HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

ECONOMIC RECOVERY

The economy and earnings are surprising on the upside, and growth expectations for both are rising. This is positive for risky assets. However, equity markets are already pricing in a very favourable outlook, but little risk of a slowdown in growth or more persistent inflation.

COMMODITY RALLY

Signs of economic recovery in China and Europe, as well as structural demand from the energy transition, have pushed industrial metals to the top of the performance rankings in the second quarter. Gold keeps pace and also outperforms equities. Commodities and commodity companies remain attractive.

POLITICAL SUMMER

Geopolitical risks, new elections in France and Trump's polarising statements are likely to cause volatility and could weigh on Europe in particular. The likelihood of an equity market pullback ahead of the US elections has recently increased significantly.

Q3 | 2024

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FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear Readers,

After a very strong performance in the first quarter, equities lost some momentum in the second quarter, although the economic outlook in Europe and China has improved and earnings expectations for 2024 and 2025 have risen. In addition to the uncertainty caused by the new elections in France, this is due to the fact that not only has the economy improved, but inflation has been more persistent so far. Interest rate cut expectations have been reduced. Bond yields have risen. However, riskier segments of the bond market have benefited from falling credit spreads. From a regional perspective, emerging Asian equities, the UK and the US were the best performers. In Europe, small caps benefited from the improving economy and the first interest rate cut by the ECB. In the US, however, market breadth remained low. The real winners were base metals, silver and gold.

What can we expect in the second half of 2024? The improved outlook for economic and earnings growth is positive for riskier assets, especially equities. However, they are already pricing in very good prospects overall and very little risk. The opportunities are therefore more likely to lie beneath the surface – in Europe, for example, were it not for the election risk in France and the US – as well as in small caps and commodities. Like the equity markets, safe government bonds are barely pricing in the risk of prolonged inflation. Unexpectedly high inflation therefore remains a major risk for both markets. Stronger economic momentum is therefore not entirely positive, as it could reignite inflation, especially as many disinflationary base effects are likely to have largely run their course. At present, markets are repeatedly reacting negatively to solid economic data – "good news is bad news" and vice versa. Inflation is likely to remain one of the defining themes of the summer, with important implications for asset allocation and the correlation between equities and safe government bonds. The second major risk is a significant slowdown in growth, which would be negative for equities, commodities and high yield bonds. Other important issues this summer are likely to be the French elections and the US election campaign. On the one hand, Europe's ability to act is at stake. On the other hand, Trump could inflame sentiment against Europe (and China) by threatening a trade war. Both could continue to support the US dollar and US equities despite their overvaluation.

Our portfolio positioning is moderately constructive, with a focus on commodities, corporate bonds and small caps, and a neutral equity allocation. Given the optimistic investor sentiment and positioning, the stretched valuations of US equities in particular, and the persistently high risks (inflation, US economy, elections, geopolitics), we do not believe that a more aggressive positioning is appropriate.

In the Insights interview on page 14, Dennis Nacken gives an insight into how single family offices, which manage the assets of entrepreneurial families and high net worth individuals, work and invest, and what other wealthy investors can learn from them. Enjoy the read!

CONTENT

HIGHER UNCERTAINTY = SIDEWAYS OVER THE SUMMER

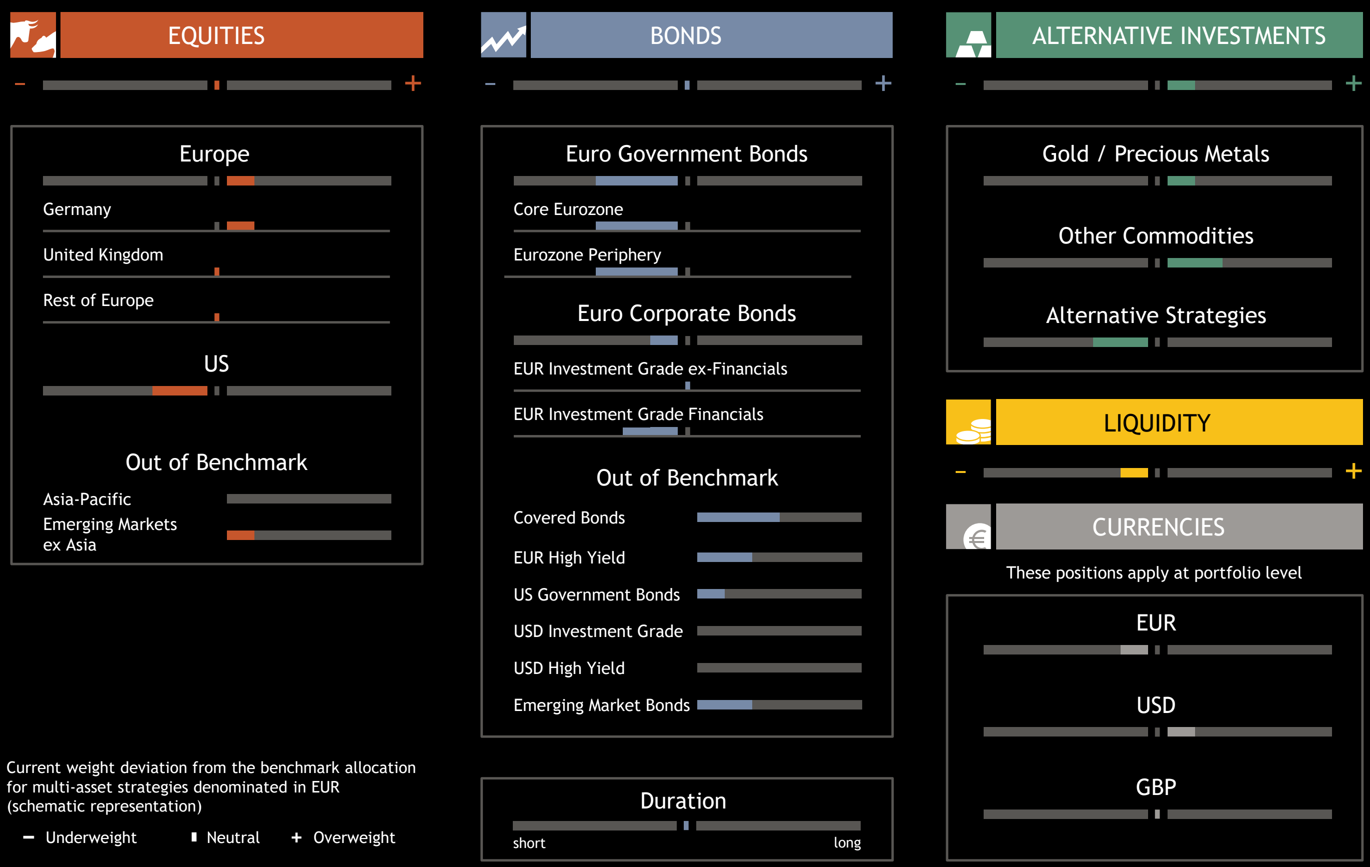
IN A NUTSHELL

- A global economic recovery has become more likely. Europe and Asia are gaining momentum and the US remains robust. Earnings expectations are rising.
- In addition to the structural reasons for higher inflation over the medium term, the risks of more persistent or higher inflation are increasing as growth improves. Neither equities nor bonds have priced this in.
- Sentiment and positioning make markets vulnerable to corrections. Equities and government bonds are likely to move sideways in a volatile manner until the US elections. We favour riskier segments of bonds, commodities, commodity companies and European equities, especially small caps.

Portfolio positioning at a glance

After a strong first quarter, we were more cautious in equities at the start of the second quarter. We took advantage of the setback in April to slightly increase our equity allocation.

The improved economic and earnings outlook is favourable for riskier assets. We are accordingly positioned with a near-neutral equity weighting, a more aggressive stock selection (small caps, materials), an overweight in commodities and a focus on credit/high yield and emerging market bonds rather than safe government bonds. Given the recent negative economic surprises in the US, the optimistic investor sentiment and positioning, the ambitious valuation of US equities in particular and the continued high level of uncertainty (inflation, elections, geopolitics), a more aggressive positioning is not appropriate. Safe government bonds offer attractive real yields, which should help in the event of weak growth. However, bonds, like equities, are vulnerable to more persistent inflation as break-even inflation rates are surprisingly low. We therefore continue to favour short to medium maturities and avoid long duration relative to the benchmark. Commodities, especially gold and industrial metals, remain a focus.



Second quarter: focus shifts to Europe and Asia

The economic picture in Europe and Asia brightened in the second quarter, while the US economy remained robust but weaker than expected after a strong first quarter. This was initially reflected in the markets. The US dollar depreciated somewhat. US equities barely made any gains. European and emerging market equities performed better. However, following the announcement of new elections in France in June, the picture reversed, with the US dollar and US equities ultimately coming out on top. The economic upturn in Europe and Asia supported base metals, which rose by more than 10% in the second quarter. Alongside the base metals, gold was the best performer in the second quarter and has now outperformed equities since the beginning of the year. Rising yields and falling credit spreads in the wake of the economic recovery led to the outperformance of riskier bond segments and shorter maturities.

Picture of a global economic recovery still intact

Consensus forecasts for global economic growth in 2024 continued to rise in the second quarter, increasingly driven by Europe and China (chart on page 5). The global manufacturing PMI has been above the critical 50 level since February and reached 50.9 in May, its highest level since June 2022. Consensus earnings expectations for 2024 and 2025 have stabilised and even been revised slightly higher, particularly in Europe (chart on page 5, centre). A sharper slowdown in US growth remains a key risk to this positive economic picture and to markets.

Inflation remains the dominant theme on the markets

In the past, we have repeatedly discussed the structural reasons for higher inflation in the medium term. However, if the soft landing of the US economy is successful, the more positive outlook for the global economy now also makes more persistent or even rising inflation another major risk for markets in the short term. The so-called base effects, i.e. the pure decline in inflation as earlier strong price increases are no longer included in the year-on-year comparison, have largely come to an end. By contrast, Chinese freight rates, US natural gas prices and other commodity prices have risen sharply, as have wages in Europe. It will be at least a few years before the use of AI has a dampening effect on inflation. Stubborn inflation in the US has already led to a further delay in the Fed's rate cuts. Instead of the three cuts expected this year in March, less than two are currently priced in. Bond yields have continued to rise, with 10-year US real yields averaging around 2.1% in the second quarter. However, as long as interest rates do not rise further, the timing and magnitude of rate cuts may become less important to markets if Europe and China gain further moementum, the US economy remains robust and earnings expectations continue to rise. The continued high correlation between equities and safe government bonds is another indication that inflation remains a key concern for markets. And the strong performance of commodities in April showed once again that they often benefit when stocks and bonds suffer from surprisingly high inflation at the same time.

Positive economic and earnings surprises boosted commodity and equity markets and weighed on bonds.

Total return	YTD and in Q2 2024 (in %, in EUR)		12-month periods of the last five years (in %, in EUR)					CAGR*	Std.-dev.*
	YTD (31/12/23-17/06/24)	Q2TD (31/03/24-17/06/23)	17/06/23 17/06/24	17/06/22 17/06/23	17/06/21 17/06/22	17/06/20 17/06/21	17/06/19 17/06/20	17/06/19 17/06/24	17/06/19 17/06/24
S&P 500	19.2	5.2	28.5	16.9	0.4	30.1	9.8	16.6	21.1
Brent	18.5	0.0	25.2	-21.0	107.7	64.2	-33.1	17.7	40.2
Gold	15.6	4.8	20.7	2.2	17.6	-3.0	28.6	12.6	13.7
Stoxx Europe 50	11.7	2.5	14.3	23.2	-3.5	20.9	-0.2	10.4	16.6
MSCI EM	9.5	4.3	9.2	1.1	-14.2	32.0	0.8	4.7	17.0
DAX	7.9	-2.3	10.5	24.6	-16.5	27.0	2.5	8.4	20.4
EM Sovereigns	5.2	1.2	11.1	1.0	-7.3	1.0	2.6	1.5	8.6
USDEUR	2.8	0.5	1.9	-4.0	13.4	-5.6	-0.2	0.9	7.2
US Sovereigns	2.4	1.1	3.5	-4.7	1.9	-8.4	10.4	0.3	7.0
Euro Overnight Deposit	1.8	0.8	3.9	1.5	-0.6	-0.5	-0.4	0.8	0.1
EUR Corporates	0.4	0.0	6.4	0.9	-13.7	3.2	0.7	-0.7	4.0
EUR Sovereigns	-0.8	-0.2	3.4	-1.8	-9.2	0.6	1.1	-1.3	3.8

Time period: 17/06/2019-17/06/2024.
Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = annualised standard deviation (in %, in EUR).

Bond yields unlikely to fall by much even if interest rates are cut

If central banks are slow and hesitant to cut interest rates in an already recovering economy, long-term bond yields are unlikely to fall. Bonds price in little inflation risk, and with structurally higher inflation and rising government debt, the yield curve is likely to steepen again in the medium term (normalisation of the term premium). In the USA in particular, in light of the high budget deficit and the resulting high supply of Treasuries, long-term yields are likely to only fall in the event of significant growth weakness.

Europe's advantage? Fundamentally yes, but with high political risks

Europe's relative performance to the US remains difficult to assess. Fundamentally, there are a number of factors working in Europe's favour: more attractive valuations, the earlier interest rate cut, the pick-up in economic growth, the low positioning of international investors and the positive inflows in May and early June. This was also reflected in the fact that European equities initially outperformed US equities in the second quarter and market breadth in Europe increased somewhat. However, the French and US elections remain major risks that argue against a strong overweight in Europe. Europe's ability to act is at stake, and Trump could cause a stir during the campaign by threatening a trade war or questioning support for Ukraine.

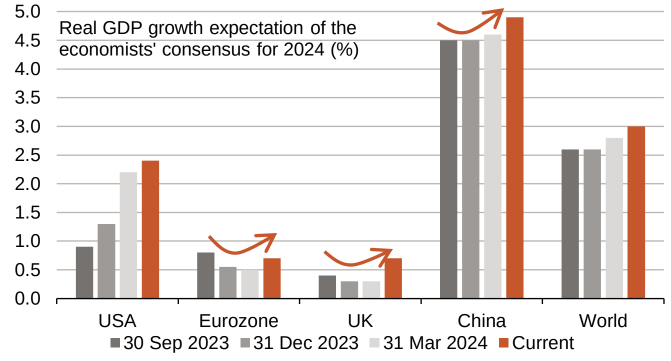
Declining volatility, dominating optimism, relatively high positioning and diverse risks for equities

Despite a slight tightening of valuations in recent months, the upside potential for equity markets remains limited – only upward revisions to earnings expectations would help. Equity markets continue to price in a very favourable economic and earnings outlook, but little risk of stubborn inflation or stagnant growth. We maintain our view that further strong valuation expansion, especially for US equities, is unlikely even if interest rates are cut. In addition, the setback in the markets in April has not led to an adjustment in the positioning of systematic investors. In particular, CTAs and volatility-targeting strategies are very positive. Investor sentiment is optimistic. This makes equity markets more vulnerable to setbacks and uncertainty (inflation, US economy, elections, geopolitics) remains significantly higher. Despite the improved economic and earnings outlook, this argues against very aggressive positioning. We expect a volatile sideways movement until the US elections.

Prof Dr Bernd Meyer, Chief Investment Strategist

Europe and China are also picking up some momentum

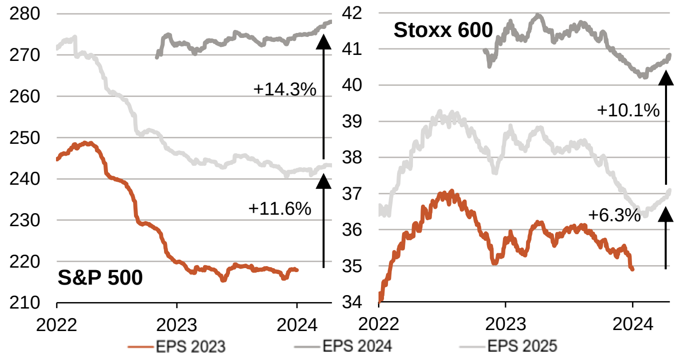
The economic upturn in the first quarter was driven by the USA. Growth expectations for Europe and China also picked up in the second quarter



Time period: 30/09/2023-17/06/2024.
Source: Bloomberg, own calculations.

Profit expectations for 2024 and 2025 are slowly increasing

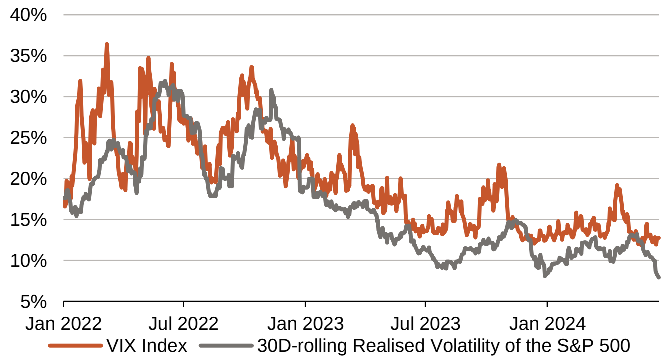
In the course of the reporting season for the first quarter, consensus expectations for earnings in the USA and Europe have stabilised and are rising slightly



Time period: 01/01/2022-17/06/2024.
Source: Factset, own calculations.

Low realised volatility for equities

The VIX index rose to 19% in April, but then fell below 12% at the end of May for the first time since 2019. Low volatility keeps systematic investors on their toes



Time period: 01/01/2022-17/06/2024.
Source: Bloomberg, own calculations.

GROWTH AND INTEREST RATES NORMALISE

IN A NUTSHELL

- US: Economy cools down somewhat.
- Europe: Signs point to an upturn.
- Germany: Recovery delayed.
- Monetary policy: ECB begins interest rate turnaround, Fed waits.

US: Economy slowly cooling down

Although the US economy appears to be cooling somewhat after a very strong period, there are no signs of a slump. In the first three months of the year, GDP growth slowed markedly to 0.3% compared with the previous quarter, with large swings in the highly volatile components of net exports and inventories contributing significantly. Although domestic demand weakened somewhat, the 0.5% quarter-on-quarter growth shows that the underlying momentum of the US economy remained quite robust at the start of the year.

The fact that the economy is only slowly losing momentum despite the Fed's restrictive monetary policy is mainly due to the expansionary fiscal policy. On the one hand, the government continues to spend a lot of money directly, while on the other it is using tax incentives to promote green (and some other) investments. Fiscal policy is likely to remain expansionary in the 2024 election year, but the stimulus to the economy is likely to be somewhat less than last year.

With growth slowing only slowly and inflation recently trending sideways at just above 3%, the Fed has no reason to cut rates at present. We therefore do not expect the Fed to initiate a turnaround in interest rates until December, i.e. after the elections. We expect a total of four rate hikes of 25 basis points each by autumn 2025, bringing the federal funds rate to a range of 4.25% to 4.50%.

The Fed will therefore remain on the brakes for a few more months in order to further dampen demand and thus price pressures. Even though monetary policy appears to be working more slowly than expected, high interest rates will not pass by the real economy unnoticed. Second quarter data suggest that the US economy has entered a period of normalisation after a period of overheating. For 2024 as a whole, we expect GDP growth to remain solid at 2.4%, followed by 1.8% in 2025.

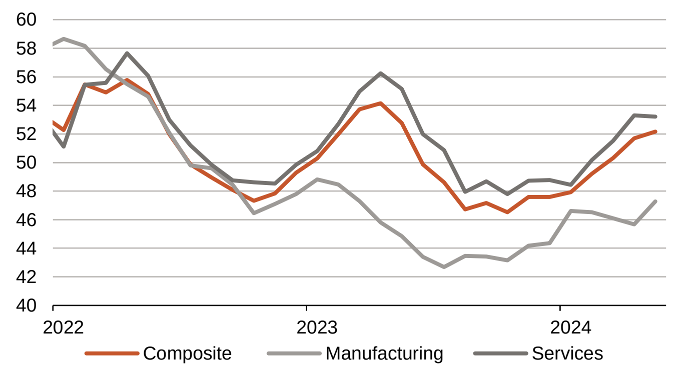
The sentiment in the eurozone is gradually brightening

After almost stagnating in 2023, the eurozone economy is slowly regaining momentum. First-quarter GDP growth was surprisingly positive at 0.3% quarter-on-quarter, although the mild winter helped. The latest purchasing managers' surveys give rise to hopes that the recovery could stabilise over the summer. Another contributing factor is that the inventory correction in the euro area (excluding Germany), in which the manufacturing sector produced less than it sold, appears to have been largely completed.

On the demand side, consumer purchasing power is picking up thanks to rising wages and falling inflation. European consumers

Sentiment in the eurozone brightens

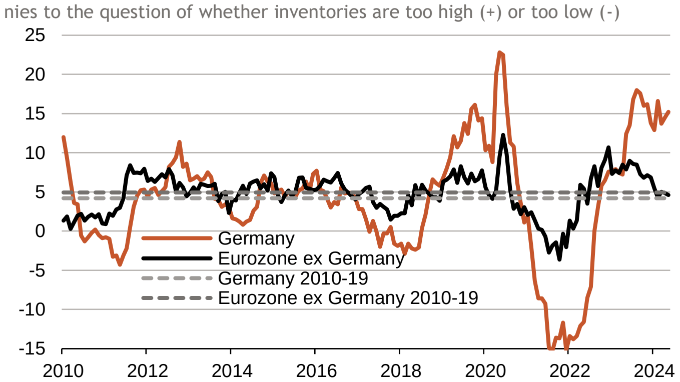
Purchasing Managers' Indices Eurozone, index points, growth threshold=50 points



Time period: 01/2022-05/2024.
Source: IHS Markit.

Inventory correction in Germany not yet over

Inventory of finished goods: Balance of responses in pp from industrial companies to the question of whether inventories are too high (+) or too low (-)



Time period: 01/2010-05/2024.
Dashed line: Average. Source: European Commission survey, Eurostat, calculations by Berenberg.

are still somewhat reluctant to spend. However, we expect this to change in the summer and that rising domestic demand, coupled with a recovery in the global economy, will provide a tailwind for the European economy. A slightly expansionary fiscal policy in southern Europe will also have a supportive effect, so that after a slightly weaker second quarter we expect GDP to grow by around 0.4% quarter-on-quarter from the summer onwards. For 2024, this implies economic growth of 0.8% for the year as a whole, followed by 1.6% next year.

The new elections in France pose a risk. With President Macron likely to be even further from a governing majority than before, further progress on reforms is unlikely. France also needs to reduce its excessive budget deficits. Judging by previous statements by political rivals, stable fiscal management would be difficult. However, there is a good chance that the parties outside the centre will moderate their stance if they actually have to assume government responsibility.

Upswing in Germany is still a long time coming

The German economy grew by 0.2% in the first quarter compared with the previous quarter. The mild winter weather and the associated increase in construction investment had a supportive effect. Without this special effect, growth would have been close to zero. The recovery is still a long way off, especially in the manufacturing sector. This is also due to the fact that the inventory correction in Germany has not yet progressed as far as in the rest of the euro area. This is partly because German industry is focused on highly cyclical goods and global manufacturing is only slowly gaining momentum. However, we expect a further recovery here as the year progresses. Another factor in Germany is the rising purchasing power of consumers. Real wages were 3.8% higher in Q1 than in the previous quarter, the highest increase since the start of the time series in 2008. Although we therefore expect the German economy to pick up from the summer, the negative statistical overhang from last year and the still weak first half of the year lead to a GDP growth forecast of only 0.2% for the year as a whole. For 2025, however, we expect quite solid growth of 1.4%.

ECB: Interest rate pivot has begun

As expected, the ECB cut its key rates by 25bp on 6 June. In the subsequent press conference, Lagarde did not provide any concrete information on the next steps. However, the moderate upward revisions to GDP growth for 2024 and to headline and core inflation for 2024 and 2025, as well as President Lagarde's comments, suggest that the ECB is in no hurry to cut key rates. In our view, the ECB will only cut the deposit rate once more this year – by 25bp in September. Inflation is likely to pick up towards the end of the year. Although this will be due to base effects, we expect the ECB to pause on its rate cuts. We expect two cuts of 25bp each in the first half of next year, before the ECB keeps the deposit rate constant at 3%.

Dr Felix Schmidt, Senior Economist
Dr Salomon Fiedler, Economist

Growth and inflation forecasts

	GDP growth (in %)						Inflation (in %)					
	2024		2025		2026		2024		2025		2026	
		∅**		∅**		∅**		∅**		∅**		∅**
USA	2.4	2.4	1.8	1.8	2.0	2.0	3.2	3.2	2.7	2.4	2.7	2.3
Eurozone	0.8	0.7	1.6	1.4	1.5	1.3	2.4	2.4	2.2	2.1	2.4	2.0
Germany	0.2	0.2	1.4	1.2	1.3	1.4	2.5	2.5	2.4	2.1	2.4	2.0
France	1.1	0.9	1.6	1.3	1.6	1.4	2.5	2.5	2.2	2.0	2.4	2.0
Italy	1.0	0.8	1.3	1.0	1.2	1.0	1.1	1.2	2.0	1.8	2.3	1.7
Spain	2.2	2.2	2.0	1.9	2.1	1.8	3.1	3.1	2.5	2.2	2.6	2.0
UK	0.8	0.7	1.7	1.2	1.7	1.4	2.5	2.6	2.4	2.2	2.5	2.0
Japan	0.2	0.3	1.2	1.1	1.1	0.9	2.3	2.4	2.0	1.9	1.7	1.7
China	5.0	4.9	4.3	4.5	4.2	4.2	0.5	0.7	1.8	1.5	2.0	1.9
World*	2.5	-	2.6	-	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 18/06/2024.

PREFERENCE FOR COUNTERCYCLICAL ACTION

IN A NUTSHELL

- Equity markets are likely to trend sideways in a volatile manner until the US elections. Accordingly, anti-cyclical trading should make sense.
- In terms of valuation, Europe has room for upside, especially if the economic upturn continues.
- Our focus is on megatrend winners, European small caps and commodity-related equities. Tactically, we also like defensive stocks as an addition.

Tripartite performance in the second quarter

In April, the withdrawal of liquidity due to the US tax season and rising interest rates weighed on markets. In May, Goldilocks hopes and a positive earnings season prevailed. In June, eurozone equities were hit by the announcement of snap elections in France. The best performers in the second quarter were Asian emerging markets, US large caps and UK equities. Robust economic data and positive earnings revisions helped. The biggest losers were Latin American equities, which suffered from political turmoil and currency devaluations.

Positive profit revisions

The Q1 reporting season was very encouraging. Not only did analysts' earnings expectations generally get beaten, but many companies also gave a positive outlook for the rest of the year. As a result, earnings revisions have been broadly positive. The consensus now expects earnings growth of 12% for US equities and 6% for European equities this year. Given the already record high profit margins and the recent negative economic surprises in the US, the downside risks are likely to outweigh the upside risks, especially for US equity estimates. This is all the more true as the pricing power of many companies is likely to diminish with the decline in inflation. In our view, artificial intelligence is more likely to lead to productivity gains in the medium rather than the short term, e.g. through automation benefits and efficiency gains.

Increase in valuation possible, especially in Europe

After the sharp rise in valuations since November, valuations at the index level did not rise further in the second quarter. Equity indices rose in line with higher earnings estimates. At 21 times forward earnings, US equities remain expensive by historical standards. By contrast, more negative factors are priced in for Europe. The Euro Stoxx 50, at 13 times forward earnings, is even trading below its historical average. In addition to different (geo)political risks, we see three reasons for this valuation gap. First, the industry structure in the US is more growth-oriented than in Europe, with a high proportion of companies in old, mature industries. Second, the US is home to the world's most innovative companies (e.g. the so-called Mag 7), for which many investors are willing to pay a premium. Third, the US has the strongest support from non-fundamental investors and flows (e.g. meme stocks, ETF savings plans, systematic strategies). As a result, we believe there is likely to be only a moderate convergence in valuations.

Emerging Asian equities led the way in the second quarter, Latin American equities lagged.

Total return	YTD and in Q2 2024 (in %, in EUR)		12-month periods of the last 5 years (in %, in EUR)					P/B*	Div.*	P/E*
	YTD (31/12/23-17/06/24)	Q2TD (31/03/24-17/06/24)	17/06/23 17/06/24	17/06/22 17/06/23	17/06/21 17/06/22	17/06/20 17/06/21	17/06/19 17/06/20	17/06/24	17/06/24	17/06/24
S&P 500	19.2	5.2	28.5	16.9	0.4	30.1	9.8	4.5	1.4	21.3
MSCI EM Asia	13.4	7.0	11.4	-0.6	-15.1	32.8	9.0	1.7	2.4	13.3
Stoxx Europe 50	11.7	2.5	14.3	23.2	-3.5	20.9	-0.2	2.4	3.3	14.5
Stoxx Europe Cyclicals	10.3	0.9	19.3	21.2	-14.1	38.1	-4.3			
MSCI UK	10.1	4.4	12.1	13.1	4.7	23.0	-13.2	1.8	4.0	11.5
Euro Stoxx 50	10.1	-2.4	13.8	31.1	-15.2	30.1	-1.7	1.9	3.3	13.4
Stoxx Europe Defensives	8.1	2.8	10.3	12.3	3.0	12.0	4.6			
DAX	7.9	-2.3	10.5	24.6	-16.5	27.0	2.5	1.5	3.2	12.3
MSCI Japan	6.8	-5.9	9.4	17.9	-11.2	16.5	7.5	1.4	2.3	15.6
Stoxx Europe Small 200	4.4	0.2	8.7	7.5	-19.5	37.6	0.7	1.4	3.3	12.7
MSCI USA Small Caps	4.1	-3.8	12.3	11.2	-11.3	49.6	-4.4	1.8	2.1	18.3
MSCI EM Latin America	-14.6	-13.2	-6.6	22.7	-1.7	30.0	-26.5	1.4	6.4	8.2

Time period: 17/06/2019-17/06/2024.
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.

Anticyclical trading favoured over the summer

We continue to see opportunities, particularly below the surface. In addition to the megatrend winners in technology, we favour European small caps, which are not only cheaply valued but should also benefit from increased M&A activity and better flow dynamics. As we expect volatility to increase over the summer and the ECB has cut interest rates for the first time, we also see tactical appeal in more defensive sectors such as consumer staples. Finally, we continue to like the commodity sectors, which remain structurally supported by the energy transition and years of underinvestment, especially as investor positioning in these sectors is not high. We see little upside potential for US equity markets at index level until the US elections in November, which argues for a countercyclical approach over the summer months. If the markets continue to rise, we can well imagine taking profits in equities. If, on the other hand, markets consolidate, we see this more as an opportunity to add to equities. We think it is unlikely that markets will continue to rise strongly. High positioning and already positive investor sentiment should limit the upside potential. Moreover, after the strong performance so far this year, many investors are likely to slow down given the political risks in the run-up to the US elections, especially as liquidity will diminish over the summer. We are therefore waiting patiently for good opportunities. Recently, for example, we bought European equities at the expense of US equities after the latter had massively underperformed on the back of the French new elections.

Ulrich Urbahn, Head of Multi Asset Strategy & Research

WHAT IS ON COMPANIES' MINDS?

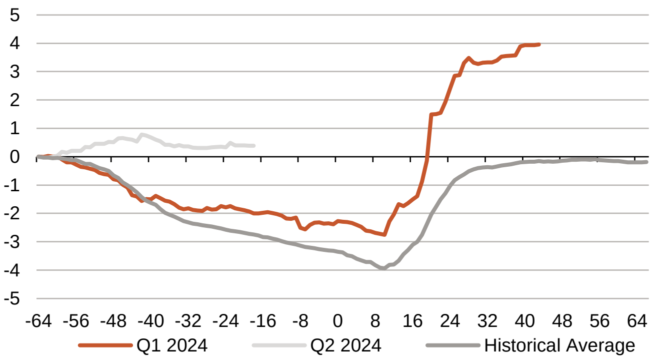
A mixed picture

In our conversations with companies at conferences and in one-on-one meetings, we are currently hearing mixed messages. In addition to the continued weakness of the Chinese consumer, there now seems to be growing concern about the US consumer. On the other hand, companies in the food industry are reporting a significant slowdown in inflation. At the same time, labour costs continue to rise, putting pressure on margins. In the asset management industry, management teams see a stabilisation. In addition to a positive trend in margins, the cash outflow situation has recently improved. The continued rise in demand for data centres, driven by AI, is putting power plant operators and electricity grids to the test. At best, operators such as Microsoft are looking to source their electricity needs from renewable sources in order to meet their sustainability targets. This has recently given the sector a boost. In the software sector, the recent reporting season has been mixed. Companies are increasingly allocating their spending to AI applications and reducing their budgets for traditional application software. We therefore expect to see a wide divergence in the performance of the companies concerned.

Matthias Born, CIO Equitites

Expectations for the Q2 reporting season are high

History of bottom-up S&P 500 consensus EPS estimates, x-axis = days from quarter-end, y-axis = EPS growth revisions



As at: 14/06/2024.
Source: UBS, own calculations; historical average = Q1 2011 to Q4 2019.

Forecast overview: Europe with catch-up potential

Berenberg and consensus forecast in comparison, values at the end of 2024 and mid-2025

	Current			Ø*
Index forecasts	**18/06/2024**	**31/12/2024**	**30/06/2025**	**In 12 months**
S&P 500	5,487	5,500	5,700	5,928
DAX	18,132	19,500	20,500	21,692
Euro Stoxx 50	4,915	5,200	5,400	5,650
MSCI UK	2,340	2,450	2,580	2,677
Index potential (in %)				
S&P 500	-	0.2	3.9	8.0
DAX	-	7.5	13.1	19.6
Euro Stoxx 50	-	5.8	9.9	14.9
MSCI UK	-	4.7	10.3	14.4

* Average, consensus bottom-up as of 18/06/2024.
Source: Bloomberg, Factset, Berenberg.

FOCUS REMAINS ON HIGHER-RISK BOND SEGMENTS

IN A NUTSHELL

- In the case of safe government bonds, investors are benefiting from the rise in interest rates, but price gains are not to be expected.
- In the case of European corporate bonds, high-yield securities are back in play.
- Improved economic prospects and yield premiums make local currency securities in emerging markets attractive.

Persistent inhomogeneity characterises the picture

The development of bonds in the current year continues to be anything but homogeneous. In view of rising (real) yields, the decisive factor was whether the resulting price pressures were counteracted by a narrowing of risk premiums (spreads). Segments with high credit ratings, such as first-class government bonds, performed weaker than riskier segments, such as corporate bonds, which benefited from falling spreads. We also expect the rest of the year to be heterogeneous. Where do we see opportunities?

Safe government bonds: no price impetus to be expected

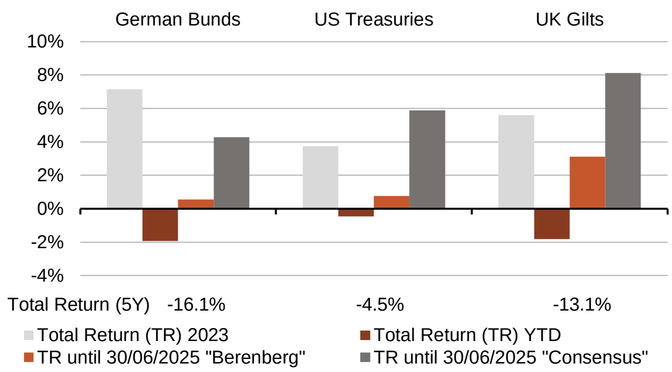
In the second quarter, the price declines of safe government bonds on this side of the Atlantic widened slightly since the beginning of the year. In Germany and the eurozone, the recently faltering disinflation trend created a headwind, but price pressure also remains high in the US. The confidence expressed for this bond segment in the previous issue of "Horizons" was therefore somewhat premature in retrospect. Nevertheless, we expect positive performance over the next 12 months in the three currency areas we analysed (see chart below left). Falling key interest rates on the part of the major central banks will have a fundamentally supportive effect, with the European Central Bank (ECB) having already made a start with a move of -25bp in June, while the US Fed is not expected to start its cycle of interest rate cuts until December. Despite falling central bank interest rates, we do not expect yields on longer-term bonds to fall in our base scenario, meaning that investors should at best be able to realise the current interest rate. However, anyone wishing to benefit from the current yield advantage of UK or US government bonds must keep an eye on the exchange rate risk from a local perspective.

European high-yield bonds are back in the game

Our scepticism regarding the valuation of high-yield bonds has not been confirmed so far this year. Corporate bonds were among the beneficiaries of the brightening economic outlook. The segment received additional tailwind from positive capital flows and a very robust development on the new issue markets. Overall, this led to a decline in risk premiums across the board. Although the potential for a further decline in risk premiums appears limited, we are more constructive on high-yield bonds with current interest rates of over 6.7%. The ongoing economic recovery coupled with positive technical factors should provide further support. We continue to like securities from the more defensive investment grade (IG) segment. These offer an adequate yield level of 3.9%. The investment grade segment could receive an additional boost from further interest rate cuts by the ECB and the expected normalisation of the interest

Government bonds: UK Gilts in local currency with best potential

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



Time period: 18/06/2019-18/06/2024.
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 the end of 2024 and mid-2025

	18/06/2024	31/12/2024		30/06/2025	
	Current		∅*		∅*
USA					
Key interest rate	5.25-5.50	5.00-5.25	5.00	4.50-4.75	4.40
10Y US yield	4.22	4.70	4.19	4.70	4.02
Eurozone					
Key interest rate	4.25	3.65	3.35	3.15	2.84
10Y Bund yield	2.40	2.60	2.26	2.70	2.27
Great Britain					
Key interest rate	5.25	4.50	4.65	3.50	3.95
10Y Gilts yield	4.05	4.30	3.79	4.30	3.64

* Average, consensus as of 18/06/2024.
Source: Bloomberg.

rate structure. In this market environment, bonds in the medium maturity segments, which make up around 45% of the IG segment, will benefit above all. The development of risk-free interest rates, which have been a burden so far this year, should also make a positive contribution in the future. However, this negative contribution has so far been fully or at least partially offset by the more positive assessment of credit risks (see figure below left).

Emerging markets: clear opportunities in local currency bonds

Emerging market bonds also performed differently in the first half of the year. While local government bonds came under pressure due to the rise in US yields and the resulting strong US dollar, government and corporate bonds in the hard currency segment performed better. The superior performance of the high-yield segment was particularly notable. There are many reasons for this: some countries, namely Argentina and Ecuador, have better economic prospects since their change of government, while others, such as Egypt and Pakistan, have benefited from rescue packages from international lenders. The fundamental picture in the emerging markets has also brightened overall. Thanks to the slight recovery of the global economy, the export outlook for emerging markets has improved (see below right figure). In addition, the situation in China has stabilised, leading to a recovery in commodity prices. In this environment, the local currency segment is particularly very attractive. On one hand, many countries have successfully combated inflation through restrictive monetary and fiscal policies, leading to the highest real interest rates in a decade. Secondly, many countries are benefiting from the recovery in commodity prices, which is giving local currencies an additional boost. Against the backdrop of historical differences to US government bonds, the current yield level offers international investors interesting opportunities. Latin American countries in particular offer an additional yield of around 5.5% p.a. in this comparison. To summarise, it can be said that both fundamental improvements and attractive yield levels make local currency bonds in particular a promising segment. This remains our preference.

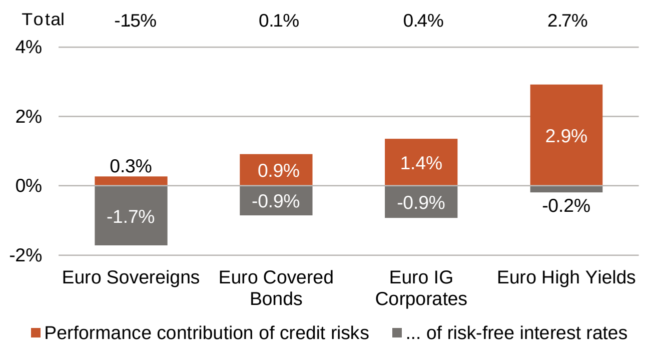
Conclusion: corporate and emerging market bonds favoured

Regarding safe government bonds, British Gilts in local currency in particular are more attractive than German Bunds, although the exchange rate risk must be taken into account. In the corporate bond segment, we prefer medium maturities in the investment grade segment, which should benefit disproportionately from a gradual normalisation of the yield curve. However, high-yield securities are also attractive and should be included in the multi-asset context. Finally, local currency securities remain our favourites in emerging markets – they are the winners in an environment of high real interest rates and recovering commodity prices.

Martin Mayer, Senior Portfolio Manager Multi Asset
Felix Stern, Head of Fixed Income Euro Balanced
Wei Lon Sung, Head Fixed Income Emerging Markets

Performance since the start of the year: the riskier, the better

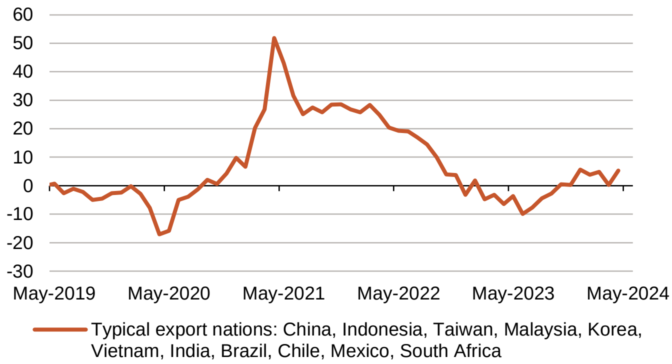
The risk premium contribution (partially) compensated for the negative effect of rising risk-free interest rates on corporate bonds and high yields



Time period: 31/12/2023-17/06/2024. Source: ICE, own calculations High yields = high-yield bonds, IG = investment grade.

Emerging markets: exports pick up speed

In key export-oriented emerging markets, export volumes measured in US dollars are gaining momentum and showing positive growth rates



Time period: 31/05/2019-31/05/2024, Source: Bloomberg, own calculations.

NOT ONLY GOLD SHINES

Oil with a tailwind over the summer

Crude oil (Brent) fell below the USD 80 mark temporarily again in early June. Despite new escalations in the Israeli war, the risk premium was steadily priced out again. In addition, the lax adherence to production cuts by some OPEC+ members led to a slight supply surplus and thus to rising oil inventories. This is likely to change in the short term as the US driving season gets underway over the summer, supported by strong holiday sentiment (almost 60% of US consumers are planning at least one trip this summer). In the medium term, however, oil is likely to have a tougher time. Although OPEC+ has extended its cuts until 2025, the small print suggests that these cuts are on the decline and that OPEC+ members intend to put more barrels on the market from October and to increase production significantly next year.

Gold with structural potential despite strong momentum

In the second quarter, gold prices built on the strength seen since the beginning of the year, reaching new highs. However, traditional drivers of the gold price were not responsible for the strong momentum. Real interest rates, the US dollar and rate expectations all rose in the second quarter. Despite this, gold climbed to new highs in tandem with equity markets. The main drivers of price strength have come from the emerging markets. Some central banks are continuously building up their gold reserves as part of a certain move away from the US dollar, above all the Chinese central bank. Private investors, particularly in China, are also increasingly favouring gold as the investment universe shrinks and liquidity increases. The new demand drivers are likely to be structural in nature, given the heightened geopolitical risks this decade. In addition, a turnaround in Western interest rate policy and rising ETF holdings should provide upward momentum. In a portfolio context, gold is therefore attractive over the medium term due to its diversification and tangible asset characteristics.

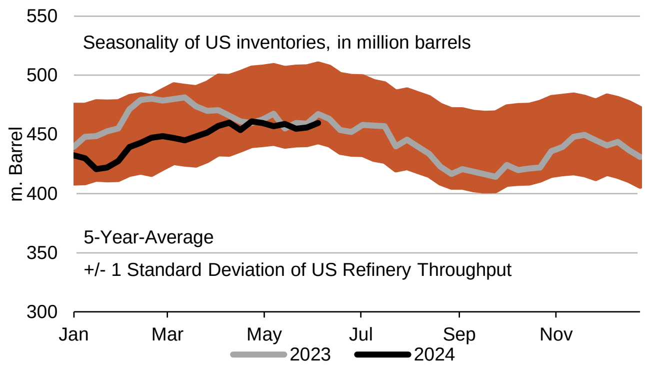
Metals look attractive long term after consolidating

The LME industrial metal index rose sharply over the second quarter with a performance of almost 8%. Rising industrial activity in the West and in China, sanctions against Russian metal exports and technicals drove metals higher. In the short term, consolidation is likely to continue after the strength, partly because positioning is still elevated. The energy transition and digitalisation will provide long-term support.

Philina Louisa Kuhzarani, Multi Asset Strategy & Research

Oil: Positive summer seasonality should support in the short term

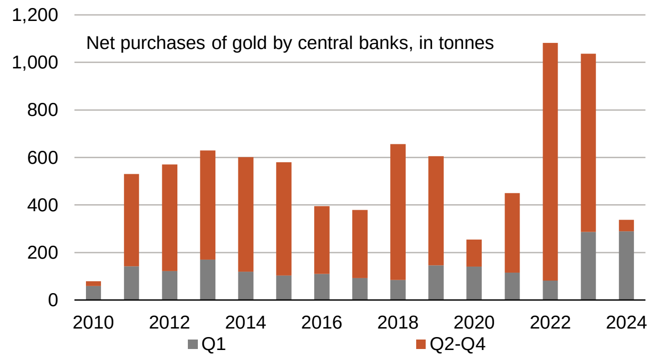
Positive summer seasonality in the wake of the US driving season should provide a short-term tailwind for oil. Lower inventories = higher prices



Time period: 01/01/2019-09/06/2024.
Source: Bloomberg, Berenberg calculations.

Gold: Central banks carry gold buying momentum into 2024

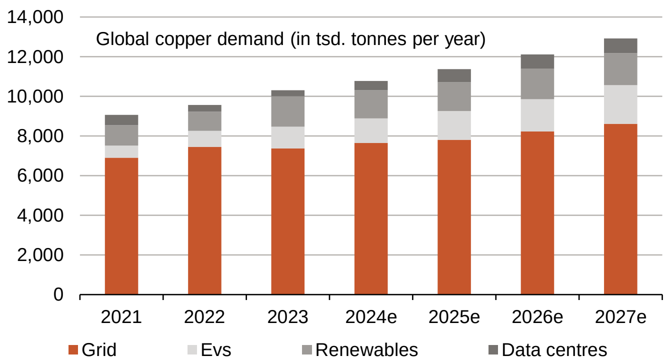
Net central bank purchases of gold, in tonnes. Central bank buying trend continues in 2024



Time period: 01/01/2010-30/04/2024.
Source: Bloomberg, Berenberg calculations.

Metals: energy transition and digitalisation drive demand for metals

Global copper demand by sector (in thousand tonnes/year). Investments in the power grid in particular support demand for the metal



Time period: 01/01/2021-31/12/2027, e = annual estimates.
Source: Woodmac, Morgan Stanley Research.

OPPOSING FORCES IN THE EURO-DOLLAR EXCHANGE RATE

Divergence in interest rates and growth influences exchange rates

A number of factors have recently provided a tailwind for the US dollar against the euro, pushing the exchange rate down to USD 1.06 per euro in the short term. These include rising geopolitical risks, which have created additional safe-haven demand for the dollar, and the continued very robust performance of the US economy. On the other hand, the euro has recently been weighed down by uncertainty following the European elections, in particular the snap elections in France.

By contrast, the eurozone economy is only slowly regaining momentum after the inflation and interest rate shock of the past few years, and the ECB's turnaround on interest rates to stimulate the economy is further weakening the common currency. At present, the US Federal Reserve is unlikely to follow its European counterpart and begin the cycle of interest rate cuts until the end of the year. Until then, each rate cut by the ECB increases the interest rate differential with the Fed, and the larger the differential, the more capital tends to flow into the US.

However, much of this has already been priced into the markets, so we expect only limited appreciation of the greenback as the year progresses. On the other hand, the euro could be supported by the fact that the eurozone economy is likely to recover somewhat as the year progresses, while the US economy is expected to slow down slightly. The exchange rate effect of a widening of the interest rate differential is therefore expected to be roughly offset by a simultaneous narrowing of the growth differential. All in all, we expect the EUR/USD exchange rate to move sideways in the coming months.

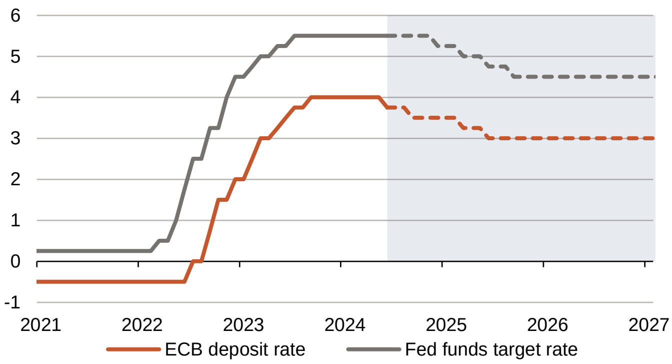
The Swiss National Bank completed its monetary policy turnaround three months before the ECB. This initially weakened the Swiss franc somewhat, pushing the exchange rate close to parity. However, once it became clear that the ECB would soon follow suit, the exchange rate moved back towards CHF 0.95 per euro.

In the coming months, we expect interest rates and the economy in the euro area and Switzerland to move at roughly the same pace. We therefore expect the exchange rate to move sideways around CHF 0.98 per euro.

Dr Felix Schmidt, Senior Economist

ECB moves ahead with interest rate pivot

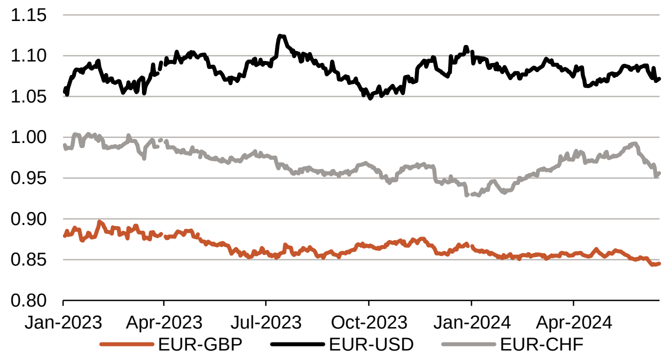
Grey area: Forecasts. Upper end of the Fed funds target rate (in %)



Time period: 01/2021-01/2027.
Source: ECB, Fed, Berenberg.

Euro-dollar exchange rate recently sideways

Euro exchange rates



Time period: 01/01/2023-17/06/2024.
Source: FT.

Exchange rate forecasts: Euro with moderate upside potential

Berenberg and consensus forecast in comparison, values at the end of 2024 and mid-2025

	18/06/2024	31/12/2024		30/06/2025	
Exchange rate forecast	**Current**		**∅***		**∅***
EUR/USD	1.07	1.08	1.09	1.10	1.11
EUR/GBP	0.85	0.85	0.86	0.85	0.85
EUR/CHF	0.95	0.98	1.00	0.98	1.00
EUR/JPY	170	167	164	165	162
Change against the euro (in %)					
USD	-	-0.6	-1.5	-2.4	-3.2
GBP	-	-0.6	-1.7	-0.6	-0.6
CHF	-	-3.1	-5.0	-3.1	-5.0
JPY	-	1.5	3.4	2.8	5.0

* Average, consensus as of 18/06/2024.
Source: Bloomberg.

INTERVIEW WITH DENNIS NACKEN

Mr Nacken, you and your team at Berenberg look after the client group of single family offices. What kind of clients are they and what are the special features of this particular client segment?

Single family offices are entrusted with managing the assets of entrepreneurial families or very wealthy private individuals. The families are aware of the responsibility that comes with a large fortune and try to utilise and manage it as efficiently as possible. The single- family office is the right vehicle for this.

Permanent managers, known as family officers, are responsible for capital investment, but often also take on tasks in the areas of legal and tax advice, follow-up advice or regulatory activities. Philanthropic commitment is also important to many entrepreneurial families. This can also be mapped and organised in a single family office structure.

The special feature is that the single family office is only committed to the interests of the family, meaning that the services are tailored precisely to the needs of the family. Family officers act independently and always advise with a view to what is best for the family's assets. The family office thus acts as an institutional and therefore professional investor.

When does it make sense to set up a family office? What role does the development of an overall wealth strategy play as a starting point for the family office?

Having your own family office is naturally also associated with costs for asset management, accounting, controlling and reporting. Especially if external managers are employed, the costs must be in proportion to the assets under management and the targeted return. If, for example, assets of over EUR 200 million are available, it makes sense to set up a family office in order to be able to act completely independently.

The overall wealth strategy acts as a compass for the work of the family office. However, the development of a family strategy precedes the wealth strategy. This should define the company succession, a clear group of shareholders and the objectives to be pursued with the assets.

The next step is to define the overall asset strategy. The strategic asset allocation forms the foundation for this. It defines return targets, risk tolerances and liquidity requirements. Another element that is often fundamental for the next generation is the integration of specific sustainability criteria.

How do these customers typically invest?

We like to say: "If you know one family office, you know one." Every family office is unique and has its own focus and goals. That is also the exciting thing about our work. What most family offices have in common, however, is an entrepreneurial investment philosophy. Seizing opportunities and taking risks with the necessary foresight is in the DNA of family businesses and their family offices. A long investment horizon and broad diversification are always important in order to protect and increase assets in the long term.

The portfolio almost always includes public investments such as equities, bonds, commodities and externally managed investments, i.e. fund solutions. In addition, and this is what distinguishes single family offices from private investors, there is often a significant proportion of direct investments in the portfolio, in the form of company or property investments. We are currently also seeing family offices taking an anti-cyclical approach to property, i.e. using the low property valuations as an opportunity. The private debt asset class is also in high demand in the current high-interest rate environment.

What is special about Berenberg for this professional and high-net-worth client group and what services do family offices focus on?

Family offices particularly appreciate Berenberg's entrepreneurial business model. Berenberg shares the philosophy of an owner-managed company with the family offices. We offer our expertise and our network to entrepreneurial families who are thinking about setting up a family office. For existing family offices, we act as a sparring partner in the areas of wealth and asset management, investment banking and corporate banking. Many family offices do not have internal specialists in each of these areas. In addition to providing advice, we can also offer exciting investment products, be it in the equity, bond and multi-asset areas on the liquid side or private debt strategies for illiquid assets. Together with Berenberg Investmentbank, we also mediate between companies and family office investors in the search for new corporate investments.

What special challenges do you face regarding the individual requirements of clients and what added value can Berenberg offer here?

The heterogeneous landscape of family offices means that there is no "one-size-fits-all" approach. Advice in this area requires a high level of expertise, competence and understanding of the individual needs of clients.

Another challenge is that the single-family office sector is characterised by the utmost discretion. You have to know the landscape of business families well and know which family office is interested in which topics. We in the team have built up a large network in the family office sector and also offer family officers various events for dialogue. For example, with the annual Berenberg Single Family Office Conference, we have created one of the largest German-speaking networking platforms for family officers and wealth holders. In a protected environment, common challenges can be discussed, impulses for the future can be given and valuable synergies can be created.

What are the lessons learnt from the work of family offices for other wealthy clients? Can they invest similarly with Berenberg?

Even if you don't have your own family office, you should think about what goals you want to pursue with your assets in the long term and what you want to focus on. Berenberg advisors can also support private clients in developing an overall wealth strategy (SAA).

Private investors can act entrepreneurially in the asset classes and utilise temporary undervaluations as an opportunity. Bond funds, for example, are currently offering attractive yield opportunities again. Berenberg investment solutions in the form of asset management or investment funds are equally available to all wealthy clients, there are no differences. Direct investments in companies or property projects also offer good earnings opportunities, but are only possible with very large liquid assets. However, these asset classes are available to our semi-professional clients in the form of fund solutions. We offer our own Berenberg funds in the areas of private debt and property. Our cooperation with the private equity fund platform Moonfare makes it possible to participate in the development of this exciting asset class. In principle, all Berenberg clients have access to the bank's full range of services.

SHORT VITA

Dennis Nacken, CFA, has been with Berenberg since 2020 and is responsible for the Family Office & Family-Owned Business division. He advises entrepreneurial families, family offices and family businesses. Previously, Dennis Nacken held various positions in the Family Office and Research division at Allianz Global Investors and Helaba Invest. He holds a degree in economics and business administration (WAH) and is a Chartered Financial Analyst (CFA).

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IMPORTANT NOTICES

Date: 21 June 2024

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