Be prepared: Plan, Protect, and Grow

Global financial markets

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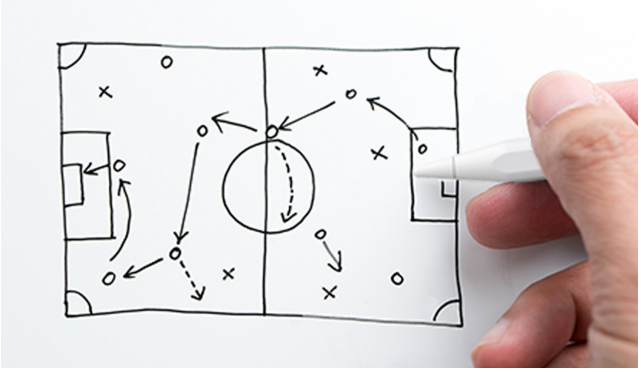
- Staying calm through 2018's volatility has paid off for investors so far in 2019. Global equities have performed well year-to-date. Yet the sharp fall in bond yields may reflect concerns about the outlook.
- Amid lower growth, and a variety of potential risks to markets, there is still cause for caution. But with low rates seemingly set to persist for an extended period, high allocations to cash and fixed income are likely to be detrimental to wealth over the long-term.
- To be prepared for the road ahead you need to *Plan*, *Protect*, and *Grow*. This report shows you how.



Q&A summary

The cycle has been running a long time; isn't cash the safest place to be right now?
In the near-term cash is almost always the safest asset, and it is important to hold some cash to ensure you can meet near-term liabilities and spending wishes. However, with interest rates likely to remain below the rate of inflation in many currencies for the foreseeable future, high allocations to cash almost guarantee real wealth destruction over the long-term. Investors should keep enough cash aside to meet financial goals over the coming two to five years. But for goals further than five years out, investors should own financial assets which offer greater prospect of long-term growth and compounded returns, while managing portfolio risk to protect against the potential for short-term downside.

How can I protect my portfolio against downside risk?
We see five key ways to manage downside risk effectively. First and foremost, make sure that your portfolio and your financial plan are in sync. The best protection against turning temporary losses into permanent losses is to remove short-term cash flow needs from equity market risk. Second, ensure diversification across regions; holding too much of your portfolio in stocks—or concentrating too much in one region in particular—opens an investor to greater tail risks. Third, to highlight a main takeaway from our Bear market guidebook, high-quality bonds (Treasuries and municipal bonds) are a portfolio's key defense against equity market risk, helping to reduce portfolio losses and help portfolios recover more quickly. Speaking of which, our fourth recommendation is to consider incorporating momentum-based asset allocation strategies to recalibrate equity exposure based on the evolving market and economic backdrop. This type of strategy has the potential to provide downside protection during bear market environment while sacrificing less than traditional hedging strategies as the bull market continues. Last, but not least, we stress the importance of diversifying within fixed income. In the

current market environment, we see several opportunities to manage risk and enhance income.

How can I improve my portfolio yield?
Investors looking to increase the level of income from their portfolios have a several options. Within equities, we see value in high-quality dividend and dividend growth strategies such as the Dividend Ruler and Opportunistic Equity Income (OEI) CIO equity model portfolios. Within fixed income, we see value in allocating to multilateral development bank bonds and green bonds, which can provide attractive income while also helping fund sustainable development. And for a more holistic approach to enhancing income without sacrificing potential capital appreciation, our House View Yield-Focused portfolios strike a good balance.

Where are the best portfolio growth opportunities?
First, investors worried about the state of the short-term economic cycle can invest with additional confidence by aligning with secular growth trends. Two of our CIO equity model portfolios—Quality Growth at a Reasonable Price (Q-GARP) and Mid-cap—are specifically geared to incorporating these trends into the US equity sleeve of the portfolio. We also recommend focusing on enduring trends such as our Long Term Investments (LTI) series, our House View Sustainable Investing portfolios, and specific investing themes such as Enabling technologies, Fintech, Business Spending, and Sustainable Value Creation in Emerging Markets. Last, but not least, holding too much can be a key obstacle to portfolio growth. For investors who have found themselves stuck on the sidelines—hoping in vain for a market pullback to offer a better entry point—we highlight strategies to help put cash to work while also mitigating the risk of "bad timing."

Regional summary

US
Of all the countries surveyed in our 1Q Investor Sentiment survey, investors based in the US were most likely to express the view that it is getting late in the market cycle. 44% of US investors describe the market cycle as "toward the end" (compared to global average of 26%).

Interestingly, US investors were also among the most optimistic about investment returns, with just 14% responding that they are either somewhat or very pessimistic on the outlook for the market over the next 6 months. We think that at least some of that optimism is justified, as economic and earnings growth looks set to re-accelerate in the months ahead.

With this dichotomy in mind, we favor hedging strategies that don't require sacrificing significant upside potential. As we discuss in the Bear market guidebook, investors can take simple steps today to limit downside without missing out on the continuing bull market.

Many investors around the globe prefer homegrown firms over international firms, and US investors are no exception. While many US investors have benefited from over allocating to US stocks in recent years, this "home bias" could hurt returns going forward. At 17 times earnings, US stocks aren't expensive—this is in line with long-term averages—but international equity markets look cheaper and stand to benefit more from the coming global re-acceleration. We recommend that investors consider rebalancing their equity portfolios to bring US stocks back to only about 50% to 60% of the equity allocation.

We also recommend that investors manage risk by ensuring that their portfolios don't have too much allocated to corporate bonds. On a tactical basis we prefer to express our risk-on stance through equities and emerging market hard-currency (USD-denominated) bonds.

Asia
Fears about the impact of a trade war and an economic slowdown in China have been prominent concerns on the minds of APAC investors in recent months, according to our 1Q Investor Sentiment survey, although market performance has started the year strongly.

China's domestic demand growth – the biggest engine for the region – has likely troughed and we believe a cyclical upturn should become visible in 2Q. High-frequency indicators that help identify a turn, support this view.

But risks remain. This could lead to an increase in short-term volatility, particularly since earnings revision still point to slower profit growth in the region. Clients could consider a collar strategy to hedge some of the downside risks, while keeping exposure to the upside.

Geographical and asset class diversification is also critical for investors in the current market environment. With Chinese equities outperforming the rest of the region, investors should consider diversifying into those markets which still have catch up potential. Meanwhile, diversification across not only equities and bonds, but also to hedge funds, could help reduce portfolio volatility, though this can reduce liquidity.

Europe
European investors have been beset by disappointing growth, political uncertainty, and weak financial market returns in recent years. From here, even if the recent

weakness of the Eurozone economy abates, the ECB looks set to keep rates lower for longer than previously expected. The deposit rate is likely to stay at –0.4% into early 2020, and the German 10-year Bund yield remains close to zero.

But once clients have sufficient cash to meet their short term liquidity needs, we believe there are better ways to protect and grow wealth than cash. For growth, investors can look to sustainable investments, which often come with lower tail risks. Investors can also boost potential returns through a higher allocation to less liquid investments such as private equity.

And despite current low or negative yields on government bonds, they could still deliver capital gains if the ECB is forced to lower rates further in any future recession, helping provide stability for investors making regular withdrawals from their portfolio.

Switzerland

Our 1Q Global Investor Sentiment survey reveals Swiss investors as among the world's most pessimistic, with just 49% "very or somewhat optimistic" on the outlook for their portfolios over the coming 6 months (compared to a global average of 64%).

That pessimism is understandable given the muted potential returns on offer in Swiss assets. Across major markets, the Swiss market stands out being the only one with a 12-month trailing PE above both its 10-year and the 20-year averages. Nervousness about equities means many investors are left holding high allocations to cash, yet rates in Switzerland are even more negative than in the Eurozone at –0.75%, versus –0.4%. And we don't see rates returning to positive territory until at least 2021.

We think it’s critical for investors to think about having a plan, protecting the downside, and looking for growth opportunities.

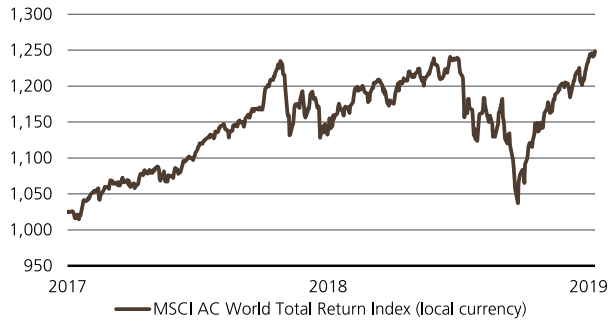
For both protection and growth, diversifying outside of Swiss equities is important to protect downside, given they’re relatively expensive. Within Swiss equity allocations, investors should look to high quality dividends to help escape low or negative yields.

Be prepared

After a calm 2017, volatility returned in 2018. Only 2 of the 19 major asset classes we track ended 2018 in positive territory, with escalating US-China trade tensions, fears of a global growth slowdown, and concerns over Fed rate hikes all weighing on global markets.

But those who stayed calm through the volatility are reaping the benefits in 2019. Global stocks have rallied 15%. Reassuring comments from the Fed and ECB, signs of a US-China trade deal, an improvement in Chinese economic data, and an encouraging start to the US earnings season have all helped sentiment.

Fig 1: Global stocks have recovered after a dismal December



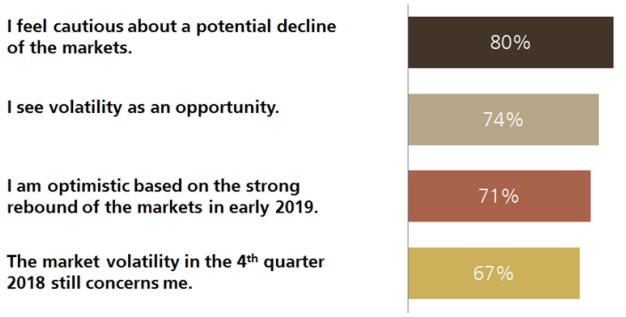
Source: Bloomberg, UBS, as of 15 April 2019

Now, equities, commodities, and credit spreads appear to be pricing a relatively benign economic scenario. But the sharp decline in global bond yields can be taken as a more cautious vision of the future.

Investors face a dilemma. 71% of investors responding to our Global Investor Sentiment survey feel "optimistic based on the strong rebound of the markets in 1Q," and confidence in personal financial situations is up by 5ppts since December. Yet 80% say they still "feel cautious about a potential decline of the markets."

Fig 2: Reaction to recent stock market activity

Agreement with the following statements, in %



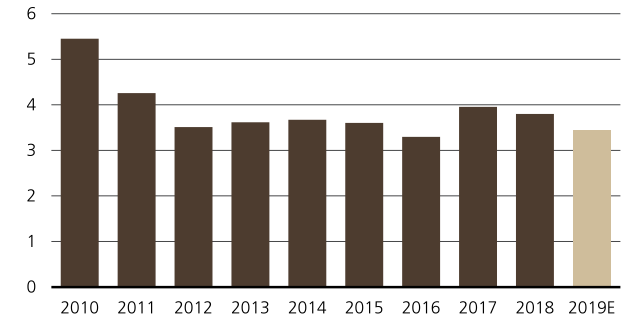
Source: UBS Global Investor Sentiment survey, as of April 2019

Despite the good start to 2019 for markets, there is still clearly cause for caution. Global growth is muted, earnings growth is slow, the bond market is telling us to worry, and there are plenty of risks which could still upset markets.

1. Global growth is muted. We forecast global GDP growth of 3.5% for 2019 versus 3.8% in 2018, and 4.0% in 2017. In the US, the impetus from Trump's tax cuts is fading. We expect 2.3% for 2019 against 2.9% for last year. The Chinese economy is continuing a longer term trend toward more moderate growth: GDP growth last year of 6.6% was the lowest since 1991, and industrial profits fell 14% in the first two months of this year. And the soft patch in Eurozone data has dragged on for longer than expected. The EU recently lowered its GDP growth forecast for this year to 1.1%, from 1.7% just a few months ago, and Italy slipped into recession in the fourth quarter.

Fig 3: Muted global growth

Global real GDP growth, in %



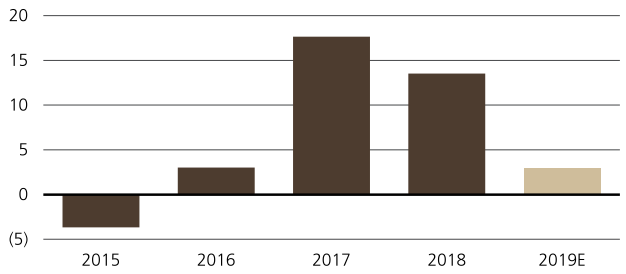
Source: UBS, as of 10 April 2019

2. Earnings growth is slow. S&P 500 earnings per share grew 23% in 2018. But profit growth is expected to slow to around 3% in 2019, with the sharpest deceleration occurring in the first half of this year: consensus is now calling for a 2% contraction in the first quarter and a modest 1% increase for the second quarter. This reflects slowing

GDP growth, a maturing smartphone market, and lower energy sector profits. And the slowdown in US profit growth is reflected in weak global earnings projections.

Fig 4: Slowing earnings growth

EPS growth, MSCI All Country World Index, in %

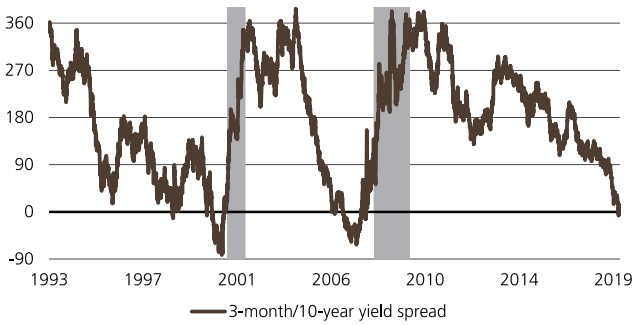


Source: Thomson Reuters, UBS, as of 14 April 2019

3. The bond market is telling us to worry. Falling yields in the US and Europe suggest worries about longer-term growth among fixed income investors. For the first time since 2007, the yield on 3-month Treasury bills rose above the yield on 10-year Treasury bonds, a move traditionally seen as a harbinger of recession. In the Eurozone, yields on 10-year German Bunds also recently turned negative for the first time since October 2016, renewing fears about the health of the Eurozone financial system in a negative rate environment.

Fig 5: The yield curve inverts

3-month/10-year yield spread, in basis points, shaded areas mark recessions



Source: Bloomberg, UBS, as of 14 April 2019

4. There are plenty of risks that could upset markets:

- **Trade negotiations:** Recent trade negotiations between the US and China have seen some progress, but it is still not certain that the trade dispute will be sustainably resolved with a deal. The same can be said about US negotiations with the EU. A collapse in talks in any one of the White House's trade policy negotiations could drag on global economic growth and markets.
- **US business cycle:** We now see downside risks to US growth as more prominent than upside risks to US inflation. Accordingly, while the risk of a hawkish Fed surprise has now fallen slightly, the risk of an economic slowdown has increased.
- **US credit:** In our base case we expect US corporate credit defaults to rise, but not above the long-term annual average of around 3.5%. However, given increasing leverage in the system, a shock to the US economy—such as an inflation-driven Fed hiking cycle—would likely see defaults rising much more quickly, with potential knock on effects to other asset classes.
- **China's economy:** Recent economic data suggests that China is successfully managing its structural slowdown. However, if the full scale of US tariffs against China were implemented, the likelihood of a much sharper downturn in Chinese growth would increase dramatically. Given that China now accounts for 16% of global GDP, a hard landing in China would have a big impact on Asian and global markets.

And this list of risks is far from exhaustive. Our recent Investor Sentiment survey revealed an even broader range of uncertainties, ranging from local political instability, debt levels, and taxation, to cyber-security, data privacy and rising healthcare costs, weighing on the minds of investors and business owners.

So with the economic and earnings growth impetus weaker, the bond market signaling caution, and a number of downside risks to growth and markets, investors need to ensure their portfolios are well-prepared for a potential downturn.

For more on the risks we're monitoring, please refer to our *Global Risk Radar* report.

But hiding isn't the answer

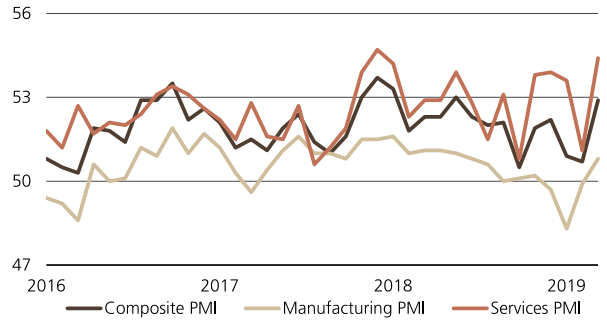
Our base case remains that a recession is not on the horizon. Global growth is steadily recovering. Equities retain a healthy risk premium over bonds. Meanwhile, cash rates look likely to stay low for an extended period. Over the long-term, we see the greater "risk" in not being invested.

1. Our base case remains that a recession is not on the horizon. We continue to monitor the various risks to markets and the global economy, yet some of the key threats we had highlighted earlier in the year now look less likely to materialize. Consistently low inflation data suggest that the risk of US overheating and sharply higher US rates are less likely. The US-China trade talks have become more constructive, raising hopes for reconciliation. And a stimulus-driven pick-up in Chinese economic data has reduced the chance of a sharp slowdown there.

2. Global growth is stabilizing. Economic confidence in China in particular has improved in the first quarter, as targeted stimulus measures have begun to have an effect. US jobs growth looks to have recovered from a blip in February. And Eurozone industrial production is showing signs of recovery from a weak patch at the end of 2018. Meanwhile, the lowest rates of global unemployment in 40 years have kept consumption strong, and we expect corporate capital spending to pick up, provided US-China trade negotiations reach a positive outcome. In our view, current low levels of capital spending are closely linked to uncertainty about the outlook for trade.

Fig 6: Recovering sentiment in China

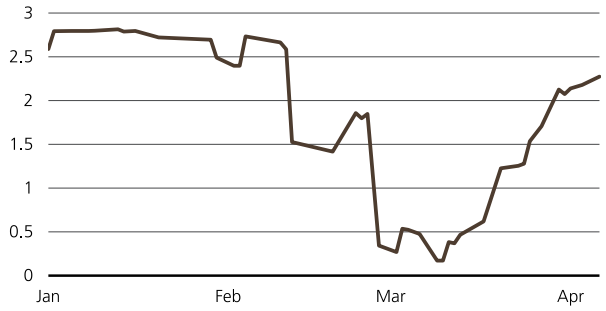
China purchasing manager indexes (composite, manufacturing, services)



Source: Bloomberg, UBS, as of 10 April 2019

Fig 7: Improving US economic data

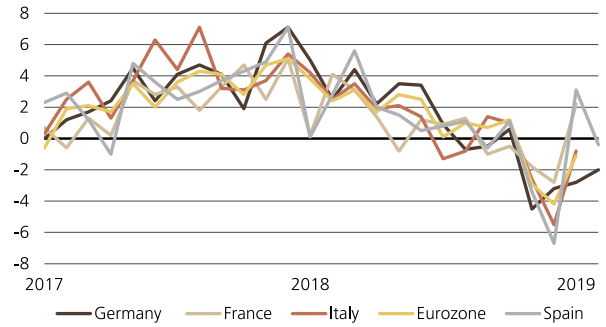
Atlanta Fed GDPNow Forecast, in %



Source: Bloomberg, UBS, as of 9 April 2019

Fig 8: Eurozone industrial production rebounds

Eurozone industrial production growth (%, year-on-year)

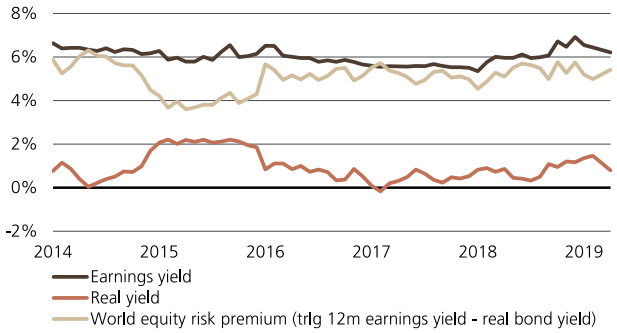


Source: Bloomberg, UBS, as of 10 April 2019

3. Equities retain a healthy risk premium over bonds. Equity markets have rallied by 15% year to date, and the equity earnings yield has dropped by 70bps. But this has been partly offset by a 30bps drop in the real (inflation-adjusted) bond yield.

Fig 9: Equities remain attractive relative to bonds

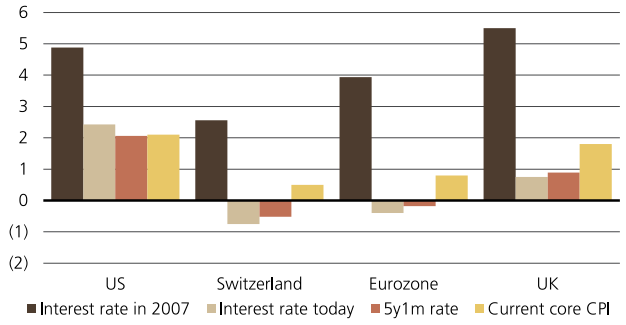
Equity earnings yield versus real bond yield



Source: Thomson Reuters, UBS, as of 10 April 2019

4. Cash rates look likely to stay low for an extended period. One of the biggest changes in the market so far in 2019 has been the reset of medium-term interest rate expectations. The market is now pricing that by 2025, interest rates will be –0.5% in Switzerland, –0.2% in the Eurozone, –0.1% in Japan, 0.9% in the UK, and 2.1% in the US. Each of these is at or below below market-implied forecasts and current rates of inflation. This means that if market pricing proves accurate, investors with high allocations to cash—particularly those holding euros and Swiss francs—are guaranteeing real medium-term wealth destruction.

Fig 10: Rates look likely to stay low in future

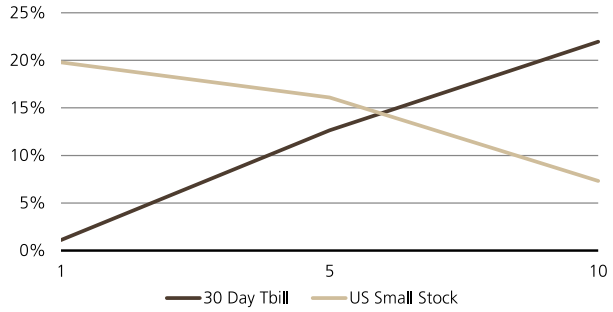


Source: Bloomberg, UBS, as of 10 April 2019

5. Over the long-term, the greater risk is not being invested. Our 1Q Global Investor Sentiment survey showed that 36% of investors are holding cash with the primary purpose of protecting against a market downturn, with 39% awaiting the right investment opportunity. But cash might provide safety and flexibility in the short run, investors who hold high cash balances persistently run the risk of failing to achieve their longer-term goals. For assets with more than a 6-year time horizon, the probability of a greater-than-5% loss in purchasing power is higher in cash (as 30-day T-Bills) than in equities (US small caps).

Fig 11: Historically, equities are safer than cash in the long run

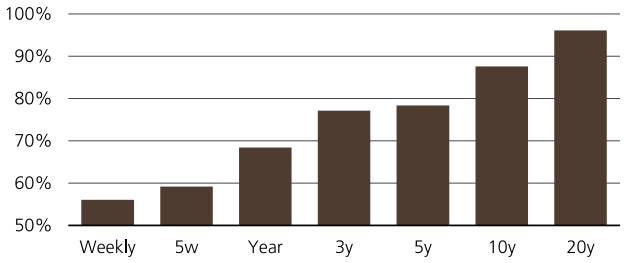
Probability (vertical axis) of an inflation-adjusted 5% or greater loss for various time periods (horizontal axis), in %



Source: Morningstar Direct, UBS, as of 31 December 2016

Fig 12: Longer-term returns are highly probable

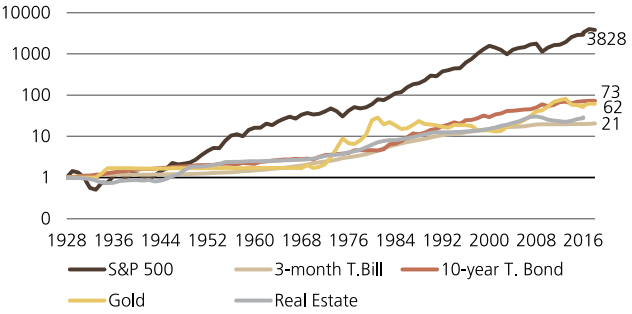
Probability of positive total returns on the S&P 500 since 1928



Source: Robert Shiller, Bloomberg, as of May 2018

Fig 13: Equities have significantly outperformed other asset classes over the long term

Total returns on various asset classes on a logarithmic scale



Source: Aswath Damodaran, Stern Business School New York University, Bloomberg, UBS, as of 2017

With a stabilizing global economy, reasonable valuations, and supportive central bank policies, investors should not dismiss the potential for significant upside for stocks. Meanwhile, a "lower for longer" outlook reaffirms that investors should remain fully invested to achieve long-term financial goals.

Plan, protect, and grow

We're in an environment in which investors need to both prepare for near-term risks and position for long-term growth. It might be tempting to try and time the market, but history shows this is almost impossible. We recommend that investors prepare their portfolios for the current market backdrop by making sure they Plan, Protect, and Grow.

Plan

Liquidity

- Short-term, lower risk, assets to maintain your lifestyle

Longevity

- Growth assets to help improve your lifestyle

Legacy

- To help improve the lives of others

Protect

- Diversify across regions
- Diversify across asset classes: don't forget bonds
- Incorporate quantitative risk mitigation strategies
- Diversify within fixed income

Grow

1. Enhance portfolio income

- Dividend Ruler and Opportunistic Equity Income (OEI) equity model portfolios
- House View Yield-Focused portfolios
- Multilateral development bank and green bonds

2. Capture secular growth opportunities

3. Tap into enduring trends

- Longer-term investments (LTIs)
- Sustainable investing (SI)
- Enabling technologies
- Sustainable value creation in emerging markets
- Business spending
- Fintech
- Sustainable investing portfolio

4. Put cash to work

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.

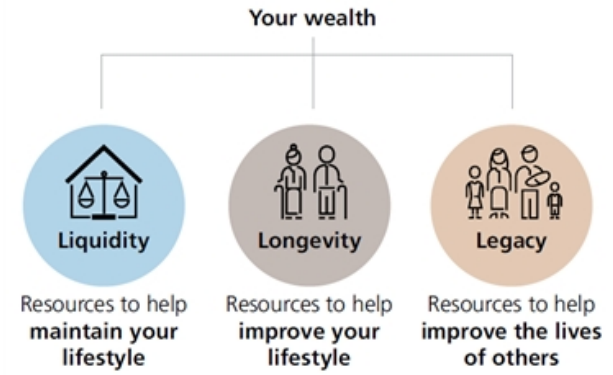
Plan

The starting point for protecting and growing your wealth is having a clear plan, linked to your financial goals. The past six months have shown how times of uncertainty create the potential for very costly investment decisions. Our Liquidity. Longevity. Legacy approach to wealth management can help you plan for your long-term goals while reducing the danger of falling prey to poor decisions during periods of market volatility.

The Liquidity. Longevity. Legacy. framework allocates your wealth into three strategies:

- **Liquidity.** A Liquidity strategy is designed to fund expenditures and meet liabilities for the next two to five years. Investments should be held in stable assets with low volatility, such as cash and/or a high quality bond ladder.
- **Longevity.** A Longevity strategy helps you meet your financial goals for the balance of your lifetime, and is characteristically well-diversified across asset classes with a growth orientation. The exact composition depends on your situation, goals, financial personality, and values.
- **Legacy.** A Legacy strategy is for assets in excess of what you need to meet your lifetime objectives. Its investment portfolios can be more aggressive and could be less liquid than those in the Liquidity or Longevity strategies given the time horizon is much longer term.

Fig 14: The Liquidity. Longevity. Legacy. approach to wealth management



Source: UBS, as of April 2019

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.

Protect

Equities are an important part of any long-term portfolio growth strategy. But slower economic growth and various macroeconomic risks mean that investors need to think carefully about downside protection. Our 1Q Investor Sentiment survey showed that 69% of investors are already hedging the downside risk in their portfolios. In our view, the most effective strategy for managing downside risk is diversification, both within equities (by diversifying across regions) and by holding the right balance of asset classes. To add a more dynamic risk-management layer, investors can consider incorporating quantitative strategies to manage the portfolio's equity allocation.

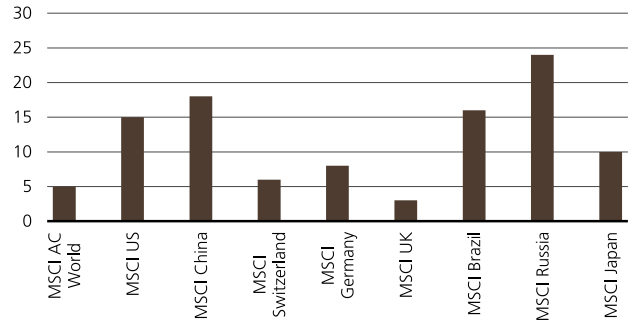
1. Diversify across regions

We are living in an era of policy experimentation. The United States' fiscal deficit is unprecedented for current stage in the business cycle, yet with "modern monetary theory" increasingly part of the policy debate deficits, could remain higher for longer. More deeply negative interest rates may have to be the response to a future Eurozone recession, given the difficulty of enacting higher fiscal spending in its current institutional structure. And while China has proven successful at employing various policy tools, its balancing act between short-term growth and long-term reform remains challenging to execute.

The only certainty is that some regions' policy remedies will prove successful, while others will prove to be failures. Concentrating wealth in individual regions near-guarantees higher volatility (every major market but the UK suffered more frequent drawdowns than global equities in 2018), and risks permanent wealth destruction in the event of major policy errors.

Fig 15: Global diversification reduces downside risk

Number of days with falls in excess of 2% in 2018



Source: Bloomberg, UBS, as of 10 April 2019

The importance of diversification is emphasized by our current tactical investment preferences.

We currently recommend a tactical overweight to both emerging markets and Japanese stocks, both of which are generally under-represented in investor portfolios. We also recommend a neutral allocation to US stocks; while they have performed very well during this bull market, and there is still room to grind higher from here, the US market is also faced by fading tailwinds and a more muted long-term return outlook.

For more on our tactical asset allocation, please refer to the latest *House View Investment Strategy Guide*.

2. Diversify across asset classes: don't forget bonds.

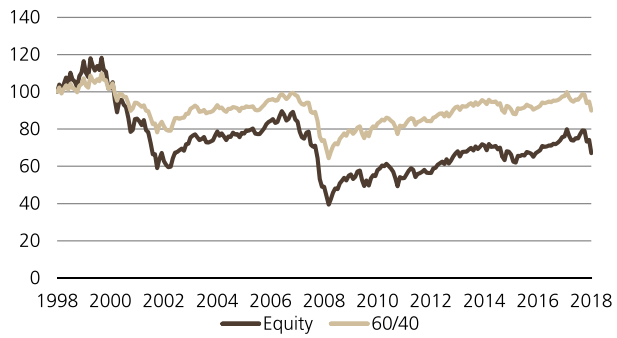
In isolation, long-duration Treasuries seem to offer a pretty poor risk-adjusted return: they exhibit high volatility, and offer little in the way of yield over cash.

This appearance has led many investors to over-allocate to cash of shorter-term bonds. In our view, this may be a dangerous approach. After all, cash does hold its value in generally all market environments but falls behind inflation over time and—perhaps more importantly—does not benefit much from a "flight to quality" during equity market corrections. Indeed, when viewed in the context of the overall portfolio, long-duration Treasuries play a key role in managing the portfolio's equity market risk.

Bonds aren't only good at limiting portfolio drawdowns; they can also help portfolios to recover from losses more quickly. For example, let's consider an investor living off of their portfolio, withdrawing 4% of the portfolio value per year (Fig. 16) during the Tech Bubble: a balanced portfolio would have outperformed an all-equity portfolio for more than 20 years.

Fig 16: Balanced portfolios are best for investors making withdrawals

Performance of hypothetical all-equity and 60/40 US stock/bond portfolios, assuming 4% annual withdrawals



Source: Morningstar, UBS, as of 2018

3. Incorporate quantitative risk-mitigation strategies

While some investors should consider the selective use of options strategies as a direct hedge, these can be relatively costly if timed poorly. An alternative strategy, which can be held strategically with a lower risk of underperforming over the long run—would be to incorporate a momentum-based strategy that cuts equity exposure during a sell-off.

By replacing a share of the investor's equity allocation with such a strategy (for example the UBS Systematic Allocation Portfolio), an investor can manage some of their portfolio risk dynamically and systematically. This approach uses a quantitative signal to determine whether conditions are favorable for risk assets, allocating more heavily to equities during times of relative economic and/or market calm, while reducing allocations during times of heightened uncertainty and/or weakening economic data.

In principle this strategy can provide downside protection during bear market environment while sacrificing less upside than traditional hedging strategies as the bull market continues. For more information about the Systematic Allocation Portfolios (SAP), please read *Systematically and dynamically managing portfolio equity risk*, published in December 2017.

4. Diversify within fixed income

a. Beyond Benchmark.

Amid the uncertain backdrop, maintaining diversification in a fixed income portfolio will remain important. We believe having a dispersion of sectors gives investors the ability to obtain extra yield in a risk-measured way. Our "Beyond benchmark fixed income investing" theme explores ways for investors to diversify away from traditional taxable fixed income benchmarks that are heavily government-weighted, such as the Bloomberg Barclays US Aggregate Bond Index. The theme incorporates a diversified mix of credit-related asset classes such as high yield (HY) bonds, commercial mortgage-backed securities (CMBS), preferred securities, and senior loans; and diversifies the government bond allocation to include Treasury Inflation Protected Securities (TIPS), agency debt, and mortgage-backed securities. The result is a mix of asset classes that offer a higher yield, and most likely improved risk-adjusted returns, over the longer term. Please read our *Beyond benchmark fixed income investing* report series for full details.

b. US senior loans: Attractive floating yield

Senior loans are attractive relative to traditional fixed income assets in the current low interest rate environment. While we do expect the Fed to remain on hold in our base case scenario, senior loans can benefit in the event that interest rates resume their upward trajectory, since they offer floating-rate coupons. The yield pick-up of US senior loans against higher quality bonds remains attractive and the default rate outlook is benign. Due to their low correlation with other asset classes, loans improve diversification of portfolios and also exhibit lower volatility than HY bonds or equities. Due to the riskier nature of HY bonds, they will usually earn more than senior loans. But in our view senior loans currently offer a more attractive risk-adjusted return outlook. Please read our *US senior loans* report series for full details.

c. Yield for the short-end

We see value in investment grade (IG) corporates with short maturities (1-3 years) given its attractive yield relative to its short duration. In fact 1-3 year IG corporates offer a roughly 80% of the broader IG index, yet with less than one-third of the interest rate risk. Earning a higher yield than the 10-year Treasury without taking on excessive credit or interest-rate risk presents an attractive risk reward opportunity, in our view. Short duration IG can also act as a dampener against an uptick in portfolio volatility. Please read our *Yield for the short-end* report series for full details.

Grow

After the recent decline in government bond yields, investors are once again focused on finding yield in other parts of your portfolio, while also maintaining diversification. Additionally, we highlight opportunities geared to secular growth and long-term trends. Last, but not least—for Investors looking to add exposure to growth assets but uncertain about the near-term outlook—we recommend phase-in strategies to help them put capital to work while mitigating short-term risks.

1. Income strategies

The recent decline in government bond yields has renewed the importance of looking for yield in other parts of your portfolio.

a. Dividend Ruler

This CIO equity model portfolio, which is benchmarked against the S&P 500 Index, emphasizes stocks with a strong track record of dividend growth and a positive fundamental outlook. Given its focus on higher-quality companies, the strategy can normally be expected to underperform in sharp upswings, but has historically added value. From its 2003 inception through March 2019, the strategy has delivered a cumulative annual growth rate (CAGR) of 10.1% p.a., versus 8.9% p.a. for the S&P 500. Please refer to our *Dividend ruler stocks* report series for full details.

b. Opportunistic Equity Income (OEI)

Benchmarked against the Russell 1000 Value Index, this CIO equity model portfolio is focused on attractively valued, high-quality companies with healthy dividend yields. The strategy has a value and income bias, currently offering a dividend yield of approximately 3.3%, versus just 2% for the S&P 500. From its 2012 inception through March 2019—a difficult period for value managers—the strategy has delivered a CAGR of 12.6%, versus 12.1% for the Russell 1000 Value Index. Please refer to our *Opportunistic Equity Income (OEI)* report series for full details.

c. House View Yield-Focused portfolios

n a low-yield world, investors looking to generate income usually face three choices: accept lower income, take more risk, or eat into principal to increase cash flow. We believe that there is a better way: re-optimizing the asset allocation process to create portfolios with a greater yield, while maintaining the benefits that come from a diversified approach.

To achieve this objective, we created the House View Yield-Focused portfolios, which are designed to provide a more balanced composition of total return, favoring income returns over capital appreciation.

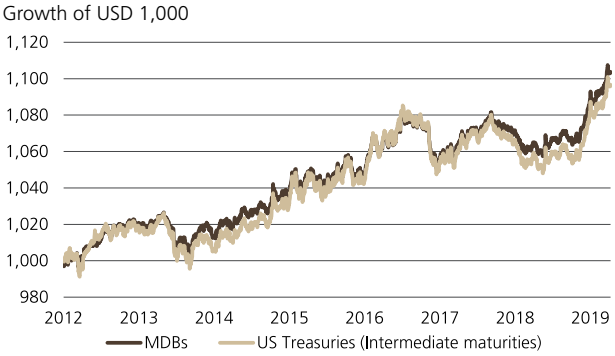
The HV Yield-Focused SAAs pursue a similar level of risk to traditional total return approaches, but with some notable allocation differences. First, they allocate to yield assets (senior loans, preferreds, MLPs, and REITs). Second, the portfolios assign a higher allocation to emerging market bonds. Lastly, the yield-focused approach adds a preference for value stocks, which tend to offer a higher dividend yield. For full details on the portfolios, please read Yield-Focused Portfolios: Efficiently Generating Income and Returns and review the asset allocations in the House View Investment Strategy Guide.

d. Multilateral development bank (MDB) and green bonds

Within fixed income, investors can boost yields—while retaining similar risk characteristics—by switching some of their government bonds into MDB bonds and shifting some IG corporate bonds into green bonds.

MDB bonds have delivered similar long-term returns to US Treasuries and currently offer a modest yield pick-up, while green bonds has demonstrated risk and return characteristics that are very similar to traditional corporate bonds. In both cases, investors can gain the added benefit of using their capital to help support global development and environmental goals. This is part of the approach we've taken within the House View Sustainable Investing (SI) strategies. See the House View Investment Strategy Guide or visit our SI website.

Fig 17: Global Multilateral Development Bank Index versus US Treasuries



Source: ICE, Bloomberg, UBS, as of 10 April 2019

2. Secular growth strategies

a. Quality Growth at a Reasonable Price (Q-GARP)

This CIO equity model portfolio, which is benchmarked against the Russell 1000 Growth Index, emphasizes high quality businesses with attractive growth and reasonable

valuations. From its 2007 inception through March 2019, the strategy has delivered a cumulative annual growth rate (CAGR) of 11.2% p.a., versus 9.8% for the Russell 1000 Growth Index. Please refer to our *Quality Growth at a Reasonable Price (Q-GARP)* report series for full details.

b. Mid cap

Benchmarked against the Russell Midcap Index, this CIO equity model portfolio is focused on high-quality mid-cap companies with sustainable revenue and earnings growth trading at attractive valuations. From its 2013 inception through March 2019, the strategy has returned a CAGR of 11.7%, versus 10.2% for the Russell Midcap Index. Please refer to our *Mid cap* report series for full details.

3. Tapping into enduring trends

a. Longer-term investment themes

Long Term Investments (LTIs) are themes designed to tap into emerging secular trends and enduring structural changes. This series of themes is focused on three major trends—population growth, urbanization, and aging.

Within this LTI series, we have developed a suite of 19 sustainable investment themes—ranging from energy efficiency to automation and robotics and from education services to emerging market healthcare—to invest in long term solutions to the environmental and social challenges posed by these trends. For more information, including a complete list of the themes—and to learn how these investments are helping to ensure access to basic resources and services for current and future generations—please visit our LTI website.

b. Sustainable investing (SI)

Evidence suggests that sustainability integration can enhance long-term risk-adjusted rates of return. SI approaches have grown significantly in popularity as investors have seen the benefit of incorporating environmental, social, and governance (ESG) standards alongside traditional financial analysis.

Moving beyond simply using an exclusion process to avoid certain stocks and industries, modern sustainable investing strategies fully integrate SI analysis into the entire portfolio and across asset classes. By helping investors avoid firms that are exposed to potential tail risks like environmental accidents or punishment from regulators, we believe that SI has the potential to enhance risk-adjusted returns. This has been borne out by the research to date, with over 90% of academic studies showing that incorporating ESG standards has either a neutral or positive impact on returns.

To begin incorporating this approach in your portfolio, consider our House View Sustainable Investing portfolios. Full details can be found in the House View Investment Strategy Guide. Please also read our SI white paper, Investing for returns and for good.

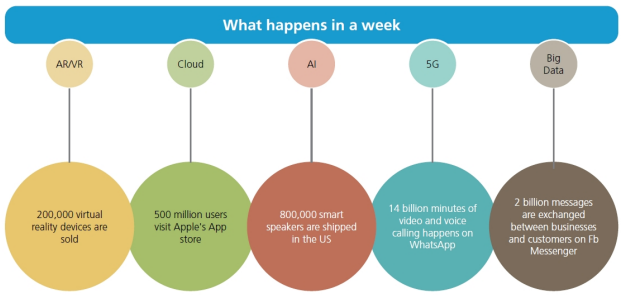
c. Enabling technologies

Our Enabling technologies LTI theme focuses on five mainstream enabling technologies: artificial intelligence (AI), augmented reality/virtual reality (AR/VR), big data, cloud computing, and 5G.

Together, these frontiers are set to transform industries—and society—over the next decade. Tech devices and advances have already disrupted every aspect of our lives, and spending on the underlying enabling technologies that enable their development and production look set to remain high over the next decade as both disrupting and incumbent companies continue to invest to grab or defend market share.

To help investors benefit in this trend, we recommend allocating capital to a diversified portfolio of equities across industries—such as software, semiconductors, hardware, internet, IT services, and select industrial companies—which are best positioned to benefit from the growth of these enabling technologies.

Fig. 18: An average week in the life of enabling technologies



Source: Company reports, Facebook, Apple, eMarketer, IDC, Bloomberg Intelligence, UBS

d. Sustainable value creation in emerging markets

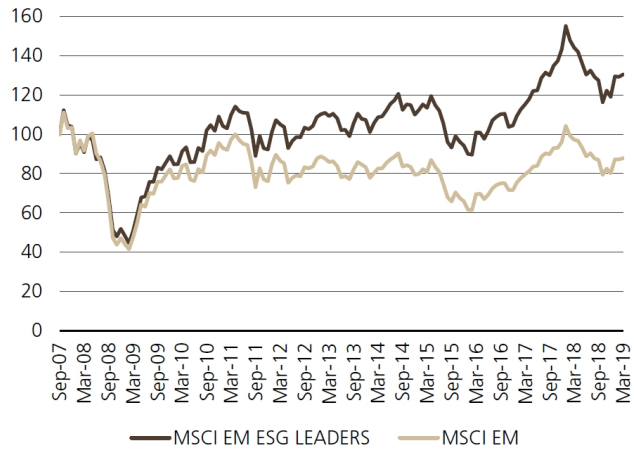
EM equities may be a surprising place to consider incorporating environmental, social, and corporate governance (ESG) considerations. Even so, academic studies—and our own analysis published over the last few years—suggest that emerging markets may actually be a uniquely suited area for incorporate such ESG considerations alongside traditional investment analysis.

In particular, research suggests that higher ESG standards can help reduce exposure to tail risk events. In addition,

using ESG considerations can help investors benefit from the rising demand for sustainable investing, especially in EM investor circles. To date, this strategy has demonstrated value, with the MSCI EM ESG Leaders Index steadily outperforming the broader EM equity market (Fig. 19). While past performance is no guarantee of future performance, we believe this trend can continue.

Fig. 19: ESG considerations have helped investors manage EM equities

Growth of USD 100



Source: MSCI, UBS, as of 31 March 2019

e. Business spending

Despite this expansion's age, we don't expect it to end anytime soon. If anything, due to few signs of overinvestment, it can continue for several years before reaching a bottleneck. Against this backdrop, we expect business spending to continue growing. In fact, we could see a reacceleration as trade tensions fade and the global economy moves past yet another "soft patch" of growth data.

To tap into this trend, we advise investors to focus on the technology, industrials, real estate, and financials sectors. Higher IT spending should benefit enterprise technology companies, and factory automation investments will help to drive higher earnings for software companies with exposure to this business segment. The capital goods subsector should benefit from higher commodity and industrial spending, so this is our preference within industrials. The growing demand for data centers can help that segment of the real estate sector, while financials are due to benefit from increased loan demand and debt and equity issuance in support of the overall uptick in commercial investment spending.

f. Fintech

Driven by rapid urbanization, strong demand from millennials, and favorable regulations, we believe the global fintech industry is at an inflection point and set to drive a major digital transformation of financial services. Fintech's solid long-term outlook offers investors above-average growth opportunities, in our view. To benefit from this trend, we recommend investors focus on leading payment players, platform companies, and disruptors in emerging technologies like blockchain and artificial intelligence.

4. Putting cash to work

Many investors understand the potential long-term growth opportunities in markets, but find themselves waiting for the right time to buy. Markets are often uncertain, making it difficult to put cash to work with confidence, but market timing is difficult (to say the least), and holding cash in the hope of a market pullback can be costly.

To see how easy it can be to get 'stuck on the sidelines' waiting for the right time to buy, try our market timing game, which uses real historical market returns to show how rare and temporary equity market losses tend to be. This exercise would be even more difficult for diversified portfolios, so we've developed a handful of strategies to help investors put funds to work more quickly, while mitigating the risk of "bad timing."

First, phasing capital into markets over time can be an attractive strategy, allowing investors to build a portfolio befitting their financial goals while also reducing the emotional stress of going "all-in" at once. We believe the best strategy is to establish a set schedule, and to commit to deploying the next phase-ins tranche if there is a market dip of at least 5%. This threshold is common enough to occur frequently during three- to 12-month phase-in processes, offering investors an opportunity to accelerate phase-ins.

Putting cash to work all at once is still the best approach, on average, but a phase-in approach helps to mitigate the cost of waiting. To further reduce this cost, we recommend putting all of the fixed income allocation to work straight away and only phase the equity allocation into the market. Investors can also use options strategies to improve outcomes: for example, 'put-writing' strategies can allow investors to commit to buying stocks if there is a market decline, while also earning a premium while they wait for one. In addition, buying call options can help give investors exposure to market upside while limiting their downside exposure. For more detail, please read *How should investors deal with lump sums?*

Appendix

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