Forward-looking
for generations

# Investment Risks & Outlook – Q4/23

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LGT Wealth Management Jersey Limited, 10 October, 2023

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- Our strategy to navigate the markets ahead


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# Top macro risks we are seeing

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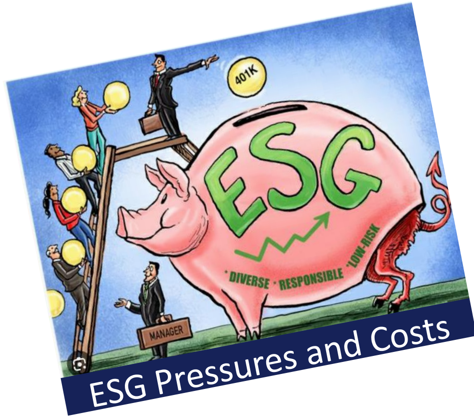
# Summarising the macro picture

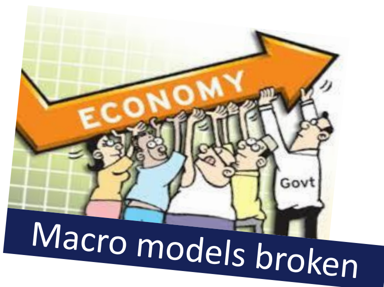


ESG Pressures and Costs

Death of 60/40 portfolios?

Excessive leverage

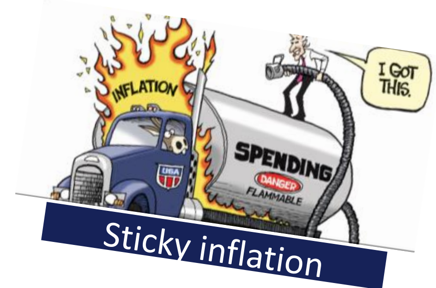
Geopolitical risks



Macro models broken

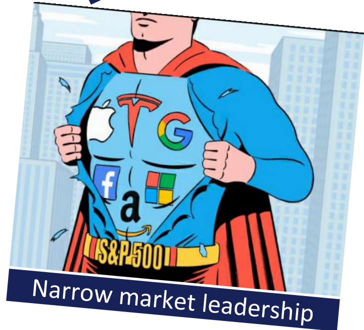
???

???



Sticky inflation

Dollar wrecking ball



Narrow market leadership

Everything is expensive

Fiscal vs. monetary policy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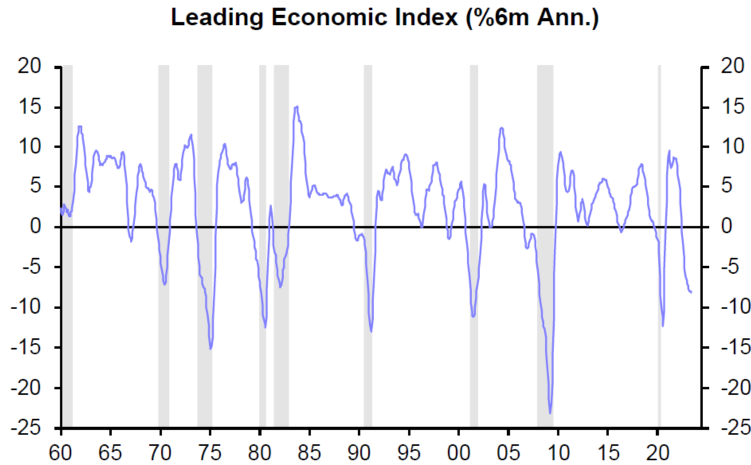
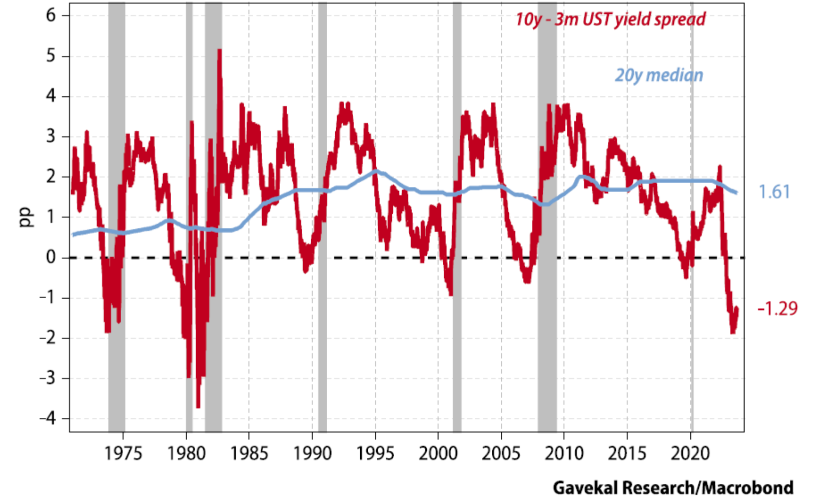
# Can we even trust the macro data?

If the US avoids recession, the LEI will post its first false positive in 60 years.



Historically the most reliable indicators started screaming warning signs in 2022…..but it has taken much longer to play out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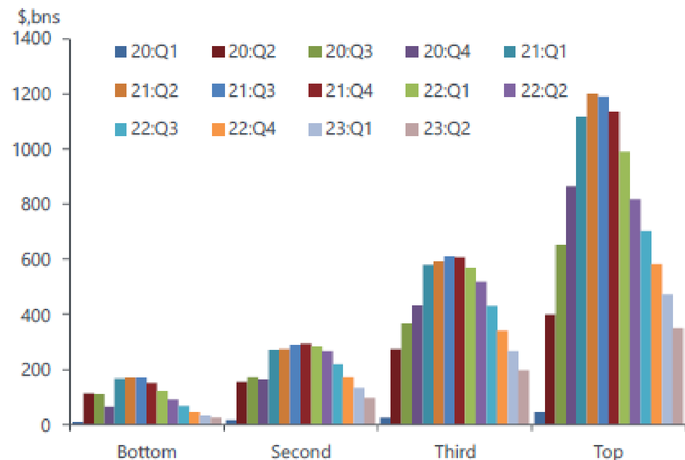
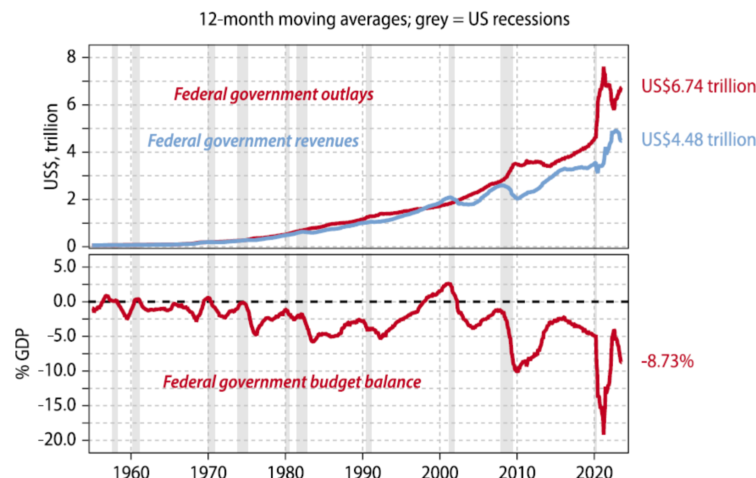
# What are other indicators telling us?

US: Excess savings by income quartile



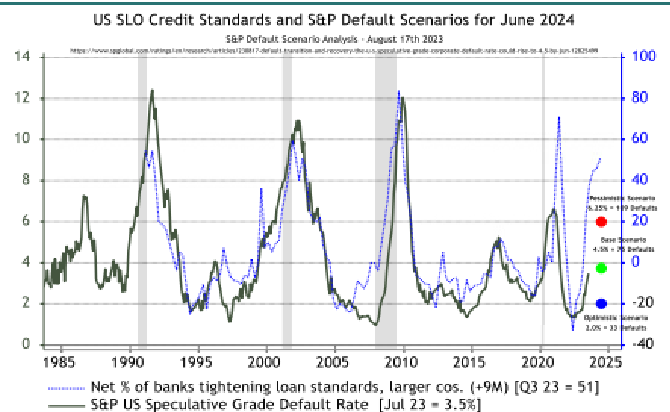

Source: Oxford Economics/Haver Analytics

**It is rare for the deficit to widen outside a recession or war**




Gavekal Research/Macrobond

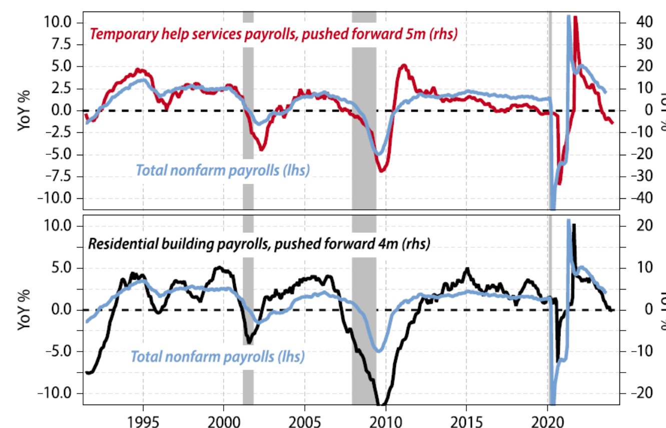
**EFI.1: US Default Rates & Fed Senior Loan Officer Opinion Survey**




Source: ASR Ltd. / S&P Global / LSEG Datastream

## Leading indicators signal a softer labor market ahead (cont.)

**Leading parts of US labor market are slowing**

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# Have key signposts lost predictive power or are they delayed?

## The US is not out of the woods yet—mind the lags

### Key recession indicators are still within the historical range of lags

| Recession indicator & signal | Range of lags, 1990, 2002 & 2007 | Time since recession signal |
|---|---|---|
| True Financial Conditions Index (TFCI below -20) | 10-28 months | 15 months |
| TMS3 Money supply (TMS3-NGDP growth below 20y median) | 11-32 months | 11 months |
| Yield curve (10y-2y yield curve inverted) | 11-22 months | 15 months |
| New home affordability (affordability below 20y median) | 14-34 months | 18 months |
| Wicksellian spread (ROIC-WACC spread below 20y median) | 3-15 months | 10 months |

Gavekal Research


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# Reasons why the most anticipated recession is delayed

1. Consumer balance sheets were flushed with cash
2. Corporate balance sheets remain flushed with cash
3. Liquidity in the private sector
4. Longer variable lags, rate hikes taking time to filter through the economy
5. Limited credit cycle vulnerabilities in the corporate sector
6. With the US in particular less sensitivity to the manufacturing sector
7. New housing market (US) saw a major development boom
8. Bidenomics (i.e. Fiscal policy)
9. Immigration
10. Labour hoarding


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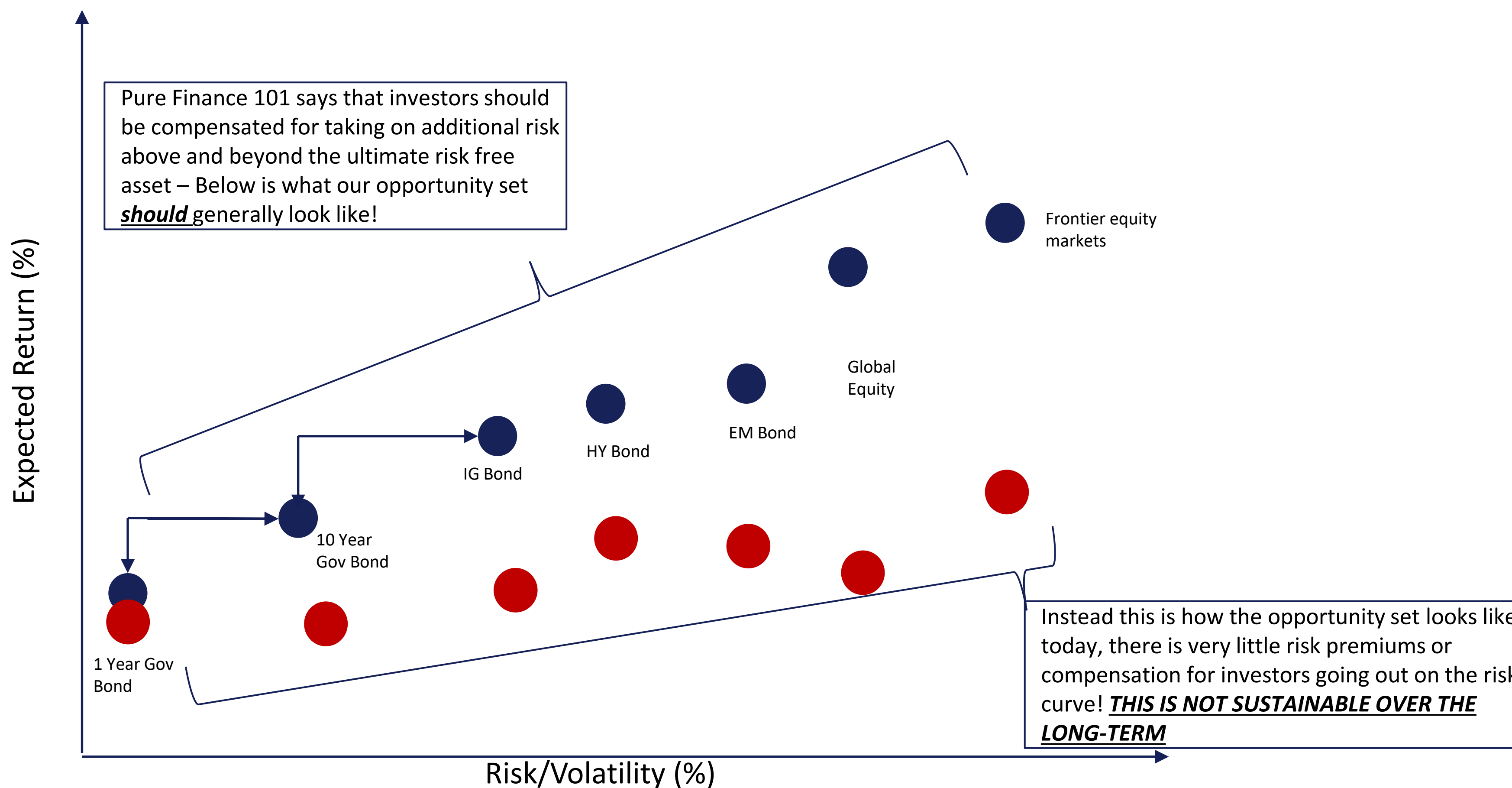
# Getting back to Finance 101





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# Risk premiums are not compensating investors

| | Current yields* | Current Risk premium (yield less 1 year Gilt rate) |
|---|---|---|
| 1 Yr Gilt | 5% | |
| UK 10yr Gilt | 4.3% | -0.7% |
| Global Corp | 5.5% | 0.5% |
| Global HY | 8.7% | 3.7% |
| Local EM debt | 6.9% | 1.9% |
| Global Eq (Earnings yield) | 5.9% | 0.9% |




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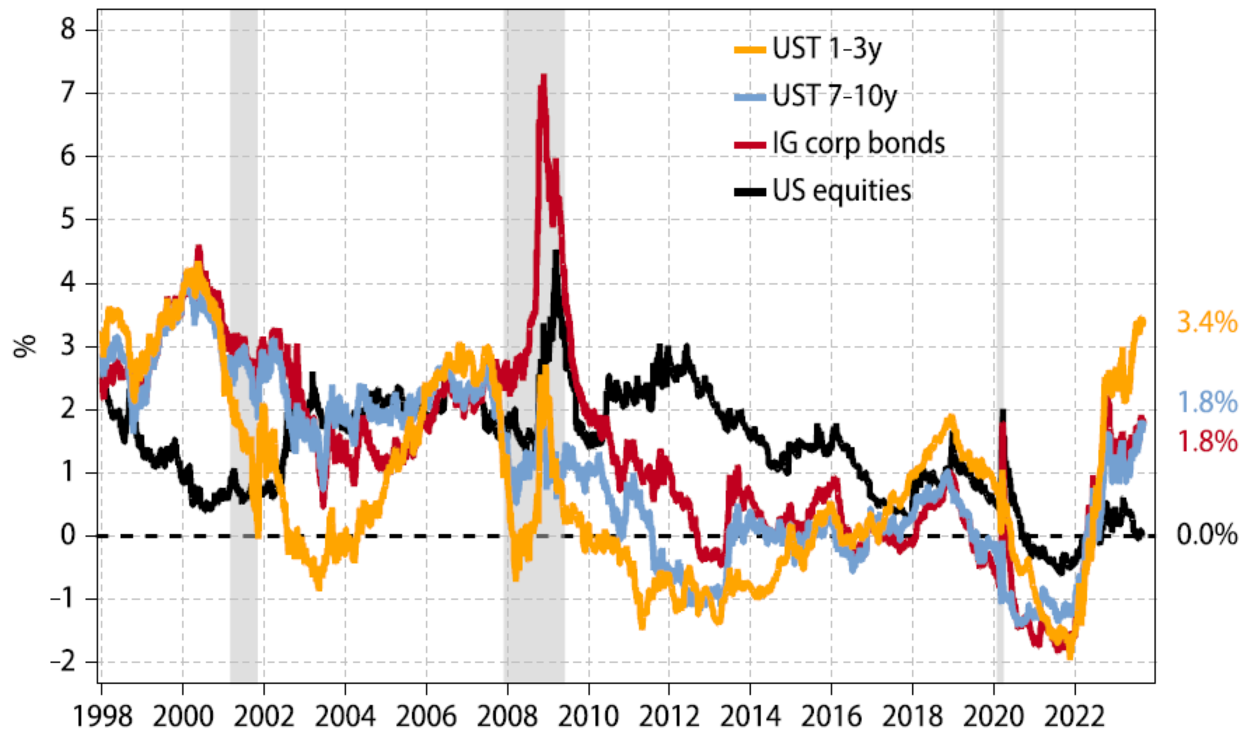
# A bias towards short dated fixed income makes sense.

## Like 2000, US equities offer relatively poor value versus US fixed income





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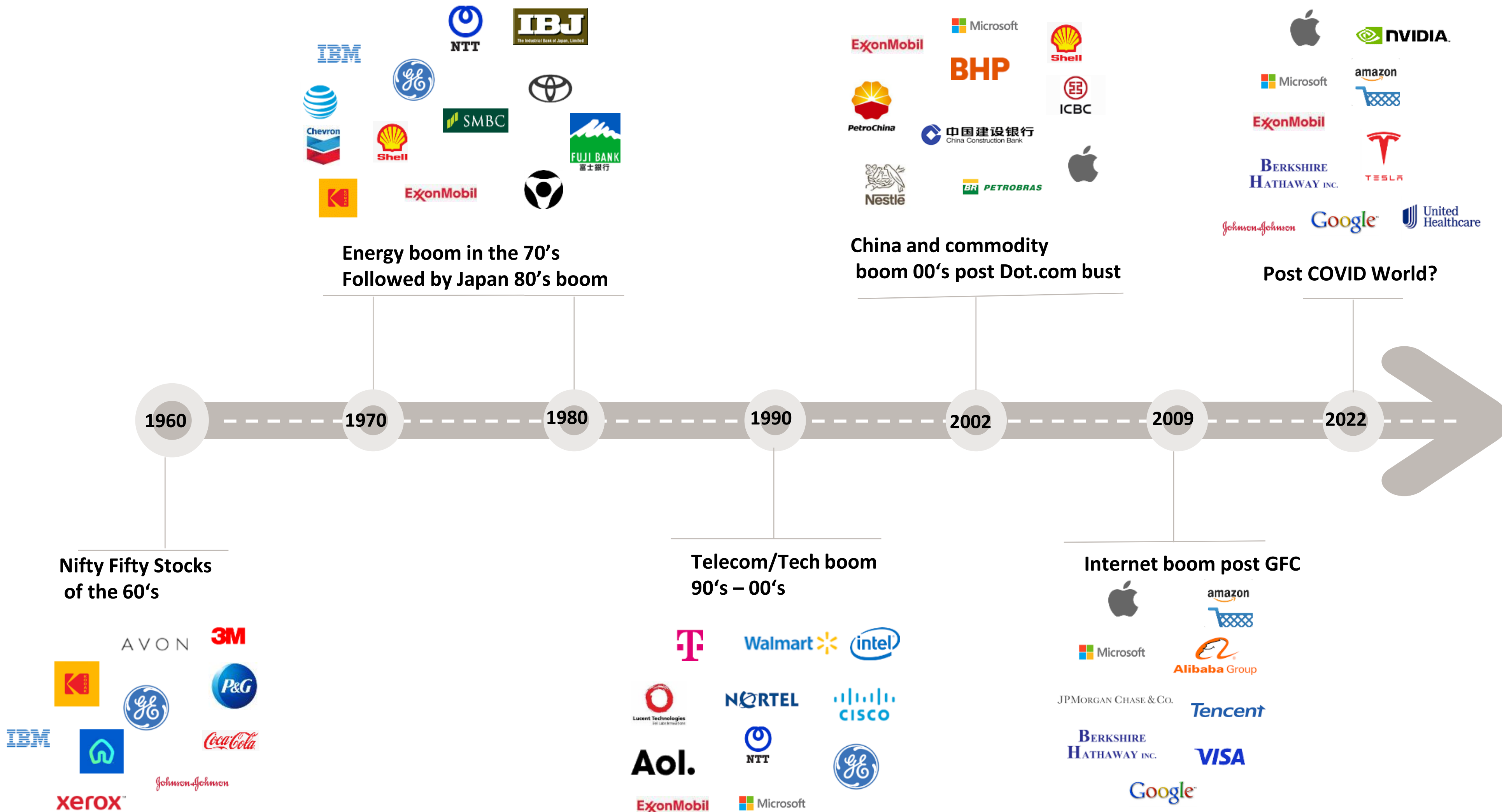
# Will market leadership change once again?





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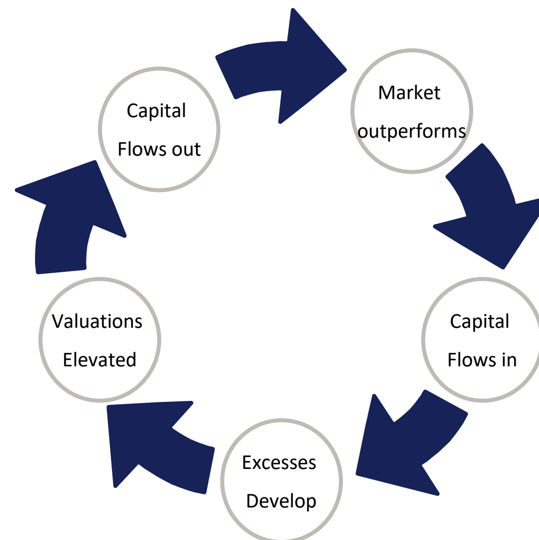
# Why does market leadership or regime change happen?

All of the major investment cycles have some sort of theme/narrative attached to it where styles/sectors/regions tend to dominate in relative performance for quite sometime.

- Prolonged period of under capital investment requires a boom to replenish supplies
- Access to cheap credit
- Introduction of new technologies
- Major inflection points in a region/countries economy





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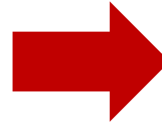
# What might characterise the new market regime?

| Post financial crisis winners: 2008 - 2020 | |
|---|---|
| Globalisation | Peace |
| Small government | Inequality up |
| Deflation | Market concentration |
| Passive investing | Global platforms |
| Technology | Profitless growth |
| Growth stocks | Just in time supply chain |
| Intangible assets | Low inventories |
| Robots | Increasing margins |
| US equities | Gov't Austerity |



| Post covid winners: 2020 onwards | |
|---|---|
| De-globalisation | War |
| Big government | Minimum wages up |
| Inflation | Broadening breadth |
| Active investing | National champions |
| Capital equipment | Dividend yield |
| Value stocks | Just in case inventories |
| Raw materials | High inventories |
| Workers | Decreasing margins |
| Non-US equities | Debt to GDP > 100% |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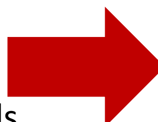
# Is there a possible regime change underway?

| Pre January 2022 | |
|---|---|
| Quality growth | Large caps |
| US equity focus | Low capital intensity |
| Maximise ROIC | Under weight hedge funds |
| High concentration | High bond duration |
| Technology bias | Profitless growth stocks |



| End of Dec 2022 & onwards | |
|---|---|
| More value stocks | More Mid & Small caps |
| Non-US equity bias | Real assets |
| Price to book | Macro strategies |
| Diversification | Moderate bond duration |
| Cyclical sectors | Dividend payers |

Should portfolios be repositioned for a possible new macro landscape which will could see a big change in market leadership over the next 5-10 years?

Portfolios may suffer as markets come to terms with the recession – but are well positioned to benefit once the recovery takes hold – problem is, timing the turn is impossible….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Our strategy to navigate the markets ahead

# Key thoughts on our strategy to deal with what is ahead

1. Bonds – Focusing on the shorter duration credit and government bonds - be patient and get paid to wait

2. Cash – Being used but our preference is to lock in attractive yields with shorter duration bonds and maintain liquidity levels high to re-deploy

3. Equities – we remain neutral; with a bias towards energy and materials given the longer term prospects – we manage our exposure around market conditions. Modest underweight to big cap tech – exposures also being actively managed. Overweight industrials and health care – given valuations and relative/absolute price momentum

4. Alternatives - minimal exposure to macro strategies that can take advantage of market dislocations. Small allocation to gold

5. We remain extremely agile given the constantly changing market conditions and uncertainty. Important to adhere to risk management discipline and not get married to any single market narrative or a position in the portfolio

6. For the time being despite the market narrative and valuations, the market technical’s remain robust – there is no reason to worry until the technical dynamics change

7. Possible change in equity/bond correlations will challenge the traditional 60/40 balanced portfolio approach. Fiscal policy, ESG headwinds, de-globalisation may translate into inflation volatility – hence interest rate volatility…long end bond yields could adjust higher


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