M.M.WARBURG & CO
BANK

ECONOMIC SITUATION AND STRATEGY

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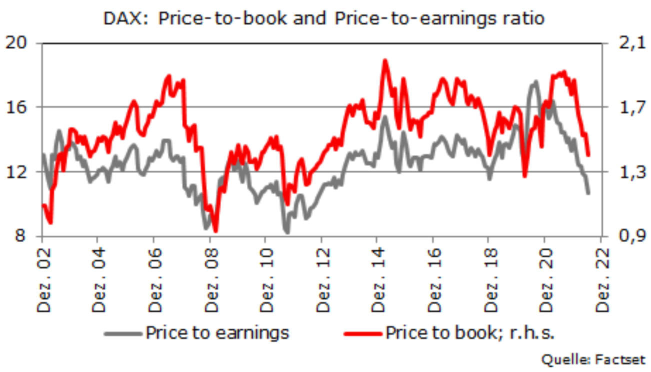
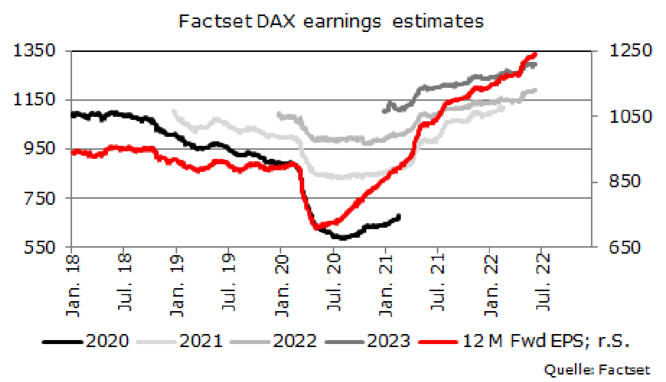
Frankfurt, New York, Tokyo,…: We have a problem!

The negative signs continue to dominate the stock markets. Even if there are strong price recoveries on individual days, the predominant trend is downwards. High inflation rates, a more restrictive monetary policy, rising interest rates, the war in Europe and corona lockdowns in China are taking their toll this year. Investors need nerves of steel in these times - and patience, because a quick turnaround for the better is not yet in sight. Since the beginning of the year, the MSCI World Equity Index is now more than 20 percent down, and the MSCI World SRI Index, which tracks particularly sustainable companies, has even lost almost 25 percent in value.

The price losses so far are mainly due to the significant rise in interest rates, to which growth stocks with high expected growth rates react particularly sensitively. Higher interest rates mean that the discount factor for future profits increases and their present value decreases. Lower valuation multiples are the result. The price losses seen this year are due to the fact that price-earnings ratios have fallen significantly. For example, US technology stocks, which have been the best performers in recent years and have led the equity boom, are down 30 percent since the beginning of the year because their P/E ratios have fallen from 30 to 20. The good news is that while stocks have been highly valued and expensive from a historical perspective in recent years, this is no longer the case. US stocks are valued at the same level as the average of the past 20 years, European indices such as the DAX or the Stoxx 50 Europe are even much cheaper. Nevertheless, this does not automatically mean that these are already buying prices again. As long as interest rates rise, valuations will remain under pressure. One should currently assume that the central banks, which were always the best friends of investors in the past years because monetary policy was eased in every approaching crisis, have now become the biggest enemy. Fighting inflation has the highest priority, an economic slowdown is accepted, and the stock market plays no role in monetary policy calculations, at least for the moment.



In addition, there is an even bigger crux: in view of the darkening economic scenario, expectations for corporate profits this year and next are likely to be too optimistic. For the DAX companies, corporate analysts have raised their profit forecasts until recently. At the beginning of the year, an increase of four percent was expected for 2022, meanwhile it is a good six percent, and in 2023 a further increase of just under ten percent is still expected. The situation is similar for the S&P 500, where earnings are expected to rise by ten percent this year and ten percent next year. But how realistic are these expectations? On the one hand, the estimates reflect higher inflation (this explicitly reflects the inflation protection that stocks offer in times like these) and, on the other hand, the stable or even better profit margins of companies. Even if earnings estimates in the major indices are still stable, there is a lot of movement beneath the surface and at industry level. In the US, where the best and most meaningful data sets are available to assess changes in forecasts at the sector level, forecasts have been significantly reduced in the consumer sectors, and the same can be observed in the communications sector and in tech stocks. At the index level, this is offset by very positive earnings revisions in the energy and commodities sectors.



What profit expectations do not take into account, however, is a more negative economic scenario. The spectre of stagflation has now become a reality, and companies are likely to find it harder to pass on prices to customers. In Germany, the economy treaded water in the first half of the year and hopes for a better second half have faded. In the upcoming holiday season we will once again enjoy ourselves and spend a lot of money, but after that the coffers will probably be pretty empty. After all, real disposable income is falling more sharply than at any time since German reunification. For this reason, we are reducing our growth forecast for the German economy this year from 2.2 to 1.7 percent. Without the statistical overhang of 1.1 percentage points, this would almost amount to stagnation. For 2023, most economic observers expect growth to accelerate, but this does not seem to us to be a realistic assumption. The high inflation rates will have a dampening effect on consumption, as well as higher interest rates and worse financing conditions. In Europe, there is also uncertainty about the security of our energy supply. In other words, the risks of recession are increasing, not only here, but worldwide. For this reason, we expect German real gross domestic product to grow by only 0.9 percent in 2023. At the moment, leading indicators such as the Ifo Business Climate Index or the Purchasing Managers' Indices speak against an even more pessimistic economic scenario, although there is a risk that these will weaken in the coming months.

Although the mostly solid balance sheets of companies, the low indebtedness of most private households and the still high demand for labour in the USA and the Eurozone argue against a strong economic downturn, current earnings expectations are probably too optimistic even in the case of stagnation or a mild recession. Thus, stock markets are currently under pressure from two sides: higher interest rates due to tighter monetary policy lead to lower valuation multiples, and the weakening economy puts pressure on earnings expectations - a perfect storm.

Despite the already large losses in the stock markets, we continue to advise caution at the moment. In the foreseeable future, the DAX is likely to tackle its low for the year at 12,500 points again. Should this level not hold, the book value at just under 10,000 points represents the decisive catch-up line in the worst-case scenario. This line served as a lower limit during the two major downturns in 2002 and 2008, at which point at the latest the stock ratio must be increased again. Since one will only catch the lower turning point with luck anyway, one should also hold a basic portfolio of shares with little dependence on the economy and good pricing power in this market phase. If there is no recession or inflation recedes faster than currently expected, this would pave the way for a significant price recovery. If you don't have any shares in your portfolio, you will be running behind the recovery. Moreover, even in this difficult market phase, the upward trend dominates the stock markets in the long term. So far, all price losses incurred in times of crisis have been recovered and investors have been compensated for having to go through a valley of tears. We are convinced that it will be the same this time.

Market data

Stock marktes	As of 23.06.2022 08:24	Change versus 09.06.2022 -1 week	13.05.2022 -1 month	15.03.2022 -3 months	15.06.2021 -1 year	31.12.2021 YTD
Dow Jones	30483	-5,5%	-5,3%	-9,1%	-11,1%	-16,1%
S&P 500	3760	-6,4%	-6,6%	-11,8%	-11,5%	-21,1%
Nasdaq	11053	-6,0%	-6,4%	-14,6%	-21,5%	-29,4%
DAX	13144	-7,4%	-6,3%	-5,6%	-16,4%	-17,3%
MDAX	27246	-8,1%	-5,5%	-10,2%	-20,2%	-22,4%
TecDAX	2857	-8,1%	-7,1%	-8,3%	-18,4%	-27,1%
EuroStoxx 50	3465	-7,0%	-6,4%	-7,3%	-16,4%	-19,4%
Stoxx 50	3397	-5,7%	-5,8%	-3,4%	-4,7%	-11,0%
SMI (Swiss Market Index)	10528	-7,0%	-9,6%	-9,9%	-11,7%	-18,2%
Nikkei 225	26171	-7,3%	-1,0%	3,3%	-11,1%	-9,1%
Brasilien BOVESPA	99522	-7,1%	-6,9%	-8,7%	-23,5%	-5,1%
Russland RTS	1403	15,7%	23,9%	49,8%	-15,7%	-12,1%
Indien BSE 30	52416	-5,3%	-0,7%	-6,0%	-0,7%	-10,0%
China CSI 300	4333	3,8%	8,6%	8,8%	-16,1%	-12,3%
MSCI Welt	2537	-6,8%	-6,1%	-11,5%	-15,9%	-21,5%
MSCI Emerging Markets	994	-6,9%	-1,1%	-3,2%	-27,9%	-19,4%
Bond markets						
Bund-Future	145,28	-252	-848	-1669	-2704	-2609
Bobl-Future	121,91	-122	-587	-920	-1234	-1133
Schatz-Future	108,32	-40	-221	-316	-386	-372
3 Monats Euribor	-0,16	42	42	41	38	43
3M Euribor Future, Dec 2017	1,46	27	90	0	199	2
3 Monats $ Libor	2,03	31	59	111	190	182
Fed Funds Future, Dec 2017	3,43	65	79	0	333	3
10 year US Treasuries	3,16	12	22	100	166	166
10 year Bunds	1,65	21	70	136	188	183
10 year JGB	0,23	-2	-1	2	19	16
10 year Swiss Government	1,37	28	61	99	158	151
US Treas 10Y Performance	591,68	-2,9%	-3,1%	-10,2%	-14,2%	-15,3%
Bund 10Y Performance	560,35	-2,0%	-6,4%	-11,6%	-15,7%	-15,4%
REX Performance Index	448,75	-1,5%	-3,7%	-6,2%	-9,1%	-8,6%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	2,82	42	93	156	256	234
IBOXX BBB, €	3,84	52	102	184	319	296
ML US High Yield	8,36	76	72	185	374	346
Convertible Bonds, Exane 25	6461	0,0%	-5,6%	-11,4%	-22,8%	-21,1%
Commodities						
MG Base Metal Index	448,05	-5,2%	-0,6%	-16,0%	4,7%	-2,9%
Crude oil Brent	110,49	-10,3%	-1,1%	11,3%	49,3%	40,9%
Gold	1833,83	-0,5%	1,0%	-4,7%	-1,4%	0,6%
Silver	21,52	-1,0%	2,5%	-13,7%	-21,6%	-7,5%
Aluminium	2569,50	-6,0%	-6,9%	-20,8%	4,3%	-8,4%
Copper	9224,50	-4,1%	0,4%	-6,4%	-3,3%	-5,3%
Iron ore	127,92	-10,9%	-3,3%	-11,6%	-40,2%	13,7%
Freight rates Baltic Dry Index	2349	0,3%	-24,3%	-12,6%	-22,3%	6,0%
Currencies						
EUR/ USD	1,0559	-1,7%	1,7%	-3,9%	-12,8%	-6,8%
EUR/ GBP	0,8622	1,5%	1,4%	2,7%	0,2%	2,7%
EUR/ JPY	143,43	-0,3%	7,1%	10,6%	7,6%	10,0%
EUR/ CHF	1,0152	-3,3%	-2,2%	-1,6%	-6,9%	-1,7%
USD/ CNY	6,7056	0,2%	-1,3%	5,2%	4,7%	5,5%
USD/ JPY	133,84	-0,4%	3,6%	13,1%	21,6%	16,3%
USD/ GBP	0,82	2,4%	-0,2%	6,7%	15,1%	10,6%

Source: Refinitiv Datastream

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