



Navigating private equity valuations

Are we approaching the end of the journey?

Core Offerings

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

May 2023



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Navigating private equity valuations

Are we approaching the end of the journey?

AN UPDATE FROM LGT CRESTONE'S CHIEF INVESTMENT OFFICER



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Alternatives

According to Preqin, among private market assets in the US, approximately 50% are classed as buyout companies, 30% are venture capital, and the remaining 20% are growth.

We view the current investment environment as more constructive than during most of 2022, given much of the valuation correction across both equities and bonds occurred last year in tandem with rapidly rising central bank policy rates. However, with the focus ahead now on the economic and earnings outlook, this month we retain our tactical preference for fixed income over equities, a relatively cautious near-term view. We continue to view alternatives as a key defensive ballast for portfolios, given the likelihood of ongoing geopolitical and inflation volatility, as well as the diversification benefits they bring.

While we don't tactically allocate to alternative assets, due in part to their illiquidity, the evolution of our clients' portfolios over recent years toward a 20% long-term allocation has provided significant protection during the past year's valuation shock for traditional bond and equity assets. However, there has recently been significant investor and media focus on the relative valuation of private equity assets, a significant share of our clients' alternative exposure. In this month's *Core Offerings*, we sort through the noise, to better understand private equity valuations and how far we are through the adjustment journey.

The rising importance of alternatives has encouraged a focus on valuations

Over the past seven years, LGT Crestone investor portfolios have evolved meaningfully, notably with the significant growth of alternatives assets, which now total over 20% of assets under management. The largest component of this (alternative) portfolio is private equity, inclusive of more traditional buyout, alongside growth equity and venture capital.

If media rhetoric is to be believed, private equity broadly has a valuation issue relative to public (listed) equity. In certain cases, there is an argument to be had. But in the majority of cases, valuation approaches, whilst nuanced, appear fair and appropriate. Ultimately, we must seek to better understand the context and cut through the noise (related to valuation approaches) to ensure that portfolio actions (and thus outcomes) continue to be managed appropriately. Below, we delve into this context, and frame how we should be thinking about private equity valuations relative to their listed counterparts.

Understanding the components of private equity

First, it's important to lay some groundwork, as it sets the scene for the valuation conversation. While private equity can be divided into a larger array of segments, the following best represents our discussion in terms of how these companies are valued.

- **Early-stage venture companies**—These companies are typically valued based on their last credible funding round (i.e., when they were funded by a reputable counterparty). Given the nature of these very young companies, this approach is arguably the most appropriate, as they often have limited revenue, are unlikely to be profitable, and are, at times, not far beyond an idea. It is simply not possible to value these companies in a traditional manner, where earnings are key. It's for this reason that a credible counterparty (and venture specialist) sets the valuation, and that valuation remains until the same or another credible counterparty, or a broader funding round, updates it (up, down, sideways or to zero).
- **Buyout companies**—These companies make up the largest percentage of the private equity universe. They are mature businesses that have meaningful corporate structures, actual earnings and profitability in most cases, and are, therefore, valued like traditional (public) businesses. They are typically valued on a quarterly basis with external oversight from accountancy firms, and in line with globally recognised valuation standards (for private companies).
- **Late-stage venture companies**—These are companies that sit between early-stage venture and traditional buyout. They include late-stage venture, early-stage growth and, to some degree, pre-IPO strategies. As private companies have progressively stayed private for longer, the level of and need for capital sitting in this segment has

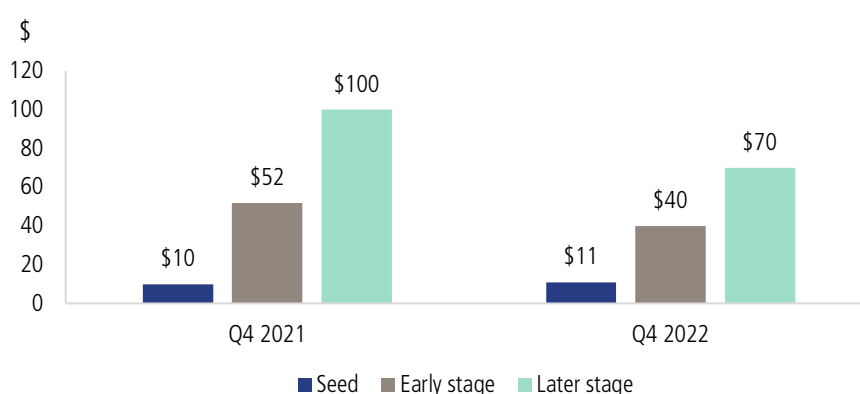
grown significantly. Most late-stage capital initially stemmed from early-stage venture funds looking to hold on to their biggest 'winners', and because of this, the early-stage valuation methodology for these companies persisted. However, it is debatable whether these companies should still be valued off the latest funding round once they grow to a point where traditional valuation metrics apply.

Late-stage venture lies at the heart of the valuation debate

With meaningful excesses in late-stage venture peaking in 2021, followed by meaningful sector-wide downgrades, there was little action through mid-2022 to mark down valuations of these late-stage venture companies. However, when you look at where new (deal) entry multiples are for late-stage venture businesses (below), or where secondary fund or company transactions are actually being traded, pricing is down some 35-50% from 2021 highs. As such, while there will always be a wide variability in valuations, it's fair to assume that actual valuations for much of this segment were inflated through 2022 relative to where new transactions were occurring.

With meaningful excesses in late-stage venture peaking in 2021, followed by meaningful sector-wide downgrades, there was little action through mid-2022 to mark down valuations of these late-stage venture companies.

Quarterly median pre-money valuation by stage (Q4 2021 to Q4 2022)



Source: For illustrative purposes only. Q4 2022 Pitchbook NVCA Venture Monitor as at 31 December 2022 (USD millions).

To avoid any implication that this approach is a function of higher fees, it's important to note that management fees are typically charged on committed or invested capital (not net asset values (NAV)), and performance fees are on exit only. So, these valuations don't impact fees paid at a fund level. In other words, funds are not making more money by not marking positions down. However, in a portfolio context, where fees are charged off NAV, the valuation of a given fund does, in fact, impact investor outcomes, which is one of the reasons why there has been so much rhetoric around how superannuation funds mark their private portfolios.

Pleasingly, and demonstrating the mis-valuation point quite clearly, the local venture and superannuation community set a healthy precedent in 2022, when it collectively marked its Canva (and other late-stage portfolio companies) position down using an external valuer. This is despite Canva not raising a subsequent funding round. For a company that would have been in the S&P/ASX 20 at its Q4 2021 valuation high, it was certainly a sensible development.

In summary, given nuances around how this segment is valued, we can argue that some of the rhetoric around over-valued private companies has been fair. However, it's important to stress that late-stage venture is not representative of the larger private equity landscape, despite that being the picture often painted.

Private equity valuations have declined but they have outperformed public markets

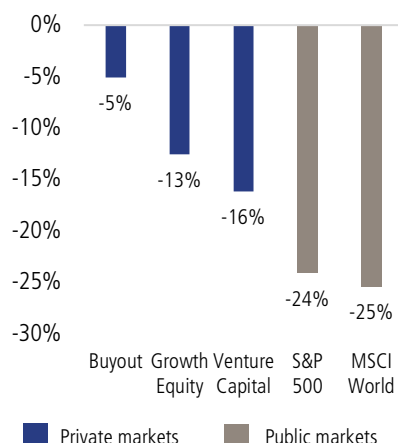
Across the broader private equity landscape, valuations are certainly not immune to market conditions and have clearly declined in 2022 as shown in the left chart below. However, private equity meaningfully outperformed its public counterparts, something that it has done consistently, including during major market downturns. Interestingly, long-term data

Across the broader private equity landscape, valuations are certainly not immune to market conditions and have clearly declined in 2022.

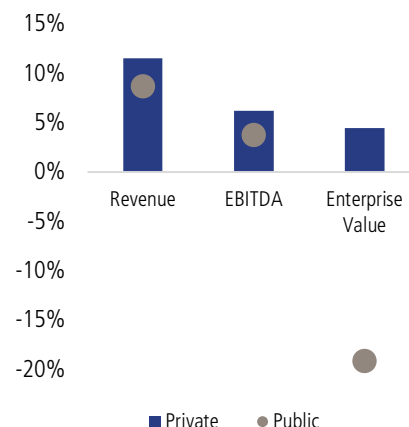
Long-term data from Hamilton Lane shows that three-year excess returns of all private equity relative to US equities ranged from 6-8% during declining, flat or moderately positive regimes.

from Hamilton Lane shows that three-year excess returns of all private equity relative to US equities ranged from 6-8% during declining, flat or moderately positive regimes. During public equity regimes where returns have been in excess of 10% per annum, the three-year excess of return of private equity has been tighter, but still positive, ranging from 1-5%.

Private versus public market returns



Median operational performance



Source: Hamilton Lane, Bloomberg (January to 30 September 2022)

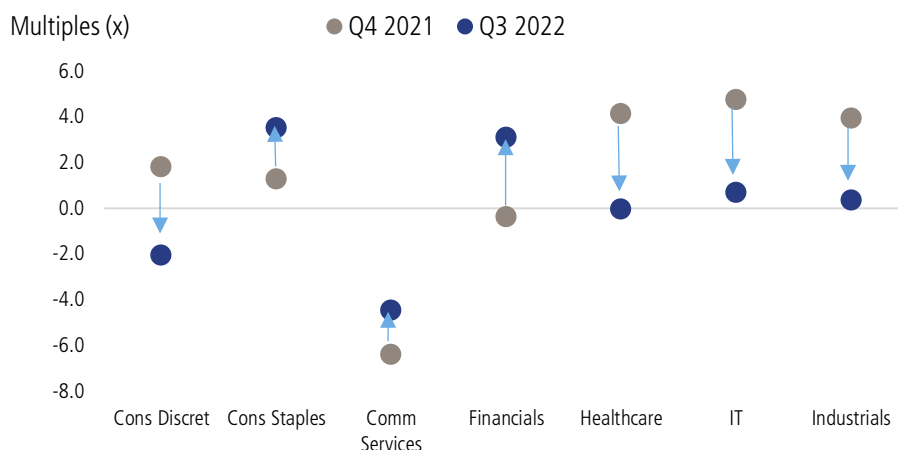
Why did private equity outperform public markets?

Factors driving private equity relative outperformance include:

- **Better operational performance** and transaction comparisons. Additionally, data shows that exits typically occur at mark-ups to holding values, implying a conservative holding valuation approach on the part of private equity.
- **Better ownership control** and alignment to long-term objectives, both of which drive better performance outcomes. As the above right chart shows, private companies outperformed their public counterparts meaningfully across revenue, EBITDA and enterprise value through 2022, which should lead to better performance outcomes.
- **Less excess in valuations.** The chart below shows that across most sectors, private market valuations started 2022 at a significant discount to public equivalents, where communication services was the primary exception. It should be noted that large public telecoms are very different from high-growth digital media companies that make up the private sample of companies. The move through the year (i.e., brown to dark blue) shows that valuations converged. Put another way, public valuations were far higher at the start of the year and had further to fall than private.

Among the factors responsible for driving outperformance of private equity over listed equity are better operational performance, better ownership control, and less excess in valuations.

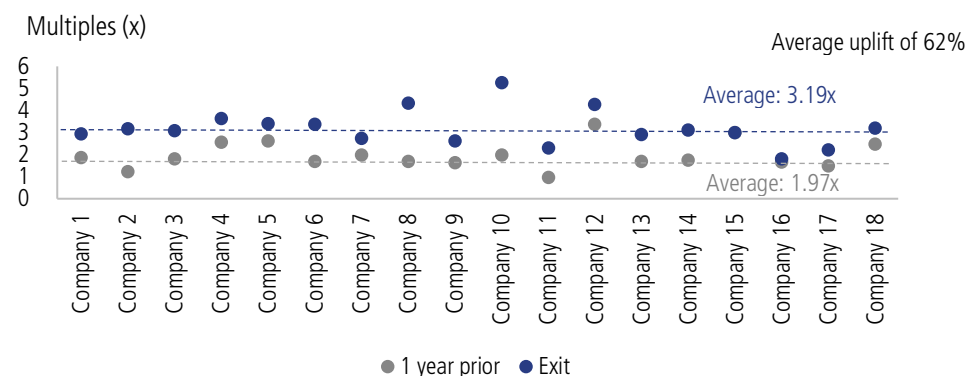
Public versus private holding valuations



Source: Hamilton Lane data, Bloomberg to 30 September 2022.

Finally, median exit mark-ups in 2022 were positive across the board when compared to holding values in the previous one to four quarters. According to data to 30 September 2022 supplied by Hamilton Lane, median TVPI (total value to paid-in capital) at exit also increased during a period of equity market declines. The following chart provides an example where there was a meaningful uplift (above average) in valuations at exit due to a conservative valuation approach. It shows gross multiples at exit of platform-wide portfolio companies for a large European private markets firm. This is compared to valuations one year before.

Gross performance multiple at exit versus one year before exit



When we remove the understandable noise around late-stage venture capital, the data certainly doesn't suggest that private equity valuations are grossly overstated. However, we would again re-iterate the fact that portfolio companies and, therefore, private equity valuations are not immune to market conditions.

Source: Partners Group (2023). Selected investments represent a sample of investments across the platform that Partners Group made on behalf of its investors. The examples shown represent transactions made between 2013 and 2022 and may be part of several closed- and open-ended products, managed by Partners Group.

Are private equity valuations overstated?

When we remove the understandable noise around late-stage venture capital, the data certainly doesn't suggest that private equity valuations have been or are grossly overstated. However, we would again re-iterate the fact that portfolio companies and, therefore, private equity valuations are not immune to market conditions. If we see earnings decline as economic growth slows, we expect to see some softness in private equity valuations too. This is implied by private equity being our least preferred component within alternatives. Our most preferred sectors are hedge funds, private debt, and unlisted infrastructure.

So, how should we be thinking about existing and new allocations to private markets?

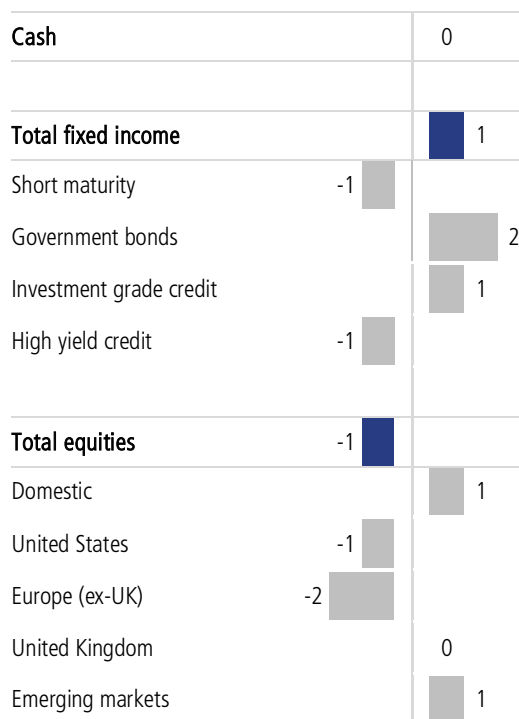
First and foremost, we're invested in private markets for the long term (especially given the relative illiquidity of the asset class), and as we explained in *Timing private markets*, vintage diversification matters (i.e., we can't time the market, so don't want to miss a vintage). To that effect, investors should be staying invested through the cycle, and across all three components of the broad private equity segments.

However, in light of ongoing economic weakness that could have a greater impact on existing positions and their valuations, we maintain a preference for new commitment structures (where available and appropriate) and/or those that are actively and cautiously investing new capital into the current environment. Entry valuations are at much healthier levels today, and while it is impossible for anyone to pick the bottom of the market, vintages post or during market downturns tend to perform strongly. Where deploying into open-end, fully invested private market strategies, consistent with our deployment stance for public equities in last month's edition of *Core Offerings*, a range of 40-60% would be an appropriate.

From an opportunity perspective, one area we think looks increasingly attractive is the secondary market for private equity funds, particularly in venture, where both performance and venture's association with the Silicon Valley Bank collapse have added to uncertainty and increased discounts. Not all of these transactions are created equal, but for those that can access secondary opportunities from leading venture funds and/or their portfolio companies, Q2 onwards should provide a ripe hunting ground to build an attractive portfolio of mid- to late-stage global start-ups.

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.

Have central banks finished hiking rates?

It is clear we are now closer to the end to the central bank rate-hiking cycle. Central banks (including in Australia, where rates were left on hold in April) have recently changed their tone and are now using economic data to drive decision-making with respect to interest rates. The prospect of interest rates that are around or below current levels, as well as lower inflation, should eventually provide a reasonable backdrop for markets in the next 12-18 months, albeit the risk of near-term volatility remains,

Inflation volatility is likely to persist—Inflation continues to fall, though services inflation remains sticky. However, fading impacts of globalisation, structurally tight labour markets, and geo-political impacts on supply chains suggest less deflation and more inflation.

A return to 'normal' interest rates—Peaking inflation is likely to foster a near-term peak in central bank hikes. But stickier inflation than over the past two decades is likely to limit a return to near-zero interest rates.

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 may matter more—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"> Energy companies now focused on shareholder returns with an 'OPEC put' in place Later-cycle defensive exposures in the consumer staples, telco and healthcare sectors Emerging markets due to China re-opening, improving earnings and better valuation metrics 	<ul style="list-style-type: none"> Companies with shorter-term debt maturities at risk of re-pricing into a higher rate environment S&P 500 companies, where valuations are now back above pre-COVID average valuations Continental Europe, where inflationary pressures suggest significant earnings headwinds
Fixed income	<ul style="list-style-type: none"> Green bonds and ESG-oriented strategies Fixed rate three to five-year senior unsecured banks Fixed-rate Australian bank subordinated tier II 	<ul style="list-style-type: none"> Short maturity bonds with a preference for more duration in portfolios
Alternatives	<ul style="list-style-type: none"> Multi-strategy, credit-oriented and discretionary macro hedge funds Domestic private debt and asset-backed securities (excluding real estate) Core and core-plus infrastructure assets with inflation linkages Private market and real assets exposed to the global energy transition 	<ul style="list-style-type: none"> Passive private market and/or real asset strategies Lower grade and/or buy-and-hold real estate assets Pre-IPO strategies Construction and/or junior real estate lending Carbon-intensive assets with no transition plan

Economic and asset class outlook

Economic outlook

Global economy



Strains in the global banking system have eased over the past month, as US and European regulators acted quickly to ease the stresses, thus averting a potential systemic banking crisis. However, the impacts of policy tightening have continued to intensify, as a more modest pace of rate hikes through March and April—and pausing in some countries—has given way to indications that credit conditions are tightening in the wake of the deposit crisis, a likely headwind to the growth outlook.

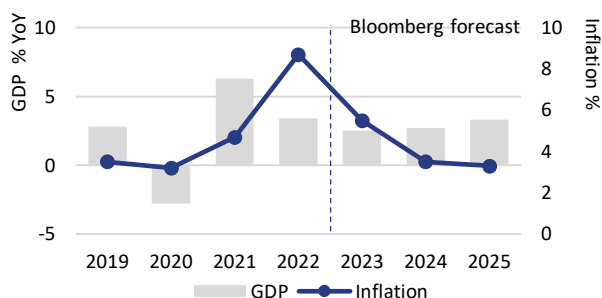
Despite this, early 2023 growth across the global economy has proved surprisingly resilient, suggesting upside risks to the outlook, even as the full weight of past tightening has yet to be revealed. In Q1, China's growth surprised positively, amid a stabilising property sector and further stimulus, while leading indicators point to a pick-up in Europe's growth rate. Jobs markets in Australia and the US have continued to deliver strong jobs growth, despite some slowing in US growth.

Still, the lagged impact of policy tightening is expected to weigh on growth into H2 2023. While unemployment remains low, vacancies are falling and unemployment claims rising, a bellwether for weaker consumer spending ahead as interest burdens remain elevated. 'Sticky' core inflation, particularly for services prices, is likely to see interest rates remain elevated, despite moves by markets to price multiple central bank rate cuts before year-end. OPEC+'s unexpected cuts to oil output during April, pressuring higher prices, also add to inflation pressures, cautioning expectations for imminent rate cuts.

The near-term growth resilience, slower disinflation than anticipated, and uncertainty about further financial pressures are likely to see interest rates held 'less high' but for longer to ensure inflation risks are removed over time. This is raising questions as to whether the growth outlook for 2024 has darkened, and the lower prospect of a rebound will underpin reductions to growth forecasts over coming months.

Forecasts for the 2023 outlook have been revised higher. UBS recently raised its forecast to 2.6% (from around 2%) and still expects a pick-up to 2.8% in 2024. Société Générale (SG) has also added around 0.5% to its latest 2023 outlook across US, Europe, UK, and China under the banner of "recession must wait", although this is ahead of a forecast 2024 recession.

Global GDP growth and inflation



Source: Bloomberg as at April 2023.

Australia



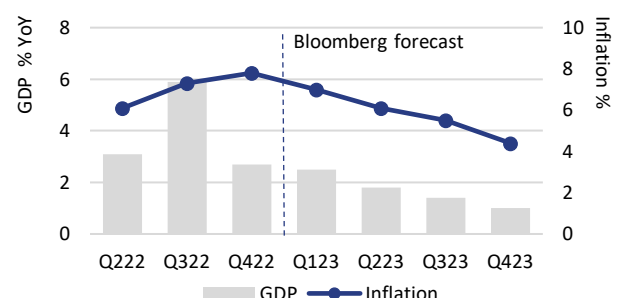
Recent data suggest the economy slowed noticeably in late 2022, with data pointing to relatively flat activity for Q1 2023. Reflecting this, together with signs of easing price pressure, the policy rate was left unchanged in April after 10 consecutive monthly hikes. With consumer spending now slowing, ahead of rising housing interest costs in Q2, growth is expected to shift below trend into mid-2023. Still, China's growth pick-up (even if less commodity intensive), as well as the recent rebound in immigration (now rising at an above-average pace), have added to confidence that Australia can avoid recession and outperform growth in other developed economies in 2023.

In Q4, quarterly growth eased to 0.5% from 0.7%, its slowest in a year. The annual pace braked from Q3's booming 5.9% to 2.7%, a near-trend rate of growth. There was broad-based slowing across consumer, housing, and business sectors. Early Q1 data remained mixed, with retail sales falling over the three months to February, but jobs growth rose strongly across February and March, keeping unemployment near a 50-year low of 3.5%. Despite new housing approvals and loan growth falling sharply, house prices appear to be stabilising after recent falls and consumer sentiment has lifted, both following signs that the policy tightening cycle is approaching its peak.

Inflation slowed to 1.4% in Q1 (from Q4's 1.9% pace), seeing annual inflation moderate from a likely peak of 7.8% to a still high 7.0%. Food, energy as well as housing-related prices across building costs and rents were key drivers. The decline in March month inflation from 6.8% to 6.3%, as well as business survey selling prices, add to the picture of moderating inflation. After pivoting more hawkish in February, the Reserve Bank of Australia (RBA) remained on hold in April at 3.60%. While retaining a tightening bias, noting that "further tightening of monetary policy may well be needed to ensure that inflation returns to target", comments were still viewed to be on the more 'dovish' side. CBA and UBS continue to forecast a final hike in May to 3.85%, on the back of the strong jobs data.

After 3.7% growth in 2022, UBS expects Australia to avoid a recession in 2023, with growth slowing to 1.3%, while CBA has lifted its forecast from 1.1% to 1.5%. UBS expects growth to recover modestly to a 1.6% pace in 2024.

Australian GDP growth and inflation



Source: Bloomberg as at April 2023.

Economic outlook

United States



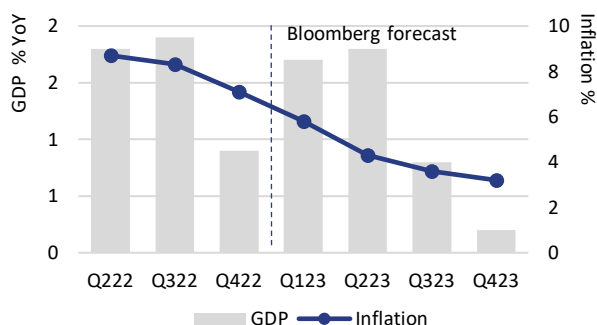
Recent strains within the US banking system eased in April, as policy actions appeared to restore confidence and deposit growth stabilised. Focus has now turned to the likely impacts of the inevitable greater-than-planned tightening of financial conditions, above that already delivered via higher interest rates. The US debt ceiling debate is once again coming into focus. While leading indicators signal an imminent, though most likely mild, recession ahead, recent data continue to flag relatively resilient activity during early 2023.

Growth missed expectations in Q1, rising just 0.3% (1.1% annualised) after Q4's 0.6% (2.6%). While consumer spending proved robust, business and housing capex fell. While the US composite purchasing managers index (PMI) rose further to 53.5 in April, its fastest since May 2022, the key manufacturing ISM fell to 46.3, its weakest reading since Q2 2020. Retail sales fell 1.0% in March, after a 0.2% fall in February, though BCA Research believes "the large monthly decline overstates the weakness", given the fall excluding energy and food was more muted. While the jobs market remains tight (with unemployment unchanged at 3.5% over recent months), jobless claims are trending higher and job gains are slowing. Housing is showing some signs of troughing.

Price pressures continues to ease, with inflation falling from 6.0% to 5.0% in March, well below its mid-2022 peak of 9.1%. But according to UBS, "progress on slowing monthly core CPI increases has stalled", with March's core rate edging higher to 5.6% from 5.5%. More positively, there were signs of easing in the key rent component, raising hopes for a renewed downward trend in core inflation. The US Federal Reserve (Fed) lifted rates 0.25% in March to 5.0%, as expected. But according to UBS, the Fed's "lack of desire" to assume more than one extra hike in its 'dot plot' was dovish. UBS and consensus expect a final hike to 5.25% in May.

After 2.1% in 2022, UBS expects growth to slow sharply to 0.8% in 2023 (and soft growth of 0.3% in 2024). SG forecasts stronger growth in 2023 of 1.7% before a clearer slowing into recession in 2024, with growth of just 0.1%.

US GDP growth and inflation



Source: Bloomberg as at April 2023.

Europe



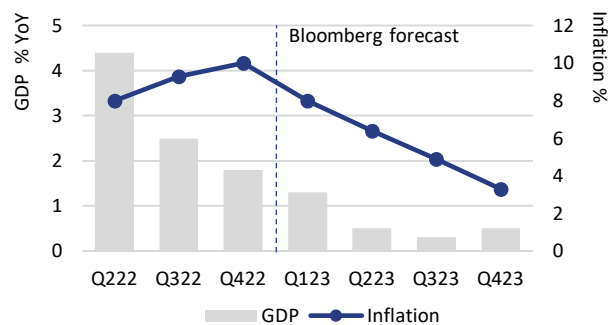
Europe's warmer-than-expected winter has increased the likelihood the region can avoid recession in 2023, albeit growth is expected to be relatively tepid in coming quarters. Stronger momentum in industrial activity is likely to be challenged by tighter credit conditions due to recent rate hikes and banking system stability issues, which saw UBS acquire Credit Suisse. With core inflation elevated, rates will likely be tightened into mid-year, and are yet to be fully felt by European households and businesses.

Europe's Q4 economic growth printed flat against expectations for a small decline. The annual pace slowed further from 2.4% to 1.8%. However, recent data flag stronger growth of around 0.3% in Q1 2023. April's PMI data jumped to 54.4 from 53.7, consistent with February's strong growth in industrial output, which rose 1.5% after 1.0% in January. According to SG, the industrial rebound reflects that 1) production of energy and energy-intensive manufacturing is bottoming out; and 2) pharmaceutical and transport equipment production is growing fast, as supply bottlenecks are easing. In contrast, retail sales remain volatile, falling 0.8% in February, reversing January's gain, while credit data reveal deteriorating conditions and slowing loan growth across corporates and households.

Inflation fell sharply in March, from 8.5% to 6.9%, well down from its 10.6% peak in October. But core inflation remains problematic, accelerating to 5.7% from 5.6%. As UBS notes, "given easing supply bottlenecks and lower energy prices, the stickiness of goods inflation has come as a surprise." With risks to the inflation outlook now skewed to the high side, April's inflation will be key to assessing whether the European Central Bank (ECB) hikes by 0.25% or 0.50% in May after March's 0.50% increase to 3.0%. UBS expects a further final 0.25% hike in May, taking policy to 3.25% for the rest of 2023, but sees a risk of a 0.5% hike given recent stronger wage deals.

After growth of 3.5% in 2022, UBS expects a sharp slowing to 0.8% in 2023 (but now sees upside risks to this). SG expects higher growth of 1.2% in 2023, while CBA upgraded its growth outlook from -0.5% to +0.5% (and 1.0% in 2024).

European GDP growth and inflation



Source: Bloomberg as at April 2023.

Economic outlook

United Kingdom



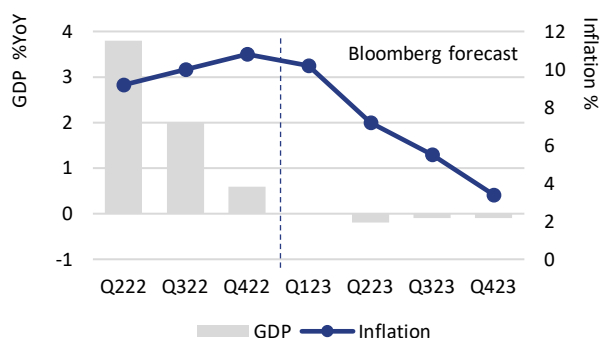
Recent data suggest momentum in the UK economy remains weak in H1 2023. According to SG, while "UK economic performance has defied predictions of an inevitable recession in 2H22, it is less clear whether this can continue in 2023", as elevated energy costs, rising inflation, and higher rates weigh on activity (including the key housing sector). The likelihood of recession in H1 2023 remains elevated and "households are in the throes of a trifecta of shocks (real income, energy, and interest rate shocks)", according to Longview Economics.

Growth expanded slightly in Q4 by 0.1% after Q3's -0.1%, helping the UK narrowly avoid a technical 'winter' recession, albeit annual growth eased to a soft 0.6% from 2.0%. The UK's PMI surprised again in April, rising to 53.9 from 52.2. But early 2023 consumer data has been mixed, with retail sales falling 0.9% in March, reversing February's 1.1% gain. The labour market remains tight (with unemployment unchanged at 3.7% for the past four months), and there has been little recent deceleration in earnings growth (still elevated at 5.9%).

Price pressures remain significant, easing only slightly in March from 10.4% to 10.1%, less than expected, with core inflation unchanged at 6.2%. But Longview Economics still believes "UK inflation should fall sharply in the next 6-12 months", as drivers of inflation have already reversed. Consistent with that, after lifting rates by 0.25% in March to 4.25%, the Bank of England (BoE) "sound like they are ready to pause", according to CBA. But more recently, the BoE's Chief Economist, Huw Pill, made hawkish comments, with the onus on ensuring enough tightening is delivered to "see the job through and sustainably return inflation to target". According to CBA, the BoE will deliver one more 0.25% hike at its May meeting, lifting the policy rate to 4.5%. "But with UK inflation still too high, the risk lies with more rate increases."

After growth of 4.0% in 2022, both UBS and SG expect it to fall by 0.4% in 2023, while CBA expects flat growth in 2023. For 2024, growth is expected to rebound modestly, with CBA forecasting 0.4%, UBS 0.6% (unchanged), and SG 1.0% (recently raised from 0.3%).

UK GDP growth and inflation



Source: Bloomberg as at April 2023.

Japan



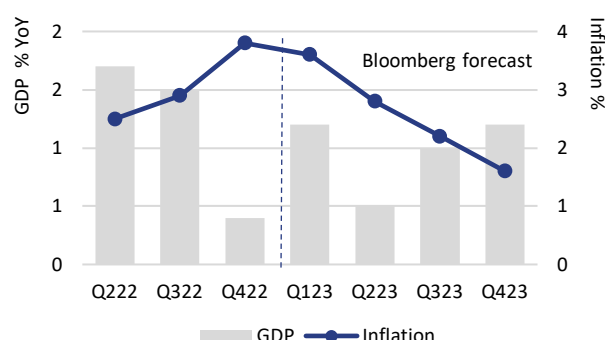
Japan appears on track to deliver steady, if not somewhat modest, growth over the next couple of years. A key focus is on the expected impact of slowing global growth on exports, and the extent to which it is more than offset by stronger activity domestically, as the economy continues to open post-pandemic. As UBS notes, a "key feature of the economy is the divergence between weakening in goods (mainly overseas) and recovery in services (mainly at home). In the goods sector, real exports and industrial production will likely contract in Q1. On the other hand, service PMI suggests that recovery is strengthening. In all, Japan's economic recovery will continue despite [an] expected US hard landing in coming quarters."

Growth in Q4 was revised to show no rebound (0.0%) after an unexpected 0.3% contraction in Q3, with the annual pace slowing to just 0.4%. Growth is expected to pick up in Q1, with Japan's PMI staying above the key 50 mark in March (at 52.5 after 52.9). Mixed consumer trends continue (given still subdued wages growth), with retail sales collapsing 4.4% in February, more than offsetting gains in December and January. After falling to 2.4%, unemployment rose to 2.6% in February, little changed over the past year. Despite recent mixed data, the business and consumer sentiment surveys are supportive of a moderate recovery through H1 2023.

In its inaugural press conference, new Bank of Japan (BoJ) Governor Ueda did not send any hint on near-term policy change. When asked whether current aggressive easing should be maintained, Ueda replied that "I think my answer is to continue the aggressive easing of previous regime." On yield curve control, he said "I think it is appropriate to maintain it given current economy, inflation, and financial conditions". This implies no intention to change policy in the near future, a somewhat dovish message. After a surprising weakening in February, core inflation was unchanged at 3.1% in March (from January's 4.2%), led lower by energy prices.

After growth of 1.0% in 2022, UBS expects a modest pick-up to 1.3% in 2023 (and 1.2% in 2024). SG forecasts 1.3% in 2023, but slowing again to 0.9% in 2024.

Japanese GDP growth and inflation



Source: Bloomberg as at April 2023.

Economic outlook

China



Signs of recovery strengthened in China in early 2023, with a stronger-than-expected rebound in activity post the end of its COVID-zero policies. As MST Marquee recently noted, "Spring has arrived in China. The COVID lockdowns are over and policy levers have been pulled...there are early signs that the economy is recovering. The policy measures include further fiscal easing while broader measures to ease policy including a reduction in interest rates" have been announced.

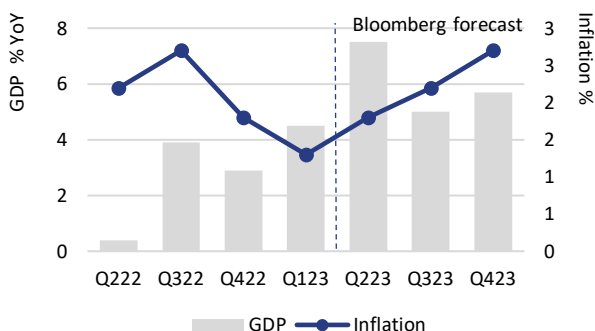
In Q1, China's output expanded by more than expected, rising 4.5% against expectations for a 4.0% gain, the fastest pace of growth in a year. Monthly data for March also revealed further positive momentum through the first quarter. Retail sales jumped to 10.6% after 3.5% in February, while industrial production rose 3.9% after 2.4%. In contrast, infrastructure and property activity weakened moderately.

Exports also rebounded in March, rising 14.8% in a broad-based gain led by demand from emerging markets, including Southeast Asian economies, Brazil, and Russia. Credit growth also beat expectations again, edging up to 10.0% from 9.9% in February and 9.3% a month earlier. Strength was broad-based but led by stronger corporate loans. This follows the authorities also unexpectedly eased monetary policy in mid-March, lowering the Reserve Ratio Requirement for banks by 0.25%, the third cut in interest rates since the start of 2022.

Inflation surprised weaker in March, rising just 0.7% against consensus and the prior month's 1.0% rise, staying at one-year lows. Falling food, pork and fuel prices contributed to the lower result. While still very low, core inflation edged higher to 0.7% from 0.6%, but supports ongoing easier policy.

China's growth dropped from 8.4% to 3.0% in 2022. But in contrast to most other economies, growth is expected to reaccelerate in 2023 and 2024. UBS recently upgraded its 2023 growth outlook from 5.4% to 5.7%, before a 5.2% pace is seen for 2024. SG has raised its 2023 forecast from 4.8% to 5.8%, with 2024 also expected to slow modestly to 4.8%.

Chinese GDP growth and inflation



Source: Bloomberg as at April 2023.

Emerging markets

After a H2 2022 rebound in activity led by Asia, the emerging market region is expected to recover moderately during 2023, as Asian growth strengthens, and emerging Europe stabilises. China's accelerated re-opening provides further support, with SG viewing this as a "game-changer" for Asia. Inflation is now more clearly moderating and some central banks have paused tightening. UBS recently upgraded its outlook for Hong Kong and Thailand. "The resumption of cross-border travel is the foremost channel through which Asian economies benefit."

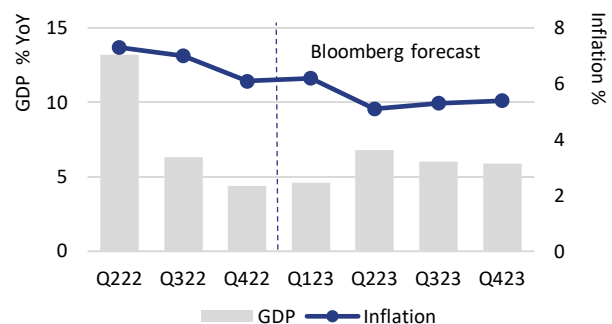
Inflation has begun to surprise significantly weaker across Southeast Asia, especially Indonesia, Thailand, and the Philippines. India's inflation fell below 6% in March, a 15-month low. But according to UBS, "core services inflation remains sticky", with food inflation a key driver. This is leading to a broader range of central banks pausing, including the Philippines, Thailand, and India, with the potential for cuts later in the year. Vietnam trimmed interest rates by 1% in March.

Growth in India rose 0.7% in Q4, with the annual pace slowing from 6.3% to 4.4%. While consumer spending was supported by re-opening, tight monetary policy is weighing on purchasing power as accrued pandemic savings are being depleted. SG analysis of disaggregated production data indicates that "while domestic demand will likely support growth, it will not drive it". UBS sees 2023 growth slowing to 5.5% from 7.0%.

UBS expects growth in Latin America to slow from 3.7% in 2022 to 1.1% in 2023, as a slowing global economy impacts external demand for exports. In Brazil, falling inflation is cementing peak central bank rates. Q4 quarterly growth fell 0.2% from 0.3%, adding to expectations that interest rates will be cut in H2 2023. For emerging Europe, weak consumer spending is one of the main drivers of an expected slowdown.

After 4.0% in 2022, UBS expects a similar pace of growth for 2023 before a modest acceleration to 4.3% in 2024. Growth in emerging Europe is expected to slow to 0.8% in 2023 after 3.2% in 2022, and to rise to 2.4% in 2024.

India GDP growth and inflation



Source: Bloomberg as at April 2023.

Asset class outlook

Short maturity and government bonds

Position: Underweight short maturity, overweight government bonds

Key points

- Central banks are likely to pause hiking rates as the crisis in the financial sector weighs on lending and activity.
- Global bond yields have fallen, as markets price lower terminal rates in H2 2023.
- We expect rate volatility to remain elevated in Q2 2023, reflecting the risk of inflation data and a slowdown in economic growth.

Short maturity—The onset of US bank failures earlier in March sparked fears of a looming credit crunch. A substantial rally in Treasuries saw the two-year yield fall from its 5.00% March high to a low of 3.75%. This whipsaw shift in sentiment will likely continue, but as time passes and the risk of further contagion in US regional banks subsides, central banks will still maintain their focus on inflation and whether the recent turmoil is likely to slow growth considerably. While the Fed increased rates by 25 basis points (bps) at its March meeting, it is likely the terminal peak in rates is near. The RBA will hold at lower-than-anticipated levels for longer and be guided by future inflation and growth data. The cash rate of 3.60% is already restrictive and the economic outlook is uncertain, but our base case is that the RBA will remain on hold before potential cuts in late 2023 or early 2024.

We are underweight short-maturity debt, which helps protect against rising interest rates. While the market will likely remain volatile at the front end of the curve, it is our six to 12-month view that global overnight fund rates will fall. We, therefore, recommend adding duration. The recent market turmoil is likely to tighten lending liquidity and slow economic growth, and as inflation is already showing signs of falling, we expect central banks will ease later in Q4 2023.

Government bonds—Our base case is that bond yields are likely to fall over the next six to 12 months as growth decelerates because of tighter financial conditions, elevated energy costs, and general macro uncertainty. The 10-year Treasury yield, now around 3.5%, is pricing in rate cuts and fears are growing of an imminent recession, which is characteristically seen in the inversion of the yield curve. Given the balance of risks between high inflation and slowing growth, we believe the asset class presents an attractive asymmetric return prospect. Bond yields may remain volatile in the short term as markets will be influenced by macro data, but we see any rise in bond yields as a buying opportunity. Above-target inflation numbers are likely to reverse and drop quickly enough for central banks to take out insurance against a recession, predicting lower energy prices, a weaker labour market, and ultimately lower cash rates. Government bonds are our most preferred sector within fixed income.

The risk-return profile for defensive, higher-quality segments of the fixed income market remains appealing, given the all-in yields on offer and the expected transition from inflation risks to growth risks. Within this context, we prefer high grade and investment grade bonds.

Investment grade and high yield credit

Position: Overweight investment grade and underweight high yield credit

Key points

- Domestic subordinated Tier II debt is our most preferred segment within investment grade credit.
- Investment grade credit spreads are stable as outright yields attract demand.
- We prefer investment grade credit over high yield, where the latter is vulnerable to an increase in default risk.

Investment grade credit—With bond yields falling, investment grade credit spreads have risen slightly, but financial sector spreads have been contained. Domestically, with the three-month Bank Bill Swap index (BBSW) now around 3.65% and a steeper swap curve at the front end, we recommend investing in fixed rate assets around the three to five-year part of the curve. Senior unsecured bank spreads have remained elevated at around BBSW+100bps, offering a yield to maturity of 4.60% for five years. We expect issuance to remain high in both subordinated Tier II and senior unsecured, which should keep spreads elevated. We see this as an investment opportunity, particularly in Tier II, as outright yields are offering attractive returns of around 6.00%.

Domestically, we have seen a widening of (Additional Tier 1) AT1 hybrids but not to the same degree as in Europe. The structure of AT1 securities differs depending on jurisdiction. In Australia, hybrids are first converted into equity and are not written down to zero. Domestic hybrids have only widened around 25bps from BBSW +275bps to BBSW +300bps. Retail investors continue to retain strong exposure to bank hybrids, given their safe-haven status. On a risk-adjusted basis, our preference is subordinated Tier II over AT1 hybrids.

High yield credit—The culmination of outright yields of around 8.00% has led to high yield spreads stabilising. However, we remain cautious about the high yield market and expect a widening of spreads in coming months. This is consistent with less supportive liquidity conditions, an increase in defaults to a more normalised level, and high yield spreads coming under further pressure from a tightening of financial conditions.

Tactically, before we become more positive on the broader high yield market, we need to see further evidence that inflation is coming under control, which will provide confirmation that central banks do not need to hike as aggressively as anticipated and that any recession will be relatively mild or avoided.

Yields for US and European high yield debt of around 8.0% provide a level of protection against falling prices. With a large part of the investment universe now trading at a discount to par, there are select opportunities available for investors. Our preference is to be higher up the credit quality curve in investment grade credit.

Asset class outlook

Domestic equities

Position: Overweight

Key points

- Domestic equities rose 1.8% in April, underperforming global equities in Australian dollar terms. All sectors rose during the month, except materials.
- The banks sector posted a strong rebound over the month and is now back to trading at the levels it was prior to the collapse of Silicon Valley Bank. However, from its year-to-date peak, the sector is about 8% lower. In April, the healthcare sector was a strong performer, with CSL Limited and Cochlear Limited both performing strongly.

In April, the S&P/ASX 200 index enjoyed some strong performance, outperforming global equities and unwinding some of its year-to-date underperformance. There are several reasons for this:

Paring back of interest rate expectations: The expected peak in the cash rate had previously been 4.35% by December 2023. This has now been revised to 3.8% by August, with many commentators forecasting that the RBA has now reached (or is close to reaching) the peak of its current rate-hiking cycle. Previously, no rate cuts were expected within 12 months of the RBA reaching the peak of its hiking cycle, but now, the market is beginning to price in 2023 rate cuts.

Cheap valuations relative to global: The 12-month forward price/earnings (P/E) ratio for the S&P/ASX 200 index is currently just 14.5x. This is one standard deviation from its 10-year average and is cheap versus the MSCI World, where it is trading at a 12% discount. The largest discount has been 15%.

China rebound: Among developed markets, Australia is the most exposed to a rebound in China growth, second only to Taiwan.

On the earnings front, UBS believes that the outlook for earnings growth now looks anaemic (low single digits), with risks building towards an acceleration of downgrades as mid-year pressure points hit the Australian consumer (i.e., lagged impact of RBA hikes plus fixed-rate mortgages rolling off). However, a sharp de-rating in valuations should provide some support. UBS believes that the case for equities has softened and has, therefore, revised down its year-end target for the S&P/ASX 200 index to 7,250 (previously 7,500).

UBS expects that the RBA will reach the end of its hiking cycle by May and will then start easing at year-end. In this modern era of monetary policy, 'rate plateaus' of at least six months have prevailed in each of the previous cycles, and equity markets have shown a tendency to track sideways during this time. In these periods, growth stocks have outperformed value, and large-cap stocks have outperformed small-caps. Insurance has been the most consistent winner of the sectors (followed by healthcare and energy), while real estate, industrials, and consumer discretionary have underperformed.

International equities

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

Key points

- In April, global equity markets rose 2.9%. Europe and the UK led the gains, while the US and emerging markets underperformed.
- As we saw domestically, healthcare stocks outperformed, as a combination of relatively defensive earnings and M&A activity attracted investors.
- During the month, IT started to lose some of its relative performance, rising 0.4%—despite what had been some very strong earnings results from key tech names.

The market has been relatively unaffected by recent bank failures. The S&P 500 is up 10% year-to-date and is only 13% from its historical peak. The expectation is that, at the first sign of trouble, the Fed and other central banks will cut rates and rescue markets. Markets are forecasting large rate cuts in H2 2023 (although these are being pared back somewhat). Challenging this is that inflation remains sticky, with month-on-month US core PCE inflation still running above the Fed's 3.5% year-end projection, let alone its 2% target. As shown so far, it is plausible that the Fed will use other tools (rather than cutting rates) to deal with stability problems in the banking system, such as the new Bank Term Funding Program, which increased the Fed's balance sheet by USD 300 billion in April (supportive for equities at the margin).

With the yield on the risk-free six-month Treasury bill now back to 5.0%, conventional finance is again being challenged over the appropriate level of compensation needed for equity risk. Equity investors are demanding no additional compensation for risk versus investment grade yields. The premium for equities over the risk-free yield of six-month Treasury bills is barely 40bps, whereas the long-term average is around 370bps. Additionally, the VIX index (the so-called 'fear gauge') is approaching post-COVID lows of 15, suggesting the market is relatively calm, and belying unprecedented bond market volatility.

Over the next few months, the US debt ceiling debate will come into focus and will likely impact markets. Already, credit default swap spreads for US Government debt in one year have risen to levels never seen before, even during the GFC.

Recent US equity market strength has seen 12-month forward P/E ratios for the S&P 500 re-rate to 18.5x, a level they have not been able to breach for the past 12 months. This strength also coincides with pre-COVID peak valuations (against a backdrop of much higher interest rates).

Until now, earnings have been remarkably stable in the face of rising interest rates. Between Q1 2023 and Q1 2024, consensus still expects year-on-year growth for S&P 500 quarterly earnings per share (EPS) to be 13%. This is expected to be driven by solid sales growth and margin expansion. Even in a soft-landing scenario, that is a high bar.

Asset class outlook

Currencies

Key points

- Increased risk aversion and persistent inflation concerns remain the focus for currency markets.
- A peak in Fed policy has paved the way for broader US dollar weakness into H2 2023.

The USD index has been on a steady decline since reaching a peak of 114 in Q4 2022. In April, it continued to trend lower as we approach a peak in Fed policy. Note that the Fed members' projections point to a peak rate of 5.1%, which is unchanged from December and suggests that most officials expect only one more rate hike ahead. Additionally, the recent collapse of Silicon Valley Bank and the ensuing stress in the US banking system have seen rate hike expectations reduced significantly. The US dollar's direction is likely to be shaped by how long the Fed keeps rates in restrictive territory. In the near term, given the counter-cyclical nature of the US dollar, further downside may be somewhat limited due to an increase in safe-haven flows. Sentiment should change once the Fed transitions to a cutting cycle. Fed Chair Powell noted that officials do not expect any rate cuts in 2023, but the market has currently priced the start of a cutting cycle from Q4.

The Australian dollar traded between USD 0.66 and USD 0.68 throughout April as perceptions of global risks continued to deteriorate, commodity prices fell on a weaker demand outlook, and the RBA kept a relatively dovish stance. At its April meeting, RBA officials voted to pause policy tightening, noting that interest rate settings are already restrictive and the economic outlook has become incrementally more uncertain. Interest rate differentials between Australia and the US have since become even more of a headwind, especially as the Fed has indicated another hike ahead is possible, or at least that rates will remain higher for longer, with no cutting cycle expected until 2024. CBA has trimmed its forecasts for the Australian dollar, and now expects it to weaken near term, falling to a low of USD 0.62 in September, before recovering slightly to USD 0.65 at year-end. UBS expects it to lift to USD 0.75 by year-end on a relatively weaker US dollar outlook.

The euro has been on a steady comeback since falling to a 20-year low in Q3 2022. In April, it rose further to USD 1.10. The outlook for the euro has improved recently after a surprisingly warm European winter saw natural gas prices plummet, reversing the negative terms of trade shocks that had been so bearish for the currency. Interest rate differentials are also an important consideration now the Fed is nearing the end of its hiking cycle. The ECB hiked by 50bps at its latest meeting and took a much more combative tone on inflation, with the bank likely to keep the policy rate higher until late 2024. This should lead to some compression in Europe/US interest rate differentials. UBS expects the euro will continue to strengthen towards USD 1.15 for end-2023, while CBA targets USD 1.08.

Commodities

Key points

- The near-term demand outlook for commodities remains uncertain, as the market considers the prospect of slowing global growth and increased supply in some areas.
- Production is beginning to outpace demand in many areas, while prices of most commodities are still experiencing steady declines.

After falling to a 15-month low in March, Brent oil prices retraced below USD 80 per barrel (bbl) in April despite the surprise announcement that OPEC+ would cut production by 1.1 million barrels per day in May and June (1.1% of global supply). Oil markets will continue to face several supply and demand factors in the months ahead. On one hand, expectations that the Fed is reaching the end of its rate-hiking cycle, and the downtrend seen in the US dollar since October, have been supportive of prices. Additionally, China remains one of the top oil importers, and the rapid re-opening of its economy should boost energy demand. That said, the supply-side response has been quite muted, and the European Union's embargo on Russian oil and associated sanctions have been less restrictive than initially envisaged, with Russian production remaining resilient to date. Both UBS and CBA recently trimmed their forecasts, now expecting end-2023 prices to reach USD 88 bbl and USD 87 bbl respectively.

After surging more than 70% since November, iron ore prices have since weakened, falling sharply in April to below USD 105 per tonne (p/t). China remains the key driver, where its recent economic growth target of 'around 5%' disappointed expectations for a stronger, infrastructure-led economic rebound. Additionally, concerns that policymakers in China will intervene in iron ore markets has added downward pressure to prices after the National Development and Reform Commission issued warnings on price gauging and hoarding. China's plan to reportedly reduce steel output again this year also looms as another downside risk to iron ore prices. Note that China's steel output fell approximately 3% in 2021 and 2% in 2022. The plan to reduce China's steel output in 2023 is linked to reducing carbon emissions from China's steel sector and is expected to limit price upside. UBS forecasts USD 111 p/t for end-2023 and USD 91 p/t for end-2024, with long-term prices settling around USD 65 p/t.

Base metal prices have continued to benefit from the positive sentiment that followed the re-opening of China. Optimism that the Fed is nearing the end of its rate-hiking cycle and a weaker US dollar have also been supportive of prices. Longer term, de-carbonisation trends are bullish for most metal and mineral demand profiles, as the world transitions away from fossil fuels. Nickel, copper, aluminium, and lithium graphite all face significant undersupply, which should support prices over the longer term.

Asset allocation views

Strategic asset allocation views

Why do we believe in strategic asset allocation?

We believe that the central component of successful long-term performance is a well-constructed strategic asset allocation. Empirical evidence suggests that a disciplined strategic asset allocation (SAA) is responsible for around 80% of overall investment performance over the long term¹. Diversification plays a critical role within SAA. By diversifying your portfolio among assets that have dissimilar return behaviour, lower overall portfolio risk can be achieved, and your portfolio can be better insulated during major market downswings.

Why do we advocate SAAs to our clients?

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

Why strategic asset allocation?

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

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

Strategic asset allocations in models

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

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

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

Active portfolio weights and tactical asset allocation views

Our current tactical asset allocation views

We remain constructive on markets relative to 2022 and expect to see them stabilise as central banks get closer to the end of their policy rate-hiking programs, most likely during Q2 2023.

As evidence emerges of a slowdown in growth and inflation, it is likely that central banks will hold rates for longer before cutting. While rate cuts were previously expected to emerge around late 2023, this is now more likely to take place in early 2024.

Stability in rates and a mild global recession should provide a reasonable backdrop for markets, where inflation should eventually settle at the higher end of the RBA's inflation target band of 2-3%. However, it also means we are unlikely to be returning to a very low interest rate environment, as experienced in the past decade.

Cash

We continue to hold a neutral cash position. This reflects a lower risk appetite than at the start of 2023, as well as the recent significant move higher in central bank policy rates.

Fixed income

At the asset class level, we remain overweight fixed income. At a sub-asset class level, we are overweight investment grade credit and government bonds, which are supported by yields appearing to remain higher for longer. We are also slightly underweight high yield credit. These positions provide a clearer reflection of our preference for investment grade (higher quality) credit over high yield, where higher-than-expected policy rates, as well as tighter financial conditions, may cause default rates to rise.

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 increasing allocations to hedge funds and unlisted infrastructure. Deployed private equity is our least preferred segment of alternatives.

Equities

We remain underweight equities and continue to prefer non-US markets. Our underweight position to the US reflects a recent rise in valuations, as well as a period of relatively good performance. We are overweight 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 China's re-opening and stronger activity.

Active portfolio weights and active tactical asset allocation tilts

	Active tilt	Yield (%)	Balanced (%)	Growth (%)	Endowment (%)
Cash	0	3	3	3	3
Fixed income	1	54	36	18	15
Short maturity	-1	7	5	2	2
Government bonds	2	34	17	9	7
Investment grade credit	1	12	12	5	5
High yield credit	-1	1	2	2	1
Equities	-1	23	41	59	37
Domestic	1	13	20	29	12
United States	-1	5	10	15	12
Europe (ex-UK)	-2	1	2	3	2
United Kingdom	0	2	3	4	3
Emerging markets	1	2	6	8	8
Alternatives	--	20	20	20	45



Decreased weight this month



Increased weight this month

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

Our view on fixed income

Short maturity

We are underweight short maturity. We favour a more balanced position in duration-related bonds and credit securities, as aggressive monetary policies from central banks have sufficiently repriced bond yields. Our base case is that central banks will be required to ease monetary policy in late 2023 (or early 2024), making a duration play in fixed rate outperform floating rate over time.

Government bonds

We are overweight government bonds. With expectations of further central bank rate hikes over coming months largely priced into markets (both domestically and offshore) and yields elevated, we remain overweight government bonds. Although it is difficult to forecast the absolute peak in yields, government bonds have largely absorbed rising rates (which we expect will reach a peak in Q2 or Q3 2023).

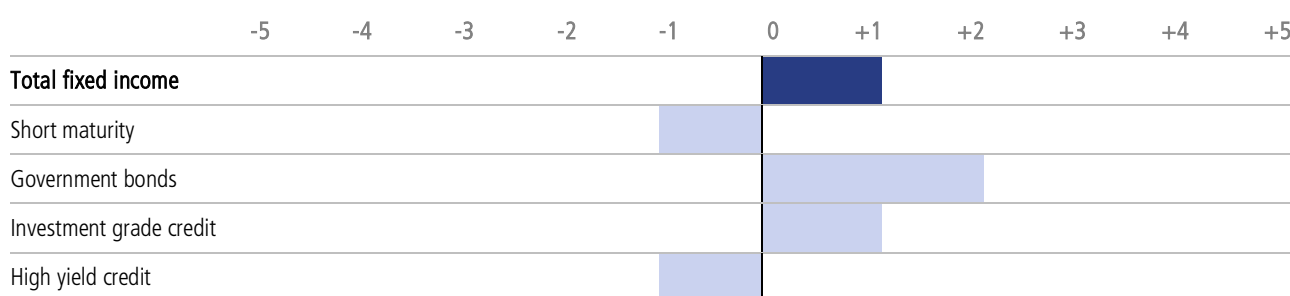
Investment grade credit

We are overweight investment grade credit. Investment grade credit spreads have moved closer to fair value, and we have now moved overweight. We are comforted by higher outright yields. Helped by a wider swap curve, they now provide a reasonable cushion for any further spread widening.

High yield credit

We are underweight 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. We believe spreads have not widened sufficiently enough to compensate for higher funding costs and a higher liquidity premium. They are also vulnerable to a potential acceleration in defaults as interest rates rise more than initially anticipated and as the global economy slows.

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



Fixed income market summary

Fixed income indices	Current	One month ago
Australian iTraxx	90.00	90.53
Australian 3-year yield	2.95%	2.94%
Australian 10-year yield	3.30%	3.30%
Australian 3/10-year spread	34.5 bps	34.3 bps
Australian/US 10-year spread	-14.8 bps	-17.3 bps
US 10-year Bond	3.45%	3.47%
German 10-year Bund	2.40%	2.29%
UK 10-year Gilt	3.73%	3.49%
Markit CDX North America Investment-Grade Index	79.0 bps	75.9 bps
Markit iTraxx Europe Main Index	86.0	84.4
Markit iTraxx Europe Crossover Index	453.2	436.4
SPX Volatility Index (VIX)	18.8	18.7

Source: LGT Crestone Wealth Management, Bloomberg as at 26 April 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 12-month forward P/E for the S&P/ASX 200 is 14.5x, which features in the bottom quartile of valuations over the past decade. With its leverage to a re-opening in China, a likely near-term pause in policy tightening, and a dividend yield almost twice that of the MSCI World index, Australia remains an overweight.

US equities

We are underweight US equities. With valuations on the S&P 500 now back to 18.5x, and 25x for the NASDAQ, US equities appear vulnerable to any earnings disappointments that may emerge (with Q1 reporting season in focus). Upcoming risks include the US Government reaching its debt ceiling, with credit spreads on a US default now the highest on record.

European (ex-UK) equities

We are underweight European (ex-UK) equities. European equities have been able to trade on a raft of 'less negative' issues. However, with the index within 5% of all-time highs, further momentum from here may be more difficult. High

inflation is also proving more problematic than elsewhere, raising the risk that sentiment and earnings growth may be impacted by ongoing central bank policy tightening.

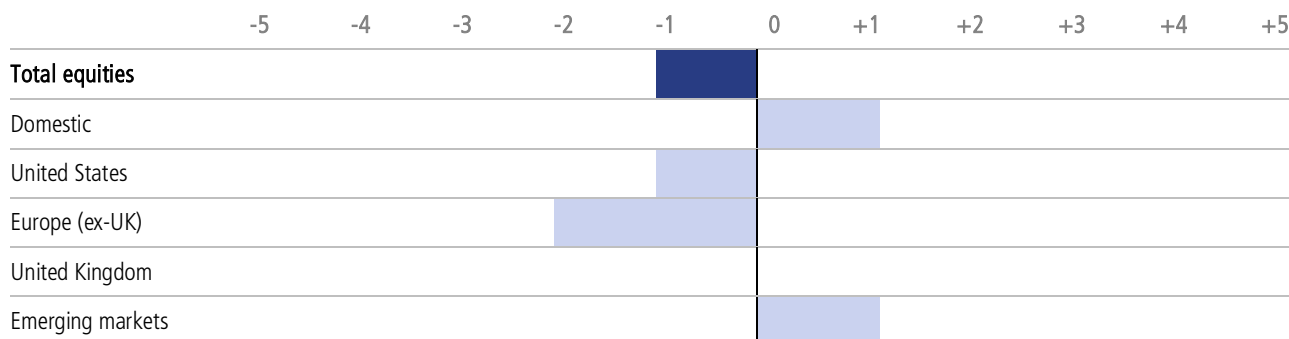
United Kingdom equities

We are neutral UK equities. The UK is a deep-value market with a defensive bias. It has the highest correlation to 'value as a style' among all the major regions. Like Australia, its China-related exposure (mining and energy) and its large healthcare exposure (which provides defensive qualities) should offer a degree of comfort in an uncertain market.

Emerging market equities

We are overweight emerging market equities. We believe the recent pull-back in emerging market equities is a correction that should be bought. China remains a key focus for investors and appears to be in the midst of a 'savings boom'. Its excess consumer savings currently stand at a record 10% of GDP.

Active equity weights (%)—We are underweight equities



Equity market summary

Region	Index	Latest price	Consensus 1 yr		Next year P/E ¹	Next year D/Y ²
			Target	Upside		
Australia	S&P ASX 200	7,316.3	7,764.4	6.1%	14.5	4.27%
New Zealand	S&P NZ 50	11,935.0	12,724.0	6.6%	30.3	2.99%
United States	S&P 500	4,056.0	4,627.7	14.1%	17.0	1.71%
Europe	Euro Stoxx	459.5	532.5	15.9%	12.0	3.42%
United Kingdom	FTSE 100	7,852.6	9,047.4	15.2%	10.7	4.12%
China	CSI 300	3,264.1	3,951.0	21.0%	9.8	3.11%
Japan	Nikkei 225	28,416.5	32,740.0	15.2%	15.6	2.09%
India	Sensex	60,300.6	71,076.8	17.9%	20.5	1.49%

Source: Bloomberg. Data as at 26 April 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. Heightened macro-economic and geo-political uncertainty is also presenting attractive opportunities for discretionary macro strategies, while idiosyncratic credit strategies should provide increasingly attractive risk-adjusted return opportunities in 2023. 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 2023. While private equity is least preferred on a relative risk-adjusted basis when compared to other alternative assets, we believe 2023 will be an attractive year to deploy new capital. 2022 served as a re-calibration with regards to private market valuations, particularly within the venture and growth sectors. As such, entry valuations are readjusting meaningfully, while secondary (fund) market activity is beginning to pick up. We recommend maintaining exposures to private equity and venture capital, albeit investors should have a preference for new primary and secondary fund commitment structures.

Private debt looks increasingly attractive as yields reset higher on the back of interest rate increases. If investors do not compromise on credit quality and cater for increased debt servicing costs, private debt should be attractive due to wider spreads, credit protections relative to public market equivalents, and their typically floating rate structures. 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 more exposed to supply-chain disruption, contractor risk and rising rates.

Real assets

Real estate allocations should prioritise core-plus, high-quality assets. We have a neutral view on real estate, given ongoing weakness across certain sectors. We see a meaningful dichotomy across different assets, sectors, 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. This can benefit during periods of higher inflation, as shorter lease terms allow rents to mark to market more often. In addition, firms that have prudently put in place longer-term debt facilities at attractive rates, and those with conservative long-term discount rate assumptions, are likely to provide a superior experience for investors.

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.

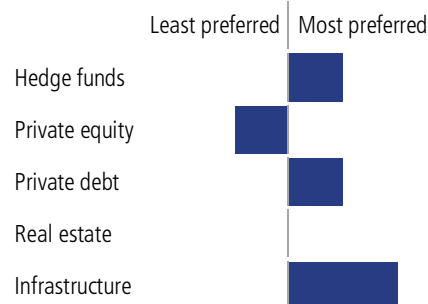
Our most preferred and least preferred exposures—We continue to favour infrastructure, private debt, and low-beta hedge fund exposures while maintaining private equity and real estate exposures

What we like

- Multi-strategy, credit-oriented and discretionary macro hedge funds
- Domestic private debt and asset-backed securities (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
- Pre-IPO strategies
- 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	Com. Services	\$140.89	-7%	49.0	1.1%	30%	28%	22.1%	AA
ALL	Aristocrat Leisure	Cons Discret	\$37.91	12%	20.1	1.7%	22%	19%	8.2%	AA
TLC	Lottery Corp	Cons Discret	\$5.04	2%	30.5	3.1%	22%	127%	8.5%	AA
MTS	Metcash	Cons Staples	\$3.90	8%	12.5	5.7%	21%	27%	-3.9%	AAA
ALD	Ampol	Energy	\$29.93	22%	10.9	6.2%	16%	18%	-2.4%	AA
MQG	Macquarie Group	Financials	\$182.60	10%	14.6	3.8%	na	16%	-5.6%	AA
IAG	Insurance Australia Group	Financials	\$4.98	5%	22.5	3.2%	na	10%	67.4%	AA
RMD	ResMed	Health Care	\$33.71	13%	34.5	0.5%	28%	25%	7.9%	A
CSL	CSL	Health Care	\$300.58	11%	37.3	0.8%	15%	17%	28.3%	A
MND	Monadelphous Group	Industrials	\$12.37	6%	22.8	3.9%	13%	13%	21.4%	AA
ALU	Altium	IT	\$38.17	5%	50.6	1.2%	34%	23%	25.3%	AA
XRO	Xero	IT	\$93.34	7%	598.5	0.0%	3%	3%	437.1%	AA
IGO	IGO	Materials	\$13.75	9%	7.0	2.7%	37%	36%	-12.6%	AA
JHX	James Hardie Industries	Materials	\$33.49	8%	16.1	0.1%	39%	40%	-10.3%	AA
GMG	Goodman Group	Real Estate	\$19.31	16%	20.6	1.6%	10%	10%	10.7%	AA
ORG	Origin Energy	Utilities	\$8.34	-3%	35.3	3.9%	7%	4%	89.8%	A

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 30 April 2023. ESG is environmental, social and corporate governance.

Trade opportunities

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

IGO Group (IGO)—Buy. IGO's 20% pull-back from its peak provides an attractive entry opportunity. Chile's recent moves to effectively nationalise its vast lithium industry should refocus investors' attention on the strategic importance of lithium and the attractive jurisdiction in which IGO operates.

Xero Limited (XRO)—Buy. XRO's software should be viewed largely as non-discretionary, and its Software as a Service (SaaS) delivery mode gives the company the ability to pass on price increases at regular intervals, with little to no churn. A 15% reduction in workforce (700 - 800) roles has been announced, which will aid profitability and free cash flow.

REA Group (REA)—Buy. REA is one of the highest quality companies globally. Although housing finance is already experiencing its biggest contraction since the GFC, history suggests that this should trough some two to three months after the end of the tightening cycle, which leads house prices by two to three months.

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	\$4.98	5.2%	13.5	1.88	30%	3.2%	71.1%	AA
MQG	Macquarie Group Ltd	Financials	\$182.60	10.2%	15.5	2.15	40%	3.8%	-0.7%	AA
WBC	Westpac Banking Corp	Financials	\$22.47	3.2%	10.7	1.12	100%	6.3%	3.7%	A
QBE	QBE Insurance Group Ltd	Financials	\$15.33	10.2%	9.2	1.68	10%	3.3%	13.2%	AA
COL	Coles Group Ltd	Cons Staples	\$18.20	1.6%	22.0	7.21	100%	3.6%	2.0%	AA
MTS	Metcash Ltd	Cons Staples	\$3.90	7.7%	13.0	3.49	100%	5.7%	-4.1%	AAA
SGR	Star Entertainment Grp	Cons Discret	\$1.27	13.2%	30.2	0.61	100%	0.0%	na	BBB
TAH	Tabcorp Holdings Ltd	Cons Discret	\$1.05	7.3%	26.9	0.90	100%	1.9%	10.0%	AA
TLS	Telstra Corp Ltd	Com. Services	\$4.37	8.6%	23.8	3.33	100%	3.9%	5.9%	AA
NEC	Nine Entertainment Co	Com. Services	\$2.06	23.3%	11.5	1.84	0%	5.7%	5.1%	AA
RMD	ResMed Inc	Health Care	\$33.71	13.1%	32.0	9.00	100%	0.5%	2.3%	A
PME	Pro Medicus Ltd	Health Care	\$61.44	-3.3%	89.2	54.88	100%	0.4%	22.9%	BBB
REP	RAM Essential Services	Real Estate	\$0.71	31.3%	12.0	1.3	0%	8.2%	1.7%	--
SGP	Stockland	Real Estate	\$4.45	-3.9%	14.3	1.0	0%	6.0%	-3.0%	AAA
IRE	IRESS Ltd	IT	\$10.30	4.8%	25.5	4.30	0%	4.2%	2.5%	AA
DBI	Dalrymple Bay Infra.	Industrials	\$2.55	7.5%	14.6	1.09	0%	8.1%	5.3%	--
ALX	Atlas Arteria Ltd	Industrials	\$6.54	-0.2%	14.2	0.97	0%	5.9%	6.3%	AA
ORG	Origin Energy Ltd	Utilities	\$8.34	-2.7%	18.6	1.66	100%	3.9%	2.1%	A
ALD	Ampol Ltd	Energy	\$29.93	22.5%	11.2	1.96	100%	6.2%	-0.9%	AA
BPT	Beach Energy	Energy	\$1.47	22.3%	6.3	na	100%	2.9%	88.1%	AA
BHP	BHP Group Ltd	Materials	\$44.40	10.4%	10.6	3.5	100%	4.7%	-9.6%	A
AMC	Amcor PLC	Materials	\$16.40	3.8%	13.4	na	0%	3.0%	2.7%	AA

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 30 April 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 5.4%, which is not far removed from the 6% yield that marked previous share price lows in 2017 and financial year 2018/19.

Beach Energy (BPT)—Buy. Based on the outlook for gas pricing, peak capex in financial year 2023/24, and production growth that is greater than 20%, Beach Energy is expected to generate around AUD 850 million in free cash flow from financial year 2025. This should lead to a free cash flow yield of almost 30% and a dividend yield of over 8%.

Ampol (ALD)—Buy. ALD is trading at 9.6x 2023 earnings, a 37% discount to its historical average of 15.3x and largely in line with global peers, which are at 9.7x. The business is now structurally better positioned and recent weakness presents a buying opportunity.

Recommendations: International equities—Best sector ideas

Objective of this list

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

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

Code	Company	Sector	Base CCY	Market price	Consensus upside (%)	P/E 1yr fwd (x)	Yield (%)	Market cap (USD bn)	MSCI ESG rating
LSEG LN	London Stock Exchange	Financials	GBP	8346.00	12.3	21.7	1.5	57,966	AA
LLOY LN	Lloyds Banking Group	Financials	GBP	48.20	35.9	6.2	6.4	39,951	AA
WFC US	Wells Fargo & Co	Financials	USD	39.75	23.1	8.1	3.8	149,587	BB
2318 HK	Ping An Insurance	Financials	HKD	56.70	26.4	5.8	5.0	134,898	A
939 HK	China Construction Bank	Financials	HKD	5.25	26.1	3.2	8.3	169,540	A
2330 TT	Taiwan Semiconductor	IT	TWD	502.00	27.5	12.8	2.5	423,326	AAA
MA US	Mastercard Inc	IT	USD	380.03	13.3	26.1	0.7	360,127	AA
ASML NA	ASML Holding	IT	EUR	573.50	25.1	25.4	1.3	255,175	AAA
GOOGL US	Alphabet Inc	Comm Services	USD	107.34	19.5	15.6	0.0	1,368,453	BBB
UMG NA	Universal Music Group	Comm Services	EUR	19.81	30.7	21.1	2.7	39,809	AA
DIS US	Walt Disney Co/The	Comm Services	USD	102.50	23.9	19.0	1.1	187,250	A
9988 HK	Alibaba Group Holding	Cons Discret	HKD	82.05	74.3	10.0	0.0	216,364	BBB
NKE US	NIKE Inc	Cons Discret	USD	126.72	7.4	31.5	1.1	194,767	BBB
SBUX US	Starbucks Corp	Cons Discret	USD	114.29	-2.0	28.0	2.0	131,353	A
ABNB US	Airbnb Inc	Cons Discret	USD	119.67	17.0	28.1	0.0	76,512	BB
RACE IM	Ferrari NV	Cons Discret	EUR	252.30	3.9	35.9	0.9	50,782	BB
BA US	Boeing Co/The	Industrials	USD	206.78	13.4	34.8	0.9	124,398	BBB
DSV DC	DSV A/S	Industrials	DKK	1270.50	9.7	20.5	0.6	41,200	AA
MSFT US	Microsoft Corp	IT	USD	307.26	7.5	28.0	0.9	2,284,628	AAA
ILMN US	Illumina Inc	Health Care	USD	205.56	15.4	67.7	0.0	32,485	AA
NOVOB DC	Novo Nordisk A/S	Health Care	DKK	1124.60	0.9	28.7	1.7	375,511	AAA
ISRG US	Intuitive Surgical Inc	Health Care	USD	301.22	1.9	47.9	0.0	105,547	A
EL US	Estee Lauder	Cons Staples	USD	246.72	17.6	33.8	1.1	88,133	A
COST US	Costco Wholesale Corp	Cons Staples	USD	503.22	7.6	32.2	0.8	223,170	A
288 HK	WH Group Ltd	Cons Staples	HKD	4.36	55.9	5.0	1.0	7,126	BBB
SHW US	Sherwin-Williams	Materials	USD	237.54	6.4	23.9	1.1	61,259	A
SHELL NA	Shell PLC	Energy	EUR	28.09	19.2	6.7	4.6	211,936	AA
EQIX US	Equinix Inc	Real Estate	USD	724.08	7.6	60.6	2.0	67,712	AA
ORSTED DC	Orsted AS	Utilities	DKK	606.60	18.9	28.3	2.5	37,759	AAA
Average Yield:							1.9%		

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 30 April 2023. ESG is environmental, social and corporate governance.

Recommendations: Thematic investing—Electric vehicles

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

Electric vehicles—Select exposures

Global penetration of electric vehicles is accelerating, offering investment opportunities across the value chain – from raw material commodities to auto component manufacturers and infrastructure providers.

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	IT	USD	\$194.99	-0.3	44.8	0.1	485,915	AAA
INTC US	Intel Corp	IT	USD	\$53.72	18.6	12.1	2.7	217,942	AA
AMD US	Advanced Micro Devices	IT	USD	\$106.19	3.6	35.5	0.0	128,805	BBB
MU US	Micron Technology Inc	IT	USD	\$77.58	49.9	6.6	0.4	87,336	BBB
NXPI US	NXP Semiconductors NV	IT	USD	\$206.39	7.7	19.4	1.2	56,912	BBB
IFX GY	Infineon Technologies	IT	EUR	\$32.14	22.8	23.8	1.0	49,788	AA
APTIV US	Aptiv PLC	Cons Discret	USD	\$166.85	-1.0	32.1	0.3	45,127	AA
FR FP	Valeo	Cons Discret	EUR	\$24.38	24.5	9.0	3.7	6,992	AAA
FCX US	Freeport-McMoRan Inc	Materials	USD	\$38.10	14.9	11.4	1.7	55,837	BB
IGO AU	IGO Ltd	Materials	AUD	\$9.51	-9.2	25.4	1.1	5,292	A
QCOM US	QUALCOMM Inc	IT	USD	\$149.80	16.2	16.3	1.9	168,974	BB
300750 CH	Contemporary Amperex Technology	Industrials	CNY	\$550.40	3.1	86.0	0.2	198,379	A
51910 KS	LG Chem Ltd	Materials	KRW	\$835,000	35.9	19.1	1.3	51,196	BB
AAPL US	Apple Inc	IT	USD	\$145.86	12.2	26.2	0.6	2,411,090	BBB
GOOG US	Alphabet Inc	Comm Services	USD	\$2,704.42	13.7	23.4	0.0	1,799,983	BBB
TSLA US	Tesla Inc	Cons Discret	USD	\$687.20	-5.6	97.4	0.0	680,338	A
VOW GY	Volkswagen AG	Cons Discret	EUR	\$280.00	0.7	8.6	3.0	148,325	B
HON US	Honeywell International	Industrials	USD	\$233.79	3.9	25.4	1.7	161,408	AA
Average Yield:							1.9%		

Source: UBS Global Research, Bloomberg Analyst consensus and MSCI Research. Data as at 30 April 2023. ESG is environmental, social and corporate governance.

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