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Markets

INVESTMENT COMMITTEE MINUTES

07 October 2021

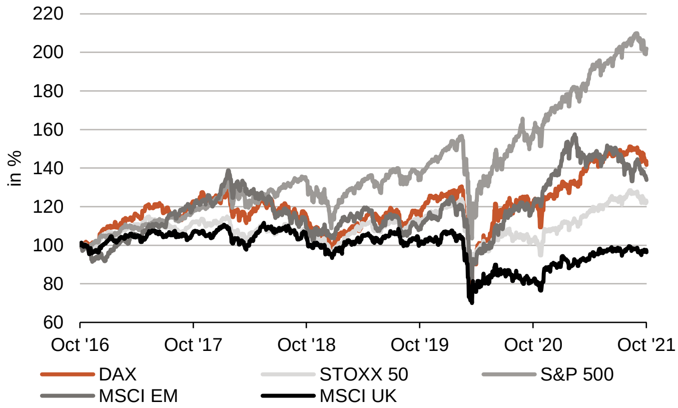
Managers of the Committee

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, 06/10/2016 - 06/10/2021.

Most important assessments at a glance

Economics	• Global economy loses momentum. Supply bottlenecks and high energy prices are a burden. A touch of "stagflation". • Outlook for 2022 is positive as there is pent-up demand, companies want to invest and politicians provide support. • Inflation: new push in autumn, decline in 2022; however, wage pressure increases – central banks will tighten cautiously.
Equities	• The equity markets can fall more sharply after all. A year-end rally is quite possible thanks to economic optimism for 2022. • The comeback of value has started, while cyclical stocks are likely to gain more – the reflation trade is back. • After the healthy setback, we are positioning ourselves with a slight overweight as our market picture remains positive.
Bonds	• Yields have risen noticeably as inflation expectations have increased and central banks have become more hawkish. • Despite moderate spread widening, we continue to favour high-yield bonds in the current interest rate environment. • We are underweight on bonds and focus on credit risk and off-benchmark themes, while we keep duration short.
Commodities	• The gold price can hold at USD1,750 per ounce, despite fundamental headwinds. Potential is limited for the time being. • The supply shortage of oil continues despite the OPEC+ production expansion. Oil price should, therefore, remain elevated. • Industrial metals remain structurally supported. The price of aluminium has continued to rise in recent weeks.
Currencies	• EUR/USD: The US dollar's "interim high" is proving stable. The Fed's policy remains in focus. • Little news on the EUR/GBP. It goes one step forward and one step back, with no definitive new trend emerging. • CHF is benefiting from heightened risks. The European single currency falls below CHF1.08 per euro.

Current market commentary

Global equity markets confirmed the typically poor autumn seasonality in September. The MSCI World experienced its biggest monthly pull-back since March 2020 – with China, high energy prices, supply chain issues and tapering concerns weighing. Growth stocks felt the sell-off most acutely as interest rates rose. For example, the Nasdaq 100 index is down nearly 7%. We view the sell-off as a healthy countermovement after the strong rally of recent months, but still think a correction of much more than 10% is unlikely. There is still a lot of money parked on the sidelines and valuation levels are no longer so extreme, while equities remain without alternative. In addition, the upcoming Q3 reporting season should provide fundamental tailwinds. The resurgence of corporate buybacks thereafter should also support the market. We believe that there is the potential for a limited year-end rally and a renewed strength in cyclical stocks as 2022 should again provide positive surprises in economic terms, with the possible end of supply chain problems. The reflation trade is, therefore, not over yet. We are positioning ourselves with a slight overweight in equities and continue to tactically supplement our quality-growth exposure with positions with a cyclical and value focus. Bond yields have risen sharply recently, following the central banks more hawkish stances. US 10-year government bonds are likely to end 2021 in negative territory for the first time since 2013. We also expect no gains in 2022 if our yield forecasts come to pass. For corporate bonds, spreads have risen slightly. In the current environment, we prefer less interest-sensitive high-yield bonds.

In regards to the commodities market, the clear winner of the last few weeks is energy commodities. The shortage of supply is causing the price to rise further. Both crude oil and natural gas were able to make significant gains. At the same time, gold is suffering from fundamental headwinds, but has held up well.

ECONOMICS

A touch of stagflation

Global economy loses momentum in autumn. Supply bottlenecks and high energy costs weigh on growth. The 2022 outlook stays positive as supply bottlenecks could ease, while consumers and companies have pent-up demand. Inflation appears to have overshot in autumn 2021 and remains an issue in 2022 - central banks will tighten cautiously.

- **A noticeable damper**: After a growth spurt in spring and summer, the global economy is currently losing momentum. While the Delta wave of COVID-19 infections is dampening consumer sentiment much less than in previous waves of the pandemic, supply bottlenecks are hampering growth across industries. In some sectors, labour shortages are preventing a rapid expansion of aggregate supply. In China and some other Pacific-Rim countries, this is compounded by the short-term affects of some regional lockdowns. The unexpectedly rapid rise in energy costs will also translate into lower growth in the coming months, with high inflation in the short term.
- **Positive outlook for 2022**: Despite a visible setback, purchasing managers' indices and other leading economic indicators continue to point to solid growth. Moreover, employment is rising strongly on both sides of the Atlantic. In the long run, this will further boost incomes and consumer spending. In the short term, the risks to our economic forecasts are tilted to the downside. However, this does not apply to the course of 2022. We even think that there is a chance that growth could surprise positively again from spring 2022 onwards, when the supply bottlenecks ease.
- **Chinese concerns**: China's economy is suffering from measures against the Delta wave, as well as a new wave of regulations and pronounced tensions in the real estate market. The government's attempt to encourage investors to behave more cautiously – especially in the real estate sector – and not to absorb all losses from the state, is causing some turbulence. But the risk of a real financial crisis with major contagion risks remains low. As a capital-rich country, with a still high savings rate, China can launch a new stimulus if necessary, should growth weaken too much.
- **High inflation in autumn 2021, decline in 2022**: Supply bottlenecks, delivery problems and rapidly rising energy prices are currently pushing inflation up more than expected. In Europe, inflation is expected to continue to rise until the end of 2021, while in the US it is likely to remain at around 5%. But the current rise in energy costs is likely to be exaggerated. As the special affects expire, the price climate will calm down again in 2022, with year-end inflation rates of around 1.5% in the euro area and 3% in the US. After that, price pressures are likely to slowly increase again.

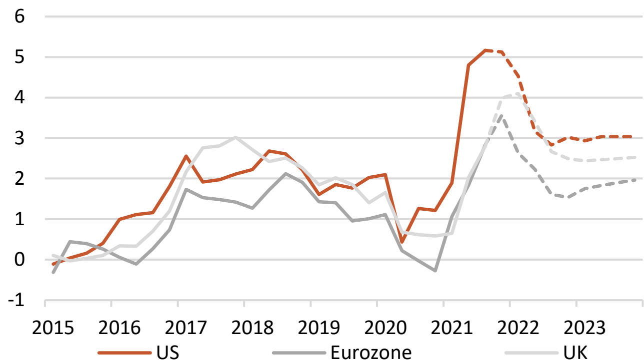
Monetary policy turnaround in three steps: Central banks are cautiously moving towards an exit from ultra-expansive monetary policy. The Fed will probably start to reduce its bond purchases somewhat in December. The European Central Bank (ECB) will probably further reduce bond purchases in Q1 2022 under the pandemic emergency purchase programme (PEPP).

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2020	2021	2022	2020	2021	2022
World	100.0	-3.1	4.8	3.7			
USA	24.5	-3.4	5.5	3.8	1.2	4.2	3.4
China	16.4	2.0	8.3	5.2	2.5	0.8	1.9
Japan	5.8	-4.7	2.5	2.4	0.0	-0.3	0.6
India	3.3	-7.3	10.0	6.5			
Latin America	5.9	-7.0	4.4	3.3			
Europe	24.4	-6.1	4.9	4.6			
Eurozone	15.3	-6.5	4.8	5.0	0.3	2.3	2.0
Germany	4.4	-4.9	2.3	5.8	0.4	2.9	2.2
France	3.1	-8.0	6.1	4.7	0.5	2.0	1.9
Italy	2.3	-8.9	5.8	4.9	-0.1	1.8	1.9
Spain	1.6	-10.8	4.2	7.5	-0.3	2.5	1.5
Other Western Europe							
United Kingdom	3.2	-9.7	6.9	5.0	0.9	2.4	3.2
Switzerland	0.8	-2.7	3.5	2.8	-0.7	0.4	0.5
Sweden	0.6	-2.9	3.6	3.4	0.5	1.7	1.3
Eastern Europe							
Russia	1.9	-3.0	3.0	2.5	3.3	5.2	4.0
Turkey	0.9	1.6	4.5	3.5	12.3	15.0	12.0

Source: Berenberg

Inflation



Year-on-year increase in %; dashed: Berenberg forecast; US: CPI-U, euro area: HICP, UK: CPI; sources: BLS, Eurostat, ONS, Berenberg; Q1 2015 - Q4 2023.

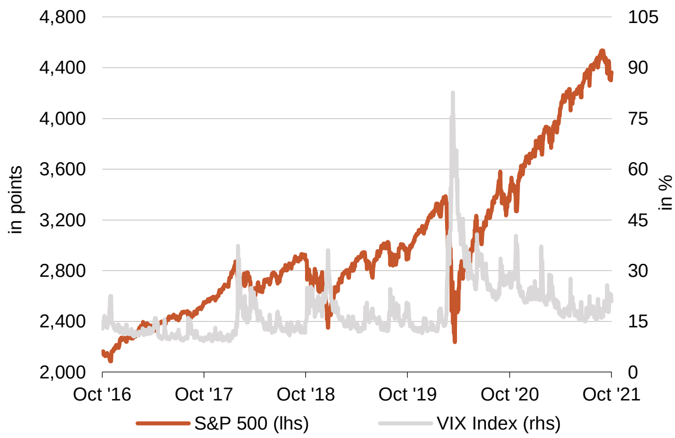
EQUITIES

Chance of a limited year-end rally

The equity markets can fall more sharply after all. Year-end rally well possible thanks to economic optimism for 2022. Value has started to make a comeback and cyclical stocks are likely to gain more – the reflation trade is back. After the healthy setback, we are positioning ourselves with a slight overweight as the market picture remains positive.

- **Global equity markets confirmed the typically weak autumn seasonality in September.** The MSCI World saw its biggest monthly pullback since March 2020 – with China, high energy prices, supply chain issues and tapering concerns weighing. Growth stocks felt the sell-off most acutely as interest rates rose. The Nasdaq 100 index, for example, is down nearly 7%.
- **Growth stocks** lost out in September after several months of outperformance. In Europe, they lost more than 5%, while **value stocks** fell by only 2%. **Cyclical stocks** were hit even harder, losing almost 7%. This did not include energy stocks, which saw the strongest month in 2021 so far.
- We consider the sell-off in September to be a healthy countermovement after the strong rally of recent months, but still believe that a correction of significantly more than 10% is unlikely. There is still a lot of money parked on the sidelines and valuation levels are no longer so extreme, while equities remain without alternative. In addition, the upcoming Q3 reporting season should provide fundamental tailwinds. The resumption of corporate equity buybacks thereafter should also support the market. We believe that a limited year-end rally is quite possible, with renewed strength in cyclical stocks, as 2022 should again provide positive surprises in terms of the economy as a result of the possible end of supply chain problems. The reflation trade is, therefore, not over yet.
- We are positioning ourselves with a **slight overweight in equities** and **tactically supplementing our quality-growth exposure with positions that have a cyclical and value focus.**

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 06/10/2016 - 06/10/2021.

Overview of equity markets (short/medium term)

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

		Performance in local currency				
	As of 06/10/2021	ytd	1-year	3-year	P/E	Dividend yield
DAX	14,973	+9.1%	+16.0%	+23.6%	14.7	2.7%
SMI	11,569	+11.2%	+16.5%	+40.7%	18.4	2.8%
MSCI UK	1,966	+12.3%	+22.5%	+5.1%	11.8	4.4%
EURO STOXX 50	4,013	+15.6%	+27.1%	+31.1%	16.2	2.9%
STOXX EUROPE 50	8,437	+14.7%	+22.3%	+25.3%	15.5	3.3%
S&P 500	4,364	+17.4%	+31.7%	+59.6%	21.5	1.4%
MSCI Em. Markets	1,227	-3.2%	+13.9%	+32.5%	12.9	2.8%

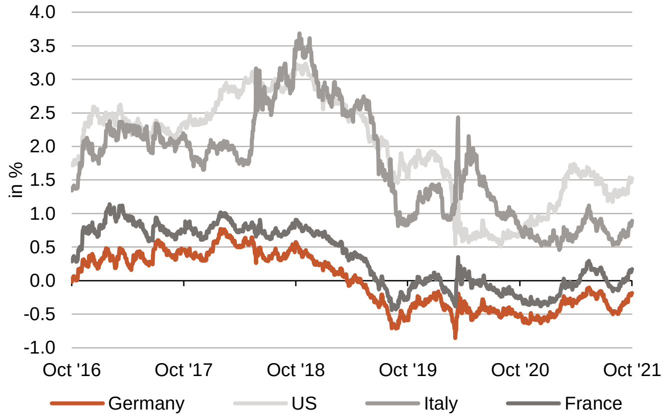
BONDS

Yields with strong upward pressure

Yields have risen noticeably as inflation expectations have increased and central banks have become more hawkish. Despite a moderate spread widening, we continue to favour high-yield bonds in the current interest rate environment. We are underweight on bonds and focus on credit risk and off-benchmark themes. Duration: short.

- The recent more hawkish signals from the Fed at its September meeting – with the prospect of tapering from November – pushed interest rates higher globally. Rising inflation expectations – amid persistently high energy prices and ongoing supply bottlenecks – added to upward pressure. As a result, **European government** bond yields have also risen markedly over the past four weeks. Yields on 10-year **German government bonds** have risen by almost 15bp. Even yields on European government bonds have, as a whole, turned positive again for the first time since July.
- **US government bonds** also saw a significant rise in yields and are likely to end 2021 in negative territory for the first time since 2013. We expect the rise in interest rates to continue and 2022 to be another negative year for government bonds.
- The recent sell-off on the equity markets had hardly any impact on high-quality **investment grade (IG) corporate bonds**. Spreads rose only marginally in a four-week comparison. However, in the case of the riskier **high-yield bonds,** especially **emerging market high-yield bonds**, the risk-off sentiment on the equity markets due to rising interest rates led to a more noticeable spread widening. Historically, however, spread levels are low with demand remaining strong and defaults falling. As the IG segment remains vulnerable to rising interest rates due to its long duration and low yield, we prefer short-duration segments with high carry, such as EUR high-yield bonds. In emerging markets, we prefer **local currency bonds.**
- **We are underweight on bonds.** We maintain our focus on corporate and emerging market bonds and keep duration short.

Yields on 10-year government bonds



Source: Bloomberg, 06/10/2016 - 06/10/2021.

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	↗	↗

	As of 06/10/2021	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	255.50	-3.0%	-2.0%	+11.2%
Covered bonds (iBOXX Euro Germany Covered)	204.27	-1.5%	-1.4%	+3.5%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	162.01	-0.7%	+0.5%	+7.9%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	161.16	-0.1%	+0.9%	+6.8%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,267.04	-1.6%	+2.4%	+19.3%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,531.89	+1.2%	+8.0%	+18.4%

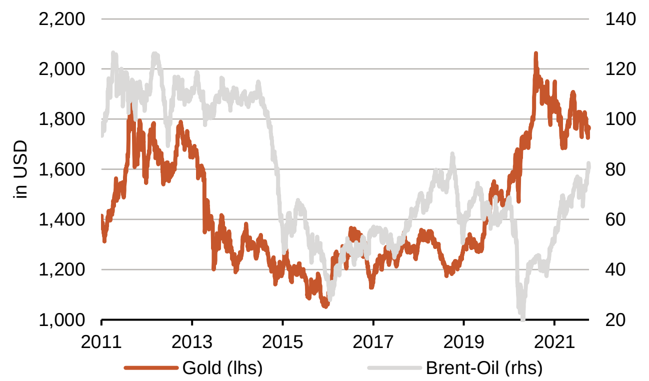
COMMODITIES

Crude oil price rises unabated

Gold is holding up well despite headwinds from all sides.
Crude oil price on upward trend amid supply shortage.
Industrial metals remain structurally in demand.

- **Gold** has recently settled around a price of USD1,750 per ounce. In view of the sharp rise in real interest rates and a stronger US dollar, the precious metal has held up surprisingly well, but – for the time being – it is only likely to regain strength in times of high uncertainty. ETF investors have recently reduced their holdings slightly.
- **Crude oil** (Brent) recently reached the USD80 per barrel mark again – for the first time since 2018. While the supply shortage of energy commodities continues, the sharp rise in gas prices is also likely to have led to substitution effects, giving oil an additional tailwind. The limited expansion of production by OPEC+ is likely to keep the price at a high level in the near future.
- **Industrial metals** remain structurally supported and would additionally benefit from a possible China stimulus. Aluminium continued to gain in September on structurally strong demand.

Price development



Source: Bloomberg, 01/01/2011 - 06/10/2021.

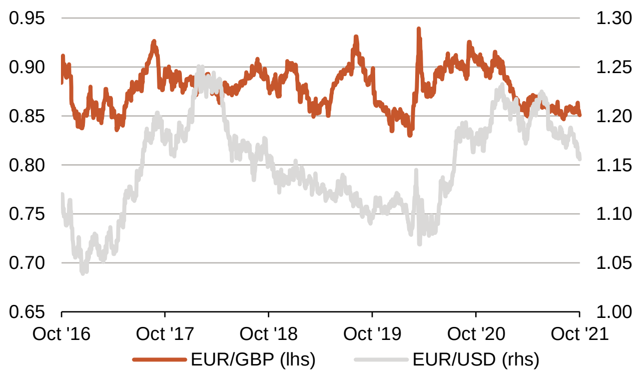
CURRENCIES

US dollar continues with unexpected strength

EUR/USD: the Fed strengthens the dollar.
EUR/GBP continues to go sideways.
CHF sought again as a safe haven.

- **EUR/USD:** The "interim high" for the US dollar is more stable than expected. The US currency was even able to increase its external value. The European single currency fell below the mark of USD1.16 per euro. Various economic risks moved into the focus of the financial markets. In addition to increasing supply bottlenecks, uncertainties surrounding a new COVID-19 winter with the Delta variant and concerns about the Chinese real estate market also played a role. In this environment, the US dollar benefited from its safe-haven status. Furthermore, the prospect of a monetary policy turnaround in the US is strengthening the dollar. High inflation is putting the Fed under pressure. Firstly, we think that the Fed will reduce its bond purchases and, next year, there should be two interest rate hikes.
- **EUR/GBP:** The Bank of England is likely to tighten the reins in a similar manner. But this was already priced in and is no surprise. Therefore, the pound is not benefiting.

Exchange rates



Source: Bloomberg, 06/10/2016 - 06/10/2021.

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 06/10/2021	ytd	1-year	3-year
Gold USD/ounce	1,763	-7.1%	-6.1%	+46.5%
Silver USD/ounce	22.6	-14.3%	-1.9%	+54.6%
Copper USD/pound	414.8	+17.9%	+40.0%	+50.1%
Brent USD/bbl	81.08	+56.5%	+90.1%	-3.7%

		Performance		
	As of 06/10/2021	ytd	1-year	3-year
EUR/USD	1.16	-5.4%	-1.5%	+0.3%
EUR/CHF	1.07	-0.9%	-0.5%	-6.3%
EUR/GBP	0.85	-4.8%	-6.6%	-3.1%
EUR/JPY	128.74	+2.0%	+3.9%	-1.7%

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
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Marco Höchst | Equity, Commodities
Christian Bettinger | Bonds
Karsten Schneider | Multi Asset Strategist, Minutes

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