CIO View
Investment Traffic Lights

April 7, 2021

DWS

Marketing Material

OUR MONTHLY MARKET ANALYSIS AND POSITIONING

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IN A NUTSHELL

_ The first quarter was propelled by rising growth expectations and bond yields, as well as by a rotation into cyclical stocks.
_ Asia is coming through the crisis well. Meanwhile the gap between the United States and Europe is continuing to widen as the U.S. economy rebounds more quickly.
_ Neither lockdowns, new Covid variants nor rising inflation expectations seem to be able to deter the equity markets. But they are climbing into ever thinner air.

1 / Market overview

The first quarter of 2021 was characterized by conflicts and contrasts. America's dynamism versus Europe's stagnation. Vaccine progress versus new waves of the virus, new mutations and further lockdowns. The United States versus China. Growth stocks versus cyclical ones. Retail investors versus institutional ones. Covid fatigue versus renascent industry. The German Constitutional Court versus the European Union's (EU's) 750 billion euro coronavirus aid package. And, in Germany specifically, the Christian Democratic Union (CDU) versus itself.

The United States once again dominated the global agenda. It is hard to believe that it is less than three months since Joe Biden was sworn in as the new U.S. President. The speed, effectiveness and tactical finesse with which he is carrying out his ambitious program have amazed not only us. The progress in vaccination and the billion-U.S. dollar fiscal packages are causing more and more economists to revise their 2021 growth estimates for the United States upward, from a consensus forecast of 3.9% at the beginning of the year to 5.7%.[1] Financial markets are taking note. Despite the relative weakness of the technology heavyweights, the S&P 500 has been able to report new record highs, breaking through the 4,000 mark for the first time at the beginning of April, driven primarily by value stocks.

In the bond market, the cyclical momentum is reflected in the 10-year yields of U.S. government bonds, which touched 1.75% in late March, and also in a dramatic shift in the yield curve of 2- to 10-year bonds: in September 2019 that curve was still negative; at the beginning of 2021, it stood at 80 basis points and it has since roughly doubled. This also explains why the financial sector was the second strongest on the stock market in the first quarter, after energy. In general, U.S. companies are doing relatively well, which is also reflected in the fact that analysts raised their first quarter earnings estimates by 6% during the course of the quarter. According to Factset's[2] calculations, this is the biggest increase within a quarter since 2002, when data collection began. However, on average, estimates are revised downward in the course of a quarter. What could put a damper on the euphoria in the medium term, and not only in the U.S. corporate sector, are the increasing signals that governments will eventually call on companies to finance the various economic stimulus packages – a reversal of the trend that has seen the burden on multinational corporations in particular falling steadily for years.

In Asia the economic recovery is somewhat less dynamic. This also has to do with the fact that the region shrank less sharply in 2020 – and in some cases did not shrink at all. That Asia was the equity market laggard in March reflects the aforementioned

[1] Bloomberg Finance L.P. as of 4/6/21
[2] https://insight.factset.com/record-high-increase-in-sp-500-eps-estimates-for-q1

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U.S. momentum – and a strong U.S. dollar and high U.S. yields tend historically to have a negative impact on emerging markets – and the increasingly sharp rhetoric of the United States toward China. We expect this tension to persist and to be more than just rhetoric: the clash between the two rival economic giants with their vastly different political and economic systems may result in concrete economic measures.

For the time being the global economy has not been affected too much by any of these longer-term fears and tensions, as can be seen in the 15-year high of 57.5 in the global Manufacturing Purchasing Managers' Index (PMI) as of March 21. This may also explain why European stock markets have also been rising steadily of late, despite the painfully slow vaccination campaign, further lockdowns and the threat that ratification of the Covid-19 bailout package may be delayed. Export-oriented industry is doing well but there is a general lack of economic momentum, which is reflected in government-bond yield increases that are muted compared to those in the United States. The fact that the European Central Bank (ECB) used the small rise in bond yields in February as grounds for expanding its monetary policy even further did not inspire confidence. But lack of confidence certainly did not stand in the way of Germany's Dax stock index: it achieved new record highs, breaking through the 15,000 point level.

In general, the first quarter's best performers were cyclical and riskier stocks. In the bond market, meanwhile, riskier, high-yield (HY) bonds were among the few winners on both sides of the Atlantic, while 30-year U.S. government bonds posted their worst quarter since 1919, with a negative total return of 16%. While oil and the cyclically sensitive metal, copper, were among the first-quarter gainers, they fell back somewhat in March. Gold and silver, on the other hand, suffered losses both for the quarter as a whole and for March. All of this was a pale shadow of the turbulence of the first quarter of 2020. But this year's first quarter was also extraordinarily eventful and full of repositionings from a capital-market perspective.

2 / Outlook and changes

After such a strong start to the year and, now, to the second quarter, what can be expected for the rest of the month and the rest of the quarter?

Market logic might suggest the recent strength will continue. The market's momentum is positive. And it has shown that it can keep going up even without technology leading the way. Secondly, investors are unlikely to want to sell equities while PMIs are strong and earnings as well as consensus earnings estimates are increasing. Finally, there is always the "don't fight the Fed" mantra. But this brings us to what may be grounds for caution. You might not want to fight the Fed, but is the Fed still in control?

Inflation is a concern. The Fed has recently reiterated that it would leave interest rates where they are at least until 2023. And that it is happy to let inflation overshoot 2% for some time. But, looking at current inflation dynamics and the mix of re-opening and supply-chain constraints, some investors might find it hard to believe (as we do) that this inflation is a one-off this and maybe next year, rather than the beginning of an inflationary trend.

Another market mantra is to buy the rumor, sell the facts. Investors have very much been looking forward to the prospect of economic reopening and fiscal stimulus – and it might already be priced into markets. When economies motor and stimulus is spent, the market might encounter more hiccups and difficulties than expected. And in relative terms we might now be seeing peak U.S. euphoria and peak Europe skepticism, which could reverse in the course of this year or next year. We have seen a similar development in Asia. It hit peak euphoria – first in and first out of the pandemic; less gross-domestic-product (GDP) loss than other regions – in the middle of last year; this might be one of the reasons why its markets are now lagging behind other regions.

2.1 Fixed income

While we believe the trajectory leading to higher sovereign-bond yields remains intact, we are only negative on German 10-year Bunds at present, as in most countries, after a high-speed run-up, consolidation is taking place at current levels. We are

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also neutral on emerging-market sovereign bonds (as well as other EM credit) as both negative local news[3] and a stronger U.S. dollar and higher rates are headwinds.

In corporates, we remain positive on most parts of the Euro and U.S. markets, except U.S. investment grade (IG), where we have turned neutral because we believe the market is running ahead of expectations. While this is also true for U.S. HY, this asset class tends to benefit from even more cyclical exposure and a lower average duration. Default rates are below the historical average and last year's expectations. Turning to Europe, corporate bonds have the benefit of less competition from sovereign bonds, some of which are still offering negative yields. We are, however, becoming a little bit more selective for both IG and HY.

We are positive on the U.S. dollar versus various currencies, because of the greater dynamism of the United States at present and the interest yield gap to many other regions, most notably the Eurozone.

2.2 Equities

There are mixed signals for equities in the next quarter. While earnings are surprisingly strong, rising interest yields are capping equity valuations. We still believe a barbell strategy, using cyclical stocks and Information Technology, may be among the best options in this situation, as we explain below.

We stick to our view that our market forecast – the S&P 500 at 4,100 in March 2022 – offers modest upside so long as real interest rates remain negative, i.e. U.S. 10-year Treasury yields stay below ~2%. Most companies should be able to pass on input-cost inflation to customers and therefore offer a certain degree of "inflation protection" to equity investors. We expect though that higher nominal yields will cap the upside on U.S. valuation multiples. Our assumptions on European valuation multiples are rather conservative.

Higher yields have triggered a massive rotation out of "high-duration" stocks into cyclical companies. As a result, the composition of "momentum" has shifted from "growth" to "value." The chances are high that this trend will continue as long as global PMIs keep improving. Therefore, we stick to a barbell strategy which should make it possible to share in strong earnings growth and limit interest-rate exposure at the same time. We therefore prefer on one side the barbell cyclical exposure between and within sectors. Automotive and consumer service stocks, commodity chemicals and many industrials in Europe and Asia remain attractive. In the United States, banks should still offer upside, as they wind down their 2020 loan-loss provisions, return excess capital to shareholders and improve their interest income. In our view, EU small caps offer more cyclical upside than their large-cap peers. Following their significant outperformance in the year to date, energy companies have by now probably seen most of their recovery. On the other side of the barbell, we stick to our long-held IT overweight, as the secular digitalization trend remains intact. We would, however, continue to avoid hyper-expensive growth stocks (e.g. those with valuations of Enterprise Valuation-to-sales larger than 20x). We stick to a real-estate underweight for the time being, however, though we are aware the sector has some "economic reopening" attractiveness.

On a regional level, we stick to our preference for Asia despite its recent underperformance. We remain attracted by expected 30% earnings-per-share (EPS) growth in 2021, reasonable valuations, Chinese economic strength and the rising participation of domestic investors.

2.3 Alternatives

The oil market has had a lot to digest in recent weeks: the Suez blockage, the OPEC meeting that resulted in the expected agreement to ramp up production gradually over the next three months, and of course the conflicting signals from vaccination progress in some countries and new lockdowns in others. Overall we expect crude prices to remain supported, though there could be some short-term volatility. Precious metals continue to bear the brunt of the rise in nominal bond yields and might also be vulnerable to a new wave of ETF liquidations. We continue to prefer industrial metals, such as copper and aluminum,

[3] See for example Turkey and its renewed replacement of its head of the centrtal bank; Brazil's mismanagement of Covid.

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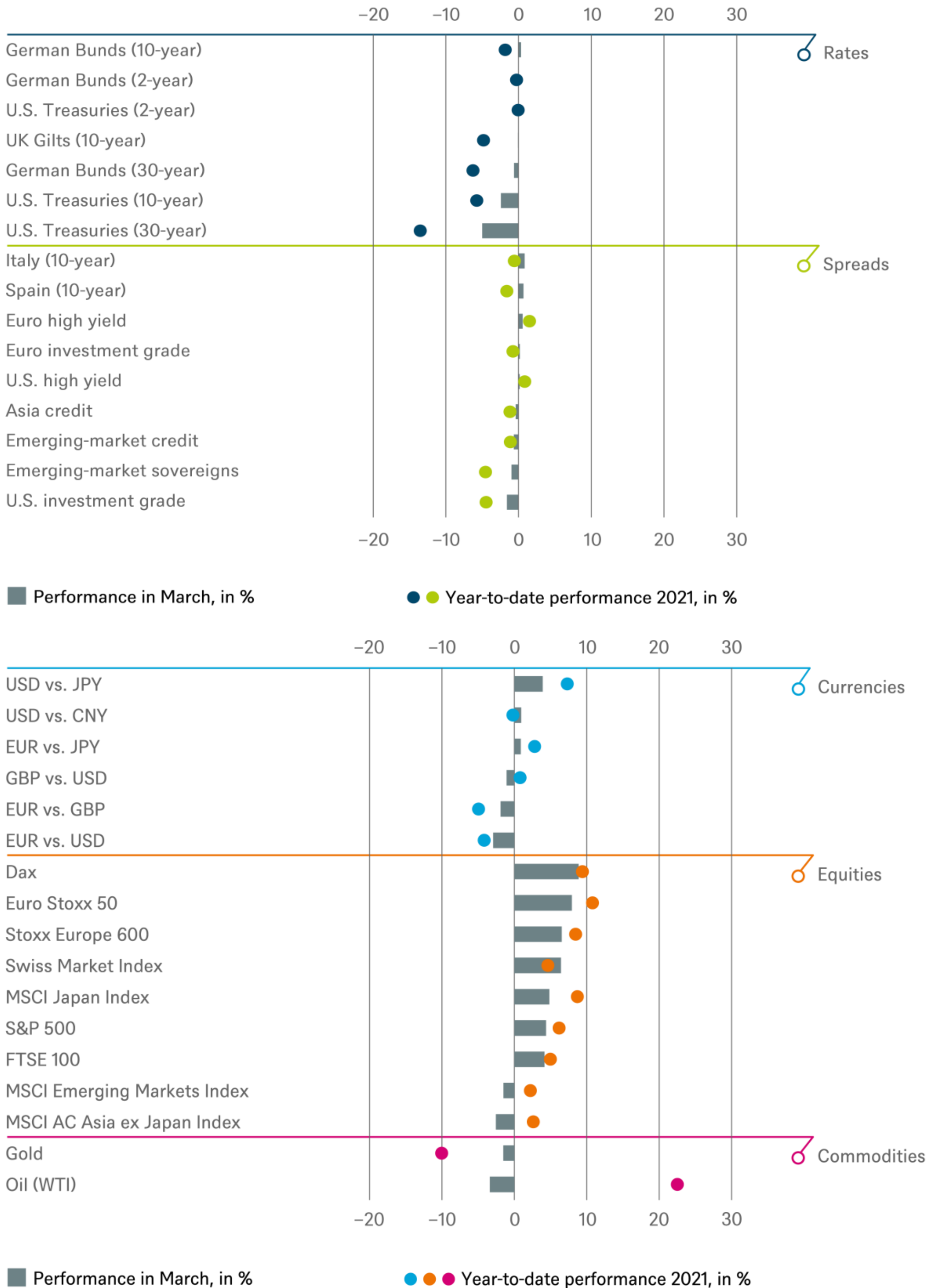
over precious metals as the economic recovery is likely to give them a renewed demand push given still restrictive supply conditions.

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. and DWS Investment GmbH as of 3/31/21

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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	until March 2022
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	until March 2022
Spain (10-year)[1]	🟢	🟡
Italy (10-year)[1]	🟡	🟢
U.S. investment grade	🟡	🟢
U.S. high yield	🟢	🟢
Euro investment grade[1]	🟢	🟢
Euro high yield[1]	🟢	🟢
Asia credit	🟡	🟢
Emerging-market credit	🟡	🟢
Emerging-market sovereigns	🟡	🟢

Secritized / specialities	1 to 3 months	until March 2022
Covered bonds[1]	🟢	🟡
U.S. municipal bonds	🔴	🟡
U.S. mortgage-backed securities	🟡	🟡

Currencies	1 to 3 months	until March 2022
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]	until March 2022
United States[3]	🟡	🟢
Europe[4]	🟡	🟡
Eurozone[5]	🟡	🟡
Germany[6]	🟡	🟡
Switzerland[7]	🟡	🟡
United Kingdom (UK)[8]	🟡	🟢
Emerging markets[9]	🟢	🟢
Asia ex Japan[10]	🟢	🟢
Japan[11]	🟡	🟢

Style	1 to 3 months
U.S. small caps[23]	🟡
European small caps[24]	🟢

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]	🟡
Real estate[22]	🔴

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4.3 Alternatives

Alternatives	1 to 3 months	until March 2022
Commodities[25]	● (green)	● (green)
Oil (WTI)	● (green)	● (green)
Gold	● (yellow)	● (yellow)
Infrastructure	● (green)	● (green)
Real estate (listed)	● (green)	● (green)
Real estate (non-listed) APAC[26]		● (green)
Real estate (non-listed) Europe[26]		● (green)
Real estate (non-listed) United States[26]		● (green)

[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] MSCI AC World Real Estate Index, [23] Russell 2000 Index relative to the S&P 500, [24] Stoxx Europe Small 200 relative to the Stoxx Europe 600, [25] Relative to the Bloomberg Commodity Index, [26] Long-term investments

4.4 Legend

TACTICAL VIEW (1 TO 3 MONTHS)

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

_ ● (green) Positive view

_ ● (yellow) Neutral view

_ ● (red) Negative view

STRATEGIC VIEW UNTIL MARCH 2022

_ 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.

_ ● (green) Positive return potential for long-only investors

_ ● (yellow) Limited return opportunity as well as downside risk

_ ● (red) Negative return potential for long-only investors

GLOSSARY

In finance, a barbell strategy means avoiding assets with an average risk-reward profile. A common example of this would be to invest in long- and short-duration bonds but not in intermediate-duration bonds.

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 Christian Democratic Union of Germany (CDU) is a Christian democratic and liberal-conservative political party in Germany that is considered center/center-right in the German political landscape. The CDU is the sister party of the Christian Social Union in Bavaria (CSU), which operates only in the state of Bavaria.

Cyclical is something that moves with the cycle.

The Dax is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

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Duration is a measure expressed in years that adds and weights the time periods in which a bond returns cash to its holder. It is used to calculate a bond's sensitivity towards interest-rate changes.

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 European Union (EU) is a political and economic union of 28 member states located primarily in Europe.

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

An exchange-traded fund (ETF) is a security that tracks an index or asset like an index fund, but trades like a stock on an exchange.

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

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.

Growth stocks are stocks from companies that are expected to grow significantly above market average for a certain period of time.

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.

Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

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 Real Estate Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Real Estate 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.

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 Purchasing Managers' Index (PMI) is an indicator of the economic health of the manufacturing sector in a specific country or region.

The real interest rate is the nominal interest rate adjusted for inflation as measured by the GDP deflator.

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.

Sovereign bonds are bonds issued by governments.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Stagnation in economics is referring to a period characterized by a lack of growth.

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.

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

Valuation attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

Value stocks are stocks from companies that are trading at prices close to their book value and that are therefore cheaper than the market average on that metric.

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.

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