Current market commentary

Since October, stock markets have been experiencing a rollercoaster ride. Trade and economic concerns initially weighed on risk assets before the verbal agreement on a ceasefire in the trade war between the US and China which significantly improved investor sentiment. The markedly increased probability of a Brexit agreement further boosted investor sentiment. The DAX climbed to a YTD high and the S&P 500 is close to its all-time high. Will the broad European stock market now also be able to reach an all-time high? To do this, the Stoxx 600 would have to break through the 400 mark on a sustained basis. Although economic worries remain, if the easing of trade tension continues, the odds are good. Many international investors who have underweighted Europe because of increased political uncertainty, among other things, would see Europe more positively again. Italy is not a problem, at least in the short term, and the Brexit saga seems to be coming to an end. Accordingly, we are also quite optimistic.

Short-term outlook

After the partial settlement in the trade dispute and the positive Brexit news of last week, the focus of market participants is on the Q3 reporting season that continues to pick up momentum. So far, companies in the US and Europe have been able to beat earnings estimates, which had fallen sharply in the run-up. Tomorrow (Tuesday) the sales figures of existing houses in the US will reveal whether the US housing market will remain robust. On Thursday, the focus will be on the Purchasing Managers’ Indices (PMIs) for Germany, France and the Eurozone. No interest rate decisions are expected to be delivered following the meetings of the Swedish and Norwegian central banks. In the US, new orders for durable goods and the first applications for unemployment benefits will be published. On Friday, market participants will focus on the German Ifo Business Climate Index and US consumer confidence. Some investors expect a further rate cut from the Fed meeting on October 30.

Stoxx 600 - can a sustained breakout above the 400 mark be achieved?

- In recent years, the Stoxx 600 has never managed to break through the 400 mark on a sustained basis.
- Now we are just below the critical level again and the chances for a breakthrough are not bad, thanks to the Brexit optimism. Europe should benefit twice from improved sentiment. On the one hand, rising interest rates would benefit the high value index weighting in Europe. On the other hand, international investors should now see Europe more positively again.

The focus is on Brexit outcome and Q3 reporting season.

The PMI indices and the Ifo index provide information on the development of the economy.
Multi Asset

<table>
<thead>
<tr>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
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Equities

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Fixed Income

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<tr>
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<td>Treasuries</td>
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Bunds: Barclays Germany Govt All Bonds TR; BTPs: Barclays Italy Govt All Bonds TR;Treasuries: Barclays US Treasury TR; Gilts: Barings; UK Govt All Bonds TR; EUR Inflation Linkers: Barings; Euro Govt Inflation Linked Bond All Maturities TR; EUR Financials: BDO Euro Fin.; Overall TR; EUR Non-Financials: BDO Euro Non-Fin.; Overall TR; EUR High Yield Markle: IBS; EUR Liquidity TR; USD Corporates: IBS; USD Corporates TR; USD High Yield: BDO; USD Liquid HY TR; GM:Hard Currency; Barings; Hard Currency Agg Related TR; GM: Local Currency; Barings; GM: Local Currency Govt TR.

Over the last four weeks there has been no pronounced differentiation in asset class returns, with the exception of Brent oil. Brent oil lost more than 6% in value, with demand worries due to the moderate global economy weighing on it. Frontier and emerging markets equities were among the relative winners. A weaker US dollar and trade optimism helped.

Over the past four weeks, cyclical stocks (regions) have performed best. The DAX gained more than 1% and is now about 20% ahead since the beginning of the year. US equities have weakened somewhat recently. Since the beginning of the year, they have been ahead of Eurozone equities in euro terms. In local currency, however, both equity regions have now developed more or less equally.

In the case of British government bonds, the GBP appreciation more than compensated for the rise in yields, making them one of the outperformers of the last four weeks in euro terms.

The majority of the other bond segments have developed negatively since mid-September. Investors’ greater appetite for risk has led to bond yields rising sharply in some cases. Safe havens were less in demand.

Total return of selected asset classes, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 17/10/2014 - 18/10/2019

Total return of selected equity indices, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 17/10/2014 - 18/10/2019

Total return of selected fixed income indices, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 17/10/2014 - 18/10/2019
Speculative investors have recently reduced their GBP short positions, but are still relying on falling GBP prices in the aggregate.

Copper short positions have been further increased. Should the economic data stabilise, the one-sided positioning could lead to a rapid rise in copper prices.

The brighter mood is not yet reflected in the ETF flows.

The last two weeks have been dominated by inflows into money market, multi-asset and US bond ETFs.

Equities, on the other hand, were hardly bought in aggregate. Among equity regions, investors preferred Japan followed by the USA.

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.

*Duration weighted average bond position.
Source: Bloomberg, CFTC. Time period: 15/10/2009 - 15/10/2019

After the recent positive newsflow in the trade dispute and the Brexit question, many investors have significantly reduced their hedges.

Investors are more positive about the Euro Stoxx 50 in particular. The put-call ratio is now below the historical average.

The put-call ratio is the ratio of traded put options (speculation on falling prices) to call options (speculation on rising prices) across all maturities. The higher (lower) the ratio, the more cautious (optimistic) are the market participants. 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.

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**SENTIMENT**

**AAII Sentiment Survey (Bulls vs Bears)**

- After the sentiment last week was still very pessimistic with a spread of -23.7 pp, bulls and bears are currently balancing each other out.
- The prospect of a “phase one” deal in the trade conflict and a good start to the reporting season made US private investors more optimistic.

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 - 17/10/19

**Realised Volatilities**

- Equities in developed countries have risen recently, but have been even more volatile than emerging market equities.
- Commodities remain by far the most volatile asset class.
- Bonds show nearly unchanged realised volatilities compared to those two weeks ago. European government bonds and inflation linkers continue to show slightly increased volatilities compared with their 5-year averages.

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: 23/07/2014 - 18/10/2019

**Implied Volatilities**

- The long-awaited easing of the trade conflict and a progress in the Brexit negotiations caused the implicit volatilities for equities, government bonds and currencies to fall.
- Oil volatility remained nearly unchanged despite increasing geopolitical risks in the Middle East.

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 - 18/10/2019
**Global**

- At the global level, in the G10 countries and in the emerging markets, the average economic surprise has recently been negative for most countries and has thus moved further away from positive territory.
- In China, economic growth in Q3 was disappointing at 6.0% year-on-year, while industrial production and inflation surprised upwards in September. China, however, is an exception in terms of inflation, as global inflation tended to surprise downwards.

See explanations below.
Source: Bloomberg, Time period: 01/01/2014 - 18/10/2019

**Eurozone and US**

- In Germany, the ZEW Economic Sentiment Index was with -22.8 points lower than in the previous month, but better than expected.
- The economic surprises in the eurozone remain negative, but improved slightly.
- In the US, the economic surprises are on a downward trend. Industrial production and retail sales have fallen recently. Nevertheless, some sentiment indicators improved (Univ. of Mich. & Empire Manufacturing Index).

See explanations below.
Source: Bloomberg, Time period: 01/01/2014 - 18/10/2019

**UK and Japan**

- The economic surprises in the UK have recently fallen back into negative territory. Falling industrial production in August contributed to this.
- In Japan, the index for economic surprises reached a new positive high for the year.

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 - 18/10/2019
**OECD Leading Indicator**

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 - 31/08/2019

**Manufacturing Purchasing Managers Index (Manufacturing PMI)**

- The global industrial PMI remains below 50 and thus below the expansion threshold.
- In the US, the Manufacturing PMI fell to its lowest level since 2009 at 47.8. In Germany, the index also fell to its lowest level since the financial crisis.

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: 30/06/2016 - 30/09/2019

**Headline Inflation**

- In the developed countries and also in some emerging markets, inflation tended to fall in September. One exception is China, where inflation rose to 3.0% in September and reached a six-year high.
- In Japan, inflation in September fell to its lowest level since February, which was driven by falling energy prices.

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: 30/09/2009 - 30/09/2019
The Japanese yen was less sought after as a safe haven due to increased risk appetite, resulting in the yen falling sharply. The US dollar also lost ground.

Emerging market currencies gained some strength as a result.

On a trade-weighted basis, the euro stabilised recently and may now be at the beginning of a slight upward trend.

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 - 18/10/2019

Sterling has made the strongest gains against the euro in the last four weeks thanks to substantial progress in Brexit negotiations.

The euro however managed to hold its ground against most other currencies.

The Norwegian krone was the biggest loser due to the poor development of energy commodity prices.

The invasion of Turkish troops in northern Syria and US sanctions weighed on the Turkish lira.

The EUR/USD exchange rate has been showing upward momentum since the beginning of the month and is currently trading at around 1.11 US dollars per euro.

A foreseeable settlement in the trade conflict and progress between the UK and the EU supported the euro.

For the end of 2020, our economists see a spread tightening of German government bonds and US Treasuries to around 1.8%.

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 - 31/12/2020
Due to rising bond yields, the European financial sector has outperformed all other sectors over the last four weeks. Value stocks have recently performed better than growth companies. Since the beginning of the year, however, the outperformance of growth over value has still been substantial at 10 pp.

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: 17/10/2014 - 18/10/2019

Even though political uncertainty has recently somewhat diminished, the economic data remain mixed. Earnings estimates are also being revised downwards sharply.

While analysts see less need for revisions for Germany and Asia, they are most sceptical for the UK.

While the expected earnings growth for 2019 now looks reasonably realistic, the expected earnings growth for 2020 is still far too optimistic.

Germany in particular is likely to require further downward revisions over the next few months.

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 18/10/2019
Contribution Analysis

- Now that the poor October performance of the previous year has been gradually thrown out of the rolling 1-year window and October this year has performed well so far, the 1-year performance looks much better.
- Earnings estimates have hardly moved compared to the previous year, but prices, and thus, valuations have risen sharply.

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

- US equities are now again more expensive than the historical average. The most recent rally was driven by an improvement in sentiment (new hopes in the trade conflict) and not by higher profits. The Q3 reporting season that has just started should shed light on whether this optimism is justified.
- European equities are now valued fairly to their own history.

Historical Distribution: Price/Earnings and Price/Book Ratio

- The price/book ratio for US equities is again close to its historic highs since 2006.
- Of all regarded regions, emerging markets are the cheapest in absolute terms. They are priced fair to slightly expensive compared to their own history however.
- A key reason for the ambitious valuation levels is the low interest rate level, which increases the relative attractiveness of equities over bonds.
10-Year Government Bond Yields

- The upward trend in government bond yields in the eurozone continues. The rapprochement in the trade dispute and the Brexit deal has led to decreasing risk aversion among market participants. As a result, safe government bonds were less in demand, leading to rising yields.
- Yields on US and British government bonds have broken through the recent downward trend and are close to their September high.

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 - 18/10/2019

Yield curve steepness (10Y - 2Y)

- The steepness of the yield curve in Germany and the US increased again slightly with the decline in political, and thus also economic, risks. At 28 basis points, the German yield curve is now well away from inversion again.

The yield curve distinguishes between the so-called short 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 - 04/01/2019

Implicit Probabilities for Changes in Key Interest Rates

- After voices have increased with concerns about the ECB’s current loose monetary policy, the market expects a further rate cut in 2019 only with a probability of less than 20%. In return, the probability of an interest rate hike has risen to around 20%.
- In the course of the Brexit deal agreement, the probability of an interest rate cut by the Bank of England has fallen further.

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: 20/09/2019 - 18/10/2019
C O R P O R A T E  B O N D S

Credit Spreads Financial and Non-Financial Bonds

- Spreads on investment-grade corporate bonds have recently fallen significantly. This was particularly noticeable in the case of USD bonds. The rapprochement in the trade conflict led to increased demand for credit risk.
- In the case of EUR corporate bonds, banks and insurance companies in particular saw the largest spread narrowing, while in the case of USD corporate bonds it was the commodity and telecommunications companies.

Explanations see middle and bottom illustration.
Source: FactSet, Time period: 01/01/2014 – 18/10/2019

Credit Spreads High Yield and Emerging Markets Bonds

- In the high-interest field, spreads have recently fallen by around 30 basis points as a result of the risk-on environment. In the case of USD high-yield bonds, the retail sector in particular saw spreads fall.
- In recent weeks, there has been a downward trend in spreads for emerging market high-yield bonds. The difference to the high for the year is now around 50 basis points.

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.
Source: FactSet, Time period: 01/01/2014 – 18/10/2019

Historical Distribution of Credit Spreads (in bp)

- The largest spread tightening in the last four weeks was experienced by USD Non-Financial Bonds. They are thus historically fairly priced. USD Financial bonds also saw a marked narrowing of spreads and have therefore become more expensive.

Source: FactSet, Time period: 18/10/2009 – 18/10/2019
**Commodities Performance**

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<tr>
<th>Commodity</th>
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<tr>
<td>Zinc (USD/t)</td>
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<td>Palladium (USD/ounce)</td>
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<td>Natural Gas (USD/MMBtu)</td>
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</tr>
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</table>

- Performance over the last four weeks has been negative in most commodity segments.
- Precious metals lost their attractiveness as safe havens as investors became more willing to take risks.
- Only palladium continued its upward trend thanks to ongoing supply concerns.
- Oil and gas suffered from the continuing weak economic outlook for the coming year. Industrial metals performed surprisingly well.

**Crude Oil**

- Despite Turkey’s invasion of northern Syria and a missile attack on an Iranian oil tanker, the oil price could not increase significantly. Geopolitical risks are currently not priced by the market.
- The oil price is still determined by the forecast of low demand growth and rising oil production in non-OPEC countries in the coming year.

**Gold**

- The gold price has recently come under some pressure again and is currently trading below the 1,500 US dollar per ounce mark.
- Although the growth in ETF holdings continues to be positive and thus has a supportive effect, the rise in yields in government bonds and the easing in (trade) policy issues are weighing on the gold price.

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 - 18/10/2019
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