BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

10 September 2020

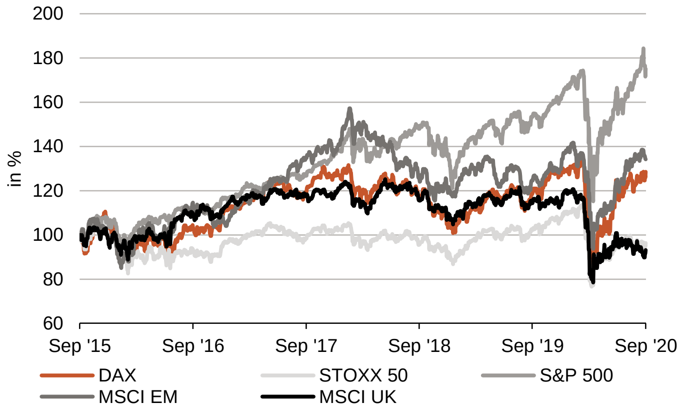
Managers of the Committee

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, 09/09/2015 - 09/09/2020.

Most important assessments at a glance

Economics	• Since May, there has been a noticeable upturn; the recovery is slowing while industry and trade are supporting the economy • The economic balance of the pandemic: more debt, low inflation, low interest rates • Living with the virus: individual countermeasures instead of new hard lockdowns. US politics becomes a top issue
Equities	• Equity markets took a deep breather - the positive August was followed by a weak start to September • Signs of rotation: Small caps and cyclical stocks have recently outperformed • We have increased our equity allocation to a slightly overweight as we see further potential until the end of the year
Bonds	• Global economic recovery and rising inflation expectations are leading to a slight rise in government bond yields • Corporate bonds remain supported, even though there is less potential for spreads to narrow • We are underweight bonds in the multi-asset portfolio and focus on credit risks with moderate maturities
Commodities	• The demand for gold has recently declined - its price has fallen well below the USD 2,000 an ounce mark • Crude oil (Brent) has also declined in the last four weeks, falling below the USD 40 per barrel mark • Industrial metals have largely priced in an economic recovery. Upside potential is now more limited
Currencies	• The strength of the euro has taken a break. Risk-off and good US economic and employment data supported the USD • The increased risk of a hard Brexit has weakened the pound. EUR/GBP is trading close to 0.91 • The Swiss franc remains the safe haven for investors during the COVID-19 crisis. CHF/EUR remains at 1.08

Current market commentary

The recovery of the stock markets has taken a breather – the summer was lacklustre, as we expected. While in the last few weeks there was initially a clear upward trend at first, there has recently been a significant setback. The S&P 500 recorded its best August in 34 years and, like the Nasdaq 100, marked a new all-time high. In contrast, the start of September was marked by a sell-off. Technology stocks in particular saw daily losses of over 5%. We have recently positioned ourselves more strongly towards European small caps and cyclicals. This orientation is also supported by the rising probability that a coronavirus vaccine will receive approval in the fourth quarter. A vaccine should further boost the economic recovery and support cyclical stocks in particular. Cyclical stocks have recently outperformed defensive stocks. Small caps have also outperformed large caps. A rotation into more-cyclical companies is, thus, already be happening. WE think, by the end of the year, there is further potential for equities because we expect an ongoing economic recovery, especially if there are vaccine advances, despite the existing risks. We have therefore taken advantage of the sell-off and increased our equity ratio to a slightly overweight position at the expense of well recovered, riskier corporate bonds.

Yields on government bonds have increased slightly recently. Rising inflation expectations and the recovering economy were the main drivers. In addition to safe haven government bonds, yield of government bonds from the European periphery also rose. 10-year Italian government bonds yielded over 1.0% again. Risk premiums on corporate bonds fell slightly, even though the pace has slowed. Carry should remain in demand.

Gold was unable to maintain its positive momentum and has recently weakened, while crude oil has sold off. In the medium term, however, we are positive about both commodities.

ECONOMICS

Gradual recovery after the mega-recession; virus risks remain; Biden just ahead of Trump

Since May, there has been a noticeable upturn; the recovery is slowing while industry and trade are supporting the economy
The economic balance of the pandemic: low debt, low inflation, low interest rates
Living with the virus: individual countermeasures instead of new hard lockdowns. US politics becomes a top issue

- **Largely stable:** The situation has not changed fundamentally in the last four weeks. Provided that the major risks (overburdened health care systems, new trade wars) do not to materialise, the economy may continue to recover. With its €750bn Recovery Programme, the EU has strengthened the basis for the recovery and the euro.
- **Out of the deep valley:** So far, the data match the tick-shaped economic recovery that we expect for the developed world. A strong but not quite V-shaped rebound in economic output from May to July has been followed by a slowly flattening upswing. The retail sector has overcome the crisis quickly, but could weaken again briefly if infection rates rise. Industry and foreign trade are recovering slowly but probably steadily. In 2021, subdued corporate investment is also likely to pick up again. In addition, more government spending will support the economy.
- **No quick return to normality:** The US, the eurozone and the UK may make up for a good half of the slump from Q2 in the third quarter. But they will probably not be able to reach the economic output of the end of 2019, i.e. before the pandemic, until early 2022 (the US, Germany), summer 2022 (eurozone) or early 2023 (the UK, which was damaged by Brexit).
- **Living with the virus:** After a dramatic increase from mid-June to mid-July, the infection curve in the USA has flattened out again somewhat. This supports our assumption that Europe will also avoid a new, hard, general and expensive lockdown.
- **America votes:** Eight weeks before the elections on November 3, Joe Biden and his Democrats are just ahead (see graph). However, their lead in the polls has narrowed somewhat. The Democrats want more regulation and higher taxes. But Biden also stands for calmer foreign and trade policies.
- **Three US scenarios:** (1) Biden wins, but misses the majority in the Senate. He could regulate more but not raise taxes against the Republicans. His calmer foreign and trade policies, would be good for Europe, but parts of the US domestic economy would be burdened with regulation. (2) Biden wins with a majority in the Senate and raise taxes. This would be negative for the US economy and US financial markets. (3) Trump wins. The risk of a trade war with Europe would increase as Trump could be even more ruthless after re-election.

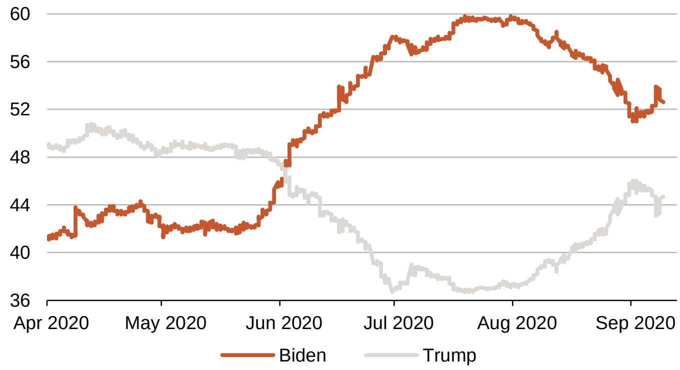
No inflation, low interest rates: In the short term, inflation will fall as demand continues to weaken. Over the next three to five years, inflation may increase slightly. The US Federal Reserve will allow this. It wants to compensate for the current low inflation rate of just over 2%. This should initially be positive for the economy and markets.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	%	2019	2020	2021	2019	2020	2021
World	100.0	2.3	-3.8	3.5			
US	24.2	2.2	-4.5	3.5	1.8	1.1	1.3
China	15.8	6.2	2.5	5.0	2.9	3.2	2.1
Japan	5.9	0.7	-5.8	3.0	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	-7.8	5.6			
Eurozone	16.1	1.3	-8.1	5.8	1.2	0.4	0.7
Germany	4.7	0.6	-6.0	4.6	1.4	0.6	1.6
France	3.3	1.5	-10.2	8.4	1.3	0.8	1.0
Italy	2.4	0.3	-10.4	6.7	0.6	-0.1	0.7
Spain	1.7	2.0	-13.5	9.2	0.8	-0.3	0.6
Rest of western Europe							
UK	3.3	1.5	-10.2	7.2	1.8	0.5	1.3
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

Next US president: probability based on betting markets



01 April - 09 September 2020. probability on betting markets, in %. Source: Electionbettingodds.com

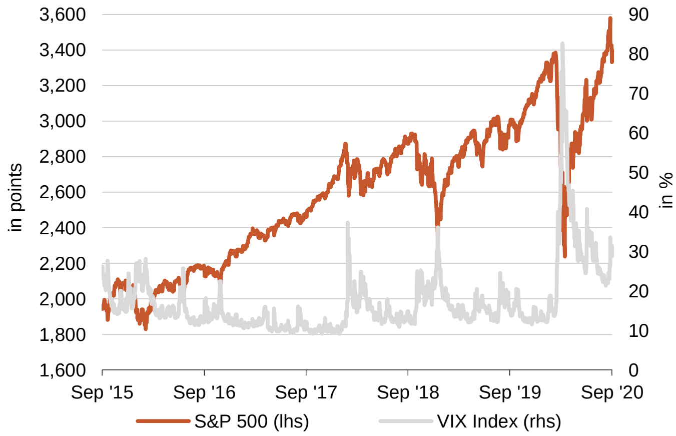
EQUITIES

Breather and rotation

Equity markets took a breather - the positive August was followed by a weak start to September
Signs of rotation: small caps and cyclical stocks have recently outperformed
We have increased our equity allocation to slightly overweight as we think there is further potential until the end of the year

- **The stock market recovery did not continue unchecked**. August was a very strong month, especially for US equities, but the markets experienced a significant setback in early September. US technology stocks in particular saw daily losses of over 5%, while more cyclical stocks held up better. The latter should continue to offer upside potential in the coming months. In the last four weeks, more-cyclical stock indices such as the DAX have already outperformed the S&P 500. The rotation into cyclical stocks is likely to continue, especially in the event of COVID-19 vaccine progress.
- **Growth stocks** have significantly outperformed **value stocks** over the past four weeks. On a global basis, they have gained more than 1%, while value stocks have lost over 1%. In Europe, **cyclicals** outperformed **defensive stocks** slightly. At a sector level, basic materials and consumer goods stocks in particular outperformed, with returns of over 3%. Relative losers were utilities. **European small caps** have also outperformed **large caps** over the past four weeks.
- In the coming weeks, the US elections, the Brexit negotiations, the global economic recovery and progress on vaccine are expected to move the markets. Despite the risks, we expect that positive progress in the fight against COVID-19 and a possible vaccine in the coming months should further boost the economy and support stock prices. Small caps and cyclicals should benefit disproportionately from this.
- We position ourselves with a **slight equity overweight** and an increased exposure to small cap/cyclical stocks, as we believe there are more opportunities than risks.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 09/09/2015 - 09/09/2020.

Overview of equity markets (short/medium term)

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

		Performance in local currency				
	As of 09/09/2020	ytd	1-year	3-year	P/E	Dividend yield
DAX	13,237	-0.1%	+8.3%	+7.6%	21.7	2.6%
SMI	10,407	+1.2%	+6.9%	+29.0%	19.9	3.1%
MSCI UK	1,693	-19.3%	-15.6%	-10.4%	19.2	3.8%
EURO STOXX 50	3,325	-9.1%	-2.2%	+6.4%	21.1	2.9%
STOXX EUROPE 50	7,071	-9.9%	-3.1%	+7.5%	20.1	3.3%
S&P 500	3,399	+6.6%	+16.3%	+46.4%	26.0	1.7%
MSCI Em. Markets	1,086	-0.7%	+10.3%	+7.9%	17.8	2.3%

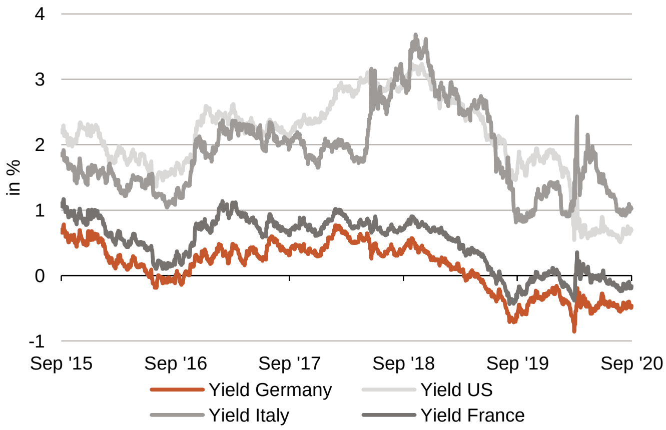
BONDS

Yields rise slightly

Global economic recovery and rising inflation expectations are leading to a slight increase in yields on government bonds
Corporate bonds remain supported, even though the narrowing potential of spreads has decreased
We underweight bonds in the multi-asset portfolio and focus on credit risks with moderate maturities

- Yields on **European government bonds** are increasing again - partly due to rising inflation expectations. German **5J5J break-even inflation**, for example, rose temporarily to over 1.2% in August. In the last four weeks, 10-year **German government bonds** temporarily saw yields of over -0.40%. In the European periphery such as Italy, the rise was even stronger. 10-year Italian government bonds are currently yielding over 1.0%.
- Yields on 10-year **US government bonds have** risen by 6 basis points over the last four weeks and most recently stood at 0.70%. Again, rising inflation expectations and the US economic recovery were the drivers. However, apart from the existing risks, the Fed's ultra-loose monetary policy with a stronger focus on employment levels should counteract too large rise.
- Spreads on **corporate bonds** have continued to narrow, albeit at a much slower pace than before. **Euro high yield bonds** saw the relatively largest spread narrowing of almost 20bp, while **USD high yield bonds** widened by around 10 bp. **Euro-IG corporate bonds** saw spreads fall by over 5 bp. Positive fund flows, declining new issuance and massive secondary market demand should continue to support at least the investment-grade segment, even if spreads are no longer very high historically. In addition to corporate bonds, we like **emerging market bonds** and increasingly prefer local currency securities.
- **We are underweight bonds in the multi-asset portfolio.** We are maintaining our focus on corporate and emerging market bonds at the expense of government bonds and are keeping maturities relatively moderate.

Yields on 10-year European government bonds



Source: Bloomberg, 09/09/2015 - 09/09/2020.

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 09/09/2020	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	258.07	+2.8%	+0.4%	+10.6%
Covered bonds (iBOXX Euro Germany Covered)	206.72	+1.4%	-0.4%	+4.0%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	160.59	+0.9%	+0.1%	+6.0%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	159.28	+0.8%	+0.2%	+4.6%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,250.44	+3.4%	+5.2%	+14.3%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,429.14	+1.0%	+4.2%	+10.2%

COMMODITIES

Gold price has slightly fallen

Gold loses momentum. ETF inflows decrease
Demand on the oil market should pick up again
Industrial metals: economic recovery is priced in

- The demand for **gold** has recently declined. Both ETF and speculative investor buying have lost momentum, pushing the gold price back below the USD2,000/oz mark. Nevertheless, we are holding on to gold, as the weak USD should support its price and gold has historically been a good diversifier.
- **Crude oil** (Brent) has also declined in the last four weeks, falling temporarily below the USD 40 per barrel mark. Despite the weak historical seasonality for the autumn, we expect prices to rise again by the end of the year, as the ongoing economic recovery should boost demand.
- **Industrial metals** have largely priced in an economic recovery. Upside potential is thus more limited now.

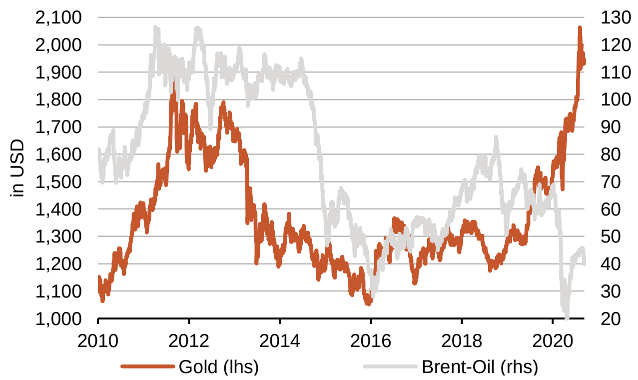
CURRENCIES

Euro strength takes a break

EUR/USD exchange rate fluctuates around 1.18
Sterling's recovery was short. EUR/GBP at 0.91.
The Swiss franc remains at 1.08 CHF/EUR.

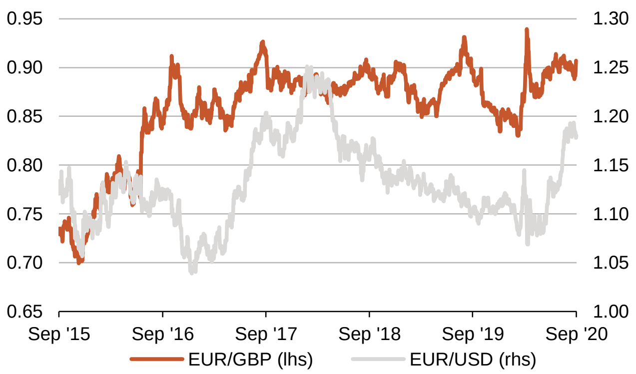
- **EUR/USD**: The euro has not been able to appreciate further against the USD in the last four weeks, fluctuating around 1.18. Good labour market data and the lower number of new infections in the US have supported the USD. Nonetheless, the Fed's continued expansionary stance, with its greater commitment to raise employment levels, should limit the upward potential of the USD.
- **EUR/GBP:** After a short period of strength, the GBP has recently weakened significantly. The UK government's counterproductive behaviour increases the risk that its negotiations with the EU will be unsuccessful and that a hard Brexit will take place on 31 December, the end of the transition period.
- The **Swiss franc** remains the safe haven for investment during the coronavirus crisis. CHF/EUR remains at 1.08.

Price development



Source: Bloomberg, 01/01/2010 - 09/09/2020.

Exchange rates



Source: Bloomberg, 09/09/2015 - 09/09/2020.

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 09/09/2020	ytd	1-year	3-year
Gold USD/ounce	1,947	+28.3%	+29.9%	+44.6%
Silver USD/ounce	27.0	+51.1%	+49.8%	+50.1%
Copper USD/pound	304.0	+8.7%	+16.5%	+0.6%
Brent USD/bbl	40.79	-38.2%	-34.8%	-24.2%

		Performance		
	As of 09/09/2020	ytd	1-year	3-year
EUR/USD	1.18	+5.3%	+6.8%	-1.9%
EUR/CHF	1.08	-0.8%	-1.7%	-5.2%
EUR/GBP	0.91	+7.3%	+1.4%	-0.4%
EUR/JPY	125.33	+2.9%	+5.8%	-3.4%

IMPORTANT NOTES

Members of the Investment Committee

Prof Dr Bernd Meyer | Chief Investment Strategist, Chairman
Dr Holger Schmieding | Chief Economist, Vice-Chairman
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
Robert Reichle | Bonds
Marco Höchst | Commodities
Ludwig Kemper | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

Disclaimer

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