INVESTMENT COMMITTEE MINUTES

12 October 2023

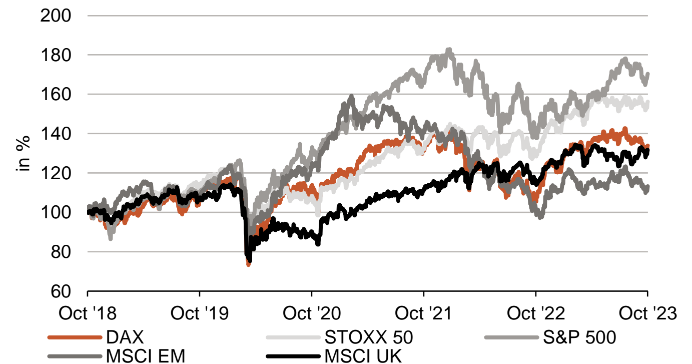
Managers of the Committee

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, 11/10/2018 - 11/10/2023.

Most important assessments at a glance

Economics	• US economy: soft landing instead of mini-recession, new momentum during 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	• Strong rise in bond yields weighs on equity markets. (Real) interest rate hike puts pressure on valuations. • Ambitious earnings expectations and late effects of the tight interest rate policy make markets vulnerable. • We are maintaining our moderate equity underweight. However, a countermovement after the recent weakness is possible
Bonds	• Safe government bond yields at year's highs amid higher long-term real interest rates. • Increased interest rate volatility and uncertain Fed rate steps continue to argue for duration near neutral. • IG inflows clearly positive for the year, HY - negative. Emerging market local currency bonds still preferred.
Commodities	• Gold suffers from 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 strong rally. • Industrial metals remain cyclically sensitive but benefit from low inventories and strong "green" demand
Currencies	• The US dollar is benefiting from the comparatively positive economic data and the geopolitical crises. • EUR/GBP continues to fluctuate around the 0.86 mark. The somewhat more stable political conditions are stabilising the pound. • Like the US dollar, the Swiss franc is benefiting from the geopolitical crises.

Current market commentary

September was driven by broad-based losses in almost all asset classes. Triggered by renewed increases in government bond yields – especially in the US – global equity markets, corporate bonds and emerging market bonds closed sharply lower. Only commodities gained, with the price of crude oil rising by 15% since the end of June. We saw a revival of 2022. US 10-year government bond yields soared 46bp in September and 78bp in the third quarter. A number of US economic data also came in better than expected, so that higher interest rates were priced into the capital market for a longer time period. The sharp rise in oil prices as a result of OPEC's production cuts, hawkish comments from the Fed at the September meeting, market fears about rapidly rising US debt and strong government bond issuance did the rest. Higher duration assets suffered disproportionately. Most recently, however, the oil price gave back some of its gains. Only when interest rates stop rising (so strongly and quickly) should there be a recovery for many capital market segments.

Against this background, caution and a balanced positioning remain appropriate for the time being in our view. Signs that we are late in the cycle and that the US economy is weakening are mounting. With investor focus shifting from inflation to economic growth, markets are likely to react more strongly to economic data, the third quarter equity and government bond synchronisation should weaken, and after the underperformance of quality and growth stocks in the third quarter, they may be in greater demand again. However, a temporary technical countermovement after the September sell-off cannot be ruled out in the short term.

ECONOMICS

US economy avoids recession, little growth in China, Europe weakens until spring 2024

US: soft landing without recession. Fed has probably reached interest rate peak and will loosen reins as of spring 2024.
Europe: strong headwinds for industry. Weak economy in winter. Noticeable growth only from spring 2024.
Price pressures continue to lessen. But core inflation remains above 2% in US and Europe in 2024. Geopolitical risks remain.

- **Soft landing for the US economy:** Although the US Federal Reserve has hit the brakes hard, 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. Since companies have built up high reserves and, unlike in earlier cycles, do not have to correct overcapacities, they are now cutting back their investments less than before despite high interest rates. Therefore, 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 again from spring 2024 onwards.
- **Europe: Manufacturing and housing in recession.** After the pandemic, there is pent-up demand in large parts of the world for services, but not for goods. Industrial production is stagnating in the US and demand is weakening in China. In addition, there is a stock correction in industry, which had built up its inventories too much worldwide with the end of the supply bottlenecks caused by the pandemic. Demand for exports from Europe is suffering as a result. However, there are first signs that exports and industry will soon bottom out.
- **Weak economy until spring.** Although consumer purchasing power has been increasing again since the spring with declining inflation and rising wages, the economy in Europe will roughly stagnate in autumn and winter. Housing construction is suffering from higher interest rates. A slight recession is possible, even probable for Germany. A new upswing is not on the horizon until spring 2024, when the global inventory correction comes to an end.
- **China remains weak.** China's long-term problems (demographics, state control, credit overhang) are becoming increasingly apparent. We expect only a mini 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 USA and Europe, inflation continues to trend downwards. 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, should keep inflation in the US and Europe above the central bank's 2% target in the second half of 2024.

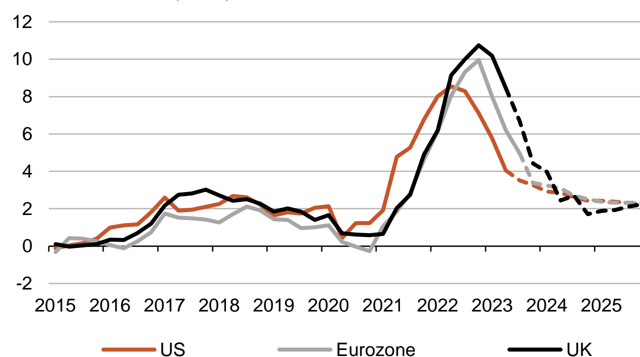
Interest rate peak (almost) reached: At 5.5%, the US Fed has probably reached the interest rate peak, even if a further step is not ruled out. With inflationary pressures slowly diminishing, it may lower interest rates from spring 2024. Since the weak economy is likely to continue to dampen inflation, the ECB will probably not raise its rates further. Unlike the US Fed, however, it will hardly lower the money market interest rate 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	2.2	2.4			
US	24.2	2.1	1.2	1.7	4.1	2.7	2.3
China	18.4	4.7	3.8	3.6	0.5	2.0	2.2
Japan	5.2	1.8	1.0	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	26.4	0.5	0.9	1.6			
Eurozone	15.2	0.4	0.8	1.7	5.6	2.9	2.3
Germany	4.4	-0.5	0.6	1.6	6.2	2.8	2.2
France	3.1	0.7	1.1	1.7	5.7	3.1	2.5
Italy	2.2	0.7	0.5	1.1	6.3	2.7	2.2
Spain	1.5	2.4	1.4	2.1	3.6	3.2	2.3
Other Western Europe							
United Kingdom	3.2	0.5	0.7	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	0.8	2.0	8.2	3.0	2.3
Eastern Europe							
Russia	1.9	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

Inflation rates (in %)



Year-over-year increase of consumer prices in %. Dashed line: Berenberg forecast. US: CPI-U, Eurozone: HICP, UK: CPI. Sources: BLS, Eurostat, ONS, Berenberg

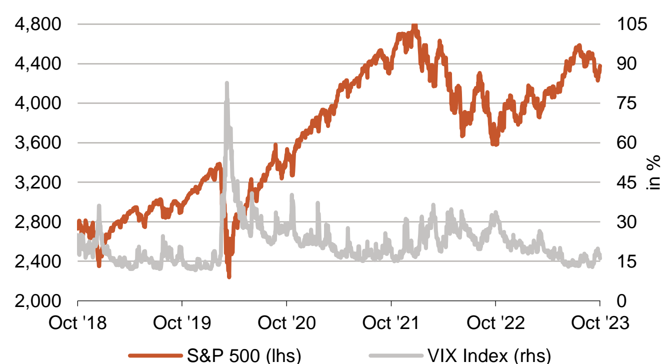
EQUITIES

Market prices soft landing – but headwinds for equities are getting stronger

Strong rise in bond yields weighs on equity markets. Recent (real) interest rate hike puts pressure on valuations. Ambitious earnings expectations and late effects of the tight interest rate policy make markets vulnerable. We are maintaining our moderate equity underweight. A countermovement after the recent weakness is possible.

- **Equity markets** ave recently been unable to escape the strong (real) rise in interest rates. In September, global equities fell by 3.3% compared to the previous month. They thus recorded the strongest monthly decline so far this year. The valuation of US equities has fallen accordingly. The P/E ratio of the S&P 500 now stands at 18.4x.
- Over the last four weeks, **energy** and **financial stocks** performed the strongest, while **consumer cyclicals** and **utilities** brought up the rear. **Technology stocks** in particular suffered from high interest rates, while the rise in oil prices in Q3 supported **energy stocks**. Regionally, the strong performance of the energy sector supported **UK equities**. At the style level, **value stocks** outperformed **growth stocks** over the last four weeks. The more cyclical **small caps** suffered particularly. The outperformance in Europe of **large caps** over small **caps** continued in September.
- With a view to a US economic slowdown, we continue to see an increased risk of setbacks and maintain our moderate underweight. There are increasing signs (stronger commodity prices, weakening consumer sentiment, ambitious profit expectations, increased bankruptcy announcements) that we are rather later in the economic cycle. At the same time, a technical countermovement cannot be ruled out in the short term after the losses in September. This is because positioning and sentiment have recently come down significantly and the market is partly oversold. In addition to the October seasonality, the restarting share buyback programmes could also provide support. Fundamentally, we feel comfortable with our defensive positioning due to the existing risks, so that we can leverage 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, 11/10/2018 - 11/10/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 11/10/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,460	+11.0%	+26.5%	+18.5%	11.2	3.6%
SMI	3,503	+4.5%	+9.3%	+9.7%	17.9	3.2%
MSCI UK	2,185	+5.3%	+14.3%	+45.3%	10.8	4.2%
EURO STOXX 50	4,201	+14.2%	+30.3%	+40.8%	11.9	3.6%
STOXX EUROPE 50	10,122	+11.2%	+21.5%	+45.2%	13.3	3.5%
S&P 500	8,211	+15.0%	+23.4%	+30.1%	20.2	1.6%
MSCI Em. Markets	957	+2.5%	+14.0%	-7.2%	13.3	3.0%

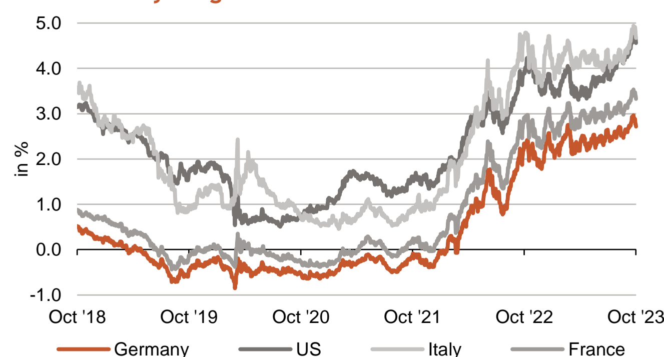
FIXED INCOME

Stronger tailwind for investment-grade segment thanks to higher fund inflows

Safe government bond yields at year's highs amid higher long-term real interest rates.
Increased interest rate volatility and uncertain Fed rate steps continue to argue for duration near neutral.
IG inflows clearly positive for the year, HY - negative. Emerging market local currency bonds still preferred.

- Continued robust US economic data and the rise in long-term real interest rates on both sides of the Atlantic weighed on **safe-haven government bonds**. 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 pressure due to the flood of new issues. As a result, the yield on **10-year government bonds** traded above 4.5% in the **US** and around 2.7% in **Germany**. The Bund yield rose to 3% at times last month, the first time since 2011. Higher-than-expected budget deficit forecasts for this year in Italy caused spreads between **Italian** and **German** government bonds to widen further to their highest level for the year around the 2.0% mark.
- **Corporate bonds** suffered from widening spreads over the last month. However, the relative long-term valuation of the **investment-grade space**, combined with solid balance sheets and generous liquidity reserves of most issuers, remains more attractive than the risk premiums in the **high-yield segment**. The IG segment is also strongly supported by technical factors, led by cash inflows. High interest rate volatility also put pressure on **emerging market bonds** in hard currencies.
- Bonds continue to offer interesting opportunities. In safe bonds, we prefer **covered bonds and their European counterparts** to government bonds due to the attractive excess yield. In Europe, we prefer corporate bonds from defensive sectors, and in emerging markets we prefer investment-grade corporate bonds to hard currency government bonds due to attractive relative valuations and limited new supply on the corporate side. However, we continue to prefer the local currency segment there. Due to the high interest rate volatility, we continue to keep the duration at neutral.

Yields on 10-year government bonds



Source: Bloomberg, 11/10/2018 - 11/10/2023.

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	→	↘

		Performance in index currency		
	As of 11/10/2023	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	208.93	+0.7%	-0.3%	-20.1%
Covered bonds (iBOXX Euro Germany Covered)	178.56	+1.2%	+1.6%	-13.8%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	138.85	+1.7%	+2.9%	-14.1%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	147.96	+3.1%	+4.3%	-7.5%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	536.50	+1.5%	+0.2%	-5.5%
High-yield bonds (ICE BofA Global High Yield Index)	414.10	+5.0%	+12.3%	-2.1%

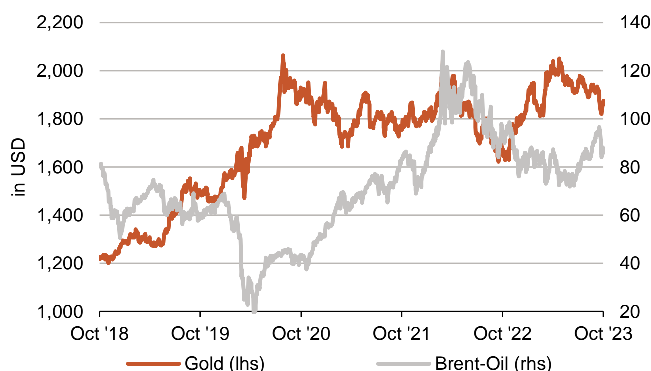
COMMODITIES

Commodities capped for the time being

High opportunity costs weigh on gold.
Crude oil with little upside potential after strong rally.
Metals remain directionless without clear economic signals.

- **Gold**, after holding up surprisingly well at the beginning of September in the face of a stronger dollar and high real interest rates, has had a harder time of it lately. In an environment of higher interest rates, the high opportunity costs are weighing on gold. For a sustainable upward trend, a lower real interest rate and US dollar are needed. Without a turnaround in interest rates, gold is likely to remain on the defensive for the time being.
- The rally in **crude oil** has intensified over September in the face of OPEC production cuts until the end of the year. The supply deficit, hopes of a soft landing and the recent Iran conflict could continue the rally in the short term, but in the medium term it will be hard to find incremental positive drivers that are not yet reflected in prices.
- **Industrial metals** held on to the sideways movement over September. Due to their high cyclicality, they remain caught in the spell of the economy and China. Without clear signals from China, metals remain directionless.

Price development



Source: Bloomberg, 11/10/2018 - 11/10/2023.

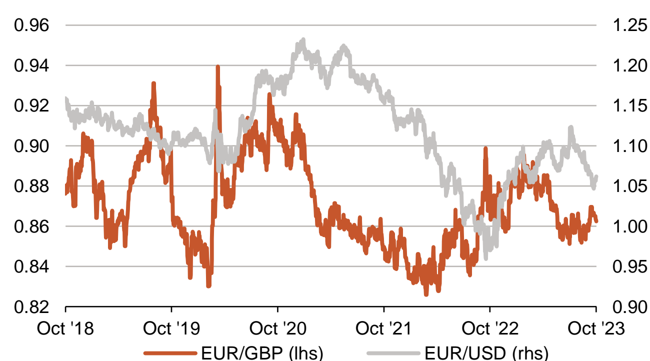
CURRENCIES

US dollar still at an advantage

EUR/USD: Economy and geopolitics strengthen USD.
EUR/GBP: Political calm stabilises the pound.
EUR/CHF: The Swiss franc remains in demand.

- **EUR/USD:** The news situation is strengthening the US dollar and thus keeping the EUR/USD exchange rate under pressure. Economically, the expected soft landing of the US economy is contributing to the soaring US dollar. In addition, the geopolitical crises are playing into the American currency's hands. The dollar – just like the Swiss franc – remains in demand. This was recently demonstrated again after the attack on Israel. The euro, on the other hand, is struggling with the very subdued economic data from the eurozone. The catch-up potential for the euro is limited for the time being. We see the EUR/USD exchange rate at the end of the year only slightly higher at around 1.08.
- **EUR/CHF:** In the longer term, the interest rate advantage of British government bonds over Bunds should decrease. Nevertheless, we expect a fairly stable pound exchange rate. One advantage for the pound is that the political situation in the UK has stabilised. EUR/GBP should continue to fluctuate around the 0.86 mark.

Exchange rates



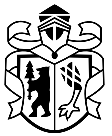
Source: Bloomberg, 11/10/2018 - 11/10/2023.

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 11/10/2023	Performance ytd	1-year	3-year
Gold USD/ounce	1,874	+2.8%	+12.5%	-2.9%
Silver USD/ounce	22.0	-8.0%	+15.1%	-12.4%
Copper USD/pound	361.2	-5.2%	+4.3%	+17.2%
Brent USD/bbl	85.82	-0.1%	-9.0%	+100.3%

	As of 11/10/2023	Performance ytd	1-year	3-year
EUR/USD	1.06	-0.8%	+9.4%	-10.2%
EUR/CHF	0.96	-3.2%	-1.0%	-11.0%
EUR/GBP	0.86	-2.6%	-2.5%	-4.9%
EUR/JPY	158.41	+12.8%	+11.9%	+26.8%



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
Daniel Sutter | Equities
Felix Stern | Fixed Income
Philina Kuhzarani | Commodities, Minutes
Dr Konstantin Ignatov | Minutes

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Joh. Berenberg, Gossler & Co. KG
Neuer Jungfernstieg 20
20354 Hamburg
Telephone +49 40 350 60-0
www.berenberg.de
MultiAssetStrategyResearch@berenberg.de