HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

SHORT-TERM DAMPENER

The powerful recovery continues despite temporary setbacks. The prevailing scepticism about growth in the third quarter seems exaggerated.

REFLATION REVIVAL

Looking ahead to an economically solid 2022, strong growth, higher inflation over the longer term and the typical seasonality, bond yields should rise and cyclical assets gain.

CLEAR PREFERENCES

Equities and some commodities will continue to be favoured over bonds. For the time being, however, short term risks caution against adopting an overly aggressive position.

Q4 | 2021

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FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear reader,
On the surface, a 'risk-on' environment dominated the markets in the third quarter. Western stock markets went from one all-time high to the next. Nevertheless, the environment was difficult for investors, with growth fears under the surface creating a 'risk-off' sentiment, and bond yields continuing to fall into August. For a long time, the markets were characterised by the outperformance of quality, growth and defensive stocks. A stabilisation has only become apparent since the second half of August. Our portfolios benefited from a slight overweight in equities and the strategic focus on quality and structural growth in equity selection.

Markets seem to see a return to an environment of low growth, low inflation rates, low interest rates and high private sector savings rates as increasingly likely again in recent months – an environment like the one we had in the wake of the global financial crisis of 2008/2009 until the COVID-19 crisis. Conviction that the massive fiscal and monetary policy measures taken in the wake of the pandemic will succeed in creating an environment of higher growth and inflation in the medium term has decreased.

Even if a certain amount of scepticism is understandable in view of the spread of the Delta variant, weak growth, the regulatory frenzy in China and the increased geopolitical uncertainty, we do not share this scepticism to the current extent. We expect growth to prove more sustainable and expect higher inflation in the medium term. We, therefore, prefer equities and some commodities over bonds as we move into 2022. High money market fund holdings, investment pressure and the lack of alternatives continue to support equities. In addition, corporate profits are growing faster than share prices, which has lowered valuations, and corporate outlooks suggest that Q4 will be another strong reporting season.

If the markets increasingly focus on another solid year in 2022, we see opportunities for a classic year-end rally from October/November. We expect bond yields to rise again in the fourth quarter and into 2022, equities to increase further, and cyclicals and value to come back into investors' focus. Before risk positions are increased further in the fourth quarter, however, a few hurdles should be overcome, above all the concrete announcement of reduced bond purchases by the US Federal Reserve, stabilisation in China and, with a view to Europe, the Bundestag elections in Germany, especially since October is often characterised by increased volatility. In addition, it is important to observe the ongoing course of the COVID-19 pandemic.

In the Insights interview starting on page 14, our fund manager Christoph Netopil discusses how defensive multi-asset strategies can react to the low-yield environment and the changed correlation properties of bonds and equities, and what constitutes modern defensive strategies today.

I hope you enjoy reading this issue of Horizon.

CONTENTS

CHANCE OF YEAR-END RALLY AND REFLATION REVIVAL

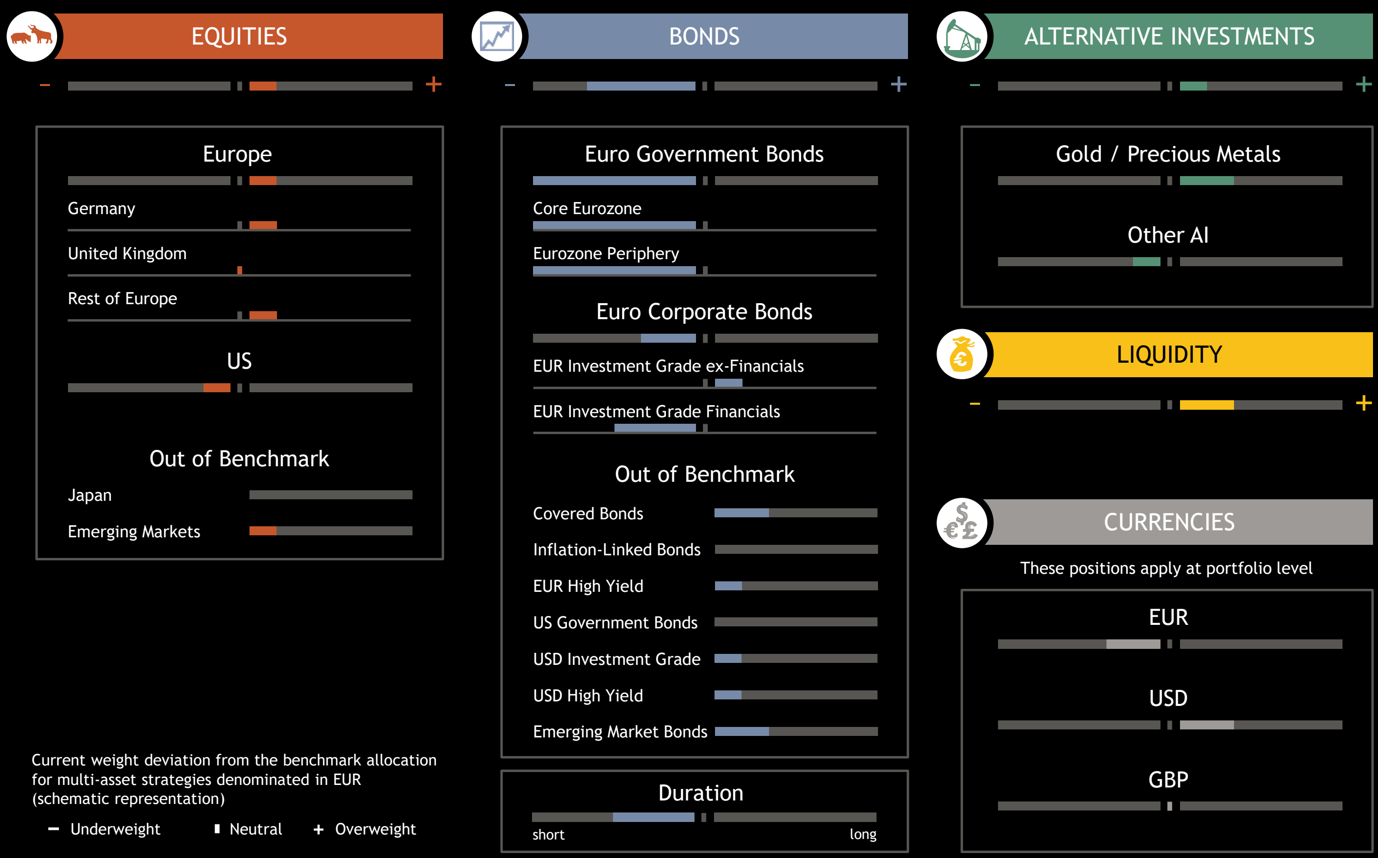
IN A NUTSHELL

- Growth fears and expectations of declining inflation dominated the markets in the summer. Despite economic dampeners, growth and inflation should be more sustainable in the medium term and have potential to surprise.
- The expectation of a solid economic year in 2022, the seasonal pattern, high money market fund holdings and the lack of alternatives support risk assets into the new year, especially equities. Bond yields are likely to rise.
- In the short term, upcoming decisions by central banks, weakness in China, COVID-19 and more offensive positioning by systematic investors could prove problematic.

Portfolio positioning at a glance

In June, we had reduced the equity quota to only a slight overweight, which we held on to over the summer. The portfolios benefited from this overweight and our balanced positioning with a strategic focus on structural growth, tactically complemented by cyclical and value-heavy elements (small caps, UK, commodities). In the third quarter, the focus on quality and growth companies in particular contributed to the outperformance.

With this asset allocation of the portfolios, we continue to feel well positioned. We remain optimistic on risk assets and see opportunities for both a limited year-end rally and a reflation revival. For a markedly more aggressive positioning, however, we would need more clarity on the behaviour of central banks and the further spread of COVID-19. Government bonds as safe havens remain unattractive. Instead, given the high inflation and negative real interest rates, we prefer a significant position in gold as a diversifier, especially since government bonds should only offer limited diversification in historical comparison. Corporate and especially emerging market bonds – China in particular – remain more interesting, despite very low risk premiums in some cases.



Third quarter review - equities rise despite 'risk-off' sentiment

Several conflicting influences shaped the third quarter. Equities rose with only minor setbacks and low volatility. Positive corporate reports, upward revisions to earnings expectations, strong equity fund inflows, buying by systematic strategies, share buybacks, corporate takeovers and the lack of alternatives in the face of strongly negative real bond yields drove Western equity indices from all-time high to all-time high. Under the surface, however, caution dominated. Increasing growth fears, the end of the long dominance of positive economic surprises (top chart p. 5), the Delta variant wave and the expectation that inflation is only temporarily elevated, despite further upside inflation surprises, caused bond yields to fall further into August. Risk premiums on low-quality bonds expanded somewhat, and emerging market equities suffered losses – mainly due to the economic weakness in China and the wave of regulations there. Within equities, defensive, quality and growth stocks outperformed, while more cyclical and value stocks underperformed until well into August (middle chart, p. 5). Safe havens like gold and the US dollar gained. Stabilisation of these developments became apparent only from the second half of August.

Growth and inflation - probably more sustainable than many think

The markets are currently dominated by scepticism about growth combined with the clear expectation that the observed high inflation, especially in the US, is a temporary phenomenon. A survey by Bank of America, for example, shows that more than two-thirds of all fund managers and capital market strategists consider the rise in inflation to be temporary. We had expected the growth and inflation sentiment to weaken somewhat in the third quarter. After significant weakening, however, we now see medium-term surprise potential to the upside. Supply bottlenecks and the COVID-19 Delta variant are only likely to dampen growth in the short term. We expect economic growth to remain at a high, above-average level in 2022. Corporate investment spending and government investment programmes enacted in the wake of the COVID-19 crisis should increasingly support growth. Inflation should ease somewhat but is likely to fall less in the medium term than most market participants expect and remain higher than before the pandemic.

Opportunities for rally in equities, cyclicals and value heading into the new year

If growth proves to be sustainable and inflation higher in the longer term, bond yields are likely to rise again into the new year – they already seem to have found the bottom in August – and reflation scenarios are likely to be revived (middle chart, p. 5). This expectation also fits with the typical seasonal pattern. Historically, October-November has been the best period to buy equities with a view to the following three months (bottom chart, p. 5). Into a new calendar year, investors often have a higher appetite for risk and investments such as equities, small and mid-caps, cyclicals and value, but also high yield bonds outperform their more defensive peers. The main reason is the often-optimistic outlook for the coming calendar year with consensus forecasts of clearly positive growth for the economy and corporate earnings. However, new risk budgets and seasonal investment flows also play a role. As is

Emerging market equities weakened in Q3; developed market equities and less risky assets such as gold, bonds and the US dollar rose

Total return	YTD and Q3 21 (in %, in EUR): YTD (31/12/20-14/09/21)	Q3 21 (30/06/21-14/09/21)	12-month periods of the last 5 years (in %, in EUR): 14/09/20 14/09/21	14/09/19 14/09/20	14/09/18 14/09/19	14/09/17 14/09/18	14/09/16 14/09/17	CAGR* 14/09/16 14/09/21	Std. dev.* 14/09/16 14/09/21
Brent	55.2	1.1	88.3	-40.7	-14.4	52.7	3.0	8.5	37.1
S&P 500	23.6	3.9	33.8	7.0	11.0	21.2	13.5	16.9	19.8
Stoxx Europe 50	17.5	2.2	22.7	-4.3	10.3	-0.1	14.2	8.1	15.4
DAX	14.6	1.2	19.2	5.8	2.8	-3.3	20.8	8.7	18.7
MSCI EM	5.4	-4.9	20.2	2.7	7.6	-2.3	20.4	9.3	15.8
EM Sovereigns	4.2	2.0	4.5	-2.1	17.4	-2.5	0.5	3.3	8.0
USDEUR	3.5	0.5	0.5	-6.7	5.0	2.6	-5.6	-1.0	6.6
EUR Corporates	0.1	0.6	2.0	0.6	5.9	-0.1	0.8	1.8	2.4
Eonia	-0.3	-0.1	-0.5	-0.5	-0.4	-0.4	-0.4	-0.4	0.0
EUR Sovereigns	-0.5	0.5	0.3	0.3	5.2	-0.4	-0.5	0.9	2.0
US Sovereigns	-0.7	0.0	-3.8	0.0	12.1	0.6	-5.4	0.5	6.1
Gold	-1.6	2.4	-7.3	22.7	30.8	-7.9	-5.1	5.4	11.9

Time period: 14/09/2016-14/09/2021.
Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = Annualised standard deviation (in %, in EUR).

so often the case, the exceptions prove the rule, but for this year, the chances of classic seasonality are not bad at all from our point of view, especially when the uncertainty about the Fed's monetary policy turnaround is behind us and markets no longer need to fear that the Fed might burden growth too quickly by taking overly restrictive measures. The fundamental situation remains good: corporate earnings are growing strongly; corporate outlooks point to another encouraging fourth quarter reporting season and valuations are falling as earnings rise faster than prices. In addition, investor sentiment has deteriorated over the summer and there is no longer any pronounced optimism.

More aggressive positioning of systematic strategies is one of the risks

As almost always, there are also risks. In addition to an overly restrictive Fed, slower growth in China, the further spread of the COVID-19 Delta variant (or other variants) and geopolitical risks could disrupt the positive outlook for 2022. Additionally, not only is the positioning of discretionary investors in risk assets above average, but systematic strategies have also become somewhat more aggressive in light of the recent low realised volatility and the recently again stronger negative correlation of equities and government bonds. If there is a trigger, the potential for a major correction has now become greater again – even if we continue to consider a sell-off of more than 10% unlikely.

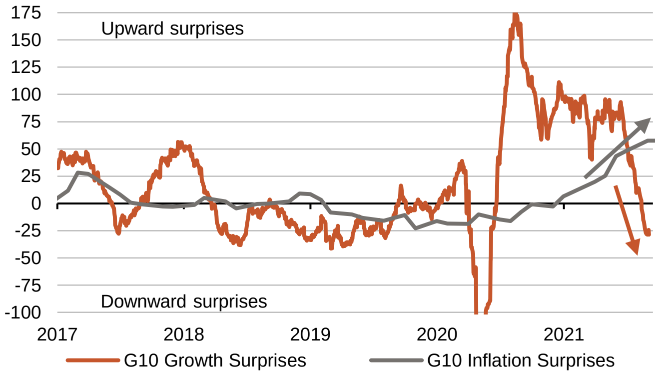
Financial repression remains and supports equities and commodities

In this environment, we clearly prefer equities and (selectively) commodities to bonds, even into 2022. However, risk positions should not be further expanded until October at the earliest, which is often characterised by increased volatility, and especially not until after the announcement of reduced bond purchases by the US Federal Reserve. For the financial markets, the exact timing and details of the 'tapering' are very relevant. For this reason, we are sticking to our existing small to moderate overweight in equities and our focus on growth stocks on the one hand and selective reflation winners on the other.

Prof Dr Bernd Meyer, Chief Investment Strategist

Inflation continued to surprise to the upside, growth disappointed

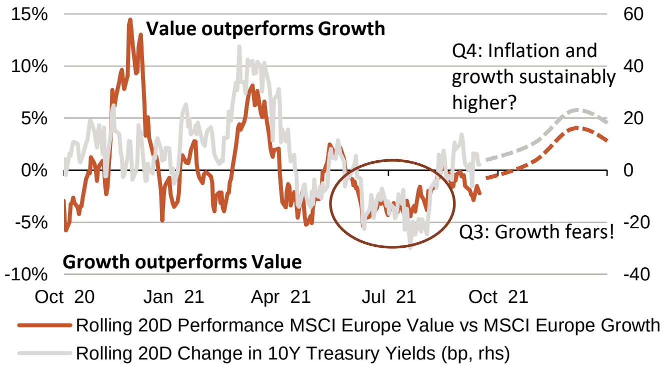
Indices of weighted growth and inflation surprises (data realisation compared to consensus expectations) of the last three months.



Time period: 01/01/2017–14/09/2021.
Source: Bloomberg, own calculations.

Growth outperformance in Q3 followed by a reflation revival in Q4?

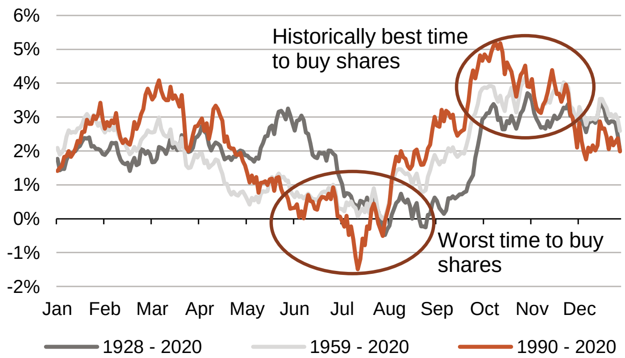
Relative development of value stocks versus growth stocks in Europe and development of yields on US government bonds.



Time period: 01/10/2020–31/12/2021, as of: 14/09/2021.
Source: Bloomberg, own calculations.

Positive seasonality for equities ahead

Average performance of the S&P 500 in the following three months depending on the time of investment in the year.



Time period: 01/01/1928–31/12/2020.
Source: Bloomberg, own calculations.

POWERFUL RECOVERY WITH SHORT-TERM DAMPENER

IN A NUTSHELL

- Global economy: supply bottlenecks and the Delta wave slow down the recovery in the short term – outlook for 2022 is positive.
- Special factors drive inflation in 2021 – normalisation in 2022, slow upward trend thereafter.
- Central banks are preparing the turning point – but slowly.

Dampener for the economy

After a growth spurt in spring and summer, the global economy is currently losing some momentum. The Delta wave of SARS-CoV-2 infections is clouding the mood of consumers and partly the service sector in many countries. Supply bottlenecks are hampering growth in manufacturing. In some areas, labour shortages are preventing a rapid expansion of aggregate supply. In China and some other Pacific countries, there are also the consequences of regional lockdowns.

It is true that the situation differs considerably in individual countries: the pandemic is currently more rampant in the US and Great Britain than in the Eurozone. Yet, global supply bottlenecks are hitting the industrial and export-heavy countries of core Europe particularly hard. Overall, key leading economic indicators are trending somewhat weaker almost everywhere in the developed world and in many emerging markets.

However, this is a correction at a very high level. Despite a slight setback in August, the Purchasing Managers' Indices for the US and Europe, for example, continue to point to above-average growth. Moreover, employment is rising strongly on both sides of the Atlantic. In the long run, this will continue to boost private consumers' incomes and consumption, even if some consumers are likely to hold back on some spending in view of the current wave of infections. In the short term, the risks to our economic forecasts are more on the downside; however, this does not apply to 2022. We even see the chance that growth may be a positive surprise in the coming year.

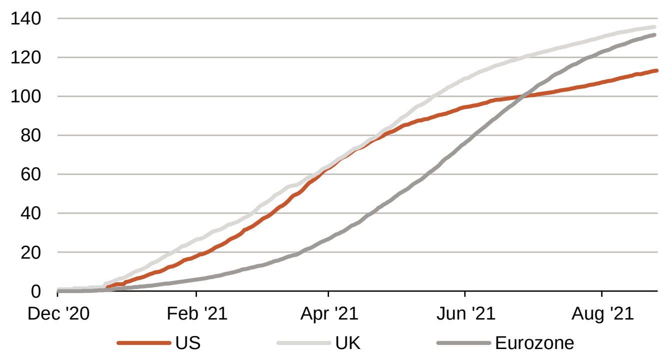
Short-term risks, long-term opportunities

The current problems are mostly of a short-term nature. The prices for transport services and for scarce intermediate products, such as semiconductors, are so high that they give companies and states a great incentive to expand supply as quickly as possible. With semiconductors, this can take time. But here, too, the situation may ease somewhat with the end of the first major rebuilding of industrial stocks. As soon as scarce intermediate products are available, manufacturing, for example, could experience a big jump in production. It is even possible that – following the pattern of a usual 'pork cycle' – there will be an oversupply in a few years.

In the UK, the US and Japan, as well as some emerging markets, the particularly contagious Delta variant of COVID-19 spread rapidly in July and August. In the Eurozone, on the other hand, the number of new infections is tending to level off, as the rise in infections in Germany has so far been offset by a decline elsewhere,

Vaccination progress against COVID-19

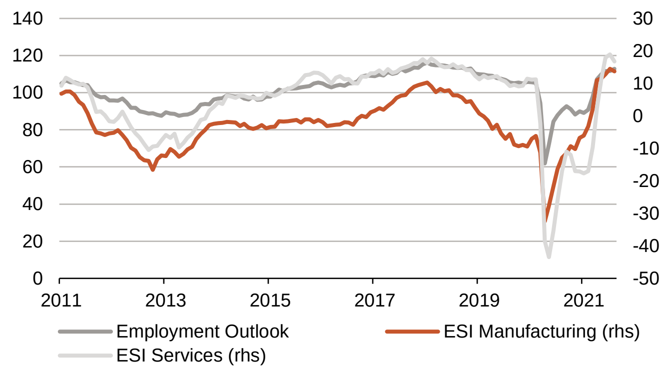
Total number of vaccinations, per 100 persons



Time period: 20/12/2020-13/09/2021.
Source: Our World in Data.

Employment expectations and business climate in the euro area

Index, long-term average = 100, ESI: Economic Sentiment Indicator



Time period: 01/01/2011-31/08/2021.
Source: Eurostat.

especially in Spain and France. But vaccination is also proving to be effective in the UK and the US. The number of severely ill people and deaths has visibly increased but far less than in previous waves of the pandemic. The health care situation has somewhat decoupled from incidence. Accordingly, concerns about the pandemic are also shaping the mood of businesses and consumers far less than before.

Vaccination works: no new lockdowns in the US and Europe despite Delta wave

In the US, where vaccination rates have now fallen far behind the progress in Europe, the tense situation in parts of the health care system has apparently been increasing vaccination readiness again since mid-July. Overall, it still seems likely that Europe and the US can avoid new economically damaging lockdowns.

The second issue of the year: inflation

In addition to the outlook for the economy, the topic of inflation is increasingly becoming a focal point. Currently, a number of one-off factors are causing a sharp rise in inflation rates. In addition to the expiry of the German VAT rebate and the extended levy on CO_2 emissions in Germany, the high transport costs and supply bottlenecks for goods in particular are having an impact in Europe and globally. In addition, there is the base effect of the extraordinarily low oil prices from March to November 2020. And in view of high demand, many service providers will raise their prices when pubs, restaurants and hotels reopen; therefore, the inflation rate in the Eurozone shot up to 3% in August. In the USA, it even reached 5.4% in June and July.

The sharp rise in inflation will not last. Base effects will naturally expire again. The shortage of containers, which is contributing to high transport costs, should be solved after Christmas at the latest. However, following a decline in inflation rates – for example, to 1.5% in summer 2022 in the Eurozone – long-term inflationary pressures are likely to increase over time, driven mainly by labour shortages and higher wage pressures.

Central banks are slow to backtrack

After years of very low inflation, central banks want to initially take a cautious approach to the rise in inflation. We expect the Fed to start tapering its bond purchases before the end of the year. The European Central Bank is also likely to slow down the pace somewhat. Higher key interest rates are not on the agenda for the time being. However, we believe inflation should remain above the current forecasts of these central banks. We therefore expect the Fed to raise its key interest rates twice in the second half of 2022, by 25 basis points each time. The ECB is expected to follow with a first step at the end of 2023.

Dr Holger Schmieding, Chief Economist

Growth and inflation forecasts

	GDP Growth (in %)						Inflation (in %)					
	2020		2021		2022		2020		2021		2022	
		Ø**		Ø**		Ø**		Ø**		Ø**		Ø**
USA	-3.4	-3.5	6.5	5.9	4.4	4.2	1.2	1.3	4.1	4.3	3.2	3.0
Eurozone	-6.5	-6.8	4.9	4.9	4.9	4.3	0.3	0.3	2.2	2.2	1.8	1.6
Germany	-4.9	-5.3	3.1	3.2	5.2	4.5	0.4	0.5	2.7	2.8	1.7	1.8
France	-8.0	-8.3	6.2	6.1	4.7	4.0	0.5	0.5	1.9	1.7	1.8	1.4
Italy	-8.9	-8.9	5.9	5.9	4.9	4.2	-0.1	-0.1	1.6	1.5	1.6	1.2
Spain	-10.8	-11.4	5.8	6.1	6.9	5.7	-0.3	-0.3	2.3	2.2	2	1.4
UK	-9.8	-9.9	6.9	6.8	5.5	5.4	0.9	0.9	2.3	2.1	2.7	2.5
Japan	-4.7	-4.8	2.5	2.4	2.3	2.5	0.0	0.0	-0.3	-0.1	0.6	0.6
China	2.0	2.3	8.8	8.4	5.3	5.6	2.5	2.5	0.9	1.3	2.0	2.3
World*	-3.1	-	5.1	-	3.8	-	-	2.2	-	3.5	-	3.2

* * Berenberg data at actual exchange rates, not purchasing power parities (PPPs). PPPs lend more weight to the fast-growing emerging-market countries.
** Average, Bloomberg consensus as of 14/09/2021.

ASIA HAS MOMENTUM INTO THE NEW YEAR

IN A NUTSHELL

- Corporate earnings should increase again next year, but growth rates should decline.
- US equities are historically expensive, which is unlikely to change any time soon due to the low interest rate environment and increasingly valuation-insensitive investors. Growth therefore remains in demand. Asian equities have catch-up potential.
- We maintain a constructive stance on equities into the new year and consider a significant correction unlikely.

Equities in Q3 at all-time highs

Strong corporate earnings, excess liquidity and the lack of alternatives were supportive for equity markets. The summer correction feared by many investors thus failed to materialise. Instead, new all-time highs were reached, in particular for US equities. However, Japanese equities, boosted by the resignation of Prime Minister Yoshihide Suga, and European small caps performed best in the third quarter. The reopening of the economy in Europe in the wake of vaccination progress has helped. Asia ex Japan was the big underperformer in Q3, with Chinese equities in particular falling significantly due to growth and regulatory concerns.

Normalisation of earnings growth next year

Analysts have revised their earnings estimates upwards in line with the strong Q2 reporting season. Consensus expects earnings to rise by 43% in 2021 for developed countries and by 51% for emerging markets – but the spread between the regions is large. For Switzerland, analysts expect profit growth of 10%. For Latin America they expect about 240%. Analysts expect a more homogeneous and normal corporate earnings trend for next year, reflected in modest consensus earnings growth forecasts of -4% to 11%. Consensus is particularly optimistic for Asian countries. Even if corporate pre-announcements once again point to a positive reporting season, after all the positive earnings revisions of the last few months it will probably be more difficult for companies to significantly exceed expectations – especially against the backdrop of rising commodity, transport and also staff costs.

US valuations remain supported by price-insensitive investors

The US has remained among the strongest equity markets globally this year. Rising corporate profits coupled with increasing equity buyback programmes have helped, as has the Fed's extremely expansionary monetary policy. However, US equities also benefit from many trends: passive, thematic and ESG investments all favour US stocks in particular, which are often heavily weighted in the corresponding indices. A new factor has recently been the growing influence of options transactions on the part of US private investors, who are also heavily invested in US stocks. Accordingly, US equities are expensive. Increasing demand from valuation-insensitive market participants ensures that valuations remain ambitious, especially for US equities. This is unlikely to change any time soon, unless US bond yields rise quickly and sharply against expectations. In contrast, emerging market equities (especially China)

Most equity markets continued to rise in Q3, especially Japanese equities and European small caps

Total return	YTD and Q3 21 (in %, in EUR): YTD (31/12/20- 14/09/21)	YTD and Q3 21 (in %, in EUR): Q3 21 (30/06/21- 14/09/21)	12-month periods of the last 5 years (in %, EUR): 14/09/20 14/09/21	14/09/19 14/09/20	14/09/18 14/09/19	14/09/17 14/09/18	14/09/16 14/09/17	P/B* 14/09/21	Div.* 14/09/21	P/E* 14/09/21
MSCI EM Eastern Europe	31.7	8.3	47.7	-20.4	26.2	2.8	22.1	1.2	6.6	7.9
S&P 500	23.6	3.9	33.8	7.0	11.0	21.2	13.5	4.4	1.4	21.9
Stoxx Europe Cyclicals	23.0	5.5	38.2	-4.5	1.9	-0.2	25.7			
Stoxx Europe Small 200	22.7	6.5	38.6	0.4	2.4	6.0	19.6	2.0	2.1	27.9
Euro Stoxx 50	19.9	3.3	28.6	-4.6	9.1	-2.6	22.0	2.1	2.7	17.7
MSCI USA Small Caps	19.6	-2.2	47.6	-7.9	0.5	24.2	12.2	2.1	1.4	23.3
MSCI UK	18.0	1.7	30.7	-19.9	5.6	3.5	9.1	1.7	4.4	12.0
Stoxx Europe 50	17.5	2.2	22.7	-4.3	10.3	-0.1	14.2	2.5	3.2	16.2
Topix	16.3	10.8	26.8	0.5	3.8	9.2	11.2	1.4	2.0	15.5
DAX	14.6	1.2	19.2	5.8	2.8	-3.3	20.8	1.8	2.8	14.5
Stoxx Europe Defensives	14.6	2.8	18.0	-2.6	9.0	4.7	7.5			
MSCI EM Asia	2.5	-6.3	17.0	12.1	4.4	0.7	21.4	2.0	2.1	15.1

Time period: 14/09/2016-14/09/2021.
Source: Bloomberg * PBV = Price/book value ratio; Div. = Dividend yield (%); PER = Price/earnings ratio. Values based on estimates for the next 12 months.

have fallen significantly, despite positive corporate results. The market is now pricing in a significantly higher risk premium due to regulatory uncertainty in China, but this also means that if the uncertainty subsides, these equities have significant catch-up potential. The strong performance of India this year and the recent better performance of Japan show that price momentum for Asia has improved.

Equities heading into the new year with positive return expectations

After the strong YTD performance and the associated higher valuations, many market participants have recently become more cautious and have hedged themselves via the options market – not least because there are a large number of risks (e.g., tapering, COVID-19, China, etc.). However, there are probably never no risks. And when many investors expect a stronger correction and are positioned accordingly, this usually does not happen. The more investors are caught on the wrong foot, the more the market falls. Against this backdrop, we remain constructive going into the new year, especially as we expect economic tailwinds next year and bonds are not an alternative source of return for many investors. Asian equities in particular should have catch-up potential.

Ulrich Urbahn, Head of Multi Asset Strategy & Research

WHAT IS ON COMPANIES' MINDS?

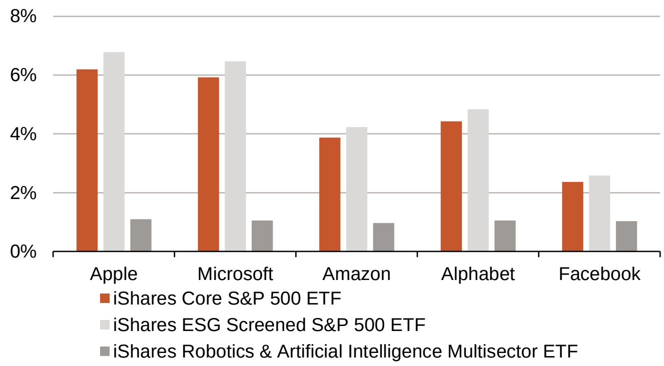
Cost pressure and pricing power

In the third quarter, the previously still isolated warnings about inflation were more widely echoed. Across almost all sectors, companies told us about the noticeable cost pressure. This is not only being driven by the considerable and persistent supply bottlenecks. Material costs, which are increasing massively in some cases, and personnel costs are also having a negative impact. In most cases, this will weigh on profitability. However, the companies we invest in tend to exploit their pricing power and pass the costs directly on to the end customer. For example, we heard from companies in the sporting goods industry that they want to react to the increased costs with price rises, and the leading participants in the semiconductor industry do not intend to absorb the higher costs either. The self-confidence of the companies naturally also reflects a continued exceptional demand environment. The luxury goods industry, for example, reported unbroken strong purchasing power from China, but the economic upswing cannot be ignored here in Germany either. In the third quarter, the strong recovery of the media industry since the beginning of the year continued. There will be discussions about price increases in this industry, too.

Matthias Born, CIO Equities

US megacaps benefit from ETF inflows

Weights of selected US equities in various ETFs (Alphabet = GOOG US Equity and GOOGL US Equity)

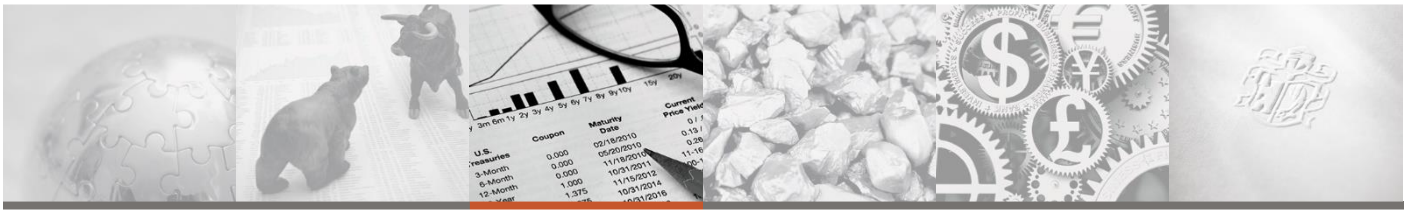


As of: 01/09/2021.
Source: iShares, Berenberg.

Forecast summary: Limited upside potential for equities

Index forecasts	Currently 14/09/2021	30/06/2022	31/12/2022	∅* in 12 months
S&P500	4,443	4,600	4,700	4,963
Dax	15,723	16,500	17,000	18,703
EuroStoxx 50	4,192	4,400	4,600	4,752
MSCI UK	1,970	2,100	2,150	2,278
Index potential (in %)				
S&P500	-	3.5	5.8	11.7
Dax	-	4.9	8.1	19.0
EuroStoxx 50	-	5.0	9.7	13.4
MSCI UK	-	6.6	9.1	15.6

* Average, consensus as of 14/09/2021.
Source: Bloomberg, FactSet, Berenberg.



CAUTIOUS APPROACH, BUT OPPORTUNITIES EXIST

IN A NUTSHELL

- Yields on safe government bonds are resuming their rising trend after an interim low in the summer.
- Within corporate bonds, we are taking a defensive position in view of high valuations.
- Within emerging markets, we see further upside potential in high-yield government bonds.

A potpourri of topics moved the bond markets

Although economic surprises seem to have already peaked, the normalisation of the global economy continues. The central banks' purchasing programmes will continue largely unchanged (for the time being), even in the face of several years of high inflation, and COVID-19 is not yet on a sustained decline, despite rising vaccination rates. In this mixed situation, our approach to bonds is one of caution. Nevertheless, we also recognise areas with upside potential – a differentiated view of the individual bond segments remains essential.

Government bonds: reflation causes yields to rise again

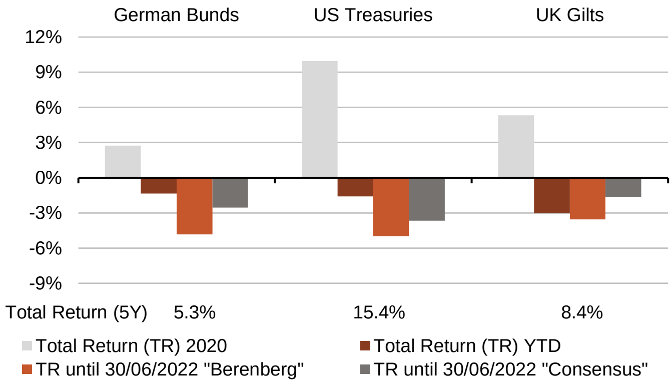
What had already begun in the middle of the second quarter continued in the third, namely the reversal of the rising yield trend in the months before. German Bunds, but also British and US government bonds, yielded about half a percentage point less in the summer than at their respective highs in the spring. However, we should have seen the next turning point, this time on the downside, in August. We expect yields to pick up again by the end of the year. Even if the economy experiences a short-term dampener, we consider the growth concerns in the market to be exaggerated. The currently high rates of price increases should also only gradually recede. Moreover, since its strategy adjustment in July, the ECB has been pursuing a *symmetric* inflation target of 2% – a slightly relaxed approach compared to the previous mark of close to but *below* 2%. The Fed is also likely to reduce its bond purchases only cautiously. Rising nominal yields in the wake of the initially persistent reflationary tendencies are thus likely. The result: we expect safe government bonds to suffer price losses and a negative overall performance in the long term.

Corporate bonds: how much better can it get?

A look in the rear-view mirror confirms that corporate bonds were a good investment over the summer. Despite almost unchanged risk premiums, both securities from the investment-grade segment and high-yield bonds delivered positive performance – thanks to falling interest rates. Can it get any better? Good corporate results speak for this. In addition, the improved profitability is still being used for balance sheet repairs, while an excess of investments or acquisition activities is not yet apparent, even though we expect more here in the future. Declining new issues in the investment-grade segment also speak for the excess demand. This would be a perfect environment, if it weren't for the historically high valuations, which hardly allow for significant price potential at the current interest and spread levels. The figure on page 11 left shows that both risk premiums and yields are close to or at the lowest

Safe government bonds: losses YTD and ahead

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



Time period: 14/09/2016-14/09/2021.
Source: Bloomberg, own calculations, iBoxx Government Bond Indices (7-10 years, TR)

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

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

	14/09/2021	30/06/2022		31/12/2022	
	Currently		∅*		∅*
USA					
Base interest rate	0.00-0.25	0.00-0.25	0.25	0.25-0.50	0.35
10Y US yield	1.29	2.00	1.85	2.30	2.02
Eurozone					
Base interest rate	0.00	0.00	0.00	0.00	0.00
10Y Bund yield	-0.34	0.10	-0.04	0.40	0.00
UK					
Base interest rate	0.10	0.10	0.20	0.50	0.30
10Y Gilt yield	0.74	1.25	1.04	1.50	1.15

* Average, consensus as of 14/09/2021.
Source: Bloomberg.

levels of the last ten years. Given this ambitious valuation, we remain relatively defensively positioned to also take potential risks into account. These consist, for example, of significantly rising interest rates and volatilities as a result of possible miscommunication by central banks, overshooting inflation figures or the uncertainties surrounding the Delta variant. We choose comparatively short to medium maturities and are particularly cautious about mixing in high-yield bonds. We would only invest liquidity opportunistically in corporate bonds at more attractive entry levels.

Emerging markets: high-yield government bonds still preferred

While both hard and local currency bonds in emerging markets still trended sideways in the first half of the past quarter, they rose significantly in the second. Positive technical factors, such as low primary market supply, shaped this picture. Even somewhat weaker capital flows on the demand side could not throw the asset class off track. Despite the recent positive performance, we continue to view current yield levels for emerging market government and corporate bonds as attractive. While our preferred sub-asset class of high-yield government bonds initially solely profited off the adequate current yield in the summer months, the recent tightening of spreads was in line with our expectations. We continue to hold on to them in the fourth quarter because spreads are still significantly far away from their levels before the COVID-19 crisis (see figure below right). This relative valuation advantage, as well as the noticeably lower sensitivity to US interest rates, promises higher potential for the rest of the year compared to government bonds from the investment-grade segment. Given the rise in interest rates in many emerging markets, coupled with the expectation that US real yields will not jump, we also maintain our recommendation for local currency bonds as an addition to portfolios.

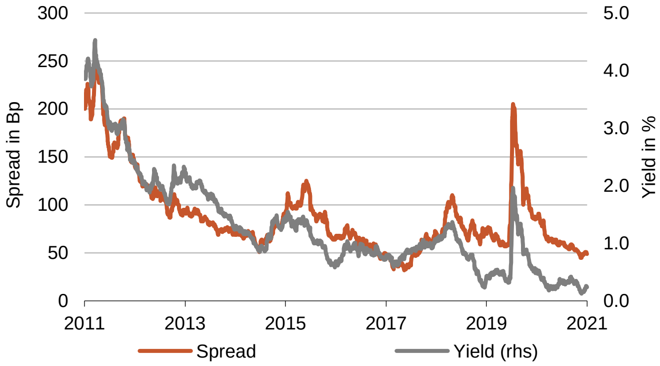
Conclusion: advantage for emerging markets

Unless unexpected risks manifest themselves from today's perspective (for example, renewed extensive lockdowns as a result of the Delta variant), reflation and rising nominal yields are likely to weigh on safe government bonds and lead to losses. In the segment of European corporate bonds, yields and risk premiums are at or near their ten-year lows and are therefore a warning to be cautious – only after higher levels have been reached, we would consider new exposures to be opportune. What's left? The answer is emerging market bonds, especially high-yield government securities. They offer attractive yield premiums, which also make further narrowing potential seem possible. Local currency bonds also benefit from the recent rise in interest rates in many emerging markets and are a suitable addition.

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

Corporate bonds: yields at decade lows

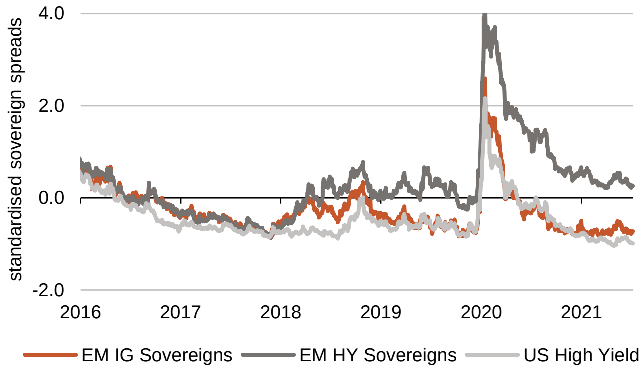
Both spreads and yields on corporate bonds are currently close to or at all-time lows, looking back over the past ten years.



Time period: 14/09/2016–14/09/2021.
Source: Bloomberg.

EM: upside-potential for high-yield government bonds

In the high-yield segment (sub-IG), government bonds offer noticeably higher risk premiums than in the investment-grade segment (IG) and than US HY.



Time period: 14/09/2006–14/09/2021, Source: Bloomberg
Presentation: historical Z-score, observation period 15 years.

STRENGTH OF CYCLICAL COMMODITIES NOT OVER YET

Oil supply deficit supports until the end of the year

The strong oil price rally since the beginning of the year was followed by consolidation in the third quarter. The headwind came from two sides. From one side, OPEC+ successively increased its production. And from the other, there was a noticeable slowdown in the recovery of demand after catch-up effects had largely materialised. Overall, oil moved volatilely sideways. Concerns about further virus-induced global demand weakness brought the oil price down several times but proved unfounded time and again. In the short term, however, things could remain difficult, since October is typically a bad month for oil, as it marks the end of the hurricane season on the one hand and the oil-intensive winter months are yet to come on the other. However, the prevailing supply deficit is likely to persist until the end of the year and speaks for slightly more upside potential until the end of the year.

Gold is (still) lacking a fundamental driver

Gold also moved volatilely sideways in Q3. In view of new negative records for real interest rates, one might have expected more potential in the safe haven. However, a strong dollar weighed on the one hand, and on the other gold seems to be preparing for a more restrictive Fed, ergo rising real interest rates. Slight outflows out of gold ETFs confirm this picture. We expect further pressure from increasing interest rates. However, as gold anticipates a certain rise in real yields, the downside potential should remain limited. So far, there is no good fundamental reason for prices to rise again, so the prevailing opinion among investors seems to be that they do not need gold at the moment. However, risks such as a renewed flare-up of geopolitical conflicts (e.g., USA-China) moved into the back of the minds of many investors and hold the potential for surprises. We therefore continue to hold on to our gold position.

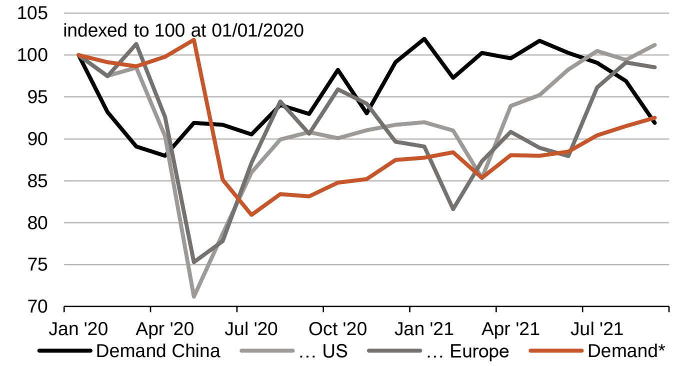
Nothing works without industrial metals – demand remains high

Industrial metals suffered from the cooling of the reflation trade in recent months. Tapering discussions, a stronger US dollar and weak economic data from China were a burden. However, the underlying fundamental drivers remain intact for most metals. New orders within manufacturing remain strong. At the same time, the supply side repeatedly struggles with disruptions such as strikes and emission- or COVID-19-related reductions in production volumes. In the medium term, demand from green technologies should provide an additional tailwind.

Ludwig Kemper, Analyst Multi-Asset Strategy & Research

Oil market in deficit despite regional demand weaknesses

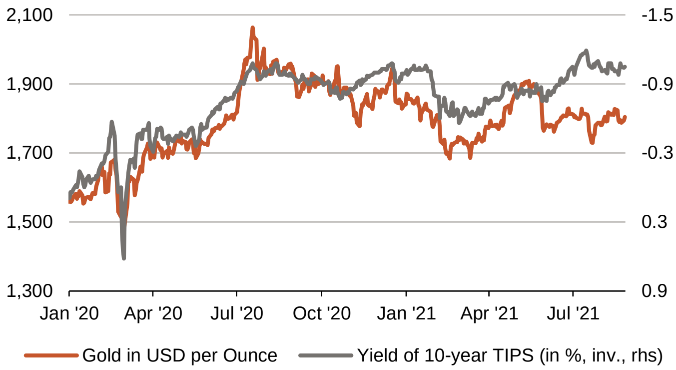
Temporary, regional weaknesses in demand (recently China) are compensated for elsewhere (US, Europe), so that overall the market remains in deficit.



*approximated by weighted average of OPEC, Russian and US oil production.
Time period: 01/01/2020–31/08/2021; Source: Bloomberg, IEA, own calculations.

Gold anticipates rising real yields

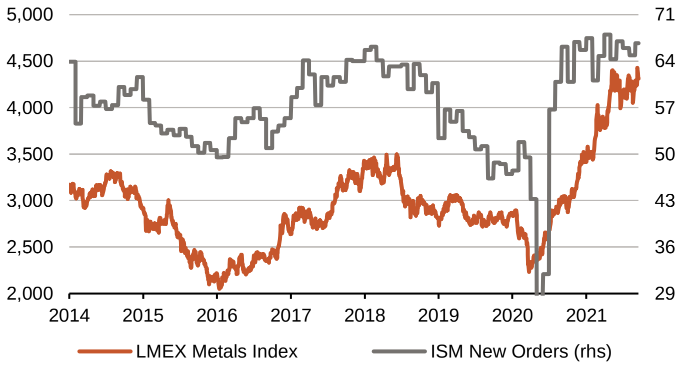
Real interest rates and gold have decoupled in recent months. Even if real interest rates rise, gold should benefit from this buffer.



Time period: 01/01/2020–14/09/2021.
Source: Bloomberg, own calculations.

Industrial metals benefit from strong manufacturing activity

New orders within manufacturing remain unaffected by tapering discussions, COVID-19 or growth worries. Industrial metals should benefit from this.



Time period: 01/01/2014–14/09/2021.
Source: Bloomberg.

SURPRISING EURO WEAKNESS

Euro with interim low

From June onwards, the euro came under pressure on the foreign exchange market. From around 1.22 US dollars per euro, the common currency fell to around 1.17 at its low. The euro has also had a hard time against the British pound, Swiss franc and Japanese yen in recent months. It was not until the second half of August that the euro exchange rate recovered somewhat. This weakness on a broader front came as something of a surprise.

US Federal Reserve under pressure to act due to inflation dynamics

An important driver was and is central bank policy. The US Fed is virtually forced by the strong increase in inflation rates to start the exit from the ultra-expansive monetary policy earlier than expected. The US inflation rate came in at a remarkable 5.4% in July. In addition, the conditions on the labour market have improved significantly and the resulting prospect of a faster exit has strengthened the US dollar. Nevertheless, Fed President Jerome Powell did not present a concrete plan at the central bank meeting in Jackson Hole at the end of August, disappointing the expectations of many market observers. Nevertheless, it is only a matter of time before the Fed scales back the volume of its bond purchases. For the financial markets, the exact timing and details of the 'tapering' are very relevant. For the economy and inflation rates in the US, on the other hand, it has hardly any impact. First, monetary policy will remain highly expansionary even as the Fed gradually reduces the volume of monthly bond purchases. Secondly, monetary policy only affects the real economy with a considerable time lag.

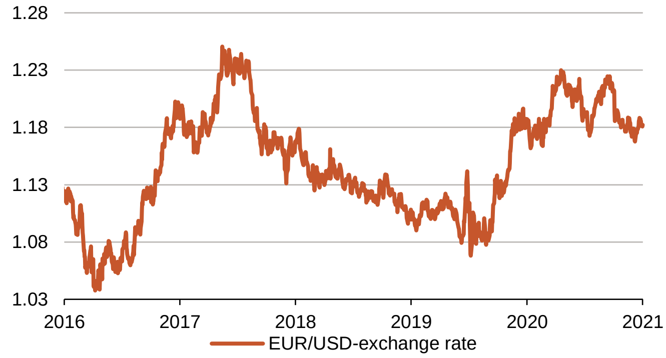
ECB has a new strategy

In the Eurozone, the inflation rate is significantly lower at 3%. Thanks to the temporary price drivers (including base effects in the oil price), the inflation rate here should fall below 2% again next year even without monetary policy tightening. The ECB's monetary policy turnaround is thus still a long way off, especially since the ECB has given itself the flexibility with its new monetary policy strategy to tolerate a longer overshooting of the inflation rate if necessary. These different expectations of the Fed and the ECB explain at least partly the dollar's strength in the third quarter. Nevertheless, looking ahead, the US faces greater fiscal and monetary challenges, which should weaken the dollar again.

Dr Jörn Quitzau, Senior Economist

US dollar benefits from prospect of monetary policy turnaround

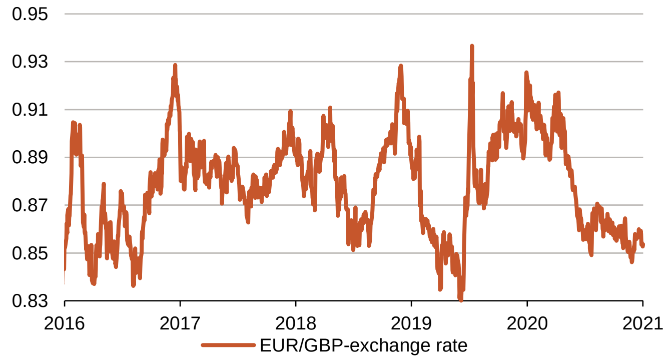
Since the US Federal Reserve's monetary policy turnaround has been discussed, the balance of power on the foreign exchange market has turned.



Time period: 14/09/2016–14/09/2021.
Source: Bloomberg.

EUR/GBP: sideways under fluctuations

The Bank of England could give the pound a slight boost



Time period: 14/09/2016–14/09/2021.
Source: Bloomberg.

Exchange rate forecasts

Euro has room for gains

	14/09/2021	30/06/2022		31/12/2022	
Exchange rate forecast	**Currently**		∅*		∅*
EUR/USD	1.18	1.23	1.20	1.25	1.20
EUR/GBP	0.85	0.85	0.85	0.85	0.85
EUR/CHF	1.09	1.10	1.11	1.10	1.13
EUR/JPY	129	132	132	134	131
Change against the euro in %					
USD	-	-4.0	-1.6	-5.6	-1.6
GBP	-	0.6	0.6	0.6	0.6
CHF	-	-1.3	-2.1	-1.3	-3.9
JPY	-	-1.9	-1.9	-3.4	-1.2

* Average, consensus as of 14/09/2021.
Source: Bloomberg.

INTERVIEW WITH CHRISTOPH NETOPIL

Mr Netopil, why did you want to become a portfolio manager? What fascinates you about multi-asset?

During my studies and as a working student, I was fascinated by the capital market and its interactions with and significance for our real economy. Even if patterns seem to repeat themselves, no two days on the markets are the same. Especially in a multi-asset context, it is a challenge to master the multidimensionality and to reconcile the asset classes, segments, currencies and instruments again and again. The constantly changing market behaviour requires us to question and adapt our own approach repeatedly. As a member of a sports team, I appreciate that I can rely on my colleagues and a well-functioning team at all times.

You are a portfolio manager in asset management and also responsible for the Berenberg Multi Asset Defensive fund. What does your job entail?

In addition to managing our defensive multi-asset fund, my responsibilities include "total return" oriented investment strategies as well as mandates with a fixed floor value and dedicated use of derivatives. In these cases, the focus is on risk-conscious portfolio construction, tactical control of investment quotas and the integration of new investment ideas.

What exactly does your day-to-day work look like? How does working with mandates differ from working with a mutual fund?

Our goal is to find the optimal mix between the different asset classes for the respective strategies and the changing market environment. Therefore, ongoing exchange with our own asset class specialists and with external analysts and managers, as well as our own analyses, is important. Ultimately, it is about correctly filtering the flood of information, drawing the right conclusions and implementing them.

But the path is not always the same: while mutual funds are often very flexible and derivatives can also be used, individual mandates are geared more specifically to the needs of the respective investor, which results in restrictions and exclusions, thereby increasing complexity in some cases.

From your point of view, what importance do defensive multi-asset strategies have today?

Due to the interest rate landscape, we are in a challenging market environment for defensive strategies. More equity-heavy (i.e., more

offensive strategies), on the other hand, enjoy greater popularity. Nevertheless, you should not underestimate more risk-conscious strategies. On the one hand, the risk-bearing capacity or the volatility tolerance of many investors limits their equity quota; while on the other, savings books, call money and fixed-term deposit accounts or even government bonds now offer only one certainty – namely the loss of purchasing power due to negative real returns. Defensive multi-asset strategies are therefore a good way to make the necessary "entry" into capital markets.

Diversification: government bonds with high credit ratings have long been safe havens in difficult times and profitable in normal times. What are the roles of these securities in multi-asset portfolios today?

In the past, this dual function benefited more bond-heavy strategies. Today, however, there is around €15trn of negative yielding debt, leading to guaranteed losses and making real capital preservation no longer possible. In addition, changing correlation properties between government bonds and equities mean that the diversification and hedging character decreases. The classic 'buy & hold' approach no longer works. Tactical asset allocation, derivatives to hedge against rising interest rates or the use of alternative investments are becoming more important as a result.

Will there be any way around a higher allocation to equities for more risk-averse investors in the future?

A higher equity quota could be an option, although this again depends on the investor's risk-bearing capacity. Combined with continuously hedging risks or implementing a fixed floor value, this option can work well in the short term and offer added value for certain investor groups. In both cases, the "insurance costs" incurred should not be neglected in the long term.

How can investors remain diversified and still generate an adequate return at the same time?

We invest on a broadly diversified basis in bond segments that still have an attractive risk/reward profile. These include, for example, Chinese bonds, frontier market bonds and convertible bonds. In addition, we actively manage our allocations and, where permitted, use futures and options to hedge but also to generate premiums. Since the end of 2018, we have also been replacing part of the traditional bond portfolio with liquid alternatives in some investment strategies.

What do you mean by alternative investments? What distinguishes them from conventional investments?

The spectrum of alternative investments can first be divided into liquid and illiquid investments. The latter include, for example, private equity, real estate or infrastructure investments, among others. Liquid investments include commodities, liquid alternatives and sometimes hedge funds.

Due to different return/risk drivers and low correlation to traditional asset classes such as equities or bonds, alternative investments are well suited for diversification and improving the return/risk profile – for example, we use precious metals as a hedge position and inflation protection or partially replace classic bond profiles with liquid alternatives.

What are liquid alternatives and what should you watch out for?

Liquid alternatives are, so to speak, liquid alternatives to hedge funds that are regulated in a structured fund and thus more transparent, and which usually aim to exploit market inefficiencies. They follow different strategies such as long/short strategies, which can bet on rising and falling prices; event-driven strategies, which focus on corporate actions such as takeover situations; or managed futures and volatility strategies, which are typically negatively correlated during market distress. Compared to conventional investments, they are usually more complex and therefore also more difficult to assess. This is why a deep understanding of the strategies and managers as well as a quantitative and qualitative selection process is crucial.

You also manage mandates with fixed floor values. Which investors may find this concept worthwhile, and which may not?

Portfolio protection strategies are particularly useful for investors who are not allowed to exceed a certain loss limit for regulatory or economic reasons. The disadvantage of such strategies becomes apparent during rapid price recoveries after market crashes. Due to the successive re-entry into risky investments, they can only benefit partially from rising prices. If an investor can withstand temporary volatility shocks, portfolio protection strategies are not the optimal solution.

How satisfied are you with the performance of your fund and the defensive multi-asset strategies?

In 2021, which has not been an easy year for defensive strategies, we have been able to achieve a positive result in every month across our defensive and total return-oriented strategies, significantly outperforming the benchmarks since the beginning of the year and also delivering a convincing performance on a risk-adjusted basis. This also applies to the Berenberg Multi Asset Defensive fund, which can look back on a decent performance over three and five years in both absolute and relative terms and has been awarded 5 stars by Morningstar within its peer group.

BRIEF BIOGRAPHY

Christoph Netopil is the portfolio manager responsible for the Berenberg Multi Asset Defensive fund and the total return strategy. He also manages special mandates with a focus on derivatives and fixed floor value. Before joining Berenberg in July 2014, the certified stock exchange trader completed a capital market-oriented trainee programme at Sal. Oppenheim and worked for Allianz Global Investors while studying business administration at Goethe University in Frankfurt.

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IMPORTANT NOTICES

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