



Wealth  
Management US

# Quarterly report

Q4 2023 market review



Forward-looking  
for generations



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**Cover image**  
Bauer brothers, Hortus Botanicus, detail from  
"Lilium," 1776/1804  
© LIECHTENSTEIN. The Princely Collections, Vaduz–Vienna

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Despite the uncertainty, the economic landscape of 2023 has given rise to opportunities for a reimagined 60/40 portfolio. By holding bonds, investors can now generate annual income of around 5%, while once again gaining protection from extreme shocks.

Sanjay Rijhsinghani, Chief Investment Officer, LGT Wealth Management

## Summary: Q4 2023

Marking a notable reversal from the preceding three lacklustre quarters, both equity and bond markets witnessed robust rallies in the final quarter of the year. This positive shift was largely attributed to the market's interpretation of recent inflation data and the dovish stance communicated by central banks. Investors perceived these signals as indicative that interest rates have reached their peak, celebrating the apparent success of central banks in orchestrating a soft landing.

### At a glance

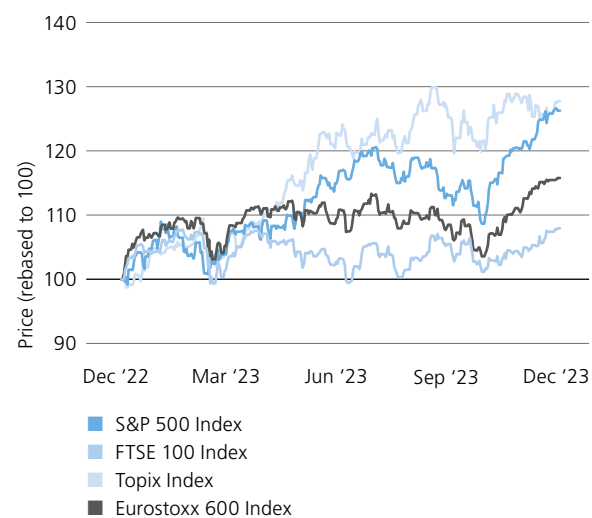
- Interest rates look to have peaked with inflation coming back towards target.
- Equity and bond markets rally over hopes of a 'soft landing'.
- Markets price in interest rate cuts for 2024.
- Investors shift focus from inflation, towards softening economic growth.



# Macro summary

Equity markets surged in November, a rally that continued in December, with the S&P 500 finishing the fourth quarter up 11.7% and 26.3% for 2023.<sup>1</sup> The equity rally was broad based, with the FTSE 100, the Eurostoxx 600 and Topix up 2.3%, 6.8% and 2% respectively over the fourth quarter in local currency terms.<sup>2</sup>

Major market indices over 2023



Source: Bloomberg, LGT Wealth Management

## From rate hikes to a dovish shift

It's an about turn from a few months ago, when strong growth led to the very real possibility of another rate hike. Resilient growth in the third quarter, supported by a relatively loose fiscal policy, allowed the US economy to shrug off the Federal Reserve's (Fed) tightening, with GDP growing at an above trend pace of 5.2% annualised over the third quarter.<sup>3</sup> Economic resilience led to concerns mounting over booming deficits and worries that interest rates would remain higher for longer, which sent ten-year Treasury yields surging to 5% in October for the first time since 2007.<sup>4</sup>

<sup>1</sup> Bloomberg  
<sup>2</sup> Bloomberg  
<sup>3</sup> Bureau of Economic Analysis  
<sup>4</sup> Bloomberg  
<sup>5</sup> Bloomberg

However, as price pressures abated over the fourth quarter, the possibility of more rate hikes faded. Softer economic data, muted price pressures and a weaker labour market boosted confidence that the hiking cycle may well and truly be over. Investors also began rapidly pricing in rate cuts for 2024. The Fed's last meeting showed a dovish pivot with a median projection that interest rates will be around 4.5% by year-end 2024, down from current levels of 5.25%. However, following the Treasury market rally in recent weeks, investors now expect an even sharper drop in interest rates, forecasting rates will hover around 4% at the end of 2024. Ten-year Treasury yields retreated to below 4% as a result, cementing a remarkable 1% drop in less than two months.<sup>5</sup>

## Commodities weakness

Commodities faced challenges as Chinese economic data consistently disappointed, despite incremental policy loosening in China aimed at enhancing growth prospects. Geopolitical tensions, spurred by the conflict in the Middle East, initially sent oil prices up sharply, though in recent months Brent has retreated sharply to 2023 lows despite further production cuts announced by OPEC+.

## Divergent monetary policies

Whilst the Fed showed signs of a dovish pivot, both the Bank of England (BoE) and the European Central Bank (ECB) remained more steadfast in their December meetings. The BoE has the longest uphill battle when it comes to reaching its inflation target, and ideally would like to see wages come down before it considers any rate cuts. Its position is also complicated by potential further fiscal loosening ahead of the next UK general election. Growth is muted and inflation is declining, although inflation remains higher than other developed countries.

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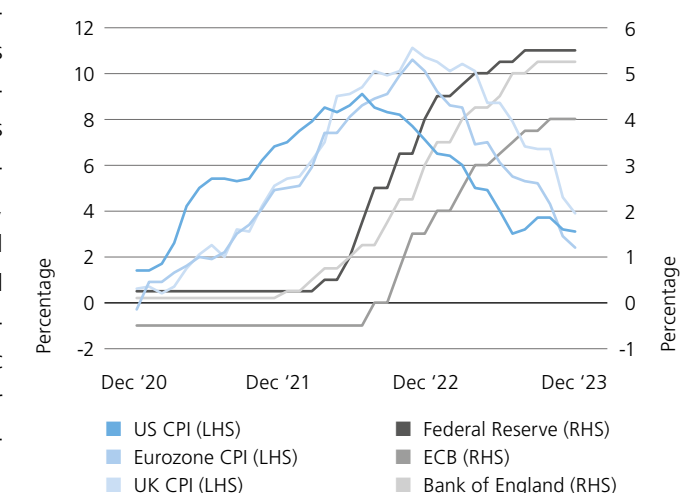
Investors have higher conviction that the ECB rate cuts will be forthcoming, with growth in Europe stagnating for months, as the economy flirts with a recession. The headline Eurozone inflation has moved rapidly lower to 2.4%, indicating that growth dynamics may continue to be weak.<sup>6</sup>

## An end to the rate hiking cycle

As financial markets price in the end of interest rate increases, the rate hiking cycle that began at the beginning of 2022 and caused so much pain for investors appears to be behind us. Investors' focus is shifting from inflation concerns and towards softening economic growth. Risks are always present as financial conditions remain constrictive – higher interest rates have made borrowing more expensive, which has reduced spending and investment. Central banks may pre-emptively cut rates towards the end of the first quarter, which should help boost economic activity. Despite the uncertainty, the economic landscape of 2023 has given rise to opportunities for a reimagined 60/40 portfolio. By holding bonds, in-

vestors can now generate annual income of around 5%, while once again gaining protection from extreme shocks. Within equities, we continue to favour quality companies which should be resilient regardless of the economic outlook due to their strong balance sheets, low debt levels and pricing power. We believe that these factors will offer the best opportunity for consistent results over the long-term.

US, UK and Eurozone CPI inflation vs central bank policy rates



Source: Bloomberg, LGT Wealth Management

<sup>6</sup> Eurostat

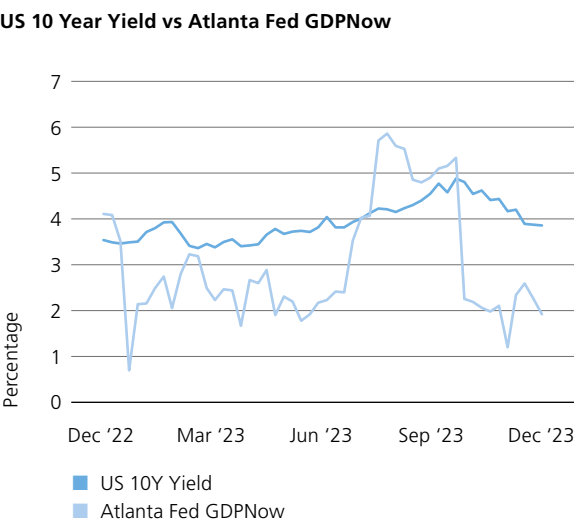


# Fixed income

Looking at ten-year Treasury yields at year-end 2022 and 2023, one would assume bond markets were relatively calm. These bonds were yielding 3.87% at the end of 2022, and by the end of 2023, only moved up 0.01%. But government debt has experienced extreme volatility in the past two years.

### Navigating yield peaks

Yields jumped to a 16-year high of 5% in October, as central banks’ interest rate hiking regime encouraged bond investors to sell longer-dated bonds in favour of shorter-dated ones paying higher rates. (Bond prices move inversely to yields, so when yields rise, bond prices fall.) This quickly reversed in the final two months of the year, as markets became increasingly confident the Federal Reserve will manage to successfully engineer a soft landing. All told, ten-year Treasury yields experienced a trading range of 1.2% in the last two months of the year, finishing the year at 3.87%.



Source: Bloomberg, LGT Wealth Management

### Restoring confidence: bond market resilience

In recent years, investors have become accustomed to inflation surprises driving bond yields upward. During the third quarter, a combination of fiscal concerns and robust economic growth prompted investors to embrace the Federal Reserve’s ‘higher for longer’ rate narrative. Unlike previous bond market selloffs, where shorter maturity debt led the decline due to its heightened sensitivity to immediate interest rate changes, this time, longer maturity debt took the lead. The closely watched spread between two-year and ten-year maturity Treasuries, which had been deeply inverted for most of the year, normalised as credibility in the Fed’s language increased, magnified by substantial deficit financing. Essentially, investors shifted away from accepting lower yields for holding longer maturity debt. These dynamics changed in November when softer data indicated a potential wane in fiscal support that had fuelled US growth. Furthermore, while questions linger about the effectiveness of monetary policy, its impact seems more delayed than entirely blunted.

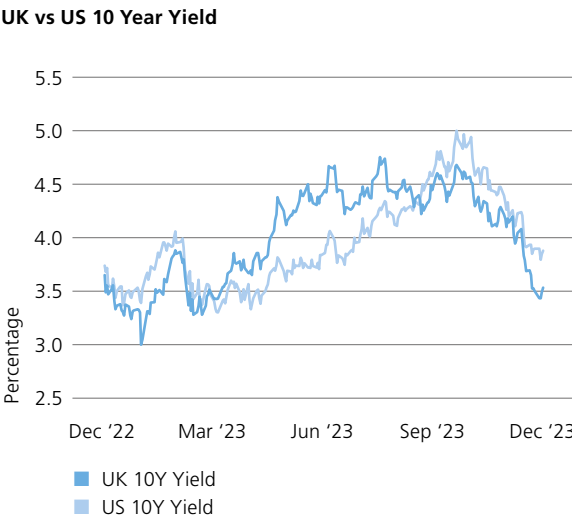


### Opportunity for growth

Recent inflation figures in developed markets fell short of central bank predictions, presenting an opportunity for central banks to implement rate cuts throughout 2024 amid waning economic momentum. The Fed’s dovish stance in its December meeting drove rallies in both bond and equity markets, fostering an environment conducive to increased borrowing, investment and spending, potentially stimulating economic growth even before interest rates are cut. Whilst this has increased the likelihood of a soft landing, inflation resurging remains a possibility. In the latter part of the fourth quarter, bonds and equities moved in tandem, benefiting 60/40 portfolios. The Bloomberg 60/40 Index gained 10.2% in the fourth quarter, the best performance in over three years. As growth becomes scarce in 2024, investors will closely watch bond markets to see if bonds and equities become negatively correlated or move in opposite directions. (Negative correlation between equities and bonds acts as a natural hedge-- when equity markets experience sharp downturns, bonds offer protection.)

### Central bank caution

The BoE and the ECB are more cautious. Both are keen to avoid heightened anticipation of rate cuts, emphasising their data dependency nature. Out of nine Monetary Policy Committee BoE members, three voted for a further rate hike in the December meeting, showing relatively hawkish sentiment. However, markets did not give much attention to the BoE’s message, as seen by Gilt yields, which remained lower than US Treasury yields. Stagflation—a combination of stagnant growth, high unemployment and high inflation – have plagued these economies for most of the year, so any policy loosening by the Fed, the de-facto central bank of the world, will provide them with increasing scope to ease policy.



Source: Bloomberg, LGT Wealth Management

Corporate bond markets performed strongly over the quarter with many investors keen to lock in attractive yields. Corporate bond supply has been muted relative to prior years given the material increases in interest rate costs. Taken together with elevated input and labour costs, companies have been keen to ensure their balance sheets are well positioned to navigate a challenging growth backdrop.

# Equities

## International Equities

After global equities dropped slightly in the third quarter over concerns inflation may be higher for longer, the fourth quarter saw an almost 180-degree shift as inflation fell across most parts of the world. The subsequent large drop in bond yields and heightened expectations for significant cuts in interest rates in 2024 meant it really was ‘risk-on’ for equities through the fourth quarter.

## Equities beyond AI

The common narrative about 2023’s strong equity performance being solely attributed to artificial intelligence ‘mega cap’ stocks is only a half-truth. The thirteen-percentage point difference between the +24% performance of the S&P 500 index in the US (market cap weighted) and the +11% of the S&P equal weighted index is testament to the largest stocks in the index having performed significantly better than the rest. However, plenty of other stocks had a great 2023 too (such as online travel operator booking.com, which surged +76%). In the fourth quarter, the change in inflation / interest rate expectations helped the S&P 500 and the technology-focused Nasdaq post gains of 11% and 14% respectively. The equally weighted S&P 500, which gives the same importance to each stock or asset regardless of market capitalisation, also rose 11% in the quarter, the same as the market cap weighted index. Though, yet again, technology led the way, with the

S&P 500 IT sector’s +17% return only bettered by the hugely interest rate sensitive real estate sector’s +18% return. After a volatile first three quarters of the year: -4%, +33%, and -12%, the S&P Financials sector joined the inflation / interest rate party in rising +13% over the quarter. If this seems curious given falling interest rates are bad news for banks, the receding threat of a hard landing and consequent increase in bad loans appears the bigger factor driving performance.

## Sector spotlight

With prospects of an imminent recession receding, the consumer discretionary sector posted a double-digit return (Amazon +20%), as did the global GDP-driven Industrials sector. Good news for railroad Union Pacific +20%, not to mention airplane maker Boeing +36%. Meanwhile, the S&P consumer staples sector even after a +5% gain during the quarter, ended 2023 lower than it started it, perhaps because volume declines show there are limits to how much you can put up the prices of fizzy drinks, crisps and detergents...

S&P 500 Index vs Shanghai Composite Index over 5 years



Source: Bloomberg, LGT Wealth Management

## A global outlook

Europe also experienced gains, with the German Dax index +9% in the fourth quarter and +20% for the year, and the CAC index in France +6% and +17% respectively. And, while the Topix index in Japan rose only +2% in the fourth quarter, the +25% 2023 return was its best annual return in a decade. The same of which cannot be said of China, where the great-reopening trade proved disappointing. The Shanghai Shenzhen composite fell -11% in the quarter and -7% in the year while the Shanghai composite dropped -4% for both.

## UK Equities

It was hardly a banner year for UK stock market investors, with the FTSE All-Share Index posting low single-digit returns. Despite an underwhelming 2023, a handful of diverse stocks from various sectors delivered strong returns.

## Remaining selective

Aerospace parts specialist Melrose, accounting software group Sage, asset manager M&G, currency transfer specialist Wise, and Whitbread, the holding company of the Premier Inn hotel chain, all posted solid gains, underscoring the importance of stock selection. Given 2024 will almost undoubtedly be dominated by a general election, stock selection will continue to be crucial.

Notably, the final three months of 2023 saw the mid-cap index FTSE 250 stage a strong recovery, driven by investor optimism on the fight against inflation, bond yields falling, and a reappraisal of the merits of the more UK-focused mid-cap names.

## A surge in M&A

We have not been particularly enthused about UK mid-cap names, and with election uncertainty this year, will most likely continue to prefer larger and more globally orientated FTSE 100 stocks. However, we believe corporate activity may lead to a fresh wave of enthusiasm for the FTSE 250 index and its underlying companies.

There were 40 transactions worth more than GBP 100 million announced in 2023, with the pace increasing through the year. The deals were predominately in the smaller company space, with just three offers made for large and mid-cap companies. The acquirors paid an average premium of 50%. This is

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Russell Harrop, Head of Equities





well above the typical 30-40% premium paid in bids over the past decade, although worth noting it was pushed higher by the 170% premium that Mars, the giant family-owned confectionary (and pet food!) company, paid for Hotel Chocolat. Around 30% of companies have delisted from the UK Small Company index over the past five years, underscoring how busy the bidding environment has been.

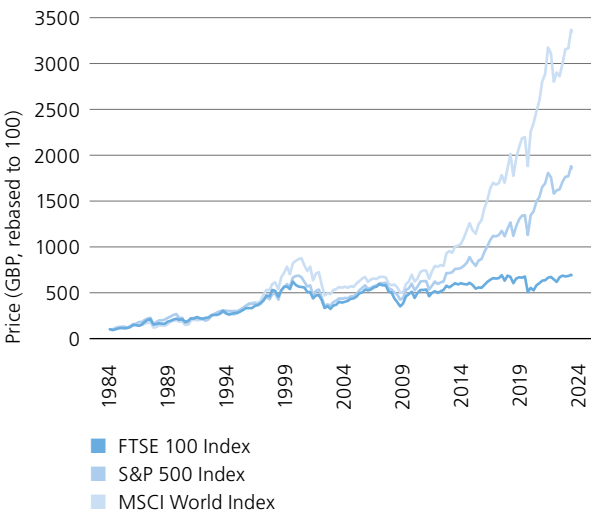
A shrinking presence

The UK has been out of favour with investors for around six years now. Brexit has played a role, as has sterling weakness (a weak currency erodes overseas investors’ returns). But the fact remains that the UK market has become progressively less important. It now accounts for less than 5% of the MSCI’s All-Country World Index and shows little growth.

Many believe US and Chinese companies, not those listed in the UK, will be at the forefront of innovation. The UK market is now worth just over GBP 2.3 trillion. In theory, one could sell Apple, buy all the stocks listed in the UK and with the spare change, buy JP-Morgan, the largest bank in the US.

Despite UK stocks being out of favour, it’s worth reflecting how much UK investors have garnered over four decades. RELX Group, previously the Reed Group and Elsevier-Reed, is the strongest performer, returning over 36,000% since the FTSE 100’s inception. Since 2000, the top performing stock is Rio Tinto, the iron ore and mining specialist, which has delivered a cumulative return of over 2,000%. That’s 20 times the original investment and the sort of return that may spark the interest of even the most jaundiced investor.

FTSE 100 vs S&P 500 vs MSCI World



Source: Bloomberg, LGT Wealth Management

“Given 2024 will almost undoubtedly be dominated by a general election, stock selection will continue to be crucial.

James Follows, Head of UK Equities

# Key market data

Key market data (as at 31 December 2023)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4232	4.40	2.54	3.31	3.85	15.20	15.15	3.85
S&P 500 (USD)	4770	4.42	11.24	7.18	24.23	26.99	90.27	24.23
Euro Stoxx 50 (EUR)	4521	3.17	8.31	2.78	19.19	27.27	50.64	19.19
Nikkei 225 (JPY)	33464	-0.07	5.04	0.83	28.24	21.94	67.20	28.24
MSCI World (USD)	2462	4.20	9.96	7.18	23.75	30.21	90.21	23.75
MSCI AC Asia Pacific ex Japan (USD)	618	3.68	5.05	3.28	7.99	-5.85	33.75	7.99
MSCI Emerging Markets (USD)	61542	3.18	5.65	4.28	10.29	-6.31	32.68	10.29
10 year bond yields **								
UK	3.53	-0.67	-0.87	-0.88	-0.13	3.34	2.26	-0.13
US	3.88	-0.48	-0.69	0.07	0.00	2.96	1.20	0.00
Germany	2.00	-0.48	-0.81	-0.40	-0.53	2.58	1.76	-0.53
Japan	0.61	-0.06	-0.15	0.22	0.19	0.59	0.62	0.19
Commodities (USD)								
Gold	2062.40	1.19	11.60	7.36	13.34	8.94	60.79	13.34
Oil	77.04	-6.99	-19.17	2.86	-10.32	48.73	35.02	-10.32
Currency								
GBP-USD	1.27	0.70	4.44	0.27	5.98	-6.74	0.09	5.98
GBP-EUR	1.15	-0.54	0.10	-0.97	2.39	3.30	3.58	2.39
EUR-USD	1.10	1.24	4.34	1.25	3.50	-9.72	-3.37	3.50
USD-JPY	140.98	-4.64	-5.53	-2.46	6.85	36.55	28.50	6.85

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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