CIO | VIEW

Americas CIO View

October 28, 2020

Marketing Material

STRONG S&P 500 EPS RESULTS FOR THE THIRD QUARTER, PROBABLY THE BEST FOR THE YEAR

David Bianco

Chief Investment Officer, Americas

IN A NUTSHELL

_ Earnings season shows the economic recovery had a strong start this summer.
_ Third quarter S&P 500 EPS (week 2): Bottom-up is now 35 dollars with 23.5% aggregate beat so far.
_ Loan-loss-reserve build stops a bit over mid-cycle levels, but half of the financial-crisis levels.
_ Democratic sweep likely benefits muni bonds, if Trump stays energy benefits.
_ Biden infrastructure priorities: clean power generation and electric vehicles.

EARNINGS SEASON SHOWS THE ECONOMIC RECOVERY HAD A STRONG START THIS SUMMER

Powerful direct fiscal assistance to small businesses and households, forbearance programs, business reopening's and warmer weather all helped the U.S. economy put in a V-shaped bottom this summer. S&P 500 earnings-per-share (EPS) trends are benefitting from this recovery, especially financials and many consumer-goods industries. We are curious to see how much the improved conditions this summer helped energy and industrial capital goods. These sectors benefit from the recession ending, but still face challenging conditions. We expect tech and health care to deliver good results with quarterly sequential and year-over-year (y/y) growth as pandemic related new norms continue to boost many of these businesses. We think third-quarter S&P 500 EPS is probably the high for 2020 as the pandemic's second wave threatens growth in Europe and the United States and more stimulus before the election remains unlikely. We are concerned that support packages will be modest until the new Congress is seated.

THIRD QUARTER S&P 500 EPS (WEEK 2): BOTTOM-UP IS NOW 35 DOLLARS WITH 23.5% AGGREGATE BEAT SO FAR

130 S&P 500 companies or 38% of index earnings reported. Sizable beats from banks and some others pushed bottom-up third quarter EPS up to 35.00 dollars from 32.80 dollars at September end. The aggregate beat on EPS is 23.5% so far, but 14% ex. financials with banks mostly reported. We expect good beats to continue, as many tech and health-care firms have yet to report. Third quarter S&P 500 EPS will be 36 dollars if the rest of the companies beat by 5%, 37 dollars if they beat by 9%. Third quarter S&P 500 EPS looks likely to be about 37 dollars or down 12% y/y, but up 30% from the second quarter.

The young vs. old sector divide in earnings growth continues. We call the resilient sectors – tech+internet retailers, communications, health care, staples, utilities – the young & healthy. The other six sectors the old & vulnerable. Now about half of S&P 500 EPS is from young & healthy and old & vulnerable each. In the second quarter of 2020, earnings of young & healthy were flat y/y while those of old & vulnerable were down two-thirds. For the third quarter of 2020, the bottom-up EPS of young & healthy is down 3% y/y, while EPS of old & vulnerable down 32% y/y. The EPS decline at the old & vulnerable is less severe than in the second quarter, but the young & healthy continues to show dominating strength in comparison.

LOAN-LOSS-RESERVE BUILD STOPS A BIT OVER MID-CYCLE LEVELS, BUT HALF OF THE FINANCIAL-CRISIS LEVELS

The total loan book of FDIC[1] banks is 11 trillion dollars at the end of the second quarter. About 45% of that is S&P 500 banks and 30% from the big four.

[1] Federal Deposit Insurance Corporation

All opinions and claims are based upon data on 10/26/20 and may not come to pass. 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 based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: DWS Investment Management Americas Inc.

Loan books expanded through the second quarter, but contracted a bit in the third quarter. Loan-loss reserves at S&P 500 banks dropped from 132 billion dollars in the second quarter to 128 dollars in the third quarter, but as a % of total loans it climbed slightly from 2.51% in the second quarter to 2.56% in the third quarter on smaller loan books. At this level, the loan-loss-reserve ratio is higher than usual mid-cycle level of 1.5%-2%, but only half of that during the financial crisis of 5%+.

Near-term inflation jump risks are still low, but longer-term it is rising for monetary reasons; albeit slowly because loan growth has slowed and so far Federal-Reserve asset purchases have been funded mostly by bank excess reserves and the Treasury department's account. Cash in circulation is rising at a faster pace than normal, but it is not surging at this time. But if loan growth picks up, excess reserves will fall and cash in circulation rise. Same as the Treasury department spends. Thus, inflation risk remains a longer-term risk, after the job market improves, dependent on future fiscal policy and its interaction with monetary policy.

DEMOCRATIC SWEEP LIKELY BENEFITS MUNI BONDS, IF TRUMP STAYS ENERGY BENEFITS

We remain skeptical about the merits of rotating to cyclical-value upon a Democratic sweep. We explained last week why greater regulation, a higher U.S. statutory corporate tax rate and dividend taxation likely weighs more on value than growth sectors. Upon Trump's surprise win in 2016, value had a burst of outperformance into early 2017. Suggesting that Trump policies were good for value and a reversal would be challenging. If Democrats sweep, we would probably seek more value opportunities in foreign equities. Europe and Japan could deliver better returns than U.S. value indices. And we still think MSCI AC Asia ex. Japan offers attractive growth to help diversify from U.S. growth/tech.

BIDEN INFRASTRUCTURE PRIORITIES: CLEAN POWER GENERATION AND ELECTRIC VEHICLES

The polls at a few key swing states, including Florida, tightened last week. Odds still favor Biden, but it’s still far from certain. In the debates last week, Biden stated his aim to more rapidly transition from fossil fuels. We think utilities would benefit from policies that promote electric vehicles, renewable energy generation and upgrades to the power grid to ensure reliability and handle two-way power flow. We think next generation infrastructure projects will be less about new roads / bridges, but rather how to power and operate what’s on them.

GLOSSARY

The Democratic Party (Democrats) is one of the two political parties in the United States. It is generally to the left of its main rival, the Republican Party.

A dividend is a distribution of a portion of a company's earnings to its shareholders.

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

Fiscal policy describes government spending policies that influence macroeconomic conditions. Through fiscal policy, the government attempts to improve unemployment rates, control inflation, stabilize business cycles and influence interest rates in an effort to control the economy.

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

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

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 Asia ex Japan Index captures large- and mid-cap representation across 2 of 3 developed-market countries (excluding Japan) and 8 emerging-market countries in Asia.

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 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.

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.

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

	09/15 - 09/16	09/16 - 09/17	09/17 - 09/18	09/18 - 09/19	09/19 - 09/20
MSCI AC Asia ex Japan Index	16.8%	22.7%	1.5%	-3.4%	17.8%
S&P 500	15.4%	18.6%	17.9%	4.3%	15.1%

All opinions and claims are based upon data on 10/26/20 and may not come to pass. 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 based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: DWS Investment Management Americas Inc.

IMPORTANT INFORMATION

This marketing communication is intended for retail clients only.

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they operate their business activities. The respective legal entities offering products or services under the DWS brand are specified in the respective contracts, sales materials and other product information documents. 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 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 Group, 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 constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as giving investment advice.

The document was not produced, reviewed or edited by any research department within DWS and is not investment research. Therefore, laws and regulations relating to investment research do not apply to it. Any opinions expressed herein may differ from the opinions expressed by other legal entities of DWS or their departments including research departments.

The information contained in this document does not constitute a financial analysis but qualifies as marketing communication. This marketing communication is neither subject to all legal provisions ensuring the impartiality of financial analysis nor to any prohibition on trading prior to the publication of financial analyses.

This document 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 document. 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 in this document. Past performance is not guarantee of future results.

We have gathered the information contained in this document from sources we believe to be reliable; but we do not guarantee the accuracy, completeness or fairness of such information. All third party data are 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, including market fluctuations, regulatory change, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you might not get back the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of any investment are possible even over short periods of time. The terms of any investment will 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 any transaction.

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 or persons associated with it may (i) maintain a long or short position in securities referred to herein, or in related futures or options, and (ii) purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation.

DWS does not give taxation or legal advice. Prospective investors should seek advice from their own taxation agents and lawyers regarding the tax consequences on the purchase, ownership, disposal, redemption or transfer of the investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time. DWS is not responsible for and has no obligation with respect to any tax implications on the investment suggested.

This document may not be reproduced or circulated without DWS written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States.

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.

DWS Investment GmbH. As of: October 2020

Issued in the UK by DWS Investments UK Limited which is authorised and regulated by the Financial Conduct Authority (Reference number 429806).

© 2020 DWS Investments UK Limited

In Hong Kong, this document is issued by DWS Investments Hong Kong Limited and the content of this document has not been reviewed by the Securities and Futures Commission.

© 2020 DWS Investments Hong Kong Limited

In Singapore, this document is issued by DWS Investments Singapore Limited and the content of this document has not been reviewed by the Monetary Authority of Singapore.

© 2020 DWS Investments Singapore Limited

In Australia, this document is issued by DWS Investments Australia Limited (ABN: 52 074 599 401) (AFSL 499640) and the content of this document has not been reviewed by the Australian Securities Investment Commission.

© 2020 DWS Investments Australia Limited