UBS House View

Monthly Extended December 2023

Chief Investment Office GWM
Investment Research

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This report was prepared by UBS AG London Branch, UBS Switzerland AG, UBS AG Hong Kong Branch, UBS AG Singapore Branch and UBS Financial Services Inc.

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.

UBS

Section 1

Investment views

Section 1.1

Asset class outlook

Asset class outlook

Global asset allocation

In our global strategy, we keep our preference for bonds over equities.

Within equities, we retain our preference for quality income. We also like the consumer staples, utilities and energy sectors, globally. Our most preferred regions are EM and China.

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

Within commodities, we hold a preference for oil.

Within foreign exchange, we have a neutral stance in all major currencies with exception of AUD which we have at most preferred.

Equities

Our base case remains for mid-to-high single-digit returns for global equities over the next 6–12 months as earnings recover.

But the path higher is getting narrower given the higher-for-longer yield environment and geopolitical risks.

Across regions, we now have **UK as least preferred** and **upgrade US market to neutral**. We still like EM markets and China.

By global sector, consumer staples, utilities and energy stay as most preferred, and materials and healthcare as least preferred. **We downgrade industrials to neutral**.

Across styles, we prefer quality income versus growth. **We have downgraded value stocks** as central banks are close to the end of the tightening cycle.

Bonds

We are 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 high grade and 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 USD strengthened towards the support levels in EURUSD and GBPUSD, AUDUSD and then weakened again. The broad ranges, e.g. EURUSD 1.05-1.10, stay intact.

Market sentiment may shift back and forth, depending on the data, given that all central banks signaled data dependency. Over the next 6 to 12 months we expect yields to converge, and consequently a slightly weaker USD relative to the rest of G10.

Short term, we look to use options for yield pickup when it comes to the USD, while investors should consider beneficiaries of higher energy prices (NOK, AUD, or CAD) in the crosses.

Within this context, **we are upgrading the AUD as most preferred,** seeing risks of further rate hikes by the central bank alongside elevated short positioning and strong structural demand drivers for those commodities linked to the energy transition.

Commodities

We expect the total return of broad commodities over 2024 to be in the mid-to-low teens, after nearly 3% returns so far in 2023. Economic growth in developed countries is expected to slow in 1H24, which is likely to weigh on demand for cyclical commodities. However, we expect prices can be supported as recent efforts by the Chinese government to boost activity kicks in alongside ongoing supply discipline (e.g., OPEC+ in oil) and low inventories.

Within commodities, we see energy, particularly crude oil, driving overall performance alongside base metals as it benefits from secular demand drivers like the energy transition. Gold remains valuable as a portfolio hedge while agriculture is primarily influenced by weather related risks associated with the El Niño event.

We also continue to recommend actively managing commodity exposure.

Section 1.2

Risk scenarios

Key scenarios – June 2024

	Upside: Lift-off	Base case: Soft landing	Downside: Hard landing	*Things to watch*
Probability	*20%*	*60%*	*20%*	
Market path	**Bonds flat to down, equities up** Equity markets and other risk assets rally, while high quality bonds will be confronted with high(er)-for-longer interest rates environment.	**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. Rising fiscal deficit and treasury supply in the US can push bond yields higher in the near term, raising the likelihood of a recession in 2024.	*US, China: PMI data* *US, Europe: industrial production* *US: capital goods orders* *US, China Europe: consumer spending* *US: housing starts* *Europe: gas prices*
Inflation	Remains above central bank target throughout next year.	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	Monetary policy stays in restrictive territory. Major central banks keep interest rates “high for longer”, i.e., do not start cutting policy rates in 2024 as inflation stays above target.	Central bank policy rates reach peak level in 2023. Major central banks start cutting policy rates in 2024 as inflation normalizes. The Fed lowers its policy rate in line with market expectations during H2 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 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	Middle East crisis de-escalates. The war in Ukraine deescalates, e.g., via a ceasefire agreement. Progress is made in bilateral relations between the US and China.	Middle East crisis results in a contained regional confrontation. The war in Ukraine drags on as ceasefire negotiations remain elusive. US-China strategic rivalry continues.	The Israel-Hamas war turns into a regional conflict with potential for greater disruption to oil supply. The war in Ukraine escalates and/or US-China tensions intensify.	*Middle East crisis and oil supply* *Territorial gains by Russia* *Weapon shipments to Ukraine* *US sanctions on Chinese companies*

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Analysts: Dirk Effenberger, Daniil Bargman

Asset class targets - June 2024

Key targets for June 2024	spot*	Upside	Base case	Downside
MSCI AC World	805	940 (+17%)	845 (+5%)	640 (-21%)
S&P 500	4,383	5,000 (+14%)	4,500 (+3%)	3,500 (-20%)
EuroStoxx 50	4,178	5,000 (+20%)	4,600 (+10%)	3,340 (-20%)
SMI	10,595	12,170 (+15%)	11,300 (+7%)	8,990 (-15%)
MSCI EM	958	1,140 (+19%)	1,050 (+10%)	760 (-21%)
US 10y Treasury yield	4.49	5.00	3.75	2.75
US 10y breakeven yield	2.36	2.50	2.25	1.50
US high yield spread**	408bps	370bps	500bps	850bps
Euro high yield spread**	458bps	370bps	500bps	850bps
US IG spread**	120bps	80bps	130bps	200bps
Euro IG spread**	156bps	110bps	170bps	220bps
EURUSD	1.07	1.15 (+7%)	1.10 (+3%)	1.00 (-7%)
Commodities (CMCI Composite)	1,797	2,100 (+17%)	1,925 (+7%)	1,600 (-11%)
Gold***	USD 1,874/oz	USD 1,800/oz (-8%)	USD 1,950/oz (-0%)	USD 2,300/oz (+17%)

* Spot prices as of market close of 8 Nov 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.

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Analysts: Dirk Effenberger, Daniil Bargman

Section 1.3

Asset class preferences and themes

Global asset class preferences

	Least preferred		Most preferred
Liquidity		=	
Equities		=	
Growth		=	
Value		= ←	⊕
Quality income			+
Small caps		=	
United States	⊖ →	=	
Eurozone		=	
Switzerland		=	
Emerging markets			+
Japan		=	
United Kingdom	− ←	⊜	
Australia		=	
Sectors			
Communication services		=	
Consumer discretionary		=	
Consumer staples			+
Energy			+
Financials		=	
Healthcare	−		
Industrials		= ←	⊕
Information technology		=	
Materials	−		
Real estate		=	
Utilities			+

	Least preferred		Most preferred
Bonds			+
High grade			+
Investment grade			+
High yield		=	
Emerging markets		=	
Commodities		=	
Oil			+
Gold		=	
Foreign exchange			
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
Equities			
Asia ex-Japan		=	
China			+
Hong Kong		=	
India			+
Indonesia		= ←	+
South Korea		=	
Malaysia	− →	=	
Philippines		=	
Singapore	−		
Taiwan		=	
Thailand		=	
Bonds			
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
Cash		=	
Fixed Income			+
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
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.

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

Manage liquidity*

We believe investors should limit their overall cash balances and optimize yields in the year ahead. War and geopolitical uncertainty may increase the perceived safety of cash, but we expect interest rates to fall in 2024, reducing the return of cash and increasing reinvestment risks. Investors should use a combination of fixed term deposits, bond ladders, and structured solutions to cover expected portfolio withdrawals over the next five years.

Fixed term deposits
Bond ladders
Structured solutions with capital preservation features

Source of funds
- Cash
- Maturing investments

Buy quality

We expect positive overall returns for both equities and bonds in the year ahead. But within each asset class, we believe investors should focus on quality. In fixed income, quality bonds (including sustainable and MDB bonds) offer attractive yields and should deliver capital appreciation if interest rate expectations decline, as we expect. In equities, quality companies with strong balance sheets and high profitability, including those in the technology sector and within ESG leaders, should be best positioned to generate earnings in an environment of weaker growth.

Quality stocks (including US IT)
Quality bonds (HG and IG)
Sustainable equivalents (ESG leader equities, sustainable bonds, MDB bonds)

Source of funds
- Cash
- Excess EM / high yield bonds
- Excess equity exposure

Trade the range in currencies and commodities

In currencies, we expect the US dollar to stay stable around current levels. But as the year progresses, USD weakness may emerge as US economic growth eases relative to other economies. This makes selling USD upside for a yield pickup attractive. In commodities, investors who can afford to wait have the ability to generate potential carry returns, as well as hedge against geopolitical or weather risks. Oil prices should fluctuate in the USD 90–100/bbl range in 2024.

Sell USD upside
Range-trading in EUR, CHF, GBP, and CNY
Trade the range in crude oil

Source of funds
- Cash
- Maturing investments
- Available collateral (for OTC range trading strategies)

Hedge market risks

Investing against a backdrop of war and geopolitical uncertainty can be challenging, and investors need to prepare for volatility ahead. We believe that investing across asset classes and regions should be most investors' first defense against potential market turbulence. But investors can also further insulate portfolios against specific risks through capital preservation strategies, alternatives, or positions in oil and gold.

Defensive structured investment strategies
Oil and energy stocks
Gold
Macro and multistrategy hedge funds

Source of funds
- Cash
- Excess equity exposure

Diversify with alternative credit

We expect high global debt balances to contribute to elevated price and spread volatility, driving investors to seek ways to benefit from dispersion. This is a supportive backdrop for various credit strategies, including credit arbitrage and distressed debt.

Credit arbitrage
Distressed debt

Source of funds
- Cash
- Maturing investments

Pick leaders from disruption

We expect some of the highest returns in equity markets over the decade ahead to come from those companies that can harness new technologies to grow markets, dislodge incumbents, or slash costs. Successfully identifying these "leaders from disruption" is critical to boosting long-term portfolio potential. We expect the decade ahead to see a wave of disruption rippling across industries, from technology to energy to healthcare.

Tech disruption
Energy disruption (greentech, clean air and carbon reduction, energy efficiency, EVs)
Healthcare disruption (obesity, medical devices)

Source of funds
- Cash
- Maturing investments

Capture growth with private markets

A new world will see significant investments in healthcare, digitalization, and energy. But high government debt levels mean public funding for innovation is likely to be constrained. Private market managers, with their ability to provide equity or debt capital to companies at different lifecycle stages, have a key role to play. Private markets offer attractive return potential and superior access to the real economy, in exchange for lower liquidity. They can also be an effective vehicle for investors focused on driving positive change through impact and sustainability.

Secondaries
Value and middle market buyout
Thematic growth
Private infrastructure
Private credit

Source of funds
- Excess bonds / equities
- Concentrated equities

Analysts: Kiran Ganesh, Sagar Khandelwal, Wayne Gordon, Jason Draho, Michael Gourd

*Time frames 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.

Key investment ideas by asset class

	We like	Source of funds
Equities	• Global value and quality stocks (incl. US IT) • Emerging market equities incl. China, India • Sectors: utilities, consumer staples, energy • Tech disruption • Energy disruption (greentech, clean air and carbon reduction, energy efficiency, EVs) • Healthcare disruption (obesity, medical devices) • ESG leader	CIO least preferred equities, excess cash
Bonds	• Quality bonds (investment grade and high grade) • Sustainable bonds • Fixed term deposits • Bond ladders	Excess cash, excess EM/HY bonds
Foreign exchange	• AUD • Range-trading in EUR, CHF, GBP, and CNY	Upside in USD
Commodities	• Active commodity exposure • Oil	Excess cash
Hedge funds, private markets	• Hedge funds (credit, discretionary macro, equity low-net, multi-strategy) • Private markets (value and middle market buyout, secondaries, private infrastructure, thematic growth, private credit)	Excess bonds and equities, concentrated equities

Section 2

Macro economic outlook

Global economy – Sense from central bankers?

Base case (60%)

Growth

Sentiment data continues to underestimate actual economic activity. While interest rate increases have hurt consumer spending, the negative impact is not evenly distributed. Middle income consumers continue to support economic activity, albeit with a focus on services spending. Signals for goods spending are mixed – while some export data has stabilized, shipping and trucking companies are sending more cautious or even pessimistic signals. The world's major central banks do not want markets to anticipate an easing cycle (as that would undo the economic effects of some of the recent tightening), but investors interpret recent commentary as more clearly signaling a peak in interest rates.

Inflation

Goods prices remain in disinflation or deflation territory. While energy prices are subtracting less from inflation, more discernment by consumers in their spending choices is helping to tame profit-led inflation.

Positive case (15%)

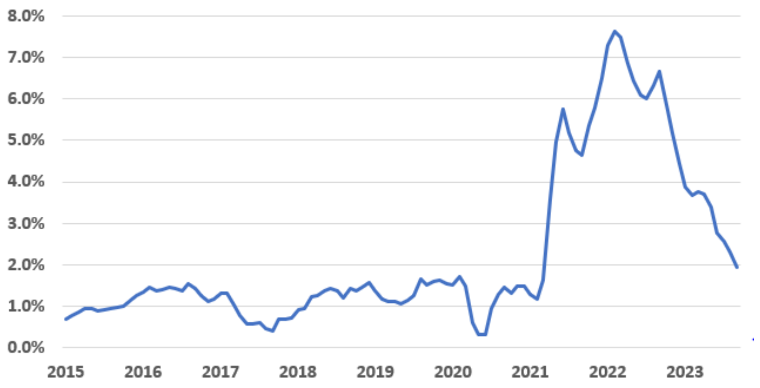
Although nominal wage growth slows, a faster decline in inflation restores stability in real wage growth more quickly, supporting consumer demand earlier than anticipated. Middle-income consumers experience below-reported inflation, which helps spending power is an important demographic. Unemployment 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. Consumer concerns about the cost of credit slows borrowing for middle income consumers as well as lower income groups. Fear of unemployment starts to increase, leading to a rise in precautionary spending. This compounds the risks to growth.

US profit-led inflation may be retreating

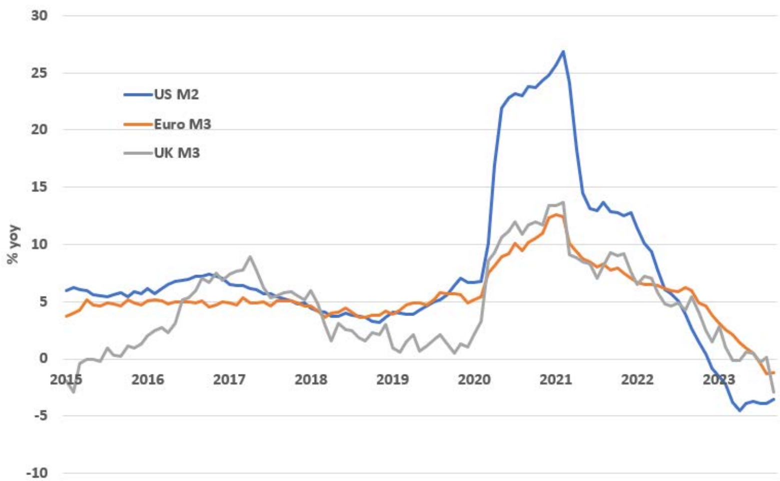
Core consumer price inflation less shelter, % yoy



Source: Haver, UBS as of 5 November, 2023

Money supply shows central bank tightening at work

Major economies' broader monetary measures decline



Source: Haver, UBS, as of 5 November, 2023

US economy – On a path toward a soft landing

Base case (60%)

Growth

Growth has remained above-trend since 3Q22, including a very strong 4.9% growth rate in 3Q23. However, other data has been less impressive, including the ISM PMIs, which point toward much more modest growth. Banks continue to tighten their lending standards and demand for borrowing continues to weaken amid high interest rates. Our base case remains a soft landing, but the Fed will likely have to start trimming rates in 2024 to avoid a recession.

Inflation

Core inflation continues to moderate, running at a comfortable pace for the Fed over the last three months. Supply chain issues have mostly been resolved, helping to bring goods inflation towards zero. However, services inflation is still elevated, led by shelter, and wage growth is too high for the Fed to sustainably hit its 2% target over the medium term. Additional softening of the labor market will be needed for the Fed to declare victory over inflation.

Positive case (15%)

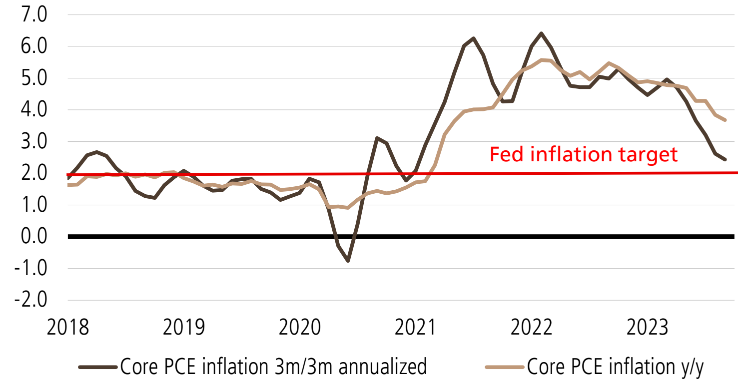
Better labor supply allows businesses to fill their open job positions. Wage growth slows to a more moderate pace and energy prices retreat, helping bring inflation down while growth remains robust. New industrial policies promote business investment. The Fed sees enough progress toward its mandates to start trimming rates in 2024 while growth stays healthy.

Negative case (25%)

Progress on inflation stalls, forcing the Fed to maintain tight monetary policy. Banks continue to tighten their lending standards, pushing up borrowing costs. 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 pushes the economy into a recession.

Core inflation still above the Fed's target

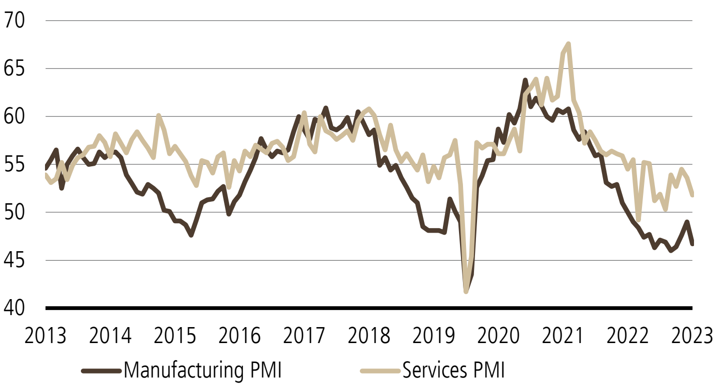
Core PCE, 3m/3m annualized and y/y change, in %



Source: Bloomberg, UBS, as of 7 November 2023

PMIs suggest economic growth is modest

ISM Manufacturing and Services PMIs, 50 = neutral



Source: Bloomberg, UBS, as of 7 November 2023

Eurozone economy – Down but not out

Base case (60%)

Growth

Sentiment surveys, and industrial production data for the Eurozone's largest economy, Germany, suggest that the risks to economic growth in the near term remain firmly skewed to the downside. The ECB kept interest on hold at its October meeting in response to fading inflation pressures and mounting concerns for growth. We expect the economy to remain on its current trend, with a modest pickup in activity later in 2024 as real incomes improve and monetary policy is eased

Inflation

Headline inflation fell sharply in October as last year's peak fell out of the calculations. With the tailwind from energy base effects now behind us, the focus is on closing the last mile to the reach the ECB's 2% inflation target. We expect core and headline inflation to fall back to target over the coming quarters, which should give the central bank the confidence to lower interest rates, most likely from the summer of next year.

Positive case (15%)

Economic activity normalizes sooner, supported by a sharp fall in inflation, earlier than expected monetary policy easing, and ongoing labor market strength.

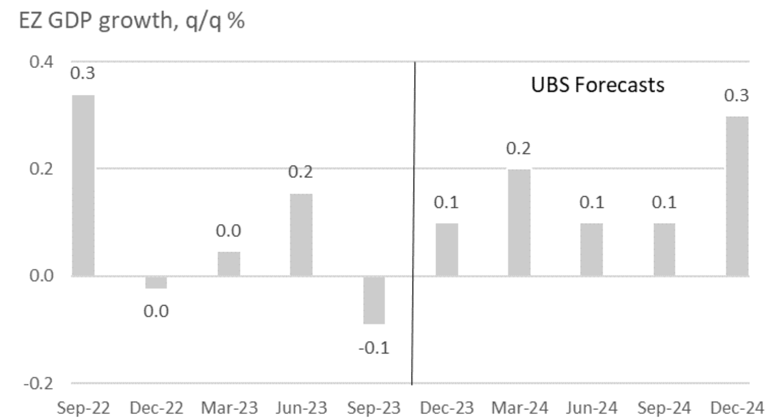
Economic growth in Asia and the US accelerates, with the latter avoiding a recession, boosting demand for Eurozone exports.

Negative case (25%)

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

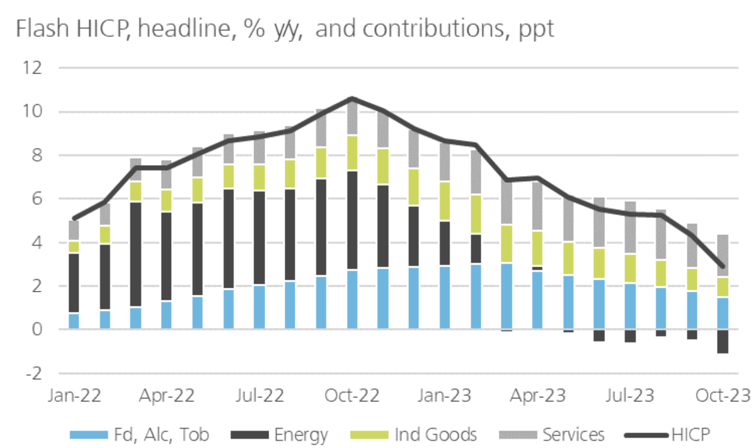
Geopolitical tensions force energy prices materially higher. Fiscal policy is too slow to respond or is tightened too early.

Growth is likely to remain anemic



Source: Haver Analytics, UBS, as of 8 November 2023

Headline inflation continues its downward trend



Source: Haver Analytics, UBS, as of 8 November 2023

Swiss economy – SNB to keep policy rate on hold

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, GDP growth is expected to improve on the back of global sport events. Furthermore, a decline in inflation and the end of interest rate hikes should support European growth and help Swiss exports to recover.

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 the coming months, 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%)

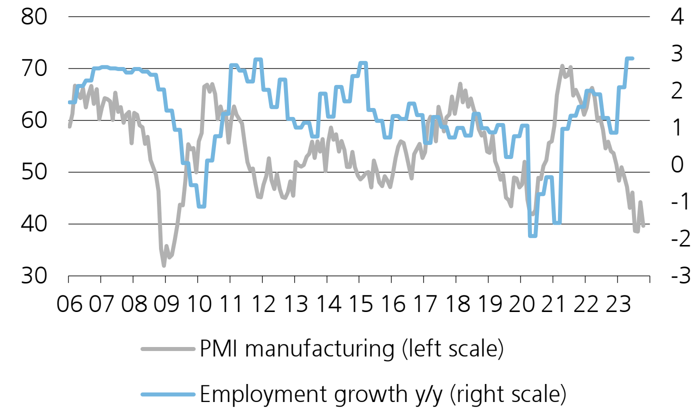
Better global growth momentum:
If the current robust growth in the US filters through to Europe and China GDP growth could surprise on the upside globally. Switzerland benefits from the stronger global backdrop and a weakening of the safe-haven Swiss franc.

Negative case (15%)

US downturn pushes Switzerland into a recession:
If the global economy falls into recession, Switzerland would suffer strongly from the slump in global export demand and from a strong appreciation of the Swiss franc.

Foreign demand soft but domestic demand resilient

Swiss PMI manufacturing and employment growth



Source: Macrobond, UBS, as of 6 November 2023

Swiss forecasts (in %; *UBS forecasts)

Source: Macrobond, UBS, as of 6 November 2023

Chinese economy – Stabilizing on policy support

Base case (70%)

Growth

3Q GDP beat expectation at 4.9% y/y. September retail sales rebounded to 5.5% y/y on low base, services and autos. Investment slowed further to 3.1% y/y ytd dragged by property but cushioned by infrastructure and manufacturing. Credit growth stabilized at 9% y/y ytd with stronger local government bond issuance. We expect GDP growth to reach 5.2% y/y in 2023. Extra CNY 1tr special central government bond will be issued to support infrastructure projects, with 0.4-0.8 ppt potential boost to 2024 GDP growth.

Inflation

CPI inflation stayed nearly muted in recent months. We expect a mild pickup to average ~0.4% y/y for full year. PPI deflation is easing, but likely to persist through early 2024.

Intensive government bond issuance leaves room for another 25-50bps of RRR cut(s) and 10-20bps MLF cut(s) over next 3-6 months.

Positive case (15%)

More policy measures are announced to revive confidence in the economy's medium outlook.

Geopolitical risks eased on rising willingness of communications between China and US.

The US economy achieves a soft landing.

Negative case (15%)

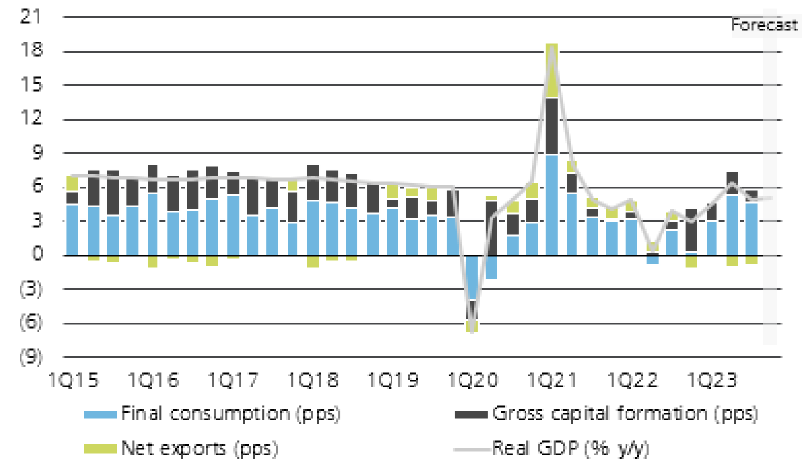
Property activity continues deteriorating despite supportive policies.

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.

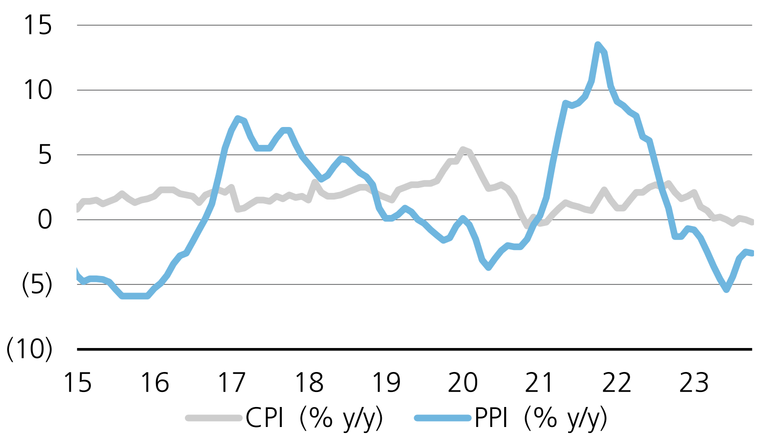
Consumption remained the main driver

GDP growth contribution breakdown



Source: CEIC, UBS, as of 3 November 2023

CPI and PPI inflation to pick up mildly



Source: CEIC, UBS, as of 9 November 2023

Section 3

Asset class views

Section 3.1

Summary of major asset classes

UBS

Equities

Central scenario

MSCI AC World June 2024 target: 845

In our global tactical strategy, we have a neutral view on equities. Forward EPS has been trending up since May, and trailing EPS finally started to follow this month. The extent to which earnings can further recover will depend on the speed of the economic growth slowdown and the ability of companies to maintain their pricing power. In our base case, we expect global equities to deliver mid-to-high single-digit returns over the next 6–12 months. But the path higher is getting narrower due to interest rate volatility, market pricing of future central bank policy moves, and geopolitics. Therefore, we keep our neutral view on equities.

Largely solid earnings. In the 3Q23 results season, top-line sales delivered upside surprises, albeit smaller than in the previous two quarters. EPS surprises were still quite robust in the US but less so in Europe, Japan, and the UK. More importantly, the MSCI AC World's consensus earnings growth forecast is now at 11% for 2024. The ability of companies to deliver or beat this forecast will depend on the resilience of the labor market and on the magnitude of the restocking cycle, which is expected to take place next year. Key things we monitor are EPS momentum, earnings revision breadth, and the general EPS trend.

Valuation is not an effective timing tool. The equity risk premium is low in a historical context, but it alone won't trigger major shifts in the equity market. What it tells us, though, is that the downside buffer is quite limited from a valuation perspective if fundamentals don't deliver.

We move the US to neutral from least preferred. The 3Q earnings season showed the US remains the strongest region in terms of earnings surprises. According to our bottom-up analysis, the country should also see a decent earnings growth acceleration in 2024 (to 9% from 0% in 2023). However, given its high valuation premium versus other markets, we think a neutral stance is appropriate—i.e., allocating the capital to US equities according to one's long-term strategic asset allocation plan.

We move the UK to least preferred. We see less upside for UK equities than their regional peers. If we combine 2023 and 2024 earnings, the UK would be one of the few developed equity markets with an earnings contraction of more than 5%.

Emerging market equities most preferred. We think emerging markets are likely to outperform their global peers in our tactical timeframe. Economic surprises have been improving since July, and China is adding more ammunition to stimulate domestic demand. Emerging market sentiment has been low, which could help prompt a technical rebound once catalysts kick in. We think a rangebound USD and gradually improving EM earnings will offer that kick.

We continue to prefer energy (most preferred) to materials (least preferred). After a robust 2022 when oil prices surged in the early stage of the Russia-Ukraine conflict, earnings have normalized in 2023. The consensus earnings growth forecast for 2024 is in the low single digits, which we think is too pessimistic. Our commodity strategists maintain a most preferred view on oil. The absence of a recession should support demand, while OPEC continues to carefully manage supply. Moreover, the energy sector remains cheap valuation-wise, with solid return on equity and free cash flow yields. The materials sector, on the other hand, exhibits the worst momentum in terms of trailing and forward earnings. Soft global manufacturing demand and a weak property market in China remain significant headwinds.

CIO themes

Quality income

We see three reasons to invest in our "Global quality income" theme: (1) These stocks tend to do better during an economic slowdown; (2) they usually outperform in a market sell-off and when volatility rises; and (3) dividends are typically safer than earnings, while balance sheets remain safe and capital returns well covered. Moreover, the dividend yield of our basket is appealing at an estimated 4.1% for 2024.

Country preferences

Most preferred: EMs

Least preferred: UK

Sector preferences

Most preferred: Utilities, consumer staples, energy

Least preferred: Healthcare, materials

Analysts: Crystal Zhao, Adrian Zuercher, Mark Andersen, Ivan Peric

Equities

Consumer staples and utilities are most preferred. Although we don't expect the global economy to enter a recession, below-trend growth should cap the upside potential for some cyclical parts of the market. Therefore, we like the defensive profile of consumer staples and utilities. Consumer staples are also likely to benefit from the normalizing inflation. Utilities are particularly cheap and are key beneficiaries of the transition toward green energy. Lower interest rates going forward should also help the sector.

Healthcare stays least preferred. Valuations have cheapened in recent months but remain more expensive than other defensive sectors. In addition, earnings forecasts are being significantly downgraded, with the sector showing the weakest earnings momentum within our sector universe.

Upside scenario

MSCI ACWI June 2024 target: 940

Inflation cools quickly and the US and European economies grow above trend: Inflationary pressures quickly dissipate, but growth turns out stronger than expected.

Geopolitical de-escalation: A ceasefire ends the war in Ukraine and between Israel and Hamas, and reduces the risk of further sanctions against Russian or Iranian commodities.

Economic growth reaccelerates: Solid economic growth in the US and emerging markets drives a sharper improvement in corporate profits.

Downside scenario

MSCI ACWI June 2024 target: 640

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

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

Economic growth shrinks sharply as a result of the lagged impact of tighter monetary policy, driving earnings growth and valuation multiples lower.

Analysts: Crystal Zhao, Adrian Zuercher, Mark Andersen, Ivan Peric

Bonds

During the summer, interest rate volatility increased as rate cut expectations for next year were recalibrated due to better-than-expected US economic data. Although terminal policy rate expectations did not move aggressively, the entire term structure of rates shift higher globally as markets priced in more restrictive policy for longer. In recent weeks, rate volatility has focused on the long end of the curve. Bond supply is picking up as governments across most major economies look to refinance existing debt and issue new notes to fund growing deficits. Central banks reducing their stock of government bonds in their pursuit of tightening financial conditions is fueling a supply-demand imbalance, which requires private sector end investors to absorb the additional supply. As a result, the long end of the curve that carries the most risk has repriced higher through an increase in term premiums. This is the extra compensation investors demand to hold long-dated bonds above short-term policy rate expectations. Historically, a widening of fiscal deficits has coincided with a deteriorating economic backdrop and hence a pickup in demand for bonds. However, given the recent strength of the US economy, inverted yield curve, and bid for risk assets, the traditional historical pattern hasn't materialized.

The increase in term premiums is an additional tightening of financial conditions on top of official policy rate adjustments. Central banks in the last year have elected to separate monetary policy and lender-of-last-resort responsibilities. Namely, central banks remain committed to keeping policy rates restrictive until inflation is closer to their designated target ranges. But they have shown a willingness to offer targeted liquidity to protect against financial instability. Within this context, we do see a limit to how quickly term premiums can rise given the negative feedback loops that entails. Our preference for high-quality bonds is centered on the 1–10-year maturity range. This is typically more correlated to the macroeconomic backdrop rather than technicals which can often have a more pronounced effect on the ultra-long end of the curve. Additionally, given the higher level of rates and lower interest rate sensitivity, there is a substantial cushion to mark-to-market volatility in this maturity range and appealing risk-adjusted returns relative to other asset classes, particularly if downside risks on growth and financial stability increase.

Within the asset class, we maintain an up-in-quality bias expressed through high grade (HG) and investment grade bonds (IG). There are select 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 global growth and earnings in developed economies suggest higher default risk in the future. Additionally, liquidity risk premiums are prone to rising over time as global money supply continues to shrink. As a result, we see HY and EM spreads as being vulnerable relative to IG and HG.

High grade bonds: We maintain our most preferred recommendation on HG bonds. With indications that inflationary pressures are abating and growth is weakening, major central banks are ready to pause and assess the full effects of aggressive policy tightening so far. Against this backdrop, we continue to like high grade bonds. Our rationale is that central banks have succeeded in ensuring inflation expectations remain stable and financial conditions are now restrictive, as evidenced by the pickup in financial instability earlier this year. We acknowledge there may be further upward pressure on short-end rates as central banks contend with the more persistent sources of inflationary strains that we see currently. To achieve structurally higher interest rates across the curve, however, we believe economic growth needs to step up. We think growth will continue to slow because of tighter financial conditions, despite the recent resilience of the US economy. Accordingly, while interest rate volatility will likely remain elevated after declining from its October 2022 peak (with high interest rates providing a buffer for returns), we see a much more even balance in terms of direction. High grade bonds are rated AA- or better, and therefore have minimal default risk.

Preference: Most preferred

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.

Bonds

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 slowing growth.

Investment grade bonds: Like HG bonds, we maintain the asset class at most preferred. The high interest rate sensitivity of the US and EUR investment grade complexes has detracted from total returns this and last year. But 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 4.4%. On US IG, yields for all maturity and intermediate profiles are around 6%. Credit fundamentals on the US IG corporate side remain solid and should provide protection in a slowing earnings environment. Any widening of spreads should be more than offset by falling interest rates as we approach the end of rate hiking cycles.

High yield bonds: We are neutral on the asset class as, relative to the higher-quality segments, we see more pronounced risks of spread widening and decompression as the tightening of financial conditions translates into higher corporate defaults for the more leveraged, growth-sensitive cyclical companies. As liquidity becomes more challenging, credit risk premiums should also widen. That said, 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. Additionally, the outright level of yields in US HY and EU HY is above 9% and 8%, respectively, which has attracted capital flows more recently and supported performance, hence our neutral stance.

Emerging market bonds: We are neutral as we see spreads as fair and expect them to trend largely sideways in coming months. A sustained move tighter in EM credit spreads would require, for instance, a significant acceleration in global growth or the Fed signaling a move towards a less restrictive monetary policy, none of which are part of our baseline assumptions in the next few months. In China, while the recent decision to increase fiscal spending should support growth prospects for 2024, the country will likely continue to face various headwinds from a weak property market, lackluster consumer sentiment, and US import restrictions. In the absence of large-scale fiscal stimulus, we expect the recovery to be gradual. Geopolitical tensions in the Middle East remain in focus, with further escalation a possible risk. On an asset class level, the region accounts for more than 20% of the emerging market sovereign and corporate bond indexes. Current yields are around 8.9% and 8.0% for sovereign and corporate bonds, respectively. We see emerging market fixed income exposure as desirable in global portfolios. The asset class should deliver healthy total returns in our base case scenario over the next six to 12 months on the back of lower-trending US benchmark rates and sideways-trending EM spreads.

FX

Elevated interest rates and robust economic growth in the US relative to the rest of the world have provided broad USD support over the past two months. Considering the latest data, the US exceptional status of being a safe-haven high yielder is apparently fading. We think the USD overvaluation will moderate in the new year.

Our big question for the EUR is whether the European Central Bank will be able to drive inflation back to the target rate of 2% without causing a recession. We see the challenge, and think the Eurozone will just escape recession, but not shine. For this reason, the Eurozone-related triggers for a higher EURUSD are muted. In other words, the upside for EURUSD is, in our view, most likely limited to levels seen earlier this year.

As for the GBP, the dovish turn from the Bank of England has left its mark. Housing market data is starting to become a greater concern as monetary policy works its way through the economy and labor market leading indicators are pointing at a downturn. The latest US labour market report pushed GBPUSD into the 1.21 to 1.27 range, which we expect to hold.

The Swiss franc is a safe-haven currency. The Swiss National Bank follows a strategy of low interest rates, which would potentially weaken the CHF, and selling FX reserves, which strengthens the currency and keeps inflation low. We see clear limits to CHF weakness and think in most pairings the implied option volatility is rather generous for vol selling strategies.

The yen remained weak despite the Bank of Japan removing the 'hard cap' on JGB 10-year yields at its October meeting, as the central bank continued to signal that it intends to manage the pace of yield rise. But the pullback in US yields has provided some relief to the USDJPY pair, and should keep the latter trading in a near-term range of 145 - 151.

For the CAD, NOK, AUD, or NZD, we see room for relative outperformance in the crosses. Chinese data should stabilize further with room to grind higher, in our view. The pullback in oil prices should also be transitory, which should ultimately support the CAD and NOK. We expect EURCAD to move lower and the NOK to outperform the SEK again.

Emerging market currencies broke out of their downtrend in force since July when US longer-term yields showed first indications of retracing. The South African rand, which tends to react strongly to global drivers, and the high-yielding Mexican peso, which saw strong outflows in September and October, stood out on the way down and up. Overall, the Fed's hawkish bias remains in place though, in our view, still creating potential pitfalls at a time when many emerging market central banks in Latin America and EMEA are getting ready to cut interest rates or are already underway. On the other hand, Asian central banks have leaned harder against currency weakness, with the Indonesian and Philippines central banks unexpectedly hiking rates in recent weeks to preserve their currencies' yield appeal vis-a-vis the greenback. Overall, we continue to prefer yield enhancement strategies rather than outright exposure to emerging market currencies.

The biggest risk to our short-term USD view is a rapid fall in US growth, which would put investor focus on structural USD negatives and the greenback's elevated valuation. The speed at which the US economy slows matters. If the US economy fails to slow because consumer demand or fiscal spending comes in strong ahead of the US elections, current market expectations for lower US rates could still be revised higher.

FX

Conversely, a hard landing, with risk assets under downward pressure, could temporarily support the USD. The USD tends to perform positively in a risk-off environment. However, for this to happen, the starting point matters as well. A richly valued USD on the back of US exceptionalism is unlikely to benefit greatly from risk-off forces if the same narrative goes into reverse gear. This would change if the weakness in US accelerates an already weak growth backdrop outside the US.

Lastly, we are also watching the US bond market at the long end of the yield curve. The US fiscal deficit seems to be too high without the market commanding a higher term premium. A further rise in the 10-year US Treasury yield north of 5% could keep the USD on a path of further strength. That being said, it will also reach a point where higher rates provide little support for the currency as investors begin to worry about the economic knockdown effect at a later stage. However, we have yet to see this point emerging for the US economy and the USD.

Commodities

Early November, Saudi Arabia and Russia announced that their voluntary cuts will be extended by another month into December. With oil demand seasonally weakening at the first quarter of every year, and with OPEC+'s desire to keep the oil market in balance, we think these cuts are likely to be extended next month. We continue to expect Brent oil to move back into a USD 90–100/bbl range, supported by lower oil inventories.

Copper prices have been lackluster, with repeated dips below the USD 8,000/mt mark. Demand concerns and higher exchange inventories have weighed on the metal price. Near-term growth challenges should keep copper prices anchored. But as China's growth picture improves and destocking in end-use sectors for copper comes to an end, secular price drivers still favor higher prices.

Gold has again demonstrated its worth as a hedge in a portfolio context. Geopolitical tensions, unusual guidance by the US Treasury, and elevated central bank buying are supporting gold prices, but a step higher requires a structural upturn in buying by exchange-traded funds. We recommend buying on dips below USD 1,900/oz.

In agriculture, soft commodity prices like sugar and cocoa are already high in nominal terms while grains declined by close to 10%. However, we believe weather risks continue to linger and are currently threatening supplies of soybeans, sugar, rice, and vegetable oils. Despite El Niño's impact on global food prices, the link with global benchmark prices is far from straightforward, and we believe production and trade disruptions via weather-related events or geopolitics remains a key risk into the year ahead. As such, we believe exposure to the sector remains a strong value-add from a diversification perspective. Livestock has seen divergent performance year-to-date, with live cattle's strong performance partly offset by weakness in lean hogs. But ongoing margin pressures for lean hogs and weather-related herd liquidation for live cattle prices indicate a step higher in prices in early 2024.

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, and silver.

Analysts:Dominic Schnider, Giovanni Staunovo, Wayne Gordon

Section 3.2

Details per asset class

Eurozone equities

Central scenario

DJ Euro Stoxx 50 June 2024 target: 4,600

We maintain our neutral stance on Eurozone equities. Valuations are now relatively attractive and already partly reflect higher bond yields and our below-consensus earnings estimates, in our view.

Eurozone equities (MSCI EMU) have stabilized but remain 7% below their recent July highs (10% in USD terms). Concerns over higher-for-longer interest rates, geopolitical uncertainty, and weak economic growth linger, but we believe current valuations already at least partly reflect these concerns. MSCI EMU trades at an 11.3x forward price-to-earnings (P/E) multiple, a 15% discount to its long-run average of 13.4x (since 1988) and a deep 27% discount to global equities (MSCI AC World).

The recent reporting season has been okay, with the typical company beating consensus earnings expectations by 2%, broadly in-line with the long-run average. Revenues though have been weaker, with more companies missing consensus revenue forecasts than beating, but better-than-expected profit margins have offset this weakness. We believe these trends reflect weakening price trends, which are driving slower revenue growth but lowering input costs. In real terms, we believe we are close to the bottom of the earnings cycle but anticipate only a gradual recovery in profits given softening prices and expectations of sub-trend economic growth. We forecast 0% earnings growth this year (consensus 4%), 3% in 2024 (consensus 7%), and 4% in 2025 (consensus 10%).

We advise a balanced positioning between cyclical and defensive sectors, with a preference for those areas in which we see inflection points emerging or valuations as especially attractive. We expect consumer sectors to be boosted by real incomes turning positive and central bank rate hikes ending. We like materials given attractive valuations with upside from an end of de-stocking and further signs of stability in China. German equities should also benefit if these drivers turn more favorable. And Eurozone small- and mid-caps would offer material upside at current valuations should the macro outlook improve. We recently downgraded industrials but still see select opportunities in greentech.

CIO themes

Eurozone small- and mid-caps

We see attractive value in small and mid-sized companies, and expect inflections in the macroeconomic outlook to emerge in 2H23, supporting these companies more than large-caps.

Consumer recovery

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

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 manufacturing begins to improve.

Greentech goes global

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.

Eurozone equities

Upside scenario

DJ Euro Stoxx 50 June 2024 target: 5,000

Inflation falls quickly, allowing central banks to ease policy in the medium term, supporting valuations that have been under pressure from sharply higher discount rates.

Economic recovery. Earnings could surprise to the upside if US/European economic growth is better than expected or China's economy begins to recover.

Companies keep pricing power. If companies can maintain some pricing power, margins could expand more than we expect, and revenues may stay resilient—leading to upside risks to our earnings forecasts.

Lower European gas prices are possible given the risk of oversupply in the coming months with European gas storage close to full capacity.

Downside scenario

DJ Euro Stoxx 50 June 2024 target: 3,340

Growth disappoints, potentially driven by a US recession, triggering weaker earnings growth and lower valuation multiples in anticipation of it.

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

Political risks or other 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. Unforeseen disruptions to gas supplies, in combination with a cold winter or tight liquefied natural gas supply, could raise the risk of production stoppages during winter.

Sector Preferences:

Most preferred: consumer discretionary, consumer staples, and materials.

Least preferred: communication services, healthcare, and industrials.

US equities

Central scenario

S&P 500 June 2024 target: 4,500

Equity markets have been volatile in the last several weeks. Relentless increases in long-term interest rates pushed stocks lower in September and October. But equity markets surged in early November as interest rates finally fell on growing market conviction that the Fed is all but done raising interest rates. We continue to expect a "softish" landing for the US economy.

While solid growth and falling inflation have supported stocks this year, economic growth will likely slow in the months ahead. The resumption of student loan repayments, lagged effects from higher interest rates, and a recent further increase in mortgage rates could prompt a bit of a slowdown in consumer spending. Geopolitical and government shutdown risks are additional potential headwinds. However, despite a cooling labor market, consumers remain in good shape. There are still more job openings than there are unemployed workers, recent revisions to household savings show consumer balance sheets are in better shape than previously thought, and the most cyclical segments of the labor market—manufacturing and construction—are still adding jobs. In addition, households and businesses (especially the largest businesses) are somewhat insulated from higher interest rates due to a high proportion of fixed-rate debt or maturities that are quite lengthy. Lastly, business inventories are now somewhat lean, there are no obvious areas of over-investment in the economy, and the imperative to invest in AI remains. So, in our base case, we expect the US economy to avoid a hard landing.

The third-quarter earnings season is winding down and results are coming in fine. The percentage of companies beating earnings per share (EPS) estimates is above historical averages and corporate profits are on track to grow by 5%, a bit more than our initial expectations of +3-4% y/y. Encouragingly, the earnings recession is over as earnings are set to grow for the first time in four quarters. Strong profit growth from the "Magnificent 7," a resilient labor market supporting consumer spending, and a near end to the slowdown in the goods segment of the economy are all key drivers. Unlike GDP, S&P 500 profits skew more towards goods rather than services, so a rebound in goods activity should support earnings going forward. On the positive side, consumer spending appears to be holding up and within tech hardware, we continue to see signs that PC and smartphone end markets are bottoming. However, some segments that have been weak—capital markets, freight, chemicals—have not yet improved.

Overall, we see moderate upside for US stocks from current levels. Sentiment and positioning remain tepid, earnings growth has turned the corner, and if the Fed is done raising rates, the likelihood of a soft landing improves. We continue to expect flat S&P 500 EPS growth in 2023 (USD 220) and 9% growth in 2024 (USD 240). We think earnings growth can accelerate in 2024 despite slowing GDP growth due to base effects in healthcare and energy as well as a potential moderate pickup in the goods side of the economy. We maintain our June 2024 price target of 4,500 and year-end 2024 price target of 4,700.

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: Both concerns about demand and some giveback in geopolitical risk premiums have likely driven the recent decline in oil prices. However, the recent announcement that Saudi Arabia and Russia would extend their voluntary production cuts by another month into December and the continued draw in global inventories support our view that oil prices are likely to head higher. Valuations are pricing in a somewhat cautious outlook and the sector should act as a cheap hedge for any unexpected increase in inflation or geopolitical tensions.
- Information technology: The sector should benefit from a bottoming in PC and smartphone end-markets. AI enthusiasm has cooled (leading to better valuations) and we think there is still upside to consensus estimates. Investors will likely continue to gravitate to high-quality companies that have good secular growth in the "late cycle" economic environment that we expect to persist.

US equities

Upside scenario

S&P 500 June 2024 target: 5,000

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 and 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.

Geopolitical turmoil: Geopolitical flashpoints spiral further out of control, potentially disrupting energy supplies or dragging more countries into hostilities.

Sector preferences

Least preferred

- Materials: Very large supply additions in chemicals is a cause for concern. Sluggish activity in China and a stronger US dollar since mid-July are headwinds.
- Real estate: High interest 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 adjusted 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.

UK equities

Preference: Least preferred

Central scenario

FTSE 100 June 2024 target: 7,860

We expect the global economy to slow further, as developed market economies continue to absorb the impact of monetary tightening. Due to the expected year-over-year changes in underlying commodity prices, we believe the energy and mining sectors will see negative earnings growth this year, as will consumer discretionary given the pressure on the consumer from inflation and interest rates. Into 2024, earnings should start to recover as the drag from commodities fades and global growth recovers, but bank earnings should fade as interest rates peak. As a result, the UK's overall earnings growth profile is weaker than that of other markets, and we anticipate better earnings revisions elsewhere. Therefore, while we see absolute upside to the FTSE 100 over the next 6–12 months, we believe it will likely underperform other equity markets.

While the UK equity market looks attractively valued, valuation is not normally a driver in the short term, but earnings momentum is. The FTSE 100 trades on a 12-month forward price-to-earnings (P/E) multiple of 10x—around 20% below its long-run average—and more than a third lower than global equities (MSCI All Country World Index). However, this is a reflection of its composition, consisting mostly of value sectors such as financials, energy, and commodities. We see the 4% dividend yield of the UK market as attractive in the context of moderate expected capital appreciation.

Upside scenario

FTSE 100 June 2024 target: 8,530

Valuation: 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 2024 target: 5,935

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

Lower economic growth: Should developed economies sink into a full recession and global economic growth slows more than anticipated, this would be negative for earnings and equity valuations.

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 2024 target: 11,300

After a strong 2021, we expect corporate profits to drop 4% over the 2021–23 period, supported by price increases to help offset cost inflation, M&A deals, and robust cost management. A drag on profits will likely come from negative sales volume growth in certain areas, restructuring costs, and currency losses. We prefer a two-year view on profit trends due to substantial one-off operating costs—primarily in the financials sector—that weighed on underlying profit trends in 2022. So, comparing 2023 profit expectations to reported 2021 numbers provides a much cleaner picture. In 2024, we expect profits to increase 7% compared to 2023, led by positive organic sales growth and margin trends.

Since early June 2022, the Swiss National Bank (SNB) has been increasing its prime interest rate to mitigate inflation pressures despite a recent slowdown in Swiss and global growth. Higher CHF interest rates support the Swiss franc, which in turn weighed on Swiss profits since 90% of them are generated in foreign currencies. We expect negative currency effects to moderate significantly from 4Q23.

Swiss equity valuation multiples are marginally above the 25-year average, which we think is fair given normalizing interest rates. Dividend yields remain attractive despite now higher bond yields, in our view. At 3.3%, the expected yield is above the 25-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. With regard to investment strategy, we recommend focusing on quality firms and service companies, and selectively on cyclicals and mid-caps. Companies with attractive and sustainable dividend and free cashflow yields are particularly appealing to us.

Key risks include protectionism, international trade disputes, a significant economic downturn, currency losses, and Swiss-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 moderated only slightly in 2021 versus 2020, and rebounded by around 6% in spring 2022 as well as in 2023, achieving a new all-time high. We expect another low-single digit percentage increase in spring 2024 as well as in 2025.

Swiss equities

Upside scenario

SMI June 2024 target: 12,170

Robust Swiss profits: If there is only a modest global economic downturn this year, corporate profits could expand by a low-single-digit percentage over the 2021–23 period.

Sustainable dividends: Swiss dividends have generally grown every year since 2009. In 2021, however, total SMI dividends fell by 3%. In 2022 and 2023, they recovered by 6% each. In our upside scenario, we would expect mid-single-digit percentage rises next year (i.e., for the business year 2023) and in 2025.

Manageable currency impact: In 2020, currency effects were clearly negative, while those in 2021 were insignificant. In 2022, they increased a bit. In 2023, we expect currency losses to be significantly negative again. If the impact is less severe than anticipated, this could boost Swiss stocks.

Downside scenario

SMI June 2024 target: 8,990

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 high-single-digit percentage in 2023 versus 2021, leaving the SMI trading at an unjustified premium of well over 10% to its 25-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, which could materialize if inflation and nominal bond yields rise.

Emerging market equities

Preference: Most preferred

Central scenario

MSCI EM June 2024 target: 1,050

We rate emerging market (EM) equities as most preferred. The macroeconomic picture in emerging markets remains healthy. Aggregate manufacturing PMIs are in expansionary territory, economic surprises have been positive across regions in recent weeks, and inflation continues to normalize. Emerging market companies look set to deliver solid earnings growth in 2024.

Valuations for the MSCI EM index are largely in line with their 10-year average, yet still stand at an above-average discount to their US peers. In our view, the gap does not factor in better earnings growth prospects for emerging markets relative to global peers looking into 2024.

A strong US dollar, sharply higher US rates, an uptick in geopolitical tensions, a pronounced US recession, and growth disappointments in China are risks to the outlook for EM equities.

From a geographic standpoint, China remains most preferred on the ongoing policy support. We think markets have priced in a lot of the negatives around China's real estate sector and weak growth. Overall economic dynamics in the country seem to have found a floor in recent weeks. We also keep India as most preferred. 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.

CIO themes

ESG matters in emerging markets

This theme offers investors an opportunity to add value to their portfolios by incorporating 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

China, India

Least preferred

Singapore

Emerging market equities

Upside scenario

MSCI EM June 2024 target: 1,140

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: 760

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..

Japanese equities

Central scenario

TOPIX June 2024 target: 2,500

We are neutral on Japanese equities in our global portfolio. The TOPIX posted two consecutive negative monthly returns in September and October (-0.4% and -3.0%) for the first time in 2023. However, the TOPIX started to rebound in late October after US 10-year yield appeared to reach its peak. MSCI ACWI also started to recover. Solid September quarter earnings progress also has supported the share price recovery.

Looking into 2024, we continue to think the Japanese equity market will offer relative safety, supported by a more favorable macro environment. We expect Japan's economic growth to be stronger than that of major developed markets next year, with higher inflation and wage growth than in the last few decades. Nominal wage growth should also support corporate earnings growth in 2024. Despite higher inflation, we expect the Bank of Japan to maintain a prudent monetary policy stance, providing a favorable investment environment for risk assets in Japan. We forecast corporate earnings growth of +9% for FY2023 (end-March 2024) and +7% for FY2024, based on a mild strengthening of the yen in 2024.

September quarter results look solid to date, with double-digit earnings growth and upward revisions to full-year corporate guidance, supported by a better-than-expected US economy, robust post-COVID domestic consumption and a weaker-than-expected JPY versus the USD. We expect consensus earnings forecasts to follow suit post the results season in November and December.

Over the next 6-12 months, we continue to prefer quality value stocks, including banks as beneficiaries of higher yields and improving shareholder returns, as well as domestic-oriented sectors like consumer discretionary, which we believe will should benefit from moderate inflation and wage growth. However, we are selective and focus on laggards and stocks with pricing power given the potential inflationary environment. In the near-term, we also see opportunities in selective growth stocks after a pullback in share prices over the past few months and peaking US 10-year yields.

Japanese equities

Upside scenario

TOPIX June 2024 target: 2,700

Global economic growth remains resilient: A strong Chinese economic recovery and a resilient US economy 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 (an aim of 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). Core inflation rose above 3% as a consequence and sits at its highest level 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: A full-blown recession in the US 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 ex-Japan equities

Central scenario

MSCI Asia ex-Japan June 2024 target: 665

From a macro perspective, CPI in Asia has bounced to 3%, with energy and food prices still the main segments that are pushing inflation higher. The US Federal Reserve opted for another hawkish hold this month, while central banks in Indonesia and Philippines had raised interest rates, and Thailand and India may follow suit. Rate cuts from Asian central banks may now be delayed to mid-2024, in our view. On the data front, South Korea shows continuous improvement in terms of exports and industrial production, and we expect the mainly tech-driven recovery to continue into next year. Although we see some initial signs of cooling in the US labor market, we believe the Fed will maintain a "careful" hold. As a result, we remain focused on relative opportunities in the region, instead of taking directional beta exposure.

Within the region, we downgraded Indonesia from most preferred to neutral, while upgrading Malaysia from least preferred to neutral. Fundamentally, Indonesia's financial sector (~60% of the equity index) remains solid thanks to a high policy rate and a healthy net interest margin (NIM) environment. However, from a macro perspective, the spike in real US yields has put pressure on the currency and foreign investor flows, forcing an additional central bank policy rate hike to limit disruptive outflows. As a result, we moved Indonesia from most preferred to neutral until we get more clarity on the US rate environment in the future. Meanwhile, we upgraded Malaysia from least preferred to neutral due to the market's relatively resilience in previous higher-for-longer rate scenarios.

Elsewhere, we keep India as most preferred. The country has a strong domestic economy and foreign interest. Macro-wise, while food CPI has bounced, the Reserve Bank of India (RBI) is staying on pause because of slowing core inflation. That said, we cannot rule out a final hike if the Fed raises rates again or oil prices jump aggressively. There is healthy demand on consumption and construction, funded by vigorous bank credit. We expect earnings to be the main driver of the market, with a potential rerating tailwind if deposit rates peak from here.

China also stays as most preferred. Policy implementation has been a potential catalyst for the market and will continue to be so in the near term. In addition to supportive policies for capital markets and the ailing property sector, we see scope for more action to address issues regarding local government bond in several provinces. The surprise issuance of Special China Government Bonds in October was the latest catalyst boosting the market’s performance. The macro recovery, however, has lagged expectations with the PMI in October particularly weaker month-over-month. We see the Chinese equities’ EPS growth (MSCI China forward 12m EPS) recovery trend continuing, and consider valuations (MSCI China P/E) to be attractive at 1 standard deviation below the five-year average, while allocations from global investors remain low. We keep our most preferred view on China for tactical outperformance opportunities.

Furthermore, Singapore is kept as least preferred. The country is sensitive to the global trade cycle, which is still weak. Its financial sector, which makes up 50% of the market, should have limited upside even under a higher-for-longer rate environment, in our view. Any signs of a turnaround in global trade cycle will be the main macro risk to watch out for, though we think the risk is manageable, for now.

Market preferences

Most preferred: India, China

Least preferred: Singapore

Asian ex-Japan equities

Upside scenario

MSCI Asia ex-Japan June 2024 target: 719

Fed starts rate cuts earlier than expected

Asian equities are likely to rebound strongly if the Fed starts to cut rates or stops quantitative tightening, especially if the economic slowdown is also less severe than feared and inflation drops faster than expected.

Strong Chinese housing demand recovery

A meaningful recovery in property investment in China later this year is likely to push Asian equity markets higher given the subdued expectations on this front.

Strong demand recovery in tech

If we see a faster-than-expected final demand pickup 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 2024 target: 479

Sharp slowdown in DM growth

If US/Europe growth turns out to be much worse than our mild recession assumptions, Asian equities could be impacted.

Re-escalation in Sino-US tensions

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

Stronger US dollar

Asia ex-Japan regional equities tend to suffer in a strong US dollar environment.

High grade

Preference: Most preferred

Central scenario

10-year US Treasury yield June 2024 target: 3.75%

With indications that inflationary pressures are abating and growth is weakening, major central banks appear to be at a point where they are ready to pause and assess the full effects of aggressive policy tightening so far. Against this backdrop, we continue to like high grade bonds. Our rationale is that central banks have succeeded in ensuring inflation expectations remain stable and financial conditions are now restrictive, as evidenced by the pickup in financial instability earlier this year. We acknowledge there may be further upward pressure on short-end rates as central banks contend with the more persistent sources of inflationary strains that we see currently. To achieve structurally higher interest rates across the curve, however, we believe economic growth needs to step up. We think growth will continue to slow because of tighter financial conditions, despite the recent resilience of the US economy. Accordingly, while interest rate volatility will likely remain elevated after declining from its October 2022 peak (with high interest rates providing a buffer for returns), we see a much more even balance in terms of direction. High grade 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 slowing growth.

Upside scenario

10-year US Treasury yield June 2024 target: 2.75%

In the upside scenario for high grade bonds, growth falls sharply on a global scale toward mid-2024 owing to the delayed impact of monetary tightening or additional tightening efforts to tame persistent core inflation. Once demand for goods and services weakens, inflation drops quickly with energy prices falling and the labor market losing momentum. As recession kicks in, major central banks cut rates aggressively. Balance sheet runoff goes on hold.

Downside scenario

10-year US Treasury yield June 2024 target: 5.00%

In the downside scenario for high grade bonds, US activity grows at its trend rate of around 2% as labor markets and household balance sheets prove resilient to monetary policy tightening. Inflation remains above central bank target throughout next year. Monetary policy stays in restrictive territory. Major central banks keep interest rates "high for longer," i.e., do not start cutting policy rates in 2024 as inflation stays above target.

Investment grade

Preference: Most preferred

Central scenario

June 2024 spread targets: 130bps (USD IG) / 170bps (EUR IG)

US and Euro investment grade spreads have moderately tightened from their late October wides alongside easing concerns about US Treasury supply as well as some weaker-than-expected data suggesting further Fed policy tightening has become less likely in the near term.

With yields remaining elevated and major central banks in developed markets nearing the end of their hiking cycle, we think total return prospects in higher-quality fixed income look appealing over the coming quarters. US investment grade (IG) yields are at 5.9% and EUR IG yields are at 4.4%, both historically elevated levels. The higher outright yields and the fact that spreads are a much smaller proportion of total returns than in the recent past are positives for forward-looking returns.

High-quality bonds tend to be resilient in a growth slowdown, as credit spread widening is usually offset to a good degree by falling interest rates. This was the case in March, when deteriorating risk sentiment related to concerns about the banking sector on both sides of the Atlantic caused IG spreads to widen. However, total returns were resilient as falling government bond yields more than offset the widening in credit spreads.

We expect prospects of falling government bond yields as economic growth slows in the coming quarters to contribute to total returns for the asset class. US IG tends to do particularly well at the end of a Federal Reserve hiking cycle, delivering double-digit returns on average over the following 12 months. We think total returns for US IG should be supported by falling government bond yields in our base case over the coming quarters.

US IG fundamentals started to modestly weaken in 2Q, though from a position of strength. Net leverage has edged up as debt growth increased, while earnings growth has remained muted. Ratings migrations have become less supportive over time, and are now hovering around zero. That said, earnings should be resilient and help limit material near-term deterioration, in our view, while issuers had been reducing debt until recently. We therefore view the risk of rising downgrades and upward pressure on spreads as limited outside a deep recession.

We maintain an up-in-quality bias and think IG bonds stand to deliver attractive risk-adjusted returns, given all-in yields and the shifting balance between inflation risks and growth risks.

Upside scenario

Bloomberg Barclays US Int. Corp. June 2024 target: 80bps/ Bloomberg Barclays Euro-Agg. Corp. June 2024 target: 110bps

Lift-off

The US economy continues to grow at or above trend, and European growth improves. Major central banks keep interest rates “high for longer" as inflation stays above target.

Downside scenario

Bloomberg Barclays US Int. Corp. June 2024 target: 200bps/ Bloomberg Barclays Euro-Agg. Corp. June 2024 target: 220bps

Hard landing

Growth falls sharply on a global scale toward mid-2024, owing to the delayed impact of monetary tightening or additional tightening efforts to tame persistently high core inflation

High yield

Central scenario

June 2024 spread targets: 500bps (USD HY) / 500bps (EUR HY)

We are constructive on bonds as an asset class. However, with more growth-sensitive segments such as HY, we are advocating a selective, up-in-quality bias. HY spreads have snapped back from their earlier November widening as easing concerns on US Treasury supply and downside surprises on key US macro data have led the market to price out odds of a further hike and bring forward expectations on the first rate cut.

US HY appears to be discounting a below-average default rate in the year ahead and a nominal growth rate in excess of 5%. We expect US nominal growth rate to slow as the lagged effect of all the policy tightening continues to work its way through the system. Lending standards remain tight, pointing to downside risks to growth and upside risks to defaults over the coming 12 months. Additionally, significant rate cuts are unlikely in the near term in the absence of a recession, given current inflation rates and tight labor markets, in our view.

Many companies were fortunate to lock in lower funding costs prior to the sharp moves higher in rates. Over time, this benefit diminishes as maturities approach and refinancing needs increase. This, coupled with a potentially more challenging earnings backdrop as growth slows, are headwinds for credit. Lower-rated issuers are at particular risk if rates remain high for longer given the large associated step up in interest expenses. Such issuers could struggle to meet their refinancing needs. Indeed, while primary markets appear to be open for many HY issuers, this is mainly for those in the upper rating buckets; we note that CCC issuance of USD 7bn YTD is the lowest level in this period since 2009. We estimate corporate defaults could rise above their long-term average to around 4–5%, compared to the current level of 3.3% in the US.

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, which gives some comfort. Leverage remains low, although it has been trending higher as earnings growth has declined and debt levels have ticked up. The energy sector in the US, which has historically been a source of defaults in downturns, is in a relatively healthy state by virtue of higher energy prices.

Currently, the level of credit risk premium is not overly cheap, in our view. This is the compensation credit investors require over and above expected credit losses. One explanation for this is the fact that the market has been shrinking from just over USD 1.5tr in 2021 to around USD 1.3tr currently. This is due to combination of rising stars (issuers upgraded to investment grade and therefore leaving the high yield universe), while net issuance has remained low. These favorable technicals are likely to slowly diminish over time, as net issuance increases due to issuers addressing their maturity walls while the scope for further net rising stars is also diminishing. We also note that a central bank pivot remains unlikely in the short term (in the absence of a systemic crisis). Central banks have shown a willingness to actively use their balance sheets temporarily when market conditions turn dysfunctional, but this is reactive rather than proactive.

We remain neutral on HY bonds. Although we forecast scope for moderately wider spreads in HY in the coming quarters, the current level of outright yields in US HY is elevated at around 9% at an index level. This is important as the high yield market generates significant carry with every passing day. The higher level of rates provides a sizable buffer against mark-to-market losses that could occur from potential widening in credit spreads.

High yield

Upside scenario

ICE BofA US high yield spread June 2024 target: 370bps / ICE BofA Euro high yield spread June 2024 target: 370bps

Lift-off

The US economy continues to grow at or above trend, while European growth improves. Major central banks stay in restrictive territory as inflation remains above target.

Downside scenario

ICE BofA US high yield spread June 2024 target: 850bps / ICE BofA Euro high yield spread June 2024 target: 850bps

Hard landing

Growth falls sharply on a global scale toward mid-2024, owing to the delayed impact of monetary tightening or additional tightening efforts to tame persistently high core inflation.

Emerging market bonds

Central scenario

June 2024 spread targets: 425bps (EM sovereign bonds) / 300bps (EM corporate bonds)

EM bond performance has recovered over the month on easing concerns about US Treasury supply as well as some weaker-than-expected economic data prints in the US suggesting further Fed policy tightening has become less likely in the near term.

We view EM spreads as fair and expect them to trend largely sideways in coming months. A sustained move tighter in EM credit spreads would require, for instance, a significant acceleration in global growth or the Fed signaling a move towards a less restrictive monetary policy, none of which are part of our baseline assumptions in the next few months.

In China, while the recent decision to increase fiscal spending should support growth prospects for 2024, the country will likely continue to face various headwinds from a weak property market, lackluster consumer sentiment, and US import restrictions. In the absence of large-scale fiscal stimulus, we expect the recovery to be gradual. Geopolitical tensions in the Middle East remain in focus, with further escalation a possible risk. On an asset class level, the region accounts for more than 20% of the emerging market sovereign and corporate bond indices.

Current yields are around 8.9% and 8.0% for sovereign and corporate bonds, respectively. We see emerging market fixed income exposure as desirable in global portfolios. The asset class should deliver healthy total returns in our base-case scenario over the next six to 12 months on the back of lower-trending US benchmark rates and sideways-trending EM spreads.

Upside scenario

EMBIG Diversified / CEMBI Diversified spread June 2024 targets: 340bps / 280bps

Goldilocks: China's economy recovers faster than expected as it opts for large-scale fiscal stimulus measures, coupled with a global economy that exhibits resilience to tighter financial conditions. 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.

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 2024 targets: 600bps / 550bps

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 higher for longer, and the Fed is forced to deliver further 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 asset.

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

Analysts: Michael Bolliger, Alejo Czerwonko, Frederick Mellors, Carolina Corvalan

Asian bonds

Central scenario

JACI composite spread June 2024 target: 260bps

Moves in US bond yields are still the main driver of global fixed income assets. Recently, the 10-year US Treasury yield briefly broke above 5% intraday, against a backdrop of geopolitical conflict, increased Treasury supply, the Federal Reserve's ongoing quantitative tightening program, and a potential US government shutdown. The 10-year US yield rapidly came down toward ~4.6% (as of 6 November), as market expectations shifted to the possibility that rates have already peaked, while US economic growth and the labor market are set to cool. As rate volatility is likely to remain high in the near term, we continue to prefer high-quality fixed income segments, like high grade (HG) and investment grade bonds, given their defensive characteristics.

Within Asia credit markets, we believe IG bonds still present solid risk-reward potential, given the attractive yield level (6.2% as of 6 November) and high credit quality (average rating of A-). In terms of valuations, spreads are tight (163 basis points as of 6 November), but are likely to largely stabilize going forward. Considering the supportive technical backdrop and solid fundamentals, we believe Asia IG is still well positioned.

For Asian high yield bonds, we maintain a relatively cautious and selective approach. Weakness in China's property sector continues to weigh. In the past month, we saw two defaults from China SCE Group and Country Garden, resulting in a rise in the LTM default rate to 20.1% for Asia HY and 40.6% for China HY (data source: BofA; as of 7 November). Aside from property companies, the environment for China HY is still challenging in view of persitently weak macro conditions—though regulators seemed to signal more support in recent days. Elsewhere, overall fundamentals for the Asia ex-China segment are relatively intact, in our view. Going into 2024, we continue to focus on improving fundamental stories, such as Macau's gaming sector, within HY.

Upside scenario

JACI composite spread June 2024 target: 220bps

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 credit.

Sharp rebound in China housing sales: So far, policy has focused on supporting the liquidity of important Chinese property developers, but housing sales recovery seems uneven and mixed. A quick rebound in 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 with quantitative tightening if inflation comes off faster than expected.

Downside scenario

JACI composite spread June 2024 target: 320bps

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

Increased 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 Asia assets.

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

Gold

Central scenario

Gold June 2024 target: USD 1,950/oz

Gold broke the phycological level of USD 2,000/oz on 27 October, as the metal's main drivers (the US dollar and US rates) took a back seat to geopolitical risks (Hamas-Israel war). According to our short-term fair-value model, geopolitical tensions have lifted gold's premium to around 10% versus the predicted value—its highest level since the COVID-19 outbreak. These premiums, on average, tend to peak around 20–30 trading days after the trigger event. But notably, the effects of Russia's invasion of Ukraine and COVID-19 lasted longer.

Still, short-covering by speculators has been the main driver of this rally so far. And although inflows from exchange-traded funds did turn positive for a couple of days, this didn't last. Unless there's a marked escalation in geopolitical events, a structural upturn in ETF buying is unlikely until the Fed pivots, which we expect to happen around mid-2024. Meanwhile, according to the World Gold Council's 3Q23 report, central bank buying increased 14% in the year to end-3Q despite demand in the quarter falling 6% y/y. We think these purchases, potentially more than 1,000 metric tons for the full year, should continue to put a floor under the gold price.

Overall, the yellow metal has again demonstrated its worth as a hedge in a portfolio context. And while we're cautious about chasing it in the short run, we forecast prices to reach USD 2,150/oz by end-2024 and recommend buying dips in the USD 1,800–1,900/oz range.

Upside scenario

Gold June 2024 target: USD 2,150–2,250/oz

The Fed becomes dovish and introduces 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 2024 target: USD 1,650–1,750/oz

The Fed becomes even more hawkish and hikes interest rates aggressively, strongly pushing up US real rates and triggering substantial outflows from gold ETFs.

Crude oil

Preference: Most preferred

Central scenario

Brent crude oil June 2024 target: USD 95/bbl

On Sunday, Saudi Arabia and Russia announced that their voluntary extra supply cuts will be kept in place for December. Saudi Arabia is curbing its production again by an extra 1mbpd, and Russia is reducing its crude exports by 0.3mbpd. Statements from both countries said the cuts will be reviewed next month to decide whether they should be extended, deepened, or reduced—depending on market conditions. We believe these voluntary supply cuts are likely to be extended into 1Q24—given seasonally weaker oil demand at the start of every year, ongoing economic growth concerns, and the aim of producers and OPEC+ to support the oil market's stability and balance.

We believe this monthly review process allows Saudi Arabia to retain control of the oil market, by adjusting its production due to market fundamentals. Russia's participation is also important, as the country is the second largest producer in the OPEC+ group. The deal ensures close coordination between the two producers.

We continue to expect Brent oil to move back into a USD 90–100/bbl range, supported by lower oil inventories. OPEC+'s next ordinary ministerial meeting is scheduled on 26 November in Vienna. We expect the group to continue to closely monitor China's incoming data (as its economic recovery remains a concern despite solid Chinese oil demand so far), and the impact aggressive monetary policy tightening may have on economic activity in Europe and the US.

Upside scenario

Brent crude oil June 2024 target: USD 120–150/bbl

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

Downside scenario

Brent crude oil June 2024 target: USD 40–70/bbl

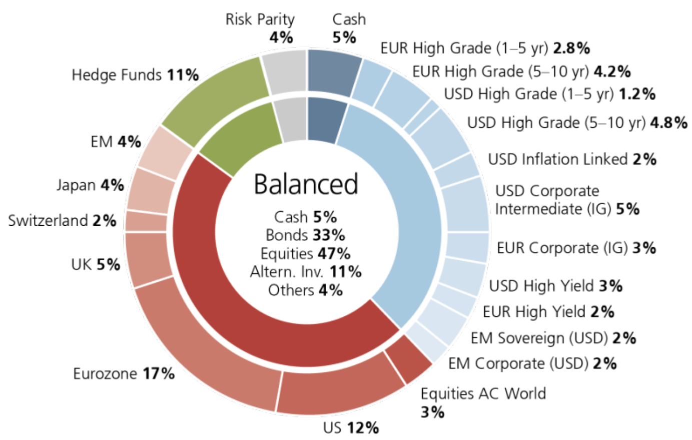
Downside risks include a deep recession or renewed extended mobility restrictions that weigh on oil demand recovery. A hard landing for the Chinese economy in 2023 would also pose a downside risk, as emerging Asia is the engine of oil demand growth. Another concern is that capital discipline in the US could start to erode. Also, the return of disrupted oil production in Venezuela and Iran could weigh on prices.

Section 4

Appendix

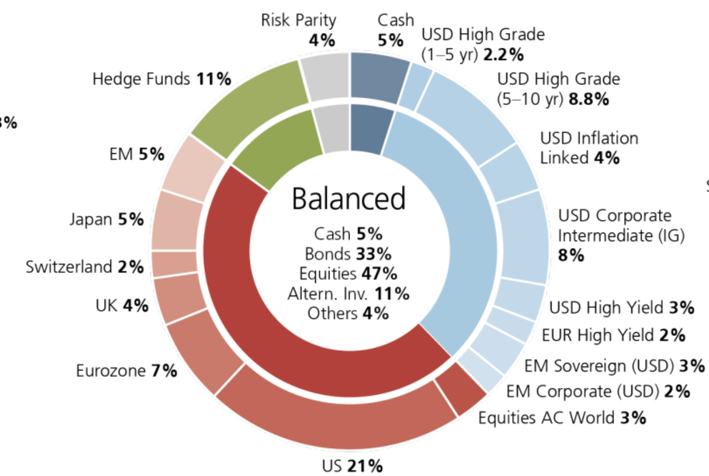
Strategic Asset Allocations (SAAs)

EUR (local portfolio with home bias)



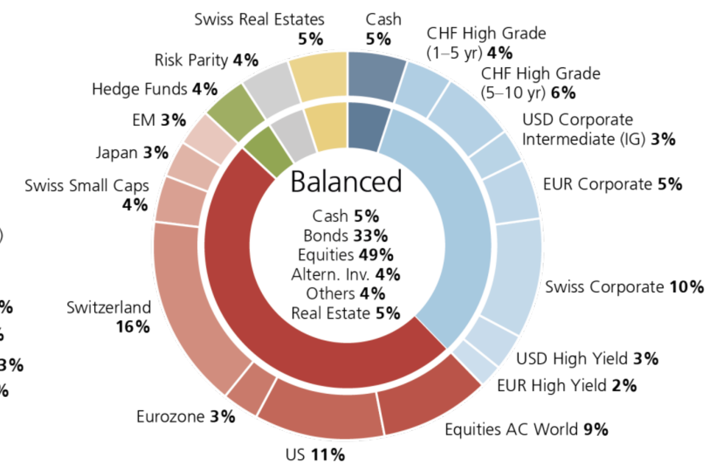
Note: Portfolio weightings are for EUR SAA with a home bias and a balanced risk profile. We expect a balanced EUR SAA to have an average total return of 5.3% p.a. and a volatility of 8.5% p.a. over the next 15 years.

USD



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 6.6% p.a. and a volatility of 8.7% p.a. over the next 15 years.

CHF (local portfolio with home bias)



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 4.9% p.a. and a volatility of 8.5% p.a. over the next 15 years.

Source: UBS, as of January 2023

For illustrative purposes only. The above asset classes and allocations are indicative only and can be changed at any time at UBS's discretion without informing the client. All expected returns are p.a. and reflect the arithmetic mean of the estimated return distribution. Risk is measured as annualized volatility of monthly log-returns. Annualized expected risk and return figures are forward-looking and not a reliable indicator of future performance. Forecasts are not a reliable indicator of future performance / results. Please always read in conjunction with the glossary and the risk information at the end of the document.

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Risk information

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