Risk outlook remains balanced

Marketing material

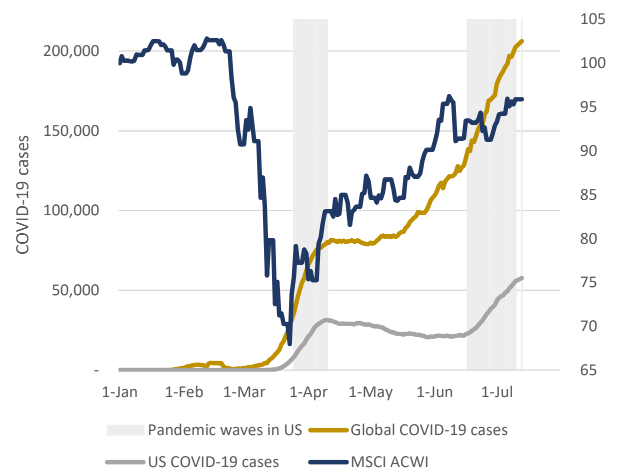
Equities and credit markets have remained well bid over the past month, albeit with less momentum than between March and June. As global equities move toward the upper limit of their recent trading range, the bullish factors are still broadly balancing the downside risks. We hence maintain our neutral equity positioning and focus on active rebalancing.

Markets shrug off pandemic resurgence for now

Despite a resurgent pandemic in the US and some other regions, market sentiment remained quite upbeat in recent weeks and global equities are trading near the highs recorded in early June. Even after a 43% surge in global equities between 23 March and 8 June, intermittent setbacks were rather short-lived and shallow so far.

Chinese equity benchmarks in particular had a very strong rally, balancing the more modest gains elsewhere. The CSI 300 added 15% in the first half of July alone and has now caught up with the S&P 500 in terms of its rebound from the trough (graph 1). Most major stock markets rebounded well from the initial pandemic panic of February and March, reclaiming about two-thirds to three-quarters, if not more, of their COVID-selloff losses. The fact that the pandemic is now experiencing its second major global outbreak since at least late May has not reversed the rally. However, it has slowed the upward momentum somewhat, keeping price levels within a sideways range since early-mid June (graph 2).

Graph 2
Stock market rallies and rising pandemic counts
(New daily cases of COVID-19 on left hand side)



Source: Bloomberg, LGT Capital Partners

Graph 1
Chinese equities perked up in July
(Rebased to 100 at the bear market low on 23 March)

Source: Bloomberg, LGT Capital Partners

As the above chart shows, equities can rally even when case-counts increase – as observed in the US in March/April and again in June/July, and globally since May. Are investors unduly ignoring the public health risks or have they simply moved on to focusing on the purely economic aspects of the outbreak?

Arguably, if investors perceive the public health systems as capable of handling the pandemic without forcing authorities to impose severe restrictions on economic activity, markets can continue to rally. The availability of a vaccine would of course be the critical improvement in terms of boosting health system capability over time.

Balanced outlook of risks

From where we stand today, we see the upside and downside risks for the coming weeks broadly canceling each other out:

Upside risks:

- Potential for a breakthrough in vaccine research
- TINA: "there is no alternative" to investing in equities
- Strong economic policy support
- Positioning – many investors have remained skeptical during the rebound, providing a large pool of potential buyers

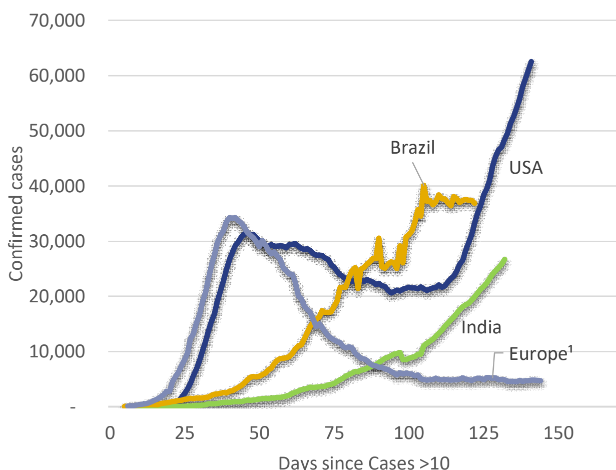
Downside risks:

- Lockdown/pandemic risks
- Equity valuations have risen, outlook unclear
- Stimulus policy disappointments
- Disruptive political action by President Trump

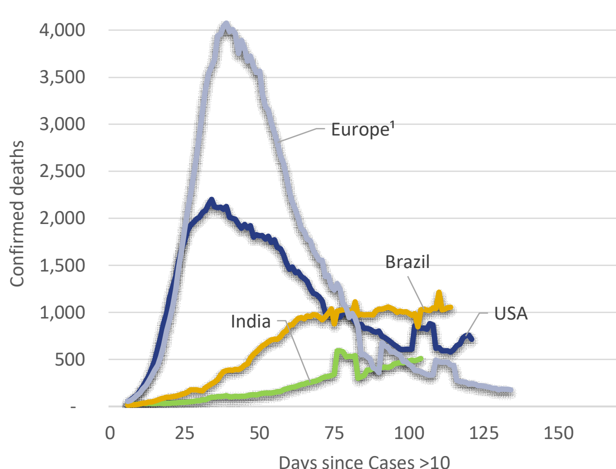
Hence, we stay the course, keeping equity risk near neutral, while focusing on regular rebalancing when prices move too much in either direction.

Graphs 3 and 4

Daily COVID-19 confirmed infection cases
(7-day moving average)



Daily COVID-19 confirmed deaths
(7-day moving average)



[1] Europe = European Union plus Switzerland and Norway, i.e. the region that is economically highly integrated and has very open borders. Source: Bloomberg, EU Commission, LGT Capital Partners

Recurring lockdown versus vaccine breakthrough

With respect to the pandemic, the key metric to watch going forward may not be the case counts, but the number of deaths and health system capabilities in coping with the crisis. So far, the daily death counts have been generally stable or declining, unlike the number of confirmed infections (graphs 3 and 4). If that changes, especially in one of the major developed economies, it would raise the risk of another round of comprehensive lockdowns and hence weigh on markets. On the other hand, targeted and localized restrictions that make it possible for most businesses to continue to operate may not have a big negative effect on markets. For example, the recent reactivation of some restrictions in California has not hurt risk sentiment.

Lastly, but very importantly, health system capability is critical. Potential news of a breakthrough in vaccine research is thus also clearly mitigating the downside risks. While considerable time would pass until any effective vaccine becomes widely available, markets would probably instantly discount medical milestone successes – potentially in an outsized manner. Earlier this week, for instance, news that Moderna Inc.'s vaccine had successfully passed its first safety trials provides a good example of the positive impact such reports can have on stock markets overall.

TINA versus increased valuations

Generally, by historical standards, equities are still attractively valued, even in the world's most expensive market, the US (graph 5). Clearly, the very low level of interest rates is a key factor supporting risk asset valuations everywhere.

Graph 5

US equity valuations: equity risk premium
(Standard deviations from the mean)

Earnings risk premium: forward earnings yield minus risk free interest rate. Source: Bloomberg, LGT Capital Partners

Furthermore, all big central banks have adopted a dovish policy stance, which means that interest rates are likely to remain very low for even longer than most analysts believed before the pandemic – if not even go negative, at least in real terms. These policies further reinforce the TINA principle ("there is no alternative") in terms of investing in equities.

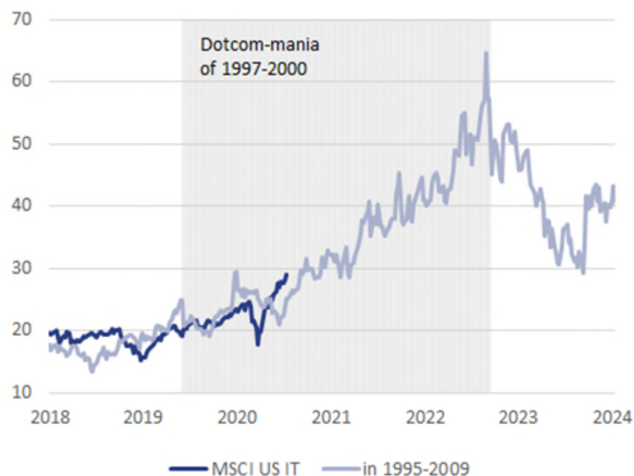
Investors seeking excess returns relative to risk-free interest income will have to take equity risk in some form. This situation creates structural upward pressure on equities over time, even as valuations continue to move higher to fair or even modestly expensive levels.

Even one of the most expensive parts of the US market, information technology (IT), is currently valued at a level that is comparable to the early phases of the dotcom boom of the 1990s (graph 6). It is also worth noting that many internet-related companies of the late 1990s were not making money, while today's tech giants are typically very profitable.

Graph 6

US information technology still far from peak bubble

(Price to forward earnings per share in USD)



Data for 1995-2009 starts on 3 February 1995. Source: Bloomberg, LGT Capital Partners

This suggests that valuations could have further upside if the coming years prove very benign economically. Still, the pace and magnitude of the recent valuation expansion seem complacent for now, given that we are in a recessionary environment.

In short: valuations have risen since March and some segments have discounted too much of an improvement too quickly. On the other hand, TINA provides a powerful counterbalance.

Strong versus disappointing stimuli

The large-scale fiscal and monetary policy support measures put in place by most major economies have helped to stabilize economic expectations and continue to support the recovery. This economic recovery is on track to becoming the shortest on record, which would be in line with our expectations. The various purchasing managers' indices (PMI) and similar business outlook indicators have either already returned to growth or are very close to doing so.

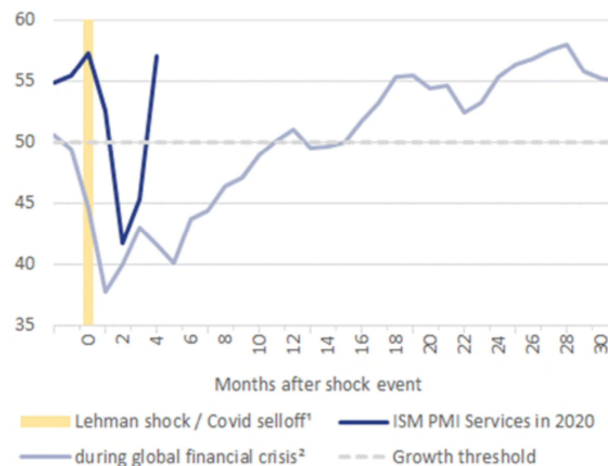
For example, in the US, the Institute for Supply Management's non-manufacturing PMI has soared back to above the growth threshold at 50 points. During the Global Financial Crisis of 2008/2009, it took the index almost a year to return to growth (graph 7). Similar indices for Europe point in the same direction (graph 8).

Nevertheless, policy disappointments are possible going forward. The high degree of confrontational political polarization in the US and the reluctance of several Northern European governments to underwrite deficit spending in the Mediterranean countries are potential obstacles to continued fiscal largesse. Any political signal that policy makers would prematurely withdraw support could also trigger selloffs by raising the specter of a relapse into recession. After all, even the stimulus-friendly Federal Reserve had made this mistake in the latter half of 2018.

Graphs 7 and 8

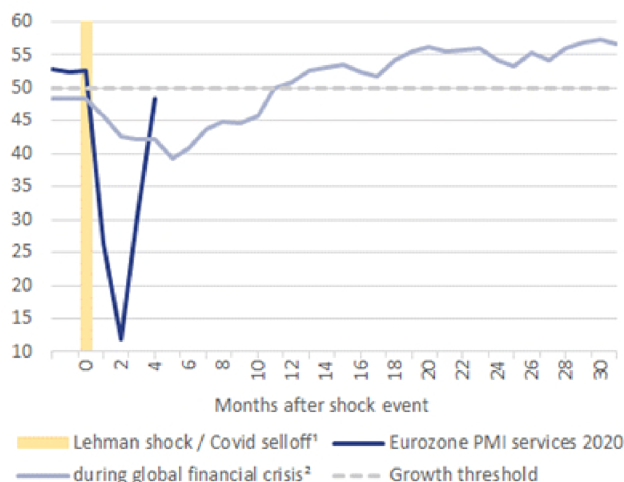
US services PMI surges back to growth

(Balance/diffusion index, growth threshold at 50 points)



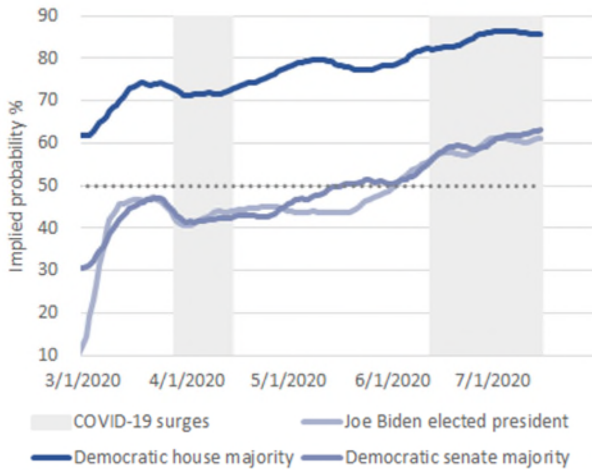
Eurozone services PMI close to returning to growth

(Balance/diffusion index, growth threshold at 50 points)



[1] September 2008 collapse of Lehman Brothers and February 2020 selloff in stock markets following a surge in COVID-19 cases in Italy. [2] Data start in July 2008, i.e. two months before the Lehman shock. ISM = Institute of Supply Management, US. IHS Markit compiled the European PMI. Source: Bloomberg, LGT Capital Partners

Graph 9
Democratic Sweep predicted
(Based on traded odds at Predictit.com)



Source: Bloomberg, LGT Capital Partners

Irritating Trump actions versus positioning risks

Finally, President Donald Trump's reelection chances in November appear to have vanished in recent weeks. Opinion polls and traded betting odds at present point to a Democratic Sweep – i.e. Joe Biden winning the White House, while the Democratic Party secures majorities in both the Senate and the House of Representatives (graph 9). Investors may not have reacted negatively to Trump's pandemic crisis management, but voters clearly have.

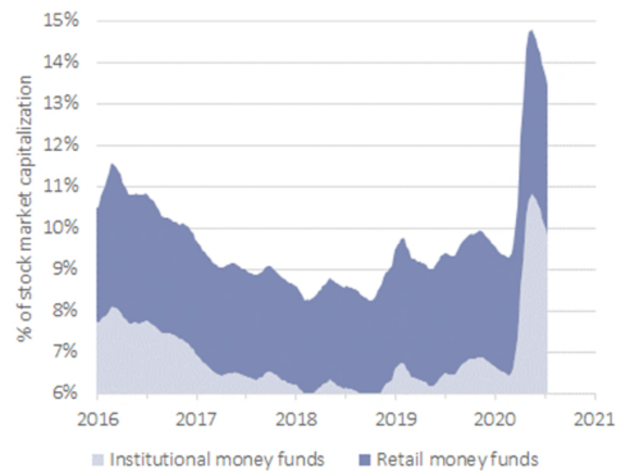
Until recently at least, market participants on balance probably considered a win for the Democrats as a potential headwind for markets. That view seems to be changing. Although market participants still expect the Democrats to pursue less business friendly policies (especially when it comes to corporate taxes), US equities remained well bid as the electoral odds steadily shifted away from the Republican administration. The key arguments are that continued deficit spending and investment in the case of a big Democratic win would outweigh any tax increases, while a less confrontational foreign policy would reduce international frictions.

This speculative outlook comes with a more intriguing risk: President Trump, in a perhaps desperate effort to boost his support base, could chose to escalate international tensions on trade and geopolitical issues vis-à-vis China and maybe other countries. Given that there is no lack of geopolitical fault lines at present, we should not dismiss this risk. At the same time, if market participants perceive Trump as a lame duck president who is on his way out, they might opt to ignore even the most irritating future presidential announcements.

As many investors have remained cautious and skeptical during the March-June stock market surge, they could hence welcome any such volatility as an opportunity to buy into the market at lower levels. Federal Reserve data suggest that both individual and institutional liquidity levels have remained high during the market's rebound that began in March (graph 10).

This positioning imbalance in favor of caution suggests there is a lot cash waiting on the sidelines to flow into higher-yielding risk asset markets at some point.

Graph 10
Institutional and retail cash levels remain high
(% of US stock market capitalization)



Liquidity represented by the value of money market funds held by institutions and individuals in billion USD, as reported by the Federal Reserve. Source: Bloomberg, 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 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 US and Japan overweight balanced by an underweight in the EM**
- **Fixed income: modestly reduced underweight in duration and investment grade borrowers**
- **Currencies and real assets: long Japanese yen against the euro, strong 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%								

Reference portfolio: LGT GIM Balanced (USD). The TAA is valid for all similar portfolios but 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 markets

		1 month	3 months	Year to date	3 years, p.a.[1]	5 years, p.a.[1]
Fixed Income						
Global government bonds	USD	0.7%	1.3%	5.8%	5.8%	4.8%
Global inflation linked bonds	USD	0.9%	1.7%	2.0%	3.4%	2.9%
Investment grade corporate bonds	USD	1.4%	4.6%	4.9%	5.2%	4.5%
High yield bonds	USD	1.2%	7.9%	-3.0%	3.3%	4.9%
Emerging markets [2]	USD	0.9%	9.2%	-3.9%	2.5%	4.0%
Equities						
Global	USD	4.5%	15.2%	-2.7%	7.4%	7.2%
Global defensive	USD	2.5%	5.4%	-5.6%	6.9%	7.6%
North America	USD	4.7%	16.6%	0.3%	10.5%	10.0%
Europe	EUR	4.5%	15.2%	-9.7%	0.9%	2.5%
Japan	JPY	2.7%	9.3%	-7.1%	1.6%	0.8%
Emerging markets	USD	10.2%	20.4%	-3.6%	2.8%	4.9%
Alternative and real assets						
Listed private equity	USD	2.1%	24.9%	-12.2%	4.2%	5.9%
Hedge funds	USD	2.2%	-3.1%	-4.7%	0.9%	1.3%
Insurance linked securities (ILS)	USD	0.8%	1.6%	1.9%	2.4%	4.0%
Real estate investment trusts (REITs)	USD	-2.3%	5.0%	-13.5%	2.8%	4.2%
Gold	USD	5.1%	5.6%	19.5%	13.8%	9.5%
Currencies (vs. rest of G10) [3]						
US dollar	USD	-1.0%	-5.8%	1.1%	1.9%	0.9%
Euro	EUR	0.1%	-0.8%	3.3%	1.8%	1.9%
Swiss franc	CHF	0.3%	-2.9%	4.5%	2.9%	1.2%
Japanese yen	JPY	-0.6%	-5.3%	2.9%	3.9%	4.3%
Australian dollar	AUD	0.2%	5.4%	0.7%	-2.3%	-0.3%
Norwegian krone	NOK	1.4%	7.4%	-5.5%	-2.9%	-2.1%
Emerging market currency index [4]	USD	-0.6%	4.4%	-10.0%	-7.4%	-5.5%
British pound	GBP	-1.0%	-5.1%	-4.4%	0.5%	-3.8%

[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

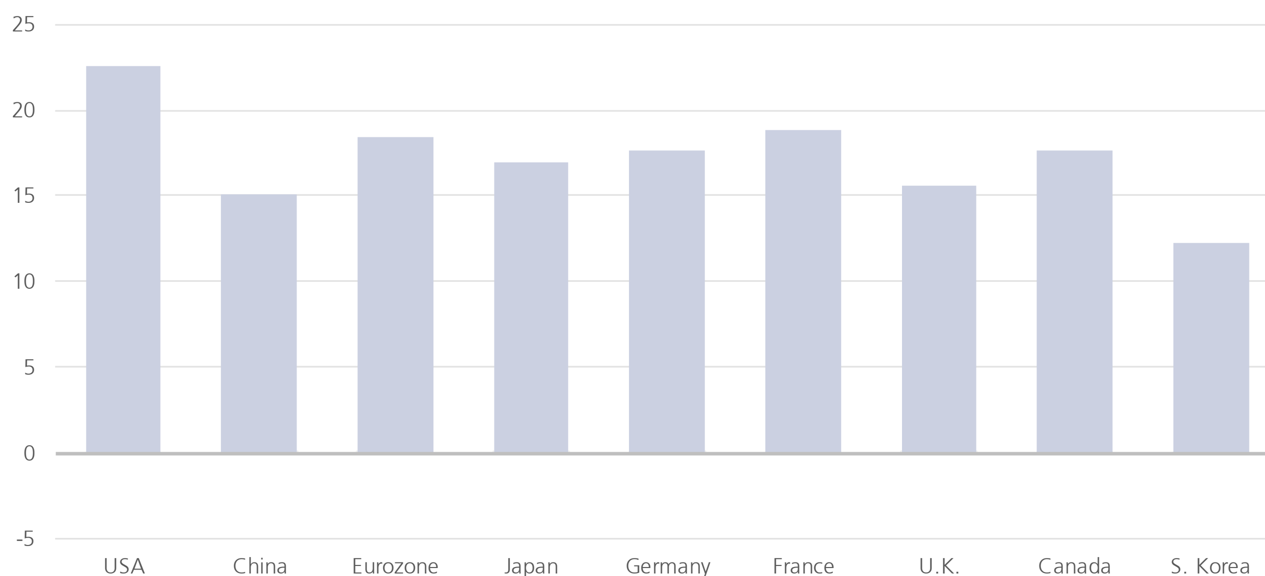
		USA	China	Eurozone	Japan	Germany	France	U.K.	Canada	S. Korea
Gross domestic product (GDP)										
Nominal, this year[1]	bn USD	22,322	15,270	13,678	5,413	3,982	2,772	2,717	1,812	1,627
Per Capita, purchasing power parity[1]	USD, PPP	67,427	20,984	40,965	46,827	55,306	48,640	48,169	52,144	46,452
Real growth this year[1]	Consensus	-5.6%	1.8%	-8.1%	-4.9%	-6.2%	4.2%	-8.8%	-7.0%	-0.6%
Real growth next year[1]	Consensus	4.0%	8.0%	5.5%	2.5%	5.0%	-4.7%	6.0%	4.6%	3.1%
Real growth current quarter	Annualized	-5.0%	-33.8%	-13.6%	-2.2%	-2.2%	-5.3%	-2.2%	-8.2%	-1.3%
Unemployment this year	Consensus	9.2%	4.3%	9.0%	3.0%	6.1%	10.1%	6.3%	9.7%	4.1%
Inflation this year	Consensus	0.9%	2.8%	0.4%	-0.1%	0.6%	4.8%	0.8%	0.6%	0.3%
Purchasing manager index (comp.) [2]	Neutral: 50	47.9	55.7	48.5	40.8	47.0	52.3	50.1	47.8	43.4
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	42.0	3,112.3	399.1	1,305.9	37.8	54.5	134.9	75.2	395.7
Govt bond yield 2yr [3]	% p.a.	0.15%	2.32%	-0.51%	-0.13%	-0.68%	-0.62%	-0.09%	0.27%	0.83%
Govt bond yield 10yr [3]	% p.a.	0.62%	2.95%	-0.26%	0.04%	-0.46%	-0.15%	0.15%	0.53%	1.41%
Main policy interest rate [4]	% p.a.	0.25%	4.35%	0.00%	-0.10%	0.00%	0.00%	0.10%	0.25%	0.50%

[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	China	Eurozone	Japan	Germany	France	U.K.	Canada	S. Korea
Exchange capitalization*	bn USD	33,858	15,272	7,557	5,800	2,166	718	2,690	575	1,842
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	7.2%	17.3%	-2.7%	15.3%	34.5%	-35.8%	40.6%	4.4%	59.9%
Next fy / 12m fwd	Consensus	11.2%	9.1%	16.4%	19.6%	17.0%	18.1%	13.8%	13.3%	16.4%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	3.2%	19.2%	-12.3%	-0.2%	3.2%	-29.0%	-16.1%	-3.0%	0.8%
Next fy / 12m fwd	Consensus	3.7%	6.1%	3.2%	4.6%	3.0%	3.7%	5.0%	4.2%	4.2%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	22.5	15.1	18.4	17.0	17.6	18.9	15.6	17.7	12.2
Price-Sales Ratio (est 12m fwd)	Consensus	2.4	1.6	1.1	0.9	0.9	1.1	1.2	1.8	0.7
Dividend yield	Consensus	1.8%	1.7%	2.8%	2.5%	2.7%	2.8%	3.9%	3.3%	2.3%

* China market cap includes Hong Kong | Source: Bloomberg — Data per: 16.07.2020

Price earnings ratios based on expected earnings



Important information: This marketing material was issued by LGT Capital Partners Ltd., Schützenstrasse 6, CH-8808Pfäffikon, Switzerland and/or its affiliates (hereafter "LGT CP") with the greatest of care and to the best of its knowledge and belief. LGT CP provides no guarantee with regard to its content and completeness and does not accept any liability for losses that might arise from making use of this information. The opinions expressed in this marketing material are those of LGT CP at the time of writing and are subject to change at any time without notice. If nothing is indicated to the contrary, all figures are unaudited. This marketing material is provided for information purposes only and is for the exclusive use of the recipient. It does not constitute an offer or a recommendation to buy or sell financial instruments or services and does not release the recipient from exercising his/her own judgment. The recipient is in particular recommended to check that the information provided is in line with his/her own circumstances with regard to any legal, regulatory, tax or other consequences, if necessary with the help of a professional advisor. This marketing material may not be reproduced either in part or in full without the written permission of LGT CP. It is not intended for persons who, due to their nationality, place of residence, or any other reason are not permitted access to such information under local law. Neither this marketing material nor any copy thereof may be sent, taken into or distributed in the United States or to U. S. persons. Every investment involves risk, especially with regard to fluctuations in value and return. Investments in foreign currencies involve the additional risk that the foreign currency might lose value against the investor's reference currency. It should be noted that historical returns and financial market scenarios are no guarantee of future performance. © LGT Capital Partners 2020. All rights reserved.

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