Marketing material

## Strategy for final quarter: staying the course

**The risks arising from the so-called trade war continue to loom over the usual late-cycle slowdown, but economic growth remains sufficient and central banks have become more accommodative. We are hence maintaining a modest overweight allocation to equities, with a defensive tilt, a preference for the US, and a bias to act counter-cyclically when opportunities arise.**

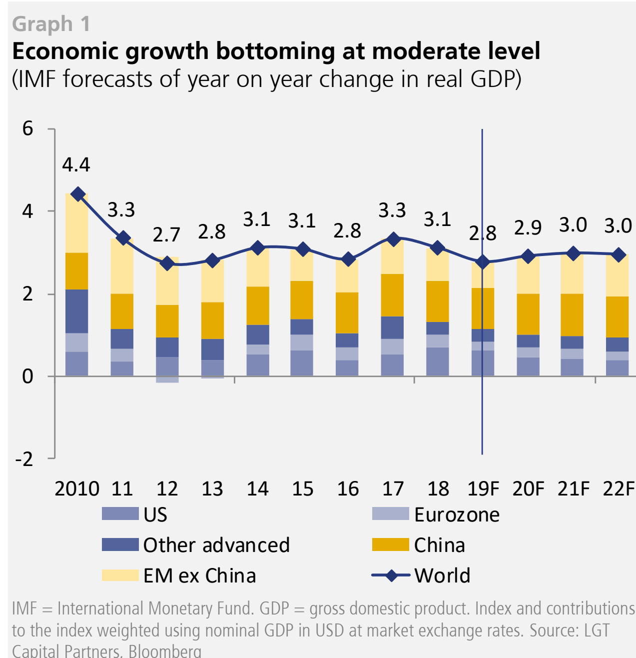
### Quarterly review concluded

Following our quarterly asset allocation review for the fourth quarter, which ended last Friday, we adjusted our investment outlook for the coming three to six months. In brief, while staying the course in general, we have further shifted our main active weight from emerging market debt (still overweight) further in favor of the US equities (increased overweight).

The global economy is likely to continue to grow at a slower pace than in recent years. However, with the US still expanding at around potential and the emerging markets stabilizing, the world should avoid a recession.

In nominal terms, a slight uptick from where we stand today would not surprise us (graph 1), which should in turn support corporate earnings just at a time when the boost from the 2017 US tax reform has faded.

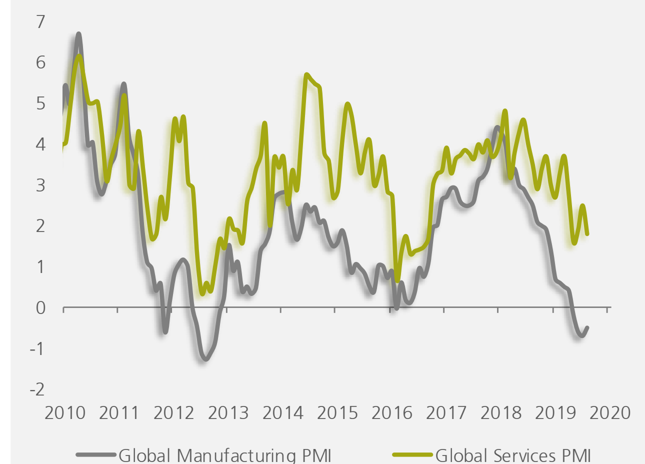
Graph 1
**Economic growth bottoming at moderate level**
(IMF forecasts of year on year change in real GDP)




IMF = International Monetary Fund. GDP = gross domestic product. Index and contributions to the index weighted using nominal GDP in USD at market exchange rates. Source: LGT Capital Partners, Bloomberg

The latest readings on activity in the manufacturing sector confirmed fears that America's on-going trade war with China has negatively affected quite a few industries. Production and international trade of goods as well as corporate capital expenditure plans are the main victims of the retaliatory rounds of tariffs and the rising uncertainty that comes with the escalation.

Graph 2
**Global economic activity: services holding up well**
(Global purchasing managers' indices by IHS Markit)




The growth threshold is at zero in this chart. Source: LGT Capital Partners, Bloomberg

On the positive side, however, we also have a more robust outlook for the service sector, healthy labor markets, resilient consumer spending and supportive financing conditions. The major central banks' renewed bias toward providing more monetary accommodation going forward will be crucial in bolstering economic activity and risk asset markets. We also note that there are first signs of a potential bottoming in global manufacturing as well (graph 2).

## Political uncertainties of a local nature

Apart from the much-discussed Sino-American trade war, many policy issues remain equally erratic and unpredictable for many market participants. The probability of a hard Brexit, i.e. the United Kingdom's exit from the European Union without an arrangement, is gyrating wildly, while Iran's isolation and the situation in Hong Kong represent potential wild cards. Luckily, however, most of these issues seem to have primarily local and regional effects with a limited impact on global markets thus far.

Recent volatility patterns highlight clearly that investors fear a potential monetary policy error (which could lead to a recession) more than the convulsions of the trade war (graph 3). Thankfully, the US Federal Reserve and most other major developed market central banks have already started or are getting ready to ease policy. In addition, 14 of the 19 largest emerging markets' central banks have also cut interest rates since the end-June.

Graph 3
**Global equity volatility index**
(Equal-weighted for the four largest stock markets*)

* USA, Europe, Japan and Hong Kong. Values are 10-day moving averages. Source: LGT Capital Partners, Bloomberg

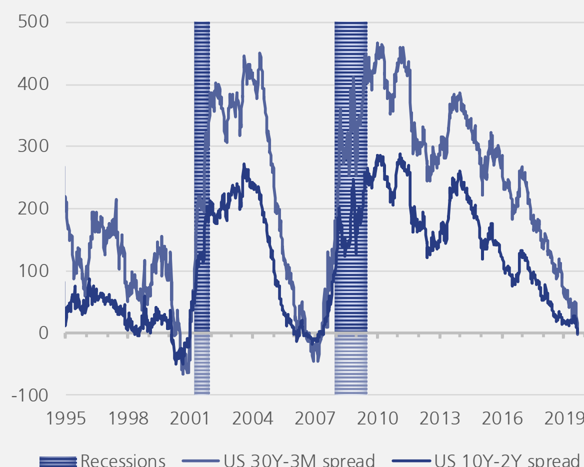
## Tactical positioning: continued modest growth

The outlook for the coming months consists of the following core elements:

- In our **baseline scenario, the world economy continues to grow at a slower but sufficiently positive pace**, warranting an accommodative monetary policy stance and potentially some fiscal expansion
- In our **less likely risk scenario, growth deceleration could take a more pronounced form**, possibly paired with stagflationary tendencies if tariff rounds spiral out of control

Equity markets have partially retraced strong year-to-date gains on the back of deteriorating macro data and waning hopes of an imminent trade agreement between Washington and Beijing. Unlike some parts of the government yield curve, equity and credit markets do not signal a recession. The yield curve has partly inverted, which generally occurs ahead of recessions (graph 4).

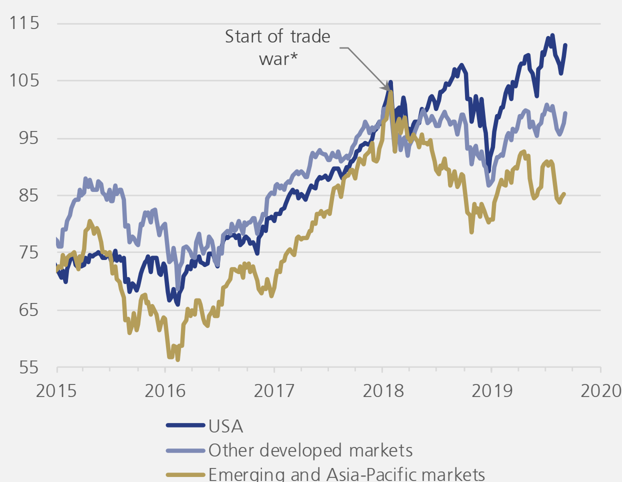
Graph 4
**US yield curve briefly inverted again**
(Spread between bond maturities, in basis points)




Source: LGT Capital Partners, Bloomberg

Equities, while volatile, remain buoyant in the US, while moving mostly sideways since the start of the trade war in the rest of the world (graph 5). In general, risk asset markets still take comfort in central banks' ability to counter economic weakness with additional easing.

Graph 5
**Equity markets since start of the trade war**
(MSCI net total return indices, rebased to end 2017)




* US launches Section 301 probe against China. Other developed markets = MSCI World excluding USA in local currency. Emerging and Asia-Pacific markets: equal weighted MSCI Emerging Markets and MSCI Asia-Pacific ex. Japan indices in USD. Source: LGT Capital Partners, Bloomberg

At the same time, government bond markets have already priced in lower policy rates and, some would argue, persistently lower growth and inflation for a long time to come.

## Bearish investor positioning bodes well for equity markets

In our view, there are a few additional positives for financial markets. Following the recent correction, investor sentiment and positioning are clearly bearish, whereas equity valuations have become more attractive. There is also the possibility that the trade dispute has reached at least a temporary low point.

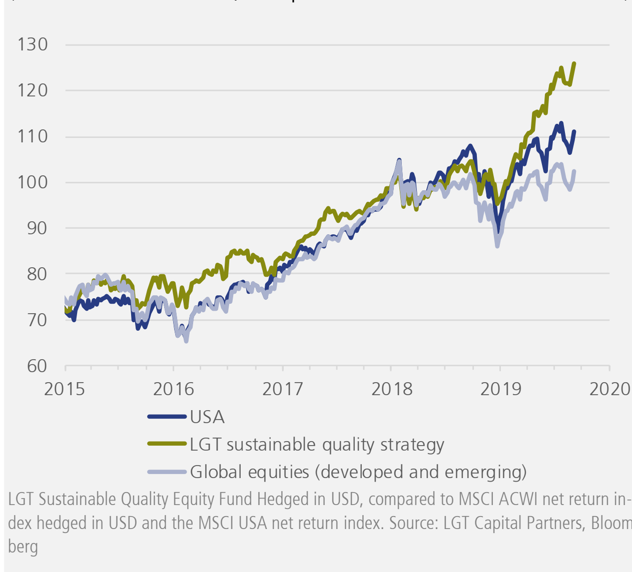
Going forward, the involved parties may be motivated to make a move towards reconciliation – or at least refrain from additional measures as they keep talking. We also note that the entirety of Chinese exports to the US are now subject to import duties, although some have not yet come into effect.

In conclusion, we made some small amendments to our cautiously optimistic stance, with equities and emerging market debt kept at a modest overweight, combined with an underweight in bond duration, as before. Going into the new quarter, we implemented the following tactical positioning:

## Equities: slight overweight due to our preference for the US

**Equities are slightly overweight, with a clear preference for the US**, where we increased exposure opportunistically following last months' selloff. We also maintain our defensive tilt in the global equity allocation, for example by investing about a third of that quota in sustainable quality equities. The later invests in companies with robust balance sheets, stable growth prospects, and strong environmental, social and governance (ESG) ratings. The strategy, managed in-house, has worked very well in this year's very volatile environment (graph 6).

Graph 6
**LGT sustainable quality strategy and global equities**
(Rebased to end 2017, compared to MSCI net return indices)




LGT Sustainable Quality Equity Fund Hedged in USD, compared to MSCI ACWI net return index hedged in USD and the MSCI USA net return index. Source: LGT Capital Partners, Bloomberg

From a regional perspective, equities in emerging markets (EM) and Europe remain at a small underweight position, on the back of the continued trade war and the different regional economic sensitivities. In the last LGT Beacon, we showed the gap between corporate earnings and revenue trends in the developed markets and the EM during the last reporting season: most companies from the former managed to beat expectations, while the latter disappointed once again. Furthermore, many EM face governance issues, while Europe suffers from tepid growth at present, with manufacturing particularly weak recently in Germany. While both regions are also under-owned by investors, which per se is a positive contrarian factor, we would still prefer to wait for the lifting of the trade war issue as a trigger for a potential relief rally. Finally, Asia-Pacific and Japan remain at neutral - although in Japan we have increased our active position owing to a separate decision-making process, as we explained last month.

## Fixed income: preference for the EM and short duration

**In fixed income, we remain underweight duration and corporate credit risk.** An active position that has cost us given the recent collapse in interest rates, as record low yields went lower still. Since the start of year, the value of bonds bearing negative yields has more than doubled from about USD 8.2 trillion to a peak of USD 16.8 trillion by end-August (graph 7).

Graph 7
**Government bonds have soared this year**
(Total return rebased to end-2017, value in trillion USD)

Global bonds: J.P. Morgan Hedged USD GBI Global total return index of developed market government bonds. Source: LGT Capital Partners, Bloomberg

However, investing in negative yielding government bonds and tight credit spreads is not a proposition we are willing to accept.

In fact, **we decided to take profit and reduce our EM hard currency bond exposure, while keeping a small overweight to local currency issues.**

The hard currency segment is now at its neutral position. The local currency segment has lagged in performance recently, but continues to offers an attractive carry in our view, as well as undervalued currencies. In addition, the relevant central banks have started to cut rates on tame inflation outlooks and have more room to cut in most cases, without risking further currency weakness.

## Currencies: long NOK position maintained

In our currency overlay, **we keep the long Norwegian krone (NOK) position against the Swiss franc (CHF)** in place. The pair trade did not move in our favor recently, as slower global growth and a waning risk appetite bolstered demand for the save haven franc.

However, macro data out of Norway remains solid, while the Norwegian central bank, in a rare deviation from the global trend, remains biased to tighten further (albeit at a slower pace than before, given that most other central banks are on an easing path).

It thus remains an attractive carry play and the pair has ample upside potential from a fundamental point of view. We do not have strong views on other currencies at present.

## Real and alternative assets: overweight in gold

Finally, **we keep our pronounced tactical position in gold**. We built this active position in two steps over the summer months, primarily on the heels of a technical breakout from a six-year-plus sideways trend. From a fundamental and policy viewpoint, the dovish shift by most central banks around the world and the rising supply of bonds with negative yields underpin this uptrend. Due to either storage costs (if held in physical form) or its futures rollover costs and fees (if held in securitized form), gold is a negative-yielding asset as well.

Last but certainly not least, gold also serves as a hedging and diversifying element in case of unforeseen events and geopolitical shocks, among others. The remaining alternative asset segments remain at their neutral, i.e. strategic, quota by design. Their main purpose is to deliver diversification benefits over the longer-term.

END OF REPORT

**LGT Capital Partners: tactical asset allocation for the Princely Strategies in USD**

The tactical asset allocation (TAA) relative to the neutral strategic allocation (SAA) is set quarterly with a time horizon of three to six months and adjusted in the interim when deemed necessary.

- **Equities: modestly overweight, with a clear preference for the US**
- **Fixed income: underweight duration and credit risk, with a small overweight in EM local currency debt**
- **Currencies: long NOK versus CHF and a small passive overweight in EM currencies**

| | Asset class | SAA | Tactical allocation versus SAA (underweight -4% … +4% overweight) |
|---|---|---|---|
| Fixed income | Short-term investments | 0.0% | +1% |
| | Global government bonds | 11.0% | -4% |
| | Global inflation linked bonds | 9.0% | -1% |
| | Investment grade corporates | 6.0% | -1% |
| | High yield bonds | 5.0% | -1% |
| | Emerging market bonds | 7.0% | +1% |
| Equities | Global | 2.0% | |
| | Global defensive | 7.5% | |
| | North America | 10.5% | +3% |
| | Europe | 5.0% | -1% |
| | Japan | 2.5% | |
| | Asia/Pacific ex Japan | 2.5% | |
| | Emerging markets | 6.0% | -1% |
| Alt. / Real | Listed private equity | 3.0% | |
| | Hedge funds | 12.0% | |
| | Insurance linked securities | 6.0% | |
| | Real estate (REITs) | 5.0% | |
| | Gold | 0.0% | +4% |

| | Currency | SAA | Tactical allocation versus SAA (-4% … +4%) |
|---|---|---|---|
| Currencies | USD | 86.0% | |
| | EUR | 0.0% | |
| | CHF | 0.0% | -2% |
| | JPY | 0.0% | |
| | AUD | 1.0% | |
| | NOK | 0.0% | +2% |
| | Others | 13.0% | +1% |

The table shows the LGT GIM Balanced (USD) strategy managed by LGT Capital Partners. The TAA is generally valid for all similar portfolios, but investment restrictions or liquidity considerations can lead to deviations in implementation. In currencies, "others" represents indirect exposures resulting from unhedged positions in various markets against a portfolio's base currency; the effective position of the base currency may thus deviate from the direct tactical position shown above.

## Performance of relevant markets

| | | 1 month | 3 months | Year to date | 3 years, p.a.[1] | 5 years, p.a.[1] |
|---|---|---|---|---|---|---|
| **Fixed Income** | | | | | | |
| Global government bonds | USD | 0.4% | 3.5% | 8.6% | 3.6% | 4.3% |
| Global inflation linked bonds | USD | -0.2% | 1.7% | 5.5% | 3.1% | 2.6% |
| Investment grade corporate bonds | USD | 0.3% | 2.6% | 8.5% | 3.5% | 3.6% |
| High yield bonds | USD | 0.9% | 1.9% | 10.2% | 5.8% | 4.4% |
| Emerging markets [2] | USD | -0.1% | 3.3% | 10.9% | 4.2% | 2.8% |
| **Equities** | | | | | | |
| Global | USD | 2.4% | 2.6% | 17.9% | 11.1% | 8.0% |
| Global defensive | USD | 0.5% | 3.3% | 18.2% | 10.2% | 9.6% |
| North America | USD | 2.1% | 3.4% | 20.2% | 13.0% | 9.1% |
| Europe | EUR | 3.4% | 1.8% | 16.9% | 7.6% | 5.6% |
| Japan | JPY | 3.9% | 0.7% | 6.7% | 7.1% | 5.2% |
| Asia/Pacific ex. Japan | USD | 3.8% | -0.4% | 8.7% | 6.7% | 3.0% |
| Emerging markets | USD | 3.0% | -1.2% | 6.5% | 6.0% | 1.2% |
| **Alternative and real assets** | | | | | | |
| Listed private equity | USD | 4.1% | 6.7% | 30.5% | 13.3% | 8.6% |
| Hedge funds | USD | 0.6% | 1.3% | 5.9% | 3.2% | 2.4% |
| Insurance linked securities (ILS) | USD | 0.6% | 2.4% | 2.2% | 2.2% | 3.6% |
| Real estate investment trusts (REITs) | USD | 0.7% | 3.5% | 23.8% | 7.3% | 7.5% |
| Gold | USD | -1.3% | 12.4% | 16.3% | 3.9% | 3.7% |
| **Currencies (vs. rest of G10) [3]** | | | | | | |
| US dollar | USD | 0.4% | 1.6% | 2.6% | 2.2% | 4.3% |
| Euro | EUR | -1.1% | -1.1% | -1.5% | 1.5% | 0.7% |
| Swiss franc | CHF | -1.8% | 1.6% | 1.5% | 1.5% | 2.9% |
| Japanese yen | JPY | -1.7% | 2.5% | 4.7% | 0.4% | 4.2% |
| Australian dollar | AUD | 1.6% | 0.0% | -0.4% | -1.3% | -2.0% |
| Norwegian krone | NOK | -0.5% | -2.4% | -1.3% | -0.9% | -3.3% |
| Emerging market currency index [4] | USD | -1.0% | -2.5% | -2.5% | -3.8% | -6.6% |

[1] Annualized return [2] Equal-weighted hard and local currency total return indices [3] Bloomberg correlation-weighted currency indices of a currency versus its nine major counterparts
[4] J.P. Morgan Emerging Market Currency Index Live Spot in USD | Source: Bloomberg

## Economic and corporate fundamentals

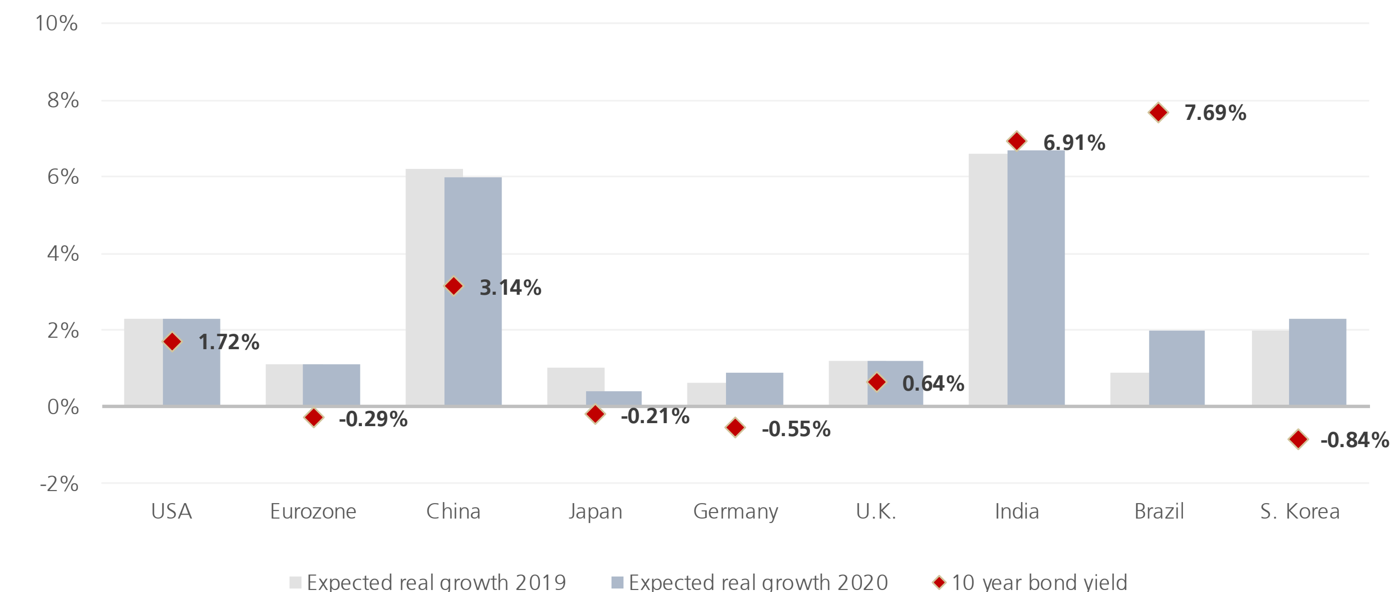
| | | USA | Eurozone | China | Japan | Germany | U.K. | India | Brazil | S. Korea |
|---|---|---|---|---|---|---|---|---|---|---|
| **Gross domestic product (GDP)** | | | | | | | | | | |
| - nominal | bn USD | 21,345 | 13,596 | 14,217 | 5,176 | 3,964 | 2,829 | 2,972 | 1,960 | 1,657 |
| - nominal, per capita 2018 [1] | USD, PPP | 64,767 | 40,965 | 19,520 | 45,565 | 53,854 | 46,782 | 8,484 | 16,662 | 42,985 |
| - expected real growth for 2019 | Consensus | 2.3% | 1.1% | 6.2% | 1.0% | 0.6% | 1.2% | 6.6% | 0.9% | 2.0% |
| - expected real growth for 2020 | Consensus | 2.3% | 1.1% | 6.0% | 0.4% | 0.9% | 1.2% | 6.7% | 2.0% | 2.3% |
| - real growth in most recent quarter | QoQ, p.a. | 2.0% | 0.8% | 6.6% | 1.3% | -0.3% | -0.8% | 4.3% | 1.8% | 4.1% |
| Unemployment rate 2019 | Consensus | 2.3% | 7.5% | 3.6% | 2.2% | 5.0% | 3.8% | 8.2% | 4.5% | 2.3% |
| Inflation rate 2019 | Consensus | 1.8% | 0.9% | 1.5% | 0.4% | 1.6% | 1.9% | 3.4% | 4.3% | 0.4% |
| Purchasing manager index (comp.) [2] | Neutral = 50 | 50.7 | 51.9 | 51.6 | 51.9 | 51.7 | 50.2 | 52.6 | 51.9 | 49.0 |
| | | | | | | | | | | |
| Structural budget balance/GDP 2019 | IMF | -5.2% | -0.9% | -6.1% | -2.8% | 0.7% | -1.2% | -6.9% | -6.3% | 2.3% |
| Gross government debt/GDP 2019 | IMF | 106.7% | 83.6% | 55.4% | 237.5% | 56.9% | 85.7% | 69.0% | 90.4% | 40.5% |
| Current account balance/GDP 2019 | IMF | -2.4% | 2.9% | 0.4% | 3.5% | 7.1% | -4.2% | -2.5% | -1.7% | 4.6% |
| International currency reserves | bn USD | 41.9 | 392.9 | 3,107.2 | 1,262.8 | 60.3 | 131.3 | 398.2 | 382.6 | 398.1 |
| | | | | | | | | | | |
| Govt bond yield 2yr [3] | p.a. | 1.66% | -0.68% | 2.67% | -0.28% | -0.84% | 0.48% | 5.77% | 7.30% | -1.06% |
| Govt bond yield 10yr [3] | p.a. | 1.72% | -0.29% | 3.14% | -0.21% | -0.55% | 0.64% | 6.91% | 7.69% | -0.84% |
| Main policy interest rate [4] | p.a. | 2.25% | 0.00% | 4.35% | -0.10% | 0.00% | 0.75% | 5.40% | 6.00% | 1.50% |

[1] IMF estimates [2] Manufacturing PMI for Korea [3] Currency swap rates for China and Brazil and closest ESM/EFSF bond for Eurozone [4] Max target rate for Fed

| | | USA | Eurozone | China | Japan | Germany | U.K. | India | Brazil | S. Korea |
|---|---|---|---|---|---|---|---|---|---|---|
| Exchange capitalization* | bn USD | 31,970 | 7,475 | 12,030 | 5,746 | 2,046 | 3,120 | 949 | 666 | 1,736 |
| **Growth in earnings per share, estimated (MSCI)** | | | | | | | | | | |
| 12 months forward / trailing 12 months | Consensus | 16.6% | 34.6% | 18.4% | 7.8% | 50.6% | 45.8% | 22.9% | -7.3% | 33.9% |
| 24m fwd / 12m fwd | Consensus | 3.6% | 2.9% | 4.1% | 2.4% | 3.4% | 2.3% | 3.8% | 0.7% | 2.8% |
| **Growth in revenue per share, estimated (MSCI)** | | | | | | | | | | |
| 12m fwd / trail 12m | Consensus | 5.5% | 3.6% | 11.3% | 2.0% | 6.2% | 1.7% | 6.9% | 3.0% | 2.7% |
| 24m fwd / 12m fwd | Consensus | 4.6% | 4.1% | 10.7% | 2.8% | 3.4% | 2.8% | 4.6% | 4.6% | 2.3% |
| **Valuations (MSCI)** | | | | | | | | | | |
| Price-Earnings Ratio (est 12m fwd) | Consensus | 17.2 | 13.4 | 11.4 | 12.6 | 13.0 | 12.2 | 12.4 | 5.8 | 16.9 |
| Price-Sales Ratio (est 12m fwd) | Consensus | 2.1 | 1.1 | 1.2 | 0.8 | 0.8 | 1.1 | 1.6 | 0.9 | 2.2 |
| Dividend yield | Consensus | 1.9% | 3.5% | 2.3% | 2.6% | 3.2% | 4.9% | 3.0% | 7.0% | 3.1% |

* China market cap includes Hong Kong | Source: Bloomberg    Data per: 9/11/2019

## Interest rates and expected economic growth

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