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Markets

INVESTMENT COMMITTEE MINUTES

09 September 2021

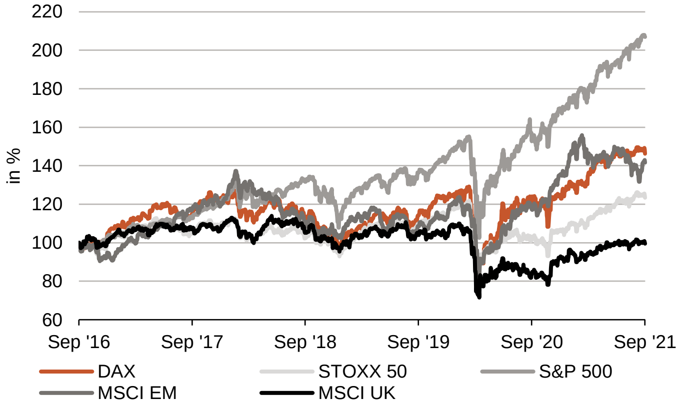
Managers of the Committee

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, 08/09/2016 - 08/09/2021.

Most important assessments at a glance

Economics	• Global economy loses momentum in the short term but vaccination progress helps against the Delta wave of the pandemic. • Outlook 2022 remains positive: consumers have pent-up demand, companies want to invest and politics are supportive. • Inflation will return more dynamically with the upswing – central banks will cautiously tighten their policies.
Equities	• Western stock markets hit new all-time highs in August. Asia attempts a turnaround and has significant catch-up potential. • Growth and defensive stocks remain strong of late. Comeback of value and cyclical stocks possible into the end of the year. • We are positioning ourselves with a slight overweight in equities and a positive market picture, but with some existing risks.
Bonds	• Government bond yields have recently been unable to escape the rise in inflation. Upward pressure is likely to persist. • New issue summer break is over. IG Corporate bonds are increasingly unattractive with low risk premiums. • We underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.
Commodities	• The gold price moved sideways in the absence of a fundamental driver. The focus is on the hedging character. • Crude oil experienced another volatile month. The supply shortage is likely to persist despite recent production expansion. • Industrial metals have continuous high demand in the economic upswing. The aluminium price reached new 10 year high.
Currencies	• EUR/USD: "Ups and downs" after a weak phase – will the euro iron out the dip again? • The euro is gaining another cent against the pound. Still, the exchange rate continues to fluctuate at 0.86 pounds per euro. • The euro is gaining against the franc. After falling to 1.07 francs per euro, the exchange rate rose to almost 1.09.

Current market commentary

Many equity regions continued to edge upwards in August thanks to positive earnings revisions, ongoing inflows and share buyback programmes. The S&P 500 marked its 54th all-time high this year – 12 of them in August. Traditional laggards such as US small caps and Japanese equities outperformed, supported by short covering and strengthening economic optimism. Asia offers catch-up potential after weak relative performance since the beginning of the year. After strong global equity market performance since the start of the year, many investors are increasingly nervous and hedging, as seen in elevated implied volatility – the VIX has never closed below 15 this year – and the high differential between hedging and upside participation costs. However, systematic investors such as trend-following strategies have continued to buy stocks, making the market slightly more vulnerable overall. But we do not expect a major pullback as investors are likely to continue buying market dislocations.

We are also cautiously optimistic, as above-trend economic growth is likely to continue for the time being and investment alternatives are scarce. Nevertheless, there are risks, such as QE tapering, geopolitics or higher COVID-19 figures in the winter. We therefore maintain our slight overweight in equities and focus on high-growth quality companies as well as tactical value positions. Bond yields have recently experienced increased upward pressure after it became clear that elevated inflation is likely to persist for the time being. In addition, the likelihood of QE tapering increased after more hawkish voices were also heard in Europe. The potential for falling risk premiums on corporate bonds at the current low level is limited. Our focus is therefore on current yields and on more risk-sensitive bond segments that can better compensate for a rise in interest rates.

Gold recently lacked fundamental drivers but is unavoidable for hedging. Crude oil, on the other hand, was able to recover.

ECONOMICS

A short-term damper on the economy

Global economy loses some momentum. US has reached pre-crisis level; Europe will follow in Q4.
Consumers and companies still need to catch up. Monetary and fiscal policy also continue to provide support.
Inflation momentum is stronger than expected, but central banks will only tighten policy cautiously.

- **A damper:** After a spurt of growth in the spring and summer, the global economy is currently losing some momentum. The delta wave of SARS-CoV-2 infections is dampening consumer sentiment and in parts of the service sector in many countries. Supply bottlenecks are hampering industrial growth. In some areas, labour shortages are preventing a rapid expansion of aggregate supply. In China and some other Pacific Rim countries, this is compounded by the short-term consequences of some regional lockdowns.
- **Correction at a very high level:** Despite a slight setback in August, the purchasing managers' indices for the US and Europe continue to point to high growth. Moreover, employment is rising strongly on both sides of the Atlantic. In the long run, this will continue to boost incomes and consumer spending, even if some consumers are likely to hold back on some spending in view of the current wave of infections. In the short term, the risks to our economic forecasts are tilted to the downside. However, this does not hold true for 2022. In fact, we see a chance that growth could surprise on the upside in 2022 if supply bottlenecks ease.
- **China's economy** is suffering from measures against the delta wave as well as a new wave of regulations. But as usual, the country can launch a new stimulus if growth slows too much.
- **Delta wave:** Even in countries such as the UK and the USA, where the number of new Corona infections has risen sharply, it can be seen how much vaccination is working. The number of severely ill people and deaths is far lower than in previous waves. The public health situation has somewhat decoupled from incidence. This supports our hope that new lockdowns can be avoided.
- **Inflation momentum likely to ease in the medium term:** Special effects such as the return to a normal oil price and supply bottlenecks are contributing to rising inflation rates. In November, the inflation rate in the eurozone could climb to around 3.5%. The shortage of containers, which is contributing to the high transport costs, should be resolved after the Christmas shopping season at the latest. However, as the special effects expire, the price climate will calm down again in 2022, with inflation of around 1.8% in the eurozone. For the US, however, we expect stronger price buoyancy in the medium term as well, driven primarily by a shortage of labour and higher wage pressure.

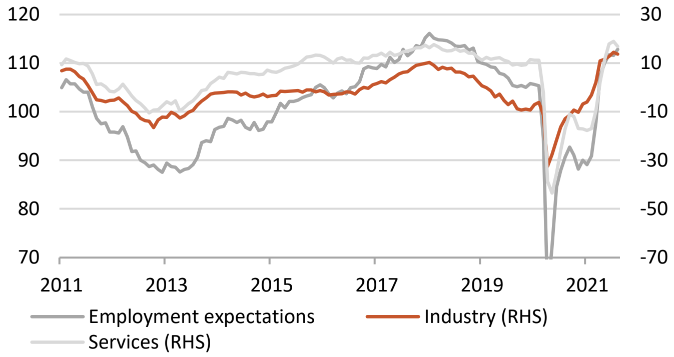
Monetary policy remains expansionary: Central banks are cautiously moving towards an exit from ultra-expansionary monetary policy. The Fed will probably start to scale back its bond purchases somewhat in December. The ECB will probably also reduce bond purchases somewhat in Q4 as part of the Pandemic Emergency Purchase Programme (PEPP).

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2020	2021	2022	2020	2021	2022
World	100.0	-3.1	5.1	3.8			
USA	24.5	-3.4	6.5	4.4	1.2	4.1	3.2
China	16.4	2.0	8.8	5.3	2.5	0.9	2.0
Japan	5.8	-4.7	2.5	2.4	0.0	-0.3	0.6
India	3.3	-7.3	10.0	6.5			
Latin America	5.9	-7.0	4.4	3.3			
Europe	24.4	-6.1	5.0	4.6			
Eurozone	15.3	-6.5	5.1	4.9	0.3	2.2	1.8
Germany	4.4	-4.9	2.8	5.4	0.4	2.7	1.7
France	3.1	-8.0	6.2	4.7	0.5	1.9	1.8
Italy	2.3	-8.9	5.9	4.9	-0.1	1.6	1.6
Spain	1.6	-10.8	5.8	6.9	-0.3	2.3	2.0
Other Western Europe							
United Kingdom	3.2	-9.8	6.9	5.5	0.9	2.3	2.7
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 - 30/08/2021.

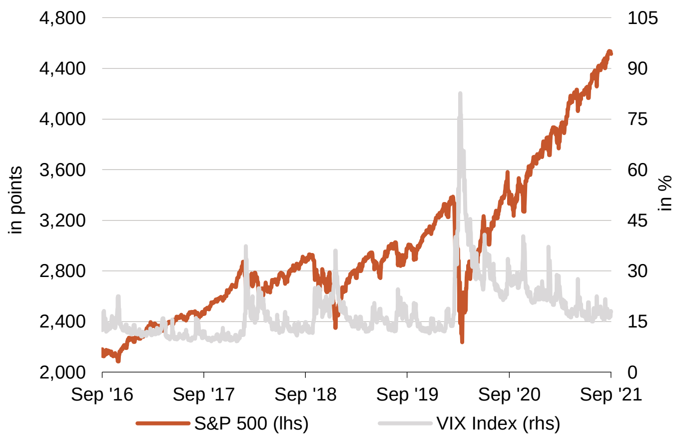
EQUITIES

From all-time high to all-time high

Western stock markets hit new all-time highs in August. Asia attempts a turnaround with significant catch-up potential. Growth and defensive stocks remain strong of late. Comeback of value and cyclical stocks possible into the end of the year. We are positioning ourselves with a slight overweight in equities and a positive market picture but with some existing risks.

- **The series of strong months for equities continued in August.** The S&P 500 hit 54 all-time highs since the beginning of the year – 12 in August alone. Strong corporate earnings performance and continued expansionary monetary and fiscal policy continue to outweigh the negative impact of the Delta spread and concerns about possible QE tapering in the US. The S&P 500 was among the biggest gainers in August but was beaten by Japanese equity indices such as the Topix, which returned over 3%. Asia appears to be turning the corner after relative weakness since the start of the year. COVID-19 concerns are easing and stimulus hopes are rising.
- **Growth** and **defensive stocks** continued to lead the way in August, which benefited our strategic investment style. However, **value** and **cyclical stocks** also performed well. We believe a catch-up movement in these is quite possible as economic optimism returns towards the end of the year. We would take advantage of this movement with some of our tactical positions, even though we have already taken some profits there.
- Following the strong equity market performance since the beginning of the year, many investors have now ramped up their hedges, which can be seen in the further increase in implied volatility – the VIX has never closed below 15 this year - and the high differential between hedging and upside participation costs. However, systematic investors such as trend-following strategies have continued to buy stocks, making the market slightly more vulnerable overall. However, we do not expect a setback above 10%. In the medium term, we remain optimistic about risk assets.
- We are positioning ourselves with a **slight equity overweight** and **some tactical positions with a cyclical and value focus**.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 08/09/2016 - 08/09/2021.

Overview of equity markets (short/medium term)

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

		Performance in local currency				
	As of 08/09/2021	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,610	+13.8%	+20.4%	+30.5%	14.4	2.8%
SMI	12,215	+17.3%	+22.7%	+51.9%	19.1	2.7%
MSCI UK	1,988	+13.5%	+24.0%	+7.1%	12.0	4.4%
EURO STOXX 50	4,177	+20.0%	+30.8%	+38.5%	17.5	2.7%
STOXX EUROPE 50	8,676	+17.9%	+24.9%	+31.5%	16.2	3.2%
S&P 500	4,514	+21.4%	+37.5%	+65.9%	22.2	1.3%
MSCI Em. Markets	1,314	+3.4%	+23.5%	+38.7%	13.7	2.6%

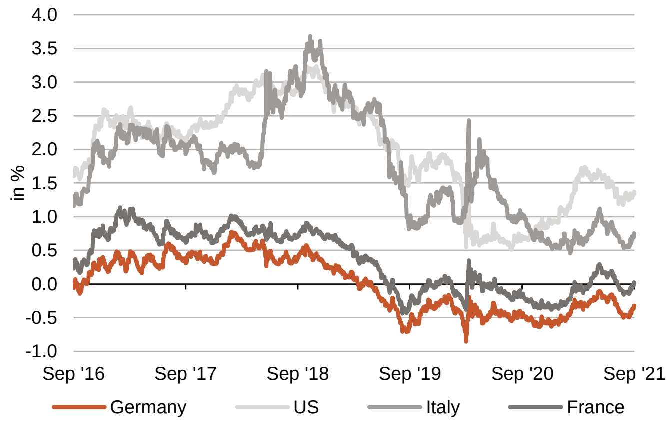
BONDS

Yields with upward pressure

Government bond yields have recently been unable to escape the rise in inflation. Upward pressure is likely to persist. New issue summer break is over. IG Corporate bonds are increasingly unattractive with low risk premiums. We underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.

- The significantly higher inflation values and the renewed rise in inflation expectations among market participants, as well as more hawkish tones from some ECB members, caused bond yields on **European government bonds** to rise noticeably over the past four weeks. Yields on **Italian government bonds, for** example, have risen by almost 20 basis points (bp), compared with 14bp for **German government bonds**, which are considered very safe. We expect the rise in yields to continue, as current nominal yields do not compensate for the inflation risk.
- **US government bond** yields have also risen. Higher inflation amid rising employee costs has led to upward pressure, which is likely to continue, even if the September Fed meeting is unlikely to provide a tapering announcement due to the labour market situation.
- In recent weeks, the European corporate bond markets have returned from their summer holiday, as evidenced by the numerous new issues. Since the beginning of the year, however, these have been below the level seen in 2020. Risk premiums nevertheless remain at a historically very low level. Recently, however, **EUR-IG corporate bonds** saw a marginal widening of spreads, while **EUR high-yield bonds** experienced a slight narrowing of spreads. Price gains are becoming increasingly difficult, which means that the focus is on carry. However, rising interest rates pose a noticeable risk, especially for IG corporate bonds, which is why we prefer more risk-sensitive bonds. In **emerging market bonds**, we like local currency bonds due to higher local interest rates and lower interest rate sensitivity.
- **We underweight bonds.** We maintain our focus on corporate and emerging market bonds and keep duration short.

Yields on 10-year government bonds



Source: Bloomberg, 08/09/2016 - 08/09/2021.

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	↗	↗

		Performance in index currency		
	As of 08/09/2021	ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	257.98	-2.1%	-0.2%	+10.8%
Covered bonds (iBOXX Euro Germany Covered)	205.58	-0.9%	-0.7%	+3.4%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	162.92	-0.1%	+1.3%	+8.2%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	161.41	+0.0%	+1.2%	+6.6%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,294.99	+0.5%	+3.6%	+22.7%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,558.84	+3.0%	+9.1%	+21.4%

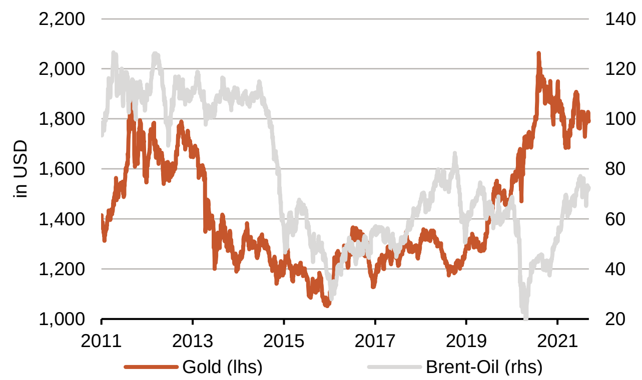
COMMODITIES

Gold in the sideways phase

Gold has recently lacked fundamental drivers.
Crude oil with volatile month but positive outlook.
Industrial metals in demand thanks to economic upswing.

- **Gold** continued its recovery after the "flash crash" in August at a reduced pace – and that is despite slightly higher real interest rates. The gold market does not seem unprepared for a somewhat tighter Fed. Most recently, the precious metal was trading close to USD1,800 per ounce again. However, fundamental drivers for gold are currently lacking, which is why significant price rises are unlikely for the time being. We continue to like gold as a hedging instrument.
- The **price of crude oil** experienced significantly increased volatility in recent weeks, falling to below USD66 per barrel at one point due to COVID-19-related demand concerns. However, the recovery followed promptly. This is because the oil market is still undersupplied and is likely to remain so in the coming months.
- Among the **industrial metals**, the aluminium price in particular was able to gain recently and recorded a new 10-year high. Industrial metals remain essential for the economic upswing and are therefore in high demand.

Price development



Source: Bloomberg, 01/01/2011 - 08/09/2021.

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

	As of 08/09/2021	Performance ytd	1-year	3-year
Gold USD/ounce	1,789	-5.7%	-7.4%	+49.5%
Silver USD/ounce	23.9	-9.3%	-10.2%	+69.0%
Copper USD/pound	423.2	+20.3%	+40.5%	+62.6%
Brent USD/bbl	72.60	+40.2%	+82.5%	-5.5%

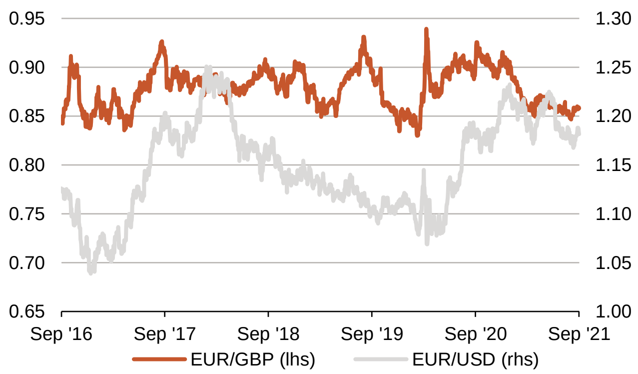
CURRENCIES

Euro can stop the fall against the dollar

EUR/USD: Euro makes a tentative comeback.
GBP/EUR fluctuates around 0.86 pounds per euro.
Franc temporarily sought as a safe haven.

- **EUR/USD:** Central bank policy was and is an important driver. The US Fed is being virtually forced by the strong rise in inflation rates to exit its ultra-expansive monetary policy earlier than expected. Nevertheless, there are still no clear statements on the exact timing and scope of the taper. Now that the inflation rate in the eurozone has risen to 3%, the focus is also on the ECB. The ECB has the flexibility to reduce bond purchases as part of its pandemic purchase programme. Even if it reduces the volume of purchases by EUR10bn or EUR20bn per month, monetary policy will still remain extremely expansionary. Still, the euro exchange rate can profit from this prospect.
- **EUR/GBP:** There has been no clear trend since the bearish first quarter. The exchange rate is fluctuating around the level of 0.86 pound per euro. The focus is on the central banks of both currency areas: who will make the first move in exiting the ultra-loose monetary policy?

Exchange rates



Source: Bloomberg, 08/09/2016 - 08/09/2021.

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 08/09/2021	Performance ytd	1-year	3-year
EUR/USD	1.18	-3.3%	+0.3%	+2.3%
EUR/CHF	1.09	+0.8%	+0.8%	-2.7%
EUR/GBP	0.86	-4.0%	-5.4%	-4.0%
EUR/JPY	130.27	+3.2%	+4.3%	+1.6%

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, European Equities
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
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Till Budelmann | US Equities
Felix Stern | Bonds
Ludwig Kemper | Commodities
Karsten Schneider | Multi Asset Strategist, Minutes

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