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Markets

INVESTMENT COMMITTEE MINUTES

09 June 2022

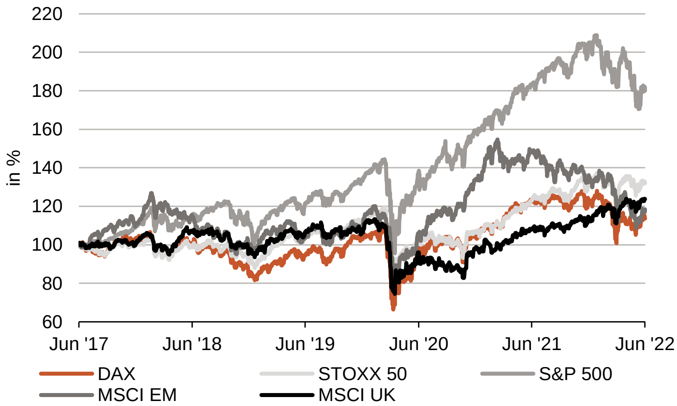
Managers of the Committee

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, 08/06/2017 - 08/06/2022.

Most important assessments at a glance

Economics	• Two big shocks: Putin's invasion of Ukraine weighs on the economy, Chinese lockdowns remain a risk. • Eurozone remains largely in stagflation until autumn. US economy loses momentum. • A recession in Europe and the US is possible but not likely. The US Fed does not want a recession.
Equities	• Equities saw a slight recovery rally from mid-May onwards due to rebalancing flows and share buyback programmes. • After a further decline in volatility, this should rise in Q3. Interest rate policy and Q2 reporting season are in investor focus. • We remain neutral on equity exposure. Potential in China's easing COVID-19 policy and Latin America.
Bonds	• Global bond markets burdened by rising interest rates and inflation concerns. Interest rate level increasingly attractive. • Corporate bonds and emerging market bonds weighed down by China, Russia and recession fears. • We underweight bonds and favour emerging market bonds. Duration: neutral.
Commodities	• Gold suffered from real interest rate hikes. With the Fed continuing to fight inflation, upside potential remains limited. • US travel season supports oil demand. Supply remains tight and the oil market situation remains tense. • Industrial metals suffered from China worries. China's easing and recovery in the automotive sector should support.
Currencies	• Prospect of an imminent interest rate turnaround in the eurozone strengthens the euro. EUR/USD low probably reached in May. • The US dollar continues to benefit from the geopolitical situation. However, there are doubts about the Fed's tightening course. • The British currency is fluctuating around the 0.85 pound per euro mark and is thus at the level we expected.

Current market commentary

In recent weeks, global equity markets rallied despite widespread recession concerns. US equities have been driven by rebalancing flows, share buyback programmes and insider buying. Lower volatility and better price momentum should also increasingly drive systematic investment strategies back into equities. In the short term, therefore, the markets could stabilise further. In the medium term, however, the decisive factor remains how persistent inflation and how robust consumption really are. The Fed's further monetary policy will then depend on this. Over the next few months, however, economic data and thus also earnings estimates are likely to come down. Accordingly, we would not chase the current rally. In the face of broadly priced economic weakness and poor sentiment, we are encouraged by the more market- and economy-friendly policies currently being pursued in China and the positive potential for surprises. On the investment style level, value outperformed growth. Looking ahead, however, growth is likely to have less difficulty following the valuation correction. We remain balanced and are neutrally weighted in equities.

Inflation is not letting up. Following renewed increases in inflation readings in Europe, interest rates in particular have jumped. 10-year German government bonds now yield above 1.3%, while yields in Italy are heading towards 3.5%. The market is now also expecting significant rate hikes from the ECB – 120 basis points by the end of the year. Corporate bonds suffered from rising recession concerns in May and saw noticeable spread widening. Even though risk premiums are now more attractive again, we consider an increase in credit exposures to be too premature.

Crude oil remains the black gold, as further upside potential remains thanks to the US driving season and supply shortages. Gold, on the other hand, is likely to trend sideways.

ECONOMICS

Sharp economic dampener due to Putin's war and Chinese lockdowns – peak of US inflation reached?

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A recession in Europe and the US is possible but not likely. The US Fed does not want a recession..

- **Sharp shocks.** The rapid rise in prices for energy, food and other key commodities following Putin's attack on Ukraine is weighing on consumers in much of the world. At the same time, Chinese lockdowns exacerbated shortages of key inputs for the world's industries in April and May. 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. The mood in industry is also slowly clouding over
- **Stagflation in Europe:** Instead of overcoming the stagnation initially triggered by the omicron wave of the pandemic, the Eurozone and UK economies are likely to tread water at best for the time being. Unlike the spotty oil embargo on Russia, which Europe can cushion 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 think such an embargo is unlikely. But given the high oil prices, the risk of a more pronounced setback for the European economy has increased. The probability of a presumably mild recession in the euro area during the year is around 30%.
- **US – Fed gets serious:** The US is not dependent on Russian natural gas. Natural gas is much cheaper there than in Europe. However, the US Federal Reserve is now vigorously tackling its home-grown inflation problem after the economy and labour market ran too hot in 2021. True, the Fed is aiming for a soft landing. But we now estimate the risk of the US falling into a mild recession in early 2023 at 40%.
- **Inflation: USA reaches peak before Europe.** In the USA there are first signs that inflation may soon have passed its peak. Wage pressures remain high, but have eased somewhat recently. In contrast, the high prices for natural gas imports and electricity have not yet fully reached consumers in Europe. In Europe - unlike in the USA - the inflation rate is therefore only likely to decline visibly from October onwards.
- **Rapid turnaround in interest rates.** In response to higher-than-expected inflation, many central banks are tightening more vigorously than expected. The US Fed is likely to raise its rates by another 0.5 percentage points each in June, July and September, the ECB could raise its rates by 0.25 points each in July and September, a move of 0.5 points is possible.

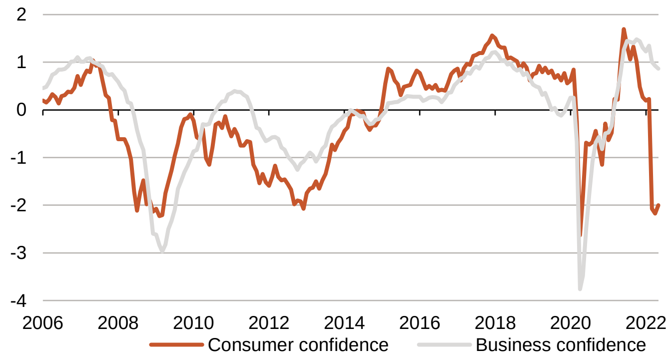
Recession course? The Fed wants to dampen wage and price pressures through a slight increase in unemployment. But it wants to avoid a recession. If the US economy cools down too much, it would probably slow down the pace of its interest rate turnaround accordingly from October onwards and thus stabilise the outlook.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	3.1	2.8	2.7			
US	24.5	2.5	1.7	1.8	7.2	3.7	3.0
China	16.4	4.3	4.9	4.5	1.9	2.3	2.3
Japan	5.8	1.8	1.9	1.4	1.8	0.9	0.7
India	3.3	9.0	7.3	6.7			
Latin America	5.9	3.0	2.5	2.5			
Europe	24.4	1.8	1.7	2.1			
Eurozone	15.3	2.6	2.1	2.3	7.3	3.2	2.3
Germany	4.4	1.7	2.1	2.4	7.3	3.1	2.4
France	3.1	2.4	2.2	2.4	5.2	2.9	2.4
Italy	2.3	2.6	1.5	1.5	6.9	3.0	2.3
Spain	1.6	4.5	3.3	2.3	7.9	3.3	2.3
Other Western Europe							
United Kingdom	3.2	3.8	1.5	1.7	7.7	3.9	2.3
Switzerland	0.8	2.4	2.0	1.5	3.0	1.4	0.9
Sweden	0.6	3.0	2.4	2.2	5.5	2.4	2.0
Eastern Europe							
Russia	1.9	-10.0	-3.0	1.0	30.0	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 - May 2022.

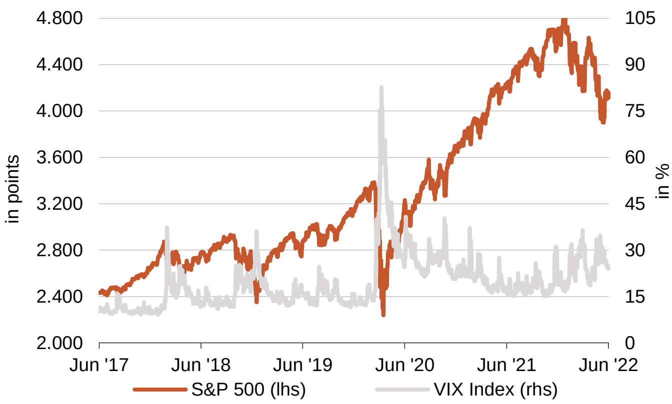
EQUITIES

China easing offers opportunities

Equities saw a slight recovery rally from mid-May onwards due to rebalancing flows and share buyback programmes. After a further decline in volatility, this should rise in Q3. Interest rate policy and Q2 reporting season are in investor focus. We remain neutral on equity exposure. Potential in China's easing COVID-19 policy and Latin America.

- Recently, the **stock markets** saw a slight recovery. The higher-valued US equities, driven by rebalancing flows from pension funds and share buyback programmes, have regained some ground. In addition, more corporate insiders have been buying shares recently. The recent recovery rally from mid-May onwards also meant, above all, a break from the valuation squeeze that has weighed heavily since the beginning of the year. On the earnings estimate side, analysts see no real headwind for corporate profits so far. In fact, earnings estimates for industrialised nations and emerging markets have recently been raised slightly. From a regional perspective, there were mainly positive earnings revisions for eastern Europe and Latin America.
- **Cyclical stocks** recovered over the last four weeks with a gain of over 7%. **Energy** remains the strongest equity sector with a performance of 9.4%. **Basic materials, financials, industrials, telecoms, utilities** and **health care** also gained over the last four weeks. **Information technology**, the loser since the beginning of the year, posted a positive result of almost 3.4%. **Value** and **large caps** held up better than **growth** and **small caps**. However, the performance edge has narrowed noticeably as growth has already experienced a marked valuation adjustment.
- After **volatility** decreased recently, it is likely to increase again in the third quarter. Investors are likely to focus on the Fed's interest rate policy and the Q2 reporting season. In the medium term, the decisive factor will be how sticky inflation dynamics and how strict China's Covid policy remain.
- We remain positioned with a **neutral equity exposure.** China offers noticeable catch-up potential with an easing of the zero-covid policy and opening of the economy. Latin America should also continue to benefit from the ongoing commodity boom and cheap valuations.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 08/06/2017 - 08/06/2022.

Overview of equity markets (short/medium term)

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

	As of 08/06/2022	Total return in local currency			P/E	Dividend yield
		ytd	1-year	3-year		
DAX	14,446	-9.1%	-7.6%	+19.9%	12.1	3.4%
SMI	3,602	-10.8%	-1.9%	+21.6%	18.1	3.0%
MSCI UK	2,188	+7.2%	+14.4%	+16.3%	10.7	5.1%
EURO STOXX 50	3,789	-9.5%	-4.3%	+22.2%	12.3	3.5%
STOXX EUROPE 50	9,029	-2.6%	+7.3%	+26.7%	13.1	3.3%
S&P 500	7,601	-13.2%	-1.7%	+48.3%	17.9	1.6%
MSCI Em. Markets	1,074	-12.0%	-19.9%	+15.3%	10.8	3.4%

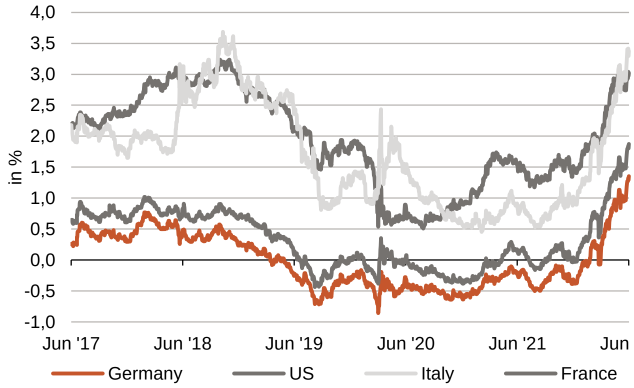
FIXED INCOME

Higher yields offer limited protection against interest rate expansion

Global bond markets burdened by rising interest rates and inflation concerns. Interest rate level increasingly attractive. Corporate bonds and emerging market bonds weighed down by China, Russia and recession fears. We underweight bonds and favour emerging market bonds. Duration: neutral.

- The **global bond market** remains under pressure, facing a mix of inflation concerns, rising interest rates and recession fears. While it seems that the markets are pricing in the high point for inflation and interest rates for the US, the May inflation data in Europe surprised significantly to the upside. As a result, **US government bonds** saw only sideways movement, last trading at 3.02%. In contrast, the higher inflation data put pressure on the ECB and so yields on safe government bonds in Europe have risen significantly. As a result, **German government bonds** recently yielded 1.35% and **Italian government bonds** over 3.37%.
- **Corporate bonds** are facing similar headwinds. Interest rates and widening spreads are weighing on the asset class. Accordingly, the volatile movements in risk premiums continued. However, after the noticeable upward movement in May, risk premiums on investment-grade corporate bonds have recently come back somewhat.
- **Emerging market bonds** continued their drawdown in the second quarter, even though recovery movements were seen in all segments since mid-May. Local currency bonds were the best performers. In contrast, corporate bonds outperformed government bonds, but suffered more from Chinese economic concerns. Looking ahead, however, we see further potential for recovery, especially in government hard currency bonds.
- **We are underweighting bonds.** Inflation is likely to stabilise at elevated levels, making real bond yields less attractive. We therefore maintain our neutral duration positioning.

Yields on 10-year government bonds



Source: Bloomberg, 08/06/2017 - 08/06/2022.

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 08/06/2022	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	223.78	-12.0%	-12.3%	-9.3%
Covered bonds (iBOXX Euro Germany Covered)	186.58	-8.1%	-9.0%	-8.5%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	143.88	-10.7%	-11.1%	-7.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	149.36	-6.8%	-7.2%	-4.3%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	536.49	-11.1%	-5.7%	-3.5%
High-yield bonds (ICE BofA Global High Yield Index)	404.92	-10.9%	-12.0%	+3.0%

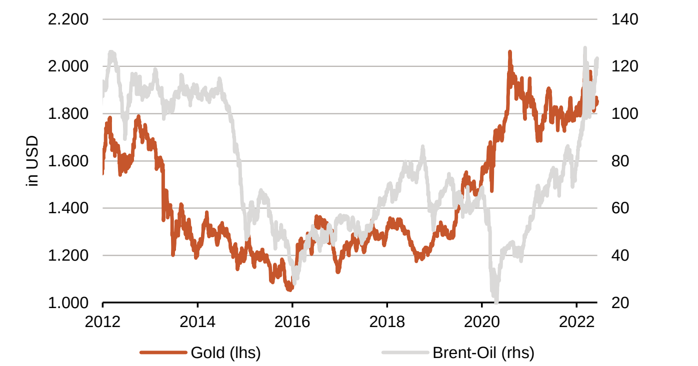
COMMODITIES

China only temporarily burdens oil and metals

Gold suffered from restrictive Fed policy.
US driving season supports oil demand.
Industrial metals suffered from China concerns.

- **Gold** was weighed down over the last few weeks by the Fed's reaction to persistently high inflation and the rise in real interest rates after the US dollar. Most recently, recession concerns combined with expectations of a further restrictive Fed policy came into focus.
- **Crude oil has** remained volatile in recent weeks, caught between news of supply shortages on the one hand and news of supply recovery and demand concerns on the other. Most recently, the oil price experienced a tailwind after the EU decided on a partial oil embargo, which prohibits the purchase of Russian oil by sea. In the short term, oil is likely to experience outward pressure from the US driving season.
- **Industrial metals** remained burdened by the slump in demand from China. An opening of China after the COVID-19 lockdowns and a recovery of the automotive industry should provide tailwinds in the short term. In the long term, drivers such as the trend towards decarbonisation remain fully intact.

Price development



Source: Bloomberg, 01/01/2012 - 08/06/2022.

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

	As of 08/06/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,853	+1.3%	-2.1%	+38.2%
Silver USD/ounce	22.1	-5.4%	-20.2%	+46.8%
Copper USD/pound	445.5	-0.2%	-2.2%	+69.5%
Brent USD/bbl	123.58	+58.9%	+71.1%	+95.3%

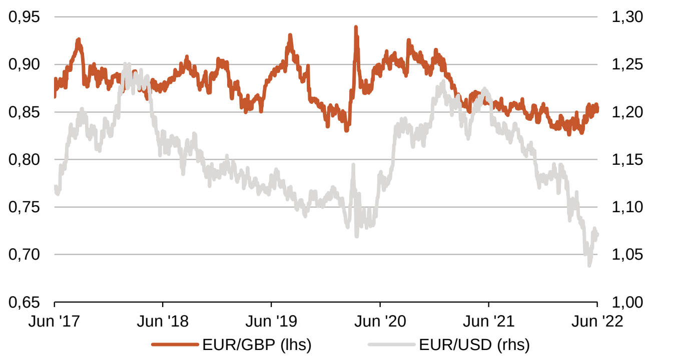
CURRENCIES

ECB ahead of rate turnaround: Euro strengthened

EUR/USD: Euro probably leaving lows behind.
EUR/GBP: Pound fluctuates at expected level.
EUR/CHF: Strong franc keeps distance to parity.

- **EUR/USD:** The pressure on the ECB has become too great. Playing for time and waiting for inflation to fall automatically are coming to an end. Since the signals from leading ECB representatives for a first interest rate hike as early as July have been doing the rounds, the euro has been able to pull away from its low of below 1.04 US dollars per euro. In addition, the first doubts arose as to whether the Fed can actually tighten monetary policy as much as many market observers expect. With the change in sentiment on the foreign exchange market, the exchange rate rose by around three cents to 1.07 US dollars per euro between the middle and end of May.
- **EUR/GBP:** After a strong first quarter, the UK economy is now cooling significantly. The BoE will therefore probably tighten monetary policy less than the markets had expected in the meantime. This is noticeable in the exchange rate. The pound has ended its high and is hovering at 0.85 pounds per euro, the level we consider appropriate.

Exchange rates



Source: Bloomberg, 08/06/2017 - 08/06/2022.

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 08/06/2022	Performance ytd	1-year	3-year
EUR/USD	1.07	-5.8%	-12.0%	-5.5%
EUR/CHF	1.05	+1.1%	-3.9%	-6.3%
EUR/GBP	0.85	+1.6%	-0.6%	-3.9%
EUR/JPY	143.86	+9.9%	+7.9%	+17.3%

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 & Equities
Felix Stern | Fixed Income
Philina Kuhzarani | Commodities & Minutes

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