

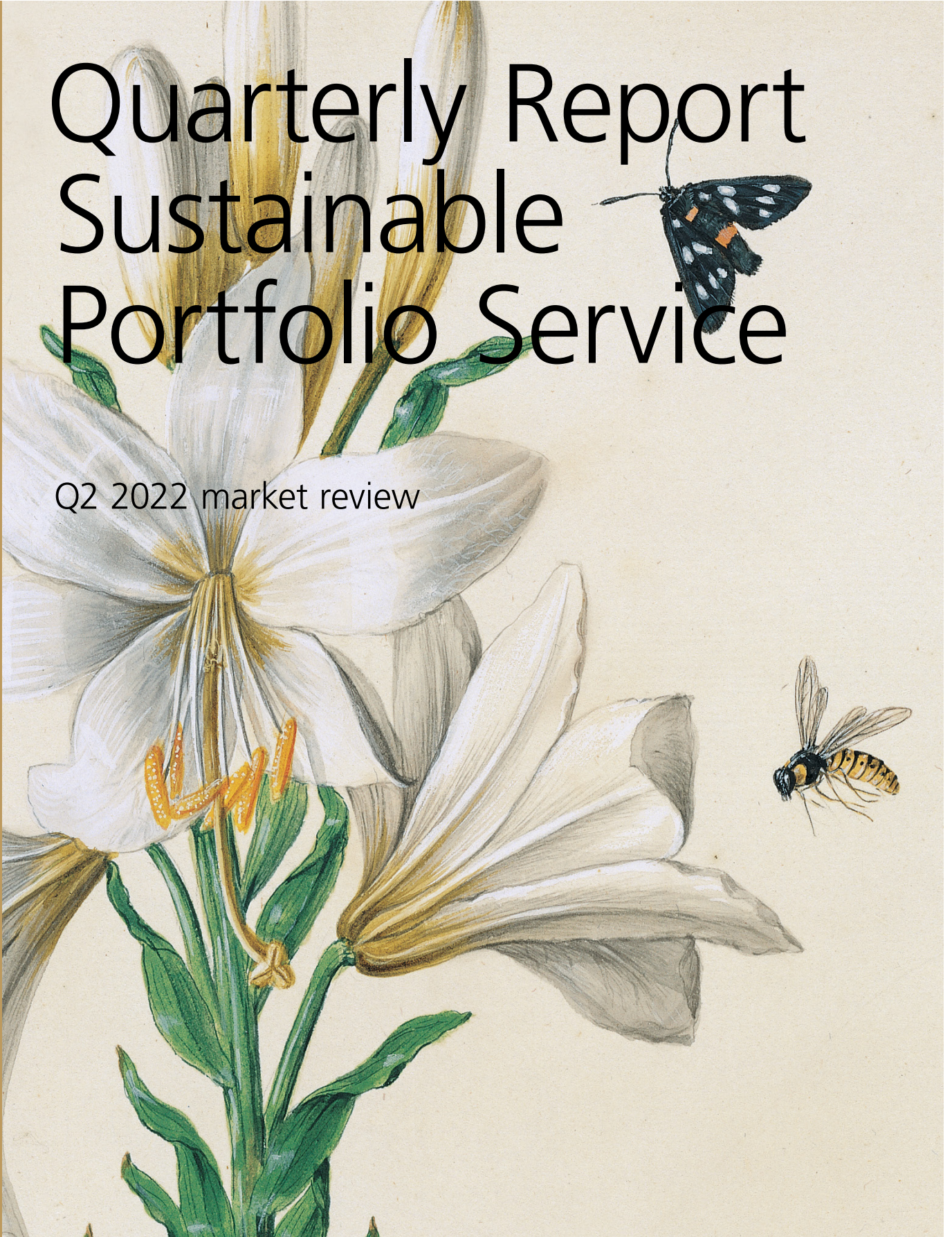


Wealth
Management

VALUES WORTH SHARING

Quarterly Report Sustainable Portfolio Service

Q2 2022 market review





A look inside the Princely Collections: the illustrations in this publication depict studies of natural objects by Franz Anton von Scheidel.

For more than 400 years, the Princes of Liechtenstein have been passionate art collectors. The Princely Collections include key works of European art stretching over five centuries and are now among the world's major private art collections. The notion of promoting fine arts for the general good enjoyed its greatest popularity during the Baroque period. The House of Liechtenstein has pursued this ideal consistently down the generations. We make deliberate use of the works of art in the Princely Collections to accompany what we do. For us, they embody those values that

form the basis for a successful partnership with our clients: a long-term focus, skill and reliability.

Illustrations: Bauer brothers, Hortus Botanicus, detail from "*Lilium candidum* L.", c. 1778.

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www.liechtensteincollections.at

Q2 2022 summary

Overview

As the global economy continues to grapple with the enduring effects of the pandemic, alongside the Ukraine war-related supply side shocks, investment markets declined over the second quarter of the year. In order to combat inflation across the world, central banks are now moving to increase interest rates and withdraw the supportive financial conditions, adding to market volatility

Over the course of the quarter, a number of sustainable investing themes continued to strengthen in importance to the global economy, particularly renewable energy investment and focus on food security. We have seen policy responses from a number of governments looking to tackle some of these issues, and significant financial commitments adding to the opportunity for companies operating in these spheres.

At a glance

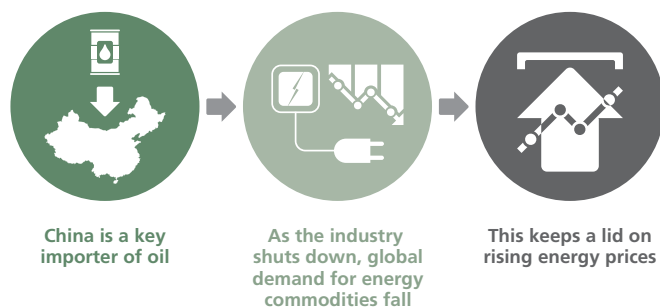
- Stubbornly high inflation and response from central banks continue to impact investment markets.
- Sustainable themes such as energy transition and food security continue to grow in importance.
- Regulators start to crack down on greenwashing and introduce new legislation for corporates.

Macro summary

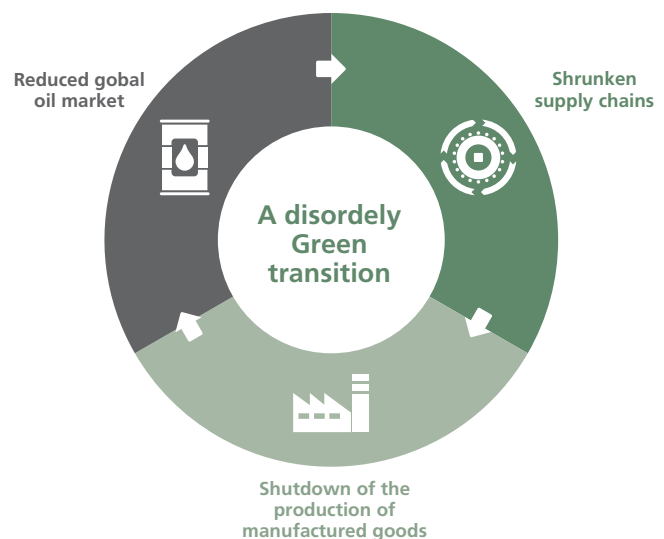
Turbulent market conditions

In the first part of 2022, the investment markets moved aggressively away from more innovative growth-focused businesses and repositioned into more short-term cash generators such as fossil fuel companies. Through the second quarter of the year, this continued with rotations often triggered by minimal catalysts, highlighting the indiscriminate and volatile short-term behaviour of markets and the fear on display.

Another force that influenced market moves over the quarter was China's continued use of zero-Covid policies with major economic hubs such as Shanghai and Beijing moving in and out of strict lockdowns. China is both a big energy importer and goods exporter which can have opposing effects on the global economy. On the one hand, as a key exporter of goods, including electronics and circuitry, as the country locks down key regions, this creates further supply shocks, potentially fuelling higher prices in these categories. On the other hand, China is a key importer of oil meaning that as industry shuts down, global demand for energy commodities falls and therefore helps keep a lid on rising energy prices. China is however one of the largest refiners of crude oil which further complicates the inflationary impacts at play, whilst at the same time producing more renewable energy than they can use.



It could be argued that the impact of a reduced global oil market, shrunken supply chains and shutdown of the production of manufactured goods signals the start of a disorderly green transition. It reminds all of us that a net-zero world is about more than cutting carbon emissions, but instead involves a total redesign of operating and production models worldwide and protecting not just our atmosphere but land and marine life systems. This will impact all markets. The shift away from traditional energy was always just the tip of the iceberg, but 2022 has demonstrated to consumers, businesses and governments that the impact will be felt across the board.



Although the macro environment remains uncertain and volatile in the short term, we see the recent falls in markets opening up attractive entry points for a number of companies held within sustainable portfolios. Going forward, growth will not reflect the easy path it has taken over the past decade, but that does not mean that every sector and geography will experience this. It will become more about the identification of high growth themes such as energy transition and food systems, themes that have compounded in importance due to recent geopolitical events.

Food security

Last quarter, the impact of the war in Ukraine on food inflation became evident, but we knew little about what the world was planning to do to tackle it. In the UK, the government has reiterated its food security strategy. It will now prioritise food security through a new initiative for farmers with funding aimed at boosting production and helping to protect consumers against future economic and geopolitical shocks.

In the UK, the UK has reiterated its food security strategy



The food security strategy will prioritise a new initiative for farmers



Funding will be aimed at boosting food production



And helping to protect consumers against future economic and geopolitical shock



The Department for Environment Food & Rural Affairs (Defra) has committed £270m to be invested in farming innovation. The aim is to boost domestic production and reduce imports of agricultural goods, thus supporting our view that countries will want to create shorter and more secure supply chains for key commodities. Farming technology also often has positive outcomes for the environment. Innovation such as precision farming and practices such as regenerative agriculture reduce the application of fertilisers on crops. This increases yield per unit of fertiliser used and minimises the spray on soil and leakage into water systems. We have seen companies exposed to this theme benefit since the start of the year. Meanwhile, the European Commission is also looking increasingly likely to push ahead with new regulation on the Sustainable Use of Plant Protection Products, including EU-wide targets to reduce by 50% the use and risk of chemical pesticides by 2030, further supporting the case for more targeted and precision agricultural techniques.



Precision Farming



Regenerative agriculture



Increased yield per unit of fertiliser used



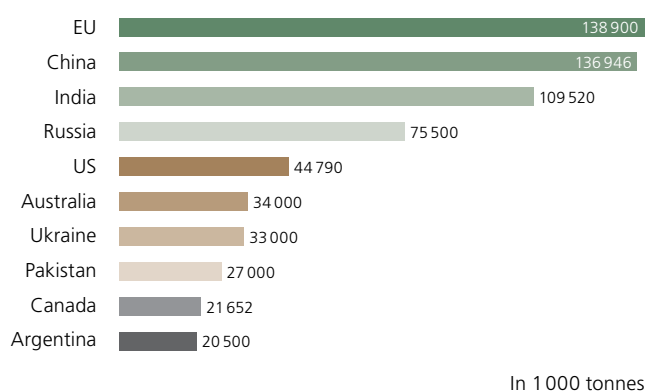
Reduced spray on soil



Minimised leakage into water systems

Russia and Ukraine represent a large part of the global agricultural market and much like oil and gas, the outbreak of war has led to focused efforts on reducing reliance on Russia. This will come in the form of boosting output and productivity gains through innovation in farming technology and techniques closer to home. The main goods that come from the region include grains and vegetable oils which are staples in many developing regions and the recent events are causing significant negative impacts in some of the poorest regions such as sub-Saharan Africa. Solving issues in these war-torn places is most likely achieved through government intervention and philanthropic activities. The LGT Venture Philanthropy foundation, which is funded via an allocation from LGT's annual dividends, has several agricultural investments in these regions including Hilltribe Organics which aims to improve agricultural practices and diminish reliance on importing food produce.

Leading wheat producers globally in 2021/22



Source: US Department of Agriculture: USDA Foreign Agricultural Service

Further away from home, the Chinese Communist Party is looking to boost grain production, promote rural revitalisation and safeguard China's food security, and the Indian Government's Procurement & Distribution System has identified the depletion of groundwater as a key risk to their food security. India is now looking at how innovation around irrigation and the use of groundwater, facilitated through subsidised electricity, can help to create greater food security.

Companies such as Deere & Co, Mahindra & Mahindra, and Bucher Industries that are held in sustainable portfolios are tied into this theme via the production of agricultural machinery. This can help facilitate more effective land management, higher productivity, and therefore higher crop yields. As the global population continues to grow and demand for food and water increases, we need to innovate new ways of meeting global nutritional demands whilst simultaneously preserving our stretched water resources. Modern solutions which reduce water usage, increase crop yield, reduce the use of fertilisers and pesticides, and reduce food miles will be the ultimate goal of most governments in the wake of the war in Ukraine.

An emerging theme, which is still currently at an early stage but growing at pace, is vertical farming. The potential environmental impacts of vertical farming are significant. EIT Food, the world's largest food innovation community, estimates that vertical farms use 90% less water, increase crop yields, use little or no fertilisers and reduce CO₂ emissions.¹ On the LGT Wealth Management sustainable investing team, we are constantly looking for emerging themes and technologies that will help us achieve our sustainability goals and we will also look to gain exposure where the investments are coupled with strong financial prospects.

1. www.eitfood.eu/blog/is-vertical-farming-really-sustainable

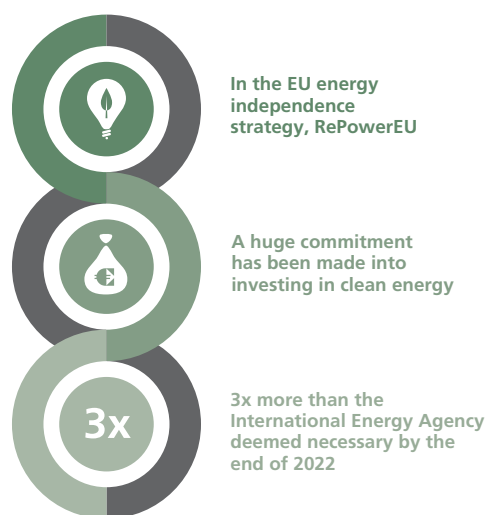
An unfortunate inflection point

Over the past few years, we have seen a rapid acceleration in the transition path of the global economy. The drop in energy demand during the peak of the Coronavirus pandemic highlighted the impact of human activities on the environment and led to increased awareness from individuals and governments. The 26th Conference of the Parties (COP26) in Glasgow in 2021 drove further net-zero commitments which now cover the vast majority of global GDP, established an end to deforestation by 2030 and solidified a commitment to tackle methane emissions, which have a much more potent warming effect than carbon.

Although we've seen increases in climate innovation and investment over recent years, we still acknowledge that it is unlikely to be enough to ensure we limit global warming to 1.5 degrees Celsius versus pre-industrial levels.

The events which have unfolded in Ukraine highlight the importance of having reliable sources of energy to power our homes and facilitate our economic activity. The war in Ukraine may well be an unfortunate inflection point for the green transition, as much of the world looks to wean itself off Russian energy dependence. The sad reality is that seismic change seldom occurs without a shock to the system and the events in Ukraine demonstrate the risk of creating supply chains dependent on regions with large geopolitical risks. Global efforts around sustainable energy generation continue to ramp up with the latest being President Biden invoking the Defence Protection Act to waive tariffs on solar imports from Southeast Asia. These imports from areas such as Cambodia, Malaysia, Thailand, and Vietnam represent 85% of all solar capacity imported into the US last year, according to Rystad Energy. The

EU has also outlined in their energy independence strategy, REPowerEU, their plans to triple the amount of investment into clean energy that the International Energy Agency deemed necessary by the end of 2022. This marks a huge acceleration of near-term investment into a core theme within the sustainable portfolios with a long runway for future growth.



Source: European Commission

This has come at a vital time as several studies have shown that limiting global warming to 1.5 degrees is drifting further out of sight, climate change mitigation is unlikely to be enough and climate change reversal will also be a necessary measure to avoid the worst impacts. Although this currently represents less of an investible option within portfolios, the recent deal LGT signed with Climeworks to extract carbon from the atmosphere as part of the firm's net-zero commitment by 2030, represents necessary action by industry to not only cut today's emissions but negate the impact of the greenhouse gases we have emitted.

Regulation afoot

The US's Security and Exchange Commission (SEC) is now stepping up its requirements around sustainability and climate change for listed businesses. The new climate risk rule requires publicly traded companies to report on climate-related risks material enough to impact their operations and financial position with the aim of producing consistent and comparable information for investors. The SEC is also cracking down on misleading ESG investment claims by product providers and therefore having a robust process to identify authentic and truly integrated ESG analysis will put the sustainable portfolios in good stead for the current regulatory developments.

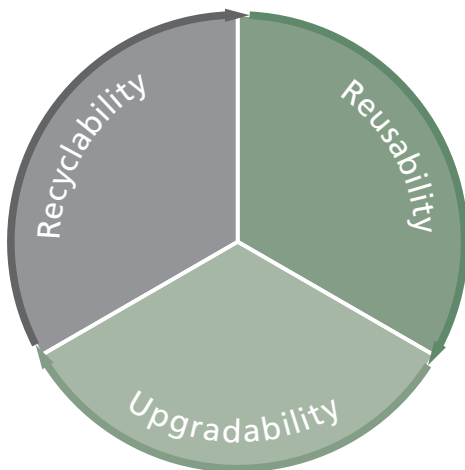
In the EU, the European Commission has recently announced the Circular Economy Package which outlines their latest wave of sustainable legislation. A key part of this is the EU Sustainable Package Initiative which will include regulation around Ecodesign requirements for packaging including recyclability, reusability, and upgradability information.

If brought in, these products may also need digital passports which publicly detail the supply chain sustainability of products and provide details around the amount of unsold consumer goods the company dispose of. The EU's consumer law may also force companies to disclose durability and repairability information, planned obsolescence and will also look to clamp down on greenwashing. Again, this change to the regulatory environment is now forcing the hand of businesses who have up until now given little or no consideration to sustainability and those that are not currently embarking on sustainable initiatives may incur significant transition costs over the coming years and decades.

One of the core tenets of a truly sustainable process is the idea of futureproofing investments and being aware and ahead of the regulatory curve. This is essential in mitigating and avoiding value destruction relating to unsustainable activities.

EU Sustainable package initiative

Regulation around Ecodesign requirements for packaging includes:



Performance review

Over the second quarter of the year markets continued to decline and this has impacted the performance of sustainable portfolios. Early in March, markets rallied upon signals of inflation potentially peaking but as real time data on activity, inflation and consumer sentiment has come through, markets retreated further, finishing the quarter lower than where they started. As a result of the risks to global growth, the longer-term growth focused companies we primarily look to invest in within sustainable portfolios have fallen in value. The market is now willing to pay for less future growth today than six months ago, and this has been triggered by the ongoing risks and uncertainty around markets. Despite this, corporate earnings have remained broadly positive and given the low relative debt profile of the sustainable portfolios, this should provide greater resilience as interest rates, and thus debt servicing as costs, increase. Although we continue to believe that long-term growth businesses will be the key driver of performance over the medium to longer term, we do acknowledge the benefits of holding some value-orientated names in the portfolios to provide greater ballast during these difficult times.

One boost for performance to UK investors this quarter has been the weakness of the pound. We have for some time been warning on the risks connected to investing in the UK market due to the unique set of risks which include Brexit and now the cost-of-living crisis. This has resulted in sterling devaluing significantly against most other major currencies, including the US dollar. This effectively increases the value of overseas earnings when converted back to sterling and therefore represents a gain to sterling denominated portfolios.

Although headline performance of the portfolios is down, there are several positive returning companies during the quarter, with many of them tied into the renewable energy value chain. Boralex, a developer and operator of renewable energy assets, is one business that has generated strong returns despite the recent market headwinds because of its strong position financially as well as within the energy transition. Another core exposure within portfolios, that is often seen as more defensive, is our exposure to the healthcare sector. Naturally, healthcare is a service that is essential and required regardless of economic conditions and although it will not be insulated from market moves, the revenues should prove to be more defensive than other more cyclical sectors. Healthcare therefore remains a core exposure within sustainable portfolios both due to the attractive growth story and the significant environmental and social impact generation.

Markets are infrequently linear and in the face of heightened volatility it is positive to see that the companies and themes the portfolios are investing in continue to see accelerated growth prospects and appealing valuations. When markets fall, it can be tempting to deviate from an investment thesis or process. However, we believe having a focus for high-quality, growth focused businesses will provide clients with strong investment returns over the longer term. We continue to believe that allocating capital to tomorrow's winners should offer attractive returns over the longer term and reviewing such factors in the eye of a storm is likely to lead to adverse outcomes.

Company in focus

Boralex (+7.09% over the quarter)

Held in Janus Henderson Global Sustainable Equity

- A developer and operator of renewable energy assets.
- The company specialises in wind, solar, hydroelectricity and energy storage.
- Over the quarter, Boralex has generated strong returns despite the recent market headwinds because of its financial strength, as well as the company's position within the energy transition.

For further information please contact:

Esther Clark

+44 (0)20 3207 8007

esther.clark@lgt.com

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Investors should be aware that past performance is not an indication of future performance, the value of investments and the income derived from them may fluctuate and you may not receive back the amount you originally invested.

“Signs are now pointing to the beginning of a disorderly green transition, a trend we’ve long been positioning the portfolios to navigate.”

Phoebe Stone, Head of Sustainable Investing





Brothers Bauer, detail from "Carlina acaulis L.", c. 1777 © LIECHTENSTEIN. The Princely Collections, Vaduz-Vienna

LGT Wealth Management UK LLP
14 Cornhill, London EC3V 3NR
Phone +44(0)20 3207 8000
info-uk@lgt.com

www.lgtwm.com