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The Capital Markets Publication by Bergos Berenberg AG

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## Executive Summary



MAXIMILIAN HEFELE, CFA  
Head of Asset Management

Dear readers,

An old investing axiom has it that “equity markets are not influenced by politics for long” meaning that this is only a short term factor and that economic growth and corporate profits are the main factors driving capital markets in the medium and long term. But what does it mean when political risks themselves cause the economy to weaken?

The ongoing US-China trade war and the unresolved Brexit issue are now having an appreciably negative impact on the real economy. Central banks too are basing their expansive monetary policy on political uncertainties and are increasingly flooding the economy with extra liquidity to counteract them. Political risks are more relevant for capital markets today than they have been for a long time. And they remain incalculable, to the detriment of investors.

Unfortunately, it cannot be foreseen when and how the trade war or Brexit will be resolved. We therefore continue to expect heightened volatility in the equity markets. However, we are sticking with our neutral positioning because the aforesaid expansive



monetary policy is having a positive effect, equities are attractively valued compared to bonds and investors are cautiously positioned as an expression of healthy scepticism.

In terms of regions, we can reaffirm our positive assessment of US equities. The relative profit growth compared to other regions such as Europe and emerging-market countries is a clear argument in favour of the US region. And the all-important US consumer is still supported by the robust jobs market.

The bond market has benefitted again from lower interest rates. The very low yields and at times inverted yield structure of US Treasuries are a reflection of the scepticism of many investors. However, no clear picture has emerged. The flight to safe havens has not caused selling pressure on low credit-quality, high-yield securities. On the contrary, the demand pressure remains very high. Whether presumably safe government bonds or corporate bonds, the future return prospects for bonds are extremely low and in some cases even negative.

The flight to safe havens has also impacted precious metals. The price of gold soared again in the third quarter and is currently trading at around 1,500 US dollars per ounce. Given our continued expectation of interest rate cuts and no deflationary scenario in the US dollar zone, the relevant real yields should remain low. Our outlook for gold is therefore positive.

As a complement to our traditional capital markets outlook, we offer a guest article on the subject of art in the section “TOPIC – beyond Capital Markets”.

In this article, our art experts address the question: “Is art per se a bubble?”

With best wishes  
for an interesting read,  
sincerely yours,

MAXIMILIAN HEFELE, CFA  
Head of Asset Management



our House View

Bank View	--	-	0	+	++
<b>Equities</b>	○	○	●	○	○
<b>North America</b>	○	○	○	●	○
Consumer Discretionary	○	○	●	○	○
Consumer Staples	○	●	○	○	○
Energy	○	○	●	○	○
Financials	○	○	○	●	○
Health Care	○	○	○	●	○
Industrials	○	○	○	●	○
Information Technology	○	○	●	○	○
Materials	○	○	●	○	○
Real Estate	○	○	●	○	○
Communication Services	○	○	●	○	○
Utilities	○	○	●	○	○
<b>Europe</b>	○	●	○	○	○
Consumer Discretionary	○	○	●	○	○
Consumer Staples	○	○	●	○	○
Energy	○	○	●	○	○
Financials	○	○	○	●	○
Health Care	○	○	●	○	○
Industrials	○	○	○	●	○
Information Technology	○	○	○	●	○
Materials	○	●	○	○	○
Real Estate	○	○	●	○	○
Communication Services	○	○	●	○	○
Utilities	○	○	○	●	○
<b>Emerging Markets</b>	○	●	○	○	○



overview

Bank View	--	-	0	+	++
<b>Fixed Income</b>	○	●	○	○	○
<b>Denomination U.S. Dollar</b>	○	○	○	●	○
Duration	○	○	●	○	○
Sovereigns	○	○	○	●	○
Corporates Non-Financial	○	○	●	○	○
Corporates Financial	○	○	●	○	○
Senior	○	○	●	○	○
Subordinated Debt	○	○	●	○	○
Corporate High Yield	○	○	●	○	○
<b>Denomination Euro</b>	○	●	○	○	○
Duration	○	●	○	○	○
Sovereigns	○	●	○	○	○
Core	○	●	○	○	○
Peripheral	○	●	○	○	○
Corporates Non-Financial	○	○	●	○	○
Corporates Financial	○	○	●	○	○
Senior	○	○	●	○	○
Subordinated Debt	○	○	●	○	○
Corporates High Yield	○	○	●	○	○
<b>Emerging Markets</b>	○	○	○	●	○
Hard Currency	○	○	○	●	○
Local Currency	○	○	○	●	○
<b>Alternative Investments</b>	○	○	○	●	○
<b>Commodities</b>	○	○	○	●	○
Energy	○	○	○	●	○
Industrials Metals	○	○	○	●	○
Precious Metals	○	○	○	●	○
<b>Hedge Fund Strategies</b>	○	○	○	●	○
Long/Short	○	○	○	●	○
Relative Value	○	○	○	●	○
Macro	○	○	○	●	○
Event Driven	○	○	○	●	○
<b>Convertibles</b>	○	○	○	●	○
<b>Real Estate</b>	○	○	○	●	○

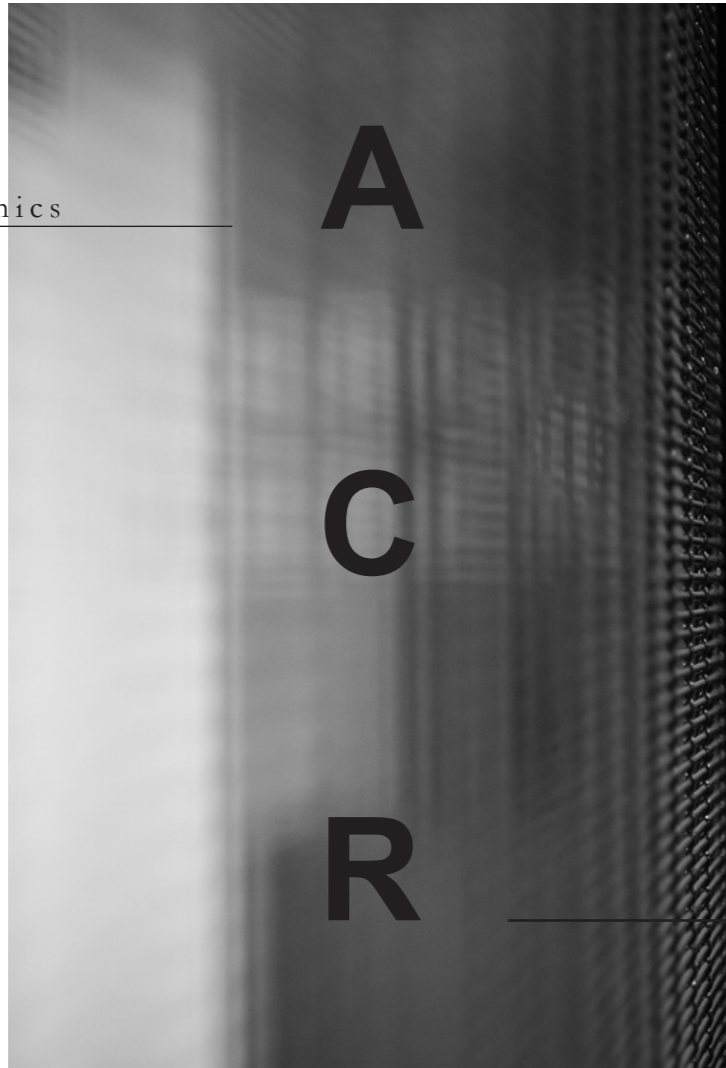
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### The global economy remains frail

The renewed escalation of the US-Chinese trade dispute in August is weighing on economic growth. The uncertainty resulting from the incalculable conflict is taking a heavier toll than the new tariffs that both sides recently imposed on each other. Companies in the Western world are increasingly holding back on capital expenditures.

### Costly trade dispute

The two sides are talking with each other again. However, their positions are apparently far apart. The United States continues to demand a verifiable reduction of subsidies for Chinese state enterprises, which could undermine the entire Chinese business model. The chances of defusing the conflict in the next three months have diminished. We now expect that the United States and China will reach a partial agreement next spring only, thus right before the US election campaign. Until then, global trade and manufacturing will probably remain weak. Germany, Italy, and the Brexit-weakened United Kingdom are currently on the verge of a mild recession.

### Divided economy

Many service industries throughout the Western world have so far been unaffected by the foreign trade turmoil. The construction sector is booming in many countries. However, manufacturing-related services are increasingly showing signs of slowing in Europe, Japan, and



Dr. HOLGER SCHMIEDING  
Chief Economist, Berenberg

even the United States. Employment growth is also weakening. This is particularly evident in Germany, which has specialised primarily in the production and exportation of cyclical capital goods.

### The bottom lies ahead

As long as the trade dispute does not worsen substantially in the coming months, companies could slowly become accustomed to the heightened uncertainty. We expect that the business climate will stabilise towards the end of the year. In that case, global trade and industrial production could bottom out in early 2020 and then slowly recover. If the United States and China reach an agreement, the recovery could then pick up steam in the spring of 2020. We consider this scenario to be probable. If the trade dispute worsens in 2020, however, the



Eurozone could slide into a recession. US growth would then weaken to around 1%.

#### **Brexit risk**

British Prime Minister Boris Johnson has failed in its attempt to disempower Parliament. His chances of agreeing on a new deal with the EU and having it ratified by Parliament in October are well below 50%. Instead, the country is presumably headed for Brexit postponement and new elections. The persistent uncertainty is crippling the economy. We see a risk of around 35% that the UK will ultimately leave the EU without a deal, i.e. a hard Brexit. In this case, the EU economy would suffer a temporary drop in economic output of 0.1-0.2%, while the UK would slide further into crisis. As a hard Brexit would no longer be a complete surprise, many companies have halfway prepared themselves for this risk. A hard Brexit would no longer be a genuine shock.

#### **Italy breathes easier**

The new centre-left government is making conciliatory overtures to the EU. The risk of an escalating budget dispute between Brussels and Rome that would unsettle markets and the economy has diminished. Italy has solved none of its economic problems, but it has won some time.

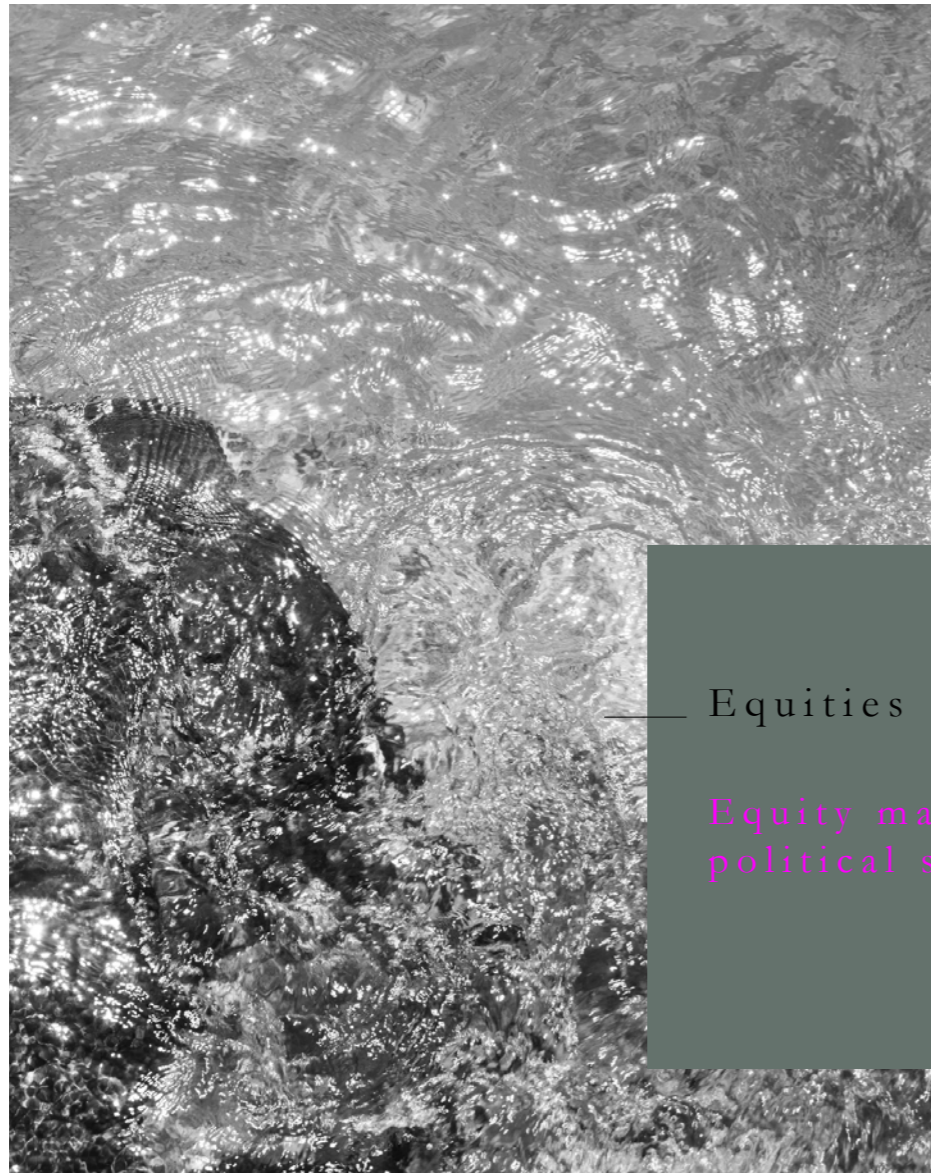
#### **Inflation risk fades further**

The downturn in Europe and slowing growth in the United States are dampening wage and inflation pressure.

#### **Central banks**

Given the absence of inflation risks, central banks can support the economy. The Fed lowered its base interest rate in July and September by 25 basis points at a time. We expect another such step in December 2019. The ECB lowered its deposit facility rate in September and announced a new bond purchasing programme. We do not expect any further steps by the ECB for now. Central banks will not be able to offset the damage of the US-Chinese trade war with their ultra-loose monetary policy, but they will lessen the risk that the weaker economy could trigger turmoil in the financial markets that could weaken the economy further. Overall, central banks and bond markets are acting as a kind of buffer. They are reacting to the weaker economy in such a way as to keep equity markets largely stable. If the economy revives again next year, that would lessen the pressure on bond yields more than it would drive big gains in the equity markets.

*Overall, central banks and bond markets are acting as a kind of buffer. They are reacting to the weaker economy in such a way as to keep equity markets largely stable.*



Equities

Equity markets defy political stress

- \_\_\_\_\_ Uncertainty has increased in capital markets
- \_\_\_\_\_ Unsettling factors for markets mainly include the trade war, the upcoming US elections, and Brexit in Europe
- \_\_\_\_\_ However, low relative valuations and investors' defensive positioning are lending markets a certain resilience
- \_\_\_\_\_ Greatest return potential can still be found in US equities



TILL C. BUDELMANN  
Equity Strategist

Capital markets are gripped by political stress. Various issues are causing uncertainty among investors, as evidenced by the development of the Global Economic Policy Uncertainty Index over the last few years, for example. However, a distinction should be made between rather short-term problems that are causing a lot of noise and those that reflect truly structural changes. One of the short-term “noise” factors is Italy, which should ease for now, however, after the formation of the new government. We also do not currently believe that the Iran conflict will have any major effects on capital markets, at least not as long as it does not escalate further, even to the point of war. As for the North Korea conflict, that is more political than economic anyway.



Fig 1: Global Economic Policy Uncertainty Index



Source: Bloomberg, Bergos Berenberg, Data as of 08/31/2019

### The US consumer is keeping the global economy afloat

Investors would be better advised to keep an eye on the protests in Hong Kong because China is involved. The civil unrest could lead to confrontations with the Western world concerning how the protests should be handled, and that could play into one of the truly important structural topics, the trade dispute. The hopes for a complete and speedy resolution of the US-Chinese trade war,

which were widespread just a few months ago, have since nearly died. A structural solution of the conflict now seems unlikely. There could possibly be a partial agreement, enabling US President Donald Trump to present himself as a dealmaker in the upcoming election campaign. We see this issue as a kind of cold war that could possibly go on for a long time. The trade dispute comes at a time when the global economy is already weakening. Global manufacturing is already in a recession. However, there is a great saviour

keeping the global economy afloat: the US consumer, who is spending prodigiously; and we do not yet see any signs that this will change anytime soon. Consumer confidence is still strong. Moreover, the recent quarterly reports of US retailers have been satisfactory. We therefore do not expect a recession in the United States in either 2019 or 2020. However, a protracted and escalating trade war would be a major problem.

### Trump has gone from being a source of hope to a factor adversely affecting markets

Another topic that could unsettle global capital markets, in our opinion, is next year's US presidential election. Donald Trump's re-election chances are currently somewhat below 50% or somewhat above 50%, depending on which Democrat candidate will oppose him. Trump had been a positive factor for equity markets thanks to his deregulation and tax reform. However, the market-friendly aspects of his policies have since run their course. His attitude towards trade, however, which now seems rather more extreme than conciliatory, is bad for markets. Once a source of hope, Trump is now a factor adversely affecting markets. However, it would be worse for markets if a candidate from the socialist wing, say Elizabeth Warren or Bernie Sanders, wins the Democrat primaries and then potentially even ousts Trump as President. The positive Democratic candidate is still the former Vice President Joe Biden, whose economic policy sounds moderate by

comparison.

A third structurally important issue is the UK's departure from the EU. Boris Johnson's election as Prime Minister had substantially increased the probability of a departure before the end of this year. After the recent developments, anything is possible again. It is very hard to say when, how, or even if Brexit will happen and no one can truly predict the consequences of a no-deal exit. Above all, it seems doubtful that companies are truly as well prepared as market participants are assuming. On the other hand, Brexit is essentially a European issue of only limited global significance.

### US equities supported by the Fed

The effects of political stress are already observable in bond markets. Safe havens are in demand. The yields of 10-year US Treasuries have come down substantially, while the yields of 10-year German Bunds have fallen to record lows in negative territory. On the other hand, the uncertainties are not as evident in equity markets as one might expect from reading the headlines. For example, the US equity market has posted a solid double-digit gain since the start of the year. However, there are reasons for the relative resilience of equity markets. Compared to the bond market, equity valuations do not seem expensive and actually seem rather cheap. For example, the "yield gap" arrived at by subtracting the yield of 10-year US treasuries from S&P 500 dividend yield is currently 4.2 in the United States.



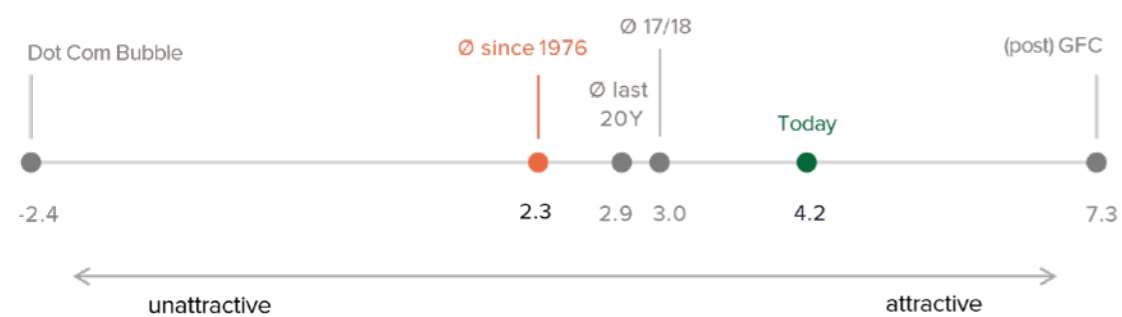
If you then compare this value with various averages of the last few years, equities appear to be relatively attractive in a cross-asset comparison. Furthermore, speculative market participants still tend to be cautiously positioned. They are not overloaded with equities that would then need to be unloaded on the market, as they were in early 2018, for example.

We consider a neutral positioning in equities to be appropriate in the current environment. Even though the bull market in the United States is now more than ten years old, we still prefer US equities to European and emerging market equities. We currently find ourselves in a volatile sideways market again. The question is whether equity markets can manage another leg up. For the United States, we would say this is more likely than not. We

expect US equity prices to continue rising into next year. The US equity market is supported by the monetary policy of the US central bank, which we currently expect will lower interest rates once more this year.

*In relation to the bond market, equity valuations do not appear to be expensive, but rather cheap.*

Fig 2: S&P 500 Earnings Yield Minus 10 Year Bond Yield (Today vs.  $\bar{\sigma}$  since 1976)



Source: Bloomberg, Refinitiv, Goldman Sachs, Bergos Berenberg, Data as of 09/30/2019



# CONFLICTING SIGNALS?

## Bond markets ponder the conflicting signals of recession fears and central bank stimulus

- \_\_\_\_\_ The global macro picture is dimming
- \_\_\_\_\_ Central banks around the world pivot to expansive monetary policy again
- \_\_\_\_\_ Persistent geopolitical uncertainty is pushing interest rates down
- \_\_\_\_\_ Yield curves point to further weakening



## The current situation:



RENÉ BOLHAR, CAIA  
Bond Strategist

The expectation of global economic slowing solidified in the past quarter and especially towards the middle of the year. After a long-lived upswing like the one that began after the global financial crisis of 2008/09, a gradual cooling of economic activity is not unusual. However, the current situation is also characterised by unusual factors such as the persistent uncertainty associated with geopolitical conflicts such as the trade dispute between the United States and China and the threatening escalation of armed conflicts, especially in the Arab region, which are additionally weighing on sentiment.

The world's major central banks have reacted by initiating accommodative measures in the form of expansive monetary policy. This was a surprising turn considering that a continuation of a more restrictive policy had been widely expected at the start of this year.

Although caution is certainly advisable, there is no reason to panic; after all, corporate profits are still largely solid and some macro indicators have been positive.

To understand whether and how market sentiment is actually reflected in the broader context of the international investment landscape, we are considering



the performance of global government bonds and corporate bonds. We are also focusing on investments in emerging-market countries because this is one of the last segments in which attractive risk-adjusted returns can still be found, in our opinion.

### So how did markets develop in the third quarter?

Not in a linear fashion. Whereas markets were basically waiting for more clarity with respect to the expected central bank measures at the start of the quarter, they regained momentum in the month of August. Then the focus of investors shifted as an escalation by the United States in the form of newly announced punitive tariffs in early August was followed by a series of counter-measures on both sides. Markets finally came to the realisation that the trade conflict will probably not be resolved in the near future. This realisation, in turn, impacted the Fed, which is now expected to implement considerably more expansive measures in the form of further interest rate cuts. The market currently expects up to three interest rate cuts by the end of next year as a means of offsetting the impact of negative factors, even though two interest rate cuts had already been implemented in the summer months.

The European Central Bank (ECB) reacted to the changed situation by reducing the deposit facility rate by another 10 basis points to -0.5% and resuming its bond purchasing programme in November.

## But are these factors already manifesting as hard facts – in the market?

One of the important leading indicators is the Purchasing Managers Index (PMI) of the major industrialised nations. Notably, this index shows that market participants expect only marginal growth, if any at all, in wide parts of the global economy. This makes it clear that economic activity has slowed markedly, even independently of the currently detrimental influence of geopolitical disputes. The PMIs are relevant because they are based on numbers relating to new orders, production, and employment and therefore give an indication of market expectations. But other indicators, mainly those focused on manufacturing, also paint a picture of weakening growth. That leaves consumer spending as the only element supporting the economy, especially in the United States.

In parts of Europe, but especially in Germany, a technical recession – defined as two consecutive quarters of negative growth – can be expected in the near future. This is doubtlessly a reflection of the international trade conflicts.



## Is this uncertainty already affecting fixed-income investments?

Yes. Taking a somewhat closer look at the markets for fixed-income investments, it makes sense to begin with government bonds and corporate bonds because they account for the lion's share of outstanding global bonds. However, they are complex and should therefore be differentiated. Government bonds can refer to those of top-rated issuers in both industrialised nations and emerging-market countries. However, this term also refers to lower-quality issuers with a more

speculative profile. Corporate bonds can be differentiated by issuers in industrialised nations vs. emerging-market countries, but also on the basis of rating and industry, financial vs. non-financial issuers, or capital structure. In both segments, moreover, specific companies or countries are influenced by unique factors. Therefore, a generalised assessment of individual segments is difficult. Broadly speaking, the developments of the past quarter have led to a significant decline in the bond yields of top-rated sovereign issuers, i.e. those bonds that are commonly known as safe haven assets. The current yield of 10-year US Treasuries, which had been above 2% at the beginning of the quarter, declined by more than 50 basis points at the start of September. The government bonds of Switzerland and Germany underwent a similar development.

That being said, the corporate bond

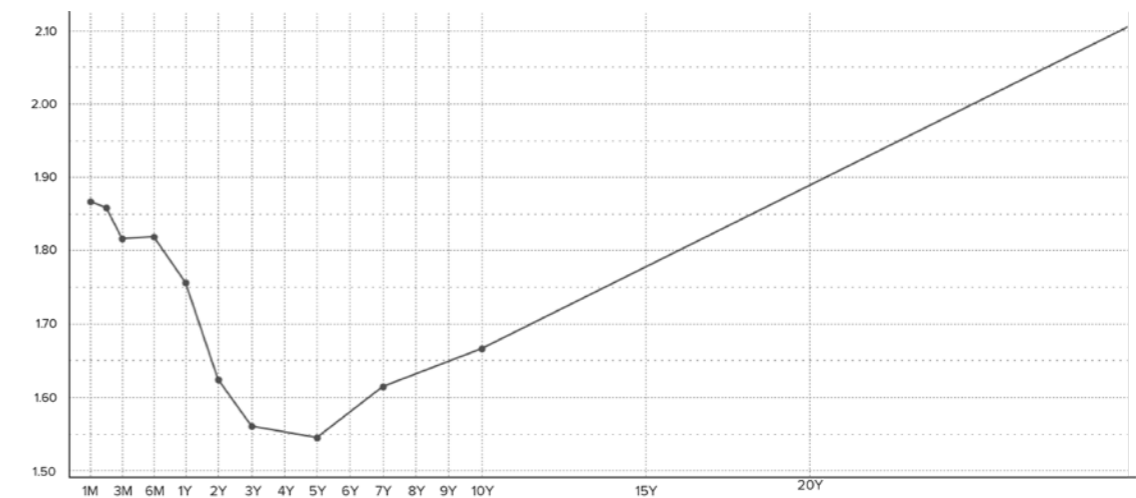
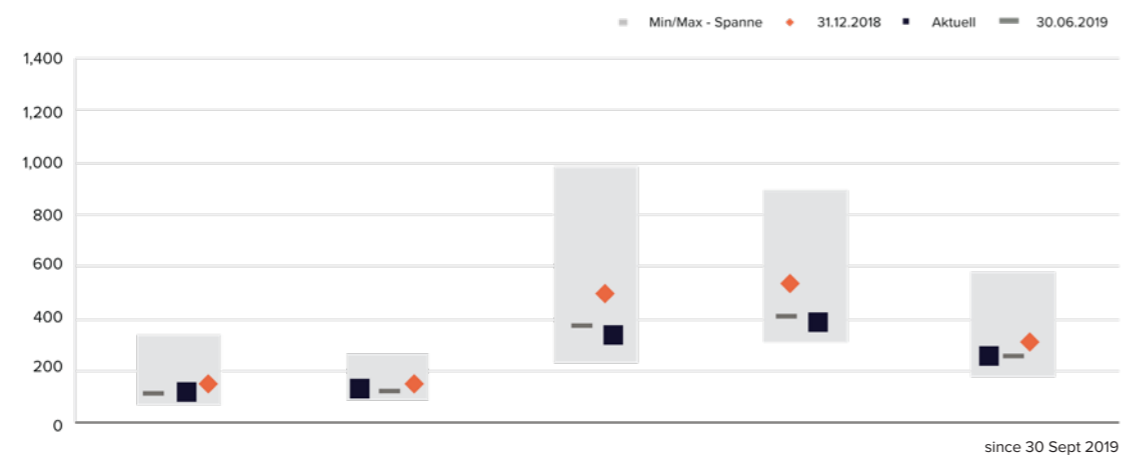


Fig 1: US Treasury Actives Curve Last Mid YTM  
Source: Bloomberg, Bergos Berenberg, Data as of 09/30/2019



market is apparently not impressed by this development. The intensity of negative headlines has lessened the risk appetite of investors, which would normally adversely affect the development of credit risk spreads.

Fig 2: Credit spreads on investment grade and high-yield bonds in EUR and USD  
Period 1 Oct 2009 until 30 Sept 2019



Source: Bloomberg, Bergos Berenberg, Data as of 09/30/2019

However, this effect is more than offset by the increasingly expansive course of central banks, so that credit spreads are either unchanged or even slightly tighter now than in the preceding quarter.

**Side Note:  
Risk Mark-Ups**

In order to compensate the potential investor for the higher risk, issuers of fixed income securities have to pay a premium over securities considered risk-free, usually government bonds, the lower the quality of the issuer and the longer the maturity, the higher the premium.



**Caution - yes.  
Panic - no!**

Key financial indicators have not deteriorated markedly. Both the fundamental situation and new issuance activity in the third quarter can be described as positive. New bond issues have been well absorbed by the market, so this has not been a negative factor leading to wider spreads.

In the current environment, we still see the danger of widening risk spreads especially if the overall economic situation worsens further. We continue to focus on high-quality companies in the medium to upper rating segment with solid financial data and a broadly diversified, crisis-resistant market positioning. We recommend a selective and opportunistic approach to high-yield bonds and bonds with low investment-grade ratings.

**Side Note:  
Carry**

A carry is the return on regular payments made by investing in a fixed-interest security. Those with higher coupons, i.e. regular payments, have a higher carry because a higher return is generated by the fixed regular payments if the valuation of the security remains the same.

As for the future path of interest rates, we believe they can fall even further, also in view of the policy pivot of major central banks. The slowing of global economic momentum is undeniable. We expect that US Treasury yields will be lower at the end of this year than they are now. Due to the mitigating effect of central bank measures, the effect on risk spreads will probably be limited; thus, duration and the interest effect will likely still be the driving force behind the development of yields.

In our opinion, special attention should be paid to investments in emerging-market countries. Expansive monetary policy measures also continue to have a positive effect on emerging-market investments, both in hard currency (US Dollars) and local currency. The usually higher coupons of emerging-market bonds deliver a steady carry and therefore a relatively constant performance contribution. Barring a dramatic escalation of the trade conflict or a massive decline in global economic growth, we see this segment as one of the last remaining attractive portfolio additions in the fixed-income sector.



# COMMODITIES

- Trade disputes and economic slowdown weigh on the market
- However, the fundamentals of commodity markets are quite stable
- We see opportunities in some segments of the commodity market



SOUMAILA TÉKÉTÉ, CAIA, CIAA  
Alternative Investments Strategist

The current phase of global economic weakness is also weighing on commodity markets to some extent. The continuing trade dispute between China and the United States and the uncertainty regarding a possible recession, which is nurtured by declining purchasing manager indices, are clearly negative factors for cyclical assets. However, the more expansive monetary policy of central banks and the specific dynamics in certain commodity markets make us optimistic about the development of the commodity complex in the fourth quarter.

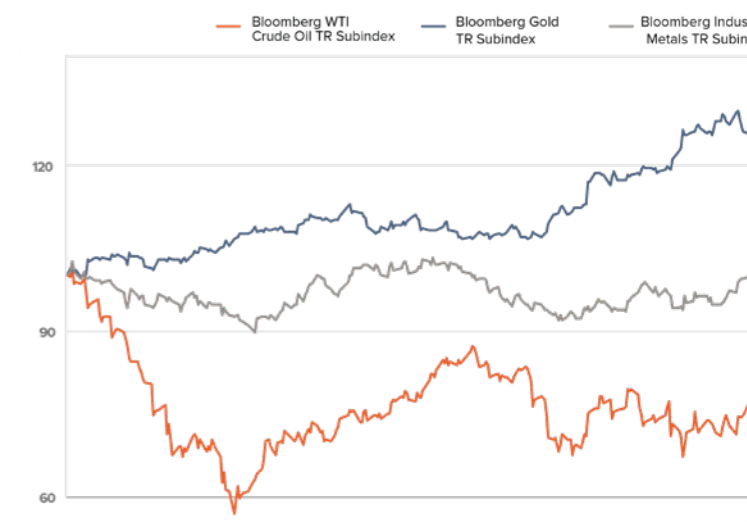


Fig 1: One Year Commodity Performance

Indexed to 100  
Source: Bloomberg, Bergos Berenberg (30. Sept 2018 - 30. Sept. 2019)



## How are current geopolitical events influencing the price of oil?

The driving factors in commodity markets balanced each other out for long stretches of the past quarter. Although fears of a potentially looming recession were negative, the supply-demand equation was largely balanced at the global level thanks to the ongoing OPEC+ production cuts and the respective compliance of member states. Also in the United States, where shale oil production has increased dramatically in the last few years, the market was more or less balanced. Thus, US crude oil stocks have fallen further again in the last few months in line with the customary seasonal pattern.

### Side Note: Shale oil production

This refers to the extraction of crude oil from hard-to-reach shale rock formations, which only became technically possible a few years ago. Thanks to this production technique commonly known as fracking, which is highly controversial from the standpoint of environmental protection, US oil production has risen from around 5.2 million barrels per day (2011) to currently 12.5 million barrels per day. Therefore, the United States has advanced to the status of the world's biggest oil producer within just a few years.

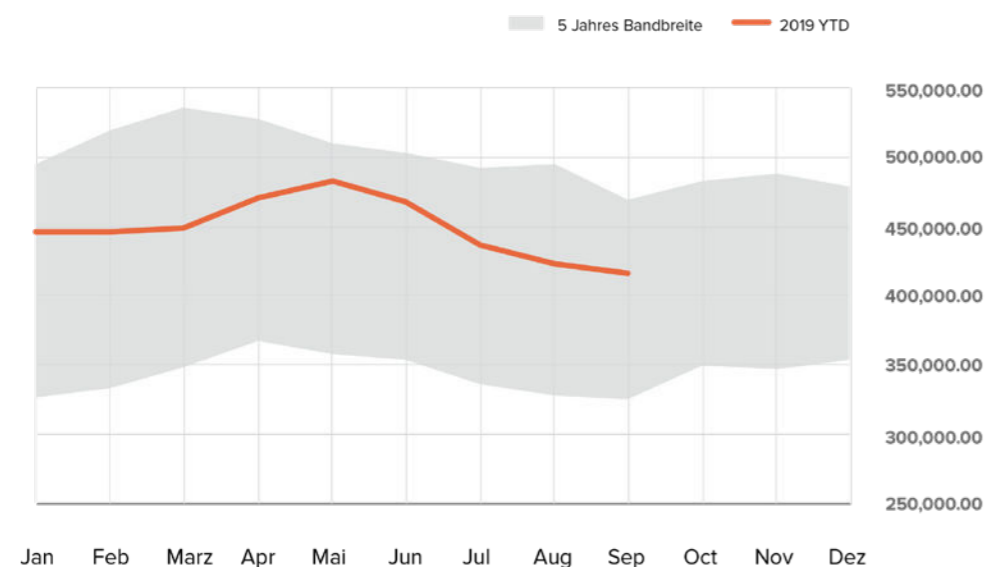


Fig 2: 5YR Crude Oil Inventory Range, US Department of Energy

Source: Bloomberg, Bergos Berenberg (01. Jan 2015 - 30. Sept 2019)



The geopolitical risks had already manifested in the previous quarter in the form of the presumed acts of sabotage of oil tankers in the Gulf of Oman. However, the recent drone attacks on Saudi Arabian production facilities marked a new stage of escalation, putting upward pressure on oil prices. Saudi Arabia is the world's biggest exporter of crude oil, producing approx. 9.8 million barrels per day. The attack temporarily halted nearly half of the country's production. As a result, a geopolitical risk premium was built into the price of oil practically overnight. An escalation of the conflict with Iran, including a potential military confrontation, seems more probable and menacing than before. Thus, the risk of further risk premiums and rising oil prices is very much in play.

### Steady tailwinds for gold

The market environment remains very constructive for gold. Nearly all important central banks have since reverted to more expansive monetary policies. The Fed, for example, announced another interest rate cut after its recent official meeting in September. This is keeping the opportunity costs for gold very low and stimulating continuing interest on the part of investors. The recent sharp rise in demand for gold ETFs helped push the price of gold to multi-year highs. The

growing fears of a looming currency war and the associated global devaluation race also enhance the safe haven appeal of gold.

After the strong gains in the last few months, a certain consolidation of the gold price is probable. This can also be seen in the historically very high number of speculative positions (Figure 4). In the medium term, however, we expect that the price of gold will continue its positive trend.

### Opportunities for industrial metals

Industrial metal prices exhibited a rather positive development in the third quarter. The continuing trade conflict between the United States and China, with the latter still being a source of marginal demand for industrial metals on the world market, continued to weigh on prices. This has slowed and delayed the onset of economic acceleration.

However, the monetary stimulus measures, as well as the announced tax cuts and infrastructure spending, will probably lead to an economic acceleration in the medium term. This supposition is also confirmed by the aggregated leading indicators, which have regained positive momentum in the last few months after having formed a bottom early in the year.



In the current environment, a potential economic recovery would coincide with comparatively reduced supply as the inventories of certain metals have declined markedly in the last quarters. In addition, speculative positions in copper, for example, are at historically low levels, with substantial net short positions (Figure 4). This increases the upside potential for prices because market participants would be compelled to cover their shorts with purchases if prices recover further.

We therefore continue to see good opportunities for price gains for industrial metals, although the dependence on the further global economic development and the trade talks between the United States and China remains very high.

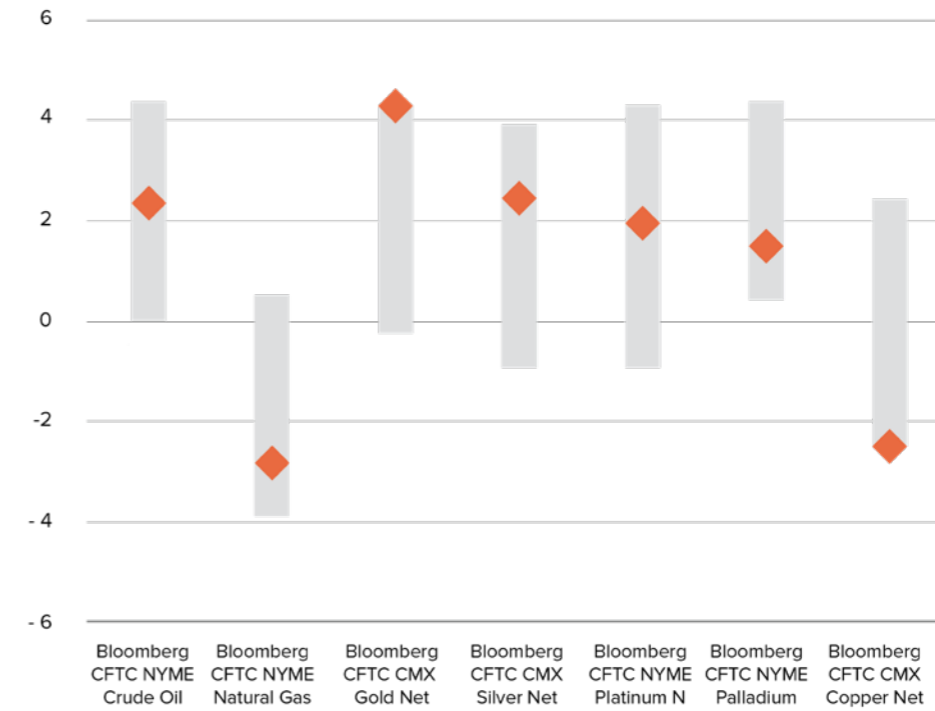


Fig 4: CFTC - Current Net Speculative Positioning and Historical Range

Quelle: Bloomberg, Bergos Berenberg (31. Dec 2008 - 30. Sept 2019)

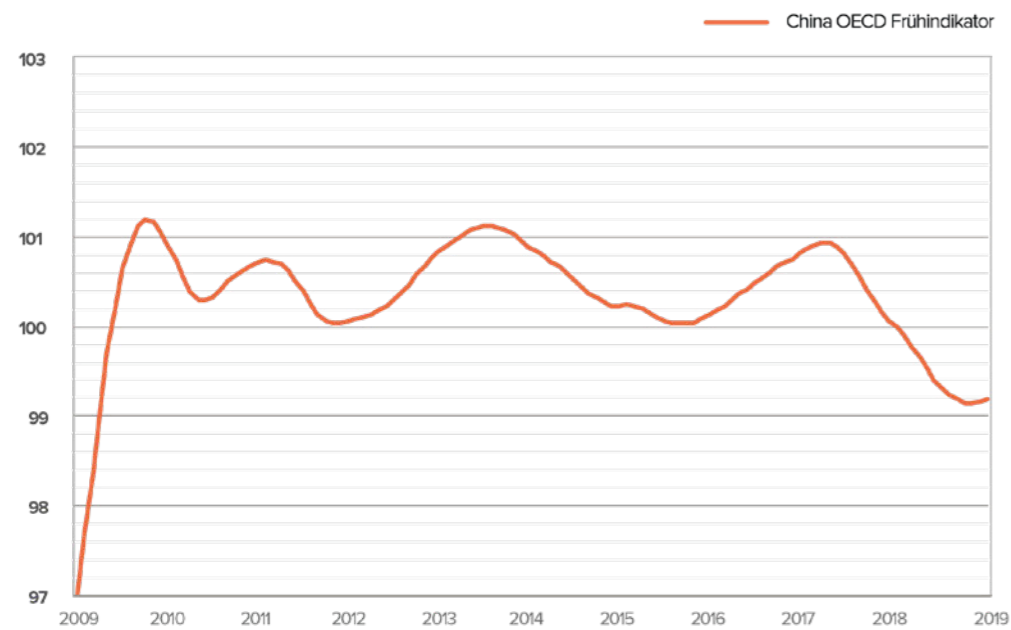


Fig 3: China OECD Leading Indicator normalized

Source: Bloomberg, Bergos Berenberg (14. March 2009 - 30. Sept 2019)



## Currency Markets

Central banks  
and persistent risks  
are setting the tone



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The currency market encountered a few surprises in the third quarter. For some time now, the global economy has been exposed to a dangerous mixture of political risks, but now fears of a currency war have been added to it. After US President Donald Trump raised tariffs again, China reacted by weakening the exchange rate of the Yuan. As a result, the US Dollar rose above 7.00 to the Yuan in early August, for the first time since 2008, and has since held at this level. This makes Chinese exports cheaper and partially thwarts the trade policy goals of the United States. The United States then designated China as a currency manipulator. Although it is rather improbable for now that the United States would expand the trade conflict to the currency market, it cannot be completely ruled out. Besides this political risk, currency markets have also been moved by the decisions of major central banks.



Fig 1: Trade weighted Euro

Source: Bloomberg



## EUR/USD

ECB policy is weighing on the common currency. The Euro's weakness against the US Dollar has continued. The common currency even fell below 1.10 US Dollars per Euro before rising slightly from there. By lowering the deposit facility rate and resuming its bond purchasing programme, the European Central Bank made it clear that ECB policy will not be normalised for a very long time. Fundamentally, however, the Euro should stabilise in the range of 1.10 to 1.11 because the Fed and the ECB are loosening their monetary policy at the same time. After the Fed lowered its base interest rate in September, for the second time this year, to a corridor of 1.75% to 2.00%, we expect another interest rate cut of 25 basis points in the fourth quarter. The continually escalating trade tensions between the United States and

China continue to pose a downside risk for the Euro. Particularly the export-oriented German economy is suffering from the uncertainty emanating from the trade conflict.

Some of the current Euro weakness or Dollar strength can be attributed to the fact that the US currency is in demand as a safe haven in the current risk environment. Sentiment could turn if the trade conflict eases or at least does not worsen further. If the pessimism slowly fades, investors would show more risk appetite again and gradually leave the Dollar zone. Nevertheless, a stronger upward trend for the Euro will remain out of reach in the fourth quarter.



Fig 2: Euro/US-Dollar exchange rate

Source: Bloomberg



Fig 3: Euro/GBP exchange rate

Source: Bloomberg

## EUR/GBP

Unlike the ECB and the US Fed, the Bank of England did not loosen its monetary policy in September. Instead, the British central bank signalled interest rate increases if a Brexit deal is reached. If it comes to a hard Brexit, however, the Bank of England would probably lower interest rates and revive the bond purchasing programme.

However, Sterling is hardly reacting to such monetary policy considerations at the present time. And macroeconomic data are playing only a minor role, at best. Instead, the exchange rate is being dictated

by the latest news on Brexit. Heightened worries of a hard Brexit had pushed the Euro above 0.93 pounds per Euro at the peak. Only when it seemed clear that Prime Minister Boris Johnson's strategy would not work did the British currency recover and the Euro fell below 0.90. The current level would be compatible with an orderly Brexit. If it comes to a hard Brexit after all, the Euro would probably approach parity with the Pound.



### EUR/CHF: Risks keep the Swiss Franc at a high level

The Swiss economy continued to struggle with an extremely strong Franc in the third quarter. At times, the Euro only fetched 1.08 Francs. In the meantime, the common currency has risen back in the direction of 1.10 Francs per Euro. The Swiss National Bank probably played a role in reducing the upward pressure on the Franc. Nevertheless, the Franc will remain in demand as a safe haven investment as long as economic and political risks do not subside. In our base scenario, we no longer expect a significant rapprochement in the

trade conflict between the United States and China this year. The uncertainties will probably linger into the spring of 2020 and the Franc will therefore remain strong for the time being. For this reason, a return to more normal levels cannot be expected in the foreseeable future.



Fig 3: Euro/CHF exchange rate

Source: Bloomberg

# TOPIC

— beyond  
Capital Markets

# ART



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*Immanuel Kant spoke of the  
“presumptuousness” of making  
judgments of taste about art.*

## Is the art market per se a bubble?

Art—what is it? Is it a fantasy? An object that resists all rational definitions? Especially when we are talking about the art market with its seemingly crazy eight- or even nine-digit prices? For thousands of years, art has been an asset class in which large sums were and are invested. People trade in art. It is admired and treasured almost everywhere in the world. The Seven Wonders of the World celebrated in ancient literature included descriptions of fabulously beautiful buildings, which consequently became socially binding travel destinations. For understandable reasons, fine art was named an asset class several years ago, for ever since the 1980s a global market for painting, sculpture, graphic art, and also photography has developed, extending from the West to the Far East and increasingly from the North to the South. There is measurable growth, and the yields are at times astonishing.



## Stable or volatile?

As a financial product, art is seemingly stable compared to other asset classes, but very volatile at the same time. If one thinks of the great successful auctions, art is highly liquid, but when one has bad luck with one’s sales, it is almost completely illiquid. Literature and music, as is well known, produce powerful emotions without building materials, canvas, or paper. Insofar as they are lacking in material substance, they have no monetary value and constitute entirely what may be termed an “emotional asset.” We, the respective societies that value the arts, decide on their worth on the basis of education and, not unrelated, with money.

Let us look back very briefly: In his “Critique of Judgment,” Immanuel Kant spoke of the “presumptuousness” of making judgments of taste about art. With a compellingly clear argument he demonstrates that an individual’s taste, however “disputable” it may be, is perceived as fitting by a society because there exists a “public spirit” that allows us to evaluate personal taste with regard to a community that cannot always be measured in quantitative terms. This is how the famous “antinomy” comes about which, according to Kant, makes it possible for us to argue about taste in relation to objects, but not about the concept of taste itself. Conceivably, Kant says, the idea of taste entails the vision of Bildung or cultivation – in his words, “the idea of an artificial faculty that is yet to be acquired.” The self-evident value we

experience in the enjoyment of natural beauty, good food, or good wine is not essentially different from the value we find in art. Its evaluation, ideal or material, follows a communal discourse, which does not necessarily imply a consensus. The art of the French Salon, for example, an officially authoritative quality selection, motivated Gustave Courbet to depict his own studio as if it were the salon.

## Delight versus displeasure

Kant calls evaluation by taste “reflective judgment.” The “delight” (sometimes displeasure) that can be elicited by the sight of a work of art has to do with emotions but also with rational scrutiny, even if we are just parroting a judgment. The art market, a highly liquid event when a sum in the high three-digit million range is spent during a single evening sale in New York, does not work without such notions and concepts of quality. When the conductor Christian Thielemann, in response to a question as to which wine he would pair with “Tristan and Isolde,” mentions as his first choice “a ’49 Cheval Blanc from the Magnum,” he leads up to that remark with, “I don’t drink any crap developed in a barrique.” One’s social position manifests itself on the scale of taste.

## \$ 100 millions and \$ 64 billions

The art market as a construct involving goods that are extremely coveted, especially at the highest level of value, and that are exchanged for big sums of money, goes



further back than the twentieth century. It is not only buyers and sellers who meet at such moments. As with the other asset classes, there are also advisors, intermediaries, silent partners and, more recently, “art lenders.” Bergos Berenberg Art Consult knows all sides and very many of the players. Some of the newcomers are free-riders, as it has become fashionable to support sellers of high-priced works in the hope of a commission. Sometimes one does not know these sellers at all; then non-disclosure agreements on single expensive pictures are sent out, even though some of these goods have been on the market for years. Ever since the sale of Picasso’s “Homme à la pipe” in 2004, the magic limit of US \$ 100 million per work has been exceeded again and again. Currently, the financially lucrative sphere of this global market is penetrating the media with US \$ 64 billion in annual sales. Regarding a newly published reference book, the Financial Times spoke in early July 2019 of “eye-watering prices, the parade of billionaires vying to acquire trophy assets, the powerful dealers advising them,” and characterized the current art market as a “high-octane world.” Ever since the 1980s, the culture sections of German newspapers (not just the Frankfurter Allgemeine) have been yearning for the “bursting of the bubble.” But exceptionally good art has only very rarely been free of charge.

The newest literature on this subject likes to take as its point of departure the pioneering art-dealing couple Leo Castelli and Ileana Sonnabend, whose influence

from 1960 to 1980 was still largely restricted to New York and Europe. In the ensuing period, their most prominent successor, Larry Gagosian, is invoked to illustrate the expansion of the trade from Los Angeles to Hong Kong and temporarily to Moscow. Today’s most powerful gallerists, such as Iwan Wirth, David Zwirner, and still Arne Glimcher, who founded the Pace Gallery over 60 years ago, are said to be prone to “excesses,” not in the way of parties or drugs but in the context of a plausibly advancing capitalization. Georgina Adam’s pertinent book, published in 2017, is titled “Dark Side of the Boom: The Excesses of the Art Market in the 21st Century.” The title Michael Shnayerson gave his recently published study was “Boom: Mad Money, Mega Dealers and the Rise of Contemporary Art.” Both authors make a great fuss about the fact that art in the new millennium has not only become an asset class but a social field with occasionally outrageous yield expectations.

*Ever since the 1980s, the culture sections of German newspapers (not just the Frankfurter Allgemeine) have been yearning for the “bursting of the bubble.” But exceptionally good art has only very rarely been free of charge.*



### Are there Excesses?

What these authors are reluctant to take into account are the well known historical precedents in Florence, Rome, or Paris, where great art has been created and shaped by “excesses” over many centuries. From a macroeconomic point of view, art flourishes especially where it has found the “Greater Fool” in investment decisions—the investor, preferably a king, the pope, or a particularly wealthy family head—who is prepared to give practically everything for a particular work, as most recently happened with Leonardo’s “Salvator Mundi.” In many cultures, the aim of art is to meet the pronounced needs of competing ruling houses for impressive representation; it is therefore a desire for style, which corresponds to a perhaps excessive need for immortality. Art is not a fantasy: After all, it is what almost exclusively distinguishes us from animals and occasionally even from the most beautiful plants. What remains of man on the physical plane? Actually, only art.

Two of the world’s major cultures, ancient Egypt and the civilization surrounding the Cambodian temple complex of Angkor Wat, developed a vigorous building activity that apparently foundered as a result of climate change. It seems that in the year 2184 BC, the Nile failed to flood the surrounding countryside with its life-giving waters, causing widespread famine in a population dependent on the cultivation of cereals. The constructions of the the Sphinx and the great pyramids of Gizeh did not disappear, but the high culture of

of the Old Kingdom came to an abrupt end. In the fifteenth century, Angkor, once the largest city of Asia with an estimated population of more than 600,000 inhabitants, thousands of whom were involved in the building activities, experienced such powerful monsoon rains after a period of drought that its highly sophisticated system of rivers and canals apparently broke down. From the eleventh to the fourteenth century, the temple kingdom in the jungle had grown steadily larger; after its sudden collapse, it was unknown to the world until the middle of the nineteenth century, when the French arrived.

Art is at times a highly dangerous asset, but even then it can yield profit as a tourist destination. The notes of Paul Fréart de Chantelou, who, after a crisis of state involving King Louis XIV and Pope Alexander VII, was assigned to accompany the famous sculptor and master builder Lorenzo Bernini to Paris to rebuild the Louvre, sound comparatively touching and conciliatory. The journey, undertaken in 1665 with Rome’s permission, at enormous expense and with extravagant expressions of homage on the part of the French king, led to relatively few artistic successes but enabled the artist to receive an annuity of 6,000 ducats and the impressive number of 3,300 pistols as his wage.

### Cultural Courage?

In this age of industrial and societal “disruptions,” it is no wonder that art and its buyers have a penchant for shock and vie for maximum attention. Let us recall that



already in 1959 in his novel “Naked Lunch,” William Burroughs rated heroin as the ideal product of capitalism, because it was so negative. After the ugly, the embarrassing, and the offensive were in the foreground for several decades, since the turn of the millennium we have increasingly been dealing with morally doctrinaire tendencies. Today, we are supposed to buy art by “women” and “people of color” and no longer art by “white men.” Recently the Frieze Bulletin added as their Second Commandment: “Why the Art World Must Back Greta Thunberg’s Global Climate Strike.” In September 2019 the New York museum

director Anne Pasternak addressed the public with a “A Call for Cultural Courage.” Museums, she said, have an obligation to “amend history.” Thus a statue showing a white ruler on horseback flanked by an American Indian on one side and a black man on the other, both of them on foot, must no longer be shown without comment. The widely prevalent catchword “diversification” is now seen and heard in the foreground of many cultural institutions that have traditionally operated under predominantly white and male auspices. Linear cultural history is a bit passé.



Cindy Sherman  
*Murder Mystery*, 1976  
 Gelatin silver print collage  
 22 1/8 x 19 7/8 inches (framed)  
 56.2 x 50.5 cm



What is the best thing we can do with our highly emotional asset class? Before we love it, it’s worth our while to touch it with caution. Art is like a lovely child that grows steadily. Once we are assured of her proximity, we love it, we care for it and grow with it. That makes her no more predictable than many another asset classes. The central issue in art is ourselves, the men and women who cherish it. Man is “at all times the noblest object of art and of artists,” wrote Johann Joachim Winckelmann in his “History of the Art of Antiquity” in 1764. What he meant by “Man” was a cultivated humanity. Art is and remains what we may safely presume is the noblest asset class, for it bestows material, spiritual, and emotional wealth. Only when absolutized can it become dangerous. To be cognizant of this, too, is one of the noblest tasks for professionals in a good private bank.



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*Art is like a lovely child that grows steadily. Once we are assured of her proximity, we love it, we care for it and grow with it.*



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