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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

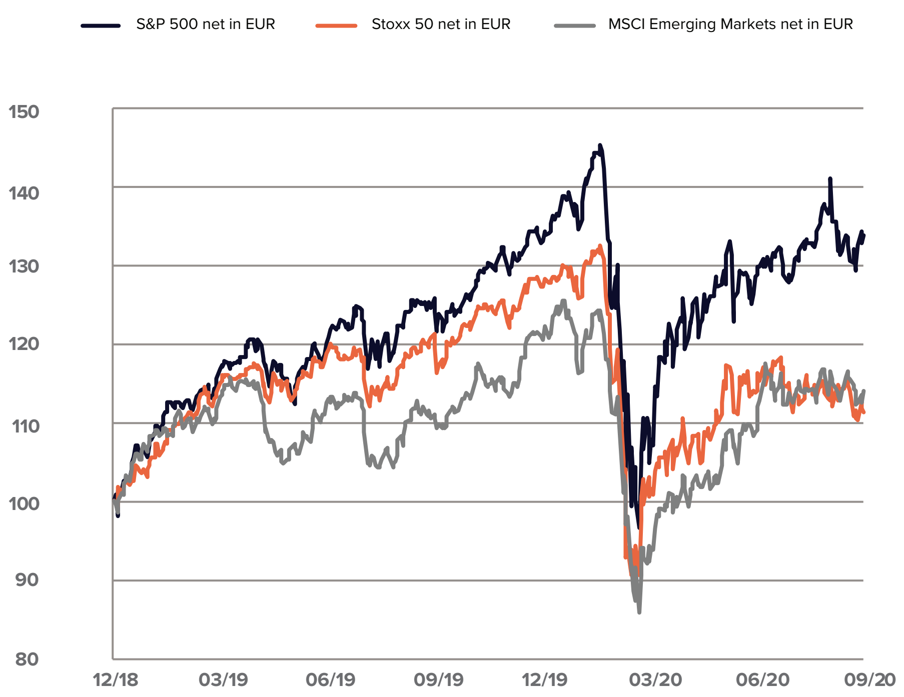
The US consumer as the engine of the global economy is holding up well

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%

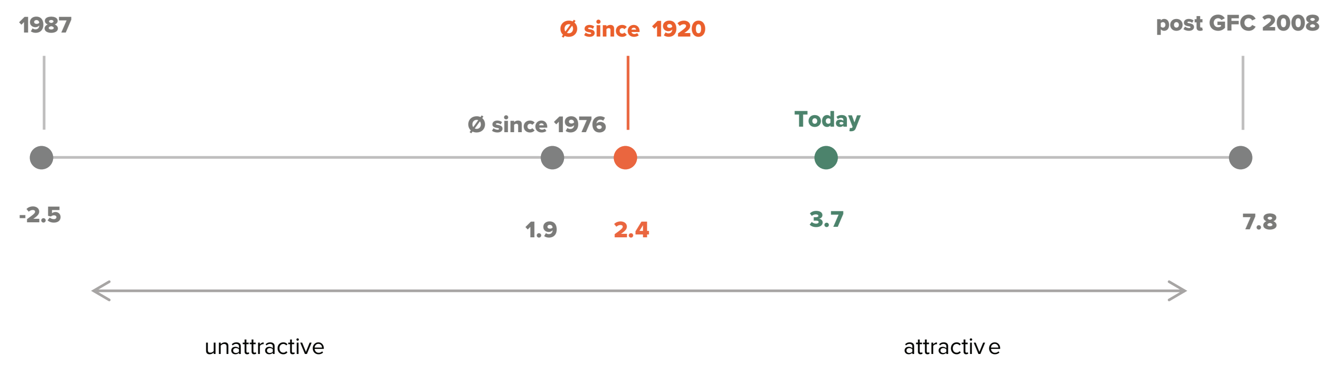


Figure 2: S&P 500 Earnings Yield Minus 10 Year Bond Yield from a Historical Perspective
Source: Bloomberg, Refinitiv, Morgan Stanley Research, Bergos Berenberg, Data as of 09/30/2020

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. 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.