HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

RATES TURNAROUND

Due to the weaker economic data and the further decline in inflation, all major central banks have now made their first interest rate cuts. More are likely to follow. However, the market's strong expectations of interest rate cuts only appear realistic in the event of significant economic weakness.

MORE MARKET BREADTH

Falling interest rates, a weaker US dollar, broader earnings growth and historically high valuation discounts between other regions and the US should lead to greater market breadth, including regionally. Small caps and Europe have already performed better in the third quarter.

CHANCES POST US ELECTION

A sustained rise above the all-time highs for equities is unlikely until after the US elections at the earliest. The tight race for the presidency and Congress is likely to prevent early clarity. The volatile sideways market is likely to continue for the time being.

Q4 | 2024

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FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear readers,

The economic recovery in Europe and China that was expected in the first half of the year has so far failed to materialise. In the third quarter, economic data was disappointing in almost all regions. Growth concerns came to the fore. With inflation continuing to fall, not only have hopes of interest rate cuts risen significantly on the market and bond yields fallen, but all major central banks have now made their first interest rate cut(s). Interest rate-sensitive and defensive investments such as gold, bonds and the property, utilities, consumer staples, telecommunications and healthcare sectors performed well. Cyclical sectors as well as oil and industrial metal prices fell. The stock markets trended sideways in the third quarter with greater fluctuations. European equities and small caps performed slightly better.

The first interest rate cuts are likely to be followed by further cuts. However, the market's high expectations for interest rate cuts only appear realistic if the US economy and the US labour market become significantly weaker. In this case, equities are likely to have little potential. In the event of a soft landing, our base scenario, interest rate cuts would be less severe, bond yields would rise again somewhat in the medium term and equities would offer more potential. For this to happen, however, the US economic surprises in the fourth quarter would have to be positive again. This does not seem impossible in view of the loosest financial conditions for more than two years, especially once the uncertainty surrounding the US elections is behind us. A sustained rise above the all-time highs for equities would then be conceivable. Until then, however, the volatile sideways market is likely to continue. The tight race for the US presidency and the US Congress is entering the hot phase and early clarity is unlikely. October is historically the most volatile month for equities anyway. In the short term, it is therefore not the time for bold portfolio positions, especially as the increasing market breadth also requires a less-focused portfolio and should benefit our broad positioning. Many investors have 'parked' money in short-term interest rate investments over the last few years. The holdings of US money market funds have increased by USD900bn to USD6.3trn since mid-2023. This strategy has not been successful so far. The 4.0% that investors achieved with overnight money in euros in the last 12 months (table on p. 4) was beaten by all other asset classes, above all by gold, which rose by almost 30%. Also, with the interest rate cuts, reinvestment is now becoming increasingly unattractive. Investors are likely to increasingly turn to other investments again in the medium term. All asset classes are likely to benefit from this, especially medium-term bonds, favourably valued equities (eg Europe, emerging markets, small caps) and gold. Even if the trees do not grow into the sky, we are confident that a broad multi-asset portfolio will continue to perform significantly better than short-term interest rate investments, despite all the uncertainties and risks.

In the Insights interview starting on page 14, Maria Ziolkowski, portfolio manager for bonds, talks about what fascinates her about bonds, what characterises the Berenberg bond team and which bond strategies are currently attractive. Enjoy reading!

CONTENT

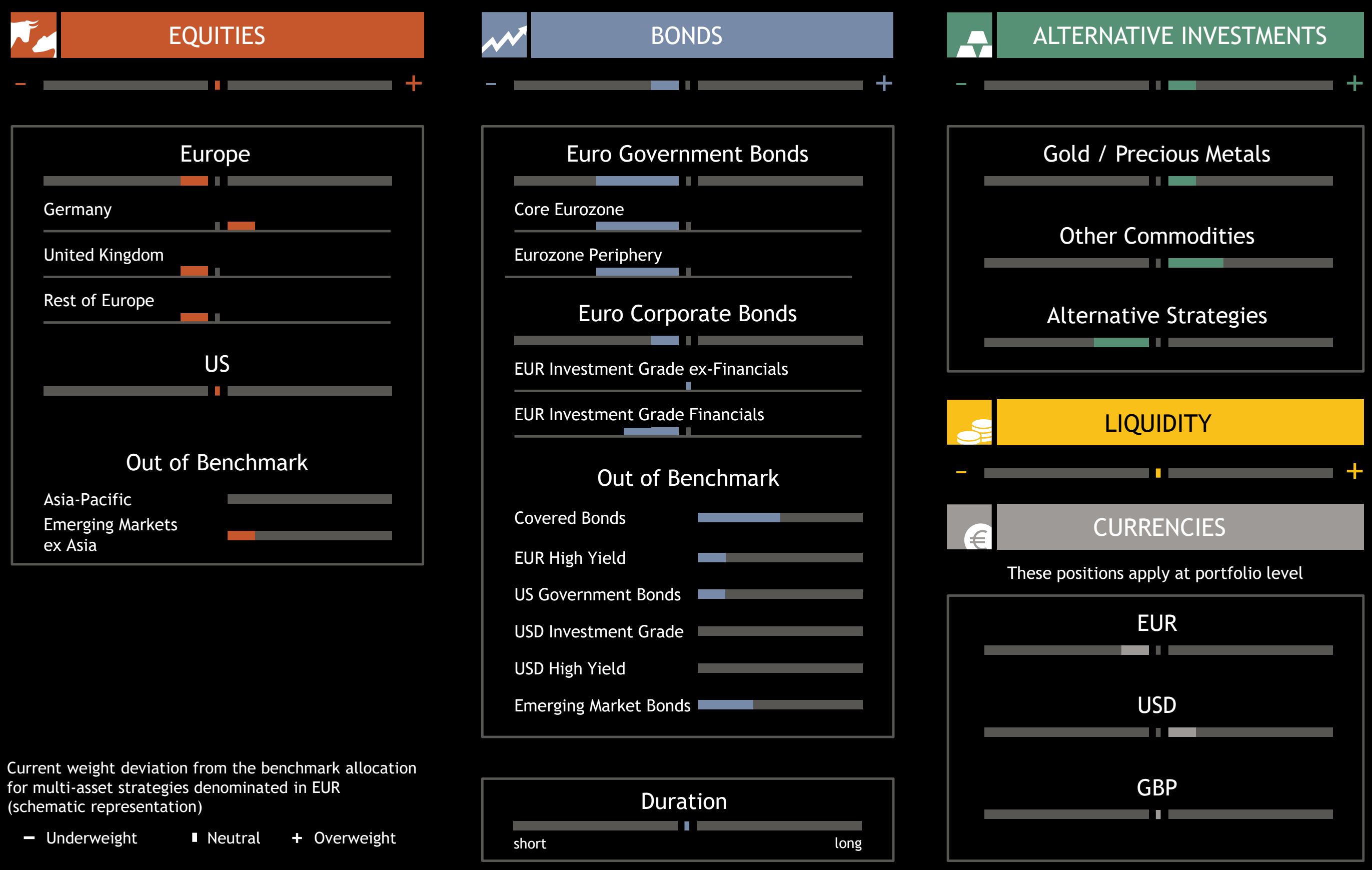
TOO MUCH CUTS HOPE OR TOO MUCH EQUITY OPTIMISM?

IN A NUTSHELL

- Renewed growth concerns have caused interest rate cut expectations to rise and bond yields to fall, while equities and bonds are developing less in sync.
- Falling interest rates, a weaker US dollar and broader earnings growth argue in favour of more market breadth – and there are early signs of this.
- In our opinion, the level of optimism on equity markets does not match the expectations of the bond and commodity markets. The US elections are causing uncertainty and seasonality remains negative for equities for the time being. We remain balanced for the time being and see more opportunities after the US elections.

Portfolio positioning at a glance

Little potential for equities and more volatility over the summer was our expectation three months ago – an environment for anti-cyclical trading, as we argued. After the markets initially continued to rise in July, we reduced our equity allocation accordingly. We then used the rapid and significant setback at the start of August to increase the equity allocation back towards neutral. We currently feel well positioned with a balanced positioning. Bonds appear less attractive after the interest rate rally of recent months, and an overweighting is not necessary here, nor is a long duration. We favour medium maturities, high-quality corporate bonds and local currency bonds from emerging markets. In contrast, we have become more cautious with high-yield bonds and have positioned ourselves somewhat more defensively than before in view of weaker economic data. Valuation of US equities is still high, but the uncertainty surrounding the US elections argues against a strong underweight. European equities are more attractive, but the economy is not really gaining momentum. Gold, which has performed well, remains significantly overweight. Other commodities, especially industrial metals, remain a sensible addition to the portfolio.



Third-quarter review: return of growth concerns

For more than a year, the markets have been wrestling with the question of whether the US economy will make a soft landing. In the first half of the year, the risks of excessive growth and high inflation took centre stage. Hopes of interest rate cuts were priced out and bond yields rose (top chart, p. 5). With disappointing economic data and falling inflation, the risk of a stronger economic slowdown came to the fore in the third quarter. Markets again priced in further interest rate cuts. The US dollar depreciated. Bond yields fell. Bonds, gold and defensive equity sectors performed positively. Equity markets corrected by around 10% compared to the highs reached in mid-July, but then recovered quickly and ultimately remained virtually unchanged, with European equities performing better. Gold leads the performance rankings in the third quarter and since the beginning of the year. As the focus shifted from inflation to growth concerns, equities and bonds ran less in parallel.

Interest rate reduction cycle has begun across the board

The normalisation of central bank interest rates has begun. The ECB cut its key interest rate for the first time in June, the BoE in August and the Fed in September. Further steps are likely to follow – the ECB already took the second step in September. Growth in the eurozone is anaemic and is likely to weaken further in the US in the coming months. However, the chances of a soft landing there are increasing. This is because the easing of financial conditions (interest rate cuts, weaker US dollar, looser lending standards, lower oil price) could give the US economy a tailwind again after a certain delay. After months dominated by disappointing US economic data, US economic surprises could then turn positive in the fourth quarter, especially if the end of uncertainty about the outcome of the US elections leads to postponed investment or consumer decisions being made. Equity markets seem to be betting on this scenario, with all-time highs and a consensus expectation of 15% for earnings growth in 2025 for the S&P 500. The bond markets, however, seem to see a different scenario, as the further eight Fed rate cuts to 2.75% by the end of 2025 that have been priced in would probably require a more significant economic downturn – the pace and extent of the rate cuts that have been priced in have never been seen historically without a recession. In the soft landing scenario, our economists expect the Fed to cut interest rates only four more times to 3.75-4.0% by mid-2025, in which case the current yields on 10-year US government bonds of 3.7% (nominal) and 1.6% (real) appear too low. So if equity markets are right, too much hope of an interest rate cut is probably priced in. If the bond markets are right, equities harbour more risks than opportunities. The truth could lie in the middle. In this case, equities offer some potential and the current interest rate on bonds helps to avoid losses – both asset classes can then be expected to generate moderately positive returns over the next 12 to 18 months. This would be a good environment for high-quality corporate bonds. An extension of the duration position beyond neutral does not appear appropriate in view of the prevailing interest rate optimism.

In the third quarter, growth fears supported government bonds, gold and defensive sectors; equities moved sideways in a volatile manner

Total return	YTD and in Q3 2024 (in %, in EUR)		12-month periods of the last 5 years (in %, in EUR)					CAGR*	Std.-dev.*
	YTD (31/12/23-16/09/24)	Q3TD (30/06/24-16/09/24)	16/09/23 16/09/24	16/09/22 16/09/23	16/09/21 16/09/22	16/09/20 16/09/21	16/09/19 16/09/20	16/09/19 16/09/24	16/09/19 16/09/24
Gold	24.2	6.9	28.5	7.9	12.2	-10.1	21.7	11.2	13.7
S&P 500	18.6	-0.4	23.2	9.6	3.3	35.0	7.0	15.0	21.1
DAX	11.2	2.2	17.2	24.7	-18.6	18.1	7.1	8.5	20.4
Stoxx Europe 50	10.4	-1.3	12.8	19.5	-0.1	20.8	-2.8	9.6	16.6
MSCI EM	7.7	-3.0	8.5	0.5	-10.6	17.3	3.4	3.4	17.1
EM Sovereigns	6.9	1.7	10.4	-0.9	-6.3	4.7	-2.3	1.0	8.5
US Sovereigns	4.1	1.8	4.9	-7.7	2.7	-1.9	1.9	-0.1	7.0
EUR Corporates	3.2	2.8	8.5	1.6	-14.0	1.9	0.5	-0.6	4.0
Euro Overnight Deposit	2.8	0.8	4.0	2.4	-0.5	-0.6	-0.5	1.0	0.1
Brent	2.5	-15.2	-15.4	10.0	76.9	82.9	-44.9	10.7	39.5
EUR Sovereigns	2.2	3.3	6.7	-1.5	-10.1	0.1	0.2	-1.1	3.8
USDEUR	-0.8	-3.8	-4.3	-6.0	17.5	0.4	-6.9	-0.2	7.2

Time period: 16/09/2019-16/09/2024.
Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = annualised standard deviation (in %, in EUR).

More market breadth – but not the time for bold positions

The inconsistency of the markets and the current highly 'data-dependent' actions of the central banks do not provide an environment for courageous investor positioning, especially as the geopolitical risks remain high and the race for the US presidency is very close. The broader the market becomes, the less need there is for highly focused positions. Recently, it was no longer just a few large technology stocks that determined the stock market trend. In the European sectors, defensive sectors led the way in the third quarter. Small caps also performed slightly better than large caps (centre chart), supported by falling interest rates and corporate profits, which grew more strongly across the board in the second quarter. If the US interest rate cuts are accompanied by a weaker US dollar, which is becoming apparent but could still be influenced by the US election result, this should also support the performance of investments in other regions, particularly in emerging markets (bottom chart). Investor funds, which have primarily flowed into the US in recent years, could once again be channelled more strongly into other regions – the rapid appreciation of the yen at the beginning of August could have been a foretaste of this. The market trend should then also gain breadth globally. However, the opportunities that arise will depend heavily on the outcome of the US election.

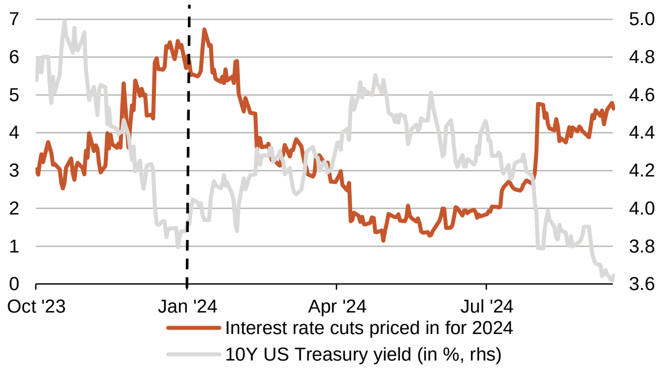
More opportunities after the US election

The race for the US presidency is likely to cause more volatility in October, especially as October is historically the month with the highest volatility anyway. We do not expect the stock markets to break out to new highs before the US election – but rather to move sideways in a volatile manner. With the end of the election uncertainty and supported by further interest rate cuts, equities are likely to perform better again in the new year, in line with the typical positive seasonality. This is particularly true if the markets are able to put growth concerns behind them with more positive US economic data and interest rates are lowered further – this would then be the Goldilocks environment of a soft landing. Which regions will then benefit in particular depends in part on the outcome of the US election. In the medium term, however, all asset classes are likely to benefit from investors shifting more capital out of short-term interest rate investments as rates fall. In recent cycles, this has been observed 6-12 months after the first interest rate cuts. We assume that medium-term bonds, as well as equities with attractive valuations such as European equities, especially small and mid-caps, and emerging market equities, are likely to benefit from this.

Prof Dr Bernd Meyer, Chief Investment Strategist

Fed rate cut expectations rise with growth concerns

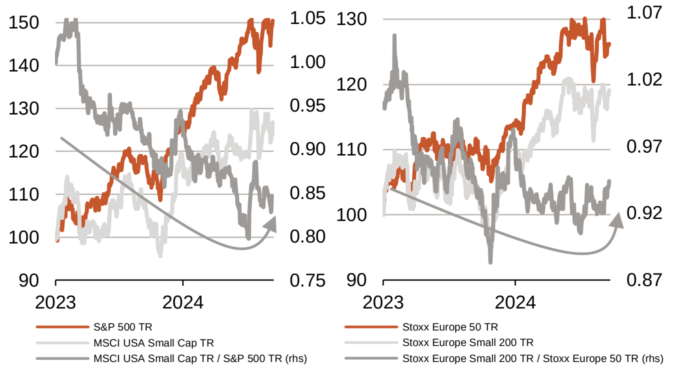
Recession fears rose sharply in the US with weak labour market data; bond yields fell and rate cut hopes rose



Time period: 01/10/2023-16/09/2024.
Source: Bloomberg, own calculations.

More market breadth: small caps have recently outperformed

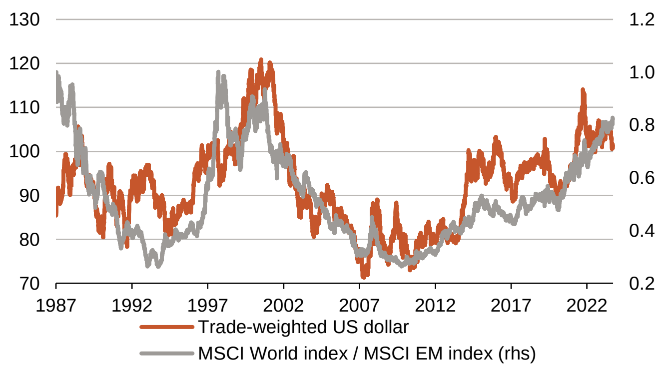
With the turnaround in interest rates and broader earnings growth, the relative performance of small caps versus large caps could finally be bottoming out



Time period: 01/01/2023-16/09/2024.
Source: Bloomberg, own calculations.

If the strength of US dollar runs out, this will favour other regions

For more than ten years, US dollar has only known one direction – upwards. At the same time, Western stock markets, especially US equities, have benefited



Time period: 01/01/1987-16/09/2024.
Source: Bloomberg, own calculations.

ECONOMY AND MONETARY POLICY NORMALISE

IN A NUTSHELL

- US: Economy cools down slowly.
- Europe: Growth will not gain momentum until 2025.
- Inflation: Continuing towards the 2% target for the time being.
- Monetary policy: Descent from the interest rate peak in Europe and the US.

US: Soft landing in sight

US economic growth once again surprised on the upside in the first half of 2024 thanks to an expansive fiscal policy and robust private consumption. However, the restrictive monetary policy has also left its mark on the US, with the result that the economy is now losing some of its momentum. In particular, the previously overheated labour market, residential construction and industry have recently cooled down. So far, all indications are that the previously overheated US economy is merely cooling down, with no sign of a slump. This can also be seen in the unemployment rate, which has risen from 3.4% to 4.2% since April 2023, but is still at a fairly moderate level by historical standards. Companies are no longer looking for labour as desperately as they were last year. As a result, wage increases are no longer quite as lavish. After hourly wages rose at a rate of 4.5% in summer 2023 compared to the previous year, the increase is currently only around 3.5%. The slowdown on the labour market is also expected to lead to a slight slowdown in private consumption in the coming months. The same applies to fiscal policy, which will remain expansive but will not provide any major new impetus. At present, it does not look as though either party will be able to win the White House in the US elections and gain control of both chambers of Congress at the same time. The adoption of new major fiscal packages after the elections therefore seems unlikely from today's perspective. All in all, a certain weakening of the US economy is therefore to be expected in the coming months. However, the current data situation does not point to a recession. We expect solid GDP growth of 2.5% for 2024 as a whole, followed by 1.5% in 2025.

Eurozone economy surprises positively in the first half of the year

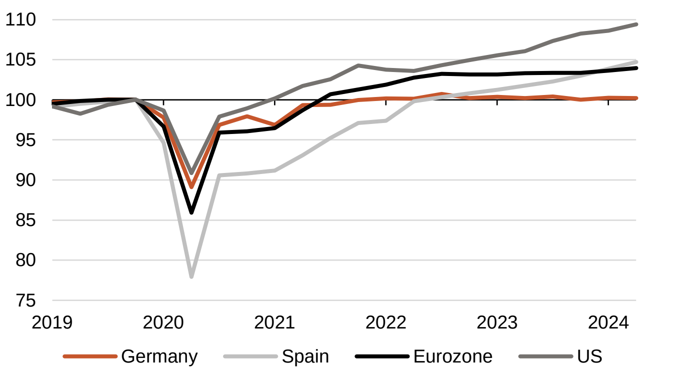
The eurozone economy made it through the first half of the year much better than we had expected at the start of the year. In the first quarter of 2024, economic output in the eurozone rose by a solid 0.3% quarter-on-quarter, followed by 0.2% in the second quarter. This was mainly due to the southern member states, where a mix of reforms, a slightly expansive fiscal policy (which is also partly based on EU funds) and booming tourism supported the economy.

Growth in the eurozone is taking place without Germany

In a European growth comparison, however, Germany is not performing well. The eurozone's largest economy has been virtually treading water for more than two years. In the second quarter of

The German economy is stagnating

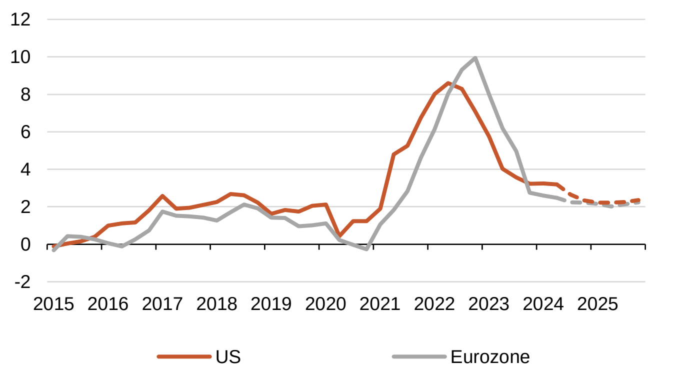
Development of real GDP since Q4 2019



Period: Q1 2019-Q2 2024
Q4 2019 = 100. Quarterly data. Source: Eurostat, BEA, Destatis.

Inflation is moving towards the 2% target

Increase in consumer prices compared to the same period last year in %



Period: Q1 2015-Q4 2025
Quarterly data, dashed: Berenberg forecast. USA: CPI-U, Eurozone: HICP. Sources: BLS, Eurostat, Berenberg.

2024, economic strength even fell by 0.1% compared to the previous quarter. There are many reasons for Germany's weak performance. Firstly, global demand continues to weaken, which is hitting Germany particularly hard as an export nation. In addition, Chinese products are increasingly competing with German products on the global sales markets. Political uncertainty, restrictive financial policies and labour shortages in Germany are also having a negative impact.

New growth impetus not expected until 2025

The current leading economic indicators do not suggest that economic growth in Germany or the eurozone will accelerate significantly in the second half of the year. For Germany, this still means almost zero growth and for the eurozone, expansion rates similar to those seen in the first two quarters of 2024. However, falling inflation and rising real wages will encourage consumers to spend more money again in the medium term. Consumers are still holding back, but this is likely to change in the coming months. Falling interest rates will also have a stimulating effect on the economy, but here too we will probably have to wait until the beginning of next year for this growth stimulus to have a real impact. For the eurozone, we expect GDP growth of 0.7% this year, followed by 1.3% next year. By contrast, the German economy is expected to shrink by 0.1% this year and we expect growth of just 0.6% in 2025.

Joint descent of the central banks from the interest rate peak

Falling inflation rates have allowed the ECB and the Fed to begin their descent from the interest rate peak. After initially underestimating the price rises in 2021 and 2022 and then starting to tighten monetary policy a little too hesitantly, the central banks now want to make sure that inflation has really been brought under control. We therefore believe that further interest rate cuts will be gradual.

This is also supported by the fact that the current easing of monetary policy is not driven by the need to protect the economy from an impending recession. Rather, the nominal interest rate should fall, as otherwise falling inflation would lead to an increase in the real interest rate and thus to an even more restrictive monetary policy. We therefore expect that key interest rates on both sides of the Atlantic will continue to fall slowly in order to loosen the monetary reins and give the economy some tailwind.

Structural reasons such as demographic change and the necessary investments in climate protection are likely to lead to inflation rates in both the eurozone and the US levelling off at a higher level than before the pandemic in the medium term. For the central banks, this means that they will loosen their monetary policy less aggressively than was previously the case. We expect the US Fed to lower its lending rate to 3.75-4.0% by the summer of 2025, while the ECB will probably stop at the deposit rate of 2.5%.

Dr Felix Schmidt, Senior Economist

Growth and inflation forecasts

	GDP growth (in %)						Inflation (in %)					
	2024		2025		2026		2024		2025		2026	
		∅**		∅**		∅**		∅**		∅**		∅**
USA	2.5	2.5	1.5	1.7	2.0	2.0	2.9	2.9	2.3	2.3	2.4	2.3
Eurozone	0.7	0.7	1.3	1.3	1.6	1.5	2.4	2.4	2.1	2.1	2.3	2.0
Germany	-0.1	0.1	0.6	1.0	1.3	1.3	2.5	2.4	2.2	2.2	2.3	1.9
France	1.1	1.1	1.3	1.1	1.4	1.3	2.6	2.5	2.1	2.0	2.3	1.9
Italy	0.8	0.8	1.2	1.0	1.2	1.1	1.1	1.2	2.0	1.8	2.3	1.8
Spain	2.8	2.7	2.2	2.0	2.1	1.7	3.0	3.0	2.6	2.2	2.6	2.1
UK	1.1	1.1	1.6	1.4	1.7	1.5	2.6	2.6	2.4	2.3	2.5	2.0
Japan	-0.2	0.0	1.2	1.2	1.1	0.9	2.5	2.5	1.9	2.0	1.7	1.6
China	4.7	4.8	4.2	4.5	4.2	4.2	0.5	0.5	1.8	1.5	2.0	1.8
World*	2.5	-	2.4	-	2.6	-	-	-	-	-	-	-

* Berenberg data at actual exchange rates, not according to purchasing power parities (PPP). PPPs lend more weight to fast-growing emerging markets.
** Average, Bloomberg consensus as of 18/09/2024.

CHANCES FOR A YEAR-END RALLY AFTER THE US ELECTION

IN A NUTSHELL

- Equity indices should still have moderate upside potential until the end of the year. However, we see this primarily following the US elections. Which regions and sectors will come out on top is likely to depend heavily on who emerges victorious in the elections and whether both US chambers are won by the same party.
- Small caps offer the greatest seasonal potential and are also likely to be supported by falling interest rates. Overall, market breadth is likely to increase.

Mixed Q3 for equities

While the major share indices barely moved in the third quarter, there was a rotation below the surface. Tech stocks were among the relative losers due to a mixture of AI hype concerns and growth worries. The latter also weighed on commodity stocks. By contrast, defensive equity sectors were among the relative winners. In regional terms, this was reflected in the underperformance of Asian and US equities and the outperformance of UK equities. The relatively favourably valued small cap stocks, for which a lot of negative factors are already priced in, held up surprisingly well.

Mixed picture with regard to earnings expectations

Although fears of recession have recently increased, mainly due to disappointing US economic data, analysts have recently raised their earnings estimates for the next 12 months – especially for Asian equities and more defensive and interest rate-sensitive sectors. The property sector saw the most positive earnings revisions. However, earnings expectations, particularly for the US, appear very ambitious. Analysts expect earnings growth of 15% for US equities in 2025 – and this with a weakening US labour market and the threat of an economic slowdown. Accordingly, there is likely to be a tendency towards negative earnings revisions in the near future.

European equities with a high risk premium

The P/E valuation for the S&P 500 has risen again after the correction at the beginning of August and, at 21.3, is as high as it was last in October 2021. European equities, on the other hand, have become even cheaper in a historical comparison and are now trading at a historically high valuation discount of more than 37% compared to US equities at index level. There are various reasons for this. In addition to the different sector structure (more innovative and high-growth companies in the US), the higher potential growth and the lower and more flexible capital market in the US are also responsible for this. In addition, the US is more strongly supported by a higher proportion of valuation-sensitive investors (e.g. ETF savings plans). However, these non-new arguments probably only explain part of the valuation difference. Higher EU energy prices and Trump's possible victory in the US presidential election (and thus probably higher tariffs) also play a role. The positive aspect is that European equities are already pricing in a high premium for all these risks and offer opportunities should they not materialise.

More defensive equities (regions) have recently been ahead, favoured by falling yields and increasing growth concerns

Total return	YTD and in Q3 2024 (in %, in EUR): YTD (31/12/23-16/09/24)	YTD and in Q3 2024 (in %, in EUR): Q3 2024 (30/06/24-16/09/24)	12-month periods of the last 5 years (in %, in EUR): 16/09/23 16/09/24	16/09/22 16/09/23	16/09/21 16/09/22	16/09/20 16/09/21	16/09/19 16/09/20	P/B* 16/09/24	Div.* 16/09/24	P/E* 16/09/24
Stoxx Europe Defensives	24.2	6.9	28.5	7.9	12.2	-10.1	21.7			
S&P 500	18.6	-0.4	23.2	9.6	3.3	35.0	7.0	4.8	1.3	21.3
Stoxx Europe Cyclicals	11.7	1.0	22.3	18.7	-16.9	36.7	-2.7			
DAX	11.2	2.2	17.2	24.7	-18.6	18.1	7.1	1.6	3.0	12.8
Stoxx Europe 50	10.4	-1.3	12.8	19.5	-0.1	20.8	-2.8	2.5	3.3	14.4
MSCI EM Asia	10.4	-3.7	9.7	0.2	-11.7	14.0	13.3	1.7	2.4	12.3
MSCI UK	10.2	2.2	11.6	10.2	10.0	19.9	-15.9	1.9	3.8	11.9
MSCI Japan	9.6	0.0	9.1	16.5	-15.0	26.0	-0.1	1.3	2.4	14.2
Euro Stoxx 50	9.1	-1.2	15.2	25.8	-13.8	27.1	-3.1	2.0	3.3	13.3
MSCI USA Small Caps	7.5	2.3	14.1	0.1	-0.9	48.2	-7.9	1.9	1.9	19.7
Stoxx Europe Small 200	-6.6	3.2	8.3	23.3	-15.0	68.0	-27.7	1.5	3.3	13.1
MSCI EM Latin America	-12.2	0.9	-4.0	12.4	15.2	23.8	-29.3	0.9	5.3	9.3

Time period: 16/09/2019-16/09/2024.
Source: Bloomberg * P/B = price-to-book ratio; Div. = dividend yield (%); P/E = price-to-earnings ratio. Values based on estimates for the next 12 months.

Market breadth likely to increase further

While equity index performance was driven by a few, predominantly tech stocks until the summer, the picture has changed since July. More defensive and above all interest rate-sensitive stocks have recently been able to gain ground. Q4 performance is likely to be strongly influenced by the outcome of the US elections. If Harris wins the presidential election, this should also tend to favour non-US equities (more international cooperation, fewer tariffs, but higher US taxes). Trump, with his focus on the US and deregulation, would at least superficially be better for US equities and especially US small caps with a lot of domestic exposure. However, a large risk premium has already been priced in for European equities and especially small cap stocks. There could also be a familiarisation effect, as international investors now know better than eight years ago what to expect under Trump. If Trump actually succeeds in ending the war between Russia and Ukraine, Europe could also benefit from this (lower risk premium, lower energy costs). However, the implications for equity markets also depend on how many of the election promises are actually implemented – which in turn depends on whether a candidate takes over both US chambers or not. History shows that volatility is usually high before elections and declines sharply afterwards, regardless of who wins, as uncertainty disappears. We therefore see good opportunities for a year-end rally and believe small caps are likely to outperform, favoured by lower interest rates and positive seasonality.

Ulrich Urbahn, Head of Multi Asset Strategy & Research

WHAT IS ON COMPANIES' MINDS?

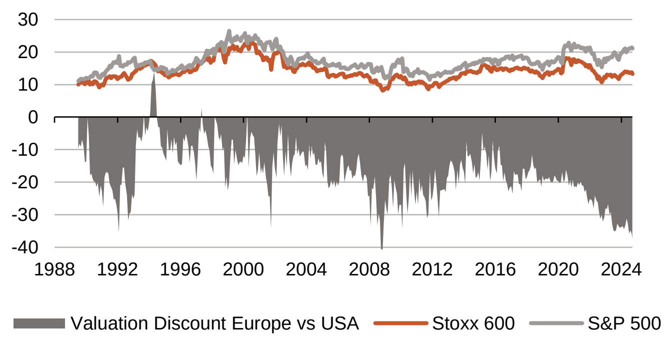
Economic uncertainty

European companies in the renewable energy sector are benefiting from at least stabilising energy prices, and the prospect of falling interest rates is making new projects more attractive. In contrast, demand trends in the automotive industry remain difficult and are characterised by uncertainties surrounding the electric car. In the luxury sector, companies have reported a further sequential deterioration in trends in recent months, particularly in Asia, and the broad downturn continues. Although the semiconductor sector continued to benefit from the strong trends driven by AI and is seeing a further recovery in its core business, expectations regarding the strength and speed of this recovery have recently been revised significantly downwards. In contrast, the trends in the healthcare sector remain solid. Both the pharmaceutical and medical technology sectors have seen some increases in their annual forecasts. After two years of downturn and prolonged destocking, we are also seeing a clear recovery among companies in the life sciences sector. The de-stocking is coming to an end and incoming orders are growing compared to the previous quarter. As in other sectors, business development in China remains weak.

Matthias Born, CIO Equitites

European equities have rarely been so cheap relative to the USA

P/E valuation based on earnings estimates for the next twelve months for European and US equities and the corresponding valuation difference (in %)



Time period: 30/06/1989–16/09/2024.
Source: Bloomberg, own calculations.

Forecast summary: trees don't grow into the sky

Berenberg and consensus forecast in comparison, values for mid-2025 and year-end 2025

	Current	Berenberg		∅*
Index forecasts	16/09/2024	30/06/2025	31/12/2025	In 12 months
S&P 500	5,633	6,000	6,100	6,232
DAX	18,633	19,800	20,500	21,756
Euro Stoxx 50	4,828	5,300	5,400	5,634
MSCI UK	2,363	2,500	2,600	2,713
Index potential (in %)				
S&P 500	-	6.5	8.3	10.6
DAX	-	6.3	10.0	13.9
Euro Stoxx 50	-	9.8	11.9	17.1
MSCI UK	-	5.8	10.0	14.1

* Average, consensus bottom-up as of 16/09/2024.
Source: Bloomberg, Factset, Berenberg.

SELECTIVE RISKS PROMISE RETURNS

IN A NUTSHELL

- Safe government bonds with a positive third quarter, but price potential exhausted.
- Market technology supports European corporate bonds, we favour the more defensive investment-grade segment.
- Local currency bonds from emerging markets with untapped potential, attractive entry opportunities.

Joint upward trend unlikely to last

The third quarter brought investors in large parts of the bond market falling yields and thus pleasing gains. For the coming weeks and months, however, we do not expect a continuation of the unified upward trend in bond prices, but rather a return to the heterogeneity of the first half of the year. In this respect, the differentiation between individual bond sectors is likely to become more important again.

Safe government bonds: recent tailwinds fade again

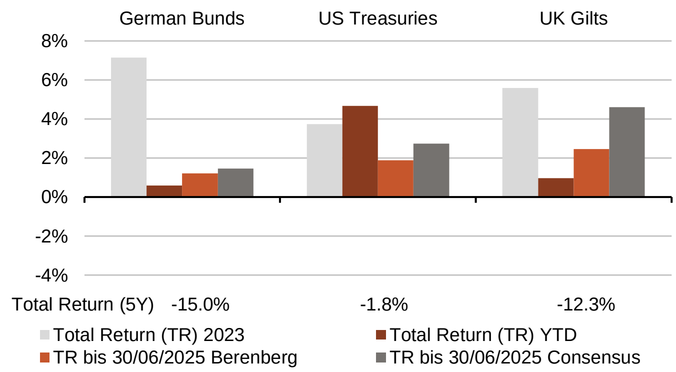
After two negative quarters, the picture for safe government bonds has recently turned around – from July to September, increases in value were recorded. In comparison, US Treasuries in particular stood out in local currency terms and have now shown a clearly positive balance since the beginning of the year (bottom left). In addition to increased demand for security, which characterised the market in the second half of July, during the temporary stock market correction at the beginning of August and again at the beginning of September, the ongoing disinflation process benefited the government bond segment. The German inflation rate fell to 1.9% in August compared to the same month of the previous year (or 2.0% on an EU harmonised scale), falling below the 2% mark for the first time since March 2021. Inflation also fell across the eurozone and in the US, meaning that hopes of further interest rate cuts provided additional support for government bonds. As yields at the short end have fallen significantly more than at the long end, the yield curves are almost flat again, at least when looking at 10-year and two-year maturities. Much now seems to have been priced in, and in our main scenario we expect yields to rise again in the longer maturity segment. Positive income from carry could therefore be partly cancelled out by price movements in the opposite direction.

Corporate bonds: technology trumps valuation

Euro-denominated corporate bonds are still ahead in 2024: the investment-grade segment has gained 3.2%, while high-yield bonds have even risen by 5.9%. Also, the segment should remain supported by technical market factors for the rest of the year. Corporate balance sheets are solid and the majority of the latest quarterly results do not show any signs of gloom due to the risk of a recession, which still cannot be completely ruled out. At the same time, the issuing markets are heading for a new record year: a net total of EUR154bn euros has already been placed amid brisk demand. Investor appetite appears to be high, with fund inflows in both the investment-grade and high-yield segments indicating growth of almost 10% in this asset class according to JP Morgan. Only when it comes to valuation is there less confidence. In many segments, risk premiums can only be described as fair

Safe government bonds: moderate returns until mid-2025

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



Time period: 18/09/2019-18/09/2024.
Source: Bloomberg, Berenberg calculations, iBoxx government bond indices (7-10 years, TR).

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

Berenberg and consensus forecast in comparison, values at mid-year 2025 and at year-end

	18/09/2024	30/06/2025		31/12/2025	
	Current		∅*		∅*
USA					
Key interest rate	4.75-5.00	3.75-4.00	3.95	3.75-4.00	3.60
10Y US yield	3.71	3.90	3.79	4.10	3.71
Eurozone					
Key interest rate	3.65	2.65	2.85	2.65	2.55
10Y Bund yield	2.19	2.30	2.27	2.50	2.24
Great Britain					
Key interest rate	5.00	4.25	4.10	4.00	3.65
10Y Gilts yield	3.85	4.00	3.72	4.10	3.65

* Average, consensus as of 18/09/2024.
Source: Bloomberg.

by historical standards (see figure below left). Assuming that the market continues as it is, this should not be a problem, but rather technical support should dominate. However, a heated US election campaign and possibly weak macroeconomic data could disrupt this picture and herald a correction. We remain cautious and continue to favour corporate bonds, albeit in the more defensive investment-grade segment rather than the high-yield segment.

Emerging markets: local currency bonds with catch-up potential

While there was still speculation about a possible interest rate hike in the US in the spring, the conviction that a cycle of interest rate cuts would begin in September prevailed during the third quarter. The weaker labour market and inflation data underlying this change of heart also influenced the market for emerging-market securities. Until April, the contributions of the interest rate component to performance were still negative, but the effect then reversed by mid-September (+4.9 % in the hard currency segment, +1.4 % in the local currency segment). It is striking that local currency bonds have not yet been able to realise their full potential despite favourable conditions (see figure below right). We see the reasons for this firstly in the fact that emerging-market central banks have initially held back with aggressive easing in view of the uncertainty surrounding US interest rate policy. Secondly, a possible election victory for Donald Trump could change the environment for emerging markets. This uncertainty is likely to persist until the presidential election on 5 November. Thirdly, surprising statements from Brazil and Colombia have led to concerns about rising budget deficits and sell-offs in their respective local currency bonds. However, we consider these movements to be exaggerated. In the long term, valuations should return to a fundamentally justified level, meaning that there are currently interesting entry opportunities. We therefore continue to favour local currency securities over their hard currency counterparts and consider the former to be the most attractive asset class within the emerging markets due to their risk/return perspective.

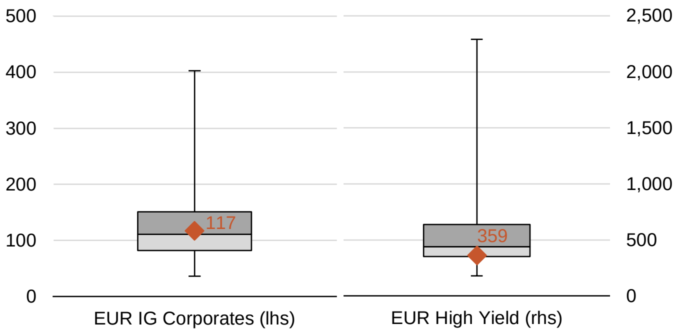
Conclusion: opportunities in corporate and emerging market bonds

After an unexpectedly good third quarter, safe government bonds have become less attractive looking ahead. In the event of a soft landing of the US economy, yields in Germany as well as US and UK bonds are likely to rise again in the medium term, resulting in price losses that will fully or partially erode the carry. Despite no longer favourable valuations, corporate bonds are well supported by market technology and should continue to perform better in the absence of a significant economic downturn. In view of the potential risks, however, we favour the defensive investment-grade segment over high-yield bonds. In emerging markets, our favourites remain local currency securities, which have not yet fully exploited their potential. This could change in the coming months.

Martin Mayer, Senior Portfolio Manager Multi Asset
Christian Bettinger, Head Fixed Income Euro & Emerging Markets
Wei Lon Sung, Head Fixed Income Emerging Markets

Corporate bonds: HY risk premiums historically unattractive

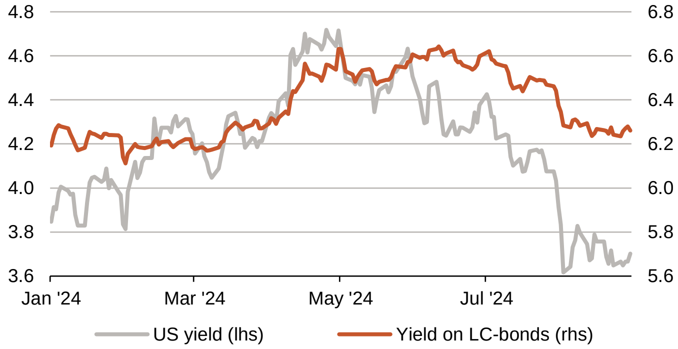
The risk premiums in the HY segment are no longer a reason to buy, whereas in the IG segment they are at the level of the historical median



Time period: 01/01/2000-16/09/2024, risk premiums compared to German government bonds, IG: investment grade, HY: high yield (high yield securities)
Source: ICE, own calculations.

Emerging markets: local currency bonds have catch-up potential

5-year US yields have fallen much more sharply since June compared to yields on duration-like EM local currency bonds (in %)



Time period: 01/01/2024-31/08/2024, Source: Bloomberg, own calculations; LC: local currencies, LC yield: J.P. Morgan GBI-EM Global Diversified Composite Yield to Maturity.

CYCLICAL COMMODITIES AWAIT ECONOMIC RECOVERY

Oil continues to move sideways despite a mixed outlook

Although crude oil has remained in a sideways trend since the beginning of the year, Q3 was characterised by falling prices. Fundamentally, this weakness is difficult to explain: According to the EIA, the oil market has been in a supply deficit since April, US inventories have fallen almost monotonically in recent months and there have recently been major production shortfalls in Libya due to political unrest. However, the outlook for the coming months is challenging. Demand in the West is likely to weaken seasonally, while the Chinese economy continues to disappoint. At the same time, OPEC+ has postponed but not cancelled its planned production increases. However, with investors already pessimistic despite the solid starting position, much already seems to be priced in. Due to the high free capacities and rising non-OPEC production, the upside potential nevertheless remains limited. The sideways trend since the beginning of the year is therefore likely to continue.

Gold at an all-time high, but there is still room for rising prices

Like in Q1 and Q2, gold also reached new all-time highs in the third quarter. However, the drivers of the rally have reversed compared to the first half of the year – from physical to financial demand. Previously, emerging-market central banks had pushed ahead with the de-dollarisation of their currency reserves and Chinese private investors had increasingly invested in gold instead of real estate. At the same time, gold ETFs recorded outflows totalling 4.5m ounces in H1. Most recently, however, physical purchases slowed significantly in the wake of the sharp rise in the price of gold, while investor interest in the safe haven suddenly increased again in the West in view of finally falling key interest rates. Despite the all-time high, the rally in gold can continue thanks to the change in drivers. In an environment of falling interest rates, rising government debt, a weaker US dollar, high uncertainty in the run-up to the US elections and geopolitical escalations in the Middle East, there are many good reasons to invest in gold.

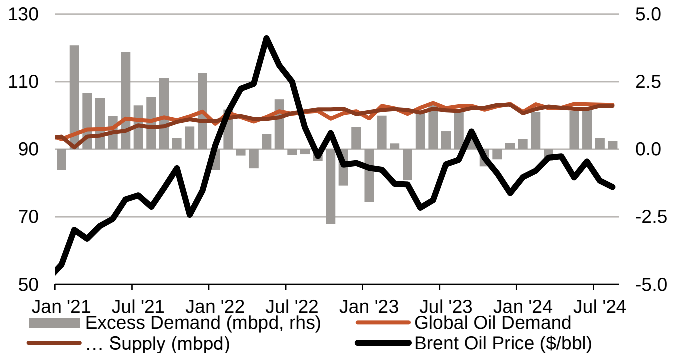
Metals await rising activity in the manufacturing sector

In recent months, industrial metals have not been spared from the continued weakening activity in the manufacturing sector, particularly in China. Despite tight supply, industrial metals are likely to continue to struggle to appreciate sustainably without impetus from the manufacturing sector. However, there are signs that demand is recovering, particularly in the Far East: local premiums are rising again and exports and high inventories are falling. Although industrial metals are already pricing in a negative outlook, the timing of the recovery remains uncertain.

Ludwig Kemper, Multi Asset Strategy & Research

Fundamental starting position for oil good, but outlook mixed

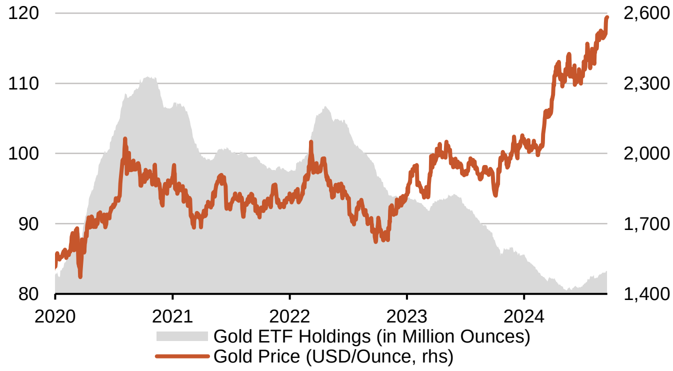
Global demand surplus (in millions of barrels per day) compared to the price of Brent crude (in USD per barrel)



Time period: 01/01/2021-31/08/2024.
Source: Bloomberg, EIA, Berenberg calculations.

Further inflows into gold ETFs should provide a tailwind

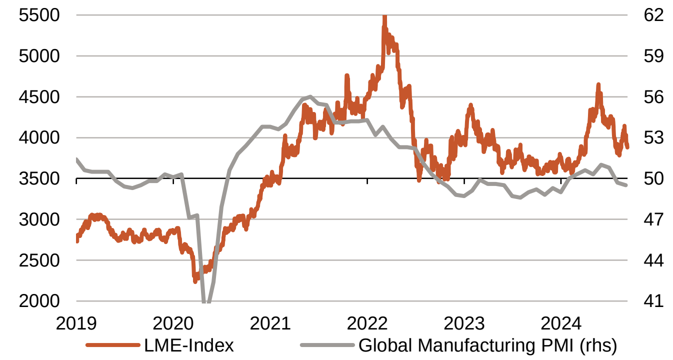
Gold price in US dollars versus global gold ETF holdings in million ounces



Time period: 01/01/2020-16/09/2024.
Source: Bloomberg, Berenberg calculations.

Metals are likely to appreciate once manufacturing activity picks up

LME Industrial Metals Index versus the Global Manufacturing Purchasing Managers' Index



Time period: 01/01/2019-16/09/2024.
Source: Bloomberg, Berenberg calculations.

START OF US INTEREST RATE TURNAROUND WEAKENS US DOLLAR

Major central banks step away from the interest rate peak

In the US, declining inflation and the cooling labour market in recent months have led the currency market to price in an earlier and more aggressive interest rate turnaround by the Fed. This prospect has recently taken some of the wind out of the greenback's sails. Since late summer, it has not only lost some of its previous strength against the euro.

Although the US Federal Reserve began its interest rate turnaround somewhat later than the ECB, it could now cut its key interest rate faster than is likely to be the case in the eurozone. For the US dollar, this means continued devaluation pressure. In addition, the US economy is likely to cool down further in the coming months, while the still hesitant upturn in the eurozone could gain some momentum in the coming year. We therefore expect the euro to appreciate slightly against the greenback in 2025.

In the medium term, a certain amount of euro strength is therefore to be expected. In the run-up to the US presidential elections on 5 November, however, the US dollar could receive another temporary tailwind. This is because the greenback is always in demand as a safe haven in politically uncertain times – ironically, even when the uncertainty emanates from the US.

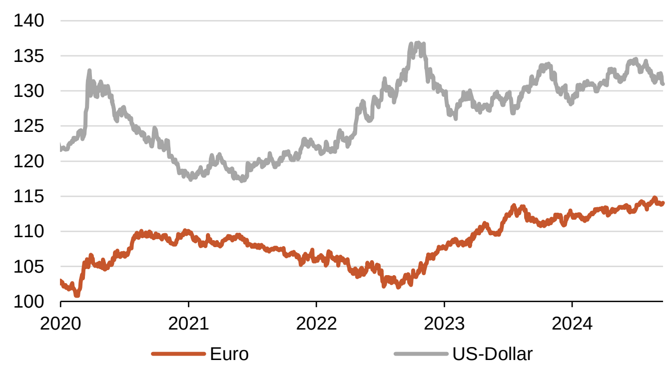
The Swiss franc also enjoys strong demand, particularly in turbulent times. This was once again evident at the beginning of August, when price slumps on the global stock markets caused the franc to appreciate significantly. In the short term, the US election could create some additional demand for the franc, but the exchange rate will move closer to parity again by the end of the year. After that, the exchange rate will be determined by the further actions of the central banks. Also, the ECB and the Swiss central bank will take very similar approaches here, which is why we expect the euro-franc exchange rate to move sideways in the coming year.

The BoE has initiated the interest rate turnaround from a slightly higher level than the ECB and is therefore likely to lower its key interest rate somewhat more than its European counterpart in the eurozone. Although the lower interest rate differential speaks against the pound, the UK economy currently has slightly more momentum than in the eurozone. Overall, we therefore expect the euro-pound exchange rate to move sideways.

Dr Felix Schmidt, Senior Economist

The dollar has recently lost some of its strength

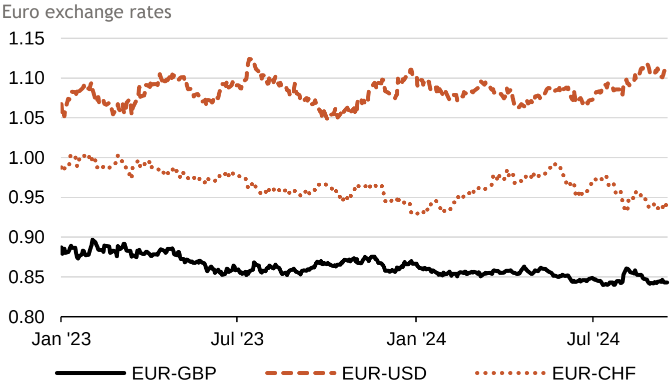
Nominal effective exchange rates



Time period: 01/01/2020-16/09/2024.
Euro and dollar against trading partner currency baskets. Source: JPM.

Swiss franc recently in demand as a safe haven

Euro exchange rates



Time period: 01/01/2023-16/09/2024.
Source: FT.

Exchange rate forecasts

Berenberg and consensus forecast in comparison, values at mid-year 2025 and at year-end

	18/09/2024	30/06/2025		31/12/2025	
Exchange rate forecast	**Current**		∅*		∅*
EUR/USD	1.11	1.13	1.12	1.15	1.13
EUR/GBP	0.84	0.84	0.85	0.84	0.85
EUR/CHF	0.94	0.96	0.97	0.97	0.98
EUR/JPY	158	154	157	152	155
Change against the euro (in %)					
USD	-	-1.6	-0.7	-3.3	-1.6
GBP	-	0.2	-1.0	0.2	-1.0
CHF	-	-2.0	-3.0	-3.0	-4.0
JPY	-	2.7	0.8	4.1	2.1

* Average, consensus as of 18/09/2024.
Source: Bloomberg.

INTERVIEW WITH MARIA ZIOLKOWSKI

Ms Ziolkowski, you manage government bonds, defensive bonds in the investment grade segment and short-dated bond concepts. What fascinates you about the bond asset class and your work as a portfolio manager?

Even in elementary school, I was allowed to choose whether I wanted to invest my gifts of money as a fixed-term deposit or a daily deposit. I later became interested in the stock market and the financial markets and came into contact with the bond markets during the global financial crisis of 2007/08. At the time, I had a geography teacher who impressed me with the fact that she owned Austrian government bonds. I found it fascinating to lend money to the state as a private individual. I decided to study economics and mainly focused on monetary policy and banking regulation.

Bonds react sensitively to economic and political developments. I really enjoy recognising the correlations, evaluating them and deriving our positioning from them. As the market environment is dynamic, it forces you to question your opinion and learn new things almost every day.

You have been with Berenberg for just over a year now. What characterises the Berenberg bond team and what makes it special?

The team is very diverse and complements each other well. Each person is responsible for a sub-area, so we can cover a lot of topics. We are also integrated into the multi-asset area and therefore benefit from synergies. Topics such as risk sentiment and the economy are developed jointly. Once an opinion has been established and justified, we have many degrees of freedom to implement active positioning decisions.

One thing that really surprised me was the widespread use of portfolio managers with programming skills and programmers. There are countless colleagues who are constantly trying to structure workflows, provide technical support and thus make them more efficient and, above all, more error-free. This gives us more time for portfolio management, fundamental analysis and specialised areas such as emerging markets or financial bonds.

Bonds offer attractive yields again. What does this mean for investors and how have you reacted to this in the bond team? What bond products does Berenberg offer its clients?

The higher interest rate environment means that investors are no longer reliant on equities to generate investment income above inflation. Berenberg is a house of short distances and new products have been created in response to the new environment. Last year, we launched the Berenberg Euro Target 2028 fund as well as various maturity and laddered strategies in asset management, which can be used to secure yield levels. This year, a pure bond strategy was launched in asset management.

What are the special features of the bond strategy euro asset management? What do you look for when selecting bonds?

The strategy has many degrees of freedom and is actively managed. The focus is on top-down decisions such as the management of duration, sector and country allocation and the opportunity-orientated selection of individual securities. It is offered from EUR5m to be able to diversify sensibly, as the majority of corporate bonds require a minimum investment of EUR100,000. ETFs and funds, on the other hand, are only used in individual cases (e.g. to avoid transaction costs when market liquidity is very low) and are limited to a maximum quota of 15%.

What are the differences between Asset Management Bond Strategy Euro and the broad bond fund Berenberg Euro Bonds, which also has an asset management character?

Both make investments on the basis of the investment committee's capital market opinion, apply both top-down and bottom-up analyses and operate in the same segments. There is no minimum investment volume for the fund and the interest rate positioning can be mapped via futures. Due to the minimum denomination of bonds, Berenberg Euro Bonds is also more diversified and also has a higher maximum quota for high-yield and subordinated investments.

What are the current yield opportunities for euro bonds and what risks are associated with them?

There are currently no signs worldwide of a return to a permanent low interest rate environment. Although interest rates are currently being lowered, structural factors such as demographic change or climate change should lead to higher (real) interest rates in the future. This should at least enable a return above inflation in many bond segments. The current yield on European government bonds is currently 2.8%, on investment grade euro bonds 3.5% and on high-yield euro bonds 6.4%.

Additional added value can be achieved through active management. For example, when fears of recession flare up, interest rates normally fall and risk premiums widen, leading to price losses for particularly risky bonds, while defensive bonds benefit. If we assume a recession, we would therefore favour a more balanced positioning with a higher proportion of covered bonds and government bonds. Active management should enable us to perform well in a variety of scenarios such as rising inflation, a stronger recession, trade wars or even stronger geopolitical risks.

Why should investors consider bond investments with longer maturities right now?

Due to the still inverted yield curve, yields on short maturities are currently higher than on longer maturities. At first it seems more attractive to buy two-year bonds. But after two years, the capital has to be reinvested and this at possibly lower interest rates. Most central banks have started to cut interest rates and the highs in yields are probably already behind us. A longer fixed interest period could therefore lead to a higher overall return. In addition to the current interest rate, however, price effects must also be taken into account. Although interest rates will probably fall more at the short end and we will return to a rising curve (historical average yields for 10 years are 80-100 bp higher than those for two years), bonds with a longer duration react more sensitively to interest rate changes, so you should position yourself in the maturity where the effect of lowering interest rates and duration is best. In our view, these are currently bonds with medium maturities of three to seven years.

You also manage term strategies. What is special about maturity strategies and maturity funds?

With maturity strategies, we only buy bonds that mature at a specific time. Our Berenberg Euro Target 2028 fund, for example, only holds bonds maturing in 2028, so the return is quite predictable because there is no reinvestment risk and default risks can also be minimised through consistent risk management. Such strategies only focus on the current interest rate and not on price effects. The prerequisite is holding to maturity. Our strategies are based on a ‘buy and maintain’ approach, i.e. we buy bonds with the aim of holding them to maturity. Changes are then made on the basis of risk management or if a more attractive bond with the same target maturity is issued or found.

Which bond segments do you currently consider to be the most attractive in the team?

We are fairly balanced in our positioning. Core investments that should deliver solid returns in different market phases are combined with individual securities offering attractive yields. Outside the eurozone, we consider local currency bonds from emerging markets to be attractive, as they offer a high current yield and most currencies are likely to appreciate against the US dollar due to the Fed's interest rate cuts..

SHORT VITA

Maria Ziolkowski, CFA, has been with Berenberg since September 2023. As a portfolio manager, she focuses on government bonds and defensive bonds in the investment-grade segment. Before joining Berenberg, she worked at Flossbach von Storch and BNP Paribas. She holds a Bachelor's degree in Economics from the Vienna University of Economics and Business, a Master's degree in Monetary and Financial Economics from the University of Lisbon and a Master's degree in Gender Studies from the University of Vienna.

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PUBLISHING INFORMATION

PUBLISHER

Prof Dr Bernd Meyer | Chief Investment Strategist

AUTHORS

Christian Bettinger, CFA | Head of Fixed Income Euro and EM
is responsible for the investment strategy for euro and EM bonds and manages the Berenberg Euro Bonds and Berenberg Credit Opportunities funds

Matthias Born | Head Portfolio Management Equities
is responsible for the investment strategy for asset management equities with a focus on the selection of specific European equities

Ludwig Kemper, CFA| Multi Asset Strategy & Research
analyses financial markets, supports the multi-asset investment process and participates in capital market publications

Martin Mayer, CEFA | Senior Portfolio Manager Multi Asset
manages multi-asset mandates and analyses bond markets. with a special emphasis on government bond markets

Prof Dr Bernd Meyer, CFA | Chief Investment Strategist
is in charge of Multi Asset and responsible for Wealth and Asset Management capital market assessments

Wei Lon Sung | Head Fixed Income Emerging Markets
is responsible for the investment strategies for EM bonds and manages mutual funds and strategies focussing on EM hard currency and local currency bonds

Dr Felix Schmidt | Senior Economist
analyses economic – especially macroeconomic – developments

Ulrich Urbahn, CFA | Head of Multi Asset Strategy & Research
focuses on the multi-asset investment process, the development of investment ideas and capital market communications

IMPORTANT NOTICES

Date: 20 September 2024

Joh. Berenberg, Gossler & Co. KG
Neuer Jungfernstieg 20
20354 Hamburg (Germany)
Phone +49 40 350 60-0
Fax +49 40 350 60-900
www.berenberg.com
multiasset@berenberg.com