CIO View

Investment Traffic Lights

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Marketing material

Our monthly market analysis and positioning

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IN A NUTSHELL

- An overall good year for investments was given an additional boost by the U.S. election but valuations, especially in the tech sector, make equities anything but cheap on a historical basis.
- Accordingly, the market can tolerate few negative surprises in the current year if it is to achieve similarly good results again.
- Falling central bank interest rates, robust labor markets and rising corporate profits mean we nonetheless look confidently to 2025.

1 / Market overview

1.1 Elections, central banks and AI drove investment returns in 2024

It would be hard to blame American investors for concentrating solely on their domestic market in 2024. Not only did U.S. equities (S&P 500 +24%) perform best, U.S. companies also led the way in the hottest investment trend – artificial intelligence. In addition, the most consequential election for global financial investments also took place on U.S. soil. Trump's re-election victory resulted in some very pronounced market movements. The consequences were not all that positive for international investments but the S&P 500 delivered the best monthly return of the year in November, with a gain of 5.8%[1] following the election. Bitcoin rose in price by as much as 50%, some prison operators gained over 60%, and the carmaker with close ties to the new presidential adviser Elon Musk was able to almost double its market capitalization to USD 1.5 trillion. The Mexican peso, European carmakers and Chinese exporters were among the losers.

There were also important elections outside the U.S. and, as is well known, more people than ever before expressed their opinions at the ballot box. Unhappiness with governments was the norm: In all twelve western industrialized countries with national elections the incumbent parties were voted out of office – for the first time in 120 years, according to the Financial Times. Despite the fact that political events often have little impact on the markets, there were other countries where, as in the U.S. last year, politics proved to be a big market mover. In France, Emmanuel Macron's dissolution of parliament in the summer fueled the underperformance of French bonds and equities, while the first year in government of radical free-market reformer Javier Milei, who took office in December 2023, gave a strong boost to Argentinian equities and bonds.

Even though politics played a special role in 2024, the main drivers for the financial markets were once again the central banks, the economic environment and corporate earnings. The central banks started their cycle of interest rate cuts in 2024, with a Swiss cut in March, followed by the European Central Bank (ECB) in June and finally the U.S. Federal Reserve (The Fed) in September, which cut by 50 basis points (bps). Going against this tide, in March the Bank of Japan (BoJ) ended its era of negative interest rates. These cuts assumed inflation would keep falling and were expected to help growth. But both

[1] All market data in this text, unless otherwise noted, is from Bloomberg Finance L.P.; as of 2 January. Unless otherwise stated, the returns for equity indices in the text are total returns, i.e. including dividends.

the economy and inflation sent mixed signals over the course of the year, leading to market corrections. The most severe of these occurred in August, when weak U.S. economic data met with a rate hike in Japan and a widespread unwinding of the so-called yen carry trade. The Nikkei, which had only surpassed its 1989 high in the spring, lost almost 11% in a single day.

Ultimately, these setbacks, and even the lack of a year-end rally (the S&P 500 fell 2.4% in December), couldn't prevent 2024 from being a positive year for investments overall. With the exception of some commodities, emerging markets (EM) and longer-dated U.S. Treasuries, most asset classes posted decent gains. They were driven by a stronger than expected U.S. economy, falling central bank interest rates and profit growth, particularly among large technology stocks in the U.S. The S&P 500 rose by more than 20% for the second year in a row. The last time this happened was in the late 1990s, when the index rose by more than 20% for five years in a row.

1.2 Equities and gold fared particularly well in 2024, whereas sovereign bonds were mixed

Even though the U.S. was at the center of the action, other stock markets were also able to achieve good results in 2024, despite adverse circumstances. For example, the Dax rose by almost a fifth despite disappointing domestic economic data, thanks to the fact that around 80% of its companies' sales are generated abroad. China's major stock indices also saw double-digit growth on average, despite equally weak economic data, but in the hope of government stimulus programs. Japan's Nikkei rose by 21%, although this increase shrinks to less than 9% in dollar terms, as the yen depreciated against the dollar for the fourth year in a row. However, America's exceptionalism becomes clear again when you look at the major technology stocks separately: The so-called Magnificent 7 rose by two-thirds, with the leading semiconductor stock Nvidia alone adding $2 trillion to its market capitalization. The narrowness of the equity rally in 2024 can also be seen from the fact that only eight stocks contributed to half the annual return from the MSCI AC World Index.

In the bond market, corporate bonds performed best on both sides of the Atlantic, while longer-dated U.S. Treasuries even posted losses as Fed rate cut hopes were scaled back. The fact that U.S. bond yields ended the year higher than expected contributed – alongside Trump's economic and foreign policy pronouncements – to the dollar index rising by as much as 7.1% over the course of the year. This put particular pressure on emerging market currencies and, to some extent, bonds. Among Europe's government bonds, French 10-year bonds yielded more than their Spanish counterparts for the first time ever. On the other hand, Swiss 10-year yields approached the zero line again, which in turn ensured that their spread over German government bonds reached 210 basis points, the highest level so far this millennium.

In commodities, the weakness of oil (Brent -3.2%) despite geopolitical tensions in the Middle East was striking, as was the sharpest rise in the price of gold since 2010, of 28%. In euro terms, the precious metal gained 35%.

2 / Outlook and changes

The market ran out of steam somewhat in December and the first few days of trading in the new year were also weak. These are far from the only developments that suggest caution would be wise in the coming months. Since the interim low in October 2022, the MSCI Global has returned almost 60%, the S&P 500 over 70% and the Magnificent 7 stocks have more than tripled. At the same time, Bank of America's[2] latest fund manager survey found that the cash position of 3.9% is the lowest in over ten years and the overweight position in U.S. equities and financial stocks is higher than ever before. Within a month of Trump's election, sentiment among fund managers rose more sharply than at any time since June 2020. And the research firm Factset[3] notes that analysts expect earnings growth of 14.8% for the S&P 500 in 2025, well above the average of the past ten years (8.0%). With projected growth of 13% (after only 4% in 2024), a significant portion of this is expected to come from companies outside the Magnificent 7.

[2] Source: Bank of America, Global Fund Manager Survey; as of 12/17/24.
[3] Source: Factset Research, as of 12/20/24.

2.1 Fixed Income

Government Bonds

Our strategic targets for the coming twelve months have already been largely achieved in the U.S., while in Germany we still see downside potential for yields at the short end of the curve. We have not made any tactical changes, but we also see downside potential in the U.S. for two-year Treasury yields, at least in the short term.

Corporate Bonds

In the corporate bond segment we expect spreads over government bonds to tend to widen on both sides of the Atlantic in 2025, particularly in the high-yield segment. However, they will likely remain attractive due to the high current yield. From a tactical point of view, we have recently raised European high-yield bonds to neutral. Despite what we consider modest compensation for the increased risks, spreads could remain low as inflows into the segment continue to be smooth. However, this is already leading to very aggressive pricing in some bond issues. We believe that the overall rather optimistic market sentiment leaves plenty of room for higher volatility in the coming months.

Emerging Markets

In the case of emerging market sovereign bonds, we have recently returned to -1 from a short-term perspective. Although we view the fundamental situation in many countries as positive overall, the hoped-for tailwind from falling U.S. interest rates is not materializing, especially after Fed Chairman Powell's recent rather hawkish comments on interest rate policy.

Currencies

We believe that the dollar could continue to appreciate, at least until Trump's inauguration, including against the euro and the yuan. In our opinion, only the yen should initially hold its own against the dollar in the short term. We also think that the British pound could appreciate against the euro from a tactical perspective.

2.2 Equities

The slight market correction in December means that our 12-month forecasts again show similar return potential to when we set the forecasts in November: around 5-10% across the various regions. No tactical changes were made in December.

2.3 Alternatives

Gold

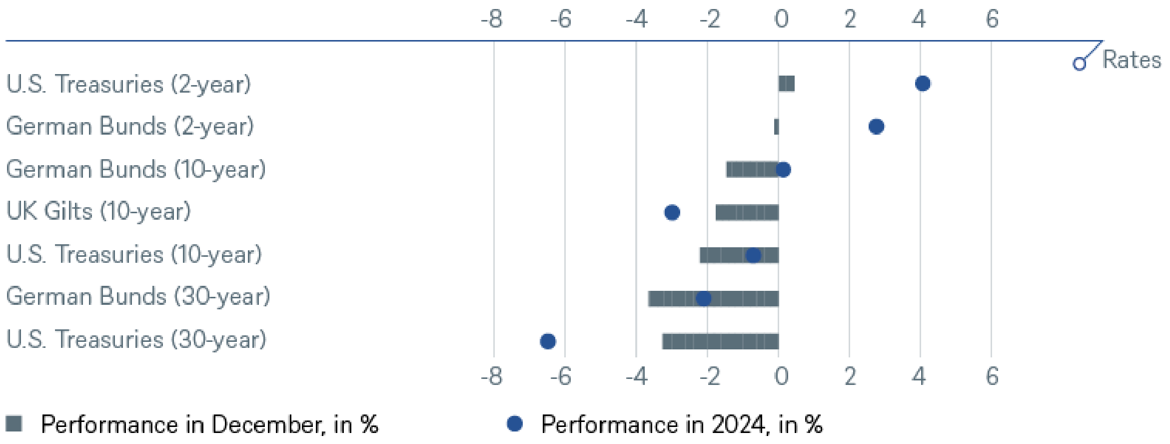
While we still see upside for gold in 2025, we expect the gold price to be range-bound in the near term.

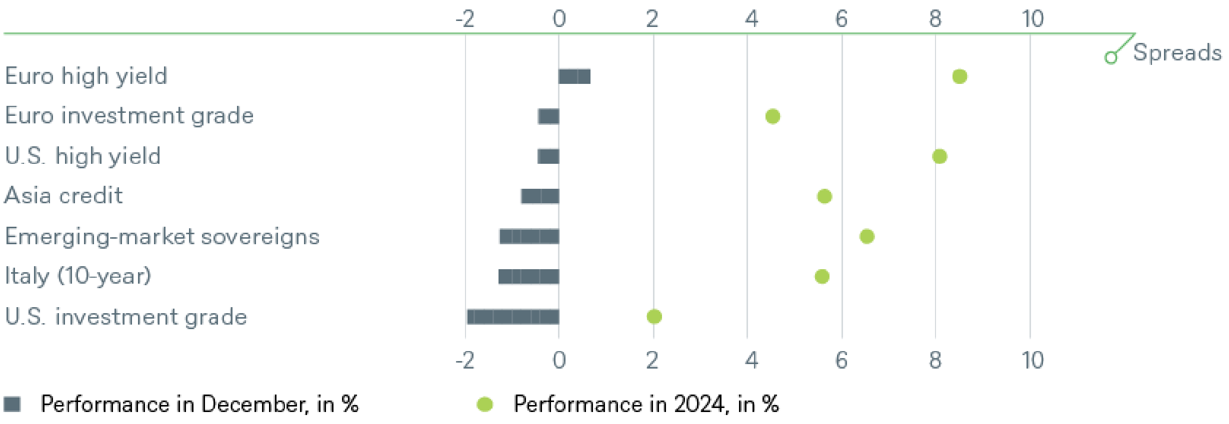
Oil

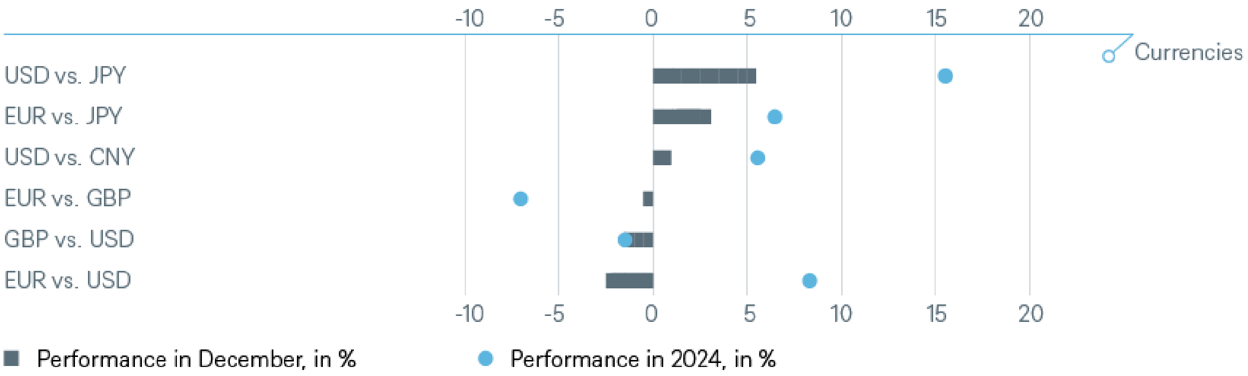
While certain U.S. policies, particularly a probable much tougher stance on Iran, present serious upside risks for energy prices, we remain bearish on crude oil in 2025 because we see the balance tipping towards an oversupplied market. In addition, uncertainty about trade tariffs could further deflate global industrial activity, and a strong U.S dollar should serve as a headwind to emerging economies that are still purchasing crude oil in dollars. Another factor is that a potential end to the Russia – Ukraine war could allow for incremental rises in oil and gas volumes and help to push global oil and gas prices lower. With so much policy uncertainty heading into 2025, sideways trading could be in store for some weeks as investors continue to assess the macro environment.

3 / Past performance of major financial assets

Total return of major financial assets in 2024 and in the December month







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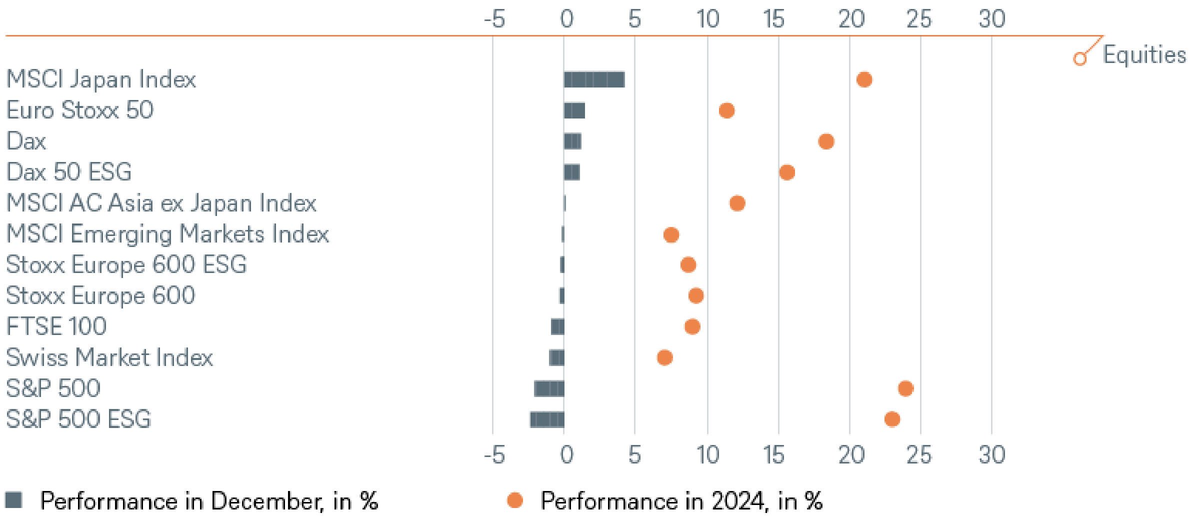

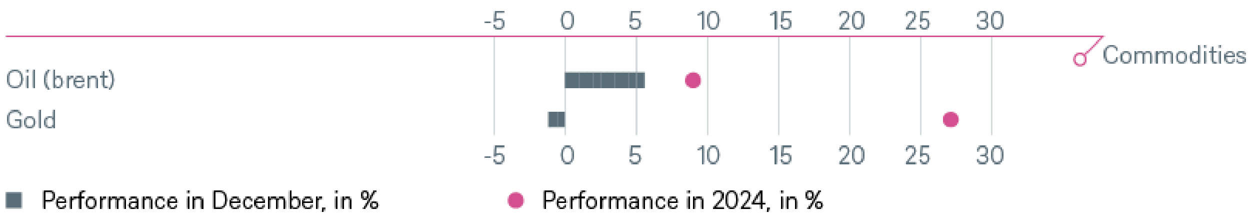

Past performance is not indicative of future returns.
Sources: Bloomberg Finance L.P., DWS Investment GmbH as of 12/31/24

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4 / Tactical and strategic signals

The following exhibit depicts our short-term and long-term positioning.

4.1 Fixed income

Rates	1 to 3 months	through Dec 2025
U.S. Treasuries (2-year)	🟢	🟢
U.S. Treasuries (10-year)	🟢	🟢
U.S. Treasuries (30-year)	🟡	🟢
German Bunds (2-year)	🟡	🟡
German Bunds (10-year)	🟡	🟢
German Bunds (30-year)	🟡	🟢
UK Gilts (10-year)	🟢	🟢
Japanese government bonds (2-year)	🟡	🟡
Japanese government bonds (10-year)	🟡	🔴

Spreads	1 to 3 months	through Dec 2025
Italy (10-year)[1]	🟢	🟡
U.S. investment grade	🟡	🟢
U.S. high yield	🟡	🟢
Euro investment grade[1]	🟡	🟢
Euro high yield[1]	🟡	🟡
Asia credit	🟡	🟢
Emerging-market sovereigns	🔴	🟢

Securitized / specialties	1 to 3 months	through Dec 2025
Covered bonds[1]	🟡	🟢
U.S. municipal bonds	🟡	🟢
U.S. mortgage-backed securities	🟡	🟢

Currencies	1 to 3 months	through Dec 2025
EUR vs. USD	🔴	🔴
USD vs. JPY	🔴	🔴
EUR vs. JPY	🟡	🔴
EUR vs. GBP	🔴	🔴
GBP vs. USD	🟡	🟡
USD vs. CNY	🟢	🟢

4.2 Equities

Regions	1 to 3 months[2]	through Dec 2025
United States[3]	🟡	🟢
Europe[4]	🟡	🟢
Eurozone[5]	🟡	🟢
Germany[6]	🟡	🟡
Switzerland[7]	🟡	🟢
United Kingdom (UK)[8]	🟡	🟡
Emerging markets[9]	🟡	🟢
Asia ex Japan[10]	🟡	🟢
Japan[11]	🟡	🟢

Sectors	1 to 3 months[2]
Consumer staples[12]	🟡
Healthcare[13]	🟢
Communication services[14]	🟡
Utilities[15]	🟡
Consumer discretionary[16]	🟢
Energy[17]	🟡
Financials[18]	🟡
Industrials[19]	🟡
Information technology[20]	🟡
Materials[21]	🟡

Style	1 to 3 months
U.S. small caps[22]	🟡
European small caps[23]	🟢

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4.3 Alternatives

Alternatives	1 to 3 months	through Dec 2025
Commodities[24]	🟡	🟢
Oil (brent)	🟢	🔴
Gold	🟢	🟡
Carbon		🟡
Infrastructure (listed)	🟢	🟢
Infrastructure (non-listed)		🟢
Real estate (listed)	🟡	🟢
Real estate (non-listed) APAC[25]		🟡
Real estate (non-listed) Europe[25]		🟢
Real estate (non-listed) United States[25]		🟢

[1] Spread over German Bunds. [2] Relative to the MSCI AC World Index (only for the tactical signals),[3] S&P 500, [4] Stoxx Europe 600, [5] Euro Stoxx 50, [6] Dax, [7] Swiss Market Index, [8] FTSE 100, [9] MSCI Emerging Markets Index, [10] MSCI AC Asia ex Japan Index, [11] MSCI Japan Index, [12] MSCI AC World Consumer Staples Index, [13] MSCI AC World Health Care Index, [14] MSCI AC World Communication Services Index, [15] MSCI AC World Utilities Index, [16] MSCI AC World Consumer Discretionary Index, [17] MSCI AC World Energy Index, [18] MSCI AC World Financials Index, [19] MSCI AC World Industrials Index, [20] MSCI AC World Information Technology Index, [21] MSCI AC World Materials Index, [22] Russell 2000 Index relative to the S&P 500, [23] Stoxx Europe Small 200 relative to the Stoxx Europe 600, [24] Relative to the Bloomberg Commodity Index, [25] Long-term investments.

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 through December 2025

- 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

Glossary

Artificial intelligence is the theory and development of computer systems able to perform tasks normally requiring human intelligence.

The Bank of Japan (BoJ) is the central bank of Japan.

One basis point equals 1/100 of a percentage point.

The Bloomberg Commodity Index (BCOM) traces 23 commodities and reflects commodity futures price movements.

The carry (of an asset) is the cost or benefit from holding the asset.

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

The Dax is a blue-chip stock-market index consisting of the 40 major German companies trading on the Frankfurt Stock Exchange.

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

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

The European Central Bank (ECB) is the central bank for the Eurozone.

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

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

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

Investment grade (IG) refers to a credit rating from a rating agency that indicates that a bond has a relatively low risk of default.

The Japanese yen (JPY) is the official currency of Japan.

Magnificent 7 is a name for the group of the 7 largest stocks in the S&P 500.

The MSCI AC World Communication Services Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Communications Services sector.

The MSCI AC World Consumer Discretionary Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Discretionary sector.

The MSCI AC World Consumer Staples Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Consumer Staples sector.

The MSCI AC World Energy Index captures large- and mid-cap securities across 23 developed-markets classified in the Energy sector.

The MSCI AC World Financials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Financials sector.

The MSCI AC World Health Care Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Health Care sector.

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

The MSCI AC World Industrials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Industrials sector.

The MSCI AC World Information Technology Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Information Technology sector.

The MSCI AC World Materials Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Materials sector.

The MSCI AC World Real Estate Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Real Estate sector.

The MSCI AC World Utilities Index captures large- and mid-cap securities across 23 developed- and 26 emerging-markets classified in the Utilities sector.

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.

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

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

The Nikkei 225 is a price-weighted index of Japan's 225 most important listed companies.

The pound sterling (GBP), or simply the pound, is the official currency of the United Kingdom and its territories.

The Russell 2000 Index is an index that captures the 2,000 smallest stocks of the Russell-3000 index, which again comprises 3,000 small- and mid-cap U.S. listed stocks.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

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

The Stoxx Europe Small 200 is an index representing the performance of 200 small capitalization companies across 17 European countries.

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.

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

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.

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Cryptocurrencies and blockchain (the technology that supports crypto) have distinct risks that can include: the physical custody of cryptocurrency (theft, loss or destruction of key(s) to access the blockchain), lack of regulation, cybersecurity incidents, new and untested technology and its reliance on the Internet.

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