HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

(TOO) STRONG CONSENSUS

The market has a surprisingly uniform opinion: the US economy will make a soft landing in the first half of 2024, the Fed will cut interest rates from the second quarter and bond yields, as well as the US dollar, will fall. The prospect of an upturn supports equity markets and risk assets.

SIGNIFICANT RISKS

However, the soft landing scenario is a fine line for the markets with risks on both sides. More robust growth leads to high interest rates in the longer term, which weighs on valuations. Weaker growth, on the other hand, weighs on profit expectations that are already too ambitious.

OUR TOPICS 2024

High interest rates burden households and companies. Global economy initially weaker, opportunity for an upturn from the middle of the year. Increased risks, but good medium-term prospects for all asset classes (equities, bonds, commodities) favour a broad portfolio structure. Market breadth should increase significantly.

Q1 | 2024

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FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear readers,
2023 was better for investors than 2022. European and US equities, many bond segments and gold performed well. However, it was not an easy year – many things turned out differently than expected. Europe came through the winter well but slipped into recession in the second half of the year. The recovery in China after the end of the COVID-19 restrictions was only brief, and the US economy remained remarkably robust – despite the banking crisis in the spring – thanks in part to the liquidity support provided by the US Federal reserve (Fed). The narrative on the markets was constantly changing and bond yields fluctuated wildly. Central banks raised interest rates more than expected. Real yields continued to rise and, as in 2022, weighed particularly heavily on interest rate-sensitive investments, including our favoured quality and growth stocks and small caps. Market breadth was very low, with a few large stocks accounting for the bulk of overall market performance. I explain what these developments meant for Berenberg's multi-asset strategies and what adjustments we made in the Insights interview.

Looking ahead to 2024, the majority of investors, bank economists and market strategists are of the same opinion: the US economy will make a soft landing in the first half of 2024, the Fed will cut interest rates from the second quarter, bond yields and the US dollar will fall, and yield curves will steepen. If there is then a prospect of an upturn, this will support the equity markets and other risk assets. Equities and bonds promise positive, generally single-digit returns. Our base scenario hardly differs from this picture either. And indeed, the cooler US inflation and weaker US economic data in recent weeks are consistent with this. However, the problem is that the markets have largely priced in this scenario since the end of October. So, if it materialises, the potential on the markets is likely to be limited. Otherwise, there is potential for disappointment, as the risks for the base scenario are high – as in 2023, many things could turn out differently again. The downstream effects of the restrictive monetary policy are likely to have an increasing impact, especially as the (re)financing requirements in 2024 are considerable. In addition, the fiscal stimulus that has cushioned the negative effects of interest rate hikes so far is likely to weaken. The US presidential elections and geopolitical tensions are further sources of uncertainty. The risk of a less soft landing should therefore not be underestimated.

Only with more clarity in this regard and foreseeable interest rate cuts should the markets focus on a subsequent upturn on both sides of the Atlantic and risky investments recover more sustainably. A broad, balanced portfolio structure, therefore, still seems advisable. Especially as this offers opportunities for positive real returns in the medium term in view of the attractive valuations in many segments (small caps, European equities) and the running yield (EUR covered bonds, emerging market (EM) local currency bonds, cat bonds).

I wish you all the best for 2024!

CONTENT

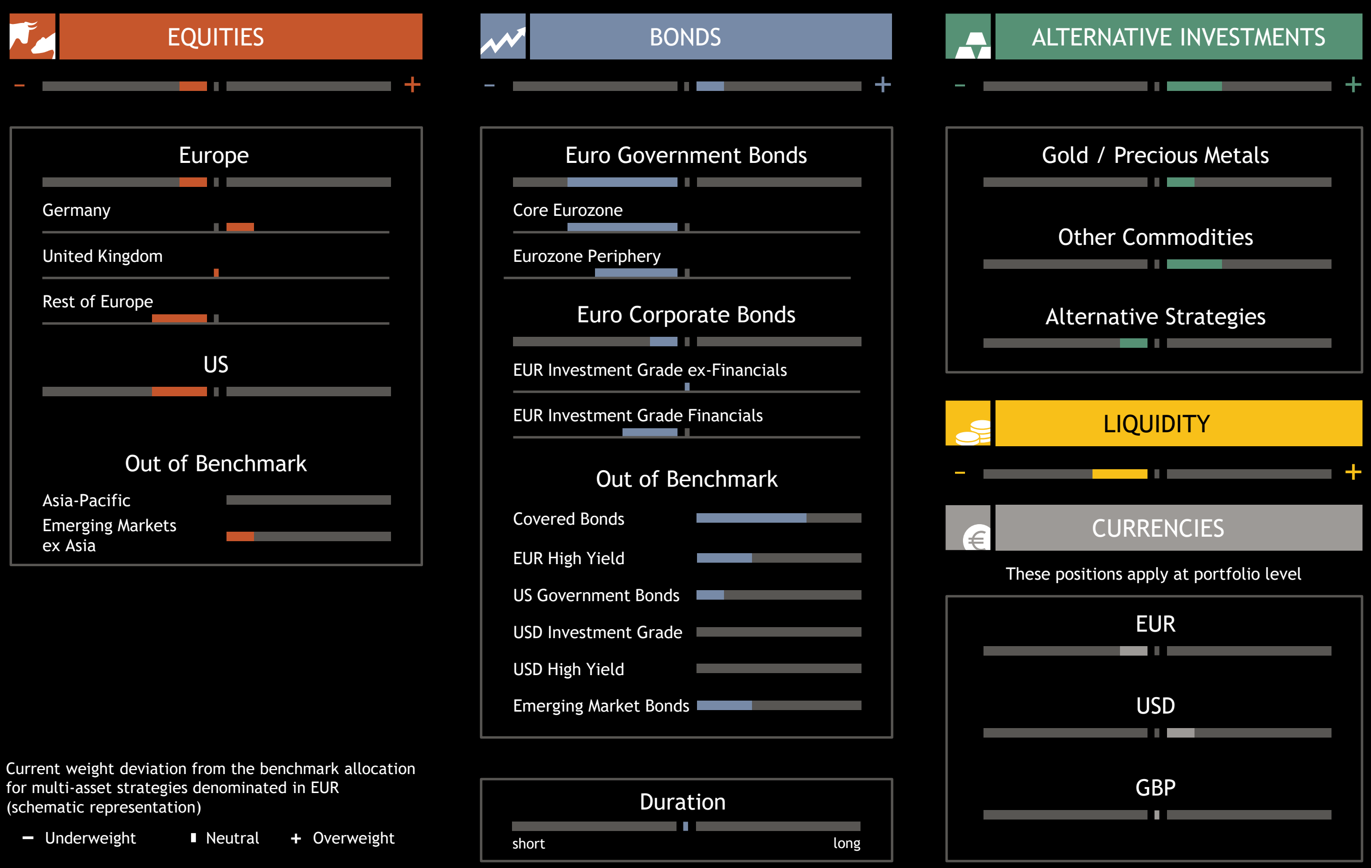
2024: CHALLENGING, BUT WITH OPPORTUNITIES

IN A NUTSHELL

- The recovery in equities and bonds since the end of October is an interest rate-driven valuation expansion and is unlikely to be the start of a more sustained market upturn.
- A phase of weaker growth still lies ahead of a possible economic upturn. The omnipresent scenario of a soft landing for the US economy is largely priced in and harbours numerous risks.
- With clearly positive real yields and in view of more growth than inflation risks, interest rate duration is more attractive again. In the event of weak growth, a negative correlation of stocks and government bonds is likely to return (temporarily).

Portfolio positioning at a glance

We started the fourth quarter with a defensive positioning. When the stock markets corrected by more than 10% from the end of July to the end of October, we reduced our equity underweighting from moderate to only small and at the same time increased our bond position and its interest rate duration in view of the high bond yields. However, we are now not chasing the subsequent strong recovery in equities and bonds. The market is already largely pricing in the strong consensus for 2024, despite the numerous risks to the scenario. We are, therefore, maintaining a broad positioning, with overweights in bonds and alternative investments such as gold, industrial metals and a position that would benefit from a steeper US yield curve. In the case of corporate bonds, we are focusing on short maturities, as risk premiums are likely to widen again in the event of economic weakness. In the case of safer bonds (government bonds, mortgage bonds), we are focusing on longer maturities. Emerging market bonds in local currency also remain attractive. Our focus on quality and growth stocks should benefit in the event of a weaker economy and without a further rise in interest rates. In view of the upturn expected later in the year, small caps and cyclical commodities, which are now very attractively valued, are also interesting.



Fourth quarter: US economic weakness brings recovery

The trends of the third quarter continued in October. The US economy continued to be surprisingly robust and yields continued to climb with higher issue volumes of US government bonds – the real yield on 10-year inflation-indexed US government bonds reached 2.5%. Bonds and equities suffered at the same time. At the end of October, global and US equities had corrected by more than 10% from their highs at the end of July. US economic data then weakened and US inflation surprised to the downside. Further rate hikes were then completely priced out and expectations of interest rate cuts increased. Bond yields fell significantly, with the 10-year US real yield dropping below 2.0%. Equities and bonds recovered significantly from their lows. The US dollar weakened and gold, additionally supported by the outbreak of the Israel-Hamas conflict, rose significantly. The oil price fell despite the conflict.

2024: From weakness to recovery, with obstacles

For 2024, our economists expect a soft landing for the US economy in winter and then an upturn in the course of 2024. In Europe, too, the economy is likely to remain weak until spring. Inflation is likely to continue to fall slowly amid weak growth, and interest rates have probably peaked. The Fed is likely to cut interest rates from the spring, while the European Central bank (ECB) will keep money market rates stable for the time being. However, this scenario harbours many risks. The recent strong improvement in financial conditions (top chart, p. 5) could further delay the US economy's landing and revive the narrative of prolonged high interest rates. Alternatively, the wave of high (re-)financing costs is yet to hit companies, private households, and governments. This could make the landing less soft after all. But even if there is a soft landing, we do not expect the markets to price this in consistently, but that there will be renewed turbulence. In addition, geopolitical risks remain high on the agenda and the US presidential election is just one of many important elections in what the *Economist* describes as the biggest election year in history.

Normalised real yields offer a good starting position

The rise in bond yields is the biggest change for investors in recent years. Due to the tightening of monetary policy, this was driven exclusively by rising real yields. The rise of a further half percentage point has prevented 2023 from being an even better year for investors (middle chart, p. 5). Real yields are now at the same level as before the financial market crisis and offer a good starting point for investors (bottom chart, p. 5). This applies not only to bonds, which offer high current yields and the chance of declining yields as price drivers, but also to equities, especially rate-sensitive segments, which have suffered greatly from the rise in interest rates. A further sharp rise is unlikely. However, without a recession and a strong easing of monetary policy, investors should not hope for a sharp fall in real yields either, as these are countered by the piling wave of refinancing in the US and its high level of new debt. A rapid increase in valuations due to a sharp fall in real yields is not to be expected. Investors should therefore pay particular attention to (structural) earnings growth and attractive valuations.

Equities or bonds, who will win the race in 2024?

There is little consensus as to whether equities will beat bonds in 2024 or vice versa. According to a survey by Bank of America, a clear

Q4 with reversal of Q3: gold, equities and bonds rose, the US dollar and oil fell. Many asset classes positive since the start of the year.

Total return	YTD and in Q4 (in %, in EUR): YTD (31/12/22-11/12/23)	Q4TD (30/09/23-11/12/23)	12-month periods of the last 5 years (in %, in EUR): 11/12/22 11/12/23	11/12/21 11/12/22	11/12/20 11/12/21	11/12/19 11/12/20	11/12/18 11/12/19	CAGR* 11/12/18 11/12/23	Std.-dev.* 11/12/18 11/12/23
S&P 500	21.9	6.5	17.2	-8.9	39.7	8.7	24.1	15.0	21.4
DAX	20.6	9.1	16.9	-8.0	19.1	-0.2	21.9	9.3	20.7
Stoxx Europe 50	14.7	4.3	10.8	4.3	24.1	-5.2	22.0	10.7	16.8
Gold	8.2	5.5	8.2	8.2	3.7	14.6	20.6	10.9	13.4
EM Sovereigns	6.4	3.9	3.5	-9.3	6.5	-3.0	16.2	2.4	8.6
EUR Corporates	6.3	3.8	3.8	-12.7	-0.7	2.8	6.8	-0.2	3.8
EUR Sovereigns	4.3	3.3	1.4	-10.0	-1.1	1.9	4.0	-0.9	3.7
MSCI EM	3.9	0.8	0.2	-12.8	7.7	11.2	14.9	3.8	16.9
Euro Overnight Deposit	3.1	0.8	3.2	-0.2	-0.6	-0.5	-0.4	0.3	0.1
US Sovereigns	0.8	1.4	-2.1	-5.1	4.4	-1.1	10.8	1.2	7.1
USD/EUR	-0.5	-1.8	-2.1	7.4	7.0	-8.1	1.7	1.0	7.2
Brent	-2.5	-15.5	7.9	40.5	77.2	-36.5	17.4	14.9	40.8

Time period: 11/12/2018-11/12/2023.
Source: Bloomberg * CAGR = annualised return (in %, in EUR); Std. dev. = annualised standard deviation (in %, in EUR).

majority of fund managers expect bonds to beat equities. However, the strategists of the major banks differ greatly on this issue, despite comparable expectations for the economy and monetary policy. This is the result of the fact that both equities and bonds are "only" expected to generate single-digit returns. A strong increase in valuations seems unlikely and earnings growth expectations in the market appear too high. This means that the nuances of the macro and interest rate picture will decide who should win the race. Our base scenario favours moderately positive return potential for all asset classes in 2024, i.e. equities, bonds, commodities and cash. Bonds could be ahead in the first few months and equities later in the year. In 2024, a large proportion of all asset classes would then generate positive returns (middle chart). In the alternative scenarios, it would only be individual asset classes. A broad, balanced positioning therefore makes sense now in particular. If, for example, there are signs of a less soft landing for the US economy, bonds are likely to perform significantly better initially. If, on the other hand, the Fed loosens the monetary reins without a recession, the US dollar is likely to weaken and risky investments, particularly small caps and emerging market exposure, are likely to rise more significantly. If growth remains robust and the issue of prolonged high or even higher interest rates returns, larger companies with strong balance sheets and probably commodities are likely to outperform.

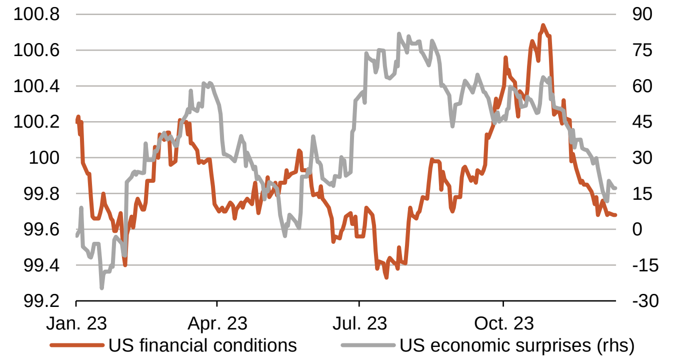
Focus on opportunities beneath the surface of asset classes

Even if a pronounced positioning across the asset classes does not currently appear to make sense, there are attractive segments within the asset classes. After two years of strong underperformance, European small and micro caps offer an attractive absolute and relative valuation despite stronger earnings growth than large caps. They are likely to recover significantly with falling interest rates and the prospect of an economic upturn. Pharma, biotech and medtech have also suffered greatly from rising interest rates and are benefiting from the ageing population. Local currency bonds from emerging and frontier markets offer double-digit running yields and the chance of currency appreciation should the US dollar weaken with a weaker US economy and less restrictive Fed policy. In addition, catastrophe bonds offer double-digit yields and are uncorrelated. Silver and industrial metals are experiencing increased demand due to the energy transition coupled with a lack of supply and would benefit from an economic recovery, particularly in Asia.

Prof Dr Bernd Meyer, Chief Investment Strategist

Easing of financial conditions could support the US economy

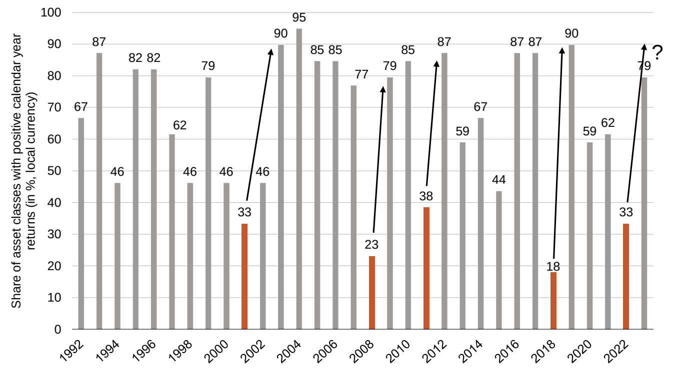
The recent weakening of the US dollar and oil price, lower bond yields and rising equity markets could give the US economy renewed momentum



Time period: 01/01/2023-11/12/2023.
Source: Goldman Sachs, Citi, Bloomberg, own calculations.

2023 was better for multi-asset, despite rise in real interest rates

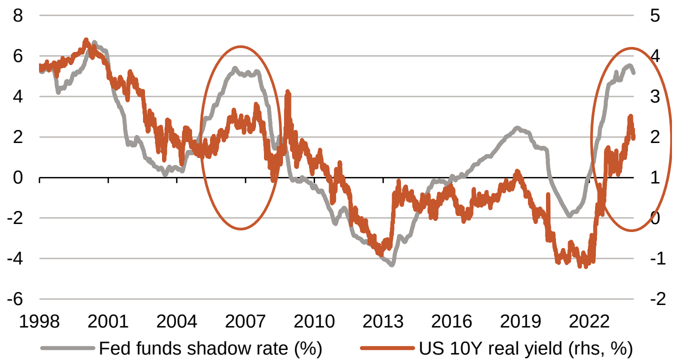
After the poor year 2022, a larger proportion of all asset classes (segments, regions,...) delivered a positive return in 2023



Time period: 01/01/1992-11/12/2023.
Source: Bloomberg, own calculations.

US real yields only fall more sharply if the Fed eases significantly

The Fed Funds shadow rate reflects the central bank rate and effects of quantitative easing/tightening and shows a strong synchronisation with real yields



Time period: 01/01/1998-11/12/2023.
Source: Bloomberg, own calculations.

WEAKER ECONOMY ENABLES INTEREST RATE TURNAROUND

IN A NUTSHELL

- Global economy loses considerable momentum.
- US: soft landing ahead, new momentum in autumn 2024.
- Europe: stagnation until spring 2024.
- Inflationary pressure continues to fall – but not to 2%.
- Monetary policy: rate peak reached, first rate cuts in 2024.

Soft landing in the US

Despite the US Fed's energetic turnaround on interest rates, the US economy has so far held up far better than expected. Residential construction, which is particularly sensitive to interest rates, has slumped by more than 20% compared to the start of 2021. As private consumers have spent the initially saved portion of the stimulus cheques, this has hardly disrupted overall economic performance. Companies have also not cut back on their investments despite higher financing costs. The tax incentives for green (and some other) investments are working against monetary policy. In addition, companies are less reliant on credit than before thanks to high reserves. In addition – unlike in previous cycles – they have not built up overcapacity in previous years. Therefore, they do not have to compensate for this with lower investments now.

However, monetary policy has a delayed effect. Much of the economic data indicates that the US economy is cooling noticeably. There are signs of a soft landing in the first half of the coming year. Even if the US can probably avoid a recession, even a soft landing means that growth will largely come to a standstill for some time. We expect investment, residential construction and private consumption in particular to stagnate over the next two quarters.

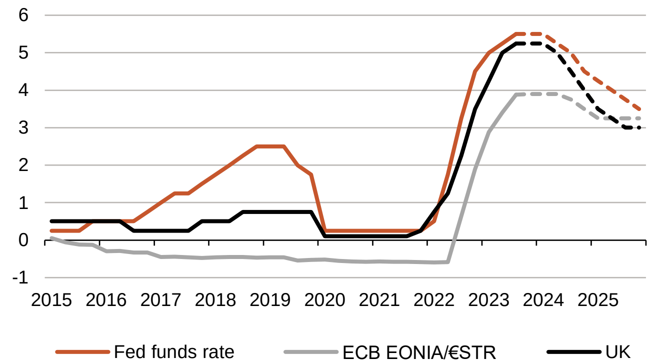
The temporary economic weakness will help to further reduce inflationary pressure in the US. From mid-2024, a less tight interest rate policy should then strengthen the economic upward forces. In view of the structurally high demand for housing, residential construction is also likely to pick up again from summer 2024. Fiscal policy is also contributing to the growth in demand. We therefore expect the US economy to be able to achieve an annualised growth rate of 2% again in autumn 2024.

Mixed outlook for Europe

Two very different forces characterise the outlook for the European economy in the coming months. On the one hand, the continent has weathered the Putin shock well. With falling inflation, a still largely stable labour market and higher wage growth, consumer incomes have been rising faster than prices since the spring. Consumers therefore have more money in their pockets again in real terms – i.e. after deducting inflation. This has already been reflected in lively travelling activity in the summer. On the other hand, the manufacturing industry is in recession. Weak global demand for goods and the inventory correction are hitting countries such as Germany, which specialise in exporting goods, particularly hard. Many companies had used the end of the pronounced supply chain bottlenecks in 2022 to build up stocks of primary and

Key rates: central banks take their foot off the brake in 2024

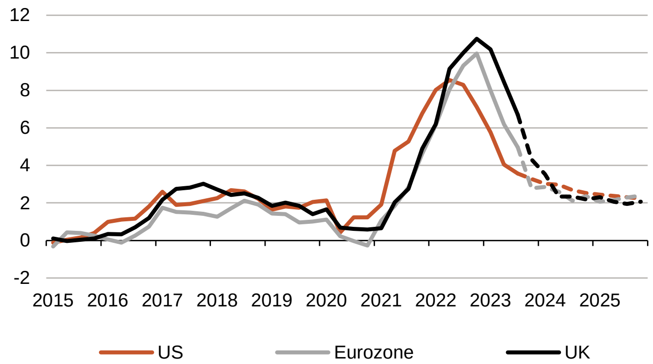
Key interest rates of selected central banks in %



Period: 01/01/2015-13/12/2023.
Dashed line: Berenberg forecast. Sources: BoE, ECB, Fed, Berenberg.

Inflation: the pressure is easing

Year-on-year increase in consumer prices in %



Period: 01/01/2015-13/12/2023.
Dashed line: Berenberg forecast. US: CPI-U, Eurozone: HICP, UK: CPI, Sources: BLS, Eurostat, ONS, Berenberg.

finished products. In view of weakening demand, they are now reducing their inventories again. For the time being, they are therefore producing less than they are selling. The recession worries are also weighing on the consumer climate. Many people are therefore likely to hold back during the Christmas shopping period. Economic output in the eurozone could shrink slightly in the final quarter of 2023.

However, it often only takes around three quarters for companies to clear their inventories sufficiently and then start producing more again. The rise in some sentiment indicators, including the German ifo Business Climate, suggests that the manufacturing industry will have reached its low point by the end of 2023.

Europe: at the low point of the economy

There are signs of a new upturn in the coming year. Many companies are currently holding back on investments in view of the major uncertainties. As soon as the economy has regained some momentum after the end of the inventory correction, they will invest more again in order to restructure supply chains and replace scarce labour. Although China will remain structurally weak, exports to China are likely to increase slightly again next year. After all, China is likely to grow by around 3–4% in 2024. Consumer spending is also likely to increase again somewhat. With the US economy returning to normal growth, the European economy is likely to return to a pace slightly above the trend growth rate of 1.3% next summer. We expect a similar trend for the UK as for the eurozone.

The big inflationary spurt is over

Price pressure has eased considerably on both sides of the Atlantic. Core inflation rates (excluding the volatile prices for energy and food) will tend to fall somewhat further in the coming year. However, the end of government energy subsidies for consumers in the eurozone will probably initially ensure that inflation is likely to rise again slightly from 2.4% in November in December and January before the downward trend resumes. As higher wage increases in Europe continue to drive up prices for labour-intensive services and the costs of climate protection also have an impact, we expect inflation in Europe to settle at around 2.5% in the medium term, instead of the approximately 1.5% seen in the years before the pandemic. We expect inflation rates in the US to be at a similar level in the coming years.

Central banks interest rates peak, first rate cuts in 2024

As soon as the phase of economic weakness has sufficiently dampened inflationary pressure, the US Fed will lower its key interest rate again from May 2024, probably to 4.5% by the end of 2024 and 3.5% by the end of 2025. However, as the ECB's key interest rate is only 4% instead of 5.5% like the US Fed, the ECB will probably lower the money market rate later and more slowly than the Fed, to around 3.5% by the end of 2024.

Dr Holger Schmieding, Chief Economist

Growth and inflation forecasts

	GDP growth (in %)						Inflation (in %)					
	2023		2024		2025		2023		2024		2025	
		∅**		∅**		∅**		∅**		∅**		∅**
USA	2.4	2.4	1.4	1.2	1.7	1.7	4.2	4.1	2.8	2.7	2.3	2.3
Eurozone	0.5	0.5	0.7	0.6	1.7	1.4	5.4	5.5	2.5	2.5	2.3	2.1
Germany	-0.2	-0.2	0.6	0.3	1.6	1.2	6.1	6.1	2.7	2.7	2.3	2.1
France	0.8	0.8	0.9	0.8	1.7	1.3	5.7	5.7	3.0	2.7	2.5	2.0
Italy	0.7	0.7	0.6	0.4	1.2	1.1	5.9	6.1	1.6	2.2	2.2	1.9
Spain	2.3	2.4	1.5	1.3	2.1	1.8	3.4	3.5	2.4	2.9	2.3	2.1
UK	0.5	0.5	0.7	0.4	1.7	1.2	7.3	7.4	2.6	3.1	2.1	2.0
Japan	1.9	1.9	0.7	0.8	1.1	1.0	3.3	3.2	2.3	2.2	1.8	1.7
China	5.0	5.2	4.0	4.5	3.6	4.3	0.4	0.4	1.7	1.4	2.0	1.8
World*	2.5	-	2.2	-	2.4	-	-	-	-	-	-	-

* Berenberg data at actual exchange rates, not according to purchasing power parities (PPP). PPPs lend more weight to fast-growing emerging markets.
** Average, Bloomberg consensus as of 13/12/2023.

EQUITY INDICES LIKELY TO RISE MODERATELY IN 2024

IN A NUTSHELL

- Limited earnings growth in 2024 is likely to limit upside potential for equities. Especially as valuations are unlikely to increase, at least in the US.
- Europe and especially small caps have more potential for PE expansion, as a lot of the negative has already been priced in.
- Our focus is on quality growth stocks, which should no longer be burdened by rising interest rates.
- We continue to find value regions such as Latin America and the UK attractive as an addition.

Split fourth quarter

The setback we predicted for the autumn actually occurred. The major stock markets fell by more than 10% from their peak before a strong recovery rally began at the beginning of November – driven primarily by falling interest rates and lower volatility. Latin America continued its outperformance and remains one of the best performing regions worldwide. European equities caught up with US equities. By contrast, small caps and Asian emerging markets remain the relative losers in 2023.

Moderate, negative profit revisions likely for 2024

The consensus is optimistic and expects global profits to grow by around 9% in 2024, including margin expansion, after stagnating this year. We believe this is too ambitious for several reasons. According to our economists, economic growth is likely to weaken in the first half of the year. Continued high wage inflation and rising corporate refinancing costs together with the now more pronounced onset of disinflation are also likely to limit profit growth. Against this backdrop, profit margins are likely to remain stable at best, meaning that profit growth should match sales growth. Accordingly, we expect global profit growth of 4–6% in 2024.

Valuation expansion probably only possible in Europe

The recent rally was strongly driven by valuations. The forward P/E ratio for the S&P 500 is now back at 19, above the historical average of 17. One driver has been the strong inflows this year into US funds and especially tech – the only equity sector with significant inflows this year, thanks to AI euphoria. This means that there is unlikely to be any major increase in valuations without a very sharp fall in interest rates. By contrast, other segments, such as European equities and small caps, are favourably valued compared to their own history. They are already pricing in an economic downturn and are underrepresented in international portfolios. If our economists are right and European growth accelerates again from the second quarter of 2024, not only profits but also the valuations of European companies are likely to rise. Small caps, which tend to be sensitive to interest rates, in particular have relative catch-up potential. On a P/E basis, European small caps are trading at a discount of 5% compared to large caps. If we were to return to the average of the last 20 years, small caps would have a relative

Heterogeneous stock market performance in Q4 – Europe and Europe with some significant gains, Asia almost unchanged

Total return	YTD and in Q4 (in %, in EUR): YTD (31/12/22-11/12/23)	Q4TD (30/09/23-11/12/23)	12-month periods of the last 5 years (in %, in EUR): 11/12/22 11/12/23	11/12/21 11/12/22	11/12/20 11/12/21	11/12/19 11/12/20	11/12/18 11/12/19	P/B* 11/12/23	Div.* 11/12/23	P/E* 11/12/23
Euro Stoxx 50	22.7	9.0	18.1	-3.7	22.8	-3.5	24.1	1.9	3.4	12.5
S&P 500	21.9	6.5	17.2	-8.9	39.7	8.7	24.1	4.2	1.5	19.2
MSCI EM Latin America	21.9	6.6	19.6	18.0	-0.3	-18.4	16.2	1.4	6.7	8.7
DAX	20.6	9.1	16.9	-8.0	19.1	-0.2	21.9	1.5	3.3	11.7
Stoxx Europe Cyclicals	20.0	9.2	15.7	-8.3	26.5	-0.6	22.9			
Stoxx Europe 50	14.7	4.3	10.8	4.3	24.1	-5.2	22.0	2.4	3.4	13.4
MSCI Japan	14.6	2.3	12.4	-10.4	12.0	3.0	19.2	1.3	2.4	14.6
MSCI USA Small Caps	9.8	4.6	6.2	-8.2	28.9	7.9	18.5	1.8	1.7	17.7
Stoxx Europe Defensives	9.5	0.5	7.0	5.2	19.6	-5.4	17.3			
MSCI UK	8.7	1.0	4.9	8.4	24.7	-15.5	18.2	1.7	4.1	10.6
Stoxx Europe Small 200	8.4	5.2	5.7	-19.7	25.4	2.4	23.9	1.4	3.2	12.7
MSCI EM Asia	2.3	0.1	-2.0	-13.6	5.6	20.1	15.4	1.5	2.7	12.1

Time period: 11/12/2018-11/12/2023.
Source: Bloomberg * P/B = price-to-book ratio; Div. = dividend yield (%); P/E = price-to-earnings ratio. Values based on estimates for the next 12 months.

catch-up potential of more than 20%. We view this as a major opportunity for 2024.

Latecomers are likely to perform better in 2024

In our opinion, market breadth is likely to increase again next year, giving the 2023 laggards the potential to catch up. This is supported by the fact that the "Magnificient 7" is a strong consensus trade that has seen many inflows in 2023 and the valuations partly anticipate the high earnings growth that can certainly be expected. In addition to small caps with healthy balance sheets, we particularly like companies from the healthcare sector and China-related stocks, such as luxury goods manufacturers. Our focus is clearly on European quality growth stocks, which are no longer facing headwinds from rising interest rates and should benefit from their above-average earnings growth rates. We continue to favour "value" regions such as Latin America and the UK for reasons of diversification. However, the upside potential is also limited by a low-risk premium for equities, only moderate 2024 earnings growth and signs that the market is already pricing in a soft landing. Overall, we therefore consider both the upside potential (earnings, valuations, optimistic investor sentiment) and the downside potential (positioning not extreme, central banks probably more supportive) for equities to be limited. A moderate setback in H1 after the strong rally since October 2023 in view of cooling economic data does not seem unlikely to us. Especially as the US presidential election campaign is also entering its hot phase. This is naturally likely to cause some volatility on the markets.

Ulrich Urbahn, Head of Multi Asset Strategy & Research

WHAT IS ON COMPANIES' MINDS?

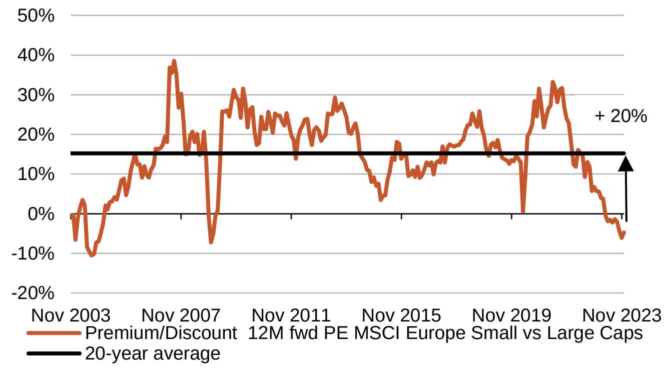
Positive signs

During our discussions with companies at conferences and one-on-one meetings, company leaders expressed very different perspectives on the coming year. In the semiconductor industry, there are increasing signs that demand should start to recover in 2024. The main drivers are the strong recovery in the storage media segment following the reduction of existing overcapacities. More positive voices are also being heard again from the private equity industry, as the environment for transactions is already brightening and the backlog of deals is also expected to clear in the coming year. In the luxury goods sector, on the other hand, the temporary slowdown in consumer spending, particularly in the US, became noticeable. However, the leading companies in the sector only see this as a temporary slowdown and not as a structural problem. Detached from economic data, the healthcare sector is currently dominated by the debates surrounding the new obesity drugs from Novo Nordisk and Eli Lilly and their expected negative impact on areas of medical technology. In conclusion, following the interest rate adjustments of recent months, the focus in 2024 is likely to be primarily on the economic development of companies.

Matthias Born, CIO Equitites

European small caps are historically attractive

Relative valuation of European small caps vs. large caps on a P/E basis (monthly data)



Period: 30/11/2003-30/11/2023.
Source: Factset, own calculations,

Forecast overview: limited upside potential

Berenberg and consensus forecast in comparison, values at mid-year 2024 and year-end 2024

	Current			∅*
Index forecasts	**13/12/2023**	**30/06/2024**	**31/12/2024**	**In 12 months**
S&P 500	4,707	4,700	4,850	5,074
DAX	16,766	17,300	18,000	19,188
Euro Stoxx 50	4,530	4,700	4,800	5,009
MSCI UK	2,164	2,350	2,400	2,556
Index potential (in %)				
S&P 500	-	-0.2	3.0	7.8
DAX	-	3.2	7.4	14.4
Euro Stoxx 50	-	3.7	6.0	10.6
MSCI UK	-	8.6	10.9	18.1

* Average, consensus bottom-up as of 13/12/2023.
Source: Bloomberg, Factset, Berenberg.

A PROMISING YEAR FOR BONDS

IN A NUTSHELL

- US Treasuries and UK Gilts in the lead for government bonds with high credit ratings in local currency – Bunds not the first choice.
- In European corporate bonds, we favour the investment grade segment and avoid cyclicals.
- In the emerging markets, we see potential in the local currency segment in particular.

The good times are not over

The disinflationary trend over roughly the past year and the recent decision by the major central banks not to continue tightening their interest rate policies have recently given bond markets a good boost. This does not mean that weaker times have to follow now. On the contrary: we also see several opportunities to generate positive returns with fixed-interest bonds in 2024. What are these in detail and which segments are we avoiding?

Safe government bonds: Outlook continues to offer opportunities

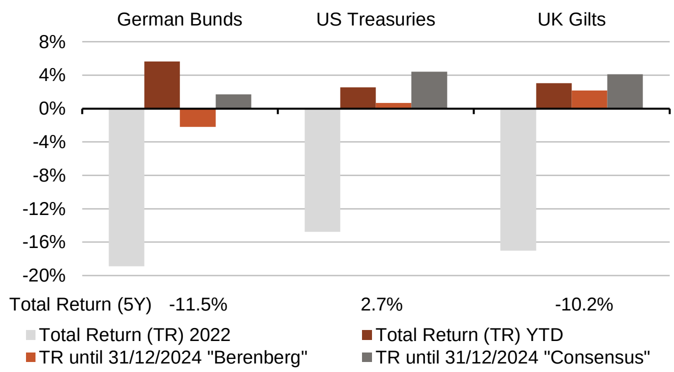
The fact that government bonds with high credit ratings will end 2023 with a positive final quarter is likely to be groundbreaking for the next twelve months, at least for the Anglo-Saxon region in the respective local currency. While we are more cautious than the consensus estimate with regard to the further development of yields in the ten-year maturity segment for both US Treasuries and UK Gilts, even if yields rise slightly, the current interest rate will be sufficient to generate positive returns overall. German Bunds, on the other hand, face stronger headwinds due to their lower base rate (see chart below left). However, across all three currency areas, our expectation that the central banks will utilise monetary policy leeway and lower their key interest rates over the course of the year as inflation continues to fall gives support. The US Fed and the Bank of England are likely to take a more dynamic approach than the European Central Bank.

Corporate bonds: Economic risks not priced in

Corporate bonds completely ignored economic risks in the past year. Riskier European high-yield bonds even performed significantly better (+9.9%) than the more defensive investment grade segment (+6.1%). Both segments benefited from significantly falling risk premiums (left chart, p. 11) and thus offered protection against rising risk-free interest rates. However, cracks are increasingly appearing in the economy and corporate results, and issuers with weak quarterly results are now being penalised by the market. In addition, part of the restrictive monetary policy is not yet fully reflected in weaker economic data. This could increasingly weigh on companies in the future. Although we consider the valuation of investment-grade corporate bonds to be fair in a long-term context, the economic risks are hardly priced into the risk premiums in the high-yield segment. As a result, these could rise disproportionately, particularly in the case of weaker credit ratings. We therefore favour the more defensive investment grade segment over high yield, also due to the predominantly solid balance sheets and

Selective government bonds with a positive outlook for 2024

Past and expected performance of 10-year government bonds, overall effect of yield/price change, coupon yield and roll-down effect



Time period: 13/12/2018-13/12/2023.
Source: Bloomberg, own calculations, iBoxx government bond indices (7-10 years, TR).

Forecasts: Key interest rates and government bond yields (in %)

Berenberg and consensus forecast in comparison, values at mid-year 2024 and year-end 2024

	13/12/2023	30/06/2024		31/12/2024	
	Current		Ø*		Ø*
USA					
Key interest rate	5.25-5.50	5.00-5.25	5.20	4.25-4.50	4.45
10Y US yield	4.02	4.30	4.19	4.40	3.91
Eurozone					
Key interest rate	4.50	4.50	4.30	4.00	3.70
10Y Bund yield	2.17	2.60	2.41	2.70	2.24
Great Britain					
Key interest rate	5.25	5.00	5.15	4.00	4.50
10Y Gilts yield	3.83	4.00	4.02	4.00	3.75

* Average, consensus as of 13/12/2023.
Source: Bloomberg.

sufficient liquidity reserves. In view of convincing quarterly results and attractive valuations, we are also maintaining our overweighting of financial bonds, while avoiding cyclical sectors. It is also worth taking a broader view. The addition of defensive covered bonds increases the stability and credit quality of the portfolio.

Emerging markets: Local currency bonds more attractive than ever

Emerging market bonds in the hard currency segment once again proved their resilience during the significant rise in US interest rates. Their risk premiums are currently close to their lows for the year, which is remarkable given the net outflow from this segment. With an increase in value of around 9% since the beginning of the year, the influencing factors on the local currency side are different. This segment is benefiting from high current interest rates and the fact that some central banks in the emerging markets have already initiated the first interest rate cuts. In fact, the central banks in many developing countries have acted more decisively in this cycle than their counterparts in the industrialised nations. In some cases, some countries began raising interest rates as early as mid-2021, while the US Fed did not initiate its interest rate turnaround until March 2022. The head start also meant that the emerging markets raised their interest rates to a higher level overall and left them there for longer. This now puts them in a position to cut rates again earlier (see figure below right). In tandem with the significant interest rate hikes, inflation in the emerging markets has fallen in exemplary fashion, giving central banks additional room to cut interest rates. However, the "higher for longer" narrative until October 2023 has so far prevented this option from being priced into the emerging market curves. In terms of valuation, there is, therefore, an attractive entry opportunity. In the local markets, we are focussing on countries that are in an early phase of the interest rate cycle, such as Brazil and Mexico. In the hard currency segment, on the other hand, we favour long-term bonds from issuers of good quality. In addition, we expect a supply shortage in the future, which should further support the positive outlook.

Conclusion: All the segments discussed offer good opportunities

In contrast to the previous year, safe government bonds should be attractive in the coming twelve months, particularly in the respective local currency outside the eurozone. We favour European corporate bonds in the investment grade segment, overweighting financial securities and avoiding cyclical exposure. Covered bonds also increase stability and credit quality. Finally, local currency bonds are to be favoured in the emerging markets – they benefit from resolute central banks that are already making their first interest rate cuts.

Martin Mayer, Senior Portfolio Manager Multi Asset
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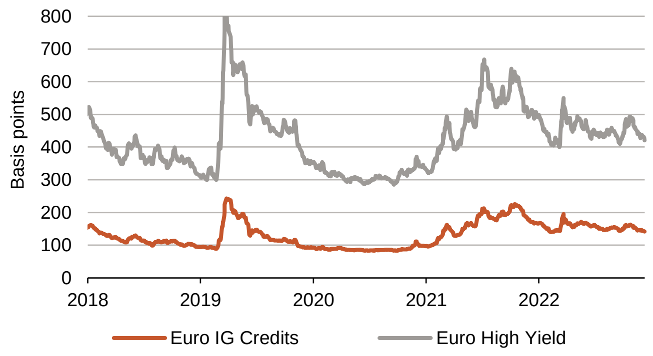
Corporate bonds: 2023 will not be repeated

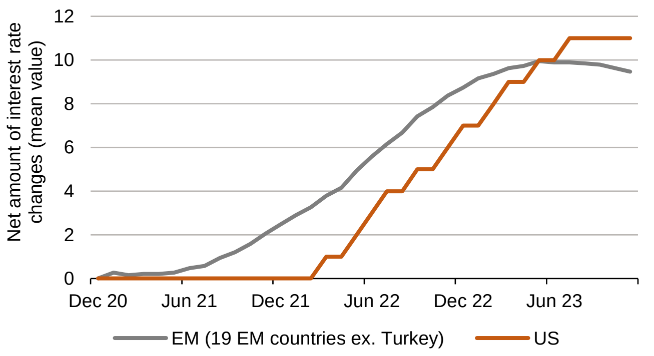
In 2023, the risk premiums on high-yield bonds narrowed more than in the investment grade segment - this should not happen again in 2024



Period: 31/12/2018-11/12/2023, risk premiums in basis points.
Source: ICE, own calculations.

Emerging markets: central banks support local currency securities

Emerging market banks initiated their interest rate hikes much earlier than the US Fed - and have already started to cut rates accordingly



Period: 31/12/2020-30/11/2023.
Source: Bloomberg, own calculations.

GEOPOLITICS AND THE ECONOMY DETERMINE COMMODITIES

Oil with upside potential in the medium term

After a strong summer and autumn, oil got off to a rather disappointing start in the fourth quarter. Increased demand concerns (US petrol demand temporarily fell to its lowest level in 25 years) caused Brent oil to fall by around USD 20 per barrel from its September high in Q4. The outbreak of the Israel-Hamas war led to a brief countermovement. Due to the geographical and political proximity to the OPEC, investors feared consequences for the already tight supply. However, once the war became apparent as a local conflict, the resulting risk premium was fully priced out again at the beginning of November. Since then, oil – caught between supply and demand concerns – has been trading in a volatile downward movement driven by data. In the short term, oil is likely to find it difficult to break out upwards. On the supply side, the OPEC is likely to keep production tight, drilling activity in the US shale oil industry is declining and global inventories are historically low. On the demand side, stronger demand from China and colder temperatures in winter should support prices.

Gold near all-time high with limited short-term potential

Gold shone in the fourth quarter. Tailwinds came from all sides: Spurred on by the increased demand for safe havens in the wake of the geopolitical escalation in the Middle East, the precious metal climbed above the USD 2,000 mark at the end of October for the first time since the regional banking crisis in the spring of this year. Supported by lower real interest rates and a weaker dollar, gold then broke through the 2,000 mark again after normalising at the end of November. Weaker US economic data had fuelled hopes of interest rate cuts in the near future. Near the all-time high, further upside potential is now limited. Following a normalisation of the price trend, the next strong fundamental driver is likely to be the actual interest rate cut by the Fed.

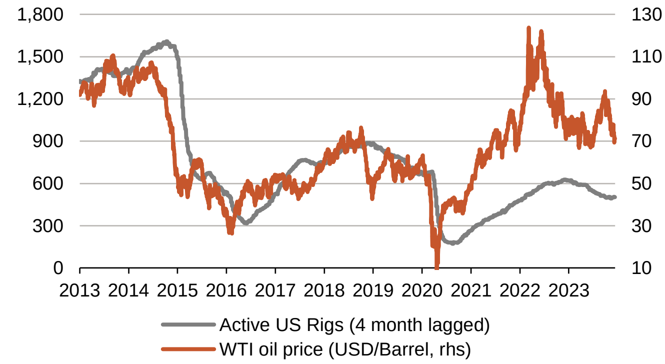
Long-term upside potential for metals intact

The LME industrial metal index fell to its lowest level of the year at the beginning of the fourth quarter. In contrast to its precious metal and energy commodity counterparts, the metal complex suffered from the possible consequences of the war in Israel for the global economy. Looking ahead, China now appears to want to stimulate the economy more sustainably. If the economic stimulus programmes are credibly implemented, metals should receive a tailwind in addition to the already supportive green demand.

Philina Kuhzarani, Multi Asset Strategy & Research

Oil: Drilling activity in the US shale oil industry is declining

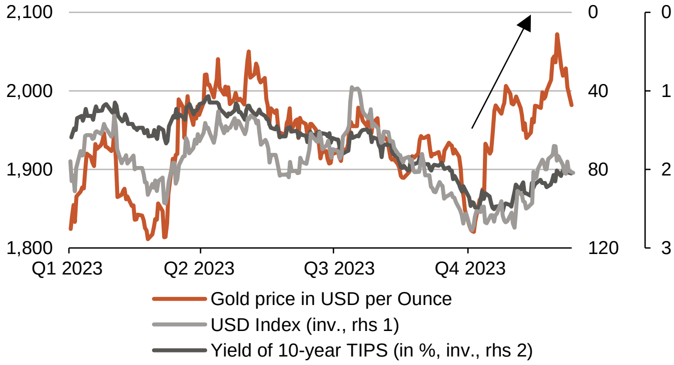
Number of active US oil wells (4 months lagged) against the WTI oil price in US dollars per barrel



Period: 01/01/2013-11/12/2023.
Source: Bloomberg, EIA, own calculations.

Gold: tailwind from falling real interest rates and the US dollar

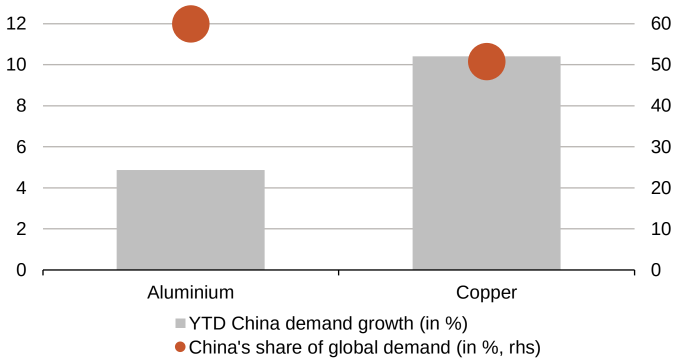
Gold price in US dollars versus interest rate of 10-year inflation-indexed Treasuries (inverted) and US dollar index (inverted)



Period: 01/01/2023-11/12/2023.
Source: Bloomberg, own calculations.

Metals: Green demand from China is providing long-term support

Demand growth in China since the start of the year and China's share of global demand for individual metals



Period: 01/01/2023-30/11/2023.
Source: Bloomberg, Goldman Sachs, own calculations.

EURO/US DOLLAR: FOCUS ON INFLATION DYNAMICS

Geopolitics and monetary policy are the main drivers on FX market

The euro suffered repeated setbacks in 2023. The third quarter in particular saw a sharp decline, with the euro starting the fourth quarter at less than USD 1.05 per euro. The euro initially remained under pressure in the fourth quarter, but was able to make up significant ground in November, appreciating to 1.10, before falling again slightly in December. The accelerator for the euro's rise was the publication of inflation data for October. Market players reacted with relief to the continuing fall in the inflation rate. Since then, a further tightening of US monetary policy has been considered extremely unlikely. As a result, the dollar has lost some of its overvaluation.

However, even at the current level, the US dollar remains overvalued in terms of fundamental criteria. This is due in particular to the geopolitical situation, which continues to drive money into the safe haven of the US dollar. This is unlikely to change much in the coming year. If the global situation remains anywhere near as unstable as it has been this year, there will always be reasons to build up US dollar positions. The greenback is therefore likely to remain structurally strong, similar to the Swiss franc, which is also in demand in times of crisis.

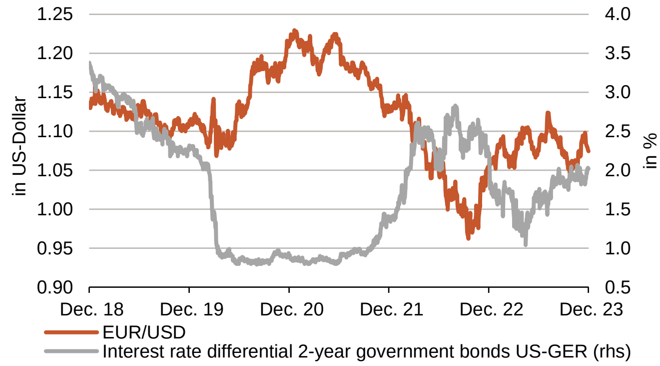
A second important factor was the resilience of the US economy. Despite the rapid rise in interest rates, the economy did not crash. So far, it looks like a soft landing. Looking ahead, much depends on the extent to which inflation in the USA and the eurozone falls and how the economy develops. The latest inflation data suggests that the central banks will be able to take their foot off the brake pedal somewhat in the coming year in order to support the economy. The US Federal Reserve could start lowering its key interest rate a little earlier. It is also likely to lower it more than the ECB over the course of the year. Overall, this argues in favour of a slightly weaker US dollar and therefore a stronger euro. However, the sharp fall in euro inflation in November and the subsequent reaction of the currency market with a weaker euro again show how much the currency market depends on inflation data and assumptions about future monetary policy.

The US presidential election is due in 2024. It is still too early to analyse the potential outcome. However, it is quite clear that the central bank will have the election in mind when making its monetary policy decisions.

Dr Jörn Quitzau, Senior Economist

EUR/USD: Will the USA's interest rate lead hold?

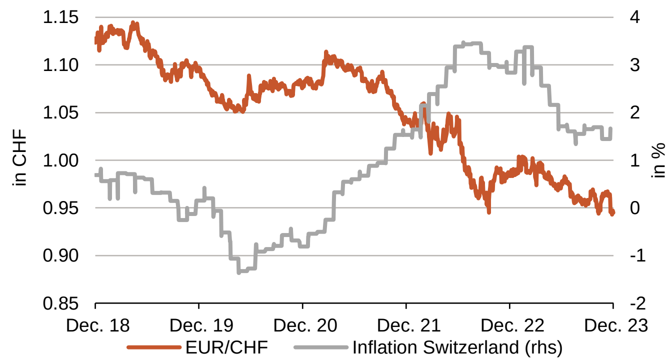
Both key interest rates and market interest rates gave the US dollar a boost in 2023. However, the advantage could diminish somewhat in 2024



Period: 11/12/2018-11/12/2023.
EUR in US-Dollar; Interest rate differential in %. Source: Macrobond.

EUR/CHF: Swiss franc remains in demand as a safe haven

EUR/CHF remains well below parity. As long as geopolitical tensions persist, the franc will remain strong



Period: 11/12/2018-11/12/2023.
Euro in Swiss francs; inflation in %. Source: Macrobond.

Exchange rate forecasts

Berenberg and consensus forecast in comparison, values at mid-year 2024 and year-end 2024

	13/12/2022	30/06/2024		31/12/2024	
Exchange rate forecast	**Current**		∅*		∅*
EUR/USD	1.09	1.12	1.10	1.15	1.12
EUR/GBP	0.86	0.86	0.88	0.85	0.88
EUR/CHF	0.95	0.96	0.97	0.97	0.99
EUR/JPY	155	145	155	140	155
Change against the euro (in %)					
USD	-	-2.9	-1.1	-5.4	-2.9
GBP	-	0.2	-2.1	1.4	-2.1
CHF	-	-1.3	-2.3	-2.3	-4.3
JPY	-	7.2	0.2	11.0	0.2

* Average, consensus as of 13/12/2023.
Source: Bloomberg.

INTERVIEW WITH PROF DR BERND MEYER

Prof Meyer, you are Chief Investment Strategist and Head of Multi Asset in Wealth & Asset Management. A year ago, you predicted that 2023 would be "better, but not easier" for investors. Has that turned out to be true?

In 2022, there were broad losses across almost all asset classes. Only commodities performed well. Equities and bonds lost in tandem. This was due to a general reduction in valuations driven by a sharp rise in real yields – the real yield on 10-year inflation-indexed US bonds rose by 2.5 percentage points. A further rise of a similar magnitude was very unlikely. In addition, the valuations of equities and bonds had already become significantly more attractive. This also proved true in 2023. Equities made up some of the losses from 2022 and bonds also performed positively across almost all segments. Therefore, 2023 was indeed a better year, albeit not an easier one for investors.

What made 2023 so difficult for investors?

There were many surprises in 2023 compared to consensus expectations. At the end of 2022, the expectation was that the US economy would stagnate in early 2023 as a result of the tighter monetary policy and then fall into a mild recession by autumn 2023, allowing the Fed to cut interest rates again from the second half of the year. In Europe, a recession already appeared to be on the horizon, which would last throughout the winter due to high energy prices. In China, the easing of the rigid zero-covid policy was expected to lead to a stabilisation and recovery of the economy. In the end, however, everything turned out differently.

Europe came through the winter much better than expected but slipped into recession in the second half of the year. The recovery in China was short-lived and the US economy proved to be surprisingly robust – despite the banking crisis in the spring. US economic data has continuously surprised on the upside throughout the year. As a result, there were further interest rate increases in the second half of the year instead of the first interest rate cuts. Monetary policy became significantly more restrictive than expected and bond yields continued to rise, also favoured by rising US government debt. The real yield on 10-year inflation-linked bonds climbed by a further percentage point in the third quarter. Similar to 2022, equities and bonds then fell again in tandem. Investments with high interest rate sensitivity, such as growth and second-line stocks, suffered in particular. To a certain extent, the markets experienced a continuation of the perfect storm of 2022. It was not until November that a countermovement set in with weaker US economic data. The dominant theme on the market was

therefore constantly changing and bond yields fluctuated wildly. This was exacerbated by the fact that in the US, the topic of artificial intelligence boosted individual large technology stocks despite rising interest rates, while the rest of the market treaded water. The low market breadth and the strong outperformance of the so-called "Magnificent 7" was a decisive feature in 2023. And finally, the Israel-Hamas conflict added another geopolitical risk.

What have these developments meant for multi-asset strategies? What adjustments have you made over the course of the year?

Like the markets, our strategies developed positively. Nevertheless, after the painful year of 2022, the performance of our strategies in 2023 was unable to match the pleasing results of previous years. The negative impact came from three fronts: broad diversification, cautious positioning from March onwards and stock selection.

We had correctly anticipated the bottoming out of equities in the second half of 2022 and started 2023 with considerable momentum from autumn 2022. However, after the significant recovery up to February and with the US regional banking crisis and the continued restrictive monetary policy, the risks increased and we positioned ourselves more defensively and more broadly again. That was too early. We hardly benefited from the performance of US equities in the wake of the AI euphoria until the end of July due to our US underweighting in view of the still high valuations of US equities. By contrast, other investments have barely risen or have fallen. The lack of a significant recovery in China weighed on the direct and indirect China exposure in our portfolios. Commodities only rose in the second half of the year. Although diversification was justified in an environment of heightened risks, it did not pay off in the first half of the year, nor did our significant addition of second-line stocks. In addition, the tailhedge certificate used in many of our strategies fell in an environment of rising equity markets and declining volatility.

From July to October, a significant admixture of commodities was beneficial, and our scepticism towards the overall market trend also paid off – European equities fell well below the levels of February, while American equities fell back to February levels. However, the further rise in US real yields to 2.5% once again weighed on the quality and growth stocks and small caps that Berenberg focuses on. In addition, there were some disappointing developments in the selected individual stocks. Our duration management for bonds was more positive. With interest rates continuing to rise, we were short here for a long time due to the high interest rate volatility and the greater synchronisation of equities and bonds. It was not until the end of the third quarter that we raised the duration to neutral, which proved to be a good move from November onwards. After the equity markets had corrected by more than 10% from July to the end of October, we raised our equity weighting to just a small underweight at the end of October.

In which scenarios are your multi-asset strategies likely to outperform in the coming months?

If the rising interest rate environment of the last two years continues, which we believe is unlikely, our strategies will not have an easy time, but they will underperform significantly less. The valuation correction in quality-growth equities should be largely behind us and carry in bonds should (partially) compensate for any further rise in interest rates. However, if interest rates stabilise or fall, our strategies are likely to outperform due to our high bond and gold exposure and our equity style (focus on growth and quality stocks as well as small caps). In a scenario in which the equity markets would fall due to a stronger economic downturn, our cautious positioning and diversification should help to ensure that our strategies only lose less than average. If markets move sideways, our strategies should perform well thanks to the high current yield at portfolio level. We also expect China to continue to recover over time. Then, our strategies should benefit from their indirect China investments (industrial metals, etc.).

How do you generally assess the environment for multi-asset strategies - especially in a world with positive bond yields?

In my view, the starting point for "true" multi-asset strategies is very good. Bonds have become an attractive asset class again thanks to the significant rise in yields. Apart from the major AI beneficiaries, equities have undergone a significant valuation correction, especially small caps and many quality stocks. Commodities are structurally supported by the energy transition, deglobalisation and rearmament, with far too little investment in production capacities in recent years. The yield expectations for the various asset classes are closer together than they have been for a long time, meaning that broad diversification should not be associated with yield disadvantages. Higher inflation and, in particular, inflation volatility in the medium term and thus a higher correlation between equities and bonds also argues in favour of broad diversification across all asset classes, segments and regions. In contrast to investments in short-dated safe bonds or time deposits, such a structure should generate a return over the next 5–10 years that is above inflation and thus not only enable the real preservation of assets, but also their growth. Multi-asset approaches that rely heavily on investments with a tangible asset character (commodities, equities) offer clear advantages over purely nominal financial investments, not only in the event of surprising inflation, but also in view of the risks posed by rising global sovereign debt.

SHORT VITA

Prof Dr Bernd Meyer, CFA, has been Chief Strategist of Wealth and Asset Management since 2017 and is responsible for Berenberg's discretionary multi-asset strategies. These also include the asset management mandates. Prof Dr Meyer was initially Head of European Equity Strategy at Deutsche Bank and built up the global cross-asset strategy research at Commerzbank from 2010. He has received several awards. For example, he and his team were ranked among the top three multi-asset research teams worldwide in the renowned Extel Survey from 2013 to 2017.

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IMPORTANT NOTICES

Date: 15 December 2023

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