This report was prepared by UBS AG.
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**
  Global equities fell about 7% in October, representing one of the worst performing months since the global financial crisis. Still, global leading indicators – especially for the service sector – point at robust economic growth. The labor market in the US remains robust, and US earnings delivered slightly more than 25% year-over-year growth in the third quarter. This will slow in 2019 as the year-over-year lift from corporate tax cuts rolls off, but we continue to expect earnings growth to be positive at 4% in the US. In Europe we look for mid-single-digits growth, and in the emerging markets 8%. Against this benign fundamental backdrop we recently added back to global equities versus high grade bonds – a position which we reduced in summer.

- **Equities**
  Volatility picked up in October with US, EM, EMU and Japanese equities falling 6-9%. The defensive Swiss market held up better. Global leading indicators continue to signal robust economic growth. In the current 3Q earnings season, US companies delivered slightly more than 25% earnings growth. As earnings improved globally valuations became more attractive. We keep our preference for Canadian stocks over Australian equities due to more compelling valuations. Earnings dynamics are also stronger in Canada than in Australia.

- **Bonds**
  We hold an overweight on emerging market (EM) sovereign bonds in USD against HG bonds. EM fundamentals and the bonds’ attractive yield of 6.9% support the position. We are overweight 2-year Italian government bonds against EUR cash. Short-term Italian rates look appealing (with yields 1.5% above those of similar maturity Bunds), given the low likelihood in our view of Italy defaulting over the coming years, and the attractive carry and roll-down. We are overweight 10-year US Treasuries versus USD cash as we think this part of the curve has largely priced in the rate-hiking cycle, and the carry is attractive. We are underweight 10-year Japanese government bonds versus JPY cash. We believe the Bank of Japan will allow yields to move further upwards as inflation picks up.

- **Foreign exchange**
  We are overweight the Japanese yen (JPY) versus the Taiwan dollar (TWD). The long JPY position should benefit from either rising Japanese inflation prompting the Bank of Japan to allow yields to move further upwards, or a downturn in global financial markets creating demand for the JPY’s safe-haven function. Meanwhile, Taiwan is exposed to risks arising from US trade policy disputes.

For further information please contact Head CIO Global Asset Allocation Andreas J Koester, andreas.koester@ubs.com or CIO asset class specialists Philipp Schöttler, philipp.schoettler@ubs.com or Carolina Corvalan, carolina.corvalan@ubs.com.
Cross-asset preferences

**We like...**
- Global equities
- Canadian equities
- Global quality stocks
- "Buy-write" strategy on US equities
- US smart beta
- Some protection via US equity put options
- EM sovereign bonds in USD
- Selected EM bonds
- 10-year US Treasuries vs. USD cash
- Long-dated USD high grade bonds
- European leveraged loans
- 2-year Italian government bonds vs. EUR cash
- Japanese yen vs...
- Navigating rising US rates with hedge funds

**We don't like...**
- Australian equities
- Developed market high grade bonds
- 10-year Japanese govt. bonds vs. JPY cash
- "Well-worn" bonds
- ...Taiwan dollar

**Model portfolios (EUR & USD)***

<table>
<thead>
<tr>
<th>EUR</th>
<th>USD</th>
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<tbody>
<tr>
<td>10%</td>
<td>12%</td>
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<tr>
<td>18%</td>
<td>21%</td>
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<td>2%</td>
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<td>5%</td>
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<tr>
<td>7.3%</td>
<td>5.5%</td>
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<tr>
<td>US TIPS</td>
<td>US TIPS</td>
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<td>2%</td>
<td>4%</td>
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<tr>
<td>Inv. grade corporate bonds</td>
<td>8%</td>
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<td>8%</td>
<td>5%</td>
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<td>High yield bonds</td>
<td>High yield bonds</td>
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<td>7.5%</td>
<td>7.5%</td>
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<td>EM bonds</td>
<td>EM bonds</td>
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<td>5%</td>
<td>5%</td>
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<tr>
<td>Equities others</td>
<td>Equities others</td>
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<tr>
<td>6%</td>
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<td>Equities EM</td>
<td>Equities EM</td>
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<td>4%</td>
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<td>Equities Europe</td>
<td>Equities Europe</td>
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<td>24%</td>
<td>13%</td>
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<td>Hedge Funds</td>
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<td>18%</td>
<td>18%</td>
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*Source: UBS, as of 15 November 2018; * Additionally, the portfolios include overweight positions in 2-year Italian government bonds, 10-year US Treasuries and an underweight in 10-year Japanese government bonds (via overlays)*

**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 3.5% p.a. and a volatility of 8% p.a. over the next seven years. We expect the USD balanced portfolio (excl. TAA) to have an average total return of 5.2% 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>Asset Class</th>
<th>underweight</th>
<th>neutral</th>
<th>overweight</th>
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<tbody>
<tr>
<td>Liquidity</td>
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<tr>
<td>Equities total**</td>
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<tr>
<td>Global</td>
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<td>US</td>
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<td>Eurozone</td>
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<td>UK</td>
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<td>Switzerland</td>
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<tr>
<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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<td>High grade bonds</td>
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<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>Italian 2-year govt bond overlay</td>
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<td>Duration overlay (USD)</td>
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<tr>
<td>Duration overlay (JPY)</td>
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*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.

***Note: Equity risk profile only.
CIO themes in focus

**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 650bn 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 and, historically, perform strongly during periods of rising rates.

- **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 mid-to-late stages of the business cycle, when monetary policy is less accommodative and volatility rises, quality matters. With increasing trade tensions, a global sector-neutral quality strategy can also offer added downside protection in a relative context.

**Bonds**

- **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 resilient global growth, sound credit fundamentals, as well as its relative attractiveness 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 vary 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.

- **Replacing well-worn bonds**
  Risk-free yields in some major developed markets are near or below zero. Even if rates stay unchanged, many short- to medium-term bonds would deliver negative total returns. We think investors can preserve wealth by taking profits on assets that will deliver negative returns (exceeding switching-out costs) in most likely scenarios. More attractive alternatives can be found on CIO’s bond recommendation lists.

- **Opportunities in European leveraged loans**
  Financial market volatility has risen from last year’s lows, while attractive fixed income investments in Europe remain hard to find. We think European leveraged loans offer an appealing risk-reward profile due to their attractive yield and generally low volatility, and our outlook for low default rates. European leveraged loans are offering a yield around 4%, which compares favorably with other bond alternatives. We expect 12-month total returns of 3–4% in EUR and 6–7% hedged into USD. Following the outperformance of US loans since the beginning of the year, we are starting to see better investment opportunities in European loans. We recommend investors in US loans to hold onto their investments, but for new investments to be made in European loans.

- **Long-dated USD high grade bonds: Buy now or never**
  Within a portfolio of equities and bonds, long-dated high grade bonds, in addition to their carry yield, can buffer losses from risk assets. Investors should use the current level of long-term US dollar yields, which we think are close to the highs of this cycle, to align the portfolio share and average tenor of high grade bonds with a strategic asset allocation reflecting their risk profile, for example by deploying excess cash or reducing potential over-allocations to lower-quality bonds.
CIO themes in focus

Alternative investments

- **Navigating rising US rates with hedge funds**
  The US Federal Reserve has started to hike interest rates. Historically, most hedge fund strategies have been resilient to rising rates, while high grade bonds have performed poorly. Investors looking for an alternative to their high grade bond exposure should consider a diversified hedge fund portfolio characterized by low directional exposure to both fixed income and equities.

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.
CIO longer term investment themes in focus

**Equities**

- **Space**
  The sharp decline in launch costs is lowering entry barriers to space. We forecast the space economy will likely grow from USD 340bn currently to almost USD 1trn 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 start-ups may offer investment opportunities in private markets.

- **Medical devices**
  The aging population and growth of the over-65 age group will create more opportunities for companies selling medical products and devices. Other drivers of the medical device industry include better penetration in emerging markets due to improved infrastructure, new innovative treatments, increased affordability due to rising per-capita GDP, and a growing prevalence of "lifestyle diseases" like obesity due to urbanization. We expect sustainable mid-single-digit revenue growth.

- **EM tourism**
  Urbanization and income growth are driving demand growth for emerging market tourism and global aviation infrastructure. Already, the number of emerging market air passengers carried globally exceed that of developed markets. Airbus forecasts that two-thirds of new plane orders will come from emerging markets in the next 20 years. The growth of EM tourism is further supported by government policy, particularly economic diversification away from commodity exports and rising visa openness to draw visitors and attract foreign-currency receipts.

- **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 120bn in 2017 to USD 265bn in 2025, implying an average annual growth rate about three times faster than the broader financial sector’s.

- **Silver spending**
  The aging of the global population provides investment opportunities. Compared with younger age groups, "silver spenders" allocate more of their disposable income to leisure and tourism (particularly cruises), as well as consumer personal care and beauty products (specifically anti-aging products). These markets are estimated to grow by 8% and 6% a year, respectively, well above the average consumer spending growth of less than 2% in G7 nations.

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 Investment (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.
## Key investment risks

<table>
<thead>
<tr>
<th>Selected Scenarios</th>
<th>Scenario Description</th>
<th>Expected market performance for select asset classes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Base case</strong></td>
<td><strong>Positive outlook with increased volatility</strong></td>
<td>US equities +0–5% due to solid economic activity supported by government spending, business confidence and capital access</td>
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<td></td>
<td>Global economic performance remains solid, but ongoing trade tensions and uncertainty about Eurozone growth keep the volatility high.</td>
<td>Eurozone equities +0–5% amid political uncertainty surrounding Italy, Brexit and the ongoing trade conflict</td>
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<td></td>
<td>EURUSD between 1.15 and 1.20 as monetary policy normalizes</td>
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<tr>
<td><strong>Key downside scenarios</strong></td>
<td><strong>Trade: Further US sanctions</strong></td>
<td>US equities down 5–10% composed of a 5% hit to our EPS estimates coupled with P/Es contracting 0–5%</td>
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<td></td>
<td>US-China trade disputes induce a slowdown in China, considerable uncertainty and a rerouting of global trade. More countries start to feel pain via disrupted supply chains.</td>
<td>Chinese equities down 20–25% as sentiment tanks further with worse-than-expected economic consequences</td>
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<td>USD appreciates to around EURUSD 1.10 as US tariffs support the USD</td>
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<td>Crude oil spikes to USD 120/bbl</td>
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<td>US energy equities +15–20% as they are in generic closely correlated to oil prices</td>
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<td>NOK appreciates, bringing USDNOK down 15-20% as higher oil prices lift the revenue of Norway’s oil export sector (around 15% of GDP)</td>
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<td></td>
<td>US equities down 10–15% as valuations fall 5–10% as fears about the end of the cycle rise and earnings do not grow in 2019</td>
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<td></td>
<td>US high yield down 6–9% as spreads widen towards recession levels, while mid- to longer-term US Treasury yields fall</td>
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<td></td>
<td>USD appreciates, bringing EURUSD to or below 1.10 as the USD strengthens due to contractionary monetary policy</td>
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<tr>
<td></td>
<td>Fed ends the business cycle sooner</td>
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<td></td>
<td>As US inflation rises rapidly, the Fed is forced to hike rates at each FOMC meeting. This leads to a flat or inverted US Treasury yield curve toward mid-2019, followed by an equity bear market. A US recession starts in early 2020.</td>
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</tr>
<tr>
<td><strong>Key upside scenarios</strong></td>
<td><strong>Trade: Negotiations avert additional sanctions</strong></td>
<td>US equities +10–15% as increased confidence in the cycle allows P/Es to expand to 17.5–18x and 2019 EPS estimates hold in the mid-US$ 170s</td>
</tr>
<tr>
<td></td>
<td>Negotiations between the US and China restart, leading to actual progress and a reduction of trade barriers. Although tensions remain high, both countries agree on a trade truce.</td>
<td>Chinese equities +10–15% due to a strong recovery on risk sentiment and better-than-expected fundamentals</td>
</tr>
<tr>
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<td>USD depreciates to EURUSD 1.20–1.25</td>
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<td>Chinese equities +15–20% due to a recovery on valuation as growth beats consensus expectations</td>
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<td>EMBIGD bonds return 6–7% as spreads tighten to around 310bps due to improving EM growth prospects</td>
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<td></td>
<td>CNY appreciates to USD/CNY 6.50 as strong Chinese growth supports the domestic equity market, preventing outflows and supporting inflows of capital</td>
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<tr>
<td>China: Stable GDP growth</td>
<td>Chinese GDP growth remains in a 6.6–6.8% range as the current account balance goes back above USD 100bn.</td>
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</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 Global Risk Radar edition for further details on the risk scenarios and investment implications.

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

Source: UBS, as of November 2018
Key points
- Investors expect the Federal Reserve to stick to the rhythm of “hike, pause, hike, pause.” This would suggest a December rate increase. Fed bond holdings, a form of liquidity supply, should continue to decline to hopefully match the reduction in liquidity demand in the economy.
- The European Central Bank (ECB) is still expected to end its bond-buying program at the end of this year. Markets expect the ECB to raise interest rates in 2019.
- The Swiss National Bank (SNB) is unlikely to raise interest rates until 2H19, given the increased global uncertainty (and the potential for safe-haven flows). The Bank of England governor will stay in office for longer than expected, to provide stability as the UK and the EU separate.

CIO view (Probability: 75%*)
- The rate rise in September demonstrated the regular rhythm of the Fed’s tightening schedule, and markets view a December rate hike as a very high-probability event. Investor discussion has now shifted to the number of rate hikes in 2019. Trade tariffs are a tax hike, and like other tax hikes will slow the US economy. The inflation consequences of trade protectionism are likely to be less of a concern than the growth consequences. The Fed continues to reduce liquidity supply to match a decline in liquidity demand in the economy. A deficit-financed fiscal stimulus by the US government at a time of full employment is a concern for the medium-term interest rate outlook.
- The ECB’s general message is that its quantitative easing (QE) program will conclude at the end of this year in the absence of a more substantial negative economic shock. The program’s EUR 30bn worth of asset purchases per month fell to EUR 15bn in October.
- Central banks have expressed a clearer bias toward tightening rather than easing; this coincidence of views probably reflects the general improvement in global growth rather than an overt coordination. Most central banks are being very clear in their intentions, meaning that markets are rarely surprised by policy moves.
- The tightening of central bank policy represents a shift from past cycles. This time, central banks have no desire to temper economic growth or inflation; the aim is to maintain them around current levels. Past episodes of policy tightening had deliberately sought to reduce company pricing power and inflation.

Positive scenario (Probability: 10%*)
- The Fed falls further behind the curve as US inflation surprises higher, with real interest rates slipping more rapidly. The ECB reverses its tone and puts a stronger emphasis on the potential to ease policy further.

Negative scenario (Probability: 15%*)
- The inflationary effect of a tighter US labor market and fiscal stimulus leads to a stronger Fed response and a combination of tight monetary policy and loose fiscal policy. Increased labor costs and commodity price pressures lead to higher European inflation, signaling a more rapid monetary policy tightening.

*Scenario probabilities are based on qualitative assessment

Key dates
Dec 19  US Federal Reserve meeting

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Key financial market driver 2 - Political risks

Key points
- A lot of political noise that dominates the news has little relevance for economics, and so there has been little need for markets to react. The ongoing Mueller investigation in the US is an example of political noise with few direct economic implications. The Italian budget disagreement with the EU has some direct economic consequences, but markets have priced in a lot.
- Negotiations on the UK’s exit from the EU continue with conflicting signals – the question is whether any deal will pass the UK Parliament. The change in leadership in the German CDU, which is likely to be decided in December, is of interest to investors as a signal as to where domestic policy may head.
- The world is not yet in a trade war (defined as global trade falling as a share of global GDP, in real terms). The risks of a Sino-US trade war remain, with investors keen to see the outcome of talks on the fringes of the G20 meeting in Buenos Aires.

CIO view (Probability: 70%*)
- Markets have seemingly developed some immunity to political rhetoric. The ongoing Mueller investigation in the United States would only impact financial markets if it were seen as changing policy outcomes. The US mid-term elections produced the result markets had expected. US political polarisation is considerable. Investors will watch the reaction of the White House to a likely gridlock in Washington, and to the likelihood of increased investigations by Congress.
- US trade taxes to-date have not generally impacted the overall volume of global trade, although imports may have accelerated to beat tariff increases. Companies do seem to be finding ways of evading the trade taxes. Extending trade protectionism into a trade war would be a more obvious tax on US consumers.
- Our base case is that a deal will be done for the separation of the UK and the EU. However, the necessity of UK parliamentary approval is likely to add uncertainty.
- Italy’s budget disagreements with the EU highlight some of the tensions on the European political scene. Nationalist and anti-politics have been gaining ground in some areas. However, Italy remains an extremely wealthy country, and should be capable of funding its debt. Germany’s governing CDU is in focus in December with leadership elections expected.

Positive scenario (Probability: 10%*)
- Better labor market conditions for low-skilled workers lead to faster wage hikes; this eases income and consumption inequality. The costs of trade protection are made more apparent to US voters through the actions of corporations, and the US retreats from its isolationist agenda.

Negative scenario (Probability: 20%*)
- Nationalist tendencies are encouraged by single-issue politics and social media. Traditional party structures fail to address the demands of large sections of the electorate. Political outcomes are increasingly unpredictable as opinion polls offer even less guidance. Trade protectionism escalates. Lower-income groups’ standards of living are hurt by populist policies and rising prices, fueling further demands for radical and unpredictable change.

*Scenario probabilities are based on qualitative assessment.

Key dates
Nov 30 G20 leaders’ summit in Buenos Aires
Dec 6 German CDU Party Conference
Key financial market driver 3 - Solid US profit growth, but deceleration ahead

Key points
- A solid economy and tax reform are driving strong earnings growth this year.
- However, growth will slow in 2019 to 4%, partly due to tariffs.
- A further escalation in trade frictions cannot be ruled out.

CIO view (Probability: 60%*)
- The US earnings growth outlook remains relatively healthy, driven by solid consumer spending, secular growth in tech, and robust capital spending. Leading indicators such as bank lending standards and capital spending intentions also remain supportive. However, the outlook has softened due to some weakness in non-US economies and rising trade frictions.
- But the US-China trade dispute is intensifying. The direct impact of the tariffs now in place will likely trim annual S&P 500 profit growth by 2–3%. If the US expands tariffs to all Chinese imports, the impact could rise to about 4–5%.
- For full-year 2018, we expect S&P 500 EPS of USD 161 (21% growth). Growth should slow in 2019 as the one-time benefit from a lower tax rate falls off. We also include a tariff-related drag of 2–3%. Our 2019 EPS estimate is USD 168 (4% growth).
- The 3Q earnings season is nearly complete. EPS growth is tracking at 27%, much stronger than our initial estimates. Although the lower tax rate is providing an 8% boost to earnings, fundamentals are still strong, with revenues growing over 8%.
- While consensus estimates for the fourth quarter are being revised down due to some cost pressures, currency headwinds, and pockets of weakness in the global economy, estimates are not falling any more than they historically do. Further, bottom-up consensus estimates still imply strong earnings growth of 16% for 4Q.
- Fears that high profit margins will decline in the near term appear overblown. Excluding the tech sector, margins are not excessive. The tech sector’s high margins are supported by companies with dominant market shares. Other structural factors, such as industry consolidation and a secular decline in tax rates, support higher-than-average profit margins. In addition, margins typically only decline in a recession. Finally, the prospect of higher wages is unlikely to dent the outlook. Labor cost inflation has virtually no correlation with earnings growth as higher consumer income is usually recycled into faster consumer spending.

* Scenario probabilities are based on qualitative assessment.

Key dates
Dec 12 Results from fourth quarter “early” reporters

For further information please contact CIO strategists Jeremy Zirin, jeremy.zirin@ubs.com, David Lefkowitz, david.lefkowitz@ubs.com or Edmund Tran, edmund.tran@ubs.com.
Global economic outlook - Summary

Key points
• Global growth continues to be reasonable. There have been some signs of a modest slowdown in the second half of this year. This was expected, in particular as the impact of US tax cuts fades. However, overall growth remains around trend.
• Companies are finding it easier to hike prices. The producer price index (PPI) excluding energy is high in the US and the UK. Consumer prices are noisy, but almost every US and European consumer price index (CPI) is around its 20-year average.
• Domestic demand remains firm in most major economies, with the strength of the labor markets an important support. Global trade is threatened by US action, but it is important to stress that this is US-focused and not a general trade dispute.

CIO view (Probability: 70%*)
• The world economy continues to perform well. Economic trends suggest that growth this year will match last year. Labor markets remain very strong in most developed economies. There is evidence in the data that this is now lifting household incomes. Income growth is being spent. In the US and the UK, retail sales volumes are growing faster than last year. In Europe, volume growth rates are generally slightly slower, with Germany and Spain somewhat weaker. The German economy seems likely to recover quickly from the temporary problems of the auto sector.
• US investment is reportedly being delayed by trade tensions, and trade issues may slow US growth later this year. To date, trade data continue to be revised higher, and labor market shortages increase household incomes and consumer demand at a faster pace than expected. Fiscal stimulus adds to the pace of economic activity, and taxes on trade are reversed.
• Emerging markets see stable domestic demand. Those markets that have experienced volatility pursue market-friendly policies. Pro-business forces guide the US policy agenda and produce growth-supportive regulatory and legislative changes.

Positive scenario (Probability: 15%*)
• European economic growth surprises positively, with better labor markets and stronger domestic demand. US economic growth data continue to be revised higher, and labor market shortages increase household incomes and consumer demand at a faster pace than expected. Fiscal stimulus adds to the pace of economic activity, and taxes on trade are reversed.
• Emerging markets see stable domestic demand. Those markets that have experienced volatility pursue market-friendly policies. Pro-business forces guide the US policy agenda and produce growth-supportive regulatory and legislative changes.

Negative scenario (Probability: 15%*)
• Additional US fiscal stimulus at a time of full employment produces economic overheating, which in turn provokes an economic recession in 2019. A full trade war (where trade policies produce a declining real-trade-to-GDP ratio) reduces US consumer spending and increases unemployment in 2019. Slower US growth translates into slower global demand, and emerging market weakness becomes more widespread.
• European growth fades as domestic demand falters. Bank lending falters and the European Central Bank fails to respond quickly.

Trend-like growth, normal inflation

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Source: UBS, as of 15 November 2018

For further information please contact UBS WM Global Chief Economist Paul Donovan, paul.donovan@ubs.com

Key dates
Dec 13 European Central Bank meeting
Dec 19 US Federal Reserve meeting
US economy - Moderate growth in the US

Key points

- Economic growth should slow over the next 12 months as fiscal and monetary stimulus fades.
- Inflation should gradually trend higher along with wage growth.
- The Fed will likely continue to hike interest rates and shrink its balance sheet gradually.

CIO view (Probability: 60%*)

Moderate expansion

- The strong labor market and income tax cuts should support robust consumer spending.
- Business investment should continue to increase, encouraged by strong profits and labor shortages, although trade disputes will likely act as a constraint.
- Manufacturing output should rise at a moderate pace.
- Recent housing data suggest that higher interest rates are restraining growth, but we still expect housing starts and home prices to trend modestly higher over time.
- Tax cuts and increased government spending are providing a substantial stimulus to growth that will start to fade in 2019.
- Trade disputes are negative for growth. Tariffs on USD 200 bn of Chinese goods are set to rise from 10% up to 25% on 1 January 2019.
- Inflation has risen to the Fed’s 2% target and is likely to move somewhat higher as the US economy begins to overheat and tariffs raise import prices. However, we expect core inflation to remain within the limits that the Fed will tolerate.
- We expect the Fed to continue hiking interest rates and shrinking its balance sheet at a gradual pace, reaching a neutral stance by the end of 2019.
- Risks to the recovery may increase toward the end of 2019 as fiscal and monetary policy offer less support.

Positive scenario (Probability: 20%*)

Strong expansion

- US real GDP grows above 3%, propelled by an accommodative monetary policy, looser fiscal policy, strong household spending, and breakthroughs in trade negotiations. Inflation overshoots the Fed’s 2% target, potentially leading the central bank to raise rates at a faster pace.

Negative scenario (Probability: 20%*)

Growth recession


*Scenario probabilities are based on qualitative assessment.

Key dates

- Nov 29: Personal income and spending, PCE deflator for October
- Dec 3: ISM Manufacturing for November
- Dec 5: ISM Non-manufacturing for November
- Dec 7: Labor report for November
Eurozone economy - *Growth to pick up after summer soft patch*

**Key points**
- We expect economic growth to normalize after the summer lull.
- Inflation is set to hover around the ECB’s target.
- We expect the ECB to start raising rates in December 2019.

**CIO view (Probability: 60%*)**
- Following the hit to car production in the summer on the back of new emission standards, activity is set to normalize by the end of the first quarter. The ECB remains in wait-and-see mode as inflation hovers around its target and until key risks fade. We think the central bank may start raising rates in December 2019.
- In Germany fundamentals such as consumer confidence, wage increases, and construction remain robust, mitigating the impact from global protectionism. In France, President Emmanuel Macron’s reforms should start to support GDP growth.
- Fiscal stimulus in Italy should be partly offset by tightening financial conditions. Spain is still growing strongly, but the momentum is likely to continue to normalize.

**Positive scenario (Probability: 20%*)**
- 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: 20%*)**
- The Eurozone suffers a disinflationary setback as markets lose faith in Italy’s debt sustainability, trade tensions escalate sharply, Brexit talks fail, or the Chinese economy suffers a severe downturn.

**Key dates**
- Nov 23: PMI flash for November
- Nov 30: Inflation estimate for November
- Nov 30: Unemployment for October
- Dec 13: ECB press conference
Chinese economy - Policy easing continues

Key points
• GDP growth is on track for moderation.
• Policy easing will continue to cushion external trade tension and internal headwinds.
• The Sino-US relationship enters a "new normal" with cycles of talk-fight-talk for years.

CIO view (Probability: 80%*)
• 3Q GDP growth moderated to 6.5% y/y from 6.75% y/y in 1H due to a slowdown in investment and consumption. 3Q FAI growth decelerated further to 4.6% y/y from 5.2% y/y in 2Q18, and retail sales growth remained at 9.0% y/y, similar to 2Q18. GDP growth is on track for moderation, likely to reach 6.5% in 2018 and 6% in 2019 on rising trade pressure.
• September CPI inflation edged up to a seven-month high of 2.5% y/y on higher food prices. CPI inflation is set to stay mild; we expect it to average 2.2% and 1.9% respectively in 2018 and 2019.
• Policy easing will continue to shield against internal and external headwinds. Monetary policy stance turned "stable" with "reasonably ample" liquidity with expectation of another 100-200 bps of RRR cuts within six to 12 months, and fiscal policy should become more active with support for infrastructure projects. China has also further deepened its market openness and actively promoted its strategic partnership with non-US economies, especially Japan.
• Facing escalating US tariff pressure, China will continue to retaliate with a mix of measures as well as policy easing. The Sino-US relationship is entering a "new normal" in our view. We believe this will be a long-term tension with cycles of talk-fight-talk. The second-round effects on global supply chains should also be closely monitored. The trade spat is likely to splinter supply chains, with the US’s benefiting from core high technology and innovation output and China’s from its large, skilled labor force, superior infrastructure, and high degree of industrialization. The rest of the world will leverage both, benefiting their own interests.

Positive scenario (Probability: 5%*)
• Annual GDP growth accelerates above 6.8% on easing trade tensions and cyclical global growth. Aggregate debt-to-GDP ratio stabilizes. Annual current account surplus increases over USD 100bn.

Negative scenario (Probability: 15%*)
• The US makes good on its threat to impose investment restrictions and tariffs on most Chinese products, introducing a sweeping 25% tariff on some USD 500bn of Chinese imports before 2020. In 2019, China experiences a sharp growth slowdown (5% real GDP growth for two quarters), and its current account deteriorates fast and turns into a deficit. The CNY slides to 7.5 or even weaker per USD within a quarter, China’s FX reserves fall dramatically, and authorities tighten capital controls. Asian and emerging market assets sell off.

Source: CEC, UBS, as of October 2018
* Scenario probabilities are based on qualitative assessments.
Swiss economy - 2019 economic outlook weakens

Key points
• Switzerland grew by a very solid 0.7% q/q in 2Q18 due to strong net exports. GDP growth for 1Q18 was revised up to 1% q/q. On the back of these strong 1H18 numbers we expect Swiss GDP to grow by 2.9% this year.
• The 2019 outlook for the Swiss economy has deteriorated somewhat, however. Global political risks, a stronger Swiss franc, slower growth in the Eurozone and the lack of catch-up potential may slow GDP growth next year to 1.6%.
• Given these risks, we expect a first SNB rate hike in 4Q19 when the ECB is set to increase its target rate.

CIO view (Probability: 60%*)
• Swiss GDP accelerated in 1H18, benefiting from an improvement in foreign trade and investments. This was in turn reflected by stronger labor markets and the output gap was closed.
• The outlook for the Swiss economy has clouded somewhat. Political risks (trade tensions, Italian budget discussion and emerging market turmoil), the recent appreciation of the Swiss franc and slower than expected growth in the Eurozone are likely to slow Swiss GDP growth in 2H18 and 2019. We forecast GDP to grow by 1.6% in 2019.
• After strong growth in 1H18 the Swiss economy lacks further catch-up potential, additionally weighing on the 2019 outlook.
• Swiss manufacturing PMI fell further in Oct. from 59.7 to 57.4, reflecting the recent appreciation of the Swiss franc and heightened uncertainty in the global economy.
• Inflation advanced by 1.1% y/y in October We expect inflation at 1% this year and next year, underpinned by a weaker franc and higher oil prices.
• With risks having increased notably in recent months, we don’t see a first rate hike by the SNB before 4Q19 when we also expect the ECB to lift its target rate. We only expect FX interventions from the SNB in case the EURCHF exchange rate should fall below the 1.10 mark.

Positive scenario (Probability: 10%*)
• 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: 30%*)
• Protectionist measures by the Trump administration lead to a global downturn, which would hurt Swiss exports. In addition, increased uncertainty about Italian politics and emerging markets could cause the franc to appreciate.

* Scenario probabilities are based on qualitative assessment.

Key dates
Nov 29 GDP (3Q18)
Dec 3 PMI manufacturing (Nov)
Dec 4 CPI (Nov)
Nov 13 SNB monetary policy assessment (4Q18)
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