September 13, 2017

Tactical asset allocation for Q4/2017

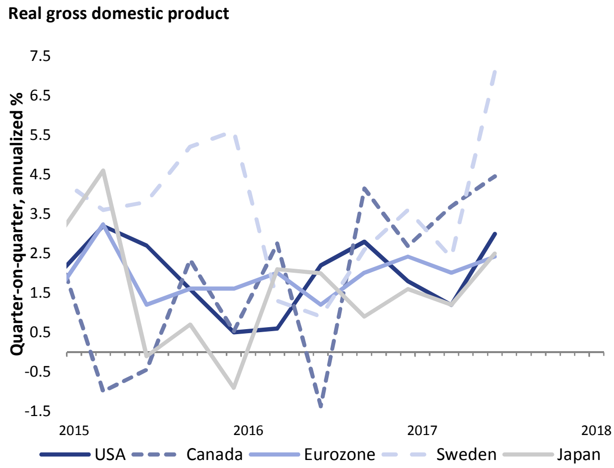
Simmering tensions have risen to the fore recently, ranging from the political deadlock in the US to the conflict involving North Korea. However, market disruptions triggered by political crises have historically proven temporary, while the current cyclical trends keep pointing to a solid global economy. We thus continue to favor growth over income assets.

In this report we present our macro assessment and tactical asset allocation for the next three to six months. The investment decisions mentioned herein concern the multi-asset investment strategies managed by LGT Capital Partners.

Economic growth has proven resilient

Over the past quarter, global economic trends have proven resilient enough to withstand some notable headwinds, including a shift to a more restrictive credit policy in China, a political stalemate in the US, and an elevated level of geopolitical belligerence by and against North Korea. Economic growth has generally picked up (graph 1).

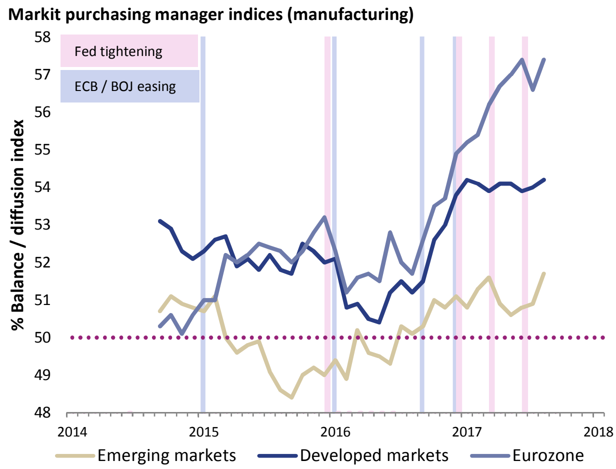
Graph 1
Economic growth picked up in most major economies



The Eurozone and Sweden, whose small but open economy tends to lead continental Europe, showed extraordinary cyclical strength recently, as we already highlighted in the last LGT Beacon. Since then, we have also seen Japan's real gross domestic product (GDP) expand at nearly three times its potential in the second quarter.

In short, most major economies are now growing near or above potential, without generating much inflation - which provides a good foundation for a sustained expansion of corporate earnings. In addition, forward-looking business surveys (graph 2) have picked up again from already high levels in the developed economies, while they continue to rebound from lower levels in the emerging markets (EM). Thus, while Europe's recent surge should naturally moderate again going forward, the global outlook certainly remains benign.

Graph 2
Business surveys point to steady growth



US politics and central banks

Furthermore, with regard to US economic policies, the once high-flying expectations for tax reform and/or an infrastructure investment program have fallen so low in the meantime that virtually any sort of progress would probably constitute a positive surprise for investors. Last week's unexpected compromise on the debt ceiling between the Republican president and the minority Democrats confirm this point - and the

S&P 500 has duly rallied to a new record within a few days. In any case, the US economy is performing rather well - with or without additional policy support from Washington.

More importantly, the major central banks are likely to remain as accommodative as possible, even as some prepare to start shrinking the monetary base, a policy commonly referred to as "balance sheet normalization." Both the US Federal Reserve and the European Central Bank are nevertheless likely to be disinclined to risk major market upheavals, given widespread concerns about hawkish policy mistakes in the face of below-target inflation rates nearly everywhere.

Geopolitical tensions: North Korea

With respect to the tensions on the Korean peninsula, we believe the situation is not likely to escalate to a point that could derail global economic growth. North Korea's renewed round of missile and nuclear bomb tests and the corresponding US responses may seem to be taking the long frozen but unresolved conflict to a whole new level. Still, given the power balance and the interests of the parties involved, our base case is that Realpolitik will prevail in the end. But even if a major escalation were to occur against the odds, the most likely outcome would be a swift collapse of the isolated regime in Pyongyang – which would also not have a negative effect on the global economy.

In terms of market impact, a major military confrontation in Korea would of course initially rattle markets. However, the medium-term market response would most likely be comparable to similar shocks in the past, such as US-led coalition wars against Iraq in 1991 and in 2003.

A larger negative economic and market impact would seem possible only if such an escalation in Korea were to lead to a hardening confrontation between the US and China. However, that is a very remote scenario in our view for now.

In any case, the historical record shows that the S&P 500 tended to quickly recover from the initial selloffs triggered by political crises - and traded significantly higher about a year later in most cases (graph 3).

Graph 3
Markets during and after major crises

S&P 500 percentage change after event / last event reaction date

Event	Last day of event reaction	During crisis	1 month later	12 months later
Japan bombs Pearl Harbor	10-Dec-1941	-7.5%	2.1%	15.8%
North Korea invades ROK	13-Jul-1950	-12.2%	10.2%	42.2%
Eisenhower heart attack	26-Sep-1955	-6.6%	-0.5%	11.9%
Cuban missile crisis	23-Oct-1962	-9.9%	15.5%	41.1%
Kennedy assassinated	22-Nov-1963	-2.8%	7.0%	27.8%
Nixon resigns	29-Aug-1974	-13.4%	-6.8%	30.2%
USSR invades Afghanistan	3-Jan-1980	-1.8%	9.9%	36.5%
First Iraq war	16-Jan-1991	-4.0%	17.2%	36.6%
Failed soviet coup	19-Aug-1991	-2.3%	3.2%	14.5%
Sept. 11 attacks on US	21-Sep-2001	-11.6%	11.3%	-11.1%
Second Iraq war	31-Mar-2003	-2.1%	8.2%	35.1%
Brexit	27-Jun-2016	-5.3%	8.4%	20.9%
Median gain / loss		**-6.6%**	**7.1%**	**25.1%**

Source: Queen's University, Toronto

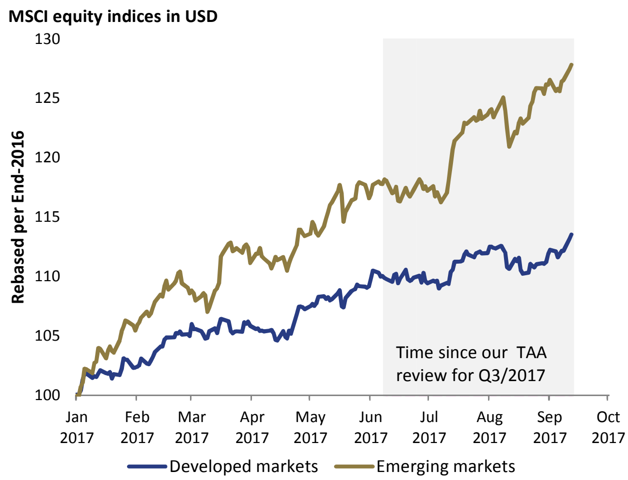
Control risk but stay the course

Returning to fundamentals, we repeat that the macro backdrop remains supportive of financial assets, while there are no signs of the global corporate earnings cycle abating. Margins remain high or keep expanding, while the profit outlook revisions are trending higher in most regions.

Investor sentiment and positioning data do not raise major warning flags for equity markets either. Even though sentiment signals are rather mixed overall and most investors are already overweight, they also typically hold relatively high cash allocations and use the low implied volatility levels to buy protective option strategies - which balances the potential warning sign.

As a caveat, however, a few technical indicators have deteriorated somewhat in recent weeks, such as market breadth in the US and momentum in Europe.

Graph 4
Equity markets have hit new highs



Against this background, we decided to only modestly trim our overall equity risk. In sum, we stay the course and maintain a tactical overweight in equities, albeit with a less pronounced regional differentiation. We are tactically long all major regions, including the emerging markets (EM).

Fine-tuning in the real assets space

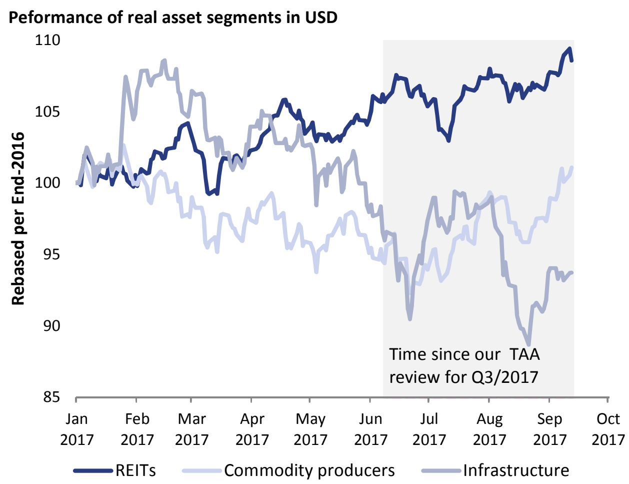
In the real and alternative assets space, we keep our overweight in Real Estate Investment Trusts (REITs), and shift from infrastructure investments (Master Limited Partnerships, or MLPs) to commodity producers' equities. Both segments are now positioned near neutral, marginally in favor of the latter.

The primarily US-based MLP sector still offers attractive dividend yields, but price trends are weak and the outlook for the US energy sector remains uncertain. The global commodity equity sector, by contrast, offers a broader range of exposures, including demand for base metals from the cyclically rebounding EM.

We maintain an underweight in Listed Private Equity to avoid boosting our overall portfolio risk ("equity beta") too much.

Graph 5

REITs outperforming in real asset segment



Lastly, we are also sticking to our neutral allocations in all hedge fund (HF) styles, and to a marginal underweight in insurance-linked strategies (ILS). We add that we maintain these positions out of strategic considerations. The former offer significant downside protection following clear shifts in markets trends, while the latter segment offers returns that are uncorrelated to macroeconomic developments.

Fixed income: adding more EM bonds

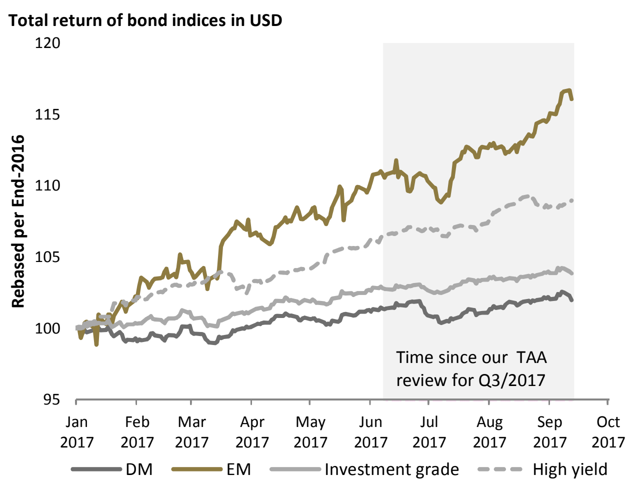
In fixed income, we further add to EM debt by increasing our position in local currency bonds. EM government bonds are supported by our constructive global cyclical outlook, the weaker US dollar, and relatively high local real yields.

The EM represent our only overweight in fixed income, where we continue to maintain a clear underweight in developed sovereigns and are consequently short in portfolio duration risk.

Finally, we are also keeping our less pronounced underweights in the historically tight corporate credit spread space, especially in the high yield segment. The risk-return profile is not attractive, especially when compared to equities.

Graph 6

EM outperform in the debt space



Foreign exchange: SEK and CAD favored

In currencies, we maintain our tactical long position in Swedish krona (SEK) versus the Swiss franc (CHF) and decided to add a new tactical long position in the Canadian dollar (CAD) versus the US dollar (USD).

The Swedish and the Canadian economies are experiencing relatively high growth rates, while policy makers in both countries face concerns about an overheating real estate market.

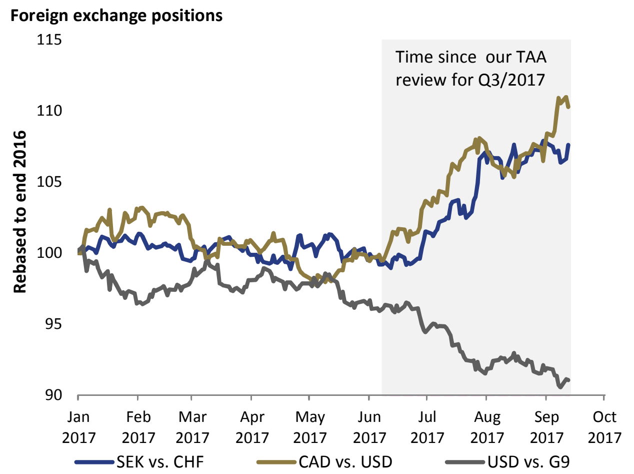
The Swedish Riksbank has thus far remained dovish, but will need to start tightening soon - if it wishes to avoid falling too far behind the curve. Conversely, the Bank of Canada has already acted and raised its policy rate twice in the last two months. Furthermore, both currencies are undervalued from a purchasing power parity perspective.

In addition, the currencies in our "others" segment also remain passively overweight - i.e. resulting from the active quota in the respective equity and debt markets. This segment mainly represents the EM currencies, such as the South Korean won, as well as the likes of the Australian or New Zealand dollars in the developed space. A positive view on most of these currencies is in line with our macro outlook, of course.

In turn, this leads to a reduction in the weight of the respective portfolio base currencies - i.e. an underweight in the USD in the case of the model reference portfolio shown on the next page.

Graph 7

Strong SEK and CAD, generally weak USD



END OF REPORT

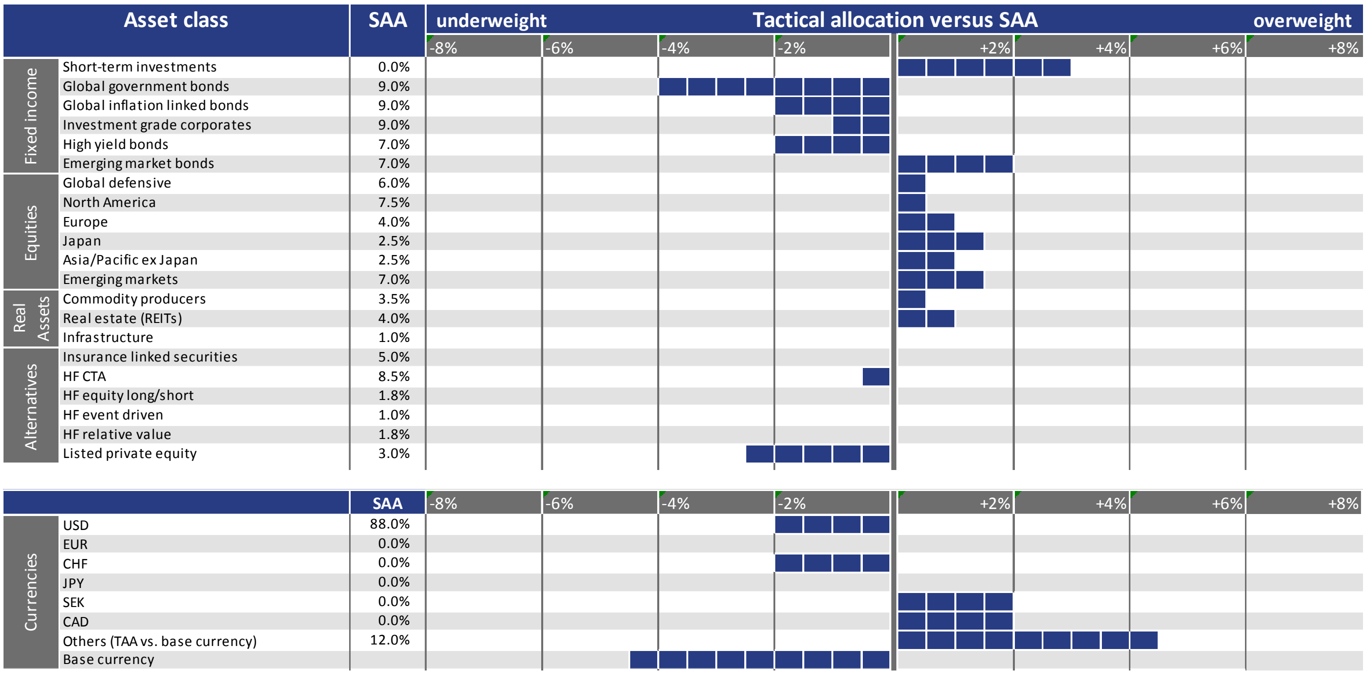
Note:

LGT Capital Partners will conduct its next quarterly TAA review in early December. The above mentioned TAA positions are also subject to monthly as well as ad-hoc adjustments if deemed necessary.

LGT Capital Partners: tactical asset allocation for a balanced model portfolio in USD

Our tactical asset allocation (TAA, i.e. positions versus our neutral strategic quota) is set following a quarterly scoring process, and reviewed monthly. Further trades can and are regularly implemented to capture short-term market movements in between these meetings, without signifying a change in our views. Our current TAA (set on Sept 8th, 2017) can be summarized as follows:

- **Maintain overweight in developed and emerging equities, with a modest regional differentiation**
- **Underweight in fixed income, especially DM sovereigns, with EM bonds representing a positive exception**
- **Real and alternative assets: REITs preferred over commodity and infrastructure stocks; avoid listed private equity**
- **Currencies: long SEK and CAD, short CHF and USD, with a passive overweight in EM and Asian currencies**



The above shown model portfolio is based on the LGT GIM Balanced (USD) portfolio, managed by LGT Capital Partners. Currency risk in developed markets is always fully hedged in our portfolios as a matter of policy.

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	0.1%	0.5%	2.0%	3.5%	3.2%
Global inflation linked bonds	USD	0.3%	0.6%	1.7%	2.0%	1.2%
Investment grade corporate bonds	USD	0.3%	1.1%	3.9%	3.3%	3.0%
High yield bonds	USD	1.3%	2.7%	9.0%	4.9%	6.2%
Emerging market bonds	USD	2.3%	3.0%	11.1%	4.5%	3.4%
Equities						
Global defensive	USD	2.1%	2.6%	13.0%	9.9%	10.6%
North America	USD	2.6%	2.9%	12.7%	8.6%	12.2%
Europe	EUR	2.4%	-0.2%	10.3%	7.0%	10.3%
Japan	JPY	0.7%	1.9%	6.7%	8.1%	18.2%
Asia/Pacific ex. Japan	USD	5.0%	8.4%	29.1%	5.4%	7.7%
Emerging markets	USD	5.9%	10.3%	30.1%	3.7%	4.8%
Real assets						
Commodities (commodity producers' equities)	USD	3.9%	4.8%	1.1%	-6.1%	-2.0%
Real estate (real estate investment trusts, or REITs)	USD	2.7%	1.5%	8.6%	6.2%	7.6%
Infrastructure (master limited partnerships, or MLPs)	USD	0.9%	-2.8%	-6.3%	-12.8%	-0.5%
Alternatives						
Insurance linked securities (ILS)	USD	-6.0%	-4.8%	-3.3%	3.1%	5.7%
HF CTA	USD	4.6%	0.0%	0.7%	2.7%	1.9%
HF equity long/short	USD	1.0%	3.3%	8.5%	3.6%	6.5%
HF event driven	USD	0.0%	1.4%	4.9%	2.8%	5.9%
HF relative value	USD	0.3%	1.2%	3.7%	3.2%	5.2%
Listed private equity	USD	2.2%	3.7%	20.9%	9.1%	14.3%
Currencies [2]						
US dollar	USD	-1.5%	-5.2%	-9.0%	3.7%	3.8%
Euro	EUR	0.0%	2.1%	5.1%	0.8%	1.9%
Swiss franc	CHF	-1.1%	-4.1%	-2.7%	2.7%	3.2%
British pound	GBP	1.0%	-0.6%	-1.1%	-3.7%	-0.6%
Japanese yen	JPY	-2.3%	-5.2%	-2.7%	2.8%	-4.0%
Swedish krona	SEK	0.7%	4.5%	5.6%	-0.5%	-0.6%

[1] Annualized returns [2] Currencies are represented by Bloomberg's correlation-weighted indices (BCWI), which measure a currency against the remaining ten other major freely convertible currencies, to show the broader strength / weakness of a currency.

Economic and corporate fundamentals

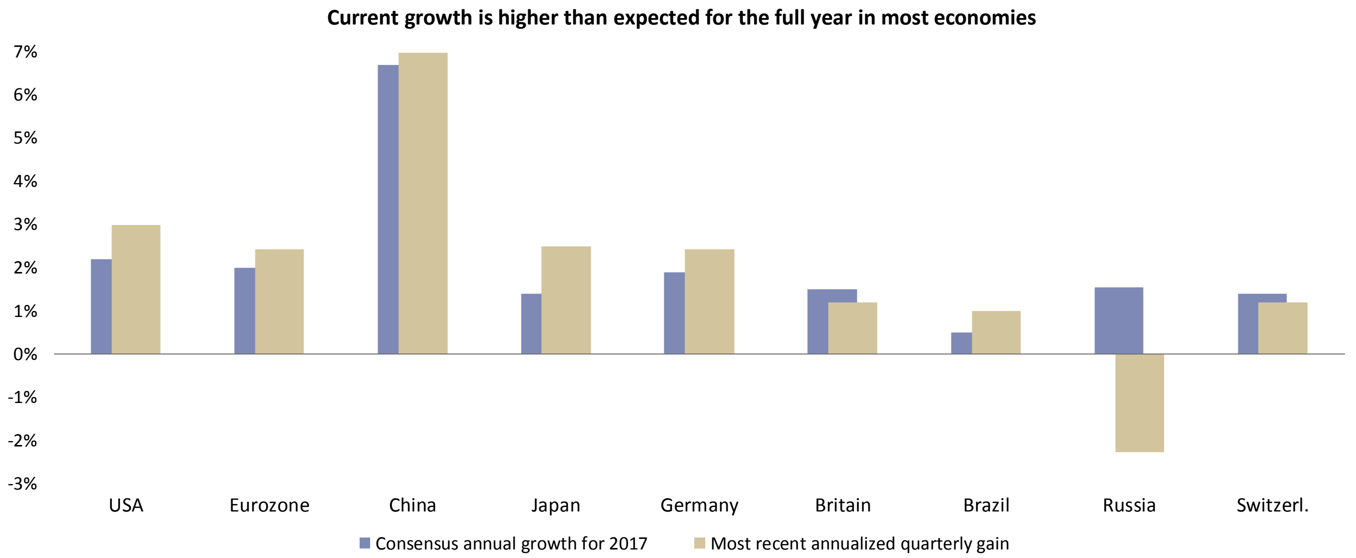
Macro fundamentals		USA	Eurozone	China	Japan	Germany	Britain	Brazil	Russia	Switzerl.
Gross domestic product (GDP)										
- nominal	bn USD	19,417	11,729	11,795	4,841	3,423	2,497	2,141	1,561	659
- nominal, per capita 2017[1]	USD, PPP	59,609	38,322	16,676	42,860	49,815	44,001	15,485	27,466	61,014
- expected real growth for 2017	Consensus	2.2%	2.0%	6.7%	1.4%	1.9%	1.5%	0.5%	1.6%	1.4%
- expected real growth for 2018	Consensus	2.3%	1.7%	6.4%	1.1%	1.8%	1.2%	2.2%	1.6%	1.7%
- real growth in most recent quarter[2]	q/q annualized	3.0%	2.4%	7.0%	2.5%	2.4%	1.2%	1.0%	-2.3%	1.2%
Unemployment rate[3]		4.4%	9.1%	4.0%	2.8%	5.7%	4.4%	8.2%	5.1%	3.2%
Inflation, core rate (CPI)	y/y	1.4%	1.2%	2.2%	-0.1%	1.7%	2.7%	2.5%	3.0%	0.4%
Purchasing manager indices (comp.)	Neutral = 50	55.3	55.7	52.4	51.9	55.8	54.0	49.6	54.2	61.2
Structural budget balance/GDP 2017	IMF	-4.0%	-1.1%	-3.7%	-3.7%	0.2%	-2.8%	-7.6%	-2.5%	0.2%
Gross government debt/GDP 2017	IMF	108%	91%	49%	239%	65%	89%	81%	17%	45%
Current account balance/GDP 2017	IMF	-2.7%	3.0%	1.3%	4.2%	8.2%	-3.3%	-1.3%	3.3%	10.8%
International currency reserves	bn USD	43	258	3,092	1,204	38	125	185	350	785
Govt bond yield 2yr[4]	p.a.	1.33%	-0.51%	3.60%	-0.14%	-0.73%	0.28%	8.18%	8.31%	-0.83%
Govt bond yield 10yr[4]	p.a.	2.16%	0.54%	3.93%	0.04%	0.40%	1.14%	7.55%	7.78%	-0.11%
Main policy interest rate[5]	p.a.	1.25%	0.00%	4.35%	-0.10%	0.00%	0.25%	8.25%	9.00%	-0.75%

[1]IMF estimates. [2]annualized, most recent qtr. [3]PRC ex. migrant workers. [4]Currency swap rates for China and Brazil, closest ESM or EFSF bonds for Eurozone. [5]Max target rate for Fed, middle of the target range for SNB

Corporate fundamentals		USA	Eurozone	China	Japan	Germany	Britain	Brazil	Russia	Switzerl.
Exchange capitalization*	bn USD	27,584	8,162	12,741	5,730	2,329	3,614	936	574	1,742
Growth in earnings per share, estimated (MSCI)										
Next fiscal year / current fiscal year	Consensus	11.3%	8.3%	14.4%	3.8%	6.8%	6.9%	11.3%	13.1%	10.9%
FY year after next / next FY	Consensus	10.4%	9.0%	15.1%	7.9%	7.8%	8.8%	19.8%	6.7%	9.4%
Growth in revenue per share, estimated (MSCI)										
Next fiscal year / current fiscal year	Consensus	5.1%	3.5%	11.8%	2.4%	3.0%	0.4%	6.5%	5.6%	3.5%
FY year after next / next FY	Consensus	5.0%	1.9%	11.7%	1.7%	3.6%	7.2%	7.3%	6.1%	2.5%
Valuation metrics (MSCI)										
Price-Earnings Ratio (est forward 12m)	Consensus	19.4	15.3	14.5	14.1	14.0	15.3	14.4	7.1	18.7
Price-Sales Ratio (est forward 12m)	Consensus	2.1	1.1	1.7	0.9	0.9	1.3	1.6	0.8	2.2
Dividend yield	Consensus	1.0%	3.2%	2.0%	2.1%	2.9%	4.2%	2.9%	5.4%	3.2%

*Includes Hong Kong. Corporate fundamentals are based on consensus estimates ."Reversal +" denotes a return to profits, "Reversal -" an expected loss next year. Source: Bloomberg.

Real gross domestic product



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