



---

## **Review and outlook**

First Quarter 2023

## Important developments in the first quarter 2023

### Economy and inflation

- Economic data and business climate in the USA and Eurozone still robust so far
- Price increase slows down also thanks to statistical base effect - core rates (excluding energy and food), meanwhile, continue to rise - inflation rates more than triple the target of 2% (USA 6.0% in February, EU 6.9% in March)
- Disruptions in international supply chains lower - Order backlogs are being worked off - Leading indicators signal significant decline in new orders - Corporate profits coming under increasing pressure (cost development, interest rates)
- Zero growth expected in the first half of 2023 - absence of a recession would already be a "positive scenario" for 2023
- China is again seen as a source of hope for stronger global economic activity - potential for disappointment is building up

### Monetary and fiscal policy

- Central banks must push for further rate hikes to remain credible and contain inflation expectations - misjudgement of inflation signals in 2021 has massively disrupted confidence - danger of "overshooting" exists
- Reduction of central bank balance sheets parallel to interest rate increases - liquidity in the banking system becomes increasingly scarce - loans become significantly more expensive and are granted more restrictively
- After the collapse of two medium-sized US banks in March, there was a danger of a new crisis in the banking sector - quick and coordinated intervention initially prevented escalation - "flight to safety" triggers sharp decline in yields

### Politics und geopolitics

- Subsidy race between US and EU has begun (e. g. US Inflation Reduction Act or EU Green Deal Industrial Plan)
- Energy crisis in Europe did not materialise thanks to mild winter and timely replacement deliveries
- Strike waves for strong wage increases in EU and UK supported by busy labour markets
- Still far too little noticed - the debt ceiling for the US government was reached in January - political agreement urgently needed by mid-2023, otherwise there is a threat of technical insolvency of the American state

### Financial markets

- Financial markets try to predict turning point of interest rate policy - thus cause strong fluctuations again and again
- Stocks continued their recovery since October'22, also with strong price swings
- Bonds experienced one of the most turbulent quarters in many years - still achieved a positive quarterly results
- Gold lived up to its role as "anchor for the portfolio" - benefiting from sustained demand due to the great uncertainty and because of sharply falling yields on risk-free bonds
- BPM portfolios performed positively across the board in the first quarter despite the difficult environment

# Stock markets

Stock markets experienced a rollercoaster ride in the first quarter. Torn between hopes for a quick end to aggressive interest rate hikes and inflation and economic data that contradicted this, triggered strong price fluctuations on several occasions. Equities showed a positive development in the first quarter, albeit with strong fluctuations and varying results (chart 1).

Reports of mostly solid corporate earnings developments for 2022 and slightly better than expected corporate results for 2023 provided good fundamental valuation support to equity markets.

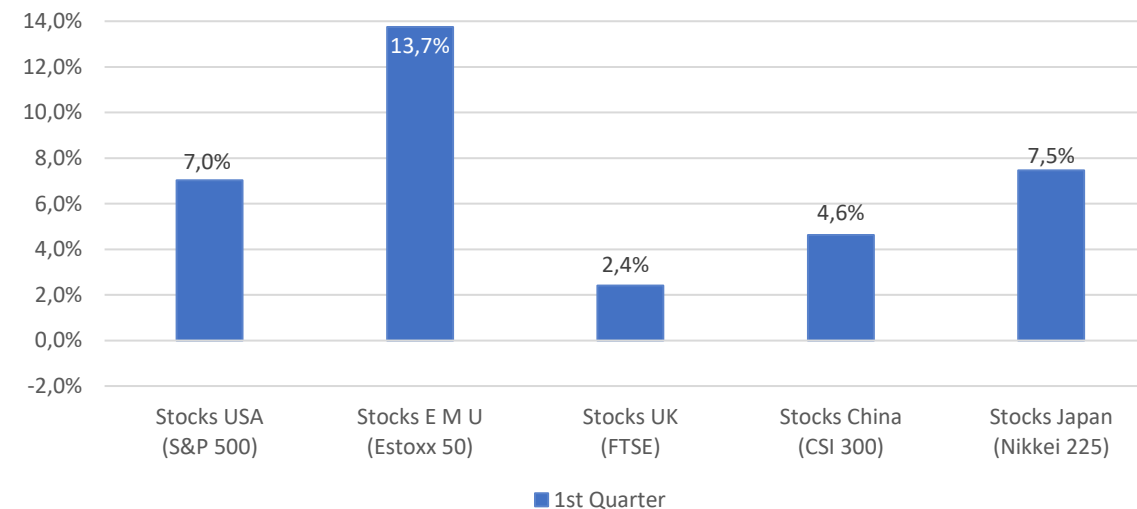
Doubts about the stability of the banking sector, emanating from problems at some medium-sized US banks and Switzerland's Credit Suisse, triggered turbulence in the second half of March (chart 2).

The loss of confidence triggered shifts in bank deposits and could only be stopped by coordinated interventions of governments, central banks and banking supervisors. Comparisons to the "Great Financial Crisis" of 2008 seem inappropriate. In addition to the other causes and the different initial situation, the fact that central banks were able to raise key interest rates again to combat inflation despite the extremely tense situation without further shaking the financial markets also speaks against this.

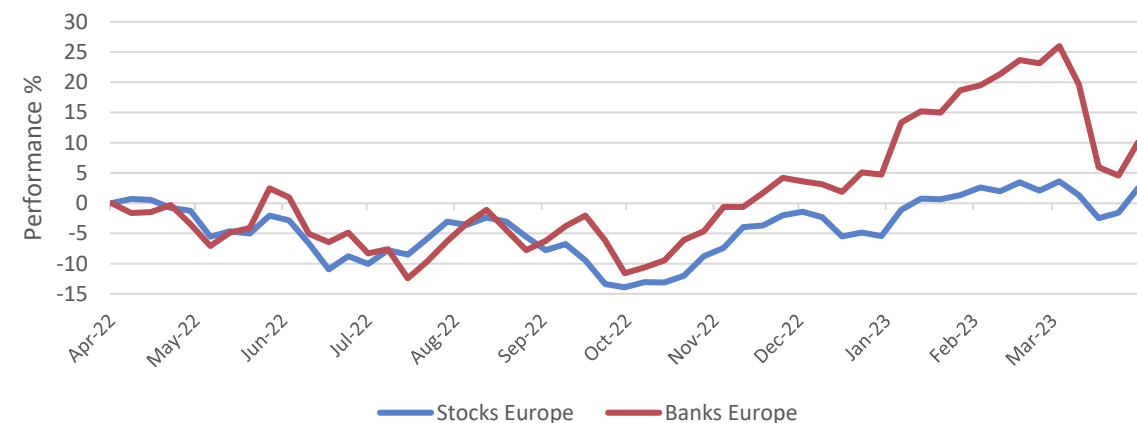
Growth stocks clearly outperformed value stocks. The Russell 1000 Growth Index rose by 20.4 %, while the Russell 1000 Value Index, which is made up of value stocks, rose by only 0.4 % in the first quarter. Thus, value stocks probably reflect the current economic situation better.

Unsettled market conditions will persist until it is easier to see how higher prices and interest rates will affect consumer and corporate behaviour. If companies continue to protect their profit margins by raising prices, a recession is unlikely to affect equity market performance.

**Chart 1: Stock markets – Performance 2023**



**Chart 2: End of a high-flying period - bank shares vs. the overall market**



Source: Bloomberg

# Bond markets and interest rates

Bonds continued their recovery after last year's heavy losses, albeit again with strong fluctuations. In the first quarter, bonds recorded positive results in all credit rating segments (chart 3).

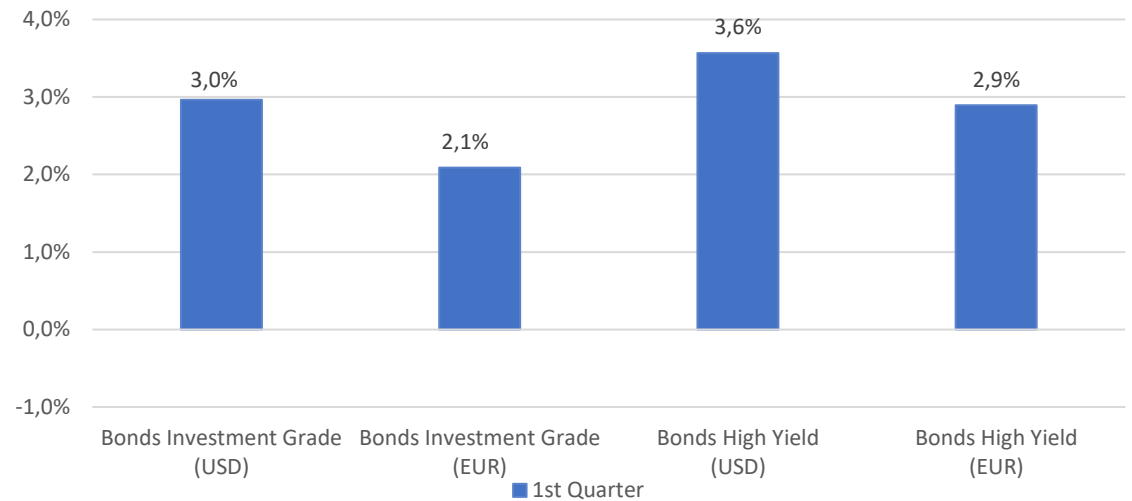
It was particularly helpful that bond portfolios have become noticeably more resilient to further increases in market interest rates due to the significantly higher yields. Yields on USD corporate bonds of good debtor quality (investment grade) are now above 5%; those on Euro corporate bonds are at 4%. Just 12 months ago, these yields were 2% and just above zero, respectively. With yields at their highest level for more than 10 years, investments in bonds are interesting for a period of 1 to 2 years. For long-term investments, however, it should be borne in mind that the "return after expected inflation" still makes real wealth preservation unlikely.

With the exception of China and Japan, the major central banks continued their policy of raising interest rates in the first quarter. The declared goal remains to reduce inflation rates, which are clearly too high. As a result, economic development is expected to slow down considerably. There is still no reliable expectation on the financial markets as to how far the interest rate hikes will go. In view of the economic data situation, this uncertainty factor will remain and produce new fluctuations in value (chart 4).

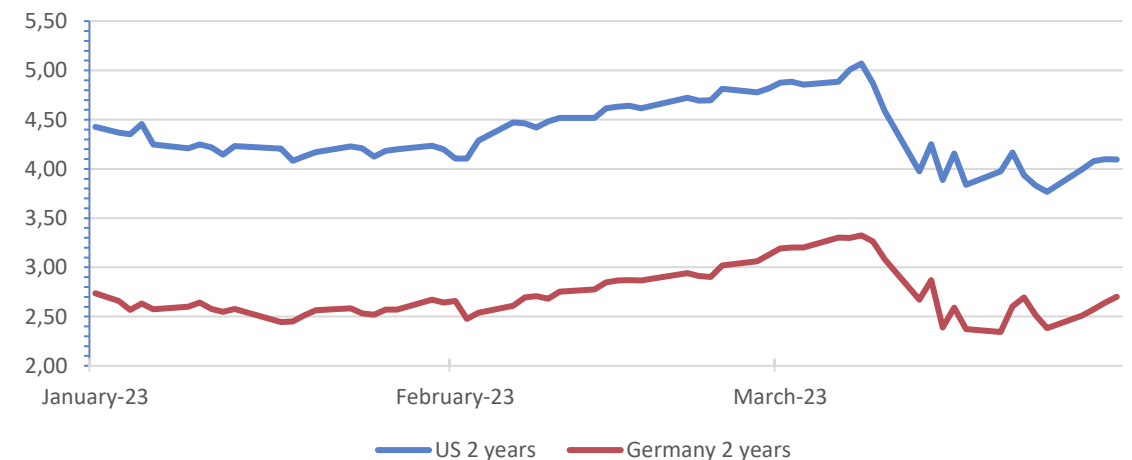
Subordinated bonds of banks were under considerable pressure after the rescue measures for Credit Suisse. This resulted in price declines that in the vast majority of cases were clearly too high. At the end of March, the start of a broad recovery movement could already be observed - confidence slowly returned.

Bonds make sense again for portfolio design, even if "buy-and-hold strategies" are not tempting given the prospect of negative real returns. On the positive side, bonds, as an important form of investment for diversified portfolios, are once again yielding appreciable returns and thus enable more stable performance of the entire portfolio in the future.

**Chart 3: Bond markets – Performance 2023**



**Chart 4: In search of a trend - interest rate fluctuations in the first quarter**



Source: Bloomberg

# Alternative investments

"Stores of value" such as physical gold or cryptocurrencies, which are independent of the classic world of shares or bonds, were particularly in demand during the crisis of confidence in the banking sector. They benefited from strong demand due to the generally high level of uncertainty. The gold price reached its highest level in more than a year at just under USD 2,000 at the end of March.

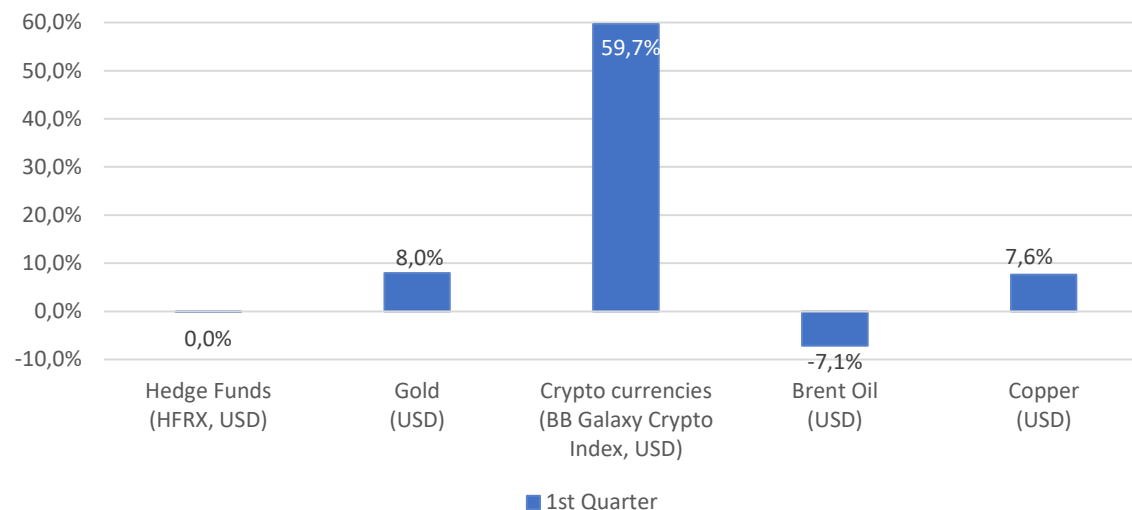
Commodities, which play a key role in the energy transition, are now part of geostrategic considerations and their development is therefore often generously subsidised. In the portfolios designed by BPM, we already invested in this investment theme with a view to the future some time ago. The price development in this segment has been disappointing recently. However, regardless of short-term negative price influences, we see a considerable structural demand overhang here due to the upcoming transformations in areas such as mobility, energy generation, energy transmission and storage.

In addition to the improved availability, lower demand (mild weather, use of other energy sources) also led to an easing of energy prices (chart 6).

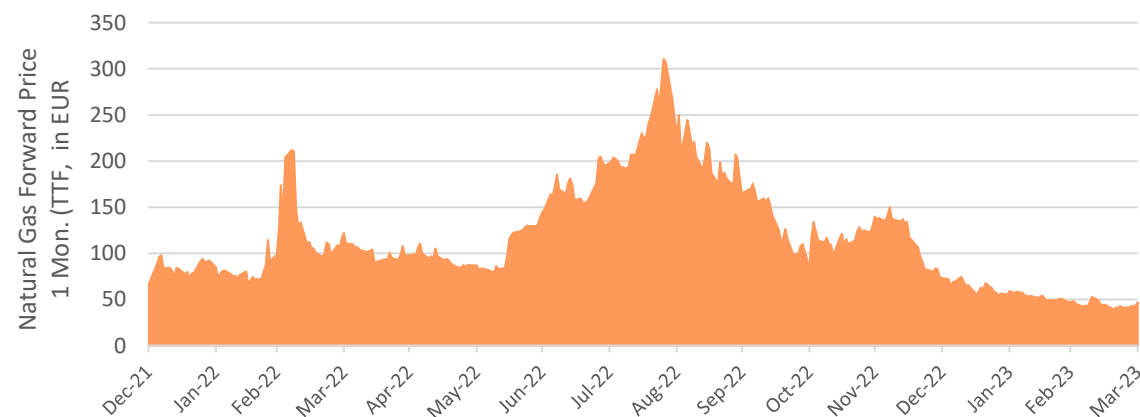
Industrial raw materials showed a mixed price trend in the first quarter. The modest economic outlook is having a negative impact. Hopes are now resting on additional demand from China after the end of the burdensome zero-covid policy and the reduction of the still relatively high inventories there. On the other hand, the lack of economic stimulus for commodity demand from the USA or Europe this year is probably already reflected in current prices.

Gold, as well as broadly diversified cryptocurrencies with a sensibly limited share, help to stabilise mixed portfolios during particular market stress. Commodities as an asset class have already proven to be an effective asset protection in earlier times when economic growth was low and prices rose sharply.

**Chart 5: Alternative investments – Performance 2023**



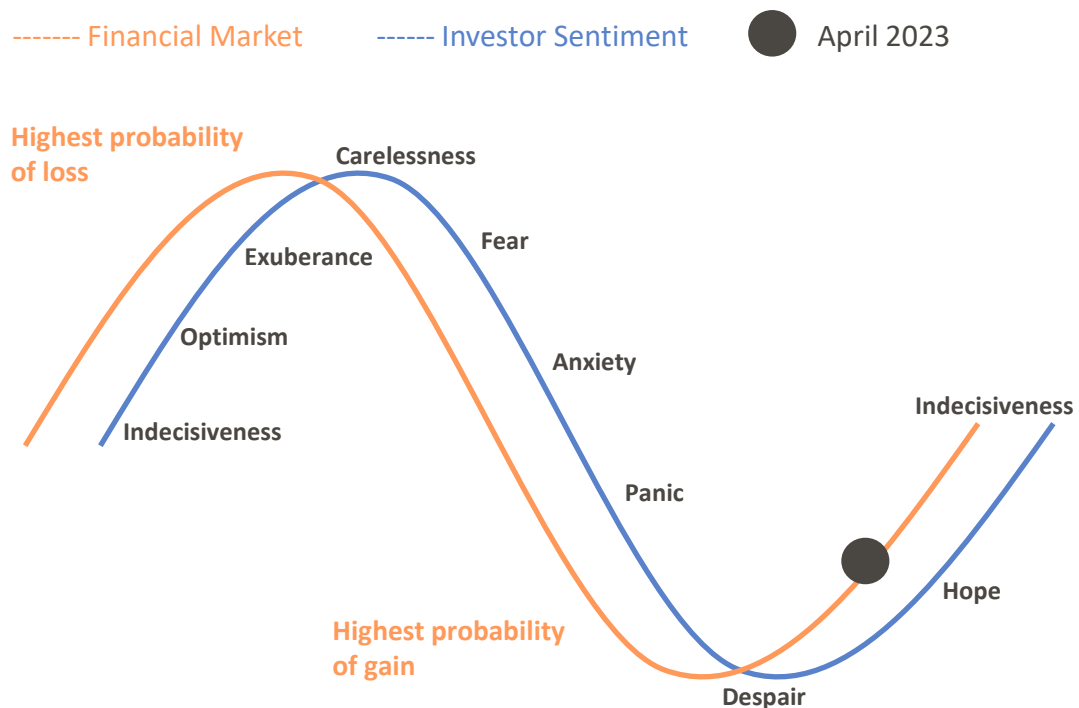
**Chart 6: Energy prices, e. g. natural gas, often lower than at the beginning of 2022**



Source: Bloomberg

# What will happen next

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



Nervousness and stronger market fluctuations are still to be expected. Interest rate development is currently the decisive factor for short-term financial market development. Stable labour markets and the ability of companies to raise prices speak for a continued robust economy, but also inflation development. Doubts about the stability of the banking sector should not become a permanent issue. Liquidity remains scarce and in high demand - this is how the central banks want it.

## Expectations and investment ideas in our portfolios

Our main scenario assumes a cautiously positive development of the financial markets on the basis of a stable, albeit not strongly growing, global economy in the coming months. The rise in interest rates should slow further before probably coming to a halt in the second half of the year in the USA and somewhat later in the eurozone.

Although there are arguments for reducing equity weightings in portfolios (e.g. tense geopolitical situation, threat of social unrest, restrictive monetary policy, tight liquidity), it seems too early for us to do so. European equity markets in particular still have room for further gains, measured by the valuation level (price/earnings ratio approx. 13x) and earnings estimates for 2023 (consensus estimate + 16%).

Bonds are now benefiting from the sharp rise in current interest rates, but are subject to a residual risk of further increases in yields and, in the event of a recession, also to rising credit risk and / or higher inflation expectations.

We expect particularly positive earnings contributions from investment ideas such as emerging market bonds (investment grade), corporate bonds (investment grade) with short to medium maturities, equities of precious metal and commodity mine operators, gold (physical) and alternative investments such as volatility premium strategies or reinsurance premiums ("cat bonds").

A broad diversification of opportunity and risk factors in the portfolio is important to us. We also explicitly take into account less likely risk scenarios such as a prolonged economic phase without growth and with high inflation. Commodity investments, physical precious metals, but also cryptocurrencies to an extent appropriate to the individual risk appetite act as "fire insurance" for the portfolio in this environment.

# Interesting questions we were asked...

## Value or Growth?

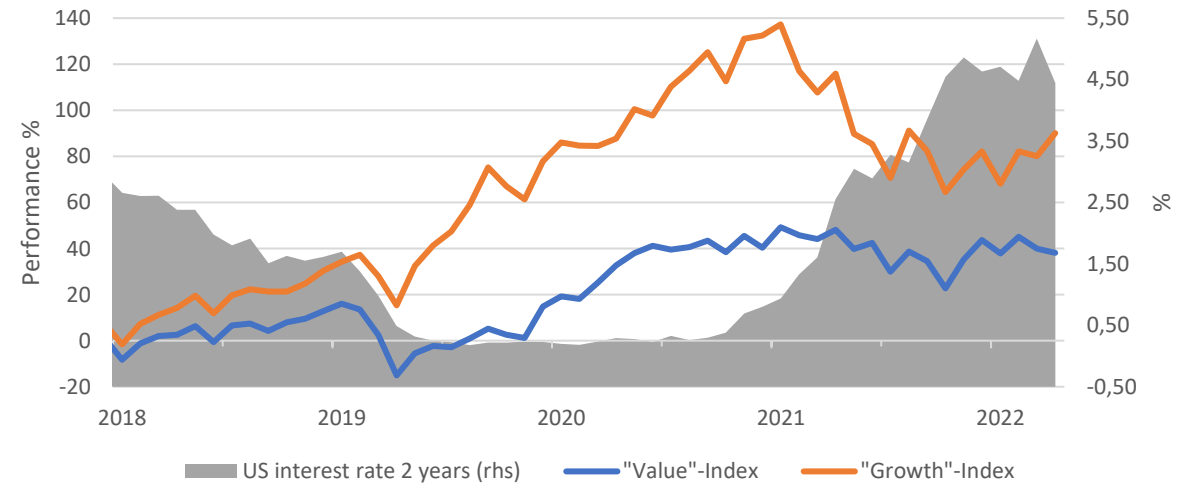
The question of whether it is better to buy shares that are considered to be value stocks in the face of rising inflation, rising interest rates and a rather weak economic situation or whether it is better to bet on shares whose business model promises strong growth in the future is currently the subject of controversial discussion, even among experienced investors. Definitions and understanding often differ. Connections are also made from time to time that do not necessarily make sense. For example: "Value" is suitable for conservative investors - dynamic investors prefer "Growth". Unfortunately, it is not that simple!

Companies that have high book values on their balance sheets and regularly pay dividends are not necessarily "value". In the same way, dividend-free but high-growth companies are not always "growth". Regardless of the already rather arbitrary criteria, we believe that a business model that does not bring investors any (real!) growth in the long term does not belong in the portfolio - regardless of which camp you assign it to.

The reason why "Value" came into focus after the years-long soaring of "Growth" is the sharp rise in interest rates since the beginning of 2022 and the resulting higher discounting of future cash flows in the investment valuation. These should be significantly higher for "Growth" (one expects high profits in the future) and thus trigger a stronger negative reaction of the share price to rising interest rates (chart 7). Growth shares achieved significantly stronger price gains than value shares during the low-interest-rate phase in 2019/2020. With the sharp rise in interest rates from the end of 2021, this advantage was initially reversed and then led to a sideways movement.

In the long run, however, the real "return engine" of growth lies in the development of new products or services and the resulting exponentially growing profits in case of success. We implement this idea in the portfolios we design, among others, in various future topics (e.g. "Internet next generation", future mobility, clean technology or BioHealth).

Chart 7: „Value“ or „Growth“ –interest rate development is not all but important



Source: Bloomberg

We like equity investments with a moderate dividend yield and a lot of qualitative growth. It is not for nothing that successful dividend funds have always focused on dividend growth.

For pure dividend strategies, we only see sense in strategies clearly focused on regular income generation.

The old Warren Buffett quote still applies: "Price is what you pay. Value is what you get."

Our primary objective is to ensure that our clients achieve real compensation for the depreciation of money over the agreed investment horizon. For us, therefore, in addition to the actual "craftsmanship" of the fund managers, things like creativity, consistency in action and far-sighted anticipation are decisive in the selection of investment forms. In our experience, this is the only way to achieve an attractive risk-adjusted performance.

## 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.

We do not guarantee the accuracy, completeness and timeliness of the data contained therein. We do not accept any liability for any damage resulting from the use of the data and information presented.

### Contact to BPM

Phone +49 30 887 10 87 0

E-Mail [info@berlin-pm.com](mailto:info@berlin-pm.com)

Website [www.berlin-pm.com/en](http://www.berlin-pm.com/en)

