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Markets

INVESTMENT COMMITTEE MINUTES

08 October 2020

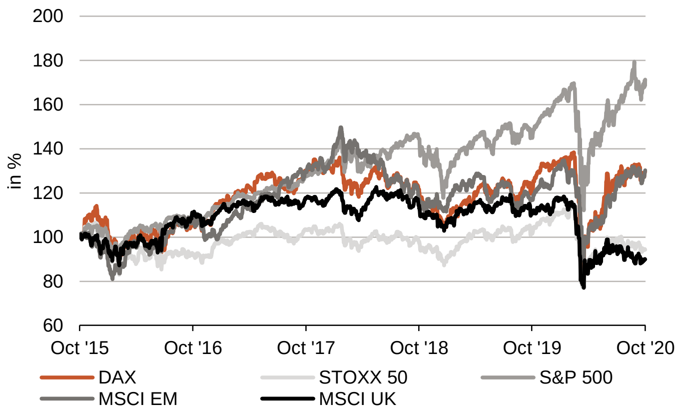
Managers of the Committee

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, 07/10/2015 - 07/10/2020.

Most important assessments at a glance

Economics	• The economy has been recovering; a strong summer, a weaker autumn; industry and trade are supporting the economy • The economic balance of the pandemic: more debt, low inflation, low interest rates • Living with the virus: second wave in Europe - economic damage so far bearable; in the US politics, becomes top issue
Equities	• Equity markets ended September with volatility. In addition to the US election, the Q3 reporting season will move markets • Growth stocks and small caps remain in demand. Looking ahead, cyclical equities are likely to perform more positively • We took advantage of the temporary US weakness and closed our US underweight position. Equities remain overweight
Bonds	• A lack of positive stimuli and rising coronavirus infections increased the demand for safe-haven government bonds • Spreads for corporate bonds have risen slightly. Current levels are likely to remain but will be volatile for the time being • We are underweight bonds in the multi-asset portfolio and focus on credit risks with moderate maturities
Commodities	• Gold experienced a setback in September, which we consider healthy. In the medium term we are positive • Crude oil fell due to demand concerns. Oil price supported by supply shortfall with upside potential in the medium term • The rally in industrial metals as a result of the economic recovery and fiscal programmes has recently faltered
Currencies	• In the recent risk-off environment, the euro depreciated slightly. EUR/USD near 1.18, maintaining a sideways trend • The Brexit negotiations continue to make very slow progress. EUR/GBP at 0.91 without a clear direction • The Swiss franc remains in demand as a safe haven for investment. CHF/EUR remains around 1.08

Current market commentary

Volatility on the stock markets remains high. In September, the VIX volatility index for US equities remained above 25%. Daily movements in equity markets above 2% were not uncommon. In the US, the Nasdaq 100 fell by more than 10% below its all-time high of 2 September. In addition to the absence of positive impulses such as a new US fiscal programme, the rising number of new coronavirus infections in particular dampened investor sentiment. In this environment, in line with our positioning, growth stocks and European small caps were able to outperform over the past four weeks. By contrast, cyclical European equities performed only slightly better than defensive stocks. Looking ahead, however, we remain positive about cyclicals. The Q3 reporting season, which has started well, and the increasing likelihood of a timely coronavirus vaccine should support the economic recovery and thus the markets. In the coming weeks, however, the US elections in particular are likely to be decisive. As the outcome of the election remains difficult to predict and US equities are structurally better positioned, we have neutralised our US underweight position. We are positioning ourselves as moderately in equities overweight as we expect further potential for recovery over a 3 to 6 month horizon.

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The recent resurgence of uncertainty in the markets has increased demand for safe haven government bonds. The yield on 10-year German government bonds fell temporarily below -0.55%. US Treasuries, on the other hand, declined somewhat, since, in addition to the higher probability of a Democratic election victory, the prospect of increasing new issuance activity in the coming years has had a negative impact. Spreads for corporate bonds rose slightly but are likely to remain volatile around the current level.

Crude oil saw a sell-off due to demand concerns and gold underwent a healthy correction. We remain positive.

ECONOMICS

Gradual recovery; virus risks increasing in Europe; Biden just ahead of Trump

Since May there has been a noticeable upturn; new risks in the autumn, industry and foreign trade support the economy
Living with the virus: measures against the second wave affect social life more than the economy
US policy: Tight election results could trigger short-term unrest, long-term risk of trade war between the US and the EU

- **Upturn without inflation:** After the sharp recession of March and April, the economic lights are now green. Provided the major risks (overburdened health care systems, new trade war) do not materialise, the global economy may continue to recover notably. The EU's €750bn COVID-19 programme has strengthened the basis for the recovery and the euro. The economic rationale is for a long recovery with very low inflation for the time being.
- **Drivers of the upswing:** After the first rebound in May-July, the upswing is likely to slowly lose momentum. While in the USA and Europe, the retail sector initially overcame the crisis quickly, industry and foreign trade are now increasingly supporting the economy. In 2021, subdued business investment is also expected to pick up again. In addition, more government spending will revive the economy.
- **Strong summer, mixed autumn:** After a surprisingly strong summer on both sides of the Atlantic, new economic risks are emerging, arising in Europe from the increase in coronavirus infections and in the US from the political situation. The good summer could be offset by a rather mixed autumn.
- **Living with the virus:** In the US, the second wave of infections has levelled off somewhat, while in Europe, new infections are currently rising sharply. However, even in Spain, which has been particularly hard hit, deaths remain far below the April figures - see graph. This supports our assumption that Europe can contain the pandemic with targeted measures that restrict our its social life but only affect small parts of the economy.
- **America votes:** Four weeks before November 3, Joe Biden is narrowly in front. Trump is battered, but he is far from losing. Biden's Democrats want more regulation and higher taxes. But Biden also stands for a calmer foreign and trade policy.
- **Three US scenarios:** (1) Biden wins, but misses the majority in the Senate. He could regulate more but Republicans would block a tax hike. Thanks to a calmer foreign and trade policy, that would be good for Europe. However, parts of the US domestic economy would be burdened. (2) Biden wins and gains a majority in the Senate, then 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.

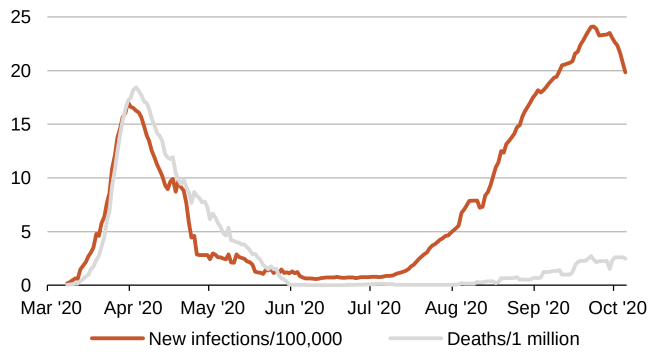
No inflation, low interest rates: In the short term, inflation will fall as demand remains weak. Over the next three to five years, inflation may increase slightly. The US Federal Reserve will allow this. It wants to compensate for the current low inflation by a rate of just over 2% later. This would 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	-3.6	3.4			
US	24.2	2.2	-3.6	3.8	1.8	1.2	1.8
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	0.3
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	5.2			
Eurozone	16.1	1.3	-7.8	5.4	1.2	0.3	0.7
Germany	4.7	0.6	-5.8	4.7	1.4	0.5	1.5
France	3.3	1.5	-10.4	8.2	1.3	0.7	1.0
Italy	2.4	0.3	-10.3	6.6	0.6	-0.1	0.7
Spain	1.7	2.0	-13.2	8.0	0.8	-0.3	0.5
Rest of western Europe							
UK	3.3	1.5	-9.9	6.4	1.8	0.7	1.1
Switzerland	0.8	0.8	-5.7	4.3	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 in Spain: New infections and deaths



01 March - 05 October 2020. new infections per 100,000 inhabitants, deaths per 1 million inhabitants; seven-day averages. Source: Johns Hopkins University

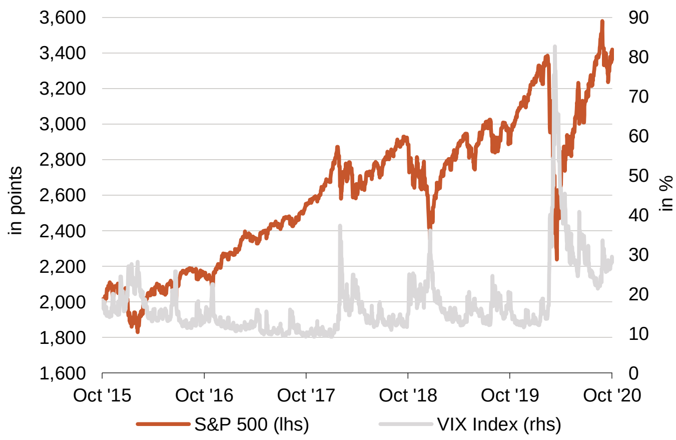
EQUITIES

US election and Q3 reporting season

Equity markets ended September with volatility. In addition to the US election, the Q3 reporting season will move markets Growth stocks and small caps remain in demand. Looking ahead, cyclical equities are likely to perform more positively We took advantage of the temporary US weakness and closed our US underweight position. Equities remain overweight

- **In the last four weeks, stock markets have been volatile.** The VIX volatility index for US equities remained above 25%. Daily volatility for both US and European equities was at times above 2%. The second wave of new coronavirus infections, the weakening economic recovery and the absence of a further US fiscal programme weighed on stock markets. In this environment, growth stocks in particular proved their worth. Looking ahead, the important developments are the US presidential election, vaccine news and the Q3 reporting season, which has already begun.
- **Growth stocks** have significantly outperformed **value stocks** over the past four weeks. In Europe, relative outperformance was above 3%, while at a global level it was around 2%. In contrast, **European small caps** outperformed **large caps** by around 3%. The recent slowdown in the economic recovery has somewhat dampened the positive performance of **cyclicals.** They were therefore only able to perform slightly better than **defensive stocks**. At a sector level in Europe, utilities and consumer goods stocks in particular performed well, with returns of over 3%. The losers were the other hand, were oil & gas companies, which suffered from falling prices.
- The weak September should be followed by a better October, at least according to seasonal factors. In addition to the positive seasonality, the main arguments for a further stock market recovery are: a good Q3 reporting season; high cash balances; expansive central banks; existing and possibly new fiscal programmes and the increasing likelihood of a Covid-19 vaccine are the main arguments for a further stock market recovery. However, risks such as the US presidential election and the Brexit negotiations remain.
- We position ourselves with a **moderately overweight in equities** and have neutralised our US underweight position.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 07/10/2015 - 07/10/2020.

Overview of equity markets (short/medium term)

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

		Performance in local currency				
	As of 07/10/2020	ytd	1-year	3-year	P/E	Dividend yield
DAX	12,929	-2.4%	+6.9%	-0.2%	20.2	2.7%
SMI	10,188	-0.9%	+6.1%	+21.6%	19.8	3.1%
MSCI UK	1,668	-20.4%	-16.3%	-13.4%	18.4	3.9%
EURO STOXX 50	3,233	-11.5%	-4.2%	-1.0%	21.6	2.8%
STOXX EUROPE 50	6,875	-12.4%	-5.6%	+0.2%	19.9	3.3%
S&P 500	3,419	+7.4%	+18.6%	+42.1%	25.5	1.7%
MSCI Em. Markets	1,108	+1.5%	+14.3%	+9.0%	17.9	2.2%

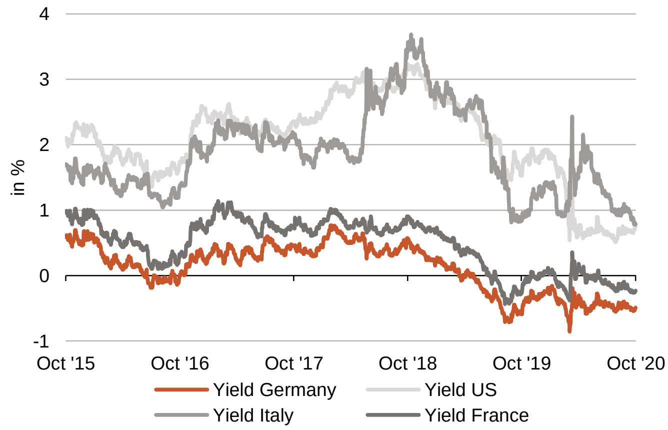
BONDS

Safty remains in demand

A lack of positive stimuli and rising coronavirus infections increased the demand for safe haven government bonds
Spreads for corporate bonds have risen slightly. Current levels are likely to remain but will be volatile for the time being
We are underweight bonds in the multi-asset portfolio and focus on credit risks with moderate maturities

- Yields on **European government bonds** have fallen in the last four weeks. The rising number of corona infections and the lack of positive impulses have driven investors into safe haven government bonds. The yield on 10-year **German government bonds** fell below -0.50%. In the European periphery, yields of **Italian government bonds** have dropped significant drop bye 24 bp in the last four weeks, also thanks to a relatively low rise in coronavirus infections. The spread over German government bonds has thus narrowed.
- The yield of 10-year **US government bonds**, on the other hand, has risen by 9 basis points over the last four weeks and most recently stood at 0.79%. In addition to the increasing likelihood of a Democratic Party election victory, which should lead to a significant rise in government spending, the market is pricing in the increased issuing activity by the US Treasury in the coming years.
- Spreads on **corporate bonds** have risen slightly in the last four weeks. The spread on **EUR high yield bonds** widened the most at more than 10bp, while for **USD high-yield bonds** spreads remained more stable. **IG corporate bonds**, on the other hand, experienced hardly any change in spreads. We expect spreads to remain at current levels in the coming weeks, with possible increased volatility, as the US elections create uncertainty despite some positive factors. In **emerging market (EM) hard currency bonds,** we prefer government bonds to corporate bonds.
- **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. We keep maturities relatively moderate.

Yields on 10-year government bonds



Source: Bloomberg, 07/10/2015 - 07/10/2020.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Moderate	Moderate
Government bonds	↘	↘
Corporate bonds	↗	↗
High-yield bonds	↗	↗
Emerging market bonds	↗	↗

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

	As of 07/10/2020	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	260.45	+3.8%	+0.9%	+12.6%
Covered bonds (iBOXX Euro Germany Covered)	207.05	+1.6%	-0.1%	+4.6%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	161.17	+1.3%	+0.6%	+6.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	159.78	+1.1%	+0.8%	+5.1%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,236.94	+2.3%	+4.0%	+13.5%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,418.59	+0.3%	+3.9%	+9.2%

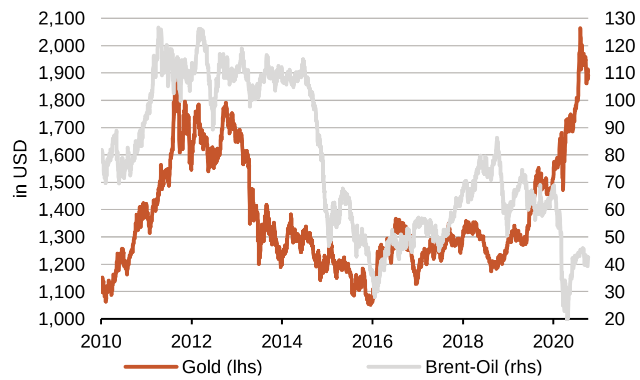
COMMODITIES

Crude oil with upside potential

Gold experienced a healthy correction. We remain positive
Oil demand concerns are only a temporary burden
Industrial metals have recently weakened somewhat

- **Gold** experienced a significant setback in September and thus did not work as a portfolio hedge. However, after the strong performance since the beginning of the year, we consider the setback to be rather healthy and remain positive about gold in the medium term, as the structural drivers such as negative real interest rates and the need for security should remain.
- **Crude oil** (Brent) fell below USD 40 per barrel for a second time due to demand concerns. However, the strict cuts by OPEC+ have created a supply deficit and a further recovery in demand should boost the oil price in the medium term.
- **Industrial metals** enjoyed an exceptional boom due to fiscal stimuli and infrastructure programmes in the wake of the corona-induced recession. However, the economy weakened recently.

Price development



Source: Bloomberg, 01/01/2010 - 07/10/2020.

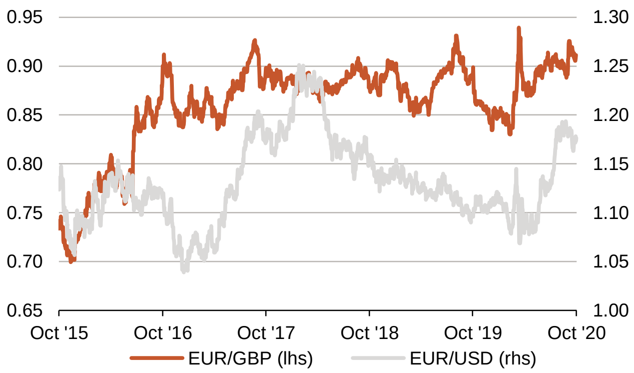
CURRENCIES

Euro fluctuates sideways

EUR/USD exchange rate is trending sidways
Pound without clear direction. EUR/GBP at 0.91
The Swiss franc remains at 1.08 CHF/EUR

- **EUR/USD**: The euro has not yet regained its strength. In the last four weeks, the trend has been sideways as investor sentiment has been subdued and the USD has been in demand as a safe haven. The rather cyclical euro has been left behind, and has recently been trading at close to 1.18 EUR/USD.
- **EUR/GBP:** Brexit negotiations continue to progress very slowly**.** Although there are isolated glimmers of hope, a solution is not yet in sight. As a result, the British pound is trading without a clear direction but with decreasing volatility. The EUR/GBR exchange rate is close to 0.91.
- The **Swiss franc** remains in demand as a safe haven for investment. CHF/EUR remains around 1.08.

Exchange rates



Source: Bloomberg, 07/10/2015 - 07/10/2020.

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 07/10/2020	ytd	1-year	3-year
Gold USD/ounce	1,887	+24.4%	+26.4%	+47.8%
Silver USD/ounce	23.8	+33.3%	+36.5%	+41.4%
Copper USD/pound	303.3	+8.4%	+17.7%	+0.1%
Brent USD/bbl	41.99	-36.4%	-28.0%	-24.5%

		Performance		
	As of 07/10/2020	ytd	1-year	3-year
EUR/USD	1.18	+4.9%	+7.2%	+0.3%
EUR/CHF	1.08	-0.6%	-1.1%	-6.1%
EUR/GBP	0.91	+7.7%	+2.0%	+1.4%
EUR/JPY	124.66	+2.4%	+5.9%	-5.7%

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
Felix Stern | Bonds
Christoph Mäder | Bonds
Marco Höchst | Commodities
Ludwig Kemper | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

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