



Wealth
Management US

Quarterly report

Q3 2023 market review



| Forward-looking
for generations

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Cover image
Bauer brothers, Hortus Botanicus, detail from
"Lilium," 1776/1804
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Economic growth surpassed expectations throughout the quarter, despite the Federal Reserve’s efforts to cool the economy with its multi-year aggressive rate hiking cycle. As such, prospects of rate cuts moved further into the future.

Sanjay Rijhsinghani, Chief Investment Officer, LGT Wealth Management

Q3 2023 summary

Throughout the second quarter of 2023, the overriding hope was that rates were close to their peak. Fast forward to the third quarter and inflation concerns have persisted in developed markets, resulting in both equities and bonds posting declines.

At a glance

- Interest rates close to peaking.
- Bond yields rise sharply on ‘higher for longer’ rhetoric.
- Equity markets pull back as a result.
- China attempts to stimulate flagging economy.
- Commodity prices rise on tighter supply.

Macro summary

It was a challenging summer for both US stocks and bonds amid an uncertain macro-economic climate. Economic growth surpassed expectations throughout the quarter, despite the Federal Reserve's (Fed) efforts to cool the economy with its multi-year aggressive rate hiking cycle. As such, prospects of rate cuts moved further into the future. After registering highs in July, both the Nasdaq Composite and S&P 500 sold off in August and September, finishing the quarter down 4% and 3.3% respectively.¹

Concerns mounted in August when ratings agency Fitch downgraded US government debt over expected fiscal deterioration in the next three years amid ballooning government debt. Rising borrowing costs hurt equity markets and put pressure on government budgets, creating larger budget deficits.

Over the quarter, we saw August CPI in the US rise to 3.7% year-on-year (vs 3.2% in July), largely due to higher oil prices.² However, we did see core CPI (excluding energy) broadly move in the right direction, a welcome sign for central banks that have been attempting to dampen inflation through the most aggressive rate hiking cycle in decades. The Fed paused its interest rate hiking in September, though it indicated that another rate hike may be necessary later this year, and it expects to maintain higher rates for longer. This provided no comfort to markets, with global developed market indices selling off after the Fed's meeting. With commodity prices rising, inflation is expected to remain stubbornly high. At the same time, Fed members now expect fewer rate cuts next year, resulting in a spike in Treasury yields.

Despite the central bank's efforts, in late September the US 10-year Treasury yield rose above 4.5% for the first time since 2007.³ The sharp move in the 10-year is partly because investors are pricing the higher for longer rhetoric, and partly due to the realisation that Treasury supply will remain elevated over mounting budget deficits.

For equities, the UK was a bright spot, with the FTSE 100 rising 2.1% in the quarter, benefiting from higher commodity and oil prices and a weaker pound.⁴ Following a rate hike in August to 5.25%, many forecasted that the Bank of England (BoE) would raise rates by a further 0.25% in September. However, lower-than-expected inflation led them to hold rates, although with a 5-to-4 split, clearly the members remain divided and have lingering concerns over future inflation. The European Central Bank (ECB) meanwhile carried on its rate hiking cycle throughout the summer taking deposit rates to 4%. This is widely expected to be their peak.

In China, property market concerns mounted over the summer, prompting further government support measures, such as lowering mortgage rates for first-time homebuyers and reducing downpayment ratios. These latest efforts by Chinese authorities are meant to restore confidence and boost growth in the economy, which has had a lacklustre post-pandemic recovery. Despite these efforts, sentiment towards Chinese and Hong Kong equities was negative. As a result, both these markets were down over the quarter.

¹ Bloomberg

² US Bureau of Labor Statistics

³ Bloomberg

⁴ Bloomberg

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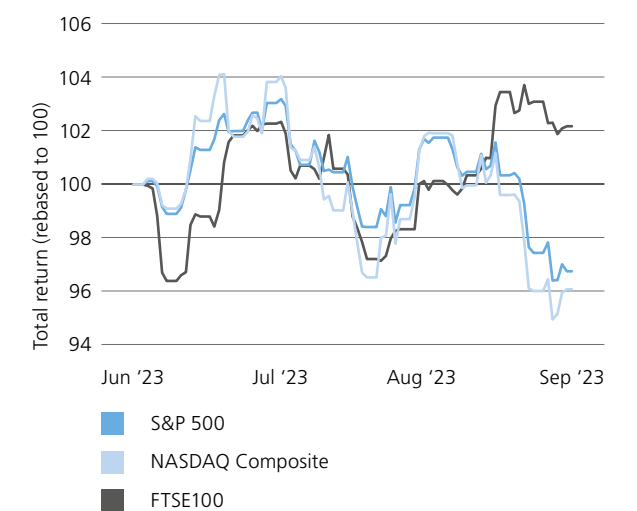
Interest rates will remain higher for longer until growth and inflation show significant signs of cooling. Rising borrowing costs mean businesses with strong balance sheets should be in a better position to weather a downturn.

Sanjay Rijhsinghani, Chief Investment Officer, LGT Wealth Management

There are, however, reasons to be optimistic when it comes to China. Equity valuations in the region trade at a significant discount to US equities, and recent data suggests the Chinese economy may have bottomed during the quarter. It is probable that the Chinese authorities' recent stimulatory actions - reducing rates, help with childcare and the elderly, a cut in stamp duty for stock trades, among others - have not yet filtered through to the economy. As such, we expect growth to pick up in the coming quarter.

In summary, both the Fed and BoE delivered a rapid series of rate hikes to bring their respective rates to over 5%. Economic resilience has surprised them, but interest rates have now reached levels to put sufficient pressure on the economy and dampen inflation. Interest rates will remain higher for longer until growth and inflation show significant signs of cooling. Rising borrowing costs mean businesses with strong balance sheets should be in a better position to weather a downturn. We continue our selective approach of quality companies that display long-term compounding of earnings.

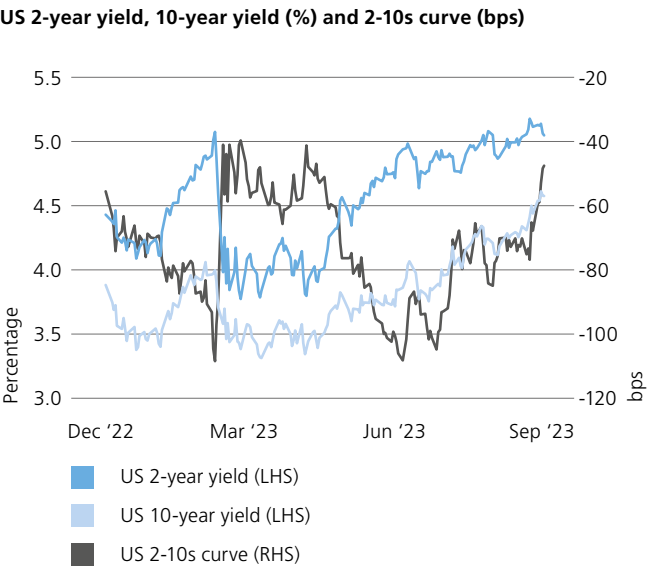
S&P 500, NASDAQ and FTSE 100 total indices over Q3



Source: Bloomberg, LGT Wealth Management

Fixed income

In our last quarterly, we noted the remarkable 1.8% rise in two-year gilt yields. While volatility on shorter term government debt remained relatively low this quarter, with yields on those maturities little changed across the main markets. It was longer dated bonds that saw much larger moves. At the end of September, benchmark ten-year treasury yields rose a notable 0.73% and breached the 4.5% level for the first time since 2007. The benchmark long dated 30-year treasury rose an even greater 0.84% and touched 4.7%. These large increases saw the near record level of inversion between two-year and ten-year treasuries at the start of the quarter move back to less extreme levels. A curve inversion has been a trusted lead indicator for decades, but the resilience of the US economy so far has tested its track record.



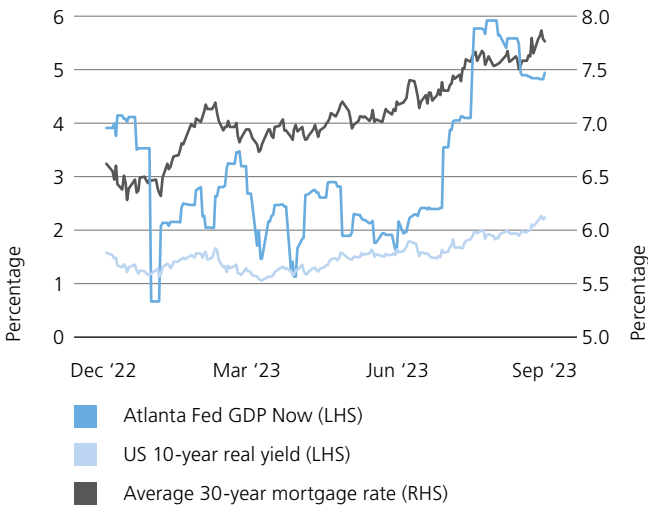
Source: Bloomberg, LGT Wealth Management

The strength of the US economy in the face of the high levels of interest rates has surprised investors. Looking at timely growth indicators, most notably the Atlanta Fed GDPNow Forecast showed the US economy growing at an annualised pace of 4.9% at the end of September. Labour market indicators are showing signs of it gradually cooling, but jobless claims remain at historically low levels. As such, wage pressures have moderated despite the highly publicised strikes from the United Auto Workers. Furthermore, the Federal Reserve's (Fed) preferred inflation indicator, the Core Personal Consumption Expenditure, fell below 3.9% for the first time since May 2021.

Taking this all together, investors have increasingly become more optimistic that a soft landing may be achieved. On the flipside, this brought a lot more credibility to central bank messaging that rates will remain higher for longer. With inflation still showing signs of moderating further, this implies that real (inflation adjusted) policy rates will become tighter over time and thus exert more pressure on the economy. Consequently, the selloff in bonds this quarter was primarily led by rising real yields.



Atlanta Fed GDP Now vs US 10-year real yields and average 30-year mortgage rate (%)



Source: Bloomberg, LGT Wealth Management

Although the Fed paused again in September after raising rates by 0.25% in July, it is the projection of future policy, better known as the dot plot, that reinforced the higher rates message. On balance, some members still favour another increase this year. However, the bigger adjustment was the expectation that

rates would be cut by a cumulative 0.5% next year rather than the 1% that was envisaged in June. This was one factor which led investors to reassess whether they would accept a lower yield for longer maturity debt, or expressed differently, factored in a lower level of reinvestment risk. This was far from the only factor affecting bonds as the downgrade by Fitch Ratings highlighted concerns of current fiscal profligacy and its impact on bond supply. Higher borrowing costs and the ongoing quantitative tightening program only exacerbate the situation, as does the selling of foreign reserves in light of recent dollar strength. The broad US Treasury index (BBG) fell by 3% over the quarter with longer dated debt facing much larger declines. While the selloff in bonds may convince the Fed to act less hawkish, for fiscal authorities this is unwelcome news as higher debt costs limit the scope of governments to intervene.

The steepening of curves was a global phenomenon, although the moves in the US were the most pronounced. In the UK, we saw the Bank of England move to pause rates in September after increasing rates in August by 0.25% to 5.25%. After facing upside inflation shocks over the second quarter, which prompted a large 0.5% increase, the latest downside surprise to inflation paired with softer growth and property market declines, convinced a slim margin to keep rates on hold. The Eurozone deposit rate is very likely to be at its peak after the European Central Bank (ECB) hiked rates twice over the quarter to 4%. The Eurozone is already showing signs of sluggish economic momentum heading into winter, with energy commodity prices on the rise. Furthermore, the new government in Italy announced some further fiscal loosening putting pressure on its sovereign bonds, complicating matters further for the ECB. Demand for corporate bonds remained firm over the summer, given limited issuance and elevated yields.

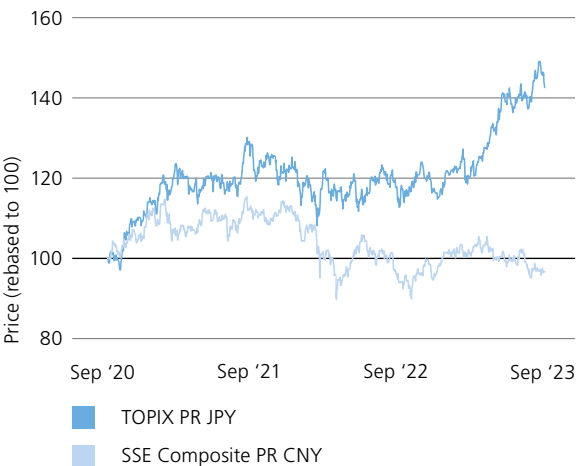
Equities

International Equities

Concerns over sticky inflation and therefore global interest rates remaining ‘higher for longer’ meant that the impressive first half performance of most global markets started to fizzle out halfway through the third quarter. This weakness gained momentum over the last two weeks of September, meaning that many indices closed at, or near, their low for the quarter. Though the S&P 500 in the US fell 3.3%, the tech-heavy Nasdaq 100 index which led US markets higher this year, fell less (down 2.9%). While mobile phone behemoth Apple gave up 12% of its market cap (\$370bn), it’s still up 32% for the year. That \$600bn in extra market cap would buy you Exxon, BP and nearly half an ARM. It may no longer be classified as a tech stock, sitting in the ‘Communication services’ sector, but it’s still surprising that in contrast to Apple, Google parent company Alphabet rose 9%, despite a trial concerning abuse of their near-monopoly position started during the quarter. While markets quietly came to terms with the disappointment of the ‘great China re-opening’ Brent crude increased by 27% to end the quarter at \$95. Consequently, the S&P Energy sector, rose 11% and was one of only two to make it into positive territory (the other being Google-driven Communication Services, up 3%).

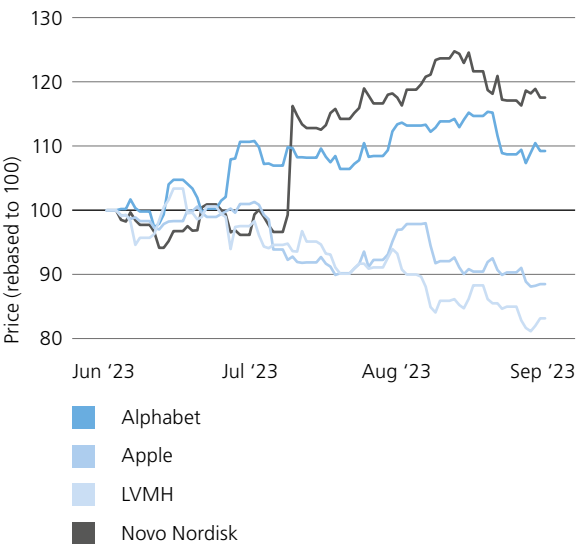
While the oil price shrugged off the sluggish Chinese re-opening, the luxury goods sector was weighed down. The likes of LVMH, Hermès, Kering (Gucci) and Burberry all fell double digits. As such, LVMH lost its crown as Europe’s largest stock to the Danish pharmaceutical company Novo Nordisk, which rose 18% over the quarter. On the whole, European indices took cues from their US peers, with the Euro STOXX 600 falling 2% over the quarter. Emerging markets

TOPIX Index vs SSE Composite Index



Source: Bloomberg, LGT Wealth Management

Alphabet vs Apple vs LVMH vs Novo Nordisk over Q3



Source: Bloomberg, LGT Wealth Management

did not stand out over the quarter, despite the negative press surrounding China. Shanghai and Shenzhen indices fell 3% and 4% respectively, while the Hong Kong listed HS Tech ended the quarter flat. A positive highlight in emerging markets was India, which rose 2%, while commodity giant Brazil’s Bovespa fell 1%.

Japan’s stock market has shown consistent improvement, posting its fifth consecutive quarterly gain, with the TOPIX index up 2% in the third quarter. This consecutive gain hasn’t occurred since 2015. However, in dollar terms it was a less impressive 1% fall as yen weakness persists given the Bank of Japan’s ultra-loose monetary policy.

UK Equities

Monetary policy expectations and commodity prices played a large role on UK equity market performance over the third quarter.

Following a rate rise in August to 5.25%, the Bank of England (BoE) was expected to raise rates again at their September meeting. However, with inflation data lower than expected and signs of the economy weakening, the Monetary Policy Committee narrowly voted to hold off. While it remains to be seen whether this marks the peak in rates, interest rates are unlikely to hit 6%. This change in rate expectation relative to a more hawkish Fed weighed heavily on the pound over the quarter.

In September, the pound suffered its worst month of the year against the dollar, and the outlook for the pound remains challenging as growth softens on the back of higher interest rates feeding through the economy. Sterling fell almost 4% against the dollar

in the third quarter. This weaker pound benefited the FTSE 100, which is dominated by international stocks that derive their earnings in dollars. Indeed, in a quarter when both US equities and bonds struggled, the UK’s FTSE 100 was a rare bright spot, rising 2.1%.

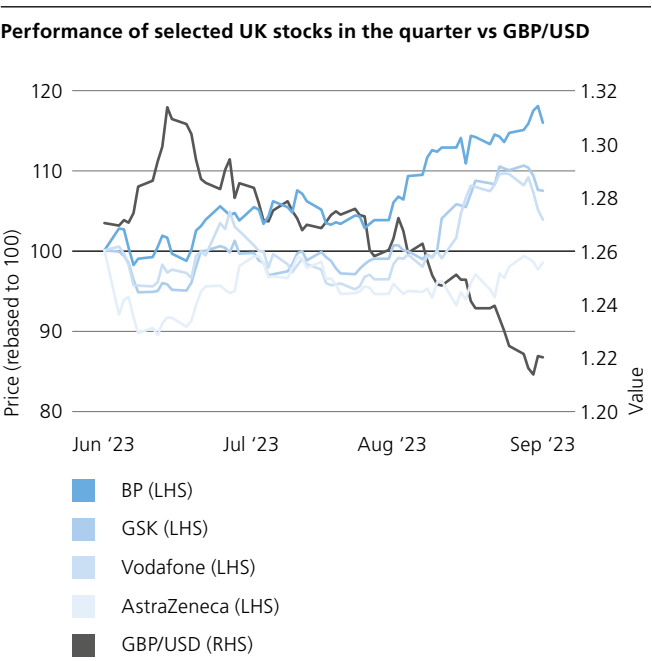
One sector in the eye of the monetary policy storm is the property market. The Nationwide survey showed house prices falling 5.3% year-on-year in September. Late in September, British Land announced Meta Platforms broke its lease on a central London office building, highlighting the challenging backdrop facing the commercial real estate market. The BoE published data in September showing that British households are falling behind on loan payments as interest rates continue to climb, with the value of home loans with late payments totalling £16.9 billion in the second quarter, the highest level since the third quarter of 2016.⁵ Furthermore, property website Rightmove notes that 36% of properties for sale in August have seen a reduction on their asking prices.⁶

Rising commodity and oil prices buoyed the FTSE 100’s returns. BP and Shell posted gains of 17.3% and 12.4% in the third quarter respectively as Brent rose from about \$75 a barrel to \$95 a barrel. This came on the back of supply cuts announced by the Organisation of the Petroleum Exporting Countries (OPEC), at a time when the US strategic petroleum reserve sits at historically low levels. Companies that also benefited from the weaker pound include pharmaceuticals AstraZeneca and GlaxoSmithKline, and wireless communications company Vodafone. The FTSE’s attractiveness as a listing destination has been diminishing, highlighted by British chip designer ARM choosing to float its shares on the Nasdaq.

⁵ Bank of England, www.bankofengland.co.uk/statistics/mortgage-lenders-and-administrators/2023/2023-q2

⁶ Rightmove, www.rightmove.co.uk/news/house-price-index/

Cambridge-based ARM's designs are used in semi-conductor chips in Apple iPhones and laptops, Samsung phones and a range of other electronic devices. Given where UK valuations are, it's not surprising the company's owner, Japanese investor SoftBank, chose to list the company in the US. That said, we do see select opportunities, particularly in larger FTSE 100 stocks. UK shares are valued cheaply and shunned by global investors. We continue to evaluate the UK market and believe there will be select opportunities. Cheap valuations and the weak pound will likely spur takeover activity, and there are several businesses in the UK we regard as being natural takeover targets.



Source: Bloomberg, LGT Wealth Management



Key market data

Key market data (as at 30 September 2023)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4127	1.67	0.76	-0.74	9.67	25.74	-0.02	1.28
S&P 500 (USD)	4288	-4.87	-3.65	4.35	19.59	27.51	47.15	11.68
Euro Stoxx 50 (EUR)	4175	-2.85	-5.10	-3.25	25.81	30.72	22.81	10.04
Nikkei 225 (JPY)	31858	-2.34	-4.01	13.61	22.83	37.41	32.08	22.09
MSCI World (USD)	2249	-3.66	-2.53	4.61	21.06	33.19	50.43	12.54
MSCI AC Asia Pacific ex Japan (USD)	590	-2.04	-1.68	-1.64	11.56	3.80	16.33	2.81
MSCI Emerging Markets (USD)	58515	-1.75	-1.29	0.53	11.35	2.96	16.36	4.40
10 year bond yields **								
UK	4.40	-0.01	-0.01	0.88	0.26	4.18	2.84	0.74
US	4.57	0.46	0.76	1.08	0.78	3.89	1.52	0.69
Germany	2.82	0.27	0.41	0.49	0.69	3.34	2.35	0.28
Japan	0.76	0.11	0.37	0.44	0.52	0.74	0.64	0.34
Commodities (USD)								
Gold	1848.10	-4.65	-3.80	-6.14	11.17	-2.09	55.11	1.56
Oil	95.31	9.73	27.25	19.48	8.36	132.75	15.22	10.94
Currency								
GBP-USD	1.22	-3.68	-4.00	-1.29	9.34	-5.59	-6.40	1.47
GBP-EUR	1.15	-1.26	-1.07	1.30	1.17	4.57	2.68	2.28
EUR-USD	1.06	-2.45	-2.96	-2.55	8.07	-9.71	-8.85	-0.80
USD-JPY	149.23	2.50	3.24	12.12	3.10	41.41	31.38	13.10

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.

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Rising borrowing costs mean businesses with strong balance sheets should be in a better position to weather a downturn. We continue our selective approach of quality companies that display long-term compounding of earnings.

Sanjay Rijhsinghani, Chief Investment Officer, LGT Wealth Management

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