

November 25, 2020

Marketing Material

## 2021 looks pretty good for equities

Earnings growth and "low-for-even-longer" interest rates imply a lower risk premium and higher valuations for equities.

- \_ Various risks that weighed on markets lost their bite at the end of 2020, emboldening investors.
- \_ Vaccines that should bring the pandemic under control and a persistent low-interest-rate environment are the basis for our optimistic view on equities.
- \_ Our preferred region is Asia, our preferred sector technology. We expect recent rallies in cyclical and value stocks to be short-lived.



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As we shape our equity-market forecasts for 2021, we see a world plagued by the worst pandemic in a century, which has upended everybody's lives as well as entire business sectors and weighed heavily on consumer and corporate spending alike. And yet stock markets have reached new highs, on the basis of record-high valuations. It sounds like the perfect combination for a market correction, and therefore for skepticism. Yet we are not pessimistic. Why? The arrival of effective Covid-19 vaccines looks set to allow a return to a more "normal life" by the end of 2021. That, in turn, should support an economic recovery that we expect governments and central banks to also be eagerly nurturing. We therefore forecast a 25-30% earnings-per-share (EPS) recovery for most markets and "low-for-even-longer" interest rates, with 10-year U.S. Treasury yields staying below or only slightly exceeding 1.0% by year-end 2021. Then a constellation of two factors, T(here) I(s) N(o) A(lternative) and F(ear) O(f) M(issing) O(ut), in alignment with rebounding economic activity, should support further market upside for equities. Our December 2021 targets are 3,800 for the S&P 500 and 14,000 for the Dax.

To get there, we believe investors will have to accept even lower equity risk premiums and higher price-to-earnings (PE) ratios

than previously assumed. But a number of factors suggest equities can make the ascent into even thinner air. The likely gridlock in the newly-elected U.S. Congress could become a "goldilocks" environment. Inflationary pressure should remain limited as we believe the probable Republican Senate majority will accept only downsized fiscal stimulus and will prevent a sweeping reversal of tax reforms. We believe global trade prospects, too, should benefit from the new political set-up in Washington. However, we expect markets outside the U.S. to continue trading at above-average valuation discounts to the U.S., mainly due to their lower relative weight of high-growth stocks. Nevertheless, we have mid-single-digit total-return expectations for European and Japanese equities for 2021.

We forecast double-digit returns for emerging-market equities and upgrade both Asia (excluding Japan) and emerging markets as a whole to overweight. Asia is our preferred region for 2021. China has successfully handled the Covid challenges without amassing significant new government debt, which bodes well for long-term growth prospects. It is now the second time (the first time was the Global Financial Crisis) that China has led the world economy out of the slump. Rebounding European and Japanese exports to China are the proof

of that now. We believe the geopolitical rise of China will become even more visible in the coming years. China remains on track to add technological leadership to its military- and economic-superpower position. We expect EPS levels for the MSCI AC Asia ex Japan Index to surpass pre-Covid levels already in 2021, well before the U.S. and Europe.

Making money by switching investment styles might be difficult in 2021. We expect several short-lived 'cyclical' and 'value' rallies as some institutional investors exit the herd of 'growth' investors and try out something supposedly new. However, we believe interest rates and economic growth prospects are likely to remain too low to make these rallies sustainable and we keep a modest preference for the 'growth' camp for the time being. Most value stocks are biased towards physical and financial balance-sheet assets. Growth stocks, on the other hand, remain beneficiaries of the global spread of digital technologies that are based on intangible assets. This sector, with many of its biggest members benefiting from positive network effects of their vast social platforms, has

proven even in 2020 that it can produce superior and growing free-cash-flow streams to shareholders. Therefore we stick to our overweight in the IT sector. In our view, the main operational risk for now remains more legal or governmental antitrust interventions. China has just recently taken its first measures against its own tech behemoths. It remains to be seen whether the new U.S. administration will follow suit or allow its own tech giants to grow further – partly in order to keep Chinese rivals at bay. Where real estate is concerned, working from home and the rising share of ecommerce in retail spending keeps us on the sidelines; we prefer an underweight in this sector.

We believe 2021 will see several new "green-deal" initiatives across the globe that should create thematic investment opportunities in climate technology in many sectors. We have therefore decided to upgrade utilities from underweight to neutral and focus on renewable energy within the sector. Our ESG team favors avoiding sectors with high environmental externalities, like oil, materials and airlines.

### CLOSE CORRELATION BETWEEN VALUATION MULTIPLES AND (INVERTED) REAL INTEREST RATES.

Plenty of fundamental factors speak for equities in 2021 but their valuation hinges more than ever on the level of interest rates.



\* Treasury inflation-protected securities

Sources: FactSet Research Systems Inc., DWS Investment GmbH as of 11/12/20

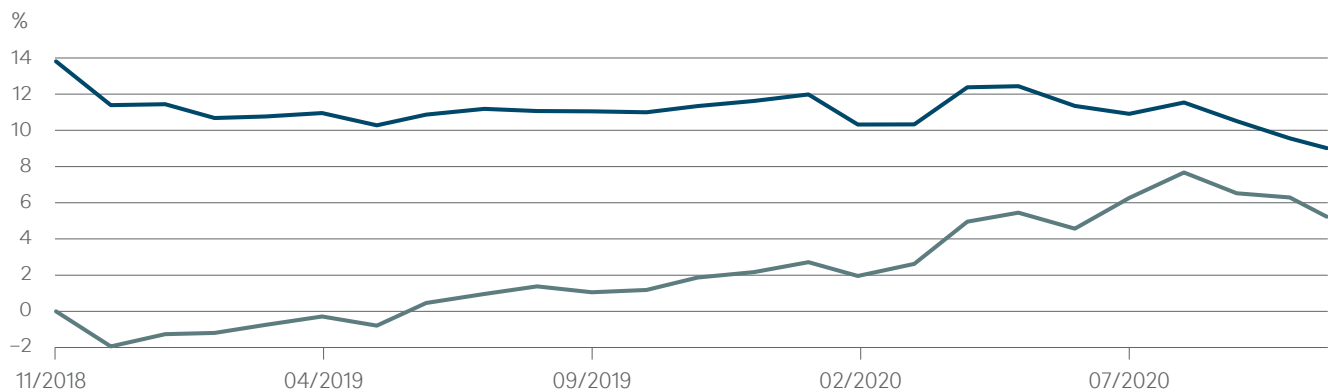
<sup>1</sup> Broad term for policies aimed at minimizing greenhouse-gas emissions as to minimize global warming and climate change overall

## Valuations overview

### UNITED STATES: NEUTRAL (NEUTRAL)\*

If the economic recovery in the U.S. continues without being thrown off course again by the pandemic, we expect earnings per share in 2021 to exceed their level in 2019. We continue to prefer growth stocks, and especially technology, to value stocks.

However, growth stocks are unlikely to repeat their marked 2020 outperformance, not least because we expect short rallies in cyclical stocks. Negative real interest rates are an important driver, especially for U.S. equities.



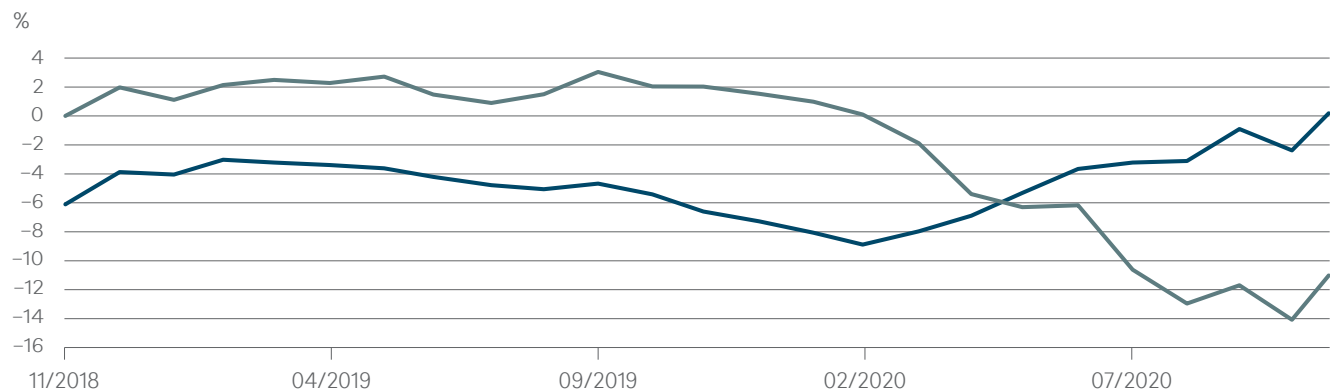
■ Relative valuation (P/E ratio): S&P 500 vs. MSCI AC World Index

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

### EUROPE: NEUTRAL (NEUTRAL)\*

European equities should continue to benefit from the recovery in Asia and the U.S. due to their higher weighting of cyclical stocks and high proportion of export-oriented producers. Should Europe's economy accelerate as well, European stocks might even lead the global market in 2021. However, at the normal-

ized lackluster pace of growth we expect in Europe, the lack of major growth stocks could once again hamper European stock markets. We have more confidence in individual sectors, such as the beneficiaries of various "green deals."



■ 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.

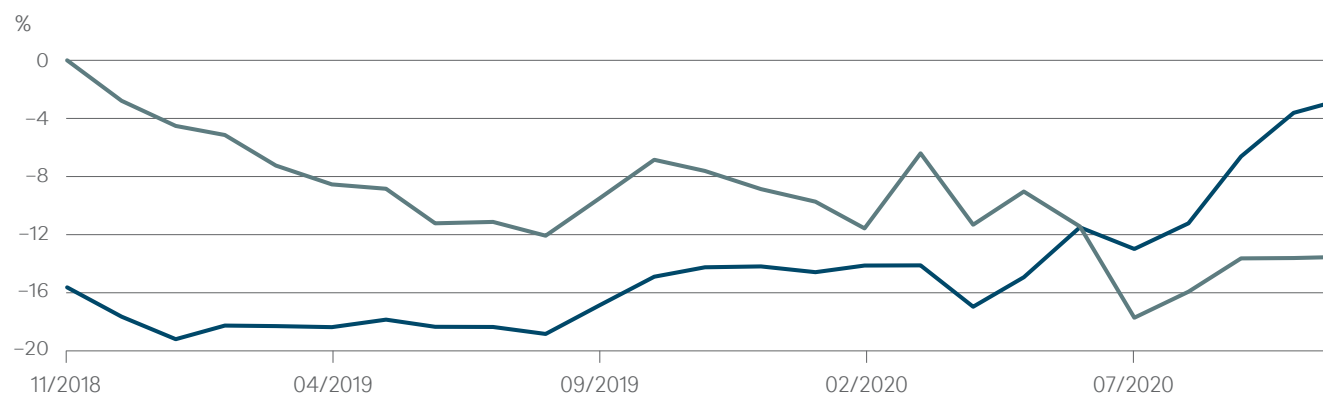
Sources: FactSet Research Systems Inc., DWS Investment GmbH; as of 11/20/20

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### JAPAN: NEUTRAL (NEUTRAL)\*

Japanese stocks are well positioned for an economic recovery due to their high export ratio. In addition, most companies have solid balance sheets, are continuing to improve their corporate governance and should continue to benefit from a reli-

able political environment (the new Premier Yoshihide Suga is business-friendly) and good management of the pandemic. Japan's proximity to China and the remaining mainland of Asia is also a particular advantage at the moment.



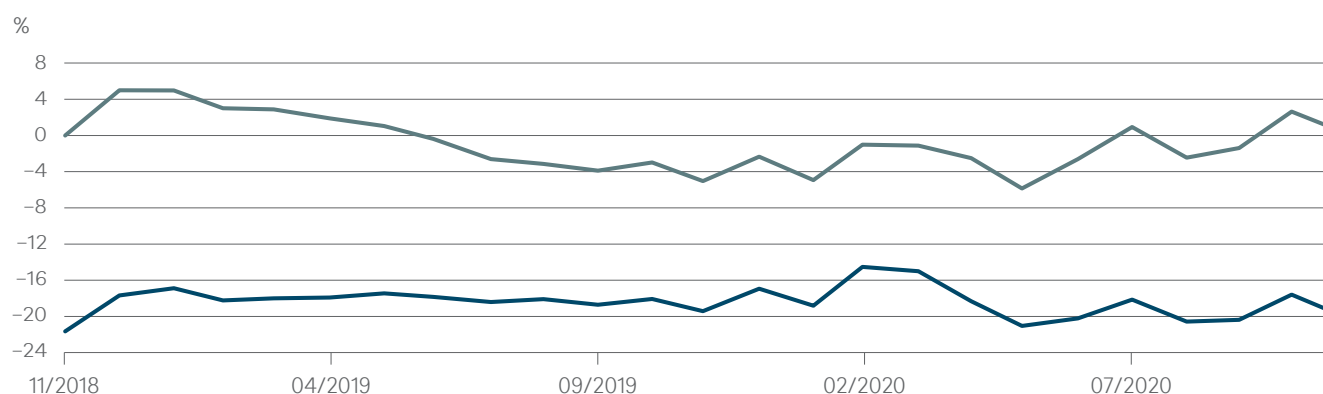
■ Relative valuation (P/E ratio): MSCI Japan Index vs. MSCI AC World Index

■ Relative performance: MSCI Japan Index (in yen) vs. MSCI AC World Index (in local currency)

### EMERGING MARKETS: NEUTRAL (OVERWEIGHT)\*

The emerging markets, and especially Asia, are our favorite pick for 2021. China, South Korea and Taiwan have on the whole come through the pandemic well without needing to ratchet up big increases in government debt. China's new 5-year plan is likely to

focus on efforts to become less dependent on imported technology and export markets. The region should also benefit from stabilized raw material prices, continuing low U.S. interest rates and a dollar that is unlikely to strengthen further.



■ 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.

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## GLOSSARY

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

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

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

**Cyclical** is something that moves with the cycle.

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

**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.

Investors increasingly take **environmental, social and governance (ESG)** criteria into account when analyzing companies in order to identify non-financial risks and opportunities.

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.

**Fiscal policy** describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

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.

**Growth stocks** are stocks from companies that are expected to grow significantly above market average for a certain period of time.

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

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

In economics, a **real** value is adjusted for inflation.

The **Republican Party (Republicans)**, also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

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

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

**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 **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.

The **United States Senate** is a legislative chamber consisting of 100 Senators, with each state being represented by two Senators. Senators are elected for six year, overlapping terms in their respective state.

**Value stocks** are stocks from companies that are trading at prices close to their book value and that are therefore cheaper than the market average on that metric.

**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 %)

	10/15 - 10/16	10/16 - 10/17	10/17 - 10/18	10/18 - 10/19	10/19 - 10/20
MSCI AC World Index	-0.1%	20.8%	-2.4%	10.3%	3.1%
MSCI Emerging Market Index	9.3%	26.5%	-12.5%	11.9%	8.3%
MSCI Japan Index	3.2%	17.8%	-3.6%	9.2%	0.3%
S&P 500	4.5%	23.6%	7.3%	14.3%	9.7%
Stoxx Europe 600	-6.2%	20.6%	-5.2%	14.0%	-11.4%

Past performance is not indicative of future returns. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 10/31/20

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