Staying calm and acting counter-cyclically

Marketing material

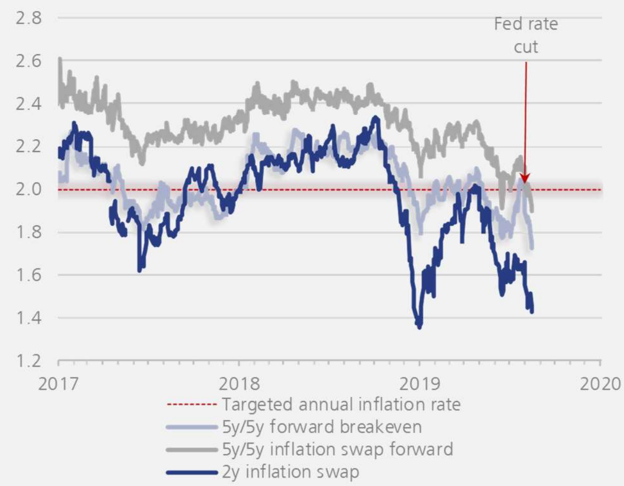
August brought a monetary policy disappointment and revived Sino-American trade tensions, triggering a global pullback in risk assets. In late July, near the markets' top, we had trimmed US equities and increased our gold position. More recently, we bought Japanese equities, after our counter-cyclical investment rules produced a buy signal for that market.

An uninspiring Fed decision

On Aug. 1, the US Federal Reserve as expected cut its policy rate by 25 basis points to a range between 2% to 2.25% and Chairman Jerome Powell communicated that policy makers did not necessarily viewed this cut as the start of new easing cycle.

Investors were particularly disappointed by Powell's policy comments: risk asset prices began to fall, government bonds rallied, and the yield curve flattened and eventually inverted. Inflation-linked instruments started to retreat as well, with short-term inflation expectations tumbling the most, while longer-term projections slipped slightly below to the targeted average level of 2% per year. It is also clear that the markets do not see the trade war as having a lasting net inflationary effect.

Graph 1
Inflation expectations decline after Fed's rate cut
(Implied inflation based on swaps and inflation-linked bonds)



Source: LGT Capital Partners, Bloomberg

Given these developments, the Fed will most likely have to ease again before too long – and perhaps more forcefully than it would have had to otherwise. Monetary theory suggests that central banks should surprise on the dovish side whenever inflation expectations are too low. Still, while the Fed may have fallen behind the curve for now, it can easily get in front of it again, as it did in January this year. Thus, we do not see this decision as having caused permanent damage to markets.

A new salvo in the trade war

Also on Aug. 1, just hours after the Fed decision, US President Donald Trump tweeted the imposition of an additional tariff of 10% on the remaining tariff-free USD 300 billion worth of Chinese imports, including common consumer goods, such as phones, shoes and toys, and potentially rising to 25% later. As things stand, all Chinese imports will eventually be subject to tariffs (table 1). Initially, the tweet shocked markets because the US and China had just restarted bilateral talks two days earlier.

Table 1
Overview of key US trade actions against China

Date	Event / tariff rate	Target country	Product
17.01.2018	Section 301 probe	China	Intellectual property
23.01.2018	20-50%	Global	Solar panels, washing machines
08.03.2018	10-25%	Global, with exemptions	Aluminum, steel
03.04.2018	25%	$50b of Chinese imports	Various goods
10.07.2018	10%	$200b of Chinese imports	Various goods
05.05.2019	Increased and new	For above $200b, rate increase to 25%; new tariffs for another $300b of Chinese goods	
18.06.2019	Agree to resume talks	China	
01.08.2019	10%, to rise to 25%	The tariff-free $300b of imports mentioned above	Various goods
05.08.2019	Currency manipulation	US Treasury designates China a currency manipulator, authorizing president to take action	

* Section 301 refers to the part of 1974 US trade law that lays out how the US should enforce its rights under trade agreements. The probe into alleged Chinese intellectual property theft on January 17, 2018 was an early sign of the escalation of trade war. Source: LGT Capital Partners, Reuters

The market seems eager to rally

In response to the latest monetary and trade policy events, market sentiment quickly soured. By mid-month, volatility had jumped to the highest levels since last December (graph 2). However, recent market behavior suggests that the worst may be behind us soon.

The newest tariffs were initially to take effect on Sept. 1. However, on Aug. 13, the president moved the tariff activation for most items to mid-December to minimize short-term business disruptions. Revealingly, this little tweak in the decision triggered an instant rally in equities, with the S&P 500 surging as much as 2.1% on that day. This response suggests that the correction may indeed have gone too far – as even small positive surprises, if not largely meaningless ones, can trigger big gains.

On the other hand, the aftereffects of the slumping inflation expectations caught up again with markets on the following day, when news about the inversion of the US yield curve triggered another selloff (yield curve inversions suggest monetary policy will remain behind the curve for a long time and have historically occurred ahead of recessions).

This kind of volatile environment continues to compel us to avoid pronounced overweight in equities and to maintain a defensive bias within our portfolios (for example, we have allocated about 1/3 of our global equity quota to our sustainable quality strategy).

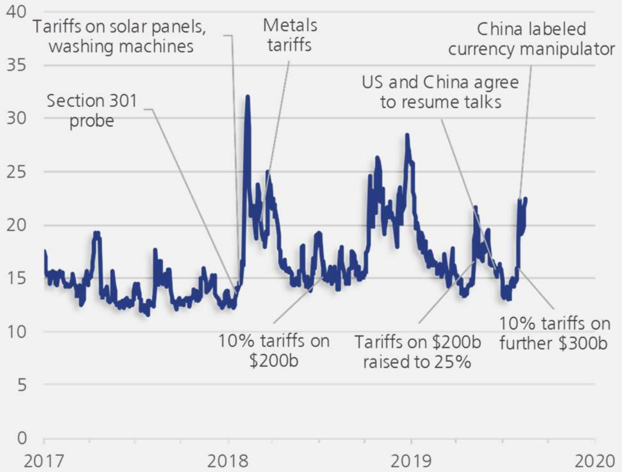
Learning to live with permanent confrontation?

Nevertheless, as our overall macro view remains constructive, we believe this kind of market regime also offers trading and counter-cyclical investment opportunities. In fact, in the bigger picture, investors seem to be getting gradually used to the constant back and forth in the Sino-America trade negotiations, which many observers increasingly view as part of a broader, potentially permanent geostrategic rivalry.

Graph 2

Global equity market volatility and trade war events

(Equal-weighted index for US, Europe, Japan and Hong Kong)



Source: LGT Capital Partners, Bloomberg

While the so-called trade war has been steadily escalating and becoming a permanent backdrop, each new convulsion in the trade war has generally had less of a negative impact, with each new surge in volatility being less intense that the previous one.

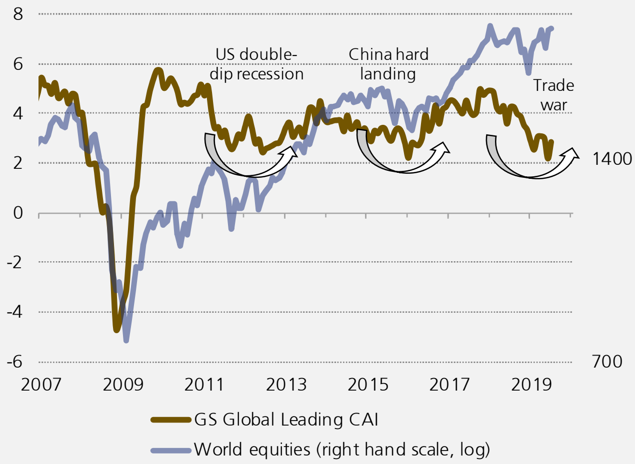
Hence, as mentioned last month, if the global economic growth outlook and corporate earnings remain sufficiently constructive, equity markets are likely to stabilize, confirming the broader bullish regime of the past decade. The often-cited concerns about the trade war could thus ultimately prove to be just the latest of the occasional major scares that, while obvious to everyone, ultimately fail to materialize (at least not in in a way that leads to a lasting bear market).

Since 2009, the global economy has experienced two slowdowns like the current one, which were accompanied by broader scares ("double-dip recession" in the US, "hard landing" in China). The slowdowns took their course, but macro policies eventually responded appropriately - and the scares never fully materialized as a result. Thus, given the recent (ongoing) dovish shift in global monetary policy, it would not surprise us if global economic activity picks up in the coming months and quarters again, from its current through (graph 3).

Graph 3

Economic cycles and market scares of this bull market

(MSCI World in local currencies)



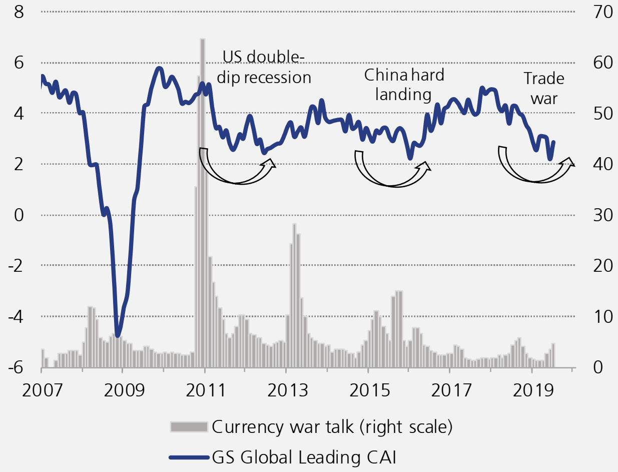
GS Global Leading CAI = Godman Sachs Global Leading Current Activity Index. This index combines a wide range of key macroeconomic data from around the world. Source: LGT Capital Partners, Goldman Sachs, Bloomberg

Are "currency wars" bad?

In this context, we would also advise against giving too much credence to buzzwords that accompany the scare. The term "currency war," for example, has resurfaced again following the US Treasury's decision to declare China a "currency manipulator" on Aug. 5. Based on Google data, the phrase tends to appear near the low points of the mentioned cyclical slowdowns (graph 4, next page). Beyond providing a catchy-sounding narrative for market stories, the phrase lacks a well-defined economic meaning.

At any rate, if a "currency war" means a US monetary policy becoming so easy that it would initiate a lasting US dollar (USD) bear market, it could actually prove very positive for global risk assets, be they real (i.e. hard assets such as precious metals) or purely financial. After all, a weaker USD tends to ease global liquidity conditions and support commodity prices, which in turn tend to bolster the emerging economies. By contrast, a strong USD, if not offset by domestic easing, can have the same effect as global monetary tightening on much of the rest of the world, particularly on emerging markets.

Graph 4
Talk of "currency wars" over the economic cycle
(Three-month moving average for currency war mentions)



Source: LGT Capital Partners, Google, Bloomberg, Goldman Sachs

Indeed, the recent surge in the gold price may be a very early confirmation for a global shift toward a reflationary outlook. If that indication proves correct, market-based interest rates and inflation expectations should eventually start to rise as well.

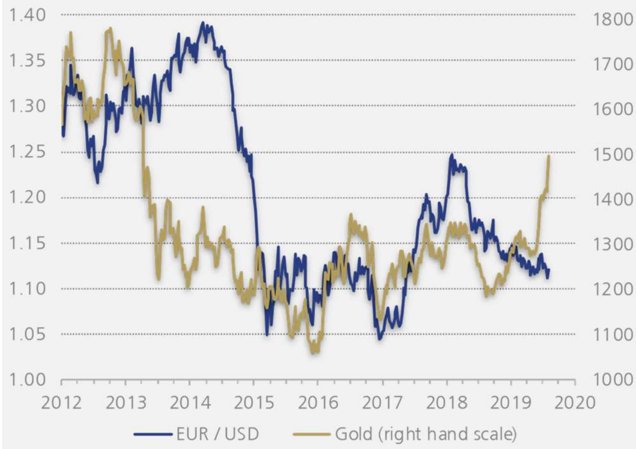
Graph 5
Is the USD bull market about to reverse?
(USD against various broad currency baskets, standardized)

The Fed's US Trade Weighted Broad Dollar Index represents the "USD Broader Basket." The Bloomberg Correlation-Weighted USD Index shows the USD as it traded versus a roughly equal weighted basket of the other nine major freely convertible currencies.
Source: LGT Capital Partners, Bloomberg

In line with this possibility, we have recently added gold to our asset allocation and are now markedly overweight in the precious metal. At the same time, at present we do not have a firm view on whether the USD is about to enter a broader bear market – although we certainly see a potential for a pullback.

After all, the Greenback has been generally strong against most trade-partners' currencies for eight years now. Expressed in standard deviation of the mean, in trade-weighted terms the USD's strength is close to historical extremes, although it is still not very strong when compared to European currencies and the Japanese yen. In the former case, it is approaching 2 standard deviations above the mean, in the later only about 0.5 times (graph 5).

Graph 6
A weaker USD helps support precious metals
(Gold spot price in USD per ounce)



Source: LGT Capital Partners, Bloomberg

Overall, given that the signs of global reflation (and inflation expectations) are still only tentative at best, we consider the precious metal to be the best way to play this theme, while also maintaining the potential to benefit from more negative topics, such as geopolitical developments, that also frequently grip many investors' minds in uncertain times (graph 6).

Better than expected earnings

The global earnings season for the second quarter of 2019, potentially the low point in this cycle, proved better than expected in most markets.

Table 2
Overview of global earnings season for Q2/2019
(Based on per-share data, in local currency)

	Earnings per share, yoy	Revenue per share, yoy	Nominal GPD, yoy	Price to next year's earnings ratio
USA	1.8%	3.7%	4.0%	15.6
Europe	-0.9%	2.0%	3.2%	12.7
Eurozone	0.2%	2.9%	2.8%	12.4
Japan	5.0%	1.6%	1.4%	11.5
Asia-Pacific ex Japan	-16.4%	2.5%	7.3%	12.2
Emerging markets	-16.9%	2.7%	9.8%	10.8
	Earnings vs. consensus	**Revenue vs. consensus**	**Percentage of positive surprises**	**Percentage of reports out**
USA	5.0%	0.6%	75.9%	92.6%
Europe	3.4%	2.0%	57.2%	57.2%
Eurozone	5.2%	2.9%	63.9%	63.9%
Japan	8.7%	1.6%	51.4%	51.4%
Asia-Pacific ex Japan	-7.5%	2.5%	48.4%	48.4%
Emerging markets	-7.2%	2.7%	46.4%	46.4%

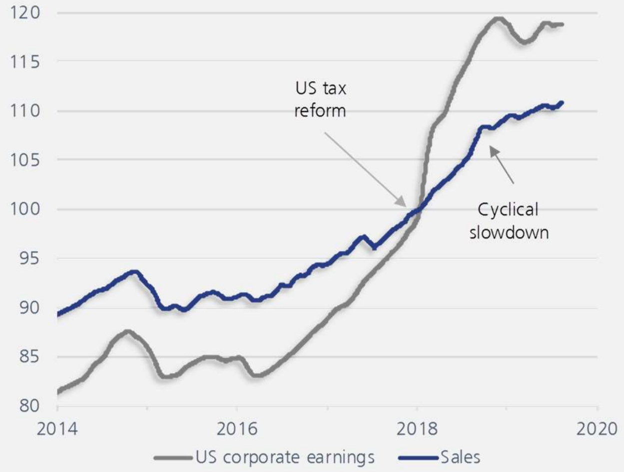
Earnings versus consensus: deviation of actual aggregated result from the aggregated consensus forecast (i.e. the average of all available analyst forecasts) in percent. Source: LGT Capital Partners, Bloomberg

Per Aug. 14, between 48% (in Asia-Pacific ex. Japan) and 91% (in the USA) of the companies in each index had published results. In all developed markets, a majority delivered earnings that were higher than expected, most notably in the US.

Japanese companies also did well, with their earnings deviating most strongly on the upside relative to the consensus forecast, as table 2 on the previous page shows. Japan is also the cheapest among the major developed markets, which is part of the reason we decided to increase allocations there. Results from Asia-Pacific ex. Japan and the emerging markets, however, underperformed forecasts again in this past quarter, as they have done for most of the past decade.

Forward earnings and revenue expectations, meanwhile, have also started to stabilize, but are not too positive (graph 7). Companies thus have room to keep beating expectations if economic growth indeed surprises on the upside in coming months.

Graph 7
Forward earnings and sales expectations for the US
(Rebased at the end of 2017)



Source: LGT Capital Partners, Bloomberg

Purchase of Japanese equities

Lastly, the mentioned increase in allocations to equities in Japan is the consequence of an investment rule set we adopted a few years ago ("anti-cyclical value opportunities.")

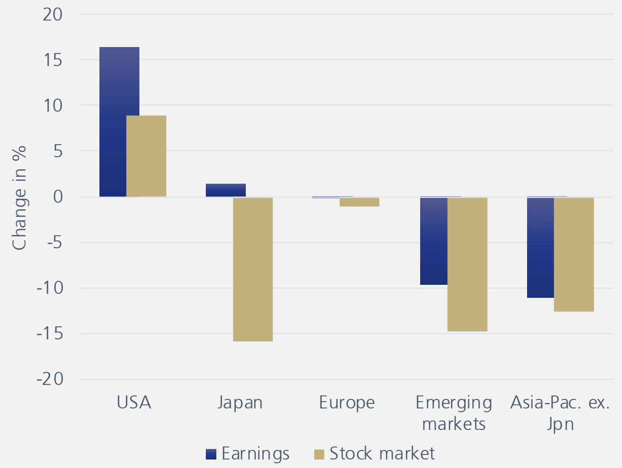
Under this rule set, we predefine buy triggers for a variety of asset classes and markets, and close these positions once the undervaluation gaps vanish. For debt markets, we look at spread levels. For equities, we look at a combination of price and valuation metrics. Over the past years, we conducted such purchases (and eventually) sales in the high yield and emerging market debt segments.

These rules help us to look beyond current sentiment to identify markets that are unjustifiably ignored by investors, or where market participants' pessimism has gone too far. They also compel us to close positions once this situation has normalized. Japanese equities triggered a first buy signal earlier this month, and we moved in accordingly.

The fundamental case is simple: despite a relatively robust earnings situation, Japanese stocks have been underperforming the other developed markets for some time now. Since the start of the trade war in early 2018, Japanese equities have been trading in line with the emerging markets and Asia-Pacific excluding Japan – even though it is the only market in corporate earnings have continued to increase (except for the US, where profits were strongly bolstered by President Trump's tax reform of December 2017.)

Hence, Japanese earnings grew despite the simultaneous global cyclical slowdown and a relatively strong Japanese yen - which has gained about 6% against the USD and 13% against the euro since the end of 2017. Although it is hard to predict at which exact point investor preferences reverse, this disparity between actual fundamentals and market perceptions is likely to be corrected by markets in due time.

Graph 8
Earnings and market performance since end-2017
(Based on MSCI indices for each market)



Source: LGT Capital Partners, Bloomberg

Formally, the implementation of our "anti-cyclical value opportunities" system is separate from our regular tactical asset allocation process. Hence, we do not register it on the graph on page 5.

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 quota (SAA) is set quarterly with a time horizon of three to six months and adjusted when deemed necessary in the interim.

- **Equities broadly neutral, with a preference for the US and a small overweight in cash**
- **Fixed income: underweight duration and credit risk, with a moderate preference for EM debt**
- **Long NOK versus CHF and a passive neutral weight in EM currencies; pronounced long position in gold**

	Asset class	SAA	Tactical allocation versus SAA (underweight -4% -3% -2% -1% / +1% +2% +3% +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%	+2%
Equities	Global	2.0%	
	Global defensive	7.5%	
	North America	10.5%	+2%
	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[2]	SAA	Tactical allocation versus SAA (-4% -3% -2% -1% / +1% +2% +3% +4%)
Currencies	USD	86.0%	
	EUR	0.0%	
	CHF	0.0%	-2%
	JPY	0.0%	
	AUD	1.0%	
	NOK	0.0%	+2%
	Others / EM	13.0%	

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	3.7%	6.4%	9.7%	3.6%	4.5%
Global inflation linked bonds	USD	1.6%	3.5%	6.1%	3.3%	2.6%
Investment grade corporate bonds	USD	1.8%	3.9%	8.7%	3.5%	3.5%
High yield bonds	USD	-1.0%	1.3%	8.6%	5.5%	3.9%
Emerging markets [2]	USD	-0.9%	4.9%	9.9%	3.6%	2.4%
Equities						
Global	USD	-5.3%	-1.6%	12.5%	9.0%	7.6%
Global defensive	USD	-1.2%	4.1%	16.1%	8.4%	9.4%
North America	USD	-5.2%	-0.8%	14.9%	10.5%	8.6%
Europe	EUR	-5.8%	-3.3%	10.8%	5.7%	5.4%
Japan	JPY	-5.1%	-3.0%	1.4%	6.6%	4.8%
Asia/Pacific ex. Japan	USD	-8.2%	-3.6%	3.5%	5.2%	1.8%
Emerging markets	USD	-8.9%	-3.5%	1.6%	4.1%	0.2%
Alternative and real assets						
Listed private equity	USD	-4.7%	0.3%	22.1%	10.8%	7.2%
Hedge funds	USD	0.6%	1.2%	5.8%	3.2%	2.3%
Insurance linked securities (ILS)	USD	0.6%	0.8%	1.6%	2.5%	3.7%
Real estate investment trusts (REITs)	USD	0.9%	4.4%	22.3%	5.7%	7.1%
Gold	USD	8.0%	18.1%	18.5%	4.1%	3.1%
Currencies (G10) [3]						
US dollar	USD	2.0%	0.7%	2.8%	2.4%	5.0%
Euro	EUR	0.9%	0.0%	-0.8%	1.9%	0.7%
Swiss franc	CHF	3.1%	4.3%	3.3%	1.8%	3.1%
British pound	GBP	-0.6%	-5.3%	-2.9%	-0.3%	-2.2%
Japanese yen	JPY	4.3%	4.6%	6.6%	0.3%	4.2%
Norwegian krone	NOK	-3.5%	-2.6%	-1.9%	-1.1%	-3.6%
Swedish krona	SEK	-0.9%	0.6%	-6.5%	-2.6%	-2.7%
Australian dollar	AUD	-1.6%	-1.0%	-1.4%	-2.2%	-2.1%
Canadian dollar	CAD	0.1%	1.9%	5.6%	1.1%	0.4%
New Zealand dollar	NZD	-2.4%	-0.9%	-1.9%	-2.1%	-1.2%

[1]Annualized return [2] Equal-weighted hard and local currency total return indices [3] Bloomberg correlation-weighted indices of currency vs. its G10 counterparts | Source: Bloomberg

Economic and corporate fundamentals

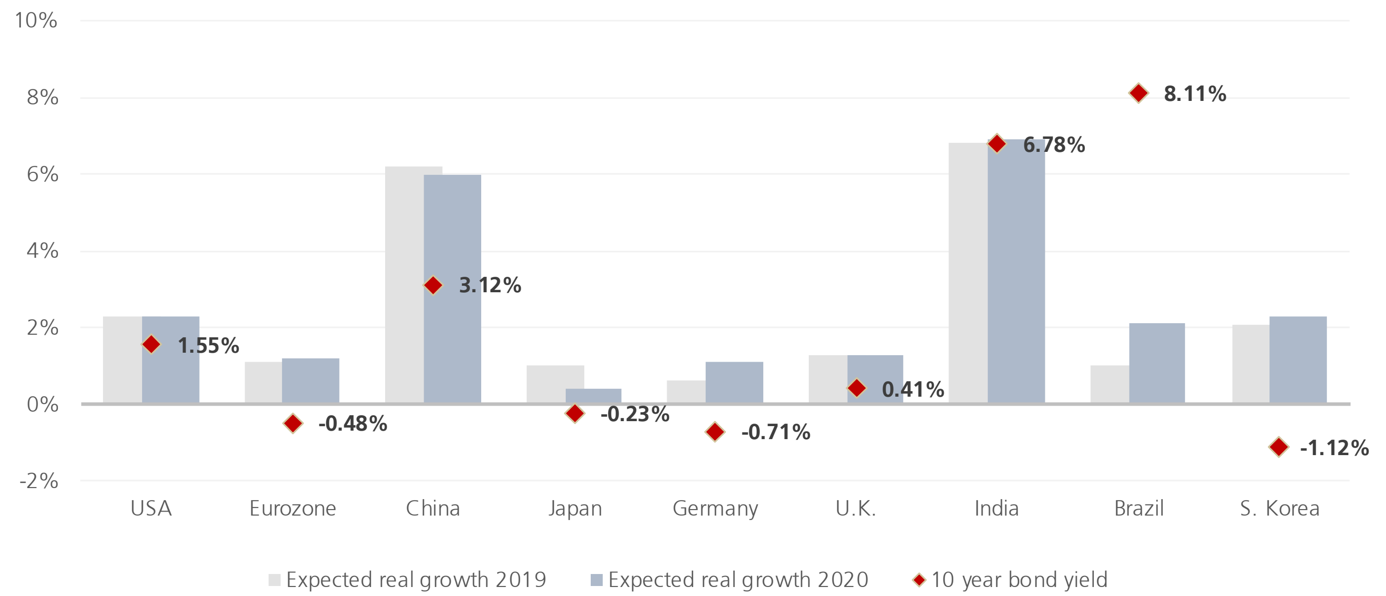
		USA	Eurozone	China	Japan	Germany	U.K.	India	Brazil	S. Korea
Gross domestic product (GDP)										
- nominal	bn USD	21,345	13,596	14,217	5,176	3,964	2,829	2,972	1,960	1,657
- nominal, per capita 2018 [1]	USD, PPP	64,767	40,965	19,520	45,565	53,854	46,782	8,484	16,662	42,985
- expected real growth for 2019	Consensus	2.3%	1.1%	6.2%	1.0%	0.6%	1.3%	6.8%	1.0%	2.1%
- expected real growth for 2020	Consensus	2.3%	1.2%	6.0%	0.4%	1.1%	1.3%	6.9%	2.1%	2.3%
- real growth in most recent quarter	QoQ, p.a.	2.1%	0.8%	6.6%	1.8%	1.7%	-0.8%	5.7%	-0.6%	4.5%
Unemployment rate 2019	Consensus	2.3%	7.5%	3.7%	2.3%	5.0%	3.9%	8.2%	4.4%	2.3%
Inflation rate 2019	Consensus	1.8%	0.9%	1.6%	0.3%	1.6%	1.9%	3.2%	4.5%	0.4%
Purchasing manager index (comp.) [2]	Neutral = 50	52.6	51.5	50.9	51.2	50.9	50.7	53.9	51.6	47.3
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	42.5	387.1	3,103.7	1,250.0	60.2	125.6	400.7	385.0	398.0
Govt bond yield 2yr [3]	p.a.	1.51%	-0.76%	2.65%	-0.28%	-0.91%	0.45%	5.78%	7.69%	-1.11%
Govt bond yield 10yr [3]	p.a.	1.55%	-0.48%	3.12%	-0.23%	-0.71%	0.41%	6.78%	8.11%	-1.12%
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	30,553	7,102	11,273	5,564	1,930	3,012	945	632	1,690
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	15.8%	33.5%	20.1%	8.4%	49.6%	49.5%	28.6%	2.1%	31.9%
24m fwd / 12m fwd	Consensus	4.2%	3.7%	5.3%	2.6%	4.5%	3.2%	5.0%	2.1%	3.6%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	5.2%	3.8%	11.2%	2.2%	6.5%	1.5%	6.9%	3.3%	2.7%
24m fwd / 12m fwd	Consensus	4.6%	4.0%	10.9%	2.3%	3.5%	2.7%	5.0%	4.0%	2.0%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	16.5	12.5	10.7	12.0	12.0	11.6	11.8	5.2	16.5
Price-Sales Ratio (est 12m fwd)	Consensus	2.0	1.0	1.2	0.7	0.8	1.1	1.5	0.8	2.1
Dividend yield	Consensus	2.0%	3.8%	2.5%	2.8%	3.5%	5.2%	3.1%	8.2%	3.2%

* China market cap includes Hong Kong | Source: Bloomberg Data per: 8/16/2019

Interest rates and expected economic growth



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