LGT Beacon

Global macro and market review

March 2020

Marketing material

Tactical asset allocation for Q2/2020

The spread of the Coronavirus outbreak beyond East Asia triggered turmoil in financial markets and prompted authorities around the world to combine severe restrictions on public life with unprecedented economic support measures. As the pandemic persists, we opted to de-risk portfolios, while remaining attentive to emerging long-term opportunities.

A mandated recession to beat the pandemic

Late February and March brought a roller coaster ride in equities and signs of distress in the credit markets, as the Coronavirus (COVID-19) pandemic went global and prompted unprecedented public health measures and economic policy responses. With almost each passing day and week, governments began to resort to radical restrictions of public life, effectively shutting down normal economic activity and hence mandating a recession as part of the cure.

Along with such containment efforts, one country after another also moved to cut interest rates and enact various monetary and fiscal support policies – by now totaling trillions of US dollars and ranging from the restart of quantitative easing programs to cash handouts to households and businesses.

As a result, the debate among investors has shifted from whether or not growth will contract to how long and deep the contraction will be. The potential silver lining was that the pandemic seems to be tentatively receding in China and some neighboring regions.

Nevertheless, within a few weeks the number of infections and deaths in Europe quickly surpassed those in China, where the outbreak had started earlier this year, while the US was catching up fast. In East Asia, meanwhile, most countries have moved from initial domestic social distancing and regional travel restrictions to

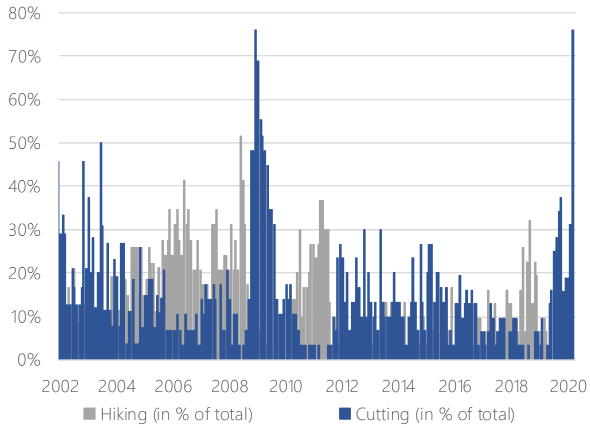
Graph 1
Countries restricting travel because of the outbreak
(As per 26 March 2020)

Sources: IATA, Bloomberg

avoiding the re-importation of the outbreak from the rest of the world.

Graph 2

Strongest monetary response since financial crisis
(Changes in central bank policy interest rates)



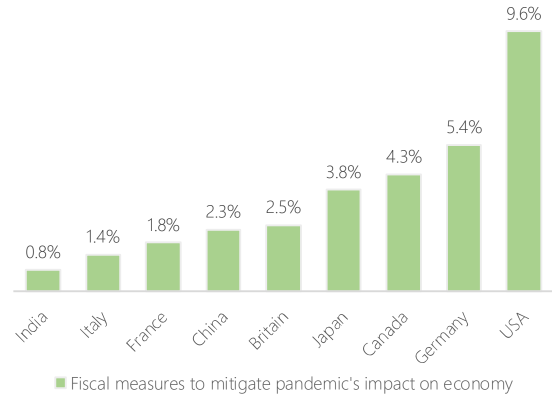
Sources: Refinitiv, LGT Capital Partners

All said, different countries find themselves in different situations: where healthcare systems are (likely to be) overburdened, comprehensive lockdowns with enforced curfews are common, while other countries have largely opted for appeals to responsible civic behavior.

For this reason, some regions may be past or near the worst stage (e.g. parts of East Asia and Northern Europe), while others seem only to be heading there still (e.g. UK, US, possibly many emerging and developing economies). In addition, China and nearby countries are at least one-month ahead of Europe and the US owed to

Graph 4

Planned government spending to combat Pandemic
(% of nominal GDP in USD at current exchange rates)



Sources: Bloomberg and various other media, LGT Capital Partners

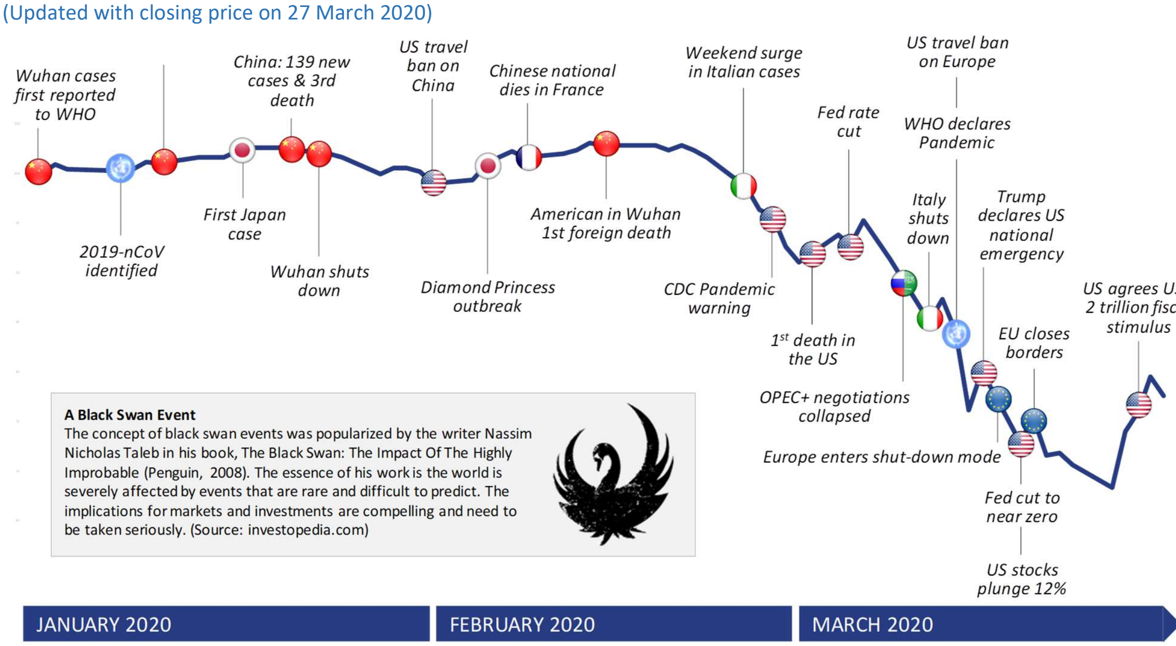
taking early country-measures, and may thus provide another possible guide for what lies ahead in the West. The global pandemic data will hence be important for some time to come.

Our macroeconomic assessment: base case and risk scenario

Returning to economics, so far, there are only few data sets available to gauge the degree of the fallout from the various containment measures, but it is clear already that the first half of 2020 will see significant drops in output and a spike in unemployment for many parts of the world.

Graph 3

Timeline of events: Coronavirus pandemic
(Updated with closing price on 27 March 2020)



Source: Investopedia, Refinitiv, LGT Capital Partners

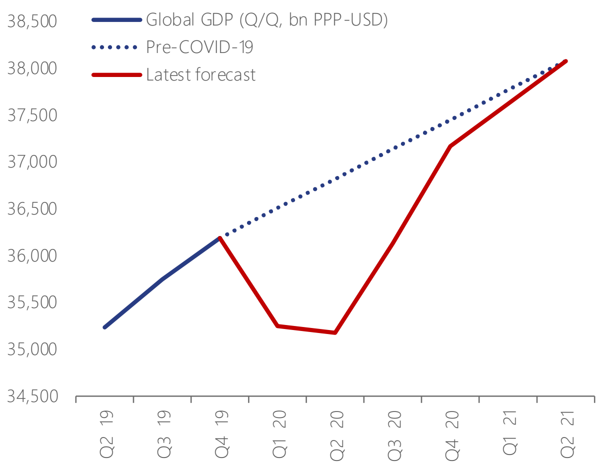
The Federal Reserve of Dallas, for instance, now expects the annualized rate of the quarter-on-quarter decline of US gross domestic product (GDP) to exceed 20% in the coming quarter, according to its President Robert Kaplan in an interview last Friday. Estimates coming from the private sector are plentiful and change frequently, and many forecasts suggest an even bigger drop. Thus, the two main questions we pose ourselves are: how long will the pandemic last and can economies recover and go back to normal mode thereafter?

- Our **base case** is that while this crisis may well last some time longer, **the spread will eventually slow and containment measures ease.** After a deep but probably short recession, we will likely see an economic recovery. There is even the **possibility for a phase of reflationary growth** fueled by the mix of pent-up demand, incoming fiscal stimuli and the rekindled monetary easing. The recent significant decline in the crude oil price offers some additional support to consumers

Graph 5

Our base case of the expected path of global output

(PPP = purchasing power parity, est. by Oxford Economics)



Sources: Bloomberg, LGT Capital Partners

and businesses in the form of reduced energy bills (although it of course also hurts nations and companies dependent on oil revenues).

- Unfortunately, however, we now have to add the **risk scenario of a longer-lasting deflationary depression:** the pandemic shock could start a self-reinforcing spiral of bankruptcies, lay-offs and persistent demand destruction.

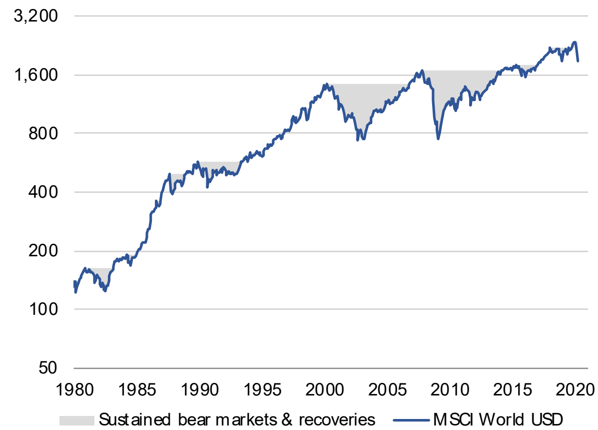
We should note that we currently do not deem the risk scenario as very probably. Unlike during historic precedents, policy makers are now doing their utmost to prevent an economic meltdown by supporting households and businesses in any conceivable way and the fiscal aid packages enacted so far already surpass anything we have seen in peace time.

In several cases, policy makers have also quickly cast aside long-held policy taboos intended to keep fiscal and monetary policy spheres separate (developed in times when inflation was easy to rekindle) and abandoned balanced budget goals. The banking system itself, meanwhile, is also in better shape today than a decade ago, and hence lends itself to expediently pass-through government backed emergency loans to struggling companies. Nonetheless, there certainly are limits as to how long economies can endure these shutdowns.

Graph 6

Historic global equity drawdowns

(Logarithmic scale)



Sources: Bloomberg, LGT Capital Partners

Market reaction: pricing in the social distancing recession

Financial markets have quickly moved to price in of the coming "stay-at-home-recession". Major equity indexes lost some 30% within just three weeks, wiping out gains of the last three years in many cases. Government bonds yields headed lower as risk-aversion surged and central banks announced emergency rate cuts and easing programs, with the largest policy change coming from the US.

However, the same yields later spiked on announcements of massive fiscal spending packages that would elevate government debt levels. Forced liquidation and unwinding of debt-funded, or levered, positions presumably played their part in the fact that safe havens including gold and treasury bonds declined during selling climaxes.

Currencies were equally erratic with the US dollar first tanking upon losing its carry advantage and then spiked as flight to safety flows began to emerge and demand for the world's main refinancing currency surged.

Commodities with sensitivity to the business cycle cratered, led by oil's double hit of falling demand and increased supply following the failure of oil producing countries to agree on quotas in early March.

Credit spreads jumped across the board and implied volatility gauges (a measure for the pricing of hedging with options) hit levels last seen during the Global Financial Crisis of 2008. Lately, tensions eased somewhat and risk assets partially recovered, a move that could be a first – but probably not the last – attempt to build a bottom in beaten down markets.

Strategy: modestly de-risk portfolios, while seizing long-term opportunities

Assuming the constraints on social life and business activity can be eased before the economy takes irreparable damage, the current market dislocations should offer long-term investment opportunities.

Our systematic monitor (our so-called Anti-Cyclical Value Opportunities, ACVO) has signaled a number of deep value cases, of which we have implemented two already – i.e. we recently raised the strategic weight in Japanese and European equities.

However, market volatility is likely to remain elevated for some time, which poses the danger of being whip-sawed with trading-oriented positions. We therefore **retain our overall neutral tactical weighting in equities and use the recent rebound to de-risk our portfolios at the margin, by selling some emerging market assets and by increasing gold and cash.** Rebalancing to policy weights is also performed in an anti-cyclical manner and more frequently by our portfolio management teams, depending on market developments.

Despite the attractive valuations and generous premia, we deem it best to wait before adding further to risk. In this regard, we will be looking for two important developments:

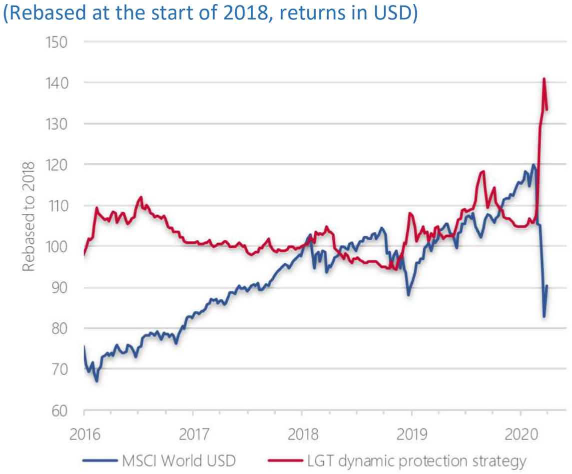
- Firstly, evidence global COVID-19-infections have peaked (which would make an easing of lockdown measures visible) and that the risk of a second wave is contained and manageable.
- Secondly, evidence that the economic freeze has by and large been successfully bridged, avoiding the creation of systemic risks to international financial system, like those witnessed during the last crisis more than a decade ago.

Finally, our portfolio management teams are also pursuing a strategy of rebalancing to policy weights in a countercyclical and more frequent manner, depending on market developments. This means that the team takes some profit in assets that performed very well such as our dynamic protection hedging strategy (graph 7), while using the proceeds to buy into beaten-down markets.

Graph 7

LGT downside mitigation has worked well

(Rebased at the start of 2018, returns in USD)



Sources: Bloomberg, LGT Capital Partners

Overview of tactical decisions

Going into the new quarter, we hence implement the following tactical positioning:

- **Equities are overall at a neutral weighting with preference for developed markets.** Our tilt towards developed markets (US and Europe are both slightly overweight, Japan is neutral) at the expense of emerging market equities (underweight) is rooted in relative vulnerabilities. Arguably, many of the less developed economies have a weaker healthcare system and can be less politically stable to efficiently deal with the crisis a pandemic creates. On top of that, they suffer from sudden demand shortfall in their export markets. Lower oil prices and a stronger US dollar also pose headwinds for some, but not all emerging market companies.

- **In fixed income, we remain underweight duration, corporate credit and emerging market sovereign risk.** Within sovereign debt, our fixed income team likes inflation-linked issues. From a relative perspective, the current deflationary shock has led to an oversold situation in linkers, especially in light of the rising future inflation potential that product shortages and massive government spending plans may entail. Investment grade debt further benefit from the restart of unlimited central bank support ("QE infinity") but are under pressure from deteriorating fundamentals (through the hit to the top and bottom line for companies and the ballooning of fiscal deficits for sovereign borrowers). Equally, many high yield borrowers are now distressed - and in the case of the oil & gas industry, many securities may remain distressed even after the pandemic is over. EM local currency bonds are now also set to a small underweight on aforementioned relative vulnerabilities that include the possibility of lasting US dollar strength.

- **In currencies and real assets, we keep the long Japanese yen (JPY) position against the euro (EUR) and add to our position in gold.** The Japanese yen is traditionally a safe haven currency that strengthens on global risk aversion, whilst investors often shun the euro under such circumstances. Although this has so far not played out to any meaningful degree, we nonetheless keep the position as a small potential portfolio stabilizer. Similarly, gold has recently not always fulfilled its role as a hedging asset, particularly on panic days with indiscriminate and/or forced selling. Going forward, however, we expect the metal to shine with lingering market fears and interest rates at or below zero globally. Its role as an alternative currency and store of real value may also gain prominence now that all governments jettison fiscal prudence, risking higher inflation further down the road.

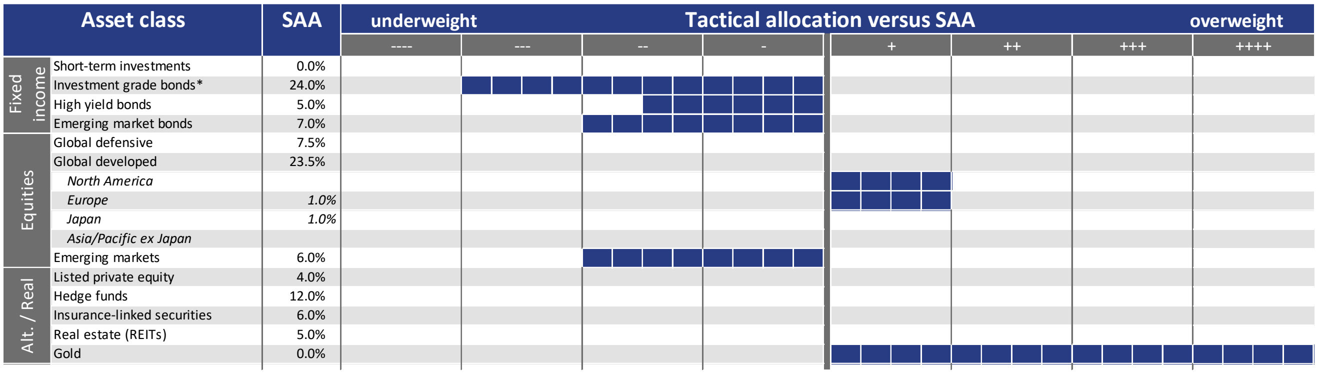
*Note: We show the recent purchases of Japanese and European equities in the Strategic Asset Allocation (SAA) column on the positioning graph on the next page, due to their strategic nature.

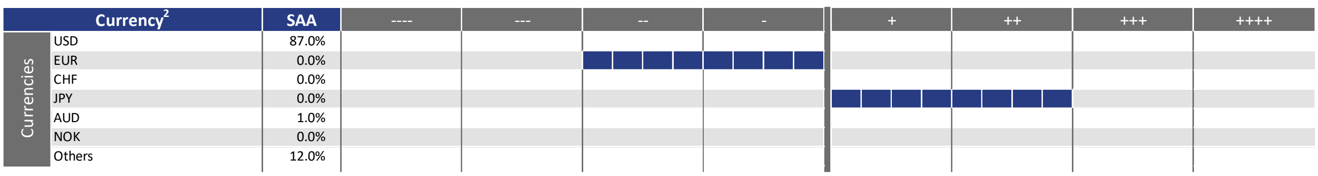
END OF REPORT

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 overweights in the US and Europe balanced by an underweight in the EM**
- **Fixed income: pronounced underweight in duration, sovereigns and investment grade credit**
- **Currencies and real assets: long Japanese yen against the euro, pronounced overweight in gold**





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	1.0%	5.1%	5.1%	5.8%	4.1%
Global inflation linked bonds	USD	-2.0%	-0.5%	-0.5%	2.5%	2.3%
Investment grade corporate bonds	USD	-6.0%	-3.7%	-3.7%	2.8%	2.6%
High yield bonds	USD	-13.3%	-14.6%	-14.6%	0.1%	2.5%
Emerging markets [2]	USD	-13.2%	-15.0%	-15.1%	-0.7%	1.4%
Equities						
Global	USD	-12.1%	-19.4%	-19.4%	2.2%	3.6%
Global defensive	USD	-8.5%	-14.2%	-14.2%	4.8%	5.8%
North America	USD	-11.9%	-19.0%	-19.0%	4.4%	5.8%
Europe	EUR	-14.8%	-22.9%	-22.9%	-3.1%	-0.6%
Japan	JPY	-5.0%	-15.5%	-15.5%	0.6%	0.1%
Emerging markets	USD	-17.1%	-25.1%	-25.1%	-2.3%	-0.8%
Alternative and real assets						
Listed private equity	USD	-24.9%	-31.2%	-31.2%	-0.4%	2.1%
Hedge funds	USD	-1.5%	0.2%	-1.3%	2.3%	2.4%
Insurance linked securities (ILS)	USD	-1.7%	0.1%	0.1%	2.2%	3.7%
Real estate investment trusts (REITs)	USD	-16.9%	-21.7%	-21.7%	0.2%	1.2%
Gold	USD	1.8%	6.6%	6.6%	9.0%	6.4%
Currencies (vs. rest of G10) [3]						
US dollar	USD	4.1%	7.9%	7.9%	2.5%	2.4%
Euro	EUR	3.8%	5.6%	5.6%	3.7%	2.9%
Swiss franc	CHF	4.4%	8.4%	8.4%	4.0%	2.6%
Japanese yen	JPY	3.7%	8.1%	8.1%	3.5%	4.8%
Australian dollar	AUD	-1.8%	-6.4%	-6.4%	-5.2%	-2.2%
Norwegian krone	NOK	-8.0%	-11.6%	-11.6%	-4.8%	-3.5%
Emerging market currency index [4]	USD	-8.5%	-13.2%	-13.2%	-8.0%	-6.4%
British pound	GBP	-0.5%	-0.6%	-0.6%	1.8%	-1.7%

[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	1.2%	-0.8%	4.0%	-0.8%	0.1%	4.9%	0.3%	0.2%	1.7%
Real growth next year[1]	Consensus	2.0%	1.4%	6.2%	1.1%	1.4%	5.3%	1.5%	2.5%	2.4%
Real growth current quarter	Annualized	2.1%	0.5%	6.1%	-7.1%	0.1%	4.5%	0.1%	2.0%	5.3%
Unemployment this year	Consensus	1.2%	7.4%	3.6%	2.4%	5.0%	8.2%	3.9%	4.6%	2.3%
Inflation this year	Consensus	1.8%	1.0%	3.3%	0.5%	1.3%	4.8%	1.3%	3.5%	1.0%
Purchasing manager index (comp.) [2]	Neutral: 50	40.5	31.4	27.5	35.8	37.2	57.6	37.1	50.9	48.7
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	41.5	387.3	3'106.7	1'288.7	61.3	437.2	130.3	359.0	404.0
Govt bond yield 2yr [3]	p.a.	0.23%	-0.39%	1.99%	-0.14%	-0.71%	5.27%	0.14%	4.82%	0.97%
Govt bond yield 10yr [3]	p.a.	0.68%	0.03%	2.63%	0.02%	-0.50%	6.13%	0.34%	8.62%	1.57%
Main policy interest rate ?	p.a.	0.25%	0.00%	4.35%	-0.10%	0.00%	4.40%	0.10%	3.75%	0.75%

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

		USA	Eurozone	China	Japan	Germany	India	U.K.	Brazil	S. Korea
Exchange capitalization*	bn USD	26'650	6'020	11'589	5'271	1'655	572	2'305	459	1'587
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	10.8%	28.5%	9.0%	13.4%	38.8%	31.9%	47.2%	2.2%	50.2%
Next fy / 12m fwd	Consensus	9.7%	10.5%	9.9%	1.1%	13.8%	0.1%	7.2%	11.4%	21.8%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	6.7%	0.1%	17.4%	1.7%	6.8%	3.5%	-9.6%	-11.0%	4.6%
Next fy / 12m fwd	Consensus	4.1%	2.9%	7.7%	0.3%	3.0%	0.6%	4.3%	5.4%	5.1%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	16.1	11.9	11.4	12.2	11.5	13.0	11.2	10.1	9.4
Price-Sales Ratio (est 12m fwd)	Consensus	1.9	0.8	1.2	0.7	0.7	1.3	0.9	1.1	0.6
Dividend yield	Consensus	2.3%	4.3%	2.4%	2.8%	4.0%	2.1%	6.3%	4.8%	3.0%

* China market cap includes Hong Kong | Source: Bloomberg   Data per: 31.03.2020

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

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