HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

MID-CYCLE YEAR

We expect neither a strong acceleration nor a deceleration in global growth, but unsynchronised growth between regions. This calls for a balanced position in regions, sectors and styles.

INFLATION

The development of inflation and central banks' corresponding reactions are likely to become the decisive factors for capital markets. We expect inflation to decline but ultimately become more persistent.

HEADWINDS

Rising (real) interest rates are weighing on valuations and earnings growth is falling. Fundamentally, the upside potential is getting smaller for equities, but alternatives are scarce due to the ongoing financial repression.

Q1 | 2022

BERENBERG
PARTNERSHIP SINCE 1590

FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear reader,

2021 was an exciting year in capital markets - especially under the surface, it was not an easy one, but ultimately a good one for investors. We were overweight equities throughout the year and broadly betting on higher commodity prices. Within bonds, where we were significantly underweight, our focus was on short duration, corporate and emerging market bonds. Our security selection within equities and bonds also made a positive contribution. As a result, our multi-asset strategies again clearly outperformed their benchmarks.

The fourth quarter brought the reflation-revival we had expected early on and the year-end rally was swift and strong - until the COVID-19 variant Omicron caused uncertainty. Both economic growth and inflation proved to be more sustainable than the market had expected, especially in the US, and economic data surprised to the upside. In China, there were signs of stabilisation. The burden of the fourth COVID-19 wave in Europe hardly played a role globally. However, the divergent development weakened the euro significantly.

For 2022, our economists expect continued strong economic growth and declining but ultimately more persistent inflation. For capital markets, this means headwinds: less fiscal and monetary support, rising, albeit still negative, real yields, as well as slowing profit growth and increasing margin pressure. Fundamentally equity markets now offer little potential. One thing seems clear, the outlook for equity markets over the next 12 months is less good than what was expected for 2021 and what the last 12 months have ultimately brought.

But "less good than 2021" should still be quite good, especially compared with other asset classes. After all, there is still no alternative to equities. Meanwhile, investors still hold large money-market fund holdings that are rapidly losing purchasing power. This should support equities for the time being, as should the not yet extreme positioning of systematic investors. Together with the typically good seasonality for equities into a new year, and in view of the recent positive growth surprises as well as the recent strong earnings revisions, we are sticking to a moderate overweight of equities for the time being. This will probably have to be reconsidered in the course of the first quarter, as the reduction of bond purchases by the central banks is likely to increase volatility again in the medium term. The risk of corrections could grow again with the increasing positioning of systematic investors. For the coming year, we see a higher probability of stronger setbacks. The development of inflation and the pandemic are the biggest factors of uncertainty.

In the Insights interview starting on page 14, our fund manager Christoph Mäder shows how to successfully invest in European bonds in a sustainable and impact-oriented manner. I wish you all the best for 2022.

CONTENTS

2022 – MID-CYCLE YEAR WITH EMERGING HEADWINDS

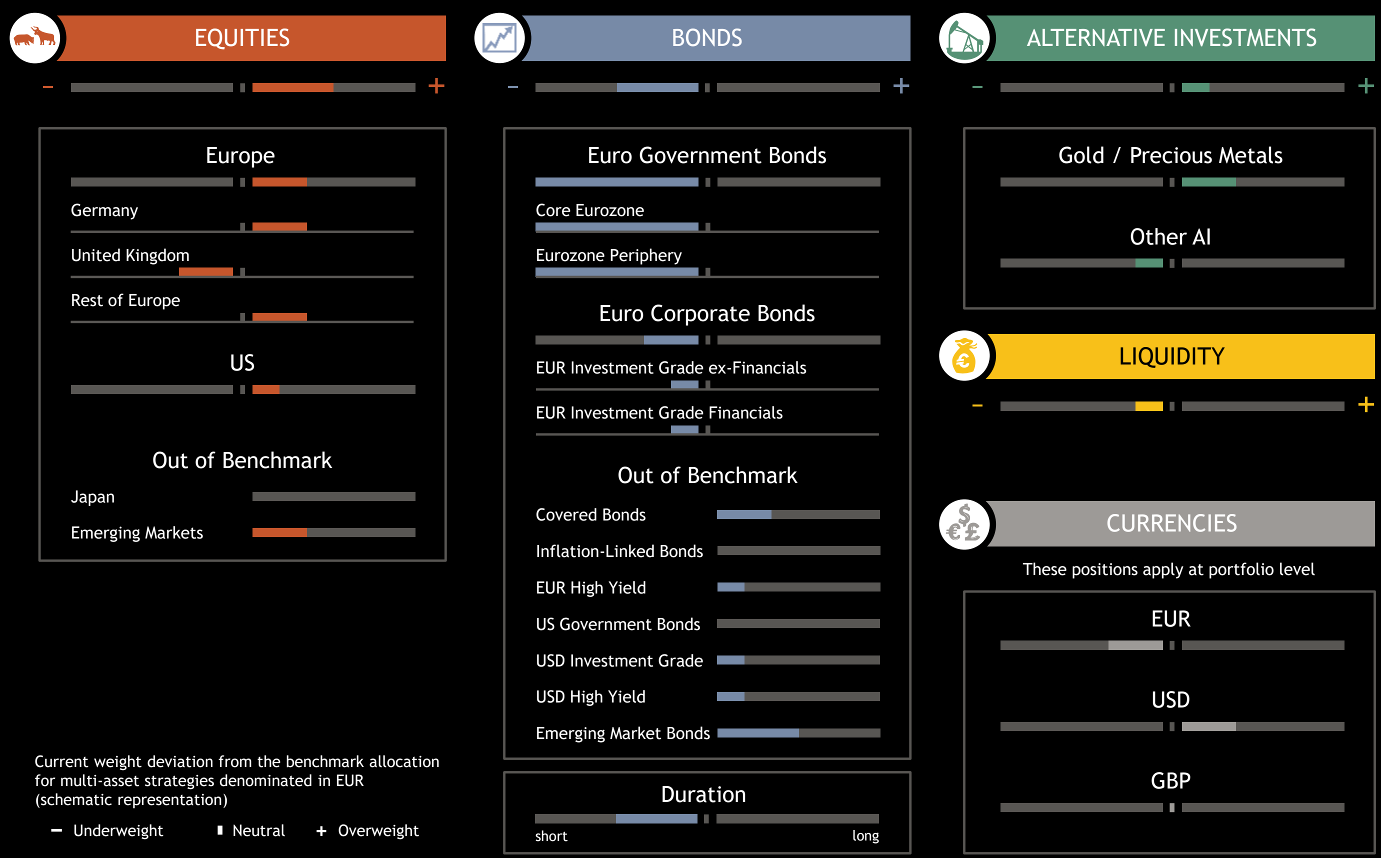
IN A NUTSHELL

- Strong economic growth with declining but ultimately more persistent inflation should determine the course of 2022. The development of inflation and the central bank reaction will be the decisive factors for capital markets.
- Rising (real) interest rates weigh on valuations and margin pressure weighs on earnings growth. Fundamentally, the air is thin for equities, but alternatives are hard to find, except for commodities, as financial repression persists.
- We expect a bottom-up market with unclear style or sector outperformance and many rotations. Setbacks of more than 5-10% become more likely.

Portfolio positioning at a glance

We started the fourth quarter with only a slight overweight in equities. We used the small market correction in September/October, the clarity about the tapering of the US Federal Reserve's bond purchases at the beginning of November and the reset due to the Omicron variant to increase the equity weighting in several steps to a moderate overweight. Among other things, we increased our position in Chinese equities with signs of stabilisation in China.

We are maintaining our overweight in equities for the time being. This is supported by the solid economic outlook, seasonality, high money-market fund holdings, the lack of alternatives and the recent positive earnings revisions. The overweight likely needs to be reconsidered in the course of the first quarter of 2022, as tapering is likely to increase volatility on markets again in the medium term. Government bonds remain unattractive and corporate bonds keep losing their appeal. Emerging-market bonds are more interesting. Gold is an important portfolio diversifier and other precious and industrial metals remain interesting portfolio additions in the face of negative real interest rates, increased inflation and structural demand from electrification.



Fourth quarter review - reflation revival and year-end rally

Growth and inflation proved stronger than expected in the fourth quarter, especially in the US. US equities and the US dollar continued to rise, the former also due to the strong third quarter earnings season. The weakness of equity markets into the fourth quarter had already been more than made up for by the end of October and the US Federal Reserve's announcement at the beginning of November that it would reduce bond purchases left hardly any traces. Continuous fund inflows and purchases by systematic investors drove US equities in particular from all-time high to all-time high. Only the new Omicron variant of COVID-19 caused temporary setbacks from the end of November. In the Eurozone, the fourth COVID-19 wave raged, resulting in renewed restrictions. In conjunction with higher inflation in the US, markets were increasingly betting on significantly earlier interest rate hikes in the US than in the Eurozone. The US dollar therefore continued to gain against the euro by more than 8% in 2021. Gold rose in the fourth quarter despite the strong US dollar, thanks to higher inflation and rising demand from India and China. Corporate and government bonds carried the red lantern.

2022 - mid-cycle year with strong economic growth

We expect economic growth to remain solid in 2022 and more positive global growth surprises in the first half of the year. After the disappointments of Q3 and Q4 2021, growth in the US and the UK has already surprised to the upside again recently. Stagflation in Europe is also likely to be temporary. Fewer disruptions in supply chains, inventory build-up, pent-up demand, business investment and high household and corporate savings are supporting growth. Government investments approved at the height of the pandemic have yet to be carried out. Growth in China is also showing signs of stabilisation and should recover somewhat in 2022. Ultimately, it is likely to be a year with neither a strong global growth acceleration nor a deceleration - a mid-cycle year with little synchronised growth in the regions and diverging central bank policies. Regional differentiation and diversification will become more important.

Inflation development and monetary policy central for markets

The development of inflation and the central bank reaction to it will be the decisive factors for capital markets. Inflation is likely to fall thanks to expiring base effects, as in the case of the oil price. This could initially be seen as a confirmation by proponents of the theory of transitory inflation. But they may be disappointed later in the year if inflation does not fall sharply or rises again after a significant decline. Even before the COVID-19 crisis, we expected inflation in the current decade to be above the level seen since the financial market crisis due to demographics, deglobalisation and decarbonisation. In our scenario, the US central bank should start raising interest rates in the second quarter. The ECB, on the other hand, is likely to remain more cautious for longer.

Challenges, but few alternatives for investors

Fading fiscal and monetary stimulus is likely to be more of a problem for markets than for the economy in the near term. Rising, albeit still negative, real interest rates are likely to weigh on highly

Equities performed strongly in the fourth quarter and gold recovered despite further US dollar strength - thanks to higher inflation

Total return	YTD and in Q4 21 (in %, EUR)		12-month periods of the last 5 years (in %, in EUR)					CAGR*	Std. dev.*
	YTD (31/12/20-14/12/21)	Q4 21 (30/09/21-14/12/21)	14/12/20 14/12/21	14/12/19 14/12/20	14/12/18 14/12/19	14/12/17 14/12/18	14/12/16 14/12/17	14/12/16 14/12/21	14/12/16 14/12/21
Brent	70.0	0.0	74.3	-37.6	19.6	6.3	0.6	6.8	36.2
S&P 500	35.7	10.8	39.0	7.2	26.4	4.3	8.5	16.3	19.2
Stoxx Europe 50	21.5	5.5	23.0	-6.2	22.2	-7.7	11.0	7.6	15.2
DAX	12.6	1.3	16.9	-0.4	22.2	-16.9	16.2	6.6	18.5
USDEUR	8.5	2.8	7.8	-8.4	1.7	4.2	-10.5	-1.3	6.4
EM Sovereigns	6.9	2.7	7.3	-3.4	15.4	-0.2	-0.9	3.4	7.6
MSCI EM	4.7	0.3	7.7	7.5	16.7	-7.4	18.7	8.2	15.5
Gold	1.2	3.6	4.5	13.4	21.2	3.0	-1.9	7.7	12.0
EUR Corporates	-0.4	0.0	-0.6	2.7	6.6	-1.9	3.4	2.0	2.3
Eonia	-0.5	-0.1	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	0.0
US Sovereigns	-0.7	0.0	-1.2	-3.3	8.3	4.6	-8.0	-0.1	5.6
EUR Sovereigns	-0.8	0.3	-1.0	2.0	3.8	-0.4	1.0	1.0	2.0

Time period: 14/12/2016-14/12/2021.
Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = Annualised standard deviation (in %, in EUR).

valued investments. Despite unabated high investment pressure (eg high money market fund holdings with negative real yields on the bulk of bonds and liquidity), a valuation expansion appears unrealistic. This fundamentally limits the potential for equities to earnings growth, which is likely to be in the low double digits at best, after the strong increase in 2021 and with increasing margin pressure. This is because not all companies will be able to pass on all price increases in the medium term. Otherwise, demand is likely to decline and growth to slow down. Companies with pricing power should be in focus.

Government bonds remain unattractive and offer less hedging potential, as in a mid-cycle environment with more restrictive monetary policy as well as core inflation rates above 3%, there is usually a stronger synchronisation of risk assets and government bonds (middle chart). Multi-asset portfolios become more vulnerable and should consider alternative hedges (eg option hedging strategies). Corporate bonds will also become less attractive given low nominal yields and risk premiums near all-time lows. In the absence of alternatives, equities and commodities are likely to remain in investors' favour for the time being. However, we expect greater differentiation, a "bottom-up" market with few clear style or sector winners and constantly changing themes. The low correlation between individual stocks, countries and regions will limit overall market volatility for the time being. Systematic investors are thus likely to further expand equity positions. This will continue to support the stock markets for the time being. However, at some point positioning could increase to levels seen at the beginning or middle of 2018 or the beginning of 2020 (lower figure), which would significantly increase the risk of sharper setbacks.

And what if things turn out differently?

If inflation falls more sustainably, the Fed is likely to reverse its tightening stance and bond yields will stabilise or even fall. This return to a "Goldilocks" environment that is neither too hot nor too cold would be positive for all assets. On the other hand, accelerating inflation or weaker growth, for example through further COVID-19 waves, and thus stagflation would be negative, especially for equities. As further risks, investors should keep an eye on (geo-)political risks such as the elections in France, the US midterm elections and the relationship between China and the US.

Prof Dr Bernd Meyer, Chief Investment Strategist

2022 - a challenging year awaits investors

Headwinds and changing market behaviour in a strong economic upswing

Base scenario
Mid-cycle year with emerging headwinds

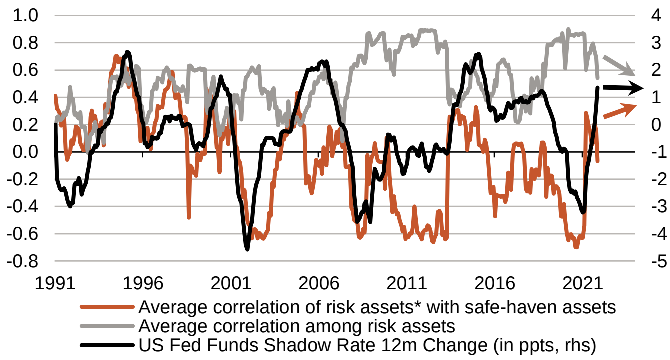
Solid economic growth, positive growth surprises	Declining but ultimately more persistent inflation	Less fiscal and monetary support	Rising but still negative real interest rates
Slowing profit growth, emerging margin pressure	Fundamentally little potential for equities, but "TINA" and dry powder remain	Government bonds unattractive, increasingly also corporate bonds	Bottom-up market, unclear style performance, declining market volatility

Bull scenario Return of Goldilocks	**Bear scenario** Stagflation or accelerating inflation

Source: Berenberg.

2022 - stronger correlation of risk assets and US government bonds

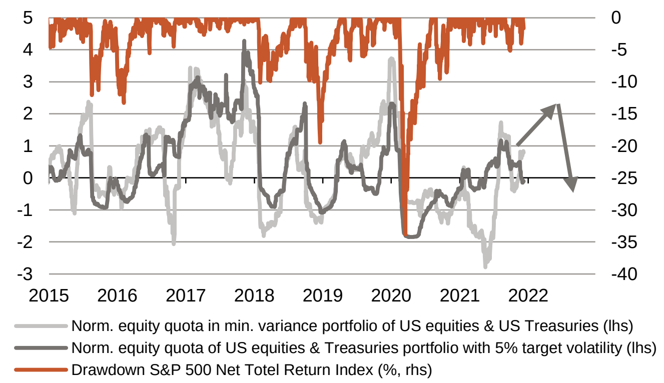
The orientation of central bank policy is a good indicator of which correlation regime (12M correlations) is currently in place



*(US-Large Caps, US-Small Caps, US-High-Yields, Commodities, REITs)
Time period: 01/01/1991-30/11/2021; Source: Bloomberg, own calculations.

2022 - setbacks of more than 10% become more likely

If volatility continues to decline, systematic investment strategies (with target volatility or risk parity) are likely to further expand their risk positions



Time period: 01/01/2015-14/12/2021.
Source: Bloomberg, own calculations.

POWERFUL UPSWING IN 2022 DESPITE HEADWINDS

IN A NUTSHELL

- Supply bottlenecks, Delta wave and Omicron worries briefly slow global upswing - outlook 2022 positive.
- Special effects drive inflation in 2021 - normalisation in 2022, slow upward trend thereafter.
- Central banks initiate the turnaround - ECB takes its time.

Dampener for the economy in Europe

After a growth spurt in spring and summer, the global economy has lost some momentum in autumn 2021. Especially in Europe and some emerging countries, the delta wave of SARS-CoV-2 infections is causing a new setback. On the European continent, where intensive care units are already overloaded in some regions, new restrictions are hitting parts of the service sector. In addition, there are concerns that the particularly contagious omicron variant could trigger a new wave of infections in early 2022 and require further restrictions on economic life. On the European continent, many leading economic indicators are pointing downwards again.

However, experience shows that economic development becomes more decoupled from the medical situation from wave to wave. From this perspective, there is much to suggest that the economic damage caused by the pandemic will be less than last winter. Moreover, postponed is not abandoned. As in spring 2021, a short-lived damper could be followed by a strong catch-up effect starting from February or March 2022.

In addition, supply bottlenecks are hampering industrial growth in large parts of the world. This particularly affects the industrial and export-heavy countries of core Europe. On both sides of the Atlantic, labour shortages are also preventing a rapid expansion of aggregate supply.

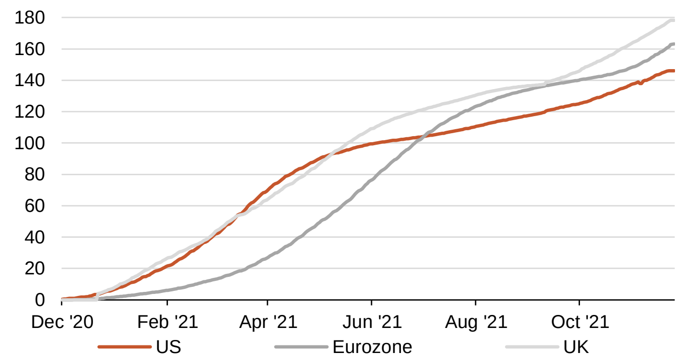
The prices for transport services and for scarce intermediate products are so high that they give companies and states a strong incentive to expand supply. Once scarce inputs are available, manufacturing could see a big jump in production in 2022.

Positive outlook for 2022

Beyond the current concerns about the pandemic and supply shortages, the outlook for 2022 remains positive. We continue to see a chance that growth can surprise positively in the course of 2022, just as it did in 2021. The recovery is broad-based. Companies on both sides of the Atlantic are looking for new workers. Employment is rising strongly. In the long run, this will further boost the incomes and spending of private consumers, who have accumulated considerable additional savings during the pandemic. In addition, companies want to invest more and restock their inventories. Many countries are also planning to increase their spending, especially on investment.

Vaccination progress against Covid-19

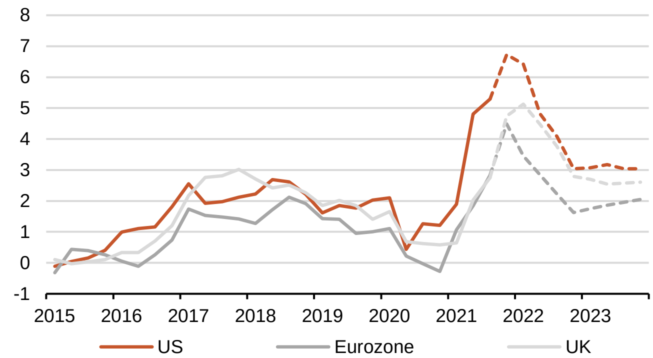
Total number of vaccinations, per 100 persons



Time period: 20/12/2020-14/12/2021.
Source: Our World in Data.

Inflation in the US, the Eurozone and the UK

Increase in consumer prices compared to previous year, in %



Quarterly data. Berenberg projections as of Q4 2021. Time period: 01/01/2015-31/12/2023.
Source: Eurostat, BLS, ONS, Berenberg-Projections.

The second theme of the year: Inflation

In addition to the outlook for the economy, the topic of inflation has increasingly come into focus in autumn 2021. A number of special factors have pushed up inflation rates even higher than expected, to 4.9% in the Eurozone and to 6.8% in the US in November. In addition to the expiry of the German VAT rebate and the extended levy on CO2 emissions in Germany, high transport costs and supply bottlenecks for goods are having an impact in Europe and globally. In addition, there is the base effect of the extraordinarily low oil prices from March to November 2020 and the overshooting of energy prices in autumn 2021. In view of high demand, many service providers also raised their prices when pubs, restaurants and hotels reopened.

Inflation will fall significantly again in 2022 - but remain higher than before the pandemic

In the coming year, these special and base effects will gradually fade out. Supply bottlenecks should slowly ease, even if it could take until well into 2023 before the supply of semiconductors finally matches the high demand. In addition, experience with earlier price forecasts suggests that energy should also be less overpriced in autumn 2022 than in autumn 2021. We therefore expect a noticeable year-on-year decline in inflation rates in Europe and the US.

However, the transatlantic difference in inflation is likely to remain. Unlike in the Eurozone, the fiscally stimulated excess consumer demand, especially for goods, is driving prices in the US. Wage inflation, which is likely to be much higher in the comparatively flexible labour markets of the US and the UK than in the Eurozone, will also contribute to the inflation differential. While inflation may briefly fall back below 2% in the Eurozone at the end of 2022, it will probably still be around 3% in the US.

Moreover, we continue to expect long-term inflationary pressures to slowly increase over time in the Eurozone as well, driven mainly by labour shortages and higher wages. Added to this are the higher costs of climate protection and potentially increased government intervention in the economy.

Central banks shift - ECB takes more time than the Fed

After years of very low inflation, central banks have long been reluctant to react to the rise in inflation. In the meantime, however, they have initiated the monetary policy turnaround. The US Fed aims to end its bond purchases in March 2021. We expect that the Fed will raise interest rates in four 25bp hikes in 2022, starting in Q2. While the ECB will significantly reduce its bond purchases from April onwards, it will probably not raise its key interest rates by 25bp for the first time until June 2023, followed by another step in December 2023 and three more rate hikes in 2024.

Dr Holger Schmieding, Chief Economist

Growth and inflation forecasts

	GDP Growth (in %)						Inflation (in %)					
	2021		2022		2023		2021		2022		2023	
		∅**		∅**		∅**		∅**		∅**		∅**
USA	5.5	5.5	4.1	3.9	3.3	2.5	4.7	4.6	4.6	3.8	3.1	2.3
Eurozone	5.1	5.1	4.5	4.2	2.9	2.4	2.6	2.5	2.5	2.4	1.9	1.5
Germany	2.6	2.8	4.2	4.2	3.0	2.2	3.2	3.1	2.7	2.6	2.0	1.7
France	6.7	6.7	4.4	4.0	2.8	2.2	2.1	2.0	2.1	2.0	1.8	1.5
Italy	6.3	6.3	4.6	4.5	2.2	2.1	1.9	1.9	2.4	2.3	1.7	1.2
Spain	4.4	4.5	6.2	5.8	3.5	3.3	2.9	2.9	2.7	2.7	2.0	1.4
UK	6.8	6.9	4.8	4.9	2.4	2.2	2.5	2.5	4.1	3.9	2.6	2.1
Japan	2.0	1.8	3.1	2.9	1.4	1.4	-0.1	-0.2	1.1	0.7	0.7	0.7
China	8.0	8.0	5.2	5.3	5.1	5.3	0.9	1.0	1.9	2.2	2.3	2.2
World*	5.7	-	4.3	-	3.5	-	-	-	-	-	-	-

* * Berenberg data at actual exchange rates, not purchasing power parities (PPPs). PPPs lend more weight to the fast-growing emerging-market countries.
** Average, Bloomberg consensus as of 14/12/2021.

ASIAN EQUITIES ATTRACTIVE

IN A NUTSHELL

- Corporate earnings should rise solidly next year.
- However, valuations are likely to decline slightly due to rising bond yields and less liquidity support.
- We therefore see limited upside potential for equities in 2022, despite the lack of alternatives. Within equities, we are optimistic for Asian stocks.

Increased volatility in the fourth quarter

The fourth quarter resembled a rollercoaster ride. After the losses in September in the wake of tapering and China concerns, the quarter started with a strong countermovement upwards, supported by an encouraging Q3 reporting season and cautious investor positioning. Many equity markets reached new all-time highs in mid-November before the Omicron variant then depressed investor sentiment significantly. In addition, the US Federal Reserve admitted that inflation was probably not only temporary after all and that a stronger reduction of bond purchases would have to be considered. Cyclical equity regions performed worst in Q4, above all Eastern Europe and Japan. But Europe also fell by more than 8% at times, while the US held up best, supported by a stronger US dollar, share buyback programmes and strong retail flows.

Normalising earnings growth for companies in 2022

After a strong increase in corporate profits in 2021 due to base effects, there should be a normalisation next year. After an increase of more than 200% for Latin America this year, analysts expect profits there to even fall next year. Solid earnings growth of 7% is expected for the Eurozone, while consensus is most optimistic for Japan with estimates of 11%. Asia and the US follow behind. We think the cautiously optimistic analyst estimates are realistic. Our economists are confident about 2022 and expect, for example, that eurozone GDP will grow at a similar pace next year as this year. Earnings growth will also be supported by more corporate investment and high profit margins. Companies have so far largely been able to pass on higher input costs. Advancing digitalisation is helping to increase profitability.

Valuations likely to decline slightly

Valuations have fallen this year as we expected. Equities have risen less than corporate profits. US equities, for example, gained more than 30%, but earnings rose by 50%. However, most equity regions remain highly valued compared with their own historical P/E ratios. US equities, for example, trade at a P/E premium of around 30% to their own history. We think rising bond yields should lead to a further normalisation in valuation levels, but not in the same way as in the past, as there are more valuation-insensitive investors (eg ETF savings plans).

Opportunities in Asia

Although upside potential is likely to be more limited next year, European equities should perform favourably in 2022, supported by solid earnings growth, continued accommodative ECB monetary policy and a weak euro, which should help exporters in

US equities ahead in Q4, Eastern Europe and Japan behind

Total return	Ytd and in Q4 21 (in %, EUR)		12-month periods of the last 5 years (in %, EUR)					P/B*	Div.*	P/E*
	Ytd (31/12/20-14/12/21)	Q4 21 (30/09/21-14/12/21)	14/12/20 14/12/21	14/12/19 14/12/20	14/12/18 14/12/19	14/12/17 14/12/18	14/12/16 14/12/17	14/12/21	14/12/21	14/12/21
S&P 500	35.7	10.8	39.0	7.2	26.4	4.3	8.5	4.6	1.3	22.0
MSCI USA Small Caps	24.2	2.1	27.6	7.0	20.9	-0.4	3.3	2.3	1.2	22.3
MSCI UK	22.8	3.7	23.5	-17.4	20.2	-6.5	6.2	1.8	4.3	11.8
MSCI EM Eastern Europe	22.8	-8.9	22.7	-17.3	29.1	4.1	5.3	1.1	8.0	6.4
Stoxx Europe 50	21.5	5.5	23.0	-6.2	22.2	-7.7	11.0	2.4	3.2	15.6
Stoxx Europe Cyclicals	21.1	1.8	23.9	-2.1	23.8	-14.2	14.9			
Euro Stoxx 50	18.9	2.6	20.6	-4.2	24.1	-10.7	13.5	2.0	2.8	15.9
Stoxx Europe Defensives	17.5	3.2	18.8	-6.1	16.9	2.3	7.9			
Stoxx Europe Small 200	17.2	-0.8	22.1	1.5	25.5	-9.7	18.9	1.8	2.5	21.1
DAX	12.6	1.3	16.9	-0.4	22.2	-16.9	16.2	1.9	2.7	14.4
MSCI Japan	10.5	-1.1	11.9	2.5	18.6	-6.2	8.5	1.4	2.3	14.7
MSCI EM Asia	2.3	1.0	5.6	15.8	17.5	-8.9	23.6	1.9	2.2	14.6

Time period: 14/12/2016-14/12/2021.
Source: Bloomberg * PBV = Price/book value ratio; Div. = Dividend yield (%); PER = Price/earnings ratio. Values based on estimates for the next 12 months.

particular. However, a slow unwinding of supply chain bottlenecks, the pace of China’s slowdown and likely Fed rate hikes represent potential headwinds.

The biggest driver of US equities in 2022 is likely to be the interest rate outlook. Our economists expect the Fed to raise rates four times in 2022, by 25 basis points each, starting in the second quarter. Most of the performance is likely to materialise in the run-up to the rate hike, with volatility rising in the second half of the year as the market digests the Fed's first rate moves – especially as the US mid-term elections in November are likely to create further uncertainty for investors.

After the correction this year, valuations of Asian equities have become attractive. Especially for Chinese equities, risk premiums are markedly high, so that an absence of further regulatory disruptions should lead to a rebound in prices. An economic stabilisation in China should also offer recovery potential, if necessary, by way of economic stimulus.

Ulrich Urbahn, Head of Multi-Asset Strategy & Research

WHAT IS ON COMPANIES’ MINDS?

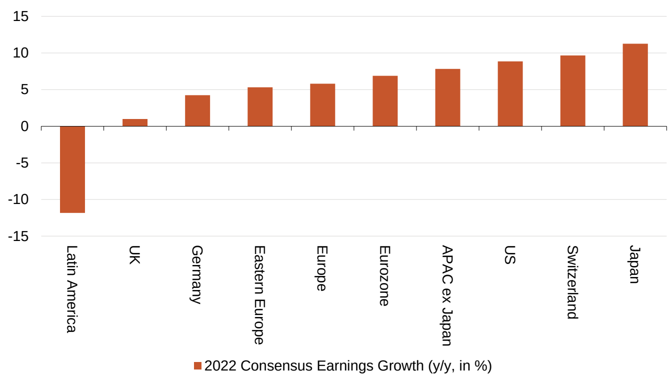
About inflation and supply bottlenecks

After a strong recovery from the COVID-19 crisis for most industries and an almost carefree sentiment on markets, problems were increasingly discussed in the fourth quarter. The topic of inflation and supply bottlenecks was raised at every company meeting. Be it the consumer goods industry, companies producing food, clothing or luxury goods, or even companies from the technology and industrial sectors, they all reported difficulties in purchasing goods, maintaining supply chains and staff shortages. Almost no company was exempt. However, there were big differences in the extent of the problems and how they were dealt with. While we heard from many well-positioned companies that rising costs can be offset by cost savings, others have to accept significant margin reductions. In even more unfavourable cases, sales losses are even expected. Our conviction to focus on high-quality companies is paying off in this environment. Despite the problems, management teams of our holdings are largely self-confident and we expect them to emerge stronger from this difficult phase.

Matthias Born, CIO Equities

Solid earnings growth expected in 2022

Consensus earnings estimates for selected equity regions

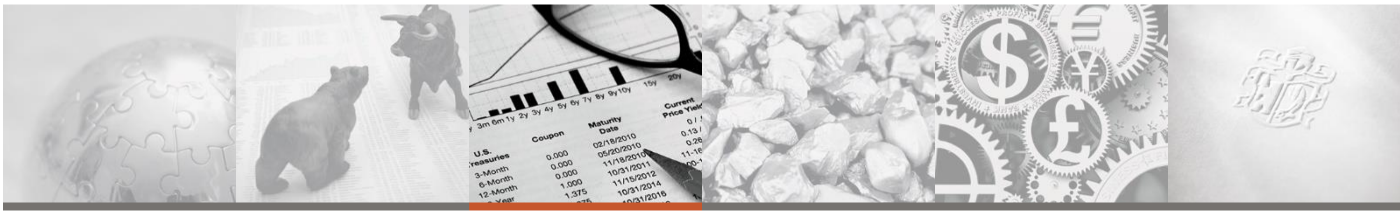


As of 14/12/2021.
Source: Factset, Berenberg.

Forecast summary: further upside potential for equities

	Currently			∅*
Index forecasts	**15/12/2021**	**30/06/2022**	**31/12/2022**	**in 12 months**
S&P500	4,710	4,850	4,950	5,193
Dax	15,476	16,500	17,000	18,816
EuroStoxx 50	4,160	4,400	4,600	4,922
MSCI UK	2,022	2,125	2,200	2,385
Index potential (in %)				
S&P500	-	3.0	5.1	10.3
Dax	-	6.6	9.8	21.6
EuroStoxx 50	-	5.8	10.6	18.3
MSCI UK	-	5.1	8.8	17.9

* Average, consensus as of 15/12/2021.
Source: Bloomberg, FactSet, Berenberg.



RISING YIELDS CONTINUE TO WEIGH ON BONDS

IN A NUTSHELL

- Safe government bonds are unlikely to get off to a good start – we expect losses.
- For European corporate bonds, we focus on short maturities with relatively high yields.
- For emerging market bonds, we are wary of high duration, but attractive valuations give us hope.

New year under different conditions

Unusually high inflation rates and rising yields were problems faced by all interest-bearing subsegments in the past year. 2022 will be different, but certainly no less challenging. In the following, we outline the issues that particularly concern us in individual bond segments and show where we see opportunities.

Government bonds continue to struggle with headwinds

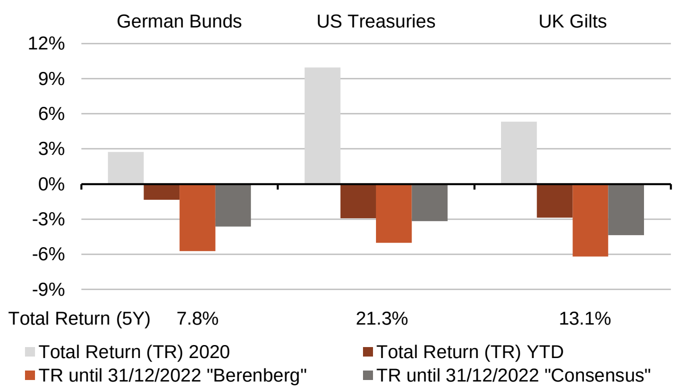
After a difficult year for safe-haven government bonds, the coming months should not bring a significant trend reversal. While persistently high COVID-19 infection figures, geopolitical turmoil or Chinese growth concerns would support demand for safety, these are not our main scenarios. Rather, we expect rising (real) yields for both German Bunds and US Treasuries in the context of solid post-COVID demand across the economy. Moreover, on the other side of the Atlantic, the Fed is likely not only to reduce its bond purchases but also to act more restrictively in the form of interest rate hikes. We expect four hikes of 25bp each by the end of 2022. In the euro area, the ECB is not quite ready yet: for the time being, it will manage the flexible adjustment of its monetary policy exclusively via its bond purchase volume and will not raise interest rates yet. Even with inflation rates falling safe government bonds will most likely not post gains. On the contrary, there will probably be no money to be made with them in 2022.

Corporate bonds: our focus is on short-dated carry

In retrospect, corporate bonds in the 2021 investment grade segment could not escape the interest rate volatility and, most recently, the widening swap spreads. It took the higher current yield ("carry") of high-yield bonds to generate positive value contributions. Looking forward, we also find it difficult to be optimistic about credit risk. High valuations lay the foundation for rather subdued earnings expectations, compounded by the ECB's successively decreasing purchases. Furthermore, institutional investors, such as insurance companies or pension funds, will need to invest less in corporate bonds as soon as government bonds again offer more adequate interest rates at the long end. Moreover, analyses by J.P. Morgan show that the average mutual fund in the investment grade segment exhibited comparatively high allocations to high-yield and subordinated bonds at the end of the third quarter of 2021. Against this backdrop, it is likely to be difficult to find the marginal buyer at high valuation levels. On the other side of the equation, the supply of new issuance is forecast to be high (bottom left chart). After several quarters of balance sheet repair, European companies are starting to reduce liquidity buffers and take on new

Another year of losses for government bonds of safe issuers ahead

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



Time period: Time period: 15/12/2016-15/12/2021.
Source: Bloomberg, own calculations, iBoxx Government Bond Indices (7-10 years, TR).

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

Comparison of Berenberg and consensus forecasts, values at mid-year and end of 2022

	15/12/2021	30/06/2022		31/12/2022	
	Currently		∅*		∅*
USA					
Base interest rate	0.00-0.25	0.25-0.50	0.30	1.00-1.25	0.60
10Y US yield	1.46	1.80	1.82	2.20	1.99
Eurozone					
Base interest rate	0.00	0.00	0.00	0.00	0.00
10Y Bund yield	-0.36	0.00	-0.02	0.30	0.08
UK					
Base interest rate	0.10	0.50	0.45	0.75	0.65
10Y Gilt yield	0.73	1.10	1.27	1.60	1.40

* Average, consensus as of 15/12/2021.
Source: Bloomberg.

debt to make upcoming investments. Also, continued strong merger and acquisition activity is likely to keep funding needs high. On balance, we expect moderate widening of risk premiums and rising yields. Both of these factors argue on the one hand for increased cash holdings in order to be able to take advantage of opportunities that arise in the meantime, and on the other hand for a focus on short bonds with high effective interest rates. These bonds can be found in the high-yield and subordinated segment.

Emerging-market bonds: valuations are attractive

In the final quarter of 2021, emerging-market bonds were unable to reduce their previous months' losses in either hard or in local currency terms. The interest rate and currency markets were characterised by increased volatility, so that all emerging market segments ended the year with negative returns. For 2022, we expect a higher degree of heterogeneity based on, among other things, differences in progress against the pandemic, divergent inflation trends and different central bank policies. We consider the Asian region to have an advantage over others: the local currency segments in particular seem to offer opportunities. However, caution is advisable with regard to interest rate sensitivity; in particular, hard-currency bonds with a high duration from Latin America should be avoided.

In general, high inflation and rising interest rates, especially in the US, pose increased risks for emerging market investments. However, we are encouraged by current valuations and the overall technical picture. Risk premiums in the hard currency segment have risen to attractive entry levels. The picture is similar in the local currency segment, where yields are as high as they have been for the last three years, with the exception of the COVID-19 crisis in March 2020. In addition, the (net) primary market supply is likely to decrease significantly compared with both the volume of the previous year and the longer-term average (chart below left). In addition to attractive valuations, this aspect should boost prices. Thus, despite a challenging environment, we have hope for a more positive development in the coming months than in 2021.

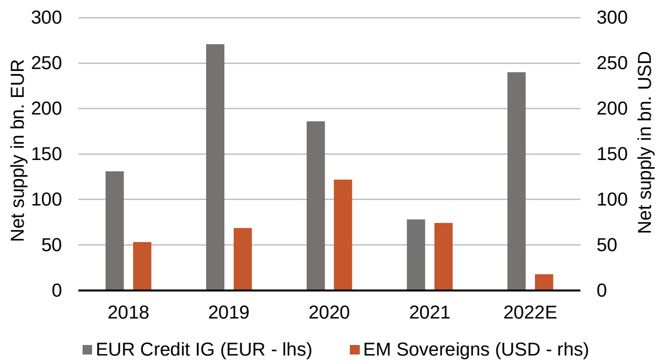
Conclusion: some risks present, but isolated opportunities remain

Safe government bonds are likely to be sought after in the event of permanently higher infection figures and the associated setbacks in growth – which is not our base case. European corporate bonds are also experiencing headwinds, especially due to high valuations, rising supply and declining ECB demand. However, we see opportunities in the exploitation of temporary setbacks as well as in high-yield and subordinated securities with short maturities. Finally, attractive yield levels and a shortage of supply speak in favour of emerging-market bonds. Thus, while the overall environment remains difficult, it still offers selective opportunities.

Martin Mayer, Senior Portfolio Manager Multi Asset
Christian Bettinger, Head of Fixed Income
Robert Reichle, Head of Emerging Markets Selection

New issues: diverging trends in individual segments

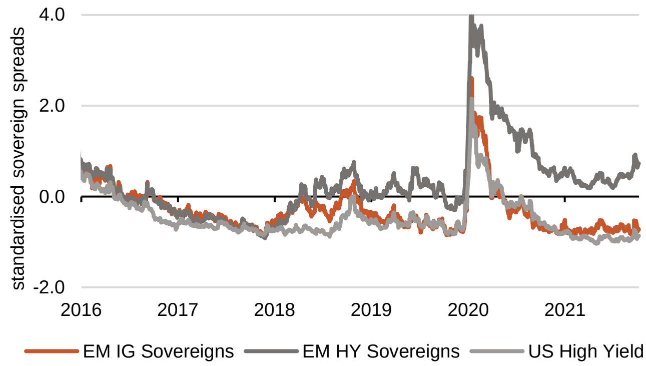
The supply of European corporate bonds (Credit IG) is increasing, while the supply of emerging-market (EM) government bonds is declining sharply.



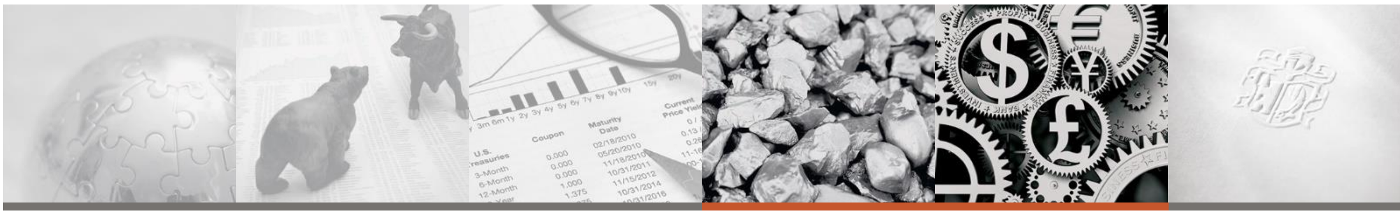
Time period: 01/01/2018-31/12/2022 (for 2022: expected values).
Source: J.P. Morgan.

Emerging-market bonds: high-yield risk premiums very attractive

In high-yield emerging market (HY) securities, yield spreads are significantly higher than in the investment grade (IG) segment and in US high-yield.



Time period: 14/12/2016-14/12/2021, Source: Bloomberg.
Presentation: Z-Score, moving 15-year average.



CYCLICAL COMMODITIES WITH OPPORTUNITIES

Oil in an unjustified bear market

The fourth quarter on the oil market was characterised by highs and lows. In October, oil reached its highest level in seven years, before it slid into a bear market in November with the spread of the Omicron variant. The extent of the sell-off, however, seemed exaggerated, implying a sharper decline in demand over the coming months than last winter. With the change in daily new infections abating, oil should gain noticeably again in the short term. If OPEC+ retains control of the oil market, as it has since April 2020, oil could benefit from a sustained supply shortage in the medium term. Like the US shale oil producers, some cartel members have sharply reduced their investment spending, which should ultimately lead to a drop in production capacity and give the oil price a tailwind.

Gold maintains old patterns

Gold could not break out of the pattern of the previous months in Q4 and continued its volatile sideways move. In view of the strong appreciation of the USD, however, the precious metal held up surprisingly well thanks to higher inflation expectations. Things are not likely to get any easier for gold in the coming months. With the Fed's monetary policy likely to become more restrictive, we expect real interest rates to rise and thus the opportunity costs for gold to increase. A weaker US dollar should in turn boost demand from emerging markets. All in all, we expect a volatile sideways movement. Nevertheless, we consider gold to be an important portfolio component as a hedge against tail risks such as stagflation fears or geopolitical conflicts that are currently not present in investors' minds.

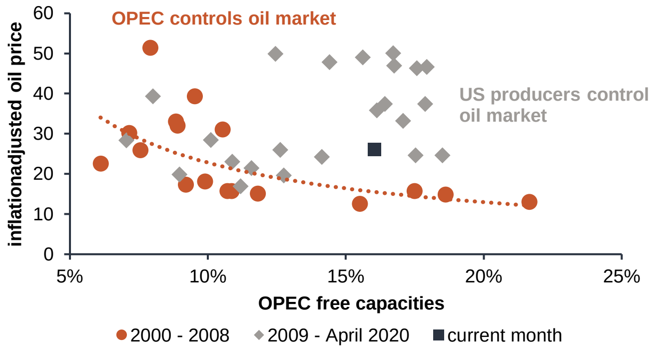
Industrial metals as beneficiaries of economic expansion

Industrial metals are among the winners of 2021. However, the upward trend did not continue in the fourth quarter with increasingly negative economic surprises. While the issue of sustainability is driving both demand (use of metals in green technologies) and supply (reduction of emissions in mining) and thus providing a longer-term tailwind, the short- to medium-term global economic outlook is likely to determine the further development of industrial metals in the coming months. If, after the downturn in Q4, we now return to a phase of expansion, as we expect, the stage will be set for a positive performance in 2022.

Ludwig Kemper, Analyst Multi-Asset Strategy & Research

Oil price rises as production capacity falls

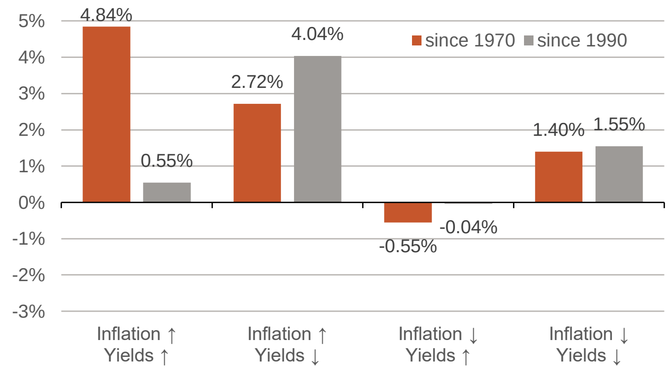
Inflation-indexed oil price relative to OPEC spare production capacity in different regimes.



Time period: 01/01/2000-30/11/2021, semi-annual averages.
Source: J.P. Morgan, Bloomberg, own calculations.

Potentially rising real interest rates slow down gold

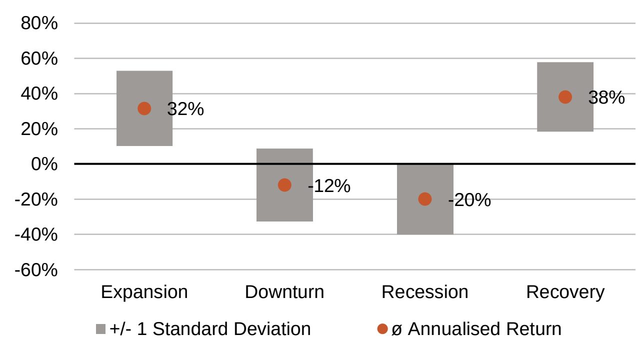
Average rolling 3-month gold price development depending on change in of the change in the US-CPI yoy and the 10Y-US-Treasury yields.



Time period: 01/01/1970-30/11/2021.
Source: Bloomberg, own calculations.

Economic outlook determines development of industrial metals

Average of the equally weighted monthly returns of copper, aluminium, nickel and zinc depending on the OECD & Major 6 NME Leading Indicator.



Time period: 01/01/1998-30/11/2021.
Source: Bloomberg.

EURO COMEBACK AFTER A DISAPPOINTING YEAR

The common currency on a dive

The year 2021 was disappointing for the euro. Yet it had started promisingly. Against the US currency, the exchange rate started at 1.22 US dollars per euro. In the first days of the year, it continued to rise to over 1.23 - which, however, was to be the high for the year on 7 January. Since then, the value of the euro has moved in a fluctuating downward trend, reaching a low of just under 1.12 US dollars per euro in November. The weakness is broader-based, as the euro also lost value against other currencies such as the Swiss franc. So far in the fourth quarter, the euro has lost around four cents and is now trading at only 1.04 francs per euro.

ECB policy as a burdening factor

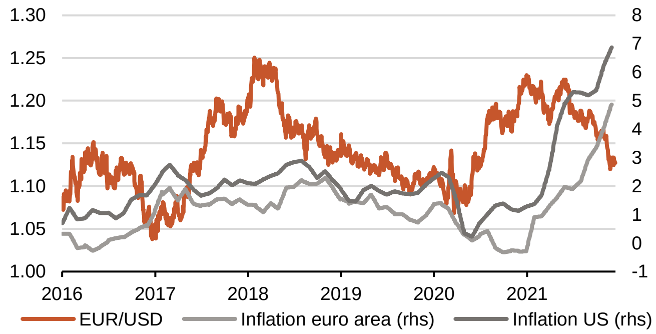
From a fundamental point of view, there were actually a lot of arguments for the euro and against the US dollar. In the course of the pandemic, the US pursued an even more expansive monetary and fiscal policy than the countries of the Eurozone. This resulted in a stronger increase in government debt and higher inflation dynamics. We were therefore optimistic that the euro could capitalise on this and that its value would rise. In the meantime, however, the ECB's wait-and-see attitude has proved to be a burden. Inflation rates have risen sharply in many countries. In the Eurozone, too, inflation stood at 4.9% in November. While the US Federal Reserve and the Bank of England, for example, have initiated a change in monetary policy and will raise key interest rates next year, the ECB is remaining relatively calm. As it tends to view inflation as transitory - despite a significant upward revision for 2022 - it will keep the key rate at 0% beyond next year.

For the time being, the foreign exchange market has largely ignored the problems with which the US has to contend in the longer term. The Fed's monetary policy turnaround and the associated interest rate advance dominate. The euro will probably only rise more strongly when a change in monetary policy also becomes credible for Europe. We expect the ECB to raise the key interest rate twice in 2023 - and thus a little bit earlier than the ECB itself currently expects. For the time being, the ECB will gradually reduce bond purchases and phase out the PEPP pandemic purchase programme in March. All in all, the ECB is preserving the possibility of reacting flexibly to new economic challenges.

Dr Jörn Quitzau, Senior Economist

EUR/USD: dollar strength and euro weakness

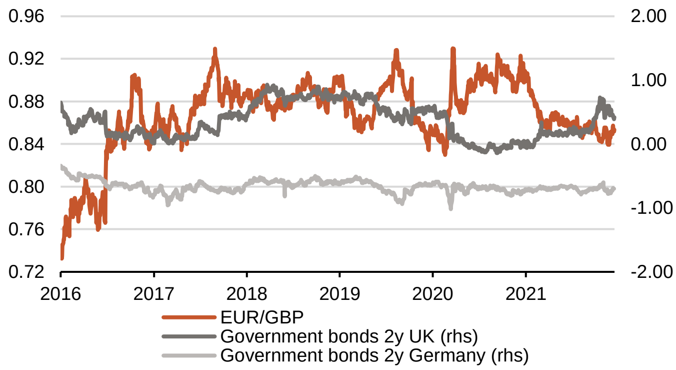
The foreign exchange market is rewarding the tightening course of the Fed. High US inflation proves to be an advantage for the dollar for the time being.



Time period: 01/01/2016-14/12/2021.
Exchange rate in US dollars; inflation in percent. Source: Macrobond.

EUR/GBP: volatile sideways movement

On balance, the pound is going sideways. Can the interest rate advantage strengthen the pound?



Time period: 01/01/2016-14/12/2021.
Exchange rate in GBP, government bonds in %. Source: Macrobond.

Exchange rate forecasts

The euro is likely to fight its way back

	15/12/2021	30/06/2022		31/12/2022	
Exchange rate forecast	Currently		∅*		∅*
EUR/USD	1.13	1.14	1.13	1.17	1.16
EUR/GBP	0.85	0.85	0.84	0.85	0.84
EUR/CHF	1.04	1.05	1.07	1.08	1.09
EUR/JPY	129	127	130	128	132
Change against the euro in %					
USD	-	-1.0	-0.1	-3.5	-2.7
GBP	-	0.2	1.4	0.2	1.4
CHF	-	-0.6	-2.4	-3.3	-4.2
JPY	-	1.4	-1.0	0.6	-2.5

* Average, consensus as of 15/12/2021.
Source: Bloomberg.

INTERVIEW WITH CHRISTOPH MÄDER

Mr Mäder, you are the fund manager of Berenberg Sustainable Euro Bonds. How would you describe your task?

A sustainable bond fund is on the one hand about classic, fundamental bond selection and portfolio construction, and on the other hand about integrating sustainability aspects into the investment process, for example the impact analysis of potential issuers and bonds. The challenge is to find the most attractive bonds from a risk-return perspective, which at the same time have a positive impact on the environment and society and fit our current market assessment.

That sounds exciting! What does your day-to-day work look like exactly?

My workday usually starts with an analysis of the morning news to get an overview of the most important portfolio drivers. Often, I then have to react at short notice to company news or corporate actions in the portfolio or organise new issue participations on the primary market. This involves, for example, analysing issuers, bond structures and assessing whether the new issue and its risk premium are attractive enough. In quieter minutes, I am usually busy with research, exchanging ideas with colleagues or attending company meetings to get to know interesting bond issuers and develop investment ideas.

Have you always wanted to be a bond portfolio manager? What makes your work so exciting?

Many of my fellow students were already strongly focused on equities during their studies. I came into contact with fixed income early on through an internship and have been fascinated by the asset class ever since. It is the versatility and complexity of the bond segment that makes it so interesting: not only does the issuer itself play an important role, but so do the maturity, the rank in the capital structure and the design of other bond features. At the same time, everything is possible, from getting to know new companies and their business models, to analysing regulatory changes, to assessing monetary policy or economic developments. There is something new to learn almost every day and the market presents you with new challenges.

What is your investment philosophy for the Berenberg Sustainable Euro Bonds?

We have defined two equally important objectives for the fund: generating an attractive return after costs above our fund

benchmark and achieving a positive impact on the environment and society. In compliance with the Berenberg ESG exclusion criteria, we look for issuers and bonds that make an active contribution to solving global challenges such as climate change, water scarcity or even demographic change. We are convinced that our focus on sustainability and the positive impact of the investments can also make an active contribution to the better financial performance of the fund. Especially in the current low interest rate environment, it is important to use a variety of return sources. An important performance driver for us is individual bond selection: through management meetings, our own research and participation in the primary market, we try to identify inefficiencies at the bond level and select the most attractive opportunities in the market. This is complemented by the flexible management of interest rate and credit risks in the portfolio.

What kind of sustainable issuers and bonds do you invest in for the fund?

On the one hand, we invest in sustainable bonds, such as green, social or sustainability bonds, which yield a direct and measurable added value through the financed projects. This type of bond is now issued by a wide variety of issuers (governments, companies, banks) and in almost every sector and rating category. On the other hand, we also use conventional bonds from issuers whose business models have a positive impact on the environment or society. This allows us to use an additional market segment that is less influenced by the strong excess demand for green bonds.

How does ESG-compliant fixed income investing differ from equities?
One major difference is the type of influence (engagement): While shareholders can exert influence directly through their voting rights, as a bond investor this is only possible indirectly through exchanges with management and communicating expectations to the company. In addition, sustainable investing is made more difficult by the complexity of the bond market. In addition to companies, states and state-related organisations must also be analysed with regard to their sustainability. More diverse responsibilities and stakeholders of states increase the complexity of the ESG analysis. At the same time, the bond structure must be taken into account. While the ESG conformity of the company and business model are decisive for equities, the impact of the financed projects must also be taken into account for bonds (eg green, social or sustainability bonds).

What are the differences between a sustainable bond and a conventional bond? And are there also similarities?
These bond types differ primarily in the use of funds. Conventional bonds are usually used for the general business purpose and are often not specified further. With sustainable bonds, the proceeds of the issue are used specifically to finance specific sustainable projects, such as a wind turbine or micro-loans for disadvantaged population groups. In addition, an impact report is published in which the financed projects and their impact are transparently communicated to investors. The biggest common feature is the credit risk. Usually, sustainable bonds are unsecured bonds that are treated the same as conventional bonds in the event of the issuer's default. Thus, while having the same credit risk, they additionally offer value for the environment or society.

What do you look for when selecting bonds and how do you deal with the issue of greenwashing in the case of sustainable bonds?
Before investing, we analyse the credit quality and financial attractiveness of each issuer and bond. When it comes to sustainability, many funds and ETFs only consider exclusion criteria or use ESG ratings from external providers as the sole decision-making criterion. This seems too short-sighted to us: While the application of exclusion criteria and a proprietary ESG opportunity and risk analysis are important building blocks in our investment process, the proprietary impact analysis of each bond and issuer is an essential component in our selection process. To assess the positive impact of an investment, we have developed a net impact scoring model together with our ESG Office. In the case of sustainable bonds such as green bonds, an analysis is particularly important to prevent possible greenwashing. The analysis of the financed sustainable projects alone is not sufficient. We also look at the issuer itself and its sustainability strategy. Only if this is credible and solid is a green bond investable for us.

How satisfied are you with the performance of your fund?
Since the launch in October 2020, we have done very well against comparable funds in the market and the fund benchmark, generating an alpha of 0.28% as of 14/12/2021 after costs since inception, although our absolute performance is slightly negative due to the market environment of rising interest rates. We are particularly satisfied with the fact that we were able to generate this outperformance with significantly lower volatility and thus offer our clients a more attractive risk-adjusted performance.

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Christoph Mäder is the portfolio manager responsible for Berenberg Sustainable Euro Bonds. Within the Fixed Income team at Berenberg, he focuses on the selection in the European bond segment and is responsible for the integration of sustainability aspects in this area. Prior to joining Berenberg in August 2017, he gained his first professional experience at UniCredit and DWS. He holds a Master's in Finance & Investments from the Rotterdam School of Management and is a CFA charterholder.

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IMPORTANT NOTICES

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