BERENBERG Markets

INVESTMENT COMMITTEE MINUTES

12 May 2022

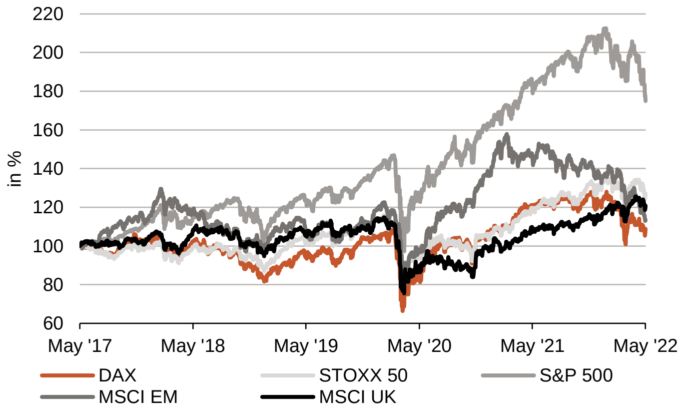
Managers of the Committee

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, 11/05/2017 - 11/05/2022.

Most important assessments at a glance

Economics	• Two big shocks: Putin's invasion of Ukraine weighs on the economy, China's Zero-Covid policy disrupts global trade. • Eurozone remains in stagflation until mid-year. US economy loses momentum. • A recession in Europe and the US is not excluded, but unlikely. The US Fed does not want a recession.
Equities	• After the recovery in March, the equity sell-off continued in April. Growth stocks were particularly burdened. • Investors are struggling with a plethora of risks. Already cautious investor positioning should prevent sharp sell-off. • We have used the recovery rally to reduce our equity exposure to neutral. Outlook remains uncertain.
Bonds	• Global bond markets are under pressure due to rising interest rates and inflation concerns. Yield levels are increasingly attractive. • Corporate bonds and emerging market bonds are weighed down by Putin's war and recession fears. • We are underweight bonds and favour emerging market bonds. Duration: neutral.
Commodities	• Gold lost ground on a strong dollar. Recession worries and high inflation versus rising real interest rates balance each other out. • Oil market with high volatility. The start of the oil embargo and a recovery in demand from China should provide a tailwind. • Decarbonisation is long term driver for industrial metals. Slump in demand from China and recession fears are temporary burden.
Currencies	• The US dollar is benefiting from its role as a safe haven and from the tighter monetary policy of the US Federal Reserve. • In contrast, the euro is suffering from the ECB's hesitancy. The EUR/USD exchange rate has fallen to around 1.05. • The euro was able to gain against the pound. The British currency was too strong and has now corrected.

Current market commentary

The markets remain unpredictable. After a recovery in March, there was a noticeable downturn again in April. Even the typical recovery rally after a major Fed meeting lasted only briefly. Further increases in bond yields spooked investors and weighed on interest-sensitive assets such as growth stocks. In addition, concerns about a recession are increasing, especially since a (quick) solution to Putin's war is not in sight and Chinese economic data have also weakened significantly. Investors are thus struggling with a tsunami of worries and problems. Investor sentiment is correspondingly negative and positioning is defensive. Another sharp sell-off therefore seems less likely without an external trigger. Nevertheless, we do not expect a big recovery as long as the problems persist and have used the short rally after the Fed meeting to reduce our equity weighting to neutral. If worst comes to worst, gold, a first small US government bond position and a hedge against extreme risks (tail hedge certificate) should help.

Safe government bonds and corporate bonds also fell in April. Both higher interest rates and rising risk premiums due to recession fears weighed on the bond universe. US government bonds thus saw the sharpest decline in value in their history, measured from the high. The picture is similarly bad for corporate bonds. Losses of over 3% were the rule rather than the exception. However, yield levels have risen noticeably, which makes corporate bonds more attractive again in the long run. Nevertheless, we believe it is still too early to increase our bond exposure.

Commodities have not been able to hide either recently. China concerns and recession risks have weighed on both crude oil and industrial metals. Looking ahead, however, the supply deficit should dominate and provide upward pressure.

ECONOMICS

Putin's war and Chinese lockdowns put a dampener on things - improvement possible from summer onwards

Two big shocks: Putin's invasion of Ukraine weighs on the economy, China's Zero-Covid policy disrupts global trade. Eurozone remains in stagflation until mid-year. US economy loses momentum. A recession in Europe and the US is not excluded, but unlikely. The US Fed does not want a recession.

- **A gloomy spring. The** economic situation and the outlook for the coming months have become gloomy. Putin's attack on Ukraine and the resulting rapid rise in the prices of energy, food and other key commodities are dealing a severe blow to consumers in large parts of the world. At the same time, Chinese lockdowns are exacerbating shortages of key inputs for the world's industries. Many companies can cope with the setback as they can pass on higher costs to consumers. But consumer confidence has plummeted on both sides of the Atlantic.
- **Stagflation in Europe:** The price shock largely triggered by Putin is putting a severe dampener on the European economy. Instead of overcoming the stagnation triggered by the Omicron wave of the pandemic, the Eurozone and UK economies are likely to tread water at best in Q2. Unlike an oil embargo on Russia, which Europe could cushion itself against by importing more from other regions, a gas embargo would require rationing of gas for parts of industry and trigger a recession in Europe. For this reason, we consider such an embargo unlikely.
- **US – further away, less affected:** The US is not dependent on Russian natural gas. In addition, very high energy prices should encourage additional investment in domestic production ("fracking"). We expect the US economy to settle at growth rates at around 2%, supported also by more investments in the energy sector ("fracking") as well as higher government spending as a result of the fiscal programmes already adopted.
- **More growth later in the year.** Provided consumers slowly get used to higher prices, China gradually gets the pandemic back under control in the summer and no new shock hits the economy, the global economy can pick up speed again in the summer, in the Eurozone also supported by a return of tourists to the Mediterranean after a two-year Coronavirus-related lull. The labour market is robust on both sides of the Atlantic. Companies and governments want to invest.
- **Rapid turnaround in interest rates.** In response to the unexpectedly high inflation, many central banks are tightening their course faster and more vigorously than expected. The US Fed is likely to raise its rates by another 0.5 percentage points each in June and July, the ECB's first rate hike of 0.25 percentage points is due in September at the latest and perhaps as early as July.

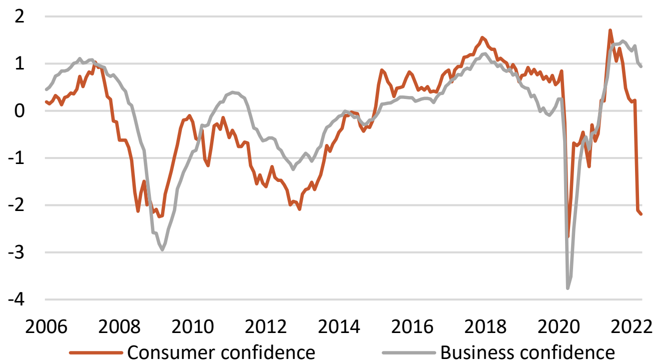
Recession course? It is not without reason that investors are asking whether the Fed's late but energetic turnaround on interest rates could trigger a recession. That is possible, but so far not very likely. The Fed does not want a recession. If the US economy cools down too much, it will probably slow down the pace of the interest rate turnaround accordingly.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	3.3	3.1	2.8			
US	24.5	2.6	2.3	2.1	7.4	3.8	3.0
China	16.4	4.6	4.5	4.3	1.8	2.3	2.3
Japan	5.8	2.7	2.4	1.5	1.6	0.8	0.7
India	3.3	9.0	7.3	6.7			
Latin America	5.9	3.0	2.5	2.5			
Europe	24.4	2.0	2.5	2.2			
Eurozone	15.3	2.8	3.1	2.3	6.8	2.6	2.4
Germany	4.4	2.1	3.3	2.4	6.8	2.5	2.4
France	3.1	3.2	3.1	2.4	4.6	2.2	2.2
Italy	2.3	2.6	2.5	1.6	6.2	2.4	2.3
Spain	1.6	5.0	4.3	2.3	7.5	2.7	2.4
Other Western Europe							
United Kingdom	3.2	3.9	1.9	2.2	7.7	3.4	2.4
Switzerland	0.8	2.4	2.0	1.5	3.0	1.4	0.9
Sweden	0.6	3.0	2.4	2.2	4.0	2.4	2.0
Eastern Europe							
Russia	1.9	-10.0	-2.0	1.0	35.0	15.0	6.0
Turkey	0.9	3.0	3.0	2.5	70.0	40.0	20.0

Source: Berenberg

Eurozone: Consumer and business confidence



Difference to the average in standard deviations (calculated from 1999). Source: European Commission; January 2006 - April 2022.

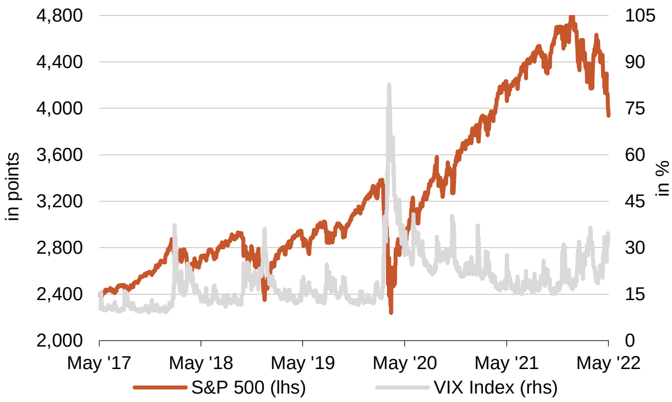
EQUITIES

Stock markets remain unpredictable

After the recovery in March, the equity sell-off continued in April. Growth stocks are particularly burdened. Investors are struggling with a plethora of risks. Already cautious investor positioning should prevent sharp sell-off. We have used the recovery rally to reduce our equity exposure to neutral. Outlook remains uncertain.

- The **sell-off in equities** continued in April after the recovery in March. Thus, the typical recovery rally following a major Fed meeting was also short-lived. Equity markets were weighed down by steadily rising bond yields, and interest-rate-sensitive assets such as growth stocks in particular struggled. Investors also face mounting recession fears. On the one hand, the end of the Russia-Ukraine war is not in sight, on the other hand, the latest Chinese economic data have also shown clear weakness. This mix of risks from all sides (geopolitical conflicts, inflation, interest rate and recession fears) weighed on investor sentiment and equity markets.
- **Cyclical equities** remained under above-average pressure due to geopolitical and stagflation concerns and, with a performance since the beginning of the year of approximately -24%, are bringing up the rear in Europe alongside the **technology sector**. European **growth stocks** have lost almost 8% over the last month, while **value stocks** have fared better with -at 3%. At the sector level, the **energy sector** leads the way with almost 2% over the last month. **Large caps** held up better than **small caps**.
- Without an external trigger, another sharp sell-off seems unlikely as some negativity is already priced in. Nevertheless, we do not expect a big recovery as long as the problems persist. The much tighter Fed continues to pose a risk to the valuation premium of the US equity market.
- We have used the recovery rally to reduce our **equity exposure** to **neutral**. We remain overweight emerging market equities. China's expansionary monetary policy and less potential for valuation tightening are supportive.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 11/05/2017 - 11/05/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 11/05/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	13,829	-12.9%	-8.5%	+14.7%	11.3	3.6%
SMI	3,647	-9.7%	+5.9%	+26.9%	17.2	3.0%
MSCI UK	2,117	+3.3%	+12.7%	+14.7%	10.3	4.3%
EURO STOXX 50	3,648	-13.4%	-4.7%	+18.6%	11.5	3.7%
STOXX EUROPE 50	8,786	-5.2%	+8.1%	+25.5%	12.4	3.5%
S&P 500	7,258	-17.2%	-4.3%	+41.4%	17.3	1.6%
MSCI Em. Markets	1,011	-17.4%	-22.0%	+5.9%	11.1	3.3%

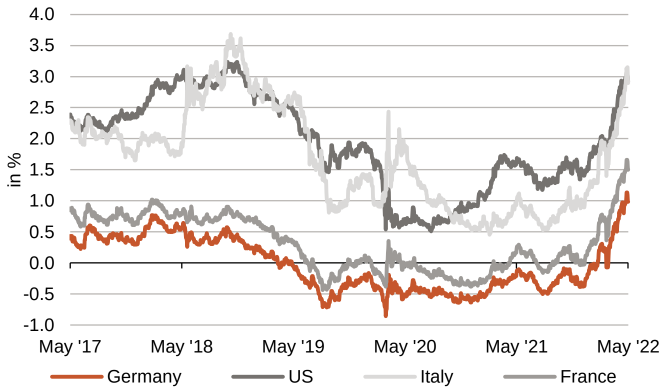
FIXED INCOME

Returns increasingly attractive

**Global bond markets under pressure due to rising interest rates and inflation concerns. Yield levels increasingly attractive. Corporate bonds and emerging market bonds are weighed down by Putin's war and recession fears.
We are underweight bonds and favour emerging market bonds. Duration: neutral.**

- The **global bond market** continues to be under pressure and safe government bonds and corporate bonds had to decline significantly. Higher interest rates as well as rising risk premiums due to recession fears have weighed on the bond universe. US government bonds, for example, saw the sharpest decline in value in their history measured from the high. Accordingly, yields on **10-year US government bonds were** at their highest level since the end of 2018 at over 3%, and yields on **10-year German government bonds** temporarily reached a level of 1.13%.
- The picture looks similarly bleak for **corporate bonds.** Losses of over 3% in the last four weeks were the rule rather than the exception. Even in the euro corporate bond segment, which is not directly affected by the Russia-Ukraine war, capital outflows continue to increase. Nevertheless, we cannot speak of a panicked flight of capital here, but this is primarily due to strong outflows in the short duration segment in exchange-traded funds.
- **Emerging** market **bonds** were heavily weighed down by the ongoing Russia-Ukraine war and recession concerns. Both hard currency and local currency emerging market bond yields rose in April. Specifically in hard currencies, there was a one-off decline in performance related to the removal of Russia from the indices. Compared to government bonds, corporate bond spreads widened less and were also less volatile.
- **We are underweighting bonds.** Even though yield levels on corporate bonds have risen noticeably, making equities less of an alternative, we believe it is still premature to increase our bond exposure. However, the attractiveness has increased.

Yields on 10-year government bonds



Source: Bloomberg, 11/05/2017 - 11/05/2022.

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 11/05/2022	Performance in index currency: ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	230.84	-9.3%	-8.9%	-4.2%
Covered bonds (iBOXX Euro Germany Covered)	188.84	-7.0%	-7.8%	-6.6%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	146.36	-9.2%	-9.3%	-5.7%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	150.52	-6.1%	-6.3%	-3.1%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	541.99	-10.2%	-3.8%	-1.5%
High-yield bonds (ICE BofA Global High Yield Index)	400.27	-11.9%	-12.3%	+2.2%

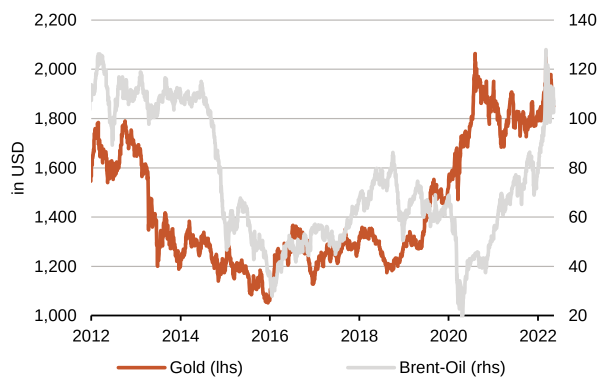
COMMODITIES

China only a short-term dampener on oil and metals

Gold lost against the strong US dollar.
Oil market with high volatility.
Decarbonisation supports industrial metals in the long term.

- **Gold** initially posted gains due to upwardly surprising inflation data, but then lost ground due to significant US dollar strength. Recession worries and rising real interest rates balance each other out, so the precious metal should continue to move sideways in a volatile manner.
- **Crude oil** was accompanied by high volatility due to the tug-of-war between fears of supply shortages, hopes for supply recovery and China demand concerns. In the short term, however, China's tough lockdown policy prevails. If an EU oil embargo is passed and demand from China recovers, the imbalance between supply and demand is likely to intensify and lead to rising prices.
- **Industrial metals** are burdened in the short term by risks from the Russia-Ukraine war, the slump in demand from China and increasing fears of recession. In the long term, however, drivers such as the trend towards decarbonisation remain fully intact.

Price development



Source: Bloomberg, 01/01/2012 - 11/05/2022.

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

	As of 11/05/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,852	+1.3%	+0.8%	+44.0%
Silver USD/ounce	21.6	-7.4%	-21.9%	+45.9%
Copper USD/pound	421.3	-5.6%	-11.8%	+51.3%
Brent USD/bbl	107.51	+38.2%	+56.8%	+52.2%

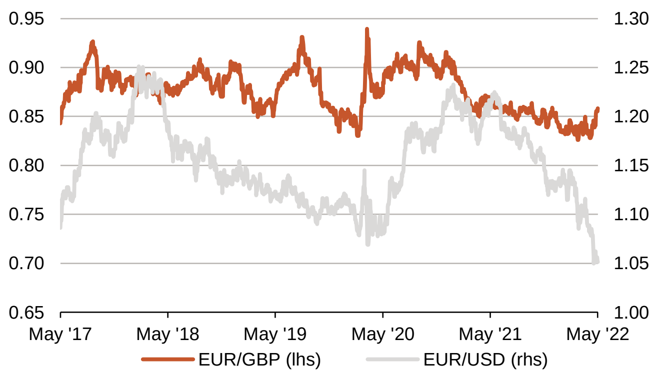
CURRENCIES

Long wait for the ECB

EUR/USD: The euro falls below 1.05 at the low.
EUR/GBP: Pound corrects due to economic risks.
EUR/CHF: Euro leaves lows behind.

- **EUR/USD:** The US Federal Reserve raised the key interest rate by 50 basis points at the beginning of May. The discussion in the US revolves solely around how much the Fed will raise interest rates further. In Europe, on the other hand, it is not even clear whether the ECB will react to the high inflation with a first small interest rate step in July or whether it will continue to wait. This discrepancy in monetary policy is reflected in the weak exchange rate. In addition, Europe is suffering much more from the Russia-Ukraine war than the US and the dollar is being targeted as a safe haven. Thus, the exchange rate has temporarily fallen below the mark of 1.05 US dollars per euro.
- **EUR/GBP:** The pound has been firmer than we expected in recent months. The Bank of England (BoE) has contributed to this, marching ahead on the interest rate turnaround. However, the BoE is likely to become more cautious now because of the economic risks. The pound has weakened and is now at the level we expected.

Exchange rates



Source: Bloomberg, 11/05/2017 - 11/05/2022.

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 11/05/2022	Performance ytd	1-year	3-year
EUR/USD	1.05	-7.5%	-13.5%	-6.4%
EUR/CHF	1.05	+0.7%	-4.8%	-8.1%
EUR/GBP	0.86	+2.0%	-0.1%	-0.7%
EUR/JPY	136.63	+4.4%	+3.5%	+10.6%

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
Torsten Ziegler | Equities
Daniel Fuchs | Fixed Income
Ludwig Kemper | Commodities
Philina Kuhzarani | Minutes

Disclaimer

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