COVID-19 market scenarios
Dear reader,

As the coronavirus outbreak continues to dominate headlines and hospitals, investors are forced to grapple with a new normal amid social distancing and self-quarantine recommendations. Ensuring everyone’s safety remains a top priority, but as markets fluctuate and the government deliberates on further stimulus packages, we are all left wondering when this period of volatility and uncertainty will end.

In this month’s Feature article we lay out upside, central, and downside market scenarios given our current understanding of the virus, health policies, and monetary and fiscal responses. We remain optimistic that our lives will return to normal eventually, but the lingering effects of the virus on our healthcare system, businesses, and affected industries will be determined by our success in social containment and unprecedented monetary and fiscal action to support our economy.

In our portfolios, we have been diversifying into assets that we think are closer to pricing in downside scenarios. We now shift our overweight in emerging market equities to an overweight in emerging market hard currency sovereign bonds. However, we remain overweight in US high yield credit and Treasury Inflation Protected Securities (TIPS).

In our Thematic Spotlight, we highlight three longer-term investment themes—Food revolution, E-commerce, and Education services—that have come into focus in recent weeks as consumers shift toward a more mobile lifestyle to replace their usual routines for grocery shopping, going to work, going to school, and socializing.

Regards,

Mike Ryan

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Monthly House View client call:
2 April 2020
1:00 PM ET

This month’s conversation will only be available through the dial-in below:
Dial-in: 1-877-200-4456
Passcode: 46502#

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# CIO Preferences

This is a visual summary of our preferences. For the full detailed asset allocations see our full detailed asset allocation tables report.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Underweight</th>
<th>Neutral</th>
<th>Overweight</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
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<tr>
<td><strong>Total bonds</strong></td>
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<tr>
<td>US government</td>
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<td>US TIPS</td>
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<tr>
<td>US Treasuries (long)</td>
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<tr>
<td>US municipal</td>
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<tr>
<td>US investment-grade corporate</td>
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<td>US high-yield</td>
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<tr>
<td>Emerging market</td>
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<tr>
<td><strong>Total equities</strong></td>
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<tr>
<td>US large-cap growth</td>
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<td>US large-cap value</td>
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<td>US mid-cap</td>
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<td>US small-cap</td>
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<tr>
<td>Int’l developed market</td>
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<tr>
<td>Emerging market</td>
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**Overweight**
Tactical recommendation to hold more of the asset class than specified in the moderate risk strategic asset allocation.

**Underweight**
Tactical recommendation to hold less of the asset class than specified in the moderate risk strategic asset allocation.

**Neutral**
Tactical recommendation to hold the asset class in line with its weight in the moderate risk strategic asset allocation.

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COVID-19 market scenarios

COVID-19 uncontained
The coronavirus continues to spread. China has controlled its outbreak for now, but it is too early to say when increasing restrictions on economic activity and movement in Europe and the US can halt the spread of the virus.

Rapid policy response
Major central banks have rolled out their Global Financial Crisis playbook in a matter of days. Fiscal policymakers have announced large-scale support, comprising a mixture of loan guarantees, deficit spending measures, and direct support.

Our central case
New cases peak in mid-April, but the virus is hard to eradicate. Monetary and fiscal actions eventually provide a backstop, but the economic recovery is U-shaped. By year-end we expect the S&P 500 to trade around 2,650.

Asset allocation
We shift our overweight in emerging market equities to an overweight in emerging market hard currency sovereign bonds. We remain overweight US high yield credit and TIPS.

World leaders have made unprecedented decisions around the costs and benefits of temporarily restricting economic activity to limit the spread of an infectious disease. The social distancing measures now in place across much of the world—ranging from the closure of entertainment venues, to travel bans, business closures, and restrictions on personal movement—will have a major economic impact. We estimate that the kind of restrictions now in place across many major economies could cut between 20% and 40% from private sector activity over the duration that they are enforced.

In response, the Federal Reserve has rolled out its entire Global Financial Crisis playbook in just three days. The European Central Bank has launched a Pandemic Emergency Purchase Program, backing its claim to do “whatever it takes.” Fiscal policy-
In this monthly letter, our goal is to examine how we see the interplay of health, monetary, and fiscal policy impacting markets, so investors can effectively evaluate risks and opportunities today. We have organized our thinking into three scenarios: upside, central, and downside, each determined by the answers to the key questions: a) how quickly economic activity can normalize, and b) how much policy responses can limit corporate bankruptcies and job losses.

In an upside scenario, some combination of high compliance with social distancing, viral seasonality, and/or pharmaceutical solutions means that virus infections in the major economies in Europe and the US follow the path of China and peak by early-April, allowing measures to be gradually relaxed from early-May onward. Government stimulus is sufficient to avoid lasting damage to the economy, and allow growth to begin a V-shaped recovery in the third and fourth quarters. By year-end we would expect the S&P 500 to trade around 2,900 in this scenario.

In our central scenario, new cases of the virus generally peak by mid-April, allowing the most severe restrictions to be lifted from mid-May, although the virus proves hard to eradicate, meaning restrictions need to be reimposed intermittently in some countries for the remainder of the year. A coordinated monetary and fiscal response eventually provides the necessary funding to backstop affected businesses and industries, but it arrives too late to protect all. A U-shaped economic recovery takes hold around the fourth quarter. By year-end we would expect the S&P 500 to trade around 2,650 in this scenario.

In a downside scenario, containment measures do not prove sufficient to halt the spread of the virus, and new cases continue to rise in Europe and the US into May/June. We also see the virus spread again in China, requiring renewed restrictions there. Most restrictions in Europe and the US remain in place into June or July, and are reimposed intermittently for the remainder of the year. In this scenario, government policy would not meaningfully offset the lengthy demand shock, leading to a sharp rise in bankruptcies and joblessness. Companies would forgo significant revenue, and losses would be borne by shareholders, creditors, and banks. Economic growth would have an L-shaped profile through 2020. In this scenario, we would expect the S&P 500 to trade around 2,100 by year-end, although the actual trough may be lower, perhaps between 1,650 and 1,950, using historical bear markets as a guide.

Addressing asset allocation gaps through averaging-in, or options strategies, can help investors reduce timing risk.
combining the sale of put options with the purchase of call options, may help investors reduce timing and overcome the human behaviors that drive underperformance.

We think investors should seek those stocks with earnings that are relatively resilient to our virus scenarios, for example, companies exposed to the 5G rollout in Asia and global quality stocks; secular themes that can benefit from the current situation like fintech, e-commerce, online gaming, and online education; as well as cyclical sectors that face risks but which we think have been oversold, like China property stocks listed in Hong Kong, and Japanese automation and machinery companies.

For investors who can use options strategies, we recommend restructuring equity exposure with put/call strategies. The fear in the market allows investors to sell put options on both US and Eurozone equities to fund the purchase of call options at better prices. This strategy provides upside exposure to rallies, while also meaning automatic rebalancing into equities at lower levels should markets fall further.

In our portfolios, we have been diversifying into assets that we think are closer to pricing in downside scenarios. We now shift our overweight in emerging market equities to an overweight in emerging market hard currency sovereign bonds (EMBI), given that, in our view, these bonds looks closer to pricing our downside scenario than emerging market equities. We remain overweight US high yield credit, where spreads are close to our targets in a down side scenario. Given that we expect inflation expectations to rise from currently very low levels, we also overweight US TIPS versus US government bonds. In our FX strategy, we overweight a basket of select emerging market foreign exchange, given very low developed market interest rates, and the British pound, which we see as heavily undervalued relative to the US dollar.

**How long will social distancing restrictions remain in place?**

China has shown that the virus can be contained. It took two to three weeks after wide-scale quarantining measures were imposed for new cases of the virus to peak, and today, seven or eight weeks later, economic activity is close to returning to normality. Traffic in 19 major industrial cities is now at 89% of 2019’s level, and coal consumption is around 78% of 2019’s level.

Similar types of restrictions on movement and activity have now been introduced across Europe and the US. In a good scenario, the social distancing measures in the
US and Europe have the same effect as in China. This would allow new cases of the virus to peak by early to mid-April, and restrictions to be lifted from May and activity to normalize from around June. We could also reach the same result through pharmaceutical solutions, like anti-virals which help mitigate symptoms or development of a vaccine, or if it proves the virus spreads more slowly with warmer temperatures.

In a bad scenario, containment measures prove less effective in Europe and the US than in China. If halting the spread of the virus takes much longer and it continues to spread widely into May/June, restrictions would need to remain in place until June or July. Furthermore, the virus could resurface in countries or regions that had previously contained it, including China, requiring renewed intermittent restrictions for the remainder of the year. Softer restrictions would likely remain in place into 2021.

It remains too early to determine the success of social distancing in Europe and the US. The number of new daily cases continues to grow in most European countries, although a sign of hope comes from Vò, a town of 3,300 people near Venice, where testing and retesting of all residents and tracking of their contacts have led to the number of new infections dropping to zero. According to the Wall Street Journal, health officials in Lombardy hope they will reach a peak number of cases within the coming week.

In our central scenario, we think that new cases of the virus in Europe and the US will generally start to peak by mid-April, allowing restrictions to start to be lifted from mid-May. However, the virus could prove hard to eradicate, and success will inevitably vary by country. As such, restrictions may need to be reimposed intermittently in some countries for the remainder of the year. We should also expect softer forms of distancing to persist in all countries throughout 2020.

Will governments provide enough support to prevent bankruptcies and job losses?
To stabilize markets, nations must show they are willing to socialize the costs of the temporary restrictions. It is now inevitable that GDP will contract in the second quarter across Europe and the US. The goal for economic policymakers now should be to help the private sector avoid job losses and corporate bankruptcies, allowing the economy to bounce back once restrictions are lifted.

Broadly, we estimate that, in order to do this, governments will need to transfer 1–2% of annual GDP to the private sector for every month that the restrictions remain in place. If properly structured, this would allow most small- and medium-sized enterprises (the most important employers in most economies) to stay afloat, and provide some bailout packages for larger companies. Provided these transfers only occur for the duration of the crisis, and total less than 15–20% of annual GDP, we think this can be achieved.

How do we calculate this? To pay most of the wages of half the small business employees in an economy would cost around 0.75% GDP per month. Then, helping those at larger companies, for example in the airline, rail, hotel, retail, and leisure sectors, as well as covering some non-labor costs on top of that, gets us to a number between 1% and 2% of GDP.

Is this plausible? In short, we think it is, provided the total costs remain below 15–20% of GDP. For context, between 2009 and 2012 the US government provided fiscal support of more than USD 1.4tr, around 9% of annual GDP at the time. US government spending more than doubled between 1942 and 1943.

Where do we stand today? Although the headline size of the packages announced so
far has been large (16% of GDP for the UK, 15% of GDP for Germany, 15% of GDP for France, and 10% of GDP for the US), the goal for elected officials now is to find the right mix between loan guarantees, deficit spending measures such as payroll tax cuts, and direct support. Business loans and payroll tax cuts will not help if business owners decide to lay off staff, rather than take out government-backed loans. But the issue with government support appears to be more one of speed than willingness or ability at this stage. As such, our central scenario is that governments will ultimately do enough to avoid widespread bankruptcies and job losses, even if assistance comes too late, or proves too loose, to prevent some increase in unemployment.

The risk to our view, and the downside scenario, comes if restrictions last for more than five or six months. In this case, we think some governments may start to run up against the limits of their ability to fund themselves, and targeting help to affected businesses and individuals will grow increasingly challenging. If fiscal support needs to be reduced, or proves insufficient, bankruptcies and unemployment would rise sharply, both deepening the recession and slowing the recovery. Companies would forgo significant revenue. Shareholders, creditors, and banks would need to bear substantial losses.

What are the potential scenarios we now face? And what would they mean for markets?

Our scenarios for the market are defined by: a) how quickly economic activity can normal-

<table>
<thead>
<tr>
<th>Virus</th>
<th>Economy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Upside scenario</strong></td>
<td>Some combination of high compliance with social distancing, viral seasonality, and/or pharmaceutical solutions mean that new cases of virus peak in Europe and the US by early-April, allowing measures to be relaxed gradually from early-May onward, although some travel restrictions are likely to persist through 2020.</td>
</tr>
<tr>
<td><strong>Central scenario</strong></td>
<td>New cases of the virus peak by mid-April, allowing the most severe restrictions to be lifted in mid-May, though reemergence of the virus means restrictions are reimposed intermittently in some countries for the remainder of the year.</td>
</tr>
<tr>
<td><strong>Downside scenario</strong></td>
<td>Containment measures do not prove sufficient to halt the spread of the virus, and new cases continue to rise in Europe and the US into May/June. We also see the virus reemerge in China. Most restrictions remain in place into June or July, and are reimposed intermittently for the remainder of the year.</td>
</tr>
</tbody>
</table>

Source: UBS, as of 19 March 2020

<table>
<thead>
<tr>
<th>Market</th>
<th>Current (18-Mar)</th>
<th>Downside</th>
<th>Year-end forecasts</th>
<th>Upside</th>
<th>Current pricing distance from downside case to upside</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P 500</td>
<td>2,398</td>
<td>2,100</td>
<td>2,650</td>
<td>2,900</td>
<td>37%</td>
</tr>
<tr>
<td>Euro Stoxx 50</td>
<td>2,385</td>
<td>1,800</td>
<td>2,600</td>
<td>3,050</td>
<td>47%</td>
</tr>
<tr>
<td>MSCI EM</td>
<td>788</td>
<td>580</td>
<td>900</td>
<td>1,000</td>
<td>50%</td>
</tr>
<tr>
<td>SMI</td>
<td>8,338</td>
<td>6,500</td>
<td>9,000</td>
<td>10,000</td>
<td>53%</td>
</tr>
<tr>
<td>USD IG spread</td>
<td>285</td>
<td>300–400bps</td>
<td>150</td>
<td>100bps</td>
<td>26%</td>
</tr>
<tr>
<td>USD HY spread</td>
<td>904</td>
<td>1,000–1,500bps</td>
<td>550</td>
<td>350bps</td>
<td>38%</td>
</tr>
<tr>
<td>EMBig spread</td>
<td>634</td>
<td>700–800bps</td>
<td>450</td>
<td>280bps</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: UBS, as of 19 March 2020
ize, and b) how much policy responses can limit corporate bankruptcies and job losses.

**Upside scenario.** In our upside scenario, a relatively swift removal of virus restrictions would mean no meaningful lasting damage to the economy, and the drop in interest rates should prove positive for both consumers, who can enjoy lower mortgage rates, and for risky assets, which are likely to attract inflows from investors currently hiding in assets like Treasuries that offer near-term safety but meager long-term prospects.

We would expect the S&P 500 to reach 2,900 by year-end, a gain of 21% from 18 March levels, Euro Stoxx 50 to hit 3,050 (a 28% gain), and MSCI EM to reach 1,000 (27% gain). We would still expect USD HY to continue to see defaults of 3–4%, concentrated in the fragile energy sector and a few other structurally challenged sectors such as retail and leisure. But, despite the likely drag from these defaults, and rising government bond yields, we would expect 12-month total returns in credit to reach double digits (15–20% EMBI; 20–25% USD HY) from current levels.

**Central scenario.** In our central scenario, the coordinated monetary and fiscal response helps backstop most affected businesses and industries, and should help support markets through the course of 2020. But the negative effects of the economic contraction in the second quarter, some increase in unemployment, and intermittent restrictions through 2020, mean that the risk premiums remain elevated.

We would expect the S&P 500 to reach 2,650 by year-end, a gain of around 10% from 18 March levels, Euro Stoxx 50 to hit 2,600 (a 9% gain), and MSCI EM to reach 900 (14% gain). For US HY, we would expect spreads to tighten from roughly 900bps to 550bps, and emerging market investment grade bond spreads to tighten to 450bps to 630bps.

**Downside scenario.** In a downside scenario, lengthy restrictions and reemergence of the virus mean that government and central bank support proves insufficient to offset a sharp rise in unemployment and widespread bankruptcies. Shareholders and banks would need to bear the losses of significant forgone revenue. Any economic recovery in 2020 would be subdued, due to the negative demand effects of higher unemployment. Risk premiums would remain elevated throughout 2020.

We would expect downside by year-end of around 15% for the S&P 500 and around
25% for Eurozone and emerging market equities. That said, in this scenario, the actual trough of the market could be lower. In the three most severe post-war US bear markets, including the financial crisis, the market fell 42.6%, 44.7%, and 51%—this would imply a trough of between 1,650 and 1,950 in the S&P 500, a further 20–30% below today's levels.

Meanwhile, we would expect US HY spreads to be at 1,000–1,500bps by year-end. This level is wider than their 2015 peak, when spreads reached 900bps, although we think that the peak in spreads would likely fall short of the levels around 2,000bps reached during the 2008–09 global financial crisis. We would expect emerging market investment grade bond spreads to trade at 700–800bps.

Where are the best risk-return opportunities?
On balance, we think markets, particularly the US HY and EMBI markets, are closer to pricing in the risk of our downside year-end targets materializing than our upside targets. However, as stated, there is meaningful downside for most asset classes should the envisioned virus containment and historic bailout packages fail to turn the tide on a situation that China seems to have stabilized in eight weeks.

Within equities, we see particular opportunities in those stocks with earnings relatively resilient to our virus scenarios, like companies exposed to the 5G rollout in Asia and global quality stocks; secular themes that can benefit from the current situation like fintech, ecommerce, online gaming, and online education; as well as those cyclical sectors which face risks, but which we think have been oversold, like China property stocks listed in Hong Kong, and Japanese automation and machinery companies. At a time of elevated volatility, using put-writing or averaging-in strategies to enter these opportunities can be a way to mitigate timing risk.

How do I hedge against the risk of further declines?
We see four main approaches to hedging in the current environment: asset class diversification, geographic diversification, the use of alternative assets, and the use of dynamic asset allocation.

Asset class diversification. Bonds have worked as a diversifier in 2020, even if correlations have become unstable in some trading sessions. This has also borne out over the longer term. During S&P 500 bear markets the maximum drawdown has been 34.5% on average, erasing 65 months of prior gains and taking 39 months to reach a new all-time high. However, for a 60/40 stock/bond portfolio, the average maximum drawdown was 19.9%, erasing 20 months of prior gains, and taking 30 months to regain the former cycle peak.

Looking ahead, with 10-year US Treasury bonds yielding little more than 1%, the value of holding long-term bonds may appear more limited. But, even if the Federal Reserve proves reluctant to lower policy rates below zero, Treasuries still function as a form of portfolio insurance by helping to protect principal.

Geographic diversification. This crisis will present, and is already presenting, a significant challenge for individual countries. As we consider the variation countries are likely to experience in dealing both with the virus and with propping up the economy, the views I expressed in November 2017’s letter “Dealing with disaster,” remain as pertinent now as then:

“Since 1900 the world has seen at least a dozen hyperinflations, 20 recessions, almost 200 sovereign defaults or debt crises, two global financial crises, and 12 bear
markets. The geopolitical picture was even worse: seven global pandemics, two world wars, hundreds of civil or regional wars, more than 2,000 nuclear detonations, and revolutions in both the world’s largest and most populous countries. [Yet] all the episodes of potentially irreversible loss [in the past century], due to inflations, wars, and sovereign defaults, were localized. Concentrated regional risk was, and is, investors’ biggest potential wealth destroyer. Preventing unrecoverable capital destruction has been about global diversification."

Alternative assets. After rallying through the initial phase of the COVID-19 outbreak, gold prices have plunged in recent days, due to investor deleveraging. From here, although volatility is likely to remain high in the near term, we think prices will be supported by uncertainty about the virus, low real rates, and a weaker dollar, and could be further supported if global government spending surges. We maintain our forecasts of USD 1,600–1700/oz over 12 months. We also view the current situation as creating potentially attractive investment opportunities for private market investors. Historically, the best vintages for private equity firms have often coincided with dislocations in public equity markets, for example in 2001 and 2008. The current disruption may present opportunities to get Asian exposure at more attractive valuation levels. Opportunities for funds specializing in turnaround and distressed situations are also likely to increase the longer the disruption continues.

Dynamic asset allocation. Some investors might recall selling during the global financial crisis, or Eurozone crisis, but also failing to get back into the markets in time. A dynamic asset allocation strategy, based on a quantitative framework, can help investors dispassionately judge market information and economic data, allowing them to exit markets during volatile times, and, importantly, also reenter them when data suggests peak uncertainty has passed. Such strategies will likely never sell at the absolute peak or buy at the absolute trough, but they can increase the chance investors avoid the
most volatile days, and regain exposure during a more sustained uptrend.

**Asset allocation**

In our portfolios, we have been diversifying into assets that we think are closer to pricing in downside scenarios. We now shift our overweight in emerging market equities to an overweight in emerging market hard currency sovereign bonds, given that, in our view, EMBI looks closer to pricing our downside scenario than EM equities. We remain overweight US high yield credit, where spreads are close to our targets in a downside scenario. Given that we expect inflation expectations to rise from currently very low levels, we also overweight US TIPS versus US government bonds. In our FX strategy, we overweight a basket of select emerging market foreign exchange given very low developed market interest rates and see the British pound as heavily undervalued relative to the US dollar.

We open an overweight to emerging market hard currency sovereign bonds (EMBI) versus US government bonds.

EM sovereign bonds look the most attractive asset class in the credit universe in our view. Yield spreads have widened to more than 600bps from 290bps at the start of the year, are at the 96th percentile of values in the last 15 years, at a post-financial-crisis peak, and are close to pricing in our downside scenario.

Technical factors have added to downside pressure, with record ETF outflows and illiquid market conditions, which have opened up an attractive risk premium. We estimate that EMBI high yield spreads of around 1,000bps are pricing in a default rate of roughly 11%. Oil-exporting HY issuers could face further downside, but are already trading at distressed levels with spreads in excess of 1,000bps, and are only

**Figure 5**

EM sovereign bonds offer an historically attractive entry point

Forward 12m returns when spreads >500bps, in %

<table>
<thead>
<tr>
<th>12m total returns</th>
<th>Median return</th>
</tr>
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</table>

Source: Bloomberg, UBS, as of 18 March 2020

10% of the index.

Since 2000 there have been 52 months with EMBI spreads in excess of 500bps. Subsequent 12-month total returns were positive in all cases, with a median return of 13%. Risks to our position are near-term overshooting of spreads due to secondary
We overweight USD high yield (HY) bonds versus US government bonds. HY bonds have suffered during the recent market correction, with illiquid market conditions exacerbating the spread widening. At current spread levels around 900bps, the asset class is pricing in defaults of 9–10%, and is close to pricing in our downside scenario. In the near term, wider spreads are still possible under current market conditions, but we advise against selling in such an illiquid environment, and see medium-term value in the asset class. Since 1987 there have been 42 months with spreads in excess of 800bps, and subsequent 12-month total returns were positive in all cases but one with a median return of 24.5%.

We overweight Treasury Inflation Protected Securities (TIPS) against US government bonds. TIPS will outperform if realized inflation comes in above the current very low US five-year breakeven rate of 0.2%. As we don’t expect COVID-19 to have a long-lasting impact on forward US inflation expectations, we think such an outcome is likely.

In our FX strategy, we overweight the British pound versus the US dollar. Sterling dropped to its lowest level against the USD since 1985 on 18 March, trading below 1.15. The main reason for the move, in our view, was increased demand for dollar funding, reduced lending activity by global reserve managers, and less liquidity in US money market funds. Illiquid market conditions exacerbated the size of the moves, amid concerns that if London were locked down market liquidity would be severely impacted, though this has now been alleviated by renewed quantitative easing from the Bank of England. Looking ahead, sterling is significantly undervalued (our estimate of GBPUSD purchasing power parity is 1.57). And negotiations on the future trading relationship between the UK and the EU appear to be on hold and not a priority for either side, so the end of the transition period may have to be delayed beyond end-2020. Against this backdrop, as the Fed and other central banks coordinate to provide dollar liquidity across the globe through tools such as swap lines, we expect dollar funding concerns to dissipate, which could then lead to a sharp rebound in sterling.

In our FX strategy, we overweight a basket of high-yielding emerging market currencies. We hold an overweight position in the Indonesian rupiah (IDR), the Indian rupee (INR), and the Brazilian real (BRL), funded by short positions in the Australian dollar (AUD), the Taiwan dollar (TWD), and the Swedish krona (SEK). Increased volatility and broad-based dollar strength driven by funding concerns have created a more challenging environment for carry trades, and our basket has undergone a correction, but the construction of the basket (with high beta currencies on both sides) has smoothed performance. In an environment of low developed market interest rates, we expect the environment for carry trading to improve once dollar funding conditions normalize.

Mark Haefele
Chief Investment Officer
Global Wealth Management
Asset allocation implementation

The UBS House View is our current assessment of the global economy and financial markets, with corresponding investment recommendations. The asset allocation implementation of this view can vary across model portfolios, depending on their objectives.

Our Tactical Asset Allocation (TAA) recommendations

**Overweights**
- Treasury Inflation-Protected Securities (TIPS)
- US corporate high yield bonds
- Emerging market dollar-denominated sovereign bonds
- China equities (all-equity portfolio)
- Senior loans (yield-focused portfolio)

**Underweights**
- US government bonds
- Preferreds (yield-focused portfolio)

**What's changed**
- Closed an overweight to emerging market equities
- Closed an overweight to Brazil equities (all-equity portfolio)
- Opened an overweight to EM dollar-denominated sovereign bonds
- Opened an overweight to US corporate high yield fixed income

Full detailed asset allocation tables
View our full set of asset allocation tables for guidance on positioning across different investor types, portfolio strategies, and risk tolerances.

Implementation guidance

Our central scenario is that new cases of the coronavirus peak by mid-April, allowing the most severe restrictions on economic activity to be lifted from May, although some may be reimposed intermittently through year-end. Monetary and fiscal responses should backstop the decline, but a U-shaped economic recovery is likely to take hold only by Q4. Financial markets are generally pricing in more downside than upside risk relative to our central scenario. But there is still meaningful potential downside for most risk assets in our bear case scenario. For that reason we recommend keeping asset allocations relatively close to their long-term strategic benchmark. Tactically, credit markets generally seem closer to pricing in our downside case more than equities and therefore we prefer to add risk exposure through credit rather than equity at this time.

**Equities**

We closed our overweight to equities, which was expressed as a preference for EM stocks. While we still see potential upside over 10% to EM equities by year-end, in the near term the risk of more volatility and further downside remains high. We see similar upside for US and European stocks over the rest of the year, as well as the same near-term downside risks.

Rather than take clear directional views on equities, for investors who can use options strategy, the high market volatility makes it attractive to sell put options on US and Eurozone equities. This can be used to generate income, to fund the purchase of call options at higher prices, and to automatically rebalance into equities at lower levels.

Within emerging markets, we closed our preference for Brazil, while keeping it for China. The rapid spread of the coronavirus, heightened global recession risk, collapsing oil prices, and domestic setbacks on the fiscal front have severely impaired Brazil’s growth outlook. In contrast, the number of new cases of the virus in China has fallen close to zero, economic activity is normalizing, policy remains supportive, and valuations are below average.

Among US equity sectors, we overweight communication services (defensive growth), offset by an underweight to tech (still expensive relative to the overall market). We closed our overweight to consumer discretionary, as discretionary spending could be dramatically curtailed for at least a few months. We closed our underweight to utilities to be more defensively positioned.

**Fixed income**

We maintain a position in Treasury Inflation-Protected Securities (TIPS) versus US government bonds. This position will benefit from a rise in inflation expectations, which have fallen to only 16bps on a 5-year horizon, from over 1.5% in late February.

We added overweights to US high-yield corporate bonds and emerging market US-dollar denominated sovereign bonds. With spreads relative to Treasuries currently over 900 and 600 basis points, respectively, both asset classes are pricing in close to our bear case scenarios, and should benefit from aggressive central bank efforts to stabilize financial markets.

A note on TAA scaling

Unless noted otherwise, the TAA percentages on this page refer to a Moderate risk profile. Generally speaking, we apply a scaling methodology to TAA tilts for lower-risk portfolios, so that a 2% overweight in the moderate risk profile reflects as a 1.5% and 1%, respectively, in the Moderately Conservative and Conservative profiles.
Non-taxable investor
Moderate risk, without non-traditional assets

<table>
<thead>
<tr>
<th>Strategic Asset Allocation (SAA)</th>
<th>Tactical tilt</th>
<th>Tactical Asset Allocation (TAA)</th>
<th>Preferences</th>
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<tbody>
<tr>
<td><strong>Cash</strong></td>
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<tr>
<td>Emerging Markets</td>
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</tbody>
</table>

**Overweight**: Tactical recommendation to hold more of the asset class than specified in the moderate risk strategic asset allocation. **Underweight**: Tactical recommendation to hold less of the asset class than specified in the moderate risk strategic asset allocation. **Neutral**: Tactical recommendation to hold the asset class in line with its weight in the moderate risk strategic asset allocation.

*Overweight position opened on 2 March 2020. Read CIO Alert: Adding to risk after market sell-off for more information.

“Emerging Markets Fl” is a blend of 50% local currency, 50% hard currency.

Source: UBS

Risk profile implementation guidance

Tactical positioning for the Moderate portfolio is applicable for other risk profiles, with adjustments. We continue to recommend a long-maturity Treasury allocation in Moderately Aggressive and Aggressive portfolios, which have large equity allocations. These bonds are effective diversifiers, but the interest rate risk that they entail is less desirable in Conservative portfolios. The decline in longer maturity yields highlights the risk that yields could rise, but we think it remains a moderate risk given monetary policy actions and near-term growth risks.

In Aggressive portfolios we recommend implementing the long-maturity Treasury position with 20-30 Treasury STRIPS (principal-only bonds), whereas 20+ year Treasury bonds offer sufficient protection for Moderately Aggressive portfolios. STRIPS have longer duration and thus offer more protection during a sustained economic slowdown when rates are likely to fall, but they’re also more volatile.

The TIPS allocation is appropriate for all risk profiles, but longer maturity TIPS (10+ years) are better for Aggressive portfolios because of their longer duration. In Conservative portfolios shorter maturities (0-5 years) are recommended because they have lower rising rate risk.
Bull Market Monitor

Equity bull markets rarely end in the absence of a recession occurring, which is why we track key attributes of the business cycle to gauge how the expansion is evolving and calculate the risks of a recession.

**Cycle status**
We think that the US business cycle has entered a recession. The longest economic recovery and bull market in history have ended. Rather than more typical cyclical forces, it has been the steps taken by governments, businesses, and individuals to slow the spread of the coronavirus that have caused unprecedented interruptions of economic activity.

**What’s new?**
It is still too early for most economic indicators to reflect the current reality. However, some timely indicators suggest that conditions have changed dramatically. The Philadelphia Fed manufacturing survey showed its biggest monthly decline ever, plunging from 36.7 in February to −12.7 in March, the lowest reading since July 2012. Jobless claims rose to 281,000 in the week ending 14 March, up from 211,000 the previous week. While this is an unusually large week-to-week jump, we believe it is just the tip of the iceberg. Early data released by some states suggests that claims will soon be hitting record levels. The Fed has cut rates to near zero and has also made large-scale asset purchases. The yield curve has steepened now that the short end is near zero. Credit conditions have become much tighter.

**What are we watching?**
It will be impossible for economic conditions to return to normal until social distancing measures can be lifted. We expect testing to ramp up quickly, which may allow some measures to be eased as it becomes possible to quarantine only people who are actually infected. At some point, the number of new daily confirmed COVID-19 cases will peak and then decline. The sooner that happens, the sooner a new recovery cycle can start. We will be focusing on the timeliest economic indicators, such as jobless claims and sentiment surveys. A large fiscal stimulus package is working its way through Congress and should help to mitigate the economic downturn. It will also be important to watch what is happening overseas, especially to see if China can resume more normal activity without causing another pickup in COVID-19 cases.

**What are the investment implications?**
The near-term outlook is highly uncertain. We have moved to a neutral setting on equities in our tactical asset allocation.

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**Key cycle indicators**
The cycle indicators gauge whether the economy is overheating and if financial conditions are restricting growth. These determine our assessment of where we are in the cycle.

<table>
<thead>
<tr>
<th>Current</th>
<th>Previous</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall: Late cycle</strong></td>
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<tr>
<td>Early</td>
<td>Late</td>
</tr>
<tr>
<td><strong>Overheating indicators</strong></td>
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</tr>
<tr>
<td>Growth (relative to potential)</td>
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</tr>
<tr>
<td>Below</td>
<td>Above</td>
</tr>
<tr>
<td>Labor market</td>
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</tr>
<tr>
<td>Weak</td>
<td>Tight</td>
</tr>
<tr>
<td>Inflation (relative to 2%)</td>
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<tr>
<td>Below</td>
<td>Above</td>
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<tr>
<td><strong>Financial indicators</strong></td>
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<tr>
<td>Monetary policy</td>
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<tr>
<td>Accommodative</td>
<td>Restrictive</td>
</tr>
<tr>
<td>Yield curve</td>
<td></td>
</tr>
<tr>
<td>Steep</td>
<td>Inverted</td>
</tr>
<tr>
<td>Credit conditions</td>
<td></td>
</tr>
<tr>
<td>Loose</td>
<td>Tight</td>
</tr>
</tbody>
</table>

Each indicator is evaluated relative to a neutral level that is sustainable over time in order to determine whether the economy is at risk of overheating or if financial conditions will start to restrict growth.
Questions we’re tracking

What does the coronavirus mean for investors?
Global equities have experienced the fastest bear market move in history as investors have adjusted to the threat of the COVID-19 pandemic. Risk assets rebounded modestly on 13 March at the end of a volatile week. While the virus is uncontained in the US and Europe, it is being brought under control in Asia, and global policymakers are responding both with fiscal and monetary stimulus measures. We continue to overweight emerging market equities, and also recommend an overweight to TIPS, which are attractively priced given low inflation expectations.

Where are the long-term opportunities?
The S&P 500 is officially in a bear market. Meanwhile, the coronavirus continues to spread across Europe and the US. But for investors that have taken care of their near-term liquidity needs, the sell-off presents an opportunity to buy into longer-term themes. Even after the current crisis passes, an aging global population and recent strides in genetic therapies all offer long-term investment opportunities for investors seeking long-term portfolio growth. The crisis may also accelerate longer-term trends in connectivity and localization, benefiting companies exposed to the fourth industrial revolution and digital transformation.

Can policymakers rescue the markets?
Central banks and governments have ramped up efforts to limit the economic downside from COVID-19, with the Federal Reserve cutting rates to near zero while the US and Germany announced fiscal support measures. So far, however, the policy response has done little to stabilize markets. Tax and rate cuts do little to offset the near-term economic impact of the pandemic, but will be more useful once a recovery gets underway. Nonetheless, rates are likely to stay lower for longer, and we recommend strategies to enhance yield.

What next for oil?
Oil futures slumped to a 16-year low on 18 March, with global demand evaporating on the back of COVID-19-related travel restrictions, and supply flooding the market amid a Saudi-Russia price war. But while an oil price slump has added to near-term pressure in the high yield market, it should be a net positive for consumers. Policy support and the eventual containment of the coronavirus should push prices higher into year-end.

Is gold still a protection against risk?
Gold is prized by many investors as a hedge against risk. However, the response of gold to the COVID-19 infection has been mixed. It initially rose on safe-haven flows, but has suffered recently as struggling investors have liquidated gold to meet margin calls. We believe fundamentals for the precious metal remain supportive, with two Federal Reserve emergency rate cuts in March lowering the opportunity cost for holding gold, and other indications suggesting a weaker dollar ahead.

Month in review
COVID-19 dominated headlines and occupied the minds of investors this month. The total number of infections has surpassed 220,000, with over 8,900 fatalities, as of 19 March. The resulting market sell-off put an end to the 12 year bull market.

Policymakers around the globe have put forth significant measures to address the economic implications of the virus. The Federal Reserve has rolled out most of its Global Financial Crisis playbook in a matter of days, cutting interest rates to zero; launching at least USD 700bn of quantitative easing; purchasing commercial paper; and introducing global swap lines with many key central banks across the globe. The response from government has also escalated to address the crisis. Congress is negotiating its third stimulus package which is likely to exceed USD 1 trn. Germany and other Eurozone countries have also indicated support to pay private sector wages.

An oil price war escalation added to market volatility. On 8 March, Saudi Arabia launched price war with Russia and oil prices have plunged since then. On 18 March WTI crude fell as much as 26% and Brent crude fell more than 14%. With Saudi Arabia, Russia, and other OPEC states set to ramp up production over the coming months, concerns over an over-supplied have risen.

While market anxiety over the course of US politics has taken a back seat to COVID-19 fears, clarity was gained around the Democratic nominee this month. Former Vice President Joe Biden has established a commanding lead over left-leaning Senator Bernie Sanders and looks set to become the challenger to President Donald Trump (although Sanders has not dropped out of the race as of this writing).
A change in life as we know it...

In a matter of weeks, the coronavirus outbreak has upended the global economy, financial markets, and our daily lives. While an unfortunate few have suffered the worst effects of the virus, tragically losing their health, loved ones, livelihoods, or lives, the remainder of society has faced a disconcerting interruption of normality. Classrooms, offices, and commuter rails are nearly empty; pajamas are the style du jour; elbow “bumps” are the new handshakes; and toilet paper has become a precious commodity. Amid these unsettling changes, the global population has adapted to a new normal, accelerating certain secular shifts—from food delivery to shopping online—that we expected to unfold over the next decade. While we expect to return to normal eventually, we may see behaviors adopted during quarantine influence post-coronavirus lifestyles. With this in mind, we highlight several of our longer-term investment (LTI) themes that have come into focus, and we reiterate the related investment opportunities that we foresee over the next decade.

In many cities, restaurants and bars have been ordered to close their doors as the government attempts to stem the rapid outbreak of COVID-19. According to data from OpenTable, seated diners at restaurants are down 84% year-over-year in the United States. In the face of these restrictions, many restaurant owners opted to continue delivery services to serve those stuck inside, especially as shelves at grocery stores rapidly emptied. In most major cities, consumers are ordering food deliveries via mobile apps—a trend that we expect to continue as consumer preferences shift and urbanization continues. Investors appear to be taking notice—the stock price of Blue Apron for example, a food delivery platform, is up over 350% so far this week. While the market remains competitive, and winners are yet to be established, food delivery is one of the fastest-growing segments in the broader food revolution that is transpiring. We expect the segment to grow at about 16% annually, and to be worth about USD 365bn by 2030. For more, please see our report Longer Term Investments: The food revolution.

Food is not the only good being ordered in. As more consumers are confined to their homes, e-commerce giants are seeing more demand, as consumers stock up on essentials without risking their health. Indices representing online retailers have modestly outperformed the S&P 500 since the downturn began and have also surpassed department stores by a wide margin. The department stores sub-industry index of the S&P 500 has experienced a drawdown of approximately 56% from market peaks, while a similar index comprised of online retailers is down less than 16%. We expect this trend toward e-commerce to continue to play out over the coming decade. Even before the outbreak, we estimated that e-commerce would grow at around 15% annually over the next 10 years with the support of rising global smartphone usage and internet penetration. Please see the full report Longer Term Investments: e-commerce for more information on related investment opportunities.

Finally, working and learning has shifted to virtual environments, as “social distancing” measures have resulted in school and office closures. For school-age children and young adults, the coronavirus has meant a rapid shift toward education technologies, or “Edtech.” New York City alone is working to move classes online for more than 1.1 million students and is quickly training teachers to adapt to the new technologies. The shift toward online education has been reflected in stock prices for some Edtech companies, with K12 Inc., for example, returning over 3% since the S&P 500 peaked in late February. Looking forward, we have a positive outlook for Edtech, which offers greater personalization and expanded access to education services. The trend toward Edtech adoption will be supported by growing affluence in emerging markets, as higher incomes create greater demand for higher education. Our report, Longer Term Investments: Education services, contains more information on how to invest.
we “consume” mobility in the coming decades. Global urbanization will call for structural entry barriers to the space economy are caus -ing an inflection point.

Growing private sector investment and lower volatility than high-yield bonds.

Yield for the short end Short-end corporate bonds offer attractive current yield without taking on excessive credit or interest-rate risk.

Equity

5G infrastructure 5G creates an attractive opportunity and infrastructure companies should benefit before smartphone-focused companies.

NEW Campaign warriors Headline risk related to policy proposals could continue through November. We believe these companies are relatively less exposed to election-related volatility.

NEW Chinese equities to lead the recovery Chinese equities offer superior growth prospects relative to most DM stocks and are trading at a discount to the MSCI EAFE.

Event-driven strategies Event-driven strategies can represent attractive ways to capitalize on companies’ corporate actions.

NEW India profits and reforms reloaded Pro-market policy measures should be supportive of equity valuations, and earnings growth is expected to be superior to several other major markets.

Pricing power standouts Companies with pricing power should be better insulated from the headwinds of slowing growth.

The power of the Internet Internet stocks offer investors exposure to consumer-related secular growth trends.

Equity–ESG

Gender lens Evidence suggests that gender-diverse companies are more profitable and tend to out-perform their less-diverse peers.

Sustainable value creation in EM Incorporating ESG considerations into EM equity investment decisions may provide a competitive edge.

KEY

Sustainable longer-term investment theme
Longer-term investments = Multi-business cycle
Shorter-term investments = Current business cycle
Global economic outlook

Efforts to limit the spread of the coronavirus are causing a sharp slowdown in global economic activity. Both fiscal and monetary policies have been loosened in many countries, but it will be difficult to generate a recovery until virus mitigation measures can be relaxed. In the US, the Fed has cut rates to near zero and Congress is working on an economic package likely to exceed USD 1 trillion. In China, the number of new COVID-19 cases has dropped sharply and economic conditions are improving.

ECONOMIC OUTLOOK SUMMARY

Economic outlook summary
Brian Rose, PhD
Senior Economist Americas

House view
Probability: 60%
A negative quarter, with policy limiting second-round effects
The spread of the coronavirus has shifted the global economic focus from supply chain disruption to a demand shock. Weak second-quarter demand in Europe and the US will hit Asia (and offset any supply chain shortages). Sentiment data is likely to overreact more than normal to shifting economic patterns. This is also a relative demand shock—some areas of the economy will see rising demand even as other areas have collapsing demand. The relative demand gains will limit but not offset other areas of weakness. The most important economic focus will be on preventing otherwise solvent businesses from closing (that would add to unemployment, and create the negative scenario). This will require policies to help companies with cash flow problems. Attempts to stimulate demand are unlikely to be effective—and health policies are aimed at reducing demand in some areas.

 Positive scenario
Probability: 15%
Stronger bounce-back
The virus still weakens growth in the near term, but consumer demand bounces back more vigorously in the second half of the year (aided by policy stimulus).

 Negative scenario
Probability: 25%
Second-round effects weaken demand further, prolonging the downturn
A failure to provide assistance to small businesses and consumers leads to a second-wave demand shock. Unemployment rises and demand weakens further. The second wave outlasts the impact of the virus, delaying the recovery for several quarters.
Central bank policy
Paul Donovan
Chief Economist

House view
Probability: 60%
Targeted policy now, stimulus later
Central banks will need to focus their attention on the problems of companies, and in particular small companies (listed companies are not especially relevant, economically speaking). Cash flow will be challenged by the demand shock of the coronavirus. Similarly, households may have more problems meeting loan payments. This means that interest rate cuts are not especially important in the coming weeks. A 0.5% interest rate cut will not persuade people to get on a cruise ship. Instead, more technical policy measures, combined with liquidity to ensure the smooth operation of the financial markets, are most likely. Central banks may have to use the regulatory channel more than the monetary or quantitative policy channels, in the near term.

Positive scenario
Probability: 25%
More aggressive policy easing as macro backdrop worsens
If job losses start to rise steeply as a result of the demand shock, central banks will eventually have to provide more accommodation to ensure that the bounce-back occurs.

Negative scenario
Probability: 15%
Fiscal stimulus and pent-up demand support the bounce-back
Central banks provide all necessary support to corporate and household cash flows during the initial phase of the demand shock, but fiscal policy and pent-up demand (plus potentially some additional inventory build) reduce the need for traditional policy accommodation thereafter.

High uncertainty
Jeremy Zirin, CFA
Head of Equities Americas
David Lefkowitz, CFA
Senior Equity Strategist Americas

House view
Probability: 50%
Earnings likely to take a hit
The continued spread of the coronavirus will clearly have an adverse impact on the economy and corporate profits. However, predicting the depth and duration of the impact is challenging. With that as a caveat, we are taking a conservative approach and expecting S&P 500 EPS to contract quite sharply in 2020 to USD 130 (-21% growth). We expect a sharp fall in earnings in the first half of the year. But profits in the second half of the year should be materially higher than the first half. The earnings momentum should continue into 2021 when we expect USD 156 (+20% growth).

Positive scenario
Probability: 30%
Spread of the coronavirus proves to be short-lived
Individual countries are able to successfully implement containment measures that prevent further spread of the virus sooner than expected—earnings only contract by 12% in 2020.

Negative scenario
Probability: 20%
Downturn in overall sentiment
Talks between OPEC and Russia continue to sour, trade and geopolitical tensions reignite, and it takes many months to fully contain the coronavirus—earnings decrease 30% in 2020.
Equities
Jeremy Zirin, CFA; David Lefkowitz, CFA; Edmund Tran, CFA

The coronavirus and prevention measures to curb its expansion threaten to disrupt global economic growth. The current late stage of the economic cycle is making it harder for global economies to face unexpected risk scenarios, pushing policymakers to intervene more intensively than before. Visibility is low, but with more attractive valuations, depressed bond yields, and potential for policy action to drive growth higher in 2H20, the medium-term risk-reward for equities has improved.

Eurozone
Neutral

Earnings growth in the region remains negative but valuations have normalized after the recent sell-off. We expect earnings growth to contract again this year amid slowing top-line growth and profit margin pressure. If the virus spread is not contained during 2Q, a global consumption slowdown and shutdown of economic activity would additionally weigh on revenues and earnings growth. Valuations are attractive relative to bonds and in absolute terms. The 12-month forward P/E is 9.6x, a 23% discount to its historical average and 33% below global equities.

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<tr>
<th>EURO STOXX (index points, current: 262)</th>
<th>December 2020 target</th>
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</thead>
<tbody>
<tr>
<td>House view</td>
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<tr>
<td>Positive scenario</td>
<td>320</td>
</tr>
<tr>
<td>Negative scenario</td>
<td>190</td>
</tr>
</tbody>
</table>

Emerging markets
Neutral

Taking into account strict containment measures being imposed by policymakers, an unexpected cut in crude oil prices, and the disruptive uncertainty in supply chain distribution, we now expect zero to low-single-digit earnings growth for emerging markets in 2020. From a valuation perspective, the EM P/E discount versus its developed market peers is no longer attractive. Thus, we are closing our overweight in EM equities. Within emerging markets we continue to have a preference for Chinese equities.

<table>
<thead>
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<th>MSCI EM (index points, current: 788)</th>
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<tr>
<td>Positive scenario</td>
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<tr>
<td>Negative scenario</td>
<td>580</td>
</tr>
</tbody>
</table>

Japan
Neutral

Japanese stocks are highly exposed to the global economy, especially the US and China. Thus, uncertainty over the COVID-19 outbreak globally will likely weigh on share prices and corporate earnings for the next few months. Recent JPY appreciation due to lower US yields is also a headwind. We have revised down our earnings forecast to -15% from -9% for FY2019 (ending March 2020) and adjusted our FY2020 forecast to +2% from +4%. Our forecasts assume the virus temporarily disrupts global supply chains and hurts demand, but economic activity will recover toward year-end.

<table>
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<th>TOPIX (index points, current: 1271)</th>
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<tr>
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<tr>
<td>Positive scenario</td>
<td>1600</td>
</tr>
<tr>
<td>Negative scenario</td>
<td>1000</td>
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</tbody>
</table>

UK
Neutral

UK equities offer an attractive valuation of 9.2x forward earnings and a dividend yield of 5.2%. Relative valuations are undemanding: the MSCI UK is trading at a 35% discount to the MSCI World—the lowest level in 20 years. However, profit growth this year is likely to be negative, driven down by the currency appreciation and lower energy price. Fiscal spending and other policy initiatives are likely to provide a lift to the economy in the near term. This, combined with an anticipated rise in GBP, should help domestically focused companies outperform large-cap, internationally exposed stocks.

<table>
<thead>
<tr>
<th>FTSE 100 (index points, current: 5081)</th>
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<td>Positive scenario</td>
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<tr>
<td>Negative scenario</td>
<td>4000</td>
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</tbody>
</table>

Note: All current values as of 18 March 2020
US Equities

After hitting a peak on 19 February, the S&P 500 has plummeted at breathtaking speed as coronavirus containment measures have forced the shutdown of vast segments of economic activity around the world. As a result, stocks entered a bear market in just 22 calendar days—the fastest 20% decline in history. While the economic hit will likely be quite severe, it should prove to be temporary, especially considering the massive amount of fiscal and monetary support governments are currently lining up globally. We maintain our neutral view on US equities.

US equities overview

Neutral

We now expect a sharp contraction in S&P 500 profits in the first half of the year before beginning a rebound that will continue into 2021. Our estimates are USD 130 (-21%) and USD 156 (+20%) for 2020 and 2021, respectively. Markets will likely remain volatile and uncertainty high until the full extent of the economic damage is known and the trajectory of the recovery becomes more clear. But bear in mind policymakers are taking aggressive action and deploying the playbook that was successful in Asian countries, where economic activity is recovering. Our year-end price target is 2,650.

US equities – size

We retain our neutral allocation across size segments. After a strong 2019, all US equity sizes are down meaningfully in 2020 due to COVID-19 fears. During this drawdown, large-caps have meaningfully outperformed (-26%) small-caps (-38%) through 16 March. Smaller firms are facing stronger headwinds due to the virus as they typically operate on thinner margins and have less access to capital to weather the falloff in demand.

US equities – sectors

This month, we are shifting our sector strategy from a modest pro-cyclical stance to a more balanced stance by downgrading consumer discretionary to neutral and upgrading utilities to neutral. This leaves us with an overweight to communication services and an underweight to information technology. With macro uncertainty elevated, we elect to have a smaller number of tactical deviations from the benchmark.

US equities – style

Value stocks continued their underperformance versus growth stocks through the recent market sell-off (-31% versus -22% through 16 March). Value stocks tend to be more sensitive to interest rates and oil prices, both of which have fallen precipitously this month. Value stocks tend to perform well when economic activity accelerates. This segment could be poised for strong outperformance as the disruption from the coronavirus eases later this year.

S&P 500 (index points, current: 2398) December 2020 target
House view 2650
Positive scenario 2900
Negative scenario 2100

Note: Current values as of 18 March 2020

Valuations are at seven-year lows
S&P 500 P/E based on earnings over the last year

Source: FactSet, UBS, as of 18 March 2020

S&P 500 earnings fall about 16% in an average recession
Peak-to-trough profit decline in a recession, dates correspond to recession trough, in %

Source: FactSet, UBS, as of 18 March 2020
**Bonds**

Interest rates have been falling since the start of the year in response to fears over the disruption triggered by the outbreak of the coronavirus in China. The fall accelerated as the virus spread globally, the drop in stock markets triggered a flight to quality, and the Fed executed emergency rate cuts. The Fed has cut rates by 2.25% since the middle of last year, taking rates to near zero and enacting other emergency measures. Within fixed income, we hold a moderate overweight in Treasury inflation protected securities (TIPS), US corporate high yield (HY), and emerging market sovereign bonds.

**Government bonds**

*Underweight*

The US 10-year yield fell to a historic low of 0.31% on concerns over recession risks due to the coronavirus. We have lowered our yield forecasts with the expectation of very low to negative second and third quarter US GDP growth. We would not buy interest rate risk under this high volatility environment.

**US investment grade corporate bonds**

*Neutral*

In one of the quickest corrections on record, credit spreads widened rapidly from post-crisis lows toward the peaks of 2011, of around 300bps. At current levels, the US IG market is pricing in a severe economic slowdown and negative earnings growth. We expect spreads to remain elevated around current levels in the weeks ahead but we advise investors to hold on to existing positions. Current market conditions are unfavorable and we foresee spreads to normalize before year-end. We continue to favor financials (US banks) over non-financials and bonds with short maturities (1–3 years).

**US high yield corporate bonds**

*Positive*

Over the past few weeks, spreads widened from post-crisis tights toward the peak of 2016, around 900 bps. Historically, with spreads at current levels, subsequent 12-month total returns have been positive in all cases but one. At current levels, market pricing implies an annual default rate of 9–10%, which is in line with a mild to medium recession. In the near term, we expect high uncertainty and illiquid market conditions to keep spreads elevated around current levels. We are holding on to our modest tactical overweight position as we expect spreads to normalize by year-end.

**Emerging market bonds**

*Positive*

The global expansion of COVID-19 and the unraveling of the OPEC+ production cut deal triggered a sharp widening of EM USD-denominated sovereign and corporate bond spreads. Despite sharply lower UST rates, the asset class posted negative returns on the order of mid-single to low-double digits. Spreads are likely to remain elevated in the near term on COVID-19 and crude oil uncertainty. However, in our baseline scenario we expect affected countries to bring COVID-19 under control, higher crude oil prices, and tighter spreads toward year-end. We find the asset class offers an attractive mid-single-digit carry and add a tactical overweight position in EM sovereign debt.
Municipal bonds

Tax-exempt yields increased markedly in the wake of a pandemic declaration. Month-to-date, through 18 March, IG munis are down 5.5%, and HY bonds have lost 12.2%. An abrupt shift in investor sentiment has triggered mutual fund outflows. Selling pressure has been more profound on short-dated high-quality bonds as asset managers raise cash to meet redemptions. Muni yields relative to taxable debt hit record highs. Crossover investors are afoot to take advantage of the dislocations in the muni space. Current AAA 10-year muni-to-Treasury yield ratio: 148.4% (last month: 73.9%).

Non-US developed fixed income

Over the past month, bond yields moved broadly lower in non-US developed markets as central banks loosened policy. However, on foreign exchange markets, the dollar gained against other major currencies, which hurt returns when measured in dollars. On net, the asset class was down for the month. With yields negative on many bonds, non-US developed fixed income remains unattractive. We do not recommend a strategic asset allocation position on the asset class.

Additional US taxable fixed income (TFI) segments

Agency bonds

Given the exogenous factors facing the fixed income markets, flight-to-safety investors moved into agency debt. Although the liquidity in the sector is small versus agency MBS, the debt side has performed well with a slightly positive return month-to-date, and a yearly total return of 3.2%. Although heightened volatility is likely to remain over the near term, investors are better compensated for lower risk assets which have better liquidity than agency debt. Going into MBS, short-end IG or short-end munis represent better value going forward. Current spread is +11bps to the 5-year (versus +8bps last month).

Mortgage-backed securities (MBS)

Long live the Fed! Once again the Fed announced a buying program for MBS. This was not surprising as supply in the sector had increased rapidly given the USD 20bn rolling off from the Fed’s balance sheet and the abundant supply due to refinancing. After the Fed stepped into the MBS market, tighter spreads and higher returns have occurred. We have remained on MBS due to volatility but flagged the sector as being cheap versus IG corporates. After the first few weeks of March this is not the case given IG’s large underperformance. IG is cheaper to MBS now but lacks the liquidity and AAA rating. Current spread is +160bps to the 5-year and 10-year Treasury blend (versus +95bps last publication).

Preferred securities

Over the past month, preferreds have plunged by more than 20% as investors continue pushing credit spreads and yield premiums to multiyear highs. This represents a violent and sharp reversal from levels that were at or near historic lows just a few weeks ago. We are also seeing a sharp reversal in another major support in 2019—ETF flows. The US $25 par preferred market is relatively small and preferred ETFs own a large portion. Flows can whipsaw performance and valuation. The pullback has led to better value among fixed-rate preferreds. We favor those with above-average coupons. We view fixed-to-floating rate preferreds (F2Fs) with greater scrutiny.

Treasury inflation-protected securities (TIPS)

TIPS performance has been very poor during March given the unexpected oil price wars. Unfortunately this was not expected, not only by the UBS commodity team but the market as a whole. WTI oil has collapsed to a USD 23 low, pushing inflation expectations close to zero in 5-year TIPS. Although we are disappointed with performance, we are staying with the position for its longer-term potential. Inflation may not be around the corner given the unknowns with the US economy and low oil/gas prices, but with a zero lower bound and lower dollar, it remains a risk. Current 5-year break-even inflation rate of 0.1% (1.64% last month).

Source: BoA Ice, Factset, UBS as of 18 March 2020.
Commodities and other asset classes

Dominic Schnider, CFA, CAIA; Giovanni Staunovo; Thomas Veraguth; Wayne Gordon

Of all the asset classes, commodities have been most adversely affected by the coronavirus outbreak. On a total return basis, broad commodity indices are down more than 20% year-to-date. Commodity demand is likely to remain weak as concerns should continue to linger in the very short run. Recent record-low manufacturing and construction PMIs suggest the asset class will display elevated volatility in the coming weeks, along with repeated bouts of price weakness. In our base case, we expect a pickup in global economic activity in late 2H20. This should provide a price-supportive backdrop for broadly diversified commodity indices. In the risk case, cyclical commodities, like crude oil and industrial metals, would likely stay at depressed levels or weaken even further in the short term.

Commodities

Neutral

Precious metals We have a positive price outlook for gold as we expect short-term real rates in the US to stay low for longer, with the US dollar being under broad downward pressure. Also, equity markets could see renewed volatility spikes due to late-cycle dynamics and geopolitical events. We continue to see gold as a valuable insurance asset in a portfolio context and expect the yellow metal in our base case to trade around USD 1,700/oz.

GOLD (current: USD 1486/oz) June 2020 target
House view USD 1650/oz
Positive scenario USD 1800/oz
Negative scenario USD 1400/oz

Crude oil If OPEC+ is no longer willing to balance the oil market, oil prices could fall further into the production cost curve and trigger supply reductions to offset coronavirus-related demand losses. The worst is not over yet, as Saudi Arabia, Russia, and other OPEC states are set to ramp up production over the coming months. This will flood an already oversupplied market and likely weigh heavily on prices. We still expect a price recovery over our forecast horizon. Saudi Arabia’s shock-and-awe strategy suggests to us that to bring Russia back to the negotiating table, it is serious about causing severe price and revenue pain for all oil producers. We expect lower prices to cause US production to decline and to support oil demand in 2H20.

BRENT (current: USD 25/bbl) June 2020 target
House view USD 50/bbl
Positive scenario USD 60/bbl
Negative scenario USD 20-30/bbl

Base metals Metal inventories are poised for a spike, as coronavirus-related demand weakness outweighs potential supply disruptions. With COVID-19 spreading outside China, there is a risk that supply outweighs demand in 2Q as well. That said, some of the demand losses in 1H could be recouped in 2H, leading to tightness in the metal market, allowing prices to recover.

Agriculture Agricultural commodities have fallen by around 12% year-to-date. Livestock—in particular lean hogs—has dragged the overall sector lower as COVID-19 disrupted supply chains in China, sending US livestock prices lower. Aside from the virus, we still expect China to ramp up pork imports this year and this should drive a modest recovery in lean hog prices. Though China has committed to massively lift purchases of agricultural products from the US, to date soybean sales to China remain slow.

Other asset classes

Listed real estate Earnings growth is 5% for 2019–20 and 6% for 2021–20 (excluding emerging markets), driven by portfolio reshuffle, repositioning, extensions, and development projects. Retail landlords need to deleverage. Some companies will see their risk spreads expanding amid an accelerated cyclical deceleration. Tenant quality is key. Physical transaction volumes will decline. The support to value from ample liquidity is receding. Capital value growth rates that have been decelerating since 2015 will accelerate their downturn. Some cap-rate expansion will occur with the exception of some niches. Vacancies will likely edge up amid new supply.

RUGL Index (current: USD 3675) June 2020 target
House view USD 4500
Positive scenario USD 5000
Negative scenario USD 4000

Note: Current values as of 18 March 2020
Foreign exchange

Thomas Flury, Strategist

In our FX strategy we maintain an overweight to the British pound versus the US dollar. We also overweight a basket of high-yielding emerging market currencies, choosing risk-sensitive currencies to finance the carry.

USD
Underweight
The US dollar carry advantage, an important reason why the greenback was expensive until now, has vanished, and is unlikely to reappear during our forecasting horizon. Now the main reason for dollar demand is liquidity concerns. Markets are heavily invested in dollar assets and purchasing power parity suggests that the USD is overvalued. When global growth normalizes, the dollar should give up its recent gains.

EUR
Neutral
We expect EURUSD to trade sideways in a broad 1.10–1.15 range for the coming months. The lower Fed rates will put the USD in a less exclusive role, and higher volatility will prevent investors from engaging in short-euro carry trades. We leave the end-year forecast at 1.19 under the assumption that the global economy will rebound in 2H20 and the Fed will nevertheless not hike rates until the end of 4Q21.

GBP
Overweight
The cable had a drastic repricing as investors unwound risk positions and pro-growth trades. In the mid-1.10s, where GBPUSD is priced at the time of writing, we think the pound is quite attractive and expect a rebound as soon as the health situation globally stabilizes, which we expect to happen within the next 1–2 months.

CHF
Neutral
We forecast USDCHF to fall to 0.92 by the end of June and stay there for the remaining forecast horizon. The Fed has cut rates to ease market uncertainties and is likely to keep rates at low levels for a prolonged period. Lower yield spreads and higher volatility put USDCHF under pressure. We now see 0.90–0.95 as the trading range. The Swiss National Bank will try to prevent heavy appreciation, but is probably unable to weaken the CHF from here.

JPY
Neutral
We cut our USDJPY forecasts to 100, 102, 104, and 104 for end-June 2020, September 2020, December 2020, and March 2021, respectively (previously 108, 108, 106, and 104). The Fed has now cut policy rates to near zero. The Bank of Japan is unlikely to match this magnitude of easing. This should bring the USDJPY down to 100 in the near term. In a risk case scenario of escalating global risk aversion, a fall below 100 cannot be ruled out.

Other developed market currencies
Neutral
Our basket of INR, IDR, and BRL on the long side, and AUD, TWD, and SEK on the short side, underwent a correction as investors were forced to unwind carry trades. The performance was smoothed by the special construction of this basket, as we are choosing risk-sensitive currencies (AUD, SEK, and TWD) to finance the carry. This shelters the basket in times of risk aversion much better than short positions in JPY or CHF.
## Key forecasts

<table>
<thead>
<tr>
<th>Asset class</th>
<th>TAA (6–12 months)</th>
<th>Change this month</th>
<th>Benchmark</th>
<th>Value</th>
<th>m/m perf. in %&lt;sup&gt;1&lt;/sup&gt;</th>
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<td>➖</td>
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<td>FTSE 100</td>
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<td>SMI</td>
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<td>➖</td>
<td>ICE BofA IG spread</td>
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<td>EMBI Diversified spread</td>
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<td>CEMBI Diversified spread</td>
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<td>Spot price</td>
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<td>Gold</td>
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<td>Spot price</td>
<td>24.88 /bbl.</td>
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<td>Brent crude oil</td>
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<td>RUGL Index</td>
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<td>GBPUSD</td>
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<td>JPY*</td>
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<td>➖</td>
<td>USDJPY</td>
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<td>CHF</td>
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<td>➖</td>
<td>USDCHF</td>
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<td><strong>Forecast (Dec 2020)</strong></td>
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<td>House View</td>
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<td>Negative scenario</td>
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<td>4500</td>
<td>5000</td>
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Source: Bloomberg, UBS

* We continue to recommend that investors hold UK and Japanese equities on an unhedged basis, as GBP and JPY offer long-term appreciation potential against the US dollar.

1 Month over month.

2 US high-yield bond overweight was introduced in the ad hoc report, *CIO Alert: Adding to risk after market sell-off*, published on 2 March.

Past performance is no indication of future performance. Forecasts are not a reliable indicator of future performance.
US equity sector allocation

<table>
<thead>
<tr>
<th>Sector</th>
<th>Benchmark Allocation</th>
<th>CIO GWM Tactical Deviation&lt;sup&gt;2&lt;/sup&gt;</th>
<th>Current Allocation&lt;sup&gt;3&lt;/sup&gt;</th>
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<td>Numeric Deviation</td>
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<tr>
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<td>Previous</td>
<td>Current</td>
<td>Previous</td>
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<tr>
<td>Communication Services</td>
<td>10.8</td>
<td>+1.0</td>
<td>+1.0</td>
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<td>Consumer Discretionary</td>
<td>9.4</td>
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<td>+0.0</td>
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<td>Consumer Staples</td>
<td>8.5</td>
<td>+0.0</td>
<td>+0.0</td>
</tr>
<tr>
<td>Energy</td>
<td>2.5</td>
<td>+0.0</td>
<td>+0.0</td>
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<tr>
<td>Financials</td>
<td>11.0</td>
<td>+0.0</td>
<td>+0.0</td>
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<tr>
<td>Healthcare</td>
<td>15.5</td>
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<td>Industrials</td>
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<td>Information Technology</td>
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<td>Materials</td>
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<td>Real Estate</td>
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<tr>
<td>Utilities</td>
<td>3.7</td>
<td>–1.0</td>
<td>+0.0</td>
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</table>

Source: UBS, as of 19 March 2020.

For US equity sub-sector recommendations please see the “Equity Preference List” for each sector. These reports are published on a monthly basis and can be found on the Online Services website in the Research > Equities section.

The benchmark allocation, as well as the tactical deviations, are intended to be applicable to the US equity portion of a portfolio across investor risk profiles.

1 The benchmark allocation is based on S&P 500 weights.

2 See "Deviations from strategic asset allocation" in the Appendix of UBS House View for an explanation regarding the interpretation of the suggested tactical deviations from the benchmark. The "current" column refers to the tactical deviation that applies as of the date of this publication. The "previous" column refers to the tactical deviation that was in place at the date of the previous edition of UBS House View or the last UBS House View Update.

3 The sum of the S&P 500 benchmark allocation and CIO GWM tactical deviation columns.

Full detailed asset allocation tables

View our full set of asset allocation tables for guidance on positioning across different investor types, portfolio strategies, and risk tolerances.

Index information

Underlying indices for Strategic Asset Allocations

- US Cash (Barclays Capital US Treasury – Bills [1–3 M])
- US Large-Cap Growth (Russell 1000 Growth)
- US Large-Cap Value (Russell 1000 Value)
- US Mid-Cap (Russell Mid Cap)
- US Small-Cap (Russell 2000)
- International Dev. Equities (MSCI EAFE)
- Emerging Markets Equities (MSCI EMF)
- US Government Fixed Income (Bloomberg Barclays US Agg Government)
- US Municipal Fixed Income (Bloomberg Barclays Municipal Bond)
- US Investment-Grade Fixed Income (Bloomberg Barclays US Agg Credit)
- US Corporate High-Yield Fixed Income (Bloomberg Barclays US Agg Corp HY)
- International Dev. Fixed Income (Bloomberg Barclays Global Agg xUS)
- Emerging Markets Fixed Income (50% Bloomberg Barclays EM Gov and 50% BarCap Global EM (USD))
- Commodities (Dow Jones-UBS Commodity Index)

Note: For additional information on indices, portfolio analytics, and performance, please see our stand-alone asset allocation report.
Cautionary statement regarding forward-looking statements

This report contains statements that constitute “forward-looking statements,” including statements relating to the current and expected state of the securities market and capital market assumptions. While these forward-looking statements represent our judgments and future expectations concerning the matters discussed in this document, a number of risks, uncertainties, changes in the market, and other important factors could cause actual developments and results to differ materially from our expectations. These factors include, but are not limited to (1) the extent and nature of future developments in the US market and in other market segments; (2) other market and macro-economic developments, including movements in local and international securities markets, credit spreads, currency exchange rates and interest rates, whether or not arising directly or indirectly from the current market crisis; (3) the impact of these developments on other markets and asset classes. UBS is not under any obligation to (and expressly disclaims any such obligation to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise.
Explanations about asset classes

Sources of strategic asset allocations and investor risk profiles
Strategic asset allocations represent the longer-term allocation of assets that is deemed suitable for a particular investor. The strategic asset allocations discussed in this publication, and the capital market assumptions used for the strategic asset allocations, were developed and approved by the Global Wealth Management Americas Asset Allocation Committee (GWMA AAC).

The strategic asset allocations are provided for illustrative purposes only and were designed by the GWMA AAC for hypothetical US investors with a total return objective under five different Investor Risk Profiles ranging from conservative to aggressive. In general, strategic asset allocations will differ among investors according to their individual circumstances, risk tolerance, return objectives and time horizon. Therefore, the strategic asset allocations in this publication may not be suitable for all investors or investment goals and should not be used as the sole basis of any investment decision. Minimum net worth requirements may apply to allocations to non-traditional assets. As always, please consult your UBS Financial Advisor to see how these weightings should be applied or modified according to your individual profile and investment goals.

The process by which the strategic asset allocations were derived is described in detail in the publication entitled “2019 Capital Market Assumptions Update,” published on 4 February 2019 by the GWMA AAC. Your Financial Advisor can provide you with a copy.

Deviations from strategic asset allocation or benchmark allocation
The recommended tactical deviations from the strategic asset allocation or benchmark allocation are provided by the Global Investment Committee and the Investment Strategy Group within CIO Americas, Wealth Management. They reflect the short- to medium-term assessment of market opportunities and risks in the respective asset classes and market segments. Positive/zero/negative tactical deviations correspond to an overweight/neutral/underweight stance for each respective asset class and market segment relative to their strategic allocation. The current allocation is the sum of the strategic asset allocation and the tactical deviation.

Note that the regional allocations on the Equities and Bonds pages in UBS House View are provided on an unhedged basis (i.e., it is assumed that investors carry the underlying currency risk of such investments) unless otherwise stated. Thus, the deviations from the strategic asset allocation reflect the views of the underlying equity and bond markets in combination with the assessment of the associated currencies. The detailed asset allocation tables integrate the country preferences within each asset class with the asset class preferences in UBS House View.

Asset allocation does not assure profits or prevent against losses from an investment portfolio or accounts in a declining market.

<table>
<thead>
<tr>
<th>Symbol</th>
<th>Description/Definition</th>
<th>Symbol</th>
<th>Description/Definition</th>
<th>Symbol</th>
<th>Description/Definition</th>
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<tr>
<td>+</td>
<td>moderate overweight vs. benchmark</td>
<td>–</td>
<td>moderate underweight vs. benchmark</td>
<td>n</td>
<td>neutral, i.e., on benchmark</td>
</tr>
<tr>
<td>++</td>
<td>overweight vs. benchmark</td>
<td>– –</td>
<td>underweight vs. benchmark</td>
<td>n/a</td>
<td>not applicable</td>
</tr>
<tr>
<td>+++</td>
<td>strong overweight vs. benchmark</td>
<td>– – –</td>
<td>strong underweight vs. benchmark</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: UBS.

Statement of risk

Equities - Stock market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables.

Fixed income - Bond market returns are difficult to forecast because of fluctuations in the economy, investor psychology, geopolitical conditions and other important variables. Corporate bonds are subject to a number of risks, including credit risk, interest rate risk, liquidity risk, and event risk. Though historical default rates are low, corporate bonds are subject to the same risks as other fixed income securities. For example, if interest rates rise, the value of a fixed coupon security will likely decline. Bonds are subject to market value fluctuations, given changes in the level of risk-free interest rates. Not all bonds can be sold quickly or easily on the open market. Prospective investors should consult their tax advisors concerning the federal, state, local, and non-U.S. tax consequences of owning any securities referenced in this report.

Preferred securities - Prospective investors should consult their tax advisors concerning the federal, state, local, and non-U.S. tax consequences of owning preferred stocks. Preferred stocks are subject to market value fluctuations, given changes in the level of interest rates. For example, if interest rates rise, the value of these securities may decline. If preferred stocks are sold prior to maturity, price and yield may vary. Adverse changes in the credit quality of the issuer may negatively affect the market value of the securities. Most preferred securities may be redeemed at par after five years. If this occurs, holders of the securities may be faced with a reinvestment decision at lower future rates. Preferred stocks are also subject to other risks, including illiquidity and certain special redemption provisions.

Municipal bonds - Although historical default rates are very low, all municipal bonds carry credit risk, with the degree of risk largely following the particular bond’s sector. Additionally, all municipal bonds feature valuation, return, and liquidity risk. Valuation tends to follow internal and external factors, including the level of interest rates, bond ratings, supply factors, and media reporting. These can be difficult or impossible to project accurately. Also, most municipal bonds are callable and/or subject to earlier than expected redemption, which can reduce an investor’s total return. Because of the large number of municipal issuers and credit structures, not all bonds can be easily or quickly sold on the open market.
Appendix

Emerging Market Investments

Investors should be aware that Emerging Market assets are subject to, among others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and sociopolitical risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. CIO Americas, WM generally recommends only those securities it believes have been registered under Federal US registration rules (Section 12 of the Securities Exchange Act of 1934) and individual State registration rules (commonly known as “Blue Sky” laws). Prospective investors should be aware that to the extent permitted under US law, CIO Americas, WM may from time to time recommend bonds that are not registered under US or State securities laws. These bonds may be issued in jurisdictions where the level of required disclosures to be made by issuers is not as frequent or complete as that required by US laws.


Investors interested in holding bonds for a longer period are advised to select the bonds of those sovereigns with the highest credit ratings (in the investment-grade band). Such an approach should decrease the risk that an investor could end up holding bonds on which the sovereign has defaulted. Subinvestment-grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher-yielding bonds for shorter periods only.

Nontraditional Assets

Nontraditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments; there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund, and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, “junk bonds,” derivatives, distressed securities, non-US securities and illiquid investments.

Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.

Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.

Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.

Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in US dollars, changes in the exchange rate between the US dollar and the issuer’s “home” currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a US investor.

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