CIO View

Investment Traffic Lights

June 6, 2024
Marketing material

Our monthly market analysis and positioning

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IN A NUTSHELL

- In May things went well for shareholders though they essentially only made up April's losses. U.S. tech stocks again outperformed other asset classes.
- U.S. bondholders also had a good month, despite the fact that the Fed is now expected to refrain from cutting interest rates until later this year. In Europe, however, bonds softened as yields rose in response to higher inflation and growth figures.
- We think the economic and interest-rate environment looks generally benign, but the risk-return profile of most asset classes is evenly balanced.

1 / Market overview[1]

1.1 Big Tech remains the winner in low-growth environment

In a way, the merry month of May lived up to its name for investors by healing many of the wounds suffered in April. Stocks turned positive, U.S. yields stopped climbing (although the same cannot be said for Bund yields), while oil and gold trended sideways.

Most of May's headlines – most of them very similar to previous months' headlines – helped the markets. Overall, inflation kept moving in the right direction, though with delays and setbacks, most recently in Europe where the (provisional) core inflation rate for May was reported at 2.9%, not the expected 2.7% annual rate seen in April. The markets have, however, come to terms with the prospect of significantly fewer interest-rate cuts this year than had been hoped for at the beginning of the year. The U.S. and the Eurozone are diverging in that the European Central Bank (ECB) has announced its first interest-rate cut at its meeting on June 6, while the U.S. Federal Reserve (the Fed) will probably wait.

Economic growth figures in Europe meanwhile continue to improve from a low level, while in the U.S. they are beginning to disappoint. For example, gross-domestic-product (GDP) growth for the first quarter was revised down from 1.6% to 1.3%, mainly because consumers are becoming cautious. However, there is still no sign of a major slump in growth, due in part to continued high state spending and immigration.

Stock markets, especially in the U.S., continue to run at two speeds. The big U.S. tech stocks known as the Magnificent 7 contributed more than half of the 4.8% rise in the S&P 500 in May. This two-speed divide is also reflected in market concentration: 27% of the market capitalization of the S&P 500 is now accounted for by the five largest stocks. This surpasses by far the last concentration peak, which dates back to 1999, at just 18%.

[1] All market data from Bloomberg Finance L.P. as of 6/4/24 unless stated otherwise.

Geopolitically, the Middle East and Ukraine remain the biggest crisis areas but there was no worsening of the market's concern in May. The United States and China, on the other hand, are continuing their trade disputes unabated. China is also continuing to announce economic support packages. In May, the news that the state wants to act as a buyer in the distressed housing market caused a stir.

1.2 Diverging bond markets, silver takes gold's top spot and tech keeps on rallying[2]

AI euphoria, curbed only in a few areas – when doubts arose about the monetization potential of AI solutions, for example – kept the technology sector (MSCI AC World Information Technology Index) out in front in May, with a total return of 8.1%. But it was a positive month for stocks in most countries, with no stock sector closing in the red globally. This was not the case at the regional level: Latin America slipped three percent into the red. Switzerland was the only major market to outperform the U.S. exchanges, with an increase of almost seven percent – driven, like the rest of Europe, by strong financial stocks.

In commodities, silver overtook gold as the most profitable precious metal this year, with an increase of 15% against "only" 13% for the yellow metal, which almost stood still in May. Bitcoin rose by eleven percent; in a year it is up by 60%.

In the bond segment, the transatlantic divergence was particularly noticeable. Although 10-year U.S. Treasuries were again soft, with their yields trending upwards in the second half of the month, they have not yet regained this year's highs from the end of April. Bund yields, however, ended the month at annual highs of 2.7%.

Japan, too, made news in May. Massive interventions by the central bank did no more than interrupt depreciation of the yen. By the end of the month the currency was trading at 157 yen per dollar, close to the 34-year record of 158 at the end of April. For the time being, even record interest rates on Japanese government bonds (JGBs) – the yield on 10-year JGBs exceeded the 1-%-mark for the first time since 2012 – cannot reverse the yen's weakness.

2 / Outlook and changes

We made few tactical changes in May. Even though equity markets were up again, May essentially only made up for the losses from April – we continue to expect volatile sideways trading. The same applies to government bonds, where markets and central banks are now better aligned than at the beginning of the year. It will be interesting to see how the transatlantic divergence on rates evolves. We are paying particular attention to what ECB President Christine Lagarde will say when she has to address the question of reconciling a cut to the interest rate with the recently higher-than-expected inflation figures.[3]

In a few days we will set out our new 12-month targets at our quarterly strategy meeting which will focus once again on the state of the U.S. economy. The recent downward revision[4] to the first-quarter GDP growth figures, with consumption in particular marked down, reinforces our somewhat more skeptical view.

2.1 Fixed Income

We expect the trend of the past few weeks to persist: the path to lower inflation will not be a straight, simple one, in our view, but will take twists and turns that will play with the market's nerves.

[2] All market data in this paragraph from LSEG Data as of 5/31/24 unless stated otherwise.
[3] Although the decision came in as expected, Christine Lagarde had a slightly more cautious tone regard to the inflation path in the press conference. (https://www.ecb.europa.eu/press/press_conference/monetary-policy-statement/2024/html/ecb.is240606~d32cd6cc8a.en.html)
[4] U.S. Bureau of Economic Analysis, as of 30.05.2024.

Government Bonds
In our view, the markets have now priced in a path for European and U.S. key interest rates that is much closer to the thinking of the central banks. We expect the ECB – after having cut the rates on June 6th - to make one more cut each in autumn and winter. The Fed is likely to wait until at least the fall to make its first move. Whether this is followed by another will depend on the data. Following the recent decrease in yields of 10-year Treasuries, we have downgraded this segment from +1 to neutral, as we don't expect this development to continue. We rather expect the bond price (and hence the yields) to stabilize at current levels for the time being. We have not made any other changes to the tactical assessments and see a better return-risk profile at the shorter end of the yield curve on both sides of the Atlantic.

Corporate Bonds
We have made no changes to our view here. The expected return looks attractive in corporates, but this is largely due to the high yields now prevailing on government bonds. The yield premium, by contrast, is low and unlikely to narrow further. By comparison to government bonds, corporate bonds are therefore not particularly attractive in our view. And if the economy does less well than expected we see greater price risks in high-yield bonds.

Emerging Markets
The government-bond yields of many emerging markets also look attractive overall but, in our view, there is little prospect that risk premiums will narrow further. Asian bonds (including corporate bonds) are the exception. Here we believe the high-yield market has now processed the negative signals from China sufficiently and will respond to the prospects for improvement in the overall situation.

Currencies
We are currently cautious about the yen as the Bank of Japan could intervene again in the market. We are more positive now, however, about the near-term prospects for the euro against the dollar. The peak of the divergence between the expected rate paths of the U.S. and the Eurozone appears to have passed, and U.S. growth is currently disappointing the market's expectations, while in our view Europe can exceed the market's expectations. This should provide the euro with a further tailwind, we believe.

2.2 Equities
We did not make any tactical changes in equities in May. From a broader perspective, the picture is mixed. Growth prospects are diverging considerably. Europe is recovering slowly from a low level while the U.S. may still have its weakest months ahead of it and China seems to need all sorts of government support measures just to achieve its 5% growth target. Valuations are high, historically and relative to bonds. U.S. profit margins are close to record highs. Geopolitical risks persist (U.S.-China, U.S. election, Ukraine) and disillusionment with the current AI hype is possible.

So much for the negative side. The more parts of the picture are calming inflation, solid balance sheets, growing real purchasing power in parts of the world and – at least as far as can we see now – no approaching recession. And, of course, notwithstanding the hype, there is hope that AI business models will prove their worth.

U.S. Market
The U.S. reporting season was positive overall, but it remains a two-speed market, with the big tech companies showing the biggest jumps in profits once again. They are also largely responsible for our expectation of about 10% profit growth for the S&P 500 this year. They are also distorting the overall market valuation considerably as, with an average price-to-earnings (P/E) ratio of 32 on their estimated 2024 profits, they are significantly more expensive than the rest of the index – with a P/E ratio of 19. We see little upside potential for U.S. stocks in the near term.

European/German Market
We continue to view Europe positively, especially compared to the U.S., given the historically high valuation discount. Real purchasing power in Europe is increasing and the region is also well positioned should the global economy progress better

than currently expected. For 2024 we expect slight earnings growth for the Stoxx Europe 600, while the consensus continues to see a slight decline.[5] We are slightly more skeptical about German stocks, as they are currently struggling with some structural disadvantages such as higher energy prices and regulatory burdens in Germany.

Emerging Markets

Though we find some Asian markets interesting, we continue to view emerging markets neutral overall. The Chinese government has succeeded in stabilizing sentiment and the stock markets, but we do not yet see enough momentum in the economic figures for a broad recovery. Elections and relatively inexperienced governments remain an issue in some countries. U.S. bond yields, which have remained high for longer than expected, remain a permanent headwind.

Japan

Japan's stock market continues to look very interesting in the long term, especially as the progress made in corporate-governance reforms is visible. In the short term, however, our position remains neutral as, after a good stock-market run and fairly conservative company outlooks, investor interest seems to be shifting to other regions in Asia. In addition, the extremely weak yen is a potential risk.

2.3 Alternatives

Real Estate

A recent MSCI report[6] on capital trends in Real Assets showed that total U.S. commercial real estate (CRE) sales volume was just USD 17.1bn in April, a 24% decrease from the same month a year ago, while global CRE data, not yet available for April, declined 17% in the first quarter to just over USD 140bn from a year ago. The U.S. downdraft in April was led by apartments, where volumes declined by almost 50%, although hotel transaction volumes almost doubled from the year ago period. The capitalization-rate (cap-rate) average for all transactions in April was 6.81%, up 2 basis points (bps) from March. Industrial assets saw the largest cap-rate expansion, 24 bps to 6.73%, while retail cap rates decreased by 6 bps to 7.15%. Additionally, the Fed’s most recent Beige Book[7] noted CRE conditions were softer given tight credit conditions, higher borrowing costs, and excess-supply concerns. However, Blackstone’s chief operating officer, speaking at an industry conference[8], noted a bottoming in the CRE sector and indicated now was the time to deploy capital. This was further illustrated by his firm’s recent investment in a USD 1 billion loan portfolio, purchased from Deutsche Pfandbriefbank and backed by multifamily, hospitality, and office assets spread across the U.S. and UK.

Infrastructure

With our Strategic CIO View meeting coming up mid-June, in which our 12-month outlook will be discussed, we will be providing a broader update on Infrastructure assets in our next edition. In the meantime, waste-to-energy (WTE) plants might be an interesting upcoming theme to highlight. Per the U.S. Energy Information Administration (EIA), WTE plants are electricity-generating facilities that burn solid waste, or garbage, in boilers to produce steam that is sent through turbines. WTE plants are more prevalent in Europe than the U.S., as the International Solid Waste Association (ISWA) estimates there were over 520 WTE plants operating in Europe compared to just 75 in the U.S. at this time last year. Sweden, with 34 plants, may be the poster child for WTE, as it is estimated that only 1% of their trash is sent to landfills, with 52% converted to energy and 47% recycled. Still, despite the low cost to build and cheap fuel expenses, WTE plants are not without environmental concerns, as they are generally considered cleaner than coal but less clean than burning natural gas.

Gold

We remain positive on gold which is currently benefiting from a number of structural factors, such as concerns about U.S. government finances, geopolitical crises and ongoing central-bank purchases, especially by countries seeking to reduce their

[5] Bloomberg Finance L.P.; Stand: 04.06.2024
[6] Blog post published by MSCI Inc “Real Assets in Focus: Are We Nearly There Yet?” on 5/15/24.
[7] Source: Bloomberg Finance L.P. as of 6/4/24
[8] Bernstein Strategic Decisions Conference, USA, 5/29/24.

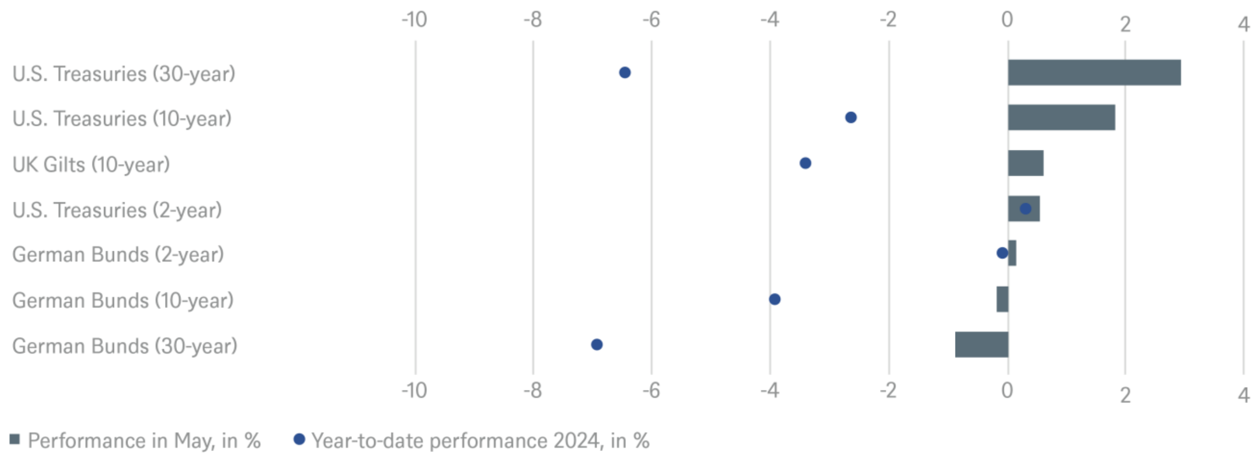
dependence on the dollar. In the short term, the yellow metal's usual link to the path of (real) U.S. interest rates appears to be suspended.

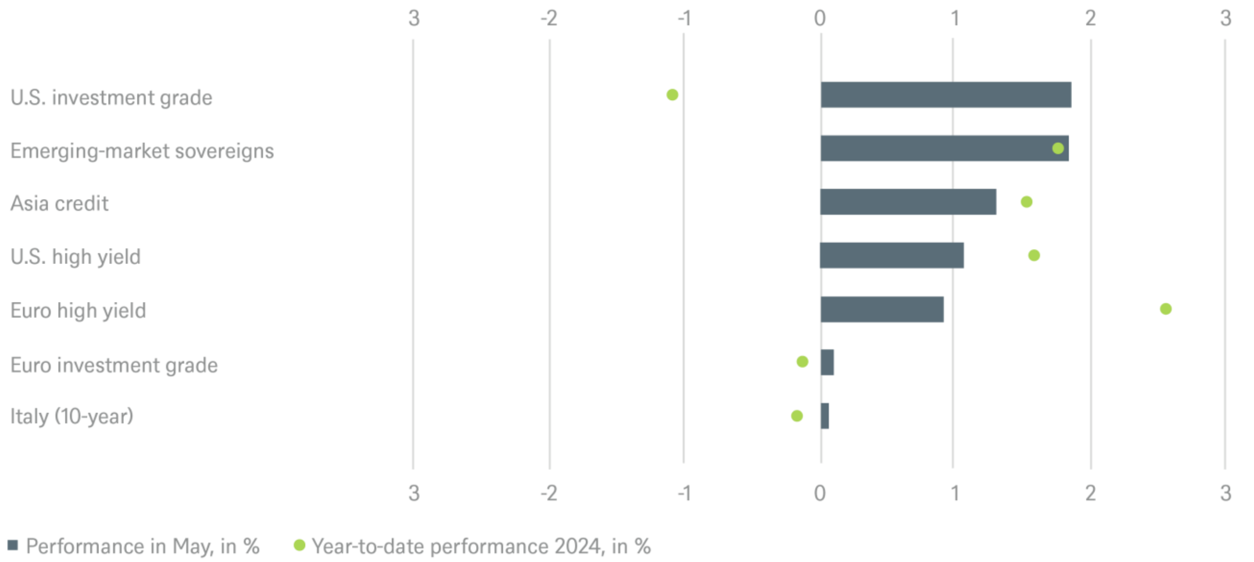
Oil

We see the latest OPEC+ announcements to extend production cuts as half-hearted in both quantity and duration. Together with the still lackluster growth in China's industrial sector, this should put a cap on the oil price for the time being, provided there are no further geopolitical escalations.

3 / Past performance of major financial assets

Total return of major financial assets year-to-date and past month





Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/31/24

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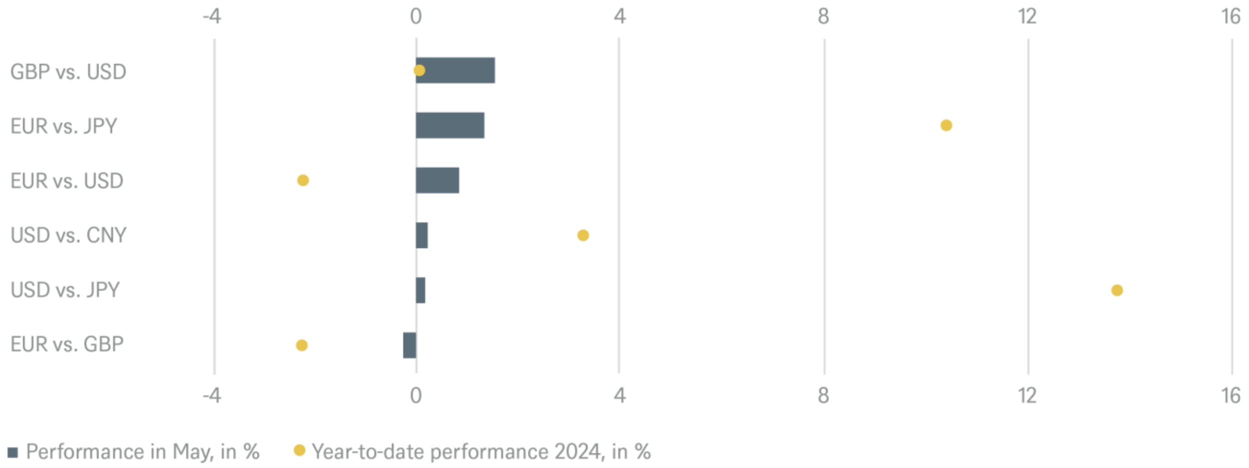

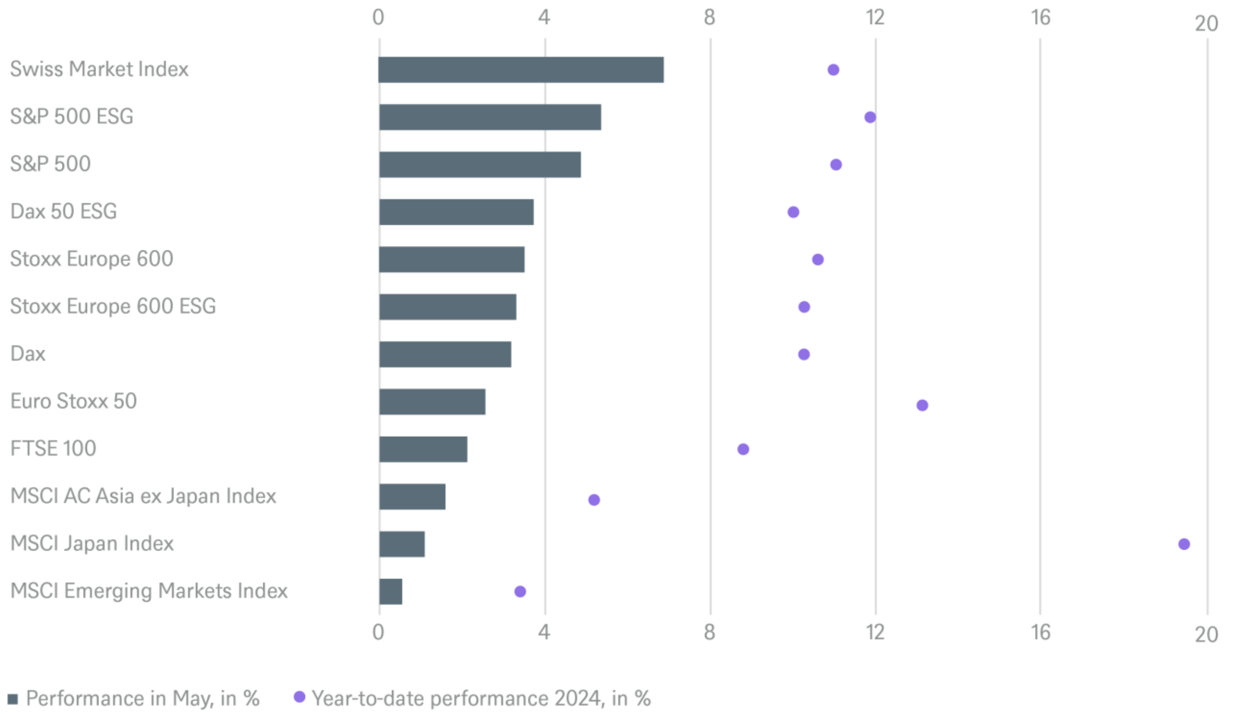

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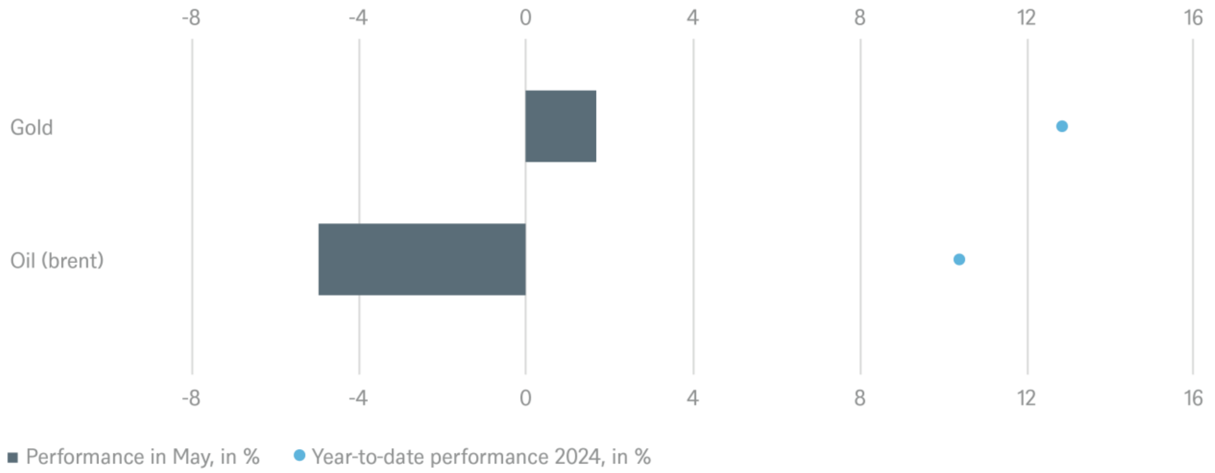

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4 / Tactical and strategic signals

The following exhibit depicts our short-term and long-term positioning.

4.1 Fixed income

Rates	1 to 3 months	through Mar 2025
U.S. Treasuries (2-year)	🟢	🟢
U.S. Treasuries (10-year)	🟡	🟢
U.S. Treasuries (30-year)	🟡	🟡
German Bunds (2-year)	🟡	🟢
German Bunds (10-year)	🟡	🟡
German Bunds (30-year)	🟡	🔴
UK Gilts (10-year)	🟡	🟢
Japanese government bonds (2-year)	🟡	🟢
Japanese government bonds (10-year)	🟡	🟢

Spreads	1 to 3 months	through Mar 2025
Italy (10-year)[1]	🔴	🔴
U.S. investment grade	🔴	🟢
U.S. high yield	🟡	🟢
Euro investment grade[1]	🟡	🟢
Euro high yield[1]	🔴	🟢
Asia credit	🟢	🟢
Emerging-market sovereigns	🟡	🟢

Securitized / specialties	1 to 3 months	through Mar 2025
Covered bonds[1]	🟡	🟢
U.S. municipal bonds	🔴	🟡
U.S. mortgage-backed securities	🟡	🟢

Currencies	1 to 3 months	through Mar 2025
EUR vs. USD	🟢	🔴
USD vs. JPY	🟡	🟢
EUR vs. JPY	🟡	🔴
EUR vs. GBP	🟡	🟡
GBP vs. USD	🟡	🔴
USD vs. CNY	🟢	🟢

4.2 Equities

Regions	1 to 3 months[2]	through Mar 2025
United States[3]	🔴	🟡
Europe[4]	🟢	🟡
Eurozone[5]	🟡	🟡
Germany[6]	🟡	🟡
Switzerland[7]	🟡	🟡
United Kingdom (UK)[8]	🟡	🟡
Emerging markets[9]	🟡	🟡
Asia ex Japan[10]	🟡	🟡
Japan[11]	🟡	🟢

Sectors	1 to 3 months[2]
Consumer staples[12]	🟡
Healthcare[13]	🟡
Communication services[14]	🟢
Utilities[15]	🟡
Consumer discretionary[16]	🟢
Energy[17]	🟡
Financials[18]	🟡
Industrials[19]	🟡
Information technology[20]	🟡
Materials[21]	🟡

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Style	1 to 3 months
U.S. small caps[22]	🟡
European small caps[23]	🟢

4.3 Alternatives

Alternatives	1 to 3 months	through Mar 2025
Commodities[24]	🟡	🟢
Oil (brent)	🟡	🟡
Gold	🟡	🟡
Carbon		🟢
Infrastructure (listed)	🟡	🟢
Infrastructure (non-listed)		🟡
Real estate (listed)	🟡	🟡
Real estate (non-listed) APAC[25]		🟡
Real estate (non-listed) Europe[25]		🟢
Real estate (non-listed) United States[25]		🟢

[1] Spread over German Bunds. [2] Relative to the MSCI AC World Index (only for the tactical signals),[3] S&P 500, [4] Stoxx Europe 600, [5] Euro Stoxx 50, [6] Dax, [7] Swiss Market Index, [8] FTSE 100, [9] MSCI Emerging Markets Index, [10] MSCI AC Asia ex Japan Index, [11] MSCI Japan Index, [12] MSCI AC World Consumer Staples Index, [13] MSCI AC World Health Care Index, [14] MSCI AC World Communication Services Index, [15] MSCI AC World Utilities Index, [16] MSCI AC World Consumer Discretionary Index, [17] MSCI AC World Energy Index, [18] MSCI AC World Financials Index, [19] MSCI AC World Industrials Index, [20] MSCI AC World Information Technology Index, [21] MSCI AC World Materials Index, [22] Russell 2000 Index relative to the S&P 500, [23] Stoxx Europe Small 200 relative to the Stoxx Europe 600, [24] Relative to the Bloomberg Commodity Index, [25] Long-term investments.

Tactical view (1 to 3 months)

The focus of our tactical view for fixed income is on trends in bond prices.

🟢 Positive view
🟡 Neutral view
🔴 Negative view

Strategic view through March 2025

- The focus of our strategic view for sovereign bonds is on bond prices.
- For corporates, securitized/specialties and emerging-market bonds in U.S. dollars, the signals depict the option-adjusted spread over U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds. Both spread and sovereign-bond-yield trends influence the bond value. For investors seeking to profit only from spread trends, a hedge against changing interest rates may be a consideration.
- The colors illustrate the return opportunities for long-only investors.
  - 🟢 Positive return potential for long-only investors
  - 🟡 Limited return opportunity as well as downside risk
  - 🔴 Negative return potential for long-only investors

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Glossary

The Bank of Japan (BoJ) is the central bank of Japan.

One basis point equals 1/100 of a percentage point.

The Bloomberg Commodity Index (BCOM) traces 23 commodities and reflects commodity futures price movements.

Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

The capitalization rate is the rate of return on a real-estate investment based on the expected income the property will generate.

The Chinese yuan (CNY) is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Commercial real estate (CRE) refers to properties that are used for business or commercial purposes, such as office buildings, retail spaces, warehouses etc.

Core inflation excludes items which can be susceptible to volatile price movements, e.g. food and energy.

A corporate bond is a bond issued by a corporation in order finance their business.

The Dax is a blue-chip stock-market index consisting of the 40 major German companies trading on the Frankfurt Stock Exchange.

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

The euro (EUR) is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

The Euro Stoxx 50 is an index that tracks the performance of blue-chip stocks in the Eurozone.

The European Central Bank (ECB) is the central bank for the Eurozone.

The Eurozone is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

The FTSE 100 is an index that tracks the performance of the 100 major companies trading on the London Stock Exchange.

The gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

The Japanese yen (JPY) is the official currency of Japan.

Japanese Government Bond (JGB) is issued by the government of Japan.

The MSCI AC World Communication Services Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Communications Sercives sector.

The MSCI AC World Consumer Discretionary Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Discretionary sector.

The MSCI AC World Consumer Staples Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Staples sector.

The MSCI AC World Energy Index captures large- and mid-cap securities across 23 developed-markets classified in the Energy sector.

The MSCI AC World Financials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Financials sector.

The MSCI AC World Health Care Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Health Care sector.

The MSCI AC World Index captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

The MSCI AC World Industrials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Industrials sector.

The MSCI AC World Information Technology Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Information Technology sector.

The MSCI AC World Materials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Materials sector.

The MSCI AC World Utilities Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Utilities sector.

The MSCI AC Asia ex Japan Index captures large- and mid-cap representation across 2 of 3 developed-market countries (excluding Japan) and 8 emerging-market countries in Asia.

The MSCI Emerging Markets Index captures large- and mid-cap representation across 23 emerging-market countries.

The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

OPEC+ is an informal alliance of OPEC members and other oil-producing countries, led by Russia, aiming to coordinate their production strategies.

The Organization of the Petroleum Exporting Countries (OPEC) is an international organization with the mandate to "coordinate and unify the petroleum policies" of its meanwhile 12 members.

The pound sterling (GBP), or simply the pound, is the official currency of the United Kingdom and its territories.

The price-to-earnings (P/E) ratio compares a company's current share price to its earnings per share.

Profit Margin is an accounting figure which describes profit in relation to revenue in percent.

In economics, a real value is adjusted for inflation.

Real assets are physical assets that have an intrinsic value due to their substance and properties.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

The Russell 2000 Index is an index that captures the 2,000 smallest stocks of the Russell-3000 index, which again comprises 3,000 small- and mid-cap U.S. listed stocks.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The Stoxx Europe 600 is an index representing the performance of 600 listed companies across 18 European countries.

The Stoxx Europe Small 200 is an index representing the performance of 200 small capitalization companies across 17 European countries.

The Swiss Market Index (SMI) is Switzerland's most important equity index, consisting of the 20 largest and most liquid large- and mid-cap stocks.

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

The U.S. dollar (USD) is the official currency of the United States and its overseas territories.

The U.S. Energy Information Administration (EIA) is a principal agency of the U.S. Federal Statistical System responsible for collecting, analyzing, and disseminating energy information.

The U.S. Federal Reserve, often referred to as "the Fed," is the central bank of the United States.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

A yield curve shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

The yield premium will increase or decrease depending on the perceived creditworthiness and relative demand for a bond. The yield premium is the mark up relative to a risk-free asset with the same maturity.

Important information – EMEA, APAC & LATAM

Important information – North America

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