No lockdowns
We have now learned enough to say that policymakers are unlikely to use national lockdowns again to control the spread of COVID-19.

Pent-up demand
Forced savings during lockdown have left consumers with money to spend, potentially further supporting the economic recovery.

Stimulus coming
Both Republicans and Democrats have an incentive to agree on further fiscal stimulus before the US presidential election.

Investment ideas
Long term, there is no alternative to equities. We show how to filter out the noise and recommend strategies for investing across three different scenarios.

Keynesian epidemiology
Dallas Federal Reserve Bank President Robert Kaplan probably never thought he would achieve international fame for his views on the economics of covering your mouth. Yet when Kaplan said that wearing face masks was “the most important thing we can do right now” to hasten the economic recovery, it reverberated around the world. Like investors, the Federal Reserve has one eye on stimulus measures to support the economy, and another on virus transmission rates. To paraphrase Milton Friedman, “We are all Keynesian epidemiologists now.”

Since last month’s letter, the Nasdaq is up 6.1% and hit a new high, the S&P 500 has gained 3.6%, China’s CSI 300 has gone up 11.7%, and global stocks have risen 4.2%. Market confidence has increased despite the spike in virus case counts in the American South, and some governments choosing to return to stricter social distancing measures.

In this letter, I discuss why we believe global equities can continue to be supported in the second half of the year. We think countries won’t lock down again because of a “second wave.” Furthermore, a combination of pent-up demand, government stimulus, and negative real interest rates should provide further upside for stocks in the months ahead. I also provide our latest thinking on positioning ahead of the US election, how to filter out some of the short-term noise, and our key investment ideas across our upside, central, and downside scenarios for markets.

Why we think investing makes sense today
1) Countries won’t lock down again

Our view remains that the recent increase in COVID-19 infections in various places around the world will not lead to the reimposition of national lockdowns. COVID-19 remains a human tragedy, and politics can drive decisions in counter-intuitive ways. However, a number of things we have learned about the virus since March seem to be pointing policymakers toward less economically destructive measures to slow the spread of the virus:

Recent increases in COVID-19 infections won’t lead to renewed national lockdowns.
– **The virus is not as deadly as it appeared at the start of the outbreak.** Part of the reason governments chose to take such stringent action against the novel coronavirus was its perceived high hospitalization and mortality rate. Early estimates from the World Health Organization put the mortality rate at 3.4%, but this proved to be an overestimate partly because asymptomatic individuals were not diagnosed due to limited testing capacity. A recent *Lancet* study estimated the mortality rate at 0.5–1% in European populations, while a study in Geneva put the number at 0.6%. This is before we consider the impact of approved treatments like remdesivir and the large variation of fatality rates across different age groups, which could influence more targeted suppression strategies in the future.

– **The virus is not as infectious as it appeared.** Another reason governments rushed to lock down was the assumption that the virus’s high infection rate meant it could rapidly overwhelm national healthcare systems. Initial estimates of “Rt”—the average number of people to whom one infected individual spreads the virus—were around 2.4. But as testing became more widespread, the estimates began to fall. For example, in March, the infection rate in Arizona was estimated at 2.61. This fell to 1.07 by the time lockdowns began, and fell further during the lockdown. While the Rt increased after reopening, it quickly dropped back and has remained broadly stable around 1.02 even throughout the widely reported second wave in the state (see chart). This leveling off around 1 is consistent with the experience in other states like Texas, Florida, and California, and across much of the developed world.

– **A significant portion of some populations have already contracted the virus.** Antibody surveys suggest that around 5% of individuals in France and Spain, 14% in New York State, 17% in London, and 21% in New York City may have been infected already. T-cell-based immunity may be higher still. These new learnings are important because they mean that a “mask-wearing-herd immunity” strategy is now more plausible. When Rt is at 2.5, the theoretical threshold to reach herd immunity is 60% of the population, as has been widely reported. Yet Rt rates of 1.02, 1.1, and 1.2 are consistent with herd immunity thresholds of 2%, 9%, and 17%, respectively, which are lower than the antibody levels observed in London and New York City. Lower mortality, lower infectiousness, and the presence of recovered cases in the population mean smaller efforts
Keynesian epidemiology

at mask wearing, contact tracing, and bar closings can be effective at slowing the public spread of the virus compared to what was initially predicted. Of course, the closer we are to herd immunity, the fewer doses of vaccine we need to start to show a public health benefit. COVID-19 remains a terrible disease for many victims, and local medical systems still face strains. Yet if we look at hospitalization rates, there are already signs that the virus outbreaks in places like Arizona and Texas are slowing again.

![The increase in those hospitalized with COVID-19 is slowing in Arizona and Texas](image)

*Figure 2*

The increase in those hospitalized with COVID-19 is slowing in Arizona and Texas

Currently hospitalized COVID-19 patients week-over-week % change

When will a COVID-19 vaccine be ready?

- Sixteen vaccine candidates were in human clinical trials globally as of 14 July.

- Both Pfizer and Moderna released preliminary Phase 1 vaccine trial results this month. The data for these two RNA-based vaccines indicate that both are safe, and both appear to lead to immune responses at least as strong as those seen in recovered COVID-19 patients.

- Substantially larger studies will be needed to determine if these antibodies lead to protection from the disease. Both vaccines, along with a third from AstraZeneca, are due to enter large-scale Phase 3 trials in the US shortly (30,000 patients each), and could produce efficacy data in the fall.

- Based on our latest assessment of the available data and current knowledge of SARS-Cov-2 immunology, we expect several of the vaccine candidates now in clinical trials to succeed. But the strength and duration of immunity are not yet known, and revaccination may be necessary.

- Our central scenario assumes one or more vaccines are widely available in the US during 2Q21, with the potential for limited doses to be available in late 2020 for at-risk workers under an emergency authorization.

- Based on disclosed capacity announcements, up to 600mn doses could be available for Western economies by late 2020 or early 2021, rising to around 4bn doses by end-2021. Actual capacity will depend on the optimal dosage for each vaccine, and assumes that each one is successful.
2) Pent-up demand should support a recovery

The bounce-back in economic activity to date has generally surpassed consensus forecasts, with economies responding more positively than expected to the lifting of lockdown restrictions.

Consumption is being driven in part by pent-up demand. The US savings rate peaked at 32% in April, its highest level ever, and remains at 23%, more than triple pre-COVID levels. In the UK, the rate has doubled from precrisis levels, and in France it is 40% higher. Although consumers may have increased savings in response to higher uncertainty, they are spending at least some of those savings. In the US retail sales jumped by a record 18% from April to May and by a further 7.5% in June, while in the Eurozone, sales also rose 18% month-on-month in May, bringing spending close to 2019 levels. In Germany, retail sales in May rebounded above 2019 levels, recording a 3.8% year-over-year rise.

Following this consumer response, we expect production to follow. The US Manufacturing ISM is back above 50. The nonmanufacturing ISM index for June rebounded to 57.1, bringing the index back to February’s prepandemic levels. In China, both the manufacturing and nonmanufacturing PMIs have been in expansionary territory above 50 for four months. Data in Europe has been more disappointing (PMIs remain below 50, and in Germany industrial production rose by a lower-than-expected 7.8% in May), but we expect data on production and consumption to continue to improve.

Another important indicator of recovery is the improvement in Asian exports. For Asia ex-Japan, the change in three-month exports relative to the three months prior is running at roughly 4%, mostly due to China. In June, both sides of Chinese trade exceeded 2019 levels, with year-over-year growth of 2.7% in imports and 0.5% in exports. This is more of a “V” shaped recovery than was experienced after the global financial crisis. We expect consumer demand to continue to improve and a lift in Asian export and income growth in 3Q to further boost local sentiment.
3) Preelection politics potentially primes the pump

Further support to the economy could be coming from preelection politics in the United States.

As it stands, the additional USD 600 per week in unemployment benefits provided in March by the CARES Act expires at the end of July, and the USD 3tr HEROES Act, which includes the distribution of USD 1,200 stimulus checks, is stuck in the Senate. This “fiscal cliff” is a risk to the recovery and is likely preventing US consumers from spending more of their savings. However, both the Democrats and Republicans have a strong incentive to push through further fiscal stimulus this summer in order to garner support ahead of November’s presidential election.

On 9 July, US Treasury Secretary Steven Mnuchin said the Trump administration is working with the Senate to pass a new stimulus bill by the end of the month. President Donald Trump said at the start of July, “I support actually larger [stimulus] than the Democrats.” Negotiations will start in earnest when Congress comes back into session on 20 July. We expect a package of at least USD 1tr to pass by the end of the month.

Looking beyond the election, the trend toward fiscal stimulus looks set to continue. This month, the House of Representatives passed the Moving Forward Act, a USD 1.5tr plan to rebuild US infrastructure, although the bill remains in the Senate. We don’t expect a large deal to be passed preelection, but the need to spend on infrastructure is one of the few issues that both US parties agree on. Meanwhile, Joe Biden recently announced his own spending proposals, unveiling a plan to “Buy American” with government purchases of USD 400bn of US-made goods, and USD 300bn of R&D spending on US technology such as 5G and electric vehicles.

Stimulus is also not just limited to the US: European Union leaders are meeting to discuss a proposed EUR 750bn recovery fund, although an agreement may not be finalized this month. In addition, on 14 July French President Emmanuel Macron promised to spend another EUR 100bn to boost the economy, on top of the EUR 460bn already in place. And, at the start of July, the UK government announced a program of further measures worth up to GBP 30bn.
Investment strategies for the US election

Both President Trump and Joe Biden have emphasized the need for more spending, but there are few similarities in their policy platforms. This divergence has important consequences for US sectors. In our latest Election-Watch report, “Investment implications of the 2020 US elections,” we detailed the implications for markets:

A *Blue Wave: the Democratic Party both takes the presidency and wins a majority in Congress.* We would expect outperformance by stocks exposed to energy efficiency, smart mobility, and renewables as President Biden adopts a green agenda. We also highlight companies that are more insulated from an increase in corporate taxes and those that could benefit if trade tensions cool. Within healthcare, we focus on companies that could benefit from an expansion of health coverage.

A *Red Wave: the Republican Party both takes the presidency and wins a majority in Congress.* Select energy and financial companies could benefit from a “relief rally” if tighter regulations from a possible Biden administration are avoided. The Trump administration has been supportive of further developments in space technologies, and defense companies could also enjoy support in a second Trump term. Within healthcare, our selections are focused on managed care companies.

_Campaign warriors: opportunities shielded from election outcomes._ Many investors may prefer to keep politics out of their portfolios. Therefore, we have also highlighted a number of stocks that are relatively insulated from campaign issues. These include companies in communication services, companies with a diverse revenue stream or diversified content, consumer staples, and portions of the IT sector that have remained out of the regulatory spotlight.

For more on the implications of the US election on markets, read our *ElectionWatch* report published 6 July.

4) Equities are a TINA market

To earn positive real returns over the long term, there is no alternative to owning equities.

As I discussed last month, the Federal Reserve has been more explicit than ever before about its commitment to support the economy through the crisis and its ability to live with rising asset prices. Using market-based forward rates, markets, encouraged by the Fed, don’t expect higher rates for years to come.

For investors, this creates at least two problems. First, portfolio income is getting harder to find almost everyday. Second, cash and high grade bonds are expected to deliver negative real returns for the foreseeable future.

Given the dire outlook for returns in cash and bonds, for investors with a long-term focus, our core recommendation is to take steps to filter out the short-term noise and start getting invested in stocks for the long term (see box on the next page). Despite the rally, based on equity risk premiums, global stocks are still cheap relative to bonds, trading in the 10th percentile of relative valuation since 1997. Historical experience suggests that excess liquidity provision will support further expansion in equity multiples (Fig. 5).
How to filter out the noise

One of the most important lessons of the first half of the year was the cost of bad market timing. By 23 March, equities had fallen 34% from their highs, equivalent to an average post-WWII bear market in just one month. But the S&P 500 has since rallied by 44% from its lows. Without a robust investment strategy, the risk of permanent wealth destruction is high.

**Have a plan.** Our latest UBS Investor Watch survey highlights the dilemma many investors face. While 81% worry about another market decline before the pandemic is over, 79% believe there is opportunity in the current environment.

Our Liquidity. Longevity. Legacy.* approach remains key to providing investors with the structure they need to prevent emotions and indecision from clouding long-term opportunity. It suggests investors should only set aside two to five years’ worth of net expenses (net of earned income) in cash and high-quality bonds. With this in place, investors should have a sufficient “buffer” in place to provide for short-term cash flow needs. The remainder of the portfolio can then be invested for growth opportunities over the medium and long term.

**Deal with volatility in a disciplined way.** One of the key costs of volatility for long-term investors is indecision, with investors often stuck in “safe” but low-yielding assets for extended periods as they wait for certainty to rise sufficiently (which invariably it never does). One way of overcoming this is to commit to a phasing-in strategy based on time or price, for example by using either dollar-cost averaging or structured investment solutions like those involving put options.

Investors can also benefit from volatility by committing to rebalancing existing portfolio holdings in a structured way. One way is to implement a rebalancing strategy, in which portfolios are automatically rebalanced once the equity concentration in the portfolio drifts beyond a certain percentage. In a good example of its potential benefits, rebalancing at the end of the first quarter in 2020, when stocks sold off and bonds rallied, would have enabled investors to increase their profits from the stock market rebound.

**Delegate your decision-making**

Over the long term, investors can also benefit from a structured approach to decision-making and risk management, whether that’s achieved by writing down and sticking to a personal investment strategy, or by delegating decision-making to something other than an investor’s own brain—be it a professional manager or a quantitative signal.

* Timeframes may vary. Strategies are subject to individual client goals, objectives, and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

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**Figure 5**

Excess liquidity supports expansion in equity multiples

OECD excess liquidity, 3-month lead (lhs); global equities, 12-month % change in P/E (rhs)

Note: Excess liquidity defined as OECD growth in M1 minus nominal GDP growth.

Source: Datastream, UBS, as of June 2020. Excess liquidity estimates are included and may change when data is released.
Investment ideas

We maintain an overall risk-on asset allocation expressed through a preference for global equities and various credit segments. Unprecedented money creation and stimulus should continue to underpin asset prices. Further improvement in the macroeconomic numbers, or positive virus developments, would allow us to capture moves to the upside.

Key COVID-19 scenarios and asset class impact

### Key COVID-19 scenarios and asset class impact

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upside</td>
<td>A return to normal social activity by 4Q20 (i.e., V-shaped recovery) partly due to an effective vaccine or cure being available at full scale by end-2020, sophisticated test and trace models, or herd immunity being reached in some countries. Minor local outbreaks remain possible. Status quo in US-China relations. Both countries stick to Phase 1 trade deal. Central banks remain accommodative but indicate rate hikes in 2H20–21.</td>
</tr>
<tr>
<td>Central</td>
<td>Sustained economic recovery starting in 3Q20 and a return to &quot;normal&quot; social activity by 1H21 (i.e., U-shaped recovery). Softer restrictions remain in place. Future local recurrences of the virus can be digested by health systems. The US and China stick to their Phase 1 deal (i.e., no tariff increase) but relations deteriorate, with new capital-flow and investment restrictions and toughening political rhetoric. Central banks remain accommodative, with no rate increase by end-2021.</td>
</tr>
<tr>
<td>Downside</td>
<td>A major second wave of the virus hits and health systems are unable to cope with it. Lockdowns are reimposed intermittently. No vaccine or drug treatment is made available until mid-2021. The global economy does not recover before 2H21. Geopolitical meddling with China, blocking Chinese tech companies, or reimposing tariffs could threaten the Phase 1 deal between the US and China. Central banks inject more liquidity to limit economic damage.</td>
</tr>
</tbody>
</table>

### Asset class impact (targets for June 2021)

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Spot</th>
<th>3,198</th>
<th>3,500</th>
<th>3,300</th>
<th>2,800</th>
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<tbody>
<tr>
<td>S&amp;P 500</td>
<td>1,071</td>
<td>11,260</td>
<td>11,300</td>
<td>10,800</td>
<td>9,000</td>
</tr>
<tr>
<td>Euro Stoxx 50</td>
<td>3,321</td>
<td>3,800</td>
<td>3,300</td>
<td>2,600</td>
<td></td>
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<tr>
<td>MSCI EM</td>
<td>347</td>
<td>1,250</td>
<td>1,150</td>
<td>800</td>
<td></td>
</tr>
<tr>
<td>SMI</td>
<td>111</td>
<td>100bps (1.5% t.r.)</td>
<td>120bps (1% t.r.)</td>
<td>300–400 bps (~5% t.r.)</td>
<td></td>
</tr>
<tr>
<td>USD IG spread*</td>
<td>603</td>
<td>400bps (12% t.r.)</td>
<td>550bps (5% t.r.)</td>
<td>1,000–1,500bps (~12% t.r.)</td>
<td></td>
</tr>
<tr>
<td>USD HY spread*</td>
<td>464</td>
<td>280bps (15% t.r.)</td>
<td>400bps (9% t.r.)</td>
<td>700–800bps (~10% t.r.)</td>
<td></td>
</tr>
<tr>
<td>EUR USD</td>
<td>1.14</td>
<td>1.25</td>
<td>1.19</td>
<td>1.05</td>
<td></td>
</tr>
<tr>
<td>Gold</td>
<td>1,806</td>
<td>USD 1,400–1,500/oz</td>
<td>USD 1,800/oz</td>
<td>USD 1,900–2,000/oz</td>
<td></td>
</tr>
</tbody>
</table>

* During periods of market stress, credit bid-offer spreads tend to widen and result in larger ranges. Percentage changes refer to expected total return (t.r.) for the indicated spread levels. Spot numbers as of 14 July.

Source: UBS, as of July 2020
Upside scenario

Position for the upside in equities. We expect the recovery to gain traction over the coming year and so focus on select parts of the market that remain below prior highs. These include US mid-caps, “laggards with growth” in Europe, and opportunities exposed to reopening economies in the US, Europe, and Asia. We also like UK equities, particularly in light of our positive view on oil.

Buy into themes accelerated by COVID-19. The pandemic has sped up secular trends like digitalization, driving a faster adoption of disruptive technologies from retail to healthcare. Our recent reports “Future of the Tech Economy” and “Doing Business in Europe” identify opportunities across the technology universe, including medtech, smart mobility, telecom, and automation, that stand to benefit from these themes.

Prepare for US dollar weakness. Over the balance of the year, we expect demand for safe-haven assets, which benefited the dollar earlier in the pandemic, to recede. We also expect prolonged Fed easing and political uncertainty ahead of the US election to undermine the greenback. Our preferred currency against the dollar is the British pound, which we see as undervalued.

Central scenario

Buy resilient stocks. Investors looking to add exposure to stocks, but concerned about potential volatility, could employ a more selective approach incorporating quality and sustainable dividends. We think quality stocks will offer another year of excess returns and lower risks than the broader market.

Buy into a green recovery. Governments around the world have been boosting investment in green projects as part of an effort to revive growth following the COVID-19 pandemic. We expect this to add further momentum to sustainable investing, which held up well during the March drawdown, and performed well in the rebound. Our preferences include green bonds, multilateral development bank (MDB) bonds, and investing in themes related to the UN’s Sustainable Development Goals.

Hunt for yield. Against a backdrop of lower-for-longer rates, investors are being pushed harder to find yield. However, while credit spreads have tightened, we still see value in credit as a means of income generation. We like US investment grade and high yield bonds, USD-denominated emerging market sovereign bonds, European crossover bonds, green bonds, and Asia high yield bonds.

Downside scenario

Gold. Gold has been the best-performing asset this year in US dollar terms. A number of uncertainties make us increasingly convinced that the gold price can keep rising. We expect the yellow metal to trade at USD 1,900/oz in 2H20. Risks such as new waves of COVID-19, further policy tweaks by the Fed, and rising tensions between the US and China (with the latter likely to be amplified in the run-up to the November US presidential election) underpin our view. Hence, we continue to see gold as a valuable insurance asset.
Swiss franc. The CHF combines safe-haven qualities with a growth-oriented currency that profits from a stronger European economy and rising global trade volumes. The Swiss National Bank has been intervening on a large scale, but we expect it might reduce its efforts and accept a somewhat stronger currency.

Take advantage of volatility. Higher volatility can work to investors’ advantage if they act with discipline. For investors worried about the risk of ill-timed investment, we recommend using a dollar-cost averaging strategy to “smooth the bumps” while building up long-term positions. A put-writing strategy, for those who can implement options, can also help investors earn a yield while precommitting to taking advantage of “buy the dip” opportunities if they arise.

Mark Haefele
Chief Investment Officer
Global Wealth Management

UBS Investor Forum Insights

At this month’s Investor Forum participants focused on the outlook for economies, policy, and markets following the COVID-19 pandemic.

- Participants agreed that the pandemic would produce lasting harm for consumption and investment. However, several participants were optimistic that a return to nationwide lockdowns would not take place, permitting a gradual economic revival.

- Central banks were seen as being in wait-and-see mode. An end to easing from central banks and governments will come – but not soon. In the near term, participants agreed central banks have the capacity to innovate if economic conditions deteriorate again. Participants also agreed that politicians will be looking to consolidate fiscal stimulus over the months ahead.

- Risks arise from the US presidential election and US-China tensions. Geopolitical fragmentation increased the importance of portfolio diversification, one participant observed.
Sustainable investing strategies aim to consider and incorporate environmental, social, and governance (ESG) factors into investment process and portfolio construction. Strategies across geographies and styles approach ESG analysis and incorporate the findings in a variety of ways. Incorporating ESG factors or Sustainable Investing considerations may inhibit the

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