OUR TACTICAL AND STRATEGIC VIEW

Markets tanked too strong and too fast in December. Now they rallied in January – too strong and too fast? While investors are still adapting to an environment of lower growth and inflation, markets are likely to move sideways in a volatile manner.

MARKET OVERVIEW

What was lost has been regained might sum up the past month. Many financial markets recovered in January almost exactly what they gave up in December. December 24 marked the low point of the almost perfect V-shaped performance of many stock indices. The same was true for the oil price, which has been remarkably closely correlated with the S&P 500 for several months now. The Vix, the index that tracks the implied volatility of the S&P 500, has meanwhile produced a near mirror image of this curve, following almost precisely the opposite trajectory over the past two months. Just before Christmas, as market alarm bells rang, it was about twice as high as at the end of January. Gold, on the other hand, has taken a completely different path, following an upward trend since August that accelerated in December and January. Several factors could be put forward to explain this, but the news that central banks have been buying more gold than for 50 years is certainly significant.

The start to the year was then very strong. With a gain of 6.9%, the S&P 500 enjoyed its fifth best January since 1930, and the MSCI AC World Index the best opening since its launch in early 1988. This is encouraging and bolsters confidence in the financial markets as they begin the year. It means that many funds already have a risk buffer and dry powder with which to buy risky assets.

However, one might question, as we did in our last monthly review, whether prices have moved too far, too fast. Politics and the economy as a whole have certainly not provided any positive impetus over the past five weeks. There are many, sometimes contradictory, reports about the U.S.-Chinese trade talks but the all-clear can only be sounded when the ink on the contracts is dry. And even this all-clear would not be convincing, as the U.S. action against one large Chinese telecommunications supplier shows in our opinion, among other things, that the U.S. authorities are concerned about more than the bilateral trade deficit or customs duties when it comes to China. Nor do recent developments in the United States suggest the predictability of U.S. foreign policy is going to improve. Special investigator Robert Mueller is on the verge of delivering his report on possible Russian interference into the U.S. election. And Trump's budget dispute with Congress could also have an impact on his decision-making. After all, his die-hard supporters regard the end of the federal government shutdown, despite the lack of a commitment to finance a border wall, as a capitulation to the Democrats. They are expressing their displeasure loudly, and Trump is often sensitive to criticism from his hardline fans.

Things are not much better across the Atlantic. The Brexit negotiations are still dominating the headlines. Despite a series of the United Kingdom's (UK's) parliamentary votes, little or no progress has been made less than two months before Britain's European-Union (EU) Exit Day, at the end of March. We think that the danger of a disorderly, hard Brexit has increased. The markets' serenity is therefore rather surprising. Meanwhile the world and the EU can offer something to restore a little faith in the sanity of global economic policies. The EU-Japan trade agreement goes live on February 1.

If politics has not provided reasons for the market recovery, what has? It is not too much of a surprise that it was, once again, the U.S. Federal Reserve Board (Fed). Having unsettled the markets with quite hawkish comments in December, it began to change its tune at the end of the year and leaned towards a more dovish approach at the end-January Fed meeting. In the tradition of his predecessors, Fed-Chairman Jerome Powell appears very receptive to the markets' concerns. The Fed's message that it would be "patient" on future interest-rate adjustments and even on reductions of its balance sheet was inspirational for markets – not only in the United States, but also in emerging markets (EM), where higher U.S. interest rates and a stronger U.S. dollar (USD) often hurt most.

The economy did not respond to the excitement. Its signals were, at best, mixed in January. While most full-year forecasts around the globe continue to be downgraded, some gross-domestic-product (GDP) figures suggest that the extent of the downturn in growth is becoming less severe. Leading indicators seem to be stabilizing at a lower level. Whether this means the global economy has softened as much as it is going to and can rebound from here will only become clear in the course of the first half of the year; it might be that the weakening we have seen is part of a longer downward journey. Whether and to what extent the various Chinese stimulus packages bear fruit will play an important role in this regard. But we do not expect a global recession this year.

OUTLOOK AND CHANGES

This month our tactical changes are centered on bonds. For equities, the reporting season to date confirms our assumption in December that the market correction was exaggerated. In particular, cyclical stocks were severely punished at the end of 2018, which suggests their prices are unlikely to fall further and may even rise in some cases, even when quarterly figures are unconvincing. Analysts continue to reduce their profit forecasts for 2019 but they are only doing what the market has already anticipated. For the biggest market, the United States, we remain optimistic about corporate earnings and expect a 4% increase over 2018. Excluding the volatile energy sector, the likely increase is 5.5%. In view of the past month's rapid rally, however, we expect only a sideways movement in the short term, having previously expected a move up.

This U.S. picture can largely be applied to global markets. We believe that cuts in earnings forecasts, especially for cyclical stocks, have only been half fulfilled. Therefore, equity markets will probably need a new "narrative" – the prospect of a global re-acceleration – in order to exceed last year's highs. Given continuing high political uncertainty and the undeniable risk of political mistakes, we are not yet prepared to put much emphasis on such an optimistic scenario.

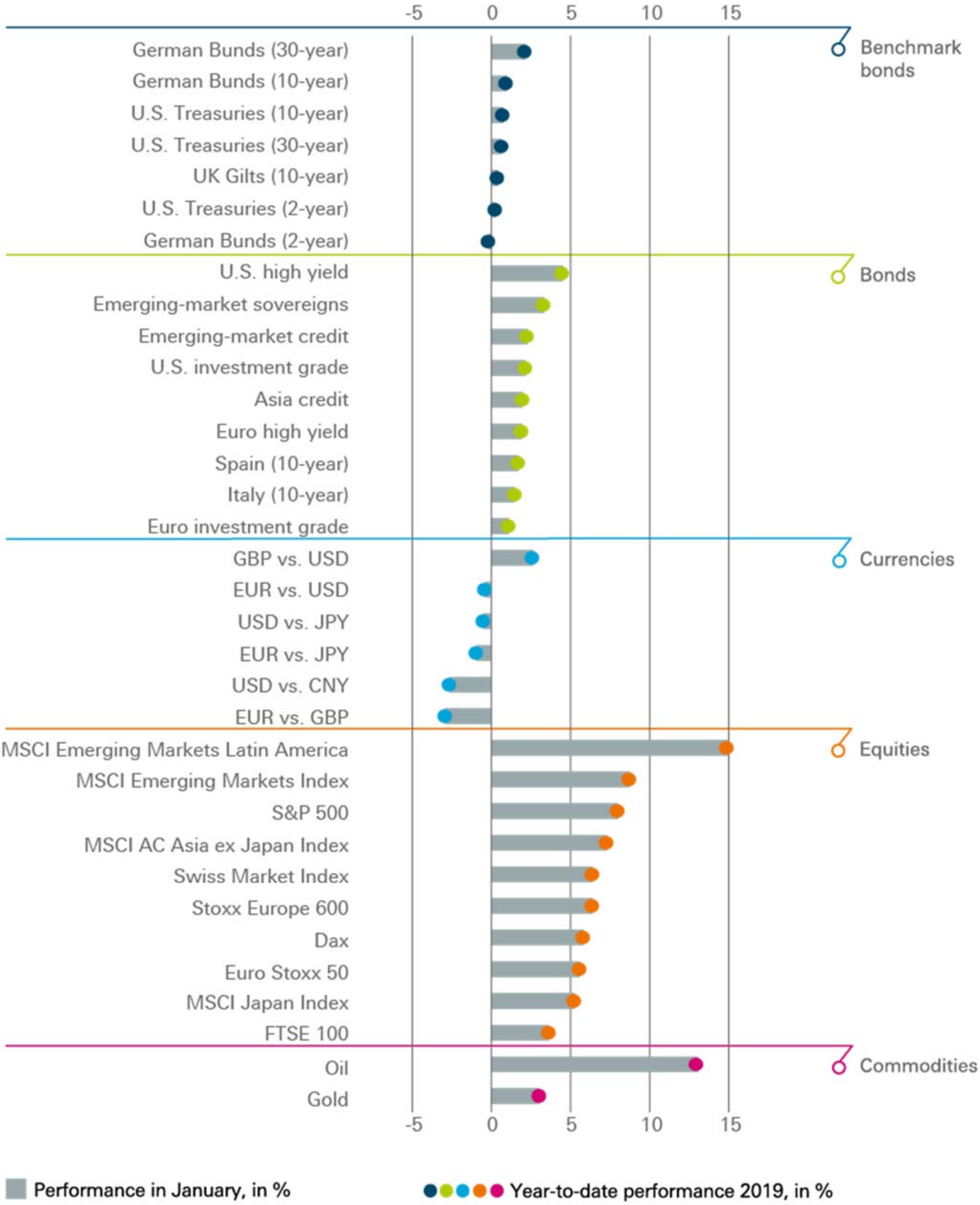
We are sticking to our neutral regional recommendations but continue to believe in the long-term growth prospects of EM. The first quarter may be a good time to consider increasing EM-equity exposure as several headwinds are expected to ease. We do not expect the USD to strengthen further, the Fed is looking tame, and reforms in China and Brazil should benefit the corporate sector. In Europe, we maintain our structural preference for small and medium-sized companies, bolstered by better growth and continued Mergers & Acquisitions (M&A) activity, over their larger competitors. We maintain our overweight in the financial sector. U.S. banks, which account for approximately 25% of the sector's global market capitalization, performed solidly in the fourth quarter of 2018 and banks have shown a willingness to return excess capital to shareholders.

In the bond market we have made some tactical changes as a result of the slowdown in the interest-rate cycle that has now been confirmed by the Fed. However, it is true that the radical change in sentiment at the turn of the year has already resulted in a narrowing of risk premiums, particularly for some higher-yielding bonds. Nevertheless, we expect investors to keep up their risk appetite for the time being, which should have a positive impact on corporate and EM bonds. Now that we have upgraded EM and U.S. high-yield bonds, we are positively positioned in them. In view of the numerous risks that also lie ahead we are also upgrading 10-year U.S. Treasuries again, not only because of the Fed's new found flexibility, but also as a hedge, in case one of the areas of risk becomes worse than we have assumed in our baseline scenario.

In Europe, we remain neutral on Bunds across the entire yield curve. Here, too, the central bank has taken a little wind out of the sails of the interest-rate-rise boat. It was much more cautious at its last meeting. We remain negative, however, on Italian government bonds. In addition to the unresolved political crisis, the latest economic figures – Italy has slipped into technical recession – also showed the extent of the difficulties the country faces. We have moved to a negative stance on Gilts. The Brexit process is proving to be painful and the current yields are still too low. As far as currencies are concerned, we have no open positions at present and are neutral on all major currency pairs.

PAST PERFORMANCE OF MAJOR FINANCIAL ASSETS

Total return of major financial assets year-to-date and past month



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 1/31/19

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FIXED INCOME*

Rates	1 to 3 months	until December 2019
U.S. Treasuries (2-year)	🟡	↗
U.S. Treasuries (10-year)	🟢	↗
U.S. Treasuries (30-year)	🟢	↗
UK Gilts (10-year)	🔴	↗
Italy (10-year)[1]	🔴	↗
Spain (10-year)[1]	🟡	→
German Bunds (2-year)	🟡	↗
German Bunds (10-year)	🟡	↗
German Bunds (30-year)	🟡	↗
Japan (2-year)	🟡	↗
Japan (10-year)	🟡	↗

Securitized / specialties		
Covered bonds[1]	🔴	↘
U.S. municipal bonds	🟡	→
U.S. mortgage-backed securities	🟡	↗

Corporates	1 to 3 months	until December 2019
U.S. investment grade	🟢	↗
U.S. high yield	🟢	↗
Euro investment grade[1]	🟢	→
Euro high yield[1]	🟢	↘
Asia credit	🟢	→
Emerging-market credit	🟢	↗

Currencies		
EUR vs. USD	🟡	→
USD vs. JPY	🟡	↗
EUR vs. GBP	🟡	→
GBP vs. USD	🟡	→
USD vs. CNY	🟡	↗

Emerging markets		
Emerging-market sovereigns	🟡	↗

EQUITIES*

Regions**	1 to 3 months	until December 2019
United States	🟡	↗
Europe	🟡	↗
Eurozone	🟡	↗
Germany	🟡	↗
Switzerland	🟡	↗
United Kingdom (UK)	🟡	↗
Emerging markets	🟡	↗
Asia ex Japan	🟡	↗
Japan	🟡	↗

Sectors**	1 to 3 months
Consumer staples	🟡
Healthcare	🟡
Telecommunications	🟡
Utilities	🟡
Consumer discretionary	🟡
Energy	🟡
Financials	🟢
Industrials	🟡
Information technology	🟡
Materials	🟡
Real Estate	🔴

Styles**	
U.S. small caps	🔴
European small caps	🟢

* as of 1/31/19
** relative to the MSCI AC World
[1] Spread over German Bunds in basis points

ALTERNATIVES*

Alternatives	1 to 3 months	until December 2019
Infrastructure (listed)	●	↗
Commodities	●	↗
Real estate (listed)	●	↗
Real estate (non-listed) APAC	●	↗
Real estate (non-listed) Europe	●	→
Real estate (non-listed) United States	●	→
Hedge funds	●	↗

* as of 1/31/19

COMMENTS REGARDING OUR TACTICAL AND STRATEGIC VIEW

Tactical view

_ The focus of our tactical view for fixed income is on trends in bond prices, not yields.

Strategic view

_ The focus of our strategic view for sovereign bonds is on yields, not trends in bond prices.

_ For corporates and securitized/specialties bonds, the arrows depict the respective option-adjusted spread.

_ For bonds not denominated in euros, the illustration depicts the spread in comparison with U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds.

_ For emerging-market sovereign bonds, the illustration depicts the spread in comparison with U.S. Treasuries.

_ Both spread and yield trends influence the bond value. For investors seeking to profit only from spread trends, a hedge against changing interest rates may be a consideration.

KEY

The tactical view (one to three months)

_ ● Positive view

_ ● Neutral view

_ ● Negative view

The strategic view up to December 2019

Equity indices, exchange rates and alternative investments:

The arrows signal whether we expect to see an upward trend ↗, a sideways trend → or a downward trend ↘ .

The **arrows' colors** illustrate the return opportunities for long-only investors.

_ ↗ Positive return potential for long-only investors

_ → Limited return opportunity as well as downside risk

_ ↘ Negative return potential for long-only investors

Fixed Income

For sovereign bonds, ↗ denotes rising yields, → unchanged yields and ↘ falling yields. For corporates, securitized/specialties and emerging-market bonds, the arrows depict the option-adjusted spread over U.S. Treasuries: ↗ depicts a rising spread, → a sideways trend and ↘ a falling spread.

The **arrows' colors** illustrate the return opportunities for long-only investors.

_ ↘ Positive return potential for long-only investors

_ → Limited return opportunity as well as downside risk

_ ↗ Negative return potential for long-only investors

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

	01/14 - 01/15	01/15 - 01/16	01/16 - 01/17	01/17 - 01/18	01/18 - 01/19
UST 30yr	28.1%	-4.4%	-3.4%	4.7%	2.1%
UST 10yr	10.2%	0.6%	-2.0%	0.2%	3.9%
UST 2yr	1.0%	0.6%	0.4%	0.0%	2.1%
UK 10yr	13.0%	0.9%	3.2%	0.8%	4.2%
GER 10yr	12.1%	1.8%	0.2%	-1.3%	5.6%
GER 2yr	0.5%	0.3%	-0.2%	-0.9%	-0.3%
GER 30yr	29.6%	-0.4%	0.0%	-1.3%	10.3%
Japan 2yr	0.3%	0.2%	0.0%	-0.3%	0.0%
Japan 10yr	3.9%	2.4%	-0.1%	0.4%	1.4%
EM Sovereign	9.2%	0.1%	11.9%	8.6%	0.0%
EM Credit	4.2%	0.5%	12.7%	6.5%	1.2%
US HY	2.4%	-6.6%	20.8%	6.6%	1.7%
US IG Corp	8.7%	-3.0%	5.4%	4.8%	0.9%
EUR HY	6.5%	-1.8%	12.0%	5.7%	-1.7%
Asia Credit	9.3%	2.3%	5.7%	4.3%	1.7%
EUR IG Corp	7.7%	-1.0%	3.5%	2.7%	0.1%
Spain 10yr	21.0%	2.1%	2.0%	4.2%	3.9%
MSCI Asia xJ	10.4%	-20.1%	18.3%	40.5%	-16.6%
MSCI EM	2.7%	-22.8%	22.5%	38.0%	-16.3%
S&P 500	11.9%	-2.7%	17.5%	23.9%	-4.2%
MSCI Japan	15.6%	-0.4%	5.6%	19.0%	-13.6%
SMI	2.4%	-0.8%	-0.3%	12.6%	-3.9%
DAX	14.9%	-8.4%	17.7%	14.3%	-15.3%
FTSE 100	3.7%	-9.9%	16.7%	6.1%	-7.5%
Stoxx600	13.8%	-6.8%	5.2%	9.8%	-9.3%
Eurostoxx 50	11.2%	-9.1%	6.1%	11.7%	-12.5%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 1/31/19

GLOSSARY

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

Brexit
Brexit is a combination of the words "Britain" and "Exit" and describes the exit of the United Kingdom of the European Union.

Bunds
Bunds is a commonly used term for bonds issued by the German federal government with a maturity of 10 years.

CBOE Volatility Index (Vix)
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.

Central bank
A central bank manages a state's currency, money supply and interest rates.

Corporate bond
A **corporate bond** is a bond issued by a corporation in order finance their business.

Correction
A **correction** is a decline in stock market prices.

Correlation
Correlation is a measure of how closely two variables move together over time.

Democratic Party (Democrats)
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.

Dove
Doves are in favor of an expansive monetary policy.

Emerging markets (EM)
Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

European Union (EU)
The **European Union (EU)** is a political and economic union of 28 member states located primarily in Europe.

Government (sovereign) debt/bonds
Government (sovereign) debts/bonds are debt/bonds issued and owed by a central government

Gross domestic product (GDP)
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.

Hawk
Hawks are in favor of a restrictive monetary policy.

Hedge
A **hedge** is an investment to reduce the risk of adverse price movements in an asset.

High Yield (HY)
High-yield bonds are issued by below-investment-grade-rated issuers and usually offer a relatively high yield.

Interest-rate cycle
Interest-rate cycle describes the up- and downswings of interest rates mainly induced by the economic cycle.

Mergers and acquisitions (M&A)
Mergers and acquisitions (M&A) are the two key methods of corporate consolidation. A merger is a combination of two companies to form a new company, while an acquisition is the purchase of one company by another in which no new company is formed.

MSCI AC World Index
The **MSCI AC World Index** captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

Recession
A **recession** is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

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

S&P 500
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
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).

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

U.S. Federal Reserve Board (the Fed)
The **U.S. Federal Reserve Board**, often referred to as **"the Fed"**, is the central bank of the United States.

United States Congress
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.

Volatility
Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

Yield
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.

Yield curve
A **yield curve** shows the annualized yields of fixed-income securities across different contract periods as a curve. When it is inverted, bonds with longer maturities have lower yields than those with shorter maturities.

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