

## Surviving tribulations of beta management: Be patient and busy elsewhere



**David Bianco**  
Americas Chief  
Investment Officer

### IN A NUTSHELL

- Charts of past cycles fail to convey the real uncertainty and anxiety of living one
- Debt ceiling fights will call more attention to deteriorating US fiscal health
- Small gets cheaper: Near-term beta danger vs. the longer and alpha opportunity
- Week 5 of 1Q EPS reporting: 1Q saved by big Banks and Tech, outlook tougher

### Charts of past cycles fail to convey the real uncertainty and anxiety of living one

Beta management isn't easy. It takes the right expertise, process discipline and especially patience. Beta management should be employed in the right parts of an investor's portfolio and usually only in moderation. We agree that success in equities is more about "time in the market" than "timing the market", but we also believe that equity beta management and other tactical asset allocations can add value. Short-term deviation from strategic asset allocation, or what's optimal long-term for an investor's specific risk tolerance, can enhance returns and help avoid losses when asset classes and segments are offering different returns or risk from what was estimated when establishing optimal longer-term allocations.

As explained in past notes, we advocate managing beta and other tactical allocations at the highest level of portfolio construction. These tilts should be managed by macro minded asset allocators with a process for assessing available return and risk across all key asset classes. We don't think active managers hired to select securities within core asset class segments should deviate in beta, duration or credit risk from assigned benchmarks. As tactical tilts within core categories could conflict with high level asset allocation positioning.

However, at certain higher risk sub asset class categories, some deviation implemented by segment active managers from benchmark systematic risk can be helpful. Particularly if strategy managers have more expertise than the asset allocator in evaluating the overall space. In our view, these categories include small caps, high yield, emerging market equity/ debt and various alternative asset allocations. But even in these categories, we think it best that managers keep systematic risk tilts moderate from benchmark and be in close contact with clients if their views are more extreme to help advise on higher level portfolio actions.

Because macro factors like beta are very uncertain and it's difficult to diversify active risk taking on such factors given the limited outcomes over intermediate time frames, thus few opportunities to diversify actions, we advocate moderation in tactical allocation. For tactical equity allocation, we advocate moderate sized tilts to avoid dips and corrections, which are more frequent than bears, and to capture outsized gains from frequent periods of stronger than usual returns. Yet, we're unlikely to have a huge under-weight on difficult to time bear market views. Similarly, we aim for moderate over-weights when confident in double-digit returns for a year or less, but unlikely to take a giant over-weight if 20%+ return is expected.

**Our advice for better beta management:** Employ dedicated expertise and process, place tactical systematic risk tilts in their proper portfolio place by adjusting aggregate weight of all respective security selection strategies (both active and passive), tilt in moderation, and find patience by seeking alpha opportunities elsewhere. We suggest stock pickers stay focused on selection and that asset allocators seek often overlooked macro-opportunities in sub regions, styles, sectors, themes, vol, isolated risk premiums, alternatives, etc. Our S&P sector strategy strives to balance beta & style tilts with sector preferences of similar beta & style. For instance, we prefer Financials over Energy/Materials, Health Care over Tech, Utilities and REITs over Staples, Communications over Consumer Discretionary. We have industry preferences in Industrials. Despite our beyond beta & style sector strategy, our beta is 0.85 and more value tilted than growth, ex. Health Care, which is “value growth”.

## **Debt ceiling fights will call more attention to deteriorating US fiscal health**

Other than default, clearly the worst and unthinkable outcome, we’d be concerned about a small and especially a large and “clean” debt ceiling raise owing to higher interest rate risk. We think it important that the debt ceiling fight produces a compromise that improves the long-term debt/ gross domestic product (GDP) outlook. Right now, long bond yields and even 1-2yr treasury note yields are low because the bond market is focused on recession. After the recession, the bond market might turn its attention to deteriorating fiscal health and residual inflation risk.

## **Small gets cheaper: Near-term beta danger vs. the longer and alpha opportunity**

Zero small cap returns year-to-date (YTD) lag large cap returns, but mostly due to mega cap Tech gains. The price-to-earnings (P/E) ratio discount at small vs. large widens on trailing earnings per share (EPS) ex. unprofitable companies. But more unprofitable firms are likely as estimates are falling with pressures on small banks and small Biotech. We prefer big banks and big medicine makers over small research firms. We see selective opportunities in small caps mostly at Industrials, Tech and Consumer.

## **Week 5 of 1Q EPS reporting: 1Q saved by big Banks and Tech, outlook tougher**

Bottom-up 1Q EPS is \$53.03, -0.8% y/y. We cut our 2023E S&P EPS from \$222 to \$220. Our standing 2Q and 3Q EPS estimates are \$55 and \$55, down 5% and 2% y/y respectively.

---

---

## Glossary

**Alpha** refers to returns in excess of a benchmark's return.

**Asset allocation** is the division of investments into individual asset classes (e.g. stocks and bonds).

Technically, a **bear market** refers to a situation where the index's value falls at least 20% from a recent high.

A **benchmark** is an index or other value against which an investment's performance is measured.

**Beta** is a measure of volatility that captures a security's systematic risk according to the capital asset pricing model.

A **correction** is a decline in stock market prices.

**Duration** is a measure expressed in years that adds and weights the time periods in which a bond returns cash to its holder. It is used to calculate a bond's sensitivity towards interest-rate changes.

**Earnings per share (EPS)** is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

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

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.

**Large cap** firms generally have a market capitalization of more than 10 billion dollars.

**Mega cap** firms refer to the twenty largest companies by market cap in the S&P 500.

**Overweight** means the investment holds a higher weighting in a given sector or security than the benchmark.

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

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

**Small cap** firms generally have a market capitalization of less than \$2 billion.

**Style investing** refers to an investor's overall investment approach (for example a preference for certain types of stocks).

## Important information – EMEA, APAC & LATAM

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they do business. The DWS legal entities offering products or services are specified in the relevant documentation. DWS, through DWS Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively "DWS") are communicating this document in good faith and on the following basis.

This document is for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as investment advice.

This document is intended to be a marketing communication, not a financial analysis. Accordingly, it may not comply with legal obligations requiring the impartiality of financial analysis or prohibiting trading prior to the publication of a financial analysis.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements. Past performance is no guarantee of future results.

The information contained in this document is obtained from sources believed to be reliable. DWS does not guarantee the accuracy, completeness or fairness of such information. All third party data is copyrighted by and proprietary to the provider. DWS has no obligation to update, modify or amend this document or to otherwise notify the recipient in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate.

Investments are subject to various risks. Detailed information on risks is contained in the relevant offering documents.

No liability for any error or omission is accepted by DWS. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. DWS does not give taxation or legal advice.

This document may not be reproduced or circulated without DWS's written authority.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

© 2023 DWS Investment GmbH

Issued in the UK by DWS Investments UK Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

© 2023 DWS Investments UK Limited

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited. The content of this document has not been reviewed by the Securities and Futures Commission.

© 2023 DWS Investments Hong Kong Limited

In Singapore, this document is issued by DWS Investments Singapore Limited. The content of this document has not been reviewed by the Monetary Authority of Singapore.

© 2023 DWS Investments Singapore Limited

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640). The content of this document has not been reviewed by the Australian Securities and Investments Commission.

© 2023 DWS Investments Australia Limited

as of 5/15/23; 095975\_1 (05/2023)

## Important information – North America

The brand DWS represents DWS Group GmbH & Co. KGaA and any of its subsidiaries, such as DWS Distributors, Inc., which offers investment products, or DWS Investment Management Americas Inc. and RREEF America L.L.C., which offer advisory services.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein and should not be treated as giving investment advice. DWS, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Investments with DWS are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. Further, investment in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets or imposition of (or change in) exchange control or tax regulations in such markets. Additionally, investments denominated in an alternative currency will be subject to currency risk, changes in exchange rates which may have an adverse effect on the value, price or income of the investment. This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction. The terms of an investment may be exclusively subject to the detailed provisions, including risk considerations, contained in the Offering Documents. When making an investment decision, you should rely on the final documentation relating to the investment and not the summary contained in this document.

This publication contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. Any securities or financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation ("FDIC") unless specifically noted, and are not guaranteed by or obligations of DWS or its affiliates. We or our affiliates or persons associated with us may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of DWS. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Past performance is no guarantee of future results; nothing contained herein shall constitute any representation or warranty as to future performance. Further information is available upon investor's request. All third party data (such as MSCI, S&P & Bloomberg) are copyrighted by and proprietary to the provider.

For Investors in Canada: No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein and any representation to the contrary is an offence. This document is intended for discussion purposes only and does not create any legally binding obligations on the part of DWS Group. Without limitation, this document does not constitute an offer, an invitation to offer or a recommendation to enter into any transaction. When making an investment decision, you should

rely solely on the final documentation relating to the transaction you are considering, and not the [document – may need to identify] contained herein. DWS Group is not acting as your financial adviser or in any other fiduciary capacity with respect to any transaction presented to you. Any transaction(s) or products(s) mentioned herein may not be appropriate for all investors and before entering into any transaction you should take steps to ensure that you fully understand such transaction(s) and have made an independent assessment of the appropriateness of the transaction(s) in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also consider seeking advice from your own advisers in making this assessment. If you decide to enter into a transaction with DWS Group you do so in reliance on your own judgment. The information contained in this document is based on material we believe to be reliable; however, we do not represent that it is accurate, current, complete, or error free. Assumptions, estimates and opinions contained in this document constitute our judgment as of the date of the document and are subject to change without notice. Any projections are based on a number of assumptions as to market conditions and there can be no guarantee that any projected results will be achieved. Past performance is not a guarantee of future results. The distribution of this document and availability of these products and services in certain jurisdictions may be restricted by law. You may not distribute this document, in whole or in part, without our express written permission.

For investors in Bermuda: This is not an offering of securities or interests in any product. Such securities may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act of 2003 of Bermuda which regulates the sale of securities in Bermuda. Additionally, non-Bermudian persons (including companies) may not carry on or engage in any trade or business in Bermuda unless such persons are permitted to do so under applicable Bermuda legislation.

© 2023 DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany.  
All rights reserved.

as of 5/15/23; 095971\_1 (05/2023)