BERENBERG *Markets*

INVESTMENT COMMITTEE MINUTES

08 December 2022

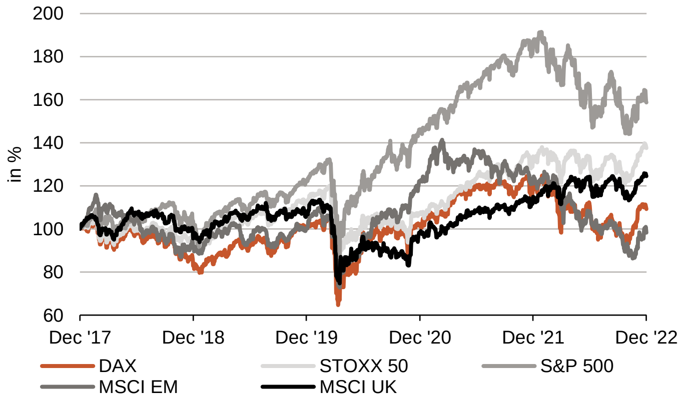
Managers of the Committee

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, 07/12/2017 - 07/12/2022.

Most important assessments at a glance

Economics	• US: Fed hits the brakes hard on monetary policy. Mild recession likely in 2023, soft landing possible. • High energy prices hit Europe hard. Recession until spring 2023, V-shaped recovery thereafter. • Inflation peak in the US passed; euro inflation about to peak. Price pressure decreases from spring 2023.
Equities	• Equity recovery in November. European equities supported by Q3 reporting, short covering and cheap valuation. • Major setbacks also likely in 2023. Limited upside potential in equities. Asia and Europe with opportunities. • We are neutral on equities. Economic risks remain. Recovery potential with interest rate turnaround and direction in 2024.
Bonds	• Recovery rally amid increasing recession fears and decreasing inflationary pressure. 10Y yield level noticeably lower. • Corporate bonds increasingly attractive with solid balance sheet data and capital inflows. Emerging market bonds ahead. • We prefer corporate and emerging market bonds to safe government bonds. Duration: close to neutral.
Commodities	• Gold recently boosted by USD weakness and real interest rate decline. Relative attractiveness despite potential at Fed pivot. • Oil on demand side burdened by China and recession worries. Structural deficit on supply side supports recovery. • Metals with fast recovery on China easing and economic recovery. Long-term drivers remain intact.
Currencies	• EUR/USD fights its way out of the trough. Improved financial market sentiment pushes euro up to 1.05 US dollars per euro. • After the political turmoil, the British currency swings back towards 0.85 pounds per euro. • Swiss National Bank relies on strong franc to fight inflation.

Current market commentary

The recovery rally in global equity markets continued in November, helped by short covering and systematic equity buying falling volatility and improving momentum. Also supportive were hints from the Fed that it may pursue a more moderate interest rate policy. Coupled with hopes that the peak of US inflation and USD strength is behind us, the major underperformers since the beginning of the year have rallied in particular. Technology stocks clearly outperformed oil stocks in November. Cyclical stocks also clearly outperformed defensive stocks. Chinese shares, however, recovered the most, benefitting from the emerging hope of a possible end to the zero-covid policy. This is one reason why the capital markets have again priced in a soft landing for the economy. However, if this does not happen, the drop for equities is likely to be somewhat higher once more. 2023 is therefore not likely to be an easy year for equities, but it promises selective potential and to be better overall than 2022. Active and anti-cyclical behaviour as well as a more balanced portfolio are therefore in focus. Due to the existing risks, especially economic ones, we are positioning ourselves with a neutral equity quota for the time being – neutral also because the diversity of opportunities in other asset classes makes equities seem relatively less attractive.

The positive correlation of the asset classes was also high in November, because in addition to equities, bonds and commodities also recovered noticeably. The massive decline in yields on government bonds due to diminishing inflation and central bank headwinds boosted bond markets. The segments we prefer, such as EUR corporate and emerging market bonds, gained disproportionately. This is because risk premiums fell in addition to yields.

The bulk of commodities also recovered. China hopes supported industrial metals in particular. Energy commodities, on the other hand, lost considerable ground.

ECONOMICS

Recession ahead in Europe (winter 2022/23) and US (2023). But the outlook is brightening somewhat.

US: Fed hits the brakes hard. Interest rate peaks at 5%. Mild US recession in 2023. Fed cuts rates from autumn 2023.
Europe: Recession until spring 2023, V-shaped recovery thereafter. Leading indicators recover somewhat.
Inflation peak passed in the US and (almost) reached in Europe. Price pressure decreases strongly in 2023.

- **The situation remains difficult:** The US economy is losing momentum, Europe is apparently already in recession and China is not getting a grip on its internal problems. Since many central banks will tighten their interest rate policies once again in December and the radical monetary policy turnaround of 2022 is only likely to have its full effect in the course of next year, the global economy could stutter even more than before in early 2023.
- **Less bad news?** The economic outlook for the coming quarters remains negative, but has brightened somewhat recently. Europe had managed to fill its gas storage facilities almost to the brim at the start of the heating season. The risk of a gas shortage has diminished. Exchange prices for gas and electricity have also eased since late summer. As consumers are therefore somewhat less pessimistic about the future, the recession in Europe could be milder than initially feared. We now expect economic output in the euro area to decline by 0.6% instead of 0.8% in 2023. As soon as the winter is over, the economy can pick up again.
- **Euro inflation about to peak:** In Europe, the high prices for natural gas imports and electricity have not yet fully reached consumers. In January, many consumers will receive new bills. But after that, inflation should drop noticeably, as the explosive rise in energy and food prices in 2022 will then drop out of the year-on-year comparison. In addition, the recession narrows the scope for companies to pass on higher costs to consumers.
- **Positive news from the US:** While the economy is holding up somewhat better than expected, US inflation appears to have peaked. Wage pressures remain high, but are not increasing. This reduces the risk that the US Fed will raise its key interest rate to well above 5% in early 2023. The end of the interest rate cycle has not yet been reached, but it is somewhat closer.
- **Hope for progress in China:** After public protests, China has apparently started to ease its rigid zero-covid policy somewhat. Currently, this is a risky strategy. But after a possible winter wave of infections subsides in spring 2023, China could turn the corner. Unlike in the weak year 2022, China should neither support nor burden the global economy in 2023.

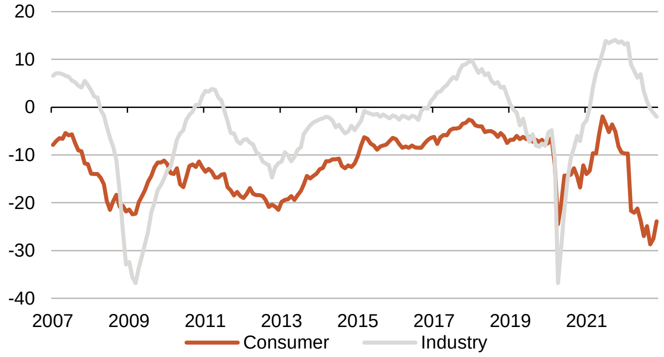
Interest rate summit in early 2023: The US Fed is likely to raise its interest rates to 5% in the first quarter of 2023. As this will weigh on the economy and the labour market as well as dampen inflation, the Fed will probably lower its rates again in 2H 2023. The ECB main refinancing rate could reach 3% or even 3.25% 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	1.9	-0.1	1.2	8.1	4.2	2.6
China	18.1	3.0	4.2	4.1	2.1	2.5	2.3
Japan	5.1	1.5	0.6	1.2	2.5	2.2	0.9
India	3.2	8.0	6.5	6.7			
Latin America	5.2	2.5	1.0	2.5			
Europe	26.3	2.6	-0.8	1.9			
Eurozone	15.1	3.2	-0.6	2.2	8.4	6.7	2.0
Germany	4.4	1.7	-0.9	2.4	8.8	7.3	2.0
France	3.0	2.4	-0.2	2.3	5.9	5.2	1.9
Italy	2.2	3.7	-0.8	1.5	8.7	7.7	2.0
Spain	1.5	4.5	0.0	2.4	8.4	2.8	2.0
Other Western Europe							
United Kingdom	3.3	4.2	-1.3	2.0	9.0	5.5	1.6
Switzerland	0.8	1.8	-0.4	1.5	2.7	2.0	0.9
Sweden	0.7	2.8	-0.6	2.2	7.9	6.0	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

Confidence indicators eurozone



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

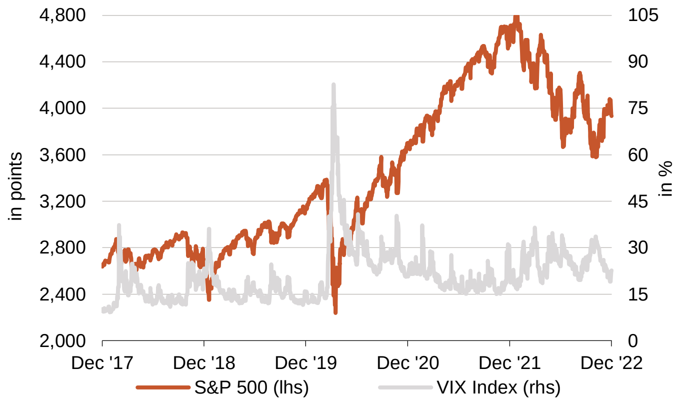
EQUITIES

Limited upside potential in 2023

Equity recovery in November. European equities supported by Q3 reporting, short covering and cheap valuation. Major setbacks also likely in 2023. Limited upside potential in equities. Asia and Europe with opportunities. We are neutral on equities. Economic risks remain. Recovery potential with interest rate turnaround and direction in 2024.

- **Equity markets** rallied in the fourth quarter on robust economic data and hopes for lower inflation and thus an end to the highly restrictive central bank policy. **European equities** in particular benefitted from the rally – fundamentally thanks to a pleasing Q3 reporting season and relatively cheap valuations, and technically through short covering. The easing of China's strict zero-covid policy boosted **Asian equities**, while USD weakness limited the recovery of **US equities** for euro investors.
- At **sector** and **style level** in Europe, **cyclical equities** in particular gained. **Information technology** stocks and **cyclical consumer goods** were clearly ahead, with a performance of nearly 10% and 8% respectively. But **utilities, industrials** and **basic materials** also gained. **Consumer staples, health care** and **telecom stocks** kept gains limited. In the aggregate, **growth** thus performed better than **value**. **Energy stocks** not only brought up the rear, but were also the only segment with a negative performance.
- Despite limited upside potential in the new year, European and Asian equities in particular should perform better. Here, the lagging effects of USD strength as well as a recession in the eurozone, which our economists expect to be less deep, are providing support. Nevertheless, with negative earnings revisions and restrictive central bank policies, 2023 is not likely to be without stronger setbacks. We expect a volatile, limited upward movement in equities.
- We leveraged the strong equity market performance from the end of September and **reduced our equity exposure**, which had risen due to the recovery, to **near neutral in an anticyclical manner**. Within US equities, we have now partially currency hedged our exposure and also swapped large caps for mid-caps due to the more favourable valuation.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 07/12/2017 - 07/12/2022.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 07/12/2022	ytd	1-year	3-year	P/E	Dividend yield
DAX	14,261	-10.2%	-9.8%	+8.3%	11.3	3.5%
SMI	3,429	-15.1%	-12.6%	+7.9%	18.4	3.1%
MSCI UK	2,154	+7.4%	+8.2%	+16.2%	9.7	4.0%
EURO STOXX 50	3,921	-5.6%	-5.1%	+15.8%	11.7	3.5%
STOXX EUROPE 50	9,365	+1.0%	+2.9%	+21.8%	12.2	3.3%
S&P 500	7,309	-16.6%	-15.1%	+29.4%	17.9	1.7%
MSCI Em. Markets	959	-19.8%	-19.8%	-0.8%	11.5	3.4%

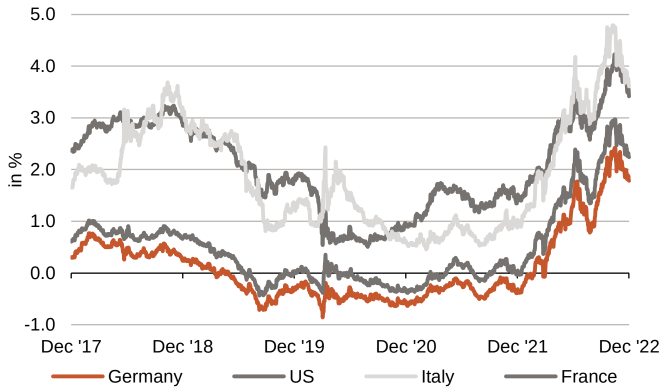
FIXED INCOME

Constructive for corporate bonds

Recovery rally amid increasing recession fears and decreasing inflationary pressure. 10Y yield level noticeably lower. Corporate bonds increasingly attractive with solid balance sheet data and capital inflows. Emerging market bonds ahead. We prefer corporate and emerging market bonds to safe government bonds. Duration: close to neutral.

- The **global bond market** rallied in November on renewed hopes of an imminent end to the Fed's restrictive policy following comments by Powell. The Fed Chair confirmed that the pace of rate hikes will slow. 10-year **US government bonds** returned to 3.4% after hitting a high of 4.2% at the end of October. Yields fell similarly in Europe. Here, in addition to the price gains, the lower yield differential between core and peripheral countries should be emphasised. While **German government bond** yields fell to just under 1.8%, **Italian government bond** yields plummeted to below 3.6%.
- In the case of **corporate bonds**, risk premiums in the investment grade segment rose again to the level of 2012 and thus offer an attractive yield again. The robust corporate balance sheets are also defying the burdens from the effects of the pandemic and higher cost pressures, especially from the increased energy prices. The recent increase in issuance volume and capital inflows are also generating greater investor interest. Accordingly, we are increasingly constructive on corporate bonds.
- **Emerging market (EM) bonds** experienced strong performance in November, especially hard currency sovereign bonds. EM local currency bonds also held up well. Here, much of the performance can be attributed to the recent USD weakness. It is also worth noting that the spread between EM sovereigns and EM corporates is at a 10-year high.
- We are maintaining our **reduced underweight in bonds** for the time being. We increased our bond allocation (corporate bonds) in November following the significant rise in interest rates. We are becoming more constructive on Euro Credit and continue to view emerging market bonds as attractive.

Yields on 10-year government bonds



Source: Bloomberg, 07/12/2017 - 07/12/2022.

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 07/12/2022	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	220.24	-13.4%	-15.1%	-12.6%
Covered bonds (iBOXX Euro Germany Covered)	181.60	-10.5%	-11.2%	-11.3%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	142.19	-11.7%	-12.6%	-10.7%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	146.31	-8.7%	-9.1%	-7.4%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	541.20	-10.3%	-11.4%	-8.2%
High-yield bonds (ICE BofA Global High Yield Index)	395.63	-12.9%	-12.4%	-3.0%

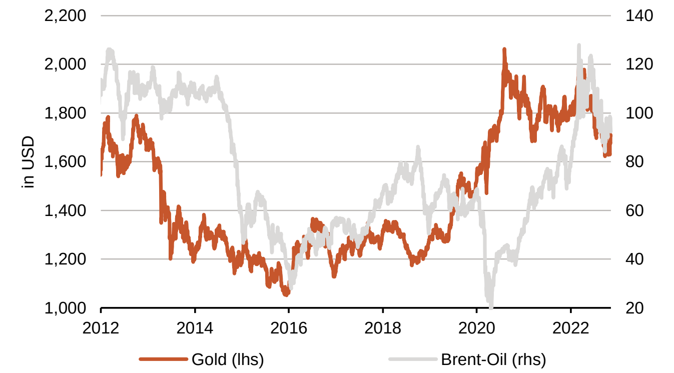
COMMODITIES

Commodities attractive in the long term

Gold gains on Fed pivot. Limited relative attractiveness.
Oil weighs on demand side. Structural deficit supports.
Metals with fast recovery on China easing.

- In Q4, **gold** broke through the weakness it had been experiencing since the spring. As a beneficiary of the recent USD and real rate weakness, it even temporarily exceeded the 1,800 mark. Nevertheless, its relative attractiveness as a non-yielding asset and in stronger tandem with equities has declined. Gold should experience tailwinds in the event of a Fed pivot.
- **Crude oil** continued its downward trend in the fourth quarter, pricing out all the gains since the beginning of the year. However, from a total return perspective, investors received a double-digit gain due to backwardation. In the short term, oil is likely to remain burdened on the demand side by China and recession concerns. However, the structural supply deficit persists. In a recovery, the tight oil market should lead to higher prices.
- **Industrial metals** remained heavily weighed down by recession fears and China lockdowns. In the long term, metals benefit from decarbonisation and should recover quickly when China opens up.

Price development



Source: Bloomberg, 07/12/2012 - 07/12/2022.

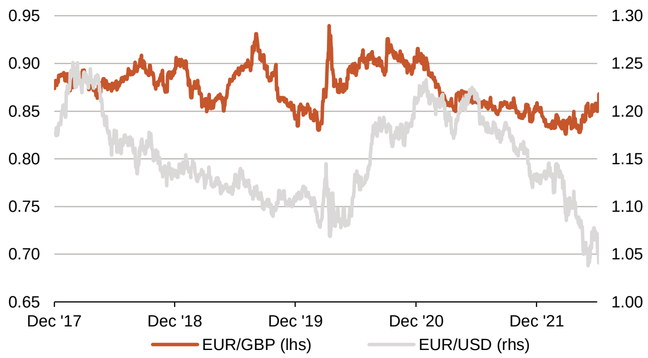
CURRENCIES

Signs of life from the euro

EUR/USD: Dollar loses attractiveness.
EUR/GBP: The pound is regaining its composure.
EUR/CHF: Swiss currency remains strong.

- **EUR/USD:** Even though the common currency is still weak at 1.05 US dollars per euro, it has recovered significantly from the lows. The friendlier market environment is taking away some of the attractiveness of the US dollar, which is benefitting from the crisis as a "safe haven". At the same time, some economic data of recent weeks suggest that the recession in Europe will be less severe than feared. Overall, the risks for the eurozone have diminished, allowing the euro to gain bit by bit. However, it is still too early to deduce a new trend from this. The danger of a setback remains. Nevertheless, we expect the euro to move a little higher in the next 12 months.
- **EUR/GBP:** The end of the (economic) political turbulence is having an effect: the British pound has regained its composure and is moving back to around 0.86 pounds per euro. At this level, we see the British currency as well valued in the coming year.

Exchange rates



Source: Bloomberg, 07/12/2017 - 07/12/2022.

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 07/12/2022	ytd	1-year	3-year
Gold USD/ounce	1,786	-2.3%	+0.1%	+22.3%
Silver USD/ounce	22.7	-2.5%	+1.0%	+37.1%
Copper USD/pound	385.6	-13.6%	-11.1%	+42.2%
Brent USD/bbl	77.17	-0.8%	+2.3%	+19.8%

		Performance		
	As of 07/12/2022	ytd	1-year	3-year
EUR/USD	1.05	-7.6%	-6.8%	-5.0%
EUR/CHF	0.99	-4.7%	-5.2%	-9.8%
EUR/GBP	0.86	+2.3%	+1.2%	+2.3%
EUR/JPY	143.52	+9.6%	+12.2%	+19.4%

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
Christian Bettinger | Fixed Income
Dr Jörn Quitzau | Economics
Philina Kuhzarani | Commodities, Minutes

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