Alternatives Investor Letter

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Marketing material

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Dear Investors,

When we left off at the start of 2024, uncertainty lingered in the wake of one of the most challenging periods for Alternatives investing in recent memory. At first glance, in the six months since, it would appear that not much has changed. However, the economic data in the U.S., starting in the month of July, has marked a significant turning point from a macroeconomic perspective:

Labor markets blinked. The July jobs report revealed unemployment at 4.3%, up from a higher-than-expected 4.1% print in June and marking the fourth consecutive monthly increase. While the rate moderated slightly to 4.2% in August (as expected), recent downward revisions to U.S. job growth (the largest since 2009) have painted a markedly weaker picture than initial estimates suggested and August nonfarm payrolls fell short of consensus forecasts. Job markets have come into sharper focus as the U.S. Federal Reserve (Fed) must balance rising unemployment risk with lingering reinflationary concerns, particularly in light of recent CPI data.

Inflation has peaked. July's 2.9% headline annual CPI print confirmed a continued decline in inflation, marking the first dip below 3% since early 2021. After signaling that the "time has come" for policy to shift its attention to the labor side of the equation, the Fed followed through in a big way by slashing its benchmark interest rate by half a percentage point. Markets are pricing in another 25 bps cut in November and 75 bps of additional cuts in total by year-end. Falling interest rates should provide a tailwind for interest rate-sensitive sectors such as real estate with a recovery in Europe already underway.

Volatility has spiked. Speculation abounds that the largest stocks have entered overbought territory. Positive momentum fueled by AI enthusiasm lifted the "Great Eight," but recent turbulence in technology stocks has highlighted the risks of high market concentration. Accordingly, the case for diversification remains a strong one.

Externals risks abound. Bouts of geopolitical volatility have been par for the course this past year and international relations appear tense as the war in Ukraine continues and resolution in Gaza remains elusive. The 2024 U.S. Presidential election will add an extra element of uncertainty (despite there being no clear great economic outcomes no matter which party is elected) while snap elections in France amongst others across the European Union have exposed potential fractures across the bloc.

What’s next?

Change is not linear.
Change is inevitable.
But growth? Growth is intentional, purposeful and entirely optional.

All too often, we do not notice the microscopic indications of the broader forces and motions at work, but change is nonetheless ferrying us on an inexorable path. When we recognize it, however, we are faced with a conscious choice – we can continue to be gradually moved by and react to the change, or we can seek to become an agent of transformation.

> *“Change is inevitable. Growth is optional.”*
>
> *-John C. Maxwell*

Entering private markets.

By transformation, we mean a deliberate and significant shift.
In an environment where public equity valuations seem stretched, at least from a historical perspective, and rates have likely peaked, where should investors go to capitalize on the megatrends that are re-shaping the opportunity landscape? We believe investors seeking diversification, thematic exposure, income, and higher returns are increasingly turning an eye towards private markets. The asset management industry has been rapidly evolving in response, with private capital poised to be one of the most powerful agents of transformation. With this in mind…

Here are three relevant themes for the remainder of 2024:

1) Real Assets demand is underpinned by long-term megatrends

While the noise has continued, for example amidst a heightened focus on politics following European elections in June and July that have seen shifts in governing power (e.g. France, UK), the policy foundation for infrastructure remains solid with the agenda focused on facilitating private capital investment in areas such as the energy transition and European economic independence. Consensus in the European market towards the need for energy security and digital capabilities help ensure that the policy environment will remain supportive and continue to evolve to address the needs of investors in the future. Against this backdrop, we continue to see value in the European midmarket for infrastructure. Key trends of demographics, digitalization, deglobalization, and decarbonization are also creating thematic and sectoral opportunities in Real Estate as the world adapts. Onshoring and nearshoring in the semi-conductor and green energy industries are trends to watch, with the potential to boost demand near expanding manufacturing hubs. This is complemented by short-term tailwinds as transports assets post-COVID recovery are brought back to market and as the next rate cutting cycle gets underway, helping to accelerate transaction volumes in the back half of 2024 and 2025.

Demographics Digitalization Deglobalization Decarbonization

2) The importance of diversified origination sources is becoming more evident to investors

Private capital is playing an increasingly important role in financial markets. At roughly $26 trillion, gross assets have nearly tripled in size, eclipsing the U.S. commercial banking industry in terms of gross asset value and capital raising. Private credit in particular is playing an ever-bigger role amidst traditional lender pullback and as innovations in structuring expand access for investors. Despite private credit's extraordinary growth over the past several years, forecasts suggest there is a lot more room to run. Once adversarial relationships between asset managers and banks are rapidly evolving into partnerships, predominantly in direct lending but with some observable expansion into asset-based financing – a trend we expect to continue. The most innovative, adaptable, and forward-thinking firms are likely to emerge winners as the industry is forced to embrace the complexity, including data integration, structuring, and governance challenges, that accompany this attractive opportunity set. Further, asset managers with strong origination capabilities across multiple channels are expected to be best-placed to secure the access, quality, and diversification of investments that can meet the demands of sophisticated clients. At DWS, our partnership with the broader Deutsche Bank Group remains a key point of strength and differentiation in sourcing differentiated exposure for our clients.

3) Evolving client needs are driving a solutions-oriented approach

Even in the above-mentioned pursuit of financial symbiosis, clients remain at the core of the evolving Alternatives opportunity set. A massive shift is underway to cater to the wealth segment, which is keen to invest in Alternatives products. Asset managers are making strides in delivering private assets to wealth clients by developing products with the right mix of characteristics, rising to meet the challenge of advisory education, and partnering with platforms that better enable access. There is clear demand for solutions that meet the evolving needs of insurers as they navigate a changing regulatory landscape. And the need for bespoke solutions has arguably never been greater – what is important for a wealth manager or family office could vary significantly. Managers with a wide range of capabilities likely will be in the strongest position to structure and deliver the right products for their clients.

How is DWS Alternatives transforming to meet these needs?

While DWS has continued to demonstrate relative performance strength in a challenging environment, markets have continued to emphasize that diversification is essential for long-term success. We have stayed the course in our core areas of strength such as Real Estate and infrastructure and have been busy at work enhancing our Alternatives private credit capabilities. These enhancements should better enable us to meet our client's needs and provide a degree of insulation from market cycles.

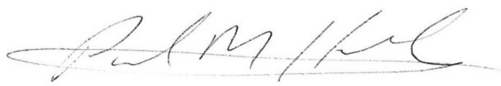
- The buildout of our Alternatives credit franchise continues as we seek to capture market share within the space, which is forecasted to grow at 11% CAGR 2023-28.[1] Thus far in 2024, key hires are enabling accelerated progress in our European CLO (Collateralized Loan Obligation) and Capital Solutions businesses. Diversified credit, insurance solutions, and asset backed lending are future areas of focus for this rapidly growing area of our franchise. We are in a strong position given our deep insurance connectivity and diversified origination capabilities.
- Infrastructure remains a targeted growth area amidst positive recovery in investor and fundraising sentiment which is supporting fresh allocations and a rebound in M&A volumes. We believe DWS is well-positioned with several funds in the market globally across equity and debt strategies. Investor sentiment is providing support that we are entering an attractive deployment window, particularly for transports where we are particularly constructive. In the U.S., growth across our infrastructure debt business is a testament to our ability to deliver truly differentiated strategies.
- Our Real Estate business is well-positioned for the next cycle, continuing to exhibit prudent active management and building on our strong track record. Critically, we have fully onboarded a new leadership team for U.S. Real Estate debt that will drive our targeted expansion strategy. Transaction volumes are picking up, fundamentals remain healthy, and peak interest rates should remove a key headwind. Investor sentiment continues to improve, underscored by increasingly positive capital formation discussions and reduced redemption queues. Across Europe, performance is stabilizing after 2 years of correction, with strong occupier markets supporting positive NOI (Net Operating Income) growth and investment activity picking up following a slow start to the year.
- Opportunities continue to be borne by strong relationships: While the declining real estate market environment has exerted pressure in the most liquid pillar of our Alternatives business, we believe the worst is behind us. Our

[1] Source: McKinsey 2024

relentless focus on client engagement and consistent performance track record has helped us weather the choppiness that is a telltale characteristic of the bottom of a market cycle. We are grateful for the trust of our clients and seek to deliver strong alpha on their behalf. Looking ahead, we expect a normalization of real estate returns as rates stabilize, which should drive AUM (Assets Under Management) growth going forward.

Long-term goals require long-term vision, along with the unfailing discipline and unrelenting stamina to execute on a strategic plan. We keep this at the forefront of our minds as we put human and financial capital to work for you every day – change is inevitable, but growth is optional. Moving onwards and upwards, we do so with confidence knowing that our organizational culture and systematic approach to growing our Alternatives platform should help us as we seek to deliver more for you – our clients. Thank you for your continued trust throughout the process.

Sincerely,



Paul Kelly

Glossary

Alpha is considered as an indicator that gauges the active return on an investment against a market index

Alternatives products are investment products such as real estate, infrastructure, real assets etc.

Alternatives credit is a strategy focused on investments in large, diversified portfolios of credit assets such as portfolios of loans, leases, financial receivables etc.

Alternatives investing is an investment strategy of investing in an asset class besides conventional products such as capital stock, bonds and cash

Asset backed lending is a lending method that is secured by an asset

Asset management is the professional management of financial assets to build and increase wealth over time.

Nonfarm payrolls is a US labor statistic for monthly employment numbers

Assets under management (AUM), also called funds under management, is the total market value of the securities a financial institution (such as a bank, mutual fund, or hedge fund) owns or manages on behalf of its clients.

The consumer price index (CPI) measures the price inflation as a percentage, year over year, of a basket of products and services that is based on the typical consumption of a private household.

Diversified credit are investments across a broader universe than traditional investment-grade credit and incorporates asset classes such as emerging market debt and high yield.

European Collateralized Loan Obligations (CLO) are bonds issued to fund a specific and diverse pool of corporate loans to firms of different sizes and in different industries all over Europe

Net Operating Income (NOI) shows the profitability of income-generating real estate

Private capital are a collection of investment strategies that deal in private assets as opposed to publicly traded ones, like stocks and bonds

Private credit is an asset defined by non-bank lending where the debt is not issued or traded on the public markets.

Private markets is a market where debt and equity instruments are traded for private companies

Public equity valuations are techniques used by investors to value the equity of a public company

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

Real Estate is a form of real property that is permanently attached to land

Thematic exposure is a standard that helps investors identify, measure and leverage the emerging, long term future trends

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Insights by Asset Class

Private Real Estate

Related link: Global Real Estate Strategic Outlook

As we enter the final part of the year, global real estate markets are showing increasing signs of recovery. Despite a slow start, midway through 2024 green shoots were already starting to emerge. One measure showed property prices increasing in the U.S. and Europe in the first six months of the year, and appraisal-based returns turned positive in the U.S. and the UK in May[1]. Anecdotally, our investment teams have observed heightened bidding activity, particularly within the logistics and residential sectors. Stabilizing interest rates are the lynchpin of the market's turnaround. To be sure, another spike in rates would upend the market once again, but with most central banks beginning to ease policy, or at least preparing to do so (in the case of the Fed), we believe this is unlikely (Japan being a notable exception).

Looking ahead, in Europe, occupier fundamentals look strong, especially given the collapse in development activity over the past two years, which suggests supply shortages will only continue to mount. Higher-entry yields and falling interest rates are also pointing towards recovery and elevated returns. We believe that U.S. Real Estate prices have found a bottom – appraisal-based values are lagging, but we expect they will return to growth in the second half of the year, particularly as peaking interest rates remove a key valuation headwind. In our view, a new U.S. real estate cycle is coming into view, characterized by improving valuations and strong fundamentals, aided by low levels of new supply. Finally, in Asia Pacific, we believe the real estate repricing cycle in Asia Pacific could bottom by the end of 2024, coinciding with an easing in financing conditions.

We expect that underlying fundamentals will drive greater dispersion in performance. In the U.S., we favor the industrial, residential, and retail sectors, and markets in the Sun Belt and Mountain West. In Europe, we continue to favor residential and logistics, with both already showing the first signs of recovery. However, we also expect rapid growth in interest in emerging niche sectors, such as data centers, self-storage and co-living. Current market conditions are attractive for value-add strategies: significant valuation declines for non-prime properties; a lack of capital to inject the equity necessary to delever and refinance loans; regulatory requirements accelerating obsolescence; and increasing undersupply as new construction is falling. In Asia Pacific, our house investment themes include Repriced Logistics and Built-to-Rent/Multifamily across Australia and Japan, underpinned by structural growth drivers, as well as tactical opportunities such as Sydney Office, High-street Retail in Japan and Structured Equity & Debt opportunities. Investors may also consider regional value-add opportunities such as asset repositioning strategies, while selective investments in higher risk operational real estate and emerging markets could drive higher returns.

[1] Green Street (prices); MSCI (UK returns); NCREIF (US returns). As of June 2024.

Private Infrastructure

Related link: Infrastructure Strategic Outlook

The infrastructure asset class has seen its performance continue to weather the higher rate environment. At the beginning of 2024, optimism with regards to rate cuts led to expectations that the infrastructure market would begin its recovery. However, as expectations for early rate cuts swiftly shifted to cuts coming later in the year, the infrastructure market remained in defensive mode, with a lack of transaction activity leading to a restriction of funds flowing into the market. Even in this environment, the performance of the infrastructure asset class has remained robust.

Looking forwards, with inflation having fallen and economic growth expected to be unremarkable, infrastructure's defensive characteristics will again be front and center of investor minds. Data from a range of private market benchmarks point to another strong year of equity returns in 2023, although conditions in 2024 for businesses will remain challenging from a macroeconomic perspective. Sectors with a high reliance on capital expenditure have been under the greatest scrutiny from the prevailing rate environment and have thus seen pressure on valuations. Elevated construction and labor costs compounded the pressures from an increase in the cost of capital. As interest rates fall, we expect the transaction market to gather pace, which should address the liquidity constraints in the fundraising market. The delay in cutting rates and resultant reticence to bring assets to market has replaced the denominator effect as the key factor impacting fundraising.
We continue to see value in the European Midmarket for the infrastructure asset class given the potential for diversification, value and a strong regulatory environment. Within this context, political risk remains a salient issue for investors. Consensus in the European market towards the need for energy security and digital capabilities help ensure that the policy environment will remain supportive and continue to evolve to address the needs of investors in future. Conversely, when looking at political risk in other markets, more binary outcomes such as those in the upcoming November election in the U.S. could see significant disruption to future policy making in thematic areas like the energy transition. Additionally, the digitalization thematic continues to draw attention to data centers and their role in facilitating the growth of artificial intelligence (AI). Although the additional AI-driven demand has bolstered an already bullish pipeline, cloud storage, data sovereignty and capacity constraints are all factors that are expected to drive additional data center requirements.

Private Debt

Related link: Direct lending shows vigorous growth

The European private debt market has continued its robust growth trajectory, driven by factors such as increased investor appetite for alternative asset classes and growing demand for (re-)financing solutions beyond traditional bank lending. While the year began with cautious optimism amid lingering economic uncertainties, the market has demonstrated resilience and adaptability. In the private credit space, deal flow has increased, with a cautious re-opening for larger transactions. However, the overall market remains slower than many market players expected at the start of the year, leaving sufficient financing opportunities expected for the next 12 to 24 months. In the real estate debt space, the financing supply-demand imbalance – which resulted in higher margins across the risk spectrum – is yet to convert into significantly more deal flow or pressured refinancings, as loan extensions were used to postpone the issue. On the contrary, the infrastructure debt space has seen issuance volume increase by €10 billion (13%) in 1H 2024 compared with the same period in 2023. Pricing power in the direct lending market has shifted over the last twelve months and has now normalized to pre-Ukraine War levels. This reflects increased lender competition, leading to moderate tightening of spreads while still showing a clear premium to comparable risk tradable corporate credit markets. In real estate, spreads have remained elevated across the capital stack, particularly for less favored risk profiles. However, spreads for high-quality real estate have started to decrease from their peak. Similarly, infrastructure spreads remain 25-50 basis points higher compared with mid-2022.

Overall, the outlook for the European private debt market remains positive, albeit with some caveats. While economic headwinds, geopolitical tensions, and political uncertainty persist, the sector's ability to provide tailored (re-)financing solutions and its focus on non-cyclical nature position it favorably. The DACH and BeNeLux regions are expected to maintain their growth trajectory, underpinned by strong economic fundamentals and a deep pool of institutional investors. Credit quality will be a critical factor, as lenders will need to exercise prudent underwriting standards to mitigate risks associated with a potentially deteriorating economic environment.

In general, we will continue to see notable opportunities around European Transformation in areas such as digitalization, technology, and health care. With higher borrower demand, ongoing fiber rollouts, and the emergence of data centers (seen as key infrastructure for the future of AI), we expect infrastructure debt issuance to increase further, particularly in the digitals and renewables space. These sectors have already been responsible for 35% of issuance volume in the first half of this year. Notably, nearly 50% of issuance volume comes from ESG-related sectors, and an increasing number of sustainability-linked loans make the infrastructure debt space appealing to ESG-minded investors. In real estate, resilient fundamentals continue to be supportive as price corrections are now all but complete, especially in sub-markets with favorable supply-demand dynamics, such as logistics and residential. Whole loans and stretched senior loans, particularly in the small-to-medium-sized part of the market, will be most attractive due to higher pricing power, while loans secured by secondary offices or shopping centers require significant risk appetite. Margins should remain stable due to the continued financing supply-demand imbalance and more (acquisition) financing opportunities, while we expect margins for high-quality real estate to further decrease from their peak. Turning to private credit, lender competition will remain. While we see compelling value in direct lending, we prefer senior debt, unlevered funds, and geographically diversified exposure. We continue to favor creditor-friendly structures and market segments where we see better risk/reward from reduced competition, more stable lender protections and better choice through multi-channel origination capabilities which, in turn, enables selectivity, quality and diversification. In order to thrive in this environment, investors and lenders must adopt a strategic and differentiated approach. A deep understanding of local market dynamics and local networks are crucial for success. Building strong relationships with various stakeholders in the region like borrowers, advisors and financial sponsors is paramount to securing a robust deal pipeline. The integration of ESG factors into investment processes is becoming a non- negotiable requirement for new debt funds, as investors seek to align their portfolios with sustainable investment goals. Borrowers however still have to get used to this and discussions on willingness to provide and availability of data are not always easy.

Liquid Real Assets

Related link: The AI explosion: Impacts on Real Assets

After a choppy start to 2024, pressure has finally begun to abate with Fed rate cuts expected to materialize in September. Global real estate and global infrastructure securities bounced into August as risk assets rallied on positive earnings news, encouraging economic data, and falling inflation, which have helped support the market's recent strength. Global infrastructure securities have been supported by underlying strength in U.S. energy and utilities names. Outside of Asia ex Japan, where Chinese property market weakness has continued to drag on performance, global real estate securities have mostly headed higher, led by the Japan developers and specialty and healthcare names in the U.S. Performance for commodities and natural resources has been mixed. Prices for soft commodities such as cocoa and coffee have been driven higher due to drought conditions while copper and gold prices have benefitted from investor enthusiasm for future demand. Natural gas prices have suffered amidst excess inventory while tensions in the Middle East and production cuts from OPEC+ have helped keep a floor under oil prices despite weak global demand. A correction in industrial metals prices from highs witnessed in May is being driven by waning hype over AI and weak global industrial activity are pressuring the miners in the near-term despite a positive long-term outlook.

The outlook for real assets is improving with the decline in U.S. 10-year Treasury yields since the end of April providing optimism. The U.S. election brings a level of uncertainty, but this is being overshadowed by the outlook for Fed rate cuts. Recent macroeconomic data suggests that both growth and inflation pressures are easing, giving the Fed more optionality regarding rate cuts, with the market currently pricing in three cuts by the end of January 2025. Within listed real estate, sector fundamentals have started to improve as the market enters peak leasing season, and this outlook continues to improve in the back half of 2024 and into 2025. Private market values have firmed marginally despite interest rate volatility, with recent apartment and industrial transactions reflecting cap rate compression. Bank lending remains tight, but public REITs retain access to the capital markets, with unsecured debt continuing to be a competitive advantage. Across listed infrastructure, volatility will likely continue; however, infrastructure should benefit given its inflation passthrough traits and necessity-based assets while a lower cost of capital in the form of lower long-duration bond yields would also be a positive. For commodities and natural resource equities, key themes include the scope of China's economic stimulus developed market economies' growth trajectory considering larger fiscal spending and potentially easing monetary policy, and dearth of capacity due to low capex levels. This space is also impacted by geopolitical developments including the Ukraine-Russia conflict, Middle East tensions, and several elections around the world in 2024. Amidst intense uncertainty and with so many variables in play, we expect we may see limited commodity demand growth until late 3Q or 4Q 2024.

We expect performance dispersion across real assets to remain pronounced at a stock and sector level, affording experienced active managers opportunities to create alpha on behalf of clients. Across listed real estate, we maintain a slight defensive tilt in the near-term given the probability of both declining economic growth and inflation for the 2nd half of 2024. In the U.S., we see compelling value in Net Lease, Industrial, Healthcare, and Residential (specifically in coastal apartments) property sectors as their respective sector fundamentals remain healthy or are expected to strengthen; conversely, we are more cautious on Hotels and Gaming given the slowing economic growth outlook. We are more constructive on Continental Europe as inflation has cooled and central banks have begun to cut rates. We continue to prefer Retail given the resilient consumer while we are less constructive on the more defensive Swiss real estate segment. In the UK, we retain a preference for less cyclical sectors such as student accommodation, life sciences, and urban logistics that offer positive supply-demand characteristics and names that own high-quality assets with an attractive implied valuation. In Asia Pacific, we are generally cautious on Hong Kong and Singapore given softening fundamentals, preferring blue-chip Japanese property stocks and Australian data centers/logistics. Within listed infrastructure, exposure continues to be driven by stock-level fundamentals and relative valuations, with a moderately defensive tilt. We prefer exposure to communications and utilities in Europe and the Americas. Within commodities, near-term, energy markets should remain volatile from the intense uncertainty stemming from both macro-economic and geo-political fronts. Given ample supplies and faltering global demand, we do not see OPEC+ capable of rolling back the expected production cuts in October, without creating a significant oversupply situation. A direct confrontation with Iran remains one of the major uncertainties with regards to oil supply and overall market stability. On the metals side, Gold continues to perform as a safe-haven asset and has been further supported by speculation surrounding Fed cuts. For Copper, despite an AI speculation reset that weighed on prices in July, Chinese policy stimulus should ultimately drive demand with rising grid spending a bullish factor. Overall, we maintain that a holistically managed real assets allocation can offer an attractive combination of growth and defensiveness and a strong income and liquidity profile – all powerful tools for managing aggregate portfolio risk.

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