LATER RECOVERY
Heightened political uncertainty is weighing on sentiment and growth: a sustained economic recovery will be delayed at the very least.

LACK OF CATALYSTS
Equity markets have already priced in a stabilisation of growth and bond markets have already priced in several interest rate cuts by the Fed.

SUMMER WEAKNESS
Without a breakthrough in the trade dispute, anything more than a volatile sideways movement for equities over the summer seems improbable.
Dear reader,

The unusual environment of declining safe haven bond yields coupled with diminishing volatility continued in the second quarter initially. In late April, the equity markets neared or even surpassed their highs from the third quarter of 2018. But this environment could not last. A stabilisation of the global economy would have led to rising yields again, while the absence of stabilisation would have led to increased volatility. That is why we expressed our expectation, in “Horizon Q2”, that a phase of summer weakness would commence in May or June after the strong start to the year. Hence, we adopted a more defensive positioning in our portfolios.

And that is exactly what happened. The escalation of the US-China trade dispute and the absence of a Brexit solution effectively destroyed the hopes for a quick abatement of political uncertainty and a quick stabilisation of economic growth. The trend of recovering economic data did not continue. Data from China weakened again and even the US economy cooled a bit after the surprisingly strong start to the year. In May, the global purchasing managers’ index for manufacturing slid below 50 for the first time since 2012, pointing to a contraction of manufacturing activity.

With no agreement in sight, political uncertainty coupled with rising tariffs will continue to weigh on sentiment and economic growth and keep the markets in check. Therefore, a sustained stabilisation of economic growth will be delayed further, in all likelihood. Although the probability of a recession has increased, stabilisation in the medium term is still more probable. The lower bond yields support growth and favour asset valuations. Monetary policy is not restrictive and central banks can be expected to loosen it further. And the Chinese government will probably take further measures to stimulate growth if necessary.

However, positive catalysts will probably be lacking in the absence of a breakthrough in the US-China trade dispute. The equity markets are already pricing in a stabilisation of growth, and even if the US central bank lowers interest rates, as we expect, the market will have anticipated this, given that more than three interest rate steps over the next 12 months have already been priced in. Anything more than a volatile sideways movement for equities over the summer is unlikely, especially because key buyer groups will probably be inactive and systematic investment strategies appear to still be substantially overweighted in equities. Caution is still advisable.

In the Insights interview beginning on p. 14, Henning Gebhardt, Head of Wealth and Asset Management, discusses the challenges in the current market as well as business environment and Berenberg’s reaction to them. We hope you enjoy reading this issue.

Dr Bernd Meyer
Chief Strategist Wealth and Asset Management

FOREWORD

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PERSISTENT SUMMER WEAKNESS

IN A NUTSHELL

• Until late April, the equity markets had priced in a quick growth recovery and an abatement of political risks. Both will be delayed, in the best case.
• The lack of positive catalysts will probably continue for now. Anything more than a volatile sideways movement for equities over the summer seems improbable.
• Conversely, a considerable rise in safe haven bond yields is no longer to be expected for the time being. That will support gold, US treasuries and emerging-market bonds.
• A higher liquidity position should be kept in reserve in order to react when the situation changes.

Portfolio positioning at a glance
In our outlook for the second quarter, we had already anticipated a phase of summer weakness commencing in May or June and lowered our equity allocation to almost neutral. After the continued strong performance in April, we reduced our equity allocation to a moderate underweight in favour of positions in US Treasuries, gold and cash in May. The higher amount of cash on hand will enable us to react to opportunities and raise the equity allocation quickly if the situation improves, i.e., if there is a trade deal between the US and China. Within the equity allocation, we particularly reduced our position in emerging markets. Emerging-market equities cannot be expected to turn in a positive performance until global growth stabilises and the trade conflict eases. We are no longer underweighting bonds. However, our focus is on non-euro-denominated government and corporate bonds. Within the category of euro-denominated corporate bonds, we prefer bonds of solid issuers with short terms to maturity. Any widening of risk spreads would not affect the bonds of this category as much and the holding of positions to maturity will serve to avoid the realisation of losses.
Second quarter: strong start followed by sharp drop

The strong recovery rally from the first quarter continued in the second quarter initially as the equity markets neared their highs from the third quarter of 2018 and US equities actually surpassed them. With this historically very fast and strong recovery, the markets priced in a quick growth recovery and an abatement of political risks. Although there had been some indications in April that confirmed these expectations, they quickly proved to be premature. The trade dispute between the US and China escalated when President Trump announced new tariffs on 5 May. He then threatened to impose punitive tariffs on Mexico to enforce foreign policy goals and revoked trade advantages for India. The probability of a hard Brexit rose and the US’s tensions with Iran increased. Consequently, the trend of recovering economic data did not continue. Data from China weakened again as the purchasing managers’ index for manufacturing, for example, slipped below 50 in May. Even the US economy cooled after the strong recovery rally from the first quarter continued in the second quarter.

Due to these uncertainties, volatility returned to the markets and the equity markets largely gave up the gains from April. In fact, emerging-market equities are lower than at the end of the first quarter. Emerging-market equities and oil prices were adversely affected by the weaker outlook and the trade dispute. Safe government bonds and gold benefited and the market increasingly priced in earlier interest rate cuts by the US Federal Reserve (Fed).

Economic recovery: later, weaker, less certain

Economic data have continued to disappoint. The global purchasing managers’ index for manufacturing declined to 49.8 in May, falling below 50 for the first time since 2012 and signalling a manufacturing recession. Rising tariffs and persistent political uncertainty – as neither a quick agreement between the US and China nor a Brexit solution is in sight – will continue to dampen activity in the coming months. This uncertainty coupled with declining corporate profitability also worsened the investment climate. Consequently, global growth is increasingly dependent on consumer spending. For this reason, a solution to the trade disputes is important because the persistent uncertainty, the more volatile capital markets, rising prices due to tariffs and a possible rise of job insecurity could tarnish consumer confidence, which is still strong at the moment.

Although the probability of a recession has risen, a stabilisation of the global economy in the medium term is more probable. The lower yields support both growth and relative asset valuations. Monetary policy is not restrictive and central banks can be expected to loosen it further. Our economists now expect the Fed to lower interest rates twice by the end of the year. And the Chinese government can be expected to take further measures to stimulate growth if needed. Furthermore, we are still firmly convinced that both President Trump and China need an agreement.

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After a strong start in April, there has been a mixed performance picture in Q2 - Dax and gold on top, oil and EM equities flopping

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Total Return</th>
<th>Year-to-date (YTD) and in Q2 2019 (in %, in EUR)</th>
<th>12-month periods of the last 5 years (in %, in EUR)</th>
<th>CAGR*</th>
<th>Std. dev.*</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>4.0%</td>
<td>YTD (31/12/18-06/19) 20.2</td>
<td>QTD (31/03/19-06/19) 19.4</td>
<td>18/06/19</td>
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<td>Brent</td>
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<td>Stoxx Europe 50</td>
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<td>EM Sovereigns</td>
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<td>MSCI EM</td>
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<td>Gold</td>
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<td>US Sovereigns</td>
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<td>EUR Corporates</td>
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<td>USD/JPY</td>
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<tr>
<td>Eonia</td>
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<td>-0.4</td>
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</tbody>
</table>

Source: Bloomberg  * CAGR = annualised return (in %, in EUR); Std. dev. = Annualised standard deviation (in %, in EUR).
Persistent summer weakness for equities

The lack of positive catalysts will probably continue as long as the US-China trade dispute remains unresolved. The equity markets are already pricing in a stabilisation of growth at the current level (upper chart) and even if the US central bank lowers interest rates, the market will have already anticipated this, having priced in more than three interest rate cuts in the next 12 months (middle chart). Moreover, many analysts’ profit estimates for this year and next year appear to be too high, considering the changed environment. We think it is realistic to assume that profits will grow at only a stable rate, or at most at a rate in the low single digits. Many companies can be expected to lower their outlooks in the second-quarter reporting season.

“The lack of positive catalysts will probably continue for now.”

For this reason, we do not expect anything more than a volatile sideways movement for equities over the summer, especially considering that key buyer groups will probably be inactive. After the recovery of equity markets since the beginning of the year, individual investors have largely pulled out of equities, as confirmed by the high level of fund outflows. While this offers potential for a market recovery in the long term, this group of investors will likely not return to the markets until they stage a significant rally. Systematic strategies of the kind employed by robo-advisors, for example, have driven the market’s recovery since the beginning of the year. Our research suggests that this group of investors is still substantially overweighted in equities (lower chart). Higher volatility and weaker price momentum will probably induce this group of investors to sell equities over the summer.

US Treasuries, gold, and emerging-market bonds preferred for now

We no longer expect bond yields to rise significantly in the summer months. We therefore consider gold and medium- to longer-dated US Treasuries to be increasingly attractive portfolio elements. They can serve as a hedge against an unexpected slowing of growth, which would probably be accompanied by lower interest rates, and in that scenario, 10-year US Treasuries, which are yielding around 2.1%, offer a much higher yield than European government bonds. Emerging-market bonds still appear to be more attractive than EUR or USD corporate bonds.

Dr Bernd Meyer, Chief Strategist Wealth and Asset Management
WEAK PHASE TO STAY - FRESH MOMENTUM IN THE AUTUMN?

IN A NUTSHELL

- Economy: global trade and manufacturing weaken further.
- The new trade dispute between China and the US delays the renewed recovery of manufacturing.
- China adds stimulus, central banks support the economy.

The manufacturing recession continues for now

A series of political crises and external shocks has knocked the economy off stride in Europe and East Asia. Besides the trade tensions stoked by the US, the growth weakness in China continues to weigh on business sentiment. Between March and May, there were many signs that the manufacturing recession in Asia and Europe was coming to an end. However, the unexpected escalation of the trade war between the US and China in late May heightened the risk that manufacturing weakness could last through the summer. We must be prepared for more bad news in the short term.

The economy in the Western world exceeded expectations in the early part of the year, due in part to exceptional effects such as the mild winter in much of Europe and the late Easter holiday. This year, a larger than usual number of holidays fell in April (thus in the second quarter), instead of in March. The second quarter numbers will likely be proportionally worse.

After the strong performance in 2018 and the good start to 2019, the US economy is currently losing momentum. Substantial slowing can be observed especially in manufacturing, due to the trade dispute with China. On the other hand, the solid growth of consumers’ real income suggests that the US economy can expand at a rate of around 2.5% in 2019.

In nearly all countries of the Western world, the primarily domestically-oriented service sector has been largely unaffected by the turmoil surrounding foreign trade. We expect that manufacturing will slowly recover in the autumn of 2019. When that happens, the unusual divide between manufacturing and services will gradually close again.

Trump is keeping the world on tenterhooks

In order for the economy in the Western world to pick up steam again, two conditions need to be met.

1. The trade tensions must ease. It cannot be said with certainty whether the US and China will be able to reach a partial agreement in the coming months after the latest escalation. However, the additional time (until mid-November) that Trump granted in the negotiations with the EU suggests that he would like to avoid a trade war with the EU. That would make sense for a president who wants to be re-elected next year. Considering that the US exports three times as much to the EU than to China, the EU could in the worst case retaliate so hard against US automobile tariffs that it would ruin

Somewhat brisker lending in China?

Chinese loans to households and businesses outside of the financial sector, annual rate of change in %

![Graph showing lending to households and enterprises from 2016 to 2019.]

Time period: 01/01/2016-31/05/2019.
Source: PBoC.

Moderate price pressure allows support by central banks

Core inflation, annual rate of change in %

![Graph showing moderate price pressure and support by central banks from 2001 to 2019.]

PCE for the USA and CPI for the Eurozone. Time period: 01/01/2001-31/05/2019.
Source: BEA, Eurostat.
Trump’s election chances. For that reason, we expect that the negotiations between the both sides will be long, tough and strident, but that it will not come to a genuine trade war.

2. China must overcome its pronounced economic weakness. Beijing has already taken steps to this end. The monetary and credit policy steps taken in late 2018 will gradually take effect in the form of somewhat brisker lending. Furthermore, China announced in early March that it will lower taxes (by around 2% of economic output), further loosen lending standards, and increase infrastructure spending again. If the new dispute with the US hits the Chinese economy hard, China could be expected to quickly launch another stimulus programme. Because such programmes only take effect after a delay, however, the news from China will probably remain somewhat mixed throughout the summer.

“The EU and the US have good reasons to avoid a costly trade war.”

Political risks in Europe
Despite making modest gains, the right-wing populists did not achieve the landslide victory in the European parliament elections that some observers had feared. In France, Marine Le Pen actually fared worse than she did five years ago. The risk that the populists could permanently disrupt European politics remains low. It is true that a loud dispute over national budget rules has broken out between Italy and Brussels. However, because Rome cannot afford higher risk premiums, Italy will eventually have to yield, in all probability, just as it did last autumn.

Central banks pivot
Wage pressure is rising only slowly in the US and Europe. Thus core inflation rates are either very low, at around 1% in the Eurozone, or well below the targeted rate of 2%, at around 1.6%, in the US. Central banks can therefore adjust their policies to reflect the outlook for the economy. The world’s two most important central banks have already reacted to the unexpectedly low inflation rates and the risks inherent in Trump’s trade policy. The Fed will already have ended the gradual run-off of its balance sheet by the autumn of this year. Furthermore, its latest statements suggest that it could soon cut interest rates. Therefore, we now expect that the Fed will reduce its interest rates in July and October 2019 by 0.25ppt at a time.

The ECB recently ruled out raising its base interest rates before mid-2020. The probability has also increased that it could cut interest rates and resume net bond purchases in the second half of the year. The turnaround of the central banks limits the downside risks for the economy.

Dr Holger Schmieding, Chief Economist

Growth and Inflation forecasts

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<th>2018</th>
<th>2019</th>
<th>2020</th>
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<tbody>
<tr>
<td><strong>GDP Growth (in %)</strong></td>
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<td></td>
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<tr>
<td>USA</td>
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<td>2.5</td>
<td>2.1</td>
</tr>
<tr>
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<td>World*</td>
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<th>2018</th>
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<tr>
<td><strong>Inflation (in %)</strong></td>
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<tr>
<td>USA</td>
<td>2.4</td>
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<td>World*</td>
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* Berenberg data on actual exchange rates, not purchasing power parity because PPP would give more weight to the fast-growing emerging-market countries
** Average, Bloomberg consensus as of 18/06/2019.
**THE SUMMER COULD WELL BE DIFFICULT**

**IN A NUTSHELL**

- While earnings estimate revisions for the developed markets have stabilised, emerging markets are still confronted with negative revisions. We expect further downgrades globally.
- Valuations are currently fair. An abatement of political uncertainty and an improvement of economic data would be needed in order for equities to rise further.
- The situation has recently worsened for emerging-market equities. Despite the medium-term potential, we prefer developed markets and frontier markets for now.

**Mixed equity market performance in the second quarter**

Whereas Asian emerging-market equities in particular sustained losses in Q2 as a result of disappointing economic data and the escalation of the trade war, European and US equities fared relatively well thanks to the support of a more cautious Fed, which seems to be no longer averse to interest rate cuts. German equities gained strongly after the market had already priced many negative factors into valuations. By contrast, UK equities were among the biggest underperformers, due in part to the heightened Brexit uncertainty after the announced resignation of former Prime Minister Theresa May.

**Sharp downward revisions for emerging-market earnings estimates**

Earnings estimate revisions for the developed markets have stabilised recently. In fact, UK and US companies have seen upward revisions. However, the situation for emerging-market countries has worsened further. Recent economic data have surprised to the downside to a degree not seen since 2013. As a result, analysts reduced their profit estimates further across all emerging-market regions, but especially for Asia and Latin America. Earnings expectations have been adversely affected by higher wages and tariffs, in addition to the heightened political uncertainty. Tariffs are likely to disrupt supply chains and squeeze companies’ profit margins. We expect that further downgrades will be necessary, especially to the European profit estimates for 2019. The consensus expectation for European companies’ profit growth is around 6%. We consider that to be too optimistic. Indeed, we expect profit warnings in the upcoming reporting season.

**Valuations are fair in comparison to their own history**

The price-earnings ratio (P/E ratio) for European and US equities has recently climbed with the rising stock markets. At 17.5, the P/E ratio of the S&P 500 is only slightly above the historical average though. The P/E ratio for the Stoxx 600 stands at 14.3, slightly below the historical average of 14.4 (since 1987). Thus, European equities appear to be relatively inexpensive.

**Developed markets and frontier markets preferred for now**

Emerging-market equities can be expected to underperform their peers in the industrialised nations in the coming months. The re-examination of international supply chains represents a significant challenge for emerging-market countries. These countries...
are also being adversely affected by the current weakness of commodities, disappointing economic data, negative earnings estimate revisions and fund outflows. We think that frontier markets (FM), i.e. the "emerging markets of tomorrow", are considerably more attractive. First, FM companies generate most of their revenues in their domestic markets and are therefore less dependent on the global economy and the trade war. Second, fewer international investors are invested in FM, which also means that less money can be withdrawn in the event of a crisis. FM equities are therefore less correlated with the broad equity market. Within the category of developed markets, we do not currently have a clear preference for Europe or the US. US equities are supported by the massive stock buyback programmes of US companies, the more cautious stance of the Fed, and a president who would like to be re-elected next year. However, US consumers are increasingly bearing the brunt of the higher tariffs – and if consumer confidence dips, consumer spending will probably take a hit. However, European equities are less expensive in terms of valuations and have the advantage that investor sentiment towards Europe is extremely poor, meaning that Europe can practically only surprise to the upside. However, the risk of a hard Brexit has risen and an (at least temporary) escalation of the trade war between the US and Europe cannot be ruled out. In any case, the summer months will probably strain the nerves of investors. We remain cautious with respect to equities.

Ullrich Urbahn, Head of Multi-Asset Strategy & Research

WHAT IS ON COMPANIES’ MINDS?

Still a tough environment for banks

At a recent European financial sector conference, we took the opportunity to speak with numerous relevant banks, insurance companies and stock exchanges in Europe. Our discussions with the big universal banks were mainly focused on four topics: 1) The low interest-rate environment and the difficulty in generating attractive income; 2) substantially increasing regulatory costs; 3) the rising pressure from digital banks such as N26 and Monzo and the resulting investment pressure; and 4) possible cost savings. These particular discussions were markedly different from our conversations with insurance companies and stock exchange operators, which were mainly about new growth opportunities and the opening of new markets. It is therefore not surprising that stock market operators, who enjoy the advantages of very high barriers to entry and a high proportion of recurring revenues, and specialist insurers feature prominently in our portfolios. The specialist insurers are benefiting from growing end-markets (protection against cyber criminality and retirement planning). These two sub-sectors should be able to generate growth regardless of the business cycle and interest rate environment.

Matthias Born, CIO Equities
BETWEEN SAFETY AND INCOME

IN A NUTSHELL

- Preventive: US Treasuries are still suitable as a hedge in crisis scenarios.
- Defensive: in the segment of corporate bonds, we prefer short durations and higher credit qualities.
- Lucrative: we still consider emerging-market bonds to be the most promising segment.

Challenging environment necessitates a differentiated view

Bond markets are in the midst of a challenging environment characterised by rising probabilities of an interest rate cut in the US, additional liquidity to be provided by the European Central Bank in September, weak inflation expectations, persistent political risks, and downward-trending economic forecasts. Based on these factors, we draw different conclusions for the different bond segments.

Safe government bonds: once declared dead, still live on

The sustained success of safe government bonds in the second quarter can be attributed to the above-mentioned factors. In mid-June, the yield of 10-year German Bunds reached a new all-time low of -0.33%, while the yields of US Treasuries and UK Gilts declined to their lowest levels of the current year. The Gilt yield actually fell to less than 0.8% for the first time since the autumn of 2016. Is this strength merely a sign of fear, a late rally before the inevitable crash? We think this is probably what will happen as soon as the political risks subside and the search for safety comes to an end. We anticipate an easing trend accompanied by rising yields again by the end of the year at the latest. For this reason and also in view of the negative yields, we do not recommend German Bunds in any case. Given the yield advantage of around 240bp, we do think that US Treasuries make sense for portfolio diversification purposes and as a hedge in phases of heightened uncertainty. Spanish and Portuguese bonds are also relatively attractive, despite the previous price gains and the somewhat lower yield levels in absolute terms. However, we are staying away from Italian bonds with longer maturities due to the smouldering conflict about the national government’s budget.

How long will the complacency last in the credit markets?

As we have been sceptical about the extent and speed of the recovery of credit markets since the beginning of the year, we have gradually withdrawn our exposure to corporate and financial bonds. After the difficult environment in 2018 and the initially ensuing significant recovery, many investors were inclined to reduce their exposures at the first sign of weakness in order to lock in profits. This trend could strengthen further. Studies suggest that the spread widening that began in late April has already led to the first outflows from the European high-yield segment. Over the summer months, when markets will have less liquidity, we expect spreads to widen further, especially in the segments of

Forecasts: Base interest rates and government bond yields (in %)

Comparison of Berenberg and consensus forecasts, values at the end of 2019 and the middle of 2020

<table>
<thead>
<tr>
<th>18/06/2019</th>
<th>31/12/2019</th>
<th>30/06/2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>USA</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>2.25 - 2.50</td>
<td>1.75 - 2.00</td>
</tr>
<tr>
<td>10Y US yield</td>
<td>2.06</td>
<td>2.30</td>
</tr>
<tr>
<td><strong>Eurozone</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>10Y Bund yield</td>
<td>-0.32</td>
<td>0.10</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>0.75</td>
<td>0.75</td>
</tr>
<tr>
<td>10Y Gilt yield</td>
<td>0.81</td>
<td>1.10</td>
</tr>
</tbody>
</table>

*Average, consensus as of 18/06/2019. Source: Bloomberg.
European high-yield bonds have not yet corrected sufficiently. Although the first spread widening occurred in late April (especially in the B segment) after the strong start to 2019, it is still too early to enter this segment. We are also cautious regarding the real estate sector, given the negative interest rates and high valuations. We could imagine re-entering the market on a broader front if risk spreads widen to more than 100bp in the European investment-grade segment and around 450bp in the high-yield segment (currently around 350bp).

Emerging-market bonds remain on a promising course. After a strong performance in the first quarter, emerging-market bonds denominated in both local currencies and hard currencies consolidated in the subsequent weeks, but without giving up much in the way of performance. Particularly in the local currency segment, investors used this trend to take accumulated profits from the two preceding quarters, as recently reflected in the declining capital inflows. Hard-currency emerging-market bonds actually posted a positive performance despite the negative exogenous factors. This was particularly due to the declining yields of US Treasuries—a phenomenon that more than offset the effect of tendentially widening risk spreads. In the hard-currency category, investment-grade bonds performed considerably better than high-yield bonds. These two asset classes remain attractive both in absolute terms and by comparison with other fixed-income segments. Relative to each other, moreover, these two assets classes have begun to converge again: yields in the hard-currency sub-segment are now slightly less than those of their local-currency counterparts. Over the long term, this segment is also attractive in comparison with US bonds, and international investors in particular are paying more attention to this comparison.

Conclusions: no change of favourites. There has been no change of favourites compared to the last issue of “Horizon”: Emerging-market bonds are still the most promising bond segment in our view, if the goal is to generate appreciably positive income. In the segment of corporate bonds, we advise investors to focus on higher-rated segments and shorter durations and to avoid cyclical and high-yield bonds. The time is not yet right to enter these segments on a broader front. The period of strength for safe government bonds will come to an end as soon as the various political crises are at least partially resolved, leading to improved economic outlooks and rising inflation expectations. To protect against the occasional turmoil to be expected in the meantime – and for the event that the economy worsens further, after all – investors can build up a protective counterweight by adding US Treasuries to their portfolios.

Martin Mayer, Senior Portfolio Manager Multi-Asset Christian Bettinger, Head of Fixed Income Robert Reichle, Head of Emerging Markets Selection
GOLD IS THE ONLY COMMODITY THAT GLITTERS

Wide fluctuations in the price of oil can be expected

The price of oil will probably continue to be subject to wide fluctuations. Driven by tight OPEC supplies and worries that stricter US sanctions against Iran would exacerbate the supply shortage, Brent crude had risen to as high as USD75 per barrel in early May. Shortly after that, however, the escalation of the trade war caused the price to plummet. Financial investors pulled back amid the risk-off environment as the growing growth worries, which imply weaker demand for oil, gained the upper hand. The supply shortage is not as clear-cut. US stockpiles are relatively high thanks to booming shale oil production, while supplies appear to be rather tight in the rest of the world – as reflected by the steep Brent futures curve and the high price difference between Brent and WTI. OPEC will probably extend its oil production cuts in the second half of the year to offset the growing supply of US oil. Whereas a stable oil price appears to be justified on the basis of fundamentals, the price pressure brought to bear by financial investors will probably continue in the short term.

Gold is likely to benefit from risk aversion and monetary policy

After a months-long consolidation phase, the price of gold has risen in the direction of USD1,350 per ounce. First, gold has benefited from its safe-haven status due to the numerous uncertainties. Second, it has been supported by the hopes for US interest rate cuts, leading to lower bond yields and real interest rates, as well as the underlying growth worries. Moreover, the hopes for interest rate cuts have also weakened the US dollar, which also helps the gold price. Although financial investors have increased their positions, there is still potential for a higher price of gold. In addition, gold remains attractive as a hedge against risks in the portfolio.

Growth worries weigh on industrial metals

A series of negative developments can explain the substantial declines in prices of industrial metals in the last few months: the trade war between the US and China, the various US tariffs, the further weakening of worldwide purchasing manager indices stoking recession fears, US dollar strength and the pull-back of financial investors have created a perfect storm. Without an end to the trade disputes and an economic recovery, including the all-important Chinese economy, the outlook for industrial metals will remain bleak. Only the possibility of additional stimulus measures gives reason for hope in the short term.

Guido Urban, Senior Analyst Multi-Asset Strategy & Research

The price of oil is still heavily influenced by investor positioning

The net long positions of non-commercial investors have been largely responsible for the wide fluctuations in the price of oil in the last few months.

Stronger ETF demand is supporting the price of gold

Due to the numerous political risks and heightened risk aversion, investors have fled to gold ETFs, causing the price of gold to rise.

Still no trend reversal in sight for industrial metals

The weakening of Chinese manufacturing, the trade war, and global growth worries continue to weigh on industrial metals.

Guido Urban, Senior Analyst Multi-Asset Strategy & Research

Source: Bloomberg.
MONETARY POLICY BRINGS NEW MOVEMENT

Currency markets in thrall to macroeconomic risks
Polical and macroeconomic conditions remain tense. Contrary to expectations, the situation of the main risks for the economy has not yet improved at the end of the second quarter. The trade conflict between the US and China has actually worsened in the last few weeks, and the success of Nigel Farage’s Brexit party in the European parliament elections has increased the probability of a hard Brexit. Therefore, the conditions for an economic recovery in the Eurozone are not yet met. This is a small setback for our fundamentally positive outlook for the euro.

Consequences for the US-Dollar by change of US monetary policy?
The US economy is still solid. However, the modest cooling that was already expected could be exacerbated by the escalation of trade disputes. That is why the Fed has signalled possible interest rate cuts. The market has reacted accordingly and the dollar has lost value, as could be expected. Consequently, the European single currency has risen from slightly over 1.11 to almost 1.13 US dollars per euro. We now expect two interest rate cuts by the Fed in 2019. Other central banks will likewise reconsider their course. The Bank of England can be expected to wait until 2020 to raise interest rates. The Australian central bank has already lowered its base interest rate, for the first time in three years. Therefore, currencies could be revalued in the currency market, leading to greater exchange rate volatility. We are sticking with our prediction that the euro will rise by the end of the year because the prospect of lower base interest rates in the US removes one of the arguments in favour of the dollar.

The pound reacts to the increased risk of a hard Brexit
As long as market participants still expected a soft Brexit, the pound was on top. One euro fetched only GBP0.85 in early May. Now that the risk of a hard Brexit has risen, one euro is now worth a little more than GBP0.89. The loss in value reflects the changed calculus resulting in large part from the European parliament elections. The probabilities of a soft or half-soft Brexit have fallen and extreme solutions are now more probable (Berenberg forecasts: hard Brexit: 35%; no Brexit: 25%). Moreover, the risk that left-leaning Jeremy Corbyn becomes prime minister has grown, and so the outlook remains uncertain. If it comes to a hard Brexit, the pound would probably crash and could even approach parity with the euro.

Dr. Jörn Quitzau, Senior Economist
INTERVIEW WITH HENNING GEBHARDT

Mr Gebhardt, you have been the Head of Wealth and Asset Management at Berenberg since the beginning of 2017. What kind of work do you do on a daily basis?
In a sense, I play a dual role: Head of Wealth and Asset Management on the one hand, and portfolio manager on the other hand. I bear responsibility for the entire division, including the strategic direction and important business decisions, for example. And as a member of the extended management team, I have other duties at the overall bank level. As a portfolio manager, I need to keep an eye on markets and companies because as the lead fund manager, I am responsible for the “Berenberg Equities Strategy Germany” fund. In this role, I hold many meetings with investors and clients throughout the world.

What differences do you see with your previous employer, Deutsche Bank? What makes Berenberg better and where must improvements still be made?
There are several things that make Berenberg different from a large corporation like Deutsche Bank. What I especially like about our bank is its agility, speed and the will to move forward. Large corporations tend to become sluggish, whereas the people at Berenberg operate like entrepreneurs at all levels to move our bank forward. We are an experienced and successful bank with a long tradition, but with the agility of a start-up company. Naturally, there are always things that can be improved and so we too are continuously optimising our processes and structures.

How do you position Berenberg in asset management and wealth management? What are your visions?
We strive for the highest quality in all our business categories. In five years, we want to be one of the strongest mid-sized asset management boutiques in Europe and the best-performing asset manager in German equities. Of course, it will take outstanding work to achieve these goals. In wealth management, we want to become the top bank in Germany with a full-range offering for our clients. It is also our goal to be a well-known institution in the ESG sector. The following slogan defines our approach: we are the personal, active and responsible asset manager, which acts with confidence and is committed to sustainability.

You have been a successful portfolio manager for many years. What is your investment philosophy and what is the secret of your success?
It begins with practicing your craft: a deep-dive company analysis and a thorough understanding of the markets are indispensable. Also, in fund management, you need to have a clear position and stick to your convictions. This can be difficult, of course, but as a fund manager you must be able to weather even difficult phases. We can see from the last 12 months how important this is. The market sell-off in late 2018 caught us flat-footed. But we did not get cold feet and we stayed true to our strategy. The reward is that the “Berenberg Equities Strategy Germany” fund, for example, is currently one of the best funds in its category.

Is something different now in the markets than in earlier years?
Yes and no! In principle, the equity markets work like they did before in that they reflect the expectations for the future trend of corporate profits. What has changed, however, are the factors influencing the markets: the importance of central banks is tremendous now due to the extremely long period of low interest rates. Moreover, technological progress, say in relation to electronic trading systems, has changed market liquidity. While these are technical factors in a sense, there has also been a change in sentiment. The old saying “polical stock markets always run out of steam” no longer applies without restriction. Precisely the sometimes erratic politics of Donald Trump and the whole trade war issue make the markets nervous and exert a major influence on them. I have never seen this before, to this extent.

Many funds in the market underperformed their benchmarks last year. Why does it still make sense to invest in an actively managed fund in this age of exchange-traded funds (ETFs)?
I don’t want to demonise ETFs. In many markets, it makes sense to use a passive fund instead of an active fund. We also use ETFs in our asset management operations. However, the active fund manager very often has an advantage over the passive product: he
Henning Gebhardt has been a member of the extended management board of Berenberg since January 2017. He is in charge of the Central Business Unit Wealth and Asset Management and is the fund manager of “Berenberg Aktien-Strategie Deutschland” fund. Before that, he worked in the Deutsche Bank Group for more than 20 years, lastly as a member of the management board of Deutsche Asset Management Investment GmbH. After completing his banking apprenticeship at Commerzbank, Henning Gebhardt studied business administration at Georg August University in Göttingen. He is also a CFA charterholder.

BRIEF BIOGRAPHY

Henning Gebhardt has been a member of the extended management board of Berenberg since January 2017. He is in charge of the Central Business Unit Wealth and Asset Management and is the fund manager of “Berenberg Aktien-Strategie Deutschland” fund. Before that, he worked in the Deutsche Bank Group for more than 20 years, lastly as a member of the management board of Deutsche Asset Management Investment GmbH. After completing his banking apprenticeship at Commerzbank, Henning Gebhardt studied business administration at Georg August University in Göttingen. He is also a CFA charterholder.

What has the MIFID 2 changed for your clients? What has it improved, what has it made worse for clients?
MIFID 2 fundamentally changed the basic operating conditions in the banking industry. Among other things, it led to a tremendous increase in documentation requirements. On the whole, the regulation has restricted flexibility to a tremendous degree. The entire process of interaction between clients and banks has become much more difficult. This applies to both individual clients and institutional clients. The way I see it, MIFID 2 has generally led to extra costs without producing any significant additional benefits for clients.

What are the greatest challenges, in your opinion, for the asset management industry in the coming years?
There are mainly two developments to be mentioned in this context: sustainable investment according to ESG criteria, and artificial intelligence (AI). The trend towards sustainable investment will become increasingly important, and a responsible asset manager must be able to give an answer to his clients. AI is also very exciting to date, only a very small portion of all available data is being used effectively for investment decisions. In the future, however, AI will make it possible to also evaluate unstructured and largely unused data such as texts and videos. AI can also analyse ESG criteria. However, AI will not be able to replace the active fund manager. Recognising connections and changed structures is a human talent. Besides that, someone needs to assess and interpret the flood of data.

Digitalisation and artificial intelligence are also becoming more important in the context of interacting with clients. What kind of digital offerings and services are you planning, or want to expand further?
We just finished redesigning our online service for clients and will make it live in the near future. And we are also working on new kinds of digital communication. Digitalisation will be one of the most important topics in the coming years, from the standpoint of both clients and banks. It will offer wonderful investment opportunities for investors, and banks will have no choice but to use digitalisation as a means of communicating with clients better and more directly. The banks’ interactions with clients will change dramatically. However, it will also require major investments, including in IT.

How have the “digital natives” changed your business?
The young generation of digital natives presents new challenges for banks. They have different expectations regarding how a bank communicates with them and conducts business with them. The way they interact with others and obtain information is different from old-style bank customers. The speed of change in this direction is not very fast at the moment, but that will change. As a bank, we must be prepared for that because the transformation will happen very quickly. You can just look at online shopping to see how fast business models can change.
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