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Marketing Material

THAT SINKING FEELING

EVEN BEFORE THE FED CUT, REAL U.S. INTEREST RATES HAD FALLEN INTO NEGATIVE TERRITORY. WHAT DOES THIS MEAN?

The U.S. Federal Reserve (Fed) unexpectedly cut interest rates by 50 basis points to a new target range of 1.00% to 1.25% on Tuesday, March 3. But U.S. yields have been falling for some time already, as our "Chart of the Week" shows. The considerable decline in U.S. Treasury yields last year was mainly due to dwindling real yields. In fact, as much as 130 of the 160 basis points of the nominal yield decline since the beginning of 2019 are accounted for by the real component. With a real interest rate of -0.5%, the United States has now also moved into the negative interest-rate territory that has long prevailed in many other industrialized countries.

Inflation expectations, as expressed in the breakeven inflation rate, do not generally coincide perfectly with consumer price inflation, as they are usually slightly lower. Nevertheless, the chart shows how stable inflation expectations have remained overall before, since the beginning of this year, moving substantially away from the Fed's inflation target of 2%.

But the decline in real interest rates is even more remarkable. Many books can be written about the consequences of negative real interest rates. The signal for the capital markets, and especially stock markets, is ambiguous. Negative real rates might signal meagre growth prospects and an abundance of investment money, i.e. a savings glut. Optimists see the potential benefit from lower capital costs and the increased attractiveness of risk assets such as stocks and corporate bonds. Pessimists, on the other hand, see negative rates as pointing to likely structural weakness in growth. "The volatile reaction of the U.S. stock market to the Fed's interest-rate cut shows investors' ambivalence," says Christian Scherrmann, U.S. economist at DWS. "The joy at lower interest rates may have been clouded by fears that the Fed sees greater risks to economic growth than the markets do."



Sources: Refinitiv, DWS Investment GmbH as of 3/5/20
* Treasury Inflation Protected Securities

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GLOSSARY

One **basis point** equals 1/100 of a percentage point.

Breakeven rates provide a useful measure of average inflation expectations derived from inflation linked sovereign bonds

The **consumer price index (CPI)** measures the price inflation as a percentage, year over year, of a basket of products and services that is based on the typical consumption of a private household.

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

In economics, a **nominal** value is not adjusted for inflation; a real value is.

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

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.

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.

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.

APPENDIX: PERFORMANCE OVER THE PAST 5 YEARS (12-MONTH PERIODS)

| | 02/15 - 02/16 | 02/16 - 02/17 | 02/17 - 02/18 | 02/18 - 02/19 | 02/19 - 02/20 |
|---------------------------|---------------|---------------|---------------|---------------|---------------|
| TIPS (10-year) | 0.0% | 2.7% | -0.2% | 2.2% | 7.4% |
| U.S. Treasuries (10-year) | 4.7% | -2.9% | -1.3% | 4.5% | 15.1% |

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 3/5/20

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