UBS House View

Monthly Extended October 2023

Please Note:

We continue to give our asset class preferences with a 6 - 12 month horizon, but we no longer include our asset class views (central, upside and downside scenarios). To get our most recent CIO Views, click the Research link from the homepage of UBS Online Services and then click any of the following links: Commodities, Currencies, Emerging Markets, Equities, Fixed Income/Muni Bonds, Preferred Securities, Real Estate and Alternative Investments.

For the most recent asset class forecasts, please refer to our publication called Global Forecast by clicking the Research link from the homepage of UBS Online Services and then clicking Economics & Forecasts.

Chief Investment Office GWM

Investment Research

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Please see the important disclaimer at the end of the document.

Section 1

Investment views

Section 1.1

Asset class outlook

Asset class outlook

Asset allocation

In our global strategy, we continue to prefer bonds over equities.

Within equities, we continue to prefer value and quality income versus growth. **We upgrade IT to neutral, but we remain cautious and very selective on the growth segment.** We also like emerging markets, including China.

Within credit, we prefer investment grade over high yield and emerging market credit.

Within commodities, we hold a preference for oil.

Within currencies, we keep the US dollar as least preferred and the euro as a most preferred currency.

Equities

The earnings outlook has improved, and on the back of US economic resilience, we have a neutral stance on global equities. But global equity valuations remain unattractive, and we see limited room for a rerating by the end of the year. So, we continue to prefer high-quality bonds to equities.

Across regions, we keep US equities as least preferred and emerging market equities as most preferred.

By global equity sector, consumer staples, utilities, energy, and industrials stay as most preferred, and materials and healthcare as least preferred. **Information technology has been upgraded to neutral.**

Across styles, we prefer value and quality income to growth (upgraded to neutral from least preferred). Value stocks remain historically very cheap compared to growth stocks.

Bonds

We continue to be most preferred on the higher-quality segments of fixed income, given the all-in yields on offer and as inflation cools, downside risks to growth remain, and restrictive monetary policy continues to transmit into the real economy. Specifically, we maintain a preference for investment grade bonds, and are neutral on high yield and emerging market credit.

The tightening of lending standards and higher official policy rates continue to weigh on growth and inflation, and should apply downward pressure on nominal interest rates. This is a positive driver for the performance of high-quality bonds. For higher-beta credit segments, we are beginning to see rising defaults and a gradual deterioration in corporate fundamentals. These dynamics and rising liquidity risk premiums are likely to have a greater impact on the lower quality segments of the asset class, such as high yield and loans.

Foreign exchange

The US dollar remains least preferred in our global strategy, although we acknowledge current bouts of strength in the greenback may mean less weakness ahead.

We keep the euro at most preferred in spite of disappointments in China and lackluster growth in Europe. We still expect investors moving away from the US dollar to look for a liquid alternative asset market, and the euro is an obvious option, in our view.

Regarding the other main currencies, we maintain a neutral positioning on the Japanese yen, Australian dollar, British pound, and Swiss franc.

Commodities

Our benchmark UBS CMCI index fell 0.6% during the month, driven by lower metal prices. Energy was the only sector with a positive performance. Therefore, within the asset class, we keep our preference for oil.

The asset class has, however, delivered a positive return in the first few days of September, with the UBS CMCI Total Return standing at the highest level since June 2022. We see further gains for commodities as a whole into year-end and target low-teens total returns on a 12-month basis.

We also continue to recommend actively managing commodity exposure.

Section 1.2

Risk scenarios

Key scenarios until June 2024

	Upside: Return to goldilocks	Base case: Soft landing	Downside: Hard landing	*Things to watch*
Probability	*20%*	*60%*	*20%*	
Market path	**Bonds slightly up, equities sharply up** Equity markets and other risk assets rally as bonds also appreciate. Equity valuations expand as policy interest rates fall.	**Bonds up, equities slightly up** Equity markets remain volatile but continue to grind higher amid slow but stable growth, falling inflation and normalizing financial conditions.	**Bonds up, equities sharply down** Global equities post double-digit losses and credit spreads widen. Safe haven assets such as high-quality bonds, gold, the Swiss franc and the Japanese yen, appreciate.	
Economic growth	The US continues to grow at or above the trend rate of approx. 2% as labor markets, household balance sheets, and corporate earnings prove resilient and the improvement in manufacturing offsets a slowdown in services. China opts for large-scale fiscal stimulus. European growth improves.	The US economy slows below trend but continues to grow over the next 12 months. Other Western economies continue to decelerate and experience sub-trend or negative growth. China announces targeted measures to support economic activity.	Falls sharply on a global scale toward mid-2024 owing to the delayed impact of monetary tightening and/or additional tightening efforts to tame persistent core inflation. China continues to decelerate amid underwhelming fiscal support.	*US, China: PMI data* *US, Europe: industrial production* *US: capital goods orders* *US, China Europe: consumer spending* *US: housing starts* *Europe: gas prices*
Inflation	Returns to central bank targets more quickly than anticipated.	Continues to slow in the US and in Europe, but ends the year above central bank targets before normalizing by mid-2024.	Falls quickly as demand for goods and services collapses.	*Global: Oil price* *US: CPI and PCE inflation* *US: ISM prices-paid subindex* *US: average hourly earnings* *US: change in nonfarm payrolls* *US: JOLTS openings and hires* *Eurozone: HICP inflation* *China: fiscal stimulus measures*
Central banks	Major central banks start cutting policy rates in early 2024 as inflation normalizes ahead of expectations, in order to avoid monetary policy becoming too restrictive in real terms.	Major central banks start cutting policy rates by 2Q 2024 as inflation normalizes. The Fed lowers its policy rate by up to 100bps next year.	Major central banks cut interest rates by 200bps or more from mid-2024 after seeing evidence of a deep recession.	
Financial conditions	Ease quickly as a better growth-inflation mix is priced in.	Ease gradually amid building expectations of upcoming monetary easing.	Tighten dramatically, causing stress in the financial system and increasing the risk of systemic events.	*Global financial conditions indexes* *Bank lending surveys*
Geopolitics	The war in Ukraine deescalates, e.g., via a ceasefire agreement. Progress is made in bilateral relations between the US and China.	The war in Ukraine drags on as ceasefire negotiations remain elusive. US-China strategic rivalry continues following outbound investment restrictions by the US.	The war in Ukraine escalates and/or US-China tensions intensify.	*Territorial gains by Russia* *Weapon shipments to Ukraine* *Further coup attempts in Russia* *US sanctions on Chinese companies*

Asset class targets – June 2024

Key targets for June 2024	spot*	Upside	Base case	Downside
MSCI AC World	820	950 (+16%)	870 (+6%)	680 (-17%)
S&P 500	4,487	5,200 (+16%)	4,700 (+5%)	3,500 (-22%)
EuroStoxx 50	4,254	5,100 (+20%)	4,700 (+10%)	3,700 (-13%)
SMI	10,972	12,800 (+17%)	12,400 (+13%)	9,800 (-11%)
MSCI EM	978	1,200 (+23%)	1,100 (+13%)	820 (-16%)
US 10y Treasury yield	4.29	3.50	3.00	2.25
US 10y breakeven yield	2.34	2.50	2.25	1.50
US high yield spread**	382bps	370bps	500bps	850bps
Euro high yield spread**	430bps	370bps	500bps	850bps
US IG spread**	110bps	80bps	120bps	200bps
Euro IG spread**	154bps	110bps	170bps	220bps
EURUSD	1.08	1.22 (+13%)	1.16 (+8%)	1.07 (-0%)
Commodities (CMCI Composite)	1,869	2,000 (+7%)	1,950 (+4%)	1,600 (-14%)
Gold***	USD 1,922/oz	USD 1,800-1,900/oz (-4%)	USD 2,100/oz (+9%)	USD 2,300-2,400/oz (+22%)

* Spot prices as of market close of 11 September 2023. Developed market constituents of the MSCI All Country (AC) World index display in the local currency. The MSCI EM index displays in US dollar. Values in brackets are expected percentage changes from the quoted spot levels. Dividends, share buybacks and other sources of carry are not included.

** During periods of market stress, credit bid-offer spreads tend to widen and result in larger ranges.
*** Gold is a safe-haven asset whose price tends to rise when risk assets, such as equities, fall, and vice versa.

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

Section 1.3

Asset class preferences and themes

US asset class preferences

	Least preferred		Most preferred
Cash		=	
Fixed Income			+
US Gov't FI		=	
US Gov't Short		=	
US Gov’t Int.		=	
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
Equity		=	
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			+
Other			
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.

UBS

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

Get in balance

We are at a rare moment when the ability to earn returns is relatively simple—in our base case, we expect cash, bonds, stocks, and alternatives all to deliver good returns over the next 6–12 months and over the longer term. But investors do need to review portfolios to ensure an effective balance across asset classes to manage potential risks and ensure that returns are durable.

Balanced asset allocation incl. alternatives
Balanced sustainable asset allocation incl. alternatives

Source of funds
- Cash
- Maturing investments

Manage liquidity

Cash rates are attractive. But we expect such high rates to be short-lived, as the central bank tightening cycle should soon end. We recommend that investors hold no more than two to five years of expected net portfolio withdrawals in a Liquidity strategy. The remainder should be put to work in a balanced portfolio. Within Liquidity portfolios, investors can optimize and future-proof yields by using a combination of deposit vehicles, bond ladders, and select structured solutions.

Bond ladder
Certificates of deposit
Capital preservation structured investments
Money market funds
Bond funds

Source of funds
- Cash
- Maturing investments

Buy quality bonds

Within fixed income, we are focused on quality bonds—at current yield levels, we see it as highly unlikely that they will deliver negative returns over the next 12 months. Our preferred duration stance is the 5–10-year range; although yields are lower than at the short end, we see the income durability and greater scope for capital appreciation as attractive. We are less positive on emerging market and high yield bonds given that the extra yield in these asset classes is limited for the additional risks borne.

Government bonds (incl. TIPS)
Investment grade bonds
Sustainable bonds
Municipal bonds
Actively managed fixed income strategies

Source of funds
- Cash
- Excess EM / high yield

Look for equity laggards

With stock market gains this year concentrated in a few companies, an economic "soft landing" looking more likely, and with more investors actively seeking cheaper stocks, we see opportunity in the parts of the market that have lagged global indexes this year. In US equities, we prefer equal-weighted indexes to cap-weighted indexes. In Europe, we like small- and mid-caps. Regionally we prefer emerging markets, which have lagged global markets this year. We continue to prefer the quality income and value styles.

US equal-weight indexes vs. cap-weight indexes
Quality income and value
Select Swiss / European opportunities
Invest in EM

Source of funds
- Cash
- Least preferred stocks

Pick leaders from disruption

Technological disruption across industries is creating compelling opportunities for investors looking for longer-term portfolio growth potential. In the technology sector, among disruptors, we like platform companies with network effects in industries like internet and software as the impact of artificial intelligence (AI) broadens. In energy, we see opportunity in the transition to renewable energy. We also see opportunities in the healthcare sector, as advances in drug development in areas like diabetes and weight loss are driving significant industry growth.

Technology disruption
Energy transition
Healthcare innovation

Source of funds
- Cash
- Least preferred stocks

Diversify with alternatives

Alternative asset classes are a key part of long-term portfolio diversification, both in terms of potentially better risk-adjusted performance over traditional asset classes and potential diversification when stocks and bonds move together. The current market environment also offers compelling individual hedge fund and private markets opportunities, particularly in specialist credit hedge fund strategies and secondaries in private equity. Higher interest rates can also support return potential for alternative asset managers, given higher yields and returns on offer in underlying assets, including in private debt.

Hedge funds (Discretionary macro, equity low-net, credit, multi-strategy)
Private equity (value buyout, secondaries, thematic)
Stay invested in private real estate / private credit

Source of funds
- Excess bonds / equities
- Concentrated equities

Invest in infrastructure

Infrastructure benefits from powerful structural tailwinds driven by digitalization, deglobalization and decarbonization trends. Government support is likely to spur capacity expansions and support current and future project economics and competitiveness (notably for renewables). In a portfolio context, we think the asset class is a valuable source of steady and inflation-linked income with lower sensitivity to economic growth and broad market movements.

Infrastructure (incl. greentech)
US industrials (incl. automation and robotics)

Source of funds
- Cash

Go sustainable

Green investment, decarbonization commitments, consumer sentiment, and regulation will continue to drive the case for investing sustainably. We like sustainable bonds; environmental, social, and governance (ESG) leaders; and innovative companies that can do more with less, including within energy and water efficiency. We also see opportunities to gain exposure to sustainable themes such as health and education through private market vehicles.

Sustainable bonds
Sustainable equities
Private market impact investing

Source of funds
- Cash
- Traditional equivalents

Long-term themes

Technology

- **Automation and robotics**
  A fourth industrial revolution is underway, which we believe will transform the future of manufacturing.
- **Digital data**
  Companies that both enable digital data and invest in its infrastructure will likely have strong earnings growth over the coming years.
- **E-commerce**
  E-commerce is altering the global retail landscape, and omni-channel companies should lead the way forward.
- **Enabling technologies**
  We identify five enabling technologies that should offer solid long-term growth amid irreversible technological disruption.
- **Fintech**
  The global fintech industry is at an inflection point and set to drive a major digital transformation in the financial services industry.
- **Healthtech**
  Aging populations are straining global healthcare budgets, spurring healthcare providers to explore new technologies that could improve efficiency.
- **Medical devices**
  The medical device industry has matured, but opportunities exist for increased penetration in emerging markets.
- **Metaverse**
  We expect iterative improvements in metaverse-related infrastructure, artificial intelligence, and experiences to continue to unfold in the years ahead.
- **Oncology**
  Advances in cancer therapeutics will create new multi-billion-dollar opportunities for successful drugs.
- **Security and safety**
  Growing trends such as urbanization, digital data, and increased regulation support demand for security and safety.
- **Smart mobility**
  Global urbanization will call for structural changes in technology that will alter the way we "consume" mobility in the coming decades.
- **Space**
  Growing private sector investment and lower entry barriers to the space economy are causing an inflection point in space-related long-term investments.

Long-term themes

Resources

- **Agricultural yield**
  The world faces a growing food production crisis as the global population rises. Companies that help to boost agricultural yields stand to benefit.
- **Circular economy**
  Four trends are emerging that we believe should catalyze circular initiatives: regulation, shifting consumer preferences, resource scarcity and cost pressures, and technological innovation. We believe companies that embrace circularity stand to benefit.
- **Clean air and carbon reduction**
  Rising populations and urbanization are fueling the need for clean-air technologies. Solution providers targeting emissions reduction stand to benefit.
- **Energy efficiency**
  Stricter regulation and corporate competition to improve product efficiency are driving demand for energy-efficiency solutions.
- **Energy transition**
  The world is facing relentless demand for energy, and several types of energy resources will be needed to satisfy that demand.
- **Frontier markets**
  Demographics and urbanization provide frontier markets with a higher medium-term growth potential relative to emerging markets and the world economy.
- **Food revolution**
  Greater technology utilization and investment throughout the food supply chain will be needed to create a healthy sustainable food system.
- **Water scarcity**
  Water scarcity is one of the biggest risks to mankind. If limited water resources can be better harnessed, the benefits could be enormous.

Society

- **Aging in comfort**
  A larger population of seniors and evolving social trends are creating opportunities in products and services geared toward older generations.
- **Consumer experience**
  Consumer behavior is shifting toward consumer experience. People are spending more on experiences that create lasting memories and happiness.
- **Diversity and equality**
  Increasing regulation and stakeholder scrutiny, paired with growing evidence of the benefits of diversity, are driving a number of related investment opportunities.
- **Education services**
  With limits to many governments' education resources, there is increased opportunity for the private education market.
- **Emerging market healthcare**
  An aging emerging market population requires stepped-up investment in healthcare. We believe global healthcare companies can benefit.

Long-term themes

Society

- **Emerging market infrastructure**
  Growing urbanization and high economic growth rates will drive demand for infrastructure investment in emerging markets.
- **Family businesses**
  Family businesses tend to align management's goals with that of shareholders, while the desire to create lasting familial wealth can act as an incentive for a long-term focus.
- **Genetic therapies**
  Genetic therapies use genes and cells to treat serious diseases. They could revolutionize medicine by removing the fundamental causes of inherited genetic conditions.
- **Obesity**
  Urbanization and rising per capita GDP in emerging markets will contribute to a greater prevalence of global obesity.

Short-term themes

Equities

- **ESG matters in emerging markets**
  Incorporating environmental, social, and corporate governance considerations into emerging market equity investment decisions may provide a competitive edge.
- **Diabetes and Obesity** *NEW*
  Innovative new obesity treatments are spurring opportunities in the healthcare sector and broadening the opportunity set for investors.
- **Investing in self-help**
  We believe companies with self-help measures to enhance profitability and increase margins are likely to be rewarded by investors.
- **Pricing power standouts**
  Companies with pricing power should be better able to offset any potential increase in input prices.
- **Made in America**
  We've put together a list of companies we expect to benefit from an increase in spending across multiple verticals, including government spending and select pockets of technology.
- **Time for quality**
  With uncertainty over the outlook for economic growth likely to persist, in conjunction with a flat yield curve, we believe high-quality stocks are well positioned. We identify high-quality companies that have strong returns on invested capital, relatively stable operating margins, and healthy free cash flow yields.

Short-term themes

Bonds

- **Enhancing liquidity strategy return potential with MLCDs**
  Market-linked certificates of deposit (MLCDs) can offer some limited upside exposure to stocks, while providing a "floor" to prevent capital losses if they are held to maturity. We believe that MLCDs should be considered as a part of a bond ladder, particularly in the liquidity strategy, where assets are earmarked for spending in the next three to five years.
- **Quality IG credits present an income opportunity**
  We believe these issuers offer attractive yields and exhibit balance sheet strength and earnings resilience.
- **Short-dated high yield bonds**
  One- to three-year maturity BB rated high yield bonds can provide over 100 basis points of spread pickup relative to similar-duration investment grade bonds, offering yields of around 6.5–7%.
- **Short-duration Pan-American bonds**
  This US-based theme recommends investors to consider select corporate bonds with relatively short maturities and provides a list of issuers domiciled in both the US and Latin America.
- **Taxable munis**
  Taxable munis exhibit lower default rates relative to corporate bonds and provide incrementally higher yield relative to other forms of taxable debt. They can also provide diversification benefits, though they are less liquid than their fixed income counterparts.
- **Yield opportunities in Latin America**
  US investors are finding it increasingly difficult to achieve decent yields to help them reach their financial goals. In this context, we recommend they contemplate investing in fixed income segments they had not considered before, among them emerging market sovereign and corporate bonds.

Alternatives

- **Opportunities in dislocated credit markets**
  Stress in the credit market has expanded the opportunity for hedge fund and private managers to deploy capital toward dislocations.

Highlighted global themes

Equities

- **23 for '23**
  Identifying the "new normal" in 2023 should bring multiple opportunities, including reopening, restocking, and a return to expansion. "23 for '23" is a bottom-up focused global stock selection that aims to reflect our highest-conviction stock ideas benefiting from these trends.

- **30 for 30**
  This stock list seeks exposure to secular growth companies in the greentech, 5G+, fintech, and healthtech spaces. We believe they are disruptors in sectors undergoing technological transformation.

- **Greentech goes global**
  We bring together our best investment ideas from several CIO regional greentech themes offering a highly diversified selection of global "green technology" stock ideas.

Section 2

Macro economic outlook

Global economy – Consumers cushioning the slowdown

Base case (60%)

Growth

Production data and consumer spending trends continue to indicate moderation in goods demand but resilience in spending on leisure related services. Middle income spending on the latter is more resilient that pre-pandemic economic cycles, and may reflect structural shifts arising from flexible working. While labour market turnover continues to normalize, job security seems to remain relatively good. This supports the idea of an episode of below trend growth, without too negative an outcome.

Inflation

Disinflation trends continue, although headline inflation is vulnerable to less of a drag from energy prices in the coming months. Energy prices may also raise survey-based consumer inflation expectations (as the two measures are strongly correlated), but this is only a policy concern if it impacts wage demands. Goods price disinflation or deflation remains intact. Local peculiarities generate regional variations in service inflation.

Positive case (15%)

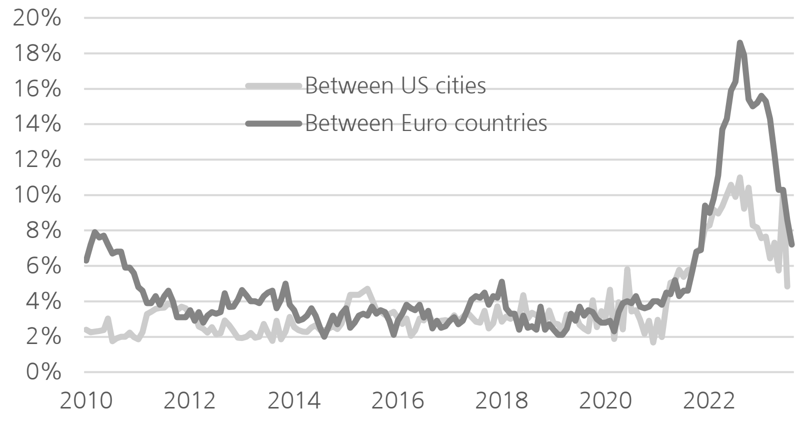
Although nominal wage growth slows, a faster decline in inflation restores stability in real wage growth more quickly, supporting consumer demand earlier than anticipated. Middle-income consumers experience below-reported inflation, which helps spending power in an important demographic. Unemployment rates remain low, and strong household balance sheets support demand.

Negative case (25%)

A more rapid tightening of credit standards and higher cost of borrowing for existing debtors produces a sharper slowdown in consumer demand as spending power is eroded. Fear of unemployment starts to increase, leading to a rise in precautionary spending. This compounds the risks to growth. Companies react to the increased uncertainty and tighter credit standards by retrenching investment plans.

Inflation experiences converge as inflation slows

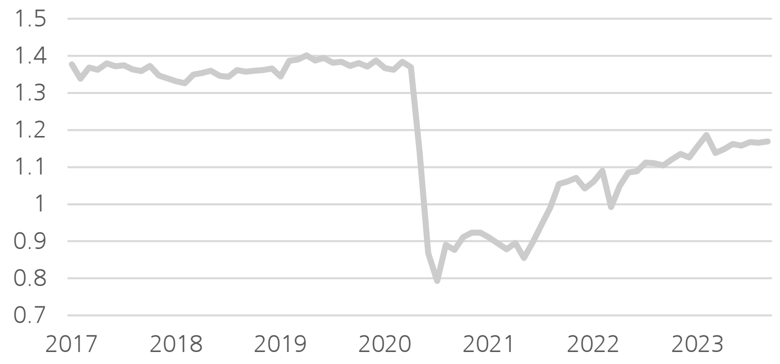
Highest less lowest inflation rate: US cities, and Euro economies



Source: Haver, UBS as of 11 September 2023

US Consumers consuming fun, not things

Ratio of spending on leisure, restaurants, travel to durable goods



Source: BEA, Haver, UBS, as of 11 September 2023

US economy – Slower growth ahead

Base case (60%)

Growth

Growth has remained above-trend over the past 12 months despite aggressive rate hikes by the Federal Reserve and stress in the banking system. But we expect growth to slow from here. Households have used up a lot of the excess savings built up during the pandemic, and loan delinquencies are rising. New industrial policies related to computer chips and green energy have promoted economic activity, but the rapid pace of growth cannot be sustained for much longer.

Inflation

Resilient growth has made it more difficult for the Fed to get inflation down toward its 2% target. However, supply chain issues have mostly been resolved, reducing inflationary pressure at the producer level, and this is now feeding through to retail prices. Broad disinflation has taken hold, with shelter inflation now trending lower. Recent data has been in a range that should allow the Fed to end its rate hiking cycle.

Positive case (15%)

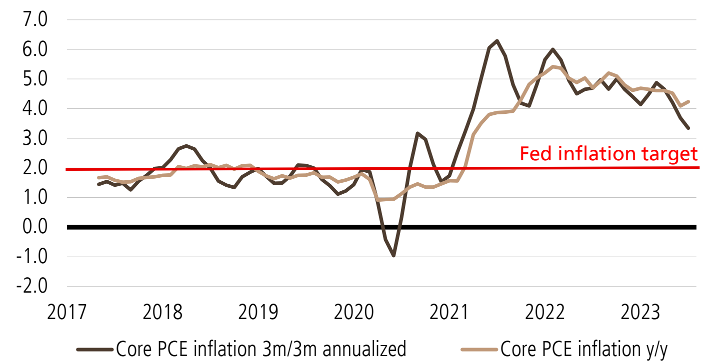
Better labor supply allows businesses to fill in their open job positions. Wage growth slows to a more moderate pace and energy prices stay low, helping bring inflation down while growth remains robust. The Fed sees enough progress toward its mandates to stop raising rates and begins to cut rates toward neutral in 2024.

Negative case (25%)

Inflation stays elevated, forcing the Fed to raise rates further. Banks continue to tighten their lending standards, making it more expensive for businesses to borrow. Households use up their excess savings, while the resumption of student loan payments leaves less money for spending. Seeing weakening consumer demand, businesses increase the pace of layoffs, and this quickly pushes the economy into a recession.

Core inflation still above the Fed's target

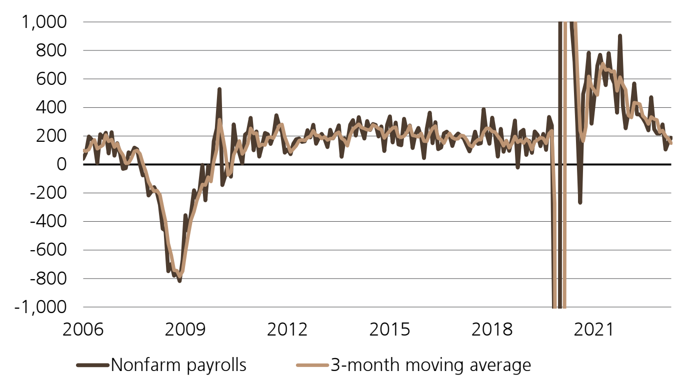
Core PCE, 3m/3m annualized and y/y change, in %



Source: Bloomberg, UBS, as of 11 September 2023

Payroll growth has slowed

Nonfarm payrolls m/m change in 000's



Source: Bloomberg, UBS, as of 11 September 2023

Eurozone economy – Growth concerns re-emerge

Base case (60%)

Growth

Economic growth rebounded in 2Q23 following six months of stagnation. Sentiment surveys have fallen sharply, but this likely signals a return to ~0% growth, not a sharper downturn. A stronger-than-expected US economy should offset the impact of a modest slowing in growth from Asia. The full impact of monetary tightening will likely be increasingly felt over the coming year, with rate cuts unlikely before 2H24.

Inflation

Headline inflation is likely to pick up again in the short term on the back of rising oil prices. Input prices and forward-looking surveys, point to further moderation . We expect inflation to continue to fall in the coming months, but the ECB is likely to continue tightening monetary policy. We look for another rate increase in September to what we expect will be a peak of 4%. Quantitative tightening is set to continue, with discussions around the next phase could begin before year-end.

Positive case (15%)

Economic activity normalizes sooner, supported by a sharp fall in inflation and ongoing labor market strength.

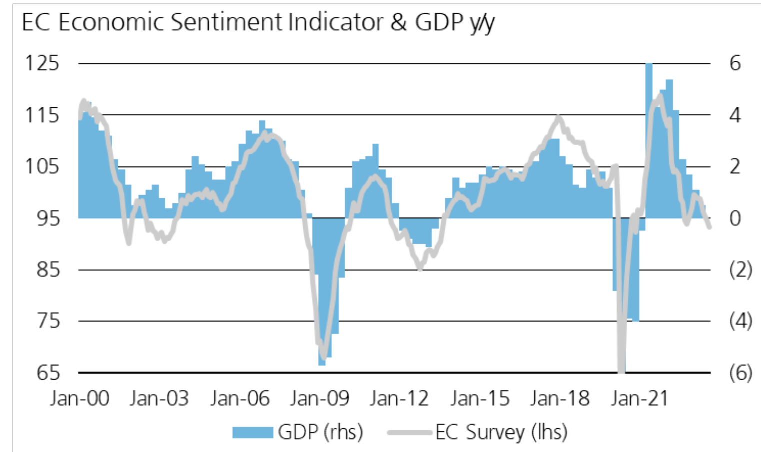
Economic growth in Asia and the US accelerates, with the latter avoiding a recession, boosting demand for Eurozone exports.

Negative case (25%)

The ECB overtightens monetary policy by placing too much weight on near-term inflation. Tighter financial conditions could see demand for credit collapse, hurting consumption and investment.

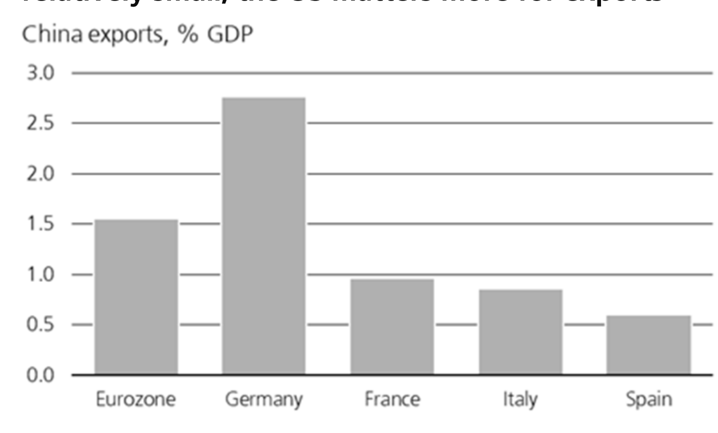
Geopolitical tensions force energy prices materially higher. Fiscal policy is too slow to respond or is tightened too early.

Sentiment surveys are turning negative, but likely signaling ~0% growth, not a sharp downturn



Source: Haver Analytics, UBS, as of 11 September 2023

The Eurozone's economic exposure to China is relatively small, the US matters more for exports



Source: Haver Analytics, UBS, as of 11 September 2023

Swiss economy – Slowdown in manufacturing

Base case (70%)

Growth

Switzerland is expected to grow at a below-average rate in 2023. The weakness in the Eurozone's economy is weighing on manufacturing sentiment. Domestic demand is likely to stay solid and cushion the slowdown in manufacturing.

In 2024, activity is expected to improve over the course of the year. A decline in inflation and the end of interest rate hikes should help European growth and also boost Swiss exports.

Inflation

Inflation has recently returned to the SNB's target range. However, part of the decline has been driven by base effects in energy. In 2H23, these effects are likely to fade, which, together with higher rents, should lead to a rebound in inflation.

We expect a stable SNB policy rate at the end of the year and in 1H24 as inflation risks still exist. Interest rate cuts are unlikely before 2H24.

Positive case (15%)

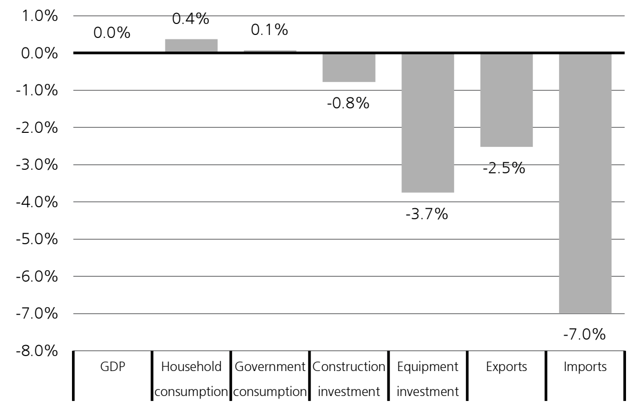
Better global growth momentum: Global inflation further softens, allowing central banks to refrain from additional rate hikes. Switzerland benefits from the stronger global backdrop and a weakening of the safe-haven Swiss franc.

Negative case (15%)

US downturn pushes Switzerland into a recession: For Switzerland to fall into a recession, we believe some preconditions must be met: Sticky inflation due to strong second-round effects, and a deep US recession that leads to a slump in global growth and a strong appreciation of the Swiss franc.

Investments and trade disappoint in 2Q23

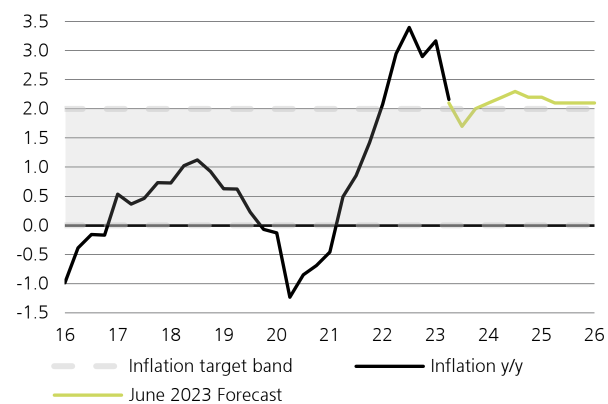
Changes in the individual expenditure components of GDP compared to the previous quarter



Source: Macrobond, UBS, as of 11 September 2023

SNB sees inflation outside of the comfort zone

Conditional inflation forecast (based on a stable policy rate in the coming quarters) of the SNB, in %



Source: Macrobond, SNB, UBS, as of 11 September 2023

Analysts: Alessandro Bee, Florian Germanier

Chinese economy – Bottoming momentum on policy support

Base case (70%)

Growth

August data showed signs of bottoming from July. Manufacturing PMI improved for a third straight month, while both import and export growth showed smaller contraction. Credit growth edged up to 9% y/y driven by local government bond issuance. Two key property easing policies were announced in late August to lower downpayments and existing mortgage rates. We expect 2023 full-year GDP growth of ~4.8% y/y backed by policy support.

Inflation

August CPI inflation turned positive at 0.1% y/y driven by pork and energy prices. We expect a mild pickup by year-end, with full-year average at 0.5%. PPI deflation is likely to persist, but to ease further through year end.

Monetary easing is expected to continue. We expect another 1-2 cuts to banks' required reserves and 10–20bps cut to MLF rate by year-end.

Positive case (15%)

More policy measures are announced to stabilize the property market, boost consumption, and revive confidence.

Geopolitical risks remain contained without dramatic spillovers.

The US economy manages to achieve a soft landing.

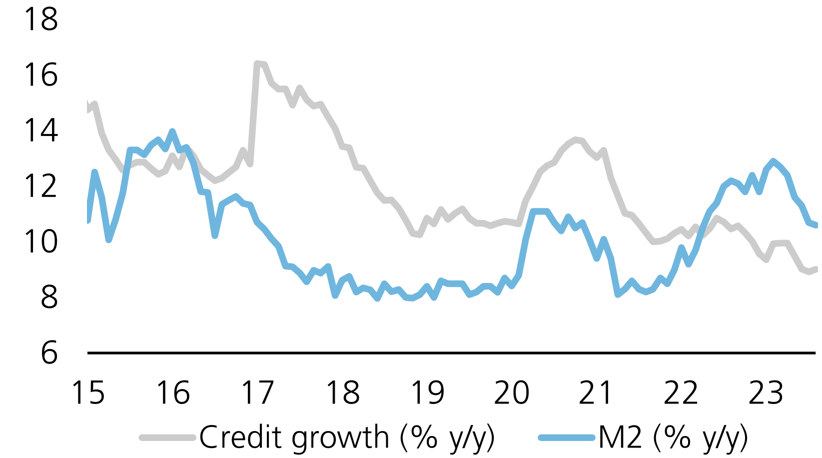
Negative case (15%)

Property activity continues deteriorating despite supportive policies.

The US falls into a deep recession due to the lagged effect of high rates.

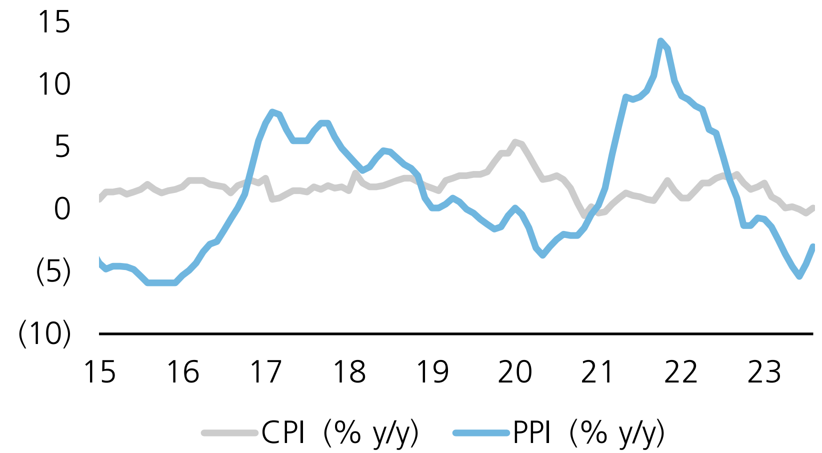
The US imposes much stricter restrictions on China's tech sectors.

Credit growth to pick up further on policy support



Source: CEIC, UBS, as of 12 September 2023

Both CPI and PPI inflation bottoming



Source: CEIC, UBS, as of 12 September 2023

Section 3

Asset class views

Section 3.1

Summary of major asset classes

Global Equities

Central scenario

MSCI AC World June 2024 target: 870

In our global tactical strategy, we have a neutral rating on equities. The latest economic and inflation data have come in ahead of expectations, with the US economy growing above trend in the second quarter and the disinflationary path remaining on track. Moreover, the 2Q reporting season has likely marked the end of the earnings recession and profitability now appears set to inflect upward in the coming quarters. We now consider a recession in the US less likely, while earnings look likely to rebound. On balance, over the months ahead, we see the risk-reward for equites as more favorable.

The earnings outlook has improved. At the beginning of the year, we were concerned the weakness in leading economic indicators and tightening credit conditions would spark a mild earnings recession in 2023. Instead, strong consumer spending coupled with high inflation has sustained nominal earnings. With the risk of a recession receding and the end of the hiking cycle getting closer, we no longer expect a contraction in global and US earnings for 2023. Instead, we see flat global earnings this year versus 2022 and expect earnings to grow by high single digits in 2024.

Equity valuations remain stretched. On a P/E basis, the MSCI All Country World Index is currently trading at 16.1x—11% above its long-term average of 14.5x. Meanwhile, the cost of equity is around 8.3% (back to 10-year highs), consistent with historical episodes of investor exuberance.

US equities are least preferred. While we do not expect an earnings recession in the coming 6–12 months (2023 EPS at 220, 0% growth y/y; and 2024 EPS at 240, 9% growth y/y), we believe the market has mostly priced in such an improvement—we only expect single-digit upside for the S&P 500 by June 2024 (S&P 500 to end the year at 4,500 and reach 4,700 by June 2024). The MSCI USA forward P/E multiple is now 19.3x, a 20% premium to the long-term average of 16.1x and well above the level implied by real rates and other variables (i.e., ISM and credit spreads). The rerating follows the repricing of the soft landing scenario and speculative fever around AI-leveraged market segments that sent valuations soaring.

Emerging market equities stay most preferred. We expect emerging market stocks to outperform their developed market peers thanks to better earnings growth prospects, undemanding relative valuations, and central banks' easing bias in 2H. The approaching end of the US rate-hike cycle also provides a tailwind for emerging market stocks. Valuations look appealing to us: The region is trading at 12x P/E, which in line with the long-term average, a 30% discount to global equities, and a 38% discount to US stocks. Importantly, China recently announced an increased number of policy support measures and their respective rollouts. The market has reacted positively to these interventions, and we believe this positive momentum will continue. China has also entered a rate-cutting cycle.

We upgrade global information technology (IT) to neutral. Earnings revisions have been strong and the sector is expected to deliver positive earnings growth next year. Corporates' IT spending is poised to increase as a function of higher profits going forward. Moreover, the generative AI investment race provides several companies in the semiconductor, cloud, and software industries with strong sales visibility into the first half of 2024. Nevertheless, the sector is exceptionally expensive by historical standards. The P/E valuation gap between IT and the global equity benchmark remains high and continues to increase (IT trades at a 37% premium to history and a 58% premium to the market). Thus, we advise investors to be selective.

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.

Time for quality

With uncertainty over the outlook for economic growth likely to persist, in conjunction with a flat yield curve, we believe high-quality stocks are well positioned. We identify high-quality companies that have strong returns on invested capital, relatively stable operating margins, and healthy free cash flow yields.

Sector preferences

Most preferred: Utilities, consumer staples, industrials, energy

Least preferred: Healthcare, materials

Analysts: Claudia Panseri, Adrian Zuercher, Mark Andersen, Ivan Peric

Global Equities

We continue to prefer energy (most preferred) to materials (least preferred). The materials sector exhibits the worst momentum both in terms of trailing and forward earnings on the back of weak global manufacturing demand and a still-depressed property market in China. Within the sector, we are particularly concerned about mining companies, which remain highly driven by Chinese demand. In addition, mining companies' capex is expected to rise, putting shareholder returns at risk.

We keep energy stocks at most preferred, as reduced recession risk is supportive of value sectors. Energy specifically looks very attractive on a number of metrics (12-month forward P/E at 9.9x, a 38% discount to the global benchmark and a 31% discount to history), with supportive return on equity and free-cash-flow yield. While earnings momentum may stay negative to the end of the year, the recent rise in the energy prices may help next year's profit growth while consensus expectations are very depressed (0.3% earnings growth expected in 2024).

Consumer staples, utilities, and industrials are most preferred. We like the defensive profile of consumer staples companies. While we are not expecting the global economy to enter a recession, below-trend economic growth should cap the upside potential for some cyclical parts of the market. After the recent underperformance of consumer staples stocks versus the benchmark, valuations looks more appealing to us as the sector now trades in line with historical standards. Utilities' defensive profile and earnings resilience in an economic slowdown should help in a volatile environment. Utilities are a traditional safe-haven during downturns. When uncertainty rises, utilities should outperform the broader index thanks to a stable revenue base and high levels of regulation. For industrials, we expect the next capital spending cycle to be strong in a number of areas: The energy transition and decarbonization (e.g., energy efficiency, renewables); defense, after two decades of underspending for most NATO states in Europe; automotives (EV transition); and the reshoring of operations (e.g., more automation).

Healthcare stays least preferred. The expected softening of the USD would be a headwind for pharmaceutical companies outside the US. Trading at 17.9x 12-month forward earnings versus other defensive sectors such as utilities (14.2x 12-month forward P/E), valuations now look expensive to us.

Prefer value (most preferred) and quality-income (most preferred) stocks over growth stocks (upgraded to neutral from least preferred). In an environment of higher-for-longer bond yields, we maintain our preference for value and high-quality stocks. The equity market and factor performance have seen significant and volatile moves in recent months. Amid market and economic uncertainty, we suggest investors to keep a balanced approach between defensive and cyclical sectors. One key factor to focus on is defensive value (high free cash flow generation or high return on equity), which requires more of a stock-picking approach than sector selection. We upgrade IT to neutral, but we remain cautious and very selective on the growth segment, which is still expensive in relative terms and negatively correlated to the rise in real rates.

Analysts: Claudia Panseri, Adrian Zuercher, Mark Andersen, Ivan Peric

Global Equities

Upside scenario

MSCI ACWI June 2024 target: 950

Inflation cools quickly, and the US and European economies grow above trend: 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 reaccelerates: Solid economic growth in the US and emerging markets drive a sharper improvement in corporate profits in 2023 and 2024.

Downside scenario

MSCI ACWI June 2024 target: 680

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

Geopolitical escalation: Additional escalation between Russia and Ukraine leads to a further disruption of Russia's energy supplies. Oil and natural gas prices rise sharply and remain elevated.

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

Analysts: Claudia Panseri, Adrian Zuercher, Mark Andersen, Ivan Peric

US fixed income recommendations

Sector Taxable	Comment	Implementation
Agency securities	We do not see value in agency debt versus other higher-quality sectors such as Treasury or agency MBS. With yields bouncing off the 2022 10-year closing high of 4.25%, those who want to lock in for a hard landing should allocate to Treasuries. For investors looking for higher yield but with high-quality rating, agency MBS is cheap relative to agency debt and IG corporates. We remain with a least preferred in agency debt.	Short-end agencies, or mutual funds
US dollar emerging markets (EM)	We keep emerging market credit as neutral as valuations look fair on average. While spreads may tighten further if a US soft-landing scenario materializes, our base case calls for sideway trends over the foreseeable future. Key risks include a global recession, a reacceleration of inflation requiring tighter policy in the US and other key markets, softer commodity price, a stronger USD, and various idiosyncratic risks, such as US-China tensions and further escalation of the war in Ukraine.	For individual sovereign and corporate bond recommendations, contact your Financial Advisor
High yield corporates (HY)	We are neutral on high yield, reflecting mainly our view of relative value rather than an expectation of soaring defaults. HY spreads, which are close to year-to-date tights, are already pricing in an economic soft landing and continued balance sheet strength, in our opinion. Yields, however, remain wide and provide carry for the asset class and a buffer to total returns. Issuer-weighted default rates stand at 3.1% and we think could rise to mid-single digits, but that would be lower than in past default cycles.	For individual corporate bond recommendations, contact your Financial Advisor
Investment grade corporates (IG)	We have a preferred allocation to IG. On fundamentals, credit metrics look solid to us, but there are downside risks with the Fed staying higher for longer. That said, average US IG yields are at historically elevated levels of 5.8% and should provide a reasonable buffer if spreads widen from current levels. Among industry sectors, financial spreads are wide relative to nonfinancials. We specifically like US G-SIB banks for their diversified business profiles and the fact that the latest developments in US banking regulation will boost capital buffers even higher.	For individual corporate bond recommendations, contact your Financial Advisor
Mortgage-backed securities (MBS)	The MBS sector downgrade by Fitch alongside US Treasury should have minimal impact on overall spreads, in our view. Increased interest rate volatility is the most recent headwind. We believe banks will increase their overall demand for agency MBS into the end of the year and throughout 2024. Risk-based capital weightings remain attractive, while the 175bps spread to Treasury for current coupon remains in the 98th percentile over the past 20 years. The outperformance of equity has kept investors focused on IG corporates. However, as the lagged impact of higher-for-longer rates streams into a slower economy, the liquidity and higher rating of the agency MBS sector will dominate.	5% to 5.5% current coupon, funds, or ETFs
Preferred securities	After consecutive, though modest, gains in June and July, preferreds posted a 0.6% loss in August and are tracking a similar, mild loss for September. With a year-to-date gain of about 3.5%, the sector has still not recovered from the March pullback brought on by regional bank concerns. So, valuations remain generally favorable. And current valuations against a backdrop of lower-trending rates could produce impressive returns. Resilient fundamentals and favorable technicals have the potential to lend support as well. We maintain a most preferred view.	For individual preferred securities, see the *Preferred Securities Overview & Preferences Report*
Treasury Inflation-Protected Securities (TIPS)	Real yields are rising as nominal yields move toward their cycle high on the heels of stronger economic data, increasing supply, the Bank of Japan, and summer illiquidity. The 10-year real yield reached a 14-year high, approaching 1.8%. While we remain neutral on the sector due to rising rate volatility, over the longer term we believe real yields are too high in the 5- and 10-year part of the curve, and we look for a downward trend heading into year-end. With oil and gas prices moving higher, we believe inflation expectations are too low and nominal yields too high.	Individual securities, 5-year or 10-year area or funds
Municipal bonds (Muni)		
Tax exempt	Tax-exempt municipal bonds play an important role within a diversified fixed income portfolio. Munis provide a steady stream of interest income exempt from US federal and often state and local income taxes, have a low probability of payment default, and have minimal correlation with equity securities.	For individual municipal bond recommendations, contact your Financial Advisor
Taxable municipal bonds	Taxable municipal bonds can provide investors with high credit quality, state tax exemption within the state of issuance, and diversification benefits within a fixed income portfolio, but generally exhibit less liquidity than investment grade corporate bonds. See "Taxable munis...Yes, taxable munis," dated 15 September 2020.	For individual taxable municipal bond recommendations, contact your Financial Advisor

FX

The US dollar remains least preferred in our global strategy, although we acknowledge current bouts of strength in the greenback may mean less weakness ahead. Strong economic data out of the US is keeping the Federal Reserve on its toes, while the timing for rate cuts has been pushed further down the road. Still, we believe the strong tightening since March 2022 should put the economy under pressure.

The Fed is likely at the inflection point we have been looking for in 2023, although uncertainty has been mounting given upside surprises in some of the data releases. As disinflation seems to be well in place, markets are still waiting for the Fed to signal a clearer shift in its policy stance. Still, the USD should weaken further once we see a softer labor market and signs of stabilization of economic activity outside the US. As excess savings run out, monetary policy should weigh more sizably on spending activity. And lower inflation should leave enough room for US rates to fall back. As this happens, international investors will have a strong incentive to move funds out of the US and into higher-yielding emerging market or formerly negative-yielding G10 currencies.

We keep the euro at most preferred despite disappointments in China and lackluster growth in Europe. We still expect investors moving away from the US dollar to look for a liquid alternative asset market, and the euro is an obvious option, in our view. Inflation in Europe remains well above target, and the healing of the current account balance has helped the euro to recover and should continue improving. We still expect to see yield decompression from the Fed and the European Central Bank (ECB) to keep rates on hold. The delta of relative growth and rates should come from the US and not Europe, and the euro's current levels remain attractive for long-term investors who have been looking to diversify considerable USD long positions. The expected shift in US monetary policy would be a good time to do so, in our view.

We keep the Japanese yen at neutral. Adjustments to the Bank of Japan's yield-curve control , should help the yen, but we see limited catalysts that will outweigh the negative 5% carry that a long yen, short dollar position entails. Our end-2023 USDJPY target of 142 implies fairly moderate upside potential for the yen, and we would recommend positioning for USD weakness via being long the EUR instead.

We keep a neutral position on the British pound and Swiss franc, both of which have been strong outperformers this year and are now consolidating. From current levels, both could outperform the USD, which justifies the one-notch difference to the least preferred USD. We still believe that the euro would be a better choice here, as it would be advantageous for a Swiss-franc-based investor to hold euro bonds—the exchange rate is expected to trade sideways and the yield is higher on the euro, providing more carry. We see EURGBP as close to the bottom of our expected trading range.

Emerging market currencies continued to struggle going into September as US yields stayed at high levels and worries over China's growth outlook persisted. Central and Eastern European currencies felt the pressure of a weaker euro against the dollar; the Polish zloty also saw a very dovish interest rate cut add to its currency's weakness. Central banks' decisions in light of lower inflation rates but still persisting inflationary pressure will be key for emerging market currencies' performances in the coming months, especially given the higher-for-longer expectations for the Federal Reserve. We think that slowing US activity and core inflation, paired with a still-sizable yield advantage for emerging market currencies, should allow high carry currencies like the Mexican peso or Czech koruna to perform well against the US dollar over the coming months. We don't expect large-scale monetary easing by emerging market central banks, but dovish decisions are certainly a key risk, next to the Federal Reserve seeing the need to deliver more interest rate hikes and China's recovery faltering.

FX

In Asia Pacific, USDCNY has consolidatied at the 7.2–7.4 range over the past month. Our year-end target of 7.4 implies that the USDCNY exchange rate could still rise to somewhat uncomfortable levels given the US-China growth divergence. But we still expect the pair to ease lower toward 7.20 by March 2024 and 7.0 by September 2024, as the Chinese economy recovers and the US economy slows. A subdued CNY in the near term should also keep a lid on the upside potential for Asian currencies over the remainder of this year. Within APAC, we maintain our preference for domestic-demand-oriented, high-yielding currencies such as the Indonesian rupiah and the Indian rupee, against a backdrop where the Fed is largely done with its rate-hike cycle.

Commodities

We hold a neutral view on commodities overall and gold, but remain most preferred on crude oil.

- **Saudi Arabia and Russia extend their extra voluntary supply cuts until the end of the year.** Saudi Arabia is curbing its production by an extra 1mbpd, and Russia is reducing its crude exports by 0.3mbpd. With OPEC+ signaling it wants to remain in control of the oil market, the voluntary extra cuts will be reviewed monthly and could be deepened or reduced depending on market conditions. With the production cut extended, we anticipate a market deficit of more than 1.5mbpd in 4Q23. So, with oil inventories set to fall further over the coming months, we expect Brent to rise to USD 95/bbl by year-end.
- **Structural factors put the base in base metals.** Exchange inventories at multi-year lows, ongoing supply-side disappointments, and structural demand drivers have offset weaker global manufacturing and disappointing China data. We believe these longer-term dynamics will shield metal prices from larger pullbacks. In fact, our supply and demand estimates still point to an undersupplied market for most metals this year, which favors higher prices into 2024 as industrial activity stages a modest recovery.
- **Central bank buying a backstop for gold.** Near-term headwinds like higher US yields and USD strength are pressuring ETF demand. But we think central bank buying will counterbalance these pressures—likely buying another 700 metric tons this year—while we await easier policy guidance from the Fed. An annual amount of this magnitude would be the second-highest since the 1960s (only to 2022). So, we reiterate gold's diversification benefits in a portfolio context and expect prices to rise toward USD 2,200/oz by mid-2024.
- **Agricultural prices don’t reflect heightened risks.** Record-breaking global temperatures, attacks on Black Sea grain infrastructure, and regional supply mismatches did not prevent grain prices from tumbling to new year-to-date lows. We believe elevated Russian and Brazilian inventories have bred complacency among consumers. But supply downgrades across key producers should drive higher grain prices (by around 10%), while soft commodities will likely stay elevated amid persistent El Niño risks.

Where to invest

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, as a rule, don’t hold much predictive power. So, vanishing available spare capacity should support longer-dated contracts, in our view.

Gold still a good hedge. We continue to recommend investors use gold as a hedge despite being neutral in our global strategy—within a balanced USD portfolio our analysis shows exposure of around a mid-single-digit percentage is most optimal.

Volatility-selling strategies. On an individual commodity level, we see opportunities to engage in selling the downside in crude oil, copper, nickel, gold, platinum, and wheat.

Long select critical metal miners. We believe recent share price setbacks in producers of metals and materials vital to the low-carbon transition offer opportunities to buy select companies on a five-year view. We prefer quality companies with high revenue exposure to commodities like aluminum, copper, lithium, rare earths, etc.

Analysts:Dominic Schnider, Giovanni Staunovo, Wayne Gordon

Section 3.2

Details per asset class

US equities

Preference: Least preferred

Central scenario

S&P 500 June 2024 target: 4,700

This year stocks have benefited from solid growth and falling inflation. While we believe the US economy is on track for a "softish" landing, economic growth will likely slow in the months ahead. The resumption of student loan repayments, dwindling excess household savings, higher oil prices, a tick up in mortgage rates, and a cooling labor market could prompt a bit of a slowdown in consumer spending. Still, we believe households and businesses (especially the largest businesses) have some protection from higher interest rates due to a high proportion of fixed-rate debt or maturities that are spread out over time. In addition, business inventories are now lean; there are no obvious areas of over-investment in the economy; the imperative to invest in AI remains; and there is still excess demand for labor. So, in our base case, we expect the US economy to avoid a hard landing.

With inflation now closer to the Fed's target, further improvements in inflation will be more incremental. So we could be transitioning to a period of both slower growth and slower improvements in inflation. Equity markets may be somewhat range-bound in this transition period, especially considering that the soft landing has become much more of a consensus view; valuations are full; and there is less dry powder on the sidelines to drive markets higher.

But looking out into 2024, we believe equity markets can move somewhat higher from current levels as earnings growth resumes. In fact, bottom-up forward consensus EPS estimates for the S&P 500 are back at all-time highs, and we think there is scope for estimates to continue to climb. Third-quarter results should confirm that the earnings recession is over and growth should accelerate to a high-single-digit pace in the quarters ahead. Recent updates from publicly traded companies suggest no significant deterioration in the environment. The prospect of Fed rate cuts in 2024 (in the context of durable growth) should also be an upside catalyst.

Our S&P 500 EPS estimates are USD 220 (0% year-over-year) in 2023 and USD 240 (9% y/y) for 2024. Our December 2023 and June 2024 price targets are 4,500 and 4,700, respectively.

CIO themes

Pricing power standouts

Companies with pricing power should enjoy greater earnings stability as late cycle dynamics unfold.

Made in America

We've put together a list of companies we expect to benefit from an increase in spending across multiple verticals, including government spending and select pockets of technology.

Sector preferences

Most preferred

- Consumer staples: While this defensive sector has lagged as the soft-landing scenario has become a consensus view, we think it's prudent to have some protection in the portfolio in the event of a hard landing. The sector trades at a discount to the market, which we believe is attractive in the context of the sector's defensive growth profile.
- Energy: Oil prices have rebounded in recent months, driving outperformance for the sector. OPEC+ supply cuts and better global economic growth have led to oil inventory declines, resulting in higher prices. We think there is further to go. Valuations are pricing in a somewhat cautious outlook. The sector should also be a cheap hedge for any unexpected increase in inflation.
- Industrials: The sector should benefit from secular growth in areas like defense, reshoring/onshoring, investments in energy supply (fossil and renewable), infrastructure spending, and aerospace. In the coming months, we may start to see an improvement in the ISM manufacturing index, which has historically been correlated with performance.

Analysts: David Lefkowitz, Nadia Lovell, Matthew Tormey

US equities

Upside scenario

S&P 500 June 2024 target: 5,200

Artificial intelligence is a game-changer: The impact of artificial intelligence on productivity and earnings growth is larger and comes sooner than investor expectations.

Resilient economic growth: High wages attract even more workers into the labor force, and demand for labor stays strong. Real incomes continue to grow and household cash cushions remain.

Inflation cools quickly: Inflationary pressures dissipate faster than expected and the Fed quickly pivots to rate cuts. This lifts expectations for economic growth and corporate earnings.

Downside scenario

S&P 500 June 2024 target: 3,500

Recession: The US slips into a full-blown recession in the next 6–12 months, primarily driven by the lagged effects of Fed rate hikes, perhaps as household cash cushions dwindle.

Inflation stays hot: Inflation pressures reaccelerate. 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 the war in Ukraine: Additional escalation leads to a further disruption of Russia's energy supplies. Oil and natural gas prices rise sharply and remain elevated.

Sector preferences

Least preferred

- Real estate: Higher rates and poor sentiment may continue to weigh on the sector. Although valuations appear fair, we think estimates are still high in some areas that over-earned during the pandemic. Growth in funds from operations will likely lag S&P 500 profit growth.
- Utilities: Increased regulatory risks and resilient economic data may lead to underperformance. We prefer to have defensive exposure through consumer staples, which continues to exhibit pricing power and benefits from resilient consumer spending.

Emerging market equities

Preference: Most preferred

Central scenario

MSCI EM June 2024 target: 1,100

We rate emerging market equities as most preferred. Aggregate manufacturing PMIs in emerging economies have improved, mostly due to China's sequential recovery, and the gap with developed economies persists. EM central banks' easing bias should continue to be a positive for local stocks. The recent US dollar strength should be short-lived given that the Fed appears to be near the end of its aggressive tightening cycle.

Valuations for the MSCI Emerging Markets Index, at 11.8x 12-month forward P/E, are largely in line with the 10-year average, and stand at a 38% discount to the S&P 500. On a price-to-book basis, the discount is even deeper at 64% versus its 10-year average of 54%. In our view, the gap does not factor in better earnings growth prospects for emerging markets relative to developed markets next year.

A strong US dollar, an uptick in geopolitical tensions, a pronounced US recession, and an underwhelming economic recovery in China are risks to the outlook for emerging market equities.

From a geographic standpoint, we continue to be positive on Brazil and Chile. Both countries have kicked off monetary easing cycles, which have historically been supportive of stocks. In addition, they both exhibit undemanding valuations. Elsewhere, China remains most preferred on the ongoing policy support. We think markets have priced in a lot of negatives around China's real estate sector and weak growth, which might have bottomed in July. Further stimulus measures should help stabilize sentiment. Finally, we keep Indonesia and India as most preferred. Growth in Indonesia remains relatively strong, and we believe India's valuation is reasonable while the corporate outlook looks healthy.

From a thematic angle, we like environmental, social, and governance (ESG) leaders in emerging markets, which can help mitigate downside risks, and present attractive valuations, in our view. For investors with a multiyear time horizon, we recommend exposure to three thematic opportunities: Frontier markets, emerging market infrastructure, and emerging market healthcare.

Upside scenario

MSCI EM June 2024 target: 1,200

Sizable GDP growth recovery: A 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 2024 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.

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 (ESG) considerations into their investment decisions. The wide disparity in ESG performance among emerging market companies tells us 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.

Market preferences

Most preferred

Brazil, Chile, China, India, Indonesia

Least preferred

Malaysia, Singapore

Japanese equities

Central scenario

TOPIX June 2024 target: 2,400

We are neutral on Japanese equities in our global portfolio. The TOPIX has rebounded from its mid-August lows, in line with the S&P 500. Both markets started to pick up after the 10-year US yield hit its peak recently. A series of property sector boosting measures from the Chinese government and a weaker JPY against the USD have also supported market sentiment. While we had expected range-bound trade during summer due to a lack of domestic catalysts before a 4Q rebound, sentiment has started to recover earlier than we had anticipated.

We believe a relatively favorable macro environment should support Japanese equities in 2024. We expect Japan’s economic growth to be stronger than that of major developed markets in 2024, with higher inflation and wage growth than in the last few decades. Nominal wage growth should support corporate earnings growth in 2024. Despite higher inflation, we expect the Bank of Japan to maintain a prudent monetary policy, providing a favorable investment environment for risk assets in Japan. We expect corporate earnings to grow 6% for FY2023 (end-March 2024) and 3% for FY2024 based on a mild strengthening of the yen in 2024.

We continue to like domestic-oriented sectors, as they should benefit from the near-term increase in reopening spending and wage growth this and next year. However, we are more selective and focused on laggards and stocks with pricing power considering the potential inflationary environment.

We also like quality value stocks, including banks as beneficiaries of medium-term changes in corporate mindsets. A sustainable inflationary environment for the first time in nearly 30 years has important implications for Japanese companies in the years ahead. For one, corporate governance reform is likely to be in focus. In the nearer term, we believe improving growth prospects will motivate Japanese companies to utilize the cash on their balance sheets and increase share buybacks and capex. The Tokyo Stock Exchange’s push to increase corporate value and return on equity should also support this trend.

Upside scenario

TOPIX June 2024 target: 2,600

Global economic growth remains resilient: A strong Chinese economic recovery and the US economy remaining resilient would likely lead to stronger top-line growth for Japanese corporate earnings.

Higher ROE: Potential business portfolio restructurings or increased investments with the aim of increasing ROE pressured by the Tokyo Stock Exchange could be a rerating catalyst for Japanese equities in the longer term.

Sustainable inflation and wage growth: The result of the 2023 Shunto wage negotiations was a 3.7% rise in wage growth (a 28-year-high), and core inflation shot up above 3% in recent months (the highest since 1981). If moderate wage growth and inflation are sustained in 2024, there could be structural changes in the economy.

Downside scenario

TOPIX June 2024 target: 2,000

Recession: The US slipping 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.

US inflation remains elevated: Inflation stays hot and the US central bank is forced to raise interest rates even more than expected, leading to a correction in valuations.

Sharp yen strengthening: Earnings growth would decline, especially for exporters in the tech and auto sectors, if the yen strengthens sharply.

Asian bonds

Central scenario

JACI composite spread June 2024 target: 240bps

Upward pressure on US Treasury yields has continued in the past month—the current 10-year yield (4.3% as of 11 September) is already higher than the level seen in late 2022. Going forward, with falling inflation, a cooling jobs market, and moderating consumer spending growth, we continue to hold the view that the Federal Reserve is likely near or at the end of its rate-hike cycle. So, we think current elevated yields present a good opportunity to lock in attractive carry. Therefore, we keep our most preferred view on high grade and investment grade bonds. In Asia, we also favor the higher-quality segment.

For Asia IG, the slightly negative total return performance over the past month is mainly due to higher US Treasury yields. Going forward, we believe Asia IG bonds still offer solid risk-reward potential, given attractive yield levels (5.8% as of 11 September) and high credit quality (average rating of A-). In terms of valuations, the JACI IG spread (170 basis points as of 12 September) has been largely stable in the past few months. While this does not appear cheap, historically speaking, we think spreads may remain in a tight range given strong technicals for the market. Net supply of China IG bonds, which account for a big proportion of the market, has been negative recently.

For Asia HY, we believe short-term challenges still remain. China property HY delivered positive total returns from spread tightening in recent weeks, mainly driven by property easing policies announced by the government that helped boost sentiment. While we believe these supportive measures could help drive some demand recovery in the next couple of months from currently subdued levels, we think these measures may not be enough to directly address HY property developers' imminent liquidity issues and allow them to avoid default risk in the face of several upcoming maturities. Therefore, we remain cautious on the China property HY space. Elsewhere, we hold a relatively positive view on Macau gaming within the Asia HY segment. This stance is underpinned by its resilient GGR (gross gaming revenue) growth and the potential earlier-than-expected deleveraging stories among gaming issuers.

Upside scenario

JACI composite spread June 2024 target: 210bps

Much faster recovery after full reopening: If China's recovery is faster and stronger than expected in the coming months, there will likely be upside for Asian credits.

Sharp rebound in China housing sales: So far, policy has focused on supporting the liquidity of important Chinese property developers, but the housing sales recovery appears uneven and mixed. A quick rebound in housing sales later this year would offer fundamental support to credit metrics in this sector.

More dovish-than-expected central bank actions: Spreads would likely compress if the Fed becomes less aggressive with quantitative tightening if inflation comes off faster than expected.

Downside scenario

JACI composite spread June 2024 target: 310bps

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

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

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

Section 4

Appendix

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Appendix

Statement of Risk
Equities - Stock market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables.

Fixed income - Bond market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables. Corporate bonds are subject to a number of risks, including credit risk, interest rate risk, liquidity risk, and event risk. Though historical default rates are low on investment-grade corporate bonds, perceived adverse changes in the credit quality of an issuer may negatively affect the market value of securities. As interest rates rise, the value of a fixed-coupon security will likely decline. Bonds are subject to market value fluctuations, given changes in the level of risk-free interest rates. Not all bonds can be sold quickly or easily on the open market. Prospective investors should consult their tax advisors concerning the federal, state, local, and non-US tax consequences of owning any securities referenced in this report.

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Municipal bonds - Although historical default rates are very low, all municipal bonds carry credit risk, with the degree of risk largely following the particular bond's sector. Additionally, all municipal bonds feature valuation, return, and liquidity risk. Valuation tends to follow internal and external factors, including the level of interest rates, bond ratings, supply factors, and media reporting. These can be difficult or impossible to project accurately. Also, most municipal bonds are callable and/or subject to earlier-than-expected redemption, which can reduce an investor's total return. Because of the large number of municipal issuers and credit structures, not all bonds can be easily or quickly sold on the open market.

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Our preferences does not assure profits or prevent against losses from an investment portfolio or accounts in a declining market.

Appendix

Emerging Market Investments

Investors should be aware that Emerging Market assets are subject to, amongst others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and socio-political risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. CIO GWM generally recommends only those securities it believes have been registered under Federal U.S. registration rules (Section 12 of the Securities Exchange Act of 1934) and individual State registration rules (commonly known as "Blue Sky" laws). Prospective investors should be aware that to the extent permitted under US law, CIO GWM may from time to time recommend bonds that are not registered under US or State securities laws. These bonds may be issued in jurisdictions where the level of required disclosures to be made by issuers is not as frequent or complete as that required by US laws.

Investors interested in holding bonds for a longer period are advised to select the bonds of those sovereigns with the highest credit ratings (in the investment grade band). Such an approach should decrease the risk that an investor could end up holding bonds on which the sovereign has defaulted. Sub-investment grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher yielding bonds for shorter periods only.

Nontraditional Assets

Nontraditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments).

Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments

(1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds;
(2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment;
(3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss;
(4) are long-term, illiquid investments; there is generally no secondary market for the interests of a fund, and none is expected to develop;
(5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer;
(6) may not be required to provide periodic pricing or valuation information to investors;
(7) generally involve complex tax strategies and there may be delays in distributing tax information to investors;
(8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, “junk bonds,” derivatives, distressed securities, non-US securities and illiquid investments.

Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.

Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.

Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.

Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in US dollars, changes in the exchange rate between the US dollar and the issuer’s “home” currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a US investor.

Appendix

Global Investment Process and Committee Description
The UBS investment process is designed to achieve replicable, high-quality results through applying intellectual rigor, strong process governance, clear responsibility and a culture of challenge.

Based on the analyses and assessments conducted and vetted throughout the investment process, the Chief Investment Officer (CIO) formulates the UBS Wealth Management Investment House View preferences at the Global Investment Committee (GIC). Senior investment professionals from UBS, complemented by selected external experts, debate and rigorously challenge the investment strategy to ensure consistency and risk control.

Global Investment Committee Composition
The GIC comprises top market and investment expertise from UBS:

- Mark Haefele (Chair)
- Solita Marcelli
- Tan Min Lin
- Themis Themistocleous
- Paul Donovan
- Bruno Marxer(*)
- Adrian Zuercher
- Mark Andersen

(*) Business area distinct from Chief Investment Office Global Wealth Management

US Investment Strategy Committee description
We recognize that a globally derived house view is most effective when complemented by local perspective and application. As such, UBS has formed a Global Wealth Management US Investment Strategy Committee.

US Investment Strategy Committee Composition
- Solita Marcelli
- Jason Draho (chair)
- Leslie Falconio
- David Lefkowitz
- Brian Rose
- Daniel Scansaroli

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