This publication has been updated as of 26 August 2019 due to the following ad-hoc changes in the global tactical asset allocation: Closed overweight in global equities vs. high grade bonds; opened underweight in emerging market (EM) equities vs. high grade bonds; reduced and adjusted the composition of the EM FX basket position. Please note that only slides related to these changes have been updated.
Global Tactical Asset Allocation

- **Asset allocation**

  Risks to the global economy and markets have increased following a renewed escalation in US-China trade tensions. While we still don’t expect the US economy to fall into recession, we think near-term risks, in particular to equity markets, have risen further. We are thus reducing our exposure to global equities and introducing an underweight in emerging market (EM) equities against high grade bonds. This is a moderate tactical risk reduction and we would 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. Meanwhile we are keeping our carry positions unchanged. Global central bank easing still leaves investors reaching for yield.

- **Equities**

  Economic risks have risen in a way that is likely to lead the Fed and the 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 have increased. We are opening an 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 the 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. 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 supported by stabilizing Eurozone growth and accommodative ECB policy. We consider the carry attractive against healthy corporate fundamentals and our base case of no recession over the coming 12 months. We keep our overweight in EM sovereign bonds in USD against HG bonds, as the search for yield should provide continued support and valuations have become more appealing. We think the market pricing of more than 1% of Fed cuts is too pessimistic and maintain our tactical short on the 2-year US Treasury note.

- **Foreign exchange**

  We are reducing the overweight of our basket of emerging market currencies and adjusting the composition. Specifically, we are closing the overweight ZAR and the underweight NZD. The remaining 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 its intention to continue raising rates. We keep our long GBP versus short USD position. Sterling has become very cheap against purchasing power parity and we think no-deal Brexit risks for October have been overpriced.

- **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 (updated 26 August 2019)

**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...
- 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 ( ↗️)
- 2-year US Treasuries vs. USD cash
- "Well-worn" bonds
- Mind the gap - Corporate "fallen angel" candidates
- ...Euro
- ...Canadian dollar
- ...US dollar
- ...DM FX (AUD, TWD) ( ↗️)
- ...base currency

---

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

EUR

- Risk Parity 2%
- Liquidity 5%
- High grade bonds 10%
- US TIPS 2%
- Inv. grade corporate bonds 12.5%
- EM bonds 5%
- Equities 14%
- Equities Europe 18%
- Equities EM 4%
- Equities others 2%

USD

- Risk Parity 2%
- Liquidity 5%
- High grade bonds 8%
- US TIPS 4%
- Inv. grade corporate bonds 12.5%
- High yield bonds 5%
- EM bonds 7.5%
- Equities US 23%
- Equities Europe 7%
- Equities EM 3%
- Equities others 5%

---

*Source: UBS, as of 26 August 2019. *Additionally, the portfolios include an underweight 2-year US Treasuries (via overlay) and 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.

Recent upgrades ↗️
Recent downgrades ↘️
Global tactical asset allocation (updated 26 August 2019)

Tactical asset allocation deviations from benchmark

<table>
<thead>
<tr>
<th>underweight</th>
<th>neutral</th>
<th>overweight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td></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>Canada</td>
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<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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<table>
<thead>
<tr>
<th>Bonds total</th>
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<tbody>
<tr>
<td>High grade bonds</td>
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<tr>
<td>Corporate bonds (IG)</td>
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<tr>
<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>
</tr>
</tbody>
</table>

| Duration overlay (USD) |
| Duration overlay (JPY) |

Hedge Funds

- new (1-4 years horizon)
- new (up to 12m horizon)
- old

Currency allocation

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

- new (1-4 years horizon)
- new (up to 12m horizon)
- old

Source: UBS, as of 26 August 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.

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

- **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.

- **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.

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.
Equities

• **Enabling technologies**
  We have identified five mainstream enabling technologies—artificial intelligence (AI), augmented reality/virtual reality (AR/VR), big data, cloud computing, and 5G—that are set to transform many industries over the next decade. We expect them to grow in aggregate by an average 12.8% annually, from USD 420 billion in 2017 to USD 1.1 trillion in 2025. Hence, we believe enabling technologies offer solid long-term growth as technological disruption is an irreversible trend. Investors can take part in this by investing in a diversified way in our theme of enabling technologies, with leading software and semiconductor companies emerging as winners.

• **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.

• **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.

• **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.

• **Emerging market infrastructure**
  Growing urbanization and the expansion of megacities in emerging markets, as well as high economic growth rates, 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.

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>Global equities 0 to +5% as valuations have fallen below their fair value, US rates to remain low as the Fed continues to ease, EURUSD rises towards 1.15 with due to lower rates in the US, US HY +3 to 4% as central banks keep their easing bias and default rates remain in check</td>
</tr>
<tr>
<td><strong>Downside scenario 30% probability</strong></td>
<td>Global downturn</td>
<td>Global equities -15 to -20% as earnings deteriorate and pressure on profit margins rises, US rates fall to new historic lows with the long end potentially moving into negative territory, EURUSD at 1.30, as the exchange rate reverses towards PPP, US HY -8 to -10% as spreads widen to around 850 bps</td>
</tr>
<tr>
<td><strong>Upside scenario 20% probability</strong></td>
<td>Re-acceleration</td>
<td>Global equities +5 to 10% with countries exposed to the global cycle leading up, US rates: short term rates reprice higher while the long end would hit a lower high, absent structural reforms, EURUSD to 1.12-1.15 as a less dovish Fed keeps the dollar in range, US HY +1 to 3% as credit spreads tighten further</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

Source: UBS, as of August 2019
Key financial market driver 1 - **Central bank policy**

**Key points**
- The Federal Reserve cut rates on 31 July and is likely to cut further in the months ahead.
- We expect the European Central Bank to lower its deposit rate at its next meeting in response to lower policy rates in the US.
- The Swiss National Bank also appears ready to cut rates deeper into negative territory. The Bank of England’s policy remains contingent on the nature of the UK-EU separation, but in our base case they would remain on hold.

**CIO view (Probability: 60%*)**
- The Federal Reserve cut rates by 25 basis points on 31 July. Further escalation of the US-China trade dispute has increased downside risks. Further, the yield curve is partially inverted, which in the past has often foreshadowed that a recession is coming. We expect an additional 75 basis points of cuts by next June, enough to ensure that the yield curve moves out of inversion.
- We expect the ECB to lower its deposit rate by 0.1% each in September and October in response to lower US policy rates. We think the hurdle for a new quantitative easing (QE) program is declining following the recent trade escalation.
- The Federal Reserve cut rates by 25 basis points on 31 July. Further escalation of the US-China trade dispute has increased downside risks. Further, the yield curve is partially inverted, which in the past has often foreshadowed that a recession is coming. We think the hurdle for a new quantitative easing (QE) program is declining following the recent trade escalation.
- Global economic data has surprised to the downside over the past two months. Trade disputes and other political risks have clouded the outlook. With the Fed now likely to cut rates more aggressively than previously expected, many central banks either have already cut rates or appear poised to cut rates soon.

**US inflation below the Fed’s 2% target**

<table>
<thead>
<tr>
<th>PCE</th>
<th>Fed 5-year forward breakeven inflation, in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>Fed target</td>
</tr>
</tbody>
</table>

Source: Bloomberg, UBS, as of 13 August 2019

**Note:** PCE = Personal Consumption Expenditures

**Policy direction**
Central banks are shifting toward easier policy (UBS forecasts)

<table>
<thead>
<tr>
<th></th>
<th>Current policy rate</th>
<th>2019 policy rate outlook</th>
<th>2019 outlook for central bank balance sheet as % GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>US Federal Reserve</td>
<td>2.25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Central Bank</td>
<td>-0.40%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank of Japan</td>
<td>-0.10%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank of England</td>
<td>0.75%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bloomberg, UBS, as of 13 August 2019

**Positive scenario (Probability: 30%*)**
- 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 such as 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.

*Scenario probabilities are based on qualitative assessment.

**Key dates**
- Sep 12: European Central Bank policy decision
- Sep 18: Federal Reserve policy decision
- Sep 19: Bank of England policy decision

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-turner@ubs.com
Key financial market driver 2 - **Tariffs delay growth pickup**

### Key points
- Corporate profit growth remains sluggish
- And tariffs extend the soft patch
- But growth should improve in 2020

### CIO view (Probability: 60%*)
- US earnings growth has decelerated as the one-time boost from a lower tax rate fades and economic growth slows in the US and overseas. 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 increased, interest rates have fallen, and overseas growth has slowed.
- We now assume that the US moves forward with 10% tariffs on an additional USD ~300bn of Chinese imports, most of which are consumer goods. This trims about 1% from our 2020 EPS estimates. While not in our estimates, should the tariff rate on this basket of goods rise to 25%, we would expect a deeper profit dent. At that level, second-round effects (e.g., weaker economic growth brought about by loss of business and consumer confidence) would likely be unavoidable. At the full 25% tariff, the estimated impact to S&P 500 earnings could be another 2-4%.
- As a result of the tariffs, lower outlooks for oil (negative for energy) and interest rates (negative for financials) we have trimmed our earnings expectations. We now expect 2019 and 2020 S&P 500 EPS of USD 164 (+1%) and USD 173 (+5%), respectively.
- Second quarter S&P 500 earnings season is nearly over and earnings growth for the quarter will likely come in around 1%. While aggregate earnings growth is being weighed down by a few mega-caps (in energy, industrials and tech), encouragingly, earnings growth for the median company is a healthier 5.5%.
- Despite continued softness in corporate earnings, growth should modestly re-accelerate later in the fourth quarter and beyond as the economic expansion continues, comparisons get easier, and tech markets stabilize.
- 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 re-acceleration 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.

### Key dates
- Sep 16
- Results from third quarter "early" reporters

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*Scenario probabilities are based on qualitative assessment.*
Global economic outlook - Summary

Key points
• Global growth has been stable around trend for an unusually long time. Risks to that stability are growing as a result of growing trade uncertainty.
• Domestic demand is still robust in most economies on the back of strong labor markets. Trade uncertainties are weighing on 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’ll 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-Chinese 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
Sep 1 US to impose tariffs on additional Chinese imports
Sep 12 ECB governing council meeting
Sep 18 FOMC meeting

For further information please contact Regional CIO Switzerland Daniel Kalt, daniel.kalt@ubs.com, CIO Chief Economist Eurozone Ricardo Garcia, ricardo-za.garcia@ubs.com or CIO US Economist Brian Rose, brian.rose@ubs.com
US economy - Slower growth amid trade disputes

Key points
- Economic growth likely to slow below trend
- Core inflation should remain near the Fed’s 2% target
- Fed likely 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.
- While demand for workers remains strong, job growth has slowed as most people who want a job already have one.
- Rising wage income and strong consumer sentiment should support consumer spending, which is the main driver of overall economic growth.
- 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. Excess inventories, softening auto sales, and weaker external demand are negatives.
- Residential investment has declined in recent quarters. Mortgage rates have declined and demand for housing should be supported by the strong labor market, limiting further downside risk.
- Core PCE inflation, which excludes food and energy prices, was weak in 1Q19 but has been showing stronger increases in recent months and could reach the Fed’s 2% target in 2020.
- The Fed cut rates by 25 basis points in July. We expect the Fed to react to events rather than aggressively trying to get ahead of the curve. Our base case calls for three more cuts by next June.
- With support from fiscal policy fading, further escalation of trade disputes or another government shutdown 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
- Aug 30: Personal income and spending, PCE inflation for July
- Sep 3: ISM manufacturing PMI for August
- Sep 5: ISM non-manufacturing PMI for August
- Sep 6: Labor report for August
Eurozone economy - **Moderate growth with downside risks**

### Key points
- Economic growth in the Eurozone should remain stable, subject to trade tensions and Brexit.
- Inflation is set to rise slightly in the second half, driven by base effects.
- We expect the ECB to cut the deposit rate in response to lower US policy rates.

### CIO view (Probability: 60%*)
- **Growth outlook subject to trade uncertainties**
  - We expect economic activity to remain stable 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% each in September and October (coupled with interest rate tiering).
  - In Germany, the stiff global export environment has increased the risk of a technical recession. In France, the slowing of yellow-vest protests, reforms, and fiscal stimulus should continue to help stabilize GDP growth.
  - Growth in Italy should continue to stabilize following the budget agreement with the European Commission. Spain is still growing strongly, but the momentum is likely to continue to normalize.

*Positive scenario (Probability: 10%*)
- 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: 30%*)
- 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
- Aug 30: Inflation estimate for August
- Aug 30: Unemployment for July
- Sep 12: ECB press conference
- Sep 23: Flash PMI for September

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*Scenario probabilities are based on qualitative assessment.*

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**Eurozone growth consolidating**

**Business and consumer surveys**

**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.

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**ECB balance sheet topping out**

Total assets in national currency (index: 2007 = 100)

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For further information please contact CIO Chief Economist Eurozone Ricardo Garcia, ricardo-za.garcia@ubs.com

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UBS
Chinese economy - Continued easing to cushion growth

Key points
• Persistent growth pressure calls for further policy support.
• We expect policy easing to continue.
• Sino-US trade tensions remain a key risk.

CIO view (Probability: 80%*)
• Weak data in July call for further policy support, in our view. Retail sales growth for the month retreated to 7.6%, while fixed-asset investment growth year-to-date edged down to 5.7%. Trade growth stayed subdued. We expect 2H19 GDP growth to trend down further but remain above 6%.
• July CPI inflation rose to 2.8%, with continued upside risk toward year-end due to surging pork prices. PPI inflation turned negative for the first time since September 2016 due in part to weaker industrial demand.
• Monetary policy remains accommodative. The central bank cut the reserve requirement ratio (RRR) for small banks by 300bps from May to July, and could make general RRR cuts of another 100–200bps for the rest of the year. Lending facilities and central bank bill swaps should keep liquidity abundant and interest rates low. July credit growth stabilized at 10.7%.
• Fiscal policy remains active. Major measures include larger local government bond issuance to support infrastructure, and cuts to fees and taxes. The current CNY 3.1 trillion quota for local government bond issuance will be reached by September, and could be raised in 4Q19.
• Sino-US trade tensions remain a key risk. If the US makes good on its threat to impose a 10% tariff on USD 300bn of Chinese goods, China could take a range of actions to retaliate, including a managed CNY depreciation, an “unreliable entity” list, reduced imports of US goods, restricted exports of rare earth metals, or a partial sale of its US Treasury holdings. The USDCNY exchange rate breached 7, in August, for the first time since 2008.

Positive scenario (Probability: 10%*)
• GDP growth accelerates above 6.5% in 2019 due to an easing in trade tensions and an upswing in global growth. Aggregate debt-to-GDP ratio stabilizes. The annual current account surplus increases over USD 100bn.

Negative scenario (Probability: 10%*)
• 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 of Chinese imports before 2020.
• In 2019, China experiences a sharp economic slowdown (less than 6% real GDP growth for two quarters) and a faster deterioration of its current account balance toward an annual deficit.
• The CNY weakens to 7.5 per USD or higher within a quarter as foreign reserves fall dramatically and capital controls tighten.

* Scenario probabilities are based on qualitative assessments.

Weak July data call for further policy easing

Fixed-asset investment and retail sales growth

Further monetary and fiscal easing expected

Key dates
Aug 31
August manufacturing and nonmanufacturing PMI
Sep 8
August trade data
Sep 10
August inflation
Sep 16
August fixed-asset investment, retail sales, industrial production

For further information please contact CIO China economist Yifan Hu, yifan.hu@ubs.com or CIO analyst Kathy Li, kathy.li@ubs.com

Source: CEIC, UBS, as of August 2019
Key points
• After a slowdown in 2H18, the Swiss economy rebounded at the start of this year. We therefore expect GDP growth of 1.3% for the full year.
• Despite the robust start into the year, we remain cautious on Switzerland’s economic outlook due to the escalation in US-China trade tensions and ongoing political uncertainties. These risks could delay the global economic recovery and weigh on Swiss exports.
• Given these risks, we expect the Swiss National Bank to cut rates by 25 basis points in September.

CIO view (Probability: 50%*)  Recovery postponed but still possible
• The Swiss economy grew robustly at the beginning of the year – slightly below the long-term average.
• Despite robust growth, we remain cautious on Switzerland’s economic outlook given the escalation in US-China trade tensions and ongoing European political uncertainties.
• These risks could delay the global economic recovery to next year or even to 2021 and weigh on exports. After the robust start, we expect Swiss growth to slow, leading to GDP growth of 1.3% this year.
• Leading indicators point to a slowdown in the economy, especially in the manufacturing sector. In July, the manufacturing purchasing managers’ index slipped to 44.7 points, its weakest level since July 2009.
• However, there are also factors benefiting the Swiss economy. 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%.
• In an environment of global uncertainty and a subdued economic picture, we expect the ECB to cut rates twice by the end of 2019 – by 10 basis points each. This significant monetary easing could put the Swiss franc under appreciation pressure and force the SNB to lower interest rates. We expect the SNB to cut rates from -0.75% to -1% in September.

Positive scenario (Probability: 15%*)  Eurozone consumer strength supports Swiss growth
• 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%*)  Trade disruption hurts Swiss growth
• More protectionist measures by the Trump administration (especially against European car makers) lead to a global downturn, which would hurt Swiss exports.

* Scenario probabilities are based on qualitative assessment.

Key dates
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
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<td>Sep 2</td>
<td>Manufacturing PMI for August</td>
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<td>Sep 3</td>
<td>CPI for August</td>
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<tr>
<td>Sep 5</td>
<td>GDP figures Q2 2019</td>
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<tr>
<td>Sep 9</td>
<td>Unemployment rate for August</td>
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