Global Tactical Asset Allocation

- **Asset allocation**
  While economic data suggest that the weak global growth backdrop will persist into 2020, investor sentiment has turned more constructive, supporting rising stock markets and bond yields. We remain skeptical on the prospect of a meaningful trade deal between China and the US anytime soon, but incrementally positive news may well continue to support equity markets in the near term. We are therefore closing our underweight to emerging market (EM) equities, taking our tactical equity allocation to neutral. We keep our overweight positions in EM sovereign bonds and a basket of EM currencies, as the environment remains supportive of carry trades. To become more constructive, we are looking for signs of a sustainable economic recovery and a significant trade agreement. Likewise, a breakdown of trade negotiations would worsen our outlook again. This very binary nature of the current backdrop, driven by political decisions, warrants a neutral equity allocation for now.

- **Equities**
  As headwinds from trade uncertainty and the slowdown of the Chinese economy may be fading, at least in the near term, EM equities could continue to be a main beneficiary of better investor sentiment. EM equities have underperformed developed market peers this year, so they have a significant catch-up potential if our upside scenario of a comprehensive trade deal and economic recovery are to materialize. We are thus closing our underweight on EM equities. We overweight US over Eurozone stocks. Should economic data weaken, we think the Federal Reserve has more leeway to act than the European Central Bank (ECB). Consensus expectations for earnings growth look more realistic in the US than in the Eurozone. We also overweight Japanese over Eurozone equities. While both regions are geared toward global growth and exports, Eurozone stocks have outperformed and are already pricing in a significantly better outcome compared to the Japanese market.

- **Bonds**
  We are closing our overweight in euro-denominated investment grade bonds, taking profits. The investment case has played out as spreads have tightened significantly, reaching their year-to-date lows recently. The ECB’s new bond purchase program provides a backstop to the asset class, but is unlikely to drive significant further spread tightening from current levels. We keep an overweight position in EM sovereign bonds in USD over high grade bonds. The current yield of 5% remains attractive, as central banks keep interest rates low and the growth differential between emerging and developed markets is likely to widen in the quarters ahead.

- **Foreign exchange**
  We keep an overweight in the US dollar against the Australian dollar (AUD) as deteriorating economic conditions in Australia are likely to keep the country’s central bank on an easing path, while the AUD remains exposed to US-China trade tensions. Our EM currency basket (overweight Indian rupee and Indonesian rupiah versus the AUD and Taiwan dollar) aims to earn the interest rate advantage without being too strongly exposed to US-China trade tensions.

- **Longer-term asset allocation (1–4 years)**
  While we generally recommend to hedge the currency risk of non-domestic equity positions, we have removed these hedges for UK and Japanese equities. The British pound and the Japanese yen are substantially undervalued and thus offer significant appreciation potential over the coming years, outweighing the benefits of currency hedging.
### Cross-asset preferences

<table>
<thead>
<tr>
<th><strong>We like...</strong></th>
<th><strong>We don't like...</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Japanese equities</td>
<td>- Eurozone equities</td>
</tr>
<tr>
<td>- US equities</td>
<td>- Developed market high grade bonds</td>
</tr>
<tr>
<td>- Global quality stocks</td>
<td>- Mind the gap: Corporate &quot;fallen angel&quot; candidates</td>
</tr>
<tr>
<td>- &quot;Buy-write&quot; strategy on US equities</td>
<td>- Time to be more selective in EM credit</td>
</tr>
<tr>
<td>- US smart beta</td>
<td>- ...Australian dollar</td>
</tr>
<tr>
<td>- Some protection via US equity put options</td>
<td>- ...base currency</td>
</tr>
<tr>
<td>- Emerging market sovereign bonds in USD</td>
<td>- ...base currency</td>
</tr>
<tr>
<td>- Global green bonds</td>
<td>- ...DM FX (AUD, TWD)</td>
</tr>
<tr>
<td>- Mind the gap: Corporate &quot;rising star&quot; candidates</td>
<td>- US dollar versus...</td>
</tr>
<tr>
<td>- Time to be more selective in EM credit</td>
<td>- EM FX (INR, IDR) versus...</td>
</tr>
<tr>
<td>- US dollar versus...</td>
<td>- Japanese yen (1–4-year horizon) versus...</td>
</tr>
<tr>
<td>- EM FX (INR, IDR) versus...</td>
<td>- British pound (1–4-year horizon) versus...</td>
</tr>
<tr>
<td>- Mind the gap: Corporate &quot;fallen angel&quot; candidates</td>
<td></td>
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</tbody>
</table>

**Model portfolios (EUR & USD)**

Source: UBS, as of 14 November 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.

**Recent upgrades**

- Recent upgrades
- Recent downgrades
Global tactical asset allocation

Tactical asset allocation deviations from benchmark

<table>
<thead>
<tr>
<th>Liquidity</th>
<th>US</th>
<th>US</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equities total*</td>
<td>Eurozone</td>
<td>UK**</td>
<td>Switzerland</td>
</tr>
<tr>
<td>High grade bonds</td>
<td>Corporate bonds (IG)</td>
<td>High yield bonds</td>
<td>EM sovereign bonds (USD)</td>
</tr>
<tr>
<td>EM corporate bonds (USD)</td>
<td>EM local currency bonds</td>
<td>TIPS</td>
<td></td>
</tr>
<tr>
<td>Duration overlay (USD)</td>
<td>Duration overlay (JPY)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UBS, as of 14 November 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 and UK equities is not hedged.

Currency allocation

<table>
<thead>
<tr>
<th>USD</th>
<th>EUR</th>
<th>GBP</th>
<th>JPY</th>
<th>CHF</th>
</tr>
</thead>
<tbody>
<tr>
<td>new (up to 12m horizon)</td>
<td>neutral</td>
<td>overweight</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

DM FX basket***

Base currency

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

Source: UBS, as of 14 November 2019

*** 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 750bn and are growing by more than 30% a year.

- **Generate yield: "Buy-write" on US equities**
  An equity buy-write strategy involves buying equities (the “buy” part) while 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 eases.

- **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 stages 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 in 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 economic growth, and sound credit fundamentals, as well as the relative attractiveness of the asset class versus other credit market segments. While emerging economies are on aggregate at earlier stages 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.
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.

* Medical devices
  The world’s aging population and the growth of the over-65 aged 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.

* 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.
## Key Investment Risks

<table>
<thead>
<tr>
<th>Selected scenario</th>
<th>Scenario description</th>
<th>Expected market performance for select asset classes</th>
</tr>
</thead>
</table>
| **Base case**     | Managed slowdown     | - Global equities 0% to +5% as we expect global earnings to remain low next year  
                   | Global growth stabilizes around 3%. Major central banks retain an easing bias. The global economy remains in "late-cycle" territory for at least another six to 12 months.  
                   | US rates to remain low as the Fed maintains the optionality to keep easing  
                   | EURUSD rises toward 1.15 as the Fed keeps an easing bias |
| **Key downside scenarios** | New breakdown in trade talks with tariff increase | - Global equities -15% to -20% as earnings deteriorate and pressure on profit margins rises  
                   | Trade talks break down. Tariffs on USD 160bn of Chinese goods come into effect on 15 December and China retaliates. US growth falls below trend and the risk of a US recession rises significantly.  
                   | US rates fall to historical lows with the long end potentially moving into negative territory  
                   | EURUSD at 1.15-1.20, as the exchange rate reverses toward PPP |
|                   | European economic slowdown | - EMU equities -10% to -15% as weakness in manufacturing spill over to services  
                   | The Eurozone economy tips into recession, driven by a further deterioration in the Sino-US trade dispute beyond announced tariffs or a tit-for-tat tariff escalation between the US and the EU.  
                   | EUR HY spread reaches 800bps amid higher default risk  
                   | EURUSD below 1.05 driven by further ECB stimulus |
| **Key upside scenarios** | Trade talks momentum builds with tariff removal | - Global equities +5 to +10% with countries exposed to the global cycle leading up  
                   | The US and China agree on a phase I deal and rollback of tariffs, and resolve core structural issues such as forced technology transfer and Chinese subsidies. Growth outlook in both countries improves considerably as uncertainty fades.  
                   | US rates Short-term rates reprice higher while the long end hits a lower high, absent structural reforms  
                   | EURUSD ≤ 1.10 as a less dovish Fed keeps the dollar in range |
|                   | European growth re-accelerates | - EMU equities +5% to +10% with positive earnings growth in 2020  
                   | External headwinds fade and European growth recovers faster than expected, given the Eurozone economy’s high reliance on global trade. Growth is supported by improving domestic demand, improved outlook in the manufacturing sector, and continued ECB stimulus  
                   | EUR HY spread tighten to 300bps but rising government yields weigh on total returns  
                   | EURUSD at 1.20 as investors start pricing ECB policy tightening |

Expected total returns over a 6-month horizon. FX and spread levels as of end of Q2 2020.  
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 2019
Key financial market driver 1 - Central bank policy

Key points

- Faced with rising risk premiums as a result of trade uncertainty, central banks have been inclined to err on the side of accommodation. This is acting as an insurance policy to maintain existing levels of activity.
- A debate seems to be starting in central bank circles about the merits of prolonged periods of negative interest rates. Sweden’s Riksbank, the first central bank to move to negative rates, is sounding less convinced of the merits of the policy. The Swiss National Bank remains a fan.
- The major central banks are signalling a pause in policy moves in the near term. The Bank of England’s decision to leave interest rates unchanged was split, but other central banks seem more certain in their chosen policy path.

CIO view (Probability: 60%*)

- The Federal Reserve has eased policy this year despite extremely low unemployment rates. Economic growth, while slowing, is not exceptionally weak. It seems that the interest rate cuts to date have been an insurance aimed at managing the uncertainties created by the current trade conflict. An escalation of the conflict may warrant additional easing, but the Fed seems unlikely to reverse its position quickly, even if there is some resolution to the dispute with China.
- European Central Bank President Christine Lagarde will remain a subject of speculation in financial markets. Lagarde has avoided making too many direct comments on policy to date. Widespread reports of divisions within the ECB Governing Council will add weight to public remarks in the weeks ahead.

Positive scenario (Probability: 20%*)

- 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: 20%*)

- A comprehensive US-China deal on trade reduces real economic risk. Investment spending and business confidence recover more than expected. Central banks focus on the economic cycle, and hint at or move toward policy normalization.

*Scenario probabilities are based on qualitative assessment.

Key dates

- Nov 27: Federal Reserve Beige Book
- Dec 12: ECB policy decision
- Dec 13: Fed Chair Jay Powell speaks to US Congress
- Dec 19: Bank of England policy decision (post general election)
- Dec 19: Swedish Riksbank policy decision

Most US prices are accelerating
Median and trimmed mean inflation avoids distortions from a small number of items, % y/y rates

Goods prices keep Eurozone consumer prices subdued
Various euro-area inflation rates, compared to their long-term averages

Source: Haver, UBS, as of 8 November 2019
Key financial market driver 2 - *Earnings growth should improve*

**Key points**
- Corporate profit growth remains sluggish.
- But headwinds are starting to fade.
- And growth should improve in 2020.

**CIO view (Probability: 60%*)**
- US earnings growth has been pressured this year due to fading fiscal stimulus, slower global growth, rising tariffs, lower commodity prices, and a stronger US dollar. Still, a material decline in profits looks unlikely. Leading indicators such as access to capital remain supportive, suggesting that profit growth should improve in 2020.
- The third-quarter reporting season is nearly complete. S&P 500 EPS likely contracted by around 1%, marking the first quarter of decline in earnings since the 2014–16 plunge in oil prices sent the US manufacturing sector into recession. At a sector level, net income growth has been fairly tepid across the board, with the greatest weakness in energy, materials, and technology. Encouragingly, the result for the typical company has been a bit better, with 4% EPS growth for the median company in the S&P 500.
- Despite the earnings contraction in 3Q, some of the factors weighing on profit growth should begin to improve. There are signs that industrial activity will bottom out soon and comparisons get much easier in the tech sector. As a result, the third quarter will likely mark the low point for year-over-year earnings growth in the current soft patch.
- We continue to expect S&P 500 EPS of USD 164 (+1% y/y) in 2019 and USD 173 (+5% y/y) in 2020, and await greater clarity on US-China trade policy and its impact on the global economy.
- We expect profit margins to fall 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.

<table>
<thead>
<tr>
<th>Positive scenario (Probability: 20%*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggressive global central bank stimulus and a resolution to the trade dispute between the US and China drive a reacceleration in growth.</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Negative scenario (Probability: 20%*)</th>
</tr>
</thead>
<tbody>
<tr>
<td>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.</td>
</tr>
</tbody>
</table>

**Key dates**
- Dec 9 4Q results for early reporters begins

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*Scenario probabilities are based on qualitative assessment.*

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**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**
- Slowing investment has slowed global growth, to a level somewhat below trend. The lack of significant imbalances in the global economy means that a more significant slowdown remains low probability.
- Consumer demand remains firm in most major economies. In particular, consumers remain willing to purchase more expensive items, which suggests a degree of confidence in their future employment, and the overall economic outlook.
- The focus for investors is the prospects for a trade agreement between the US and China. While a deal would be positive economically, it is unlikely to restore trust in the world trade order. That may limit the extent of any investment revival.

**CIO view (Probability: 50%*)**
- Trade uncertainty continues to be felt via weaker investment spending. A partial trade deal between China and the US would have a positive but limited impact on this. Avoidance of existing trade taxes through supply-chain shifts has increased and should continue to blunt their negative impact. There is some evidence of a stabilization or modest improvement in global trade volumes.
- Manufacturing-sensitive, investment-focused economies like Germany have already felt the consequences of trade tensions. Economies with a high exposure to global trade or the investment cycle are more at risk than domestic-centered economies. However, recent Asian and European data offer some signs of more stable growth.
- Labor market strength is continuing in most major economies, supporting consumers’ income (via increased employment, increased wages, or both). Global unemployment is near a 40-year low. Domestic demand should limit the drag from the export and investment weakness.
- However, the longer the downturn in investment continues, the greater the risk it will spill into labor markets and weaken domestic demand.
- Underlying inflation trends remain relatively benign, with companies absorbing trade taxes rather than passing them on. The effect of strong labor markets should be monitored.

*Positive scenario (Probability: 25%*)
- Trade uncertainty recedes after a breakthrough in US-China negotiations, triggering a recovery in investment spending. Labor markets continue to support consumer demand.
- The fiscal and monetary stimulus measures in Europe and Asia support economic growth.

*Negative scenario (Probability: 25%*)
- Trade tensions escalate, unsettling business confidence further. Companies decide to retrench, meaning not only lower investment, but also attempts to cut labor costs. This weakens 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**
- **Dec 11** US Federal Reserve meeting
- **Dec 12** UK general election

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For further information please contact Chief Economist Paul Donovan, paul.donovan@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 is likely to slow below trend.
- Core inflation should hit the Fed’s 2% target in 2020.
- The Fed remains on hold for now.

CIO view (Probability: 50%*)
- GDP is likely to expand at or below the 2% potential growth rate 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.
- Strong profits and labor shortages provide an incentive for businesses to invest. However, political uncertainty is acting as a constraint. Further escalation of trade disputes would pose a serious threat to the recovery, while a solid US-China agreement could boost growth.
- The manufacturing sector is struggling amid the trade disputes, with the purchasing managers’ index below 50 since August, and manufacturing output is down year-to-date. Domestic demand should provide enough support to prevent a severe downturn.
- Residential investment turned positive in 3Q19 and should trend higher. Mortgage rates have declined, and demand for housing should be supported by the strong labor market.
- We expect core PCE inflation, which excludes food and energy prices, to reach the Fed’s 2% target in 2020.
- The Fed cut rates by a total of 75 basis points between July and October, and is now signalling a neutral stance. The Fed still has room to cut further if economic conditions deteriorate.

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, but rate hikes remain unlikely within the next 12 months.

Negative scenario (Probability: 30%*)
- Trade disputes, political uncertainty, and tighter financial conditions weigh on business investment. Weaker demand for labor undermines consumer spending. The Fed cuts rates further, potentially to zero if the economy enters recession.

*Scenario probabilities are based on qualitative assessment.

Key dates
Nov 15 Retail sales for October
Nov 15 Industrial production for October
Nov 20 Minutes of 30 October FOMC meeting
Nov 27 Personal income and spending, PCE inflation for October

For further information please contact US economist Brian Rose, brian.rose@ubs.com
Eurozone economy - Moderate growth with upside risks

Key points
- Improved momentum in trade talks underpins our Eurozone growth outlook.
- Inflation is set to move slowly higher, driven by energy-related base effects.
- Should current trade talks succeed, the probability is high that the ECB won’t have to cut anymore.

CIO view (Probability: 50%*)
- The Eurozone economy may see better growth momentum in 2020 on the back of substantial progress in trade talks. Meanwhile, energy-related base effects are set to push inflation moderately higher. The ECB is expected to decrease the deposit rate by 0.1% in March, but successful trade talks would clearly reduce the probability of further rate cuts.
- In Germany, moderate fiscal measures and better world trade should stabilize its manufacturing sector. In France, the waning yellow-vest protests, reforms, and fiscal stimulus should help safeguard robust economic growth.
- Growth in Italy should continue to stabilize following the compression in bond risk premiums. Spanish growth is set to remain solid, but the political stalemate is capping its growth upside.

Positive scenario (Probability: 30%*)
- 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 falls into recession 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
- Nov 22: Flash PMI for November
- Nov 29: Unemployment for October
- Nov 29: Inflation estimate for November
- Dec 12: ECB press conference

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

Source: Haver, UBS, as of October 2019 (SNB data as of September 2019)
Chinese economy - Slower economy, continued easing

Key points
- October activity data decelerated calling for continued policy support.
- Both monetary and fiscal policies stay supportive to cushion the economic slowdown.
- Sino-US trade tensions remain a key risk.

CIO view (Probability: 70%*)
- The generally weaker October data shows ongoing downward pressure in the economy. Jan-Oct fixed asset investment growth slowed further to 5.2% y/y with lackluster infrastructure, cooling property, sluggish manufacturing. October retail sales growth weakened to 7.2% y/y in part reflecting some purchase deferral ahead of the 11 November shopping festival. Both export and import growth remained in contraction in October.
- October CPI inflation surged to a seven-year high of 3.8% y/y, driven by surging pork prices, while core inflation stayed subdued at 1.5%. PPI deflation widened further to –1.2% due to base effects and weak manufacturing.
- Monetary and fiscal policy remains supportive. The central bank announced a 50bps cut to the reserve requirement ratio in September. We expect another 50–100bps of cuts for 4Q. Local government bond issuance will continue in 4Q via the use of the accumulated leftover quota or front-loading some 2020 quotas to support infrastructure, following CNY 3.1 trillion of bond issuance by September.
- The Sino-US trade tension remains a key risk. China and the US may reach an interim deal. The US suspended the 5% tariff hike on USD 250bn of Chinese imports planned 15 October, while China agreed to increase purchases of US agricultural products.

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 USD 300bn worth of annual Chinese imports before 2020.
- In 2019, Chinese GDP growth experiences a sharp slowdown below 5.5% for two consecutive quarters and a faster deterioration of its current account into annual deficit.
- The CNY slides to 7.5 per USD or weaker within a quarter, while FX reserves fall dramatically and capital controls are tightened up.

* Scenario probabilities are based on qualitative assessments.

Key dates
- Nov 30: November manufacturing and nonmanufacturing PMI
- Dec 8: November trade data
- Dec 10: November inflation
- Dec 16: November 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
Swiss economy - No recovery in sight

Key points
- The Swiss economy has lost considerable momentum since mid-2018. We therefore expect GDP growth of only 0.7% for 2019.
- Given the ongoing trade tensions between the US and China, political uncertainty 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%*)
- The Swiss economy has lost considerable momentum since mid-2018. Given sustained tensions between the US and China, political uncertainty and weak economic growth will likely continue.
- Leading indicators point to a slowdown in the economy as well, especially in the manufacturing sector. The manufacturing purchasing managers’ index increased from 44.6 to 49.4 in October. The index is still slightly below the 50-point mark and indicates a stagnation in the manufacturing sector in the coming months.
- Although Switzerland is strongly exposed to global trade, a robust domestic economy helps stabilize Swiss activity. The labor market has recovered noticeably, and real wage growth should be positive. This could be a key driver of private consumption.
- 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 uncertainties persist, GDP may grow only 0.9% next year (previously 1.6%).
- The strengthening Swiss franc and lower oil prices (compared to last year) will have a dampening effect on inflation this year. We expect consumer prices to grow 0.4%, after last year’s 0.9%. For next year, we expect an inflation rate of 0.5%.
- At the moment, the SNB is not intervening in the currency market. That said, we see further monetary easing by the ECB next year on the back of political uncertainty and the subdued economic picture in the Eurozone, which could pressure the Swiss franc and force the SNB to lower interest rates as well. In this case, we expect the SNB to cut rates from –0.75% to –1% next March.

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) leads to a global downturn, which would hurt Swiss exports.

* Scenario probabilities are based on qualitative assessment.

Key dates
- Dec 2: Manufacturing PMI for November
- Dec 3: CPI for November
- Dec 9: Unemployment rate for November
- Dec 19: Trade balance November

Weaker growth and inflation in 2019 and 2020
GDP growth and inflation on an annual basis with UBS forecasts for 2019 and 2020

No SNB intervention at the moment
Change in sight deposits (to previous week in CHF bn, since 2017)
# Contact List

## Global Chief Investment Officer GWM

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## UBS CIO GWM Global Investment Office

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<th>Investment Themes</th>
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<tr>
<td>Andreas Koester</td>
<td>Mark Andersen</td>
<td>Philippe G. Müller</td>
<td>Simon Smiles</td>
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## UBS CIO GWM Regional Chief Investment Offices

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<tr>
<td>Mike Ryan</td>
<td>Min Lan Tan</td>
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