Current market commentary

Middle East tensions? Markets digested this at record speed thanks to the absence of an escalation. Emerging market equities in particular continued to rise, while US stock markets celebrated all-time highs. Since the beginning of the year, all risk asset classes have now been in the black - with the exception of oil. Loose central bank policy worldwide and the Phase 1 deal are supporting this. Now the market is focusing on the Q4 corporate reporting season that has just started. The exciting question remains whether equity markets can meet the optimistic expectations that have already been priced in. So far, negative earnings revisions for developed markets are persisting, while economic data is also only mixed. The pro-risk positioning of market participants and valuation levels has increased significantly. This makes the market more vulnerable to a pullback. We feel comfortable with a neutral equity exposure and slightly increased cash position. This way we are capable of acting as required.

Short-term outlook

On 31st January the UK will complete Brexit and leave the EU in an official and (for the time being) regulated manner. But monetary policy also remains exciting. The Bank of England is meeting on 30th January and should provide clarity about the latest interest rate cut speculation. The ECB (Jan 23.) and the Fed (Jan 29.) are also meeting - no surprises are expected here. Further regional elections will be held in Italy on January 26th, which should provide information about the political sentiment in the country. On the corporate side, the course of the Q4 reporting season is of importance. In the S&P 500, 44 companies have already reported and 70.5% of them have exceeded analysts’ earnings expectations. More important, however, is the outlook that companies give for 2020. Another 48 companies are expected to open their books this week. The ZEW and Ifo business expectations (Jan 21. / Jan 27.), the US consumer confidence (Jan 28.) and the Purchasing Managers’ Indices in Germany, France, U.K. and the U.S. (Jan 24.) are also scheduled.

Euphoria? Share positioning of institutional investors strongly increased

- Both institutional investors and hedge funds have recently significantly increased their positions in US equities. The positioning of asset managers and leveraged funds is now even higher than at the turn of 2017/2018.
- This alone is not bad and the positioning may even increase further. However, it does make the market vulnerable should negative surprises occur, especially as equity market valuations are already pricing in a lot of positive things.

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 and central bank meetings are on the agenda.

The current corporate reporting season should move into the focus of investors.
## Multi Asset

4-week & YTD  

<table>
<thead>
<tr>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
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<tbody>
<tr>
<td></td>
<td>17/01/19</td>
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<td></td>
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<tr>
<td>Gold</td>
<td>23.8</td>
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<tr>
<td>MSCI Emerging Markets</td>
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<td>Global Convertibles</td>
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<td>Global Corporates</td>
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<td>Industrial Metals</td>
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<tr>
<td>Global Treasuries</td>
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<tr>
<td>Eonia</td>
<td>-0.4</td>
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<tr>
<td>USD/EUR</td>
<td>2.7</td>
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<td>Brent</td>
<td>20.4</td>
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</tbody>
</table>

- The best asset class over the last four weeks was gold, profiting from geopolitical tensions in the Middle East and falling US government bond yields.
- Within the major equity regions, frontier markets and emerging markets have been ahead of recent developed nations.
- Corporate bonds have recently outperformed government bonds, aided by the ongoing hunt for yield in the low-interest environment.

**Total return of selected asset classes, in euros and in percent, sorted by 4-week performance.**

Source: Bloomberg, Time period: 16/01/2015 - 17/01/2020

## Equities

4-week & YTD  

<table>
<thead>
<tr>
<th>4-week &amp; YTD</th>
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<td>17/01/19</td>
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<td></td>
<td>17/01/20</td>
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<tr>
<td>MSCI EM Eastern Europe</td>
<td>34.5</td>
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<tr>
<td>MSCI EM Asia</td>
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<tr>
<td>S&amp;P 500</td>
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<tr>
<td>Stoxx Europe Defensive</td>
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<tr>
<td>Stoxx Europe Small 200</td>
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<td>Russell 2000</td>
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<tr>
<td>DAX</td>
<td>23.9</td>
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<tr>
<td>Stoxx Europe 50</td>
<td>26.9</td>
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<tr>
<td>MSCI UK</td>
<td>20.7</td>
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<td>Euro Stoxx 50</td>
<td>27.5</td>
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<tr>
<td>Stoxx Europe Cyclicals</td>
<td>22.5</td>
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<tr>
<td>Topic</td>
<td>17.1</td>
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</table>

**S&P 500: S&P 500 Index; Stoxx Europe 500: Stoxx Europe 500 Index; Euro Stoxx 500: Euro Stoxx 500 Index; Total Topic: Topic Index (equal-weights); Stoxx Europe Small 200: Stoxx Europe Small 200 Index; Russell 2000: Russell 2000 Index; Stoxx Europe Cyclicals: Stoxx Europe Cyclicals Index; Stoxx Europe Defensive: Stoxx Europe Defensive Index; DAX: DAX Index; MSCI EM Asia: MSCI EM Asia Index; MSCI EM Eastern Europe: MSCI EM Eastern Europe Index.**

**Total return of selected equity indices, in euros and in percent, sorted by 4-week performance.**

Source: Bloomberg, Time period: 16/01/2015 - 17/01/2020

## Fixed Income

4-week & YTD  

<table>
<thead>
<tr>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
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<td>17/01/19</td>
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<td>17/01/20</td>
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<tr>
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<td>EM Hard Currency Bonds</td>
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<tr>
<td>USD Corporates</td>
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<tr>
<td>EUR High Yield</td>
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</tr>
<tr>
<td>USD High Yield</td>
<td>14.1</td>
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<td>EUR Financials</td>
<td>6.2</td>
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<tr>
<td>Bunds</td>
<td>3.1</td>
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- In the bond segment, British government bonds performed best by far. Disappointing economic data and dovish comments by British central bankers have recently made a rate cut by the Bank of England much more likely.
- EM government bonds were also among the big winners. The hunt for yield by investors remains supportive.

**Total return of selected fixed income indices, in euros and in percent, sorted by 4-week performance.**

Source: Bloomberg, Time period: 16/01/2015 - 17/01/2020
Non-Commercial Positioning

- Speculative investors are particularly optimistic about commodities, especially gold and platinum.
- On the other hand, they are sceptical about US bonds and are neutrally positioned in equities - even if optimism has recently increased.

Put-Call Ratio

- Put-call ratios remain unspectacular. They remain close to their historical averages.
- Investors in the options markets thus do not appear to have a clear market opinion at the moment.

ETF Flows

- Only money market ETFs have had to contend with outflows over the last four weeks. Bonds, on the other hand, were in strong demand, especially from emerging markets.
- Within equities there were also inflows, with Japan recording the most in percent of assets under management.

Estimated ETF flows in percent of assets under management, sorted by 2-week average.
Source: Bloomberg, Time period: 31/12/2019 - 17/01/2020
Following the signing of the "Phase 1" deal between the USA and China and an easing of tensions in the Middle East, many of the recently undecided US private investors are once again looking optimistically to the future.

The bull-bear spread of 14.3 is well above the historical average.

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 - 16/01/20

Thanks to the apparent easing of the trade conflict, most asset classes exhibit relatively low realised volatility compared to their own history.

While volatility in emerging market equities has recently increased slightly, it is now abnormally low for developed market equities compared to their own 5-year history. Even REITs, which are considered to be more defensive, have shown a higher variability in returns over the past 60 days.

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: 17/01/2015 - 17/01/2020

Implied volatilities also benefited from the easing tendencies, although numerous political trouble spots remain.

The VIX has returned to a level at which the equity market is vulnerable to setbacks. Meanwhile, the implied volatility in the currency market has marked a new all-time low.

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: 01/01/2015 - 17/01/2020
The upward trend in economic surprises has continued over the past two weeks. Both economic surprises for the industrial nations and on a global level have recently turned positive.

- Economic surprises have also reached positive territory in emerging markets. In China, imports and exports, industrial production and retail sales rose more than expected in December. The economy grew by 6% (YoY) in Q4.

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 17/01/2020

- The economy in the eurozone has on average also recently been able to surprise positively. Industrial production from November exceeded expectations in Germany (+1.1%) and France (+1.3%). Factory Orders in Germany (-1.3% MoM) and consumer confidence in France were disappointing.

- In the USA, the Empire State Index for business activity in the manufacturing industry surprised positively, while retail sales rose as expected (+0.3% MoM).

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 17/01/2020

- In the UK, industrial production fell more sharply than expected in November. The same applies to retail sales in December, which fell by 0.6%.

- Core Machine orders for November surprisingly rose by 18% (MoM) in Japan.

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: 01/01/2015 - 17/01/2020
OECD Leading Indicator

- The OECD leading indicator continued to rise in November. At least according to this indicator, the global economy is on the road to recovery. This is also suggested by the number of countries with a rising indicator compared to the previous month. The value was recently close to the 50% mark.

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 - 31/11/2019

Manufacturing Purchasing Managers Index (Manufacturing PMI)

- The global purchasing managers’ index fell slightly to 50.1 points in December, but remains above the important growth mark of 50 points.
- The US ISM index for December has fallen to its lowest level since 2009.

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: 30/09/2016 - 31/12/2019

Headline Inflation

- Inflation in the US rose to 2.3% in December, the highest level since October 2018. The main driver was the year-on-year increase in energy prices.
- In the euro area, inflation has also recently risen to 1.3%.
- In China, inflation remained stable at 4.5% in December. Food prices remain high as the price of pork continues to rise.

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: 31/10/2009 - 31/12/2019
Thanks to the escalation in the Middle East, the Japanese Yen was temporarily high in the favor of investors. However, the safe haven fell sharply as tensions in the Iran conflict eased and the "Phase 1" deal was signed.

The euro, US dollar and emerging market currencies have been trending sideways on a trade-weighted basis for the past two weeks.

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.

There has been no clear trend in the euro against the regions shown here the past four weeks.

Among the biggest losers were the Brazilian real and the Chilean peso. The reasons for this were the ongoing protests in the region and the expansionary course of the local central banks.

In the wake of the Iran conflict, cryptocurrencies were in strong demand again due to their function as uncorrelated investments.

In the last two weeks, the euro-dollar exchange rate exhibited no clear trend. Further impulses from the Fed or the ECB seem to be off the table at the moment. Economic developments on both sides of the Atlantic therefore remain decisive. At present the US dollar is again trading below the 1.12 euro mark.

The interest rate differential has temporarily fallen below 2% for the first time since the beginning of 2018.
European Sector & Style Performance

<table>
<thead>
<tr>
<th>Sector</th>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>£W (20/12/19 - 17/01/20)</td>
<td>£W (31/12/18 - 17/01/19)</td>
</tr>
<tr>
<td>Information Technology</td>
<td>1.7</td>
<td>39.9, -6.6, 23.2, 14.8, 4.4</td>
</tr>
<tr>
<td>Utilities</td>
<td>-0.1</td>
<td>31.7, 5.2, 11.5, 0.3, -4.9</td>
</tr>
<tr>
<td>Health Care</td>
<td>3.4</td>
<td>33.6, 2.5, 3.0, -0.7, -4.0</td>
</tr>
<tr>
<td>Growth</td>
<td>3.8</td>
<td>32.4, -7.5, 13.7, 7.9, 0.9</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>2.6</td>
<td>31.0, -13.1, 11.7, 13.2, -3.2</td>
</tr>
<tr>
<td>Consumer Staples</td>
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<td>25.8, -6.0, 8.7, 6.1, 4.7</td>
</tr>
<tr>
<td>Industrials</td>
<td>1.7</td>
<td>33.1, -12.7, 18.3, 23.6, -4.0</td>
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<td>Energy</td>
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<td>Telecommunications</td>
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<td>Materials</td>
<td>-1.1</td>
<td>15.8, -18.7, 16.6, 13.9, -6.1</td>
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Changes in Consensus Earnings Estimates

- Technology stocks remain in demand in the new year. They have gained more than 5% so far.
- At the bottom of the European sector performance table are also industries that were already among the underperformers last year: financials and telecommunications.
- All in all, the sector trends for the new year are therefore continuing as last year ended.

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: 16/01/2015 - 17/01/2020

Earnings Growth

- Earnings revisions for the next twelve months are slightly negative in aggregate. Analysts have become more optimistic about companies in emerging markets though. Eastern Europe and Asia saw the largest positive earnings revisions.
- However, the changes in consensus earnings estimates are more negative for industrial nations. Downward revisions have occurred above all for Switzerland and Japan.

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 17/01/2020

Consensus forecasts the highest 2020 earnings growth for Latin America, followed by Asia Pacific ex Japan. Consensus is also optimistic for Germany following the weak earnings growth in 2019.

Overall, corporate earnings are expected to grow by 5% or more across all regions. However, history shows that analysts are almost always overly 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 17/01/2020
• Following the elimination of poor stock market performance in Q4 2018 from the rolling 12-month period, the contribution analysis looks much more positive.

• Over the past twelve months, both US and European equities have gained more than 20%. Earnings in the US have risen slightly, while they have stagnated in Europe. Consequently, the rise in valuations have been the main driver of strong equity market performance.

Analysis of the stock market drivers over the last 12 months. This takes into account the change in earnings estimates and the change in valuation (price/earnings ratio). EPS = earnings per share
Source: Bloomberg, Time period: 01/01/2010 – 17/01/2020

• European and particularly US stocks remain expensively priced relative to their own history. US equities are at similar levels seen towards the end of 2017, when markets anticipated the US tax reform.

• Compared to bonds, however, European equities remain favourably valued. The dividend yield stands at 3.5%, while German government bonds yields are still negative.

P/E valuation based on earnings estimates for the next twelve months for European and US equities and the respective P/E average since 1988 * For the Stoxx 600, the history prior to 2000 is of MSCI Europe.
Source: Bloomberg, IBES; Time period: 31/12/1987 – 17/01/2020

• All equity regions are priced expensively to their own history on both P/E and P/B basis.

• However, US equities are by far the most expensive and emerging market equities the least expensive.

Historical distribution of valuation indicators for selected stock regions since 2006, showing the current value, the observation four weeks ago and the historical median, the maximum (upper limit of the grey bar) and the minimum (lower limit of the grey bar).
Source: Bloomberg, Time period: 01/01/2006 - 17/01/2020
• At -0.22%, German 10-year government bonds are recording significantly higher yields than several months ago. However, the negative net new issuance in 2020 after central bank purchases should keep the rise in yields limited.

• The prospect of the Bank of England cutting interest rates has caused yields on British government bonds to fall.

• US government bonds saw yields fall on a monthly basis. Temporarily, the escalation in the Iran conflict caused yields to fall close to 1.75% in January.

Effective yield of 10-year government bonds and change in the last four weeks in basis points (in brackets).
Source: Bloomberg, Time period: 01/01/2015 - 17/01/2020

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 - 17/01/2020

After some members of the BoE’s Monetary Policy Committee said that an interest rate cut could be imminent, the market priced in the move.

Further interest rate cuts in the US have become less likely, as the Fed is satisfied with its current monetary policy.

For the euro zone, the market has priced out a rate cut until October.

Derivatives on money market rates - such as the Fed funds futures - can be used to determine changes (number of steps) in the key interest rate priced by the market.
Source: Bloomberg, Time period: 20/12/2019 - 17/01/2020

Implicit Changes in Key Interest Rates

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Credit Spreads Financial and Non-Financial Bonds

- Spreads on corporate bonds have fallen slightly in the last two weeks. EUR corporate bonds saw stable spreads. The friendly market environment, solid corporate key figures and positive capital inflows into the corporate bond market should allow spreads to fall further, at least temporarily.

Credit Spreads High Yield and Emerging Markets Bonds

- Spreads on emerging market and USD high yield bonds have fallen by more than 15 basis points thanks to increased risk appetite and the declining political uncertainty.
- However, EUR high yield bonds were hardly able to benefit from this. The spread narrowed by only three basis points.

Historical Distribution of Credit Spreads (in bp)

- Emerging market high-yield bonds saw spreads continue to fall, moving well away from the historical 10-year median.
- All bond segments appear historically expensive. USD high-yield bonds in particular are at the lower end of the 10-year range.
**Commodities Performance**

- Precious metals have shown a positive trend in the last four weeks across the board. Palladium continued its high flight thanks to the very tight supply situation and is now more than 50% more expensive than gold. Meanwhile, the sharp rise in the net long position of speculative investors boosted platinum.

- Base metals also recorded gains thanks to the partial agreement between the US and China and, most recently, better economic data.

Total return of selected commodity prices, in percent, sorted by 4-week performance. Source: Bloomberg, Time period: 20/12/2019 - 17/01/2020

**Crude Oil**

- As quickly as the fear of war between the USA and Iran came, it went after the Iranians’ response to the killing of Qasem Soleimani was far less drastic than initially feared.

- As a result, the price of Brent dropped sharply and is currently trading around USD 65 per barrel again.

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: 01/01/2015 - 17/01/2020

**Gold**

- Gold also had to give back some of its gains after the easing of the Iran conflict, but the price loss was less extreme than for oil. Gold proves to be the better hedge in times of geopolitical uncertainty in the Middle East. However, the price was not supported by ETF purchases as in the past, but by speculative investors.

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: 01/01/2015 - 17/01/2020
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