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Markets

INVESTMENT COMMITTEE MINUTES

09 July 2020

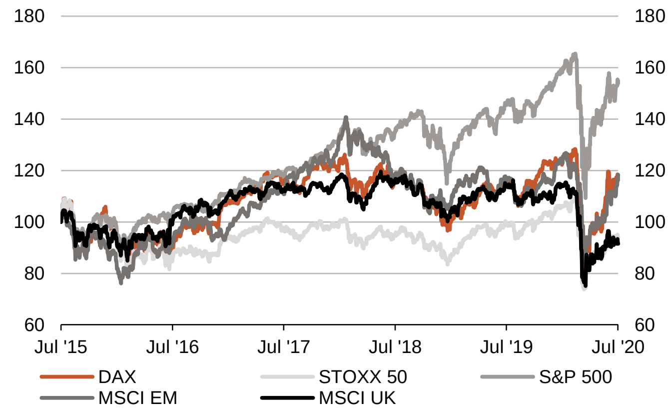
Managers of the Committee

Prof Dr Bernd Meyer
Chief Investment Strategist
Chairman

Dr Holger Schmieding
Chief Economist,
Vice Chairman

The **Committee Members** are listed in the notes.

Development of selected equity indices



Source: Bloomberg, 08/07/2015 - 08/07/2020.

Most important assessments at a glance

Economics	• Global economy: The upturn has started with slightly more momentum than expected. Consumers are spending money. • Monetary and fiscal policy remains more expansionary than ever before. Inflation remains low. • In economic terms, the traffic lights are green. But the increase in infections in the US poses a considerable risk.
Equities	• Equity markets were not able to make gains in the last 4 weeks. European stocks have recently beaten their US counterparts. • Growth stocks emerged as the winners on a monthly basis. European small caps have recently been weaker than large caps. • After the stock market rally in Q2, we are positioning ourselves with a neutral equity weighting and prefer European equities.
Bonds	• Yields on safe government bonds are likely to be capped in the short term thanks to the expansive central banks. • Spreads on corporate and emerging market bonds remain attractive and offer narrowing potential. • We slightly underweight bonds in the multi-asset portfolio and keep the maturity moderate.
Commodities	• Underinvested investors, liquidity floods and ongoing uncertainties pushed gold further towards USD1,800. • Crude oil (Brent) held above USD40 per barrel. The most important supporting factor was OPEC+. • Strong PMIs and positive economic surprises caused industrial metals to rise – copper benefited particularly strongly.
Currencies	• Thanks to successful crisis management, the euro has a tailwind and fluctuates between 1.12 and 1.14 dollars per euro. • The UK pound is suffering from COVID-19 and remaining Brexit risks. EUR/GBP is trading slightly above 0.90. • The CHF does not want to weaken permanently. The currency stands at just over 1.06 CHF/EUR.

Current market commentary

Stock markets are again approaching their interim highs of early June, driven by vaccine hopes and positive economic surprises. The DAX is only about 3% away from this, while the S&P 500 is around 2%. Only the Nasdaq 100 has reached new all-time highs. The start of the Q2 reporting season will bring further movement to the market. Without a new exogenous shock, the downward potential remains limited, in our view. Investor sentiment is still not enthusiastic and their positioning remains cautious. A lot of money is parked on the sidelines, but this is gradually coming back into the market. Money market funds, for example, have recently recorded the largest outflows since December 2019. Money supply growth fuelled by the central banks is also providing support. Recently, volatility has fallen significantly again, which should lead to further stock purchases of systematic strategies. Increased COVID-19 cases in the US and in many emerging markets and ambitious valuations are clouding the picture somewhat. We are therefore positioning ourselves with a neutral equity allocation, as both upside and downside potential over the summer is likely to be limited. Tactically, we prefer European equities to US equities.

The desire for security remains high and has caused yields on safe-haven government bonds to fall again. In the last four weeks, yields on 10-year German government bonds have fallen by 11bp to around -0.44%, while yields on 10-year US government bonds fell by 6bp to around 0.66%. By contrast, risk premiums on corporate and high-yield bonds have tended to rise. Defaults and rising COVID-19 cases in the US have made investors more cautious.

Gold has been able to gain further ground in recent weeks and is now trading at around USD1,800 an ounce. Crude oil and most of the industrial metals have also seen price increases.

ECONOMICS

Gradual recovery after the mega-recession; long-term losses limited

Deep slump in supply and demand in March and April; a slow recovery started in May.
Economic policy has averted a financial crisis and is supporting the upturn. More debt, low inflation, low interest rates.
The top risk: will the US have to go into a hard lockdown again, or will it get the situation under control in time?

- **An unprecedented shock:** The measures taken to combat the COVID-19 pandemic have plunged the economies of Europe and the US into the deepest recession of the post-war period. In April, economic output was 20-30% below normal levels.
- **Full steam ahead against the crisis:** Economic policy has succeeded in preventing a major financial crisis. With the lifting of a number of restrictions, the economy already rebounded in May. Above all, consumers on both sides of the Atlantic have opened their wallets.
- **Out of the deep valley:** We do not expect a "V" but rather a hook-shaped course of the economy with an angle of increase that will initially be quite steep if restrictions are relaxed. However, the angle of increase will then flatten out, as households and businesses will continue to hold back on major purchases and investments for some time.
- **The policy is working:** Supported by aggressive fiscal and monetary policy, economic output in the Western world may return to 2019 levels about two years after the low point. So far the data confirm this assessment. Since many data, such as those for retail trade in the US and Europe in May, have provided positive surprises, the recession in the second quarter may even have been somewhat less severe than we had previously expected.
- **The major risk:** In Europe, the infection curves have flattened out, and new local outbreaks have so far been contained by targeted regional measures. In the US, however, the number of cases is rising. However, the authorities appear to be far more successful in containing the losses than in March and April. The growing gap between infections and deaths in the US (see chart) nourishes the hope that regional and targeted countermeasures will be sufficient to control the pandemic there. On the other hand, if new hard lockdowns become necessary for large parts of the US, this would be a major setback for the economy.
- **Political risks:** A new trade dispute would be very expensive for China and the US. With luck, therefore, the sabre-rattling will probably remain the most used tool. The EU is discussing a EUR750bn programme for reconstruction. If this aid package is adopted as expected in the coming months, it could further limit risks in Europe.
- **America votes:** The 3 November US Presidential elections are in the offing. Right now, Joe Biden and his Democrats are in the lead. They want more regulation at home. For Europe, a calmer foreign and trade policy would be good.

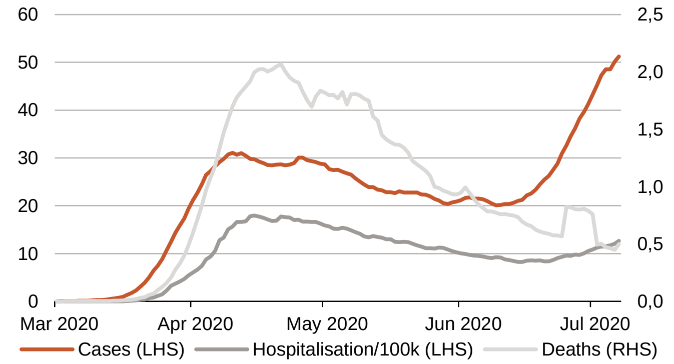
More debt: Central banks need to buy more bonds to provide the extra prudential funds that households, businesses and financial institutions want to hold during and after a crisis. This does not seem inflationary. In the short term, inflation will fall as demand continues to weaken. Over the next five years, inflation may increase slightly.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	%	2019	2020	2021	2019	2020	2021
World	100.0	2.4	-4.3	3.4			
US	24.2	2.3	-4.1	3.5	1.8	0.7	0.6
China	15.8	6.2	-3.0	4.0	2.9	3.4	2.1
Japan	5.9	0.7	-4.5	3.6	0.5	0.1	0.2
India	3.2	5.0	-2.5	3.5			
Latin America	6.2	1.5	-6.0	3.5			
Europe	25.7	1.2	-7.6	5.9			
Eurozone	16.1	1.2	-8.2	6.6	1.2	0.4	0.8
Germany	4.7	0.6	-6.2	4.9	1.4	0.1	1.6
France	3.3	1.5	-10.7	8.6	1.3	0.4	0.9
Italy	2.4	0.3	-11.3	7.7	0.6	-0.2	0.6
Spain	1.7	2.0	-10.6	8.4	0.8	-0.6	0.7
Rest of western Europe							
UK	3.3	1.5	-8.5	5.5	1.8	0.5	1.0
Switzerland	0.8	0.8	-6.5	5.0	0.6	0.0	0.6
Sweden	0.7	1.3	-6.0	5.0	1.8	0.9	1.3
Eastern Europe							
Russia	1.9	1.0	-5.0	3.5	4.5	2.0	3.0
Turkey	0.9	-1.2	-6.0	3.5	15.2	9.0	8.5

Source: Berenberg

Covid-19: New infections and deaths in the USA



1 March - 7 July 2020. new infections and deaths in thousands per day. Sources: Covid-19 Tracking Project

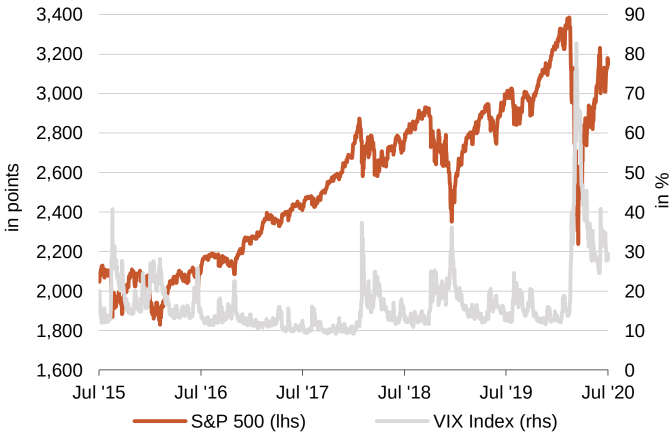
EQUITIES

Upward and downward potential limited

The stock markets were not able to make gains over the month. European stocks have recently beaten their US counterparts. Growth stocks are emerging as the winners on a monthly basis. European small caps have recently been weaker than large caps. After the stock market rally in Q2, we position ourselves with a neutral equity weighting and prefer European equities.

- **The stock markets took a breather in the last 4 weeks**. The DAX lost around 3%, while the S&P 500 lost around 2%. Only the Nasdaq 100 was able to make significant gains of over 7%. After the strong Q2 performance on the stock markets – the DAX, for example, gained over 23%, the best quarter since 2003 – the air got thinning for further high returns. The winners over the summer could be European stocks that have recently outperformed their US counterparts. The more cyclical nature of the economy and better COVID-19 handling should offer an advantage in the event of a further economic recovery.
- **Growth stocks** have recently been clearly ahead again. On a global level, they have outperformed **value stocks** by around 12% in the last four weeks. In Europe, **cyclicals** have remained relatively stable and have only slightly underperformed **defensive stocks**. On a sector level, the technology sector in Europe was the main sector to outperform on a monthly basis, with returns of over 5%. In contrast, **European small caps** were less in demand and performed slightly worse than **large caps**.
- Despite the limited upside potential, without a new exogenous shock the downside potential is also likely to remain limited. Investor sentiment is still not enthusiastic and their positioning remains cautious. Much parked money is gradually being pumped back into the market. The money supply growth fuelled by the central banks is also having a supportive effect. However, a rising number of COVID-19 cases in the US and many emerging markets and ambitious valuations are clouding the picture somewhat.
- We position ourselves with a **neutral equity weighting**, as both upside and downside potential over the summer should be limited. Tactically, we prefer European equities to US equities.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 08/07/2015 - 08/07/2020.

Overview of equity markets (short/medium term)

Regions	Old	New
US	→	→
Europe	→	↗
Emerging markets	→	→
Japan	→	→

	As of 08/07/2020	Performance in local currency ytd	1-year	3-year	P/E 2019E	Dividend yield
DAX	12,495	-5.7%	-0.4%	+0.9%	19.7	2.8%
SMI	10,178	-1.0%	+5.2%	+26.6%	19.3	3.1%
MSCI UK	1,741	-17.8%	-16.7%	-7.5%	17.9	3.9%
EURO STOXX 50	3,286	-10.4%	-4.2%	+4.6%	20.2	3.0%
STOXX EUROPE 50	7,125	-9.2%	-3.2%	+6.9%	19.3	3.4%
S&P 500	3,170	-0.9%	+8.6%	+38.6%	25.3	1.9%
MSCI Em. Markets	1,070	-2.6%	+5.1%	+15.9%	2.3	2.4%

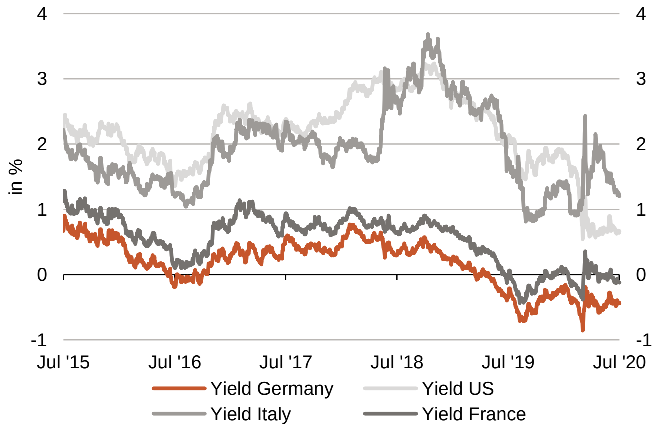
BONDS

Central banks set the tone

Yields on safe government bonds are likely to be capped in the short term thanks to the expansive central banks. Spreads on corporate and emerging market bonds remain attractive and offer narrowing potential. We are slightly underweight bonds in the multi-asset portfolio and keep the maturity moderate.

- In the last four weeks, global yields have continued to fall. The yield on 10-year **German government bonds** fell to -0.44%, while the yield on 10-year **French government bonds** slid back well into negative territory at -0.13%. Yield spreads on the peripheral countries and thus also on Italy were driven further down by hopes of greater EU integration and a reconstruction fund.
- The yield on 10-year **US government bonds has** fallen by 6bp to 0.66% over the last four weeks. The Fed continues to make massive purchases of US government and corporate bonds and should thus provide more stability in the interest rate and credit markets. Yields should therefore be capped at the top in the short term. The market even expects the Fed to cut rates in the next 12 months with a probability of over 30%.
- Spreads on **EUR-IG corporate** and **EUR high-yield bonds** have risen over the past four weeks, while they have fallen slightly for **USD-IG corporate bonds**. However, **USD high yield bonds** saw a significant widening of spreads. Rising default rates and concerns about another lockdown have pushed spreads up by over 50bp. High-yield bonds thus continue to offer attractive yields. We prefer hard currencies to local currencies in **emerging market bonds**, as they have significant potential for narrowing at the spread level. In the medium term, we also consider local currency bonds to be attractive.
- We are **slightly underweight bonds in the multi-asset portfolio.** Here we maintain our focus on corporate and emerging market bonds at the expense of government bonds and keep the maturity comparatively moderate.

Yields on 10-year European government bonds



Source: Bloomberg, 08/07/2015 - 08/07/2020.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Moderat	Moderat
Government bonds	→	→
Corporate bonds	↗	↗
High-yield bonds	↗	↗
Emerging market bonds	↗	↗

Yields (10-year)	Old	New
Germany	→	→
UK	→	→
US	→	→

		Performance in index currency		
	As of 08/07/2020	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	256.47	+2.2%	+2.1%	+12.3%
Covered bonds (iBOXX Euro Germany Covered)	206.14	+1.1%	+0.3%	+4.8%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	158.04	-0.7%	-0.6%	+5.7%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	157.58	-0.3%	-0.2%	+4.4%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,215.00	+0.5%	+3.5%	+14.7%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,366.48	-3.4%	-0.7%	+8.7%

COMMODITIES

Gold above USD1,800 an ounce

Gold price climbs above USD1,800 an ounce.
Oil price (Brent) depends on OPEC+ compliance
Industrial metals are in demand. Copper is a winner.

- **Gold** broke out of the recent sideways trend, driven by global liquidity floods and is currently trading around USD1,800/oz. Many investors are still underinvested, so ETF inflows at the current elevated prices are partly strategic in nature. ETF holdings have already seen a 25% ytd rise and uncertainties surrounding the US elections are driving the need for hedging.
- In recent weeks, **crude oil** (Brent) has been able to hold above the USD40 per barrel mark. The most important supporting factor here was OPEC+. At present, it appears that all member states are almost completely adhering to its cuts. But whether the typical outliers Russia, Iraq and Nigeria will continue to meet their agreed quotas in the coming months is questionable.
- **Industrial metals** across the board with positive returns. Copper benefited particularly from the economic recovery.

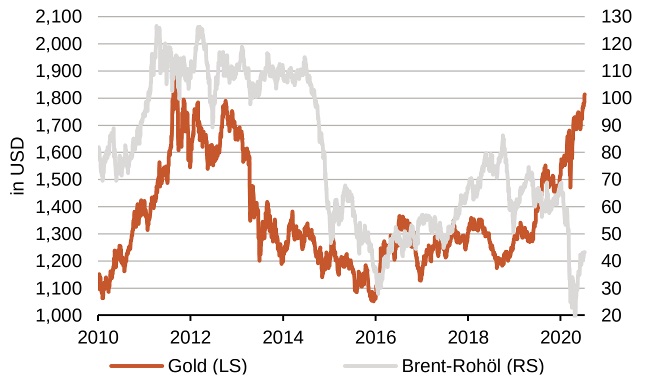
CURRENCIES

Euro maintains higher level

EUR/USD exchange rate rose above 1.13.
Uncertainty over Brexit agreements weighs on the pound.
The CHF/EUR remains expensive at just over 1.06.

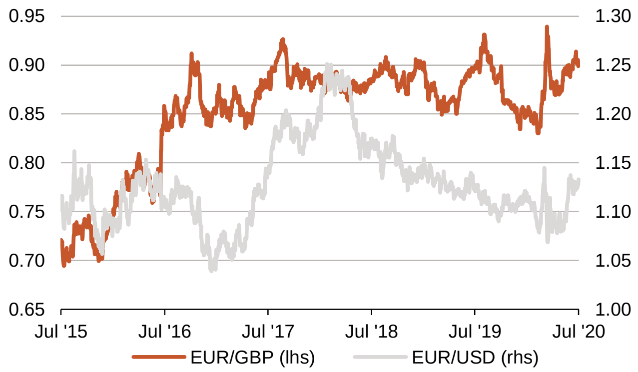
- **EUR/USD:** Determined action by the central bank and politicians has significantly eased concerns about the eurozone. In particular, the proposal for a reconstruction fund has sent a signal to the markets that Europe will go through the crisis in solidarity with the countries particularly hard hit by the pandemic. The clear statement by the US Federal Reserve that interest rates will not rise for a very long time also means that the chances of a sustained strengthening of the euro are good.
- **EUR/GBP:** The eurozone is further ahead than the UK in the fight against the COVID-19 pandemic and the negotiations on a Brexit follow-up agreement remain a risk. Both are weighing on the pound. The euro is set at 0.90 pounds per euro.
- The **CHF** has appreciated again. However, at 1.06 Swiss francs to the euro, it is still above the May high.

Price development



Source: Bloomberg, 01/01/2010 - 08/07/2020.

Exchange rates



Source: Bloomberg, 08/07/2015 - 08/07/2020.

Overview of commodities (short/medium term)	Old	New
Gold	↗	↗
Oil (Brent)	→	→

Overview of currencies (short/medium term)	Old	New
EUR/USD | Euro/US dollar	↗	↗
EUR/CHF | Euro/Swiss franc	↗	↗
EUR/GBP | Euro/Sterling	→	↗
EUR/JPY | Euro/Japanese yen	↗	↗

		Performance		
	As of 08/07/2020	ytd	1-year	3-year
Gold USD/ounce	1,809	+19.2%	+29.6%	+49.2%
Silver USD/ounce	18.7	+4.9%	+24.5%	+19.9%
Copper USD/pound	281.5	+0.6%	+6.0%	+6.7%
Brent USD/bbl	43.29	-34.4%	-32.5%	-7.3%

		Performance		
	As of 08/07/2020	ytd	1-year	3-year
EUR/USD	1.13	+1.0%	+1.0%	-0.6%
EUR/CHF	1.06	-2.1%	-4.6%	-3.2%
EUR/GBP	0.90	+6.2%	+0.3%	+1.6%
EUR/JPY	121.52	-0.2%	-0.3%	-6.5%

IMPORTANT NOTES

Members of the Investment Committee

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Matthias Born | Head Portfolio Management Equities, European Equities
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
Ansgar Nolte | Co-Head Portfolio Management Multi Asset
Till Budelmann | US Equities
Christian Bettinger | Bonds
Christoph Mäder | Bonds
Marco Höchst | Commodities
Ludwig Kemper | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

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