Surprisingly optimistic for 2021

As the year draws to a close, 2020's big risks start to look less bad, allowing investors to meet 2021 with optimism. We believe low interest rates will remain key.

"The pandemic is likely to restrict consumers and companies for some months to come. But we expect investors to look beyond these difficulties and focus on profit growth and continuing loose monetary policy."

Stefan Kreuzkamp
Chief Investment Officer and
Head of Investment Division

Would our annual outlook for 2021 have looked different if we had written it in mid-October? Yes, but only in part. Little would have changed in our economic forecasts but our asset-class outlook would have been different. What has taken place macro-economically has been very much in line with our forecasts. But the markets had big risks on their mind. Now those risks have eased, and with them the fear of a major correction. We believe the new optimism should continue to sustain markets in the New Year.

It is news of the first Covid-19 vaccine, the outcome of the U.S. elections and quarterly economic and corporate figures that have changed the mood. The biggest market reaction was triggered by the news from Mainz, Germany, on the successful vaccine trial – and with good reason. Progress in the handling of Covid-19 was the basis of our 2021 outlook but confirmation that a vaccine is effective and will soon be available is transformative. For the first time, consumers and companies can see light at the end of the tunnel, and we expect the pandemic to be largely under control by the end of 2021. The U.S. elections, meanwhile, went smoothly overall and delivered a result that investors have been quick to welcome. America's trading partners are hoping for a more predictable trade policy under Joe Biden. America's companies, on the other hand, appear relieved that the Senate is likely to remain Republican and probably will not approve any major tax increases. A further boost for markets was that both macroeconomic data and corporate results in the third quarter were surprisingly positive. It has become apparent that many economies revived fairly quickly after the spring lockdown.

Other factors, too, have helped foment a far happier mood. The European Union (EU) is moving toward a 750 billion euro coronavirus rescue package, and the world's major central banks have committed themselves to not responding immediately to any rise in inflation. Last but not least, the chance of more constructive negotiations between the EU and the UK has probably increased, now that the domestic pressure on Prime Minister Boris Johnson has become more intense and his controversial chief advisor, Dominic Cummings, has departed.

What this means for individual asset classes can only be understood if we first consider the overall picture from an investor's perspective: It is only thanks to China that the global economy should be able to return to its 2019 output level in 2021. Nevertheless, the world's stock markets[1] are trading at record highs. How can this be explained? In our opinion, this is due to the expected strong recovery which, however, carries little risk of overheating and inflation as capacity remains very underutilized. The recession which has long been feared now seems off the table for some time – because it has already occurred in 2020. And central banks have made policy even looser while strengthening their commitment to avoiding monetary

[1] On November 16, the MSCI AC World Index, for example, was trading approx. five percent above its historic high in February 2020. Source: Bloomberg Finance L.P.

tightening. This leads us to expect low interest rates even beyond our forecast horizon.

Earnings growth and a low interest-rate environment form the basis for our optimistic view on equities and allow us to reduce the risk premium and increase our target price-to-earnings ratio and. This results in further upside potential, in the higher single-digit percentage range, and for Asia even in the double-digit range. Asia has managed the pandemic significantly better, even avoiding sharply increasing debt. It also has leading companies in our favored technology and Internet sector. Technology is even more prevalent in the U.S. market, which we still like despite its above-average valuation. Europe's markets may look more favorably valued at first glance, but we think their cyclical, export-oriented profile won't inspire investors for long. We believe growth stocks are likely to remain structurally more attractive in the low-growth environment expected from 2022 onwards. We find sectors with a positive carbon balance, which are often identified by our ESG-led investment approach anyway, equally attractive. We believe they should receive a further boost from the focus of European – and we think soon American – policymakers on a "green deal[2]."

There has been little change in bonds, with riskier segments also benefiting from the low-interest-rate environment. Some corporate bond indices have not yet returned to their pre-crisis levels since the market panic early in 2020. We expect significantly lower issuance in 2021, with demand remaining more or less unchanged and, in the Eurozone, still supported by the European Central Bank. In emerging markets, too, we continue to see good opportunities in selected regions and sectors, also against the background of stabilized raw-material prices and a generally sideways-trending dollar. We see U.S. 10-year government-bond yields trading at around one percent, and we also expect German government bonds to tend to move sideways, with only a slight upward trend.

We see further upside potential for gold, not least due to the ongoing fiscal and monetary support, rising to a price of up to $2,100 an ounce. In the case of oil, we expect less upside in price than the economic recovery might suggest. Saudi Arabia and Russia in particular are in a position to expand their production immediately at any time.

Real-estate markets have diverged significantly in 2020. Housing has done well but retail, hotel and leisure has suffered. We remain cautious on the latter, and prefer industrial and residential real estate and select office properties.

An optimistic capital-market outlook may come as a surprise in the middle of a pandemic. And, of course, there is no end of risks – among them ones that are predictable now. Accidents around Brexit or in the wake of the U.S. elections as well as setbacks in the fight against the pandemic cannot be ruled out. Neither can further natural disasters nor geopolitical conflicts. But we expect the markets to continue to be driven primarily by profit growth and low interest rates. It's for this reason that we are quite optimistic for 2021.

[2] Broad term for policies aimed at minimizing greenhouse-gas emissions as to minimize global warming and climate change overall

GLOSSARY

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

A correction is a decline in stock market prices.

The European Central Bank (ECB) is the central bank for the Eurozone.

The European Union (EU) is a political and economic union of 28 member states located primarily in Europe.

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

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.

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

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

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

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

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

The 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.

PERFORMANCE / Overview

Performance in the past 12-month periods (%)

	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%

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

Important Information

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