EMERGING TURNAROUND?

Emerging markets are sending out encouraging economic signals, confirming our positive view on the region.

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In a nutshell

_ Latest economic data from China was surprisingly strong.
_ Together with other indicators, such as export figures, they suggest emerging markets are improving.
_ Investors are relieved as central-bank economic worries had dictated the market mood previously.

A RETURN TO WEAK DEVELOPED MARKETS AND DYNAMIC EMERGING ONES?

The headlines suggest the only show in Europe is at the Brexit Theatre. However, most capital markets take a different view. Either they were counting from the outset on a pragmatic, i.e. treaty-based exit for the United Kingdom from the European Union (EU) shortly before twelve o'clock or they have simply given up dancing to the discordant tunes from London's politicians. In our opinion and hardly surprising, central-bank decisions and, of course, economic data from the major world economies will have a more lasting impact on asset prices. Particular attention is being paid to Asia's emerging markets (EM). They continue to provide the greatest growth momentum currently and no other country seems capable of taking countermeasures as quickly and as concertedly as China in the event of a slowdown in growth. Now that the country has left double-digit growth rates behind, it is noticeable that its economic cycles have become more short-lived. The economic model has gradually changed as a result of far advanced industrialization. It is just over three years since the devaluation of the Renminbi when worries about Chinese growth kept world markets on their toes. Of course, U.S. trade policy under Donald Trump is contributing to the current nervousness about China and is having a negative influence not only on China but on world trade as a whole.

It is therefore not surprising that, in addition to following the almost daily progress reports on U.S.-China trade talks, investors are monitoring closely Beijing's announcements of various stimulus programs. The fact that the CSI 300 Index is up by over 35% since the beginning of the year suggests investors are confident on both issues. The latest export and purchasing manager indices (PMIs) are further confidence boosters.

WHAT DO THE INDICATORS SAY?

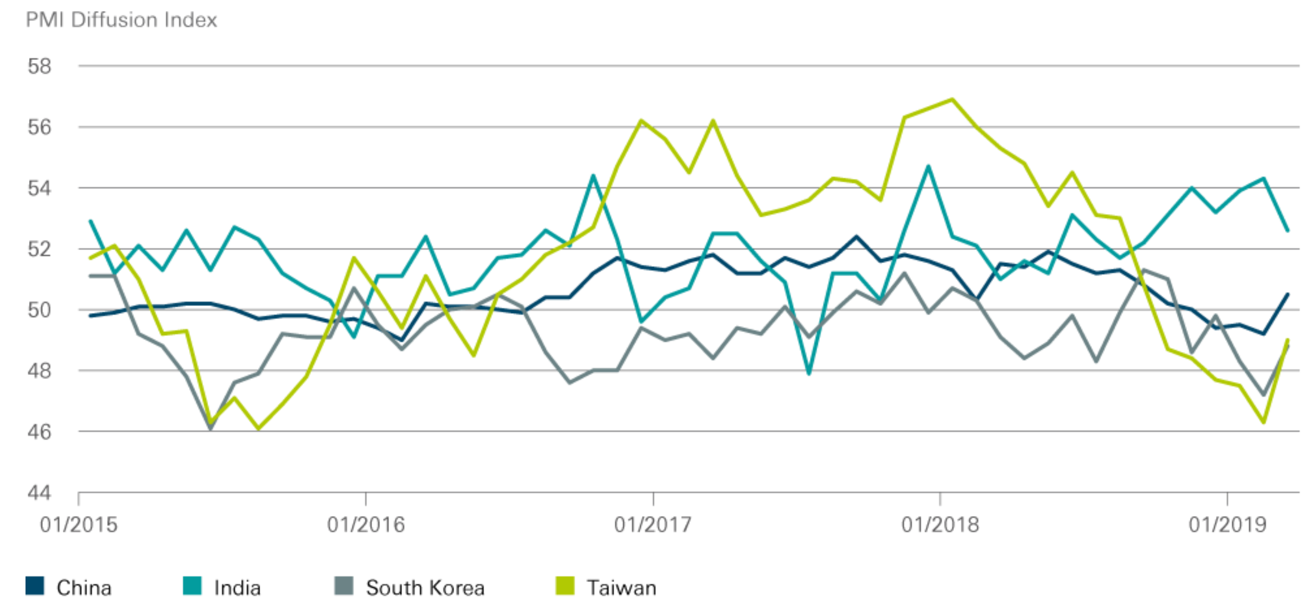
An interim short-term, tactical assessment of China's challenges is timely. Whether they are enough to generate a sustained turnaround is unclear but some data series are certainly sending out positive signals. The chart below shows global, U.S. and Asian export figures, adjusted seasonally and for currency fluctuations, which can be read as an indicator of the state of world trade. Although the latest data are only available through January 2019, they already show a clear recovery from the weak final quarter of 2018, especially for Asia's emerging markets. Even though the absolute export figures for the first quarter do not look as rosy, their weakness is partly due to base effects – in February 2018 China's exports grew by 43%, which may be one of the reasons why this year's figure has been so weak at minus 20%. We expect improved figures to unfold in the second quarter.

WORLD TRADE TOOK A LITTLE REPRIEVE IN JANUARY FROM DONALD TRUMP'S ONGOING INTERVENTIONS

Sources: CPB Netherlands Bureau for Economic Policy Analysis, Thomson Reuters Datastream, DWS Investment GmbH as of 4/3/19
* Adjusted for currency and seasonal effects

By contrast, improved figures are already much more evident in the PMIs for the manufacturing sector whose strong March figures were a positive surprise. In China the index recorded its strongest month-on-month increase since 2012. At 50.5 points, it is now just above the expansion threshold again. And in Taiwan, South Korea and everywhere else, too, the export sub-indicator also showed a clear upward trend. The supposed trough in the semiconductor sector, the softer tones of the U.S. Federal Reserve (Fed), and hopes for settlement of the trade dispute could all also further boost the indices in the second quarter. One exception from the March boost might be India, where numbers came down, albeit from a high level.

A STRONG MARCH FOR THE MANUFACTURING PMI'S, THAT TEND TO LEAD AGGREGATE PMI'S



Sources: Thomson Reuters Datastream, DWS Investment GmbH as of 4/3/19

But of course there are still risks. After all, the Fed has eased up on interest rate projections not only to satisfy the stock markets but also because it has reduced its growth forecasts. It would also be bold to imagine that Washington will lose all its appetite for trade disputes in the near future: whether it be with Europe (car sector), China again (sanctions against individual companies) or the still incomplete post-North-American-Free-Trade-Agreement (NAFTA) treaty. And, last but not least, the emerging markets themselves could still be sources of trouble:

- In Venezuela the extent of the misery is increasing daily and the political situation remains highly uncertain, with the government taking increasingly vehement action against the self-proclaimed reform President, Juan Guaidó.
- In Argentina elections are due in October and the reform-minded government is behind in the polls. Once again, there is a danger that there will not be enough time for reforms to show some economic results that would help to justify them. The risk is that again the spiral of devaluation and inflation is not broken.
- In Turkey too, the devaluation and inflation spiral threatens. The almost unassailable government is pursuing an increasingly unorthodox economic policy that is frightening more and more foreign investors away.
- In Brazil disillusion could soon be apparent. The markets have given reform announcements a lot of advance praise, but disappointments and delays in implementation are to be expected. The cyclical recovery hoped for by many has also failed to materialize so far. This means that economic growth in the current year threatens once again to fall short of most observers' expectations.

On the other hand, there are positive developments in other emerging markets, including those already mentioned:

- in China the unemployment rate, which rose to 5.3% in February, was still better than expected. The housing market fell less than feared and consumption is stabilizing. In the second quarter, we then expect the first effects of the fiscal programs. Around 800-900 billion Renminbi in value-added-tax (VAT) relief will be available from April, and since the beginning of the year income tax has been reduced by around 300 billion Renminbi. Companies will receive a further 800 billion Renminbi in relief from the beginning of May as a result of lower social contribution rates (reduced from 20 to 16%). "This stimulus program is much more geared towards boosting domestic consumption, whereas previous programs were aiming at driving up capital investments. This not only serves to boost the economy but to reduce dependence on foreign countries," explains Xueming Song, DWS Chief Economist for China. In addition, companies report that financing conditions are at their best in six years.
- in India the election campaign leads to some volatility in markets. We expect investors to be reassured should the current government stay in power after the May elections. Election-related fiscal measures and monetary stimulus are likely to follow, but inflation should remain well below its tolerated high.
- in Indonesia an improvement in sentiment is expected after the election in April, as is a revival in investment demand. The interest-rate outlook seems more supportive after the interest-rate hikes of the previous year.
- in South Korea fiscal stimulus and a record high budget for 2019 (tax breaks and subsidies) should lead to a strengthening of consumption and investment.

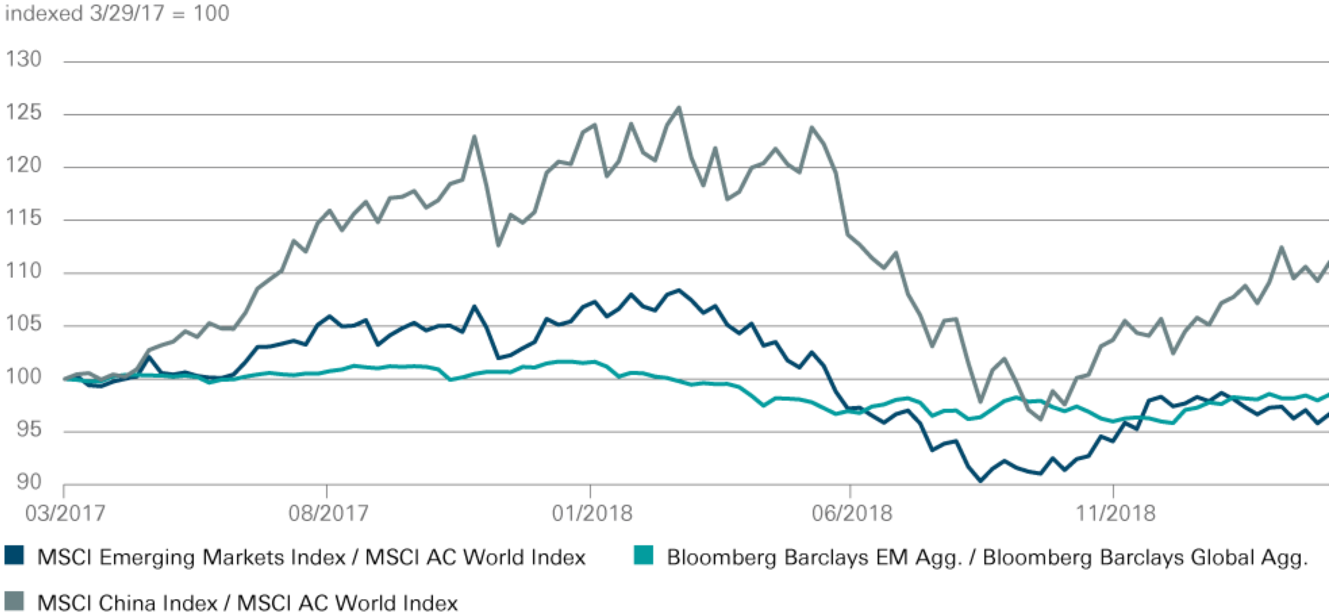
OUR MARKET OUTLOOK

Our strategic view of emerging markets remains positive. Tactically, too, the latest encouraging figures suggest there are numerous opportunities, even though some markets have already outperformed developed ones since the fourth quarter of 2018.

- For equities, in all regions, we still prefer emerging markets. Solid corporate figures, above-average growth and continued low inflation rates are convincing. We regard Asian emerging markets in particular as positive, while we are now becoming somewhat more cautious with Brazil.
- In bonds we continue to like emerging markets though they have lost some of their relative attractiveness due to their strong price performance in the first quarter. Both government and corporate bonds are therefore rated tactically neutral. However, we see a broad mix of high-yield government and corporate bonds from different regions as the best way to escape the low yield environment of most developed countries. A broad mix does not rule out careful selection. For example, our preference between Brazilian and Turkish hard currency government bonds has shifted in favor of Turkey.

Elke Speidel-Walz, Chief Economist for Emerging Markets, sums up the current situation as follows: "The macroeconomic picture in the emerging markets is improving. Potential further interest-rate hikes by the Fed are much less of a risk and there are at least signs of some progress in the U.S.-China trade dispute. Above all the recent strong data in the manufacturing sector and better Asian export figures give grounds for optimism. One should, however, not be tempted to simply extrapolate the latest developments, as plenty of risk factors have not abated."

RELATIVE PERFORMANCE OF EMERGING-MARKETS EQUITIES WAS STRONG IN 4Q18. BONDS FOLLOWED IN EARLY 2019. CHINA'S EQUITIES HAVE BEEN PARTICULARLY RECEPTIVE TO TRUMP TALK AND DOMESTIC STIMULI PROGRAMS.



Sources: Thomson Reuters Datastream, DWS Investment GmbH as of 4/3/19

GLOSSARY

Barclays Global Aggregate Bond Index
The **Barclays Global Aggregate Bond Index** contains investment-grade bonds from 24 different local currency markets.

Bloomberg Barclays Emerging Markets Sovereign USD Index
The **Bloomberg Barclays Emerging Markets Sovereign USD Index** measures the performance of USD-denominated government bonds from more than 60 emerging markets.

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

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.

CSI 300 Index
The **CSI 300 Index** includes the 300 largest companies of the Chinese mainland, that is companies listed on the Shanghai and Shenzhen Stock Exchange (so called A-shares).

Devaluation
Devaluation is the forced reduction of the value of a currency against other currencies.

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

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

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

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

MSCI China Index
The **MSCI China Index** tracks large and medium-sized listed companies listed as H-shares, B-shares, red chips and P-chips.

MSCI Emerging Markets Index
The **MSCI Emerging Markets Index** captures large- and mid-cap representation across 23 emerging-market countries.

North American Free Trade Agreement (NAFTA)
The **North American Free Trade Agreement (NAFTA)** is a trade agreement signed by Canada, Mexico and the United States, creating a trilateral trade bloc in North America, which came into force on January 1st, 1994.

Purchasing Managers Index (PMI)
The **Purchasing Managers Index (PMI)** is an indicator of the economic health of the manufacturing sector in a specific country or region.

Renminbi (RMB)
Renminbi (RMB) is the currency of the People's Republic of China.

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

Value-added tax (VAT)
A **value-added tax (VAT)** is a consumption tax that is collected based on the incremental value added in each stage of production (as opposed to a sales tax where only the final consumer is taxed).

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.

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