Current market commentary

After sliding into a bear market at record speed, the S&P 500 last week posted its strongest three-day rise since the 1930s. As absurd as it may seem, the Dow Jones has risen more than 20% from its low and has already started a new bull market. Is it a bear market trap or something more sustainable? No one can know for sure. While stocks have certainly priced in a huge amount of bad data, nothing can compare with the coronavirus in terms of the severity of the shock to the economy. In the short term, the further path of the stock markets depends strongly on the duration of the corona shock. It is therefore likely to remain very volatile. In the long term, however, there are many reasons not to be too pessimistic: in addition to the massive stimulus measures and the enormous relative attractiveness of equities, the dry powder of many investors - the holdings in money market funds have reached a record level.

Short-term outlook

The Q1 reporting season will provide a further insight into the Corona consequences. For the S&P 500, the reporting season will pick up speed with the Q1 figures of the major banks. J.P. Morgan and Wells Fargo will present their quarterly figures on the 14th of April. The limited share buyback programs during the reporting season are definitely depriving the market of important buyers. Tomorrow, China’s official Purchasing Managers Index (PMI) for the service and manufacturing industries will be released. This, and the Caixin PMIs released later this week, should provide further insight into China’s economic recovery. The Retail Sales (Feb) and Unemployment Rate (March) for Germany will also be released, as well as the U.S. Consumer Confidence. The March PMIs for the US, Italy and Spain will be released on Wednesday (Industry) and Friday (Services), and the US Labor Market data will be released on Thursday and Friday.

Severe daily fluctuations in the S&P 500 - easy go easy come?

The sharp countermovement in equities was supported by the rebalancing flows of pension funds, for example. Pension funds have to buy shares at the end of the quarter to get back to their target equity ratio.

We consider a continuation of the V-shaped recovery beyond the end of the quarter to be unlikely, even though there is further potential for the year as a whole.

We see the recovery more as part of a volatile bottoming in the coming weeks.

See page 2 for the 5-year performance of the S&P 500. Source: Bloomberg, Time period: 02/01/2020 - 27/03/2020
Multi Asset

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<thead>
<tr>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
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<tr>
<td></td>
<td>27/03/19 - 27/03/18</td>
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<tr>
<td>Gold</td>
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<tr>
<td>Brent</td>
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- 12-month periods over that last 5 years
- YTD (31/12/19 - 27/03/20)
- 4W (28/02/20 - 27/03/20)

MSCI World: MSCI World Net Return; MSCI Emerging Markets: MSCI EM Net Return; MSCI Frontier Markets: MSCI Frontier Markets Net Return; REITs: MSCI World REIT's Index; Global Treasuries: Bloomberg Barclays Global Aggregate Index; Global Corporates: Bloomberg Barclays Global Aggregate Corporate Index; Global Convertibles: Bloomberg Barclays Global Convertibles Index; Gold: Gold/USD Spot; Brent Crude: Bloomberg Brent Crude Futures Index; Industrial Metals: Bloomberg Industrial Metals Index; USDEUR: Price of 1 USD in EUR.

Equities

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<tr>
<td>Topic</td>
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<tr>
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<td>Stoxx Europe 50</td>
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<tr>
<td>S&amp;P 500</td>
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<td>MSCI UK</td>
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<td>Stoxx Europe Cyclical</td>
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<td>MSCI USA Small Caps</td>
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<td>MSCI EM Eastern Europe</td>
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- Over the past four weeks, Asian equities have held up best - at least in the large cap segment.
- Small caps have recently performed significantly worse than companies with a large market capitalisation, especially in the US. US small caps are suffering from their high net debt and the unfavourable sector structure (e.g. many oil companies). Investors fear that the coronavirus crisis could lead to liquidity bottlenecks.

Fixed Income

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<td>USD High Yield</td>
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<tr>
<td>EUR High Yield</td>
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- US government bonds were the only bond segment to close March on a positive note. Supporting factors were the Fed’s lowering of interest rates to zero, the announcement of unprecedented purchases of government bonds and mortgage-backed bonds and the initiation of various aid programs.
- High yield and hard currency emerging market bonds lost more than 10% in the last four weeks. Investors are increasingly worried about credit defaults.

Total return of selected asset classes, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 26/03/2015 - 27/03/2020

Total return of selected equity indices, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 26/03/2015 - 27/03/2020

Source: Bloomberg, Time period: 26/03/2015 - 27/03/2020

- The markets remain unpredictable. Over the last four weeks, almost all asset classes have continued to fall - even though equity markets recovered strongly last week. Even safe havens have hardly/not been able to gain recently.
- Brent oil remains the big loser since the beginning of the year, with a loss of more than 50%.
Speculative investors have recently reduced their "high conviction" positions. Particularly in the currency space, they now tend to be neutrally positioned in aggregate. The increased volatility in recent weeks has led to a declining risk appetite.

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: 24/03/2010 – 24/03/2020

Most recently, hedges were unwound in Europe and the US, mainly due to the strong performance of put options, for example.

As a result, put call ratios have recently fallen below their historical averages. This makes the markets somewhat more vulnerable in the coming weeks.

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 data have been available for the S&P 500 since 20 December 1993 and for the Euro Stoxx 50 since 24 February 2006.

Source: Bloomberg, Time period: 20/12/1993 – 27/03/2020

Cash is king! Money market ETFs have seen massive inflows over the past four weeks. Investors have sold off almost everything but gold.

Japanese equity ETFs are an exception: the Japanese central bank significantly increased its ETF purchase program in March and purchased more than 100 billion yen in Japanese equity ETFs on individual days.

Estimated ETF flows in percent of assets under management, sorted by 2-week average.
Source: Bloomberg, Time period: 31/12/2019 – 27/03/2020
As the coronavirus is now spreading rapidly in the United States, US private investors are very pessimistic - despite massive support from the Fed and fiscal policy.

Nevertheless, the proportion of bulls is only slightly below the historical average. Around one-third of those surveyed see the crisis as an opportunity.

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 - 26/03/20

Realised volatility is currently well above the historical average in all asset classes presented here. The coronavirus did not even spare government bonds.

Daily losses of more than 10% and the quickest correction of all time caused realised volatilities on the stock markets to explode.

REITs fluctuated the most because of their tendency to higher leverage and potential special arrangements for non-paying tenants.

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: 01/01/2015 - 27/03/2020

Implied volatilities have also skyrocketed. At 82, the VIX reached a all-time high on a daily closing price basis. The current panic on the stock markets is thus comparable with October 2008 - the peak of the financial market crisis.

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.

Stocks = VIX Index, Oil = OVX Index, Government Bonds = MOVE Index, Currencies = CVIX Index

Source: Bloomberg, Time period: 01/01/2015 - 27/03/2020
• The effects of the coronavirus on the global economy are now clearly visible. The economic surprises in all regions have clearly turned negative. Industrial production (Feb., YoY) in China has fallen by -13.5% and retail sales (Feb., YoY) by -20.5%, and consumer confidence in the US has dropped significantly.

• On the other hand, inflation in the emerging markets is expected to surprise on the upside, partly due to significantly higher food prices.

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 27/03/2020

• In the eurozone, the latest economic data has surprised on the downside. The Ifo Business Climate Index and the ZEW Index in March for Germany have provided a distinctly negative surprise. The Purchasing Managers’ Indices in France and Germany, especially for the service sector, were also weak.

• The US cannot escape the global economic slowdown either. The number of first-time applications for unemployment assistance has recently risen by 3.3 million.

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 27/03/2020

• In the UK, the purchasing manager index of the service industry was 35.7, which was disappointing along with the labour market figures.

• In Japan, the industrial purchasing manager index in March was the weakest it has been since the tsunami in 2011, at 44.8 points.

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 - 27/03/2020
The coronavirus is now fully impacting the economy. A global recession in 2020 can no longer be ruled out. As soon as the Corona wave weakens, the economy should recover significantly thanks to monetary and fiscal support. The continued low oil price also helps.

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 - 31/12/2020

After significantly worse PMIs in China in February, it has now hit the rest of the world. All industrial PMIs published so far in March have fallen well below the 50 mark, signaling a decline in industrial activity compared to the previous month.

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: 31/12/2016 - 27/03/2020

Aggregate global inflation fell slightly to 2.5% in February.

In the UK, inflation fell to 1.7% in February.

In Japan, inflation has dropped to 0.4%. A value below zero in March cannot be ruled out given the currently low energy prices. This was already the case in Switzerland and Taiwan in February.

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: 28/02/2010 - 29/02/2020
The winner on a trade-weighted basis over the past two weeks was the US dollar. Although the Fed had drastically cut the key interest rate, the dollar was in strong demand thanks to its function as a safe haven.

The Japanese yen, on the other hand, has had to give back a large part of its gains as investors are increasingly concerned about the impact of the corona crisis on the already weak Japanese economy.

In the last four weeks, the euro has held its ground against almost all the currencies presented here. Since the beginning of the year, only a few foreign currencies have shown a stronger performance.

As a result of the massive unwinding of so-called carry trades, the euro has been able to appreciate, particularly against the high-interest rate currencies in the emerging markets.

Crypto currencies also failed to provide any protection in recent weeks.

The sudden strength of the euro against the US dollar was short-lived. After Europe started becoming the epicentre of Covid-19, the common currency had to give way and is currently trading at around 1.10 US dollars per euro.

The interest rate differential between Treasuries and Bunds narrowed further following the Fed’s announcement of unlimited quantitative easing.

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.

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Energy and finance have been the big losers over the last four weeks. European energy companies are suffering from the sharp drop in oil prices and the financial sector from falling interest rates and the threat of credit defaults due to the coronavirus.

As both sectors are strongly represented in the value investment style, it is not surprising that the underperformance of value versus growth has persisted.

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.

With the exception of the Swiss equity market, which is benefiting from its defensive sector structure (many consumer staples and pharmaceutical companies), all other equity regions have seen significant negative earnings revisions.

Eastern Europe and Latin America saw the biggest negative changes in earnings estimates - more than 20% last month alone.

In Germany, earnings estimates were also revised down by a substantial 10% last month.

The consensus still expects positive earnings growth for many equity regions, including Japan and the US.

In view of the impending deep recessions in many regions of the world, we consider this to be far too optimistic.

Further negative earnings revisions should follow.

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 27/03/2020
Contribution Analysis

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

Historical Distribution: Price/Earnings and Price/Book Ratio

In the wake of the coronavirus crisis, risk premia for equities have risen sharply and valuation levels have fallen accordingly. The analysts, who initially adjusted their earnings estimates only slowly, have recently made strong negative revisions.

Over the past 12 months European and US equity markets have fallen by around 20%.

Last week’s strong rebound in US equity markets has led to the S&P 500 now being valued at a similar P/E ratio to the sell-off in December 2018. We are far from the levels of the financial crisis.

European stocks have already priced in more.

In contrast to 2008, however, equities are much more attractive relative to bonds. Even in the US the dividend yield is now higher than the yield on 30-year Treasuries.

In times of crisis, market participants often look at the price/book ratio, which puts market capitalisation in relation to the book value of a company (assets minus liabilities). Book values do not change as quickly and are usually easier to estimate than profits. European and emerging market equities are already attractively valued on a P/B basis.
10-Year Government Bond Yields

- The winners of the Corona crisis, safe government bonds, recently saw yields rising slightly again. The yield on 10-year German government bonds, recently saw yields rising slightly again. The yield on 10-year German government bonds recently settled at around 0.7%.
- Italian government bonds have recently settled at around 1.3%.

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 - 27/03/2020

Yield Curve Steepness (10Y - 2Y)

- The steepness of the US yield curve has continued to increase and has jumped temporarily above the 50 basis point mark. Longer maturities for government bonds have thus become more attractive again, even if the interest rate risk should not be underestimated.

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 - 27/03/2020

Implicit Changes in Key Interest Rates

- For the time being, the market does not expect the Fed to cut interest rates further in 2020, which means that negative interest rates in the USA are not currently being priced in. However, the Fed has recently emphasised that it has not yet reached the end of its possibilities despite the massive purchasing programs.

An interest rate cut by the ECB by 10 basis points to -0.6% is priced in by the market at over 50%, probably for September.

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: 28/02/2020 - 27/03/2020
C O R P O R A T E  B O N D S

Credit Spreads Financial and Non-Financial Bonds

- Liquidity in the bond market remains very thin, which has caused spreads to rise further. In a two-week comparison, spreads on USD-IG corporate bonds have risen by almost 100 basis points. This was significantly more than for EUR-IG corporate bonds, which only saw a similarly high increase in financial bonds. The sector with the highest spreads is the leisure sector, followed by the automotive sector.

Credit Spreads High Yield and Emerging Markets Bonds

- Spreads on high-yield bonds reached new 5-year highs. The risk premium for emerging market high-yield bonds rose to 960 basis points, an increase of almost 200 basis points within two weeks. USD high yield bonds saw an expansion to over 700 and EUR high yield bonds to over 600 basis points.

Historical Distribution of Credit Spreads (in bp)

- Following the recent spread widening, spreads on EUR non-financial bonds and EM-IG bonds have risen to a new 10-year high.
- Compared to the 10-year median, all segments shown currently have significantly more attractive spreads.

Explanations see middle and bottom illustration.
Source: FactSet, Time period: 01/01/2015 – 27/03/2020

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: 01/01/2015 – 27/03/2020

Source: FactSet, Time period: 04/01/2010 – 27/03/2020
Commodities Performance

- In recent weeks, most commodities have recorded. Only gold could profit in this environment.
- The losses of industrial metals were relatively modest in light of the heavy sell-offs of cyclical stocks in the last four weeks. A quick recovery, however, seems unlikely.
- Energy commodities were punished twice: by the Corona crisis and the OPEC fiasco.

Total return of selected commodity prices, in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 01/01/2020 - 27/03/2020

Crude Oil

- Due to the international standstill in manufacturing and transportation, demand for crude oil is likely to decline for the first time since the global financial crisis. In combination with the massive production expansions by OPEC+, global storage capacities will probably not even be sufficient to absorb the excess supply in the short term. The sharp decline in prices in recent weeks is therefore hardly surprising.
- US shale oil producers have been hit particularly hard by the low oil price. 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 - 27/03/2020

Gold

- When the mantra "cash is king" dominated the market, even gold at times had to give way noticeably in the last two weeks.
- However, after the "Fed bazooka" it was able to make strong gains again. Thanks to negative real interest rates and low bond yields, the opportunity cost of gold remains very low and its relative attractiveness high.

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 - 27/03/2020
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