Our monthly market analysis and positioning

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IN A NUTSHELL

- After a turbulent March, April offered some time to digest what had happened
- Investors used the time to rebuild some confidence but, at the beginning of May, their nervousness returned.
- Inflation, recession and the banking system are the three big worries, and not only for central bankers. "Muddling through" remains our base case

1 / Market overview

1.1 Calm April, tumultuous May

For the first time in decades, Hessen, home state of Frankfurt, granted its pupils (and thereby indirectly their parents) three weeks holiday at Easter, not just two. The timing couldn't have been any better for Frankfurt's financial community, as April proved to be very calm, and almost boring, especially compared to March. Volatility dropped in almost all asset classes, sideways trading was the name of the game and even on the political front it was a relatively calm month. And yet subtle marks from March's troubles remained visible in the markets. Although the broad equity indices, including the S&P 500, ended April significantly higher than they were just before the banking troubles started in early March, U.S. banks (as reflected, for example, in the KBW Bank index) were still trading almost one third below their pre-crisis level. Bonds, meanwhile, did not recover fully from their March woes; nor did the market implied forecasts of the main interest rates for the Fed and the ECB. And gold, a traditional safe haven, came close to a new historic high. These developments can be interpreted in three ways. First, the markets may believe that the banks' troubles will help tighten financial conditions, therefore relieving central banks of the need to do all the inflation fighting by themselves. Second, the market is becoming more worried about recession than about inflation risks. Third, the market might also be partly pricing in further systemic banking troubles that could lead to immediate central bank action – in other words, rate cuts. Given that these various scenarios are less sanguine, perhaps market participants' main scenario might still be closer to the central banks' own projections than seems the case. But, as we enter May, the discrepancy between the fairly hawkish comments from the Fed and the ECB after their latest meetings and the rather dovish market pricing of interest rates remains striking[1].

1.2 Main movers in April

April was calm in that volatility was low and many asset classes made gains. Developed market equities did especially well, with the Nikkei up 2.9%, the Stoxx 600 up 2.6% and the S&P 500 up 1.6%. Emerging markets fared less well, as the MSCI EM index lost -1.1%. Continuing tensions between China and the U.S. and less dynamic reopening in China[2] overshadowed new initiatives to help the economy by Beijing. In Europe sovereign bonds recorded slight losses while U.S. credit gained slightly; with U.S. HY and EUR HY each rose by more than 0.8%. Within commodities, precious metals were strong, with gold up 1.1%,

[1] In the U.S., for example, markets are pricing in almost three rate cuts á 25bps until year end, although Powell reiterated this wasn't on the agenda.
[2] Given the slightly better than expected 1Q23 GDP figures for China, one should probably rather say: less dynamic reopening speed than anticipated by equity markets in the past months.

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silver 4.0% and platinum 8.3%, but industrial metals and energy did less well: copper lost -5.5%, Brent -0.3% and European natural gas a considerable -19%. The Japanese Yen fell -2.5% against the U.S. dollar - the worst performance among G10 currencies.

2 / Outlook and changes

"Data-dependent" will be the guiding principle of the Fed for the months to come, as it told investors after its May 3rd meeting. And when the central bank isn't so sure any more about what is likely to happen next to inflation, labor markets and the economy, investors might be forgiven for taking a similar approach. For portfolios this means: remain prudent, prepared for various potential outcomes and don't commit to strong single bets. Our baseline view remains that there will be a mild recession in the U.S. and no recession in Europe and that inflation will recede and yet remain quite high, especially in Europe. The earnings reporting season has not helped to give a clear direction, so that we believe markets will go from data point to data point, assessing their inflation, recession and U.S. banking fears – as well as the noisy debt ceiling debate in the U.S. Central banks will be doing the same.

2.1 Fixed Income

Government Bonds

The Federal Reserve (Fed) delivered the 25 basis points (bps) hike expected on May 3rd. In line with our assumptions, the Fed indicated that its pause in rate rises was a "hawkish" one – ready to do more. The slope of the U.S. Treasury yield curve is expected to remain unchanged but renewed stress in the banking system might cause it to steepen. The European Central Bank (ECB) followed the Fed with a 25bps hike but indicated that this was certainly not the last step. Sentiment in Bunds swung between cyclical dampening data, continued worries about regional banks in the U.S. and positive sentiment on the Eurozone; and the market also kept a close eye on the central banks. Volatility declined. We remain neutral on 10-year German Bunds but recently reduced 2-year Bunds to underweight (-1). Yields have declined since mid-April but the ECB has reiterated that it has "more ground to cover", and that "this is a journey, we haven't arrived yet"[3] We moved to +1 on 10-year Italian government bonds (BTP) as the government keeps on surprising positively in its economic policy. The BTP-Bund spread shows low volatility. Higher yields offer good carry but also reduce debt sustainability long term. On Spain's 10-year bond spread we remain +1. Spreads have been relatively stable, with the support of Eurozone and ECB mechanisms making government bonds more robust in general. In Japan, the outcome of the 3rd round of pay negotiations (known as the "Shunto" spring wage talks) suggests that total wages will rise by around 3.7% and that base pay will rise by around 2% year over year – the highest outcomes for around 30 years. Kazuo Ueda's new leadership of the Bank of Japan has so far been more dovish than expected. The BoJ will undertake a "broad-perspective review" of its monetary policy – but will take one to one and a half years to carry it out.

Investment Grade Credit

Euro Investment Grade (EUR IG) remains overweight (+1). Primary market activity was seasonally low in April, which helped the secondary market. Earnings from banks and the first quarter earnings season overall were solid and support an overweight recommendation on EUR IG. We remain neutral on U.S. IG. Recent market activity has begun to price in several different scenarios going forward. A good first quarter earnings season from banks but a mild recession as a base case in the U.S. is concerning, as is the debt ceiling brinkmanship.

High Yield Credit

We are overweight Euro high yield as the economy remains broadly solid. We remain neutral on U.S. HY.

[3] Christine Lagarde, ECB press conference, May 4.

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Emerging Markets

We have upgraded Asian Credit back to +1, as Asian credit market sentiment has improved along with the macro-outlook. China aggregate financing remains strong with new Yuan loans in March exceeding estimates, and March export data also came in stronger than expected. Liquidity in the region remains ample and with a lack of new supply, demand for bonds issued by good quality IG and HY issuers remains strong. We expect new supply to come soon as the outlook for Fed rates has stabilized.

Foreign Exchange

On Euro (EUR) vs. Dollar (USD) we are positioned EUR long (+1) because the USD has been weak across the board. Next to the economic momentum that speaks for the Eurozone, the latest central bank action also favors the euro. Market sentiment toward the British pound sterling (GBP) has improved remarkably. On the back of relatively good performance from the UK economy and the hawkish stance of the Bank of England (BoE) we are long the pound vs the dollar, but not versus the euro. The Japanese yen (JPY) weakened after the disappointing BoJ meeting; we are thus short (-1) on USD vs. JPY.

2.2 Equities

In the first quarter of 2023 the global banking industry lost two iconic brands. Yet global equity markets closed +6% up. Since outflows from deposit accounts into money market funds have slowed significantly now, we believe that a systemic crisis has been avoided. Our general view remains that European and U.S. bank balance-sheets have sufficient capital and liquidity. Given the turmoil, we expect somewhat tighter lending conditions in the second quarter. This is likely to hurt most of all the construction sector, labor market and capex plans.

The U.S. economy shows signs of slowing, pointing to a moderate recession in 2023 – allowing the Fed to conclude its hiking cycle as soon as May. Furthermore, muted growth prospects have led to a significant drop in U.S. 10-year yields, supporting broad equity market valuations, especially for long duration stocks mostly found in the IT-sector (neutral) and communication sector (outperform).

Beyond this, we see no upside for U.S. equities at current levels. Instead, we see potential downside to our 0% earnings per share (EPS) growth assumption for 2023. We confirm our unchanged relative preference for markets outside the U.S. – Europe, EM, Asia – and for the very attractive valuations of European small and mid-caps.

The MSCI AC Real Estate index includes quite a diverse set of market segments. In aggregate, current valuation levels are just in line with historical levels, but not yet below. In addition, refinancing needs at interest rates that have doubled are still not fully reflected in analysts' estimates. We remain underweight on the global listed real estate sector.

On a more positive note, we are still convinced that generative artificial intelligence (GAI) is more than just hype and expect this new technology to shape sectors and companies for a long time. The first-quarter reporting season has seen many companies mention GAI when it comes to their growth prospects.

U.S. Market

The U.S. market remains historically rather expensive and therefore interest rates matter a lot in this market. In this regard the "hawkish pause" by the Fed was not a major relief. Furthermore, while the reporting season was okay, the outlook given by many companies was uninspiring. We remain neutral.

European Market

Markets were positive till March but appear to be more positioned for negative revisions in Europe – against high expectations – than they are in other regions. China's reopening remains supportive for European equities. Valuations have rebounded somewhat from all-time lows but remain at a steep discount to U.S. equities. We remain overweight for the time being.

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German Market
Solid first quarter reporting and economic growth have helped the market, assisted by reaccelerating exports and increased automobile production. Recession risk in the U.S. has created short-term uncertainty and geopolitical risks remain in place. Our view remains neutral.

Emerging Markets
Global headwinds are easing for emerging markets (EM). The dollar is weaker relative to last year and there is more visibility on the end game for the Fed's rate hike cycle. Global export weakness remains a headwind, but a lot of that has been priced in. EM valuations are now reasonable. A cyclical pick up is possible in the second half of 2023 if the forecasted U.S. recession is indeed shallow and not severe. Patience is needed. We are overweight on EM.

2.3 Alternatives
While gold came close to achieving a new historic high in early May and oil kept easing lower, another alternative asset class came to the fore. Investors have been focusing on U.S. commercial real estate (CRE) as it relies to a great extent on funding from regional banks, some of which are under heavy strain right now. We would like to stress a couple of important points with respect to U.S. CRE. One of the most troubled areas, much talked about these days, is the office sector, but it represents only a fraction (around a sixth) of the total value of real estate in the U.S. While it is the sector on which we are most negative, as we certainly prefer residential and logistics, we expect we have seen the worst of the downside in its valuation in part because we believe 10-year U.S. Treasury yields, the chief benchmark for this sector, have only limited upside potential from here (though more than the market is pricing in, according to our forecasts).

Gold
Gold remains an attractive safe haven given the recent banking turmoil and the continuing battle between elevated inflation and slowing economic growth. In fact, its price has also remained relatively stable after the Fed took rates up. While higher interest rates could remain a headwind near-term, we remain positive as several central banks are increasing their gold inventory. Furthermore, we expect more investor participation should global central banks slow the pace of rate hikes in 2023. In the medium to long term, the fundamental case for the metal remains intact as global economic uncertainty remains high. Additionally, gold could benefit should the U.S. dollar continue to weaken over the next 12-months, as we expect. As our target price is only set once per quarter we expect that the current target will be lifted during the next scheduled review.

Oil
There is a good chance that oil will recover its mid-April highs as energy commodities suffered a significant correction last week. However, this might take time to play out as the markets are primarily focused on the possibility of a U.S. recession which would offset positive demand trends out of Asia. Additional supply, from Nigeria and possibly Iraq, might cap any potential rebound in prices in the near-term.

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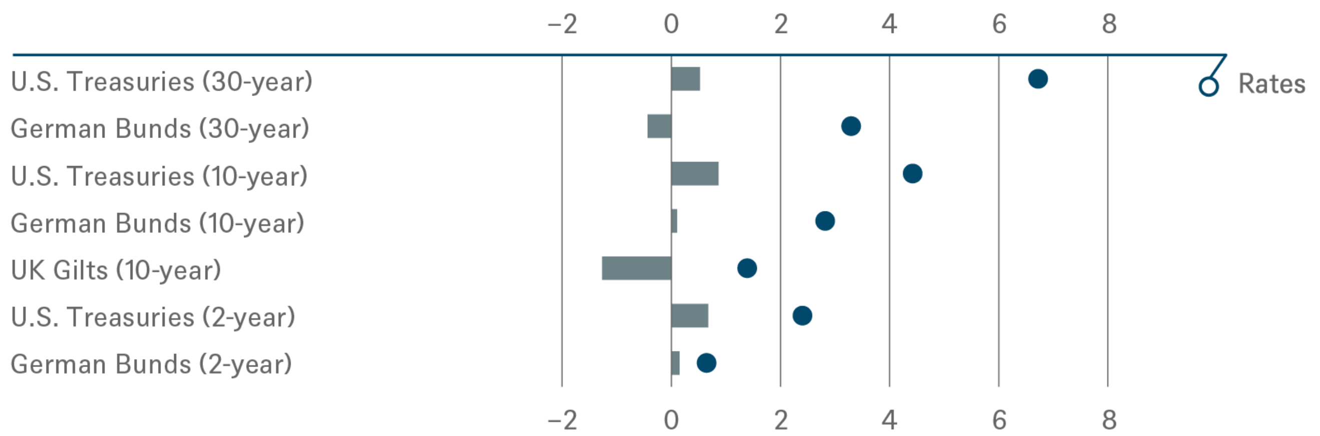
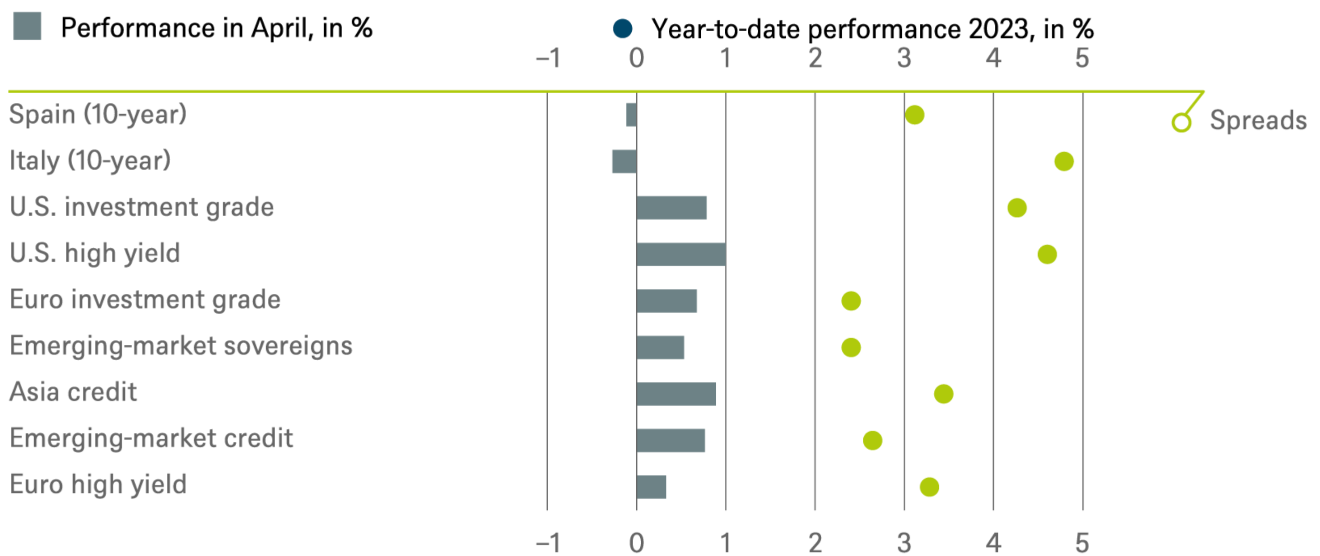
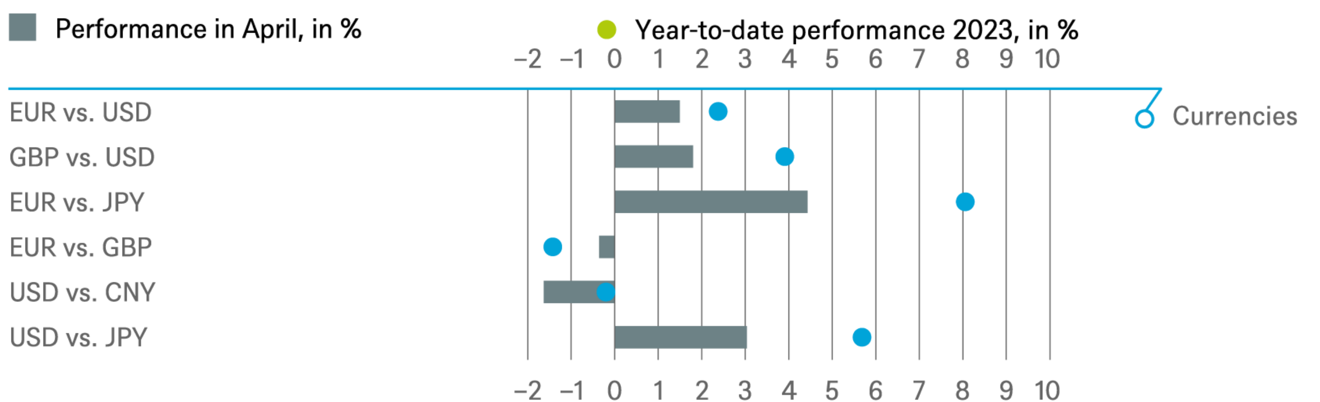
3 / Past performance of major financial assets

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







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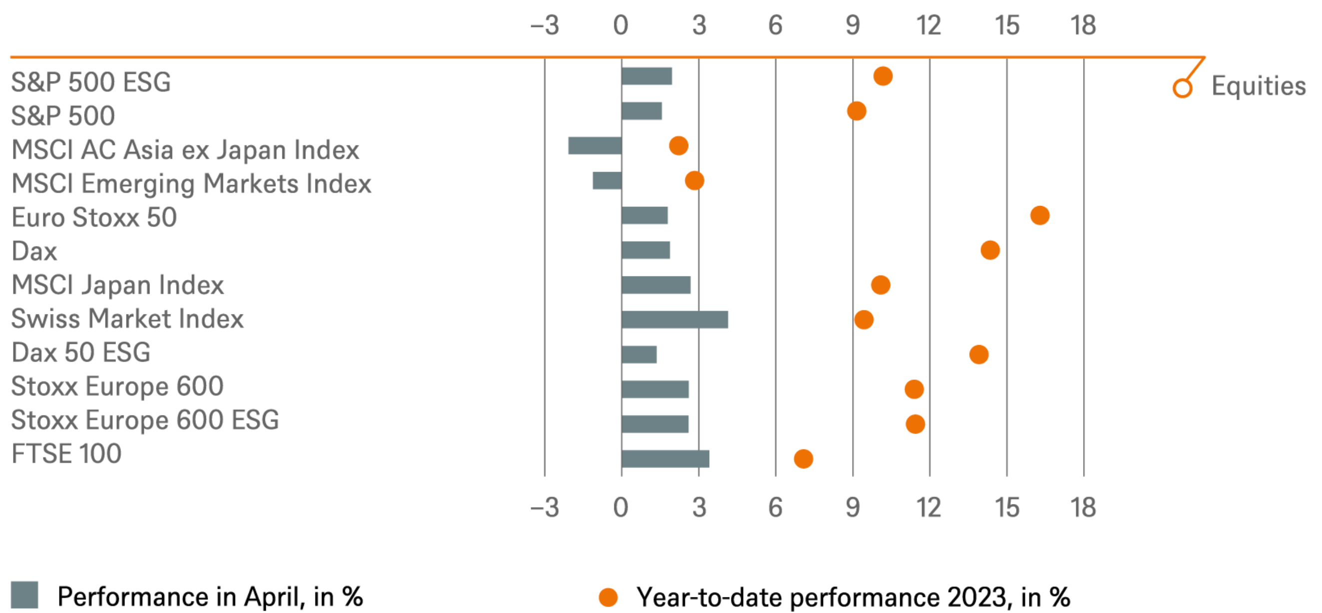

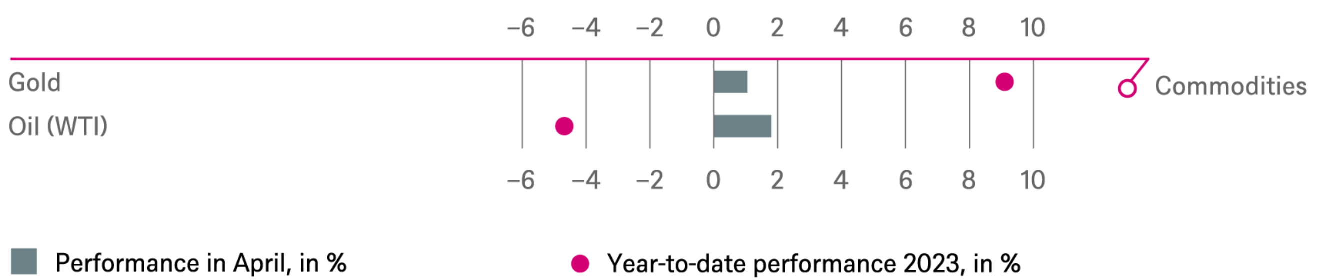

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 4/30/23

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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 Mar 2024
U.S. Treasuries (2-year)	yellow	green
U.S. Treasuries (10-year)	yellow	red
U.S. Treasuries (30-year)	yellow	red
German Bunds (2-year)	red	green
German Bunds (10-year)	yellow	red
German Bunds (30-year)	yellow	red
UK Gilts (10-year)	yellow	green
Japanese government bonds (2-year)	yellow	red
Japanese government bonds (10-year)	yellow	red

Spreads*	1 to 3 months	until Mar 2024
Spain (10-year)	green	red
Italy (10-year)	green	red
U.S. investment grade[4]	yellow	red
U.S. high yield[5]	yellow	green
Euro investment grade[6]	green	green
Euro high yield[7]	green	green
Asia credit[8]	green	green
Emerging-market credit[9]	green	green
Emerging-market sovereigns[10]	yellow	green

Secritized / specialities	1 to 3 months	until Mar 2024
Covered bonds[1]*	green	green
U.S. high-yield municipal bonds[2]	green	yellow
U.S. mortgage-backed securities[3]	green	green

Currencies	1 to 3 months	until Mar 2024
EUR vs. USD	green	red
USD vs. JPY	red	red
EUR vs. JPY	yellow	red
EUR vs. GBP	yellow	yellow
GBP vs. USD	green	red
USD vs. CNY	yellow	green

4.2 Equities

Regions	1 to 3 months**	until Mar 2024
United States[11]	yellow	yellow
Europe[12]	green	green
Eurozone[13]	yellow	yellow
Germany[14]	yellow	yellow
Switzerland[15]	yellow	yellow
United Kingdom (UK)[16]	yellow	green
Emerging markets[17]	green	green
Asia ex Japan[18]	green	green
Japan[19]	yellow	yellow

Sectors	1 to 3 months**
Consumer staples[20]	red
Healthcare[21]	yellow
Communication services[22]	green
Utilities[23]	yellow
Consumer discretionary[24]	yellow
Energy[25]	yellow
Financials[26]	yellow
Industrials[27]	yellow
Information technology[28]	yellow
Materials[29]	yellow

Style	1 to 3 months**
U.S. small caps[30]	yellow
European small caps[31]	green

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4.3 Alternatives

Alternatives	1 to 3 months**	until Mar 2024
Commodities[32]	yellow	green
Oil (Brent)	yellow	green
Gold	yellow	red
Infrastructure	yellow	green
Real estate (listed)	yellow	yellow
Real estate (non-listed) APAC[33]		yellow
Real estate (non-listed) Europe[33]		green
Real estate (non-listed) United States[33]		yellow

* Spread over German Bunds, ** Relative to the MSCI AC World Index (only for the tactical signals),[1] iBoxx Euro Covered Total Return Index, [2] Municipal Bond Index Total Return Index Value Unhedged USD. [3] FNCL Spread, [4] UA Credit Avg OAS Index, [5] US Corporate High Yield Average OAS, [6] ICE BofA Euro Corporate Index, [7] ICE BofA Euro Non-Financial High Yield Constrained Index, [8] J.P. Morgan JACI composite Blended Spread, [9] J.P. Morgan CEMBI Broad Composite Blended Spread, [10] J.P. Morgan EMBI Global Diversified Sovereign Spread, [11] S&P 500, [12] Stoxx Europe 600, [13] Euro Stoxx 50, [14] Dax, [15] Swiss Market Index, [16] FTSE 100, [17] MSCI Emerging Markets Index, [18] MSCI AC Asia ex Japan Index, [19] MSCI Japan Index, [20] MSCI AC World Consumer Staples Index, [21] MSCI AC World Health Care Index, [22] MSCI AC World Communication Services Index, [23] MSCI AC World Utilities Index, [24] MSCI AC World Consumer Discretionary Index, [25] MSCI AC World Energy Index, [26] MSCI AC World Financials Index, [27] MSCI AC World Industrials Index, [28] MSCI AC World Information Technology Index, [29] MSCI AC World Materials Index, [30] Russell 2000 Index relative to the S&P 500, [31] Stoxx Europe Small 200 relative to the Stoxx Europe 600, [32] Relative to the Bloomberg Commodity Index, [33] Long-term investments

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 2024

– 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

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Glossary

The Bank of England (BoE) is the central bank of the United Kingdom.

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.

Capital expenditure (Capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

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

Earnings per share (EPS) is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

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

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.

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 KBW Bank Index is a benchmark stock index of the banking sector, representing large U.S. national money center banks, regional banks, and thrift institutions.

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 Nikkei 225 is a price-weighted index of Japan's 225 most important listed companies.

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

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. 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.

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