BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

08 September 2022

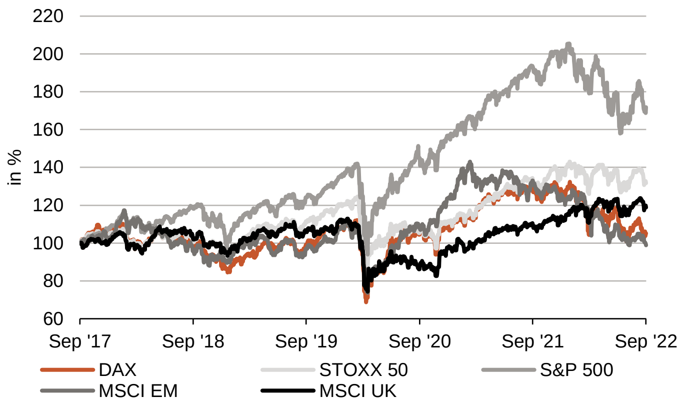
Managers of the Committee

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, 07/09/2017 - 07/09/2022.

Most important assessments at a glance

Economics	• US: The Fed has hesitated for a long time, now it is stepping hard on the brakes. Mild US recession in 2023. • Putin cuts gas supply. High gas prices hit Europe hard. Recession until spring 2023, recovery afterwards. • US-Inflation peak reached. Euro inflation to rise until the end of 2022. Price pressure decreases strongly from spring 2023.
Equities	• Equities burdened by ongoing restrictive interest rate policy after summer rally. Limited drawdown risks below annual lows. • End of reporting season means markets shift focus to macro data and central banks. Volatility is likely to rise. • We are slightly underweight in equities, but with a tendency to neutralise. Recovery potential in the event of a rate pivot.
Bonds	• Inflation concerns once again dominate markets. Yields on safe government bonds have risen noticeably recently. • Corporate bonds are attractive over the long term. Emerging market bonds have weakened, but held their ground in relative terms. • We maintain our less severe underweight in bonds and position ourselves close to neutral in duration.
Commodities	• Gold recently burdened by USD strength and central banks' rate policy. Recession scenario holds upside potential. • Oil price supported by supply shortage and new demand. OPEC cuts and gas substitution exacerbate deficit. • Metals weighed down by China lockdowns and recession. If the trend reverses, the recovery should come quickly.
Currencies	• The euro under pressure ahead of the ECB's September meeting. Could a big interest rate move turn the negative sentiment? • Parity with the US dollar is now the new reality. For the time being, significantly higher quotations are unlikely. • Against the franc, the euro has fallen well below parity due to political risks and the ECB's hesitancy.

Current market commentary

Hawkish Fed comments, stronger-than-expected inflation figures in Europe and unchecked energy worries in Europe – as we expected – abruptly ended the summer recovery rally. European equities fell almost to their June lows. But US equities and especially technology stocks also suffered as interest rates rose sharply. European growth companies fell significantly more than value stocks due to the interest rate pressure. Only cyclical and small companies were punished even more due to recession fears and high energy costs. Now that the Q2 reporting season is over, the equity market is likely to be more macro-driven again and volatility is likely to pick up – not least because of a stronger curbing of bond purchases by the Fed from September. The market's focus is clearly on central banks and the upcoming inflation figures. However, we do not expect markets to fall significantly below the lows for the year, as many risks are already known and priced in. In the medium term, we think that there are more upside risks, as the central banks could become less restrictive at the turn of the year and the market is already looking towards the subsequent economic recovery after the recession has started. We are, therefore, positioning ourselves only with a slight equity underweight, with the potential of neutralising our equity exposure in the coming weeks.

The U-turn in bond yields in August, triggered by more conspicuously hawkish central bank statements, weighed on all bond segments. Risk premiums on corporate bonds have also risen again recently, which added additional pressure. With clearly positive yields, bonds now increasingly offer an alternative to equities, which confirms our focus on corporate bonds within the bond space.

Commodities, especially industrial metals, have also been in low demand recently as a cyclical investment. However, supply has plummeted due to high energy costs, which has strengthened our long-term case.

ECONOMICS

Gas and electricity prices explode in Europe, Fed and ECB put the brakes on rates: recession in Europe and US

US: The Fed has hesitated for a long time, now it is stepping hard on the brakes. Mild US recession in 2023.
Putin cuts gas supply. High gas prices have hit Europe hard. Recession until spring 2023, recovery afterwards.
US-Inflation peak reached. Euro inflation to rise until end of 2022. Price pressure decreases strongly from spring 2023.

- **Recession in Europe and – probably – in the US.** High prices for energy, food and important raw materials are a burden on consumers in large parts of the world. Added to this is the aggressive interest rate policy of the US Fed, which the ECB now apparently wants to follow in part. After the slump in consumer confidence on both sides of the Atlantic, companies, especially in Europe, are also taking a much more sceptical view of the future. They are receiving fewer new orders.
- **High gas prices drive Europe into recession.** Since Russia ended gas supplies through Nord Stream 1 indefinitely, gas and electricity prices in Europe have shot up again. Even if governments cushion this with some interventions and aid packages, consumers will have to bear even higher costs. After two Corona years, a buoyant travel season kept the eurozone economy from collapsing in the summer. After that, however, hard-pressed consumers will probably cut back their spending considerably. We now expect euro GDP to decline by just under 2.5% by Q1 2023. As storage continues to fill up, the risk that gas will have to be rationed in Germany in winter has diminished. Otherwise, the recession would be even sharper. Once the winter is over and the gas market has eased again, the euro economy can rebound strongly in summer 2023.
- **US: Fed hits the brakes.** The US is not dependent on Russian natural gas. However, the Fed is now vigorously tackling its home-grown inflation problem after the economy and labour market ran too hot in 2021. We expect the US to go through a – probably mild – recession in 2023.
- **China is stepping on the gas – but it is helping less than usual.** As a result of its failed zero-covid policy, China still does not have the pandemic under control. The government is stepping up the stimulus. Despite major long-term problems, China can temporarily gain momentum again in autumn, but less than before.
- **Inflation: US reaches peak before Europe.** Inflation seems to have peaked in the US. Wage pressure remains high, but is not increasing any 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 declining in 2023. The exact inflation profile depends on when and to what extent the gas price shock reaches consumers.

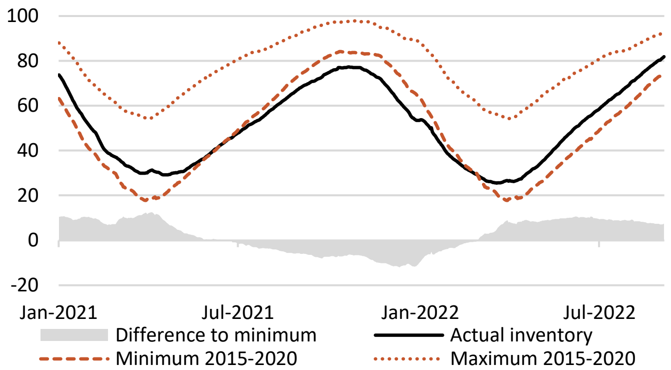
Interest rate turnaround. The Fed is expected to raise rates to 4% by January 2023. We expect Fed rate cuts in 2H 2023. However, the Fed is not likely to do so for the time being. The ECB's main refinancing rate could reach 2% in December, followed by a recession-related pause in 2023.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	2.5	0.8	2.4			
US	24.5	1.6	-0.6	1.0	7.9	3.9	2.8
China	16.4	3.0	4.0	4.0	2.1	2.4	2.3
Japan	5.8	1.4	0.5	1.4	2.1	1.3	0.7
India	3.3	8.0	6.5	6.7			
Latin America	5.9	2.5	1.0	2.5			
Europe	24.4	1.8	-1.5	2.0			
Eurozone	15.3	2.5	-1.5	2.4	8.4	6.2	2.0
Germany	4.4	1.1	-1.8	2.6	8.6	6.7	1.9
France	3.1	2.1	-1.1	2.4	6.2	5.2	1.9
Italy	2.3	2.9	-1.7	1.5	7.9	6.0	1.8
Spain	1.6	4.2	-0.6	2.4	9.3	4.8	2.0
Other Western Europe							
United Kingdom	3.2	3.0	-1.5	2.0	9.6	7.6	1.8
Switzerland	0.8	1.8	-0.8	1.5	3.0	2.0	0.9
Sweden	0.6	2.0	-1.0	2.2	6.5	4.0	2.0
Eastern Europe							
Russia	1.9	-8.0	-4.0	-1.0	25.0	15.0	6.0
Turkey	0.9	4.0	1.0	2.5	70.0	40.0	20.0

Source: Berenberg

EU gas storage (filling level in percent)



EU-27; difference to minimum in percentage points. Source: AGSI, 1 January 2021 – 4 September 2022.

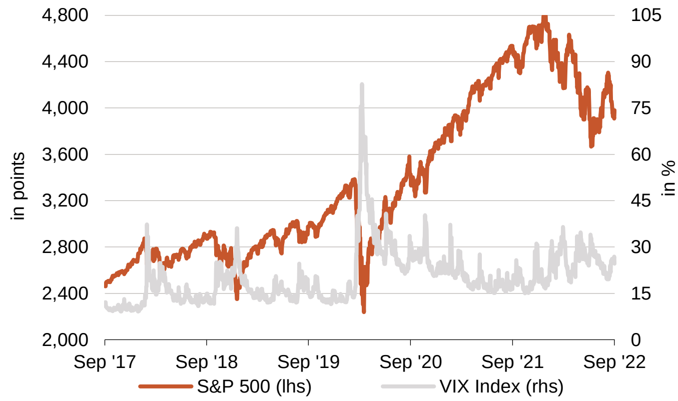
EQUITIES

Central banks set the tone

Equities burdened by ongoing restrictive interest rate policy after summer rally. Limited drawdown risks below annual lows. End of reporting season means markets shift focus to macro data and central banks. Volatility is likely to rise. We are slightly underweight in equities, but with a tendency to neutralise. Recovery potential in the event of a rate pivot.

- Driven by the restrictive Fed tones, the higher-than-expected inflation figures and the worsening energy crisis in Europe, **equity markets** abruptly ended the summer recovery rally – as we expected. After the unconditional inflation rate of 2% was confirmed at Jackson Hole, despite the recession risks, equities suffered from interest rate pressure. Most recently, US economic data also stabilised again in part, which should not mean a quick turnaround to a loose monetary policy stance for the Fed's interest rate policy.
- At **sector** and **style level,** no one was able to shine. Technology and industrial stocks in particular had to give up their gains. Technology equities brought up the rear with a loss of just under -10% over the last four weeks. **Defensive stocks** outperformed **cyclical stocks**, but also lost more than 7% in value. At the sector level, energy, financials and utilities were less affected. Moreover, **Value stocks** and **large caps were** ahead of **growth stocks** and **small caps**.
- With the end of the Q2 reporting season, investors are likely to focus more on economic data again and thus increase the volatility of the equity market. Nevertheless, we believe that the likelihood of a sharp fall of markets below the lows for the year are limited, as many risks are already known and priced by the market. Therefore, we see more upside potential again in the medium term, as the central banks could initiate the monetary policy turnaround in 2023 and the market will already be focusing on the post-recession economic recovery.
- We remain **slightly underweight in equities** for the time being, but with a tendency towards a possible neutralisation of the equity quota.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 07/09/2017 - 07/09/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 07/09/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	12,916	-18.7%	-18.5%	+5.9%	10.4	3.9%
SMI	3,400	-15.8%	-12.4%	+9.9%	17.0	3.1%
MSCI UK	2,081	+3.2%	+7.9%	+11.4%	8.9	4.3%
EURO STOXX 50	3,502	-16.1%	-14.2%	+9.1%	10.6	3.8%
STOXX EUROPE 50	8,639	-6.8%	-1.4%	+17.9%	10.9	3.7%
S&P 500	7,371	-15.9%	-11.0%	+38.3%	17.6	1.6%
MSCI Em. Markets	957	-20.4%	-25.4%	+2.9%	11.0	3.5%

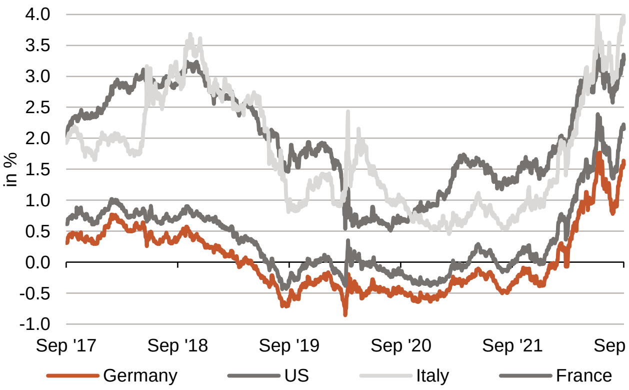
FIXED INCOME

U-turn in bond yields

Inflation concerns once again dominate markets. Yields on safe government bonds have risen noticeably recently. Corporate bonds attractive over the long term. Emerging market bonds weakened, but held their ground in relative terms. We maintain our less severe underweight in bonds and position ourselves close to neutral in duration.

- The **global bond market** experienced a significant turnaround in bond yields in August, as global central banks took a much more restrictive stance than initially expected by the market. 10-year **US government bonds** recently yielded above 3.2% again. In Europe, yields rose similarly strongly, but here the widening gap between core and peripheral countries should be emphasised. While yields on **German government bonds** rose to just under 1.6%, **Italian government bond yields** even climbed to almost 4%.
- In **corporate bonds,** risk premiums have also risen noticeably again in recent weeks. Especially for European investment grade bonds, risk premiums increased over the last four weeks: 11 basis points for financial bonds and 4 basis points for non-financial bonds. Corporate bonds are very attractive again in the long term.
- **Emerging** market **bonds** lost some of the gains from the rally from mid-July. Relative to developed countries, however, they held their ground. The two major fundamental fear factors, inflation and recession, were the dominant drivers. On the hard currency side, corporate bonds were able to keep the downward movement somewhat smaller than government bonds. The absolute spread difference between EM corporate and government bonds is close to the highs over the past five years.
- We are maintaining our **less severe underweight in bonds** and a **duration close to neutral**. Despite the recent jump 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 compared to government bonds.

Yields on 10-year government bonds



Source: Bloomberg, 07/09/2017 - 07/09/2022.

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	→	→

	As of 07/09/2022	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	220.41	-13.4%	-14.5%	-14.8%
Covered bonds (iBOXX Euro Germany Covered)	182.66	-10.0%	-11.1%	-12.1%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	140.69	-12.7%	-13.6%	-12.5%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	146.81	-8.4%	-9.1%	-7.8%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	555.45	-7.9%	-6.5%	-7.0%
High-yield bonds (ICE BofA Global High Yield Index)	385.47	-15.2%	-16.6%	-4.0%

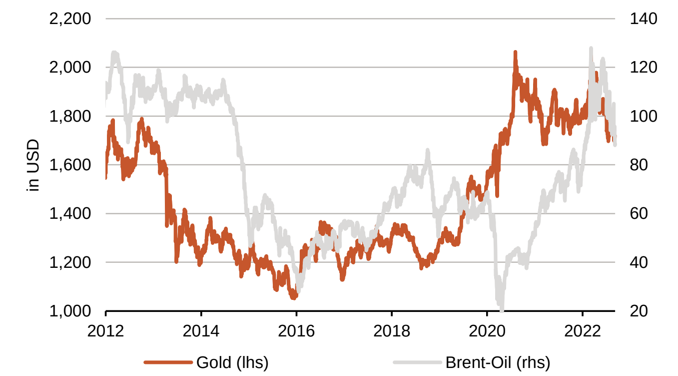
COMMODITIES

Commodities remain the long-term winners

Gold under the Fed's spell. Recession holds chances.
Oil should be supported by supply-and-demand dynamic.
Metals weighed down by China lockdowns and recession.

- **Gold** recovered until mid-August due to less aggressively priced interest rate policies, recession fears and China-US worries. However, gold did not cross the important psychological 1,800 mark. Instead, the precious metal fell after the restrictive tones at Jackson Hole due to USD strength. In the short term, gold is likely to remain under the Fed's spell. With more stubborn inflation and thus tighter monetary policy, the upward trend seems limited. However, as soon as recession concerns prevail, the picture should turn.
- **Crude oil has been** almost unchanged over the last four weeks. On the demand side, high energy costs are supported by the substitution of gas with oil, and on the supply side, the expiry of the use of strategic US oil reserves in October and OPEC's production cuts are supporting. Oil thus has a tailwind again in a recovery.
- **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 - 07/09/2022.

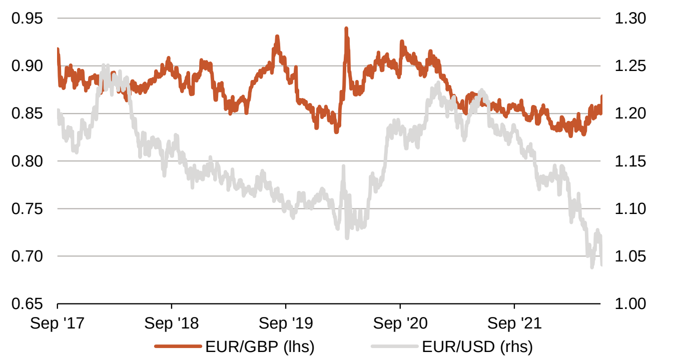
CURRENCIES

Tough stand for the euro

EUR/USD: Now below parity again.
EUR/GBP: Euro partially recovers losses.
EUR/CHF: Switzerland bets on franc strength.

- **EUR/USD:** The euro is having a hard time on the foreign exchange market. It may be fundamentally undervalued against the US dollar, but sentiment is clearly against the common currency. The energy crisis, staggering inflation rates, a weakening economy, the proximity to the war zone and a central bank that has been hesitant so far are not good arguments for the euro. The US dollar also benefits from its status as a safe haven and, thanks to greater US energy self-sufficiency, from massively cheaper energy prices. At present, it looks as if the US will be able to get inflation dynamics under control faster than the eurozone.
- **EUR/GBP:** The exchange rate has been fluctuating around the 0.85 pound per euro mark since spring 2021. Will the exchange rate gain fresh impetus now that Ms Truss is the new prime minister? Recently there have been reports that Truss might want to exert more influence on the Bank of England's policy. The euro has at least gained slightly.

Exchange rates



Source: Bloomberg, 07/09/2017 - 07/09/2022.

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 07/09/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,718	-6.1%	-4.2%	+14.0%
Silver USD/ounce	18.5	-20.8%	-24.1%	+1.6%
Copper USD/pound	343.8	-23.0%	-19.6%	+31.4%
Brent USD/bbl	88.00	+13.1%	+22.8%	+43.0%

	As of 07/09/2022	Performance ytd	1-year	3-year
EUR/USD	1.00	-12.0%	-15.5%	-9.3%
EUR/CHF	0.98	-5.8%	-10.3%	-10.3%
EUR/GBP	0.87	+3.1%	+1.0%	-3.4%
EUR/JPY	143.85	+9.9%	+10.2%	+22.0%

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

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