

OUR MONTHLY MARKET ANALYSIS AND POSITIONING

The month of May was tough rather than merry. After many stock exchanges touched new record highs, the impulsive U.S. trade policy sent both equities and bond yields on a downward slide. The summer could be uncomfortably hot.

MARKET OVERVIEW

"In case of emergency, break glass" – there is something of that about President Trump's latest international swipe, this time at Mexico, where he appears to be opening yet another front in the trade war. When a belligerent White House in this trading-blows mood meets a stock exchange that is quite ready to "sell in May and go away," one can hardly be surprised at the results. And they were clear. After a four-month rally that carried some indices to new record highs, most stock markets ended May heavily in negative territory. The MSCI All Country World Index (ACWI) (total return) lost 5.8%, a third of the ground it had gained previously year-to-date. Oil, meanwhile slid, the West-Texas-Intermediate (WTI) price was down by as much as 16.2%. The bond markets also took Trump's latest ballistics badly. The yield on 10-year U.S. government bonds plummeted in May from just over 2.5% to 2.12%, below the key interest rate of the U.S. Federal Reserve (the federal funds rate). The markets are now pricing in two rate cuts by the Fed before the end of the year. In Europe, the 10-year bund yields again fell below the zero line and even recorded a new historic low of -0.21% on May 31.

Yet this correction is still only modest, seen in the broader context of the strong start to the year, which probably priced in too much economic recovery. After all, the hard and soft macroeconomic data of the past month were generally muted: a little better here – consumption in Europe and the United States – a little worse there – the composition¹ of U.S. gross domestic product (GDP), the malaise of global manufacturing [[DWS U.S. Economic Outlook as of 5/20/19](#)].

Overall, they showed no continuation of the acceleration in growth evident in March and April, but rather a listless sideways movement. And finally, the MSCI ACWI is still "only" trading around 7% below its previous record high.

The big question that arises is whether all the risks resulting from the recent exchanges in the trade disputes have already been factored into prices. The focus remains on the conflict between China and the United States, which has escalated from a tariff dispute to a war over technological supremacy. But even the disputes with Japan and Europe remain unresolved. And the ratification of the North-American-Free-Trade-Agreement's (NAFTA's) successor, the United States-Mexico-Canada Agreement (USMCA)², is entirely off the table after Trump's Mexico tweet on May 31. It threatened punitive tariffs on Mexican imports, rising from an initial 5% in further 5% steps up to 25% in October, if Mexico does not prevent "illegal migrants coming through Mexico, and [into] our country³." The escalation with China had already increased our concerns that trade disputes could be with us for longer than previously expected. The Mexico tweet makes that seem more likely. It reduces our hope for rational solutions and increases the danger that conflicts will develop their own uncontrollable momentum.

U.S. companies and consumers are likely to feel the negative implications of the Mexican punitive tariffs even faster and more clearly than for Chinese products – not least because of the higher trade volumes and affected supply chains. Companies are likely to feel an increased level of uncertainty if neither Congress nor the Republican Party were able to convince

¹A major contributor to GDP growth has been inventory build-up.

²The United States-Mexico-Canada Agreement (USMCA) is the signed, but not ratified agreement, which should replace NAFTA. One of the changes in the new agreement is that it incentivizes more domestic production of cars and trucks.

³<https://www.whitehouse.gov/briefings-statements/statement-president-regarding-emergency-measures-address-border-crisis/>

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the U.S. President now that his actions are prone to be detrimental for U.S. businesses. International trade partners might feel similar unease after the unexpected tweet concerning Mexico. With the USMCA treaty just about to be ratified by the three legislative bodies, it undermines the U.S. commitment in diplomatic matters.

Sentiment, financing conditions and the capital markets could all suffer significantly from Trump's escalation of trade fights this year. We believe, however, that the larger hit to global economic growth, should these disputes continue, would come in 2020.

OUTLOOK AND CHANGES

This leads us to our new 12-month forecasts for June 2020, made at our investment conference on May 23. Our base scenario for the global economy remains optimistic overall as we still do not expect a further escalation in the trade war. We have become only a little more cautious and have reduced our global growth forecast for the current year by 0.1% to 3.4%. We do not expect the Fed to raise interest rates further and inflationary pressure should remain moderate. That brings us back close to the ideal for capital markets: the "Goldilocks economy" of low inflation and low rates. But there are plenty of global problems to prevent us from getting too excited. In Europe, Brexit, Italy and populism dominate the stage, and the outcomes of these dramas remain highly uncertain. In China, meanwhile, there are worrying economic signs. The government has again been forced to support the economy with stimulus programs, and its debt level continues to look vulnerable to a crisis – as does that of the U.S. corporate sector. Trump's new stand-off with Mexico makes matters worse. We therefore believe our quite positive base case is more at risk than in the past. We expect nervous markets in coming months and as a result are focusing our strategy on carry – the income component of investments – rather than on price appreciation.

For the individual asset classes, this means we do not see any increases in government-bond yields in the United States, and only slight increases in yields in Europe, given the central banks have turned more dovish in recent months. U.S. Treasuries thus continue to offer a good risk-return profile. This is not the case for European government bonds, whose yields are low or even negative, but they should offer some defensive protection if equity markets hit the skids. We continue to like corporate bonds, but are very selective in the U.S. high-yield area. We also continue to

view emerging-market bonds positively, but the trade disputes could also have a negative impact on them in the short term.

In currency markets we see the U.S. dollar trending sideways over the next twelve months. The Yuan, however, could head south if monthly export surpluses trend down. But we assume Beijing won't be keen to let the currency depreciate too much.

Global equities, for their part, are set to benefit from a low interest-rate environment. But we believe most indices have moved close to their fair levels since the spring rally. Our target returns are the lowest we have predicted since the financial crisis. Our regional preferences, strategically, are for the United States and emerging markets.

From a tactical point of view, we have made two linked changes for equities. We downgraded emerging markets and Asia ex Japan to Neutral because the escalated trade war may have a negative impact not only on China but also on its neighbors. For the same reason, we have also tactically downgraded Asian bonds to neutral. Our positive view of U.S. government bonds has paid off and we stay invested for the time being. In the case of UK gilts, on the other hand, we move to the sidelines: neither Brexit-dominated politics nor the economy are giving clear signals on the future.

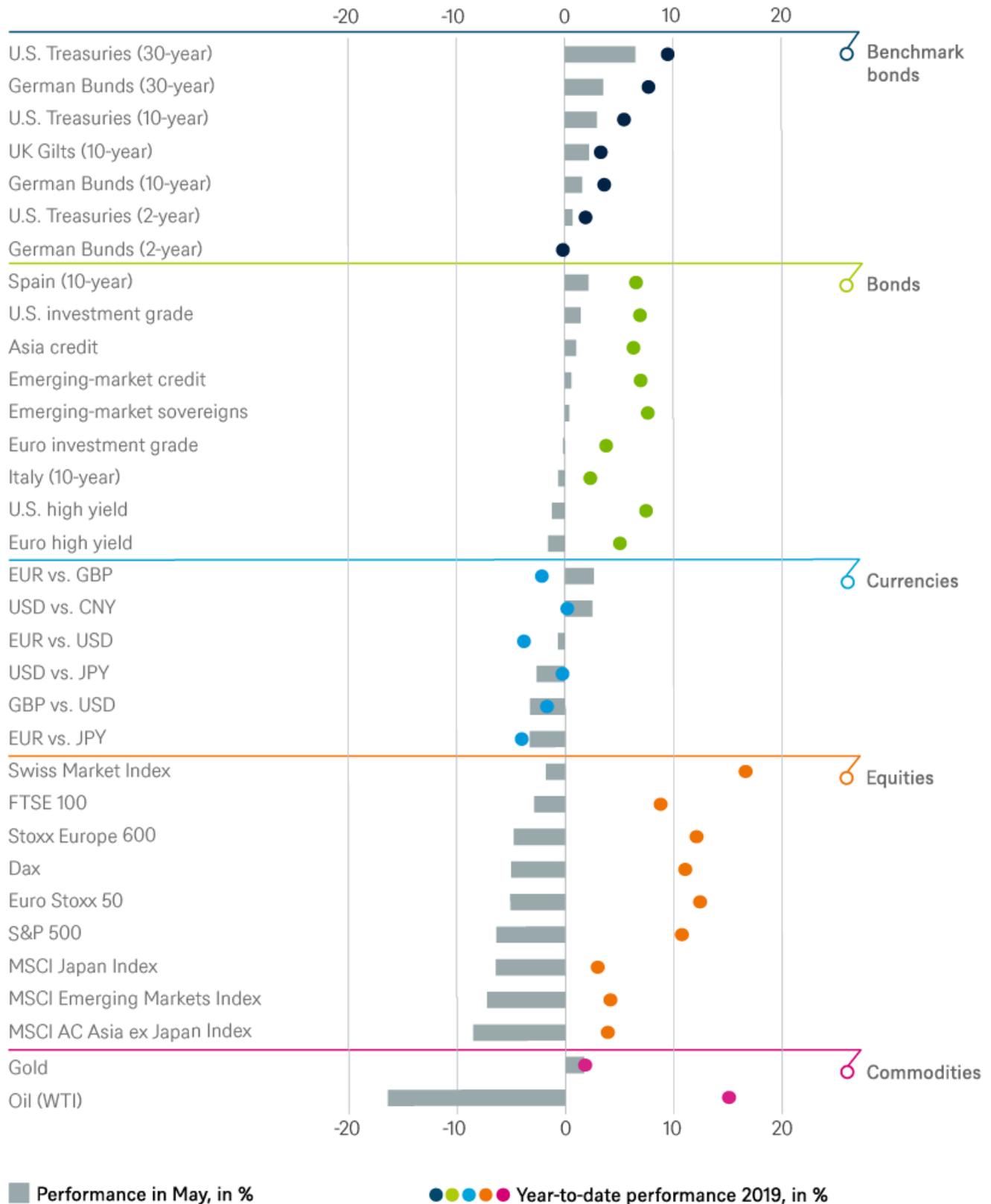
THE MULTI-ASSET PERSPECTIVE

In our multi-asset portfolios we are currently defensive and are running below-average risk. In coming months, for the reasons explained above, we consider the danger of continued negative news to be high and don't see much chance of the global economy picking up. If the trade disputes look set to drag on even longer we would consider an even more defensive portfolio structure. On the other hand, with the central banks being supportive, we do not see any danger of a recession this year. We would therefore use any market slides as an opportunity to take on more risk – with American and Asian equities and European corporate bonds the assets we would favor – provided there is no further economic deterioration. In bonds we are focusing for now on shorter residual maturities given the currently low yield levels.

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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 05/31/19
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FIXED INCOME

Rates	1 to 3 months	until June 2020
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	●	●

EQUITIES

Regions	1 to 3 months*	until June 2020
United States	●	●
Europe	●	●
Eurozone	●	●
Germany	●	●
Switzerland	●	●
United Kingdom (UK)	●	●
Emerging markets	●	●
Asia ex Japan	●	●
Japan	●	●

Corporates	1 to 3 months	until June 2020
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. JPY	●	●
EUR vs. GBP	●	●
GBP vs. USD	●	●
USD vs. CNY	●	●

Emerging markets

Emerging-market sovereigns	●	●
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Sectors	1 to 3 months*
Consumer staples	●
Healthcare	●
Communication services	●
Utilities	●
Consumer discretionary	●
Energy	●
Financials	●
Industrials	●
Information technology	●
Materials	●
Real Estate	●
Style	
	1 to 3 months
U.S. small caps**	●
European small caps***	●

* Relative to the MSCI AC World Index

** Relative to the S&P 500

*** Relative to the Stoxx Europe 600

¹ Spread over German Bunds in basis points

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ALTERNATIVES

Alternatives	1 to 3 months	until June 2020
Infrastructure (listed)		
Commodities		
Real estate (listed)		
Real estate (non-listed) APAC		
Real estate (non-listed) Europe		
Real estate (non-listed) United States		

LEGEND

Tactical view (1 to 3 months)

- _ The focus of our tactical view for fixed income is on trends in bond prices.
- _  Positive view
- _  Neutral view
- _  Negative view

Strategic view until June 2020

- _ The focus of our strategic view for sovereign bonds is on bond prices.
- _ For corporates, securitized/specialties and emerging-market bonds in U.S. dollars, the signals depict the option-adjusted spread over U.S. Treasuries. For bonds denominated in euros, the illustration depicts the spread in comparison with German Bunds. Both spread and sovereign-bond-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.
- _ The 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)

	05/14 - 05/15	05/15 - 05/16	05/16 - 05/17	05/17 - 05/18	05/18 - 05/19
UST 30yr	9.7%	8.4%	-1.6%	0.1%	11.0%
UST 10yr	5.0%	4.4%	-0.4%	-2.4%	8.6%
UST 2yr	0.8%	0.7%	0.6%	-0.1%	3.5%
UK 10yr	7.8%	5.5%	5.2%	-0.4%	4.8%
GER 10yr	7.5%	4.4%	0.0%	0.8%	5.0%
GER 2yr	0.4%	0.2%	-0.3%	-0.6%	-0.5%
GER 30yr	20.2%	6.5%	-2.7%	3.0%	10.6%
Japan 2yr	0.3%	0.4%	-0.4%	-0.1%	-0.1%
Japan 10yr	2.5%	4.7%	-1.2%	0.4%	1.5%
EM Sovereign	2.5%	4.5%	9.8%	-0.6%	7.5%
EM Credit	3.3%	2.2%	9.0%	0.2%	8.4%
US HY	2.0%	-0.8%	13.6%	2.3%	5.5%
US IG Corp	2.8%	3.3%	3.9%	0.1%	7.4%
EUR HY	5.4%	0.6%	9.5%	1.5%	2.2%
Asia Credit	5.5%	4.7%	4.7%	0.0%	7.7%
EUR IG Corp	4.3%	2.0%	2.8%	0.6%	3.1%
Spain 10yr	9.9%	6.2%	2.3%	2.2%	8.9%
Italy 10yr	10.2%	6.6%	-2.5%	-2.9%	6.2%
MSCI Asia xJ	8.0%	-19.5%	25.1%	14.7%	-13.2%
MSCI EM	-2.3%	-19.6%	24.5%	11.5%	-10.9%
S&P 500	9.6%	-0.5%	15.0%	12.2%	1.7%
MSCI Japan	39.2%	-19.4%	12.5%	10.5%	-11.8%
SMI	6.5%	-11.1%	9.7%	-6.2%	12.6%
DAX	14.8%	-10.1%	22.9%	-0.1%	-7.0%
FTSE 100	2.0%	-10.8%	20.7%	2.1%	-6.7%
Stoxx600	16.2%	-13.1%	12.2%	-1.8%	-3.7%
Eurostoxx 50	10.1%	-14.2%	16.0%	-4.2%	-3.7%
MSCI ACWI Index	3.1%	-7.4%	15.2%	9.7%	-3.3%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 6/3/19

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GLOSSARY

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.

Carry (strategy)

Carry is a strategy in which an investor sells a certain currency with a relatively low interest rate and then buys another, higher-yielding currency.

CB

CB is the abbreviation for central bank.

Chinese yuan (CNY)

The **Chinese yuan (CNY)** is legal tender on the Chinese mainland and the unit of account of the currency, Renminbi (RMB).

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.

Dax

The **Dax** is a blue-chip stock-market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

Depreciation

In relation to currencies, **depreciation** refers to a loss of value against another currency over time.

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.

Euro Stoxx 50

The **Euro Stoxx 50** is an index that tracks the performance of blue-chip stocks in the Eurozone.

Federal funds rate

The **federal funds rate** is the interest rate, set by the Fed, at which banks lend money to each other, usually on an overnight basis.

Financial crisis

The **financial crisis** refers to the period of market turmoil that started in 2007 and worsened sharply in 2008 with the collapse of Lehman Brothers.

FTSE 100

The **FTSE 100** is an index that tracks the performance of the 100 major companies trading on the London Stock Exchange.

Gilts

Gilts are bonds that are issued by the British Government.

Goldilocks economy

The term **Goldilocks economy** refers to a state of the economy, where there is neither a threat of inflation due to an overheating economy, nor a threat of a recession.

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.

High Yield (HY)

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

MSCI AC World Index

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

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MSCI Asia ex Japan Index

The **MSCI AC Asia ex Japan Index** captures large- and mid-cap representation across 2 of 3 developed-market countries (excluding Japan) and 8 emerging-market countries in Asia.

MSCI Emerging Markets Index

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

MSCI Japan Index

The **MSCI Japan Index** is designed to measure the performance of the large- and mid-cap segments of the Japanese market.

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.

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.

Republican Party (Republicans)

The **Republican Party (Republicans)**, also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

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.

Stoxx Europe 600

The **Stoxx Europe 600** is an index representing the performance of 600 listed companies across 18 European countries.

Swiss Market Index (SMI)

The **Swiss Market Index (SMI)** is Switzerland's most important equity index, consisting of the 20 largest and most liquid large- and mid-cap stocks.

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 (Fed)

The **U.S. Federal Reserve**, 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.

West Texas Intermediate (WTI)

West Texas Intermediate (WTI) is a grade of crude oil used as a benchmark in oil pricing.

White House

The **White House** is the official residence and principal workplace of the President of the United States.

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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