DWS

Marketing Material

Will price hikes be the next S&P EPS leap?: Beware nitrous engine damage

David Bianco
Americas Chief Investment Officer

IN A NUTSHELL

- Recovery and digital leap boosts to S&P EPS are peaking: Are price hikes next?
- Higher costs put "fair" price hikes in play, but it's very risky to raise prices
- Smaller 3Q EPS positive revisions, pre-season reporters beat by much less
- The two strong engines to this equity bull market start to down throttle

Recovery and digital leap boosts to S&P EPS are peaking: Are price hikes next?

This earnings season, we expect S&P 500 companies to beat analyst earnings estimates by more normal amounts; by roughly 5% in aggregate, not 20%+ like the last 5 quarters. We also expect the giant leaps in sequential quarterly earnings per share (EPS) of the past 5 quarters to stop. As 3Q21 S&P EPS will most likely be flat or slightly above 2Q21 S&P EPS of nearly $53. While growth rates from a year ago will still be high, given pandemic slump comparisons, investor focus is on sequential quarterly growth in 2021 to help shape the 2022 outlook.

It's normal for 3rd quarter S&P EPS to be flat or just slightly above 2nd quarter, but US gross domestic product (GDP) growth should be at a 3-5% annualized pace in 3Q, well above 2-3% norm, as demand for services hit by the pandemic made recovery progress and goods demand stayed strong. Despite this favorable macro backdrop, profit growth was challenged by costs owing to many recovering service businesses operating sub scale and higher material costs or lack of availability at goods businesses. Both reported labor cost and availability challenges.

Higher costs put "fair" price hikes in play, but it's very risky to raise prices

Many companies have raised prices this year and are contemplating further hikes. While instances of pandemic and then reopening induced lopsided demand gave some select enterprises bonafide pricing power, most firms are raising prices in response to higher direct costs and lower capacity utilization or fixed cost spreading. Such price hikes, while fair, don't boost profits; yet risk damaging customer demand on affordability or sending them in search of alternatives. Thus, a firm raising prices because it must, even if initially successful, still faces higher cost related risks. A business raising prices because it can, on a windfall of luck, is subject to changing winds or might create future competition problems by raising an attractive price umbrella. In our view, it's not a good sign when a firm must or chooses to "take price". Unless raising prices from levels deliberately set unsustainably low to accelerate adoption, raising prices to meet costs or especially if to boost profits strains the engine of a business. Price hikes might yield fast profits, but it's mixing nitrous into the fuel line; it will damage the engine of an enterprise by disappointing customers and encouraging competitors. We generally prefer companies not experiencing acute cost pressures and with good volume growth absorbing unit fixed costs.

Taking price (raising price) differs from price taking. Fluctuating commodity prices are set on marginal supply cost and market demand at that price. Price takers have no control on price, but still face demand destruction and search for alternative risk. This might be a tougher cycle for consumers, but that doesn't necessarily mean it's better for producers.

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.

Smaller 3Q EPS positive revisions, pre-season reporters beat by much less

The strong earnings momentum since 3Q20 shows signs of slowing in 3Q21. In the past four quarters (3Q21-2Q21), bottom-up S&P EPS was raised by 5% on average during the quarter; 1Q21 and 2Q21 had even stronger up revisions by 5.8% and 7.4% respectively. However, 3Q21 bottom-up EPS was raised only 3% during the full quarter as it was actually cut in September. In the past four quarters, pre-season reporters (August quarter end firms) delivered very strong beats of 30%+. For 3Q21, the 19 pre-season reporters beat analyst EPS estimates by only 3.6% in aggregate. We think S&P 500 companies will beat by 5% in aggregate and 3Q EPS will finish at roughly $53. Stronger beats at digital companies, Health Care and Financials, while the rest lower than 5%.

The two strong engines to this equity bull market start to down throttle

Strong EPS growth momentum and very low long term interest rates have been two bull market rocket engines. In recent months, however, there are signs that both engines are starting to throttle down. The U.S. Federal Reserve (Fed) is planning policy normalization, first tapering then rate hikes, perhaps faster as inflation persists above the Fed's target. Thus upward long-term interest rates. Our view is that 10yr Treasury yields rise to about 2% in year and 10yr treasury inflation-protected securities (TIPS) yield approach but don't exceed 0%. Beyond interest rates, S&P EPS growth is past its recession recovery bounce and supplemental digital surge from the new work and living modes since the pandemic. Digital service demand growth might slow, but such demand growth remains strong and is being met by digital providers at prices of consumer value as growth brings shared economies of scale. Whereas the physical side of the economy is supply side constrained. Goods demand still appears quite strong, but some orders might be customers holding place in two or more lines for one item. Material and labor constraints with a corporate tax hike could stop the ascent in quarterly S&P EPS well into next year.

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.

GLOSSARY

A bull market is a financial market where prices are rising - usually used in the context of equities markets.

Capacity utilization refers to the share of an economy's productive capacity that is in use.

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.

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.

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

Tapering is a slow, continuous reduction of the central bank's asset purchases; especially referring to the U.S. Federal Reserve.

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).

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.

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

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.

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.

© 2021 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.

© 2021 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.

© 2021 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.

© 2021 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.

© 2021 DWS Investments Australia Limited

as of 10/12/21; 085973_1 (10/2021)

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.

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. Any securities or financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation ("FDIC") unless specifically noted, and are not guaranteed by or obligations of DWS or its affiliates. We or our affiliates or persons associated with us may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. 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 [document – may need to identify] 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.

© 2021 DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany.

All rights reserved.

as of 10/12/21; 085980_1 (10/2021)