A professional portrait of Christian Kopf, a man with dark hair, wearing a dark blue suit, white shirt, and light blue tie. He is looking slightly to the right of the camera with a neutral expression. The background is a bright, out-of-focus office interior with windows.

Supply bottlenecks have become a drag on growth and are driving up prices. But we are now seeing signs that shortages are starting to ease.

Christian Kopf,
Head of Fixed-Income Fund Management

Market news and expert views

Monthly report
November 2021

The markets at a glance

Summary

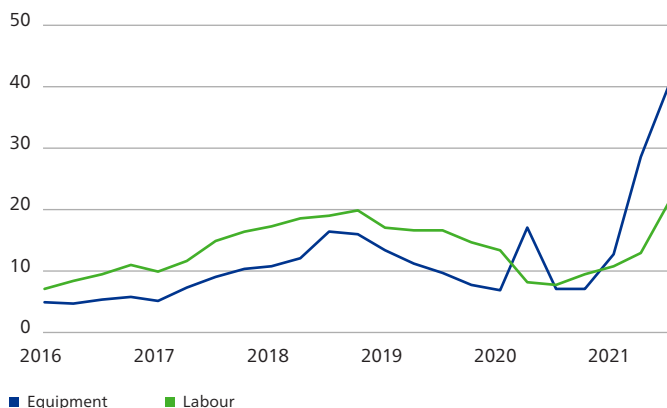
The capital market outlook is promising even though conditions remain challenging. Global economic growth continues to slow, which is due in part to disruptions in global supply chains. The short-term upward pressure on prices that this is creating in many areas is coinciding with year-on-year effects. The result is strongly elevated inflation that paints an exaggerated picture of the underlying price trend. The commencement of tapering action (i.e. a reduction of bond purchases) by the Federal Reserve (Fed) is drawing closer, heralding the end of the ultra-expansionary monetary policy era for the Fed and other major central banks. China's economy is struggling with weak growth and tighter regulation. In addition, the crisis surrounding the troubled real estate developer Evergrande has not been resolved yet.

In addition, coronavirus case numbers have started to rise again, especially in Europe, as the beginning of autumn is bringing colder weather to the northern hemisphere. But thanks to extensive vaccination campaigns, the situation ahead of this winter season is calmer than in late 2020 because fewer infections are resulting in severe illness. On this basis, we expect that the reintroduction of serious containment measures (lockdowns) can be largely avoided in key economic areas and growth should therefore not be severely impacted.

Global supply bottlenecks also seemed to be starting to ease recently. The number of container vessels waiting outside Los Angeles, the most important port on the US west coast, has been declining for several weeks and Shanghai, too, has seen its backlog come down by nearly half. Consequently, freight charges per container from China to the US have now started to fall. The economic cycle thus remains intact and justifies a moderately bullish position in spite of persistent challenges (RoRo meter at level 4).

Production hit by supply bottlenecks

Business survey on factors limiting production, Frequency of mention (%)



Sources: Macrobond, Bloomberg, European Commission, Union Investment, as at 27 October 2021.

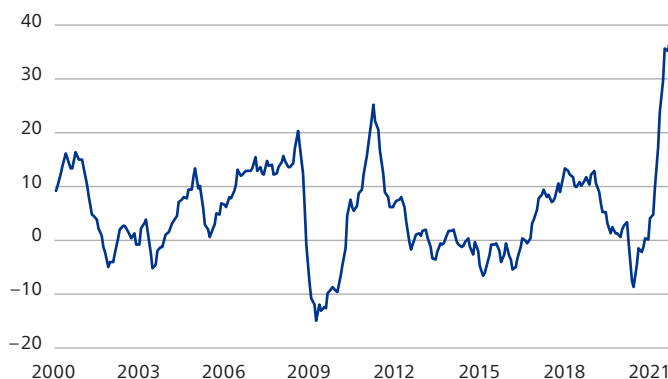
Economy, growth, inflation

Leading indicators such as the recently published purchasing managers' indices and the ifo Business Climate Index continue to reflect the slowdown in global economic growth. The main cause for concern in Europe recently has been the sharp rise in energy prices. Our experts believe that it will take some wind out of the economy's sails, but not stymie the economic upturn completely. Over the rest of the year, lingering supply shortages will likely be a bigger issue than energy prices. We have therefore lowered our economic growth forecasts for the industrialised economies slightly (to 5.6 per cent in 2021 and 4.2 per cent in 2022 for the US and 5.1 per cent in 2021 and 4.7 per cent in 2022 for the eurozone).

Rising energy prices could spell trouble if the resulting loss of purchasing power were to slow the economy down too much. Our economists estimate that the steep rise in gas prices will drive up inflation even further over the winter and have therefore raised the inflation forecasts for the next twelve months once again across the board. Specifically, we anticipate price rises of 2.4 per cent for 2021 and 2.1 per cent for 2022 in the eurozone and 4.3 per cent for 2021 and 2.8 per cent for 2022 in the US. However, we do not expect the higher energy prices to produce significant second-round effects, meaning that medium-term inflation expectations should hold steady. In addition, there is still no indication of a significant upward trend in wages. A wage-price spiral, which would force central banks to intervene much sooner than currently expected, thus remains unlikely, especially in Europe.

Inflation: pricing power of companies is increasing

Confidence in the ability to command higher prices, as measured in the eurozone's manufacturing industry



Sources: Bloomberg, European Commission, as at 26 October 2021.

The markets at a glance

Monetary policy: Fed to announce tapering in November

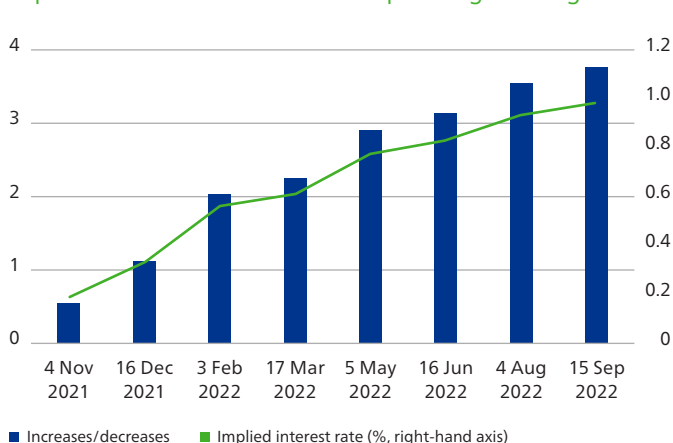
The central banks are seeking a path back to normality even if many are still a long way from making their first interest-rate hike. As far as the Fed and the European Central Bank (ECB) are concerned, our outlook remains practically unchanged. It seems to be more or less decided now that the Fed will announce tapering steps in November. The completion of tapering measures by the middle of 2022 would pave the way for the Fed's first interest-rate increase in early 2023. It also seems safe to assume that the ECB will take a decision in December to end its pandemic emergency purchase programme. We continue to expect that the bank will slightly increase purchases under its other asset purchase programmes for a limited period in order to ensure a smooth transition. An interest-rate hike remains a very distant prospect for the ECB.

However, an interest-rate rise is looking increasingly probable at the Bank of England, which has recently been advocating more restrictive monetary policy. Our view is that interest rates in the United Kingdom now seem likely to go up in February 2022, contrary to market expectations that the first hike will be announced at the upcoming central bank meeting on 4 November.

It is striking that many market participants are currently pricing in more and earlier base rate changes than the central banks' forward guidance suggests. This goes hand in hand with concerns that interest-rate increases by the central banks could stifle economic momentum. Considerable importance will thus be attached to the upcoming central bank meetings. We believe that the market is somewhat overshooting the mark in this respect and that potential interest-rate hikes will be smaller in scale and happen later than currently expected by market participants.

Bank of England: markets have priced in two base rate increases by March 2022

Expected base rate as at dates of upcoming meetings



Source: Bloomberg, as at 26 October 2021.

Fixed income: everything hinges on inflation

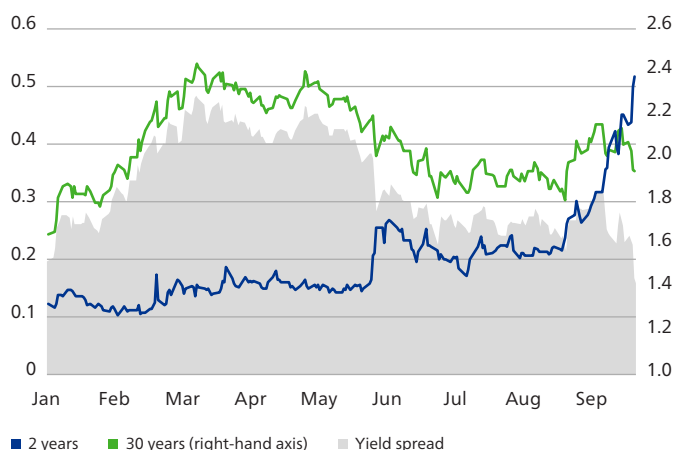
The trend towards rising yields on safe-haven government bonds persisted in October. Ten-year Bund yields climbed to minus 0.087 per cent, their highest level since May 2019. US Treasury yields also briefly came close to their high from this spring. For the bond markets, the big question remains whether the surge in inflation since the beginning of the year represents a temporary phenomenon or the start of a sustained period of price increases. The markets' fear of the latter scenario is clearly reflected in the current yield trend, which has been characterised by rising break-even rates and falling real rates of return. Moreover, the macroeconomic data is still not providing a clear answer to the 'temporary vs. lasting' conundrum. We are still convinced that, overall, the current high level of inflation is mainly a product of year-on-year effects and shortages and is therefore likely to recede again in 2022.

Spreads on eurozone periphery bonds and corporate bonds with investment-grade ratings have been trending sideways in recent weeks and now have very little scope to contract further. We also anticipate a flurry of new issues before the end of the year. This would further contribute to an environment in which spreads are unlikely to narrow. High-yield bonds and bonds from the emerging markets offer slightly more potential in this respect, but also come with higher risks.

- **Change:** None.
- **Positioning:** We continue to steer clear of safe-haven government bonds from eurozone core countries and the US. Our position in all other bond segments is neutral.

US: interest-rate hikes priced in at the short end

Comparison of yields in the year to date (%)



Source: Bloomberg, as at 28 September 2021.

The markets at a glance

Equities: preference still for stocks from the industrialised countries

The equity markets have recently detached themselves from the influence of persistent background factors such as weak global growth, the issues affecting global supply chains and the high level of inflation. Investors appeared unfazed even by the latest developments on the coronavirus front, namely fresh outbreaks in northern China and sharp rises in case numbers in Europe. A positive start to the corporate reporting season for the third quarter helped the equity markets to regain their footing after they had slipped in September. The US indices have already climbed to new all-time highs. In response to these trends, we raised the position in stocks from industrialised countries over the course of October. A number of Asian countries have abandoned their zero COVID policy in respect of new outbreaks of coronavirus. As a result, October saw the first improvements in the local purchasing managers' indices in these countries for a long time. Against this backdrop, we now regard the opportunities and risks of investments in equities from the emerging markets as more balanced again and are taking a less hesitant approach to this segment.

Another consequence of the prevailing supply chain disruptions is that the fulfilment of many orders has been delayed. The processing of this backlog should fuel the economic upturn for a while longer. The latest corporate profit figures were at such high levels that further growth seems very hard to achieve. But at the same time, there is no profit slump on the horizon.

- **Change:** We have returned to a neutral stance towards equities from the emerging markets.
- **Positioning:** Our overall view of equities is positive. Within this asset class, we favour equities from the industrialised economies.

Reporting season positive so far and providing a tailwind for equities

Based on the results published so far

	Increase	Expectations exceeded
US (S&P 500)		
Revenue	85.3%	67.6%
Profit	82.0%	82.0%
Europe (STOXX Europe 600)		
Revenue	86.3%	61.5%
Profit	70.2%	61.8%

Source: Bloomberg, as at 28 October 2021.

Commodities: upside potential for precious metal prices

The sharp rise in energy prices has continued in recent weeks. Demand for oil, gas and electricity remains high and the current level of global supply is not enough to satisfy it. The trend in the number of active drilling rigs and fracking teams shows that US shale oil producers are increasing their output. But the OPEC+ countries have so far stuck to their current schedule of raising supply each month by 400,000 barrels per day, meaning that the supply deficit is easing only slowly. Most investors are positioned in anticipation of a further rise in energy commodity prices, partly because implied roll yields are very high (12 per cent p.a.). This means that future oil prices are lower than current prices.

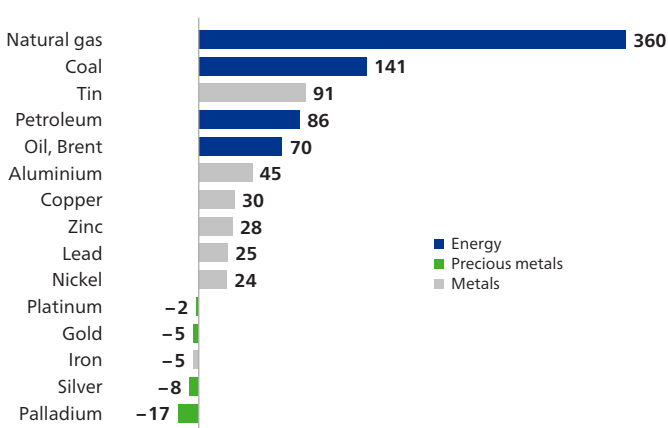
The rising energy prices have in recent weeks forced some producers of energy-intensive industrial metals to restrict production. This was one reason why metal prices spiked again in October following the price correction at the end of the third quarter.

We continue to favour precious metals because their prices have not yet risen to the same extent as those of other commodities. Gold, for example, appears undervalued relative to US real interest rates, and most investors are positioned very lightly at present. Platinum and palladium remain the potential wild cards in the precious metal sector. The automotive industry's dependence on these metals means that their prices could go up significantly once the car production backlog caused by disruptions in the supply of microchips starts to clear.

- **Change:** None.
- **Positioning:** We are positioned in anticipation of price gains for precious metals and are thus overweight in commodities overall. Our stance towards industrial metals and the energy sector is neutral.

Strong rise in energy prices

Performance of selected commodities in the year to date (%)



Source: Bloomberg, as at 26 October 2021.

The markets at a glance

Currencies: no positioning due to countervailing effects

The debate surrounding a reduction of bond purchases by the Fed has, since the beginning of the summer, provided a strong tailwind for the US dollar, while weakening global growth has created an equally strong headwind for the euro. The Fed is several months ahead of the ECB in terms of calling time on its ultra-expansionary monetary policy. In principle, this means the US dollar continues to be supported against the euro. However, investors are now positioned more or less exclusively on the pro-dollar side due to the greenback's appreciation over recent months, and this makes further rises unlikely in the short term. The decision as to whether the US debt ceiling should be raised has been put back to December, which could become problematic for the US dollar if an agreement proves difficult to reach or talks break down completely.

The fact that the market now increasingly expects the Bank of England to raise interest rates soon, despite it so far expressing reluctance to do so, has given pound sterling a lift of late. Moreover, the negative consequences of Brexit are becoming more and more evident. One example is the shortage of truck drivers, which is resulting in empty shelves in supermarkets and fuel shortages at petrol pumps. These overlapping, countervailing effects explain why we are currently staying on the sidelines in the currency segment.

The currencies of countries where interest rates have already been raised are now appreciating, most notably in various eastern European states.

- **Change and positioning:** None.

Turkish lira at an all-time low due to pressure from high inflation

Turkish lira continues to depreciate (Turkish liras to the euro)



Source: Bloomberg, as at 26 October 2021.

Real estate: office market in Germany

Demand for office space in major German cities picked up again in the third quarter. In Berlin, Frankfurt, Düsseldorf, Hamburg and Munich, the five biggest German office markets, total lettings for the twelve months up to the end of the third quarter of 2021 came to around 2.5 million square metres. This was up by about 10 per cent on the figure from the end of the previous quarter. However, the scale of the increase varied significantly between these five cities. Frankfurt recorded a rise of just 1.5 per cent, while lettings in Munich went up by 15.1 per cent.

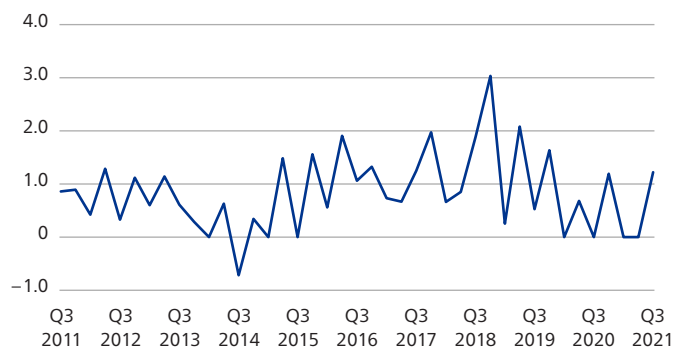
The average vacancy rate across the five office hotspots rose by around 110 basis points year on year to 5.3 per cent. The market with the lowest vacancy rate is currently Hamburg, where just 3.6 per cent of office space is unoccupied. However, the upward trend in vacancy rates slowed significantly in the third quarter of 2021. The supply of high-quality office real estate in prime locations remained relatively limited. Competition among those bidding for these properties thus paved the way for further rental price increases. Berlin saw particularly steep rental price growth of 4.1 per cent compared with the prior-year quarter. On average, rental prices went up by 2.4 per cent across the five German office hotspots.

Investors are currently interested in core properties, i.e. modern properties under long-term lease to tenants of strong credit standing. This type of real estate is scarce and highly sought-after. As a result, prime yields fell by around 10 basis points year on year despite the pandemic. The average prime yield of the five biggest German office markets now stands at around 2.7 per cent.

Over the coming quarters, demand for office space will continue to recover. The upward trend in vacancies should therefore level off soon, meaning that there is further scope for future rental price growth. High demand from investors for core office properties should bring initial yields down even further.

Quarterly change in prime office rents in Germany

Average (%)*



*Average of the five biggest German office markets.
Source: JLL, as at 30 September 2021.

Our assessment at a glance

Our current risk assessment

- Supply chain disruptions are driving up prices in the short term and slowing down economic growth.
- The commencement of tapering action by the Fed is drawing closer and will also herald the end of the ultra-expansionary monetary policy era for other major central banks.
- Coronavirus infections in Europe are rising again, but progress with vaccination programmes means that strict lockdowns can hopefully be avoided.
- Overall, the economic cycle remains intact, as confirmed by the solid quarterly reporting season.
- Our general risk assessment (RoRo meter) remains at level 4 (slightly bullish).

Our view of the asset classes

- **Fixed income:** Yields are likely to continue to rise in the coming months. Spread products now offer hardly any upside potential, but there are opportunities if a selective approach is taken.
- **Equities:** The positive quarterly reporting season is allowing equities to detach themselves from prevailing adverse influences. Our view of equities from the emerging markets is no longer negative.
- **Currencies:** Countervailing effects are deterring us from taking a position. The US dollar is being supported by the Fed's monetary policy but could be adversely affected if the US government raises the debt ceiling.
- **Commodities:** Demand for energy commodities looks set to remain robust, but prices are already very high. We favour precious metals, especially platinum and palladium, which should benefit as car production starts to return to normal.
- Holding **cash** is currently unattractive due to low or even negative interest rates.
- Our assessment of **absolute return strategies** remains positive.
- The outlook for **real estate** has improved a little in Germany but deteriorated slightly in the US.

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

Not favoured  Strongly favoured
Neutral













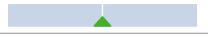


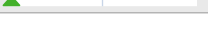

RoRo meter



Source: Union Investment, as at 28 October 2021. Last changed (from 3 to 4) on 19 October 2021.





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.

Appeal of different asset classes

Fixed income		=
Eurozone core government bonds		=
US government bonds		=
Eurozone periphery government bonds		=
Investment-grade euro corporate bonds		=
High-yield euro corporate bonds		=
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 2 November 2021.

Note: The table above provides a **relative view of a multi-asset portfolio (excluding real estate)**. If one asset class becomes 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 15 July 2021. Assessment is valid up to 31 December 2021.

Note: The table above provides a **relative view of the office real-estate markets** in light of current market prospects. Due to a lack of more frequently available data, it is only updated every six months.

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READ THE PROSPECTUS BEFORE INVESTING

Unless otherwise stated, all information, descriptions and explanations are dated **2 November 2021**.

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