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Markets

INVESTMENT COMMITTEE MINUTES

09 June 2023

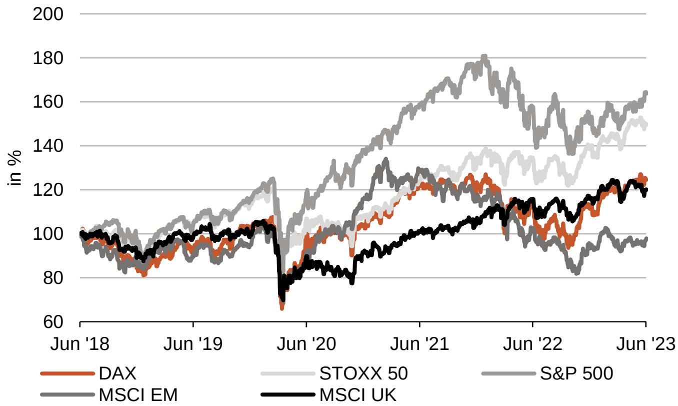
Managers of the Committee

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, 06/06/2018 - 06/06/2023.

Most important assessments at a glance

Economics	• US: Bank quake and higher financing costs send US economy into mild recession. Recovery 2024. • Europe: Consumer purchasing power recovers, but headwinds for industry from abroad. Hardly any growth in 2H 2023. • Inflation declining, rate peak almost reached. Fed cuts rates from end 2023; ECB tightens further, its rates remain high in 2024.
Equities	• Equities in May with performance heterogeneity. Stabilising earnings expectations and AI hype are supporting. • Under the surface, investors act more sceptically. Low market breadth and falling net liquidity as risks. • We maintain our balanced, non-offensive positioning with a moderate underweight in equities.
Bonds	• Government bond yields in sideways trend. Preference for covered bonds over pure government bonds. • Financial bonds were only able to shake off the bank worries temporarily. However, we expect catch-up potential. • We have continued to increase bonds and duration across segments and are now positioned close to neutral.
Commodities	• Gold burdened by real interest rate and USD strength after leap towards all-time high. Potential limited without interest rate pivot. • Crude oil prices decoupled from fundamentals. Demand potential in China and services sector with supply still tight. • Industrial metals suffer from sluggish economic recovery in China. Long-term upward trend intact.
Currencies	• EUR/USD back at 1.07. In the short term, the euro is facing headwinds. However, it should rise again in the course of the year. • The pound has strengthened further. Monetary policy is providing tailwinds. EUR/GBP falls back to 0.86. • Nothing new with the franc: The Swiss currency remains very strong. EUR/CHF is trading at 0.97, well below parity.

Current market commentary

Equity markets remained robust despite prevailing economic concerns. US and Japanese equities in particular rose. Driving factors were the AI hype and the hope for a Fed pause, rebounding earnings expectations as well as purchases of systematic investment strategies. However, risks such as tightening central banks for longer than the market expected, credit crunches due to the banking turmoil, falling net liquidity, weak market breadth, higher valuation levels, rising margin pressure and renewed vulnerable positioning among systematic investors remain. Beneath the surface, the narrow market breadth and outperformance of large- versus small-caps is evidence of low investor conviction. We remain cautiously positive and maintain our balanced, non-offensive positioning with a moderate underweight in equities.

Bonds not only offer an attractive yield, but also diversify multi-asset portfolios thanks to their negative correlation to equities. Yields on safe government bonds continued their volatile sideways movement in May. In the case of safe bonds, we prefer covered bonds to pure government bonds due to the attractive excess yield. US financial bonds remain burdened by the US banking worries, as shown by the rising risk premiums. We remain cautious here and focus on systemically important large European banks. We have continued to increase bonds and duration across segments and are now positioned close to neutral.

Gold as a safe haven initially approached all-time highs, but then the headwinds from a stronger US dollar and higher real interest rates prevailed. Without an interest rate cut, the fundamental upside potential remains limited. Energy commodities and industrial metals suffered from economic concerns, especially in China, as well as systematic selling. However, with a sustained economic recovery, the situation is likely to turn around quickly.

ECONOMICS

US economy slowly losing momentum, China disappointing, Europe weakening until early 2024

US: Soft landing possible, but mild recession in 2H 2023 remains likely. Fed to cut interest rates from end of 2023.
Europe: Services strong, but headwinds from abroad; noticeable growth only after US weakness ends.
Inflation peaks passed in the US and Europe. Price pressures continue to decline. But core inflation still above 2% in 2024.

- **Creeping credit crunch in the US:** In view of the problems of many regional banks, US banks are restricting their lending. This reinforces the braking effect of the higher key interest rates. Europe's banks are more robust.
- **US heading into a mild recession:** So far, the US economy has held up a little better than expected. But after housing, manufacturing has also slipped into recession. The labour market is also slowly losing momentum. We expect US economic output to decline slightly in the second half of the year before a new upswing begins in spring 2024. However, a soft landing without recession is possible.
- **Europe: More purchasing power...** Two major supply shocks have weighed heavily on Europe's economy in 2021 and 2022, pushing inflation up. But Europe (and Japan) are weathering these shocks. Supply bottlenecks have largely dissipated, and exchange prices for gas and electricity have eased noticeably. From summer onwards, wages will probably rise faster than prices. Thanks to higher purchasing power, consumers are likely to demand more goods and services.
- **… but headwinds for manufacturing.** In the aftermath of the pandemic, there is pent-up demand in large parts of the world for services, but not for goods. In the US, industrial production is declining, in China consumers are spending more on services, while demand for capital goods is weakening. Demand for exports from Europe is suffering as a result. Therefore, economic activity in Europe will remain very subdued for the time being. Only in spring 2024, with the recovery in the US, is stronger growth on the horizon for Europe.
- **China: Short-term boost.** After the abrupt departure from the zero-covid policy, demand is rising, especially for services. So far, however, the recovery has been more restrained than expected. Whether China can also experience a growth spurt in the summer after a good start to 2023 depends on whether monetary and fiscal policy switches to an expansionary course. So far, there are no signs of this happening.
- **Inflation has peaked:** Inflation is falling in the US and Europe. In Europe, the explosive rise in energy and food prices of 2022 falls out of the year-on-year comparison. However, the core rate of inflation will remain high for the time being. Wage pressures should ensure that inflation in the US and Europe remains above the central banks' 2% target in 2024.

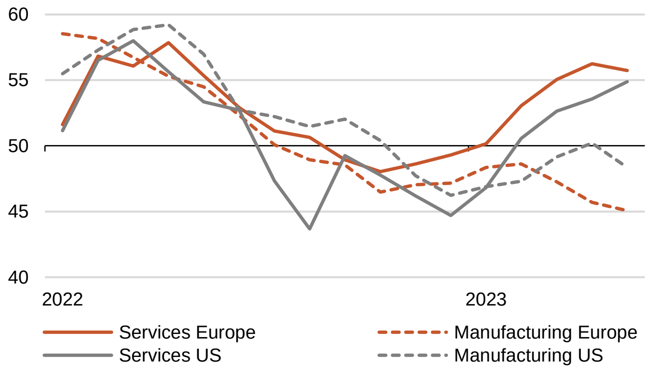
Interest rate peak in sight. As the economy and inflation are slowly weakening, the Fed will probably raise its key interest rate only once more, to 5.5%. If inflationary pressures continue to ease, it may cut rates from the end of 2023 or at the start of the 2024 election year. The ECB will probably raise its deposit rate in June and July by 25 basis points each to then 3.75%, and then stay there for the foreseeable future.

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	1.1	0.5	2.0	4.2	2.6	2.4
China	18.3	5.7	4.1	4.0	1.3	2.6	2.2
Japan	5.1	1.1	1.2	1.3	3.0	1.8	1.3
India	3.3	6.5	6.7	6.0			
Latin America	5.2	1.0	2.4	2.5			
Europe	26.2	0.3	1.2	1.6			
Eurozone	15.0	0.5	1.2	1.8	5.2	2.4	2.4
Germany	4.4	-0.4	1.3	1.7	5.8	2.3	2.5
France	3.0	0.6	1.5	1.7	5.3	2.2	2.5
Italy	2.2	1.1	1.0	1.2	6.1	2.1	2.4
Spain	1.5	1.9	1.6	2.1	3.2	2.7	2.7
Other Western Europe							
United Kingdom	3.3	0.4	1.2	1.7	7.3	2.4	2.2
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 manager indices Europe and US



Europe: 80% Eurozone and 20% UK. Sources: Markit, Berenberg, January 2022 - May 2023

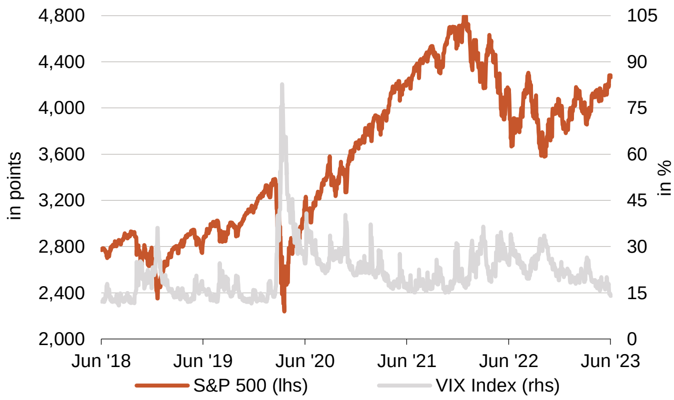
EQUITIES

Low market breadth as a warning signal

Equities in May with performance heterogeneity. Stabilising earnings expectations and AI hype are supporting. Under the surface, investors operate more sceptically. Low market breadth and falling net liquidity as risks. We maintain our balanced, non-offensive positioning with a moderate underweight in equities.

- The **equity markets** were characterised by significant performance heterogeneity in May. While Japanese and US equities rose, European equities were flat after strong outperformance at the beginning of the year and in Q4 2022. Japanese equities benefited from strong inflows from international investors, US equities from the hype around artificial intelligence and a stabilisation of earnings expectations.
- Beneath the surface, the narrow market breadth is a testament to investors' low conviction. The S&P 500, for example, would be unchanged since the beginning of the year without the ten strongest performers. At the sector level, **technology** and **industrial stocks** have shone in Europe over the last four weeks. **Communications**, **consumer staples** and **utilities** lagged. Thus, **cyclicals** clearly outperformed **defensive stocks**. In addition, **large caps** and **growth stocks** outperformed **small caps** and **value stocks**.
- In addition to the economic risks (negative indicators, rising US unemployment, credit crunch), a sharp drop in net liquidity is likely to become a headwind for the markets in the coming months. Within the equity regions, emerging markets offer the greatest surprise potential. Overall, we consider the upside potential to be fundamentally limited. We consider the cyclical outperformance to be unjustified and position ourselves rather defensively (given the risks and risk-reward). However, a massive sell-off is unlikely for positioning reasons, which again speaks for a moderate underweight. Growth and quality stocks are becoming increasingly attractive, as the valuation correction has already taken place and the fundamental dynamics should offer protection against the uncertainties for the equity market in the rest of the year.
- As valuations have risen and systematic strategies are more heavily invested again, which makes the market vulnerable, we are maintaining the **moderate underweight** for the time being.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 06/06/2023 - 06/06/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 06/06/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,992	+14.9%	+9.1%	+24.5%	11.2	3.5%
SMI	3,653	+9.0%	+0.7%	+17.0%	18.2	3.0%
MSCI UK	2,184	+3.8%	+3.5%	+33.5%	10.3	4.3%
EURO STOXX 50	4,295	+16.3%	+15.9%	+40.1%	12.2	3.6%
STOXX EUROPE 50	10,154	+11.5%	+11.6%	+40.4%	13.3	3.5%
S&P 500	8,007	+12.2%	+5.2%	+38.7%	19.6	1.6%
MSCI Em. Markets	988	+4.4%	-4.7%	+7.0%	13.0	3.0%

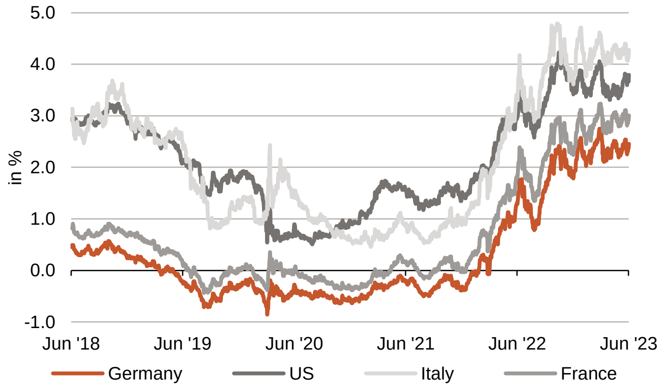
FIXED INCOME

Duration increasingly attractive

Government bond yields in sideways trend. Preference for covered bonds over pure government bonds. Financial bonds were only able to shake off the bank worries temporarily. However, we expect catch-up potential. We have continued to increase bonds and duration across segments and are now positioned close to neutral.

- **Yields** on safe **10-year government bonds** continued to fluctuate volatilely sideways throughout May. While lower-than-expected May inflation data pushed German government bond yields to the 2.3%-mark, high inflation data in the UK lifted gilt yields to over 4.2%. The German and US yield curves have now been inverted for several months and continue to point to a recession. While the market was still expecting the first Fed rate cut in September a few weeks ago, the market now considers rate cuts for 2023 rather unlikely.
- On the **corporate bond market**, European **high-yield** and **IG bonds** rose only slightly in the second quarter, with risk premiums remaining attractive. However, **US financial bonds**, which still could not shake off the worries from the banking sector, deserve special mention. As a result, risk premiums widened noticeably compared to **non-financial bonds**. In **emerging market bonds**, we continue to prefer the local currency segment with low duration and attractive current yields.
- In an environment of heightened uncertainty, we **prefer bonds** to equities. In the case of safe bonds, we prefer covered bonds to pure government bonds due to the attractive additional yield. In the case of financial bonds, we remain cautious in view of the problems in the US banking sector and concentrate on the systemically important major European banks. We have continued to increase bonds and duration across segments and are now positioned close to neutral. We do not expect any new highs in yields for the time being, which is why the increase in duration appears opportune if economic risks persist.

Yields on 10-year government bonds



Source: Bloomberg, 06/06/2018 - 06/06/2023.

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 06/06/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	212.15	+2.2%	-5.2%	-15.7%
Covered bonds (iBOXX Euro Germany Covered)	179.38	+1.7%	-4.0%	-12.3%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	139.79	+2.3%	-3.0%	-11.3%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	146.46	+2.1%	-2.2%	-7.1%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	541.48	+2.5%	+0.3%	-4.1%
High-yield bonds (ICE BofA Global High Yield Index)	410.51	+4.1%	+1.0%	+1.6%

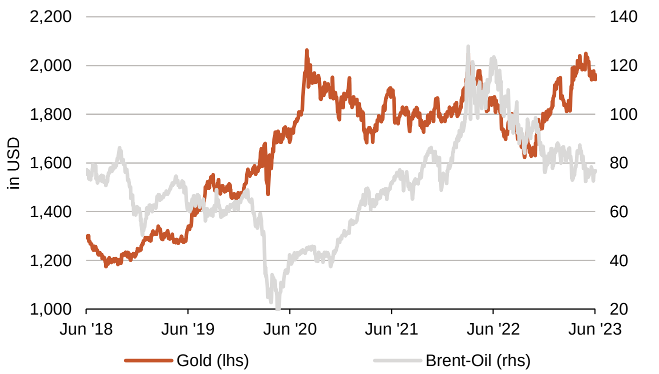
COMMODITIES

Oil and metals fundamentally solid in the mid-term

Gold needs interest rate cuts for a sustained recovery.
Oil fundamentally on solid grounds.
Metals show strong long-term potential.

- **Gold** initially rose towards an all-time high at the beginning of May as a safe haven. However, with the settlement of the US debt dispute and the end of the US banking worries, the strong US dollar and high real interest rates finally prevailed. Only an interest rate pause is likely to provide little tailwind; only the Fed pivot promises more potential. With risks persisting, gold nevertheless remains an important hedge.
- **Crude oil** continued its volatile sideways movement since the beginning of the year in Q2. Fundamentally, supply remains tight: US drilling activity is falling, investment is lacking and OPEC is lowering its production target for 2024. Nevertheless, oil demand is rising, driven by the recovery in China and the service sector.
- **Industrial** metals came under increasing pressure in Q2 with tepid economic data, especially from China. However, the long-term picture remains intact. The low inventory levels in combination with demand from the energy transition provide plenty of upside potential.

Price development



Source: Bloomberg, 08/05/2018 - 06/06/2023.

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

		Performance		
	As of 06/06/2023	ytd	1-year	3-year
Gold USD/ounce	1,964	+7.6%	+6.6%	+16.5%
Silver USD/ounce	23.6	-1.6%	+6.8%	+35.3%
Copper USD/pound	376.9	-1.1%	-15.0%	+47.5%
Brent USD/bbl	76.29	-11.2%	-36.2%	+80.4%

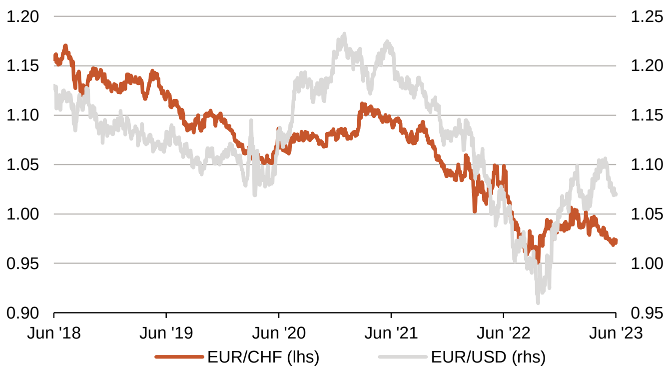
CURRENCIES

Setback for the euro

EUR/USD: Short-term outlook gloomy.
EUR/GBP: The pound continues to strengthen.
EUR/CHF: Swiss currency chronically strong.

- **EUR/USD:** In the short term, the outlook for the euro has dimmed. The exchange rate has fallen from above 1.10 US dollars per euro to below 1.07. The economy in the eurozone is developing somewhat weaker than expected and the ECB could thus end its cycle of interest rate hikes somewhat earlier after only two more small interest rate steps. In addition, it has become clear that the US Federal Reserve has not yet reached the end of its interest rate hikes and that it is likely to make another rate hike of 25 basis points. In the short term, therefore, the euro is facing headwinds. For the rest of the year, however, we expect the highs of the year so far to be reached again and then exceeded. Our forecast for the end of the year is USD 1.15 per euro.
- **EUR/CHF:** The euro remains well below parity against the franc. The Swiss National Bank (SNB) is counting on a strong currency to dampen inflation. But for how long? In May, inflation fell to 2.16%.

Exchange rates



Source: Bloomberg, 06/06/2018 - 06/06/2023.

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 06/06/2023	ytd	1-year	3-year
EUR/USD	1.07	-0.1%	-0.0%	-5.3%
EUR/CHF	0.97	-1.9%	-6.5%	-10.7%
EUR/GBP	0.86	-2.8%	+0.8%	-3.4%
EUR/JPY	149.32	+6.3%	+5.9%	+20.7%

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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Robert Reichle | Fixed Income
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