

## Equities still the place to be

**Monetary and fiscal packages are driving the markets, but their valuation leaves little room for economic disappointment.**

- \_ One can interpret the course of the economies, markets and the pandemic quite differently; at present, the (too?) optimistic view prevails.
- \_ Even if the summer holidays could lead to a reversal of some of the lockdown-easings, we do not expect the economy to come to a new standstill globally.
- \_ In our opinion, the monetary and fiscal packages are primarily supporting equities and corporate bonds, but there is also a lot to be said for commodities and gold at present.



Klaus Kaldemorgen  
Fund manager

Stock-market trading would dry up quite quickly if market participants did not have different forecasts for the economy, politics and this year the likely course of a pandemic. Views differ, however, not only about the future but also the present and the past. History is constantly being rewritten and reinterpreted. To give one example: has the U.S. economy been on the brink of a recession anyway, as the inverted yield curve in August 2019 suggested? Even without Covid-19 might the U.S. have been facing recession? In the summer of 2020 these different aspects and ultimately the capital markets are particularly open to completely different interpretations. This is the almost inevitable consequence of a global economy that has been forced into partial hibernation by the push of a pandemic alarm button, has shrunk at record speed and begun to revive and recover to some extent quite soon after its mandatory slump. One crucial factor is the reference point. If the low point for mobility, business activity and markets was in March/April, then the current situation may not be so bad because things are clearly looking up. If the yardstick is the pre-crisis level, the economy is still a long way down.

According to our estimates, it may not be before 2023 that some countries return to their end-2019 level. The capital

markets, meanwhile, are already quite a few steps ahead. The leading global stock index, the S&P 500, has almost made it back to its level at the beginning of the year. The Nasdaq 100 Index gained more than 10% and was able to exceed its previous highs at the beginning of June. The situation on the bond markets is in some way similar. There was considerable panic in these markets in March, when even trading in U.S. Treasuries was thought to be disrupted but since then the losses have been largely recovered. The price index for U.S. investment-grade corporate bonds<sup>1</sup>, for example, is around 5% higher than at the beginning of the year and only a few percentage points below its record high of March 6.

The markets were more volatile than during the financial crisis of 2008: in March, the S&P 500 fell by 15.4% within two weeks and then rose by 13.3% in less than a month. These capital-market rallies were mainly driven by the courageous rescue packages of governments and above all central banks, whose glasses are not so much full as constantly overflowing. The key interest rates of all major central banks are close to zero or slightly below. Yield-curve control, i.e. the direct control of market interest rates, is increasingly being discussed by members of the U.S. Federal Reserve (Fed) – on top of the multiple credit guarantees, liquidity tenders and of course bond

<sup>1</sup> Bloomberg Barclays U.S. Aggregate Credit Index

purchases. The Fed is now even buying non-investment-grade corporate bonds. Jerome Powell, the Fed Chairman, who was initially perceived as a hawk three years ago, revealed in a recent Congressional survey how he now interprets his task: as long as inflation does not rise, he said, the clear mandate is to support the labour market, and not prevent any asset price bubbles that may arise.<sup>2</sup>

Many investors should have taken Powell's statement on the Fed's current philosophy with relief. After all, the negative effects of rising debt levels and immense government intervention will only become apparent with a longer time lag, for example by reducing potential economic growth, as we have argued in the study "CIO Special: Fiscal packages – necessary in the short term, dangerous in the long term".

The original problem that created the need for rescue packages, the pandemic triggered by Covid-19, is also open to a variety of assessments. A focus on regions such as East Asia and Europe, where the pandemic appears to have been largely brought under control, might generate a more optimistic view. Things look much less optimistic, however, when Latin America and the United States are considered. Here the spread of the virus has even regained momentum, reflected – at least so far – more in the number of new infections rather than deaths. Even if there seems little interest at the highest political levels in the United States in imposing an extensive lockdown, economic recovery could still be delayed. First, lockdowns are the responsibility of state governors, some of whom already feel compelled to act in the face of rapid new infection numbers. And second, people could become more cautious by themselves, without being instructed to do so. Mobility data are already showing signs of decline again in some U.S. states. To what extent investors are being guided by this new dynamic is difficult to say. The major stock markets though have been unable to push their recovery rally higher in June. Many investors may be hoping for new fiscal largesse or central-bank rescue packages in the event of new lockdowns or slowing economic recovery. And even if the virus and the resulting economic rollercoaster ride currently still dominate market events, other troubling issues have lingered or are regaining momentum. First and foremost among them is the U.S.-China trade and technology dispute, which is again moving markets as it worsens or eases.

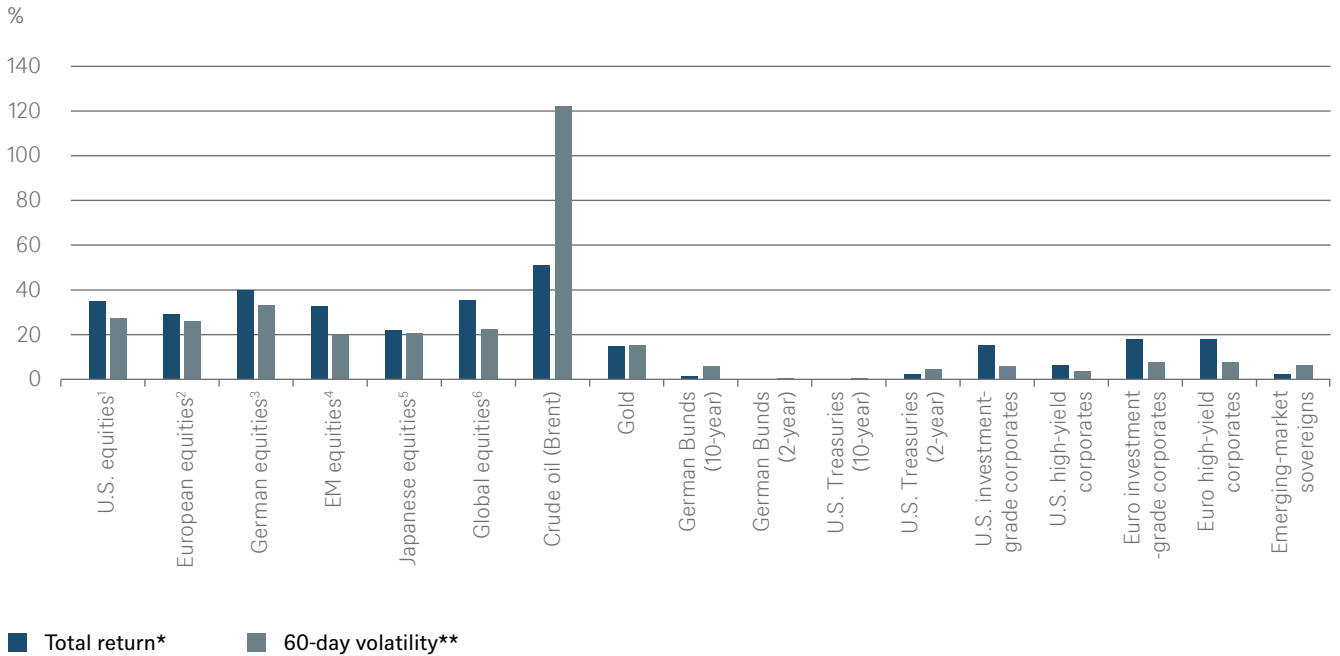
Based on our main scenario of a gradual recovery from now on – not without hiccups, but without a second global lockdown – we believe the strategic outlook for equities and corporate bonds is attractive, especially in view of the fact that interest rates are anchored close to zero in the short-maturity segment around the globe. The extremely expansionary, liquidity-promoting monetary policy of central banks also helps these asset classes. Together with recovering fundamental data, this also puts rapidly rising equity valuations into perspective. However, anyone who is concerned about inflation in the longer term as a result of the current highly expansionary monetary policy is likely to give a clear preference to equities. We do not yet see inflation emerging in a 12-month perspective and are sticking to a moderate equity allocation target. Increasing exposure to European equities can make the equity component somewhat more cyclical and more in favor of value stocks. Overall, however, we believe the focus should remain on quality and growth stocks, with a slightly elevated positioning in U.S. equities.

After their strong performance since the beginning of the year, government bonds (especially U.S. Treasuries) have lost much of their appeal. Low yields are likely to reduce not only current income but also future diversification potential. By contrast, investment-grade corporate bonds look much better. Although this bond segment has already performed well in recent months thanks to narrowing yield spreads, in our opinion, it should continue to benefit from structural demand from central banks and institutional investors. We also believe that parts of the high-yield segment are currently much more attractive than government bonds. There are still some interesting securities to be found, especially in the European corporate-bond segment, and to a lesser extent in U.S. companies. By contrast, we do not believe that risks have yet decreased to the same extent in emerging markets. Given low opportunity costs (interest rates close to zero or negative) and low inflation expectations, we feel that commodities and gold should not be missing in the portfolio.

<sup>2</sup> See: <https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200610.pdf>

**A BROAD RECOVERY WITH RETURNS GENERALLY IN LINE WITH HISTORIC RISK LEVELS**

Since the lows in most equity indices on March 23, equities and corporate bonds have performed especially well.



\* total return from 3/23/20 to 6/29/20

\*\* as of 6/29/20

<sup>1</sup> S&P 500; <sup>2</sup> Stoxx Europe 600; <sup>3</sup> Dax; <sup>4</sup> MSCI Emerging Markets Index; <sup>5</sup> MSCI Japan Index; <sup>6</sup> MSCI AC World Index

Sources: Refinitiv, DWS Investment GmbH as of 6/29/20

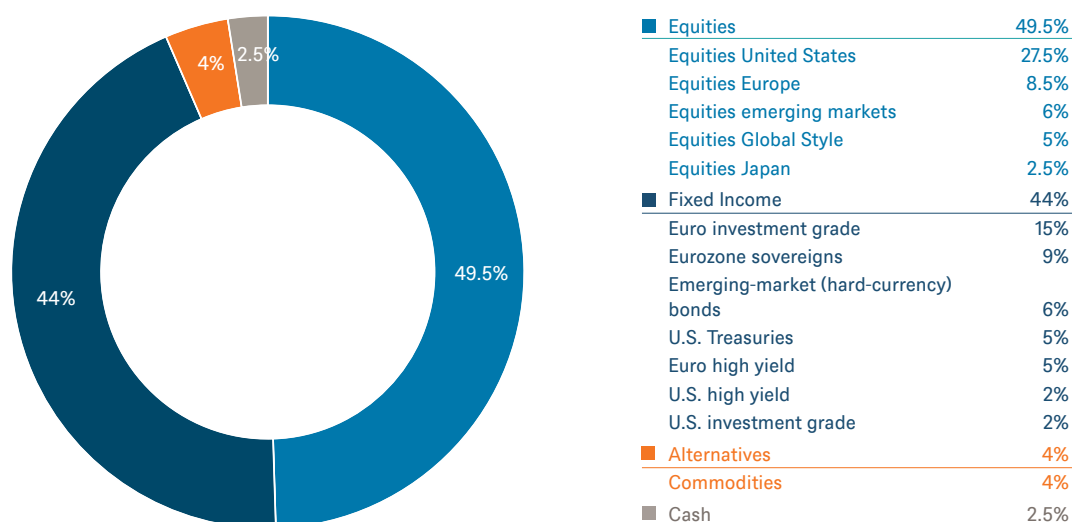
## Slightly defensive in a positive environment

The economic recovery is largely priced into assets. Low inflation favors riskier assets.

### MULTI-ASSET ALLOCATION FOR EUROPEAN INVESTORS

In our opinion the overall investment environment remains positive. But portfolios need to be rebalanced somewhat in light of the strong price movements that have taken place. In equities, quality and growth stocks continue to look promising, but they might be supplemented by more cyclical asset classes, preferably from Europe rather than emerging markets (EM).

In case of government bonds, both yields and the scope for diversification have declined sharply following the recent price gains, which is why we would increase the share of corporate bonds. In the high-yield segment we prefer Europe to EM. In terms of foreign currency composition, we still view a global positioning as appropriate.



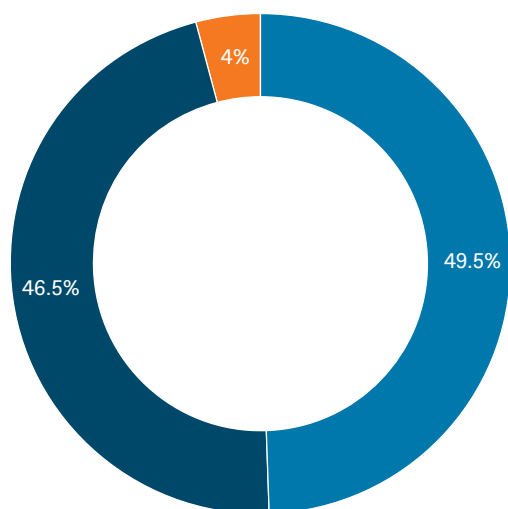
The chart shows how we would currently design a balanced, euro-denominated portfolio for a European investor taking global exposure. This allocation may not be suitable for all investors and can be changed at any time without notice. Alternative investments involve various risks and are not necessarily suitable for all clients or for every portfolio. Source: Multi Asset Group, DWS Investment GmbH as of 6/19/20

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### MULTI-ASSET ALLOCATION FOR ASIAN INVESTORS

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markets (EM). In case of government bonds, both yields and the scope for diversification have declined sharply following the recent price gains, which is why we would increase the share of corporate bonds. In terms of foreign currency composition, we still view a global positioning as appropriate.



<b>Equity</b>	<b>49.5%</b>
Equities United States	31%
Equities Europe	9.5%
Equities Asia ex Japan	6%
Equities Japan	3%
<b>Fixed Income</b>	<b>46.5%</b>
Asia Credit	15%
U.S. Treasuries	12%
Emerging-market (hard-currency) bonds	7%
U.S. investment grade	6.5%
U.S. high yield	6%
<b>Alternatives</b>	<b>4%</b>
Commodities	4%

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 6/19/20

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# Investors sunbathe – in heavy rain

## Great mood, bad outlook

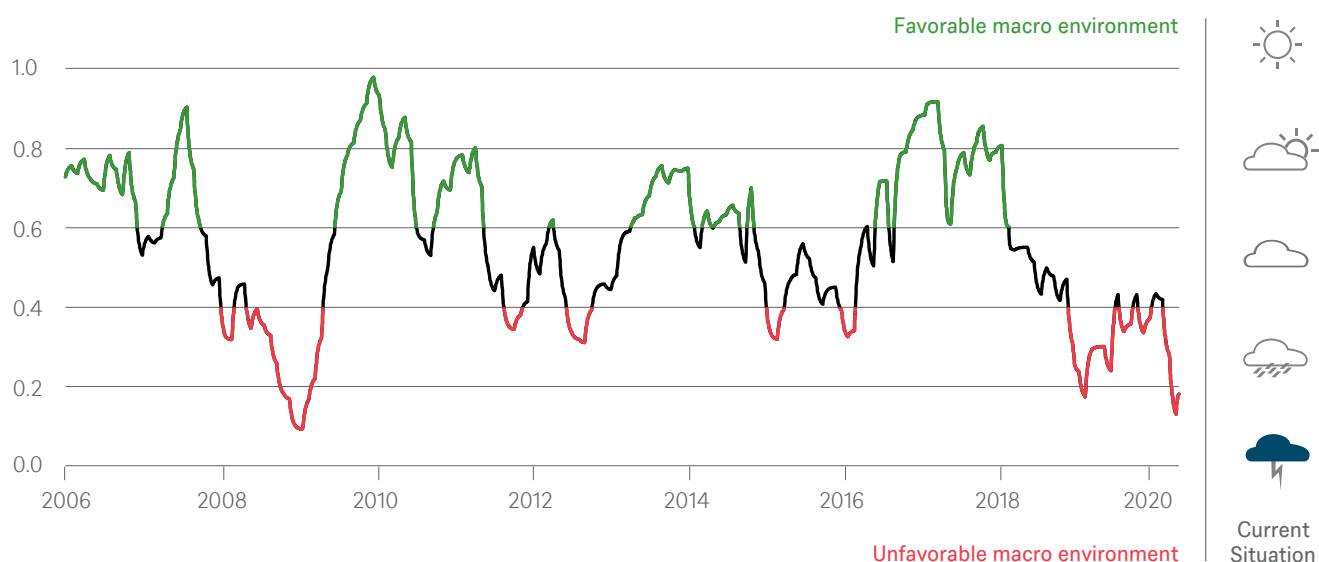
Covid-19 remained the dominant topic on the markets in the second quarter, though with different dynamics. In the first quarter, the virus's galloping and devastating spread around the world terrified investors. In the second quarter, by contrast, the news was dominated by the unprecedented fiscal and monetary support announced by politicians and central banks. The goal was to cushion the worst effects of the profound recession into which the global economy was falling and to generate a V-shaped bounce as quickly as possible. The U.S. government debt's extreme increase is just one example of markets' response: It rose by more than 12 percentage points in the past three months. And in the same period, showing some of the cause behind the effect, the U.S. Federal Reserve's (Fed's) balance sheet doubled.

Investors' high hopes in the authorities' emergency measures are reflected in the DWS indicators. A huge gap has opened up between the DWS surprise and risk indicators, which reflects investors' mood, and the actual fundamental situation (the DWS macro indicator). The divergence has been the largest among the worst readings over the last 15 years. Historically, such a large divergence between the indicators' readings has never lasted long.

In the medium term, therefore, some convergence between sentiment and fundamentals can be expected. Since experience shows that fundamentals tend to change more slowly it can be assumed that the adjustment will take place via a clouding of investor sentiment. This in turn is likely to be associated with setbacks for the capital markets.

### MACRO INDICATOR / Condenses a wide range of economic data

Given that the current recession is the deepest in industrialized countries since the Second World War, the frail fundamental picture is not surprising. In May, the macro indicator fell to its lowest level since 2008, with all sub-indicators trading at historic lows. The slight recovery in June cannot hide the fact that the economic environment remains clearly negative overall. The indicator is likely to remain in its weakest segment (see chart) for some time to come.

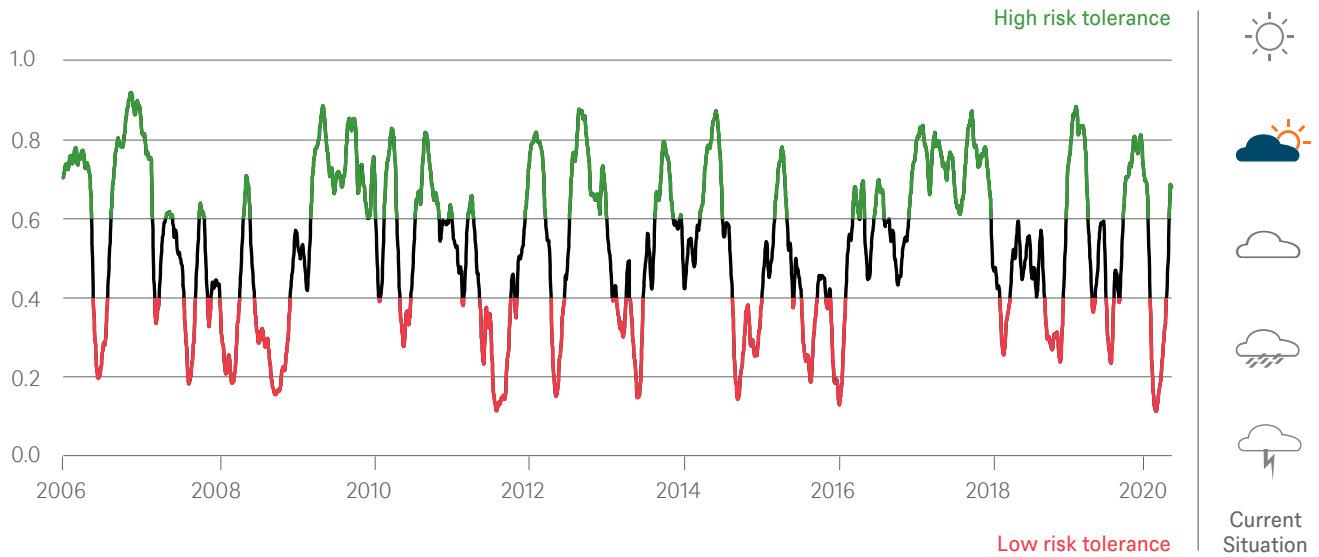


Source: DWS Investment GmbH as of 6/16/20

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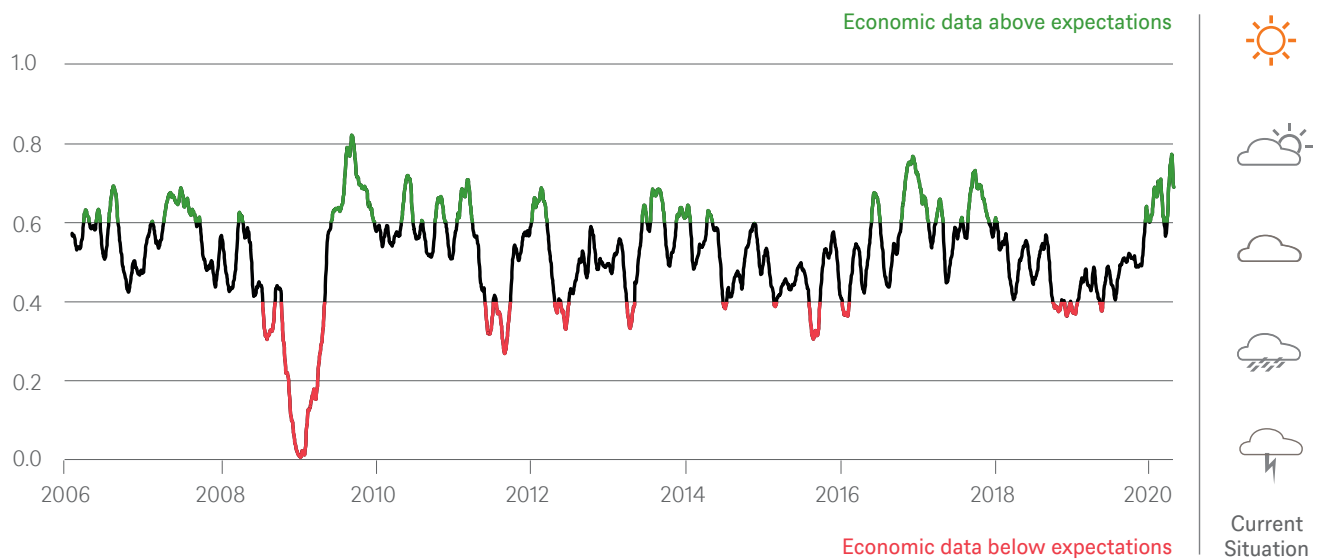
**RISK INDICATOR /** Reflects investors' current level of risk tolerance in the financial markets

The risk indicator has risen rapidly from its low at the end of March and has been in positive territory again since mid-May. All sub-indicators have contributed equally to the positive development. However, the indicator currently reacts very sensitively to changes in the sub-indicators, in both a positive and negative direction. Therefore, the current positive risk appetite could soon reverse again.



**SURPRISE INDICATOR /** Tracks economic data relative to consensus expectations

The surprise indicator has been on the rise since the beginning of 2019. The sentiment figures in particular have exceeded analysts' low expectations for some time now. After data in the United States disappointed in April, positive surprises have dominated since May, and the situation in Asia is similar. In Europe, on the other hand, the data continue to regularly fall short of expectations. We believe that this could also be the way forward for the global indicator and expect it to weaken soon again.



Source: DWS Investment GmbH as of 6/16/20

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## GLOSSARY

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

The **Bloomberg Barclays U.S. Aggregate Credit Index** measures the investment grade, U.S. dollar-denominated, fixed-rate, taxable corporate and government-related bond markets.

A **central bank** manages a state's currency, money supply and interest rates.

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

**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.

**Diversification** refers to the dispersal of investments across asset types, geographies and so on with the aim of reducing risk or boosting risk-adjusted returns.

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

The **financial crisis** refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

**Fundamentals** are data giving information about the general well-being of companies, securities or currencies and serving for the subsequent valuation of these as an investment opportunity.

**Government (sovereign) debts/bonds** are debt/bonds issued and owed by a central government

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

**Hawks** are in favor of a restrictive monetary policy.

**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.

**Monetary policy** focuses on controlling the supply of money with the ulterior motive of price stability, reducing unemployment, boosting growth, etc. (depending on the central bank's mandate).

The **MSCI AC World Index** captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

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.

The **Nasdaq 100** is an equity index which contains the 100 biggest common stocks listed on the Nasdaq composite index.

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.

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.

**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.

The **United States Congress** is the legislature of the federal government. It is comprised of the Senate and the House of Representatives, consisting of 435 Representatives and 100 Senators.



**Valuation** attempts to quantify the attractiveness of an asset, for example through looking at a firm's stock price in relation to its earnings.

**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.

**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.

A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

## PERFORMANCE / Overview

Performance in the past 12-month periods (%)

	06/15 - 06/16	06/16 - 06/17	06/17 - 06/18	06/18 - 06/19	06/19 - 06/20
Crude oil	-17.7%	-8.9%	21.0%	-8.5%	-31.5%
Dax	-11.6%	27.3%	-0.2%	0.8%	-0.7%
Emerging-market sovereigns	10.3%	5.5%	-2.4%	11.3%	1.2%
Euro high-yield corporates	2.2%	9.8%	0.8%	5.2%	-1.4%
Euro investment-grade corporates	5.0%	1.2%	1.1%	4.8%	-0.2%
German Bunds (10-year)	8.4%	-3.5%	2.6%	5.7%	0.3%
German Bunds (2-year)	0.4%	-0.8%	-0.3%	-0.3%	-0.9%
Gold	12.8%	-6.1%	0.9%	12.5%	22.5%
MSCI AC World	-4.7%	15.9%	9.0%	4.3%	1.9%
MSCI Emerging Markets Index (USD)	-12.1%	23.7%	8.2%	1.2%	-4.1%
MSCI Japan Index	-8.9%	19.2%	10.5%	-4.2%	5.7%
S&P 500	4.0%	17.9%	14.4%	10.4%	8.3%
Stoxx Europe 600	-10.4%	18.8%	3.5%	5.1%	-3.1%
U.S. high-yield corporates	1.6%	12.7%	2.6%	7.5%	2.0%
U.S. investment-grade corporates	7.6%	1.8%	-0.6%	10.3%	8.7%
U.S. Treasuries (10-year)	9.4%	-4.0%	-1.8%	10.1%	11.9%
U.S. Treasuries (2-year)	1.4%	-0.1%	0.0%	4.0%	4.0%

Source: Bloomberg Finance L.P. as of 6/30/20

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