Market update | Liquid real assets

As of March 31, 2021

Macroeconomic indicators

Broad themes

_ Markets pulled back in mid-March as a rise in both nominal and real U.S. 10-Year yields weighed on valuations, but regained their footing to end the month higher, supported by stimulus efforts and optimism over the vaccine rollout in the U.S. The month was marked by the passage of the Biden administration's much-anticipated $1.9 trillion relief bill and further punctuated by the announcement of an additional $2 trillion in proposed infrastructure stimulus. Meanwhile, on the coronavirus front, case counts continued to surge globally with John Hopkins reporting over 130 million confirmed cases worldwide. While markets have been encouraged by daily case counts trending downward in the U.S. overall, sharp increases internationally remain sources of unease, particularly in India, Brazil, and across the European Union (EU). Governments in Europe have expressed concern that the virus is threatening to overrun healthcare and hospital systems, prompting renewed lockdown considerations in Germany and France. While Israel and the U.S. lead the world in terms of administered vaccines, the EU continues to languish. Worse still, a bungled EU vaccination rollout has damaged public confidence in both the administration as well as vaccine efficacy and safety.

_ On the U.S. political front, the passage of the $1.9 trillion relief bill marked the first major victory for the Biden administration, and included $1,400 direct payments to individuals, expansion of child tax credits, federal aid for state and local governments, and additional funds for vaccination distribution and virus-tracking efforts, including variants. Additional infrastructure-specific stimulus, were it to pass Congress, would to go towards fortifying, improving, and modernizing U.S. infrastructure in order to compete with China as Sino-U.S. relations continue to deteriorate. Although expectations that the bill will pass in its current form are low, the potential exists for Democrats to use the reconciliation process to push significant portions through. Listed infrastructure companies were well-supported on the news, outperforming broader equity markets by +4% on the month and leading gains across the majority of real assets classes.

_ Precious metals continue to bear the brunt of the rise in nominal yields, as Gold broke below the $1,700/oz level and a new wave of ETF liquidation threatens a breach of the $1,650/oz level. A resurgence in U.S. dollar strength (DXY) also weighed during the month. We expect Gold to remain challenged in the near-term.

_ Oil prices were whipsawed during the month of March, owing largely to heightened volatility after an enormous cargo ship ran aground in the Suez Canal, disrupting a critical shipping route; the blockage was ultimately cleared with prices moderating in response. The OPEC+ meeting was the highlight in March, as members agreed to ramp up production gradually over the next three months, including tapering Saudi Arabia's voluntary cuts. The news was largely in line with expectations, and the oil market rallied in response, a sign of confidence in the ability to absorb additional barrels this summer. Nonetheless, we expect continued volatility as demand will remain in the spotlight. Continuing lockdowns, including in France and Mumbai, will keep the market on edge.

_ On the economic front, markets are now looking ahead towards continuing jobless claims, personal income, and spending data for signs that the economic recovery continues to trend in the right direction. Though various risks threaten to disrupt appetite for risk assets, credit spreads continue to show little signs of distress. Of particular note, volatility was muted into month-end, with the VIX falling below the 19 level for the first time in over a year. Should this measure continue to trend downward, we expect that some quantitative allocation strategies will increase equity exposure as risk-adjusted returns implicitly rise. We note that our reflation thesis has been challenged of late, with U.S. economic growth poised to accelerate at its highest rate ever. Looking ahead, we remain vigilant, but steadfast in our assertion that the benefit of the doubt tilts towards our preferred exposures in natural resources, commodities, and select infrastructure sectors, which are well-positioned to protect against rising prices.

_ **For real assets classes:**

  _ Global Real Estate securities posted solid gains during the month, trailing just slightly behind broader equity markets. In the U.S., we observed a pause in the re-opening trade, with Industrial, Apartments, Self Storage, and Data Centers leading gains. Amongst the re-opening sectors, gains were more modest as Hotels and Malls fought to regain footing after a sharp late-month pullback. Internationally, Asia ex Japan was the weakest performer after leading gains the prior month. While Singapore developers were the standouts, posting gains in excess of 12%, weakness stemmed from Hong Kong as tensions between the U.S. and China weighed during the period. Continental Europe was flat as an ineffective and further-delayed vaccine program continues to stunt recovery progress across the region. The United Kingdom fared better, posting modest gains. Canada, Japan, and Australia were the top performers from a regional standpoint, with notably strength from Canada REITs (broadly), diversified residential developers in Australia, and Japan developers.

  _ Commodities slipped while Natural Resources posted moderate gains during March. On the commodities side, Livestock was the only segment to post gains, supported by concerns regarding the containment of African Swine Flu (ASF) in China. Agriculture was next, with performance mixed. Corn and Soybean were the top performers while Softs and Wheat were weak, dragging down the complex. On the metals side, Palladium had a standout month while Gold and Silver were challenged against a backdrop of rising nominal yields and a strengthening USD. Across base metals, Zinc and Aluminum posted modest gains while Nickel was the clear laggard. Within the Energy space, most commodities posted losses as demand concerns weighed, with Gasoline the only exception, eking out a small gain. Higher-beta Natural Resources posted modest gains on the month, with strength broad-based. Steel and precious metals and miners were the top performers while Bulk Metals & Mining names were the only segment to post losses.

  _ Global infrastructure was the top performing real asset class in March, supported by positive sentiment surrounding the large infrastructure spending bill proposed in the U.S. ($2 trillion), as well as strength from the technology sector. Within the U.S. and Europe, communications names were the standouts during March. Globally, strength was broad-based with few exceptions, including Europe Transports which struggled against a troublesome vaccine backdrop on the Continent, and Canada Midstream Energy names as environmental concerns threaten pipeline development. Within the Americas, MLPs, Rail, Waste, and Airports were all well-bid during the month Internationally, Australia, Japan, and Asia ex Japan infrastructure names also responded positively to the potential impact of stimulus funds.

Global real estate

Broad themes

Across the real estate landscape, we are focused on current valuations and the likelihood of cash flows to recover to pre-Covid-19 levels as a framework to assess potential opportunities. From a positioning perspective, we expect the economic environment to continue to recover from the pandemic and government induced shutdowns as Covid-19 vaccines get disseminated. At the margin, we have increased exposure to sub-sectors that have better chances of recovery after a vaccine.

Sector-level themes

_ **Hotels** – despite a new wave of COVID-19 shutdowns, our view is that the market will look through some of these negative headlines and focus on a gradual distribution and uptake of a vaccine, resulting in reacceleration of some of the reopening trends. Additionally, our growth and inflation model suggests that during the first half of 2021, the economy will see an acceleration in inflation (CPI) and growth GDP), which is positive for short duration and cyclical sectors such as Hotels.

_ **Retail / Malls** – we see select opportunities within regional malls, driven by M&A catalysts. Across the retail segment, we have a less favorable view, continuing to favor core strips anchored by essential businesses (i.e. grocery stores, pharmacies) which are providing support as COVID-19 case counts fluctuate across the globe.

_ **Office** – the rationalization of space needs continues across the sector. Short-term, occupancy is likely to hold up relatively better, but longer-term, companies are likely to need less space as the "work from home" dynamic has proven successful.

_ **Apartments** – we continue to favor single-family rentals and manufactured housing, given the trend of people leaving the urban core at the margin in favor of the suburbs. By contrast, we are particularly bearish on pure apartments.

_ **Data Centers / Towers** – the macro backdrop for these sectors remains very attractive, with network upgrades providing the next wave of rental growth for towers and outsized cloud usage lending strength to data center fundamentals. However, these sectors may take a pause in the near-term given significant outperformance throughout the pandemic-driven sell-off.

_ **Industrial** – while we still have a favorable view of fundamentals, our view it that fundamentals in sectors hit hard by COVID-19 shutdowns will accelerate faster than Industrial at cheaper valuations. We favor select smaller cap names within the sector as we see relative valuation as attractive relative to the higher-quality large cap names.

Source: DWS International GmbH.
Past performance is not a reliable indicator of future returns. Forecasts are based on assumptions, estimates, views and hypothetical models or analyses,which might prove inaccurate or incorrect.

Global infrastructure

Broad themes

Within the listed infrastructure space, we believe the current environment should favor sectors poised to benefit from further economic re-opening trends and improving mobility. Fundamentals remain healthy within the defensive communication and utility sectors, though attractive relative valuations and robust recovery growth rates in other sectors, such as energy and transports, warrant minimal near-term exposure to defensives, in our view. Given our expectation for a "Quadrant 2" environment, cyclical sectors such as energy and transports typically perform well when economic growth is accelerating, and our conviction in these sectors are further supported when combined with attractive valuations and accelerating fundamentals.

Sector-level themes

_ **Midstream Energy** – An improving fundamental backdrop coupled with emerging growth catalysts should support the midstream sector in the near-term. Specifically, higher oil prices are supporting volumes for traditional hydrocarbons, while the global increase in demand for natural gas and industry-wide ESG trends are presenting new project opportunities among industry leaders. In the near-term, we expect relative valuations and fundamentals to offer tactical investment opportunities, whereas quality and ESG factors should facilitate longer-term sustainable growth catalysts.

_ **Regulated Utilities** – Fundamentals are stable, but disperse business profiles require selective exposure. In Europe, we are concerned on mixed valuations and uncertain policy measures. We believe minimal exposure is justified based on the current economic backdrop, though we see select opportunities in attractively valued names with stable business models. In addition, we expect the renewable energy sector to benefit from secular tailwinds and favorable government policy.

_ **Communications** – The long-term story remains robust, aided by sustainable growth catalysts. However, slowing near-term fundamentals may hinder performance for select cell tower companies. We believe steady growth names present upside opportunity, specifically small-cell tower businesses that are seeing cash flows accelerate as cellular carriers continue spending on 5G – a trend we expect to continue. In Europe, the tower business continues to expand which speaks well for future growth opportunities.

_ **Transports** – We expect the global transport sector to benefit from continued economic re-opening trends and a resurgence in fundamental growth drivers. Select airports appear attractively valued and bottoming fundamentals should provide support. Furthermore, certain transport companies are better positioned with stronger balance sheets and plenty of liquidity cushion should the pace of the economic recovery stall. For toll roads, we believe companies with high quality assets and visible project pipelines should remain well bid in this environment.

Natural resource equities

Broad themes

Natural resource equities posted gains during March. Steel names were the standouts, followed by Precious Metals & Mining names, which found their footing after a difficult month prior. Bulk Metals & Mining stocks were the only sub-sector to post losses. Meanwhile, Agriculture also performed well overall, with Agricultural Chemicals names among the standouts.

Sector-level themes

_ **Base metals producers** – While China demand data continues to be robust (notwithstanding the anticipated seasonal slowdown) as credit expansion has been commodity intensive, positive vaccine development also highlights the recovery of Western demand going forward. Combined with supply constraints from reduced capex, we expect strength in base metals to persist. We retain a positive view on iron ore and steel in this environment.

_ **Precious metals and mining companies** – rising COVID-19 infection rates in several countries has resulted in increased risks to supply. We are monitoring names with reasonable valuations and potential catalysts, but are cautious at this time given the muted outlook for Gold. We retain a positive view on PGM (Palladium) mining exposure.

_ **Paper and packaging** – corrugated box demand continues to be strong, supported by acceleration of e-commerce and a shift away from services to goods consumption.

_ **Energy companies** – given positive vaccine developments, we expect pressure on oil prices to lift somewhat in the near-term, particularly in light of the latest stimulus bill. We remain on the lookout for tactical opportunities across the space.

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Commodities

Sector-level themes

Energy

_ The Energy sector w as w eak during March as pandemic-driven concerns w eighed on demand during the period. To begin, Crude Oil sold off prior to the OPEC + Russia monthly review meeting as markets expected Saudi Arabia to reverse its voluntary 1MM barrels per day cut w ith additional increases from other members of the agreement. How ever, Saudi Arabia once again surprised the market by maintaining the voluntary cut. This sent the Oil price up once again. During the month, volatility w as further compounded by trouble at the Suez Canal, w here one of the w orld's largest container ships (the Ever Given) ran aground. The blockage along this critical trade route, w hich sees 12% of global trade and 10% of the w orld's oil pass through its w aters on an annual basis, about a w eek to resolve, preventing estimated $9.6 billion w orth of goods from passing each day. The impact w as temporary, and prices moderated after the ship w as re-floated. Other highlights during March included a second OPEC meeting, w here members agreed to ramp up production gradually over the next three months, including tapering Saudi Arabia's voluntary cuts. The move w as largely expected, and markets responded positively. Additionally, in the U.S., a bi-partisan group of Senators issued a press release announcing their intention to re-introduce the No Oil Producing and Exporting Cartels Act (NOPEC), designed to authorize the Justice Department to bring law suits against oil cartel members for anti-trust violations. Similar ttempts have continued to pop up and fail since 2000. Elsew here across the complex, volatility resumed in Natural Gas, w hich saw steep price declines during the month as disruption from the recent storm receded. Prices stabilized into month-end as U.S. production has recovered fully to pre-w inter storm levels. The rate for inventory build-up is now above the seasonal average.

_ **Our view:** While there could be some short term volatility, w e expect Crude Oil prices to remain supported as the rate of vaccinations in the U.S. gathers steam and the economy moves tow ards re-opening. Meanw hile, natural gas demand should remain susceptible to changing w eather patterns.

Metals

_ **Base Metals** experienced some retracement during the month as risk sentiment remained muted. Nickel and Copper underperformed w hile Aluminum and Zinc logged modest gains. The dramatic drop in Nickel prices came as major stainless steel producer Tsingshan Holding Group Co. announced plans to bring new supply to market w hile Tesla also announced the development of new battery technology w ithout Nickel, triggering a change in investor sentiment. Copper slid as new catalysts failed to emerge against a backdrop of rising virus cases. Meanw hile, Aluminum found support as Chinese focus on environmental regulations put supply at risk w ith production curtailments announced in Inner Mongolia.

_ **Precious Metals** continued to slide during March, w ith the exception of Palladium, w hich continued its run on supply concerns as Norilsk Nickel announced a longer than expected restart time from flooded mines, putting a significant amount of palladium production (almost 5% of supply) at risk. Silver and Gold succumbed to pressure from rising nominal yields and a resurgence in USD strength, w hich w eighed on the complex as a w hole.

_ **Our view:** We continue to prefer industrial metals (copper and ali) over precious metals as a recovery, albeit slightly delayed, is likely to give the complex a renew ed demand push in light of restrictive supply conditions.

Agriculture

_ **Agriculture** w as mixed during the month, w ith U.S. dollar strength a headw ind. Livestock w as the standout given production concerns compounded by African Sw ine Flu (ASF) spread in China. Corn, Soybeans, and Soybean Oil managed positive returns, w hereas Cotton, Cocoa, Sugar, and Coffee led the complex low er. During the final w eek of March, the USDA released the Prospective Planting and Quarterly Stocks report. The complex w as up 5% on the day as the farmers surprised the market w ith planting coming in w ay under expectations. Many pointed to lack of incentive for farmers to expand their acreage; prices w ill need to go higher to incentivize planting or w e w ill need to deter demand.

_ **Our view:** We continue to prefer Sugar and Cotton over Coffee, and Corn and Soybeans over Wheat, and remain constructive on the grains complex w here low inventories demand high risk premium as w e approach spring. While there could be some acreage expansions in the next report (June), clearly the report w as bullish as w e do expect a backdrop of improving global demand as w e move tow ards re-opening.

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