Marketing Material

CIO VIEW

June 2019

OUR 12-MONTH ECONOMIC & MARKET OUTLOOK

DWS

Content

From a trade dispute to a trade war. And back?

The U.S.-China dispute weighs on our strategic outlook, even though its initial economic impact is small.

" The trade war is building up such a momentum that we fear it may slip out of the hands of the main actors. The measures taken so far may well have unintended consequences whose full impact remains quite uncertain. This issue is now weighing heavily over our forecasts. "

Stefan Kreuzkamp
Chief Investment Officer

In April, the market hoped for a resolution. Instead, the U.S.-Chinese trade dispute has moved on, via various retaliations, to a new, higher level: a war rather than a battle. The United States has now made it clear that this conflict is not just about import tariffs and trade surpluses, but also about global technological supremacy. And as the crisis has ramped up, the recent words and deeds of both sides have made face-saving de-escalation more difficult. Chinese statements protesting about "interference in sovereignty" and an "attack on Chinese honor" show that Beijing sees an escalation of the dispute.[1] Meanwhile, further U.S. sanctions are unambiguous provocations.[2] We believe President Trump's interests also speak against a short-term solution: the president is now thought to have a better chance of re-election if the conflict continues to smolder and he takes a hard line against China. It now seems to be a cross-party and social consensus in the U.S. that the thumbscrews on China should not be loosened.

So, it cannot be ruled out that 2019 will go down in history as the year in which the U.S. and China fought with open eyes for global (technology) supremacy for the first time. An increasing number of politicians in Washington and Beijing would probably no longer contradict this view. But what do the capital markets think? At the end of May, despite some heavy selling in the last days, a few stock exchanges were still trading in reach of their record levels. Is this serenity mere wishful thinking? Or does it show that the political noise from the dispute might be far greater than its actual economic damage? World trade is vital but the decline the dispute provokes will initially have a much smaller impact on global gross domestic product (GDP). Most flows of goods will only be diverted. And the Chinese and U.S. economies are relatively closed, with a foreign-trade contribution to GDP of only 20% and 13%, respectively, and so the impact, at least in the short term, on the world's two largest economies is likely to be much less severe than might be imagined. In fact, the Washington/Beijing fight might leave the two boxers relatively unscathed while unfortunate bystanders, such as South Korea or Germany, with their much more open economies, take the hit. On the equity side, meanwhile, a few blows might well land on individual sectors and companies, as has already been seen in previous sell-offs. But at the macro level, even if we consider a long-term political solution increasingly unlikely, global growth should stay on its feet over the coming twelve months and, in fact, not be knocked down much at all.

It is not so much the direct effects of past and potential future sanctions that are worrying, however – it's the indirect

[1] See for example: https://www.scmp.com/news/china/diplomacy/article/3011832/arrogant-demands-us-invade-chinas-economic-sovereignty-state
[2] Numerous sanctions against individual Chinese companies; expansion of U.S. representation in Taiwan

effects. As they watch the worsening trade fight, consumers and businesses could take fright. Manufacturing data looks punch-drunk already: it has been coming in worse for months as a result of the trade dispute.

Consumers, however, still seem to be in good buying spirits for the time being. But that could change if tariff increases keep pushing prices up. Another indirect channel of trade woe is financing conditions. These could deteriorate due to higher risk premiums, which would also be reflected in weaker stock markets. But a market knock-out could actually have its benefits. After all, it's falling U.S. stock markets that have so far proved to be the most effective corrective to the U.S. President's more unorthodox plans. One could call it the Trump put.[3]

Our overall view of the economy remains optimistic. We have only become a bit more cautious and have reduced our global growth forecast for the current year by 0.1% to 3.4%. We expect the Federal Reserve to refrain from raising interest rates any further and inflationary pressure to remain moderate. This would lead us back towards the ideal conditions for capital markets – the goldilocks scenario. We will, however, be far from ebullient, and not just because of the trade war. In Europe, Brexit, Italy and populism are big worries. Meanwhile, China once again needs to support its economy with stimulus programs, and the debt situation both in China and the U.S. corporate sector has not become more solid and crisis-resistant. We therefore see our relatively optimistic central forecast scenario as being more at risk than in the past. And in the coming months we expect nervous markets. We are therefore focusing on carry, the income component of investments, rather than on rising multiples.

For the individual asset classes, this means that we do not see any increase in government-bond yields in the U.S. and only slight increases in yields in Europe. The central banks have announced they are going to move at a cautious pace on interest rates. U.S. Treasuries therefore continue to offer a good risk-return profile. That is not true for European government bonds, given prevailing low or even negative rates, but they do offer protection should markets turn bad. We continue to like corporate bonds, but are very selective in the U.S. high-yield area. We also continue to see emerging-market bonds as positive, but the trade dispute could have a negative impact here in the short term. For the dollar, we expect a sideways trend over the next twelve months. For the yuan, on the other hand, a declining export surplus could lead to further weakening, but we assume that Beijing does not want to let the currency depreciate too much. Equities naturally benefit from an environment of lower interest rates, but we believe most indices have come close to fair levels since the spring rally. We now see some of the lowest potential gains for share prices since the financial crisis. Our regional preferences are for the U.S. and emerging markets.

Look at our forecasts to see our 12-month outlook in numbers (Page 28).

[3] In memory of the so-called Greenspan put

Increasingly fragile

The outlook for the world economy is getting cloudier. Escalating trade tensions could trigger further downgrades.

_ With the latest policy proposals, the U.S. is challenging the very technology clusters behind much of the country's recent economic prowess

_ As yet, we have not given up hope that economic rationality and self-interest will eventually prevail.

_ For now we have only downgraded our growth forecasts very modestly, but caution that growth is not the only concern markets are likely to worry about.

Johannes Müller
Head of Macro Research

Ever since protectionist measures were initially introduced by the Trump administration, we warned of the potential for initial trade tensions to escalate to a full-blown trade war. Trade wars of various sorts are clearly now upon us. However, it remains too early to say whether decision-makers have already reached the point of no return towards further escalation. This is reflected in the very modest downgrades of our growth forecasts so far. For the U.S., we now expect gross-domestic-product (GDP) increases of 2.5% in 2019 and 2% in 2020. For both years, we have penciled in 1.2% for the Eurozone, and 6% for China.

In all these instances, our forecasts reflect a bit of a balancing act. The rebound in the first quarter of 2019 was much stronger than expected. In China and Germany in particular, there were plenty of hopeful signs early in the year. Not all of this momentum will fade immediately. In China, some of the fiscal countermeasures are only starting to kick in and for 2019 at least, the risks to our 6% growth forecast look pretty evenly balanced.

In the U.S., robust labor-market data continues to underpin our assessment that we are dealing with a well-behaved moderation. The U.S. Federal Reserve appears to take a similar view and looks set to continue its "wait-and-see" approach. For the next twelve months, we expect the Fed neither to raise nor cut interest rates. Beyond that, we now see a better than even chance that we are at the peak of the U.S. rate cycle.

In the current environment, though, 12 months appears like an awfully long time. The U.S. trade stance towards Mexico, for example, has been constantly changing. Which brings us back to trade tensions and the reasons why we thought them so worrying, even a year ago. When it comes to tariffs, the impact on inflation, central-bank responses and even GDP growth tends to be, in pretty substantive ways, the least of the many concerns they habitually trigger in financial markets.

Trade in finished goods and services allows countries to specialize. According to about two centuries of economic theorizing and economic history, this process of specializing tends to be beneficial to all countries involved. This is true even if some country is "better" at producing all finished goods and services. Trade allows all countries involved to use available resources, including land, labor and capital, more efficiently.

Assume, for example, that Austria, is a better place to grow both potatoes and corn than Czechia. Trading can still increase overall food production, if Czechia's disadvantage is comparatively smaller in one of those vegetables. The same logic holds not just for vegetables, but often with a bit of a twist. For most goods and services, the quality of land or climate matters less than benefitting from having an educated workforce nearby. That will attract more businesses and, in turn, more workers, giving rise to economies of learning. In our example, highly efficient manufacturing clusters might emerge in Czechia, precisely because it was initially less attractive for farming.

The snag is that this process of specialization leaves economies highly vulnerable to the shifting winds of history and geopolitics. The results can be dramatic and lasting, as was the case in real-world Austria and Czechia, almost exactly 100 years ago as the century-old Habsburg Empire disintegrated. New trade barriers meant that from one day to the next, those highly efficient Czech manufacturers lost many of the markets for their products. That was obviously bad for growth and inflation. More importantly, plenty of investments in both newly independent countries turned out to be misguided, because they relied on being able to trade freely.

Fast forward a century, and today's interdependent world economy looks, if anything, even more vulnerable than such historic examples might suggest. The reason is that nowadays, countries have increasingly specialized less in finished goods and services and more in particular intermediate steps in the supply chain. A "Chinese" smartphone might indeed be assembled and designed in China – but rely on a U.S.-owned operating system along with components sourced from around the world. A competing "U.S." handset might merely be designed in the Silicon Valley, assembled in China and marketed by a London-based advertising firm.

This complex web of interconnections would seem to deter policymakers from upsetting global supply chains. Most obviously, the U.S. is challenging the very technology clusters behind much of the country's recent economic prowess. So you would expect businesses to lean on their respective governments. As yet, we have not completely given up hope that rationality and economic self-interest will eventually prevail.

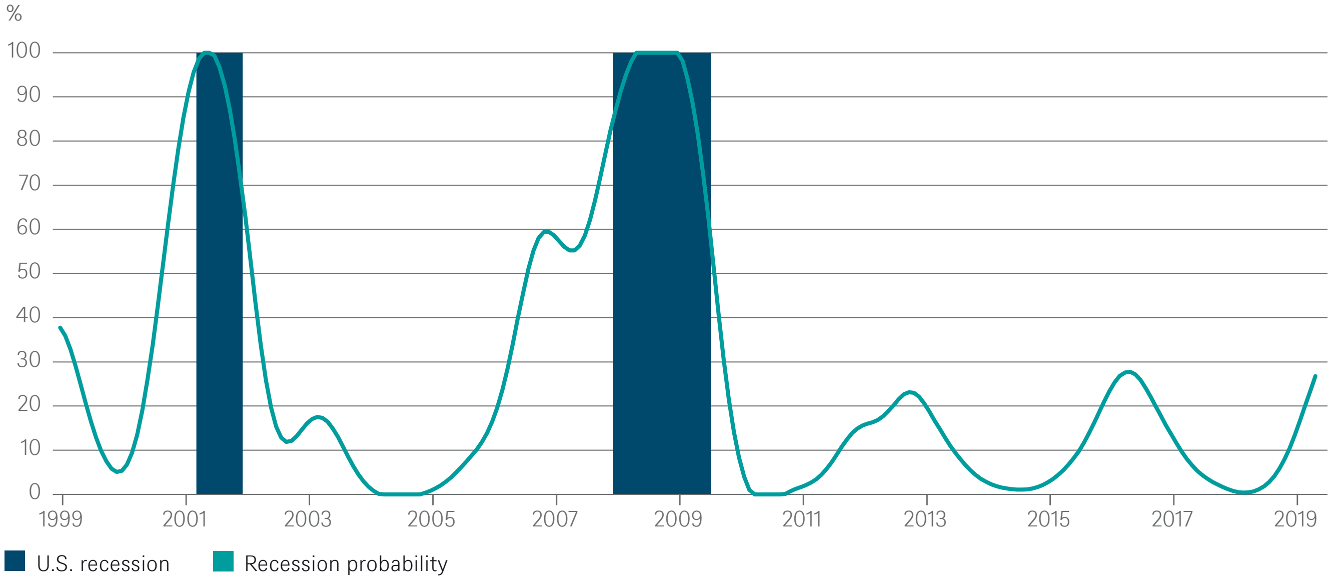
Unfortunately, the nature of trade wars is that they foster nationalist sentiment and jingoism. The same is, of course, true of actual wars. The first shots are fired in the hope of quick victories. And before decision makers know what they are up against, both sides are stuck in the trenches, with no obvious and politically feasible way out. In the conflict between the U.S. and China, we think that we are rapidly approaching the point at which both parties might not be able to find face-saving compromises any time soon. Events in that conflict and, to a lesser extent, the one between the U.S. and Mexico, may make it ever harder for the decision makers involved to contain them. Tariffs are bad enough, but at least economists have some ways to quantify their potential impact. Non-tariff barriers, such as blacklisting particular companies, are even worse.

So, who will suffer most? In the case of U.S. tariffs, the immediate answer is fairly obvious. A recent working paper by the National Bureau of Economic Research looked at the impact of the initial measures the Trump administration enacted in 2018. Unsurprisingly, it found that "the U.S. tariffs were almost completely passed through into U.S. domestic prices, so that the entire incidence of the tariffs fell on domestic consumers and importers up to now, with no impact so far on the prices received by foreign exporters."[1] Arguably even more worrying is the damage for the world's longer-term growth prospects, which could be felt for many years to come.

[1] Amiti, M.; Redding, S.; Weinstein, W. (2019) "The Impact of the 2018 Trade War on U.S. Prices and Welfare", NBER Working Paper No. 25672, available online: https://www.nber.org/papers/w25672; They also point to the relative scarcity of data and note that: "The Trump administration’s trade war provides a natural experiment for evaluating the effects of trade policy." This is a helpful reminder that even with plain-vanilla tariffs, there is plenty of uncertainty over their longer-term impact – which is one of the reasons why among wiser policy makers, they have been going out of fashion in recent decades."

OUR U.S. RECESSION INDICATOR IS SENDING EARLY WARNING SIGNS

Our proprietary U.S. recession indicator has rebounded sharply since the start of the year. It currently suggests a recession probability of about 25% for the coming 12 months.



Source: DWS Investment GmbH as of 5/30/19

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Neither cuts nor hikes. So far.

Having just taken interest-rate hikes off the table, the market is putting interest-rate cuts on. Too soon, we think.

_ Interest-rate hikes appear to be off the table for now and the market already expects rate cuts in the U.S. this year. We do not.

_ We expect most government-bond yields to move sideways. This makes U.S. sovereigns interesting again.

_ Elsewhere, our focus is on corporate and emerging-market bonds with attractive yields.

Jörn Wasmund
Head of Fixed Income/Cash

Interest-rate 'normalization.' It was an encouraging term for European savers and retail banks: signaling happier days when interest rates would return to more normal levels, ones that would pay savers more on their deposits and banks more on their loans. What happened to the normalization story? It has fallen victim to our still exceptional times.

The turnaround is stark. Further rate increases were expected in the summer of 2016, half a year after the Federal Reserve (Fed) began its interest-rate hiking cycle. Yields on both sides of the Atlantic picked up fast: 10-year U.S. Treasuries rose from 1.35% to 3.23% (December 2018) and Bund yields rose from -0.2% to 0.77% (August 2018). Briefly, U.S. yields even broke out of their almost 35-year downward trend.

But it took only a little while for yields to get dizzy on their upward climb – and they went back down again. The reasons for the renewed downturn were quickly identified: weaker economic data and sentiment indicators, followed by a turnaround in the line taken by major central banks whose hawks fell from their perches while the doves started to fly.

The renewed concern about economic growth is well documented in two data points: banks and brokers have reduced their global consensus growth forecast for 2019 from 3.7% in July 2018 to 3.3% now. Over roughly the same period, the oil price has lost about a third of its value. Since inflation expectations in most countries have also fallen again during this period, the decline in government yields is not entirely surprising.

Meanwhile the foreign- and trade-policy ideas and tweets of the U.S. President have again proven surprising and disruptive, altering the global economic picture. In May, negotiations with China were virtually ended by his announcement of new tariffs. The threatened punitive tariffs on car imports, which are presumably compromising U.S. security, were not revoked, but only postponed. Mexico, to everyone's surprise, was threatened with new punitive tariffs unless they supported the U.S. in stopping illegal migration via the U.S.-Mexican border. India's special trade status was revoked because of "unfair practices." Plans to impose punitive tariffs on Australian aluminum imports were prevented by the U.S. Defense Department. We believe that the accumulation and escalation of trade disputes will only be noticeable in global economic figures in 2020. The consequences, however, are becoming evident in capital markets, financing conditions and sentiment indicators.

As annoying as these developments may be, it should not be forgotten that they are taking place when the global economy is quite robust. Labor markets are still strong on both sides of

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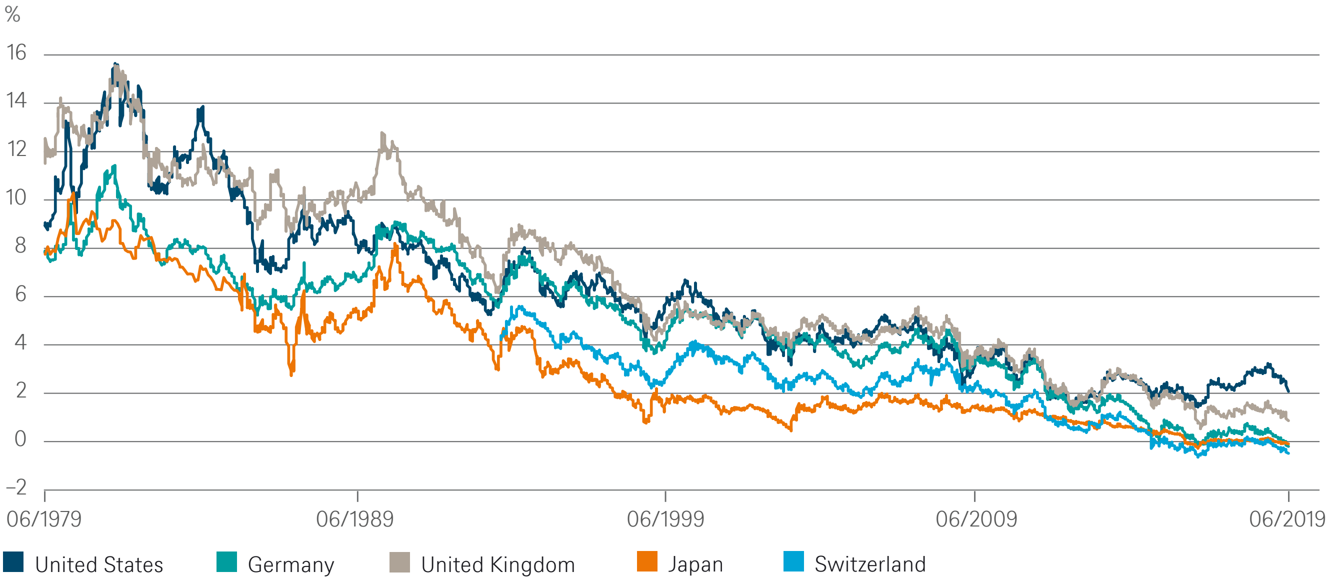
the Atlantic. We expect growth of 3.4% in 2019 and continue to expect no significant spurt in inflation. And we note that the persistent low-interest-rate trend is not only due to short-term developments. The chart shows that the decline in interest rates in developed countries is a longer-term phenomenon. Whether it's demographics, debt levels, globalization or digitization that is driving this will be examined in more detail in a separate note.

TREND IN 10-YEAR GOVERNMENT BOND YIELDS. ZERO AS THE LOWER BOUND MORE OR LESS HOLDS FOR NOW.



Source: Refinitiv as of 6/3/19

Our 12-month forecasts for bonds and currencies were also dominated by the renewed decline in yields. The epicenter was once again the United States, where we made the biggest changes for sovereign bonds. We have lowered the yield forecast for 10-year Treasuries from 3.0% to 2.3% and for 2-year Treasuries from 2.75% to 2.0%. Thus, on May 23, we predicted that yields would fall again – for the first time in a long time. However, interest-rate developments have now overtaken us and our forecasts are above current yields. Again, our impression is that Trump's actions may be part of this. The changed tone at the Fed, where Governor Jerome Powell has shifted from calling the key interest rate a long way from neutral in October last year towards a Trump-like point of view is certainly remarkable.[1]

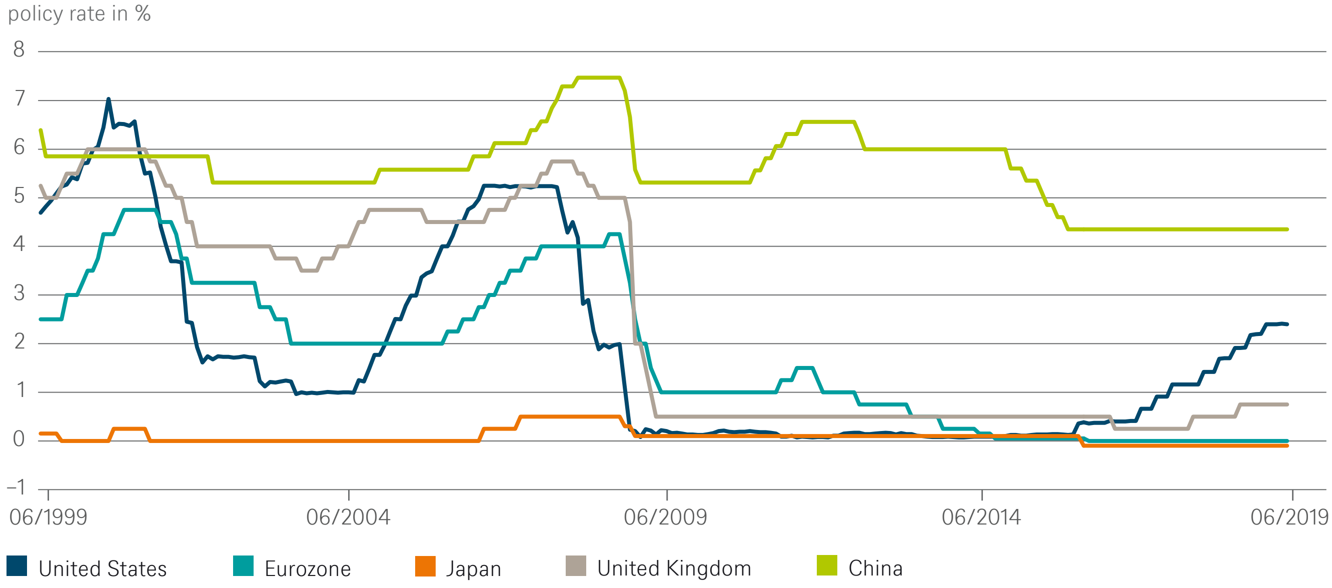
Interest-rate hikes in the U.S. appear to be off the table for now, and the market expects two to three interest-rate cuts before the end of the year. We doubt that. The labor market remains

[1] On May 14, the U.S. President tweeted that the Fed should follow the Chinese monetary-policy path and cut rates. At the time, many people thought this more of a reason for the Fed to leave interest rates unchanged in order to show its independence. But less than three weeks later, James Bullard became the first Fed member to sympathise with the President's line. The voting member of the Federal Open Market Committee (FOMC) said at the beginning of June: "The financial markets could be affected by the trade conflict to such an extent that a downward adjustment of monetary policy could soon be justified." Bullard is, however, one of the chief doves among U.S. central bankers and we do not want to over-interpret his view therefore.

solid. And there is a danger that the trade wars will push up inflation, and not just temporarily. We therefore stick to our forecast of an unchanged federal funds rate. However, we do not expect any further increases in this interest-rate cycle. We believe U.S. government bonds are likely to trend sideways over the next 12 months after the sharp yield declines around the turn of the month. The same applies to German government bonds, although we expect them to trend slightly higher until mid-2020.

We see clearer movement for UK Gilts. In twelve months there should be more clarity in the Brexit saga and a new prime minister, or even a new government. We do not expect an economic slump but inflation may move above target because of the weak pound. We therefore expect the Bank of England to raise interest rates and 10-year Gilt yields to rise to 1.5%. Among Europe's peripheral states, we continue to favor Spain over Italy.

WHILE OTHERS STAYED FLAT, U.S. AND UK POLICY RATES WERE INCREASED RECENTLY. FOR THE U.S. WE MIGHT BE AT THE PEAK.



Source: Refinity as of 6/4/19

In our view, bonds with higher yields are more attractive in the persistently low interest-rate environment; for example, corporate bonds from Europe and the U.S. We prefer high-yield bonds in Europe and investment-grade bonds in the U.S. In emerging markets, we continue to prefer hard-currency bonds. For corporate bonds from this region, we particularly like the high-yield segment.

As far as currencies are concerned, we are sticking to our forecast of 1.15 dollars per euro for the euro-dollar pair. Though we believe the euro could weaken to $1.10 or below in the near term, we think that the dollar will slowly weaken at the end of our forecast horizon. To hedge against major market distortions, we continue to rely on the yen. We expect the Chinese currency to weaken only slightly. Although a decline in China's net exports would encourage a weakening of the currency, we do not believe that Beijing will favor a marked devaluation of its currency in the medium term.

More troubles ahead

Big gains so far this year and continuing trade conflicts limit the near-time upside in equity markets.

- The combination of the year-to-date rally and deteriorating prospects of a trade deal make the near-term risk-reward for equities unattractive.
- In the near term, the U.S. budgetary process as well as trade could add further volatility.
- Over the next 12 months, we expect companies and investors to adjust to the new global political environment, allowing markets to trade higher.

Dr. Thomas Schüssler
Co-Head of Equities

Andre Köttner
Co-Head of Equities

After a few turbulent weeks, it is easy to forget just how well global equities have performed since the start of this year. Until early May, some indices had already surpassed our strategic target levels for March 2020. To understand the current situation, it is helpful to recall how we got here. Since the start of 2019, a supportive U.S. Federal Reserve (Fed), solid economic growth in the U.S. and China, reasonable company earnings reports in the first quarter and the hope of a U.S.-Chinese trade deal helped risky assets to make up all of the ground lost in the fourth quarter of 2018.

In recent weeks, however, markets have reassessed two parameters – trade and interest rates. In our view, the U.S.-Chinese trade conflict is unlikely to be resolved through a "big deal" in the near term. Instead, higher tariffs and new non-tariff measures appear to stay longer than we had originally hoped for as the conflict moves from its economic to its geo-political dimension.

The U.S. appears increasingly keen to try to shape and align the rise of China with U.S. interests. This is evident from restrictions on leading-edge U.S. technology exports and limits on Chinese exports. We have not heard of many changes to the global supply chain yet, as these take longer to implement. However, several companies are already reporting that they are delaying investment decisions and expecting a negative impact on global consumer spending.

The combination of the year-to-date rally, deteriorating prospects of a trade deal and potential near-term volatility in the U.S. budgetary process make the near-term risk-reward for equities unattractive, in our view. We now consider the risk of a full-blown correction (with the S&P declining by more than 10% from its peak) as high.

The difficult environment in certain cyclical sectors such as cars, semi-conductors and industrial goods excluding defense is likely to persist. As a result, the previously expected earnings recovery in the second half of 2019 remains at risk. The trade conflict is evolving, as the recent, very worrying signs of an escalation with Mexico show.

Increasingly, trade tariffs are becoming an all-purpose weapon, serving as instruments not only to promote fair trade, but other policy priorities of the Trump administration as well. In the case of the recent Mexican tariff threats, the stated objective was to strengthen U.S. border security. As of June 10, the punitive tariffs were not enacted after

Mexico agreed to a range of measures that seek to reduce illegal immigration. Still, these threats have introduced a new quality to various trade disputes.

To put it bluntly, erratic trade measures announced via Twitter do more than just hurt U.S. relations with allies, such as Mexico, and geopolitical rivals, such as China, alike. Nor do they just damage sentiment in financial markets – an effect partially ameliorated by financial-market expectations that the Fed might come to the rescue by cutting rates.

More fundamentally, tariffs, like any government intervention in free markets, create distortions. They effectively act as a tax on U.S. consumers and often do so in capricious, unpredictable ways. Washington bureaucrats are in charge of how and to which specific goods tariffs and other trade measures are applied. Worst of all from the perspective of U.S. companies and their shareholders, companies are often penalized for investment decisions that cannot quickly or easily be reversed.

As a first approximation, we think that the tariffs implemented so far will have a 3% negative impact on U.S. earnings per share this year, as a direct result of higher import costs. However, this is very much a "place-holder" estimate. It does not, for example, reflect the reduced value of U.S.-owned plants abroad, if protectionist policies are sustained. Conversely, there could of course be some upside because of reduced foreign competition, again at the expense of U.S. consumers and longer-term growth prospects. Eventually, investors would have to totally reevaluate the risks posed to individual companies and industries. The use of non-tariff measures, such as black-listing individual companies, is especially worrying in our view.

Of course, there remains some hope that policymakers will change course, before all of these potential costs fully materialize. For now, we keep the base-case view that a global earnings recession will be avoided. Defensive sectors, secular-growth segments, such as software, digital payments and health care, as well as share buybacks should help to support some moderate growth in earnings per share in the U.S., Europe and emerging markets.

The second parameter that requires a review are long-term interest rates and their impact on valuation multiples. Modest global-growth prospects and limited inflation are likely to leave the U.S. 10-year yield "lower for longer"; this is reflected in our updated CIO View forecast which predicts unchanged U.S. 10-year yields of 2.30% on a 12-month horizon. We remain of the view that low yields are not harbingers of an economic recession in 2019 or 2020. Instead low interest rates should allow equities to sustain structurally elevated valuation levels at or above historical averages.

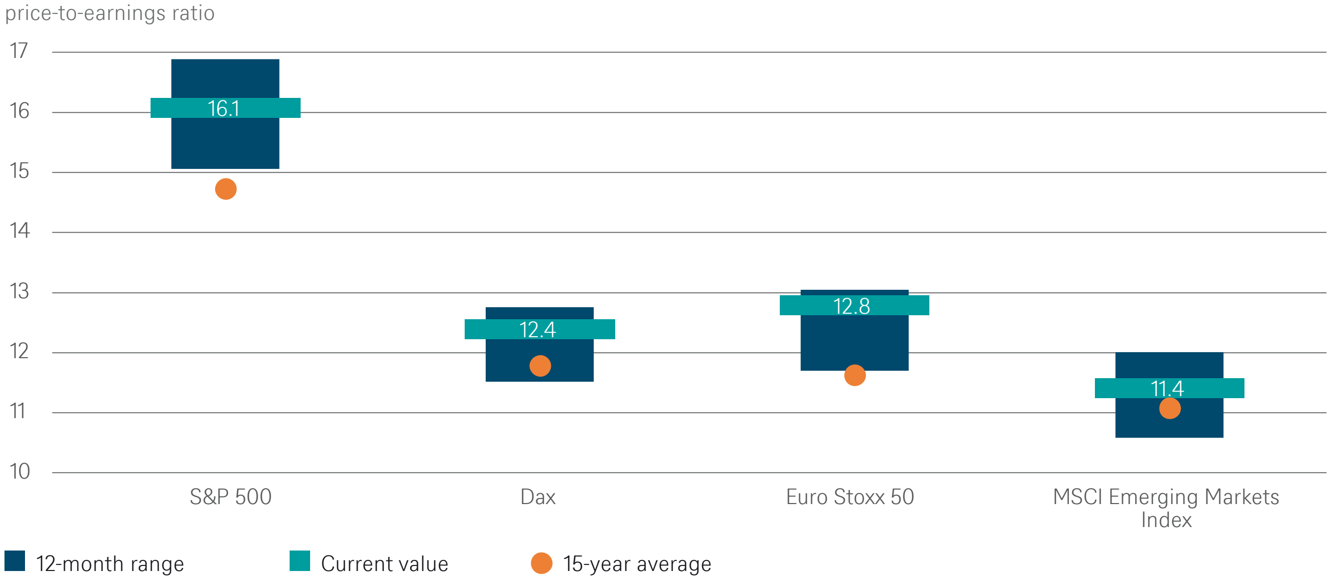
That again presupposes that trade tensions do not get out of hand completely. In the near term, the U.S. budgetary process as well as trade could add further volatility. On this, the political calendar could prove modestly helpful. With the U.S. elections of 2020 already looming large, both Congress and the Trump administration may have strong political incentives to try to prevent further escalations.

While we see near-term downside risk for equity markets we expect companies and investors to adjust their expectations to the new global political environment over the next 12 months. In our view, the S&P 500 could reach levels of 3000 by June 2020, implying an unchanged price-earnings ratio of 17.3x. In the rest of the world, we forecast a widening valuation discount to the U.S. as our confidence in a cyclical earnings recovery is fading. For the Dax we see little upside, as the automotive industry faces continued demand weakness.

Obviously, the trade conflict has made it difficult for our emerging-markets overweight to work. We are keeping the highest 12-month return forecasts due to attractive valuation and strong expected 2020 earnings-per-share growth. In the near term, however, we no longer prefer the region to others.

NOT YET CHEAP

Despite recent market turbulences, most major equity markets remain more expensive than recent historic averages. Fears of a global slowdown could prompt further corrections.

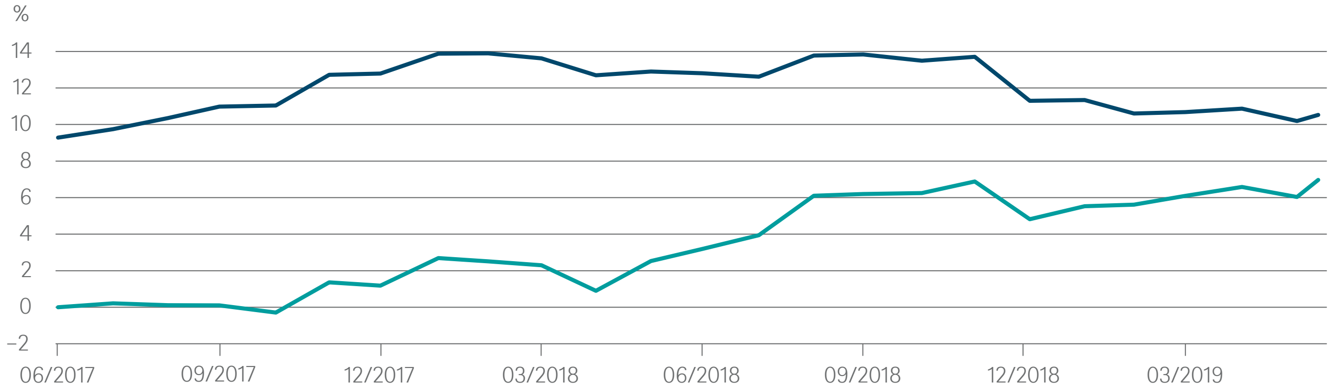


Source: Thomson Reuters Datastream, DWS Investment GmbH as of 6/10/19

Valuations overview

UNITED STATES: NEUTRAL (NEUTRAL)*

The short-term outlook for U.S. equities appears decidedly murky, not least given trade and geopolitical concerns. Trade could easily knock a few additional bucks out of earnings estimates, if tensions escalate further or the economy continues to weaken. It might also take a while yet for the U.S. Federal Reserve (Fed) to come to the rescue. That said, we would expect companies and investors to be able to adjust over the next 12 month, suggesting some upside sooner or later as we head into 2020.

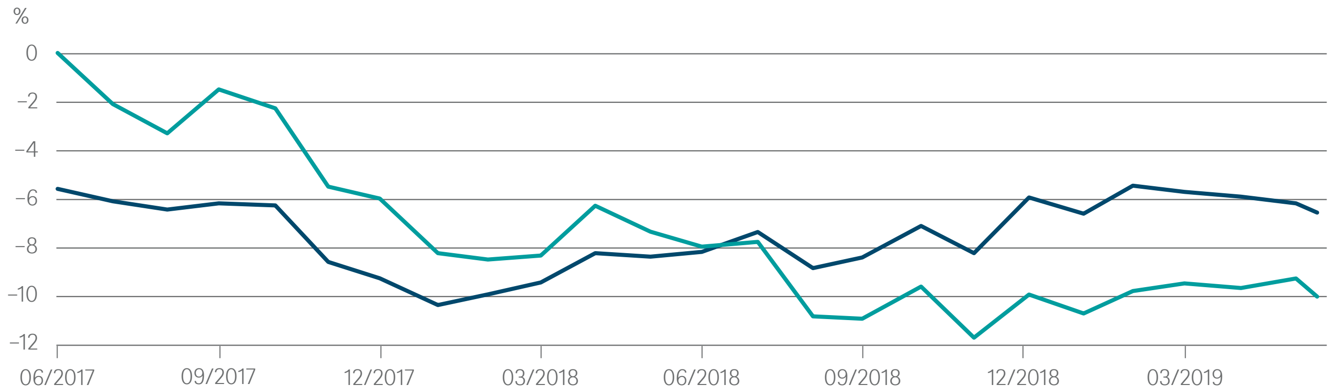


Relative valuation (P/E ratio): S&P 500 vs. MSCI AC World Index

Relative performance: S&P 500 (in dollars) vs. MSCI AC World Index (in local currency)

EUROPE: NEUTRAL (NEUTRAL)*

In addition to trade, European investors face plenty of home-made issues. Politics could continue to generate unnerving headlines, about Brexit, Italy or the uncertain survival prospects of Germany's coalition government. More importantly, Europe's export-driven economies have already shown signs of slowing. This is doubly painful for equity indices, such as Germany's Dax, that are heavily exposed to such cyclical sectors as cars, semi-conductors and industrial goods.



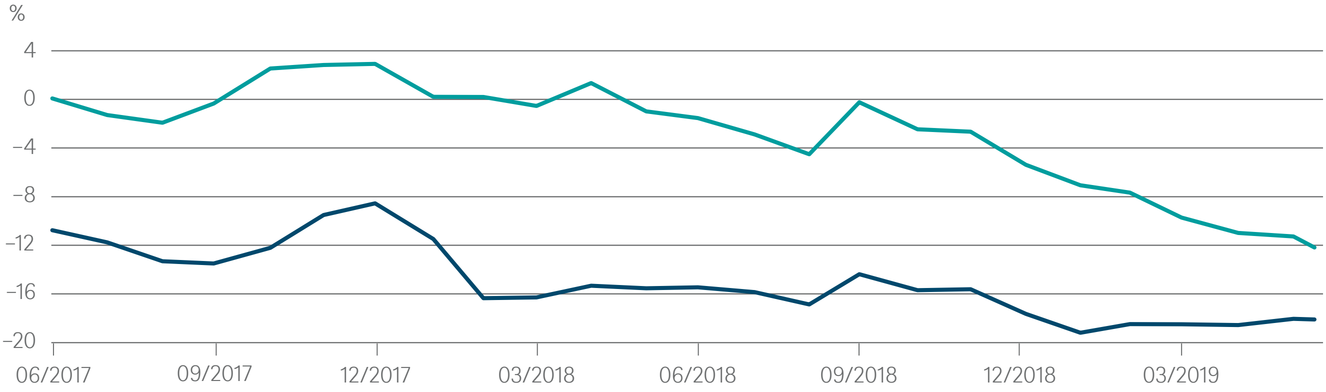
Relative valuation (P/E ratio): Stoxx Europe 600 vs. MSCI AC World Index

Relative performance: Stoxx Europe 600 (in euros) vs. MSCI AC World Index (in local currency)

* Our assessment is relative to the MSCI AC World Index, the last quarter's view is shown in parentheses.
Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 6/12/19

JAPAN: NEUTRAL (NEUTRAL)*

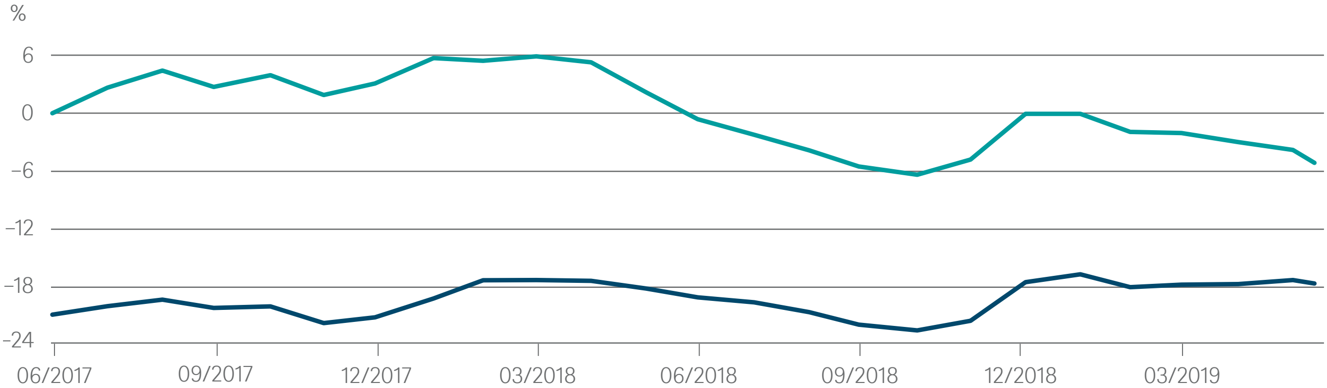
In Japan, valuations continue to look compelling by historic standards. Then again, they have been so for quite a while. Corporate governance has been improving but the Japanese market is still lacking credible triggers for a rerating. Like Europe, Japan looks exposed to trade tensions. Recent earnings have been disappointing, especially among manufacturers and global cyclicals. Domestically, demand has been strong, but a consumption-tax hike scheduled for October could hurt sentiment.



Relative valuation (P/E ratio): MSCI Japan Index vs. MSCI AC World Index
Relative performance: MSCI Japan Index (in yen) vs. MSCI AC World Index (in local currency)

EMERGING MARKETS: NEUTRAL (OVERWEIGHT)*

In the short term, emerging-market performance looks set to be driven by changing expectations for U.S. interest rates, hopes for a trade deal between the United States and China, and tentative signs of stabilization in China. Given the potential risks in all three areas, we reduced our rating to neutral in May. That said, valuations continue to look attractive and we expect strong earnings growth, heading into next year.



Relative valuation (P/E ratio): MSCI Emerging Markets Index vs. MSCI AC World Index
Relative performance: MSCI Emerging Markets Index (in dollars) vs. MSCI AC World Index (in local currency)

* Our assessment is relative to the MSCI AC World Index, the last quarter's view is shown in parentheses.
Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 6/12/19

The best of both worlds?

The rapid growth of a secondary market in private equity has created new opportunities. It is not without risks, however.

- _ The growth in the secondary market has made the whole private-equity asset class more liquid.
- _ We believe there is a way to get the best of both direct and secondary investing.
- _ A tactical strategy that focuses on "stock picking" later-stage investments within an existing PE portfolio may help.

Mark McDonald
Head of Private Equity

Over the past 20 years, private equity (PE) has grown to about $3 trillion under management globally. Traditionally, investors – called limited partners (LPs) – have mostly gained exposure to underlying companies either via funds, which own companies directly, or funds of funds (which aggregate many PE-fund investments into a single product). Collectively, investment into a PE fund from "day one" is known as the "primary" market. Over the past decade, however, we have also seen growth of the PE "secondary" market – which specializes in buying funds and portfolio stakes second-hand from investors desiring early liquidity in these funds.

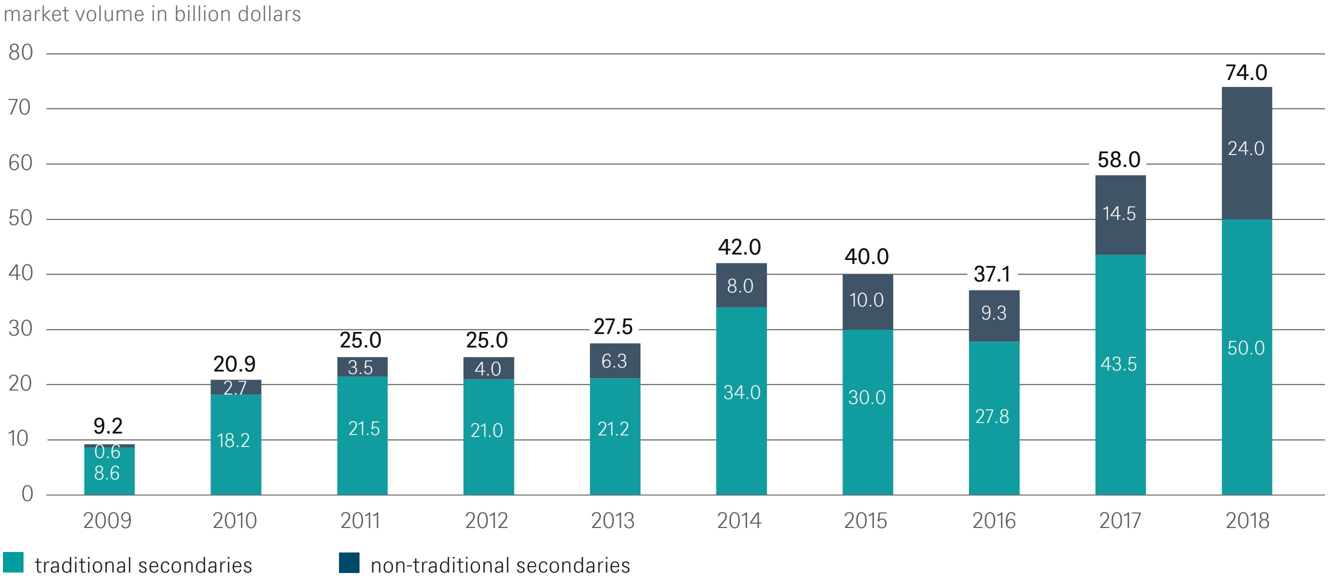
The private-equity market continues to be an inherently long-term, illiquid asset class, as evidenced by an average fund life of 15 years. With the increasing prevalence of secondaries capital in the market, LPs have been able to sell their stakes in private-equity funds prior to the end of the fund life. The most common type of secondary deal is known as a limited-partner transaction. A fund investor sells an interest, or a portfolio of interests, to another investor (a purchasing investor) based on a negotiated price, usually as a percentage of net asset value (NAV). The purchasing investor assumes the legal and financial obligations to the underlying fund(s).

Sellers are usually motivated to undertake these transactions for the following three reasons: active portfolio management, strategic and regulatory drivers or liquidity-driven situations. Over the past several years, for example, large pension and sovereign-wealth funds have begun to use a more liquid secondary market in order to re-balance exposures and reduce the number of private-equity relationships – effectively adopting traditional-asset-management techniques to managing their illiquid PE portfolios. Using the secondaries market has also become more economically attractive to sellers as the discount to NAV has narrowed in recent years and prices paid (on average) have increased.

Limited-partnership sales accounted for around three quarters of transaction volumes in 2017 (see chart). The growth in secondaries really started during the global financial crisis ten years ago. Increased scrutiny and regulation of large financial institutions and banks led to strategic portfolio sales of illiquid and directly held private-equity assets and underlying private-equity-fund commitments. While this part of the market has historically generated attractive opportunities, its prevalence has waned in recent years as banks have reduced their balance sheets and exposure to private assets. Liquidity-driven or distressed situations can also still occur today, but have historically been less common.

SECONDARY MARKET VOLUME REMAINS AT RECORD LEVELS

In recent decades, the secondary market has grown rapidly, with volumes increasing from $9 billion in 2009 to $74 billion in 2018.



Sources: Greenhill & Co., Inc. as of 01/2017; Greenhill & Co., Inc. as of 01/2019; DWS Investment GmbH as of 6/13/19

Another, increasingly common type of secondaries are manager-led transactions. Managers – called general partners (GPs) – might seek liquidity options on behalf of investors for the remaining assets in a fund, while also potentially securing additional time (and sometimes capital) for a portfolio of legacy assets to mature and be primed for sale (usually called an "exit"). The structuring (or re-structuring) of these types of transactions can be complex and time consuming. Usually, it requires highly bespoke solutions around the composition of the underlying portfolio, the price to sellers and the alignment between old and new investors, as well as the manager. GP-led deals and other non-traditional secondary transactions such as preferred-equity purchases, already account for between a quarter and a third of deal volume (see chart) and we believe such deals may play an increasingly important role in the future.

Effectively, growth in the secondary market has contributed to somewhat greater liquidity in the PE asset class. The secondary market offers investors (in secondaries funds) instant access to a highly diversified private-equity portfolio; providing exposure across vintage years, sectors and geographies – while sellers benefit from an active buyer universe for their illiquid PE positions. However, the secondary market still remains much smaller than the primary market: less than 2% of private-equity assets are estimated to trade hands each year. Its rapid growth reflects structural changes in the market.

Traditionally there has been a trade-off when investing via the secondary market. Historically, cash returns have tended to be lower because of less risk (usually due to a high level of diversification), shorter holding periods, reduced scope for valuation anomalies and the fact that often secondaries sales are of portfolios that include assets of varying quality. In buying a whole fund position, you get the good with the bad.

However, we believe there may be ways to get the best of both direct and secondary investing. By focusing on "stock-picking" later-stage investments within an existing PE-fund portfolio, new investors may be able to collaborate with a fund manager's (GP's) best portfolio companies.

Supporting these companies can ideally satisfy every stakeholder: new investor, incumbent investors, GPs, as well as the underlying portfolio companies. It may also result in higher returns relative to the market, not least by maintaining the key tenets of a secondary transaction (shorter duration, earlier distributions) while tactically identifying individual, attractive assets within an existing PE-fund portfolio.

A partnership approach is not without risks, however. The market for secondaries has experienced record fundraising, with dry powder now at 2.6 times the supply of deal flow, more than double what it was six years ago. As a result, the market has become far more competitive, making returns harder to generate, particularly for more "traditional" secondaries specialists.

A strong historical correlation between public-market volatility and growth and pricing in the traditional secondaries market, investors looking for entry points will likely face similar dynamics to public markets. As long as listed-equity markets continue to rise and a solid macroeconomic backdrop prevails, it could contribute to more optimistic underwritings at the asset level, thereby validating current pricing levels. A wide-spread downturn, though, triggered, for example, by escalating trade tensions, would no doubt also be felt in PE generally, and in the market for secondaries in particular. On the positive side, it may also create new, attractive opportunities, especially for tactical strategies as outlined previously.

Reduce risk, increase flexibility

We are less gloomy on the outlook than bond markets. In our view, equity markets have to correct before offering opportunities for entry.

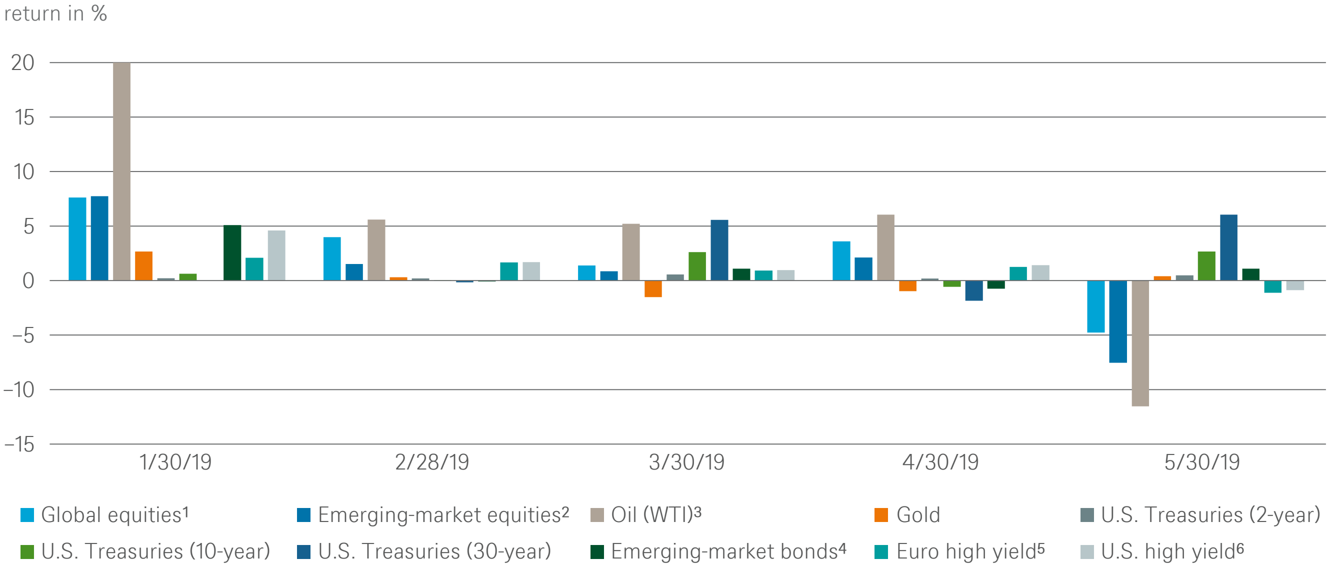
- After a strong start to the year for most asset classes, returns have faded and diverged. For multi-asset managers, however, both periods were similarly challenging.
- The escalation in the trade conflict, lower interest rates and rich stock-market valuations lead us to enter the summer with a more defensive allocation.

Christian Hille
Head of Multi Asset

When can multi-asset managers actually show their worth? Let's take a look at the first five months of this year. As the chart shows, the timeframe can roughly be divided into two phases. In the first three months it went well for almost all asset classes. But results were mixed in April and in May as almost everything that was not labelled "long-term government bond" crashed. Some people might think that having the right asset mix was unimportant in the first three months of the year, as almost every asset class yielded good returns anyway. And that, by contrast, in April and May, multi-asset managers might have proven their worth as it took the right hand to reap a good harvest.

A DIVERSE YEAR

As the returns on various asset classes declined sharply over the period, the divergence in returns between the individual asset classes increased sharply.



[1] MSCI World Index; [2] MSCI Emerging Markets Index; [3] West Texas Intermediate; [4] J.P. Morgan Emerging Market Bond Index; [5] Markit iBoxx EUR Liquid High Yield Index; [6] ICE BofA Merrill Lynch US High Yield Index; Sources: Refinitv, DWS Investment GmbH as of 6/18/19

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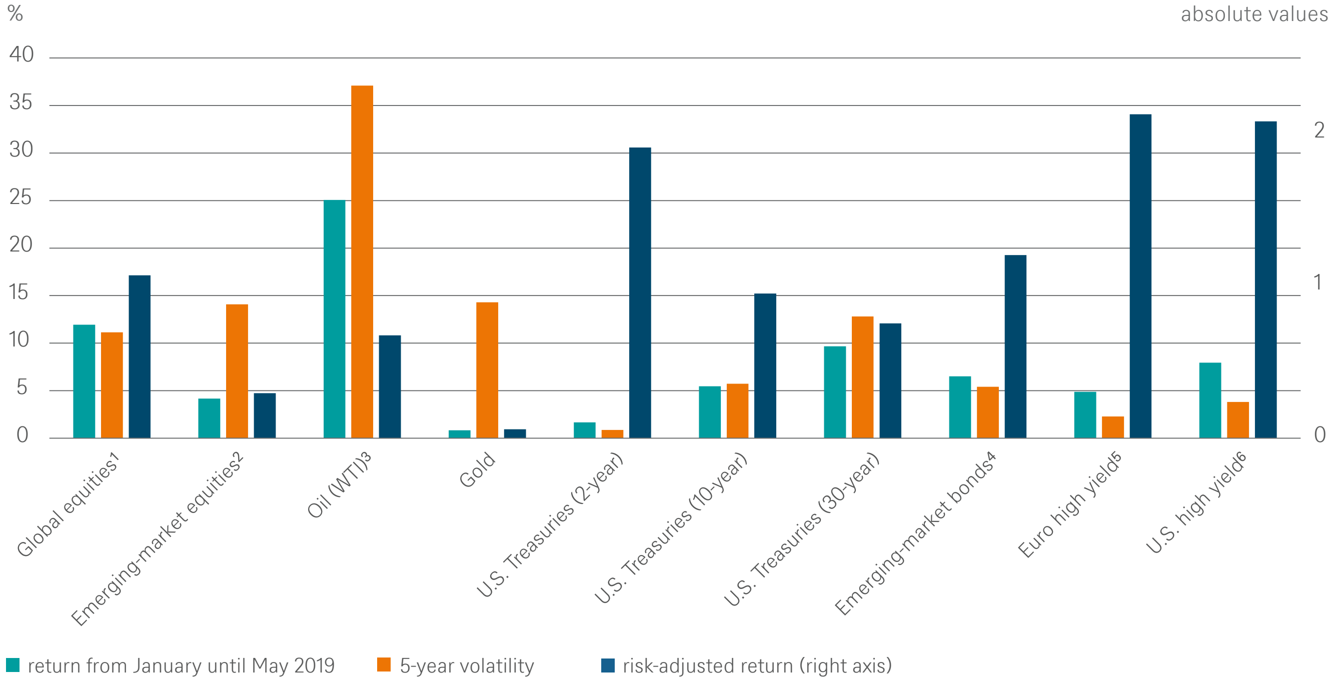
The argument above, however, is not quite right, in our view. We believe that multi-asset funds have the potential to be the better option in good as well as bad market environments. Returns on different asset classes, even if they are the same, can be of different quality. In this case, quality means risk, which is commonly expressed in capital markets by volatility. The more the returns on an investment fluctuate, i.e. the higher its volatility, the more investors want to be remunerated for holding it. This explains the attraction of government bonds from industrialized countries or even the preference of some households for cash. As well known as the low-volatility appeal of bonds and cash is, it is often forgotten when the performance of different asset classes is compared. The second chart shows how over time, the ranking of the top-return-delivering asset classes changes if the question of risk or volatility is taken into account. It shows the risk-return profile of various investments by relating the return achieved from the beginning of the year to the end of May to historical volatility. What was perceived to be best in class, namely oil, plunges into a middle ranking when adjusted for risk, while the previously thought to be rather poorly ranking U.S. and euro high-yield bonds take the lead – ahead of the long-term risk-return king, 2-year U.S. government bonds. So even if the markets march uniformly in one direction, it is still a matter of choosing the right investments, i.e. those with a better risk-return profile. And the job of the multi-asset manager is to select the right investments in each market phase and put them together with the right weighting.

THERE IS ALMOST NO RETURN WITHOUT RISK

The performance ranking changes quite a bit when adjusting returns for risk.



[1] MSCI World Index; [2] MSCI Emerging Markets Index; [3] West Texas Intermediate; [4] J.P. Morgan Emerging Market Bond Index; [5] Markit iBoxx EUR Liquid High Yield Index; [6] ICE BofA Merrill Lynch US High Yield Index; Sources: Refinitv, DWS Investment GmbH as of 6/19/19

Good multi-asset management depends on finding the assets with the best risk-return profile within different asset classes. And then, finding the most suitable collective mix of these types of assets. Depending on how strongly individual asset classes are correlated, the weightings of multi-asset funds can be determined in such a way to provide exposure to the lowest level of risk for a given target return. Or, to put it another way, seek the maximum return for a certain targeted level of risk. We discussed this briefly in our last Quarterly CIO View (Strength through length as of 3/15/19) and at greater length in our January study (Multi-Asset Long View as of 1/31/19).

Even if quantitative models play a major role in portfolio optimization, we believe the basis for investment decisions remains the qualitative analysis of the economy and politics, which brings us to our past and present portfolio construction. Given our view of the global economy we believed that the market setback in December was exaggerated and was partly triggered by non-fundamental issues. This meant that staying invested in risk assets was recommendable and it proved to be the right choice as the recovery started at the beginning of the year. The price declines were more severe than we believed justified, given our view of the economy. For our current portfolio construction, we are guided by two basic macroeconomic assumptions: 1. The market is too optimistic in the short term, which is reflected in high valuations; 2. We believe that a recession will not occur this year and will be only a risk in 2020, but even then it will not be our base case. For this central scenario to hold, we believe the U.S. administration will have to refrain from exacerbating its conflict with China or opening up any further fronts in its trade disputes with the rest of the world. As this scenario is far from being certain, we have recently recommended to take some profits. And to keep some powder dry (cash) in order to be able to expand risk positions again (see our model portfolio in the chart) in the event that asset prices fall heavily to attractive re-entry levels. We think prices could easily suffer a serious summer meltdown. It will not, in our view, be troubles in Europe such as Brexit and the Italian budget, nor fresh tanker fires in the Persian Gulf, that will cause it. Three other issues have, we believe, far more explosive potential: 1. A worsening of the conflict between China and the United States, dragging on well beyond the G20[1] summit; 2. A U.S. Federal Reserve (Fed) which fails to satisfy markets having delivered such a dovish statement on June 19 – perhaps because of a surprisingly strong economy; 3. Or, on the contrary, there are signs that the economies in the United States, Europe or Asia are developing weaker than the market expects.

If there were to be major price setbacks without us having to revise our medium-term macroeconomic outlook, we would be buyers in the market. Therefore, our current allocation is defensive and diversified. We have significantly reduced our equity exposure in our allocation. Some stock markets are not far from their historic highs, boosted recently by the "Powell Put,"[2] at least, as perceived by the market. We prefer emerging markets and the United States strategically, even though we might still face setbacks in individual companies and sectors in the short term as a result of the trade war. We currently see no reason why Japan and Europe should outperform over the summer months.

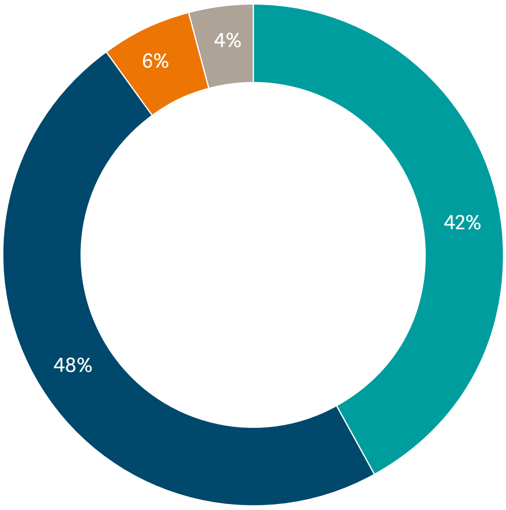
We have topped up bonds in our multi-asset mixture. We assume that government-bond yields will remain low for longer and that we will have seen the peak in the cycle of interest-rate hikes in the United States. Though markets seemed a bit ahead of themselves in recent weeks when they pushed down yields so far, the moves were justified by central-bank actions. In Europe, we are increasingly focusing on corporate bonds because they offer a good mix of security, diversification and yield. Of course, the cash position, which we have also expanded, always offers the greatest security and agility to re-enter the market.

Buy-and-hold is not likely to be an appropriate investment strategy over the summer. We will react in an agile way to steps forward or back in the markets in response to the trade disputes and to signals from the Fed. At the same time, we will look for points where the market has anticipated too much in one direction or another in order to adjust our allocation in our model portfolio (see chart). The recent confirmation of the structural low-yield environment by central banks is one more reason why we believe that risk assets such as equities should be added in periods of market weakness.

1 This year the G20 meeting is taking place in Osaka on June 28 and 29.
2 In reference to the "Greenspan Put," the market is now also talking about the "Powell Put" after the clear rhetorical turn of Fed Chairman, Jerome Powell, at the end of 2018. This refers to the central bank's willingness to intervene with an expansive monetary policy in the event of a sharp fall in stock markets.

MULTI-ASSET ALLOCATION FOR EUROPEAN INVESTORS

Broadly positioned with less risk and more cash to be prepared for the opportunities in summer.

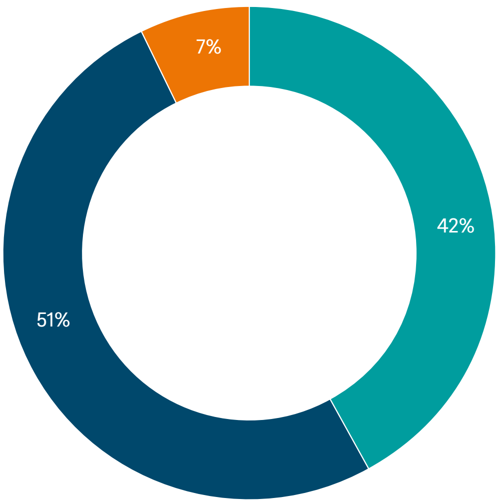


Equities	**42%**
Equities United States	23%
Equities Europe	5.5%
Equities emerging markets	5%
Equities Global Style	5%
Equities Japan	3.5%
Fixed Income	**48%**
Euro investment grade	13%
Eurozone sovereigns	13%
U.S. Treasuries	8%
Emerging-market (hard currency) bonds	7%
Euro high yield	5%
U.S. high yield	2%
Alternatives	**6%**
Commodities	3%
Convertibles (euro-hedged)	3%
Cash	**4%**

The chart shows how we would currently design a balanced, euro-denominated portfolio for an European investor taking global exposure. This allocation may not be suitable for all investors and can be changed at any time without notice. Alternative investments involve various risks and are not necessarily suitable for all clients or for every portfolio. Source: Multi Asset Group, DWS Investment GmbH as of 5/31/19

MULTI-ASSET ALLOCATION FOR ASIAN INVESTORS

We have reduced the equity and alternatives exposure and increased the bond allocation.



Equities	**42%**
Equities United States	24%
Equities Asia ex Japan	7%
Equities Europe	7%
Equities Japan	4%
Fixed Income	**51%**
U.S. Treasuries	18%
Asia Credit	14%
Emerging-market (hard-currency) bonds	10%
U.S. high yield	5%
U.S. investment grade	4%
Alternatives	**7%**
Convertibles	4%
Commodities	3%

The chart shows how we would currently design a balanced, dollar-denominated portfolio for an Asian investor taking global exposure. This allocation may not be suitable for all investors and can be changed at any time without notice. Alternative investments involve various risks and are not necessarily suitable for all clients or for every portfolio. Source: Multi Asset Group, DWS Investment GmbH as of 5/31/19

Rough weather conditions

All three indicators currently paint the same picture.

And it is none too rosy. Therefore caution is advisable, in our opinion. All three DWS indicators have been unanimously indicating a negative environment for a good three weeks now. The macro indicator is at its lowest level since 2009 and shows little sign of improving. The risk indicator shows investors' risk appetite is low and the surprise indicator reflects the fact that most analysts' expectations are being disappointed. The current escalation of geopolitical risks, especially the trade dispute between the United States and China, seems to explain this gloomy picture.

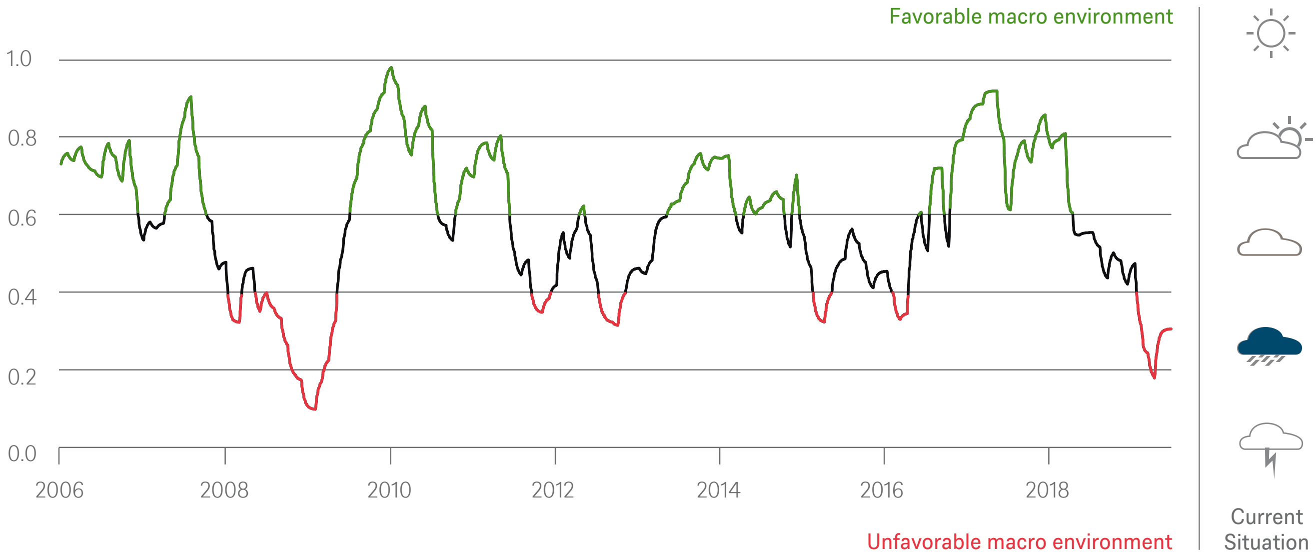
And yet, despite this dark backdrop, the capital markets are almost bewilderingly sunny. All major stock indices are within reach of their annual highs. In the case of U.S. stock markets, they are even within striking distance of their historic highs.

The very dovish attitude of the central banks seems to have fuelled this divergence. The market now expects the U.S. Federal Reserve (Fed) to cut interest rates almost three times this year. Our indicators point to the unique fragility of the market environment. Should the Fed fail to deliver the priced-in rate cuts, a correction in the equity market can probably be expected.

If one considers that economic growth in the United States in the first quarter was at an annualized rate of over 3% and that nearly full employment prevails, disappointment in the hopes for an interest-rate cut soon can certainly not be ruled out. Or are the central banks seeing something approaching of which the stock market may not yet be aware?

MACRO INDICATOR / Condenses a wide range of economic data

In April, the macro indicator recorded its lowest level since 2009. Thenceforth, it has recovered somewhat but remains deep in the red zone. The global purchasing managers' indices and sentiment in the manufacturing sector are particularly depressed.



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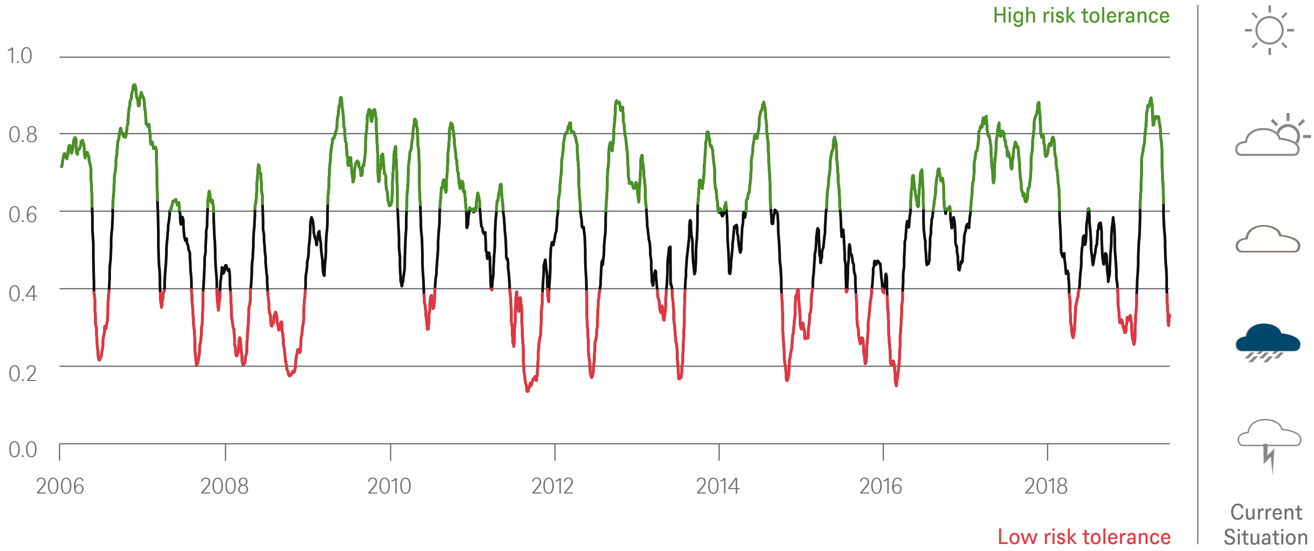
DWS Investment GmbH

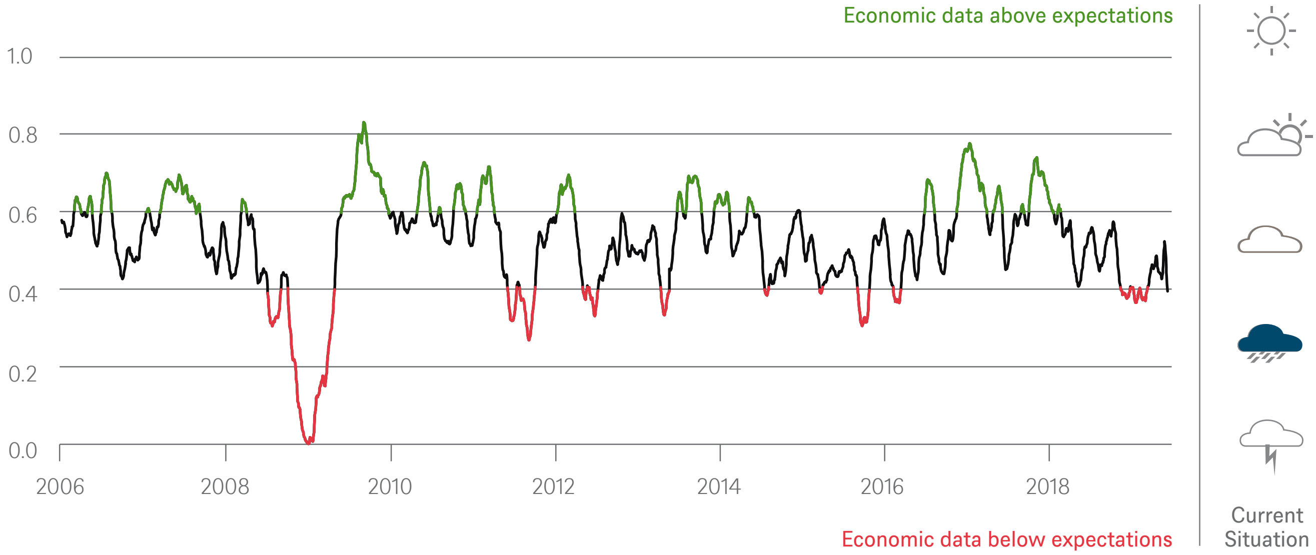
RISK INDICATOR / Reflects investors' current level of risk tolerance in the financial markets

After the recovery in the risk indicator in the first quarter, the spontaneous intensification of trade-war rhetoric on the part of the United States very quickly clouded risk sentiment. In mid-May, the risk indicator fell back into negative territory and is currently roughly at the very low level of late 2018.



SURPRISE INDICATOR / Tracks economic data relative to consensus expectations

The surprise indicator has been in the red for most of the year. But regional sub-indicators have been quite divergent. Recently, however, all the main regions (United States, Europe and Asia) have been in the negative zone at the same time. Expectations within these regions are therefore regularly disappointed.



Source: DWS Investment GmbH as of 6/10/19

Europe's green wave

Green electoral gains at the European elections reflect broader changes in attitudes, especially towards climate change.

- In recent elections to the European Parliament (EP), green parties saw sizeable gains in a wide range of member states.
- The consequences for the rest of the world could be far-reaching, given the EP's growing role on trade and its growing willingness to resolutely pursue climate-change goals.
- Of course, it remains to be seen how lasting these changes in policy preferences will prove.

Petra Pflaum
CIO for Responsible Investments

Some political surprises can create a big splash. Others are barely noticed at first glance. But, like a small rock thrown into a pond, they can cause powerful ripple effects. This certainly appears to be the case of the 2019 elections to the European Parliament (EP), the continent-wide vote which took place between May 23 and 26. As is becoming increasingly clear, the lasting impact of the electoral results is hard to overestimate, especially when it comes to environmental, social and governance (ESG) issues.

This has little to do with the aggregate size of polling surprises for Europe as a whole. In the months leading up to the vote, many commentators feared another populist wave, not yet visible in the polling data. In our previews ahead of the vote, we were dubious of such forecasts. (Macro Perspectives: Another populist shock in Europe as of 3/12/19). In the event, the European elections did not mark a breakthrough moment for the right-wing, euroskeptic parties. In the UK, for example, the combined share of votes and seats for euroskeptic parties fell sharply compared to 2014. The country is still scheduled to leave the European Union (EU) on October 31, but, has arguably ended up electing the most europhile national delegation of Members to the European Parliament (MEPs) in 20 years. Similarly, across the channel in France, Marine Le Pen's Rassemblement National saw its share of the vote and seats decline compared to 2014.[1]

Prominent among the winners in both France and the UK were the green and liberal parties. It was a similar story in many of the 28 member states. The balance between centrist forces broadly in favor of the EU and those opposed to further integration did not change all that much. But there were significant shifts in terms of who the centrists will be within the EP. The Group of the Greens / European Free Alliance (Greens/EFA) in the EP, saw its number of MEPs swell from 52 to 75 (out of 751 seats overall, for as long as the UK remains a member). The strength of the Greens/EFA was all the more remarkable, because cross-country electoral correlations have tended to be rare in previous European elections, and as we have highlighted in the past. (Macro Perspectives: A giant stirs as of 5/2/19)

This time around, the Greens outperformed polling averages across a wide range of member states. In addition to doing quite well on historically favorable terrain (Austria, Germany, the Nordic member states and the Benelux countries), they also scored surprise wins in Ireland and Portugal. With a few exceptions, green parties have remained weak in the new

1 For detailed breakdowns of the election results, see http://www.europarl.europa.eu/elections2014-results/en/election-results-2009.html and https://www.election-results.eu/european-results/2019-2024/

member states of the former communist east and Southern member states, such as Italy. However, it has become increasingly likely in recent weeks that the Greens may be able to have an even bigger influence on the policies of the next European Commission than their number of MEPs might suggest.

One reason for this is the interplay between national and European politics in key member states, particularly Germany and France. Green electoral gains at the EP partly reflect broader changes in attitudes, especially towards climate change. This has been symbolized by the continuing strength of new youth movements demanding urgent action, not just, but especially in Western Europe. The European elections sharply accelerated the process of other parties trying to co-opt green ideas, most notably in Germany, where opinion polls currently show the Greens are well on track towards becoming the largest political party.[2]

This matters because it will be in the coming weeks and months that the composition of the next European Commission will be decided which will set the political agenda for the next five years in the EP. Under the Lisbon treaty, the EP has gained new power, notably on trade. The consequences for the rest of the world could be far-reaching.

Already, the previous EP has shown itself willing to risk trade tensions in pursuit of climate-change goals and human rights, as well as better labor and environmental standards.[3] Recent EU trade conflicts over palm oil with Indonesia, Thailand and Malaysia perhaps offer a foretaste of how European trade policy is changing – as well as the potential for hostile reactions elsewhere.[4] Getting any trade deal with the U.S. negotiated by the Trump administration through the EP certainly looks tricky. Instead, it seems quite possible that the new EP could inadvertently get dragged into the U.S. political debate, particularly if proposals for a carbon border tax were to gain favor.[5] Already, a consensus is starting to emerge to end European fuel-tax exemptions for the aviation sector – a key priority, given the growth in carbon emissions from air travel.[6]

Of course, it remains to be seen how lasting these changes in policy preferences will prove. Much will depend on the Greens being able to defend or extend recent electoral gains in national elections, over the next few years. In countries where they have long been established, Greens have had to get used to seeing their electoral fortunes wax and wane. It is only two years ago, for example, that Germany's Greens were struggling in several regional elections. Neighboring Austria elected Europe's first green president in 2016. A year later Austria's Greens failed to clear the country's four-percent hurdle, losing parliamentary representation for the first time since 1986. In terms of European policy making, however, the recent green wave looks set to create plenty of opportunities for sensible policy changes in order to mitigate climate-change risks.

2 A useful source for German polling is https://www.wahlrecht.de/umfragen/, unfortunately only available in German.
3 Deringer, H.; Hosuk, L. and Murty, D. (2019) "Europe and South-East Asia: Shifting from Diplomacy to Unilateralism" in European Centre for International Political Economy (ECIPE) Policy Briefs, available at: https://ecipe.org/publications/europe-asia-shifting-unilateralism/
4 For more details, see https://www.dw.com/en/malaysia-threatens-to-raise-stakes-in-eu-palm-oil-spat/a-48075278; https://www.dw.com/en/does-eu-biofuel-deal-compromise-the-environment-for-trade-with-southeast-asia/a-44350293 and on the related issues involving U.S. soy beans: https://www.euractiv.com/section/agriculture-food/news/us-soy-for-producing-biofuels-an-unsustainable-giveaway-to-trump/ and https://www.reuters.com/article/us-usa-trade-eu/eu-seeks-to-soothe-u-s-by-clearing-soybeans-for-biofuel-idUSKCN1PN1GT
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MACRO / Far from dismal

GDP growth (in %, year-on-year)

Region	2019F		2020F
United States	2.5	↘	2.0
Eurozone	1.2	→	1.2
United Kingdom	1.4	↗	1.5
Japan	0.5	↗	0.6
China	6.0	→	6.0
World	3.4	→	3.4

Fiscal deficit (in % of GDP)

Region	2019F		2020F
United States	4.4	→	4.4
Eurozone	0.8	↘	0.7
United Kingdom	1.8	↘	1.4
Japan	3.1	↘	2.4
China	4.8	↘	3.8

Consumer price inflation (in %, year-on-year)

Region	2019F		2020F
United States[1]	1.9	↗	2.0
Eurozone	1.4	↗	1.5
United Kingdom	1.8	↗	2.1
Japan	0.9	↗	1.7
China	1.5	↗	1.8

Current-account balance (in % of GDP)

Region	2019F		2020F
United States	–2.7	↗	–2.6
Eurozone	2.9	→	2.9
United Kingdom	–3.5	↗	–3.2
Japan	3.8	↗	4.1
China	0.6	↘	0.2

Benchmark rates (in %)

Region	Current*		Jun 2020F
United States	2.25–2.50	↘	1.75–2.00
Eurozone	0.00	→	0.00
United Kingdom	0.75	↗	1.00
Japan	0.00	→	0.00
China	4.35	↘	4.10

Commodities (in dollars)

	Current*		Jun 2020F
Crude oil (WTI)	58.5	→	60
Gold	1,410	→	1,400
Copper (LME)	5,993	↗	6.400

* Source: Bloomberg Finance L.P. as of 6/28/19
[1] core rate, personal consumption expenditure Dec/Dec in % (no average as for the other figures)
F refers to our forecasts as of 6/24/19
WTI = West Texas Intermediate
LME = London Metal Exchange

Legend applies to this and the following page
_ 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 ↘.
_ 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.

Equities / Cautious, for now

	Current*		Jun 2020F Forecast	Total return (expected)[1]	Expected earnings growth	P/E impact	Dividend yield
United States (S&P 500)	2,942	↗	3,000	4.0%	5%	–3%	2.0%
Europe (Stoxx Europe 600)	385	→	380	2.4%	5%	–6%	3.7%
Eurozone (Euro Stoxx 50)	3,474	→	3,370	0.7%	5%	–8%	3.7%
Germany (Dax)[2]	12,399	→	12,300	–0.8%	6%	–10%	3.2%
United Kingdom (FTSE 100)	7,426	→	7,220	1.9%	3%	–6%	4.7%
Switzerland (Swiss Market Index)	9,898	→	9,450	–1.2%	7%	–12%	3.3%
Japan (MSCI Japan Index)	936	↗	970	6.0%	–1%	5%	2.4%
MSCI Emerging Markets Index (USD)	1,055	↗	1,080	5.3%	5%	–3%	3.0%
MSCI AC Asia ex Japan Index (USD)	653	↗	680	6.9%	5%	0%	2.7%

* Sources: Bloomberg Finance L.P., FactSet Research Systems Inc. as of 6/28/19
[1] Expected total return includes interest, dividends and capital gains where applicable
[2] Total-return index (includes dividends)

Fixed Income / So much for rate hikes

United States

	Current*		Jun 2020F
U.S. Treasuries (10-year)	2.01%	→	2.00%
U.S. municipal bonds	81%	→	80%
U.S. investment-grade corporates	109 bp	→	105 bp
U.S. high-yield corporates	377 bp	↗	440 bp
Securitized: mortgage-backed securities[1]	39 bp	→	38 bp

Europe

	Current*		Jun 2020F
German Bunds (10-year)	–0.33%	↗	–0.10%
UK Gilts (10-year)	0.83%	↗	1.50%
Euro investment-grade corporates[2]	124 bp	↘	90 bp
Euro high-yield corporates[2]	379 bp	→	380 bp
Securitized: covered bonds[2]	49 bp	→	50 bp
Italy (10-year)[2]	243 bp	↗	270 bp

* Source: Bloomberg Finance L.P. as of 6/28/19
[1] Bloomberg Barclays MBS Forward Index
[2] Spread over German Bunds

Asia-Pacific

	Current*		Jun 2020F
Japanese government bonds (10-year)	–0.16%	↗	0.15%
Asia credit	265 bp	→	265 bp

Global

	Current*		Jun 2020F
Emerging-market sovereigns	344 bp	↘	330 bp
Emerging-market credit	330 bp	↘	300 bp

Currencies

	Current*		Jun 2020F
EUR vs. USD	1.14	→	1,15
USD vs. JPY	108	→	107
EUR vs. GBP	0.90	→	0.88
GBP vs. USD	1.27	→	1.30
USD vs. CNY	6.87	→	7.00

F refers to our forecasts as of 6/24/19
bp = basis points

The Alliance 90/The Greens, also referred to as the "Greens", is a environmentalist political party in Germany that is considered center-left in the German political landscape.

A balance sheet summarizes a company's assets, liabilities and shareholder equity.

The Bank of England (BoE) is the central bank of the United Kingdom.

The Benelux Union is the politico-economic union of Belgium, the Netherlands and Luxembourg. The name is an acronym of the starting letters of those countries and is also often used when generally referring to them.

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

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

Carry is a strategy in which an investor sells a certain currency with a relatively low interest rate and then buys another, higher-yielding currency.

The Chinese yuan (CNY) is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

Corporate Governance – The methods by which corporations are run and controlled

A correction is a decline in stock market prices.

Correlation is a measure of how closely two variables move together over time.

Covered bonds are securities similar to asset-backed securities (ABS) which are covered with public-sector or mortgages loans and remain on the issuer's balance sheet.

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

Diversification refers to the dispersal of investments across asset types, geographies and so on with the aim of reducing risk or boosting risk-adjusted returns.

Doves are in favor of an expansive monetary policy.

Dry powder, in a private-equity context, refers to cash or other very liquid reserves that can easily be deployed for investment.

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.

Environmental, Social and Governance (ESG) issues refer to non-financial issues that may affect the sustainability of an investment.

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

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

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.

The financial crisis refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

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

In a private-equity context, general partner refers to the managing partners in a private-equity firm who make the investment decisions.

Gilts are bonds that are issued by the British Government.

The term Goldilocks economy refers to a state of the economy, where there is neither a threat of inflation due to an overheating economy, nor a threat of a recession.

Government (sovereign) debts/bonds are debt/bonds issued and owed by a central government

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.

Hard-currency bonds (debt) are bonds (debt) issued in a historically stable currency such as the U.S. dollar or the euro.

A hedge is an investment to reduce the risk of adverse price movements in an asset.

High-yield (HY) bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

The ICE BofA Merrill Lynch US High Yield Index tracks the performance of dollar-denominated below investment grade, including zero-coupon and payment-in-kind (PIK) bonds.

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

The J.P. Morgan Emerging Market Bond Index (EMBI) provides investors with access to a range of emerging-market bond indices, including emerging-market bonds denominated in foreign currencies (e.g. corporate bonds).

The Japanese yen (JPY) is the official currency of Japan.

Limited partnerships (LPs) are a form of partnership where one or more partners has only limited liability and no management authority. Private equity operations often exist in this form.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

The Markit iBoxx EUR Liquid High Yield Index consists of liquid euro sub-investment-grade-rated bonds, selected to provide a balanced representation of the Markit iBoxx EUR Core High Yield 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.

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

Multi asset determines investing in more than one asset class, thus creating a group or portfolio of assets with varying weights and types of classes. The diversification of an overall portfolio is thus increased, and risk (volatility) reduced.

A multiple is a ratio that is used to measure aspects of a company's well-being by setting various of the company's metrics against each other and thereby building indicative ratios.

National Central Banks (NCBs) are the central banks of the euro area, and the non-euro area central banks that decide to settle their currencies in TARGET2-Securities.

Net asset value (NAV) is the value of an organisation's assets minus the value of its liabilities.

Periphery countries are less developed than the core countries of a specific region. In the Eurozone, the euro periphery consists of the economically weaker countries such as Greece, Portugal, Italy, Spain and Ireland.

The pound sterling (GBP), or simply the pound, is the official currency of the United Kingdom and its territories.

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

Private equity is a direct or indirect investment by a financial investor in a substantial part of a company's equity. Usually the company invested in is not listed.

Pro-cyclical sectors are those likely to particularly benefit from an upturn in the economic cycle (i.e. stronger growth).

The Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector in a specific country or region.

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

On the secondary market, securities or assets are purchased from other investors, rather than from issuing companies themselves.

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

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

The United States Congress is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.

Valuation attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

A private-equity fund's "Vintage" generally refers to the year when the fund closes or starts investing.

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.

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

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.

PERFORMANCE / Overview

Performance in the past 12-month periods (in %)

	05/14 – 05/15	05/15 – 05/16	05/16 – 05/17	05/17 – 05/18	05/18 – 05/19
Asia credit	1.9%	3.2%	-12.8%	7.6%	8.5%
Dax	14.8%	-10.1%	22.9%	-0.1%	-7.0%
Emerging-market sovereigns	2.5%	4.5%	9.8%	-0.6%	7.5%
Emerging-markets credit	3.3%	2.2%	9.0%	0.2%	8.4%
Euro high-yield corporates	5.4%	0.6%	9.5%	1.5%	2.2%
Euro investment-grade corporates	4.3%	2.0%	2.8%	0.6%	3.1%
Euro securitized: covered bonds	4.7%	1.8%	0.2%	0.2%	2.6%
Euro Stoxx 50	10.1%	-14.2%	16.0%	-4.2%	-3.7%
FTSE 100	2.0%	-10.8%	20.7%	2.1%	-6.7%
German Bunds (10-year)	7.5%	4.4%	0.0%	0.8%	5.0%
ICE BofA Merrill Lynch US High Yield Index	1.8%	-0.9%	13.9%	2.3%	5.4%
Italy (10-year)	10.2%	6.6%	-2.5%	-2.9%	6.2%
J.P. Morgan Emerging Market Bond Index	0.5%	6.3%	8.9%	-3.7%	6.2%
Japanese government bonds (10-year)	2.5%	4.7%	-1.2%	0.4%	1.5%
Markit iBoxx EUR Liquid High Yield Index	3.6%	0.1%	7.4%	0.8%	2.2%
MSCI AC Asia ex Japan Index	8.0%	-19.5%	25.1%	14.7%	-13.2%
MSCI AC World Index	3.1%	-7.4%	15.2%	9.7%	-3.3%
MSCI Emerging Market Index	-2.3%	-19.6%	24.5%	11.5%	-10.9%
MSCI Japan Index	39.2%	-19.4%	12.5%	10.5%	-11.8%
MSCI World Index	3.7%	-5.9%	14.2%	9.5%	-2.2%
S&P 500	9.6%	-0.5%	15.0%	12.2%	1.7%
Stoxx Europe 600	16.2%	-13.1%	12.2%	-1.8%	-3.7%
Swiss Market Index	6.5%	-11.1%	9.7%	-6.2%	12.6%
U.S. high-yield corporates	2.0%	-0.8%	13.6%	2.3%	5.5%
U.S. investment-grade corporates	2.8%	3.3%	3.9%	0.1%	7.4%
U.S. municipal bonds	2.8%	-29.2%	16.2%	27.7%	-31.9%
U.S. securitized: mortgage-backed securities	3.3%	2.7%	1.2%	-0.3%	5.5%
U.S. Treasuries (10-year)	5.0%	4.4%	-0.4%	-2.4%	8.6%
U.S. Treasuries (2-year)	0.8%	0.7%	0.6%	-0.1%	3.5%
U.S. Treasuries (30-year)	9.7%	8.4%	-1.6%	0.1%	11.0%
UK Gilts (10-years)	7.8%	5.5%	5.2%	-0.4%	4.8%

Quelle: Bloomberg Finance L.P. as of 5/31/2019

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