



# Future proof your portfolio

## Capturing opportunities in the energy transition

### Core Offerings

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

September 2023



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# Future proof your portfolio

## Capturing opportunities in the energy transition

AN UPDATE FROM LGT CRESTONE'S CHIEF INVESTMENT OFFICER



**Scott Haslem**  
Chief Investment Officer

The world is undergoing a colossal change in the way it thinks about sourcing, producing, and delivering energy as it attempts to reduce carbon emissions and transition to a 'net-zero' economy. When we look around us, there is no doubt that the energy transition is under way, but this is a multi-decade journey of which we are still in the very early stages.

Several geo-political, macro-economic, and environmental events over the past few years have affected the global energy system in multiple ways, both positively and negatively. And the choices that we make in the coming years are no doubt going to have profound consequences on the future of the climate and, indeed, the planet.

In this month's edition of *Core Offerings*, we provide an update on global investment trends in the energy transition to date, some inconvenient truths, and where we see the opportunities in the coming years.

### Energy security now comes at a premium

Eighteen months on from Russia's invasion of Ukraine, the global energy landscape has changed. The war destabilised global energy supplies, which increased price volatility and shone a spotlight on energy security. One key question to arise from this is: did the energy crisis lead to accelerated investment in the energy transition, or has it prompted renewed investment in fossil fuels?

The International Energy Agency's (IEA) *2023 Energy Investment Report* shows that the war accelerated investment into a range of clean energy technologies, but also led to a short-term scramble for oil and gas supply (not necessarily new investment). There is no doubt that the war highlighted the world's dependence on fossil fuel consumption—but it also revealed the lack of reliability that offshoring energy provides.

Previously, fossil fuels and energy security came as a package. Both were seen as reliable and affordable, and it was renewables that came at a premium. Not anymore. Clean energy, in many parts of the world, is now the more affordable option, and energy security comes with the higher price tag (for a range of reasons, including geo-political as well as reduced capex). The benefits of clean energy are that it can now support energy security, and the quest for greater energy security is ultimately leading to a faster transition.

### Investment momentum remains strong

According to BloombergNEF, global investment in renewable energy skyrocketed to USD 358 billion in the first six months of 2023, a 22% rise compared to the start of last year and an all-time high for any previous six-month period. Most of this investment was related to small-scale solar, but renewable energy venture capital commitments were also up 25%. According to the IEA, for every USD 1 spent on fossil fuels, USD 1.70 is now spent on clean energy. Five years ago, that ratio was 1:1.

A multitude of factors has driven the momentum in clean energy investment. Policy support, including the US *Inflation Reduction Act* (IRA), the REPowerEU plan in Europe, and the GX (Green Transformation) programme in Japan are just a few examples of how some global policymakers have taken bold action to support investment in renewables. Adding to that, high fossil fuel prices (aided by lower investment) and a strong alignment of climate and energy security goals are fuelling capital into this space.

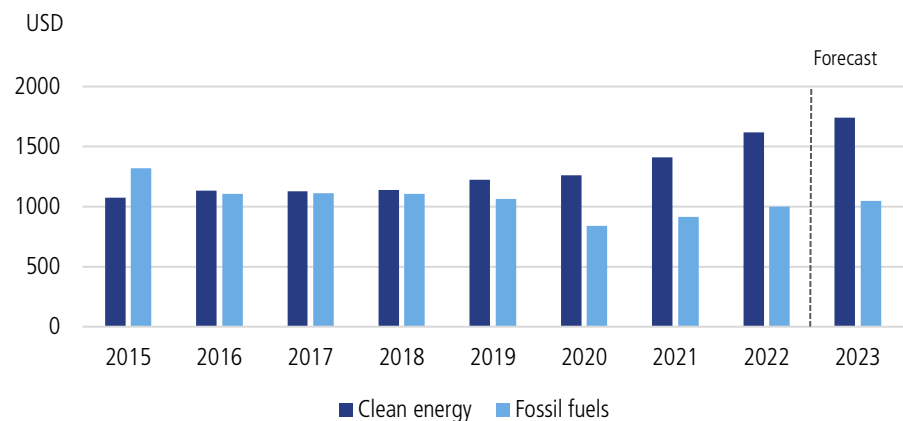
Consumers too are investing in more electrified end uses—demand for electric vehicles (EVs) is up, and global sales are expected to break through 2022's record of 10 million to reach 13 million in total sales in 2023. In Australia, Tesla sales recently reached sixth place in the monthly sales leader board, its best ever performance. The momentum is being led by renewable power and EVs, but with strong contributions from batteries, heat pumps and nuclear power.

Did the energy crisis lead to accelerated investment in the energy transition, or has it prompted renewed investment in fossil fuels?

"Thermal coal exports, worth A\$60bn last year (2022), will be reduced to 1% of that in 40 years if the world limits global warming to 1.5 degrees above pre-industrial levels."

Jim Chalmers, Treasurer  
August 2023

## Global energy investment in clean energy versus fossil fuels (2015-2023)



Source: International Energy Agency 2023 Energy Investment outlook.

"The levelized cost of renewable energy continues to fall with onshore wind falling 6.3% in 2022, offshore wind falling 10.2% and fixed axis PV falling 1.7%. Electric vehicle sales are continuing to increase, and are expected to hit 13 million in 2023, up from 10 million in 2022."

International Energy Agency,  
*World Energy Outlook 2023*

### To date, China is by far the biggest contributor to energy transition investment

China's clean energy investment hit USD 546 billion in 2021, just under half of the world's total. For H1 2023, China was again the largest contributor with USD 177 billion of new investment. The accelerated investment forms part of the Chinese government's strategy to cut its energy intensity and reach peak emissions in a "well-planned and phased out approach" with the aim of being carbon neutral by 2060, according to President of China, Xi Jinping. In 2020, Xi pledged to achieve peak CO<sub>2</sub> emissions before 2030 and carbon neutrality by 2060.

Indeed, China has already invested heavily in solar, and represents around 40% of the world's solar industry. According to the Global Energy Monitor, China is set to double its production of wind and solar to produce 1,200 gigawatts of energy by 2025, five years ahead of reaching its goal by 2030.

China is not only at the forefront of renewable energy investment, but it also dominates global critical mineral supply chains, accounting for around 60% of worldwide production and 85% of processing. Many critical minerals have no viable substitutes and are indispensable for the energy transition, as they are required in almost every piece of renewable energy infrastructure, including EVs, solar and wind turbines. You can read more about our views on critical minerals in *Australia's next mining boom? The role of critical minerals in renewable energy*.

### However, there are some inconvenient truths

Whilst it is the world's largest investor in renewables, China remains the largest consumer of coal and, as a result, is the world's largest CO<sub>2</sub> emitter. Its economy still remains heavily dependent on coal to meet its electricity needs, and it is responsible for around 30% of global emissions—more than the US and Europe combined.

However, environmental pollution costs China significant sums every year, and many believe that China is nearing peak fossil fuel generation. According to the China Electricity Council, forecasted consumption for fossil fuels is expected to rise for another three years, but renewables are expected to account for half of new capacity additions.

Further, it is viewed that China's supply chains for critical minerals are rife with forced labour, and many western countries have released policies that aim to reduce the reliance on China for critical minerals. Policies like the IRA have clear directives to reduce reliance on 'dirty' supply chains, which in theory cuts China out of the energy transition in the US. But it's incredibly difficult to completely decouple from China. Many inputs into renewables are sourced from China but traded on global markets with no trace of Chinese origin.

What's clear is the energy transition won't be without its trade-offs. Countries and policymakers will need to weigh up the costs and benefits for each and every stage of the transition. China's investment in renewable energy is creating healthy competition between the East and West, as all global economies focus on reducing carbon emissions.

Even as global energy supplies tightened during 2022, the development of China's renewable energy investment continued unabated.

David Stanway,  
Reuters, July 2023

The IRA includes approximately USD 390 billion of spending/tax credits over the next 10 years related to energy and climate change. The goal is to put the US on track towards 40% emissions reductions by 2030.

UBS Investment Bank  
March 2023

Decarbonisation is a major threat to revenue, given Australia has relied extensively for decades on the taxes gleaned from exports of commodities like coal and gas.

Australian Government,  
*2023 Intergenerational Report*, August 2023

If the world is to achieve net zero emissions by 2050, global demand for critical minerals is going to have to increase by 350% by 2040.

2023 Intergenerational Report, Australian Government, August 2023

### The US passes major climate legislation

The IRA has, no doubt, been the most comprehensive and ambitious climate legislation ever passed in the US, or globally for that matter. The economics are extremely attractive, offering generous credits and tax subsidies for both commercial and residential consumers across multiple renewable energy technologies.

A year on from the legislation being signed into law, it is making significant progress toward shifting the US to 80% clean electricity and cutting emissions by 40% by 2030. To date, there has been USD 278 billion in private clean energy investments, and around USD 70 billion has become available in grants, rebates, and subsidies for the end user. To date, around 272 new clean energy projects have been announced, including EV manufacturing facilities, battery manufacturing sites, and wind and solar construction. Sales of EVs are expected to reach over 1.5 million in 2023, fuelled by the generous incentives of the IRA.

What is becoming clear is that the US, China, and the rest of the world are now in explicit competition for jobs, economic value, technological leadership, and supply chain dominance across multiple clean energy markets. The reasons for this are based on both economics and security. It is possible that the healthy competition between leading nations could spark a 'green war' of sorts, which will be beneficial to the long-term health and stability of the planet but could ultimately result in increased cost pressures and supply chain disruption.

### Australia needs to position itself to be competitive on the global stage

Australia is targeting a 43% fall in emissions by 2030 and the achievement of net-zero emissions by 2050. It is widely known that these targets will require an enormous collaborative effort from government, the private sector, and individuals alike.

Minister for Climate Change and Energy, Chris Bowen, has highlighted the mammoth task ahead. He says that in order for Australia to reach net-zero emissions, Australia must install 22,000 500-watt solar panels every day for eight years, along with 40 7MW turbines every month—backed by at least 10,000kms of additional transmission lines.

Several key governmental policy reforms will support these targets, including the Safeguard Mechanism, Rewiring the Nation program, National Electric Vehicle Strategy, and the National Reconstruction Fund. But a key risk for Australia is that it lacks progressive policy action, or in other words, a clear policy runway to encourage private sector action.

Whilst the IRA is, no doubt, beneficial for global decarbonisation, it encourages capital towards the US that may otherwise have stayed in Australia. Bowen recently said, "The task of the Australian Government is to ensure that the IRA does not distort activity that would have otherwise would have happened in Australia". Australia needs the policy support to keep invested capital local, otherwise it runs the risk of seriously locking itself out of the next decade of climate opportunities.

Further, the recent *Intergenerational Report* from the Australian Government has made the bold prediction that Australia's multi-billion-dollar thermal coal export industry will be all but wiped out in 40 years if the world continues on its path towards net-zero emissions by 2050. Australia needs to be developing strategies now in order to ensure that gaps left by the coal, oil and gas industry are filled with the unprecedented opportunities that are likely coming from critical minerals.

The good news is that Australia is in the prime position to capture value in the clean energy transition, from critical minerals extraction to the onshoring of refining. But we need pragmatic leadership at the helm (both across public and private sectors) to ensure that Australians can see the advantages, and ensure costs are not going to blow out.

Decarbonisation can drive economic growth, create jobs, and bring substantial benefits to the environment and public health. But it must be done purposefully and strategically. It cannot be forgotten that the correlation between cheap energy and prosperity, defined by GDP growth, go hand-in-hand. Few believe the transition to clean energy is 'costless'.

### What about the recent run in fossil fuels?

2022 was an extraordinary year for many fossil fuel companies, as high energy prices resulted in high revenues. Oil prices peaked at approximately USD 128 per barrel (bbl) in March 2022, two weeks after the Russian invasion of Ukraine. Since that peak, oil prices have fallen by around 35% to USD 83 bbl. At its lowest (in June), the pullback was 44%. However, despite this fall in oil prices, the MSCI World Energy sector (the companies engaged in this sector) has seen a positive total return over the same period—around 9%—significantly outperforming the underlying commodity price.



“There is only one way to get the world off oil and gas, and that is not to expect the companies that benefit from that industry most to lead the way. These companies are set up to maximise shareholder returns and they are doing exactly that.”

Adrienne Buller  
Director of Research  
Common Wealth

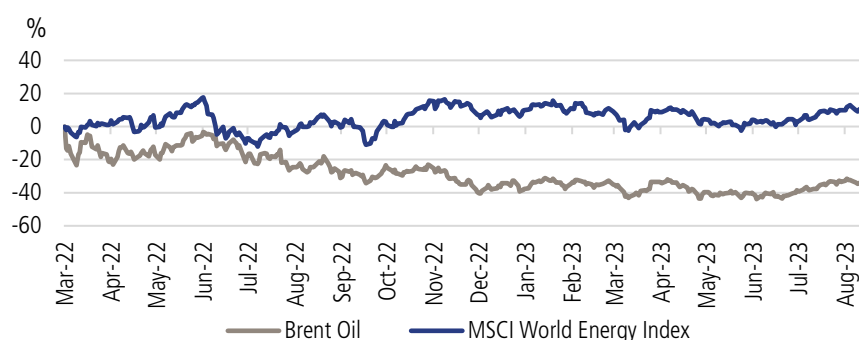
For any long-term investor, considering the implications of climate change will play a crucial role in portfolio risk mitigation over the coming decades.

Part of the explanation for this divergence lies with the transition to net zero and sustainability factors that now govern corporate decision making. Uncertainty over the pace, cost and means of the energy transition is being reflected in the capital allocation framework of company boards. The major constraint on near-term investment levels has shifted from capital availability to capital allocation, returns, and the cost of bringing new supply to market in a higher interest rate environment.

Oil and gas companies are experiencing record profits—however, they are prioritising returns to shareholders via dividends, share buybacks, and debt repayment.

According to the IEA, less than half the oil and gas industry’s unprecedented cash flow is going back into traditional supply. Between 2010 and 2019, three quarters of cash outflows were typically invested into new supply. This is now less than half, with the majority going to dividends and share buybacks (39%) and debt repayment (13%).

#### Total return of oil versus energy stocks



Source: Bloomberg.

#### Decarbonisation as an investment thematic

For any long-term investor, considering the implications of climate change will play a crucial role in portfolio risk mitigation over the coming decades. Changes in long-term structural trends will weigh heavily on fossil fuel demand and portfolios need to pivot in such a way that they are resilient and positioned for success in a net-zero world.

Investors are likely to continue to be challenged by a heightened level of uncertainty surrounding the pace and path of the energy transition. Notwithstanding a lack of clarity, and questions surrounding the precise characteristics of the future, we believe there are still investments and sectors that will play a durable role in mitigating portfolio risk.

#### Sectors and themes we like

**Net-zero infrastructure** – Infrastructure investments are, by nature, in it for the long haul. To reach net zero, significant infrastructure will be needed for decarbonisation, especially mature sustainable technologies like wind and solar.

**Critical minerals** – With demand expected to increase exponentially for many critical minerals (lithium, copper, rare earths), we favour exposure to this thematic through specific stock selection, thematic exchange-traded funds (ETFs) and direct commodity ETF exposure.

#### Companies pivoting towards the new era of clean energy

**Companies in transition** – Companies which have clearly defined transition pathways and that have developed a holistic understanding of the risks and opportunities associated with the move to a low carbon future.

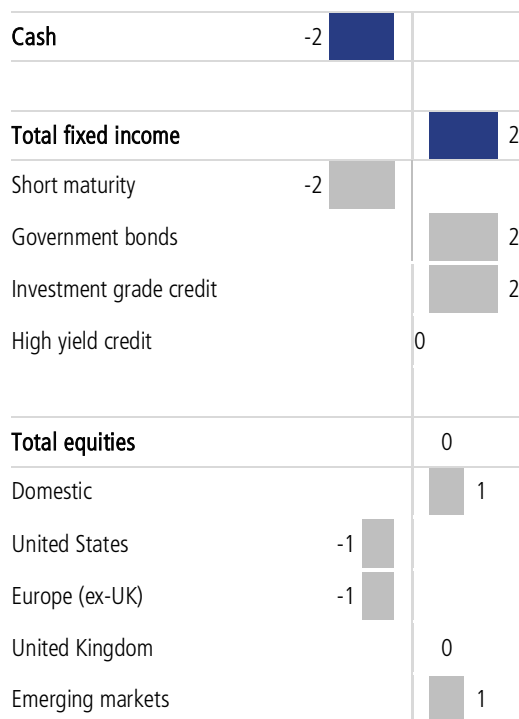
**Enablers of the transition** – Efficiency and optimisation, on both the supply and demand side, need to be augmented with digital technology for energy system balancing and control. We like companies which consider adopting artificial intelligence technology, data management, connectivity, and security.

**Survival of the adapters** – Traditional fossil fuel companies face diminishing marginal demand that threatens revenues and could make assets worthless in the future. To remain relevant in an ever-changing world, companies need to adapt to the clean energy future.

For a list of recommended stock ideas, refer to page 26. You can also access a list of ETFs, which provide exposure to this theme, in *A quick guide to net zero*.

# What's driving our views

## Tactical asset allocations (% weights)



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

## Peak rates nearer as inflation slows

While growth has remained resilient in H1 2023, and jobs markets have stayed tight, core inflation has begun slowing more clearly, and there are expectations that lower credit availability will weigh on growth ahead.

Our views have changed to reflect a move closer to peak interest rates and slowing inflation. We retain an overweight to fixed income, as we expect it to perform well relative to equities under several scenarios in the short term, but we have moved our equities underweight to a neutral position.

**Inflation volatility is likely to persist**—Inflation is now falling meaningfully. But fading impacts of globalisation, structurally tight jobs markets, and geo-political impacts on supply chains suggest a more volatile inflation outlook.

**A return to 'normal' interest rates**—Falling inflation is likely to foster a near-term peak in central bank rates. But fewer deflationary forces than in the past is likely to limit a return to a near-zero policy rates environment.

**Geo-political volatility likely to be enduring**—Russia's invasion of Ukraine has ended a long period of benign globalisation. Ongoing decoupling of leading-edge technology, political and trade alignment, as well as military and energy security, are all key potential drivers of growth and profits.

**Diversification matters**—In a world of heightened volatility and fewer long-cycle trends, it is important to maintain portfolio diversification, avoiding over-exposure to individual markets, sectors and other specific return drivers. Unlisted investments are likely to grow in favour.

## Structural themes

**The energy transition**—As the world faces a trade-off between net-zero commitments, cost, and energy security, this is setting the scene for both old and new forms of energy to play a role.

**Sustainable investing**—As the world becomes more connected, it is also becoming more socially aware. The intersection of finance and sustainability will govern a reallocation of capital.

**The search for income**—The exit of 'zero-bound interest rates' has resulted in a resetting of income expectations across all asset classes, including equities, fixed income, and income-generating unlisted assets.

**Deglobalisation**—Brexit, trade wars, COVID-19, and Russia's invasion of Ukraine have up-ended a relatively harmonious world order, with impacts spanning geo-politics, military spend, supply chains and demographics.

|              | What we like   | What we don't like  |
|--------------|--|---|
| Equities     | <ul style="list-style-type: none"> <li>Energy companies now focused on shareholder returns with an 'OPEC put' in place</li> <li>Later-cycle defensive exposures in the consumer staples, telco and healthcare sectors</li> <li>Emerging markets due to output and earnings per share (EPS) growth differentials relative to developed markets</li> </ul> | <ul style="list-style-type: none"> <li>Companies with shorter-term debt maturities at risk of re-pricing into a higher rate environment</li> <li>Market-cap weighted S&amp;P 500, where valuations and concentration favour the equally weighted index</li> <li>Stocks trading at historically tight dividend yields to the risk-free rate</li> </ul> |
| Fixed income | <ul style="list-style-type: none"> <li>Actively managed funds investing in higher quality credits</li> <li>Fixed rate three- to five-year senior unsecured banks</li> <li>Fixed rate Australian bank subordinated tier 2</li> </ul>  | <ul style="list-style-type: none"> <li>Short maturity bonds with a preference for more duration in portfolios</li> <li>High yield corporates vulnerable to higher cost of funds</li> </ul>  |
| Alternatives | <ul style="list-style-type: none"> <li>Multi-strategy, credit-oriented and discretionary macro hedge funds</li> <li>Senior private debt (strategies excluding real estate)</li> <li>Core and core-plus infrastructure assets with inflation linkages, particularly exposures to the energy transition</li> </ul>   | <ul style="list-style-type: none"> <li>Lower grade and/or buy-and-hold real estate assets (particularly office)</li> <li>Construction and/or junior lending within real estate</li> <li>Carbon-intensive assets and industries with no transition plan</li> </ul>   |

## Economic and asset class outlook



# Economic outlook

## Global economy



Over the past month, data for the US economy have implied a strong start to Q3 growth, emboldening those looking for a soft landing and recovery in growth next year. Yet, leading indicators for the US and elsewhere have instead been broadly consistent with our expectation for some renewed softening in growth during H2 2023. Global business surveys have weakened, particularly for Europe and the UK, while China's economy has continued to stumble. Jobs markets are also now showing tentative signs of becoming less tight, even in the US. We expect a near-recessionary period into late 2023 to give way to a patchy growth recovery through 2024.

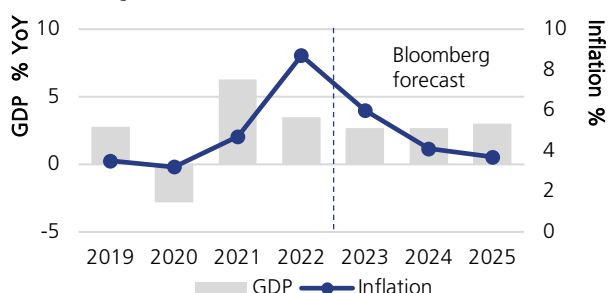
For Q2, growth in the world economy rose solidly, lifting the annual pace from 2.8% to 3.4%, above trend, led by the US, Japan and emerging markets. Recent data suggest the pace of global growth will slow to a below trend 2.5% in H2 2023.

Significantly, recent months have seen a more broad-based easing of underlying (services-driven) inflationary pressures. While unemployment has remained low, falling job vacancies suggest some easing of tight labour demand that should also reduce concerns about a reacceleration of inflation. This has aided optimism that we are nearing the peak of interest rate tightening, with central banks in the US, Europe and Australia signalling a more 'data dependent' approach, while some central banks in emerging markets have already begun easing.

Of course, the more 'soft-ish' the economic landing, the more likely that interest rates will be held restrictive for longer to ensure inflation risks are removed over time. However, while consensus does not anticipate interest rate cuts beginning before mid-2024, market yields have begun to moderate, supporting both fixed income and equity returns over recent months. A clearer peak in US policy tightening (and a growth recovery into 2024) could support a weaker US dollar ahead.

Forecasts for 2023 growth have recently been raised. UBS lifted its forecast to 2.8% (from around 2.0%) and expects a similar pace for 2024 (at 2.5%). In contrast, while Société Générale (SG) has added around 0.5% to its latest 2023 outlook for the US, Europe, UK, and China under the banner of "recession must wait", it expects (like CBA) a global recession in 2024, led by a recession in the US.

### Global GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

## Australia



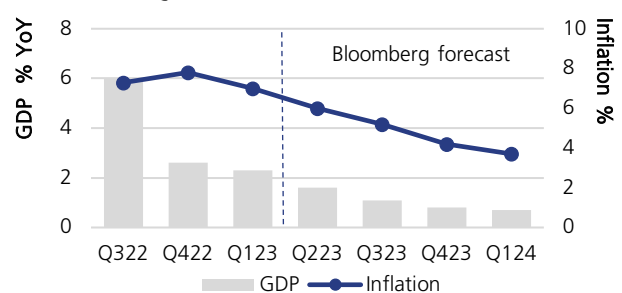
Signs of some further slowing in consumer activity—together with a renewed easing of inflationary pressures and rise in unemployment—have strengthened the narrative that the peak in policy tightening has been reached in Australia. While business conditions remain favourable, rising costs are inhibiting activity, particularly in housing. This suggests a likely further moderation in growth to a further below-trend pace during H2 2023. Still, we expect the recent strong uplift in immigration and lower inflation that aide consumer buying power to support growth sufficiently to avoid a near-term recession.

Growth in Q1 slowed further to 0.2% after Q4's 0.6% gain, its weakest since mid-2021. The annual pace eased from 2.7% to 2.3%, masking a sharper drop to an annualised pace of just over 1% over the past two quarters. Data for Q2 is expected to show further consumer slowing. In July, retail sales rebounded modestly from June's weakness, but broader household spending is slowing sharply, according to UBS. More positively, house prices have gained 4% since February, albeit new lending and building approvals remain subdued. The jobs market is tight, though July revealed signs of softness, falling by 14,600 jobs after 100,000 across May and June. The unemployment rate retraced higher to 3.7% (from 3.5%).

Inflation is moderating more quickly, falling to a lower-than-expected 4.9% in July (with core inflation easing to 5.6%). Q2 wages growth also edged lower to 3.6%, a touch below the Reserve Bank of Australia's (RBA) forecast. After hiking to 4.10% in May and June, the RBA stayed on hold in July and August, suggesting the current 4.1% cash rate should be consistent with inflation returning to target over time. Ahead of Governor Lowe's last meeting in September, the RBA noted that "[the Board] is also seeking to strike the right balance between getting inflation down in a timely way and preserving as many of the gains in the labour market as possible". UBS and CBA have now shifted lower their peak to 4.10% (was 4.35%), with both seeing the first cut in H1 2024.

After 3.7% in 2022, UBS expects Australia to avoid a recession in 2023, with growth slowing to 1.4% before a modest recovery to 1.6% in 2024. CBA expects below trend (non-recessionary) growth of 1.4% during both 2023 and 2024.

### Australian GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

# Economic outlook

## United States



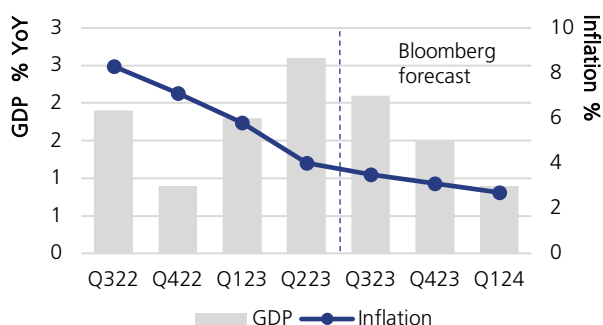
Optimism continues to grow surrounding the possibility of a soft landing for the US economy, and one accompanied by virtually no meaningful job losses. Despite still-strong activity in early Q3, some slowing through the back half of the year seems likely to be needed to signal a peak in rates, absent further faster falls in inflation. Nonetheless, weaker growth would still align with a relatively mild downturn. Key to the mix between slowing growth and a softer jobs market will be consumer spending trends and whether policy rates peak soon. In the wake of the US debt ceiling debate, and as BCA Research notes, "US financial markets were dealt a summer shock with Fitch Ratings lowering its sovereign credit rating on the US to AA+ from AAA." This brings the rating down to the same level as that of S&P (announced 12 years earlier).

Growth for Q2 accelerated to a higher-than-expected 0.5% (from 0.4%) to be 2.1% annualised, with Atlanta Fed's latest GDPNow pointing to growth of almost 6% for Q3. The composite purchasing managers index (PMI) eased to 50.4 in August from 52.0, flagging slower growth, led by a weakening manufacturing sector. How much excess consumer saving exists remains key to the outlook. Retail sales started Q3 strongly, rising 0.7% in July, its fourth consecutive gain. Solid jobs gains suggest the labour market is only gradually cooling, albeit a drop in job openings has suggested some weakening.

The easing of price pressures quickened in July, with monthly headline and core changes up less than 0.2%. Annual inflation edged higher to 3.2% (from 3.0%), while core inflation eased from 4.8% to 4.7%, with signs of easing pressure in both housing and non-housing core prices. While the US Federal Reserve (Fed) hiked again in late July, it signalled a clear move to being more data-dependent, a message echoed by Chair Powell at the Jackson Hole Conference. According to BCA, the Fed is unlikely to deliver another rate hike in September.

After 2.1% in 2022, UBS has revised its 2023 forecast higher again to 2.1% (was 1.9%), ahead of a more material drop in 2024, where growth is 0.4%. This closely mirrors the views of SG, which is forecasting 1.7% in 2023 and 0.4% in 2024.

### US GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

## Europe



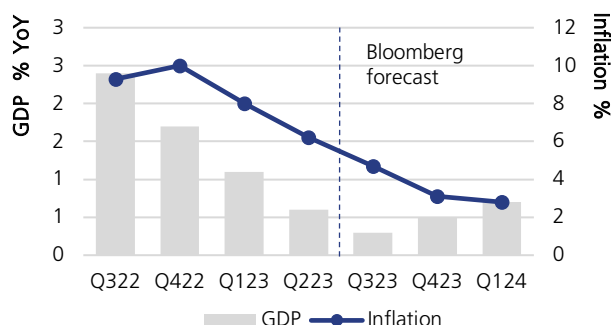
Despite weak near-recessionary growth during H1 2023, prior expectations for a deep recession have given way to an alternative outlook that embodies a year of sub-potential growth married with persistently high inflation. According to SG, this stagflationary environment suggests, unlike in the US and elsewhere, interest rates have further to rise in H2 2023. Some countries, like Germany, are more clearly in recession. However, they are expected to join France, Spain, and Italy on a modest recovery path into 2024, with strong jobs markets a key support. Interestingly, most expect Europe's growth in 2024 to exceed 2023, in contrast to a delayed US slowdown.

Europe's Q2 growth rose by a stronger-than-expected 0.3% (after 0.0%), with the annual pace slowing to 0.6% from 1.1%. France surprised to the upside, Spain grew strongly, while Italy and Germany came in below expectations. For Q3, the data has been mixed, and uncertainty about the pace of activity in H2 2023 has increased. The PMI has relapsed below the key 50-mark in recent months, falling further to 47.0 in August from 48.6, suggesting weaker manufacturing and services activity. In contrast, consumer sentiment has been recovering and the labour market remains surprisingly tight, with unemployment easing to a record low of 6.4% in June.

Inflation remains the key challenge for the region. While easing upstream price pressures signal relief ahead, recent data has disappointed, with the CPI falling more slowly than expected to 5.3% in July, and core inflation reaccelerating in June to 5.5% (from 5.3%), where it remained in July. While base effects have masked progress on easing inflationary pressures, ongoing hawkish commentary from the European Central Bank (ECB) suggest it believes it has little choice other than to further hike rates. Following a 0.25% hike in late July to 3.75%, both UBS and CBA expect a further rise to 4.0% in September, albeit the ECB sounded more 'data-dependent'.

After 3.5% in 2022, UBS expects a sharp slowing in growth to 0.5% in 2023 (was 0.8%), ahead of a limited pick-up to 0.7% in 2024. SG expects better growth of 1.1% in 2024, while CBA retains its recession view, with growth of just 0.5% for 2024.

### European GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

# Economic outlook

## United Kingdom



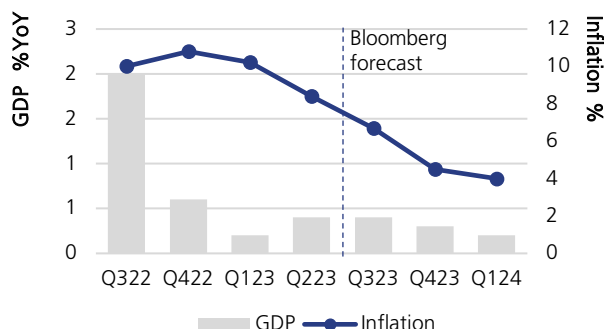
UK growth proved more resilient than expected during H1 2023, delivering weak positive growth. Recent data suggest that activity remains relatively soft as H2 2023 unfolds. Ending government energy support, tightening financial conditions, as well as a wave of mortgage resets in H2 2023, will likely weigh on consumer spending. Elevated inflation is proving much stickier than elsewhere (with wages continuing to rise), with this likely to lead to further near-term rate hikes (and weaker sentiment). As such, growth is expected to stay soft in H2 2023, ahead of an only tepid recovery in 2024.

Output grew 0.2% in Q2 after an upwardly revised 0.1% for Q1 (was 0.0%), edging higher the annual pace to a still tepid 0.4% (from 0.2%). However, according to CBA, “the UK economy is losing steam and a recession is expected to begin in Q3 2023”. The UK’s PMI continues to re-weaken, dropping to 47.9 in August from 50.8 in July. Retail sales fell 1.2% in July, reversing three months of gains. But like elsewhere, the jobs market remains tight, with average weekly earnings up a monstrous 8.2% annually in July from 7.2% in May, adding to expectations for further policy tightening in H2 2023.

Inflation continues to be problematic for the UK. There was some relief in the July data, with the headline CPI easing from 7.9% to 6.8% (its lowest since February 2022). However, core inflation missed expectations for some moderation, remaining unchanged near its recent peak at 6.9%. An acceleration in services inflation likely limits the Bank of England’s (BoE) ability to join other global central banks turning more data dependent. Nonetheless, after hiking rates 0.25% to 5.25% in early August, the BoE commentary suggested that it sees a peak in rates coming into view, albeit there was still more work to do beyond the August move. UBS expects a further hike to 5.50%, while CBA expects two hikes to 5.75%.

After 4.1% in 2022, UBS forecasts growth of just 0.2% for 2023 (and a modest pick-up to 0.6% in 2024), while CBA expects flat growth (and further weakness in 2024). SG sees similar weak growth for 2023 but a solid 1.2% lift in 2024.

### UK GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

## Japan



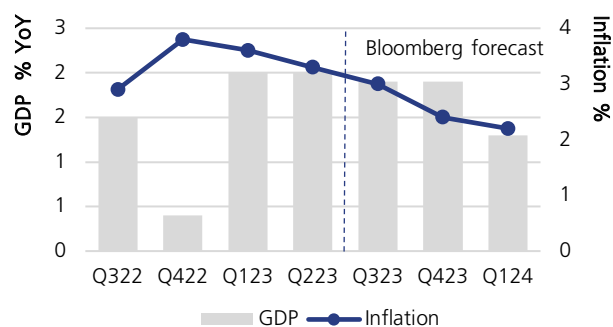
Japan appears on track to deliver somewhat modest growth over the next couple of years. A key focus is on the expected impact of slowing global growth on exports, and the extent to which it is more than offset by stronger domestic activity—particularly the consumer as the economy continues to open post-pandemic. After a surge in mid-year growth on the back of stronger exports (but also weak imports on soft consumer demand), attention will focus on the extent of pay-back, or slower growth, that will emerge in H2 2023, as well as whether currently weak domestic activity can recover.

Growth was much stronger than expected in Q2, rising 1.5% (6.0% annualised), and sustaining Q1’s pick-up to an annual pace of 2.0% into Q2. But the gain was largely driven by strong exports and weak imports, with domestic demand -0.3% in Q2 as consumer spending and capex weakened. There was also considerable focus on the strength of nominal growth, which has risen almost 11% in H1 2023 (helped by rising inflation), its second fastest since 1994. Early Q3 data point to ongoing, albeit slower, growth. Japan’s PMI lifted modestly in July to 52.6—above the key 50 mark—after easing from 54.3 in June. Retail sales remains volatile, easing 0.4% in June after May’s 1.3% jump (but still 5.6% higher than a year ago). While the labour market remains tight, supporting wages growth, July unemployment lifted to 2.7%, above the 2.5% level over the past three months (though still below March’s 2.8% peak).

Inflation, after a peak of 4.3% in January, has been remarkably stable at around 3.3% between February and July, ahead of expected further easing. The Bank of Japan (BoJ) surprised markets, making a modest tightening of policy at its late July meeting, adding flexibility to its 0.5% yield curve target by allowing flexibility out to 1.0%, which saw the yen strengthen temporarily. Despite a tight labour market, wage growth has not materially stepped up. Reflecting this, CBA expects the BoJ to maintain its ultra easy monetary policy this year.

After growth of 1.0% in 2022, UBS expects a pick-up to 2.0% in 2023, before slowing again to 0.8% in 2024. SG forecasts 1.3% in 2023 and a similar slowing to 0.9% in 2024.

### Japanese GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

# Economic outlook

## China



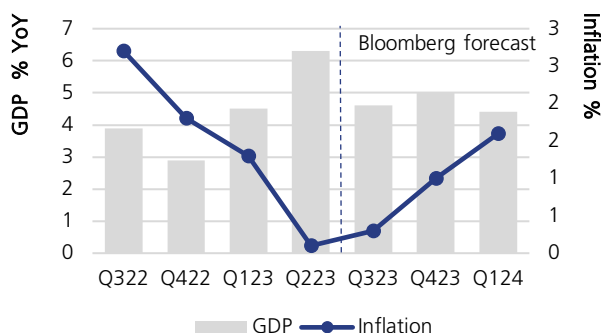
Despite promising signs in early 2023, China's economy has relapsed into mid-year, disappointing expectations for a sustained recovery. Growth has been decelerating since April as the property downturn deepened, with a number of large property firms proving insolvent and adding uncertainty to the outlook. Consumer spending has not rebounded noticeably post pandemic and rising youth unemployment has raised concerns about economic (and political) stability. According to UBS, "while the July Politburo meeting signalled more macro and property policy support, there has been no announcement of meaningful fiscal spending and property easing has been piecemeal and modest." Outlooks are now being trimmed.

China's output rose by 6.3% over the year to Q2, lifting from 4.5% in Q1. However, momentum between quarters stepped back at just 0.8% in Q2 after Q1's strong 2.2% pick-up. Early Q3 data reveal a further loss of momentum. In July, property stayed weak, with sales and new starts falling further to 4% and 15% below year-ago levels. Retail sales growth slowed from 3.3% to 2.5% on weaker goods sales, while exports, infrastructure and manufacturing investment slowed. July credit growth also came in weaker than expected, consistent with weaker-than-expected government policy support.

Attention remains focused on the potential for further modest policy stimulus in the wake of the July Politburo meeting, which called for stronger 'counter-cyclical' macro policies to boost domestic demand (and no longer referred to housing as just for 'living'). Some modest rate reductions have been delivered in August. But July's deflationary price data (and a rising trend of youth unemployment) have added pressure for further policy support, with consumer prices down by 0.3% over the year and producer prices down over 4%.

China's growth dropped from 8.4% to 3.0% in 2022. While growth is still expected to strengthen in 2023 and 2024, forecasts have been cut. UBS has again trimmed its 2023 growth outlook from 5.2% (was 5.7%) to 4.8%, before more moderate growth of 4.2% (was 5.0%) emerges in 2024. SG expects a similar slower 4.5% pace in 2024.

### Chinese GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

## Emerging markets

Growth in emerging markets is expected to stabilise through H2 2023 before a more robust recovery through 2024. While Southeast Asian economies will continue their modest recovery this year, Northeast Asia's sharper-than-expected decline in 2023 is expected to give way to a strong 2024 rebound, along with Latin America and emerging Europe. A focus on headline inflation is building a platform for central banks to ease interest rates and support consumption over the coming year.

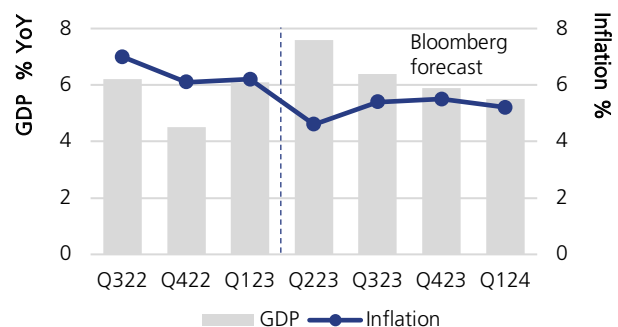
Across Southeast Asia, inflation continues to fall. In July, it remained low at 0.4% in Thailand; it fell from 3.5% to 3.1% in Indonesia and from 5.4% to 4.7% in the Philippines. For Singapore, it fell from 4.5% to 4.1% and in Malaysia from 2.4% to 2.0%. While rates may stay on hold for some months as uncertainty over the inflation outlook lingers, central banks are expected to begin cutting late in 2023 and early 2024.

India's Q1 growth rose 1.9%, lifting the annual pace to 6.1% from 4.5%. Recent data is consistent with a sustained 6% growth rate over the coming couple of years. UBS sees 2023 growth slowing to 6.2% (recently revised from 5.5%) after 7.2%, with 6.0% in 2024. India's inflation rate reaccelerated mid-year on higher food prices. However, core inflation eased below 5%, and food prices are expected to ease again in H2 2023. This saw the Reserve Bank of India remain on hold at 6.5% in August, with rates expected to ease late in 2024.

UBS expects growth in Latin America to slow to 1.7% in 2023 (after 3.6%) on the back of weak export demand. In Brazil, recent data suggest Q1 strength carried over into Q2. But June monthly data flag a loss of momentum into H2 as the H1 farm export boost fades. Falling core inflation (despite a lift in headline CPI in July) has led the central bank to start cutting the policy rate—from 13.75% to 13.25% in August (with a similar cut expected in September). For emerging Europe, weaker growth largely reflects weaker consumer demand.

After 4.1% in 2022, UBS expects a similar pace for 2023 and 2024. Growth in emerging Europe is expected to weaken to 1.2% in 2023 after 3.2% in 2022, before a rebound in 2024.

### India GDP growth and inflation



Source: Bloomberg as of 31 August 2023.

# Asset class outlook

## Short maturity and government bonds

Position: Underweight short maturity, overweight government bonds

### Key points

- We recommend adding duration within high grade and investment grade asset classes, with a bias towards fixed rate over floating rate bonds.
- Bond volatility remained high in August as we approach the end of global rate-hiking cycles. We anticipate yields will be lower over the next six to 12 months.

**Short maturity**— Global central banks are now entering into the final stages of their rate-hiking cycles. Recent inflation data continues to show that the aggressive tightening cycle witnessed over the last 16 months is working. Although the UK's elevated inflation data is proving to be stickier, in the Eurozone and the US, headline inflation continued its sharp retreat, largely due to energy prices.

While inflation is slowing, it remains elevated above central banks' target bands. The market is expecting one further hike of 25 basis points (bps) in the Eurozone but does not expect the Fed to move again post its July hike to 5.50%. Additional hikes may depend on data releases, including multiple jobs and CPI reports, but there is a risk that central banks may become overly restrictive, especially as rates have remained higher for longer. This could see a reversal in the resilient economy highlighted in the output and labour market data.

Domestically, 2-year bond yields peaked at 4.30%, but have since retraced under 4.00% following the RBA's decision to keep rates at 4.10%. Any further movement in the cash rate will be data driven, with the market pricing in a 30% chance of one more hike. Our six to 12-month view is that global policy rates will be lower. We, therefore, recommend adding duration now. Inflation has already shown signs of falling, recent turmoil is likely to tighten liquidity and slow economic growth, so central banks are expected to ease in H1 2024.

**Government bonds**— US growth has stayed above trend, despite Fed tightening. The jobs market remains strong and broader data is positive. Rates are, therefore, likely to remain higher for longer, having already reacted negatively. The 10-year Treasury yield rose to 4.30% in August, its highest level since October 2022. We see current levels as a buying opportunity. Growth will likely decelerate under tighter financial conditions as uncertainty persists about whether the US economy will experience a mild or deeper recession. Although interest rate volatility will remain elevated, we see a much more even balance in terms of direction. Given the sharp repricing higher in rates, returns should be attractive, considering the shifting balance of risks between high inflation and decelerating growth.

Domestic high-grade bond yields have been influenced by the global offshore markets, particularly in the US. While the RBA may hike once more, we are overweight high grade. We recommend investing in the three- to five -year part of the curve, as we expect steepening trades, as the RBA reduces rates to a more unrestrictive level in mid-2024.

## Investment grade and high yield credit

Position: Overweight investment grade, neutral high yield credit

### Key points

- Investment grade bonds have attracted strong buying, driven by outright yields and tightening credit spreads.
- Within credit, high yield is our least preferred sub-sector, where we are advocating a selective, higher-quality bias.

**Investment grade credit**— Investment grade credit spreads have been remarkably stable. Unfortunately, rising interest rates have more than offset the income over the tightening cycle. However, with rates now close to the highs and likely to fall in 2024, the income along with capital returns should be captured. We believe corporate credit spreads are sitting at fair value, and fundamentals on the US and Australian corporate side remain robust. The banking sector seems to have recovered, with stable earnings results from the larger US banks helping to contain any widening pressure from the investment grade corporate sector. The sensitivity of lower-rated asset classes around an economic slowdown is likely to increase default risk. We are, therefore, recommending staying in the high-quality investment and high-grade sectors.

Domestically, demand for subordinated tier II major bank paper has been strong and outstripping supply. Demand has been driven by wider-than-average credit spreads due to banks issuing to meet their regulatory total loss absorbing capital requirements, with outright yields in excess of 6.25%. However, major banks are now ahead of their 2023 funding requirements and spreads have tightened back to close to their long-term average of around BBSW +190bps. While spreads on additional tier 1 hybrids are expensive on an historical basis, NAB successfully issued a new money only additional tier 1 hybrid at BBSW +280bps, with investors attracted by the 7.00% running yield.

**High yield credit**— Within credit, high yield is our least preferred sector. We are constructive on bonds as an asset class. However, with the more growth-sensitive segments, such as high yield, we are advocating a selective, higher-quality bias. Spreads have tightened in the riskier credit segments over the last three months as the market has repriced the risk of recession in light of resilient US economic data. At current spreads of around 400bps in US dollar high yield, the market appears to be discounting a benign default environment in the year ahead. This is consistent with above-trend growth. The risk is that the high yield sector is more vulnerable to tightening financial conditions, which can translate into higher corporate defaults, especially for leveraged companies. Our preference is to move higher up the credit quality curve into investment grade credit on a risk-adjusted basis, despite the 8.00% returns on offer.



# Asset class outlook

## Domestic equities

Position: Overweight

### Key points

- Domestic equities fell 0.7% in August, outperforming global equities in local currency terms. However, the sharply weaker Australian dollar cushioned offshore returns. This led to global equities being flat in Australian dollar terms for the month.
- There was widespread weakness across the S&P/ASX 200 index, with only the consumer discretionary sector trading higher on the month.
- Utilities, materials, consumer staples, and industrials all fell more than 2% in August as a combination of China weakness and earnings weighed on performance.

Company profit results in August saw 'beats' outnumber 'misses' on net profit after tax (NPAT) by a ratio of 5:3. This illustrates the underlying strength the domestic economy has enjoyed for much of the past six months. However, softer (and more uncertain) forward guidance has seen analysts downgrade financial year 2024 earnings. Companies have downgraded their forward guidance by a ratio of 3:2, and analysts have revised their expectations for financial year 2024 profits at a ratio of two downgrades for each upgrade. Consequently, financial year 2024 NPAT growth for the S&P/ASX 200 is now -5.7% (it was -0.8% at the end of July and +0.7% six months ago).

The biggest headwind for companies is costs, with management teams pointing to increased costs in labour, rent, energy, transport, and technology spend. For now, the cost pressures that companies continue to face are still being largely passed onto customers, which is allowing companies to defend their profit margins.

Through reporting season, we saw an unusual number of outsized share price moves on company results. This reflects crowded positioning among investors and underscores the highly unpredictable nature of this economic cycle.

The long and variable lags associated with higher interest rates have been very evident in the results season so far, with their impact not being uniform. Several parts of the retail complex have shown top-line resilience - the sector has not only risen for the month, but is the second best performer year-to-date. Conversely, several of the more indebted companies in the real estate and industrials sectors are seeing interest rate pressures impact profitability.

The S&P/ASX 200 index now trades on a forward price/earnings (P/E) ratio of 15.4x (versus a long-run average 14.5x). UBS believes that prices and valuations appear somewhat complacent toward the challenges ahead. As a result, it sees the recent rally in some domestic cyclical stocks as a selling opportunity. This leaves a preference for the less cyclical parts of the index that are detached from the consumer (technology and insurance, healthcare, plus infrastructure and utilities).

## International equities

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

### Key points

- In August, global equity markets were up 1.5% in Australian dollar terms. However, in local currency terms, they were 2.3% weaker. This represented the worst monthly performance since December 2022.
- Commodity-focused indices, such as those in Australia and the UK, underperformed in August. They were the most sensitive to weakness from China.
- Energy and healthcare stocks rebounded from recent weakness to lead sector gains. Sectors that had been leaders year-to-date, such as consumer discretionary and IT, underperformed.

Markets could be set for an interesting cross-current over the next six months. Key questions are: How much will the global consumer be forced to eat into their pandemic-era excess savings cushion? Will disinflation arrive in time, and will there be enough of it, so central banks can ease their restrictive monetary policy settings and economic activity can rebound? How and when the intersection of these two forces occurs may be the crucial factor that decides the direction of equity markets over the remainder of the year.

European equities have been struggling to break higher for five months. The STOXX 50 index is at the same level it was in Q1, and European stocks appear to have peaked relative to the US in May. However, relative valuations still offer some support versus the market-cap weighted S&P 500. In part, some of this struggle likely reflects these stocks 'giving back' some very strong performance that may have been associated with the perceived China COVID re-opening. Combined with falling gas prices, this underpinned a very positive backdrop for European equities. But more recently, China's growth data has been much weaker than expected, and gas prices have bottomed. There is some upside risk from strikes in Australia, which has led to the index's 12-month outperformance eroding by around 50%. While EPS revisions in the Eurozone have managed to stay in positive territory, analysts are questioning their sustainability. Eurozone earnings display a clear correlation to PMIs, which suggest considerable downside.

China has seen a string of disappointing data, with manufacturing PMIs contracting. July trade data weakened significantly, with exports seeing the worst decline since February 2020. China's year-on-year CPI turned negative in July, largely due to a drop in food prices. Credit creation is anaemic and with high unemployment, there is seemingly ample scope for the Chinese authorities to stimulate. Thus far, measures have been targeted and at the margin. Despite China's woes, MSCI emerging market earnings are showing clear signs of bottoming out. This trend is broad-based, with bottoming trends visible in Korea, India, Brazil, South Africa (while Mexico continues to show upgrades).



# Asset class outlook

## Currencies

### Key points

- The US dollar strengthened in August, supported by sluggish global growth, a resilient US economy, and general investor risk aversion.
- These global currents also weighed on the Australian dollar, which weakened to USD 0.64. With the RBA likely to remain on hold near term, the outlook for the global (particularly Chinese) economy and US interest rates will be a key driver for the Australian dollar.

The US dollar continued to grind higher in August, as the US economy showed surprising resilience, outperforming other major regions, including Europe and China. Relatively light trading volumes over the northern summer and concerns over global economic growth outside the US further supported the greenback. Over the near term, the outlook for the global economy relative to the US will be a key driver for the US dollar. A continuation of relative global weakness could support further US dollar strength. Policy-wise, the closely watched Jackson Hole Symposium held in late August did not signal a meaningful shift in the Fed's policy outlook, with Chair Powell reiterating that while the peak of its tightening cycle may be in, the Fed is committed to maintaining restrictive policy until it is comfortable that inflation will return sustainably towards its objective.

The Australian dollar faced ongoing downward pressure over the month, buffeted by a backdrop of broader US dollar strength and a weaker Chinese economy weighing on commodity prices. Domestically, there were further signs that the economy is responding to tighter monetary policy, with aggregate inflation and household spending levels easing. This dynamic has seen growing confidence among economists that the RBA (which welcomes new Governor Bullock) may have already reached the peak of its tightening cycle. With policy likely on hold for some time, the outlook for the global (and particularly Chinese) economy will be a key driver for the Australian dollar over the coming year. CBA sees it staying around current levels at USD 0.64 at year-end, ahead of a rise to USD 0.74 at the end of 2024.

Elsewhere, the broader macro backdrop also weighed on the euro, with the currency trading around USD 1.08. CBA sees downside risks for the euro on a sluggish near-term global economic outlook, particularly if higher energy prices weigh on the Eurozone's terms of trade as we head into the northern winter. Meanwhile, the Japanese yen gave back most of its gains from July, weakening from USD 141 to USD 146 amid ongoing dovish rhetoric from the BoJ and easing domestic inflation prints. That said, the yen is at levels that have previously driven policymakers to intervene to support the currency. Weakening global growth and a potential further normalisation in BoJ policy may provide support for the yen in the year ahead.

## Commodities

### Key points

- Global commodities fell 1% in August, giving back some of July's strong gains as macro headwinds weighed, with sentiment toward China's growth outlook worsening.
- There was broad-based weakness across energy, metals and soft commodities, though iron ore was a standout performer.

Oil has remained rangebound between USD 70 and USD 90 bbl year-to-date, with OPEC+ expected to continue to manage production to keep markets tight amid a weakening economic outlook. Natural gas prices were volatile over the month, driven by the risk of worker strikes at Australian liquefied natural gas (LNG) plants, which threatened to impact production and shipments (Australia accounts for roughly 20% of global exports of LNG). This has the potential to be a growing concern for Europe as we approach cooler weather in the northern hemisphere.

Iron ore has been the standout performer in the commodity complex over the month, rising around 6.6% to USD 117 per tonne, supported by improving steel mill margins and steel production in China.

Chinese economic weakness (and market hopes for further stimulus) have been the key macro drivers for commodity prices over recent months. Recent data continues to point towards further near-term weakness, as authorities remain hesitant to resort to the debt-driven property and infrastructure-led stimulus packages of yesteryear. This approach reflects China's multi-year efforts to wean its economy off debt-fuelled expansion and rebalance towards more sustainable consumer-led growth, while addressing deep structural issues in its property market and debt dynamics.

While this pivot may be prudent from a longer-term perspective, further sluggish growth may increase domestic political pressures on authorities to announce more substantial stimulus. This move could have significant positive implications for the commodity complex and the broader cyclical growth pulse. While such a move might support commodity prices (and broader risk sentiment) in the near term, it raises the risk of exacerbating the long-running structural imbalances in China's economy and adding to inflationary pressures (and central bank hawkishness) globally.

Looking beyond the cyclical horizon, longer-term themes, including climate change and geo-politics, could 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 likely to see a clearer trend in commodity prices if and when these dynamics align more noticeably.

## 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<sup>1</sup>. 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 (%) |
|-------------------------|-----------|--------------|------------|---------------|
| <b>Cash</b>             | <b>3</b>  | <b>3</b>     | <b>3</b>   | <b>3</b>      |
| <b>Fixed income</b>     | <b>53</b> | <b>35</b>    | <b>17</b>  | <b>14</b>     |
| 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             |
| <b>Equities</b>         | <b>24</b> | <b>42</b>    | <b>60</b>  | <b>38</b>     |
| 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             |
| <b>Alternatives</b>     | <b>20</b> | <b>20</b>    | <b>20</b>  | <b>45</b>     |
| 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.

<sup>1</sup> 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

Growth and inflation continue to slow in most developed economies, and we feel that we are close to the peak for interest rates this cycle. Expectations for any interest rate cuts have now been pushed out to mid-2024, though risks of an earlier easing remain. In Australia, recent (core) inflation data is easing, while unemployment remains close to near 50-year lows. The US is displaying similar inflation levels and tightness in the jobs market.

We retain the view that if there is a recession, it will be a relatively shallow/soft landing as we approach a new phase of the cycle. Our positioning is unchanged this month and continues to reflect our expectation that fixed income will perform well relative to equities under several scenarios in the short term.

### Cash

Our underweight cash position remains at -2. With equities at neutral, our cash underweight is entirely funding the +2 overweight to fixed income.

### Fixed income

At an overall asset class level, fixed income remains our highest conviction position at +2. At a sub-asset class level our positioning remains unchanged from last month. We are neutral high yield, underweight short maturity, and overweight government bonds and investment grade credit. We remain cautious about risk assets in the face of mixed fundamental and economic data and tighter credit conditions ahead. If markets experience volatility, we believe fixed income (particularly government bonds and investment grade credit) will hold up well—particularly in a situation where inflation is 'stickier' than expected and if the growth outlook deteriorates.

## 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.

### 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.

### Equities

We remain neutral equities and continue to prefer some non-US markets. US equities remain expensive and driven by advances in the largest seven (growth) stocks. We retain an overweight to domestic equities and emerging markets due to attractive valuations (on a relative basis) in Australia and China, as well as the potential for tailwinds associated with stronger activity in China. The recent slight upweight to Europe reflects its recent underperformance.

## Active portfolio weights and active tactical asset allocation tilts

|                         | Active tilt | Yield (%) | Balanced (%) | Growth (%) | Endowment (%) |
|-------------------------|-------------|-----------|--------------|------------|---------------|
| <b>Cash</b>             | -2          | 1         | 1            | 1          | 1             |
| <b>Fixed income</b>     | 2           | 55        | 37           | 19         | 16            |
| Short maturity          | -2          | 6         | 4            | 1          | 1             |
| Government bonds        | 2           | 34        | 17           | 9          | 7             |
| Investment grade credit | 2           | 13        | 13           | 6          | 6             |
| High yield credit       | 0           | 2         | 3            | 3          | 2             |
| <b>Equities</b>         | 0           | 24        | 42           | 60         | 38            |
| Domestic                | 1           | 13        | 20           | 29         | 12            |
| United States           | -1          | 5         | 10           | 15         | 12            |
| Europe (ex-UK)          | -1          | 2         | 3            | 4          | 3             |
| United Kingdom          | 0           | 2         | 3            | 4          | 3             |
| Emerging markets        | 1           | 2         | 6            | 8          | 8             |
| <b>Alternatives</b>     | --          | 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. Our base case is that central banks will be required to ease monetary policy by mid-2024, making a duration play in fixed rate outperform floating rate over time.

## Government bonds

**We are overweight government bonds.** With expectations central bank are near the end of their rate-hiking cycles, we are tactically overweight government bonds. Although it is difficult to forecast the absolute peak in yields, government bonds have largely absorbed rising rates and we expect yields to be lower over the next three to nine months.

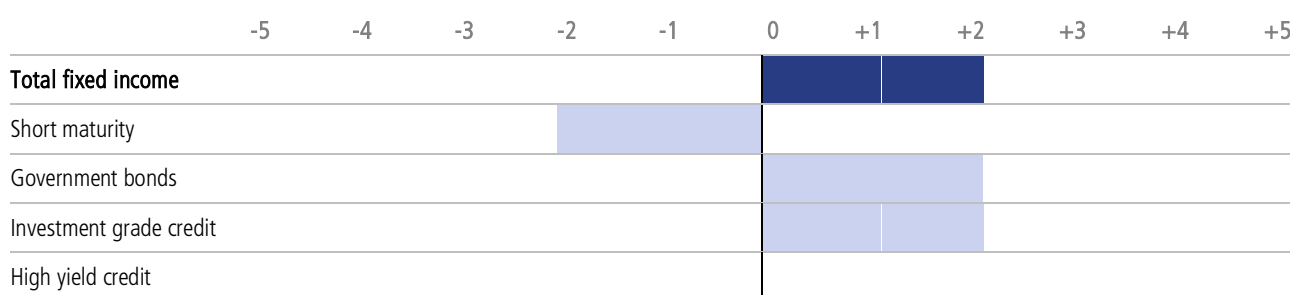
## Investment grade credit

**We are overweight investment grade credit.** Investment grade credit spreads are tightening, driven by outright yields and demand for quality issuers. Investors should look to move higher up the credit quality spectrum to protect against a potentially weaker corporate earnings season.

## High yield credit

**We are neutral high yield credit.** With central banks unlikely to ease near term and unemployment yet to rise, high yield credit spreads are vulnerable to some widening. But with base rates increasing, and although spreads have tightened, issuers are paying higher funding costs and a higher liquidity premium. High yield remains at risk of a potential acceleration in defaults, with some sectors more vulnerable than others.

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



## Fixed income market summary

| Fixed income indices                            | Current | One month ago |
|---|---------|---------------|
| Australian iTraxx                               | 86.97   | 72.44         |
| Australian 3-year yield                         | 3.74%   | 3.86%         |
| Australian 10-year yield                        | 4.03%   | 4.06%         |
| Australian 3/10-year spread                     | 28.1 bp | 18.7 bp       |
| Australian/US 10-year spread                    | -6.3 bp | 0.1 bp        |
| US 10-year Bond                                 | 4.08%   | 3.96%         |
| German 10-year Bund                             | 2.47%   | 2.49%         |
| UK 10-year Gilt                                 | 4.36%   | 4.31%         |
| Markit CDX North America Investment-Grade Index | 63.5 bp | 62.9 bp       |
| Markit iTraxx Europe Main Index                 | 70.5    | 67.8          |
| Markit iTraxx Europe Crossover Index            | 396.3   | 380.4         |
| SPX Volatility Index (VIX)                      | 13.5    | 13.6          |

Source: LGT Crestone Wealth Management, Bloomberg as at 31 August 2023. Pricing based on UBS Global Research. 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 EPS growth forecast for financial year 2024 for companies in the S&P/ASX 200 index is currently -6%. The main drag on profits for domestic corporates is from the commodity producers, where EPS is forecast to hit a low over the next 12 months. With P/E ratios of 15.4x, the index is in line with its five-year pre-COVID average.

## US equities

**We are underweight US equities.** Whilst the S&P 500 has performed strongly, the equally weighted S&P 500 has been largely range bound (+/-10% since December 2020). The recent results season, where firms beating on EPS underperformed, suggests that valuation is a headwind.

## European (ex-UK) equities

We are underweight European (ex-UK) equities. European equities have been largely range bound, and over August cemented the tightest five-month trading range since 1995 and the fifth tightest on record.

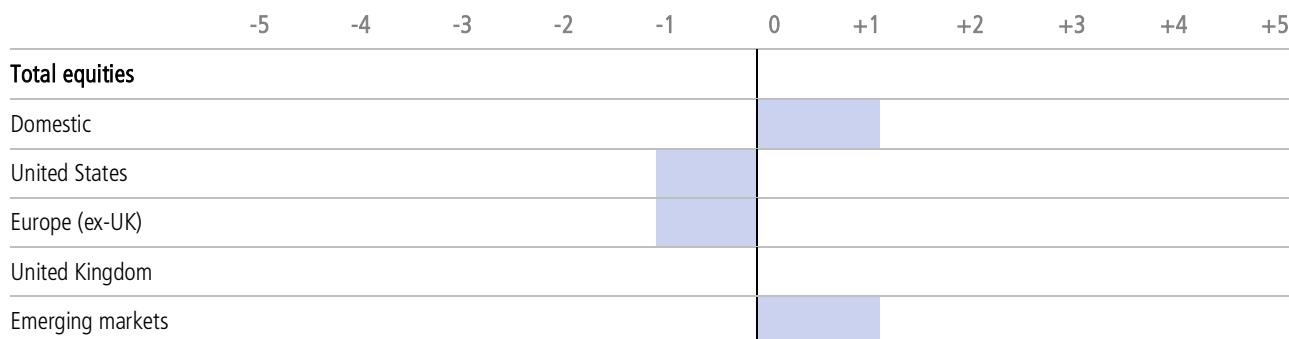
## United Kingdom equities

**We are neutral UK equities.** The overhang of persistent inflationary pressures (which has resulted in elevated interest rates) continues to pressure domestic UK exposures. Consequently, within an overall neutral UK positioning, we prefer the FTSE 100 (which has greater offshore exposure) to the FTSE 250 index (which has greater domestic exposure).

## Emerging market equities

**We are overweight emerging market equities.** While consensus emerging market EPS could still see some downgrades on slowing global growth, the emerging market EPS compound annual growth rate (for financial years 2024-2025) of 16% is still stronger than that of developed markets at 10.5%. Coupled with the large gap in expected output growth between emerging and developed markets (a gap of over 3.1% has historically led to emerging market outperformance), we expect to see some relative outperformance going forward.

**Active equity weights (%)—We are neutral equities.**



## Equity market summary

| Region         | Index       | Latest price | Consensus 1 yr |        | Next year P/E <sup>1</sup> | Next year D/Y <sup>2</sup> |
|----------------|-------------|--------------|----------------|--------|----------------------------|----------------------------|
|                |             |              | Target         | Upside |                            |                            |
| Australia      | S&P ASX 200 | 7,305.3      | 7,685.8        | 5.2%   | 16.8                       | 4.06%                      |
| New Zealand    | S&P NZ 50   | 11,554.5     | 12,552.8       | 8.6%   | 24.1                       | 3.38%                      |
| United States  | S&P 500     | 4,517.9      | 5,120.3        | 13.3%  | 18.6                       | 1.57%                      |
| Europe         | Euro Stoxx  | 455.4        | 541.1          | 18.8%  | 11.8                       | 3.52%                      |
| United Kingdom | FTSE 100    | 7,439.1      | 9,002.7        | 21.0%  | 10.4                       | 4.17%                      |
| China          | CSI 300     | 3,119.9      | 3,798.6        | 21.8%  | 9.7                        | 3.22%                      |
| Japan          | Nikkei 225  | 32,619.3     | 35,789.8       | 9.7%   | 18.4                       | 1.88%                      |
| India          | Sensex      | 64,831.4     | 75,324.9       | 16.2%  | 20.7                       | 1.54%                      |

Source: Bloomberg. Data as at 31 August 2023; 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

**Low beta hedge fund strategies are preferred, but credit remains attractive.** Market volatility continues to provide a ripe hunting ground for hedge funds, where mis-pricing has created opportunities across asset classes for skilled managers. Despite weak performance year-to-date, ongoing macro-economic and geo-political uncertainty should continue to present attractive opportunities for discretionary macro strategies, while idiosyncratic credit strategies should provide attractive risk-adjusted return opportunities in financial year 2024. We are, therefore, focusing on satellite exposures in those areas, alongside diversified multi-strategy solutions that can take advantage of the wider investment universe.

## Private markets

**The normalisation of valuations should present an attractive deployment opportunity for private equity and venture in financial year 2024.** With entry valuations having readjusted meaningfully and secondary (fund) market activity beginning to pick up, we recommend maintaining exposures to private equity and venture capital. Where investors have underweight positions, we recommend adding exposures with a preference for new primary and secondary fund commitment structures. Investors should maintain discipline in partnering with firms that can source high quality opportunities and be a value-added partner—whether a portfolio company or a fund manager (i.e., if an allocator).

**Private debt looks highly attractive.** If investors do not compromise on credit quality and cater for increased debt servicing costs, private debt should be highly attractive due to higher rates, wider spreads, and greater credit protections relative to public market equivalents. Lenders can now attract senior deals with strong covenants at unlevered double-digit yields. We prefer direct lending and sponsor-backed transactions versus broadly syndicated strategies, as loan terms can be negotiated directly, offering greater protection to the end investor. We also prefer corporate transactions relative to real estate lending strategies that are often heavily focussed on construction, a sector with greater headwinds.

## Real assets

**Real estate is our least preferred alternative asset class, given ongoing weakness in certain sectors.** Allocations should prioritise core-plus, high-quality assets. We see a meaningful dichotomy across different assets, sectors, geography and investment approaches, and a particular bifurcation between prime office and lower grades worldwide. To that effect, we prefer high-grade commercial assets where there is some ability to add value through up-leasing, repositioning, or marking rents to market, for example. These initiatives can help to partially offset ongoing valuation declines arising from interest rate increases. We also like high-quality, overseas, multi-family accommodation and other alternative sectors, such as self-storage, student accommodation and manufactured housing. These are likely to play a growing role in globally diversified portfolios.

**Infrastructure is our most favoured sub-asset class.** 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. With most COVID-19 related travel restrictions likely behind us, volume-based transport-related assets, such as airports, and contracted assets should play a key role in diversified portfolios. Further, we see attractive investment opportunities focussed on energy transition.

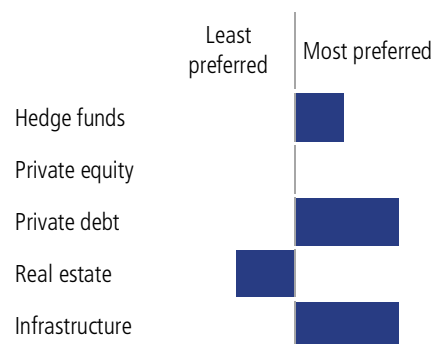
**Our most preferred and least preferred exposures—We favour infrastructure, private debt, and low-beta hedge fund exposures while maintaining private equity exposures. We are taking a cautious approach to real estate globally.**

### What we like

- Multi-strategy, credit-oriented and discretionary macro hedge funds
- 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

- Passive private market and/or real asset 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 GICs 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 upside | P/E 1yr fwd (x) | Dividend yield | ROIC | ROE  | 1yr EPS growth | MSCI ESG rating |
|------|---------------------------|---------------|--------------|------------------|-----------------|----------------|------|------|----------------|-----------------|
| REA  | REA Group Ltd             | Com. Services | \$161.06     | -3%              | 46.8            | 1.2%           | 35%  | 29%  | 18.2%          | AA              |
| ALL  | Aristocrat Leisure Ltd    | Cons. Disc.   | \$40.50      | 13%              | 21.0            | 1.5%           | 22%  | 21%  | 7.6%           | AA              |
| TLC  | Lottery Corp Ltd/The      | Cons. Disc.   | \$5.04       | 7%               | 29.2            | 3.4%           | 23%  | 131% | 9.8%           | AA              |
| MTS  | Metcash Ltd               | Cons. Staples | \$3.69       | 10%              | 12.5            | 5.7%           | 19%  | 26%  | 1.3%           | N.S.            |
| ALD  | Ampol Ltd                 | Energy        | \$34.48      | 6%               | 12.1            | 6.1%           | 16%  | 18%  | -2.6%          | AA              |
| MQG  | Macquarie Group Ltd       | Financials    | \$173.65     | 7%               | 16.5            | 3.6%           | na   | 12%  | 10.0%          | AA              |
| IAG  | Insurance Australia Group | Financials    | \$5.79       | 2%               | 16.9            | 4.5%           | na   | 13%  | 13.9%          | AA              |
| RMD  | ResMed Inc                | Health Care   | \$25.34      | 46%              | 22.6            | 0.8%           | 23%  | 22%  | 13.1%          | A               |
| CSL  | CSL Ltd                   | Health Care   | \$267.20     | 21%              | 29.0            | 1.0%           | 13%  | 17%  | 17.2%          | AA              |
| MND  | Monadelphous Group Ltd    | Industrials   | \$14.28      | -4%              | 21.9            | 4.0%           | 18%  | 14%  | 20.3%          | N.S.            |
| ALU  | Altium Ltd                | Info. Tech.   | \$48.02      | -12%             | 51.2            | 1.1%           | 39%  | 26%  | 23.7%          | N.S.            |
| XRO  | Xero Ltd                  | Info. Tech.   | \$119.73     | 2%               | 130.6           | 0.0%           | 10%  | 13%  | 61.6%          | AA              |
| IGO  | IGO Ltd                   | Materials     | \$12.88      | 6%               | 8.5             | 2.9%           | 15%  | 28%  | -14.0%         | AA              |
| JHX  | James Hardie Industries   | Materials     | \$44.57      | 7%               | 20.8            | 0.0%           | 48%  | 32%  | 8.6%           | AA              |
| GMG  | Goodman Group             | Real Estate   | \$22.64      | 4%               | 21.9            | 1.3%           | 10%  | 10%  | 9.7%           | AA              |
| ORG  | Origin Energy Ltd         | Utilities     | \$8.67       | 2%               | 14.2            | 4.8%           | 13%  | 10%  | 24.0%          | A               |

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as of 28 August 2023. ESG is environmental, social, and corporate governance.

## Trade opportunities

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

**Metcash Limited (MTS)—Buy.** MTS is now trading at a 12-month forward dividend yield of 5.8%, which is not far removed from the 6% yield that marked previous share price lows in 2017 and financial year 2018/19.

**CSL Limited (CSL)—Buy.** EPS expectations have been lowered by 7-9%, but with the stock having fallen by twice this amount, this means it has de-rated quite aggressively. Its absolute and relative valuation is back at levels that have marked troughs over the past five years.

**ResMed (RMD)—Buy.** ResMed has fallen by more than 25% in August as investors questioned how much market share anti-obesity drugs might be able to take from the sleep apnoea market. We believe this presents a buying opportunity.

# 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 upside | P/E 1yr fwd (x) | P/B 1yr fwd (x) | Franking | Grossed up yield | 1yr DPS growth | MSCI ESG rating |
|------|---------------------------|---------------|--------------|------------------|-----------------|-----------------|----------|------------------|----------------|-----------------|
| IAG  | Insurance Australia Group | Financials    | \$5.79       | 2.7%             | 14.7            | 2.12            | 30%      | 4.6%             | 14.7%          | AA              |
| MQG  | Macquarie Group Ltd       | Financials    | \$173.59     | 8.5%             | 14.7            | 1.94            | 40%      | 3.7%             | 7.6%           | AA              |
| WBC  | Westpac Banking Corp      | Financials    | \$21.40      | 2.3%             | 11.3            | 1.03            | 100%     | 6.6%             | -0.1%          | A               |
| QBE  | QBE Insurance Group Ltd   | Financials    | \$14.55      | 22.2%            | 8.2             | 1.55            | 10%      | 3.4%             | 27.3%          | AAA             |
| COL  | Coles Group Ltd           | Cons. Staples | \$16.03      | 3.7%             | 19.7            | 6.37            | 100%     | 3.9%             | 7.5%           | AA              |
| MTS  | Metcash Ltd               | Cons. Staples | \$3.70       | 10.4%            | 12.2            | 3.33            | 100%     | 5.7%             | 1.4%           | --              |
| SGR  | Star Entertainment Grp    | Cons. Disc.   | \$0.93       | 49.4%            | 28.0            | 0.44            | 100%     | 0.0%             | n/a            | BBB             |
| TAH  | Tabcorp Holdings Ltd      | Cons. Disc.   | \$1.04       | 14.8%            | 18.9            | 0.89            | 100%     | 2.1%             | 59.1%          | AA              |
| TLS  | Telstra Group Ltd         | Com. Services | \$4.00       | 16.9%            | 20.0            | 3.00            | 100%     | 4.5%             | 5.0%           | AA              |
| NEC  | Nine Entertainment Co.    | Com. Services | \$2.01       | 19.9%            | 13.1            | 1.94            | 0%       | 5.0%             | 13.0%          | AA              |
| RMD  | ResMed Inc                | Health Care   | \$25.34      | 42.5%            | 20.4            | 5.73            | 100%     | 0.8%             | 8.2%           | A               |
| PME  | Pro Medicus Ltd           | Health Care   | \$72.83      | -4.5%            | 79.9            | 54.81           | 100%     | 0.5%             | 22.8%          | BBB             |
| REP  | RAM Essential Services    | Real Estate   | \$0.72       | 18.9%            | 13.0            | 1.3             | 0%       | 8.0%             | -5.3%          | --              |
| SGP  | Stockland                 | Real Estate   | \$4.22       | 4.2%             | 12.9            | 1.0             | 0%       | 6.0%             | 3.6%           | AA              |
| IRE  | IRESS Ltd                 | Info. Tech.   | \$6.56       | 21.2%            | 23.8            | 4.58            | 0%       | 2.6%             | 59.1%          | AA              |
| DBI  | Dalrymple Bay Infra.      | Industrials   | \$2.74       | 11.5%            | 15.4            | 1.17            | 39%      | 7.6%             | 5.3%           | --              |
| ALX  | Atlas Arteria Ltd         | Industrials   | \$6.05       | 10.3%            | 13.2            | 0.89            | 0%       | 6.3%             | 6.8%           | AA              |
| ORG  | Origin Energy Ltd         | Utilities     | \$8.67       | 2.0%             | 11.4            | 1.68            | 100%     | 4.8%             | 10.2%          | A               |
| ALD  | Ampol Ltd                 | Energy        | \$34.48      | 6.6%             | 12.4            | 2.46            | 100%     | 6.1%             | -8.1%          | AA              |
| AMC  | Beach Energy Ltd          | Energy        | \$1.53       | 16.1%            | 5.4             | na              | 100%     | 3.3%             | 121.6%         | AA              |
| BHP  | BHP Group Ltd             | Materials     | \$43.49      | 6.8%             | 11.4            | 3.2             | 100%     | 3.3%             | 1.6%           | A               |
| AMC  | Amcor PLC                 | Materials     | \$14.80      | 1.9%             | 12.7            | na              | 0%       | 3.3%             | 0.8%           | AA              |

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as of 28 August 2023. ESG is environmental, social, and corporate governance.

## Trade opportunities

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

**Amcor Limited (AMC)—Buy.** AMC is now trading at around 13.5x 12-month forward P/E. This is close to the lowest level it has traded at, with the exception of during COVID. Over the past decade, its current multiple would rank in the lowest 6% of multiples recorded over the past decade and is only the third drawdown of over 20% in the past decade.

**Coles Group (BPT)—Buy.** COL is currently trading at a 17% discount to Woolworths, below its historical 7% average discount. With the stock at 12-month lows and back at levels that have historically yielded support, not to mention a relative strength index that is the lowest in its history, the stock looks over-sold, despite a disappointing financial year 2023 result.

**Atlas Arteria (ALX)—Buy.** ALX is trading at 52-week lows and its 6.8% dividend yield ranks in the 99<sup>th</sup> percentile of observations seen over the past decade.

# 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<br>CCY | Market<br>price | Consensus<br>upside (%) | P/E 1yr<br>fwd (x) | Yield<br>(%) | Market cap<br>(USD bn) | MSCI ESG<br>rating |
|----------------|---------------------------|------------------|-------------|-----------------|-------------------------|--------------------|--------------|------------------------|--------------------|
| LSEG LN        | London Stock Exchange     | Financials       | GBP         | 8182.00         | 17.1                    | 22.2               | 1.6          | 56,783                 | AA                 |
| LLOY LN        | Lloyds Banking Group PLC  | Financials       | GBP         | 41.80           | 44.2                    | 5.5                | 7.4          | 33,499                 | AA                 |
| WFC US         | Wells Fargo & Co          | Financials       | USD         | 41.23           | 23.9                    | 8.5                | 3.6          | 151,219                | BB                 |
| 2318 HK        | Ping An Insurance Group   | Financials       | HKD         | 45.95           | 58.0                    | 5.1                | 5.7          | 115,343                | A                  |
| 939 HK         | China Construction Bank   | Financials       | HKD         | 4.19            | 44.9                    | 2.8                | 10.1         | 136,489                | A                  |
| 2330 TT        | Taiwan Semi. Manuf.       | Info. Tech.      | TWD         | 552.00          | 19.2                    | 15.1               | 2.3          | 449,689                | AAA                |
| MA US          | Mastercard Inc            | Financials       | USD         | 402.89          | 13.1                    | 27.6               | 0.6          | 379,608                | AA                 |
| ASML NA        | ASML Holding NV           | Info. Tech.      | EUR         | 594.20          | 23.2                    | 27.1               | 1.2          | 258,924                | AAA                |
| GOOGL US       | Alphabet Inc              | Comm. Services   | USD         | 129.88          | 16.9                    | 18.6               | 0.0          | 1,642,710              | BBB                |
| UMG NA         | Universal Music Group NV  | Comm. Services   | EUR         | 22.86           | 12.3                    | 24.0               | 2.4          | 44,990                 | AA                 |
| DIS US         | Walt Disney Co/The        | Comm. Services   | USD         | 83.36           | 34.4                    | 17.0               | 0.7          | 152,530                | A                  |
| 9988 HK%       | Alibaba Group Holding Ltd | Cons. Disc.      | HKD         | 90.05           | 53.2                    | 9.4                | 0.0          | 233,599                | BBB                |
| NKE US         | NIKE Inc                  | Cons. Disc.      | USD         | 98.84           | 28.5                    | 22.5               | 1.6          | 151,222                | BBB                |
| SBUX US        | Starbucks Corp            | Cons. Disc.      | USD         | 95.48           | 16.9                    | 23.5               | 2.4          | 109,363                | A                  |
| ABNB US        | Airbnb Inc                | Cons. Disc.      | USD         | 125.79          | 15.5                    | 27.6               | 0.0          | 81,422                 | BB                 |
| RACE IM        | Ferrari NV                | Cons. Disc.      | EUR         | 286.80          | 7.8                     | 38.6               | 0.9          | 56,437                 | BB                 |
| BA US          | Boeing Co/The             | Industrials      | USD         | 223.41          | 15.5                    | 41.4               | 0.7          | 134,762                | BBB                |
| DSV DC         | DSV A/S                   | Industrials      | DKK         | 1304.00         | 15.6                    | 21.7               | 0.6          | 41,423                 | AA                 |
| MSFT US        | Microsoft Corp            | Info. Tech.      | USD         | 322.98          | 21.7                    | 25.6               | 1.0          | 2,399,665              | AAA                |
| ILMN US        | Illumina Inc              | Health Care      | USD         | 158.08          | 34.9                    | 67.3               | 0.0          | 25,024                 | A                  |
| NOVOB DC       | Novo Nordisk A/S          | Health Care      | DKK         | 1278.00         | -2.0                    | 30.7               | 1.5          | 418,023                | AAA                |
| ISRG US        | Intuitive Surgical Inc    | Health Care      | USD         | 297.55          | 19.5                    | 46.4               | 0.0          | 104,546                | A                  |
| EL US          | Estee Lauder Cos Inc/The  | Consumer Staples | USD         | 153.20          | 23.7                    | 27.4               | 1.9          | 54,798                 | A                  |
| COST US        | Costco Wholesale Corp     | Consumer Staples | USD         | 534.01          | 7.3                     | 34.6               | 0.8          | 236,646                | A                  |
| 288 HK         | WH Group Ltd              | Consumer Staples | HKD         | 4.02            | 49.8                    | 5.1                | 0.9          | 6,576                  | BBB                |
| SHW US         | Sherwin-Williams Co/The   | Materials        | USD         | 264.63          | 12.9                    | 24.5               | 1.0          | 68,049                 | A                  |
| RDSA NA        | Shell PLC                 | Energy           | EUR         | 28.15           | 21.0                    | 7.3                | 4.9          | 202,908                | AA                 |
| EQIX US        | Equinix Inc               | Real Estate      | USD         | 770.92          | 8.1                     | 74.2               | 1.9          | 72,131                 | AA                 |
| ORSTED DC      | Orsted AS                 | Utilities        | DKK         | 554.80          | 30.7                    | 22.8               | 2.8          | 33,830                 | AAA                |
| Average Yield: |                           |                  |             |                 |                         |                    | 2.0%         |                        |                    |

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as of 28 August 2023. ESG is environmental, social, and corporate governance.

# Recommendations: Thematic investing—Energy transition

## 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
- Metaverse
- Security and safety
- Supply chain disruption
- Sustainable investing

## Energy Transition—Select exposures.

The Global Energy Transition has multiple touch points for investors to gain exposure, from energy efficiency to renewable energy, as well as the tools, processes and commodities that will allow the world to move to a Net Zero environment affordably and sustainably.

| Code           | Company                | Sector         | Base CCY | Market price | Consensus upside (%) | P/E 1yr fwd (x) | Yield (%) | Market cap (USD bn) | MSCI ESG rating |
|----------------|------------------------|----------------|----------|--------------|----------------------|-----------------|-----------|---------------------|-----------------|
| NVDA US        | NVIDIA Corp            | Info. Tech.    | USD      | \$468.35     | 36.3                 | 29.4            | 0.0       | 1,156,825           | AAA             |
| KSP ID         | Kingspan Group PLC     | Industrials    | EUR      | \$76.20      | 4.5                  | 21.2            | 0.7       | 15,021              | AA              |
| APD US         | Air Products & Chem.   | Materials      | USD      | \$289.86     | 13.9                 | 22.8            | 2.5       | 64,392              | BBB             |
| FSLR US        | First Solar Inc        | Info. Tech.    | USD      | \$176.76     | 37.8                 | 13.8            | 0.0       | 18,884              | AA              |
| GE US          | General Electric Co    | Industrials    | USD      | \$113.96     | 12.3                 | 26.6            | 0.3       | 124,032             | BBB             |
| IFX GY         | Infineon Technologies  | Info. Tech.    | EUR      | \$32.60      | 44.5                 | 12.5            | 1.4       | 46,128              | AA              |
| NEE US         | NextEra Energy Inc     | Utilities      | USD      | \$68.02      | 31.4                 | 20.5            | 3.0       | 137,653             | AA              |
| CF US          | CF Industries Holdings | Materials      | USD      | \$75.33      | 16.6                 | 11.4            | 2.1       | 14,535              | BBB             |
| FCX US         | Freeport-McMoRan Inc   | Materials      | USD      | \$38.96      | 19.9                 | 18.4            | 1.4       | 55,854              | BBB             |
| IGO AU         | IGO Ltd                | Materials      | AUD      | \$13.04      | 14.4                 | 7.8             | 3.4       | 6,360               | AA              |
| ON US          | ON Semiconductor Corp  | Info. Tech.    | USD      | \$93.63      | 28.6                 | 16.4            | 0.0       | 40,404              | A               |
| WOR AU         | Worley Ltd             | Industrials    | AUD      | \$16.92      | 6.1                  | 17.9            | 3.5       | 5,734               | --              |
| 51910 KS       | LG Chem Ltd            | Materials      | KRW      | \$559,000    | 60.5                 | 10.7            | 2.1       | 29,875              | BBB             |
| RIO AU         | Rio Tinto Ltd          | Materials      | AUD      | \$110.04     | 9.4                  | 10.6            | 3.6       | 101,273             | A               |
| SIE GY         | Siemens AG             | Industrials    | EUR      | \$138.00     | 31.5                 | 13.6            | 3.4       | 119,618             | AA              |
| TSLA US        | Tesla Inc              | Consumer Disc. | USD      | \$238.82     | 8.4                  | 49.8            | 0.0       | 758,013             | A               |
| ORSTED DC      | Orsted AS              | Utilities      | DKK      | \$555.20     | 30.6                 | 22.8            | 2.8       | 33,929              | AAA             |
| SU FP          | Schneider Electric SE  | Industrials    | EUR      | \$158.86     | 9.7                  | 18.7            | 2.4       | 98,599              | AAA             |
| ENEL IM        | Enel SpA               | Utilities      | EUR      | \$6.13       | 20.7                 | 9.5             | 7.1       | 67,526              | AAA             |
| QCOM US        | QUALCOMM Inc           | Info. Tech.    | USD      | \$111.68     | 23.8                 | 12.3            | 2.9       | 124,635             | A               |
| Average Yield: |                        |                |          |              |                      |                 | 2.1%      |                     |                 |

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as of 29 August 2023. ESG is environmental, social, and corporate governance.



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