M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

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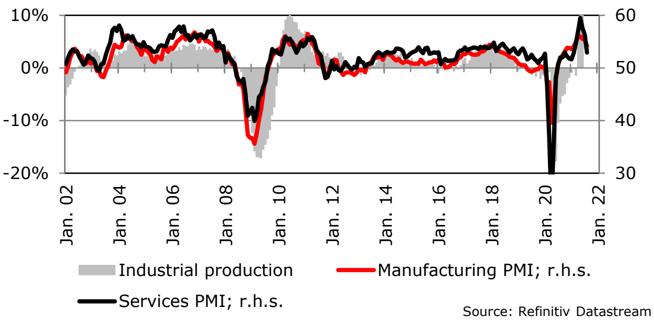
Share price targets raised despite growth dip

After the global economy put in a near-record, year-on-year performance in the second quarter it looks like things are going to cool off a bit in the third quarter of this year. This is partially due to the comparative base effect but also to the increasing spread of the Covid delta variant in parts of the world, which is slowing the economic normalization process and even brought back lockdowns and economic restrictions. This applies to some extent to the USA and Japan but mostly to China and other mainland Asian economies. As in the past, the services sector has been hit harder than manufacturing. The primary economic effect in industrialized countries came from persistent supply chain problems for important input materials as well as the lack of skilled labor.

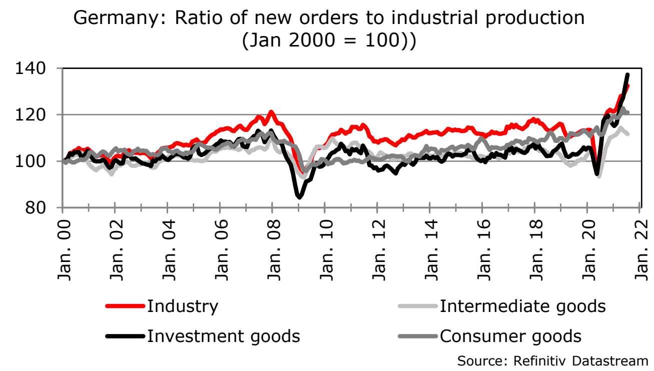
Global PMIs and OECD-industrial production y/y



Source: Refinitiv Datastream

Emerging economies suffered most from new infections with Covid. This affected Asia more than Latin America or Eastern Europe due to China's drastic reactions. It's zero-tolerance policy hit the domestic tourism industry hard and resulted in shutting down major ports. This caused the purchasing managers' indices for manufacturing and services to slip below the 50-points mark for the first time in over a year in August, which is their lowest level since the end of 2008 excepting February 2020. Considering the fact that the Chinese economy had already contracted quarter-on-quarter in Q2/2021, there is an increased risk that Q3/2021 could bring another disappointment. If this were to happen, the Chinese growth target of 6 percent would be at risk. That would be bad news for all of China's trading partners and especially its Southeast Asian neighbors.

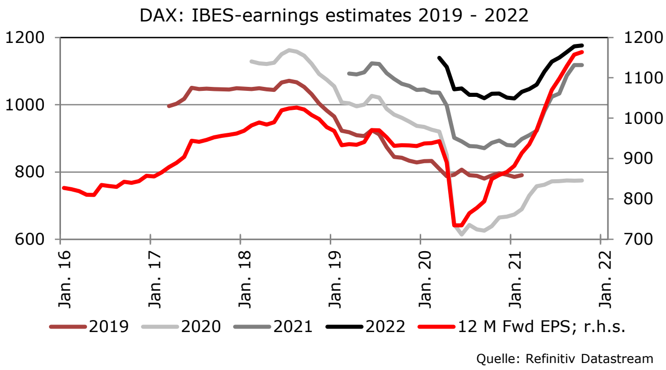
However, the purchasing managers' indices did not fall this markedly all across the globe in the past few months. Euroland made a welcome exception with both manufacturing and service PMIs remaining near their all-time highs. And the German companies surveyed again expressed great optimism. After economic momentum already increased substantially in the second quarter, quarter-on-quarter growth should accelerate some more in the current third quarter. For the year as a whole, though, German economic growth should total only some three percent thus falling a bit short of our original expectations after a weak start into this year. However, the prerequisites for a sustained economic upswing possibly even at a higher rate around five percent next year are still given. After all, the order books of German enterprises are fuller than ever. When input product supply chains normalize again there will be no more obstacles to vigorous production growth. That could give Germany an edge in economic growth over most of Euroland next year after huffing and puffing at the tail end of the field this year. We expect overall economic growth in Euroland of 5.5 percent this year and 4 percent in 2022.



What does that mean for the German stock market? The DAX has been trading in a relatively narrow range between 15,400 and 16,000 index points since the beginning of May. Even the outstanding Q2 reporting did not take the DAX out of its rut in contrast to the S&P 500 and the EURO STOXX 50. This may be due to the fact that German economic forecasts had to be revised downward at the time but uncertainties ahead of Germany's federal elections on 26 September could also have figured into this. Unless Germany's new ruling coalition will be comprised of the social democrats (SPD), green party (die Grünen), and the socialist party (Linkspartei), there will probably be only marginal direct impact of the elections on the DAX.

We believe that DAX earnings expectations inadequately reflect the favorable economic outlook. Although expected earnings growth for 2021 has been revised upwards from almost 25 to just short of 60 percent since the beginning of the year, the growth forecast for 2022 dropped from 16 to 4 percent. That would make the earnings growth forecast lower than he expected nominal economic growth. Earnings growth expectations for 2023 have also dwindled from 12 percent to 8 percent since the beginning of the year. The equal-weighted mean of earnings changes in all DAX 30 stocks, however, only comes to eight percent for each of the next two years. Based on the new DAX 40, earnings forecasts average 10 percent growth next year and 11 percent the year after that.

A comparison with earnings outlooks for other stock markets shows that corporate analysts looking at German stocks are exceedingly conservative. Similarly low and even lower expectations only apply to the earnings of TecDAX companies (+2.6 percent), the Dow Jones Industrial (+2.9 percent) and the EURO STOXX Large 200 (+4.2 percent). All of the other indices in our tracking universe (26 in total) indicate 14 percent earnings growth on average next year. Woe to whosoever believeth that such cautious earnings expectations would coincide with a higher index valuation (as this would limit the disappointment potential)! The DAX P/E on which the earnings expectations for the following twelve months are based currently stands at 13.8, which is significantly lower than the 15.7 at the beginning of the year. Even an averages comparison to other indices shows that there are hardly any other stock exchanges with similarly low valuations.

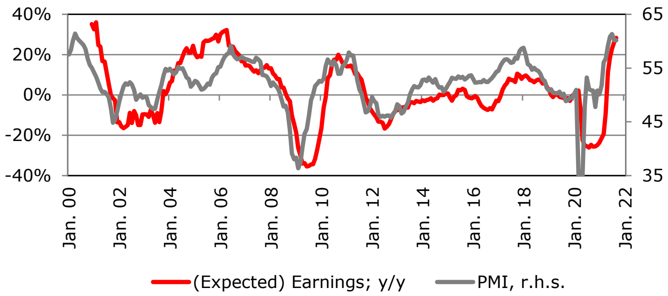


Assuming that this low valuation is going to stand for the time being but that corporate earnings will increase next year not just by four but by ten percent, the year-end DAX target will be much higher than under our previous assumptions. Indeed, this would put the fair year-end DAX value rather at 17,000 index points than the previous value of 16.500 index points. However, we assume that this knot may not be unraveled until after Germany's federal elections and depending on how long it will take to form what ruling coalition will investors be willing to turn Germany's better economic and earnings prospects into higher stock quotes.

We are also raising our price targets for the EURO STOXX 50 and Germany's STOXX 50. Euroland's economic outlook remains robust. Daily new Covid infections dropped from just over 93,000 cases at the end of July to recently below 70,000 and the number of Covid deaths remains relatively low. We consider a year-end EURO STOXX 50 level of 4,500 index points (previously 4.350 index points) realistic and raise our German STOXX 50 forecast for the end of the year from 3,550 to 3,800 index points. Both indices are higher valued (EURO STOXX 50: 17.2, German STOXX 50: 16.3) than the DAX and have higher earnings expectations for 2022 (EURO STOXX 50: +8.9 percent, German STOXX 50: +6.2 percent). Combining the slightly lower valuations with the somewhat higher earnings outlook means new price targets. Pease note that the earnings expectations for the EURO STOXX 50 and the German STOXX 50 are still 30 percent below their historic highs from

2007 while DAX earnings expectations are at an all-time high.

Euro Stoxx 50: Earnings and PMI



Source: Refinitiv Datastream

We furthermore revised our price target for the S&P 500 (4,400 index points). The US economy grew vigorously in the first half of this year but recently the business outlook has clouded over. The marked rise in daily new Covid infections is spooking businesses and consumers alike worried about new mask mandates, travel restrictions, and event cancellations. The recent labor market report surprised on the negative side and consumer sentiment is deteriorating with retail sales going south. However, not all is lost just yet. Although the Atlanta Fed growth tracker only forecasts 3.7 percent quarter-on-quarter growth for the third quarter of 2021 representing 0.5 percent quarter-on-quarter real-economic GDP contraction, we do not think that this is very likely. The New York Fed's Weekly Economic Index has been a more dependable indicator in the past. And the WEI currently signals almost eight percent year-on-year growth, which also indicates healthy quarter-on-quarter growth.

Despite what we consider persistently good fundamental data, the stock market may develop some purely seasonal volatility given that September and October are notoriously difficult months for the stock exchange. We are still raising our year-end index forecast for the S&P 500 from 4,400 to 4,800 index points for two reasons. On the one hand, it looks as if the USA, too, may have reached the crest of the delta wave; and on the other, and more importantly, the earnings expectations for the S&P 500 are too low. This becomes evident when scrutinizing the quarterly earnings estimates. Current figures assume 7 percent quarter-on-quarter earnings declines for the third quarter, which seems unrealistic if the economy grows as expected. We saw a similar treatment of earnings estimates ahead of the Q2 reporting season. In June, market observers expected eight percent quarter-on-quarter earnings declines. The actual figure turned out to be eight percent earnings growth. Assuming a similar development in the third and fourth quarters (with current earnings expectations even below the second quarter) earnings estimates for the whole years of 2021 and 2022 have to be revised upwards. Presuming unchanged valuation multipliers, the new price target comes to 4,800 index points.

Investors will be well advised not to rush into the market and recklessly raise their equity ratios. For seasonal reasons and due to weakening economic momentum volatility may increase in the short term. However, any larger market correction should be rather viewed as an opportunity than a risk. The continuing positive outlook for earnings and economic momentum should dominate stock market sentiment in the medium term.

Market data

Stock marktes	As of 10.09.2021 09:12	Change versus 03.09.2021 -1 week	09.08.2021 -1 month	09.06.2021 -3 months	09.09.2020 -1 year	31.12.2020 YTD
Dow Jones	34879	-1,4%	-0,6%	1,3%	24,8%	14,0%
S&P 500	4493	-0,9%	1,4%	6,5%	32,2%	19,6%
Nasdaq	15248	-0,8%	2,6%	9,6%	36,9%	18,3%
DAX	15641	-0,9%	-0,7%	0,4%	18,2%	14,0%
MDAX	36125	0,2%	1,5%	6,9%	31,2%	17,3%
TecDAX	3943	0,2%	2,9%	15,5%	27,5%	22,7%
EuroStoxx 50	4177	-0,6%	0,0%	2,0%	25,6%	17,6%
Stoxx 50	3570	-1,2%	-1,5%	1,7%	19,1%	14,8%
SMI (Swiss Market Index)	12116	-1,9%	-1,6%	2,8%	16,4%	13,2%
Nikkei 225	30382	4,3%	9,2%	5,3%	31,9%	10,7%
Brasilien BOVESPA	115361	-1,3%	-6,2%	-11,2%	13,9%	-3,1%
Russland RTS	1728	-0,3%	5,3%	3,2%	43,9%	24,6%
Indien BSE 30	58305	0,3%	7,2%	12,3%	52,7%	22,1%
China CSI 300	5013	3,5%	0,6%	-4,3%	9,4%	-3,8%
MSCI Welt (in €)	3136	-0,6%	0,6%	7,9%	30,3%	20,9%
MSCI Emerging Markets (in €)	1300	-0,9%	-0,2%	-2,4%	19,1%	4,4%
Bond markets						
Bund-Future	172,28	-289	-424	-28	-140	-536
Bobl-Future	135,57	64	33	123	54	39
Schatz-Future	112,26	-1	-7	7	-3	-2
3 Monats Euribor	-0,54	3	3	2	-5	4
3M Euribor Future, Dec 2017	-0,54	0	0	-1	-2	0
3 Monats $ Libor	0,12	0	-1	-1	-13	-12
Fed Funds Future, Dec 2017	0,08	0	-1	0	5	0
10 year US Treasuries	1,31	-1	0	-17	61	40
10 year Bunds	-0,36	0	15	-11	10	22
10 year JGB	0,04	1	3	-2	2	2
10 year Swiss Government	-0,31	2	8	-10	13	19
US Treas 10Y Performance	706,64	0,4%	0,6%	2,4%	-2,9%	-1,3%
Bund 10Y Performance	674,86	0,0%	-1,0%	1,4%	-0,5%	-1,4%
REX Performance Index	494,88	-0,3%	-0,7%	0,2%	-0,9%	-0,9%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	0,21	1	10	-4	3	19
IBOXX BBB, €	0,57	1	10	-8	-38	2
ML US High Yield	4,59	0	-10	-7	-134	-39
Convertible Bonds, Exane 25	8311	0,0%	-0,1%	-0,9%	6,2%	-0,2%
Commodities						
MG Base Metal Index	444,70	1,7%	3,5%	2,1%	42,2%	25,4%
Crude oil Brent	72,14	-0,8%	4,2%	-0,2%	76,7%	39,0%
Gold	1801,28	-1,8%	4,2%	-4,7%	-7,4%	-5,1%
Silver	24,08	-2,7%	2,8%	-13,6%	-10,1%	-8,7%
Aluminium	2828,75	4,1%	11,4%	14,5%	62,1%	43,3%
Copper	9369,25	-0,5%	0,3%	-5,9%	38,6%	20,9%
Iron ore	133,82	-7,6%	-22,9%	-36,3%	5,6%	-14,1%
Freight rates Baltic Dry Index	3643	-7,6%	8,1%	46,8%	181,1%	166,7%
Currencies						
EUR/ USD	1,1833	-0,3%	0,6%	-3,0%	0,5%	-3,6%
EUR/ GBP	0,8538	-0,3%	0,7%	-1,0%	-6,0%	-4,6%
EUR/ JPY	130,08	-0,4%	0,4%	-2,5%	4,0%	2,8%
EUR/ CHF	1,0844	-0,2%	0,5%	-0,6%	0,4%	0,4%
USD/ CNY	6,4426	-0,2%	-0,7%	0,9%	-5,7%	-1,3%
USD/ JPY	109,72	0,0%	-0,5%	0,1%	3,3%	6,3%
USD/ GBP	0,72	0,1%	-0,1%	1,9%	-6,2%	-1,4%

Source: Refinitiv Datastream

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