BERENBERG
Markets

INVESTMENT COMMITTEE MINUTES

04 November 2021

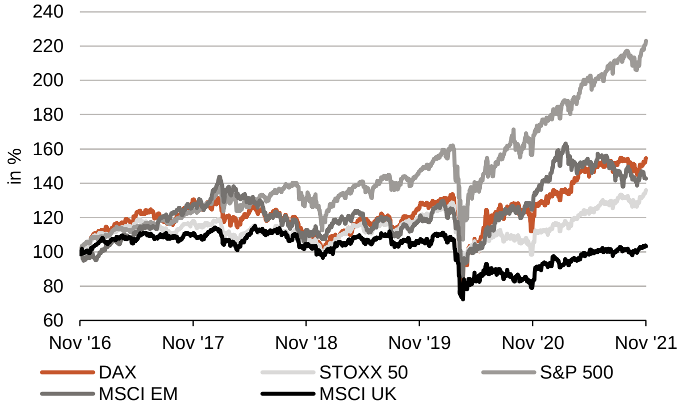
Managers of the Committee

Prof Dr Bernd Meyer
Chief Investment Strategist
Chairman

Dr Holger Schmieding
Chief Economist,
Vice Chairman

The **Committee Members** are listed in the notes.

Development of selected equity indices



Source: Bloomberg, 03/11/2016 - 03/11/2021.

Most important assessments at a glance

Economics	• Global economy loses momentum. Supply bottlenecks and high energy prices are a burden. A touch of "stagflation". • Outlook for 2022 is positive as there is pent-up demand; companies want to invest and politicians provide support. • Inflation: new push in autumn, decline in 2022; however, wage pressure increases – Fed initiates monetary policy shift.
Equities	• Strong reporting season supported equity markets. Moreover, equities remain without alternatives and setbacks are bought. • Style volatility continues. Growth stocks led the way in October. A clear style direction is not apparent. • We maintain our moderate equity overweight as we think there is limited upside. 2022 is likely to be more challenging.
Bonds	• High inflation expectations lead to pressure on central banks to act. Yields therefore continue to rise. • Attractiveness of investment grade and high yield bonds has declined with now historically low spreads. • We underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.
Commodities	• Gold has continued to fluctuate sideways over the past few months. Rising real interest rates limit upside potential. • Oil supply remains tight and demand high. The result: a pronounced supply deficit and rising prices. • Industrial metals benefit from high energy prices. Coupled with robust industrial demand, they remain well supported.
Currencies	• EUR/USD should find a bottom at 1.15. However, upside potential for the euro is limited for the time being. • After an upward move towards 0.84 pound per euro, sterling is weakening again. The sideways trend is likely to continue. • The franc is very strong again. The Swiss National Bank is fighting against an even stronger franc.

Current market commentary

A weak September has been followed by a strong October. Investor sentiment has improved significantly thanks to new all-time highs in the S&P 500 and an encouraging Q3 reporting season. Investors appear to have unwound put options on the S&P 500, while systematic strategies have increased their equity exposure due to the fall in volatility and positive momentum. The equity market has thus recently become more vulnerable again. However, we still do not expect a major correction this year, as equity markets remain well supported by inflows, share buyback programmes and the lack of alternatives. Next year, on the other hand, is likely to be more challenging for investors. Potential stumbling blocks include tighter central bank monetary policy, China's further development, lower corporate earnings growth and the US mid-term elections. We are positioning ourselves with a moderate overweight in equities, as we still see envisage potential at least until the end of the year. At the style level, it was volatile again. Most recently, growth stocks were again in the lead.

Looking ahead, the volatility of styles is likely to continue, which is why we still consider a balanced portfolio to be appropriate. Pressure on central banks is increasing as inflation remains high and inflation expectations are above 2%. The yield curve has flattened recently, mainly due to rising interest rates at the short end, which have historically implied a slowdown in growth. However, we consider this merely a countermovement and envisage interest rates also rising at the long end in the medium term. Government bonds thus remain unattractive. However, investment-grade and high-yield bonds are also losing their appeal with historically low risk premiums. We think there is potential in emerging market bonds, which offer a significantly positive carry. In commodities, we remain positive about crude oil due to the supply deficit. Industrial metals are benefiting from high energy prices. Gold should continue to have a difficult time in an environment of rising real interest rates.

ECONOMICS

A touch of stagflation

Global economy loses momentum in autumn. Supply bottlenecks and high energy costs weigh on growth.
The 2022 outlook stays positive as supply bottlenecks could ease, while consumers and companies have pent-up demand.
Inflation appears to have overshot in autumn 2021 and remains an issue in 2022 - Fed initiates monetary tightening.

- **A touch of stagflation:** After a growth spurt in spring and summer, the global economy is currently losing momentum. While the Delta wave of COVID-19 infections is hardly burdening the economy in Europe and the US due to high vaccination rates, supply bottlenecks are hampering growth in manufacturing. In some sectors, labour shortages are preventing a rapid expansion of aggregate economic supply. In China and some other APAC countries, this is compounded by the short-term impact of regional lockdowns. The faster-than-expected rise in energy costs is also translating into lower growth and higher inflation in the short term.
- **Positive outlook for 2022:** Despite a slight setback since July, purchasing managers' indices and other leading economic indicators continue to point to solid growth. Moreover, employment rates are increasing on both sides of the Atlantic. In the long run, this will continue to boost incomes and consumption of private consumers, even if the currently high energy prices may initially weigh somewhat on consumption. In the autumn, pronounced supply bottlenecks are likely to put a noticeable dampener on growth, especially in Europe's industry-heavy economies. However, during the course of 2022, economic data may surprise positively again if the supply bottlenecks ease.
- **China's economy** is suffering from measures taken against the Delta wave, a new wave of regulations and pronounced tensions in the real estate market. The government's attempt to encourage investors to be more cautious in the real estate sector and not to absorb all losses is causing turbulence. However, the risk of a real financial crisis remains low. As a capital-rich country with a high savings rate, China can launch a new stimulus if necessary. As their own domestic demand is robust, the US and Europe are not currently dependent on a growing Chinese market.
- **High inflation in autumn 2021, decline in 2022:** Supply bottlenecks, delivery problems and high energy prices are currently pushing inflation up more than expected. In Europe, inflation is expected to rise to up to 4.5% by the end of 2021, while in the US it is likely to remain at around 5%. However, the current rise in energy costs is overdone. With the expiry of some special effects, the inflation should calm down again in 2022 with year-end inflation rates around 1.5% in the euro area and 3% in the US. After that, inflation is likely to pick up again slowly on stronger wage pressures.

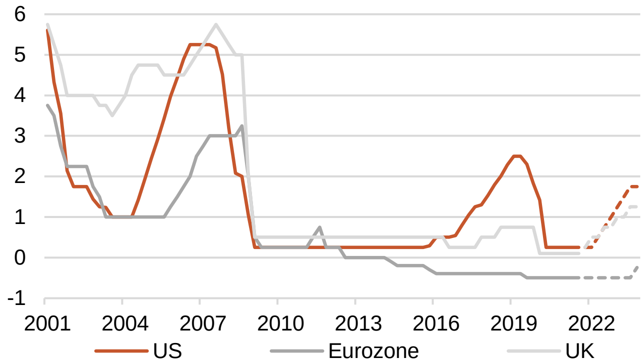
Monetary policy turnaround: In view of persistently high inflation, the Fed will probably end its bond purchases in mid-2022 and raise its key interest rate by 0.25 percentage points six times between June 2022 and the end of 2023. The ECB, facing lower inflationary pressures, will reduce its bond purchases in 2022 but not end them before the summer of 2023. The first ECB interest rate hike will probably be at the end of 2023.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2020	2021	2022	2020	2021	2022
World	100.0	-3.1	4.8	3.6			
USA	24.5	-3.4	5.5	3.7	1.2	4.2	3.9
China	16.4	2.0	8.0	5.2	2.5	0.8	1.9
Japan	5.8	-4.7	2.5	2.4	0.0	-0.2	0.8
India	3.3	-7.3	10.0	6.5			
Latin America	5.9	-7.0	4.4	3.3			
Europe	24.4	-6.1	5.0	4.6			
Eurozone	15.3	-6.5	5.1	4.9	0.3	2.5	2.3
Germany	4.4	-4.9	2.7	5.0	0.4	3.0	2.3
France	3.1	-8.0	6.8	4.7	0.5	2.1	2.1
Italy	2.3	-9.0	6.4	5.0	-0.1	1.8	1.7
Spain	1.6	-10.8	4.4	6.7	-0.3	2.9	2.4
Other Western Europe							
United Kingdom	3.2	-9.7	6.9	5.0	0.9	2.3	3.5
Switzerland	0.8	-2.7	3.5	2.8	-0.7	0.4	0.5
Sweden	0.6	-2.9	3.6	3.4	0.5	1.7	1.3
Eastern Europe							
Russia	1.9	-3.0	3.0	2.5	3.3	5.2	4.0
Turkey	0.9	1.6	4.5	3.5	12.3	15.0	12.0

Source: Berenberg

Central bank interest rates



Interest rates in %; dashed: Berenberg forecast; US: Federal funds rate, Eurozone: deposit rate, GB: Bank rate; Sources: Federal Reserve, ECB, BoE, Berenberg; Q1 2001 - Q4 2023.

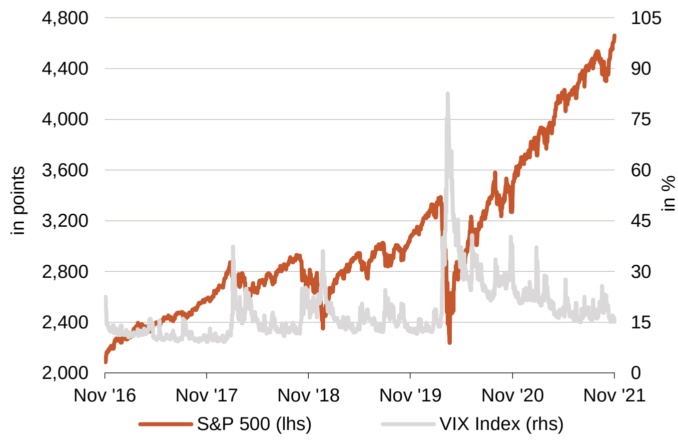
EQUITIES

Upside potential limited

A strong reporting season supported equities. In addition, equities remain without alternatives and setbacks are bought. Style volatility continues. Growth stocks led the way in October. A clear style direction is not apparent. We maintain our moderate equity overweight and think there is limited upside potential. 2022 should be more challenging.

- **A weak September for equity markets was followed by a strong October:** The S&P 500 reached a new all-time high despite rising nominal interest rates. The good Q3 reporting season brightened investor sentiment significantly, which once again led to buying the September setback. Europe fared similarly well. Asian equity markets, on the other hand, made little headway, partly due to continued weakness in China.
- Volatility at the style level continues. After a strong September for **value stocks** in Europe, growth stocks led the way again in October. Growth stocks gained more than 5% compared to around 3% for value stocks. **Cyclical** and **defensive equities** performed almost identically, with each gaining around 4%. In addition, **large caps** were more in demand than **small caps**. Looking ahead, style volatility is likely to continue for the time being.
- Investor sentiment has become much more optimistic again and retail investors remain net buyers. At the same time, investors appear to have unwound put options on the S&P 500, while systematic strategies have increased their equity exposure due to the fall in volatility and positive momentum. The equity market has thus become more vulnerable again. However, we still do not expect a major correction this year, as the equity market remains supported by inflows, share buyback programmes and the lack of alternatives. Next year, on the other hand, is likely to be more challenging for investors. Potential stumbling blocks include tighter monetary policy, China's further development, lower corporate earnings growth and the US midterm elections.
- We are positioning ourselves with a **moderate equity overweight** and **continue to tactically add cyclical and value-focused positions to our quality-growth exposure.**

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 03/11/2016 - 03/11/2021.

Overview of equity markets (short/medium term)

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

	As of 03/11/2021	Performance in local currency ytd	1-year	3-year	P/E	Dividend yield
DAX	15,960	+16.3%	+32.0%	+38.6%	15.4	2.5%
SMI	12,383	+19.0%	+27.5%	+51.4%	19.4	2.6%
MSCI UK	2,039	+16.6%	+30.9%	+12.4%	12.2	4.2%
EURO STOXX 50	4,310	+24.3%	+42.6%	+46.6%	16.9	2.7%
STOXX EUROPE 50	9,055	+23.1%	+35.9%	+38.1%	16.2	3.1%
S&P 500	4,661	+25.5%	+40.3%	+80.6%	22.5	1.3%
MSCI Em. Markets	1,262	-0.3%	+15.3%	+36.9%	13.3	2.8%

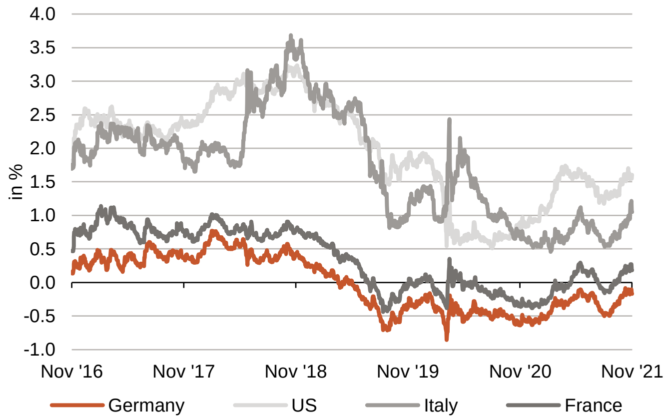
BONDS

Pressure on central banks rises

High inflation expectations put pressure on central banks to act. Yields therefore continue to rise. Attractiveness of investment grade and high yield bonds has declined with now historically low spreads. We underweight bonds and focus on credit risk and off-benchmark themes. Duration: short.

- The pressure on central banks is increasing as inflation prints remain high and market participants' inflation expectations are also rising. Yields at the short end of the yield curve, in particular, have risen. Yields on 10-year government bonds, on the other hand, have risen less sharply, as the market fears a slowdown in growth with a more restrictive monetary policy. The yield curves have thus flattened recently.
- Yields on 10-year **German government bonds** have risen by only 1 basis points (bp) in the past four weeks. For the more cyclical and risk-sensitive 10-year **Italian government bonds,** yields have risen by more than 15 bps.
- For 10-year **US government bonds** yields have risen by about 8bp. Looking ahead, however, we expect interest rates to increase more strongly again, as inflationary pressures are likely to persist for the time being and the Fed is thus likely to become more restrictive in its monetary policy.
- The risk premiums on **investment-grade corporate bonds** have fallen further in recent weeks. However, the potential for further spread tightening is now limited, as risk premiums are already at historically low levels. Consequently, the asset class is becoming increasingly unattractive as interest rates look set to rise. The riskier **high-yield bonds** also experienced falling risk premiums but offer a higher current yield. Nevertheless, the risk-return profile is also becoming less attractive. We think there is more potential for **emerging market bonds**. We prefer local currency bonds in particular.
- **We underweight bonds:** We maintain our focus on corporate and emerging market bonds and keep maturities short.

Yields on 10-year government bonds



Source: Bloomberg, 03/11/2016 - 03/11/2021.

Overview of bond markets (short/medium term)

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

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

	As of 03/11/2021	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	255.96	-2.9%	-2.7%	+10.6%
Covered bonds (iBOXX Euro Germany Covered)	203.67	-1.8%	-1.9%	+2.8%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	161.74	-0.8%	-0.2%	+7.8%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	160.59	-0.5%	+0.3%	+6.3%
Emerging market bonds (Bloomberg Barclays EM USD Aggregate TR Index Unhedged)	1,264.48	-1.8%	+2.4%	+19.5%
High-yield bonds (Bloomberg Barclays Global High Yield Total Return Index, USD)	1,530.41	+1.1%	+7.9%	+19.2%

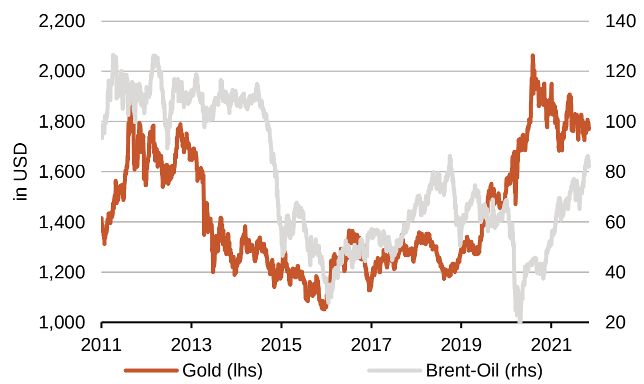
COMMODITIES

Cyclical commodities remain strong

Gold with no upside prospects as real interest rates rise.
Crude oil price very robust thanks to supply shortage.
Industrial metals benefit from high energy costs.

- **Gold** rose slightly in October. However, from the perspective of the past few months, this movement is negligible. Investors are showing little interest in the precious metal. Demand is likely to remain subdued in the coming months as real interest rates tend to rise. We expect gold to continue to move sideways.
- **Crude oil** (Brent) is trading robustly above the USD80 per barrel mark, as black gold remains scarce. With OPEC+ restrictive, little production expansion from US shale oil producers and demand recently reaching pre-crisis levels, oil remains in a supply deficit. As long as the market remains undersupplied, prices are likely to rise until a new equilibrium is found.
- **Industrial metals** benefited from the strong increase in energy prices in October, as the latter account for a significant part of processing costs. Coupled with strong industrial demand, metals remain well supported.

Price development



Source: Bloomberg, 01/01/2011 - 03/11/2021.

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

		Performance		
	As of 03/11/2021	ytd	1-year	3-year
Gold USD/ounce	1,770	-6.8%	-7.3%	+43.6%
Silver USD/ounce	23.5	-10.9%	-2.9%	+59.8%
Copper USD/pound	432.1	+22.8%	+39.7%	+53.9%
Brent USD/bbl	81.99	+58.3%	+106.5%	+12.6%

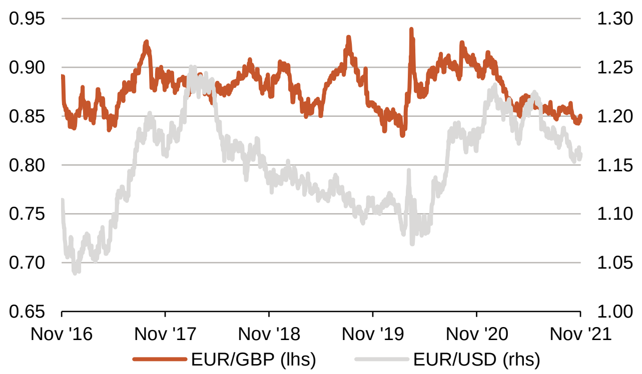
CURRENCIES

The euro calls for patience

EUR/USD: The euro is not recovering from the trough.
EUR/GBP: Continued sideways trend likely.
EUR/CHF: Franc too expensive, SNB counteracts.

- **EUR/USD:** The big picture is similar to the previous month. Several factors are strengthening the US dollar - at least in the short term. One of them is the monetary policy outlook: the US Fed is about to tighten its monetary policy, while the ECB think there is no need for action and continues to "look through" the high inflation rates. The US dollar is also benefiting from its status as a haven. Even the escalating national debt is positive for the US dollar in the short term: market players are rewarding the fact that the expansive fiscal policy is strengthening overall economic demand. The risks resulting from the high debt are only gradually being taken into account by markets. We remain positive on the euro for the next six to 12 months.
- **EUR/CHF:** The Swiss franc is very strong again. For the Swiss National Bank (SNB), which wants to prevent too strong an appreciation, the pain threshold has been reached. The SNB is apparently intervening in the foreign exchange market**.**

Exchange rates



Source: Bloomberg, 03/11/2016 - 03/11/2021.

Overview of currencies (short/medium term)	Old	New
EUR/USD | Euro/US dollar	↗	↗
EUR/CHF | Euro/Swiss franc	↗	↗
EUR/GBP | Euro/Sterling	→	↗
EUR/JPY | Euro/Japanese yen	↗	→

		Performance		
	As of 03/11/2021	ytd	1-year	3-year
EUR/USD	1.16	-4.9%	-0.9%	+2.0%
EUR/CHF	1.06	-2.1%	-1.0%	-7.3%
EUR/GBP	0.85	-5.1%	-5.4%	-3.4%
EUR/JPY	132.38	+4.9%	+8.1%	+2.7%

IMPORTANT NOTES

Members of the Investment Committee

Prof Dr Bernd Meyer | Chief Investment Strategist, Chairman
Dr Holger Schmieding | Chief Economist, Vice-Chairman
Matthias Born | Head Portfolio Management Equities, European Equities
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
Ansgar Nolte | Co-Head Portfolio Management Multi Asset
Torsten Ziegler | Equities
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Disclaimer

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