This report was prepared by UBS AG.
All forecasts in this publication are as of 26 September 2019 at 09:00am CET and might change after that. This publication will only be updated intra-monthly to reflect changes in our TAA positions or thematic views. To get our most recent forecasts, please refer to our publication called “Global forecasts.”
Please see the important disclaimer at the end of the document.
This document is a snapshot view. We update the tactical asset allocation as changes occur and resend it to subscribers. For all other forecasts and information, we advise you to check the Investment Views section in your E-Banking or in Quotes.
**Financial Market Outlook – short term**

**Global Tactical Asset Allocation**

- **Asset allocation**
  
  While we don’t expect the US economy to fall into recession, we think near-term risks, in particular to equity markets, are elevated. Despite recent tentative signs of an improvement in Sino-US trade talks, global economic and earnings growth are decelerating and political uncertainty remains high. We thus hold onto our underweight in equities, especially emerging market (EM) stocks, against high grade bonds. This is a moderate tactical underweight in equity risk. We caution against large equity underweights, given the longer-term value of stocks in an environment of ultra-low rates, and also keeping in mind that risk is currently not primarily driven by a looming recession, but by (geo-)politics. We are keeping our carry positions unchanged. Global central bank easing still leaves investors reaching for yield.

- **Equities**
  
  Risks of an economic slowdown have risen since the summer leading the Fed and ECB to respond. Recent data points to a slowing in global growth, driven by a downturn in the manufacturing sector. While equity valuations look attractive relative to bonds in the long run, near-term risks around China-US trade remain high. We are underweight in EM equities against high grade bonds. EM firms are more exposed to heightened market volatility, a slowing global economy, and heightened trade tensions. We keep an overweight in Japanese and US equities vs Eurozone equities. While both the Eurozone and Japan are geared to the global cycle, the former has priced in a macro recovery while the latter has not. Eurozone stocks look expensive compared to Japanese stocks. We prefer US versus Eurozone stocks as the former should deliver superior profit growth in 2019 and 2020. We also believe that the Fed has more ammunition than the ECB to combat slowing growth should trade tensions escalate.

- **Bonds**
  
  We keep our overweight in EUR IG against higher-rated bonds. We expect the former to be particularly supported by open-ended ECB bond purchases. We think the carry is attractive against healthy corporate fundamentals and our base case of no recession over the next 12 months. We keep our overweight in EM sovereign bonds in USD against HG bonds, as the search for yield should provide continued support.

- **Foreign exchange**
  
  We are opening an overweight in the US dollar (USD) against the Australian dollar (AUD) as deteriorating economic conditions in Australia are likely to keep the Reserve Bank of Australia on an easing path, while the currency remains exposed to US-China trade tensions. Our EM currency basket (overweight INR, IDR vs. AUD, TWD) aims to earn the interest rate advantage without being too strongly exposed to US-China trade tensions. We retain our NOK overweight position against the CAD and the EUR to benefit from central bank divergences – Norway’s central bank is unique in keeping a hawkish stance. We keep our long GBP versus short USD position. Sterling is still very cheap against purchasing power parity and we think a no-deal Brexit in October remains unlikely.

- **Longer-term asset allocation (1-4 years)**
  
  We are underweight UK equities. While the UK was formerly seen as a conservative, lower risk market, prolonged Brexit uncertainties could change this view and lead to a rising risk premium. Emerging market US dollar-denominated sovereign bonds have a more favorable longer-term risk-return outlook, in our view. We also recommend investors in Japanese equities not to hedge the currency exposure as the JPY is significantly undervalued and offers long-term appreciation potential against the USD, the EUR and the CHF.
Cross-asset preferences

We like...
- Japanese equities
- US equities
- Global quality stocks
- "Buy-write" strategy on US equities
- US smart beta
- Some protection via US equity put options
- Emerging market sovereign bonds USD
- Euro investment grade corporate bonds
- Global green bonds
- Mind the gap – Corporate "rising star" candidates
- Time to be more selective in EM credit
- Norwegian krone versus...
- Norwegian krone versus...
- British pound versus...
- US dollar (_stride)
- EM FX (INR, IDR) versus...
- Japanese yen (1–4-year horizon) versus...

We don’t like...
- UK equities (1–4-year horizon)
- Emerging market equities
- Eurozone equities
- Developed market high grade bonds
- Mind the gap - Corporate "fallen angel" candidates
- ...Euro
- ...Canadian dollar
- ...US dollar
- ...Australian dollar (_stride)
- ...DM FX (AUD, TWD)
- ...base currency

Model portfolios (EUR & USD)*

Source: UBS, as of 26 September 2019. * Additionally, the portfolios include a put option on the S&P 500 index.

Note: Portfolio weightings are for a EUR model portfolio and a USD model portfolio, with a balanced risk profile (including TAA). We expect the EUR balanced portfolio (excluding TAA) to have an average total return of 2.8% p.a. and a volatility of 7.9% p.a. over the next seven years. We expect the USD balanced portfolio (excluding TAA) to have an average total return of 5.1% p.a. and a volatility of 7.9% p.a. over the next seven years.
Global tactical asset allocation

Tactical asset allocation deviations from benchmark

<table>
<thead>
<tr>
<th>Category</th>
<th>underweight</th>
<th>neutral</th>
<th>overweight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td></td>
<td></td>
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<tr>
<td>Equities total*</td>
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<td></td>
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<tr>
<td>US</td>
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<tr>
<td>Eurozone</td>
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<td>UK</td>
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<td>Switzerland</td>
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<td>Canada</td>
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<tr>
<td>Japan**</td>
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<tr>
<td>Emerging markets (EM)</td>
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<tr>
<td>Australia</td>
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<tr>
<td>Bonds total</td>
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<tr>
<td>High grade bonds</td>
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<tr>
<td>Corporate bonds (IG)</td>
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<td>High yield bonds</td>
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<tr>
<td>EM sovereign bonds (USD)</td>
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<tr>
<td>EM corporate bonds (USD)</td>
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<tr>
<td>EM local currency bonds</td>
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<tr>
<td>US TIPS</td>
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<tr>
<td>Duration overlay (USD)</td>
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<tr>
<td>Duration overlay (JPY)</td>
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<tr>
<td>Hedge Funds</td>
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</tbody>
</table>

Source: UBS, as of 26 September 2019

Please note that the bar charts show total portfolio preferences, which can be interpreted as the recommended deviation from the relevant portfolio benchmark for any given asset class and sub-asset class.

*We are holding a put option on the S&P 500 to partly protect the tactical asset allocation.

**Currency exposure of Japanese equities is not hedged.

Currency allocation

<table>
<thead>
<tr>
<th>Currency</th>
<th>underweight</th>
<th>neutral</th>
<th>overweight</th>
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</thead>
<tbody>
<tr>
<td>USD</td>
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<td>EUR</td>
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<tr>
<td>GBP</td>
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<td>JPY</td>
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<td>CHF</td>
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<td>SEK</td>
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<tr>
<td>NOK</td>
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<td>CAD</td>
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<tr>
<td>NZD</td>
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<tr>
<td>AUD</td>
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<tr>
<td>EM FX basket***</td>
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<td></td>
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<tr>
<td>DM FX basket***</td>
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<tr>
<td>Base currency</td>
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</tbody>
</table>

Source: UBS, as of 26 September 2019

*** EM FX basket contains Indian rupee and Indonesian rupiah. DM FX basket contains Australian dollar and Taiwanese dollar (all equally weighted).
**Equities**

- **US smart beta**
  Certain stock characteristics (momentum, quality, small capitalization, risk-weighting, value, and yield) have been shown to deliver long-term investment outperformance relative to a market-capitalization-weighted index. Combining these characteristics, known in the industry as smart beta, makes the investment less cyclical and creates a “passive-plus” solution. Smart beta’s compelling value proposition has resulted in considerable growth in assets. Smart beta ETF assets have risen to over USD 700bn and are growing by more than 30% a year.

- **Generate yield: “Buy-write” on US equities**
  An equity buy-write strategy involves the purchase of equities (the “buy” part) while systematically selling (or “writing”) call options that cover the position, typically on a monthly schedule. In exchange for giving a counterparty the right, but not the obligation, to buy the underlying asset at a predetermined price, the buy-writer receives a premium. Over an economic cycle, equity buy-write strategies generate attractive risk-adjusted returns as they capture both the equity and volatility risk premium. They are most appealing when equity returns moderate and market momentum decreases.

- **Global quality matters**
  The quality factor aims to reflect the performance of companies with durable business models and sustainable competitive advantages. It therefore targets companies with a high return on equity, stable earnings, and low financial leverage. In the late stage of the business cycle, when economic growth slows down and volatility rises, quality matters. As trade uncertainties remain, a global sector-neutral quality strategy can also offer added downside protection in a relative context.

**Bonds**

- **Green bonds: Sustainability meets late-cycle stability**
  We view green bonds as a sound, sustainable alternative to global investment grade (IG) bonds. While an individual green bond usually performs in line with an otherwise identical non-green one, the green bond market has a more conservative sector and risk profile and benefits from demand for sustainable investments outgrowing supply. This should lead to outperformance during times when credit risk premiums rise, making green bonds an appealing late-cycle investment, following the recent recovery in credit risk premiums globally. To benefit from green bonds’ less cyclical profile, investors should diversify broadly and in particular avoid issuer concentration risk.

- **Mind the gap: Investing in the crossover zone**
  Investors able and willing to stomach the potential volatility of “crossover credit” investments can earn potentially significant alpha if key rating agency action is anticipated correctly. While we emphasize that investments into BBB or lower quality bonds are not suitable for risk-averse investors, we provide credit views on the issuers trading in the crossover area. We also offer long and short bond baskets to help investors navigate the crossover zone.

- **Time to be more selective in EM credit**
  With this theme, we provide advice on how to build diversified exposure to emerging market (EM) credit, drawing from our top-down view on the asset class, as well as the bottom-up insights of our credit analysts. Emerging market credit should benefit from accommodative global liquidity conditions, resilient (though slowing) global growth, sound credit fundamentals, as well as the relative attractiveness of the asset class against other credit market segments. While emerging economies are on aggregate at an earlier stage in the business cycle than developed markets, there are big differences between countries and market sectors. Exposure to global risks varies from country to country as well. We think it is becoming increasingly important to invest in the right credits, and to actively adjust exposure toward the most promising opportunities.
CIO longer-term investment themes in focus

Equities

• **Obesity**
  Urbanization and rising per capita GDP in emerging markets will contribute to the prevalence of obesity globally in the coming decades. Western economies are most associated with the obesity epidemic, but it is no longer just a rich-world problem. Based on current trends, the combined population of obese and overweight adults globally could exceed 40% by 2030.

• **Space**
  The sharp decline in launch costs is lowering entry barriers to space. We forecast the space economy will grow from USD 340 billion currently to almost USD 1 trillion in the next couple of decades, catalyzed by sustained capital investment by new-economy billionaires. Investment exposure at this early stage is best gained via existing listed companies in the aerospace, satellite, and communications segments. New space startups may offer investment opportunities in private markets.

• **Fintech**
  Driven by rapid urbanization, strong demand from millennials, and favorable regulations, the global fintech industry is at an inflection point and set to drive a major digital transformation in the financial services industry. We expect global fintech revenues to grow from USD 120 billion in 2017 to USD 265 billion in 2025, implying an average annual growth rate that’s about three times faster than the broader financial sector’s.

• **Emerging market infrastructure**
  Growing urbanization and the expansion of megacities in emerging markets are driving demand for infrastructure investment. Spending on EM infrastructure is expected to grow to USD 5.5 trillion from the current USD 3 trillion, bringing its share of global spending to two-thirds by 2025 from the current half. Inadequate urban and nationwide infrastructure acts as a bottleneck to economic growth, making infrastructure investment a national priority.

• **Water scarcity**
  Water is essential to life and represents a key driver of economic growth. Unfortunately, fresh water is distributed unequally worldwide. As the world’s population grows, the planet’s limited natural resources are subject to increasing strain, which in turn can detract from social and economic prosperity. Population growth alone is a problem, but how and where it takes place can make resource management that much more of a challenge. While urbanization provides a major boost to GDP growth, it also requires vast amounts of scarce water. Many countries confront the increasing challenge of water scarcity while some face overabundance. We see attractive long-term investment opportunities in water that are likely to remain valid for decades.

This selection of themes is a subset of a larger theme universe. It represents the highest conviction themes of the UBS Chief Investment Office GWM, taking into account the current market environment and risk-return characteristics. The Longer Term Investments (LTI) theme series focuses on inevitable global trends, such as population growth, aging, and urbanization, that create a variety of opportunities, with certain companies and subsectors experiencing a higher-than-GDP rate of revenue growth. Here, we include a subset of a larger universe of LTI themes expected to offer good entry points for theme-oriented investors in the coming months, and highlight our preference for a diversified approach to themes.
## Business cycle scenarios

<table>
<thead>
<tr>
<th>CIO cycle scenarios</th>
<th>Scenario description</th>
<th>Expected market performance for select asset classes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Base case</strong> 50% probability</td>
<td>Managed slowdown with &quot;insurance&quot; easing</td>
<td>- <strong>Global equities</strong> -5% to 0% as we expect global earnings to decline this year and next</td>
</tr>
<tr>
<td></td>
<td>Global growth stabilizes around 3%. Fed further cuts rates to mitigate downside risks. The global economy remains in &quot;late-cycle&quot; territory for at least another six to 12 months.</td>
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<tr>
<td></td>
<td></td>
<td>- <strong>EURUSD</strong> rises toward 1.12 due to lower US rates</td>
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<tr>
<td></td>
<td></td>
<td>- <strong>US HY</strong> +1% to +2% as central banks keep their easing bias and default rates remain in check</td>
</tr>
<tr>
<td><strong>Downside scenario</strong> 30% probability</td>
<td><strong>Global downturn</strong></td>
<td>- <strong>Global equities</strong> -15% to -20% as earnings deteriorate and pressure on profit margins rises</td>
</tr>
<tr>
<td></td>
<td>External shocks end the global business cycle. This could stem from the US imposing higher tariffs on all US imports from China.</td>
<td>- <strong>US rates</strong> fall to historical lows with the long end potentially moving into negative territory</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- <strong>EURUSD</strong> at 1.20, as the exchange rate reverses toward PPP</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- <strong>US HY</strong> -8% to -10% as spreads widen to around 850bps</td>
</tr>
<tr>
<td><strong>Upside scenario</strong> 20% probability</td>
<td><strong>Re-acceleration</strong></td>
<td>- <strong>Global equities</strong> 0% to +10% with countries exposed to the global cycle leading up</td>
</tr>
<tr>
<td></td>
<td>The global economy reaccelerates thanks, e.g., to the trade dispute being resolved. Uncertainty lessens and investment spending picks up.</td>
<td>- <strong>US rates</strong>: short-term rates reprice higher while the long end would hit a lower high, absent structural reforms</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- <strong>EURUSD</strong> to 1.05-1.10 as a less dovish Fed keeps the dollar in range</td>
</tr>
<tr>
<td></td>
<td></td>
<td>- <strong>US HY</strong> +2% to +3% as credit spreads tighten further, but Treasury rates rise</td>
</tr>
</tbody>
</table>

*Expected total returns over a 6-month horizon*

*Note: Upside and downside scenarios are possible events outside of CIO's base case expectations.*

*Please refer to the last published Cycle report for further details on the scenarios and investment implications*

*For further information please contact CIO strategist Dirk Effenberger, dirk.effenberger@ubs.com*
Key points

- The US Federal Reserve cut rates by 25 basis points (bps) on 18 September and is prepared to cut further.
- The European Central Bank delivered a package of easing measures on 12 September, including a 10bp rate cut and additional asset purchases. We expect one further 10bp cut in March 2020.
- The Swiss National Bank and Bank of Japan both left rates unchanged at their September meetings but could still ease in the months ahead. The Bank of England’s policy remains contingent on the nature of the potential UK-EU separation, but in our base case they would remain on hold.

CIO view (Probability: 60%*)

- The US Federal Reserve cut rates by 25bps on 18 September, noting slower global growth and risks from the US-China trade dispute. The inverted yield curve is another reason to cut rates. While not promising anything, it appears that the Fed may be prepared to cut one more time even if economic growth remains near trend. If economic conditions deteriorate then they would have room to cut more aggressively.
- The ECB delivered a package of easing measures on 12 September, including a 10bp 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. We believe these changes are unlikely unless there is a severe recession. We expect one further 10bp cut in March 2020.
- With the Federal Reserve and ECB both cutting rates, many other central banks, especially in emerging markets, have also cut rates. Subdued global inflation should allow central banks to support growth with additional cuts.

*Scenario probabilities are based on qualitative assessment.

Key dates

| Oct 24 | European Central Bank policy decision |
| Oct 30 | Federal Reserve policy decision |
| Nov 7  | Bank of England policy decision |

### Positive scenario (Probability: 30%*)
- More aggressive policy easing as macro backdrop worsens

- 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.

### Negative scenario (Probability: 10%*)
- 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.

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*For further information please contact US economist Brian Rose, brian.rose@ubs.com, European economist Ricardo Garcia, ricardo-za.garcia@ubs.com or UK economist Dean Turner, dean-a.turner@ubs.com*
Key financial market driver 2 - *Earnings growth remains tepid*

Key points
- Corporate profit growth remains sluggish...
- ...and tariffs extend the soft patch.
- But growth should improve

**CIO view (Probability: 60%*)**
- US earnings growth continues to decelerate as the one-time boost from a lower tax rate fades and global economic growth slows. While a material decline in profits looks unlikely—leading indicators such as access to capital remain supportive—profit drivers have weakened over the last few months. Business sentiment has moderated, trade frictions have escalated, interest rates have fallen, and overseas growth has slowed.
- As a result, in late August we trimmed our earnings growth expectations. We expect 2019 and 2020 S&P 500 EPS of USD 164 (+1% y/y) and USD 173 (+5% y/y), respectively.
- Our estimates include some but not all of the negative impact from the announced tariffs between the US and China. Full implementation of the tariffs could reduce our 2020 estimates by another 1–3%, with the reduction at the high end of the range if business and consumer confidence takes a hit.
- Growth should modestly improve in the fourth quarter and beyond as the economic expansion continues, comparisons get easier, and tech markets stabilize. However, full implementation of the tariffs could delay the growth pickup.
- We expect profit margins to fall by 0.5% in 2019. Still, we don’t expect a sustained margin decline. The weakness is due to slow revenue growth and idiosyncratic factors such as investment spending in communications services and currency headwinds in consumer staples and tech. Most of the pressure is not due to rising wages. Labor-intensive consumer discretionary companies are the most exposed to higher wage costs but, outside of this sector, the average company should be able to offset higher wages through greater productivity and targeted price increases. Also, bear in mind that higher wages typically translate into faster consumer spending.

**Positive scenario (Probability: 20%*)**
- Aggressive global central bank stimulus and a resolution to the trade dispute between the US and China drives a reacceleration in growth.

**Negative scenario (Probability: 20%*)**
- 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.

*Scenario probabilities are based on qualitative assessment.*

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**Key dates**
- Oct 14: Start of third quarter earnings season

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**Earnings growth should improve**

<table>
<thead>
<tr>
<th>S&amp;P 500 EPS growth; actual and consensus estimates.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tan represents boost from tax reform.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>1Q16</th>
<th>2Q16</th>
<th>3Q16</th>
<th>4Q16</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPS</td>
<td>0%</td>
<td>5%</td>
<td>10%</td>
<td>15%</td>
</tr>
</tbody>
</table>

**Trade frictions have escalated**

<table>
<thead>
<tr>
<th>Estimated impact to S&amp;P 500 earnings growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tariffs assumed in CIO estimates</td>
</tr>
<tr>
<td>Remaining tariffs</td>
</tr>
<tr>
<td>3.5%</td>
</tr>
</tbody>
</table>

Source: Factset, UBS, as of 19 September 2019
Global economic outlook - Summary

Key points
• Global growth has been stable around trend for an unusually long time. Risks to that stability are rising as a result of growing trade uncertainty.
• Domestic demand remains robust in most economies on the back of strong labor markets. Trade uncertainties are weighing on the business sentiment of manufacturing companies which in turn is hurting exports and investments.
• The risk of a global recession in 2019 has clearly risen on the back of trade tensions, but nonetheless remains unlikely. We expect a protracted period of below-trend growth.

CIO view (Probability: 50%*)
• The latest escalation in the US-China trade dispute makes a deal or a truce in the coming quarters unlikely. The resulting uncertainty around trade remains a drag on exports this year and for most of next year. We postpone our expectation for a return to trend growth to late 2020 or even to 2021.
• Manufacturing-sensitive economies like Germany are already feeling the impact of trade tensions – German GDP contracted in 2Q19. As the uncertainty around trade is likely to continue, the slowdown in manufacturing could intensify. Economies with a high exposure to global trade (small open economies in Asia and Europe) 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. We expect domestic demand to cushion the drag from an export and/or manufacturing slowdown.
• However, the longer the downturn in manufacturing continues, the more it will spill over into labor markets, thereby weakening domestic demand.
• Underlying inflation trends remain relatively benign, but strong labor markets and the impact of higher tariffs on inflation should be monitored.

Positive scenario (Probability: 20%*)
• Trade uncertainty recedes after a breakthrough in US-China negotiations, triggering a rebound 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 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.

*Scenario probabilities are based on qualitative assessment.

Key dates
Oct 1  US ISM manufacturing index (Sep)
Oct 7  Germany manufacturing orders (Aug)
Oct 18 China GDP 3Q

Global growth to fall below trend
Real GDP growth rates in % (UBS estimates and forecasts)

Unemployment rates at multi-year lows
Unemployment rates, in %

Source: UBS, as of 24 September 2019
Forecasts and estimates are current only as of the date of this publication, and may change without notice.
US economy - *Slower growth amid trade disputes*

**Key points**
- Economic growth likely to slow below trend
- Core inflation should hit the Fed’s 2% target in 2020
- Fed has room to cut rates further

**CIO view (Probability: 50%*)**
- GDP expanded at a 2.1% pace in 2Q19, in line with the 2% potential growth rate. Growth is likely to be at or below potential in the quarters ahead.
- Job growth has slowed and the number of job openings has declined, suggesting that demand for labor has softened. However, the labor market remains very tight with the unemployment rate near a 50-year low.
- Rising wage income should continue to support consumer spending, which is the main driver of overall economic growth. However, the very strong retail sales growth seen in recent months is likely to fade.
- Strong profits and labor shortages provide an incentive for businesses to invest. However, political uncertainty, especially on trade, is acting as a constraint.
- The manufacturing sector is struggling amid the trade disputes, with the Purchasing Managers Index falling below 50 in August and manufacturing output falling year-to-date. Domestic demand should provide enough support to prevent a severe downturn.
- Residential investment has declined in recent quarters but should soon turn positive. Mortgage rates have declined and demand for housing should be supported by the strong labor market.
- Core PCE inflation, which excludes food and energy prices, has been showing stronger increases in recent months and should reach the Fed’s 2% target in 2020.
- The Fed cut rates by 25 basis points each in July and September, and has room to cut further. We expect the Fed to react to events rather than aggressively trying to get ahead of the curve.
- With support from fiscal policy fading, further escalation of trade disputes could pose a more serious threat to the recovery.

**Positive scenario (Probability: 20%*)**
- A breakthrough in trade negotiations removes uncertainty, allowing business investment to strengthen and GDP growth to rebound. The Fed refrains from further rate cuts.

**Negative scenario (Probability: 30%*)**
- Trade disputes, political uncertainty, and tighter financial conditions weigh on business investment and consumer spending, pushing the economy into recession. The Fed cuts rates sharply.

*Scenario probabilities are based on qualitative assessment.

**Key dates**
- **Sep 27**
  - Personal income and spending, PCE inflation for August
- **Oct 1**
  - ISM manufacturing PMI for September
- **Oct 3**
  - ISM non-manufacturing PMI for September
- **Oct 4**
  - Labor report for September

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**Manufacturing in downturn, non-manufacturing holding up**

<table>
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<tr>
<th>Year</th>
<th>ISM manufacturing PMI</th>
<th>ISM non-manufacturing PMI</th>
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<tr>
<td>2019</td>
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</tr>
</tbody>
</table>

Source: Bloomberg, UBS, as of 19 September 2019

**Job growth has slowed**

Nonfarm payrolls growth and 6-month moving average, in ’000s

Source: Bloomberg, UBS, as of 19 September 2019
Eurozone economy - Moderate growth with downside risks

Key points
- Lower US and China growth on the back of the trade spat to act as drag on the Eurozone.
- Inflation is set to move sideways for the time being.
- We expect the ECB to cut the deposit rate further in response to lower US policy rates.

CIO view (Probability: 50%*)
- We expect economic activity to remain at moderate levels as long as trade uncertainties linger. In the event of a further significant escalation, growth is likely to turn out lower than expected. We expect the ECB to respond to lower US policy rates by reducing the deposit rate by 0.1% in March (with a high risk of an earlier cut in December 2019).
- In Germany, the tight global export environment has increased the risk of a technical recession and we expect moderate fiscal measures in the next six months. In France, the waning yellow-vest protests, reforms, and fiscal stimulus should help to stabilize GDP growth.
- Growth in Italy should continue to stabilize following the budget agreement with the European Commission and the compression in bond risk premia. Spain is still growing strongly, but the momentum is likely to continue to normalize as foreign growth moderates.

Key dates
- Sep 30: Unemployment for August
- Oct 1: Inflation estimate for September
- Oct 24: ECB press conference
- Oct 24: Flash PMI for October

Growth outlook subject to trade uncertainties
- Positive scenario (Probability: 25%*)
  - The global economy accelerates again and the euro weakens. Eurozone loan demand and the economy recover faster than envisaged. Political risks fade.

- Negative scenario (Probability: 25%*)
  - The Eurozone suffers a disinflationary setback as trade tensions escalate sharply, markets lose faith in Italy's debt sustainability, Brexit talks fail, or the Chinese economy suffers a severe downturn.

*Scenario probabilities are based on qualitative assessment.

Better-than-expected growth
- The global economy accelerates again and the euro weakens. Eurozone loan demand and the economy recover faster than envisaged. Political risks fade.

Disinflationary setback
- The Eurozone suffers a disinflationary setback as trade tensions escalate sharply, markets lose faith in Italy's debt sustainability, Brexit talks fail, or the Chinese economy suffers a severe downturn.

Key dates
- Sep 30: Unemployment for August
- Oct 1: Inflation estimate for September
- Oct 24: ECB press conference
- Oct 24: Flash PMI for October

Eurozone growth consolidating
Business and consumer surveys

Source: Haver Analytics, UBS, as of August 2019

ECB balance sheet topping out
Total assets in national currency (index: 2007=100)

Source: Haver, UBS, as of August 2019 (SNB data as of July 2019)
Chinese economy - Policy easing cushions slowdown

Key points
- Weak economic data hints at continued easing bias.
- Both monetary and fiscal policy remain supportive.
- Sino-US trade tensions remain a key risk.

CIO view (Probability: 70%*)
- Weak activity data hints at a continued easing bias. August retail sales softened to 7.5% y/y, dragged down by the auto sector, but we believe they are likely to remain over 8% for the full year supported by resilient consumer staples. Jan-Aug FAI growth edged down to 5.5% y/y due to slower manufacturing and property, but was partially offset by a pick up in infrastructure. Trade growth remained subdued. We expect GDP growth to decelerate further in 2H, but to remain above 6% y/y for 2019, in line with the government’s target range of 6%–6.5%.
- August CPI inflation remained at 2.8% y/y, a 17-month high, with continued upside risk due to rising pork prices toward year end. Core CPI inflation remained as low as 1.5% y/y in August. PPI deflation deepened to -0.8% y/y from -0.3% y/y in July on weakened domestic demand and a higher base for commodity prices.
- Monetary policy remains accommodative. The central bank announced on 6 September a 50bps general RRR cut, effective on 16 September, and a further 100bps of targeted RRR cuts of 50bps each on 15 October and 15 November, releasing liquidity of CNY 900bn. We expect a further 50–150bps of general RRR cuts and 10-20bps of medium lending facility rate cuts for the rest of the year. August credit growth stabilized at 10.7% y/y supported by local government bonds.
- Fiscal policy remains active. The local government bond quota will be lifted in 4Q to support infrastructure spending, after the current CNY 3.1trn quota for this year is due to be completed by September.
- Sino-US trade tension remains a key risk. Both countries agreed to resume talks in October after a new round of tit-for-tat tariff escalation in August. China announced on 13 September to rollback tariffs on US pork and soybeans, after the US postponed additional tariffs imposed on Chinese goods on 1 October. An interim deal is likely to be reached, with China’s potential increased purchase of US goods in exchange for a US delay in applying new tariffs.

Positive scenario (Probability: 5%*)
- Annual GDP growth accelerates above 6.5% in 2019 on easing trade tensions and a global cyclical growth upswing. Aggregate debt-to-GDP ratio stabilizes. Annual current account surplus increases over USD 100bn.

Negative scenario (Probability: 25%*)
- The US makes good on its threats to impose investment restrictions and tariffs on most Chinese products, introducing a sweeping tariff of 25% on the remaining USD 300bn worth of annual Chinese imports before 2020.
- In 2019, China experiences a sharp slowdown in growth (<5.5% real GDP growth for two quarters) and a faster deterioration of its current account into annual deficit.
- CNY slides to 7.5 or weaker within a quarter, alongside a fall in FX reserves. Capital controls are tightened.

* Scenario probabilities are based on qualitative assessments.

Key dates
- Sep 30: September manufacturing and nonmanufacturing PMI
- Oct 14: September trade data
- Oct 18: 3Q GDP, September fixed-asset investment, retail sales, industrial production

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Swiss economy - No recovery in sight

Key points
• Swiss GDP advanced 0.3% qoq in 2Q19 – slightly stronger than expected by consensus (0.2%). But the Swiss economy has lost considerable momentum since mid-2018. We therefore expect GDP growth of only 0.7% for the full year.
• With the escalation of the US-China trade dispute, political uncertainties and weak economic growth will likely continue. The Swiss economy is unlikely to recover before mid-2020.
• Given these risks, we expect the Swiss National Bank to cut rates by an additional 25 basis points in March 2020.

CIO view (Probability: 50%*)
• Swiss gross domestic product (GDP) increased in 2Q19 by 0.3% q/q and y/y, slightly stronger than expected by consensus (0.2%).
• Following the SECO’s significant downward revision of recent GDP data, we expect the Swiss economy to grow 0.7% this year (previously 1.3%). If the current weakness persists, GDP may grow only 0.9% next year (previously 1.6%).
• The Swiss economy has lost considerable momentum since mid-2018. With the escalation of the US-China trade dispute, political uncertainties and weak economic growth will likely continue. The Swiss economy is unlikely to recover before mid-2020.
• Leading indicators point to a slowdown in the economy as well, especially in the manufacturing sector. In August, the manufacturing purchasing managers’ index improved slightly (from 44.7 to 47.2 points), indicating weak growth in the manufacturing sector in the coming months.
• Although Switzerland is strongly exposed to global trade, a robust domestic economy helps to stabilize Swiss activity. The labor market has recovered noticeably and can be a key driver of private consumption.
• The strengthening Swiss franc will have a dampening effect on inflation this year. We expect consumer prices to grow 0.6%, after last year’s 0.9%.
• We foresee additional monetary easing of the ECB next year on the back of political uncertainty and the subdued economic picture in the Eurozone. This could put the Swiss franc under appreciation pressure and force the SNB to lower interest rates as well. We expect the SNB to cut rates from -0.75% to -1% next March if the global slowdown materializes.

Positive scenario (Probability: 15%*)
• A further drop in Eurozone unemployment leads to a rebound in Europe and shores up domestic demand, which in turn supports Swiss exports.

Negative scenario (Probability: 35%*)
• More protectionist measures by the Trump administration (especially against European car makers) lead to a global downturn, which would hurt Swiss exports.

Key dates
| Oct 1 | Manufacturing PMI for September |
| Oct 2 | CPI for September |
| Oct 8 | Unemployment Rate for September |
| Oct 17 | Trade Balance for September |

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