BERENBERG Markets

INVESTMENT COMMITTEE MINUTES

10 August 2023

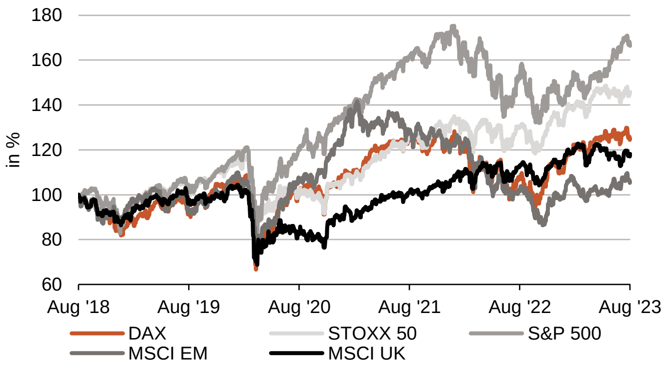
Managers of the Committee

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, 09/08/2018 – 09/08/2023.

Most important assessments at a glance

Economics	• US economy more robust than expected, soft landing instead of mini-recession, new upswing in 2024 sales. • Europe: Consumer purchasing power recovers, but headwinds for industry from abroad. Stagnation in H2 2023. • Inflation declining, interest rate peak (almost) reached. Fed will cut rates from spring 2024, ECB will keep rates stable in 2024.
Equities	• Economic optimism regarding the equity markets continued in July. Equity performance mainly valuation-driven. • Cyclical outperformance, continued high positioning and first rifts in the Q2 reporting season make markets vulnerable. • We maintain a moderate equity underweight and see an increased risk of a setback in Q3.
Bonds	• Price rally in investment grade and high-yield bonds due to declining risk premiums. • The rate hikes cycle seems to have peaked. However, high interest rate volatility favours a duration close to neutral. • Covered bonds, IG corporate bonds (especially financial bonds) and emerging market bonds in local currency remain attractive.
Commodities	• Gold unchanged over July on stronger real interest rates and US dollar. Potential is limited with "soft landing". • Oil with recovery due to more pronounced supply deficit. Catalysts increasingly materialised after strong rally. • Base metals stabilise on optimism in regards to China's stimulus measures. Clear signals are still necessary.
Currencies	• EUR/USD is looking for guidance after the latest ECB and Fed rate decisions and is hovering around 1.10. • The BoE's tighter monetary policy is helping the pound. EUR/GBP remains at around 0.86 pound per euro. • The Swiss franc remains bearish and continues to push the euro well below parity with an exchange rate of 0.96.

Current market commentary

Equity markets continued to develop favourably in July amid ongoing investor optimism. The positive stock market development was primarily driven by valuations. For example, the S&P 500 was – at times – as highly valued as it was at the beginning of 2022, despite the current significantly higher interest rates. The start of the Q2 reporting season shifted the focus back to fundamental data. The corporate figures were better than feared, even though the year-on-year profit trend at the index level was negative and profit expectations for the next quarters were revised slightly downwards. Under the surface, the outperformance of cyclicals continued. In view of the predominantly negative economic indicators, this seems exaggerated and unsustainable. With risks persisting (eg tighter central banks, high valuations and vulnerable positioning), we remain cautiously positioned and maintain a slight underweight in equities. We see increased risk for setbacks in Q3 2023.

Yields on 10-year government bonds rose slightly in July despite stable to declining core inflation. Fears about US solvency and strong US new issuance were a drag. High-yield corporate bonds continued the trend of falling risk premiums and performed correspondingly strong. However, the segment is now increasingly unattractively valued, while IG corporate bonds, especially financial bonds, are still historically attractively valued despite their recent strong performance. As long as interest rate and inflation volatility persist and bonds and equities increasingly move in tandem, an overweight in bonds and a duration above neutral is not yet an obvious choice.

While gold remained almost unchanged over July with headwinds from higher real interest rates and the US dollar, energy commodities and industrial metals benefited from China stimulus hopes and improved supply-demand fundamentals. Clear signals are needed for a further rally.

ECONOMICS

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

US: soft landing instead of mini-recession in H2 2023. Fed has reached interest rate peak and will loosen from spring 2024.
Europe: strong headwinds for industry; stagnation until winter, noticeable growth only from spring 2024.
Inflation peak passed. Price pressures continue to ease, but core inflation remains above 2% in the US and Europe in 2024.

- **Soft landing for the US economy:** Although the manufacturing sector has slipped into recession, the US economy continues to hold up better than expected despite higher interest rates. After a strong correction, interest-sensitive residential construction has already stabilised. Thanks to declining inflation and a still robust labour market, an increase in real disposable income is supporting consumer purchasing power. Instead of a mini-recession at the turn of the year, we now expect a soft landing with subdued growth in the coming quarters before the economy can pick up speed again from spring 2024. Unlike for Europe, we have revised our forecasts for the US economy sharply upwards since the beginning of the year – see chart below.
- **Europe: Strong headwinds for manufacturing.** In the aftermath of COVID-19, 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. In addition, there is an inventory correction in the manufacturing sector, which had built up stockpiles too much with the end of the pandemic-related supply bottlenecks worldwide.
- **Stagnation ahead:** Although the purchasing power of consumers in Europe has been increasing again since the middle of the year with declining inflation and rising wages, the economy in Europe will hardly grow in the next two to three quarters. A slight recession is possible, even probable for Germany. A new upswing for Europe is not on the horizon until spring 2024, when the global inventory correction comes to an end and growth picks up again.
- **China remains weak**. After the abrupt departure from its zero-covid policy, China's long-term problems (eg demographics, state control, credit overhang) are becoming increasingly apparent. We continue to expect only modest stimulus as the government does not want to exacerbate credit problems. Therefore, China is not providing much impetus for the global economy
- **Inflation declining:** In the US and Europe, inflation continues to decline despite a slight increase in oil prices. However, the core rate of inflation excluding energy and food is falling only slowly, especially in Europe. Wage pressures, which are currently more pronounced in Europe than in the US, should ensure that inflation in the US and Europe remains above the 2% central bank target in 2024.

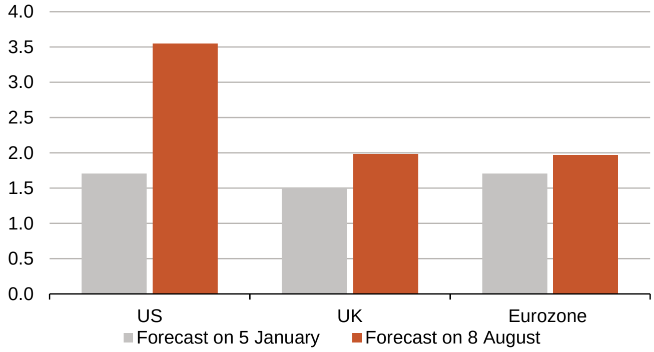
Interest rate peak (almost) reached: At 5.5%, the US Fed has probably reached the interest rate peak, even if a further step is not ruled out. If inflationary pressure continues to decline, it may lower interest rates from spring 2024. Whether the ECB will raise rates again in September with inflation still high despite the weak economy is unclear (60% probability for final rate step). Unlike the US Fed, however, it will hardly lower its interest rates in 2024 in view of inflation of over 2%.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	2.3	2.2	2.5			
US	23.7	2.1	1.1	1.7	4.0	2.5	2.3
China	18.3	4.9	3.9	3.9	0.5	2.0	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	0.4	1.1	1.7			
Eurozone	15.0	0.6	1.0	1.8	5.4	2.6	2.5
Germany	4.4	-0.3	0.8	1.7	6.0	2.5	2.5
France	3.0	0.7	1.3	1.7	5.6	2.7	2.5
Italy	2.2	0.8	0.8	1.2	5.9	2.0	2.4
Spain	1.5	2.2	1.6	2.1	3.4	2.9	2.7
Other Western Europe							
United Kingdom	3.3	0.4	1.0	1.7	7.4	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

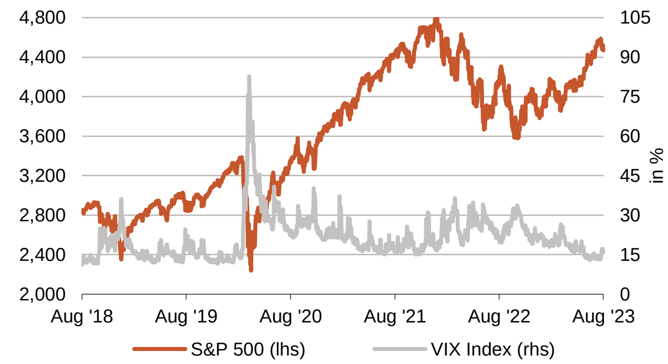
EQUITIES

Optimism in the equity markets calls for caution

Economic optimism regarding the equity markets continued in July. Equity performance mainly valuation-driven. Cyclical outperformance, continued high positioning and first rifts in the Q2 reporting season make markets vulnerable. We maintain a moderate equity underweight and see an increased risk of a setback in Q3.

- The **equity markets** performed well in July amid continuing economic optimism. The positive development was primarily driven by valuations. The P/E ratio of the S&P 500, for example, was over 21 at one stage – ie as high as it had last been since the beginning of 2022. Under the surface, cyclicals continued to outperform defensive stocks. However, the predominantly negative economic indicators currently speak against the continuation of these trends and call for caution.
- At the sector level, **health care**, **energy** and **financial stocks** shone in Europe over the last four weeks. **Utilities** and **information technology stocks**, on the other hand, were left behind. At the style level, **value stocks** outperformed **growth stocks** over the last four weeks. In addition, **large caps** outperformed **small caps** in Europe.
- We see an increased risk of setbacks in the third quarter and maintain our **moderate underweight**. The Q2 reporting season has already revealed the first signs of the weakening economy with more profit warnings from the cyclical sectors and the first disappointments from larger technology companies. The loner-term outlook of companies therefore remains crucial. The optimistic investor sentiment, the continued high valuation and high equity positioning also make the markets increasingly vulnerable.
- Regionally, the better economic situation in the US compared to Europe seems to be already reflected and priced into the markets with the US outperformance. A reallocation within equities therefore seems too pro-cyclical to us. We are therefore maintaining our current **underweight**, but increasingly see the US as a possible candidate for an increase.
- 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, 09/08/2018 - 09/08/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 09/08/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,853	+13.9%	+17.1%	+25.1%	11.4	3.5%
SMI	3,538	+5.6%	+0.3%	+13.8%	18.5	3.1%
MSCI UK	2,167	+3.5%	+4.3%	+43.2%	10.8	4.2%
EURO STOXX 50	4,317	+17.2%	+20.4%	+45.8%	12.3	3.5%
STOXX EUROPE 50	10,143	+11.4%	+12.1%	+46.2%	13.8	3.4%
S&P 500	8,363	+17.2%	+9.7%	+37.8%	20.6	1.6%
MSCI Em. Markets	1,008	+7.6%	+4.0%	+0.7%	13.5	2.9%

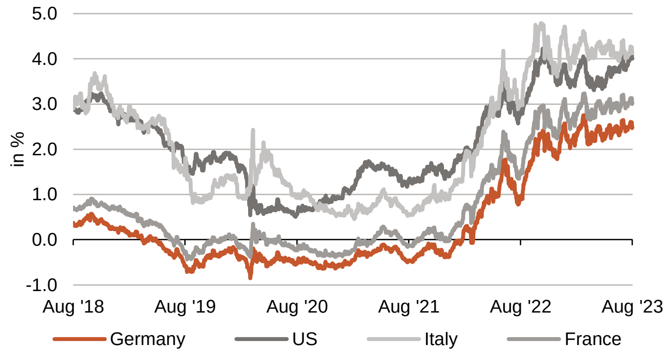
FIXED INCOME

High-yield segment increasingly unattractive compared to investment grade

Price rally in investment grade and high-yield bonds due to declining risk premiums.
The rate hikes cycle seems to have peaked. However, high interest rate volatility favours a duration close to neutral.
Covered bonds, IG corporate bonds (especially financial bonds) and emerging market bonds in local currency remain attractive.

- **Yields on safe government bonds** developed unevenly at the various curve points. Yields on **10-year bonds** increased slightly despite stable to declining core inflation. At the short end of the yield curve, yields on 2-year Bunds and US Treasuries fell again by almost 16 and 2 basis points respectively. The steepening of the yield curve was, therefore, driven by falling interest rates at the short end and rising interest rates at the long end on both sides of the Atlantic. Interest rate markets are pricing in a maximum of one more rate hike in the Eurozone and no more by the US Fed.
- **High-yield corporate bonds** were able to continue the trend of falling risk premiums and, therefore, belong to the bond segment with the best performance over the year, both in euros and in US dollars. Thus, the segment is increasingly unattractively valued, while **investment-grade corporate bonds** are still attractively valued despite their recent strong performance. In **emerging market bonds**, we are reducing our underweight in corporate bonds versus government bonds. However, the latter can benefit from interest rate cuts in local currency and remain an attractive portfolio addition.
- While cyclical companies in the chemical and industrial sectors reported revenue declines and profit regressions, banks continued to show strong earnings and clean balance sheets. We therefore continue to **favour financial bonds** in this environment due to their operational strength and further narrowing potential of the still elevated risk premiums. Our focus remains on the systemically important major European banks. As long as interest rate and inflation volatility persist and bonds and equities increasingly move in tandem, a bond overweight and a duration above neutral are not yet appropriate.

Yields on 10-year government bonds



Source: Bloomberg, 09/08/2018 - 09/08/2023.

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 09/08/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	212.41	+2.4%	-8.1%	-18.1%
Covered bonds (iBOXX Euro Germany Covered)	179.22	+1.6%	-5.1%	-13.3%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	140.72	+3.0%	-4.9%	-12.2%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	147.91	+3.1%	-2.1%	-7.1%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	539.89	+2.2%	-3.3%	-6.1%
High-yield bonds (ICE BofA Global High Yield Index)	420.34	+6.6%	+5.6%	+0.3%

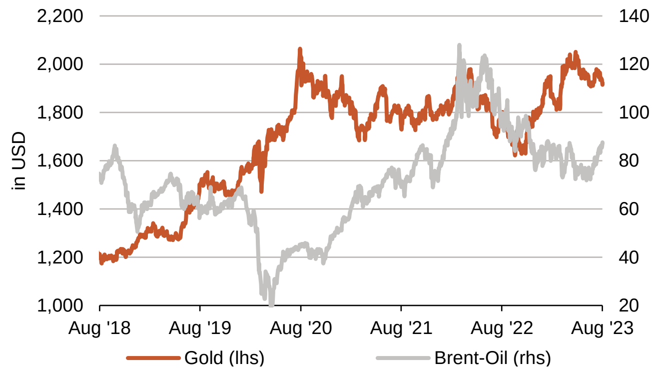
COMMODITIES

July dominated by cyclical commodities

Gold with capped potential on soft landing.
Crude oil's strong July rally limits room to the upside.
Metals are already supported by energy turnaround.

- **Gold** remained almost unchanged over July with headwinds from solid US economic data, higher real interest rates and the US dollar. Looking ahead, the further course of the economic and interest rate cycle remains crucial. A "soft landing" should keep the upside potential capped.
- **Crude oil** received directional guidance to the upside with increased signs of undersupply in the market. OPEC extended the production cut of 1 million barrels into September, and Russia put its promises of cuts into practice. Demand in the West and East remains robust. Many factors of a short-term rally have thus already materialised. This limits the upside potential for the time being.
- **Industrial metals** stabilised in July. The Politburo meeting in China and possible stimulus measures provided a tailwind. Structurally, metal demand is already supported by the decarbonisation theme. However, for a more sustainable rally, clear signals from China are still needed.

Price development



Source: Bloomberg, 09/08/2018 - 09/08/2023.

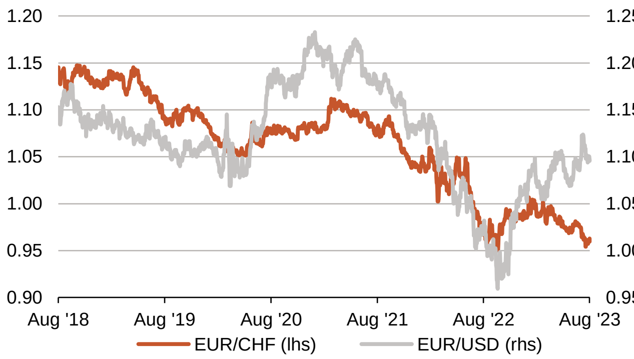
CURRENCIES

A lean period for the euro

EUR/USD: In search of direction.
EUR/GBP: Monetary policy keeps pound at higher level.
EUR/CHF: The euro continues to trade well below parity.

- **EUR/USD:** Central banks and economic data keep the currency pair on its toes. Ultimately, however, it is moving sideways with some fluctuations. In the short and medium term, the potential for the euro is limited. When the interest rate gap between the US and Europe closes in the course of next year and the US dollar is no longer so much required as a safe haven, the situation on the foreign exchange market would normalise and the euro should rise again. In the long term (around five years), the risk of the high US government debt and possible problems in refinancing the debt must also be kept in mind. A significantly weaker US dollar could then be possible.
- **EUR/CHF:** The Swiss National Bank (SNB) is in a comfortable situation. The internal and external value of the franc is high. The inflation rate fell further in July – also due to the high franc exchange rate – to only 1.6 %.

Exchange rates



Source: Bloomberg, 09/08/2018 - 09/08/2023.

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 09/08/2023	Performance ytd	Performance 1-year	Performance 3-year
Gold USD/ounce	1,914	+5.0%	+6.7%	-5.9%
Silver USD/ounce	22.7	-5.4%	+10.4%	-19.9%
Copper USD/pound	378.4	-0.7%	+5.5%	+35.5%
Brent USD/bbl	87.55	+1.9%	-9.1%	+97.2%

	As of 09/08/2023	Performance ytd	Performance 1-year	Performance 3-year
EUR/USD	1.10	+2.5%	+7.5%	-6.9%
EUR/CHF	0.96	-2.7%	-1.1%	-10.5%
EUR/GBP	0.86	-2.5%	+2.0%	-4.5%
EUR/JPY	157.76	+12.4%	+14.4%	+26.4%

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
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Disclaimer

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