BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

07 April 2022

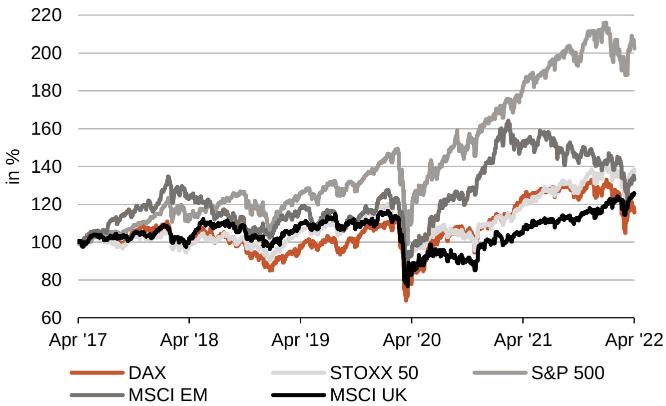
Managers of the Committee

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, 06/04/2017 - 06/04/2022.

Most important assessments at a glance

Economics	• Putin's invasion of Ukraine is weighing on the economy. Europe is hit much harder than the US. • In the course of the year, the economy should recover from the shock and growth return. • Potential commodity embargo (or Russian supply freeze) as a risk factor especially for German economy.
Equities	• After the war-related sell-off with high volatility, the recovery came recently. April seasonality is good for equities. • Medium-term upside limited is amid inflation and downturn concerns. Regions with commodity exposure are ahead. • We are positioning ourselves with only a small overweight in equities and remain tactically flexible.
Bonds	• Yields on safe government bonds still on an upward trend. Yet yield levels becoming increasingly attractive in the long term. • No further escalation in Putin's war makes for tighter risk premiums. We remain cautious on credit for the time being. • We are underweight bonds and prefer emerging market bonds. Duration: short.
Commodities	• Gold defies more restrictive central bank policy. Growth slowdown and inflation support. • Supply shortage pushes the oil price up. Prices are likely to fall in the short term only if demand collapses. • War and decarbonisation support industrial metals. The wave of infection in China is only a temporary demand dampener.
Currencies	• The first war shock is behind us on the forex market. The currencies of the safe investment countries do not gain further. • Difficult conditions for the euro. Regional proximity to the Ukraine-Russia war is also a relative burden factor in the longer term. • The yen is under pressure. Rising interest rate differential burdens. Could highly indebted Japan cope with higher interest rates?

Current market commentary

The great uncertainties regarding monetary policy and the economic effects of Putin's war are causing increased stock market volatility in both directions. After having fallen until mid-March in the wake of tighter sanctions, equity markets have rallied significantly since then. The market seems to be looking beyond the war and focusing on a number of supportive factors, including strong pre-war economic momentum, healthy labour markets, an expiring COVID-19 headwind in the industrialised world, an easing of Chinese monetary and fiscal policy, and historically positive seasonality in April. With better price momentum and lower volatility, more systematic strategies are now likely to increase their equity exposure. After the strong rally, however, we see the upside potential as limited in the medium term, as many analysts are likely to reduce their earnings estimates and economic data could be less good with restrictive central banks. Tactical action is therefore essential. For example, we had used the market setbacks to increase our equity exposure. In the course of the rally, we then took profits. We position ourselves with a small overweight in equities and an increased tactical focus.

Government bond yields have risen noticeably in recent weeks. We have used the rise to build up an initial position in safe government bonds (US Treasuries), as the level appears attractive in the medium term and markets are likely to continue to be characterised by high uncertainty. In addition, the market is increasingly pricing in a recession with the inversion of the US yield curve (10Y-2Y), which should mitigate a further rise in interest rates. With risk premiums recently falling again, corporate bonds do not paint such a gloomy picture. Gold defies restrictive central banks and oil remains supported by the supply shortage. Industrial metals are benefiting from supply disruptions and decarbonisation.

ECONOMICS

Short-term harsh dampener due to Putin's war – return of economic growth as of summer

Putin's invasion of Ukraine is weighing on the economy. Europe is hit much harder than the US.
In the course of the year, the economy should recover from the shock and growth return.
Potential commodity embargo (or Russian supply freeze) as a risk factor especially for German economy.

- **A few months of stagflation in Europe:** Putin's war of aggression is a geopolitical earthquake. The war is also a shock economically. The invasion and subsequent sanctions against Russia led to a rapid increase in the prices of energy, food and other key commodities. Inflation has continued to rise, surprising on the upside in the major economic regions. This external cost shock is putting a severe dampener on the European economy, which was just shaking off the stagnation triggered by the Omicron wave of the pandemic. The war is clouding the growth outlook. Nevertheless, we expect the Eurozone to grow by 3.2 % this year. German GDP is expected to grow by 2.7 %.
- **Return of the upswing later in the year:** If the conflict does not escalate further – even the Soviet Union avoided direct military confrontation with NATO countries – and the economic situation clears up from the summer, the European economy should regain its footing. Households continue to have considerable 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. Based on the expected recovery, we expect GDP in the Eurozone to rise by 3.3% in 2023 (Germany 3.6%). A commodity embargo would require a reassessment especially for the German economic outlook.
- **US – more distant, less affected:** The US is not dependent on Russian natural gas, its trade links with Russia and Ukraine are smaller and consumer and business confidence are 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.

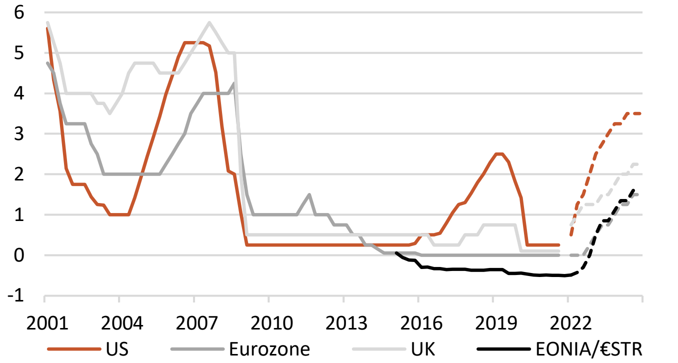
Monetary policy outlook: Because of the extremely high inflation, the Fed is likely to raise its interest rates by a total of 1.5 percentage points this year. The ECB is more likely to take a sighted approach, further reduce its bond purchases and probably end its net purchases in the third quarter. We then expect the first interest rate step in December of this year.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	3.7	3.3	2.9			
USA	24.5	3.4	2.9	2.7	7.2	3.8	3.0
China	16.4	4.8	4.7	4.3	1.8	2.3	2.3
Japan	5.8	2.7	2.4	1.5	1.3	0.8	0.7
India	3.3	9.0	6.8	6.7			
Latin America	5.9	3.0	2.9	2.4			
Europe	24.4	2.7	2.6	2.2			
Eurozone	15.3	3.2	3.3	2.3	6.3	2.2	2.3
Germany	4.4	2.7	3.6	2.3	6.8	2.5	2.3
France	3.1	3.4	3.1	2.4	4.6	2.2	2.2
Italy	2.3	3.1	2.6	1.6	6.4	2.3	2.1
Spain	1.6	5.1	4.3	2.3	8.2	2.7	2.4
Other Western Europe							
United Kingdom	3.2	4.1	2.4	2.4	7.4	3.2	2.3
Switzerland	0.8	2.4	2.0	1.5	3.0	1.4	0.9
Sweden	0.6	2.0	2.8	2.2	4.7	2.4	2.0
Eastern Europe							
Russia	1.9	-5.0	-3.0	1.0	28.0	15.0	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.

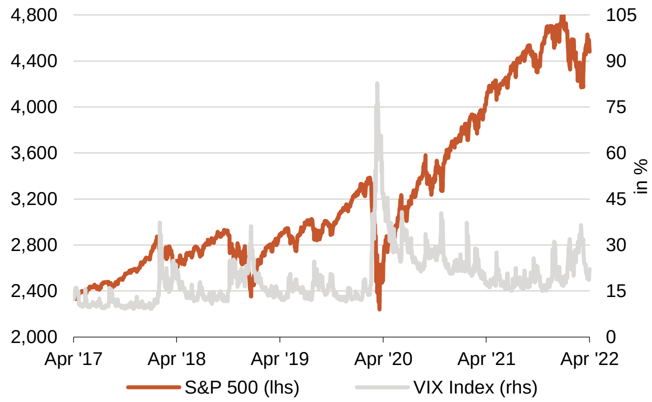
EQUITIES

Decreasing tailwind and uncertainty make tactical action essential

After the war-related sell-off with high volatility, the recovery came recently. April seasonality is good for equities. Medium-term upside limited is amid inflation and downturn concerns. Regions with commodity exposure are ahead. We are positioning ourselves with only a small overweight in equities and remain tactically flexible.

- **The sell-off in equities** continued at the beginning of March as the Russia-Ukraine war weighed on sentiment. Since mid-March, stock markets then experienced a significant recovery. The market assesses the consequences of the war as less severe for the US compared to Europe, where input cost inflation could become a threat to the cyclical upswing. However, the current recovery seems to be mainly technically driven. The historically positive seasonality in April could provide further support in the short term. Regionally, commodity exporters continued to lead, while commodity importers remained depressed. China, in particular, was under pressure as the new wave of infections and ongoing Zero-Covid strategy created headwinds.
- Even though **cyclical stocks** gained over the last month, they remained weighed down by geopolitical and stagflation concerns and have been the laggards in Europe since the beginning of the year, along with the **technology** sector. European **value stocks** gained just under 10% over March, while **growth stocks** outperformed with 14%. At the sector level, the **energy sector** lagged with only 3% over the last month, but remained ahead with a gain of over 20% since the beginning of the year. **Large caps** held up better than **small caps**.
- After the recent recovery, upside potential seems limited in the medium term amid continued war and increasing signs of a downturn. Earnings revisions in the developed world remain weighed down by high commodity prices and tighter central bank policies. However, with a timely end to the war, equity markets are likely to rally further as investor sentiment and positioning are already very pessimistic and the economic outlook is likely to improve.
- We position ourselves with a **small equity overweight** and an increased tactical focus.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 06/04/2017 - 06/04/2022.

Overview of equity markets (short/medium term)

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

	As of 06/04/2022	Total return in local currency: ytd	1-year	3-year	P/E	Dividend yield
DAX	14,152	-10.9%	-7.0%	+17.8%	12.4	3.3%
SMI	3,859	-4.5%	+11.1%	+34.8%	18.5	2.7%
MSCI UK	2,180	+6.0%	+18.6%	+14.4%	11.2	4.0%
EURO STOXX 50	3,825	-10.6%	-1.3%	+21.0%	12.9	3.3%
STOXX EUROPE 50	9,149	-1.3%	+14.1%	+27.9%	13.8	3.2%
S&P 500	8,259	-5.7%	+11.1%	+60.5%	19.8	1.4%
MSCI Em. Markets	1,143	-6.9%	-13.1%	+13.8%	12.2	3.0%

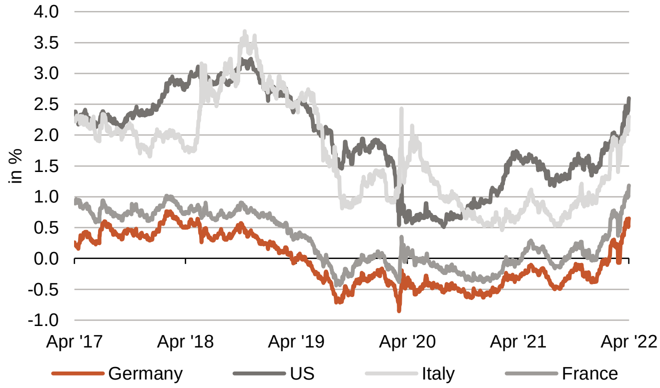
FIXED INCOME

Yields more attractive again but still under upward pressure

Yields on safe government bonds still on an upward trend. Yet yield levels becoming increasingly attractive in the long term. No further escalation in Putin's war makes for tighter risk premiums. We remain cautious on credit for the time being. We are underweight bonds and prefer emerging market bonds. Duration: short.

- The global bond market remains under pressure. Government bond yields have also risen significantly in recent weeks. At 0.64%, yields on **10-year German government bonds** were at their highest level since 2018, and yields on **10-year US government bonds** temporarily reached a level of 2.59%.
- The rise in yields is likely to continue in the medium term, but counter-movements cannot be ruled out. The inversion of the US yield curve (2Y vs. 10Y), an important leading indicator for a recession, should at least mitigate a further rise in interest rates, as central banks would have to rethink their restrictive stance in the event of a looming recession.
- Risk premiums on **corporate bonds** have recently fallen again after a sharp rise at the beginning of March. Even if a progressive easing of tensions in the Russia-Ukraine war could lead to tighter risk premiums, we do not expect a sustained and pronounced rally. Geopolitical risks, high commodity prices and an ECB in retreat may cause further volatility for corporate bonds.
- **Emerging market bonds** were heavily burdened by the further escalation of the Russia-Ukraine war. We favour local currency bonds, which, excluding Russia, have even managed to stay in positive territory since the beginning of the year.
- **We are underweight bonds.** We are positioning ourselves with a simple duration underweight. We have recently built up an initial position in safe government bonds (US Treasuries), as the level appears attractive in the medium term and markets are likely to continue to be characterised by high uncertainty. We are also maintaining our emerging market corporate bond overweight for risk, duration, diversification and carry reasons.

Yields on 10-year government bonds



Source: Bloomberg, 06/04/2017 - 06/04/2022.

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 06/04/2022	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	237.21	-6.8%	-7.8%	-1.4%
Covered bonds (iBOXX Euro Germany Covered)	192.60	-5.1%	-6.4%	-4.4%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	151.79	-5.8%	-6.4%	-1.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	154.00	-3.9%	-4.4%	-0.6%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	558.03	-7.5%	-1.6%	+1.2%
High-yield bonds (ICE BofA Global High Yield Index)	423.08	-6.9%	-6.2%	+8.3%

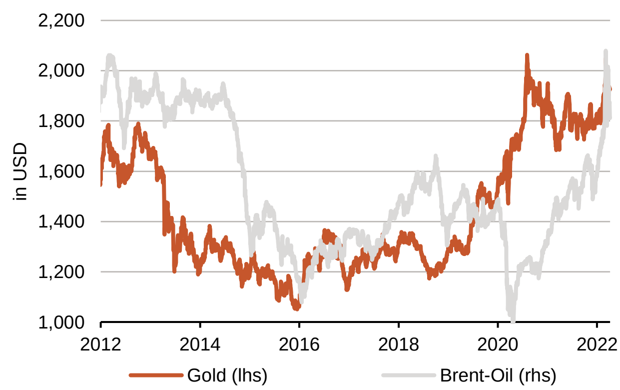
COMMODITIES

Continuing supply shortage of oil and metals

Gold defies more restrictive central bank policy.
Supply shortage drives the oil price up.
War and decarbonisation support industrial metals.

- **Gold** was initially in demand as a safe haven due to the escalation of Putin's war and as an inflation hedge, but consolidated a little later as real interest rates rose. Opportunities and risks currently balance each other out.
- **Crude oil** remained caught between fears of supply shortages, hopes for supply recovery and China demand concerns due to the ongoing uncertainty about the further course of the war. Crude oil inventories remain at rock bottom and alternative sources, including the release of strategic reserves, cannot sustainably address the existing supply deficit. In the short term, falling prices are only likely in the event of a collapse in demand.
- **Industrial metals** remained dominated by supply risks. While the wave of infection in China poses demand risks, these are likely to be only a temporary damper. Long-term drivers such as supply shortages and rising demand due to decarbonisation remain intact.

Price development



Source: Bloomberg, 01/01/2012 - 06/04/2022.

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

	As of 06/04/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1.925	+5.3%	+10.4%	+49.0%
Silver USD/ounce	24.5	+4.9%	-2.8%	+61.9%
Copper USD/pound	473.8	+6.1%	+15.1%	+63.7%
Brent USD/bbl	101.07	+29.9%	+61.1%	+43.7%

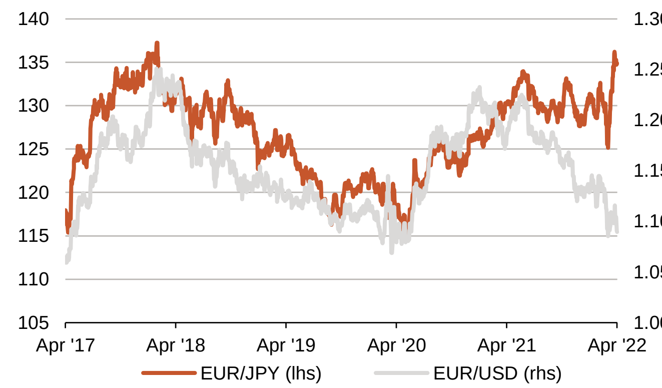
CURRENCIES

First shock on the forex market behind us

EUR/USD: Stabilisation at USD1.10 dollars per EUR.
EUR/JPY: Japanese currency is under pressure.
EUR/CHF: EUR moves slightly away from parity.

- **EUR/USD:** The first shock of the Russian war of aggression on the forex market is now behind us. Initially, the classic "safe haven" currencies (USD, CHF, JPY) had visibly gained. The EUR was able to pull back slightly from its lows against the USD and the CHF. Against the USD it went up from around 1.08 to almost USD1.12 per euro. Overall, however, the exchange rate is now hovering around the 1.10 mark again and seems to be looking for orientation. In the long term, we see moderate upward potential for the euro as soon as the ECB's punitive course becomes more apparent. In addition, higher US inflation is likely to put pressure on the dollar exchange rate in the long term.
- **EUR/JPY:** Following the outbreak of the war, the Japanese currency initially gained. The euro fell to below JPY125 per euro. In the meantime, the exchange rate has risen to around 135. The fact that interest rates in Japan are (able to) rise less is weighing on the yen.

Exchange rates



Source: Bloomberg, 06/04/2017 - 06/04/2022.

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 06/04/2022	Performance ytd	1-year	3-year
EUR/USD	1.09	-4.2%	-8.3%	-2.9%
EUR/CHF	1.02	-2.0%	-8.0%	-9.4%
EUR/GBP	0.83	-0.9%	-3.0%	-3.1%
EUR/JPY	134.88	+3.0%	+3.5%	+7.6%

IMPORTANT NOTES

Members of the Investment Committee

Prof Dr Bernd Meyer | Chief Investment Strategist, Chairman
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Matthias Born | Head Portfolio Management Equities
Ulrich Urbahn | Head Multi Asset Strategy & Research
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Christian Bettinger | Fixed Income
Philina Kuhzarani | Commodities, Minutes

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