CIO View
Americas CIO View

November 19, 2024
Marketing material

DWS

Valuation under Trump: Optimism, scenarios, segmentation, flexible forecasts

David Bianco
Americas Chief Investment Officer

IN A NUTSHELL

– Valuation modeling under Trump: Intrinsic valuation methods are still relevant
– Intrinsic valuation drivers: EPS, cost of capital, economic profit growth premiums
– Valuing Great Eight: Exceptional EPS growth for longer, advantaged capital cost
– Valuing the S&P 492: Normal EPS growth after the Trump bump in 2025
– We think it's better to differentiate by sectors than S&P 492 vs. Great Eight

Valuation modeling under Trump: Intrinsic valuation methods are still relevant

Upon Trump's win and the Republican sweep, we raised our S&P earnings per share (EPS) estimates for 2025 to $275 from $270 on deregulation and expect 2026 S&P EPS to slightly exceed $300. This note provides our updated S&P EPS models that detail our earnings estimates by sectors and industries. We expect a little over 20% y/y EPS growth in 2025 from the Great Eight digital companies (AAPL, AMZN, GOOG/GOOGL, META, MSFT, NFLX, NVDA, TSLA) of the S&P 500 and near 10% from the rest in 2025; assuming the hits and risks from tariffs are offset by the benefits and confidence of lower corporate taxes. While 2024 isn't complete, earnings results year-to-date (YTD) vs. our estimates suggest an acceleration in S&P EPS growth from about 10% this year to 10-15% next year with growth decelerating from over 30% at the Great Eight, but accelerating at the rest from about 4% this year.

Consistent with DWS macro forecasts, our 2025 S&P EPS estimates incorporate 2.0% US gross domestic product (GDP) growth and 2.4% inflation, which will assist earnings growth, but also West Texas Intermediate (WTI) oil falling to $65/bbl and the euro falling to $1.02 at 2025 end, which will weigh on S&P EPS growth. Global GDP is expected to be decent, with some acceleration in Europe to 1%, 1.2% in Japan, but China decelerates to 4.2% given likelihood of tariffs and its internal challenges.

Intrinsic valuation drivers: EPS, cost of capital, economic profit growth premiums

Our intrinsic valuation framework rests on three inputs, which we think valid for any equity.
1) We estimate normalized earnings by sector, considering the macroeconomic and sector specific business cycle and we also consider the accounting quality of the non-GAAP (Generally accepted accounting principles) EPS.
2) We estimate the cost of capital by sector, we observe and forecast 10-year Treasury yields and particularly 10-year Treasury Inflation-Protected Securities (TIPS) yields to estimate the long-term real risk-free interest rate and then we add an equity risk premium to account for the uncertainty of equity returns.
3) We determine whether the anchor or steady-state valuation – determined by normalized EPS capitalized at the real cost of equity – warrants a premium (or discount) for long-term economic profit growth (or fading). If a sector can generate long-term EPS growth over its nominal cost of capital less its dividend yield, it typically suggests rising economic profits.
The ongoing shifting sector composition of the S&P 500 from value to growth sectors, requires considering a significant growth premium for the S&P 500 in aggregate today. In the past, it was unusual for the S&P 500 in aggregate to sustain a significant premium price-to-earnings (PE) vs. its steady-state PE applied to non-GAAP EPS. It's because of issues such as this, that we have

This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients. Source: DWS Investment GmbH.

found it very helpful to model the earnings and the valuation of the S&P 500 using a middle-up approach or sector-by-sector approach and not just top-down. Our valuation framework has its top-down model integrated with our sector/industry valuation models.

Valuing Great Eight: Exceptional EPS growth for longer, advantaged capital cost

As said, we expect a bit over 20% EPS growth in aggregate from the Great Eight in 2025 and probably 15% in 2026 and perhaps 10-15% for the rest of the decade for most. These companies have strong balance sheets and Free Cash Flow (FCF) and most have $1Trillion+ market caps. Our S&P 500 targets and supporting intrinsic value estimates assume a 5.25% real cost of equity. Thus, most of the Great Eight should be near 5.0% real CoE or 7.5% nominal, in our view. This real CoE and long-term EPS growth outlook for the Great Eight, generally supports 25-30 PEs on 2025 EPS today or 25-50% growth premiums. Our models assign growth premiums by industry, mindful of certain companies dominating. While differing across industries, we think our growth premium estimates are generous for all, but some still trade at higher valuations and some less. Thus, opportunities for selection exist even within this this advantaged group of stocks that have been winning and winning for so long.

Valuing the S&P 492: Normal EPS growth after the Trump bump in 2025

After likely near 10% EPS growth in 2025, we think S&P 492 EPS growth slows to 5% to 8% for the rest of the decade or until next recession. This plus dividend yields of near 1.5%, should deliver upon an 8% nominal or 5.5% real CoE with an unchanged PE. The unchanged or fair sustainable PE should be about 18 or 1/5.5%. Thus, unless one sees EPS growth differently, we think both the Great Eight and S&P 492 are fairly valued relative to each other and both are at full fair values inclusive of optimistic outlooks.

We think it’s better to differentiate by sectors than S&P 492 vs. Great Eight

Our sector strategy is overweight Health Care, Financials, Capital Goods and Utilities. Underweight conventional Retailers, Auto, Semiconductors, Materials, and Real Estate Investment Trusts (REITs). We added selectively to Capital Goods and parts of Energy that are combustion plays (fossil fuel users) and some Transports, moving from Airlines to Airfreight & Logistics upon expected inventory building before tariffs.

This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients. Source: DWS Investment GmbH.

Glossary

In business administration, the cost of capital is the cost incurred by a company in using equity capital for investments or in obtaining debt capital for them.

Cost of equity (CoE) is the return (often expressed as a rate of return) a firm theoretically pays to its equity investors, to compensate for the risk they undertake by investing their capital.

The dividend yield is the dividend that a company pays out each year divided by its share price.

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.

Equity risk premium is an excess return earned by an investor when they invest in the stock markt over a risk-free rate. This return compensates investors for taking on the higher risk of equity investing.

Free Cash Flow (FCF) is a measure of financial performance calculated as operating cash flow minus capital expenditures. It shows how much cash a company is able to generate after deducting the money required to maintain or expand its asset base.

Generally accepted accounting principles, or GAAP, are a set of rules that encompass the details, complexities, and legalities of business and corporate accounting.

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.

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

The intrinsic value is the one that comes closest to the value that an objective fundamental analysis would ascribe to an asset.

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

A Real Estate Investment Trust (REIT) is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

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

Treasury Inflation-Protected Securities (TIPS) are a form of U.S. Treasury bonds designed to protect investors against inflation. These bonds are indexed to inflation and pay investors a fixed interest rate as the bond's par value adjusts with the inflation rate.

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

This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients. Source: DWS Investment GmbH.

Important information – EMEA, APAC & LATAM

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

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

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

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

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

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

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

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

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

For institutional / professional investors in Taiwan:
This document is distributed to professional investors only and not others. Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

© 2024 DWS Investment GmbH

Issued in the UK by DWS Investments UK Limited which is authorised and regulated in the UK by the Financial Conduct Authority.
© 2024 DWS Investments UK Limited

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited. The content of this document has not been reviewed by the Securities and Futures Commission.
© 2024 DWS Investments Hong Kong Limited

In Singapore, this document is issued by DWS Investments Singapore Limited. The content of this document has not been reviewed by the Monetary Authority of Singapore.
© 2024 DWS Investments Singapore Limited

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640). The content of this document has not been reviewed by the Australian Securities and Investments Commission.
© 2024 DWS Investments Australia Limited

as of 11/19/24; 096935_18 (11/2024)

Important information – North America

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

Diversification neither assures a profit nor guarantees against loss. Index returns do not reflect fees or expenses, and it is not possible to invest directly in an index.

DWS does not intend to promote a particular outcome to the U.S. election due to take place in November 2024. Readers should, of course, vote in the election as they personally see fit.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by DWS, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction or the basis for any contract to purchase or sell any security, or other instrument, or for DWS to enter into or arrange any type of transaction as a consequence of any information contained herein and should not be treated as giving investment advice. DWS, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for

the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Investments with DWS are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

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

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

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of DWS. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject DWS to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

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

For Investors in Canada: No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein and any representation to the contrary is an offence. This document is intended for discussion purposes only and does not create any legally binding obligations on the part of DWS Group. Without limitation, this document does not constitute an offer, an invitation to offer or a recommendation to enter into any transaction. When making an investment decision, you should rely solely on the final documentation relating to the transaction you are considering, and not the information contained herein. DWS Group is not acting as your financial adviser or in any other fiduciary capacity with respect to any transaction presented to you. Any transaction(s) or products(s) mentioned herein may not be appropriate for all investors and before entering into any transaction you should take steps to ensure that you fully understand such transaction(s) and have made an independent assessment of the appropriateness of the transaction(s) in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also consider seeking advice from your own advisers in making this assessment. If you decide to enter into a transaction with DWS Group you do so in reliance on your own judgment. The information contained in this document is based on material we believe to be reliable; however, we do not represent that it is accurate, current, complete, or error free. Assumptions, estimates and opinions contained in this document constitute our judgment as of the date of the document and are subject to change without notice. Any projections are based on a number of assumptions as to market conditions and there can be no guarantee that any projected results will be achieved. Past performance is not a guarantee of future results. The distribution of this document and availability of these products and services in certain jurisdictions may be restricted by law. You may not distribute this document, in whole or in part, without our express written permission.

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

© 2024 DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany.
All rights reserved.

as of 11/19/24; 103760_1 (11/2024)