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Markets

INVESTMENT COMMITTEE MINUTES

06 April 2023

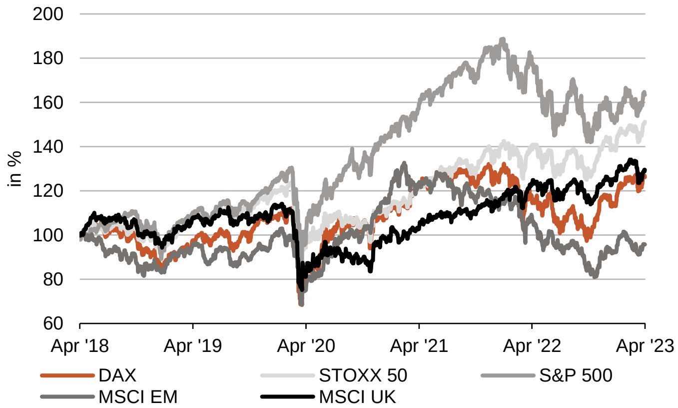
Managers of the Committee

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, 05/04/2018 - 05/04/2023.

Most important assessments at a glance

Economics	• Bank turmoil triggers mild credit crunch and sends US economy into mild recession. Recovery in 2024. • Europe has mastered the winter without a gas shortage. New upswing from summer. Inflation slowly declining. • Central banks: Bank turmoil leads to lower interest rate peak. US Fed cuts rates from end of 2023, ECB rates remain high.
Equities	• Equity markets rise despite banking and recession worries. Defensive and growth stocks ahead of value and cyclicals. • Economic challenges and monetary policy increase the likelihood of negative summer seasonality. • Underweight appropriate with less attractive risk-reward profile. Relative potential in emerging market equities.
Bonds	• Yields on safe government bonds fall in the face of banking and economic worries. Ten-year treasuries yield below 3.5%. • Financial bonds suffer from bank worries. Sharp rise in risk premiums. Emerging-market local currency bonds preferred. • We remain slightly underweight in bonds. Investment-grade corporate bonds and emerging-market bonds preferred.
Commodities	• Gold a big beneficiary of banking sector worries. Gold and silver with potential on Fed reversal. • Structural oil shortage widened by OPEC cuts. US driving season brings seasonal tailwind to oil. • Industrial metals suffer from economic worries. Potential in the medium term with a stronger Chinese recovery.
Currencies	• Interrupted by the turbulence in the banking sector, the euro is now continuing its upward trend. • The euro consolidates its position against the pound above the 0.85 pound per euro mark. • Hardly any movement in the EUR/CHF currency pair. The upward potential for the euro remains limited.

Current market commentary

Global equities performed slightly positive in March despite the increased economic risks due to the banking turmoil. Under the surface, however, a risk-off in cyclical segments in favour of defensive and growth stocks could already be observed. The more cyclically sensitive small caps underperformed large caps. The renewed interest rate hikes by central banks in March increase the likelihood of further dislocations. The increasing risk of recession, recently rebounding valuations and the coming withdrawal of liquidity make the classic seasonal pattern in equities with a weaker summer probable. We thus feel comfortable with the underweight in equities going into the summer. We think there is relative potential in emerging-market equities, also thanks to the economic tailwind from China reopening. Moreover, central banks in emerging markets are still in the interest rate cycle and monetary policy in China remains expansionary.

In the bond market, the banking turmoil had a much stronger impact. Yields on safe government bonds fell in line with lowered expectations of further interest rate hikes by central banks. The market is now pricing in the first interest rate cuts again this year. The yield on 10-year US government bonds is below 3.5%. The negative correlation between bonds and equities is back, at least temporarily, and stabilised multi-asset portfolios. In addition, the inversion of the US yield curve has declined significantly, as we expected. While interest rates have fallen, risk premiums have risen significantly. More risk-sensitive bond segments such as high-yield bonds or emerging market bonds were most clearly affected by this.

With the rising uncertainty, gold and other precious metals were able to make noticeable gains. Fundamentally, the potential remains limited in the short term. We see more opportunities in the medium term due to the supply situation for industrial metals and energy.

ECONOMICS

Central banks cushion financial turbulence by raising interest rates less sharply

US: Fed has almost reached interest rate peak. Mild US recession in 2023. Fed cuts rates from end of 2023.
Europe: Winter is over, leading indicators have recovered. Subdued recovery in 2023, strong growth in 2024.
Inflation peaks in the US and Europe passed. Price pressures continue to decline. But core inflation still above 2% in 2024.

- **2023 is not 2008.** The crisis of some regional banks in the US and the turmoil around Credit Suisse in Europe will not trigger a major financial crisis. On both sides of the Atlantic, most banks are in a far more robust position than in 2008. Policymakers will not repeat the mistake of the disorderly Lehman bankruptcy. But in view of the turmoil, banks in the US and partly also in Europe will reduce risks and restrict their lending.
- **US on the way into a mild recession:** So far, the US economy has held up a little better than expected, but after housing, manufacturing is also slowly sliding into recession. The labour market, while remaining robust, is losing momentum. The creeping credit crunch as a result of the banking quake is likely to exacerbate these trends. We expect US economic output to decline by about 1% over the remainder of the year before a new upswing begins in 2024.
- **Europe: Improvement in sight.** In contrast, the economic outlook has brightened somewhat in Europe, China and Japan. At the end of the heating period, Europe's gas storage facilities were far better filled than usual for the season, at 56%. As less gas needs to be bought in the summer, the risk of a gas shortage in the winter of 2023/24 has decreased significantly. Exchange prices for gas and electricity have fallen noticeably. Consumers are less pessimistic about the future. Therefore, after a winter stagnation, the economy may pick up again in spring. In view of the US recession, however, growth will remain subdued for the time being. For 2024, with the recovery in the US, above-trend growth is on the horizon for Europe.
- **China: Short-term boost.** After the abrupt departure from the zero-COVID-19 policy, demand is rising, especially for services. Together with additional monetary and fiscal stimulus, China may experience a growth spurt for a few quarters. Since production in China is increasing at the same time, this will hardly fuel world inflation. For the global economy, the upswing in China and Japan at least partially offsets the slight US recession.
- **Inflation has peaked:** Inflation is falling in the US and Europe. In Europe, the explosive rise in 2022 energy and food prices drops out of year-on-year comparisons from March. Supply chains are less disrupted. This also helps the economy and eases price pressures. However, the core rate of inflation (excluding energy and food) remains high for the time being.

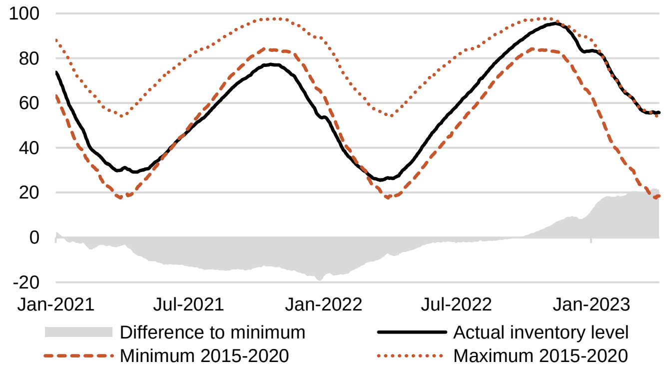
Interest rate summit in mid-2023. The US Fed is expected to raise its key interest rate to 5.25% in May. After the bank quake, the Fed will probably not go beyond that. If inflationary pressures abate, it may cut rates from the end of 2023 or at the start of the 2024 election year. The ECB's deposit rate will probably reach 3.5% by mid-year and then remain there for the time being.

GDP and inflation forecasts (%)

		GDP growth			Inflation		
	Share	2023	2024	2025	2023	2024	2025
World	100.0	1.8	2.3	2.5			
US	23.7	0.6	0.7	2.2	4.3	2.6	2.4
China	18.3	4.7	4.2	3.9	2.0	2.4	2.3
Japan	5.1	1.3	1.2	1.6	2.1	1.1	0.8
India	3.3	6.5	6.7	6.0			
Latin America	5.2	1.0	2.4	2.5			
Europe	26.2	0.2	1.5	1.4			
Eurozone	15.0	0.7	1.6	1.5	5.2	2.4	2.5
Germany	4.4	0.1	1.6	1.6	5.6	2.4	2.5
France	3.0	0.7	1.7	1.7	5.5	2.3	2.5
Italy	2.2	0.6	1.1	1.1	5.8	2.3	2.5
Spain	1.5	1.1	2.2	2.2	3.3	2.2	2.5
Other Western Europe							
United Kingdom	3.3	0.2	1.5	1.7	6.6	2.0	2.3
Switzerland	0.8	0.6	1.4	1.2	2.2	1.3	1.5
Sweden	0.7	0.0	1.7	1.6	6.0	2.2	2.4
Eastern Europe							
Russia	1.8	-3.5	-1.5	-1.5	7.0	5.0	4.5
Turkey	0.8	2.5	2.5	2.0	45.0	25.0	20.0

Source: Berenberg

EU gas storage (fill level in percent)



EU-27; difference to minimum in percentage points. Source: AGSI, 1 January 2021 - 3 April 2023.

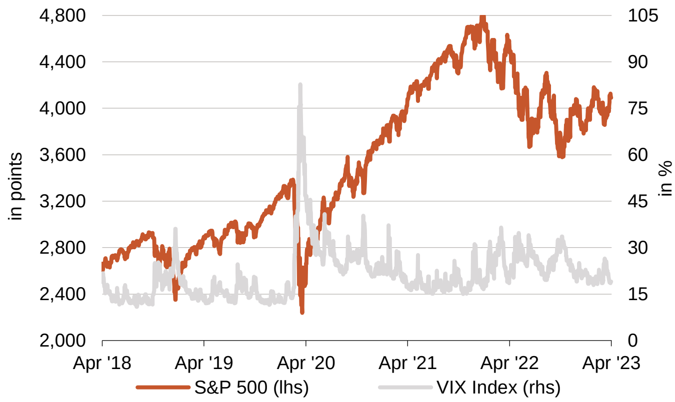
EQUITIES

Equity markets ignore economic risks

Equity markets rise despite banking and recession worries. Defensive and growth stocks ahead of value and cyclicals. Economic challenges and monetary policy increase the likelihood of negative summer seasonality. Underweight appropriate with less attractive risk-reward profile. Relative potential in emerging market equities.

- **Equity markets** developed slightly positively in March despite the increased economic risks due to the turmoil in the banking sector. Recent banking and recession concerns lowered expectations of further interest rate hikes by the Fed. The markets are thus betting on an end to monetary tightening and a return to liquidity expansion.
- Under the surface, however, a **risk-off** in **cyclical segments** in favour of **defensive** and **growth stocks** could already be observed. At the sector level, **utilities stocks** in particular shone in Europe over the last four weeks with a performance of just under 7%, closely followed by **healthcare, consumer staples** and **technology stocks**. **Energy** and **basic materials stocks,** on the other hand, tended to lose out. Not surprisingly, given the prevalence of banking worries, **financials** were the losers, losing almost 9% over the past four weeks. **Large caps** were ahead of their more cyclically sensitive **small cap** counterparts. After the outperformance of **value stocks** in the environment of rising interest rates, **growth stocks** have recently outperformed as the valuation burden due to the rise in interest rates has eased.
- Looking ahead, the high key interest rates and a potential credit crunch due to stricter lending standards increase the probability of further distortions. The stock market seems to be ignoring the economic risks at the moment – also due to systematic buyers and passive investors. The classic seasonal pattern of a weaker summer for equities could occur. The increasing risk of recession, recently rising valuations and the coming withdrawal of liquidity make this likely.
- With the **underweight** in equities, we thus feel comfortable going into the summer. We see relative potential in **emerging market equities,** also thanks to the economic tailwind from the China reopening.

Performance and volatility of the S&P 500 Index



Source: Bloomberg, 05/04/2018 - 05/04/2023.

Overview of equity markets (short/medium term)

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

		Total return in local currency				
	As of 05/04/2023	ytd	1-year	3-year	P/E	Dividend yield
DAX	15,520	+11.5%	+7.6%	+62.9%	11.9	3.4%
SMI	3,529	+5.3%	-9.2%	+24.1%	18.4	3.1%
MSCI UK	2,203	+3.9%	+4.7%	+59.6%	10.5	4.3%
EURO STOXX 50	4,298	+13.9%	+13.9%	+76.4%	12.7	3.5%
STOXX EUROPE 50	9,967	+9.5%	+7.7%	+60.5%	13.6	3.4%
S&P 500	7,630	+6.9%	-8.5%	+70.0%	18.7	1.7%
MSCI Em. Markets	988	+3.8%	-11.7%	+28.8%	12.3	3.1%

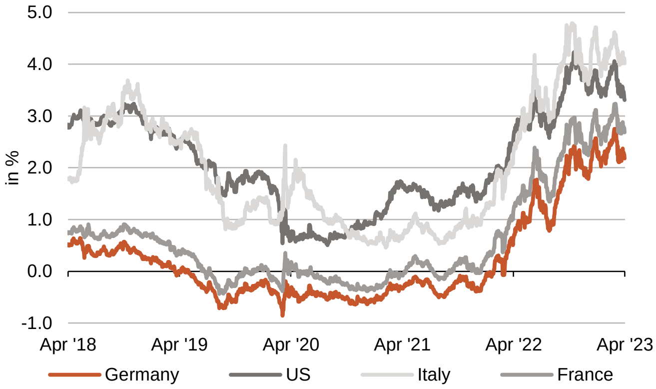
FIXED INCOME

Bank turmoil gets bond markets moving

Yields on safe government bonds fall in the face of banking and economic worries. Ten-year treasuries yield below 3.5%. Financial bonds suffer from bank worries. Sharp rise in risk premiums. Emerging-market local currency bonds preferred. We remain slightly underweight in bonds. Investment-grade corporate bonds and emerging-market bonds preferred.

- The bond market clearly felt the impact of the recent bank turmoil. The market is pricing in an increased recession risk and thus the first interest rate cuts for this year. With market expectations of an imminent end to the Fed's restrictive interest rate policy, yields on **safe government bonds** fell. In the **US**, the yield on 10-year government bonds is now below 3.5% again. Looking at the European periphery, the spreads between **Italian** and **German government bonds have** remained surprisingly stable around the 1.9% mark.
- **Corporate bonds** were also not left untouched by the banking sector worries. Stress in the banking sector has pushed AT1 bond spreads to the old highs of March 2020. Other credit segments have also reacted sensitively. The risk premium on investment-grade credit is thus back in the 92% percentile. Banks and real estate are likely to be primarily responsible for this. US high-yield bonds moreover now represent the most expensive (sub-)asset class relative to their own history.
- **Emerging market bonds** in the hard currency segment saw a reversal in capital flows, with inflows in January turning into outflows in February and March. While yields have fallen, risk premiums have risen significantly – high yield bonds in particular stand out here with a spread widening of almost 80 bps. We prefer the local currency segment with low duration and attractive current yields.
- We consider bonds, especially investment-grade credit and emerging-market bonds, with a manageable maturity to be a real alternative to equities due to the high current yield and less exposure to an economic downturn compared to equities. After the reduction of the underweight, we currently feel well positioned with only a **slight underweight** in bonds.

Yields on 10-year government bonds



Source: Bloomberg, 05/04/2018 - 05/04/2023.

Overview of bond markets (short/medium term)

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

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

	As of 05/04/2023	Performance in index currency ytd	1-year	3-year
Government bonds (iBOXX Europe Sovereigns Eurozone)	214.33	+3.3%	-10.0%	-14.7%
Covered bonds (iBOXX Euro Germany Covered)	180.15	+2.1%	-6.6%	-11.7%
Corporate bonds (iBOXX Euro Liquid Corporates 100 Non-Financials)	140.91	+3.2%	-7.4%	-6.0%
Financial bonds (iBOXX Euro Liquid Corporates 100 Financials)	146.40	+2.1%	-5.1%	-2.4%
Emerging market bonds (J.P. Morgan EMBI Global Diversified unhedged Return EUR)	529.90	+0.3%	-5.7%	+0.1%
High-yield bonds (ICE BofA Global High Yield Index)	408.92	+3.7%	-3.9%	+16.9%

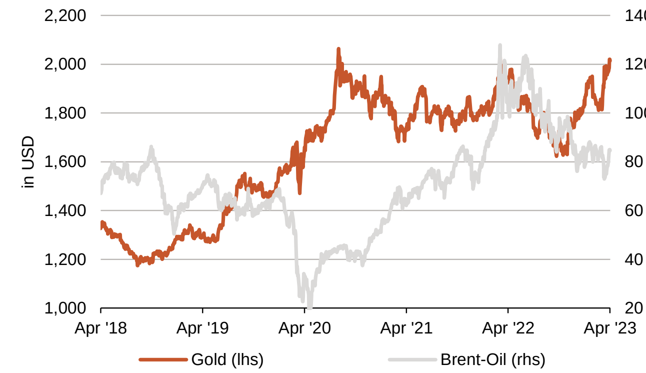
COMMODITIES

Oil with potential due to US driving season

Gold and silver benefit from interest rate pivot.
Oil with seasonal tailwind due to US driving season.
Metals gain on China recovery.

- **Gold** benefited as a safe haven from the recent banking and reces-sion worries, and proved its diversification properties with negative correlation to risky assets such as equities again. In the short term, the potential is likely to be limited after the strong performance. However, in the event of an interest rate turnaround by the Fed, both gold and silver should experi-ence further tailwinds.
- **Crude oil** continued its volatile sideways movement. The latest OPEC cuts (totalling 1.6 million barrels per day) sup-port a bottoming out and further widen the imbalance of tight production against the economic recovery of non-OECD countries. Seasonally, we are also facing the best months for oil historically with the start of the US driving season.
- **Industrial metals** need a full turnaround of the economic recovery in China despite initial green shoots in infrastructure and mobility. In the long term, the trend towards decarboni-sation is fuelling metal demand.

Price development



Source: Bloomberg, 05/04/2018 - 05/04/2023.

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

	As of 05/04/2023	Performance ytd	1-year	3-year
Gold USD/ounce	2,021	+10.8%	+5.0%	+24.7%
Silver USD/ounce	24.9	+4.1%	+2.5%	+73.3%
Copper USD/pound	398.7	+4.6%	-16.9%	+81.8%
Brent USD/bbl	84.99	-1.1%	-20.3%	+149.2%

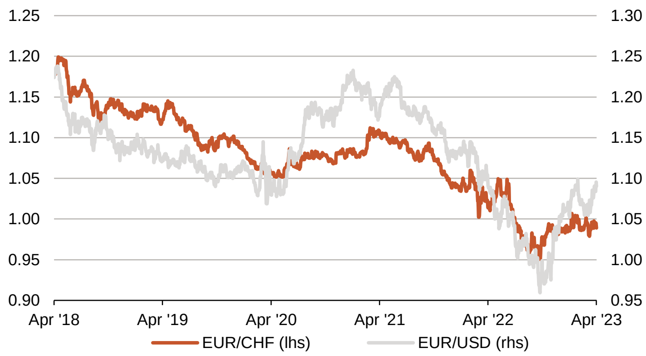
CURRENCIES

Problems in the banking sector weaken the dollar

EUR/USD: Euro back on track.
EUR/GBP: High UK inflation – advantage euro.
EUR/CHF: Monetary policy gives Swiss franc tailwind.

- **EUR/USD:** In March, players in the foreign exchange market had to deal with the problems in the American banking sector, the takeover of Credit Suisse by UBS and concerns about a broader financial crisis. How would cen-tral banks now react to ensure price stability and financial stability at the same time? Both central banks – the Fed and the ECB – were not deterred from raising interest rates in March. While the ECB made a bigger move of 50bps, the Fed acted more cautiously and settled for a 25% move. The Fed is likely to remain more cautious going forward given the problems in the banking sector. This fits our picture of a higher EUR/USD rate.
- **EUR/CHF:** The exchange rate continues to hover just below parity. The Swiss National Bank and the ECB are marching in lockstep on key interest rates (+50 bps each in March). In the fight against inflation, the Swiss National Bank continues to rely on a strong franc.

Exchange rates



Source: Bloomberg, 05/04/2018 - 05/04/2023.

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

	As of 05/04/2023	Performance ytd	1-year	3-year
EUR/USD	1.09	+1.9%	-0.0%	+1.0%
EUR/CHF	0.99	-0.1%	-2.4%	-6.4%
EUR/GBP	0.88	-1.1%	+4.9%	-0.5%
EUR/JPY	143.12	+1.9%	+6.2%	+22.2%

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
Ulrich Urbahn | Head Multi Asset Strategy & Research
Oliver Brunner | Co-Head Portfolio Management Multi Asset
Ansgar Nolte | Co-Head Portfolio Management Multi Asset & Equities, Equities
Marco Höchst | Equities
Christian Bettinger | Fixed Income
Philina Kuhzarani | Commodities, Minutes

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