BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

04 August 2022

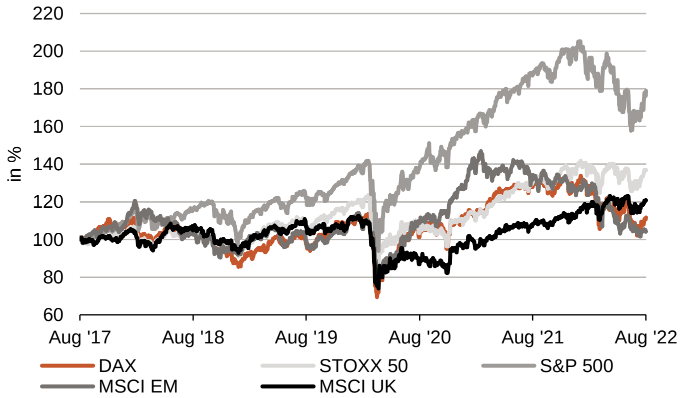
Managers of the Committee

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, 03/08/2017 - 03/08/2022.

Most important assessments at a glance

Economics	• US: The Fed has hesitated for a long time, but is stepping hard on the brakes. Mild US recession in 2023. • Putin cuts gas supply. The renewed rise in gas prices hits Europe hard. Recession until spring 2023. • US-Inflation peak in sight. Euro inflation continues to rise until late autumn. Price pressure decreases strongly in 2023.
Equities	• Equities rallied on hopes of a Fed turnaround. However, the environment for equities remains challenging. • Profit stability and growth more decisive again. Quality Growth shares thus with tailwind in H2. • We are slightly underweight in the equity quota. Bottom formation later in the year, but risks in the coming months.
Bonds	• Inflation worries replaced by recession worries. Yields on safe government bonds have fallen noticeably recently. • Corporate bonds influenced by technical factors. Emerging market bonds have recovered from mid-July onwards. • We are maintaining our lower underweight in bonds and a duration close to neutral.
Commodities	• Gold benefited from falling US dollar and real interest rates. However, a tighter interest rate policy could limit upside potential. • Oil suffered from recession and demand slump concerns. The tight situation on the supply side remains. • Metals weighed down by China lockdowns and recession. When the trend turns, the recovery usually comes quickly.
Currencies	• ECB with first interest rate step and decision of the "Transmission Protection Instrument" (TPI) to stabilise the Eurozone. • At least the euro has since been able to stabilise slightly above parity against the US dollar. • The euro remains weak against the Swiss franc, falling below the 0.98 franc per euro mark.

Current market commentary

July was all about "Bad News is Good News". Eurozone PMIs signalled contraction and US economic growth was negative for the second consecutive quarter – the US is in a technical recession. Meanwhile, central banks raised interest rates, the ECB by 50bps, the Fed by 75bps. However, Powell said he would decide on further interest rate steps from now on, driven by data. Hopes of a short recession – coupled with looser financing conditions soon – caused a rally across all asset classes. Investors are likely to focus more on earnings stability and growth and less on valuations in this environment. And indeed, our quality-growth style has already outperformed the broad equity market in recent weeks. However, we believe it is too early to sound the all-clear for equities. Earnings expectations are ambitious, cost pressures are high, inflation is not yet on the decline, the Fed has not yet turned around and the energy crisis is smouldering. There is thus a risk that the recent good market development is a bear market rally. We are therefore keeping our slight equity underweight for the time being, as we believe the risks still predominate.

Recession fears put significant pressure on yields in recent weeks, eclipsing inflation fears. The yield on 10-year German government bonds, for example, fell by around 55 basis points in July. With spreads falling at the same time, bonds thus also made a clearly positive contribution to the multi-asset portfolio. However, the massive drop in yields makes us more cautious about longer duration, as we now no longer see too much downward leeway in yields.

Despite recession-related weakness, we see further upside potential for energy commodities (supply shortage) and industrial metals (structural demand) in the medium term. Gold benefits from falling real interest rates and declining dollar strength.

ECONOMICS

Gas price explosion in Europe, US Fed hits the interest rate brakes hard: US and Europe slide into recession

US: The Fed has hesitated for a long time, but is stepping hard on the brakes. Mild US recession in 2023.
Putin cuts gas supply. The renewed rise in gas prices hits Europe hard. Recession until spring 2023.
US-Inflation peak in sight. Euro inflation continues to rise until late autumn. Price pressure decreases strongly in 2023

- **Harsh shocks for the global economy. The** outlook for the coming quarters has deteriorated further. High prices for energy, food and important raw materials are burdening consumers in large parts of the world. Added to this is the aggressive interest rate policy of the US Fed. After the slump in consumer confidence on both sides of the Atlantic, companies are now also looking to the future with much more scepticism, despite their healthy order books. They are receiving fewer new orders**.**
- **High gas prices drive Europe into recession.** Since Russia cut its gas supplies through Nord Stream 1 again on 25 July to now only 20% of capacity, gas prices have shot up again. Even if governments cushion this with some intervention and aid packages, consumers will ultimately have to bear even higher costs. After two Corona years, a buoyant summer travel season may yet save the eurozone economy from a slump. After that, however, hard-pressed consumers will probably cut back their spending considerably. We now expect euro GDP to contract by a total of 2% by Q2 2023, and if gas has to be rationed, the recession would be even sharper. Once the winter is over and the gas market has eased again, however, the euro economy may rebound strongly next summer.
- **US: Fed hits the brakes.** The US is not dependent on Russian natural gas. However, the Fed is now taking an overly vigorous approach to its home-grown inflation problem after the economy and labour market ran too hot in 2021. We expect the US to go through a recession – probably mild – by mid-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 the autumn.
- **Inflation: US reaches peak before Europe.** In the US, there are the first signs that inflation may soon have passed its peak. Wage pressures remain high, but are not increasing further. 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 10% in the autumn before also falling. The exact inflation profile depends on when and to what extent the high gas prices reach consumers.

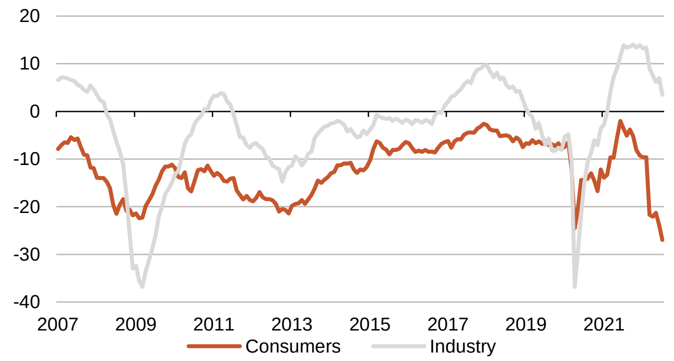
Interest rate turnaround. The US Fed is expected to raise rates by another 0.75 percentage points in September, land at 3.75-4.00% in early 2023 and cut rates again from mid-2023. From the ECB we expect further rate hikes totalling 100bps by the end of 2022 – and a recession-related pause in 2023.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	2.5	1.4	2.5			
US	24.5	1.5	-0.6	1.0	8.1	4.1	2.8
China	16.4	3.5	4.6	4.3	2.0	2.3	2.3
Japan	5.8	1.2	0.0	1.3	1.9	1.1	0.7
India	3.3	8.0	6.5	6.7			
Latin America	5.9	2.5	1.5	2.5			
Europe	24.4	1.7	-0.8	2.1			
Eurozone	15.3	2.6	-1.1	2.3	8.1	4.4	2.0
Germany	4.4	1.0	-1.4	2.3	8.1	4.7	2.1
France	3.1	2.1	-0.8	2.2	5.9	3.9	2.1
Italy	2.3	2.9	-1.2	1.4	7.6	4.6	2.1
Spain	1.6	4.1	-0.8	2.4	9.0	3.9	2.1
Other Western Europe							
United Kingdom	3.2	3.1	-1.1	1.7	8.6	4.9	2.0
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

Confidence indicators Eurozone



Balance of positive and negative responses in percentage points, seasonally adjusted. Source: European Commission, January 2007 - July 2022.

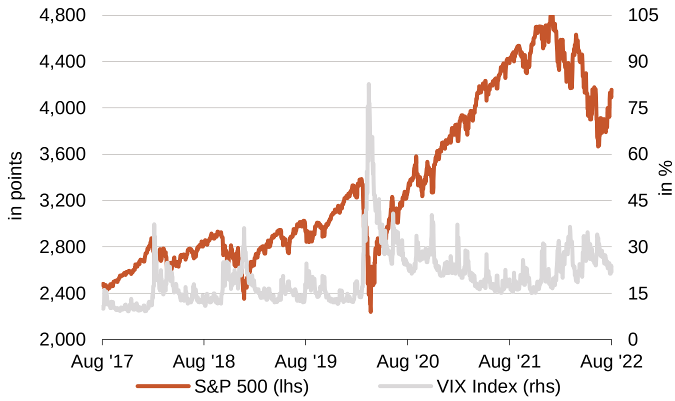
EQUITIES

Light and shadow

Equities rallied on hopes of a Fed turnaround. However, the environment for equities remains challenging. Profit stability and growth more decisive again. Quality Growth shares thus with tailwind in H2. We are slightly underweight in the equity quota. Bottom formation later in the year, but risks in the coming months

- **Equity markets** have moved from inflation to recession worries, although the US inflation rate in July was again higher than expected at 9.1%. Central bank interest rates may continue to rise for the time being. After the last FOMC meeting, which was received as rather dovish, two to three rate cuts by the Fed are already priced in for 2023 after further rate hikes in 2022. The market thus expects a reversal of the Fed's monetary policy in view of weaker growth and easing inflation concerns. Rising equity markets since mid-July already seem to anticipate this.
- At **sector** and **style level, there** was a change in favourites over the last four weeks compared to the first half of the year. **Cyclical stocks** outperformed **defensive stocks** and gained almost 14% over the past weeks. At the sector level, the IT, industrial and basic materials sectors benefited the most. The health care and telecommunications sectors brought up the rear. **Growth stocks** and **small caps were** ahead of **value stocks** and **large caps**.
- Investors are likely to focus more on earnings stability and growth and less on valuations in a recessionary environment coupled with potentially looser financing conditions. Our quality-growth style in particular should benefit in the coming weeks. Nevertheless, the risk is high that the recent good market performance is a bear market rally. Earnings expectations are ambitious, cost pressures are high, inflation has not yet started to decline, the Fed's turnaround is still pending and there is no solution to the energy crisis yet.
- We remain **slightly underweight equities** for the time being, as fundamental risks still dominate with central banks remaining restrictive.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 03/08/2017 - 03/08/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 03/08/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	13,588	-14.5%	-12.6%	+14.4%	11.2	3.6%
SMI	3,549	-12.1%	-7.1%	+18.2%	17.6	3.0%
MSCI UK	2,147	+5.4%	+11.6%	+13.2%	9.7	4.0%
EURO STOXX 50	3,733	-10.6%	-6.2%	+20.4%	11.6	3.5%
STOXX EUROPE 50	9,070	-2.2%	+5.0%	+27.5%	11.7	3.5%
S&P 500	7,685	-12.3%	-5.1%	+46.7%	18.3	1.6%
MSCI Em. Markets	986	-18.3%	-21.5%	+6.3%	11.2	3.5%

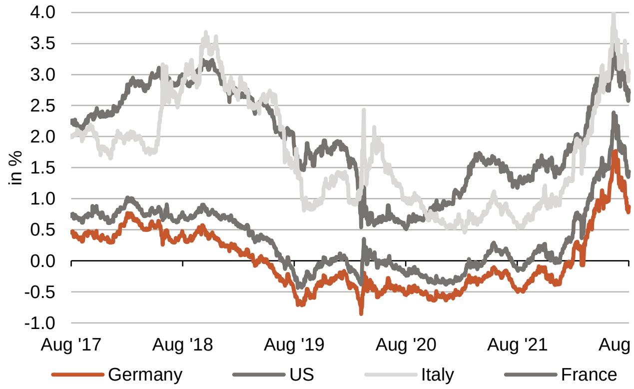
FIXED INCOME

Safe government bonds in demand as safe havens amid recession worries

Inflation worries replaced by recession worries. Yields on safe government bonds have fallen noticeably recently. Corporate bonds influenced by technical factors. Emerging market bonds have recovered from mid-July onwards. We maintain our less severe underweight in bonds and position ourselves close to neutral in duration.

- In the **global bond market,** recession worries are increasingly dominating inflation concerns. The market is thus already eyeing more dovish central banks again. As a result, yield levels on **safe government bonds** have fallen significantly since the beginning of July. **US government bonds** recently yielded 2.7% again. While yields fell similarly in Europe, what is particularly noteworthy here is the more pronounced divergence between European core and periphery states despite the ECB's new "Transmission Protection Instrument" to combat defragmentation. While yields on **German government bonds** fell to above 0.8%, **Italian government bonds** experienced a decline in yields to just over 3%.
- Spreads on **corporate bonds** have fallen noticeably in recent weeks. Technical factors such as positive momentum, thin liquidity due to dry new issue markets and low investor positioning are likely to have given corporate bonds a tailwind despite recession concerns. Both **investment-grade corporate bonds** and riskier **EUR** and **USD high-yield bonds** thus performed significantly positively in July.
- **Emerging market bonds** initially remained under pressure in July and were only able to recover as the strength of the US dollar declined from the middle of the month. **Hard currency bonds** were able to keep the drawdown lower, but also participated less in the recovery. In contrast, **local currency bond**s recorded significant price gains in the recovery.
- We are maintaining our **lower underweight in bonds** and a **duration close to neutral**. However, after the recent decline in yields, we refrain from a further increase in duration for the time being. We are becoming more constructive on **credit** and value the higher carry and shorter duration over government bonds..

Yields on 10-year government bonds



Source: Bloomberg, 03/08/2017 - 03/08/2022.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Neutral	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 03/08/2022	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	232.18	-8.7%	-11.1%	-8.8%
Covered bonds (iBOXX Euro Germany Covered)	189.85	-6.5%	-8.1%	-8.2%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	148.55	-7.8%	-9.7%	-7.6%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	151.50	-5.5%	-6.6%	-4.7%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	556.40	-7.8%	-5.6%	-4.9%
High-yield bonds (ICE BofA Global High Yield Index)	396.19	-12.8%	-13.7%	-0.8%

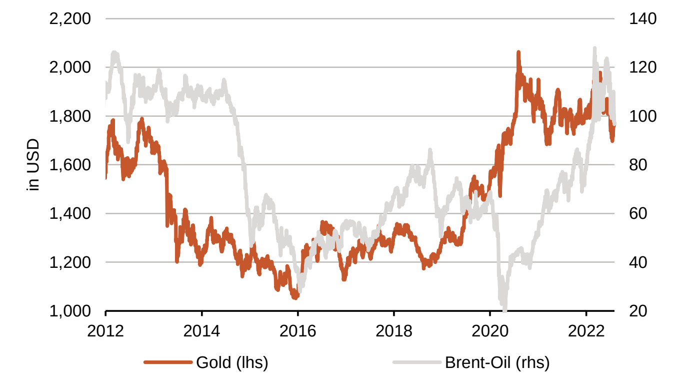
COMMODITIES

Oil and metal markets dominated by recession

Gold benefited from falling US dollar and real interest rates.
Oil suffered from recession and demand slump worries.
Metals weighed down by China lockdowns and recession.

- After the huge dollar strength up until mid-July, **gold** recently gained again on a falling dollar and real interest rate. While markets are already pricing in the Fed's interest rate turnaround for spring 2023, which would mean tailwinds for gold with a declining dollar and real interest rate, more stubborn inflation and thus tighter monetary policy should keep the upside potential for gold limited.
- **Crude oil has** suffered over the past four weeks from deepening recession concerns. Significant declines can already be seen on the demand side. For oil, however, the decisive factor is the extent to which the recession is mild or aggressive. In a mild recession, demand growth declines but does not collapse. In the case of a recovery, the oil market is likely to encounter the still tight supply situation, which should support the oil price.
- **Industrial metals** remained heavily weighed down by fears of recession and the China lockdowns. However, if the trend reverses, the metals should recover quickly.

Price development



Source: Bloomberg, 01/01/2012 - 03/08/2022.

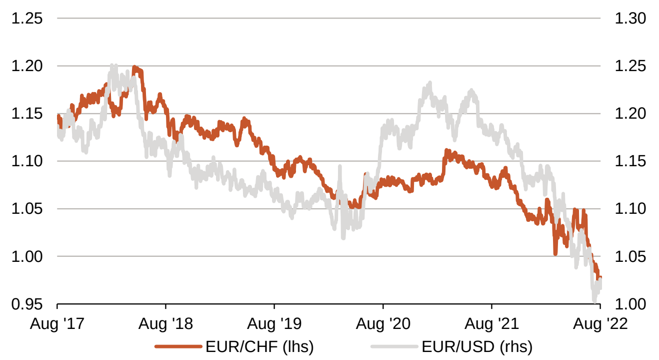
CURRENCIES

ECB rate hike comes late and only helps partly

EUR/USD: Stabilisation slightly above parity.
EUR/GBP: Trend sideways, recently euro losses.
EUR/CHF: Unbroken franc strength.

- **EUR/USD:** The ECB surprisingly raised the key interest rate by 50 basis points to 0.50% in July. In addition, it launched the "Transmission Protection Instrument" (TPI) to allay concerns about a euro crisis 2.0. This has only helped the EUR/USD exchange rate to the extent that it has since stabilised slightly above parity. However, as the Fed has taken a tougher stance – there was also a 75 basis point rate hike in July – and as the geopolitical situation strengthens the dollar, it remains difficult for the euro to make up ground against the overvalued US currency for the time being.
- **EUR/CHF:** The franc has overcome parity with the euro and settled there. The franc is also benefiting from its "safe haven" status. Moreover, Switzerland is still in an early phase of rising inflation rates and yet the central bank has already reacted with higher key interest rates, thereby strengthening its credibility.

Exchange rates



Source: Bloomberg, 03/08/2017 - 03/08/2022.

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	↘	↘

		Performance		
	As of 03/08/2022	ytd	1-year	3-year
Gold USD/ounce	1,765	-3.5%	-2.5%	+22.5%
Silver USD/ounce	20.1	-13.9%	-21.4%	+23.8%
Copper USD/pound	346.7	-22.3%	-21.0%	+34.8%
Brent USD/bbl	96.78	+24.4%	+33.7%	+56.4%

		Performance		
	As of 03/08/2022	ytd	1-year	3-year
EUR/USD	1.02	-10.6%	-14.3%	-8.5%
EUR/CHF	0.98	-5.9%	-9.0%	-10.5%
EUR/GBP	0.84	-0.5%	-1.9%	-8.4%
EUR/JPY	136.08	+4.0%	+5.2%	+14.9%

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
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Christian Bettinger | Fixed Income
Philina Kuhzarani | Commodities, Minutes

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