CONTAGION RISK
Unless the political uncertainties subside and manufacturing stabilises, the weakness of this sector could also dampen consumer spending. However, a deep recession remains improbable.

EQUITIES ARE ATTRACTIVE
Equities are supported by increasingly negative bond yields, cautious investor positioning, historically positive Q4 seasonality, and loose monetary policy. Bond yields appear to have seen their lows for now.

LIMITED OPTIMISM
We have begun to selectively build up riskier positions in our portfolio. However, we would need to see signs of an economic recovery before substantially increasing the equity allocation.
FOREWORD

Dr Bernd Meyer
Chief Strategist Wealth and Asset Management

Dear reader,
For a long time, nothing more than a volatile sideways movement for equities occurred in the third quarter. The trade war escalated further, a no-deal Brexit became more probable and economic data did not stabilise. Although central banks lowered interest rates, they did not exceed the market’s high expectations. It was not until September that the situation eased somewhat, with burgeoning hopes for a solution in the trade dispute, the almost certain end to a no-deal Brexit on 31 October and the formation of a new government in Italy.

At first glance, markets still appear to be rather inconsistent. Considering the expected further interest rate cuts by the Fed, the low bond yields and the inversion of the US yield curve, the bond market is pricing in a recession scenario. In contrast, equity markets are surprisingly robust. How can that be? Cautious positioning, pessimistic investors and (hopes for) further support by central banks are playing a role in this discrepancy. However, the relative attractiveness of equities appears to be the more significant factor. The percentage of negative-yielding bonds has increased dramatically. Globally, this percentage is more than 25% and for euro-denominated bonds it is actually 36%. There is hardly any alternative to equities in the medium term. Stable dividend stocks and growth stocks in particular have benefitted. By contrast, many cyclical stocks have fallen below their levels at the beginning of the year and are pricing in a slowing of growth. The valuation difference between growth stocks and value stocks has reached new highs.

So what happens next? The easing of the situation triggered the first wave of a change of favourites in September, providing a foretaste of what would probably happen if growth begins to accelerate again. In this case, bond yields would rise and the price of gold would fall. The equity market would see a re-allocation in favour of low-valued cyclical stocks, e.g. in manufacturing and chemicals, with limited recovery potential for the overall market.

But risk remains. If the political uncertainties do not ease and manufacturing does not stabilise, the weakness could spill over to consumer spending. Profit estimates would be downgraded further and equity markets would undergo a correction. Considering fundamentals, however, there is practically no reason to fear a deep recession; the environment of moderate growth and low interest rates is likely to continue in the medium term, especially in Europe. This outlook for 2020 favours the first scenario of moderately rising equity prices until year-end. This scenario is further supported by the usually better seasonality for equities beginning in November and next year’s US Presidential election.

We have selectively taken riskier positions in the portfolio again over the last month. However, it still seems too early for highly aggressive positioning. In the meantime, market performance will probably still be heavily influenced by the Brexit drama and the trade war. I hope you enjoy reading this issue.

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Waiting for Signs of Economic Stabilisation

In a Nutshell

- Manufacturing weakness threatens to dampen consumer spending. In addition, the Brexit drama and the trade dispute continue to weigh on growth and markets.
- A deep recession remains improbable. Moderate growth and low interest rates will probably continue in the medium term.
- Declining and increasingly negative bond yields have increased the relative attractiveness of equities considerably, even though profit expectations are too high.
- Equities are supported by cautious investor positioning, the typically positive Q4 seasonality and loose monetary policy. Bond yields appear to have seen their lows for now.
- We have already reduced US Treasuries and cash in favour of equities, but maintain a moderate underweight position in equities. We would need to see signs of economic stabilisation before substantially increasing risk positions.

Portfolio positioning at a glance

In the expectation of persistent summer weakness, we had already substantially reduced our equity allocation in early summer in favour of gold, US Treasuries and cash. Within equities, we had especially reduced our position in emerging markets. Our portfolios have benefited from this positioning in the last few months.

Although we took the first step to selectively build up risk positions in the last month, we are still underweighted in equities. The cash position will allow us to end this underweight if we see clearer signs of economic stabilisation or of a solution of the current political risks. We are sticking with our gold overweight for the time being, for portfolio hedging purposes. We have already reduced our position in US Treasuries as economic stabilisation would lead to rising bond yields and a weaker US dollar. Then emerging market equities should also become attractive again. For the time being, we are only invested in frontier markets.

Portfolio Positioning at a Glance

Equities

- European equities
  - Germany
  - United Kingdom
  - Rest of Europe
  - US

- Out of Benchmark
  - Japan
  - Emerging Markets

Bonds

- Euro Corporate Bonds
  - Core Eurozone
  - Eurozone Periphery

- Euro Government Bonds
  - CORE ECONOMIC AREA
  - EMU PERIPHERY

- Out of Benchmark
  - Covered Bonds
  - Inflation Linked Bonds
  - EUR High Yield
  - US Government Bonds
  - USD Investment Grade
  - USD High Yield
  - Emerging Market Bonds

Duration

- Short
- Neutral
- Long

Alternative Investments

- Gold / Precious Metals
  - Other AI

Liquidity

- Short
- Neutral
- Long

Currencies

- EUR
- USD
- GBP
Looking back on the third quarter - mostly summer weakness

As we expected, positive market catalysts were lacking over the summer for a long time. This only changed in September with renewed hopes of an at least temporary settlement in the trade war and the reduced probability of a disorderly Brexit. In view of growth and recession fears, market participants had significantly raised their expectations of further Fed interest rate cuts by then. Bond yields declined substantially. The yields of 10-year Bunds reached record lows of -0.73% and the yields of 30-year Bunds turned negative for the first time ever. The yields of US Treasuries fell even further from their higher levels. Accordingly, the prices of government bonds rose considerably. The yields of 10-year Bunds declined substantially. The yields of US Treasuries fell even further from their higher levels. This only changed in September with the enactment of fiscal stimulus measures and/or the avoidance of a no-deal Brexit. These developments are not impossible, but they are also not yet foreseeable. The longer the uncertainty persists, the more probable it will be that consumer spending weakens, leading to a further economic downturn.

Dimming profit outlooks weigh on the economy

Without a stabilisation of industrial production, corporate profit outlooks will probably dim further. Already this year, there will be no growth of US corporate profits, despite 4.5% revenue growth, pointing to increasing pressure on profit margins. And global profit expectations for the coming year seem too optimistic. They will probably be reduced in the coming months. Espec-

<table>
<thead>
<tr>
<th>Total return</th>
<th>Year-to-date (YTD) and in Q3 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>
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<td>Brent</td>
<td>YTD (31/12/18-09/09) 22.5</td>
<td>12/09/18 -10.6 55.0 1.8 -18.4 -51.9</td>
<td>18/09/14 -11.2 35.3</td>
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<tr>
<td>S&amp;P 500</td>
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<td>18/09/19 14.1 16.1</td>
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<td></td>
</tr>
<tr>
<td>Gold</td>
<td>31.9 -6.1 -6.9 16.5 6.3</td>
<td>18/09/18 7.4 12.3</td>
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<td></td>
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<tr>
<td>Stoxx Europe 50</td>
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<td>18/09/17 4.0 15.4</td>
<td></td>
<td></td>
</tr>
<tr>
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<td></td>
<td></td>
</tr>
<tr>
<td>EM Sovereigns</td>
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<td>18/09/15 8.4 8.9</td>
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<td></td>
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<td>18/09/14 4.9 15.8</td>
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<td></td>
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<td>18/09/19 5.4 8.0</td>
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<td>EUR Corporates</td>
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<td>USDEUR</td>
<td>5.8 2.5 -6.7 1.3 14.3</td>
<td>18/09/17 3.2 8.4</td>
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<td></td>
</tr>
<tr>
<td>£/EUR</td>
<td>0.0 -0.1 0.0 -0.1 -0.1</td>
<td>18/09/15 -0.3 0.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bloomberg  * CAGR = annualised return (in %, in EUR); Std. dev. = Annualised standard deviation (in %, in EUR).
Equities supported by relative valuations and investor sentiment

The relative attractiveness of equities compared to bonds has increased dramatically due to the decline of bond yields. Thus, the difference between dividend and bond yields in Europe and the United States is at or close to extreme values in the past. Therefore, there is no real alternative to equities in the medium to longer term. In our opinion, however, an aggressive portfolio positioning in the coming months would require clearer signs of a stabilization of leading economic indicators and continued stable consumption.

Such signs are certainly imaginable in the course of the fourth quarter, especially considering that there are few reasons for a deep recession (no real economic excesses; no inflation that central banks would need to combat; low interest rates; no excessive indebtedness of private households). In that case, the shift of market favourites, signs of which were already evident in September, would be expected to continue for now. Bond yields would rise, but equities would probably only rise moderately for that reason. Favourably valued cyclical equities would lead the way. European and emerging-market equities would benefit. Gold would be adversely impacted, but would probably find support from a weaker US dollar. This scenario would also be favoured by the usually better seasonality for equities beginning in November and next year’s Presidential election in the US.

Especially weak relative performance for cycicals

Defensive and growth stocks have supported the equity market due to low interest rates; cycicals have declined along with inflation expectations.

Declining profitability crimps capital spending

Profits in the United States have hardly grown at all in the last 12 months, which is why companies are cutting back on capital spending.
ECONOMY WEIGHED DOWN BY TRADE WAR AND BREXIT

IN A NUTSHELL

- Economy: Global trade and manufacturing have weakened further. Brexit chaos is another negative factor for Europe.
- Fresh momentum in 2020 if the trade and Brexit risks subside.
- Central banks are supporting the economy and the markets.

No end in sight for the manufacturing downturn
A series of political crises and external shocks has knocked the economy off stride in Europe, East Asia and many emerging-market countries. Above all, the trade war between the United States and China is clouding business sentiment. The hopes for an early US-Chinese trade agreement were dashed in early May and again in late July. Both sides imposed new punitive tariffs on each other, effective 1 September. After business sentiment had stabilised in the spring, the downward pressure on global trade and manufacturing intensified again.

The outlook mainly depends on whether trade tensions will fade or escalate further. Whereas we had assumed that the United States and China would be able to narrow their disagreement within six months, we have since changed this assumption. Our forecast is now based on the assumption that the conflict will drag on into 2020, but will not worsen dramatically. Given the currently high level of uncertainty, companies are likely to hold off on decisions on whether to invest and where, and how they would like to re-arrange their cross-border supply chains. In the second half of 2019, global trade and industrial production in the developed world will probably be slightly lower than in the second half of 2018.

Countries that have specialised in the production and export of cyclical goods like machines, base materials, and automobiles are especially affected by this trend. Germany and Italy are on the verge of recession, as is the UK due to Brexit. We must be prepared for more bad news in the short term.

The downturn could bottom out in early 2020
If the trade war does not worsen dramatically in the coming months, a habituation effect could well take hold in the course of time. Given the still brisk demand of consumers for consumer goods around the world, companies cannot put off their investment decisions forever. We therefore expect that the downturn of global trade and manufacturing will bottom out in early 2020. After that, a subdued recovery could begin.

So far, consumers in the United States and Europe have been hardly affected by the manufacturing downturn. However, there are growing signs that employment growth is slowing. Consumer spending in the United States and Europe will probably lose some momentum in the autumn and winter.

Worldwide uncertainty
Index based on the relative frequency with which the three terms economy, politics and uncertainty are used together in newspaper articles.


The weakness is spreading: Manufacturing versus services
Purchasing manager indices for industrialised nations.

Time period: 01/01/2015–30/08/2019.
Source: Markit.
Political logic suggests that the United States and China will de-escalate their trade dispute well before the US elections in November 2020. Even though the strong services sector in the United States and a number of economic programmes in China will mitigate some of the damage, the trade tensions are taking an appreciable toll on manufacturing in both countries. In particular, US President Donald Trump can be expected to want to improve his re-election chances with a good economy in 2020, instead of endangering the US upswing by escalating the trade dispute further. If a US-Chinese trade agreement is concluded in the spring of 2020, global trade and manufacturing and the economy, also in Germany and the Eurozone, could return to normal growth rates.

**Growth and Inflation forecasts**

<table>
<thead>
<tr>
<th></th>
<th>GDP Growth (in %)</th>
<th>Inflation (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>2.3</td>
<td>2.3</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Germany</td>
<td>0.6</td>
<td>0.6</td>
</tr>
<tr>
<td>France</td>
<td>1.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Italy</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Spain</td>
<td>2.2</td>
<td>2.2</td>
</tr>
<tr>
<td>UK</td>
<td>1.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Japan</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>China</td>
<td>6.2</td>
<td>6.2</td>
</tr>
<tr>
<td>World*</td>
<td>2.4</td>
<td>3.2</td>
</tr>
<tr>
<td></td>
<td>1.8</td>
<td>1.8</td>
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<tr>
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<td>1.2</td>
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<td></td>
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<td>0.7</td>
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<td></td>
<td>2.4</td>
<td>2.4</td>
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<tr>
<td></td>
<td>-</td>
<td>3.0</td>
</tr>
</tbody>
</table>

* 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 18/09/2019.

If, on the other hand, the trade dispute escalates further in 2020, the Eurozone could slide into recession next year. In that case, even the US growth rate would fall considerably below the trend of around 2%. On the other hand, an early US-Chinese agreement could end the current downslide of the world economy and bring about a turn for the better before Christmas.

**Political progress and risks in Europe**

Now that a new and very pro-European government has been formed in Italy, the danger of a hard confrontation with the EU that would stress financial markets has diminished. In France, President Emmanuel Macron is continuing his growth-promoting reform policies and Greece is developing into an attractive destination for investments under its new government. However, the outcome of the Brexit debacle is still completely unclear. If the United Kingdom leaves the EU without a follow-on agreement, that would create a moderate impediment for the Eurozone economy for half a year. The United Kingdom would very probably slide into a light recession and then suffer from a permanently lower growth trend.

**Central banks as buffers**

Wage and inflation pressures are increasing only slowly in the United States and Europe. These risks are further lessened by the current economic weakness. Central banks can therefore adapt their policies to the outlook for the economy. Having already lowered its base interest rates twice in the third quarter, the US Fed will probably cut interest rates once again until the end of the year. The ECB also loosened its policy considerably on 12 September.

The pivot of central banks limits the downside risks for the economy. Although it will hardly stimulate demand, it will prevent financial turbulence that could be harmful to the economy.

Dr Holger Schmieding, Chief Economist
RISKS ARE LIKELY TO SUBSIDE IN THE FOURTH QUARTER

IN A NUTSHELL

• Negative profit estimate revisions have continued for emerging-market countries in particular. Further reductions of 2020 earnings estimates for all regions will probably follow.
• Equities are fairly valued by their own history. However, there are big differences between investment styles. Compared to bonds, equity valuations are extremely attractive.
• We like frontier market equities and plan to increase the allocation for European equities as soon as the outlook for the world economy improves.

Heightened volatility in the third quarter

The stock markets went through a roller coaster ride in the third quarter. Whereas most equity markets exhibited a positive performance in July, they turned negative in August. Besides weak economic data, an escalation of the trade dispute between the United States and China and the rising probability of a hard Brexit were the causes of the equity markets pullback. On the other hand, equity prices did not crash because many investors were already positioned pessimistically. Furthermore, central banks supported the markets with their indicated loosening measures, which were then actually implemented in September. Almost all equity regions rose in Q3, only cyclical European and German equities remained virtually unchanged.

Cyclical stocks underperformed due to the trade conflict and global growth slowdown in the third quarter

<table>
<thead>
<tr>
<th>Total return</th>
<th>Year-to-date and in Q3 (in %, EUR)</th>
<th>12-month periods of the last 5 years (in %, EUR)</th>
<th>P/B*</th>
<th>Div.*</th>
<th>P/E*</th>
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<tbody>
<tr>
<td>S&amp;P 500</td>
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<td>QTD (30/06/18-19/09/19)</td>
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<td></td>
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<tr>
<td>MSCI EM Eastern Europe</td>
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<tr>
<td>Russell 2000</td>
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<tr>
<td>Euro Stoxx 50</td>
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<tr>
<td>Stoxx Europe 50</td>
<td></td>
<td></td>
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<tr>
<td>Stoxx Europe Small 200</td>
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<tr>
<td>DAX</td>
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<tr>
<td>Stoxx Europe Cyclical</td>
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<tr>
<td>Stoxx Europe Defensive</td>
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<tr>
<td>MSCI EM Asia</td>
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</tbody>
</table>

Negative profit estimate revisions for 2020 are probable

The economic slowdown is also reflected in the latest profit estimate revisions of analysts. Profit estimates for emerging-market countries in particular have been downgraded. The slowing of global growth and higher tariffs are taking a toll. Whereas profit forecasts for 2019 have fallen substantially, the consensus still expects double-digit profit growth for many regions in 2020. For example, 14% profit growth is predicted for Germany in 2020. However, we consider this to be too optimistic in light of persistent economic weakness and heightened political uncertainty. Further downgrades will probably follow in the fourth quarter as analysts increasingly turn their attention to the next calendar year.

Equity valuations are cheap compared to bonds

The equity market is fairly valued by its own history right now. US equities are slightly more expensive, while European equities appear fairly valued. Nevertheless, there are big differences within equity segments. Whereas the valuations of defensive and growth-oriented stocks are ambitious, cyclical and value stocks are trading at a discount. In times of limited growth and low interest rates, this is not surprising because investors are willing to pay a premium for strong or high profit growth. Due to the high relative valuation difference between growth and value stocks, however, there is a risk of a change of favourites – as already observed in September – in the event of an overly sharp sell-off in the equity markets or, alternatively, an economic recovery. However, neither one of these scenarios seems to be
sustainable. We expect neither a deep recession accompanied by a long-term bear market for equities nor a strong economic recovery in the coming year. Growth will be rare, especially in Europe, and therefore the stocks of companies that deliver sustainable and steady growth will remain in demand. Equities are also benefiting from the increasing unattractiveness of bonds, which are increasingly yielding low or negative interest. Even in the United States, the dividend yield of the S&P 500 is currently higher than the yield of 10-year US Treasuries.

**Frontier markets (FM) preferred in the short term**

In view of the political uncertainty and the protracted trade dispute, we prefer FM equities to emerging-market equities as the former are only weakly correlated with the rest of the world. This is mainly due to the fact that such companies are normally focused on their domestic markets and only few international investors are invested in them. The near-term upside potential for European equities is probably limited due to the approaching Brexit deadline. Depending on the outcome, Brexit could fuel heightened volatility for European equities. However, we could see ourselves increasing our European equity allocation in the case of the US Presidential election campaign would be helpful for business-cycle-sensitive Europe. Another advantage lies in the fact that international investors are very cautiously positioned in relation to Europe.

**WHAT IS ON COMPANIES’ MINDS?**

**Trade dispute comes to the real economy**

The uncertainty surrounding the trade dispute between the United States and China is now starting to impact the companies we analyse. After the negotiations to eliminate the tariffs ended without success in late May, business investment in many parts of the Chinese economy was scaled back substantially. Electronics and automotive suppliers in particular are reporting revenue declines, in some cases substantial. Our contacts do not expect their order intake to improve until an agreement is reached in the trade dispute. Whereas companies had hoped for an economic recovery at the start of this year, these hopes have since dissipated. One of the few remaining bright spots in the cyclical sector is luxury goods, which have posted record results one quarter after another thanks to the continued strength of US and Chinese consumers. Another interesting observation is that many companies continue to invest in digitalisation despite the economic slowdown. While companies have implemented massive cost-savings programmes in many other areas, they have actually increased their IT budgets in some cases. We are benefiting from this trend with companies like Amadeus and SAP in our portfolio.

Matthias Born, CIO Equities

**Forecast overview: Equities will probably rise further**

<table>
<thead>
<tr>
<th>Index forecasts</th>
<th>Currently</th>
<th>30/06/2020</th>
<th>31/12/2020</th>
<th>In 12 months</th>
</tr>
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<tbody>
<tr>
<td>S&amp;P500</td>
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<td>1,050</td>
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<td>Dax</td>
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<table>
<thead>
<tr>
<th>Index potential (in %)</th>
<th>17/09/2019</th>
<th>31/12/2020</th>
<th>In 12 months</th>
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<tbody>
<tr>
<td>S&amp;P500</td>
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<td>4.8</td>
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<tr>
<td>Dax</td>
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<tr>
<td>MSCI UK</td>
<td>-</td>
<td>9.3</td>
<td>11.7</td>
</tr>
</tbody>
</table>

* Average, consensus, as of 18/09/2019.

Source: Bloomberg, FactSet, Berenberg.
IT WILL NOT GET EASIER (YET)

IN A NUTSHELL

- European government bond yields have plumbed record lows; US Treasuries are comparatively attractive.
- Corporate bond yields are increasingly negative in longer maturity segments; we have adopted a cautious position.
- Emerging-market bonds present opportunities, especially in the sub-segment of hard currencies.

Investors are still faced with tough decisions

The challenges for bond investors have not lessened of late, on the contrary. Although fears of recession and the expectation of additional central bank support have caused bonds to appreciate handsomely, these factors have not made the question of future portfolio configuration any easier. Nevertheless, we do see interesting opportunities here and there.

Government bonds: Yields in the basement

Once again, records have been shattered in Europe until the end of August. The yields of the 10-year government bonds of all larger countries in the Eurozone have reached new lows – mostly in negative territory. But even the yields of UK Gilts are lower than ever before. In the United States, prices of 10-year US Treasuries have likewise risen as yields have fallen, albeit not to record lows. That being said, US Treasuries have proved to be the best investment in the class of top-rated countries this year, thanks to higher basic interest and the comparatively greatest decline in yields; and we have benefitted from this in our bond portfolios.

How long can this unprecedented run go on? While we have revised our yield forecasts downward in view of the macroeconomic and political uncertainties, we expect that bond prices will fall from the current levels in our main scenario. This expectation is supported by the fact that additional expansive monetary policy measures appear to be largely priced in already and some central banks could certainly disappoint expectations in this regard. If, in addition, constructive approaches are found in the Brexit issue and trade policy, a rather quick turnaround in the government bond market would be both possible and probable. US Treasuries, which offer an attractive yield premium compared to European bonds and also exhibit favourable characteristics for portfolio diversification, remain relatively attracting.

Corporate bonds: No more bets - everything on the ECB

The third quarter has been very successful to date. At +1.04%, Euro-denominated corporate bonds in the investment grade segment have performed weaker than high-yield bonds (+1.79%). While risk spreads in the investment grade segment tended to move sideways, they fell slightly for high-yield bonds. After outperforming until the end of August, investment grade bonds underperformed their high-yield counterparts. The reasons for

Risk for government bonds: Losses ahead as yields rise?

Past and expected performance of 10-year government bonds, total effect of yield/change in price, coupon income and roll-down effect

<table>
<thead>
<tr>
<th></th>
<th>German Bunds</th>
<th>US Treasuries</th>
<th>UK Gilts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Return (5Y)</td>
<td>17.5%</td>
<td>19.4%</td>
<td>25.7%</td>
</tr>
<tr>
<td>Total Return (TR) YTD</td>
<td>(2.00 - 2.25)</td>
<td>1.77</td>
<td>0.00</td>
</tr>
<tr>
<td>TR until 30/06/2020 “Berenberg”</td>
<td>1.50-1.75</td>
<td>1.84</td>
<td>0.00</td>
</tr>
<tr>
<td>TR until 30/06/2020 “Consensus”</td>
<td>1.50-1.75</td>
<td>2.10</td>
<td>0.00</td>
</tr>
</tbody>
</table>

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

Comparison of Berenberg and consensus forecasts, values as of mid-2020 and year-end 2020

<table>
<thead>
<tr>
<th></th>
<th>18/09/2019</th>
<th>30/06/2020</th>
<th>31/12/2020</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>USA</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>2.00 - 2.25</td>
<td>1.50-1.75</td>
<td>1.90</td>
</tr>
<tr>
<td>10Y US yield</td>
<td>1.77</td>
<td>2.10</td>
<td>1.84</td>
</tr>
<tr>
<td><strong>Eurozone</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>10Y Bund yield</td>
<td>-0.51</td>
<td>-0.10</td>
<td>-0.33</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Base interest rate</td>
<td>0.75</td>
<td>1.00</td>
<td>0.71</td>
</tr>
<tr>
<td>10Y Gilt yield</td>
<td>0.64</td>
<td>1.10</td>
<td>0.76</td>
</tr>
</tbody>
</table>

this were both the lower risk premiums in the high-yield segment and the longer duration in the investment grade sector (5.1 versus 4.2 years) as interest rates rose. This poses a dilemma for investors: While a recession remains a risk factor, the restart of the ECB’s expansive policy provides hope. Such hopes explain the steady inflows into investment-grade (+8.3% of assets under management) and high-yield bond funds (+10.0%) since the beginning of the year. Consequently, whereas the yields of BBB-rated and A-rated corporate bonds were only negative in maturities of up to six months and almost two years in January, negative yields have since shifted to three (BBB) and five years (A) (see the graph at bottom left).

We have adopted a cautious positioning and prefer defensive sectors for short or medium maturity ranges. On the other hand, we are specifically avoiding the automotive sector and other export-heavy economic sectors. After the very good performance of insurance company bonds, moreover, we have become more cautious regarding these bonds, especially subordinated, because the long-lasting environment of low interest rates crimps their revenues and profitability and threatens their solvency ratios.

**Emerging-market bonds: hard currencies preferred**

Also in emerging markets, the positive performance of the last few weeks was mainly due to falling interest rates accompanied by largely stable risk spreads. If we are truly at the start of a new cycle of interest rate reductions, we consider this asset class to be very well supported thanks to both low funding costs and the structurally higher need for positive-yielding investment alternatives. This is also reflected in the capital inflows to date, which have more than doubled compared to all of last year. Capital inflows this year could become the second-strongest since 2013.

If on the other hand, the direction of interest rates points to a nearing and long-lasting economic slowdown, lower-rated emerging-market countries in particular will not be unaffected. In view of this uncertainty and the comparatively high prices of local-currency bonds, we are currently inclined to prefer economically more resilient and lower-volatility hard-currency bonds.

**Upshot: Opportunities can still be found even in the low interest-rate environment**

We still see the most attractive prospects in the search for positive income and appreciation potential in emerging-market bonds, with a preference for bonds denominated in hard currencies over their local-currency counterparts. In the event of economic weakness or an escalation of political disputes (e.g. international trade conflicts), US Treasuries are the instrument of choice for portfolio diversification. By contrast, Eurozone government bonds are largely unattractive due to record-low yield levels. Finally, corporate bonds offer some opportunities here and there, but defensive sectors should be preferred and overly long durations, as well as cyclical and export-intensive sectors, should be avoided.

**European corporate bond yields: negative in longer maturities**

In January, yields of BBB-rated and A-rated bonds were only negative in the ranges of up to six months and two years, now in up to five and eight years.

**Emerging-market bonds: strong inflows compared to last year**

Until late August of the current year, inflows into emerging-market bonds are already more than double what they were all of last year.

*Source:* Bloomberg.

*Source:* J.P. Morgan.

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**Robert Reichle, Head of Emerging Markets Selection**

**Christian Bettinger, Head of Fixed Income**

**Martin Mayer, Senior Portfolio Manager Multi Asset**
PRECIOUS METALS STILL OFFER OPPORTUNITIES

Oil prices are likely to trend sideways

Until the recent attacks on Saudi production and refining facilities, oil prices have declined in the last months due to economic and demand worries resulting from the trade war. The steep futures curve of Brent crude signals overly tight oil supplies in the short term, in particular due to Saudi production shortfalls. The recently slacking discipline of the OPEC+ countries in complying with the agreed production cuts has not had a sustainable effect. However, the oil market could be oversupplied from early 2020 onward if the expected expansion of oil production by non-OPEC countries comes to pass. Whether OPEC extends its production cuts again will be critical for the price of oil. The price of oil will probably trend sideways from now to the end of the year and then face headwinds next year.

Even after the rally, gold has more upside potential

Gold broke through its chart-technical resistance points and then began to soar in the third quarter, rising to more than USD1,550 per ounce, a new six-year high and a new all-time high in euro terms. Gold has benefited from the anticipated more expansive monetary policy of central banks, which led to a massive decline in bond yields and a growing volume of bonds with negative yields. Political risks and the lack of investment alternatives drove investors into gold, as evidenced by ETF inflows and high net long positioning. In the short term, gold appears to be overbought and a price decline would not be surprising, particularly if bond yields begin to rise. In the medium term, gold can be expected to benefit further from expansive monetary policy and remain in demand as a portfolio hedge.

Still no trend reversal in sight for industrial metals

Industrial metal prices have been dominated by the economic picture, so much so that some price-supporting fundamental data have been ignored. Industrial metals are being weighed down by globally weaker economic growth, persistently weak leading indicators for manufacturing, the escalating trade dispute between the United States and China, and the weakening of the Chinese yuan. Unless the trade war eases and Chinese manufacturing, which accounts for around 50% of worldwide metal demand, picks up again, there is no end in sight for the downward trend. Fiscal stimulus by the Chinese government could be supportive, but this is currently not foreseeable. A few positive outliers like nickel are bucking the generally weak outlook.

Guido Urban, Senior Analyst Multi Asset Strategy & Research

Oil: Investors are holding back due to economic worries

Speculative net long positions in oil are relatively moderate in a reflection of investors’ economic and demand worries.

The low interest-rate environment is driving the price of gold

The continually growing volume of bonds with negative yields, expansive monetary policy and political risks are driving the price of gold.

Devaluation of the Chinese yuan is weighing on metal prices

Amid the trade war, the Chinese central bank has allowed the yuan to depreciate, which is weighing on metal prices along with weak industrial demand.
FOCUS ON CENTRAL BANKS AND BREXIT

All eyes on China
The risk cocktail was already dangerous enough before being exacerbated by worries about a currency war. China has responded to US President Donald Trump’s sharper tariff policy with a weaker yuan exchange rate. As a result, the US dollar rose above 7.00 to the yuan in early August for the first time since 2008. This move makes Chinese exports cheaper and partially thwarts the trade policy goals of the United States. The United States then designated China as a currency manipulator. However, it is unlikely for now that the United States will expand the trade conflict to the currency market, but it is not completely out of question.

Fed poised to cut rates further, euro will probably stabilise
The euro’s weakness against the US dollar has continued. In the meantime, in fact, Europe’s single currency fell below USD1.10 per euro before rebounding a little. Generally speaking, however, the euro should be able to stabilise within the range of 1.10 to 1.11 because the Fed and the ECB are loosening monetary policy at the same time. After the Fed lowered its base interest rate in September for the second time this year, we expect another interest rate cut in the fourth quarter. The constantly intensifying trade tensions between the United States and China continue to pose a downside risk. Some of the current euro weakness or dollar strength can be attributed to the fact that the US currency is in demand as a safe haven in the current risk environment. Market sentiment could change if the trade conflict eases or at least does not worsen further. If the pessimism gradually fades, investors would show more risk appetite and slowly leave the dollar zone again. Nevertheless, a stronger upward trend for the euro is not to be expected in the fourth quarter.

Everything depends on Brexit
The British pound is mainly driven by Brexit news these days, with macroeconomic data playing a secondary role at best. Heightened fears of a hard Brexit had caused the euro to rise above 0.93 pounds per euro at one point. Only as it became clear that Prime Minister Boris Johnson’s strategy would not succeed did the British pound recover and the euro fall back to below 0.90. If it comes to a hard Brexit, however, the euro would approach parity with the pound.

Dr Jörn Quitzau, Senior Economist

EUR/USD: US dollar benefits from risk aversion
The US dollar is benefitting from the diverse risks and the euro is accordingly weak. However, the euro could benefit by the declining US yield advantage.

EUR/GBP exchange rate is driven by Brexit risk
Boris Johnson’s threat of a hard Brexit has recently driven the EUR/GBP. The exchange rate and the FTSE100 index develop in an inverse manner.

Exchange rate forecasts
The euro exchange rate would rise again if the weight of political risks is lifted.

<table>
<thead>
<tr>
<th>Exchange rate forecast</th>
<th>17/09/2019</th>
<th>30/06/2020</th>
<th>31/12/2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>EUR/USD</td>
<td>1.11</td>
<td>1.13</td>
<td>1.15</td>
</tr>
<tr>
<td>EUR/GBP</td>
<td>0.89</td>
<td>0.88</td>
<td>0.87</td>
</tr>
<tr>
<td>EUR/CHF</td>
<td>1.10</td>
<td>1.11</td>
<td>1.12</td>
</tr>
<tr>
<td>EUR/JPY</td>
<td>120</td>
<td>119</td>
<td>120</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Change against the euro in %</th>
<th>17/09/2019</th>
<th>30/06/2020</th>
<th>31/12/2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD</td>
<td>-</td>
<td>-2.0</td>
<td>-3.7</td>
</tr>
<tr>
<td>GBP</td>
<td>-</td>
<td>0.7</td>
<td>3.0</td>
</tr>
<tr>
<td>CHF</td>
<td>-</td>
<td>-0.9</td>
<td>-2.7</td>
</tr>
<tr>
<td>JPY</td>
<td>-</td>
<td>0.6</td>
<td>-1.1</td>
</tr>
</tbody>
</table>

*Average consensus as of 18/09/2019, Source: Bloomberg.
SUSTAINABLE INVESTING WITH BERENBERG

Growing awareness for sustainability
Topics such as climate change, CO2 emissions, plastic contamination of the world’s oceans and rainforest destruction are increasingly dominating political and societal discussions. Also in the financial sector, everyone is talking about “sustainable investing” and investors increasingly consider this to be important.

Sustainable investing is nothing new at Berenberg. For decades, we have managed investment strategies and mandates based on sustainability criteria for our clients. Our more than 425-year history means that we are fundamentally committed to sustainable business and action.

Our fundamental understanding of ESG
ESG, which stands for “environmental, social and governance”, is often used to describe sustainability factors. The sustainability of a business model and the integrity of a company’s management team are decisive factors influencing long-term value creation. By considering ecological and social criteria in making our investment decisions, we can avoid such risks in the portfolios we manage and increase return chances with a view to future challenges.

Developments and advances
At the beginning of 2018, Berenberg formed an ESG Office to underscore the importance of sustainable investing for our bank. The ESG Office is responsible for the sustainability strategy, integration, innovation and ESG-related product offerings. Berenberg has also signed the UN PRI, the UN-supported Principles for Responsible Investment. We apply our ESG approaches to all asset classes, have established ESG exclusion criteria and adopted our own voting guidelines for proxy voting.

ESG-compliant investment offerings at Berenberg
We apply ESG criteria in asset management and mutual funds. Various multi-asset strategies and the “Berenberg-1590-Stiftung” fund invest according to our own ESG criteria. In addition, we offer tailored mandates for clients with individual investment restrictions or sustainability convictions. We offer the “Berenberg Sustainable Emerging Market Bonds” fund and the “Berenberg Sustainable World Equities” fund as single asset-class mutual funds. But even our strategies and portfolios that are not explicitly ESG-compliant increasingly fulfill minimum requirements by excluding ESG-controversial companies such as weapons manufacturers, for example.

ESG integration process in our portfolio
To analyse ESG-related opportunities and risks, we rely on our in-house research and obtain data from third-party providers such as MSCI to better understand a company’s sustainability profile – both in relation to exclusion criteria and with a view to general ESG factors. Our ESG approach to investment selection combines a number of different methods such as exclusion criteria, impact investing, best-in-class approaches and the consideration of ESG criteria in our basic evaluation process. Thus, we pursue a bottom-up approach, analysing companies and countries on the basis of our sustainability criteria in order to ensure long-term profitability and ESG compliance. We consider ESG criteria both with respect to direct investments in government bonds, corporate bonds, and equities and with respect to the selection of ETFs and investment funds.

Monitoring the ESG compliance of single-asset investments
We consider ESG risks not only in making purchase decisions, but also during the entire holding period, and apply them as decision criteria for sales of equities or bonds. Thus, we perform ESG analysis regularly in the course of reviewing portfolios. With the aid of a detailed ESG database, we monitor every one of our investments with respect to various ESG issues. We regularly communicate with the company’s management team to gain a good understanding of relevant ESG topics and emerging risks. Using the MSCI’s ESG data, we also pay attention to problems that could arise in companies or countries, including conflicts that could pose ethical questions. In such cases, we mark companies with an orange or red flag. These two colours signal a high degree of controversy and point to heightened risks. When a company is marked with a red flag, we rule out direct investments in this company in all our portfolios.

<table>
<thead>
<tr>
<th>Flapping</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minor controversies</td>
</tr>
<tr>
<td>Moderate controversies</td>
</tr>
<tr>
<td>Questionable controversies</td>
</tr>
<tr>
<td>Very Severe controversies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Active Engagement</th>
</tr>
</thead>
<tbody>
<tr>
<td>No analysis of controversies</td>
</tr>
<tr>
<td>If controversial, no further research and, if applicable, no start active engagement with the relevant companies.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Assessment and Follow-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not Excluded</td>
</tr>
<tr>
<td>Discussions and assessing if position is removed from the portfolio. Ongoing monitoring of investments in the portfolio.</td>
</tr>
</tbody>
</table>

| Dr Rupini Deepa Rajagopalan, Head of ESG Office |
| Dr Bernd Meyer, Chief Strategist and Head Multi Asset |

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INTERVIEW WITH ANSGAR NOLTE

Mr Nolte, how can you offer investors added value for their portfolios in your asset management work?

In our investment process, we focus on two main sources of performance. The first is the tactical management of investment allocations based on our rather short-term assessment of markets and the search for attractive long-term asset classes and investments. The second important source of performance is stock selection, particularly in the European equity markets. Here we work closely with our equity portfolio management team, an experienced and successful team for selecting European equities.

How exactly do you work with the equity portfolio management team?

We constantly discuss the stocks in our portfolios and new ideas and decide whether to buy, increase, hold, or sell individual stocks. We can do this rather easily thanks to our physical proximity in Frankfurt. In some cases, we jointly attend meetings with companies, telephone conferences and analyst meetings. We purchase larger stocks directly for Asset Management. Our active funds, which we can purchase in Asset Management without paying an additional management fee, are well-suited for investments in smaller-cap and less liquid stocks.

Where else do you use investment funds and ETFs in Asset Management?

ETFs are well-suited for managing tactical positioning because they can be easily and quickly traded and are inexpensive. However, we will also invest in an active fund if we find a special market or segment to be strategically interesting and there are active managers with convincing qualitative and quantitative characteristics. When it comes to bonds, moreover, the market structure has changed dramatically. Many bonds can only be purchased in a minimum denomination of EUR100,000, so that it makes sense to use ETFs and funds for this purpose also.

What can investors expect of Berenberg’s expertise and investment philosophy?

Every active manager should strive to create added value for investors, meaning performance that exceeds a benchmark, by means of clear positioning. We are willing to accept deviations from the benchmark, which only serves as a general guideline. Our well-reasoned view of capital markets is what really matters. This approach also means that we should consciously act in an anti-cyclical manner when we consider that to be opportune, or even hold on to an unpopular position if we believe this is the right thing to do. By means of this approach, investors should reap higher returns over the long term, even if higher volatility must be accepted in the short term.

What are the biggest challenges for investors and portfolio managers right now?

In the current environment, I would point to the heightened political risks, which are increasingly having an adverse impact on economic growth. Above all, the development of US trade policy under President Trump and the pending Brexit. Although central bank stimulus is stabilising markets by reducing interest rates, which are then somewhat decoupled from the weak economy, this also causes something of an investment crisis for conservative investors because it makes real capital preservation nearly impossible for them.

BRIEF BIOGRAPHY

Ansgar Nolte has worked for Berenberg since 2011 and has been Co-Head of Multi-Asset Portfolio Management since 2013. In this role, he bears responsibility for balanced and aggressive asset management strategies and special mandates. Before joining Berenberg, he worked for several years as Senior Portfolio Manager for Deutsche Bank and UBS, so that he has more than 18 years of professional experience in portfolio management. He has also been a CFA Charterholder since 2007.
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Robert Reichele, CFA, CQF | Head of Emerging Markets Selection
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Guido Urban, CFA | Senior Analyst Multi Asset Strategy & Research
Is in charge of capital market publications, analyses commodities, supports the investment process and develops investment ideas

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Date: 19 September 2019

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