US election and vaccine news reduce uncertainty

Marketing material

Following the US election and the news of a promising COVID-19 vaccine, the S&P 500 surged to an all-time high, with participation in the rally improving further, as investors shifted toward stocks that had thus far lagged in the recovery phase. While this sudden bullish outburst seems somewhat overdone for now, we do expect further gains over time.

Markets surge to new highs

Less than a week after the US election on 3 November, the S&P 500 hit a new all-time. Equities rallied globally as well, with the Nikkei 225 breaking out to the highest level since 1991. At the same time, the sectors that rallied most during the initial rebound from the COVID-19 shock seem stuck in a sideways range since August (graph 1).

As far as investors are concerned, the key facts with regard to the US election seem to be the following:

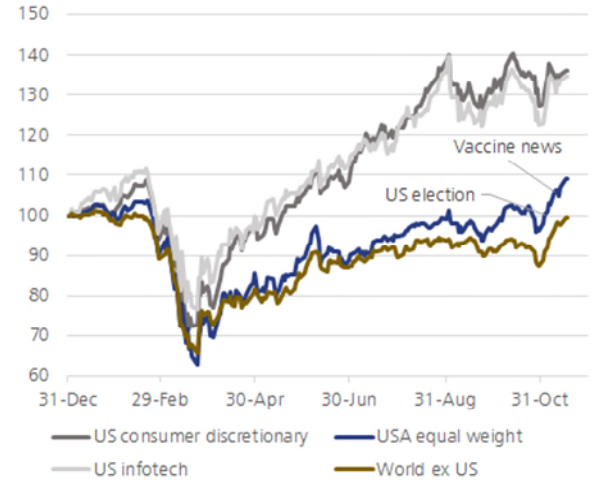
- As an event risk, the US election is over – even though it may take a few more weeks until the constitutional authorities formally certify the results and for the politics to settle
- Democrat Joe Biden has won the White House, while incumbent Republican Donald Trump has performed much better than indicated by most opinion polls
- The Republicans seem on track to keep control of the Senate, while the Democrats have held on to a slightly reduced majority in the House of Representatives

In short, Americans have denied a second term to Trump, but without generally rejecting all aspects of the Republican policy platform, or, vice-versa, without wholly embracing the Democrat agenda. As a result, the Biden presidency entails a reduced fiscal stimulus package in the near future, but brings the mid-term benefit of a softer foreign policy stance. Taxes will remain low, or rise less than would have been the case in a broader Democrat electoral victory.

Downsized pandemic relief package and de-escalation of lockdown debate

A gridlocked Congress means that Biden will face possible opposition from budget-hawkish and just re-elected Republican Senators, who hence have little incentive to compromise in this area. The result would most likely be a downsized fiscal package. The perceived risk of US lockdowns is certainly higher under Biden relative to Trump. However, the decision remains ultimately with state governors and not Washington. Moreover, national exit polls suggest that only 17% of voters considered COVID the biggest election issue, while 35% cited the economy. This too is a constraint on further lockdowns in the US, which the incoming Biden administration seems to be aware of as the latest comments suggest.

Graph 1
Big tech stalls as other market segments catch up
(MSCI equity indices, rebased per start of 2020)



Source: Bloomberg, LGT Capital Partners

Regarding his domestic agenda, Biden will be unable to purse key policy plans like tax increases or re-regulation beyond executive orders. As such, he is likely to focus on foreign policy, where presidents have larger authority to act unilaterally.

For example, he could attempt a diplomatic reset with China, to tone down the confrontation. While we believe the strategic rivalry with China will continue, a Biden administration would most likely seek to build a broad coalition of allies to act jointly vis-à-vis China, which will take time and effort. This multilateral

approach should also reduce tensions with Europe and other US allies.

In any case, the markets have clearly welcomed the political developments, especially when combined with the news released six days after the election: on that day, 9 November, two pharmaceutical companies announced that their COVID vaccine showed an efficacy rate of 90%. Other drug makers have announced vaccines with similar efficacy rates since. These events have reaffirmed expectations that a vaccine could indeed be widely available for distribution in the coming weeks or months.

Early vaccine availability reduces importance of another fiscal stimulus

Besides the obvious public health considerations, vaccine availability is important for markets because it also reduces the urgency and perhaps the ultimate size for the much-discussed fiscal stimulus package, further cushioning the potential downside of a divided Congress. Indeed, stock markets registered the surge to new highs on the day the vaccine news broke.

In fact, the overall market responses to the mentioned events seem to project a near-perfect world, i.e. modestly accelerating economic growth but below-target inflation – and hence a very low risk of a premature reversal of economic policy stimulus. The latter will continue to underpin risk assets for a good while longer – even more so if effective vaccines become available soon. This kind of environment is sometimes described as the "goldilocks economy' – a term that was widely used during the 1990s boom under President Bill Clinton.

Graph 2

Market responses since election: "Goldilocks" pattern

(Change in prices, per 17 November 2020)

Market instrument	Change since election	Signal
US 10y bond yield	Lower	Deflationary
US 10y-2y bond yield spread	Higher	Inflationary
US 1y swap-based inflation compensation	Higher	Inflationary
US 2y inflation compensation	Higher	Inflationary
US 5y/5y forward inflation compensation	Lower	Deflationary
Gold	Lower	Deflationary
US equities	Higher	Inflationary
JP equities	Higher	Inflationary
US equity futures, today, vs. previous day	Lower	Deflationary
Crude oil price	Higher	Inflationary
Copper price	Higher	Inflationary

Prices compared to close on 2 November 2020, the day before the US election. Source: Bloomberg, LGT Capital Partners

Clearly, this sanguine backdrop will not prevent short-term bouts of volatility, e.g. in the form of disruptive (trade) policy actions of the outgoing administration or prolonged stimulus talks, from occurring. However, the broader drivers of this recovery should effectively limit the downside and length of a resulting market hiccup.

Resurgent pandemic waves have not reversed recoveries

On the pandemic itself, the global pandemic situation has been steadily worsening since July, without reversing the stock rebound (graph 3). Thus, the question is – why should it do so now, given that we may have a vaccine out soon, people are now psychologically and practically more familiar with lockdowns, and the lockdowns themselves are generally less restrictive?

Graph 3

Pandemic has not stopped the market rebound

(Daily COVID-19 deaths and the MSCI World equity index)

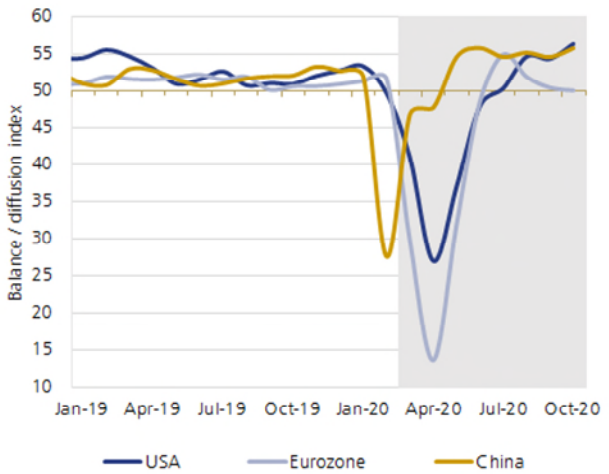
Source: Bloomberg, LGT Capital Partners

Notably, it is not only the financial markets that have held up well in recent weeks and months – the macroeconomic data have also remained rather robust, despite the second and third waves of COVID. For instance, the most recent readings of the composite purchasing managers' indices (PMI) for China and the US, released on 31 October and 4 November, respectively, continued to point to an acceleration of economic activity in the coming months (graph 4). The level of the surveyed optimism, at around 55, is also higher than it was before the virus outbreak, which is remarkable so soon after the V-shaped rebound between April and late summer.

Graph 4

US and China on track for a cyclical acceleration

(IHS Markit composite purchasing managers' indices, PMI)



Composite PMIs combine the survey results for the manufacturing as well as the services sectors. Source: Bloomberg, LGT Capital Partners

The main exception when it comes to the current momentum is Europe, where the escalating virus dynamics, including rising death and hospitalization rates, have forced national governments to reinstate some form of lockdowns recently. With the exception of France, these mobility impairments mainly aim to stop crowd gatherings, e.g. in restaurants, cinemas and other places of leisure. On the other hand, manufacturing and construction sites, as well as educational facilities, remain open.

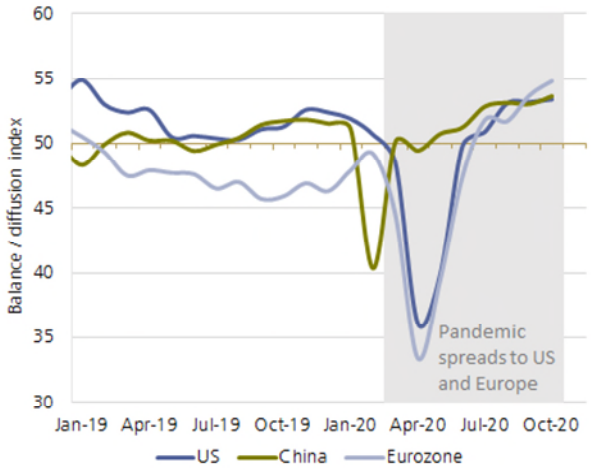
From an economic perspective, the impacted sectors only account for a small share of value added. For example, restaurants and hotels make up less than 5% of annual gross domestic product (GDP) in the EU on average. The impact on growth will thus not be as big as during the first lockdown in March and April.

Nevertheless, Europe's service sector activity is prone to contract further over the coming months. The Eurozone composite PMI, for instance, has recently fallen to just about the borderline to a contraction, meaning that the continent is clearly at risk of falling into another recession. One the other hand, European manufacturing continued to show upward momentum (graph 5), along with the other major economies – highlighting how the recent pandemic impact is likely to remain limited to certain services sector segments.

Graph 5

Even in Europe, manufacturers stay upbeat

(Markit manufacturing purchasing managers' indices, PMI)



Source: IHS Markit, LGT Capital Partners

The US is also facing headwinds due to the absence of additional fiscal stimulus and worsening COVID dynamics at present, but the latest leading indicators give no indication that the recovery is losing steam. On the contrary, growth in the US has been holding up surprisingly well, despite the lack of more state aid.

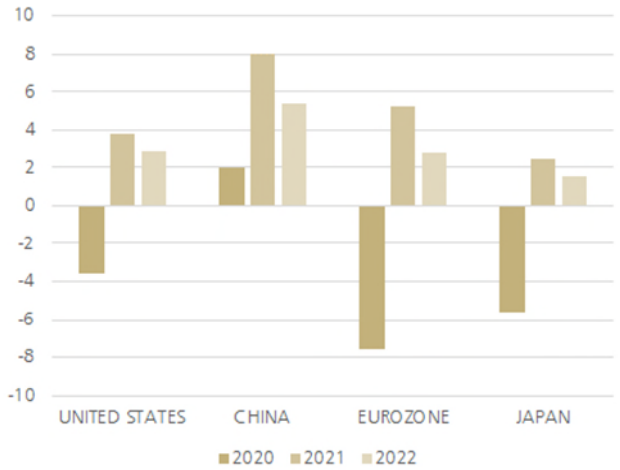
The same is largely true for most of Northeast Asia, which continues to enjoy a robust and almost virus-free recovery. In consequence, China and Taiwan are almost certain to achieve positive annual GDP growth this year already – ahead of all others (graph 6). Put differently, they have rebounded further and faster than any other economies. In sum, the global growth outlook thus continues to look reasonably sound.

Another reason not to become overly concerned with global growth due to current virus dynamics is the willingness of policymakers to provide more stimulus. A deterioration of the pandemic outlook will once again increase the necessity for support and more importantly, lower political opposition to it.

Graph 6

Among G4, only China will avoid recession this year

(Year-on-year change in annual GDP, in %)



GDP = gross domestic product. Numbers represent consensus estimates compiled by Bloomberg. Source: Bloomberg, LGT Capital Partners

For example, the German government has already announced that it will reimburse smaller enterprises with up to 75% of their loss in sales during the lockdown period, while the European Central Bank (ECB) has indicated it will expand asset purchases if needed. The US Federal Reserve (Fed) has also committed itself to the same policy stance.

The recent warnings against premature vaccine optimism by both central banks heads, Christine Lagarde and Jay Powell, only reaffirm the fact that the monetary authorities are not likely to consider retracting their accommodative framework anytime soon.

Concluding, with many of the major economies moving ever closer to distributing effective vaccines in the coming months, the COVID numbers may prove to be even less of a headwind for the markets that they have been since April, as long as economic policy countermeasures remain in place.

Market positioning: taking profit and staying the course

We remain constructive over the medium term and therefore retain our current tactical positioning, with an equity overweight in developed countries and an underweight in emerging markets assets.

Fixed income is underweight, and we keep a sizeable position in gold. The precious metal serves a potential insurance against unforeseen events, but also as an asset geared towards further reflationary expansion on fiscal and monetary largesse.

In terms of the immediate short-term market outlook, we believe that markets may need to digest the most recent surge in risk asset prices, before resuming their upward path. As a reminder, we had added to our equity position in mid-September and then shifted further in favor of the US market. We thus entered the US election with an overweight – which only increased further since 3 November. Hence, we decided to rebalance, to lock in those gains.

Lastly, we also see a potential for the laggard sectors of the post-lockdown rebound to outperform the big tech names for a while - or at least perform more in line with the winners of the pandemic lockdowns, including Real Estate Investment Trusts (REITs). However, as we already hold a strategically relatively high position in REITs (see TAA, page 5), we refrain from further adding to these risk exposures. Our views and positions in the alternative investment segments remain unchanged as well.

Gold moves sideways as the case for reflation and uncertainty fades

With respect to gold, however, its fundamental attractiveness as a safe haven asset has arguably decreased somewhat in the immediate aftermath of the US election and the vaccine news, for the following reasons:

- **Reduced inflation risk:** The US election has not produced a so-called Blue Sweep, i.e. a clear landslide in favor of the Democrats. That outcome – if confirmed by the two remaining Senate races at the beginning of January – reduces the prospect of large fiscal spending programs that go beyond providing lockdown relief measures. Large-scale public infrastructure investment plans, for example, will probably prove more modest than they appeared during the election campaign. As the result, the outlook contains less inflationary risks than would have been the case otherwise

- **Defused trade war and geopolitical conflict potential:** Most analysts agree that President Joe Biden will be less confrontational when it comes to trade with all countries in general, and with China in particular. That takes the edge off of fears of a reignited trade war, and/or its potential geopolitical aftershocks

- **Declining pandemic-related uncertainty:** Health authorities move closer to approving and rolling out vaccines against COVID and hence the risk of persisting economic uncertainty in certain segments of the economy, such as travel, leisure, or urban office property, are less pronounced than before – or at least are arguably set to decrease as times passes

That is not to say that gold does not remain useful as a diversifying element in a multi-asset portfolio. The long-term factors favoring gold as a portfolio diversifier remain in place and we continue to hold a sizeable position in the precious metal. This hedge has paid off handsomely during the pandemic-related market turmoil earlier this year, when gold was the best-performing asset.

For now, however, as long as investors focus on benign economic and trade policy scenarios, we expect gold to continue to trade within a broad sideways trading range, between around USD 1,850 and about USD 1,950 per ounce.

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: maintained at a moderate overweight in favor of developed markets**
- **Fixed income: underweight, with a relative preference for corporate credit and emerging market debt**
- **Alternatives and currencies: big tactical position in gold maintained, with no active positions in currencies**

	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												
	Japan												
	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	-0.4%	0.1%	5.8%	5.3%	4.4%
Global inflation linked bonds	USD	-0.3%	0.3%	3.3%	3.3%	3.3%
Investment grade corporate bonds	USD	0.4%	0.7%	6.4%	5.4%	4.7%
High yield bonds	USD	2.6%	3.1%	4.2%	5.0%	7.1%
Emerging markets [2]	USD	3.1%	2.8%	0.8%	3.8%	5.8%
Equities						
Global	USD	4.5%	6.9%	8.7%	9.7%	10.2%
Global defensive	USD	3.0%	3.2%	1.6%	7.9%	9.3%
North America	USD	3.6%	6.9%	14.1%	13.4%	13.2%
Europe	EUR	5.9%	6.2%	-4.5%	2.3%	4.6%
Japan	JPY	8.1%	8.8%	4.0%	2.4%	3.9%
Emerging markets	USD	6.9%	9.1%	9.9%	4.3%	10.4%
Alternative and real assets						
Listed private equity	USD	9.0%	8.8%	-0.2%	8.3%	10.2%
Hedge funds	USD	0.0%	0.6%	-0.6%	1.4%	2.6%
Insurance linked securities (ILS)	USD	0.2%	1.4%	5.1%	4.5%	4.0%
Real estate investment trusts (REITs)	USD	5.9%	5.7%	-4.8%	4.6%	6.0%
Gold	USD	-1.2%	-6.0%	24.0%	13.3%	11.9%
Currencies (vs. rest of G10) [3]						
US dollar	USD	-2.4%	-0.6%	-3.1%	0.1%	-0.6%
Euro	EUR	-0.8%	-1.0%	3.4%	0.4%	1.9%
Swiss franc	CHF	-1.8%	-1.4%	3.6%	3.2%	2.0%
Japanese yen	JPY	-0.8%	1.0%	1.8%	3.0%	3.4%
Australian dollar	AUD	1.3%	0.5%	1.5%	-1.1%	0.1%
Norwegian krone	NOK	1.9%	-2.9%	-6.0%	-3.2%	-1.5%
British pound	GBP	0.8%	-0.3%	-2.9%	0.3%	-3.6%
Canadian dollar	CAD	-1.4%	0.2%	-3.7%	-0.8%	-0.2%
New Zealand dollar	NZD	2.9%	4.8%	-0.1%	0.7%	0.9%

[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 | Source: Bloomberg

Economic and corporate fundamentals

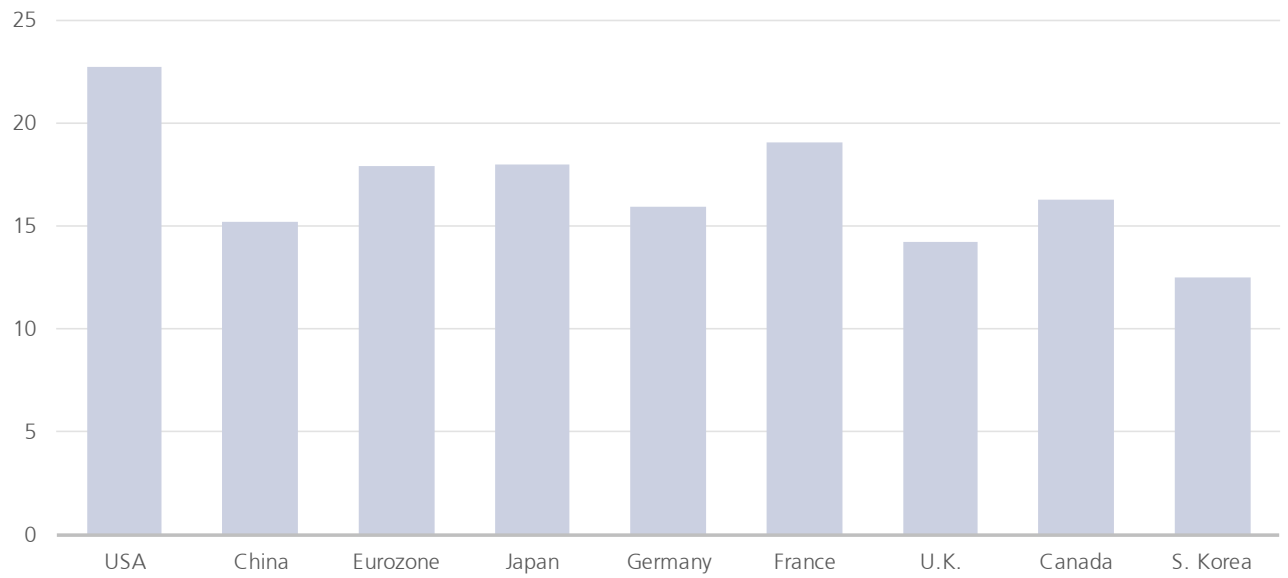
		USA	China	Eurozone	Japan	Germany	France	U.K.	Canada	S. Korea
Gross domestic product (GDP)										
Nominal, this year[1]	bn USD	20,807	14,861	12,712	4,911	3,781	2,551	2,638	1,600	1,587
Per Capita, purchasing power parity[1]	USD, PPP	63,051	17,206	40,965	41,637	53,571	45,454	44,288	47,569	44,292
Real growth this year[1]	Consensus	-3.6%	2.0%	-7.4%	-5.6%	-5.7%	4.2%	-10.7%	-5.6%	-1.1%
Real growth next year[1]	Consensus	3.8%	8.0%	5.0%	2.5%	4.0%	-9.0%	5.3%	4.7%	3.2%
Real growth current quarter	Annualized	33.1%	11.3%	60.5%	21.4%	8.2%	18.2%	15.5%	-38.7%	1.9%
Unemployment this year	Consensus	8.1%	3.8%	8.0%	2.9%	6.0%	8.3%	5.0%	9.5%	4.1%
Inflation this year	Consensus	1.2%	2.8%	0.3%	0.0%	0.5%	4.8%	0.9%	0.7%	0.5%
Purchasing manager index (comp.) [2]	Neutral: 50	56.3	55.7	50.0	48.0	55.0	51.3	53.7	55.5	51.2
Structural budget balance/GDP	IMF	-15.0%	-10.2%	-5.3%	-12.7%	-5.8%	-4.5%	-14.0%	-16.5%	-1.0%
Gross government debt/GDP	IMF	131.2%	61.7%	101.1%	266.2%	73.3%	118.7%	108.0%	114.6%	48.4%
Current account balance/GDP	IMF	-2.1%	1.3%	1.9%	2.9%	5.8%	-1.9%	-2.0%	-2.0%	3.3%
International currency reserves	bn USD	43.7	3,128.0	412.4	1,303.4	36.6	54.1	132.3	77.8	406.6
Govt bond yield 2yr [3]	% p.a.	0.17%	3.01%	-0.65%	-0.13%	-0.72%	-0.70%	-0.04%	0.26%	0.79%
Govt bond yield 10yr [3]	% p.a.	0.84%	3.30%	-0.37%	0.02%	-0.57%	-0.34%	0.31%	0.68%	1.62%
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	39,998	16,571	8,446	6,597	2,363	790	3,036	597	1,957
Growth in earnings per share, estimated (MSCI)										
12 months forward / trailing 12 months	Consensus	27.2%	36.4%	247.1%	64.0%	370.1%	203.8%	1199.8%	44.0%	70.7%
Next fy / 12m fwd	Consensus	4.0%	2.7%	4.6%	11.0%	5.6%	5.1%	0.9%	7.4%	3.6%
Growth in revenue per share, estimated (MSCI)										
12m fwd / trail 12m	Consensus	7.7%	22.4%	3.4%	6.3%	8.6%	1.4%	2.5%	-1.9%	4.6%
Next fy / 12m fwd	Consensus	1.7%	1.9%	1.0%	2.4%	1.0%	1.0%	1.7%	2.0%	1.0%
Valuations (MSCI)										
Price-Earnings Ratio (est 12m fwd)	Consensus	22.7	15.2	17.9	18.0	15.9	19.0	14.2	16.3	12.5
Price-Sales Ratio (est 12m fwd)	Consensus	2.6	1.6	1.2	1.0	0.9	1.3	1.2	1.9	0.8
Dividend yield	Consensus	1.6%	1.6%	2.6%	2.1%	2.6%	2.5%	3.6%	3.1%	1.9%

* China market cap includes Hong Kong | Source: Bloomberg Data per: 18.11.2020

Price earnings ratios based on expected earnings



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