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**Review and outlook**

Third Quarter 2023

## Important developments in the third quarter 2023

### Economy and inflation

- Sentiment and economic data differ between USA (positive) and Eurozone (negative) - Growth expectations below long-term average - IMF estimates + 1.8 % (USA) and + 0.9 % (Eurozone) for 2023 and + 1.0 % and + 1.5 % for 2024 respectively
- Inflation down in Q3 - Core inflation recently +4.3 % (US) and +5.3 % (Eurozone), well above 2 % target - Consumer demand resilient despite higher prices thanks to continued labor shortages and rising wages
- Critical: Inflation expectations are becoming increasingly entrenched - according to the ECB's latest estimate, the 2 % target will be reached 2026
- China could miss its own target of 5 % growth in 2023 - "Stimulus measures" start moderately - Real estate market crisis and withdrawal of foreign capital continues - Countries like India, Indonesia or Vietnam benefit from new investor interest

### Monetary and fiscal policy

- Key interest rate increases in the 3rd quarter - USA now with 5 % points / Eurozone with 4.5 % points increase within 1 ½ years - strongest increase since the beginning of the 1980s - so far there is still much uncertainty about consequences for the real economy
- Ongoing balance sheet reduction at FED (-10 % from high) and ECB (-20 %) reduces lending and liquidity in financial markets
- Fiscal policy of the G7 countries remains "ultra-expansive" (climate protection, defense, subsidies for new chip factories or industrial electricity)
- Japan facing end of zero interest rate policy - interest rate rise starts slowly - higher inflation at home with good economic situation and change in sentiment in the economy - Japanese capital could be increasingly brought back from abroad

### Politics und geopolitics

- Prices for industrial metals stabilize after decline - negative economic expectations are factored in - economic stimulus in China gives hope for trend reversal - crude oil prices rise due to aggressive production limits (Russia and Saudi Arabia)
- USA loses top rating "AAA" from second rating agency in August - correctly justified by high debt level, rising interest costs and increasing political incapacity to act - renewed "government shutdown" at the end of September only temporarily averted
- G20 summit showed global division, bloc formation and eager courting of strategically important and commodity-rich emerging economies

### Financial markets

- Date for expected first FED interest rate cut postponed further - "Higher for longer" scenario was priced in and led to price declines for almost all forms of investment in the second half of September, especially due to sharply rising long-term interest rates
- Consensus estimates of future corporate earnings for US and EU equities rise slightly for the first time since mid-2022
- Strong contrast between growth in the US, recession outlook for Europe and problems in China leads to US dollar appreciation
- Gold price falls - strong US dollar and rise in real yields weigh - ongoing purchases by some central banks dampen price decline ('unpegging' of currency reserves from the US dollar)

# Stock markets

## Rude awakening from summer lull

At the latest after the FED's rejection of rapid interest rate cuts, alarmed equity investors gave themselves several waves of selling, causing prices to fall sharply. On sober reflection, this had a lot to do with previously overly optimistic expectations and now with excessive pessimism. Sentiments can be stronger than data in the short term.

Shares in the special metals sector, which we use as an investment in electromobility and battery technology, recently lost disproportionately in value. In the rather small market segment of precious metal miners (all gold and silver mining shares together account for only about 1/6 of Apple's market capitalization), the price drop in precious metals led to price declines in mining shares. This development is hardly to explain from a fundamental point of view and has for a long time contrasted with the strikingly good profit and balance sheet quality of these companies.

If you believe the popular market index S&P 500, US equities are among the winners this year. However, as is often the case, it is worth taking a look behind the scenes - the performance is dominated by a small group of highly weighted individual stocks in the index. The TOP 5 stocks (Apple, Microsoft, Amazon, Nvidia and Alphabet) account for around 24 % of the market capitalization of the 500-stock index. **Chart 2** shows the development of the index if the consequences of the overweights are eliminated and dividend payments are taken into account. The result of + 1.9 % in 2023 and - 4.4 % in the third quarter gives a more realistic picture of the development of US equities when compared with the other regions.

The performance of equity markets in the third quarter reflects multiple geopolitical uncertainties, confusing economic data, societal divisive tendencies and the efforts of central banks desperately trying to get the ghost of inflation back into its lamp.

It is easy to overlook the fact that the performance of many companies and the propensity to consume remain strong when measured against the mixed-up environment. Bonds are again a real competitor for equity investments. However, despite annoying short-term fluctuations, shares are indispensable as "tangible assets with a productive character".

Chart 1: Stock markets – Performance 2023

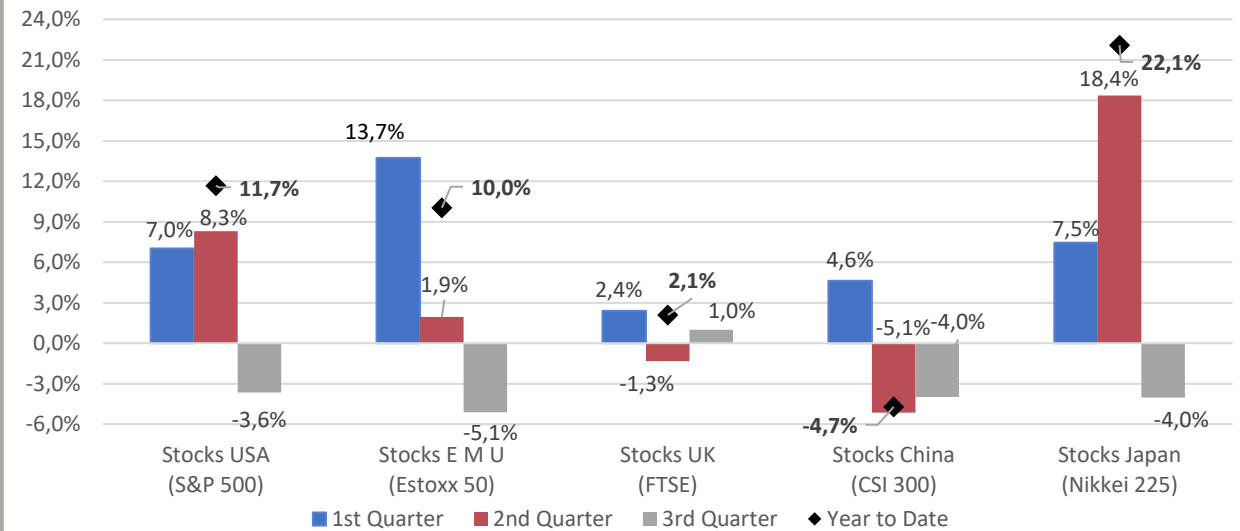
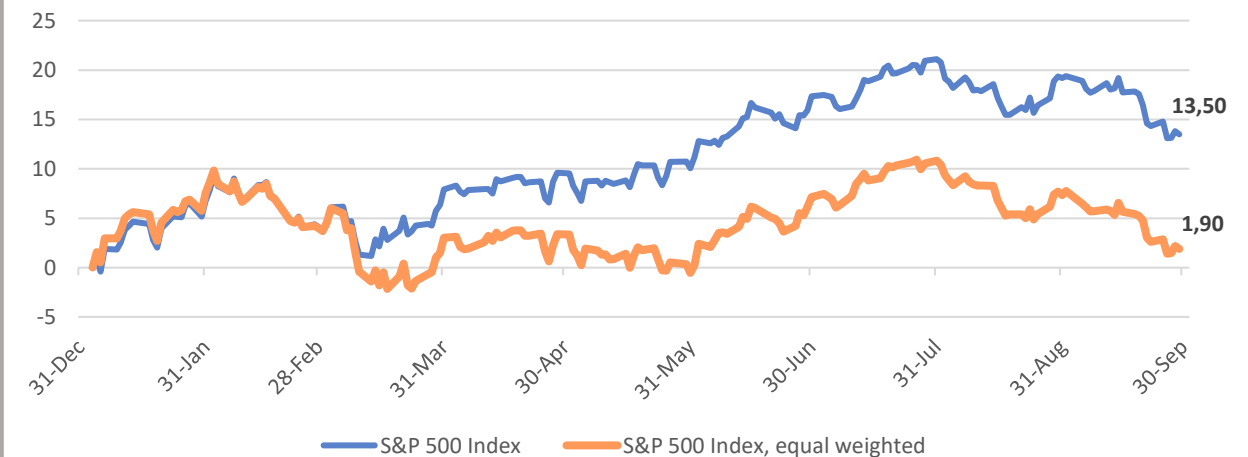


Chart 2: US equities only strong at first sight (dividends included)



Sources: Bloomberg

# Bond markets and interest rates

## Duration makes the difference

With the announcement, unusually clear for a central banker, that key interest rates in the USA will be kept at a high level for longer and, if necessary, raised even further, the FED head unpleasantly surprised the financial markets. Until then, many expected the first rate cuts as early as the beginning of 2024. The adjustment led to a veritable sell-off in long-dated bonds and a rise in yields to new highs in the current cycle. Rising market interest rates always mean falling valuation prices for bonds - this leads to the negative price development in the third quarter - including current interest payments, mind you.

Similar statements also came from the European Central Bank, in addition to two other interest rate hikes. We cannot deny the impression that the central banks, in a joint effort, wanted to prepare the markets for the fact that the "fight against inflation" will take longer than originally expected.

**High-yield bonds** (non-investment grade) were able to counter the interest rate-related price reductions with high running interest income and thus achieve a positive overall development.

A risk factor that has been somewhat neglected in the years of "stable zero interest rates" was again particularly decisive for success in the last quarter - the maturity of bonds, also referred to as "duration". The difference between "short" and "long" became particularly clear during the sharp rise in interest rates in recent weeks. But other parameters, such as debtor quality or regional affiliation, are also significant. **Chart 4** shows the results of important bond strategies used in BPM portfolios compared to a broad market index with longer duration for the last quarter (BB Global Aggregate).

Inflation rates, probably the most important decision-making basis for central banks at present, showed a clear downward trend on both sides of the Atlantic in the last quarter, even if the road to the 2 % target may still be long. However, we believe that the central banks are only now assessing the impact of the previous rate cuts on the economy and consumers and want to avoid further rate hikes for the time being.

Special bond segments continue to offer yield potential. Short-dated bonds promise stability and respectable returns.

Chart 3: Bond markets – Performance 2023

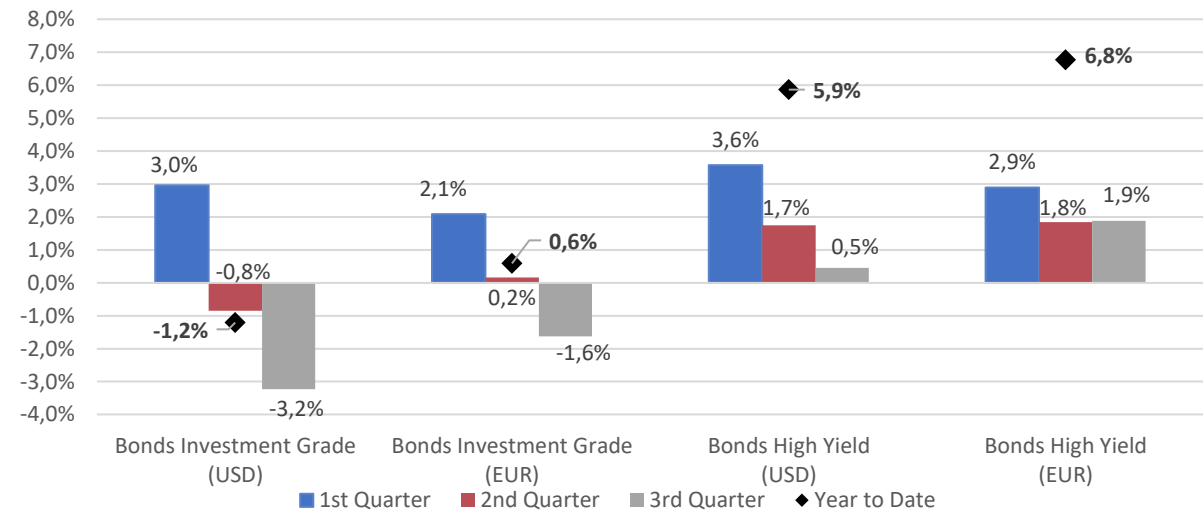
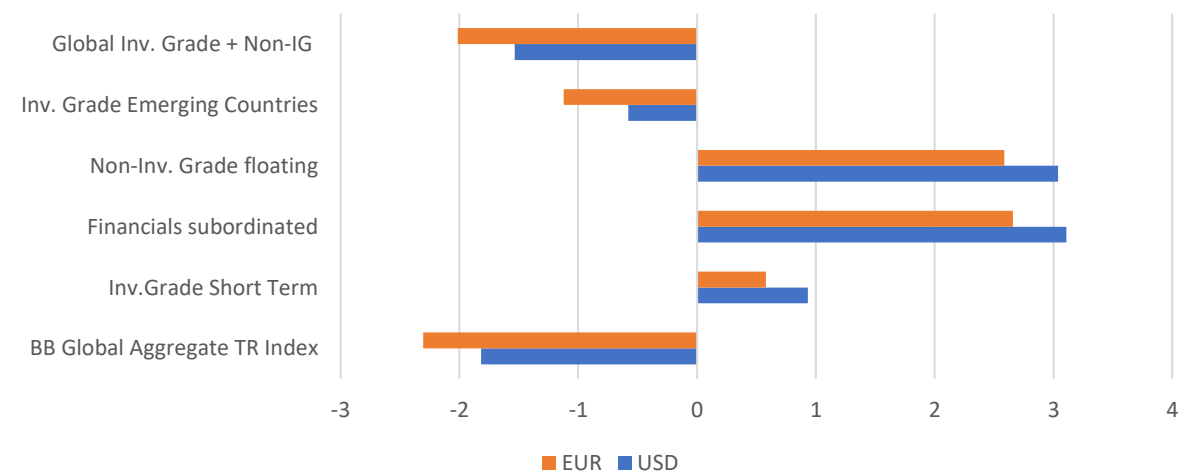


Chart 4: Results and comparison of key BPM bond strategies in the third quarter



Source: Bloomberg

# Alternative investments

## High interest rates and unclear growth prospects weigh down

Among the thematically very diverse investments in the category "Hedge Funds", only a few have been convincing so far. Among them were so-called "event driven" strategies, market-neutral equity investments in the environment of corporate takeovers. The investment solution we used achieved +3.0 % (EUR) and +3.4 % (USD) in Q3 and was convincing as a lower-risk investment compared to the broadly diversified hedge fund index over the current year with +3.6 % and +4.9 % respectively. The investment solution chosen by us for the collection of "volatility premiums" achieved very attractive performance with +6.5 % (EUR) and +8.2 % (USD) in the current year but was also only able to end Q3 with a "zero".

Gold continued its price decline in the last quarter from the high of over USD 2,000 reached in April and ended just above the low for the year to date of around USD 1,840. Despite continued strong gold purchases by some central banks, two factors accelerated the price decline recently. On the one hand, the US dollar appreciated massively due to the changed interest rate outlook, which makes buying gold more expensive for non-US investors and slows down investment demand. Secondly, the real yields achievable via inflation-linked bonds have increased massively, especially from the second half of September, making gold less attractive as an inflation hedge (chart 6).

Alternative investments are intended to have a risk-balancing effect in the portfolios we design and also to generate returns as far as possible in phases in which conventional equity or interest investments are under pressure. However, short-term negative influences caused by "market stress" were also noticeable here.

Recent price movements in gold have been disappointing. However, the causes of the current declines are disruptive factors whose effectiveness is usually not very persistent and in no way calls into question the long-term sense and usefulness of gold in a responsibly diversified portfolio.

Chart 5: Alternative investments – Performance 2023

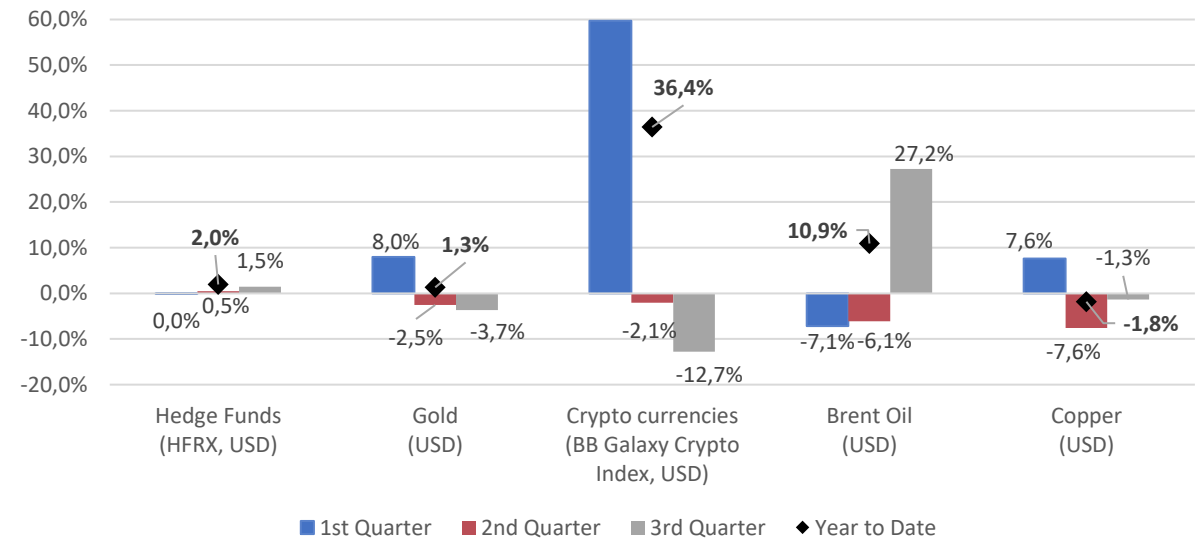
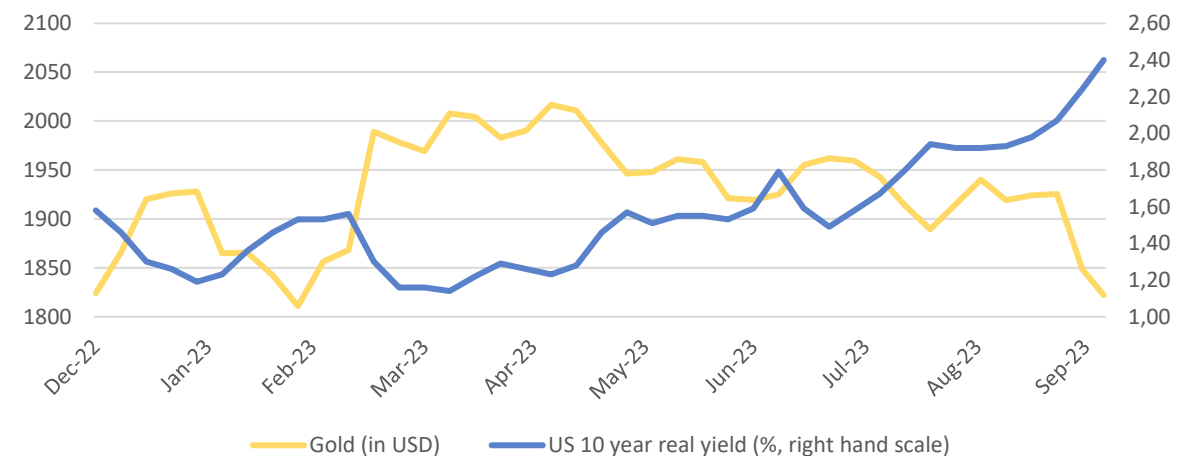


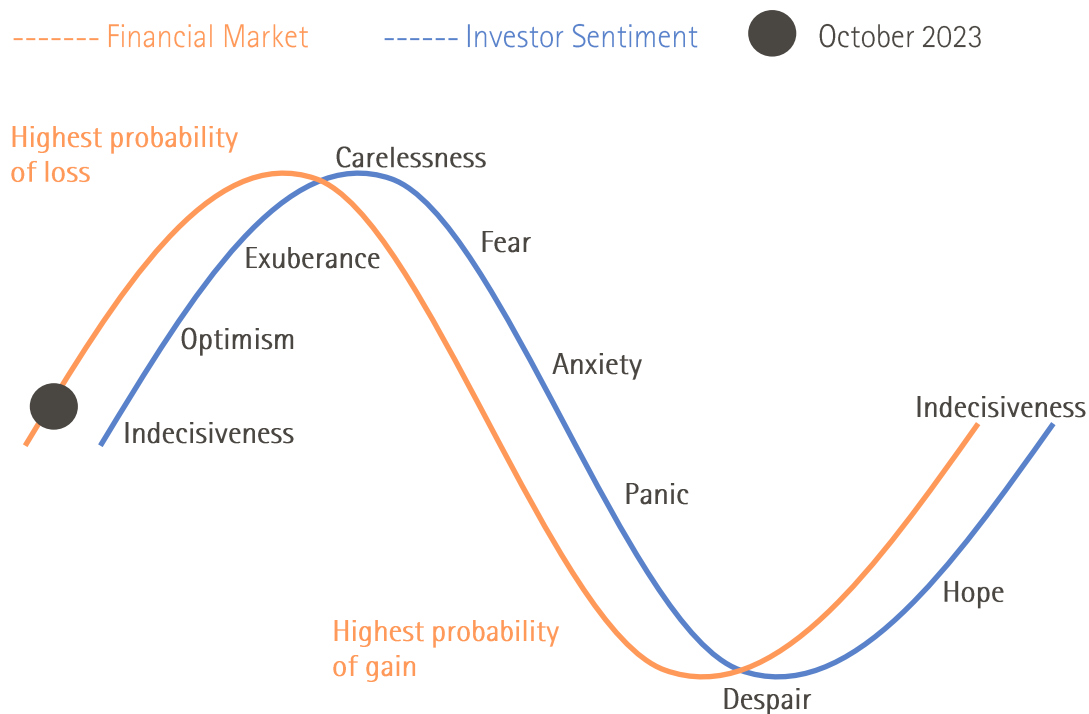
Chart 6: Current headwinds for gold – rising real yields



Sources: Bloomberg

# What will happen next

## The „emotional investment cycle“ – Where are we now?



The third quarter was inconsistent in sentiment and data, generating temporary declines in value across almost all asset classes. Financial markets suffered from an uncertain interest rate outlook and seasonally low activity. Under these conditions, no one likes to make investment decisions of a long-term strategic nature. The fourth quarter, on the other hand, should bring increasing clarity about the development directions of the economy, interest rates, prices and corporate profits in the coming year.

## Expectations and investment ideas in our portfolios

In the first quarter of 2024, the FED could officially end its series of key interest rate hikes and the ECB could follow suit with some delay. We do not share the long-held hope in the financial markets of a rapid transition to interest rate cuts. We do not expect an acute economic weakness to which the central banks would have to react in terms of monetary policy, and a return of inflation rates to the 2 % target requires more time. It should also be borne in mind that interest rate cuts would counteract the central banks' balance sheet reduction, which is far from being completed.

Higher interest rates for a longer period of time burden consumers and companies and reduce the market valuation of future corporate profits (= share prices). In our perception, the necessary adjustment process to this situation is already well advanced and should therefore no longer bring any major surprises.

Equities of companies with high financial strength, strong brand and competitive position as well as reliable earnings growth, so-called "quality growth", remain our favorites in the equity part of the portfolio, rounded off by investments in long-term themes that will be relevant in the future, such as environmental technology, special metals or the health sector.

The bond investments have an average return of 7.5 % (in EUR) or over 9.0 % (in USD) in a typical balanced portfolio of BPM at the end of September. Investment-grade bonds from emerging markets in hard currencies, financial subordinated capital, reinsurance premiums but also high-yield bonds (non-IG) enable such returns. We continue to avoid long maturities and prefer to use the inverse yield curve with the higher yield of "short-dated" bonds.

When designing the portfolio, we pay attention to a balanced relationship between return opportunities and the possible risks. In view of the current growth outlook, we consider equity market returns above the long-term average to be unlikely. Bonds, on the other hand, offer an attractive risk-reward profile over the next few quarters. However, it is also important to differentiate carefully and to take precautions for the possible non-occurrence of our optimistic expectations.

## Disclaimer and contact information

The information and details contained herein do not constitute a recommendation. It is intended solely for the information of our clients and interested parties and constitutes neither an offer nor an invitation to make an offer nor a recommendation to purchase financial products. In particular, this information does not replace a thorough individual and professional examination of the tax, legal and risk-specific implications of an investment in financial products.

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