“After having been sent into rally mode by the central banks, the markets continued their recovery on the back of a better-than-feared reporting season and reduced political risks. Economic activity remains weak, however, so we would be ill-advised to shift into risk-on territory.”

Benjardin Gärtner, Head of Equity Fund Management

Union Investment

March 2019: Market news and expert views

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The markets at a glance

Four subjects are currently dominating the capital markets: central bank policy, the US/Chinese trade dispute, Brexit and the economy. We don't expect the central banks to provide any further notable stimulus over the coming weeks – a very different situation to what we've seen in recent months. The (geo)political factors have quietened down significantly of late. In particular, there are growing signs that a last-minute Brexit deal will be reached – as we anticipated – even if it remains to be seen what the arrangement between Brussels and London will ultimately entail. The latest developments in the trade dispute between the US and China make further escalation seem unlikely, and this is providing support for the markets. However, the economic data remains challenging. Specifically, the weak economy suggests that taking a position that is (overly) bullish is not a good idea at present, despite tentative signs of stabilisation emerging. At our regular meeting in February, we therefore decided to retain our neutral risk position. The RoRo meter thus remains unchanged at level 3. At the same time, however, we have identified improvements to a number of key environmental factors, which points to a modest upward trend for the capital markets going forward. With this in mind, we will be trying not to be too cautious with regard to higher-risk asset classes. Our overall view, however, is that the conditions are still too fragile to justify a shift into risk-on territory. We will instead be treading carefully by opening strategic positions in opportunity-oriented asset classes, particularly in fixed-income and currency segments.

Other important news

Economy: The prevailing weakness is hitting industry especially hard, above all in economies that are heavily involved in global trade. Germany, whose latest economic data reflects this negative trend, is a prime example of this combination. In particular, the level of new orders in industry is sounding warning bells. The 'new orders' component of the German purchasing managers' index, for example, is worryingly low, at just 42.6 points. Nevertheless, data for the service sector is still good – even in Germany. The consumer sentiment index of German market research company GfK, for example, held steady at a high level in February. So it is not the case that industry's weakness is already impacting on the wider German economy. Given the diminishing effect of negative one-off factors (bad weather, sector-specific issues such as the diesel scandal) and the easing of geopolitical tensions, the economic prospects are expected to brighten a little in the coming weeks and months. Consequently, we still don't think that the global economy will slide into recession.

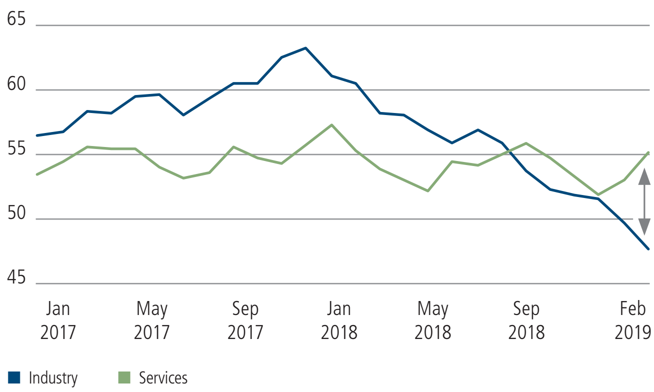
Fixed income: The more gradual raising of interest rates by the Fed and the European Central Bank (ECB) will limit the upside potential of yields on safe-haven government bonds (primarily Bunds and US Treasuries). The prospect of new targeted longer-term refinancing operations (TLTROs) being offered by the ECB from September is acting as an additional brake on yields in the eurozone. The yield forecast for ten-year Bunds was thus lowered again, to 0.45 per cent, at the end of 2019. With yields on safe government bonds entrenched at a low level for a long period, fixed-income investors are coming under increasing pressure to take on more risk. The marked widening of spreads in the fourth quarter meant that these segments regained some of their appeal. As long as the central banks act cautiously and there are no unpleasant surprises at geopolitical level (trade dispute between the US and China, Brexit), it should be possible to collect the risk premiums.

Equities: The past four weeks have seen the equity markets stage a recovery. This trend is broad-based, as can be seen from the US markets. Above all, the technical key figures have improved significantly. The markets are receiving additional support from companies' record volumes of share repurchases. Going forward, the performance of the economy will continue to be the main driving factor. In view of the weaker leading indicators, analysts have recently lowered their profit estimates even further for 2019. This year, profits are predicted to rise by just short of 5 per cent at global level. So a profit recession does not look likely at the moment. Equally, we believe that the generally improving environment removes the risk of falling prices. As sentiment is currently upbeat, we are therefore positioning ourselves on the sidelines for the time being.

Commodities: Despite the impressive price rises, the majority of commodities are still attractively valued by historical standards. However, supply and demand are likely to be evenly matched in the energy market in the second half of the year due to the curbing of output by OPEC and Russia. US production is expected to be stepped up again as the year goes on.

Divergent trends: Service sector still in good shape

Comparison of German PMIs since the beginning of 2017



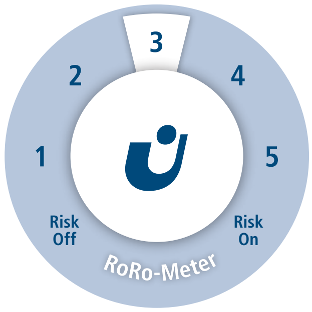
Source: Union Investment, Macrobond, Bloomberg, as at 26 February 2019.

The markets at a glance

Our current risk assessment

- Mixed signals from the leading indicators: industry weak, consumer spending strong.
- The adverse political factors have eased somewhat of late.
- A little more time has been gained in the trade dispute and a hard Brexit is now less likely.
- Low inflation rates are giving the central banks scope to hold off on normalising monetary policy.
- Profit revisions remain negative.
- Our general risk assessment (RoRo meter) remains at level 3 (neutral).

RoRo meter



Source: Union Investment, as at 12 March 2019. Last changed (from 4 to 3) on 20 November 2018.

Note: The investment strategy is established by first closely analysing the market environment. The result is reflected in a risk rating. For this, the Union Investment Committee (UIC) expresses a risk-on/risk-off decision at one of five levels (1, 2, 3, 4 or 5). It is to be interpreted as follows: a '5' indicates a strong appetite for risk while a '1' indicates a general withdrawal from risk assets.

Our view of the asset classes

- **Fixed income:** Corporate bonds have become more attractive again relative to the low-yielding government bonds from the core countries. Yields are unlikely to rise sharply because of low inflation rates.
- **Equities:** The positive start to the year has brightened the mood; declining political risks and further share buybacks are also providing support. On 26 February, we therefore switched our underweight position to neutral.
- **Currencies:** We are anticipating a rally in pound sterling after it recently became less likely that the UK would crash out of the EU without a deal.
- **Commodities:** Precious metals look vulnerable due to the surge in the price of palladium. We are staying on the sidelines here. After their recent strong performance, the active positions in the energy commodities and industrial metals segments are being closed.
- The situation in the money markets remains unchanged. Interest rates are still close to zero, which means that holding **cash** is not a good idea.
- With regard to **absolute return strategies**, we currently see a balanced relationship between risks and opportunities.
- The outlook for **real estate** has improved in Germany but deteriorated in the US.

The → = ← signs indicate the change compared with the UIC's previous decision.

Not favoured **Strongly favoured**
Neutral

Appeal of different asset classes

Fixed income		=
Eurzone core government bonds		=
Covered bonds		=
Eurozone periphery government bonds		=
Corporate bonds (investment-grade)		=
Corporate bonds (high-yield)		=
Emerging-market government bonds		=
Equities		=
Industrialised countries		=
Emerging markets		=
Commodities		←
Currencies		
US dollar		→
Pound sterling		→
Japanese yen		←
Emerging-market currencies		=
Absolute return		→
Cash		=

Source: Union Investment. as at 12 March 2019.

Note: The table above provides a **relative view of a multi-asset portfolio (excluding real estate).** If one asset class is more strongly favoured, a lower level of investment in another asset class is required in return. The latter would then be classified as less favoured – or vice versa. Real estate is excluded from this analysis.

Real estate		
Germany		→
Europe (ex Germany)		=
US		←
Asia-Pacific		=

Source: Union Investment, as at 31 December 2018. Assessment is valid up to 30 April 2019.

Note: The table above provides a **relative view of the office real-estate markets** in light of current market prospects. Owing to data availability, it is only updated quarterly.

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Forecasts

These forecasts represent Union Investment's assessment at the current time and may be changed without notice. Where a forecast has been significantly revised in comparison with the previous report, we will explain this in the relevant section. Routine adjustments that arise from a change in the forecasting horizon are not usually explained.

GDP	Germany	UK	Eurozone	US	Japan	China
2018	1.5%	1.4%	1.8%	2.9%	0.8%	6.6%
2019	0.7%	1.4%	1.0%	2.4%	1.5%	6.3%
2020	1.3%	1.4%	1.4%	1.7%	0.0%	6.2%

Inflation	Germany	UK	Eurozone	US	Japan	China
2018	1.9%	2.5%	1.7%	2.4%	1.0%	2.1%
2019	1.8%	2.4%	1.8%	2.0%	1.0%	2.0%
2020	2.2%	2.0%	2.0%	2.5%	1.9%	2.3%

10-year yields	Germany	US
Current status*	0.2%	2.6%
In 3 months	0.4%	2.9%
In 12 months	0.5%	2.8%

Benchmark rates	Eurozone	US
Current status*	0.00%	2.25–2.50%
In 3 months	0.00%	2.25–2.50%
In 12 months	0.00%	2.50–2.75%

Equities	DAX 30	EURO STOXX 50	S&P 500	Nikkei 225
Current status*	11,600	3,320	2,800	21,600
In 3 months	11,100	3,150	2,650	21,000
In 12 months	11,100	3,150	2,650	21,000

Commodities	Gold	Oil (Brent)	MS RADAR ex Ag.
Current status*	1,310	66	158
In 3 months	1,350	70	159
In 12 months	1,350	70	160

Currencies	Euro/US dollar	Euro/pound sterling	Euro/Japanese yen	Euro/Swiss franc
Current status*	1.14	0.88	127	1.14
In 3 months	1.16	0.88	125	1.16
In 12 months	1.18	0.90	134	1.20

Real-estate yields**	Germany	Europe (ex Germany)	US	Asia-Pacific
30 December 2018	3.1%	3.8%	4.7%	4.2%
30 December 2019	3.0%	3.7%	4.9%	4.2%

* As at 12 March 2019.
** Data is updated every quarter. The following cities have been aggregated on the basis of regional indices: **Germany**: Berlin, Düsseldorf, Frankfurt, Hamburg, Munich. **Europe:** Amsterdam, Brussels, Helsinki, Lisbon, London, Luxembourg, Madrid, Milan, Paris, Prague, Stockholm, Warsaw. **US:** Atlanta, Boston, Chicago, Dallas, Houston, Los Angeles, New York, Miami, San Francisco, Seattle, Washington. **Asia-Pacific:** Tokyo, Kuala Lumpur, Singapore, Seoul, Sydney.

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Unless otherwise stated, all information, descriptions and explanations are dated **12 March 2019**.

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