Current market commentary

Recently, declining bond yields have dominated the headlines. The US yield curve has inverted - a reliable harbinger of an imminent recession in the past - while the 10y German government bond yield has fallen below the Japanese government bond yield. What is going on? Economic data fell short of the already low expectations bringing back growth concerns. Moreover, political concerns have not diminished and safe haven assets remain in demand. In addition, the major central banks in the USA and the Eurozone have sent a sustained signal to the market that they are in no hurry to raise rates, which has further fuelled the hunt for yields. In the USA, interest rate cuts are now being priced in by the market. Accordingly, global real estate stocks have rallied - +18% since the beginning of the year! As long as political risks do not subside and economic data does not stabilise, bond yields are unlikely to pick up.

Short-term outlook

Brexit reaches crunch time as without approval of the withdrawal agreement by the British Parliament, the resignation period is only extended until April 12. The negotiations between the US and China on trade, on the other hand, seem to be constructive. Therefore, there is great optimism among market participants for a trade agreement despite the delays.

With the start of a new quarter, a number of data releases are pending in the US: On Tuesday, new orders for durable goods will be published, on Wednesday the ISM index outside the manufacturing sector and on Friday labor market data including hourly wage developments. In Germany, new industrial orders will be released on Thursday which will reveal whether the outlook from the weak PMI data will improve. The ECB meeting on April 10 is also of interest, although no further interest rate hikes are expected in 2019. In addition, the new US reporting season starts next week.

Is the inversion of the US yield curve a warning signal?

The bi-weekly Monitor gives you a structured overview of the current capital market environment and highlights important developments:

- Performance
- Positioning
- Sentiment
- Surprise Indicators
- Economics
- Foreign Exchange
- Equities
- Sovereign Bonds & Central Banks
- Corporate Bonds
- Commodities

Brexit crunch time is imminent.

In the US, in particular, a number of economic data are published this week.

- An inverse US yield curve was observed in the past 12-24 months prior to a US recession.
- However, the inversion also has other causes than growth fears and falling inflation expectations: central bank bond holdings, political risks and the hunt for yield in the low-interest environment. It is more likely to reflect these aspects than factors leading to a recession.
- There is the danger of a self-fulfilling prophecy though.

Source: Bloomberg, Time period: 01/01/2000 - 29/03/2019
Multi Asset

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<tr>
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- REITs have been the best performing asset class over the past four weeks due to further declines in bond yields. Also, they offer the second best YTD performance behind crude oil.
- Equities, bonds and commodities also gained, while global convertible bonds fell slightly.
- Since the beginning of the year, all asset classes, with the exception of cash, have been in the green zone.

Total return of selected asset classes, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 28/03/2014 - 29/03/2019

- Over a 4-week period, European equities outperformed US equities, resulting in the Stoxx Europe 50 almost catching up with the S&P 500 YTD.
- However, the German DAX recently posted a negative performance. Among other things, the weak PMI for the manufacturing sector in March (44.1 points) intensified economic concerns.

Total return of selected equity indices, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 28/03/2014 - 29/03/2019

- With the exception of EM government bonds denominated in local currency, all bond segments have gained over the past four weeks.
- UK Gilts continued to rally as they were in demand as safe havens in the uncertainty surrounding Brexit.
- USD fixed income benefited from falling treasury yields and a stronger US dollar.

Total return of selected fixed income indices, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 28/03/2014 - 29/03/2019
Speculative investors have reduced their short positions in US bonds recently, exacerbating the decline in bond yields. Short positions in equities also tended to be closed.

Hedge funds remain optimistic about crude oil and the Russian ruble and increased their long positions further.

Recently, the put-call ratios for European and US equities diverged considerably.

While market participants appear to be more optimistic about the US again, they increased hedging for European equities due to ongoing political uncertainties and growth concerns.

The largest ETF inflows (in % of AUM) were experienced by eurozone bond ETFs, while European equity ETFs saw further net outflows - now amounting to USD -3.9bn since the beginning of the year. The largest ETF outflows were suffered by money market ETFs.

In absolute terms, the largest net outflows over the last two weeks have been recorded by US equity ETFs (USD -5.0bn).

Estimated ETF flows in percent of assets under management, sorted by 2-week average.
Source: Bloomberg, Time period: 31/12/2018 - 29/03/2019
The sentiment survey conducted by the American Association of Individual Investors determines the percentage of private investors who are optimistic, pessimistic or neutral regarding the US equity market outlook for the upcoming six months. It has been carried out since 1987. The survey is conducted from Thursday to Wednesday and the results are published every Thursday. For the stock market, it tends to be supportive when there is a high proportion of bears and a low proportion of bulls. However, it is a negative indicator when there are significantly more optimists than pessimists.

Source: Bloomberg, AAII, Time period: 23/07/87 - 28/03/19

- The share of bulls has fallen by 4 percentage points relative to the previous week, while the share of bears has risen by almost exactly the same amount.
- The bull/bear spread, which fell to 6.0%, reflects only a moderately optimistic stance of investors, which offers further potential for the markets.

Over the past two weeks, 60-day realised volatilities have declined widely, especially for commodities and REITs. Compared to the volatile months of December and January, relative calm has returned.

With the exception of EUR high-yield bonds, the realised volatility in all sub asset classes fell below their respective 5-year average.

Realised volatility (in percent) measures the historical range of variation of a time series and is defined here as the standard deviation of the daily returns over the last 60 trading days. Volatility is often used as a measure of risk.

Source: Bloomberg, Time period: 29/03/2014 - 29/03/2019

- Implied volatilities remained predominantly at low levels, with the exception of government bonds.
- The short-term inversion of the US yield curve triggered growth concerns, driving the demand for government bonds. In the USA, interest rate cuts are now being priced in by the market and the ECB pushed back a first rate hike which has also been supportive.

Implied volatility can therefore be interpreted as a measure of the currently expected fluctuation range of the underlying compared to the market over the remaining term of the option. It is a measure of prevailing uncertainty in the financial markets.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019
• Economic data in the emerging markets have recently been less disappointing. In Russia, for example, industrial production and retail sales in February were better than expected.

• From a global and G10 point of view, there was hardly any improvement. The economic data continued to disappoint. Particularly disappointing data were recently released from the euro zone.

See explanations below.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019

• The eurozone was unable to continue the momentum towards positive economic surprises. In Germany, the Purchasing Managers’ Index for industry disappointed heavily at 44.1 points (exp. 48), causing fears of recession to flare up again. However, a better than expected IFO and ZEW index has calmed markets somewhat.

• In the US, consumer confidence was worse than expected, while the trade balance in January was better than expected.

See explanations below.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019

• In spite of the Brexit chaos, economic data in Great Britain could surprise upwards. The unemployment rate fell to 3.9%, the lowest level since 1975. Inflation rose unexpectedly to 1.9% (expected 1.8%).

• In Japan, the unemployment rate has fallen to an all-time low of 2.3%.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019

Citigroup Economic Surprise Indices are defined as weighted historical, normalized data surprises (actual releases vs. Bloomberg survey median) over the last three months. A positive value of the index indicates that the economic data have exceeded the consensus on balance. The indices are calculated daily based on a rolling three-month period. The indices use a time decay function to replicate the markets limited memory, i.e. the weight of a data surprise decreases over time.
The industrial situation in Germany has deteriorated further. The PMI fell to 44.1, its lowest level since August 2012.

In China, the PMIs have recently risen above 50 again, which could indicate a recovery of the economy.

After recent stable inflation data in Germany, inflation in March at 1.4% was significantly lower than in the previous month. In France, inflation fell to 1.3%.

Inflation in the UK rose to 1.9% in February. Rising food prices in particular led to higher inflation.

The OECD Leading Indicator is composed of a series of selected economic indicators whose composition provides a robust signal for future turning points. A turning point in the indicator usually signals a turning point in the economic cycle in 6-9 months. However, lead times are sometimes outside this range and turning points are not always correctly detected.

Source: Bloomberg, Time period: 31/01/2000 - 28/02/2019

After the recently disappointing European PMI values, economic recovery will take some time. The global PMI could fall below the important 50 mark in March.

This picture is also confirmed by the OECD leading indicator, which is still falling, albeit at a declining pace.

The PMI is an overall index that provides a general overview of the economic situation in industry. The PMI is derived from a total of eleven sub-indices, which reflect the change from the previous month. A value of 50 is regarded as neutral, a value of over 50 points as an indicator of rising activity in industry and a value of less than 50 points for falling activity in industry compared with the previous month. The index has an average lead time before actual industrial production of three to six months. The PMI is based on a survey of a relevant selection of purchasing managers regarding the development of parameters such as incoming orders.

Headline inflation is measured (in percent, year-on-year comparison) using a consumer price index, also known as a shopping basket of goods. This shopping basket contains all goods and services that a household purchases on average per year.

Source: Bloomberg, Time period: 31/01/2009 - 31/03/2019
The trade-weighted yen initially ended the downward trend that had prevailed since the beginning of the year. Demand has been driven by global growth concerns.

• Accordingly, the USD appreciated while EM currencies have sold off.

• The euro was additionally burdened by the uncertainties around Brexit as well as economic concerns.

A trade-weighted index is used to measure the effective value of an exchange rate against a basket of currencies. The importance of other currencies depends on the share of trade with the country or currency zone.

Source: Bloomberg, Time period: 01/01/2018 - 29/03/2019

Among the G10 currencies, the Swiss franc and the Japanese yen performed best against the euro due to their safe haven characteristics.

• A further brightening of the economic data as well as internal and external political stabilization have benefited the Indian rupee.

• The Brazilian real, the Chilean and Colombian peso, primarily Latin American currencies came under pressure.

Performance of selected currencies against the euro, in percent.

Source: Bloomberg, Time period: 01/01/2019 - 29/03/2019

The EUR/USD exchange rate continues to fluctuate sideways at around 1.13 dollars per euro. Our economists expect the euro to appreciate against the USD in the course of the year.

• After government bond yields on both sides of the Atlantic recently declined, the interest rate differential between 10y Bunds and 10y Treasuries remains around 2.5 percentage points.

EUR/USD exchange rate and interest rate differential (in percentage points) of 10-year US Treasuries and 10-year Bunds. Forecasts made by Berenberg economists.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019
European Sector & Style Performance

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- Consumer staples have experienced strong growth in the last four weeks, now leading the European stock markets on an YTD-view.
- Other defensive sectors, such as utilities and telecommunications, have rallied as well, while financials, industrials and consumer discretionary have performed negatively over the past four weeks.

Total return of European equity sectors and European style indices, in euros and in percent, sorted by 4-week performance. The differences between Value and Growth lies in the valuation. A growth stock is highly valued because the company is expected to grow strongly. Value stocks generally have less growth potential but are valued lower.

Source: Bloomberg, Time period: 28/03/2014 - 29/03/2019

Changes in Consensus Earnings Estimates

**With the exception of Eastern Europe and the UK, negative earnings revisions continued.**

**Companies in Emerging Markets, particularly in Asia-Pacific, remain affected by the global economic slowdown.**

**In Europe, earnings estimates appear to be stabilising.**

Earnings Growth

- Consensus profit growth expectations for 2019 vary widely from region to region: While earnings in Japan and Eastern Europe are expected to be down vs the previous year, analysts believe that Latin American companies will be able to increase earnings by 20%.
- The picture for 2020 is much more uniform, with Asia-Pacific expected to experience the strongest growth in earnings.

Calendar year earnings growth expected to the consensus for selected equity regions, compared to the previous year and in percent. The earnings estimates of the individual companies are aggregated using the index weights (bottom-up).

Source: FactSet, as of 29/03/2019
**Contribution Analysis**

- Equities have gone up in value in both Europe and the US over the last twelve months, driven by rising earnings estimates.
- By contrast, the price/earnings ratio has declined slightly compared to the previous year.

**Price-Earnings Ratio (P/E Ratio) of European and US Equities**

- Negative earnings revisions and rising share prices have pushed up the price/earnings ratios recently.
- US equities are now slightly more expensive than their historical average, while European equities continue to trade below their historical average.
- In order for stocks to continue to rally, economic data has to stabilise.

**Historical Distribution: Price/Earnings and Price/Book Ratio**

- Compared to their historical median since 2006, Eurozone-, European- and Emerging Market- equities are slightly expensive on a price/earnings basis.
- The US remains the most expensive equity-region in absolute and relative terms. This observation is based on both the price/earnings ratio and the price/book ratio.
With central banks continuing to act dovish and economic concerns returning, yields on government bonds have fallen across the board. With a yield reduction of 35 basis points, US government bonds were the leaders.

Yields on 10-year German government bonds have turned negative, the last time this happened was in 2016.

Both 2-year and 10-year German government bonds are now showing negative yields. As a result, the spread has narrowed to 53 bp.

The slope between 3-month and 10-year US government bonds has recently turned negative, while the difference between 2 and 10-year bonds remains close to 20 basis points.

For 2019, the market no longer prices in interest rate hikes by the Fed, ECB or BoE. Low inflation rates and weak economic data are putting the brakes on the central banks.

For the USA, the market even expects an interest rate cut in 2019 with a probability of just under 70%, as Trump puts pressure on the US interest rate structure curve (3M vs. 10J) and recently inverted it.

Derivatives on money market rates - such as the Fed funds futures - can be used to determine the probability of a change in the key interest rate priced by the market.

Source: Bloomberg, Time period: 01/01/2014 - 29/03/2019
Recently, credit spreads on corporate bonds have increased slightly which could indicate an end to the spread tightening that has been progressing since the beginning of the year.

Only EUR non-financial bonds have held up over the past two-weeks. The media and energy sectors in particular have experienced a tightening of credit spreads.

The credit spreads on high-yield bonds have also gone up recently, particularly for EM and USD high yield bonds.

For US Dollar denominated bonds, automotive, retail and leisure were amongst the worst performing sectors. Hence, the deteriorating economic outlook primarily weighed on cyclical sectors.

Following a steady decline in credit spreads since the beginning of the year, spreads have started to widen recently.

Following the latest move, credit spreads on USD non-financial bonds is now close to the 10-year median.


Source: FactSet, Time period: 01/01/2014 - 29/03/2019
Most recently, a rise in net long speculative positions supported the oil price. OPEC and Saudi Arabia in particular are keeping oil supply tight. In addition, production shortfalls in Venezuela are driving up the oil price. The decline in Russian production, which was less than agreed, had no significant impact. The decline in active wells in the US could be an indication that the future increase in US oil production will be less pronounced than previously expected. Most recently, a rise in net long speculative positions supported the oil price.

Gold has recently fallen below USD 1,300 per ounce. A strong US dollar has had an especially negative impact. The combination of economic worries, declining US real rates, rising ETF holdings and the wait-and-see attitude of the Fed and ECB suggests that gold prices are likely to rise.

The US dollar and the real interest rate, i.e. adjusted for inflation, are among the fundamental price factors of the gold price. Rising real interest rates tend to depress the price of gold, while falling real interest rates have a supportive effect. The same applies to the US dollar. The development of gold ETF holdings reflects the demand for gold from financial investors.

**Commodities Performance**

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**Crude Oil**

- The decline in active wells in the US could be an indication that the future increase in US oil production will be less pronounced than previously expected.
- OPEC and Saudi Arabia in particular are keeping oil supply tight.
- Production shortfalls in Venezuela are driving up the oil price.
- The decline in Russian production, which was less than agreed, had no significant impact.

**Gold**

- Gold has recently fallen below USD 1,300 per ounce.
- A strong US dollar has had an especially negative impact.
- The combination of economic worries, declining US real rates, rising ETF holdings and the wait-and-see attitude of the Fed and ECB suggests that gold prices are likely to rise.

**Total return of selected commodity prices, in percent, sorted by 4-week performance.**

Source: Bloomberg, Time period: 01/01/2019 - 29/03/2019
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