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REFLEXIONS

Q4 20

BERGOS BERENBERG

Bergos Berenberg AG is an internationally operating, independent Swiss Private Bank based in Zurich with offices in Geneva. With a history that traces back to 1590, to the founding of Joh. Berenberg, Gossler & Co. KG, it has been active in the Swiss financial center for more than 30 years. The international team is dedicated to all aspects of asset management and advisory with a focus on private clients, family entrepreneurs, next generation, and shipping clients. Our business model is oriented towards pure private banking and offers advice for all liquid asset classes and alternative investments.

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MAXIMILIAN HEFELE, CFA
Head of Asset Management

Exec. Summary

Dear Investors,

the dark hours of the unprecedented stock market crash in March 2020 are a good six months in the past. Back then, assets on the capital market were decimated within weeks. An environment that triggered panic among many investors. But also an environment in which established and solid investment processes have proven their worth.

In our then 6th edition of Reflexions, I referred to important cornerstones of Bergos' investment philosophy. Namely, global diversification, anti-cyclical decision-making patterns, and a long-term investment horizon. All three aspects have contributed to the fact that our core strategies have enabled us to make up for temporary losses almost completely within a very short time. This is a circumstance that cannot be taken for granted against the background of the enormous uncertainties.

In fact, at that time, a large part of the risks associated with a recession was espoused. Today we are faced with the tense question of how to move forward?

If we look through the short-term uncertainties of the US-Presidential election, market conditions are opening up which basically give us a positive outlook for the equity markets. These include the increasing learning effects of politics with regard to how to deal with the Covid crisis. With increasing knowledge, restrictions are implemented more accurately. The economic collateral damage, the result of conscious measures, is expected to decrease.

Thus, the current economic upswing can continue to unfold with excessive liquidity. The inflation, which is being watched with suspicion, is not a damper at present either. Even for 2021, we do not expect any inflationary tendencies that will prompt the most important central banks to abandon their extremely expansive monetary policy.

I hope you enjoy reading the current issue of Reflexions and that you will find this overall assessment of the situation informative.

Stay healthy and confident!

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

RECOVERY WITH RISKS

After the dramatic plunge in economic output in March and April, the economy has recovered appreciably in the Western world since May. However, the risk of a setback has risen recently again due to the rise in new infections in Europe in August and September.

So far, the economic recovery on both sides of the Atlantic has roughly resembled a "checkmark" shape. The unprecedented collapse in March and April in the course of lockdowns was followed by a rebound that did not initially resemble a V-shape, however, and is currently flattening out somewhat, as expected. As most restrictions and contact limitations were gradually lifted, parts of the economy such as retail sales were quickly ramped up from late April or during the course of May. The economy therefore experienced a strong recovery. After the initial catch-up effect faded, the economy appears to be on a flatter trajectory in the Western world since July.

The forces driving the recovery have also changed since roughly July. Consumer spending probably increased only moderately. In Europe, it may even drop temporarily as a result of the higher infection numbers. On the other hand, manufacturing and foreign trade have since risen further from the bottom of the trough. These sectors have been supported by the better economy in China, which has recovered from the pandemic relatively quickly and has also provided considerable support to the domestic economy, as usual. However, it will probably take up to two years before manufacturing returns to more normal conditions. That being said, the outlook for the consumer goods industry is considerably more positive than for mechanical engineering, at least in the near term, due to the fact that consumer demand for goods has since returned to almost normal levels.

Companies tend to hold back on capital expenditures in times of uncertainty. German equipment investment, for example, plummeted by 28% in the second quarter, after having declined by 10.4% in the first quarter, when it was noticeably impacted by the pandemic already in March, of course. In large parts of the world, equipment investment is likely to recover from the shock of the pandemic only after a delay and then only gradually. While investment will presumably remain relatively weak in the autumn of this year, it could increase substantially again in the course of next year. That would then represent a third phase of the recovery. Also in 2021, additional government spending will lend considerable support to the economy in the Western world. Fiscal policy is increasingly pivoting from the original objective of softening the blow of the downturn to the objective of supporting the new recovery.

Although the pattern of economic recovery has been similar everywhere in the Western world, considerable differences can also be observed. The decline was somewhat less severe in the United States, where economic output contracted by a total of 9.1% in the first quarter, than in Germany (-11.5%), and was significantly milder than in the overall Eurozone (-15.1%) and the United Kingdom (-22.1%). The lockdowns were mostly less harsh in the United States than in Europe. Because the United Kingdom initially hesitated to impose harsh restrictions in March, causing the virus to spread on the island for an exponentially longer time, the country was then forced to keep its harsh restrictions in place for a much longer period of time. For that reason, the recovery in the United Kingdom only began in June, instead of in May. This is reflected in the weak Q2 numbers.

Thanks to an especially large fiscal impulse, which will probably be replenished at the latest after the US elections on 3 November, the United States will presumably maintain its lead over the Eurozone. We expect that the United States will have regained the level of economic output reached at the end of 2019, as the last full quarter before the pandemic, by the end of 2021. Germany, France, and Switzerland will probably follow suit in early 2022. Structurally weaker Italy and the Brexit-damaged UK will most probably regain their pre-crisis levels of economic output only during the course of 2023.

Our forecasts are based on the assumption that governments in Europe will not need to impose similarly drastic restrictions on economic life as in March and April, despite considerably higher infection numbers. The experience in the United States over the last few months supports

this assumption. We have learned much about dealing with the virus since March. We know better today how to protect ourselves and above all especially vulnerable persons. Medicine has made significant progress. Despite the rapid rise in infections in the United States in June and July, hospitalisations and Covid-19 fatalities increased at a much slower rate than in March and April. In August and early September, the United States has apparently managed to control the pandemic somewhat better with relatively mild and regionally limited interventions and the increased use of facemasks. We therefore expect that the same approach will also succeed in Europe, where case numbers have likewise risen considerably since August. Also in Europe, the percentage of infected persons who require hospital treatment, the number of patients in intensive care units, and the number of fatalities have so far remained well below the corresponding numbers in March and April.

Our cautiously optimistic expectation that Europe will be able to withstand the second wave without a renewed plunge in economic activity despite the onset of cooler weather, which is more favourable for the virus, is based on two additional considerations:

First, governments and citizens will be better able to weigh the trade-off between health risks and economic damage after the experience made in the Spring. New restrictions will indeed limit the freedom of citizens again, including by means of a stricter mask-wearing mandate, a ban on larger events, and new quarantine requirements. Nevertheless, governments will strive to keep schools and day-care centres, as well as businesses, open as much as possible. That will limit the economic damage considerably.

Second, the US economy was brought to its knees at nearly the same time as the economy in Europe in the Spring when many supply chains with China were disrupted. The US economy is currently recovering at a rapid pace and China has largely gotten its problems under control, at least for now. For this reason, the outlook for manufacturing and cross-border trade in goods is substantially more positive than in March or April.

For the coming months, we therefore expect a temporary downturn in consumer spending in Europe due to the second wave of Covid-19 infections. However, the recovery of other parts of the economy and a modest increase in inventories after the dramatic inventory correction in Q2 can be expected to keep the economy on a course of growth, if only moderate growth. After the second wave subsides, the economy can take off again.

Possible disruptive factors in the coming months include the US elections and Brexit. The risk that the Britons will leave the EU common market at the end of the year without a follow-on deal on future relations has risen further of late. This would be a tough blow for the British economy. Because the much larger EU is significantly less dependent on free trade with the United Kingdom than vice-versa, the possible damage on the continent will probably be limited. The loss of preferential access to the British market will be offset by the rerouting of trade and investment flows, as well as qualified workers, from the island to the continent.

The economy and markets could be considerably impacted by US politics especially if (i) civil unrest erupts in the United States after a narrow or uncertain election outcome, (ii) a re-elected President Donald Trump provokes a trade war with Europe, or (iii) a President Biden pursues left-wing policies to an extent that could permanently damage the US economy. From the European standpoint, however, the advantages of a change of President would outweigh the disadvantages, assuming that Biden's policies are sufficiently moderate, because Biden would presumably pursue calmer – though not necessarily softer – trade and foreign policy.

While we must learn to live with the virus, monetary and fiscal policy will probably continue to be highly expansive for some years to come. Cost and price pressures will remain low due to much higher unemployment than before and the still rather cautious behaviour of consumers and businesses. Economically, therefore, the Western world is at the beginning of a new cycle with initially low inflation risks. As long as the pandemic does not strike another massive blow and the United States does not provoke new trade wars after the elections, the outlook for the economy and financial markets in the next six to twelve months is therefore rather positive.

TILL C. BUDELMANN
Capital Market Strategist

Equities

THE GLOBAL RECOVERY CONTINUES

US ELECTIONS AND CONCERNS ABOUT TIGHTER COVID-19 RESTRICTIONS COULD LEAD TO INCREASED VOLATILITY

Equity markets and the economy are recovering more quickly in the US than in Europe

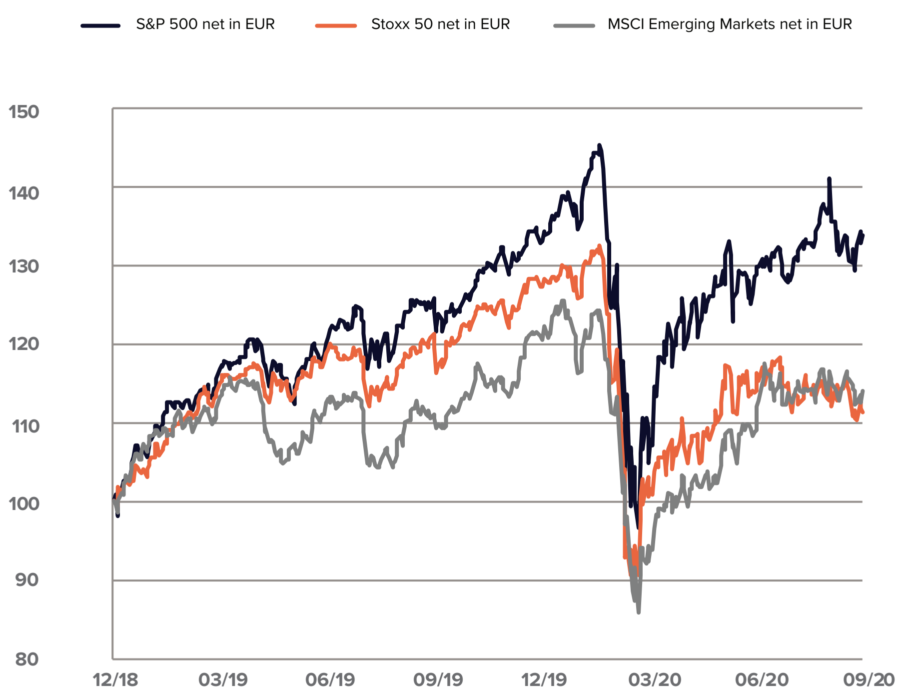
The US consumer as the engine of the global economy is holding up well

Tighter Covid-19 restrictions remain a major risk for markets

Political uncertainties could cause price fluctuations in the coming weeks

Following a strong recovery in the second quarter, global equity markets have mostly moved sideways recently. Only the US equity market made further gains on a local-currency basis. Markets were supported by encouraging macro numbers, a much better-than-expected corporate reporting season, and progress made on a Covid-19 vaccination. Monetary and fiscal policies have also continued to be supportive.

While the US equity market temporarily managed to surpass previous all-time highs reached shortly before the coronavirus crisis, European equity indices are still far from their pre-crisis levels. In fact, this year's regional differences are greater than they have been in a long time. For example, a comparison of the S&P 500, as the indicator for the US equity market, with the STOXX 600 as the European counterpart shows a performance differential of currently 12 points on a uniform currency basis. This gap is mainly attributable to the different sector weightings. Sectors that benefited from the current crisis are especially dominant in the United States: technology, healthcare, and the new communications sector established in 2018. In addition to the transatlantic differences, however, clear differences can also be observed within Europe. Cyclical equity indices such as the DAX have benefited recently from the economic recovery, while defensive sectors have struggled lately after their considerable outperformance in the first half of the year. British equities have been the relative losers due to the ongoing Brexit uncertainties and continue to be deeply in the red in the current calendar year.



INDEX	2020	2019
S&P 500	0.6%	33.1%
Stoxx 50	-12.7%	27.4%
MSCI EM	-5.4%	20.6%

Figure 1: Performance of International Equity Markets
All indices are in EUR, including net dividends and as of 09/30/2020
Source: Bloomberg, Bergos Berenberg

US RETAIL SALES ALREADY BACK AT PRE-CRISIS LEVEL

The US consumer remains an important indicator not only for the US economy, but for the global economy as well. Although monthly retail sales fell sharply at the beginning of the „Great Covid Recession", they have recently been slightly higher than in February, thanks in part to the federal corona aid for private households. The V-shaped recovery took only five months. In the global financial crisis of 2008/09, it took 40 months to regain the pre-crisis level. Although total consumer spending has returned to record levels, considerable shifts can be observed beneath the surface. After all, recessions are known to change or accelerate trends and that is exactly what we have seen this year. Online sales, which had already been in a secular growth cycle, increased at a considerably accelerated rate. Since many Americans are still confined to their homes for the most part, the shift in spending to online vendors appears to be plausible. The next biggest winners are supermarkets, whose sales gains have come at the expense of bars and restaurants, many of which remain closed or can only operate at limited capacity in the best case. Petrol stations and apparel shops have also suffered as consumers are spending more time at home. We currently expect the US economic output to contract by a little less than four percent in 2020 and are therefore less sceptical than we had been in the Spring. In the United States, the GDP contraction could be made up in one to one and a half years; we currently do not see this happening in Europe, where the recovery is proceeding more slowly.

SIGNIFICANTLY BETTER-THAN-EXPECTED Q2 REPORTING SEASON

In terms of corporate earnings, we have seen a Q2 reporting season that - measured in absolute figures - was of course historically poor. However, compared to expectations, it was one of the strongest reporting seasons ever in both the United States and Europe. More than 80% of US companies were able to exceed earnings expectations, as compared to the long-term average of less than 60%. Even more impressive was the so-called "guidance spread", meaning the difference in the number of companies that raised vs. lowered their forecasts. Whereas the long-term average of this indicator is negative, it was almost 30% in Q2 2020. Presumably, we will also not see a S&P 500 surprise factor of just below 23% anytime soon. All in all, however, corporate profits are likely to be markedly lower this year. The consensus expectation is a profit decline of 20% for the industrialised nations, albeit with significant differences between the regions. While analysts expect a profit decline of less than 10% for Switzerland, a decline of more than 40% is expected for the United Kingdom. A synchronous recovery is anticipated for next year, with potentially double-digit profit growth rates. In line with the improved economic data, analysts have recently revised their earnings estimates upwards, particularly for the US.

Driven by enormous liquidity and low interest rates, equity prices have recently gotten well ahead of profit estimates. Although equities are expensive in comparison to their own history, they are still attractive compared to bonds. For example, the yield gap calculated by subtracting the yields of 10-year US Treasuries from earnings yields in the S&P 500 currently stands at 3.7 in the United States. Comparing this figure with various average values of recent years, equities still appear attractive in a cross-asset comparison. This correlation is actually even more pronounced in Europe.

S&P 500 (closing price 09/30/2020)	3'363.00 Points
Forward EPS (Q3 2020 - Q2 2021)	146.26 USD
Earnings Yield	4.35%
10 Year Bond Yield	0.68%

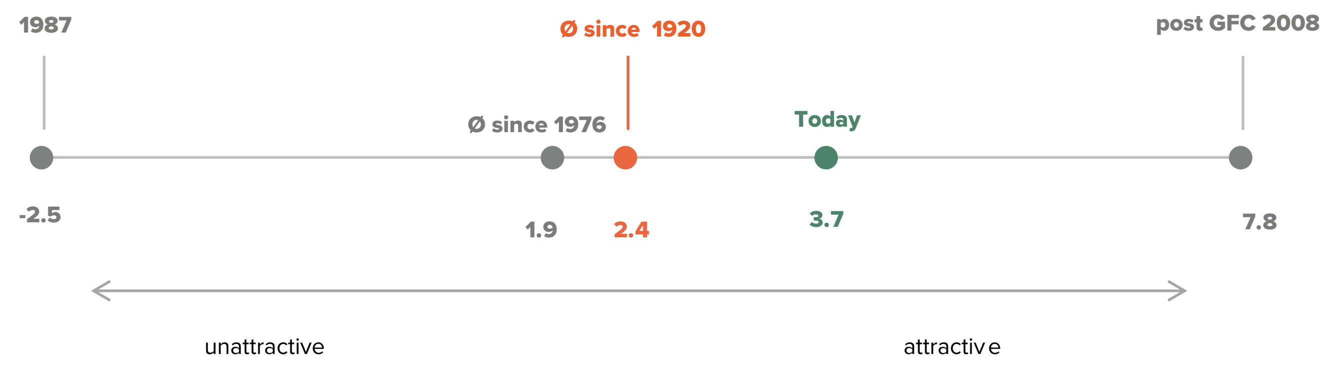


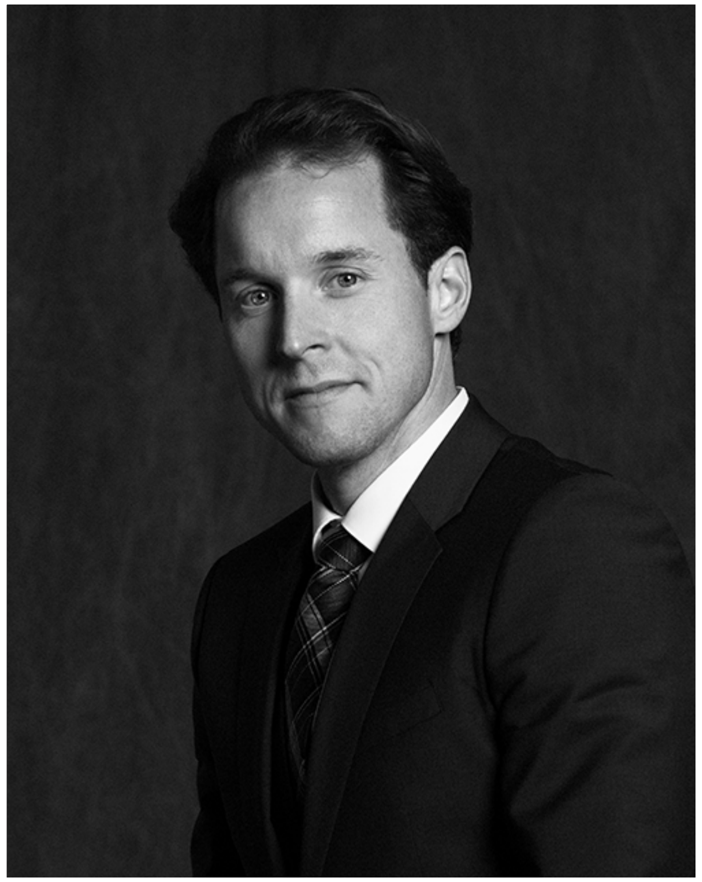
Figure 2: S&P 500 Earnings Yield Minus 10 Year Bond Yield from a Historical Perspective
Source: Bloomberg, Refinitiv, Morgan Stanley Research, Bergos Berenberg, Data as of 09/30/2020

UNCERTAINTIES REMAIN

Covid-19 and especially the potential for additional governmental measures to contain the Covid-19 pandemic still represent the biggest risk for equities. Renewed tough restrictions are currently discussed especially in Europe and this is already causing concerns in the equity markets. The prospect of turbulent markets is particularly attributable to the most important event of the coming weeks: the upcoming US-Presidential election on 3 November (please also see our special topic). This and the developments surrounding Brexit are likely to have a significant impact on capital markets. Here, the risk of a disorderly Brexit has noticeably increased recently. We therefore expect the global equity market to continue its volatile sideways movement in the coming weeks, at least until November. There will be different winners depending on the outcome. However, it is not yet possible to adopt a clear positioning because the forecasts are still too uncertain.

On the other hand, we consider it probable that significant progress will be made in the development of medicines and vaccinations against the coronavirus. Many vaccine makers are expressing optimism and Donald Trump will do everything possible to ensure that a vaccination is approved before the US elections in November, as that would increase his odds of winning. The approval of medicines or vaccines would clear the way for a synchronised, global economic recovery in 2021. Equities are also supported by investor sentiment, which has brightened somewhat recently, but is still far from euphoric. Speculative market participants tend to be cautiously positioned still and individual investors in particular are sitting on large amounts of liquidity. Moreover, sentiment (as a contra-indicator) remains cautious, which continues to favour equities. After carefully weighing the opportunities and risks, we are currently sticking with our neutral positioning in equities.

In terms of regions, we continue to prefer the US equity market – especially the large cap segment of that market – over the rest of the world. We still expect a smaller contraction of US gross domestic product in 2020. Moreover, US companies have proved in the past that they are more resilient in times of crisis and recover more quickly afterwards. Furthermore, the already mentioned dominance of the technology, healthcare, and communications sectors should continue to support the US equity market in the current environment. If the current political and Covid-19-related uncertainties are resolved positively, this would mark the beginning of a broader economic recovery. At the same time, this could lead to a catch-up effect for coronavirus-ravaged sectors and regions.



RENÉ BOLHAR, CAIA
Bond Strategist

Bonds

FURIOUS FALL AFTER A CALM SUMMER?

Compared to past years - not taking the fact into account that the world is still facing an extraordinary situation - the third quarter of this year was a pretty usual. After what was a very active preceding period, characterized by record-high new issuance and, consequently, also secondary market activity, markets as usual entered a calm summer season. This has not been too bad in the past. With no individual negative events catching attention of market participants, the absence of parts of the investment community during the months of July and especially August usually led to low turnover and stable to even falling yield levels.

This year was not different: the interest rate levels on sovereign debt issued by the US or Germany for example are pretty close to where they were already three months ago. Over the course of the quarter there have been periods of rising yields. However, this cannot be seen as a change in direction for interest rates in general but rather a technical reaction stemming from concentrated new issuance activity within just a few days, which had to be digested by markets, or simply as a consequence of the improving investor sentiment.

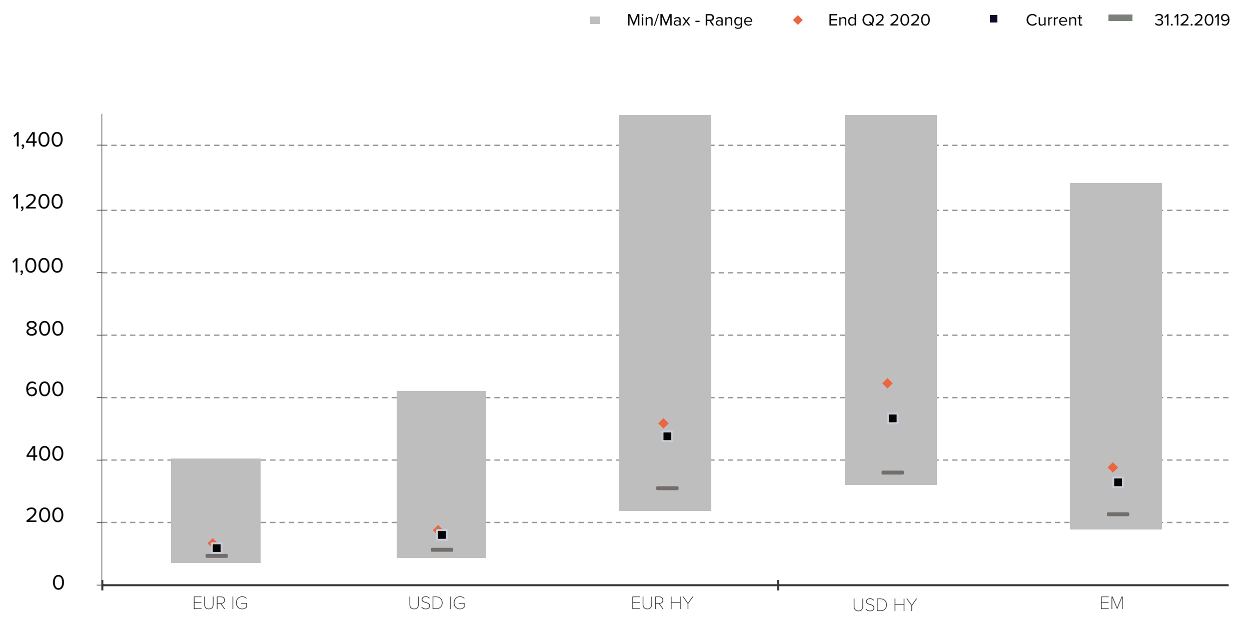


Figure 1: Risk premiums of investment grade, High Yield and emerging market bonds in EUR and USD
Period: 01 August 2007 - 30 September 2020
Source: Bloomberg; Illustration: Bergos Berenberg

Supported by improving investor sentiment and ongoing central bank purchases, credit risk spreads, regardless of the respective denomination or regional focus, continued their path towards lower levels. It seems as if markets' initial expectation of what impact Covid-19 might have on the fundamental situation of most companies, as well as on valuations, has been too pessimistic. It remains to be seen if this offers additional potential for a recovery in bond prices, once the factual impact becomes more visible.

As the "Cold Season" is approaching, we may wonder what the last months of this year will look like

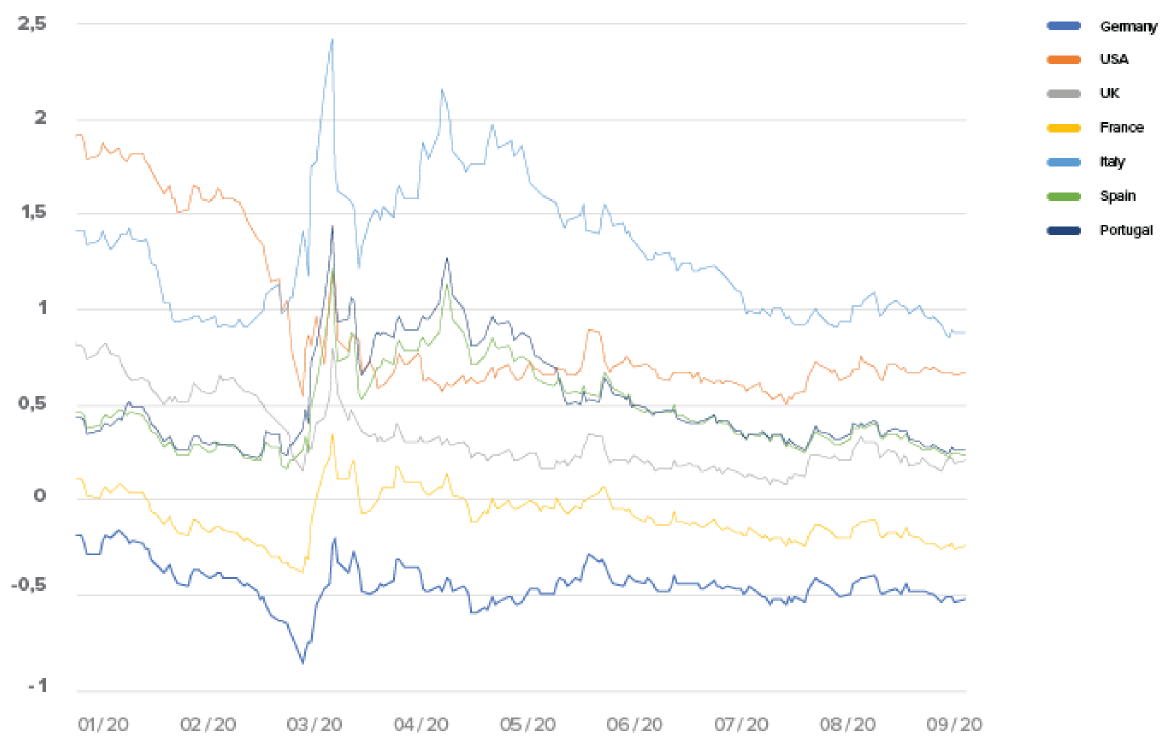


Figure 2: Development of sovereign bond yields (absolute level) YtD
Source: Bloomberg; Illustration: Bergos Berenberg; 30 September 2020

SO, WHERE DO WE STAND?

We stay cautiously optimistic with regards to the future development of the Covid-19 pandemic. Looking at the number of newly confirmed cases in isolation does not give a sufficient picture, as this does not give a relation to other factors. Taking into consideration the increased testing efforts, the number of hospitalizations and casualties, it seems the virus loses severity over time. In addition, the capacities for hospitalizations have been extended and scientists and medical staff gained valuable experience in treating patients so that a recovery is likely in more cases. The medical dimension of the issues, however, clearly remains the predominant source of weal or woe for markets.

Fortunately, now we see a tendency that the virus often only occurs in locally limited areas, rather than across entire countries. It therefore looks as if local and temporary restrictions and lockdowns in those hotspots are sufficient to keep the virus in check. Without new large-scale lockdowns the impact on consumption and eventually on the fundamental situation of companies in the producing and service sectors shall be less pronounced.

The third important pillar of our constructive view lies in the extraordinary efforts made by big central banks globally. Although not visible at first sight, the huge purchase programs set in place by ECB, Fed, BoE and other central banks did an incredible job in restoring market liquidity and calming market participants. But still the volumes are far from being used up and continue to show their positive effect on credit risk spreads. Consensus view is that those measures are more likely to be extended going forward than abruptly withdrawn.

To sum it up: the medical situation seems to be slightly different to how it was back in March, far-reaching lock- and shutdowns and the resulting negative implications are less likely now; fiscal as well as monetary policy remains the key anchor in maintaining market functioning.

SO, WHAT CAN BE EXPECTED FOR THE DIFFERENT SUBSECTORS?

"Safe Haven" assets like US treasuries or German BUNDs performed strongly during the period of elevated market pressure in March. The necessity to keep those assets in high allocations has somewhat decreased with the falling level of market stress and concerns. We hence do not see reasons to keep an overweight in highest quality sovereign debt for the moment. As the situation can change quickly, we keep a neutral positioning in US treasuries. With little reason to expect a withdrawal of central bank measures we stay overweight in duration for US investments.

As outlined before, central bank purchases of corporate bond securities should also lead to further falling credit risk spreads until year end. Especially those securities directly involved in the programs, namely those of non-financial issuers, should benefit.

Although not included in large scale in the current CB programs, high yield securities should benefit as well from the aforementioned factors. Market participants expected a severe impact on balance sheets when the pandemic broke out. The majority of the segment, however, shows that this initial expectation was somewhat exaggerated. We close our underweight to a now neutral position.

On this side of the pond, the situation is somewhat different. With the beginning of what is now called the "Great Corona Recession," general interest rates levels in the Eurozone were already depressed. The refinancing rate or deposit rate set by the ECB were already in negative territory.

The relative attractiveness and future potential are consequently lower compared to other currencies. We hence consider core European sovereign debt as unattractive and stay underweight. As a proxy we prefer to have exposure to covered bonds: in case the situation deteriorates again, covered bonds will benefit due to their rather conservative risk/return profile and overcollateralization. For our base scenario of a slow but steady recovery covered bonds will participate in further spread tightening.

European peripherals will likely benefit most from the central bank measures, which is why we keep a neutral positioning besides the generally depressed yield levels. The same applies to corporate bond investments which still offer some spread tightening potential.

Our overweight in emerging markets debt, local as well as hard currency, can be confirmed. Besides the prevailing spread tightening potential we consider this segment to be a strategic source of income given the generally higher coupon levels.

With a dedicated and diligent portfolio construction and a flexible approach on investment and risk management investors should be able to weather also times of heightened uncertainty. We focus on high liquid securities from top quality issuers with select opportunistic admixtures.

SO, EVERYTHING IS FINE?

It might look like it. But many issues remain unresolved. Topics like the still ongoing BREXIT debate will need a solution at some point in the future and hence take center stage then. Other topics, like the US-China trade dispute, are far from being off the table as well. Although the outcome of the US- Presidential election will most likely have a bigger impact on equity markets, newsflow and headline risk for fixed income investments could make the first half of the quarter more volatile.

On balance we have a cautiously optimistic view looking forward. Newsflow and headlines might bring temporary stress. Markets should, however, prove to be resilient enough and look through the noise and concentrate on the future.

SOUMAILA TÉKÉTÉ, CAIA, CIIA
Alternative Investments Strategist

Commodities

POSITIVE OUTLOOK FOR GOLD DESPITE RECORD HIGHS AND HEIGHTENED VOLATILITY

It is likely that declining nominal interest rates will be gradually superseded by new drivers

Despite this volatile transitional phase, the medium-term outlook for gold remains positive

After the strong run-up in the first half and the attainment of new all-time highs at USD 2'075 per troy ounce, the price of gold has remained within a volatile trading range of between USD 1'850 and USD 2'000 since the middle of the year. The fact that the price of gold is currently influenced less by the jewellery industry and more by investor demand makes the gold price sensitive to changes in sentiment in the financial markets. The massive measures undertaken by central banks and governments around the world to revive the economy have lessened the relative attractiveness of gold in the short term, expectedly leading to a modest consolidation after the preceding rally. At the same time, however, there has been a slight reduction of speculative derivative positions. Thus, the previous extremely high level of speculative positions has since reverted to a level that is closer to average, and that has reduced the probability of abrupt market corrections in the short term.

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

Admittedly, the main drivers to date in the form of falling opportunity costs and interest rates appear to be largely exhausted. The low opportunity costs continue to create a friendly environment and support the price of gold. However, new impulses driving the price of gold higher probably cannot be expected from this factor, especially considering the fact that interest rates have fallen further from their already extremely low levels in the last few months.

Instead, various other factors are emerging as possible new drivers of further price gains, including the increase in the money supply in the wake of monetary and fiscal policy stimulus measures and the heightened probability of a rise in inflation if the economy regains momentum. But even if the coronavirus pandemic worsens again, leading to renewed economic shutdowns, gold would probably remain in demand as a safe haven. In view of the massive increase in government budget deficits across the world, the re-emerging discussion of the long-term viability of government debt will provide long-term support to gold as a safe store of value.

In the medium term, therefore, we expect that the price of gold will continue to rise considering that gold is supported by a number of key fundamental drivers that could lift prices higher even in a positive economic environment, in addition to its function as a store of value and a safe haven in times of crisis. Nevertheless, we believe that volatility will probably remain high in the current transitional phase.

OIL MARKETS: OVERCAPACITIES AS A LIMITING FACTOR

We expect further gradual increases in oil prices in the course of the global economic recovery

However, the upside potential is slowed and limited by global excess capacity

After oil prices recovered from the historic declines earlier in the year, WTI Crude prices have fluctuated, sometimes rather widely, around the level of USD 40 per barrel in the last few months.

The consequences of the corona-virus-induced lockdowns and the accompanying drop in demand are still clearly evident in the oil markets. Cyclical sectors and especially those sectors that consume large amounts of crude oil such as transportation and aviation are still far from their earlier capacity utilisation levels.

The continuing OPEC production cuts and the heightened discipline of member states in terms of production are helping to partially offset the reduction of demand and stabilise the markets. Also in the United States, where the number of active drilling rigs has plummeted since the outbreak of the crisis, the reduced drilling activity has recently shown up in the form of lower production quantities. Thus, oil markets are still searching for the new equilibrium price and we see a certain upside potential for prices. However, overall demand for oil is still far below the levels from before the coronavirus crisis. It will probably recover gradually in dependence on the further development of the economy.

The storage situation is considerably less dire than it was in April and May. However, storage utilisation is still unusually high, despite the seasonal decline in the last few months . Therefore, there remains very little if any leeway to absorb the impact of potential further economic lockdowns and demand shocks. For this reason, the market will probably remain highly prone to volatility and will depend particularly on the further course of the coronavirus pandemic.

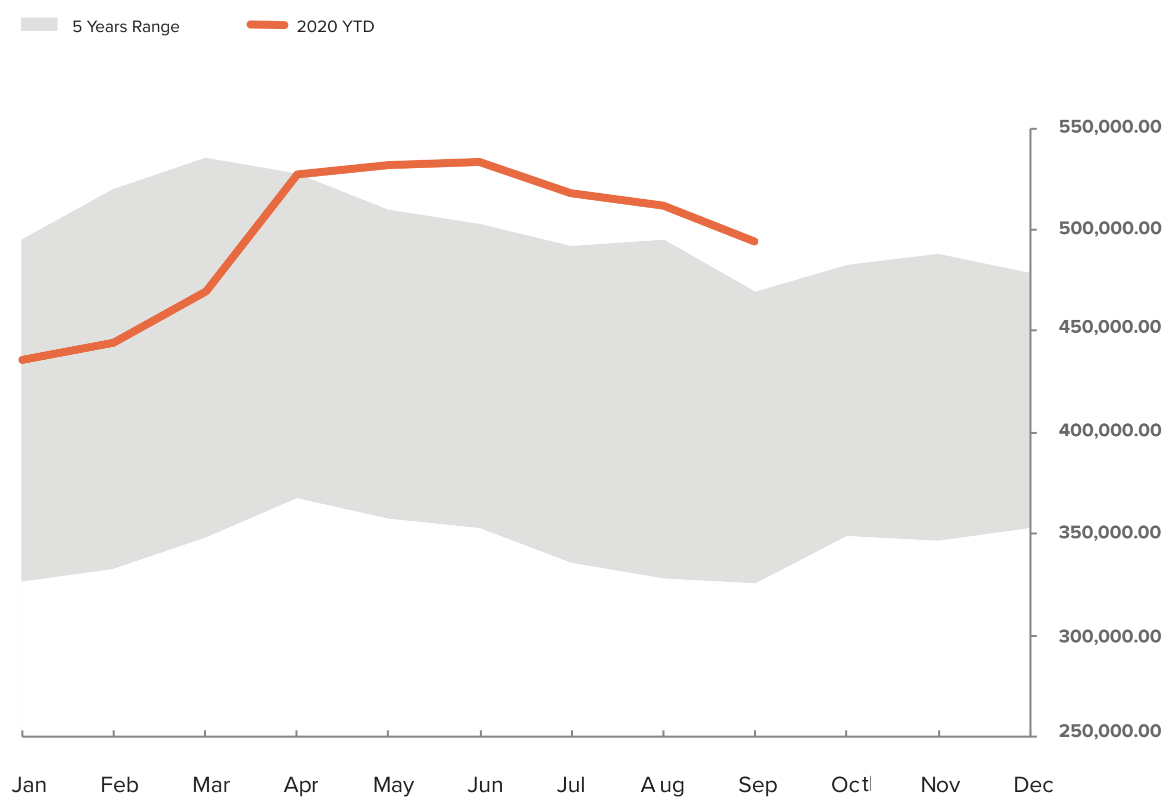


Figure 2: Current Crude Oil Inventory vs. 5 YR Range, US Department of Energy
Source: Bloomberg; Illustration: Bergos Berenberg

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Currencies

THE EURO CEMENTS ITS POSITION

CURRENCY MARKET ENVIRONMENT

The currency market trend from the previous quarter has been confirmed: The "EU Recovery Fund" is giving the Euro a continuing tailwind. In July, the EU countries agreed on the new financial vehicle which is meant to overcome the economic consequences of the pandemic through solidarity. As a result, the latent fears that the Euro could break down have been priced out of financial markets. By contrast, the US Dollar slid further, on balance, in the third quarter. However, the ensuing estimation of many market observers that the US currency has lost its safe-haven status in unsettled times is unjustified. It will indeed take a longer time for the real economy to digest the coronavirus-induced downturn. It is therefore totally appropriate to say that the real economy remains in a state of crisis. However, the financial markets – which are decisive for an assessment of safe-haven status – have already moved on from the crisis and have priced it out. Accordingly, the Dollar sustained its losses already after risk appetite returned to the markets (Fig.1). Economic worries resurfaced and share prices fell sharply in the fourth week of September. In this situation, the US Dollar proved again that it is still in demand as a safe haven for investments. It gained about two cents against the Euro.

EUR/USD:

NEW CRISIS FUND HERE, NEW MONETARY POLICY STRATEGY THERE

Having been relatively quiet in the second quarter, the currency market took off in July. The rise of the Euro against the US Dollar is remarkable: Starting from slightly more than USD 1.12 per Euro, the European common currency soared to a preliminary high of almost 1.20 in the middle of August. As share prices weakened in September, the exchange rate fell back to a range of between 1.16 and 1.17 US Dollars per Euro. Some verbal interventions of ECB representatives against the high exchange rate of the Euro likely also contributed to this decline.

The above-mentioned "EU Recovery Fund" can be credited for a considerable part of the Euro's appreciation in the summer months. However, the Euro's rise cannot be attributed entirely to its own strength. Instead, the high level of the Euro's exchange rate is a reflection of the US currency's weaknesses. There are different reasons why the Dollar is no longer as popular among investors, including the inadequate management of the coronavirus pandemic, the generally weak political leadership, and civil unrest. The changed monetary policy strategy of the Fed is probably also contributing to a weaker US Dollar over the longer term. First, the Fed will attach more importance to a robust labour market than to price stability within its dual mandate. Second, the Fed will no longer aim for a fixed inflation target, but rather an average inflation rate of 2%. If inflation has remained below the 2% target for a longer period of time, a higher inflation rate will be accepted as a kind of compensation ("Average Inflation Targeting"). This shift means that US monetary policy will continue to be very expansive for even longer than was already expected, and that that will have a corresponding effect on the Dollar's exchange rate.

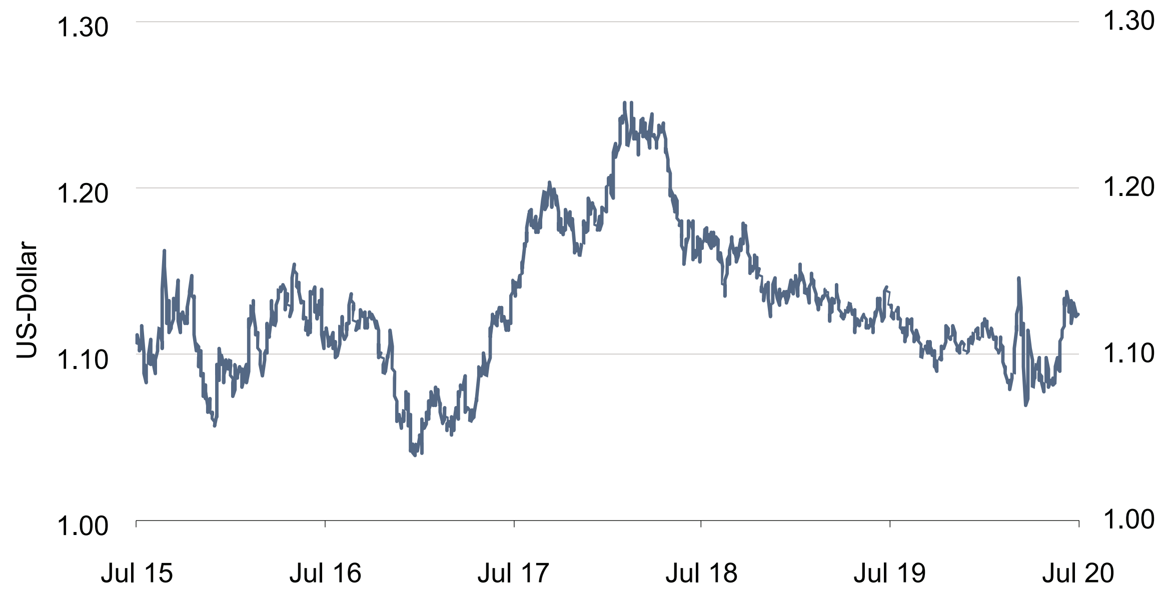

Figure 1: Euro / US-Dollar
Source: Bloomberg; Illustration: Bergos Berenberg

EUR/GBP:

RISK OF A "HARD BREXIT" RE-EMERGES

With regard to the Euro/Pound currency pair, the focus has since shifted completely back to the negotiations on a Brexit follow-on treaty. Boris Johnson's dubious manoeuvre in the Brexit poker game lifted the Euro still higher against the Pound, to well more than 0.90 Pounds per Euro. The probability of a hard Brexit has risen again; and if it actually comes to a hard Brexit, the Pound will weaken further. If the EU and the UK can at least agree on a partial deal, thereby averting a totally hard Brexit, the British currency would probably return to the level of 0.90 Pounds per Euro. However, big jumps are not to be expected.

The political imponderables have partially overshadowed the truly important subject of central bank policy. That being said, the Bank of England is currently in wait-and-see mode. It did not change its monetary policy in September. Nevertheless, we expect that the Bank of England will announce a further GBP 100 billion increase in its securities purchasing programme after its monetary policy meeting in November. This would mean that it will continue net purchases into the year 2021. Another risk for the British economy besides the heightened risk of a hard Brexit would be higher numbers of new coronavirus infections, making it necessary for the Bank of England to continue supporting the economy with monetary policy.

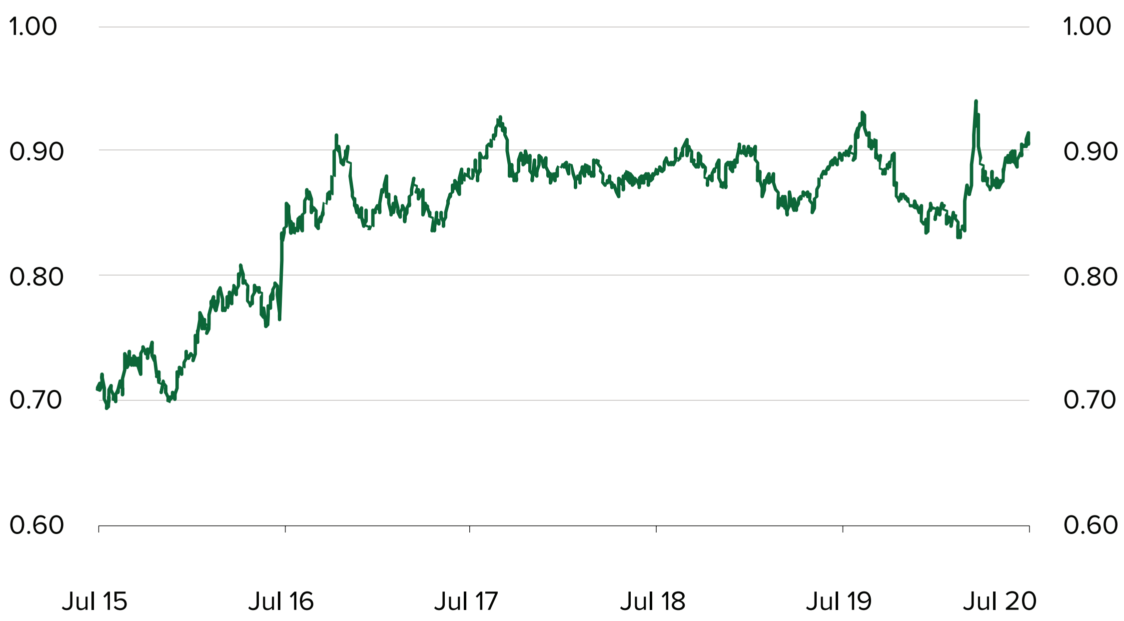

Figure 2: Euro / GBP
Source: Illustration; Darstellung: Bergos Berenberg

EUR/CHF:

MOVING UP IN BABY STEPS

The story of the Swiss Franc has been the same for several years: It is strong. Nevertheless, the current tailwind has helped the Euro rise against the Franc in baby steps – from slightly more than 1.06 to slightly less than 1.08 Francs per Euro.

Like the Bank of England, the Swiss National Bank (SNB) did not adopt any monetary policy resolutions at its meeting in September. However, it emphasised its willingness to intervene further in the currency market if necessary to counteract an overly strong appreciation of the Franc. It also stated its view that the value of the Swiss Franc remains stubbornly high.

Even if the sentiment in the financial markets worsens considerably again, triggering a flight to safety and creating strong demand for the Swiss Franc, the Euro would probably not fall below the level of 1.05 Francs per Euro due to SNB support. If the economy and financial markets recover further, the European common currency should be able to slowly rise in the direction of 1.10 Francs per Euro.

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

TOPIC

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US-Presidential Election

TILL C. BUDELMANN
Capital Market Strategist

THE IMPORTANCE OF THE SUPREME COURT FOR THE US ELECTION CAMPAIGN

On November 3, the President, a new House of Representatives and a third of the Senate will be elected in the United States. With the death of Supreme Court Justice Ruth Bader Ginsburg, a new topic moves into the focus of the election campaign. It is expected that the upcoming Presidential elections will lead to increased volatility in capital markets.

US-ELECTION:

CLOSE PRESIDENTIAL RACE, DEMOCRATS TO RETAIN CONTROL OF THE HOUSE OF REPRESENTATIVES

In national surveys, support for the Democrat candidate Joe Biden is currently at 49 percent, ahead of the Republican incumbent Donald Trump with 43 percent. These numbers must be taken with a grain of salt, however, as it is not the most votes that decides the election, but the votes of the electors from the individual states. Biden needs a vote lead of about 3 percentage points to draw even. Another factor to consider is the usual margin of error in surveys. We compared the polling average on the evening before the election with the actual results of Presidential elections since 1980. The average error rate was 2 to 3 percentage points. All things considered, the two candidates are very close. On the other hand, the Democrats will certainly keep control of the House of Representatives.

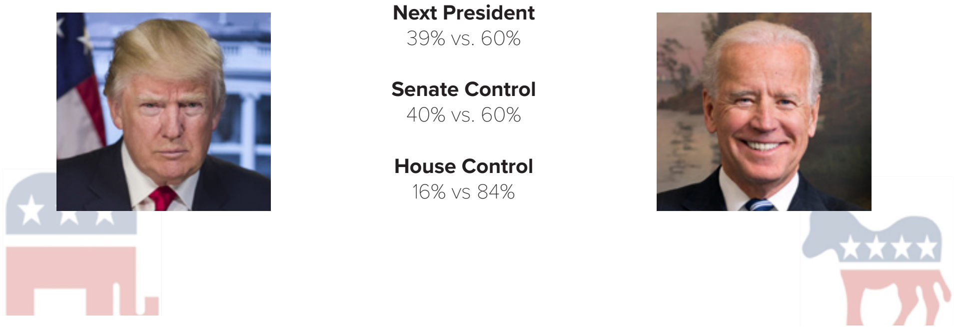

Figure 1: US Election Probabilities
Source: Election Betting Odds, Betfair, PredictIt, Bergos Berenberg, Data as of 09/30/2020

This means that a re-elected Trump would not be able to push through further tax cuts. He could be expected to continue the trade dispute with China in the same manner as before and possibly even extend it to Europe. This would be negative for international equity markets. By contrast, a President Joe Biden would not resolve the trade conflict with China, in all probability, but would pursue it with a more objective and moderate tone, which would be less negative for equity markets.

The same cannot be said of his tax plans: If the Democrats win the House of Representatives and the Senate, Biden could partially reverse Trump's tax reform. The corporate income tax, which was reduced from 39 percent to 26 percent on average under Trump, could be raised again to around 33 percent. This would burden after-tax profits of companies and therefore also impact equity prices.

SUPREME COURT TO INFLUENCE THE ELECTIONS

A major new issue became the forefront of the election campaign with the death of Ruth Bader Ginsburg at the end of September. This event is more likely to benefit the Republicans than the Democrats. The liberal icon Ginsburg was a Justice on the Supreme Court, which now has only three liberal judges and five conservative judges. Trump has already announced that he will quickly nominate a successor, who will then have to be confirmed by the Senate. There was a similar situation four years ago. The conservative Supreme Court Justice Antonin Scalia died in February 2016. The Republican-dominated Senate refused to confirm the successor nominated by the Democratic President Barack Obama before the elections. That benefited Trump and likely gave him the decisive votes. Republican voters who were uncomfortable with Trump in 2016 voted for him anyway because he would at least nominate conservative judges. Also now, Republicans hold a slim majority in the Senate and chances are fairly good that Trump's nomination will be approved before the elections.

The Supreme Court is extremely important in the United States and it can even affect the outcome of a Presidential election. The disputed election result in 2000 was finally settled by the Supreme Court, where conservative Justices had a majority of five to four. One of the important decisions in this case was decided along these lines and the Republican George W. Bush was ultimately confirmed as President. The Supreme Court has now emerged as another major issue along with the coronavirus pandemic and its impact on the economy and domestic security.

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