BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

07 December 2023

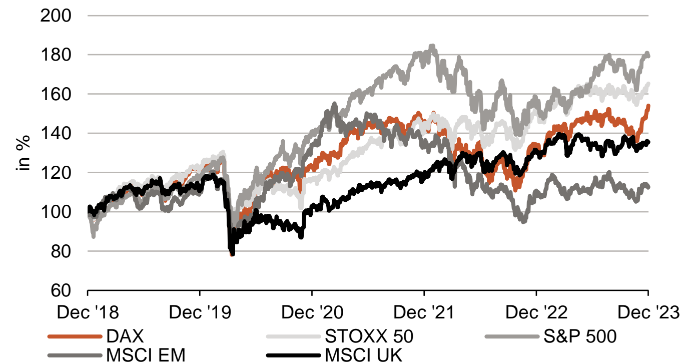
Managers of the Committee

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, 06/12/2018 – 06/12/2023.

Most important assessments at a glance

Economics	• US economy: soft landing ahead, new momentum in the second half of 2024. China slowly stabilising. • Europe: economy at low point; inventory correction in industry ends at the beginning of 2024; upturn from Easter. • Inflation declines; interest rates peak. Fed cuts interest rates from spring 2024; ECB eases later and more cautiously.
Equities	• Equities rally strongly in November. Small caps, cyclicals and interest rate-sensitive stocks were clearly ahead. • Further potential limited after strong movement. Late effects of the tight interest rate policy continue to make markets vulnerable. • We continue to feel comfortable with the reduced equity underweight. Small caps more attractive again as the economy recovers.
Bonds	• A further decline in yields on safe government bonds in view of hopes of interest rate cuts and a 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. Emerging market 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 supporting the price trend.
Currencies	• The USD remains strong due to the geopolitical crises, among other factors. Inflation data recently caused some movement. • EUR/GBP countermovement. The EUR has to accept a setback, also due to the euro inflation data. • After an interim recovery, the euro has fallen back below the 0.95 mark against the franc.

Current market commentary

November – historically one of the better months for equities in terms of seasonality – has once again shown its strength this year. The S&P 500 rose by more than 8 % and the DAX by almost 10 % over November. The combination of falling interest rates, falling volatility (the VIX is currently only at 13.0) and hopes of a "Goldilocks" scenario fuelled share prices. Small caps and interest rate-sensitive shares made particularly strong gains. After the strong movement, further potential is more limited until the end of the year. Consolidation seems likely. This is because many shares are now overbought, sentiment among private investors is characterised by strong optimism and the positioning of systematic and fundamental investors has risen sharply. Portfolio rebalancing at the turn of the year is likely to exert additional pressure on equities.

There has also been strong movement on the bond market over the last four weeks. Weaker US economic data and a cooler US inflation rate reinforced the narrative that the Fed has now reached the interest rate peak. Accordingly, the last interest rate hike was priced out for the time being in November and interest rates fell significantly. Yields on 10-year US government bonds fell to below 4.2 %. In the case of safe bonds, we continue to favour covered bonds over government bonds due to the attractive additional yield. Due to the high interest rate volatility, we are leaving the duration at neutral.

On the commodities side, gold reached a new all-time high thanks to interest rate cut fantasies, geopolitical concerns, falling real interest rates and a weaker US dollar. From here, the air seems thinner in the short term – at least as long as it is not foreseeable that the Fed will actually cut interest rates in the near future. Crude oil and industrial metals tended to have a harder time over November. Increased demand concerns weighed on them. In the long term, the increasing supply deficit and green demand should provide support. There are already initial signs of this (especially from China).

ECONOMICS

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

US economy: soft landing ahead, new momentum in the second half of 2024. China slowly stabilising.
Europe: economy at low point; inventory correction in industry ends at the beginning of 2024; upturn from Easter.
Inflation declines; interest rates peak. Fed cuts interest rates from spring 2024; ECB eases later and more cautiously.

- **A 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 rate-sensitive residential construction has largely stabilised after a strong correction. Since, unlike in previous cycles, companies 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. The labour market is losing momentum. Overall, the US economy is set for a soft landing with sharply reduced growth in the first half of 2024 before the economy can pick up speed again.
- **Europe: Manufacturing and residential construction in recession.** After the end of the pandemic-related supply bottlenecks, many companies had built up their stocks too much. They have been reducing their stocks again since May. As a result, they are currently producing less than they are selling. The recession in industry and in interest-dependent residential construction is also weighing on consumer sentiment and demand. The euro economy as a whole is in a slight recession.
- **New upswing in spring:** However, there are increasing signs that the industry will bottom out at the end of 2023. Companies are less pessimistic overall than they were two months ago. This suggests that the inventory correction will come to an end at the beginning of 2024. Although consumers' purchasing power has been increasing again since the start of 2023 amid falling inflation and rising wages, they are currently holding back on purchases. However, if the economy stabilises in winter and the news situation improves, they will probably spend more again in spring and thus give the economy new momentum.
- **China weak:** China's long-term problems (demographics, state control, credit overhang) are becoming increasingly apparent. However, China can and wants to prevent the correction on the property market from triggering a major financial crisis. Surveys indicate that the situation is stabilising.
- **Inflation declining:** In the US and Europe, inflation is falling faster than expected thanks to a correction in oil prices. However, the core rate 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 the core inflation rate in the US and Europe above the central banks' 2% target in the second half of 2024 as well.

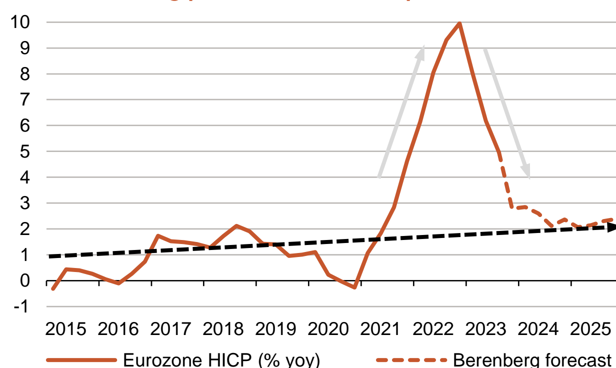
At the interest rate peak: The major central banks have reached the rate peak. With a weaker economy and slowly diminishing inflationary pressure, the US Fed may cut its key rate from spring 2024, from the current 5.5% to probably 4.5% at the end of 2024 and 3.5% at the end of 2025. In view of long-term inflation risks, the ECB will only ease its monetary policy cautiously, probably not until summer 2024. We now expect a euro money market rate of 3.5% at the end of 2024 and 3.25% at the end of 2025.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	2.4	2.2	2.4			
US	24.2	2.4	1.4	1.7	4.2	2.8	2.3
China	18.4	5.0	4.0	3.6	0.4	1.9	2.1
Japan	5.2	1.7	0.9	1.1	3.3	2.5	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	5.4	2.5	2.2
Germany	4.4	-0.2	0.6	1.6	6.1	2.7	2.3
France	3.1	0.8	0.9	1.7	5.7	3.0	2.5
Italy	2.2	0.7	0.6	1.2	5.9	1.6	2.2
Spain	1.5	2.3	1.5	2.1	3.4	2.4	2.3
Other Western Europe							
United Kingdom	3.2	0.5	0.7	1.7	7.3	2.6	2.1
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: The big push is over - but upward trend



Harmonised Consumer Price Index; quarterly data. Sources: Eurostat, Berenberg

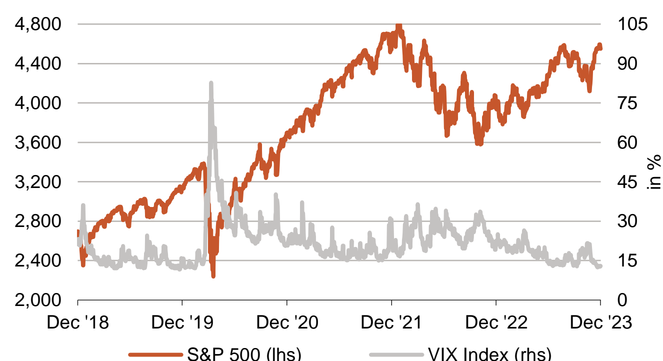
EQUITIES

"Goldilocks" hopes boost stock markets

Equities rally strongly in November. Small caps, cyclicals and interest rate-sensitive stocks were clearly ahead. Further potential limited after strong movement. Late effects of the tight rate policy continue to make markets vulnerable. We continue to feel comfortable with the reduced equity underweight. Small caps more attractive as the economy recovers.

- The **stock markets** have only known one direction over the past four weeks. "Goldilocks" hopes, easing interest rate pressure and falling volatility drove the markets upwards. The Dax even reached a new all-time high a few days ago. The price movements were characterised by strong rotations: small caps and cyclical shares rose sharply. Interest rate-sensitive shares in particular benefited from lower (real) interest rates and the hope of interest rate cuts in the near future.
- At sector level, all sectors in Europe performed positively over the last four weeks with the exception of **energy stocks** (which suffered from lower oil prices). **Information technology** and **industrial stocks** were the relative winners, closely followed by **financials** and **utilities**. At the style level, **growth stocks** outperformed **value stocks** in Europe over the last four weeks. In the US, **small caps** also outperformed their **large cap** counterparts.
- After the strong rally, we consider the potential for a continuation of the movement on a similar scale to be limited. Instead, we expect a consolidation. This is because the risks remain: The upward movement does not match the economic mix, earnings expectations for 2024 still appear unrealistic, many stocks are oversold, positioning is optimistic and the lagging effects of interest rate hikes should weigh more heavily on consumers and companies next year.
- After reducing our equity underweight at the end of October, we feel comfortable with our broad positioning with overweights in bonds and alternative investments. With signs of interest rate cuts and a sustained easing of economic risks, small caps are likely to become increasingly attractive.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 06/12/2018 - 06/12/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 06/12/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	16,656	+19.6%	+16.1%	+25.2%	12.2	3.3%
SMI	3,486	+4.0%	+0.6%	+9.8%	18.4	3.2%
MSCI UK	2,153	+4.3%	+3.5%	+31.4%	10.9	4.1%
EURO STOXX 50	4,483	+22.2%	+17.8%	+39.2%	12.6	3.4%
STOXX EUROPE 50	10,350	+13.7%	+9.9%	+41.6%	13.7	3.4%
S&P 500	8,550	+19.8%	+16.8%	+27.1%	21.0	1.5%
MSCI Em. Markets	975	+4.7%	+3.2%	-15.0%	13.4	3.3%

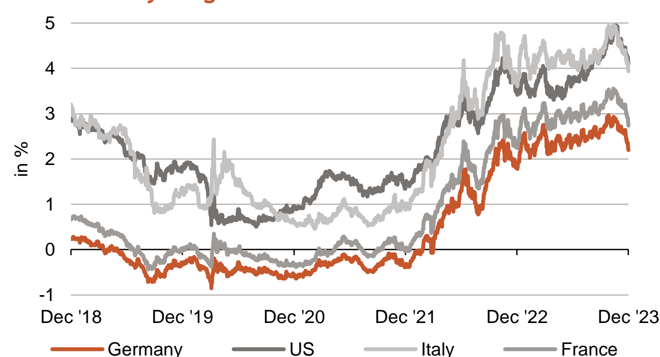
FIXED INCOME

Despite restrictive tones from central banks, the markets increasingly price in expectations of interest rate cuts

A further decline in yields on safe government bonds in view of hopes of interest rate cuts and a 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. Emerging market local currency bonds still preferred.

- The signs of a slowdown in the US economy and the stabilisation of the inflation rate in Europe reinforced the expectation of stronger interest rate cuts on both sides of the Atlantic. Despite warnings from central bank representatives in the US and Europe about the market's overly optimistic expectations of interest rate cuts next year, bond yields on **safe government bonds** have fallen sharply over the past month. US government bonds received an additional tailwind from a better-than-expected uptake of new issues by the market. As a result, the yield on **10-year government bonds** in the **US** is at 4.2% and 2.2% in **Germany**. A positive rating surprise from Moody's for Italy gave Italian government bonds an additional tailwind – the **BTP-Bund spread** narrowed to just under 180 bp.
- **Corporate bonds** increasingly benefited from the narrowing of spreads in November. The relative valuation of the **IG segment** in a long-term comparison, combined with 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 also supported by technical factors, above all cash inflows. Falling real interest rates and narrower spreads also supported **emerging market bonds in hard currency**.
- In the case of safe bonds, we continue to favour **covered bonds and their European counterparts** over government bonds due to the attractive additional yield. In Europe, we favour corporate bonds from defensive sectors, and in emerging markets we prefer government bonds to IG corporate bonds in hard currency due to higher yields and longer duration. However, we continue to favour the local currency segment. Due to the high interest rate volatility, we are leaving the duration at neutral.

Yields on 10-year government bonds



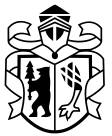
Source: Bloomberg, 06/12/2018 - 06/12/2023.

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 06/12/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	218.72	+5.4%	-0.5%	-16.7%
Covered bonds (iBOXX Euro Germany Covered)	183.89	+4.2%	+1.3%	-11.3%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	145.21	+6.3%	+2.2%	-11.0%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	152.99	+6.6%	+4.7%	-5.2%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	563.55	+6.6%	+4.4%	-1.0%
High-yield bonds (ICE BofA Global High Yield Index)	433.15	+9.9%	+9.5%	-2.2%



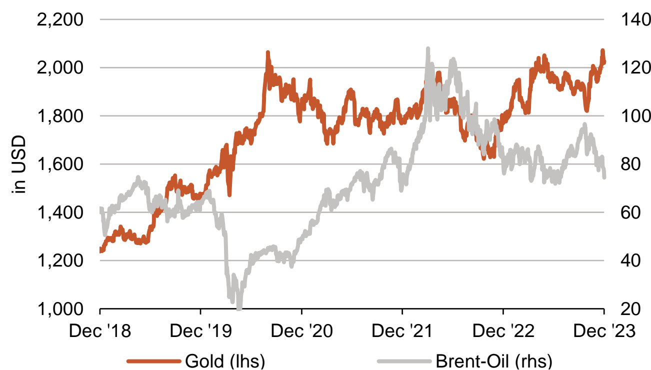
COMMODITIES

Gold shines, oil and metals suffer

Gold has a tailwind from all sides.
Crude oil has medium-term potential after strong rally.
Metals are already supported by green demand from China.

- **Gold** reached a new all-time high last month. There were tailwinds from all sides: Interest rate cut fantasies, geopolitical tensions, a weak real interest rate and a lower US dollar. If interest rates are cut, gold (and silver) should benefit quickly and strongly.
- **Crude** oil remained trapped in a volatile sideways movement in November. The OPEC meeting promised further cuts. However, the market remained sceptical due to a lack of transparency regarding the implementation of the "voluntary cut". In the long term, however, the market is likely to turn back into a deficit. This is because the OPEC cuts are keeping the market tight, rig activity in the US shale oil industry is declining and inventories are historically low.
- **Industrial metals** rose only sporadically over the last month. While the newly announced economic stimulus programmes in China have so far failed to provide a tailwind for metals, strong green demand is already providing support.

Price development



Source: Bloomberg, 06/12/2018 - 06/12/2023.

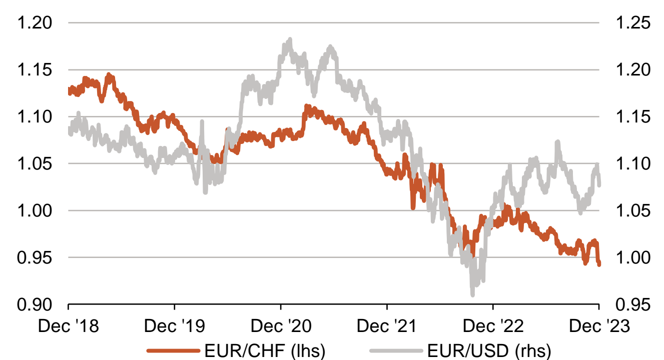
CURRENCIES

Inflation data makes the difference

EUR/USD: Setback after euro inflation data.
EUR/GBP: The EUR falls again towards 0.85.
EUR/CHF: The interim recovery has halted.

- **EUR/USD:** Back and forth for the euro-dollar exchange rate: After a noticeable recovery of the euro to USD 1.10 per euro, there was recently a setback to below USD 1.08. Both movements were primarily due to the declining inflation momentum on both sides of the Atlantic. Initially, inflation in the US fell significantly, meaning that the remaining interest rate hike expectations for the Fed were priced out. The dollar weakened as a result. Later, the sharper than expected decline in eurozone inflation led to a reassessment of the ECB's future policy. The expectation of a faster turnaround in interest rates put pressure on the euro exchange rate. The upcoming inflation data is likely to continue to be a key factor influencing the EUR/USD exchange rate.
- **EUR/CHF:** The EUR/CHF exchange rate pair followed a similar trajectory. After recovering from below CHF 0.95 to almost CHF 0.97 per euro, the single currency gave up this gain following the inflation data.

Exchange rates



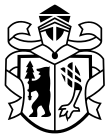
Source: Bloomberg, 06/12/2018 - 06/12/2023.

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 06/12/2023	Performance ytd	1-year	3-year
Gold USD/ounce	2,026	+11.0%	+14.4%	+10.2%
Silver USD/ounce	23.9	-0.2%	+7.7%	-1.2%
Copper USD/pound	371.7	-2.5%	-2.5%	+5.8%
Brent USD/bbl	74.30	-13.5%	-6.4%	+50.9%

	As of 06/12/2023	Performance ytd	1-year	3-year
EUR/USD	1.08	+0.6%	+2.8%	-11.2%
EUR/CHF	0.94	-4.8%	-4.5%	-12.9%
EUR/GBP	0.86	-3.2%	-0.6%	-5.0%
EUR/JPY	158.57	+12.9%	+10.6%	+25.5%



IMPORTANT NOTES

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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
Maria Ziolkowski | 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