DWS

FROM EUPHORIA TO PANIC, AND BACK

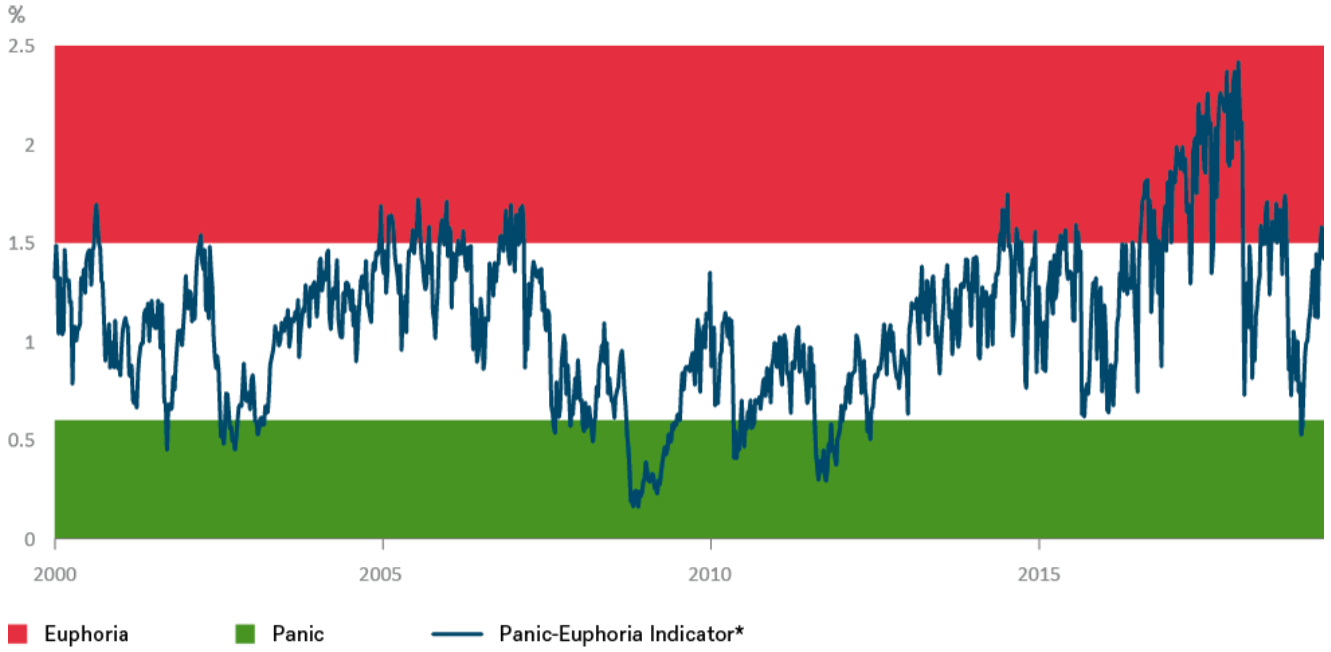
The S&P 500 is climbing to new records, although earnings estimates are declining. Analyst lethargy or investor euphoria? Probably both.

It took only seven months for the S&P 500 to recover from a 19.8% (near bear-market) decline and surpass its previous peak reached last September. The S&P 500 rallied more than 25% since the Christmas Eve trough, led by technology, consumer discretionary and communications (growth sectors). David Bianco, CIO Americas at DWS, thinks that subsiding economic and profit recession fears, the U.S. Federal Reserve (Fed) dovish pivot, and positive developments with China on a trade deal and more time to negotiate Brexit indeed justify this recovery.

A look at the factors behind the recovery reveals that an expansion in price-to-earnings (P/E) ratios has been the driver for the performance, while earnings estimates have even been cut by roughly 3% during this rally. One should consider though that analysts tend to trail market movements with their forecasts. Current S&P 500 P/E multiples are still lower than the highs reached in January 2018: S&P 500 aggregate trailing P/E is 18.0 now vs. 21.2 in January 2018. From our perspective, the latter P/E multiple, however, was largely based on strong 2018 earnings-per-share (EPS) growth expectations from the recently passed U.S. corporate tax rate cut.

In particular, it is interesting to look at the rise in P/E valuations since the start of the year in context with another market indicator: David Bianco uses a combination of the observed trailing S&P 500 P/E and options-market-implied near-term volatility index (CBOE Vix Index) expectations to gauge equity investor sentiment. As our "Chart of the Week" demonstrates, this "Panic-Euphoria Indicator" went all the way from panic territory into a state of complacency, if not euphoria, within four months.

Depending on macro risks, we think that a 17 to 18 trailing S&P 500 P/E valuation is reasonable. We believe, however, that further S&P 500 upside will require higher earnings estimates.



Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 4/26/19
* S&P 500 trailing P/E ratio divided by the volatility index (Vix)

GLOSSARY

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

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.

Consumer discretionary
Consumer discretionary is a sector of the economy that sells non-essential goods and services.

Dove
Doves are in favor of an expansive monetary policy.

Earnings per share (EPS)
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.

Multiple
A **multiple** is a ratio that is used to measure aspects of a company's well-being by setting various of the company's metrics against each other and thereby building indicative ratios.

Price-to-earnings (P/E) ratio or multiple
The **price-to-earnings (P/E) ratio** compares a company's current share price to its earnings per share.

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.

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.

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

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

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

	04/14 - 04/15	04/15 - 04/16	04/16 - 04/17	04/17 - 04/18	04/18 - 04/19
S&P 500	10.7%	-1.0%	15.4%	11.1%	11.2%

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 5/2/19

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