BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

10 March 2022

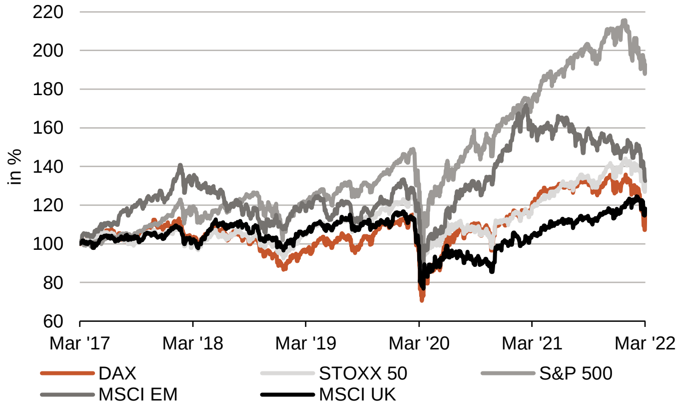
Managers of the Committee

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, 09/03/2017 - 09/03/2022.

Most important assessments at a glance

Economics	• Putin's invasion of Ukraine weighs on the economy. Europe is hit much harder than the US. • Higher prices for energy, food and raw materials are causing an inflation shock. • In the course of the year, the economy should recover from the shock and growth should return.
Equities	• Russia-Ukraine war triggers significant sell-off in equities. Cyclical equities are heavily weighed down by stagflation concerns. • Equity regions with many commodity companies are at an advantage. Strong pessimism offers opportunities for recovery. • Asymmetric risk-reward ratio favours equities, which is why we are maintaining our moderate overweight.
Bonds	• Safe haven government bonds have benefited. The geopolitical crisis does not change our medium-term interest rate outlook. • Corporate bonds are increasingly attractive due to widening spreads and rising interest rates. Opportunities are on the horizon. • We are underweight bonds and remain overweight corporate bonds; duration: short.
Commodities	• Gold benefited as a safe haven. Possible headwind from real interest rates only moderate with simultaneously rising interest rates. • Supply shortage drives oil price up. Further sanctions and supply cuts by Russia provide upward pressure. • Industrial metals are supported by high oil prices and supply concerns. Decarbonisation accelerates as a long-term driver.
Currencies	• The Russia-Ukraine war is driving investors into safe havens. The US dollar, Swiss franc and yen are benefitting. • These are difficult times for the euro – the regional proximity to the Ukraine-Russia war is a relative burdening factor. • The Bank of England's interest rate turnaround marches ahead. The British pound continues to strive upwards.

Current market commentary

The Russia-Ukraine war has led to massive economic uncertainty, resulting in a sell-off on the stock markets. Cyclical stocks and companies with high input costs suffered disproportionately as commodity prices went through the roof due to a war-related supply shortage. European equities were also punished due to their proximity to the war zone. The stagflation risk - low economic growth with high inflation - is increasing, but it does not form the base scenario of our economists. In addition, equity valuations have fallen massively and, at least in Europe, are historically cheap - and this with an economy that is likely to grow above trend despite everything. Since investor pessimism is already widespread and systematic investors are likely to become buyers again in the foreseeable future, we consider the risk-return profile to be full of opportunities in the medium term. The current situation thus represents a buying rather than a selling opportunity. We are positioning ourselves with a moderate overweight in equities with an admixture of commodity-rich regions.

Safe government bonds have paid off in markets characterised by uncertainty, even if the positive effect has been limited due to the noticeable increase in inflation and thus pressure on central banks to raise interest rates. For example, the market continues to price in six rate hikes by the Fed by December 2022. The steepness of the US yield curve has flattened further, reflecting increasing fears of recession. In corporate bonds, EUR investment grade outperformed EUR high yield, with risk premiums rising across the board. Commodities, however, performed better than safe-haven government bonds due to significant supply concerns and demand for precious metals such as gold. The appreciation of the USD also helped euro investors. However, the strong movement in the commodities market also poses demand risks in the event of an economic slowdown, which is why slight profit-taking makes sense.

ECONOMICS

Short-term dampener from Putin's war - but economic growth to return in summer

Putin's invasion of Ukraine weighs on the economy. Europe is hit much harder than the US.
Higher prices for energy, food and raw materials are causing an inflation shock.
In the course of the year, the economy should recover from the shock and growth should return.

- **A few months of stagflation in Europe:** Putin's war of aggression causes arguably the worst geopolitical earthquake since the collapse of the Eastern bloc in 1989/1990. The invasion and subsequent sanctions against Russia led to a rapid rise in the prices of energy, food and other key commodities. This external cost shock is putting a severe damper on the European economy, which was just shaking off the stagnation triggered by the Omicron wave of the pandemic. Inflation will continue to skyrocket in the coming months and supply bottlenecks – for the automotive industry, for example – are slowing down production. For 2022, we have lowered our growth forecasts for the Eurozone by 1ppt to 3.3% and for the UK by 0.8ppt to 4.0%.
- **Return of the upswing later in the year:** If the conflict does not escalate further – and we note that even the Soviet Union avoided direct military confrontation with NATO countries – and the economic situation clears up from summer onwards, the European economy should regain its footing. Households continue to have substantial excess savings accumulated during the pandemic, unemployment in the Eurozone is at record low levels, companies want to invest, and governments are also planning additional spending. Moreover, there is still considerable catch-up potential in Europe after the end of the pandemic-related restrictions. Due to the expected rebound, we have raised our GDP forecasts for the Eurozone and the UK by 0.3ppt for 2023 and 0.2ppt for 2024, respectively.
- **US – more distant, less affected:** The US is not dependent on Russian natural gas; its trade links with Russia and Ukraine are smaller; and US consumer and business confidence is likely to decline less because of the geographical distance. In addition, very high energy prices should encourage additional investment in domestic production ("fracking").
- **High inflation on both sides of the Atlantic – for different reasons:** In both Europe and the US, inflation is being driven up by high energy prices and supply bottlenecks. In contrast to the Eurozone, however, there is also a general excess demand in the US due to the extremely expansive fiscal policy. Therefore, the Fed cannot claim that the overshooting of inflation is merely temporary.

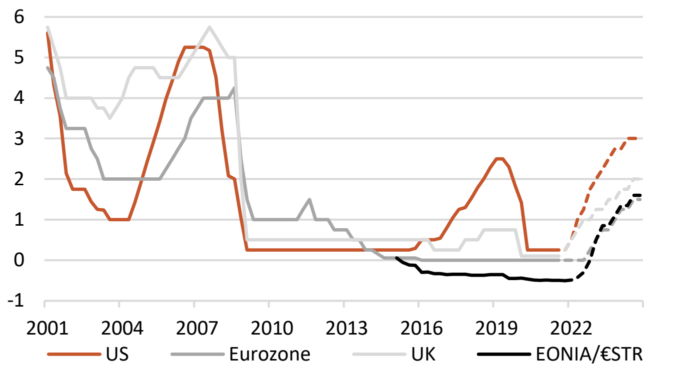
Monetary policy outlook: Due to extremely high inflation, the Fed is likely to raise interest rates in six 25bp hikes this year. The ECB will tend to take a more cautious approach and probably reduce its bond purchases further, but leave the timing of the first rate hike open for the time being. For our economic forecast, we continue to expect its first move to come in December 2022.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	3.9	3.5	2.9			
USA	24.5	3.8	3.1	2.7	6.8	3.9	3.2
China	16.4	4.8	4.7	4.3	1.9	2.3	2.3
Japan	5.8	2.9	2.4	1.5	0.9	0.7	0.7
India	3.3	9.0	6.8	6.7			
Latin America	5.9	3.0	2.9	2.4			
Europe	24.4	3.0	2.8	2.2			
Eurozone	15.3	3.3	3.3	2.3	6.1	2.3	2.3
Germany	4.4	2.8	3.5	2.3	5.6	2.6	2.5
France	3.1	3.5	3.0	2.4	4.5	2.2	2.3
Italy	2.3	3.3	2.6	1.6	6.0	2.0	2.1
Spain	1.6	5.1	4.2	2.3	6.4	1.9	2.2
Other Western Europe							
United Kingdom	3.2	4.0	2.8	2.4	6.4	2.7	2.3
Switzerland	0.8	2.0	2.0	1.5	3.6	1.5	0.9
Sweden	0.6	2.0	2.8	2.2	4.7	2.4	2.0
Eastern Europe							
Russia	1.9	-1.0	0.0	1.0	23.0	12.0	6.0
Turkey	0.9	3.5	3.0	2.5	21.0	15.0	11.0

Source: Berenberg

Central bank interest rates



Interest rates in %; dashed: Berenberg forecast; US: Federal funds rate, Eurozone: deposit rate, GB: Bank rate; Sources: Federal Reserve, ECB, BoE, Berenberg; Q1 2001 - Q4 2024.

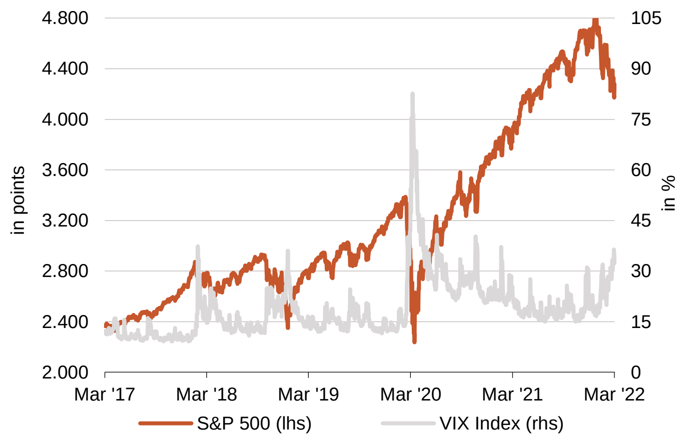
EQUITIES

Commodity-heavy regions at an advantage

Russia-Ukraine war triggers significant equities sell-off. Cyclical equities are heavily weighed down by stagflation concerns. Equity regions with many commodity companies are at an advantage. Strong pessimism offers opportunities for recovery. Asymmetric risk-reward ratio favours equities, which is why we are maintaining our moderate overweight.

- **The sell-off on the stock markets** continued amid increasing concerns about stagflation (high inflation, low growth) due to the Russia-Ukraine conflict. European and eastern European shares as well as banks (falling interest rates, sanctions, exposure to Russia) experienced particular downward pressure due to the geopolitical conflict. One exception was UK equities, which performed better due to their high weighting in energy and defensive stocks.
- Geopolitical uncertainty and stagflation concerns weighed on **cyclical equities** more than average, making them the worst performers in Europe since the beginning of the year, along with the **technology sector**. European **value stocks** have lost almost 9% over the past four weeks, while **growth stocks** have only fared slightly better at -7%. At the sector level, the **energy sector** leads the way with a gain of more than 14% since the beginning of the year. **Large caps** have held up much better than **small caps**.
- Russia's war of aggression is likely to depress economic growth and lead to commodity shortages with persistently high inflation. Consequently, concerns about stagflation are increasing and diversification is more important than ever. In the short term, given the war, companies with high pricing power and commodity producers not affected by sanctions are likely to be the relative winners. We continue to like Latin America as an admixture due to its attractive valuation, sector structure and geographic distance from the war. Moreover, if the war ends soon, equity markets should rally quickly, as investor sentiment and positioning are already very pessimistic.
- We position ourselves with a **moderate equity overweight** and **maintain our focus on emerging markets, especially Latin America and China**.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 09/03/2017 - 09/03/2022.

Overview of equity markets (short/medium term)

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

	As of 09/03/2022	Performance in local currency			P/E	Dividend yield
		ytd	1-year	3-year		
DAX	13,848	-12.8%	-4.1%	+20.9%	12.1	3.4%
SMI	3,596	-11.0%	+7.6%	+29.9%	17.5	2.9%
MSCI UK	2,058	-0.6%	+13.0%	+12.5%	11.2	4.1%
EURO STOXX 50	3.766	-12.1%	+2.0%	+25.2%	12.6	3.5%
STOXX EUROPE 50	8,638	-6.8%	+11.7%	+26.9%	13.3	3.4%
S&P 500	7,878	-10.1%	+11.5%	+61.6%	19.1	1.5%
MSCI Em. Markets	1,091	-11.3%	-15.2%	+14.4%	11.2	3.4%

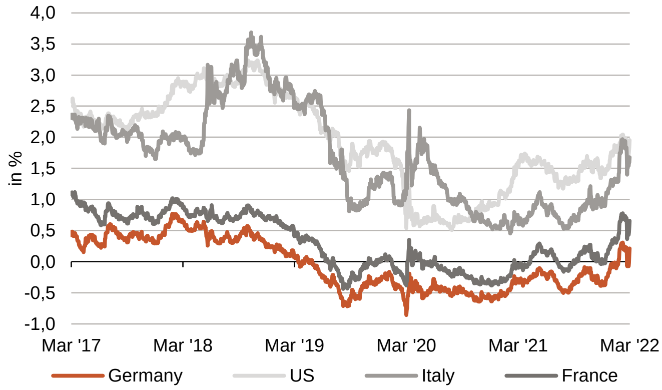
BONDS

Credit risk more attractive again

Safe-haven government bonds have benefited. The geopolitical crisis does not change our medium-term interest rate outlook. Corporate bonds are increasingly attractive due to widening spreads and rising interest rates. Opportunities are on the horizon. We are underweight bonds and remain overweight corporate bonds. Duration: short.

- The global bond market is currently caught between geopolitics and central bank policy. The increased need for security as a result of the Russia-Ukraine war has temporarily led to rising demand for safe havens. German Bunds and US Treasuries have gained. In the course of this, the yields of 10-year **German government bonds** were again temporarily below zero and the yields on 10-year **US government bonds** temporarily reached the level of the beginning of February at 1.77%.
- If the geopolitical situation calms down, the short-term tailwind for government bonds is likely to disappear and the bond markets will again be confronted with rising yields due to high inflation. For, despite the war drama and stagflation concerns – the steepness of the US yield curve is approaching zero – the market is pricing in six rate hikes by the Fed by December 2022.
- The risk premiums on **corporate bonds** has increased significantly in both the investment grade and high yield segments. The increasing spreads and the rise in interest rates make the asset class increasingly attractive, and the fundamental situation of most companies also speaks in favour of this. While we are cautious in the short term, due to our increased equity exposure, in the medium term there could be opportunities in the riskier bond segment in terms of valuation.
- **Emerging market bonds** have been heavily burdened by the Russia-Ukraine war. We favour **local currency bonds**, which ex-Russia have even managed to stay in positive territory since the beginning of the year.
- **We underweight bonds.** We are positioned with a simple duration underweight and remain overweight in corporate and emerging market bonds ex-Russia.

Yields on 10-year government bonds



Source: Bloomberg, 09/03/2017 - 09/03/2022.

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 09/03/2022	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	246.93	-2.9%	-4.2%	+3.3%
Covered bonds (iBOXX Euro Germany Covered)	197.39	-2.7%	-4.1%	-1.7%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	153.86	-4.5%	-4.9%	+0.7%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	155.50	-3.0%	-3.3%	+1.4%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	548.38	-9.1%	-1.8%	+1.8%
High-yield bonds (ICE BofA Global High Yield Index)	423.24	-6.9%	-5.3%	+10.4%

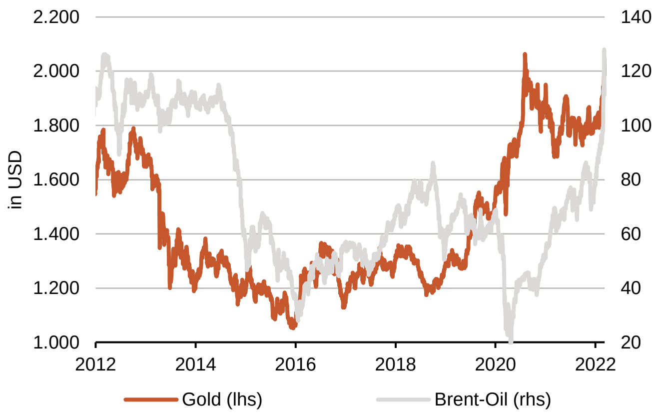
COMMODITIES

All commodities currently in demand

Gold benefited as a safe haven.
Supply shortage drives oil price up.
War and decarbonisation support industrial metals.

- **Gold** has gained as a safe haven since Russia's invasion and is trading above the 2,000 mark. As uncertainty subsides, gold is likely to lose its tailwind. Expected rising real interest rates are historically less problematic during rate hike cycles.
- **Crude oil** has been spurred by supply concerns driven up by the Russia-Ukraine war and is trading at its highest level since 2008. A complete supply shutdown by Russia could further exacerbate the situation. Alternative sources of supply from OPEC+, Iran, strategic reserves or redistribution towards China could provide relief. The oil price should therefore fall again somewhat, but remain high and very volatile overall.
- **Industrial metals** have benefited from high oil prices because of their energy-intensive production. The war has also led to divergences between metals produced in Russia and other metals. The trend towards decarbonisation is likely to have accelerated further.

Price development



Source: Bloomberg, 01/01/2012 - 09/03/2022.

Overview of commodities (short/medium term)

	Old	New
Gold	→	→
Oil (Brent)	→	↘
Industrial metals	→	→

	As of 09/03/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,992	+8.9%	+16.1%	+53.4%
Silver USD/ounce	25.8	+10.6%	-0.6%	+68.1%
Copper USD/pound	456.4	+2.3%	+13.5%	+57.7%
Brent USD/bbl	111.14	+42.9%	+64.6%	+69.1%

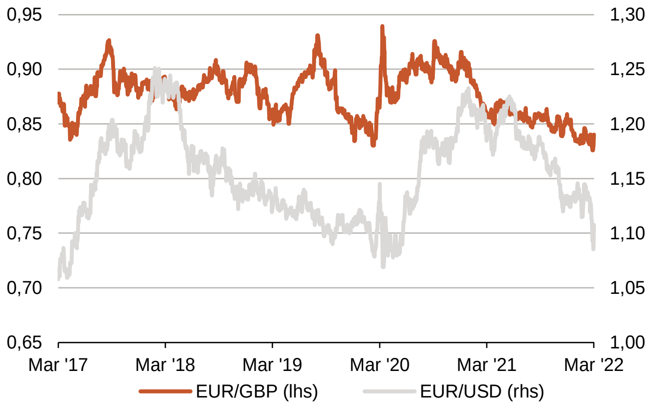
CURRENCIES

Euro trend reversal nipped in the bud

EUR/USD: US dollar sought as a "safe haven".
EUR/GBP: Monetary policy strengthens the pound.
EUR/CHF: Crisis drives exchange rate to parity.

- **EUR/USD:** The beginnings of a trend reversal lasted only briefly. The vague prospect of an earlier turnaround in rates had briefly interrupted the weakness of the euro and pushed the exchange rate back towards USD1.15 per euro. But with the outbreak of war, the classic "safe-haven" currencies are being sought and they are appreciating strongly. The euro has fallen below USD1.10 per euro and even to parity with the Swiss franc. Despite the renewed rise in inflation, the ECB will probably again be "on the lookout" and will hardly give the euro exchange rate any impetus.
- **EUR/GBP:** The BoE is moving ahead with the interest rate turnaround. Thanks to this support from the central bank, the pound was able to hold its ground at a high level. However, the UK currency is also benefiting from the weakness of the euro. In the meantime, the exchange rate has fallen to below GBP0.83 per euro.

Exchange rates



Source: Bloomberg, 09/03/2017 - 09/03/2022.

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	↘	↗

	As of 09/03/2022	Performance ytd	1-year	3-year
EUR/USD	1.11	-2.6%	-6.9%	-1.4%
EUR/CHF	1.03	-1.1%	-7.1%	-9.4%
EUR/GBP	0.84	-0.1%	-1.9%	-2.6%
EUR/JPY	128.29	-2.0%	-0.6%	+2.7%

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
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
Ansgar Nolte | Co-Head Portfolio Management Multi Asset
Robert Reichle | Fixed Income
Ludwig Kemper | Commodities
Philina Kuhzarani | Multi Asset Strategist, Minutes

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Joh. Berenberg, Gossler & Co. KG
Neuer Jungfernstieg 20
20354 Hamburg
Telephone +49 40 350 60-0
www.berenberg.de
MultiAssetStrategyResearch@berenberg.de