

Our monthly market analysis and positioning



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IN A NUTSHELL

- Shareholders had another happy month in February, even though government bond yields rose
- Tailwinds continued to blow, coming from AI euphoria, a partly good reporting season and fewer worries about a U.S. recession
- We believe that the positive momentum in markets can continue in the short term, but we see valuations limiting the rally in terms of valuation in the medium term

1 / Market overview

February: strong for riskier investments despite rising government bond yields

Downer: stubborn inflation and wait-and-see central banks

There was one real downer for investors in February:¹ inflation figures that seem to confirm that the last few miles towards the central banks' 2% target are going to be the hardest. The U.S. Federal Reserve's (Fed) preferred inflation measure, the core personal consumption expenditure (Core PCE) price index, showed a year-on-year increase of 2.85% for the month of January, compared to consensus forecasts of 2.8%. The month-on-month increase was more worrisome: at 0.42% it was the strongest in twelve months. The annualized rate for the past three months is 4%. Accordingly, the market has significantly reduced its expectations for interest rate cuts by the Fed and pushed them back. In February alone the consensus expectation of the number of possible Fed interest rate cuts (of 25bps each) fell from approximately six to three.

In Europe, too, the market now expects fewer cuts this year, although this is less due to the inflation figures than to the ECB's messaging. It has once again emphasized that it considers early interest rate cuts to be dangerous and that it is therefore waiting for more reassuring data before taking any action. Even if the preliminary figures for the Eurozone (consumer prices) published on March 1 point in the right direction, falling to 2.6% in February from 2.8% in January, the core rate, of 3.1%, and services inflation, at 3.9%, remain high, preventing an early interest rate cut.

Bonds suffer while shareholders' favorites shine

Against this backdrop it is unsurprising that government bonds were among the biggest losers in February. The respective indices for 10-year U.S. and German government bonds lost around 2%. Investment-grade corporate bonds also did not escape the negativity. But high-yield bonds were able once again to post a positive total return thanks to their higher coupons.

The stock markets had yet another celebratory month. Many of them reached new highs, led by Japan's Nikkei 225, which rose by almost 7% in February and finally surpassed its peak of almost 40 years ago. The Nasdaq reached its first new high since 2021, while the S&P 500 jumped above the 5,000-mark for the first time and the Dax exceeded 17,000 points for the

¹ Leaving aside the new stress at financial institutions in Europe and the U.S. with exposure to the U.S. office market, which the market quickly dismissed as a potentially non-systemic risk anyway.

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first time. What is striking about these share price movements is the stock markets' indifference to higher bond yields. Improving economic sentiment may be the reason for stocks' ebullience: Only a slight slowdown is expected in the U.S. in coming months, with a recession now only considered a tail risk.

And yet it was again noticeable that only a handful of stocks provided the upward momentum for U.S. and European markets. In the U.S. the technology warriors, the "Magnificent 7,"² were the leaders and in Europe a mix of technology, pharmaceutical and luxury goods stocks. In other words, big became bigger (the Magnificent 7 rose by 12% in February), while the small caps once again lagged behind, particularly in Europe, as they are considered more sensitive to interest rates due to their financing structure. Of course, artificial intelligence (AI) was the overarching theme once again, reflected in almost every quarterly report – and filling the order books of AI providers accordingly.

India's stock market dull but economy strong; in China the opposite

In India the stock market gained a less than exciting 1% in February despite stellar gross domestic product (GDP) growth figures at the end of the month. Annual growth of 8.4% was reported for the fourth quarter of 2023, prompting numerous economists to revise their 2024 growth figures upwards (see our study "India - a poorly kept secret"³).

Stock markets in China, by contrast, having underperformed global equities for more than three years, finally stirred into life. The CSI 300 gained almost 10%, while the Hang Seng, which is more relevant for foreign investors, rose by almost 7%. This is probably in part because China's valuations have now set a record low compared to global equities. What may also have helped is a plethora of measures taken by the government to support the economy and stock markets in particular.

2 / Outlook and changes

We have made only a few tactical changes over the past month and our quarterly strategy meeting, at which the new 12-month strategic targets will be set, will be held in a few days' time.

In recent weeks we have seen that the riskier segments of the market - in particular equities and corporate bonds - have once again performed well, even though government bond yields have risen and expectations for interest rate cuts have been scaled back. One reason for this is probably that the markets are also pricing out the risk of a recession in the U.S.. High interest rates are much easier for companies to bear when the economy is doing well. At the same time, it's difficult for market participants to hold back from a market riding the wave of AI euphoria. Index-oriented investors in particular have clearly lagged the market if they dared to underweight the big U.S. technology stocks and major European stocks from the luxury, pharmaceutical and technology sectors. And as various indicators are still not showing the values that are usually observed shortly before the bursting of an exuberant price rally, the momentum could continue. The best performing investment style for equities since the beginning of the year has been "momentum." And investors are still more inclined to jump on the bandwagon than jump off it. However, the big risks that are currently being ignored are sure to become the focus of the market's attention again over the course of the year. Among those risks are the U.S. budget deficit and its refinancing constraints, the fiscal burdens on the European Union (EU) where defense and decarbonization are concerned and China's growth difficulties and potential deflationary tendencies.

2.1 Fixed Income

The market has come closer to our view in recent weeks, cutting back significantly the number of interest rate cuts it had priced in for this year. We foresee three interest rate cuts from the ECB and Fed this year, starting in the summer.

² These are Microsoft, Amazon, Meta, Apple, Alphabet, Nvidia and Tesla.

³ [India – a poorly kept secret](#) | DWS Investment GmbH | Published on February 22, 2024.

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Government Bonds

After what we believe was an exaggerated (or rather premature) slump in yields in the fourth quarter of 2023, government bond yields have risen again significantly this year, and appears to be no end in sight to this trend yet. But we expect a normalization of the yield curve in the medium term, driven primarily by a decline in yields at the short end; we expect less movement at the long end. For German government bonds, however, we also expect yields at the longer end to rise slightly. Accordingly, we still consider the two-to-five-year range to be the most attractive. In the U.S., though, we see a greater risk that the long end could be influenced by brisk Treasury issuance due to the high budget deficit.

Corporate Bonds

In our opinion risk spreads on corporate bonds have already narrowed so much, particularly in the high-yield segment, that we see no further potential for the bonds to gain in the U.S. and little potential for it in Europe. But the yields still look attractive. We expect spreads on high-yield bonds to widen slightly. We have seen a marked narrowing here for around six months, which neither inflation nor rising government bond yields have been able to halt. Although the slightly better economic outlook certainly helps, we expect the markets to remain volatile in the short term.

Emerging Markets

With Dollar strength probably past its peak and U.S. yields set to move sideways or down, the backdrop for EM Sovereigns is rather constructive. Volatility might increase, however, given the U.S. election at year end. We are mainly looking at lower rated countries whose ability to refinance seems to us convincing. Political stability and progress on economic reforms remain key for HY sovereigns. Spread tightening is possible among so-called "distressed names" (with spreads above 1,000 bps) and defaulted issuers. We continue to like EUR-denominated bonds because of their attractive yield. We also like Asian Credit, where HY spreads are still at elevated levels compared to the past ten years, while IG is trading at the lower end of its 10-year band. China remains weak; other countries are doing better. Technical support comes from the fact that we expect another year of negative net issuance in EM.

Currencies

We have made no changes in currencies and do not expect any clear movements in any particular direction. The relative strength of the dollar against the euro should be coming to an end as economic data in Europe has recently exceeded expectations, while in the U.S. the opposite has happened.

2.2 Equities

There are grounds for the euphoria in the stock markets. The U.S. economy is holding up well - even if another absurdly high budget deficit is part of it. Japan's companies are delivering decent earnings growth. Europe's economy, with the exception of Germany, is gaining momentum. Last but not least, the U.S. technology and communications sector are delivering such good earnings growth and upwardly revised earnings estimates that valuations - especially compared to the 2000s - do not appear absurdly high. And yet there is a feeling that the market is currently giving much more weight to the positive factors than the negative ones - not least the risk of an escalation of the war on Europe's borders. But to resist the momentum is not easy given the current dynamics. It might take a few disappointments from the AI sector to put a stop to the party.

U.S. Market

The earnings season shows the bifurcation in the U.S.: while earnings for the S&P 500 as a whole rose by 8% in the fourth quarter of 2023, earnings in the communications sector increased by 49%, technology by 22% and discretionary consumption by 29%. The so-called Magnificent Seven are in these three sectors. If you exclude their profit growth, the overall market increase of 8% turns into minus 2%. The market now seems to want to trade even higher, but we remain skeptical that companies can deliver over the next 12 months the growth that their current valuations demand.

European Market

In Europe, too, some large stocks have driven the market as a whole, although, unlike in the U.S., they are spread across a range of sectors. We still consider Europe's valuation discount to the U.S. exaggerated and see room for upside given the better-than-expected macroeconomic figures.

German Market

Although Germany's economy is currently lagging behind the rest of the continent, the Dax has been able to climb to new record highs. We are less positive on the Dax than Europe's Stoxx 600 as a whole due to Germany's increasing competitive disadvantages and the relatively poor sector mix.

Japan

In February the Nikkei exceeded its 1989 high for the first time and the 40,000 mark. Companies have reported good figures, profit expectations have been raised further and the yen remains weak. We are sticking to our positive view.

Emerging Markets

The emerging markets (EM) present a mixed picture. In terms of valuation, China appears to have bottomed out after a long period of underperformance, while government-led purchases on the onshore market are also providing some support. However, the economic policy headwinds remain strong and Beijing's - quite justified - concern about over-stimulating the economy and creating excess capacity is not going down well with some investors. We now have to wait for uneasy private consumers to start spending again.

We prefer other countries in Asia, such as India or Indonesia. The emerging markets should be helped overall by the fact that the U.S. dollar is unlikely to appreciate from its current levels and U.S. Treasury rates should be close to the upper end of their trading corridor. However, weak Chinese demand reduces support for commodity-intensive industries and limits the scope for a revaluation of commodity-exporting countries.

2.3 Alternatives

Real estate

Is the neighbor's grass greener or snow whiter? With multifamily apartment REITs' earnings in the rearview mirror, we wanted to highlight some differences we're seeing between the U.S. and Canada. In the U.S., same-property net operating income is likely to be hampered this year (< 1% growth overall based on company guidance) due to softening demand and elevated levels of new units being delivered. While these effects will be felt across the country, they're even more notable in the Sunbelt, where cities like Austin and Nashville have outstripped new supply and could be hit hardest. In contrast, Canadian apartment companies are expecting same-property net operating income to grow in the range of high single digits to low double digits (think 8 to 12%). Canada is benefiting from incredibly high demand and a poor supply of new apartments, despite low turnover and rent control in some areas.

Gold

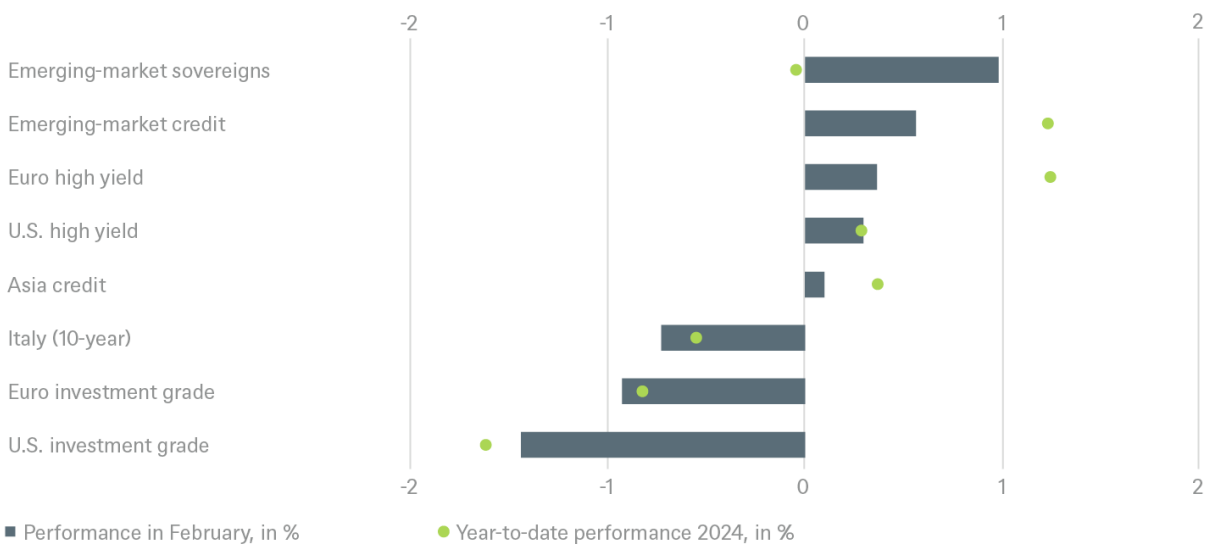
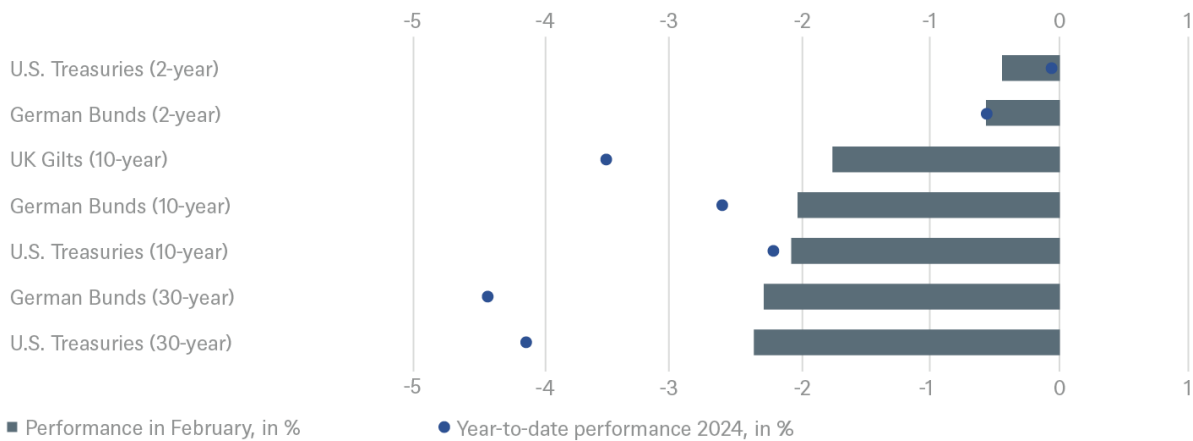
In our opinion the price of gold will continue to track U.S. government bond yields closely and therefore show similar volatility. But strong demand from central banks and private consumers should continue to support the gold price above USD 2,000.

Oil

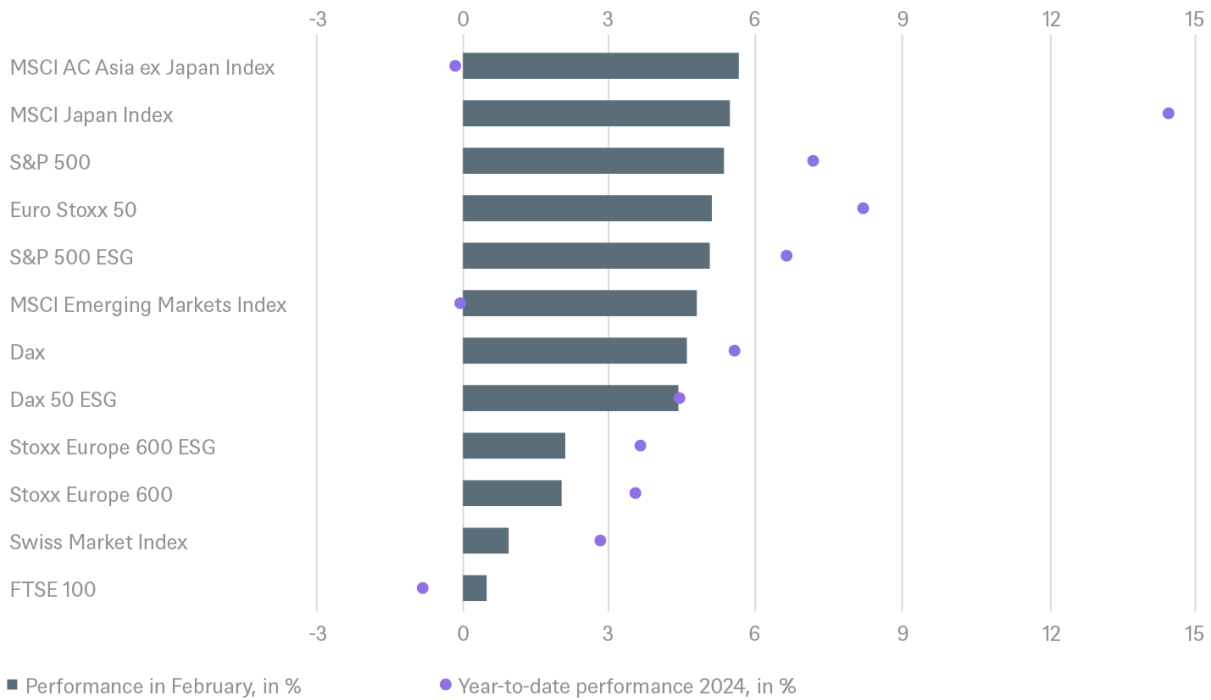
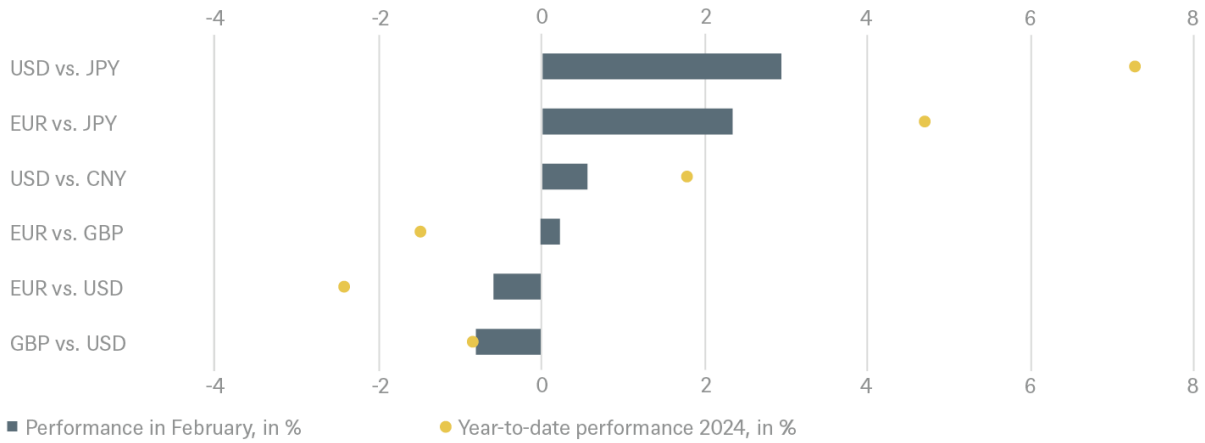
We continue to see Brent crude oil prices of between USD 70 and 80 per barrel, with the price capped by the availability of spare production capacity. As we expected, OPEC+ has extended its production cuts into the summer; but growth in non-OPEC regions is offsetting these cuts. We still do not expect any demand stimulus from China. Natural gas prices for both U.S. and global LNG supply continue to be closely linked to the weather. The market is well supplied and limited storage capacity should drive prices down.

3 / Past performance of major financial assets

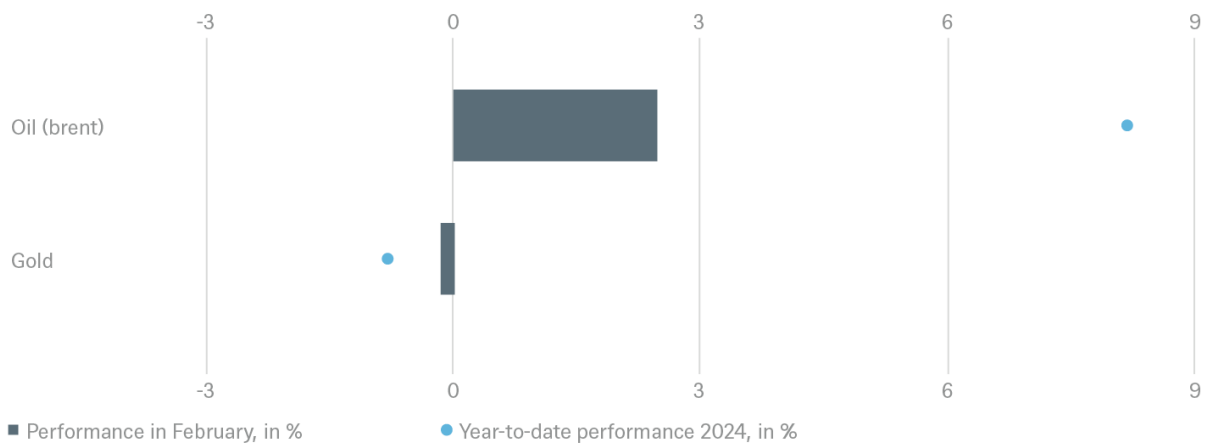
Total return of major financial assets year-to-date (as of 2/29/24) and past month



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Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 2/29/24

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 Dec 2024
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)	●	●

Securitized / specialties	1 to 3 months	through Dec 2024
Covered bonds ¹	●	●
U.S. high yield municipal bonds	●	●
U.S. mortgage-backed securities	●	●

4.2 Equities

Regions	1 to 3 months ²	through Dec 2024
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 ²²	●
European small caps ²³	●

Spreads	1 to 3 months	through Dec 2024
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	●	●

Currencies	1 to 3 months	through Dec 2024
EUR vs. USD	●	●
USD vs. JPY	●	●
EUR vs. JPY	●	●
EUR vs. GBP	●	●
GBP vs. USD	●	●
USD vs. CNY	●	●

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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4.3 Alternatives

Alternatives	1 to 3 months	through Dec 2024
Commodities ²⁴	●	●
Oil (brent)	●	●
Gold	●	●
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		●

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

Glossary

Artificial intelligence is the theory and development of computer systems able to perform tasks normally requiring human intelligence.

A **barrel (bbl)** is the commonly used unit to measure crude oil. One barrel is about 159 liters.

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

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

The **CSI 300 Index** includes the 300 largest companies of the Chinese mainland, that is companies listed on the Shanghai and Shenzhen Stock Exchange (so called A-shares).

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

Deflation is a sustained decrease in the general price level of goods and services.

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 **European Union (EU)** is a political and economic union of 27 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.

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.

The **Hang Seng Index (HSI)** is a freefloat-adjusted market-capitalization-weighted stock-market index in Hong Kong. It tracks the 50 biggest and most traded companies on the Hong Kong 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 **MSCI AC World Communication Services Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Communications Services 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.

MSCI AC World ex Japan Index tracks the performance of mid- and large-cap stocks in 22 developed-market countries (excluding Japan) and 24 emerging-market countries around the world.

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 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 **Nasdaq-100** is an equity index which contains the 100 biggest common stocks listed on the Nasdaq Stock Market.

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

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

The personal consumption expenditure (PCE) measure is the component statistic for consumption in gross domestic product (GDP) collected by the United States Bureau of Economic Analysis (BEA).

A **Real Estate Investment Trust (REIT)** is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

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.

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.

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