CIO View

Investment Traffic Lights

November 5, 2024
Marketing material

DWS

Our monthly market analysis and positioning

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IN A NUTSHELL

- In October, both equity as well as bond investors suffered losses for the first time in months.
- While economic growth remains satisfactory overall, progress in disinflation is faltering somewhat, and many asset classes remain relatively highly valued.
- Investors will first have to digest the implications of the U.S. election before contemplating a potential yearend rally.

1 / Market overview

1.1 The resurging Trump-trade wasn't the only thing moving markets in October

Though on some days it certainly didn't feel like it, the unbearably vacuous U.S. election campaign did not dominate all headlines in October. Developments in the Middle East also kept the world in suspense, investors awaited further details of the Chinese stimulus package, Japan's prime minister made a bad bet, Europe suffered some rather mixed economic figures and UK chancellor shocked investors with her inaugural budget. Meanwhile, in the markets, the quarterly reporting season began, providing investors with plenty of numbers to chew on. One thing at a time. Although the U.S. election campaign produced nothing meaningful, it still dictated the mood on the U.S. financial markets. The "Trump trade" was back as the former president regained significant ground in the polls. Furthermore, some economic data surprised on the upside. This caused U.S. interest rates to rise, the dollar to strengthen and, for some reason, outperformance by U.S. stock markets of those in the rest of the world. As our CIO for the Americas speculated: "The last few days price in the best of all worlds. After the election, the hard decisions await."

China's stimuli packages failed to meet expectations - maybe one of the reasons for the weak oil price

In China those in power would love investors to price in the best of all possible worlds. The initial euphoria over the stimulus package announced at the end of September evaporated during the course of the month, as little of substance followed. Another blow was industry profits, weaker than at any time since the Covid slump of 2020. In Japan, Shigeru Ishiba, the newly elected leader of the ruling Liberal democratic (LDP) party miscalculated by calling for snap elections in which his party lost its parliamentary majority for the first time since 2009. The fact that the stock markets performed relatively well despite the political uncertainty can probably only be explained by the simultaneous weakening of the yen, which favors Japanese exports. In Europe, economic data was mixed. The once proud core countries performed rather weakly, while Europe's periphery, led by Spain, did much better.

Finally, there is the region that currently has bigger concerns than economic growth, the Middle East. Here, the conflict threatened to escalate, particularly between Israel and Iran. When fears eased a little, the oil market quickly calmed down again and the price of Brent fell almost to USD 70/barrel at the end of the month, about the same as its low point in the past year.

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1.2 Gold reaches new record highs – despite rising real interest rates

A weak final trading day in October caused almost all global equity and bond markets to slip into negative territory for the month. Only Japan remained in the green. Emerging markets took the biggest hit, down 4.3%. For the S&P 500, it was the first negative month in six months. For global bonds, it was the worst month since September 2022 – with 10-year Treasuries losing almost 4%. Euro high-yield bonds were one of the few segments to achieve a positive return.

Two curiosities and a déjà-vu in the UK

Two curiosities in other markets were more interesting. The first relates to the weak oil price. While inflation expectations, and thus ultimately interest rates, are usually closely aligned with the oil price, both data series rose again in the month despite weak commodity prices – which in turn can probably only be explained by the "Trump trade," which reflects a certain degree of concern about rising inflation rates. The price of gold is the basis for the second curiosity. It continued to rise unabated to new record highs, even though the dollar index rose by almost 4% and even though U.S. real interest rates (10year) rose by almost half a percentage point. That certainly is the dark side of the Trump trade: the fear of debt-induced currency devaluation. On an annualized basis, gold and silver are now up by 33 and 35%, respectively. Also worth mentioning was the jump in yields on British government bonds. 10-years rose to 4.45% after the budget, with its ample new borrowing, had some minor echoes of Liz Truss's catastrophic mini-budget two years ago. Other than during the brief Truss panic, British 10-year yields traded at the end of October at their highest premium (over 200 basis points (bps)) over German government bonds since the early 1990s.

2 / Outlook and changes

Regardless of how the U.S. elections ultimately turn out and it could take days, if not weeks, before the exact result and repercussions for the Congress are known -- nothing could be more difficult than predicting the immediate market reaction after the first projections of the result. The 2020 election was very close and then, as now, the market mostly assumed that a Trump victory would boost the stock market more. Biden won, and yet the S&P 500 initially rose. In addition, no one knows what probability of victory the market has really priced in. Finally, the details of the election result, in terms of seats and political control -- in other words, whether a candidate can govern with his party or not – will determine to what degree anything significant will change for the economy and the markets.

2.1 Fixed Income

After the better-than-expected economic data in the U.S., coupled with a slight uptick in inflation, market expectations regarding Fed interest rate cuts have clearly moved towards fewer cuts, which had been our expectation. In the space of six weeks three interest rate moves by mid-2025 have been priced out of the consensus view. In the run-up to the U.S. election, however, there is another influence on bond yields, especially at the long end of the yield curve: concern about the U.S. debt mountain and the budget deficit. The recent rise in yields in the UK has also shown that bond investors are concerned about the size and growth in government debt.

Government Bonds

We made a few tactical changes in October because some yield developments seemed exaggerated to us, especially in the U.S. We believe that 2-year Treasury yields do not sufficiently reflect the Fed's plans to cut interest rates and have set our signal to +1, i.e. buy. At the beginning of November, we also took this step on 10-year debt.

Corporate Bonds

We remain strategically positive on corporate bonds, as the economic environment and the major central banks' intended path of interest rate cuts remain positive for this investment segment. But risk premiums have already narrowed so much against government bond yields that we see little room for maneuver. We have therefore downgraded investment-grade European corporate bonds to neutral from a tactical perspective.

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Emerging Markets

For similar reasons we have also downgraded emerging market government bonds, albeit from neutral to minus 1. In addition to the narrow risk premiums, there is the more immediate risk from the U.S. election, which could weigh on emerging market economies in a variety of ways, such as trade sanctions and dollar strength.

Currencies

The currency market could be one of the asset classes most affected by the U.S. election. This is where possible punitive import tariffs and other trade sanctions, as well as the size of the future increase in the U.S. debt mountain, come into play. For now, we expect the dollar to appreciate further on the back of the better-than-expected performance of the U.S. economy.

2.2 Equities

Once we have finally put the U.S. election behind us, equity investors will be able to focus again in the coming months on what they prefer: an economy that is performing well -- or the prospect of more generous central banks because it is not. The quarterly figures do not show a clear trend; rather, there are strong differences between sectors, but also within sectors. On the surface, only the Chinese market looks favorable in terms of valuations at present, but in our view those low valuations are warranted, as shareholder interests don’t seem to be the priority of companies and the government. However, before we get to the regions (in which we have made no tactical changes), we want to talk about a tactical change in sectors: We have upgraded the utilities sector to overweight, driven primarily by the U.S. market, where rapidly expanding AI infrastructure is driving up demand for electricity.

U.S. Market

The U.S. remains the most expensively valued stock market, thanks in part to tech stocks, which continue to benefit from AI speculation as well as actual AI investments. We expect a period of disillusionment after the U.S. election, during which investors may have to downgrade some of the hopes they had pinned on the election.

European Market

Europe’s valuation discount to the U.S., as measured by the price-earnings ratio, remains at a record level. While this does not help on timing any market entry, it is one reason why Europe remains our only overweight region. Europe's economy is continuing to recover, albeit in small steps and at different speeds.

German Market

German companies have achieved mixed results in the current reporting season. 2025 earnings expectations have recently been revised down, which has not been the case in the rest of Europe. This has not prevented the market from outperforming the Stoxx 600 over the past three months, but we will only believe in a sustainable recovery when the global goods industry really gets back on its feet.

Japan

Japanese companies continue to struggle with a sharply fluctuating currency, which is also unwelcome for stock investors. Together with the weak global market for manufactured goods, this currently prevents us from raising the market to overweight, even though we like it very much from a structural point of view.

2.3 Alternatives

Alternative investments are also being strongly influenced by the U.S. election, as well as by the question of how sustainable the recent rise in yields on government bonds on both sides of the Atlantic will prove to be. In October, for example, real 10-year U.S. yields rose by almost half a percentage point, which in theory should be bad news for alternative investments. But so far precious metals have reacted surprisingly little.

Real Estate

Over the coming months and years, the 2024 presidential election is likely to affect U.S. real estate in three main areas: economic growth, changes in inflation, and tax policies on property types and regions. Rent controls or home-buying

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incentives from a Harris administration could be a headwind. Easing of building regulations by a Trump administration could be a tailwind for the sector, although one that could be partially offset by stricter immigration policy. Any overall impacts from the election on the apartment sector are likely to be small.

Infrastructure

We believe the imminent U.S. presidential election could potentially create uncertainty and have a long-lasting impact on infrastructure investors and citizens. Stable, "pure-play" infrastructure companies that own physical economic assets may prove to be winners over the long term.

Gold

We expect the gold price to gradually climb from here. Some of the risk premium will be priced out of the gold market post U.S. election but policy risk thereafter could replace it, maintaining the interest in investing in gold.

Silver

We are not surprised to see silver performing well given a number of supportive factors, including increasing global money supply, accelerating inflation, and rising gold prices. Other bullish fundamentals include its industrial uses, such as for solar panel manufacturing, and a multi-year structural supply deficit. According to the Silver Institute, 2024 will be the fourth consecutive year of supply-demand deficit, with the deficit widening in 2024, and the sixth consecutive year with the market balance in deficit when investment from exchange-traded products (ETPs) is included. We expect these deficits could last into 2025 and beyond and would not be surprised to see silver make a run towards an all-time high in the not-too-distant future.

Oil

Just when one thought that supply side concerns were moderating and attention turning once again to demand for crude, it has become evident that the oil market will have to deal with geopolitical risks more than it wants to. Our main scenario, that weakness in demand growth into year-end will keep the oil price contained for the time being, has been tested again recently as OPEC+ decided at the beginning of November to postpone its production increase planned for December by one month. It's also not yet clear, after the U.S. warning to Iran on November 3rd not to attack Israel again, whether Israel-Iran tensions have peaked.

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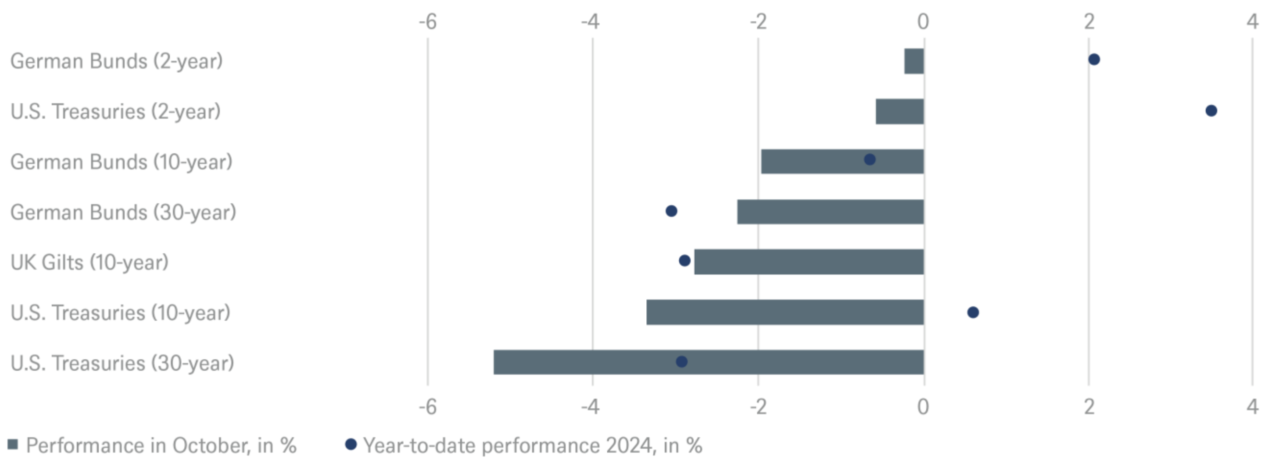
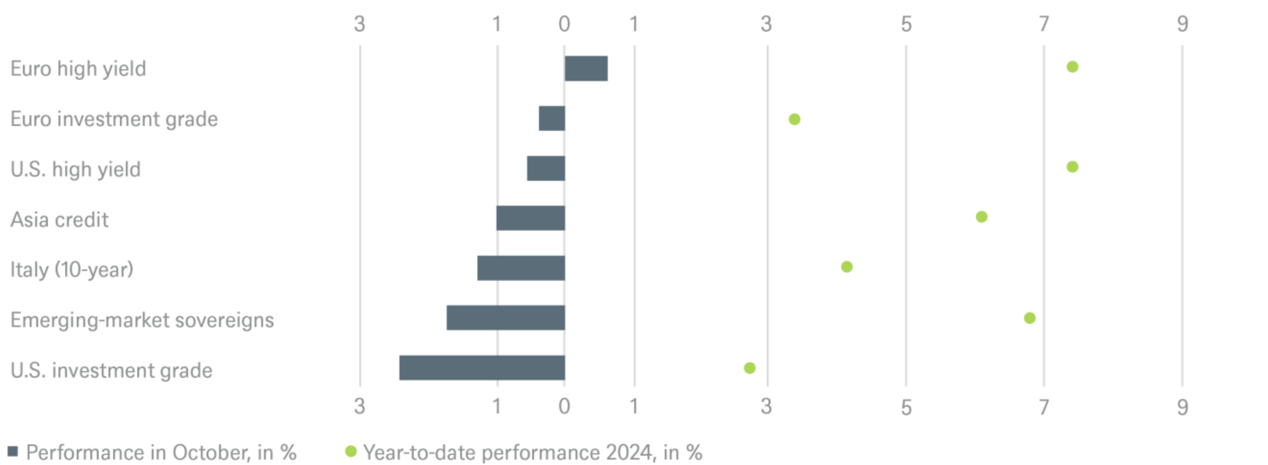
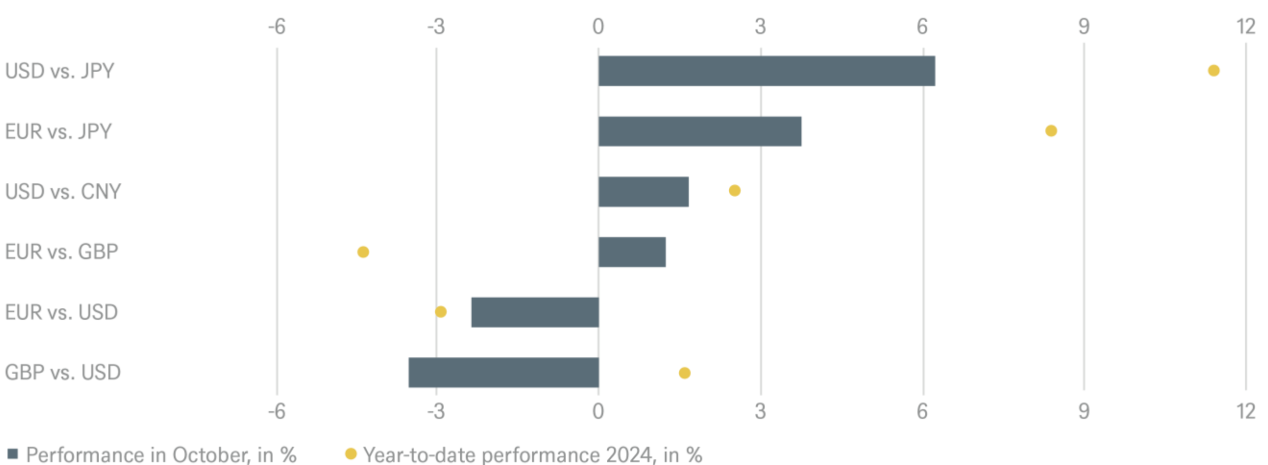
2 / Past performance of major financial assets







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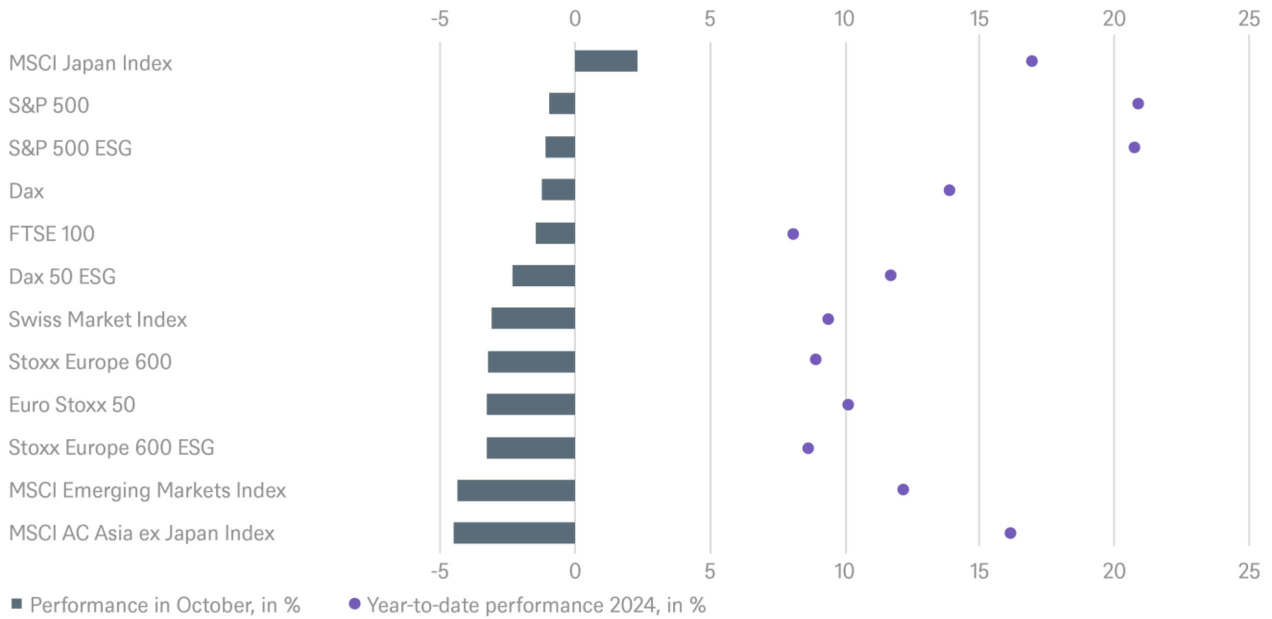

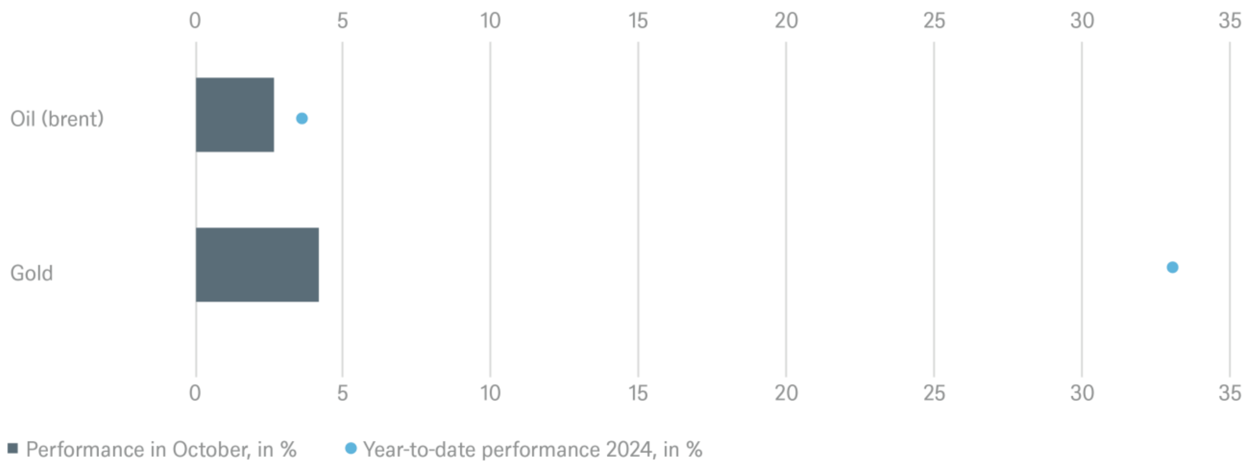

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4 / Tactical and strategic signals

The following exhibit depicts our short-term and long-term positioning.

4.1 Fixed income

Rates	1 to 3 months	through Sep 2025
U.S. Treasuries (2-year)	Green	Green
U.S. Treasuries (10-year)	Green	Green
U.S. Treasuries (30-year)	Yellow	Green
German Bunds (2-year)	Yellow	Green
German Bunds (10-year)	Yellow	Green
German Bunds (30-year)	Yellow	Green
UK Gilts (10-year)	Yellow	Green
Japanese government bonds (2-year)	Yellow	Yellow
Japanese government bonds (10-year)	Red	Red

Spreads	1 to 3 months	through Sep 2025
Italy (10-year)[1]	Green	Yellow
U.S. investment grade	Yellow	Green
U.S. high yield	Red	Green
Euro investment grade[1]	Yellow	Green
Euro high yield[1]	Red	Yellow
Asia credit	Yellow	Green
Emerging-market sovereigns	Red	Green

Securitized / specialties	1 to 3 months	through Sep 2025
Covered bonds[1]	Yellow	Green
U.S. municipal bonds	Yellow	Yellow
U.S. mortgage-backed securities	Green	Green

Currencies	1 to 3 months	through Sep 2025
EUR vs. USD	Yellow	Red
USD vs. JPY	Yellow	Red
EUR vs. JPY	Yellow	Red
EUR vs. GBP	Red	Red
GBP vs. USD	Yellow	Red
USD vs. CNY	Yellow	Yellow

4.2 Equities

Regions	1 to 3 months[2]	through Sep 2025
United States[3]	Red	Yellow
Europe[4]	Green	Green
Eurozone[5]	Yellow	Green
Germany[6]	Yellow	Yellow
Switzerland[7]	Yellow	Green
United Kingdom (UK)[8]	Yellow	Green
Emerging markets[9]	Yellow	Yellow
Asia ex Japan[10]	Yellow	Yellow
Japan[11]	Yellow	Green

Sectors	1 to 3 months[2]
Consumer staples[12]	Yellow
Healthcare[13]	Green
Communication services[14]	Yellow
Utilities[15]	Green
Consumer discretionary[16]	Green
Energy[17]	Yellow
Financials[18]	Yellow
Industrials[19]	Yellow
Information technology[20]	Yellow
Materials[21]	Yellow

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Style	1 to 3 months
U.S. small caps[22]	yellow
European small caps[23]	green

4.3 Alternatives

Alternatives	1 to 3 months	through Sep 2025
Commodities[24]	yellow	green
Oil (brent)	yellow	green
Gold	yellow	red
Carbon		green
Infrastructure (listed)	green	green
Infrastructure (non-listed)		green
Real estate (listed)	yellow	green
Real estate (non-listed) APAC[25]		yellow
Real estate (non-listed) Europe[25]		green
Real estate (non-listed) United States[25]		green

[1] Spread over German Bunds. [2] Relative to the MSCI AC World Index (only for the tactical signals),[3] S&P 500, [4] Stoxx Europe 600, [5] Euro Stoxx 50, [6] Dax, [7] Swiss Market Index, [8] FTSE 100, [9] MSCI Emerging Markets Index, [10] MSCI AC Asia ex Japan Index, [11] MSCI Japan Index, [12] MSCI AC World Consumer Staples Index, [13] MSCI AC World Health Care Index, [14] MSCI AC World Communication Services Index, [15] MSCI AC World Utilities Index, [16] MSCI AC World Consumer Discretionary Index, [17] MSCI AC World Energy Index, [18] MSCI AC World Financials Index, [19] MSCI AC World Industrials Index, [20] MSCI AC World Information Technology Index, [21] MSCI AC World Materials Index, [22] Russell 2000 Index relative to the S&P 500, [23] Stoxx Europe Small 200 relative to the Stoxx Europe 600, [24] Relative to the Bloomberg Commodity Index, [25] 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 through September 2025

– 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

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

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

Brent crude is a grade of crude oil dominant in the European market.

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

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.

Federal Reserve Bank is a regional bank of the Federal Reserve System, the central banking system of the United States. There are twelve in total.

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

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

The price-to-earnings (P/E) ratio compares a company's current share price to its earnings per share.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

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 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.

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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 yield premium will increase or decrease depending on the perceived creditworthiness and relative demand for a bond. The yield premium is the mark up relative to a risk-free asset with the same maturity.

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