Switching channels

**House View Website:** Visit our mobile-friendly website, ubs.com/houseview, to experience our monthly publication online.
Dear reader,

Over the past month, two geopolitical risks—US-China trade tensions and Brexit—have abated. Although neither has been resolved (nor does a final resolution look imminent), global stocks have reversed their August weakness and rallied back to within a hair’s breadth of another all-time high. As we discuss in this month’s Feature article, it’s too early to signal the all-clear, or to dismiss these important issues, but the current respite does allow us to focus more on economic fundamentals, which are currently giving mixed signals that reinforce our cautious—but not bearish—tactical positioning.

Our Thematic Spotlight also explores a change in perspective. While many investors are rightfully focused on managing the risks of the current late cycle environment, we also recommend looking beyond the cyclical turbulence. For example, our “Power of the internet” theme looks at stocks that provide exposure to secular growth trends such as the e-commerce and digital advertising, yet also trade at undemanding valuations.

As discussed in our Asset allocation implementation section, we continue to recommend a modest underweight to stocks versus bonds. As a reminder, our Detailed asset allocation section is available as a standalone report, available at ubs.com/houseview.

Regards,

Mike Ryan

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Mike Ryan, CFA
Chief Investment Officer Americas,
Global Wealth Management

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7 November 2019
1:00 PM ET
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A dial in is also available
Dial in: 1-877-200-4456
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Watch this month’s in context video featuring Jason Draho, Head of Asset Allocation Americas.
CIO Preferences

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This is a visual summary of our preferences. For the full detailed asset allocations see our full detailed asset allocation tables report.

**Important note:** The next edition of the *UBS House View: Investment Strategy Guide* will be published in January 2020. For asset allocation updates during the remainder of the year, please reference the *UBS House View Monthly Letter*. We will also publish our *Year Ahead 2020* outlook in November.

**Overweight**
Tactical recommendation to hold more of the asset class than specified in the moderate risk strategic asset allocation.

**Underweight**
Tactical recommendation to hold less of the asset class than specified in the moderate risk strategic asset allocation.

**Neutral**
Tactical recommendation to hold the asset class in line with its weight in the moderate risk strategic asset allocation.
Switching channels

Shifting focus
Progress on Brexit and the US-China trade dispute may allow investors to focus less on geopolitics and more on the economic fundamentals, but trade will continue to play a key role in shaping the outlook.

Caution warranted
Signs of improvement in manufacturing and investment have been accompanied by softness in consumer data, while some forecasts for corporate earnings look too optimistic.

Recession unlikely
Monetary policy will continue to limit recession risks, but we don’t expect sufficient fiscal stimulus to move markets much higher.

Asset allocation
We prefer US equities over Eurozone stocks and prefer hard currency debt relative to equities in emerging markets.

The UK’s Sky News has launched a “Brexit Free” channel, specifically excluding news items related to the UK’s departure from the EU. But while UK viewers have the luxury of switching channels at any time, investors often feel compelled to watch whatever is moving the markets day to day.

Will a resolution of trade tensions and a Brexit deal allow investors to switch their focus from geopolitics to fundamentals? And if they do, will they find a thriller or a horror show?

First, it is too early to say whether the trade drama will subside, as no US-China deal has yet been signed, Europe has threatened retaliation for recent US tariffs, and US congressional discussions regarding Hong Kong threaten to complicate the picture. Second, economic and earnings data remain mixed. We see scope for some disappointment to consensus earnings forecasts, with Eurozone and emerging market (EM) equities looking particularly vulnerable. Third, while there are some grounds for optimism on fiscal policy stimulus, in our view there is little hope for meaningful policy expansion unless the economy deteriorates.

On balance we continue to focus on earning yield rather than looking for higher equity prices. It is certainly possible that equities finally break out of their last six months’ trading range, for example in the event of a positive surprise on US-China trade such as an indefinite suspension of the December tariff increase, or a better-than-expected recovery in manufacturing. However, after a strong year for balanced portfolios, we think it is prudent to be more critical about the current valuation, growth, and geopolitical outlook.

Our current positioning includes a modest overall underweight to equities with a preference for US equities relative to Eurozone stocks and a relative value trade in emerging markets preferring hard currency sovereign debt.

We think it is prudent to be more critical about the current valuation, growth, and geopolitical outlook.

Mark Haefele
Global Chief Investment Officer
Wealth Management

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**US-China**

President Trump now appears more willing to consider a partial deal, focused on the US postponing tariff increases in exchange for China purchasing more agricultural products. This may reflect a loss of momentum in the US economy now that the stimulus from tax cuts has faded. Our view of the Chinese perspective is that while domestic media coverage has managed down expectations, China may be prepared to agree to an interim deal, provided it is based on “mutual respect”. In our view, this means two-sided enforcement mechanisms and reciprocity in areas such as intellectual property and market access. We think China is prepared to negotiate national security issues separately from the trade issue.

But even a limited deal is not certain. The US has postponed October’s tariff increase, but China is reported to want a tariff cut and the December increase canceled as part of the deal. Meanwhile, even if agreed, there are still hurdles to overcome. We think President Trump’s announcement of a Chinese commitment to buy USD 40–50bn of US agricultural products appears unrealistic – US exports to China peaked at just USD 26bn in 2012, when prices were much higher – and a shortfall on agreed agricultural purchase commitments might well lead to a re-escalation in the conflict further down the road. Businesses may continue to restrain spending in anticipation of a re-escalation. And the US economy still needs to absorb the effect of tariff increases put through in September.

**Economic data**

Beneath the geopolitical noise in recent months, the market has generally developed a consensus of “manufacturing and investment bad; consumer and employment good”. So in the months ahead investors are likely to be looking for signs of change in that consensus – i.e., a bottoming in the manufacturing data, or evidence that the consumer is beginning to suffer.

We think there may be cause for cautious optimism in recent investment data. We are doubtful that businesses are going to embark on a spending spree even if there is an interim US-China trade deal. However, there are early signs of stabilization in capital expenditure, which we think may have already slowed to maintenance levels,

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**Figure 1**

**Capital expenditure may be at a trough**

OECD gross fixed capital formation annual growth rate, quarterly data, in %

![Graph showing capital expenditure]

Source: OECD, as of October 2019
suggesting limited further downside. Growth in OECD capital expenditure declined from an annual rate of 5% in mid–2017 to less than 1% in 1Q19, but ticked higher in 2Q19, the latest quarter for which data is available.

In China, meanwhile, cooling property and manufacturing fixed asset investment is being partly offset by increased growth in government-backed infrastructure investment. Chinese industrial production growth also unexpectedly rebounded to 5.8% year-over-year in September, from a 17-year low of 4.4% in August.

Despite some better news on manufacturing and investment, indications on the consumer and employment have become less encouraging. In September, US retail sales unexpectedly dropped for the first time in seven months. Elsewhere, the US ISM non-manufacturing employment component has fallen to the lowest level since 2014. We also think US continuing jobless claims are likely to rise in the months ahead. Although much of this can be explained by seasonal adjustments, the move might be hard for the market to overlook entirely.

**Corporate earnings**

With the 3Q earnings season underway, investors are likely to question whether current consensus global earnings forecasts of roughly 10% growth in 2020 are realistic.

We think US earnings will modestly bounce back next year, after coming in roughly flat in 2019. Although we forecast just 5% earnings per share (EPS) growth in the US next year versus consensus of 10%, this gap is close to normal given the trend for bottom-up estimates to be revised down over the course of a year. In Japan we expect EPS growth of 1% compared with market forecasts of 6%, but this gap is also relatively small. In addition, Japanese equity market performance has lagged other markets in recent months, delivering total returns of 12% this year compared with 18% for global stocks.

But we think analysts may be too optimistic on EM and Eurozone earnings. The gap between our estimates and consensus is widest in the Eurozone, where we expect a further contraction in EPS of 3% in 2020, compared with consensus forecasts for 10.5% growth. In emerging markets, our estimate is for 6.5% EPS growth next year against a consensus of 14.1%. Despite the greater scope for earnings downgrades, the Stoxx Europe 600 has risen 7.6% and the MSCI EM index 7.9% since the August

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**Figure 2**

**Corporate earnings may disappoint**

Annual growth in earnings per share, in %

![Graph showing earnings growth](source: Factset, UBS, as of 22 October 2019)
flows on increased optimism about a resolution to the US-China trade dispute. In contrast the S&P 500 has gained only 5.5% over the same period.

Within emerging market equities we prefer Chinese stocks. Although China is clearly exposed to the trade conflict with the US, only 2% of listed companies’ sales go to North America, and the Chinese authorities are stimulating the economy in response to the conflict.

**Fiscal and monetary expansion**

If investors turn their attention further from trade they are also likely to consider the prospects for policy stimulus. In our view, the policy outlook remains supportive of continued sluggish expansion.

We remain confident that central bank actions will continue to limit the risk of a US or global recession and the chances of a major sell-off in risk assets. The effects of lower rates could be more keenly felt if political uncertainty ebbs. Lower rates for longer also lead us to expect bond yields to remain under pressure, increasing the relative attractiveness of equities versus fixed income. Equity risk premiums are currently 6%, above the long-run average of less than 4%.

There is also scope for optimism on an increased role for fiscal policy in supporting the economic expansion. Recent reports suggest that Germany’s CDU may be willing to step away from its commitment to a “black zero” balanced budget policy in case of a downturn. The UK is likely to see an increase in government spending after Brexit, regardless of who wins a future general election. And the US presidential election is unlikely to be fought on policies of fiscal prudence.

However, we continue to doubt that policymakers are in a position to act preemptively and drive meaningful upside in risk assets. On the fiscal side, the Eurozone remains constrained by budget rules, Congress will likely limit further fiscal expansion in the US for at least another year, and China will remain focused on the risk of rising debt. Meanwhile, the effectiveness of monetary policy is diminishing, and a partial resolution to trade and Brexit uncertainties may lead central bankers to feel less need to deliver insurance rate cuts and drive higher discount rates for risky assets.
**Asset allocation**

The US-China trade conflict is a key near-term variable. An interim agreement, if reached, would remove a source of downside risk. In a scenario in which the US ISM manufacturing index recovers to 55, we estimate the S&P 500 could reach 3,170 (5% upside), with 4% upside coming from earnings upgrades and 1% coming from multiple expansion.

But it isn’t clear that an interim deal would be sufficient to allay investors’ concerns about the economic, earnings, and policy backdrop. Markets are also unlikely to fully dismiss the risk of a future re-escalation after the dramatic highs and lows the trade conflict has seen in the past year. On balance the impact the tensions are having on economic data is one reason we continue to focus on earning investment yield, more than looking for higher equity prices.

This month we highlight three main investment ideas: overweight US stocks relative to their Eurozone counterparts, a relative value trade in emerging markets, preferring credit to equities, and trimming—but maintaining—exposure to the British pound.

- **We prefer US equities to Eurozone equities.** Given ongoing concerns over a global economic slowdown and trade tensions, we think the Federal Reserve has more leeway to act than the European Central Bank (ECB), which has already announced a return to quantitative easing. In addition, consensus expectations for earnings growth look more realistic in the US than in the Eurozone, in our view. For investors who can implement options, a small allocation to protective put options on the S&P 500 may be worthwhile in the event of a more marked equity slowdown.

- **In emerging markets, we prefer credit to stocks.** Emerging market stocks are geared to the global economic cycle and heavily exposed to an escalation in trade tensions. Inflation in the region is moderating, central banks are easing policy, and while growth is slowing, there are no immediate signs of a hard landing. That backdrop is supportive for bonds so we prefer to take emerging market exposure via the EMBIGD Index, which has an attractive 310 basis points (bps) spread over Treasuries, and is more regionally balanced (with less than 20% weight in Asia and just 4% in China).

- **We trim, but maintain, exposure to the British pound.** The British pound (GBP) has rallied about 3% versus the US dollar since we introduced our tactical overweight in the FX strategy. We recommend taking this opportunity to lock in these tactical profits, but sterling remains undervalued, so we continue to recommend that investors with UK assets own them without a currency hedge to maintain exposure to the pound’s long-term appreciation potential.

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**Receding risk of a no-deal Brexit has boosted sterling**

GBPUSD daily data

![GBPUSD daily data chart](source: Bloomberg, as of 23 October 2019)
We have also made the following changes to our asset allocation:

- **Within our FX strategy, we close our overweight to the Norwegian krone versus the euro and the Canadian dollar.** Though Norwegian inflation and growth have been relatively stable since we opened our position, and the nation’s central bank has raised rates four times over the 14 months, the risks to our position have materialized. Low liquidity amid global growth concerns has weighed on the Norwegian krone, even against the euro, which has weakened generally on dovish ECB policy. The krone has also weakened against the Canadian dollar, which has been stable as the Bank of Canada has been more reluctant to follow the Fed in easing.

We also hold the following positions:

- **We overweight US TIPS versus nominal US government bonds.** Given the Fed’s stated goal of raising inflation expectations, we prefer to “not fight the Fed” by maintaining our overweight in US Treasury Inflation Protected Securities (TIPS) against nominal US government bonds. This is effectively an overweight in breakeven inflation expectations, the metric the Fed is trying to raise.

- **Within our FX strategy, we overweight select high-yielding emerging market currencies (IDR, INR) versus a set of lower-yielding currencies (AUD, TWD).** The Indonesian rupiah and the Indian rupee boast a yield advantage of around 5–5.5% and 4.5–5% respectively versus the US dollar. With global economic growth sluggish, domestic-demand oriented economies like Indonesia and India are more insulated from weakening external demand, providing some protection against an escalation in trade tensions.

- **Within our FX strategy, we underweight the Australian dollar versus the US dollar.** Due to the Australian economy’s heavy exposure to China, which faces its own deceleration, the Australian dollar is often seen as a proxy for Chinese growth. While there has been a slight drop in unemployment in Australia in the past month, the labor market remains weak. Both of these factors could lead the Reserve Bank of Australia to become even more dovish, setting the stage for further easing.

Mark Haefele
Chief Investment Officer
Global Wealth Management

Watch this month’s in context video featuring Jason Draho, Head of Asset Allocation Americas.
Asset allocation implementation

The UBS House View is our current assessment of the global economy and financial markets, with corresponding investment recommendations. The asset allocation implementation of this view can vary across model portfolios, depending on their objectives.

Our Tactical Asset Allocation (TAA) recommendations

Overweights
- China and Brazil equities (all-equity portfolio)
- Treasury Inflation-Protected Securities (TIPS)
- Emerging market (EM) USD-denominated sovereign bonds

Underweights
- US government bonds
- International developed market equities
- Emerging market equities

What’s changed
- No changes this month

Implementation guidance

The economic and market environment has experienced positive and negative developments the past month. The positives are the growing likelihood that the US and China sign a partial trade deal in November and the prospect of a completed Brexit deal by year-end. Countering this was disappointing US data on business sentiment, industrial production, and retail sales. This hasn’t changed the fundamental economic outlook, but it could be at least a few months before the global economy improves. While overall the developments are positive, the good news is already priced into equity and bond markets. Consequently, we continue to modestly underweight equities versus fixed income. Equities and rates are likely to stay range bound until the growth outlook is clearly on the upswing, or the positive policy developments fizzle out.

Equities
We maintain our preference for US equities over ex-US stocks (the Eurozone and emerging markets in particular). The economy in the US should be more resilient than these regions and US stocks benefit from their growth and domestic consumer-oriented composition. Additionally, Eurozone and emerging market economies are more sensitive to the ongoing trade tensions between the US and China, and should tensions flare up further from here, US equities would likely outperform these regional markets.

Within our all-equity portfolio, we maintain the preference for Japanese equities versus international developed market equities. They are pricing in more of the growth slowdown and in a recession the yen should appreciate against the US dollar, offsetting any equity weakness. We keep our preferences for China and Brazil within EM. China is attractive on the prospect of more policy stimulus, while Brazil stands out for an improving macro outlook and progress on major structural reforms.

Among US equity sectors, we remain tilted to a more balanced and defensive allocation. We prefer consumer staples (improving fundamentals in a low beta sector), consumer discretionary (consumer spending is solid) and communication services (defensive growth) sectors. We balance this with underweights to industrials and energy (both exposed to the global cycle) and tech, which is expensive relative to the overall market and is vulnerable to weaker enterprise IT spending given uncertainty in the global trade outlook.

Fixed income
We maintain our overweight position to emerging market US dollar-denominated sovereign bonds. These bonds have an attractive yield near 5%, which is especially favorable considering that roughly USD 13tr of bonds globally now offer a negative yield. The position provides attractive interest rate carry without taking excessive risk, as these bonds have historically delivered strong risk-adjusted returns. We maintain a position in TIPS versus US government bonds to position for rising inflation expectations, which have risen modestly month-on-month. They’re inexpensive and lifting them is a primary goal for the Fed.

Full detailed asset allocation tables
View our full set of asset allocation tables for guidance on positioning across different investor types, portfolio strategies, and risk tolerances.

A note on TAA scaling
Unless noted otherwise, the TAA percentages on this page refer to a Moderate risk profile. Generally speaking, we apply a scaling methodology to TAA tilts for lower-risk portfolios, so that a 2% overweight in the Moderate risk profile reflects as a 1.5% and 1%, respectively, in the Moderately Conservative and Conservative profiles.
Non-taxable investor
Moderate risk, without non-traditional assets

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| Fixed Income                  | 46.0         | +2.0                           | 48.0        |
| US Gov’t Fl                   | 16.0         | -2.0                           | 14.0        |
| US TIPS                       | 0.0          | +2.0                           | 2.0         |
| US Treasuries (long)          | 0.0          |                                |             |
| US Municipal                  | 0.0          |                                |             |
| US IG Corp Fl                 | 21.0         |                                |             |
| US HY Corp Fl                 | 5.0          |                                |             |
| Int’l Developed Fl            | 0.0          |                                |             |
| Emerging Markets Fl           | 4.0          |                                |             |
| EM Local Currency Fl          | 0.0          |                                |             |
| EM Hard Currency Fl           | 0.0          | +2.0                           | 2.0         |

| Equity                        | 49.0         | -2.0                           | 47.0        |
| US All Cap                    | 0.0          |                                |             |
| US Large Cap Growth           | 9.0          |                                |             |
| US Large Cap Value            | 9.0          |                                |             |
| US Mid Cap                    | 5.0          |                                |             |
| US Small Cap                  | 3.0          |                                |             |
| Int’l Developed Markets       | 17.0         | -1.0                           | 16.0        |
| Japan                         | 0.0          |                                |             |
| Emerging Markets              | 6.0          | -1.0                           | 5.0         |

- **Overweight**: Tactical recommendation to hold more of the asset class than specified in the moderate risk strategic asset allocation.
- **Underweight**: Tactical recommendation to hold less of the asset class than specified in the moderate risk strategic asset allocation.
- **Neutral**: Tactical recommendation to hold the asset class in line with its weight in the moderate risk strategic asset allocation.

“Emerging Markets Fl” is a blend of 50% local currency, 50% hard currency.

Source: UBS

Risk profile implementation guidance

Tactical positioning for the Moderate portfolio is applicable for other risk profiles, with adjustments. While we closed the long-maturity Treasury allocation in Conservative to Moderate portfolios in August, we continue to recommend them in Moderately Aggressive and Aggressive portfolios that have high equity allocations. Longer-duration Treasuries are very effective diversifiers in portfolios with high equity risk, but the interest rate risk that they entail is less desirable in Conservative portfolios.

In Aggressive portfolios we recommend 20-30 Treasury strips paying only principal in place of 20+ year Treasury bonds, while the latter are sufficient protection for Moderately Aggressive portfolios. STRIPS have longer duration and thus offer more protection during a sustained economic slowdown when rates are likely to fall, but they’re also more volatile.

The TIPS allocation is appropriate for all risk profiles, but longer maturity TIPS (10+ years) are better for Aggressive portfolios because of their longer duration. In Conservative portfolios shorter maturities (0-5 years) are recommended because they have lower rising rate risk.
Bull Market Monitor

Equity bull markets rarely end in the absence of a recession occurring, which is why we track key attributes of the business cycle to gauge how the expansion is evolving and calculate the risks of a recession.

**Cycle status**
We think that the US business cycle has transitioned to the late stage. Growth decelerating from its peak toward long-term potential and Fed monetary policy being roughly neutral are the two characteristics typical of a late-cycle economy. The good news is that the economy can be late-cycle for a long time. Last year, our main concern was that the economy would overheat, forcing the Fed to tighten monetary policy and causing the cycle to end. More recently growth has slowed and the Fed has been cutting rates. The main risk now appears to be that the economy will simply continue slowing until a recession begins.

**What’s new?**
The US and China have made progress in trade negotiations. The increase in US tariffs from 25% to 30% scheduled for 15 October was postponed, and China has resumed purchases of US agricultural products. Negotiations on completing a “Phase 1” deal continue with the aim of President Trump and President Xi signing an agreement when they meet at the November APEC summit. Economic data in recent weeks has mostly surprised to the downside; we believe that noise in the data is at least partially responsible for this after stronger data in previous weeks. Consumer spending continues to be the main engine of growth, while business investment is soft. Job growth has slowed but is still strong enough to keep the labor market tight. The ISM manufacturing PMI fell further below 50 in September. Housing data suggests that lower mortgage rates are providing a boost. We lower our growth indicator to slightly below neutral. The yield curve has moved out of inversion, with 10-year Treasury yields back above 3-month yields. Inflation data has been stronger in recent months. Credit spreads on corporate bonds are fairly tight. The Fed cut rates by 25 basis points (bps) in both July and September. The market is pricing in a high probability of another cut at the next FOMC meeting on 30 October.

**What are we watching?**
We are focusing on signs that business demand for labor is slowing, as this could undermine the outlook for consumer spending and increase the risk of recession. In addition to the US-China trade dispute, a decision on auto tariffs should be made by November. Overseas, we are keeping an eye on both slowing growth and political issues with the potential to rattle markets.

**What are the investment implications?**
Risks for the economy are skewed to the downside. We remain underweight equities in our tactical asset allocation.

**Key cycle indicators**
The cycle indicators gauge whether the economy is overheating and if financial conditions are restricting growth. These determine our assessment of where we are in the cycle.

- **Current month: ▼** Last month: ▼
- **Overall: Late cycle**
  - Early
  - Late

**Overheating indicators**
- **Growth (relative to potential)**
  - Below
  - Above
- **Labor market**
  - Weak
  - Tight
- **Inflation (relative to 2%)**
  - Below
  - Above

**Financial indicators**
- **Monetary policy**
  - Accommodative
  - Restrictive
- **Yield curve**
  - Steep
  - Inverted
- **Credit conditions**
  - Loose
  - Tight

Each indicator is evaluated relative to a neutral level that is sustainable over time in order to determine whether the economy is at risk of overheating or if financial conditions will start to restrict growth.
The US 3Q earnings season kicked off earlier this month and 45% of the S&P 500 by market cap has now reported results as of 24 October. So far results have been mostly in line with our expectations, with 77% of companies exceeding EPS estimates. Earnings are tracking slightly better than our outlook for a 2% decline.

Meanwhile, US economic data disappointed in October. Retail sales unexpectedly posted the first decline in seven months, and the US ISM manufacturing index print hit a decade-low at 47.8.

On the trade front the US and China made progress in negotiations. The increase in US tariffs from 25% to 30% scheduled for 15 October was postponed, and negotiations on completing a Phase 1 deal will continue with the aim of having President Trump and President Xi sign an agreement when they meet at the November APEC summit in Chile.

For the first time, UK Members of Parliament delivered a majority in favor of a deal to leave the EU. MPs voted by a majority of 329 to 299 to support Boris Johnson’s call for a December election, which requires a two-thirds majority. We remain positive on sterling.

US corporate earnings look likely to decline in 3Q, the first quarterly contraction since 2016. But consensus forecasts for a 4% contraction look overdone. With weakness concentrated in a few sectors, median company results will be more resilient. For full year 2019 we still forecast modest earnings growth but expect a fairly muted outlook for many companies in economically-sensitive industries. We maintain a modest underweight to equities and prefer US versus Eurozone stocks within international developed markets.

Faced by geopolitical uncertainty, a slowing global economy and equity markets that have been making little headway, investors may be tempted not to stay invested. But holding cash is costly, both in terms of loss of purchasing power and opportunity cost. Instead, there are strategies that investors can use, including adopting a longer time horizon, and diversifying across asset classes and geographic regions, to reduce investment risk while remaining invested.

Could investors benefit from negative rates?

Central banks are back in easing mode, as global growth has slowed. Markets are now pricing in negative policy rates in the Eurozone and Switzerland for over a decade to come. This is a challenge for investors seeking a risk free rate of return. In this environment we favor income-generating investments, including hard currency emerging market bonds and select high yielding currencies. Lower rates also increases the appeal of borrowing—whether to improve returns or fund spending. While this comes with risks that need to be managed, borrowing can help investors achieve their financial goals.

Questions we’re tracking

Can the US and China finalize a trade deal?

The US and China have agreed in principle to a partial trade deal. China will buy more US agricultural products; the US has postponed October’s planned tariff increases and talks will continue. But a number of issues were either left unresolved or unclear. Not enough was achieved to alter the global economic outlook meaningfully, in our view. Global growth is slowing and below trend; there is scope for earnings disappointment; and uncertainty keeps weighing on business investment. We maintain a modest underweight to equities.

Can the British pound hold on to its gains?

For the first time the UK Parliament has agreed on a deal to leave the EU, and sterling has gained more than 5% versus the USD since its 9 October low. But obstacles remain before an exit is possible. The government’s fast-track timetable has been voted down, making an extension from the EU necessary. But the EU is delaying a decision until the UK Parliament votes on Prime Minister Boris Johnson’s call for a December election, which requires a two-thirds majority. We remain positive on sterling.

Should investors fear the US 3Q earnings season?

US corporate earnings look likely to decline in 3Q, the first quarterly contraction since 2016. But consensus forecasts for a 4% contraction look overdone. With weakness concentrated in a few sectors, median company results will be more resilient. For full year 2019 we still forecast modest earnings growth but expect a fairly muted outlook for many companies in economically-sensitive industries. We maintain a modest underweight to equities and prefer US versus Eurozone stocks within international developed markets.

Is now the right time to invest?

Faced by geopolitical uncertainty, a slowing global economy and equity markets that have been making little headway, investors may be tempted not to stay invested. But holding cash is costly, both in terms of loss of purchasing power and opportunity cost. Instead, there are strategies that investors can use, including adopting a longer time horizon, and diversifying across asset classes and geographic regions, to reduce investment risk while remaining invested.

Could investors benefit from negative rates?

Central banks are back in easing mode, as global growth has slowed. Markets are now pricing in negative policy rates in the Eurozone and Switzerland for over a decade to come. This is a challenge for investors seeking a risk free rate of return. In this environment we favor income-generating investments, including hard currency emerging market bonds and select high yielding currencies. Lower rates also increases the appeal of borrowing—whether to improve returns or fund spending. While this comes with risks that need to be managed, borrowing can help investors achieve their financial goals.
Looking beyond the turbulence

The world’s longest flight—a 19.5-hour haul from New York to Sydney—recently made its maiden voyage. If just thinking about that flight makes your legs cramp and gives you a sense of claustrophobia, you’re not alone. A similar sense of unease has also seeped into the minds of investors, especially as the longest-ever economic expansion and bull market experiences yet another soft patch, this time due to trade tensions and weaker manufacturing growth.

In uncertain times, investors tend to gravitate toward defensive sectors, hoping to protect themselves against a possible downturn in the economic cycle. While such adjustments can be worthwhile, we also recommend looking beyond the cyclical turbulence to seek opportunities in attractively priced secular growth stories.

In our view, internet stocks are one of the rare areas where investors can tap into enduring consumer-related secular growth trends, such as e-commerce and digital advertising, at undemanding valuations. In light of these market dynamics, we have launched a new theme to capture this opportunity, *US equities: The power of the internet*, which recommends exposure to the Nasdaq Internet Index.

Our view on internet companies fits with our current equity sector preferences. Internet companies are primarily associated with the communication services and consumer discretionary sectors, both of which we are overweight in our US equity sector strategy. Although internet companies are sensitive to global growth, they are also exposed to US consumers, who remain a bright spot in the economic backdrop. Similarly, in China we see long-term potential growth for the consumer segment, as a greater portion of the population moves into the middle class. We are underweight the technology sector, but the IT services and software sub-sectors to which this index is exposed have healthy secular growth prospects and are less exposed to rising tariffs than tech hardware and semiconductors.

We also see this theme as relatively insulated from trade uncertainty. Large internet companies tend to be domestic or regional champions. For instance, large US internet companies have little to no exposure to China, while the large Chinese companies derive the majority of revenue within China. Index constituents in the consumer services industry are similar in that the large Chinese companies tend to operate almost entirely within their borders, while the US constituents’ revenues are largely domestic or from regions outside of China. Lastly, software companies, which represent roughly 20% of the index, in general have de minimis exposure to China, providing another avenue of secular growth (US software has generally grown about 8% this cycle) and a potential safe haven from trade wars.

The potential for more stringent regulations is one of the theme’s most prominent risks. Large US internet companies are facing regulatory scrutiny on the back of data privacy concerns and antitrust litigation. These risks could escalate as we enter an election year in the US. Even so, the dominant US internet companies have experience with these investigations in Europe and have shown an ability to adapt with limited impact on their core businesses. To read more on the theme’s regulation risk, please see the report, “Communication Services: Digging into technology regulation.”

These concerns are, in part, why internet companies (based on the Nasdaq Internet Index) are currently trading at attractive valuations relative to the S&P 500. Although we don’t expect these companies’ relative valuation discount to disappear over the next 6-12 months, due to the regulatory risk overhang, it still represents a compelling entry point. In addition, we believe that investors will be compensated by internet companies’ superior earnings growth relative to the S&P 500. We expect these companies to outperform the S&P 500 over the next 6–12 months as investors begin to appreciate their full growth potential.
we “consume” mobility in the coming decades. Changes in technology that will alter the way Global urbanization will call for structural long-term investments. Causing an inflection point in space-related demand for energy-efficiency solutions.

Renewables
Increasing energy demand from urbanization and population growth will benefit renewable energy as lower costs drive competitiveness with fossil fuels.

Waste management and recycling
Low waste treatment rates in EMs offer big catch-up potential that could lead to extraordinary growth rates.

Water scarcity
Water scarcity is one of the biggest risks to mankind. If limited water resources can be better harnessed, the benefits could be enormous.

Society
Education services
With limits to many governments’ education resources, there is increased opportunity for the private education market.

Emerging market healthcare
An aging EM population requires stepped-up investment in healthcare. We believe global healthcare companies can benefit.

Emerging market infrastructure
Growing urbanization and high economic growth rates will drive demand for infrastructure investment in EMs.

Generics
As healthcare costs grow, government policy and demographics will be important drivers of increased generic drug sales.

Genetic Therapies
Genetic therapies use genes and cells to treat serious diseases. They could revolutionize medicine by removing the fundamental causes of inherited genetic conditions.

Oncology
Advances in cancer therapeutics will create new multi-billion dollar opportunities for successful drugs.

Security and safety
Growing trends such as urbanization, digital data growth, and increased regulation support demand for security and safety.

Smart Mobility
Global urbanization will call for structural changes in technology that will alter the way we “consume” mobility in the coming decades.

Space
Growing private sector investment and lower entry barriers to the space economy are causing an inflection point in space-related long-term investments.

Resources
Agricultural yield
The world faces a growing food production crisis as the global population increases. Companies that help to boost agricultural yields stand to benefit.

Clean air and carbon reduction
Rising populations and urbanization are fueling the need for clean-air technologies. Solution providers targeting emissions reductions stand to benefit.

Energy efficiency
Stricter regulation and corporate competition to improve product efficiency are driving demand for energy-efficiency solutions.

Mortgage IOs
Mortgage Interest only (MIOs) offer the opportunity to benefit from rising interest rates along with attractive yields and high credit quality.

US senior loans
Senior loans offer attractive floating-rate coupons with low correlation to other asset classes and lower volatility than high-yield bonds.

Yield for the short end
Short-end corporate bonds offer attractive current yield without taking on excessive credit or interest-rate risk.

Equity
Event-driven strategies
Event-driven strategies can represent attractive ways to capitalize on companies’ corporate actions.

Pricing power standouts
As the business cycle progresses to later stages, companies with pricing power should be better insulated from the headwinds of slowing growth and rising input costs.

Rewarding experiences
Consumers are increasingly spending more on experiences vs. goods.

NEW The power of the internet
We believe that internet stocks offer investors exposure to enduring consumer-related secular growth trends, such as e-commerce and digital advertising, while remaining relatively insulated from trade headwinds.

Equity–ESG
Gender lens
Evidence suggests that gender-diverse companies are more profitable and tend to outperform their less-diverse peers.

Sustainable value creation in EM
Incorporating environmental, social, and corporate governance considerations into EM equity investment decisions may provide a competitive edge.

KEY
- Sustainable longer-term investment theme
- Longer-term investments = Multi-business cycle
- Shorter-term investments = Current business cycle

November 2019 UBS House View 15
Global economic outlook

Trade tensions are reverberating through the global economy, hurting the manufacturing sector in particular. We expect 2019 growth to be the slowest in a decade, and 2020 could be even weaker. In the US, consumer spending is the main engine of growth, and lower mortgage rates are helping the housing market. In China, government policy is helping to prevent a sharper slowdown. Inflation remains subdued in most countries, allowing central banks to run very loose monetary policy.

Global growth in 2019 expected to be 3.2%.

<table>
<thead>
<tr>
<th>Country</th>
<th>Real GDP growth in %</th>
<th>Inflation in %</th>
</tr>
</thead>
<tbody>
<tr>
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</tr>
<tr>
<td>Canada</td>
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<tr>
<td>World</td>
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<td>3.2</td>
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Source: Reuters EcoWin, IMF, UBS, as of 23 October 2019
Note: In developing the CIO economic forecasts, CIO economists work in collaboration with economists employed by UBS Investment Research. Forecasts and estimates are current only as of the date of this publication and may change without notice.

Economic outlook summary
Brian Rose, PhD
Senior Economist Americas

House view
Probability: 50%
Global growth below trend
Trade uncertainty grows, with markets focused on the possibility of a November meeting between Chinese President Xi and US President Trump. The damage of trade uncertainty continues to be felt via weaker investment spending. A partial trade deal would have a positive but limited impact on this. Avoidance of existing trade taxes through supply chain shifts has increased and should continue to blunt their negative impact. Manufacturing-sensitive, investment-focused economies like Germany are already feeling the consequences of trade tensions. Economies with a high exposure to global trade (small, open economies in Asia and Europe) or the investment cycle are more at risk than domestic-centered economies. Labor market strength is continuing in most major economies, supporting consumers’ income (via increased employment, increased wages, or both). Global unemployment is at or near a 40-year low. Domestic demand should limit the drag from export and investment weakness.

Positive scenario
Probability: 20%
Return to trend growth
Trade uncertainty recedes after a breakthrough in US-China negotiations, triggering a recovery in investment spending. Labor markets continue to support consumer demand. The fiscal and monetary stimulus measures in China have positive spillover effects in Asia.

Negative scenario
Probability: 30%
Trade escalation pushes the world economy toward recession
Trade tensions escalate, unsettling business confidence further, which may weigh on business investments and on export activity. Rising job losses undermine consumer spending. Limited monetary and fiscal policy measures are insufficient to counter a fast global downturn.
Central bank policy
Brian Rose, PhD
Senior Economist Americas

House view
Probability: 60%
More rate cuts
The US Federal Reserve cut rates by 25 basis points (bps) at its two most recent policy meetings, July and September. With its policy rate still above 10-year Treasury yields and recent economic data turning softer, it appears that the Fed is prepared to cut again at its next meeting on 30 October. If economic conditions deteriorate further the Fed would have room to cut more aggressively. The ECB delivered a package of easing measures on 12 September, including a 10bps rate cut. It will also make asset purchases (quantitative easing) of EUR 20bn per month, but the lack of eligible bonds limits what it can do as long as issue/issuer limits and capital key rules aren’t changed.

Positive scenario
Probability: 30%
More aggressive policy easing as macro backdrop worsens
Political policy errors threaten economic growth either through more aggressive trade disruption or weaker US or European growth. Central banks respond to the changing economic outlook with easing that goes beyond our base case forecasts.

Negative scenario
Probability: 10%
Policy breakthroughs reduce uncertainty
Policy breakthroughs such as a US-China deal on trade removes some of the clouds over the economic outlook. Central banks call off plans to cut rates and in some cases start moving back toward policy normalization.

Earnings growth remains tepid
Jeremy Zirin, CFA
Head of Equities Americas
David Lefkowitz, CFA
Senior Equity Strategist Americas

House view
Probability: 60%
Earnings soft patch extends
US earnings growth has been pressured this year due to fading fiscal stimulus, slower global growth, rising tariffs, lower commodity prices, and a stronger US dollar. While a material decline in profits looks unlikely—leading indicators such as access to capital remain supportive—profit drivers have continued to weaken over the last few months. Third-quarter results will see a continuation and modest intensification of most of the recent headwinds. We look for S&P 500 earnings per share (EPS) to contract by 2% in 3Q, marking the first quarter of declining earnings since the 2014-16 plunge in oil prices sent the US manufacturing sector into recession.

Positive scenario
Probability: 20%
Central bank stimulus and trade dispute resolution
Aggressive global central bank stimulus and a resolution to the trade dispute between the US and China drives a re-acceleration in growth.

Negative scenario
Probability: 20%
Downturn in sentiment
Trade and geopolitical tensions flare up, depressing business and consumer sentiment. Wage pressures, without improving consumer and business demand, crimp profit margins and earnings growth rates. Declines in long-term interest rates pressure financial sector earnings.

Key dates
30 October 2019
FOMC rate decision
The Fed appears ready to deliver a third 25 basis point (bps) rate cut. Market reaction will depend on what the wording of the FOMC statement and Fed Chair Powell’s news conference imply about the likelihood of further cuts.

30 October 2019
GDP for 3Q19
With the US-China trade dispute escalating further, it appears that growth slowed in the third quarter. Consumer spending continues to be the main engine of growth. With help from lower mortgage rates, we also expect residential investment to turn positive.

31 October 2019
Employment cost index for 3Q19
While not as timely as the average hourly earnings data from the monthly labor report, we consider the ECI to be a better measure of wage growth.

1 November 2019
ISM manufacturing PMI for October
The ISM Purchasing Managers Index has fallen six months in a row, dropping below 50 for the first time in three years as trade uncertainty weighs on the manufacturing sector. The strength of US consumer spending should provide enough support to prevent a severe downturn.

1 November 2019
Labor report for October
Job growth has slowed in 2019. In our view, this mainly reflects the tight labor market, which makes it difficult for businesses to find new workers. However, demand for labor also appears to be softening.
Equities

Jeremy Zirin, CFA; David Lefkowitz, CFA; Edmund Tran, CFA

While there has been more optimism in recent days around a potential interim deal to defuse US-China trade tensions, we are skeptical that this is sufficient to lift corporate confidence and equities meaningfully higher. The escalation in the trade dispute poses a significant risk to emerging markets (EMs) and cyclically exposed developed markets, with earnings being affected directly via tariffs and indirectly via slowing economic activity.

**Eurozone**

*Underweight*

Economic activity in the region remains weak. We expect earnings growth to be at -4% this year and -3% in 2020. Eurozone equities, however, have rallied strongly since the beginning of the year and now appear to be priced for an overly optimistic macro scenario. At the same time, external risks remain elevated. In addition, valuation, as measured by the 12-month forward price-to-earnings ratio (P/E), is not particularly attractive: the MSCI EMU is trading in line with its 20-year average and slightly above its 10-year average.

**Emerging markets**

*Underweight*

Recent performance for EM equities has been positive amid the US-China trade truce. Renewed talks help shake off some market worries, but we don’t see an imminent recovery in fundamentals. Economic data remains weak, though manufacturing data has shown signs of stabilizing. Valuations are above historical averages with little room to the upside given earnings pressure and the weak global macro backdrop.

**Japan**

*Neutral*

Japanese equities have lagged other cyclical markets since the beginning of the year, limiting downside risks and providing re-rating potential if global data were to improve from here. Even considering our weak earnings forecasts for FY2019 at -4% due to an escalation of trade tensions and yen appreciation, valuations continue to look attractive. We expect an earnings recovery in the December quarter, largely due to base effects.

**UK**

*Neutral*

UK equities offer an attractive valuation of 12.3x 12-month forward P/E and dividend yield of 5%. However, we stay neutral over our tactical horizon due to Brexit risks and uncertainties about sterling, oil, and global growth. Sterling may pose downside risks to the UK should it strengthen on a Brexit extension or a deal being passed. Our oil forecast of USD 55/bbl poses downside risks to UK earnings, given that energy comprises 16% of the UK equity market. Given weak global growth and Brexit uncertainties we don’t favor taking large sector positions within the UK.
US Equities

Global economic data continues to be soft, but hopes for a US-China trade deal coupled with a “better than feared” start to earnings season have provided support for US equities. However, significantly higher S&P 500 levels appear unlikely over the next few months. Market valuations appear fair, corporate earnings growth remains close to flat, and a trade deal remains elusive. We are neutral on US equities, favoring consumer-facing industries and secular growers over cyclical sectors with exposure to the global economy.

US equities overview

Neutral

US stocks have rallied sharply year-to-date but have been largely range-bound over the past three months. Weaker economic trends and flattening corporate profits have been offset by two Federal Reserve interest rate cuts along with investor hopes for a trade deal with China. Stocks appear fairly valued at 17x our forward 12-month earnings expectations provided the economy continues to expand and inflation remains muted. Corporate earnings growth should pick up in 2020; we forecast S&P 500 earnings per share (EPS) to rise by 5% next year. We are neutral US equities with a June 2020 S&P 500 price target of 3,000 (previously 2,950).

US equities – sectors

Both the consumer discretionary and consumer staples sector appear well positioned in the current environment. Many consumer staples stocks have seen a clear acceleration of organic growth over the past several quarters. Secular growth in e-commerce, resilient consumer spending, and healthy housing activity should also help drive earnings for consumer discretionary stocks. We also find the communication services sector attractive for its exposure to strong digital advertising trends and the increasing popularity of streaming platforms. We are underweight global cyclicals—technology, energy, industrials.

US equities – size

We retain our neutral allocation across size segments. Large- and mid-cap stocks continue to outperform small-caps. Earnings growth for small-caps has lagged behind its larger peers. Small-caps have more cyclical exposure and appear to have been disproportionately hurt by the economic slowdown. However, as economic growth stabilizes, the earnings headwinds for small-caps should improve.

US equities – style

After a strong September, value stocks have given back some of the relative outperformance versus growth stocks over the last few weeks. Value stocks have outperformed since late August given increased optimism about global economic growth and an improvement in the US-China trade dispute. However, we are skeptical that value stocks can continue to outperform. Any improvement in the economy will likely be modest, and late cycle environments tend to favor growth stocks. We retain our neutral allocation between growth and value.

*S&P 500* (index points, current: 3005)  
June 2020 target

<table>
<thead>
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<th>House view</th>
<th>3000</th>
</tr>
</thead>
<tbody>
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<td>Positive scenario</td>
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<tr>
<td>Negative scenario</td>
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</tbody>
</table>

Note: Current values as of 23 October 2019

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**Figure 1**

Business sentiment is weakening

ISM manufacturing and non-manufacturing (services) indices (above 50 denotes expansion)

Source: Bloomberg, UBS, as of 21 October 2019

**Figure 2**

Earnings growth remains sluggish

S&P 500 EPS growth, actual and CIO estimates; tax reform impact in tan, in%

Source: FactSet, UBS, as of 21 October 2019
ASSET CLASSES OVERVIEW

Bonds

Treasury volatility has risen from the historically low levels prevalent over the past two years, driven by uncertainty surrounding the US-China trade conflict and Brexit. After trending lower for the first half of the year, the 10-year Treasury yield has traded in a wide range for nearly three months. The Fed, concerned by weak business investment and exports, has eased policy as insurance against risks around trade policy and global growth. The Fed will also begin purchasing T-bills this month.

Government bonds

Neutral

The US Treasury 10-year yield reached 1.80% in October on the back of better news out of China and the UK. We believe yields will remain range bound through the end of the year and the recent yield curve steepening will persist as the Fed begins buying T-bills and a potential new 20-year Treasury security comes to the marketplace. Volatility will remain high into year end, but we look for rates to remain within their 1.5-1.9% range.

US investment grade corporate bonds

Neutral

We remain neutral on IG. While corporate leverage among US issuers has surpassed previous peaks, we think there are strong mitigating factors such as persistently low interest costs and high earnings margins. We believe aggregate credit quality is not a key risk for now, in the absence of an economic recession. We continue to favor financials (US banks) over non-financials due to their strong credit profiles. In addition, we believe corporates with short maturities (1-3 years) provide attractive yield relative to their low duration.

US high yield corporate bonds

Neutral

As the US and China agreed to a partial trade deal in principle, HY credit spreads tightened toward the midpoint of their trading range in 2019. We maintain a neutral allocation to HY bonds. Credit spreads should remain contained until year end, given accommodative monetary policy globally, record amounts of negative-yielding bonds, and the pervasive search for yield. Looking into 1H20, we expect credit spreads to widen as the full impact of trade tariffs causes global growth to slow and fundamentals to weaken. We expect the HY default rate to gradually rise to around 3% over the next year from 2.7% at present.

Emerging market bonds

Overweight

EM corporate and sovereign credit delivered year-to-date gains in the low-to-mid teens on tighter spreads and significantly lower Treasury yields. The asset class also benefited from dovish central banks and continued Chinese stimulus measures, despite a more uncertain global environment. We expect spreads to trend sideways to slightly wider, with further bouts of volatility. Global macro and geopolitical risks remain elevated, but dovish central banks appear as a supportive factor. We are tactically overweight emerging market (EM) USD-denominated sovereign bonds as we think the current macroeconomic environment favors carry strategies.

*EMBIG div / CEMBI div SPREAD (current: 311bps / 315bps) June 2020 target

House view 350bps / 360bps

Positive scenario 90bps

Negative scenario 275bps

*EMBIG diversified *ex-Venezuela

Note: Current values as of 23 October 2019. Overweight position is to emerging market hard-currency bonds.

*Data based on ICE BAML High Yield indices

Leslie Falconio; Kathleen McNamara, CFA, CFP; Barry McAlinden, CFA; Philipp Schoettler; Frank Sileo, CFA
**Municipal bonds**

Neutral

Munis are holding up relatively well despite some weaker technicals now present in the fourth quarter. Over the past few weeks, tax-exempt paper has declined by a modest amount (~0.1%). New issuance has increased, as is often the case at this time of year. At the same time, municipal bond mutual funds have now attracted net cash for 41 consecutive weeks. In credit, we continue to favor investment grade munis rather than lower-rated high yield credits based on tight credit quality spreads.

Current AAA 10-year muni-to-Treasury yield ratio: 85.3% (last month: 85%)

**Non-US developed fixed income**

Neutral

Over the past month, bond yields have moved mostly higher in non-US developed markets. On foreign exchange markets overall, the dollar depreciated against other major currencies, helping returns when measured in dollars. These factors offset each other, leaving the asset class little changed for the month. With yields still negative on many bonds, non-US developed fixed income remains unattractive. We do not recommend a strategic asset allocation position on the asset class.

**Additional US taxable fixed income (TFI) segments**

**Agency bonds**

The agency market has a year-to-date total return of 5.7%. Spreads in non-callables remain tight in spite of a USD 2bn Federal National Mortgage Association (FNMA) issue, which priced about +9bps to the 5-year Treasury. Callable flows were strong in spite of some richer funding through Federal Home Loan Mortgage Corporation (FHLMC) and the Federal Home Loan Banks (FHLB). Accounts appear more comfortable deploying cash to short-end agency debt as the recent issues with repo have subsided. Most accounts prefer the 1-5 year area even though spreads are not ample. We continue to prefer MBS to agency debt as the relative value in agency debt remains minimal.

Current spread is +9bps to the 5-year (versus +11bps last month).

**Mortgage-backed securities (MBS)**

MBS spreads continue to leak wider versus Treasuries. Spreads have reached a year-to-date wide of 108bps, as measured by the current coupon MBS versus the 5y/10y Treasury blend. Although this widening has been welcomed by investors, we continue to have a wait-and-see approach as increased volatility may impact performance heading into year end. The Fed’s recent decision to expand the balance sheet should indirectly support MBS as the yield curve steepens. While we believe that MBS provide an attractive opportunity, particularly versus IG corporates, we choose to remain neutral given the time of year.

Current spread is +108bps to the 5-year and 10-year Treasury blend (versus +99bps last publication).

**UBS interest rate forecasts**

<table>
<thead>
<tr>
<th>US</th>
<th>Current</th>
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<th>Mar-19</th>
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<tr>
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</tbody>
</table>

Source: Bloomberg, UBS, as of 23 October 2019

**Treasury inflation-protected securities (TIPS)**

The TIPS market has witnessed an uptick in performance as the risk-off sentiment abates. The status quo news from the China-US trade tensions and likely Brexit deal has led to a decline in the safe-haven appeal of nominal US Treasuries. We continue to prefer 5-year TIPS over 5-year Treasuries. New 5-year TIPS were auctioned in October and were met with strong investor demand. We believe TIPS are set to outperform given the market’s low inflation expectations versus the fundamental data, particularly as we turn a new year.

Current 5-year breakeven inflation rate of 1.52% (1.39% last month)

**Preferred securities**

Preferreds have performed consistently all year. Fed messaging suggests rate risk has abated, though we could see a pull back if risk aversion returns and yields gap higher. But so far, yield spreads remain within historical ranges, which may buffer any fear-driven push toward higher yields (although spreads on USD 25 pars are a bit below average). We favor fixed-rate preferreds with above-average coupons. We view fixed-to-floating rate preferreds with greater scrutiny given increased potential for Libor rates to fall further from here and lingering uncertainty regarding the discontinuation of Libor in 2022 or soon after. We favor those with at least four years of call protection, high reset spreads, and strong prospectus language regarding floating-rate coupon calculation in the absence of Libor.
Commodities and other asset classes

Dominic Schnider, CFA, CAIA; Giovanni Staunovo; Thomas Veraguth; Wayne Gordon

Commodity indexes have continued to move sideways since the end of August. Broad diversified have risen by around 4%-5% this year, supported primarily by energy and precious metals. The outlook for commodity prices has clearly dimmed from a top down perspective. US recession risks have increased, while we expect global 2020 GDP to grow at the slowest pace since the global financial crisis. Hence, for now, overall commodity exposure looks unattractive over six and 12 months. That said, we advise investors to stay long gold.

Commodities

Neutral

Precious metals We are bullish on gold over our forecast horizon given trade uncertainties between the US and China and a dovish Federal Reserve pushing US real rates lower. Our expectation of a weaker USD, factors associated with the late stage of an economic cycle, and ongoing political noise as we approach the 2020 US presidential elections are also price supportive. We continue to see gold as a valuable insurance asset in a portfolio context and expect the yellow metal to rise to USD 1,600-1,650/oz by mid-2020.

GOLD (current: USD 1492/oz) June 2020 target

<table>
<thead>
<tr>
<th>House view</th>
<th>June 2020 target</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD 1600/oz</td>
</tr>
<tr>
<td>➕ Positive scenario</td>
<td>USD 1700/oz</td>
</tr>
<tr>
<td>➖ Negative scenario</td>
<td>USD 1400/oz</td>
</tr>
</tbody>
</table>

Crude oil The mid-September attacks on Saudi energy infrastructure resulted in the largest oil production disruption in history. The oil market has tools to offset temporary oil disruptions (higher production from countries with spare capacity, tapping oil inventories). So far, growing recession risks have capped oil price upside. Low spare capacity, the risk of renewed attacks on oil infrastructure in the Middle East, and likely larger oil inventory declines until the end of 2020 following the sharp drop in Saudi oil output suggest to us that oil prices should trade higher in the short term. We see the Brent oil price rising toward USD 63/bbl by the end of the year, before giving back those gains and declining toward USD 55/bbl by mid-2020.

BRENT (current: USD 61/bbl) June 2020 target

<table>
<thead>
<tr>
<th>House view</th>
<th>June 2020 target</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD 55/bbl</td>
</tr>
<tr>
<td>➕ Positive scenario</td>
<td>USD 70/bbl</td>
</tr>
<tr>
<td>➖ Negative scenario</td>
<td>USD 40-50/bbl</td>
</tr>
</tbody>
</table>

Base metals Trade headlines have caused base metal prices to rise and fall in recent weeks, resulting in a largely sideways movement on average. Lead and zinc prices have risen on supportive supply stories, aluminum prices have fallen deeper into the production cost curve, and nickel and copper prices have trodden water. With a comprehensive US-China trade deal unlikely before the 2020 US presidential elections, price upside will likely depend on supply factors. Although the downshift in industrial production should end in 2020, we’re negative on zinc and lead because of weak supply dynamics (market surplus expected) and nickel because prices have likely overshot over Indonesia concerns.

Agriculture Agriculture and livestock prices have benefited from a moderation of US-China trade tensions, including prospects that China could significantly increase its purchases of agriculture productions (namely pork and soybeans); however, early claims that China will eventually buy USD 40-50bn annually is too optimistic, in our view. The USDA made modest changes to corn and soybeans area forecasts in October, lifting corn yields (against consensus) and lowering soybeans. We still believe the USDA remains too optimistic on corn production and final US production and inventories will decline from current estimates.

Other asset classes

Listed real estate We forecast earnings growth of 4.7% for 2019–20 (excl. emerging markets [EMS]), driven by internal growth, positive rental reversion, repositioning, or extensions. A few companies need to deleverage, while the majority still optimize financing. The number of companies with expanding risk spreads will grow if the cyclical deceleration intensifies. Searching for value is key. Physical transaction volumes were at their highest levels in 2015. They declined by over 9% in 1H19, while capital value growth has been decelerating since 2015. The cap-rate compression cycle is ending. Increasing cap rates are eroding values slightly amid weaker rental growth but only locally.

RUGL Index (current: USD 5882) June 2020 target

<table>
<thead>
<tr>
<th>House view</th>
<th>June 2020 target</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD 5500</td>
<td>USD 5700</td>
</tr>
<tr>
<td>➕ Positive scenario</td>
<td>USD 5700</td>
</tr>
<tr>
<td>➖ Negative scenario</td>
<td>USD 4800</td>
</tr>
</tbody>
</table>

Note: Current values as of 23 October 2019
Foreign exchange

Thomas Flury, Strategist

In our FX strategy we keep our long USD/short Australian dollar (AUD) position as well as our basket of high-yielding emerging market currencies, funded by growth-sensitive low-yielding currencies. We close our long GBP/short USD position and our Norwegian krone (NOK) overweight positions against the EUR and the Canadian dollar (CAD).

USD

Neutral

Markets have recently shown increasing optimism on US-China trade talks, lifting most currencies relative to the USD. Nevertheless, we think it is worth positioning for a global slowdown and trade tensions, as we think it is too early to expect a political and economic rebound on the trade front.

EUR

Neutral

The EURUSD pairing rose from its October lows, with markets driven by hopes that Brexit woes are behind us and that trade talks are set to become more constructive. We remain skeptical on both fronts, given the tough decisions that lie ahead, and we forecast only a mild appreciation of the EURUSD, to 1.15 in June 2020, with volatility in the intervening months.

GBP

Neutral

We confirm our bullish view on sterling (GBP) but have closed our tactical long GBP position against the short USD position. According to our models, sterling has been undervalued against the Swiss franc (CHF) since 2008, against the US dollar since 2014, and against the euro since 2016. We expect this valuation to improve over the next three to four years.

CHF

Neutral

The rebound of the EUR showed that the Swedish National Bank (SNB) felt little need to intervene and prevent further CHF strengthening. For this reason we see room for the USDCHF to fall. We think this trend will continue and forecast USDCHF 0.96 in June. A series of Fed rate cuts, concerns about global trade, a slowdown in growth, and rising political uncertainty in the US should guide USDCHF lower.

JPY

Neutral

The Fed is expected to bring a series of rate cuts this year and next. The Bank of Japan is also likely to ease policy slightly in response to lower core inflation and slightly subdued growth after the value-added tax (VAT) hike. It will, however, be unable to match the Fed and therefore we expect a controlled, slow appreciation of the JPY versus the USD.

Other developed market currencies

Underweight

We close our NOK overweight positions against the EUR and the CAD. The original underlying reasons for our NOK positions—strong domestic economic growth and core inflation above the central bank’s target—remain largely intact. Concerns about weaker global growth and lower liquidity in this smaller currency, especially toward year-end, are probably the reasons for recent NOK weakness. We keep our long USD/short AUD position. Australia’s economy is negatively exposed to US-China trade tensions. Furthermore, the Reserve Bank of Australia openly wishes a weaker AUD and better terms of trade in light of a weakening domestic labor market.

UBS CIO FX forecasts

<table>
<thead>
<tr>
<th></th>
<th>Mar 20</th>
<th>Jun 20</th>
<th>Sep 20</th>
<th>PPP</th>
</tr>
</thead>
<tbody>
<tr>
<td>EURUSD</td>
<td>1.12</td>
<td>1.15</td>
<td>1.17</td>
<td>1.28</td>
</tr>
<tr>
<td>EURCHF</td>
<td>1.07</td>
<td>1.10</td>
<td>1.10</td>
<td>1.20</td>
</tr>
<tr>
<td>USDCHF</td>
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<td>0.96</td>
<td>0.94</td>
<td>0.93</td>
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<tr>
<td>GBPUSD</td>
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<td>1.34</td>
<td>1.36</td>
<td>1.56</td>
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<tr>
<td>EURGBP</td>
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<td>0.86</td>
<td>0.86</td>
<td>0.82</td>
</tr>
<tr>
<td>GBPCHF</td>
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<td>1.45</td>
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<tr>
<td>USDJPY</td>
<td>104</td>
<td>102</td>
<td>100</td>
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<td>EURJPY</td>
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<td>117</td>
<td>117</td>
<td>96</td>
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<td>USDCAD</td>
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<td>1.33</td>
<td>1.32</td>
<td>1.21</td>
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<tr>
<td>AUDUSD</td>
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<td>0.68</td>
<td>0.68</td>
<td>0.67</td>
</tr>
<tr>
<td>NZDUSD</td>
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<td>0.65</td>
<td>0.57</td>
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<tr>
<td>EURSEK</td>
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<td>11.20</td>
<td>11.20</td>
<td>9.77</td>
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<tr>
<td>EURNOK</td>
<td>10.00</td>
<td>10.10</td>
<td>10.20</td>
<td>10.57</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters, UBS, as of 23 October 2019
Note: Past performance is not an indication of future returns.
*PPP = Purchasing Power Parity
Key forecasts

<table>
<thead>
<tr>
<th>Asset class</th>
<th>TAA (6–12 months)</th>
<th>Change this month</th>
<th>Benchmark</th>
<th>Value</th>
<th>m/m perf. in %¹</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>EQUITIES</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>-</td>
<td>-</td>
<td>S&amp;P 500</td>
<td>3005</td>
<td>0.9%</td>
</tr>
<tr>
<td>Eurozone</td>
<td>-</td>
<td>-</td>
<td>Euro Stoxx</td>
<td>388</td>
<td>1.9%</td>
</tr>
<tr>
<td>UK</td>
<td>-</td>
<td>-</td>
<td>FTSE 100</td>
<td>7261</td>
<td>-1.2%</td>
</tr>
<tr>
<td>Japan</td>
<td>-</td>
<td>-</td>
<td>Topix</td>
<td>1638</td>
<td>0.9%</td>
</tr>
<tr>
<td>Switzerland</td>
<td>-</td>
<td>-</td>
<td>SMI</td>
<td>10024</td>
<td>0.1%</td>
</tr>
<tr>
<td>Emerging Markets</td>
<td>-</td>
<td>-</td>
<td>MSCI EM</td>
<td>1031</td>
<td>2.1%</td>
</tr>
<tr>
<td><strong>BONDS</strong></td>
<td></td>
<td></td>
<td>10yr Treasury yield</td>
<td>1.8%</td>
<td>-0.3%</td>
</tr>
<tr>
<td>US Government bonds²</td>
<td>-</td>
<td>-</td>
<td>BAML IG spread</td>
<td>117</td>
<td>0.1%</td>
</tr>
<tr>
<td>US Corporate bonds (IG)</td>
<td>-</td>
<td>-</td>
<td>BAML US HY spread</td>
<td>398</td>
<td>0.2%</td>
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<tr>
<td>US High-yield bonds</td>
<td>-</td>
<td>-</td>
<td>EMBI Diversified spread³</td>
<td>311</td>
<td>0.4%</td>
</tr>
<tr>
<td>EM Sovereign</td>
<td>-</td>
<td>-</td>
<td>CEMBI Diversified spread³</td>
<td>315</td>
<td>1.7%</td>
</tr>
<tr>
<td>EM Corporate</td>
<td>-</td>
<td>-</td>
<td>Spot price</td>
<td>1492 /oz.</td>
<td>-0.8%</td>
</tr>
<tr>
<td>Listed real estate</td>
<td>-</td>
<td>-</td>
<td>Spot price</td>
<td>61.17 /bbl.</td>
<td>-2.5%</td>
</tr>
<tr>
<td><strong>OTHER ASSET CLASSES</strong></td>
<td></td>
<td></td>
<td>RUGL Index</td>
<td>5882</td>
<td>2.6%</td>
</tr>
<tr>
<td>Gold</td>
<td>-</td>
<td>-</td>
<td>USD</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Brent crude oil</td>
<td>-</td>
<td>-</td>
<td>EUR</td>
<td>1.11</td>
<td>1.9%</td>
</tr>
<tr>
<td>Listed real estate</td>
<td>-</td>
<td>-</td>
<td>GBPU USD</td>
<td>1.29</td>
<td>4.7%</td>
</tr>
<tr>
<td><strong>CURRENCIES</strong></td>
<td></td>
<td></td>
<td>USDJPY</td>
<td>109</td>
<td>0.8%</td>
</tr>
<tr>
<td>GBP*</td>
<td>-</td>
<td>-</td>
<td>USDCHF</td>
<td>0.99</td>
<td>-0.3%</td>
</tr>
<tr>
<td>JPY*</td>
<td>-</td>
<td>-</td>
<td>EURUSD</td>
<td>1.15</td>
<td>NA</td>
</tr>
<tr>
<td>CHF</td>
<td>-</td>
<td>-</td>
<td>GBPU USD</td>
<td>1.34</td>
<td>NA</td>
</tr>
<tr>
<td><strong>Forecast (June 2020)</strong></td>
<td></td>
<td></td>
<td>USDJPY</td>
<td>102</td>
<td>NA</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>USDCHF</td>
<td>0.96</td>
<td>NA</td>
</tr>
</tbody>
</table>

Source: Bloomberg, UBS

¹ Month over month.
² We are neutral US government bonds, but maintain an overweight to US Treasury Inflation-Protected Securities against nominal US government bonds within this category.
³ EMBIG Diversified ex-Venezuela

Note: Current values as of 23 October 2019. Currency values as of 24 October 2019.

Past performance is no indication of future performance. Forecasts are not a reliable indicator of future performance.
US equity sector allocation

<table>
<thead>
<tr>
<th>S&amp;P 500 Benchmark allocation</th>
<th>CIO GWM tactical deviation</th>
<th>Current allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Numeric Previous</td>
<td>Current Symbol</td>
</tr>
<tr>
<td>Communication Services</td>
<td>10.4</td>
<td>+1.0</td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>10.2</td>
<td>+1.0</td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>7.5</td>
<td>+1.0</td>
</tr>
<tr>
<td>Energy</td>
<td>4.5</td>
<td>-1.0</td>
</tr>
<tr>
<td>Financials</td>
<td>13.0</td>
<td>+0.0</td>
</tr>
<tr>
<td>Health Care</td>
<td>13.8</td>
<td>+0.0</td>
</tr>
<tr>
<td>Industrials</td>
<td>9.3</td>
<td>-1.0</td>
</tr>
<tr>
<td>Information Technology</td>
<td>21.8</td>
<td>-1.0</td>
</tr>
<tr>
<td>Materials</td>
<td>2.7</td>
<td>+0.0</td>
</tr>
<tr>
<td>Real Estate</td>
<td>3.3</td>
<td>+0.0</td>
</tr>
<tr>
<td>Utilities</td>
<td>3.5</td>
<td>+0.0</td>
</tr>
</tbody>
</table>

Source: UBS, as of 24 October 2019.

For US equity sub-sector recommendations please see the “Equity Preference List” for each sector. These reports are published on a monthly basis and can be found on the Online Services website in the Research > Equities section.

The benchmark allocation, as well as the tactical deviations, are intended to be applicable to the US equity portion of a portfolio across investor risk profiles.

1 The benchmark allocation is based on S&P 500 weights.

2 See “Deviations from strategic asset allocation” in the Appendix of UBS House View for an explanation regarding the interpretation of the suggested tactical deviations from benchmark. The “current” column refers to the tactical deviation that applies as of the date of this publication. The “previous” column refers to the tactical deviation that was in place at the date of the previous edition of the previous edition of UBS House View or the last UBS House View Update.

3 The sum of the S&P 500 benchmark allocation and CIO GWM tactical deviation columns.

Full detailed asset allocation tables
View our full set of asset allocation tables for guidance on positioning across different investor types, portfolio strategies, and risk tolerances.

Index information

Underlying indices for Strategic Asset Allocations

- US Cash (Barclays Capital US Treasury – Bills [1–3 M])
- US Large-Cap Growth (Russell 1000 Growth)
- US Large-Cap Value (Russell 1000 Value)
- US Mid-Cap (Russell Mid Cap)
- US Small-Cap (Russell 2000)
- International Dev. Equities (MSCI EAFE)
- Emerging Markets Equities (MSCI EMF)
- US Government Fixed Income (Bloomberg Barclays US Agg Government)
- US Municipal Fixed Income (Bloomberg Barclays Municipal Bond)
- US Investment-Grade Fixed Income (Bloomberg Barclays US Agg Credit)
- US Corporate High-Yield Fixed Income (Bloomberg Barclays US Agg Corp HY)
- International Dev. Fixed Income (Bloomberg Barclays Global Agg xUS)
- Emerging Markets Fixed Income (50% Bloomberg Barclays EM Gov and 50% BarCap Global EM (USD))
- Commodities (Dow Jones-UBS Commodity Index)

Note: For additional information on indices, portfolio analytics, and performance, please see our standalone asset allocation report.
Investment committee

Global Investment Process and Committee description
The UBS investment process is designed to achieve replicable, high-quality results through applying intellectual rigor, strong process governance, clear responsibility, and a culture of challenge.

Based on the analyses and assessments conducted and vetted throughout the investment process, the Chief Investment Officer (CIO) formulates the UBS Wealth Management Investment House View (e.g., overweight, neutral, underweight stances for asset classes and market segments relative to their benchmark allocation) at the Global Investment Committee (GIC). Senior investment professionals from across UBS, complemented by selected external experts, debate and rigorously challenge the investment strategy to ensure consistency and risk control.

Global Investment Committee composition
The GIC comprises top market and investment expertise from across all divisions of UBS:

- Mark Haefele (Chair)
- Paul Donovan
- Jorge Mariscal
- Mike Ryan
- Simon Smiles
- Tan Min Lan
- Themis Themistocleous
- Bruno Marner (*)
- Andreas Koester

WMA Asset Allocation Committee description
We recognize that a globally derived house view is most effective when complemented by local perspective and application. As such, UBS has formed a Wealth Management Americas Asset Allocation Committee (WMA AAC). WMA AAC is responsible for the development and monitoring of UBS WMA’s strategic asset allocation models and capital market assumptions. The WMA AAC sets parameters for the CIO Americas, WM Investment Strategy Group to follow during the translation process of the GIC’s House Views and the incorporation of US-specific asset class views into the US-specific tactical asset allocation models.

WMA Asset Allocation Committee composition
The WMA Asset Allocation Committee comprises nine members:

- Mike Ryan
- Michael Crook
- Brian Rose
- Jeremy Zirin
- Jason Draho
- Tom McLoughlin
- Leslie Falconio
- Laura Kane
- David Lefkowitz

(*) Business area distinct from Chief Investment Office Americas, Wealth Management

Cautionary statement regarding forward-looking statements

This report contains statements that constitute “forward-looking statements,” including but not limited to statements relating to the current and expected state of the securities market and capital market assumptions. While these forward-looking statements represent our judgments and future expectations concerning the matters discussed in this document, a number of risks, uncertainties, changes in the market, and other important factors could cause actual developments and results to differ materially from our expectations. These factors include, but are not limited to (1) the extent and nature of future developments in the US market and in other market segments; (2) other market and macro-economic developments, including movements in local and international securities markets, credit spreads, currency exchange rates and interest rates, whether or not arising directly or indirectly from the current market crisis; (3) the impact of these developments on other markets and asset classes. UBS is not under any obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise.
Explanations about asset classes

Sources of strategic asset allocations and investor risk profiles

Strategic asset allocations represent the longer-term allocation of assets that is deemed suitable for a particular investor. The strategic asset allocation models discussed in this publication, and the capital market assumptions used for the strategic asset allocations, were developed and approved by the WMA AAC.

The strategic asset allocations are provided for illustrative purposes only and were designed by the WMA AAC for hypothetical US investors with a total return objective under five different Investor Risk Profiles ranging from conservative to aggressive. In general, strategic asset allocations will differ among investors according to their individual circumstances, risk tolerance, return objectives and time horizon. Therefore, the strategic asset allocations in this publication may not be suitable for all investors or investment goals and should not be used as the sole basis of any investment decision. Minimum net worth requirements may apply to allocations to non-traditional assets. As always, please consult your UBS Financial Advisor to see how these weightings should be applied or modified according to your individual profile and investment goals.

The process by which the strategic asset allocations were derived is described in detail in the publication entitled “Strategic Asset Allocation (SAA) Methodology and Portfolios.” Your Financial Advisor can provide you with a copy.

Deviations from strategic asset allocation or benchmark allocation

The recommended tactical deviations from the strategic asset allocation or benchmark allocation are provided by the Global Investment Committee and the Investment Strategy Group within CIO Americas, Wealth Management. They reflect the short- to medium-term assessment of market opportunities and risks in the respective asset classes and market segments. Positive/zero/negative tactical deviations correspond to an overweight/neutral/underweight stance for each respective asset class and market segment relative to their strategic allocation. The current allocation is the sum of the strategic asset allocation and the tactical deviation.

Note that the regional allocations on the Equities and Bonds pages in UBS House View are provided on an unhedged basis (i.e., it is assumed that investors carry the underlying currency risk of such investments) unless otherwise stated. Thus, the deviations from the strategic asset allocation reflect the views of the underlying equity and bond markets in combination with the assessment of the associated currencies. The detailed asset allocation tables integrate the country preferences within each asset class with the asset class preferences in UBS House View.

Asset allocation does not assure profits or prevent against losses from an investment portfolio or accounts in a declining market.

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Description/Definition</th>
<th>Symbol</th>
<th>Description/Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>+</td>
<td>moderate overweight vs. benchmark</td>
<td>–</td>
<td>moderate underweight vs. benchmark</td>
</tr>
<tr>
<td>++</td>
<td>overweight vs. benchmark</td>
<td>– –</td>
<td>underweight vs. benchmark</td>
</tr>
<tr>
<td>+++</td>
<td>strong overweight vs. benchmark</td>
<td>– – –</td>
<td>strong underweight vs. benchmark</td>
</tr>
<tr>
<td>n/a</td>
<td>not applicable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UBS

Statement of risk

Equities - Stock market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables.

Fixed income - Bond market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables. Corporate bonds are subject to a number of risks, including credit risk, interest rate risk, liquidity risk, and event risk. Though historical default rates are low on investment grade corporate bonds, perceived adverse changes in the credit quality of an issuer may negatively affect the market value of securities. As interest rates rise, the value of a fixed coupon security will likely decline. Bonds are subject to market value fluctuations, given changes in the level of risk-free interest rates. Not all bonds can be sold quickly or easily on the open market. Prospectives investors should consult their tax advisors concerning the federal, state, local, and non-U.S. tax consequences of owning any securities referenced in this report.

Preferred securities - Prospective investors should consult their tax advisors concerning the federal, state, local, and non-U.S. tax consequences of owning preferred stocks. Preferred stocks are subject to market value fluctuations, given changes in the level of interest rates. For example, if interest rates rise, the value of these securities could decline. If preferred stocks are sold prior to maturity, price and yield may vary. Adverse changes in the credit quality of the issuer may negatively affect the market value of the securities. Most preferred securities may be redeemed at par after five years. If this occurs, holders of the securities may be faced with a reinvestment decision at lower future rates. Preferred stocks are also subject to other risks, including illiquidity and certain special redemption provisions.

Municipal bonds - Although historical default rates are very low, all municipal bonds carry credit risk, with the degree of risk largely following the particular bond’s sector. Additionally, all municipal bonds feature valuation, return, and liquidity risk. Valuation tends to follow internal and external factors, including the level of interest rates, bond ratings, supply factors, and media reporting. These can be difficult or impossible to project accurately. Also, most municipal bonds are callable and/or subject to earlier than expected redemption, which can reduce an investor’s total return. Because of the large number of municipal issuers and credit structures, not all bonds can be easily or quickly sold on the open market.
Appendix

Emerging Market Investments
Investors should be aware that Emerging Market assets are subject to, among others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and socio-political risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. CIO Americas, WM generally recommends only those securities it has been registered under Federal US registration rules (Section 12 of the Securities Exchange Act of 1934) and individual State registration rules (commonly known as “Blue Sky” laws). Prospective investors should be aware that to the extent permitted under US law, CIO Americas, WM may from time to time recommend bonds that are not registered under US or State securities laws. These bonds may be issued in jurisdictions where the level of required disclosures to be made by issuers is not as frequent or complete as that required by US laws.


Investors interested in holding bonds for a longer period are advised to select the bonds of those sovereigns with the highest credit ratings (in the investment-grade band). Such an approach should decrease the risk that an investor could end up holding bonds on which the sovereign has defaulted. Subinvestment-grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher-yielding bonds for shorter periods only.

Nontraditional Assets
Nontraditional 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-US 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 US dollars, changes in the exchange rate between the US 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 US investor.
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