COVID-19 PREVENTION: AN UNPRECEDENTED GLOBAL ECONOMIC SHOCK

David Bianco
Chief Investment Officer, Americas

IN A NUTSHELL

- Prioritizing prevention over production: expect a sharp but brief recession
- We cut our 2020E S&P 500 EPS to 150 dollars, down 10% vs. 2019, down 20% in the first half
- We cut S&P 500 2020 end target to 3100, 18.75 times 2020 normalized S&P 500 EPS
- Fourth quarter S&P 500 EPS likely 40 dollars plus, but uncertain and valuations are repricing for risks
- A different type of recovery will occur: return to work will be a priority soon

PRIORITIZING PREVENTION OVER PRODUCTION: EXPECT A SHARP BUT BRIEF RECESSION

Many cities and institutions around the world are putting prevention over production. They are curtailing large group activities through March or longer to contain the virus. Local actions and the Federal 30-day U.S. travel ban to or from Europe and parts of Asia are tremendous global economic shocks that will bring giant short-term supply and demand-side destruction. Disruptions comparable or worse than after September 11, 2001 and the onset of the financial crisis in late 2008. However, this shock and economic downturn should be brief; with no subsequent wars or extended balance-sheet repair. Gross-domestic-product (GDP) growth should rebound strongly in the back half of 2020.

Moreover, we think this economic shock will be less damaging to S&P 500 profits than past recessions; because the disruptions from this health-security shock are tilted toward in person services. Whereas, the S&P 500 is tilted toward virtual economy or electronic and automated services, such as technology, communications, and internet retailing; which are about a third of S&P 500 profits. Virtual services and essential goods and services from health care, consumer staples and utilities are now about half of S&P 500 profits. Although heavy manufacturing and financial services are still important earnings contributors, they are much smaller than historically, energy is minor, and a 2008 like surge in mortgage defaults and financial-system distress is unlikely.

WE CUT OUR 2020E S&P 500 EPS TO 150 DOLLARS, DOWN 10% VS. 2019, DOWN 20% IN THE FIRST HALF

We expect S&P 500 earnings per share (EPS) to fall about 10% to 150 dollars in 2020 from 164 dollars in 2019. We expect the first half of 2020 S&P 500 level to be down 15-20% year-over-year, followed by flattish earnings in the second half. Our quarterly S&P 500 EPS estimates are: 33+34+41+42 = 150 dollars. We introduce 2021E (expected) S&P 500 EPS of 171 dollars. Adjusting for a lower interest rate, oil price and related capex outlook, we now estimate normalized 2020 S&P 500 EPS at 160-170 dollars. When recessions occur, long-term investors focus on normalized or recovery EPS to gauge valuations. Metrics such as S&P 500 EPS excluding negatives are also used. Although negative earnings might threaten bankruptcy at some companies, they are not perpetual and mask the earnings power of the index. We expect big first half of 2020 losses at S&P 500 airlines, energy, hotels (inc. cruise, casino operators). We expect huge profit declines at S&P 500 retailers, restaurants, auto, transports and aircraft. Many industries will receive government liquidity and liability support and regulatory and creditor forbearance.

During the recessions of 1982, 1991, 2001, S&P 500 EPS fell near 20% from its four-quarter peak to trough. Declines were led by 25-50% plunges at energy, materials, and industrials. Each large sectors back then. Technology and consumer-discretionary earnings fell less than those sectors, yet more than the S&P 500 average, but mostly from tech hardware and auto, which are much smaller parts of these two sectors today. Except in 2008-2009, when S&P 500 EPS fell 45% led by financials, financial-sector earnings, especially banks, usually do not fall more than the index average.

WE CUT S&P 500 2020 END TARGET TO 3100, 18.75 TIMES 2020 NORMALIZED S&P 500 EPS

The S&P 500 fell 27% from its 3386 February 19 peak to its recent 2480 trough, among its steepest declines in history. At Friday's 2711 closing price, the S&P 500 is right on the -

20% bear-market line. We expect the S&P 500 to revisit its lows near-term, quite possibly lower, but then trade in a large range between 2500-3000 until the U.S. election. We consider 18-20 times trailing normalized earnings to be fair given low interest rates, low investment fees and a higher quality sector mix of the S&P 500 vs. history. Our intrinsic fair value estimate for the S&P 500 at 2020 end is 3150, our yearend target is 3100 and our 12-month target out to March 2021 end is 3200.

FOURTH QUARTER S&P 500 EPS LIKELY 40 DOLLARS PLUS, BUT UNCERTAIN AND VALUATIONS ARE RE-PRICING FOR RISKS

Feasibility and visibility of normalized earnings estimates will be crucial to navigating this market. Our sector preferences tilt toward attractive valuations on normalized earnings where we have better confidence in our normalized earnings estimates. Our confidence is badly shaken at industrials, materials and financials. Our confidence is shattered at energy. Our 150 dollars 2020E S&P 500 EPS includes just one dollar from energy. Energy's normal S&P 500 EPS is roughly 6 dollars or just 3.5%. Consumer discretionary, excluding internet retail, and airlines within industrials are hit the hardest by this in-person delivered services shock to the economy. Here uncertainty is less about the level of normalized earnings, but rather when a return to normal occurs. Consumer-discretionary stocks will likely be most sensitive to domestic virus developments.

A DIFFERENT TYPE OF RECOVERY WILL OCCUR: RETURN TO WORK WILL BE PRIORITY SOON

We expect unemployment and jobless claims to temporarily jump, in part on expanded eligibility for those at shut workplaces. But provided new daily infections plateau in coming weeks on preventions, we think many businesses and employees will begin to shift their priorities back to production and seek safe ways to return to work with precautions. Frequent hand washing, facility sanitizing, distancing, masks, and temperature checks will most likely be the new norm. But not going to work is unsustainable in the long term in our opinion.

GLOSSARY

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

Technically, a bear market refers to a situation where the index's value falls at least 20% from a recent high.

Capital expenditure (Capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

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.

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.

The intrinsic value is the one that comes closest to the value that an objective fundamental analysis would ascribe to an asset.

Liquidity refers to the degree to which an asset or security can be bought or sold in the market without affecting the asset's price and to the ability to convert an asset to cash quickly.

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

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

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

	02/15 - 02/16	02/16 - 02/17	02/17 - 02/18	02/18 - 02/19	02/19 - 02/20
S&P 500	-6.2%	25.0%	17.1%	4.7%	8.2%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 3/16/20

IMPORTANT INFORMATION: EMEA

The following document is intended as marketing communication.

DWS is the brand name under which DWS Group GmbH & Co. KGaA and its subsidiaries operate their business activities. Clients will be provided DWS products or services by one or more legal entities that will be identified to clients pursuant to the contracts, agreements, offering materials or other documentation relevant to such products or services.

The information contained in this document does not constitute investment advice.

All statements of opinion reflect the current assessment of DWS Investment GmbH and are subject to change without notice.

Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical performance analysis, therefore actual results may vary, perhaps materially, from the results contained here.

Past performance, [actual or simulated], is not a reliable indication of future performance.

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 and the information contained herein may only be distributed and published in jurisdictions in which such distribution and publication is permissible in accordance with applicable law in those jurisdictions. Direct or indirect distribution of this document is prohibited in the USA as well as to or for the account of US persons and persons residing in the USA.

IMPORTANT INFORMATION: UK

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

DWS is the brand name of DWS Group GmbH & Co. KGaA. 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 is a financial promotion and is for general information purposes only and consequently may not be complete or accurate for your specific purposes. It is not intended to be an offer or solicitation, advice or recommendation, 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. It has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor.

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. 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 suitable and appropriate, in light of their particular investment needs, objectives and financial circumstances. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

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 and it should not be relied on as such. 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.

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 any investments and strategies suggested by DWS. The relevant tax laws or regulations of the tax authorities may change at any time.

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 judgement as of the date of this document. Forward looking statements involve significant elements of subjective judgements and analysis 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 NO GUARANTEE OF FUTURE RESULTS.

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

IMPORTANT INFORMATION – APAC

DWS is the brand name of DWS Group GmbH & Co. KGaA. 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 Group GmbH & Co. KGaA, its affiliated companies and its officers and employees (collectively “DWS Group”) 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.

DWS Group does not give tax or legal advice. Investors should seek advice from their own tax experts and lawyers, in considering investments and strategies suggested by DWS Group. Investments with DWS Group are not guaranteed, unless specified.

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 the 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 the transaction and not the summary contained herein. Past performance is no guarantee of current or future performance. Nothing contained herein shall constitute any representation or warranty as to future performance.

Although the information herein has been obtained from sources believed to be reliable, DWS Group does not guarantee its accuracy, completeness or fairness. No liability for any error or omission is accepted by DWS Group. Opinions and estimates may be changed without notice and involve a number of assumptions which may not prove valid. All third party data (such as MSCI, S&P, Dow Jones, FTSE, Bank of America Merrill Lynch, Factset & Bloomberg) are copyrighted by and proprietary to the provider. DWS Group 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.

The document was not produced, reviewed or edited by any research department within DWS Group 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 DWS Group departments including research departments. This document may contain 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 Group as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein.

This document may not be reproduced or circulated without DWS Group’s 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 Group 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.

Unless notified to the contrary in a particular case, investment instruments are not insured by the Federal Deposit Insurance Corporation (”FDIC“) or any other governmental entity, and are not guaranteed by or obligations of DWS Group.

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.

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.

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.

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