Looking forward to a boring year

After a rollercoaster 2020, chances for a more "normal" 2021 are good. Economic recovery and central-bank support can serve as a safety net.

- Thanks to good vaccine news, economic recovery seems probable in 2021.
- With central banks still offering plenty of support this results in a scenario much appreciated by investors.
- This situation has not gone unnoticed with investors well positioned for this risk-on environment. That is one of the reasons why we enter the year well diversified.

Björn Jesch
Global Head of Multi Asset
& Solutions, CIO EMEA

In 2020, finding the right balance between participating in the market rally and hedging for possible downturns was the challenge. Given the global pandemic and the hotly contested U.S. elections, markets always seemed vulnerable. In 2021, too, that balancing act could again be difficult. And there will be other challenges, such as figuring out which of the market patterns and cross-asset correlations that were prevalent in 2020 could persist in a year in which the grip of the pandemic should loosen and life become more normal. The U.S. dollar has been central to one typical pandemic market pattern: for the better part of 2020 it has reacted predominantly to changes in risk appetite and aversion. That might change, eventually. Another, more familiar challenge for 2021 will be to assess to what extent markets respond to the verbal reassurance offered by central banks – or whether only perceived changes in the volume and pace of support (in the form of liquidity) affects them. Inflation expectations, too, and their impact on different asset classes will also have to be carefully monitored. And after the strong rally in almost all markets that we have seen in 2020, we are, from a multi-asset perspective, weighing carefully in which assets it still makes sense to chase a few extra points, and where it makes more sense to protect gains.

We have little doubt that in 2021 central banks will again stand ready to protect markets. But we believe there may be little reason for them to intervene massively again. The outlook seems much better now than it did only a few weeks ago. The basis for our investment strategy are the following assumptions: economic and market tail risks have diminished, given the results of the U.S. elections and recent progress with several effective coronavirus vaccines. Exceptionally high fiscal support and already ultra-accommodative central-bank policy provide a favorable economic-policy backdrop as 2021 begins. This should provide support for most areas of equity and fixed-income asset classes, even though some risks remain.

In equities we believe that emerging markets (EM) can maintain the strong relative performance they have displayed for some time. We particularly like Asian equities for a mix of short- and long-term factors. Short-term positives include the circumstance that many Asian EMs have recovered quickly from the pandemic. Longer-term positives include lower debt levels and the prevalence of high tech in some Asian EM equity indices.

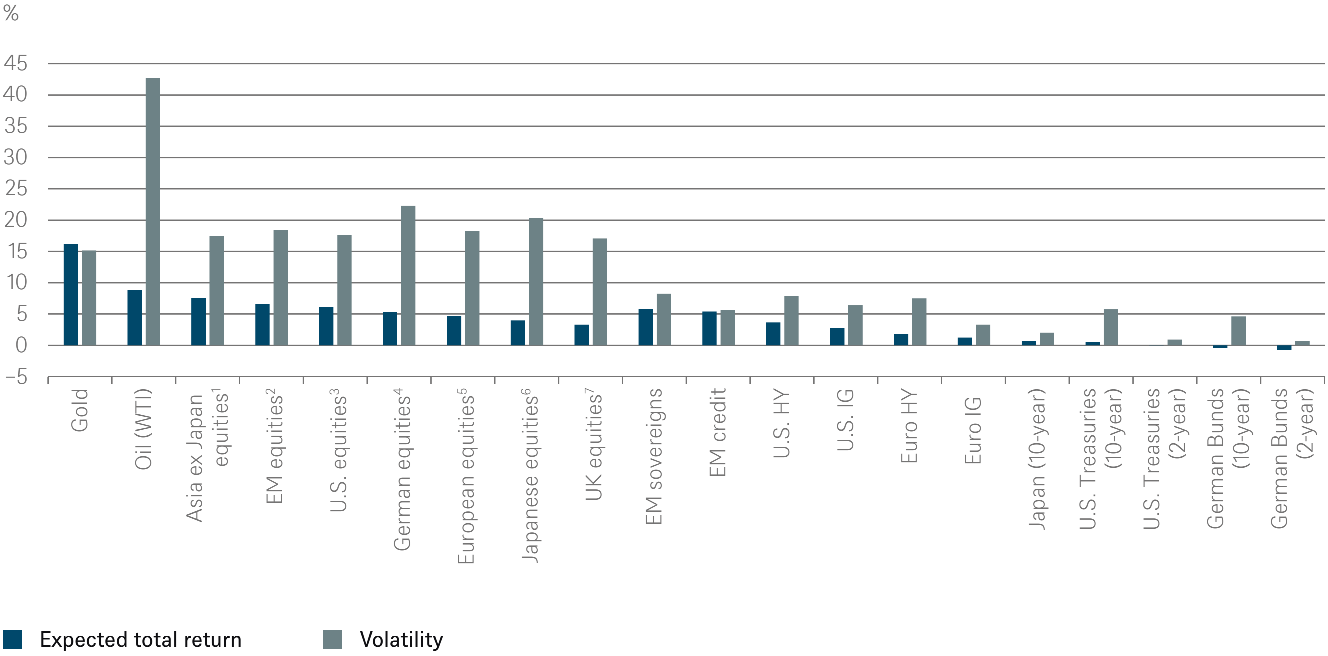
At a global level we still favor growth over cyclical and value stocks, although we believe that the current market rotation into value has not yet come to an end. We therefore prefer a more balanced allocation in terms of styles. Markets are positioning for an economic upturn but economic growth could wane again in the course of 2021, reinforcing the case for companies that have proven able to deliver growth even in a difficult, low-economic-growth environment. We are well aware that we are not alone in taking a positive view of equities and we are keeping a close eye on investor flows and positioning. Most investors are prepared to look through the current wave of Covid. But they might lose their nerve if the pace of recovery slows again because of negative health or economic developments.

Sovereign bonds, on the other hand, have lost most of their appeal, given that yields are more than likely to remain very low or even negative. Corporate-bond spreads have tightened so much since the initial Covid spike in March that the outlook for 2021 is much less promising. But corporate bonds will, we believe, be supported by lower supply and continued demand, not least from central banks. We continue to prefer euro over U.S. dollar investment-grade (IG) bonds given the European Central Bank's dominant role as a price-insensitive buyer. Our preference for euro high yield (HY) remains marked, both over U.S. HY and euro IG, because we think it has the potential to catch up during the recovery. Meanwhile, although it lacks direct central-bank support, EM debt, both sovereign and corporate, looks most appealing to us now. It is benefiting from both the good news on vaccines and the U.S. election outcome, which we expect to have positive implications for liquidity in the coming year. Within the EM space, we prefer high-yield issuers over investment grade, given where valuations are.

Although we do not expect consumer-price inflation to be a major issue in 2021 some industrial commodities might benefit further from the economic upswing, especially given reduced investment on the supply side this year. Among precious metals, gold could still appeal in a negative-rates environment, even though it is now struggling in the risk-on environment as economic sentiment improves. For currencies we have become more cautious on the U.S. dollar and prefer the Japanese yen. Since March 2020, many currencies have been driven more by overall changes in risk-on/risk-off market sentiment than by economic or policy fundamentals. Continued risk-on sentiment could temporarily weaken the U.S. dollar over the next few months, while the Japanese yen might act as a shock absorber at times of unexpected market stress.

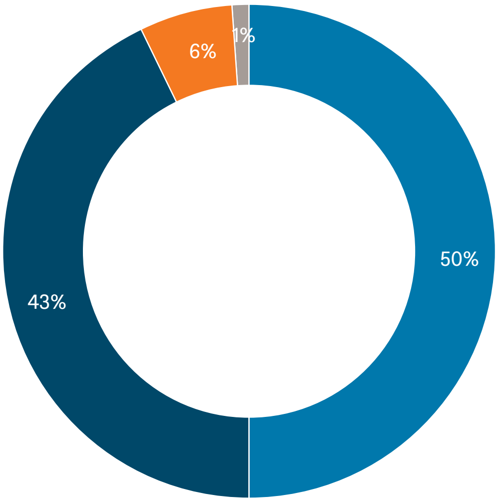
DWS RETURN EXPECTATIONS VS HISTORIC VOLATILITY, CROSS ASSET

Expected returns based on DWS's end-2021 forecasts. Volatility is based on past ten year's data.



One cannot invest directly into an index
1 MSCI AC Asia ex Japan Index
2 MSCI Emerging Markets Index
3 S&P 500
4 Dax
5 Stoxx Europe 600
6 MSCI Japan Index
7 FTSE 100
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 11/25/20

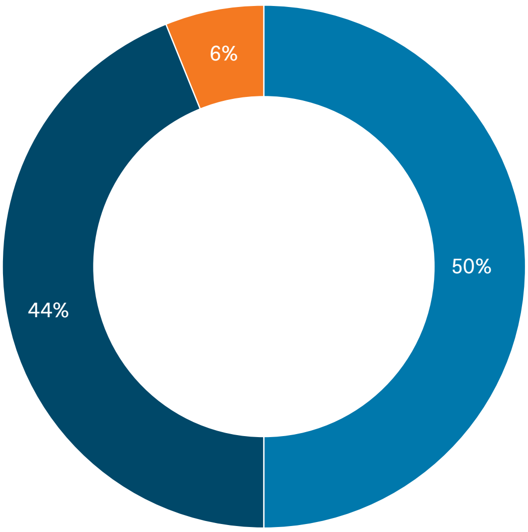
Multi-asset allocation for European investors



Equities	50%
Equities United States	27%
Equities Europe	8.5%
Equities emerging markets	7%
Equities Global Style	5%
Equities Japan	2.5%
Fixed Income	43%
Euro investment grade	12%
Emerging-market (hard-currency) bonds	8%
Eurozone sovereigns	7%
U.S. Treasuries	5%
Euro high yield	5%
U.S. investment grade	4%
U.S. high yield	2%
Alternatives	6%
Commodities	6%
Cash	1%

The chart shows how we would currently design a balanced, euro-denominated portfolio for a 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 11/25/20

Multi-asset allocation for Asian investors



Equities	50%
Equities United States	30.5%
Equities Europe	9.5%
Equities Emerging Markets	7%
Equities Japan	3%
Fixed Income	44%
Asia Credit	13.5%
U.S. Treasuries	10%
Emerging-market (hard-currency) bonds	9%
U.S. high yield	6%
U.S. investment grade	5.5%
Alternatives	6%
Commodities	6%

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 11/25/20

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Sunny outlook with just a few clouds emerging

Good mood despite near-term uncertainties

The markets' dominant topic in 2020 was, is and will probably remain Covid-19. Even the U.S. presidential election only temporarily dominated media attention. Even then, the capital markets remained more concerned with the pandemic. Optimism about the early availability of a vaccine, and in sufficiently large quantities, has become prevalent and the beginnings of an emerging V-shaped recovery have been visible in the DWS macro indicator for several months. After its low at the beginning of June, the indicator has rapidly moved into the clearly positive range, predicting a much improved macroeconomic environment.

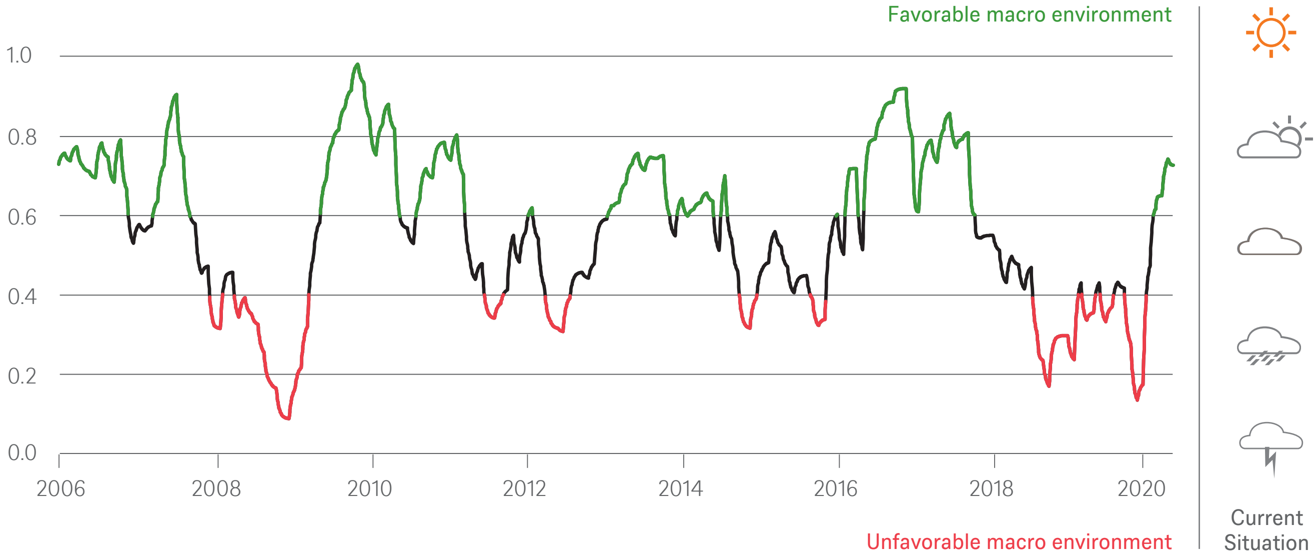
The DWS risk indicator looks similar. When it first appeared, Covid-19 deeply unsettled market participants. Accordingly, the DWS risk indicator signaled a very high degree of risk aversion. Now that vaccines promise a remedy for the virus and the U.S. presidential election is mostly behind us, risk appetite has turned around completely. As measured by the DWS risk indicator, optimism is at its highest level since 2007.

The DWS surprise indicator, however, signals that the prevailing optimism may be premature. The resurgence of new infections and associated reintroduction of lockdown measures are gradually showing their impact on parts of the economy. Analysts' expectations have not only been positively surprised recently.

Taken at current face value, all three DWS indicators signal an overall very positive economic environment. That being said, the economic effects of the recent lockdown measures can only be observed in the DWS macro and surprise indicators with a certain time lag.

MACRO INDICATOR / Condenses a wide range of economic data

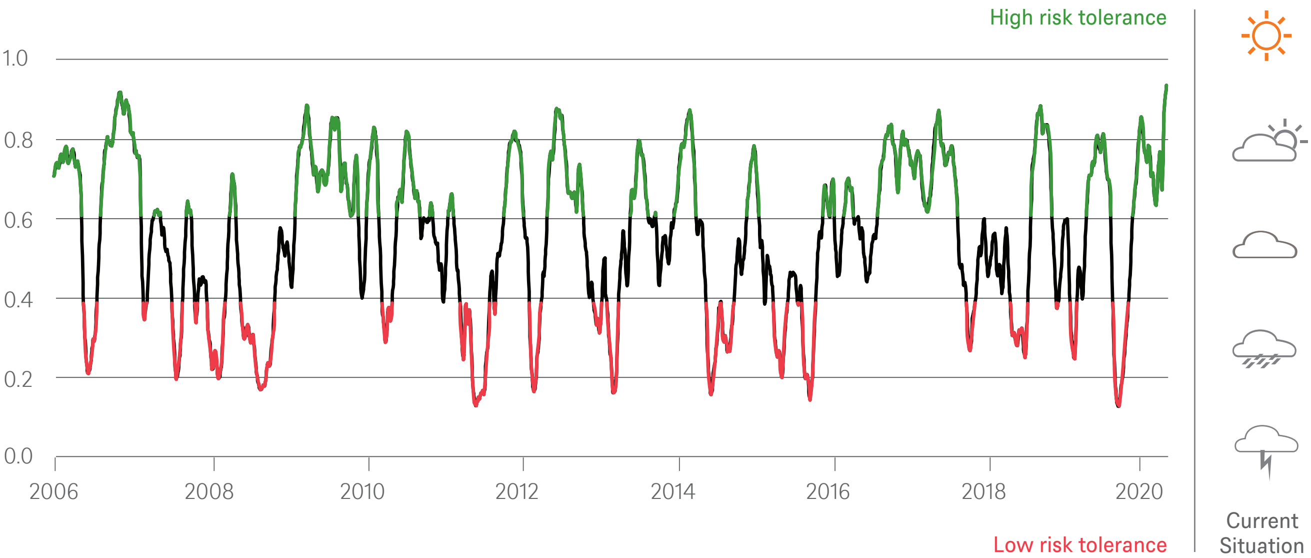
The DWS macro indicator improved steadily in the middle of the year. At the beginning of August, the indicator climbed above the 0.5 level for the first time since mid-2018, but has lost some momentum since then. However, the effects of renewed Covid-19-related restrictions are still barely visible.



Source: DWS Investment GmbH as of 11/26/20

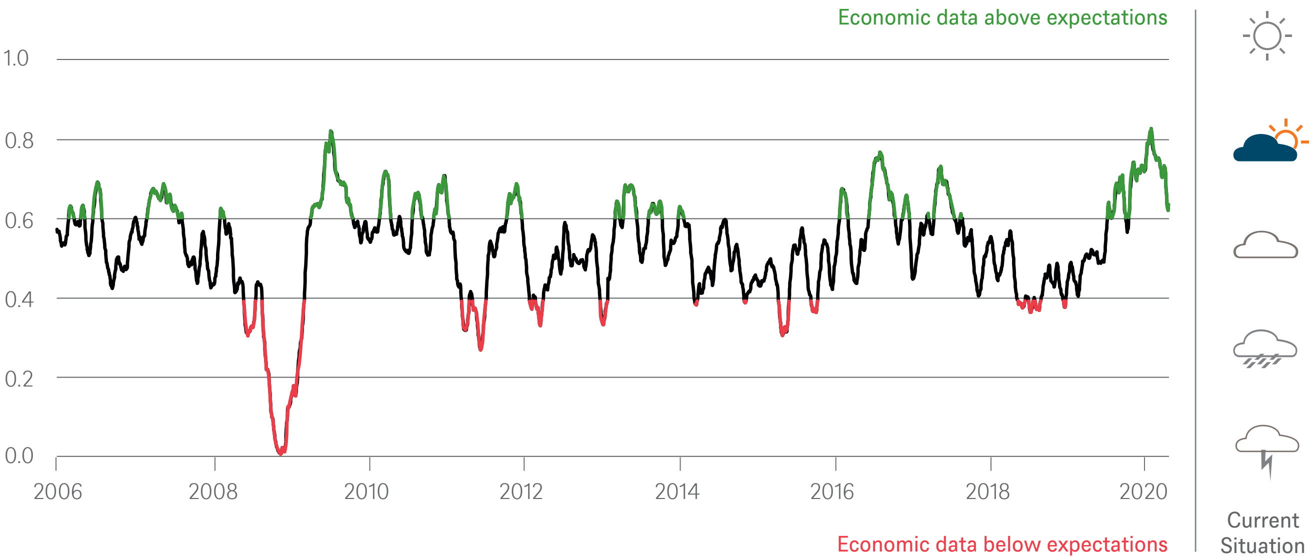
RISK INDICATOR / Reflects investors' current level of risk tolerance in the financial markets

After reaching a peak in mid-August, the DWS risk indicator has declined somewhat in the last months. Most recently, however, the index has benefited again from the elimination of uncertainties surrounding the U.S. elections and news about the effectiveness of various vaccines against Covid-19.



SURPRISE INDICATOR / Tracks economic data relative to consensus expectations

The DWS surprise indicator has corrected from a very high level reached in late summer, but remains positive. In the first half of the year, the three global regions had diverged significantly from each other but later converged. Recently, however, Europe recorded worse figures than Asia and the U.S., while still remaining in positive territory.



Source: DWS Investment GmbH as of 11/26/20

GLOSSARY

The aim of an accommodative monetary policy is to support the economy by means of monetary expansion.

A corporate bond is a bond issued by a corporation in order finance their business.

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.

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

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

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 FTSE 100 is an index that tracks the performance of the 100 major companies trading on the London Stock Exchange.

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

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

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

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

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

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 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.

Risk aversion is a characteristic of investors to prefer the asset with lower risk and thus accept a lower potential yield.

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

Sovereign bonds are bonds issued by governments.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

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

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.

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.

Important Information