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Markets

INVESTMENT COMMITTEE MINUTES

15 September 2023

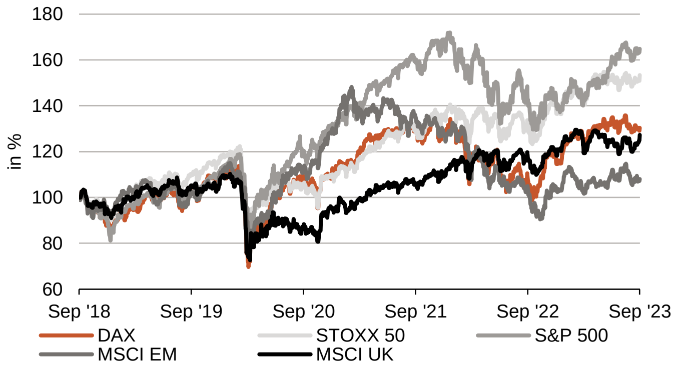
Managers of the Committee

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, 14/09/2018 – 14/09/2023.

Most important assessments at a glance

Economics	• US economy: soft landing instead of mini-recession, new upswing in the course of 2024. • Europe: Consumer purchasing power recovers, but industry and residential construction decline. Economy weak for now. • Inflation declining, interest rate peak (almost) reached. Fed cuts rates from spring 2024, ECB keeps rates stable in 2024.
Equities	• Equity markets recovered at the end of the month after weakness until mid-August. Valuations still elevated. • Ambitious earnings expectations, seasonality and late effects of tight interest rate policy make markets vulnerable. • We maintain the moderate equity underweight and see an increased risk of a setback by the end of the year.
Bonds	• Safe government bond yields rise in the face of higher long-term real interest rates and a flood of new issues. • High interest rate volatility and uncertain Fed interest rate policy continue to argue for duration near neutral. • IG corporate bonds clearly more attractive than high-yield bonds. EM local currency bonds still preferred.
Commodities	• Gold currently lacklustre with strong dollar and high real interest rates. Only a turnaround by central banks offers potential. • Oil with recovery due to more pronounced supply deficit. Catalysts increasingly materialised after the strong rally. • Base metals remain cyclically sensitive but benefit from low inventories and strong "green" demand.
Currencies	• The US dollar has the upper hand thanks to the monetary policy outlook, EUR/USD falls back towards 1.07. • EUR/GBP remains stable at 0.86 pounds per euro. Bank of England approaches interest rate summit. • Nothing new with the Swiss franc: it remains very strong and continues to hold the euro well below parity at around 0.96.

Current market commentary

Equity markets developed twofold in August. Concerns about higher US fiscal spending, thus higher US government bond volumes and consequently higher yields initially led to a setback until the middle of the month. High duration assets suffered disproportionately. From mid-August onwards, the markets stabilised in the face of somewhat weaker economic data ("bad news is good news"). Under the surface, there are increasing signs that the late effects of the tight monetary policy are reaching the real economy (weakening consumer sentiment, slowly rising US unemployment, increased bankruptcy reports). With risks persisting (quantitative tightening, high valuations and ambitious earnings expectations), we remain cautiously positioned and maintain a moderate underweight in equities. At the same time, investor focus is likely to return to quality and growth in corporate earnings, which supports our focus on quality and growth stocks.

Safe government bonds saw further yield increases in August. In particular, the strong flood of new Treasury issues weighed on US government bonds. In corporate bonds, we find IG bonds relatively more attractive after the strong annual performance and ambitious valuation of high-yield bonds. In emerging markets, we prefer local currency bonds and corporate bonds over government bonds in hard currency.

Gold held up surprisingly well over July in the face of the strengthening US dollar and high real interest rates. Countercyclical central bank purchases and reduced ETF and futures positioning limit downside risks, but without a Fed turnaround, fundamental upside potential remains limited for now. The rally in crude oil in August is likely to lose momentum over the autumn despite the supply shortage amid the seasonal decline in demand. Industrial metals should continue to wait for more solid (China) economic data, while the decarbonisation trend is already supporting demand.

ECONOMICS

US economy avoids recession, China disappoints, Europe weakens until spring 2024

US: soft landing without recession. Fed has reached interest rate peak and will loosen reins from spring 2024.
Europe: strong headwinds for industry. Weak economy in winter. Noticeable growth only from spring 2024.
Price pressures slowly easing despite higher oil prices. 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 a mild recession, the US economy is only slowly losing momentum. After a sharp correction, interest-sensitive residential construction has largely stabilised. Thanks to declining inflation, an increase in real disposable income is supporting consumer purchasing power – see chart. Since, unlike in earlier cycles, companies do not have to correct overcapacities, they are now cutting back their investments less than before despite high interest rates. As a result, the US economy is likely to experience only a soft landing with sharply reduced growth in the coming quarters before the economy can pick up speed again from spring 2024.
- **Europe: Manufacturing and housing in recession.** 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 demand for capital goods is weakening. In addition, there is an inventory correction in industry, which had built up its stocks too much with the end of the pandemic-related supply bottlenecks worldwide. Demand for exports from Europe is suffering as a result.
- **Weak economy until spring.** Although consumers' purchasing power has been increasing again since spring with declining inflation and rising wages, the economy in Europe will hardly grow in autumn and winter. Housing construction suffers from higher interest rates. A slight recession is possible, even probable for Germany. A new upswing is not on the horizon for Europe until spring 2024, when the global inventory correction comes to an end.
- **China remains weak.** After the abrupt departure from the zero-COVID-19 policy, China's long-term problems (demographics, state control, credit overhang) are becoming more apparent. We expect only a modest stimulus, as the government does not want to exacerbate the credit problems. However, China can and will prevent the property market correction from triggering a major financial crisis. From the beginning of 2024, China's imports could increase again somewhat.
- **Inflation declining.** In the US and Europe, inflation continues to trend downwards despite the rise in oil prices. However, the core rate of inflation excluding energy and food is falling only slowly, especially in Europe. Wage pressures, which are now more pronounced in Europe than in the US, are likely to keep inflation in the US and Europe above the 2% central bank target also in the second half of 2024.

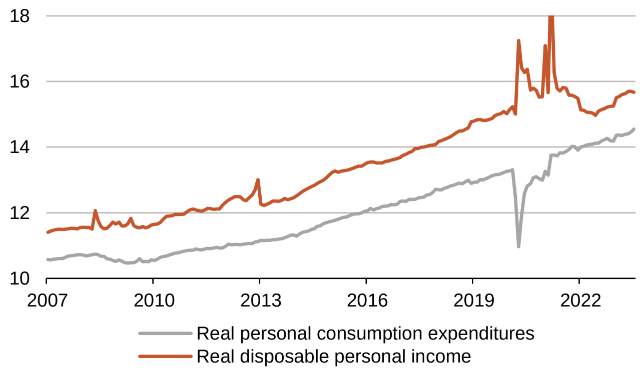
Interest rate peak (almost) reached: At 5.5%, the US Fed has probably reached the interest rate peak, even if a further step is not ruled out. With inflationary pressures slowly declining further, it may lower interest rates from spring 2024. Since the weak economy is likely to continue to dampen inflation, the ECB will probably not raise its key rates further. Unlike the US Fed, however, it will hardly lower its rates in 2024 in view of inflation remaining well above 2%.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	2.3	2.1	2.4			
US	23.7	2.1	1.2	1.7	4.1	2.6	2.3
China	18.3	4.6	3.8	3.6	0.5	2.0	2.2
Japan	5.1	1.6	0.7	1.1	3.1	2.0	1.5
India	3.3	6.0	6.5	6.0			
Latin America	5.2	1.5	2.2	2.2			
Europe	26.2	0.5	1.0	1.7			
Eurozone	15.0	0.4	0.8	1.8	5.6	3.0	2.4
Germany	4.4	-0.5	0.6	1.7	6.2	2.8	2.3
France	3.0	0.7	1.1	1.7	6.0	3.7	2.5
Italy	2.2	0.7	0.5	1.2	6.4	2.5	2.4
Spain	1.5	2.2	1.4	2.1	3.6	3.1	2.7
Other Western Europe							
United Kingdom	3.3	0.3	0.8	1.7	7.4	2.7	2.0
Switzerland	0.8	0.7	1.2	1.4	2.4	1.5	1.3
Sweden	0.7	-0.5	1.2	2.0	6.7	2.3	2.3
Eastern Europe							
Russia	1.8	0.5	0.0	-0.5	8.0	7.0	6.0
Turkey	0.8	2.5	2.5	2.5	46.0	38.0	30.0

Source: Berenberg

US: real disposable income and consumer spending



In trillions of dollars at 2012 prices. Seasonally adjusted annualised monthly data.
Source: BEA

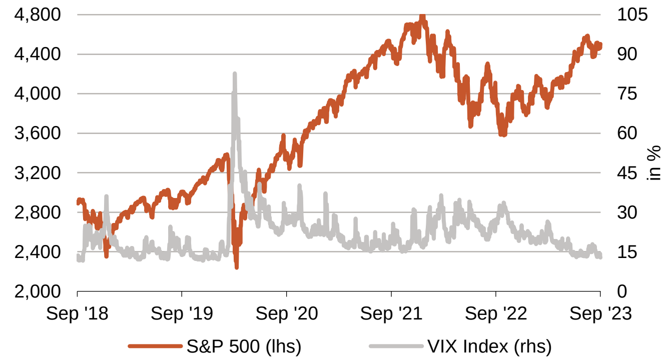
EQUITIES

Increased risk of setbacks on the stock markets

Equity markets recovered at the end of the month after weakness until mid-August. Valuations still elevated. Ambitious earnings expectations, seasonality and late effects of tight interest rate policy make markets vulnerable. We maintain the moderate equity underweight and see an increased risk of a setback by the end of the year.

- **Equity markets** developed two-fold in August. Concerns about higher US fiscal spending, thus higher US government bond volumes and consequently higher yields initially led to a setback until mid-month – the S&P 500, for example, experienced the first major setback of almost 5% since March this year. High duration assets suffered disproportionately. From mid-August onwards, the markets stabilised in the face of somewhat weaker economic data ("bad news is good news").
- European stock markets have shone only sporadically over the last four weeks. The style and sector picture is ambiguous. Cyclical sectors occupied both the first (**energy**) and the last places (**industry, cyclical consumer goods**). Energy stocks benefited from the stronger crude oil price and positive earnings revisions. 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 until the end of the year and are maintaining our **moderate underweight**. There are increasing signs (inverted yield curves, strengthening commodity prices, weakening consumer sentiment, slowly rising US unemployment, increased bankruptcy reports) that we are rather later in the economic cycle. At the same time, risks such as increased treasury supply, continued elevated valuations, ambitious earnings expectations and elevated equity positioning of rule-based investment strategies (systematics) persist. The risks call for caution. We therefore feel comfortable with our balanced, non-offensive positioning so that we can take advantage of attractive entry opportunities in the event of a sell-off.
- In view of the expected economic slowdown, we maintain our **focus on quality and growth stocks**.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 14/09/2018 - 14/09/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 14/09/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,805	+13.5%	+21.3%	+19.8%	11.5	3.5%
SMI	3,531	+5.4%	+4.5%	+9.5%	18.0	3.1%
MSCI UK	2,193	+5.5%	+8.8%	+45.2%	10.7	4.3%
EURO STOXX 50	4,280	+16.2%	+24.3%	+41.6%	12.2	3.6%
STOXX EUROPE 50	10,241	+12.5%	+16.8%	+45.3%	13.8	3.4%
S&P 500	8,446	+18.3%	+15.5%	+37.6%	20.7	1.6%
MSCI Em. Markets	982	+5.2%	+5.2%	-3.1%	13.5	3.0%

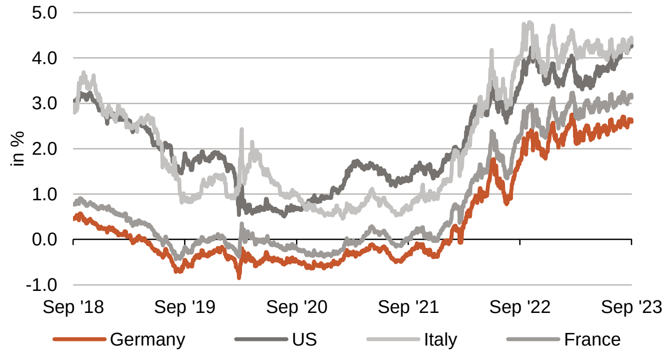
FIXED INCOME

Good opportunities with a differentiating view

Safe government bond yields rise in the face of higher long-term real interest rates and a flood of new issues. High interest rate volatility and uncertain Fed interest rate policy continue to argue for duration near neutral. IG corporate bonds clearly more attractive than high-yield bonds. EM local currency bonds still preferred.

- Following robust US economic data and the rise in long-term real interest rates on both sides of the Atlantic, yields on **safe government bonds** rose again. The steepening of yield curves continued due to the much stronger rise in interest rates at the long end than at the short end, with US government securities coming under particular pressure due to the flood of new issues. As a result, the yield on **10-year government bonds** was above 4.2% in the **USA** and around 2.6% again in **Germany**. Higher budget deficit forecasts in Italy caused spreads between **Italian** and **German** government bonds to widen further by 10 basis points above the 1.7% mark.
- **Corporate bonds** also suffered from rising risk-free interest rates, although the trend of falling risk premiums on **high-yield bonds** continued last month. The relative valuation of the **investment grade segment** in a long-term comparison, combined with solid balance sheets and generous liquidity reserves of most issuers, is more attractive than the risk premiums in the high-yield segment. The rise in Treasury rates also put pressure on hard currency **emerging market bonds**, with high yield outperforming the investment grade segment. We continue to favour the local currency segment.
- The bond segment still offers interesting opportunities, but it is important to differentiate here. In the case of safe bonds, we prefer **covered bonds** to government bonds due to the attractive additional yield. In Europe, we prefer corporate bonds with good credit ratings, and in emerging markets we prefer corporate bonds over hard currency government bonds due to attractive relative valuations and limited new supply on the corporate side. Due to the high interest rate volatility, we are leaving the duration at Neutral for the time being.

Yields on 10-year government bonds



Source: Bloomberg, 14/09/2018 - 14/09/2023.

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 14/09/2023	Performance in index currency		
		ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	211.02	+1.7%	-3.5%	-18.5%
Covered bonds (iBOXX Euro Germany Covered)	179.23	+1.6%	-1.2%	-13.4%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	139.83	+2.4%	-0.3%	-13.0%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	148.05	+3.2%	+1.3%	-7.1%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	549.78	+4.0%	-0.7%	-3.4%
High-yield bonds (ICE BofA Global High Yield Index)	420.08	+6.5%	+8.7%	-0.4%

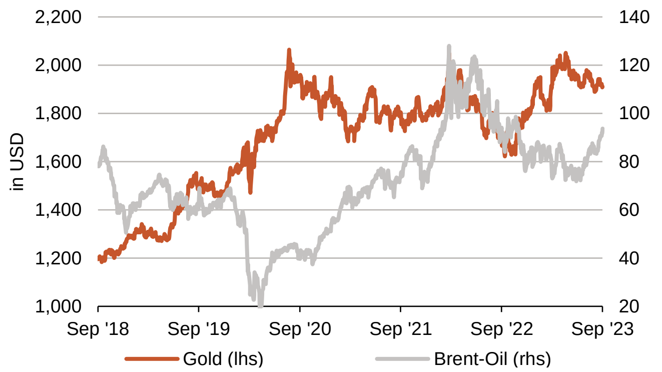
COMMODITIES

Commodities are and remain cyclical

High opportunity costs weigh on gold.
Good starting position for oil, few positive catalysts.
Metals already supported by energy transition.

- **Gold** has struggled to gain over the past month in an environment of a strengthening dollar and high real interest rates. Central banks continue to buy the dips in the gold price, while investors have been withdrawing money from gold ETFs unabated for 15 weeks. As long as the central banks' turnaround and thus lower interest rates are still pending, the upside potential is likely to remain limited.
- The rally in **crude oil** found new momentum at the end of August, fuelled by supply shortages and buying by CTAs. With the end of the travel season, demand is likely to weaken for the time being, while further production cuts are not forthcoming. Thus, despite a fundamentally good starting position, oil is likely to visibly lose momentum.
- **Industrial metals** moved volatilely sideways over the last month. Although they are not immune to the gloomy situation in the manufacturing sector, there are many signs of strength apart from this: low inventories, production problems and rising "green" demand.

Price development



Source: Bloomberg, 14/09/2018 - 14/09/2023.

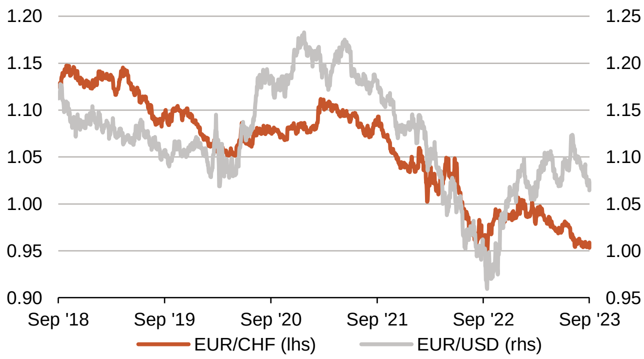
CURRENCIES

US dollar benefits from lead in interest rates

EUR/USD: US economy with soft landing.
EUR/GBP: Monetary policy close to rate peak; GBP stable.
EUR/CHF: The euro continues to trade well below parity.

- **EUR/USD:** At the central bank meeting in Jackson Hole it was confirmed that neither the US Federal Reserve nor the ECB want to be committed to a specific monetary policy approach. They want to act depending on the data. The data prompted the ECB to raise interest rates in September, probably for the last time. More should not be necessary. The US economy looks set for a soft landing. This reduces the need for a monetary policy stimulus through significantly lower interest rates. Even a final rate hike is not completely out of the question. For the Eurozone, this makes it more difficult to catch up on interest rates – the euro weakens accordingly.
- **EUR/CHF:** The Swiss National Bank (SNB) has committed itself to a strong franc policy to fight inflation. With success: since June, Switzerland's inflation rate has been below the two percent mark again. In this respect, it is questionable how long the SNB will stick to the policy of the very strong franc.

Exchange rates



Source: Bloomberg, 14/09/2018 - 14/09/2023.

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 14/09/2023	ytd	1-year	3-year
Gold USD/ounce	1,911	+4.8%	+12.6%	-2.4%
Silver USD/ounce	22.6	-5.4%	+15.4%	-16.5%
Copper USD/pound	378.3	-0.7%	+6.7%	+23.3%
Brent USD/bbl	93.70	+9.1%	-0.4%	+136.6%

		Performance		
	As of 14/09/2023	ytd	1-year	3-year
EUR/USD	1.06	-0.6%	+6.6%	-10.3%
EUR/CHF	0.95	-3.7%	-0.8%	-11.6%
EUR/GBP	0.86	-3.1%	-0.8%	-7.1%
EUR/JPY	156.97	+11.8%	+10.0%	+25.1%

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
Ansgar Nolte | Equities
Christian Bettinger | Fixed Income
Ludwig Kemper | Commodities
Philina Kuhzarani | Minutes
Dr Konstantin Ignatov | Minutes

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