CIO View

Americas CIO View

September 23, 2021

DWS

Marketing Material

Sector Strategy: Alpha from the middle

David Bianco
Americas Chief Investment Officer

IN A NUTSHELL

- Sector Strategy: An opportunity in between equity index and stock selection
- Macro minded intrinsic investing, expressed through sector and industry tilts
- Sector Strategy: Tilt determination process, time horizons and active risk targets
- S&P is Digital Dominated: Sector strategy beyond Tech, as Tech is a market call

Sector Strategy: An opportunity in between equity index and stock selection

Most asset owners and primary advisors focus on asset allocation. This includes how much of the total portfolio should be in the S&P 500 strategically and tactically. Many seek stock selection strategies to enhance returns. But, stock selection is risky and might bring tactical beta or other macro factor exposures that can conflict with desired asset allocation. This is why many allocators prefer to construct portfolios with index funds or stock selection strategies with limited beta and other macro factor active risk. However, opportunities exist to enhance returns with specialized macro factor management without large beta tilts and also without active stock selection risk. This is the opportunity of a pure sector strategy.

Pure sector strategy gives asset allocators a distinct third choice in portfolio building blocks from that of the usual passive index and active stock selection strategies. Index funds are efficient for tactical management and several dedicated stock selection strategies have the potential to generate uncorrelated alpha to add value. Adding a pure sector strategy allows a targeted pursuit of alpha at desired size from variation in sector and industry returns.

Macro minded intrinsic investing, expressed through sector and industry tilts

The philosophy and premise of our sector strategy is that investment allocated to S&P 500 opportunity/ risk can be enhanced by overweighting its sectors favorably exposed to macro trends without taking company specific active risk. We describe our strategy as macro minded intrinsic investing. We focus more on macro than micro, but use the same intrinsic valuation methods that most stock analysts use to seek the best intrinsic value available.

Our strategy is fundamental in nature with a focus on forward year and normalized earnings estimates by sector: S&P earnings per share (EPS) “middle-up.” Our earnings estimates reflect DWS CIO Views on key macro conditions likely to prevail in the current economic cycle. These include pace and duration of economic growth, inflation and real interest rates. Also, which regions and segments of the global economy offer the best growth; such as investment vs. consumption and within such segments, like capacity expansion vs. productivity enhancers or goods vs. services consumption. DWS CIO Views for commodity prices, key asset values, credit conditions, foreign exchange rates, taxes and other policies affect our earnings outlook.

We capitalize normalized earnings with cost of equity estimates by sector supported by history and models that use current long-term interest rates and risk premium indicators. We aim for reasonable cost of equity estimates across sectors relatively to justly account for differing systematic risk, but to avoid an overpowering sensitivity. Beyond capitalized value of normalized earnings, we consider whether or not each sector has probable long-term economic profit growth potential or decay. These considerations produce fair present values, which we compare to observed market values. We position our sector tilts consistent with the favor of macro trends, unless our valuation analysis suggests excessive market expectations of such. We

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 not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients.

consider sentiment signals and price momentum, but mostly to call our attention to where our forecasts might be wrong and require scrutiny.

Sector Strategy: Tilt determination process, time horizons and active risk targets

We aim to keep each of the 11 sector's tilts within +/- 500bp of index weight. This keeps the strategy from being too sensitive to large tilts on just one or two sectors. Our strategy is not about rotating into a few favored sectors at a time, but rather moderate tilts usually across most sectors and on key industries within sectors. Tilts on industries (S&P Global Industry Classification Standard (GICS) 3) are the active risk building blocks of this strategy. We establish tilts with the goal of working within and for at least 6 months. Once an industry's target weight is established, as its benchmark plus active weight, each stock therein is held at its industry weight in the benchmark. This eliminates active risk from stock selection, other than that from the industry tilt. Some stock active risk might exist in portfolios for trading efficiency. Low active share in a sector strategy is not low active risk. Even small sector tilts can bring significant active risk, it's difference difficult to diversify away. Different in right spots beats benchmark.

S&P is Digital Dominated: Sector strategy beyond Tech, as Tech is a market call

Our strategy still prefers intangible over physical assets, as more scalable and nimble, thus more profitable and risk resilient. Asia's industrialization has matured, thus global growth to be more consumption and service driven. All equities are real assets, strong businesses provide best inflation protection; beware of 1970's style inflation protection value traps. The global saving glut suggests no real return without risk and low returns without innovation. Health Care is an underappreciated innovator; it's the key for 21st century productivity. We see attractive capitalized earnings value at Financials, Utilities and Real Estate Investment Trusts (REITs). We underweight Energy, Materials, most Industrials and are selective by industry at the Consumer sectors.

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 not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients.

GLOSSARY

Active Share measures the percentage of stock holdings in a manager's portfolio that differ from the benchmark index. Active Share is calculated by taking the sum of the absolute value of the differences of the weight of each holding in a portfolio versus the weight of each holding in the benchmark index and dividing by two.

Alpha refers to returns in excess of a benchmark's return.

Asset allocation is the division of investments into individual asset classes (e.g. stocks and bonds).

A benchmark is an index or other value against which an investment's performance is measured.

Beta is a measure of volatility that captures a security's systematic risk according to the capital asset pricing model.

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.

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.

FX or foreign exchange is the currency — literally foreign money — used in the settlement of international trade between countries.

The Global Industry Classification Standard (GICS) is a four-tiered scheme to hierarchically classify firms by the sector and industry these firms primarily operate in.

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

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

Momentum refers to the rate of growth of an index or security's price. Momentum investors believe that strong growth is likely to be followed by further gains.

Productivity measures how much economic output is produced for a given level of inputs (such as capital and labor).

A Real Estate Investment Trust (REIT) is a company that owns and, in most cases, operates income-producing real estate. REITs sell like a stock on the major exchanges and invest in real estate directly, either through properties or mortgages.

The real interest rate is the nominal interest rate adjusted for inflation as measured by the GDP deflator.

The risk premium is the expected return on an investment minus the return that would be earned on a risk-free investment.

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

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 not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Alternative investments may be speculative and involve significant risks including illiquidity, heightened potential for loss and lack of transparency. Alternatives are not suitable for all clients.

IMPORTANT INFORMATION – EMEA, APAC & LATAM

DWS is the brand name of DWS Group GmbH & Co. KGaA and its subsidiaries under which they do business. The DWS legal entities offering products or services are specified in the relevant documentation. 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 for information/discussion purposes only and does not constitute an offer, recommendation or solicitation to conclude a transaction and should not be treated as investment advice.

This document is intended to be a marketing communication, not a financial analysis. Accordingly, it may not comply with legal obligations requiring the impartiality of financial analysis or prohibiting trading prior to the publication of a financial analysis.

This document contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements. Past performance is no guarantee of future results.

The information contained in this document is obtained from sources believed to be reliable. DWS does not guarantee the accuracy, completeness or fairness of such information. All third party data is 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. Detailed information on risks is contained in the relevant offering documents.

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 does not give taxation or legal advice.

This document may not be reproduced or circulated without DWS's written authority.

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.

For institutional / professional investors in Taiwan:

This document is distributed to professional investors only and not others. Investing involves risk. The value of an investment and the income from it will fluctuate and investors may not get back the principal invested. Past performance is not indicative of future performance. This is a marketing communication. It is for informational purposes only. This document does not constitute investment advice or a recommendation to buy, sell or hold any security and shall not be deemed an offer to sell or a solicitation of an offer to buy any security. The views and opinions expressed herein, which are subject to change without notice, are those of the issuer or its affiliated companies at the time of publication. Certain data used are derived from various sources believed to be reliable, but the accuracy or completeness of the data is not guaranteed and no liability is assumed for any direct or consequential losses arising from their use. The duplication, publication, extraction or transmission of the contents, irrespective of the form, is not permitted.

© 2021 DWS Investment GmbH

Issued in the UK by DWS Investments UK Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

© 2021 DWS Investments UK Limited

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

© 2021 DWS Investments Hong Kong Limited

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

© 2021 DWS Investments Singapore Limited

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

© 2021 DWS Investments Australia Limited

as of 9/23/21; 085612_1 (09/2021)

IMPORTANT INFORMATION – NORTH AMERICA

The brand DWS represents DWS Group GmbH & Co. KGaA and any of its subsidiaries, such as DWS Distributors, Inc., which offers investment products, or DWS Investment Management Americas Inc. and RREEF America L.L.C., which offer advisory services.

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, 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 and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction 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 and should not be treated as giving investment advice. DWS, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Investments with DWS are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover 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. Further, investment in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets or imposition of (or change in) exchange control or tax regulations in such markets. Additionally, investments denominated in an alternative currency will be subject to currency risk, changes in exchange rates which may have an adverse effect on the value, price or income of the investment. 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. The terms of an investment may 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 investment and not the summary contained in this document.

This publication 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 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 as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. Any securities or financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation ("FDIC") unless specifically noted, and are not guaranteed by or obligations of DWS or its affiliates. We or our affiliates or persons associated with us may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of DWS. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. 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.

Past performance is no guarantee of future results; nothing contained herein shall constitute any representation or warranty as to future performance. Further information is available upon investor's request. All third party data (such as MSCI, S&P & Bloomberg) are copyrighted by and proprietary to the provider.

For Investors in Canada: No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein and any representation to the contrary is an offence. This document is intended for discussion purposes only and does not create any legally binding obligations on the part of DWS Group. Without limitation, this document does not constitute an offer, an invitation to offer or a recommendation to enter into any transaction. When making an investment decision, you should rely solely on the final documentation relating to the transaction you are considering, and not the [document – may need to identify] contained herein. DWS Group is not acting as your financial adviser or in any other fiduciary capacity with respect to any transaction presented to you. Any transaction(s) or products(s) mentioned herein may not be appropriate for all investors and before entering into any transaction you should take steps to ensure that you fully understand such transaction(s) and have made an independent assessment of the appropriateness of the transaction(s) in the light of your own objectives and circumstances, including the possible risks and benefits of entering into such transaction. You should also consider seeking advice from your own advisers in making this assessment. If you decide to enter into a transaction with DWS Group you do so in reliance on your own judgment. The information contained in this document is based on material we believe to be reliable; however, we do not represent that it is accurate, current, complete, or error free. Assumptions, estimates and opinions contained in this document constitute our judgment as of the date of the document and are subject to change without notice. Any projections are based on a number of assumptions as to market conditions and there can be no guarantee that any projected results will be achieved. Past performance is not a guarantee of future results. The distribution of this document and availability of these products and services in certain jurisdictions may be restricted by law. You may not distribute this document, in whole or in part, without our express written permission.

For investors in Bermuda: This is not an offering of securities or interests in any product. Such securities may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act of 2003 of Bermuda which regulates the sale of securities in Bermuda. Additionally, non-Bermudian persons (including companies) may not carry on or engage in any trade or business in Bermuda unless such persons are permitted to do so under applicable Bermuda legislation.

© 2021 DWS Investment GmbH, Mainzer Landstraße 11-17, 60329 Frankfurt am Main, Germany.

All rights reserved.

as of 9/23/21; 085611_1 (09/2021)