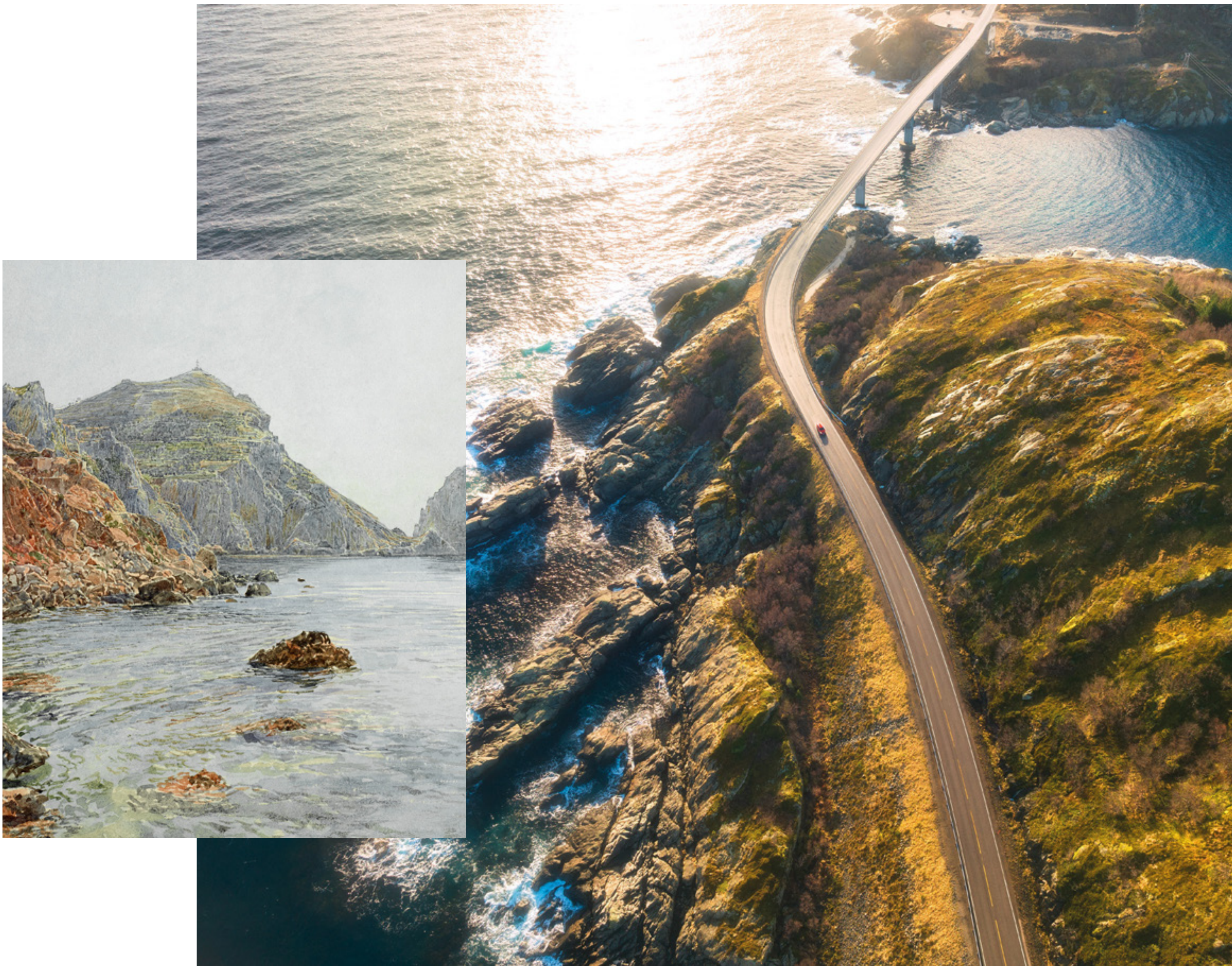
Wealth Management

# Outlook 2024



Forward-looking
for generations

**Cover image**
Rudolf von Alt (1812–1905), detail from
"The faraglioni rocks of Capri," 1835


# Contents

Sanjay Rijhsinghani, Chief Investment Officer



# A message from our CIO

Dear Reader,

I would like to start by wishing all our clients a very happy 2024.

Welcome to the first edition of our new annual outlook document, where we will explore the global economic landscape and discuss macroeconomic shifts that shape our vision for the future.

In a world of evolving opportunities and dynamic challenges, our outlook offers a forward-looking perspective that explores the latest market trends, geopolitical developments and economic indicators. This publication serves as a guide to key investment trends, ultimately determining our investment strategies and positioning our clients for success in an ever-changing environment over the long term.

Making market predictions is challenging at the best of times. However, the task becomes even more formidable when grappling with uncertainties such as the swiftest rate-hiking cycle in recent history driven by inflation concerns coupled with geopolitical events. It's evident that many 2023 forecasts missed the mark, with anticipated scenarios like a recession in the West, Chinese markets outperforming their developed counterparts, a mid-year pivot by the Federal Reserve and bonds outperforming equities not materialising as expected.

Forecasting is complex and, in many cases, impossible. Which is why, at LGT, we do not manage portfolios based on short-term market movements. Instead, our analysts highlight global shifts, themes and trends that reshape the investment landscape over the long term.

In the following sections, we will briefly discuss what the elections in some of the major global economies mean for markets as policies and geopolitical tensions take centre stage. We look at why Asian markets are poised to outperform developed markets as high interest rates begin to weigh on consumer and corporate balance sheets in the West. We also outline areas that should perform well now that interest rates, we believe, will start to come down. This includes private equity and corporate bonds. Quality companies, which have resilient business models, low debt and stable cashflows, will always remain a pillar of our investment approach, whether it's in our equity or bond portfolios.

Sanjay

Sanjay Rijhsinghani
Chief Investment Officer, LGT Wealth Management

# Global economic outlook 2024

Finding value in the treasure chest of yesterday's forecasts.

Sanjay Rijhsinghani, Chief Investment Officer

As we enter 2024, we believe the market focus will shift away from inflation to growth. Recent data suggests that the process of 'disinflation' is underway, and interest rates seem to have peaked. Looking at recent central bank communication, the big question is not whether rates start coming down in 2024 – but why.

## Immaculate disinflation

**(i.e., slowing inflation allowing for rate cuts without causing recession)**

Will central banks lower rates, or will the long and variable lags result in an economic slowdown prompting central banks to cut faster than markets are expecting? Each of these two scenarios may result in very different outcomes for equities. A scenario where immaculate disinflation prevails would likely be positive for equities. Conversely, a situation where central banks react swiftly to market-driven economic deceleration might favour the security of high-quality corporate and sovereign bonds. In navigating this landscape, investors must remain vigilant and adaptable, as the unfolding dynamics between inflation, growth and central bank responses will play a crucial role in shaping market conditions throughout the year.

Over the past 19 months, the world has grappled with the reality of central bank rates surging at an unprecedented pace from being close to zero for a long time. Against this intense monetary policy headwind, brokers and analysts were certain that the first half-year of 2023 would bring a US recession. Fast forward one year, and the global economy has taken a very different turn: the US delivered some economic growth throughout 2023, helped by intense fiscal support and resilient consumption amid strong labour income gains. On the other hand, the widely anticipated Chinese growth boost amid its re-opening fell well short of expectations. The slowdown in China became a major burden on global growth and particularly closely interlinked economies like the Eurozone, where output had already suffered from the war in Ukraine leading to the natural gas price crisis.

Notwithstanding the improvement in returns in 2023, the challenging macroeconomic backdrop, along with the higher rate regime, should provide greater investment opportunities and options in both bonds and equities in 2024.

## Taking stock of where we stand to identify the likely path in 2024

This year should see a continuing of divergence between regions. Throughout 2023, the US economy grew an average of 0.7%[1] each quarter, strongly outperforming the Eurozone's zero growth, and the troubled Chinese economy, which expanded by a disappointing 1.2%[2] on an average quarterly basis. Although these numbers are disappointing, they are still surprisingly robust considering intense headwinds from monetary policy, geopolitical developments, weak external demand, rising input costs and tight labour supply.

[1] Bloomberg
[2] Bloomberg



> "In navigating this landscape, investors must remain vigilant and adaptable as the unfolding dynamics between inflation, growth and central bank responses will play a crucial role in shaping market conditions throughout the year.
>
> Sanjay Rijhsinghani, Chief Investment Officer

This resilience is indeed encouraging, and understandable considering a few key aspects that painted the global economic landscape going into this "interest rates hurricane".

- First, pent-up savings from previous fiscal stimulus packages and the lack of spending opportunities due to lockdowns meant that the American consumer entered this slowdown with a comfortable safety cushion.
- Second, the red-hot US employment market offered an enormous labour demand overhang when the world recovered from the Covid crisis, not only leading to sizeable wage gains but also providing an additional buffer to keep consumer spending buoyant even in the face of acute price pressures.
- Third, and probably most surprisingly, US fiscal spending came at a pace that offset much of the interest rate-induced slump in business spending, making the US economy even more resilient.

These factors have been decisive in the ability of the US to cope comparatively well with the tighter financial conditions as monetary headwinds continue to stall the global economic engine.

## Optimising returns amid trend shifts

The years 2022/2023 highlighted the effectiveness of cash in a rising interest rate environment. Investors were grappling with uncertainties surrounding corporate profitability amid these conditions. Looking ahead to 2024, we expect to see cash as a less attractive choice in a declining interest rate climate. This is anticipated to be complemented by an upswing in earnings and improved growth expectations. Consequently, we believe that risk assets will outshine cash as the preferred investment option for the year.

Corporate bond fortunes were initially tied to the interest hiking cycle. Given the quantum of debt refinancing that's due over the next few years, concerns mounted over the so-called maturity wall—i.e., when debt is due. Management of indebted companies became more cautious and took measures to strengthen their balance sheets. Central banks have also kept liquidity flowing through markets, which has helped moderate financial conditions. This indicates the level of defaults will likely remain benign when compared to previous cycles. This makes owning corporate debt look favourable, excluding companies facing extreme stress.

In 2023, certain sectors faced undue scrutiny, overshadowed by the market's primary focus on AI. While we acknowledge the continued dominance of AI on a global scale, 2024 should see a resurgence of undervalued sectors from last year, including healthcare, consumer staples and more (all of which will also benefit from the continued development of AI).

## Grounds for optimism

The resilience displayed by the global economy has defied expectations, with robust government spending and a high consumer savings rate playing pivotal roles. However, the sustainability of these factors as the driving forces behind continued US economic growth raises questions. Despite this uncertainty, there are grounds for optimism.

Several positive indicators contribute to a hopeful outlook: pricing pressures are subsiding, energy prices remain low and the upcoming election year in 2024 suggests a potentially more accommodative stance from governments. Equity valuations in many regions are reasonable and corporate balance sheets are in solid shape, providing a strong foundation for supporting and reinforcing equity markets.

Nevertheless, resurging inflation remains a potential concern. The market, in the short term, appears to have been overly optimistic, having priced in excessive expectations of rate cuts, which could introduce volatility. While the outlook for bonds has dramatically improved, we would encourage patience as the market has oscillated wildly last year. This suggests that there may be better entry points ahead to add government debt exposure.

Asia's detachment from the Western economic landscape, coupled with access to commodities in local currencies, presents a promising scenario for growth and the underlying equity markets. However, a caveat exists in the form of China. Notably, concerns surrounding consumer confidence in the property market and geopolitical tensions with the U.S. may persist, especially in a contentious election year, potentially deterring investors.

In summary, we believe that 2024 will mark a shift in market focus towards growth. Over the past 18 months, there has been a sense of caution, fuelled by concerns that central banks might engineer a recession. Contrary to this narrative, we anticipate that companies, beyond the top players, will be rewarded based on positive developments.



# Seeking stability through quality

Jeremy Sterngold, Deputy Chief Investment Officer

We believe quality companies will be a central theme for 2024. In 2023, the S&P 500 surged 26.3%,[3] driven by the artificial intelligence boom and AI's impact on the so-called 'Magnificent Seven' technology stocks. These companies, which include Meta, Apple and Alphabet, collectively delivered a staggering 107% return last year. (It is worth noting that when considering an equally weighted basis – which gives the same importance to each stock within the index, regardless of market capitalisation—the S&P 500 'only' gained 13.8% in 2023.)[4]

However, given the recent acceleration in disinflationary trends and high interest rates, the landscape for growth is likely to become more challenging this year. This means owning robust businesses with a focus on earnings and cashflow will become crucial. In fixed income, ensuring the credit quality of bonds will be equally important.

## Chasing resilience

While some investment styles, such as growth investing, prioritise finding the fastest growing companies, quality investing aims to identify financially strong businesses offering sustainable and attractive returns. Quality companies have resilient business models, low debt levels and positive cash flows, and should therefore be positioned to withstand a slowdown in growth.

We prefer companies less vulnerable to cyclical and structural headwinds. Companies in consumer staples and healthcare sectors are better positioned to withstand weakening demand and deflationary pricing power compared to cyclical companies. People will still buy toothpaste as the economy slows but are far less likely to buy a new car. So stocks which offer steady, consistent sales and earnings might move in favour relative to cyclical companies such as car manufacturers.

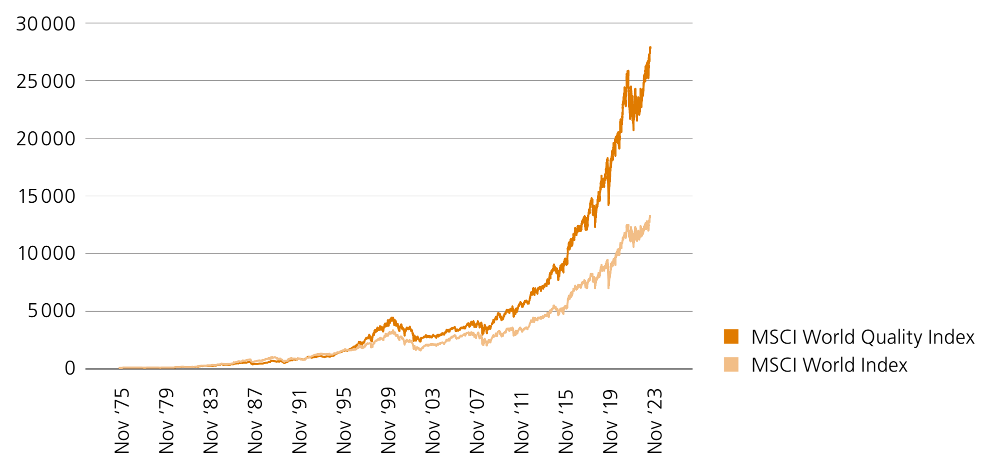
There are several reasons why we believe quality equities and bonds will play an important role in multi-asset portfolios in 2024.

1. As inflation pressures recede, we expect markets to focus on slowing economic growth. Fiscal support helped the US economy grow faster than expected in 2023, but in 2024, we believe a potential growth slow-down will make it more challenging for businesses to see revenue and earnings growth.
2. In a low-growth environment, companies capable of sustaining growth look more desirable for investors. The combination of predictable bond returns and defensive stocks, namely consumer staples, are currently trading with attractive historic valuations, making it an opportune time to invest.
3. While more indebted businesses delivered the strongest returns for bond investors last year, as top-line growth and earnings come under pressure, investors will likely demand more compensation to hold these types of businesses. As such, higher rated bonds are likely to be a good source of return for investors this year.

Given market uncertainty, quality companies provide steady, consistent returns whilst also having defensive characteristics in down markets. We have a well-established preference for high-quality equities, which we believe will help cushion in the next economic turn of the cycle.

[3] Bloomberg
[4] Bloomberg

**MSCI World Quality Index vs MSCI World Index since inception**




Bloomberg

# Unlocking Asia's potential

Henry Wilson, Senior Portfolio Manager

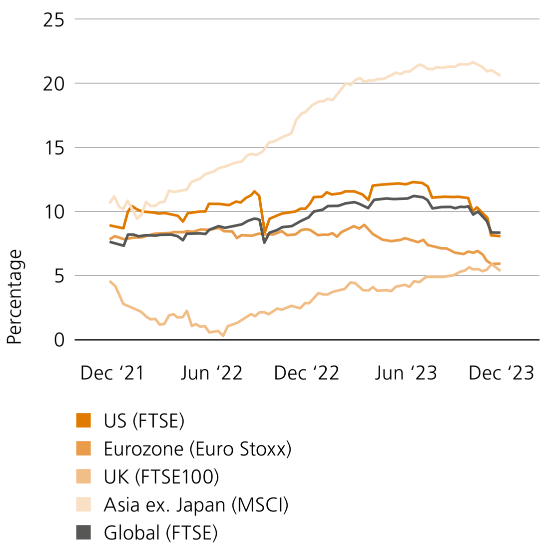
2023 was a mixed year for Asian equities, both in absolute and relative terms. Notably Chinese equities, the dominant force in the region, faced significant challenges, with onshore and offshore markets experiencing declines of 18% and 6%, respectively.[5] Meanwhile Indian equities, the other large player in the region, demonstrated their resilience and performed well, posting commendable gains of 14%.[6] So given the mixed year behind us, do we still see value in the region and if so, why?

## Economic and earnings growth: a shining light

As we enter 2024, Asia's strong economic and earnings growth is expected to be a source of optimism. This contrasts with Western economies such as the Eurozone and UK, where economic growth is expected to slow on the back of higher rates. Against a backdrop of limited economic growth globally, Asia's attractive growth should set it apart. India surpassed expectations with an annualised GDP growth rate of 7.6% while China grew by 5.2% in 2024.

The chart 'Corporate Earnings Expectations for 2024 vs 2023' shows expected earnings per share (EPS) growth for 2024. The prospect of EPS growth rates of 5.5% and 6% for the UK and Eurozone may not evoke much excitement, even with low equity market valuations. Likewise, US earnings growth of 8.1% is also not that exciting, given rich valuations. On the other hand, Asia (ex-Japan) boasts EPS growth expectations of 20.6% - certainly a more compelling prospect for investors. Depressed by Western growth prospects, perhaps international investors will take note of Asian equities?

**Corporate earnings expectations, 2024 vs 2023**




Absolute Strategy Research (ASR)

## Trade and geopolitics

Asia's role as a Geostrategic Superpower continues to grow and, frankly, size matters. One cannot ignore the sheer scale of the region where circa 60% of the world's population reside and which accounts for around 45% of global GDP.[7] The decoupling between East and West continues and Asia is determined to stand on its own two feet, independent of whatever policies the West attempts to restrict Asia, or specifically China, from growing.

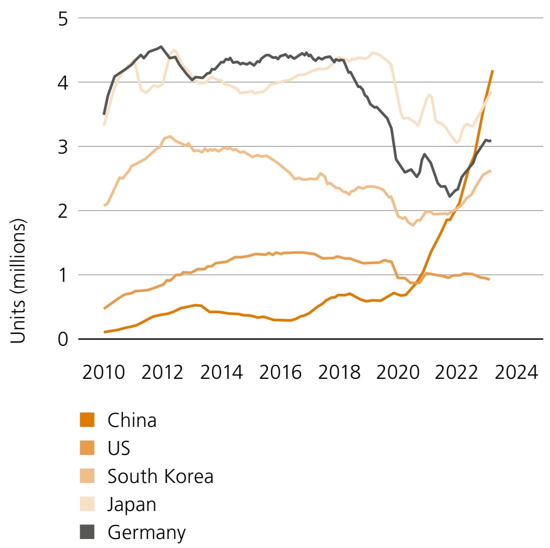
A great example of this is China's remarkable ascent to the summit of the global car export market, as highlighted in the chart overleaf. China continues to take a leading role in the Eastern bloc of economies and is aware of the need to become a self-sufficient, demand-led economy, free from the shackles of Western politics or sanctions.

[5] Factset
[6] Factset
[7] www.mckinsey.com/mgi/our-research/asia-on-the-cusp-of-a-new-era



After the creation of the new RCEP Asian trading bloc in 2020, the expansion of the BRICS in January 2024 (from 5 to 10 countries) is testament to the growing cooperation between Eastern economies and likely marks the beginning of a trend. As political uncertainty continues to beset Western economies, we expect Asia to take an increasingly prominent role globally, particularly in trade.

**China's export of passenger cars, rolling 12m sum**




Gavekal Research / Macrobond

## The energy landscape

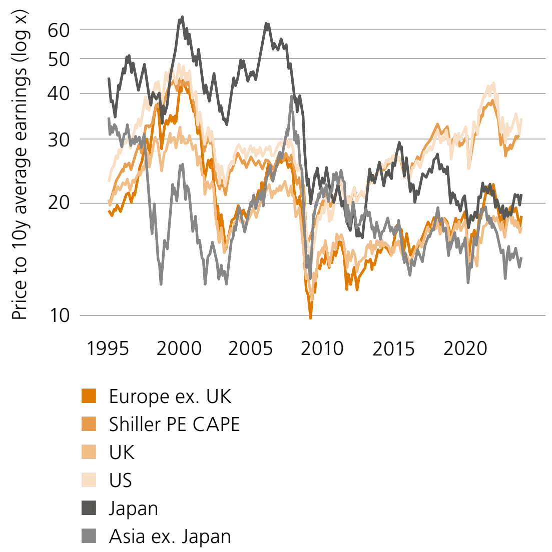
The global focus on energy security has gained greater prominence on global policymakers' agenda since Covid and then the onset of the war in Ukraine. Recent developments reveal that China and India, both significant global importers of oil, have emerged as major beneficiaries of the Russia-Ukraine crisis. They appear to have benefited from an arrangement to buy oil from Russia at a rumoured 30% discount to spot price (N.B. the actual amount has not been confirmed).

While the world transitions towards greener and cleaner energy sources, Asia's cheap energy access alongside China's control of circa 85% of the renewables supply chain, leaves Asia in an enviable position to be benefit from this structural change in energy demand.

## Valuations and growth potential

Valuations in the Asia Pacific region are attractive, particularly when you consider currencies and growth dynamics, and notably, when compared to the elevated US equity valuations. As the below chart demonstrates, valuations in the region are very attractive both relative to history and relative to other key markets. It is worth highlighting that India stands as an outlier with relatively rich valuations in the region. However, elsewhere in Asia valuations are downbeat which should provide some support should investor appetite return.

**Cyclically adjusted PE valuations by region**




Absolute Strategy Research (ASR)

## To summarise

Asia remains a real diamond in the rough, rich with exciting growth potential and favourable equity valuations after a mixed 2023. China is expected to continue with fiscal stimulus in 2024, India is expected to grow at a strong pace. While Asia may not currently have the financial market might of the US, it is undoubtedly an increasingly important player geo-strategically. We expect the East – West decoupling trend to continue and, with access to cheaper energy and a growing sense of co-operation between Eastern economies, perhaps this is the beginning of a new order.

Compared to the West, Asia boasts an enviable demographic situation. The growth of the middle-class consumer in Asia is a source of particular excitement, a demographic cohort that will take an increasingly prominent role within global growth dynamics over the next few decades. Opportunities are plentiful. We see a raft of investment opportunities within Asian consumer facing companies such as Indian banks, Chinese liquor companies, and Singaporean video game and e-commerce companies who are all potential beneficiaries of the long-term growth of the Asian consumer, despite being in optically very different end markets. The combination of attractive equity valuations both in relative and absolute terns, undervalued currencies and favourable demographics makes the region especially attractive from an investment perspective and perhaps 2024 will be the year that international investors take note.

# Governments move into election mode

Jeremy Sterngold, Deputy Chief Investment Officer

Ahead of what will be a year of controversial elections in the US, we have already seen some surprising results globally.

## Netherlands

In November, populist leader Geert Wilders's Freedom party (PVV) caused a dramatic upset by winning a significant number of seats in the Netherlands general election. Wilders's party needs the backing of other major parties before he can become prime minister, but his victory nonetheless sent shockwaves around Europe due to Wilders's anti-immigration views which include closing borders.

## Argentina

Meanwhile in Argentina, Javier Milei, a politician known for his radical and provocative policy proposals, won by a landslide in the country's run-off presidential election on 19 November. Milei's bold plan includes dollarising the economy by eliminating the Argentine Central Bank, a move that would help combat the country's hyperinflation. Mid-December, Milei's new government enacted plans to weaken its currency by devaluing the peso from roughly 390 to the dollar to 800, representing a staggering devaluation of more than 50%.[8] It was a drastic step and highlights just how serious President Milei is about reinvigorating the economy.

Ultimately, it is unclear if the Dutch and Argentine elections represent isolated events or trends that could spill over to the US and UK.

## Taiwan

In Taiwan, Lai Ching-te of the incumbent Democratic Progressive Party (DPP) won the presidential election, with analysts now forecasting increased tension between China and Taiwan for years to come as a result. After his victory, Beijing condemned foreign governments for "interfering" in its affairs by sending their congratulations to Lai. So far, there has not been any escalating rhetoric from the DPP or China, with research suggesting limited friction in the immediate aftermath. No invasion seems imminent, and the US and China appear keen to maintain the peace achieved when Presidents Joe Biden and Xi Jinping met in November.[9] However, greater risks will come later, and China can push back against efforts to deepen Taipei-Washington relations.[10] Geopolitical risks will remain in the region for some time.

## United States

As far as monumental elections go, look no further than across the pond. It is hard to understate just how extraordinary the upcoming elections in the United States are. The leading Republican presidential candidate Donald Trump and the son of the incumbent president are both on trial. Trump faces four criminal cases, including one in the District of Columbia related to the events on 6 January when a mob of his supporters stormed the Capitol and one in New York about falsifying his business records. Hunter Biden faces tax and firearm offenses, including lying on an application form about drug use to purchase a handgun in 2018.

[8] BBC, www.bbc.com/news/business-67688727
[9] Gavekal Daily – Where Now For China's Investibility?
[10] TS Lombard – Taiwan Election – Risk



Trump still has a 63% chance of becoming the Republican nominee, despite not being able to go out and rally as his trial continues.[11] It is worth taking a closer look at how these elections are decided. Margins are crucial. States where the margin of victory was below 3% have decided four of the last six elections. In 2000, 2004, 2016 and 2020, states with margins of 3% or less decided the presidency, and in 2000, 2016 and 2020, that margin was less than 1%.[12] This recent US presidential election data shows that the presidency is being determined by an extremely small number of voters. Despite Trump's legal battles, he currently leads Biden in four crucial swing states: North Carolina, Nevada, Georgia and Arizona, according to the US poll analysis website FiveThirtyEight. Furthermore, overnight on 15 January, Trump convincingly beat his rivals at the Iowa caucuses, putting him on course for a rematch against President Biden in November.

What would a Trump victory mean for markets? The biggest concern is his rhetoric around geopolitical events such as Russia's invasion of Ukraine and tensions between China and Taiwan. However, small businesses and banks may see a cut in red tape, which would support those sectors. Ultimately, a lot depends on how the House of Representatives and the Senate are divided and whether Trump has a majority.

## United Kingdom

The British also go to the polls this year to elect a new prime minister, with the Conservatives now facing a 1997-style wipe out. Even Chancellor Jeremy Hunt cutting taxes in his most recent autumn statement has not helped the Conservatives in the polls, with the tax cuts quickly drowned out by the material increase of net migration numbers, indicating a key Tory pledge has not been met. Prime Minister, Rishi Sunak, has fallen to his lowest opinion rating among Conservative campaigners. Sir Keir Starmer and his fellow Labour Party members are acting as the Government in waiting and have already met with businesses to discuss tactics. The upside to this is that when the UK 2024 election does take place, likely in October or November, it is highly probable it will be a non-event as markets will have priced in a Labour government.

## In summary

These elections come at a precarious time - geopolitical tensions are heightened with the Ukraine war, strains between the US and China, and now escalating violence in the Middle East. Given the Western support for war-torn countries in global conflicts, namely Ukraine and Israel and Gaza, any change in leadership could bring about different support and political aide.

Despite all the concerns around geopolitics, looking through these events, we find that, time and time again, investing in stable, cash generative businesses while having the flexibility to deploy cash should opportunities arise is the best approach in what will be a politically charged year.

[11] FiveThirtyEight
[12] Strategas

# Sustainability outlook

Ben Palmer, Senior Portfolio Manager

## The transition from fossil fuels

In 2015 at COP21 in Paris, and after years of painstaking negotiations, arguably one of the most important global agreements in history was signed by 196 UN parties. Its ambition was grand, yet its focus was simple: limit global temperature rises to well below 2 degrees Celsius above pre-industrial levels (1900) by the end of this century, and pursue efforts to limit increases to 1.5 degrees Celsius. This science-based roadmap for achieving this aimed to halve global emissions by 2030 and reach net-zero emissions by 2050. Whilst global warming and the effects of climate change had been known for several decades, the Paris Agreement really lit the touch paper on the project to decarbonise the global economy. A fundamental aspect to this is evolving our energy system away from reliance on highly polluting fossil fuels to low and zero carbon energy sources, such as solar and wind energy.

## New opportunities

Following the Paris agreement, we saw a surge in supportive policy measures and the falling cost of renewable technologies made them ever more competitive from an economic perspective. Today onshore wind and solar have become the cheapest forms of new electricity generation globally. The energy transition has created huge opportunities for companies across a broad range of industries that are creating cleaner energy systems and making our use of energy more efficient. This in turn has provided a very fertile investment landscape for investors looking to both contribute to and benefit from the energy transition. Whilst there are periods of volatility, many established companies and emerging challengers have experienced substantial share price increases.

Recently, some have questioned the importance and strength of the energy transition in the face of higher interest rates, rising geopolitical tensions and a lower growth outlook. However, we believe the structural drivers not only remain in place but are being consistently reinforced. This is evidenced by the continued escalation in green energy investment, particularly relative to fossil fuels, as highlighted in the chart overleaf from the International Energy Agency.

## Reflecting on COP 28

The United Nations climate change conference (COP 28) in the United Arab Emirates last year, proved to be contentious due to its location and connections with the fossil fuel industry. However we think the concluding statement and commitments should be viewed in a broadly positive light. We believe it signals the next gear change in the energy transition, and not just because it was the first explicit acknowledgement of the need to transition away from fossil fuels. More tangible were the two practical targets set, a commitment to treble renewable energy generation, and double energy savings by 2030. Recognising that the statements could have gone further, and that this now needs to be translated into policy, the trajectory of travel is clear and high-quality companies helping to deliver on these goals are well positioned. Despite the risks remaining, 2024 looks to be a promising year for investments in the energy transition theme and there are three key factors that support this outlook:

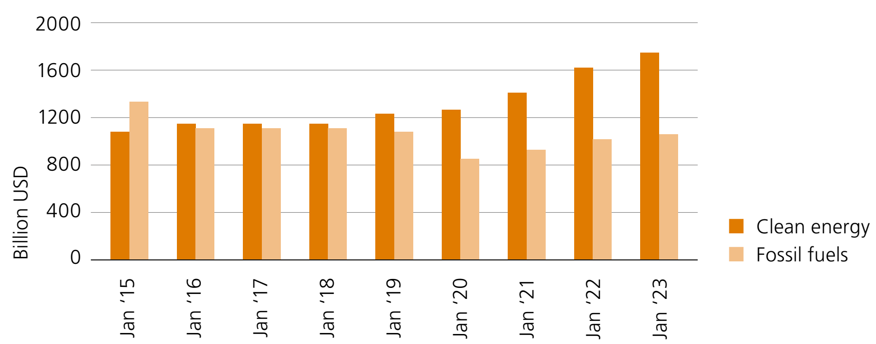
- increasing global policy commitments
- more stable inflation and interest rate expectations
- attractive valuations.

## Climate risk and the financial impact

There is increasing relevance to the energy transition and climate risk debate in terms of how it relates to an investment manager's fiduciary duty. Put simply, what an investment manager's responsibility is in acting in the best interests of their clients. As the financial costs associated with climate change become more apparent, and the aforementioned policy landscape tightens, there is an increasing consensus that climate risks are financial risks that are filtering down to corporate performance, and should be treated as such.

This change in perspective is significant as one of the central arguments against broader adoption of climate analysis in investment decision-making was that it would undermine the responsibility of -investment managers to focus on financial returns, whereas now it is not just seen as compatible but necessary. Moving forward, we expect to see more investment frameworks integrate climate risks. This has broader implications than focusing in on energy transition enablers as it impacts all areas of the economy. We have been considering climate-related risks in our analysis for several years and, as we continue to evolve our approach, we believe our ability to effectively value these risks will continue to improve, benefiting our portfolio management and fiduciary responsibility to our clients.

**Global investment in clean energy is outpacing fossil fuels**




IEA
Note: Estimate values for 2023

# Higher for longer

## What does 'higher for longer' mean for Private Equity investing in 2024 and 2025?

Robert Jolliffe, Head of Private Markets

Central banks have indicated that interest rates have peaked and the next series of rate moves will likely follow a downward path from their current fifteen year high. It is worth noting that despite this downward trajectory, interest rates are expected to remain at higher-than-average levels for some time. Against this backdrop, we are regularly asked about what the 'Higher For Longer' interest rate environment may mean for Private Equity investors over the next 18-24 months.

### 1. A much tighter liquidity environment for all

While generalisations about any asset class can be dangerous, it seems increasingly likely that well-established, broadly diversified sophisticated investors who have been committing capital to private equity funds over the last decade or more may face growing liquidity pressures over the next 12-18 months. There are several reasons for this.

**i. Slower than expected rate of distributions from maturing funds**

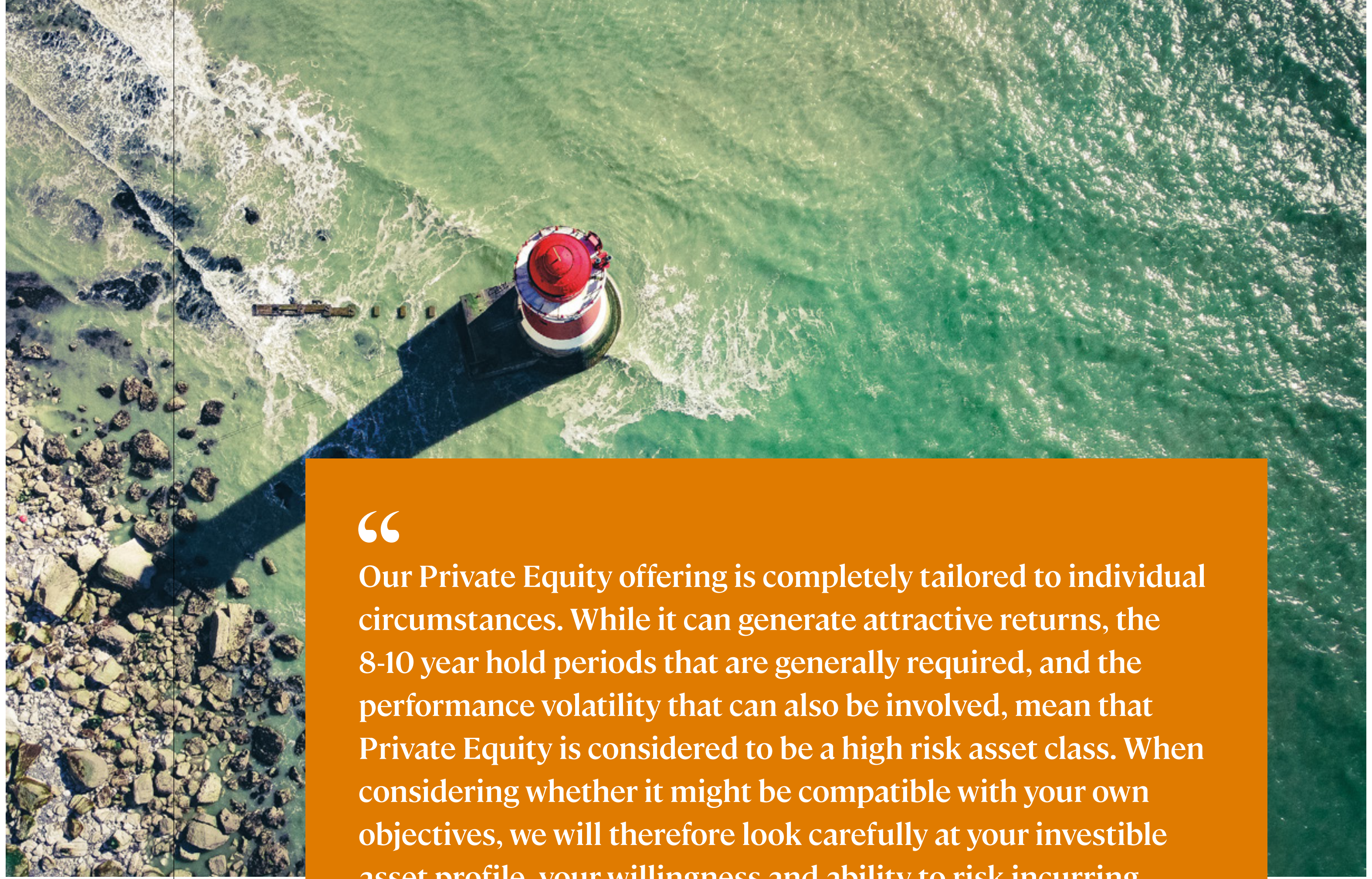
- The first is that the rate of distributions from maturing private equity instruments to which investors committed between five and ten years ago will almost certainly now be slower than might originally have been expected.
- From a valuation perspective, higher interest rates mean more aggressive discounting of future profit streams and lower prospective exit valuations. Therefore, managers of maturing private equity funds may well now decide to delay exits that were originally planned for 2024 or 2025.

As part of this trend, managers may also invoke their rights to extend the lives of their maturing structures, in the hope of selling their remaining portfolio companies at higher valuation multiples in 2-3 years' time as interest rates fall back to less challenging levels.

**ii. Faster than expected rate of capital calls from more recent funds**

- While the flow of distributions from their more mature investments may be slower than originally anticipated, the rate of capital calls that a broadly based investor will be receiving from the funds to which they have committed in the last 2-3 years or so may well now be significantly faster than originally expected.
- Even where fund managers do try to sell, prospective corporate or institutional buyers of the portfolio company in question will find that both debt and equity financing to cover the cost of the acquisition will be much harder and more expensive to come by, with the IPO (Initial Public Offering) based route to exit for portfolio companies in maturing funds still also being largely closed for the moment.





"Our Private Equity offering is completely tailored to individual circumstances. While it can generate attractive returns, the 8-10 year hold periods that are generally required, and the performance volatility that can also be involved, mean that Private Equity is considered to be a high risk asset class. When considering whether it might be compatible with your own objectives, we will therefore look carefully at your investible asset profile, your willingness and ability to risk incurring financial losses, and your capacity to commit a proportion of your capital to long-term investment structures.

Robert Jolliffe, Head of Private Markets

### 2. Differing implications for different type of Private Equity investor.

As mentioned above, broad generalisations about the 12-24 month performance outlook for a very diverse asset class like private equity are not always that helpful, especially given the different levels of leverage used by different kinds of private equity funds. That said, once considered on a more granular basis, the following trends look likely to continue for at least the next couple of years while interest rates remain at elevated levels.

**i. Lower returns for heavily leveraged, late stage, large cap buy-out funds**

- Heavily leveraged, late stage, buy-out funds that have relied heavily on increased levels of borrowing to boost the rate of return made at the asset level look likely to deliver significantly lower returns in the current higher interest rate environment.

Quantifying the extent to which returns may fall is clearly a very speculative exercise, but our own analysis suggests that somewhere between a third and a

quarter of the recent returns delivered by mega-cap, late stage, buy-out funds may have been generated by the beneficial impact of the unusually low interest rate environment that has prevailed for much of the last decade.

**ii. Further strong buying opportunities for distressed asset and secondary equities funds**

In the current interest rate environment, even some high-quality businesses will encounter difficulties and may well require restructuring. As a result, there should be no shortage of opportunities within the distressed assets sphere.

- Secondary equities specialists could reasonably expect to see a substantial expansion in the volume of opportunities available to them, accompanied by increasingly favourable asset pricing conditions, with the tightening cashflow environment, driving up the discount to NAV (Net Asset Value) at which cash strapped, later stage investors may need to sell down end of fund life secondaries funds positions to generate much needed liquidity.

**iii. Less competitive acquisition environment for unleveraged growth capital investors**

- With the allocation of funding to earlier stage venture capital strategies having fallen very significantly since the market peaked at the end of 2021, competition for deal flow amongst leading venture capital managers should also be significantly less intense over the next few years.
- From a wider risk-return perspective and given the tighter liquidity conditions and tighter fund raising environment, it is also worth noting that portfolio company founders are often now taking a much more conservative approach to business development, with slower hiring, less aggressive rollout strategies and a much greater focus on a shorter dated route through to break even and profitability.
- The fact that venture capital and early-stage growth funds have generally used little or no leverage and relied instead on top line revenue growth and improved operating margin-based value creation model, leaves them with little or no direct exposure to increased borrowing costs at a fund or an individual portfolio company level.



## 3. What does all this mean for asset allocations to Private Market funds in 2024 and 2025?

From a top-down asset allocation perspective, our advice remains largely unchanged. Subject to a suitability assessment based on their own personal risk appetite, and their willingness to hold illiquid assets for an 8-10 year fund life, we continue to believe high net worth investors should consider allocating capital to longer dated private debt and equity structures with the reasonable target of generating a higher return than they might be able to achieve in mainstream quoted investments over a similar period.

**i. Weighting by stage and instrument**

- The basis on which this top-down allocation is divided up between different unquoted asset opportunities will depend heavily on the individual investors risk-return profile. The various different strategies that we can make available would include tax enhanced seed and earlier stage venture capital funds, mid to later stage private equity growth funds, control stage private equity buy-out funds, secondary equities funds and distressed asset based restructuring and turnaround funds.
- Those with a higher risk appetite, who believe that interest rates will fall hereon may wish to consider venture capital and early to mid-stage growth funds.
- More cautious investors who expect further geopolitical volatility, high energy prices, stubborn inflation and persistently high interest rates should weight more heavily in favour of the more defensive distressed asset and secondary equity strategies outlined above.

**ii. Portfolio building process**

- As a wealth manager with a genuinely bespoke offering, and with an advisory, fund by fund approach in unquoted assets, our comprehensive risk-return and suitability-based discovery and relationship building process allows LGT Wealth Management to work hand in hand with existing or prospective clients to build private market portfolios that fully reflect their own individual instincts, preferences and objectives.



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