LGT vestraUS

VALUES WORTH SHARING

Quarterly report

Q4 2021 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 2021 summary

Looking back at 2021, investment markets have been dominated by three interlinked factors: the ongoing pandemic, the steep rise in inflation, and the potential withdrawal of central bank stimulus and interest rate rises. All these factors could have damaged the prospects for equity markets, and yet in December many indices reached new highs.

At a glance

- The new variant drives investor caution
- Inflation remains elevated
- Central banks start withdrawing stimulus
- Equity performance dispersion increases
- Governments look to balance budgets

Macro summary

The ongoing pandemic

The year had opened on an optimistic note, with the vaccine roll-out bringing hope for an end to the pandemic. Unfortunately, this was met with the spread of both the Delta and, more recently, the Omicron variants, reminding us that the pandemic is far from over. Omicron in particular brought with it more restrictions. While data suggests it is less dangerous, it appears to be more infectious. Thus far, the spread has been dramatic and is applying additional pressure to healthcare services. Given that most people are now set up for home working, the impact of the latest restrictions has been easier to manage in the short term. Despite an initial dip following the announcement of the new variant, markets have chosen to look through these developments to better times ahead.

Inflation

Inflation has risen dramatically, and the debate has been about how transitory this is. The increase is partly due to a recovery in prices from the depressed levels of 2020. There have been shortages of supply due to the pandemic, which was exacerbated by the Suez Canal blockage earlier in the year. With containers in the wrong place, shipping costs between Asia and the West have soared. The shortage of gas has seen energy costs rise steeply. In the UK, the full force of this will not be felt until the first half of the new year. As a result, in the UK, we are likely to see even higher annual inflation numbers in the coming months. However, there are signs of some commodity prices easing off their highs and, while we started last year with low base costs, the reverse may be true this year, easing inflationary pressures. While the market expectation is that inflation is more persistent, we believe that the rate will eventually ease back towards the central banks' 2% target as many of the price rises are not repeated in 2022.

> "Despite an initial dip following the announcement of the new variant, markets have chosen to look through these developments to better times ahead."
>
> Jonathan Marriott, Chief Investment Officer

Central bank stimulus and interest rate rises

In 2021, rising inflation put pressure on central banks to tighten monetary conditions. In the UK, we have already seen a small rate rise. Elsewhere, the bond purchase programmes put in place to support the economy are being reduced or coming to an end. This has been priced in with bonds selling off. However, with the surge of the Omicron variant and the fear that rising rates risk a fresh recession, longer dated bonds, particularly in the US, held up in the fourth quarter. Having priced in rate rises, we see some value in US shorter dated bonds for those looking to balance equity risk in portfolios.

Equity markets came through the scares of the last year to focus on a post-pandemic recovery. The debate within equity markets at the start of 2021 was value versus growth, with value strongly outperforming. By the end of the year, growth had caught up and, based on the US Russell Index, was slightly ahead. However, this debate disguises a concentration of return with some huge tech names particularly strong. Only a short time ago Apple was the first trillion-dollar company, at the end of 2021 it was flirting with market capitalisation of $3 trillion. The dispersion of returns has been high, and we expect it to remain so in the year to come.

Challenges will remain as central banks begin withdrawing the pandemic support and look to raise rates. Higher prices are in themselves a constraint on consumer spending. This, combined with interest rate rises and potential tax increases, may constrain economic growth after the recovery from the pandemic. As a result, we expect eventual interest rate rises to be moderate and less than the market has priced in. Overall, this will support selective equity exposure but retain a preference for companies that have pricing power and can pass on any rise in input costs. As long as COVID-19 vaccination rates remain low in many parts of the world, new variants are likely to emerge, which will no doubt add volatility to markets. As 2021 demonstrated, it may be best to look through these short-term developments to focus on long-term returns.

Fixed income

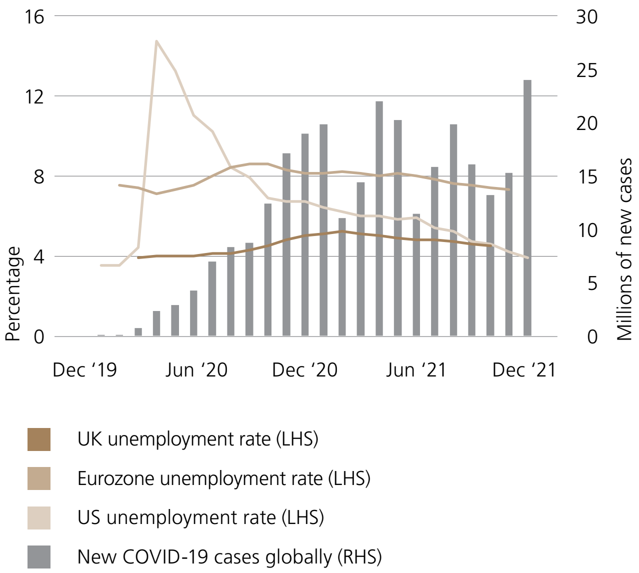
During the third quarter of 2021, major central banks began to adopt a more hawkish rhetoric regarding policy. By the end of the fourth quarter, we saw these words translate into action.

The new Omicron variant dominated headlines in December, although fewer hospitalisations and deaths have been reported than that seen in previous waves. Many countries have opted to reimpose restrictions, with some favouring short-term lockdowns. This is weighing on economies globally, particularly in leisure, travel and hospitality.

Despite this reignited strain on economic activity, there has been little response from governments. During previous waves of the pandemic, government support in the form of job support schemes has been available, particularly in the UK and US. This time around, both governments and central banks are more focused on price pressures in the economy given the prolonged period of above-target inflation. As the furlough schemes and enhanced employment insurance payments have expired, the labour market has continued to tighten. This has posed some concern for policymakers, as inflation could become a more permanent issue should this lead to a wage spiral. With this in mind, central bank priorities have shifted. While lockdowns and other restrictions may weigh on activity, the concern will be the additional pressure this places on supply chains as consumers once more substitute services for goods.

> "As the furlough schemes and enhanced employment insurance payments have expired, the labour market has continued to tighten. This has posed some concern for policymakers, as inflation could become a more permanent issue should this lead to a wage spiral."
>
> Jeremy Sterngold, Head of Fixed Income

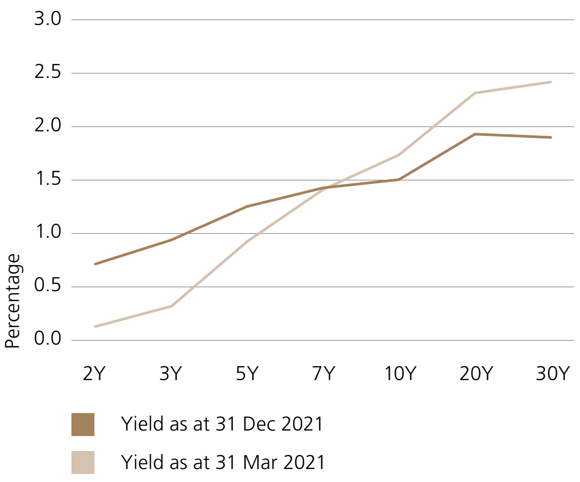
Unemployment rates in the US, UK, and EU and COVID-19 cases worldwide



Source: Bloomberg, WHO, LGT Vestra

The changes at the US Federal Reserve (Fed) over the year are remarkable. Looking back to March, the median projections showed their expectation for rates to remain on hold through 2023. As they had telegraphed at the September meeting, the Fed first tapered their $120bn asset purchases by $15bn a month in November. Only a few weeks later, Chair Powell stated to the US Congress that it was probably time to retire the word "transitory" as the base effects from the pandemic were likely to be behind us now. With that in mind, he opened the door to a faster pace of tapering, raising expectations of further policy adjustments. At the Fed's December meeting, they not only decided to double the pace of tapering to $30bn a month, but the median projections now showed three quarter percentage hikes in 2022, followed by a further three hikes in 2023. Quite a shift in stance relative to what they were communicating to markets only nine months earlier. These policy changes have led the US yield curve to flatten.

The US Treasury yield curve has flattened during the year



Source: Bloomberg, LGT Vestra

The Bank of England (BoE) has found its credibility challenged over the quarter. It first signalled that a rate hike was imminent ahead of its November meeting, but then waivered stating that they wanted to see more labour market data following the end of the furlough scheme. Given a robust labour market, the BoE subsequently raised rates in December from 0.1% to 0.25%. This to-ing and fro-ing has led to the press dubbing Governor Bailey as the 'unreliable boyfriend'. However, in our opinion, the way in which the BoE conducts its monetary policy made implementing an interest rate hike in November problematic. Their Quantitative Easing target meant that they were still buying bonds during the quarter, therefore had they decided to raise interest rates, they would have had to stop their asset purchases as well. This conundrum, and its signalling to the market of a much more pressing need to raise interest rates, is what we believe swayed the BoE to wait another month.

The BoE were not the only developed market central bank to raise rates over the quarter. They were kept in good company by the Norwegian Central Bank, the Bank of Korea and the Reserve Bank of New Zealand. In 2022, we should expect more banks to follow suit. The European Central Bank (ECB) does not foresee any changes in base rates, instead it vowed to end additional purchases from its pandemic program next year as planned. However, it moved to smooth the impact by temporarily increasing their other asset purchase program, thus opting for a more staged approach. Moving in the opposite direction, the People's Bank of China loosened its bank reserve requirements a touch to offset the impact of its embattled property sector following high profile defaults, including Evergrande.

Corporate bonds saw a modest correction following the rapid spread of the new variant. However, given the absence of wide sweeping restrictions and the solid state of corporate balance sheets, this correction was short lived and December ended as one of the strongest months for the US High Yield market.

Equities

International Equities

At first glance, the extremely strong performance of the US equity market continued into Q4 2021. The S&P 500 Index and the technology-heavy Nasdaq Index both rose 11%. Specifically, the companies that performed most strongly pre-pandemic have continued to do so during the pandemic. The S&P information technology sector led the way, rising 16%. Meanwhile, the previously ignored materials sector was only one percentage point behind as investors started to think that inflation might stay a little longer. However, beneath the surface performance was more concentrated than it has been. While both Netflix and Amazon saw their share prices rise considerably in 2020, more recently they have languished. In Q4 2021, Amazon's share price rose just 1%, while Netflix's share price fell 1%. Alphabet, parent company of Google had a stellar 2021 in rising 65%, though its 9% performance in Q4 lagged the sector and the index. The really big action, however, was even more concentrated. The world's largest company by market capitalisation, Apple, rose an astonishing 25% during the fourth quarter. Indeed, the $574bn in market capitalisation it added during the quarter was more than its entire market capitalisation only five years ago! Electric vehicle pioneer, Tesla, rose more than a third too, adding $285bn to its value; nearly two Royal Dutch Shells.

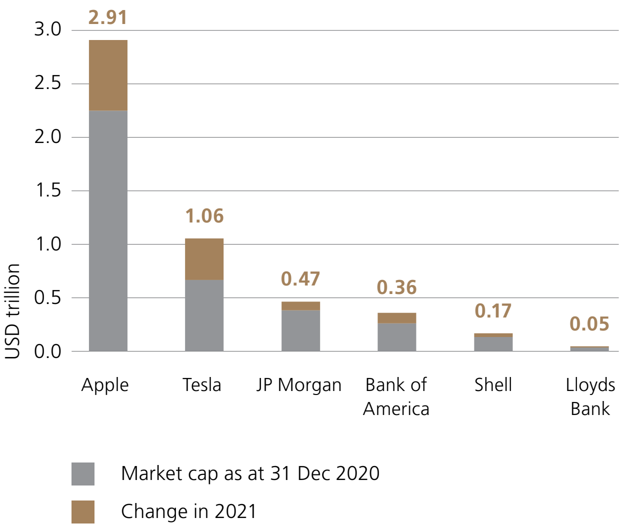
> "The world's largest company by market capitalisation, Apple, rose an astonishing 25% during the fourth quarter. Indeed, the $574bn in market capitalisation it added during the quarter was more than its entire market capitalisation only five years ago!"
>
> Russell Harrop, Head of International Equities

Surprisingly, given all the talk on inflation, the financials sector in the US rose only 4% during the quarter, with megabank JP Morgan falling 4%, though it still rose more than a quarter over the year. Competitor, Bank of America, added nearly 50% to its market capitalisation in 2021; this $100bn increase would buy you two Lloyds Banks, with $10bn of spending money for treats left over.

Once more, the MSCI Europe lagged US indices, though a 7% quarterly return is nothing to be sniffed at. Meanwhile over in Japan, tightening of COVID-19 restrictions and the closing of borders hampered share prices, with the Topix Index ending the quarter 2% lower. This is despite the positive impact provided by a 4% weakening of the Yen against the dollar. Both the Shenzhen and Shanghai Chinese indices eked out 2% gains as the government's action against US listed Chinese companies affected sentiment, even domestically.

We continue to focus on well managed businesses, with sensibly managed balance sheets that can compound away whatever slings and arrows are thrown at equity markets in the coming year.

Year-end market capitalisation of Apple, Tesla, JP Morgan, Bank of America, Shell and Lloyds Bank

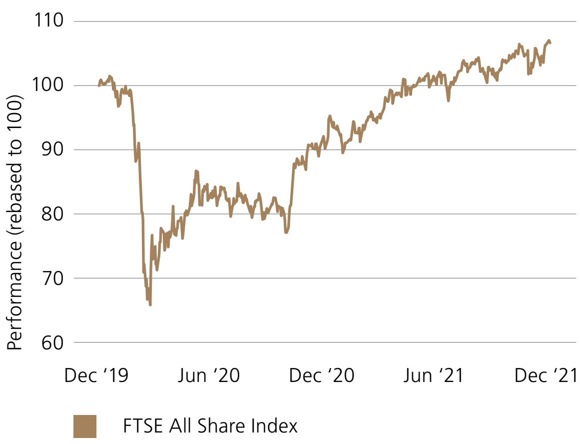


Source: Bloomberg, LGT Vestra

UK Equities

In 2021, UK stocks posted their biggest annual rise since 2016. The FTSE 100 Index rose by 14% and the FTSE 250 by 15%. With the addition of dividends, this translated into an FTSE All-Share Index total return of 18%. Consequently, the FTSE 100 Index has retraced its pandemic losses. Over the last quarter, the dispersion of returns within the index has been relatively broad. Energy and financial sectors lagged during the quarter but led the index over the year. Reopening sectors, such as travel and leisure, saw initial interest which faded towards the end of the year as the new Omicron variant weighed heavily on activity.

The FTSE All-Share index has recovered its pandemic losses

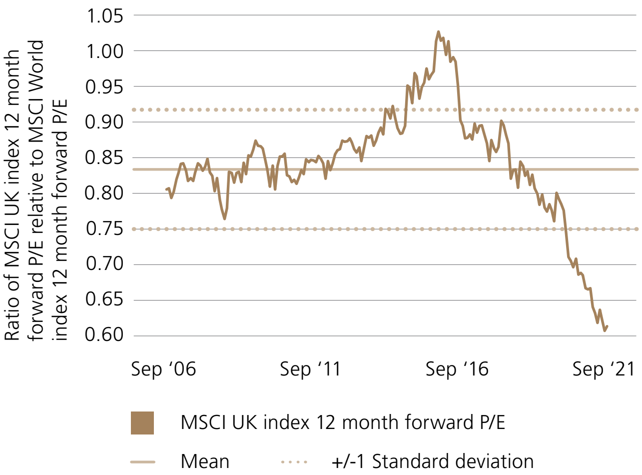


Source: Bloomberg, LGT Vestra

Nevertheless, as we have previously highlighted, the UK equity market continues to trade on a low relative valuation, and UK companies have seen a number of bids from overseas investors.

The cyclical aspect of the UK is often cited as the reason for its relative cheapness. However, as the chart below shows, the UK still trades at a discount to the global market. As a result, it would not surprise if bargain hunting by overseas predators proved to be one of the defining features of the market in 2022.

UK equity market remains cheap relative to global equity markets



Source: Bloomberg, LGT Vestra

Note: A ratio above one means the MSCI UK Index trades at a valuation more expensive than that of the MSCI World Index; a ratio below one means the MSCI UK Index trades at a valuation less expensive than that of the MSCI World Index; and a ratio equal to one means the MSCI UK Index trades at a valuation equal to that of the MSCI World Index.

General enthusiasm for the UK market will depend on robust global growth and easing cross-border tensions, rather than just domestic factors. A shortage of workers, driven by a rise in infections, may weigh on activity but is unlikely to have a longer lasting impact. Despite continued, albeit moderating, impact from the pandemic, the BoE has decided to look through this and start increasing interest rates. They are expected to increase rates at a moderate pace, with inflation pressures likely peaking in the first half of the year. Higher interest rates will provide support to the banking sector, but the impact on consumption remains to be seen with squeezed real incomes. How these counterbalancing factors play out will heavily affect market gyrations between value and growth sectors.

We see value in a number of stocks, with UK equities looking cheap relative to other leading stock markets, and continue to see sense in owning a balanced basket of companies with sensible balance sheets and good prospects. The pandemic resulted in some high-profile dividend cuts in 2020, but as the impact on profits was not sustained, a number of large UK companies felt confident enough to increase their payments to shareholders last year. This meant that dividends proved to be a useful component of total returns in 2021 and is likely to continue to do so. Given the lack of returns available from savings accounts, gilts etc., we would not be surprised to see 2022 hallmarked by investors' 'hunt for yield'.

"We see value in a number of stocks, with UK equities looking cheap relative to other leading stock markets, and continue to see sense in owning a balanced basket of companies with sensible balance sheets and good prospects."

James Follows, Head of UK Equities

Key market data

Key market data (as at 31 December 2021)

Asset class	Level	1m %	3m %	6m %	1y %	3y %	5y %	YTD %
Equity indices (total return) *								
FTSE All-Share (GBP)	4208	4.7	4.2	6.5	18.3	27.2	30.2	18.3
S&P 500 (USD)	4766	4.5	11.0	11.7	28.7	100.4	133.4	28.7
Euro Stoxx 50 (EUR)	4298	5.8	6.4	6.3	23.3	53.1	46.2	23.3
Nikkei 225 (JPY)	28792	3.6	-2.1	0.8	6.7	52.3	65.7	6.7
MSCI World (USD)	3232	4.3	7.8	7.8	21.8	80.3	101.2	21.8
MSCI AC Asia Pacific ex Japan (USD)	630	1.9	-0.8	-9.1	-2.9	41.7	67.0	-2.9
MSCI Emerging Markets (USD)	1232	1.9	-1.3	-9.3	-2.5	36.5	60.2	-2.5
10 year bond yields **								
UK	0.97	0.2	-0.1	0.3	0.8	-0.3	-0.3	0.8
US	1.51	0.1	0.0	0.0	0.6	-1.2	-0.9	0.6
Germany	-0.18	0.2	0.0	0.0	0.4	-0.4	-0.4	0.4
Japan	0.07	0.0	0.0	0.0	0.1	0.1	0.0	0.1
Commodities (USD)								
Gold	1829	3.1	4.1	3.3	-3.6	42.6	59.4	-3.6
Oil	78	10.2	-0.9	3.5	50.2	44.6	36.9	50.2
Currency								
GBP-USD	1.35	1.8	0.4	-2.2	-1.0	6.1	10.2	-1.0
GBP-EUR	1.19	1.4	2.2	1.9	6.3	6.9	1.3	6.3
EUR-USD	1.14	0.3	-1.8	-4.1	-6.9	-0.8	8.8	-6.9
USD-JPY	115.08	1.7	3.4	3.6	11.5	4.9	-2.1	11.5

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

Jonathan Marriott, Chief Investment Officer
James Follows, Head of UK Equities
Russell Harrop, Head of International Equities
Jeremy Sterngold, Head of Fixed Income

For further information please contact:
Chloe Poole
+44 (0)20 3207 8466
chloe.poole@lgtvestra.com

“Looking back at 2021, investment markets have been dominated by three interlinked factors: the ongoing pandemic, the steep rise in inflation, and the potential withdrawal of central bank stimulus and interest rate rises.”

Jonathan Marriott, Chief Investment Officer

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

www.lgtvestra-us.com

0118 2T PP