



Review and outlook

Fourth Quarter 2023

Important developments in the fourth quarter 2023

Economy and inflation

- Tense economic sentiment and situation – growth expected to be below long-term average in 2023 and 2024 – World Bank reduces forecast for global growth again (2024 +2.4% and 2025 + 2,5%)
- Inflation Q4 declining: +3.4 % (USA) and +2.9 % (Eurozone), core inflation (excluding food and energy) falling more slowly (below 4 %)
- Stable demand for labour and slower price increases support private consumption – Record low unemployment rate in the Eurozone in December – Recession "feels" far away – US economy grows by 4.9% in the third quarter, Germany shrinks by 0.1%
- China suffers from weak exports, domestic property sector and consumer boycott – government intervenes to break negative spiral – consumer prices fall – increased probability of deflation scenario

Monetary and fiscal policy

- No more Fed or ECB rate hikes in Q4 – Central banks recognise declining inflation, but keep the "back door" open for another rate hike – Fed Board expects 3 rate cuts in 2024 – US futures markets price in up to 6 cuts
- Balance sheet reduction by central banks and sharp increase in new issues of government bonds weighs on monetary excess liquidity
- Budget deficits of many countries increased in 2023 – Example: USA 6.3% in 2023 (5.4% in 2022) – Reductions not expected in 2024 – Moody's is the last rating agency to cancel the USA's TOP credit rating – German federal government unexpectedly finds itself in budgetary difficulties due to supreme court judgement – Budget plans show significantly higher interest burdens for 2024

Politics und geopolitics

- Hamas attack on Israel triggers war in the Middle East – Danger of escalation despite international diplomacy – Obstruction of transport routes through the Red Sea causes logistics costs to rise – Oil price little affected so far – Investors use gold and cryptocurrencies as "safe havens" in October, while government bonds are avoided
- US presidential elections in November 2024 are moving into the financial markets' consciousness – changes in Fed communication since December could be related to this ("Goldilocks scenario" creates better voter sentiment)

Financial markets

- Remarkable change in sentiment in November: financial markets suddenly believe in "victory over inflation", expect key interest rate cuts soon – contrast to extremely poor sentiment and yields at 16-year highs only shortly before
- Hope for interest rate cuts triggers strong "year-end rally" of all investments – "best of all worlds" included in current prices – first signs of "irrational exuberance", e.g. hype around "Magnificent 7" (market-dominating US technology stocks)
- New EU laws and rigorous "clean-up" by US regulators make cryptocurrencies the best asset class in 2023
- Gold price at new all-time highs in many currencies – "de-dollarization" (shifting of currency reserves of some central banks into gold) continues – investment demand still weak due to interest rate levels – key interest rate cuts as a trigger for further gold price increases

Stock markets

All's well that ends well

The hope for aggressive interest rate cuts that appeared out of nowhere in November turned what had been a good year for Euro and US equities into an excellent one. By contrast, markets that had already tended to be weak had little or no benefit from the "interest rate blessing".

Chinese equities continue to suffer from persistently difficult economic and political conditions. Even government-orchestrated stimulus measures have so far done little against the fact that foreign investors are increasingly turning their backs on China. The weak performance of **British equities** was also due to domestic political reasons and can be interpreted as a late consequence of Brexit.

Japanese equities are benefiting from the positive course set by the Japanese stock markets recently, which should force companies to be more responsive to the needs of their shareholders. Unfortunately, the Bank of Japan has still not decided on a clear departure from its ultra-loose monetary policy, which is severely affecting the yen's exchange rate. As a result, the impressive performance of 28.2 % (in yen) in Euro or US dollar terms is losing some of its shine. (Chart 2)

The strong influence of the large, dominant US technology and consumer companies - now known as the "Magnificent Seven" - waned somewhat in the fourth quarter. Nevertheless, the performance of these 7 stocks alone accounted for more than 50 % of the increase in the 500-stock US index.

Euro and US equities have benefited greatly from the "tailwind" of falling interest rates in recent weeks. It seems prudent to expect at least temporary disruptions to the favorable sentiment. The geopolitical situation in the Middle East, the war in Ukraine and the unresolved conflict over Taiwan are firmly anchored in the subconscious of the financial markets and are only likely to weigh on share prices in the event of a serious escalation. In view of the corporate profits expected for 2024, the valuation of the equity markets does not appear to us to be excessively high if known excesses (e.g. in the technology sector) are factored out.

Chart 1: Stock markets – Performance 2023 (in the respective currency)

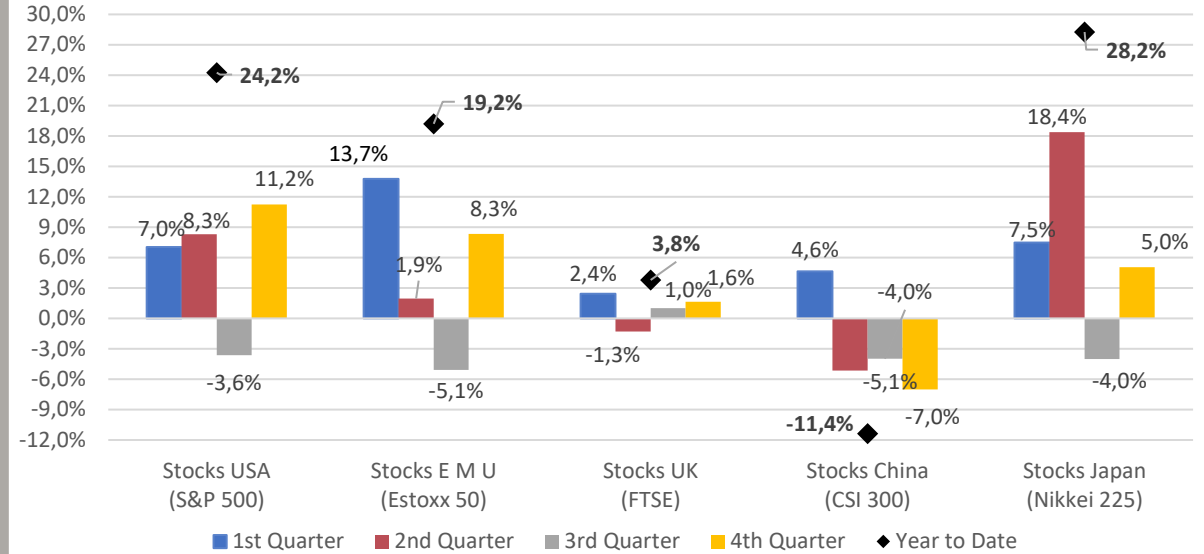
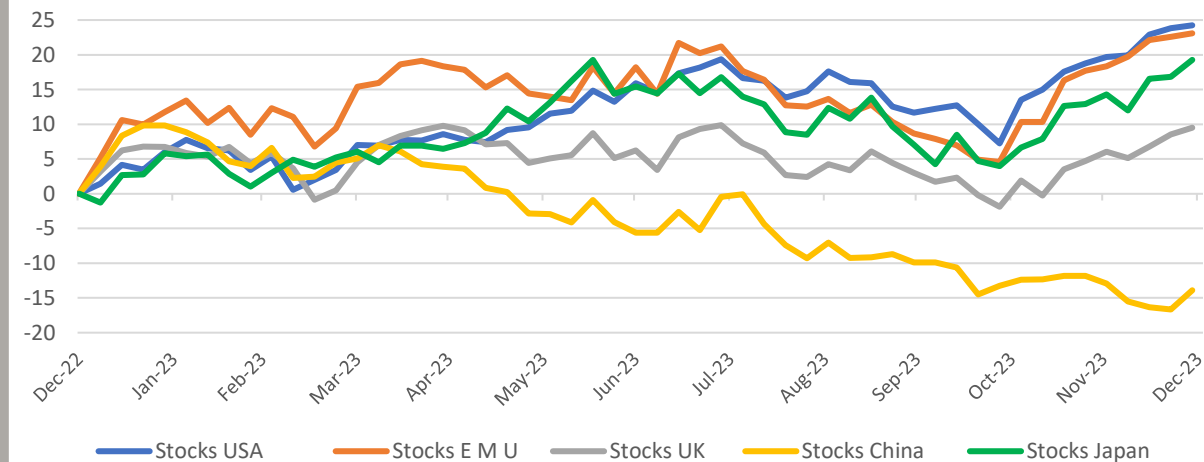


Chart 2: Equity year 2023 – mostly upwards for US dollar investors



Sources: Bloomberg

Bond markets and interest rates

Interest rate cuts? Yes, just not as quickly as recently dreamed of

There has rarely been such a rapid change in sentiment on the bond markets. While 10-year interest rates on US government bonds reached their highest level in 16 years at just over 5% in October, they fell to 3.8% just two months later. Euro interest rates experienced a similar development. Hopes for an end to the interest rate hikes by central banks, which have been depressing the bond market in particular for almost two years, were sparked by falling inflation rates and anaemic economic prospects and triggered veritable price fireworks.

Investment grade bonds were able to "turn around" their previously unsatisfactory performance for the year as a whole and closed 2023 with a pleasing positive result.

High-yield bonds (non-investment grade) benefited from the already very high current interest income and, at around 13%, achieved a very positive annual result, even by historical standards.

Chart 4 shows the results of key bond strategies used in BPM portfolios compared to a broad-based market index (BB Global Aggregate) with longer duration in the last quarter. Unlike in previous quarters, falling interest rates mainly helped strategies traditionally associated with longer duration. In 2023, the Euro strategies in the BPM portfolios achieved between +5.5% and 12% (market index +4.7%), and in USD between +7.2% and 14.4% (market index +7.2%).

Inflation rates, probably the most important basis for central bank interest rate decisions at present, fell in the fourth quarter, although the pace slowed noticeably. In our opinion, the expectation of rapid interest rate cuts bears the potential for disappointment. On the positive side, companies and consumers are increasingly succeeding in adapting to the new interest rate environment. The return to target inflation (2 %) may still take some time. Meanwhile, bonds continue to offer very attractive yields. We even see particularly promising earnings opportunities in specific bond segments.

Chart 3: Bond markets – Performance 2023

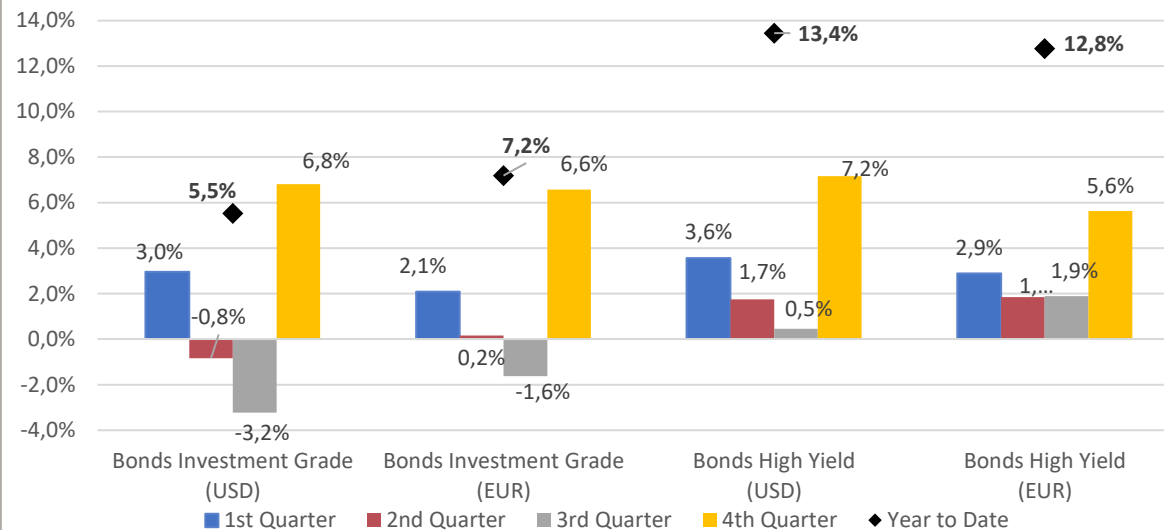
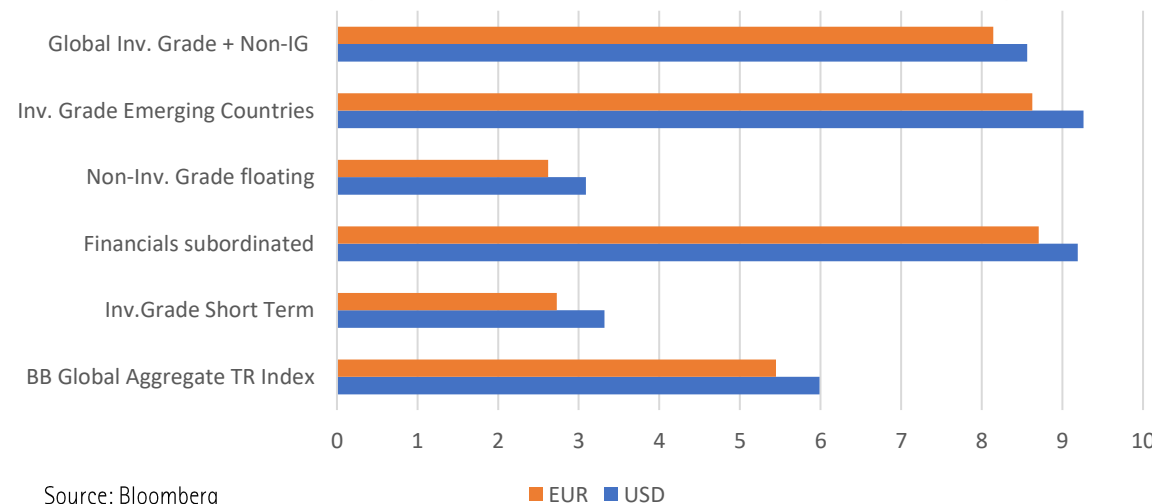


Chart 4: Results and comparison of key BPM bond strategies in the third quarter



Source: Bloomberg

Alternative investments

Gold and crypto currencies are booming – despite "perfect world" sentiment

Our investments in the very heterogeneous "hedge funds" category were convincing in the 4th quarter. The "event-driven" strategies, low-risk, market-neutral investments in the context of corporate takeovers, achieved +1.0% (EUR) and +1.3% (USD). Our chosen investment solution for the collection of "volatility premiums" once again achieved a very good result of +4.5% (EUR) and +4.8% (USD). For the year as a whole, the increase in value totalled 11.3% (EUR) and 13.3% (USD). Cryptocurrencies performed exceptionally well last year. Our broadly diversified "cryptocurrency basket" achieved an increase in value of more than 130% in 2023 – around 60% of this in the fourth quarter alone.

The gold price showed remarkable upward momentum in the fourth quarter. In view of the persistently high real bond yields and the further strengthening of the US dollar, this cannot be taken for granted. Ongoing extensive gold purchases by some central banks, which are keen to reduce their US dollar currency reserves, are only part of the explanation. The expectation, which has dominated the market since mid-November, that the US Federal Reserve will soon have to cut interest rates due to declining inflation and increasing economic risks has also helped the recent price rally. We see excellent opportunities for the gold price to overcome the "price ceiling" in the USD 2,070 range that has been in place for over three years in the new year and establish itself permanently above the USD 2,100 mark. The unstoppable rise in government debt, geopolitical scares and the upcoming US presidential election will keep demand for this alternative store of value going! (Chart 6)

In the portfolios we design, alternative investments should have a value-stabilising effect, but also generate current income regardless of stock market or interest rate trends.

Gold and, to a lesser extent, cryptocurrencies, serve to diversify assets outside the central bank-dominated money supply. In the long term, we believe this is an indispensable building block to enable real wealth preservation.

Chart 5: Alternative investments – Performance 2023

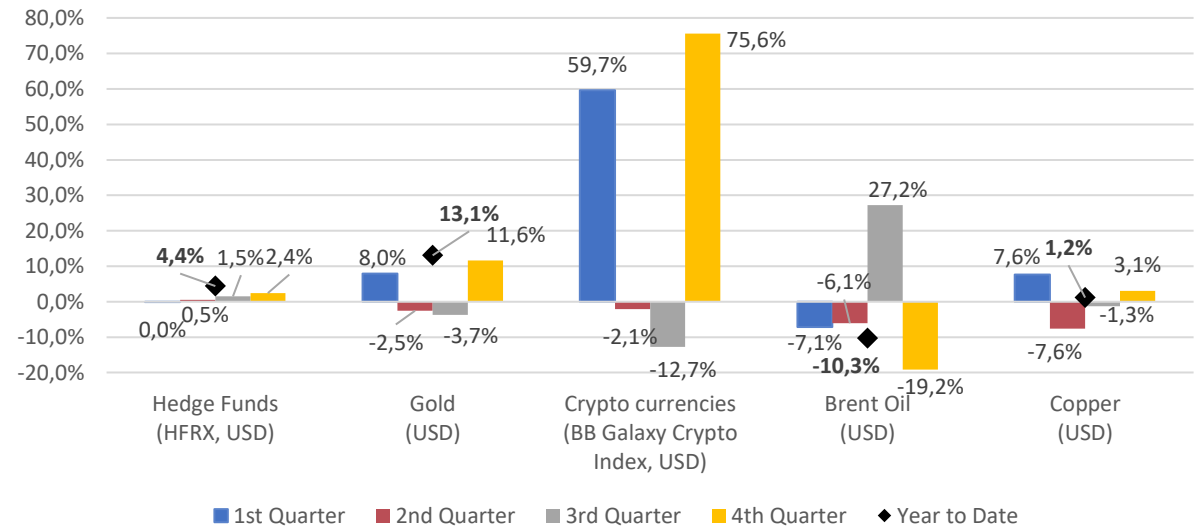


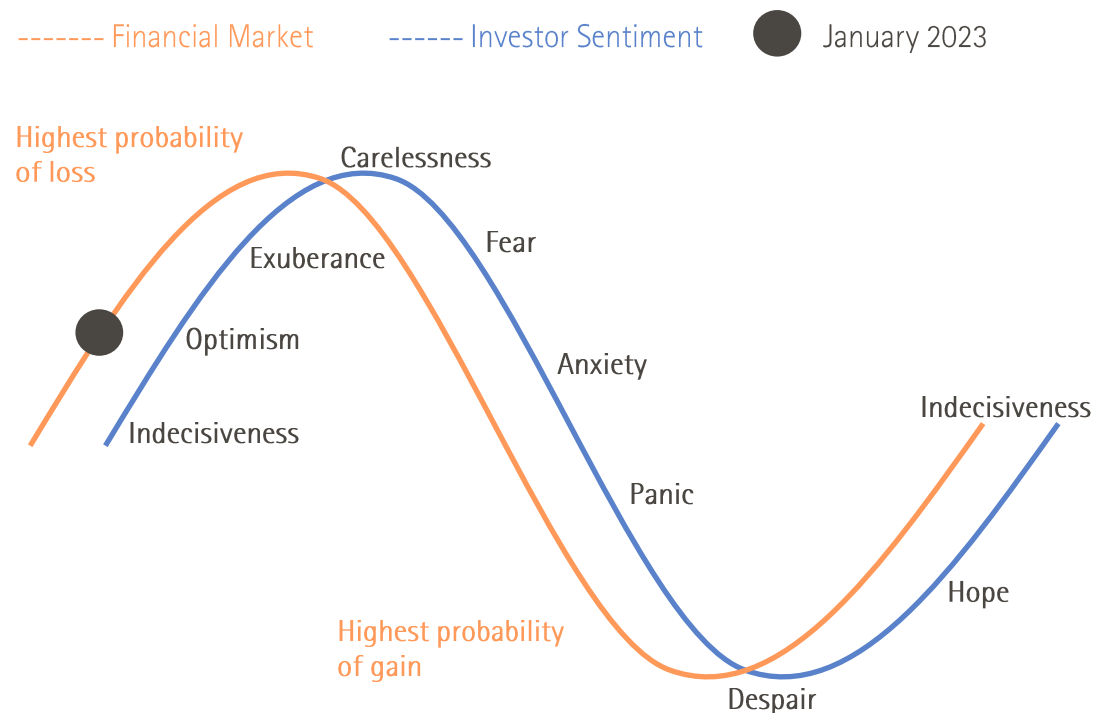
Chart 6: Will the "gold price ceiling" lift after more than 3 years?



Sources: Bloomberg

What will happen next

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



The fourth quarter was fairly unprecedented in terms of "mood swings" on the financial markets. The exuberance in December driven by flaring expectations of interest rate cuts must first be reduced in order to create a sustainable basis for further increases. We therefore consider price corrections in the course of the first few weeks of the new year to be likely and healthy for the further upward trend.

Expectations and investment ideas in our portfolios

Interest rate cuts are likely to be the key topic for the financial markets in 2024, but also for large parts of the real economy. Even if we do not believe that the first interest rate cut will come as quickly as many currently expect, the era of tight interest rate hikes should be over. This prospect is good news for practically all forms of investment in BPM portfolios, as it should ease the valuation pressure exerted by the sharp rise in interest rates over the last two years.

We see an important advantage of the interest rate level reached today in the fact that, unlike in mid-2022, the central banks now have room to cut interest rates again in order to stimulate the economy if necessary or to react to shock events. This is likely to be an important "tranquilizer" for the financial markets, as the central banks can once again be seen as a lifeline. We saw the stabilizing effect this can have during the bank collapses in the US and Switzerland in the first half of 2023.

Falling interest rates mean a reduction in financing costs and help not only highly indebted national budgets but also private households and companies. This helps to protect the economy in the USA and Europe from a prolonged recession. The structural shortage of labour is also supporting the economy. This factor, which is closely linked to the unfavourable demographic development in many countries, is also likely to explain the continuing enthusiasm for technological developments such as artificial intelligence. An at least partial replacement for future labour shortages seems realistic to us.

Low unemployment and rising wages will allow consumer spending to remain at a relatively high level. Rising corporate profits in 2024, possibly even stronger than previously assumed, will support the valuation level of the equity markets reached today.

"Surprise winners in 2024" could be the European equity markets with their very low valuations. Especially if the Chinese government's measures to stimulate the economy take effect over the course of the year the European economy, which is strong in exports to China, is one of the first to benefit.

What will happen next

Companies with high financial strength, valuable brands and reliable earnings growth, so-called "quality growth", remain our favourites in the equity section of the portfolio. We are weighting this segment slightly higher again at the start of the year. In addition, relevant long-term themes such as environmental technology, speciality metals, the healthcare sector and the technology sector remain our favourites. We are selectively interested in equities from some emerging markets, which historically have large valuation differences to developed markets and in which investors are now heavily underinvested after years of cash outflows. We intend to make our first investments here shortly.

The bond investments in the typical balanced BPM portfolio had an average yield of around 6.5% (in EUR) and around 7.5% (in USD) at the end of the year. This is made possible by investment-grade bonds from emerging markets in hard currency, financial subordinated capital, reinsurance premiums as well as floating-rate high-yield bonds. We rely less on government bonds and favour corporate debtors. Even though the yield curve in euros and US dollars is now less inverted, we believe that it is still a little too early to focus more on long bond maturities.

The central banks will continue to monitor inflation developments closely, as experience shows that the final stretch to the inflation target is particularly challenging. We are factoring in temporary setbacks. We can change our positioning at any time, provided the market signals accordingly. Flexibility is crucial for Bonds 2024.

The "perfect world" of the financial markets in the fourth quarter of 2023 cannot hide the fact that there are considerable challenges in the real world. Some influences will be political in origin, such as important elections with significant global consequences. In economic terms, we are not expecting a boom, but neither are we expecting a significant recession. Our optimism for the new year is based on the increasing robustness of the economic areas in which we have invested. But above all on our carefully diversified portfolios. The positive sentiment at the end of 2023 is therefore justified for us.

We are therefore working to make 2024 an outstanding investment year for our clients.

In focus 2024: Gold and shares of precious metal miners



The chart shows the development of the gold price in the three interest rate cut phases of the US Federal Reserve since 2000. In all phases, the gold price (in USD) rose by more than 50%. The orange dotted line shows the Fed's interest rate expectations for 2024 to 2026. Regardless of the question of when the first interest rate cut will actually take place, gold should continue to enjoy good times in the portfolios we have designed.

This scenario should be particularly interesting for shares of precious metal miners, which we also hold in many mandates. This market segment appears to be fundamentally undervalued. Once the long-term gold price ceiling of around USD 2,100/ounce has been overcome, this comparatively small market segment should suddenly attract attention and encourage new investments.

Disclaimer and contact information

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