Marketing material

Investment perspectives February 2023

- **Global equities extend gains in Febuary, as investors now expect the US and even Europe to avoid a recession**
- **US yield curve shifts higher and US dollar rises on prospect of stronger economy and continued policy tightening**
- **Latest US data show that prices in the services sector continue to rise, keeping prospect of hawkish surprises alive**
- **Chinese equities retreat after a three-month rally, as geopolitical tensions and domestic policy concerns return**

Investment actions:

- **We view the recent optimism as overdone and use the rally to reduce equities in favor of cash**
- **Recent developments around China reaffirm our preference for accessing that space selectively via private markets**

Global economy: from “hard landing” to “no landing”

Financial markets remained buoyant over the past month, with equities and interest rates rising, and the US dollar strengthening again against most peers. Energy prices continued to fall, while most industrial metal prices trended lower as well. Backing this global trend was China, where stocks shed about a quarter of the gains they had registered during their strong reopening rebound over the previous three months. In fact, European and Japanese equities began to show relative strength in recent weeks, along with cyclical sectors as well as private equity-related strategies and small caps. Europe benefited from the reopening of China, which should support its exports, while Japanese stocks were supported by a weaker yen.

Bonds were sold off, in particular at the longer end, leading to an upward shift of as much as 50 basis points of the US yield curve – with slightly reduced inversion. These developments reflect that many investors now anticipate the US and even Europe to avoid a recession this year, helped by diverse factors such as China’s sudden reopening in January. They also expect the Federal Reserve to stop raising interest rates later this year.

Indeed, the International Monetary Fund’s (IMF) January Update of its 2023 World Economic Outlook confirmed these improved expectations by upgrading its forecasts for this year. The IMF now projects the global economy to grow 2.9% in 2023 and then accelerate to 3.1% in 2024.

Graph 1

The IMF’s latest projections of growth and inflation

January update of 2023 World Economic Outlook

	Estimate	Projections	
Real GDP, annual change in %	**2022**	**2023**	**2024**
World	**3.4**	**2.9**	**3.1**
Advanced economies	**2.7**	**1.2**	**1.4**
USA	**2.0**	**1.4**	**1.0**
Eurozone	**3.5**	**0.7**	**1.6**
Japan	**1.4**	**1.8**	**0.9**
United Kingdom	**4.1**	**-0.6**	**0.9**
Canada	**3.5**	**1.5**	**1.5**
Emerging economies	**3.9**	**4.0**	**4.2**
China	**3.0**	**5.2**	**4.5**
India	**6.7**	**6.1**	**6.8**
Consumer prices, annual change in %	**2022**	**2023**	**2024**
World	**8.8**	**6.6**	**4.3**
Advanced economies	**7.3**	**4.6**	**2.6**
Emerging economies	**9.9**	**8.1**	**5.5**

GDP = gross domestic product.
Source: International Monetary Fund, LGT Capital Partners

The 2023 forecast is below the historical average of 3.8%, but 0.2 percentage point higher than the IMF projected in October. While rising interest rates and the war in Ukraine continue to weigh on economic activity, China’s recent reopening has paved the way for a faster-than-expected recovery, the IMF said. Global inflation, meanhwile, is expected to fall to 6.6% in 2023 and 4.3% in 2024, still above pre-pandemic levels. In the developed economies, inflation is expected to fall from 7.3% in 2022 to 4.6% this year and 2.6% next year.
This brightening up of expectations also became visible in the consensus forecasts for 2023. On average, economists now

expect the eurozone to narrowly avoid a recession this year, while growth in the US, China, and Japan is expected to increase at a higher level. Among large economies, only the UK is expected to remain in a relatively deep recession.

Graph 2

Consensus expectations for GDP growth in 2023

Forecast annualized change in %

Source: Bloomberg, LGT Capital Partners

Realistic or too good to be true?

Since the start of the year, an increasing number of investors seem to buy into the view that inflation can keep moderating even as growth picks up. Indeed, in recent weeks, market participants have started discussing the likelihood that the Western economies will experience a so-called "no landing" business cycle – as opposed to either a "hard landing" (recession) or a "soft landing" (slowdown).

While such a benign development is possible, we remain cautious in that regard for now. Thus far, the economies of North America and Europe are generally performing better than expected, for a variety of reasons, including sticky consumer demand, tight labor markets, wage gains, and a mild winter in Europe. Unfortunately, the main headwinds remain in place nevertheless, namely that the negative economic impact of the monetary policy tightening has yet to come. In addition, this relative strength of the economy could also prolong the current central bank tightening campaigns.

Moreover, the first signs of weakness may be appearing underneath the headline numbers. After all, US money supply has now been contracting steadily since July on a month-on-month basis, representing the biggest and longest decline since the aftermath of the Global Financial Crisis, and before that since the 1990s. While such steady declines in money supply typically denote disinflationary or deflationary phases, the impact on actual economic activity is uncertain. Hence, we prefer to await for clearer signs of either the Fed's intentions or from the economy itself, before abandoning our caution on risk assets.

Graph 3

US high-powered M2 money supply growth

Quarter-on-quarter, annualized change in %

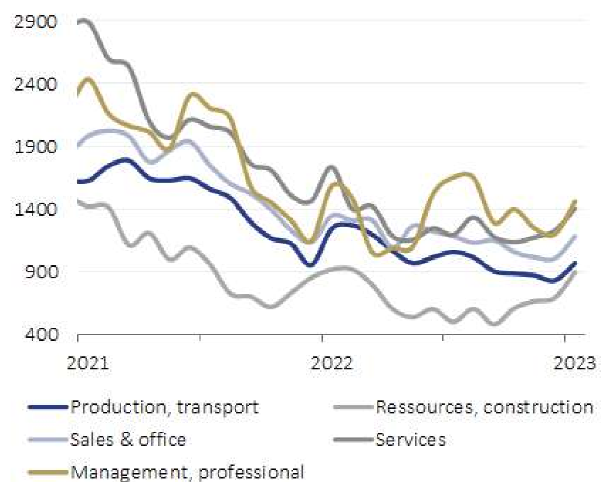
M2 = currency in circulation, bank deposits, and in some markets very liquid money market instruments.
Source: Bloomberg, LGT Capital Partners

Moreover, the recent strength in the overall employment reports is tricky to interpret. Firstly, overall employment statistics tend to look strongest shortly before a recession, because labor market data are backward-looking. Secondly, if we look a little closer under the hood, we see that some cracks have started to appear. The overall seasonally-adjusted US unemployment rate in January again fell to 3.4%, i.e. the lowest it has been since 1968. However, the unadjusted number of unemployed persons has actually started to rise in most professions in recent months.

Graph 4

US unemployed persons by occupation

Non-seasonally adjusted, in thousands



Source: Bloomberg, LGT Capital Partners

Finally, the overall annual inflation rate continues to decline broadly as expected. However, that drop was thus far driven by deflating goods and energy prices. By contrast, inflation in services – the far larger part of the economy – remains rather sticky. For that reason, the Fed may still be inclined to surprise on the hawkish side, be it by raising policy rates higher or by keeping them high for longer than markets currently price in.

Positioning: reduced risk exposure

So far this year, financial markets saw a partial reversal of last year's broad-based selloff in risk assets. The drivers of this development are manifold. While the US economy is supported by resilient consumer data and declining headline inflation, Europe benefited from lower prices and full storage of gas in the context of a mild winter. The fading risks of an acute supply shortage and energy crisis helped the region to avoid the broadly anticipated recession. Furthermore, China's reopening provided optimism. Market participants extrapolated the falling headline inflation and strong growth into the future and discount a sooner rather than later reversal of the monetary tightening cycle which would support risk assets.

We think that this is premature. A significant and sustained decline in inflation to the desired levels will likely require a pronounced slowdown in economic activity that will hit companies' profits. If growth remains resilient, central banks will be forced to tighten their policy further. Both outcomes are bearish for risk assets. We thus believe that the market rebound will likely fade and that there will be better entry points down the road. We therefore keep an underweight in duration and credit in our portfolios and have now slightly reduced our equity quota as well by underweighting US equities. When it comes to currencies, we have no active positions for the moment. As the macro environment will likely continue to induce volatility, we still prefer to follow an anti-cyclical approach and currently hold ample cash reserves which increases our flexibility and our ability to act opportunistically in this difficult market environment.

Private markets: recent investment activities in Asia

One of the findings of our broader strategic asset allocation review last year was that despite the geopolitical tensions, (a) China remains an investable market in principle, and (b) private markets are probably the best path into China in particular, as well as emerging Asia in general. Admittedly, jurisdiction risk – i.e., the possibility of the imposition of investment and trade restrictions due to a flare-up of geopolitical tensions – is now a factor to be considered by international investors who are active in China. At the same time, China is a very large, and in many areas a technologically and operationally advanced economy, with a wide opportunity set for investors. In the private equity space, we have long-standing relationships with many managers and businesses with very good track records. From a more practical perspective, the fact is that the end of China's Zero-COVID policy has revived regional activity markedly of late.

The bottom line is that we will continue to invest in China, albeit with a greater consideration of the risks involved. In practice, since private equity has very long time-horizons, this means that our commitment to investments in China will remain either stable or grow more cautiously than our investments elsewhere in Asia. But we will continue to invest where we see good business cases and deals that can be executed well with trusted partners.

As an example of our approach, as a firm, we recently decided to move ahead with an investment in a global fund administration and corporate services business that has meaningful exposure to Asia. With significant revenue and free cash flows as well as a well-diversified global customer base that has a higher exposure to Asian growth markets, we felt the company was operating in a rather defensive space both from a cyclical economic as well as a political risk perspective. This type of business might even benefit from geopolitically motivated supply chain realignments in the much-discussed context of de-globalization/regionalization in both directions.

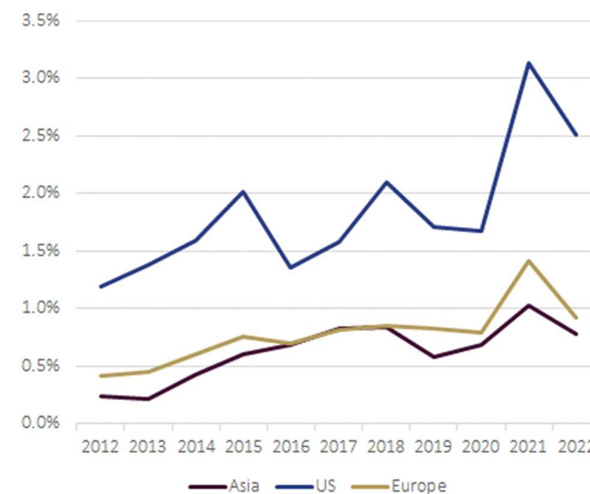
Furthermore, we derived comfort from the fact that, as a matter of principle, we focus on executing investments in partnership with trusted and strong managers. In addition, we have known the asset for many years on both the primary and secondary side of our business. Our global reach and experience also helped us gain conviction around the deal, as we own similar assets in Europe and the US. We should also add that trust in managers' skills, including their grasp of the local market and relevant developments, is built over time. In another instance, one of our managers was able to foresee the impact of the 2021 regulatory changes in the Chinese education-tech space – and was able to divest in time, increasing our confidence in the relationship. Moreover, the fact that some investors are currently shying away from new commitments in China may also offer an advantage, making the space less crowded.

Concluding, we intend to continue to invest in China with and via trusted partners, albeit perhaps more selectively and with proper consideration of the new, non-economic risks involved. At the same time, it is fair to say that investments in Asia ex-China will probably increase at a faster pace.

Graph 5

Private equity penetration

Private equity capital deployed, in % of GDP



GDP = gross domestic product.
Source: Preqin, LGT Capital Partners

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. The table shows our current positioning versus the strategic allocation (SAA) of the LGT Group Endowment, or Princely Strategy.

- **Modest equities underweight overall, tilted in favor of defensive equity strategies**
- **Fixed income: underweight, with a preference for emerging markets and high yield credit**
- **Alternatives: small overweight, resulting from a position in listed private equity**
- **Currencies and cash: neutral in currencies exposures and significant cash reserves (5%)**

	Asset class	underweight				Tactical allocation versus SAA			overweight
		----	---	--	-	+	++	+++	++++
Fixed income	Short-term investments					■■■■	■■■■	■■■■	■■■■
	Investment grade bonds*			■■■■	■■■■				
	High yield bonds				■■■■				
	Emerging market bonds								
Equities	Global defensive					■■■■	■■■■		
	Global developed			■■■■	■■■■				
	North America				■■■■				
	Europe			■■■■	■■■■				
	Japan								
	Emerging Asia								
Alt. / Real	Listed private equity					■■■■			
	Liquid alternatives								
	Insurance-linked securities								
	Real estate (REITs)								
	Gold								

	Currency[2]	----	---	--	-	+	++	+++	++++
Currencies	USD								
	EUR								
	CHF								
	GBP								
	Others								

Reference portfolio: LGT GIM Balanced (USD). The positioning shown above is valid for all similar portfolios in general. Various restrictions or liquidity considerations can lead to deviations in implementation. In currencies, "others" represents indirect exposures resulting from unhedged positions in markets against the base currency. * Includes global government, inflation-linked and corporate bonds.

Performance of relevant market segments

		1 month	3 months	Year to date	3 years, p.a.[1]	5 years, p.a.[1]
Fixed Income						
Global government bonds	USD	-1.9%	-0.7%	0.3%	-3.8%	0.5%
Global inflation linked bonds	USD	-2.7%	-0.9%	0.4%	-4.2%	-1.4%
Investment grade corporate bonds	USD	-1.8%	1.1%	0.4%	-1.7%	1.6%
High yield bonds	USD	-1.8%	3.6%	1.9%	-1.4%	1.2%
Emerging markets, local currency*	USD	-2.6%	5.8%	1.3%	-5.2%	-3.0%
Emerging markets, hard currency*	USD	0.0%	0.0%	0.0%	0.0%	0.0%
Equities						
Global	USD	1.2%	1.8%	5.5%	6.6%	8.1%
Global defensive	USD	-0.8%	-0.5%	0.2%	0.7%	5.3%
North America	USD	0.8%	0.4%	4.6%	7.1%	9.3%
Europe	EUR	2.6%	7.3%	9.2%	5.5%	6.3%
Japan	JPY	3.4%	-0.2%	5.7%	8.2%	5.4%
Emerging markets	USD	-3.9%	7.7%	4.1%	-0.5%	-1.3%
Alternative and real assets						
Listed private equity	USD	2.4%	5.3%	11.1%	7.2%	8.9%
Hedge funds	USD	2.0%	2.7%	2.0%	4.8%	3.2%
Insurance linked securities (ILS)	USD	2.3%	5.8%	2.9%	3.3%	3.4%
Real estate investment trusts (REITs)	USD	-1.1%	2.7%	5.1%	-2.0%	5.4%
Gold	USD	-5.1%	5.3%	0.5%	3.7%	6.6%
Currencies (vs. rest of G10) [3]						
US dollar	USD	2.4%	-1.6%	1.0%	1.4%	3.2%
Euro	EUR	0.0%	1.8%	0.2%	0.6%	-0.2%
Swiss franc	CHF	1.2%	1.0%	0.4%	3.3%	3.2%
British pound	GBP	-0.6%	0.1%	0.8%	-1.3%	-0.1%
Japanese yen	JPY	-1.9%	3.7%	-2.0%	-5.4%	-2.0%
Canadian dollar	CAD	1.0%	-2.9%	1.1%	0.5%	1.7%
Norwegian krone	NOK	-2.6%	-3.9%	-4.6%	-2.5%	-2.9%

[1] Annualized return [2] Bloomberg correlation-weighted currency indices. Source: Bloomberg

Economic and corporate fundamentals

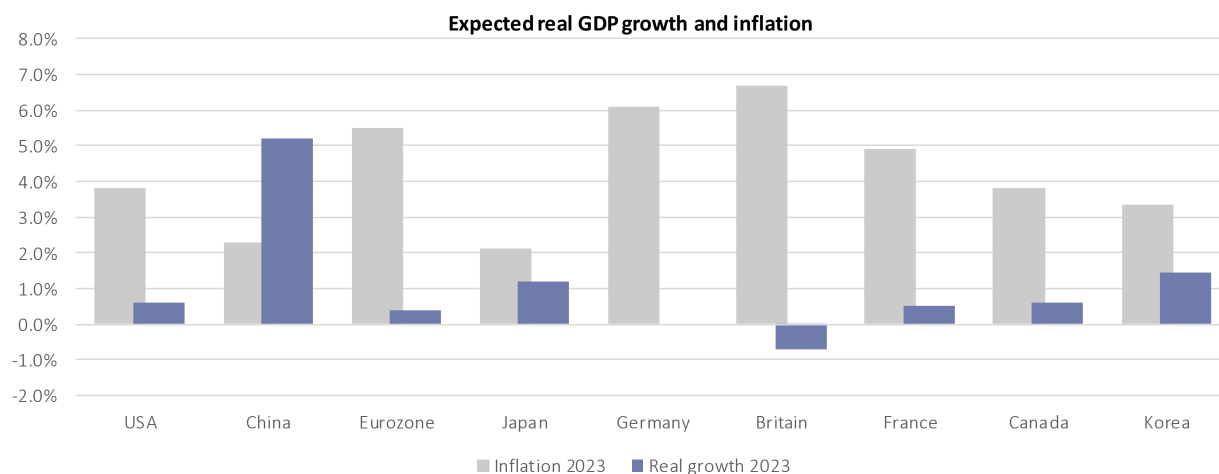
Economic and corporate fundamentals

		USA	China	Eurozone	Japan	Germany	Britain	France	Canada	Korea
Gross domestic product (GDP)										
Nominal, this year[1]	bn USD	26'185	21'643	14'224	4'366	4'120	3'479	2'807	2'327	1'792
Per Capita, purchasing power parity[1]	USD, PPP	78'422	23'038	40'965	51'594	65'865	57'822	58'421	59'872	56'694
Real growth 2023	Consensus	0.6%	5.2%	0.4%	1.2%	0.0%	-0.7%	0.5%	0.6%	1.5%
Real growth 2024	Consensus	1.2%	5.0%	1.2%	1.1%	1.2%	0.9%	1.2%	1.5%	2.3%
Real growth current quarter	Consensus	0.6%	5.9%	0.5%	1.0%	0.4%	-0.5%	0.5%	1.0%	2.5%
Unemployment 2023	Consensus	4.8%	4.0%	7.0%	2.4%	5.3%	4.7%	7.7%	6.3%	3.4%
Inflation 2023	Consensus	3.8%	2.3%	5.5%	2.1%	6.1%	6.7%	4.9%	3.8%	3.4%
Inflation 2024	Consensus	2.5%	2.2%	2.4%	1.2%	2.6%	2.4%	2.3%	2.1%	2.0%
Purchasing manager index[2]	Neutral=50									
Structural budget balance/GDP	IMF	-5.3%	-6.5%	-2.9%	-3.2%	-1.8%	-1.7%	-4.8%	-1.2%	0.3%
Gross government debt/GDP	IMF	122.9%	84.1%	91.3%	261.1%	68.3%	79.9%	112.5%	98.7%	54.4%
Current account balance/GDP	IMF	-3.1%	1.3%	1.4%	2.2%	5.3%	-4.5%	-1.5%	-0.2%	3.5%
International currency reserves	bn USD	36	3'184	557	1'123	37	108	53	82	399
Govt bond yield 2yr[3]	% p.a.	4.7%	2.4%	2.9%	0.0%	2.9%	4.0%	3.0%	4.2%	3.7%
Govt bond yield 10yr[3]	% p.a.	3.9%	2.9%	2.5%	0.5%	2.5%	3.6%	3.0%	3.4%	3.6%
Main policy interest rate *	% p.a.	4.8%	4.4%	3.0%	-0.1%	3.0%	4.0%	3.0%	2.5%	3.5%
Spread 10y-2y treasury yield	Basis points	-74.5	47.4	-40.8	52.4	-41.3	-32.5	-1.5	-80.2	-6.7

[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	China	Eurozone	Japan	Germany	Britain	France	Canada	Korea
Exchange capitalization**	bn USD	43'984	16'504	9'064	5'582	2'383	3'105	3'210	2'836	1'720
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 montl	Consensus	0.4%	24.4%	2.1%	16.0%	-3.8%	-2.8%	-9.0%	-0.1%	-35.5%
Next fy / 12m fwd	Consensus	8.9%	-2.1%	-1.1%	3.5%	-1.6%	5.0%	-0.2%	-0.7%	37.3%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	1.9%	18.3%	-0.3%	2.7%	-3.1%	3.0%	7.2%	4.8%	0.0%
Next fy / 12m fwd	Consensus	4.1%	-1.3%	-0.3%	0.3%	-0.5%	2.0%	-0.2%	-0.5%	6.7%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	18.6	10.6	13.0	13.2	11.7	13.7	10.8	12.8	9.3
Price-Sales Ratio (est 12m fwd)	Consensus	2.3	1.1	1.1	0.9	0.8	1.3	1.2	1.7	0.5
Dividend yield	Consensus	1.7	2.3	3.0	2.6	3.3	3.1	3.5	3.2	3.5

** China market cap includes Hong Kong | Source: Bloomberg Data per: 22.02.2023



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