Capital Partners
your partner for alternative investments

Life beyond zero

Investment outlook 2023

“I can’t change the direction of the wind, but I can adjust my sails to always reach my destination.”

Jimmy Dean

Cover picture: www.istockphoto.com, Man with a mask for diving emerges from the lake, head closeup

Contents

Introduction

Not too long ago, we were lamenting the dearth of investment opportunities in a world awash with cheap liquidity and deeply suppressed yields. But now that interest rates around the world are moving up, we realize that life beyond zero is not exactly the joyful return to the land of plenty. Quite to the contrary, in fact, as monetary policy is not the only one that turned from friend to foe and stiff headwinds abound. In this publication, we first look at the various shifts and rifts that are disrupting the global economy and financial markets, and how investors should adapt to the changing realities, but also prepare to embrace new opportunities arising.

In a second section, we delve into the segments of the alternative investment landscape, where we have been actively engaging as a principal investor for over two decades. We share our observations and assessments on private equity, private credit, real estate, and infrastructure, as well as liquid alternatives and insurance-linked strategies. In particular, we emphasize recent trends, the challenges of the current environment and attractive future investment opportunities. Last but not least, we provide an update on pertinent issues regarding sustainable investing.

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

Life beyond zero–investment outlook 2023

With their rapid emergence from below zero, interest rates are causing a violent re-rating in financial markets and a clouding of the economic outlook. And as the receding liquidity tide is laying bare vulnerabilities, investors need to tread carefully and re-examine the robustness of their portfolios. But the shifts and rifts in policies and the markets lead to a changed investment landscape that also opens up a multitude of long-term investment opportunities.

Real economy

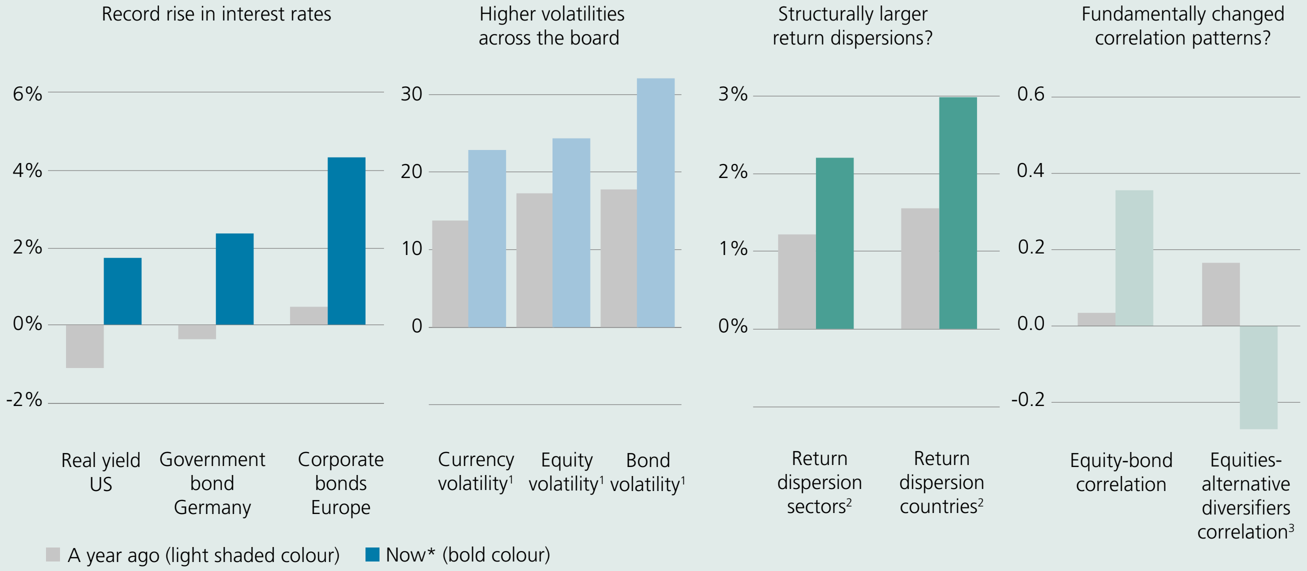
Rising interest rates are taking their toll on the economic outlook, as are swelling geopolitical tensions and growing global fragmentation. For 2023, the business cycle is first pointing downwards, with stagflation a dominant risk. But later on, the global economy could be revived by a relaxation of current headwinds and an intensifying of investment activity that might usher in a buildout boom.

Financial markets

The old market regime is clearly disrupted, with financial assets re-rating to tighter liquidity conditions and higher macro-volatility. This process, although already advanced, may still have some ways to go. It results in a reshuffled ranking of attractiveness for asset classes. But it also upends and changes behavioral patterns in markets, with far-reaching implications for optimal asset allocation.

Life beyond zero

(Yields, volatilities, correlations)



* per November 2022
[1] VIX Index, MOVE Index (rebased), Global FX Volatility Index (rebased)
[2] standard deviation on returns from 11 GICS sectors, 33 largest countries by equity market cap
[3] global equities versus Managed Futures, Commodities, US Dollar Index; average 6-months correlation coefficient
Source: Refinitiv, LGT Capital Partners

Asset allocation

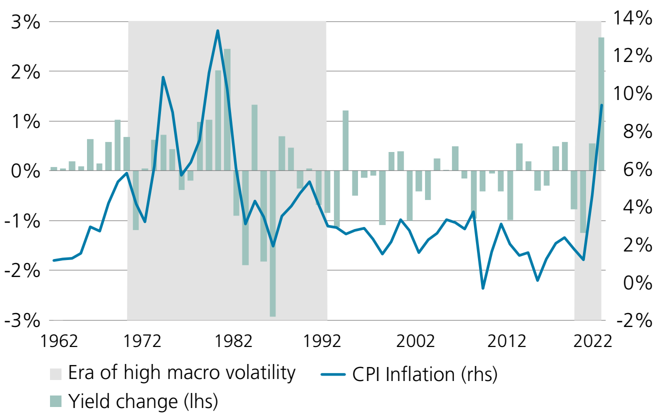
A robust strategic asset allocation and an active management approach go a long way in weathering the ongoing storm, while also not foregoing the potential upside upon a relaxation of the various headwinds. At its core, the LGT Group Endowment is a combination of diversifying liquid alternatives, long-term private market commitments, and carefully selected listed investments–all with a strong bias towards sustainable quality and a focus on risk-adjusted real returns.

On page 9 we make ten concrete recommendations to position a long-term growth portfolio for the new regime and to adapt asset allocation in the face of the many profound changes, as laid out on the next double page.

The global economy: seismic shifts and deeper rifts

The return of macro volatility

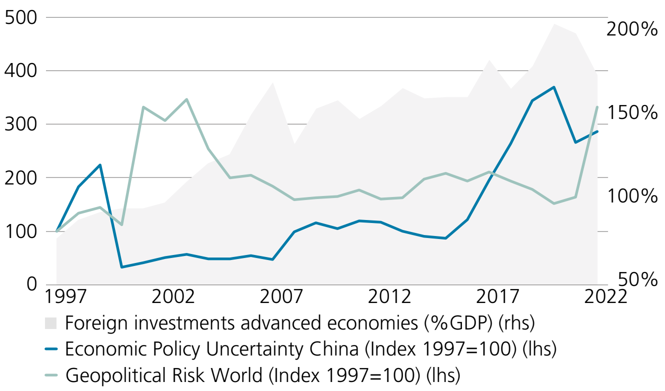
(Inflation, change in long-term interest rates; for US)*



* CPI All Urban Items; YoY%, change in 10Y US Treasury yields
Source: Refinitiv, LGT Capital Partners

The (head-)winds of policy change

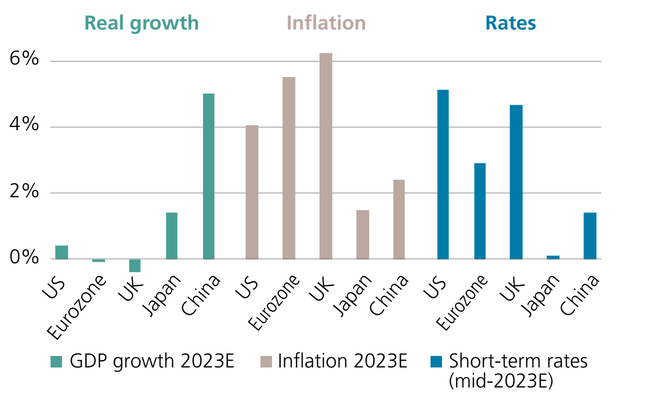
(Foreign investments*, geopolitical risk, economic uncertainty)



* international investment position of G7 nations, in % of GDP
Source: Refinitiv, Davis, Liu, and Shang (2019), Caldara, Dario, and Matteo Lacoviello (2021), LGT Capital Partners

Global fragmentation

(Real GDP growth, CPI Inflation, interest rate forcasts*)



* economic consensus forecasts for real growth and inflation rates; YoY%, short-term interest rates as implied by OIS pricing; except China = current policy rate
Source: Bloomberg, LGT Capital Partners

The last couple of years changed everything. For the global economy, the seismic shifts of post-pandemic dynamics mean that we have been jolted out of the drowsy state of secular stagnation for good. The massive surge in inflation rates and central banks' hurried moves to rein them in, have led to a regime change with profound consequences. For one, real interest rates are no longer pushed below zero. Restoring price stability has become policymakers' one and only goal for now, even at the expense of sacrificing growth. Expectations are already tilted toward an oncoming economic contraction – because an abrupt withdrawal of liquidity has usually led to a recession in the past. However, a "soft landing" or further "stagflation" are also possible outcomes for 2023. Either way, the return of the business cycle and erratic policy means that higher macro-economic volatility is likely here to stay.

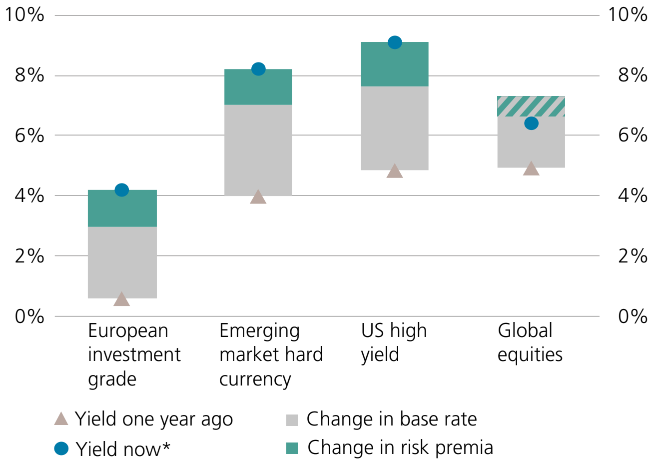
Monetary policy is not the only one that turned from tail- to headwind. Fiscal policy could become less generous as government spending is currently constrained by the fear that it might further fan inflation. The towering debt levels are also an issue, but, for better or worse, voices of concern may be drowned out by the many calls for even more state support. "Big Governments," whether they hail from the left or the right, are bound to intervene in a more frequent and incisive manner. This can provide stimulus, but it also increases uncertainty. A major manifestation of this can be found in the awakened "Great Power" rivalry between the US and China – and between their respective allies. The geopolitical confrontation has global investors on alert. Jurisdiction risks now need to be reassessed and foreign holdings stress-tested for a scenario of escalating economic sanctions and financial warfare.

In conjunction, the return of the business cycle and global fragmentation imply a higher degree of regional heterogeneity. As global transmission mechanisms are impeded, a nation's (or region's) economy will be more about its domestic conditions and policies. Japan, for instance, is now in a decidedly different phase of the cycle than the US or Europe, whereas the UK is experiencing stagflation much worse than elsewhere. Meanwhile, China is clearly not taking its cue from the rest of the global economy. But the geopolitical rivalry with its goals for national self-sufficiency, together with the more economic motivations to redirect global supply chains, means that businesses and governments alike will need to continue investing. Moreover, achieving independence and resilience requires the realization of the energy transition. Ideally, this could usher in a great buildout boom in the years to come.

Financial markets: leaving low yields behind

The "Great Re-Rate" of financial assets

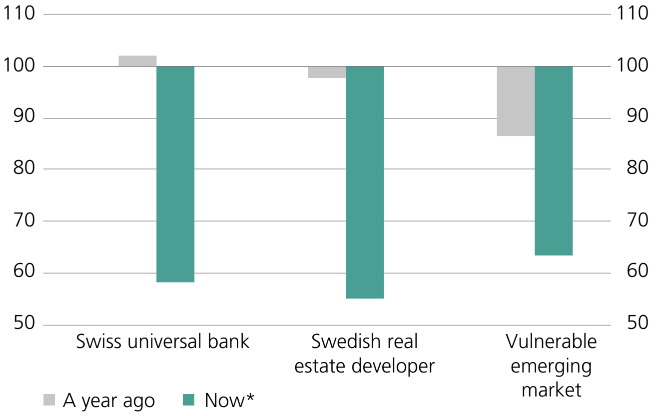
(Yield change* on select financial instruments)



* YoY change, per November 2022
Source: Refinitiv, LGT Capital Partners

Who has been swimming naked?

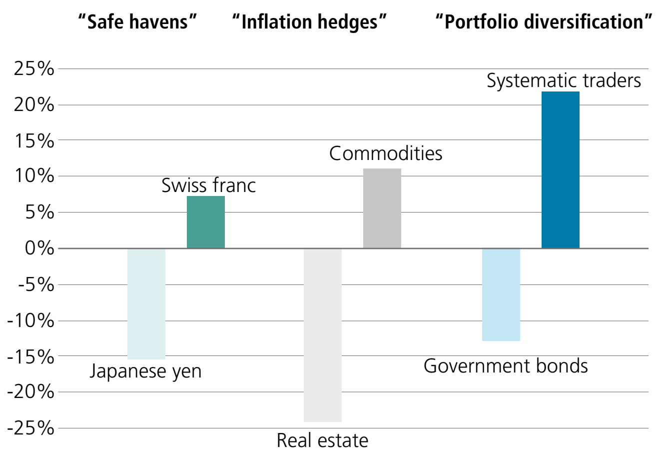
(Subordinated bond prices; vs. par value 100, a year ago and now*)



* as of November 2022
Credit Suisse AG Jr. subordinated, Castellum AB Jr. subordinated, Turkey government bond
Source: Refinitiv, LGT Capital Partners

Tallying tantrums

(One year performance of select financial assets/strategies*)



* YoY% change of index returns, in USD, per November 2022
Source: Refinitiv, LGT Capital Partners

In financial markets, the sharp rise in interest rates has already wreaked havoc. Assets have been repriced to incorporate higher base rates and provide risk premia that are more consistent with the economic slowdown currently underway. There are variations, however. While most credit segments now seem to fully price a mild recession with higher defaults, equity markets appear to be more sanguine about growth prospects. Thus, the great re-rating of asset classes to the new world of above-zero interest rates and higher macro-volatility is still underway. Short-term, this offers tactical opportunities as different markets may under- or overprice certain risks. Long-term, it means that we have a genuine chance of returning to normalcy, where investors can enjoy the full suite of asset classes and base their allocation decisions on economic fundamentals rather than all-distorting monetary policies.

Unwinding a decade of zero-rate financing is a painful affair. Spiking debt servicing costs and a strong US dollar are exerting pressure all over, but most notably on levered and externally financed positions. In addition, central banks have stopped purchasing bonds in the open market and are looking to let trillions worth of debt mature and run off their balance sheets. Episodes of liquidity stress are already visible. So far, markets have toyed with the possibility of a rerun of the last financial crisis. This is not very likely. The banking system is in much better shape, and real estate, although red-hot and now cooling in places, is more conservatively financed. Nevertheless, permanently higher interest rates will take their toll somewhere. A strict focus on sustainable quality and sound financing structures goes a long way in surviving and thriving in a higher rate environment.

The regime shift goes beyond the rise in yields. The year 2022 has brought a series of rattling changes in the market's reaction function and interdependencies. Take the Japanese yen, for instance: Traditionally a safe haven in times of turmoil, Nihon's currency could not fulfill that role recently – on the back of strong divergences in its monetary policy (see opposite page). Worse still is the breakdown of traditional portfolio diversification between equities and bonds, or the failure of many real assets to adequately protect against rampant inflation. As the initial shock of the rate surge wanes, some of these long-standing relationships may start functioning again. However, others may not. It is therefore vital for investors to revisit their portfolios' robustness and, where appropriate, adapt the asset allocation to the changed realities.

“Kites rise highest against the wind – not with it.”

Winston Churchill

Asset allocation: adapting to life beyond zero

The LGT Group Endowment's approach

Without a doubt, the transition to a world with above-zero interest rates has been hard on existing investment portfolios. The good news is that this change also brings many fixed income segments back on the map for asset allocators, and the dislocations around the regime shifts can create myriad investment opportunities on top of that. But in a rapidly altering world, asset allocation is now more than ever about managing risks. And while this is still the time-tested mission of carefully selecting and optimally combining return sources to an effectively diversified portfolio, the ways in which this is accomplished have arguably changed. After all, investors need to adapt their thinking to the new environment and (re)learn to cope and thrive above zero.

Based on the core investment convictions and the strategic asset allocation of the LGT Group Endowment (see page 21), we have the following ten recommendations to position long-term growth portfolios for the future:

1. Set up a robust strategic asset allocation that can weather different macro-economic scenarios, more pronounced business cycles, regional heterogeneity, and adverse policy interventions – do not bet on one particular future outcome.

2. Adhere to an active management approach with benchmark-agnostic security selection, frequent portfolio rebalancing, and anti-cyclical buying of deep value on market dislocations.

3. Add to flexible systematic and discretionary strategies that are beneficiaries of higher macro- and market volatility, and that can enhance returns in benign environments, but also mitigate portfolio drawdowns in broad-based corrections – Managed Futures and Global Macro, in particular, are such flexible and adaptive strategies.

4. Choose financial assets with a focus on the real returns they may provide, and combine nominal growth-sensitive assets (such as real assets and equity) with more outright inflation-protection (from inflation-linked bonds or gold).

5. Shift some exposure into the now relatively attractive credit segments of high yield bonds or emerging market debt, and commit to private credit programs that cover a wide range of solutions and time-diversify their investments.

6. Keep committing to cycle-tested, high-quality private equity managers that stand to profit from industry consolidations and value opportunities in the secondary markets.

7. Maintain significant exposure to listed equity risk, but implement with a defensive style-tilt by focusing on sustainability, quality, and low volatility.

8. Stress-test allocations and exposures with regard to domicile- and jurisdiction risks upon major geopolitical clashes, and with regards to necessary alignment with world-wide efforts to avert climate change; avoid concentration in carbon-intensive industries.

9. Stay invested in China but avoid business that could come into the crosshairs of domestic or international policy conflicts; access superior growth sectors through private equity, include flexible strategies such as Long-Short or Relative Value, diversify into other Asian markets, and hedge currency exposures to Greater China, where feasible.

10. Hedge most foreign currency exposures, but keep a strategic allocation to the US dollar for portfolio risk mitigation purposes – despite the fundamental overvaluation and stretched positioning.

“Life is a series of natural and spontaneous changes. Don’t resist them – that only creates sorrow. Let reality be reality. Let things flow naturally forward in whatever way they like.”

Laozi

Special topic: is China still investable?

In the aftermath of the pandemic, the international geopolitical realignment that followed Russia's invasion of Ukraine and a shift in China's domestic policies, investing in the People's Republic has become a much-discussed topic.

Waning economic tailwinds

Economically, while China does not face immediate stagflationary risks and has room to respond with policy stimulation, the property bust and debt deflation pressures are impairing its outlook. The country will also continue to experience a flatter trajectory in its future economic potential because the credit-reliant growth is hitting limits, demographics are turning into a headwind, and productivity gains are set to fall further due to its autocratic push at the expense of private economic freedom and liberal market reform.

Mounting political headwinds

Politically, the US–China "Great Power rivalry" is becoming entrenched as it gets codified in laws and regulations, and the attitude among US allies, especially in Europe, has markedly turned. Both sides of the growing divide will thus strive for greater supply chain security and self-sufficiency – which has broader economic consequences for all. Although a détente is possible in principle, the current tensions over technological, economic, military, and political or ideological issues, as well as differences over human rights will probably remain in place in the years to come. However, an immediate and drastic escalation of animosities, possibly over Taiwan, with damaging consequences for the global economy is rather unlikely – and remains a tail risk only.

Investment case put to the test but selectively intact

That said, the market is still likely to remain investable and attractive in several areas. The fact that China turns inward and aims for substitution of high-tech imports via industrial policies, combined with the size of its economy, efforts to strengthen domestic consumption, and its dominant role in global supply chains, means that many domestic growth areas will remain in place. This particularly applies to consumer products and services, renewable energy, electric mobility, and the key materials needed for the energy transition. Climate action-related sectors could also remain quite open as Western and Chinese goals are more aligned here, and both sides need a relatively "safe space" for diplomacy and cooperation. Finally, China may also offer significant diversification advantages to international asset allocators due to the already fairly low correlation of its equity and bond markets with developments in the respective global markets.

A measured approach to investing in China

Nonetheless, higher political and governance risks will require a higher risk premium for holding Chinese assets going forward – and thus a larger than average valuation discount versus developed market assets. In addition, an active approach is of utmost importance to avoid sectors and businesses that could be caught in the crosshairs of domestic policy efforts or as a result of the geostrategic conflict. Investors should keep their overall risk exposure to Greater China within reasonable bounds and increase efforts to diversify into other Asian markets, such as South East Asia, India, Korea, and Japan, which are likely to benefit from a shift in trade patterns and supply chains. Finally, currency exposures to China and Taiwan should be hedged, where feasible, as the risk/reward ratio now looks asymmetric and the hedging conditions have improved markedly on narrowing interest rate differentials.

Private equity

The year 2022 capped off more than a decade of unmitigated growth in private equity markets, with a sense of euphoria surrounding record performance. This trend was punctuated by a series of events: the conflict in Ukraine, substantial inflation, rising energy costs, and 14 years of interest rate declines erased in a few months.

We may now be in the early stages of a broader market correction, but unlike the Great Financial Crisis, we have not yet seen substantial declines in private equity valuations. While there has been a slowdown in private equity activity after an extraordinary 2021, the asset class remains robust in the overall macroeconomic context. The question we are asking is, how will the asset class cope with the next phase in what may be a protracted market correction? Historically, private equity's success has not been predicated on short-term market movements, and private equity and venture capital have never underperformed their public equity benchmarks, therefore showing resilience during times of market corrections.

We enter this environment with significant unrealized assets in private equity funds. Based on our own estimates*, around 87% of invested capital from 2017-2020 vintage year funds remains unrealized, a high number in historic context. These assets will seek fresh near-term liquidity, which is expected to result in meaningful deal flow and investment opportunities over the coming years. Thus, the current environment, although certainly challenging, is also a chance for the most skilled managers to excel and lay the foundation for potentially exceptional performance on the latest vintage years as well.

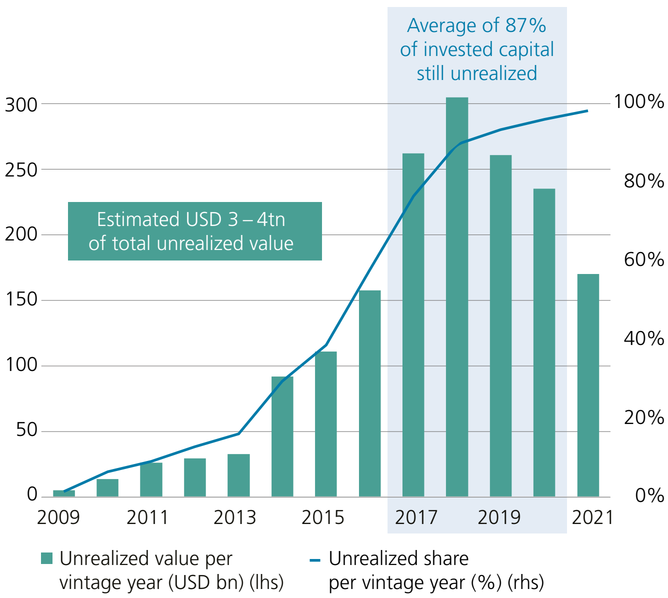
Investment activity

Amid rising rates, deal activity has been markedly slower in the second half of 2022 relative to prior years. Tighter access to debt financing and slackening public listings have resulted in a meaningful decline in dealmaking compared to most recent years. However, this comes off a record 2021, when financing was nearly free and public markets were highly accommodative. Managers are increasingly looking at smaller businesses as accretive add-ons and roll-up plays – those investments that require little leverage and can help businesses grow into the heady multiples paid in the last several years.

Investment activity has also moved increasingly to the secondary market with both managers and investors investing and generating liquidity through continuation funds and the sale of limited partnership interests. Volumes in the secondary market were higher in the first half of 2022 compared to the same period last year, with GP-led activity giving way to investor portfolio sales. The latter accounted for approximately two-thirds of transaction activity, as sellers, mostly pension funds and endowments, were driven by the "denominator

GPs – unrealized private equity NAV needs a solution

(Unrealized value in PE portfolios by vintage year, share of total)*

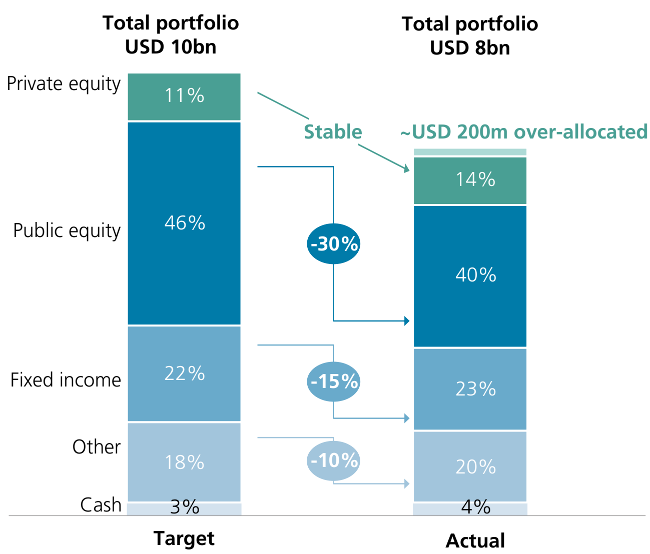


* LGT CP estimates; net asset values and share NAVs/total paid-in per vintage year for private equity Buyout funds, as of 30 June 2022

Source: LGT Capital Partners proprietary database

LPs – market volatility drives over-allocation to PE

(Illustrative impact of public market declines on a USD 10bn pension fund's portfolio)



Source: American Investment Council, LGT Capital Partners effect" – the need to rebalance portfolios, increase liquidity, and free up investment capacity. The slowdown in GP-led activity was largely driven by buyers taking a more cautious and selective approach and hitting single-asset exposure limits in their current funds. However, the volume of GP-led deals could rebound in upcoming quarters as managers look to extend the life of an asset while generating liquidity for investors.

Valuations

Private equity valuations often lag behind those of public markets, with public market drawdowns historically more slowly transmitting to private equity, and often to a lesser extent. We have thus far seen more significant declines in large buyout valuations, driven by both the mark-to-market effects of public comparables as well as the typically higher levels of leverage employed by larger funds.

The greatest impact on valuations has come in software and venture-backed businesses. Unsurprisingly, high-quality, profitable businesses have shown greater resilience than businesses that are yet to fully demonstrate their worth.

Market participants

As managers seek liquidity in their portfolios and play defense on existing assets, continuation funds and equity recaps are forming the basis for alternative forms of liquidity for funds. Portfolio financing and NAV-based loans are tools increasingly used by managers to protect assets and secure more time to work with portfolio companies' management teams. Investors are facing tough decisions as the denominator effect continues to drive over-allocation to private equity, thus impeding re-ups and the addition of new managers. However, private equity has often been the highest performing asset class on an absolute basis in many long-term investors' portfolios. As a result, investors either decide to raise caps on private equity allocations by widening the target range or to remain active in the market by rebalancing portfolios. Investors are increasingly assessing secondary sales as a practical, or necessary, route to de-risk portfolios. However, a significant cohort of investors are taking advantage of a more muted fundraising environment to remain active, capitalize on a potential dislocation, and gain access to high-quality funds.

2023: Where do we go from here?

While the broader outlook is uncertain, private equity has already tested its resilience during multiple crises and developed tools in the last decade to both defend existing portfolio companies and capitalize on a market dislocation. Both managers and investors have a higher degree of sophistication, and substantially more dry powder than in past downturns. We have been in a market that has been "up and to the right" for a long time, and all market participants will have to sharpen their pencils in both re-underwriting their existing portfolios and identifying the managers and assets that they believe will be able to withstand a protracted correction.

Of course, we do not have a crystal ball to tell us if this will be a short-term dislocation or a longer-term structural change. We do, however, remain convinced that private equity has the patience and dry powder to continue its long-term, consistent relative outperformance and strong absolute performance as we enter the coming year.

Key themes in private markets

Investments	Sector trends	■ Technology seeing a re-rating as cyclicals start to fade
	Deal structures	■ Add-ons widely preferred while public-to-privates and carve outs also gain traction
	Financing	■ Less levered businesses favored as financing constraints bite
Divestments	Exit pacing	■ Exit activity has slowed ■ Managers are waiting to maximize value
	Exit types	■ Roll-ups and add-ons favored ■ Continuation funds remain robust
Market participants	General Partners	■ Alternative liquidity routes: NAV-based lending and GP-led secondaries ■ Mix of sentiment, preparing to play both defense and offense
	Limited Partners	■ Significant over-allocation and denominator affect ■ Many investors testing the secondary market ■ Investors looking to capitalize on potentially strong vintages

Source: LGT Capital Partners

"The key is to embrace disruption and change early. Don't react to it decades later. You can't fight innovation."

Ryan Kavanaugh

Private credit

The private credit asset class has seen sustained expansion since the retrenchment of the banks following the Great Financial Crisis in 2008. According to data provider Preqin, total private credit manager assets under management surpassed USD 1 trillion in 2021. This expansion has provided investors with the choice of an ever-broadening set of underlying strategies making up the private credit universe.

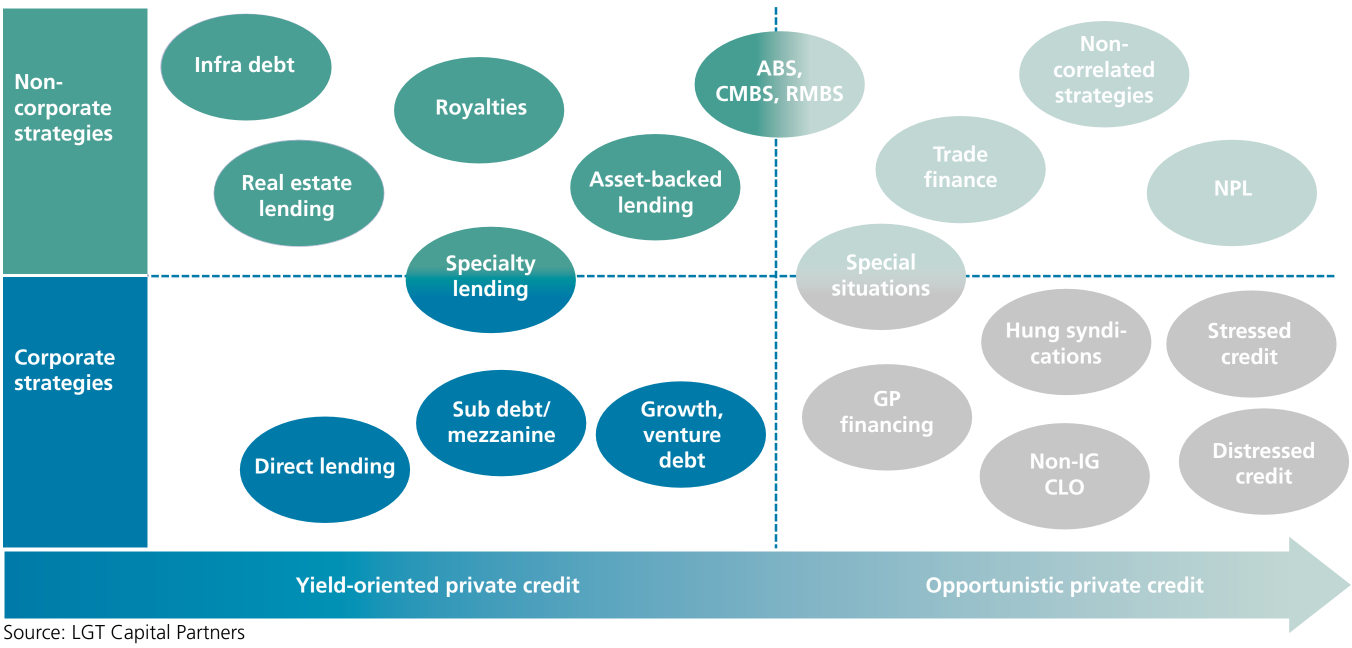
More recently, the separation between public and private credit markets has become evident. Geopolitical and macroeconomic uncertainty during 2022 has translated into significant volatility in public credit markets, such as high-yield bonds, with new issuance largely grinding to a halt. Meanwhile, private credit has gained market share due to significant dry powder and its inherently less volatile nature. Amongst investors, private credit is increasingly viewed as a mature and stable asset class which can deliver consistent returns, even in turbulent market conditions.

Recent central bank policy response has highlighted a substantial benefit of private credit as an asset class. Private credit assets are typically floating rate instruments, which provide built-in inflation mitigation and enhanced returns in a rising interest rate environment. Return profiles have been further boosted in 2022 due to widening credit terms, in the form of higher margins and original issue discounts.

On the other side of the coin, in Direct Lending for example, the impact of rising inflation on portfolio companies is only starting to show now due to the lagging effect it has on margins. For businesses that are not able to pass on input price increases, the combination of demand side pressure, margin erosion, and heightened interest expense could mean higher stress. We expect an increase in default rates over the coming quarters, which have been close to historical lows for some time. As a result, there will likely be higher dispersion in the performance of credit assets and with the specialists that manage them, making asset and/or manager selection of paramount importance. In our in-house investment process, we partner with top tier sponsors, favor high-quality borrowers operating in non-cyclical sectors, and employ a well-defined and prudent portfolio construction methodology. The private credit market has also seen ESG considerations become more prevalent in investment selection and documentation. Margin ratchets linked to defined ESG criteria are one example of this, and we expect this trend to continue.

Finally, the growth of non-corporate strategies is evident too, with infrastructure debt, non-performing loans ("NPL") and non-correlated strategies now commonplace. With widening choice, and more than 2,300 private credit managers active globally, comes added complexity. It is vital for investors to build a diversified and balanced portfolio which can exploit market opportunities, withstand volatility, and build value over the long term.

Broad private credit universe



Source: LGT Capital Partners

Real estate

Dramatically heightened geopolitical risks, coupled with inflationary pressure and the resulting shifts in monetary policy, clearly affected real estate, although sharp declines in private market transaction activity from Q2 2022 onwards have resulted in limited price discovery to date.

Cap rate softening and consequently price corrections can be expected in real estate in the short- to mid-term. Along with higher interest rates, it is anticipated these impacts will be felt across the market: at one end, priciest core assets where margins over risk-free rates are thinnest; at the "worst" end, where assets have already become close to obsolete due to other long-term shifts (e.g. regional shopping centres, dated offices in remote locations) and have now become practically unfinanceable; and in the middle, assets that need to be refinanced in the next 12 months and potentially face lower loan proceeds and a corresponding capital infusion.

On the bright side, tenant demand in most sectors continues to hold up, with vacancy levels at record lows in multiple niches such as last-mile logistics, life sciences, and certain pockets of the residential sector. At the same time, new supply, which had already been limited pre-2022 due to a slowdown in activity from Covid-19, is now facing additional shortages stemming from construction price inflation and difficulties in securing speculative development financing. Whilst the demand impact of a prolonged scenario of economic turmoil and/or high inflation is difficult to predict at this stage, we feel confident that the market will continue to see resilient tenant and ultimately investor demand in those sectors, being largely driven by long-term trends with limited cyclicality such as e-commerce, urbanization, and an ageing population.

While we do not expect broad-based distress, we anticipate interesting opportunities over the next 12–24 months to arise from selective special situations, for example ill-capitalized or stalled development projects with potential refinancing difficulties in the current environment. Market participants with the ability to invest creatively across the capital stack will likely be able to capitalize on these opportunities by providing structured rescue financing or resolving insolvency situations, thereby locking in attractive acquisition bases far below replacement costs.

We also expect investor demand to provide price support in resilient, long-term demand-driven niches, in particular where leases are fully indexed to consumer price indices, thereby providing effective inflation protection as a highly attractive differentiating factor setting real estate apart from most fixed-income alternatives. An ability to manufacture strong, inflation-protected cash flow by means of active asset management will remain key to unlock value in those opportunity spaces.

Finally, ESG has become an increasingly pressing topic for real estate, especially in Europe, with North America and certain institutional Asian markets catching up swiftly. We expect ESG to remain a focal point for years to come as dated stock will need to be upgraded to comply with (partially government-enforced) environmental standards. The market across the board is not yet fully pricing these inevitable capex measures, which we believe will provide ample opportunity to capture upside for those investors equipped with the necessary expertise to address ESG-led refurbishments.

Infrastructure

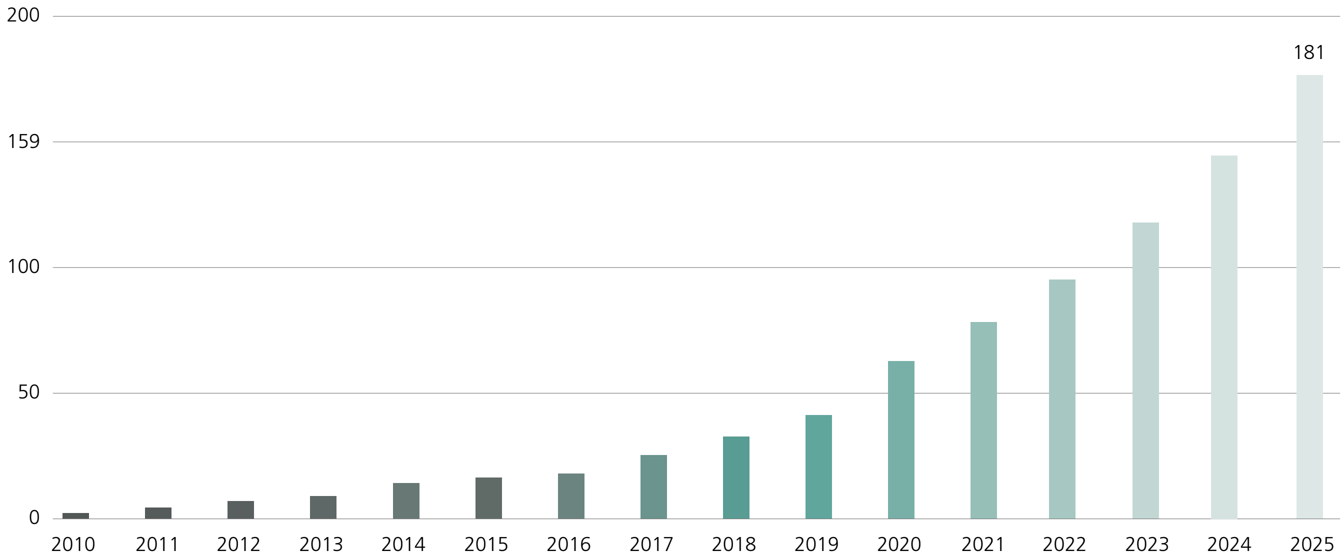
While the macro-economic landscape continues to be challenging with persistent high inflation, supply chain constraints, and rising interest rates, LGT CP's infrastructure portfolio has been able to weather the current challenges well. The resiliency of the portfolio reflects our focus on businesses with key infrastructure characteristics, including the provision of essential services, high barriers to entry, and an ability to pass through inflationary pressures.

Sustainability factors continue to be an industry-wide focus, with decarbonization as the key industry trend shaping both opportunities and challenges. Decarbonization efforts are not only leading to the replacement of fossil fuel power generation with renewables and batteries, but also driving new investment opportunities in emerging sectors such as green hydrogen, EV charging infrastructure and renewable fuels. In addition to energy transition, we also continue to see strong deal flow in the digital infrastructure sector, driven by the world's growing demand for data and the resilience of the sub-sector during the Covid-19 pandemic when digital connectivity proved critical for business continuity in times of crisis.

According to forecasts from data provider IDC, the global volume of data is expected to grow to 181 zettabytes by 2025, ten times the data that existed in 2016. To address the ever-growing demand for connectivity, a significant number of infrastructure funds are establishing large greenfield platforms to roll out fiber as well as investing in mobile towers, data centers, and related digital infrastructure.

In terms of valuations, we have not yet seen a significant impact on infrastructure given sustained high levels of dry powder. In particular, assets that have proven their resilience during the pandemic and have an ability to pass-through inflationary pressures continue to command high prices. However, we do expect some stress in infrastructure financing markets for assets with significant exposure to energy prices and an inability to pass-through inflation if the economic climate continued to deteriorate. With the definition of infrastructure expanding and macroeconomic headwinds mounting, we remain as focused as ever on investing in assets which provide essential services with strong barriers to entry, pricing power, and no near-term refinancing requirements.

A growing digital economy needs a strong backbone
(Global data demand in zettabytes*)



* One zettabyte is equivalent to a trillion gigabytes. A single zettabyte is equivalent to 250 billion DVDs
Source: IDC Global DataSphere Forecast, 2022-2025

Liquid alternatives

Over the past couple of years, the world has been fighting a pandemic, which has drastically changed consumer behaviors while severely distorting global supply chains. In response, unprecedented fiscal and monetary stimulus has led to persistently high inflation and large market dislocations. We firmly believe that liquid alternatives are well equipped to capitalize on the seismic shifts that are underway. The end of the era of "Great Moderation" and "Financial Repression", the return of the business cycle with larger regional and sector dispersions, and changing interdependencies in many investment markets all create a backdrop that is favorable for such active investment strategies.

As for systematic strategies, they are able to capture regime shifts agnostically, immediately and with complete objectivity. Thanks to their broad diversification and scalability, systematic strategies are able to capture opportunities across multiple asset classes and thousands of markets simultaneously. They provide investors not only with long/short equities and bonds exposures but also with actively managed positions across a wide array of commodity and currency markets. This ability to go long and short in a very broad range of assets is highly beneficial in the current market environment as it allows flexible trading around business and interest rates cycles. Systematic strategies can comfortably profit from shorting equities and/or fixed income in bear markets and are able to capitalize on significant price moves in commodities, especially during inflationary or deflationary periods.

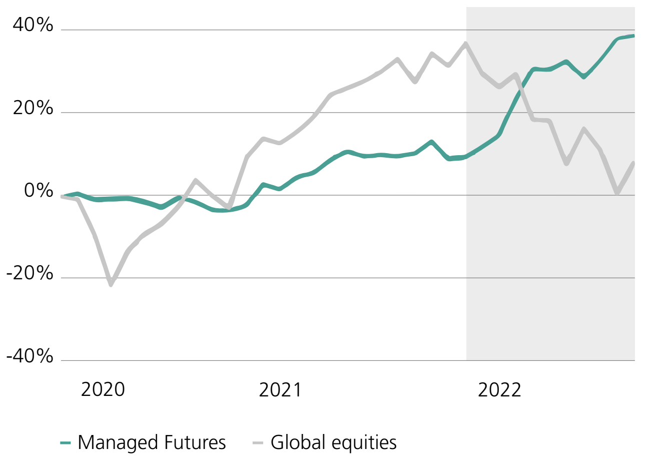
Most systematic trading programs have performed very well recently, having just had one of their best years in history. Strategies such as quantitative macro or trend-following that systematically consider economic and price related data have captured the large market moves and mainly profited from short interest rates and long commodity positions. They have also benefited from the increased FX volatility. These strategies are particularly well-qualified to handle the new, more uncertain market environment.

As for discretionary strategies, the renewed importance of fundamentals and increased dispersion broadens the opportunity set and improves the odds of success of long-short equity and credit approaches. Moreover, the higher interest rates environment favors event-driven strategies as cost of capital has risen, putting pressure on earnings, leading to deteriorating financials, and resulting in more corporate restructurings.

History has shown that liquid alternatives can perform in a wide range of scenarios. Given the current macroeconomic imbalances worldwide and the renewed importance of fundamentals, there will be further tailwinds. We believe that liquid alternatives should be an integral part of a well-diversified portfolio, as they tend to deliver uncorrelated and attractive returns regardless of the market environment. As the gratifying recent performance shows, the asset class is able to fulfil the role of an alternative return source.

Strong performance of systematic strategies

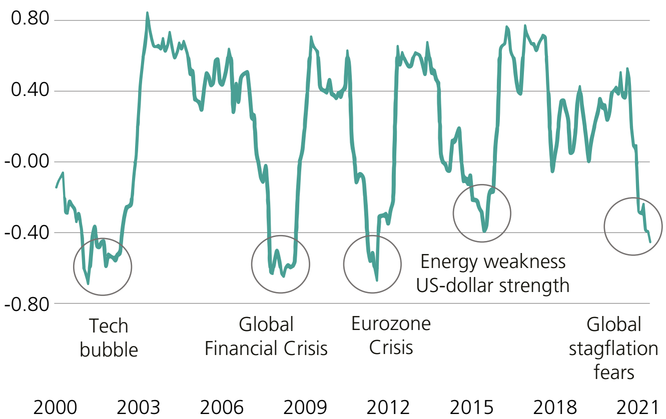
(Managed Futures vs. global equities)*



* Managed Futures is SG CTA Index, global equities are MSCI World, in USD
Source: Bloomberg, LGT Capital Partners

Adaptiveness of systematic strategies

(Correlation with a traditional portfolio)*



* 12-months rolling correlation coefficient – Managed Futures vs. 60/40 stock/bond portfolio. Managed Futures represented by SG CTA Index
Source: Bloomberg, LGT Capital Partners

Insurance-linked strategies (ILS)

The year 2022 has presented ILS investors with a rollercoaster ride of emotions. On the one hand, the ILS and reinsurance market are going through a fundamental "hardening" phase with significantly improved premiums and contractual conditions, which creates a phenomenal momentum in ILS and reinsurance investing. On the other hand, the return experience of recent years, the impact from secondary perils (e.g. flood and severe weather events) and just recently the occurrence of major hurricane Ian, have caused some skepticism towards the asset class, especially when taking into account the effect of climate change on the frequency and severity of weather-related natural disasters.

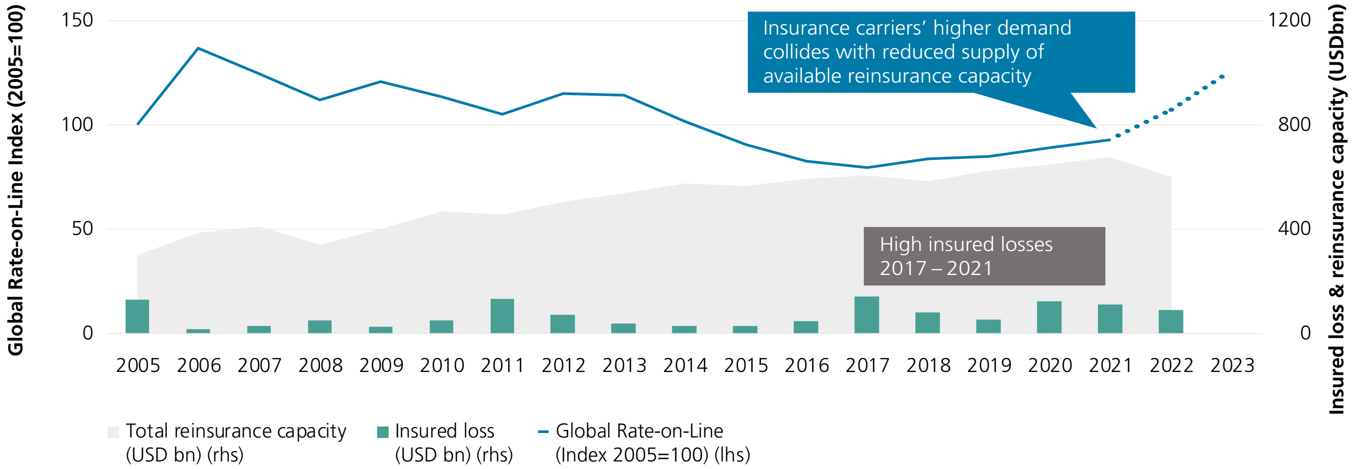
Indeed, the event activity over recent years has eroded a significant amount of surplus capital from insurers' balance sheets. As a response, market participants have put a much stronger focus on generating positive underwriting returns again. The term "responding to climate change" was thus often used during this year's renewal rounds as a general explanation for underwriting actions taken by insurance and reinsurance carriers to optimize their portfolios.

In addition, the corrections in equity and fixed income markets this year have further weakened insurers' balance sheets, and financial markets no longer offer the comfort of a strong, uninterrupted equity rally or record-low interest rates. Lastly, whilst inflation has been a somewhat theoretical (although modelable) threat for some time, it has now rapidly evolved into a very real and active strain on the industry, as inflation leads to higher replacement values, increasing the cost of future loss events. As a result, the insurance sector is now facing stricter capital requirements from rating agencies and regulators.

This overall challenging environment for the insurance sector may lead to the most attractive period for ILS since the last truly hard market occurred in the aftermath of hurricanes Katrina, Rita, and Wilma in 2005, and hurricane Ike in 2008. ILS managers who are able to provide reinsurance capacity to meet the demands of buyers will be differentiated from peers and rewarded through preferential terms and very attractive risk premiums.

Attractive outlook for the global reinsurance market after loss-heavy years

(Reinsurance capacity, insured losses, premiums ratio)*



* Rate-on-Line is the ratio of premiums paid relative to the loss recoverable in a reinsurance contract and is thus a measure of risk pricing

Source: LGT ILS Partners, Swiss Re Sigma, Munich Re, Guy Carpenter; data as of 30 September 2022; insured losses for 2022 are based on latest available industry loss estimates and assessment of LGT ILS Partners; premium estimation for 2023 is based on LGT ILS Partners' latest market assessment. This data is purely illustrative and is not a guarantee of future results.

Sustainability update

Spotlight: energy goals
On the back of the war in Ukraine, energy prices have seen a drastic increase globally. This has led to revived and increased momentum for renewable energy, which with the high price levels of fossil-based energy sources have become more cost competitive than ever. Increased energy bills, combined with the sense of urgency to limit emissions and halt global warming, have forced many consumers and businesses to reduce their energy consumption and implement energy efficiency measures. In a way, while it still requires significant efforts to achieve the emission levels agreed in the Paris Agreement, the current energy crisis could well be an important catalyst for the energy transition.

The implementation of environmental, social and governance ("ESG") considerations in investment decisions has become standard practice, and the ESG agenda has received widespread support among asset owners and asset managers globally.

Over the past year, however, ESG integration has also faced a surge of public criticism. This criticism typically claims that ESG is not always effective in turning its ambitions into real-world outcomes, that it relies on too many different frameworks without appropriate measurement tools, and that it ultimately could have a detrimental effect on corporate earnings and investment performance. Certain investors have been accused of "greenwashing", sometimes rightfully, and various asset managers have downgraded the ESG credentials of their offerings. All of this has led to an increased awareness among a broader audience about potential ESG shortfalls.

Making real progress against the environmental and social challenges we face requires a wide-ranging, holistic effort that includes substantial contributions from companies, consumers, and lawmakers. LGT CP recognizes that the financial industry has a role to play, too. It controls the levers which can push the global economy towards more sustainable business practices, steering investors to allocate more capital to companies with solid ESG track records, and away from economic activities that harm the environment or societies.

In addition to the work of investors, smart, effective laws and regulations are essential. Sustainable business practices should translate into clear commercial benefits and competitive advantages for companies. The EU Sustainable Finance Action Plan has begun defining ESG standards to ensure that those who claim to invest sustainably also do so in practice. Other jurisdictions are working toward similar regulatory frameworks. In the US, for example, the Securities and Exchange Commission has expanded its mandate to investigate ESG and sustainability claims. In the UK, the Financial Conduct Authority is working on a Sustainability Disclosure Regime ("SDR"), largely mirroring the EU disclosure and transparency rules. We believe that such regulations will play an important role in creating a more sustainable global economy.

We at LGT Capital Partners acknowledge the challenges the financial industry is facing with ESG integration. We also agree that the current existing frameworks require further improvements, especially when defining benchmarks and measuring ESG outcomes. We are, however, convinced that integrating ESG into investment processes and aligning the efforts with frameworks such as the Sustainable Development Goals ("SDGs") and the Paris Agreement on climate change remains essential. When practiced with integrity and rigor, it will help to identify long-term risks and opportunities that affect investors' bottom line, as well as people and planet. Still, the criticism against ESG is a useful call to investment managers to approach ESG in a systematic, robust way, and for asset owners to demand the highest standards of their managers.

As such, it is encouraging to observe, in recent months, an accelerating allocation of capital to investments with clear positive outcomes and impact. For example, the worldwide impact investing market reached USD 1.164 trillion in October 2022, up from USD 715 billion in 2020, as estimated by the Global Impact Investing Network. This is a positive development which we expect to continue in 2023 and beyond.

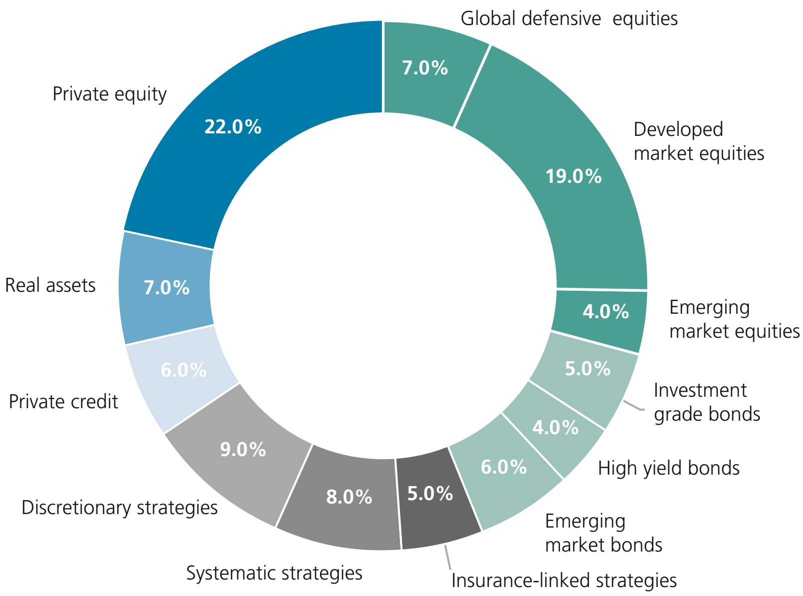
How we invest our own money

LGT Capital Partners has been managing and investing a combined portfolio of traditional and alternative investments, the LGT Group Endowment, for 24 years. Today, this strategy has more than USD 17 billion in assets under management* with USD 3 billion coming from LGT Group's sole shareholder, along with substantial capital from key investment professionals at LGT Capital Partners. This allows for a strong alignment of interest between the firm's owner, the investment team, and our investors.

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 and robust diversification help us build an investment portfolio with the ambition of generating attractive risk-adjusted returns despite changing market environments.

Life beyond zero

Our adaption of the strategic asset allocation for 2023 and beyond includes a shift from public equity to high yield bonds and private credit, an increase in diversifying elements such as systematic trading strategies, and additional hedging of foreign currency exposures.



Private markets

The owner-manager structure of private equity holdings, together with long investment horizons, allows for active value creation over a full cycle. In private credit, 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 discretionary managers. Insurance-linked strategies too, focus on returns that are independent of overall market direction. The dynamic protection program 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 quotas 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. Please note that the portfolio holds a leverage of 2% and 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.
Source: LGT Capital Partners

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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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