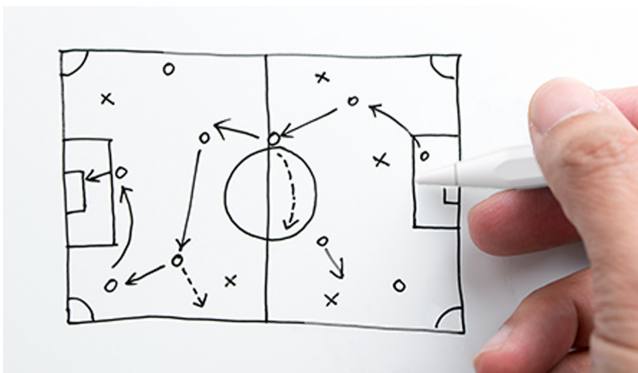


Be prepared: Plan, Protect, and Grow

Global financial markets

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- Staying calm through 2018's volatility has paid off for investors so far in 2019. Global equities have performed well year-to-date. Yet the sharp fall in bond yields may reflect concerns about the outlook.
- Amid lower growth, and a variety of potential risks to markets, there is still cause for caution. But with low rates seemingly set to persist for an extended period, high allocations to cash and fixed income are likely to be detrimental to wealth over the long-term.
- To be prepared for the road ahead you need to *Plan*, *Protect*, and *Grow*. This report shows you how.



Q&A summary

The cycle has been running a long time, isn't cash the safest place to be right now?

In the near-term cash is almost always the safest asset, and it is important to hold some cash to ensure you can meet near-term liabilities and spending wishes. However, with interest rates likely to remain below the rate of inflation in many currencies for the foreseeable future, high allocations to cash almost guarantee real wealth destruction over the long-term. Investors should keep enough cash aside to meet financial goals over the coming two to five years. But for goals further than five years out, investors should own financial assets which offer greater prospect of long-term growth and compounded returns, while managing portfolio risk to protect against the potential for short-term downside.

How can I protect my portfolio against downside risk?

There are three key ways to ensure you are managing downside risk effectively. First, use the current low volatility environment to embed relatively low cost downside protection. Second, consider including quantitative strategies– which recalibrate equity allocations depending on the market and economic backdrop - for controlling risk within your portfolio. Finally, ensure proper diversification across regions and asset classes. Regional diversification limits the risk of being caught on the wrong side of an individual political or monetary policy change, and including a mixture of equities, bonds, and alternatives can keep portfolio performance more stable than by just owning equities and cash. Portfolio stability is a particularly important consideration for investors making regular portfolio withdrawals.

How can I improve my portfolio yield?

Investors looking to increase the level of income from their portfolios have a range of options. First, we see high quality dividend paying equities as attractive for

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investors in Switzerland, the Eurozone, and the UK, where the differential between real bond yields and dividend yields is close to its highest level in a decade. Second, bonds issued by countries in the GCC are attractively valued and well-positioned for a cyclical rebound in the region, in our view. Third, bonds issued by multilateral development banks can provide a higher-yielding but similar risk alternative to government bonds, while helping fund sustainable development. Finally, combining multi-asset income strategies, including credit, REITs, and option writing, into a portfolio, can help deliver higher income in a diversified way.

Where are the best portfolio growth opportunities?

First, investors worried about the state of the short-term economic cycle can look to invest in secular trends. We expect fintech, medical devices, and genetic therapies, and innovations to support "Smart Cities" – including 5G, health-tech, and smart mobility to deliver above-GDP levels of revenue growth through the cycle. Investors can also benefit from the increasing opportunities in sustainable investing, by substituting existing asset classes for sustainable alternatives with comparable risk-return profiles. Second, investors can look to pick up stocks left behind in the year-to-date rally but which still have a positive fundamental outlook. Finally, some of our highest conviction regional ideas include companies benefiting from the expansion of China's Greater Bay Area, technology disrupters in the US, and profitable stocks trading below book value in Europe.

Regional summary

US

Of all the countries surveyed in our 1Q Investor Sentiment survey, investors based in the US were most likely to express the view that it is getting late in the market cycle – with 44% of US investors describing the market cycle as "toward the end" (compared to global average of 26%).

But equally US investors were among the most optimistic about investment returns, with just 14% somewhat, or very, pessimistic on the outlook for the market over the next 6 months. And we think that at least some of that optimism is justified – economic and earnings growth in the US looks set to re-accelerate somewhat in the months ahead.

With this dichotomy in mind, we favor hedging strategies that don't require sacrificing significant upside potential. As we discuss in the Bear market guidebook, investors can take simple steps today to limit downside without missing out on the continuing bull market.

Reducing home bias in stocks, a common problem for US investors, is a good first step. While US equity valuations are about average, at 17x earnings, international equity markets look relatively cheaper. This makes it a good time to get back to a neutral allocation in US stocks, in line with our current tactical view (generally speaking, US stocks should be about 50% of equity allocations).

We also recommend that investors manage risk by ensuring that their portfolios don't have too much allocated to corporate bonds. On a tactical basis we see greater opportunity in EM USD fixed income.

Asia

Fears about the impact of a trade war and an economic slowdown in China have been prominent concerns on the minds of APAC investors in recent months, according to our 1Q Investor Sentiment survey, although market performance has started the year strongly.

China's domestic demand growth – the biggest engine for the region – has likely troughed and we believe a cyclical upturn should become visible in 2Q. High-frequency indicators that help identify a turn, support this view.

But risks remain. This could lead to an increase in short-term volatility, particularly since earnings revision still point to slower profit growth in the region. Clients could consider a collar strategy to hedge some of the downside risks, while keeping exposure to the upside.

Geographical and asset class diversification is also critical for investors in the current market environment. With Chinese equities outperforming the rest of the region, investors should consider diversifying into those markets which still have catch up potential. Meanwhile, diversification across not only equities and bonds, but also to hedge funds, could help reduce portfolio volatility, though this can reduce liquidity.

Europe

European investors have been beset by disappointing growth, political uncertainty, and weak financial market returns in recent years. From here, even if the recent weakness of the Eurozone economy abates, the ECB looks set to keep rates lower for longer than previously expected. The deposit rate is likely to stay at –0.4% into early 2020, and the German 10-year Bund yield remains close to zero.

But once clients have sufficient cash to meet their short term liquidity needs, we believe there are better ways to protect and grow wealth than cash. For growth, investors can look to sustainable investments, which often come with lower tail risks. Investors can also boost potential returns through

a higher allocation to less liquid investments such as private equity.

And despite current low or negative yields on government bonds, they could still deliver capital gains if the ECB is forced to lower rates further in any future recession, helping provide stability for investors making regular withdrawals from their portfolio.

Switzerland

Our 1Q Global Investor Sentiment survey reveals Swiss investors as among the world's most pessimistic, with just 49% "very or somewhat optimistic" on the outlook for their portfolios over the coming 6 months (compared to a global average of 64%).

That pessimism is understandable given the muted potential returns on offer in Swiss assets. Across major markets, the Swiss market stands out being the only one with a 12-month trailing PE above both its 10-year and the 20-year averages. Nervousness about equities means many investors are left holding high allocations to cash, yet rates in Switzerland are even more negative than in the Eurozone at -0.75% , versus -0.4% . And we don't see rates returning to positive territory until at least 2021.

We think it's critical for investors to think about having a plan, protecting the downside, and looking for growth opportunities.

For both protection and growth, diversifying outside of Swiss equities is important to protect downside, given they're relatively expensive. Within Swiss equity allocations, investors should look to high quality dividends to help escape low or negative yields.

Be prepared

After a calm 2017, volatility returned in 2018. Only 2 of the 19 major asset classes we track ended 2018 in positive territory, with escalating US-China trade tensions, fears of a global growth slowdown, and concerns over Fed rate hikes all weighing on global markets.

But those who stayed calm through the volatility are reaping the benefits in 2019. Global stocks have rallied 15%. Reassuring comments from the Fed and ECB, signs of a US-China trade deal, an improvement in Chinese economic data, and an encouraging start to the US earnings season have all helped sentiment.

Fig 1: Global stocks have recovered after a dismal December



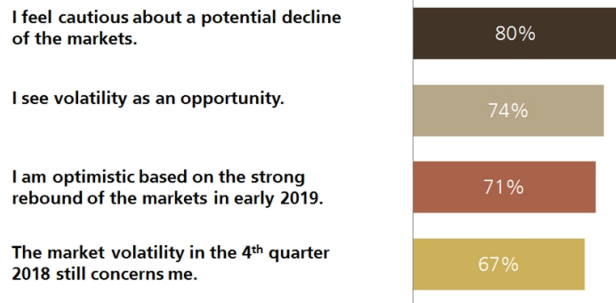
Source: Bloomberg, UBS, as of 15 April 2019

Now, equities, commodities, and credit spreads appear to be pricing a relatively benign economic scenario. But the sharp decline in global bond yields can be taken as a more cautious vision of the future.

Investors face a dilemma. 71% of investors surveyed in our Global Investor Sentiment survey said they feel “optimistic based on the strong rebound of the markets in 1Q,” and confidence in personal financial situations is up by 5ppts since December. Yet 80% say they still “feel cautious about a potential decline of the markets.”

Fig 2: Reaction to recent stock market activity

Agreement with the following statements, in %



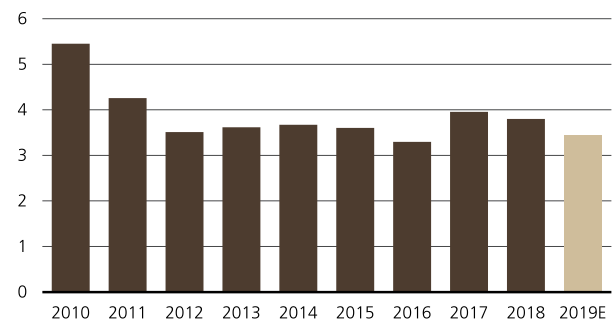
Source: UBS Global Investor Sentiment survey, as of April 2019

Despite the good start to 2019 for markets, there is still clearly cause for caution. Global growth is muted, earnings growth is slow, the bond market is telling us to worry, and there are plenty of risks which could still upset markets.

1. Global growth is muted. We forecast global GDP growth of 3.5% for 2019 versus 3.8% in 2018, and 4.0% in 2017. In the US, the impetus from Trump’s tax cuts is fading. We expect 2.3% for 2019 against 2.9% for last year. The Chinese economy is continuing a longer term trend toward more moderate growth: GDP growth last year of 6.6% was the lowest since 1991, and industrial profits fell 14% in the first two months of this year. And the soft patch in Eurozone data has dragged on for longer than expected. The EU recently lowered its GDP growth forecast for this year to 1.1%, from 1.7% just a few months ago, and Italy slipped into recession in the fourth quarter.

Fig 3: Muted global growth

Global real GDP growth, in %



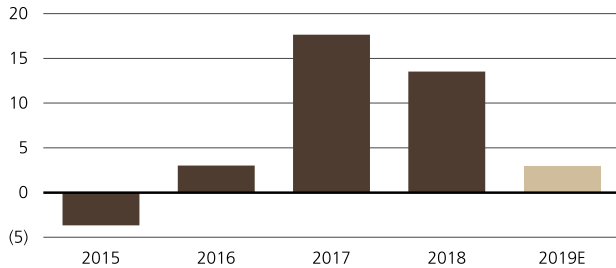
Source: UBS, as of 10 April 2019

2. Earnings growth is slow. S&P 500 earnings per share grew 23% in 2018. But profit growth is expected to slow to around 3% in 2019, with the sharpest deceleration occurring in the first half of this year: consensus is now calling for a 2% contraction in the first quarter and a modest 1% increase for the second quarter. This reflects slowing

GDP growth, a maturing smartphone market, and lower energy sector profits. And the slowdown in US profit growth is reflected in weak global earnings projections.

Fig 4: Slowing earnings growth

EPS growth, MSCI All Country World Index, in %

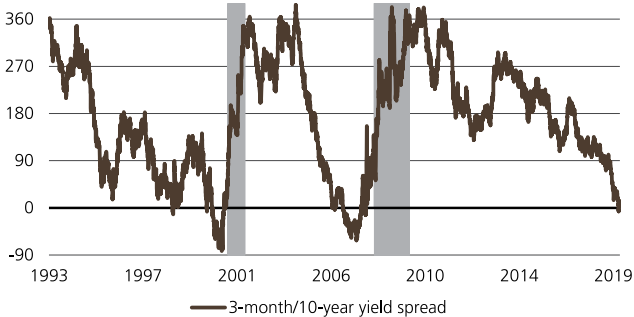


Source: Thomson Reuters, UBS, as of 14 April 2019

3. The bond market is telling us to worry. Falling yields in the US and Europe suggest worries about longer-term growth among fixed income investors. For the first time since 2007, the yield on 3-month Treasury bills rose above the yield on 10-year Treasury bonds, a move traditionally seen as a harbinger of recession. In the Eurozone, yields on 10-year German Bunds also recently turned negative for the first time since October 2016, renewing fears about the health of the Eurozone financial system in a negative rate environment.

Fig 5: The yield curve inverts

3-month/10-year yield spread, in basis points, shaded areas mark recessions



Source: Bloomberg, UBS, as of 14 April 2019

4. There are plenty of risks that could upset markets:

- **Trade negotiations:** Recent trade negotiations between the US and China have seen some progress, but it is still not certain that the trade dispute will be sustainably resolved with a deal. The same can be said about US negotiations with the EU. A collapse in talks in

any one of the White House's trade policy negotiations could drag on global economic growth and markets.

- **US business cycle:** We now see downside risks to US growth as more prominent than upside risks to US inflation. Accordingly, while the risk of a hawkish Fed surprise has now fallen slightly, the risk of an economic slowdown has increased.
- **US credit:** In our base case we expect US corporate credit defaults to rise, but not above long-term average levels of around 3.5% annually. However, given increasing leverage in the system, a shock to the US economy, such as an inflation-driven Fed hiking cycle, would likely see defaults rising much more quickly, with potential knock on effects to other asset classes.
- **China's economy:** Recent economic data suggests that China is successfully managing its structural slowdown. However, if the full scale of US tariffs against China were implemented, the likelihood of a much sharper downturn in Chinese growth would increase dramatically. Given that China now accounts for 16% of global GDP, a hard landing in China would have a big impact on Asian and global markets.

And this list of risks is far from exhaustive. Our recent Investor Sentiment survey revealed an even broader range of uncertainties, ranging from local political instability, debt levels, and taxation, to cyber-security, data privacy and rising healthcare costs, weighing on the minds of investors and business owners.

So with the economic and earnings growth impetus weaker, the bond market signaling caution, and a number of downside risks to growth and markets, investors need to ensure their portfolios are well-prepared for a potential downturn.

For more on the risks we're monitoring, please refer to our [Global Risk Radar](#) report.

But hiding isn't the answer

Our base case remains that a recession is not on the horizon. Global growth is steadily recovering. Equities retain a healthy risk premium over bonds. Meanwhile, cash rates look likely to stay low for an extended period. Over the long-term, we see the greater “risk” in not being invested.

1. Our base case remains that a recession is not on the horizon.

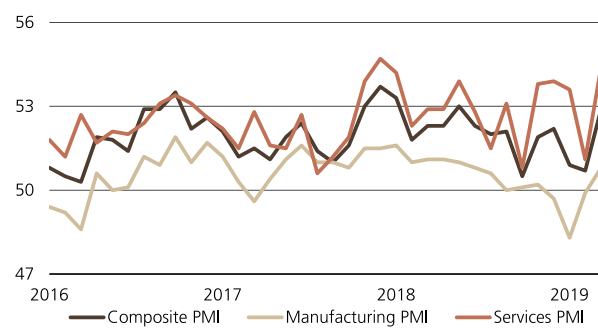
We continue to monitor the various risks to markets and the global economy, yet some of the key threats we had highlighted earlier in the year now look less likely to materialize. Consistently low inflation data suggest that the risk of US overheating and sharply higher US rates are less likely. The US-China trade talks have become more constructive, raising hopes for reconciliation. And a stimulus-driven pick-up in Chinese economic data has reduced the chance of a sharp slowdown there.

2. Global growth is stabilizing.

Economic confidence in China in particular has improved in the first quarter, as targeted stimulus measures have begun to have an effect. US jobs growth looks to have recovered from a blip in February. And Eurozone industrial production is showing signs of recovery from a weak patch at the end of 2018. Meanwhile, the lowest rates of global unemployment in 40 years have kept consumption strong, and we expect corporate capital spending to pick up, provided US-China trade negotiations reach a positive outcome. In our view, current low levels of capital spending are closely linked to uncertainty about the outlook for trade.

Fig 6: Recovering sentiment in China

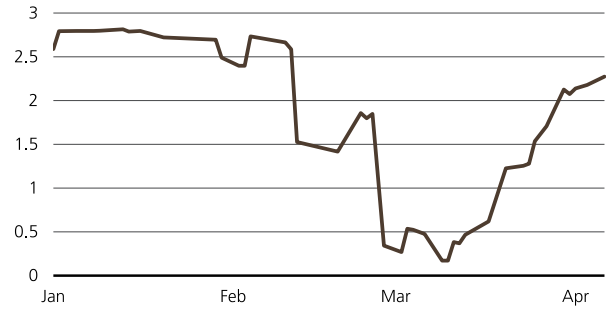
China purchasing manager indexes (composite, manufacturing, services)



Source: Bloomberg, UBS, as of 10 April 2019

Fig 7: Improving US economic data

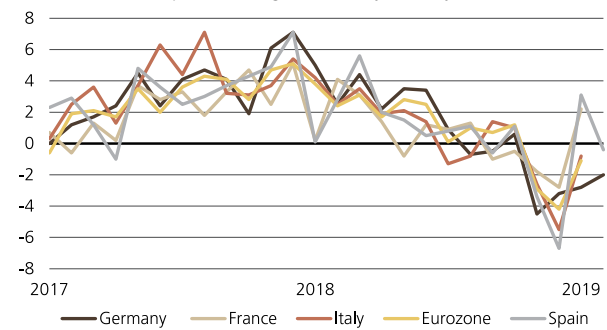
Atlanta Fed GDPNow Forecast, in %



Source: Bloomberg, UBS, as of 9 April 2019

Fig 8: Eurozone industrial production rebounds

Eurozone industrial production growth (% year-on-year)



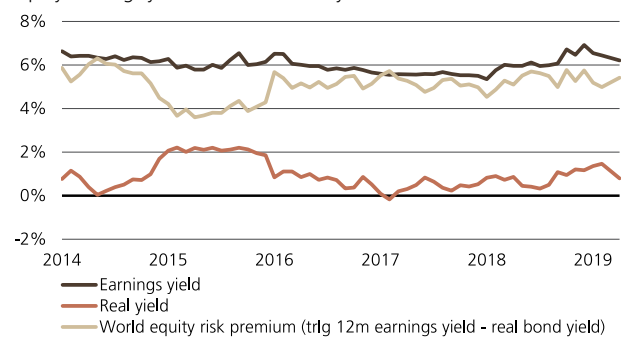
Source: Bloomberg, UBS, as of 10 April 2019

3. Equities retain a healthy risk premium over bonds.

Equity markets have rallied by 15% year to date, and the equity earnings yield has dropped by 70bps. But this has been partly offset by a 30bps drop in the real bond yield.

Fig 9: Equities remain attractive relative to bonds

Equity earnings yield versus real bond yield



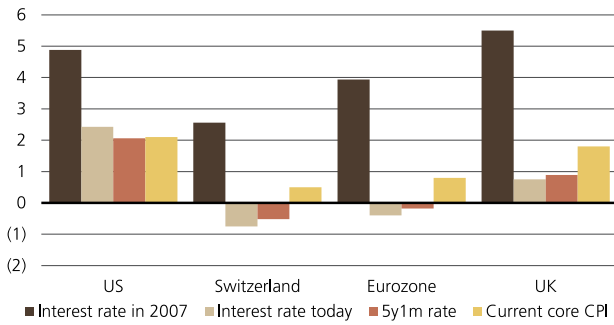
Source: Thomson Reuters, UBS, as of 10 April 2019

4. Cash rates look likely to stay low for an extended period.

One of the biggest changes in the market so far in 2019 has been the reset of medium term interest rate expectations. The market is now pricing that by 2025,

interest rates will be -0.5% in Switzerland, -0.2% in the Eurozone, -0.1% in Japan, 0.9% in the UK, and 2.1% in the US. Each is at or below below market-implied forecasts and current rates of inflation. This means that if market pricing proves accurate, investors with high allocations to cash, and particularly for investors in euros and Swiss francs are guaranteeing real medium term wealth destruction.

Fig 10: Rates look likely to stay low in future

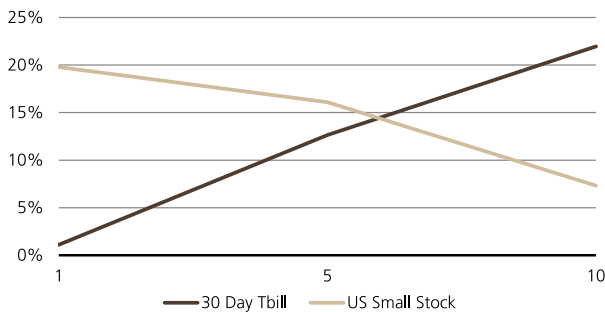


Source: Bloomberg, UBS, as of 10 April 2019

5. Over the long-term, the greater risk is not being invested. Our 1Q Global Investor Sentiment survey showed that 36% of investors are holding cash with the primary purpose of protecting against a market downturn, with 39% awaiting the right investment opportunity. But cash might provide safety and flexibility in the short run, investors who hold high cash balances persistently run the risk of failing to achieve their longer-term goals. For investors with a >6 year time horizon, the probability of a >5% loss in purchasing power is higher in cash (as 30-day T-Bills) than in equities (US small caps).

Fig 11: Historically, equities are safer than cash in the long run

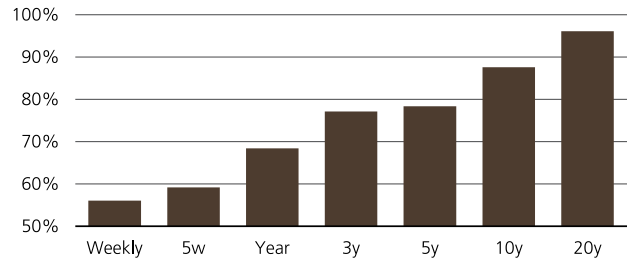
Probability (vertical axis) of an inflation-adjusted 5% or greater loss for various time periods (horizontal axis), in %



Source: Morningstar Direct, UBS, as of 31 December 2016

Fig 12: Longer-term returns are highly probable

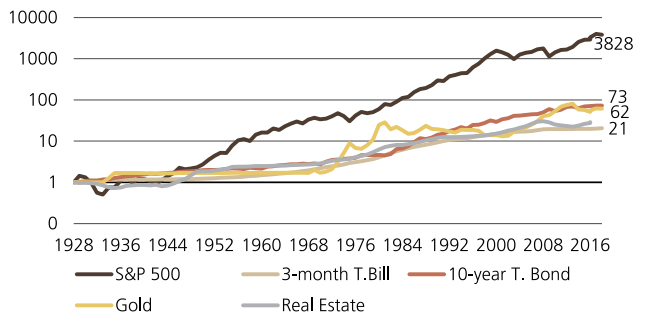
Probability of positive total returns on the S&P 500 since 1928



Source: Robert Shiller, Bloomberg, as of May 2018

Fig 13: Equities have significantly outperformed other asset classes over the long term

Total returns on various asset classes on a logarithmic scale



Source: Aswath Damodaran, Stern Business School New York University, Bloomberg, UBS, as of 2017

A stabilizing global economy, reasonable relative valuations, and dovish central bank policies suggest that investors shouldn't dismiss the potential for near-term upside for stocks. The increasing likelihood of continued negative real interest rates on cash reaffirm that a diversified investment portfolio is the best way to build toward long-term financial goals.

Plan, protect, and grow

We're in an environment in which investors need to both prepare for near-term risks and position for long-term growth. It might be tempting to try and time the market, but history shows this is almost impossible. We recommend that investors prepare their portfolios for the current market backdrop by making sure they Plan, Protect, and Grow.

Plan

Liquidity

- Short-term, lower risk, assets to maintain your lifestyle

Longevity

- Growth assets to help improve your lifestyle

Legacy

- To help improve the lives of others

Protect

- Diversify across regions
- Diversify across asset classes: don't forget bonds
- Use the low volatility environment to hedge equity positions
- Incorporate quantitative risk mitigation strategies
- Be selective in crossover credit

Grow

1. Escape low yields:

- Dividend strategies
- GCC credit
- Multilateral development bank and green bonds
- Multi-asset income

2. Buy the laggards

3. Tap into enduring trends

- Longer-term investment themes: fintech, medical devices, and genetic therapies.
- Asia smart cities
- Sustainable investing portfolio

4. Highest conviction regional ideas

- Asia: The Greater Bay Area, Collar hedging in China

- US: US Smart Beta, Technology disruption
- Europe: High quality and minimum volatility in the Eurozone, Solid stocks trading below book value
- Switzerland: Swiss high quality dividends

5. Phasing-in to markets to build exposure

Time -frames 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.

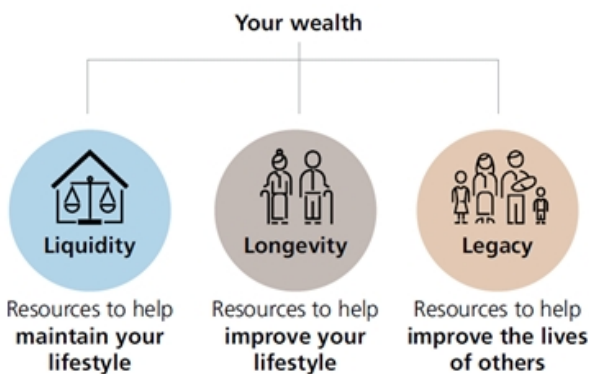
Plan

The starting point for protecting and growing your wealth is having a clear plan, linked to your financial goals. The past six months have shown how times of uncertainty create the potential for very costly investment decisions. Our Liquidity. Longevity. Legacy approach to wealth management can help you plan for your long-term goals while reducing the danger of falling prey to poor decisions during periods of market volatility.

The Liquidity. Longevity. Legacy. framework allocates your wealth into three strategies:

- **Liquidity.** A Liquidity strategy is designed to fund expenditures and meet liabilities for the next two to five years. Investments should be held in stable assets with low volatility, such as cash and/or a high quality bond ladder.
- **Longevity.** A Longevity strategy helps you meet your financial goals for the balance of your lifetime, and is characteristically well-diversified across asset classes with a growth orientation. The exact composition depends on your situation, goals, financial personality, and values.
- **Legacy.** A Legacy strategy is for assets in excess of what you need to meet your lifetime objectives. Its investment portfolios can be more aggressive and could be less liquid than those in the Liquidity or Longevity strategies given the time horizon is much longer term.

Fig 14: The Liquidity. Longevity. Legacy. approach to wealth management



Source: UBS, as of April 2019

Time -frames 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.

Protect

Equities are an important part of any long-term portfolio growth strategy. But slower economic growth and various macroeconomic risks mean that investors need to think carefully about downside protection. Our 1Q Investor Sentiment survey showed that 69% of investors are already hedging the downside risk in their portfolios. In our view, one key part of this is diversification, across both regions and asset classes. Incorporating quantitative strategies to reduce equity position in times of high volatility is another way to control portfolio risk. Investors can also use the current period of relatively low volatility to take out relatively low cost protection on the riskier parts of their portfolio.

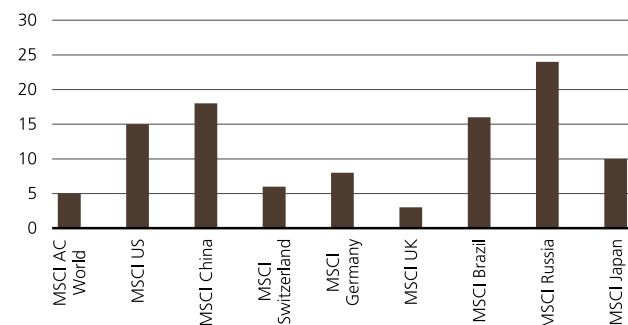
1. Diversify across regions

We are living in an era of policy experimentation. The United States' fiscal deficit is unprecedented for current stage in the business cycle, yet with "modern monetary theory" increasingly part of the policy debate deficits, could remain higher for longer. More deeply negative interest rates may have to be the response to a future Eurozone recession, given the difficulty of enacting higher fiscal spending in its current institutional structure. And while China has proven successful at employing various policy tools, its balancing act between short-term growth and long-term reform remains challenging to execute.

The only certainty is that some regions' policy remedies will prove successful, while others will prove to be failures. Concentrating wealth in individual regions near-guarantees higher volatility (every major market but the UK suffered more frequent drawdowns than global equities in 2018), and risks permanent wealth destruction in the event of major policy errors.

Fig 15: Global diversification reduces downside risk

Number of days with falls in excess of 2% in 2018



Source: Bloomberg, UBS, as of 10 April 2019

The importance of diversification is emphasized by our current tactical investment preferences, which are currently

for regions often under-represented in developed market investor portfolios:

We overweight emerging markets and Canadian equities relative to Swiss equities. EM equities are trading on 12.4x 12-month trailing earnings – 20% below their 30-year average. In contrast, Swiss equity valuations are relatively unattractive, at 18.2x, with Switzerland's 12-month trailing P/E above both its 20-year and 30-year average. Swiss stocks are also over 20% more expensive than their Canadian counterparts on a trailing P/E basis. We expect that gap to close due to a stronger economic environment in North America than in Europe.

We also overweight Japan, a major capital market with relatively low overseas ownership, relative to the Eurozone. Over the past six months the Japanese market has lagged Europe by 11%, its sharpest underperformance since 2016. Eurozone stocks also look expensive compared to the Japanese market. In Europe the P/E stands around 6% above the 10-year average, and the relative dividend yield is close to a multi-decade low.

For more on our regional equity views, please refer to the latest *Equity Compass* report.

2. Diversify across asset classes: don't forget bonds.

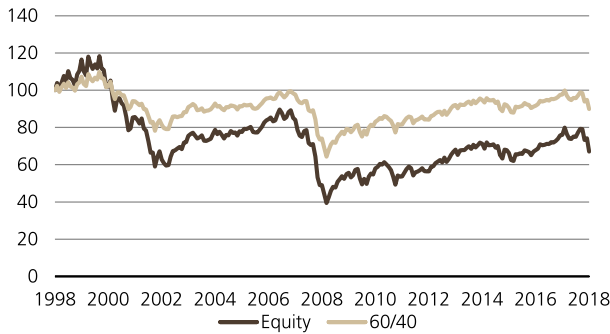
Long-term bonds suffer from volatility, but offer little in the way of yield over cash. So some investors have been tempted into pursuing barbell strategies – investing in the most risky assets, like equities, alongside the most stable, like cash.

But while holding bonds with a negative expected return might not make sense for investors with a very long-term time horizon, neglecting bonds in a portfolio can be costly for those reliant on regular portfolio withdrawals to fund their spending.

Historically, if we assume an investor withdrew 4% of their portfolio value per annum, a balanced portfolio would have outperformed both cash and equities. And despite low yields available on bonds today, we believe that this relationship will continue to hold in the future.

Fig 16: Balanced portfolios are best for investors making withdrawals

Performance of hypothetical US equity and US 60/40 portfolios, assuming 4% annual withdrawals



Source: Morningstar, UBS, as of 2018

3. Use low volatility to hedge.

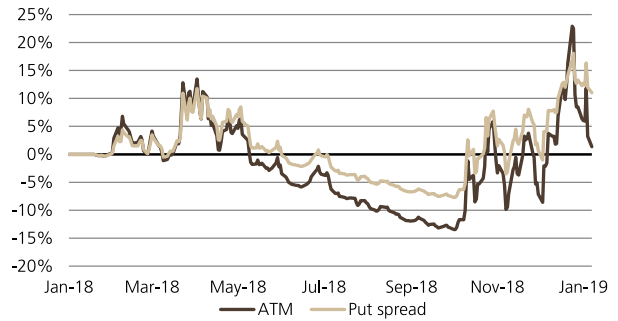
The current macroeconomic environment is uncertain. But the cost of hedging is currently relatively low across all asset classes.

Within equities we favor hedging using put spreads and "appearing" put spreads.

- **Put spreads.** Recent sell-offs have been characterized by relatively modest or short-lived maximum drawdowns, making put spreads an attractive strategy for hedging at lower cost than a simple put. In 2018 a strategy which buys and holds three-month 100-90 put spreads until expiry would have offered similar protection, but at lower cost, to three-month at-the-money put options.
- **"Appearing" put spreads.** A variation is the appearing put spread. In a fairly typical implementation, instead of purchasing a conventional 100/90 vanilla put spread, the investor can purchase, for slightly higher cost, a 100/90 put spread in which the short 90% put only "appears" if the index drops below 80% of its initial value during the period of the option. As long as the index stays above 80% of its initial value, it gives the same protection as a 100% put, but it would turn into a vanilla 100/90 put spread if the index drops below 80% of its initial value.

Fig 17: Put spreads offered equal protection to puts at a lower cost in 2018

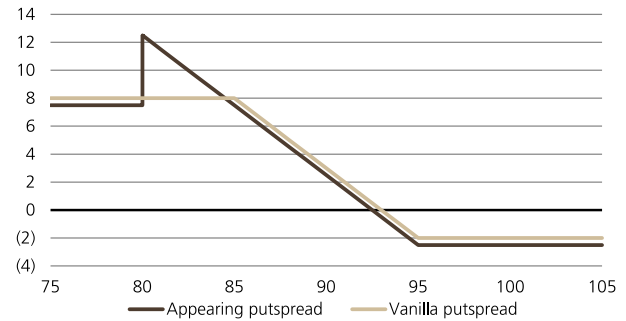
Cumulative performance of 3M ATM put options and 3M 100-90 put spreads, 100% notional exposure



Source: Bloomberg, UBS, as of 7 January 2019

Fig 18: "Appearing" put spreads can offer flexible protection

Illustrative pay-off diagram of an appearing put spread versus a vanilla put spread at expiration



Source: Bloomberg, UBS, as of 17 April 2019

For more on our views on hedging strategies, please see our recent report *Hedging Guidebook*.

4. Incorporate quantitative risk-mitigation strategies

Investors can also manage their portfolio risk quantitatively. Our systematic allocation strategy uses a signal-based approach to allocate more heavily to equities during times of relative economic and/or market calm, while reducing allocations during times of heightened uncertainty and/or weakening economic data. The result is a strategy which has historically proven less volatile through the cycle than equities in isolation, but with superior long-term risk-return characteristics.

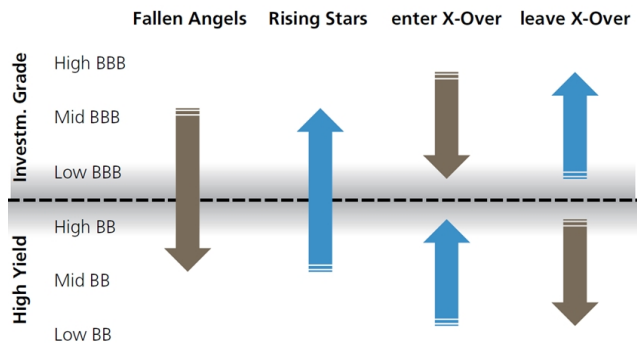
5. Be selective in crossover credit

The significant growth in the BBB segment of the credit market in recent years increases the risk that the high yield credit market (BB-rated and below) may have to absorb a high volume of issuers in any future downturn.

Our recent note, *Mind the Gap* highlights a number of issuers in the crossover zone at risk of rating downgrades. Investors looking to improve the quality of their bond portfolio could look to avoid these issuers in favor of those with better ratings outlooks.

Fig 19: Opportunities in the crossover zone

Definitions used in the report (low BBB- and high BB-rated bonds)



Source: UBS, as of 21 March 2019

Grow

Interest rates appear likely to remain at very low levels for the foreseeable future, so we emphasize income strategies which can help improve the potential for compounded returns over time. Additionally, we highlight attractive stocks and sectors left behind in the 1Q rally, companies exposed to enduring long-term trends, and our highest conviction investment ideas from each major economic region. Investors looking to add exposure to growth assets but uncertain about the near-term outlook can also consider phase-in strategies.

1. Income strategies

a. Dividends

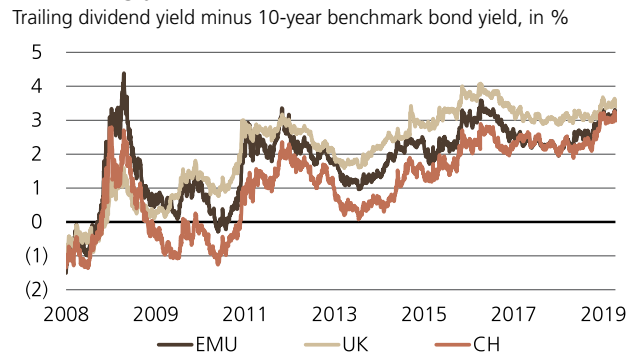
The recent decline in government bond yields has renewed the importance of looking for yield in other parts of your portfolio, and dividend-based equity strategies can play a part in that. Such strategies currently look appealing in several major markets.

- **US:** Our "Dividend Ruler" strategy emphasizes stocks with a strong track record of dividend growth and a positive fundamental outlook, and offers a current estimated dividend yield of 2.4%. Given a focus on higher-quality companies, the strategy can normally be expected to underperform in sharp upswings, yet delivered 1Q performance of 13.3%, almost matching the S&P 500's 13.6%. It has delivered a CAGR since inception of 10.1% p.a., vs 8.9% for the S&P 500.
- **Eurozone:** The MSCI EMU's expected dividend yield of ca. 3.8% is attractive, compared to a 10-year German Bund yield of -0.03%, and investors can earn a higher yield with a dividend-focused strategy. We like stocks of companies with attractive, good quality, and sustainable dividends. Diversification among sectors is also important.
- **Switzerland:** The Swiss equity market offers a dividend yield of over 3% (based on 12-month historic dividends), while bond yields in the Swiss franc fixed income market are near or below zero. This yield gap is attractive in the medium term, in our view, particularly if investors focus on companies with sustainable payouts relative to profitability. Swiss companies are currently enjoying historically low net indebtedness and reporting robust profitability.
- **UK:** The UK market's 5.2% dividend yield remains attractive, in our view, despite the uncertain political backdrop. The yield compares favorably to a 10-year Gilt yield of 1.2%, and 2.8% yield on investment

grade credit. In selecting attractive dividend stocks, we quantitatively screen for UK stocks that offer a combination of high dividend yields, good dividend coverage, and growth potential, while maintaining diversified sector exposure.

Please refer to our reports on *Dividend ruler stocks*, *Eurozone sustainable high dividend yield*, *Swiss high-quality dividends*, and *UK diversified dividends* for specific stock ideas.

Fig 20: European dividend yields have become increasingly attractive



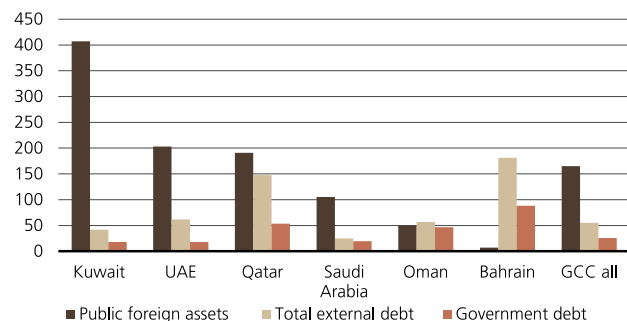
Source: Thomson Reuters, UBS, as of 14 April 2019

b. Emerging market credit

We expect attractive returns from sovereign Eurobond issues from the nations of the Gulf Cooperation Council (GCC). Attractive valuations, stabilizing sovereign credit fundamentals, and an improving supply-demand balance all support this theme. We expect a cyclical rebound, and a shift to twin surpluses in most GCC countries on the back of rising energy prices, ongoing reforms, fiscal consolidation, and growing oil output. Declining GCC bond supply, limited refinancing needs, and a recent inclusion into EM bond indexes may also provide additional technical tailwinds.

Please refer to the *Weekly Emerging Markets Bond List* for our current bond recommendations in the region.

Fig 21: GCC sovereigns have large buffers in place

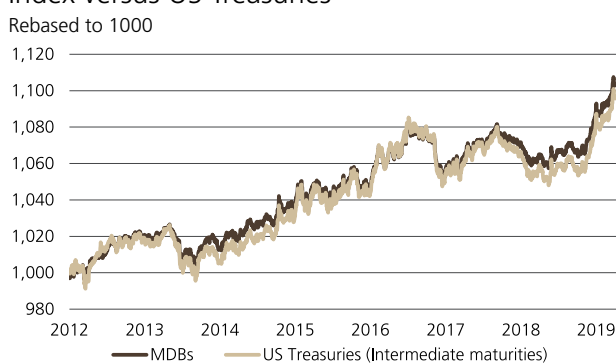


Source: Bloomberg, UBS, as of 10 April 2019

c. Multilateral development bank and green bonds

Investors can often boost the yield on their bond holdings while retaining similar risk and insurance characteristics by switching some or all of their high grade and investment grade bond allocation toward multilateral development bank and green bonds, respectively. MDB bonds have historically delivered similar long-term returns to US Treasuries and currently offer a modest yield pick-up. And the green bond index (GREN) has achieved an almost identical total return as the ICE global corporate credit index since March 2014. In both cases, investors gain the added benefit of using their capital to help support global development and environmental goals.

Fig 22: Global Multilateral Development Bank Index versus US Treasuries



Source: ICE, Bloomberg, UBS, as of 10 April 2019

d. Multi-asset income approach

Investors looking to increase the income derived from their portfolio can also take a multi-asset approach: adjusting their strategic asset allocation to include a higher allocation to credit and emerging market bonds, adding real estate investment trusts, and incorporating systematic option-writing strategies to generate extra premium. Our multi-asset income approach combines a number of these income generating strategies to create a diversified, global, high income portfolio.

2. Laggards

After a sharp decline and equally rapid recovery in markets over the past six months there is an opportunity to pick up stocks which got caught up in the sell-off but failed to recover in the rally, in spite of their positive fundamental outlook.

Even if stock markets only slowly move higher from here, there is potential for some of these "Laggards" to catch up in the months ahead, delivering outperformance over market indices.

We look for stocks with a positive fundamental outlook (rated "Most Preferred" by our country and sector specialists) but with a) <10% year-to-date performance, b) prices more than 10% away from their 12 month highs, c) valuations close to their lowest price-to-book ratios seen in the past decade.

While we identify stocks across a range of regions and sectors, our screen in particular reveals Asian financials, banks, and telco, European industrials and consumer, and US energy, materials, and financials, as sectors with a relatively high concentration of "laggards."

For more details on specific stocks in our screen, please refer to our report *After the rally – laggards anyone?*

3. Tapping into enduring trends

a. Longer-term investment themes

[Long Term Investments](#) (LTIs) tap into emerging secular trends and enduring structural changes. These include opportunities in financial technology, medical devices, and genetic therapies.

Rapid urbanization, widespread smartphone penetration and advances in AI will translate into strong demand for fintech; we expect revenues for the sector to more than double by 2025, to USD 265bn.

The aging population will create more opportunities for companies selling medical products and devices, a market that we think has a collective size of around USD 104bn and can expect mid-single digit growth over the long term.

Genetic therapies use genes and cells to treat serious diseases, and we think the industry is at an inflection point. The first treatments to reach the market could achieve combined sales exceeding USD 20bn on our estimates.

Many of our themes involve investing in areas of disruption, which means there can be winners and losers. We therefore advocate not only diversifying within a theme, but also across our longer term investment themes. Investors can also gain exposure to secular trends through alternatives, including select hedge funds and private equity.

b. Smart Cities

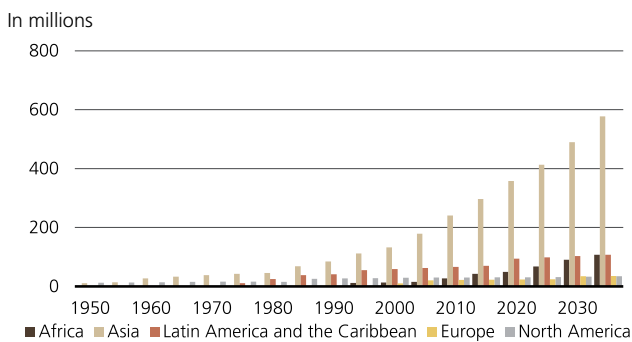
Asia is home to more than half of the world's "megacities" – with at least 10 million inhabitants each. And the UN estimates three out of four people in Asia will live in urban settings by 2050, up from about half now. This shift underscores the Asia opportunity for private sector smart city solutions, spanning cybersecurity, connectivity, governance, services, automation, health, and new mobility.

Smart city innovation is already happening. Singaporeans routinely file their taxes, monitor transit schedules, and access secure government services on their mobiles. 5G is being rolled out in China and will arrive across most of Asia in the next few years. Widespread, low-latency network coverage will accelerate smart city developments, leading to breakthroughs like autonomous buses on select Tokyo roads by next year.

We estimate Asia’s smart city market will grow to USD 800bn in 2025. Companies in faster growth segments like fintech, 5G, [smart mobility](#), and health-tech should benefit from strong demand and regulatory support.

Read more in our [Shifting Asia: Smart Cities](#) report.

Fig 23: Number of people living in cities with populations over 10m will double in Asia from 2010-30



Source: United Nations Population Division (UNPD), as of 2018

c. Sustainable investing

Evidence suggests that sustainability integration can enhance long-term risk-adjusted rates of return. Moving beyond simply excluding stocks, modern sustainable investing strategies incorporate environmental, social, and governance (ESG) standards alongside traditional financial analysis. This can help investors avoid firms that are exposed to potential tail risks like environmental accidents or punishment from regulators, and thus enhance risk-adjusted returns. Over 90% of academic studies show that incorporating ESG standards has a neutral, or even positive, impact on returns.

CIO has developed a range of SI thematic ideas that address a range of environmental, social and governance (ESG) concerns, which aim to outperform the global equity market and allow investors to focus on compelling long term developments that align with their values such as water investment, renewable energies, energy efficiency, and agribusiness.

Gender Diversity: One sustainable investing strategy with a particularly strong track record is based around investing in firms with greater gender diversity in top positions. We have found that companies in which women occupy at least 20% of leadership positions were more profitable across various metrics than their less gender-diverse peers. We view gender diversity as a proxy for a well-run company. This group of companies has outperformed the MSCI World Index by more than 20 percentage points since the end of 2010, as explained in our *Gender diversity matters* publication.

3. High conviction tactical ideas

Asia

The Greater Bay Area: With growth moderating, investors should focus on pockets of secular growth. In this regard, we expect the Greater Bay Area (GBA) to become one of the fastest-growing regions in China, supported by favorable policies, greater connectivity, and population growth. GBA development will offer multi-year investment opportunities in select sectors, including infrastructure, trade and logistics, property, consumption, technology, and financial services.

Our equity preference list consists of stocks with meaningful exposure to the GBA and above-average earnings growth. For more see our report *Greater Bay Area: Launching a world-class metropolis*.

Collar hedging China exposure: China has been one of best performing major markets so far in 2019, spurred by hopes of a resolution to US-China trade tensions. We remain positive on the market. But those seeking protection in case the outlook sours, could consider overlaying their equity exposure with a "collar." Here an investor buys an out of the money put, limiting the downside, while selling an out of the money call. The sale of the call reduces the price of downside insurance, in exchange for giving up part of the upside if markets continue to rally.

US

US Smart Beta: In equities, smart beta is a semi-passive strategy that takes a regular market capitalization index (like MSCI USA) and tilts the stock composition to exploit investor behavior and capture traditional risk premiums. An equally weighted portfolio of the six most frequently cited US smart beta factors has, on a back-test since 2001, outperformed MSCI USA by 2.1% a year. Furthermore, smart beta investing generally has lower fees than active management.

For more see our reports on *US Smart Beta*.

Technology Disruption: While "technology disruption" is a global investment theme, US companies are

disproportionately represented among businesses set to displace established competitors. We believe technological disruption is only in the early stages and should continue as tech and tech-enabled companies continue to gain market share against incumbent competitors across various industries. We like companies exposed to trends like cloud, Big Data, and artificial intelligence (AI). Meanwhile, we stay away from companies with weak product portfolios, market share losses, or facing cyclical risks.

For specific stocks we recommend, see our reports on *Technology Disruption*.

Europe

High quality and minimum volatility in the Eurozone:

Faced with high levels of uncertainty over politics and growth, many investors in the Eurozone want to protect their portfolios against higher volatility. Higher quality and minimum volatility stocks can contribute to this goal. These have historically performed well and shown smaller absolute drawdowns in turbulent markets. On average, high quality has outperformed the MSCI EMU by 7.2% during recessions and by 4.6% during previous slowdowns, while Minimum volatility strategies have outperformed the MSCI EMU by 8.6% during previous recessions and by 5.1% during previous slowdowns. During market turbulence, both strategies have also suffered the smallest quarterly drawdowns.

For more on these strategies, see our report *Investing in the late cycle and beyond in the Eurozone*.

Solid stocks trading below book value: Recent volatility has left a number of companies trading below tangible book value. In our view, these underappreciated stocks have the potential to outperform over the longer term, even in periods of risk aversion. We identified stocks across regions and sectors that trade below their tangible book value and offer attractive investment opportunities. Our basket of most preferred European stocks in this theme trades at an average 2019E P/E of 8.1x and that of our least preferred at 27.7x. Consensus earnings median growth is 16% for the former and 3% for the latter.

For more on the specific stocks we recommend in this theme, see our latest *Equity Radar*.

Switzerland

Swiss high quality dividends: Government bonds are a crucial part of a balanced portfolio. But with Swiss yields negative, they can also represent a drag on returns – unless the Swiss National Bank is forced to cut rates further to combat an abrupt slowdown. High quality Swiss firms that offer a higher than average dividend have the potential to

lift returns. Even the average dividend of Swiss companies is an attractive 3%, versus around -0.3% for 10-year government bonds. We believe in identifying firms with the most attractive dividends, with low indebtedness and robust profitability.

See our latest *Swiss high-quality dividends* report for individual stock preferences.

4. Phasing in

Many investors may see the potential long-term growth opportunities in markets, but amid cyclical uncertainty are waiting for the right time to enter. Attempting to time the market can, however, be difficult and costly, and particularly for entrepreneurs who have recently been left with a lump sum after selling a business. To see how easy it can be to get "stuck on the sidelines" waiting for the right time to buy, try our market timing game on ubs.com/cio, which uses real market data to show how tough it can be.

Therefore, phasing capital into markets over time can be an attractive strategy to allow investors to build a portfolio befitting their financial goals, while reducing the emotional stress of going "all-in" at once.

We believe the best strategy is to establish a set schedule, and to accelerate each phase-in tranche if there is a market dip of at least 5%. This threshold is common enough to occur frequently during three- to 12-month phase-in processes, and most tend to be temporary. Investors can also consider "put-writing" strategies, allowing investors to earn a premium while they wait for market declines, or buying call options, to provide exposure to market upside while limiting downside.

For more detail on strategies for phasing capital into markets, see our report [How should investors deal with lump sums?](#)

Appendix

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