

# UBS House View

Monthly Letter | 7 December 2023 | Chief Investment Office GWM, Investment Research

## Plan for 2024

Now is a good time for investors to get in balance, manage liquidity, and build a strategy for achieving their financial goals.

## Buy quality

We expect positive overall returns for equities and bonds in the year ahead. But within both asset classes, we are focused on quality.

## Pick leaders from disruption

Disruptive trends in tech and other industries should create compelling long-term investment opportunities.


## Asset allocation

Fixed income remains our preferred asset class. Within equities, our preferences include the US tech sector.



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## New Year's portfolio resolutions

A remarkable year is drawing to a close. A record-breaking pace of interest rate hikes helped push bond yields to 16-year highs. The US economy confounded expectations for a recession and grew at a 5% annualized pace in the third quarter. Transformative innovations in generative AI powered a stock market rally. Wars impacting two energy-producing regions also captured market attention.

The dawn of a new year is a time to reflect and to make plans for the year ahead. In this letter, we present 10 New Year's resolutions aimed at helping your portfolio navigate what we are calling "a new world":

1. Spend more time with family and friends – best wishes for the year ahead
2. Take up yoga – get in balance, and stay disciplined yet agile
3. Go for quality over quantity – buy quality in both bonds and stocks
4. Embrace change – pick leaders from disruption
5. Prepare for a rainy day – hedge market risks
6. Don't put all your eggs in one basket – diversify with alternative credit
7. Try to see things from both sides – trade the range in currencies and commodities
8. Think about the long term – capture growth with private markets
9. Build a plan – a strategy for achieving your goals is key
10. Seize the moment – manage liquidity

We enter the new year with a preference for quality bonds, which we think still offer attractive yields and the potential for capital appreciation as growth decelerates. Lower bond yields in 2024 should also provide a supportive backdrop for equities.

In equities, we see particular opportunity in quality stocks across all sectors, including the US technology sector, which should be well placed to grow earnings despite a weaker economic environment.

Longer term, we expect disruptive trends in technology and other industries to create compelling investment opportunities in both public and private markets.

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The economic consequences of the pandemic are still being felt today.

Investors should build balance, strength, and flexibility in their portfolios.

## New Year's resolutions

### 1. Spend more time with family and friends – best wishes for the year ahead

The economic consequences of the COVID-19 pandemic have been far-reaching. Never before in human history have governments forcibly and almost simultaneously shut down their economies and then shocked them back to life. The results are still being felt today: the return of inflation, labor market stress, and a surge in interest rates, bond yields, and government debt.

We believe the result is a new world, one in which many are rediscovering the importance of spending time with family and friends. We can see evidence of this in consumers' willingness to prioritize holiday spending and in the recovery in air travel over major holidays. On the Sunday after Thanksgiving, the Transportation Security Administration screened more than 2.9 million passengers at US airports, setting a new record for the most in a single day.

In the year ahead, how the US consumer fares will be important, because continued spending—on things like seeing loved ones—is part of achieving a “soft-ish” landing for the economy.

### 2. Take up yoga – get in balance, and stay disciplined yet agile

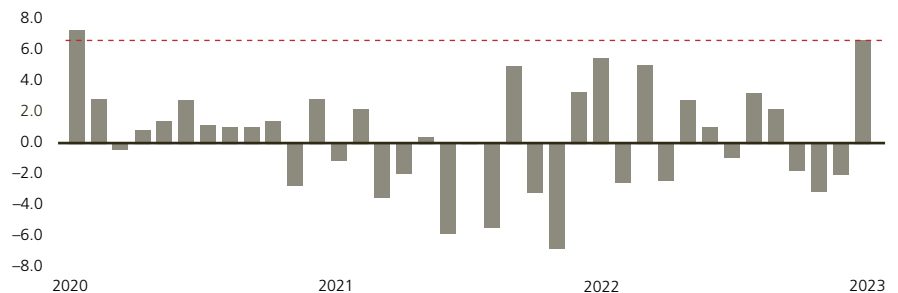
Yoga is a mind and body practice that can improve balance, strength, and flexibility—attributes that are also important for investors seeking to build resilient portfolios for the long term. The concept of a balanced portfolio is rooted in the principle of diversification—spreading investments across a variety of assets to earn returns and manage risks. In November, a 60/40 portfolio (comprising 60% stocks and 40% bonds, based on the MSCI All Country World Index in local currency and the Bloomberg Global Aggregate bond index) delivered the best monthly performance in three years, returning 6.9%. Stocks and bonds rallied in tandem as slowing inflation raised hopes of central bank rate cuts in 2024.

There is never a bad time to invest in a balanced portfolio. But given our positive outlook for equities, bonds, and alternatives over the next year, as well as the potential for equities and bonds to diversify each other in our key risk scenarios, we believe now is a good time for investors to get in balance.

Figure 1

### The 60/40 portfolio had its best month in three years in November

60/40 portfolio, monthly total return, in %. Indices used: MSCI ACWI in local currency, Bloomberg Global Aggregate bond index



Source: Bloomberg, UBS, as of December 2023

We recommend focusing on quality in bonds and stocks in 2024.

Finding the right balance is just the start, however. Discipline is also key to successful investing for the long term: With the right “core” strategy, the adage “time in the market, not timing the market” has held true over time. But markets evolve and investors’ needs change. Investors should therefore regularly review their plans for strategic allocations, tactical allocations, and “satellite” investment ideas.

### **3. Go for quality over quantity – buy quality in both bonds and stocks**

Once the excesses of the holiday season are over, many of us view the new year as a time to focus less on quantity and more on quality.

That theme of quality runs through our investment views in both fixed income and equities.

#### *Buy quality bonds*

November was the best month for US bonds in nearly 40 years: Total returns for the Bloomberg US Aggregate index were 4.5% in November, the best month since May 1985.

After such a strong run, we do note that in the short term, the market may be overestimating the likely pace of Federal Reserve rate cuts. The latest market pricing suggests almost five 25-basis-point reductions by December 2024, with a more-than-50% chance that the first cut comes as early as March. Our base case is that the Fed will deliver three cuts next year, with the timing data dependent, but most likely starting around the middle of the year.

But over the balance of 2024, we think quality bonds have further to rally. Recent data show that the tightness in the US labor market is beginning to ease and inflation is continuing to recede. Although inflation will likely remain above the Fed’s 2% target through most, or all, of the year ahead, we believe policymakers will be sufficiently confident about inflation to begin cutting rates by midyear. Our year-end 2024 forecast for the 10-year US Treasury yield is 3.5%, compared with 4.1% as of 6 December, implying a total return of 9%.

We continue to recommend high-quality bonds—including high grade (government) and investment grade—of a 1–10-year duration, particularly the five-year segment. In addition, in a downside scenario of a sharper economic slowdown or potential financial instability, the capital upside would likely be substantial.

#### *Buy quality stocks*

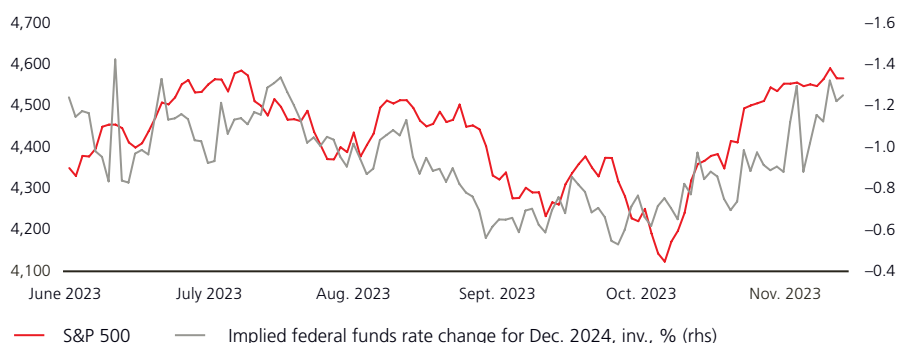
November was also a good month for equities, with a 9% return for the S&P 500, the best monthly return of the year. In our base case, we see the S&P 500 rising to 4,700 by December next year, implying a total return of 5% at the index level.

We recommend investors focus on quality in equities. In a year of slowing economic growth and potential refinancing challenges, we believe companies with strong returns on invested capital, resilient operating margins, and low debt on their balance sheets will be best positioned. Quality stocks have historically outperformed during periods of economic slowdown or contraction.

Figure 2

### Stocks have rallied as markets have priced in more aggressive cuts

S&P 500 (lhs) and implied federal funds rate change for Dec. 2024 based on futures, inv., % (rhs)



Source: Bloomberg, UBS, as of December 2023

The quality tilt also speaks in favor of a focus on US technology companies. Technology offers the highest ROIC of the 11 US equity sectors: 20% over the last 12 months (compared with just 3–4% for utilities or real estate). Tech sector balance sheets are also the strongest, with a net-debt-to-EBITDA ratio of just 0.5x. With business models that combine subscription-based revenue streams with a presence in high-growth segments including artificial intelligence, we think tech companies look poised to deliver healthy earnings growth next year.

The sector is also not as expensive as many perceive: The forward price-to-earnings ratio of the S&P 500 technology sector has fallen from 28x in July to 26x today. While this is still close to a 30% premium versus its 10-year historical average, we believe this is reasonable considering the sector now has a more recurring revenue profile.

#### 4. Embrace change – pick leaders from disruption

Disruptive technologies like AI create compelling long-term growth opportunities.

A new year is often seen as a time to embrace change, and with disruptive technologies having a significant impact across sectors, we think this theme of change is also key for investors looking for portfolio growth.

We expect some of the highest returns in equity markets over the next decade will come from companies that can harness new technologies to expand their markets, dislodge incumbents, or cut costs. For investors, identifying these “leaders from disruption” may be key to boosting long-term portfolio potential.

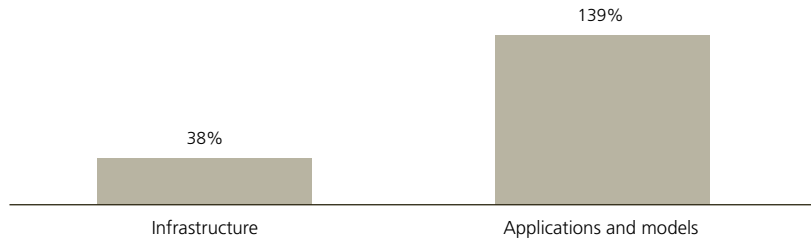
For example, we expect global AI demand to increase from USD 28 billion in 2022 to USD 300 billion in 2027, based on Bloomberg Intelligence data—a compound annual growth rate of 61%. In that time, we think the infrastructure segment will grow by 38% and the applications and models segment by 139%. We see upside risk to our estimates given improving visibility on infrastructure spending and broadening AI demand for applications.

Stocks have already rallied hard in anticipation of higher AI demand, yet we think companies across the AI value chain—from cloud to semis, software, and internet—have further to run, both in 2024 and over the longer term. For example, recent guidance from leading memory companies suggests chip prices should rebound by mid-to-high

Figure 3

### AI demand is growing fast

Expected AI demand growth (CAGR) from 2022 to 2027, by segment



Source: Bloomberg Intelligence, UBS, as of December 2023

teen percentages in 4Q23, and we expect the broad global semiconductor industry to deliver around 50% profit growth next year. Alongside semis, we continue to like software, given its bias to quality and broadening AI demand.

Beyond tech, we see opportunities in companies driving disruptive innovation in energy (e.g., the green transition) and healthcare.

#### 5. Prepare for a rainy day – hedge market risks

As the old saying goes, the time to repair the roof is when the sun is shining. New Year reflections are often a good time to think about where your portfolio could do with more insulation.

The market rally in recent weeks has coincided with the price of protecting portfolios against future equity market sell-offs becoming more affordable. In November, the cost of hedging against a market decline of around 10% retreated to its lowest level since at least 2013, and the VIX index of implied US stock volatility, a measure of option pricing, fell to its lowest closing level since February 2020. Low implied volatility generally improves the terms of structured investments with capital preservation features.

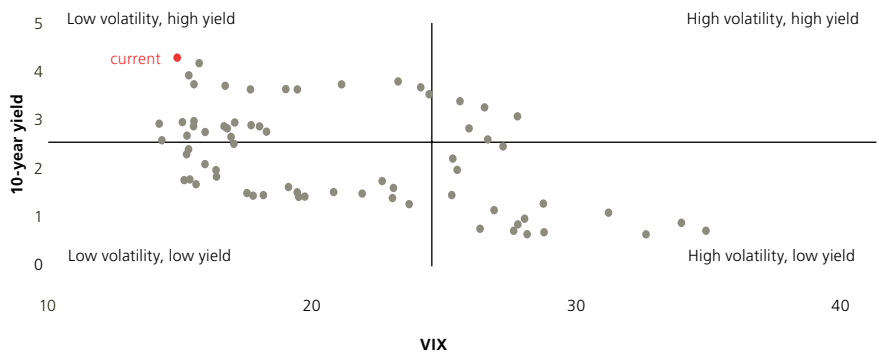
Capital preservation strategies can also help investors gain exposure to Japanese equities, where, following the strong year-to-date rally, options can provide “cheap” exposure to further potential gains thanks to favorable earnings, regulatory, and seasonal trends.

Now is a good time to consider ways to insulate portfolios.

Figure 4

### Capital preservation strategies benefit from high yields and low equity volatility

Six-month trailing average VIX vs. 10-year bond yield, and current level



Source: Bloomberg, UBS, as of December 2023

Investors can also consider other ways to protect their portfolios against specific risks. For example, Brent crude prices recently fell below USD 75/bbl. We think the decline is overdone and expect tight market supply and demand fundamentals to support a recovery toward a USD 90/bbl to USD 100/bbl range in 2024. But long oil positions also have the potential to act as a hedge against escalations in the Russia-Ukraine or Israel-Hamas wars, which would likely drive crude prices even higher. Risk-tolerant investors can consider adding exposure to oil via longer-dated Brent crude contracts, or selling the risk of prices falling.

Gold also has value as a portfolio hedge, in our view, and we expect it to rise toward USD 2,250/oz by the end of 2024. However, with gold prices reaching a record high of USD 2,135/oz in early December, we advise investors not to chase the rally and add exposure. Instead, we recommend using options or buying dips below USD 2,000/oz.

#### **6. Don't put all your eggs in one basket – diversify with alternative credit**

The strength of the US economy in 2023 has defied expectations, with GDP growth in the third quarter running at just over 5% annualized. This has helped support riskier areas of the US credit market, keeping a lid on spreads and default rates. Since we published our *Year Ahead* outlook on 16 November, US high yield spreads have tightened by 23 basis points (and by 63 basis points in total since the end of October, based on the ICE BofA US HY index).

We expect a less benign environment in the year ahead as growth slows and lending conditions remain tight. Still-high interest rates could put pressure on the ability of weaker companies to refinance. CCC-rated bond issuance is down 57% year-over-year in the US, according to Pitchbook LCD data. US high yield interest coverage ratios have fallen back below 5x for the first time in a year. High yield spreads are consistent with a default rate of 2–3%, rather than the 4% we expect in 2024.

A more challenging macro environment may create opportunities for credit arbitrage and distressed debt managers.

While this speaks in favor of our quality focus within bonds, a more challenging macro environment should also create opportunities for credit arbitrage and distressed debt managers. Dispersion is already slightly above average. This may present opportunities for discerning credit arbitrage managers to make single-name credit choices based on fundamental analysis.

Meanwhile, distressed debt managers may be able to identify opportunities amid the almost USD 1 trillion of market value in global high yield debt and convertible bonds that will approach maturity in 2025 and 2026. Some firms that issued these securities in the former low-interest-rate world may struggle to refinance, or even fall into financial distress.

#### **7. Try to see things from both sides – trade the range in currencies and commodities**

In a polarized world, many people will be looking to try and “see things from both sides” more often in the new year. In investing, we think that approach will be most important in the currency markets.

On the one hand, we see the US dollar as overvalued; yet on the other hand, a rate premium and resilient US growth speak in its favor. Since we published our *Year Ahead* report, the Dollar Index—which measures the value of the greenback against six other major currencies—has fallen by 0.2% (and by 2.4% since the start of November) as investors have focused on the potential for Fed rate cuts next year. Our view is that the market is expecting too many rate cuts in the short term from the Fed. We maintain our view that the US dollar is likely to stay stable in the first months of the year due to robust

US economic growth and high US interest rates relative to the rest of the world. But as the year progresses, USD weakness may emerge, which makes selling USD upside for a yield pickup an attractive strategy, in our view.

The Australian dollar is our preferred currency.

The Australian dollar is our preferred currency, as the Reserve Bank of Australia should be one of the last major central banks to cut interest rates. Favorable fiscal and external account positions add to the currency's attractions.

### **8. Think about the long term – capture growth with private markets**

It can be easy to get wrapped up in the day-to-day. But the New Year is a point when many of us get some time and space to think about the bigger picture.

Our *Year Ahead* publication looks ahead to some of the significant investments in healthcare, digitalization, and energy needed from the private sector over the coming decade. Private market managers will likely have a key role to play, with their ability to provide equity or debt capital to companies at different lifecycle stages. The asset class offers attractive return potential and direct access to the real economy, in exchange for lower liquidity.

Gaining exposure to fast-growing and innovative businesses through listed equities is becoming harder due to the shrinking supply of new listed firms. More companies are choosing to stay private, delay listings, or avoid them altogether, a trend we do not expect to reverse in the decade ahead. Similar dynamics apply in the debt markets, where traditional lenders' market share is declining in favor of private debt, particularly in funding small and midsize businesses. Investors should be aware of the drawbacks involved when investing in private markets, including illiquidity risks.

### **9. Build a plan – a strategy for achieving your goals is key**

A clear plan linking strategies with goals and values can help investors stay focused on the bigger picture.

Navigating a noisier world, in which data are more abundant but not necessarily more informative, can be daunting. But building a clear plan that links strategies with goals and values can help investors cut through the noise and stay focused on the bigger picture. It can also help investors clarify why they are investing, and therefore boost the chances of achieving their financial goals.

The Liquidity. Longevity. Legacy.\* approach is designed to help investors explore and pursue their wealth goals over different time frames. It involves segmenting wealth into three strategies. First, the Liquidity strategy helps ensure investors have enough liquid assets to meet their short-term spending needs and is typically invested in cash or cash-like securities. It can offer investors peace of mind during periods of market volatility, and a disciplined process of drawing on, and later refilling, the strategy during bear markets can help generate outperformance over time.

Second, the Longevity strategy focuses on assets that can provide income over the course of an investor's lifetime. Amid heightened uncertainty in our new world, we believe this strategy is best invested in a well-diversified global portfolio, balancing return requirements with risk management, and complemented with tactical ideas. Third, the Legacy strategy considers needs that go beyond an investor's own lifetime, such as maximizing the value of assets for inheritance or philanthropy.

\* Timeframes may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

The opportunity to invest cash at high rates may be fleeting.

#### **10. Seize the moment – manage liquidity**

We often regret missed opportunities, and the New Year is a good time to resolve to not put things off. Time is running out to invest cash at higher rates. Markets are already starting to focus on the potential for central bank rate cuts in 2024. The 48-basis-point decline in the 2-year US Treasury yield since the start of November underlines how fast rate expectations can change.

We think investors should “seize the moment”—before central banks start lowering rates—to manage their liquidity, ensure they are not holding too much cash, and seek to lock in yields for the year and years ahead. If bonds and equities rally further, investors could be left on the sidelines holding lower-yielding cash.

Building a liquidity strategy to cover two to five years of expected portfolio withdrawals, across a range of instruments, can help investors meet liabilities and maximize growth opportunities for the rest of their wealth. Fixed-term deposits enable investors to lock in high yields on cash and cover potential expenses and liabilities up to 12 months out. Investors can also make use of bond ladders to lock in still-attractive yields over the next 12–36 months. For cash intended for use in 3–5 years’ time, investors concerned about limiting losses but also participating in equity gains can consider structured strategies with capital preservation features.

Whatever your aspirations for the coming year, I hope these resolutions can help you build a robust portfolio for 2024 and beyond. We wish you a happy holiday season and a prosperous year ahead.



Mark Haefele  
Chief Investment Officer  
Global Wealth Management



## Global forecasts

## Economy

## Real GDP y/y, in %

	2022	2023E	2024E
<b>US</b>	1.9	2.4	1.2
<b>Canada</b>	3.4	1.1	0.2
<b>Japan</b>	1.0	1.8	0.7
<b>Eurozone</b>	3.4	0.5	0.6
<b>UK</b>	4.3	0.6	0.6
<b>Switzerland</b>	2.7	0.7	1.2
<b>Australia</b>	3.7	1.9	1.6
<b>China</b>	3.0	5.2	4.4
<b>India</b>	7.2	6.7	6.2
<b>EM</b>	4.1	4.4	3.9
<b>World</b>	3.4	3.2	2.6

## Inflation (average CPI), y/y, in %

	2022	2023E	2024E
<b>US</b>	8.0	4.1	2.7
<b>Canada</b>	6.8	3.9	2.5
<b>Japan</b>	2.5	3.3	2.3
<b>Eurozone</b>	8.4	5.4	2.4
<b>UK</b>	9.0	7.4	2.8
<b>Switzerland</b>	2.8	2.1	1.6
<b>Australia</b>	6.6	5.7	3.6
<b>China</b>	2.0	0.4	1.2
<b>India</b>	6.7	5.5	4.8
<b>EM</b>	9.5	7.6	8.7
<b>World</b>	8.4	6.2	6.0

Source: Bloomberg, UBS, as of 6 December 2023. Latest forecasts available in the *Global forecasts* publication, published weekly.

## Asset classes

	Spot	Jun-24	Dec-24
<b>Equities</b>			
S&P 500	4,549	4,500	4,700
Eurostoxx 50	4,483	4,600	4,700
FTSE 100	7,515	7,860	8,160
SMI	11,002	11,300	11,640
MSCI Asia ex-Japan	612	665	685
MSCI China	55	65	67
Topix	2,387	2,485	2,555
MSCI EM	975	1,050	1,080
MSCI AC World	835	845	880
<b>Currencies</b>			
EURUSD	1.08	1.10	1.12
GBPUSD	1.26	1.25	1.27
USDCHF	0.87	0.88	0.87
USDCAD	1.36	1.34	1.32
AUDUSD	0.65	0.69	0.72
EURCHF	0.94	0.97	0.97
NZDUSD	0.61	0.61	0.62
USDJPY	147	143	140
USDCNY	7.16	7.20	7.00

	Spot	Jun-24	Dec-24
<b>2-year yields, in %</b>			
USD 2y Treas.	4.59	3.75	3.25
EUR 2y Bund	2.61	2.50	2.00
GBP 2y Gilts	4.48	4.00	3.50
CHF 2y Eidg.	1.10	0.75	0.70
JPY 2y JGB	0.04	0.20	0.25
<b>10-year yields, in %</b>			
USD 10y Treas.	4.10	3.75	3.50
EUR 10y Bund	2.20	2.25	2.25
GBP 10y Gilts	3.94	3.75	3.50
CHF 10y Eidg.	0.69	0.90	0.90
JPY 10y JGB	0.63	1.00	0.80
<b>Commodities</b>			
Brent crude, USD/bbl	74	95	95
WTI, USD/bbl	69	91	91
Gold, USD/oz	2,031	2,050	2,250

Source: Bloomberg, UBS, as of 6 December 2023. Latest forecasts available in the *Global forecasts* publication, published weekly.

# Disclaimer

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