UBS House View

Monthly Extended January 2024

Chief Investment Office GWM

Investment Research

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

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

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.

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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 is that global equities will deliver mid- to high-single digit returns over the next 12 months.

Recovering earnings and normalizing inflation provide a favorable backdrop. That said, the improved outlook is well priced in and economic risks remain high, warranting a neutral stance.

We continue to like emerging market equities and prefer a balanced approach for tactical strategy positioning.

Across regions, we have UK as least preferred and EM markets and China as most preferred.

By global sector, consumer staples, utilities and energy stay as most preferred, and materials and healthcare as least preferred.

Across styles, we retain our preference for quality income.

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 (government) and investment grade bonds, and are neutral on high yield and emerging market credit.

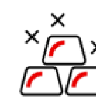
The tightening of lending standards and higher official policy rates continue to weigh on growth and inflation, and apply downward pressure on nominal interest rates. This is a positive driver for the performance of high-quality bonds. For higher-beta credit segments, we are beginning to see rising defaults 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 declined over the last two months, but rebounded after inflation also softened in all G10 countries due to low oil prices. The broad ranges, e.g., EURUSD between 1.05 and 1.10, remain intact. Our most preferred currency with upside potential against the USD is the AUD. We keep a neutral positioning in all major G10 currencies.

The USD slump in November also boosted emerging market currencies, with EUR-linked currencies among the best performers. However, we caution on extrapolating from last month's experience as markets have pushed expectations for Fed rate cuts quite far, in our view.

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



Commodities

We forecast mid- to low-teen total returns for broad commodities in 2024. Slowing economic growth in developed countries in 1H24 should weigh on demand for cyclical commodities. But we expect prices to be supported by Chinese government efforts to boost activity alongside ongoing supply discipline (e.g., OPEC+ in oil) and low inventories.

We expect energy, particularly crude oil, to drive overall performance, with help from base metals as they benefit from secular demand drivers like the energy transition. We therefore keep our preference for oil. 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: Softish 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 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* *US: savings rates / depletion* *UE, Europe: delinquency rates* *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 around mid-2024 as inflation normalizes. The Fed lowers its policy rate from Q3 onwards.	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*

Analysts: Dirk Effenberger, Daniil Bargman

Asset class targets - June 2024

Key targets for June 2024	spot*	Upside	Base case	Downside
MSCI AC World	835	940 (+13%)	845 (+1%)	640 (-23%)
S&P 500	4,549	5,000 (+10%)	4,500 (-1%)	3,500 (-23%)
EuroStoxx 50	4,483	5,100 (+14%)	4,600 (+3%)	3,700 (-17%)
SMI	11,002	12,170 (+11%)	11,300 (+3%)	8,990 (-18%)
MSCI EM	975	1,140 (+17%)	1,050 (+8%)	760 (-22%)
US 10y Treasury yield	4.10	4.75	3.75	2.75
US 10y breakeven yield	2.16	2.50	2.25	1.50
US high yield spread**	379bps	370bps	500bps	850bps
Euro high yield spread**	429bps	370bps	500bps	850bps
US IG spread**	101bps	80bps	130bps	200bps
Euro IG spread**	144bps	110bps	170bps	220bps
EURUSD	1.08	1.15 (+7%)	1.10 (+2%)	1.00 (-7%)
Commodities (CMCI Composite)	1,726	2,100 (+22%)	1,925 (+12%)	1,600 (-7%)
Gold***	USD 2,031/oz	USD 1,750 - 1,850/oz	USD 2,050/oz	USD 2,250 - 2,350/oz

* Spot prices as of market close of 6 Dec 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.

Analysts: Dirk Effenberger, Daniil Bargman

Section 1.3

Asset class preferences and themes

UBS

Global asset class preferences

	Least preferred		Most preferred
Liquidity		=	
Equities		=	
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. Economic 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 investment strategies to cover expected portfolio withdrawals over the next five years.

Fixed term deposits
Bond ladders
Structured investment strategies with capital preservation features

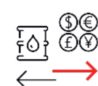
Source of funds
- Cash
- Maturing investments

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

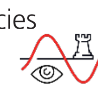


Trade the range in currencies and commodities

The dollar has weakened in recent weeks but we expect the US dollar to stay stable around current level over the coming months. As the year progresses, more USD weakness may emerge as US economic growth eases relative to other economies. This makes selling USD upside for 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. We expect oil prices to 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

Implied equity market volatility has fallen to multi-year lows, making this a particularly attractive time to consider using capital preservation strategies to hedge against potential market risks. We also continue to see macro hedge funds as an effective portfolio diversifier, which have historically delivered consistent performance in times of market turbulence. Meanwhile, investors can also further help insulate portfolios against specific risks through 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 differentiated 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

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

The growth patterns established early on this year continue to play out. Consumption in developed economies is supported by middle income families, but the increasing interest rate burden and erosion of savings is slowing consumer momentum. Purchases of goods are stagnant or slowing, pushing down global trade as a share of the global economy and disproportionately affecting the exports of manufacturing economies. Service sector spending remains resilient. The real world data remains consistent with a softish economic landing.

Inflation

Inflation has started to surprise by consistently coming in lower than expected across a number of advanced economies. This is consistent with the ending of a profit-led inflation episode, as economic models tends to be bad at forecasting a profit-led pricing cycle. Goods price disinflation and deflation remains intact.

Positive case (15%)

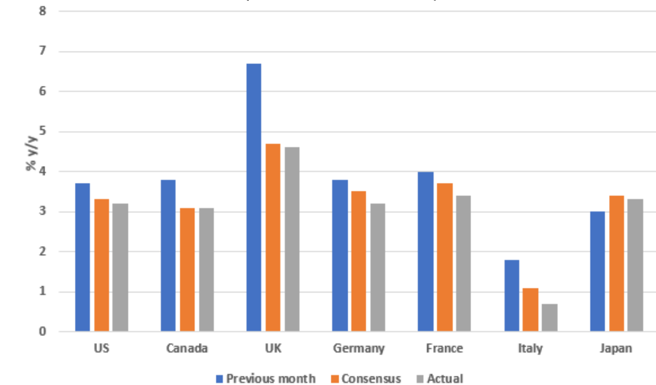
Real wage growth is enhanced by a faster decline in inflation, and consumers respond with more support to the economy. The low inflation rate still allows some moderation of interest rates (as central banks seek to avoid rising real interest rates). Unemployment rates remain low as volume of sales take over from margin expansion in driving corporate profit levels, 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.

G7 inflation slows more than expected

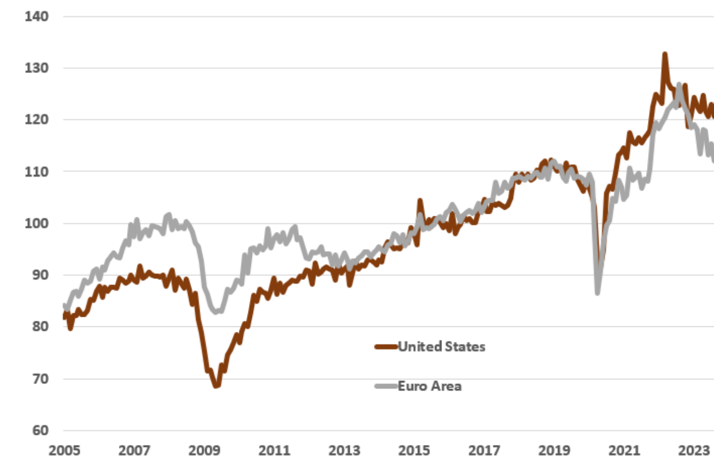
Headline inflation: previous month, consensus forecast, latest data



Source: Bloomberg, UBS as of 4 December, 2023. European data current month = November, other economies current month - October

Global trade in goods is stalling

Volume of goods imports, 2015=100



Source: Haver, UBS, as of 4 December, 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 5.2% 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 six 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%)

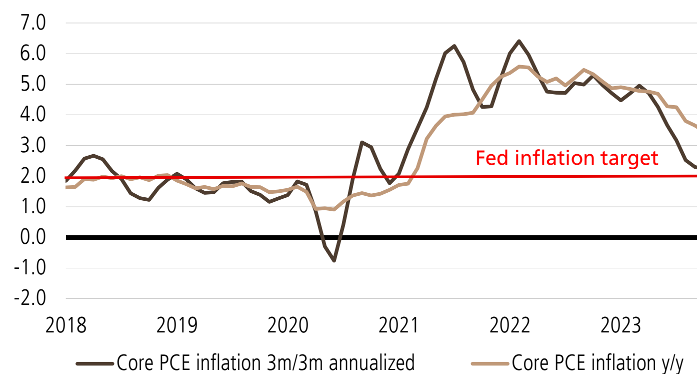
Better labor supply allows businesses to fill their open job positions. Wage growth slows to a more moderate pace and energy prices retreat, helping bring inflation down while growth remains robust. New industrial policies promote business investment. The Fed sees enough progress toward its mandates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

Negative case (25%)

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. A spike in energy prices could lead to stagflation, but otherwise inflation should fall quickly, allowing the Fed to cut rates aggressively and helping to prevent a severe downtown.

Core inflation continues to trend lower

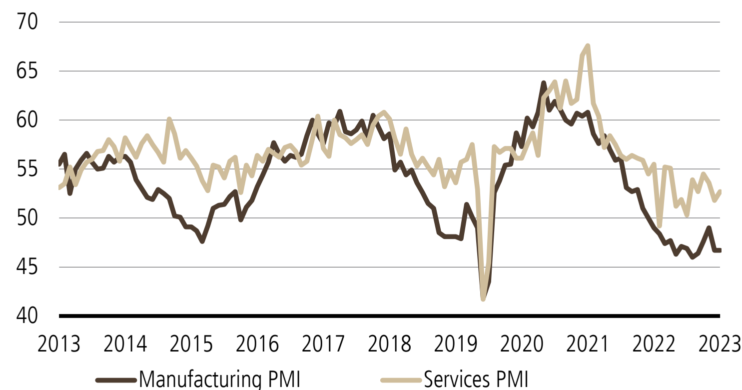
Core PCE, 3m/3m annualized and y/y change, in %



Source: Bloomberg, UBS, as of 5 December 2023

PMIs suggest economic growth is modest

ISM Manufacturing and Services PMIs, 50 = neutral



Source: Bloomberg, UBS, as of 5 December 2023

Eurozone economy – Better than bad is still not good

Base case (60%)

Growth

Sentiment surveys improved in November, while remaining at a low level. Furthermore, the contraction in credit growth showed signs of slowing. Nevertheless, hard data is still weak suggesting the economy remains fragile. We expect the economy to stay on its current sideways trend, with a modest pickup in activity later in 2024 as real incomes improve and monetary policy is eased.

Inflation

Inflation surprised to the downside in November, as the headline rate fell closer to target at 2.4%. But 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 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%)

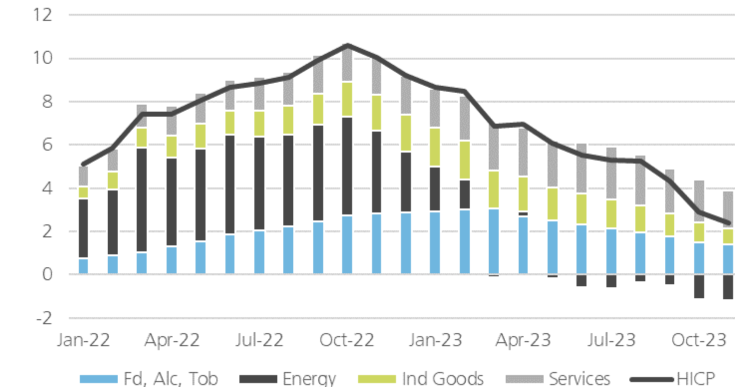
The ECB overtightens monetary policy by placing too much weight on near-term inflation. Tighter financial conditions see demand for credit collapse further, hurting consumption and investment.

Geopolitical tensions force energy prices materially higher. Fiscal policy is too slow to respond or is tightened too much, as the budget row in Germany results in larger spending cuts next year.

Growth is likely to remain anemic

Source: Haver Analytics, UBS, as of 5 December 2023

Headline inflation continues its downward trend



Source: Haver Analytics, UBS, as of 5 December 2023

Swiss economy – SNB to cut earlier than expected

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 fallen to 1.4%, the lowest level since October 2021. In the coming months, we expect a slight rise in inflation but the risk of inflation exceeding 2% has dropped.

Given lower inflation risks we bring forward our forecast for the first policy rate cut by the Swiss National Bank (SNB) to June 2024 from September.

Positive case (15%)

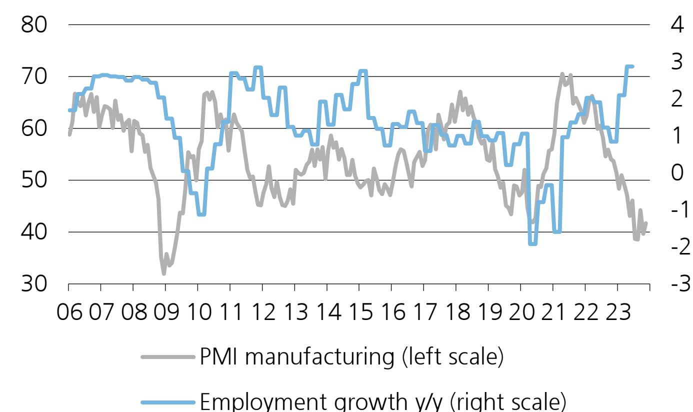
Better global growth momentum:
If the current robust growth in the US filters through to Europe and China GDP growth could surprise on the upside globally. Switzerland benefits from the stronger global backdrop and a weakening of the safe-haven Swiss franc.

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.

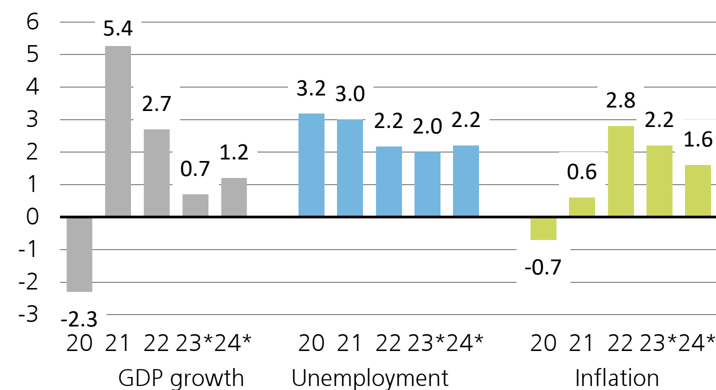
Foreign demand soft but domestic demand resilient

Swiss PMI manufacturing and employment growth



Source: Macrobond, UBS, as of 6 December 2023

Swiss forecasts (in %; *UBS forecasts)



Source: Macrobond, UBS, as of 6 December 2023

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Analysts: Alessandro Bee, Florian Germanier, Maxime Botteron

Chinese economy – More policy needed to lift growth

Base case (70%)

Growth

Recovery continues, yet not on a solid footing. October retail sales rebounded to 7.6% y/y (YTD: 6.9%) on services, autos and low base. Investment slowed further to 2.9% y/y ytd dragged by property despite resilient infrastructure and manufacturing. November PMI went below 50, calling for more policy supports to stabilize economy.

More measures were announced recently to alleviate concerns on property and LGFV debt. We expect further fiscal expansion alongside one RRR cut ahead of Chinese New Year. GDP growth is likely to reach 5.2% y/y in 2023 and around mid-4% in 2024.

Inflation

Inflation stayed muted. October CPI inflation reached -0.2% y/y (YTD: 0.4%) and may pick up mildly to average about 1.2% y/y in 2024. PPI deflation narrowed to -2.6% y/y (YTD: -3.1%) and may turn mildly positive by 2Q24.

Positive case (15%)

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

Geopolitical risks ease on rising willingness of communications between China and US post Xi-Biden talk at APEC summit.

The US economy achieves a soft landing.

Negative case (15%)

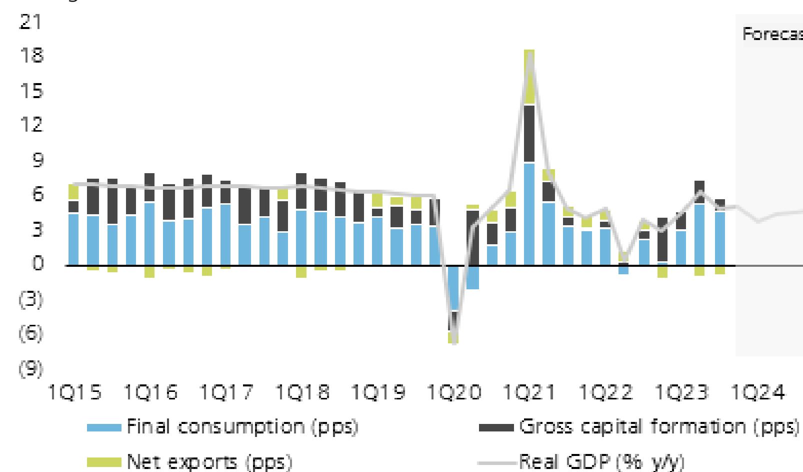
Property activity continues to deteriorate despite supportive policies.

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.

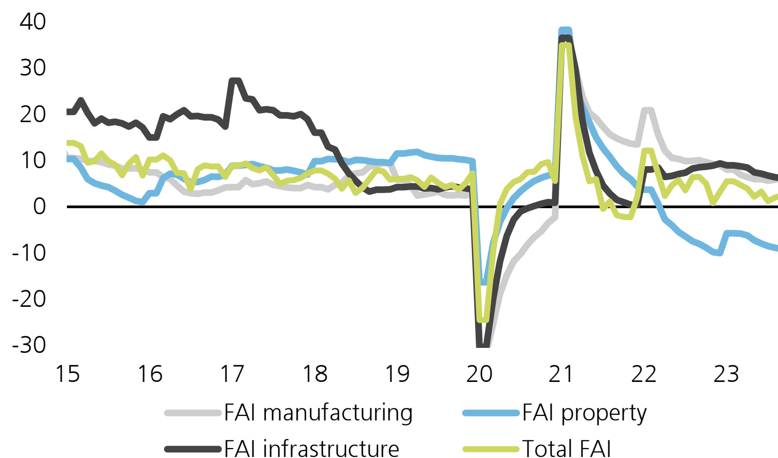
Policymakers may still aim "~5%" growth for 2024

GDP growth contribution breakdown



Source: CEIC, UBS, as of 5 December 2023

Property remained the key drag to investment



Source: CEIC, UBS, as of 5 December 2023

Please see important disclaimers and disclosures at the end of the document

Analysts: Yifan Hu, Kathy Li

Section 3

Asset class views

Section 3.1

Summary of major asset classes

Equities

Central scenario

MSCI AC World June 2024 target: 845

We maintain a neutral view on global equities. After dipping more than 10% between August and October, global equities strongly rebounded in November amid hopes central banks will pivot to a more dovish stance. Lower market rates and resilient earnings are likely to support the asset class going forward, but a lot of optimism seems to already be priced in and macroeconomic risks are more skewed to the downside. Against this backdrop, we maintain a neutral stance in our asset strategy and expect global equities to deliver mid- to high-single-digit returns by end-2024.

Equities remain very sensitive to interest rates. With the global economy slowing and inflation rolling over, we expect lower yields going forward. Unless markets start pricing in a US recession—which is not our base case—we believe lower yields should still act as a tailwind to equity valuations for now. That said, any valuation expansion has limits, and earnings support would eventually be needed for gains to be sustained.

The earnings outlook has improved. The latest economic data support our base case that a soft landing is the most likely outcome. Against this backdrop, 2023 earnings should narrowly avoid a contraction, and we expect a rebound in 2024. This recovery should be led by technology sectors, which are expected to see rising AI-linked revenues. More favorable base effects (i.e., a lower drag from the commodities and healthcare sectors) are also playing a role. That said, we find the current consensus for 2024 earnings-per-share (EPS) growth quite aggressive (~10% for MSCI AC World), which suggests the improved earnings backdrop is well priced in already. Companies' ability to deliver or beat this forecast will depend on their ability to defend margins, on the resilience of the labor market, and on the magnitude of the restocking cycle, which is expected to take place next year.

Valuation in line with 10-year averages. Global equities are currently trading at a 12m forward price-to-equity ratio of 16.2x. This is broadly in line with their 10-year average and supports our neutral stance. That said, the equity risk premium remains low in a historical context, especially against fixed income markets.

Tactical indicators are mixed. With the latest rebound, global equities are trading comfortably above their key moving averages, which suggests a solid price momentum picture. Investor positioning has been grinding higher, but is still far away from extreme levels. That said, shorter-term indicators such as the 30-day relative-strength index (RSI) appear stretched.

Emerging market equities most preferred. In emerging markets (EM), expectations have normalized after overly optimistic hopes about the China reopening earlier this year. Economic surprises have turned positive in the summer already and China is increasingly stimulating its economy. While challenges remain, fundamentals are solid in international comparison. In terms of earnings, emerging markets are expected to see a stronger recovery in 2024 than developed markets. In addition, multiples remain particularly attractive, both in absolute and in relative terms. Against this backdrop, we see value in emerging market equities, which could be unlocked when the USD dollar stabilizes or even potentially retreats.

UK equities least preferred. That said, we expect UK equities to rise less than their regional peers in our tactical horizon. Earnings contracted significantly in 2023, dragged by commodity sectors, and should show one of the weakest recoveries in 2024 among major equity markets.

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, Fabian Deriaz, Adrian Zuercher, Mark Andersen

Equities

We favor energy (most preferred) to materials (least preferred). After a robust 2022, when oil prices surged in the early stages of the Russia-Ukraine war, 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, meanwhile, is seeing very slow momentum in terms of trailing and forward earnings. Soft global manufacturing demand and a weak property market in China remain significant headwinds.

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. In addition, both sectors are trading below their 10-year average price-to-earnings ratio, while utilities should also benefit from the ongoing transitions toward green energy.

Healthcare stays least preferred. Valuations are now back in line with other defensive sectors, but the earnings outlook remains fragile. Earnings forecasts are being significantly downgraded, with the sector showing one of the weakest earnings momentums 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

Preference: Most preferred

In recent weeks, evidence has been mounting that US economic resilience is beginning to weaken and tight labor markets are loosening. This has translated into a sharp pullback in bond yields across the curve as the market has rapidly increased expectations for rate cuts. Central banks have pushed back on market pricing and maintained a somewhat hawkish stance as inflation, although cooling, is still above price stability goals. Nonetheless, rather than actively talk about the need for further rate hikes, they are acknowledging policy is now restrictive and their preferred approach is to wait and see how the data unfolds as the tightening undertaken continues to transmit into the real economy.

Rate volatility remains elevated and has migrated further up the term structure as terminal policy rate expectations stabilized and the long end looks to price neutral policy rate assumptions and supply dynamics. Bond supply is picking up as governments across most major economies refinance existing debt and issue new notes to fund growing deficits. Central banks reducing their stock of government bonds in their efforts to tighten financial conditions imply that private sector end-investors need to absorb the additional supply. As a result, we have observed a pickup in term premium volatility. 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, historical patterns are being disrupted. As a result, our preferred approach is to take exposure in the 1-10yr part of the curve which has a stronger link to growth, inflation and policy, rather than the ultra-long end of the curve, which is more sensitive to these technical elements.

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 have paused hiking rates and are currently assessing the full effects of policy tightening so far. They have succeeded in ensuring inflation expectations remain anchored by taking financial conditions into restrictive territory. To see structurally higher interest rates across the curve from here, we believe economic growth needs to step up. As excess savings have been run down, we see growth more likely to slow than accelerate going forward. 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 in light of the prospective inflation and growth mix.

Investment grade bonds: Like HG bonds, we maintain the asset class at most preferred. This year, total returns have been mid-single digit. Looking ahead, given downside risks to growth and cooling inflation, we see comparable to higher return prospects. Within EUR IG, the average yield is around 4%. On US IG, yields for all maturity and intermediate profiles are around 5.5%. 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 hiking cycles and the focus turns toward rate cuts.

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.

Analysts: Frederick Mellors

Bonds

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 tightens, 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 around 8% and 7%, 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. 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 8.7% and 7.3% 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

As in previous months, inflation releases and changing expectations over central bank easing again influenced the USD in November and confirmed our general guidance that EURUSD is likely to stay in a 1.05 to 1.10 range. The USD reacted strongly to the drop in US inflation and rising market expectations for FOMC rate cuts in 2024. As fundamental investors tend to be quite long USD, any change in the outlook tends to lead to a stronger reaction in the USD than in other currencies.

The EUR, meanwhile, profited from changing rate cut expectations in the US, even though markets now see more rate cuts by the ECB than they did a month ago. Eurozone inflation surprised to the downside in November and economic activity did not rebound. The logic behind the euro rebound, then, is the high positioning in the USD and a reduction of exposure in line with lower interest rates. This also benefited other G10 currencies.

As for the GBP, the dovish turn from the Bank of England is in balance with a softer US outlook. The pound subsequently rebounded over the last two months. Housing market data remains a concern as monetary policy works its way through the economy and labor market, with leading indicators also pointing at a downturn. The latest US labor market report pushed GBPUSD into the 1.21 to 1.27 range, which we expect to hold.

The Swiss franc has been a safe-haven currency, as other currencies have depreciated over the last two years due to high inflation. The Swiss National Bank follows a strategy of low interest rates, which could potentially weaken the CHF, while selling FX reserves, which strengthens the currency and keeps inflation low. Because of this, we see clear limits to CHF weakness and think in most pairings, the implied option volatility is rather generous for vol selling strategies.

For the USDJPY, the near-term risk has become more balanced after the pairing fell from nearly 152 in mid-November to around 147 currently. On one hand, US-Japan yield differentials imply that USDJPY could still fall toward the 145 level. But on the other, we see room for a near-term USD rebound, considering current market expectations for Fed rate cuts look very aggressive to us. Overall, we favor selling USDJPY on rallies toward 150, or selling upside risk above this level for yield pickup.

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

The USD slump in November also boosted emerging market currencies, with EUR-linked currencies among the best performers. However, we caution against extrapolating this trend, as markets pushed their expectations for Fed rate cuts quite far. Risks that the dynamic will reverse, or that markets begin to take weaker US data as a trigger to worry about a hard landing, could again weigh on sentiment for emerging market assets and currencies. Accordingly, we continue to prefer yield-enhancement strategies rather than outright exposure to emerging market currencies to allow for some buffers. One currency that has shown less sensitivity to global dynamics and more sensitivity to local policies is the Turkish lira, which we expect to deliver positive total returns over the coming year after policymakers shifted back to more orthodox policies in recent months. In Asia, we expect Asian currencies to remain largely range-bound versus the USD in the near term, but we remain positive on their medium-term rebound potential, especially as the Fed moves toward rate cuts in 2H24.

FX

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 doesn't 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.

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 the 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

Oil prices are trading at the lowest level since July, driven by solid supply and demand concerns. We believe new OPEC+ production cuts, to be implemented in January, will help ensure the market stays undersupplied and lift prices. Crude production from OPEC+ should fall by around 0.5mbpd in 1Q24 versus current levels. If the compliance rate of the group improves from here, even more barrels could get removed. At the end of 1Q24, those removed barrels will only return in a gradual way, which should help keep the oil market in deficit in 1H24.

Industrial metal prices have lacked a clear direction over 2H. As 2024 approaches, the sector is facing an uncompelling top-down narrative, in our view, which we believe will keep prices largely rangebound for now. Our supply and demand estimates across the metals point toward largely balanced fundamentals. In order of preference, we like copper and aluminum over zinc and lead, while we avoid nickel for now.

In early December, gold set an intra-day record high of USD 2,135/oz, eclipsing the previous record close of USD 2,070/oz (August 2020) and again proving the metal's worth as a long-term portfolio diversifier. We target gold to reach USD 2,250/oz by the end of 2024, recognizing that market positioning is light versus previous times that prices tested these levels. Central bank buying has been supportive—at the current pace, this could hit 1,180 metric tons for 2023 (a new high). So to see even higher prices from this high base, investment demand needs to increase in the form of greater ETF purchases.

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. While the economic slowdown and softer prices may slow the earnings recovery, the likely lower interest rates should allow valuations to expand from currently depressed levels.

Eurozone equities are up 9% from their recent low, but they remain below their July highs and valuations remain reasonable, in our view. 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 and we see modest upside to equities in 2024. MSCI EMU trades at an 11.9x forward price-to-earnings (P/E) multiple, an 11% discount to its long-run average of 13.4x (since 1988).

We forecast gradually improving earnings. The recent 3Q results season showed signs that earnings might be bottoming in real terms, with margins improving for a third consecutive quarter and volumes now potentially bottoming too. However, we anticipate only a gradual recovery in profits given softening prices and expectations of sub-trend economic growth. After almost no earnings growth in 2023, we forecast 3% earnings growth in 2024 (consensus 9%) and 4% in 2025 (consensus 9%).

We advise a balanced positioning in our Eurozone sector preferences, with a preference for areas where we see inflection points emerging or valuations especially attractive. We expect consumer sentiment to improve as real incomes turn positive and rate hikes end, boosting consumer sectors. We like materials given attractive valuations with upside from an end of destocking, an improvement in China's outlook, and/or lower gas prices. German equities should also benefit if these drivers turn more favorable, and Eurozone small- and mid-caps offer material upside at current valuations with the macro data turning more favorable. 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 believe that supportive inflections are starting to emerge in the macroeconomic backdrop.

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: 5,100

Inflation falls quickly, allowing central banks to start easing policy sooner, supporting valuations that have been under pressure from higher discount rates.

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

Companies keep pricing power. If companies can maintain 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 European gas storage is currently close to full capacity.

Downside scenario

DJ Euro Stoxx 50 June 2024 target: 3,700

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

Inflation start to turn back up could mean rates stay higher for longer, weighing on valuations and raising 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

US equity markets have rallied since the end of October. A better-than expected third-quarter earnings season, cooler inflation data, and resilient economic growth have all contributed to the rally. In addition, the November FOMC minutes and recent Fed commentary have pulled forward rate cut expectations, with the market now anticipating the first one to take place as early as March. In our view, we expect the Fed to cut rates starting mid-2024 and our base case is for a "softish" landing for the US economy.

The rally has led to a sharp increase in valuations, with the S&P 500 forward P/E up from 17x at the end of October to nearly 19x today. We believe this reflects the higher probability of a soft landing being priced into the market, suggesting only somewhat modest upside potential over the next year. Excluding the Magnificent 7, valuations appear more reasonable around 17x. An uptick in interest rates driven by a re-acceleration in inflation, or a hard landing, would represent valuation headwinds.

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 elevated 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. Furthermore, 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 results were better than expected. Corporate profits grew by 6% year over year, the first quarter of earnings growth in a year. Strong profit growth from the "Magnificent 7," a resilient labor market supporting consumer spending, and diminishing headwinds from 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 modest upside for US stocks from current levels. Both sentiment and positioning have improved, posing greater downside risks if there are any negative economic or earnings surprises. 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 diminished headwinds from the goods segment 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: Our belief that the under supplied oil market should see prices rising over the coming months should benefit the sector, despite concerns about demand and compliance with OPEC+ production cuts. Additionally, the continued draw in global inventories supports 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 and sluggish activity in China are overhangs. This cyclical sector may struggle in the context of a deceleration in US economic growth.
- Real estate: The sector seems to be pricing in lower interest rates. 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. During 2024, earnings should start to recover as the drag from commodities fades. However, 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 10.4x—around 15–20% 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 7% over the 2021–23 period due to the global economic slowdown and significant currency losses. In 2024, we expect 7% earnings growth, supported by robust organic sales growth; margin improvements particularly in the healthcare, consumer staples, and financials sectors; cost-cutting measures; and more moderate currency losses. Although we are working on the basis of a significant economic slowdown, the greatest risk to our 2024 earnings expectations lies in an even weaker global economy than currently forecast. This would probably cause the Swiss franc to appreciate even more.

Since early June 2022, the Swiss National Bank (SNB) has increased 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. This in turn has weighed on Swiss profits, of which 90% of are generated in foreign currencies. We expect negative currency effects to moderate significantly from 4Q23. Moreover, we currently forecast the SNB to begin cutting its prime rate in June 2024.

Swiss equity valuation multiples are in line with the 25-year average, which we think is fair given normalized 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 robust 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.

Swiss equities

Upside scenario

SMI June 2024 target: 12,170

Robust Swiss profits: If there is only a modest global economic downturn ahead, corporate profits could expand by low teens in 2024.

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. They then increased a bit in 2022 and significantly in 2023. In 2024, we expect currency losses to moderate.

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 flat in 2024, leaving the SMI trading at an unjustified premium to its 25-year forward P/E average.

Sector composition: The SMI has a high exposure to defensive industries and quality companies that tend to underperform when bond yield increase strongly or economic growth expands.

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 US stocks. In our view, the gap does not factor in the 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 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.

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.

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

Japanese equities

Central scenario

TOPIX June 2024 target: 2,485

We are neutral on Japanese equities in our global portfolio. The TOPIX rebounded in November, after two consecutive months of negative returns, due to improving global risk sentiment following the 10-year US yield reaching an apparent peak. Solid September quarter earnings and share buybacks have also supported the share price recovery.

Looking to 2024, we continue to think that the Japanese equity market will offer relative safety, supported by 1) a favorable domestic macro outlook with higher inflation and wage growth than the last few decades; 2) solid earnings growth as 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; 3) fair valuations with P/E at 14.7x, which is above the historical average (13.7x) but still fair versus the MSCI ACWI (16.2x); and 4) corporate governance reforms, which are expected to increase share buybacks.

Over the next 6–10 months, we continue to prefer quality value stocks, such as banks, which are beneficiaries of higher yields and improving shareholder returns, as well as domestic-oriented sectors such as consumer discretionary, due to their price competitiveness, which we believe should benefit from moderate inflation and wage growth. In addition to quality value, we also recommend adding laggard growth stocks which have an above-market earnings growth outlook in FY24, given that the US 10-year yield appears to be peaking out.

Upside scenario

TOPIX June 2024 target: 2,700

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). Consequently, core inflation rose above 3%, and now 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.

Higher ROE: Potential business portfolio restructuring or increased investment to increase ROE (an aim of the Tokyo Stock Exchange) could be a rerating catalyst for Japanese equities in the longer term.

Global economic growth remains resilient: A strong Chinese economic recovery and a resilient US economy would likely lead to stronger topline growth for Japanese corporate earnings.

Downside scenario

TOPIX June 2024 target: 2,000

Recession: Slower-than-expected economic growth 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 Federal Reserve 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

Inflation in Asia has been trending lower and steadily moving back toward central banks' comfort zones, offering headroom for policymakers in Asia to cut interest rates in 2024, after the Federal Reserve. Economic growth for the region as a whole should now be at the turning point after finding a bottom. However, the recovery is proving uneven, with global orders driving export improvements that benefit Korea and Taiwan, while PMIs elsewhere are more mixed (e.g., weak in mainland China and less strong in South Asian markets). We expect a mainly tech-driven recovery to continue into next year, with the whole region gaining more momentum in 2H24. Despite the strong rebound of Asia ex-Japan markets in November amid retreating US yields and a weakening USD, we believe it is still too early for a directional trend to develop. We remain focused on relative opportunities, and keep our most preferred view on China and India, and least preferred view on Singapore.

Within the region, we like India. The Reserve Bank of India (RBI) will likely keep its policy rate on pause, but there is a risk of a final top-up hike if a stronger US dollar leads to disruptive outflows. India has a strong domestic economy, driven by robust urban consumption, rural consumer spending, and manufacturing/logistics/construction supports. Valuations, as measured by MSCI India index's forward P/E ratio, are relatively high compared to history in the longer term, but rather average from a more recent five-year perspective. We continue to expect earnings growth to be the key driver for India's stocks, with a potential rerating tailwind if deposit rates to peak during 2024. Recent state election results have shown odds are increasing for Prime Minister Modi to win the upcoming national elections in spring 2024. A stable political environment should continue to be important for foreign investors to see India as an attractive investment destination, both tactically and structurally.

We also keep China as most preferred. Policy implementation has been the main potential catalyst of China's stock market for much of this year, and will continue to be in the near term. After the announcement of fresh special China government bond (CGB) issuance in October, we have recently also seen reports emerge of RMB 1tr in newly pledged supplementary lending (PSL) to support urban village renovation and affordable housing, as well as faster-than-expected local government financing vehicle (LGFV) restructuring moves. The Central Economic work conference (CEWC) in mid-December is a key event to watch, as the government will set the macro policy tone for 2024. We have seen some initial signs of economic recovery, including improving retail sales and industrial production, as well as a narrowing property sales (y/y growth) decline. However, we need more evidence to gain confidence in the macro rebound. Particularly the November PMI was weaker than expected. In terms of fundamentals, Chinese EPS growth (MSCI China forward 12m EPS) continues to follow broad earnings revisions to the downside, but is still on an upward trend from a year-over-year perspective. The market's valuation (MSCI China P/E) is attractive at 1 standard deviation below the five-year average. Positioning from global investors is still light. With more clarity on policy to emerge this month, we stay most preferred on China for tactical outperformance opportunities.

Meanwhile, Singapore is kept as least preferred. Its financial sector, which makes up 50% of the market, should continue to see pressure from declining net interest margins going into 2024 (2.18% for 3Q23, 2.15% for 4Q23E). Singapore REITs have held up well, in contrast, rising in November amid declining US yields. Significant upside risks from this sector should be limited as REITs account for just around 15% of the MSCI Singapore index.

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 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. Going forward, we believe growth will slow as the lagged transmission of all the policy rate tightening transmits into the economy. Interest rate volatility is likely to remain elevated, particularly in the long end of the curve, as government bond supply ramps up given existing deficits and maturity profiles. Accordingly, our preferred approach is to take rate risk in the 1–10yr part of the curve where the link to growth, inflation, and policy is stronger, as opposed to the ultra-long end of the curve, which has sensitivity to technical dynamics.

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: 4.75%

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 dollar and euro investment grade spreads have tightened from their late October wides. This was driven by easing concerns about US Treasury supply as well as weaker-than-expected data, particularly on inflation, suggesting further central bank policy tightening has become less likely.

With yields remaining elevated and major central banks in developed markets likely having ended their hiking cycles, we think total return prospects in higher-quality fixed income remain appealing over the coming quarters. US investment grade (IG) yields are at 5.5% and EUR IG yields are at 3.9%. While these levels are off their recent peaks, they remain historically elevated. The elevated outright yields and the fact that spreads are a much smaller proportion of all-in yields 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 of this year, 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 for lower government bond yields as economic growth slows, inflation continues to moderate and markets look to price the upcoming rate-cutting cycle 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. While yields have moved sharply lower over the past month, we think the total returns outlook for US IG remains supported by expected lower government bond yields in our base case over the coming quarters and our outlook of relatively resilient spreads.

US IG fundamentals remain generally solid. While ratings migrations have become less supportive over time, they remain slightly positive. Median net leverage (excluding financials and utilities) remained broadly stable at 2.0x in 3Q, and compares to 2.2x in 4Q19, just prior to the pandemic. The median interest coverage ratio has declined on rising interest expenses, however, as of 3Q it is still at a solid level of 10.6x, compared to 10.4x in 4Q19. While we do expect nominal growth to slow, earnings should be resilient in our base case and help limit material near-term credit quality deterioration, in our view. We also note that debt growth has remained very muted as issuers continue to exhibit a conservative balance sheet management approach. 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.

Investment grade

Preference: Most preferred

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 high yield (HY), we are advocating a selective, up-in-quality bias. HY spreads have retraced their late October widening on easing concerns regarding US Treasury supply and downside surprises to key US macro data, in particular inflation, suggesting further central bank policy tightening has become less likely.

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. While less tight than in the prior quarter, lending standards remain historically tight, pointing to some downside risks to growth and upside risks to defaults over the coming 12 months. Additionally, while further rate hikes look unlikely at this stage, scope for significant rate cuts also look unlikely in the near term, in the absence of a recession, given current inflation and what still appears to be relatively 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 3.4% 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 shrunk from USD 1.5tr in 2021 to USD 1.3tr. This is due to net 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. While inflation has continued to move lower, we think significant rate cuts by central banks remains unlikely in the short term (in the absence of a recession or 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 8.5% 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.

Please see important disclaimers and disclosures at the end of the document
Analysts: Carolina Corvalan, Antoine Geiller, Frederick Mellors

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) / 350bps (EM corporate bonds)

Emerging market (EM) bond performance has been strong over the past month on easing concerns about US Treasury supply as well as some weaker-than-expected economic data prints in the US suggesting further Federal Reserve policy tightening has become less likely in the near term. This has fueled both a fall in government bond yields, as well as tighter spreads.

We view EM spreads as fair and expect them to trend largely sideways in the coming months. A sustained move tighter in EM credit spreads would likely require, for instance, prospects of a significant acceleration in global growth or the Fed signaling a move toward a less restrictive monetary policy, which is not part of our base case over the next few months. We expect global growth to slow, while we think the Fed may only be gradually cutting interest rates toward the second half of 2024.

In China, sequential growth momentum appears to be softening, with the recent PMI prints disappointing expectations. The recent decision to increase fiscal spending should support growth prospects for 2024. In the absence of large-scale fiscal stimulus, however, 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 8.5% and 7.5% 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 assets.

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

Asian bonds

Central scenario

JACI composite spread June 2024 target: 260bps

With evidence mounting that the US economy is slowing into year-end and inflation is continuing to cool globally, expectations have risen that major central banks are finished with rate hikes and will begin to cut rates next year. After briefly breaking above 5% intraday in mid-October, 10-year US Treasury yields have steadily declined to below 4.3% (as of 5 December). We expect bond yields to fall further in 2024, but the decline is unlikely to be smooth, meaning rates volatility could remain high. Under this backdrop, we continue to prefer high-quality segments, like high grade (HG) and investment grade (IG) bonds, as outright yields remain appealing and the risk-return in a sharper economic slowdown scenario is favorable.

Among Asian credit markets, we believe Asian IG bonds still present solid risk-reward potential, given the attractive yield level (5.9% as of 1 December) and high credit quality (average rating of A-). Heading into 2024, we think such levels offer both a compelling entry point and a sizable income cushion against risks like further rate hikes. Valuations are still tight (153 bps as of 1 December), but we expect spreads to be resilient given supportive technicals within Asia IG. Moody's revised its outlook for China's A1 sovereign credit rating down to negative on 5 December, suggesting the need to support local government financing vehicles (LGFVs) poses "broad downside risks to China's fiscal, economic and institutional strength." But we believe central support for LGFVs should on balance reduce financial strains, not increase them, and recent action from China's central government has effectively removed some implicit tail risk. The credit rating warning also does not necessarily lead to any fundamental changes. Broadly speaking, we still keep our quality tilt within Asian credit.

On the other side, we retain a relatively cautious and selective approach towards Asian high yield (HY) bonds. For the Chinese property sector, sentiment has turned more constructive following news reports of a financing white list for 50 developers and unsecured loans from banks in late-November. But in general, we don't expect China's property sector to turn around anytime soon as fundamentals are still under pressure from falling property sales and prices. Elsewhere, there are some relative bright spots from non-China Asian HY segments. For example, we still like Macau gaming bonds for good yield opportunities. The better-than-expected recovery in Macau's gross gaming revenue (GGR) has led to some positive rating actions recently, and the momentum is likely to continue, in our view.

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 be upside for Asian credits.

Sharp property rebound: So far, policy has been focused on demand-side measures, but a housing sales recovery still seems uneven and mixed. A rebound in housing sales or more details on supporting developer liquidity needs would offer fundamental support to the credit metrics in this sector.

More dovish-than-expected central bank action: Spreads would likely compress if the Fed becomes less aggressive with quantitative tightening or begins easing sooner than expected 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 upcoming US elections in 2024 could hurt risk appetite for EM Asian 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.

Analysts: Adrian Zuercher, Chun Lai Wu, Clarissa Teng, Vanny Wang

Gold

Central scenario

Gold June 2024 target: USD 2,050/oz

Gold set an intra-day record high of USD 2,135/oz, eclipsing the previous record close of USD 2,070/oz (August 2020) and again proving the metal's worth as a long-term portfolio diversifier. Fed speak and the October PCE print, the Federal Reserve's preferred inflation gauge, are recent catalysts. Balanced comments by Fed Governor Christopher Waller—who has historically held a more hawkish bias—sparked a bond rally and a dovish market reassessment of the rates path. Fed Chair Jerome Powell then all but confirmed they were done hiking on Friday. Subsequently, markets began to price in about 150bps of cuts for 2024 (starting perhaps as early as March).

We believe market pricing is now too aggressive versus recent US economic data. We acknowledge the economy is slowing from the above-trend 3Q23 pace, but current conditions appear more consistent with 50–75bps of cuts (beginning in 2H24). As such, we are cautious on chasing gold at current levels in the short term. According to our short-term model, gold's "fair value" is around USD 1,950/oz. We lift our forecasts by USD 100/oz across all tenors, recognizing that market positioning is light versus previous times that prices tested these levels. Central bank buying has been supportive—at the current pace, this could potentially hit 1,180 metric tons for 2023 (a new high). So to see even higher prices from this high base, investment demand needs to increase in the form of greater ETF purchases.

Upside scenario

Gold June 2024 target: USD 2,250–2,350/oz

The Fed becomes even more 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 1,750–1,850/oz

The Fed becomes even more hawkish and hikes interest rates even more, 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

Oil prices have risen over the last few days, supported by reports of potential new production cuts by OPEC+. The reaction of prices on the day of the OPEC+ meeting (November 30) has been like sitting on a rollercoaster, with prices first up followed by a drop, and then a modest recovery.

While we believe OPEC+ wants to stay in control of the oil market by taking a proactive approach to prevent oil inventories from rising in 1Q24 when oil demand normally seasonally weakens, the way those production cuts has been announced has created confusion. In contrast to the past, when the OPEC+ press release contained all relevant information, it was up to individual member states issuing statements on the size of their voluntary cuts for 1Q24. As those are voluntary cuts, market participants seem to be concerned that a large fraction of those new pledged cuts won't get implemented. Also, part of the current OPEC+ production cuts are voluntary, so we should still lower OPEC+ crude production in 1Q.

The 758kbpd in new cuts also include an additional pledge by Russia to reduce its refined product exports by 200kbpd. So, crude production of the group should fall by around 0.5mbpd in 1Q24 versus current levels. If the compliance rate of the group improves from here, even more barrels could get removed. At the end of 1Q24, those removed barrels will only return in a gradual way, based on the statement, which should help keep the oil market in deficit in 1H24.

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

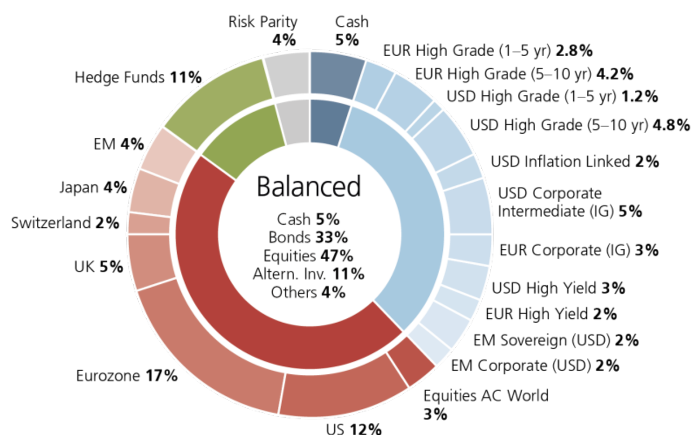
Downside risks include a deep recession or renewed extended mobility restrictions that weigh on oil demand recovery. A hard landing for the Chinese economy in 2024 would also pose a downside risk, as emerging Asia is the engine of oil demand growth. Another concern is that capital discipline in the US could start to erode. Also, the return of disrupted oil production in Venezuela and Iran could weigh on prices.

Section 4

Appendix

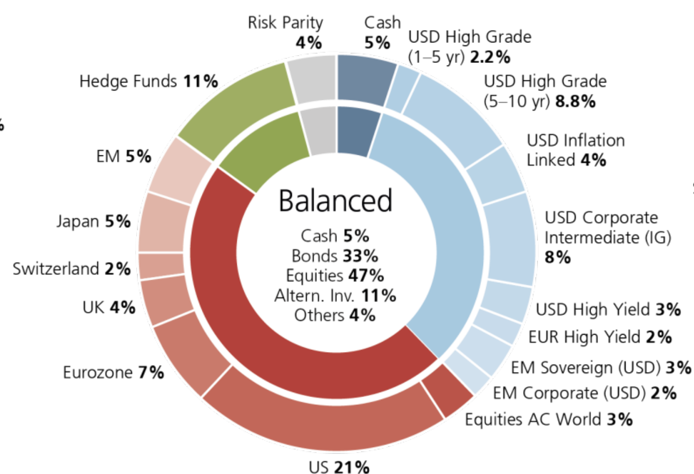
Strategic Asset Allocations (SAAs)

EUR (local portfolio)



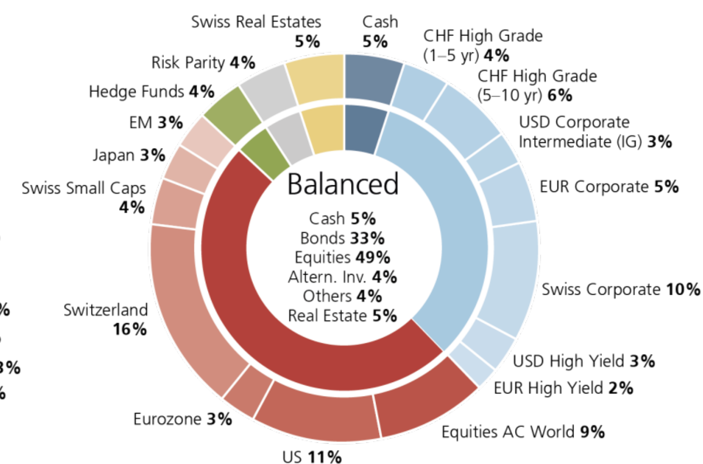
Note: Portfolio weightings are for EUR SAA with a home bias and a balanced risk profile. We expect a balanced EUR SAA to have an average total return of 5.7% p.a. and a volatility of 8.7% p.a. over the next 15 years.

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 6.4% p.a. and a volatility of 8.9% p.a. over the next 15 years.

CHF (local portfolio)



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 8.6% p.a. over the next 15 years.

Source: SAA as of January 2023, new calculation on returns and volatility as of November 2023

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