# UBS House View

*Weekly*

Chief Investment Office
GWM

25 March 2019

## Week Ahead

- **Can Theresa May resurrect her Brexit deal?** The British PM looks set to make a third attempt to win parliamentary approval for her deal ahead of the planned Brexit date of 29 March. The last time her deal was put to the House it was voted down 391 to 242. Any developments that help reduce the probability of a hard Brexit can be expected to support sterling. But we do not recommend investors taking strong directional trades.

- **Will US data support or undermine the Fed's dovish outlook?** After a dovish shift at the Fed, the market focus will turn to the January release of the Personal Consumption Expenditure inflation index. The Fed will become concerned if core inflation falls further below their 2% target.

- **Will US–China trade talks deliver a breakthrough?** US Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin plan to fly to Beijing to meet with Chinese Vice Premier Liu He. A signing ceremony, which had initially been planned for the end of March, has been pushed back. With investors already expecting some kind of deal, a positive surprise will be required to push risk assets higher.

## Investor Spotlight

- **Risk aversion.** Investors poured USD 12.1bn into bonds, and pulled USD 20.7bn out of global equities funds in the week to 20 March, more than reversing the previous week's USD 14bn equity inflow.

- **US falls out of favor**. Of the weekly outflow from equities, US funds represented the majority with USD 13.2bn in outflows, followed by Europe with USD 4bn, according to EPFR data.

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## Key Messages

**Mueller finds no collusion.** Special Counsel Robert Mueller's investigation "did not establish that members of the Trump campaign conspired with the Russian government" to influence the 2016 election, according to excerpts detailed in a 4-page letter by US Attorney General William Barr. The special counsel did not conclude whether or not President Trump's actions constituted obstruction of justice, with Barr and his deputy Rod Rosenstein instead finding the Mueller report uncovered no actions sufficient to establish such an offense under the law. Trump welcomed the report's conclusions as a "complete and total exoneration", while Democrat leaders called for the release of the full report and underlying documentation.

*Takeaway: While news of the launch of the Mueller inquiry in May 2017 coincided with a 1.8% one-day fall in the S&P 500 – one of the largest single-session drops of the year – the impact was short-lived and the index rallied again to an all-time high the following week. We would anticipate any near-term reaction to the report to have a similar lifespan. Read more in our special report.*

**Even a dovish Fed risks disappointing investors.** The Federal Reserve sent its clearest signal yet at last week's policy meeting that tightening may be nearing an end. The median forecast from Fed officials, which late last year had implied two rate hikes in 2019, now implies none. The Fed also announced plans to wind down its balance sheet reduction by September. But while the dovish shift in Fed policy has been a major driver of the almost 20% rally in US stocks since late December, there is now potential for the central bank to disappoint. Indeed, while the Fed is now saying the data does not point to a rate move in either direction, the market is pricing a near 40% probability of rate cuts this year, up from 25% ahead of the meeting. The sharp fall in the S&P 500 at the end of last week suggests the Fed's dovishness has been insufficient to allay fears about the weakening in growth that lies behind the shift in policy stance. This supports our view that equity markets have priced in a lot good news and that it's prudent to lock in some profits.

*Takeaway: We have reduced our tactical exposure to equities and would like to see more confirmation that growth and inflation have stabilized before adding to risk-on stocks. However, the increasingly dovish tone from the Fed supports our positive view of emerging market USD sovereign bonds, since EM assets tend to benefit from a weaker US currency.*

**Brace for volatility as Brexit nears crunch point.** Volatility in G10 currencies is at the lowest level since 2014, with the British pound being a notable exception. A fresh spike in one-month implied volatility in sterling versus the euro makes the UK currency roughly twice as risky as the G10 average. While the EU granted a two-week extension to the scheduled Brexit day – which had been this Friday 29 March – the outcome remains highly uncertain. Prime Minister Theresa May now faces the challenge of winning approval from lawmakers for her Brexit deal, which they have resoundingly rejected twice before. Even this assumes she can overcome resistance from the House of Commons Speaker, who has objected to a further vote. If MPs refuse again to approve her deal, the EU is insisting that the government "indicates a way forward before 12 April." That leaves investors considering the full range of possibilities, from a May victory, to brief Brexit delay, to a long delay and a second referendum, or even a no-deal exit. Until some clarity emerges, we do not advocate taking directional views on sterling and advise hedging downside risks.

*Takeaway: Investors with exposure to the pound should consider hedging downside risks over the coming months.*

UBS

Deeper Dive

# More good news is priced in: time to lock in some profits

**Mark Haefele**

The December equity sell-off showed why it pays not to panic out of investments. Global equities have rallied by 16% since the December low, helped by a shift to more accommodative central bank policy and positive rhetoric surrounding a US–China trade deal.

But a lot of good news is now priced in. The balance of risk–reward has changed at the margin, and we think it's prudent to take some profit after this run-up:

- Markets appear to be pricing in little risk of recession, low inflation, and no rate hikes. Global growth expectations have rebounded sharply according to the BAML global fund manager survey, and Fed funds futures are pointing to a rate cut in the next 12 months. That backdrop is positive for global stocks, which have rallied 11% since the start of the year. Bonds have rallied too – the US 10-year Treasury yield has fallen by a further 22 basis points and bond proxies have performed well. For example, the US utilities sector is up 10%. This raises the question of whether a "goldilocks" scenario is priced in for bonds as well as equities.

- The Federal Reserve has delivered another dovish surprise, but markets appear to want more. At last week's Fed meeting the updated "dot plot," which indicates where FOMC participants expect rates to be at the end of each calendar year, showed a significant downgrade. Fed members now expect no hikes in 2019, compared with the two hikes shown in December's dot plot. The Fed also confirmed that it would complete the reduction in its balance sheet by September, compared with our estimate at the start of the year that the run-off would end in March 2020. Fed Chair Jerome Powell stated in his press conference that current data does not point to a rate move in either direction, yet markets are pricing in a cut. The sharp fall in the S&P 500 at the end of last week suggests the Fed's dovishness has been insufficient to allay fears about the weakening in growth that lies behind the shift in policy stance.

- A US–China trade deal looks accounted for in market pricing too. Our base case, to which we assign a 60% probability, is that a trade agreement will be signed in the next two to three months. We think any deal would include a commitment to reduce bilateral trade imbalances, and a review of intellectual property protection and forced technology transfer. But this positive outcome appears to be well priced in. Chinese stocks, which are highly sensitive to the result of the talks, have been the best performing market of the year, with the Shanghai Composite up 22%, roughly twice the rise in global stocks. And US industrials, a sector which is also sensitive to trade conditions, have outperformed the S&P 500 by nearly 2 percentage points this year. Also, regardless of whether an agreement is reached, the deep-seated, longer-term nature of US–China rivalry is likely to continue to be a source of periodic volatility, and should temper any market enthusiasm in the event of a trade deal.

## Bottom line

Against this backdrop, we have reduced our equity exposure. We remain risk-on through our overweights in US equities and emerging market USD sovereign bonds. At current levels, we would like to see more confirmation that growth and inflation have stabilized before we increase risk.

Regional view

# Yield curve diversion

Michael Ryan
CFA, Chief Investment Officer Americas

To infer from a modest curve inversion that a financial crisis is imminent is a misuse of the informational content.

Playing basketball well into my 40s has taken a predictable toll upon my body. After having an assortment of ligaments repaired and cartilage removed, I've had to shift my exercise routine to less physically punishing activities such as swimming. So I often find myself in the pool with an assortment of swimmers from various age categories and different professional backgrounds. This makes for some interesting and at times entertaining conversations.

This past weekend I overheard an animated discussion between two men whom I have grown to know over the past couple of years at the pool. One is a high school English teacher who works as a lifeguard during the summer and the other is a Nassau County police officer who does triathlons. What caught my attention about their conversation was the subject matter. Typically the locker room banter among middle-aged males centers around sports, politics or just the overall cruelty of the aging process. But this time around, the conversation centered upon a rather arcane matter – the inversion of the yield curve.

Not only was I surprised by the topic, but also by the command each assumed they had over the subject matter. The lifeguard confidently noted that curve inversions were the most important indicators for equity markets, while the cop authoritatively stated that every prior inversion was immediately followed by a "financial crisis." Both solemnly agreed that they would need to make changes to their investment portfolios.

This got me to thinking – how many similar conversations have taken place over the past several days?

Due to the ubiquitous nature of the financial media in our present age, even the most casual of investors have broad access to a wide assortment of information. Unfortunately, there has not been as much scrutiny of the spurious conclusions that are often drawn from such observations. While it's true that yield curves can be useful indicators of both macro and market developments, shifts in the term structure alone have not been a very accurate predictor of either recessions or bull markets.

As my colleague David Lefkowitz noted in a recent blog post, the lag between a curve inversion and an economic recession can range from less than a year to almost three years. So making premature changes to portfolio positioning based solely upon the shape of the yield curve can lead to misallocation of resources and missed opportunities.

The extraordinary nature of monetary policy during the current cycle may also render the yield curve a less effective tool for forecasting economic and market outcomes this time around. Keep in mind that the Fed's balance sheet currently stands at about USD 3.8 trillion versus just USD 800 billion prior to the global financial crisis. With the average maturity of the Fed holdings significantly above the average maturity of Treasury debt held by the public, the inversion may be – at least in part – attributable to the shortage of longer duration high risk free assets.

Also, with global government bond yields still hovering near historical lows, there has been a strong demand on the part of global investors for dollar-denominated debt. This has likely contributed to both a suppression in long-term bond yields within the US Treasury market and an inversion of the curve.

We're not suggesting for a moment that investors ignore curve inversions – nor are we trying to rationalize away the potential implications from a flattening of the term structure. After all, the inversion has occurred amid both a weakening of global growth prospects and a softening of inflation pressures. But to infer from a modest curve inversion that a financial

Regional view

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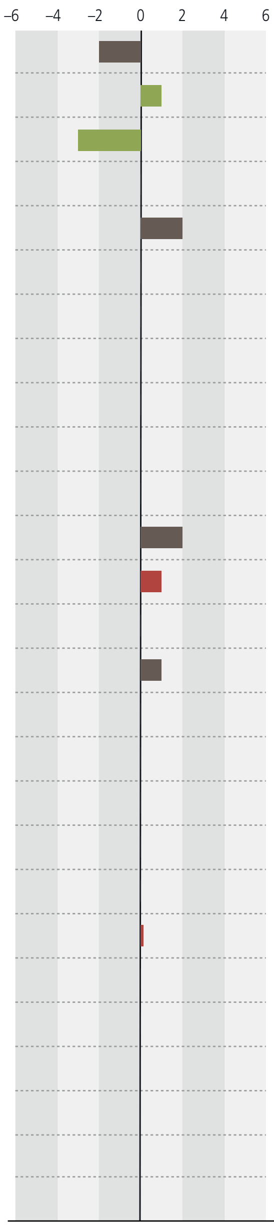
So while we have progressed to the late phase of the business cycle, we don't foresee either a recession or the beginnings of a bear market over the next 6-12 months. We therefore continue to retain a modest overweight to risk assets, but also include hedges in the portfolio appropriate for this late stage of the cycle.

# Strategy and performance

## TAA and market returns




| Asset class | Tactical Deviation in %* | Total return in % 1–week | 1–month | YTD | Annualized total return in % 1–Year | 5–Year | 10–Year** | Benchmark |
|---|---|---|---|---|---|---|---|---|
| **Cash** | **–2.0** | **0.05** | **0.19** | **0.56** | **2.20** | **0.79** | **0.49** | Barclays Capital US Treasury – Bills [1–3 M] |
| **Fixed Income** | **+1.0** | | | | | | | |
| US Gov't FI | –3.0 | 0.85 | 1.23 | 1.73 | 4.38 | 2.11 | 2.43 | BarCap US Agg Government |
| US 10 year Treasury | 0.0 | 1.25 | 1.97 | 2.65 | 6.04 | 2.56 | 2.89 | Bloomberg Barclays US Treasury Bellwethers 10 Year |
| US Treasuries (long) | +2.0 | 2.45 | 2.78 | 3.39 | 6.75 | 5.64 | 4.92 | ICE U.S. Treasury 20+ Years Bond Index |
| US Municipal FI | 0.0 | 0.67 | 1.25 | 2.48 | 5.21 | 3.72 | 4.55 | BarCap Municipal Bond |
| US IG Corp FI | 0.0 | 1.10 | 1.86 | 4.39 | 5.09 | 3.60 | 5.95 | BarCap US Agg Credit |
| US HY Corp FI | 0.0 | 0.28 | 1.05 | 6.89 | 5.56 | 4.67 | 11.49 | BarCap US Agg Corp HY |
| Int'l Developed FI | 0.0 | 1.03 | 1.18 | 2.04 | –3.80 | –0.09 | 2.68 | BarCap Global Agg xUS |
| EM FI | 0.0 | 0.48 | 0.66 | 3.90 | 0.77 | 3.07 | 7.33 | 50% BarCap EM Gov and 50% BarCap Global EM (USD) |
| EM FI - Local Currency | 0.0 | 0.30 | –0.15 | 2.55 | –3.05 | 1.16 | 5.84 | BarCap EM Gov |
| EM FI - Hard Currency | +2.0 | 0.66 | 1.47 | 5.24 | 4.59 | 4.97 | 8.82 | BarCap Global EM (USD) |
| **Equity** | **+1.0** | | | | | | | |
| Global Equity | 0.0 | –0.53 | 0.52 | 11.46 | 1.51 | 6.68 | 12.72 | MSCI ACWI |
| US All cap | +1.0 | –0.99 | –0.16 | 12.52 | 7.14 | 10.07 | 16.79 | Russell 3000 |
| US Large cap Growth | 0.0 | –0.17 | 1.36 | 14.57 | 10.63 | 13.09 | 18.18 | Russell 1000 Growth |
| US Large cap Value | 0.0 | –1.49 | –0.88 | 10.58 | 4.80 | 7.66 | 15.38 | Russell 1000 Value |
| US Mid cap | 0.0 | –1.07 | –1.20 | 14.58 | 4.82 | 8.39 | 17.79 | Russell Mid Cap |
| US Small cap | 0.0 | –3.05 | –5.16 | 11.99 | –1.13 | 6.20 | 16.58 | Russell 2000 |
| Int'l Developed Markets | 0.0 | –0.34 | 1.05 | 10.09 | –3.88 | 2.90 | 9.55 | MSCI EAFE |
| EM Equity | 0.0 | 0.23 | 0.20 | 9.99 | –9.28 | 4.77 | 10.32 | MSCI EMF |
| **Commodities** | **0.0** | **0.25** | **–0.27** | **7.14** | **–4.08** | **–8.55** | **N/A** | Blooomberg Commodity Index |
| **Yield Assets** | **0.0** | | | | | | | |
| Senior Loans | 0.0 | –0.12 | 0.44 | 4.15 | 3.16 | 3.67 | 8.15 | S&P/LSTA U.S. Leveraged Loan 100 Index |
| Preferreds | 0.0 | –0.13 | 1.53 | 8.28 | 4.74 | 6.28 | 12.52 | BofA Merrill Lynch Fixed Rate Preferred Securities Index |
| MLPs | 0.0 | 1.89 | 1.71 | 16.91 | 14.91 | –4.45 | 9.82 | Alerian MLP Total Return |
| US Real Estate | 0.0 | 0.55 | 0.64 | 14.84 | 21.93 | 9.07 | 18.34 | FTSE NAREIT Equity REIT Index |

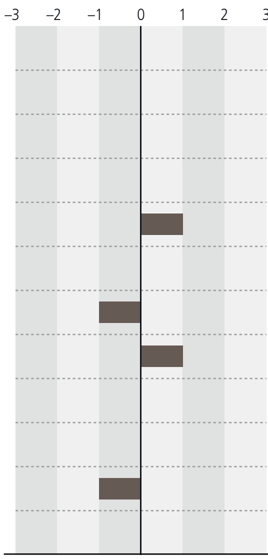
*The tactical deviation is for a moderate, non-taxable investor without alternative investments. See the latest *UBS House View: Investment Strategy Guide* for an interpretation of the tactical deviations and an explanation of the corresponding benchmark allocation.
**As of last month end
Source: UBS, as of 22 March 2019

| **S&P 500 forecast** | **CIO GWM** |
|---|---|
| 6-month rolling price target | USD 2850 |
| 2017 earnings per share actual | USD 133.0 |
| 2018 earnings per share estimate | USD 164.0 |
| 2019 earnings per share estimate | USD 171.0 |

Source: UBS, as of 22 March 2019

# Strategy and performance

## TAA and market returns: US equity sectors




| Sector | Tactical Deviation | Total return in % 1–week | 1–month | YTD | Annualized total return in % 1–Year | 5–Year | 10–Year** | Benchmark |
|---|---|---|---|---|---|---|---|---|
| Communication Services | 0.0 | –0.06 | 2.74 | 14.53 | 9.86 | 5.71 | 10.11 | SPX Index |
| Consumer Discretionary | 0.0 | 1.18 | 1.50 | 13.62 | 10.18 | 12.82 | 22.00 | S5COND Index |
| Consumer Staples | 0.0 | 0.80 | 2.22 | 10.15 | 11.07 | 8.48 | 13.47 | S5CONS Index |
| Energy | 0.0 | 0.01 | 0.43 | 15.33 | 0.77 | –2.50 | 6.54 | S5ENRS Index |
| Financials | +1.0 | –4.83 | –3.72 | 6.97 | –6.42 | 8.94 | 17.89 | S5FINL Index |
| Health Care | 0.0 | –1.48 | –1.73 | 5.27 | 13.30 | 11.04 | 17.01 | S5HLTH Index |
| Industrials | –1.0 | –1.52 | –3.74 | 13.91 | 0.94 | 8.96 | 18.35 | S5INDU Index |
| Information Technology | +1.0 | 0.43 | 4.12 | 18.71 | 13.13 | 18.32 | 20.81 | S5INFT Index |
| Materials | 0.0 | –1.99 | –2.18 | 8.01 | –2.88 | 4.81 | 13.85 | S5MATR Index |
| Real Estate | 0.0 | 0.95 | 2.65 | 16.19 | 21.75 | 8.96 | 16.99 | S5RLST Index |
| Utilities | –1.0 | 0.46 | 3.28 | 11.38 | 21.79 | 11.50 | 12.83 | S5TELS Index |
| S&P 500 | | –0.75 | 0.47 | 12.26 | 8.07 | 10.69 | 16.65 | S5UTIL Index |

Note: Tactical deviations are intended to be applicable to the US equity portion of a portfolio across investor risk profiles.
**As of last month end
Source: UBS, as of 22 March 2019

### Market moves

| | *Level* | *1–w chg* | *YTD chg* |
|---|---|---|---|
| S&P 500 | 2,801 | –0.75% | 12.26% |
| DJIA | 25,502 | –1.34% | 9.97% |
| Nasdaq | 7,643 | –0.58% | 15.48% |
| Nikkei 225 | 21,627 | 0.82% | 8.14% |
| Eurostoxx 50 | 3,306 | –2.31% | 10.61% |
| MSCI EM* | 1,060 | 0.24% | 10.00% |
| MSCI World* | 2,095 | –0.63% | 11.81% |
| MSCI EAFE* | 1,883 | –0.33% | 10.23% |
| DXY | 97 | 0.06% | 0.50% |
| Gold | $ 1314/oz | 0.87% | 2.43% |
| Brent crude oil | $ 67/bbl | –0.19% | 24.59% |
| US 10–year yield | 2.44% | –15 bps | –25 bps |
| VIX | 16.5 | +3.6 pts | –8.9 pts |

Source: Bloomberg, as of 22 March 2019
Note: All returns are in local currency
* As of intraday 21 March 2019

**Tactical time horizon is approximately six months.**
Total return market performance is from Bloomberg as of close of business on source date, using representative indices, and is provided for information only. Past performance is no indication of future performance.

\+ – Indicates +/– change

**Terms and abbreviations**
YTD = year-to-date.
TAA = tactical asset allocation.

# Earnings calendar

The Earnings Calendar provides publicly announced reporting dates and times of companies covered by Chief Investment Office GWM. Reporting dates and times are subject to change by the reporting companies.

| Date | Company | Ticker | Company | Ticker | Company | Ticker |
|---|---|---|---|---|---|---|
| 25-Mar-2019 | Red Hat, Inc. | RHT | | | | |
| 26-Mar-2019 | McCormick & Co., Inc. | MKC | | | | |
| 27-Mar-2019 | lululemon athletica, Inc. | LULU | Lennar Corp. | LEN | | |

Source: FactSet, UBS, as of 22 March 2019

# Key economic indicators

| Date | Indicator | Period | Time (ET) | Unit | Consensus | Previous |
|---|---|---|---|---|---|---|
| 25-Mar-19 | Dallas Fed Mfg Survey | Mar | 10:30 AM | level | 9.6 | 13.1 |
| 26-Mar-19 | Housing Starts | Feb | 08:30 AM | level | –0.4% | 18.6% |
| 26-Mar-19 | Housing Permits | Feb | 08:30 AM | level | 0.2% | 1.4% |
| 26-Mar-19 | FHFA House Price Index | Jan | 09:00 AM | m/m | 0.4% | 0.3% |
| 26-Mar-19 | Consumer Confidence | Mar | 10:00 AM | level | 132.0 | 131.4 |
| 27-Mar-19 | Trade Balance | Jan | 08:30 AM | level | –$57.3b | –$59.8b |
| 27-Mar-19 | Current Account Balance | 4Q | 08:30 AM | q/q | –$130.0b | –$124.8b |
| 28-Mar-19 | Real Gross Domestic Product (annualized) | 4Q T | 08:30 AM | q/q | 2.4% | 2.6% |
| 28-Mar-19 | Pending Home Sales Index | Feb | 10:00 AM | m/m | 0.5% | 4.6% |
| 29-Mar-19 | Personal Income | Feb | 08:30 AM | m/m | 0.3% | –0.1% |
| 29-Mar-19 | Consumer Spending | Feb | 08:30 AM | m/m | 0.3% | –0.5% |
| 29-Mar-19 | New Home Sales | Feb | 10:00 AM | m/m | 1.7% | –6.9% |
| 29-Mar-19 | Uni. of Mich. Consumer Sentiment | Mar F | 10:00 AM | level | 97.8 | 97.8 |

Source: Bloomberg, UBS, as of 22 March 2019
UBS forecast estimates are published on Friday evenings in *Economic Perspectives* by economists employed by UBS Investment Research, a part of UBS Investment Bank.
m/m = month–over–month. q/q = quarter–over–quarter. y/y = year–over–year. k = thousand. mn = million. bn = billion. P = preliminary.

**ESG/Sustainable Investing Considerations:** Sustainable investing strategies aim to consider and in some instances integrate the analysis of environmental, social and governance (ESG) factors into the investment process and portfolio. Strategies across geographies and styles approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit the portfolio manager's ability to participate in certain investment opportunities that otherwise would be consistent with its investment objective and other principal investment strategies. The returns on a portfolio consisting primarily of ESG or sustainable investments may be lower or higher than a portfolio where such factors are not considered by the portfolio manager. Because sustainability criteria can exclude some investments, investors may not be able to take advantage of the same opportunities or market trends as investors that do not use such criteria. Companies may not necessarily meet high performance standards on all aspects of ESG or sustainable investing issues; there is also no guarantee that any company will meet expectations in connection with corporate responsibility, sustainability, and/or impact performance.

## 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:

- Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer's "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

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