DWS

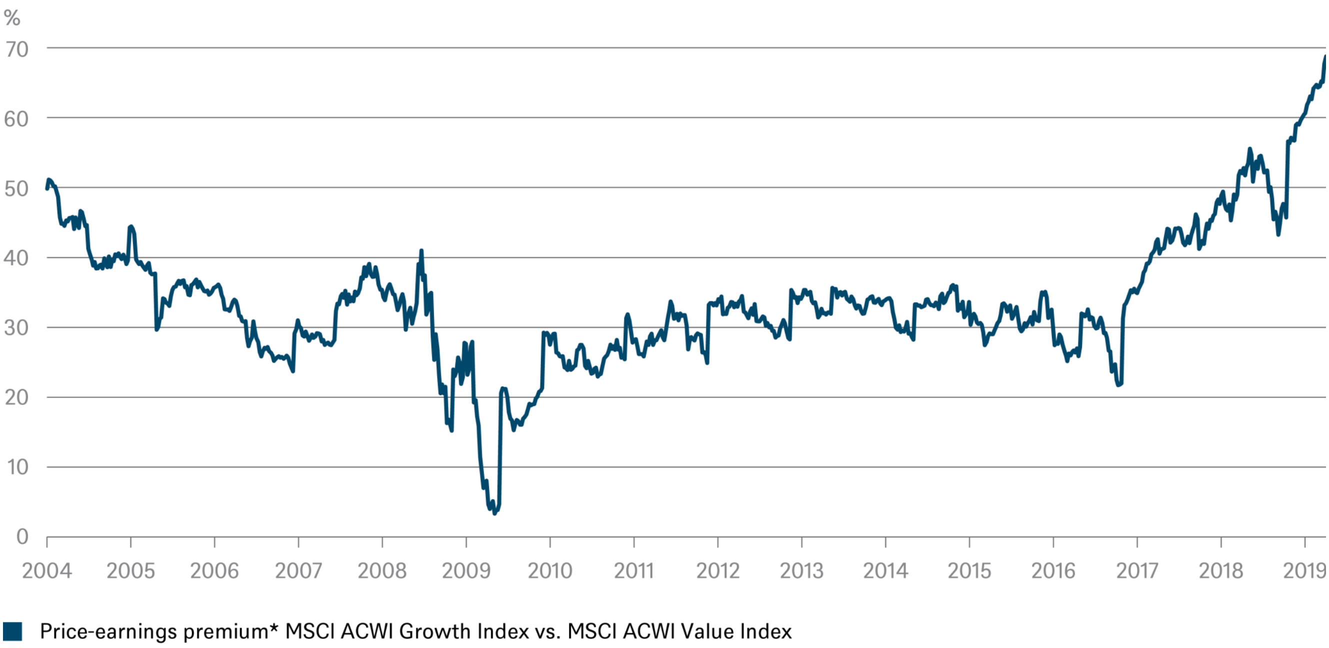
Marketing Material

# GROWING VALUATION GAP FOR GROWTH STOCKS

Growth stocks continue to grow, value stocks continue to gain value, if this is defined as a discount to the market. This cannot go on forever. But still may for a while.

There have been some surprising price moves in the current reporting season and "short covering" must be the reason for some of them. "Short covering" describes panic buying of stocks by investors who have previously sold them short in expectation of falling prices. It can happen when, for example, a cyclical industrial stock delivers disappointing results and the stock rallies nonetheless. Often if a company comes up with figures that are not as bad as feared, investors may be forced to cover their shorts. Another explanation for surprising price jumps in value stocks – for example in shares of the German automotive sector this week – could be that market expectations cannot possibly go any lower: they already assume the worst, which is reflected in the valuation.

Especially in their relative valuations , which in particular, are testimony to the current low expectations of value stocks. As our "Chart of the Week" shows, the valuation premium for growth stocks vs. value stocks (MSCI ACWI Growth and Value Index) is at record levels. Measured by the price-earnings ratio (P/E ratio), growth costs 70% more than value. "We have been observing for some time now that the expensive stocks are becoming ever more expensive while the cheap even cheaper, " says Thomas Schuessler, Co-Head of Equities at DWS. We believe there may be two main reasons . The first is that the economic boom has been going on for a long time, but with below-average growth. The longer the boom phase lasts, the greater the concern that it could end. In an environment of this kind, investors have a tendency to look for companies that can achieve growth even in a less than helpful economic environment (growth stocks historically showed their strongest performance just before markets collapsed). The second reason also has to do with the economic environment. The low interest rates, which central banks have extended further into the future, mean that future profits, which naturally carry more weight in growth stocks, continue to be discounted by a lower factor, increasing their present value. "In the absence of an upward move in interest rates, or a recession , we do not expect the trend to end, though we do not expect its recent momentum to continue. But we believe quality growth stocks will continue to find buyers in an environment that combines low interest rates and high growth," says Schuessler.




*based on next 12-months consensus earnings forecasts; Sources: Refinitiv, DWS Investment GmbH as of 7/24/19
[1]The quotient of the P/E ratio of growth and value stocks

## GLOSSARY

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

### Cyclical
**Cyclical** is something that moves with the cycle.

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

### MSCI ACWI Growth Index
The MSCI ACWI Growth Index captures large- and mid-cap securities across 23 developed- and 26 emerging markets, classified as growth stocks.

### MSCI ACWI Value Index
The **MSCI ACWI Value Index** captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified as value stocks.

### Present value
**Present value** is the value of an expected future income stream at the date of valuation.

### price-to-earnings (P/E) ratio
The **price-to-earnings (P/E) ratio** compares a company's current share price to its earnings per share.

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

### Short
**Short**, in a financial-markets context, refers to approaches that seek to gain from a fall in the price of the underlying asset.

### Valuation
**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
**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.

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