A new breed of private markets

Accessing liquidity through evergreen funds

Core Offerings

Our latest view of markets and insights into our latest strategic and tactical asset allocation positions

May 2024

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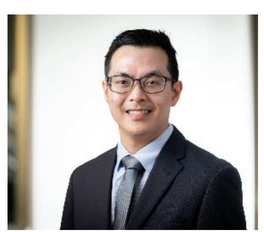
AN UPDATE FROM LGT CRESTONE'S CHIEF INVESTMENT OFFICE

Martin Randall
Head of Private Markets



Matthew Tan
Senior Asset Allocation Specialist

As recently as 10 years ago, private markets represented a minor holding in private client portfolios versus their more sizeable positions in listed bonds and equities. Today, they represent the largest segment of our alternatives program, which makes up nearly 20% of assets under advice at LGT Crestone. At the heart of this growth is a rapid evolution of private markets and the means by which private clients can access the asset class. This includes closed-end fund vehicles, used heavily by institutional investors, and evergreen vehicles, which are today dominating flows across private wealth.

Like anything that evolves rapidly, it's important to review developments from time to time to assess the broader implications. In this month's *Core Offerings*, we discuss how evergreen private market vehicles have improved liquidity dynamics and the impact on asset allocation. We also explore how this liquidity is generated and argue that not all liquidity is equal.

Revisiting the challenges of the 'old-school' approach

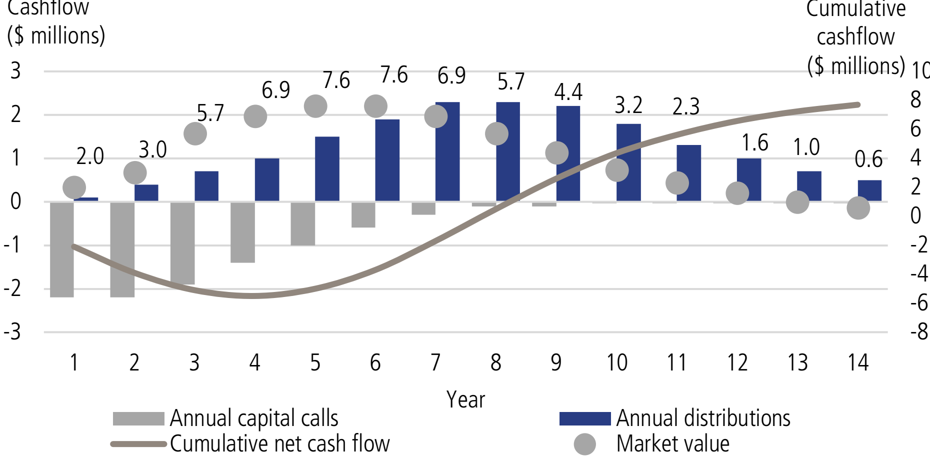
Firstly, it's worth revisiting how the market has evolved and how institutions continue to invest in private markets broadly. The closed-end fund takes its name from the fact that it has a limited life—typically, 10 or more years with potential extensions.

Closed-end vehicles align to the illiquid nature of private markets on both an inbound and outbound basis, whereby capital is called when investments are made and distributed as and when they are exited. This is shown in the illustrative chart below:

- Unlike public securities, which can be bought on an exchange at any time, private assets must be sourced, structured, priced and executed. This takes significantly longer than their public counterparts (the grey bars in the chart below represent capital calls for purchases). This means that it takes longer to become fully invested in a portfolio of private assets, i.e., inbound liquidity is limited.
- The disposal of assets also takes time relative to public securities, where a portfolio of private assets is gradually sold down during the fund's 10-year life (the blue bars represent distributions/liquidity events). Liquidity is at the discretion of the manager, reflecting when the manager wishes to and are able to exit a position—i.e., outbound liquidity is also limited.
- Maintaining market exposure (the grey dots show the fund's net asset value) also presents a challenge owing to these dynamics. Investors are required to continually over-allocate through the cycle to hit their target allocations.

Unlike public securities, which can be bought on an exchange at any time, private assets must be sourced, structured, priced and executed.

Investment life cycle ($10 million commitment to buy-out)



Source: Hamilton Lane's Proprietary Horizon Model. For illustrative purposes only. Past performance is not indicative of future results.

There certainly remains a meaningful place in private client portfolios for these structures, but their liquidity parameters, as well as operational complexities, present portfolio management and administration issues. This is something that evergreen structures seek to address.

The evolution of 'evergreen'

The new breed of private market vehicles for private clients are typically referred to as 'evergreen'.

The new breed of private market vehicles for private clients are typically referred to as 'evergreen'. This means they are available to buy and own on a perpetual basis. The table below provides an example of funds that are available in the local market and their high-level subscription and redemption terms.

Although much of the focus of these funds is on outbound liquidity (i.e., when the investor can get their funds back), inbound liquidity is arguably the more important development. This is because it enables private clients to typically invest monthly with limited notice and to gain access to a (fully invested) portfolio of assets immediately in line with desired allocation targets.

One of the most significant implications of this relates to those investors who are building allocations from scratch or from a low base. An investor can invest a dollar in private markets today via an evergreen fund and compound that dollar immediately. Conversely, if the investor commits to multiple closed-end funds over many years in order to target an overall dollar exposure, they are initially only compounding cents. Compounding the full dollar commitment only begins many years later once capital is invested to that point. Simply put, the impact on portfolio outcomes of initially introducing private markets exposure via evergreen structures is efficient and simpler when compared to a closed-end fund approach. That is not to say evergreen is the only way to invest. In fact, our preference is to combine both, but it is a factor that is often missed.

The impact on portfolio outcomes of initially introducing private markets exposure via evergreen structures is efficient and simpler when compared to a closed-end fund approach.

The ability to maintain and adjust exposures through the cycle using evergreen funds is significantly enhanced, as is the ability to build meaningful diversity into portfolios in a considered way (i.e., including geography, sector, manager, stage, type and vintage year).

In terms of outbound liquidity, the 'new normal' is for a fund to aim to meet liquidity of up to 5% of net asset value (NAV) in any given quarter. There are, however, meaningful variations across prior notice and post settlement periods. Where funds are able to meet these redemption terms, full or partial redemptions can be used for portfolio rebalancing and/or repositioning, medium-term cashflow needs for non-portfolio purposes, as well as other requirements, such as death or divorce proceedings. The experience with equivalent closed-end equivalent vehicles is to wait for distributions to be returned over the following decade, unless a means of (private) secondary sale can be facilitated. This typically takes place at a discount to NAV.

Now, for the big caveat…evergreen fund redemption terms mean that liquidity is by no means guaranteed. In the event of meaningful redemptions, particularly those beyond the imposed limits, it could take months, quarters or even years in certain scenarios. Whilst well structured evergreen vehicles should be able to broadly meet reasonable redemption requests during normal market conditions, such liquidity should not be relied upon in the same way as a public equity exchange-traded fund, for example.

Subscription/redemption terms of sample local evergreen funds

Redemption gates are 5% of net asset value per quarter (Partners Group Global Value can apply a 2.5% maximum if in the best interest of the fund).

Fund	Subscription timing	Redemptions	Redemption timing
EQT Nexus Fund	10 business days before month-end. NAV issued 25 business days post month-end.	Quarterly	35 calendar days before quarter-end. Settlement 40 business days post quarter-end.
KKR Private Equity (K-PRIME)	10 business days prior to month-end.	Monthly	10 business days prior to month-end. Settlement within 50 calendar days.
LGT Multi Alternatives Australia	13th calendar day of month. Settlement 30 calendar days after month-end.	Monthly	13th calendar day of the month. Settlement 30 calendar days post month-end.
Hamilton Lane Global Private Assets	18th calendar day of month. Settlement 25 business days after month-end.	Monthly	18 calendar days' notice. Settlement 25 business days after month-end.
Partners Group Global Value	15th calendar day of month. Settlement 20 business days after month-end.	Monthly	2 business days prior to month-end. Settlement 3 months post month-end.
Schroder Specialist Private Equity	11th calendar day of month. Units issued 23 business days after month-end.	Quarterly	90 calendar days' notice. Settlement typically 23 business days post quarter-end.

Source: publicly available product disclosure statements and investment memoranda. All subscriptions are monthly.

When you combine asset level diversification with vintage diversification it results in asset exposures that are both numerous and at varying points of their respective life cycles.

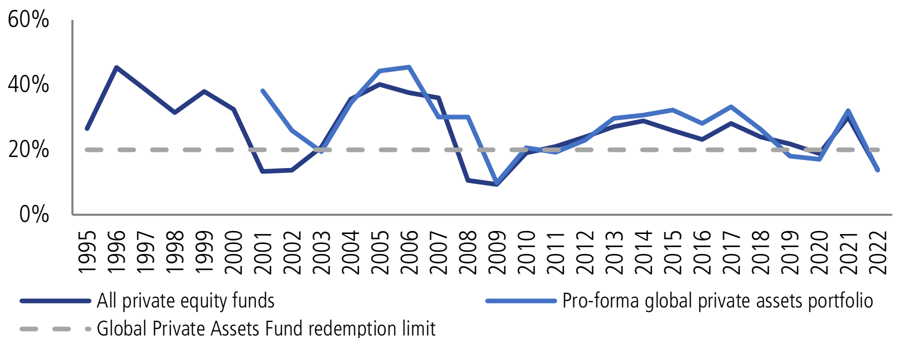
Deriving liquidity from an illiquid asset class

So, how do evergreen vehicles translate what is an inherently illiquid asset class into one that has some form of structured liquidity on an ongoing basis? The enabler here is diversification, and critically asset level diversification (i.e., the number of assets or funds) and vintage diversification. The latter relates to assets or funds acquired over multiple prior years and not simply a discrete or limited number of years (vintages).

When you combine these two components, it results in asset exposures that are both numerous and at varying points of their respective life cycles. Some of these are young and in value-creation mode, while others are nearing maturity and thus ready to exit. In the situation of a mature and highly diversified portfolio, natural portfolio liquidity via asset sales and resultant distributions should arise through the cycle. This is because the portfolio should always have a portion of its assets exposed to the mature end of its life cycle and be close to exit.

This point is arguably the most critical to evergreen private market solutions that offer some form of outbound liquidity. This is because the natural portfolio level liquidity should form the primary basis on which liquidity is provided, as opposed to other components. These other components are typically cash or traded securities, positive net subscriptions (that can be offset against redemptions) and fund level credit lines.

Pro-forma liquidity analysis of an evergreen private markets fund



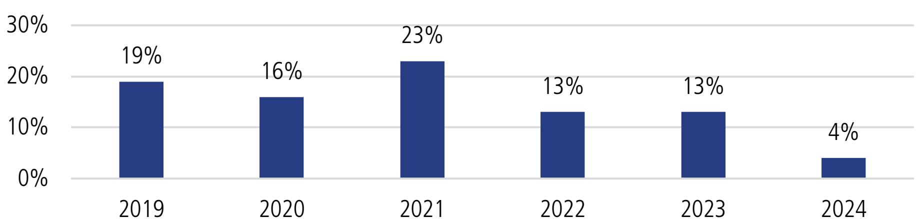
Source: Source Hamilton Lane data via Cobalt as at 31 December 2022. Pro-forma private assets portfolio consists of Hamilton Lane's discretionary track record in co-investment equity and credit, and secondary investments that would have been considered for the Global Private Assets Portfolio had it existed at the time.

If there are significant redemptions on any evergreen product, full liquidity in a traditional sense may not always be available and shouldn't be expected.

To demonstrate this point, the above chart shows a pro-forma liquidity analysis of natural liquidity generated through time using private equity funds tracked by Hamilton Lane. It also shows a pro-forma portfolio liquidity analysis based on the portfolio parameters of its evergreen private market strategy launched in 2019. The grey dotted line shows a 20% redemption limit, which has become the market norm (annual limit) for evergreen private markets vehicles.

The following chart, however, shows actual annual distributions of the live fund through to March 2024. Here, the distributions are currently averaging below 20% per annum. On the positive side, liquidity has been generated naturally from the portfolio, but it has averaged below 20% per annum so far. There are rational explanations for this (such as portfolio ramping and recent market disruption) and other liquidity routes are excluded. But the important point to make is that if there are significant redemptions on any evergreen product, full liquidity in a traditional sense may not always be available and shouldn't be expected.

Annual portfolio level distributions of an evergreen portfolio



Source: Source Hamilton Lane. Hamilton Lane Global Private Assets Fund as at 31 March 2024. Portfolio distributions are percentage of starting period net asset value.

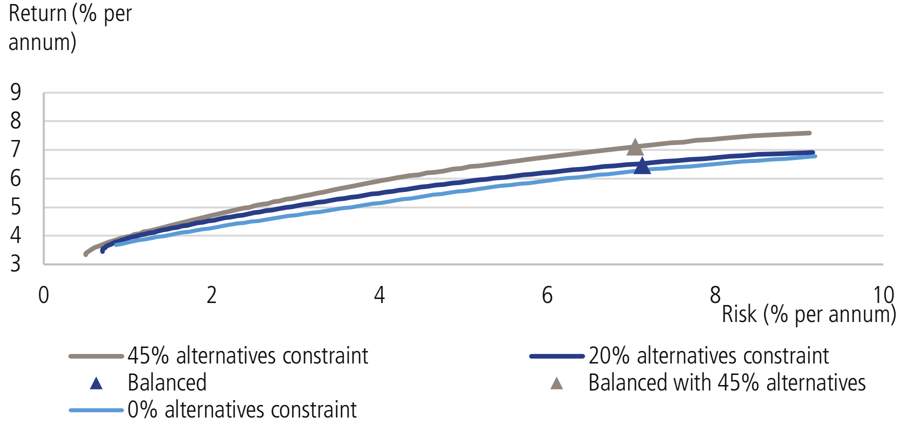
Improving underlying liquidity in private markets can open up new frontiers for asset allocation

While investors need to be cognisant that private market assets will likely never be as tradeable as publicly listed investments, astute investors can leverage the improvement in underlying liquidity that we have explored. This will enable them to broaden their investment universe and build better risk-adjusted portfolios.

While private market assets will likely never be as tradeable as publicly listed investments, investors can leverage the improvement in underlying liquidity.

Notwithstanding some caveats, what does this improved liquidity in private markets mean for asset allocation? The simplest way to explore this dynamic is to conduct efficient frontier analysis, which seeks to build efficient multi-asset portfolios utilising forward-looking asset class risk and return assumptions. At the same time, consideration should be given to the expected interactions between those asset classes. The outcome of this is to derive the most efficient mix of asset classes that provide the highest return for any given level of expected risk. Such portfolios can be plotted on a chart (as in the example below) and are referred to as the efficient frontier.

Efficient frontier within varying alternatives exposures



Source: LGT Crestone. Calculations based on five-year forward-looking expectations.

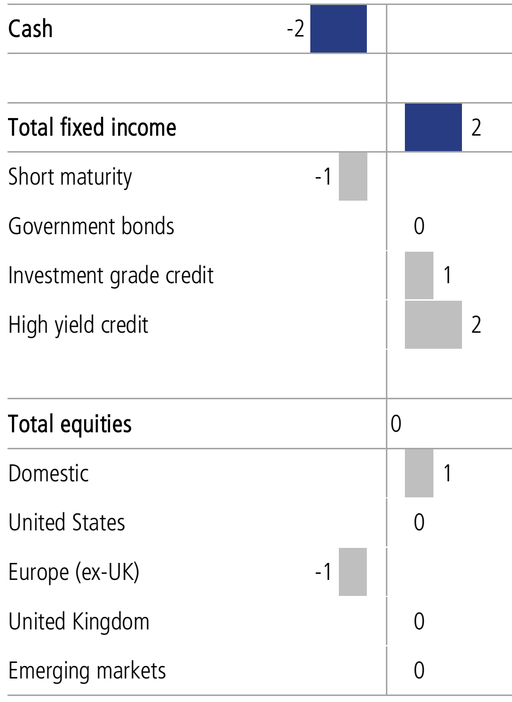
The chart above shows three different efficient frontiers, each constructed by applying a different constraint to alternative or unlisted asset exposures. The 0% alternatives constraint represents a completely publicly traded portfolio; a 20% alternatives constraint, which is a typical exposure for our clients; and a 45% alternatives constraint, which is more typical of endowment-style investors who have lower liquidity needs. The analysis shows that relaxing the alternatives constraint to invest in more unlisted assets enables investors to target higher expected returns for any given level of expected risk. Alternatively, they can minimise expected risk for any given level of targeted return. The outcome is a more efficient total portfolio at the cost of lower liquidity.

The absolute level of liquidity available to private clients in private markets has fundamentally changed for the better. This should ultimately provide the case for private clients to add incremental exposure to private markets.

We are not advocating that all investors should allocate nearly half of their portfolio to alternative assets! Each investor will have his or her own individual needs and tolerances for liquidity. These range from investors who may need 100% liquidity at a week's notice to long-term university endowments, who typically need little liquidity. In addition, increasing illiquidity in portfolios will reduce the flexibility and ability for investors to adjust portfolios in the face of changing market conditions and take advantage of market dislocations.

That said, whilst the caveats discussed previously are critical to understand, we believe the absolute level of liquidity available to private clients in private markets has fundamentally changed for the better. This should ultimately provide the case for private clients to add incremental exposure to private markets, which, in turn, should improve portfolio outcomes through the cycle.

What's driving our views



Source: LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocations. Investment grade credit includes Australian listed hybrid securities.

We are trimming duration

The US economy continued to outperform in April, while there were signs a cyclical upswing may be starting in Europe. Capital expenditure, driven by both top-down and bottom-up considerations, may be underpinning a higher resting rate for growth, inflation, and interest rates and challenging hopes for significant cuts by the US Federal Reserve (Fed) this year.

This month, we have increased our risk-on bias via high yield, while trimming our exposure to investment grade credit and government bonds to reflect the risk that neutral rates have risen.

Can policymakers stick the landing? After a fast and steep tightening cycle, central bankers now need to calibrate policy to continue lowering inflation without triggering a recession. While consumer sentiment is still healthy, there are political and geo-political risks, financial markets are hyperactive, and the secular inflation outlook is more volatile.

Politics takes centre stage in 2024: After the geo-political shocks of the past two years, politics will be a key market driver this year. More than 64 elections will take place in 2024, headlined by the US in November.

Diverging cycles: The US economy is resilient, but momentum may be peaking, while Europe may be bottoming, and China faces key cyclical and structural challenges. How these macro dynamics play out will be a key driver for markets this year.

Fortune favours the flexible: With ongoing volatility and uncertainty, we believe it pays to be diversified, nimble, and flexible over the year ahead. Investors will benefit from prudently managing liquidity, investing with high quality active managers, and flexibly managing portfolios.

Structural thematics

Positioning for multi-polarity: As the world order continues to transition towards multi-polarity, we expect more volatility and more geo-political shocks, but also more growth and opportunities for astute investors.

A challenging energy transition: Amid rising political and geo-political tensions, the world faces an increasingly challenging trade-off between net-zero commitments, cost, and energy security.

Innovative upside: Artificial intelligence (AI) presents a key challenge and opportunity, while advances in pharmaceuticals show that human ingenuity remains potent and is a key constructive force for the long term.

Higher rates increase investors' options: The resetting of interest rates at a higher level increases forward-looking returns across all asset classes, and gives investors more options to construct robust, diversified portfolios.

	What we like	What we don't like
Equities	■ Broader S&P 500 exposure over mega-cap (long equally weighted S&P 500 over market cap-weighted S&P 500). ■ Value and quality-tilted active strategies. ■ Actively managed small and mid-cap equities.	■ Companies with shorter-term debt maturities at risk of re-pricing into a higher rate environment. ■ Stocks trading at historically tight dividend yields to the risk-free rate.
Fixed income	■ Actively managed funds investing in higher quality credit. ■ Fixed rate three- to five-year senior and tier 2 bank credit. ■ Shorter maturity high quality bonds (two to five years). ■ High quality actively managed funds within high yield credit.	■ Longer-maturity bonds, which are vulnerable to rising inflation and term premia risk. ■ Lower quality credit vulnerable to higher cost of funds.
Alternatives	■ Credit-oriented strategies, including corporate/asset-backed. ■ Senior private debt (strategies excluding real estate). ■ Real assets with inflation linkages and/or exposure to secular themes (e.g., multi-polarity and energy transition).	■ Lower grade real estate assets (particularly office). ■ Assets that have not adjusted to a higher rate environment. ■ Assets and industries with no transition plan.

Economic and asset class outlook

Economic outlook

Global economy

Recent data have broadly supported expectations for a relatively mild global growth slowdown through 2024, with most major economies outside the US going through various stages of a 'traditional' cyclical slowdown sparked by tight monetary policy. This 'softish' landing for the world economy should embody a period of clearly below-trend growth (particularly H1 2024). However, top-line growth masks divergence between ongoing US and Asia economic resilience and a confirmed recession in the UK, and recently relatively flat growth in Europe and Japan.

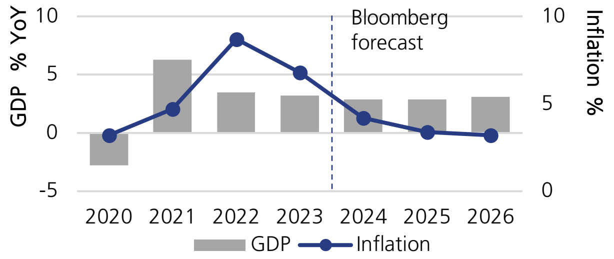
A slowing in global growth should set in train a new phase for the global economy, where interest rates have peaked, but are unlikely to fall to pre-pandemic levels. We are also cognisant of a growing secular pulse of capital expenditure (capex), driven by a combination of top-down (industrial policy, energy transition, geo-politics) and bottom-up (investment necessary to scale up AI) forces. This wave of capex has the potential to underpin a higher level of growth and inflation across global economies over the next five to 10 years.

Recent uncomfortably high inflation prints in the US have seen markets push out the timing of rate cuts there, though softer economic conditions in Europe have allowed the European Central Bank (ECB) to pre-signal a June cut. We continue to expect policy easing to occur from H2 2024. Residual concerns of a hard economic landing have given way to concerns of a 'no-landing' scenario that could delay initial cuts into 2025.

Politics remains a focus in 2024, with the potential to drive geo-politics. Ballots have already been cast in Taiwan, Indonesia, and Russia, with elections ahead in India, the US, the UK, and Europe (Parliament). During the year, markets may turn their attention to the implication of a Trump victory for markets and the economy. Meanwhile, renewed geo-political uncertainty in the Middle East, sparked by direct conflict between Israel and Iran in April, presents a near-term exogenous challenge to elevated equity markets.

Consensus expects global growth to slow in 2024 to a pace modestly below long-term averages. The International Monetary Fund (IMF) recently upgraded its 2024 outlook further (lifting global growth from 3.1% to 3.2%) led by a further upgrade to US growth. Similarly, Société Générale (SG) and UBS have stepped away from their US and global recession outlooks.

Global GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Australia

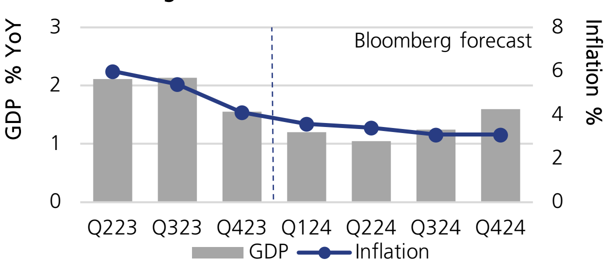
Recent data have confirmed Australia's economy expanded at a significantly below-trend pace through H2 2023. Data for Q1 indicates further slowing in momentum - population growth was the main factor supporting the economy, with clearer signs of some softening in the jobs market. However, concerns around inflation pressures and productivity challenges have resurfaced in the wake of recent industrial relations changes, stronger-than-expected wage growth, and renewed acceleration in house prices. News that the May Federal budget will flesh out an industrial policy (the *Future Made in Australia Act*) response to the US *Inflation Reduction Act*, in addition to additional cost-of-living relief and already significant personal income tax cuts, have fostered speculation that H2 2024 interest rate cuts may be delayed into 2025.

Growth in the economy eased to 0.2% in Q4 2023 after 0.3%, with the annual pace slowing to 1.5% from 2.1%. For H2, growth annualised at just 1%, falling sharply from H1's 2% pace. In Q4, a weak consumer and housing sector was modestly offset by stronger trade, as well as capex and public spending. Early 2024 data have been volatile, with retail sales slowing to 0.3% month-on-month in February after 1.1% in January. CBA assesses consumer trends as 'weak', with much of the February boost attributable to Taylor Swift's Eras Tour. The labour market continued to cool in March, with a fall of 6,600 jobs. The unemployment rate for March was 3.8%, up from 3.7%.

Inflation eased from 4.1% year-on-year in Q4 to 3.6% year-on-year in Q1. However, this was above market and Reserve Bank of Australia (RBA) expectations, with particular stickiness in domestic non-discretionary price pressures. The disappointing print signalled that Australian inflation is entering a similar 'hard last mile' zone as the US, with domestic pressures around immigration and housing limiting progress towards the RBA's 2-3% target band. Markets have pushed back expectations for an RBA cut, with the first full cut not priced until early 2025.

After growth of 2.1% in 2023, UBS expects Australia to avoid a recession, with growth of 1.6% in 2024, ahead of a recovery to 2.2% in 2025. CBA sees slightly slower growth of 1.2% for 2024, ahead of similar rebound to 2.1% in 2025.

Australian GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Economic outlook

United States

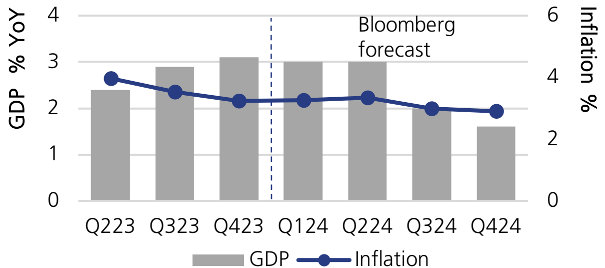
Recent data have meaningfully challenged market expectations for a 'soft landing' in the US, with the most recent Q1 GDP accounts painting a potentially stagflationary picture of slowing growth and stubborn inflation. Meanwhile, a still-tight labour market has supported resilience in household consumption. This combination has compelled policymakers and markets to push out expectations for rate cuts to the latter part of the year, with some commentators even pressing the case for no cuts at all this year. With progress on inflation having stalled in early 2024, this has given voice to the advocates of a 'no-landing' scenario where rate cuts could slip into 2025.

Q1 growth more than halved to 1.6% annualised, a significant slowing to a below-trend pace of growth, though volatile items including inventories and imports were key drags and domestic consumption remained healthy. In April, the composite Purchasing Managers Index (PMI) moderated 1.2 points to 50.9, just about maintaining expansionary conditions. Retail sales surprised well to the upside, rising 0.7% after February's 0.6%, with underlying measures also pointing to ongoing consumer resilience. Non-farm payrolls rose 303,000 in March, indicative of a still tight US labour market, though there were signs of easing in wages growth.

Inflation prints have continued to surprise higher in Q1. The headline rate accelerated to 3.5% year-on-year in March from 3.2%, while core inflation rose 0.4% for the third consecutive month, leaving the annual rate unchanged at 3.8%. The combination of stronger-than-expected growth and stubborn inflation has seen the Fed emphasise a patient stance regarding potential rate cuts. It also compelled the market to again push out 'first-cut' expectations, now to September, with between one and two cuts now priced for 2024 (compared to seven at the start of this year).

After 2.5% in 2023, UBS now sees growth maintaining an above-trend 2.3% pace (revised up from 1.6%) in 2024, before slowing to 1.4% in 2025. SG no longer expects a US recession in 2024, upgrading growth from 0.9% to 2.5% for 2024 (and 2.3% for 2025).

US GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Europe

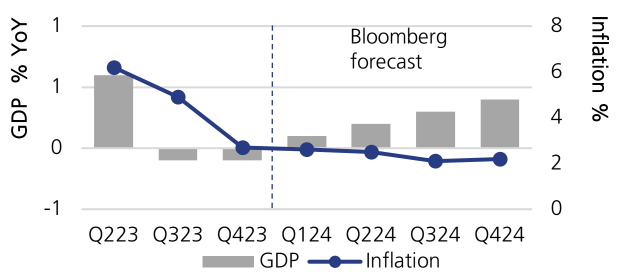
The European economy has shown signs of bottoming in early 2024, though the weak external environment and fiscal consolidation are expected to present challenges to growth in coming quarters. Twin (and potentially escalating) wars in the region, Red Sea supply impacts, and tighter German fiscal policy are other risks to consider. However, the Citi economic surprise index for the Eurozone has been rising in recent months, while BCA Research has noted the likelihood for a cyclical up-turn, supported by recovering German industrial production, an improving credit impulse, and improving investor confidence (the ZEW survey of investor confidence rose 10.4 points to 43.9 in April, a 26-month high). Further, ongoing disinflationary trends which have been stronger than in the US so far, have allowed the ECB to pre-signal a June rate cut, with markets pricing in two more for the remainder of the year, a stark contrast to the US.

Europe's Q4 growth was 'flat' after Q3's -0.1% print, narrowly missing avoiding a technical recession. The annual pace remained unchanged, also 'flat' and down from 0.6% in mid-2023. Consumer activity remains weak, with retail sales falling 0.5% month-on-month in February after a flat January print, though the composite PMI rose 1.1 points to 51.4 in April, signalling expansionary conditions for the first time since May 2023. According to UBS, "low unemployment and the recovery in real wage growth should support household consumption". Unemployment remains close to its record low of 6.5%, signalling a tight labour market.

Inflation has continued to trend lower into early 2024, easing to 2.4% in March from 2.6% in February. Core inflation fell to 2.9% (from 3.1%), albeit still above the 2% target. At its April meeting, the ECB left interest rates unchanged as was widely expected, but effectively pre-signalled a rate cut in June.

After relatively weak growth of 0.5% in 2023, UBS expects a soft recovery in H2 2024, with year-average growth of 0.6% for 2024, and 1.2% in 2025. SG now expects similar growth of 0.8% (was 0.6%) in 2024, while CBA sees just 0.2% growth in 2024.

European GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Economic outlook

United Kingdom

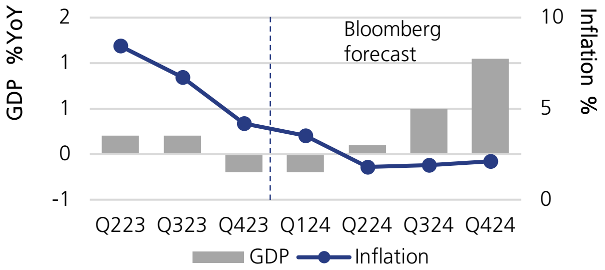
The UK entered a technical recession in H2 2023, with tighter financial conditions, higher mortgage payments, and external sector weakness the key drivers. Still, the economy has defied expectations for a sharper 2023 contraction, helped by a resilient consumer, solid capex, and a relatively tight jobs market. Recent data are pointing to a pick-up in activity and recovery in Q1, led by improving activity in the industrial and services sectors.

Monthly GDP data has been positive at 0.1% month-on-month in February and (upwardly revised) 0.3% month-on-month in January. This points to strong growth of around 0.4% quarter-on-quarter in Q1. The UK Composite PMI rose by 1.2 points to 54.0, signalling the fastest pace of expansion since May 2023. Wages growth has continued to moderate, though not as much as expected, to 5.6% year-on-year in February from 6.2% in January. The unemployment rate increased to 4.2% in February (from 3.9%).

Inflation has continued to trend lower, albeit it at a slower pace. In March, the headline rate of inflation eased by 0.2 percentage points to 3.2% year-on-year, while core inflation moderated by 0.3 percentage points to 4.2% year-on-year. The Bank of England (BoE) kept policy steady at 5.25% in March, with a relatively dovish tilt in voting (8-1 in favour of holding, compared to 8-3 in February). Markets are pricing in relatively dovish expectations for the BoE, with a first cut priced by September and just under two cuts priced over the remainder of 2024. BoE Governor Andrew Bailey noted in his commentary that "we are not yet at the point we can cut rates but things are moving in the right direction." The Monetary Policy Committee statement also noted rates can be changed at any meeting (according to Lazard) and "the Committee recognised that the stance of monetary policy could remain restrictive even if [the] Bank Rate were to be reduced."

After growth of just 0.1% for 2023, UBS sees a weak recovery to 0.2% for 2024 ahead of stronger growth of 1.5% in 2025. CBA expects a recession in 2024, with activity growth falling 0.2% before recovering to 0.7% in 2025.

UK GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Japan

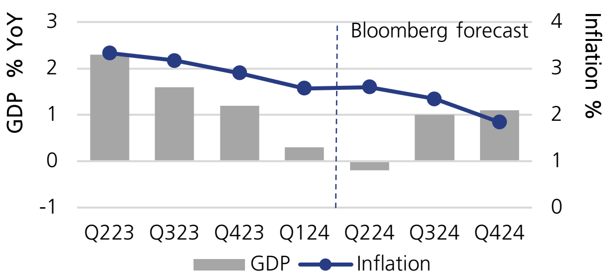
After narrowly avoiding recession in H2 2023 following revised data, there is increasing optimism around the Japanese economy's ability to successfully transition from secular stagnation to nominal recovery. Relatively robust business conditions, solid tourist arrivals, and rising wage growth (punctuated by the recent RENGO union negotiations securing average pay rises of 5.3%) are likely to support a moderate rebound in consumer spending. At the same time, a lift in global trade should incrementally support the growth outlook.

Japan's real growth was revised higher from -0.4% in Q4 2023 (annualised) to 0.4%, reflecting stronger estimates for capex, amid relatively weak housing investment, consumer and public spending. Annual growth remains weak at just 0.1%. Japan's Composite PMI rose to 52.6 in April from 51.7 in March, with an acceleration in service sector activity (to its fastest pace since May 2023) pointing to improving economic momentum. Japan's unemployment rate for February rose 0.2 percentage points to 2.6%, though overall data suggest the labour market in Japan remains tight and likely to maintain upward pressure on wages. Retail sales surprised on the upside, accelerating to 4.7% year-on-year growth in February after January's 2.1%. The latest round of 'Shunto' wage negotiations indicates wages growth may top 5% for the first time in 30 years, corroborating broader data suggesting the labour market in Japan remains tight and likely to put upward pressure on wages. Retail sales recovered further, to 1.7% month-on-month in February after 0.8% in January.

Inflation decelerated modestly to 2.7% year-on-year in March after reaching 2.8% in February. This followed the Bank of Japan's (BoJ) decision to exit its negative interest rate policy in March. That said, the BoJ has maintained a dovish stance relative to its developed market peers, signalling it was in no rush to normalise policy. UBS currently expects a second BoJ hike to 0.25% in October.

After strong growth of 1.9% in 2023, UBS expects growth to moderate to 0.8% in 2024 (was 0.5%) before steadying at around a 1.2% pace in 2025 (was 1.1%). SG forecasts a weaker pace of just 0.2% for 2024, but a strong rebound to 1.3% for 2025.

Japanese GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Economic outlook

China

While the latest Chinese GDP data came in above expectations, expanding at a 5.3% year-on-year pace in Q1 2024, near-term momentum appears to be weakening. Most of Q1's growth appears to have been front-loaded into the January-February period, and fundamental headwinds to the economy remain persistent. Notably, economic momentum appears to have slowed into March, with retail sales and industrial production figures both disappointing, and UBS also pointing to weaker property sales, passenger turnover, truck traffic, and construction activity. The property market continues to face deep challenges, and the Government's focus on targeted stimulus measures continue to look insufficient to spark a broad-based recovery amid poor consumer confidence.

Inflation softened in March, rising only 0.1% year-on-year after hopes of a rebound from February's 0.7% year-on-year figures. Food prices declined 3.2% month-on-month. Core CPI slowed to 0.7% year-on-year from 1.2%, with a wind-back of touring and outgoing prices post-Lunar New Year.

Policy support since the March National People's Congress meeting has been modest, with UBS estimating only a 1% expansion in broad fiscal policy, driven by infrastructure investment. Authorities have also announced additional property stabilising measures, though ongoing support will likely be needed to put a floor under the Chinese property market. UBS sees considerable downside risk in the absence of this. However, given the stronger-than-expected Q1 GDP outcome, and China's ongoing structural efforts to deleverage and rebalance the economy to a more consumer-led model, authorities will likely be reluctant to roll out additional stimulus measures, unless macro data deteriorates further.

After 5.2% in 2023, UBS expects China's 2024 and 2025 growth to slow to 4.6%. SG expects a similar slowdown to 4.7% in 2024, while CBA expects stronger growth of 4.9% for 2024 and 5.1% in 2025.

Emerging markets

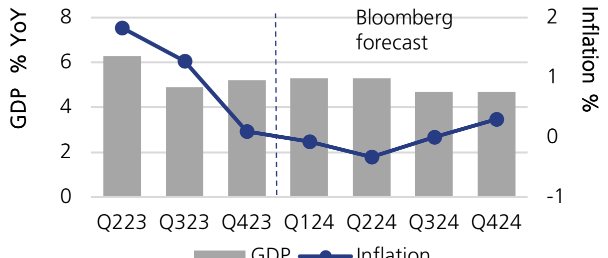
Emerging market growth is now expected to decelerate by almost 0.5% (including and excluding China) through 2024, albeit mostly through H1 2024. In contrast, H2 2024 should embody modest recoveries in Latin American and emerging European growth. Asia is expected to strengthen into mid-year, helped by ongoing disinflation that paves the way for some renewed central bank easing in H1 2024 (as well as support via the tech export recovery for North Asia). However, China's mixed growth outlook and potential US dollar strength on geo-political and political concern could weigh on the emerging market export and currency outlook.

AI and tech remains a key driver for the Asian region. UBS noted a further acceleration in Korea's 20-day export growth to 10.9% year-on-year in March, led by semi-conductors with robust growth of 46.5% year-on-year. Meanwhile, Taiwan export growth is showing signs of picking up, rising 9.5% year-on-year in combined figures for January and February with AI-related products (automatic data processing machines) surging 161% year-on-year. Exports in Singapore rose 9.2% year-on-year in January-February, while UBS has revised up its Malaysian 2024 growth forecast on a slightly better export and consumption outlook. India's economic growth remained robust, with real GDP rising 8.4% year-on-year in Q4 2023, with leading indicators suggesting that economic momentum is continuing to hold up well as the country begins a six-week long election process, where sitting Prime Minister Modi is expected to win a rare third consecutive term.

For Latin America, growth is expected to slow in 2024, particularly into mid-year, though moderating inflation should support ongoing rate cuts. Central banks in Mexico, Argentina, Chile, and Brazil have cut rates in the last two months. Easing monetary policy should underpin some recovery in growth in the region in 2025 (2.2% in 2025 compared to 1.8% in 2024, according to UBS).

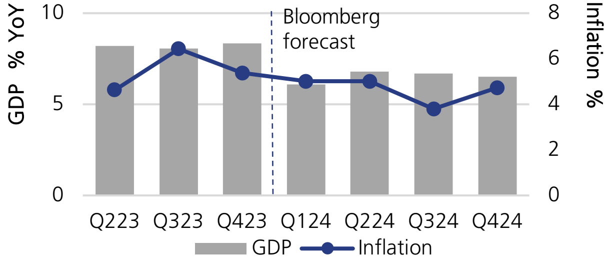
After 4.5% in 2023, UBS expects a moderate slowing to 4.1% in 2024 (as does SG) before a pick-up to 4.4% in 2025.

Chinese GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

India GDP growth and inflation



Source: Bloomberg as of 30 April 2024.

Asset class outlook

Short maturity and government bonds

Position: Underweight short maturity, neutral government bonds

Key points

- We recommend maintaining a diversified portfolio of fixed and floating rate bonds.
- The market now expects the Fed to cut rates only twice this year.
- When central banks provide a clearer outlook on rates, we expect the government bond curve to steepen.

Short maturity—Markets remain focused on inflation and economic indicators to gauge when central banks might lower rates. Despite decade-high interest rates curbing inflation, robust economic data (particularly employment figures) suggests a potentially soft landing (or even no landing) for the economy. This introduces uncertainty around the timing of rate cuts. Any easing in 2024 hinges on progressive data releases, with unexpectedly high CPI readings and less dovish Fed rhetoric delaying rate cuts to Q4 2024. Though markets anticipate a September rate cut in the US, some hawkish Fed officials hint at a longer wait. Economic resilience, persistent services inflation, and employment data should keep volatility elevated in the short term.

The Fed is expected to proceed cautiously, where it is anticipated to cut twice in 2024, down to approximately 4.95%. The initial cut has been postponed to September. This approach hinges on a sustained downward trajectory in core inflation, which would require rates to stay higher for longer. Present pricing suggests investors would be well placed to invest in the shorter end of the curve, with limited capital upside for longer-dated maturities. Following strong inflation prints domestically, the RBA is no longer expected to cut this year. Consensus suggest it is unlikely to cut before the Fed and may even need to increase rates, given the persistence of services inflation. Unlike in the US, the RBA has not tightened as aggressively and its curve has never been inverted.

Government bonds—In 2024, global rates have been adjusting to a higher-for-longer scenario, as inflation stalls and US economic growth exceeds expectations. Markets anticipate a more restrained approach from the Federal Open Market Committee this year, pricing in only a 50 basis points (bps) reduction in rates. Recent CPI data, labour market indicators, and statements from Fed officials tempering rate cut expectations have driven bond yields to their highest levels this year, with the 10-year Treasury reaching 4.66%. While inflation is expected to resume its decline, the Fed is likely to proceed cautiously, resulting in less aggressive rate cuts. We recommend investing in the two to five-year segment of the bond curve, where yields are higher compared to the longer end and are expected to decrease over the next six to 12 months as central banks ease. We have moved to a more neutral position in government bonds. The Australian 10-year yield has risen to approximately 4.5%, underperforming US Treasuries. Volatility is likely to persist in the short term. Investors would be well placed to buy on pricing dips, focusing on the four to seven-year part of the curve.

Investment grade and high yield credit

Position: Overweight investment grade, overweight high yield credit

Key points

- We prefer investment grade bonds as inflation cools and downside risks to growth moderate.
- High yield credit quality has improved and demand for outright yields has risen, driving spreads lower.

Investment grade credit— Investment grade credit spreads remain resilient, despite bond market volatility, as investors are drawn to attractive outright yields, which has pushed spreads lower. Record issuance levels in the US and Europe this quarter reflect favourable conditions for issuers, further fuelling demand amid climbing yields. Although corporate credit spreads are historically tight, robust economic fundamentals suggest they may remain so, implying a soft landing. As global central banks ease later in the year, spreads may widen, but positive total returns are expected as bond yields decline. Holding high-quality bonds can safeguard portfolios during a growth slowdown, as widening credit spreads are typically offset by falling government bond yields.

Domestically, issuance remains robust, with both financial and corporate issuers active. Notably, Sydney and Adelaide Airports issued senior unsecured notes, alongside United Overseas Bank, Bank of Queensland, and MAFG Finance's inaugural AUD 70 million issue. Subordinated Tier II spreads tightened by a further 3bps in April, with major banks priced around BBSW +177bps for a five-year non-call 10 structure. The Suncorp Group Ltd's 6.25-year Additional Tier 1 issuance at BBSW +280bps attracted over AUD 1 billion in demand, with investors being scaled to 16%. With limited expected refinancing for the remainder of the year and a redemption from Commonwealth Bank of Australia, demand for this sector remains high. Secondary pricing for major banks with maturities of more than five years now sits at historical lows of BBSW +242bps.

High yield credit—The high yield index reflected spread widening, driven by the re-pricing of a higher-for-longer scenario, which could impact corporate earnings and elevate the risk of credit quality deterioration and defaults among highly leveraged, lower-rated firms. Despite concerns about the sustainability of current spreads, US high yield and European high yield still offer yields around 8% and 6.5% respectively, which has attracted capital inflows. Although high yield markets are sensitive to interest rates, leverage, and economic cycles, overall credit quality has improved, with most US issuers now rated BB. Many high yield issuers have bolstered their financial positions, maintaining low leverage and manageable interest coverage, leading to stable near-term default rates. While modestly wider spreads are possible in the coming quarters, the current elevated yields in US high yield, around 8%, offer significant carry, providing a buffer against potential mark-to-market losses from spread widening.

Asset class outlook

Domestic equities

Position: Overweight

Key points

- In April, domestic equities fell for the first time in five months, down 2.9% as rate cut expectations were wound back.
- The market is pricing the cash rate to be around 4.13% in December, which implies approximately one rate cut. This led to interest rate sensitive sectors falling in April. Real estate fell 7.8%, consumer discretionary fell 5.1%, and IT was down 3.9%.

On the back of upgraded GDP forecasts, UBS equity strategists view upside risks for equity markets. They now forecast the benchmark S&P/ASX 200 index to trade to 8,000 by year-end, up from their previous forecast of 7,660. Despite the upgrade, this still leaves only modest gains from here of around 2%. UBS prefers sectors that are the causes of inflation rather than the victims. As a consequence, it has upgraded the energy sector to overweight. The global macro backdrop is not as negative as initially feared, and a better supply/demand mix in commodity markets is something investors may want exposure to. Energy stocks also provide a hedge against any deterioration in geo-politics. However, the inflationary effects of commodity price strength could lead to higher-for-longer rates. This can lead to longer-duration equities not benefiting from the uplift they would otherwise have expected from lower rates. With infrastructure and tech stocks now less likely to see such a valuation tailwind from declining rates, UBS has reduced both of these sectors to a neutral weighting.

Despite the equity market having rallied around 16% since the start of November, and with valuations "undeniably stretched", UBS sees no sign that market psychology is yet euphoric. It has identified several measures as indicators that euphoria has not yet swept markets. This suggests the potential for a 'melt higher' through the year. Firstly, small-cap stocks are yet to participate in any outperformance. Usually, when cyclicals outperform, so do smaller companies. Secondly, the most defensive stocks still trade at a premium. This implies that a reasonable segment of the investment community is either still fearful of a correction or unwilling to pay the multiples that the less defensive names trade at. Thirdly, the market is still a 'crowded short' in domestic banks and retailers. Long-only investors and hedge funds are either underweight or short these names. Should this scepticism re-trace, then further upward pressure would seem likely. Finally, global investors are not that excited about Australia. Despite anecdotal evidence that global investors are increasing allocations to Australia (either due to our positive macro-economic backdrop or as an Asia-Pacific proxy ex-China), this is not supported by the official data. Further, the rally in domestic banks has lagged the performance seen in the US, Europe, and Canada.

International equities

Position: Underweight Europe. neutral the US, UK and emerging markets

Key points

- The MSCI World ex-Australia index fell 3.0% in Australian dollar terms in April, as weakness in mega-cap tech and the S&P 500 weighed on global returns.
- Fed Fund expectations for December are now 4.95%, the highest they have been this cycle.
- The sector trends seen in Australia also played out on a global basis. Worst performing sectors were real estate (-7.3%), IT (-5.7%), and consumer discretionary (-5.0%).

The bulk of equity performance so far this year, and indeed over the past 18 months, has been driven by multiple expansion. Globally, 12-month forward earnings are up only 7% from their lows. This is in contrast to an almost 30% price/earnings (P/E) increase. The current US forward P/E multiple of 21.4x is up 6% year-to-date, up 20% since October 2023, and up 30% since October 2022. European P/Es are up by a similar magnitude, but from a lower starting point. Regionally, China equities have shown no re-rating over the past 18 months, still trading around 9x forward, which is at absolute and relative lows. Compared to past trends, Europe overall is not expensive versus the US and Japan, where markets have moved above their historical ranges.

Ultimately, equity valuations will respond to earnings momentum trends, as there is a clear historical correlation between P/E multiples and earnings revisions. The last 18 months have seen an easing in the downtrend of earnings downgrades. Overall, if central banks turn out to be more dovish than currently projected, and growth does not disappoint, present equity multiples could be defended. However, if activity momentum, and in particular earnings delivery, disappoint, and central banks become more hawkish than anticipated, valuation multiples could be at risk.

After the index's 25% rise from its late-October lows, the interest rate and inflationary regime may be a key driver of performance from here. AI as an incremental growth driver, and how pervasive that becomes, will likely be crucial to the macro backdrop and the performance of the broader market. However, the performance of small-caps versus large-caps and value versus growth styles will most likely be tied to what is happening in the underlying economy and with interest rates. Citi sees that a soft or no-landing scenario (i.e., where recession is avoided but there is slower but positive growth, inflation is sticky, and there are no Fed rate cuts this year) as positive for value. It sees a 'Goldilocks' scenario (where there is strong growth, inflation trends lower, and the Fed begins easing) as positive for small and mid-caps. It sees recession as supportive of growth outperforming, given resilient and less economically sensitive business models. The underlying set-up is that both small-cap and value earnings growth should converge with growth indices, supporting the view that equity market returns should become less concentrated over time.

Asset class outlook

Currencies

Key points

- The US dollar rally extends amid stubborn inflation, resilient growth, and geo-political risks.
- The Australian dollar is trading at around USD 0.65.

The US dollar strengthened around 1% over the month as ongoing signs of stubborn inflation, coupled with resilient economic growth and geo-political risks out of the Middle East, drove bond yields higher and saw investors bid up the greenback. Political risks around the US election and the ongoing evolution of the global economic cycle and inflation are likely to be key drivers for the US dollar this year. Structural factors, including a deteriorating US budget deficit and increasing geo-political multipolarity, point to downside pressures longer term, but these will not be in markets' minds for some time.

The Australian dollar experienced significant volatility in April, though at the time we went to print, was trading around USD 0.65, broadly unchanged for the month. Current levels remain in line with or at the low end of longer-term fair value estimates. Stubborn inflation (where March quarter CPI printed above expectations) could provide some support. A significant Chinese stimulus program is a key upside risk for the Australian dollar. Our external partners are forecasting moderate upside risks to the currency for the year ahead, to around USD 0.70.

The euro generally weakened over the month, driven by US dollar influences, but also by the ECB signalling a strong intention to commence its easing cycle in June, well before the Fed. Markets are also pricing in about 1.5 more cuts in the Eurozone compared to the US. We continue to expect the Eurozone to face macro risks going forward, though we are cognisant that economic conditions are bottoming out and a modest cyclical recovery may be in sight.

The Japanese yen continued to depreciate against most major currencies over the month, as markets continued to digest the BoJ's relatively dovish policy stance after it raised rates for the first time 17 years in March. Rampant US dollar strength saw the yen trade well past the previous 152 psychological barrier against the US dollar (where markets expected policymakers to intervene to support the currency). The currency now trades around at around 154. There is potential upside support for the yen as a downside risk hedge, and Japan's internal inflation and macro dynamics remain tilted towards policy normalisation to continue over the next 12-18 months.

Commodities

Key points

- Global commodity prices continued to recover in April, supported by positive Chinese and global economic momentum. Gold rose to around USD 2,330 per ounce.
- Iron ore prices rebounded around 15% to USD 118 per tonne.

Positive Chinese GDP data, as well as geo-political risk and rising gold prices, supported the global commodity complex in April. Brent crude prices are around 0.5% over the month, though they have pared back a short-term spike in response to Middle East tensions.

Gold continued its rise to fresh record highs and is trading around USD 2,330 per ounce, as a combination of geo-political risk and concerns around currency debasement started to take hold.

Industrial metals prices also rose, with copper and aluminium up above 10% for the month. Iron ore also bounced back from its March weakness, with prices up around 15% to USD 118 per tonne.

The evolution of the Chinese economy will continue to play a key role in the near-term outlook for commodities. We expect that authorities will continue to emphasise targeted and limited stimulus packages to support, but not ignite, China's growth pulse. This approach reflects China's multi-year efforts to rebalance its economy towards more sustainable consumer- and services-led growth, while addressing structural issues in its property market and debt dynamics.

Recent data suggests that the Chinese economy continues to face significant cyclical and structural challenges, which present fundamental headwinds to commodity prices. That said, even a stabilisation in broad economic conditions could underpin a broader recovery in ex-US economic growth and commodity demand.

The key upside risk for commodities is that economic stresses threaten social stability and force authorities to pursue more aggressive stimulus, which could support a cyclical rebound in commodity prices in the absence of a broader global slowdown. This backdrop is likely to lead to ongoing elevated volatility in commodity prices.

Looking beyond the cyclical horizon, longer-term themes, including climate change and geo-politics, are likely to support the commodity complex on a secular basis. It is difficult to determine how these competing cyclical and secular forces might evolve over the year ahead, and we are particularly cognisant of the risk that a cyclical downturn could outweigh the secular tailwinds in the near term.

Asset allocation views

Strategic asset allocation views

Why do we believe in strategic asset allocation?

We believe that the central component of successful long-term performance is a well-constructed strategic asset allocation. Empirical evidence suggests that a disciplined strategic asset allocation (SAA) is responsible for around 80% of overall investment performance over the long term[1]. Diversification plays a critical role within SAA. By diversifying your portfolio among assets that have dissimilar return behaviour, lower overall portfolio risk can be achieved, and your portfolio can be better insulated during major market downswings.

Why do we advocate SAAs to our clients?

We believe that SAAs encourage a disciplined approach to investment decision-making and help to remove emotion from these decisions. A thoughtfully designed SAA provides a long-term policy anchor for clients. Over the long term, we believe clients are best served by identifying the risk they can bear, then adjusting their return expectations accordingly. Return expectations may be anchored unrealistically. However, risk tolerance tends to remain more consistent throughout the cycle.

Why strategic asset allocation?

Strategic asset allocation is an important part of portfolio construction as it structures your portfolio at the asset class level to match your specific objectives and risk tolerance.

Furthermore, history has shown that a disciplined strategic asset allocation is responsible for around 80% of overall investment performance over the long term.

Strategic asset allocations in models

	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
Cash	3	3	3	3
Fixed income	53	35	17	14
Short maturity	8	6	3	3
Government bonds	32	15	7	5
Investment grade credit	11	11	4	4
High yield credit	2	3	3	2
Equities	24	42	60	38
Domestic	12	19	28	11
United States	6	11	16	13
Europe (ex-UK)	3	4	5	4
United Kingdom	2	3	4	3
Emerging markets	1	5	7	7
Alternatives	20	20	20	45
Hedge funds	6	6	5	14
Private markets	7	7	9	17
Real assets	7	7	6	14

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.

[1] Ibbotson, Roger G., and Paul D. Kaplan. 2000. *Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?* Financial Analysts Journal, vol. 56, no. 1 (January/February).

Active portfolio weights and tactical asset allocation views

Our current tactical asset allocation views

We expect that growth and inflation will continue to slow in most developed economies this year. We believe that cash rates have peaked, though we appreciate risks appear tilted to the upside. Central banks in Europe and the UK have signalled an intention to ease policy from mid-year, though stubborn inflation is limiting rate cut expectations in the US and Australia.

The US economy remains resilient, likely supported by increasing capital expenditure driven by government incentives and the AI build-out. Australian households continue to face cost-of-living pressures in the face of productivity challenges. We retain a near-term view that is supportive of a 'softer' economic landing. Overall, we continue to believe that fixed income will perform well relative to equities under several scenarios in the short term.

Why tactical asset allocation?

Tactical asset allocations have a six- to 12-month investment horizon and are reviewed monthly. They can be considered an interim strategy where the aim is to provide a smoother investment journey without altering the end goal.

Cash

Our underweight cash position remains at -2, reflecting our view that rates have likely peaked, favouring fixed income over cash.

Fixed income

At an asset class level, fixed income remains our highest conviction position at +2. At a sub-asset class level, we are positioned in favour of high yield credit to take advantage of attractive all-in yields and still robust economic conditions. Within this, we have trimmed our investment grade and government bond overweights to reflect the shifting balance of risks to interest rates.

Alternatives

We favour infrastructure, private debt, and low-beta hedge fund exposures, while maintaining private equity exposures. We are taking a cautious approach to real estate globally, albeit 2024 may present an attractive long-term entry point for those that can look past short-term volatility.

Equities

We are neutral equities overall, reflecting the ongoing resilience of the US economy and corporate earnings. We are overweight domestic equities due to attractive relative valuations and potential tailwinds from economic outperformance. We are underweight Europe due to its weaker macro and earnings outlook.

Active portfolio weights and active tactical asset allocation tilts

	Active tilt	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
Cash	-2	1	1	1	1
Fixed income	2	55	37	19	16
Short maturity	^ -1	7	5	2	2
Government bonds	v 0	32	15	7	5
Investment grade credit	v 1	12	12	5	5
High yield credit	^ 2	4	5	5	4
Equities	0	24	42	60	38
Domestic	1	13	20	29	12
United States	0	6	11	16	13
Europe (ex-UK)	-1	2	3	4	3
United Kingdom	0	2	3	4	3
Emerging markets	0	1	5	7	7
Alternatives	–	20	20	20	45

Decreased weight this month Increased weight this month

Source: LGT Crestone Wealth Management. Investment grade credit includes Australian listed hybrid securities.

Our view on fixed income

Short maturity

We are underweight short maturity. We favour a more balanced position in duration-related bonds and credit securities, as aggressive monetary policies from central banks have sufficiently repriced bond yields for now. Our base case is that central banks will be required to ease monetary policy moderately from mid-2024. This will contribute to the positive total returns from adding duration with fixed rate relative to floating rate over time.

Government bonds

We are neutral government bonds. While our base case is that disinflation will prevail, central banks are likely to remain cautious in their approach to monetary policy and in cutting rates. Inflation has stalled, volatility in this sector remains high, and therefore we are more neutral. Markets are no longer pricing rate cuts in 2024, so we expect yields to remain firm.

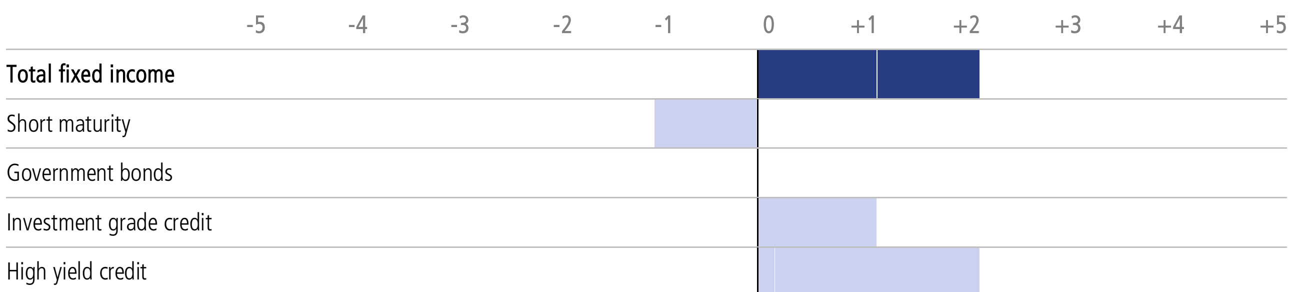
Investment grade credit

We are overweight investment grade credit. While all-in yields are at historically elevated levels, we believe investors should continue deploying into investment grade credit. Credit fundamentals remain solid, and we expect limited credit quality deterioration. Any widening of spreads should be more than offset by falling interest rates, as eventually the focus will return towards rate cuts.

High yield credit

We are overweight high yield credit. Although high yield credit spreads are near historically low levels, the credit quality of high-yield issuers has improved. The average rating of high-yield US issuers is now BB. Many issuers have strengthened their financial positions and are maintaining low leverage and manageable interest coverage. We believe that high interest rates make all-in yields attractive.

Active fixed income weights (%)—We are overweight fixed income



Fixed income market summary

Fixed income indices	Current	One month ago.
Australian iTraxx	75.35	64.84
Australian 3-year yield	4.04%	3.62%
Australian 10-year yield	4.42%	3.96%
Australian 3/10-year spread	38.0 bp	32.6 bp
Australian/US 10-year spread	-0.3 bp	-0.4 bp
US 10-year Bond	4.68%	4.33%
German 10-year Bund	2.58%	2.30%
UK 10-year Gilt	4.35%	3.93%
Markit CDX North America Investment-Grade Index	53.7 bp	52.1 bp
Markit iTraxx Europe Main Index	55.75	54.25
Markit iTraxx Europe Crossover Index	317.78	297.03
SPX Volatility Index (VIX)	15.65	13.83

Source: LGT Crestone Wealth Management, Bloomberg as of 30 April 2024. Active fixed income weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

Our view on equities

Domestic equities

We are overweight domestic equities. The S&P/ASX 200 has broken above its all-time highs. The prospect of stronger returns is reasonable given a likely electorate-friendly budget, the stage three tax cuts, resilient earnings, and eventual interest rate cuts. A 'less bad' China backdrop would also be additive.

US equities

We are neutral US equities. US equities are at a crucial inflection point, where real interest rates have moved sharply higher, as Fed rate cuts are priced out. There is potential for a repeat of events between August and October 2023, which makes the current earnings season particularly important.

European (ex-UK) equities

We are underweight European (ex-UK) equities. We are cautiously underweight Europe for several reasons: valuations are more reasonable than in the US; concentration risk is not as bad; earnings are resilient and moving steadily higher; there is some leverage to a stabilising China; and rate cut expectations have not been pared back as much as in the US.

United Kingdom equities

We are neutral UK equities. The UK continues to lag global peers, suffering from the value bias inherent to the index. For Q1 2024, the FTSE All-Share index lagged the S&P 500 by 7%, continuing the trend through 2023. The UK economy has been showing signs of a turnaround, with economic growth positive in January and inflation falling. Inflation was 3.4% year-on-year in February, down from 4.0% in January. In Q2 2024, it is expected to fall below the 2% target once fuel duty is frozen.

Emerging market equities

We are neutral emerging market equities. Over the past three months, emerging markets have performed more strongly, largely due to a rebound in Chinese equities. Despite ongoing pessimism, corporate earnings are recovering, with positive surprises on capital returns (dividend payout and buy-backs), as well as margin improvements. A delay in Fed rate cuts and a stronger US dollar are macro offsets to a valuation that is in line with its 10-year average of 12x P/E.

Active equity weights (%)—We are neutral equities

-5 -4 -3 -2 -1 0 +1 +2 +3 +4 +5

Total equities
Domestic
United States
Europe (ex-UK)
United Kingdom
Emerging markets

Equity market summary

Region	Index	Latest price	Consensus 1 yr Target	Consensus 1 yr Upside	Next year P/E [1]	Next year D/Y [2]
Australia	S&P ASX 200	7,664.1	7,901.1	3.1%	16.9	3.8%
New Zealand	S&P NZ 50	11,957.5	12,780.8	6.9%	26.8	3.4%
United States	S&P 500	5,035.7	5,748.5	14.2%	18.6	1.5%
Europe	Euro Stoxx	507.5	575.9	13.5%	12.4	3.4%
United Kingdom	FTSE 100	8,144.1	9,160.4	12.5%	11.3	3.9%
China	CSI 300	3,104.8	3,536.3	13.9%	10.1	3.3%
Japan	Nikkei 225	38,405.7	42,610.5	10.9%	20.2	1.8%
India	Sensex	74,482.8	81,941.6	10.0%	21.3	1.5%

Source: Bloomberg. Data as of 30 April 2024; 1 P/E = Price to earnings ratio; 2 D/Y = Dividend yield. Active equity weights sourced from LGT Crestone Wealth Management. Units refer to the percentage point deviation from strategic asset allocation.

Our view on alternatives

Hedge funds

Higher rates and greater asset price dispersion should support the case for hedge funds. A decade of quantitative easing has suppressed volatility and dispersion across underlying industries and securities, which is now shifting. Combined with the higher interest rates regime, the opportunity set for hedge fund managers has improved materially. Across the hedge fund universe, we continue to favour idiosyncratic credit-orientated strategies, where outright yield increases further support the investment case and pockets of dislocation across both corporate and asset-backed sectors provide a ripe opportunity set for more flexible strategies with broader mandates.

Private markets

Private equity remains core, with venture secondaries looking particularly attractive. With entry valuations having re-adjusted meaningfully, we recommend maintaining exposures to private equity and venture capital and building positions where underweight. We maintain a preference for new primary and secondary fund commitment structures, with venture secondaries looking particularly attractive, given the ongoing market dislocations and heightened discounts relative to buy-out equivalents. However, investors should maintain discipline and partner with fund managers that have sufficient data and qualitative insights to source and assess high quality opportunities.

Private debt is our favoured alternative asset class. Higher base rates and increased spreads on private debt offshore mean that risk-adjusted returns look highly attractive relative to other asset classes. Lenders can attract senior deals with strong covenants and an equity cushion of more than 50-60% at unlevered double-digit yields. We prefer direct, sponsor-backed transactions versus broadly syndicated strategies, as loan terms can be negotiated directly, offering greater protection to the end investor. Investors can also further diversify through private, asset-backed securities, albeit we remain cautious on construction and land-focussed real estate lending. We anticipate significant product proliferation across global direct lending exposures in 2024. As such, we are taking a prudent approach to research, given existing offshore exposures typically have both significantly higher fees (management and performance) and leverage.

Real assets

Real estate is our least preferred alternative asset class, yet 2024 may present an attractive long-term entry point. There remains a meaningful dichotomy across different assets, sectors, geography and investment approaches. To that effect, we prefer high-grade assets, where there is some ability to add value through up-leasing, repositioning, or marking rents to market. Offshore industrial assets and multi-family accommodation are favoured alongside alternative sectors, such as self-storage, student accommodation, data infrastructure and manufactured housing. Valuer sentiment in Australia has finally shifted resulting in meaningful downgrades in valuations, but we anticipate that both local and global valuations may settle in 2024 and present an attractive long-term entry point for those that can look past the noise.

We favour growing infrastructure exposures in portfolios. Infrastructure can provide more defensively positioned core assets on long-term, typically inflation-linked contracts. This can provide both a defensive ballast and inflation protection, both of which are in high demand currently. We see attractive investment opportunities focussed on energy transition, but where scale investors are able to build on established platforms and be prudent on entry valuations.

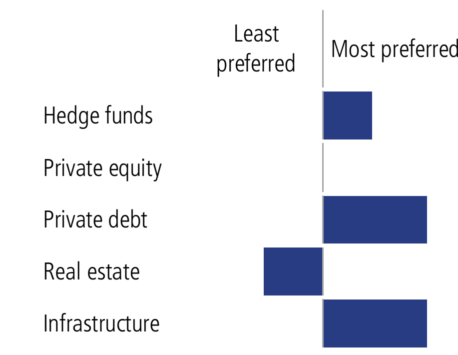
Our most preferred and least preferred exposures—We favour infrastructure, private debt, and low-beta hedge fund exposures while maintaining private equity exposures. We are taking a cautious approach to real estate globally.

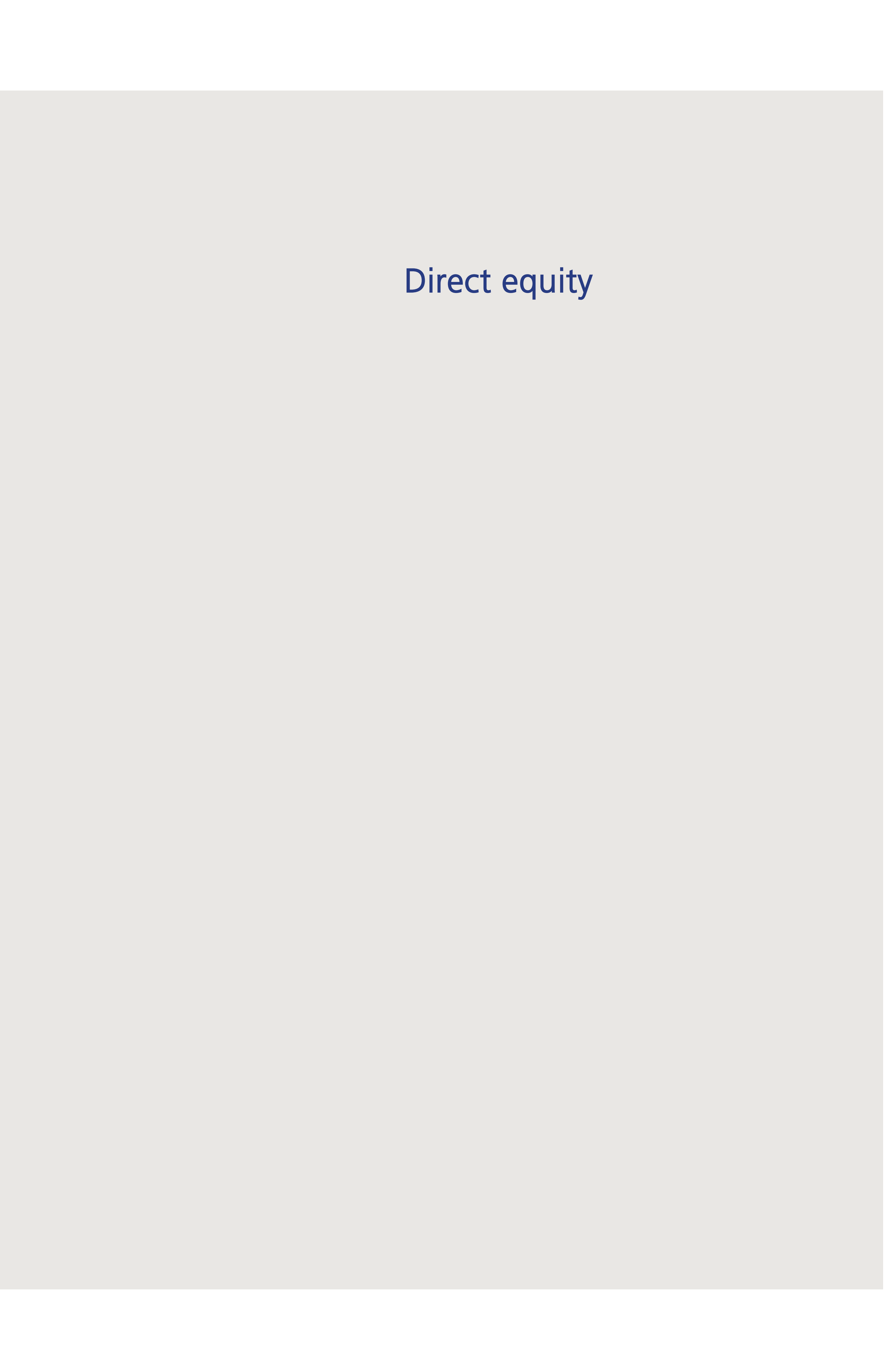
What we like

- Credit-oriented strategies including corporate and asset-backed sectors.
- Senior private debt (strategies excluding real estate).
- Core and core-plus infrastructure assets with inflation linkages.
- Private market and real assets exposed to the global energy transition.

What we don't like

- Long-bias equity hedge fund strategies.
- Lower grade and/or buy-and-hold real estate assets (particularly office).
- Construction and/or junior lending within real estate.
- Carbon-intensive assets and industries with no transition plan.





Direct equity

Recommendations:
Domestic equities—Best sector ideas

Objective of this list

The objective is to identify the best business models or best in breed by GIC's Industry Group for longer-term investors. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity.
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to earnings before interest, tax, depreciation, and amortisation (EBITDA).
- **Efficiency**—Capital expenditure to sales.
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens.

Code	Company	Sector	Market price	Consensus price target	P/E 1yr fwd (x)	Dividend yield	ROIC	ROE	1yr EPS growth	MSCI ESG rating
REA	REA Group Ltd	Com. Services	$179.64	$176.65	52.7	1.0%	34%	28%	21.0%	AA
ALL	Aristocrat Leisure Ltd	Cons. Disc.	$39.92	$47.83	18.2	1.8%	23%	21%	9.2%	AA
TLC	Lottery Corp Ltd/The	Cons. Disc.	$4.88	$5.49	27.9	3.4%	23%	126%	4.0%	AA
MTS	Metcash Ltd	Cons. Staples	$3.94	$4.22	14.0	5.1%	20%	22%	2.5%	AAA
ALD	Ampol Ltd	Energy	$36.81	$39.06	12.9	6.0%	17%	19%	0.8%	AA
MQG	Macquarie Group Ltd	Financials	$187.47	$191.16	16.5	3.4%	2.7%	11%	21%	AA
SUN	Suncorp Group Ltd	Financials	$16.62	$16.75	15.6	4.5%	1.7%	10%	0.0%	AAA
RMD	ResMed Inc	Health Care	$32.85	$35.23	27.5	0.6%	25%	25%	13.5%	A
CSL	CSL Ltd	Health Care	$276.76	$313.47	29.1	1.0%	14%	17%	14.9%	AA
MND	Monadelphous Group	Industrials	$13.49	$14.75	21.3	4.0%	17%	13%	16.4%	AAA
BXB	Brambles Ltd	Industrials	$14.62	$15.88	17.7	2.0%	20%	24%	11.4%	AAA
ALU	Altium Ltd	Info. Tech	$66.01	$67.35	72.7	0.8%	36%	25%	28.7%	AA
XRO	Xero Ltd	Info. Tech.	$122.08	$134.02	129.8	0.0%	10%	13%	59.1%	AA
IGO	IGO Ltd	Materials	$7.91	$7.60	12.1	2.3%	4%	14%	-36.6%	AA
JHX	James Hardie Industries	Materials	$54.21	$59.26	21.6	0.0%	52%	38%	9.4%	AA
GMG	Goodman Group	Real Estate	$31.69	$30.71	29.7	0.9%	10%	11%	9.6%	AA
APA	APA Group	Utilities	$8.32	$8.99	44.5	6.7%	7%	9%	4.8%	A

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 April 2024. ESG is environmental, social, and corporate governance.

Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

Suncorp Group (SUN)—Buy. Having received approval for the divestment of its banking division to ANZ, SUN is set to become a focused general insurer. This paves the way for a more disciplined capital allocation policy, greater focus, and ultimately, greater returns. Demergers in Australia have a history of outperforming.

Goodman Group (GMG)—Trim. Although a long-term holding, GMG has performed strongly recently, and is now approaching 30x P/E. Index-buying and a lack of credible ways to gain AI exposure have resulted in it gaining more than 65% since October.

IGO Group (IGO)—Buy. IGO's 40% share price fall is its largest since 2019, but in line with its average drawdown since 2015. As the world's lowest cost producer of lithium with a large net cash position, IGO is well positioned to weather the current weakness in lithium prices.

Recommendations: Domestic equities—Sustainable income

Objective of this list

This objective is to generate 'sustainable income' over time. Historically, companies that grow their dividends consistently can offer superior long-term performance. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to this list, some metrics we consider are:

- **Profitability measures—**Return on assets, cashflow, return on invested capital and return on equity.
- **Liquidity and leverage**—Net debt to equity.
- **Efficiency**—Change in revenue, EBITDA, and margins.
- **Management signalling**—Dividend growth and pay-out ratios.

Code	Company	Sector	Market price	Consensus price target	P/E 1yr fwd (x)	P/B 1yr fwd (x)	Franking	Div. yield	1yr DPS growth	MSCI ESG rating
SUN	Suncorp Group Ltd	Financials	$16.62	$16.75	15.6	1.5	100%	4.5%	13.1%	AAA
MQG	Macquarie Group Ltd	Financials	$187.47	$191.16	16.6	2.1	40%	3.4%	9.9%	AA
WBC	Westpac Banking Corp	Financials	$25.96	$23.69	14.0	1.3	100%	5.5%	0.3%	A
QBE	QBE Insurance Group Ltd	Financials	$17.73	$18.75	9.7	1.7	10%	3.4%	7.7%	AAA
COL	Coles Group Ltd	Cons. Staples	$16.22	$17.24	19.3	6.1	100%	4.1%	5.2%	AA
MTS	Metcash Ltd	Cons. Staples	$3.94	$4.22	13.6	3.4	100%	5.1%	2.0%	AAA
TLC	Lottery Corp Ltd/The	Cons. Disc	$4.88	$5.49	26.8	31.2	100%	3.4%	4.8%	AA
TAH	Tabcorp Holdings Ltd	Cons. Disc	$0.74	$0.85	15.6	0.8	100%	2.4%	61.1%	AA
TLS	Telstra Group Ltd	Com. Services	$3.67	$4.46	19.0	2.8	100%	4.9%	4.4%	AA
NEC	Nine Entertainment Co.	Com. Services	$1.53	$2.04	12.2	1.5	0%	5.1%	12.8%	AA
RMD	ResMed Inc	Health Care	$32.85	$35.23	24.3	6.8	100%	0.6%	11.2%	A
PME	Pro Medicus Ltd	Health Care	$111.41	$98.26	112.6	73.1	100%	0.3%	26.9%	BBB
REP	RAM Essential Services	Real Estate	$0.65	$0.78	14.1	1.4	0%	8.5%	-5.5%	-
SGP	Stockland	Real Estate	$4.45	$4.80	13.4	1.1	0%	5.7%	5.5%	AA
IRE	IRESS Ltd	IT	$8.58	$9.10	22.4	5.7	0%	1.2%	196.1%	AA
DBI	Dalrymple Bay Infra	Industrials	$2.79	$2.91	15.2	1.3	68%	7.9%	4.5%	-
ALX	Atlas Arteria Ltd	Industrials	$5.19	$5.70	11.6	1.2	0%	7.8%	0.7%	AA
APA	APA Group	Utilities	$8.32	$8.99	42.4	2.9	0%	6.7%	2.0%	A
ALD	Ampol Ltd	Energy	$36.81	$39.06	12.8	2.5	100%	6.0%	-0.8%	AA
AMC	Beach Energy Ltd	Energy	$1.61	$1.85	7.3	1.1	100%	2.8%	91.1%	AAA
BHP	BHP Group Ltd	Materials	$43.03	$47.61	10.6	3.4	100%	3.4%	1.7%	A
AMC	Amcor PLC	Materials	$13.82	$15.14	12.2	3.3	0%	3.6%	2.2%	AA

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 April 2024. ESG is environmental, social, and corporate governance.

Trade opportunities

Please note the following opportunities may not fully satisfy metrics for the above table.

The Lottery Corp (TLC)—Buy. Gearing levels for a defensive cashflow business such as TLC are forecast to fall well below target levels into next year. This should open the possibility for additional capital management opportunities. With CBA forecasting six rate cuts over the next 15 months, the valuation pressure from higher rates could turn into a tailwind.

Beach Energy (BPT) – Buy. BPT is trading below book value and has a free cash flow yield exceeding 13%. A recent capex overrun related to its Waitsia project has resulted in stock price weakness, however the project now has ample conservatism embedded and an upcoming strategic review could provide a further catalyst.

APA Group (APA)—Buy. APA is trading close to nine-year lows, and with easing bond yields, valuation pressure has moderated. This makes its decade-low enterprise value/EBITDA of around 11.5x attractive—not to mention a 7% dividend yield for a company whose dividend per share has increased every year for 20 years.

Recommendations: International equities—Best sector ideas

Objective of this list

The objective is to provide a list of large-cap international companies across sectors with sustainable business models that generate compounding returns on investment and capital over the longer term. While we also overlay valuation, companies are included based on anticipated three to five-year performance. When analysing companies to add to the list, some metrics we consider are:

- **Profitability measures**—Return on net operating assets, return on invested capital, free cashflow and return on equity.
- **Liquidity and leverage**—Net debt to equity, Altman Z-score, net debt to EBITDA.
- **Efficiency**—Capital expenditure to sales.
- **Valuation**—Price/earnings ratio, price/book ratio, enterprise value to sales and EBITDA, private equity screens.

Code	Company	Sector	Base CCY	Market price	Consensus price target	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
GOOGL US	Alphabet Inc	Com. Services	USD	162.78	192.04	19.2	0.2	2,022,889	BBB
UMG NA	Universal Music Group	Com. Services	EUR	27.70	29.71	25.8	2.2	54,021	AA
DIS US	Walt Disney Co/The	Com. Services	USD	111.10	128.00	20.2	0.9	203,794	A
9988 HK	Alibaba Group Holding	Consumer Disc.	HKD	74.35	98.68	8.8	1.1	185,010	BBB
NKE US	NIKE Inc	Consumer Disc.	USD	92.26	110.59	23.3	1.7	139,253	BB
SBUX US	Starbucks Corp	Consumer Disc.	USD	88.49	102.89	19.0	2.7	100,188	A
ABNB US	Airbnb Inc	Consumer Disc.	USD	158.57	152.35	30.0	0.0	102,605	BB
RACE IM	Ferrari NV	Consumer Disc.	EUR	387.20	381.60	44.8	0.7	74,996	BB
EL US	Estee Lauder Cos Inc/The	Consumer Staples	USD	146.71	160.93	34.1	1.9	52,592	A
COST US	Costco Wholesale Corp	Consumer Staples	USD	722.90	774.39	41.4	0.6	320,609	A
288 HK	WH Group Ltd	Consumer Staples	HKD	5.72	6.43	7.4	0.9	9,380	BBB
SHEL LN	Shell PLC	Energy	GBP	2863.00	3,054.03	8.7	0.1	228,540	AA
LSEG LN	London Stock Exchange	Financials	GBP	8846.00	10,407.40	21.8	1.6	59,333	AA
LLOY LN	Lloyds Banking Group	Financials	GBP	51.90	59.32	6.9	6.4	40,961	AA
WFC US	Wells Fargo & Co	Financials	USD	59.32	62.71	10.7	2.7	207,721	BB
2318 HK	Ping An Insurance Group	Financials	HKD	35.95	52.18	4.7	7.3	95,695	A
939 HK	China Construction Bank	Financials	HKD	5.10	6.35	3.5	8.1	166,147	AA
MA US	Mastercard Inc	Financials	USD	451.20	516.45	27.0	0.6	420,921	AA
NOVOB DC	Novo Nordisk A/S	Health Care	DKK	902.60	911.71	31.7	1.6	576,265	AAA
ISRG US	Intuitive Surgical Inc	Health Care	USD	370.62	419.32	50.6	0.0	131,461	A
BA US	Boeing Co/The	Industrials	USD	167.84	220.74	26.7	0.3	103,034	BBB
DSV DC	DSV A/S	Industrials	DKK	997.80	1,393.36	16.1	0.8	30,533	AA
2330 TT	Taiwan Semiconductor	Information Tech.	TWD	790.00	925.79	16.3	1.9	628,911	AAA
ASML NA	ASML Holding NV	Information Tech.	EUR	832.70	1,009.33	27.8	1.0	354,861	AAA
MSFT US	Microsoft Corp	Information Tech.	USD	389.33	479.67	29.1	0.8	2,893,620	AA
ACN US	Accenture PLC	Information Tech.	USD	300.91	384.96	23.0	1.8	201,947	AA
SHW US	Sherwin-Williams Co/The	Materials	USD	299.61	342.20	23.5	1.1	75,966	A
EQIX US	Equinix Inc	Real Estate	USD	711.11	915.68	49.6	2.6	67,488	AA
ORSTED DC	Orsted AS	Utilities	DKK	385.70	450.17	12.6	3.6	23,185	AAA
JNJ US	Johnson & Johnson	Health Care	USD	144.59	172.43	13.2	3.6	348,431	A
		Average Yield:					2.0%		

Source: Bloomberg Analyst consensus and MSCI Research. This list does not constitute research and is the output of material prepared by our research providers. To obtain a copy of the underlying research, please contact your investment adviser. Data as of 30 April 2024. ESG is environmental, social, and corporate governance.

Recommendations:
Thematic investing—Artificial intelligence

Objective of this list

Thematic investing is an approach which focuses on predicting long-term trends rather than specific companies or sectors. As it is also often associated with secular forces, this means it can provide investors with exposure to themes that are expected to grow at rates above economic growth over the longer term. Thematic investing is best suited to longer-term investors and those looking for opportunities beyond the comparatively smaller investment universe that exists in Australia. Some key themes that investors are exploring include:

- Climate change
- Cryptocurrency and blockchain
- Demographics
- Electric vehicles
- Healthcare and genomics
- Energy transition
- Artificial Intelligence
- Security and safety
- Supply chain disruption
- Sustainable investing

Artificial intelligence—Select exposures

Healthcare and genomics sit at the intersection of several other major long-term investment trends – ageing, population growth, finance, and technology. The ageing of societies is one of the easiest predictions to make about the future.

Code	Company	Sector	Base CCY	Market price	Consensus price target	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
JNJ US	Johnson & Johnson	Health Care	USD	144.59	172.43	13.2	3.6	348,431	A
UNH US	UnitedHealth Group Inc	Health Care	USD	483.70	563.88	15.6	1.8	445,043	AA
LLY US	Eli Lilly & Co	Health Care	USD	781.10	832.63	42.7	0.7	742,362	A
NOVOB DC	Novo Nordisk A/S	Health Care	DKK	902.60	911.71	31.7	1.6	576,265	AAA
DHR US	Danaher Corp	Health Care	USD	246.62	274.22	28.4	0.5	182,668	AA
ISRG US	Intuitive Surgical Inc	Health Care	USD	370.62	419.32	50.6	0.0	131,461	A
ILMN US	Illumina Inc	Health Care	USD	123.05	154.43	41.4	0.0	19,553	A
CSL AU	CSL Ltd	Health Care	AUD	276.76	313.47	25.3	1.1	86,560	AA
RMD AU	ResMed Inc	Health Care	AUD	32.85	35.23	24.3	0.7	31,233	A
COH AU	Cochlear Ltd	Health Care	AUD	325.10	287.47	47.2	1.5	13,780	AAA
PME AU	Pro Medicus Ltd	Health Care	AUD	111.41	98.26	112.6	0.4	7,530	BBB
TLX AU	Telix Pharmaceuticals	Health Care	AUD	15.05	15.29	39.5	0.0	3,221	-
A US	Agilent Technologies Inc	Health Care	USD	137.04	149.47	22.5	0.8	40,160	AA
FRE GY	Fresenius SE & Co KGaA	Health Care	EUR	27.97	36.56	8.1	3.7	16,801	A
MRK US	Merck & Co Inc	Health Care	USD	129.22	141.36	13.0	2.5	327,318	A
EXAS US	Exact Sciences Corp	Health Care	USD	59.35	90.20	824.3	0.0	10,774	A
CRSP US	CRISPR Therapeutics AG	Health Care	USD	52.99	89.73	na	0.0	4,498	-
PFE US	Pfizer Inc	Health Care	USD	25.62	31.75	9.3	6.8	144,670	A
ROG SW	Roche Holding AG	Health Care	CHF	220.60	279.67	11.2	4.5	196,494	A
NOVN SW	Novartis AG	Health Care	CHF	89.05	98.64	12.2	4.4	220,565	AA
AZN LN	AstraZeneca PLC	Health Care	GBP	12062.00	13,073.73	16.5	0.0	233,568	AA

Source: Bloomberg Analyst consensus and MSCI Research. Data as of 30 April 2024. ESG is environmental, social, and corporate governance.

Important information

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