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REFLEXIONS

Q3 20

BERGOS BERENBERG

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Executive Summary

Dear Investors,

Reflecting on the events of the last few months in an adequate way is challenging. The coronavirus crisis is pervading many different levels of our existence all at once: politics, business, culture, social behaviour, and ethics are affected by it. This is what makes the crisis so unique.

In Switzerland and many other countries, we can be grateful that the measures initiated to curb the pandemic have been effective. We are now taking small steps towards returning to our longed-for social life while, of course, taking appropriate precautions. But these are indeed just small steps. The resulting economic recovery will take patience.

Capital markets do not seem to have this patience. Equity markets have galloped forward since March and seem to be confident that the economic recovery will be relatively smooth. However, intermittent pullbacks make it clear that markets are sensitive to re-emerging risks. New and longer-lasting lockdowns in the United States are especially dangerous for the recovery.

Central banks are seeking to counter these risks with a monetary policy bazooka. The goal is to keep interest rates as low as possible. From the standpoint of national governments, interest rates should ideally remain below the rate of inflation. This will keep the burden of interest payments as low as possible so that government debt can be reduced by creeping currency devaluation. This is an environment that rewards equity investors with a long-term investment horizon and punishes traditional savers who depend on interest income.

However, counting on expansive monetary policy does not constitute a successful investment strategy. Identifying promising market segments remains essential. As we see it, the coronavirus crisis has buoyed those market segments that were already benefiting from a structural growth trend, chief among them the megatrend of digitalisation. Unfortunately, it is impossible to describe this new market environment without using anglicisms: E-commerce, social media, and media streaming have become fixtures of our everyday life.

These trends confirm once more that an opportunity can be found in every crisis. In our current issue of REFLEXIONS, we show you the opportunities we see in this unusual environment from the perspective of capital markets. We hope you enjoy reading it!

Stay healthy and confident!

Yours, Maximilian Hefele
HEAD OF ASSET MANAGEMENT

BANK VIEW

	--	-	0	+	++
Equities			●		
North America				●	
Consumer Discretionary			●		
Consumer Staples		●			
Energy			●		
Financials			●		
Health Care				●	
Industrials			●		
Information Technology			●		
Materials			●		
Real Estate			●		
Communication Services				●	
Utilities		●			
Europe			●		
Consumer Discretionary				●	
Consumer Staples		●			
Energy			●		
Financials			●		
Health Care			●		
Industrials			●		
Information Technology				●	
Materials		●			
Real Estate			●		
Communication Services			●		
Utilities			●		
Emerging Markets		●			

	--	-	0	+	++
Fixed Income		●			
Denomination U.S. Dollar				●	
Duration				●	
Sovereigns				●	
Corporates Non-Financial				●	
Corporates Financial			●		
Senior			●		
Subordinated Debt			●		
Corporate High Yield		●			
Denomination Euro		●			
Duration		●			
Sovereigns		●			
Core		●			
Peripheral			●		
Corporates Non-Financial			●		
Corporates Financial			●		
Senior			●		
Subordinated Debt			●		
Corporates High Yield		●			
Emerging Markets				●	
Hard Currency				●	
Local Currency				●	

	--	-	0	+	++
Alternative Investments				●	
Commodities				●	
Energy			●		
Industrials Metals			●		
Precious Metals				●	
Hedge Fund Strategies			●		
Long/Short			●		
Relative Value				●	
Macro			●		
Event Driven			●		
Convertibles				●	
Real Estate			●		

Dr. HOLGER SCHMIEDING
Chief Economist, Berenberg

Economics

THE RECOVERY HAS BEGUN

Have we overcome the worst? Since the end of April, there are growing signs of a gradual recovery from the unprecedented economic downturn on both sides of the Atlantic. It is still much too early to send a genuine all-clear signal. But cautious optimism is definitely in order.

Since March - when we downgraded our economic forecasts for Germany, Europe, and the rest of the world more quickly and dramatically than ever – the outlook has largely stabilised. At the end of March, we had predicted a check-mark-shaped pattern of economic activity in the developed world. We said that the dramatic decline in March and April would be followed by a powerful, but not V-shaped recovery beginning in mid-May as various lockdowns are eased. We also said that the slope of recovery would flatten beginning in the autumn of 2020 and that the gross domestic product of reasonably structurally healthy economies in the Western world could regain their levels of the time before the coronavirus pandemic in approximately two years after the low point in the second quarter of 2020. While it would take the consumer spending and business investment a little bit longer to recover, additional government spending would slowly close this gap.

In the meantime, we have been able to observe five developments. First, central banks and supervisory authorities have done practically everything imaginable, as expected, to prevent the inevitable mega-recession from additionally triggering a major financial crisis, which would have lengthened and deepened the economic downturn. Second, finance ministers and parliaments in the Western world energetically countered the crisis with national stimulus programmes. Third, the harsh economic numbers for March and partially also for April were actually somewhat worse than feared. Fourth, the easing of strict restrictions on everyday life and economic activity in many countries began somewhat earlier that we had expected at the end of March. And fifth, several of the economic numbers for the United States and – to a somewhat lesser extent – also for Europe in May and June were not as bad as we had expected in late March. All things considered, we can stand by our economic forecast.

Because the United States could possibly add to this year's extraordinary fiscal stimulus financed by a budget deficit equal to 17% of GDP this summer, the country will probably already regain the level of economic output achieved at the end of 2019 in the course of 2021. On the other hand, in the Brexit-damaged United Kingdom and in a structurally weak Italy, it will presumably take a bit longer than two years to reach the levels from before the pandemic.

Normally, signs of an impending upswing roughly follow a certain pattern. Monetary policy stimulus sends a signal against recession and creates room for more spending by households, businesses, and governments. Supported by more liquidity and in hopes of a turn to the better, financial markets begin to rise. Shortly after that, the sentiment of analysts and then that of business and households improves again. This leads to less restrained consumer spending and investments and therefore a better economy.

After the unprecedented shock of the pandemic and lockdowns, we can now observe this pattern in fast motion. On both sides of the Atlantic, the supply of money has been growing dramatically since early March, equity prices have been soaring since April, and the German ZEW Economic Sentiment Index has rocketed higher, rising from -49.5 in March to +63.4 in June. Even the Ifo Business Climate Index recovered significantly to 91.4 in June, after 69.4 in April. In the United States and Europe the latest retail sales and job market numbers have surprised to the upside.

Thus, the recovery has begun. While it is still too early to say how strong it will be, so far the numbers fit in with our prediction that both the United States and the Eurozone could regain more than half their second-quarter losses in the third quarter of this year. In the United States, the recovery could actually be a little better at first. The government assistance provided to many citizens and especially unemployed persons in the United States has been so generous that incomes in April rose by 10.5% over March, although the (correctly measured) unemployment rate (including involuntary part-time workers) reached a record level of 19.5% in April. As more and more businesses have reopened, US consumers clearly began to spend some of this money in May.

A certain base effect also favours strong growth in the third quarter. The second quarter will be mainly influenced by the absolute low point in April when economic output in the Eurozone, for example, was probably at least 30% below normal. Thanks to the recovery that already began in May and June, the third quarter will start at a much higher level than the average for the second quarter.

Nevertheless, we need to keep an eye on certain risks. Although the pandemic is under control in Europe, it is far from over. The virus is spreading quickly in large parts of Latin America and some other emerging-market countries. On the other hand, these countries account for a rather modest share of the global economy. But even in the United States the situation is unclear. Whereas the pandemic is receding in the greater New York metropolitan area, similar to Europe, case numbers are rising quickly in other states such as California, Florida, Texas, and Arizona. We will have to live with the virus in the foreseeable future.

Thus, our forecasts are based on a central assumption: The United States too will not be forced to re-impose lockdowns in large parts of the country to an extent that would deal another tough blow to the economy. Instead, it will be possible to regionally contain hot spots. Similar to Sweden, some parts of the United States are apparently willing to accept higher numbers of cases and deaths than in Europe. Assuming that in the US a number of regional measures to contain the spread of the virus leads to a flattening of the curve of total registered infections, the US recovery, which is so important for the global economy, will be able to continue.

Our outlook for financial markets is generally positive. Also considering the prospect of low inflation and even lower base interest rates for at least two more years, markets have further upside potential for the next 6 to 12 months assuming an economic recovery. However, after the explosive gains of the last three months, an intervening correction would certainly fit in with our outlook for the economy.

The economy is picking
up again,
but risks remain.

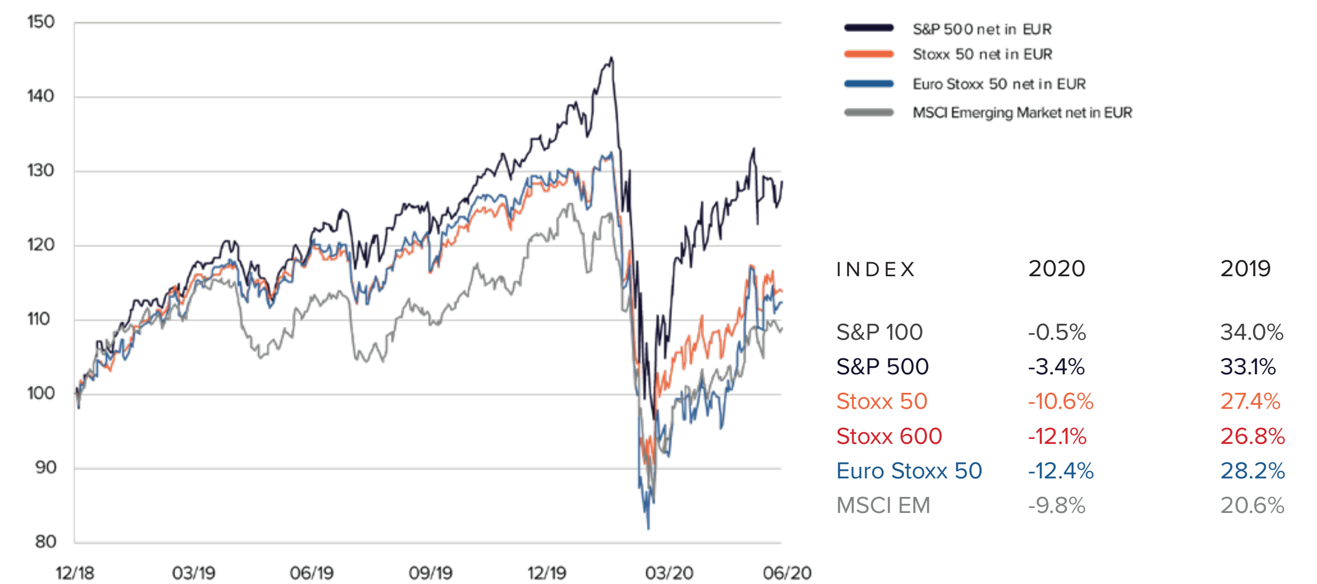
TILL C. BUDELMANN

Equity Strategist

Equities

BROAD EQUITY MARKET RECOVERY DESPITE ONGOING RISKS

The global stock market is currently more or less at the level where it was trading a year ago, even though the situation has changed completely since then. The oil price has collapsed, unemployment has skyrocketed and the global economy is in a deep recession. However, this development is not as unusual as it appears at first glance. The equity market is a massive discounting machine. It does not look at the present, but always ahead. Future corporate profits are being "discounted" from now until eternity. And since this is currently happening at an (interest) rate of close to 0 globally, corporate earnings of 2021/2022 appear almost as relevant as the earnings of the coming quarters. How resilient the stock market has recently been is surprising though. Many market participants not only seem to be looking ahead, but are completely neglecting all current problems and are mentally in the middle of a recovery phase. Nevertheless, there are several risks for the world economy and for global equity markets that must be put into perspective.



INDEX	2020	2019
S&P 100	-0.5%	34.0%
S&P 500	-3.4%	33.1%
Stoxx 50	-10.6%	27.4%
Stoxx 600	-12.1%	26.8%
Euro Stoxx 50	-12.4%	28.2%
MSCI EM	-9.8%	20.6%

Figure 1: Performance of International Equity Markets
Indexed to 100; All indices are in EUR, including net dividends and as of 06/30/2020
Source: Bloomberg, Bergos Berenberg

RISKS TO CONSIDER

One of the risks currently being discussed by market participants revolves around the unrest in numerous US cities following the death of African-American George Floyd at the hands of police officers. But however disturbing the developments may be from a human and moral perspective, the effects on capital markets should be limited as long as the situation does not devolve into something resembling a civil war. The Covid-19 pandemic remains another risk. This situation appears to be easing somewhat in the developed world. Even in the hotspot United States, daily deaths have declined rather steadily since the peak in April. However, the number of newly infected people has recently increased again in certain areas and the risk of a second wave of restrictions imposed by governments around the world remains. A renewed shutdown of the economy would be extremely detrimental for individual markets. However, US Treasury Secretary Steve Mnuchin has already proclaimed that the United States are not aiming for another nationwide lockdown.

A third risk is the trade dispute between the United States and China. The rhetoric has recently become much more belligerent, which seems opportune for both sides. Trump uses the subject for his political intentions during the current election campaign – and for China's President it also makes sense to demonstrate strength. However, we do not expect the dispute to escalate to the level of new tariffs. That would not be advantageous for the leader of either country in the current economic situation. Moreover, we see a very low probability that all three risks would escalate at the same time given that they appear to be negatively correlated with each other. Nevertheless, these risks will not dissipate in the second half of the year. Then, however, the US election campaign will be the most important issue as it is highly relevant for the economy and equity markets not only in the United States, but worldwide who the future occupant of the White House and especially who the parties holding majorities in the Senate and House of Representatives will be.

THREAT OF TAX INCREASES VS. TRADE TENSIONS

The President, a new House of Representatives, and a third of the Senate will be elected in November. Donald Trump is running for the Republicans, Joe Biden for the Democrats. Biden represents the moderate camp of the Democrat party. Two issues of lasting concern for equity markets are taxes/regulation and the trade dispute with China. On balance, equity markets welcomed Trump's tax cuts and reduction of regulations. On the other hand, the trade tensions that Trump has repeatedly stoked have unsettled markets quite severely. If Trump wins another term, the trade stress would probably persist and possibly be exacerbated by a serious dispute with Europe. Presidential candidate Biden, on the other hand, declared his intentions to raise taxes and increase regulations. That would be rather negative for the US stock market in particular. Democrat voters are also not especially China-friendly, but a democratic President would probably be more restrained, which would be more pleasant for global equity markets. The capital market-related opportunities and risks of the two candidates seem to balance each other out. While the Presidency is important, the distribution of power in the Senate and House of Representatives is just as important. For example, the approval of both chambers would be needed to enact a tax reform.

PRESIDENTIAL ELECTION: TRUMP AND BIDEN ARE CURRENTLY HEAD-TO-HEAD

Basically, there are four conceivable scenarios for the election outcome. In the first two scenarios, the Republicans control the Senate and the Democrats control the House of Representatives, as it is currently the case. In the first scenario, Trump is President, in the second Biden is President. In the two other scenarios, one of the two parties holds the Presidency and controls both houses of Congress. Above all, the scenario in which the Democrat Biden has a free hand and can therefore enact his party's planned tax increases could adversely affect markets and even make

US equities less attractive compared to the rest of the world. But the outlook of Trump no longer being in the White House should lead to some relief outside of the United States. According to prediction markets, the probability of such a scenario coming to pass is not very low at the moment (see Figure 2). Based on our in-house tool, however, the probability of Trump or Biden winning the race is currently about 50:50, although Trump's popularity continued to decrease in recent weeks. The probability of the Democrats retaining the House of Representatives is approximately 80 to 20. By contrast, the race for control of the Senate will be very close, with a small number of states determining the outcome, as in the case of the Presidential election. The senate races in Iowa, Maine, and North Carolina will be particularly decisive.

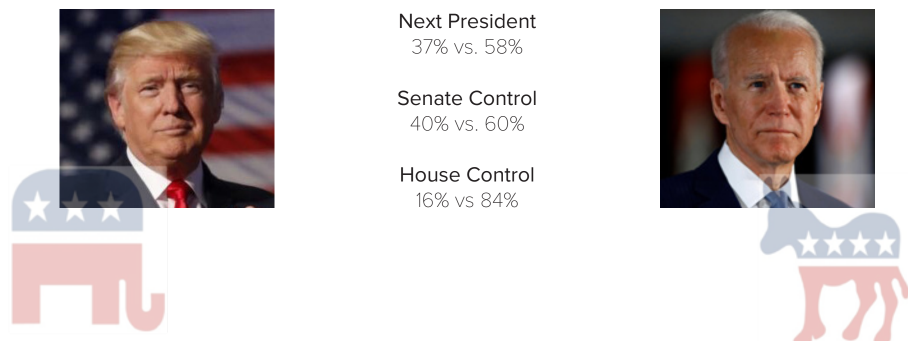


Figure 2: US Election Probabilities
Source: Election Betting Odds, Betfair, PredictIt, Bergos Berenberg, Data as of 06/30/2020

HOW THE ELECTION OUTCOME WILL AFFECT DIFFERENT SECTORS

The election outcome will affect individual sectors differently. If Trump's tax reform can be reversed, sectors such as consumer staples and utilities will likely suffer as these have benefitted the most from the reduced corporate tax rate. Energy plays an important role in the campaigns of both parties. If the Democrats are in charge, renewable energy would benefit and conventional US energy stocks would suffer. If the Republicans are in charge, the situation would be the exact opposite. Moreover, pharmaceuticals and tobacco would probably come under pressure if the Democrats take power. The perception of Trump's crisis management will be a major election issue. The economy and healthcare will also be important. A strong economic recovery would probably increase Trump's prospects. However, stock market prices are also important for voters in the United States (unlike in Germany) because the retirement savings of many Americans are tied to the stock market's performance. All things considered, a very close race can be expected from today's point of view and the balance of power in the Senate is a matter of great interest to equity markets, along with the Presidency.

NEUTRAL EQUITY ALLOCATION WITH A REGIONAL FOCUS ON US EQUITIES

Despite the above mentioned risks, we hold on to our neutral equity quota as we expect a volatile sideways trend for markets over the coming months. Compared to bonds, the valuation of equities remains relatively attractive. The return on equities is notably higher than the return on bonds and the enormous liquidity provided by central banks and fiscal policy around the world is just as supportive. A neutral positioning at best and a cautious sentiment (as a contra indicator) further support equities. Regionally, we continue to favour the US stock market for the coming months and above all the large

cap segment. Compared to the rest of the world, we expect the US gross domestic product to decline significantly less in 2020, particularly because of the quick and bold measures of the US Fed. In addition, US companies have shown greater resilience during past crises and subsequent recoveries. The US stock market also has a structural advantage as it includes sectors that are more likely to benefit from this crisis: technology, healthcare and the recently created communications sector, which includes companies such as Alphabet and Electronic Arts.

We expect a volatile sideways trend for the markets over the coming months.

RENÉ BOLHAR, CAIA
Bond Strategist

Bonds

GREEN SHOOTS OF RECOVERY AS FAR AS THE EYE CAN SEE?!

WELL, IT DEPENDS…

Record new primary market issuance activity across major currencies, increased investor demand across the yield curve, and steadily tightening credit spreads: the picture does not look that bad for fixed income investors throughout most of the second quarter of 2020. But, wait a minute, wasn't that completely different only two months ago?

Indeed, it was. Not too long ago, markets were shaken by fading liquidity, sky rocketing credit default- and credit risk - spreads and market participants pulling out more and more assets from fixed income investments. The effects of the Covid-19-pandemic, which the world began to face in the last quarter, painted a bleak picture for the remainder of the year. Even the extraordinary measures taken from both the monetary and the fiscal side did not show immediate effects intended.

But seemingly, markets just needed some more time to grasp the firepower of the announced or applied tools.

Going into the second half of the year, the underlying factors that caused the sudden and severe hit in valuations across almost all asset classes remain prevalent: albeit, so far unseen measures are taken to find a vaccine against the virus, many parts of the world are just at the high point of the pandemic. Even those regions that took severe measures, such as lock- and shutdowns, don't seem to be out of the woods yet. Most of those US states that eased the existing restrictions after what was assumed to be the peak of infections, are now experiencing skyrocketing new cases.

If, at all, the lockdowns only bought some time to extend capacities for hospitalization in case a second wave will hit before an effective treatment has been found. But this can take some time and until then markets are torn

between reclaimed civic liberties and the fear of what is yet to come.

But this only encompasses the medical dimension. In addition, investors are reluctant to believe that the damages done can be reversed by even cheaper refinancing conditions induced by central banks and governments. Foregone consumption - be it in the travel or restaurant industry, Automotive industry - or any other impacted sector - will catch up only over time. How long the recovery will take is still far from certain. Investor behavior, and hence the recovery in fixed income markets, shows that markets expect a tick-shaped or hockeystick-recovery, rather than the often quoted "V-shape".

This natural skepticism is still reflected in most of the fixed income subsectors. While the support measures definitely helped to restore the functioning of markets and sentiment, credit risk spreads are still somewhat higher than at the beginning of the year. Looking at the different subsectors, most of them recovered by half to two thirds of the widening seen in the wake of Covid-19.

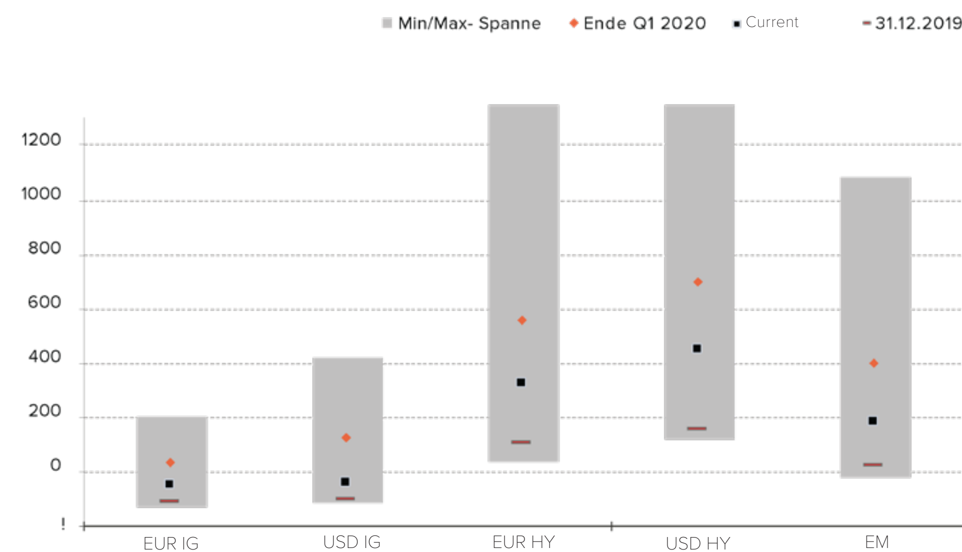


Figure 1: Risk premiums of investment grade, High Yield and emerging market bonds in EUR and USD
Period: 01 August 2007 - 30 June 2020
Source: Bloomberg; Illustration: Bergos Berenberg

But the comparison of currency regions reveals significant differences of what investors can expect for the near future. In contrast to the US where the Fed was able to bolster the markets, among other measures, by cutting the benchmark interest rates by stunning 150 bps within only few weeks, the European fixed income markets were already under a different regime. With the general deposit rate set by the ECB being already at -50bps, there was not much room left to support markets from this side. Consequently, USD denominated securities benefitted from a positive contribution from falling benchmark rates, while the development on Euro-denominated debt was more directly attributed to the spread development. As an effect of that, Investment Grade bonds in US Dollar roughly back to where they were before the outbreak when measured by the yield to maturity, whereas the Euro denominated part still has some room to improve.

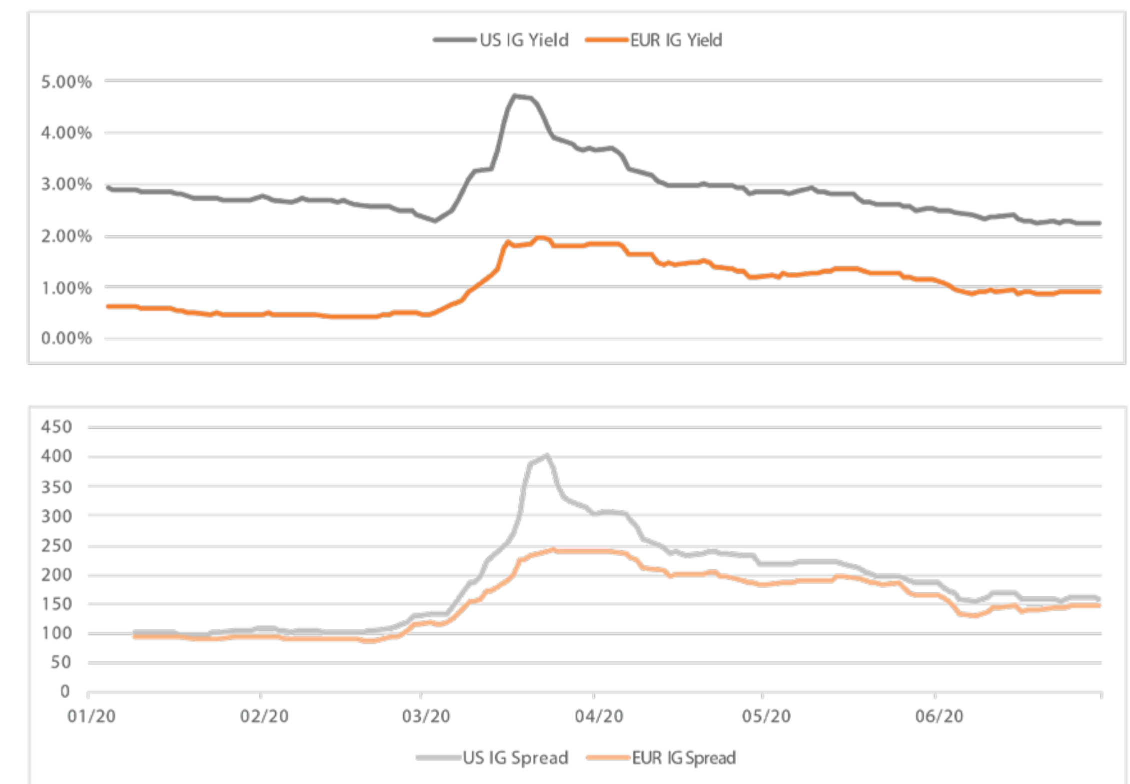


Figure 2: Year to Date Yield vs. Credit Risk Spreads on Euro and US Dollar Investment Grade Debt
Source: Bloomberg; Illustration: Bergos Berenberg; 30 June 2020

BUT WHY IS IT THAT EQUITY MARKETS SWIFTLY RECOVERED WHILE DEBT MARKETS REMAIN HESITANT?

It's been said that "markets look through the crisis" when it comes to the valuation of equity investments. From the equity perspective, with no defined maturity of the investment, the company will be able to weather some quarters of negative growth and return to positive territory in the future. Therefor important factor is the long-term potential of a company, its products, its ability to adjust to the market environment, and so on. In addition, investors are more used to the volatility linked to equities. The extraordinarily low volatility seen in 2019 is not representative of the norm.

Many investors were indeed waiting for a setback to enter the markets long-term at more attractive levels. The so called "Yield Gap", that is the difference between the earnings yield on equity and the yield offered by fixed income securities, widened to levels that make equities appear very attractive in a cross-asset comparison.

Fixed income investors, in contrast, often need clarity on their long term projections: usually investors involved in debt securities focus on the limitation of downside risks and not on potential upside gains in valuation. Any material changes in a company's ability to generate cash necessary to keep the business running and pay back outstanding debt will have an impact on risk premia and has to be evaluated and incorporated in market prices. A negative shock on cash flow generation will therefore be incorporated in credit risk, with the sensitivity being higher for longer maturities.

ARE PROJECTIONS SO BAD?

As mentioned before, the recovery will highly depend on a possible second wave of the Covid-19 pandemic and, consequently, potential measures taken – new lockdowns, store closings, etc. As long as this uncertainty prevails, the journey back to the historically low credit spreads will be long and bumpy.

The uncertainty and – to some extent already the impact of Covid-19 – can also be seen in the rating trend of the big three rating agencies. In a long-term comparison, the ratio of rating upgrades to downgrades is now as poor as after the Global Financial Crisis.

Figure 3: Quarterly ratios of Rating Upgrades to Downgrades from the big three agencies (S&P, Moody's and Fitch)
Source: Bloomberg; Illustration: Bergos Berenberg; 30 June 2020

North America Combined

Ratio	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Q1	0.17	0.61	0.81	1.09	0.34	0.79	1.91	0.84	0.36	1.19	0.39
Q2	0.09	0.67	1.08	0.69	0.62	1.53	1.25	1.31	0.59	1.70	1.17
Q3		0.67	1.04	0.86	0.88	0.69	1.19	0.90	0.83	0.79	1.32
Q4		0.60	0.67	0.79	0.70	0.37	1.04	1.22	0.65	0.38	1.36
Total	0.12	0.64	0.88	0.84	0.57	0.84	1.31	1.08	0.55	0.84	0.87

Western Europe Combined

Ratio	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Q1	0.08	1.05	1.81	1.42	0.33	3.75	1.39	0.24	0.10	0.28	0.19
Q2	0.06	1.13	2.05	0.92	0.81	0.75	1.96	0.51	0.14	0.68	0.29
Q3		0.27	1.30	0.91	1.17	1.34	1.19	0.32	0.32	0.27	0.57
Q4		0.65	0.81	1.23	0.99	0.75	0.44	0.71	0.33	1.03	0.42
Total	0.07	0.53	1.30	1.08	0.77	1.54	1.10	0.41	0.17	0.68	0.33

Taking the rating measures of Standard & Poor's, Moody's and Fitch together, this year shows that on every rating upgrade, that means a positive change in the rating agencies' assessment of the company's fundamentals, came ten rating downgrades in the North American Market. The situation in Western Europe with a ratio of one to 14 is even worse.

SO, THE ROAD IS EXPECTED TO BE BUMPY. SHALL WE BE CONCERNED?

Although currently the threat posed by Covid-19 and therewith the long-term implications on company balance sheets are uncertain, first green shoots can be seen. The extraordinary measures taken by central banks that were already announced or set in place were necessary to restore the functioning of markets. Also, with regards to valuations it definitely was

helpful to foster a subsequent recovery after the severe drop.

Some of the measures have only recently been applied, like the purchases of single corporate bonds by the Fed. In addition, it seems central bank officials are keen to take additional preemptive steps to reassure a swift recovery instead of risking being too late. This can be seen, for example, at the latest ECB action to even extend the amount available for bond purchase by additional EUR 600bn – incredible amounts never seen in the past.

But still- this will not be enough to calm down markets completely. Based on our baseline market scenario outlined before, we expect a continuation of the grinding tighter in credit spreads over the coming months. As long as there is no additional derailing event coming up, central bank money should be more than helpful to support debt securities going forward. But the current situation will certainly have a sustaining impact on industries and companies. Some are better prepared for changing supply and production chains, offer a more diverse array of products or already have a more solid fundamental background when it comes to finances, than others. Due diligence, risk monitoring and a careful selection of investments hence remains paramount. While central bank purchases tended to lift all boats in the past, the picture is somewhat different now. Given the current state of markets, a diligent approach to identify solid and less-sensitive investment opportunities will separate winners from losers.

At least the duration component of investments lost some importance for the time being. There is reason to believe that the measures in place are here to stay, a sudden withdrawal is less likely than additional measures going forward.

There, however, is a caveat. Low refinancing opportunities on the side of companies and high issuance needs to finance fiscal measures can ultimately lead to rising benchmark rates as the pace of supply exceeds the rise in demand. For the time being, however, we are not overly concerned about that.

TO SUM IT UP: WHERE IS STILL VALUE LEFT IN FIXED INCOME?

We remain cautious on High Yield investments given the prevailing uncertainties. The lower-rated a company is, the less solid and crisis-proof its balance sheet. For the moment, we favor Investment Grade rated companies with diversified product offerings, high margins and less sensitivity to market stress.

Due to the overall slumped yield level in USD denominated fixed income, we still like non-financial corporates in US Dollar. Institutional as well as retail investors are still looking into this market segment in order to achieve their overall investment goals. With risk spread levels still elevated, we see return potential here and therefor keep our slight overweight.

The market for Euro-denominated bonds can be evaluated as neutral: albeit increased total returns due to wider risk spreads make the segment attractive for new investments, quality remains key in the selection. With obviously more headwinds prevailing compared to the US Dollar market, we remain opportunistically and selective.

We continue to like Emerging Market debt. Although some regions within the emerging markets space might still have to face the worst when it comes to Covid-19, especially the Asian region is already in recovery mode. Industrial production, trade and business activity is close to pre- Covid levels. With solid balance sheets and still some pick-up potential left, we remain overweighed. At the same time any re-intensification of the pandemic can put a damper on the recovery. We stay cautiously optimistic for the time being.

SOUMAILA TÉKÉTÉ, CAIA, CIIA
Alternative Investments Strategist

Commodities

FURTHER TAILWIND FOR GOLD INVESTMENTS

Gold has once again proved its strengths, particularly in the current crisis. This has been especially valuable in the portfolio context because nearly all other asset classes suffered drastic losses in the downward spiral of the coronavirus crisis.

Beginning with the extremely low yields at the present time and the attempt of central banks and governments across the world to stimulate the economy to combat the recession caused by the virus, we expect the relative appeal of gold compared to higher-yielding asset classes to weaken somewhat in the short term. Comparatively excessive positions of speculative investors and the fact that the price of gold is less influenced by demand from the jewellery industry and central banks than by investor demand represent current drawbacks. Eventually, upcoming technical price resistance points could represent a psychological hurdle on the way to potential new record highs. We have come to believe that we should see more volatility in the gold market and -the probability of short-term corrections has increased

Nevertheless, we are still firmly convinced that the price of gold should rise further in the medium term, given that gold is supported not only by its properties as a "safe-haven" investment in times of crisis, but also by a number of important fundamental drivers. The main driver to date, namely lower opportunity costs and real interest rates, is likely to be gradually replaced by new drivers and catalysts, including for example the increased supply of money resulting from monetary and fiscal stimulus measures, potential currency devaluation, and finally the heightened probability of a spike in inflation when the economy accelerates again.

Figure 1: Gold Price vs. Real Rates
Source: Bloomberg; Illustration: Bergos Berenberg

We therefore anticipate a positive performance of gold in the second half of the year, although we also expect greater susceptibility to fluctuations in this transitional phase.

OIL MARKETS: THE RECOVERY REMAINS FRAGILE AFTER THE SHOCK

Energy and oil markets have repeatedly been the subject of intense focus by market participants in the first half of 2020. In retrospect, moreover, they have proved to be an excellent gauge of the course of the coronavirus crisis considering that oil prices dropped in reaction to the ever-worsening situation already in January, much earlier than other markets. The first plunge in oil prices, of a magnitude not seen since the Gulf War, came after the surprising failure of OPEC+ negotiations in March. But the downward slide had only begun, as it was followed by a meltdown of historical proportions in April, when quoted prices for US WTI crude fell into negative territory for the first time ever. At the date of the futures contract expiration on 20 April, the price of oil closed at the unprecedented level of USD -37.6. All this was due to the increased lockdowns and a collapse in demand resulting from the coronavirus pandemic. This situation pushed storage capacities, especially for shale oil in the United States, close to their absolute limits, forcing some desperate market participants to pay money to unload the futures contracts, given that their settlement also entails the consequence of a physical oil delivery which had to be avoided at any price. Although this total collapse lasted only a short time and only affected a small part of the futures market, it was emblematic of the broad-based decline of energy prices, the massive physical oversupply in the market, and the abrupt collapse in demand.

In the meantime, the price of oil has recovered to around USD 40 at the end of June. Under tremendous market pressure, Russia and OPEC finally reached an agreement to cut production, and as the lockdowns are progressively eased the gradual return of oil demand can be foreseen. Therefore, the outlook for supply-and-demand balance has brightened, especially considering that declining drilling activity in the United States will slowly translate to lower production quantities. As expected, therefore, oil markets are searching for the new equilibrium price and we continue to see a certain potential for higher oil prices. However, the ongoing surplus offers little or no cushion and room to absorb further shocks. Therefore, there is a probability that the market will still be highly susceptible to fluctuations and will depend particularly on the further course of the coronavirus pandemic.

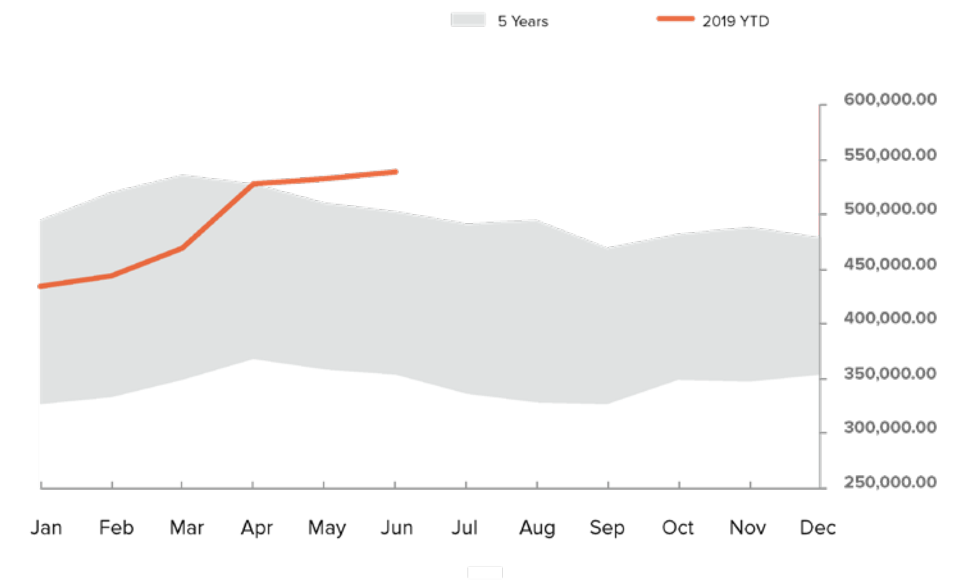


Figure 2: Current Crude Oil Inventory vs. 5 YR Range, US Department of Energy
Source: Bloomberg; Illustration: Bergos Berenberg

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Currencies

THE EURO COULD EMERGE STRENGTHENED FROM THE CORONAVIRUS CRISIS

CURRENCY MARKET ENVIRONMENT

The Euro has taken centre stage in the last few weeks. Fears of a renewed Euro crisis have vanished. The EU Commission's plan to create a EUR 750 billion "Reconstruction Fund" gave it decisive impetus. This fund sends a strong signal that Europe will overcome the coronavirus crisis through solidarity. That being said, various aspects of the plan are still being negotiated and all member states must sign off on the "Reconstruction Fund". Previously, the Euro had been under considerable pressure in the currency market. But since the idea of the "Reconstruction Fund" was floated, the risk spreads of Italian government bonds have tightened again. In addition, the powerful economic stimulus programmes and massive monetary policy support by the ECB have bolstered the confidence of financial market participants in the European single currency, helping it recover. Given that we are also seeing signs of "light at the end of the tunnel" economically; safe-haven currencies have lost at least some of their appeal. As a result, the European single currency has not only risen against the US Dollar and the British Pound, but also made strong gains against the Yen and the Swiss Franc initially. In the meantime, the Euro has given up some of the preceding gains. Nevertheless, we think chances are good that the higher Euro valuation is not just a temporary phenomenon.

EUR/USD:

EURO FINDS ITS WAY OUT OF CRISIS MODE

The United States has been confronted with numerous challenges in the last few weeks. For one, the economic downturn has impacted the labour market much more severely than in Europe, where the crisis has been weathered to a much better degree thanks to well-developed social welfare systems and short-time work benefits. The United States is also contending with increasing infections, while the situation in Europe has stabilised. Other challenges include domestic tensions with open unrest on American streets and the re-escalation of the trade conflict with China. Finally, inflows from emerging-market countries had strengthened the dollar, but this effect can now be expected to fade.

In this environment, the Euro rose to as high as 1.14 US Dollars per Euro at the peak from a level of only 1.08 in mid-May. In the meantime, the Dollar has made up some of the lost ground after surprisingly positive economic data from the United States. The price for the less severe economic downturn is a massive US budget deficit of tentatively 17% of GDP (Eurozone: -11.5%), which is financing the dynamic recovery of consumer spending.

All things considered, there is good reason to think that the current level of around 1.12 US Dollars per Euro can be held and even extended to a certain degree in the further course of the year. We anticipate an exchange rate of around 1.15 US Dollars per Euro at the end of 2020.

Figure 1: Euro / US-Dollar
Source: Bloomberg; Illustration: Bergos Berenberg

EUR/GBP:

ADVANTAGE EURO

Against the British currency, the Euro has settled in at around 0.90 Pounds per Euro. One reason for this is the improved status of the European (single?) currency described above. However, the higher exchange rate is not only a sign of the Euro's strength, but also the Pound's weakness due to the high level of political and economic risks in the United Kingdom. The risk that no follow-up agreement can be reached between the EU and the UK by the end of this year, resulting in a hard Brexit, has not been eliminated and must still be watched. In addition, the sharp economic downturn and a somewhat weaker recovery in the coming year are likely to weigh on the Pound for now. We expect a 9.0% GDP decline in the current year for both the Eurozone and the United Kingdom. The recovery in the coming year will probably be more dynamic in the Eurozone, with GDP growth of around 7%, compared to the United Kingdom with 5.0%. We therefore see little chance that the British Pound can strengthen significantly in the current year. At the end of the year, we see an exchange rate of around 0.91, very similar to the current level.

Figure 2: Euro / GBP
Source: Bloomberg; Illustration: Bergos Berenberg

EUR/CHF:

WILL THE ECONOMIC COMEBACK BRING RELIEF?

The Swiss currency has retreated just a little bit from its high of 1.05 Francs per Euro. The improved situation in Europe with regard to coronavirus infections has somewhat diminished the appeal of safe-haven currencies like the Swiss Franc. Moreover, the Euro has benefitted from renewed confidence, as described above. For these reasons, the European currency rose relatively quickly to almost 1.09 Francs per Euro in May before the countermovement took it back to below 1.07. Nevertheless, the Euro is holding at the higher level.

However, all of this doesn't change anything about the fundamental situation: The Swiss Franc will continue to be in very high demand as a safe-haven currency, even if the international headlines are somewhat improving. At least however, the somewhat positive political and economic news and developments in the coronavirus situation will help the Swiss National Bank (SNB), which has repeatedly had to engage in currency purchases to counteract the Franc's strength – in addition to its highly expansive monetary policy. We think the Euro could potentially rise to around 1.10 by the end of the year. But even then, the Franc would still be very expensive.

Figure 3: Euro / CHF
Source: Bloomberg; Illustration: Bergos Berenberg

Governments and the ECB are easing fears of a new euro crisis.

TOPIC

beyond
Capital Markets

VANESSA SKOURA
Head of Bergos Berenberg Geneva

Family Office

ENGAGE, EVALUATE, ENHANCE: FAMILY OFFICE SERVICES

We are half way through 2020 and I would still like to think: "new year, new challenges" but most certainly also new opportunities !

This year, the world was forced to accept and deal with a very distressing reality. In some regions, that was the case as early as January. Whilst we have moved from an environment of massive uncertainty and loss of life, to one that, for the most part, returns to a sense of stability and hope, we are still processing and adapting to what many call „a new normal."

Our leaders and policy makers act in their best efforts to control the virus and its effects on our societies, whilst we, as individuals, focus on how to best protect our loved ones and all those who depend on us. During the past months, how to best do exactly that was certainly a primary topic in the conversations with our clients.

At Bergos Berenberg, we always appreciate the opportunity to speak to our clients. Earning their valuable time and confidence is at the core of our approach. It allows us to better understand what really matters to them - to you! It gives us invaluable insights so we can be of best assistance to you. It also allows us to offer relevant and well informed advice in order to support your decisions.

Most of us have experienced a number of crises standing by our clients and it is not a surprise that each time, we find similarities when confronted with the question: what does all this mean for families?

Since, certainly, one could stop at the simple questions which are too often driven by greed or fear:

Is now the time to deploy my liquidity and take on additional risk to benefit from lower markets?

What defensive positions must I adopt to get through this whilst safeguarding my portfolio?

But we find that our clients are addressing much more nuanced questions:

Is my bank's creditworthiness still strong?

Is our liquid wealth well diversified across custodians and investment positions?

Are the investment managers we are currently engaging best qualified?

Particularly during this current crisis, the uncomfortable thought of survival forced many such fundamental questions:

Who in the family has the competence and willingness to run the business?

Who can ensure our legacy is honoured?

Will the family members try honour and build our legacy?

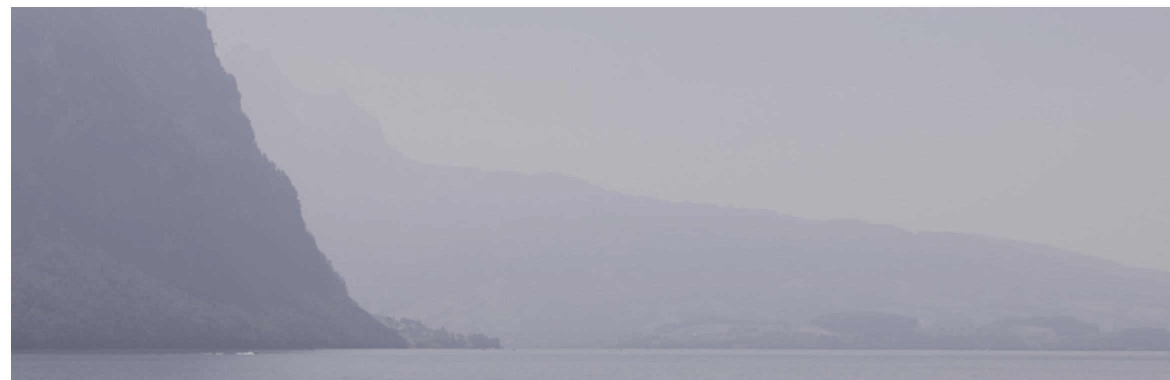
Who can protect the wealth and the next generation?

How could all this be achieved and who can responsibly help us through this process?

Our clients are managing the challenges and opportunities of wealth. We, as good advisers are often called to support them in various areas, ranging from accounting, legal and tax to risk management and investment consulting, as well as family services.

About a year ago, we established a joint venture that enables us to best offer the bespoke and important services needed in these cases via our separate multi family office services company Bergos Fleming AG, which handles the long-term support of wealthy individuals and families.

It is our experience that wealthy individuals and families with complex and broadly diversified assets often benefit immensely from a partner who can offer confidential professional advice and expert knowledge to help care for and structure investments and family matters.



So, what does Bergos Fleming do for our clients?

We specialise in assisting with the structuring and advising of simple and complex assets (both liquid and illiquid). We offer our services across Europe as well as the Middle and Far East.

But what have we learned from our clients? That an appropriate structure of assets for future generations is at the very core of their concern, so we focus on that. Equally important is to foster transparency so we can create a sound base for important investment decisions. Here is how we achieve that:

Family Services

- Family Governance
- Crisis Coverage
- Succession Planning
- Legal Wealth Structuring

It is often said that successful families adopt the beyond financial capital perspective of wealth, recognising the importance of human, intellectual, spiritual, social and time capital. This results in a much broader view of the family's "balance sheet" where the greatest assets are the family members themselves.

Especially the past few months have brought forward an increased focus on the question if the family succession planning is in place and how to best introduce the "Next Generation" to a nuanced understanding of wealth management, strengthening relationships and communication within the family.

This is a sensitive area of exchange amongst family members and their advisers, but it is necessary and helps with the next steps of succession management and the transferral of a legacy to the Next Generation. Families often need a place to express opinions, make shared decisions, learn from mistakes and cultivate togetherness. A place where investing with a common perspective and entrepreneurship can be taught and nurtured.

Security issues may also be important for you and your family, as well as administrative matters, structuring your wealth for protection and regularly reviewing any existing structures in order to ensure their relevance and validity.

Reporting & Controlling

Consolidation

Controlling of Family Assets

Performance Measuring

This module offers a professional performance analysis of your asset managers and places it in relation to the corresponding risk. At a consolidated level, we examine whether the overall portfolio structure aligns with your defined investment strategy. We monitor the portfolio structure for consolidations and the interaction of different investment classes. Then, we report on our findings in an extensive and informative written document that gives you a solid basis for future investment decisions.

In addition to transparent performance reporting, at agreed intervals we collate all key indicators that enable professional risk management.

Strategic Investment Advice

Strategic Asset Allocation

Structuring

Evaluation

Investment Process

In this area, we aim to assist you in planning for short- and long-term requirements. We identify important overlaps and key risks in your current positioning. We also discuss new opportunities.

The team coordinates and manages the implementation of entire asset strategies on the basis of long-term client agreements.

If you will indulge me for a few more sentences, I would like to share a personal note. I have dedicated my career of 26 years to the management of wealth and to advising individuals and their families in all related matters. The unprecedented circumstances of the past few months have deepened my conviction that economic and financial market "equilibrium" is by no means assured, even with sophisticated Central Banks and public officials using their impressive toolbox.

Therefore I must assume bad tail risks may materialise putting family wealth at risk, and to be best prepared I deploy a three pronged strategy of (1) dynamic and flexible asset allocation to capture opportunities for manageable downside risk, (2) rigorous review of family structures to update and adjust for necessary legal, tax, and custodial developments, and last but not least (3) passionate inter-action with key family members to optimise decision making.

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