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Markets

INVESTMENT COMMITTEE MINUTES

10 November 2022

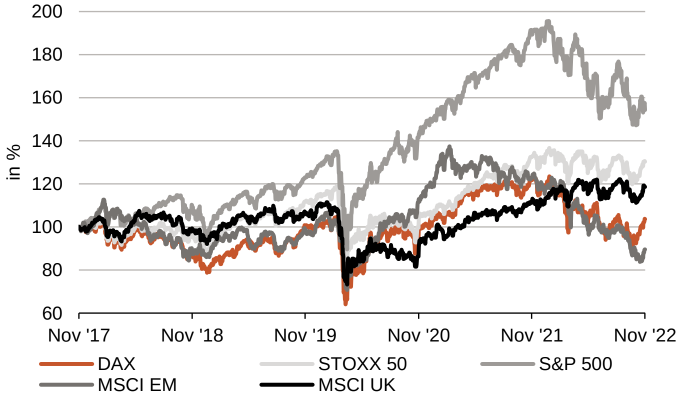
Managers of the Committee

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, 09/11/2017 - 09/11/2022.

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. Recession until spring 2023, followed by a V-shaped upswing. • Inflation peak in the US passed. Euro inflation continues to rise until end of 2022. Price pressures ease from spring 2023.
Equities	• The still unfulfilled hope of a Fed pivot and the end of the zero-COVID policy in China provided a tailwind. • Value stocks gained significantly thanks to China hopes and small caps outperformed large caps. • We have reduced our equity allocation to near neutral with the market recovery, as risks are not off the table.
Bonds	• Unabated high inflation keeps central banks on track. Hopes of a Fed pivot appear premature. • We consider corporate and emerging market bonds attractive - especially versus government bonds. • As bond attractiveness increases, we remain moderately underweight with a duration close to neutral.
Commodities	• Gold is bottoming out. The Fed pivot is still needed for a sustained recovery. Relative attractiveness has declined. • Oil demand from China is likely to further tighten the oil market if zero-COVID is abandoned. G7 price cap ineffective. • Industrial metals also benefit from positive news from China. Long-term trends remain intact.
Currencies	• EUR/USD continues to hover around parity. A new trend depends on how Europe's economy gets through the winter. • After the political turmoil, the pound exchange rate is looking for direction and fluctuates around the 0.87 pound per euro mark. • The franc remains strong. Nevertheless, the euro was able to recover somewhat from its low of 0.95 francs per euro.

Current market commentary

Hopes of a turnaround in US monetary policy ("Fed pivot"), speculation about an end to the zero-COVID policy in China and the US mid-term elections (possible gridlock) led to a noticeable recovery on global equity markets. In this environment, cyclical stocks outperformed defensive stocks. European industrial and financial stocks, for example, gained more than 10% in the last four weeks. The value style thus outperformed the growth style in the still-difficult interest rate environment, and small caps saw a significant recovery. Looking ahead, however, we believe that a sustained recovery in the equity markets will require continued weaker economic and inflation data. Only then would we consider a real Fed pivot likely. After the recent positive development, we have therefore reduced our equity exposure to close to neutral. In addition, we are increasingly focusing on the more favourably valued mid-caps in the US and have reduced the USD risk of the portfolios.

As we had feared, market hopes for a quick turnaround by the Fed once again proved premature. Powell made it clear at the Fed meeting in early November that the pace of rate hikes is likely to slow, but that this does not equate to a pause and thus a Fed pivot. Accordingly, interest rates are likely to remain elevated for longer. The rise in interest rates in October thus weighed on the global bond markets. Accordingly, the yield on 10-year US government bonds exceeded the 4% mark. In our opinion, however, the action is currently in beta segments such as corporate and emerging market bonds. Both segments offer yields that have not been seen since the financial market crisis and thus offer a real alternative to equities. We continue to keep an eye on opportunistic purchases here.

Despite a possible positive development, gold is likely to have a difficult time relative to bonds and equities without carry. We are more optimistic about industrial metals and energy commodities.

ECONOMICS

Recession ahead in Europe (winter 2022/23) and US (2023), but the outlook does not dim further

US: Fed hits the brakes hard. Interest rate peaks at 5%. Mild US recession in 2023. Fed cuts rates from autumn 2023.
Europe: High prices for electricity and gas = recession until spring 2023. V-shaped recovery thereafter.
Inflation peak in US passed. Euro inflation continues to rise until the end of 2022. Price pressure decreases strongly in 2023.

- **Recession in Europe and - presumably - 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 are the aggressive interest rate policy of the US Fed, followed by the ECB and other central banks. Following the collapse in consumer confidence on both sides of the Atlantic, companies, especially in Europe, are also looking to the future with scepticism. They are receiving fewer new orders.
- **The end of the bad news?** In the third quarter, economic activity in the US, China and the eurozone held up somewhat better than expected. Although the economic outlook for the coming quarters remains negative, it is not becoming any gloomier.
- **Well prepared for winter?** Now that Europe has managed to fill its gas storage facilities (to over 95% of capacity in the EU), the risk that gas will have to be forcibly rationed this winter has diminished. Gas prices, while still very high, have softened significantly in recent weeks. This limits the downside risks somewhat. The new aid packages of some governments may also help to make the recession in the eurozone this winter somewhat less severe than initially feared. We now expect an overall decline in eurozone economic output of 1.7% instead of 2.2% this winter.
- **China a little more stable again?** There are first indications from China that Beijing might relax its rigid zero-COVID policy somewhat, perhaps from spring 2023 onwards after a possible winter wave of infections has subsided. We now expect China to grow by 4.4% instead of 3.9% in 2023, which is a weak figure for China. China should neither support nor weigh on the global economy in 2023.
- **Mild US recession ahead:** The interest-rate-sensitive real estate market is in deep crisis and other sectors are losing momentum. We expect a mild recession in 2023.
- **Inflation:** US peaks ahead of Europe. Inflation seems to have peaked in the US. However, it will only fall slowly in the US. Wage pressures remain high, but are not increasing further. In Europe, on the other hand, the high prices for 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.

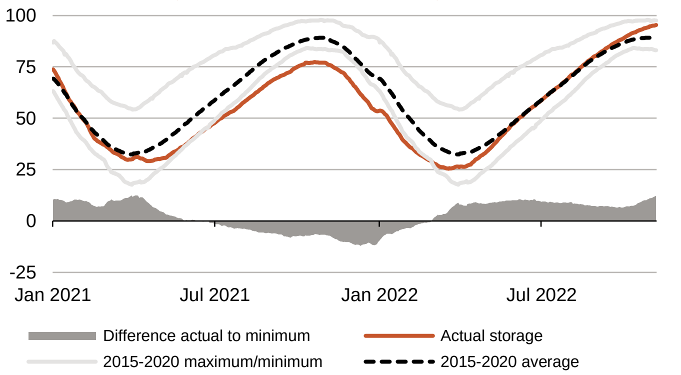
Interest rate summit in early 2023: The US Fed is expected to raise its rates to 5% by January 2023. As this will weigh on the economy and the labour market as well as dampen inflation, it will probably lower its rates again in H2 2023. The ECB's main refinancing rate could reach 2.75% or even 3% in early 2023, followed by a recession-related pause.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2022	2023	2024	2022	2023	2024
World	100.0	2.9	1.2	2.6			
US	23.9	1.8	-0.3	1.2	8.1	4.0	2.5
China	18.1	3.3	4.4	3.9	2.2	2.5	2.3
Japan	5.1	1.7	0.5	1.4	2.3	1.6	0.7
India	3.2	8.0	6.5	6.7			
Latin America	5.2	2.5	1.0	2.5			
Europe	26.3	2.5	-1.0	1.9			
Eurozone	15.1	3.1	-0.8	2.3	8.6	6.7	2.1
Germany	4.4	1.6	-1.1	2.6	8.8	7.1	2.1
France	3.0	2.3	-0.5	2.3	5.9	5.2	1.9
Italy	2.2	3.6	-1.0	1.5	8.8	8.3	1.8
Spain	1.5	4.4	-0.6	2.4	8.5	3.2	2.0
Other Western Europe							
United Kingdom	3.3	4.1	-1.3	1.9	8.8	4.9	1.6
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.

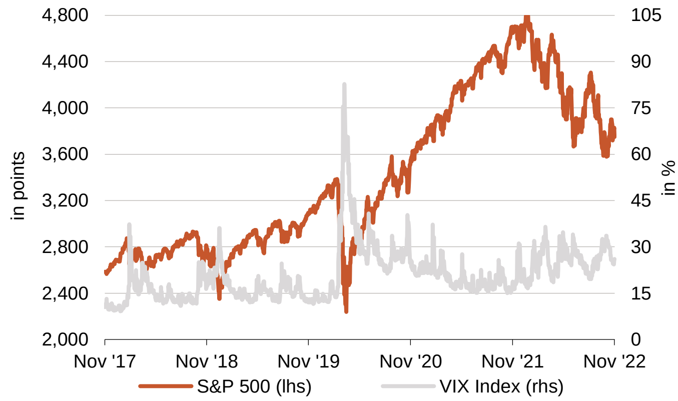
EQUITIES

Return potential limited with restrictive central banks

The still unfulfilled hope of a Fed pivot and the end of the zero-COVID policy in China provided a tailwind. Value stocks gained significantly thanks to China hopes and small caps outperformed large caps. We have reduced our equity allocation to near neutral with the market recovery, as risks are not off the table.

- **Equity markets** were unimpressed by the absence of a monetary policy turnaround by the Fed (Fed pivot). The market's hope for a Fed pivot seems to have merely been postponed into the future, as global equity markets gained more than 6% in the last four weeks. Rumours and hopes of a departure from China's zero-COVID policy next year also helped. Cyclical sectors or regions such as European equities benefitted the most.
- At the **style level**, there was a clear winner in the last four weeks. **Value stocks** were able to gain significantly more than **growth stocks** while monetary policy remained restrictive. Sectors that led to this outperformance in Europe were primarily financials, real estate and industrials. **Cyclical stocks** also outperformed **defensive stocks** thanks to hopes of a "China-COVID rethink". **Small caps** gained more than **large caps.** Here we still see clear relative catch-up potential.
- In our view, however, a sustained recovery of the equity markets requires continued weaker economic and inflation data. Only then do we consider a real Fed pivot likely. Even then, however, we do not consider the return potential for equities to be outstanding in comparison with other investments, as earnings are likely to come under pressure due to the recession and inflation. Moreover, the flood of liquidity from central banks is unlikely to return any time soon. However, the lows in the equity markets are most likely behind us.
- We have leveraged the recent strong equity market performance and reduced our equity exposure, which has risen as a result of the recovery, to close to neutral, as we do not yet believe in a sustainable upward trend despite the existing opportunities and the risks that still exist.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 09/11/2017 - 09/11/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 09/11/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	13,666	-14.0%	-14.8%	+3.3%	11.0	3.7%
SMI	3,412	-15.5%	-12.6%	+8.9%	17.7	3.1%
MSCI UK	2,100	+4.3%	+6.6%	+11.3%	9.0	4.3%
EURO STOXX 50	3,728	-10.5%	-11.3%	+9.7%	11.1	3.7%
STOXX EUROPE 50	8,954	-3.4%	-1.5%	+16.6%	11.5	3.5%
S&P 500	6,956	-20.6%	-19.1%	+25.4%	16.9	1.8%
MSCI Em. Markets	900	-24.8%	-27.0%	-8.4%	11.0	3.5%

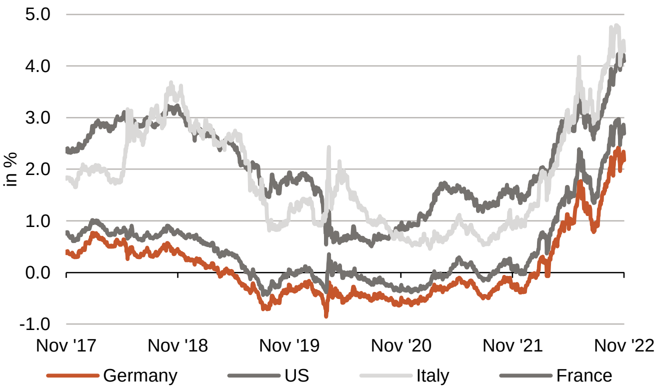
FIXED INCOME

Corporate bonds are the name of the game

Unabated high inflation keeps central banks on course. Hopes of a Fed pivot appear premature.
We consider corporate and emerging market bonds attractive - especially compared to government bonds.
With increasing bond attractiveness, we are only moderately underweight with a duration close to neutral.

- As we feared, market hopes for a quick turnaround by the Fed once again proved premature. Powell made it clear at the Fed meeting at the beginning of November that the pace of interest rate hikes is likely to slow down, but that this does not mean a pause and thus a "Fed pivot" (reversal of monetary policy). Accordingly, interest rates are likely to remain elevated for longer. The rise in interest rates in October weighed on the **global bond markets**. Accordingly, the yield on 10-year **US government bonds** exceeded the 4% mark. In Europe, interest rate pressure also continued. The spread between Italian and German government bond yields narrowed, which can also be attributed to the hitherto calm Italian policy.
- In our opinion, the action is currently in beta segments such as **corporate bonds**. Most segments are yielding at or near their highest levels since the global financial market crisis. With yields of more than 4% on **EUR investment-grade bonds** and more than 8% on **EUR high-yield bonds**, we consider these to be real alternatives to equities, especially as the economy is holding up better than expected thanks to government support and high default rates can thus most likely be avoided.
- We also consider **emerging market bonds** attractive. These suffered from historically high outflows in 2022 and were thus significantly under pressure. Yields have risen disproportionately in the process. An end to US dollar strength should also give emerging markets a tailwind.
- Bonds are increasingly attractive relative to equities, so we do not rule out a further reduction of our **underweight in bonds**. We are constructive on **credit** and **emerging market bonds** and appreciate the high carry and often manageable duration.

Yields on 10-year government bonds



Source: Bloomberg, 09/11/2017 - 09/11/2022.

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 09/11/2022	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	212.43	-16.5%	-17.9%	-15.9%
Covered bonds (iBOXX Euro Germany Covered)	178.34	-12.1%	-12.9%	-12.8%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	137.15	-14.9%	-15.9%	-13.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	142.61	-11.0%	-11.6%	-9.6%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	529.29	-12.3%	-11.9%	-10.4%
High-yield bonds (ICE BofA Global High Yield Index)	375.11	-17.4%	-17.7%	-7.4%

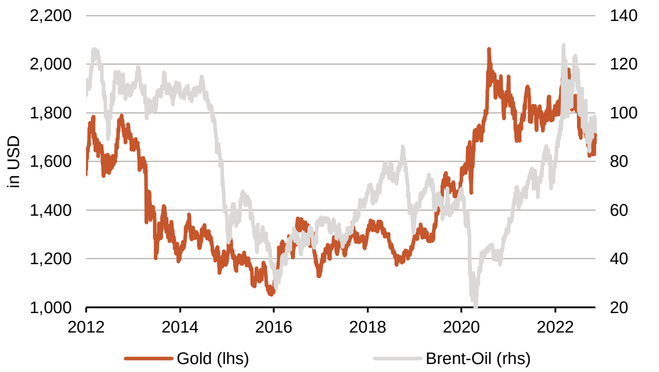
COMMODITIES

China boosts cyclical commodities

Gold bottoming, but less attractive.
Oil and metals benefit from news from China.
In the long term, supply remains tight for both.

- **Gold** started to form a bottom in October. In particular, the already very pessimistic investor positioning limits the downside potential. However, gold has lost some of its attractiveness in the portfolio context in recent months. On the one hand, it is currently highly correlated to equities. On the other hand, other safe havens such as government bonds are again delivering adequate returns.
- **Crude oil** has benefited from the gradual abandonment of the zero-covid policy in China. After months of weakness, demand for oil there is likely to pick up noticeably, thus further exacerbating the supply shortage. The price cap on Russian oil decided by the G7 is likely to remain ineffective, as none of the members will import Russian oil at the turn of the year anyway.
- **Industrial metals** also benefited from the positive news from China. Physical premiums for copper there have recently risen significantly – a signal for rising demand. The long-term trends remain intact.

Price development



Source: Bloomberg, 01/01/2012 - 09/11/2022.

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

	As of 09/11/2022	Performance ytd	1-year	3-year
Gold USD/ounce	1,707	-6.7%	-6.8%	+17.0%
Silver USD/ounce	21.1	-9.7%	-13.4%	+25.2%
Copper USD/pound	370.0	-17.1%	-15.4%	+38.0%
Brent USD/bbl	92.65	+19.1%	+9.3%	+48.2%

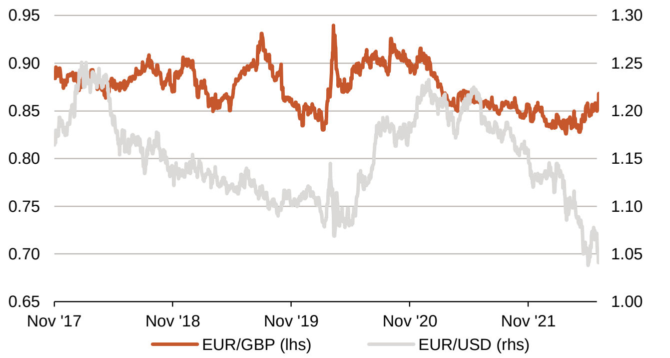
CURRENCIES

Euro: Waiting for winter

EUR/USD: Fluctuating around parity.
EUR/GBP: Reorientation after political turmoil.
EUR/CHF: The euro is making up ground.

- **EUR/USD:** The euro exchange rate remains weak, even though it has recovered somewhat from its low. In the current exchange rate, the usual valuation yardsticks such as purchasing power parities or interest rate and growth differentials naturally play a role. But these fundamental criteria are currently overshadowed by geopolitical uncertainties and the resulting imponderables for future economic development. The next few months will determine whether the European economy emerges unscathed from first winter of the energy crisis with a black eye. The further trend of the euro will largely depend on this.
- **EUR/GBP:** The British pound has had a turbulent few weeks. First, the "Trussonomics" sent the pound on a downward slide. An intervention by the Bank of England in the bond market calmed market players. Then Prime Minister Liz Truss resigned, and Rishi Sunak took over. Now the pound is looking for its future direction.

Exchange rates



Source: Bloomberg, 09/11/2017 - 09/11/2022.

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 09/11/2022	Performance ytd	1-year	3-year
EUR/USD	1.00	-12.0%	-13.6%	-9.1%
EUR/CHF	0.99	-5.0%	-6.7%	-10.3%
EUR/GBP	0.88	+4.8%	+3.1%	+2.2%
EUR/JPY	146.60	+12.0%	+12.0%	+21.8%

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
Torsten Ziegler | Equities
Robert Reichle | Fixed Income
Ludwig Kemper | Commodities
Karsten Schneider | Minutes

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