UBS House View

Monthly Letter | 18 January 2024 | Chief Investment Office GWM, Investment Research

Soft landing

Cooling inflation, positive (albeit slower) growth, and lower interest rates should create a supportive backdrop for stocks and bonds in 2024.

Back in balance

Now is the time to get "back in balance." We see tactical and strategic benefits to shifting portfolios away from cash and toward bonds and equities.

Geopolitics in focus

We do not expect the recent escalation in the Middle East to have a major impact on global inflation, though it may add market volatility in the near term.

Asset allocation

We continue to prefer quality fixed income. Within equities, we like quality stocks, US technology, and emerging markets.

Mark Haefele

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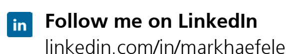

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Key questions for 2024

In the final two months of 2023, a 60/40 portfolio of equities and bonds[1] delivered its third-best two-month return in at least three decades. The trigger? A further decline in US inflation and a "dovish pivot" from Federal Reserve Chair Jerome Powell. The result? US equities sit close to their all-time highs and 10-year US Treasuries trade with yields almost 100 basis points below their October peaks.

After these moves, the questions I'm getting from investors revolve around three themes:

1. Can equity and bond markets keep rising in 2024?
2. How should we navigate portfolios through the coming turn in the rate cycle?
3. How to think about the geopolitical and political risks we face in the months ahead?

In short:

1. *We think there is more upside for both equity and bond markets.* Our base case scenario is for a soft landing. Lower interest rates, positive (albeit slowing) economic growth, and growing corporate earnings should support modest further upside for equities. We also think long-term bond yields have room to fall further, given long-term real rates are still higher than the Fed's estimate of the real neutral rate, in our view. We favor bonds on a risk-adjusted basis.
2. *Lower interest rates will reduce returns and increase reinvestment risks for cash and money market investors.* We think now is the time for investors to get portfolios back in balance. We see both tactical and strategic benefits to shifting portfolios away from cash and toward bonds and equities.
3. *Geopolitics are likely to remain prominent, but we think it is important to disassociate broad investment decisions from politics.* We do not expect the recent escalation in the Middle East to have a major impact on global inflation, though it may add market volatility in the near term. We also note that US elections have not historically had a decisive impact on broad markets, though the presence of the November election is contributing to investor speculation that the Fed may start the rate-cutting cycle sooner.

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1 MSCI All Country World in local currency and Bloomberg Global Aggregate indexes.

We recommend focusing on quality in both bonds and stocks.

How to position? We retain a positive stance on quality fixed income. In equities, we focus on quality stocks that should be well placed in an environment of slower economic growth thanks to their strong balance sheets, high profitability, and resilient earnings profile. We like the US tech sector, which aligns with our quality tilt and offers exposure to compelling disruptive trends like artificial intelligence.

Furthermore, we see tactical opportunities in areas of the equity market that would likely be particular beneficiaries of a "Goldilocks" scenario of faster growth, lower inflation, and preemptive Fed rate cuts—while also faring well in our base case. For example, we would expect emerging market equities, and small-cap stocks in the US and Europe, to do well in both scenarios.

Can equity and bond markets keep rising?

Modest equity upside driven by "soft landing" evidence and earnings growth

Equities should be supported by evidence of a US soft landing and by corporate earnings growth.

We think equity markets can move higher in 2024, driven by increasing evidence that the soft-landing scenario for the US economy is playing out and by growth in corporate earnings.

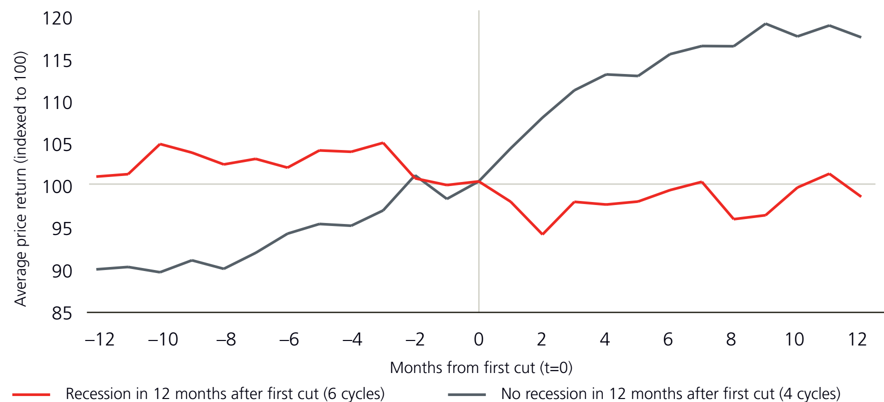
We forecast S&P 500 earnings per share of USD 240 in 2024, an 8% year-over-year increase. Such a rate of growth has historically driven the index higher. Based on data going back to the 1960s, the S&P 500 has risen 10% on average in years when earnings growth has been 8% or higher.

The direction of Fed policy should also support equities. In non-recessionary episodes over the last 50 years, the S&P 500 tends to rise 8% in the six months before the first Fed rate cut and then goes on to rise a further 16% on average in the 12 months following the first cut.

Figure 1

The direction of Fed policy should support equities

S&P 500's performance since the Fed's first cut with recession in the 12 months after the first cut and no recession. Data since the 1970s



Source: Bloomberg, UBS, as of January 2024

That said, much of this may already be priced in at the index level. Futures markets are pricing around 140bps of rate cuts from the Fed in 2024, versus our expectation of 100bps.

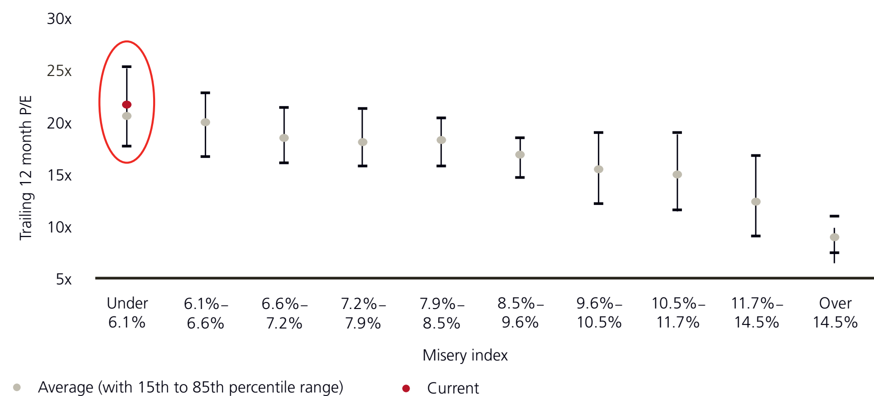
We think elevated US equity valuations are justifiable given the economic backdrop.

The S&P 500 trades at a forward price-to-earnings ratio of over 19 times—historically elevated, but, in our view, justifiable given that the economy is still growing and inflation is falling. Since 1960, a "Misery Index" (the sum of the unemployment and inflation rate) reading of less than 6.1% has been consistent with a trailing P/E ratio of up to 25x. The trailing P/E is currently 21.5x, and a modified version of the Misery Index (using the unemployment rate and expected inflation) stands at 5.9%.

Figure 2

Equities supported by evidence of soft landing

S&P 500 trailing 12-month P/E ratio at different levels of the Misery Index,* since 1960



* From 1960 to 1999, we use the unemployment rate plus the inflation rate. After 1999, we use the unemployment rate and expected inflation over the next 10 years from the TIPS market.
Source: Bloomberg, Factset, UBS, as of January 2024

Overall, we expect modest upside for the S&P 500 over the course of 2024, with a December target of 5,000 in our base case. Within equities, we think investors should focus on parts of the market that can deliver performance across a range of potential economic scenarios, including quality stocks, the US technology sector, emerging market equities, and small-caps in the US and Europe.

Expect lower yields for quality bonds as real rate expectations decline

Core US consumer price inflation continues to trend lower.

Core US consumer price inflation has declined steadily since the second quarter of 2023, from 5.6% year-over-year last March to 3.9% in December. Shelter remains the main source of inflation, currently accounting for 70% of overall core inflation. Excluding shelter, core inflation was subdued at 2.2% in December. Data on new rental agreements suggest that shelter inflation, which lags those agreements by around 12 months, will continue to slow in the months ahead.

An expected further decline in core inflation has added to our confidence that the Fed will cut rates this year and that the prospect of stagflation is a very low probability.

The end point for rates, as well as their path, is important.

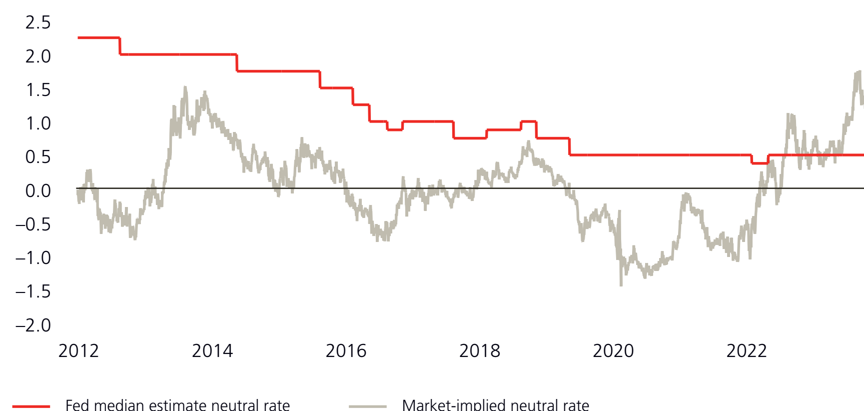
Unsurprisingly, the near-term path for policy rates is attracting a lot of investor attention. We expect four 25bps Fed rate cuts this year, less than market expectations for 140bps of cuts. But the end point for rates, as well as their path, is important. Fed officials' median estimate for the longer-term policy rate is 2.5% (or 0.5% in real, post-inflation terms).

The current market-implied long-term real policy rate is 0.9%, still above the Fed's 0.5% estimate. We therefore think that the next leg lower in yields is likely to be driven by lower long-term real rates. One driver is likely to be a tapering of the Fed's bond-selling program (quantitative tightening), which would reduce upward pressure on real rates. The FOMC minutes show that Fed officials are already discussing when to reduce the pace of sales.

Figure 3

The next leg lower in yields is likely to be driven by lower long-term real rates

Fed policymakers' median estimate of the neutral rate, market-implied neutral rate, in %



Source: Bloomberg, UBS, as of January 2024

Of course, uncertainty about the Fed rate path and high US government deficits mean we should expect continued volatility. Yields won't fall in a straight line. But overall, we think quality fixed income offers an attractive risk-return proposition across scenarios. In a soft-landing scenario, we expect returns for high-quality, medium-duration fixed income to be in the high single-digit range. In a "hard landing" scenario, we would expect double-digit returns. Even in a Goldilocks scenario (the least favorable for quality fixed income), we would expect returns to be positive.

How should we navigate portfolios through the coming turn in the interest rate cycle?

We think now is the time for investors to review cash-heavy portfolios.

Shift from cash to bonds

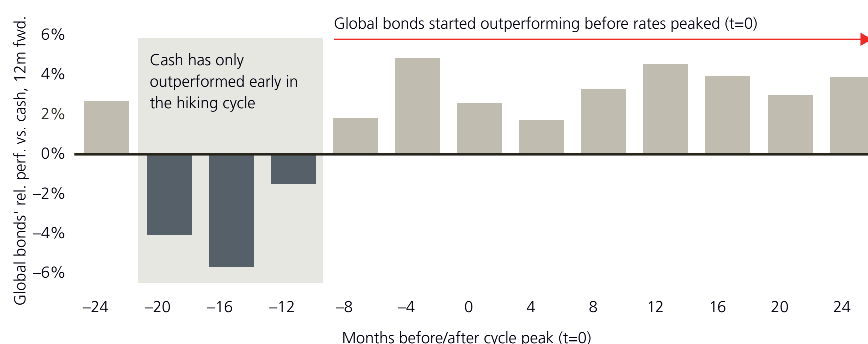
The past two years have offered investors the opportunity to earn attractive returns in cash and money market funds, and rates are still above 5% in US dollars. But with inflation falling and interest rate cuts on the agenda, we think now is the time for investors to review cash-heavy portfolios. We see the 10-year US Treasury yield falling to 3.5% by December 2024 in our base case, and to 2.5% in a hard-landing scenario. This poses a reinvestment risk for investors currently holding cash.

Historically, it has paid to be proactive and switch from cash to bonds well ahead of the first interest rate cut. Cash tends to outperform bonds during the first stages of rate-hiking cycles (as we saw in 2022) but underperform in the later stages and during rate-cutting cycles. We think that will prove to be the case again this year—in our base case, we expect 8.5% returns for high-quality, medium-duration bonds, versus 4.3% for cash.

Figure 4

Cash's outperformance has been short-lived

Bloomberg Global Aggregate Index vs. Bloomberg 1–3m T-bills, average 12-month forward returns over the past 4 hiking cycles, in % (chart shows average over 4 months). Data since 1990



Source: Bloomberg, UBS, as of January 2024

In a portfolio context, the case for investing cash in longer-term fixed income is even stronger. For example, in our hard-landing scenario in which economic growth falters and the US enters a recession, we would expect equity markets to fall by more than 15% on a total return basis. For investors holding a diversified portfolio of equities and bonds, losses would be limited by a 16% rally in bonds—we estimate a 60/40 stock/bond portfolio[2] would fall by just 3% in this scenario. Investors holding excessive cash would not be as well insulated in this scenario—cash does not "rally," and the returns on rates would likely fall in this scenario.

A scenario in which rates stay higher for longer appears less likely given falling inflation and Fed rate expectations.

Hedging the "higher-for-longer" scenario

The scenario in which cash would outperform both stocks and bonds is a higher-for-longer scenario. Although the recent decline in inflation and Fed rate expectations makes this scenario less likely, it is possible that hotter-than-expected inflation data or excess US Treasury supply could push the 10-year US yield back toward 5% again. Such a scenario would be negative for both bond and equity markets.

Still, we see more efficient ways to hedge against such a scenario than over allocating to cash.

Yield curve "steepener" trades—buying short- or medium-duration bonds and selling longer-duration bonds—can help hedge this risk in fixed income. We would expect such trades to deliver good performance in our base case (in which we expect the current 2-year/10-year inversion of –26bps to end by the middle of the year), but also in case of an aggressive rate-cutting cycle or in scenarios in which the term premium rises sharply due to short-term supply indigestion.

2 MSCI ACWI in local currency and 10-year US Treasuries.

Investors looking to hedge against the risk of equity losses can make use of structured strategies with capital preservation features. Such strategies are usually most attractive in times of high bond yields and average or below-average implied equity market volatility. We also continue to see macro hedge funds as an effective portfolio diversifier, which have historically delivered consistent performance in times of market turbulence.

How to think about the geopolitical and political risks we face in the months ahead?

We don't think the war in the Middle East will drive meaningfully higher inflation

Attacks on shipping in the Red Sea have led to more trade being diverted to alternative routes.

Geopolitical tensions in the Middle East have increased. Recent weeks have seen a series of drone and missile attacks on commercial shipping in the Red Sea and subsequent US-led airstrikes in Yemen. Iran's Islamic Revolutionary Guard Corps has also launched missile strikes on targets in northern Iraq, Syria, and Pakistan.

In response to the Red Sea attacks, more trade is being diverted to safer (though more costly) routes including via the Cape of Good Hope or by air. During the first 11 days of January, ship traffic through the Suez Canal decreased by 30% when compared with the same period last year, according to Suez Canal Authority chief Osama Rabie.

While the conflict is now wider and has the potential to add market volatility, in our base case we do not expect an escalation that would alter our views on equity and bond markets. We note that historically the impact of geopolitical events on broad markets has typically been short-lived.

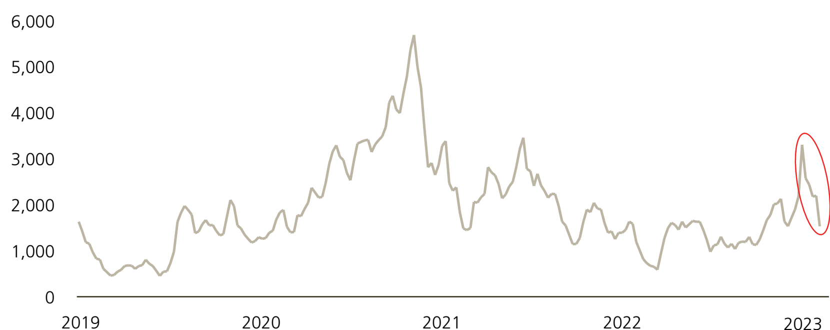
At this stage, we also think the impact on broader inflation should be limited for a few reasons.

First, the availability of an alternative route means that while shippers face delays and higher costs, major outright shortages should be avoided. This should limit the inflationary effects and is notably different from during the pandemic (when production was shut down or insufficient) and the Russia-Ukraine war (when commodity supplies were restricted or disrupted).

Figure 5

The Baltic Dry Index has declined in recent weeks

Baltic Dry Index, a measure of shipping costs



Source: Bloomberg, UBS, as of January 2024

Second, while the cost of shipping containers from Asia to Europe has risen, the impact on other routes has been more limited. Notably, the Baltic Dry Index—the global benchmark for the price of moving raw materials by sea—has declined in recent weeks. That said, we will need to continue to monitor other issues facing global shipping, including the drought in the Panama Canal.

Finally, shipping represents a relatively small proportion of the overall cost of goods, so price increases associated with higher shipping costs should be less visible to most consumers. The prices consumers pay are influenced more by factors that arise after goods arrive at a port, including internal distribution, advertising, and wholesale and retail costs. For example, shipping costs contribute about 5% of the total cost of a pair of sneakers.

With respect to oil, while events are fluid, our base case is for no significant disruption in oil supplies, even if the risk of an escalation likely contributes to higher hedging demand for oil. We think Brent crude prices are likely to trade in a USD 80–90/bbl range in the months ahead, from the mid-USD 70s today. As such, we advise risk-seeking investors to sell Brent's downside price risks or add exposure to longer-dated Brent oil contracts.

Investors should try to disassociate broad investment decisions from politics

Investors should expect plenty of political headlines this year.

A crowded global election calendar this year, encompassing an estimated 4 billion eligible voters around the world, means investors should expect plenty of political headlines. Earlier this month, elections in Taiwan resulted in a status-quo outcome, although cross-strait relations are likely to remain a constant source of geopolitical tensions in the coming years.

With US presidential primaries getting underway, attention is also turning to November's US presidential elections. President Joe Biden and former President Donald Trump are the presumptive nominees, though policy slates are yet to be laid out, and it is too early to meaningfully assess the probable composition of Congress in different scenarios.

For now, a key area of focus will be the effect that the pending election may have on Fed policy. In our base case, we expect four 25bps rate cuts from the Fed this year, starting in May. The closer Fed actions get to the election, the more likely the institution gets dragged into politics. Yet a failure to act could also be seen as political if an economic slowdown is accelerating into the election.

Alongside stronger growth and lower inflation, a part of our upside Goldilocks scenario is the possibility that speculation about preemptive Fed rate cuts ahead of the election season becomes a positive for both bond and equity markets.

We recommend trying to keep investment decisions separate from politics.

All that said, we think it is important to try and disassociate broad investment decisions from politics. Academic research[3] shows that investors who share an affiliation with the political party in office are more likely to increase their allocation to equities, while investors disappointed with an election result may tend toward a risk-off strategy. This can lead to asset allocations drifting away from those most appropriate to help investors achieve their longer-term goals.

3 Yosef Bonaparte and Alok Kumar, et al., "Political Climate, Optimism, and Investment Decisions," University of Miami, 26 February 2012.

Messages in Focus

Manage liquidity	We believe investors should limit their overall cash balances in the year ahead. Interest rates are likely to fall in 2024, potentially sharply. This will reduce the return of cash and increase reinvestment risks. Beyond cash and money market funds, investors should diversify their liquidity strategy with a combination of fixed term deposits, bond ladders, and structured investment strategies to cover expected portfolio withdrawals over the next five years.
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 multilateral development bank 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.
Trade the range in currencies and commodities	We expect the US dollar to stay stable around current levels over the coming months, though USD weakness may emerge later in the year as US rates fall. This makes selling USD upside for yield pickup attractive. Meanwhile, we expect oil prices to fluctuate in the USD 80–90/bbl range in 2024, creating opportunities for investors to sell downside risks or navigate the range.
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. We also see opportunities in convertible arbitrage, a strategy which we expect to see more opportunities as companies refinance maturing debt.
Anticipate a "Goldilocks" scenario	In our upside scenario, preemptive Fed interest rate cuts alongside still-robust growth and falling inflation drive strong performance in equity and bond markets. Investors should therefore seek to position in parts of the market that can capture more upside in a Goldilocks scenario, while also faring well in a base case scenario. For example, we would expect US and European small caps, Swiss midcaps, and emerging market equities, to be particular beneficiaries, given their interest rate sensitivity and low valuations. We would also expect them to fare well in our base case scenario.
Hedge market risks	In our downside scenario, weaker economic growth would lead to significant weakness in global equity markets. The good news is that implied equity market volatility has fallen to multi-year lows, making this an attractive time to consider capital preservation strategies to hedge against market risks. We also think gold would be a major beneficiary of lower interest rates and heightened risk aversion in a downside scenario, and we also see upside for gold in our base case. Meanwhile, we would expect macro hedge funds, which have historically delivered consistent performance in times of market turbulence, to act as an effective portfolio diversifier.
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.
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.

Investment ideas

We retain our preference for quality bonds.

Fixed income

We continue to like high-quality fixed income. In our base case, we expect 10-year US yields to fall to 3.5% by the end of 2024 (from 4.1% today) and think the asset class offers an attractive risk-return proposition across scenarios—ranging from high-single-digit returns in our soft-landing scenario, to double-digits in our hard-landing scenario.

We stay neutral on high yield credit and cautious on leveraged loans. High yield spreads over US Treasuries have tightened further and are currently trading at

362bps (versus historical norms in the mid-400s during periods of 4–5% nominal GDP growth). This suggests there is scope for spread widening if growth slows this year as we expect. We think defaults could rise to around 4–5% over the next year, from 3.4% over the past year. Meanwhile, leveraged loans have higher exposure to lower-rated companies than high yield (70% rated B+ and below versus 50%), capital structures are often weaker (loan-only, covenant-lite), and signs of credit degradation are more evident.

Equities

Quality stocks should be well placed in an environment of slowing economic growth.

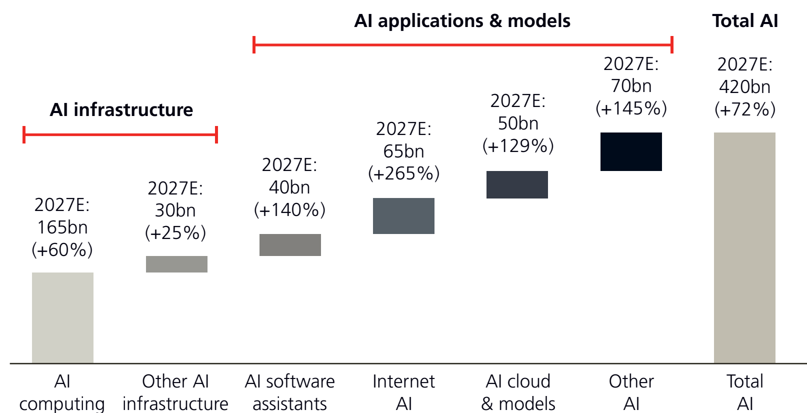
In equities, we continue to see quality stocks—those of companies with a high return on invested capital, strong balance sheets, and resilient earnings—as a core theme in 2024. Quality companies have historically outperformed broader indexes during periods of slowing economic growth, like we expect in our base case soft-landing scenario.

We also like the US tech sector, which is home to many quality stocks and offers exposure to various disruptive trends, most notably AI. We forecast that global AI industry revenues will rise to USD 420bn by 2027—a 72% annual growth rate from USD 28bn in 2022 and a fifteenfold increase in just five years. Demand for AI computing, including GPUs, custom chips, and memory, is surpassing expectations, and visibility on corporate spending plans is rising.

Figure 6

Strong growth expected for AI across segments

CIO's forecasts for AI's 2022–27 CAGR across segments; revenues in USD



Source: UBS, as of January 2024

We see tactical opportunities in small-cap stocks.

We think investors should complement core holdings in quality stocks with tactical exposure to small-cap stocks. In the US, nearly half of the debt held by Russell 2000 companies is floating rate (versus around a tenth for large-cap companies), making small-caps key beneficiaries of lower rates. Relative valuations look attractive. The Russell 2000 is trading at a roughly 53% discount to the Russell 1000 on a price-to-book ratio, versus a 10-year average discount of 32%. We also see opportunities in European small- and mid-caps, which should benefit from easing lending conditions and bottoming activity, with relative valuations at 20-year lows (MSCI EMU SMID Index versus the MSCI EMU Large Index).

Lastly, we retain our preference for emerging market stocks. The economic picture in emerging markets remains healthy—though momentum has slowed—

and inflation continues to normalize. The global central bank hiking cycle has been a headwind for emerging market assets in recent years. But the Fed pivot and expected falling US interest rates should become tailwinds going forward. We expect emerging market companies to deliver solid mid-teens earnings growth in 2024, outpacing global peers.

Valuations for the MSCI Emerging Markets index are largely in line with their 10-year average, though with big divergences within the region, and trade at an above-average discount to developed markets. In our view, this gap does not factor in the better relative earnings growth prospects we see for emerging markets. By geography, we like the Chinese, Indian, and Indonesian equity markets. On China, we expect additional policy support to be forthcoming in the first quarter, presenting a potential near-term upside catalyst, which would be supportive of our preference for Chinese stocks.

Currencies and commodities

Most G10 currency pairings are likely to remain range-bound in the months ahead.

The US dollar has regained ground in recent weeks after depreciating in late 2023. Most G10 currency pairings are now back in familiar ranges (e.g., EURUSD between 1.05 and 1.10), where we expect them to remain in the coming months. Better relative growth in the US than in Europe and a partial reversal of US rate cut expectations should support the greenback in the near term. However, the Fed's dovish pivot is likely to limit the extent of any rallies and sets the tone for the dollar to weaken into year-end 2024.

Our most preferred currency is the Australian dollar. We also see opportunities for investors to sell near-term upside risks in EURUSD and GBPUSD, or downside risks in USDCHF, GBPCHF, and USDJPY in exchange for yield pickup.

We see a positive outlook for broad commodity indexes in 2024, despite slower economic growth. Our total return forecast for the year is around 10%. We expect higher oil prices. We expect a slightly undersupplied market (–0.1 million barrels per day) in 2024, with OPEC+ holding back production until midyear and only gradually returning it in the second half. We also see upside for gold prices over the course of the year and like the yellow metal as a hedge within portfolios. With Fed rate cuts likely to begin in the second quarter, we expect to see exchange-traded fund demand for gold turning positive. Our December 2024 price target is USD 2,250/oz, and we recommend adding fresh longs on dips below USD 2,000/oz.

Mark Haefele
Chief Investment Officer
Global Wealth Management

Global forecasts

Economy

Real GDP y/y, in %

	2023	2024E	2025E
US	2.4	1.1	1.7
Canada	1.1	0.2	1.3
Japan	2.0	0.6	1.0
Eurozone	0.5	0.6	1.2
UK	0.6	0.6	1.5
Switzerland	0.7	1.2	1.5
Australia	2.0	1.5	2.1
China	5.2	4.4	4.6
India	7.0	6.2	6.2
EM	4.5	3.9	4.3
World	3.2	2.6	3.1

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

	2023	2024E	2025E
US	4.1	2.5	2.2
Canada	3.9	2.5	2.1
Japan	3.3	2.3	1.5
Eurozone	5.4	2.3	2.1
UK	7.3	2.3	2.1
Switzerland	2.1	1.5	1.5
Australia	5.7	3.5	3.0
China	0.2	0.8	1.6
India	5.4	4.8	4.4
EM	7.5	8.3	5.0
World	6.2	5.7	3.8

Source: Bloomberg, UBS, as of 17 January 2024. Latest forecasts available in the *Global forecasts* publication, published weekly.

Asset classes

	Spot	Dec-24
Equities		
S&P 500	4,739	5,000
Eurostoxx 50	4,403	4,700
FTSE 100	7,446	7,900
SMI	11,149	11,640
MSCI Asia ex-Japan	595	685
MSCI China	51	60
Topix	2,496	2,620
MSCI EM	958	1,080
MSCI AC World	859	910
Currencies		
EURUSD	1.09	1.12
GBPUSD	1.27	1.27
USDCHF	0.86	0.87
USDCAD	1.35	1.32
AUDUSD	0.66	0.72
EURCHF	0.94	0.97
NZDUSD	0.61	0.62
USDJPY	148	140
USDCNY	7.20	7.00

	Spot	Dec-24
2-year yields, in %		
USD 2y Treas.	4.36	3.25
EUR 2y Bund	2.69	2.00
GBP 2y Gilts	4.36	3.50
CHF 2y Eidg.	1.11	0.70
JPY 2y JGB	0.02	0.25
10-year yields, in %		
USD 10y Treas.	4.10	3.50
EUR 10y Bund	2.31	2.25
GBP 10y Gilts	3.98	3.50
CHF 10y Eidg.	0.86	0.70
JPY 10y JGB	0.60	0.80
Commodities		
Brent crude, USD/bbl	78	82
WTI, USD/bbl	73	77
Gold, USD/oz	2,007	2,250

Source: Bloomberg, UBS, as of 17 January 2024. Latest forecasts available in the *Global forecasts* publication, published weekly.

Disclaimer / Risk Information

Non-Traditional Assets

Non-traditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

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

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

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- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
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- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
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