Global risk radar

Too much optimism?
11 February 2021

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This publication series helps investors identify and assess global financial market risks and their investment implications.

At a glance

• CIO holds a risk-on bias in its tactical asset class preferences. In our base case, we expect the vaccine rollout to accelerate in developed countries, allowing restrictions to be lifted more sustainably in the second quarter. Monetary and fiscal policy should remain accommodative. In the US, we expect the Biden administration to pass a fiscal package of over USD 1tr through reconciliation over the coming weeks.

• Risks to this outlook are centered around the path of monetary and fiscal policy; the speed of the recovery from the pandemic; geopolitical developments, especially around US trade policy; and the potential for too much market optimism.

• We have slightly upgraded the equity targets across our scenarios, resulting in single-digit return expectations for most developed market equities, while we anticipate further weakness for the US dollar.

Table 1: Scenario asset class targets for December 2021

<table>
<thead>
<tr>
<th>Asset class impact (targets for December 2021)</th>
<th>Spot*</th>
<th>Upside</th>
<th>Central</th>
<th>Downside</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>3909</td>
<td>4,300</td>
<td>4,100</td>
<td>3,200</td>
</tr>
<tr>
<td>Euro Stoxx 50</td>
<td>3657</td>
<td>4,200</td>
<td>3,800</td>
<td>3,000</td>
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<tr>
<td>MSCI EM</td>
<td>1,400</td>
<td>1,650</td>
<td>1,500</td>
<td>1,100</td>
</tr>
<tr>
<td>SMI</td>
<td>10,793</td>
<td>12,500</td>
<td>11,500</td>
<td>9,500</td>
</tr>
<tr>
<td>USD IG spread **</td>
<td>65</td>
<td>45bps / +0.5%</td>
<td>70bps / +0.5%</td>
<td>150bps / -1.5%</td>
</tr>
<tr>
<td>USD HY spread **</td>
<td>354</td>
<td>270bps / +5.0%</td>
<td>300 bps / +5.0%</td>
<td>550bps / -6.0%</td>
</tr>
<tr>
<td>EM/BIG spread**</td>
<td>342</td>
<td>280bps / +4.0%</td>
<td>340bps / +3.0%</td>
<td>550bps / -9.0%</td>
</tr>
<tr>
<td>EUR/USD</td>
<td>1.21</td>
<td>1.32</td>
<td>1.27</td>
<td>1.15</td>
</tr>
<tr>
<td>Gold</td>
<td>1,843</td>
<td>USD 1,500-1,600/oz</td>
<td>USD 1,800/oz</td>
<td>USD 2,000-2,100/oz</td>
</tr>
</tbody>
</table>

Source: UBS, as of 11 February 2021
* Spot prices as of 9 February 2021
** During periods of market stress, credit bid-offer spreads tend to widen and result in larger ranges. Percentage changes refer to expected return (t.r.) for the indicated spread levels.
Note: asset class targets above refer to the respective macro scenarios. Individual asset prices can be influenced by factors not reflected in the macro scenarios.

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In our 2021 Year Ahead outlook report, we identified three potential sources of market setbacks this year: economic policy, the pandemic, and geopolitics. While all of these risks remain valid and deserve close monitoring, the needle has moved in the right direction, in our view. For example, the new US administration has signaled its willingness to pass a large fiscal stimulus package; the vaccine rollout has accelerated in many countries (with some notable exceptions in continental Europe) and is showing early signs of success in lowering hospitalization rates; and US President Joe Biden has reaffirmed the importance of global alliances, easing worries about the continuation of a unilateral approach toward global trade and diplomacy.

CIO holds a risk-on bias in its tactical asset class preferences. In our base case, we expect the vaccine rollout to accelerate in developed countries (Fig. 1), allowing restrictions to be lifted more sustainably in the second quarter. Both monetary and fiscal policy should remain accommodative. In the US, for example, we expect the Biden administration to pass a fiscal package of over USD 1tr through reconciliation over the coming weeks.

With key market drivers falling into place, equities have the potential to generate high single-digit returns this year. Returns on fixed income should be in the low single digits, driven mainly by carry rather than a further narrowing of spreads. We also expect the US dollar to weaken further against the euro.

But there are many risks to this view. Key among them is uncertainty around virus mutation and the vaccines’ ability to protect against illness from new strains. Surprises on this front will have a bearing on policymakers’ reaction function toward economic reopening.

Another risk is increasing optimism in the market itself. While volatility markets are showing signs of cautiousness (see box), asset prices are increasingly accounting for a brighter investment environment, as clearly seen in near-record-high equity prices in developed countries. But too much optimism can lead to unintended consequences for investors in at least two ways:

- **Bubble risk:** As discussed in our House View letter in January, some of the preconditions for a financial market bubble are in place, and we are seeing signs of irrational exuberance in some market segments. At present, the broader equity market is not in a bubble, in our view. But while we think that positioning for a bubble to burst poses more risk than reward, high valuations make the market more vulnerable to setbacks.

- **Tapering risk:** Economic recovery is widely expected to pick up in the second quarter. A key question is whether this provides central banks the opportunity to reduce some of the stimulus they injected over the last 12 months and start tapering their asset purchases. In our base case, we don’t think conditions will be right for central banks to dial down on purchases until at least this September. However, we see a risk that investors could become increasingly worried about a premature tapering starting even if no actual tapering takes place.

We think investors should keep these risks in mind as they will likely gain in importance in the second half of the year. However, given our...
generally constructive outlook, we remain positive on risk assets (see House View letter).

**Fig. 1: Risk map**

### Scenario probabilities

- **Next 6–12 months**
  - Central
  - Downside
  - Upside

#### Pandemic recovery

- 60% probability: Uncertainty over vaccine timing, efficiency and availability
- 20% probability: Public fear and restrictions in light of virus mutations

#### Economic policy

- 60% probability: Upside risks to inflation
- 20% probability: Repricing of central bank policy

#### Geopolitics

- 70% probability: Uncertainty over US external policy under a new administration
- 15% probability: US-China and US-Iran relations

**Probability weighted returns**

- <0%
- 0–3%
- 3–6%
- >6%

Source: UBS, powered by Bing © OSIAT Edrav

### Table 2: Key market driver scenarios

<table>
<thead>
<tr>
<th>Economic policy &amp; momentum</th>
<th>Pandemic recovery</th>
<th>Politics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fiscal policy</strong></td>
<td><strong>Monetary policy</strong></td>
<td><strong>Growth</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
</tr>
<tr>
<td><strong>Upside</strong></td>
<td>Discretionary fiscal impulse continues to support the economy. US Congress passes USD 1.9tr fiscal bill through resolution.</td>
<td>Central banks stay accommodative but reduce asset purchases in 2H 2021 as recovery beats expectations.</td>
</tr>
<tr>
<td><strong>Central</strong></td>
<td>Fiscal impulse fades gradually as governments adapt to recovery. US Congress passes USD 1.5tr fiscal bill through resolution.</td>
<td>Central banks stay accommodative. No tapering of asset purchases until at least September 2021.</td>
</tr>
<tr>
<td><strong>Downside</strong></td>
<td>Diminishing fiscal impulse unable to compensate for economic weakness. President Biden’s proposed fiscal bill fails to pass through resolution.</td>
<td>Central banks stay accommodative, but higher inflation raises market concerns about earlier tightening.</td>
</tr>
</tbody>
</table>

<sup>1</sup>GDP back to pre-pandemic level in developed countries

<sup>2</sup>Programs are deemed sufficient once they have fully vaccinated 70% of key risk groups (age 65+ and health care employees)

Source: UBS, as of February 2021
Key dates to watch

**February**
- 27 February, Expiration of China’s tariff waiver of certain US imports

**March**
- 4 March, OPEC meeting
- 11 March, ECB meeting
- 16 - 17 March, FOMC meeting
- 17 March, Dutch general elections
- 18 - 19 March, BoJ meeting
- 23 March, Israeli legislative election
- 25 March, SNB meeting
- 25 - 26 March, European Council

**April**
- 26 - 27 April, BoJ meeting
- 22 April, ECB meeting
- 27 - 28 April, FOMC meeting
- 5 - 11 April, IMF / World Bank spring meeting

**May**
- 6 May, BoE meeting
- 6 May, United Kingdom local elections
- 18 May, Expiration of China’s tariff waiver of certain US commodities

**June**
- 6 June, Iraq parliamentary election
- 10 June, ECB meeting
- 11-13 June, G7 summit
- 15 - 16 June, FOMC meeting
- 17 - 18 June, BoJ meeting
- 17 June, SNB meeting
- 18 June, Iranian presidential election
- 24 - 25 June, European Council

**July**
- 15 - 16 July, BoJ meeting
- 22 July, ECB meeting
- 27 - 28 July, FOMC meeting

**August**
- 5 August, BoE meeting
- 17 - 20 August, World Economic Forum annual meeting

**September**
- 9 September, ECB meeting
- 19 September, Russian legislative election (date to be confirmed)
- 21 - 22 September, BoJ meeting
- 21 - 22 September, FOMC meeting

**Ongoing Monitoring**

- **Central bank policy**
  - Board meetings / interest rate decisions
  - Statements by key officials

- **Politics**
  - Supranational organizations (e.g. G7, G20, IMF)
  - US-China relations (One China policy, South China Sea)
  - Middle East
  - Elections
  - Sanctions (e.g. Russia, Iran, North Korea)

- **International trade**
  - Negotiation on new and existing free trade agreements (e.g. USMCA)
  - Discussion and action on tariffs (e.g. US tariffs on Chinese goods)
Pandemic recovery

Will vaccinations allow a return to normality?

Recent developments

Israel and the United Arab Emirates have already successfully vaccinated large portions of their populations. As of this writing, more than one-third of Israelis have had at least one of the two jabs, and early signs suggest a significant reduction in hospitalizations among the elderly following these vaccinations. The rollout has been slower across Europe and the US, but it is accelerating. Supply issues have reportedly been a key hindrance.

Meanwhile, COVID-19 hospitalizations remain high in the US and Europe, and the last two months have seen fresh outbreaks sweeping the UK, Brazil, and South Africa, raising concerns about the spread of new virus mutations (Fig. 2). In response, France and Germany tightened restrictions further. Nonetheless, despite having already implemented strict measures in the fourth quarter, Germany still surprised positively by narrowly avoiding another GDP contraction.

Our view

Base case (60% probability): Vaccines and limited public fear allow a continued recovery despite recurring outbreaks

Once a sufficient part of key at-risk groups has been vaccinated, restrictions can be lifted more meaningfully and sustainably. Major developed economies should reach that point in the second quarter. Their most vulnerable people—mainly defined as people aged 65 and over and health workers—typically make up 20–30% of the population. Thanks to a faster rollout and more robust supply, they should be fully immunized in the US by April; inoculating 1 in 200 people every day throughout the first quarter (Fig. 3) should be a sufficient speed to reach that target. We expect the European Union to follow through by June. Some emerging economies may take well into the second half due to a later start and smaller supply contracts.

Hence, we expect developed economies to recover to pre-pandemic GDP levels by end-2021. The US may even achieve that feat in the second quarter. Lifting restrictions after having vaccinated at-risk groups should be much more sustainable than the back-and-forth that has often happened in this pandemic (Fig. 4). While COVID-19 is unlikely to disappear, a lower mortality rate among at-risk groups should calm public fears. Hospitals would be less likely to be overwhelmed even if the virus continues to circulate in high numbers in the younger population. Businesses that depend on large indoor gatherings, such as the hospitality and entertainment sectors, should finally be able to begin their return to normalcy after having suffered from forced closures during winter in the Northern Hemisphere.

Upside (20% probability): Very high vaccination rates and low public fear speed up economic recovery

Recent lockdowns in Europe and North America appear to have caused much less economic damage than the preceding episode in early 2020 (Fig. 5). We see this as a sign that societies are finding new ways to adapt to this difficult situation while reducing the negative impact on most businesses. Pandemic fatigue may be one part of this story, which could lead to lower levels of fear over subsequent outbreaks.
Technological advancements like faster and cheaper mass-scale testing may further facilitate a more efficient handling of the crisis.

If such progress is combined with rapid, large-scale vaccinations, we could see a speedier economic recovery than in our base case. Developed countries could then see their GDP return to pre-pandemic levels by mid-2021, especially if fiscal and monetary policy stay accommodative in such a scenario, which seems likely.

**Downside (20% probability): Heightened public fear and strict business restrictions postpone full recovery into 2023**

A worse scenario could materialize if vaccination programs stumble, for instance due to difficulties in ramping up the production of vaccines. It is also possible that virus mutations significantly reduce the effectiveness of vaccines. Rolling out modified vaccines against such mutations would probably take between a few months and a couple of quarters, and could thus also significantly postpone our economic recovery timeline.

Government restrictions on business activity would keep recurring throughout 2021. We would then expect developed economies to reach pre-pandemic levels of activity only by end-2022 or later. Fiscal and monetary policy support would likely be increased if needed. But such a more protracted crisis would still increase the risk of longer-lasting economic damage on the back of rising debt and bankruptcies among the more heavily affected businesses.

**Investment conclusions**

Increasingly widespread vaccinations should support the economic recovery from COVID-19, and thus a risk-on stance in financial markets via equities (global small-caps) and Asian high yield credit (Table 1). Even though vaccinations are likely to be rolled out more slowly in most emerging markets, we see attractive value in their equities. They are historically more cyclical in nature, and should hence benefit from a solid global growth recovery. Likewise, oil prices should rise and the US dollar should weaken. Further opportunities may be found outside listed equities in private markets, such as in dislocated credit markets.

In our upside scenario, a faster and broader global economic recovery would push emerging market equities and EUR/USD significantly higher still. We would expect broad US dollar weakness amid continued easy monetary and fiscal policy. The EUR and GBP should benefit. High grade bonds and the safe-havens gold and Japanese yen would likely suffer.

The downside scenario would be negative for risk assets due to repeated economic growth setbacks. Commodities and the euro would also weaken. Assets or strategies that should perform better under such circumstances should include gold, dynamic asset allocation strategies, long duration Treasuries, and option structures.
Global risk radar

Economic policy

Will there be a taper tantrum in 2021?

Recent developments
At the onset of the COVID-19 pandemic, all major central banks lowered policy interest rates to the effective lower bound and initiated unprecedented amounts of asset purchases (see Fed example, Fig. 2). This has suppressed yields on safe bonds to record-low levels. Currently nearly USD 18tr worth of debt is negative yielding, accounting for around a quarter of all debt outstanding (Fig. 3).

With safe bonds all but guaranteeing losses in real terms over the long run, investors have been forced to reallocate capital into riskier alternatives such as equities and credit. As a result, risk assets have rallied throughout the second half of 2020 and into 2021, despite a weak economy (see equity example, Fig. 4).

Until the global recovery accelerates and catches up with the market, capital gains in risk assets will continue to hinge on economic stimulus. On the fiscal side, this requires the success of major spending projects like the European Union’s EUR 750bn recovery fund and US President Biden’s proposed USD 1.9tr relief bill. On the monetary policy side, it means ultra-loose policy remaining in place for the foreseeable future.

Our view
Base case (60% probability): Recovery catches up with markets
CIO continues to expect an economic acceleration in 2021. GDP growth should reach 6.1% globally (5% in the US and Europe) for the full year, from negative rates in 2020. This growth relies on continued policy support from governments and central banks, and assumes the lifting of pandemic-related restrictions from late spring or early summer.

We expect no tapering of asset purchases by any major central bank until at least September, with no interest rate hikes on the cards for at least another couple of years thereafter. Fiscal policy is also likely to remain expansionary, with the US continuing to take the lead (Fig. 5). Given President Biden’s latest announcements, spending on pandemic relief, infrastructure, and green energy look likely to occur before less market-friendly policies like tax increases for the time being. We expect a package of around USD 1.5tr to be passed through reconciliation before the end of March. Fundamentally, these conditions should continue to support risk assets over the next six to 12 months.

Downside (20% probability): Taper tantrum 2021
All major central banks are currently officially committed to maintaining ultra-loose monetary policy for an extended period, even in the face of near-term rises in inflation. However, the market’s confidence in central banks’ ability to keep their promises may be tested if inflation starts to move rapidly above policy targets. While this is not our base case, CIO sees a non-negligible risk of increased market worries about monetary policy in the coming months for a number of reasons, including:
1. Elevated inflation due to low a low base of comparison from April and May 2020;
2. The delayed arrival of price pressures from the first waves of fiscal stimulus; and
3. A rapid increase in economic activity following the relaxation of restrictions related to the COVID-19 pandemic.
These forces may conspire to push inflation numbers well past central bank targets in late spring to early summer, with US core PCE inflation potentially reaching as high as 3% compared to the Fed’s long-term target of 2%. Even though central banks are likely to look beyond such a surge in prices, for a time investors will have to grapple with a higher risk of sustained inflationary pressures, and accordingly a higher probability of earlier-than-expected policy tightening. At the current level of Treasury yields and equity valuations, this could result in a market event similar to the "taper tantrum" seen in summer 2013.

Investor concerns could be further exacerbated if an inflationary surge were to last longer than two or three months, or if it were to coincide with a disappointment in fiscal spending, such as the US fiscal package failing to pass through reconciliation in Congress.

**Upside (20% probability): Tapering for good reasons**

Conversely, the economy may also surprise positively in 2021:

- Inflation may not spike materially in late spring as structural disinflationary forces outweigh the base effects from 2020;
- Government spending announcements may surprise on the upside, for example with US Congress passing President Biden’s proposed USD 1.9tr fiscal package in full through reconciliation in the first quarter;
- The growth benefits of recent economic policy measures may turn out to have been underestimated.

As a result, the economic recovery this year may surprise even the market’s currently high expectations, leading to further outperformance of risk assets. Central banks would then be able to start unwinding asset purchases come the second half without disturbing financial markets.

**Investment conclusions**

CIO maintains a constructive view on risk assets such as equities and credit, while remaining cautious toward higher grade bonds.

- In the **base case**, stronger growth and moderately higher inflation in 2021 should benefit global equities. In the context of ultra-loose monetary policy, credit is likely to generate positive returns as well. In equities, we like cyclical sectors such as energy and materials; technology-enabled themes like fintech, greentech, and healthtech; and the more attractively valued market segments like small-cap stocks. In credit, we see the most value in Asia high yield.

- In our **downside scenario**, a taper-tantrum event could trigger a correction in many traditional asset classes including equities, bonds, commodities, and gold. The US dollar would likely appreciate, with volatility-linked instruments benefiting as well. According to CIO’s simulations, emerging market assets and the safest fixed income segments (government bonds and investment grade credit) would take the longest to recover. Developed market risk assets are likely to retrace most of the capital losses over a six-month horizon.

- In our **upside scenario**, CIO’s base case recommendations would likely outperform our central projections and offer even stronger returns to investors this year. High-quality bonds would underperform on a six- to 12-month horizon.

For more information, please refer to the latest CIO House View.
Geopolitics

How will US foreign policy be defined under a Biden-led administration?

Recent developments
In his first days in office, President Joe Biden immediately signaled a shift in US foreign policy. One clear priority of his administration is to rebuild US ties with traditional allies that it believes have been strained under the Trump presidency. By rejoining the Paris climate agreement and the WHO, the administration demonstrated its commitment to international cooperation and tackling climate change.

The appointment of Obama veterans to Biden’s foreign policy team is further evidence of a return to a more traditional approach to international relations. The appointment of diplomat Kurt Campbell as coordinator for Indo-Pacific affairs shows a further intention to deepen US engagement in Asia.

Our view
Base case (70% probability): A nuanced and multilateral approach
A Biden presidency lessens the uncertainty around US external policy. The approach and tone of the new administration will likely be more collaborative and targeted, and, most important for markets, less volatile than under Trump. We expect a multilateral approach toward rivals (e.g., China, Iran), which in our base case does not lead to an escalation of tensions. We think, however, that Biden’s focus will primarily be on domestic issues, at least initially in his presidency.

US-China
We continue to believe that the new administration will refrain from using tariffs as its primary trade policy tool, and instead seek to reduce tensions and emphasize negotiations. CIO, however, doesn’t expect a significant shift in China policy. While we could see occasional flare-ups in tensions, we see little reason to expect a significantly negative economic impact in the near term as long as tariffs don’t rise further. Yet investors should still be positioned for a structural decoupling between the two economies.

With bipartisan support to maintain a tough policy on China, we do not expect the new cabinet to rush to reverse Trump’s policies and tariffs. Despite the more moderate views of the new administration compared to some of Trump’s hardliners, we believe the strategy of China containment is set to continue. During his confirmation hearing, Secretary of State Anthony Blinken set the tone by backing the previous administration’s tough posture toward China, although disagreeing with Trump’s tactics. We expect the new administration to focus on human rights and strategic issues such as intellectual property protection, while strengthening US alliances and potentially working toward a framework of competitive coexistence.

For its part, China’s approach to the US is unlikely to change. Beijing now recognizes that the US has developed a distrust of China that will not reverse despite the new occupant in the White House. It is therefore likely that China will make concessions only in return for US concessions.
US-Middle East

Iran could be the first test of Biden’s foreign policy. Since the start of the year, Iranian leaders have made a series of comments intended to challenge the new US administration to remove the sanctions imposed when Trump pulled out of the Joint Comprehensive Plan of Action (JCPOA). Iran is demanding that the US lift sanctions before it returns to compliance with the previous nuclear deal. The US has responded that Iran should take the first steps. The priority of the US administration seems to be to improve relations while working with the other parties to the original deal. Given these challenges, CIO does not expect any material developments over the short term, but rather drawn-out negotiations.

With Iranian presidential elections next June, Hassan Rouhani may wish to apply pressure. But the US holds significant leverage over Iran’s economy, as oil exports—Teheran’s most important source of revenue and hard currency—remain heavily impacted by the sanctions, despite a recent ramp-up in production. So we believe Biden should have sufficient tools to engage with Iran to halt the nuclear proliferation in return for an easing of sanctions pressure.

On balance, we retain our positive outlook for oil prices, with Brent reaching USD 60/bbl by midyear and the oil market remaining undersupplied this year.

Downside (15% probability): Renewed tensions hurt growth

In our risk case, we see an escalation of tensions that leads to confrontation with other major or regional powers, which could lead to a risk-off move in markets. Events that could trigger our risk case include:

- **US-China**: A worsening of tensions is still possible. For example, Chinese actions perceived by the US to be hostile (e.g., related to the South China Sea, Taiwan, etc.), or an unwillingness to work on specific issues such as human rights and intellectual property (IP) protection, could make their relations more contentious. Biden has also said he wants to protect US manufacturing jobs and technological competitiveness. This is likely to keep the IP and industrial disputes alive, with lingering tariffs or other export control measures on Chinese companies.

- **US-Middle East**: Iran’s recent actions suggest a confrontational attitude, and in testing the will of the new presidency, a miscalculation is not to be excluded. Iran can also mobilize its proxies to disrupt oil supply from the region, should it decide to. We think it is unlikely that they will block shipping in the Strait of Hormuz, but they may temporarily impact the movement of tankers through the Strait. Iran and its proxies can also target oil facilities across the Middle East. Such destabilization in oil-producing countries could trigger a sharp drop in supply for a sustained period. In our pessimistic scenario, prices could spike above USD 85/bbl for several months. This could weigh on global capital spending and the consumer.

Upside (15% probability): Further easing of tensions accelerating growth upswing

- **US-China**: The new administration may consider constructive talks in the next few months after the secretary of commerce and the US trade representative receive Senate confirmation.
This could later lead to relaxing the US blacklist of Chinese tech companies, or cutting tariffs on China. This may prove a tough call, as these measures have bipartisan support in Congress. However, a removal of tariffs is possible over time, in exchange for Chinese commitments to IP protection, human rights, and US market access in China. A further easing of tensions could support the recovery in business sentiment and lead to higher investments and stronger economic growth.

- **US-Middle East**: Similarly, the US and Iran could return to the JCPOA more quickly than expected, with preliminary negotiations resuming and progressing rapidly. Either a renewal of the deal or an interim agreement could allow Iran to return to compliance and to reengage with international financial markets and resume some oil exports. However, the net impact on oil would depend on how much global demand recovers over the year.

**Investment conclusions**

**Base case**: Improved policy predictability could boost investor sentiment. This should be positive for risk assets in general, including both global equities and credit. We think this environment should be particularly positive for emerging market and Chinese equities.

**Downside case**: Our downside scenario would significantly increase the risk of a bear market in 2021. High-quality bonds have offered some protection in the past, but they may be a less effective hedge today as interest rates are close to all-time lows. Safe-haven currencies such as the Swiss franc and the Japanese yen would likely appreciate alongside gold. **US-China**: Equity sectors exposed to the trade conflict (e.g., industrials and materials) would suffer more than defensive sectors such as consumer staples and healthcare. **US-Iran**: Global equities have fallen on average about 15% during previous oil price shocks, but recovered within six months. In credit, high yield and emerging market bonds have suffered the most, but recovered within three months. The worst-hit markets would likely be high-yielding crude importers. In the past, the US dollar initially appreciated as investors sought a safe haven, but then weakened on higher oil prices.

**UpSide case**: Risk assets could gain from an easing in tensions, while yields on safe bonds could rise. Emerging market currencies would also benefit. Improved US-China relations would benefit regions and sectors impacted by tariffs in emerging markets as well as the Chinese yuan. Chinese stocks should further benefit if the threat of delisting Chinese companies from US exchanges were to recede. If improved US-Iran relations lead to lower oil prices, it would help sectors such as consumer discretionary and staples, due to lower input costs and higher disposable income. The high-yielding crude importers could also benefit.

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**Table 1: Expected market impact**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Base case</th>
<th>Downside</th>
<th>Upside</th>
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<tbody>
<tr>
<td></td>
<td>EM equities</td>
<td>Gold</td>
<td>Global equities</td>
</tr>
<tr>
<td></td>
<td>Asian high yield credit</td>
<td>High-quality bonds</td>
<td>Credit</td>
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<td></td>
<td>Oil</td>
<td>CHF</td>
<td>US-China specific</td>
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<tr>
<td></td>
<td>USD</td>
<td>JPY</td>
<td>CNY</td>
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<td>NOK, CAD, RUB</td>
<td>AUD</td>
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<td>US-Iran specific</td>
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<td></td>
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<td>High yielding crude importers</td>
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<td></td>
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<td>USD</td>
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Source: UBS, as of February 2020
Important Information About Sustainable Investing Strategies

Sustainable investing strategies aim to consider and incorporate environmental, social and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies and styles approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or screening, exclusion or negative features into a portfolio management strategy, may reduce the portfolio manager’s ability to participate in certain investment opportunities that otherwise would be consistent with its investment objective and other principal investment strategies. The returns on a portfolio consisting primarily of sustainable investments may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered by the portfolio manager, and the investment opportunities available to such portfolios may differ. Companies may not necessarily meet high performance standards on all aspects of ESG or sustainable investing issues; there is also no guarantee that any company will meet expectations in connection with corporate responsibility, sustainability, and/or other feature. Structured investments may include call features and, if a structured investment is called early, investors would not earn any further return and may not be able to reinvest in similar investments with similar terms. Structured investments include costs and fees which are generally embedded in the price of the investment. The tax treatment of a structured investment may be complex and may differ from a direct investment in the underlying asset. UBS Financial Services Inc. and its employees do not provide tax advice. Investors should consult their own tax advisor about their own tax situation before investing in any securities.

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