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Markets

INVESTMENT COMMITTEE MINUTES

06 July 2023

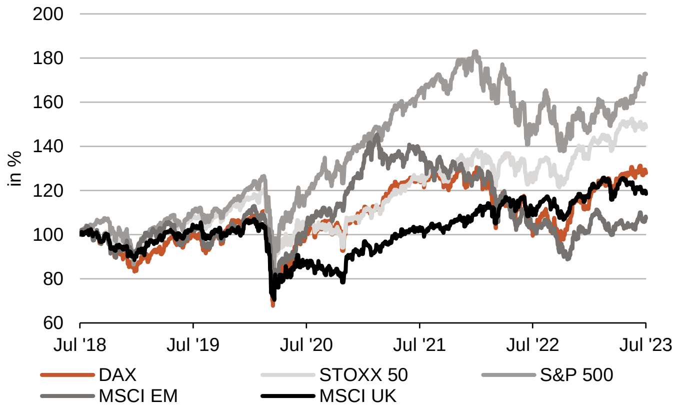
Managers of the Committee

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, 05/07/2018 - 05/07/2023.

Most important assessments at a glance

Economics	• US: economy more robust than expected, mini-recession H2 2023 likely, soft landing possible. Upswing 2024. • Europe: Consumer purchasing power recovering, but headwinds for industry from abroad. Hardly any growth in H2 2023. • Inflation declining, interest rate peak almost reached. Fed cuts rates early 2024; ECB tightens further, its rates remain high in 2024.
Equities	• Equities in June with performance heterogeneity. Cyclicals outperform defensive stocks. • High positioning makes markets vulnerable to setbacks. Recession risks and falling net liquidity remain risks. • We maintain our balanced, non-offensive positioning with a moderate underweight in equities.
Bonds	• Duration of sovereign and covered bonds recently hindered performance but will be a performance driver in the future. • The relative valuation of investment grade corporate bonds is now much more attractive than high yield bonds. • We continue to be positioned close to neutral in duration with a rising focus on rate duration instead of spread duration
Commodities	• Gold burdened by general risk-on sentiment. Potential without an interest rate cut currently fundamentally limited. • Oil has stabilised recently thanks to a declining supply surplus. Further production cuts should provide tailwind. • Industrial metals are pricing in weaker manufacturing. Supply remains tight, however. Long-term upward trend intact.
Currencies	• EUR/USD currently without a clear trend. At the current rate of USD 1.09 per euro, the euro has some room to move upwards. • The tighter monetary policy continues to give the GBP stability. EUR/GBP is firming at GBP0.86 per EUR. • Switzerland has managed to push the inflation rate back below the 2% mark. The CHF remains strong.

Current market commentary

Equity markets knew almost only one direction in June. Although rebalancing flows, hawkish statements by central banks and the ongoing withdrawal of liquidity temporarily led to downward pressure, the trend quickly turned upwards again. US and Latin American equities in particular rose. Under the surface, cyclical stocks dominated defensive stocks. In the coming weeks, the Q2 reporting season should bring investor focus back to fundamentals. The currently expected decline in earnings limits the downside surprises. However, the outlook of the companies will be decisive. With risks remaining (tighter central banks, falling net liquidity and vulnerable positioning), we remain cautiously positive and stick to 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 again negative correlations to equities. Yields on safe government bonds rose slightly in June in the face of stubbornly high core inflation. In the maturity spectrum of up to three years, we prefer covered bonds to corporate bonds with strong credit ratings due to the attractive additional yield and better rating. In the case of financial bonds, we see potential for narrowing due to the continued increase in risk premiums. With a view to an imminent peak of the interest rate increase cycle, we continue to position the portfolio duration close to neutral against the benchmark. With yields rising, a duration overweight could increasingly make sense opportunistically.

Gold suffered in June from solid US economic data, restrictive central bank rhetoric and general risk-on sentiment. Without an interest rate cut, the fundamental potential remains limited. Energy commodities and industrial metals suffered from mixed economic and fundamental data. However, with a sustained economic recovery, the tide should turn quickly.

ECONOMICS

US economy more robust than expected, China disappoints, Europe weakening until spring 2024

US: Soft landing possible, but a mini recession in H2 2023 remains likely. Fed to cut interest rates from early 2024.
Europe: Services robust, strong headwinds for industry; noticeable growth only after US weakness ends.
Inflation peak passed. Price pressures continue to ease, but core inflation will stay above 2% in the US and Europe in 2024.

- **US economy loses momentum:** So far, the US economy has held up better than expected, but the manufacturing sector has 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, with interest-rate-sensitive housing construction already stabilising after a sharp correction, the chances of a soft landing without recession are increasing.
- **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 disappeared, and exchange prices for gas and electricity have eased noticeably. From summer onwards, wages will probably rise faster than prices. Thanks to greater purchasing power, consumers are likely to demand more goods and services.
- **... but there are headwinds for manufacturing:** In the aftermath of the COVID-19 pandemic, there is a backlog of demand for services in large parts of the world, 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. In addition, there is an inventory correction in industry. Therefore, the economy in Europe will hardly grow for the time being. A slight recession is possible. Only in spring 2024, with the recovery in the US, is stronger growth on the horizon for Europe.
- **China weaker than expected:** After its abrupt departure from the zero-COVID-19 policy, China's recovery has so far been much more restrained than expected, especially in the industrial sector. This is weighing on world trade. China's long-term problems (demographics, state control, credit overhang) are becoming increasingly apparent. We expect only modest monetary and fiscal stimulus as the government does not want to exacerbate credit problems through fees.
- **Inflation slowly declining:** Inflation is declining in the US and Europe. In Europe, the explosive rise in energy and food prices in 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.

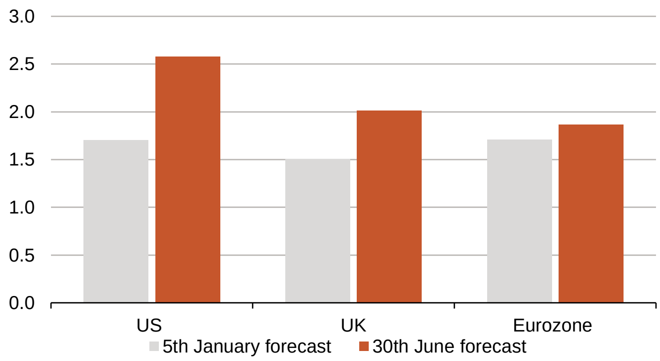
Interest rate peak in sight. The US Fed will probably raise its key interest rate again in July, to 5.5%. If inflationary pressures continue to abate, it may lower rates from the beginning of 2024. The ECB will probably raise its deposit rate again in July by 25 basis points to 3.75%. After that, it could stay there for the foreseeable future. Risk: ECB and Fed go 25 basis points further than we currently expect.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	2.2	2.1	2.6			
US	23.7	1.5	0.6	1.8	4.1	2.6	2.4
China	18.3	5.3	3.9	3.9	1.1	2.5	2.2
Japan	5.1	1.2	1.1	1.3	2.9	1.7	1.3
India	3.3	6.0	6.5	6.0			
Latin America	5.2	1.5	2.2	2.2			
Europe	26.2	0.3	1.2	1.7			
Eurozone	15.0	0.3	1.2	1.8	5.3	2.5	2.5
Germany	4.4	-0.4	1.2	1.7	5.9	2.3	2.5
France	3.0	0.5	1.4	1.7	5.4	2.3	2.5
Italy	2.2	1.1	1.0	1.2	6.1	2.0	2.4
Spain	1.5	2.2	1.6	2.1	3.3	2.8	2.7
Other Western Europe							
United Kingdom	3.3	0.4	1.0	1.7	7.6	2.7	2.0
Switzerland	0.8	0.6	1.4	1.2	2.4	1.5	1.5
Sweden	0.7	0.0	1.2	1.2	6.5	2.3	2.3
Eastern Europe							
Russia	1.8	-2.0	-1.0	-0.5	6.5	5.0	4.5
Turkey	0.8	3.0	2.8	2.5	45.0	35.0	30.0

Source: Berenberg

Better growth expectations for the US and Europe



Cumulative real GDP growth for Q4 2024 over Q3 2022, in percent; comparison of Berenberg forecasts of 5 January and 30 June 2023. Source: Berenberg

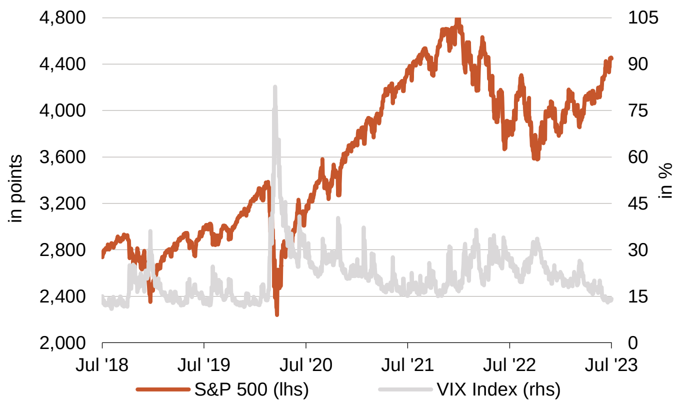
EQUITIES

Equity markets vulnerable to a setback

Equities in June with performance heterogeneity. Cyclicals outperform defensive stocks.
High positioning makes markets vulnerable to setbacks. Recession risks and falling net liquidity remain risks.
We maintain our balanced, non-offensive positioning with a moderate underweight in equities.

- **Equity markets** were characterised by regional performance heterogeneity in June: Asian equities brought up the rear, while Latin American and US equities led the way. Temporarily, rebalancing flows, hawkish statements by central banks and the ongoing withdrawal of liquidity led to downward pressure, but this was quickly recovered. Under the surface, the outperformance of cyclicals over defensive stocks is evidence of renewed risk-on sentiment among investors. The risk appetite is also reflected in the futures positioning for the S&P 500, which is at its highest level in the last 10 years.
- At the sector level, **utilities, cyclical consumer goods** and **energy stocks** have performed well in Europe over the last four weeks**. Industrial** and **health care stocks**, on the other hand, were left behind. **Value stocks** were clearly ahead of **growth stocks** over the last four weeks, and **large caps** outperformed **small caps** in Europe.
- The upcoming Q2 reporting season should shift investor focus back towards fundamentals. Currently, earnings are expected to decline by around 5% for the S&P 500, which limits the scope for negative surprises. For H2, consensus expectations show significant earnings growth, so the corporate outlook will be crucial. As valuations have risen, investors are increasingly optimistic and systematic strategies are more invested again, which makes the market vulnerable, we are maintaining the **moderate underweight** for the time being.
- Regionally, we remain cautious with regard to the US. With the recent US outperformance, valuations have risen further relative to Europe. We are therefore maintaining our current **underweight** and are not chasing the trend.
- Especially in view of the expected economic slowdown, our **focus on quality and growth stocks** remains justified.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 05/07/2018 - 05/07/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 03/07/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	16,081	+15.5%	+25.5%	+28.4%	11.3	3.5%
SMI	3,579	+6.8%	+5.0%	+14.8%	18.1	3.1%
MSCI UK	2,150	+2.4%	+7.9%	+38.5%	10.4	4.3%
EURO STOXX 50	4,398	+19.1%	+32.2%	+46.8%	12.5	3.5%
STOXX EUROPE 50	10,139	+11.3%	+19.0%	+42.7%	13.4	3.5%
S&P 500	8,334	+16.7%	+17.9%	+47.1%	20.4	1.6%
MSCI Em. Markets	1,005	+6.7%	+4.6%	+5.7%	13.5	3.0%

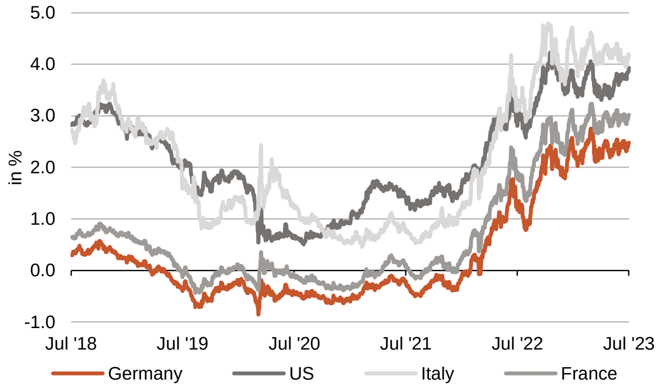
FIXED INCOME

High-yield segment increasingly unattractive compared to investment grade

Duration of sovereign and covered bonds recently hindered performance but will be a performance driver in the future. The relative valuation of investment grade corporate bonds is now much more attractive than high yield bonds. We continue to be positioned close to neutral in duration with a rising focus on rate duration instead of spread duration.

- **Yields on 10-year government bonds** rose slightly in June in the face of stubbornly high core inflation. A more pronounced movement was seen at the short end of the yield curve, where the **2-year Bund and US Treasury yields** each shot up by almost 50 basis points. The US yield curve has now been inverted for over a year, while the Bund curve is approaching the post-German reunification highs of inversion. Interest rate cuts on the other side of the Atlantic before the end of the year have now been priced out of the bond market.
- Historically, risk premiums in the **IG corporate bond market** are certainly at an attractive level, whereas the high-yield segment is only attractively valued on average. With regard to a possible economic slowdown, we consider the priced-in risk in the high-yield segment to be too low. In **emerging market** bonds, we still 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 maturity spectrum of up to three years, we prefer covered bonds to corporate bonds with strong credit ratings due to the attractive additional yield and better rating. In the case of financial bonds, we see a narrowing potential due to the continued increase in risk premiums, but we are focusing on the systemically important major European banks. With a view to an imminent peak of the interest rate hike cycle, we continue to position the portfolio duration close to neutral against the benchmark. However, we are considering going opportunistically into a duration overweight if yields continue to rise.

Yields on 10-year government bonds



Source: Bloomberg, 05/07/2018 - 05/07/2023.

Overview of bond markets (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 03/07/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	212.29	+2.3%	-6.1%	-17.0%
Covered bonds (iBOXX Euro Germany Covered)	178.11	+1.0%	-4.8%	-13.6%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	139.39	+2.0%	-1.8%	-11.7%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	145.99	+1.8%	-1.2%	-7.3%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	539.17	+2.0%	+1.5%	-7.0%
High-yield bonds (ICE BofA Global High Yield Index)	415.35	+5.3%	+9.7%	+3.8%

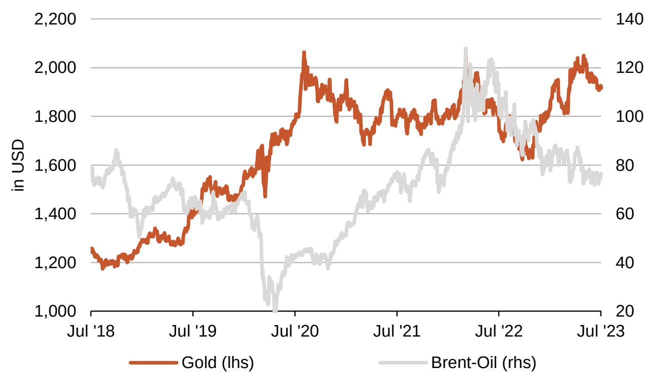
COMMODITIES

Cyclical commodities price downturn

Gold with fundamental potential only with rate pivot.
Production cuts should give oil a tailwind.
Metals scarce despite weak industrial activity.

- **Gold** experienced headwinds in June from solid US economic data, restrictive central bank rhetoric and general risk-on sentiment. An interest rate pause is unlikely to provide much tailwind; only the Fed turnaround promises more potential. Nevertheless, if economic risks persist, gold remains an important hedge.
- **Crude oil** recently consolidated between USD 72 and 78 per barrel. In recent months, the surprisingly strong oil exports from Russia, Iran and Venezuela have weighed on the price. However, with the additional production cut by the Saudis, supply should now become noticeably tighter and the oil price should experience a corresponding tailwind.
- **Industrial metals** were surprisingly robust in June despite weak manufacturing, as many metals remain in short supply, as shown by very low inventories. The Politburo meeting in China and any stimulus measures could provide new impetus.

Price development



Source: Bloomberg, 05/07/2018 - 05/07/2023.

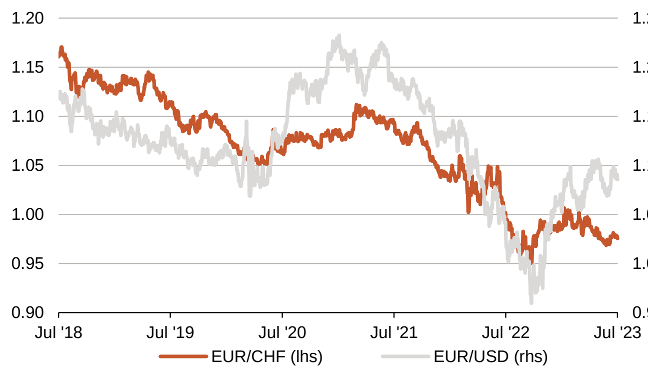
CURRENCIES

Economic weakness limits euro potential

EUR/USD: Without a clear trend.
EUR/GBP: Policies have positive effect on EUR/GBP.
EUR/CHF: The EUR has difficulties against the CHF.

- **EUR/USD:** There was some movement after the Fed and ECB central bank meetings. At first it looked like a point victory for ECB President Lagarde, whose words were apparently given more credence by the forex markets than those of Fed President Jerome Powell. The EUR initially gained significantly and was temporarily quoted at around USD1.10 US per EUR. Subsequently, however, there was a slight dampener, so that the EUR fell back to around 1.09. The weak economy in the euro zone limits the upward potential for the common currency. We consider an increase to USD1.12 per EUR possible by the end of 2023.
- **EUR/CHF:** In Switzerland, the inflation rate fell to 1.7% in June (from 2.2% in May). This puts inflation back within the Swiss National Bank's target corridor (0-2%). The SNB is in a comfortable situation by international standards. The franc is convincing through its strength - both internally and externally.

Exchange rates



Source: Bloomberg, 05/07/2018 - 05/07/2023.

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	→	→

	As of 03/07/2023	Performance ytd	1-year	3-year
Gold USD/ounce	1,922	+5.4%	+6.1%	+8.2%
Silver USD/ounce	22.9	-4.3%	+15.3%	+27.2%
Copper USD/pound	377.9	-0.8%	+4.4%	+38.2%
Brent USD/bbl	74.65	-13.1%	-33.1%	+74.4%

	As of 03/07/2023	Performance ytd	1-year	3-year
EUR/USD	1.09	+1.9%	+4.8%	-3.0%
EUR/CHF	0.98	-1.2%	-2.3%	-8.0%
EUR/GBP	0.86	-2.9%	-0.2%	-4.6%
EUR/JPY	157.89	+12.4%	+12.0%	+30.5%

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
Daniel Sutter | Equities
Felix Stern | Fixed Income
Ludwig Kemper | Commodities
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