LGT Beacon
Global Market Update

July 12, 2017

The improved case for a summer rally in stock markets
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In mid-June, the Federal Reserve reaffirmed its shallow rate-hiking plans and that it would also start to slowly shrink the US monetary base soon. Interestingly, after several months in retreat, commodity prices and inflation expectations have responded positively. With a promising earnings season underway, the stage seems set for a summer rally.

The market's response to the Fed's most recent decision was benign. After almost half a year in retreat, long-term inflation expectations have started to recover somewhat. Commodity prices are also tentatively stabilizing and stock markets are proving resilient, while volatility remains very low.

The so-called 5y/5y forward breakeven rate - the expected inflation rate derived from the five-year forward contracts of nominal and inflation-linked US government bonds of the same maturity - has risen from about 1.8% in mid-June to 1.91%. Brent crude oil is up from $45 per barrel to about $48 today, after trading rising as high as $50 earlier this month.

In equities, many of the very popular technology stocks have corrected from recent all-time highs, but the broader markets are little changed since mid-June, with slight losses in the US and Europe balanced by gains in Asia and elsewhere. Moreover, financial shares have rallied to post-2008 highs globally, implying that general economic conditions will keep improving in the foreseeable future.

Increasing confidence in central bankers' views

All this suggests that the US in particular and the global economy in general are moving toward eventually hitting their 2% inflation target, which has positive implications for nominal global economic growth and hence corporate earnings. Investors thus appear to be coming around to the Fed's view that the soft patch in the inflation data will indeed prove temporary.

As far as the latter issue is concerned, we maintain a degree of caution. Inflationary pressures remain weak in our view, and the mentioned rebounds in commodities and inflation expectations are still tentative (see page 2). However, that does not exclude a rally in the coming weeks. On the contrary, the following factors have improved the case for a spike up in equity prices:

- Below-target inflation is not a major problem in the short-term, as long as a further build-up of deflationary expectations can be avoided and yield curves (i.e. the difference between long-term and short-term interest rates) stop flattening further or reverse. Inflation below but near 2% can produce good enough conditions for continued earnings growth.
- US economic data surprise indices have collapsed since last March, after trending higher for most of the preceding two years. The indices are now at such low levels that this negativity is unlikely to persist. A gradual return to positive macro surprises is thus more likely to prevail in the coming months.
- The corporate reporting season for the most recent quarter is just starting, and the profit outlook remains benign around the globe. The first indications from the US are encouraging: revenues have risen 6.6%, while earnings surged 24% year-on-year for the S&P 500. More importantly, these initial results are well ahead of consensus forecasts across sectors. The final result should thus once again comfortably beat even the recently somewhat elevated expectations (for earnings growth projections see page 4).

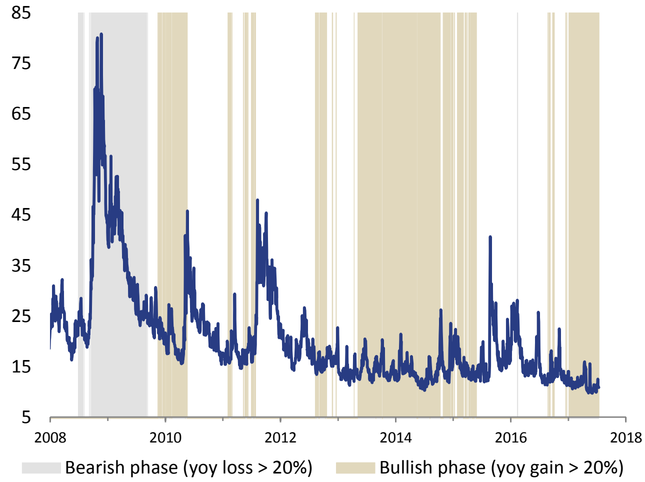
Concluding, we remain overweight in equities and certain selected categories of risk assets (see graph, page 4), and keep a modestly raised cash position for opportunistic purchases going forward. Our relative caution mainly concerns the richly-valued lower quality credit segments, such as high yield bonds, rather than equities - which are still well supported by economic fundamentals.

Charts and further background information:

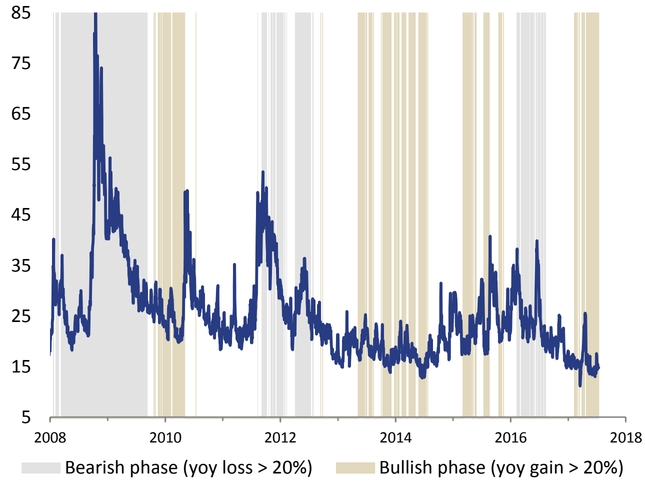
Persistently low volatility is typical for bull markets

Below we show the volatility indices for the major US and European stock markets, charted against bullish and bearish market phases (i.e. when the annual index gain or loss is greater than 20%). European equities are generally more volatile than their US counterparts, which is in large part a function of the more export-driven and cyclical nature of their earnings. However, in both cases, high losses (more than 20% year-on-year) are rare during phases of low volatility, while phases of high gains (more than 20%) are very frequent. Finally, the last bullish phase of very low volatility, in 2012-2015, lasted much longer than the current one.

US stock market volatility index (CBOE S&P 500 VIX)



EU stock market volatility (VSTOXX)



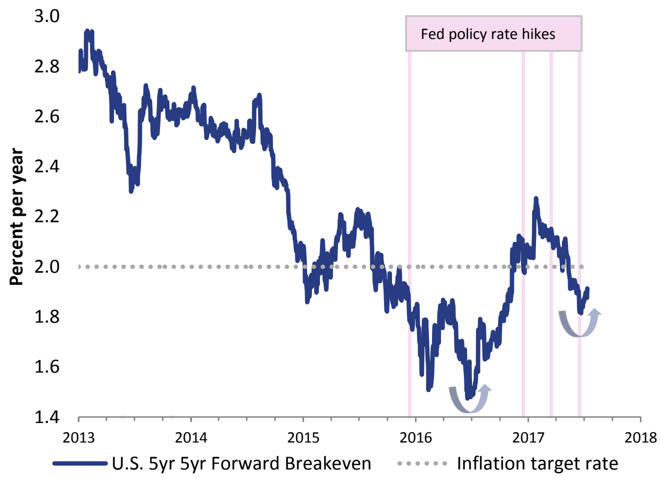
Breakeven rates and commodity prices have responded well to the Fed's decision

The last two charts show the market-based longer term inflation expectations (five year/five year breakeven rate) for the US, and industrial commodity prices. We show the Brent crude oil price per barrel and the Bloomberg Industrial Metals Spot price index, representing the following weights: Copper ~44% weight, Aluminum ~28%, Zinc ~16%, and Nickel ~12%).

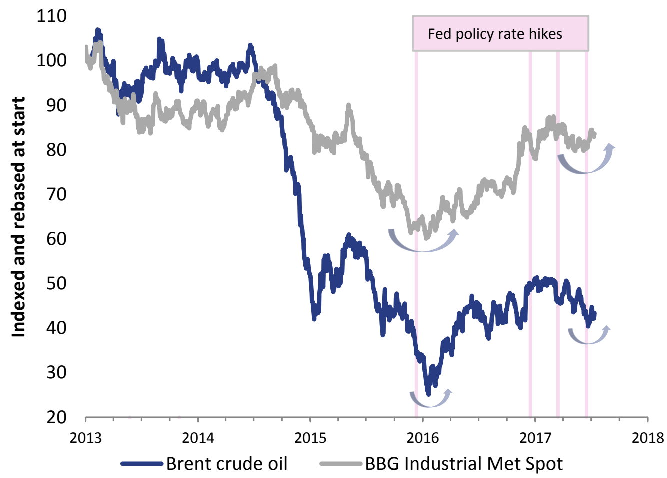
On June 15th, the Fed as fully expected raised the upper bound of the Fed funds target rate from 1% to 1.25%. The Fed also hinted that it would start the so-called "balance sheet normalization" process - meaning that it will not be fully reinvesting the proceeds from the maturing US treasuries and other debt instruments that it holds. As a result, the Fed will be reducing the value of the assets on its balance sheet, and hence also its liabilities (i.e. the currency it creates when it buys assets held in the real economy). Generally, the theoretical impact of such action is disinflationary, as money is deleted from the financial system. In large part, the steady slide in inflation expectations over the past few years reflects these disinflationary expectations at a time in which the Fed prepared to transition from quantitative easing to - gradual - quantitative tightening.

However, while inflation expectations have declined again since the start of the year, they are still trading much higher than last summer - and much closer to the Fed's target. Moreover, breakeven rates and commodities responded positively to the Fed's most recent decision. That suggests that either the market is done worrying, or that it expects the Fed's view that inflation will start rebounding soon to be proved broadly correct.

Long term inflation expectations for USA



Industrial commodity prices



Market Performance

Equities		Global share	Mkt Cap. in $	Last price	5 days	1 month	3 months	6 months	1 year	Year to date	Trend over past yr
World	BBG World All Country	100%	75,614	215.0	0.0%	0.5%	4.0%	8.4%	13.0%	10.5%	Rising
Americas											
USA	S&P 500	35.8%	27,104	2,425.5	-0.1%	-0.2%	3.4%	6.8%	12.7%	8.3%	Rising
	Nasdaq Composite *	12.7%	9,600	6,193.3	1.4%	0.3%	6.1%	11.6%	23.3%	15.1%	Rising
	S&P 600 Small Cap *	1.0%	770	851.4	-1.4%	-1.3%	3.2%	2.2%	15.0%	1.6%	Rising
Canada	TSX	2.8%	2,110	15,149.1	0.1%	-1.5%	-3.2%	-1.7%	4.6%	-0.9%	Sideways
Brazil	Bovespa	1.0%	756	63,832.2	0.9%	3.5%	-0.1%	-0.2%	17.6%	6.0%	Rising
Mexico	Mexbol	0.5%	398	50,510.2	0.9%	2.8%	3.2%	9.7%	8.8%	10.7%	Rising
Europe											
Euroland	Euro Stoxx *	8.4%	6,389	375.7	-0.3%	-1.9%	1.1%	7.1%	19.7%	7.3%	Rising
UK	FTSE 100	4.5%	3,401	7,329.8	-0.4%	-2.4%	-0.3%	0.5%	9.7%	2.6%	Rising
Germany	DAX Price Ix	2.9%	2,187	5,894.5	0.0%	-2.0%	0.3%	5.1%	21.5%	5.5%	Rising
Switzerl.	Swiss Perf Extra Pr Ix	2.3%	1,718	273.9	0.0%	0.3%	4.1%	14.1%	21.6%	15.7%	Rising
Poland	WSE	0.2%	180	2,297.7	0.2%	0.1%	3.8%	13.6%	31.0%	18.0%	Rising
Russia	Micex	0.7%	516	1,937.6	1.1%	2.9%	-0.5%	-12.4%	0.0%	-13.2%	Sideways
Asia											
Japan	Nikkei 225	7.4%	5,584	20,100.5	0.1%	1.0%	8.3%	5.0%	24.9%	5.2%	Rising
Hong Kong	Hang Seng Ix	6.1%	4,612	26,099.0	2.3%	1.5%	7.3%	14.3%	23.0%	18.6%	Rising
China H	China Enterprises Ix	9.2%	6,947	10,580.4	1.9%	0.9%	3.6%	8.8%	19.5%	12.6%	Rising
China A	CSI 300	5.2%	3,949	3,674.8	0.4%	2.8%	4.7%	10.8%	12.3%	11.0%	Rising
Australia	ASX 200	1.7%	1,255	5,688.4	-1.3%	0.2%	-4.1%	-1.4%	6.3%	0.4%	Rising
India	Sensex	2.7%	2,022	31,747.1	1.6%	2.1%	7.1%	16.5%	14.2%	19.2%	Rising
Korea	Kospi	2.0%	1,492	2,394.0	0.2%	1.5%	12.4%	14.7%	20.2%	18.1%	Rising
Taiwan	Taiex	1.5%	1,132	10,436.5	0.3%	3.2%	6.3%	10.9%	18.0%	12.8%	Rising

All indices: price indices (excl. dividends), in local currency. Market cap in billion USD at current exchange rates refers to country or index where marked with asterisk (*)

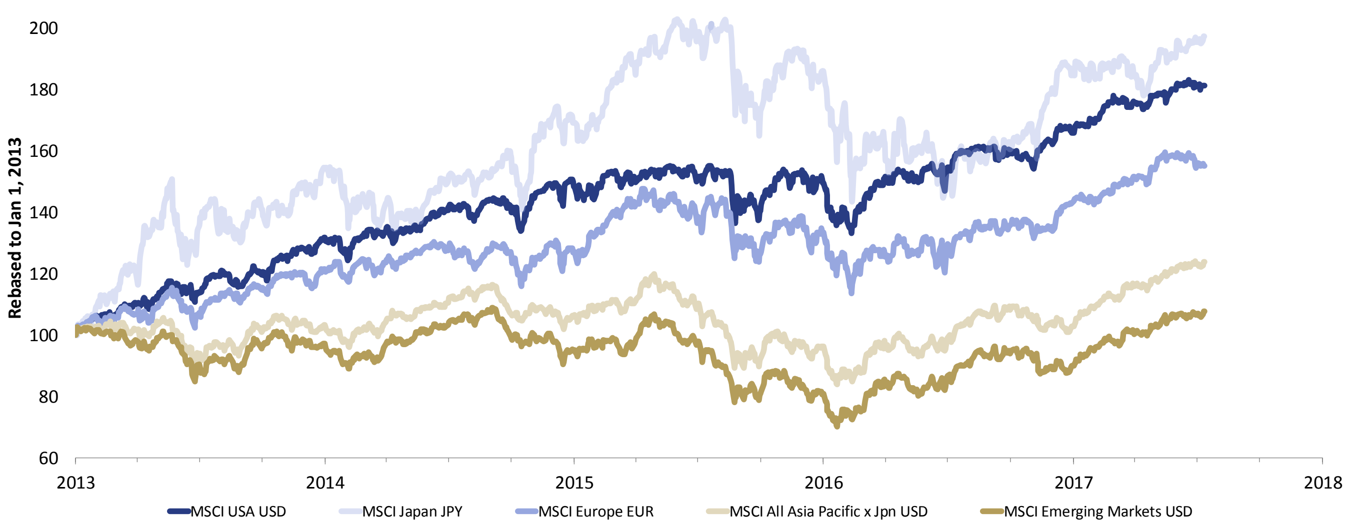
Currencies										
US Dollar, correlation-weighted index		USD	117.5	-0.4%	-1.7%	-3.5%	-4.0%	-0.3%	-5.4%	Falling
Euro, correlation-weighted index		USD	101.9	0.8%	0.9%	4.7%	4.7%	3.8%	4.2%	Rising
Japanese yen, correlation-weighted index		USD	341.4	-0.6%	-5.1%	-7.6%	-2.8%	-8.9%	-2.1%	Falling
Swiss franc, correlation-weighted index		USD	349.9	-0.3%	-1.1%	1.0%	1.3%	2.7%	0.7%	Rising
Bonds										
US Treasuries **		USD	382.6	-0.1%	-0.4%	0.0%	1.1%	-2.8%	1.7%	Sideways
EMU Bonds (Germany) **		EUR	227.6	-0.7%	-1.9%	-0.6%	-1.0%	-4.0%	-1.6%	Falling
UK Gilts **		GBP	640.9	-0.3%	-2.5%	-2.5%	0.8%	-2.1%	-0.1%	Falling
EM Bonds USD ***		USD	822.7	-0.4%	-1.1%	1.3%	4.5%	3.4%	5.7%	Rising
EM Bonds Local ***		USD	279.9	-0.5%	-1.4%	3.1%	10.6%	4.8%	9.3%	Rising
Investment Grade USD +		USD	148.9	0.1%	0.0%	1.6%	3.0%	0.7%	3.7%	Rising
High Yield USD +		USD	178.1	-0.1%	-0.2%	1.5%	3.7%	10.3%	4.9%	Rising

**Total return, indices of bonds with maturities of more than 1 year ***JP Morgan Indices + Bloomberg Indices

Commodities										
WTI Crude oil (generic future)		USD	45.8	1.5%	-0.6%	-13.7%	-13.6%	-2.1%	-14.7%	Falling
Industrial Metals Index (S&P GSCI)		USD	150.9	-0.9%	2.6%	1.3%	4.4%	19.8%	8.4%	Rising
Gold, spot price		USD	1,219.7	-0.6%	-3.7%	-5.2%	2.0%	-8.5%	6.3%	Sideways

Source: Bloomberg. All data based on last traded price at cut off time: 7/12/2017 11:48

Net total return indices of major equity regions



Note: equity positions in the USA, Europe and Japan are always hedged against currency risk in our portfolios as a matter of principle.

Economic and Corporate Snapshots

Macro fundamentals		USA	Euroland	China	Japan	Germany	Britain	Brazil	Russia	Switzerl.
GDP, nominal, 2017 ¹	bn USD	19,417	11,729	11,795	4,841	3,423	2,497	2,141	1,561	659
GDP per capita, 2017 ¹	USD, PPP	59,609	38,322	16,676	42,860	49,815	44,001	15,485	27,466	61,014
Real GDP growth, expected 2017	Consensus	2.2%	1.9%	6.6%	1.3%	1.8%	1.6%	0.5%	1.3%	1.4%
Real GDP growth, expected 2018	Consensus	2.3%	1.6%	6.3%	1.0%	1.6%	1.3%	2.0%	1.5%	1.7%
Real GDP growth last quarter *	q/q annualized	1.4%	2.4%	5.3%	1.0%	2.4%	0.8%	4.3%	-2.3%	1.2%
Unemployment rate ²		4.4%	9.3%	4.0%	3.1%	5.7%	4.6%	8.2%	5.2%	3.2%
Inflation, core rate (CPI)	y/y	1.4%	2.2%	1.1%	-0.2%	1.3%	3.7%	3.0%	3.5%	0.2%
Purchasing manager indices (comp.)	Neutral = 50	53.0	56.3	51.1	52.9	56.4	53.8	48.5	54.8	60.1
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	41	261	3,057	1,188	37	120	185	343	764
			ESM / EFSF							
Govt bond yield 2yr **	p.a.	1.37%	-0.42%	3.52%	-0.10%	-0.60%	0.30%	9.09%	8.67%	-0.78%
Govt bond yield 10yr **	p.a.	2.36%	0.88%	4.13%	0.10%	0.55%	1.28%	7.86%	8.01%	0.02%
Policy rate (or approximation) °	p.a.	1.25%	-0.40%	4.35%	-0.05%	-0.40%	0.25%	10.25%	8.25%	-0.75%

¹IMF estimates. *annualized, most recent qtr. ²PRC ex. migrant workers. ** Currency swap rates for China and Brazil, closest ESM or EFSF bonds for Eurozone. °Max target rate for Fed, SNB

Corporate fundamentals		USA	Euroland	China	Japan	Germany	Britain	Brazil	Russia	Switzerl.
Exchange capitalization*	USD	27,104	7,735	11,559	5,584	2,187	3,401	756	516	1,718
Growth in earnings per share, estimated (MSCI)										
Next fiscal year / current fiscal year	Consensus	12.3%	9.4%	14.1%	5.7%	8.0%	8.6%	10.3%	12.5%	10.3%
FY year after next / next FY	Consensus	10.7%	8.8%	13.6%	7.6%	7.8%	10.0%	18.7%	8.4%	9.5%
Growth in revenue per share, estimated (MSCI)										
Next fiscal year / current fiscal year	Consensus	5.0%	3.7%	11.3%	2.5%	3.3%	2.7%	7.2%	7.6%	3.6%
FY year after next / next FY	Consensus	5.1%	1.7%	10.8%	2.4%	3.2%	7.6%	7.1%	6.0%	2.6%
Valuation metrics (MSCI)										
Price-Earnings Ratio (est forward 12m)	Consensus	18.9	15.1	13.7	14.5	13.9	15.0	12.1	6.5	18.3
Price-Sales Ratio (est forward 12m)	Consensus	2.0	1.1	1.5	0.9	0.9	1.2	1.3	0.8	2.1
Dividend yield	Consensus	2.0%	3.2%	2.1%	2.1%	2.9%	4.3%	3.5%	5.7%	3.3%

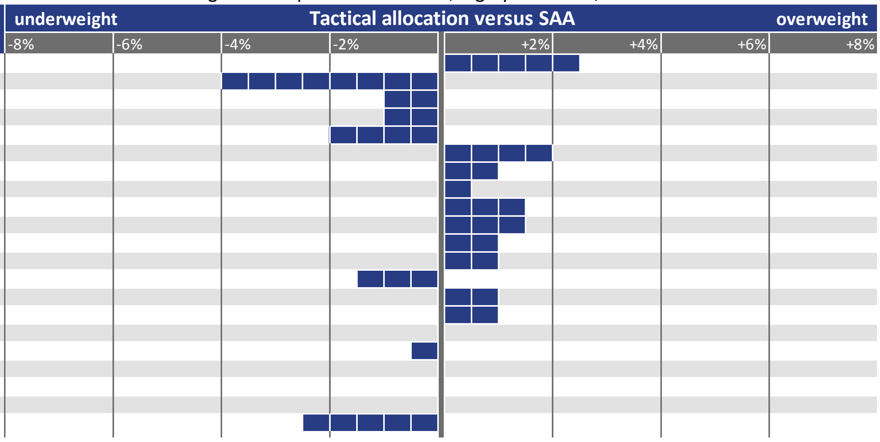
* China includes Hong Kong. Notes: Corporate fundamentals are based on consensus estimates ."Reversal +" denotes a return to profits, "Reversal -" an expected loss next year. Source: Bloomberg.

12.07.2017

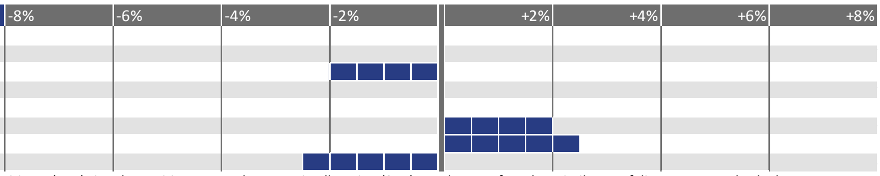
LGT Asset Allocation for Q3/2017 for a balanced model portfolio¹ managed by LGT Capital Partners

Overweight cash, emerging market bonds, equities, and Swedish krona. Underweight developed market bonds, high yield credit, and LPE.

	Asset class	SAA
Fixed income	Short-term investments	0.0%
	Global sovereign bonds	9.0%
	Inflation linked bonds	9.0%
	Investment grade corporates	9.0%
	High yield bonds	7.0%
	Emerging markets bonds	7.0%
Equities	Equities defensive	6.0%
	Equities North America	7.5%
	Equities Europe	4.0%
	Equities Japan	2.5%
	Equities Asia/Pacific ex Japan	2.5%
	Equities emerging markets	7.0%
Real	Commodity producers	3.5%
	Real estate (REITs)	4.0%
	Infrastructure	1.0%
Alternatives	Insurance linked strategies	5.0%
	HF CTA	8.5%
	HF equity long/short	1.8%
	HF event driven	1.0%
	HF relative value	1.8%
	Listed private equity	3.0%



	Currency²	SAA
Currencies	USD	88.0%
	EUR	0.0%
	CHF	0.0%
	GBP	0.0%
	JPY	0.0%
	SEK	0.0%
	Others (TAA vs. base currency)	12.0%
	Base currency	



Source: LGT Capital Partners. 1 Based on LGT GIM Balanced (USD). Tactical positions (TAA), i.e. the position versus the stratetic allocation (SAA), can be transferred to similar portfolios as a general rule, but investment restrictions or liquidity considerations may lead to deviations in implementation. 2 Position in other currencies (Others) is against base currency – in this case USD.