HORIZON

The Berenberg Capital Market Outlook · Wealth and Asset Management

RECOVERY

An appreciable recovery from the deepest recession since the 1930s began in May, supported by aggressive monetary and fiscal policy.

LACKLUSTRE SUMMER

Equities have largely priced in the quick part of the economic recovery and political risks are taking centre stage again. The hurdle for positive surprises in the third quarter is high.

DRY POWDER

Investors are sitting on huge piles of cash at negative real interest rates. This will support real assets such as equities and gold in the medium term.

Q3 | 2020

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FOREWORD

Prof Dr Bernd Meyer
Chief Investment Strategist

Dear reader,
The unprecedented recovery of capital markets in the second quarter is unlikely to continue at the same rapid pace in the third quarter. The recovery was fuelled by powerful monetary and fiscal policy stimulus measures, the high attractiveness of equities after the overblown selloff, and the extreme pessimism and cautious positioning of many investors. By mid-April, the US equity market had risen by more than 20% from its low on 23 March; technically speaking, therefore, the US bear market had already come to an end and a new bull market had begun. By early June, the market rose by another 20% and was only about 5% below its high in February. The rally was fed by scepticism. The vast majority of investors were still under-invested when coronavirus infection numbers began to come down, restrictions were gradually eased and signs of an economic recovery emerged. As we predicted for the second quarter, financial markets quickly priced in the scenario of a substantial economic recovery. We profited noticeably from our modestly optimistic positioning.

Although investors are still sitting on huge piles of cash yielding negative real interest rates, the third quarter will probably be more difficult. In our core scenario without a second wave of infections, we anticipate a "lacklustre summer" characterised by a volatile sideways movement with pullbacks of up to 10%. Our economists expect a tick-shaped economic recovery, meaning that after a quick V-shaped recovery of most of the lost economic output, the rest of the recovery will be slow. For example, consumption and the labour market will be restrained for a longer period of time. Savings rates will probably remain high. The V-shaped part of the recovery is probably already largely priced in and the market will now increasingly focus on the slower part. Moreover, the support afforded by sentiment and positioning will gradually fade as investor sentiment brightens. The Q2 reporting season and, particularly, company outlooks could weigh on the further recovery of equities as a kind of reality check on expectations. After the monetary and fiscal-policy fireworks in the second quarter, further positive surprises from this direction can hardly be expected. Moreover, political risks, above all the US Presidential election, the conflict between the US and China, and the unsolved Brexit situation will probably come into focus again. All this speaks against a (considerable) overweighting of equities even if there is no genuine alternative in the longer term. Corporate bonds and emerging-market bonds will probably fare the best in the third quarter. Gradually rising yields will probably weigh on safe government bonds.

Against this backdrop, fund manager Andreas Strobl shares his fascination for German SMEs in the Insight Interview and explains which companies are likely to emerge from the crisis in a stronger position.

I hope you enjoy reading this issue of Horizon.

CONTENTS

LACKLUSTRE SUMMER

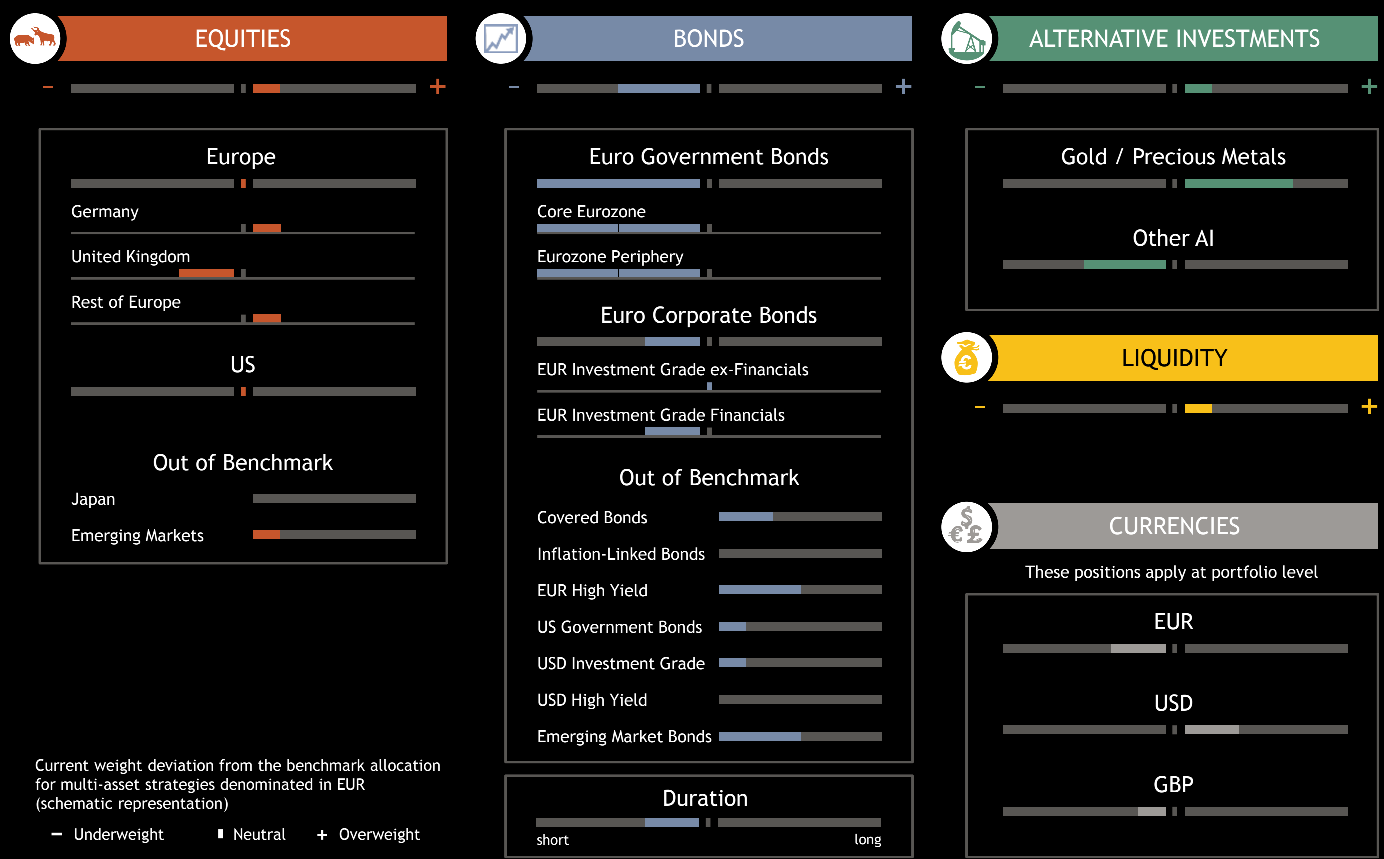
IN A NUTSHELL

- Stocks have largely priced in the V-shaped part of the expected tick-shaped recovery of the economy.
- Investors still have a lot of dry powder, but political uncertainties will probably come into focus again. The hurdle for positive surprises in Q3 is high.
- Equity market pullbacks of up to 10% in Q3 should not be ruled out. Corporate and emerging-market bonds with reasonable sideways yields and the potential for spread tightening from the current levels should add value.
- Gold will continue to benefit from negative real interest rates and rising government debt levels in the medium term.

Portfolio positioning at a glance

We have maintained a modest overweight in equities since late March. An underweight was the greater risk, in our view. In the balanced strategy, the overweight was in a range of 2-5 percentage points. Within equities, we increased our exposure to small caps, for example, which have more recovery potential as the economy picks up. Since March, we have also increased our positions in corporate bonds in order to benefit from the substantially wider spreads. We maintained our overweight in gold and our position in US Treasuries.

In our view, increasing the equities allocation after the strong recovery in Q2 makes little sense. Although the economy will recover step by step, the first positive surprises have been seen. Major positive surprises should no longer be expected. Yields of safe government bonds are likely to gradually rise again. We remain underweighted in this segment. The US dollar can be expected to further depreciate. Within equities, emerging markets will probably benefit from a resumption of global economic growth. Europe will probably continue to catch up to the US. Corporate bonds and emerging-market bonds offer positive yields and the potential of tightening spreads.



Look back on the second quarter: Courage was rewarded

After the sharp selloff of all riskier investments in the spring, which was exacerbated by systematic investment strategies, a rebound began in late March as the pessimistic sentiment and positioning of investors coincided with monetary and fiscal policy fireworks and declining coronavirus infection rates. Nevertheless, scepticism remained high for quite a while. Until mid-May, investors mainly stuck with defensive stocks, quality stocks and growth stocks. Only as coronavirus restrictions were gradually eased, early signs of reviving economic activity appeared and positive economic surprises emerged did safe-haven assets such as the yen and the US dollar lose their support in mid-May. The euro and emerging-market currencies appreciated, the yields of safe government bonds rose, gold came under pressure and more cyclical or value investments gained somewhat as the result of the rotation. Due to the prevailing scepticism, many investors were still under-invested and were then gradually forced back into the market. Sir John Templeton, known as the founding father of the idea of investment funds, once said: "Bull markets are born on pessimism, grow on scepticism, mature on optimism, and die on euphoria." Investor sentiment brightened further over the course of June, but euphoria has not been reached.

Equities rally despite record recession: Does that make sense?

Many investors are surprised by the strong recovery of equity markets and wondering how that fits in with this year's collapse of economic activity and corporate profits. They consider the equity market's performance to be ungrounded and expect sharp pullbacks. However, it should not be forgotten that the value of equities reflects the discounted value of all future expected profits. If corporate profits disappear entirely in the current year or if they are cut in half for two years and then revert to the old trend, the fair value of equities would only be reduced by around 5%, assuming that interest rates remain the same. The sharp decline in US bond yields since the beginning of this year actually supports higher equity valuations. The massive monetary and fiscal policy stimulus and the absence of major real economy exuberance that would require a longer recession to correct suggest a rather quick recovery scenario. Our economists expect that economic output will return to the pre-crisis level two years after the trough, ie the middle of 2022. The top graph on page 5 shows that stock market performance is consistent with a recovery of the global purchasing managers index to slightly over 50 in the coming months. We consider this scenario to be realistic. Already in May, the index rose from 39.6 to 42.2.

Risk premiums are still attractive given negative real interest rates

So why did equity markets slide so drastically in the first place? This can only be explained by a substantially higher discount factor. The discount factor is composed of the risk-free interest rate and a premium for the assumption of equity risks. The former was declining. It was therefore the substantially higher equity risk premium resulting from heightened uncertainty and the fear of losses, coupled with the parallel increase in risk premiums for corporate bonds or emerging-market bonds or higher volatility indices, that exacerbated the decline.

Substantial recovery of equities, corporate bonds and emerging-market bonds in Q2, also further gains for gold

Total return	YTD and in Q2 20 (in %, EUR)		12-month periods of the last 5 years (in %, in EUR)					CAGR*	Std. dev.*
	YTD (31/12/19-17/06/20)	Q2 20 (31/03/20-17/06/20)	17/06/19 17/06/20	17/06/18 17/06/19	17/06/17 17/06/18	17/06/16 17/06/17	17/06/15 17/06/16	17/06/15 17/06/20	17/06/15 17/06/20
Gold	13.5	7.4	28.6	8.4	-1.6	-2.8	10.2	8.0	12.3
US Sovereigns	5.5	-2.0	7.5	9.7	-5.0	0.3	3.6	3.1	7.4
EUR Sovereigns	0.5	0.6	1.1	3.0	-0.1	0.4	4.2	1.7	2.1
Eonia	-0.2	-0.1	-0.4	-0.4	-0.4	-0.4	-0.2	-0.3	0.0
USDEUR	-0.3	-1.9	-0.2	3.5	-3.5	0.7	0.5	0.2	7.6
EUR Corporates	-1.0	5.5	0.7	3.7	0.6	2.3	4.4	2.3	2.5
EM Sovereigns	-2.2	8.3	2.6	13.6	-6.7	9.6	8.4	5.3	9.1
S&P 500	-2.7	18.2	9.8	9.7	12.3	20.8	0.8	10.5	20.9
DAX	-6.5	24.6	2.5	-7.1	2.0	32.4	-12.3	2.4	20.5
Stoxx Europe 50	-9.1	12.2	-0.2	4.7	-0.1	20.9	-14.6	1.5	17.8
MSCI EM	-10.0	15.0	0.8	-3.7	9.5	28.1	-14.8	3.0	17.5
Brent	-43.3	26.7	-33.1	-10.8	54.4	-14.3	-35.9	-12.7	40.8

Time period: 17/06/2015-17/06/2020.
Source: Bloomberg * CAGR = Compound annual growth rate (in %, in EUR); Std. Dev = Annualised standard deviation (in %, in EUR).

Precisely these premiums have made equities, corporate bonds and emerging-market bonds attractive in the last months, and still make them attractive compared to the negative real interest rates that investors receive from safe government bonds or cash. Investors accumulated record-high cash holdings until late May and only began to reduce them somewhat beginning in June (centre graph). Investors cannot watch the purchasing power of these cash holdings erode indefinitely. And the situation might not improve. Ultimately, the sharply higher levels of government debt can only be sustained at negative interest rates and interest rates can therefore be expected to remain below the rate of inflation over the long term. This environment of financial repression favours real assets. In the medium term, therefore, the high level of cash holdings will probably support equities and gold in particular. In the short term, corporate bonds and emerging-market bonds are likely to benefit as well, given that the still unusually high spreads offer positive real yields for the most part.

Companies focus on bondholder value

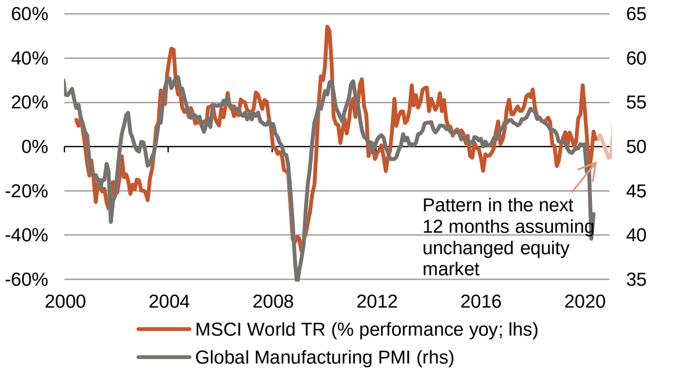
However, corporate bonds are currently also being supported by the bond purchases of central banks and companies' focus on strong balance sheets. In the past few years, companies clearly prioritised shareholder value and therefore made decisions that particularly benefited shareholders, such as share buybacks and high dividends at the cost of rising debt levels. This year's drop in profits is leading to an undesired increase in debt levels accompanied by substantially higher funding costs. This is shifting the focus to bondholder value. Companies are scaling back or ceasing stock buybacks and dividend payments. Instead they are issuing shares to repair their balance sheets. This phase of the debt cycle is typically the best phase for corporate bonds, which often perform equally well to equities, particularly on a risk-adjusted basis.

Emerging-market bonds are likely to benefit from the economic recovery and a weaker dollar in the further course of the year. As fears subside and the economy is gradually reopened after the coronavirus lockdown, the now increasingly diminished yield advantage of bonds denominated in US dollars should put further pressure on the US dollar.

Prof Dr Bernd Meyer, Chief Investment Strategist

Equity market performance consistent with a PMI slightly over 50

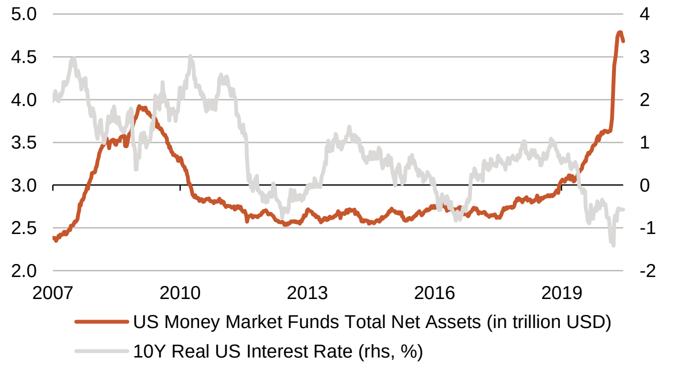
Year-over-year performance of global equities compared to the global purchasing managers index (PMI) for manufacturing



Time period: 01/01/2000-31/12/2020.
Source: Bloomberg, own calculations.

Investors sitting on piles of money at negative real interest rates

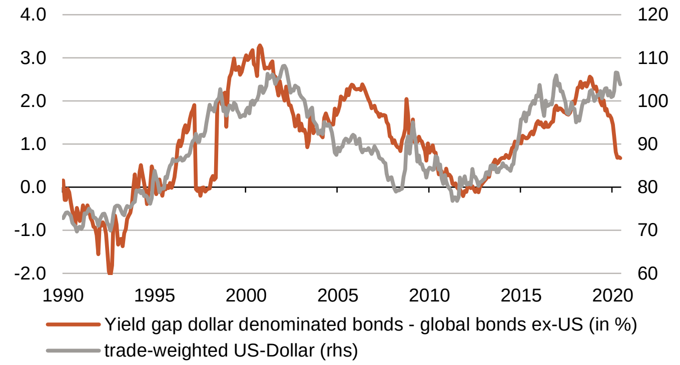
Record volume of US money market funds of USD 4.7 trillion, by comparison: Eurozone equity market capitalisation (emerging markets) is USD3.7 (5.1) trillion



Time period: 31/01/2007-17/06/2020.
Source: Bloomberg, own calculations.

Declining yield advantage puts pressure on the US dollar

The yield advantage of USD bonds against global (ex-USD) bonds has fallen by 1 pp this year. The recent USD weakness could continue.



Time period: 31/01/1990-17/06/2020.
Source: Bloomberg, own calculations.

CORONAVIRUS RECESSION: THE RECOVERY BEGINS

IN A NUTSHELL

- Economy: The COVID-19 pandemic has plunged the global economy into the deepest recession since the 1930s.
- An appreciable recovery began in May.
- Aggressive monetary and fiscal policies are preventing a financial crisis and supporting the recovery.

Unprecedented shock

The global economy has been hard hit by the COVID-19 pandemic and the drastic restrictions imposed on everyday life to curb the spread of the virus. These measures have curtailed both supply and demand to a degree rarely seen in peacetime. In March and April 2020, practically all developed nations slid into a deep recession. Depending on the severity of the restrictions on everyday life and economic activity imposed in each country, economic output will probably contract by a total of anywhere from 11% (US) to as high as 20% (Eurozone, UK) in the first two quarters of this year. With an expected drop of almost 15%, Germany will presumably not be as severely affected as most other large countries of western Europe.

The measures to curb the pandemic are working. Since southern Europe became the second epicentre of the pandemic after China and the virus spread to the rest of Europe in March, the infection curve in the Eurozone has flattened considerably (graph at bottom left). The UK has also made progress, while in the US the progress made in some states such as New York has been offset by a rapid rise in other states such as California.

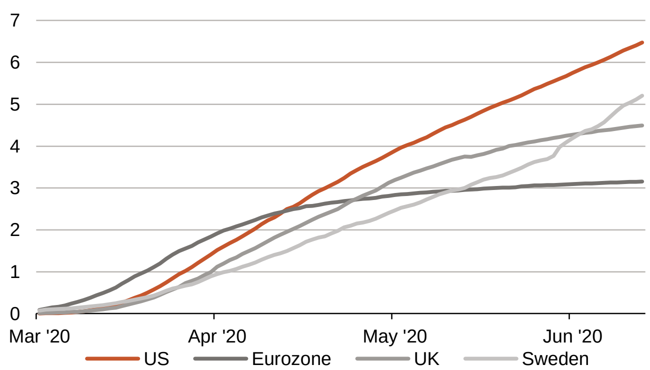
Already in April, some countries in Europe such as Austria, Germany and Denmark began to gradually ease the restrictions. So far, this has not led to a new increase in case numbers. On the other hand, the virus continues to spread quickly in some emerging-market countries. Brazil and Latin America appear to have become the new epicentre of the pandemic. With the exception of Mexico, however, the importance of these countries for the world economy and global supply chains is rather low.

We expect a tick-shaped economic recovery. After a drastic contraction in the first half of the year, a good part of economic activity can recover quickly if the restrictions are gradually eased. The growth rates from the deep trough could be substantial for some time. After the great coronavirus shock, however, consumers and businesses will probably be more restrained in their spending and investments than in earlier upswings. The slope of the upswing is likely to flatten considerably over time. Even in countries such as Germany that are structurally healthy for the most part, it could well take into the middle of 2022 for economic output to regain the level of the time before the coronavirus crisis.

While the pandemic is indeed a severe economic shock, many countries will probably overcome it in two to three years. The determined economic policy response is preventing a financial crisis.

Coronavirus infections: The curve is flattening in Europe

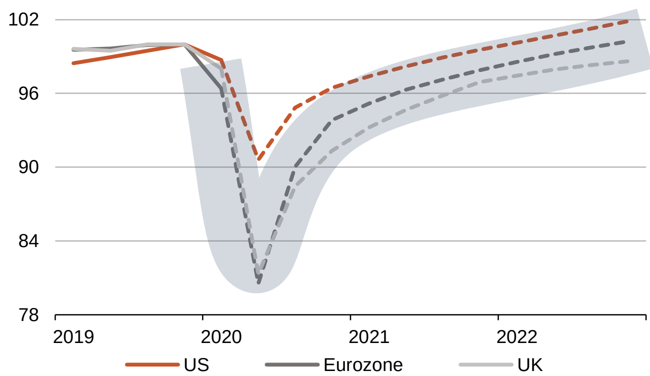
Confirmed cases per 100,000 residents



Time period: 14/03/2020-17/06/2020.
Source: Johns Hopkins University.

Tick-shaped collapse and recovery

Real gross domestic product, Q4 2019 = 100



Time period: 01/01/2019-31/12/2022.
Source: BLS, ONS, Eurostat.

Monetary and fiscal policies in response to the shock

Monetary and fiscal policies and supervisory authorities on both sides of the Atlantic have never responded to a shock so quickly and extensively as in the past few months. Low inflation rates make it possible for central banks to counteract the economic weakness. The US Fed lowered its base interest rate to now only 0.00-0.25% and the Bank of England has gone to 0.1%. Banks that are required to meet certain lending conditions can even borrow funds from the European Central Bank at an interest rate of -1%. Moreover, the ECB has launched a new bond-purchase programme with a total volume of EUR1,350bn through the middle of 2021. We do not expect any more large-scale initiatives at this time.

The monetary stimulus is underpinned by extensive economic programmes that were mainly focused initially on helping companies bridge liquidity shortages and preventing as many employees as possible from being laid off in the crisis. In particular, the instrument of short-time work that many countries introduced under different names appears to be working. Even the US has employed tools that are roughly similar in their effect to the German concept of short-time work. The numbers for May suggest that the trend reversal in the labour market has already begun in the US. Also in Europe, the highest level of short-time work may have been reached or even passed in May.

After the first response to prevent a liquidity and financial crisis, fiscal policy is now increasingly shifting to nourish the recovery. Thanks to solid government finances, Germany can afford an especially big stimulus. Including the new package of EUR130bn, Germany has announced fiscal aid totalling around 14% of the country's annual economic output, although this amount will be paid out over the course of roughly three to four years. These programmes can provide appreciable support to the recovery.

"After the pandemic subsides, monetary and fiscal policy will provide appreciable support to the recovery"

After hesitating for two months, Berlin decided to send a major signal of solidarity with the harder-hit countries of southern Europe. The European Union's proposal for a recovery fund of EUR750bn can help dampen the dangerous anti-EU sentiment in Italy and other countries of southern Europe. Otherwise, a political discussion of Italy's departure from the EU and the Eurozone could have run the risk of triggering a fresh euro crisis that would also be costly for northern Europe.

Pronounced risks

The first coronavirus shock is subsiding in the western world. However, we must keep our eyes open to the risk of a second wave. On the other hand, we are slowly learning to live with the virus. We expect that any fresh regional outbreaks will not necessitate new national lockdowns, which would be costly.

Dr. Holger Schmieding, Chief Economist

Growth and inflation forecasts

	GDP Growth (in %)						Inflation (in %)					
	2019		2020		2021		2019		2020		2021	
		∅**		∅**		∅**		∅**		∅**		∅**
USA	2.3	2.3	-4.1	-5.7	3.5	4.0	1.8	1.8	0.7	0.8	0.6	1.7
Eurozone	1.2	1.2	-9.0	-7.8	6.9	5.2	1.2	1.2	0.2	0.4	0.8	1.1
Germany	0.6	0.6	-7.4	-6.3	5.9	4.9	1.4	1.4	0.1	0.7	1.6	1.4
France	1.2	1.2	-11.2	-9.0	8.7	5.9	1.3	1.1	0.5	0.4	0.9	1.0
Italy	0.2	0.2	-11.7	-10.1	7.8	5.5	0.6	0.6	-0.1	0.0	0.4	0.7
Spain	2.0	2.0	-11.0	-9.3	9.0	5.9	0.8	0.8	-0.5	-0.1	0.4	0.9
UK	1.4	1.3	-9.0	-7.9	5.0	5.5	1.8	1.8	0.5	0.9	1.0	1.5
Japan	0.8	1.0	-4.5	-4.9	3.6	2.3	0.5	0.5	0.1	-0.1	0.2	0.3
China	6.2	6.1	-3.0	1.8	4.0	8.0	2.9	2.9	3.4	3.0	2.1	2.2
World*	2.4	3.0	-4.4	-3.7	3.5	5.0		3.0		2.0		2.5

* Berenberg data at actual exchange rates, not purchasing power parities (PPP). PPP lends more weight to the fast-growing merging-market countries.
** Average, Bloomberg consensus as of 19/06/2020.

FOCUS ON COMPANY OUTLOOKS AND US ELECTIONS

IN A NUTSHELL

- Equity markets in all regions recovered substantially in the second quarter, also thanks to powerful stimulus measures.
- The pace of negative earnings revisions is likely to slow. The company outlooks issued in the course of the Q2 reporting season will show the way forward.
- We like equities in more cyclical regions that will benefit from the economic recovery that appears to be underway. The US elections will increase the level of political uncertainty.

Strong recovery in Europe in Q2

After being gripped by the coronavirus panic in Q1, investors focused in Q2 more on the expected economic recovery fuelled by global stimulus measures. Consequently, cyclically sensitive regions and sectors stand to benefit the most. Besides the DAX and US small caps, eastern European stocks are among the relative winners in Q2 and benefited additionally from a strong recovery of oil prices. Equity indices such as the S&P 500 and MSCI EM Asia that have outperformed during the coronavirus crisis made below-average gains in Q2.

Pace of negative earnings revisions is likely to slow

Analysts have lowered their earnings estimates in line with the weaker economic data and poorer consumer sentiment, although the pace of these downgrades has slowed considerably lately. The Q2 reporting season will probably provide a fresh impulse. Besides the Q2 results, company outlooks will be especially important. We anticipate further negative profit estimate revisions. The consensus expectation for 2020 is a collapse in profits of approximately 20% for the MSCI World. We think 25% and more is possible.

On the other hand, earnings growth will probably recover substantially in 2021. Firstly, the year-on-year comparison will be much easier because profits will then be compared with the recession year 2020. Secondly, the full effect of the liquidity programmes of central banks and the fiscal programmes of governments will probably unfold in 2021. Therefore, it is not surprising that analysts are optimistic, especially for Germany.

Time effect leads to lower valuations again

Equity valuations, especially for US stocks, currently seem to be exorbitantly high on a P/E-ratio basis. They are at the highest level since the technology bubble at the beginning of the millennium. However, it should be remembered that interest rates were much higher back then and other asset classes were considerably more attractive than they are today. Moreover, it is relatively clear that the duration of the current crisis will be very short. Q2 economic growth was especially hard hit. If this period is taken out of the calculation of future 12-month profit expectations, profits will be much higher. For the S&P 500, for example, analysts anticipate that corporate profits in Q2 2021 will be c65% higher than in Q2 2020. Thus, the more weak-profit quarters fall out of

All equity regions saw a substantial recovery in Q2, especially cyclically sensitive equity indices

Total return	YTD and in Q2 20 (in %, EUR)		12-month periods of the last 5 years (in %, EUR)					P/B*	Div.*	P/E*
	YTD (31/12/19-17/06/20)	Q2 20 (31/03/20-17/06/20)	17/06/18 17/06/19	17/06/17 17/06/18	17/06/16 17/06/17	17/06/15 17/06/16	17/06/14 17/06/15	17/06/20	17/06/20	17/06/20
S&P 500	-2.7	21.5	9.8	9.7	12.3	20.8	0.8	3.4	1.9	24.9
MSCI EM Asia	-4.6	19.3	9.0	-8.9	13.5	31.3	-14.7	1.6	2.2	16.0
Stoxx Europe Defensives	-5.4	17.6	4.6	5.7	1.1	13.5	-9.8			
Topix	-5.4	17.3	7.0	-7.2	10.6	23.5	-6.9	1.1	2.4	17.6
DAX	-6.5	33.3	2.5	-7.1	2.0	32.4	-12.3	1.5	2.9	20.5
Stoxx Europe 50	-9.1	23.5	-0.2	4.7	-0.1	20.9	-14.6	1.9	3.4	19.5
Stoxx Europe Small 200	-11.2	35.6	0.7	-4.8	8.7	24.3	-9.2	1.7	2.4	28.1
Euro Stoxx 50	-11.7	33.9	-1.7	-0.8	1.5	27.7	-14.5	1.5	3.1	19.7
MSCI USA Small Caps	-12.7	42.3	-4.4	-1.0	15.7	22.0	-6.5	1.9	1.5	50.4
Stoxx Europe Cyclicals	-14.8	40.3	-4.3	-6.5	5.1	31.6	-17.8			
MSCI UK	-21.0	37.3	-13.2	-1.4	5.8	15.9	-15.3	1.5	4.0	18.3
MSCI EM Eastern Europe	-22.2	54.1	-11.5	25.2	9.7	20.1	-11.2	0.9	5.9	11.0

Time period: 17/06/2015-17/06/2020.
Source: Bloomberg * PBV = Price/book value ratio; Div. = Dividend yield (%); PER = Price/earnings ratio. Values based on estimates for the next 12 months.

the rolling calculation, the more favourable P/E ratios will be again, all other things being equal.

Preference for equities in more cyclical regions

US equities are still attractive in the long term, considering that many of the most innovative and profitable companies are in the United States. In the short term, however, the US market could struggle. Donald Trump's suboptimal crisis management and the high level of US unemployment have set him back in the favour of voters. In the meantime, it seems no longer impossible that the Democrats could not only win the Presidency in November, but also both chambers of Congress. In that case, the tax reform could be partially rolled back. The trade conflicts with other countries would probably become less intense. This would be positive for Europe and emerging-market countries, which would probably also benefit from the expected synchronous economic recovery next year and an end to US dollar strength. Moreover, both these regions exhibit lower valuations than the US and are under-represented in the portfolios of international investors. The powerful fiscal policy programmes that have been announced also favour the Eurozone. The UK is likely to still be Europe's problem child as long as Brexit uncertainty remains high.

Ulrich Urbahn, Head of Multi-Asset Strategy & Research

WHAT IS ON THE MIND OF COMPANIES?

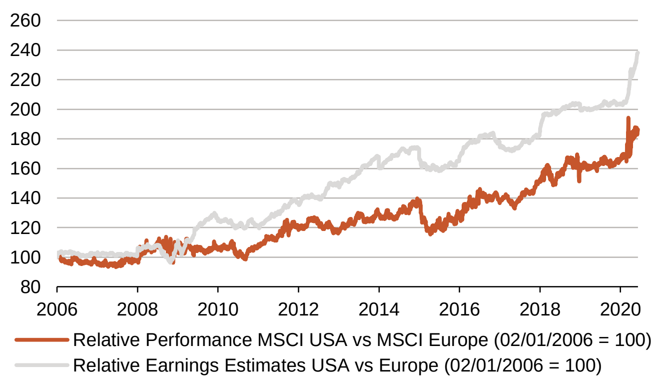
Coronavirus separates the wheat from the chaff

The second quarter of this year was entirely dominated by the coronavirus crisis, and so the economic effects of the pandemic were at the centre of nearly all our conversations with investors. However, sectors have been affected very differently. Whereas the travel and aviation industry are still suffering from a tremendous drop in demand, some parts of the consumer goods industry are enjoying growth again, particularly in China. Large parts of the technology sector, above all payment service providers, and cloud and software companies, continue to report an acceleration of already strong growth. Differences can be observed even within certain sectors. For example, the major pharmaceutical companies have been largely unscathed by the crisis, while medical engineering companies are suffering from closed medical practices and the deferment of less time-critical operations. Hopefully the trough was seen in April. However, a recovery will probably last at least through the end of this year. Like past crises, this crisis is accelerating existing structural trends and mainly harming those companies that were already falling behind.

Matthias Born, CIO Equities

Will US outperformance come to an end, at least temporarily?

Relative performance on the basis of net return indices (including dividends) and relative earnings estimates for the next 12 months

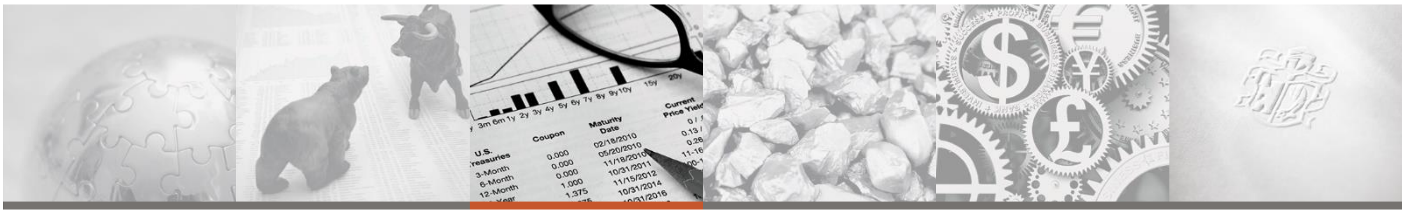


Time period: 02/01/2006–17/06/2020.
Source: Bloomberg, Berenberg.

Forecast overview: Catch-up potential for Europe

Index forecasts	Currently 17/06/2020	31/12/2020	30/06/2021	∅* in 12 months
S&P500	3,113	3,250	3,400	3,288
Dax	12,382	13,000	13,700	12,999
EuroStoxx 50	3,267	3,500	3,650	3,447
MSCI UK	1,771	1,900	2,000	1,927
Index potential (in %)				
S&P500	-	4.4	9.2	5.6
Dax	-	5.0	10.6	5.0
EuroStoxx 50	-	7.1	11.7	5.5
MSCI UK	-	7.3	13.0	8.8

* Average, consensus as of 17/06/2020.
Source: Bloomberg, FactSet, Berenberg.



STILL OPPORTUNITIES AFTER THE CHANGE OF DIRECTION

IN A NUTSHELL

- Despite central bank purchase programmes, the rise in safe government bond yields should continue thanks to the prevailing risk-on sentiment.
- European corporate bonds present attractive opportunities, especially in the BBB rating segment.
- Hard-currency bonds in emerging-market countries, especially in the government sector, are still attractive even after the recovery.

Bond markets in a turning manoeuvre

The combination of an increasingly less tense situation with regard to the coronavirus pandemic and the political will to overcome the crisis triggered a clear change of direction in the bond markets in the second quarter: Safe government bond yields trended slightly higher while the spreads of corporate bonds and emerging-market bonds narrowed considerably. Attractive opportunities can be found in the coming months even after the, in some cases, substantial recovery of prices in risky bond segments.

Government bonds between economic recovery and central banks

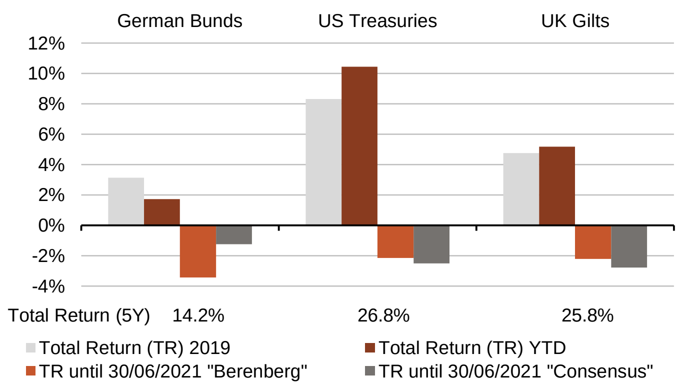
The extreme turbulence in March, which was characterised by a back-and-forth between the poles of "flight to safety " with rapidly declining yields and the "liquidity preference of investors" causing yields to rise just as rapidly, did not recur in this form in the second quarter. On the contrary, we have entered a phase – which can be expected to persist in the coming months – in which other factors are primarily at work. On the one hand, rising public-sector deficits and hopes for a successive normalisation of economic life make government bonds unattractive, while on the other hand, major central banks are purchasing securities on a massive scale and working against an excessively fast and strong rise in yields. On balance, we expect that the yield-increasing influence of economic recovery tendencies will gain the upper hand in the further course of the year. Spanish and Portuguese government bonds are still relatively attractive due to their yield advantage over German government bonds. For the purpose of hedging multi-asset portfolios, US Treasuries also offer a higher yield, but will probably suffer from a weakening US dollar.

Hope in credit markets

After the massive price losses in the first quarter, European corporate bond markets have experienced a substantial recovery rally. Specifically, riskier bond segments such as co-co bonds (contingent convertible bonds) or high-yield bonds outperformed the market and already offset significant parts of their previous losses. We still consider European corporate bonds to be attractive. Even though spreads have tightened to a large extent, the chart on the following page shows that they are still attractive from an historical perspective. This segment is further favoured by the fact that companies typically strive to strengthen their balance sheets, reduce debt and limit cash outflows by means of

Safe government bonds are only attractive for hedging purposes

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



Time period: 17/06/2015–17/06/2020.
Source: Bloomberg, own calculations, iBoxx government bond indices (7-10 years, TR)

Forecast: Base interest rates and government bond yields (in %)

Berenberg forecast compared to consensus forecast, values at end of year 2019 and at mid-year 2020

	17/06/2020	31/12/2020		30/06/2021	
	Currently		∅*		∅*
USA					
Base interest rate	0.00 - 0.25	0.00-0.25	0.25	0.00-0.25	0.30
10Y US yield	0.74	1.00	0.93	1.10	1.14
Eurozone					
Base interest rate	0.00	0.00	0.00	0.00	0.00
10Y Bund yield	-0.40	-0.20	-0.38	0.00	-0.23
UK					
Base interest rate	0.10	0.10	0.10	0.10	0.15
10Y Gilt yield	0.19	0.40	0.41	0.50	0.56

* Average, consensus as of 18/06/2020.
Source: Bloomberg

savings programmes and dividend cuts in recessionary phases. The favourable sentiment is reflected in the fund inflows into investment-grade bond funds, which have persisted for 10 weeks now and can be expected to continue to support this segment, in addition to ongoing central bank purchases in a gradually improving environment. After a rally in the segment of higher-rated quality bonds, it could make sense to look for selective opportunities in the BBB segment. We currently prefer defensive industries such as telecommunications, pharmaceuticals and utilities. By contrast, we continue to resist the temptation of higher yields in sectors that are especially vulnerable to the coronavirus pandemic such as tourism, hotels and airlines, at least until a sustained stabilisation of business models can be observed.

Emerging markets: Hard-currency bonds are still attractive

Both hard-currency and local-currency bonds exhibited a positive performance in the second quarter, contrary to the expectations of nearly all market participants just a few weeks earlier. Besides the general improvement of general conditions, the lower degree of fluctuation of US Treasury yields and the weakening US dollar were advantageous factors. Hard-currency bonds in particular benefited from these developments, those in the high-yield segment the most. Whereas market participants were still cautious at first, as reflected in capital outflows, the perception quickly changed. The positive performance resulted mainly from the considerable tightening of risk spreads in the second half of the quarter. Despite double-digit percentage gains in some cases, especially in the segment of lower credit ratings, attention must still be paid to idiosyncratic risks. Currently prominent examples of such risks include the default in Argentina and substantially higher credit risks in countries such as Sri Lanka, Ecuador and Angola. We still see the current spreads for hard-currency government and corporate bonds as attractive and the yields of local-currency bonds as rather unattractive. In the latter case, the current level of local interest rates, which have already declined substantially, is not enough to compensate for the potential risk of currency volatility. Nevertheless, emerging-market currencies still have appreciation potential in the medium term.

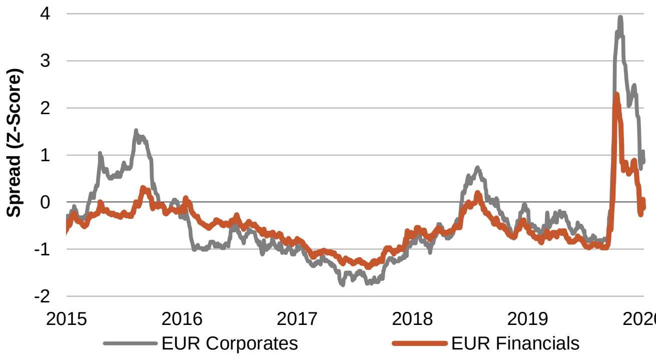
Conclusion: Change of favourites likely to continue

"The first will be last" we wrote in the previous issue, thereby predicting that safe government bonds will lose their status as favourites in the course of a gradual recovery from the coronavirus crisis. This expectation has recently been fulfilled and the trend will continue in the coming quarter, according to our main scenario. Top-rated government bonds, specifically US Treasuries, are only attractive for hedging purposes. By contrast, European corporate bonds, especially in the lower investment-grade segment (BBB+ to BBB-), offer better income prospects. We take an explicitly optimistic view of emerging-market countries, where we prefer hard-currency government bonds. Their risk premiums have not yet regained their fair value, unlike US corporate bonds (see the chart at bottom right).

Martin Mayer, Senior Portfolio Manager Multi-Asset
Christian Bettinger, Head of Fixed Income
Robert Reichle, Head of Emerging Markets Selection

Corporate bond premiums are still historically attractive

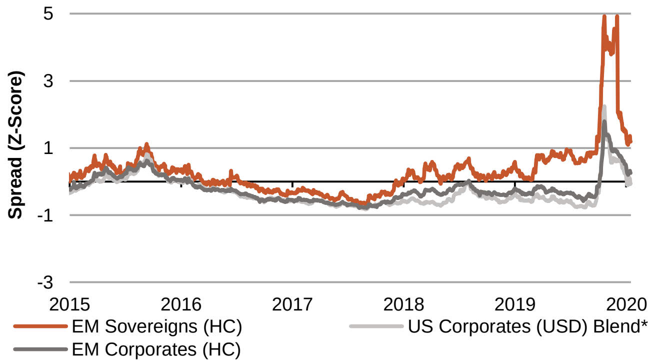
From historical perspective, yield spreads for corporate bonds are still attractive, despite having narrowed recently



Time period: 17/06/2010-17/06/2020, Source: Bloomberg.
Presentation: historic Z-Score, Observation period 10 years

Emerging markets: Clear preference for hard-currency government

Especially compared to US corporate bonds, hard-currency (HC) emerging-market (EM) government bonds offer higher risk premiums



Time period: 17/06/2005-17/06/2020, Source: Bloomberg, * 80%/20% investment grade (IG)/non-IG, Presentation: historic Z-score, Observation period 15 years

GOLD AS THE BENEFICIARY OF UNCERTAINTY

Crude oil's historic catch-up race has ended for now

In the past months, the oil market experienced what is probably the most spectacular quarter of its history. The price was initially influenced by worries that storage capacities would run out, causing WTI to turn negative in mid-April for the first time in history. That was followed by a furious catch-up run thanks to massive production cuts, with oil experiencing the best quarter of the past 30 years. In the short term, however, downside risks predominate. Firstly, further upside price potential is limited by the enormously high inventories. Secondly, US shale oil producers are already announcing their intention to turn on the taps again. Moreover, compliance within OPEC+ will probably fall off appreciably in order to keep US producers in check. On the other hand, demand will return only gradually. Finally, the current positioning of speculative investors is extremely optimistic, which would exacerbate a price fall in reaction to negative surprises.

Gold as a hedge against uncertainty

Gold was unimpressed by the rally of many risk assets in the second quarter. On the contrary, it continues to be one of the best investments since the beginning of the year despite the recent strength of the euro. Even as equity markets raced higher, gold continued to be well supported by negative real interest rates and a number of risks such as fears of a second wave of infections and the re-ignited trade war. And despite record ETF holdings, many investors are probably still under-invested in the precious metal considering that the ratio of gold ETFs to global equity market capitalisation is just 1 to 500 (or 0.02%). Hence, demand is likely to remain strong in the medium term. However, a phase of strong economic recovery or rising interest rates could temporarily derail this trend. In the portfolio context, gold remains an important hedge.

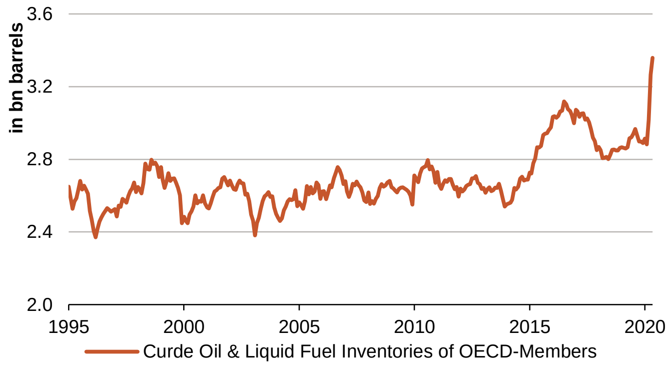
Industrial metals to recover over time

Industrial metals followed the positive direction of cyclical stocks in the second quarter, albeit to a lesser extent. Although the economic downturn was also felt in the metal markets, this effect was more than offset by the temporary closure of mines in many places. In addition, metals used in infrastructure projects can be expected to benefit from China's economic stimulus programmes. In the short term, however, metal prices will come under pressure as supply comes back online.

Ludwig Kemper, Analyst Multi-Asset Strategy & Research

Enormous inventories limit the potential of crude oil

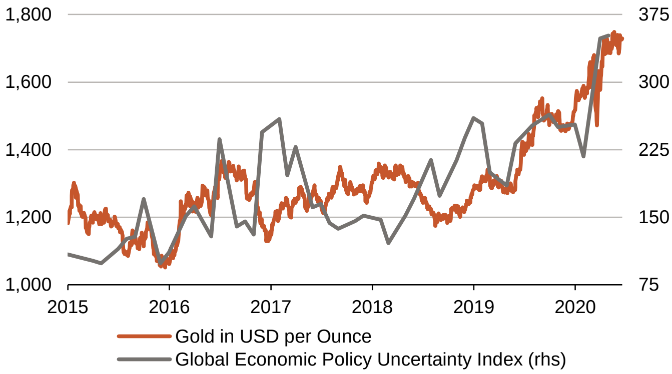
The collapse of demand led to massive inventory builds. Only after inventories normalise will crude oil be able to recover sustainably.



Time period: 01/01/1995-31/05/2020.
Source: Bloomberg, EIA.

Investors are increasingly fleeing into gold

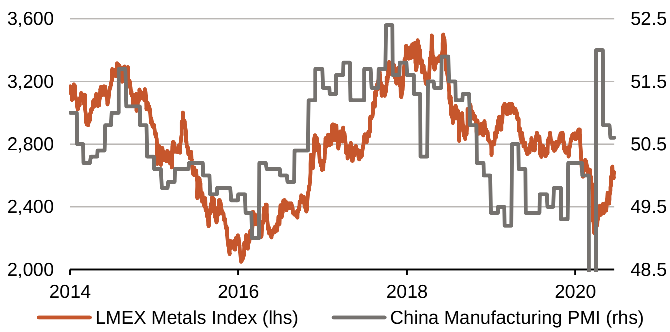
Besides negative real interest rates, gold has also benefited from constantly rising global uncertainty in the past few years.



Time period: 01/01/2015-17/06/2020.
Source: Bloomberg, Baker, Bloom & Davis.

Industrial metals are supported by Chinese industrial demand

The Chinese purchasing managers index for manufacturing has risen above 50 again, signalling the return of demand for industrial metals.



Time period: 01/01/2014-17/06/2020.
Source: Bloomberg.

IMPROVING OUTLOOK FOR THE EURO

Solidarity strengthens the euro

Central banks continued to pursue extremely expansive monetary policies in the second quarter. However, fiscal policy has recently been more impactful on the currency market than monetary policy. The European Commission's plan to create a €750bn "recovery fund" sends a strong signal that Europe will overcome the coronavirus crisis through solidarity. Spreads of Italian government bonds tightened again. Moreover, the powerful economic programmes have bolstered the confidence of market participants in the European currency, helping the euro recover in the past few weeks. Fears of a new euro crisis have subsided considerably. As light appears at the end of the economic tunnel, the "safe-haven" currencies have lost some of their appeal. For that reason, the euro has not only gained against the US dollar and the British pound, but has also risen sharply against the yen and the Swiss franc. We see good chances that the higher euro valuation is not just a temporary phenomenon.

Problems for the US dollar

The US is currently confronted with several challenges. The sharp economic downturn has affected the labour market much more severely than in Europe, where the blow has been cushioned to a much greater degree by extensive social welfare programmes and short-time work allowances. Other challenges include domestic tensions, with civil unrest in the streets, and the renewed flare-up of the trade conflict with China. Finally, the dollar's exchange rate had been strengthened by inflows from emerging-market countries. This effect will probably fade now, reducing the demand for dollars. All things considered, therefore, there is good reason to think that the euro can hold the current level of 1.12 US dollars per euro and extend it somewhat further in the rest of the year.

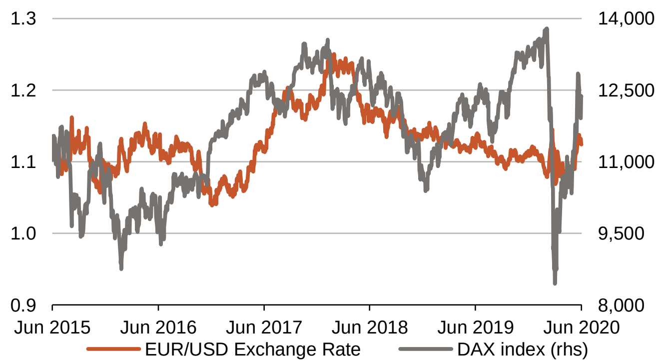
Sterling weighed down by economic and political risks

The euro's exchange rate against the British currency has recently settled in at slightly below 0.90 pounds per euro. The rise can be attributed in part to the general strength of the euro, but also to the political and economic risks in the UK. The risk that no agreement can be reached in a follow-on treaty with the EU by the end of the year, resulting in a hard Brexit, has not been eliminated. Moreover, the pound will probably be weighed down further by the sharper economic contraction and a weaker recovery next year.

Dr. Jörn Quitzau, Senior Economist

EUR/USD: Fresh impetus for a euro comeback

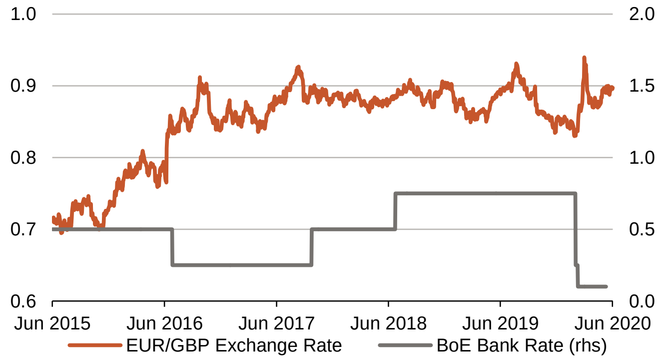
Positive impulse from monetary policy and now also European fiscal policy



Time period: 17/06/2015–17/06/2020.
Exchange rate in US dollars; DAX Index in points. Source: Bloomberg.

EUR/GBP weighed down by the risk of a no-deal Brexit

The euro is benefitting from economic and political risks in the United Kingdom. The pound will probably not see better days until next year.



Time period: 17/06/2015–17/06/2020.
Exchange rate in GBP, base interest rate in %. Source: Bloomberg.

Exchange rate forecasts

When the burden of political risks is lifted, the euro will rise further.

	17/06/2020	31/12/2020		30/06/2021	
Exchange rate forecast	**Currently**		∅*		∅*
EUR/USD	1.12	1.15	1.13	1.16	1.15
EUR/GBP	0.90	0.91	0.89	0.89	0.89
EUR/CHF	1.07	1.10	1.08	1.11	1.10
EUR/JPY	120	124	120	124	123
Change against the euro in %					
USD	-	-2.2	-0.5	-3.1	-2.2
GBP	-	-1.6	0.6	0.6	0.6
CHF	-	-3.0	-1.2	-3.9	-3.0
JPY	-	-3.0	0.3	-3.0	-2.2

* Average, consensus as of 17/06/2020.
Source: Bloomberg.

INTERVIEW WITH ANDREAS STROBL

Mr Strobl, as a portfolio manager you are responsible for the German equity funds at Berenberg and you have a passion for German small and medium-sized enterprises (SMEs). What do you like so much about these companies and what makes them so unique?

Small and medium-sized enterprises are the backbone of the German economy. More than one out of two euros of net value-added in Germany is generated by small companies. Many firms are hidden champions, meaning they are world market leaders in their niches and have been very successful in defending this position against global competitors. However, they are relatively unknown to the public and also receive little attention from analysts. That is why I can create much more value for the funds with my own investigations and observations than with large corporations that are covered by numerous analysts.

And what else distinguishes the big companies from the small ones?

Thanks to their technologically superior products, SMEs can generate more attractive growth rates than large corporations in the medium term. I also attach great importance to family-led businesses. That is because in smaller companies the senior management has much more influence on the company's development than in large corporations. In addition, there is more alignment with the interests of shareholders because founder families usually still hold a significant portion of their company's equity. Making contact with the senior management, discovering fascinating products, and getting to know and correctly analyse the key persons behind the company's success is the most exciting and essential part of my job. That was something that always fascinated me about small caps: why are some companies and persons successful, others not?

You have been successful in your work for many years. What is your secret?

Detailed analysis, a clear awareness of risk and, above all, discipline. You cannot shy away from risk and you must seize opportunities. But that also requires strict discipline in the investment process. The coronavirus pullback is a good example. In such a situation, you need to stay calm and examine your investment approach, but also critically scrutinise the decisions you have made. This is all the more important in volatile, fast-changing markets.

How is that reflected in your investment philosophy?

A concentrated portfolio based on a strictly fundamental selection process with a long-term orientation, independently of the

benchmark. I place a deliberate emphasis on stock picking, although always with a clear focus on robust, sustainable business models and a strong management team, along with high profitability and a sound balance sheet.

Have high-growth, high-quality companies not become very expensive lately?

The main problem is that analysts consistently underestimate structural growth drivers. But they also underestimate economic risks. Precisely in times of crisis, this tendency leads them to think that high-growth companies are too expensive. However, high-quality companies with structural growth can weather times of crisis much better and often emerge stronger from a crisis, which also justifies higher valuations in the long term.

Does the coronavirus pandemic not dash the expectations of high growth?

Although the German economy overall has been hard hit by the coronavirus pandemic, there will also be companies that benefit from it. SMEs can help their customers lower their costs or master structural changes with technologically superior products while continuing to generate solid growth for themselves. Moreover, family-owned enterprises often have strong balance sheets and can use them for acquisitions in economically weaker phases. Thus, many German small and medium-sized enterprises emerged stronger from the 2008/09 financial crisis than their European and global competitors.

What are the structural drivers and how are they reflected in your investment funds?

Digitalisation and demographic change are two decisive megatrends. That is why even before the coronavirus outbreak we had a defensive sector allocation with nearly 50% of our holdings in the IT and healthcare sectors, which is a clear overweight of these sectors compared to the benchmark. For many companies in these sectors, the powerful structural growth drivers have become even stronger. IT systems houses have benefited from the need to catch-up to digitalisation for some time now. The crisis has again illumined the need for investment in IT infrastructure among German companies and the public-sector entities, particularly to allow working from home, for example.

"Sustainability has always been part of the DNA and business strategy of most owner-managed family enterprises, only they didn't call it that"

Not only do pharmaceutical and medical engineering companies benefit from an ageing population in the long term, they are also benefiting at the moment from the significant need for test capacities in laboratories and personal protective equipment. But the same can also be said of the more efficient configuration of IT landscapes in the healthcare sector. Moreover, the current crisis has led to new behaviours such a sharp increase in electronic payments.

Another key topic is sustainability. How do owner-managed companies rate in this respect?

Sustainability has always been part of the DNA and business strategy of most owner-managed family enterprises, only they didn't call it that. These entrepreneurs usually think in terms of much longer cycles even if this perspective precludes the maximisation of short-term profitability. In addition, sustainable product and corporate development enhances the loyalty of employees, which is a critical factor for long-term business success. However, SMEs must still considerably increase their communication efforts on the subject of sustainability. Owner-managed enterprises often receive lower ratings than blue-chip companies because their commitment is not adequately documented and cannot be evaluated properly.

How satisfied are you with the performance of your funds?

Since the inception of the 1590-Aktien Mittelstand fund in December 2015, we are well ahead of the benchmark and also ahead of our closest competitors. This is also reflected in Morningstar's five-star rating. In addition, the fund was recently named Europe's best fund in the category of "Equity German Small- and Mid-Cap" by the fund rating agency Refinitiv Lipper due to its outstanding performance in the past three years. And despite the coronavirus crisis, we are again well ahead of the benchmark since the start of this year. This is a vindication of our investment approach of building a concentrated portfolio with defensive, but also high-growth companies, and especially companies with strong balance sheets. And the Aktien-Strategie Deutschland fund, which I have managed together with Sebastian Leigh since September 2019, is ahead of its benchmark since inception and is in the top 10% of its peer group. Like the 1590-Aktien-Mittelstand fund, German SMEs play an important role in the Aktien-Strategie Deutschland fund.

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Andreas Strobl has been a Senior Portfolio Manager at Berenberg since November 2016. He began his career as an analyst at BayernLB in 2002. In 2006, he moved to Allianz as a Senior Investment Manager. Since 2015, Andreas Strobl was a Senior Portfolio Manager at Allianz Global Investors, where he was responsible for managing and developing various European small/mid-cap equity portfolios. He studied business administration at LMU in Munich. In 2005, he completed the continuing education programme for CIIA and CEFA, finishing at the top of his class.

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IMPORTANT NOTICES

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