BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

11 May 2023

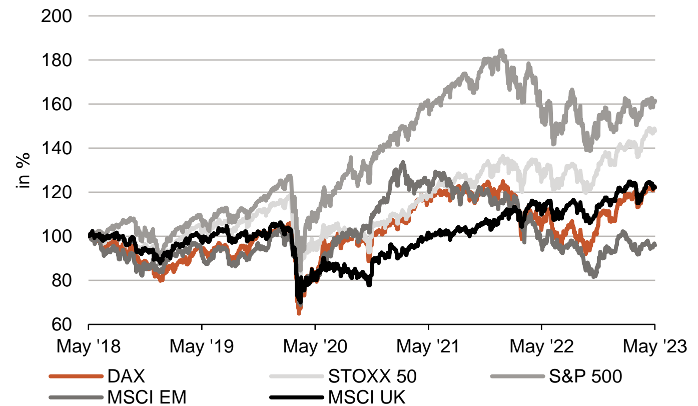
Managers of the Committee

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, 10/05/2018 - 10/05/2023.

Most important assessments at a glance

Economics	• USA: Bank quake triggers mild credit crunch and sends US economy into mild recession; recovery in 2024. • Europe: Domestic demand picks up, moderate growth in 2023, strong recovery after end of US recession in 2024. • Bank quake = US interest rate peak. Fed cuts rates from end 2023; ECB tightens, ECB rates remain high in 2024.
Equities	• Equities have recently been volatile and moving sideways. Q1 reporting season provided support, while recession concerns weighed. • Under the surface, investors are acting more sceptically. Cyclical stocks were the relative losers. • We have increased our equity underweight in light of increased risks (debt ceiling, credit crunch) and valuations.
Bonds	• Government bond yields in sideways trend. Recession concerns compensated for the rise in key interest rates. • Financial bonds were only able to shake off the bank worries temporarily. US high-yield bonds also under pressure. • We are now only slightly underweighted in bonds and plan to gradually increase our bond positions.
Commodities	• Gold benefited from banking and recession worries. All-time highs within reach. Upside limited without interest rate turnaround. • Crude oil prices are increasingly pricing in a recession, despite solid oil fundamentals. We remain optimistic in the medium term. • Industrial metals defy the economic worries. Short-term potential is limited. Long-term upward trend intact.
Currencies	• EUR/USD is fluctuating around the 1.10 mark. In the course of the year, the euro exchange rate should continue to rise. • The pound is gaining some momentum after a long lull. The euro is moving back towards 0.85. • The franc remains very strong. EUR/CHF is trading below parity. The upside potential for the euro is moderate.

Current market commentary

Equity markets have held up surprisingly well despite increasing risks. Global equities have gained slightly over the last four weeks. Driving factors were hopes for a Fed pivot in the second half of the year coupled with a soft landing for the economy, a better-than-expected reporting season and buying from systematic investment strategies. However, risks such as tightening central banks for longer than the market expected, credit squeeze due to bank turmoil, US debt debate and thus potential spending cuts, weak market breadth (most of the S&P 500 YTD performance driven by mega-cap), higher valuation levels, rising margin pressure and more vulnerable positioning again in the systematics are largely neglected. Under the surface, investors are already more sceptical, as can be seen for example in the outperformance of large- versus small-caps or the outperformance of defensive versus cyclical stocks. We have taken advantage of the strong equity market performance and reduced the equity quota further in an anti-cyclical manner - also against a background where bonds increasingly appear relatively attractive compared with equities. Bonds not only have a respectable yield in the meantime, but also diversify multi-asset portfolios thanks to the at least temporarily negative correlation again compared with equities. Despite continued high inflation and restrictive central bank policies (albeit already well advanced), yields have hardly risen recently. In addition to banking worries, emerging recession concerns have weighed on yields. The banking worries are not over yet, which is also shown by the recently rising risk premiums on financial bonds. High-yield bonds have also recently experienced a widening of spreads. We can imagine a further increase in the bond position.

Energy commodities suffered significantly from recession worries. Industrial metals, on the other hand, held up much better and gold, as a safe haven, approached its all-time high.

ECONOMICS

US Federal Reserve cushions banking crisis by raising its key interest rate less sharply

USA: Fed has reached interest rate peak. Mild recession in H2 2023. Fed cuts rates from end 2023.
Europe: Subdued recovery in 2023, services strong; strong growth in 2024 after end of US weakness.
Inflation peaks in the USA and Europe passed. Price pressures continue to decline. But core inflation still above 2% in 2024.

- **Creeping credit crunch:** The crisis of many regional banks in the USA is far from over. But it will not trigger a major financial crisis. Policymakers will not repeat the mistake of the disorderly Lehman bankruptcy. But in view of the turmoil, banks, especially in the USA, will reduce risks and limit their lending. To compensate, the Fed will probably not raise interest rates further. Europe's banks are more robust.
- **US on the way to a mild recession: T**he US economy has so far held up a little better than expected. But after housing, manufacturing is also slowly sliding into recession. The labour market is also losing momentum. We expect US economic output to decline slightly in the second half of the year before a new upswing begins in 2024. However, a soft landing without recession is possible.
- **Europe: stable in 2023, recovery in 2024.** Two major supply shocks have weighed heavily on Europe's economy over the past two years, pushing inflation up. But Europe (and Japan) are in the process of absorbing these shocks. Supply constraints have largely eased. As the gas situation has also improved, exchange prices for gas and electricity have eased noticeably. Therefore, the economy can grow moderately despite the headwind from the USA. This is mainly driven by additional demand for services. For 2024, the recovery in the USA is expected to lead to above-trend growth in Europe.
- **China: Short-term boost.** After the abrupt departure from the zero-COVID-19 policy, demand is rising, especially for services. Together with additional monetary and fiscal stimulus, China may experience a growth spurt for a few quarters. Since production in China is increasing at the same time, this will hardly fuel world inflation. For the global economy, however, the upswing in China and Japan only partially offsets the slight US recession.
- **Inflation has peaked:** Inflation is falling in the USA and Europe. In Europe, the explosion in 2022 energy and food prices is falling out of year-on-year comparisons. Supply chains are less disrupted. This also helps the economy and eases price pressures. However, the core rate of inflation remains high for now. Wage pressures are likely to keep inflation in the US and Europe above the central banks' 2% target in 2024.

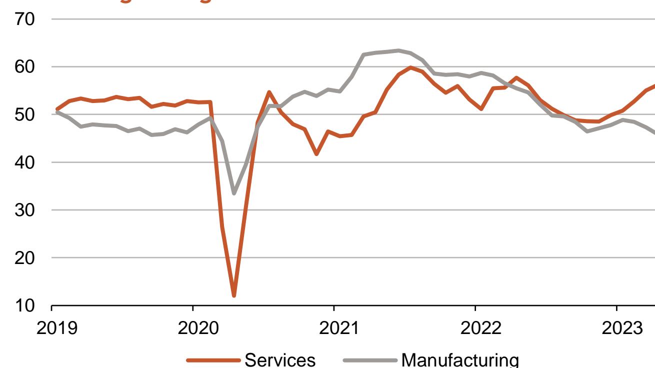
Fed at interest rate summit, ECB not yet. After the bank quake, the Fed will probably not go beyond a key interest rate of 5.25%. With inflationary pressures slowly abating, it may cut rates from late 2023 or at the start of the 2024 election year. The ECB will probably raise its deposit rate to 3.75% in July and then stay there for the time being.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	2.1	2.2	2.6			
US	23.7	0.8	0.4	2.2	4.2	2.6	2.4
China	18.3	5.7	4.1	4.0	1.9	2.4	2.3
Japan	5.1	1.3	1.2	1.6	2.3	1.2	0.8
India	3.3	6.5	6.7	6.0			
Latin America	5.2	1.0	2.4	2.5			
Europe	26.2	0.4	1.4	1.4			
Eurozone	15.0	0.8	1.5	1.5	5.4	2.4	2.4
Germany	4.4	0.0	1.4	1.5	6.1	2.4	2.5
France	3.0	0.8	1.7	1.7	5.7	2.4	2.5
Italy	2.2	1.1	1.1	1.1	6.1	2.0	2.4
Spain	1.5	2.0	1.8	2.0	3.4	2.8	2.7
Other Western Europe							
United Kingdom	3.3	0.3	1.5	1.7	6.9	2.1	2.4
Switzerland	0.8	0.6	1.4	1.2	2.2	1.3	1.5
Sweden	0.7	0.0	1.7	1.6	6.0	2.2	2.4
Eastern Europe							
Russia	1.8	-3.5	-1.5	-1.5	7.0	5.0	4.5
Turkey	0.8	2.5	2.5	2.0	45.0	25.0	20.0

Source: Berenberg

Purchasing managers' indices Eurozone



Above 50 = growth. Source: S&P, January 2019 - April 2023

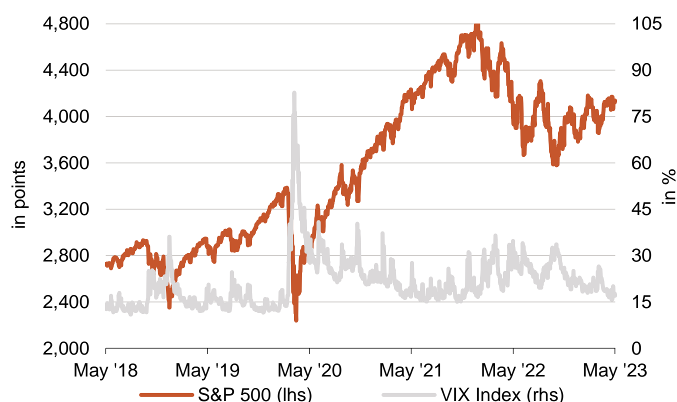
EQUITIES

Scepticism so far only under the surface

Equities have been volatile and moving sideways. Q1 reporting season provided support, while recession concerns weighed. Beneath the surface, investors are acting more sceptically. Cyclical stocks were the relative losers.
We have increased our underweight in light of increased risks (debt ceiling, credit crunch) and valuations.

- The **stock markets** have continued to gain since the beginning of April and thus remained true to their positive seasonal pattern. In addition to decreasing volatility, the better-than-expected reporting season provided support. Besides Latin American stocks, European stocks were the best performers. US equities gained slightly, while Chinese equities lost value amid disappointing reopening momentum and geopolitical risks.
- However, the positive development on the stock markets could not be observed across the board. On the S&P 500, for example, it was mainly the mega-caps that were responsible for the positive development. Under the surface in Europe, **defensive stocks** clearly outperformed **cyclical stocks**. At the sector level, **health care** and **consumer goods stocks** shone above all over the last four weeks. **Energy, technology** and **communications stocks,** on the other hand, were left behind. In addition, **large caps have** performed better than **small caps**. **Growth stocks** also outperformed **value stocks** recently.
- With recent central bank rate hikes, the likelihood of a credit crunch in the coming months has increased once again. This, coupled with arguably declining liquidity (US debt ceiling, QT) and rising US unemployment in the coming months, should significantly limit the potential for risk assets. Given the diversity of risks and low risk premiums, we feel comfortable with our more cautious and still broadly diversified allocation.
- As equity valuations have risen significantly recently and systematic strategies are now more heavily invested again, which increases the potential drop in equities, we have recently reduced our equity exposure from a small to a **moderate underweight.**

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 10/05/2018 - 10/05/2023.

Overview of equity markets (short/medium term)

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

	As of 10/05/2023	Total return in local currency ytd	1-year	3-year	P/E	Dividend yield
DAX	15,896	+14.2%	+17.4%	+45.8%	11.6	3.4%
SMI	3,663	+9.3%	+0.6%	+21.8%	19.3	3.0%
MSCI UK	2,222	+5.1%	+10.5%	+47.4%	10.8	4.2%
EURO STOXX 50	4,307	+15.8%	+25.5%	+62.9%	12.5	3.5%
STOXX EUROPE 50	10,174	+11.7%	+17.6%	+52.3%	13.7	3.4%
S&P 500	7,724	+8.2%	+4.7%	+46.0%	18.9	1.7%
MSCI Em. Markets	980	+3.2%	+0.6%	+16.7%	12.5	3.1%

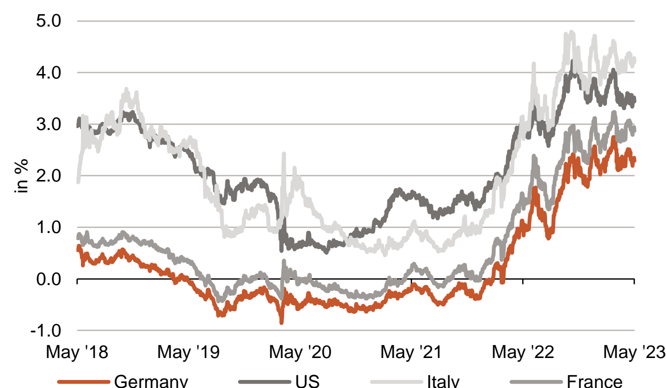
FIXED INCOME

Yields show disorientation

Government bond yields in sideways trend. Recession concerns compensated for the rise in key interest rates. Financial bonds were only able to shake off the bank worries only temporarily. US high-yield bonds also under pressure. We are now only slightly underweight in bonds and plan to gradually increase our positions further.

- **Yields** on safe **10-year government bonds** have recently fluctuated sideways in a volatile manner. Although many central banks continued to raise interest rates, increasing concerns about recession offset this. The German and US yield curves remain inverted and continue to point to a recession - even if the US curve is now significantly less inverted than in March. The market is pricing in several rate cuts by the Fed by the end of the year - the first already in September.
- On the **corporate bond market,** concerns about the banking sector eased only temporarily. **Financial bonds,** after a significant decline at the beginning of April, recently experienced significantly rising spreads again with new bank bankruptcies. In addition to financial bonds, **high-yield bonds** also reacted to the uncertain situation and deteriorating financing conditions. Spreads on US high-yield bonds are again trading close to the level of mid-March (SVB banking crisis). In **emerging market bonds,** we prefer the local currency segment with low duration and attractive current yield.
- In an environment of heightened uncertainty, we **prefer bonds** to equities. In corporate bonds, we allocate to attractive special themes such as cat bonds in addition to classic credit segments. Among the more secure bonds, we prefer covered bonds to pure government bonds, as they offer an attractive excess return. Looking ahead, we can imagine gradually reducing our bond underweight and increasing the duration - also because the equity-bond correlation is clearly negative again with increasing recession concerns.

Yields on 10-year government bonds



Source: Bloomberg, 10/05/2018 - 10/05/2023.

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	→	→

	As of 10/05/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	212.57	+2.4%	-7.7%	-15.5%
Covered bonds (iBOXX Euro Germany Covered)	179.80	+1.9%	-4.7%	-12.3%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	140.63	+3.0%	-3.9%	-9.6%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	146.10	+1.8%	-2.8%	-5.3%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	525.78	-0.5%	-2.8%	-4.3%
High-yield bonds (ICE BofA Global High Yield Index)	411.10	+4.3%	+2.8%	+9.9%

COMMODITIES

Precious metals en vogue thanks to bank worries

Gold heading for all-time high thanks to uncertainty.
Oil under great pressure without specific news.
Metals defy worse economic data.

- **Gold** benefited as a safe haven from the banking and recession worries and is within reach of its all-time high. The fact that neither speculative nor ETF investors are strongly positioned is positive. For a sustained upward movement, however, the US dollar would now have to depreciate further and/or real interest rates would have to fall, because gold is now very highly valued.
- **Crude oil** was on a steady downward trend in April, although negative oil-specific news was absent. Supply remains tight: US production is stagnating and OPEC is implementing planned production cuts. Demand, on the other hand, is picking up: US inventories are falling, contrary to seasonality, and consumption is rising strongly in China. Oil is nevertheless not rising, but is already pricing in a recession.
- **Industrial metals are** defying the poorer economic data and have recently been fluctuating sideways. Inventories point to further tight supply. In the short term, the potential is limited; in the long term, we remain optimistic.

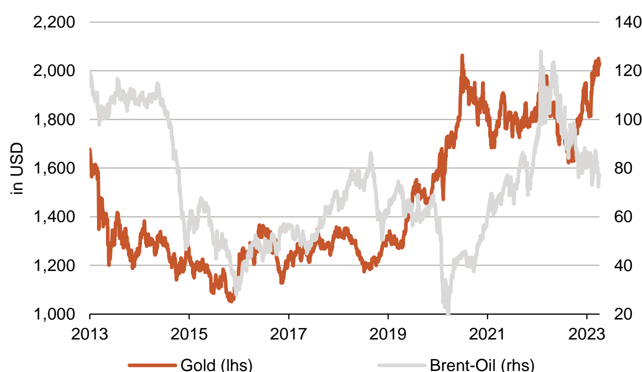
CURRENCIES

Euro on the expected path

EUR/USD: dollar with less shine.
EUR/GBP: pound gains a little again.
EUR/CHF: the Swiss franc remains very stable.

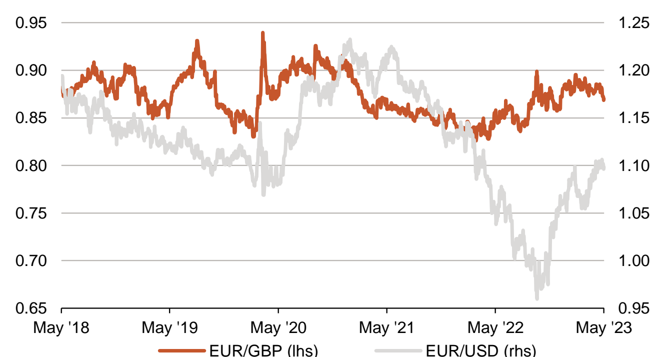
- **EUR/USD:** In general, there is still a lot of uncertainty in the market: When will the recession start in the US? How quickly will inflation weaken (further)? How much will credit and financing conditions tighten? When will the central banks pause? In addition, the discussion about the US debt ceiling is currently in focus. In terms of monetary policy, there is much to suggest that the interest rate differential between the eurozone and the US will narrow. The US Federal Reserve will probably not raise interest rates any further, while the ECB is likely to make two more small rate hikes. We expect euro rates to move even a little higher in the course of the year.
- **EUR/GBP:** The Bank of England had already seemed to have reached the end of the interest rate cycle, but the unexpectedly high March inflation (10.1%; core rate: 6.2%) is forcing it to tighten further. The pound is gaining a little.

Price development



Source: Bloomberg, 10/05/2018 – 10/05/2023.

Exchange rates



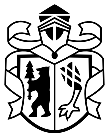
Source: Bloomberg, 10/05/2018 – 10/05/2023.

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 10/05/2023	ytd	1-year	3-year
Gold USD/ounce	2,030	+11.3%	+10.4%	+19.2%
Silver USD/ounce	25.4	+6.0%	+19.5%	+64.1%
Copper USD/pound	382.8	+0.5%	-7.9%	+58.9%
Brent USD/bbl	76.41	-11.1%	-25.4%	+146.7%

		Performance		
	As of 10/05/2023	ytd	1-year	3-year
EUR/USD	1.10	+2.6%	+4.3%	+1.3%
EUR/CHF	0.98	-1.3%	-6.8%	-7.1%
EUR/GBP	0.87	-1.7%	+1.7%	-0.4%
EUR/JPY	147.56	+5.1%	+7.4%	+27.8%



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
Zinzile Dube | Fixed Income
Ludwig Kemper | Commodities, Minutes
Karsten Schneider | Minutes

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