OUR TACTICAL AND STRATEGIC VIEW

We believe G20 results are a weak basis for a year-end rally.
Our 2019 outlook, however, is still cautiously optimistic.

MARKET OVERVIEW

So now December has to fix it. After October pushed the total returns of most markets deep into the red for the year to date, a rather balanced November did not change much. According to calculations by Jim Reid, chief economist of Deutsche Bank, you can go back until 1901 and you will not find a single instance in which so many asset classes showed a negative return for the first eleven months of any given year, calculated in U.S. dollars (USD). The study examined 60 equity and government-bond indices, four credit indices, one near-money-market index and five commodities. A total of 89% of these are in the red for 2018 – a record. By contrast, 2017 stood out as a year where the number of losers was unusually low. Thus, while losses have not been high in 2018, the breadth of the declines is noteworthy.

However, the first market reactions to the G20 summit on December 3 were enough to push the MSCI World Index back into positive territory for the year to date. How sustainable this start to any widely hoped-for year-end rally will be is just as uncertain as the sustainability of what was agreed between the United States and China. As our outlook for the G20 meeting (see G20 summit: no big deal, we guess) already notes, we do not believe the United States is ultimately only concerned with the trade deficit and punitive tariffs. Unfortunately, it is only when it comes to tariffs that the summit appears to have yielded tangible results. Moreover, these results are only temporary: The United States is initially suspending its increase from 10% to 25% on Chinese exports of 200 billion USD for a period of 90 days. During this period, Beijing is expected to make concessions on some contentious issues. We remain cautiously apprehensive. Meanwhile, the avoidance of any further escalation has had at least an initial calming effect on markets.

Europe will also have to deal with plenty of political uncertainties. The wrangling between Italy and Brussels continues. Many hope that Italy's willingness to compromise will be based on the daily level of Italian government-bond yields – but believe that things might have to get worse before they can get better. Regarding the other permanent issue, Brexit, the market finds it difficult to give clear signals because neither the market nor the English politicians seem to know what the alternatives to the current draft treaty might actually be. Paradoxically, the fact that almost everyone in the United Kingdom is rumbling against the Treaty Theresa May has negotiated with the EU, is actually still the best indication that it will ultimately be approved. On the other side of the Channel, President Emmanuel Macron has to deal with an unsatisfied and protesting population. This political mix, coupled with sector-specific concerns, is likely to ensure that neither the euro (EUR) nor European equities will detach themselves more clearly from the dollar and U.S. equities.

Apart from all that, the oil price in particular continued its downward slide in November, declining by around 22%. Global worries about growth led to 10-year U.S. government bonds clearly relinquishing their interim high of 3.25% and even falling briefly below the 3% mark. Statements by U.S. Federal Reserve (Fed) Chairman Jerome Powell, which many investors interpreted as a departure from a rapid cycle of interest-rate hikes,[1] may also have contributed to this. Or did Powell simply say that the Fed did not know exactly where the neutral interest rate was either? As the subsequent price rally suggests, the market seems less afraid of ignorance than of rising interest rates. This may also explain why Trump's economic policy continues to be accompanied by little concern in markets, as he regularly lets the world know that he relies less on experts than on his gut feeling.[2]

[1] https://www.wsj.com/articles/fed-chairman-flags-rising-indebtedness-of-some-u-s-businesses-1543424400
[2] https://www.reuters.com/article/us-usa-trump-fed/trump-says-not-even-a-little-bit-happy-with-feds-powell-report-idUSKCN1NW2LO

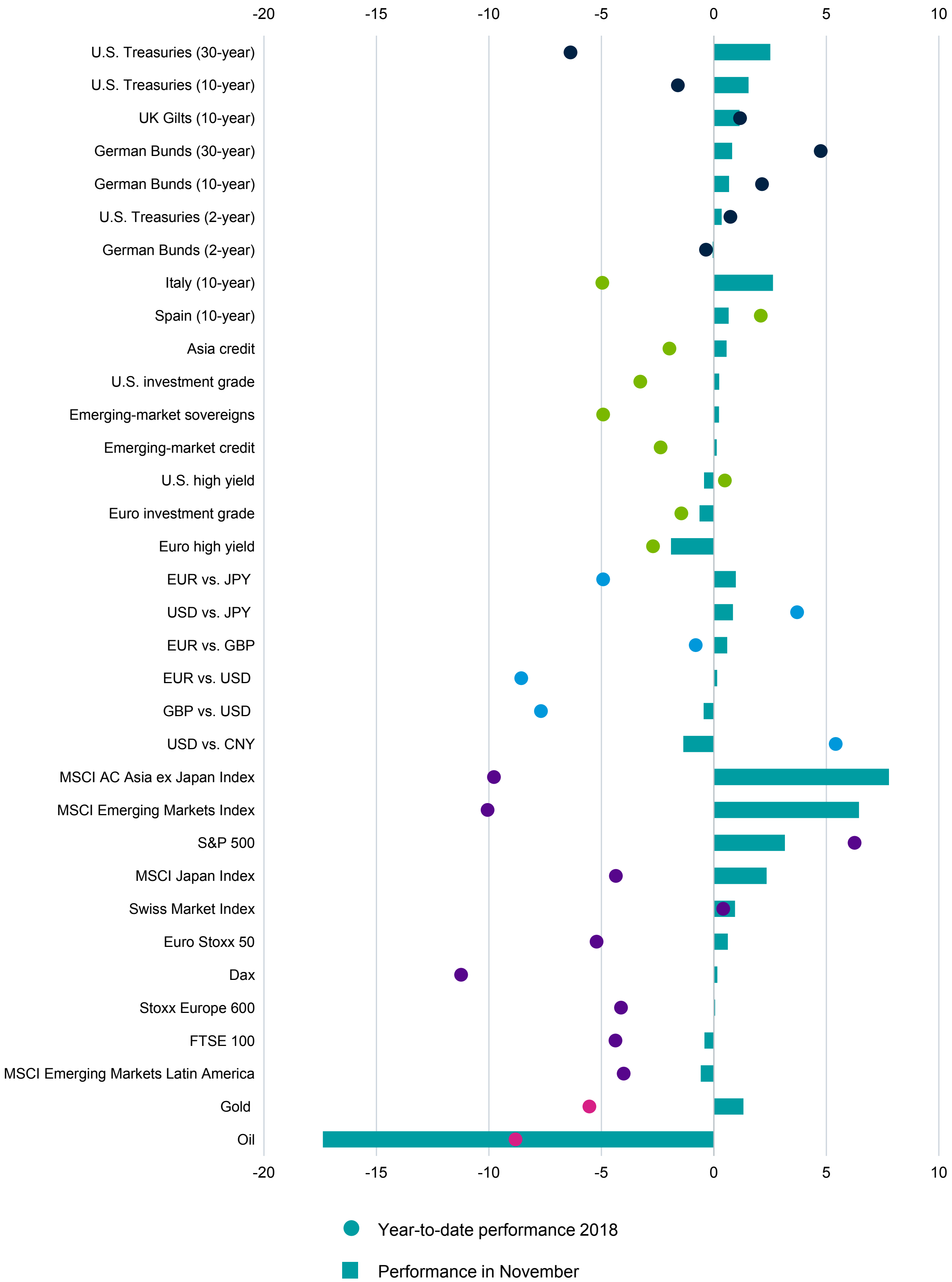
OUTLOOK AND CHANGES

At our recent quarterly CIO strategy meeting, we have just updated our forecasts for the coming year. This is why our focus, for this current outlook, is our strategic (12-month) orientation. Overall, we are cautiously optimistic about 2019. At 3.6% global economic growth, we expect a slight slowdown compared to the previous year, but still maintain a reasonably robust level. Based on classic economic forecasting tools, we do not see any indications of a recession in 2019. Nevertheless, we note that there are a number of downside risks to our forecasts. Brexit, Italy, the trade war and China's growth should be mentioned here, as should the end of the ultra-loose monetary policy with record levels of indebtedness on the part of some economic entities and countries.

In the baseline scenario, we expect global equities to generate high-single-digit overall returns in 2019, driven by moderate earnings growth and decent dividend contributions. The latter continue to be well supported by strong corporate cash flows for most industries. We have set our index target for the S&P 500 for December 2019 at 2,950 (see U.S. equities - a tough choice, but the right one), for the Dax at 12,200 and for the Stoxx 600 at 370 points. We believe that the S&P 500 in particular has a good chance of recovering from its slump in the foreseeable future. In view of the high level of uncertainty about short-term political decisions, we are not taking any strong tactical positions – be it at the regional or sector level. As the structural rise of emerging markets (EM) looks set to continue in the coming years, we are waiting for an opportunity to overweight the region again. At this stage, however, we first need more clarity about the trade conflict and its impact on the dollar and global interest rates. In the short term, we are also concerned about market's profit expectations being too high. For the United States, the earnings-growth expectations for 2019 remain above 10%, which is almost twice as high as our forecasts. Although consensus estimates have been gradually declining in recent weeks, we believe that this could still weigh on the market. For bonds, we assume that the Fed's interest-rate move at the end of December could be followed by three more steps next year. On the one hand, Fed action will continue to be data-dependent. On the other hand, we see the interest-rate cycle, especially at the long end, in the United States already close to its cyclical peak. We leave our forecast for 10-year Treasuries at 3.25% and continue to believe that yield curve will not turn negative in 2019. We expect the 10-year Bund yield to be at 0.8% at the end of 2019 and remain cautious about Italian bonds for now. We also stay cautious in selecting corporate bonds and pay attention to both cyclical and sector-specific risks. Overall, however, we continue to view corporate bonds fairly positively, not least because of the recent increase in yields. The same applies to emerging markets, especially in Asia, where we expect volatile but positive markets in the medium term. We are maintaining our EUR/USD target of 1.15 dollars per euro. We therefore remain optimistic about markets as a whole, but acknowledge the political risks and the economic fall-out that could result from severe or sustained market corrections.

PAST PERFORMANCE OF MAJOR FINANCIAL ASSETS

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



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 12/3/18

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ALTERNATIVES*

Alternatives	1 to 3 months	until December 2019
Infrastructure (listed)	🟢	↗
Commodities	🟡	↗
Real estate (listed)	🟢	↗
Real estate (non-listed) APAC	🟢	↗
Real estate (non-listed) Europe	🟢	↗
Real estate (non-listed) United States	🟡	→
Hedge funds	🟢	↗

* as of 12/3/18

COMMENTS REGARDING OUR TACTICAL AND STRATEGIC VIEW

Tactical view

_ The focus of our tactical view for fixed income is on trends in bond prices, not yields.

Strategic view

_ The focus of our strategic view for sovereign bonds is on yields, not trends in bond prices.

_ For corporates and securitized/specialties bonds, the arrows depict the respective option-adjusted spread.

_ For bonds not denominated in euros, the illustration depicts the spread in comparison with U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds.

_ For emerging-market sovereign bonds, the illustration depicts the spread in comparison with U.S. Treasuries.

_ Both spread and yield trends influence the bond value. Investors who aim to profit only from spread trends should hedge against changing interest rates.

KEY

The tactical view (one to three months)

_ 🟢 Positive view

_ 🟡 Neutral view

_ 🔴 Negative view

The strategic view up to December 2019

Equity indices, exchange rates and alternative investments:

The arrows signal whether we expect to see an upward trend ↗, a sideways trend → or a downward trend ↘ .

The **arrows' 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

Fixed Income

For sovereign bonds, ↗ denotes rising yields, → unchanged yields and ↘ falling yields. For corporates, securitized/specialties and emerging-market bonds, the arrows depict the option-adjusted spread over U.S. Treasuries: ↗ depicts a rising spread, → a sideways trend and ↘ a falling spread.

The **arrows' 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

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

	11/13 - 11/14	11/14 - 11/15	11/15 - 11/16	11/16 - 11/17	11/17 - 11/18
UST 30yr	19.2%	1.8%	1.2%	6.3%	-5.3%
UST 10yr	6.7%	2.0%	0.6%	2.2%	-1.6%
UST 2yr	0.8%	0.4%	0.7%	0.4%	0.8%
UK 10yr	8.9%	2.9%	5.2%	2.2%	2.0%
GER 10yr	10.1%	3.2%	2.5%	0.4%	1.6%
GER 2yr	0.4%	0.4%	0.1%	-0.8%	-0.5%
GER 30yr	20.1%	5.8%	6.6%	-1.3%	3.8%
Japan 2yr	0.4%	0.1%	0.1%	-0.1%	-0.1%
Japan 10yr	2.8%	1.8%	2.1%	0.3%	0.1%
EM Sovereign	10.5%	0.2%	7.2%	10.9%	-4.8%
EM Credit	7.1%	-0.2%	8.6%	8.6%	-2.4%
US HY	4.5%	-3.4%	12.1%	9.2%	0.4%
US IG Corp	7.2%	0.0%	4.2%	6.0%	-2.8%
EUR HY	6.5%	2.4%	5.8%	8.1%	-3.0%
Asia Credit	8.6%	2.7%	5.7%	5.4%	-1.9%
EUR IG Corp	7.3%	0.6%	3.2%	3.3%	-1.7%
Spain 10yr	22.1%	4.7%	2.2%	4.2%	1.5%
MSCI Asia xJ	3.4%	-12.7%	4.6%	32.2%	-11.7%
MSCI EM	-1.3%	-19.0%	6.0%	29.9%	-11.2%
MSCI Latam	-8.6%	-36.2%	21.4%	16.7%	-4.4%
S&P 500	14.5%	0.6%	5.7%	20.4%	4.3%
MSCI Japan	11.9%	10.0%	-7.7%	19.9%	-6.4%
SMI	10.7%	-1.7%	-12.4%	18.3%	-3.0%
DAX	6.1%	14.0%	-6.5%	22.4%	-13.6%
FTSE 100	1.1%	-5.5%	6.7%	8.0%	-4.7%
Stoxx600	6.8%	11.0%	-11.3%	13.1%	-7.6%
Eurostoxx 50	5.3%	7.9%	-13.0%	17.0%	-11.1%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 12/3/18

GLOSSARY

Brexit
Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

Bunds
Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

Corporate bond
A corporate bond is a bond issued by a corporation in order finance their business

Credit market
The **credit market** is the market for corporate bonds.

Correction
A correction is a decline in stock market prices.

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

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

Euro (EUR)
The **euro (EUR)** is the common currency of states participating in the Economic and Monetary Union and is the second most held reserve currency in the world after the dollar.

G20
The **Group of 20** are the largest industrialized and emerging economies in the world.

Government bonds
Government bonds are bonds issued and owed by a central government.

MSCI AC World Index
The **MSCI AC World Index** captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

MSCI World Index
The **MSCI World Index** tracks the performance of mid- and large-cap stocks in 23 developed countries around the world.

Monetary policy
Monetary policy focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

Recession
A **recession** is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

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.

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. dollar (USD)
The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

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

Volatility
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
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.

FIXED INCOME*

Rates	1 to 3 months	until December 2019
U.S. Treasuries (2-year)	🟡	↗ (red)
U.S. Treasuries (10-year)	🟡	↗ (red)
U.S. Treasuries (30-year)	🟡	↗ (red)
UK Gilts (10-year)	🟡	↗ (red)
Italy (10-year)[1]	🔴	↗ (red)
Spain (10-year)[1]	🟡	↘ (green)
German Bunds (2-year)	🟡	↗ (red)
German Bunds (10-year)	🟡	↗ (red)
German Bunds (30-year)	🟡	↗ (red)
Japan (2-year)	🟡	↗ (red)
Japan (10-year)	🟡	↗ (red)

Securitized / specialties		
Covered bonds[1]	🔴	↘ (green)
U.S. municipal bonds	🟡	→ (yellow)
U.S. mortgage-backed securities	🟢	↗ (red)

Corporates	1 to 3 months	until December 2019
U.S. investment grade	🟡	↗ (red)
U.S. high yield	🟡	↗ (red)
Euro investment grade[1]	🟡	↘ (green)
Euro high yield[1]	🟡	↘ (green)
Asia credit	🟡	→ (yellow)
Emerging-market credit	🟡	↗ (red)

Currencies		
EUR vs. USD	🟡	→ (yellow)
USD vs. JPY	🟡	→ (yellow)
EUR vs. GBP	🟡	→ (yellow)
GBP vs. USD	🟡	→ (yellow)
USD vs. CNY	🟢	→ (yellow)

Emerging markets		
Emerging-market sovereigns	🟡	→ (yellow)

EQUITIES*

Regions**	1 to 3 months	until December 2019
United States	🟡	↗ (green)
Europe	🟡	↗ (green)
Eurozone	🟡	↗ (green)
Germany	🟡	↗ (green)
Switzerland	🟡	↗ (green)
United Kingdom (UK)	🟡	↗ (green)
Emerging markets	🟡	↗ (green)
Asia ex Japan	🟡	↗ (green)
Japan	🟡	→ (yellow)
Latin America	🟡	↗ (green)

Sectors**	1 to 3 months
Consumer staples	🟡
Healthcare	🟡
Telecommunications	🟡
Utilities	🟡
Consumer discretionary	🟡
Energy	🟡
Financials	🟡
Industrials	🟡
Information technology	🟡
Materials	🟡
Real Estate	🟡

Styles**	
U.S. small caps	🔴
European small caps	🟢

* as of 12/3/18
** relative to the MSCI AC World
[1] Spread over German Bunds in basis points

IMPORTANT INFORMATION: EMEA

IMPORTANT INFORMATION: UK

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