LGT Capital Partners
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**LGT Beacon**

Global macro and market review

May 2020

## The risks have titled to the upside

Marketing material

**Authorities around the world have started to reopen their economies and borders. Risk markets, after consolidating the strongest rebound in recorded history for about a month, have begun to perk up again recently. While uncertainties about the outlook remain, investors should also not ignore the chances that a new major bull market may be in the making.**

## Economies reopen as pandemic begins to fade

The COVID-19 pandemic continues to subside globally and many economies are beginning to reopen. In the meantime, the social and economic costs of the crisis have become visible, which motivates governments to try to avoid further hard lockdowns. Such measures are economically unsustainable and can exacerbate existing social and political risks, from European tensions regarding pandemic aid to the intensification of the strategic rivalry between the USA and China. In addition, knowledge about pandemic management increases over time. Future measures could therefore be less invasive even in the event of renewed waves of infections.

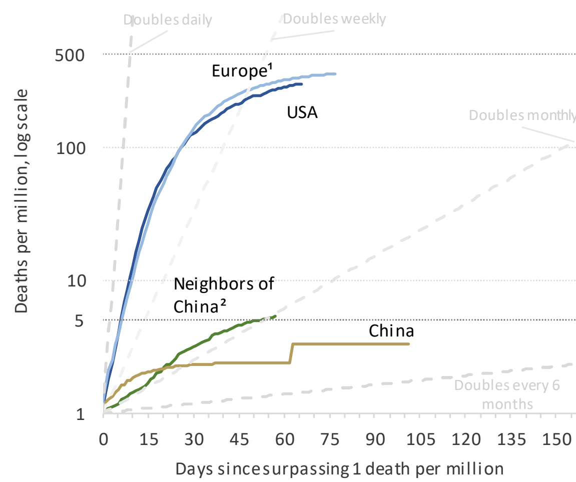
The numbers speak for themselves. In the United States alone, more than 38 million people have lost their jobs since mid-March - one in five adults of working age. In addition, several countries will have to run budget deficits of 10% or more of gross domestic product in the near term. In return for such numbers, the authorities, at least in the developed economies, have managed to bring the pandemic under control – i.e. to a level that allows their health systems to cope reasonably well from now on. As made evident for instance by the developed economies neighboring China, it is possible for governments to manage pandemics without extremely restrictive measures given enough preparedness. In fact, all these economies combined have thus far reported only five COVID-19 deaths per million people (graph 1).

## Strongest rebound from a bear market on record

Importantly for investors, financial markets have started to price out the fear of a prolonged economic slump, and to consider the consequences of a stimulus-flooded world economy that has learned to manage virus outbreaks more smoothly. At the very least, markets have taken such scenarios more seriously than many (if not most) analysts in recent weeks. Consequently, equities, industrial commodities and credit markets have been remarkably strong, despite no lack of gloomy economic commentaries.

Graph 1

**Pandemic continues to slow down**
(COVID-19 deaths per million of regional population)




¹ European Union including United Kingdom, plus Switzerland and Norway. ²Japan, South Korea, Taiwan. Source: Bloomberg, LGT Capital Partners

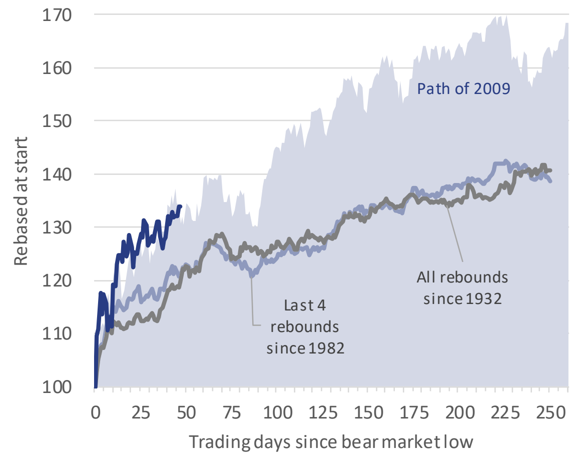
For investors that can tolerate some degree of uncertainty and volatility in the short term, it was clear that the pandemic selloff had made many market segments attractive. Valuation measures developed by LGT Capital Partners had pointed this out during the panic of February-March, and we selectively added some exposure accordingly (i.e. Japanese and European equities).

Indeed, starting on 23 March, equities began to recover, staging the strongest-ever rebound from a bear market low (graph 2). The only comparable recovery was the rally that began on 11 March 2009, i.e. the rally that took us out of the Great Financial Crisis and which was also met with widespread disbelief by many investors for a long time. For about the first month of the rally, from 23 March to 29 April, the current recovery was stronger than the one of 2009.

Graphs 2 and 3

**Exceptionally strong rebound from selloff**

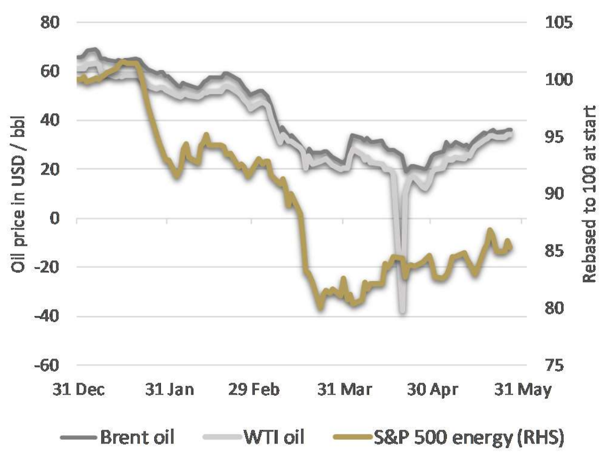
(Current rally vs. past recoveries from bear markets*)




* Bear markets: peak to trough drops of at least 20%, including the one-day selloff of 1987. Equal-weighted moving average of index performance in respective periods.

**Growth-sensitive commodities have stabilized**

(Crude oil price per barrel, industrial metals index, in USD)




Source: Bloomberg, LGT Capital Partners, Goldman Sachs Industrial Metals Spot Index

Industrial commodity spot prices have also stabilized and have gradually risen since late March. The same is true for crude oil prices, despite the very brief drop of West Texas Intermediate crude oil into negative territory. Commodity prices, however, in general remain below last year's levels (graph 3).

The same is true for equities, albeit to a lesser degree, with differences remaining between regions - most major indices are down between 8% to 12% in case of the US, China, Japan and Switzerland, while they have shed 20% to 30% in Europe since the end of 2019.

## A reflationary tide that lifts all boats

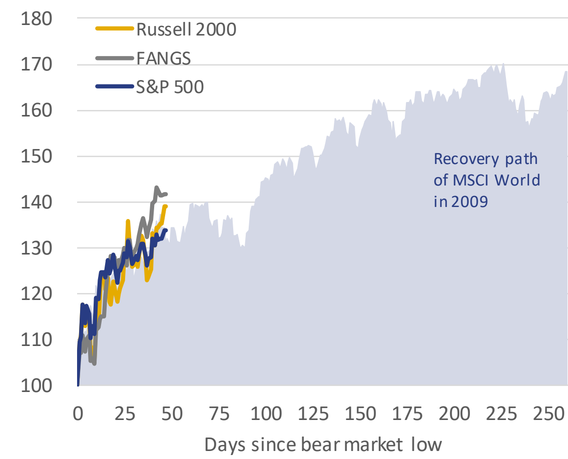
Nevertheless, we should also look into the recovery itself to assess its quality and breadth. The US equity rebound has actually been quite broad based if we take its starting point as the basis – meaning that small caps, blue chips, and the handful of most popular technology stocks, the so-called FANGS, have rallied much more in line than they usually do.

While the FANGS have started to regain their former relative strength in May, they had been rising in line with the other market segments during the first month of the rebound. This contrasts with the performance of the regions since the March low, which was significantly less synchronous (graphs 4 and 5).

Graphs 4 and 5

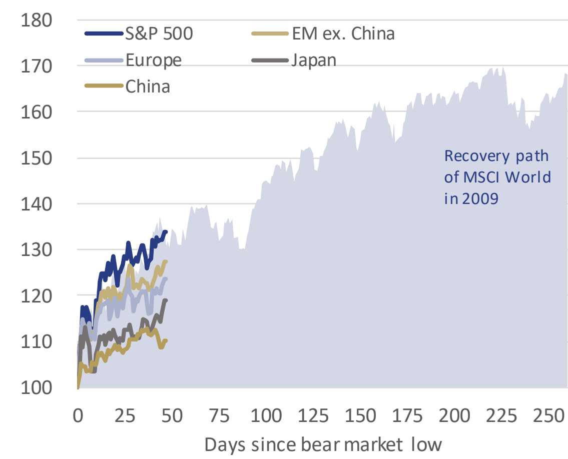
**In the US, the rebound has been broad-based**

(Indices rebased to the respective bear market low)




**The rebound varied by country and region**

(Indices rebased to the respective bear market low)




MSCI indices used for all regions except for the US. EM = Emerging Markets. Source: Bloomberg, LGT Capital Partners

From a longer-term perspective, the relative strength of the FANGS versus the blue chips versus small caps still holds, of course. Still, the fact that the rebound itself has been remarkably non-discriminatory in terms of market segments does suggest this rebound was quite broad-based in the US, especially when compared to the regions.

## Bad macro data that fail to shock

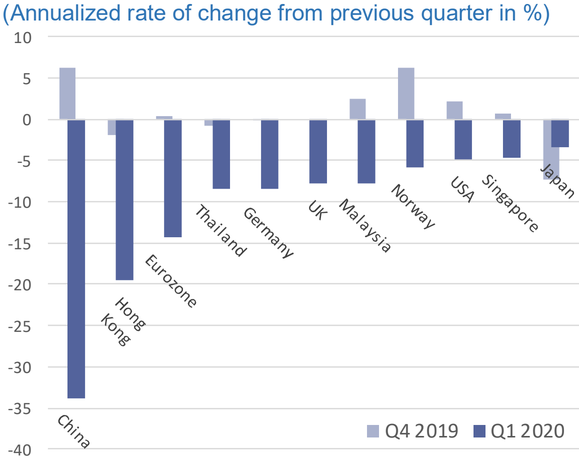
To some degree, the disbelief in the strength of the recent rebound is understandable, as the rally intensified amid the horrible deterioration of the economic data. The gross domestic product (GDP) data released over the past couple of weeks paint a very clear picture (graph 6), highlighting how the lockdowns brought large segments of most economies to a screeching halt.

Many media and research reports tend to show different types of growth rates for different countries, while we compare the quarter-on-quarter annualized growth rate of the official GDP data for each economy. In China, the decline approached 35%, i.e. probably the biggest ever. Economies such as the US and Japan in particular have fared comparatively well thus far. However, most countries' growth data might still worsen significantly in Q2/2020, which is when the lockdowns peaked in most countries except China. The Atlanta Federal Reserve's GDPNow index predicts an annualized drop of almost 42% for the US for the current quarter.

Graph 6

**Global Lockdown crash on a comparable basis**

(Annualized rate of change from previous quarter in %)




Source: International Monetary Fund, Bloomberg, LGT Capital Partners

## Bull markets begin well before the economy improves

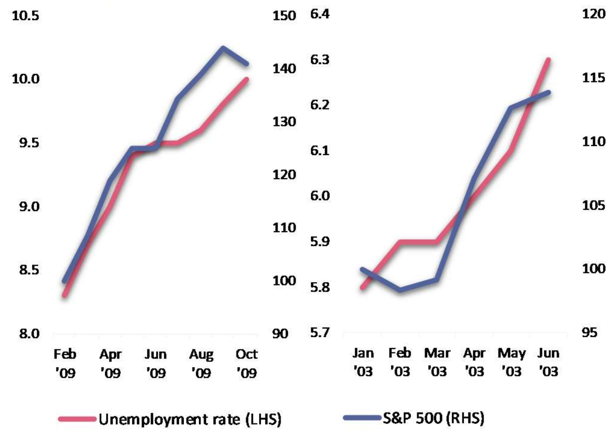
Against the background of such macro data, it is natural to wonder how markets can rally when unemployment is high and/or rising. The answer includes a number of aspects:

- Financial markets look ahead and typically begin to rally before the hard economic data improves. This happened during the exit rallies of the last two bear markets as well, i.e. in 2003 and 2009 (graph 7).
- In addition, the current recession is to a large degree the result of a public health policy decision to shut down public life. The rebound from the slump could hence occur relatively quickly once the pandemic is under control. Indeed, many data points highlight the atypical economic nature of recent events.
- The economic stimulus measures that governments have legislated around the globe are significant enough to avoid turning this public health response into a long-lasting economic and financial problem.

Graph 7

**Bull markets are born when unemployment is still rising**

(Unemployment in % of workforce, stocks rebased to100)



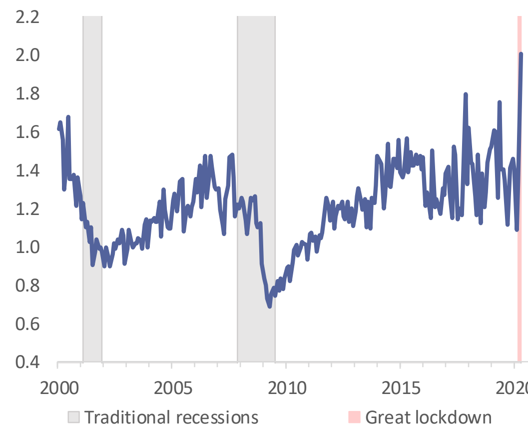

Source: IMF, Bloomberg, LGT Capital Partners

An example for the atypical nature of this slump: when comparing the unemployment rates in services to the unemployment rate in manufacturing, we can see that services are typically least affected during recessions. Services unemployment in fact tends to fall relative to manufacturing during recessions. This time, the extreme opposite is true (graph 8).

Graph 8

**The exact opposite of a normal recession**

(Unemployment in services* versus manufacturing)



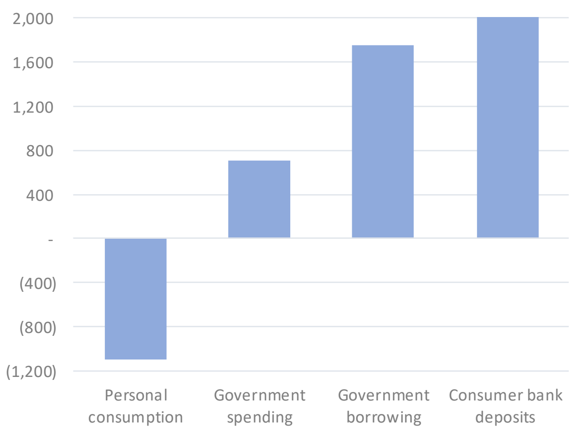

Equal-weighted unemployment rate of the sectors Leisure & Hospitality, Other Services, and Retail and Wholesale. Source: Bloomberg, LGT Capital Partners

In turn, the types of services jobs lost are also those that can return most easily and quickly, and are least likely to move overseas. After all – one cannot outsource the local bar, dentist or food delivery service to another country. While some job losses will be permanent or will take a long time to return, most jobs should come back more quickly than during a normal recession.

Furthermore, the economic support measures are just too big to ignore, especially in the US – the risk of a meaningful strengthening of the economy later this year is clearly there. In the last edition, we highlighted that the US fiscal and monetary stimulus is only comparable to the World War II era. In this edition, we compare the fiscal response since the end of January, when the US declared a public health emergency, to the collapse in consumption and the surge in consumer cash savings (graph 9).

Graph 9

**Government spending makes up for collapse in private spending and surge in precautionary savings**
(Change in billion USD since 31 January*)




*Declaration of public health emergency in the US by President Donald Trump. Source: IMF, Bloomberg, LGT Capital Partners

As we can see, the government spending in February-April covers more than half of the drop in consumption. The total level of Federal government borrowing since January far outweighs the drop in consumption, providing some reassurance that more money will flow into the economy in the near future. The surge in private savings, meanwhile, exceeds both. While the latter represents consumer precaution during a crisis, the fact that it has never occurred before in this magnitude, combined with the general rule that current savings equal future investment, probably make it a net positive factor.

These numbers of course exclude the hundreds of billions the Federal Reserve and other central banks will be pumping into their respective financial systems in the coming months.

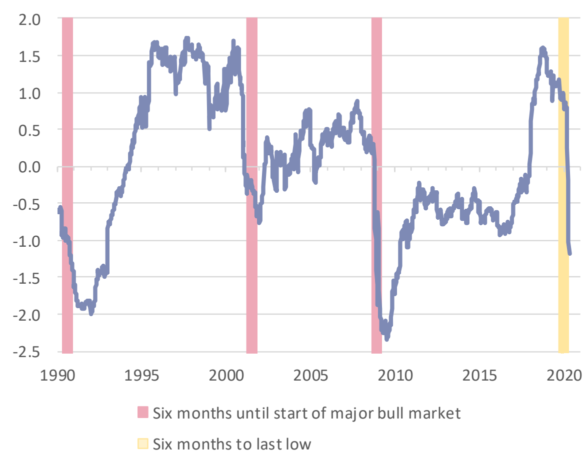
## A new bull market may have already begun

Finally, if we look at equity valuations, there is certainly considerable uncertainty and volatility with regard to the outlook. However, if we look at the expected earnings (Bloomberg consensus) in relation to the actual and less volatile book value, we see that the current level of expectation is more than a standard deviation below the historical mean (Chart 10).

The interesting point here is that we had seen comparably sharp drops precede each of the last three big bulls markets that began in 1990, in 2002 and in 2009.

Graphs 10

**Forward earnings versus book value for S&P 500**
(Standard deviation from long term mean)




Forward earnings based on Bloomberg consensus. Book value is actual book value. Source: IMF, Bloomberg, LGT Capital Partners

We cannot be sure that we have already passed the low of the pandemic bear market. Nevertheless, the chances that we are at the beginning of a new bull market have also increased.

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: broadly neutral positioning in favor of developed markets**
- **Fixed income: pronounced underweight in duration and investment grade borrowers**
- **Currencies and real assets: long Japanese yen against the euro, overweight in gold**

| | Asset class | SAA | underweight ---- | --- | -- | - | Tactical allocation versus SAA + | ++ | +++ | overweight ++++ |
|---|---|---|---|---|---|---|---|---|---|---|
| Fixed income | Short-term investments | 0.0% | | | | | | | | |
| | Investment grade bonds* | 24.0% | | ■■■■ | ■■■■ | ■■■■ | | | | |
| | High yield bonds | 5.0% | | | ■■ | ■■■■ | | | | |
| | Emerging market bonds | 7.0% | | | ■■■■ | ■■■■ | | | | |
| Equities | Global defensive | 7.5% | | | | | | | | |
| | Global developed | 23.5% | | | | | | | | |
| | *North America* | | | | | | ■■■■ | | | |
| | *Europe* | 1.0% | | | | | ■■■■ | | | |
| | *Japan* | 1.0% | | | | | | | | |
| | *Emerging markets* | 6.0% | | | ■■■■ | ■■■■ | | | | |
| Alt. / Real | Listed private equity | 4.0% | | | | | | | | |
| | Hedge funds | 12.0% | | | | | | | | |
| | Insurance-linked securities | 6.0% | | | | | | | | |
| | Real estate (REITs) | 5.0% | | | | | | | | |
| | Gold | 0.0% | | | | | ■■■■ | ■■■■ | ■■■■ | ■■■■ |

| | Currency[2] | SAA | ---- | --- | -- | - | + | ++ | +++ | ++++ |
|---|---|---|---|---|---|---|---|---|---|---|
| Currencies | USD | 87.0% | | | | | | | | |
| | EUR | 0.0% | | | ■■■■ | ■■■■ | | | | |
| | CHF | 0.0% | | | | | | | | |
| | JPY | 0.0% | | | | | ■■■■ | ■■■■ | | |
| | AUD | 1.0% | | | | | | | | |
| | NOK | 0.0% | | | | | | | | |
| | Others | 12.0% | | | | | | | | |

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 | -0.2% | 1.6% | 4.9% | 5.3% | 4.4% |
| Global inflation linked bonds | USD | 0.6% | -0.7% | 0.7% | 2.7% | 2.5% |
| Investment grade corporate bonds | USD | 1.8% | 0.1% | 2.1% | 4.4% | 3.8% |
| High yield bonds | USD | 4.7% | -6.3% | -7.0% | 2.1% | 3.8% |
| Emerging markets [2] | USD | 8.1% | -6.5% | -6.6% | 1.8% | 3.1% |
| **Equities** | | | | | | |
| Global | USD | 4.5% | -2.3% | -8.8% | 5.5% | 5.5% |
| Global defensive | USD | 0.1% | -5.2% | -8.7% | 5.8% | 6.8% |
| North America | USD | 4.5% | 0.5% | -6.8% | 8.7% | 8.2% |
| Europe | EUR | 4.3% | -9.1% | -14.9% | -1.3% | 0.8% |
| Japan | JPY | 5.6% | -2.3% | -9.8% | 1.7% | 0.0% |
| Emerging markets | USD | 3.7% | -9.6% | -16.3% | -0.7% | 0.5% |
| **Alternative and real assets** | | | | | | |
| Listed private equity | USD | 10.7% | -11.9% | -16.9% | 3.1% | 4.9% |
| Hedge funds | USD | 4.3% | -6.1% | -5.9% | 0.5% | 1.1% |
| Insurance linked securities (ILS) | USD | 0.4% | -0.3% | 1.0% | 2.4% | 3.8% |
| Real estate investment trusts (REITs) | USD | 0.8% | -13.8% | -16.4% | 1.8% | 3.1% |
| Gold | USD | -0.1% | 4.0% | 12.8% | 10.6% | 7.6% |
| **Currencies (vs. rest of G10) [3]** | | | | | | |
| US dollar | USD | -1.9% | 1.5% | 5.2% | 2.2% | 2.2% |
| Euro | EUR | -0.6% | 1.0% | 2.5% | 1.4% | 2.3% |
| Swiss franc | CHF | -0.9% | 1.6% | 5.2% | 2.5% | 1.8% |
| Japanese yen | JPY | -2.1% | 3.7% | 6.4% | 3.5% | 5.4% |
| Australian dollar | AUD | 1.1% | 2.8% | -1.1% | -2.1% | -1.2% |
| Norwegian krone | NOK | 4.6% | -4.5% | -8.1% | -4.0% | -3.3% |
| Emerging market currency index [4] | USD | 4.3% | -6.4% | -11.1% | -7.4% | -6.1% |
| British pound | GBP | -2.9% | -3.5% | -3.1% | 0.7% | -2.7% |

[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 | China | Eurozone | Japan | Germany | France | U.K. | Canada | S. Korea |
|---|---|---|---|---|---|---|---|---|---|---|
| **Gross domestic product (GDP)** | | | | | | | | | | |
| Nominal, this year[1] | bn USD | 22,322 | 15,270 | 13,678 | 5,413 | 3,982 | 2,772 | 2,717 | 1,812 | 1,627 |
| Per Capita, purchasing power parity[1] | USD, PPP | 67,427 | 20,984 | 40,965 | 46,827 | 55,306 | 48,640 | 48,169 | 52,144 | 46,452 |
| Real growth this year[1] | Consensus | -5.7% | 1.8% | -7.6% | -4.7% | -6.2% | 4.3% | -7.8% | -7.1% | -0.5% |
| Real growth next year[1] | Consensus | 3.9% | 8.0% | 5.0% | 2.2% | 4.9% | 1.5% | 5.5% | 4.9% | 2.9% |
| Real growth current quarter | Annualized | -4.8% | -33.8% | -14.2% | -3.4% | -2.2% | -5.8% | -2.0% | 0.3% | -1.4% |
| Unemployment this year | Consensus | 11.0% | 4.3% | 9.5% | 3.0% | 5.8% | 10.0% | 6.7% | 9.6% | 4.1% |
| Inflation this year | Consensus | 0.8% | 3.2% | 0.4% | 0.0% | 0.8% | 4.5% | 1.0% | 0.5% | 0.6% |
| Purchasing manager index (comp.) [2] | Neutral: 50 | 36.4 | 47.6 | 30.5 | 27.4 | 31.4 | 40.3 | 40.6 | 33.0 | 41.6 |
| | | | | | | | | | | |
| Structural budget balance/GDP | IMF | -6.3% | -6.2% | -0.9% | -2.1% | 1.0% | -2.5% | -1.4% | -0.8% | -0.3% |
| Gross government debt/GDP | IMF | 108.0% | 60.9% | 82.3% | 237.6% | 55.7% | 99.2% | 84.8% | 85.0% | 43.4% |
| Current account balance/GDP | IMF | -2.6% | 0.5% | 2.6% | 1.7% | 6.6% | -0.7% | -4.4% | -3.7% | 4.9% |
| International currency reserves | bn USD | 41.1 | 3,091.5 | 396.0 | 1,294.8 | 37.8 | 53.6 | 135.9 | 76.0 | 389.3 |
| | | | | | | | | | | |
| Govt bond yield 2yr [3] | % p.a. | 0.17% | 1.67% | -0.42% | -0.14% | -0.67% | -0.53% | -0.02% | 0.30% | 0.81% |
| Govt bond yield 10yr [3] | % p.a. | 0.69% | 2.68% | -0.12% | 0.01% | -0.43% | 0.00% | 0.22% | 0.55% | 1.34% |
| Main policy interest rate [4] | % p.a. | 0.25% | 4.35% | 0.00% | -0.10% | 0.00% | 0.00% | 0.10% | 0.25% | 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 [4] Max target rate for Fed

| | | USA | China | Eurozone | Japan | Germany | France | U.K. | Canada | S. Korea |
|---|---|---|---|---|---|---|---|---|---|---|
| Exchange capitalization* | bn USD | 31,399 | 12,370 | 6,653 | 5,675 | 1,962 | 625 | 2,538 | 593 | 1,729 |
| **Growth in earnings per share, estimated (MSCI)** | | | | | | | | | | |
| 12 months forward / trailing 12 months | Consensus | -0.1% | 10.5% | 19.2% | 19.0% | 31.7% | 5.2% | 41.5% | -7.1% | 55.1% |
| Next fy / 12m fwd | Consensus | 14.4% | 11.4% | 19.9% | 17.4% | 21.6% | 19.8% | 18.5% | 20.2% | 22.4% |
| **Growth in revenue per share, estimated (MSCI)** | | | | | | | | | | |
| 12m fwd / trail 12m | Consensus | 2.3% | 16.9% | -2.5% | 1.4% | 4.0% | -5.1% | -15.7% | -0.9% | 0.4% |
| Next fy / 12m fwd | Consensus | 4.6% | 7.6% | 4.0% | 3.8% | 3.8% | 4.4% | 6.1% | 4.9% | 5.4% |
| **Valuations (MSCI)** | | | | | | | | | | |
| Price-Earnings Ratio (est 12m fwd) | Consensus | 21.6 | 12.6 | 16.8 | 15.1 | 16.0 | 17.1 | 15.2 | 17.9 | 11.7 |
| Price-Sales Ratio (est 12m fwd) | Consensus | 2.2 | 1.3 | 1.0 | 0.8 | 0.8 | 1.0 | 1.1 | 1.6 | 0.7 |
| Dividend yield | Consensus | 1.9% | 2.1% | 3.2% | 2.6% | 3.0% | 3.3% | 4.3% | 3.6% | 2.4% |

* China market cap includes Hong Kong | Source: Bloomberg　　Data per: 27.05.2020

## Price earnings ratios based on expected earnings