BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

12 January 2023

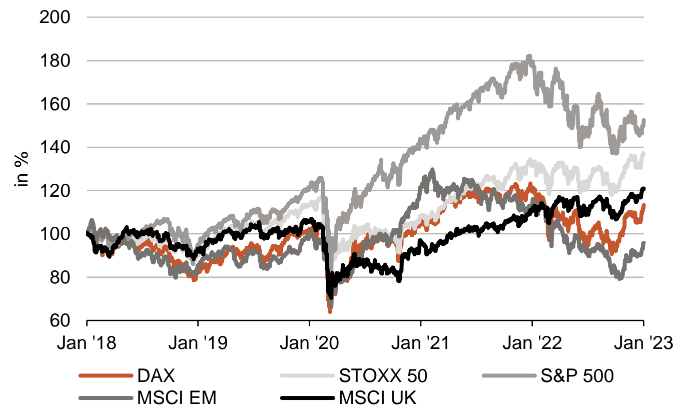
Managers of the Committee

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, 11/01/2018 - 11/01/2023.

Most important assessments at a glance

Economics	• US: Inflationary pressure easing. Mini recession likely in 2023, soft landing possible. Upswing in 2024. • Europe: Gas situation easing. Mild recession in winter, new upswing from summer. Inflation slowly declining. • Central bank interest rate summit in sight. US Fed cuts rates from late autumn, ECB not until 2024.
Equities	• Good start to the year thanks to forward guidance and technical buying. European equities and cyclicals outperform. • China opening and absence of energy crisis offers potential for emerging markets and European equities. • We maintain neutral positioning on equities as earnings, interest rate and economic risks still exist.
Bonds	• Recovery rally analogous to equities. 10-year yields have fallen since the start of the year. Euro periphery spreads offer potential. • Corporate bonds attractive with high yields and solid balance sheets. Local currency bonds preferred in emerging markets. • Relative attractiveness of bonds over equities has risen markedly due to yield advantage. Duration: neutral.
Commodities	• Gold recently boosted by technical factors. Limited diversification effect. Potential with Fed pivot. • Oil with upside potential when China opens. Downside risks limited by SPR purchases and increased production costs. • Metals surprisingly robust thanks to ongoing supply shortages. Decarbonisation provides long-term tailwind.
Currencies	• Outlook for the euro continues to brighten. The euro is gaining against the US dollar, also because the dollar is losing attractiveness. • The pound has calmed down after the political turbulence. Nevertheless, it is falling back against the strengthening euro. • The Swiss National Bank is counting on a strong franc in its fight against inflation. EUR/CHF remains below parity.

Current market commentary

One of the most difficult years for multi-asset investors has come to an end. 2023, on the other hand, started surprisingly positive. The upward movement after the December sell-off is based on the hope of a "soft landing" thanks to disinflation, still stable labour markets and healthy consumer and corporate balance sheets. In addition, the likely slower Fed tightening in the future, depressed sentiment and positioning indicators, the rapid opening of China and the avoidance of an energy crisis in Europe are supporting markets. The last two points in particular, combined with short covering, led to the significant outperformance of European equities versus US equities. Emerging market equities have also been among the winners since the beginning of the year. However, the risks of overly restrictive central banks (liquidity risk), a stronger-than-expected global recession or earnings risk on the corporate side remain. The Q4 reporting season, which will pick up pace from mid-January, will provide a more detailed insight into the latter. We are maintaining our neutral position in the still uncertain environment, also because we see real alternatives to equities.

The ECB, which was much more restrictive than the market expected, led to new highs in European bond yields at the end of 2022. In 2023, however, bonds recovered in line with equities. Even though central banks are likely to remain restrictive this year, the significantly higher current yields compared to last year's start provide a noticeable buffer. In the current uncertain environment, we therefore prefer bonds to equities when buying. Within bonds, we particularly like corporate and emerging market bonds with a rather moderate duration.

The gold price has recovered noticeably in recent weeks. We consider the short-term upside potential to be limited. Industrial metals and especially energy commodities, on the other hand, should offer much more potential with the opening of China.

ECONOMICS

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

US: Fed hits the brakes hard. Interest rate summit in sight. Mild US recession. Fed cuts interest rates from autumn 2023.
Europe: Mild recession until spring 2023, noticeable upswing thereafter. Leading indicators recover somewhat.
Inflation peak passed in the US and Europe. Price pressure decreases strongly in 2023. But core inflation above 2% in 2024.

- **The situation remains difficult:** The US economy is losing momentum, Europe is apparently already in recession and China is not yet getting a grip on its problems. Since many central banks will tighten their interest rate policy again in the first months of 2023 and the radical monetary policy turnaround of 2022 is only likely to have its full effect over the course of the year, the global economy could initially stutter even more than before.
- **Improvement in sight:** The economic outlook for now, however, has brightened further. Europe has filled its gas storage well and cut its consumption by almost 20%. The risk of a gas shortage this winter and next has diminished. Exchange prices for gas and electricity have also fallen significantly. As consumers are therefore less pessimistic about the future, the recession in Europe could be quite mild. For the eurozone, we now expect economic output to decline by 0.2% instead of 0.6% in 2023. As soon as the winter is over, the economy may pick up again.
- **Euro inflation has peaked:** Inflation is likely to fall noticeably from March at the latest, as the explosive rise in energy and food prices in 2022 will then fall out of the year-on-year comparison. Moreover, the winter recession narrows the scope for companies to pass on higher costs to consumers. Supply chains are less disrupted. This helps the economy and reduces price pressure.
- **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 slowly declining. This reduces the risk that the US Fed will raise its key interest rate to well above the 5.25% we expect. The end of the interest rate cycle has not yet been reached, but it has come closer.
- **China: Stimulus has less effect than before.** After public protests, China has abandoned its rigid zero-COVID-19 policy. Currently, this is a risky strategy, as the country has not prepared itself sufficiently. But after the severe winter wave of infections subsides, China could turn the corner in a few months. The government is expanding its monetary and fiscal stimulus. In view of high domestic debt and a deeply insecure population, however, the stimulus is having less effect than before. Unlike in the weak year of 2022, China should neither support nor burden the global economy in 2023.

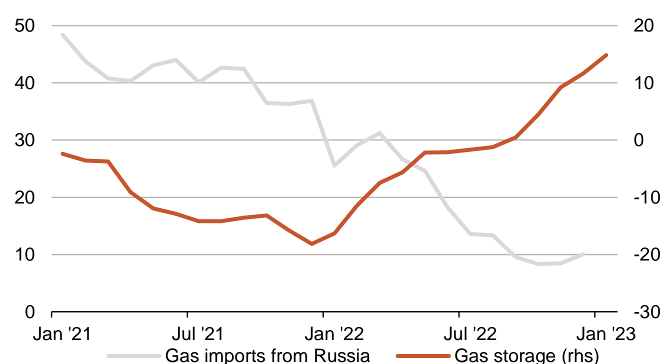
Interest rate summit in early 2023: The US Fed is expected to raise its key interest rate to 5.25% by the start of May. As this will weigh on the economy and the labour market as well as dampen inflation, it will then probably lower the rate again from late fall. The ECB's main refinancing rate could reach 3.5% in March (or even 3.75% in April), 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	1.4	2.4			
US	23.9	2.0	0.0	1.2	8.0	4.1	2.6
China	18.1	2.8	4.0	4.1	2.0	2.5	2.3
Japan	5.1	1.2	1.5	1.2	2.5	2.4	1.2
India	3.2	8.0	6.5	6.7			
Latin America	5.2	2.5	1.0	2.4			
Europe	26.3	2.8	-0.5	1.6			
Eurozone	15.1	3.3	-0.2	1.8	8.4	6.5	2.3
Germany	4.4	1.8	-0.4	1.7	8.7	6.5	2.3
France	3.0	2.5	0.1	1.8	5.9	5.4	2.1
Italy	2.2	3.7	-0.4	1.3	8.7	7.4	2.2
Spain	1.5	5.1	0.4	1.9	8.3	3.9	2.3
Other Western Europe							
United Kingdom	3.3	4.0	-1.0	1.6	9.0	6.3	1.9
Switzerland	0.8	2.0	0.3	1.5	2.9	2.2	1.3
Sweden	0.7	2.8	-0.5	1.8	8.0	6.0	2.2
Eastern Europe							
Russia	1.8	-4.0	-3.5	-1.5	14.0	7.0	5.0
Turkey	0.8	5.0	2.5	2.5	73.0	45.0	25.0

Source: Berenberg

EU: Gas storage levels and gas supply from Russia



Russia's share of EU gas imports, in %, left scale. EU gas storage levels, difference from the average at the respective time in 2015-2020, in percentage points of capacity, right scale. Sources: Bruegel, EIG, Berenberg, January 2021 - January 2023.

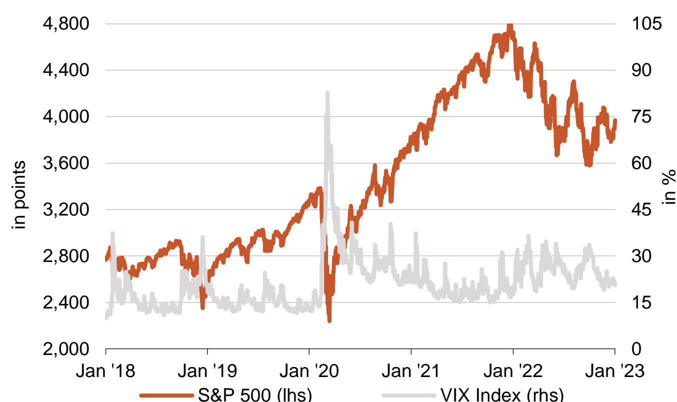
EQUITIES

January effect in full swing

Good start to the year thanks to forward guidance and technical buying. European equities and cyclicals outperform. China opening and absence of energy crisis offers potential for emerging markets and European equities. We maintain neutral positioning on equities as earnings, interest rate and economic risks still exist.

- The difficult year of 2022 was contrasted by a friendlier first few days of 2023. The empirically known January effect – the losers of the previous year were the winners of the first trading week and vice versa – also characterised the beginning of this year. There was also upward momentum from the optimists, who increasingly hoped for a "soft landing" thanks to disinflation and the still robust economic data. The averting of the energy crisis in Europe and short-covering also provided momentum. The end of the zero-COVID-19 policy in China is clearly positive for Asian equities, but also for European exporters, such as the luxury goods industry, for which China represents an important sales market.
- At **sector** and **style levels** in Europe, **cyclical stocks** in particular gained over the last four weeks. **Cyclical consumer goods** and **financials** were clearly ahead with a performance of roughly 7% and 5% respectively. However, selectivity is likely to be called for in cyclicals, as earnings estimates for 2023 are still demanding across the board. **Consumer staples** and **health stocks**, on the other hand, experienced slight losses. In the aggregate, **value** thus performed better than **growth**. **Regionally**, the US underperformed Europe. Both the better profit development and the more favourable valuation support European equities.
- We are sceptical about the rapid upward movement and are not chasing the recovery. This is because the risks of overly restrictive central banks, a stronger-than-expected global recession or earnings risk on the corporate side remain. The Q4 reporting season coming up in mid-January will provide a more detailed insight into the latter. Given the still unclear situation, we are maintaining our **neutral positioning**, also because we see real alternatives to equities.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 11/01/2018 - 11/01/2023.

Overview of equity markets (short/medium term)

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

	As of 11/01/2023	Total return in local currency ytd	1-year	3-year	P/E	Dividend yield
DAX	14,948	+7.4%	-6.2%	+10.9%	11.9	3.4%
SMI	3,517	+5.0%	-11.2%	+8.9%	16.7	3.1%
MSCI UK	2,220	+3.5%	+8.9%	+14.4%	10.1	4.3%
EURO STOXX 50	4,100	+8.2%	-0.8%	+18.1%	12.3	3.4%
STOXX EUROPE 50	9,559	+5.0%	+3.5%	+20.7%	12.7	3.5%
S&P 500	7,383	+3.4%	-14.8%	+25.8%	17.6	1.7%
MSCI Em. Markets	1,017	+6.4%	-15.6%	-2.9%	12.3	3.3%

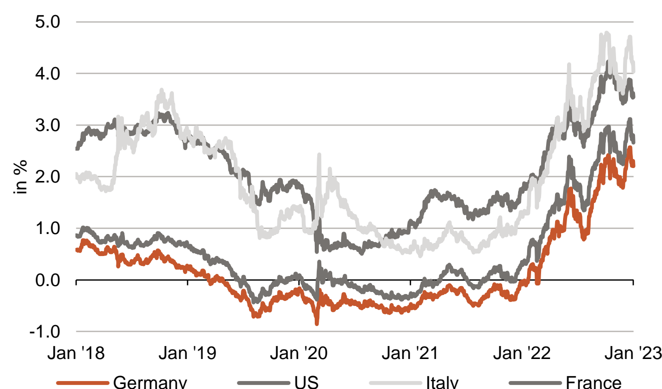
FIXED INCOME

High yield levels attract investors

Recovery rally analogous to equities. 10-year yields have fallen since the start of the year. Euro periphery spreads offer potential. Corporate bonds attractive with high yields and solid balance sheets. Local currency bonds preferred in emerging markets. Relative attractiveness of bonds over equities has risen markedly due to yield advantage. Duration: neutral.

- At year end 2022, central banks being considerably more restrictive than expected by the market led to new highs in European bond yields. The start of 2023, on the other hand, brought a recovery of bonds analogous to that of equities. Accordingly, the yield on 10-year **US government bonds** was just below 3.6% again after exceeding the 4% mark. In **Germany**, too, the yield on 10-year government bonds fell from over 2.5% in 2022 to roughly 2.2%. Looking at the European periphery, spreads between **Italian** and **German government bonds** rose in the aftermath of the ECB meeting and settled around the 2% level.
- In the case of **corporate bonds**, the market seems to have priced in the economic risks, especially in the investment grade segment. In addition, corporate balance sheets remain robust, defying ongoing supply chain problems and higher cost pressures caused by the pandemic and the Russia-Ukraine war. However, the high issuance volume of €25.2bn in the first trading week of 2023 poses increased saturation risk due to the catch-up effect after last year's below-average issuance and greater demand in the multi-asset investment context. We are constructive on corporate bonds and see bonds as an increasing alternative to equities.
- **Emerging market (EM) bonds** continued their recovery into the new year. Local currency bonds are likely to be the most attractive from a euro investor's perspective. Here, duration should help as a value driver, especially in the second half of the year.
- We are **maintaining the reduced underweight in bonds**, but are increasingly considering a further reduction of the underweight. With significantly higher current yields compared to the start of the previous year, we tend to favour bonds rather than equities for purchases.

Yields on 10-year government bonds



Source: Bloomberg, 11/01/2018 - 11/01/2023.

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 11/01/2023	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	213.47	+2.9%	-15.4%	-15.3%
Covered bonds (iBOXX Euro Germany Covered)	179.41	+1.7%	-11.3%	-12.2%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	139.45	+2.1%	-12.9%	-12.5%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	144.37	+0.6%	-9.5%	-8.6%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	533.27	+0.9%	-10.1%	-11.1%
High-yield bonds (ICE BofA Global High Yield Index)	406.13	+3.0%	-9.8%	-2.5%

COMMODITIES

Commodities with potential in the long term

Gold has limited diversification. Chances with Fed pivot.
Oil with opportunities on rising mobility in China.
Supply shortages support metals.

- **Gold** has gained 3% in US dollar terms since the beginning of the year. In addition to increased demand from central banks, the upward movement also seems to be driven by positive momentum. Looking ahead, technical factors such as a golden cross are likely to provide further support in the short term. Nevertheless, the diversification effect and the upside potential remain limited without a Fed turnaround.
- **Crude oil** continued its downward trend at the start of the year. While in the short term the recovery in demand in China is delayed due to high infection figures, in the medium term the possible increase in the strategic US reserve and in the long term the problem of years of underinvestment remain. Oil thus holds recovery potential.
- **Industrial metals** defied the fears of recession and received new impetus from the opening of China. In addition, there is the ongoing scarcity and repeated short-term production losses, which are offset by the increased demand due to decarbonisation.

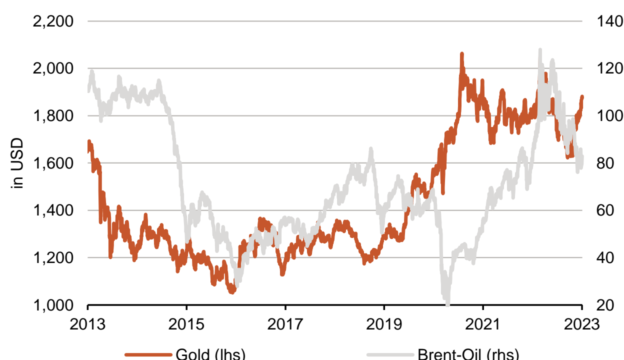
CURRENCIES

Improved outlook for the euro

EUR/USD: Euro continues to rise.
EUR/GBP: The pound falls back against the euro.
EUR/CHF: Franc strength unbroken.

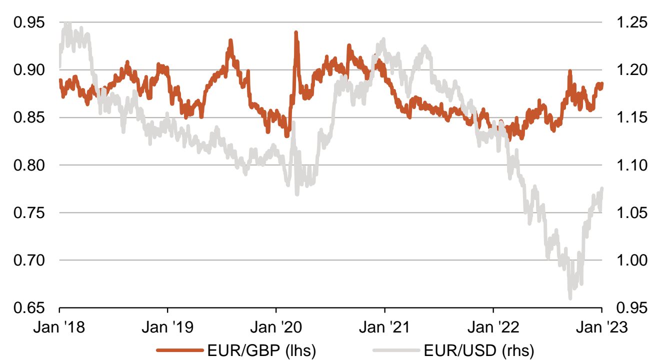
- **EUR/USD:** Our economic baseline scenario argues for a weaker US dollar in 2023. If there are no new political and economic disruptions this year, the risk appetite in the markets will continue to rise, so that the US dollar will lose more of its crisis-related attractiveness. For the euro, this means further upside potential. Monetary policy is also likely to strengthen the euro. While last year the ECB's hesitancy (and the US Fed's decisiveness) weighed on the euro exchange rate for a long time, no major monetary policy discrepancy is expected this year – and if it does, it will be to the detriment of the dollar, because the Fed could ease again sooner than the ECB. By the end of the year, the exchange rate could rise to around 1.15 US dollars per euro in such an environment.
- **EUR/GBP:** The British pound has regained its composure after the end of the politically explosive period in the autumn. However, the strengthening euro is putting pressure on the pound exchange rate.

Price development



Source: Bloomberg, 11/01/2013 - 11/01/2023.

Exchange rates



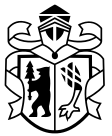
Source: Bloomberg, 11/01/2018 - 11/01/2023.

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 11/01/2023	ytd	1-year	3-year
Gold USD/ounce	1,876	+2.8%	+3.0%	+20.1%
Silver USD/ounce	23.4	-2.2%	+2.8%	+29.3%
Copper USD/pound	416.6	+9.3%	-5.9%	+48.1%
Brent USD/bbl	82.67	-3.8%	-1.3%	+27.2%

		Performance		
	As of 11/01/2023	ytd	1-year	3-year
EUR/USD	1.08	+0.5%	-5.4%	-3.3%
EUR/CHF	1.00	+1.3%	-4.6%	-7.4%
EUR/GBP	0.89	+0.0%	+6.2%	+4.0%
EUR/JPY	142.51	+1.5%	+8.7%	+17.1%



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
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Marco Höchst | Equities
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