Changes in the strategic asset allocation

Marketing material

Today, we present the key results of the recent annual strategy review for the LGT Endowment, or Princely Portfolio. In brief, we decided to raise the allocation to equities and private real estate somewhat, while reducing investment grade bonds. Furthermore, we also comment on the current Coronavirus outbreak's potential impact on financial markets.

Revised set of future scenarios

In setting the strategic asset allocation (SAA) for the Princely Strategy, we use scenario planning to deal with uncertainties. This approach allows for a variety of future paths with both benign and adverse developments, hence reducing the risk of surprises and helping to avoid potentially costly and unnecessary ad-hoc position shifts. During 2019, like every year in principle, we reviewed and subsequently revised the existing scenario landscape based on structured discussions as well as inputs from external experts. These considerations covered a whole host of driving factors and topical issues, ranging from the future of monetary and fiscal policy to rising inequality and its implications or the potential economic impact of climate change.

Muddling through to an era of "competitive prosperity"?

In our view, the most likely path going forward will not differ much from the developments experienced in the aftermath of the 2008 global financial crisis. We are probably headed toward another period of "muddling through," i.e. a global scenario in which monetary and fiscal policy makers react in a reluctant, piece-meal fashion to a plethora of economic challenges, albeit only when (and if) problems intensify.

Thus, the environment of sluggish economic growth accompanied by stubbornly low inflation and near-zero or even negative real interest rates will most likely persist (i.e. nominal interest rates are likely to be lower than the annual rate of inflation in many cases). At the same time, in the absence of major economic imbalances, financial markets conditions should remain quite benign, although volatility and the occurrence of intermittent corrections could well increase from currently very low and infrequent levels.

The newly added scenario "competitive prosperity" is the reformulation and repositioning of an existing scenario. In short, it is a more benign variation of the existing "global protectionism." The race for technological supremacy between the US and China is at the center of this possible future path and encapsulates a wave of government-sponsored research and development (R&D) investments that nurtures innovation, boosts productivity and stimulates economic growth. This scenario also leaves the global economy less integrated as the superpowers repatriate supply chains and set their own technology standards.

Adverse outlier scenarios loom in the background

Finally, in our less likely and mostly adverse outlier scenarios, a new path features a sharp rise in government interventions and redistribution policies as a response to the surge in perceived income and wealth inequality. This scenario entails a breaking up and/or punitive taxation of very large and powerful corporations ("taming corporate power"). Furthermore, we intend to do more research regarding the potential impact of climate change on the global economy and asset classes. One the next page, we present the overview of our new scenarios set and highlight the changes.

Reaffirming the strategic pillars for 2020

Due to the likely extension of the prevailing economic and market environment, our revised scenario framework (graph 1, next) and our updated capital market assumptions (graph 2, page after next), we reaffirm the positioning of the Princely Strategy and implement only minor changes in the SAA. The main pillars and core beliefs of our long-term allocation are as follows:

- **Long-term growth portfolio with significant private market, public equity and select credit exposure.** The Princely Strategy aims to achieve capital preservation and appreciation, which gives equity investments in developed and to a lesser degree in emerging markets their due place in the portfolio. The long-term investment horizon of the strategy further allows the harvesting of extra returns on illiquidity and active value creation from private market investments, namely in private debt and private equity.

- **Portfolio diversification with a focus on liquid alternative assets and real assets.** Preparing the Princely Strategy for a variety of future developments means that the portfolio must optimally diversify across asset classes, risk factors, industries and geographic regions. As high-grade government bonds are no longer providing real income, only a reduced quota remains in the portfolio for risk management purposes. Complementary, systematic trading and dynamic protection programs are in place to provide downside mitigation in periods of market stress. Real assets, such as real estate and infrastructure, balance current income with future capital appreciation, while they also bring inflation-protecting features to the portfolio.

- **Active management.** We select best in class managers based on their proven ability to generate excess returns, up and above market beta and style biases. The same strict qualification criteria apply for our internal (fee-forbearing) direct strategies. Furthermore, we use cost-efficient passive instruments to manage the various positions tactically and to rebalance the portfolio.

Graph 1
Scenario framework 2020 and overview changes

	Baseline (high likelihood)	Alternative scenarios (medium probability of occurrence)			Outlier scenarios (low probability of occurrence)		
	"Muddling through"	**Reflationary growth**	**Competitive prosperity**	**Global protectionism**	**Monetary debasement**	**Taming corporate power**	**Deflationary depression**
2020	Elevated economic volatility due to interplay between politics and markets/economy	Coordinated monetary/fiscal easing succeeds in reflating the global economy	Bipolar world order fosters race for technological and economic supremacy	Nationalistic and protectionist policies halt trade growth	Loss of confidence in fiat money leads to runaway inflation	Splitting up monopolies and redistributing economic profits	Debt defaults, deflation and recessions dominate
Changes	**Reclassifications** ▪ Reduce number of baseline scenarios ▪ Effective reflation would require explicit or implicit fiscal and monetary policy coordination to a much larger extent ▪ A muddling through the structural challenges remains the single most likely path		**Adjustment of scenarios** ▪ Increasingly bipolar world order ▪ Sino-US arms race for technological, military and economic supremacy drives public investments, fosters innovation and spurs productivity ▪ Fragmentation with a US- and China-led sphere of influence			**New outlier scenario** ▪ Opposition against multinational companies that are seen as abusing their corporate power and aggravating socio-economic inequalities ▪ Governments/governmental institutions are expanding their influence, splitting up quasi-monopolies and intensifying market regulation	

Source: LGT Capital Partners

Changes in the strategic weights

For this review, actual amendments to the SAA are hence few and mostly in affirmation of aforementioned core beliefs. Those amendments are as follows:

- **Aggregation and reduction of investment grade bonds.** We aggregate investment grade bonds and treat it as one asset class, as somewhat reduced in terms of the overall weight. As in the past, our in-house fixed income team will manage the entire allocation, which will consist of the three strategic pillars of global government bonds, global inflation-linked bonds and investment-grade corporate bonds. Furthermore, **the overall weight of the new IG position declines from 8% to now 6%**. Given the persistently low rate environment, the remaining quota in investment grade bonds is mainly held for diversification purposes and as a source of portfolio liquidity, for instance in case anti-cyclical buying opportunities in other asset classes should arise.

- **Small increase in global developed equities quota.** We increase the allocation to global developed equities from 17% to 18%, as the equity risk premium remains attractive given current market metrics and our long-term scenario outlook. Our strategic baseline scenario "muddling through" is generally a positive scenario for equities, as it envisions input costs (e.g. labor, raw materials) remaining under control and margins staying attractive. The strategic allocation to defensive equity strategies, such as minimum volatility and sustainable quality, remains unchanged. In sum, the allocation to public equities increases from 30% to 31%.We also stopped listing the Asia-Pacific ex. Japan segment separately as the corresponding markets are already included in the mentioned global, regional as well as the emerging markets positions.

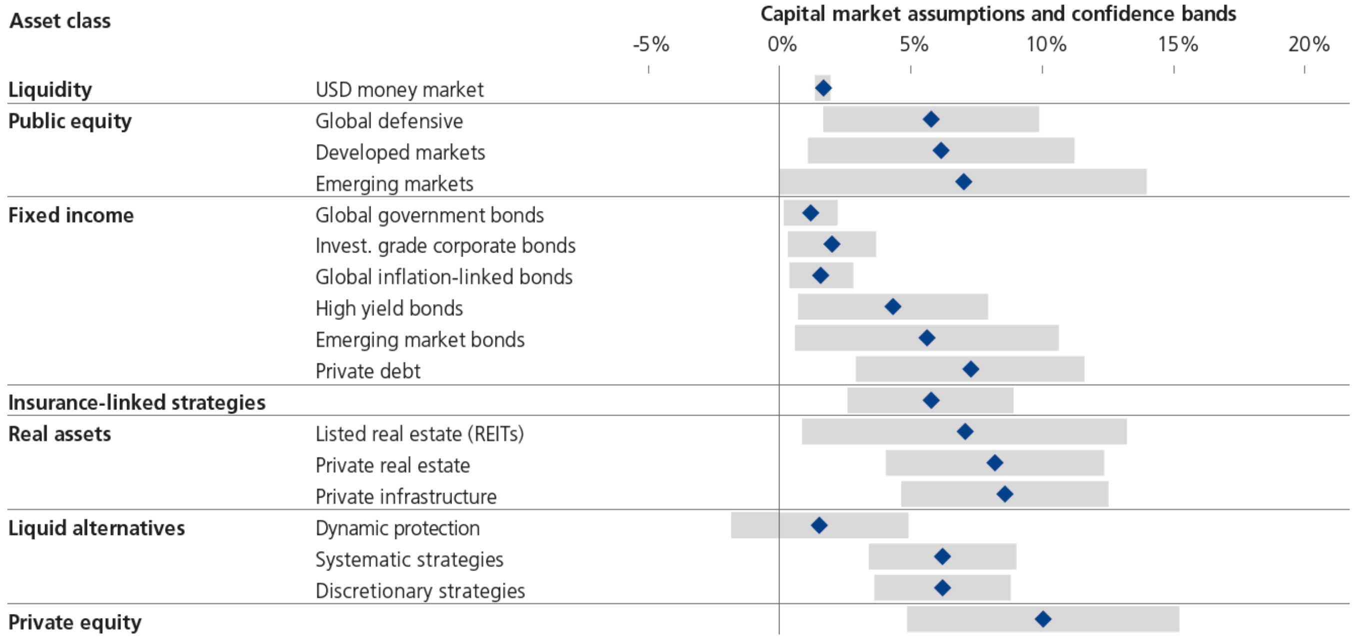
- **Small increase in private real estate.** The real asset quota will be increased by 1% on the back of attractive bottom-up opportunities in value-add real estate and their attributes of bringing income, growth and partial inflation protection to the portfolio.

The new SAA became effective on 1 January 2020. As always, our portfolio managers will implement these changes over a reasonable period, allowing to take market conditions into account.

Graph 2

LGT Capital Partners return expectations for the asset classes until 2025

(Total nominal returns in USD, p.a., valid per 1 January 2020)

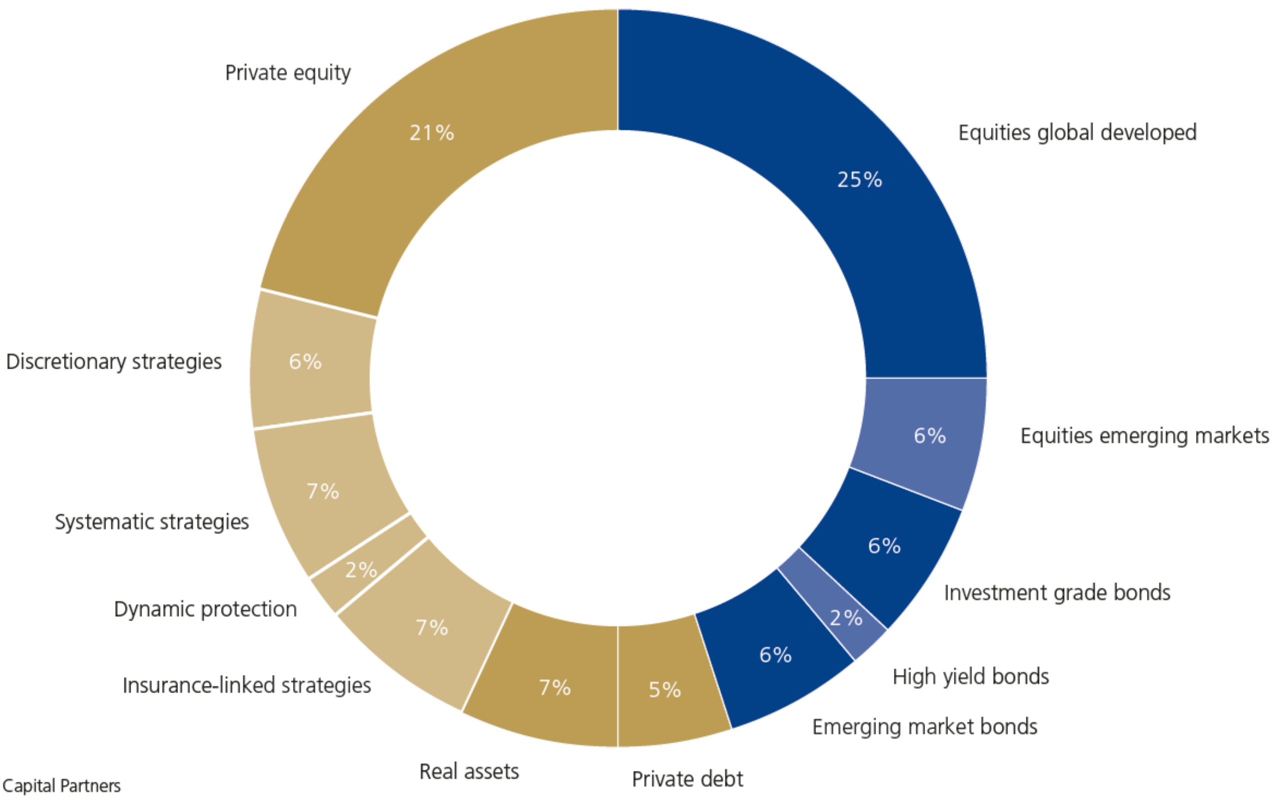


Source: LGT Capital Partners

LGT Capital Partners capital market assumptions are market, or beta, geometric return expectations over a horizon of 5 years. The confidence bands represent the 25th and 75th percentiles of the potential return pathways. **Returns may increase or decrease as a result of currency fluctuations. Performance data net of fees and all costs charged by the underlying funds, gross of all LGT fees. Fees and other costs will reduce the performance to the investor. This data is purely indicative and is not a guarantee of future results, and there can be no assurance that the fund will achieve comparable results.**

Graph 3

Strategic asset allocation of the Princely Strategy



Source: LGT Capital Partners

The above pie chart represents the SAA for the endowment version of the Princely Strategy. The quotas for the liquid versions of the strategy vary depending on regulatory and investor requirements, with private market investments substituted by publicly traded proxies, as is the case in the reference portfolio of this publication, as shown on page 4 (i.e. the LGT GIM Balanced in USD).

Special current topic:

Coronavirus outbreak: caution without panic

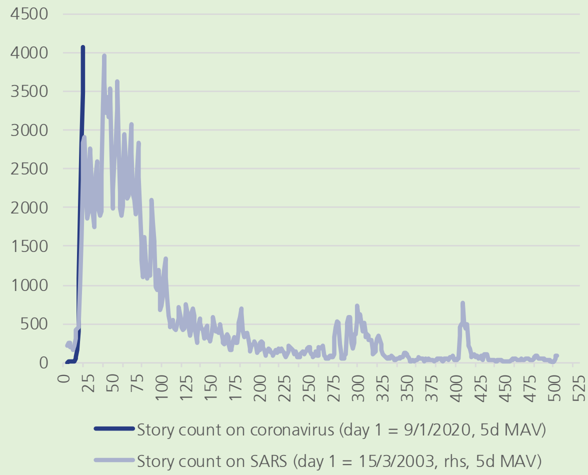
The outbreak of the novel Coronavirus, or COVID-19, in Wuhan, China, last December began to attract worldwide media attention in late January, initially triggering sharp selloffs in equities while boosting government bonds and other so-called safe assets close to recent highs. History shows that market reactions can be severe and volatile until a slowdown of the infection growth rate, i.e. first step of containment, becomes visible. This may already be the case, as trend projections show. Furthermore, monetary policy signals in particular China and the US helped restore confidence in risk assets rather quickly, while also depressing bond yields and term premia lower once again.

Nevertheless, some caution remains warranted. The massive movement of people returning from the Chinese Lunar New Year holiday and COVID-19's relatively long incubation period (around 14 days) pose challenges to the containment. There is still a risk of another uptick in the pace infections as a result. Its economic impact will also start to show up in the data in the coming weeks. At present, analysts expect COVID-19 to cause a much larger economic drag than the Severe Acute Respiratory Syndrome (SARS) epidemic in 2003. According to surveys, forecasters expect the drag on global growth to amount to 3% (quarter-on-quarter, annualized), compared to 1% for SARS, mainly because China's economy is much larger and much more interconnected today than 17 years ago. A post-virus recovery could also prove slow for the same reason.

Graph 4

Counts of media stories about the epidemics

(Five-day moving average of story count per day)



Source: Bloomberg, LGT Capital Partners

Over the medium term, however, such concerns may prove overdone. Consensus forecasts tend to rebound quickly as risk aversion recedes and markets recover. During the SARS outbreak, the first part of the second quarter of 2003 saw a panicked reaction, with both private sector and government economists hurrying to downgrade their forecasts. As the health authorities eventually contained the spread and confidence returned, they quickly reversed course accordingly, even though initial economic disruptions were indeed large.

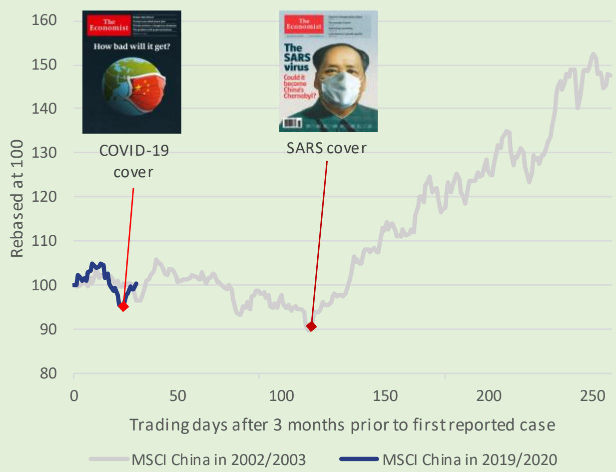
In this context, media attention can offer a useful counter-indicator for a trend reversal in broader confidence and the news cycles of the current Wuhan virus outbreak and the SARS epidemic of 2002 offer similarities. Indeed, peak media attention may already be behind us – at least as far as media that investors and business people generally follow are concerned.

Below we inserted The Economist magazine's covers of 26 April 2003, related to SARS, and on 1 February 2020, related to the Coronavirus. The SARS cover marked the beginning of the post-SARS rally and – so far – markets are on track to follow the same pattern this time as well (graph 5).

Graph 5

Financial media attention and equities

(Rebased on the date of first reported patient*)



*16 Nov 2002 for SARS and 31 Dec. 2019 for COVID-19 Source: Wikipedia, Bloomberg, LGT Capital Partners

Positioning: neutral in equities, with gold as a diversifier

Our post-outbreak investment views are as follows:

- **We continue to expect a modest cyclical growth pick up this year:** The COVID-19 outbreak may complicate and delay the recovery if it lasts for much longer, particularly in China and economically exposed partner countries. At the same time, reduced trade tensions, due to the US-Chinese agreement last month, and in all likelihood additional fiscal and monetary stimuli should provide relief over the medium term.

- **We reiterate our broadly neutral tactical equity allocation:** we should add that we had decided to cut equities to neutral in late December, with an overweight in the US balancing an underweight in the emerging markets (EM). Since then, markets have generally traded in line with this positioning since, with US equities up about 3% year-to-date, while the EM are down about 1.3%. **The overall equity quota and the regional weights thus remain appropriate.**

- **Gold remains our most pronounced tactical overweight** as an attractive risk-diversifier

END OF REPORT

LGT Capital Partners: tactical asset allocation

The tactical asset allocation (TAA) is set quarterly with a time horizon of up to six months and adjusted in the interim if necessary; it shows our current positioning versus the strategic allocation (SAA) of the LGT Endowment, or Princely Strategy.

- **Equities: neutral overall with an US overweight balanced by underweights in Europe and the EM**
- **Fixed income: pronounced underweight in duration and investment grade borrowers**
- **Currencies and real assets: long Japanese yen against the euro, overweight in gold**

	Asset class	SAA	underweight ----	---	--	-	Tactical allocation versus SAA +	++	+++	overweight ++++
Fixed income	Short-term investments	0.0%								
	Investment grade bonds*	24.0%								
	High yield bonds	5.0%								
	Emerging market bonds	7.0%								
Equities	Global defensive	7.5%								
	Global developed	23.5%								
	North America									
	Europe									
	Japan									
	Emerging markets	6.0%								
Alt. / Real	Listed private equity	4.0%								
	Hedge funds	12.0%								
	Insurance-linked securities	6.0%								
	Real estate (REITs)	5.0%								
	Gold	0.0%								

	Currency[2]	SAA	----	---	--	-	+	++	+++	++++
Currencies	USD	87.0%								
	EUR	0.0%								
	CHF	0.0%								
	JPY	0.0%								
	AUD	1.0%								
	NOK	0.0%								
	Others	12.0%								

The liquid LGT GIM Balanced (USD) is used a reference portfolio in the above table. 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. * Includes global government, inflation-linked and corporate bonds.

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	1.6%	2.4%	2.0%	5.0%	3.7%
Global inflation linked bonds	USD	0.5%	1.2%	0.9%	3.0%	2.7%
Investment grade corporate bonds	USD	1.1%	2.4%	1.4%	4.8%	3.8%
High yield bonds	USD	0.3%	3.1%	0.7%	6.1%	6.0%
Emerging markets [2]	USD	0.0%	2.9%	0.4%	5.9%	4.8%
Equities						
Global	USD	2.4%	7.1%	3.6%	12.0%	9.3%
Global defensive	USD	3.4%	6.8%	3.7%	12.5%	10.0%
North America	USD	3.0%	9.0%	4.2%	14.3%	11.1%
Europe	EUR	1.6%	4.2%	2.5%	8.1%	6.4%
Japan	JPY	-0.5%	1.2%	0.5%	6.0%	5.1%
Emerging markets	USD	-3.0%	4.5%	-1.3%	8.3%	5.0%
Alternative and real assets						
Listed private equity	USD	4.2%	10.4%	5.0%	14.9%	11.2%
Hedge funds	USD	1.5%	2.6%	8.3%	3.4%	3.0%
Insurance linked securities (ILS)	USD	0.4%	1.1%	0.6%	2.5%	3.8%
Real estate investment trusts (REITs)	USD	4.9%	7.9%	4.6%	10.8%	6.8%
Gold	USD	1.1%	7.4%	3.1%	8.2%	5.1%
Currencies (vs. rest of G10) [3]						
US dollar	USD	1.9%	0.0%	3.0%	1.2%	2.0%
Euro	EUR	-0.3%	-1.0%	-0.1%	2.1%	1.0%
Swiss franc	CHF	1.5%	1.9%	1.9%	2.2%	1.0%
British pund	GBP	0.9%	1.0%	0.4%	2.5%	-1.8%
Japanese yen	JPY	1.4%	-0.9%	1.7%	2.3%	3.9%
Australian dollar	AUD	-1.0%	-1.9%	-1.9%	-3.7%	-1.1%
Norwegian krone	NOK	-2.5%	-1.0%	-2.7%	-2.5%	-2.2%
Emerging market currency index [4]	USD	-2.3%	-0.6%	-2.6%	-3.9%	-4.6%

[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

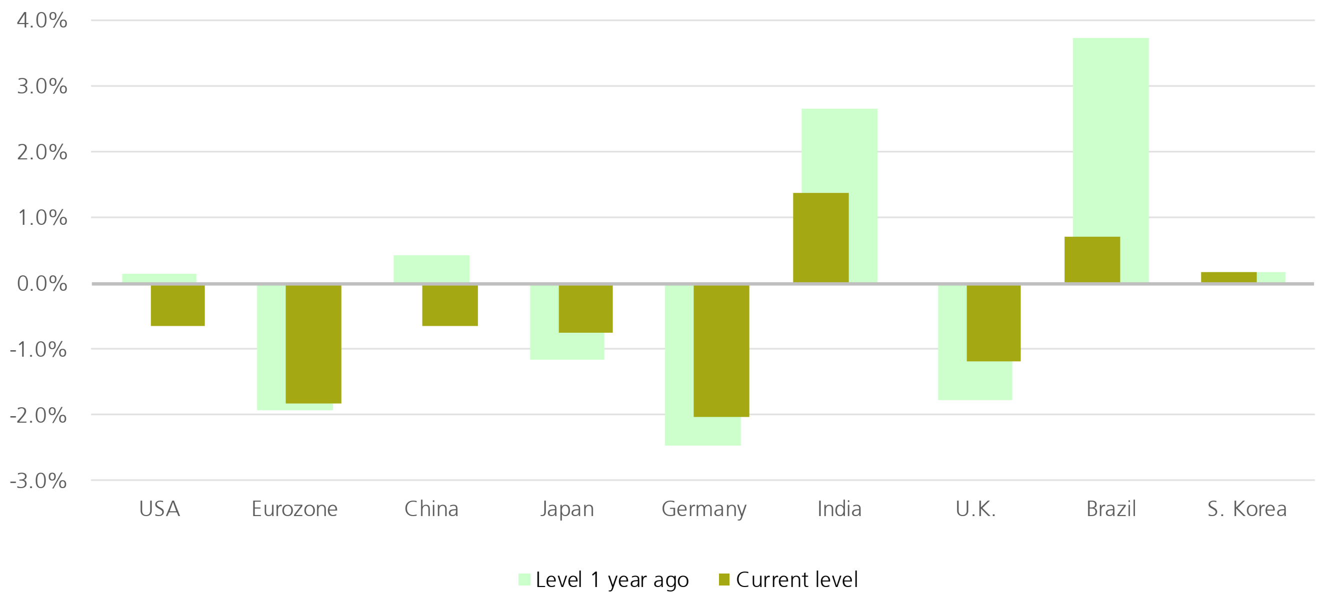
		USA	Eurozone	China	Japan	Germany	India	U.K.	Brazil	S. Korea
Gross domestic product (GDP)										
Nominal, this year[1]	bn USD	22,322	13,678	15,270	5,413	3,982	3,202	2,717	1,893	1,627
Per Capita, purchasing power parity[1]	USD, PPP	67,427	40,965	20,984	46,827	55,306	9,027	48,169	17,016	46,452
Real growth this year[1]	Consensus	1.8%	1.0%	5.8%	0.4%	0.7%	5.0%	1.0%	2.2%	2.2%
Real growth next year[1]	Consensus	1.9%	1.3%	5.8%	0.8%	1.2%	6.0%	1.4%	2.5%	2.3%
Real growth current quarter	Annualized	2.1%	0.4%	6.1%	1.8%	0.3%	4.3%	1.7%	2.5%	4.9%
Unemployment this year	Consensus	1.8%	7.4%	3.6%	2.2%	5.0%	8.2%	3.8%	4.6%	2.3%
Inflation this year	Consensus	2.1%	1.3%	3.1%	0.6%	1.4%	4.4%	1.7%	3.8%	1.1%
Purchasing manager index (comp.) [2]	Neutral: 50	53.3	51.3	51.9	50.1	51.2	56.3	53.3	52.2	49.8
Structural budget balance/GDP	IMF	-6.3%	-0.9%	-6.2%	-2.1%	1.0%	-7.1%	-1.4%	-6.0%	-0.3%
Gross government debt/GDP	IMF	108.0%	82.3%	60.9%	237.6%	55.7%	68.5%	84.8%	93.9%	43.4%
Current account balance/GDP	IMF	-2.6%	2.7%	0.9%	3.3%	6.6%	-2.3%	-3.7%	-1.0%	2.9%
International currency reserves	bn USD	41.0	386.6	3,115.5	1,272.5	59.2	419.4	137.5	353.6	402.4
Govt bond yield 2yr [3]	p.a.	1.44%	-0.52%	2.45%	-0.15%	-0.64%	5.79%	0.50%	4.52%	1.26%
Govt bond yield 10yr [3]	p.a.	1.62%	-0.22%	2.99%	-0.04%	-0.39%	6.48%	0.57%	6.50%	1.60%
Main policy interest rate [4]	p.a.	1.75%	0.00%	4.35%	-0.10%	0.00%	5.15%	0.75%	4.25%	1.25%

[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	India	U.K.	Brazil	S. Korea
Exchange capitalization*	bn USD	35,571	8,136	12,791	6,198	2,227	1,003	3,331	738	1,919
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	18.9%	41.2%	20.3%	12.2%	63.7%	34.6%	47.4%	17.8%	48.7%
Next fy / 12m fwd	Consensus	9.1%	7.9%	10.0%	1.7%	10.3%	2.7%	4.3%	8.2%	23.3%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	10.0%	4.7%	23.9%	3.2%	10.9%	6.2%	-0.7%	5.6%	-0.7%
Next fy / 12m fwd	Consensus	4.1%	2.6%	8.7%	0.4%	2.8%	1.8%	2.2%	6.0%	5.3%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	19.2	14.8	12.2	14.0	14.3	18.4	13.1	13.7	11.7
Price-Sales Ratio (est 12m fwd)	Consensus	2.3	1.1	1.3	0.9	0.9	1.8	1.2	1.7	0.8
Dividend yield	Consensus	1.8%	3.3%	2.2%	2.4%	3.0%	1.5%	4.8%	3.4%	2.4%

* China market cap includes Hong Kong | Source: Bloomberg — Data per: 12.02.2020

Real government interest rates (based on two-year bond yield)



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