CIO | VIEW

Americas CIO View

November 3, 2020

DWS

Marketing Material

HALLOWEEN'S BLUE MOON: LIGHT IN THE NIGHT OR JUST OMINOUS?

David Bianco
Chief Investment Officer, Americas

IN A NUTSHELL

_ Winter chills ahead spooked investors, despite receiving pictures of summer fun.
_ Third-quarter S&P 500 EPS (week 3): Bottom-up is now 37.50 dollars, most reliable firms deliver again.
_ U.S. GDP bounces strongly on consumption, but capex stays weak outside of tech.
_ U.S. manufacturing is a bifurcated situation of consumer goods vs. industrial goods.
_ Fair P/E for energy? Beware risk of a shift from perpetuity to annuity valuation.
_ Last minute portfolio tweaks before the election? Protection is not cheap.

WINTER CHILLS AHEAD SPOOKED INVESTORS, DESPITE RECEIVING PICTURES OF SUMMER FUN

The S&P 500 fell 5.6% last week, its worst week since March as cooler weather infections hit Europe and the United States. Also, a longer wait for additional stimulus became evident with the U.S. elections now knocking. Investors are contemplating how a Democratic sweep could raise policy and profit uncertainty. The dip occurred despite strong third-quarter gross domestic product (GDP) and earnings reports all week that confirmed a leap forward this summer on the recovery path. But with eerie days ahead, third-quarter reports were received like a summer memories photo album.

THIRD-QUARTER S&P 500 EPS (WEEK 3): BOTTOM-UP IS NOW 37.50 DOLLARS, MOST RELIABLE FIRMS DELIVER AGAIN

Last week was the heaviest reporting week of the season with more than 180 companies or 42% of S&P 500 index earnings reporting. Now, 315 S&P 500 companies or 78% of index earnings have reported. Health care and technology delivered again and continue to post the strongest year-over-year (y/y) earnings-per-share (EPS) growth of 7% and 5%, respectively. Some cyclical sectors, particularly industrials and materials, also beat very low expectations (by 46% and 29%, respectively), but despite big bounces still have EPS well below last year (-49% and -4% y/y, respectively). Consumer discretionary also delivered big beats so far, but retailers have yet to report. Aggregate consumer discretionary bottom-up third-quarter EPS growth is -14% y/y. Despite banks arguably under provisioning, annualized S&P 500 EPS is now about 150 dollars.

U.S. GDP BOUNCES STRONGLY ON CONSUMPTION, BUT CAPEX STAYS WEAK OUTSIDE OF TECH

GDP bounced sharply after the sharpest fall in post war history, led by a rebound in consumption / production of both services and goods as well as a large inventory rebuild. Service consumption remains below normal, but goods consumption has fully recovered. Despite third quarter's bounce, investment spending remains quite depressed, especially outside of spending on information technology and single family home construction. This is because many consumer goods in demand are imported, but more because demand and production of capital goods is weak. U.S. industrial production as of September end remains at levels below that of seven years ago and U.S. manufacturing within it more depressed, despite the rebound at cars. Some were encouraged by the September durable-goods report, but new orders still remain well below shipments, which historically suggests that shipments have further to fall. Inside, we dive deeper into the data to distinguish conditions between strength in consumer goods demand / production vs. weakness at industrial capital goods.

U.S. MANUFACTURING IS A BIFURCATED SITUATION OF CONSUMER GOODS VS. INDUSTRIAL GOODS

There is strength in manufacturing of computers and technology, where both consumer and business spending is good, and also consumer durable goods, particularly of cars and homes. But machinery demand is weak, which is likely related to weak private non-residential construction, weak aircraft and energy equipment demand. Auto units manufactured rebounded to trend in the third quarter, but the trend here still appears downward. U.S. housing starts are up sharply for single family, but down sharply at multifamily /

apartments. Many industrial capital goods are long cycle businesses still with soft outlooks. We think many industrials stocks are dependent on infrastructure stimulus, we prefer utilities.

FAIR P/E FOR ENERGY? BEWARE RISK OF A SHIFT FROM PERPETUITY TO ANNUITY VALUATION

The energy sector has been clobbered by excess supply and Covid-19 demand destruction. The elections could bring policies that accelerate transitions to clean energy and electric vehicles. This would require reexamining the likely level and longevity of recovery earnings at energy. Most investors would then probably find it too risky to capitalize such earnings in perpetuity, as they might fade rapidly or require much higher maintenance capital expenditures (capex) than depreciation to sustain. If the fair price-to-earnings ratio (P/E) construct on recovery EPS moves from 1/real cost of equity (CoE) (6%+) to a 20-40 year annuity valuation, then the fair P/E on recovery EPS drops from about 16x to 12-15x. Without a large allocation of earnings to profit replacement projects, we think sector profits could disappear in 20 years under accelerated transitions. Whether recovery profits last just 20 years or require a 25% retention for profit replacement projects to be sustained (instead of fueling real profit growth as normal), then the fair P/E on recovery EPS is about 12.5x. The sector's current 550 billion dollars market cap is about 12x our estimate of normalized profits of about 45 billion dollars assuming normal oil prices of about 55 dollars per barrel. If transition policies accelerate post-election, we think the sector's valuation is no better than fair.

LAST MINUTE PORTFOLIO TWEAKS BEFORE THE ELECTION? PROTECTION IS NOT CHEAP

We see the volatility index (Vix) as too high and Treasury yields as too low to offer much protection to a contested election. We think Asia, including Japan, may be a viable protection play while being a solid add even if not needed. Energy likely benefits most on a Trump victory surprise.

GLOSSARY

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

The CBOE Volatility Index (Vix) is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index. It is a popular measure of the volatility of the S&P 500 as implied in the short term option prices on the index.

Cost of equity (CoE) is the return (often expressed as a rate of return) a firm theoretically pays to its equity investors, to compensate for the risk they undertake by investing their capital.

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.

In relation to currencies, depreciation refers to a loss of value against another currency over time.

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 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.

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.

Pro-cyclical sectors are those likely to particularly benefit from an upturn in the economic cycle (i.e. stronger growth).

In economics, a real value is adjusted for inflation.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

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).

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

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.

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

	10/15 - 10/16	10/16 - 10/17	10/17 - 10/18	10/18 - 10/19	10/19 - 10/20
S&P 500	4.5%	23.6%	7.3%	14.3%	9.7%
U.S. Treasuries (10 -year)	4.6%	-1.8%	-3.2%	14.6%	8.5%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 11/3/20

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: [03.11.2020]

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

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.