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Markets

INVESTMENT COMMITTEE MINUTES

07 July 2022

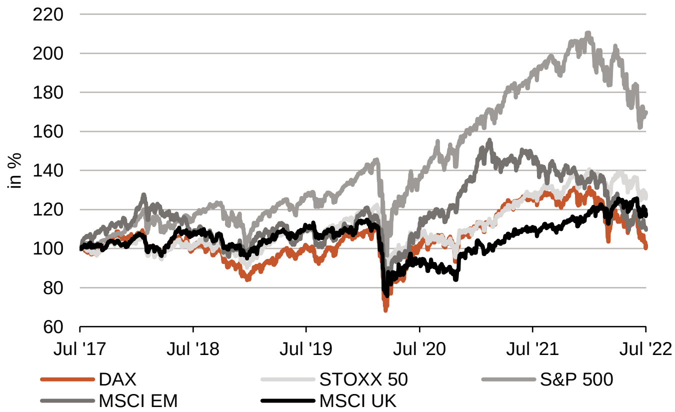
Managers of the Committee

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, 06/07/2017 - 06/07/2022.

Most important assessments at a glance

Economics	• US: The Fed hesitated for far too long, now it is hitting the brakes hard. We forecast a mild US recession in 2023. • Putin cuts gas supply. Another gas price hike will hit Eurozone hard. Recession from autumn. • Inflation peak in sight in the US. Euro inflation will continue to rise until late fall. Price pressure decreases sharply in 2023.
Equities	• Equities have suffered one of the weakest first halves in history. Inflation and recession concerns burdened. • Increasing recession concerns should mean a shift in investor focus from valuation to fundamentals. • We are moderately underweight in equities. Quality growth with significant potential with less interest rate pressure.
Bonds	• Recession dominates inflation. Yields have fallen noticeably recently, as government bonds were in demand as safe havens. • Corporate and emerging market bonds are increasingly pricing in recession risks. Yields are increasingly attractive. • In the current environment, a duration increase via safe bonds is likely to make sense. We are increasing our bond allocation.
Commodities	• Gold is caught between recession worries and real interest rates. It is still an important portfolio component as a hedge. • Oil has suffered from recession and demand slump concerns. However, supply remains tight for the time being. • Industrial metals are weighed down by China lockdowns. If the trend reverses, there should be a quick recovery.
Currencies	• The European Central Bank is lagging behind the other central banks. The euro is suffering from the hesitation. • At the same time, the US dollar is benefiting from risk aversion. EUR/USD has therefore fallen below 1.03. • After the interest rate hike, the Swiss franc is bearish. The euro has fallen below parity against the franc.

Current market commentary

The S&P 500 posted its worst quarterly performance in Q2 since the peak of pandemic concerns in Q1 2020 and its most negative H1 result since 1970. Inflation and recession concerns burdened. The barrage of comments from central bankers at the ECB's Sintra conference again highlighted that policymakers are prioritising the fight against inflation, even if this carries the risk of recession. The bulk of recent economic data has already disappointed. As the likelihood of a recession increases, market participants' focus is likely to shift from valuation to fundamentals. We are therefore critical of analysts' very optimistic earnings estimates, as cost pressures are still likely to have a noticeable impact on companies and weigh on profit margins. This should continue to put pressure on risk assets. In this environment, our preferred equity style quality-growth should regain ground, at least relative to the benchmark. This has already been observed with the quality factor. Due to our expectation that the final sell-off in a recession is still missing, we have once again tactically reduced our equity exposure in the recent rally. However, we expect the equity markets to find their bottom in H2.

The bond market is pricing in the recession with rising spreads on corporate bonds and recently sharply falling yields on government bonds. US government bonds are now yielding below 3% again, while spreads on high-yield bonds have rarely been this high in the last ten years. Emerging market (EM) bonds also suffered noticeably. The risk-off environment is thus clearly felt, which is why an increase in duration through safe bonds seems sensible. This should stabilise the multi-asset portfolio in the risk-off environment.

Industrial metals also had to give up significant performance and even crude oil suffered recently from recession concerns, although the fundamental case remains intact in the medium term..

ECONOMICS

Shocks take over: US and Europe slide into recession

US: The Fed hesitated for far too long, now it is hitting the brakes hard. We forecast a mild US recession in 2023.
Putin cuts gas supply. Another gas price hike will hit Eurozone hard. Recession from autumn.
Inflation peak in sight in the US. Euro inflation will continue to rise until late fall. Price pressure decreases sharply in 2023.

- **Harsh shocks for the global economy:** The global economic outlook has deteriorated further. The rapid rise in prices for energy, food and key commodities following Putin's attack on Ukraine is weighing on consumers in large parts of the world. Persistent supply bottlenecks are still slowing down production. On both sides of the Atlantic, consumer confidence has plummeted. In industry, too, the mood is gloomy. To be sure, many companies still have a healthy order cushion. But since they are receiving fewer new orders, their optimism is fading bit by bit.
- **High gas prices drive Europe into recession:** Instead of overcoming the stagnation initially triggered by the Omicron wave of the pandemic, the economy in the Eurozone and the UK is going into reverse. Since Russia cut its oil exports through the Nord Stream 1 pipeline by 60% on 14 June, prices have shot up again. Even if governments cushion this with some intervention and aid packages, consumers will ultimately have to bear higher costs again. After two Corona years, a buoyant summer travel season could still keep the eurozone economy stable. After that, however, hard-pressed consumers will probably curb their spending to such an extent that the eurozone slides into recession. Once the winter is over and the situation on the gas market has eased again, the economy could then pick up again next summer.
- **US:** The Fed is getting serious. The US is not dependent on Russian natural gas. However, the Fed is now too vigorously tackling its home-grown inflation problem after the economy and labour market ran too hot in 2021. We now expect the US to go through a - probably mild - recession in early 2023.
- **China steps on the gas:** As a result of its failed zero-covid policy, China still does not have the pandemic under control. But the port of Shanghai is open again and the government is stepping up the stimulus. Despite major long-term problems, China should temporarily regain momentum in autumn.
- **Inflation:** US peaks ahead of Europe. In the US, there are first signs that inflation may have peaked soon. Wage pressures remain high, but have recently eased somewhat. In Europe, on the other hand, the prices of imported natural gas and electricity, which have just risen again, have not yet fully reached consumers. Inflation in Europe could reach almost 10% in September before it also declines.

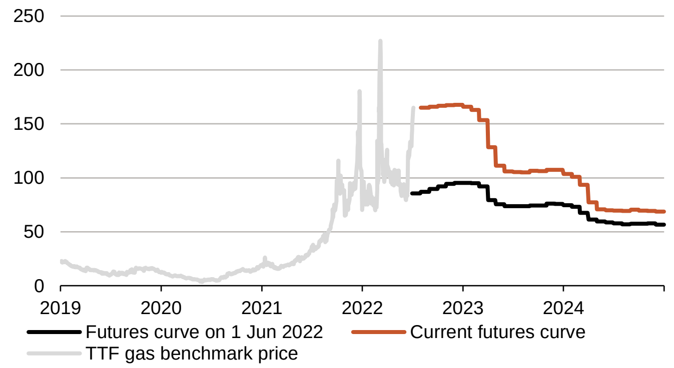
Interest rate turnaround: The US Fed is expected to raise rates by another 0.75 percentage points in July and September, reach 3.5-3.75% in early 2023 and cut rates again from mid-2023. We expect the ECB to raise rates by a total of 100bp by the end of 2022 - and a recession-related pause in 2023.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	2.6	1.3	2.6			
US	24.5	1.7	-0.5	1.0	7.8	3.4	2.7
China	16.4	3.8	3.8	5.3	1.9	2.3	2.3
Japan	5.8	1.2	0.0	1.3	2.0	1.2	0.7
India	3.3	8.0	6.5	6.7			
Latin America	5.9	2.5	1.5	2.5			
Europe	24.4	1.3	-0.8	2.0			
Eurozone	15.3	2.2	-1.0	2.1	8.1	4.3	2.0
Germany	4.4	1.0	-1.2	2.2	8.0	4.6	2.1
France	3.1	1.9	-0.6	2.1	5.9	3.9	2.1
Italy	2.3	2.3	-1.1	1.3	7.7	4.4	2.1
Spain	1.6	3.6	-0.8	2.2	8.9	3.8	2.1
Other Western Europe							
United Kingdom	3.2	2.7	-1.0	1.7	8.0	4.2	1.8
Switzerland	0.8	2.0	-0.5	1.5	3.0	1.4	0.9
Sweden	0.6	2.4	-0.5	2.2	6.5	2.7	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

Natural gas in Europe: a new price push



In €/MWh; benchmark: TTF front month; futures curves: prices for future months on the given day. Sources: ICE, European Energy Derivatives Exchange; 01/01/2019 – 31/12/2024.

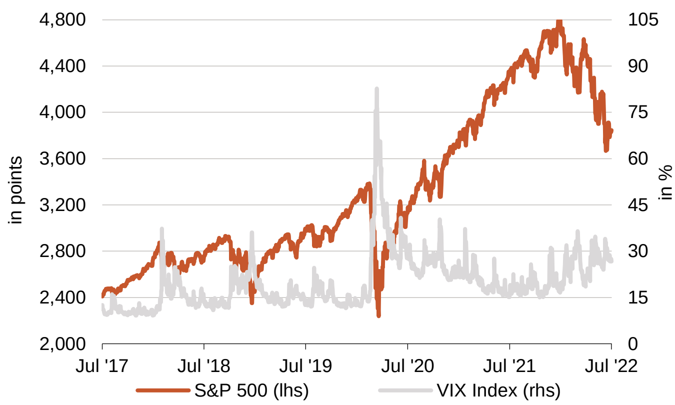
EQUITIES

Change of investor focus from valuation to fundamentals

Equities have suffered one of the weakest first halves in history. Inflation and recession concerns burdened. Increasing recession concerns should mean a shift in investor focus from valuation to fundamentals. We are moderately underweight in equities. Quality-Growth with significant potential with less interest rate pressure.

- **Equity markets** could not escape the sell-off over the last quarter. In the second quarter, the S&P500 suffered its weakest performance since the pandemic in 2020 and the worst first half of the year since 1970. Even the rebalancing flows of pension funds at the end of the quarter could only provide a brief tailwind.
- At **sector and style level**, the picture over the last four weeks was almost entirely negative. **Defensive stocks** held up better than **cyclical stocks,** but also suffered significant losses of around -10%. The least affected equity sectors over the last four weeks were **communications** and **health care. Growth stocks** and **large caps** held up better than **value stocks** and **small caps**.
- As recession risks increase, investor focus is likely to shift from valuation to fundamentals. Since the beginning of the year, 2022 earnings estimates have risen for both Europe and the US. However, higher inventories and declining profit margins by companies have already been highlighted, which, in addition to existing supply chain issues and high raw material and labour costs, mean that earnings expectations are still significantly too optimistic. There is thus still considerable room for downward adjustments. The focus on fundamentals with less interest rate pressure should lead to a rally for our preferred quality-growth stocks, at least relative to the benchmark.
- We have used the short rally from the rebalancing flows at the end of June to **further reduce our equity exposure**. Taking into account our position in the tail hedge certificate, we are now **moderately underweight equities**.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 06/07/2017 - 06/07/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 06/07/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	12,595	-20.7%	-18.8%	+0.2%	10.3	3.9%
SMI	3,433	-15.0%	-8.8%	+13.3%	16.5	3.1%
MSCI UK	2,053	+0.7%	+7.1%	+6.0%	9.8	4.3%
EURO STOXX 50	3,422	-18.2%	-12.6%	+5.6%	10.7	3.8%
STOXX EUROPE 50	8,527	-8.0%	+0.5%	+15.8%	11.4	3.7%
S&P 500	7,107	-18.9%	-10.6%	+33.2%	16.8	1.7%
MSCI Em. Markets	981	-19.0%	-24.9%	+0.1%	11.2	3.4%

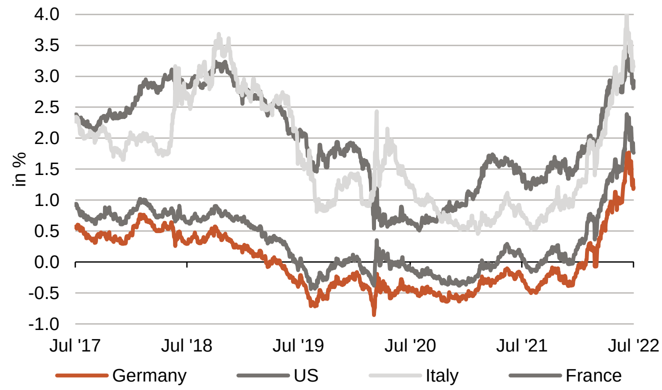
FIXED INCOME

Safe government bonds benefit in the risk-off environment

Recession dominates inflation. Yields have fallen noticeably recently, as government bonds were in demand as safe havens. Corporate and emerging market bonds are increasingly pricing in recession risks. Yields are increasingly attractive. In the current environment, a duration increase via safe bonds should be sensible. We are increasing our bond allocation.

- The **global bond market** has continued to be exposed to a mixture of inflation concerns, rising interest rates and fears of recession over the past few weeks. Recently, however, the increasing growth concerns clearly dominated and allowed safe government bonds to profit as a place of refuge in times of crisis. As a result, the yield levels of safe government bonds have fallen significantly. **US government bonds** recently yielded below 3% again after a temporary high of just under 3.5% for the year. Similarly, yields on **German government bonds** fell to around 1.2%. **Italian government bonds** also experienced a decline in yields to just over 3% after the ECB announced a new crisis instrument to support indebted peripheral states.
- **Corporate bonds** are already pricing in the risk of a mild recession or a significant economic slowdown, but not yet a full-blown recession. The risk premiums are historically significantly elevated. The risk-off environment in the markets is already prevalent and the uncertainty regarding the demand gap after the ECB's exit from the bond-buying programmes is an additional burden. Nevertheless, EUR credit markets are increasingly attractive in terms of spreads and absolute yields.
- **Emerging market bonds** experienced significant spread widening since the beginning of the year. The first half of the year was also characterised by significant heterogeneity. Commodity exporters and local currency bonds significantly outperformed commodity importers and hard currency bonds. The attractive yields and supply shortage speak in favour of emerging markets.
- **We are underweighting bonds less heavily.** With high volatility and increasing risk of recession, the risk-off environment is already evident, which is why we consider an increase in duration with the help of safe bonds to be sensible.

Yields on 10-year government bonds



Source: Bloomberg, 06/07/2017 - 06/07/2022.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Short	Neutral
Government bonds	→	→
Corporate bonds	→	→
High-yield bonds	→	→
Emerging market bonds	↗	↗

Yields (10-year)	Old	New
Germany	→	→
UK	→	→
US	→	→

		Performance in index currency		
	As of 06/07/2022	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	226.17	-11.1%	-12.0%	-10.0%
Covered bonds (iBOXX Euro Germany Covered)	187.77	-7.5%	-8.6%	-8.6%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	143.02	-11.2%	-12.1%	-9.9%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	148.72	-7.2%	-7.8%	-5.8%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	538.50	-10.7%	-8.1%	-6.5%
High-yield bonds (ICE BofA Global High Yield Index)	377.23	-17.0%	-18.0%	-5.7%

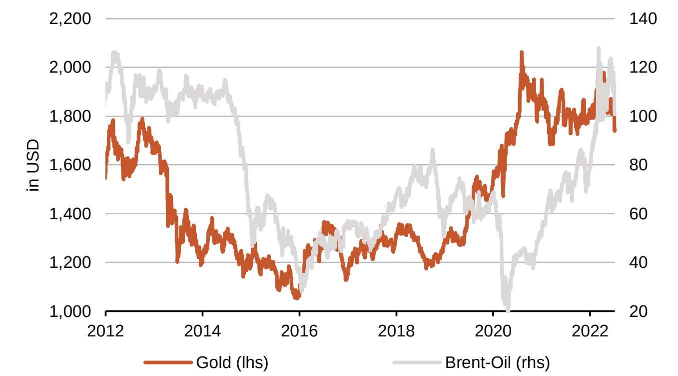
COMMODITIES

Recession worries weigh on oil and metal markets

Gold is caught between recession and interest rate worries. Oil has suffered from recession and demand slump worries. Industrial metals are weighed down by China lockdowns.

- In recent weeks, **gold** has been caught in the middle of burgeoning recession concerns and restrictive interest rate policies and was thus unable to benefit as a safe haven despite the economic worries. Nevertheless, it remains an important portfolio component as a hedging instrument.
- **Oil** recorded losses over a four-week period for the first time since the beginning of the year. In the wake of recession fears, concerns about a collapse in demand in particular put pressure on the price. However, a look at the crack spread shows that there is no sign of a decline in consumption yet. While the oil price could remain burdened by demand concerns in the short term, the fundamental picture of supply shortages and underinvestment remains intact. Only a global recession (unlikely due to China's asynchronous development) poses significant risk.
- **Industrial metals** remain heavily weighed down by recession fears and China lockdowns. However, if the trend reverses, the metals should recover quickly.

Price development



Source: Bloomberg, 01/01/2012 - 06/07/2022.

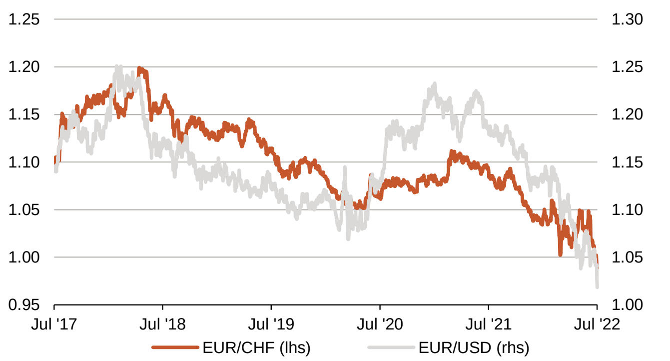
CURRENCIES

ECB is left behind, the euro remains weak

**EUR/USD: Euro still in a downward spiral.
EUR/GBP: Trend continues sideways.
EUR/CHF: Frank takes off thanks to interest rate hike.**

- **EUR/USD:** Central banks continue to put pressure on the euro exchange rate. Not even the end of net bond purchases in the eurozone and the ECB's announcement of an imminent interest rate turnaround have helped the euro. On the contrary, while the ECB continues to dither, the US Fed and other central banks are moving ahead with interest rate hikes. In this environment, the euro has fallen to below 1.03 US dollars per euro. As long as the ECB lags behind the other central banks in terms of pace and decisiveness, the outlook for the single currency remains bleak.
- **EUR/CHF:** Switzerland is still in a relatively moderate inflation environment. Nevertheless, the Swiss National Bank (SNB) has already raised the key interest rate by 50 basis points with inflation at 2.9%. In the meantime, inflation has risen to 3.4%. Monetary policy is thus likely to be tightened further. The Swiss franc has reacted promptly and has risen above parity to the euro.

Exchange rates



Source: Bloomberg, 06/07/2017 - 06/07/2022.

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

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 06/07/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,739	-4.9%	-3.2%	+24.3%
Silver USD/ounce	19.2	-17.6%	-26.6%	+28.1%
Copper USD/pound	341.8	-23.4%	-19.7%	+28.6%
Brent USD/bbl	100.69	+29.5%	+35.1%	+56.8%

	As of 06/07/2022	Performance ytd	1-year	3-year
EUR/USD	1.02	-10.4%	-13.9%	-9.3%
EUR/CHF	0.99	-4.7%	-9.6%	-11.2%
EUR/GBP	0.85	+1.5%	-0.3%	-4.7%
EUR/JPY	138.43	+5.8%	+5.8%	+13.7%

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 & Equities
Marco Höchst | Equities
Christoph Mäder | Fixed Income
Ludwig Kemper | Commodities
Philina Kuhzarani | Minutes

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