BERENBERG *Markets*

INVESTMENT COMMITTEE MINUTES

13 October 2022

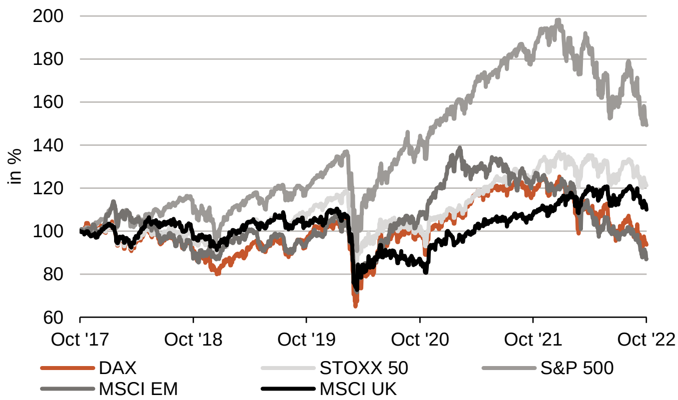
Managers of the Committee

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, 12/10/2017 - 12/10/2022.

Most important assessments at a glance

Economics	• US: Fed hits the brakes hard on monetary policy - mild US recession in 2023. • High prices for natural gas hit Europe hard this winter - recession until spring 2023, recovery afterwards. • US inflation peak reached. Euro inflation will continue to rise until the end of 2022. Price pressure decreases from spring 2023.
Equities	• Equities fell to new lows for the year. European and emerging market equities held up better than US equities. • Value is again ahead of growth. The Q3 reporting season should provide clarity on margin pressure. Prices reflect many risks. • We increased our equity weighting to neutral in the autumn sell-off. Opportunities and risks are already balanced.
Bonds	• Inflation concerns and restrictive monetary policy cause massive interest rate volatility. Significant rise in yields across the board. • Corporate bonds already attractive over the long term. For emerging market bonds, we prefer local currencies. • We maintain our less strong underweight in bonds and position ourselves close to neutral in duration.
Commodities	• Gold still burdened by central bank policy and US dollar strength. Sustained upward trend requires a turnaround by the Fed. • OPEC cuts exacerbate supply deficit. With mild recession, significant collapse in demand seems unlikely. • Industrial metals surprisingly stable recently. End of economic weakness holds recovery potential. Long-term trends intact.
Currencies	• The EUR/USD exchange rate has now settled below parity. The energy crisis is weighing on the euro. • The British pound experienced some turbulent days and stabilised after a central bank intervention in the bond market. • The franc is benefiting from the geopolitical situation, comparatively low inflation and the firm monetary policy.

Current market commentary

Equities and bonds have never been simultaneously negative for three consecutive quarters. That has changed this year. In the third quarter, commodity prices also fell. So unlike Q1 and Q2, there was no hiding. The drivers were the extremely restrictive central bank policies and the thus an increasingly likely recession. US equities have come under much more pressure in the past four weeks than our preferred European and emerging market equities. Small-cap and cyclical stocks, which are more susceptible to economic cycles, have suffered disproportionately. However, the continued robustness of the US economy should make a rethink by the Fed unlikely for the time being. In the short term, the market should therefore remain macro- and inflation-driven. The upcoming Q3 reporting season could also lead to increased volatility. In the medium term, however, the outlook for investors is improving. Much negativity is already acknowledged and reflected in market prices. The opportunities, such as a possible China reopening, a less hawkish Fed or an improvement in Europe, seem to be on the radar of few. We consequently remain neutrally weighted in equities, with an underweight in US equities, which remain expensively valued and tend to suffer from the strong US dollar.

Bonds are increasingly competing with equities with historically attractive yields. While many segments continue to suffer from rising interest rates, they have significant long-term return potential. Central bank pressure should also ease in the medium term. If a deep recession is avoided, spreads should also fall again. Despite a gradual increase in duration in recent months, we are still sticking to a somewhat shorter duration and a moderate bond underweight.

Commodities have held up comparatively well recently, but also been the victim of recession fears. Crude oil offers noticeable upside potential in the event of a supply shortage.

ECONOMICS

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

US: Fed hits the brakes hard. Mild US recession in 2023.
Europe: Putin cuts gas supply. High gas prices mean a recession until spring 2023. Recovery afterwards.
Inflation: Peak reached in the US. Euro inflation continues to rise until the end of 2022. Price pressure decreases in 2023.

- **Recession in Europe and – probably – in the US.** Consumers are struggling with high prices for energy, food and important raw materials in large parts of the world. This has been compounded by the aggressive interest rate policy of the US Fed, along with the ECB and other central banks. 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.
- **Europe: a V-shaped recession.** After Russia ended gas supplies through Nord Stream 1, gas and electricity prices in Europe have shot up yet again. Even though governments are cushioning this with some intervention and aid packages, consumers will have to shoulder even higher costs. They are likely to cut back significantly on their other spending this winter. To save gas, some companies are already cutting back production. We expect euro GDP to decline by around 2% by Q1 2023. As storage facilities are well stocked, the risk that gas will have to be rationed in Germany in winter has diminished. Once the winter is over and the gas market has eased again, the economy may rebound strongly in summer 2023. As supply chain issues are likely to further ease, the post-recession recovery may be V-shaped.
- **USA: Fed hits the brakes.** The US is not dependent on Russian natural gas. However, the Fed is 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 in the US has apparently passed its peak. However, it will only fall slowly in the US. Wage pressures remain high, but are not increasing. In Europe, on the other hand, the high prices of natural gas imports and electricity have not yet fully reached consumers. Inflation in Europe could exceed 10% by the end of 2022 before declining from spring 2023. The explosive rise in energy and food prices in 2022 then falls out of the year-on-year comparison.

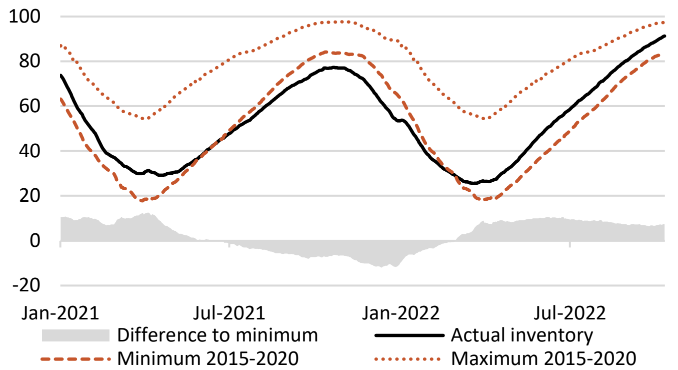
Interest rate summit in early 2023. The US Fed is expected to raise its interest rates to 4.75% by January 2023. As this will weigh on the economy and the labour market as well as dampen inflation, it will probably lower its rates again in H2 2023. The ECB's main refinancing rate could reach 2.75% in early 2023, 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	2.8	1.0	2.5			
US	23.9	1.7	-0.4	0.9	8.0	3.8	2.5
China	18.1	2.9	3.9	3.9	2.1	2.4	2.3
Japan	5.1	1.7	0.5	1.4	2.2	1.4	0.7
India	3.2	8.0	6.5	6.7			
Latin America	5.2	2.5	1.0	2.5			
Europe	26.3	2.3	-1.3	2.0			
Eurozone	15.1	2.8	-1.3	2.5	8.5	6.3	2.1
Germany	4.4	1.1	-1.8	2.6	8.7	6.8	2.0
France	3.0	2.1	-1.1	2.4	5.7	4.5	1.9
Italy	2.2	3.2	-1.5	1.5	8.0	6.2	1.8
Spain	1.5	4.4	-0.5	2.4	8.9	4.3	2.0
Other Western Europe							
United Kingdom	3.3	4.1	-1.5	2.1	8.8	5.0	1.3
Switzerland	0.8	1.8	-0.8	1.5	3.0	2.0	0.9
Sweden	0.7	2.0	-1.0	2.2	6.5	4.0	2.0
Eastern Europe							
Russia	1.8	-6.0	-4.0	-2.0	25.0	15.0	6.0
Turkey	0.8	5.0	1.0	2.5	73.0	40.0	20.0

Source: Berenberg

EU gas storage (filling level in per cent)



EU-27; difference to minimum in percentage points. Source: AGSI, 1 January 2021 - 10 October 2022.

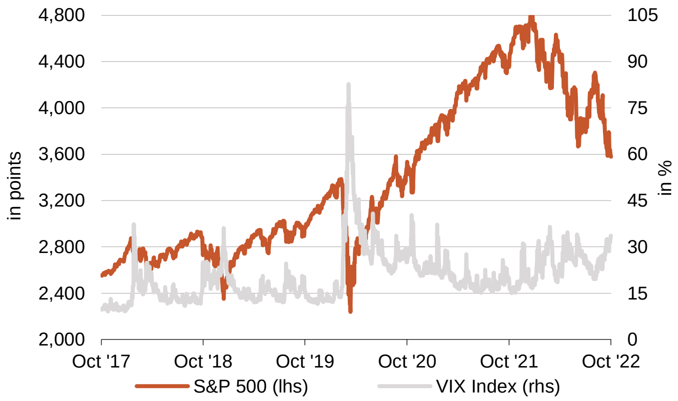
EQUITIES

Opportunities and risks balance each other out

Equities fell to new lows for the year. European and emerging market equities held up better than US equities. Value is again ahead of growth. Q3 reporting season should provide clarity on margin pressure. Prices reflect many risks. We increased our equity weighting to neutral in the autumn sell-off. Opportunities and risks are balanced.

- Recession fears and restrictive central bank policies brought the **stock markets** to their knees in September. Due to their higher valuation, US equities suffered more than the European or emerging market equities we currently favour. Many global indices, such as the S&P 500, hit new lows for the year. In the short term, the market is likely to remain macro- and inflation-driven and thus volatile. The upcoming Q3 reporting season could also lead to increased volatility as the market is likely to closely scrutinise the impact of high cost inflation and consumer weakness on earnings and outlooks. We expect increasing pressure on margins, but this is likely to be largely reflected in the already falling share prices.
- At **sector** and **style level**, there were only losers in the last four weeks. Among the European sectors, real estate stocks suffered in particular, disproportionately affected by rising interest rates due to their tendency to be highly indebted. Energy stocks, on the other hand, held up comparatively well. **Defensive stocks** performed slightly better than **cyclical stocks**, but also lost more than 9% in value. **Value stocks** and **large caps** were ahead of **growth stocks** and **small caps**.
- Although markets are likely to remain under pressure in the short term, the medium-term outlook for investors is currently improving on a weekly basis. Much negativity is already acknowledged and reflected in market prices. The opportunities, such as a possible China reopening, a less hawkish Fed or an improvement in Europe, seem to be on the radar of few.
- We have taken advantage of the autumn sell-off and increased our **equity weighting** to **neutral,** as we think there are clear opportunities in addition to risks in the medium term. We believe that many risks are already known and priced and that there is upside surprise potential.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 12/10/2017 - 12/10/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 12/10/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	12,172	-23.4%	-19.6%	-2.7%	9.8	4.1%
SMI	3,203	-20.7%	-13.3%	+4.5%	16.1	3.4%
MSCI UK	1,969	-2.3%	+1.9%	+5.9%	8.4	4.6%
EURO STOXX 50	3,332	-20.1%	-15.1%	+1.6%	9.9	4.1%
STOXX EUROPE 50	8,322	-10.2%	-2.8%	+12.1%	10.5	3.8%
S&P 500	6,632	-24.3%	-16.9%	+24.6%	16.0	1.8%
MSCI Em. Markets	865	-27.8%	-28.8%	-7.3%	10.5	3.7%

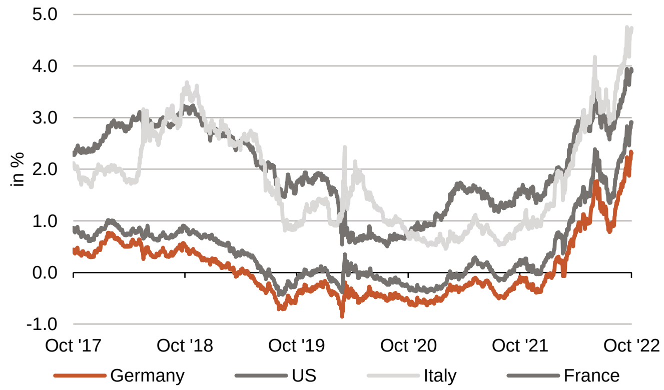
FIXED INCOME

Real alternative to equities

Inflation concerns and restrictive monetary policy have caused massive rate volatility. Rise in yields across the board. Corporate bonds already attractive over the long term. For emerging market bonds, we prefer local currencies. We maintain our less strong underweight in bonds and position ourselves close to neutral in duration.

- The unchanged high inflation data and restrictive central bank policies continued to weigh on the **global bond markets in** September. Accordingly, the yield on 10-year **US government bonds** temporarily exceeded the 4% mark. In Europe, yields rose similarly strongly. The spread between Italian and German government bond yields remains high. While **German government bond** yields rose to more than 2.3%, **Italian government bonds** are already yielding more than 4.7%, as they were burdened by both rising central bank interest rates and the risk-off environment.
- The **corporate bond market** was also affected by the recent risk-off in the markets. Investment-grade corporate bond spreads have widened by more than 15 basis points in the past four weeks, high-yield bonds even by more than 50 basis points. Thanks to the high yield and lower duration, high-yield bonds were among the best performers during this period, illustrating the increased attractiveness of this asset class. At the same time, new issuance has been scarce due the high refinancing cost and the risk-off environment.
- After the recovery move in the summer, **emerging market bonds** suffered renewed weakness in September. The absolute spread difference between emerging market sovereign and corporate bonds is at historical highs. On a risk-adjusted level, emerging market sovereign bonds also appear significantly more attractive than their corporate counterparts.
- We have **reduced** our existing **underweight in bonds** and are moving towards **neutral on duration**. Despite the recent jump in yields, we refrain from a further increase in duration for the time being. We are becoming more constructive about **credit** and appreciate the higher carry and shorter duration compared to government bonds.

Yields on 10-year government bonds



Source: Bloomberg, 12/10/2017 - 12/10/2022.

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 12/10/2022	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	208.41	-18.1%	-18.1%	-18.6%
Covered bonds (iBOXX Euro Germany Covered)	175.53	-13.5%	-13.7%	-14.9%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	134.57	-16.5%	-16.5%	-15.6%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	141.48	-11.7%	-11.9%	-10.6%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	534.50	-11.4%	-9.6%	-9.6%
High-yield bonds (ICE BofA Global High Yield Index)	368.22	-19.0%	-18.7%	-8.4%

COMMODITIES

Gold needs Fed pivot

Gold has upside potential only with Fed turnaround.
Oil becomes scarcer towards the end of the year.
Long-term trends in industrial metals remain intact.

- Despite further escalation in the Russia-Ukraine war and great economic uncertainty, **gold** continued its downward trend in September and temporarily fell towards the 1,600 mark. In the medium term, a sustained upward movement requires a turnaround by the Fed, which is expected for H1 next year.
- **Crude oil** initially suffered from demand concerns, but then received support from OPEC+. The cartel decided to cut production by 2 million barrels per day. Looking ahead, oil should remain well supported at the end of the year despite a mild recession and further supply shortages, thanks not only to OPEC+ but also to the end of the release of strategic US oil reserves.
- Despite fears of recession, **industrial metals have** been surprisingly robust recently, even if the remaining months are unlikely to offer much tailwind as the risk of recession increases. In the long term, however, metals should benefit from the supply deficit and the energy transition.

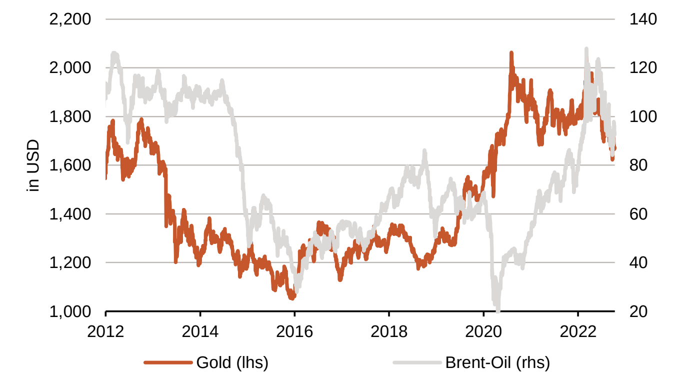
CURRENCIES

Euro: Winter risks priced in

EUR/USD: Further below parity.
EUR/GBP: Turbulent days for the pound.
EUR/CHF: Franc remains in demand as a "safe haven".

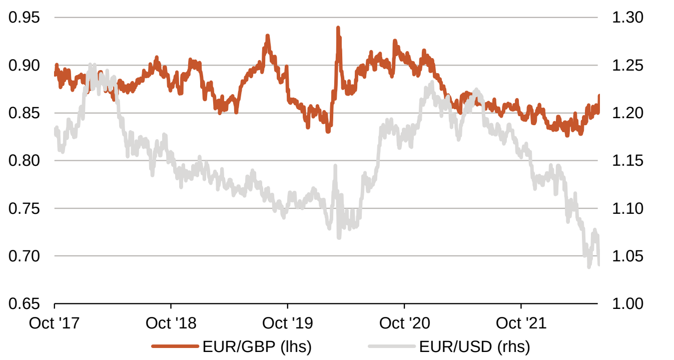
- **EUR/USD:** The euro is under pressure from several angles. The energy crisis with all its uncertainties for the German and European economy is a particular burden at the beginning of the cold season. The euro exchange rate has fallen below parity with the dollar and does not have much upside potential for the time being. If this winter passes without any major negative surprises, the situation on the foreign exchange market should ease somewhat in the coming year. The US dollar would then lose its attractiveness and the euro would gain again.
- **EUR/GBP:** The pound has experienced a sometimes rapid decline in recent weeks. At the same time, interest rates shot up. This was triggered by the British government's announcement of a package of measures that will further increase the national debt. The markets reacted to this aggressively. An intervention by the Bank of England in the bond market has calmed market players for the time being.

Price development



Source: Bloomberg, 01/01/2012 - 12/10/2022.

Exchange rates



Source: Bloomberg, 12/10/2017 - 12/10/2022.

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 12/10/2022	ytd	1-year	3-year
Gold USD/ounce	1,673	-8.5%	-4.9%	+12.4%
Silver USD/ounce	19.0	-18.4%	-15.7%	+8.4%
Copper USD/pound	342.5	-23.3%	-20.8%	+30.3%
Brent USD/bbl	92.45	+18.9%	+10.8%	+52.8%

		Performance		
	As of 12/10/2022	ytd	1-year	3-year
EUR/USD	0.97	-14.7%	-15.8%	-12.1%
EUR/CHF	0.97	-6.7%	-9.8%	-12.0%
EUR/GBP	0.87	+3.9%	+3.0%	+0.2%
EUR/JPY	142.57	+8.9%	+8.8%	+19.1%

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
Marco Höchst | Equities
Robert Reichle | Fixed Income
Ludwig Kemper | Commodities
Karsten Schneider | Minutes

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Date: 13 October 2022

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