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Markets

INVESTMENT COMMITTEE MINUTES

05 August 2021

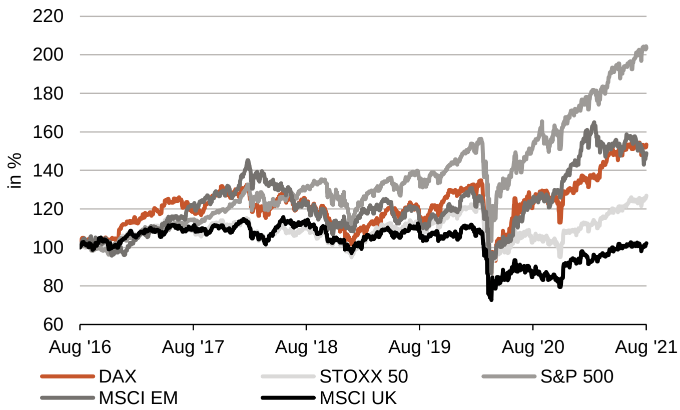
Managers of the Committee

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, 04/08/2016 - 04/08/2021.

Most important assessments at a glance

Economics	• The recovery continues. Thanks to vaccinations, health systems should no longer be stretched to their limits. • Consumers have pent-up demand, companies want to invest, politicians are supporting - already there are some bottlenecks. • Inflation returned more dynamically with the upswing - central banks will tighten policy cautiously.
Equities	• Equity markets rose for the 6th month in a row. Earnings and economic development supported. Asia with difficulties. • Reflation trade is not dead but is losing momentum. Cyclical and growth equities developed positively. • We think there is limited upside potential and have taken a balanced position with only a slight overweight in equities.
Bonds	• Recently yields have fallen significantly. The room for more downside is now limited, which increases the risk of rising rates. • Growth concerns have caused spreads on high-yield and emerging market bonds to rise moderately. • We are underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.
Commodities	• The gold price has moved sideways despite the fall in real interest rates. Growth concerns could increase demand again. • Crude oil had a volatile month but is expected to rise again as supply tightens and the economy recovers. • Industrial metals have recently gained in value again. We think there is more upside than downside in a strong economy.
Currencies	• EUR/USD: The Fed is helping the dollar to new strength. Loose ECB policy weighs on the euro. • The UK pound has gains slightly against the euro again. Is the Bank of England giving the pound a further tailwind? • The Swiss franc is taking wing again. The losses against the euro from the first quarter have now been more than made up.

Current market commentary

The strength in the equity markets continues. July was the sixth month in a row in which the S&P 500 and the STOXX Europe 600 rose. In addition to expansionary monetary and fiscal policies, investors have recently been persuaded by better-than-expected corporate earnings on average. However, not all markets have risen. Asian equity markets in particular were weighed down by Covid-19 concerns, economic disappointments and regulatory uncertainty in China. In terms of investment styles, growth and cyclical stocks in Europe in particular gained, while value stocks moved sideways. The reflation trade is not dead but has lost momentum. Looking ahead, we remain optimistic about equities, but we believe the upside in the coming months is limited as much of the upside is already priced in. Moreover, August tends to be a bad month for equities historically. Consequently, we are only slightly overweight in equities and have a balanced position within the asset class.

Yields on safe haven government bonds have fallen significantly in recent weeks, which should limit the future drop considerably. Currently, both 10-year German government bonds and US government bonds are yielding close to their levels at the beginning of the year. At that time, however, the economic recovery and the inflation trend were still clearly below the current dynamic. Fundamentally, the development of yields is difficult to explain and the bond market thus paints a different picture than the stock market. We expect yields to rise in the medium term. Duration should therefore be kept short. Spreads on corporate bonds are at historically low levels, even though they have risen somewhat recently, especially on high-yield bonds. We continue to favour credit risk but are becoming increasingly cautious.

Gold was unable to gain despite the fall in real interest rates. We remain positive on crude oil, even though future developments are likely to remain volatile, as they were in July.

ECONOMICS

The economic traffic lights remain green; ECB presents result of its policy review.

The recovery of the global economy continues. The US has reached pre-crisis level, Europe will follow in Q4. Catch-up support of economy by consumers and businesses. Monetary and fiscal policy continue to support. Inflation dynamics are stronger than expected - but central banks will only tighten their policies cautiously.

- **Strong recovery:** Life has gradually returned to normal in the US. However, infection rates continue to rise. Expansionary monetary and fiscal policies have enabled a rapid return of GDP to pre-crisis levels. However, the inflation dynamic continues unabated. In June, the inflation rate rose to 5.4 % and core inflation to 4.5 %.
- **The Eurozone is catching up:** GDP data for the second quarter have surprised positively. The recovery is dynamic and is leading to supply bottlenecks in some places. Although the COVID-19 infection figures have shot up in some countries in the meantime, thanks to the success of the vaccination, the infection is not likely to lead to new hard lockdowns. Our economic outlook therefore remains positive. GDP is expected to return to pre-crisis levels in the fourth quarter of 2021.
- **UK test case:** The number of new infections has risen rapidly in UK since 23 May despite rapid progress in vaccination. In the meantime, however, the number of new infections is falling just as rapidly - despite the complete removal of restrictions on 19 July. Since the risk groups seem to be well protected by vaccination, we do not currently expect the medical system to be pushed to its breaking point again as it was last winter.
- **China** remains robust for the time being thanks to its credit stimulus, despite significant long-term risks. Strong growth in key consumer countries is also supporting many other emerging markets. However, some, such as India, Brazil and Turkey, have damaged themselves by mishandling the pandemic.
- **Inflation momentum likely to ease in the medium term:** Special effects such as the return to a normal oil price and supply bottlenecks contribute to rising inflation rates. As the special effects fade out, however, the price climate will calm down again in 2022 with inflation at a good 1.5% in Germany and the eurozone. For the US, however, we also expect stronger upward pressure on prices in the medium term. The central banks are cautiously moving towards an exit from ultra-expansionary monetary policy. The Bank of England meeting on 5 August will provide further insight. The Fed could concretise its exit plans at the Jackson Hole conference on 26-28 August. The ECB is expected to slowly reduce bond purchases under the Pandemic Emergency Programme (PEPP) from the end of 2021.

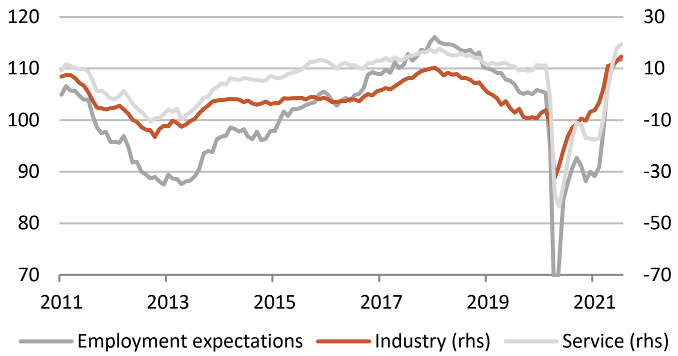
The ECB has a new strategy: As a result of its latest strategy review, the ECB will pursue a symmetrical inflation target of 2% in future. In doing so, it emphasised that in future it wants to counter the danger of a slide below the effective interest rate floor particularly decisively. In addition, it will include the consequences of climate change in its considerations in the future.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	%	2020	2021	2022	2020	2021	2022
World	100.0	-3.1	5.1	3.8			
US	24.5	-3.4	6.5	4.3	1.2	4.0	3.0
China	16.4	2.0	8.8	5.3	2.5	1.3	2.2
Japan	5.8	-4.7	3.3	2.2	0.0	0.1	0.7
India	3.3	-7.3	10.0	6.5			
Latin America	5.9	-7.0	4.4	3.3			
Europe	24.4	-6.2	4.9	4.7			
Eurozone	15.3	-6.5	4.9	4.9	0.3	1.9	1.7
Germany	4.4	-4.9	3.1	5.0	0.4	2.7	1.6
France	3.1	-8.0	6.2	4.7	0.5	1.5	1.4
Italy	2.3	-8.9	5.9	4.8	-0.1	0.9	1.3
Spain	1.6	-10.8	5.8	6.9	-0.3	2.1	1.7
Rest of western Europe							
UK	3.2	-9.8	6.8	5.5	0.9	2.1	2.4
Switzerland	0.8	-2.7	3.5	2.8	-0.7	0.4	0.5
Sweden	0.6	-2.9	3.6	3.4	0.5	1.7	1.3
Eastern Europe							
Russia	1.9	-3.0	3.0	2.5	3.3	5.2	4.0
Turkey	0.9	1.6	4.5	3.5	12.3	15.0	12.0

Source: Berenberg

Eurozone business climate



Source: European Commission, 01/01/2011 – 31/07/2021.

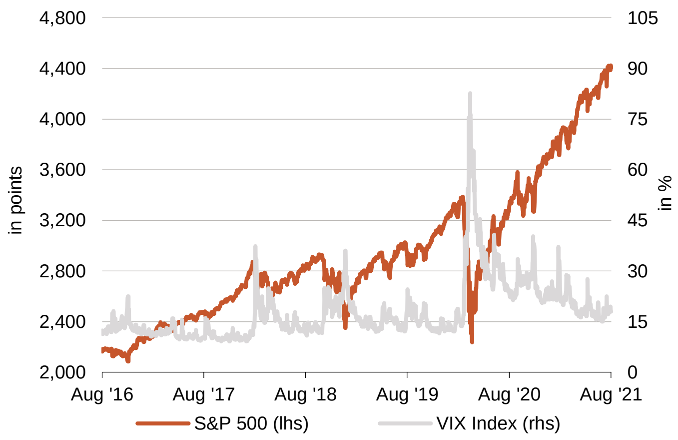
EQUITIES

Earning development supports the markets

Equity markets rose for the 6th month in a row. Earnings and economic development supported. Asia with difficulties. Reflation trades are not dead, but they are losing momentum. Cyclical, and growth equities developed positively. We think there is limited upside potential and have taken a balanced position with only a slight overweight in equities.

- **Equity markets continued to perform well in July** - with the S&P 500 and STOXX Europe 600 indices posting their sixth consecutive monthly increase. In addition to macroeconomic support from monetary and fiscal policy, prices were also supported by better-than-expected earnings in the current Q2 reporting season. However, not all regions were able to gain in July. In Asia, Japan and China, among others, weakened as COVID-19 increasingly weighed again there, economic data disappointed and regulatory measures in China unsettled investors.
- Developments in investment styles were mixed. Although the reflation trade does not seem to be completely dead, it has been clearly neglected by investors in recent months. Investors increasingly believe that the peak in inflation and economic growth will come soon. **Growth stocks** in Europe thus gained over 3% in July, while **value stocks** only rose slightly. **Cyclical stocks,** on the other hand, gained over 2.5% and thus outperformed defensive stocks (+0.7%).
- Although the stock markets continued to rise in July, this was not entirely without fluctuations. We expect these to continue in the coming weeks. Historically, August was a rather difficult month for equities. In the medium term, however, we remain positive due to the positive economic and earnings development above the long-term trend.
- We are positioning ourselves with a **slight overweight position in equities** and **remain balanced.** The regional focus remains on Europe and the emerging markets.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 04/08/2016 - 04/08/2021.

Overview of equity markets (short/medium term)

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

As of 04/08/2021		Performance in local currency ytd	1-year	3-year	P/E	Dividend yield
DAX	15,692	+14.4%	+24.5%	+24.4%	14.8	2.8%
SMI	12,179	+16.9%	+23.4%	+46.2%	19.4	2.7%
MSCI UK	2,007	+13.2%	+22.2%	+2.4%	12.4	4.2%
EURO STOXX 50	4,145	+19.1%	+30.5%	+30.0%	17.9	2.7%
STOXX EUROPE 50	8,683	+18.0%	+24.1%	+25.2%	16.6	3.2%
S&P 500	4,403	+18.2%	+35.2%	+63.7%	22.1	1.4%
MSCI Em. Markets	1,304	+2.3%	+22.3%	+31.2%	13.6	2.6%

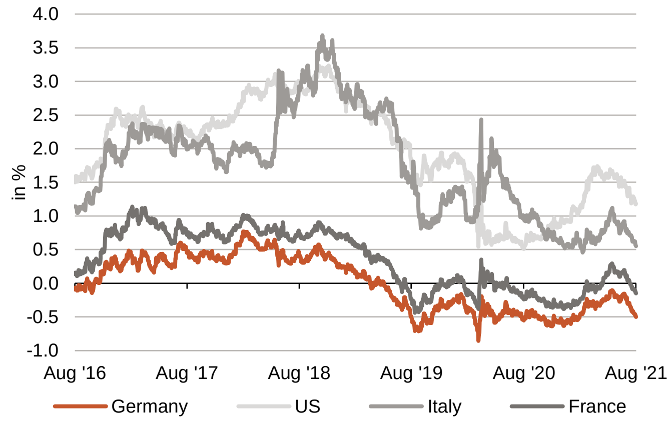
BONDS

Yields have little room to move downwards

Yields have fallen significantly recently. The room for more downside is now limited, which increases the risk of rising rates. Growth concerns have caused spreads on high-yield and emerging market bonds to rise moderately.
We are underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.

- Yields on **European government bonds** have recently fallen significantly and seem to have decoupled from fundamentals. With significantly higher inflation and continued positive economic development, rising yields should again be inevitable in the medium term. With yields at around -0.5% on **10-year German government bonds,** we view the way down as limited. The risks of rising yields thus clearly outweigh the hedging advantages of government bonds.
- The picture is similar for **US government bonds**. The yield has fallen by over 20bp in recent weeks to below 1.2%, a level last recorded at the beginning of the year. As then, we consider the current yield level unsustainable in view of the current economic development and think interest rates will rise in the medium term.
- Starting from very low spread levels, spreads have risen moderately in the last four weeks amid increased market volatility due to growth concerns, especially for **high-yield** and **emerging market bonds**. The **USD high yield bonds** spread widened by over 25bp. While we continue to favour credit over interest rate risk, we are becoming increasingly cautious here as well. In **EUR-IG corporate bonds**, however, spreads have declined slightly thanks to low summer new issues and ECB purchases. Price gains are thus becoming increasingly difficult, which puts the focus on carry. In **emerging market bonds,** we like local currency bonds from a cyclical perspective and higher interest rates, as well as high-yield hard currency bonds.
- **We are underweight bonds:** We maintain our focus on corporate and emerging market bonds and keep duration short.

Yields on 10-year government bonds



Source: Bloomberg, 04/08/2016 - 04/08/2021.

Overview of bond markets (short/medium term)

Orientation	Old	New
Duration	Short	Short
Government bonds	↘	↘
Corporate bonds	→	→
High-yield bonds	↗	↗
Emerging market bonds	↗	↗

Yields (10-year)	Old	New
Germany	↗	↗
UK	↗	↗
US	↗	↗

	As of 04/08/2021	Performance in index currency: ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	261.13	-0.9%	+0.6%	+12.2%
Covered bonds (iBOXX Euro Germany Covered)	206.67	-0.4%	-0.1%	+4.1%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	164.57	+0.9%	+2.6%	+8.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	162.20	+0.5%	+2.0%	+6.9%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,287.86	-0.0%	+3.3%	+20.5%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,547.91	+2.2%	+9.5%	+19.5%

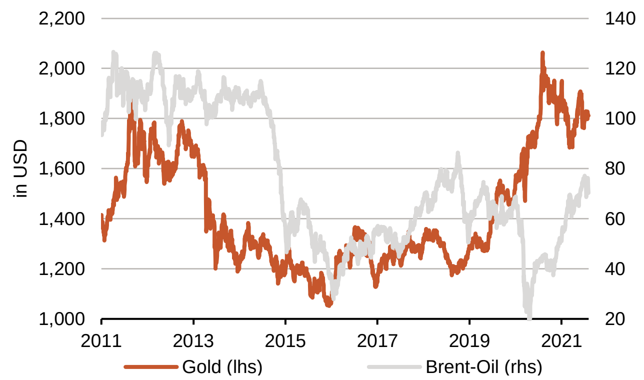
COMMODITIES

Gold decoupled from real interest rates

Gold moved sideways despite falling real interest rates.
Crude oil had a volatile month but the outlook is positive.
Industrial metals remain in demand due to strong economies.

- The **gold price** has hardly moved recently, although real interest rates are at record lows. Investors probably consider this situation unsustainable and are pricing in rising interest rates. Demand for gold could increase again if growth worries arise. There is still downside risk, but it is limited.
- The **crude oil price** briefly fell below the 70 USD mark last month due to supply expansions and delta spread fears. However, the sell-off was primarily caused by speculative investors. Fundamentally, we continue to think there is potential in crude oil, especially with a recovery in the Asian economy and a continued supply shortage.
- **Industrial metal prices** have also recently benefited from the strong economy and were able to make further gains. Despite the strong development so far, we believe that the downside should be limited in a good economic situation and that the upside has not yet been fully exhausted.

Price development



Source: Bloomberg, 01/01/2011 - 04/08/2021.

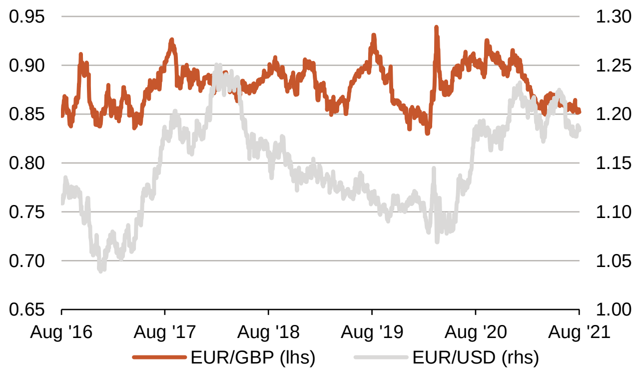
CURRENCIES

Euro/US dollar exchange rate remains below 1.20

EUR/USD: US central bank and ECB in focus.
GBP/EUR rises again. Will BoE end bond purchases?
Swiss franc regains its former strength.

- **EUR/USD:** The Euro remains under slight pressure against the US dollar. The prospect of the Fed's exit from its ultra-expansive monetary policy has strengthened the US dollar at least temporarily. In addition, the ECB's new monetary policy strategy has given it the flexibility to continue its extremely expansionary monetary policy for longer. Strategically, the ECB is moving a little bit in the direction of US monetary policy, which does not help the euro. However, we expect a somewhat tighter monetary policy from the ECB than it itself is currently holding out for. The EUR/USD exchange rate should recover if this view prevails in the market.
- **EUR/GBP:** The pound had a strong first quarter. In the second quarter, it tended to move sideways. Recently, however, the British currency was able to gain slightly again. Will the Bank of England provide additional impetus with an earlier end to its purchase programme?

Exchange rates



Source: Bloomberg, 04/08/2016 - 04/08/2021.

Overview of commodities (short/medium term)	Old	New
Gold	↗	→
Oil (Brent)	↗	↗

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 04/08/2021	ytd	1-year	3-year
Gold USD/ounce	1,812	-4.6%	-10.3%	+49.1%
Silver USD/ounce	25.4	-3.9%	-2.4%	+64.6%
Copper USD/pound	433.3	+23.1%	+49.7%	+56.8%
Brent USD/bbl	70.38	+35.9%	+58.4%	-3.9%

		Performance		
	As of 04/08/2021	ytd	1-year	3-year
EUR/USD	1.18	-3.1%	+0.3%	+2.3%
EUR/CHF	1.07	-0.8%	-0.4%	-6.7%
EUR/GBP	0.85	-4.6%	-5.6%	-4.2%
EUR/JPY	129.60	+2.7%	+3.9%	+0.7%

IMPORTANT NOTES

Members of the Investment Committee

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Dr Holger Schmieding | Chief Economist, Vice-Chairman
Matthias Born | Head Portfolio Management Equities, European 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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Christoph Mäder | Bonds
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Marco Höchst | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

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