



HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

SEVERE SHOCK

The spread of coronavirus is a severe, but temporary exogenous shock to the economy that is being exacerbated in the short term by the drop in oil prices.

RELATIVE ATTRACTIVENESS

Equity markets are pricing in a significant growth slow-down. Not only equities, but also corporate and emerging-market bonds have become considerably more attractive than government bonds.

SEIZING OPPORTUNITIES

Catch-up effects, monetary and fiscal policy stimuli and low oil prices are likely to support a stronger economic recovery after the coronavirus outbreak subsides, and financial markets should recover.

Q2 | 2020



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FOREWORD



Prof. Dr. Bernd Meyer
Chief Investment Strategist

Dear reader,

After 2019, political risks were still high on the agenda of financial markets in 2020. But now a global pandemic and oil price war! These “black swans”, with a correspondingly strong market reaction, will continue to determine economic and financial market developments in the coming months.

For investors, the year got off to a positive start initially. Economic data signalled a turn for the better and political risks were subsiding. Equity markets repeatedly climbed to new highs until the middle of February, when the global coronavirus outbreak changed the narrative. Equity markets had already priced in a growth recovery. But now a deep global recession is inevitable. Stocks, oil and base metals have fallen sharply. In 16 days, the US stock market lost more than 20% from its all-time high – faster than ever before. The initial setback triggered a cascade of automated selling of rule-based investment strategies that have gained market influence over the past decade. The long-standing bull market in equities has thus come to an end. We are in a bear market. Safe havens were in demand. Yields on safe government bonds temporarily fell to record lows.

The global spread of the virus is an extremely severe, but ultimately temporary, shock to the real economy, which will be exacerbated in the short term by the fall in oil prices. The global economy is experiencing a deep recession, at least in the first half of the year. Expectations for corporate earnings must be significantly reduced. Corporate earnings are likely to fall noticeably in 2020. As soon as the coronavirus shock subsides, the economy should recover and some of the losses should be recovered. Our economists expect that these catch-up effects, the tailwind provided by additional monetary and fiscal policy support and the lower oil price will lead to a noticeable recovery from the second half of the year onwards. If this becomes apparent in the course of the second quarter, the financial markets should quickly price in this scenario.

The distortions on the capital markets will thus open up opportunities in the medium term. This is because equities in particular, but also corporate and emerging market bonds, have become significantly more attractive relative to government bonds. For long-term investors, the lack of alternatives to equities has further increased. The stock markets are already pricing in a temporary recession. However, the risks remain high in the short term. Further setbacks cannot be ruled out. Risk positions should only be built up gradually with signs of improvement. Some patience is needed.

In the Insights interview, Ulrich Urbahn, Head of Multi-Asset Strategy & Research, explains why an analysis of the interaction between asset classes is indispensable and how multi-asset strategies benefit from his team’s expertise.

I hope you enjoy reading this issue of Horizon.

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EMERGING OPPORTUNITIES

IN A NUTSHELL

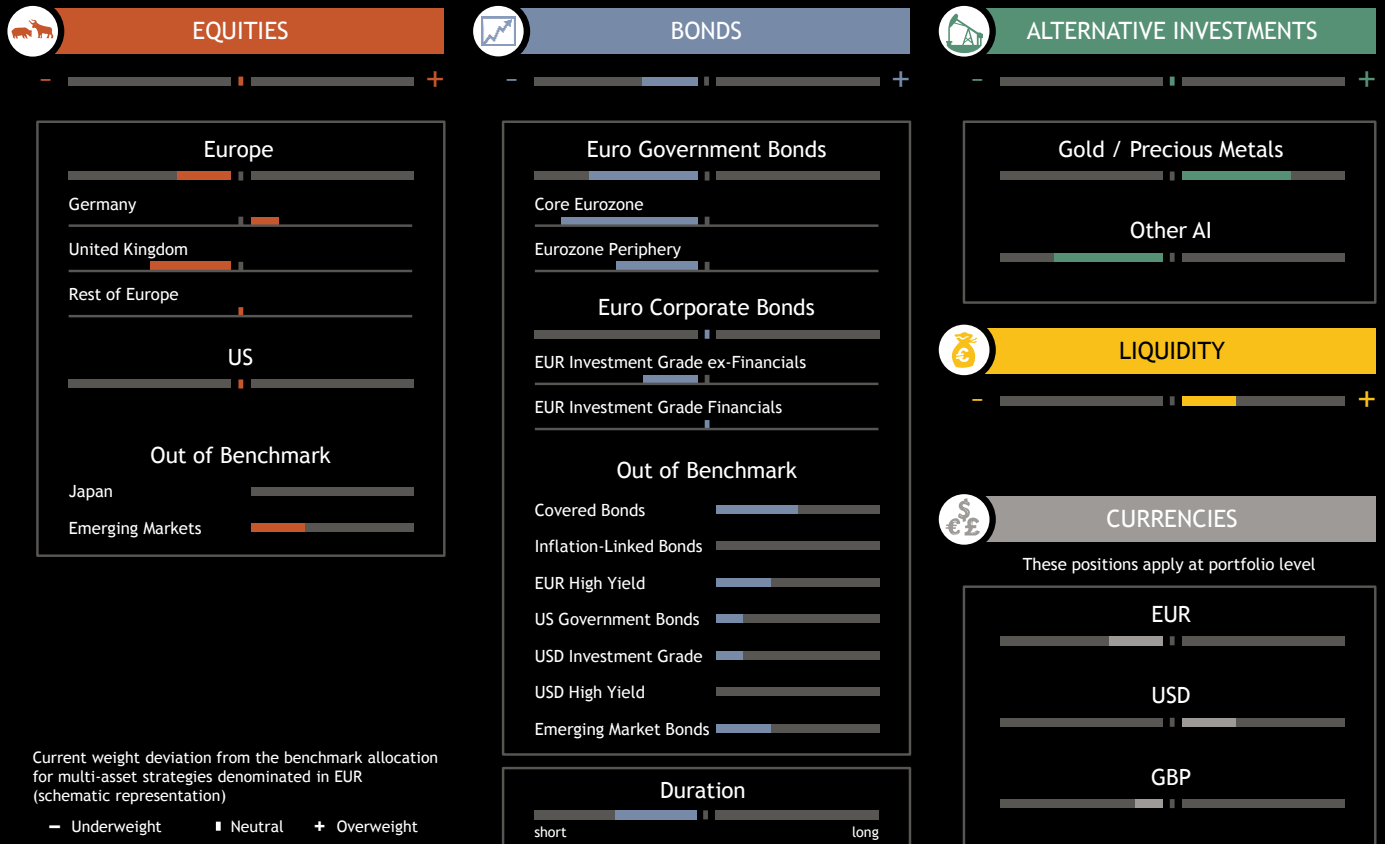
- After a deep recession resulting from the coronavirus shock in the first half of the year, catch-up effects, additional monetary and fiscal policy measures and the low oil price could trigger a significant recovery in the second half.
- Once the coronavirus outbreak has passed its peak and ebbed away, reallocations from safe havens to riskier investments would be likely. We are taking a wait-and-see approach to our positioning for now.
- After the correction in Q1, equity markets are already pricing in a temporary recession and, thus, in the above scenario have recovery potential until the end of the year.

with only a small overweight in equities. The fundamental potential seemed limited to us and rule-based investment strategies were heavily weighted in equities. We also held a substantial overweight in gold and a position in US Treasuries. This has paid off. Shortly after the beginning of the correction, we reduced equities in our portfolios, but maintained a close-to-neutral weighting.

In light of the still predominant risks, we have only acted on opportunities selectively so far and we are close to our strategic allocation. A substantial cash position will enable us to react quickly to signs that the coronavirus outbreak is subsiding. Within equities, emerging-market countries can be expected to benefit in the medium term from a recovery of global growth. In that case, Europe would probably catch up to the United States. We remain underweighted in bonds due to the low yields. Any signs that the situation is stabilising would probably cause the yield of safe bonds to rise again. For now, we are retaining our gold position as a portfolio hedge.

Portfolio positioning at a glance

Despite the good performance towards the end of 2019 and the strong propensity of investors to buy, we started the new year



Looking back on the first quarter - infected sentiment

The trends in effect at the end of 2019 initially continued at the start of 2020. Equities, corporate bonds and emerging-market bonds were supported by signs of an economic recovery and diminishing political risks. But even safe government bonds rose in price. The Iran conflict and the coronavirus epidemic weighed on bond yields, but put pressure on equities only briefly until mid-February, when the global spread of coronavirus created an entirely new situation. The S&P 500 index underwent a record-fast correction – in just six days it fell by more than 10% and in just 16 days by more than 20% from its all-time high on 19 February (see top graph on p5). The oil price war between Saudi Arabia and Russia that erupted in March exacerbated the sense of uncertainty in the markets and caused risk spreads in the bond market to widen substantially. The volatility index in the US equity market experienced the sharpest weekly increase of all time, rising to more than 80 and thus reaching the highest level since the global financial crisis. From the beginning of the year, equity markets lost between 20% (S&P 500) and 32% (DAX) amid the correction. The price of oil plunged by more than 50%. Safe havens like gold, but also government bonds, have been the best performers since the beginning of the year. Bond yields fell significantly and temporarily reached new record lows.

Short blossom of the euro

The euro initially lost around 4% against the US dollar as the exchange rate fell from 1.12 EUR/USD at the start of the year to 1.08 on 19 February. But then the euro appreciated substantially

to almost 1.15 EUR/USD during the first correction phase for risk assets. Contrary to the expectation of many market participants, the dollar did not prove to be a safe haven. For one thing, the US Federal Reserve has more room to lower interest rates, which it has since done. In normal times, moreover, investors use currencies with low or even negative interest rates such as the euro to finance positions in currencies with higher interest rates in order to collect the interest differential (carry trade). If market risks rise, such positions are often liquidated to reduce portfolio risks. Investments in foreign currencies are sold, the financing currency is repurchased and the financing is ended. However, this support for the euro was not sustainable and it gave up its gains as fears of recession grew.

A stronger recovery could follow the recession

The economy was on a good path before the coronavirus outbreak. There were signs of the turn for the better we expected for 2020 and that had been priced in by the equity markets already at the end of last year. The Global Purchasing Managers Index for Manufacturing soared to 50.4 in January, the highest level since April 2019 (centre graph on p5). The worldwide coronavirus outbreak and the oil price war caused a severe, but presumably temporary, shock to the economy. Supply and demand contracted sharply in a short time, as shown by the collapse of the Global Purchasing Managers Index to 47.2 in February. The service sector has also been hit hard. In China, however, the spread of the virus has already slowed considerably and the stresses are easing. Based on the number of passengers using public mass

Government bonds and gold have shone YTD; oil and equities under heavy pressure from the global coronavirus outbreak and oil price war

Total return	YTD and in 2019 (in %, EUR)		12-month periods of the last 5 years (in %, in EUR)					CAGR*	Std. dev.*
	■ YTD (31/12/19-17/03/20)		17/03/19	17/03/18	17/03/17	17/03/16	17/03/15		
	■ 2019 (31/12/18-31/12/19)		17/03/20	17/03/19	17/03/18	17/03/17	17/03/16	17/03/20	17/03/20
US Sovereigns	6.1	7.6	11.9	12.3	-12.6	4.8	-4.3	2.0	7.6
Gold	2.7	21.0	20.8	7.5	-6.6	3.0	2.5	5.1	11.8
USDEUR	2.0	2.3	3.0	8.5	-12.6	5.4	-6.4	-0.7	8.0
Eonia	-0.1	-0.4	-0.4	-0.4	-0.4	-0.3	-0.1	-0.3	0.0
EUR Sovereigns	-1.7	3.1	0.3	1.4	1.6	-0.8	1.5	0.8	2.1
EUR Corporates	-4.5	6.3	-1.0	1.6	2.2	2.5	0.0	1.1	2.2
EM Sovereigns	-8.9	16.7	-0.5	11.7	-9.3	14.7	-0.5	2.8	8.9
S&P 500	-19.6	34.1	-5.8	13.6	3.2	25.4	-5.9	5.4	19.2
MSCI EM	-24.1	20.8	-17.4	-3.0	12.3	27.4	-17.4	-1.1	16.7
Stoxx Europe 50	-26.3	27.4	-17.4	6.8	-1.0	14.9	-14.6	-3.1	16.5
DAX	-32.5	25.5	-23.5	-5.7	2.4	22.3	-17.4	-5.7	18.6
Brent	-51.9	38.3	-47.2	14.3	12.3	13.6	-39.9	-14.3	36.6

Time period: 17/03/2015-17/03/2020. Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = Annualised standard deviation (in %, in EUR).



transit in Beijing and Shanghai, traffic congestion in Beijing and the coal consumption of the biggest electricity producers in China, the country is slowly but steadily returning to normalcy.

The spread of the virus in the rest of the world is likely to continue to weigh heavily on confidence and economic activity in the second quarter. If the coronavirus outbreak subsides, however, the economy should recover at a much faster rate than expected to date. Firstly, some of the lost activity will probably lead to catch-up effects later in the year. Secondly, the additional monetary and fiscal policy support and low oil prices will create tailwinds.

Emerging opportunities: Equities attractive in the medium term

The fundamental potential for equity markets in 2020 was limited even before the coronavirus outbreak. The equity markets had already priced in an economic recovery and the expectations for corporate profit growth were too optimistic. Although profit expectations have steadily declined since the start of the year, we must now expect corporate profits to fall significantly in 2020. Market expectations are therefore still much too high. On the other hand, the market is already clearly pricing in a recession (see centre chart).

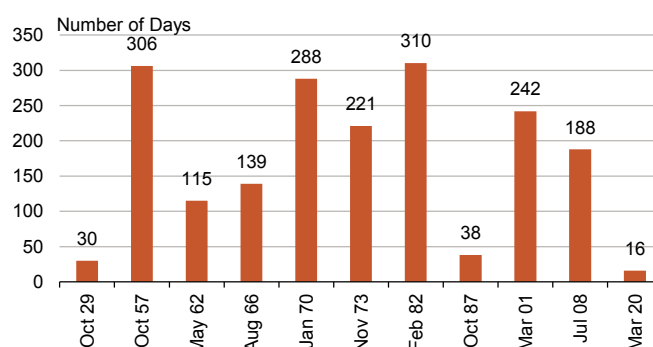
If, as in our base-case scenario, there are signs of a stronger economic recovery by the end of the year at the latest, there is now significant upward potential again. The slower profit growth could well be offset at least by the lower interest rates, additional stimulus measures and the increased relative attractiveness of equities compared to bonds. For example, the difference between the dividend yield of European equities and the yield of government or corporate bonds has risen to a new high (see bottom graph).

For the markets, this means that equities could rise more sustainably again after a volatile stabilisation phase once the probability of our basic scenario increases significantly. In that case, bond yields could be expected to rise slightly again and the risk spreads of corporate and emerging-market bonds would tighten. More cyclical stocks and commodities in particular would offer recovery potential, while gold could suffer. However, it is difficult to say whether these developments will begin in the second quarter or later.

Prof Dr Bernd Meyer, Chief Investment Strategist

Fastest bear market ever: 16 days is a new record

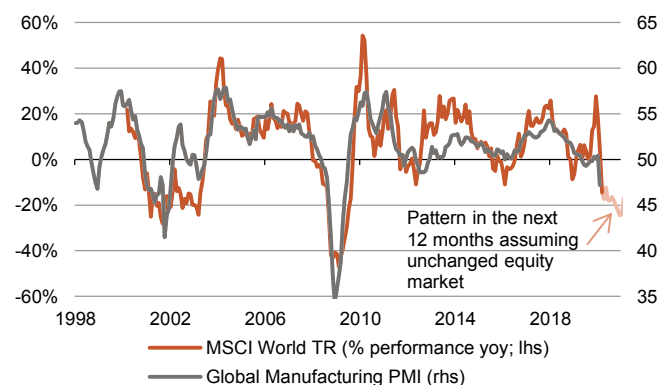
The number of days until a 20% correction of the S&P 500 index from its previous all-time high - current situation only comparable to 1929 and 1987



Time period: 03/01/1928-16/03/2020.
Source: Bloomberg, own calculations.

Recession already priced in, but not a deep and long recession

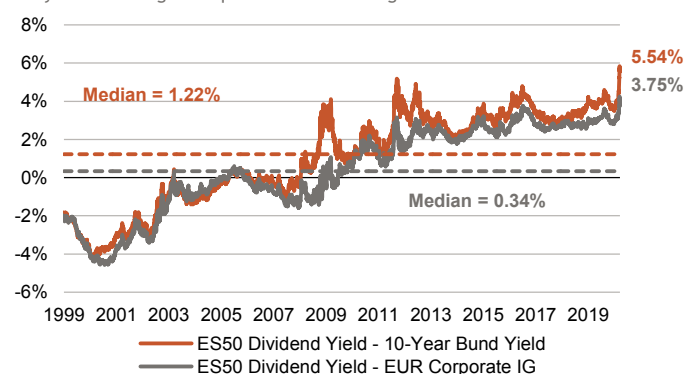
Year-on-year performance of global equities versus the Global Purchasing Managers Index for Manufacturing, which has fallen due to coronavirus stresses



Time period: 01/01/2000-31/12/2020.
Source: Bloomberg, own calculations.

Relative attractiveness of equities at all-time highs

Falling bond yields combined with the equity markets correction have pushed the yield advantage of equities to all-time highs



Time period: 01/01/1999-17/03/2020.
Source: Bloomberg, own calculations.



CORONAVIRUS RECESSION: DEEP BUT TEMPORARY

IN A NUTSHELL

- Economy: virus shock triggers deep recession.
- Noticeable recovery likely as soon as the shock subsides.
- Monetary and fiscal policy becomes more expansionary than ever before.

A shock like never before

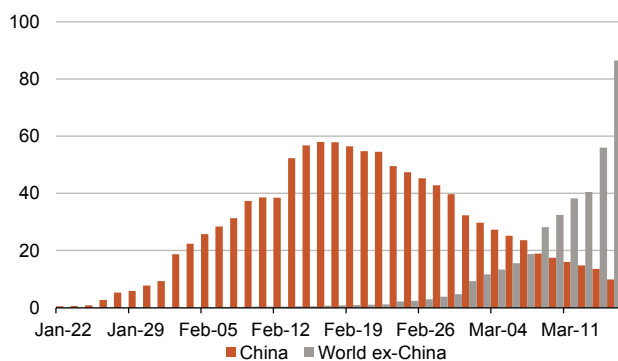
Europe became the new epicentre of the coronavirus pandemic in March. In order to slow down the further spread of the virus, Germany and many other countries introduced extensive border controls within a few days and dramatically restricted public life.

The virus and the necessary interventions in everyday life are hitting the economy hard. They restrict both supply and demand in a way that is unparalleled in peacetime. While these measures are in full force, economic output is likely to decline even more sharply than during the major financial crisis in the autumn and winter of 2008/2009. A deep coronavirus recession is looming in almost all developed countries for the first half of 2020.

If these restrictions are gradually eased at a later stage, a substantial part of economic activity may recover rapidly. From the deep trough, growth rates are also likely to be substantial for some time to come, although the level seen before the coronavirus crisis is unlikely to be reached for the time being. When the

Coronavirus infections: Second wave

Active cases (confirmed cases excluding deaths and recoveries, in thousands)



Time period: 23/01/2020-16/03/2020.
Source: Johns Hopkins University.

recovery will begin is currently one of the major open questions for today's outlook.

However, our fundamental view of the global economy remains unchanged. The pandemic is an extremely severe, but ultimately temporary, shock to the real economy. It is not a reason for a real financial crisis, provided that economic policy takes a courageous approach to the risks.

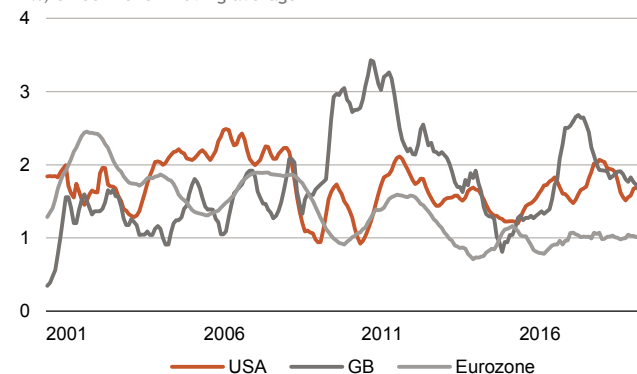
Monetary and fiscal policy respond to the shock

Never before has monetary and fiscal policy and the supervisory authorities on both sides of the Atlantic reacted so quickly and comprehensively to a shock as in the past few days. The US Federal Reserve has cut its key interest rate to a range of only 0.00-0.25% in two special meetings, and the Bank of England is likely to cut its current key rate of 0.25% again shortly to (virtually) zero. In addition, it has introduced a new credit line to benefit small and medium-sized companies in particular. The European Central Bank has increased its bond purchase programme by a total of €120bn. It is also offering liquidity on such favourable terms that this could correspond to a 0.25ppt cut in its key interest rate if banks accept the ECB's offer. We expect further bold steps to be taken should this become necessary.

The low inflation rates (chart p6 right), which could fall again for a short time due to lower oil prices, will allow central banks to counteract the economic weakness.

Subdued core inflation in industrialised nations

Consumer prices excluding food and energy (PCE for USA), annual rate of change in %, three-month moving average



Time period: 01/01/2001-29/02/2020.
Source: BLS, ONS, Eurostat.



The monetary policy stimulus is accompanied by extensive fiscal stimulus packages. The focus is less on traditional instruments such as lower taxes or higher government spending. Instead, in most countries the main focus is on helping companies in the event of liquidity shortages and saving as many employees as possible from being dismissed during the crisis.

Economic policy measures will not be able to stem the spread of the virus. But they can limit second-round effects and ensure that the economy gets back on track once the medical challenge is overcome.

“In the short term, risks are clearly on the downside; once the pandemic has abated, monetary and fiscal policy can then support the recovery”

The pandemic directly affects the real economy. This distinguishes it from the major financial crisis of 2008/2009 and the euro crisis of 2011/2012, which originated mainly from the financial sector itself and could therefore be halted with the financial resources of the central banks. The situation on financial markets is likely to remain very volatile until the further spread of the pandemic can be assessed at least somewhat better than is currently the case.

The in some cases panic-like reaction on some financial markets could in extreme cases trigger a real financial crisis, which would then in turn exacerbate the recession. However, central banks,

finance ministers and supervisory authorities can limit this risk by using their resources wisely. Their behaviour to date shows that they are aware of this. They are obviously prepared to do everything possible to prevent such second-round effects.

Pronounced risks

The risks to our economic forecasts are extraordinarily high in the short term and are clearly directed downwards. As soon as the crisis subsides, expansionary monetary and fiscal policy could then provide lasting and substantial support for the recovery. However, this is unlikely to become apparent until autumn at the earliest, and possibly even some time later.

Once the coronavirus shock has finally subsided, it is quite possible that economic output will then recover quickly, boosted by the stimulus. Compared to the respective previous quarter, there could then even be growth rates that are far above the long-term trend in order to make up for some of the losses. For the time being, however, we will have to deal primarily with the dramatic downside risks threatening the economy until the pandemic has been sufficiently contained.

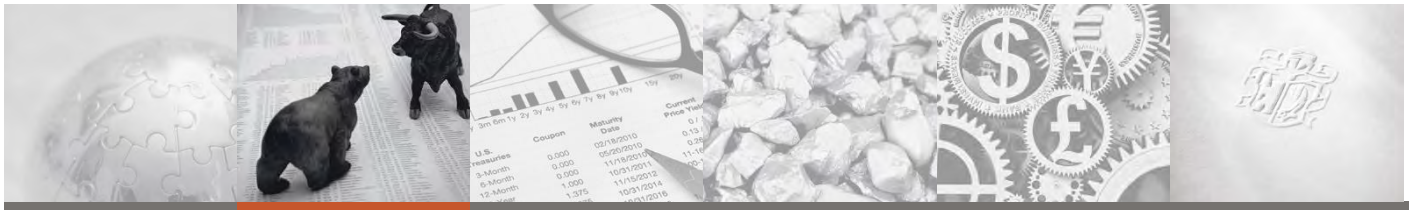
Dr Holger Schmieding, Chief Economist

Growth and inflation forecasts

	GDP Growth (in %)						Inflation (in %)					
	2019		2020		2021		2019		2020		2021	
		Ø**		Ø**		Ø**		Ø**		Ø**		Ø**
USA	2.3	2.3	-2.3	1.8	1.4	2.0	1.8	1.8	0.7	2.0	1.5	2.1
Eurozone	1.2	1.2	-3.5	1.0	2.3	1.3	1.2	1.2	1.0	1.2	1.2	1.4
Germany	0.6	0.6	-3.2	0.6	2.3	1.2	1.4	1.4	1.0	1.4	1.6	1.5
France	1.2	1.2	-2.7	1.0	2.7	1.3	1.3	1.3	1.2	1.3	1.4	1.4
Italy	0.2	0.2	-4.9	0.2	2.6	0.6	0.6	0.6	0.6	0.7	0.9	1.0
Spain	2.0	2.0	-3.4	1.6	2.7	1.6	0.8	0.8	0.7	1.0	1.0	1.4
UK	1.4	1.3	-2.0	1.0	2.4	1.5	1.8	1.8	0.9	1.6	0.9	1.9
Japan	0.8	1.0	-3.6	0.2	-0.9	0.8	0.5	0.5	-0.1	0.7	0.9	0.6
China	--	6.1	--	5.5	--	5.8	--	2.9	--	3.3	--	2.2
World*	--	--	--	--	--	--	--	3.0	--	3.0	--	3.0

* Due to the great uncertainty surrounding the coronavirus, Berenberg is not publishing economic forecasts for China and World.

** Average, Bloomberg consensus as of 17/03/2020.



MARKED INCREASE IN RELATIVE ATTRACTIVENESS

IN A NUTSHELL

- The momentum of earnings downgrades is likely to increase. Analysts have only made modest adjustments to date. The consensus is much too optimistic.
- Valuation ratios are below their historical averages again. Compared to bonds, equities are extremely attractive and a must-have for the long term.
- In the short term, we prefer the US as a defensive equity market and we like Asian emerging markets.

Momentum of negative earnings revisions likely to increase

In line with the rising number of profit warnings, analysts have recently downgraded their profit estimates across all regions, albeit only very slowly. On aggregate, negative profit forecast revisions have been mainly directed at emerging-market countries in the last month under the pressure of the coronavirus outbreak and the resulting weakness of commodities. Within emerging markets, analysts have downgraded profit estimates for eastern European companies the most. By contrast, earnings estimates have recently been downgraded only modestly for US equities. We expect global corporate earnings in 2020 to fall significantly compared to the previous year. Currently, the consensus expectation is still for earnings growth of around 4%.

Equity markets completely upended by coronavirus

Equity markets got off to a good start to the year, buoyed by the partial deal in the trade dispute and robust economic data. The geopolitical tensions between Iran and the US and the outbreak of coronavirus in China were well digested by the markets. The DAX, for example, hit an all-time high in mid-February. Growth worries emerged when coronavirus began to spread outside of China, and then erupted in full force when Russia and Saudi Arabia unexpectedly launched an oil price war. Caught off guard, hedge funds and systematic investors in particular magnified the sell-off. The S&P 500 tumbled into a bear market for the first time since the financial crisis. Asian emerging-market countries have been among the relative winners, thanks to the support of fiscal stimulus measures, especially in China. In particular, eastern European stocks were disproportionately impacted by the weakness of commodities.

Valuations are much more attractive again

As a result of the sharp sell-off in equity markets, valuation ratios have fallen to below their historical averages. As of mid-March, European equities are trading at a P/E ratio of 11.2, close to the valuation lows of the 2011 euro crisis. On a P/B basis, the DAX is now even trading close to the lows reached during the global financial crisis of 2009. The stock markets have already priced in a mild recession scenario. Relative to bonds, equities have become even more attractive. The yield of 10-year US Treasuries dipped below 1% for the first time in March. And even the yield of 30-year US Treasuries has fallen below the dividend yield of the S&P 500. In many countries of the world, the expected dividend yield of their equity markets has risen above the yield of their 10-year government bonds. This could lead to fresh inflows

Coronavirus and oil price war a heavy blow to equity markets across the world

Total return	YTD and in 2019 (in %, EUR)		12-month periods of the last 5 years (in %, EUR)					P/B*	Div.*	P/E*
	■ YTD (31/12/19-17/03/20)	■ 2019 (31/12/18-31/12/19)	17/03/19	17/03/18	17/03/17	17/03/16	17/03/15			
MSCI EM Asia	-19.2	21.6	-11.8	-3.7	15.4	27.9	-18.6	1.3	3.0	11.5
S&P 500	-19.6	34.1	-5.8	13.6	3.2	25.4	-5.9	2.6	2.5	15.1
Topix	-23.7	22.2	-13.2	-2.6	5.1	22.6	-10.0	0.9	3.1	11.3
Stoxx Europe Defensives	-24.0	22.2	-16.3	14.2	-1.9	7.0	-9.4			
Stoxx Europe 50	-26.3	27.4	-17.4	6.8	-1.0	14.9	-14.6	1.4	5.4	11.2
Euro Stoxx 50	-32.3	28.2	-23.2	1.2	2.2	16.7	-15.1	1.1	5.4	9.9
DAX	-32.5	25.5	-23.5	-5.7	2.4	22.3	-17.4	1.0	4.8	9.4
MSCI USA Small Caps	-32.5	29.3	-25.8	10.3	0.7	31.8	-14.4	1.3	2.5	0.2
Stoxx Europe Small 200	-33.9	29.1	-25.2	0.1	9.7	14.0	-6.2	1.2	4.3	11.8
MSCI UK	-34.3	23.3	-29.1	9.0	-1.8	12.1	-13.7	1.2	6.8	10.1
Stoxx Europe Cyclical	-35.3	27.3	-27.9	-4.0	6.9	21.7	-16.1			
MSCI EM Eastern Europe	-39.3	36.9	-24.7	7.7	7.0	29.5	-3.3	0.7	9.6	5.6

Time period: 17/03/2015-17/03/2020.

Source: Bloomberg * PBV = Price/book value ratio; Div. = Dividend yield (%); PER = Price/earnings ratio. Values based on estimates for the next 12 months.



into the equity markets by the end of the year if the coronavirus crisis subsides. Now more than ever, there is no liquid alternative to equities for investors wishing to earn adequate returns.

US preferred for now

Coronavirus has already rendered the economic forecasts from the beginning of 2020 obsolete. The consensus expectation had been that the global economy will accelerate over the course of the year, mainly thanks to the partial deal in the trade dispute between the US and China. Instead, we are now seeing deep recessions in many regions and especially in Europe. This prospect speaks more for defensive equity markets such as those in the US, where equities are supported by share buyback programmes and the greater manoeuvring room for the Fed. Moreover, the sector structure is less cyclical than in Europe or emerging-market countries. In the meantime, the risk of a leftist-progressive US President such as Bernie Sanders has also lessened. We also like emerging markets because Asian countries above all are receiving substantial support from the stimulus measures of regional governments and central banks.

Ulrich Urbahn, Head of Multi-Asset Strategy & Research

WHAT IS ON COMPANIES' MINDS?

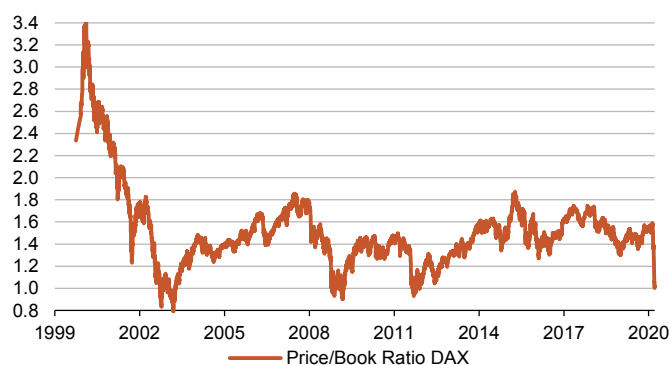
Coronavirus outbreak delays recovery

The entirely respectable European corporate results of the fourth quarter have been overshadowed by the coronavirus outbreak in the past few weeks. Both in Europe and in the US, we are only at the start of the epidemic and no one really knows how long it will impact the business of companies. Most of the companies we have spoken with refrained from making predictions, stating that any forecasts would depend on further developments in the current situation. Many companies are indeed trying to quantify the effects of coronavirus. But these efforts mostly amount to an analysis of how different scenarios would play out. At the moment, companies are unwilling and unable to provide more exact estimates of the impact on airlines and travel companies (for example), whose business is especially threatened. On the other hand, what we are hearing from companies in China gives reason for optimism. After many companies, including those in the luxury goods and capital goods sectors, saw their business nearly grind to a halt, they are now reporting a significant improvement.

Matthias Born, CIO Equities



DAX valuation now close to the lows of the financial crisis

Price/book value ratio of the DAX

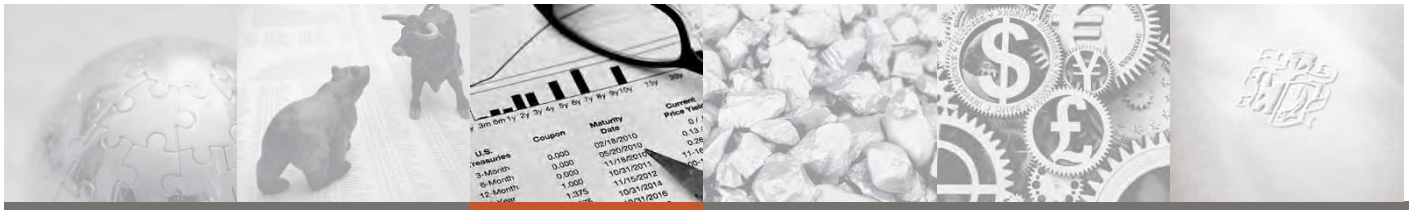


Time period: 01/01/1999-17/03/2020.
Source: Factset, Berenberg.

Forecast summary: Equities with upside potential

Index forecasts	Currently			in 12 months
	17/03/2020	31/12/2020	30/06/2021	
S&P500	2,529	2,900	3,100	3,505
Dax	8,939	11,500	12,500	14,294
EuroStoxx 50	2,531	3,150	3,400	3,998
MSCI UK	1,511	1,850	2,000	2,308
Index potential (in %)				
S&P500	-	14.7	22.6	38.6
Dax	-	28.6	39.8	59.9
EuroStoxx 50	-	24.5	34.4	58.0
MSCI UK	-	22.5	32.4	52.8

* Average, consensus as of 17/03/2020.
Source: Bloomberg, Factset, Berenberg.



BONDS ARE WINNERS AND LOSERS OF THE CORONAVIRUS CRISIS

IN A NUTSHELL

- Safe government bonds are benefiting from uncertainty; southern European periphery to become more attractive.
- Among corporate bonds, we prefer defensive sectors and financials; cyclicals should be avoided at the present time.
- Hard-currency emerging-market bonds present opportunities; preferably corporate bonds.

Bond markets in the grip of coronavirus and recession fears

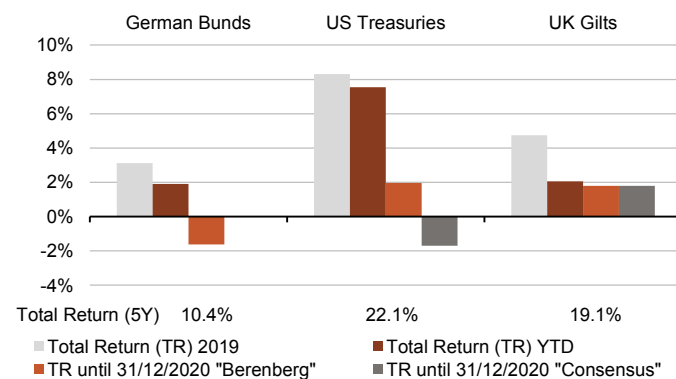
The notion that coronavirus could only be a purely Chinese problem has quickly proved to be wishful thinking. As the viral spread went global, the world has been gripped by both health and economic fears. Bond markets have reacted accordingly, although in different directions depending on the risk segment.

Safe government bonds in demand as investors seek refuge

Not surprisingly, top-rated government bonds have proved to be the biggest winners of the worldwide uncertainty. Above all, investors are piling into US Treasuries, which have benefited from the US Federal Reserve's 150bp rate cut, in addition to their traditional "safe haven" status. The yield of 10-year US Treasuries has fallen by around 1.1% since the beginning of the year, at one point even reaching a historical all-time low of 0.31%. German Bund prices have likewise risen sharply. The move back towards positive yields for the first time since May 2019 was

Safe government bonds: Prices will fall after the crisis

Past and expected performance, 10-year government bonds, total effect of yield/price change, coupon income and roll-down effect



Time period: 17/03/2015-17/03/2020.
Source: Bloomberg, own calculations, iBoxx Government Bond Indices (7-10 years, TR).

aborted already early this year. Instead, the 10-year yield fell to a low of -0.91%. Although we have downgraded our yield forecasts slightly, the message is clear: as soon as the uncertainties subside, the winners of the current crisis will become the losers. Comparatively interesting in the euro area are still bonds from Spain and Portugal. Yields rose there, resulting in higher risk premiums compared with Bunds and making these countries relatively more attractive. To be on the safe side, however, we are avoiding Italy.

Corporate bonds: Still too early for heightened risks

The early part of this year has been turbulent, to say the least. While so-called CoCo bonds (contingent convertibles) suffered a 15% drop in price until mid-March, European high-yield bonds, with a relative loss of 7.5% compared to government bonds, even posted the largest weekly loss in the past 11 years (see chart at bottom left on the next page). We would have to look back to the Lehman crisis of 2008 to find an even bigger weekly decline. Although we do not anticipate a deep recession, significant braking effects are to be expected at the company level in the coming quarters. Despite the fact that entry levels have become more attractive again in the meantime, we are cautious in our positioning and avoiding issuers from the automotive and tourism sectors, as well as airlines. On the other hand, we are favouring defensive segments such as utilities, telecommunications and financials. Thanks to stricter regulations, European banks and insurance companies in particular have built up substantial capital and liquidity buffers in the past few years and should therefore be able to weather a temporary growth dip. Nevertheless, we would

Forecasts: Base interest rates and government bond yields (in %)

Comparison of Berenberg and consensus forecasts, values at the end of 2020 and the middle of 2021

	17/03/2020	31/12/2020	30/06/2020		
	Currently	🇺🇸	🇪🇺*	🇺🇸	🇪🇺*
USA					
Base interest rate	0.00-0.25	0.00-0.25	0.60	0.00-0.25	0.75
10Y US yield	1.08	1.00	1.16	1.00	1.41
Eurozone					
Base interest rate	0.00	0.00	0.00	0.00	0.00
10Y Bund yield	-0.44	-0.30	-0.42	-0.10	-0.27
UK					
Base interest rate	0.25	0.10	0.20	0.10	0.27
10Y Gilt yield	0.55	0.30	0.51	0.60	0.60

* Average, consensus as of 17/03/2020. Source: Bloomberg.



first need to see a global decline in new coronavirus infections and a sustained bottom in the markets before we increase risks appreciably. However, several weeks or even months can pass before that happens.

Emerging markets: Hard-currency bonds attractive in some cases

Although bond markets were in pretty good shape at the start of the year, prices have come under pressure from the strong increase in risk aversion resulting from the coronavirus outbreak. The situation eased in early March when yields of government bonds and especially US Treasuries declined markedly as a result of globally coordinated central bank activities. However, this hiatus did not last long before the “price war” between Russia and Saudi Arabia put extreme pressure on oil prices. This new shock on top of the further spread of the virus provoked panic selling. Not immune to these circumstances, emerging-market bonds were afflicted by a massive widening of risk spreads. In addition, investors should pay explicit attention to idiosyncratic risks in both currencies and in lower-rated emerging-market countries. Currently, prominent examples include Lebanon’s default and the developments in Ecuador and other, particularly African, countries that are hard hit by the collapse in oil prices. For these reasons, we currently prefer less volatile, hard-currency, investment-grade bonds to their high-yield counterparts. After the recent pullbacks, we consider the current risk spreads for hard-currency government bonds to be fairly priced and those for corporate bonds even to be attractively priced. Even if the coronavirus crisis worsens, we like corporate bonds for their

more favourable volatility properties combined with still adequate yields. Nevertheless, investors remain cautious, as reflected in the recent capital outflows (see graph at bottom right).

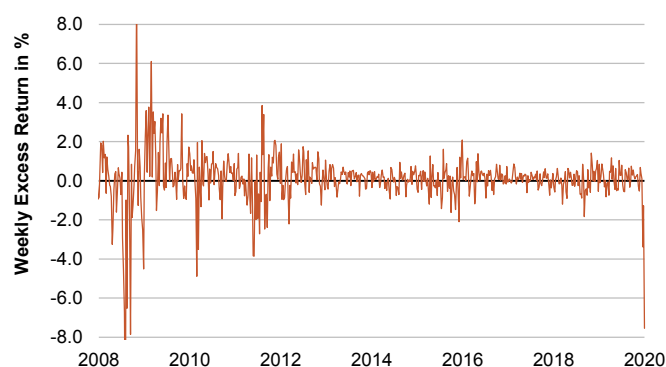
Conclusion

The first will be last as soon as the coronavirus situation eases, expectations for the further development of the global economy are less fraught with uncertainty, and a sufficiently large number of market participants shed their risk aversion. When that happens, capital will flow out of safe havens and safe government bonds will lose their first-place status in the minds of investors. Both corporate bonds of all types and emerging-market bonds will benefit from this development. Until such time, however, we will hold on to our position in US Treasuries, adopt a cautious positioning in the corporate bond segment, avoid crisis-sensitive sectors, and give preference to lower-volatility, well-rated hard-currency bonds in emerging markets. The challenge will be choosing the right time, possibly already in the next quarter, to take a more aggressive stance.

Martin Mayer, Senior Portfolio Manager Multi-Asset
Christian Bettinger, Head of Fixed Income
Robert Reichle, Head of Emerging Markets Selection

European high-yield bonds: Biggest relative loss since 2008

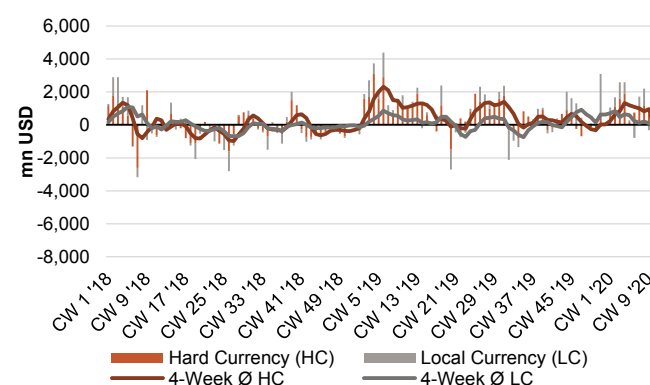
Relative to government bonds, European high-yield bonds have recently suffered the biggest weekly loss of the last 11 years



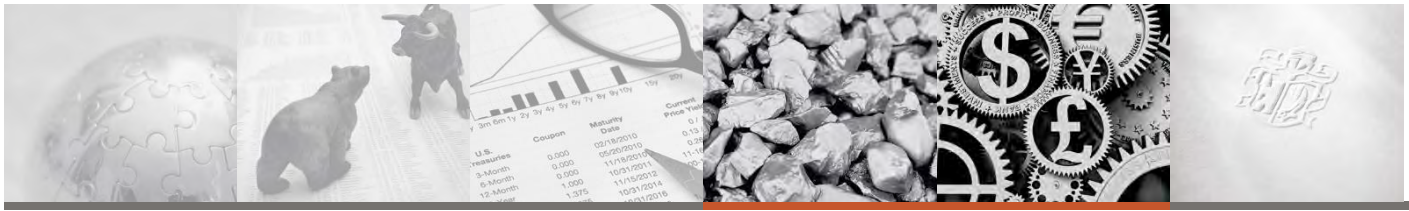
Time period: 13/03/2008-13/03/2020.
Source: Bloomberg.

Emerging-market bonds have recently suffered heavy outflows

Since February, emerging-market bonds have experienced the largest weekly capital outflows in the past two years



Time period: 01/01/2018-13/03/2020 (stated in calendar weeks [CW]).
Source: J.P. Morgan.



VIRUS-WEAKENED PROSPECTS BEYOND GOLD

Catastrophic start to the year for crude oil

After oil prices were severely impacted by coronavirus, many market participants hoped for additional OPEC+ production cuts in early March. The outcome of the meeting could not have been worse, with Russia declaring war on the US shale oil industry and Saudi Arabia promptly responding with a massive increase in its own production to force the Russians back to the negotiating table. After that, crude oil suffered the biggest daily loss since 1991. Oil prices are now down about -55% since the beginning of the year. However, the Saudis' price war will probably only be temporary given that it will strain their own national budget and greatly upset the US, Saudi Arabia's most important geopolitical ally.

Gold remains attractive as a hedge

Thanks to the Iran conflict and coronavirus, gold was initially in strong demand in the first quarter. However, some investors have recently had to substantially reduce their positions in order to meet margin calls in riskier positions that have fallen sharply. As a result, gold has also had to give up all its gains since the beginning of the year. However, the opportunity costs for gold remain low thanks to low real interest rates. The relative attractiveness of gold compared to safe government bonds remains high thanks to expansive monetary policy. However, record ETF holdings and the pronounced positioning of speculative investors limit the price potential. Nevertheless, gold remains an important portfolio constituent as a diversifier and hedge against political and economic risks.

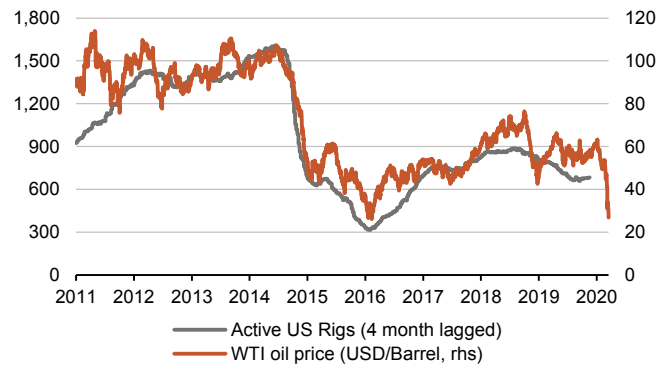
Industrial metals to recover only when equity markets improve

Hopes that industrial metals would catch up to cyclical stocks have been dashed by the coronavirus-induced manufacturing standstill. Instead, prices of all metals are negative for the year. And despite the lower prices, any relative attractiveness resulting from the drastic losses in equity markets has been lost. While the supply chains of many businesses are still disrupted, inventories are piling up at the metal exchanges. For this reason, a quick recovery seems improbable. Stimulus measures on the part of China could provide some relief. As soon as manufacturing returns to normal, some metals like copper or cobalt that benefit from structural trends, could present opportunities in the medium to long term.

Ludwig Kemper, Analyst Multi-Asset Strategy & Research

Low oil prices put the brakes on growth of US shale oil production

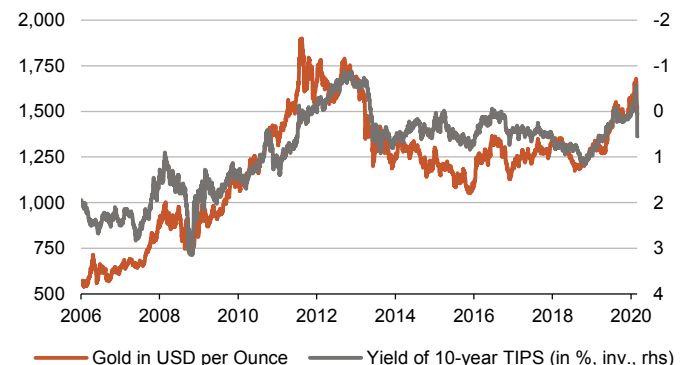
Due to the sharp decline of oil prices, increases in US shale oil production will be much lower than originally expected



Time period: 01/01/2011-17/03/2020.
Source: Bloomberg.

Gold: low opportunity costs thanks to low real interest rates

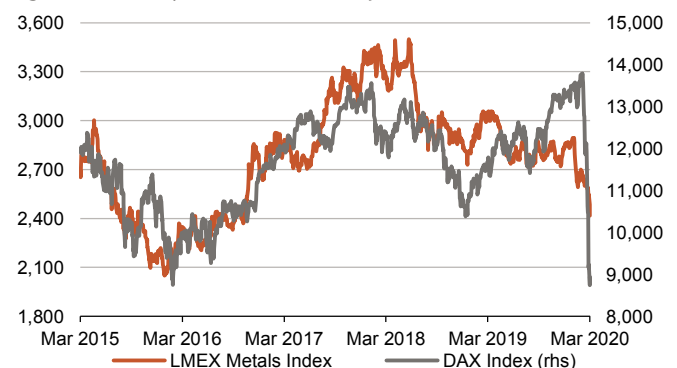
Low real interest rates and an expansive monetary policy make gold, despite its higher price, still attractive relative to government bonds



Time period: 01/01/2006-17/03/2020.
Source: Bloomberg.

Industrial metals surprisingly stable relative to equities

After the sharp sell-off of cyclical stocks due to coronavirus, industrial metals no longer seem as cheap as at the start of the year



Time period: 17/03/2015-17/03/2020.
Source: Bloomberg.



CORONAVIRUS HITS CURRENCY MARKET HARD

New situation in the currency market

Worries about the economic consequences of coronavirus have fundamentally changed the situation in the currency market. When cases were still limited to China, the US dollar benefited initially from the improved US economy and continued to rise. However, the unexpected wave of infections in Italy in late February changed the situation practically overnight. In parallel with the dramatically rising concerns about the global economy and the drastic losses in equity markets, the European single currency made significant gains. In this situation, the euro is benefiting from the extremely lax monetary policy of the ECB, which compared to other central banks has only limited potential to further loosen its policy in reaction to rising economic risks. Furthermore, the euro has been used as the financing currency for carry trades due to the extremely low interest rates. When the financial markets become turbulent, such interest rate differential trades are unwound, generating demand for the financing currency – in this case the euro.

EUR/USD: Two steps forward and two steps back

Although economic data from the US are still robust, the Federal Reserve cut the key interest rate by a total of 150bp to 0.00-0.25% at two emergency meetings in March and announced comprehensive liquidity measures. It made these moves proactively to mitigate the potential economic damage of the coronavirus outbreak. We expect a further interest rate cut of 25bp in the second quarter. The clouded outlook for interest rates – even market interest rates in the US are sharply lower – cost the dollar some of its previous strength and weakened it by USD0.06 within 14 days. However, the euro has recently had to give up these gains just as quickly.

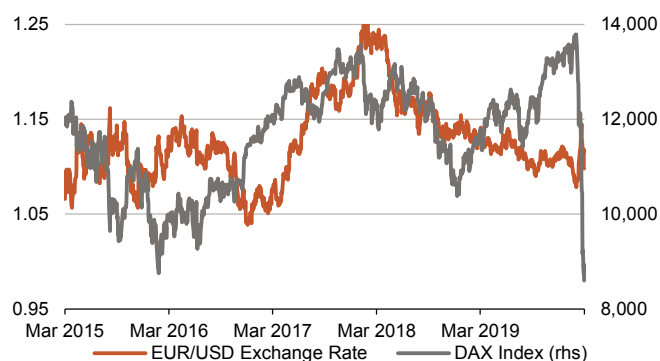
Euro rises against the pound

Until the coronavirus crisis, the pound's exchange rate had been largely driven by Brexit. The pound had risen for months after a solution for the Brexit drama began to emerge. In mid-February, thus immediately before the eruption of the coronavirus crisis in Italy, EUR1 only fetched around GBP0.83. The Bank of England has since lowered the base interest rate by 50bp on an emergency basis and it is likely to loosen monetary policy further. The rise in the euro exchange rate to more than GBP0.90 per euro is certainly justified because it reflects the changed monetary policy outlook.

Dr Jörn Quitzau, Senior Economist

EUR/USD: Euro is the winner of the crisis

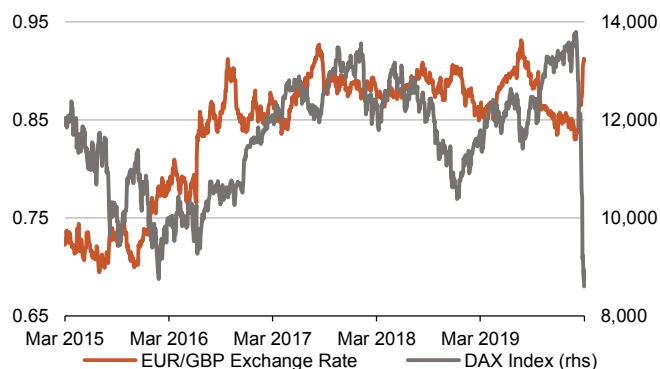
Economic uncertainties have forced the US central bank to adopt expansive monetary policy. The euro should benefit from the Fed's rate cuts.



Time period: 17/03/2015-17/03/2020.
Exchange rate in USD; DAX Index in points. Source: Bloomberg.

EUR/GBP: Bank of England loosens monetary policy

Whereas the Bank of England has lowered interest rates, the ECB has only limited tools to counteract the economic risks. This strengthens the euro.



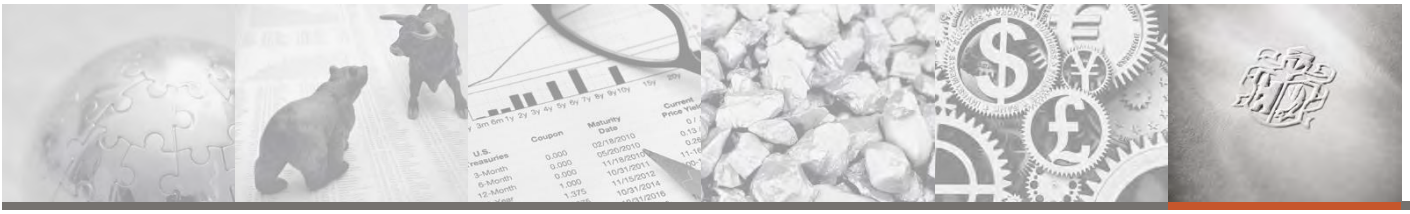
Time period: 17/03/2015-17/03/2020.
Exchange rate in GBP, DAX Index in points. Source: Bloomberg.

Exchange rate forecasts

Great uncertainty due to corona crisis

Exchange rate forecast	17/03/2020	31/12/2020		30/06/2021	
	Currently	€	Ø*	€	Ø*
EUR/USD	1.10	1.13	1.13	1.15	-
EUR/GBP	0.91	0.86	0.85	0.85	-
EUR/CHF	1.06	1.09	1.09	1.11	-
EUR/JPY	118	125	120	128	-
Change against the euro in %					
USD	-	-2.7	-2.7	-4.4	-
GBP	-	6.1	7.3	7.3	-
CHF	-	-3.0	-3.0	-4.8	-
JPY	-	-5.2	-1.3	-7.5	-

* Average, consensus as of 17/03/2020.
Source: Bloomberg.



INTERVIEW WITH ULRICH URBAHN

Mr Urbahn, you are the Head of Multi-Asset Strategy & Research. What motivated you to pursue a career in the financial sector and how did you come to Berenberg?

A little chance and a love of numbers. My parents are both lawyers and, despite having no family history in the financial sector, I studied mathematics and economics in the lovely town of Heidelberg. I discovered my fascination for financial markets mostly as a result of the technology bubble and then the time around 2007/2008 cemented this attraction. At Commerzbank, I advised institutional investors on capital markets-related issues for 10 years. When I had a chance to switch to Wealth and Asset Management at Berenberg in the autumn of 2017, I took it. Here we enjoy a high degree of freedom, short decision paths and a very inspiring environment.

What are your primary day-to-day tasks?

Together with my team, I guide the asset management investment process, for example. This includes preparations for the monthly Investment Committee meetings and the weekly Asset Allocation Committee meetings, or AACs for short. As a voting member of the AAC, I am actively involved in allocation decisions. I am helped by the fact that my team continuously analyses market developments and generates investment ideas. Some of this analysis shows up in our capital market publications, on which I work closely with our Chief Investment Strategist Prof Dr Bernd Meyer. In addition, we both manage the flexible multi-asset fund Berenberg Variato. Finally, I serve our fund selector Tobias Schäfer as a sparring partner in fund selection.

What does the name Strategy & Research actually mean?

That's a good question! I always have trouble explaining that to my children. My team, which includes Karsten Schneider and Ludwig Kemper, provides analytical support to everyday investment processes and develops and programs applications for the risk monitoring of our investment strategies, for example. We also generate ideas for the strategic and tactical alignment of our multi-asset strategies. We also attach great importance to capital markets communication, including press enquiries, market commentary and a morning briefing for our colleagues. This holistic approach has the advantage that we speak with one voice to our clients and the markets and our portfolio performance is consistent across all mandates. Developing an accurate market



assessment and defining an investment strategy on that basis are separate from selection and portfolio structuring. We explain the background of major market developments for the portfolio managers.

Why is risk monitoring so important for an asset manager?

It's about understanding how a portfolio could behave in certain market phases and how to react. To that end, we look at certain risk parameters in particular. To simplify things: how will the portfolio react, based on historical data, if European equities fall by 1%? Or if interest rates rise? This way, we can make a good assessment of what risks our portfolios are exposed to and estimate the risk contribution of individual positions in relation to the overall portfolio risk in order to avoid major individual risks. The goal is to minimise risks while generating an appropriate return by skilfully selecting investment components. Of course, we cannot and do not want to eliminate all risks because there can be no return without risk. Compared to 2018, for example, we have raised our gold allocation and US Treasuries allocation to make the portfolio more balanced. This has paid off very well so far.

What is the most exciting part of your work?

Variatio delectat! I like the variety most of all. We are constantly learning new things, also thanks to our lively discussions with brokers, portfolio managers, advisors and clients.



And we also continually acquire more knowledge over time by conducting many analyses ourselves and writing capital market publications.

How are new investment ideas generated? Can you give us an example?

At my old job, it was my task to generate new ideas and discuss them with portfolio managers. That is also how we work here: We conduct many small investment analyses ourselves in our team. We also look at many research reports of other banks. Basically, we always ask ourselves the following questions: what is the market missing? Where do we see opportunities, and how big are they? What are the risks if we're wrong? An asymmetric risk/return profile is especially important in this regard. In other words, the idea should offer more upside than downside potential.

“What is the market missing? Where do we see opportunities, and how big are they? What are the risks if we're wrong?”

A good recent example was the disproportionately sharp sell-off of commodities in the course of the coronavirus crisis. Oil, for example, fell by more than 20%. As a result, we made a tactical investment in commodities. After commodity prices recovered substantially within two weeks, we sold this investment.

You manage the Berenberg Variato fund together with Bernd Meyer. What investment concept do you pursue with this fund? What distinguishes this fund from conventional asset management?

The rise of systematic investment strategies led us to the conclusion that investor behaviour has become frequently aligned and therefore trend-reinforcing. This trend increasingly leads to sharp market movements that regularly end in excesses. To be successful in this environment, investors need to be more selective and opportunistic – and even act against the trend sometimes. We take this approach in conventional asset management and in the Berenberg Variato fund. However, the latter gives us even more flexibility to also follow up on more exotic ideas. It is a benchmark-free multi-asset fund without fixed allocations for equities, bonds, or currencies. Individual ideas are paramount, while overall portfolio risks are managed downstream. The fund also benefits from ideas from everywhere in the bank, but it is explicitly

not an especially aggressive strategy. We pursue a medium-term total return target of 4% pa after expenses with a combination of long-term core investments, medium-term thematic ideas and tactical opportunities. Ideally, we want to avoid a maximum drawdown of more than 10%. Besides the high degree of flexibility, the focus on thematic investments is the biggest difference from conventional asset management.

How do you communicate the positioning of Asset Management? What options do your clients have to stay informed of developments in the capital markets?

Every two weeks, we publish the Berenberg Markets Monitor, which provides a structured overview of the different asset classes and an up-to-date assessment of capital markets. In addition, we always publish the minutes of our Investment Committee meetings, providing a transparent summary of our latest thinking. And at the end of every quarter we publish Horizon with an outlook for the coming quarter. This outlook is updated every month in the Horizon Handout. Finally, we address special topics on a situational basis, such as the US elections, in a Focus publication.

BRIEF BIOGRAPHY

Ulrich Urbahn has worked for Berenberg since October 2017. He is responsible for quantitative analysis and the development of strategic and tactical allocation ideas and is involved in capital markets communication. He is a member of the Asset Allocation Committee and Co-Portfolio Manager of the Berenberg Variato fund. After earning master's degrees in economics and mathematics at the University of Heidelberg, he worked at Commerzbank for more than 10 years, including as Senior Cross-Asset Strategist. Ulrich Urbahn is a CFA Charterholder and has been part of one of the world's three best multi-asset research teams in the prestigious Extel survey for many years.



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prospectus is available, investment decisions should always be made on the basis of the securities prospectus, which contains detailed information on the opportunities and risks of this financial instrument, otherwise at least on the basis of the product information document. All the aforementioned documents can be obtained from Joh. Berenberg, Gossler & Co. KG (Berenberg), Neuer Jungfernstieg 20, 20354 Hamburg, Germany, free of charge. The fund sales documents and the product information sheets for other securities are available via a download portal using the password "berenberg" at the Internet address <https://docman.vwd.com/portal/berenberg/index.html>. The sales documents of the funds can also be requested from the respective investment management company. We will be pleased to provide you with the specific address details upon request.

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