LGT Capital Partners
your partner for alternative investments

LGT Beacon
Global macro and market review

June 2019

Tactical asset allocation for Q3/2019

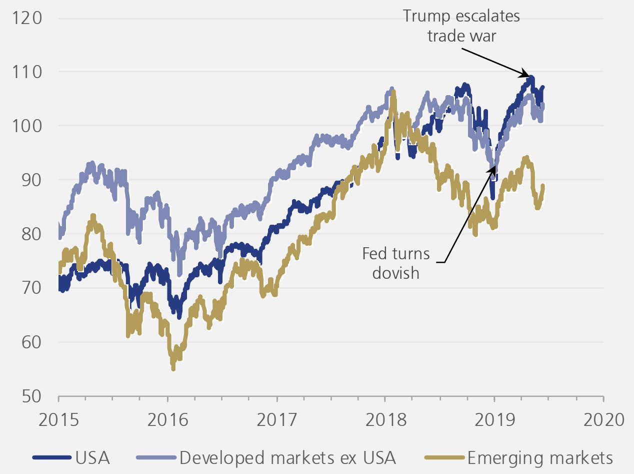
Marketing material

Early last month, just when a Sino-American trade agreement seemed within reach, Washington abruptly escalated its confrontation with China, prompting the US and other central banks to signal an increased willingness to ease policy if needed. We opt to maintain a small equity overweight, while trimming emerging market positions in favor of US assets.

US-China trade truce off the table for now

After a good start into the second quarter, with US stock indices hitting new marginal highs on April 29 and May 1, investor sentiment soured on May 6, as US President Donald Trump shocked market participants with an overnight tweet that effectively ended the US trade talks with China. Stocks dropped sharply in response, but a US-led recovery seems to have started in the meantime (graph 1).

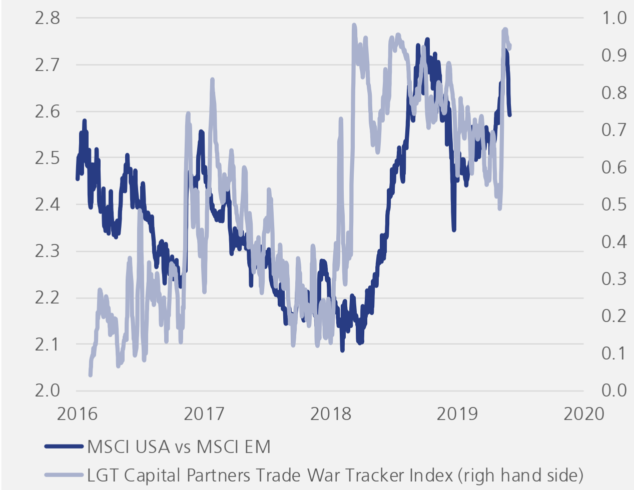
Graph 1
US equities continue to outperform peer groups
(MSCI net return indices, rebased to March 8, 2018*)



* Date of US announcement of tariffs on steel and aluminum imports, which started the so-called trade war. Source: LGT Capital Partners, Bloomberg

In that context, it is important to note that US equities thus far have clearly outperformed since the so-called trade war began to heat up in early 2018, particularly vis-à-vis the emerging markets. The interim phases of détente were thus far not long enough to bring about a reversal of that pattern (graph 2).

Graph 2
US stocks and the trade war: strength during escalation
(Percentile ranks for trade war index*)



* Seven-day moving average is used for improved visibility. Source: LGT Capital Partners, Bloomberg

US escalates trade and technology sanctions against China

To recap, on May 5, Trump tweeted that the US would raise tariffs on USD 200bn of Chinese imports from 10% to 25%, as initially threatened, and warned that a 25% rate on the remaining USD 325bn of thus far tariff-free imports would follow. On the following day, Washington's negotiators accused Beijing of backpedaling on major agreements reached during the preceding months of reportedly constructive talks.

About a week later, the Trump administration also decided to ban American companies from doing business with Huawei, China's largest communications equipment maker. Many non-US technology suppliers have since announced that they would comply with the decision.

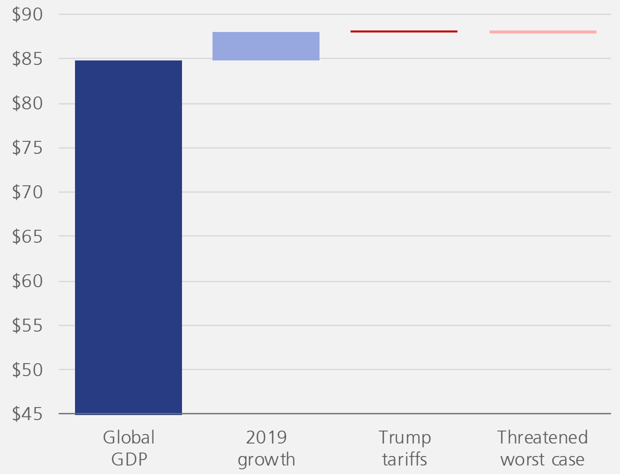
Several US allies, particularly those in the Asia-Pacific region, have already taken, or are considering, similar measures to protect their data and communication infrastructure citing potential national security risks, albeit in a more nuanced and quiet fashion. These countries include the Five Eyes military intelligence network members Australia, New Zealand, and the United Kingdom, as well as Japan.

Measured responses from Beijing

With more measures against China in preparation or discussion in the US, including rules that could effectively cut Chinese companies' access to US capital markets, Beijing has markedly ramped up anti-American and patriotic vitriol in the domestic media and has showcased its improving strategic relationship with Russia as well as China's dominance of rare earths market. Beyond the rhetoric and symbolism, however, China's actual policy responses have been more measured by comparison, at least thus far. Most threats come from media reports, while official policy action has been limited to retaliatory tariffs on USD 60bn worth of US imports. Still, both sides have occasionally signaled they remain open to resuming talks at some point.

The uncertainty over how far the US-China trade dispute might ultimately go is a cause for serious concern and weighs on business sentiment and expectations. At the same time, as long as the global economy stays sufficiently healthy, the actual first-order tariff impact should remain manageable in our view (graph 3).

Graph 3
First-order impact of US tariffs on global economy
(Trillion USD)



GDP = Gross domestic product. Source: LGT Capital Partners, World Bank, Bloomberg

Our base case is that Washington and Beijing will ultimately find a workable arrangement for managing their strategic rivalry, although it may take more time and more pain for a proper trade agreement to materialize.

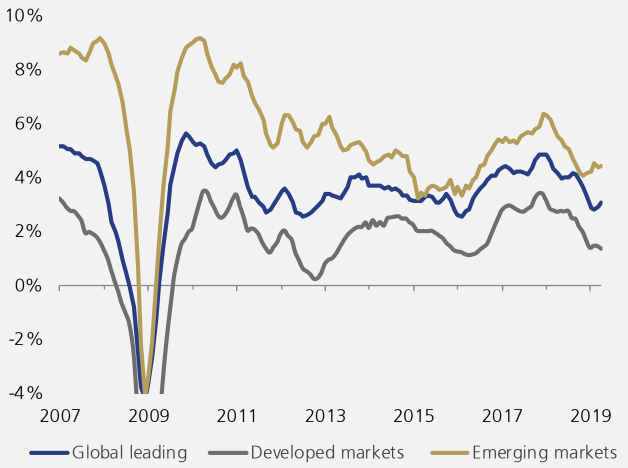
Global economy: no longer slowing

On a brighter note, macroeconomic developments over the past quarter have proven less problematic than the trade war noise might imply. Our global view for the next three to six months still consists of the following elements:

- **Baseline scenario**: the world economy continues to grow and should not materially slow going forward
- **Risk scenario (less likely)**: growth decelerates markedly as various negative structural factors, including the second-order effects of the changes in the international trade order, continue to fuel recession fears

The global leading indicators highlight a soft landing of the economy and are still clearly shy of signaling a contraction. In fact, economic activity indices appear to be stabilizing and even picking up somewhat more recently, mostly due to domestic stimulus policies in China (graph 4).

Graph 4
Leading and current economic activity indicators
(Three-month moving average of year-on-year change)



Source: LGT Capital Partners, Goldman Sachs, Datastream

International policy makers' responses

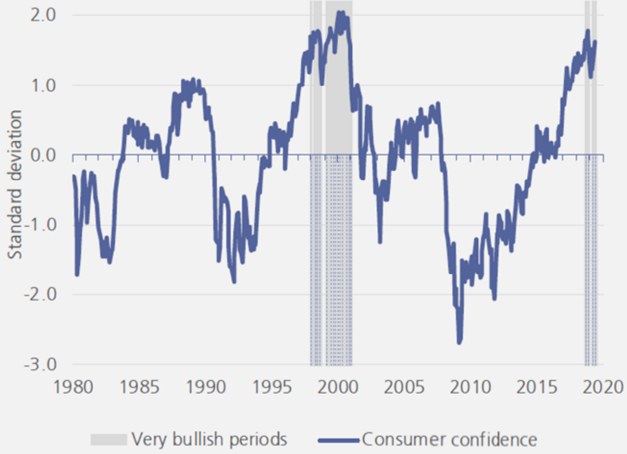
With regard to trade, it now seems unlikely that President Trump and his Chinese counterpart Xi Jinping will announce a trade deal at the G20 meeting in Japan later this month. However, the conference could very well lend itself to opening the way for a renewed round of negotiations.

Furthermore, and perhaps more importantly, the US Federal Reserve (Fed) has already explicitly clarified that it is open to cutting rates if the macro outlook weakens. The European Central Bank (ECB) and the Bank of Japan (BOJ) have also reaffirmed their commitment to add stimulus if/when needed.

So far, US economic performance has remain quite robust: in the bigger picture, overall consumer sentiment is still very high – holding up at levels that were surpassed only during the boom of the second half of the 1990s (graph 5, next page).

At the same time, an unemployment rate at cyclical lows suggests that the fruits of the long and slow recovery from the Great Recession of 2008-2009 have started to reach broader parts of the population that were left out for many years.

Graph 5
US Conference Board consumer confidence
(Deviation from the mean level)



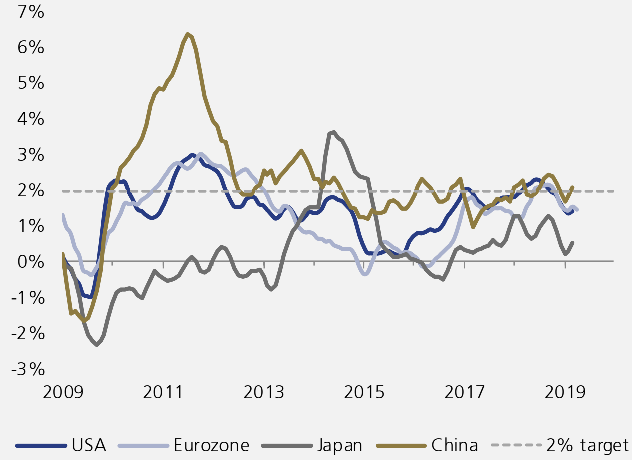
Source: LGT Capital Partners, Conference Board, Bloomberg

Meanwhile, China has been countering the US trade policy headwinds with various domestic stimulus measures. As long as the confrontation persists, Beijing is also likely to continue to do so.

We therefore believe that recession fears based on the escalating trade dispute are still somewhat premature. The underlying forces of the broader economic upswing remain intact, while various fiscal and monetary policy initiatives continue to support the case for a moderate expansion.

After all, actual inflation rates in the major economies continue to be below target (usually 2% per year as a rule for the developed markets) and long-term expectations remain moderate. Hence, imported inflation through higher tariffs is neither a major nor a lasting concern, providing central banks with sufficient room for policy easing (graph 6).

Graph 6
Headline inflation rates
(Three-month moving average, year-on-year change)



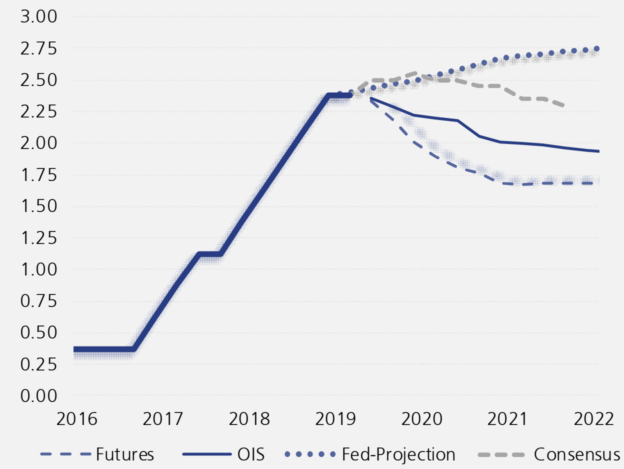
Source: LGT Capital Partners, Bloomberg

Tactical asset allocation: trimming EM risks and pivoting toward the US

Equity markets corrected last month as trade policy uncertainty resurfaced. In fixed income markets, government bond yields declined quickly and yield curves flattened again, signaling a weaker economy and a dovish monetary policy response ahead.

Unsurprisingly, the Fed has already verbally moved closer to these market-based expectations in recent days. Futures markets currently price in at least three rate cuts of 25 basis points each by the end of next year (graph 7).

Graph 7
US Fed funds rate and Fed funds path expectations
(Percent per year)



OIS = Overnight interest rate swaps. Source: LGT Capital Partners, Bloomberg

Overall market positioning remains constructive

We maintain our moderately bullish stance in risk assets, with a small overweight in equities overall, and a meaningful exposure to emerging markets (EM) debt. We also continue to avoid government bond duration. On the defensive side, we continue to underweight corporate credit risk, while keeping ample cash reserves.

Within that framework, we further accentuate our preference for US assets, at the expense of the emerging markets (EM). We believe the US is least exposed to trade risks among the major nations, while its economy should continue to outperform. Specifically, we have undertaken the following actions:

- **Sell EM local currency debt to** reduce the **overweight** in the segment and trim corresponding currency risks
- **Buy US equites and sell EM stocks** to account for tariff- and technology sanction-related opportunities and risks
- **Buy the US dollar (USD) against the euro (EUR)** to benefit from the relevant rate and growth potentials and differentials

Equities: small overweight maintained

Equities remain slightly overweight with a **clear preference for the US**. We had already increased our exposure in a first step last month, when we added US equities shortly after the initial selloff.

Economic growth and corporate earnings in the US are most solid and less prone to downward revisions due to the ongoing drag from international trade. Companies in the EM, on the other hand, are in a weaker position due to their generally higher reliance on exports, be it either directly to US consumers or indirectly as suppliers to Chinese manufacturers, which are in turn under pressure due to the US export sanctions. We have thus **increased our overweight in US equities and commensurately cut our EM quota** from neutral to a small underweight.

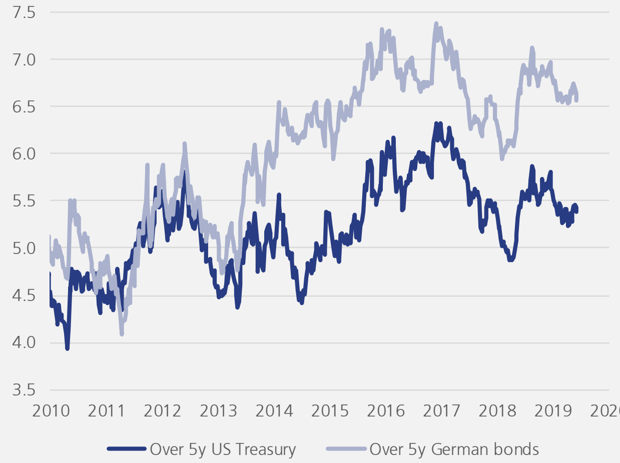
We keep Europe at a small underweight due to ongoing domestic and external cyclical headwinds, while Japan stays on neutral. For now, the US seems to have backed off from imposing tariffs on Europe and Japan, although that may change going forward.

Fixed income: reduced EM overweight

In fixed income, we remain **underweight duration and corporate credit risk**. Historically very low and/or negative government bond yields do not entice us - even less so after their latest slump. At the same time, the credit cycle is increasingly mature and companies engage in activities titled in favor of shareholders, rather than creditors (e.g. share buybacks, mergers and acquisitions.)

The ongoing trade dispute and our positive outlook for the USD (see below) led us to reduce the exposure to EM local currency debt, resulting in a small **decline in our overall fixed income quota**.

Graph 8
EM local currency bond yield over German and US bonds
(Percentage points, derived from the J.P. Morgan index)



Source: LGT Capital Partners, Bloomberg

Nevertheless, we still keep the **EM space above neutral**: the interest rate pickup, or carry, remains attractive (graph 8), the currencies are still cheap in fundamental terms, and central banks have plenty of leeway to cut rates if needed and ample foreign exchange reserves to support their currencies if/when needed.

Currencies: going long USD against EUR

In foreign exchange, we initiated **a long USD position against the EUR**. We believe the US Fed may not cut the policy rate by as many times as the futures markets have priced in, as the US economy may prove more resilient than presently expected.

By contrast, the ECB remains hostage to low real growth in the Eurozone and to inflation rates that are far below its target. The Governing Council and its next president will therefore probably remain dovish and keep interest rates in negative territory for much longer. As such, the Euro should remain an attractive funding currency for carry trades in our view.

At the same time, we retain a **long position in the Norwegian krone (NOK) against the Swiss franc (CHF)**. The Norges Bank has started to raise rates and is looking to tighten further, as the economy is growing robustly and core inflation has risen above the 2% target level. In addition, volatile oil markets have proven to be less of a driving force for the NOK during this cycle.

Conversely, the CHF features negative interest rates and is mainly in demand when markets turn highly risk averse. Given our global macro assessment, we therefore believe the CHF should consequently give back the gains it made in May.

END OF REPORT

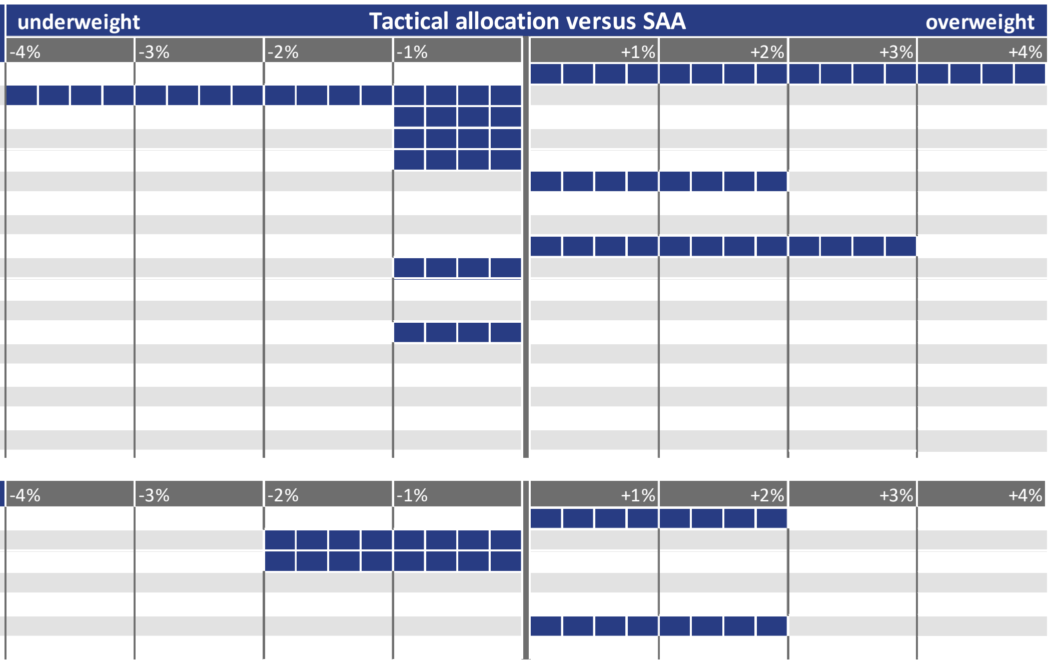
LGT Capital Partners: tactical asset allocation for the Princely Strategies in USD

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

- **Equities modestly overweight, with a clear preference for the US and balanced by ample cash reserves**
- **Fixed income: still underweight duration and credit risk, with a moderated preference for EM debt**
- **Long NOK and USD versus CHF and the EUR, respectively; passive neutral weight of EM currencies**

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

	Currency[2]	SAA
Currencies	USD	86.0%
	EUR	0.0%
	CHF	0.0%
	JPY	0.0%
	AUD	1.0%
	NOK	0.0%
	Others	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	2.1%	3.5%	5.0%	2.6%	3.9%
Global inflation linked bonds	USD	1.4%	2.4%	3.7%	3.0%	2.4%
Investment grade corporate bonds	USD	1.4%	2.9%	5.8%	3.0%	3.1%
High yield bonds	USD	0.7%	2.4%	8.2%	6.6%	3.8%
Emerging markets [2]	USD	2.6%	3.3%	7.6%	4.8%	2.1%
Equities						
Global	USD	0.8%	3.3%	14.9%	11.4%	8.0%
Global defensive	USD	3.2%	5.4%	14.4%	9.2%	9.4%
North America	USD	0.3%	3.6%	16.2%	12.5%	9.3%
Europe	EUR	2.1%	4.4%	14.8%	9.4%	5.1%
Japan	JPY	0.7%	-1.5%	6.0%	7.6%	6.2%
Asia/Pacific ex. Japan	USD	-0.2%	-1.0%	9.1%	10.5%	3.7%
Emerging markets	USD	0.2%	-1.2%	7.8%	10.4%	1.9%
Alternative and real assets						
Listed private equity	USD	1.0%	7.9%	22.2%	11.8%	6.1%
Hedge funds	USD	0.9%	1.9%	4.5%	3.6%	2.4%
Insurance linked securities (ILS)	USD	-0.9%	-1.7%	-0.2%	2.3%	3.6%
Real estate investment trusts (REITs)	USD	3.5%	5.4%	19.5%	6.5%	7.3%
Gold	USD	2.9%	2.8%	4.3%	1.6%	1.0%
Currencies (G10) [3]						
US dollar	USD	-0.5%	0.5%	1.0%	1.8%	4.9%
Euro	EUR	0.4%	0.9%	-0.4%	2.1%	0.8%
Swiss franc	CHF	1.7%	2.3%	-0.1%	0.8%	2.6%
British pound	GBP	-2.7%	-2.3%	0.9%	-2.3%	-1.5%
Japanese yen	JPY	1.2%	3.8%	2.5%	1.4%	3.5%
Norwegian krone	NOK	0.4%	0.4%	1.0%	0.2%	-3.3%
Swedish krona	SEK	1.4%	-0.4%	-6.0%	-2.9%	-2.8%
Australian dollar	AUD	-1.3%	-1.5%	-0.6%	-0.4%	-2.0%
Canadian dollar	CAD	0.5%	1.0%	3.8%	0.4%	0.3%
New Zealand dollar	NZD	-0.8%	-4.0%	-1.3%	-0.8%	-1.4%

[1] Annualized return [2] Equal-weighted hard and local currency total return indices [3] Bloomberg correlation-weighted currency indices of a currency vs. its nine other 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	2.5%	1.2%	6.3%	0.6%	0.9%	1.4%	7.0%	1.4%	2.3%
- expected real growth for 2020	Consensus	2.5%	1.3%	6.0%	0.5%	1.3%	1.4%	7.1%	2.3%	2.4%
- real growth in most recent quarter	QoQ, p.a.	3.1%	1.6%	5.7%	2.2%	1.7%	2.0%	5.7%	-0.6%	-1.6%
Unemployment rate 2019	Consensus	2.5%	7.6%	3.7%	2.4%	5.0%	3.8%	8.2%	4.7%	2.4%
Inflation rate 2019	Consensus	1.9%	0.8%	1.6%	0.5%	1.8%	1.8%	4.7%	4.7%	0.6%
Purchasing manager index (comp.) [2]	Neutral = 50	50.9	51.8	51.5	50.7	52.6	50.9	51.7	48.4	48.4
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	41.7	385.2	3,101.0	1,244.2	59.8	122.6	391.0	381.0	399.0
Govt bond yield 2yr [3]	p.a.	1.92%	-0.59%	2.77%	-0.19%	-0.67%	0.59%	6.40%	7.73%	-0.82%
Govt bond yield 10yr [3]	p.a.	2.14%	0.11%	3.29%	-0.11%	-0.23%	0.86%	8.33%	8.59%	-0.47%
Main policy interest rate [4]	p.a.	2.50%	0.00%	4.35%	-0.10%	0.00%	0.75%	5.75%	6.50%	1.75%

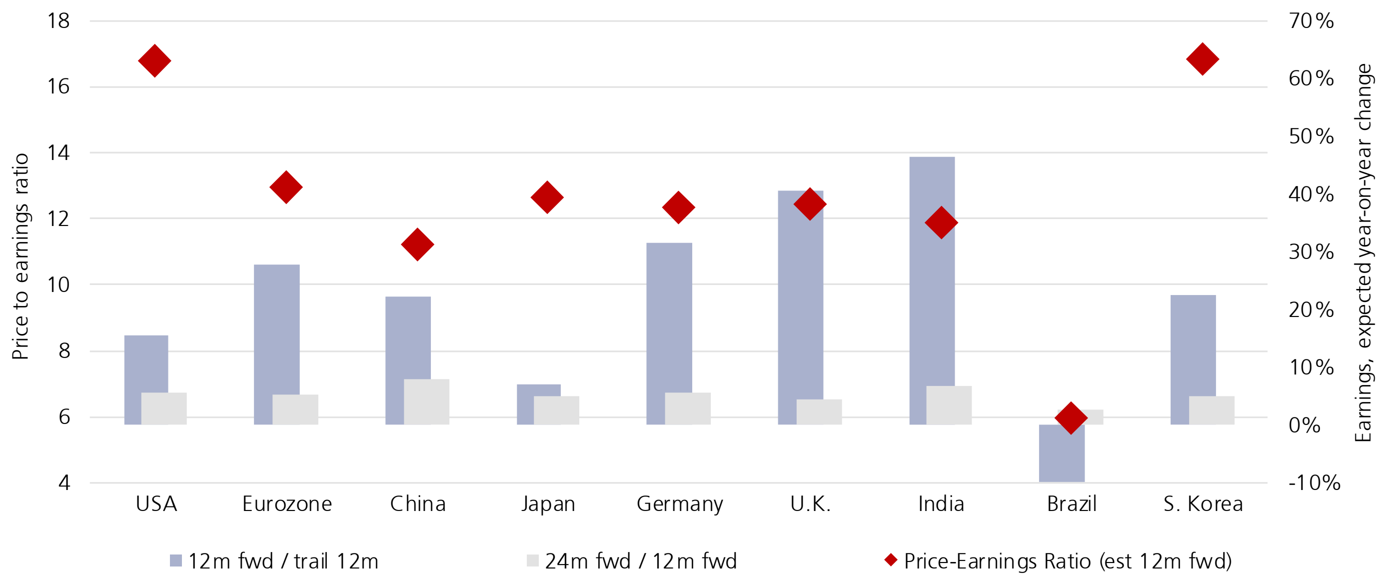
[1] IMF estimates [2] Manufacturing PMI for Korea [3] Currency swap rates for China and Brazil and closest ESM/EFSF bond for Eurozone [4] Max target rate for Fed

		USA	Eurozone	China	Japan	Germany	U.K.	India	Brazil	S. Korea
Exchange capitalization*	bn USD	31,094	7,479	11,891	5,704	2,042	3,300	940	663	1,689
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	15.6%	27.8%	22.3%	7.2%	31.4%	40.7%	46.4%	-9.9%	22.5%
24m fwd / 12m fwd	Consensus	5.7%	5.2%	8.0%	5.0%	5.5%	4.3%	6.9%	2.6%	5.1%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	5.6%	3.5%	11.4%	2.1%	5.4%	2.5%	7.0%	4.1%	2.3%
24m fwd / 12m fwd	Consensus	4.3%	2.9%	10.9%	1.9%	3.6%	2.5%	4.4%	4.3%	1.3%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	16.8	13.0	11.2	12.6	12.3	12.5	11.9	6.0	16.8
Price-Sales Ratio (est 12m fwd)	Consensus	2.0	1.0	1.2	0.8	0.8	1.1	1.6	0.9	2.2
Dividend yield	Consensus	2.0%	3.6%	2.5%	2.6%	3.4%	4.8%	3.5%	6.8%	3.2%

* China market cap includes Hong Kong | Source: Bloomberg — Data per: 6/12/2019

Current equity market valuations and earnings growth expectations

(Implied growth based on Bloomberg BEst Estimates for the next 12 to 24 months)



Picture on title page: Quentin Massys (Löwen 1466-1530 Antwerp), detail from "The Tax Collectors", after 1501 © LIECHTENSTEIN. The Princely Collections, Vaduz-Vienna