Current market commentary

Risk assets have recovered significantly over the last few weeks. This was mainly due to the cautious positioning and pessimistic sentiment of investors. Bad news such as the weakness of the yuan and low order intake worldwide in the manufacturing sector were largely ignored by the market. However, good news such as robust US economic data and an announced trade meeting between China and the US in October were rewarded with strong price increases. Central bank decisions in the next two weeks will be decisive for the future direction of the capital markets. The market expects (strong) easing measures from the Fed and the ECB. There is therefore potential for disappointment. In the US, the most recent economic data was surprisingly robust, while in Europe, the ECB’s resources are limited. Alongside this high uncertainty, the outcome of Brexit and the trade conflict remain open. Caution remains the order of the day.

Short-term outlook

The political risks for capital markets have not yet been averted, but the recently reduced probability of a hard Brexit and the expected resumption of trade talks between the US and China have boosted the equity markets in the last few weeks. This also applies to the expected easing of monetary policy in the fight against the still disappointing economic data. Tomorrow, the focus will be on industrial production data in France and Italy as well as data on the labour market in the UK. On Thursday, investors will focus on the ECB meeting and their decisions regarding deposit rates and bond purchases. In the US, Friday’s Retail Sales and US Consumer Confidence will provide information on whether US consumption, which is significantly important for the US economy, will remain stable. Next week, Wednesday (18 September) will see the FOMC meeting and the expected US rate cut being at the centre of attention, followed by the Bank of England meeting on Thursday (19 September).

Macro hedge funds remain cautiously positioned

In light of the numerous political and economic risks, the majority of international investors are positioned defensively, including the global macro hedge funds, which were much more optimistic last year. This one-sided positioning of market participants means that bad news is less negatively received by the market. Good news, on the other hand, leads to stronger positive market reactions.
Accordingly, high yields were also amongst the outperformers in euro terms. Finally, hopes of avoiding the hard Brexit have risen again.

Within bonds, Italian government bonds (government reshuffle) and British bonds (GBP appreciation) were the clear outperformers. A growing risk appetite amongst investors was supportive.

Commodities have rallied strongly over the past four weeks. Brent oil and industrial metals rose by more than 6%, boosting hopes of a de-escalation in the trade conflict.

All other asset classes also recorded gains. The cautious positioning and pessimistic sentiment supported risk assets in particular. While bad news had hardly any impact, good news was immediately translated into price gains.
The positioning with regard to equities remains very moderate.

The Commodity Futures Trading Commission (CFTC) publishes the Commitments of Traders Reports every Friday. A distinction is made between "non-commercial" and "commercial traders" positions. Non-commercial traders enter into purely speculative positions. Commercial traders hedge underlying transactions with futures or options. The chart shows the historical, normalized distribution in standard deviations and focuses on the net future position (long positions minus short positions) of non-commercial traders, thus indicating how speculative investors have positioned themselves.

Speculative investors have recently expanded their positions in precious metals in particular. Falling bond yields and persistently high political uncertainty supported this trend.

The majority of investors are currently underweight in equities. Moderate economic data and falling profit expectations are making investors sceptical.

The 3-week-averages of the put-call ratios continue to move above their historical averages.

Most recently, commodity ETFs in particular were in demand. Precious metal ETFs, recorded large inflows after bond yields continued to fall and important technical resistance in the chart was broken.

Demand for bond ETFs also continued.

European and emerging market equities, on the other hand, recorded further outflows over the last four weeks.

Estimated ETF flows in percent of assets under management, sorted by 2-week average.
Source: Bloomberg, Time period: 31/12/2018 - 06/09/2019
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 - 05/09/19

- Although the mood of US private investors has improved recently, the bears still outnumber the bulls with just under 11%.
- The already prevailing scepticism among investors gives additional price potential for equities at least in the short term in the event of positive economic or political surprises.

Realised 60-day volatilities are almost unchanged from two weeks ago.
- Commodities, developed country equities and European government bonds continue to show above-average volatility.
- The global economic slowdown did not leave the emerging markets unscathed, so much so that volatility in equities recently approached its 5-year average.

Revised 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: 06/09/2014 - 06/09/2019

- “No news” in the trade war and a curtailment of the power of Boris Johnson show a calming effect.

The price of options depends on the volatility of the underlying instrument. 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 - 06/09/2019
• On average, global economic surprises remained negative. However, both the G10 and emerging markets have improved on a three-month average. Among the emerging markets, the Caixm Service PMI in China surprised positively with 52.1 points and industrials gained. In South Korea, exports fell 13.6% YoY in August and India’s Q2 GDP rose only 5.0% (5.6% expected).

Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019

• Despite the weak ISM Manufacturing Purchasing Managers’ Index in August, which fell below 50 points for the first time since 2016, economic surprises in the US have fought their way into positive territory. In addition to labor market figures and consumer confidence, the service sector (August ISM: 56.4) is also holding up surprisingly well.

• In Germany, the Ifo business climate index disappointed with 94.3 points in August, and the eurozone is still in negative economic territory.

Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019

• In the UK, both retail sales (-0.5%) and manufacturing PMI (47.4 points) were disappointing in August.

• In Japan, industrial production rose in July and the unemployment rate fell to 2.2%.

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.

Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019
OECD Leading Indicator

- The OECD leading indicator has been indicating a global economic slowdown for months. While the manufacturing sector is already struggling with a global recession, the service sector and private consumers are still holding up relatively well. Should both come under pressure, a recession can no longer be ruled out.

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: 31/01/1994 - 30/06/2019

Manufacturing Purchasing Managers Index (Manufacturing PMI)

- The global PMI is below 50 points for the fourth time in a row, although it improved slightly in August.
- In August, the US PMI fell below 50 points for the first time since 2016. Hence, the US is thus joining the global industrial downturn.

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.

Source: Bloomberg, Time period: 31/05/2016 - 31/08/2019

Headline Inflation

- August is also marked by low inflation. Inflation in the eurozone remained unchanged from the previous month at 1.0% and in Germany it even fell slightly. Only the Netherlands recorded rising inflation, which is now well above the 2% ECB target.
- Inflation in South Korea was 0% in August, fueling fears of deflation.

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: 31/08/2009 - 31/08/2019
Trade-Weighted Currency Development

Currency Moves vs Euro

EUR/USD exchange rate and interest rate differential

- Recently, the safe havens of the US dollar and Japanese yen were no longer in demand, in contrast to August, and have depreciated on a trade-weighted basis. The hope of a rapprochement in the trade dispute supported the emerging market currencies.

- In the last few weeks, the euro has weakened slightly in anticipation of a much more expansionary monetary policy on the part of the ECB. The ECB meeting on 12 September will bring more clarity here.

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 - 06/09/2019

- The euro has been weak for the past four weeks. The G10 and Asian currencies have all appreciated against the euro.

- Depending on the extent of the monetary policy measures decided by the ECB on 12 September, the euro is likely to gain or lose ground.

- The crypto-currencies have come under pressure in recent weeks. Since the beginning of the year, however, considerable gains have still been made.

Performance of selected currencies against the euro, in percent.
Source: Bloomberg, Time period: 31/12/2018 - 06/09/2019

- The EUR/USD exchange rate fell temporarily below 1.10 dollars per euro. Comparatively weak economic data and the expected easing of monetary policy weighed on the euro.

- The interest rate differential between 10-year US Treasuries and German government bonds fell to around 2.1%. Our economists expect a somewhat stronger euro next year, when the growth advantage of the USA will diminish.

EUR/USD exchange rate and interest rate differential (in percentage points) of 10-year US Treasuries and 10-year Bunds.
Source: Bloomberg, Time period: 01/01/2014 - 30/06/2020
European Sector & Style Performance

<table>
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<th>Materials</th>
<th>Consumer Staples</th>
<th>Industrials</th>
<th>Consumer Discretionary</th>
<th>Utilities</th>
<th>Growth</th>
<th>Information Technology</th>
<th>Telecommunications</th>
<th>Value</th>
<th>Health Care</th>
<th>Finance</th>
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<td>4W (09/08/19 - 06/09/19) YTD 28.6</td>
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<td>4.9</td>
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<td>12-month periods over that last 5 years 06/09/18</td>
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</tbody>
</table>

- Over the past four weeks, all European equity sectors have gained ground. Materials and consumer staples performed best, while energy and financials lagged behind.
- The picture over the last 12 months is similar: consumer staples gained strongly, while financials lost value.

Total return of European equity sectors and European style indices, in euros and in percent, sorted by 4-week performance. The difference 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 and are valued lower.

Source: Bloomberg, Time period: 05/09/2014 - 06/09/2019

Changes in Consensus Earnings Estimates

- The analysts continue to adjust their earnings estimates downwards. One exception is Switzerland, whose index mainly contains defensive companies.
- For the US and Europe, the momentum of earnings downgrades has also slowed recently.
- For Latin America, Asia and Eastern Europe, on the other hand, the negative earnings revisions are continuing.

1-month and 3-month changes in consensus earnings estimates for the next 12 months, in percent. APAC ex Japan = Asia Pacific ex Japan
Source: FactSet, as of 06/09/2019

Earnings Growth

- Analysts are already expecting a profit recession this year for Asia Pacific ex Japan, Japan and Eastern Europe. Germany and the USA are not far away.
- The largest earnings growth this year is expected for Switzerland.
- Next year, double-digit earnings growth is expected for many regions – although this seems too optimistic.

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). APAC ex Japan = Asia Pacific ex Japan
Source: FactSet, as of 06/09/2019
Contribution Analysis

• Neither European nor US equities have risen markedly over the past year. The equity market moved more or less directionless, which was also due to the weak development of corporate profits.

• Valuations at index level have hardly changed compared to the previous year.

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

• In recent weeks, P/E valuations have risen slightly. While earnings expectations have been reduced downwards, the stock markets have recovered.

• US and European equities are now slightly more expensive than the historical average.

Historical Distribution: Price/Earnings and Price/Book Ratio

• Compared to four weeks ago, all equity regions have become more expensive - both on a P/E and P/B basis.

• Emerging market equities have the lowest overall valuations.
• Fears of a recession initially led to a further decline in yields on the bond markets. For example, 30-year US Treasuries traded below the 2% mark for the first time in their history and German Bunds reached a new record low of -0.74%.

• However, the tide has turned recently. Optimism regarding the trade war, good US economic data and increasing substitution by issues of investment-grade corporate bonds led, in some cases, to yield jumps of more than 10 basis points.

Effective yield of 10-year government bonds and change in the last four weeks in basis points (in brackets). 
Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019

The yield curve distinguishes between the so-called short end and the long end. The reason for this lies in the way in which factors influence returns. Central banks control the short end of the curve through their monetary policy and key rates. By contrast, the long end is influenced less by central banks than by inflation expectations, supply, demand and risk premia. Source: Bloomberg, Time period: 01/01/1998 - 06/09/2019

• The steepness of the US yield curve has increased again thanks to the recent increase in risk appetite.
• The steepness of the German yield curve temporarily reached a new 10-year low, but has recently remained stable above the 20 basis points.

• Interest rate cuts in September by both the Fed and the ECB are now considered to be certain, with a probability of 100%. By December at the latest, both central banks are expected to make a second rate cut with a probability of around 80%.

• Only at the Bank of England has the probability of an interest rate cut decreased, at least for this year, compared to two weeks ago.

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: 09/08/2019 - 06/09/2019
Risk premiums on USD corporate bonds have risen slightly over the past two weeks. Hardly any news in the trade war and record-breaking new issues have caused spreads to move sideways.

• The picture is similar for EUR corporate bonds, even though risk premiums have risen somewhat more sharply, by around five basis points.

• After the risk-on sentiment experienced in the equity markets, defensive sectors such as healthcare and consumer goods faced the largest widening of spreads in corporate bonds.

In high-yield bonds, USD and EUR bonds benefited from the recent risk appetite, while emerging market bonds continued to be sold. Emerging market high-yield bonds have seen spreads widen by seven basis points over the past two weeks and USD high-yield bonds by 15 basis points. The mechanical and transport sectors were the losers in USD high yield.

The largest spread widening in the past four weeks was experienced by emerging market high-yield bonds. Historically, they are therefore almost fairly priced.

• USD non-financial bonds continue to look historically expensive, while EUR financial bonds appear cheap.

The extent of the risk associated with a corporate bond is shown by its asset swap spread (in basis points). This indicates the yield that the issuer must pay in addition to the swap rate for the respective term to offset its credit risk. See further explanations below.

The EM indices shown here are hard currency bonds.

• The largest spread widening in the past four weeks was experienced by emerging market high-yield bonds. Historically, they are therefore almost fairly priced.

• USD non-financial bonds continue to look historically expensive, while EUR financial bonds appear cheap.
**Commodities Performance**

- Nickel has recently gained significantly. Since Indonesia has imposed an export ban on nickel ore from the beginning of 2020, concerns about a supply deficit and speculators have driven prices up.
- Precious metals benefitted from speculative positioning and negative interest rates on bonds. Silver and platinum had catch-up potential and performed even better than gold.
- The easing of growth concerns has recently supported energy commodities and industrial metals.

Total return of selected commodity prices, in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 01/01/2019 - 06/09/2019

**Crude Oil**

- The price of Brent crude has recently risen to over USD 60 per barrel. The declining growth and thus demand concerns, as well as the curbing of OPEC production have supported the oil price.
- US oil inventories are rising despite a growing US oil production. The growing oil supply from non-OPEC countries could lead to an oversupply of oil at the beginning of 2020 if OPEC does not take countermeasures.

Higher oil production and higher inventories tend to depress oil prices and vice versa. An increase in active oil rigs indicates a future increase in oil production.
Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019

**Gold**

- The price of gold has recently fallen slightly, but remains above the USD 1,500 an ounce mark.
- The sharp decline in US real interest rates, the widespread negative bond interest rates and a more expansionary monetary policy make gold more attractive in the medium term. In the short term however, gold appears overbought and its positioning too long.

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.
Source: Bloomberg, Time period: 01/01/2014 - 06/09/2019
Ulrich Urbahn, CFA | Head Multi Asset Strategy & Research
focuses on the multi-asset investment process, the development of investment ideas and capital market communications
+49 69 91 30 90-501 | ulrich.urbahn@berenberg.de

Guido Urban, CFA | Senior Analyst Multi Asset Strategy & Research
is in charge of capital market publications with a focus on commodities, supports the investment process and develops investment ideas
+49 69 91 30 90-215 | guido.urban@berenberg.de

Karsten Schneider | Analyst Multi Asset Strategy & Research
analyses financial markets, supports the multi-asset investment process and participates in capital market publications
+49 69 91 30 90-502 | karsten.schneider@berenberg.de

Richard Garland | UK Wealth Management
will be in charge of managing UK Discretionary Wealth Management portfolios
+44 20 3753 · 3126 | richard.garland@berenberg.com

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Please refer to the online glossary at www.berenberg.de/glossar for definitions of the technical terms used in this document.

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