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Markets

INVESTMENT COMMITTEE MINUTES

14 January 2021

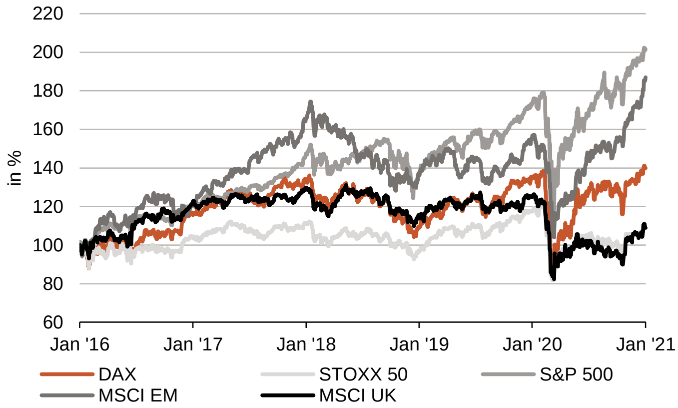
Managers of the Committee

Prof Dr Bernd Meyer
Chief Investment Strategist
Chairman

Dr Holger Schmieding
Chief Economist,
Vice Chairman

The **Committee Members** are listed in the notes.

Development of selected equity indices



Source: Bloomberg, 13/01/2016 - 13/01/2021.

Most important assessments at a glance

Economics	• Gloomy pandemic winter in Europe and USA. But outlook improved from spring thanks to Biden and start of vaccination • Post-election USA: Calmer foreign and trade policy is good for the world, Biden appoints competent experts • Strong growth in 2021 in many parts of the world with low inflation, monetary and fiscal policy support the economy
Equities	• Stock markets had a good start to the year - especially in the UK. 2021 is the year of cyclicals and small caps • Cyclicals and small caps ahead of defensive stocks and large caps. Value should remain supported by the economy • We remain significantly overweight in equity and have a cyclical bias with heightened vigilance
Bonds	• Concerns about rising inflation are pushing up yields. Safe haven government bonds remain unattractive • Negative interest rates continue to drive investors into credit risk. Upside potential in high-yield and emerging market bonds • We are underweight bonds and focus on credit risk and off-benchmark themes. Duration: short
Commodities	• Gold is under pressure due to increased real rates. However, expansionary monetary and fiscal policies are supportive • Brent oil continued the positive trend and is now trading above USD 55 per barrel. The supply deficit provides a tailwind • Industrial metals also made significant gains. Cyclical commodities benefited from the positive economic outlook
Currencies	• The common currency settles above USD 1.20 per euro. The euro outlook for 2021 remains positive • The Brexit agreement will support the pound in the medium term. In the short term, the 3rd wave of infection is unsettling • CHF remains very strong. If the risks recede, the franc should weaken slightly

Current market commentary

The stock markets have had a good start to the year. The majority of the global markets have already experienced a clearly positive development - even if the volatility remains high. UK equities have been among the best performers since the beginning of the year, benefiting from the Brexit agreement and their sector structure. The rotation from growth stocks into value stocks has slowed but continues. Value style could continue to have catch-up potential over growth stocks in the coming months as interest rates rise, although growth remains in demand. With the global economic recovery, however, small caps and cyclical stocks in particular are likely to come out ahead, as these benefit disproportionately from an economic recoveries. This is already shown by the price development over the last few weeks, where both styles were able to clearly outperform defensive stocks and large caps. Even though the market has already priced in a lot of positives, we think there is further potential in equities. So far, investor positioning has not reached extreme levels and positive news is still being rewarded by the market. Thus, remain clearly overweight in equity with a cyclical bias, even though our vigilance is steadily increasing and our next step will rather be to reduce our the equity quota.

Yields on safe government bonds have increased significantly as inflation expectations rise in the wake of the expected global economic recovery. The largest upward movement has been in US government bonds, as in Europe the rise in yields is capped by the ECB purchases. We therefore consider safe government bonds to be unattractive. The potential for investment-grade corporate bonds is also limited. We prefer more market-sensitive high-yield and emerging market bonds.

Our cyclical orientation also paid off in commodities. Industrial metals and crude oil in particular were able to make gains, while precious metals tended to weaken.

ECONOMICS

Despite the second wave of the pandemic, green light for the global economy

We expect a strong rebound in global economy from spring 2021 after the mega-recession in 2020
Calm trade policy thanks to Biden: the outlook for global trade is good. Janet Yellen stands for strong fiscal stimulus
Second wave of the pandemic: an economic setback for Europe, but vaccines support positive outlook for 2021

- **Upturn without inflation:** Despite the current setback in Europe and - to a lesser extent - in the USA, the traffic lights for the global economy are likely to jump to green in spring 2021. The early phase of a new upswing is normally characterized by strong growth with initially low inflation. Economic policy is giving the economy a stronger push than ever before. China remains robust for the time being thanks to its own credit stimulus, despite significant long-term risks. Strong growth in key consumer countries coupled with low interest rates is also positive for many emerging markets.
- **Severe setback:** With the onset of winter, SARS-CoV-2 infections and deaths have increased sharply in Europe and the US. A new, faster-spreading variant of the virus hit the UK and Ireland particularly hard. Many countries have had to significantly curtail economic activity again. Because of continuing increases in the number of infections and the risk of the new virus variant spreading to other countries, some countries are planning to tighten restrictions (even further). In large parts of Europe, economic output will decline significantly in Q4 and Q1. However, the setback will be far less pronounced than in March and April 2020: the measures are more targeted and do not come as a shock. Instead of disrupted supply chains, strong demand from China is shaping the state of the industry.
- **Hope for vaccines and spring:** The UK and the USA are the most advanced among the major industrialized nations. The situation should ease noticeably by spring at the latest, thanks to warmer weather and medical advances. After the first wave, the euro zone had made up almost all of its Q2 2020 losses in Q3. This suggests that the economy will also be able to recover from the current setback in spring 2021. Pent-up demand for services may spur the recovery. Unlike usual after recessions, many households have high savings - see chart.
- **Hello Joe:** The winner of the US elections stands for a calm foreign and trade policy. This will benefit global trade and Europe, which is particularly dependent on exports, in 2021. The Trump risk of a US-EU trade war is off the table. We expect a policy that provides fiscal support for the economy and, because the Democrats only have a narrow majority in Congress, only slightly burdens the economy with higher taxes and regulations.

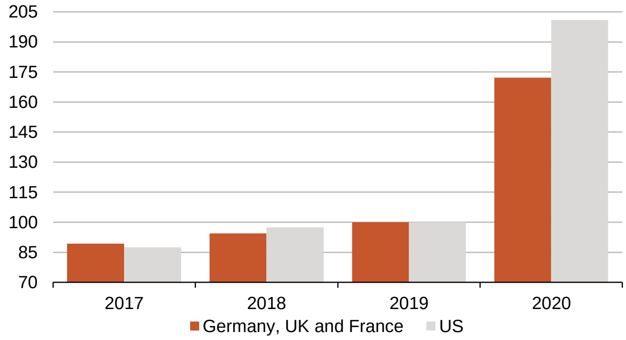
Inflation and interest rates rising - but slowly: Initially, inflation will rise only slowly with unemployment still high. Over a three-year horizon, it will continue to rise. The US Federal Reserve and the ECB will allow this to happen. They want to support the economy for a long time and will only take countermeasures when inflation is much higher. This is positive for the economy and the markets.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	%	2019	2020	2021	2019	2020	2021
World	100.0	2.3	-3.4	4.3			
US	24.5	2.2	-3.7	5.0	1.8	1.3	2.2
China	16.4	6.2	2.7	9.0	2.9	2.5	1.4
Japan	5.8	0.3	-5.3	3.4	0.5	0.0	0.1
India	3.3	4.8	-9.0	8.0			
Latin America	5.9	0.0	-8.1	4.0			
Europe	24.4	1.3	-7.0	4.4			
Eurozone	15.3	1.3	-7.2	4.7	1.2	0.2	0.8
Germany	4.4	0.6	-5.5	4.1	1.4	0.4	1.3
France	3.1	1.5	-9.0	6.6	1.3	0.5	0.9
Italy	2.3	0.3	-9.2	5.4	0.6	-0.1	0.6
Spain	1.6	2.0	-11.7	6.7	0.8	-0.3	0.7
Rest of western Europe							
UK	3.2	1.3	-11.5	6.0	1.8	0.9	1.2
Switzerland	0.8	0.8	-3.1	2.5	0.4	-0.7	0.0
Sweden	0.6	1.3	-3.1	2.9	1.8	0.5	1.0
Eastern Europe							
Russia	1.9	1.3	-3.4	2.5	4.5	3.4	3.0
Turkey	0.9	1.0	-1.3	2.3	15.2	12.0	10.0

Source: Berenberg

Households can spend money - they have saved a lot



Household savings, Q1 to Q3 of the respective year, 2019=100. Figures in US dollars for the US, in euros for Europe (GB converted at the respective GBP/EUR exchange rate). Source: BEA; Bundesbank, ONS, BoE, INSEE, Berenberg

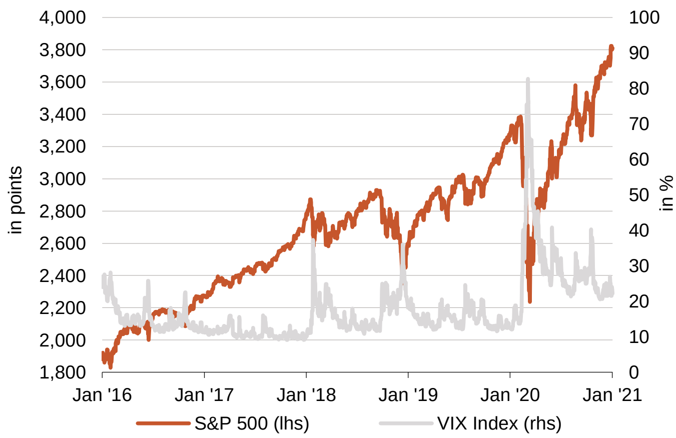
EQUITIES

Small caps and cyclicals

Equity markets have had a good start to the year - especially in the UK. 2021 is the year of cyclicals and small caps
Cyclicals and small caps ahead of defensive stocks and large caps. Value should remain supported by the economy
We remain significantly overweight in equity, with a cyclical bias and heightened vigilance

- The **stock markets are unstoppable**. In addition to the stock markets' good performance in December, the start of the year was also successful - especially in the UK. Since the beginning of the year, British stocks have gained just under 5%, compared to above 2% for Eurozone stocks (Euro Stoxx 50) and only a good 1% for US stocks (S&P 500). The Brexit solution has cleared the way for a catch-up this year. A globally synchronised economic recovery should also argue in favour of a good performance for cyclical shares and second-line stocks in the future, as these tend to lead the way in the upswing. This benefits Europe, as cyclically sensitive stocks are plentiful there.
- **Cyclicals** and **small caps** were also the winners in Europe in the last four weeks, with a return of around 5%. **Value stocks**, on the other hand, with a return of just under 4%, have only slightly outperformed **growth stocks** with a return of just below 3%. The rotation from growth to value has thus weakened somewhat. However, this should continue for the time being as interest rates/inflation expectations continue to rise. At the sector level, equities from the basic materials and utilities sectors in Europe gained the most in the last four weeks with over 8%.
- Equities remain our preferred asset class, even if the air is getting thinner on the upside. The massive recovery in 2020 and the increased positioning of investors are making markets increasingly vulnerable. However, we are still far from extreme positioning levels and the massive money supply and fiscal programme should continue to drive prices up for the time being. There is also a lack of attractive investment alternatives. We therefore think there is further upside potential at least in H1 2021.
- We maintain a **clear equity overweight** and a **cyclical bias.** However, a lot of positives are already priced in, which makes us more vigilant.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 13/01/2016 – 13/01/2021.

Overview of equity markets (short/medium term)

Regions	Old	New
US	↗	↗
Europe	↗	↗
Emerging markets	↗	↗
Japan	→	→

		Performance in local currency				
	As of 13/01/2021	ytd	1-year	3-year	P/E	Dividend yield
DAX	13,940	+1.6%	+3.6%	+5.2%	16.1	2.8%
SMI	10,847	+1.3%	+5.6%	+25.7%	17.9	3.0%
MSCI UK	1,891	+4.5%	-10.1%	-5.0%	15.1	3.8%
EURO STOXX 50	3,617	+1.9%	-1.7%	+10.4%	18.5	2.8%
STOXX EUROPE 50	7,527	+2.3%	-4.7%	+7.5%	17.3	3.2%
S&P 500	3,810	+1.5%	+18.0%	+44.8%	23.1	1.6%
MSCI Em. Markets	1,364	+5.7%	+22.0%	+22.2%	16.4	2.2%

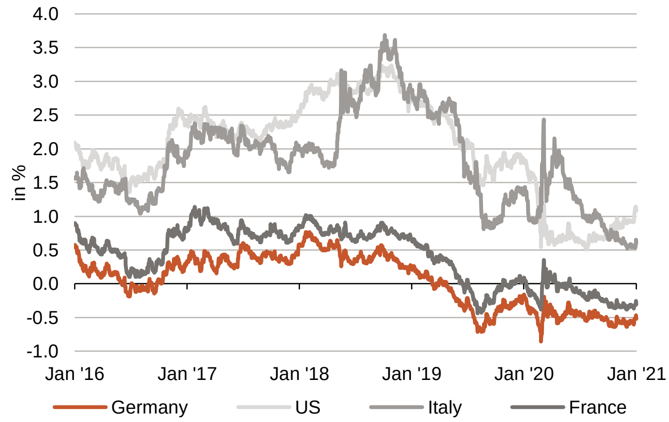
BONDS

Pressure on yields

Concerns about rising inflation are pushing up yields. Safe government bonds thus remain unattractive
Negative interest rates continue to drive investors into credit risk. Potential in high-yield and emerging market bonds
We underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.

- The global economic recovery expected in 2021, increasing risk appetite and higher inflation expectations among investors have recently caused yields on **European government bonds to** rise significantly - despite the still explosive COVID 19 situation. In the last four weeks, yields on **German, French, Italian** and **British government bonds have** risen by around 5 basis points (bp). Government bonds have thus not had a good start to the year compared to equities.
- The yield on 10-year **US government bonds,** on the other hand, has been under much more pressure in the last four weeks. The Democrats' victory in the run-off elections in Georgia, the OPEC oil cuts and the good economic data in December led to rising inflation expectations and yields. The latter have risen more than 15 bp in the last four weeks. Thus, the steepness of the US yield curve has also increased significantly.
- **Corporate bonds** remain in demand in an environment of negative interest rates. This is especially true for papers with increased credit risk and current yield. The risk premiums on **USD high-yield bonds** have fallen by almost 30 bp and on **EUR high-yield bonds** by more than 10 bp in the last four weeks. For investment-grade (IG) corporate bonds, we prefer EUR-IG over USD-IG. The ongoing ECB purchases, declining new issues and the lower duration speak in favour of EUR-IG. **Emerging market bonds** remain an attractive segment. We prefer sovereign over corporate bonds and local currency over hard currency.
- **We significantly underweight bonds.** We keep our focus on corporate and emerging market bonds and keep the duration comparatively short.

Yields on 10-year government bonds



Source: Bloomberg, 13/01/2016 - 13/01/2021.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Short	Short
Government bonds	↘	↘
Corporate bonds	↗	→
High-yield bonds	↗	↗
Emerging market bonds	↗	↗

Yields (10-year)	Old	New
Germany	↗	↗
UK	↗	↗
US	↗	↗

		Performance in index currency		
	As of 13/01/2021	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	262.96	-0.2%	+4.7%	+13.1%
Covered bonds (iBOXX Euro Germany Covered)	207.26	-0.1%	+1.6%	+4.9%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	163.34	+0.1%	+2.6%	+8.2%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	161.12	-0.2%	+2.1%	+6.0%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,273.18	-1.2%	+4.7%	+16.1%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,509.18	-0.3%	+6.2%	+14.3%

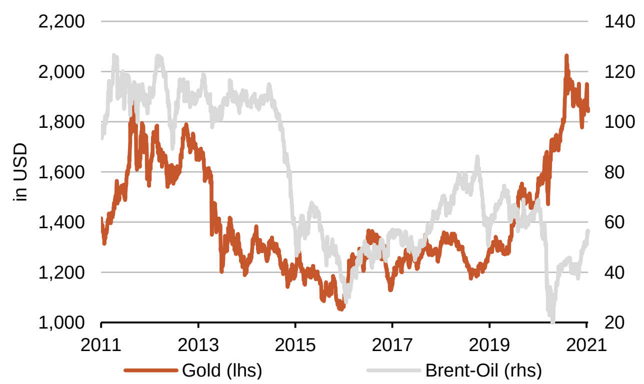
COMMODITIES

Cyclical commodities with tailwind

Gold should recover as equity markets rise
Oil market well supported thanks to supply deficit
Industrial metals benefit from the cyclical upswing

- At the beginning of January, **gold was** still moving towards the USD 2,000 per ounce mark, only to fall significantly below USD 1,900 per ounce due to rising interest rates and the strong USD. Looking ahead, due to the limited physical holdings, the gold price is also likely to rise with rising stock markets if investors want to keep their gold quota in the portfolio stable.
- The **price of crude oil** (Brent) continued its positive momentum and was able to break through the USD 55 per barrel mark. In addition to the expected global economic recovery and thus rising demand, the existing supply deficit thanks to Saudi Arabia's restrictive production policy was the main price driver.
- **Industrial metals** also made significant gains. Cyclical commodities benefited significantly from the positive economic outlook.

Price development



Source: Bloomberg, 01/01/2011 - 13/01/2021.

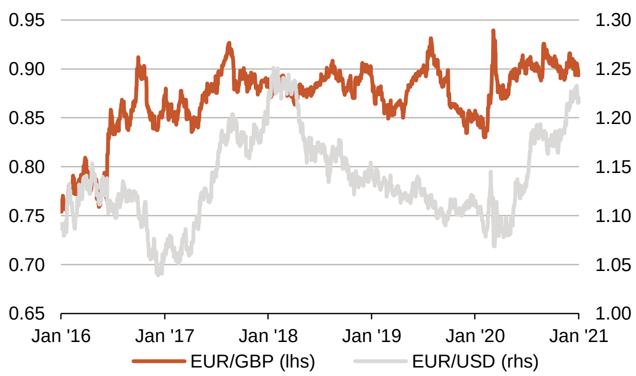
CURRENCIES

Positive outlook for the euro for the year

EUR/USD before further rise
Brexit connection agreement takes pressure off the pound
Swiss franc remains structurally strong

- **EUR/USD**: The euro exchange rate is establishing itself above the 1.20 mark. We see the euro continuing to rise against the US dollar in the new year. The main reasons for a weaker dollar are the ultra-expansive monetary policy of the US Federal Reserve in the longer term and the new majority in the US Congress, which is expected to lead to rising government debt and inflation. In addition, the US dollar is likely to be less sought after as a safe haven, so that money will flow out of the USA. Nevertheless, there may be countermovements in the meantime. How the ECB reacts to the stronger euro exchange rate remains to be seen.
- **EUR/GBP:** Shortly before the end of the year, the Brexit agreement was reached after all. This removes an important burden on the pound. In the short term, the fierce wave of infection is causing uncertainty. But in the course of the year the pound exchange rate should rise.

Exchange rates



Source: Bloomberg, 13/01/2016 - 13/01/2021.

Overview of commodities (short/medium term)	Old	New
Gold	↗	↗
Oil (Brent)	→	→

Overview of currencies (short/medium term)	Old	New
EUR/USD | Euro/US dollar	↗	↗
EUR/CHF | Euro/Swiss franc	↗	→
EUR/GBP | Euro/Sterling	↘	↘
EUR/JPY | Euro/Japanese yen	↗	↗

		Performance		
	As of 13/01/2021	ytd	1-year	3-year
Gold USD/ounce	1,846	-2.8%	+19.2%	+38.0%
Silver USD/ounce	25.2	-4.5%	+40.4%	+46.6%
Copper USD/pound	361.7	+2.8%	+26.4%	+12.4%
Brent USD/bbl	56.06	+8.2%	-12.7%	-19.8%

		Performance		
	As of 13/01/2021	ytd	1-year	3-year
EUR/USD	1.22	-0.5%	+9.2%	-0.4%
EUR/CHF	1.08	-0.2%	-0.2%	-8.5%
EUR/GBP	0.89	-0.3%	+4.0%	+0.3%
EUR/JPY	126.30	+0.1%	+3.2%	-6.8%

IMPORTANT NOTES

Members of the Investment Committee

Prof Dr Bernd Meyer | Chief Investment Strategist, Chairman
Dr Holger Schmieding | Chief Economist, Vice-Chairman
Matthias Born | Head Portfolio Management Equities, European Equities
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
Ansgar Nolte | Co-Head Portfolio Management Multi Asset
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Marco Höchst | Equities
Felix Stern | Bonds
Alexander Pichler | Bonds
Ludwig Kemper | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

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