LGT Beacon
Global macro and market review

May 2019

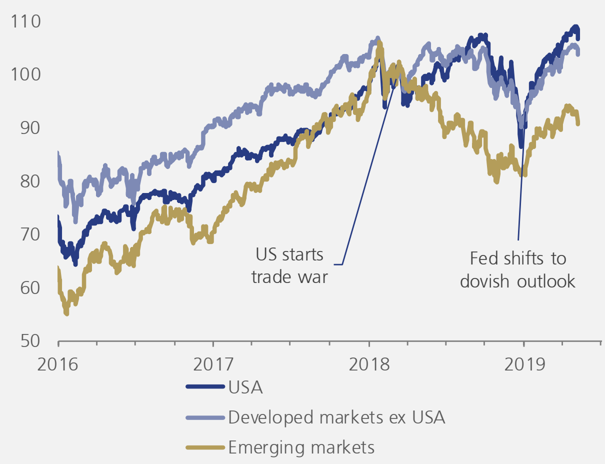
Marketing material

Supportive economics, challenging geopolitics

Last fall, investors feared the US could be sliding toward a recession by this time of the year. In the meantime, the Federal Reserve has eased its policy stance, the US economy has remained rather strong, and global growth is stabilizing. These factors should ultimately outweigh the risks emanating from the contentious Sino-American trade dispute.

Equity and credit markets extended gains in April, led by the US (graph 1). The NASDAQ and the S&P 500 hit new marginal highs on April 29 and May 1 and the interest rate environment began to normalize somewhat. Inflation expectations returned to target and the risk-free yield curve steepened, reversing the short-lived inversion (graph 2). This is fortunate because longer-lasting inversions preceded recessions in the past.

Graph 1
US has led this year's stock market rebound
(MSCI net return indices, rebased to March 8, 2018)

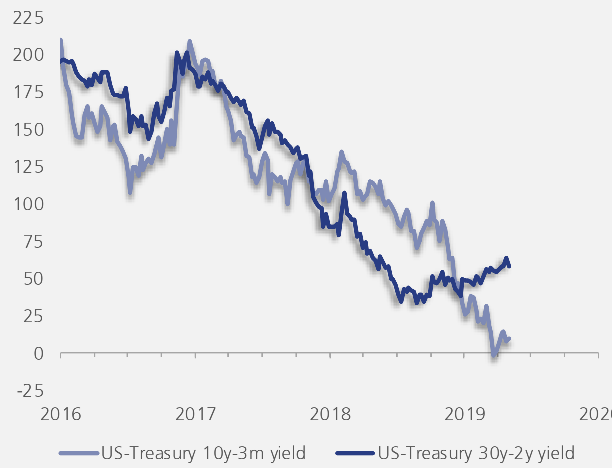


March 8, 2018 = US announces metals tariffs, starting the so-called trade war.
Source: LGT Capital Partners, Bloomberg

The year-to-date market advances are comparable with the highest annual gains since 2009, and volatility indicators for both equities and bonds had decreased close to their record lows by early May. A pullback in prices was thus clearly due.

In that sense, the global selloff triggered by US President Donald Trump last Monday could even help consolidate the recovery. On Sunday, the president tweeted he would raise tariffs on USD 200bn worth of Chinese imports from 10% to 25% this Friday, and impose 25% on the remaining USD 325bn of imports that are not subject to duties "shortly." The tweet surprised investors because the president had been more positive on the talks in the preceding weeks, creating the expectation that the two sides would reach an agreement sometime this month.

Graph 2
US yield curve inversion has reversed
(Term premia in basis points)



Inversion: long-term yields are lower than short-term yields.
Source: LGT Capital Partners, Bloomberg

Supportive economics, challenging geopolitics on trade

As things stand today, Washington has accused China of backpedaling on major agreements just as the negotiations enter their most difficult final phase. The Chinese negotiating team is traveling to the US this week to resume the talks. While such political developments raise concerns, the broader macro picture has generally improved over the past few weeks.

Buoyed by the Federal Reserve's (Fed) dovish policy shift on January 4, the rally is justifiable from a fundamental perspective. Following the market selloff of last fall, many investors saw the US sliding toward a recession by this time of the year. Instead, the economy has shown resilience, while China and other major economies appear to be stabilizing. The US corporate earnings season for the first quarter of 2019 was also stronger than expected (see page 4).

Nevertheless, the coming weeks could remain volatile and news sensitive. Our base case is that the two parties will eventually reach an agreement, although the probability of a reescalation in the tariff dispute has now clearly increased.

Tariffs: manageable impact on global economy

However, investors should put tariffs into perspective. Taken at full face value, the total US tariffs on China are worth about 0.7% and 1.1% of the US and Chinese nominal gross domestic products (GDP). They impose extra costs on many companies and may even force some uncompetitive ones into bankruptcy, but are probably not high enough to derail global growth significantly. Finally, there is ongoing trade among other nations and new and upcoming trade agreements, while China is increasingly a domestic demand-driven economy itself.

Given the current supportive monetary and fiscal policy in an environment of stabilizing growth and muted inflation, asset prices can hence eventually regain upward momentum even if the tariffs on China prove permanent.

However, should the US indeed increase tariffs on Friday, anything short of an initial retreat in asset prices would be a surprise. Such risks would increase if the US decides to double down by May 18 by levying import duties on European autos as well.

Against this background, we reviewed markets in late April (i.e. before the latest Trump tweets) and agreed that a modest consolidation was overdue. We expected the correction to prove rather shallow (i.e. a drop of not more than 5% from peak level) and this week's developments do not change this assessment.

Beyond regular rebalancing actions, we decided to maintain our current positioning (neutral in equities, titled in favor of the US at the expense of Europe, see page 5). However, acknowledging the recent stabilization of Chinese and by extension Asian growth, we closed a short position in the Australian dollar (AUD, details see page 4).

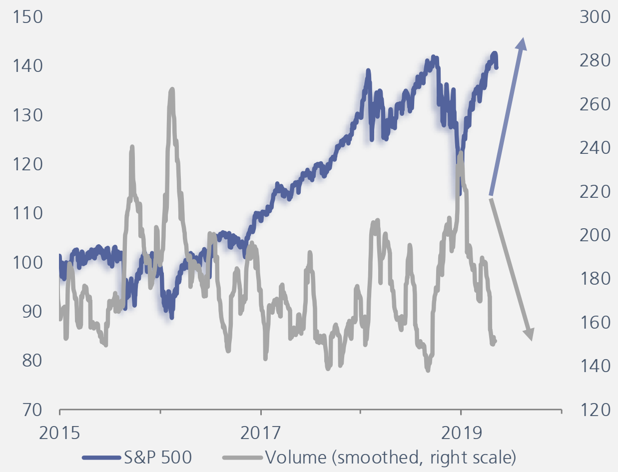
The fear-of-missing-out could drive markets higher still

With regard to the ongoing consolidation, we note that this year's equity rally occurred amid declining volumes – indicating that many investors did not participate in the recovery. If the macro outlook remains constructive and trade issues prove manageable, as we generally expect, this lack of participation increases the chances for further gains in the medium term. The fear of missing out again should prompt many investors to use drawdowns in prices to enter the market. For that reason, we are inclined to buy into the market on dips from an overall neutral position.

Graph 3

Many investors have not participated in the rally

(Volume of traded shares, rebased to 100 at end-2018)



Smoothed: 24-day moving average volume. Source: LGT Capital Partners, Bloomberg

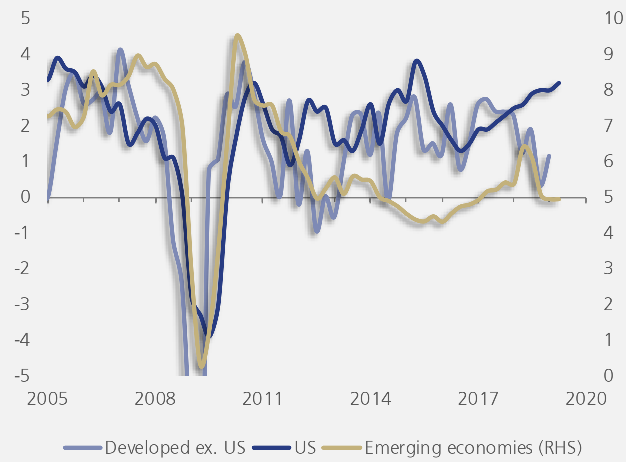
US economy and corporate earnings proved resilient

Returning to the fundamental economic case, we now revisit the recent macro developments. For starters, US real GDP growth in the first quarter of 2019 accelerated to an annualized 3.2% quarter-on-quarter gain, from 2.2% in the fourth quarter of 2018, comfortably beating expectations. The US growth momentum hence continues to outperform all other major economies (graph 4).

Graph 4

US economy continues to expand

(Annualized quarter-on-quarter growth, in percent)

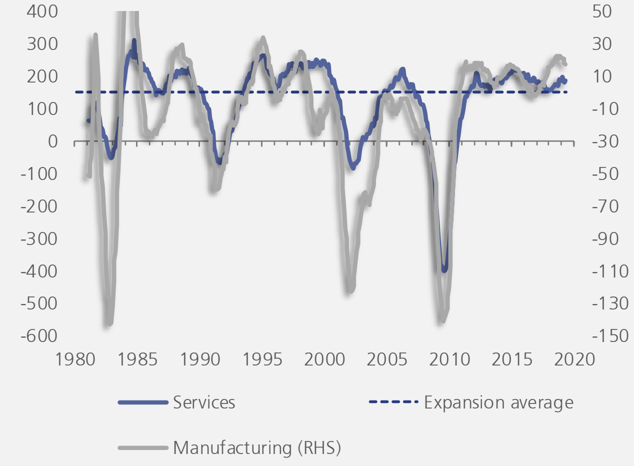


Source: LGT Capital Partners, Bloomberg

The US job market, meanwhile, continues to show strength and wages keep rising. Total monthly job creation (nonfarm

payrolls) rose from 189,000 in March to 263,000 in April, compared to an expected 190,000 jobs.
More importantly, the medium-term trend (using the 12-month averages) for the monthly nonfarm payrolls added in the services and manufacturing sectors remains stronger than during all cyclical expansion phases since 1980 (i.e. from July 1980 to June 1981, November 1982 to June 1990, November 1991 to February 2001, November 2001 to November 2007, and since June 2009, graph 5).

Graph 5
US labor market continues to show strength
(Nonfarm payrolls, 12-month moving average, in thousand)

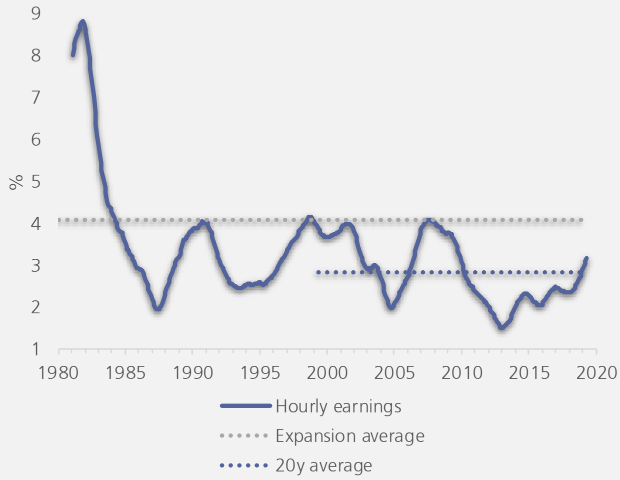


Source: LGT Capital Partners, Bloomberg

Slow but steady wage gains and stable but moderate inflation

Gains in hourly average worker earnings continue to recover from historically very low levels, suggesting that there is still a meaningful upside before the Fed begins worrying about undue price pressures (graph 6).

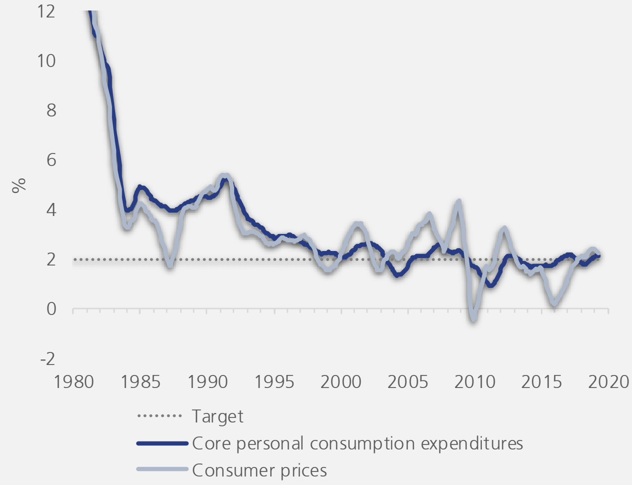
Graph 6
Trend in US average hourly earnings is positive
(12-month moving average, year-on-year change)



Source: LGT Capital Partners, Bloomberg

At the same time, despite the pullback in medium-term inflation expectations in the second half of last year, actual inflation rates remain on target (graph 7). The strong job market and moderate but stable actual inflation highlight that the Fed's policy of the past several years has been just about right.
In the meantime, inflation expectations have recovered back to the targeted 2% level – which means that the Fed's current policy bias is also the right one and that the Fed's decision to refrain from further monetary tightening this year did not come too late. Stable inflation expectations are important because they reduce the risk of recession in the near term.

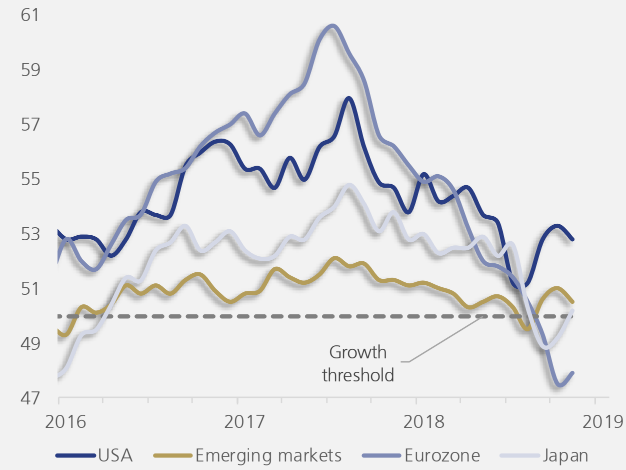
Graph 7
US actual inflation is right on target again
(Indices for consumer prices and core personal expenditures)



Source: LGT Capital Partners, Bloomberg

Finally, the purchasing manager surveys have either held at high levels (in the US) or have started to stabilize, as Europe and Japan appear to be rebounding, while the emerging markets are holding just above the growth threshold (graph 8).

Graph 8
Purchasing managers' indices for manufacturing
(Balance/Diffusion indices by IHS Markit)



Source: LGT Capital Partners, Bloomberg

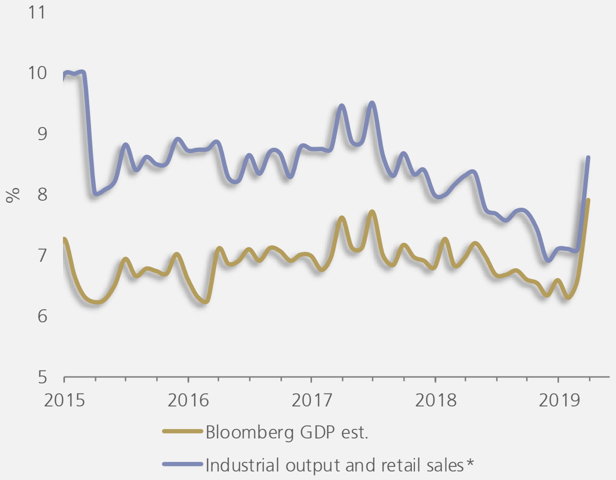
Constructive corporate reporting season

Lastly, US corporate earnings have once again proven stronger than expected, with 76% of companies beating forecasts, compared to a bull market average of 70%. Aggregate earnings per share for the S&P 500 member companies grew close to 2% year-on-year in the first quarter, while analysts had predicted a decline of about 4%. Revenue rose by about 4.6%, exactly as forecast. Hence, the anticipated collapse in profit margins did not occur on a broad basis, which should help companies keep profitability high if growth continues to surprise on the upside. Results are more mixed in most other markets, but still sufficiently constructive. In particular, Europe and Japan actually delivered higher EPS growth on an aggregate level, although results varied strongly from sector to sector.

Forex: switching from short AUD to short CHF on China

As mentioned earlier, we recently sold the Swiss franc (CHF) and bought back the AUD against the Norwegian krone (NOK), swapping a long NOK/short AUD with a long NOK/short CHF position. China's cyclical slowdown is bottoming out following a number of policy stimulus measures adopted since last year, and global monetary settings have turned more accommodative this year. Indeed, the data flow from China was constructive in April: retail sales, industrial output and GDP readings clearly beat analysts' expectations, and credit growth has picked up – which should support business activity going forward (graphs 9 and 10).

Graph 9
China: clear signs of a rebound in growth
(Year-on-year change)



*Weighted by size of manufacturing and services sectors relative to GDP
Source: LGT Capital Partners, Bloomberg

The global growth headwinds emanating from China are hence easing, which erodes the case for shorting the pro-cyclical and China-sensitive Aussie dollar.

Consequently, we find it increasingly difficult to see the AUD weaken further from current levels, despite a relatively weak domestic economy (notably the property market) and the dovish Reserve Bank of Australia.

Graph 10
China: credit impulse points higher again
(Monthly total debt financing* as share of GDP in percent)

*Total social financing excluding equity financing
Source: LGT Capital Partners, Bloomberg

The opposite is true for the CHF. As a safe-haven asset, the CHF would not benefit from an improvement in global risk appetite. Furthermore, the Swiss National Bank (SNB) is effectively bound to follow the European Central Bank's (ECB) dovish path and thus likely to keep negative interest rates on excess reserves beyond 2019. Hence, as the Norges Bank continues on its hiking trajectory, the interest rate differential (carry) is set to widen further in favor of the NOK.

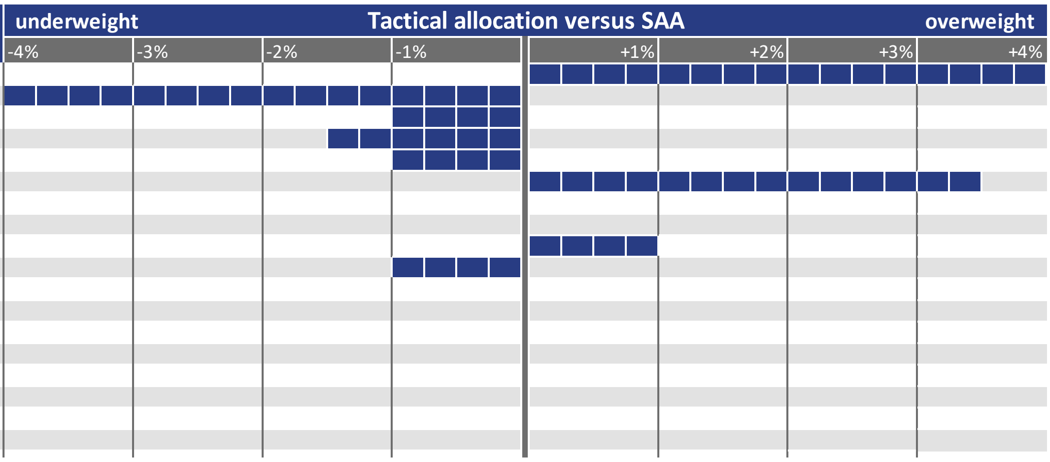
END OF REPORT

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

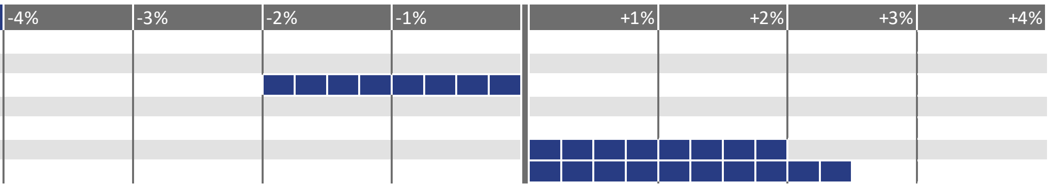
The tactical asset allocation (TAA) relative to the neutral strategic quotas (SAA) is set quarterly with a time horizon of three to six months and adjusted when deemed necessary in the interim.

- **Equities neutral, with a preference for the US at the expense of Europe**
- **Fixed income: still underweight duration and credit risk, with a clear preference for EM debt**
- **Long NOK vs. CHF; EM currencies remain a passive overweight; liquidity remains high**

	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	0.5%	2.0%	2.8%	2.3%	3.6%
Global inflation linked bonds	USD	0.4%	1.4%	2.2%	2.7%	2.1%
Investment grade corporate bonds	USD	0.7%	2.4%	4.4%	2.8%	2.9%
High yield bonds	USD	0.4%	3.4%	7.6%	7.2%	3.8%
Emerging markets [2]	USD	-1.0%	0.0%	4.7%	4.3%	1.8%
Equities						
Global	USD	-0.4%	6.7%	14.6%	11.9%	8.6%
Global defensive	USD	-0.3%	4.5%	10.5%	8.5%	9.0%
North America	USD	-0.4%	6.7%	15.9%	13.3%	9.9%
Europe	EUR	-0.7%	7.4%	13.5%	9.2%	5.3%
Japan	JPY	-1.0%	5.2%	8.5%	9.2%	8.1%
Asia/Pacific ex. Japan	USD	-2.0%	4.3%	11.7%	12.6%	5.1%
Emerging markets	USD	-2.8%	2.5%	10.0%	12.1%	3.3%
Alternative and real assets						
Listed private equity	USD	3.4%	9.1%	21.1%	12.5%	7.2%
Hedge funds	USD	0.4%	3.6%	3.6%	3.6%	2.2%
Insurance linked securities (ILS)	USD	-0.5%	-1.0%	0.7%	2.9%	3.8%
Real estate investment trusts (REITs)	USD	-1.8%	2.8%	14.1%	4.6%	6.4%
Gold	USD	-0.9%	-2.1%	0.3%	-0.1%	0.0%
Currencies (G10) [3]						
US dollar	USD	1.5%	1.4%	1.7%	2.1%	5.3%
Euro	EUR	0.8%	0.2%	-0.9%	1.5%	0.4%
Swiss franc	CHF	-0.7%	-0.6%	-2.3%	0.4%	1.9%
British pound	GBP	1.0%	1.9%	4.0%	-1.7%	-0.7%
Japanese yen	JPY	2.8%	1.0%	1.2%	1.1%	3.4%
Norwegian krone	NOK	-1.3%	-0.2%	0.1%	-0.3%	-3.6%
Swedish krona	SEK	-2.4%	-2.3%	-6.9%	-3.9%	-3.4%
Australian dollar	AUD	-0.4%	0.1%	1.1%	0.3%	-1.3%
Canadian dollar	CAD	0.2%	-0.1%	3.2%	0.6%	0.3%
New Zealand dollar	NZD	-1.0%	-1.1%	-0.5%	0.8%	-0.9%

[1] Annualized return [2] Equal-weighted hard and local currency total return indices [3] Bloomberg correlation-weighted currency indices of a currency verus its nine major counterparts | Source: Bloomberg

[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	2.4%	1.1%	6.3%	0.7%	0.9%	1.3%	7.0%	1.9%	2.4%
- expected real growth for 2020	Consensus	2.4%	1.4%	6.0%	0.5%	1.4%	1.4%	7.2%	2.5%	2.4%
- real growth in most recent quarter	QoQ, p.a.	3.2%	1.5%	5.7%	1.9%	0.1%	0.9%	6.6%	0.5%	-1.2%
Unemployment rate 2019	Consensus	2.4%	7.7%	3.8%	2.5%	4.9%	3.9%	8.2%	4.7%	2.4%
Inflation rate 2019	Consensus	1.9%	1.2%	1.8%	0.3%	1.1%	1.8%	4.6%	4.6%	0.5%
Purchasing manager index (comp.) [2]	Neutral = 50	53.0	51.5	52.7	50.8	52.2	50.9	51.7	50.6	50.2
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	41.2	382.3	3,095.0	1,229.4	59.3	133.2	385.4	381.4	400.3
Govt bond yield 2yr [3]	p.a.	2.27%	-0.50%	2.82%	-0.15%	-0.61%	0.72%	7.30%	8.33%	-0.76%
Govt bond yield 10yr [3]	p.a.	2.44%	0.28%	3.41%	-0.05%	-0.05%	1.11%	7.49%	8.90%	-0.31%
Main policy interest rate [4]	p.a.	2.50%	0.00%	4.35%	-0.10%	0.00%	0.75%	6.00%	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	31,679	7,582	12,130	5,760	2,116	3,388	889	622	1,632
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	14.7%	26.3%	17.9%	8.1%	27.6%	34.4%	28.2%	-8.0%	22.9%
24m fwd / 12m fwd	Consensus	6.6%	6.0%	9.1%	5.0%	6.4%	5.1%	6.2%	4.6%	6.0%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	5.4%	4.1%	11.1%	4.9%	6.7%	2.7%	6.7%	4.9%	2.5%
24m fwd / 12m fwd	Consensus	4.4%	1.2%	8.6%	-2.3%	2.9%	2.6%	8.9%	5.3%	-0.5%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	16.7	13.1	11.6	12.4	12.6	12.3	11.1	5.7	16.4
Price-Sales Ratio (est 12m fwd)	Consensus	2.0	1.0	1.3	0.8	0.9	1.1	1.5	0.8	2.1
Dividend yield	Consensus	2.0%	3.6%	2.4%	2.6%	3.4%	4.9%	3.9%	7.0%	3.3%

* China market cap includes Hong Kong | Source: Bloomberg Data per: 5/8/2019

Current equity market valuations and earnings growth expectations

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