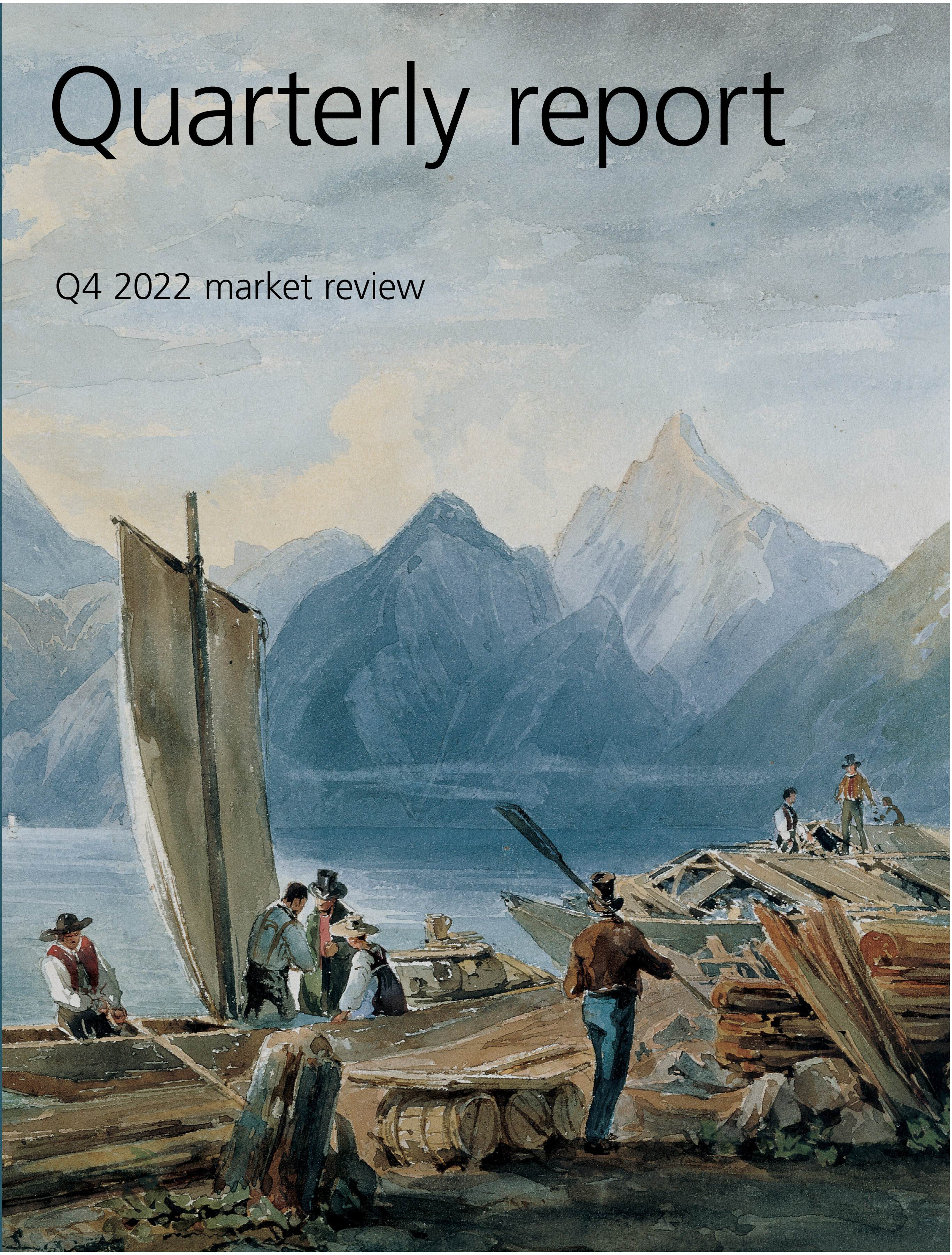
Wealth
Management US

VALUES WORTH SHARING

Quarterly report

Q4 2022 market review



Joseph Höger, detail from "View of Lake Gmunden near Ebensee", 1836

Landscape painter Josef Höger was closely connected with the Princely House of Liechtenstein through the numerous commissions he received from the family. As a result, an incredible body of his work in watercolour has been preserved in the collections. In his paintings, Höger documented the family's assets. He also frequently accompanied Prince Alois II von Liechtenstein on his travels, and therefore assumed a very special status. He captured the countries and landscapes through which they travelled, sometimes with astonishingly quick and fresh sketches, but sometimes also in large, detailed presentation drawings that demonstrate the full extent of his skill. Höger›s views of Salzkammergut play an important role here. In his work, the artist painted cities such as Bad Ischl, Gmunden and Hallstatt, as well as the surrounding landscapes in which everyday life in the region is always depicted.

A look inside the Princely Collections

For more than 400 years, the Princes of Liechtenstein have been passionate art collectors. The Princely Collections include key works of European art stretching over five centuries and are now among the world's major private art collections. The notion of promoting fine arts for the general good enjoyed its greatest popularity during the Baroque period. The House of Liechtenstein has pursued this ideal consistently down the generations. We make deliberate use of the works of art in the Princely Collections to accompany what we do. For us, they embody those values that form the basis for a successful partnership with our clients: a long-term focus, skill and reliability.

www.liechtensteincollections.at

Q4 2022 summary

Whilst the fourth quarter saw signs of inflation trending lower, central banks remained broadly hawkish, despite slowing the pace of interest rate hikes. Looking back at 2022, it may well be heralded as the ‘transition year’. Less than twelve months ago, the path taken by central banks was seen as unlikely. However, 2022 quickly brought about the end to a decade that was mired by low inflation and near-zero interest rates, exacerbated by the Russian war in Ukraine. As higher rates and ‘sticky’ inflation became a reality last year, we witnessed a repricing of assets whereby both equities and bonds registered double-digit declines.

At a glance

- Inflation is showing signs of moderating.
- Central banks maintain their hawkish stance and continue to raise rates.
- Bond markets have stabilised following the UK political turmoil.
- Dollar weakens as the terminal rate is in sight.
- Equities and bonds deliver positive returns over the quarter.

Macro summary

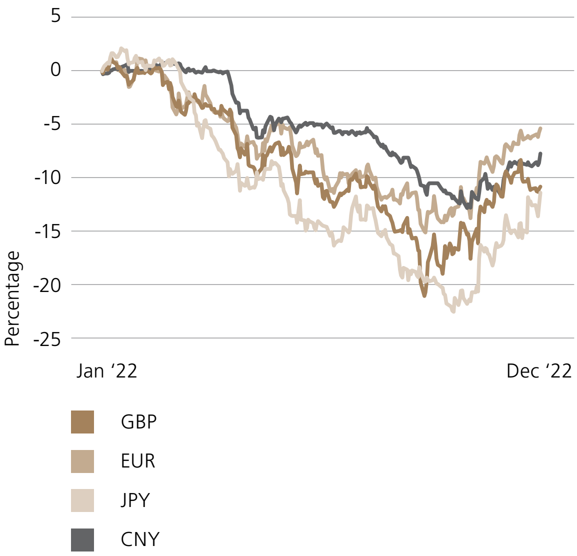
Over the quarter, the Federal Reserve (Fed), European Central Bank (ECB) and the Bank of England (BoE) all increased rates by 1.25%. For most of the year, all eyes were on the Fed given its swift hiking cycle. Hence, slowing the pace from 0.75% hikes to 0.5% amidst softening price pressures was initially seen as dovish. However, they pushed back hard on a quick policy reversal and indicated that they expect rates to peak above 5% and remain there for some time. The ECB joined them by pushing their own hawkish message and drove market rate expectations higher. The hawkish chorus was cemented by the Bank of Japan (BoJ) surprising investors and shifting the cap on their ten-year sovereign bonds. While the target remained at 0%, the cap was lifted from 0.25% to 0.5%, bringing about speculation of what is further to come.

The BoE managed to follow the path of the other central banks despite the fluid political situation. Following the ‘mini budget’, there was remarkable volatility that quickly led to a change in government. The appointment of Jeremy Hunt as Chancellor and Rishi Sunak as Prime Minister, backed by a more fiscally sound autumn statement, meant that interest rates will not have to rise as high as feared and garnered support for sterling.

Over to the East, China sought to move decisively away from its zero-COVID strategy, bringing some welcome relief to the local population and Chinese equity markets. Further stimulus measures have also helped improve sentiment. While the risk of a surge in COVID cases in the near term may bring about travel restrictions, the medium-term path forward is clearer and economic growth is again a priority.

Whilst we saw most other major equity indices post negative returns for the month of December, the last quarter was, in the main, a positive one for both bonds and equities globally. Currency markets were very volatile, with the dollar paring its gains following softer inflation prints and more hawkish central bank activity elsewhere. The change in BoJ policy also drove a sharp rally in the yen.

GBP, EUR, JPY and CNY vs USD over 2022



Source: Bloomberg, LGT Wealth Management

Looking ahead, there is every reason to believe that both equities and bonds should outperform cash and inflation over the medium term. As each month goes by, we are getting closer to the end of the current tightening cycle. Inflationary pressures driven by the pandemic shock will abate which should see inflation fall to more normalised levels. After a decade of developed market bonds yielding virtually zero, and investors forced to increase their risk to get returns, bonds are now much better placed to deliver attractive levels of income. Although higher rates and quantitative tightening result in a slowing of demand, if this results in a sustained fall in inflation, equities may fall back into favour. While markets are likely to remain volatile depending on what type of slowdown we may see, we have to be highly selective in our equity exposure. As history has shown, selective companies with solid balance sheets and pricing power should be able to perform well through this environment.

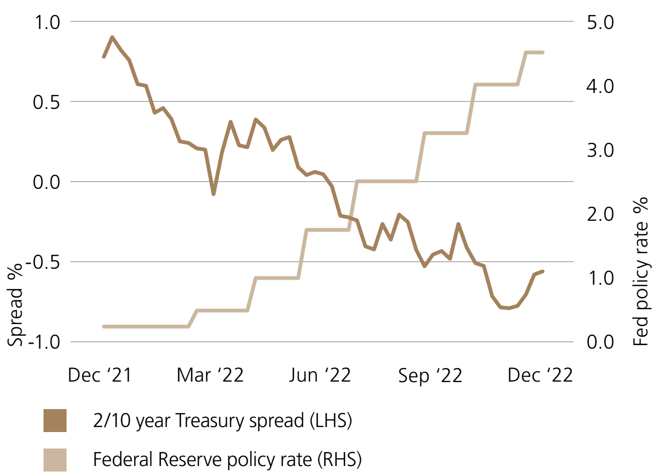
> "After a decade of developed market bonds yielding virtually zero, and investors forced to increase their risk to get returns, bonds are now much better placed to deliver attractive levels of income."
>
> Sanjay Rijhsinghani, Chief Investment Officer

Fixed income

The interplay between inflation data and central bank hawkishness came to a head this quarter. Looking back over the year, the numerous shocks to the supply side of the economy have forced central banks to undertake the swiftest hiking cycle in decades. While the shrinking labour force, largely due to early retirement and illness, was becoming better understood by central bankers, the Russian war in Ukraine has resulted in higher food and energy costs across the world. Despite the fact that the zero-COVID policy in China was finally abandoned during the quarter, for the majority of the year it has added to supply disruption and raised costs. Given these dynamics, developed market central banks, barring Japan, have acted swiftly to avoid inflation becoming entrenched further.

The Fed's cumulative 4.25% of rate increases over the past year has matched the entire rate hiking cycle that took place between 2004 and 2006. On top of this rapid hiking cycle, the Fed has also been shrinking its balance sheet by shedding Treasury and mortgage-backed security holdings. During Q4, the Fed tried to shift the attention from the magnitude of rate hikes to the absolute level of interest rates. After four consecutive 0.75% hikes, in December they deemed it appropriate to slow the pace to 0.5%. Given the softer economic and inflation data, the market was quick to see this as the Fed nearing the end of the hiking cycle and started to price in a significant reversal towards the end of 2023. However, the messaging surrounding the hike remained rather hawkish. The Fed's concern remains around the strength of the labour market. This could make inflation more persistent if wages move to catch up with prices. As such, they expect rates to rise somewhat further from here, peaking above 5% and remaining at a restrictive level for some time. Despite this narrative, the market was more focused on core price pressures. The annual rate peaked in September at 6.6% and has come down to 6% over the following two reports. The combination of weaker prices and economic momentum has seen yields on two-year Treasuries push meaningfully higher relative to their ten-year counterparts. This so-called yield curve inversion became more extreme over the quarter as bond investors sense that the Fed will have to change course sooner rather than later in response to the slowdown in economic activity.

2/10Yr Treasury spread vs Federal Reserve policy rate



Source: Bloomberg, LGT Wealth Management

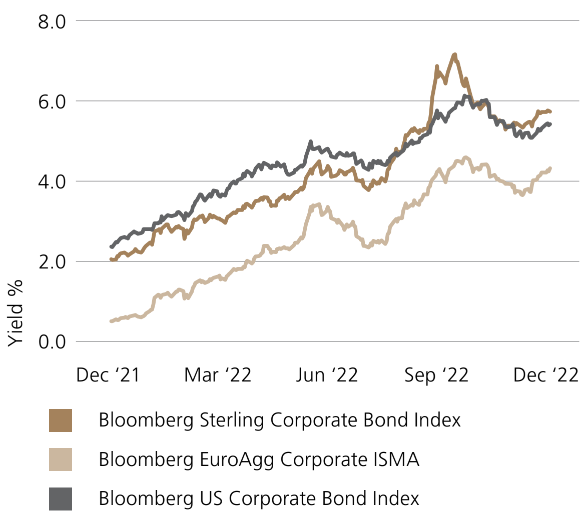
While both the BoE and the ECB followed the Fed in raising rates by 1.25% over the quarter, the economic situation is rather more precarious. Both are facing a larger squeeze on real incomes given their reliance on food and energy imports, exacerbated by the fall in both sterling and euro. The milder winter has meant that Europe has avoided potential blackouts, with less restrictions on the productive capacity of the Eurozone economy than initially feared. This improvement in sentiment, despite double-digit inflation, meant the ECB became more hawkish towards the end of year. While the ECB only started its hiking cycle in the second half of the year, it still raised rates by a cumulative 2.5%. This marked a quick step change from nearly a decade of negative interest rate policy. They indicated that at least two further 0.5% rate increases are anticipated, more than market expectations. On the other hand, the BoE finds itself more conflicted on the way forward. While the tighter fiscal stance of the new UK government brought some respite to the pound in the wake of the mini budget fiasco, this means further pressure to come on real incomes. Furthermore, given shorter-term fixed rate mortgages, the effects of rising interest rates are felt more quickly. As such, even though six members of the nine-strong Monetary Policy voted to raise rates 0.5% in December, two were in favour of keeping rates unchanged - highlighting just how difficult the outlook is.

> "While both the Bank of England and the European Central Bank followed the Federal Reserve in raising rates by 1.25% over the quarter, the economic situation is rather more precarious."
>
> Jeremy Sterngold, Deputy Chief Investment Officer

The hawkish ECB may have forced the BoJ to increase the range on implementing its yield curve control policy. Defending it in light of hawkish central banks had become challenging given the quantities they had to buy and risked deteriorating liquidity conditions. While the change is not on a policy rate per se, it highlights just how much of an outlier Japan has been and the potential need for change. The term of the current BoJ Governor, Haruhiko Kuroda, ends in April and speculation surrounding his replacement policy is likely to keep volatility high.

For investors, the resulting repricing in the fixed income market and the corresponding rise in yields has made bonds much more attractive. Corporate bonds have seen demand pick up materially, given the yields on offer in the wake of the shock of the mini budget. While the market has recovered from those extremes, with yields on offer still north of 5% in both the US and sterling investment grade market and 4% in the Eurozone market, this is still an attractive proposition. A contractual level of income, despite the economic and central bank volatility, seems to be increasingly valuable for investors.

Investment grade corporate bond indices yields (%)



Source: Bloomberg, LGT Wealth Management

Equities

International Equities

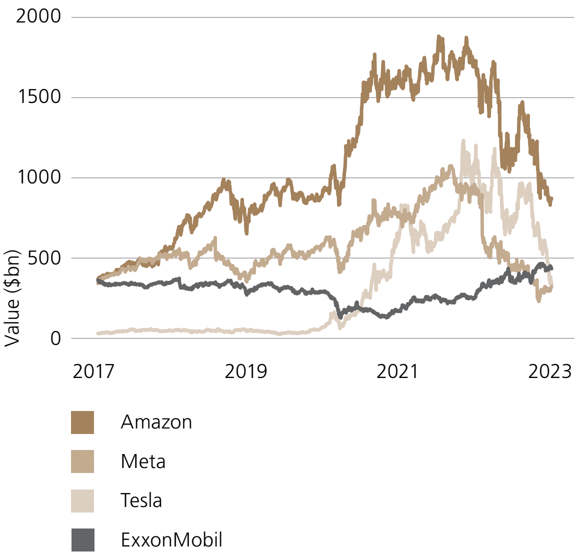
The fourth quarter of 2022 might have seen a positive return for plenty of global markets, but the context is one of large declines over the previous nine months. The broad S&P 500 index in the US rose 7%, with the energy sector rising by a fifth, even as Brent crude oil fell 2% over the quarter. Investors, perhaps, focused more on the $50bn of net profit the likes of ExxonMobil made in 2022 (more than double in 2021) than a small fall in the price of oil. Consumer staples are usually a good place to hide in a big market decline, given their lower economic sensitivity and decent dividends. The latter, however, provided cold comfort through the first nine months of the year in a world of sharply rising global dividends. The last quarter of the year saw investors reassess these companies. While economic concerns broadened, speculation rose that the Fed may be done with interest rate increases or, at least, pausing for some time. This brought the consumer staples sector in the US up by 12%.

> "The fourth quarter of 2022 might have seen a positive return for plenty of global markets, but the context is one of large declines over the previous nine months."
>
> Russell Harrop, Head of Equities

The technology-heavy Nasdaq index was flat over the quarter, having shed a third of its value over the whole of 2022. Online retail behemoth, Amazon, lost $800bn of market cap in 2022, wiping out two years of pandemic gains. Its revenue, however, was 80% larger ($220bn more) than just before the pandemic. Meta, the stock formerly known as Facebook, is no longer in the 'half trillion' dollar club, let alone the 'trillion' one. It saw six years of gains and $600bn of market cap wiped out in 2022.

Despite losing $800bn of its valuation in 2022, Apple actually outperformed the Nasdaq index. For context, just a year ago, we were writing in this report about an increase in market cap of $600bn in just one quarter. Electric car pioneer Tesla somehow managed to perform worse than Bitcoin in 2022 (-65% vs. -64%). Despite giving away $700bn of market value over 2022, this must be seen in the context of the $1trn that the stock added over the previous two years.

Market capitalisation ($bn) of Tesla, Amazon, Meta and ExxonMobil



Source: Bloomberg, LGT Wealth Management

Elsewhere, the Topix index in Japan only eked out a 3% quarterly gain. When measured in dollars, this was 14%, as the yen strengthened from ¥144 to ¥131 to the Dollar, having started the year at ¥115.

Europe followed the lead of the US, with the DAX in Germany up 15%, and the CAC Index in France up 12%. While insurance giant Allianz, industrial bellwhether Siemens and Deutsche Bank's respective returns of 15%, 28% and 38% were impressive, this only brought the stocks to where they were in April. Similarly, the 33% gains that re-badged French oil company Total Energies added only took it back to where it was in June 2022.

Meanwhile, the Shenzhen and Shanghai indices in China both rose just +2%, even as the country abandoned its zero-COVID strategy in early December.

Looking ahead, 2023 is likely to show which companies truly have pricing power, because, as Warren Buffett so succinctly put it, "only when the tide goes out, do you see who has been swimming without trunks". We prefer businesses that are correctly clothed.

UK Equities

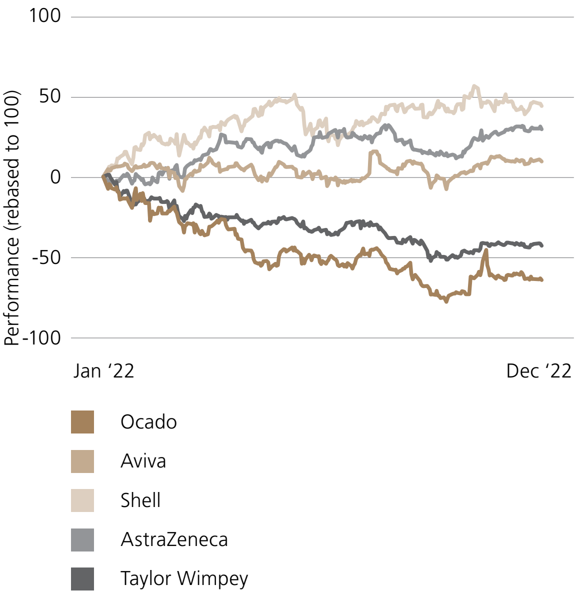
Over the course of 2022, global stock markets suffered their worst year since 2008, with some leading indices down double-digits. By way of contrast, the FTSE 100 index managed to deliver a total return of 4.6% in sterling terms.

Higher energy prices boosted BP and Shell shares by 40%, while the demand for relative 'safe havens' lifted AstraZeneca's share price by almost 30%. Weakness in the pound over the course of the year (it fell by 11% against the dollar) benefitted companies that generate a high proportion of their revenue from overseas. This was clearly a factor in the performance of the UK market.

General risk aversion during 2022 dampened sentiment towards a number of UK-listed financial stocks. However, investors were buoyed by Aviva's capital return plans, leading to the share price rising by 9%. The high yield paid by Phoenix also ensured that it delivered a positive total return. In the wake of the mini budget's impact on liability driven investment schemes and the resulting intervention by the Bank of England to shore up support, sentiment surrounding UK-listed insurance companies deteriorated. This resulted in a sharp decline in the share prices of groups like Phoenix, Aviva and Legal & General. We believed that these concerns were misplaced, given that these companies are well-managed, with excellent balance sheets, and limited exposure to the problems. The subsequent recovery in their share prices over the last three months of the year validated this stance.

In our previous quarterly report, we highlighted the risks to the UK's more domestically-focused FTSE 250 index. Concerns over the cost-of-living crisis weighed on retail shares in 2022, and house builders, such as Taylor Wimpey, were hit hard by concerns over rising interest rates and its impact on the housing market. Given the combination of these headwinds, the FTSE 250 fell by more than a fifth over 2022. Growth stocks such as Ocado, Deliveroo, and S4 Capital performed badly, with their valuations undermined by recession fears and higher interest rates.

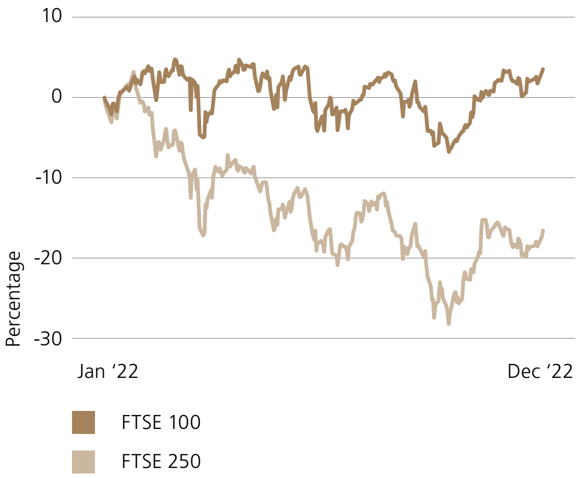
Share price performance of selected UK stocks



Source: Bloomberg, LGT Wealth Management

The performance of the FTSE 100 index during 2022 was noteworthy. London-listed stocks have been unloved by global investors since the Brexit vote in mid-2016. Over the last five years, the FTSE 100 index has seen a moderate decline. By way of contrast, the S&P 500 index in the US has risen by almost 40% over the same period. This dichotomy in performance, paired with the weak pound, increases the probability that businesses located outside of the UK could be attracted to acquisition opportunities. There was no related surge in takeover activity over the course of the last six months, but we remain of the view that investors should be alert to the possibility that lowly valued UK sector leaders may be subject to predatory interest. In more general terms, we remain highly selective and continue to place emphasis on the FTSE 100 index rather than the more domestically-oriented FSE 250 index.

FTSE 100 vs FTSE 250 index performance over 2022



Source: Bloomberg, LGT Wealth Management

Key market data

Key market data (as at 31 December 2022)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4075	-1.64	5.88	5.47	-4.73	-3.79	-4.03	-3.16
S&P 500 (USD)	3840	-3.98	1.49	0.21	-18.32	18.69	39.97	-19.44
Euro Stoxx 50 (EUR)	3794	-4.12	10.03	12.91	-13.63	0.54	5.16	-11.74
Nikkei 225 (JPY)	26095	-6.20	-3.78	-1.24	-11.04	10.31	10.04	-9.37
MSCI World (USD)	2033	-3.65	2.45	2.17	-14.95	19.62	39.70	-15.62
MSCI AC Asia Pacific ex Japan (USD)	589	-2.60	4.84	-1.14	-12.07	2.75	8.15	-12.53
MSCI Emerging Markets (USD)	956	-2.56	3.21	-1.58	-14.61	0.38	5.45	-15.16
10 year bond yields **								
UK	3.66	0.48	-0.48	1.35	2.69	2.84	2.41	2.69
US	3.88	0.18	0.08	0.90	2.37	1.96	1.45	2.37
Germany	2.53	0.57	0.40	1.15	2.71	2.72	2.06	2.71
Japan	0.42	0.17	0.18	0.20	0.36	0.44	0.38	0.36
Commodities (USD)								
Gold	1819.70	4.22	9.46	0.86	-0.43	19.76	39.30	-0.43
Oil	85.91	0.3973	-2.33	-23.04	10.45	30.17	28.47	10.45
Currency								
GBP-USD	1.20	-1.55	6.98	0.96	-11.33	-7.97	-11.31	-11.19
GBP-EUR	1.13	-2.89	-1.21	-3.11	-5.82	-3.73	0.02	-5.37
EUR-USD	1.07	1.38	8.29	4.20	-5.86	-4.41	-11.33	-6.15
USD-JPY	131.95	-3.19	-8.86	-2.99	13.95	22.14	16.53	14.58

Source: Bloomberg, ICE, London Stock Exchange, MSCI, Standard & Poor's, Stoxx Tokyo Stock Exchange

* Performance is given on total return indices, but the levels are for the main indices.
** Displayed as absolute changes in yields, rather than percentages.

Quarterly report contributors

Sanjay Rijhsinghani, Chief Investment Officer

Jeremy Sterngold, Deputy Chief Investment Officer

Russell Harrop, Head of Equities

James Follows, Head of UK Equities

For further information please contact:

Esther Clark

+44 (0)20 3207 8007

esther.clark@lgt.com

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LGT Wealth Management US Limited
14 Cornhill, London EC3V 3NR
Phone +44(0)20 3207 8000
info-us@lgt.com

www.lgtwm-us.com

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