



# UBS House View

Monthly Extended **February 2023**

Chief Investment Office GWM  
Investment Research

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To see our most recent forecasts, please refer to our publication called "Global forecasts "

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This document is a snapshot view. For all other forecasts and information, we advise you to check the Investment Views section in your E-Banking or in Quotes.

|           |   |    |
|-----------|---|----|
| Section 1 | <b>Macroeconomic outlook and views</b>                        | 2  |
|           | Section 1.1 Summary of financial markets and economic outlook | 3  |
|           | Section 1.2 Risk scenarios                                    | 7  |
|           | Section 1.3 Asset class preferences and themes                | 10 |
|           | Section 1.4 Regional views                                    | 17 |
| Section 2 | <b>Asset class views</b>                                      | 22 |
|           | Section 2.1 Summary of major asset classes                    | 23 |
|           | Section 2.2 Details per asset class                           | 32 |
| Section 3 | <b>Appendix</b>   | 55 |

Section 1

# Macroeconomic outlook and views

Section 1.1

# Summary of financial markets and economic outlook

# Financial market outlook

## Asset allocation

High inflation, rising interest rates, and slowing economic growth remain the biggest concerns. At the same time, economic and inflation data have been encouraging in recent weeks. Some parts of the market are likely to reach inflection points sooner than others, meaning dispersion in asset returns is likely to be elevated. We therefore think selectivity will be rewarded, and our positioning reflects that.

Within equities, we still prefer value and quality income versus growth. We also like emerging markets, China, Australia, and the UK. We also prefer high grade, investment grade, and emerging market bonds over high yield. We like broad commodities and oil. Regarding currencies, we like the Australian dollar and do not like the British pound. We keep a neutral stance on the Swiss franc, the euro, and the Japanese yen.

## Equities

Global equities have bounced back 15% over the last three months. Peaking inflation, falling bond yields, and an earlier-than-expected reopening in China have supported the rebound. Investors will be closely watching the coming earnings season.

In our global tactical asset allocation, we upgrade emerging market equities to most preferred. Earnings momentum and estimate revisions have bottomed in emerging markets relative to developed markets, and valuations look appealing even after the recent rally. We keep US equities as least preferred and the UK and Australia as most preferred. Across sectors, we upgrade consumer discretionary to neutral as it has significantly derated over the last 12 months and should benefit from lower inflation and China's reopening. We still like global energy, healthcare, and consumer staples, and stay least preferred on IT and industrials. Across styles, we prefer value and quality income to growth.

## Bonds

Despite their recent strong returns, the more defensive, higher-quality segments of fixed income remain appealing given the all-in yields on offer and as inflation risks transition to growth risks. We maintain a preference for high grade and investment grade bonds.

Tighter lending standards and slower economic growth suggest higher corporate default risk, while liquidity risk premiums are likely to rise over time as central banks continue to reduce the money supply. As a result, we see high yield spreads as being vulnerable relative to investment grade and high grade. We therefore have a least preferred stance on the asset class.

China's economic reopening has improved investor sentiment and should contribute to global growth. This, along with the recent downshift in US rate hikes, should directly and indirectly benefit emerging market bonds. Given the opportunities we now see in the asset class, we have upgraded emerging market bonds to most preferred.

## Foreign exchange

Support for the US dollar has evaporated as the Federal Reserve's rate hike campaign draws closer to an end. The strong equity market performance in Europe, China, and Japan in recent months has not helped the dollar, either. As a result, many investors who were highly exposed to the US after several years of USD strength and solid US equity gains had to reposition their exposure. We keep a neutral stance on the USD as we await a clearer view on the Fed's rate hike cycle.

We are moving the euro to neutral from least preferred. The European Central Bank has turned increasingly hawkish in response to inflation, which has proven stickier than policymakers thought a year ago. The general risk-on mood is also supporting Italian bonds, which are the Achilles' heel for European rate hikes. The ECB's opportunity to hike has therefore increased. Finally, China's reopening supports European equities as well, and with this, demand for euros.

We also change our most preferred view on the Swiss franc to neutral after its strong gains against the USD recently. Nevertheless, we believe the Swiss National Bank is committed to preserving CHF strength to limit imported inflation, and that the currency will be supported by safe-haven flows. In sum, we expect USDCHF to consolidate over the next couple of months. In 2H23, we expect USDCHF and EURCHF to follow the drop seen in their respective equilibrium values during 2022. With the CHF well bid during unexpected bouts of market uncertainty, the currency continues to offer an attractive risk-reward to investors, in our view.

# Financial market outlook

## Commodities

We are upgrading commodities to most preferred. With high-teen returns forecast for the asset class in 2023, we recommend taking on broad commodity exposure once again. Energy is likely to lead all other sectors in returns. We keep a neutral instance on gold.

Our positive view for 2023 is based on a robust economic recovery in China from the second quarter onwards, the start of a Fed rate-cutting cycle later in the year, and several unresolved supply-side issues that should keep market balances tight.

Roll gains and cash collateral returns provide a highly attractive carry that pays commodity investors for patience until the necessary macro and policy turning points arrive.

We reiterate the need for investors to manage commodity exposures actively.

# Global economic outlook – Summary

## Key points

- As inflation starts to moderate across the major industrial economies, real wage growth should recover from deeply negative levels. This will help offset signs of a slowdown in the use of savings and credit in support of consumer spending. However, pay bargaining power remains weak (as signaled by the failure of workers to maintain their standards of living). This suggests that nominal wages will fall, but more slowly than inflation drops.
- While companies have complained of labor market tightness, there is less evidence of this in the data—the rate of job hiring is at historically high levels. This suggests that there has been a fair amount of churn in labor markets (with the pandemic either encouraging or forcing people to change employer). One aspect of a high labor turnover is that it will temporarily depress productivity. As workers stop jumping from job to job, the productivity rate is likely to increase.
- Central banks' communication is likely to err on the hawkish side, but the rhetoric is likely to be more hawkish than reality. The record-breaking speed with which inflation has dropped in some sectors of the economy is a reminder of how unusual the situation has been in the past 18 months.

## CIO view (Probability: 50%\*)

### Declining inflation does less damage to consumers

- Inflation should continue to moderate across most major economies, although local peculiarities in the calculation of consumer prices will mean the decline is not necessarily smooth. Profit-led inflation could surprise with the speed of the decline—as this pricing power can correct more quickly than an inflation that has been spurred by higher labor costs. The decline in inflation is likely to focus market attention on the sustainability of consumer demand, and thus the resilience of economic activity.
- Lower-income consumers are more negatively affected by recent price increases. As turnover in the labor market slows, this group is also likely to experience more pressure on wages. This may result in a further increase in the number of people taking multiple jobs (increase labor supply, without increasing the labor force participation rate). Middle- and higher-income consumers are generally better positioned, and this may result in more resilience in spending from these groups.
- Central banks do not wish to encourage a market-led easing of financial conditions, and so are likely to maintain a fairly hawkish rhetoric. However, the trashing of forward guidance by the Fed and the ECB in 2022 means that market attention to central bank speak has perhaps declined.

## Positive scenario (Probability: 20%\*)

### More resilience from consumer demand

Consumer spending continues to rise as higher-income households' savings are put to work. Inflation is less damaging than headline numbers suggest, implying more spending firepower for middle-income households. New forms of employment, unreported in the traditional data, mean better household income than is officially recognized..

## Negative scenario (Probability: 30%\*)

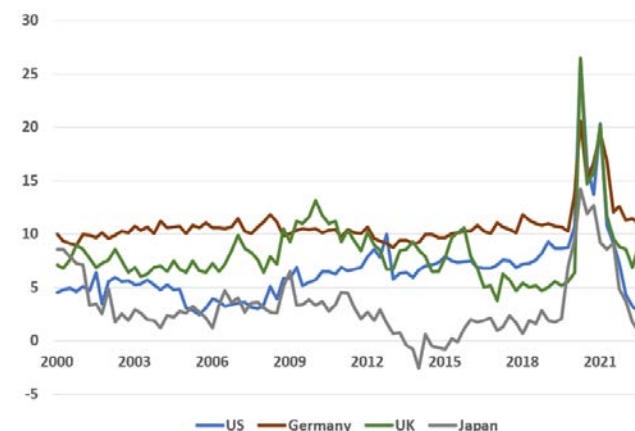
### Negative real wages drive negative consumption

Inflation is slower to fall, leading to a prolonged period of negative real wages and falling wage share of GDP. Fears over job security increase, leading to a desire to hold precautionary savings. Consumer spending starts to decline in line with real wages. Poor-quality data or policy error leads to a delayed central bank response to weaker demand.

\* Scenario probabilities are based on qualitative assessment.

## Saving less to spend more

Major economy savings rates, %



Source: Oxford Economic Forecasting as of 16 January 2023

## The speed of some inflation decline is unprecedented

Rate of change of US durable goods consumer prices, % y/y



Source: Haver, UBS, as of 16 January 2023

Section 1.2

# Risk scenarios



# Key scenarios – June 2023

|                                  | Upside  | Base case   | Downside   | Things to watch   |
|----------------------------------|---|---|--|---|
| <i>Probability</i>               | <b>25% (up from 20%)</b>  | <b>50%</b>  | <b>25% (down from 30%)</b>   |   |
| <i>Inflation / Central banks</i> | <ul style="list-style-type: none"> <li>Inflation falls faster than expected, allowing central banks to tilt toward rate cuts sooner.</li> </ul>   | <ul style="list-style-type: none"> <li>Inflation continues to slow in the US and in Europe, allowing the Fed, the ECB, the SNB, and the BoE to complete their hiking cycles in 1H23.</li> <li>As inflation comes closer to major central bank targets toward end-2023, interest rate cuts are considered later in the year.</li> </ul>  | <ul style="list-style-type: none"> <li>Inflation proves more persistent than central banks and markets expect, resulting in a protracted period of tighter monetary policy.</li> </ul>   | <ul style="list-style-type: none"> <li>US: CPI and PCE inflation</li> <li>US: ISM prices-paid subindex</li> <li>US: Average hourly earnings</li> <li>US: JOLTS openings and hires</li> <li>Eurozone: HICP inflation</li> <li>Global: Oil price</li> </ul>       |
| <i>Economic growth</i>           | <ul style="list-style-type: none"> <li>Economic activity reaccelerates as falling inflation boosts real household incomes.</li> <li>Financial conditions ease, lifting market valuations</li> <li>The outlook for corporate earnings improves.</li> </ul> | <ul style="list-style-type: none"> <li>The US economy slows further and enters a mild recession in 2H23, owing to the lagged impact of monetary policy.</li> <li>Economic activity in China reaccelerates from 2Q23 onwards.</li> <li>In the Eurozone and the UK, lower energy prices pose upside risk to growth. We still expect activity to remain below trend through the winter months, followed by a modest recovery.</li> </ul> | <ul style="list-style-type: none"> <li>Growth in Europe and the US falls more sharply than expected owing to tight monetary policy and a deepening cost-of-living crisis.</li> <li>Financial conditions tighten further, causing stress in the financial system.</li> <li>Central banks cut interest rates toward 2H23 as recession deepens and unemployment and corporate defaults rise. Economic recovery starts in 2024.</li> </ul> | <ul style="list-style-type: none"> <li>US, China: Manufacturing PMI</li> <li>US, China: Services PMI</li> <li>US, China: Industrial production</li> <li>US: Change in nonfarm payrolls</li> <li>China: Consumer mobility</li> <li>Europe: Gas prices</li> </ul> |
| <i>Geopolitics &amp; others</i>  | <ul style="list-style-type: none"> <li>The war in Ukraine deescalates, e.g., via a ceasefire agreement.</li> <li>A quicker-than-expected reacceleration in China boosts global demand.</li> </ul>   | <ul style="list-style-type: none"> <li>The war in Ukraine drags on and keeps markets volatile for the foreseeable future. A cessation of hostilities remains an unlikely outcome.</li> <li>Global financial conditions remain tight, increasing the market's vulnerability to negative surprises or external shocks.</li> </ul>   | <ul style="list-style-type: none"> <li>China takes a U-turn in its economic reopening as COVID cases soar.</li> <li>The war in Ukraine escalates or US-China tensions intensify.</li> <li><i>Tail risk:</i> The US debt ceiling is not raised by July or August, resulting in a US debt default and a global market sell-off.</li> </ul>   | <ul style="list-style-type: none"> <li>War in Ukraine: Territorial shifts</li> <li>War in Ukraine: Weapons supply</li> <li>War in Ukraine: Putin support polls</li> <li>Other: Financial conditions indexes</li> </ul>  |
| <i>Market path</i>               | <ul style="list-style-type: none"> <li>Risk assets are lifted by easing financial conditions and a brightening outlook for global growth.</li> </ul>  | <ul style="list-style-type: none"> <li>Markets remain volatile in 1H23 owing to uncertainty about inflation, monetary tightening, and economic growth.</li> <li>Risk assets start trending higher in 2H23 amid turning points in growth, inflation, and interest rates.</li> </ul>  | <ul style="list-style-type: none"> <li>Markets experience a severe downturn, with global equities posting double-digit losses.</li> <li>Credit spreads widen, while safe-haven assets benefit.</li> </ul>  |   |

# Asset class impact scenarios – June 2023

| Market targets (June '23)    | Spot*        | Upside             | Base Case    | Downside           |
|------------------------------|--------------|--------------------|--------------|--------------------|
| MSCI AC World                | 762          | 850                | 720          | 640                |
| S&P 500                      | 3,929        | 4,400              | 3,700        | 3,300              |
| Euro Stoxx 50                | 4,174        | 4,550              | 3,800        | 3,300              |
| MSCI China                   | 72           | 78                 | 72           | 55                 |
| US 10-year Treasury yield    | 3.37%        | 2.5%               | 3.5%         | 4.5%               |
| US 10-year breakeven yield   | 2.12%        | 2%                 | 2.25%        | 3%                 |
| US high yield spread**       | 425bps       | 300bps             | 550bps       | 850bps             |
| US IG spread**               | 110bps       | 60bps              | 120bps       | 200bps             |
| EURUSD                       | 1.08         | 1.10               | 1.07         | 1.00               |
| Commodities (CMCI Composite) | 1,915        | 2,200              | 2,100        | 1,600              |
| Gold                         | USD 1,904/oz | USD 2,000–2,100/oz | USD 1,800/oz | USD 1,500–1,600/oz |

\* Spot prices as of market close of 18 January 2023

\*\* During periods of market stress, credit bid-offer spreads tend to widen and result in larger ranges. Percentage changes refer to expected total return (t.r.) for the indicated spread levels.

Note: The asset class targets above refer to the respective macro scenarios. Individual asset prices can be influenced by factors not reflected in the macro scenarios,

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Section 1.3

# Asset class preferences and themes

# Global asset class preferences

|                  | Least preferred | Most preferred |
|------------------|-----------------|----------------|
| <b>Liquidity</b> |                 | =              |
| <b>Equities</b>  |                 | =              |
| Growth           | -               |                |
| Value            |                 | +              |
| Quality income   |                 | +              |
| Small caps       |                 | =              |
| United States    | -               |                |
| Eurozone         |                 | =              |
| Switzerland      |                 | =              |
| Emerging markets | =               | +              |
| Japan            |                 | =              |
| United Kingdom   |                 | +              |
| Australia        |                 | +              |
| <b>Sectors</b>   |                 |                |
| Consumer discr.  | -               | =              |
| Consumer staples |                 | +              |
| Energy           |                 | +              |
| Financials       |                 | =              |
| Healthcare       |                 | +              |
| Industrials      | -               |                |
| IT               | -               |                |
| Real estate      |                 | =              |
| Utilities        |                 | =              |

|                         | Least preferred | Most preferred |
|-------------------------|-----------------|----------------|
| <b>Bonds</b>            |                 | =              |
| High grade              |                 | +              |
| Investment grade        |                 | +              |
| High yield              | -               |                |
| Emerging markets        | =               | +              |
| <b>Commodities</b>      |                 | =              |
| Oil                     |                 | +              |
| Gold                    |                 | =              |
| <b>Foreign exchange</b> |                 |                |
| USD                     |                 | =              |
| EUR                     | -               | =              |
| JPY                     |                 | =              |
| GBP                     | -               |                |
| CHF                     |                 | =              |
| AUD                     |                 | +              |

Note: The global asset class preferences reflect the high-level UBS House View. The tactical asset allocation (TAA) positioning of our different investment strategies may differ from this view because our strategies seek specific investment objectives and can frequently adjust portfolio allocation to achieve them. Also, these preferences may vary in different regions for various reasons such as currency considerations.

## Least preferred

We expect this asset class to deliver the least attractive risk-adjusted returns over the next 12 months within our asset class universe.

## Most preferred

We expect this asset class to deliver the most attractive risk-adjusted returns over the next 12 months within our asset class universe.

# Asia ex-Japan asset class preferences

|                              | Least preferred | Most preferred |
|------------------------------|-----------------|----------------|
| <b>Equities</b>              |                 |                |
| Asia ex-Japan                |                 | =              |
| China                        |                 | +              |
| Hong Kong                    |                 | =              |
| India                        |                 | =              |
| Indonesia                    |                 | =              |
| South Korea                  |                 | =              |
| Malaysia                     | -               |                |
| Philippines                  |                 | +              |
| Singapore                    | -               |                |
| Taiwan                       |                 | =              |
| Thailand                     |                 | +              |
| <b>Bonds</b>                 |                 |                |
| Asian investment grade bonds |                 | =              |
| Asian high yield bonds       |                 | =              |
| Chinese government bonds     |                 | =              |

Note: The Asia ex-Japan asset class preferences reflect the high-level UBS House View. The TAA positioning of our different investment strategies may differ from this view because our strategies seek specific investment objectives and can frequently adjust portfolio allocation to achieve them.

#### Least preferred

We expect this asset class to deliver the least attractive risk-adjusted returns over the next 12 months within our asset class universe.

#### Most preferred

We expect this asset class to deliver the most attractive risk-adjusted returns over the next 12 months within our asset class universe.

# US asset class preferences

|                       | Least preferred | Most preferred |
|-----------------------|-----------------|----------------|
| <b>Cash</b>           |                 | =              |
| <b>Fixed Income</b>   |                 | =              |
| US Gov't FI           |                 | =              |
| US Gov't Short        |                 | =              |
| US Gov't Intermediate | -               |                |
| US Gov't Long         |                 | =              |
| TIPS                  |                 | =              |
| US Agency MBS         |                 | +              |
| US Municipal          |                 | =              |
| US IG Corp FI         |                 | +              |
| US HY Corp FI         | -               |                |
| Senior Loans          | -               |                |
| Preferreds            |                 | =              |
| CMBS                  |                 | =              |
| EM Hard Currency FI   |                 | = → +          |
| EM Local Currency FI  |                 | =              |

|                         | Least preferred | Most preferred |
|-------------------------|-----------------|----------------|
| <b>Equity</b>           |                 | =              |
| US Equity               | -               |                |
| US Large Cap Growth     | -               |                |
| US Large Cap Value      |                 | +              |
| US Mid Cap              |                 | =              |
| US Small Cap            |                 | =              |
| Int'l Developed Markets |                 | =              |
| UK                      |                 | +              |
| Eurozone                |                 | =              |
| Japan                   |                 | =              |
| Australia               |                 | +              |
| Emerging Markets        |                 | = → +          |
| <b>Other</b>            |                 |                |
| Commodities             |                 | = → +          |
| Gold                    |                 | =              |
| Oil                     |                 | +              |
| MLPs                    |                 | =              |
| US REITs                |                 | =              |

Note: The US asset class preferences reflect the high-level UBS House View. The TAA positioning of our different investment strategies may differ from this view because our strategies seek specific investment objectives and can frequently adjust portfolio allocation to achieve them.

## Least preferred

We expect this asset class to deliver the least attractive risk-adjusted returns over the next 12 months within our asset class universe.

## Most preferred

We expect this asset class to deliver the most attractive risk-adjusted returns over the next 12 months within our asset class universe.

# Global and regional sector preferences

| Sectors                | LP | Global | MP | LP | US    | MP | LP | Eurozone | MP |
|------------------------|----|--------|----|----|-------|----|----|----------|----|
| Communication services |    | =      |    |    | =     |    |    | -        |    |
| Consumer discretionary |    | ⊖ → =  |    |    | ⊖ → = |    |    | = → ⊕    |    |
| Consumer staples       |    |        | ⊕  |    |       | ⊕  |    |          | ⊕  |
| Energy                 |    |        | ⊕  |    |       | ⊕  |    | = ← ⊕    |    |
| Financials             |    | =      |    |    | -     |    |    | =        |    |
| Healthcare             |    |        | ⊕  |    |       | ⊕  |    | = ← ⊕    |    |
| Industrials            |    | -      |    |    | =     |    |    | -        |    |
| Information technology |    | -      |    |    | -     |    |    | -        |    |
| Materials              |    | =      |    |    | =     |    |    | =        |    |
| Real estate            |    | =      |    |    | =     |    |    |          | ⊕  |
| Utilities              |    | =      |    |    | =     |    |    | =        |    |

## Least preferred (LP)

We expect this sector to deliver the least attractive risk-adjusted returns over the next 12 months within our sector universe.

## Most preferred (MP)

We expect this sector to deliver the most attractive risk-adjusted returns over the next 12 months within our sector universe.

# Messages in focus including linked ideas

**Overall stance** The backdrop remains one of high inflation, rising interest rates, and slowing economic growth. At the same time, economic and inflation data have been encouraging in recent weeks. Some parts of the market are likely to reach inflection points sooner than others, meaning dispersion in asset returns is likely to be elevated. We therefore think selectivity will be rewarded, and our positioning reflects that: We incorporate a combination of defensive, value, and income opportunities that should outperform the market in a high-inflation, slowing-growth environment, alongside select cyclical sectors that should do well as and when markets start to anticipate inflection points. Diversification, including into alternative assets, remains a pillar of portfolio risk management in the current environment, and we continue to see long-term opportunity in the era of security and by investing sustainably.

| Scenarios | MIF name  | MIF description   | Linked ideas   | Source of funds   |
|-----------|---|---|--|---|
| Downside* | <b>Seek uncorrelated hedge fund strategies</b>  | Equities and bonds failed to act as counterweight to each other's performance in 2022, as concerns around monetary policy and inflation drove their correlation to a 23-year high. In spite of recent data showing falling inflation, fears about future inflation and monetary policy are likely to remain in focus in 2023, so uncorrelated hedge fund strategies such as macro, equity market neutral, and multi-strategy funds should once again play an important role in diversifying portfolios.   | - Macro<br>- Equity market neutral<br>- Multi-strategy   | - Excess bonds / equities<br>- Sell- / expensive-rated bonds<br>- Concentrated stocks   |
|           | <b>Protect with defensives and value</b>        | Slowing US growth, rising interest rates, and fears about inflation proving more persistent are likely to impact markets over the coming months. Defensive sectors such as consumer staples and healthcare should prove relatively insulated from a weakening economy, while value stocks tend to perform well when inflation is high.  | - Global healthcare and consumer staples<br>- Global value<br>- Global energy<br>- High-quality bonds<br>- CHF and JPY<br>- Capital protection structured investments  | - Excess US stocks<br>- Excess growth stocks<br>- Excess IT<br>- Least preferred stocks<br>- Limited upside list                                      |
|           | <b>Seek income opportunities</b>                | Interest rates and bond yields moved significantly higher in 2022, boosting the range of options for investors seeking income, and we see particular opportunity in investment grade bonds, resilient credits, emerging market credit, and quality income stocks. Market volatility itself can also offer investors a means of generating income. A slowing US economy means we are cautious on high yield credit.  | - Investment grade bonds<br>- Select short-duration bonds, resilient credit, sustainable bonds<br>- Quality income stocks<br>- Emerging market credit<br>- Select AT 1s<br>- Yield-generating structured investments | - Excess cash<br>- Limited upside list<br>- Least preferred stocks<br>- Sell- / expensive-rated bonds<br>- Excess senior loans<br>- Excess high yield |
| Base case | <b>Invest sustainably</b>                       | The long-term performance of sustainable investments remains strong on an absolute and relative basis, despite the underperformance in certain areas over the past year. Sustainability can be a key driver of corporate performance, and companies that manage their business, stakeholder, and environmental impact better should also be well positioned to deliver on financial results. As the past year has shown, investors need to pay particular attention to portfolio diversification by sector, style and asset class.  | - Sustainability-linked LTIs<br>- ESG equity strategies incl. engagement and improvers<br>- Thematic sustainable fixed income<br>- Sustainable asset allocations   | - Excess cash<br>- Excess IT<br>- Traditional counterparts  |
|           | <b>Position for the era of security</b>         | The government, business, and consumer response to US-China tensions and Russia's invasion of Ukraine demonstrate that we are entering an era of security, in which energy security, food security, and technological security will be increasingly prioritized, even if they come at the cost of efficiency. The era of security will drive winners and losers across the investment landscape.  | - Energy security (active commodity exposure, clean air and carbon reduction, energy efficiency, greentech)<br>- Food security (agricultural yield)<br>- Cybersecurity   | - Excess cash<br>- Excess IT<br>- Least preferred stocks<br>- Limited upside list   |
|           | <b>Seek value and growth in private markets</b> | Some private market funds are likely to cut net asset value estimates as a result of the public market correction in the past year. But putting fresh capital to work in private markets following declines in public market valuations has historically been a rewarding strategy. In the current environment, value-oriented strategies are becoming increasingly attractive, in our view.  | - Secondaries<br>- Distressed / restructuring debt<br>- Value-oriented buyouts<br>- Direct lending   | - Excess cash<br>- Excess equities<br>- Excess growth stocks  |
| Upside    | <b>Anticipate the inflections</b>               | In our base case, equity markets face a challenging backdrop in the months ahead. But we also believe 2023 will bring inflection points in inflation, monetary policy, and economic growth, which will eventually lead to a turning point for markets. Lower inflation data and China's reopening also mean that turning points may come earlier for individual parts of the market. Investors should therefore plan how to phase cash into markets; seek opportunities in commodities, emerging markets, and early-cycle markets like Germany; select stocks exposed to China's reopening; and position in currency structures to take advantage of the turn in the US dollar. | - Phasing strategies<br>- Emerging market equities<br>- Commodities<br>- Early-cycle markets (Germany)<br>- Consumer recovery<br>- China and China reopening opportunities<br>- Currency structures incl. AUD        | - Excess cash<br>- Excess US stocks<br>- Limited upside list<br>- Least preferred stocks  |

3L disclaimer: Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved. \*Investment ideas mapped against the downside scenario would perform well relative to other portfolio assets in a downside scenario, in our view. This doesn't exclude the possibility that, in absolute terms, individual ideas may perform better in central or upside scenarios than in the downside scenario. Please see important disclaimers and disclosures at the end of the document  
More information [here](#)



# Key investment ideas by asset class

|  | We like   | Source of funds  |
|--|---|--|
| <b>Equities</b>                          | <ul style="list-style-type: none"> <li>• Sectors: Energy, healthcare, consumer staples</li> <li>• Global value</li> <li>• Quality income</li> <li>• UK, Australia, China</li> <li>• Energy security (active commodity exposure, clean air and carbon reduction, energy efficiency, greentech)</li> <li>• Food security (agricultural yield)</li> <li>• Cybersecurity</li> <li>• Emerging market equities</li> <li>• ESG equity strategies incl. engagement and improvers</li> </ul> | Limited upside list, CIO least preferred stocks, excess growth stocks, concentrated stocks, excess IT, excess US stocks, excess cash |
| <b>Bonds</b>                             | <ul style="list-style-type: none"> <li>• Investment grade bonds</li> <li>• Select short-duration bonds, resilient credit, sustainable bonds</li> <li>• High-quality bonds</li> <li>• Emerging market credit</li> <li>• Select AT1s</li> <li>• Yield-generating structured investments</li> <li>• Thematic sustainable fixed income</li> </ul>   | Sell- / Expensive-rated bonds, excess senior loans, excess high yield, excess cash   |
| <b>Foreign exchange</b>                  | <ul style="list-style-type: none"> <li>• AUD</li> <li>• CHF and JPY as defensive currencies</li> </ul>  | GBP  |
| <b>Precious metals &amp; commodities</b> | <ul style="list-style-type: none"> <li>• Active commodity exposure</li> <li>• Oil</li> <li>• Commodities</li> </ul>   |  |
| <b>Hedge funds &amp; private markets</b> | <ul style="list-style-type: none"> <li>• Macro</li> <li>• Equity market neutral</li> <li>• Multi-strategy</li> <li>• Secondaries</li> <li>• Distressed / restructuring debt</li> <li>• Value-oriented buyouts</li> <li>• Direct lending</li> </ul>  | Excess cash, excess bonds, excess equities   |

Section 1.4

# Regional views

# US economy – Tighter policy poses risks to growth

## Key points

- Tighter monetary policy is weighing on economic activity.
- Inflation has peaked as core goods prices decline, but service prices continue to rise.
- A period of subtrend or negative growth is likely as the Fed tries to reestablish price stability.

## CIO view (Probability: 50%\*)

### Sub-trend growth as policy tightens

- Economic conditions are mixed, with some interest-rate-sensitive areas of the economy in recession. However, consumers continue to spend on services.
- The labor market remains very tight. While most indicators are off their peaks, job growth remains solid and the unemployment rate has fallen back to its pre-pandemic low of 3.5%.
- More households are starting to struggle as wage growth failed to keep up with inflation in 2022 and the government is providing less support. The household savings rate has been near record lows in recent months, and credit card balances have risen rapidly.
- High mortgage rates have pushed the housing market into recession. However, there is still a fundamental shortage of housing and rents are higher than normal, encouraging construction of multifamily housing.
- Inflation has peaked, helped by lower energy prices, softer demand for goods, and progress on supply chain bottlenecks. Service prices are likely to continue rising at a robust pace in the month ahead, boosted by rents, which are a lagging indicator in the official CPI data, as well as strong demand for leisure travel.
- The Fed raised rates by 425bps in 2022. We expect it to hike an additional 50bps by the end of 1Q23 before it ends the rate hiking cycle. The Fed will also continue quantitative tightening.
- A period of subtrend or negative growth will likely be necessary to bring inflation down to a level acceptable to the Fed. Rate cuts could start by late 2023 if inflation slows sufficiently, especially if the economy enters a recession.

## Positive scenario (Probability: 20%\*)

### Bottlenecks resolved quickly

More workers return to the labor market, helping to ease labor shortages. Supply-side bottlenecks are resolved quickly, allowing inflation to slow as output increases.

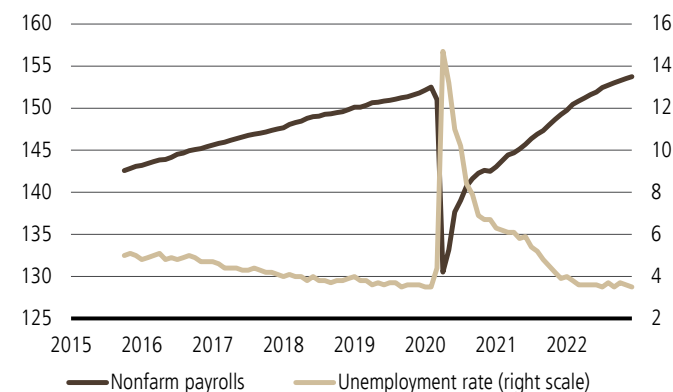
## Negative scenario (Probability: 30%\*)

### Fed hikes trigger slump

Persistent shortages limit economic activity while adding to inflationary pressure, forcing the Fed to maintain a restrictive policy stance despite disappointing growth, eventually leading to a more severe recession and higher unemployment.

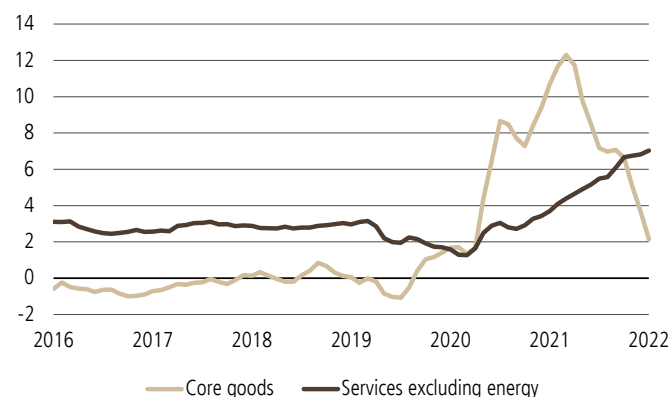
\* Scenario probabilities are based on qualitative assessment.

Strong labor market encourages Fed to keep hiking  
Nonfarm payrolls in millions, unemployment rate in %



Source: Bloomberg, UBS, as of 17 January 2023

Inflation appears to have peaked, goods prices falling  
CPI and core CPI, year-over-year change in %



Source: Bloomberg, UBS, as of 17 January 2023

# Eurozone economy – Set to benefit from lower gas prices

## Key points

- The war in Ukraine and high energy, food, and raw material prices continue to take their toll on the Eurozone economy. Nevertheless, it is proving more resilient than feared, helped by a warm winter and a fall in energy prices
- Sentiment indicators still point to a sharp slowdown in manufacturing, while the outlook for services has improved. Below-trend growth is still likely.
- Inflation concerns remain top of mind among ECB policymakers. We expect the deposit rate to reach 3% by March.

## CIO view (Probability: 60%\*)

### Mild recession

- The Eurozone economy is slowing, but consumer and business confidence is improving. Industrial production and retail spending have stabilized, and the economy is proving more resilient than feared. Fiscal support aimed at cushioning the economic shock has helped, but a mild winter and falling gas prices have also changed the Eurozone outlook.
- Europe continues to reduce its dependence on Russian hydrocarbons, with plans to cut down consumption across the bloc. Less consumption means that, despite supply disruptions, gas storage levels are exceeding expectations. The threat of supply disruptions from Russia remains, but this year's storage refill will be less challenging.
- We think inflation will continue to trump growth concerns for the ECB, with 50bps of rate hikes likely at its February and March meetings, taking the deposit rate to 3%. The recently announced Transmission Protection Instrument (TPI) has helped ease near-term concerns about peripheral bond spreads, which have fallen further.
- Wage negotiations are key. Although wages are rising, settlements for the most part are still resulting in negative real wage gains. This suggests that the bargaining position of workers is not high despite falling unemployment. The threat of a wage price spiral is low. Inflation is set to fall in 2023 as base effects from energy prices fade and demand falls.

## Positive scenario (Probability: 10%\*)

### Better-than-expected growth

Economic activity normalizes sooner, supported by a rapid normalization in energy prices. Economic growth in Asia and the US accelerates, boosting demand for Eurozone exports. Progress is made on trade talks with the US, and outstanding Brexit issues with the UK are resolved. Global energy prices subside, and supplies normalize.

## Negative scenario (Probability: 30%\*)

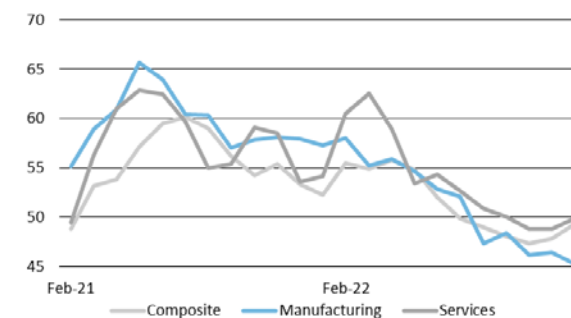
### Deep downturn

The ECB overtightens monetary policy by placing too much weight on near-term inflation. Geopolitical tensions keep energy prices elevated and gas supplies restricted. Combining these with supply chain disruptions, labor market frictions, and the threat of rationing energy supplies, a deeper recession emerges. Fiscal policy is too slow to respond or is tightened too early.

\* Scenario probabilities are based on qualitative assessment.

Business surveys show improvement in services at the end of 2022

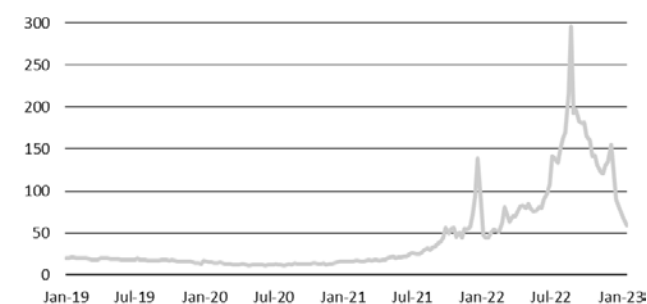
Eurozone Headline PMIs



Source: Haver Analytics, UBS, as of January 2023

Natural gas prices have fallen 80% from their peak

TTF, gas price MWh



Source: Refinitiv, UBS, as of 16 January 2023

# Swiss economy – Better than feared

## Key points

- Against the backdrop of elevated inflation, high energy prices, and weak momentum in the Eurozone, we expect Swiss GDP growth to slow this winter. However, as an energy shortage has become unlikely, a recession should be averted.
- Inflation averaged 2.8% both in December and in 2022. While administered prices have kept inflation high in January, we expect Swiss inflation to find its way back to the SNB's target range by mid-2023.
- In the short term, the SNB remains focused on inflation. We expect it to raise policy rates to 1.5% in March then keep rates unchanged as inflation pressures subside.

## CIO view (Probability: 70%\*)

### Weakness but no recession

- In 3Q22, the Swiss economy rose 0.2% in real and seasonally adjusted terms compared to the previous quarter, and 0.5% compared to the same period the previous year. This was partly attributable to a catch-up in consumer spending and increased investment in equipment.
- Although still in expansion area, the PMI points to a weakening in manufacturing and services and ultimately weaker economic growth. A slowdown in Switzerland seems inevitable due to the weak momentum in the Eurozone and inflation weighing on households' real incomes. However, the outlook has improved recently thanks to lower energy prices. We expect GDP growth of 2% in 2022 and 0.4% in 2023.
- Swiss inflation declined to 2.8% in December. Given the increase in administered prices, inflation is likely to stay high in January before declining over the course of the year. We expect an annual inflation rate of 2.1% for 2023.
- In the short term, the SNB remains focused on inflation. We expect it to raise policy rates to 1.5% in March then keep rates unchanged as inflation pressures subside. We do not see any interest rate cuts before 2024.
- Ten-year Swiss interest rates were on a roller-coaster ride in 2022 and are likely to fluctuate strongly as well in the months ahead. In line with our forecasts, markets expect an SNB policy rate of around 1.5% over the next 12 months. As a result, long-term interest rates are likely to trend sideways in the coming quarters.

## Positive scenario (Probability: 20%\*)

### Better global growth momentum

An easing of supply chains and energy issues reduce inflationary pressures and boost global demand. Switzerland benefits from the stronger global backdrop and a weakening of the safe-haven Swiss franc.

## Negative scenario (Probability: 10%\*)

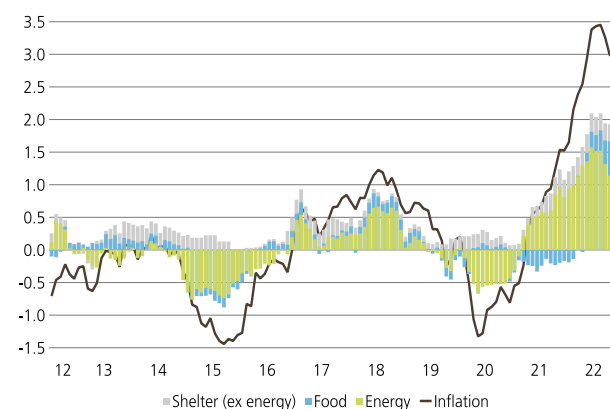
### Eurozone slump pushes Switzerland into a recession

For Switzerland to dive into a recession multiple preconditions must be met: elevated energy prices and restricted gas supplies; a deep Eurozone recession and a strong appreciation of the Swiss franc.

\*Scenario probabilities are based on a qualitative assessment.

## Inflation is on a declining trend

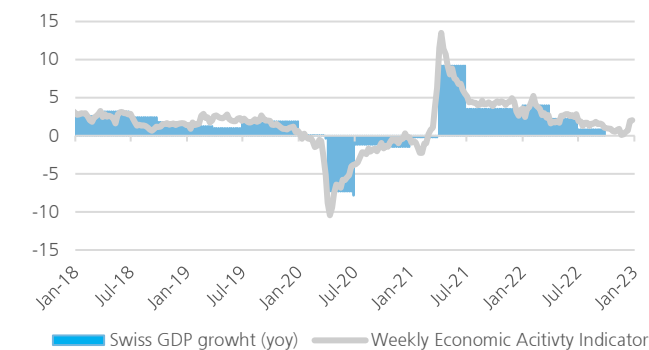
Year-over-year change in Swiss CPI and contribution of selected components, in %



Source: Macrobond, UBS, as of January 2023

## High-frequency data have risen recently

Weekly economic activity indicator and monthly Swiss GDP growth (year-over-year), in %



Source: Macrobond, UBS, as of January 2023

# Chinese economy – Recovering on reopening tailwinds

## Key points

- Expect 2023 GDP growth to reach ~5% y/y led by consumption and investment
- Fiscal and monetary support to continue
- Faster-than-expected reopening underway

## CIO view (Probability: 70%\*)

- **2023 growth to rebound to ~5% y/y.** Three main concerns on Chinese economy – COVID lockdowns, property woes and geopolitical risks have been alleviated in the recent months. Recovering consumption, steady infrastructure investment, and resilient manufacturing would be the main drivers of 2023 economic recovery.
- **CPI inflation to pick up mildly.** Expect 2023 CPI inflation to pick up on reopening and low base, but to stay below 3% comparing to 2% in 2022. PPI deflation may continue in 1Q23 on base effects and slowing global demand.
- **Policy support continues.** Pro-growth stance was affirmed at Central Economic Work Conference. Fiscal policy will stay proactive. We expect special LG bond quota similar to last year's size and frontloading to support infrastructure. Monetary policy is to stay supportive with expectation of another 1-2 RRR cuts and continued credit easing.
- **Faster-than-expected reopening underway.** Reopening has been extended to international travel by removing quarantine requirements for inbound travelers since 8 January. We estimate first wave of infections to peak in January. Consumption could pick up in February and rebound strongly from 2Q.

## Stabilizing on an upward trend

## Positive scenario (Probability: 20%\*)

Economy recovers faster with stronger policy support and smooth reopening. The US economy manages a soft landing with easing inflation. The US applies more predictable and less adversarial moves toward China.

## Negative scenario (Probability: 10%\*)

Continued slump in property activities without narrowing decline by 1H23. The reopening path is bumpier than expected. The US and EU economies dip into a deeper recession.

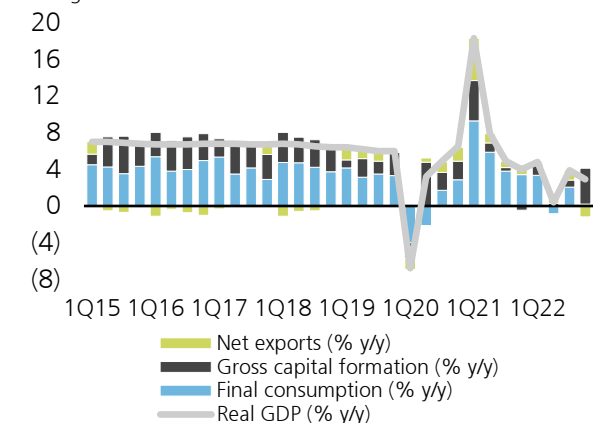
\* Scenario probabilities are based on qualitative assessment.

## Strong rebound

## Growth decelerates sharply

2023 growth likely to rebound to ~5% y/y

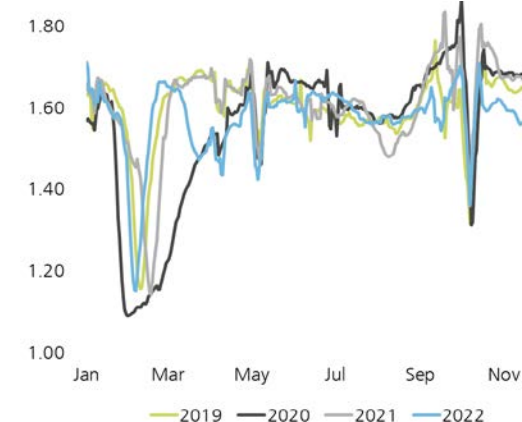
GDP growth breakdown



Source: UBS, as of January 2023

Mobility started picking up in major cities from late Dec

7DMA, traffic congestion index in 19 major industrial cities



Source: WIND, UBS, as of January 2023

Section 2

# Asset class views

Section 2.1

# Summary of major asset classes



# Equities

## Central scenario

**MSCI AC World June 2023 target: 720**

In our global tactical asset allocation, we keep equity at neutral but upgrade emerging markets to most preferred. China's idiosyncratic recovery and a softer dollar should now support emerging market equity (EM) performance versus developed countries (DM). Based on price to book, EM still trade at more than 40% discount to DM. Within equities as a whole, we keep UK and Australia at most preferred and US at least preferred. Across sectors, we upgrade consumer discretionary to neutral which has significantly de-rated over the last 12 months and should benefit from a China reopening and lower inflation. We still like global energy, health care and consumer staples, and stay least preferred on information technology and industrials. Across styles, we prefer value and quality income to growth.

Risks around EPS are skewed to the downside. We expect global earnings growth to turn negative in 2023 (-3% vs. +2% consensus forecast), and we see US earnings contracting 4.4% (consensus still expects 3% growth). Earnings momentum continues to deteriorate, and earnings downgrades are outpacing upgrades. With these indicators in negative territory, we expect equity volatility to stay high.

We believe valuations remain unattractive versus high grade bonds. The MSCI AC World P/E multiple has corrected from a high of about 20x since the pandemic to 15x today, slightly above the long-term average of 14.5x. The valuation of the MSCI US index is above the long-term average, at 17.7x, a 15% premium to the global benchmark. When compared to high grade bonds, global equities are not attractive yet; the equity risk premium is falling and the cost of equity is consistent with future negative returns versus high-quality sovereign bonds.

We upgrade emerging markets equity to most preferred. China's idiosyncratic recovery and a softer dollar should now support emerging market equity (EM) performance versus developed countries (DM). Earnings momentum and earnings revisions are still negative in absolute terms but bottoming versus developed countries. Based on price to book, EM still trade at more than 40% discount to DM (12-month forward price-to-book value at 1.5x versus 2.5x for DM) which is consistent with positive performance in the coming 12 months.

US equities are rated as least preferred. US stocks have performed negatively in 2022. However, the market performance can be mostly explained by the change in discount rates. Real yields have soared over the past months. Changes in real yields have largely reflected the shift in Federal Reserve policy rather than growth expectations. The S&P 500 forward P/E multiple has collapsed from 21x at the start of 2022 when real rates were negative to 17.7x today when real rates are positive. However, the relationship has dislocated; equity valuations have declined from their peak but still trade above the level implied by the recent relationship with real rates.

We are keeping the UK and Australia as most preferred. We believe UK's valuation is extremely attractive; based on 12-month forward P/E, MSCI UK is trading at a 34% discount to MSCI AC World. With the Brent expected to trade above 100 USD/b and inflation peaking in UK, we expect multiples to expand this year offsetting the risks on the earnings side. Australia also remains appealing as high commodity prices should support relative stock performance in the months to come, in addition the China reopening should support earnings growth versus other regions.

## CIO themes

### 23 for '23

2023 should bring turning points for inflation, interest rates and economic growth while financial markets deal with a complex geopolitical backdrop. 23 for '23 is a bottom-up focused global stock selection that aims to reflect our highest conviction stock ideas exploiting these inflections, while incorporating dynamically tactical ideas.

### Sustainable investing, global leaders

The wealth of sustainability-related information available to investors is often overlooked by the mainstream investment community, in our view. Integrating such factors, along with traditional financial parameters, into security selection can help identify investment opportunities and risks. Our global sustainable investing (SI) equity preference list features 20–25 stocks with risk-return profiles we consider attractive and that exhibit better-than-average UBS SI scores.

### Global quality income

Three reasons to invest in the Global Quality Income theme: 1) It benefits during an economic slowdown; 2) it outperforms in market sell-offs and when volatility rises; and 3) dividends are safer than earnings while balance sheets remain healthy and capital returns well covered.

## Sector preferences

**Most preferred:** Energy, consumer staples, healthcare

**Least preferred:** Industrials, IT

# Equities

Energy, health care and consumer staples remain our preferred sectors. The energy sector had a great performance last year, but we still see some upside versus global equity in the coming months. First, we expect the sector to extend share buybacks and dividends; second, while earnings growth and net earnings revisions should deteriorate on lower oil prices, expectations for a higher Brent oil price in 2023 should avert an earnings collapse (consensus is far too negative on 2023 earnings growth forecasts); and 3) valuations look extremely appealing (the sector is trading at 7.8x 12-month forward earnings, a 50% discount to the MSCI AC World index). We also like consumer staples: relative earnings momentum is positive and strengthening, and while absolute valuation appears expensive, it is in line with historical averages. Consumer staples tend to outperform global equity when the ISM falls. We also keep health care at most preferred: the sector is no longer attractively valued but relative earnings momentum remains positively oriented. The depreciation of the dollar represents a risk for non-US names.

We upgrade consumer discretionary to neutral. Improving real incomes will likely allow spending to remain resilient despite the savings rate needing to rise. Moreover, consumer confidence is rebounding from extremely low levels. Valuations have improved over the last 12 months (the sector was trading at 24x at the beginning of 2022 and now at 18x) and now the sector trades at 5% discount versus the 10-year average. Consumer cyclical companies should benefit from China reopening and lower inflation.

We keep information technology and industrials as least preferred. We keep industrials as least preferred as we think slowing macroeconomic growth should weigh on the sector's relative performance. Global tech stocks have underperformed global equities since the beginning of 2022. In this environment of higher rates and slowing demand, we expect IT to continue to underperform value. The valuation gap between IT and the benchmark remains high, while earnings downgrades in the tech sector can be expected. Tense US-China relations and the race for global tech supremacy are other risks facing certain tech industries.

We continue to prefer value and quality income to growth stocks. In an environment of rising bond yields and high inflation, we maintain our preference for value and defensive high-quality stocks. Growth names are still expensive in relative terms and negatively correlated to the rise in real rates.

# Equities

## Upside scenario

**MSCI AC World June 2023 target: 850**

**Inflation cools quickly and US and Europe economy do not enter into recession:** Inflationary pressures quickly dissipate, and the Fed and other central banks become more accommodative.

**Geopolitical de-escalation:** A ceasefire ends the war in Ukraine and reduces the risk of further sanctions against Russian commodities.

**Economic growth re-accelerates:** A reopening in China and solid economic growth in the US drive an even sharper improvement in corporate profits in 2023.

**Economic expansion lasts longer:** A reopening in China and solid economic growth in the US drive an even sharper improvement in corporate profits in 2022 and beyond.

## Downside scenario

**MSCI AC World June 2023 target: 640**

**Inflation runs hot:** Inflation surprises again on the upside and central banks are forced to hike more than expected.

**Geopolitical escalation:** The Russia-Ukraine war proves more protracted, increasing the risk of a prolonged and widespread disruption to commodity supplies, either as a result of the war directly or due to stronger sanctions aimed at immediately cutting off Russian energy exports. In this scenario, oil could hit USD 150/bbl and gas may need to be rationed, particularly in Europe.

**Coronavirus:** Lockdowns are reimposed in China, delaying a return to normal economic activity.

# Bonds

Bond market volatility has moderated of late as the inflation outlook has cooled and expectations grow that central banks are close to the end of their rate hiking cycles. As a consequence investor demand for fixed income exposure has increased. All-in yields look appealing, particularly relative to opportunities in other asset classes. Within this context, we maintain a preference for high grade (HG) and investment grade bonds (IG). There are also opportunities in the more growth sensitive areas of high yield (HY) and emerging markets (EM). However, we are cognizant that tighter lending standards operate with a lag on fundamentals and current slower growth and earnings in developed economies suggest higher default risk in the future. Additionally, liquidity risk premiums are likely to rise over time as global money supply continues to shrink. As a result, we see HY spreads as being vulnerable relative to IG and HG. Therefore, we have a least preferred stance on HY. EM bonds have benefited from the decline in US inflation, a shift in China's COVID policy stance, and increased support for China's property sector. We see the performance drivers for this segment coming from carry and upside on special situations in the distressed space with a number of sovereigns currently progressing towards restructurings (eg Argentina). We upgraded EM bonds to most preferred.

**High grade (HG) bonds:** We maintain our most preferred recommendation on HG bonds. With growth decelerating, it is our assumption that the recent moderation in inflation will continue. We acknowledge that labor markets remain tight, wage growth robust and core service inflation high. Therefore, there is an element of complacency in the market regarding the assumption that rate hikes are close to the end. As such, rate volatility has been trending lower however we can envisage periodic spikes higher as it remains too early to declare victory on the inflation fight. Despite these risks, we see strong total returns for the asset class going forward. They are rated AA- or better, therefore have minimal default risk. The higher level of interest rates provides a sizable cushion, should rates move higher and further mark-to-market losses be recorded. In the event of a sharper slowdown, rates would move lower across the curve, and the asset class would benefit strongly given its defensive characteristics.

**Investment grade (IG) bonds:** We maintain the asset class at most preferred. Switching from lower-quality to higher-quality credit makes sense given growth risks. The high interest rate sensitivity of the US and EUR investment grade complexes has been a detractor from total returns this year. Looking ahead, we see the balance of risks more equally distributed as concerns shift from inflation to growth. Within EUR IG, the average yield is around 3.8%. The war in Ukraine and the European Central Bank's (ECB) recent hawkishness have slowed economic growth on the continent, however a mild December weather wise has reduced the risks of an energy crunch. On US IG, yields for all maturity and intermediate profiles are now around 5%. Credit fundamentals on the US IG corporate side remain solid and should provide protection in a slowing earnings environment.

## CIO themes

### Resilient credits

Resilient credits offer a decent income, following a sharp rise in interest rates and credit spreads. Our selection of tenors around five to seven years offers additional potential outperformance over riskier bonds (and stocks) in case of a recession, where interest rates would likely decline materially, while risk premiums of resilient credits would only rise moderately. Investors concerned about recession risk should prefer this positioning over shorter-dated bonds with higher credit risk.

### Income returning to fixed income

Global interest rates have moved sharply higher, resulting in mark-to-market losses this year for fixed income investors. Given that interest rates are now much higher and there are significant expectations priced in regarding central bank rate hikes, we believe the risk-return to the asset class has been restored. So, we think investors should consider closing underweight positions, and actively look at select opportunities in the front end of the yield curve.

# Bonds

**High yield (HY) bonds:** We maintain our least preferred tactical recommendation on the asset class. Our concern on the lower-rated segment is that as fundamentals continue to deteriorate, market liquidity will become more challenging and the credit risk premiums could widen significantly. The fundamental backdrop in HY is arguably not too bad. There has only been a limited amount of time since the last downturn, so we have not had the classic buildup of financial excess or leverage seen in previous cycles. In fact, the average credit quality in HY has improved. And in US HY, the energy sector—which has been a source of defaults in past downturns—is benefiting from globally elevated energy prices. Additionally, the outright level of yields in US HY and EU HY are around 8% and 7% which has attracted capital flows more recently and supported performance. Over the medium- to longer-term investment horizon, we see justification for riding out the likely near-term downside risks for investors holding well-diversified positions and who are willing to continue stomaching mark-to-market volatility. However, for those with a more tactical mindset, we recommend moving up in quality at this juncture, given concerns around market liquidity and headwinds coming on the earnings side. By moving up in quality, investors can still benefit from higher outright levels of rates and reduce their credit spread volatility in the process.

**Emerging market (EM) sovereign bonds:** This month we upgrade EM bonds to most preferred. Recently they have profited from a decline in US inflation, a shift in China's COVID policy stance, and increased support for China's property sector. With these incrementally more positive developments, recession risks have declined or been pushed into the future. Risks remain regarding the fallout from tighter financial conditions and the impact on fundamentals. Additionally, the cooling of inflation is a positive development however labor markets remain tight and core service inflation elevated. As such, although central banks are closer to the end of their rate hiking cycles than the beginning, uncertainty remains. Tactically speaking, we acknowledge that the China re-opening is a big deal and will both directly and indirectly benefit EM through growth, sentiment, commodities and capital flows. As such, we do not recommend fading the recent market strength but rather see it lasting further, thus the change in asset class recommendation. The value in EM credit sits in the distressed segment. Bond prices were incredibly depressed. The more positive tone is allowing progress to be made on restructurings, and we think provides some upside to prices and the overall EM complex. We note that the sovereign index yield is now around 8.2% and the corporate index yield is around 6.7%.

# FX

Support for the US dollar has evaporated as the Federal Reserve's rate hike campaign draws closer to an end. The strong performance by equity markets in Europe, China, and Japan in recent months has not helped the currency, either. As a result, many investors who were highly exposed to the US after several years of USD strength and solid US equity gains had to reposition their exposure. We are still in the neutral camp on the USD, though we expect it to weaken by year-end. A lot depends on the Fed's policy cycle. Market expectations for Fed rate cuts are much more aggressive than the Fed's own assumptions, and we see a large possibility that the current risk-on sentiment supporting the rest of the G10 currencies versus the USD may flip again to a more cautious stance that supports the greenback.

We raise the euro to neutral. The European Central Bank has turned increasingly hawkish in response to inflation, which has proven more sticky than many policymakers thought a year ago. The general risk-on mood is also supporting Italian bonds, which are the Achilles' heel for European rate hikes. The opportunity to hike has therefore increased. Finally, China's reopening supports European equities, and with this, demand for euros. That said, we are not lifting the euro to most preferred. The war in Ukraine is ongoing, and the geopolitical risk raises the risk premium for the euro and limits the trade opportunities with Central and Eastern Europe.

We change our most preferred view on the Swiss franc to neutral after strong gains versus the USD recently. Nevertheless, we believe the Swiss National Bank (SNB) is committed to preserving CHF strength to limit imported inflation, and that the currency will be supported by safe-haven flows. In sum, we expect USDCHF to consolidate over the next couple of months. In 2H23, we expect USDCHF and EURCHF to follow the drop seen in their respective equilibrium values during 2022. With the CHF well bid during unexpected bouts of market uncertainty, the currency continues to offer an attractive risk-reward to investors, in our view.

The Bank of England faces a big dilemma. Growth concerns challenge rate-hike prospects, while higher yields are needed to rein in rising inflation expectations. Meanwhile, our stance on the Japanese yen remains neutral. We see potential for the Bank of Japan to tighten monetary policy, but it remains willing to keep policy settings unchanged for now.

The Australian Dollar enters our list as most preferred. It is supported by the re-opening of China, the relatively strong economic growth and a central bank that is likely to keep the reins tight when the Fed is starting to ease monetary conditions.

In Asia, we expect the Chinese yuan to appreciate steadily in 2023 thanks to growth tailwinds from China's reopening as well as measures to support its property sector. We also expect the Singapore dollar to trend stronger thanks to its central bank's policy of gradual, trade-weighted currency appreciation.

Sentiment toward emerging market currencies in Latin America and EMEA (Europe, the Middle East, and Africa) is thawing as the outlook for China's economy improves and the end of Fed rate hikes draws closer. Near-term setbacks are possible as the market still needs to resolve the disconnect between the assumed Fed policy path and the Fed's own communication, as well as lingering risks around the global growth outlook. With more certainty on these factors, select currencies in Latin America and EMEA can continue to perform well, with the interest rate carry acting as an important total return driver. Risks persist that some central banks, particularly in Central and Eastern Europe, are turning dovish too soon.

# FX

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# Commodities

We see another strong year for commodities in 2023, and forecast high-teen percentage total returns on an asset class level. More than half of the anticipated performance should come from higher spot prices, while roll yields and cash collateral returns are expected to deliver 4–5 percentage points of returns each. In terms of spot appreciation and roll yields, we expect energy to take the top spot again with total returns of more than 30%. Industrial and precious metals are forecast to return 10% and close to 5%, respectively. Agriculture and livestock should deliver flat to positive returns on a full-year basis.

Our view is that a firm economic recovery in China, the start of the Federal Reserve's rate cuts later in the year, and several unresolved supply-side issues due to years of underinvestment should all drive prices higher. We expect the supply side will struggle to meet the demand from a cyclical China bounce while catering to global decarbonization efforts. Higher prices should still be needed to limit destocking across the different commodities and keep markets in balance—that is, to constrain demand and incentivize supply via new capacity additions. Our positive asset class view does come with a fair bit of uncertainty. Slowing economic growth in the US and Europe, terminal interest rate considerations for the Fed and the European Central Bank, and war dynamics in Ukraine remain key top-down drivers. For a broad commodity engagement, we think volatility is likely to come in at 15–20% in 2023.

With an attractive return-to-risk ratio, taking on broad commodity exposure is advised. We favor an active investment strategy to take advantage of the macro and policy turning points we anticipate in the year ahead. Our sector preferences remain for energy, followed by industrial metals. Precious metals look attractive from a portfolio insurance perspective and for volatility-selling strategies to set lower entry points. Alternative return opportunities can be found in agriculture and livestock exposure. While we could say this every year, we think current prices do not adequately reflect the degree of climate and geopolitical risks present in 1H23. Hence, exposure to agriculture and livestock should effectively complement the cyclical nature of energy and industrial metals in an overall commodity context.

Capturing the return and volatility potential in individual commodities should be done selectively. Here, we like selling the downside price risks in Brent crude oil, copper, aluminum, platinum, and sugar. Considering the risks of such strategies, they should come with indicative yields in the higher single digits.

Preference: Most preferred

## CIO themes

### **Commodities: Reimagining commodity investing**

Given the longer-lasting bull and bear markets in commodities, and the unique characteristics and drivers of individual sectors and structural trends, we advise clients who invest in commodities to pursue an actively managed strategy. The CIO Active Commodity Strategy is designed to capture these benefits while improving risk-adjusted returns versus passive commodity investments.

### **Crude oil: Opportunities in longer-dated oil contracts**

Longer-dated oil contracts are trading cheaper than spot prices. While commodity markets tend to price in the "now," futures curves don't have a lot of predictive power. Due to falling oil inventories, the futures curve is downward-sloped, meaning longer-dated contracts are cheaper. Vanishing available spare capacity should support longer-dated contracts, in our view.

## Preferences

### **Directional**

Long longer-dated Brent oil contracts

### **Yield pickup**

Brent crude oil

Platinum

Copper

Aluminum



Section 2.1

## Details per asset class

# Eurozone equities

## Central scenario

### **DJ Euro Stoxx 50 June 2023 target: 3,800**

We are Neutral on Eurozone equities in our global asset class universe. While fears of energy crunches in the Eurozone have faded on the back of a milder-than-expected winter, geopolitical tensions are still looming over the region, which is also likely to enter a period of slower growth. All in all, downside risks to earnings seem partially priced in at current levels, with valuations looking fair to us.

Eurozone equities are up 23% from their recent lows. A sharp drop in gas prices, a faster-than-expected China reopening, and early signs that inflation is subsiding have supported a rerating of Eurozone equities. Even after this rally, we think valuations remain reasonable at 12.4x consensus 2023 P/E, a discount to the long-run average and 22% below where they started 2022.

While we do not view the market as expensive, growth is still highly uncertain, and we believe that consensus earnings estimates will need to be revised down. The upcoming 4Q results season therefore poses a challenging backdrop for equities to perform against, as markets may increasingly focus on the growth slowdown and risk to earnings in the coming weeks. We currently expect earnings to fall 5% in 2023, versus consensus expectations for 1% growth. Using our own earnings estimates, Eurozone equities are trading at 13.7x 2023 P/E, broadly in line with 20-year average valuations.

We like a combination of defensive and early-cycle cyclical stocks to withstand the weak economic growth backdrop, but benefit from some of the inflections we are starting to see in inflation, gas prices, and China. This supports our preference for the consumer sectors, real estate, and German equities, and our Equity Radar Top 5 topics. In the more medium term, we like Europe's greentech and digital leaders as beneficiaries of government investment plans.

## CIO themes

### **Consumer recovery**

We like European consumer stocks that are poised to benefit from an improving consumer outlook as wages rise, inflation pressures ease, central banks stop hiking, and China reopens.

### **German equities – attractively priced quality**

We like German equities given attractive relative valuations and improving sentiment indicators as energy crisis fears subside and the outlook for growth begins to improve.

### **Investing in Europe's digital leaders**

In this theme, we employ a framework that identifies European companies poised to benefit from the accelerated transition to a more digital world.

### **Investing in Europe's greentech leaders**

This theme recommends companies that will likely play a key role in Europe's energy transition and stand to benefit from the Green Deal—the biggest green stimulus program the world has ever seen.

## Sector Preferences:

Most preferred: consumer discretionary, consumer staples, and real estate.

Least preferred: communication services, industrials, and information technology.

# Eurozone equities

## Upside scenario

**DJ Euro Stoxx 50 June 2023 target: 4,550**

**Inflation falls quickly and rate hikes slow**, supporting valuations that have been under pressure from sharply higher discount rates.

**Recession avoided.** Earnings could surprise to the upside if a "soft landing" scenario emerges, where growth is better than expected.

**Companies keep pricing power.** If companies can maintain some pricing power in 2023, margins may not contract as much as we expect, and revenues could overshoot expectations again—leading to upside risks to our earnings forecasts.

**Europe exits the winter with above-average gas storage levels.** This could materially reduce the risk of a gas shortage next winter and support high valuation multiples.

## Downside scenario

**DJ Euro Stoxx 50 June 2023 target: 3,300**

**Growth disappoints** as a result of the lagged impact of tighter monetary policy, driving earnings growth and valuation multiples lower.

**Sticky inflation** could keep central bank policy tighter for longer, which would weigh on valuations and raise the risk of a deeper growth downturn.

**Political risks or unforeseen consequences of higher yields** could emerge at a fragile time given high government debt levels and the reliance of some economies on disbursements from the EU recovery fund.

**Gas concerns re-emerge next winter.** Further disruption to gas supplies that raises the risk of production stoppages next winter is a downside risk for valuations and potentially earnings.

# US equities

## Central scenario **S&P 500 June 2023 target: 3,700**

US stocks are off to a good start this year, propelled by better economic growth prospects in Europe (natural gas prices are lower largely due to a mild winter) and a rapid improvement in the outlook for China on the heels of the country's abandonment of its zero-COVID policy. Closer to home, the risk of even higher Fed rate hikes has diminished due to a slowdown in wage pressures and more benign inflation readings. Generally cautious investor positioning has also helped propel gains as some market participants may have been caught offside by the improving growth and inflation mix.

Still, we have a hard time seeing much near-term equity market upside from current levels. Based on tightening bank lending standards, a likely move higher in the unemployment rate (in order to reach the Fed's 2% inflation target), and continued weak business sentiment, we believe S&P 500 profits will be under pressure in the coming months. As a result, our S&P 500 EPS estimate for 2023 is USD 215 (-4%) which is about 6% lower than the bottom-up consensus estimate. Please see our earnings season preview for more details about our outlook for corporate profits.

In addition, valuation multiples do not leave that much room for upside. The S&P 500 forward P/E is already at 17.3x. We struggle to see the multiple rising above 18x. Since the early 1980s, the only time the P/E has been higher than 18x was during periods when profit growth was very rapid (10–20% growth) or interest rates were at rock-bottom levels similar to 2020–21 when the 10-year Treasury yield averaged around 1%. Furthermore, while the Fed may be getting closer to the end of its rate hikes, it will likely keep rates at a lofty level until there are clear signs that inflation is moving back to its 2% target, which may take some time.

Overall, we think stocks are at the upper end of their near-term range. Upside beyond these levels will likely be driven by indications of a reacceleration in corporate profit growth. But that likely won't happen until the Fed starts to cut interest rates, which seems a long way off considering that the Fed is not yet done raising rates. Historically, the Fed does not cut rates unless the unemployment rate is higher or inflation is lower than levels likely to prevail in the coming months. And there are still risks that the economy slips into a full-blown recession, especially if the Fed needs to keep monetary policy tighter for longer. Plus, the lagged effects of last year's rate hikes may start showing up in areas like construction employment, which surprisingly continues to make new highs despite very weak housing market dynamics. Our June and December S&P 500 price targets are 3,700 and 4,000, respectively.

Preference: Least preferred

## CIO themes

### Security takes center stage

The Russian invasion of Ukraine will likely have a meaningful and long-term impact on security considerations that will affect conventional defense spending, cyberspace, as well as energy, food, and semiconductor supplies. This theme identifies companies that are leveraged to these trends.

## Sector preferences

### Most preferred

- Consumer staples: Earnings growth should be more resilient as macro headwinds persist. Relative valuations appear reasonable given the sector's defensive nature.
- Energy: The sector remains cheap relative to oil prices. We believe the sector's free cash flow yield is very attractive, capital discipline has improved, and the sector should benefit from continued strong demand. There appears to be more upside than downside risk in oil prices.
- Healthcare: In a slowing economic growth environment, the sector has a more favorable earnings outlook. This defensive sector should outperform while recession risks remain elevated. Drug pricing reform lifts a long-standing overhang on the pharmaceutical industry.

# US equities

## Upside scenario

**S&P 500 June 2023 target: 4,400**

**Resilient economic growth:** High wages attract more workers to return to the labor force. US economic growth proves to be durable, and supply-side bottlenecks are resolved. China reopens its economy and global economic growth accelerates.

**Inflation cools quickly:** Inflationary pressures quickly dissipate. The Fed ends its rate-hiking cycle and pivots to rate cuts. This lifts expectations for economic growth and corporate earnings.

**Progress in Ukraine:** Ukraine and Russia agree to negotiate a settlement, triggering a significant improvement in investor sentiment.

## Downside scenario

**S&P 500 June 2023 target: 3,300**

**Recession:** The US slips into a full-blown recession in the next 6–12 months, primarily driven by Fed rate hikes, which choke off economic growth and lead to a notable increase in the unemployment rate.

**Inflation remains elevated:** Inflation stays hot and central banks are forced to raise interest rates even more than expected or keep them at lofty levels for longer than expected. Stagflation risks increase as wage-price spirals start to form.

**Further disruption from Ukraine war:** Further escalation leads to a further disruption of Russia's energy supplies to Europe. Oil and natural gas prices rise sharply and remain elevated.

**Coronavirus:** New virus variants prove to be resistant to vaccines and antibodies related to prior infections. US consumers hunker down, leading to a slowdown in economic activity.

## Sector preferences

### Least preferred

- Financials: Recession risks remain elevated, and if the unemployment rate rises, earnings will take a hit. Additionally, bank deposit rates are rising, which could crimp net interest income growth.
- Information technology: As corporate profits come under pressure, there may be risks to IT enterprise spending. Relative valuations remain lofty and above pre-pandemic levels.

# UK equities

Preference: Most preferred

## Central scenario

### **FTSE 100 June 2023 target: 8,100**

UK equities are Most Preferred in our global equity preferences. The FTSE 100 has proven to be relatively resilient to domestic challenges, thanks in part to its large international exposure and heavy weighting to commodity and defensive sectors. We expect this to continue to support UK equities relative to other major regional markets in the coming months and recommend a broad-based exposure to the UK stock market, given our most preferred global sectors (energy, healthcare, and consumer staples) are well represented in the FTSE 100.

The FTSE 100 was the top-performing major benchmark in 2022. While other markets suffered from rising rates, high inflation, and slowing growth, the UK's combination of value, commodity-exposed, and defensive sectors helped it hold up relatively well, despite domestic challenges. Earnings, in particular, were strong and are expected to have grown over 20% in 2022—around double the current projected growth rate for global equities.

But looking ahead in 2023, we expect earnings growth to slow. A combination of an economic slowdown, less corporate pricing power, and fading tailwinds from high oil prices, and a weak sterling is likely to make 2023 a tougher year for companies. We expect corporate profits to fall in the region of 5%. But at current valuations, we believe this is already largely priced in.

The FTSE 100 trades on a 12-month forward P/E of 10.4x—around 20% below its long-run average—and almost a third lower than global equities (MSCI AC World). This continues to support our preference for UK equities in our regional market preferences. We see the 4% dividend yield on the UK market as attractive in the context of moderate expected capital appreciation.

## Upside scenario

### **FTSE 100 June 2023 target: 8,600**

**Valuation:** An earlier-than-expected end to rate hikes, or a reduction of the UK's discount versus global equities, offers upside risk to valuations.

**Oil price:** Higher oil prices could provide additional upside to FTSE 100 earnings, especially relative to other regions.

**Better global growth:** If global economic growth is better than expected, this could support higher earnings than we currently anticipate, and boost equity valuations.

## Downside scenario

### **FTSE 100 June 2023 target: 6,500**

**Oil price:** If the price of Brent falls, earnings growth could be hurt as the energy sector contributes around 25% of FTSE 100 earnings.

**Stagflation risks:** A combination of weaker global growth expectations, high inflation, and rising bond yields could put further downward pressure on equities.

**Stronger sterling:** Sterling strength would be a drag on the FTSE 100, which generates close to 75% of its revenues outside the UK.

# Swiss equities

## Central scenario

### **SMI June 2023 target: 10,400**

In 2021, a significant economic recovery, an overall lack of currency losses, economies of scale, and more M&A transactions led to a 24% increase in corporate profits. Consequently, aggregate earnings for Swiss Market Index (SMI) companies have significantly exceeded the previous record year of 2019. Dividend payments also increased by around 6% in spring 2022.

We expect corporate profits to fall 8% in 2022, the second-best year on record, supported by positive organic sales growth, restructuring efforts, M&A deals, and robust cost management and price increases to compensate for raw material and supply chain cost inflation. Dividends are likely to rise by a (very) low-single-digit percentage in spring 2023. We expect profits to recover by 8% next year. This will be driven by further price increases, easing supply chain costs, and restructuring benefits despite close to flat sales volume growth and currency losses.

Since early June 2022, the Swiss National Bank (SNB) has been increasing its prime rate to moderate inflation pressures despite a recent slowdown Swiss and global growth. Higher CHF interest rates support the Swiss franc, which in turn weighs on Swiss profits since 90% of them are generated in foreign currencies. Upward pressure on the CHF versus the EUR is likely to ease in 2023, but to increase versus the USD.

With regard to investment strategy, we recommend keeping a good mix of defensive underlying assets and cyclically sensitive supplementary securities. Financials also enhance portfolios given the benefits from rising interest rates as a result of higher inflation.

Swiss equity valuation multiples are a bit above the 20-year average, which we think is slightly expensive, given low but rising interest rates. Dividend yields remain attractive despite now higher bond yields, in our view. At over 3%, the expected yield is above the 20-year average of 2.4%. We think the key drivers for Swiss stock prices from here will be companies showing profit improvement and, to a lesser degree, multiple expansion. Hence, stock selection is important.

With European and global economic growth prospects weakening, the defensive characteristics of the Swiss market look favorable compared to other equity markets. Its slightly expensive valuation, however, leaves limited upside potential, in our view.

Aside from a worsening of the pandemic, key risks include protectionism, international trade disputes, an economic downturn, currency losses, and Switzerland-EU negotiations.

## CIO themes

### **Swiss high-quality dividends**

Swiss dividend-paying equities are attractive, in our view. The average yield of the Swiss equity market, at over 3%, is higher than that of Swiss franc-denominated corporate and government bonds. Historically, dividend yields have tended to be similar to or lower than bond yields. Balance sheets and profitability are generally robust, suggesting that market-wide distributions are sustainable despite risks to corporate profits on the back of weaker economic prospects. For the SMI, the total cash distribution amount only moderated slightly in 2021 versus 2020, and rebounded by 6% in 2022, achieving a new all-time high. We expect another low-single-digit percentage increase in 2023.

# Swiss equities

## Upside scenario

**SMI June 2023 target: 12,200**

**Robust Swiss profits:** As a result of the global economic recovery from the pandemic and the lack of large currency losses, we expect corporate profits to expand slightly this year and the next.

**Sustainable dividends:** Swiss dividends have generally grown every year since 2009. In 2021, however, total SMI dividends fell by 3%. In 2022, they recovered by 6%. In our upside scenario, we would expect another mid-single-digit percentage rise in 2023 (i.e., for the business year 2022).

**Manageable currency impact:** In 2020, currency effects were clearly negative, while those in 2021 were insignificant. In 2022–2023, we expect currency losses to increase again.

## Downside scenario

**SMI June 2023 target: 9,000**

**Economic and political risks:** Significant global economic risks, negative currency trends, and international political disputes are headwinds for a small country with above-average international exposure.

**Valuations:** While dividend yields are attractive, corporate profits may be down by a mid-single-digit percentage in 2023 versus 2021, and the SMI would thus be trading at an unjustified premium of over 10% to its 20-year forward P/E average.

**Sector composition:** The SMI has a high exposure to defensive industries that tend to have rich valuations with downside risks as inflation and nominal bond yields rise.



# Emerging market equities

## Central scenario

### MSCI EM June 2023 target: 1,050

We hold a most preferred stance on emerging market equities. The faster-than-expected economic reopening in China, in our view, should be a catalyst for the asset class to outperform their developed market peers. A recovery in consumption demand (on goods and services including tourism) from China is set to benefit the country's neighbors in emerging Asia. China's likely increase in commodities demand should also support several commodity-sensitive economies in the emerging world.

Emerging market equities' valuations, on a 12-month forward P/E basis, have recovered to their long-term average, led mostly by positive sentiment toward Chinese equities. In our view, however, the implications from China's economic normalization are not fully reflected in current valuations. Emerging market equities' earnings revision ratio is still negative, but likely has bottomed versus developed market stocks; and forward EPS momentum is picking up pace.

A deep US recession, if materialized, is a key headwind to emerging market stocks, which would be partially mitigated by an eventual easing of Fed policy. Other risks include a strong US dollar and an uptick of global geopolitical tensions.

Within emerging markets, we expect high-quality structural earnings growth leaders such as internet and e-commerce companies to outperform the broader MSCI EM benchmark. Meanwhile, ESG leaders can help mitigate the downside risks. For investors with a multiyear investment horizon, we recommend exposure to three thematic opportunities: frontier markets, emerging market infrastructure, and emerging market healthcare.

From a geographic standpoint, we remain positive on Chinese equities: The country is on track to fully reopen by 1Q23, and domestic economic policy has pivoted to prioritize growth this year. In addition, the lifting of domestic and US regulatory overhangs around Chinese internet companies and American depositary receipts (ADRs) also largely clears important sources of downside risks for Chinese equities. All these should support a further valuation rebound as well as a quicker turnaround in earnings estimate revisions for MSCI China. We also continue to like Thailand and the Philippines. Singapore and Malaysia stay least preferred.

## Upside scenario

### MSCI EM June 2023 target: 1,150

**Sizable GDP growth recovery:** Continued economic recovery would benefit corporate earnings and lift valuation multiples.

**Global monetary policy:** A less hawkish policy stance would bring about a more benign external environment.

**China policy support:** Stronger-than-expected policy easing and faster demand recovery in China would support emerging market stocks.

## Downside scenario

### MSCI EM June 2023 target: 820

**Global GDP growth fears:** Persistently high inflation could force central banks to tighten more aggressively, sending economies into a deep recession.

**US dollar strength:** Emerging market stocks typically suffer in a strong US dollar environment.

**Geopolitics:** A further deterioration in US-China relations and the war in Ukraine would hurt emerging market assets.

Preference: Most preferred

## CIO themes

### ESG matters in emerging markets

This theme offers investors an opportunity to add value to their portfolios by incorporating environmental, social, and governance considerations into their investment decisions. The wide disparity in ESG performance among emerging market companies means investors should focus on those with strong management to reduce the risk of tail-risk events, particularly in relation to governance (e.g., accounting and audit issues) as well as severe environmental accidents.

### EM internet and e-commerce

As economic and corporate profit growth normalizes in emerging markets, we believe it is time to reposition in high-quality and structurally attractive internet and e-commerce stocks. We expect these stocks to outperform the MSCI EM index by 10–15% over the next 12–18 months, driven by resilient earnings prospects and attractive valuations relative to recent history and their global internet peers.

## Market preferences

### Most preferred

China, Thailand, Philippines

### Least preferred

Malaysia, Singapore

# Japanese equities

## Central scenario

### TOPIX June 2023 target: 1,950

We are Neutral on Japanese equities in our global asset class universe. Share price downside risks are limited, in our view, thanks to cheap valuations and relatively resilient corporate earnings trends compared to other developed markets. China's faster-than-expected reopening should be positive for select Japanese companies in 2023, particularly in capex-related and consumer sectors. The ongoing domestic reopening—including increased inbound tourists—should also spur earnings growth. After the Bank of Japan surprised the market by raising the 10-year yield ceiling from 0.25% to 0.5% in late December, yen strength has continued into the new year and Japanese financials have emerged as an immediate beneficiary.

We expect 8% profit growth for FY22 (ending 31 March 2023) and 3% for FY23. The JPY appreciated 13% against the USD from a trough in October, but the currency remains weak compared to a year ago, which is positive for Japanese corporate earnings. With the TOPIX's P/E at 11.7x, below the long-term average and at a wide discount versus the MSCI ACWI, valuations remain undemanding.

Japan's economic reopening will be a bright spot in 2023. We also believe Japanese financial companies are in a good position to benefit from higher lending rates. Greentech and ESG themes may also present opportunities as long-term investment strategies.

## Upside scenario (Reflation)

### TOPIX June 2023 target: 2,200

**Stronger-than-expected re-opening spending:** A full reopening of the border and expected increase in Chinese visitors to Japan in 2023 could fuel a faster consumption recovery and boost earnings beyond our forecasts.

**Accelerating share buybacks:** As earnings recover from the pandemic and companies feel less need to hold on to emergency cash, share buybacks could accelerate and support Japanese equities.

**Lower input costs:** Higher costs, including commodities and logistics, have squeezed margins over the last two quarters. Any price softening or stabilization would likely lift the earnings outlook.

## Downside scenario (Slump)

### TOPIX June 2023 target: 1,600

**Recession:** Risks that the US slips into a full-blown recession and increased tensions between the US and China would put downward pressure on Japan's economic and earnings growth outlook.

**Higher inflation for longer:** An acceleration in inflation would affect consumer sentiment, and rising input costs could hurt 2023 earnings.

**Stronger yen:** Earnings growth would decline if the yen sharply strengthens, especially for exporters such as those in the tech and auto sectors.

## CIO themes

### Be ready for Japan's normalization

After the Japanese government reopened its border in October 2022, the number of inbound tourists is increasing. China's reopening is likely to accelerate the trend in 2023. A weaker yen is also providing impetus to visit Japan. We think service sector companies that survived the pandemic will benefit from pent-up demand and a less competitive business environment during the normalization period.

### Japan's financial winners

After the BoJ surprised the market by raising the 10-year yield ceiling from 0.25% to 0.5% in late December, Japanese financials have emerged as an immediate beneficiary. We still prefer those with a relatively high dividend yield and higher exposure to potential monetary policy changes. Although we do not expect the BoJ to raise rates in 2023, we cannot rule out the possibility of further policy changes, particularly after a new governor takes office on 8 April.

### Japan's corporate governance improves shareholder returns

Japanese companies are becoming more shareholder-friendly, supported by the earnings recovery from the pandemic and less need to hold emergency cash. We see blue-chip companies accelerating share buybacks and dividend payments.

# Asian ex-Japan equities

## Central scenario

### MSCI Asia ex-Japan June 2023 target: 665

The Asia ex-Japan equity market has had a strong run year-to-date thanks to China's reopening and a weakening USD. We expect some consolidation in the next few weeks as investors attempt to reach a consensus on where US rates will peak. What's more, investors are keen to see actual data improvement from China before pushing the market another leg up. For now, we stick to our neutral stance. Once there is better visibility on the above-mentioned factors, it will make sense for us to add beta exposure.

One of the themes we have favored since April 2021 is Asia's reopening and reflation, with a focus on six sectors: capital goods, consumer services, construction material, commodity combo, banks, and transportation. These sectors have outperformed MSCI Asia ex Japan by 13pps since then, and the underlying stock basket added another 9pps of outperformance on top. But we don't expect this theme to outperform from here as Chinese tech has rebounded from very depressed levels and tech in Korea and Taiwan are likely to follow suit in due course.

Within the region, we made an ad-hoc upgrade for Chinese equities from neutral to most preferred on 5 January. China has surprised the world with the lightning speed of its domestic reopening, while international travel also resumed on 8 January. In the near term, macro data is likely to remain weak as COVID infections surge. But with cases heading for a nationwide peak around late January to early February, 2Q data should see a meaningful improvement. It is common for any market to consolidate after a very strong relief rally, but we still expect further upside from here—especially compared with peers in Asia—thanks to a release in pent-up demand and further policy support.

Besides China, we keep our most preference on the Philippines and Thailand. Economic activity in the Philippines has recovered further, with manufacturing PMI rising to 53.1 in December from 52.7 the previous month, and an expansion in production and new orders for a fourth consecutive month. Moreover, earnings momentum in the Philippines (both in terms of earnings revision breadth and trailing EPS) is among the strongest in the region. For Thailand, the recovery is mainly driven by a rebound in international tourism. It is one of the key beneficiaries of China's earlier-than-expected border reopening.

On the other hand, we keep our least preferred on Singapore and Malaysia. In the long term, Singapore remains an interesting market as its capital inflow trend is partially structural. But on a tactical basis, Singapore faces a market rotation risk as it was one of the main outperformers last year. As a small open economy, it is also more exposed to growth risks in developed countries. Malaysia's manufacturing PMI, meanwhile, edged down to 47.8 in December, which points to a further slowdown in business conditions. In terms of valuations, equity risk premiums for Malaysian equities are also becoming less attractive, in our view.

## CIO themes

### Playing Asia catch-up within emerging markets

This theme aims to position in Asian laggards that we expect to catch-up with their EM peers this year through cheap growth (China) and cheap value (ASEAN) markets.

Key drivers include relative earnings strength, policy easing in China, attractive valuations, and a strong USD outlook.

Main risks include a commodity super-cycle, new lockdowns in ASEAN, and an escalation in Sino-US frictions..

## Market preferences

**Most preferred:** China, Thailand, Philippines

**Least preferred:** Singapore, Malaysia

# Asian ex-Japan equities

## Upside scenario

**MSCI Asia ex-Japan June 2023 target: 702**

### **Fed turns less hawkish than market pricing**

Asian equities are likely to rebound if the Fed delivers fewer rate hikes or less aggressive QT than current market expectations amid still solid earnings growth.

### **Speedy recovery despite current COVID wave**

A meaningful recovery in consumption and property sales despite the current COVID wave would further lift risk sentiment toward Chinese assets.

### **Strong demand recovery in tech**

Asia tech has corrected the earliest among global peers. If we see faster-than-expected final demand pick up in this space, it would lift the Asian market as a whole since tech is a key component of MSCI Asia ex-Japan.

## Downside scenario

**MSCI Asia ex-Japan June 2023 target: 533**

### **Sharp slowdown in US growth or China's recovery**

If US growth turns out much worse than our mild recession assumption, or if China's growth recovery is much slower and shallower than expected, Asian equities could suffer.

### **Re-escalation in Sino-US tensions**

Risk sentiment should weaken if the US adds secondary sanctions on Chinese firms or financial institutions.

### **Stronger-than-expected DM central bank tightening**

If the Fed and the ECB surprise markets with the magnitude of their monetary tightening, there will likely be further headwinds for global GDP growth and growth stock valuations.

# High grade

Preference: Most preferred

## Central scenario

### 10-year US Treasury yield June 2023 target: 3.5%

With indications that inflationary pressures are abating, major central banks have started to moderate the pace of rate increases. After a series of initial aggressive hikes in 2022, policymakers appear poised to wait for the full effects of tightening to materialize. Against this backdrop, we continue to recommend an overweight position in high grade (HG) bonds. Our rationale is that central banks have succeeded in repricing expectations and that we are closer to the end of the rate hiking cycle than to the beginning. That said, we acknowledge that there may be further upward pressure on rates as central banks contend with the more persistent sources of inflationary pressures. To achieve structurally higher interest rates, however, economic growth needs to step up. We think growth is currently decelerating because of tighter financial conditions, with significant uncertainty about whether the US economy is going to experience a mild or deep recession. Accordingly, while interest rate volatility may likely remain elevated after declining from its October peak (with high interest rates providing a buffer for returns), we see a much more even balance in terms of direction. HG bonds are rated AA– or better, and therefore have minimal default risk. Given the sharp repricing higher in rates in 2022, we see an attractive asymmetric absolute return profile looking forward in light of the shifting balance of risks between high inflation and decelerating growth.

## Upside scenario

### 10-year US Treasury yield June 2023 target: 2.5%

**Economic growth:** In the downside case for the US economy, the risk is that a more aggressive Fed triggers a recession. This is not our base case, but the risk is there. It could occur should the economy, contrary to the Fed's analysis, prove unable to withstand the policy tightening required to subdue inflation.

**Well-anchored inflation expectations:** Inflation drops quickly enough so that the Fed begins to take out insurance against a recession. In this scenario, energy prices drop and the labor market loses momentum.

**Fed goes on hold:** In response to falling inflation, the Fed halts its rate hiking cycle and perhaps even cuts policy rates to take out insurance against recession. Balance sheet runoff goes on hold.

## Downside scenario

### 10-year US Treasury yield June 2023 target: 4.5%

**Economic growth:** US GDP growth remains above trend in the face of Fed tightening. The job market is strong, and wages increase at a rapid pace. Inflation stays elevated, and the Fed is forced to hike more aggressively and to a higher level than currently priced in, and at the same time accelerates the shrinking of its balance sheet through active sales.

**Market pricing:** The market currently prices the fed funds rate peaking close to 5% around early 2023. In the downside scenario, inflation remains persistently elevated, and the market prices in a more extended hiking cycle, ending at a higher level. The pricing of the terminal rate moves up, and interest rates move higher across the curve, likely accompanied by a greater inversion of the curve.

# Investment grade

Preference: Most preferred

## Central scenario

### June 2023 spread targets: 120bps (USD IG) / 170bps (EUR IG)

Interest rates across developed markets surged last year as central banks tightened policy in response to elevated inflation. Given the high interest rate sensitivity of the US and European investment grade (IG) bond segments, the speed and magnitude of the move higher in rates more than offset income earned over the period and hence resulted in poor total returns. Heading into the end of the year and commencing this year, performance has begun to recover as signs are emerging that inflation is trending lower and central banks are approaching the end of their policy rate hiking cycles. With this money has begun to return to the asset class.

While rates volatility has moderated, it is likely to remain elevated as concerns shift from inflation to growth. On US IG, average yields are currently just under 5%. Despite evidence of slowing growth in the US, the market has focused on declining inflation and prospects of an end to rate hikes. On US IG fundamentals, we regard current credit metrics as solid with improved levels of coverage and leverage. Looking forward, we anticipate some degradation in metrics as earnings growth slows, in which case downgrades are likely to increase and could pressure spreads upwards. Spreads are sitting around their long term average so are not cheap, however we gain comfort from the higher outright yields and the fact that spreads are a much smaller proportion than the recent past. This should provide a sizable offset to further widening.

Within EUR IG, the average yield sits at 3.8%, lower than its October peak of 4.6%. Index spreads are trading at 157 basis points, which is cheap to long term averages. The war in Ukraine and risks of an energy crunch hang over the market given recession risks. More recently, the risk of a deep recession has fallen as the risk of gas rationing has subsided thanks to elevated gas storage levels, in addition to state-support packages to limit energy costs for households and firms. The European Central Bank remains committed to bringing inflation down, leaving it caught between a rock and a hard place. By working to ensure inflation returns to its price stability goal, monetary policy is essentially working against fiscal at present. The announcement of planned ECB tapering of asset purchases (EUR15bn per month as of March or half of expected monthly APP bond reinvestments) was a hawkish surprise and European rates moved sharply higher. However, the impact for credit markets was muted and spreads were relatively contained around the announcement date. Looking ahead, there is the risk of crowding out, as the anticipation of rising European government bond supply in coming weeks could have an impact on corporate credit spreads for new issues.

At this juncture, our recommendation is for investors to either approach the asset class selectively by focusing on bottom up opportunities in fundamentally sound credits or switch from lower-rated non-investment grade credits into the asset class.

## CIO themes

### Resilient credits

Resilient credits offer a decent income following a sharp rise in interest rates and credit spreads. Our selection of tenors around five to seven years offers additional potential outperformance over riskier bonds (and stocks) in the case of a recession, where interest rates would likely decline materially, while risk premiums of resilient credits would only rise moderately. Investors concerned about recession risk should prefer this positioning over shorter-dated bonds with higher credit risk.

### Income returning to fixed income

Global interest rates have moved sharply higher, resulting in mark-to-market losses year-to-date for fixed income investors. Given that interest rates are now much higher and there are significant expectations priced in regarding central bank rate hikes, we believe the risk-return balance for the asset class has been restored. Accordingly, we believe investors should consider closing underweight positions and actively look at select opportunities in the front-end of the yield curve.

# Investment grade

## Upside scenario

**Bloomberg Barclays US Int. Corp June 2023 target: 60bps**

**Bloomberg Barclays Euro-Agg. Corp. June 2023 target: 70bps**

### **Inflation and Fed policy**

Inflation moderates at a swift pace, taking the pressure off the Fed to normalize policy rates and withdraw liquidity. This provides a much more predictable policy path and leads to a loosening of financial conditions, which is supportive for economic growth prospects.

## Downside scenario

**Bloomberg Barclays US Int. Corp. June 2023 target: 200bps**

**Bloomberg Barclays Euro-Agg. Corp. June 2023 target: 250bps**

### **Inflation and Fed policy:**

Inflation remains persistently high, forcing central banks to tighten policy more aggressively. This raises growth fears and default risks, and leads to wider credit spreads.

### **War in Ukraine:**

The prolonged war in Ukraine increases the likelihood of further disruption to energy supplies. This would have a detrimental effect on growth and earnings, and increase the possibility of a sharp recession.

# High yield

Preference: Least preferred

## Central scenario

### June 2023 spread targets: 550bps (USD HY) / 550bps (EUR HY)

The last couple of months have seen strong returns for HY as declining inflation and prospects of a near-term end to monetary policy tightening has buoyed risk markets. The large outright yields on offer in the asset class have also grabbed the attention of investors. Despite this optimism, growth continues to slow as the impact of tighter financial conditions slowly works its way through the system. We are constructive on fixed income as an asset class, however with the more growth sensitive segments such as HY we are advocating a more selective and up in quality bias.

Although there is optimism on the inflation front, levels remain well above central bank targets—which is why they are yet to officially signal an end to the rate hiking cycles. Many companies were fortunate enough to lock in lower funding costs prior to the sharp moves higher in rates. As time passes, this benefit diminishes as maturities approach and refinancing needs increase. This coupled with a more challenging earnings backdrop is a nasty cocktail. Our view is that credit metrics will continue to deteriorate from here and more levered corporates without reasonably priced market access will be forced into aggressive balance sheet restructuring. This is what underpins our current least preferred asset class recommendation.

We are forecasting a rise in corporate defaults of mid single digits over the next 12mths, compared to the current level of 1.6%. Of some comfort is the fact that we have not seen the classic buildup of financial excess and leverage since the last default cycle in 2020 related to the COVID-19 pandemic. Leverage has declined as earnings have increased while debt growth has been mute. On top of this, the energy sector in the US, which is often a source of defaults in downturns, is in a relatively healthy state by virtue of higher energy prices. By virtue of these facts, our spread forecasts are wider than today but not aggressively as would be the case in a traditional economic downturn, turn in the default cycle.

Taking aside default risk, we do have some concern around the current levels of credit risk premiums, which is the compensation credit investors require over and above expected credit losses. These we consider to be tight. This may be due to market hopes that central banks will pivot quickly to backstop credit markets or due to excess liquidity in the system (due to the large growth in the money supply resulting from COVID-related fiscal and monetary stimulus measures). Our assessment is that a central bank pivot remains unlikely in the short term, liquidity will continue to be drained from the financial system, and any policy response to support credit markets will be reactive rather than proactive in that the credit risk premiums will need to widen first.

Over the medium to longer term, for investors holding well-diversified positions and who are willing to stomach mark-to-market volatility, we see justification for riding out the likely near-term downside risks. The current level of outright yields in US HY and EU HY are around 8% and 7% (in local currency), respectively, at an index level. This is appealing based on history and relative to potential returns in other asset classes. Additionally, the repricing in spreads and yields has happened in a short period of time, creating a scenario where the majority of bonds are currently trading at deep discounts to par and hence generating positive convexity. This means that prices will rise by more on a fall in yields than a comparable rise in yields.

For investors with a more tactical mindset, we recommend moving up in quality given concerns about market liquidity and expected headwinds for earnings, which we think are likely to reprice spreads wider. By moving up in quality, we believe investors can still benefit from higher outright levels of rates and reduce their credit spread volatility in the process.

## CIO themes

### Income returning to Fixed Income

Global interest rates have moved sharply higher, resulting in mark-to-market losses year-to-date for fixed income investors. Given that interest rates are now much higher and there are significant expectations priced in regarding central bank rate hikes, we believe the risk-return balance of the asset class has been restored. So, we believe investors should consider closing underweight positions and actively look at select opportunities in the front-end of the yield curve.



# High yield

## Upside scenario

**ICE BofA US high yield spread June 2023 target: 300bps / ICE BofA Euro high yield spread June 2023 target: 290bps**

### **Inflation and Fed policy**

Inflation moderates at a swift pace, taking the pressure off the Fed to normalize policy rates and withdraw liquidity. This provides a much more predictable policy path and leads to a loosening of financial conditions, which is supportive for economic growth prospects.

## Downside scenario

**ICE BofA US high yield spread June 2023 target: 850bps / ICE BofA Euro high yield spread June 2023 target: 850bps**

**Inflation and Fed policy:** Inflation remains persistently high, forcing central banks to tighten policy more aggressively than expected. This raises economic growth fears and default risks, and leads to much wider credit spreads.

**War in Ukraine:** The prolonged war in Ukraine increases the likelihood of further disruption to energy supplies. This would have a detrimental effect on growth and earnings, and increase the possibility of a sharp recession.

# Emerging market bonds

Preference: Most preferred

## Central scenario

### June 2023 spread targets: 425bps (EM sovereign bonds) / 300bps (EM corporate bonds)

The investment backdrop has become more favourable for EM credit, given that near-term risks related to Fed policy and global growth have diminished, in our view. The Fed has moved away from aggressive rate hikes as inflation has moderated and policy is in restrictive territory, with leading US growth indicators pointing to a softening of economic activity. The US central bank is getting closer to the end of its rate-hiking cycle, which we believe is likely by the end of the first quarter, and the likelihood of the Fed having to raise rates much higher than expected has diminished.

At the same time, China's rapid dismantling of COVID restrictions is paving the way for a faster-than-anticipated economic reopening, while policymakers are emphasizing the need for monetary and fiscal support to aid the domestic recovery. We think China's reopening should support global growth prospects in 2023, supporting EM fixed income in general. Finally, we think the risk of an energy crisis in Europe—and therefore a deep recession—has fallen due to fiscal support measures, and amid a mild winter supporting elevated gas storage levels and lower gas prices.

While spreads on EM sovereign and corporate bonds have tightened in recent months reflecting these positive developments, we think spreads are likely to remain supported in the coming months by signs of further progress on these drivers. We also expect further moderate tightening over our forecast horizon. We see value in EM sovereign bonds where current valuations are attractive relative to historical levels, driven by the HY segment. The proportion of the index trading at spreads above 600bps remains elevated. Within this category, we find value in some of the larger sovereign issuers that are willing and able to work with the IMF or other international lenders, or where we see upside to potential restructuring scenarios.

We hold a most preferred stance on the asset class. The sovereign index yield is now around 8.2% and the corporate index yield is around 6.9%. We expect mid-single-digit total returns for the asset class in a baseline scenario in the coming six months (non-annualized), supported by carry and spread compression. But investors need to be mindful that the range of possible outcomes at this stage remains somewhat elevated. In particular, we have yet to see the full economic impact of the tightening efforts by the Fed on the US economy, and the key risk for our constructive view is a sharp US recession.

## CIO themes

### Short-duration bonds

Select short-duration bonds from emerging market issuers lie in a "sweet spot" within the asset class in the current market environment—one characterized by high inflation, rising US Treasury yields, and global economic growth concerns emanating from the war in Ukraine. Not only can they mitigate duration risk, they can also aid in portfolio yield enhancement and diversification, in our view.

### Oil and gas bonds

We see opportunities in the oil and gas space, given our positive view on oil prices. With lingering uncertainties, selectivity is essential.

### Sustainable bonds

Sustainable bonds include green, social, and sustainability (GSS) bonds, and sustainability-linked bonds. We think sustainable bonds are a good way to diversify portfolios.

### Opportunities in sukuku

Islamic investors adhering to Sharia restrictions are most likely to choose from Sharia-compliant debt instruments, such as sukuku. In recent years, sukuku have become an increasingly popular investment choice in conventional bond portfolios. We think sukuku offer diversification opportunities.

# Emerging market bonds

## Upside scenario

**EMBIG Diversified / CEMBI Diversified spread June 2023 targets: 300bps / 280bps**

**A quick economic recovery:** China's economy recovers faster than expected with stronger policy support, coupled with a global economy that exhibits resilience to the tightening of financial conditions.

**Commodity price recovery:** A further price appreciation in commodities improves the terms of trade for commodity-exposed issuers and strengthens fiscal positions.

## Downside scenario

**EMBIG Diversified / CEMBI Diversified spread June 2023 targets: 600bps / 550bps**

**Prolonged economic slump:** A sharp global economic slowdown leads to weaker EM currencies, deteriorating credit quality due to fiscal vulnerabilities, and wider spreads.

**Fed tightens aggressively:** Inflation remains high for longer, and the Fed is forced to accelerate monetary policy tightening, slowing economic growth in the process.

**Increased Russia-China-US tensions:** Heightened friction emanating from either the war in Ukraine or broader geopolitical tensions hurts risk sentiment, strengthening the US dollar and curbing appetite for EM assets.

**Rising populism:** Increased conflicts within and between countries could arise as populist policies become more widespread globally.

# Asian bonds

## Central scenario

### **JACI composite spread June 2023 target: 270bps**

Asian credits have enjoyed the tailwind from continuous policy easing on China property and improving global risk sentiment. The approaching peak in US interest rates offers additional support for the higher beta segment. As a result, JACI composite spreads tightened 20 basis points in the past month, led by a sharp firming for the high yield (HY) part. We expect further spread tightening on Asia credit, especially for select good quality high yield names.

China's property sector has been the key contributor to the sharp spread tightening of Asia HY bonds over the past month. Key reasons are the continuous policy support for this sector and better-than-expected restructuring deal terms. On 5 January, China's central bank loosened the floor for mortgage rates in cities with home price declines for three consecutive months, offering more flexibility for local banks to decide on the actual lending rate. On 12 January, the People's Bank of China (PBoC) and the banking regulator CBIRC urged commercial banks to help high-quality and systemically important developers to reduce liquidity risk and improve their balance sheets. In the primary market, Dalian Wanda issued a 2-year USD bond at 12.375% on 12 January, the first Chinese USD HY property issuance in a year. As for distressed names, some aspects of the restructuring plan panned out more creditor-friendly than expected. For instance, Logan indicated no haircut on its restructured USD bond, lifting its residual value.

So far, the rally has been driven by depressed valuations, light positioning, and expectations of more survivors amid policy support. But the timing of a Chinese housing sales recovery remains uncertain. December sales data from 31 listed names was still weak (-30% y/y) due to COVID outbreaks. For housing sales to rebound, we need to see investment demand and investor confidence bounce back. After the 30% total return rebound of Asia HY and the 70% recovery of China HY from last November's lows, we expect some consolidation before the market's next leg up.

Aside from the property sector, mainland China's reopening is also helping Macau gaming, the aviation industry, Hong Kong landlords, insurers, and securities firms with exposure to the Hong Kong market. We have been seeing a meaningful tourism recovery in Macau over the past week, and most casino hotels have been fully booked for the lunar new year holiday period.

# Asian bonds

## Upside scenario

**JACI composite spread June 2023 target: 230bps**

**Much faster recovery after full reopening:** If China's macroeconomic data recovers faster and stronger than expected, the upside for Asia credits would be larger than our base case as many Chinese bonds remain in low valuation territory.

**Sharp rebound in China housing sales:** So far, policy has focused on supporting the liquidity of important Chinese property developers, but housing sales remain quite weak. A quick rebound of housing sales would offer fundamental support to the credit metrics of this sector.

**More dovish-than-expected central bank actions:** Spreads would likely compress if the Fed stops hiking sooner than expected and becomes less aggressive on quantitative tightening.

## Downside scenario

**JACI composite spread June 2023 target: 330bps**

**Much higher default rates** The HY sector may see a sell-off if default rates far exceed current market pricing.

**Sovereign vulnerability** Pakistan is the wild card in the Asia region, which could pose downside risks if it went under.

**Deep US/Europe recession:** If the US or Europe fell into a deep recession, growth in Asia and sentiment toward Asian credits would be impacted.

# Gold

## Central scenario

### **Gold June 2023 target: USD 1,800/oz**

The price of gold has rallied to its highest level since June 2022, triggered by a rally in US government bonds and broad USD weakness. US average December hourly earnings undershot expectations by 0.4 percentage points (4.6% y/y vs. 5% y/y), while the US services ISM posted its biggest monthly drop outside of a recession since the mid-1990s, against expectations of a small rise. The indicator slumped 6.9pts to 49.6 last month—below 50 for the first time since May 2020. These, coupled with downside surprises in recent US core inflation data, have money markets now expecting fewer Fed rate hikes and an earlier cut. We disagree and expect a terminal fed funds rate around 5%, with a relatively low likelihood of rate cuts this year unless the unemployment rate rises sharply (to 5% or above).

Given our view and gold's correlation with the US dollar and nominal interest rates, we expect prices to fall over the short run. As the quarter unfolds, we anticipate some residual USD strength, a revaluation of expectations for Fed rate cuts this year, and subsequently higher US real rates (as inflation eases further)—which limit gold's upside for now, in our view. But as a hard landing in the US cannot be ruled out, we reiterate gold's historical insurance qualities in a portfolio context alongside an income strategy, which can enhance returns on gold holdings.

## Upside scenario

### **Gold June 2023 target: USD 2,000–2,100/oz**

The Fed becomes dovish, introducing another round of quantitative easing measures, or it allows inflation to overshoot, which would once again support investment demand for gold.

## Downside scenario

### **Gold June 2023 target: USD 1,500–1,600/oz**

The Fed becomes even more hawkish, hiking interest rates aggressively in 2023 and pushing up US real rates strongly, which would likely trigger substantial outflows from gold ETFs.

# Crude oil

Preference: Most preferred

## Central scenario

### Brent crude oil June 2023 target: USD 110/bbl

We expect crude oil prices to rise in 2023 for several reasons. With China reopening, oil demand looks set to exceed 2019 levels and hit a record high in 2H23. Emerging Asia, including India, should also return to driving oil demand growth. Meanwhile, Russian oil production should fall in 2023 due to the European Union's embargo on Russian crude and refined products (to come into force on 5 February). While production outside the OPEC+ group, which is primarily driven by the US, will likely expand again this year, the increase should only be modest following years of underinvestment in building new supply.

So, to keep the market in balance, we expect OPEC+ to ease production cuts once again in 2023 and provide more barrels to the market to cover rising oil demand as Russian supply drops off. With OECD oil inventories (commercial and strategic) standing at the lowest level since 2004 and spare capacity set to keep dwindling this year, we continue to believe higher prices are needed to slow down oil demand growth and encourage investments in new production.

We therefore continue to see oil prices moving above USD 100/bbl over the coming months, with Brent trading at USD 110/bbl at mid-2023 and end-2023 (WTI USD 107/bbl). Given our positive price outlook, we reiterate our investment recommendations. With the oil futures curve sloping downward (in backwardation) and higher prices likely ahead, we continue to advise risk-taking investors to add long positions in longer-dated Brent oil contracts. Alternatively, investors can make use of lower spot prices and high option implied volatility by selling Brent's downside price risks over the next six months. Another way to gain exposure is through Brent crude oil first generation indexes. Such strategies should benefit from solid roll returns on top of the expected spot appreciation. But considering oil's volatility of more than 40%, this strategy requires investors to have an elevated risk appetite.

## Upside scenario

### Brent crude oil June 2023 target: USD 140–170/bbl

Upside risks to our forecasts include a large, long-lasting disruption of Russian crude production and destabilizing political events in oil-producing regions such as Libya, Venezuela, Nigeria, and the Middle East, which could trigger a sharp drop in supply for a sustained period. A faster-than-expected oil demand recovery as mobility picks up and a slow production response (i.e., increase) from the US would also be price-supportive.

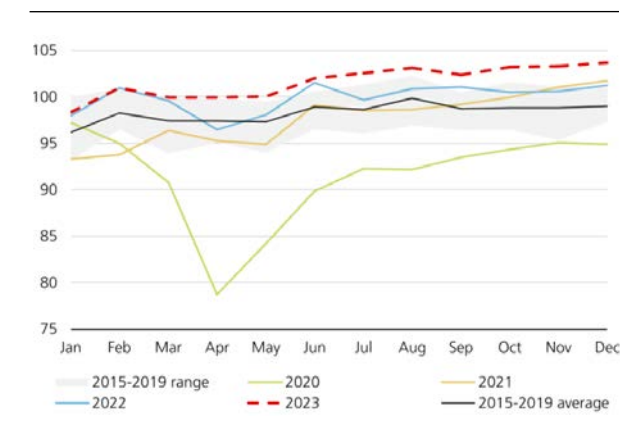
## Downside scenario

### Brent crude oil June 2023 target: USD 50–80/bbl

Downside risks include a sharp price increase over the coming months due to large disruptions in Russia, which could trigger a recession. Renewed extended mobility restrictions that weigh on the oil demand recovery are another risk. A potential hard landing of the Chinese economy would also pose a downside risk as emerging Asia has been the engine of oil demand growth in recent years. Another concern is that capital discipline in the US could start to erode. Also, the return of oil production in Venezuela and Iran, which has been disrupted, could weigh on prices.

## Oil demand to reach a record high later this year

Values are in million barrels per day



Source: IEA, UBS estimates

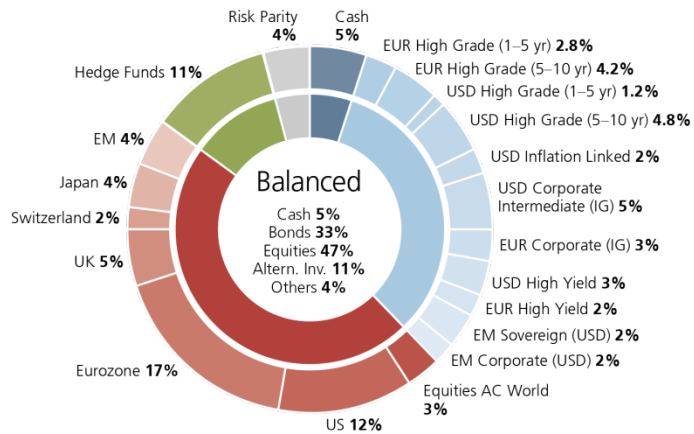
Section 3

# Appendix

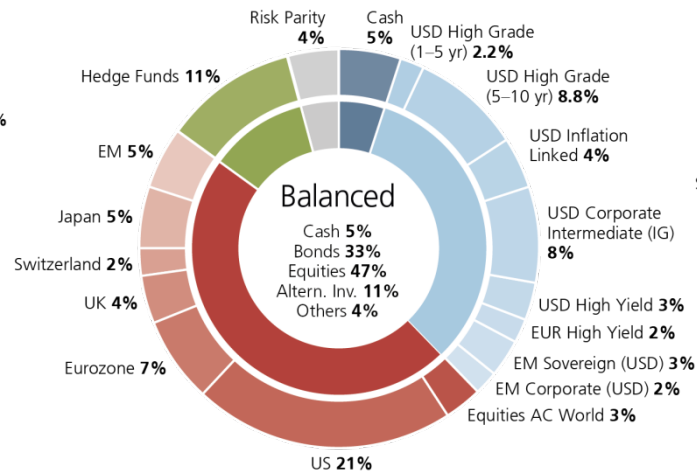


# Strategic Asset Allocations (SAAs)

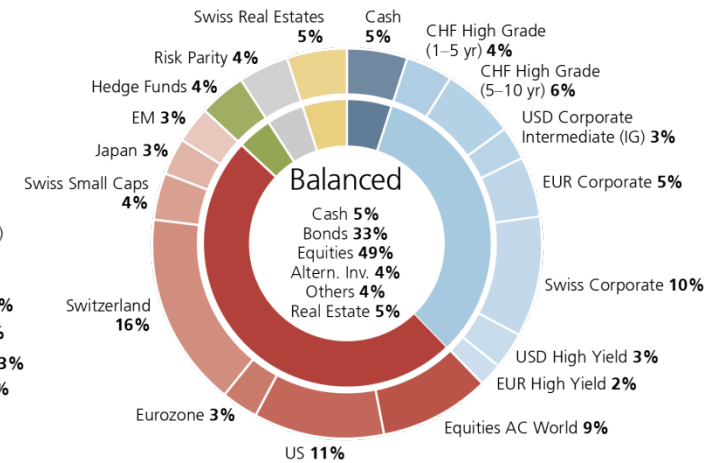
EUR (local portfolio with home bias)



USD



CHF (local portfolio with home bias)



Note: Portfolio weightings are for EUR SAA with a home bias and a balanced risk profile. We expect a balanced EUR SAA to have an average total return of 4.1% p.a. and a volatility of 8.4% p.a. over the next 15 years.

Note: Portfolio weightings are for a USD SAA with a balanced risk profile. We expect a balanced USD SAA to have an average total return of 5.3% p.a. and a volatility of 8.5% p.a. over the next 15 years.

Note: Portfolio weightings are for CHF SAA with a home bias and a balanced risk profile. We expect a balanced CHF SAA to have an average total return of 3.7% p.a. and a volatility of 8.3% p.a. over the next 15 years.

Source: UBS, as of January 2022

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