# LIVING IN HISTORY: HOW WILL WE LOOK BACK AT THIS MOMENT?

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IN A NUTSHELL

- Pandemic 2020: a passing moment or a new era that shapes our future?
- New cycles tend to bring new trends, themes and investment leadership.
- First-quarter earnings season and preliminary economic reports confirm recession.
- Prevention measures will shift to local, private and personal responsibility.

## PANDEMIC 2020: A PASSING MOMENT OR A NEW ERA THAT SHAPES OUR FUTURE?

Contemplating how we will look back at this pandemic and see it in hindsight helps to predict the future. History is made by momentous events, both good and bad, but events that define an era are loud thunderclaps that echo and shake things well after their first bolt flashes. This pandemic is such an event. Epochal. It will hit previously distinct issues hard and cause them to veer in different directions because of it.

September 11, 2001, as grave the day, affected air travel for a time, but security at airports permanently. More broadly, it affected policies on Iraq, energy, etc., even today. In that mindset, we can see the waves that big storms push onto future shores. This pandemic will affect U.S. elections and complicate many domestic and world issues as last recessions did or more. Including economic and political relations between the United States and China, emerging economy prospects, European-Union (EU) unity, U.S. fiscal health, nominal and real interest rates, taxes, healthcare, banking, energy, transportation, trade, migration, globalization, tourism, consumption, retailing, environmentalism, labor costs, automation, factory / fixed asset location, baby boomer longevity, science and medicine. This pandemic greatly damages our immediate living standards – worse to come if poorly navigated – but it could spark innovations beneficial in the long-term.

These effects are difficult to forecast, quantify and total; both the enormous net negatives near-term and perhaps positives long-term. But for now, we see no reason to change our cautious stance. We wait to better gauge this pandemic, identify the issues it intersects, and evaluate if positive, negative or neither for investors. Unlike many recessions, this social and economic crisis originates from a force of nature rather than man. This might make investors more patient, optimistic and forgiving of financial harm or tolerant of that risk. Nevertheless, the threat is real and substantial. Our preference stays lower risk corporate credits and growth and defensive equities.

## NEW CYCLES TEND TO BRING NEW TRENDS, THEMES AND INVESTMENT LEADERSHIP

A new cycle began with the recession that the coronavirus quickly started, but there is still no clear horizon. We go into this new cycle with the same dominant wind and current as before, but now with wild turbulence. Leadership cannot change until the horizon clears and guiding stars appear. We know little about the course we now take or the sea we sail. The abrupt shock perhaps did not allow prior cycle trends to fully play out and yet the shock brings new trends that could overpower those prior. Recessions and early cycle years are very uncertain and do not support peak price-to-earnings ratios (P/Es) on recovery earnings estimates or leadership changes in pursuit of value opportunities before some glimpses are seen of the newly reset earning power and balance sheets.

## FIRST-QUARTER EARNINGS SEASON AND PRELIMINARY ECONOMIC REPORTS CONFIRM RECESSION

Big Banks dominated the first week of earnings season as usual. Results were very weak owing to large loan loss provisions (LLPs) to boost credit loss reserves. In addition to large LLPs charged to net income, banks adopted Current

Expected Credit Loss (CECL) accounting rules. This new U.S. generally accepted accounting principles (GAAP) standard requires banks to estimate total credit losses that will be suffered on a loan over its full life instead of taking loss provisions in-line with nonperformance each period. Adopting this rule boosted loss reserves with charges directly to the balance sheet from equity via other comprehensive income. We expect LLPs to be at first-quarter levels on average for full 2020. A loan in forbearance will not be considered delinquent or cause charges to reserves if performing according to the forbearance program. Loss reserves likely peak in the second quarter.

Through last week, which is the second week of earnings season, a third of first quarter S&P 500 earnings per share (EPS) was reported. Week two had many non-financial multinationals report, especially from consumer staples and health care's big pharma and biotech and other non-financial blue chips. It is weeks three to five, when most non-defensive sectors such as industrials, energy, materials, auto, retailers, Real Estate Investment Trusts (REITs) and other non-financials most vulnerable to this recession report. However, most mega cap technology and communications firms have yet to report. Companies are missing the reduced estimates at the first quarter end, but estimates are being further slashed just before a company reports, which is still happening. We expect first quarter S&P 500 EPS to be 28.00 to 31.00 dollars or down 20% to 30% year-over-year. We expect second quarter S&P 500 EPS to be 10 to 20 dollars or down 50% to 75%. Our 2020E (estimated) S&P 500 EPS is 110 dollars.

### PREVENTION MEASURES WILL SHIFT TO LOCAL, PRIVATE AND PERSONAL RESPONSIBILITY

We expect federal-lockdown guidelines to be lifted by many states in mid-May. Most states will roll out opening steps by specific industry and public services and with city and county rules that consider infection rates and risk factors like population density. We find the pace of contagion still concerning in many big U.S. cities. Prevention will likely continue for longer in these cities and by their institutions and individual choice.

## GLOSSARY

A balance sheet summarizes a company's assets, liabilities and shareholder equity.

The credit market is the market for corporate bonds

Defensive stocks are stocks from companies whose sales are expected to fluctuate less than the market average as the demand for their products are less tied to business cycles.

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 European Union (EU) is a political and economic union of 28 member states located primarily in Europe.
The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The U.S. dollar (USD) is the official currency of the United States and its overseas territories.

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

Market capitalization, in the context of an individual firms, is the number of shares issued multiplied by the value of the shares.

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

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

## IMPORTANT INFORMATION: EMEA



## IMPORTANT INFORMATION: UK



Publisher: DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany

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