



Capital Partners

your partner for alternative investments

Big Government on the Rise

Investment outlook 2021

“There is nothing new about the sudden enthusiasm for aggressive government intervention during a health crisis. Throughout history, pandemics have led to an expansion of the power of the state.”

Anne Applebaum

“This used to be a government of checks and balances. Now it's all checks and no balances.”

Gracie Allen

“Nothing is so permanent as a temporary government program.”

Milton Friedman

“The ten most dangerous words in the English language are: Hi, I’m from the government and I’m here to help.”

Ronald Reagan

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Introduction

Unprecedented times call for unprecedented measures. With the lingering fallout of the last debt binge, an ongoing global health crisis and potentially devastating climate change in the making, we are facing challenges of historic proportions. Governments have begun to respond with resolute determination, spending, lending and regulating like never before. Financial markets too have become a tool for policy, distorting asset prices and correlation patterns in the process. In this publication, we first look at the many ramifications of “Big Government” and discuss the implications for long-term investors.

In a second section, we delve into the segments of the alternative investment landscape, where we have been actively engaging as a principal investor over more than two decades. We share our observations and assessments on current developments in private equity, private debt, real estate and infrastructure as well as liquid alternatives and insurance-linked strategies. In particular, we discuss the immediate impact of the global pandemic and look at the trends that emerged and are likely to reign long beyond the current crisis. Furthermore, we highlight where we see some interesting investment opportunities.

We hope that you find the following pages insightful and invite you to share your views and ideas with us.

Big Government on the Rise – investment outlook 2021

The trend toward Big Government has many ramifications, which are not just limited to the steady increase in laws and regulations governing more and more aspects of our lives. Neither is it predominantly about more redistributions through taxes and transfers. Over the past decade and likely for the years to come, the massive efforts to revive crisis-hit

economies have arguably expanded the role of policymakers from simple watchdogs to powerful participants in economic affairs. The selection below covers some, but certainly not all strands of the growing influence of governments, particularly on financial markets, and derives possible implications for investors.

Financial repression & reflation

Issues

- Low/negative rates and inert yield curves for the foreseeable future
- Central bank asset purchases encompass ever more segments of financial markets
- The declared goal is reflationary expansion of the economy

Investment implications

- Maintain pro-risk stance but go beyond leverage and duration with alternative return sources
- Add alternative portfolio diversification strategies
- Include assets with inherent inflation-protecting properties

Regulation & repatriation

Issues

- Increasing risk of anti-trust action for “Big Tech”
- Barriers to global trade and push for on-shoring of industrial production
- Curtailing greenhouse gas emissions to combat climate change

Investment implications

- Favor venture and small buyout funds with an edge in emerging technology
- Favor high value-add sectors in the developed world over low-cost manufacturers in emerging markets
- De-carbonize investment portfolios and focus on overall sustainability

Fiscal spending & social welfare

Issues

- Infrastructure build-out as part of fiscal boost
- Healthcare system upgrade in the wake of the pandemic
- Insufficient state aid for some companies embattled by the COVID-19 crisis.

Investment implications

- Invest in new infrastructure including renewable energy, possibly through public-private partnerships
- Participate in transformation and growth of healthcare sector
- Consider opportunities in private and distressed debt

Taxation & redistribution

Issues

- Income inequality, large deficits and ballooning debt will entail more taxation and redistribution that can come in many shapes and forms

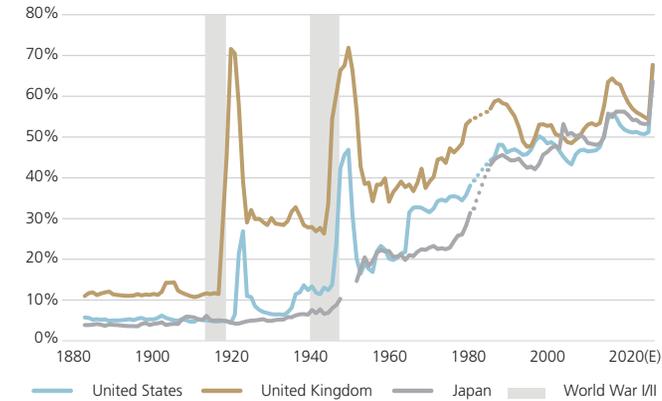
Investment implications

- Monitor law-making process in relevant jurisdictions of own legal structure and for investment portfolio holdings

The global economy: a big reflationary push

The rise and rise of Big Government

(Total government expenditures* in % of GDP)

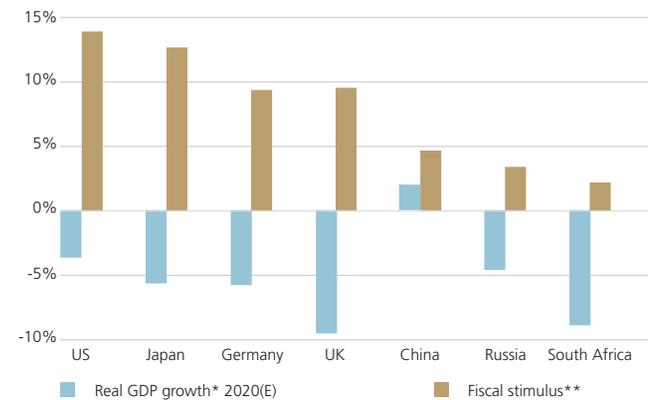


* includes government consumption, investments, interest payments and transfers to private sector
 historic data based on IMF/Mauro et al., from 1980 on including forecast: Oxford Economics
 Source: Refinitiv, ourworldindata.org, LGT Capital Partners

The ubiquitous role of government in economic life has been long in the making. In part, this is a natural consequence of development: as societies become more affluent, the role of the state expands from basic law-and-order functions to a more encompassing agenda that includes, for instance, income transfers to attain social welfare goals. But the bailout and rescue packages in the wake of the financial crisis a decade ago represented a novel set of responsibilities burdened on officials. Add to that the recent massive efforts to cushion the blow of the global pandemic, and today's situation starts to somewhat resemble the most extraordinary of times in history, namely the few past periods of "wartime economics." Unlike those times, though, governments nowadays align interests with businesses and workers, and not vice versa. Thus, a planned economy is not the intended path.

Bridging the gaps beyond the pandemic?

(Real GDP contraction in 2020* and fiscal stimulus in % of GDP)



* full year expected (Oxford Economics)

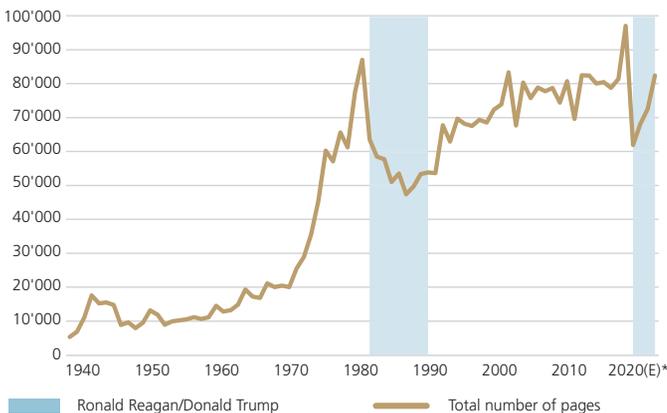
** direct stimulus only, excluding potential loan guarantees et al.

Source: Refinitiv, IMF Fiscal Monitor, various news sources, LGT Capital Partners

State intervention nowadays is more about saving the economy in its current structure. Presumably, the decisive and generous crisis responses have thus far averted an unstoppable spiral of deflationary depression. However, there is a great deal of uncertainty regarding the longer-term economic damage of the health crisis, as labor markets have been slow to recover and a wave of corporate bankruptcies may still take place. Government aid in many emerging countries has been less lavish, which could materially slow their respective economic recoveries. Even so, the unprecedented stimulus boost of both monetary and fiscal policy in the US, Europe and Japan could prove very potent going forward. Once the pandemic passes – and it eventually will – the combination of pent-up demand and lingering policy support could finally usher in the long-awaited reflationary expansion.

Regulation inflation

(Pages on regulation, rules and orders in the US Federal Register)



* pages of October 2020 volume annualized

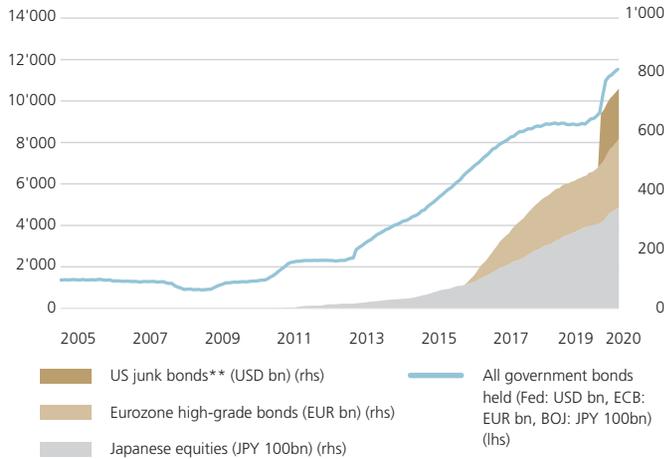
Source: Federal Register; govinfo.gov, ballotpedia.org, LGT Capital Partners

Rules and regulations frequently take on a less benevolent form of state involvement in economic affairs. Here too, the long-term trend is firmly on an upward trajectory, with ever more red tape added. There are a few examples of governments that tried to halt the surge, but regulatory activity seems untamable in the long run. Often, it is merely about a shift in priorities: While the Trump administration has been loath to introduce new regulation, its many executive orders to raise tariffs and other protective measures have considerably weighed on global free trade, for example. Under a Biden-led government, we will likely see less of the latter, but more interventions to align the US with the rest of the world in averting climate change. As investors, we need to cope with, adapt to and even anticipate the changing landscape of the regulatory jungle (see also opposite page).

Financial markets: the bull is dead, long live the bull?

The political investor

(Cumulated financial securities held by top three central banks*)

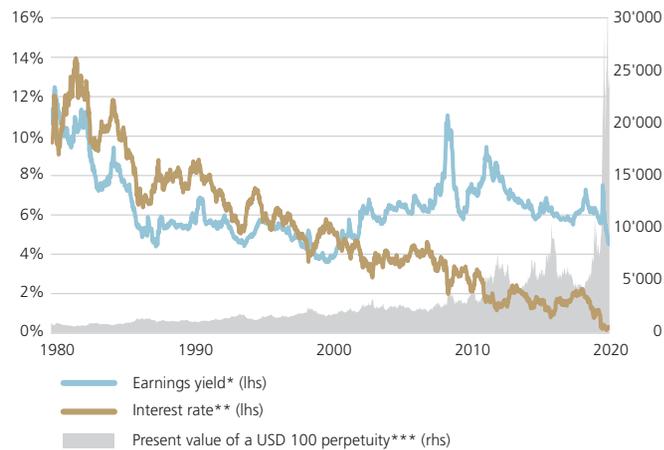


* US Federal Reserve (Fed), European Central Bank (ECB), Bank of Japan (BoJ)
 ** current available capacity under the Fed's Secondary Market Corporate Credit Facility
 Source: Refinitiv, LGT Capital Partners

For investors, the most fateful manifestation of Big Government comes with policymakers' meddling in financial markets. With zero to negative policy rates and large-scale asset purchases, central banks distort market mechanisms and asset pricing. Sovereign bond yields, for instance, have long become an instrument in the expanded toolset of monetary policy. As a result, they have not reflected rational economic expectations in years. This may increasingly also become the case with other asset classes that are now being loaded onto central bank balance sheets, from corporate bonds to even equities. As such, the COVID-19-related crash has not brought about a new paradigm, but rather reinforced and accelerated the regime that fueled the previous, decade-long bull run.

"How I learned to stop worrying and love the ZIRP"

(Earnings yield on global equities and long-term interest rates)

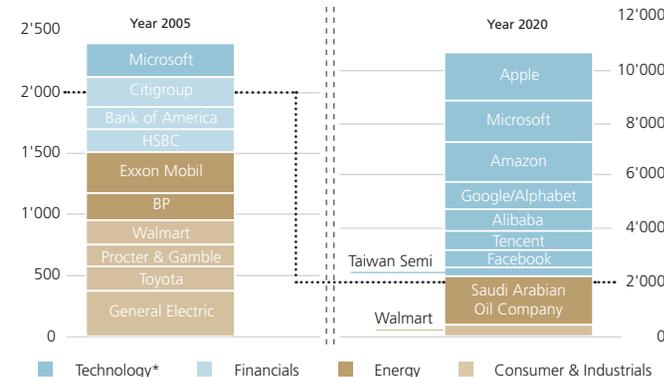


* based on average trailing and forward price-earnings ratios of equities world
 ** based on weighted 10-Year government bond yields in the developed world
 *** USD 100 divided by the prevailing long-term interest rate
 Source: Refinitiv, LGT Capital Partners

In the benign case, monetary policy would slowly revert course in a self-sustained economy. If balance sheet expansion continues endlessly, however, a loss of confidence and debasement of fiat currencies may be the end game. However, neither path is very likely for the foreseeable future. Interest rates remain credibly anchored around zero, underpinning demand for risky assets. Financial bubbles are a possible future consequence but not a current reality – at least not in broad fashion. Yes, valuations are above historical averages in some segments, but not so on a relative basis. Treasury yields and earnings yields (the inverse of price-to-earnings ratios on stocks), often in lockstep, have diverged. This signals that equity markets thus far resisted to fully price for a lasting zero-interest-rate policy (ZIRP) environment. Thus, theoretically, there is still ample room for asset prices to run higher on cash flows being discounted near nil.

Too big to roam free

(Largest 10 public companies by market cap, USD bn)



* Amazon and Alibaba reclassified from Consumer Discretionary for illustrative purpose
 Source: Refinitiv, LGT Capital Partners

The technology sector was a notable beneficiary of this effect, as expectations of strong future growth already translated into impressive present values. But investors now face the risk of more regulatory scrutiny. The dominance of tech giants, in particular, has raised concerns ranging from monopolistic behavior to privacy and data protection issues. A comprehensive investigation by US legislators found bi-partisan agreement to the notion of power abuse and the need for tighter rules on "Big Tech." Proposed measures span from stricter oversight to anti-trust action such as forced separation of business lines. It would not be the first time that a mixture of corporate overextension and regulatory backlash unseat reigning champions. Banks and energy companies, once featured among the top ten by market cap, eventually drew the ire of the public and lawmakers alike on their excessive business practices that were increasingly perceived as harmful to society.

Asset allocation: alternative thinking required

Adapt and align

How can one invest in the age of lasting financial repression and pervasive government intervention? One approach would be to align with central banks and hold the assets they are supporting through their steady purchases. But this likely requires considerable leverage to boost meager returns on traditional assets such as European investment grade bonds, for instance. These positions would then be highly susceptible to changes in interest rates, even though they are unlikely to jump up anytime soon.

We prefer a strategy that combines premia from alternative investments in a diversified portfolio. Private market commitments provide exposure to equity and credit betas, but beyond this, they add illiquidity premia and returns based on the skills of best-in-class managers. In addition, active, discretionary and systematic strategies are also a great source of pure alpha and style premia. Our liquid alternatives and specialized long-only allocations (see page 18) are set up for the purpose of harnessing returns beyond traditional market betas.

Two areas where we would invest alongside governments is in the build-out of infrastructure and healthcare, both

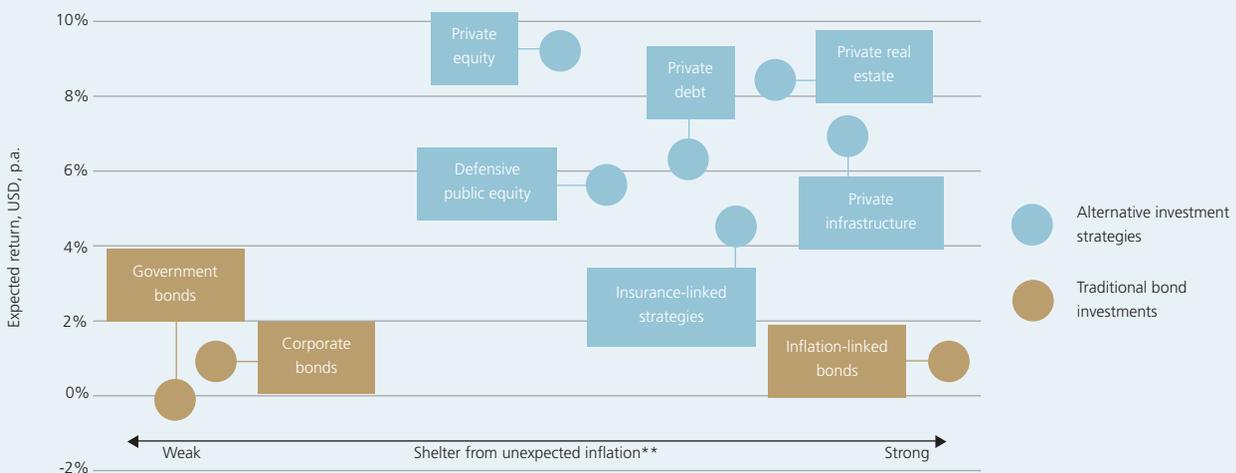
through quality public market instruments and select private market commitments. Real assets and equity stakes with pricing power come with inherent inflation-protecting properties, a helpful feature in case governments' reflation efforts come to fruition.

Technology also merits a prominent place in a growth-oriented portfolio, but considering the cluster risk and the danger of regulatory backlash surrounding the biggest public companies (see page 7), it seems prudent to commit to emerging players as well. Venture investments nowadays capture a wide range of growth potential, from early stage companies to astonishingly mature businesses, as many successful companies opt to stay private for longer.

Lastly, with climate change on top of the political agenda, carbon-intensive industries are under considerable regulatory pressure. Aligning one's investment portfolio with efforts to de-carbonize the economy is not only the responsible thing to do, but it has also become an indispensable part of risk management amid the search for sustainable investment returns (see the LGT Group Endowment's ESG Report detailing our Climate Action Strategy).

Portfolio building blocks for repression & reflation

(Expected returns* and inflation shelter** on select asset classes)



* Expected returns are total, per annum returns in USD over the next five years. LGT Capital Partners capital market assumptions are market, or beta, geometric return expectations gross of any fees over a horizon of approximately five years. **This data is purely indicative and is not a guarantee of future results, and there can be no assurance that the fund or portfolio will achieve comparable results.**

** Shelter from unexpected inflation is illustrative only and based on qualitative assessment
Source: LGT Capital Partners

Farewell to an asset class

There is little doubt that government bonds are now a broken asset class. In most of the developed world, they do not offer any yield to speak of. Worse still, at the zero-bound, they seem to have lost their risk-diversifying nature and are thus unable to provide downside protection in an investment portfolio. For the LGT Group Endowment (see page 18), we have therefore markedly reduced our allocation to these bonds over the years, relying instead on various alternative means for proper diversification. Adding uncorrelated return sources, such as insurance-linked strategies, is one expedient way to improve portfolio robustness. Another is to introduce a defensive tilt within risky asset classes. To that end, we combined the styles of "quality," "sustainability," and "minimum variance" within an equity allocation that is more defensive and therefore expected to suffer smaller drawdowns, if and when they occur.

Moreover, we implemented dedicated dynamic protection strategies. These are rule-based strategies that seek exposure to safe-haven assets and insurance instruments upon "risk-off" events. The beauty of these strategies lies in avoiding the prohibitively high costs associated with permanently holding protection (e.g. put option premia). The drawback is that they can not provide a perfect hedge in the short first phase of shock-like market stress.

Finally, gold deserves a place in multi-asset portfolios. Although it may not protect in all kinds of market sell-offs, it does arguably provide a certain hedge against geopolitical risks, inflation surprises and the long-term outlier scenario of monetary debasement. After all, gold is a currency that governments cannot print.

Hedging hitches

(Global equity, bonds and dynamic protection strategy – 2020*)



* YTD performance per 31.10.2020
 ** LGT Dynamic Protection Fund
 Source: Refinitiv, LGT Capital Partners

Dynamic protection strategy

(Exposures upon systematic trading signals)

Assets/instruments	Dynamic position
"Safe-haven" currencies	long
Money market contracts	long bias
Long-term interest rates	short
Gold	long
Cyclical commodities (e.g. oil)	short
Equity indexes	short bias
Implied volatility (VIX)	long

Source: LGT Capital Partners

Private equity

Navigating rapidly changing markets with patience and foresight

The year 2020 was one of volatility. Private equity markets started with cautious optimism and ended with a rather stable outlook. However, in between, we experienced an entire private equity cycle in just a few months. Fear and liquidity concerns took over in March and April, followed by a rapid snap-back of COVID-19 resistant businesses during the summer. Most recently, euphoria took over headlining public listings, trade sales, and record valuations for high-quality software assets. The private equity industry has shown that despite its long-term orientation, it can adapt to rapidly evolving market environments. While too premature to assess, private equity managers demonstrated agility in the face of the global pandemic, turning some of the challenges into new opportunities.

COVID-19 propelled the private equity market into a new cycle, substantially different from the Great Financial Crisis 12 years ago. Private equity managers reacted very quickly to defend their companies and secure liquidity in case of a prolonged downturn. On the back of the market shock in Q1, global investment activity in private equity dropped significantly, both in terms of new deals done and exits completed. In our portfolios, the fewer exits we have registered were however often very strong ones.

More recently, private equity managers have begun playing offense again, including making more aggressive add-on acquisitions and paying high prices for stable platform assets. While deal activity has picked up in the second part of the

year, we have observed a strong flow of sponsor-to-sponsor transactions, minority recaps and a noticeable uptick in manager-led secondary transactions. Exits have also rebounded, especially through financial sponsor transactions, SPACs, or by way of public listings, which are all benefiting from renewed strength of credit and public equity markets.

We have identified a few trends that emerged during the year:

- Sector expertise as a differentiator: Private equity managers' deep sector expertise has become increasingly important in this complex, fast-moving – and virtual – environment. Unique sector insights can provide an important edge in winning over both sellers and management.
- Vibrant secondaries market: While volume was down significantly in Q2, the second half of the year has been as active as ever for secondaries, in particular for manager-led deals. The trend of private equity managers holding on to their best assets and looking for ways to manage assets across fund families has played right into the hands of players active in that space of the market.
- Bifurcated market between the “haves” and “have nots”: Fundraising for established platforms is moving very fast, while less proven managers struggle to get the attention from the private equity investor community. Similarly, high quality assets continue to attract record high prices, while cyclical companies are not generating any buyer interest.
- High growth sectors keep growing: The technology sector has shown remarkable stability and growth, driven by sticky revenues and high margins. Software and tech have quickly become the dominant sector of the private equity market.

Examples of successful exits

Allegro: Private equity value creation culminating into successful IPO

LGT Capital Partners co-invested in Allegro in December 2016 alongside top tier private equity managers Cinven and Permira. Allegro is the largest online marketplace in Poland. The two private equity sponsors identified Allegro as a leading e-commerce player, with strong market tailwinds and attractive margins. They also identified opportunities for significant operational value creation, building Allegro into a best-in-class e-commerce platform and advancing the offline to online conversion in Poland. The positive return levers identified in 2016 were further accelerated by the global pandemic, which had an additional positive impact on Allegro's financial performance. Allegro successfully listed on the Warsaw stock exchange in October 2020, generating an attractive return for investors.

Puulo: Alternative liquidity solution through single asset recap

Today more than ever before, private equity players are proactively managing the value creation and liquidity profile of their fund investments. Puulo, a best-in-class Finnish discount retailer of "do-it-yourself" stores, is owned by Adelis, the majority shareholder. As the company continued to grow substantially since acquisition in 2015, it became a relatively large position in the Adelis portfolio. At the same time, the manager had identified several routes for additional value creation. Our private equity team crafted a bespoke transaction whereby Adelis was able to reduce its stake in the company, provide partial liquidity to its investors, and retain control while maximizing investor value through a longer hold. LGT Capital Partners acquired a minority stake in the asset in the form of a structured equity recapitalization with an attractive risk-return profile. Since our entry, the company has been able to navigate the market environment, and delivered an impressive growth throughout the period.

Both situations demonstrate our ability to remain nimble and selective in identifying unique transactions and top quality assets. We aim to consistently expand our investment toolkit in order to provide innovative solutions to our private equity managers. Our ability to move quickly and seize the most attractive opportunities identified by our global staff has become a critical success factor for our private equity business.

Private debt

As an investor in private debt in the current COVID-19 dominated environment, one is facing the following questions:

- How does the current crisis differ from the Great Financial Crisis (GFC)?
- Is the market now saturated with distressed debt opportunities?
- How has it affected the private debt market in general for deals and fundraising?

The single biggest difference between the GFC of a decade or so ago and the current COVID-19-related crisis is the availability of liquidity. Arguably, the GFC was a crisis of liquidity. Indeed, some banks were in the unenviable position of being forced to pull lines of credit, the very liquidity that could have helped to save their own portfolio companies, in order to preserve their own balance sheets, making a difficult situation far worse.

The current crisis could not be more different. Liquidity has been in plentiful supply – thus far. Instead of bailing out banks, governments all over the globe have been investing in wage support schemes of varying generosity, as well as in state backed loans directly to corporates, preventing the jobs market from going into free fall. This in turn has had a galvanising effect on private equity firms. Private equity managers, have injected further liquidity of their own, shoring up portfolio company balance sheets, and ensuring fewer of the debt for equity swaps that wiped out private equity positions post GFC. For private debt funds, and their investors, the change in approach has been encouraging. The availability of liquidity has meant negotiations with private equity firms have been collaborative rather than challenging, and the equity injections have protected our positions, ensuring that valuations have been far less volatile than post GFC. The level of distress in the market, however, should not be ignored. Some businesses (and sectors) have suffered terribly. Yet the scale of opportunities that had distressed debt players licking their lips nine months ago has not fully materialized, and certainly not at the lower end of the mid-market where LGT private debt operates. In 2008, banks dominated the leveraged finance market, and when performance levels started to dip, they sold their positions – positions which were eagerly lapped up by a quickly expanding distressed debt market. Today, the market is dominated by

private debt funds, whose modus operandi is generally to work out underperforming situations – not trade out of them at the first sign of trouble. At the larger end of the market, distressed opportunities undoubtedly exist, and of course there are certain sectors that no amount of state or private equity support can hope to protect entirely, such as travel and consumer retail. As countries start to count the cost of such grandiose support schemes, it remains to be seen if this state of affairs can continue as Europe, in particular, experiences a second wave of COVID-19 infections and accompanying lockdowns, but in the meantime the continued availability of liquidity has helped to keep businesses in the hands of their current owners, and importantly for us, debt positions whole.

Just as some sectors have suffered from COVID-19, others have proved themselves to be resilient: healthcare, IT services, remote learning businesses and others have not just survived, but are flourishing in the current environment. The market in general therefore is alive and kicking. After a material drop in deal flow in the first half of 2020 (Q2 in particular), there has been a dramatic catch up as private equity and debt firms chase those companies that have performed robustly through the last nine months. Fundraising has followed a similar trajectory, and as we get used to less travel and viewing the homes of those we would otherwise have met in offices through the screens of our laptops, this is also recovering quickly.

Despite the volatility of public credit markets, lower mid-market private debt strategies continue to offer high cash yielding, stable returns. Investors are increasingly taking advantage of this, and as a result, the asset class as a whole is continuing to show buoyant growth.

Real estate

As the COVID-19 crisis continues to unfold, the real estate market remains in triage mode in its assessment of the pandemic's long-term impact on the sector.

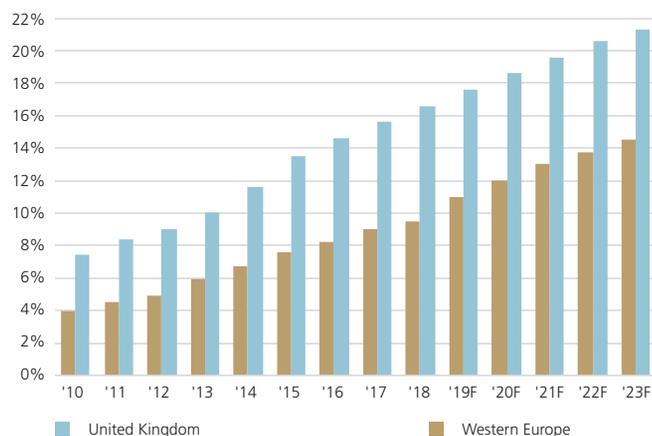
Going into 2021 with broadly solid tenant fundamentals such as limited number of insolvencies, high rent collection rates and moderate leverage, well-capitalized market participants are poised to hold on to assets rather than trade, thereby resulting in subdued transaction activity and slower price discovery. One thing apparent is that the crisis is acting as a catalyst to the already pre-existing bifurcation of real estate into winning and losing subsectors. For instance, as many traditional retail formats have already been struggling before COVID-19, the pandemic has exacerbated the pressure on the sector, whilst giving the trend towards e-commerce and the resulting necessity for specialized logistics space a further boost. All the while, as the market enters a period of heightened uncertainty, in-place rental yield is attaining paramount importance for most investors, with assets that can provide stable, long-term cash flow demanding premia. Investors should stay keenly focused on the viability of rental cash flow as downside protection to their portfolios and remain mindful of market overreactions towards certain sectors such as traditional offices. Further up the risk curve, opportunities stemming for example from distress in the hotel sector are likely to emerge as the crisis continues.

COVID-19 also impacting asset class demand

- Impact on demand directly related to stay-at-home measures
- In most instances, despite length of lease terms, asset classes with a high degree of social interaction will suffer long-term
- Fallout of the negative demand story will vary by asset class, both in terms of immediate recovery (e.g. hotels) and long-term survivability (e.g. shopping malls)
- Move into the digital age: e-retail, logistics and data centers as clear winners, riding a long-term trend

Online retail sales

(% of total retail sales)



Source: OECD/CBRE

Infrastructure

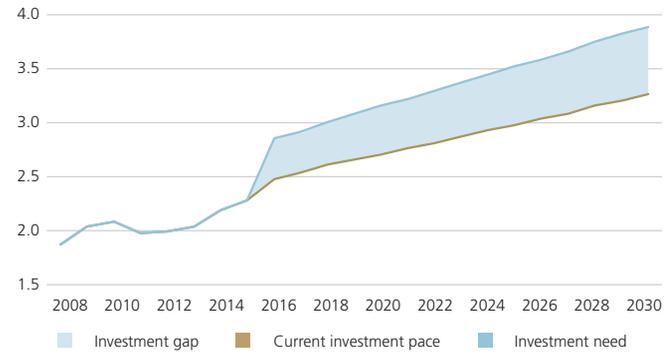
Despite the pandemic, most of the sectors within infrastructure have remained resilient and in line with investor expectations.

Sectors negatively affected are those linked to demand risk including some areas of transportation and oil and gas. However, for the most part infrastructure assets have weathered the crisis well given the high visibility of cash flows with long term contracted revenues and the essential nature of the services provided. Strong performing sectors have been those scoring highly on Environmental, Social and Governance (ESG), especially renewable energy and telecoms, which helped reduce the carbon footprint. Going forward we expect these sectors to continue to grow given the energy transition agenda from fossil fuel to electricity, and the increase of connectivity through the internet for work, shopping and social media. Finally, with various government efforts to stimulate the economy there are expectations of an increase in infrastructure spending which could generate more opportunities for the private sector.

Growing private infrastructure opportunity set

- Increasing demand – infrastructure spending driven by secular trends and the need to replace and operate existing infrastructure
- Need for private funding – government spending and high public debt, further accelerated by COVID-19, offers opportunities for private capital
- Growing opportunity set – assets under management¹ has grown from USD 162 billion in 2010 to an estimated USD 582 billion² and growing, generating secondary and co-investment opportunities

Infrastructure investments at current trend and projected need (USD trillion)



Source: Global Infrastructure Hub, Preqin

¹ Closed-end infrastructure funds.

² As of 30 June 2019

Liquid alternatives

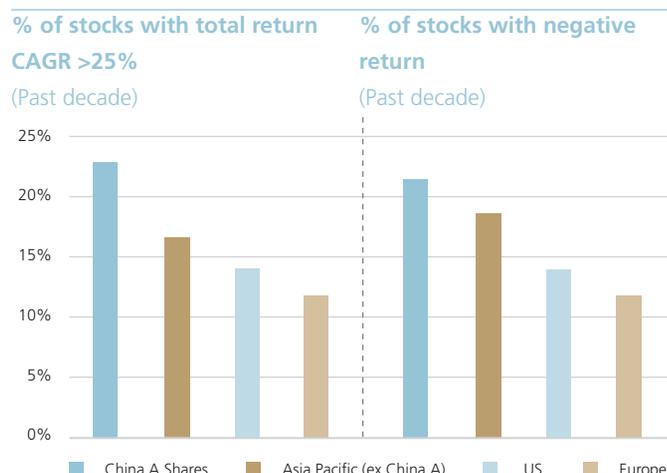
What happened in 2020 was both unexpected and turbulent – to say the least. However, it was an environment which provided liquid alternatives with one of the best opportunities to shine in many years.

In 2020, while return dispersion between different strategies and managers was comparably high, the overall picture for liquid alternatives was positive (as of November 2020). The following areas stood out:

- **Active management:** active management was once more able to make a difference and to produce alpha by trading both long and short positions. The insolvency of Wirecard, the German payments group, is just one example.
- **Artificial intelligence:** strategies using artificial intelligence, both discretionary and systematic, were able to extrapolate rules from new data and to produce positive returns.
- **Trend following:** on the systematic side, many trend following strategies were able to generate positive returns amid unprecedented volatility and market drops.
- **Tail-protection:** as volatility spiked in spring, some strategies were able to lock in gains and to protect them throughout the remainder of the year.

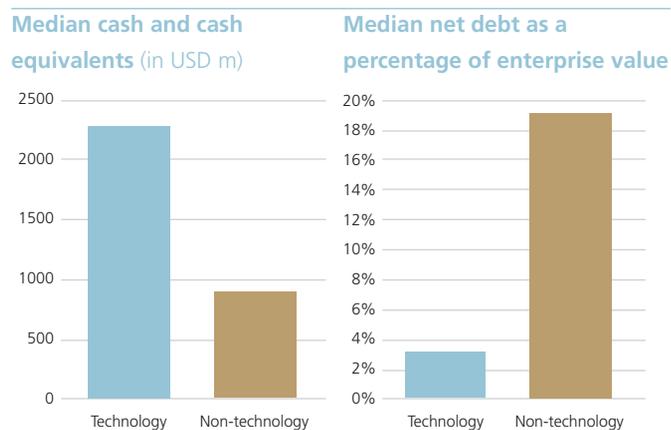
What does this mean for 2021? We want to highlight two pre-existing investment trends, which have been accelerated by the pandemic:

- **Asia:** while global capital pools tend to be myopic, Asian markets supply rich and de-correlated return opportunities. As illustrated in the charts on the right and as an example, return dispersion in China A shares is higher than in other markets. As a consequence, today's market capitalization, liquidity and ability to short are comparable to the rest of the world and therefore, Asia is no longer the partially unknown territory in the East. As an example, recent regulatory changes have opened up the onshore Chinese markets to international capital. The related ability to trade futures and build short exposure has led to the emergence of investment strategies applying innovative approaches to new markets.



Source: Bloomberg, Total return (incl. Dividends) CAGR in local currency from 2 Jan 2011 until 31 Dec 2019

- **Technology:** the continuous flow of winners and losers makes it an ideal sector for active management. Contrary to the perception, it is not “high risk, high growth” anymore as these days, technology companies tend to have some of the strongest balance sheets with ample cash and low debt. However, as valuations already price in steep future growth, we see an active approach with the ability to short as a disciplined way to access the sector.



Source: Bloomberg, Lightstreet.com

Technology index consists of technology and communication services stocks of the S&P 500. Non-Technology index consists of healthcare, consumer discretionary, financials, industrials, consumer staples, utilities, energy, real estate and material stocks of the S&P 500.

The proof of concept for liquid alternatives in 2020 came very timely. While the “eternally low” interest rate environment remains the new normal, investors looking for de-correlated return-streams or shock absorbers are increasingly turning to liquid alternatives. As a result, we expect the idea of hedging portfolios with hedge funds to stage a comeback.

Insurance-linked strategies (ILS)

A (very optimistic) outlook for 2021

The state of the market

The COVID-19 pandemic has also left its marks on the insurance and reinsurance industry: Carriers across the globe were facing a significant reduction (albeit short-termed) of balance sheet strength due to extreme volatility of financial markets seen in March and April. The pandemic furthermore resulted in substantial insured losses and combined with the financial impact from the recent natural catastrophe events, makes 2020 the fourth consecutive loss-heavy year for the (re-)insurance industry.

And as opposed to the loss-heavy 2018, where the availability of ample reinsurance capital hindered the possibility of premium increases, the market is now finally seeing a notable reduction of available capacity – both due to the loss impacts, paired with reduced investor interest likely linked to the uncertainties in financial markets. This reduced capital supply is now clashing with a higher demand from reinsurance buyers to offload risk in order to comply with the requirements from regulators and rating agencies. The combination of increased demand and limited supply results in attractive premium increases, which will ultimately translate into higher running yields for ILS funds for 2021.

The chart on the next page shows the development of the general rate environment in connection with the annual insured loss worldwide.

Review: Catastrophe insurance events of 2020

COVID-19

In order to contain the spread of the novel Coronavirus, governments around the globe implemented a variety of measures, in extreme cases a complete lockdown. The insurance industry is exposed to COVID-19 across various business lines, from the most obvious areas such as life and health insurance, to property and casualty (P&C) business lines. Heavy losses are recorded in specialty insurance covers like travel and event cancellation but also in property insurance, and financial insurance lines such as trade credit and surety. The ultimate insured loss linked to COVID-19 will likely exceed USD 50bn, which equates to a very significant hurricane event, such as Hurricane Katrina (2005). Significant uncertainty around market impact remains, especially in the area of retrocession (“reinsurance for reinsurers”). Some ILS funds with a strong focus on such retro business are thus forced to establish side-pockets and/or block significant portions of the invested capital to accommodate for the uncertainties. This is acting to further reduce the available capacity for the upcoming renewals in January 2021.

Natural catastrophe events

In addition to these losses from COVID-19, especially the US experienced a series of painful mid-sized catastrophe events, which ultimately makes 2020 the fourth consecutive year where earnings of global reinsurers and US primary insurers have come under pressure. The overview highlights the key loss activity in 2020.

Insurance events 2020

Events 2020	Industry loss	Comment
Australia wildfires	USD 2bn	Significant losses for local carriers
COVID-19	USD 50bn	Massive losses from travel insurance, event cancellations, and business interruption
Atlantic hurricane season	USD 10-20bn	Extremely active season but insured losses within long term average
California wildfires	USD 4-6bn	High loss burden for local carriers, but below record years of 2017/2018
US-Midwest super-storm (“derecho”)	> USD 10bn	Widespread damage in the US Midwest, very costly single event

Source: LGT ILS Partners, AIR, RMS, PCS, Aon; preliminary estimates

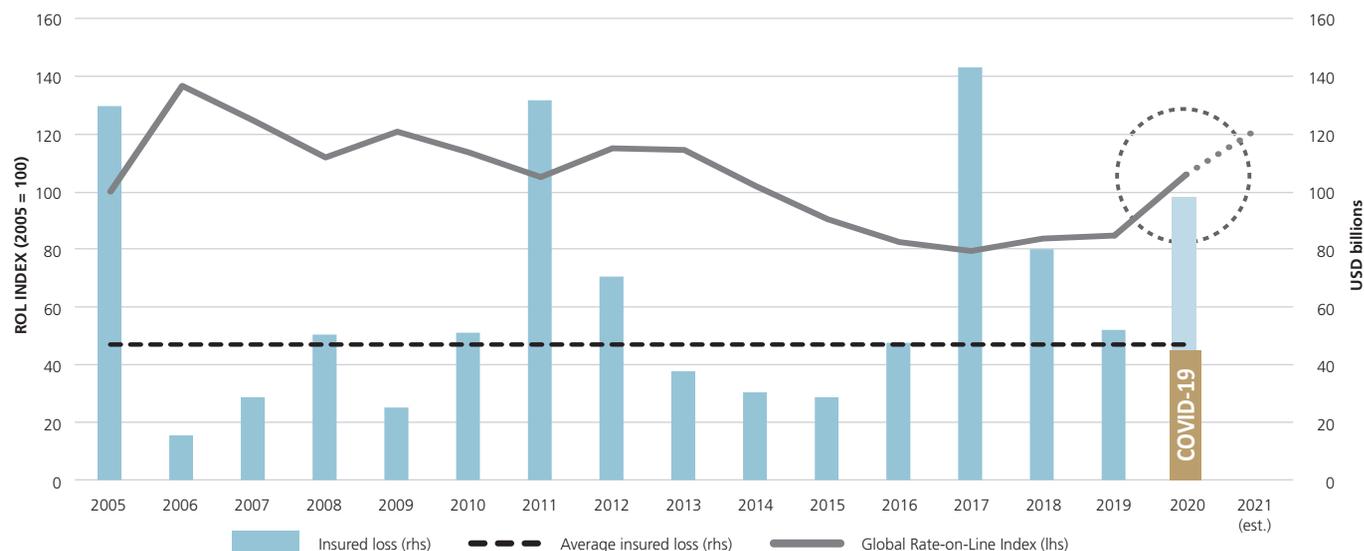
Outlook for 2021 – market momentum

Following such a loss-heavy year, we typically see a “flight to quality” effect as reinsurers look to re-align themselves with best-in-class insurance companies. For 2021, reinsurance providers and ILS markets themselves are now confronted with a similar transformation, as insurance buyers are tiering their reinsurance and ILS counterparties in favor of the most stable, best performing companies. The current combination of a reduction in available collateralized reinsurance capacity, the losses from both natural catastrophe events and the COVID-19 pandemic as well as a reduced net risk tolerance from rated carriers and some ILS funds have accelerated this flight to quality. LGT ILS is optimally positioned to capitalize on this market momentum like never before. Our stable asset base and our constant risk approach are a true value proposition and differentiates us from the rest of the market.

Summary and conclusion

The market has clearly shifted to be a seller's market, and top-tier providers of reinsurance and ILS capacity are pressing not only for higher premium levels, but very much also for improved contractual terms such as firmer exclusions, particularly for cyber and pandemic risks. For 2021, investors will thus benefit not only from attractive premium levels, but also from improved terms and conditions. And the key benefit of the asset class remains unchanged – the low correlation to movements in financial markets is especially valuable in times of uncertainty.

Development of insured losses versus premia



Source: LGT ILS Partners, Swiss Re Sigma, Guy Carpenter; premium estimation for 2021 is based on LGT ILS Partners' market assessment, insured-loss 2020 based on most recent estimates

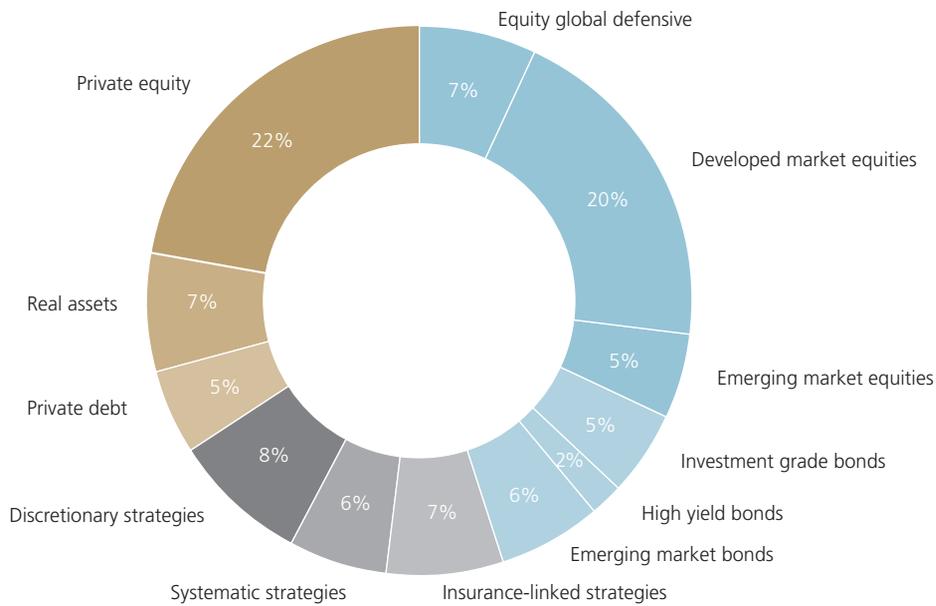
How we invest our own money

LGT Capital Partners has been managing and investing a combined portfolio of traditional and alternative investments, the LGT Group Endowment, for 22 years. Today, this strategy has around USD 14 billion in assets under management.*

The Group Endowment’s investment mandate is to achieve sustainable long-term asset growth with moderate volatility. To this end, we developed our proprietary strategic asset allocation methodology. At its core, scenario planning ensures diversification of attractive risk premia across global investable markets. Institutions and families who have preserved and

developed wealth over generations are well aware of the central role of diversification. They have gone through times of war, inflation, depression, and may have even witnessed confiscation of assets. We are convinced that diversification is a fundamental concept for long-term investors.

LGT Group currently invests around USD 3 billion in this strategy, along with substantial capital from the key investment professionals of LGT Capital Partners, allowing for significant alignment of interests with clients.



Please note that the 3% allocation to the dynamic protection strategy is an overlay strategy and is thus not added to the overall sum of assets allocated.

Private markets
 The owner-manager structure of private equity holdings, together with long investment horizons, allow for active value creation over a full cycle. In private debt, contracts are individually negotiated in close relationship with the counterparties. Carefully selected infrastructure and real estate deals offer the potential for income yield and capital growth.

Liquid alternatives
 Alternative investment strategies are a source of uncorrelated returns found in the systematic harvest of alternative risk premia or the generation of true alpha from proven discretionary managers. Insurance-linked strategies too, focus on returns that are independent of overall market direction. The dynamic protection strategy is specifically designed to cushion market drawdowns in the portfolio.

Specialized equities & fixed income
 A strong focus on sustainability and quality permeates all our efforts in the selection of publicly traded securities for our multi-asset portfolios and individual mandates. Value-add through active management is another cornerstone of our public market strategies. In addition, we engage in attractive niches such as global inflation-linked bonds or emerging market debt in local currency.

* Assets include shareholder, staff and client investments
 The quota above represent the long-term, strategic asset allocation. The actual, invested asset allocation can deviate considerably from these numbers for tactical and portfolio management reasons.
 Source: LGT Capital Partners

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Legal information

The LGT Group Endowment follows the same investment approach that is used for the Princely Family of Liechtenstein. LGT Group Endowment is not available for investment by US investors.

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