BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

09 November 2023

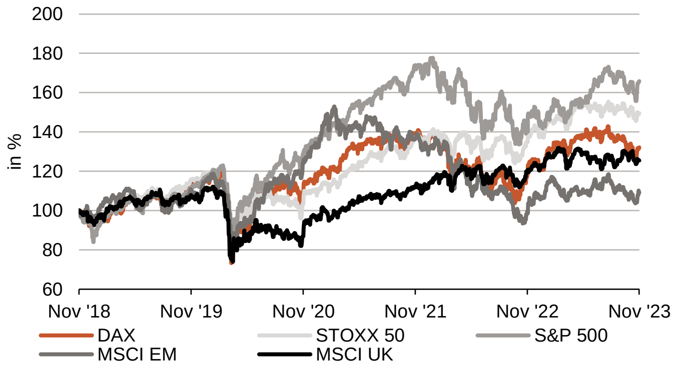
Managers of the Committee

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, 08/11/2018 - 08/11/2023.

Most important assessments at a glance

Economics	• US economy: soft landing in winter after robust economy in summer; new momentum in the course of 2024. • Europe: consumer purchasing power recovers, but industry and residential construction decline. Economy weak for now. • Inflation declines, rate peak probably reached. Fed cuts rates from spring 2024, ECB keeps money market rate stable in 2024.
Equities	• Equity markets recovered after weakness of recent weeks at start of November. Rally mainly driven by technical factors. • Cyclical risks currently only partially priced in. Late effects of tight interest rate policy continue to make markets vulnerable. • We have reduced our equity underweight. A continuation of the rally seems possible for the time being.
Bonds	• Decline in yields on safe government bonds in view of central bank interest rate pauses and cooling economy. • Increased interest rate volatility on both sides of the Atlantic continues to argue for duration close to neutral. • IG inflows remain positive for the year, HY – almost unchanged. EM local currency bonds still preferred.
Commodities	• Geopolitics and falling real interest rates boost gold. Only a turnaround by the central banks offers further potential. • Demand worries have recently outweighed supply risks. After a strong rally, crude oil only has potential again in the medium term. • Industrial metals remain sensitive to the economy, but the decarbonisation trend is already supporting the price trend.
Currencies	• US dollar remains strong, partly due to the geopolitical crises. A small setback recently because interest rates have probably peaked. • The Bank of England keeps base rate constant despite high inflation. The pound weakens slightly – EUR/GBP rises to 0.87. • Even though the euro has recently gained slightly against the franc: The Swiss currency is strong due to the many crises.

Current market commentary

Equity markets have developed twofold over the last four weeks. Geopolitical concerns and rising interest rates initially led to a sell-off until the end of October. Triggered by recently weaker US macro data ("bad news is good news"), less restrictive central banks and significantly lower interest rates, there was then a significant countermovement at the beginning of November and equity markets rose sharply. Nevertheless, the movement is likely to have been strongly technically driven by short covering and pessimistic investor sentiment – sentiment among US private investors is now as pessimistic as it was in March of this year during the banking crisis.

Movements on the bond market have also been heterogenous over the last four weeks. Initially, yields rose significantly, as in the previous month. Concerns about higher government bond volumes, solid US economic data and hawkish Fed comments initially strengthened the "higher for longer" narrative. Yields on 10-year US treasuries even exceeded the 5 % mark for a time. More dovish Fed comments, statements by the Treasury Department that it now wants to refinance more at the short end and less at the long end, and weaker US labour market data turned the tide at the beginning of November – yields fell significantly.

On the commodities side, the military conflict in the Middle East strengthened demand for safe havens and, together with the recent fall in real interest rates, boosted the price of gold. Following its strength in the summer, however, crude oil has shown renewed weakness over the last four weeks, dominated by demand concerns.

We leveraged the sell-off at the end of October to reduce our equity underweight and increase our exposure to US equities. Now that the reporting season is over, the share buyback programmes of US companies should support share prices. While the strong correction could also lead to a technical continuation of the equity rally in the course of a year-end rally, we remain sceptical from a fundamental perspective.

ECONOMICS

US economy lands softly, China stabilises, Europe weakens until spring 2024

USA: Fiscal policy supports; no recession despite high interest rates. Fed reaches rate peak and loosens reins from May 2024.
Europe: strong headwind 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. Interest-sensitive residential construction has largely stabilised after a strong correction. As companies have built up high reserves and, unlike in previous cycles, do not have to correct overcapacity, they are now reducing their investments less than before despite high interest rates. The expansive fiscal policy is supporting demand. However, the boom in private consumption is over. Overall, the US economy is likely to experience a soft landing with a sharp slowdown in growth in the coming quarters before the economy can pick up speed again from mid-2024.
- **Europe: Manufacturing and residential construction in recession.** After the pandemic, there is pent-up demand for services in many countries, but not for goods. Industrial production is stagnating in the USA and demand is weakening in China. In addition, there is an inventory correction in industry, which had built up too much stock worldwide with the end of the pandemic-related supply bottlenecks. As a result, demand for exports from Europe is suffering. However, there are increasing signs that exports and the industry will bottom out at the end of 2023.
- **Weak economy until spring:** Although consumer purchasing power has been increasing again since the start of 2023 with falling inflation and rising wages, the European economy will stagnate in the fall and winter. A slight recession is possible, even probable for Germany. There are no signs of a new upturn until spring 2024, when the global inventory correction comes to an end. However, residential construction is likely to decline until autumn 2024.
- **China 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 further increase the credit overhang. However, China can and will prevent the correction in the real estate market from triggering a major financial crisis. Surveys suggest that the situation is stabilising. China's imports could increase again somewhat by 2024 at the latest.
- **Inflation declining:** Inflation continues to fall in the USA and Europe. However, the core rate of inflation excluding energy and food is only falling slowly. Wage pressure, which is now more pronounced in Europe than in the US, is likely to keep inflation in the US and Europe above the 2% central bank target in the second half of 2024 as well.

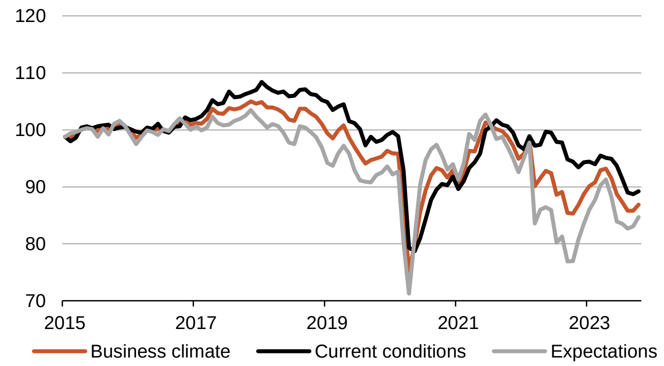
At the interest rate peak: At 5.5%, the US Fed has probably reached the interest rate peak, even if a further move is not ruled out. With inflationary pressure slowly diminishing, it may lower its key interest rate from spring 2024. As the weak economy is likely to continue to dampen inflation in Europe, the ECB and the BoE will not raise their interest rates any further either. Unlike the Fed, however, the ECB is unlikely to lower the money market 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	2.4	2.3	2.5			
US	24.2	2.4	1.5	1.7	4.2	2.9	2.3
China	18.4	5.0	4.0	3.6	0.4	1.9	2.1
Japan	5.2	1.8	1.0	1.1	3.2	2.1	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	0.7	1.7	5.5	2.7	2.3
Germany	4.4	-0.2	0.6	1.6	6.1	2.7	2.2
France	3.1	0.9	1.1	1.7	5.7	3.2	2.5
Italy	2.2	0.6	0.4	1.1	6.1	2.2	2.2
Spain	1.5	2.3	1.5	2.1	3.5	3.0	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

Turnaround ahead? Ifo expectations slightly less depressed



Ifo Business Climate Index with current situation and expectations. Source: Ifo

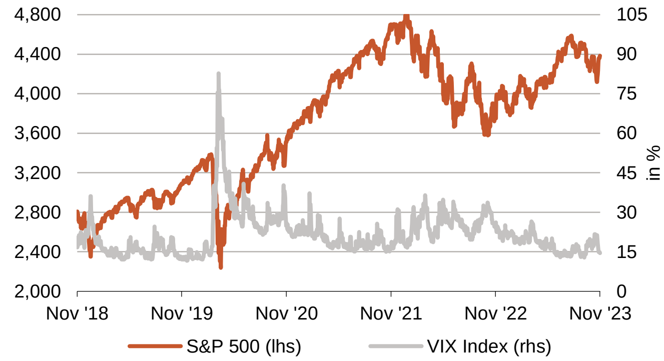
EQUITIES

Technicals and interest rate hopes drive risk appetite on equity markets

Equity markets recovered after weakness of recent weeks at start of November. Rally mainly driven by technical factors. Cyclical risks currently only partially priced in. Late effects of tight interest rate policy continue to make markets vulnerable. We have reduced our equity underweight. A continuation of the rally seems possible for the time being.

- The movement on **equity markets has** been split over the last four weeks. Until the end of October, the equity markets initially fell significantly due to geopolitical concerns and rising interest rates. The turnaround then came at the beginning of November. The solid Q3 reporting season, poorer US macro data ("bad news is good news") and the recent fall in (real) interest rates led to a technical upward movement. The rally was aided by short covering and pessimistic investor sentiment.
- At the sector level, **utilities** and **energy stocks** performed strongest in Europe over the last four weeks, while **financial** and **healthcare stocks** brought up the rear. Regionally, the Polish election results and better economic prospects pushed **Eastern European equities to the** top. At the style level, **growth stocks** outperformed **value stocks** over the last four weeks.
- We currently consider the optimism on the equity markets to be unsustainable. The upward movement was primarily driven by technical factors (oversold market and low positioning) as well as increased risk appetite due to hopes of interest rate cuts in the near future in the wake of more dovish Fed comments. Although the pricing in of cyclical risks has begun, it does not yet appear to be complete. The market seems to be largely ignoring the continuing recession risks.
- We leveraged the sell-off at the end of October to reduce our equity underweight and add to US equities. With the end of the reporting season, the share buyback programmes of US companies should now begin and support share prices. While the strong correction could also lead to a technical continuation of the equity rally in the course of a year-end rally, we remain sceptical in the medium term for fundamental reasons.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 08/11/2018 - 08/11/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 08/11/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,230	+9.4%	+11.3%	+22.0%	11.1	3.6%
SMI	3,371	+0.6%	-0.5%	+5.9%	17.3	3.3%
MSCI UK	2,121	+2.3%	+4.8%	+44.0%	10.5	4.3%
EURO STOXX 50	4,178	+13.7%	+15.8%	+43.1%	11.8	3.6%
STOXX EUROPE 50	9,926	+9.0%	+10.6%	+44.9%	13.1	3.6%
S&P 500	8,226	+15.2%	+15.8%	+29.0%	20.3	1.6%
MSCI Em. Markets	958	+2.8%	+9.7%	-11.3%	13.4	3.2%

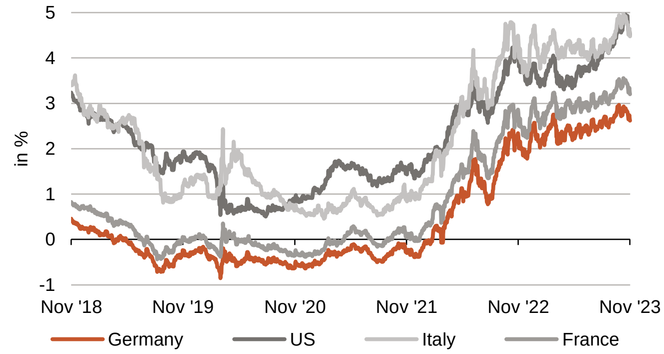
FIXED INCOME

Deteriorating economic data and falling inflation rates give central banks a break

Decline in yields on safe government bonds in view of central bank interest rate pauses and cooling economy. Increased interest rate volatility on both sides of the Atlantic continues to argue for duration close to neutral. IG inflows remain positive for the year, HY – almost unchanged. EM local currency bonds still preferred.

- Signs of a slowdown in the economy and the decline in newly created jobs in the USA, as well as interest rate pauses by central banks on both sides of the Atlantic, boosted **safe government bonds**. The steepening of the yield curves continued in October due to the significantly sharper decline in interest rates at the short end than at the long end. Long-term US government bonds received an additional tailwind from the US Treasury's announcement that it would issue fewer bonds at the long end of the curve. As a result, the yield on **10-year government bonds** in the **USA** is back at 4.5% and in **Germany** at 2.6%. The spreads between **French** and **German** and **Italian** and **German** government bonds widened due to the high budget deficit forecasts in France and Italy.
- **Corporate bonds** again suffered from widening spreads over the last month. The relative valuation of the **IG segment** in a long-term comparison, combined with the solid balance sheets and generous liquidity reserves of most issuers, remains more attractive than the risk premiums in the **HY segment**. The IG segment is additionally supported by technical factors, above all cash inflows. Ongoing interest rate volatility continues to put pressure on **emerging market hard currency bonds**.
- In the case of safe bonds, we continue to prefer **covered bonds** and **their European counterparts** to government bonds due to the attractive additional yield. In Europe, we prefer corporate bonds from defensive sectors, and in emerging markets we prefer IG 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. Due to the high interest rate volatility, we are leaving the duration at neutral.

Yields on 10-year government bonds



Source: Bloomberg, 08/11/2018 - 08/11/2023.

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 08/11/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	211.27	+1.8%	-0.0%	-19.7%
Covered bonds (iBOXX Euro Germany Covered)	180.27	+2.2%	+1.6%	-13.2%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	140.64	+3.0%	+3.0%	-13.4%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	148.97	+3.8%	+4.7%	-7.2%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	542.29	+2.6%	+2.9%	-4.6%
High-yield bonds (ICE BofA Global High Yield Index)	419.91	+6.5%	+11.5%	-1.8%

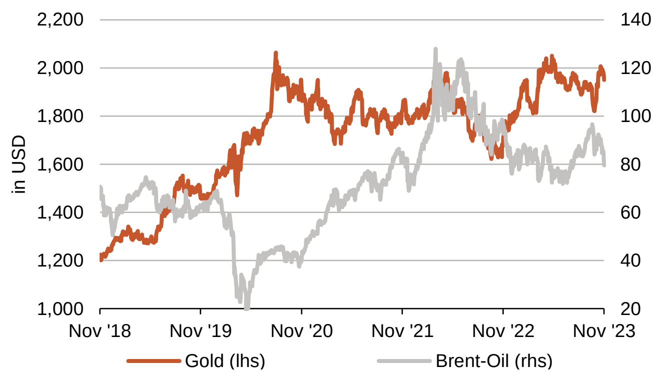
COMMODITIES

Commodities capped for the time being

Geopolitics and falling real interest rates boost gold.
Crude oil with medium-term potential after strong rally.
Metals already supported by decarbonisation trend.

- **Gold** surpassed the USD 2,000 mark, triggered by the war in the Middle East and later fundamentally supported by falling real interest rates and a weaker US dollar. However, the market recently priced out part of the safety premium again. An end to the restrictive interest rate policy is required for a sustained upward trend.
- **Crude oil has** fallen sharply over the last four weeks. Driven by growing demand concerns, the market even priced out the supply shortage premium resulting from OPEC's production cuts by the end of the year. If the war in Israel remains localised, supply concerns are likely to subside here too. In the medium term, however, the high capital discipline of producers and refineries argues in favour of an increasing supply shortage.
- **Industrial metals** have been treading water over the last four weeks. Beneath the surface, however, demand for green technologies – particularly in China – is providing support. This is likely to pick up speed as the economy recovers.

Price development



Source: Bloomberg, 08/11/2018 - 08/11/2023.

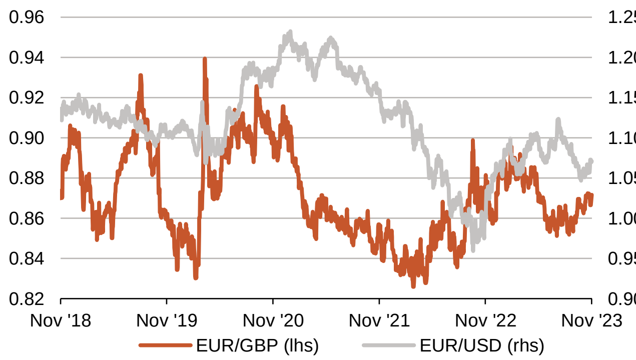
CURRENCIES

Safe haven currencies still in demand

EUR/USD: Dollar weakens slightly, rate peak reached.
EUR/GBP: BoE pauses, pound tends to ease.
EUR/CHF: Optimum environment for the franc.

- **EUR/USD:** The last few weeks have been characterised by the "flight to safety" – the US dollar benefited from this. Prior to this, the US currency had already gained as the emerging soft landing of the economy made monetary stimulus from the Fed appear less and less necessary next year. Now that there has been some weaker economic data from the US, the interest rate peak seems to have been reached. As a result, the euro was able to gain somewhat against the US dollar. The exchange rate has risen to just over USD 1.07 per euro and is thus on track to meet our year-end forecast of 1.08.
- **EUR/CHF:** The pound weakened slightly in the short term. EUR/GBP rose to 0.87 pounds per euro after the Bank of England kept the base rate constant at the beginning of November despite still high inflation. In general, we continue to expect a pound exchange rate in the region of 0.86. The somewhat more stable political situation in the UK should tend to help the pound.

Exchange rates



Source: Bloomberg, 08/11/2018 - 08/11/2023.

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 08/11/2023	ytd	1-year	3-year
Gold USD/ounce	1,950	+6.9%	+13.9%	-0.1%
Silver USD/ounce	22.6	-5.8%	+5.6%	-11.9%
Copper USD/pound	363.8	-4.5%	-1.2%	+15.3%
Brent USD/bbl	79.54	-7.4%	-16.6%	+101.6%

		Performance		
	As of 08/11/2023	ytd	1-year	3-year
EUR/USD	1.07	+0.0%	+6.3%	-9.8%
EUR/CHF	0.96	-2.7%	-3.0%	-9.9%
EUR/GBP	0.87	-1.5%	-0.1%	-3.4%
EUR/JPY	161.69	+15.2%	+10.2%	+31.8%

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

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