LGT Beacon
Global macro and market review

July 2019

The case for a sustained bull market

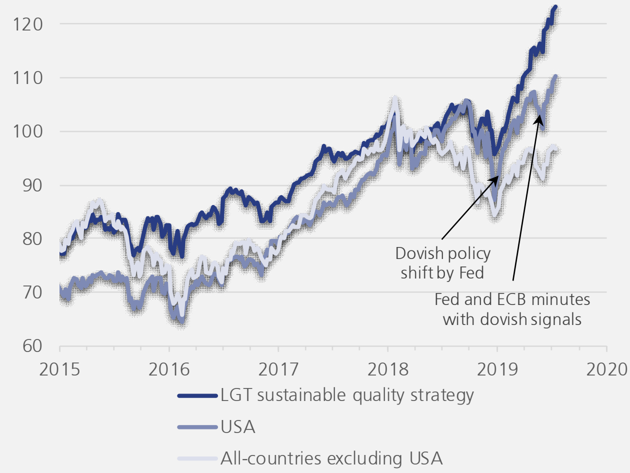
Marketing material

A dovish monetary policy shift outweighed concerns about slowing economic growth and the so-called trade war, fueling the strongest first half-year US equity rally since 1997. The short-term upside thus looks rather limited, amid a relatively weak earnings season. In the medium term, a successful soft landing of the US economy should sustain further gains.

An auspicious first half?

This year's first half was exceptionally strong for risk asset markets. US equities outperformed all other markets, reaching historic highs, while our defensively-tiled sustainable quality strategy surged even more, and was much less volatile (graph 1).

Graph 1
Stocks and LGT sustainable quality strategy
(MSCI net return indices, rebased to March 8, 2018*)

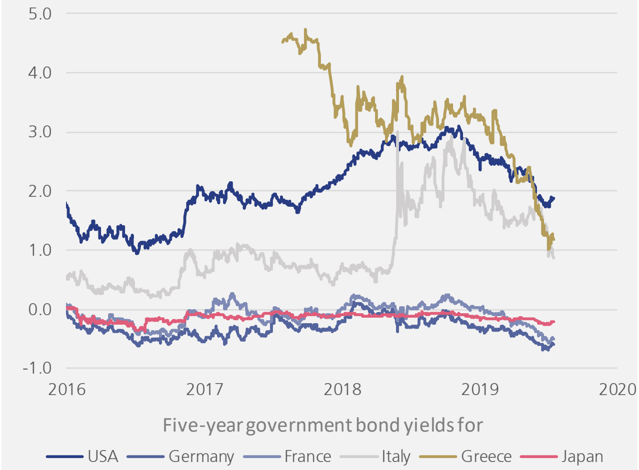


* Date of US announcement of tariffs on steel and aluminum imports, which started the so-called trade war. Source: LGT Capital Partners, Bloomberg

Credit spreads tightened as interest rates generally slumped, with euro area sliding to new lows in negative territory (e.g. in Germany and France, graph 2). About one fifth of the world's outstanding government bonds, or about 12.5 trillion US dollars (USD), now guarantee negative returns if held to maturity.

Further highlighting the current risk-friendly environment is the fact that the yield of Greek government bonds, rated "junk" by the major rating agencies, dropped to levels below equivalent US treasuries. Thanks to the probable extension of negative interest rate policy of the European Central Bank (ECB), even Greek bonds may approach zero if the newly elected center-right administration delivers pro-growth reforms.

Graph 2
Lower-rated sovereigns lead bond rally
(Five-year yields to maturity in percent)



Greece has the lowest non-investment grade ("junk") sovereign rating among all developed markets. Source: LGT Capital Partners, Bloomberg

Looking ahead, however, we would not chase current prices higher. Following these strong gains, investors should exercise prudent caution, until the macro data confirms the rally was fully justified, or, alternatively, prices correct lower to become sufficiently attractive again.

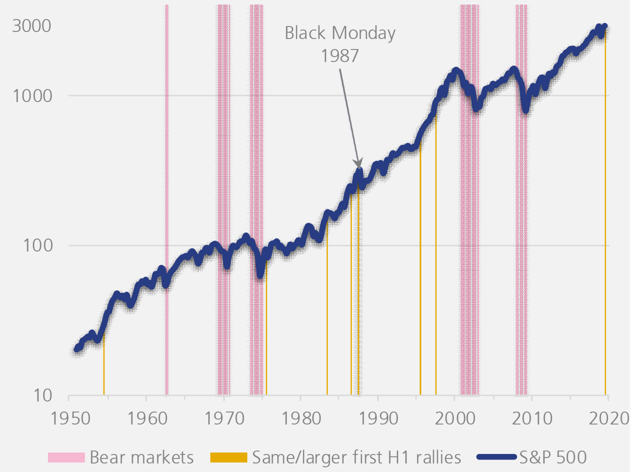
Consequently, we have refrained from raising risk allocations further in recent weeks. The global macro slowdown, the import tariffs' impact and the additional trade policy uncertainty come at a time in which the tax stimulus has fully evaporated, making corporate revenue growth critically important again. Earnings cannot sustainably grow without a successful soft landing.

A strong first half is typical in secular bull markets

At the same time, we also caution against too much caution. The long-term historic perspective is interesting, perhaps even auspicious: the S&P 500 has surged 16.9% since the start of the year. The gain represents the highest first-half surge since 1997. The US index peaked two years and nine months later, in March 2000, but only after surging another 75%.

Going back to 1950, such strong first half gains have occurred only seven times and in all cases heralded a continued strong bull market in the years that followed. Such strong rallies are more a symptom of an intact boom, rather than a warning of an imminent bear market - i.e. a gradual drop of more than 20% from peak levels. Nevertheless, significant bull corrections within intact secular bull markets have occurred within days or weeks of such a surge in 1976 and in 1987, and within a year in 1997 (graph 3). A degree of prudent caution thus seems warranted even for bullish investors.

Graph 3
Comparable first half-year rallies since 1950
(S&P 500 in logarithmic scale)



Black Monday (Oct. 19, 1987) does not qualify as a bear market because the downtrend lasted only one day. Source: LGT Capital Partners, Bloomberg

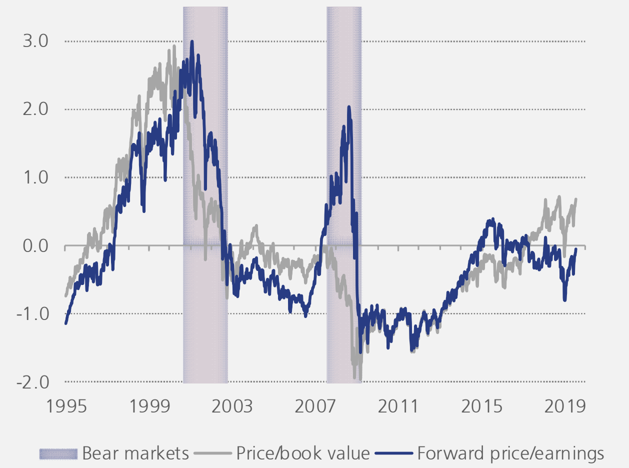
Reasonable valuations and responsive monetary policy makers

At the same time, valuations remain generally reasonable. Even in the relatively expensive US market, the price/book- and forward price/earnings-ratios are far from extreme levels (graph 4). In all other major markets, these ratios are typically even lower. Current global valuation levels continue to imply very low future growth rates of not more than 2% annually in the developed markets and close to historic lows in the emerging economies (graph 5).

A modest valuation provides comfort because it creates a price buffer, thereby making markets capable of absorbing temporary economic or political disappointments going forward.

Of course, moderate valuation levels alone cannot guarantee continued gains - current valuations are at similar levels as in 2007, i.e. the start of the last bear market. However, priced-in growth rates were significantly more upbeat in 2007. Thus, today's situation is generally more benign.

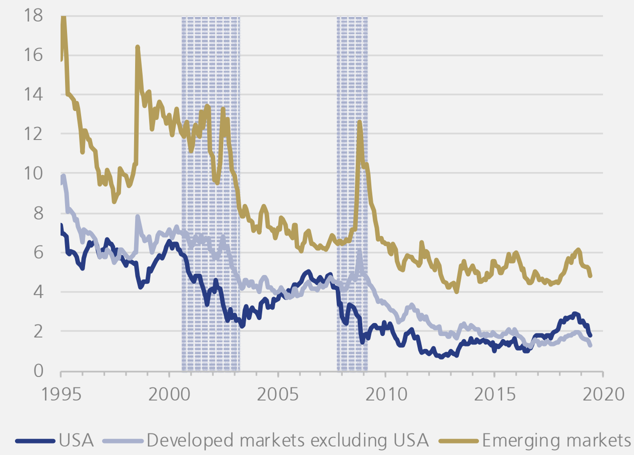
Graph 4
US equity market valuations are reasonable
(Standard deviation from the mean)



Source: LGT Capital Partners, Bloomberg

In that context, it is worth remembering that the Federal Reserve (Fed) had raised the policy rate seventeen times and then kept it at that level until September 2007, at which point the first US banks and financial institution had already begun to fail. Today, the Fed's stance seems to be more flexible in terms of reversing policy if needed. As long as policy makers continue to avoid major policy errors, current conditions generally suggest that underlying economics could start improving and surprising on the upside in due time.

Graph 5
Priced in earnings growth rates for major markets
(Annual rates in percent)



Calculations based on MSCI index data. Five-year government bond yields used as risk-free rate proxies. Source: LGT Capital Partners, Bloomberg

Still, while the combination of responsive central banks with moderate valuations and expectations is quite benign, as mentioned earlier, we prefer to await for the actual improvement to become more tangible in the fundamental data before procyclically increasing risk allocation in our strategies further.

Economic soft landing ahead?

If the Fed and other central banks will indeed provide timely and sufficient accommodation and the trade negotiations stay or return to a reasonably pragmatic path, we will most probably see a stabilization and perhaps even an acceleration of cyclical economic activity in due time. At the same time, the data so far does not fully confirm that path.

For example, the global purchasing manager indices (PMI) have generally dropped close to the growth threshold but have not yet started to point higher. Successful soft landings have occurred twice since the start of this expansion and bull market in 2009 (graph 6). The first soft landing happened in 2010-2011, when many investors feared the US would relapse into a recession following a rather weak rebound from the Great Recession of 2008-2009. That recession never materialized. In 2016, the economy bounced back again, when concerns about a hard landing of the Chinese economy proved overdone as well. China's slowdown continues to this day, but it did not have much impact on global markets outside of the commodity space.

Goldman Sachs' broader Global Leading Current Activity Indicator, which foreshadows global economic growth, had been declining last year and only managed to stabilize around February 2019. While it has remained in growth territory since, it has not started to move higher yet.

Graph 6
Cycle lows in the global leading activity indicators
(Growth threshold at 50 for PMIs)

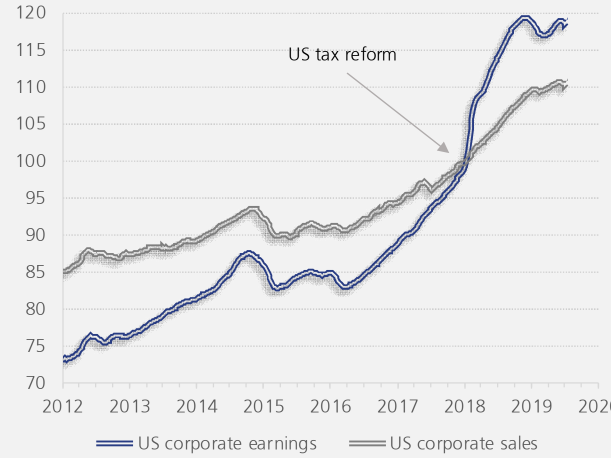
PMI = Purchasing Manager Indices by IHS Markit. Source: LGT Capital Partners, Goldman Sachs, J.P. Morgan Chase, Bloomberg

First earnings season with full tariff impact has started

Meanwhile, the corporate earnings season for the second quarter of 2019 has just started in the US and may prove rather disappointing in coming weeks. On average, analysts predict US earnings per share (EPS) declined 2.2% year-on-year - the first drop in years. They see sales per share (SPS) up less than 2%, which is also a multi-year low, given that US nominal gross domestic product should be growing at more than 4% annually. Companies' guidance may also prove subdued, as the bulk of the hitherto announced US and Chinese import tariffs became effective very recently and there is still uncertainty about the future international trade rules and the resulting supply chain costs.

Corporate profits surged following US President Donald Trump's December 2017 tax reform, but sales have not followed the same path. Moreover, they had been gradually stalling this year. While earnings have picked up again recently, due also to increased share buybacks, they have not yet broken out to a new high (graph 7).

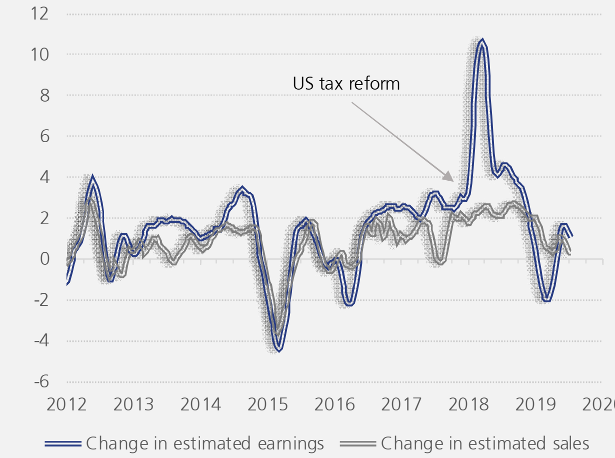
Graph 7
US corporate earnings and revenues
(Six-week moving average value per share in USD)



Source: LGT Capital Partners, Bloomberg

Finally, after trending higher for most of this year, analysts' estimate revisions have started to decline in recent days (graph 8). While earnings revisions tend to be very volatile and have been frequently negative during this decade's bull market, they can have a big impact on short-term price moves.

Graph 8
Consensus estimate revisions for US companies
(Six-week moving average of per share-values in USD)



Source: LGT Capital Partners, Bloomberg

Tactical positioning: moderately bullish, with a defensive tilt

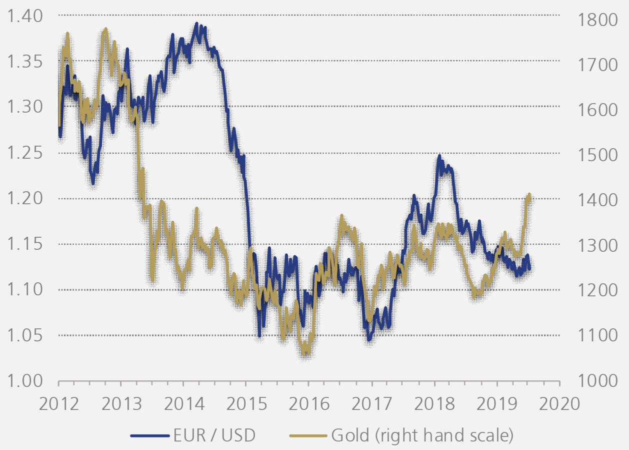
We conclude this report with an update on our tactical view: **equities remain moderately overweight** with a **clear preference for the US** due to its comparatively stronger economy and reduced vulnerability to trade risks. We note that we raised our US equities exposure twice in recent months – during the big selloff in May and then again in early June. However, we refrained from buying even more after the G20 summit late last month. Positions in our sustainable quality and minimum variance strategies represent our defensive tilt.

In **fixed income**, we remain **underweight duration and corporate credit risk**, as historically very low and/or negative government bond yields continue to be unattractive for long-term investors - 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). However, we maintain a clear preference for EM debt in the fixed income space (our only overweight in bonds). We also keep a **high cash quota** and the **alternative space** at around our relatively high neutral strategic position.

Buying gold and closing long USD/EUR position

Finally, last month we **closed a long position in the US dollar (USD) against the euro (EUR)** and **bought an equivalent amount in gold** against a small reduction in our elevated cash quota (graph 9).

Graph 9
Gold surges as USD strength stalls
(Spot price per ounce in USD)



Source: LGT Capital Partners, Conference Board, Bloomberg

Following a harsh bear market and prolonged bottoming period, gold is now looking to leave its trading range on the upside. As this would mark the end of a multi-year sideways consolidation pattern, the metal could flourish on a longer-term viewpoint this time.

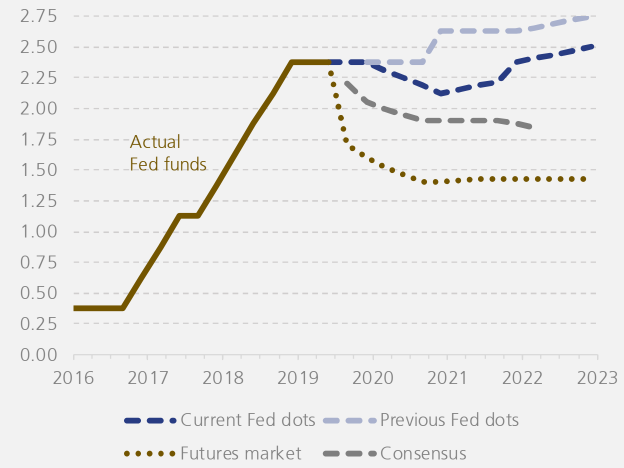
Apart from the technical aspect, gold can also act as a diversifier for a whole host of event risks, including geopolitical ones, which also could increase its allure further over time.

Meanwhile, while correlation with most other financial indicators is generally loose, the negative relationship with the USD is comparatively stable. As a result, our USD/EUR pair trade made less sense if we were to hold gold.

Since our last quarterly review in June, both the ECB and the Fed have turned more dovish. As the Fed's dot plot shows, the US central bank is now officially signaling a Fed funds policy rate cut of at least 25 basis points in the near future, while it was still projecting a rising rate as recently as May (graph 10).

While we view market participants' expectations of as much as 100 basis points in cuts within the next twelve months as overdone, the Fed's dovish policy reversal has weighed more on the USD than the possibility of renewed ECB stimulus on the EUR.

Graph 10
Fed funds rate projection and market expectations
(Mid-rate in percent)



Fed dots = policy makers' average projection of the future policy rate. Source: LGT Capital Partners, Bloomberg

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; balanced by ample cash reserves**
- **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; long position in gold**

	Asset class	SAA	Tactical allocation versus SAA (underweight -4% … +4% overweight)
Fixed income	Short-term investments	0.0%	+2%
Fixed income	Global government bonds	11.0%	-4%
Fixed income	Global inflation linked bonds	9.0%	-1%
Fixed income	Investment grade corporates	6.0%	-1%
Fixed income	High yield bonds	5.0%	-1%
Fixed income	Emerging market bonds	7.0%	+2%
Equities	Global	2.0%	
Equities	Global defensive	7.5%	
Equities	North America	10.5%	+3%
Equities	Europe	5.0%	-1%
Equities	Japan	2.5%	
Equities	Asia/Pacific ex Japan	2.5%	
Equities	Emerging markets	6.0%	-1%
Alt. / Real	Listed private equity	3.0%	
Alt. / Real	Hedge funds	12.0%	
Alt. / Real	Insurance linked securities	6.0%	
Alt. / Real	Real estate (REITs)	5.0%	
Alt. / Real	Gold	0.0%	+2%

	Currency[2]	SAA	Tactical allocation versus SAA (-4% … +4%)
Currencies	USD	86.0%	
Currencies	EUR	0.0%	
Currencies	CHF	0.0%	-2%
Currencies	JPY	0.0%	
Currencies	AUD	1.0%	
Currencies	NOK	0.0%	+2%
Currencies	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	0.8%	4.1%	6.1%	2.6%	4.0%
Global inflation linked bonds	USD	1.1%	2.9%	4.6%	3.0%	2.4%
Investment grade corporate bonds	USD	0.7%	3.0%	7.0%	3.1%	3.3%
High yield bonds	USD	1.2%	1.8%	9.6%	6.5%	4.0%
Emerging markets [2]	USD	3.2%	4.8%	10.9%	4.6%	2.5%
Equities						
Global	USD	2.1%	2.2%	18.2%	11.2%	8.4%
Global defensive	USD	2.2%	6.8%	17.6%	8.8%	9.6%
North America	USD	2.4%	3.1%	20.4%	12.6%	9.4%
Europe	EUR	0.9%	1.2%	17.1%	8.6%	6.0%
Japan	JPY	2.6%	-2.5%	6.8%	8.0%	6.0%
Asia/Pacific ex. Japan	USD	4.1%	-1.8%	12.5%	9.7%	4.0%
Emerging markets	USD	3.7%	-2.3%	11.0%	9.2%	2.2%
Alternative and real assets						
Listed private equity	USD	3.7%	5.5%	26.7%	14.1%	7.0%
Hedge funds	USD	1.6%	1.9%	5.6%	3.6%	2.2%
Insurance linked securities (ILS)	USD	1.1%	0.3%	1.0%	2.5%	3.8%
Real estate investment trusts (REITs)	USD	-0.1%	5.9%	20.8%	5.0%	6.9%
Gold	USD	5.3%	11.1%	10.5%	2.2%	1.6%
Currencies (G10) [3]						
US dollar	USD	-1.4%	-0.1%	0.5%	1.1%	4.7%
Euro	EUR	-1.1%	-0.2%	-1.9%	1.6%	0.5%
Swiss franc	CHF	0.2%	3.2%	0.1%	1.0%	2.6%
British pound	GBP	-2.1%	-4.5%	-1.9%	-1.1%	-2.3%
Japanese yen	JPY	-0.8%	4.1%	2.4%	0.5%	3.3%
Norwegian krone	NOK	0.5%	-1.2%	1.1%	0.5%	-2.6%
Swedish krona	SEK	0.6%	-0.8%	-5.5%	-2.2%	-2.3%
Australian dollar	AUD	1.1%	-1.9%	0.3%	-1.7%	-1.8%
Canadian dollar	CAD	1.3%	2.6%	5.5%	0.8%	0.3%
New Zealand dollar	NZD	2.1%	0.8%	0.8%	-0.9%	-1.0%

[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

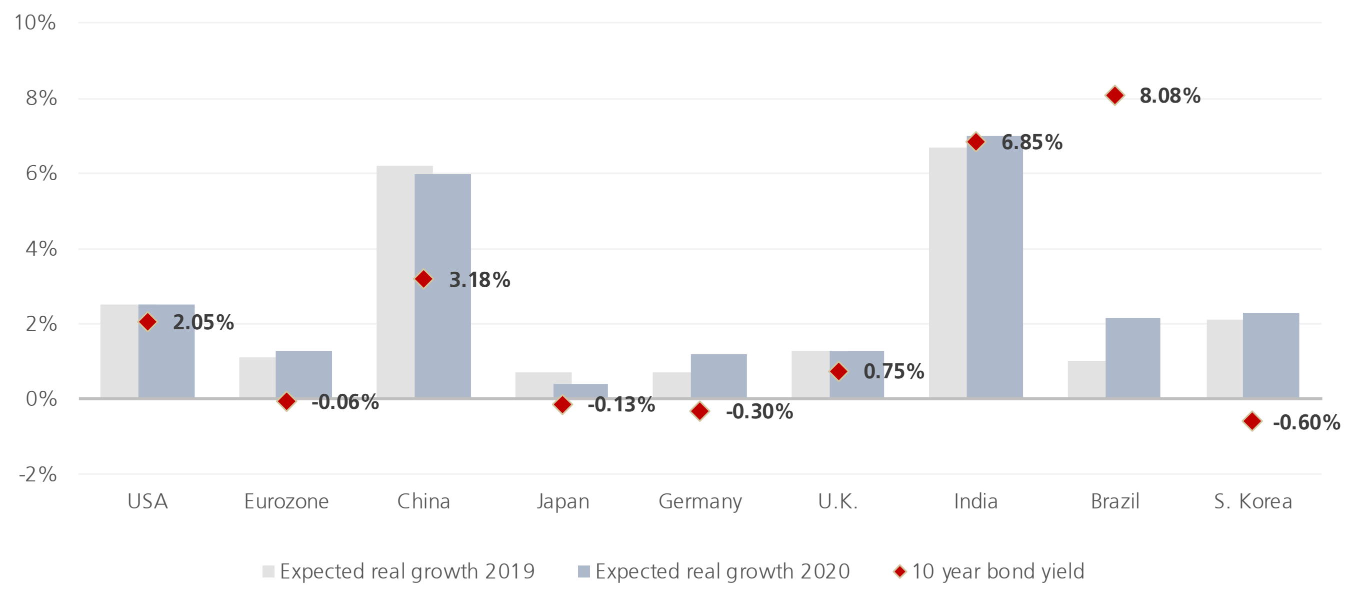
		USA	Eurozone	China	Japan	Germany	U.K.	India	Brazil	S. Korea
Gross domestic product (GDP)										
- nominal	bn USD	21,345	13,596	14,217	5,176	3,964	2,829	2,972	1,960	1,657
- nominal, per capita 2018 [1]	USD, PPP	64,767	40,965	19,520	45,565	53,854	46,782	8,484	16,662	42,985
- expected real growth for 2019	Consensus	2.5%	1.1%	6.2%	0.7%	0.7%	1.3%	6.7%	1.0%	2.1%
- expected real growth for 2020	Consensus	2.5%	1.3%	6.0%	0.4%	1.2%	1.3%	7.0%	2.2%	2.3%
- real growth in most recent quarter	QoQ, p.a.	3.1%	1.6%	6.6%	2.2%	1.7%	2.0%	5.7%	-0.6%	-1.6%
Unemployment rate 2019	Consensus	2.5%	7.5%	3.7%	2.4%	5.0%	3.8%	8.2%	4.4%	2.3%
Inflation rate 2019	Consensus	1.8%	1.1%	1.6%	0.3%	1.6%	1.8%	3.4%	4.6%	0.7%
Purchasing manager index (comp.) [2]	Neutral = 50	51.5	52.2	50.6	50.8	52.6	49.7	50.8	49.0	47.5
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	42.0	387.5	3,119.2	1,255.9	60.2	125.6	394.1	383.3	396.9
Govt bond yield 2yr [3]	p.a.	1.81%	-0.68%	2.65%	-0.19%	-0.75%	0.53%	5.77%	7.58%	-0.94%
Govt bond yield 10yr [3]	p.a.	2.05%	-0.06%	3.18%	-0.13%	-0.30%	0.75%	6.85%	8.08%	-0.60%
Main policy interest rate [4]	p.a.	2.50%	0.00%	4.35%	-0.10%	0.00%	0.75%	5.75%	6.50%	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	32,463	7,675	12,057	5,768	2,094	3,301	1,028	683	1,708
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	15.8%	27.3%	23.4%	9.4%	28.7%	43.3%	49.3%	-3.8%	22.6%
24m fwd / 12m fwd	Consensus	5.0%	4.5%	6.5%	3.3%	5.0%	3.3%	5.1%	2.5%	4.3%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	5.0%	3.6%	11.2%	2.2%	5.5%	2.4%	7.2%	3.3%	3.3%
24m fwd / 12m fwd	Consensus	4.4%	4.1%	11.1%	2.2%	3.6%	2.6%	4.6%	4.6%	0.9%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	17.3	13.3	11.5	12.5	12.8	12.5	12.4	5.6	17.0
Price-Sales Ratio (est 12m fwd)	Consensus	2.1	1.1	1.2	0.8	0.8	1.1	1.7	0.9	2.2
Dividend yield	Consensus	1.9%	3.6%	2.4%	2.6%	3.3%	4.8%	3.1%	7.2%	3.1%

* China market cap includes Hong Kong | Source: Bloomberg Data per: 7/18/2019

Interest rates and expected economic growth



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