DWS

March 19, 2021

Marketing Material

An unusual upswing is gaining pace

The global economy is expected to achieve remarkably high growth in 2021. This is a good basis for the capital markets, but it creates risks and may require reallocations.

- We have revised growth for the US and China up compared to our November forecasts.
- The current economic euphoria is driving U.S. bond yields higher, causing nervousness in the market.
- On a 12-month horizon, we do not see any sustainable upward trend in real yields, which means that risk assets still have potential.

Investors' dilemma can currently be summarized as follows: On the one hand, the economy is at the beginning of an upswing that could this year produce one of the highest growth rates for the global economy in many decades. Hence we are seeing signs of early-cycle euphoria. On the other hand, the capital markets are displaying characteristics that one would expect in the late stages of a cycle: high valuations, a large number of IPOs, a boom in exotic forms of investment[1], and a certain degree of complacency on the part of investors. This means many investors don't want to get off the dance floor – just so long as the music keeps playing.

The unusual mix of early and late cycle and investors' consequent dilemmas reflect the pandemic, which is also upsetting other patterns. For example, a large part of the momentum in financial markets is based solely on catch-up effects in an economy that previously suffered quarters of partial paralysis. You might say the dancers have only just been able to get back on the dance floor. There is therefore great uncertainty among economists about the sustainability of the current momentum. Gross-domestic-product (GDP) growth forecasts for the U.S. in 2022 range from just 1.8% to 6.1%, an unusually wide margin.[2]

Another pattern that could be broken is the common market logic of "buy the rumor, sell the fact." That adage would suggest that if the pandemic is largely brought under control later this year, markets may have peaked. After all, the economy should be able to stand almost completely on its own feet again and there should be no more need for aid packages that are music to investors' ears. But in our view, the two largest stimulus packages, the U.S. and the European, will not begin to have an impact until later in the year. This, in turn, brings up another source of doubt, reinforcing the concerns of some market participants that some economies could overheat sooner or later. Especially since the central banks have so far countered any impression that they want to dampen the party just when it is getting swinging. That government bond yields are being pulled up in this environment is unsurprising; the speed at which they are doing so is.

1 Such as Special Purpose Acquisition Verhicles (SPAC) or crypto currencies
2 Source: Bloomberg Finance L.P. as of 3/10/21

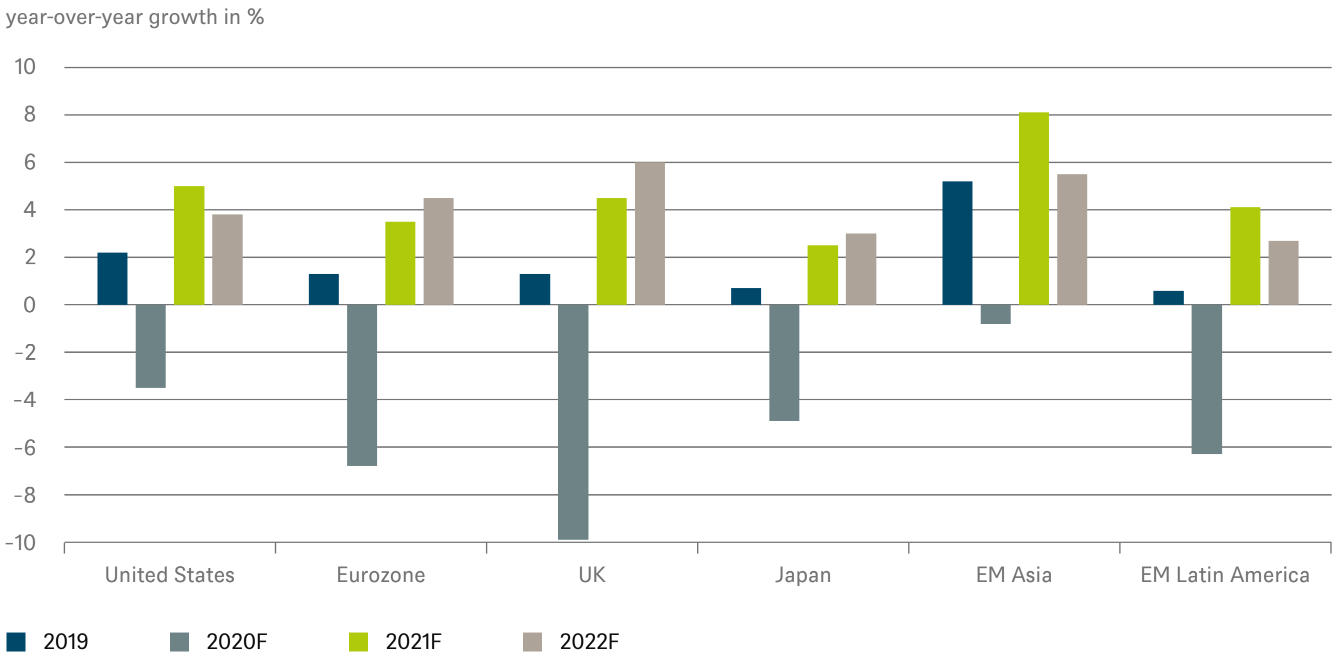
We believe speed is also apparent in another area: sustainability. And here, too, central banks are playing a key role. DWS is also moving forward in leaps and bounds on this topic. This year, for example, we will review government and corporate bonds in terms of the ESG profile of their respective home country. In addition, we are planning to make ESG an integral part of the investment process across all asset classes this year. Besides meeting regulatory requirements and customer demands in this area, we believe a consistent focus on ESG has the potential to be positive for returns and, above all, the risk profile of individual investments.

Global economy likely to grow at record pace – yields are taking notice

The basis of our macroeconomic forecasts is the assumption that the pandemic will be largely brought under control in the course of the year and that no lockdowns on a similar scale to the winter now ending will be necessary next winter. We have upgraded somewhat our forecasts for global growth since our November 2020 outlook. We now expect 5.3% growth in 2021, instead of 5.2%, and 5.5% in 2022, instead of 5.2%. In particular, we have increased the 2021 forecasts for China (to 8.7% from 8.2%) and the United States (to 5.0% from 4.0%). We believe the two largest economies should therefore act as still more of a locomotive for the global economy and, in view of the latest figures on the economy and the pandemic, it cannot be ruled out that there may be a need for further upward adjustments. All the more so now that the stimulus package worth the full 1.9 trillion U.S. dollars has been passed in Washington. Because of its design – a large part is accounted for by direct checks to households and an increase in unemployment assistance – the U.S. package will in our view have a much faster impact than the European one. Of the 750 billion euros from the EU bailout fund, a maximum of one-third is likely to be disbursed to member countries this year. And further months are likely to pass before it is spent, so that the stimulus may approach 0.5% of GDP in the best case, compared with over 5% in the U.S., again in the best case.

GLOBAL GROWTH FORECASTS

We expect the U.S. and Asia to show a stronger recovery than Europe, Japan and Latin America



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 2/18/21; F refers to DWS Investment GmbH forecasts

The consequently increased transatlantic growth differential is certainly the most important change from our forecasts published in November, especially because of the impact on financial markets. Much has favored the U.S. so far this year. The Georgia by-elections provided political clarity and increased the government's ability to act. The fact that the Democrats were also able to secure a working majority in the Senate helped them to pass the stimulus package quickly. It continued with a relatively good reporting season for listed companies and the vaccination campaign, which is making rapid progress. In Europe, meanwhile, vaccinations are lagging. Only the United Kingdom is doing well, but it has otherwise been noticeably affected by Brexit and, like continental Europe, by extended lockdowns.

Inflation has come back into focus sooner than expected as a result of the combination of the growth upswing, stimulus packages and expansive central banks – and most recently also, sharply rising oil prices. In our view the inflation rate could reach or even exceed three percent in the U.S. in the second quarter and also in Germany towards the end of the year. However, we see this as only a temporary phenomenon, as many of the drivers of the inflationary uptick are pandemic-related one-off effects. The massive underutilization of productive capacity and labor in 2020 depressed prices last year. And normalization of commodity prices alone is providing a significant base effect. Together with pent-up demand for many goods, especially in services, this is likely to increase inflationary pressure this year, before it then subsides.

We do not expect larger, sustainable interest-rate increases

Central banks have repeatedly declared their willingness to look through the 2021 inflation spikes just described and leave both their key interest rates and bond purchases untouched. The market, however, is not buying the U.S. Federal Reserve's (the Fed's) story and has priced in one rate hike for early 2023 and two more by the end of 2023[3]. Although the Fed has given itself a very flexible decision framework, we expect it will, at the least, face major communication challenges in the current year. Questions will mount about when it is going to respond to the likely rise in inflation, 10-year Treasury bond yields, mortgage rates and the dollar. Or, alternatively, whether it would take a sharp correction in the stock market or corporate bonds to prompt it to intervene. The Fed will have to strike a balance, finding reasons to remain expansionary without transmitting a pessimistic economic outlook.

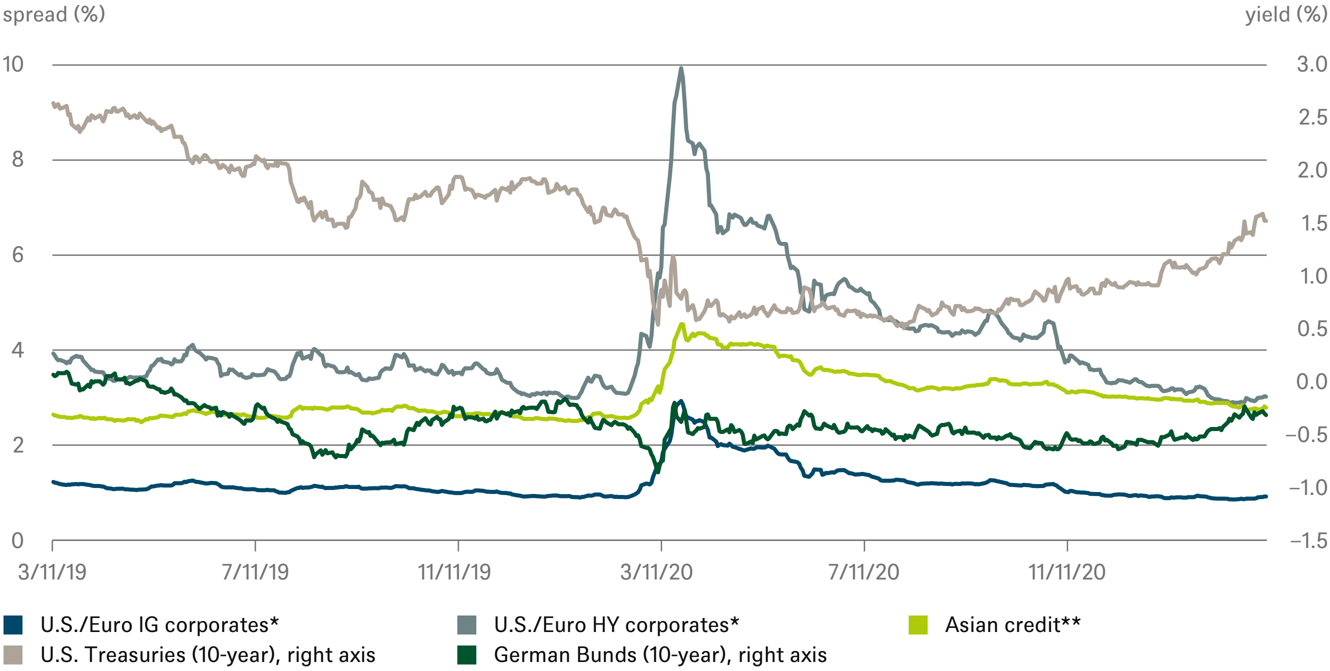
Boredom is therefore unlikely in the U.S. bond market this year. In the case of 10-year Treasury yields, the two-percent mark could well still be breached, which could cause corresponding nervousness in risk assets. However, over a 12-month perspective, our strategic planning horizon, we expect the bond market to calm down again and see 10-year yields remaining close to 1.5%. In Europe, the European Central Bank (ECB) appears to have a much more relaxed year ahead. It seems likely to be able to operate largely on autopilot, at least as long as there is no surprise slump in the economy or markets. We see Bund yields at around current levels in twelve months' time, following the upward movement in U.S. Treasury yields only to a small extent. Over the next one to two years, and this is the key assumption in our forecasts, we expect the low-interest-rate environment to continue. This also means that we expect negative real yields in the ten-year range in both the U.S. and Germany over the next two years.

Our focus in these regions therefore remains on corporate bonds. Although they are not immune to the current rise in yields, we expect fewer non-performing loans in 2021 than originally thought and less issuance activity, which should take the pressure off prices. We also remain positive on emerging markets from a strategic perspective. In Asia, in particular, countries have mastered the pandemic relatively well without unduly straining their public finances. As an export-oriented region, Asia is also benefiting from the global economic recovery. In the short term, the strengthening dollar and higher U.S. yields are creating some headwinds. We do not see the dollar's upward trend that started at the beginning of the year[4] coming to an end yet; against the euro, we expect a rate of 1.15 dollars per euro. A stronger dollar and a tendency towards slightly rising real interest rates do not favor gold, in which we see little upside potential over the next 12 months.

3 Based on implied rates from Fed Fund Futures on January 5th.
4 Measured against a basket of currencies, see for example the Dollar Index.

YIELD DEVELOPMENT FOR MAJOR BONDS

While U.S. and euro corporate spreads are trading below their pre-crisis levels, Asian credit is not there yet.



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 3/10/21

* Average of U.S. and Euro option-adjusted spreads (OAS); U.S. investment grade (IG): Barclays U.S. Aggregate Bond Index; Euro IG: iBoxx Euro Corporate Index; U.S. high yield (HY): Bloomberg USD High-Yield Corporate Bond Index; EUR HY: Bloomberg EUR High-Yield Corporate Bond Index.

** J.P. Morgan Asia Credit Index (JACI)

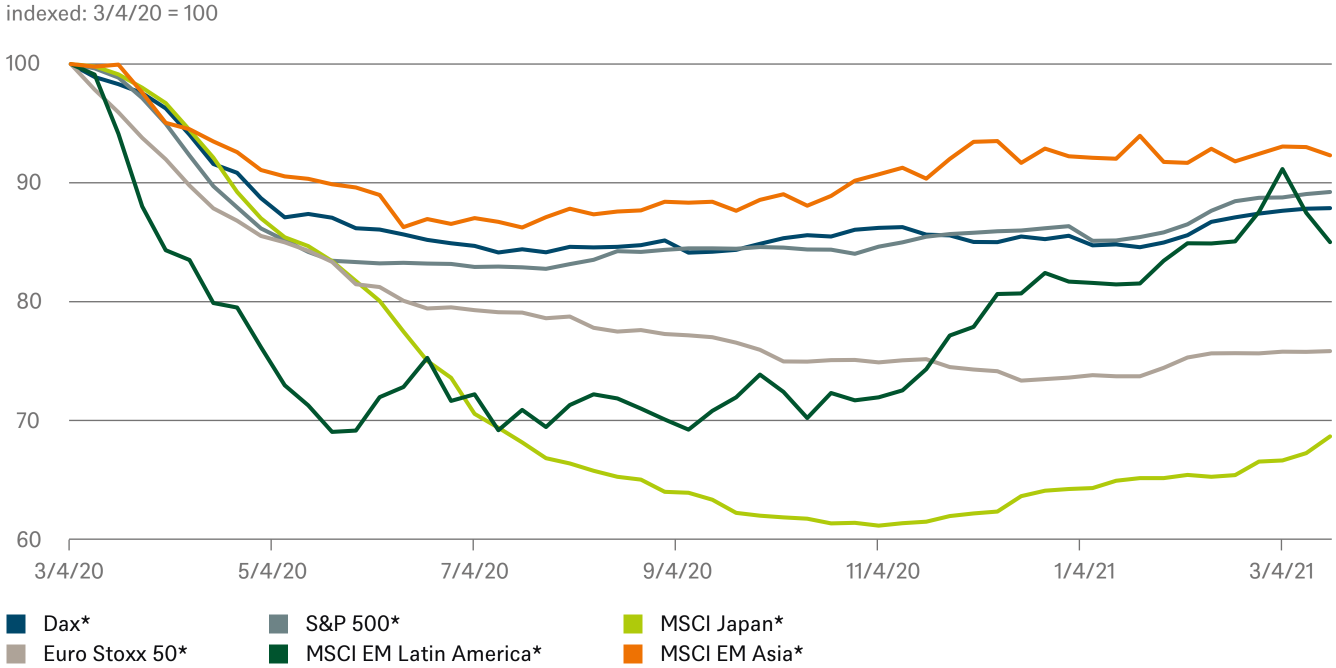
We believe equity markets will be driven by structural winners and cyclical beneficiaries

Our view is that equities still have upside potential, thanks to likely higher earnings. We favor Asia and European small caps. Our optimism is based on the global vaccination campaign, which could transform an uncontrolled acute disease into a controllable chronic one. As a result, consumers should be able to emerge from the dark Covid tunnel in the coming months. The reallocation of consumers' excess savings and pent-up demand, and additional government stimulus, should provide further upside for cyclical stocks in particular. We are raising our 12-month targets due to the prospect of higher earnings across the board. The new targets for the S&P 500 and the Dax are 4,100 and 14,800, respectively, leaving moderate upside potential at index level. Broad investor confidence makes us somewhat cautious, as do the valuations already attained. But for 2021, we expect the music to keep playing, with the rotation into cyclical stocks continuing.

The equity rally that has been underway since May was vindicated at the turn of the year, with earnings being revised upwards for the first time (see chart). Higher commodity prices and lower bank provisions were also major drivers. Tech companies were doing well anyway, which helped U.S. stock markets in particular. This trend will continue, in our view, and it justifies a whopping price-to-earnings (P/E) ratio of 22 on estimated 2022 earnings for now, assuming that real yields remain negative. The flip side, however, is that the current yield increases are hitting growth stocks the hardest, and among them, again, those that are not yet profitable. However, due to the S&P 500's strong focus on global technology and other growth stocks, the index is not representative of the U.S. economy. As a result, we expect little positive impact on S&P earnings from the U.S. stimulus program, which is more likely to support smaller companies and households.

DEVELOPMENT OF CONSENSUS EARNINGS FORECASTS FOR 2021

Analysts' earnings forecasts for 2021 are still way behind where they have been 12 months ago. Europe and Japan are trailing most.



Source: Refinitiv as of 3/10/21
* All indices (Dax, S&P 500, MSCI Japan, Euro Stoxx 50, MSCI EM Latin America and MSCI EM Asia) can be found in the glossary

In this environment, a twofold (also called "barbell") strategy should prove particularly robust: one pillar consisting of structural winners from the technology sector and the other consisting of cyclical companies that should benefit from the economic upturn. European small and midcaps could be a suitable vehicle for the latter. Cyclical commodity and energy stocks, which are currently valued relatively favorably, are also benefiting from the current environment. But those who are serious about their ESG orientation might want to choose very carefully here.

Other examples of attractive sectors with high cyclical sensitivity include automotive and (Asian) semiconductors. A more constructive view on financials has long been hindered by low interest rates. But since November they have outperformed the market thanks to rising yields. Industrials have already discounted the upswing, in our view. In previous cycles, German stocks would have been an obvious consideration, due to their cyclical bias. But this time, Japanese stocks appear to be a better option due to the more diversified composition of their index and higher share of exports to emerging Asia. It is indeed emerging Asia that remains our favored region due to the combination of earnings growth of 30% already in the current year, reasonable valuations, proximity to China and increased buying by domestic investors.

Real estate remains an attractive alternative

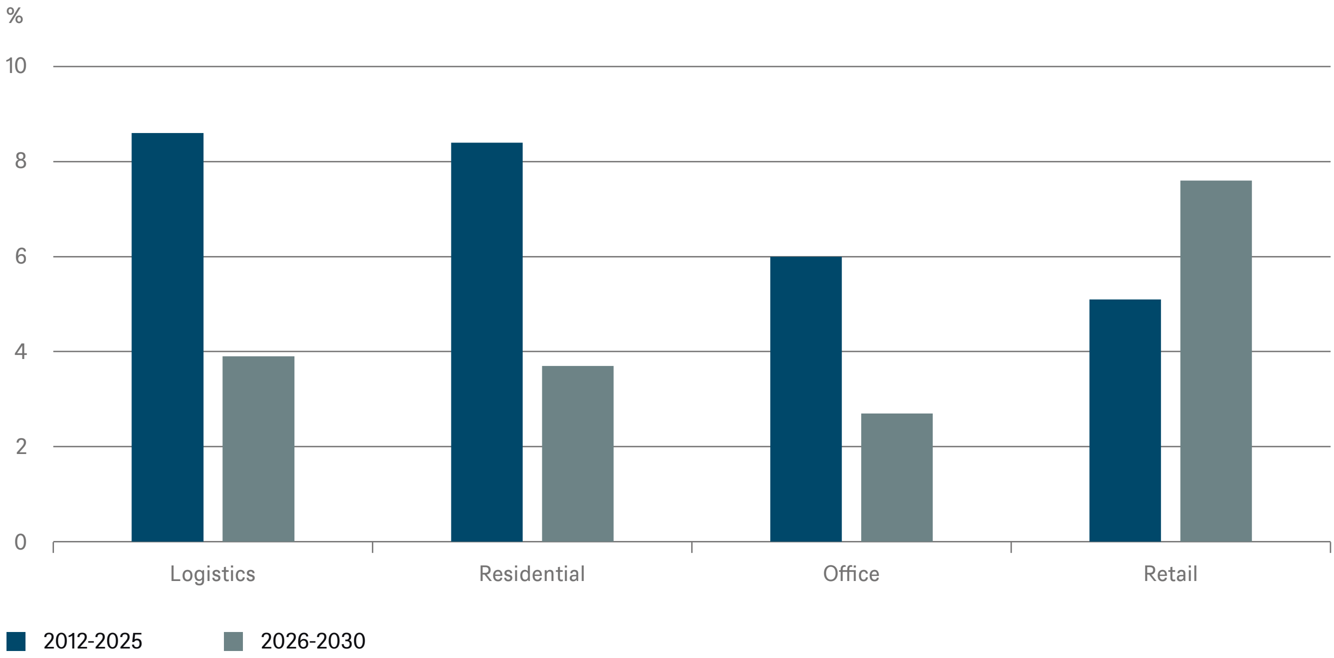
We also believe that suitable investments can be found in alternative asset classes both for the medium-term continuation of the low-interest-rate environment that we expect and for a temporary rise in inflation. For example, a large number of privately run infrastructure projects contain inflation-compensating price mechanisms that should also benefit from a renewed increase in mobility.

As an alternative to low-interest government bonds, some investors have been relying on real estate for a long time, which has had a corresponding impact on prices. Due to the pandemic, some fundamental drivers in this otherwise rather sluggish market have changed almost overnight, so that many new opportunities but also risks have arisen. We differentiate between coronavirus effects that are likely to last and those that are only temporary. For example, we would consider the challenges that the leisure and gastronomy sectors continue to face as only temporary. The lower demand for office space meanwhile should be longer lasting, since we don't expect that working from home will be scaled back to pre-crisis levels any time soon. We also think that the extent of business travel and overnight stays will remain below its pre-crisis level for a long time to come. On the other hand, we believe the share of online consumer spending is likely to remain at a higher level in the long term, even if people will initially pour into pedestrian zones at the end of lockdowns. Residential accommodation, on the other hand, has gained in importance again due to Covid.

These considerations also shape our sector preferences. For the most part, we are still avoiding classic office and retail properties. Our focus is on residential and logistics properties, especially in structurally attractive cities such as London, Amsterdam, Paris, Warsaw, Berlin and Helsinki. In apartments, we consider suburban areas to be interesting, while for logistics locations, inner-city areas continue to be among the most sought-after. Even though real-estate prices appear quite high in some places, we do not see them necessarily as bubbly. In Europe, where construction activity is too low, excess demand for property, especially in the major cities, favors high prices. So does the low-interest-rate environment.

YIELD EXPECTATIONS FOR VARIOUS EUROPEAN REAL-ESTATE SECTORS

Logistics and residential have been the major beneficiaries of the pandemic. For office space we expect longer-lasting lower yields.



Source: DWS Investment GmbH as of 12/2020

GLOSSARY

The Barclays U.S. Aggregate Bond Index tracks the performance of U.S. investment-grade bonds.

The Barclays U.S. High Yield Index captures the performance of U.S. high-yield debt securities.

The Bloomberg EUR High-Yield Corporate Bond Index is a market-value-weighted index engineered to measure publicly issued non-investment grade EUR fixed-rate, taxable and corporate bonds

The Bloomberg USD High-Yield Corporate Bond Index is a market-value-weighted index engineered to measure publicly issued non-investment grade USD fixed-rate, taxable and corporate bonds. Emerging market debt is excluded

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.

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.

The Democratic Party (Democrats) is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

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

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 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.

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

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

The iBoxx Euro Corporate Index includes euro-denominated corporate bonds issued by investment-grade-rated entities.

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

Initial public offering (IPO) is a type of public offering in which shares of stock in a company usually are sold to institutional investors that may in turn sell them to the general public, on a securities exchange, for the first time.

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

The J.P. Morgan Asia Credit Index (JACI Index) provides investors the opportunity to track total return performance of the Asia fixed-rate dollar bond market. The index is a market cap-weighted index comprising sovereign, quasi-sovereign and corporate bonds and it is partitioned by country, sector and credit rating.

The MSCI Emerging Markets (EM) Latin America Index captures large- and mid-cap representation across five emerging-market countries in Latin America.

The MSCI Emerging Markets Asia Index captures large and mid cap representation across nine Emerging Markets countries.

GLOSSARY

The MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

The option-adjusted spread ("OAS") is a commonly used measure for fixed-income securities with embedded options (call, put or sink). It makes the yield of such instruments comparable to similar securities without such embedded options. Typically, the OAS for credit sensitive instruments is quoted vis-à-vis the respective Swap spread curve. Technically, option pricing methods are used to evaluate the instruments with embedded options.

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

The real interest rate is the nominal interest rate adjusted for inflation as measured by the GDP deflator.

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

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.

Important Information

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