

ADJUSTING OUR 12-MONTH TARGETS

Central banks look set to cave in the face of bond-market pressure. We are adjusting our forecasts accordingly.

In our last strategic outlook, we warned that a worsening trade conflict could lead to a revision of our forecasts. This has now occurred indirectly. Although the conflict has not escalated recently, central banks referred to it as one of the reasons for their renewed "dovishness." We had predicted that the U.S. Federal Reserve (Fed) would leave interest rates on hold for that period. We have now penciled in a reduction of 50 basis points, which would equal two rate cuts of 25 basis points each. For the European Central Bank (ECB) we expect looser policies too in coming months. Most probably, the ECB will try to do this via one cut of 10 basis points in the deposit rate and the implementation of a tiering system for commercial banks parking money with the ECB.

Uncertainties around these forecasts are unusually large. They mostly reflect changing rhetoric from the central banks themselves, rather than the occasional pockets of weaknesses in incoming economic data. Dovish central-bank rhetoric, in turn, appears to be mainly driven by falling bond yields, and in particular declines in inflation expectations. Rightly or wrongly, many market participants appear to think that the tariff wars could unleash deflationary forces again around the world. And the Fed seems to be edging towards the conclusion that this will justify cutting rates pre-emptively.

Against this backdrop, we are reducing our U.S. Treasury forecasts until June 2020 by 30 basis points along the yield curve, compared to our previous targets, while leaving U.S. corporate-bond spreads unchanged. The picture for European sovereign bonds is similar. Whereas for European corporate bonds, we expect spreads to tighten, on the back of hopes that the ECB might eventually revive its bond-purchase programs. For the same reason, we also expect spreads for riskier Eurozone sovereign bonds to tighten.

Most of our other 12-month targets remain unchanged, including in particular those for all major equity indices. This reflects our concern that even if no new tariffs are implemented, corporate margins are likely to suffer from the ones already implemented. And, in the face of lingering trade wars, it is far from clear that the modest rate cuts, we now

envision, will suffice to give equity markets another boost. It is equally possible that we see a market correction, before the Fed cuts. At least, that would provide a better justification for such a cut than what we have seen so far.

	Current level June 21, 2019*	Forecast June 2020
Capital market yields (sovereign bonds)		
United States (2-year)	1.90%	1.70%
United States (10-year)	2.13%	2.00%
United States (30-year)	2.61%	2.50%
Municipal bonds*	77.78%	80.00%
Securitized / MBS*	40 bp	38 bp
Germany (2-year)	-0.68%	-0.70%
Germany (10-year)	-0.23%	-0.10%
Germany (30-year)	0.38%	0.40%
Italy (10-year)	265 bp	270 bp
Spain (10-year)	83 bp	80 bp
United Kingdom (10-year)	0.86%	1.50%
Japan (2-year)	-0.19%	-0.05%
Japan (10-year)	-0.11%	0.15%
Currencies		
EUR vs USD	1.12	1.15
USD vs JPY	108	107
EUR vs JPY	122	123
EUR vs GBP	0.89	0.88
GBP vs USD	1.27	1.30
USD vs CNY	6.91	7.00
Commodities in U.S. dollars		
Gold	1,330	1,400
Crude Oil (WTI)	57	60

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Source: DWS Investment GmbH

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	Current level June 21, 2019*	Forecast June 2020
Equity markets (index value in points)		
United States (S&P 500)	2,856	3,000
Germany (DAX)*	12,064	12,300
Eurozone (Euro Stoxx 50)	3,373	3,370
Europe (Stoxx Europe 600)	378	380
Japan (MSCI Japan Index)	926	970
Switzerland (SMI)	9,756	9,450
United Kingdom (FTSE 100)	7,311	7,220
Emerging Markets (MSCI Emerging Market Index)	1,014	1,080
Asia ex Japan (MSCI AC Asia ex Japan Index)	626	680

	Current level June 21, 2019*	Forecast June 2020
Benchmark rates in percent		
United States (federal funds rate)**	2.25-2.50	1.75-2.00
Eurozone (refi rate)	0.0	0.0
United Kingdom (repo rate)	0.75	1.00
Japan (overnight call rate)	0.0	0.0
Spreads (corporate & EM bonds) in bps		
EUR IG Corp	138	90
EUR HY	414	380
US IG Corp	118	105
US HY	401	440
Asia Credit	268	265
EM Credit	340	300
EM Sovereign	362	330

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GLOSSARY

Basis point

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

Central bank

A **central bank** manages a state's currency, money supply and interest rates.

Dax

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

Deflation

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

Deposit rate

The **deposit rate** is the rate banks receive when they make overnight deposits with the ECB.

Dove

Doves are in favor of an expansive monetary policy.

Emerging markets (EM)

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

Euro Stoxx 50

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

European Central Bank (ECB)

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

Eurozone

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

Federal funds rate

The **federal funds rate** is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

FTSE 100

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

Inflation

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

Mortgage-backed security (MBS)

A **mortgage-backed security (MBS)** is a special type of asset-backed security where the holder receives interest and redemption payments from pooled mortgage debtors, secured by the underlying mortgages.

MSCI Asia ex Japan Index

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.

MSCI Emerging Markets Index

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

MSCI Japan Index

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

Municipal bonds (Munis)

Municipal bonds (Munis) are debt securities issued by a state, municipality or country.

S&P 500

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

Spread

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

Stoxx Europe 600

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

Swiss Market Index (SMI)

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.

GLOSSARY (CONTINUED)

Treasuries

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).

U.S. Federal Reserve (Fed)

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

West Texas Intermediate (WTI)

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing.

Yield

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.

Yield curve

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.

APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

	05/14 - 05/15	05/15 - 05/16	05/16 - 05/17	05/17 - 05/18	05/18 - 05/19
UST 30yr	9.7%	8.4%	-1.6%	0.1%	11.0%
UST 10yr	5.0%	4.4%	-0.4%	-2.4%	8.6%
UST 2yr	0.8%	0.7%	0.6%	-0.1%	3.5%
UK 10yr	7.8%	5.5%	5.2%	-0.4%	4.8%
GER 10yr	7.5%	4.4%	0.0%	0.8%	5.0%
GER 2yr	0.4%	0.2%	-0.3%	-0.6%	-0.5%
GER 30yr	20.2%	6.5%	-2.7%	3.0%	10.6%
Japan 2yr	0.3%	0.4%	-0.4%	-0.1%	-0.1%
Japan 10yr	2.5%	4.7%	-1.2%	0.4%	1.5%
EM Sovereign	2.5%	4.5%	9.8%	-0.6%	7.5%
EM Credit	3.3%	2.2%	9.0%	0.2%	8.4%
US HY	2.0%	-0.8%	13.6%	2.3%	5.5%
US IG Corp	2.8%	3.3%	3.9%	0.1%	7.4%
EUR HY	5.4%	0.6%	9.5%	1.5%	2.2%
Asia Credit	5.5%	4.7%	4.7%	0.0%	7.7%
EUR IG Corp	4.3%	2.0%	2.8%	0.6%	3.1%
Spain 10yr	9.9%	6.2%	2.3%	2.2%	8.9%
Italy 10yr	10.2%	6.6%	-2.5%	-2.9%	6.2%
MSCI Asia ex Japan	8.0%	-19.5%	25.1%	14.7%	-13.2%
MSCI EM	-2.3%	-19.6%	24.5%	11.5%	-10.9%
S&P 500	9.6%	-0.5%	15.0%	12.2%	1.7%
MSCI Japan	39.2%	-19.4%	12.5%	10.5%	-11.8%
SMI	6.5%	-11.1%	9.7%	-6.2%	12.6%
DAX	14.8%	-10.1%	22.9%	-0.1%	-7.0%
FTSE 100	2.0%	-10.8%	20.7%	2.1%	-6.7%
Stoxx600	16.2%	-13.1%	12.2%	-1.8%	-3.7%
Eurostoxx 50	10.1%	-14.2%	16.0%	-4.2%	-3.7%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 6/3/19

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