Too hot, too cold, or just right?

Investing in Asia Pacific - March edition

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Investing in Asia Pacific
A monthly guide to investing in Asia Pacific financial markets

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Editorial

Dear reader,

In the popular fairy tale, Goldilocks decides to try three different bowls of porridge in the empty home of three bears. She finds the first too hot, the second too cold, but the last one "just right."

Investors too are hoping financial conditions turn "just right" for portfolios before the bears return to the table. After all, steady global growth, an encouraging earnings season, and rapid AI adoption are all reasons to be optimistic that an upside Goldilocks scenario can materialize. Such expectations have helped last year's outperformers extend their gains into 2024 (TOPIX +12% YTD, Magnificent 7 +8.8%), with the S&P 500 already establishing 11 new all-time highs this year.

But recent data show the US economy still remains too hot for the Federal Reserve to begin cutting rates, while China's economy remains too cold for investor comfort amid deflation and a struggling property sector. Until these complications are resolved, we see only modest additional upside for assets this year at the broad index level in key developed markets.

There are still, however, specific opportunities within these markets where the risk-reward already looks "just right." In particular, we like US tech, US small caps, large-cap Japanese banks, and Europe's own Magnificent 7, which includes innovative market leaders in European luxury, pharmaceuticals, and industrials. Globally we also have a most preferred stance on EM equities: India and Indonesia are solid structural growth stories, China's defensive sectors offer high dividend yields and inexpensive policy upside, and Asian AI beneficiaries provide better value versus their global peers for investors looking to diversify their tech holdings.

A Fed affair

The timing and extent of Fed rate cuts are key to Asia's prospects. Robust US growth data has reduced easing expectations, reset bond yields higher, and helped the dollar recoup its 2023 losses, but we still expect the Fed to cut rates by 75bps starting in June.

This would be a constructive outcome for the region: Not only can Asian central banks ease policy rates from mid-year onwards too, particularly as local inflation trends toward 2% (from 2.5% currently), solid US growth is also supporting a global tech and manufacturing recovery that should benefit cyclical exporters (North Asia), sectors (tech, consumption), and currencies (KRW, SGD).

Indeed, a look back at previous Fed easing cycles during periods of positive growth shows Asian ex-Japan equities delivered high-single digit median returns in the months after a first cut (versus near 0% at times when the Fed has cut during a US recession). The conclusion is intuitive enough: Risk assets tend to do well when economies are growing and rates are falling.

Policy heat needed in China

China begins the Year of the Dragon with a lack of fire in its economy. Though Lunar New Year travel and spending bounced past pre-COVID levels, consumer prices deflated at the fastest pace in 15 years (–0.8% y/y) in January, while sales at the country's top 100 developers contracted another 35% y/y.

Market sentiment is gradually starting to stabilize thanks to a string of positive policy developments. After plunging 12% in the first 16 trading days of 2024, MSCI China has climbed around 10% from its YTD depths as policymakers stepped in with measures to support the market and the "National team" began buying.

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We do think a more holistic approach is still needed to address China's well-known trifecta of property, deflation, and debt challenges, making the upcoming Two Sessions a major policy test. But given the extent that these concerns are already in the price, we think the balance of risks for Chinese equities is skewed to the upside.

In particular, we like high-yielding names in the SOE-heavy financials, utilities, and telecommunications sectors. Select Hong Kong companies with strong balance sheets, resilient dividends, and sensitivity to falling US rates can be a lower risk proxy to Chinese upside.

Japanese equities reach a record high

For all the parallels drawn between Japan and China in recent years, few could have seen this coming: In 2023, Japan's nominal growth rate (5.7%) overtook China's (4.6%) for the first time in more than four decades.

We see more gains ahead for Japanese equities after the Nikkei 225 broke through a record high set in 1989. Corporate reforms are accelerating, with businesses giving in to shareholder pressure to unwind their cross-shareholdings. The result is likely a broadening of share buybacks, representing an earnings per share growth driver for Japanese equities over the medium term.

On the macro front, we expect solid wage growth this year compared to last (3.6% y/y), meaning the BoJ is likely to end its negative interest rate policy in 2Q24. But a still-negative output gap means the central bank is unlikely to tighten much beyond that, creating just the right macroeconomic environment for risk assets.

Japanese banks outperformed the benchmark index in 2023, but the sector's P/BV at 0.7x is still below pre-2016 levels when the BoJ first introduced negative interest rates. We expect a re-rating higher as profitability improves, share buybacks are undertaken, and a dividend yield of 3.5–4% remains attractive.

We also expect the JPY to rebound once the Fed signals its readiness to cut rates toward mid-2024. We believe investors should go long the yen versus low-yielding currencies such as the TWD or CNY (instead of the high-yielding USD) to reduce the carry costs of the position.

Asia's growth opportunities

India offers the best structural growth story in the region yet continues to be overlooked by some global investors. We expect real annual GDP growth in excess of 6% over the next five years, and corporate profit growth in the low-to-mid teens, likely supported by policy continuity after this year's elections.

We are also upbeat on the post-election macro outlook for Indonesia. The new leadership inherits an economy in good shape, characterized by subdued inflation, solid FDI and infrastructure capex, and room to lower interest rates.

We stay most preferred on equities in both these markets, and also favor their high-yielding currencies against the low-yielding CNY and TWD. Strong sovereign fundamentals make Indonesia IG bonds attractive relative to their peers as well. Thematically, we like local consumer proxies offering resilient growth at compelling valuations, and banks.

For investors looking to optimize their tech exposure, Asia also offers a wealth of AI beneficiaries trading at reasonable valuations, including supply chain names exposed to AI edge-computing. Those still underinvested in the sector should position in tech leaders with significant market share—we recently raised our global tech (IT and internet) 2024 EPS growth forecast to 18% y/y from 16%.

The three bears: Geopolitics, geopolitics, geopolitics

Geopolitics still represents the main market risk for Asia. This month, we identify three key areas to watch, related to the upcoming US elections: 1) the potential imposition of tariffs, 2) the future of green and mobility incentives, and 3) fiscal spending.

While still early, potential winners and losers are emerging no matter who takes office. Further technology restrictions on mainland China could benefit Taiwanese foundries and Korean memory suppliers, and hurt most Chinese semi companies—though select mature node process companies may gain from domestic demand and policy support.

For those worried that the bears could return and ruin the fun for Goldilocks, now is also an opportune time to hedge market risks through defensive structured strategies, gold (also a beneficiary of lower rates), and alternatives like hedge funds.

Mark Haefele

Min Lan Tan

Messages in focus

Anticipate a "Goldilocks" scenario

Investors should prepare for a potential broadening of the equity market rally, which could materialize with a combination of Fed interest rate cuts, still-robust growth, and falling inflation. We expect US and European small-caps, select Swiss mid-caps, and emerging and frontier market equities to be particular beneficiaries in this scenario.

Optimize tech exposure

Investors cannot afford to be underinvested in tech, where we expect rapid earnings growth and think the big will get bigger. Equally, investors need to be wary of concentration and overexposure. We see opportunities to diversify tech holdings by geography and segment, while structured and diversified solutions can help investors grow exposure and mitigate downside risks.

Manage liquidity*

Investors should diversify beyond cash and money market funds as interest rates fall, with a combination of fixed term deposits, bond ladders, and structured investment strategies to cover expected portfolio withdrawals over the next five years.

Buy quality

As economic growth slows and inflation falls as we expect, quality fixed income offers attractive yields and potential capital appreciation, while strong companies are better positioned to perform.

Capture upside and protect downside

A mix of low equity market volatility and high bond yields makes this an attractive time to consider strategies to capture market upside while protecting against downside. These can be particularly effective ways to invest in markets that have downside risks but also high potential upside, including technology and China.

Trade the range in currencies and commodities

We expect most major currency pairings to continue to trade in established ranges in the months ahead. Some exceptions include the Australian dollar and Japanese yen, where we expect appreciation driven by relative policy tightening.

Diversify with alternative credit

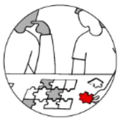
High dispersion within the high yield credit universe is creating opportunities for specialized credit hedge fund managers to generate performance. This is a supportive backdrop for various credit strategies, including credit arbitrage and distressed debt.

Capture growth with private markets

Private markets offer attractive return potential and differentiated opportunities, in exchange for lower liquidity. They can also be an effective vehicle for investors focused on driving positive change through impact and sustainability.

*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.

Asset class views



Asset allocation

- **We remain focused on relative value opportunities in the Asia ex-Japan region.**
- **Within equities, we keep India, China, and Indonesia as most preferred.**
- **Singapore and Malaysia are maintained as least preferred.**

Equities

- **China's medium- to long-term opportunities.** Changing retail trends, rising global presence, and strengthening tech supply chains are three core structural drivers. Position in names that benefit from these in the autos, consumer, healthcare, technology, and gaming sectors.
- **Select growth opportunities in Asia.** Within Asia tech, we like AI beneficiaries that are trading at reasonable valuations, China's software and cybersecurity segments, and IT services. In addition, banks for the next billions and select Asia ex-China consumer proxies offer resilient growth at attractive valuations.
- **Investing in Asian titans.** This is a benchmark-heavyweight-driven strategy benefiting from solid market share positions, resilient growth outlooks, and other fundamental support.

Japanese equities

- **Large-cap banks.** Bank stocks' valuation, at P/B at 0.7x, is still below pre-2016 levels and potential share buybacks are near-term catalysts. Dividend yields of 3.5-4% look attractive.
- **Laggard growth stocks** with above-market-average earnings growth outlook in FY24, given a potentially lower US 10-year yield, are also preferred.

Australian equities

- **Quality income and defensive growth sectors preferred.** We remain constructive on sectors such as insurance, infrastructure, and REITs, as well as select defensive growth names in IT and healthcare.
- **Constructive on select energy and mining.** The recent price correction has opened an attractive entry point to gain exposure to structural growth drivers.

Bonds

- **Within IG,** we prefer a barbell strategy of IG combining short duration and high quality long bonds. Indonesia IG and select Thai T2s also offer value.
- **Very selective in HY.** We prefer select fundamental improvement stories, such as Macau gaming.

Currencies

- **Position for medium-term JPY strength** by being outright long the yen versus the TWD or CNY instead of the high-yielding USD.
- **Long AUD (vs EUR and CHF),** with the RBA likely the last major central bank to cut rates.
- **Long INR and IDR (vs CNY and TWD),** with carry strategies set to do well.
- **Long KRW and SGD (vs. the CNY)** as key beneficiaries of an electronics export recovery.

Commodities

- **Opportunities in longer-dated oil contracts,** amid vanishing spare capacity.
- **Gold still a good hedge.** We continue to recommend investors to use gold as a hedge despite being neutral in the global asset allocation—within a balanced USD portfolio, our analysis shows around a mid-single digit percentage is optimal.
- **Volatility-selling strategies.** On an individual commodity level, we see opportunities to engage in selling downside in crude oil, copper, gold, and platinum.

Asia outlook

Too hot, too cold, or just right?

Key views for Asia

- A sturdy US economy is supporting areas of strength in both advanced and emerging Asia. North Asia, particularly Korea and Taiwan, is seeing a sizable boost from positive net-trade momentum—resulting in the early stages of a cyclical upturn.
- Stronger-than-expected policy signals at the "Two Sessions", such as a higher fiscal deficit, central bank purchase program, or more forceful property easing would indicate that policy support is moving into our upside scenario.
- We now expect AI industry revenues to grow 15x between 2022 and 2027, expanding from USD 28bn in 2022 to USD 420bn in 2027, or a 72% CAGR.
- As for elections in Asia, we generally see a preservation of the status quo ahead.

Introduction

Author: Wayne Gordon

Our index targets have been raised this month, but returns are still projected to be modest in the absence of stronger economic growth. That means investors should put a greater focus on finding specific opportunities with better risk-reward. So, to emphasize our best regional tactical ideas this month, you'll notice they are highlighted at the start of each focus question.

Aside from just its namesake's culinary preferences, the Goldilocks principle can be widely applied across nearly all disciplines. In astronomy, it refers to the habitable zone around a star—or as Stephen Hawking put it, where temperatures are "just right" for intelligent life. In psychology, it describes our preference for events that are neither too complicated or simple to understand.

Of course, a Goldilocks economy—where growth is just right for inflation to fall and rate cuts to begin—is also ideal for financial markets. An improving global economic outlook, broad disinflation, and solid earnings have raised optimism that this upside scenario is not just a fairy tale, pushing developed equity markets to new heights. While we are less sanguine on a "just right" scenario and still see sub-trend growth eventually, we cannot ignore the more constructive developments. Our index targets have been raised this month, but returns are still projected to be modest in the absence of stronger economic growth.

That means investors should put a greater focus on finding specific opportunities with better risk-reward. We think Asia, in particular, offers plenty of these prospects where the conditions are closer to "just right" due to a mix of cyclical, structural, and fundamental tailwinds. So, to emphasize our best regional tactical ideas this month, you'll notice they are highlighted at the start of each focus question and in our updated key messages, which include:

Anticipate a Goldilocks scenario

We remain most preferred on EM equities, which would benefit most from a potential broadening of the equity rally. Within the segment, **India and Indonesia** are our favorite regional markets, where we like consumer growth proxies and regional banks. In **China, high-yielding SOE banks, utilities, and telcos** are inexpensive plays on policy upside. Select **Hong Kong stocks** can be a defensive proxy to Chinese growth.

Optimize tech holdings

We think future performance will rest heavily on the level of exposure to the tech sector. Though we remain bullish on US tech, investors that are overexposed to the segment (the Magnificent 7 and information technology represent 18% and 24% of the MSCI All-Country World Index, respectively) can find better value and upside in **Asian AI beneficiaries**, in our view. These include names in the **AI infrastructure and edge computing supply chain**.

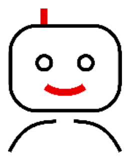
Buy quality

Within Asian equities, we have a clear preference for quality and large caps across indexes—these **Asian titans** hold solid market share positions, resilient growth outlooks, and other fundamental supports. Large cap **Japanese banks** should benefit from Japan's better macro environment and the BoJ's approaching normalization. In fixed income, **Indonesian IG** and **Indian local currency sovereign bonds** are trading at attractive yields and can provide diversified returns.

Trade the range in currencies

With currency majors likely stuck in a range, relative opportunities can be found in the Asian complex. The **AUD** is supported against European peers by an RBA that will likely be last to cut. Position for medium-term **JPY** strength vs. the low-yielding CNY and TWD for more holding power. Long the high-yielding **INR** and **IDR** (vs. CNY, TWD) for carry performance. Finally, the **KRW** and **SGD** (vs. CNY) should benefit the most from a global tech and manufacturing upcycle.

Investors can find more of our high conviction ideas and insights in the pages that follow. As always, we wish you an enjoyable read and a prosperous investment journey ahead.



On a consolidated basis, we expect the AI infrastructure segment to grow from USD 25.8bn in 2022 to USD 195bn in 2027—a 50% CAGR.

Question 1

What does US exceptionalism mean for Asia?

Authors: Philip Wyatt, Delwin Kurnia Limas, Devinda Paranathanthri, Teck Leng Tan, Hiromu Uezato, Chisa Kobayashi

Trade ideas: Indonesian equities and IG bonds; Indian equities and LC bonds; consumption proxies; regional banks; Long IDR, INR vs. CNY, TWD; long KRW, SGD vs. CNY; long JPY vs. CNY, TWD; Japanese banks.

US economic exceptionalism has remained on full display in 2024. Indeed, with both payrolls and inflation data surprising to the upside in January, macroeconomic conditions are running hotter than expected in an economy that's grown above trend since 3Q22.

On cue, markets have pulled back their Federal Reserve interest rate cut expectations from nearly seven cuts this year in early January, to around half of that now. That's far more in line with our projections than before: Our US economics team now expects the Fed to make its first 25-basis-point cut in June rather than May, with one rate cut per quarter after that until the fed funds target range reaches our longer-run neutral rate estimate of 3.25–3.5%.

But disinflation needs to continue for this to happen. Despite the January CPI heat, an ongoing moderation in wage growth is reassuring with the employment cost index and the Atlanta Fed wage tracker at their lowest levels since the end of 2022. As the labor market cools further, we think the end result is most likely a Fed that's still biased toward easing amid near-trend economic growth—representing good, but not yet "Goldilocks"-great, conditions for the global economy and risk assets.

That's still enough to boost our global GDP growth forecasts for 2024/2025 this month to 2.4%/1.8% (from 2/1.7% previously) and our year-end equity targets across markets (S&P 500 to 5,200, Euro Stoxx 50 to 4,700, MSCI EM to 1,080). Asia, too, should still benefit in such a scenario.

Asia's Fed affair

For the region, the important takeaway is that the Fed is still set to cut rates into non-recessionary conditions. This should allow Asian central banks, which find themselves in an increasingly favorable position to begin their own easing cycle, to sync their start with the Fed from 2Q onwards.

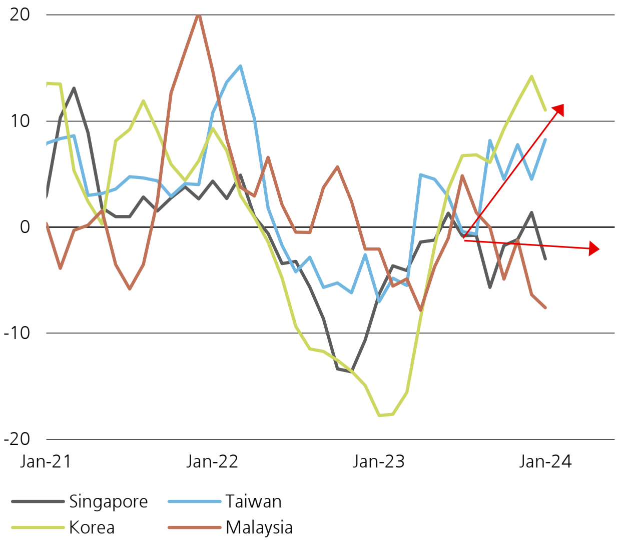
Regional CPI has already descended earlier than expected to around 2.5% on average, and could slow toward 2% given subdued broad money growth in the background. With such sluggish money and credit trends, nominal GDP growth has declined further even as real GDP is starting to recover to trend from the 2023 slump—a local macro headwind that is restraining corporate revenues and raises the impetus for monetary easing.

Even better, a sturdy US economy is supporting areas of strength in both advanced and emerging Asia. North Asia, particularly Korea and Taiwan, is seeing a sizable boost from positive net-trade momentum—resulting in the early stages of a cyclical upturn. This is most evident in Korean data, where net trade has been the biggest contributor to headline GDP growth. Behind the numbers, exports are enjoying a vigorous recovery while imports and investment remain generally lackluster, resulting in a climbing trade surplus that should support the KRW.

Driven by the electronics sector, North Asia is also riding a re-expansion in manufacturing output. Supply-side dynamics, such as Korean shipments to inventory ratios, are still trending upward—a typically reliable signal for manufacturing output expansion and better producer pricing and profits.

Export recovery remains product specific favouring North Asia

Electronic exports ($ s.a.) % 3m/3m



Source: CEIC, UBS, as of February 2024

Meanwhile, ASEAN is holding up relatively better on the services side, partly due to the reduced impact of higher interest rates in economies with low private sector gearing, like Indonesia, India, and the Philippines. Construction is another differentiator, generally favoring ASEAN where capex is being driven by governments and budgets. For example, 4Q fixed investment was up 5% y/y in Indonesia and up 10% y/y in the Philippines, compared to a contraction of 1.6% y/y in Korea.

India's growth story remains one of the strongest globally, in our view. Consumption has held up well in the higher interest rate period, with private consumption growing just over 3% y/y in the September quarter (in line with the previous four quarters). Less visible is the fact that today's consumption is less reliant on government subsidies than in the past as technology permanently expands the bankable consumer universe and increases household access to credit. FDI inflows should also continue apace amid domestic reforms and supply chain diversification. The general election due in April (see Question 4) is unlikely to change this, given expected leadership continuity. All this means there are no compelling local reasons to quickly cut high policy rates, with sticky inflation, strong bank lending, and wider-for-longer trade deficits likely delaying cuts to 2H24. Over the next 12 months though, we see 50–75bps in repo cuts alongside CPI settling down to 4–5%.

Look local for returns

Asia's stable macro backdrop and approaching rate cuts create a conducive environment for risk assets. Within Asian ex-China equities, we stay most preferred on India and Indonesia, where consumption proxies and banks for the next billions offer resilient growth at attractive valuations. For the latter, recent earnings and guidance confirm the loan growth outlook and asset quality is robust, even if potential rate cuts impact NIMs slightly.

For the region more broadly, the tech upcycle should be the biggest driver by far for an expected Asian corporate earnings rebound this year. Following an estimated 8% earnings decline in 2023, we expect a rebound of 18% in 2024—far outpacing both the US and Europe—with tech accounting for nearly 80% of the change. This presents a wealth of opportunities in the region for investors looking to optimize or add to their tech exposure (see Question 3).

> Global tech stocks have performed strongly year-to-date amid resilient 4Q earnings results and a generally supportive management outlook over the next six to 12 months.

Globally, we continue to think the risk-reward for fixed income is better than equities, with high quality bonds a key portfolio building block. Locally, Indonesian IG bonds are compelling: Post-election sovereign fundamentals are solid and could spur a positive outlook change from credit rating agencies. For now, we prefer playing duration in this space.

A unique opportunity is also emerging in Indian local currency government bonds—the second-largest in Asia behind China. With the inclusion of India in major government bond indexes, the Reserve Bank of India's policy cycle at a peak, and a fiscal consolidation underway, alongside a stable currency, we think 10-year government bonds can effectively diversify fixed income exposure.

Trade the range with Asian currencies

With major central banks now more synchronized around the world, major currency pairs are likely to be stuck in a range. While APAC currencies could rebound by 3–4% on average versus the greenback this year as Fed easing begins, we see specific opportunities supported by regional tailwinds.

Electronics export-oriented economies such as Korea and Singapore will likely benefit from the recovering global manufacturing cycle, which should bolster these currencies. High-yielders such as the INR and the IDR also look attractive as investors look for yield carry amid easing global bond yields. Meanwhile, we expect the CNY to underperform as the PBoC keeps policy settings accommodative amid ongoing growth challenges (see Question 2), making it a suitable funding currency.

> Stronger-than-expected policy signals at the "Two Sessions", such as a higher fiscal deficit, central bank purchase program, or more forceful property easing would indicate that policy support is moving into our upside scenario.

Japan pivots higher

After a year of momentous shifts for Japan in 2023—when its nominal GDP growth (5.7%) outpaced China's (4.6%) for the first time in more than 40 years—the market is quickly passing new milestones: The Bank of Japan could soon lift its negative interest rate policy and the Nikkei 225 has topped a record high set in 1989.

The Shunto labor union wage negotiations in March are key to both. If the solid wage growth we expect this year materializes, we think that will pave the way for the BoJ to lift its short-term policy rate to 0% as early as its April meeting. Focus after that, however, will likely turn to a still-negative GDP gap, meaning policymakers are likely to keep conditions accommodative this year.

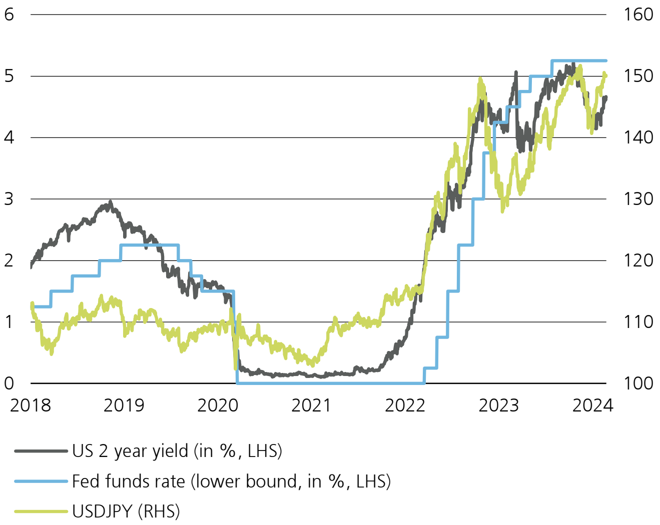
Policy normalization in Japan should still place the yen on a firmer footing when the time comes for a decisive lowering of US interest rates. We think that the yen is close to a multi-year trough and see an opportunity to position for a medium-term recovery by going outright long the JPY against low-yielders like the CNY and the TWD (rather than the high-yielding USD), which can provide more holding power.

The better nominal growth environment and a strong US economy come as corporate reforms are accelerating. Businesses are giving in to pressure to unwind their cross-shareholdings, which could result in the broadening of share buybacks and present an EPS growth driver for Japanese equities over the medium term. In the near term, Japan's fiscal year-end in March could spur higher dividend payouts or share buybacks from companies trading at low P/BV and ROE.

Together, these catalysts point to moderately more upside for Japanese equities from here. To date, the 30 largest stocks by market capitalization in the Nikkei 225 have contributed to more than 60% of the index's performance this year, with beneficiaries of JPY weakness and AI-related stocks leading the charge. We think the outperformers will rotate back to sectors like Japanese banks, where a P/BV of 0.7x is still below pre-2016 levels (when the BoJ first introduced negative interest rates). We see a re-rating higher as profitability improves, share buybacks are undertaken, and a dividend yield of 3.5–4% remains attractive.

A Fed easing cycle from 2H24 onwards should put downward pressure on the USDJPY

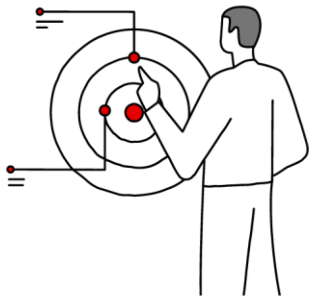
USDJPY vs US 2 year yields and Fed funds rate



Source: Bloomberg, UBS, as of 22 February 2024

Question 2

Will the "Two Sessions" stoke a turnaround in China?



Authors: Yifan Hu, Eva Lee, Kathy Li, Summer Xia

Trade ideas: Select defensive mainland Chinese SOE banks, utilities, and telecommunications; mainland Chinese structural growth proxies; defensive Hong Kong equities.

China is beginning the Year of the Dragon with a lack of fire in its economy and plenty of volatility in its equity markets.

While visitors (+34% y/y; 119% of 2019 levels) and tourism spending (+47% y/y; 108% of 2019 levels) rebounded over the Lunar New Year holidays, deflation is becoming more entrenched and the property market remains in a deep freeze. Indeed, consumer prices fell at the fastest pace in 15 years (–0.8% y/y) in January while sales at the country's top 100 developers contracted another 35% y/y.

But though macroeconomic conditions have yet to thaw, market sentiment is gradually starting to stabilize. After falling 11% y/y in the first month of the year, MSCI China is up around 10% from its year-to-date depths thanks to more forceful capital market support.

Among the recent highlights: On 7 February, the China Securities Regulatory Commission (CSRC) replaced its chairman with industry veteran Wu Qing—a tactic that's been used previously in times of market turmoil. Just a day earlier, Central Huijin (the "national team") also pledged to expand the scope of its ETF buying to support the stock market in another page out of the old playbook. And the previously announced 50bps reserve requirement ratio (RRR) cut came into effect the day before that, releasing around CNY 1tr in long-term liquidity.

On the property front, 5-year loan prime rates were recently cut by a surprisingly large 25bps, two Tier-1 cities have partially eased purchase restrictions in recent weeks, and funding for a white list of real estate projects is already being approved.

Together, these developments are in line with our expectations that policy support would be ramped up in the runup to the "Two Sessions" in early March. Moreover, we've highlighted that continuous and larger-scale national team buying could be one policy put in an upside case—though this is beginning to materialize, a look back at previous rescue plans shows not all are effective unless accompanied by other measures to improve macro conditions. For instance, in 2015, when the national team bought CNY 1.3tr worth of A-shares, the market didn't bottom until the introduction of forceful fiscal easing including the shanty town redevelopment program in early 2016.

In our view, a more holistic approach is still needed to address China's well-known property, deflation, and debt challenges. In particular, we continue to see a gap between the measures announced so far and what's needed to help property sales find a floor—which we view as the most important near-term determinant of consumer and investor confidence. This makes the upcoming "Two Sessions" a key policy test.

> Though Beijing is showing more willingness to respond to economic growth concerns, we think a "just enough" approach to cushioning the impact of the property and LGFV deleveraging remains the current policy stance for now.

"Two Sessions" expectations

In our last update ("Asia's Year Ahead 2024, revisited"), we said policymakers will likely again set an official growth target of around 5% at the "Two Sessions." Since then, 2024 targets outlined at the local level have aligned with this view—nearly every province and both Beijing and Shanghai pegged growth at no lower than "around 5%."

Achieving this, however, would require a package of unconventional demand-stimulative policies that includes large-scale fiscal, monetary, and property easing. But though Beijing is showing more willingness to respond to economic growth concerns, we think a "just enough" approach to cushioning the impact of the property and LGFV deleveraging remains the current policy stance for now (see Table below).

The central government balance sheet, to be announced at the National People's Congress, will likely confirm this: We project a fiscal deficit of around 3.5% of GDP (vs. 3.8% in 2023) with a special local government bond (LGB) quota of around CNY 4tr and the moderate use of quasi-fiscal tools, including CNY 1tr in annual pledged supplementary lending (PSL) to support the property sector. Monetary policy should remain in an easing bias, with another two RRR cuts of up to 50–100bps and MLF/LPR cuts up to 20–30bps. Bond swaps to refinance local government bonds could emerge as a band-aid solution to debt challenges.

The end result is likely GDP growth in the mid-4% range in 2024 and a less painful contraction of about 7% y/y in the property sector, an outcome officials are likely to accept if progress is made on longer-term objectives such as the economic rebalancing and self-sufficiency.

Stronger-than-expected policy signals at the "Two Sessions", such as a higher fiscal deficit, central bank purchase program, or more forceful property easing would indicate that policy support is moving into our upside scenario. The latter could include a step-up in PSL funding (either >CNY 1tr in 2024 or a medium-term plan totaling CNY 3–5tr) and a rollout of cash-resettlement for urban village renewal—a measure which proved to be effective in the shanty town redevelopment scheme. The risks of a policy disappointment, however, should not be completely discounted either.

Over a longer term, policy consistency and plans to address fundamental structural issues are required to sustainably rerate Chinese equities higher.

Potential policy catalysts from NPC

Policy	Measures
Real estate	• CNY 1tr+ PSL to support urban renewal and affordable housing • Roll-out of Cash-resettlement under urban village renewal scheme • Direct financing support to private developers • Set-up of housing-related policy bank/housing administration
Capital market	• Set-up of a stock stabilization fund , and/or other methods to provide stronger stock market support
Fiscal	• GDP target ~5% • Fiscal deficit at least 3.5% • Additional CNY 1 tr special CGB
Regulation	• Sector-specific policy support on private sectors, e.g. education

Source: UBS, as of February 2024

Staying defensive

So far, the recent policy measures do appear to be "circuit-breaking" the downward spiral in sentiment. After all, direct government buying can be one of the most effective ways to lift the market in the short run if done effectively. But over a longer term, policy consistency and plans to address fundamental structural issues are required to sustainably rerate Chinese equities higher.

We are more confident than not that those policy catalysts will eventually materialize, and given the extent that concerns and negativity are already largely in the price, the balance of risks for Chinese equities is still skewed to the upside in the short term. But investors should remain defensively positioned in a volatile market still contending with macro disappointments, downward earnings revisions (we lower our FY earnings growth forecast to 8% from 9.4%), and rising geopolitical concerns (see Question 4).

Over a tactical horizon, we therefore stick to sectors with resilient earnings growth, better visibility, and defensive high yields. In particular, we like select SOE financials and names in the heavily state-owned utilities and telecommunications sectors. These have outperformed MSCI China by up to 43pps since the beginning of 2023 thanks to attractive dividend yields (6% on average for banks) and ongoing reforms to enhance SOE valuations, which have continued into January with regulators adding market cap and capital management (including dividend payouts) to their assessment of executive performance. Their large weightings in onshore and offshore indexes also make them the biggest beneficiaries of national team buying.

Over a medium- to longer-term horizon, investors with low China exposure should take advantage of the cheap valuations today (-1.6 standard deviations below the forward P/E historical average) to pick up exposure to structural growth proxies. We continue to see opportunities in companies that can tap into China's changing consumption trends, domestic tech ecosystem and megatrends like AI, as well as those with a strong and rising global presence. Names that benefit from these investment drivers can be found in the auto, consumer, healthcare, technology, and gaming sectors.

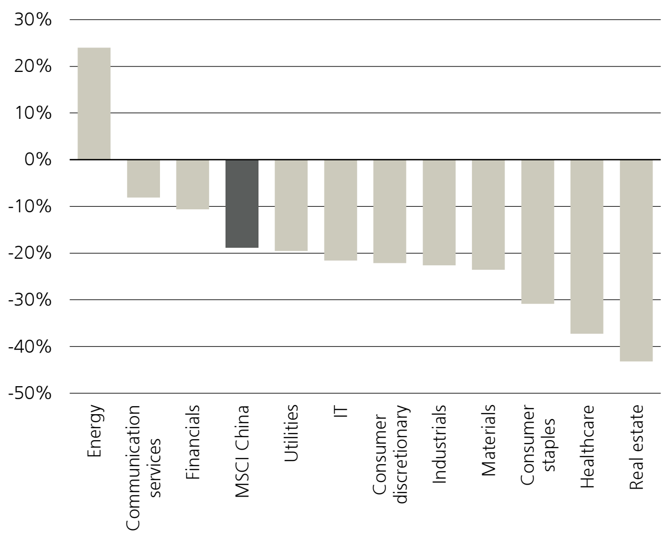
Look for yield support offshore

We also think select Hong Kong equities can be a lower risk proxy to a turnaround in mainland China. Dividend yields are at the high end (4.3% on average) compared to both history and their onshore peers, offering a decent degree of protection amid the volatility. The market is also more sensitive to Fed policy, which we still expect to begin easing from mid-year onwards. Finally, the close correlation between MSCI HK and MSCI China makes the former a beneficiary of greater onshore policy and macro upside.

Altogether, more than 60% of the MSCI HK basket either offers attractive dividend yields (financials and property) or quality China beta (insurers and gaming). Following a sharp year-to-date selloff, we see a mid-teen rebound for the overall index and see opportunities to position in companies with resilient payouts and balance sheet strength.

Sectors with relatively higher dividend yields have outperformed since the beginning of 2023

MSCI China sectors share performance since 2023

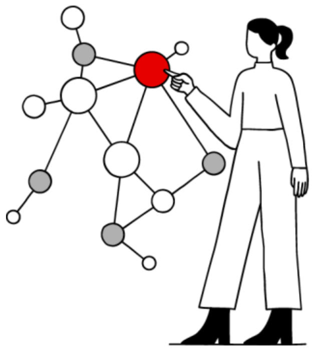


Note: MSCI Communication Services exclude telecom operators CM, CT, & CU.
Source: Bloomberg, UBS as of Feb 2024

Question 3

How to optimize tech exposure in Asia?

Authors: Sundeep Gantori, Delwin Kurnia Limas, Bennett Chu



Trade ideas: AI beneficiaries, AI infrastructure, supply chain names exposed to AI edge computing, tech leaders with significant market share.

Global tech stocks have performed strongly year-to-date amid resilient 4Q earnings results and a generally supportive management outlook over the next six to 12 months. With solid end-user demand and an improving monetization outlook, we raise our global tech (IT and internet) 2024 earnings per share (EPS) growth forecast—from 16% previously to 18% now.

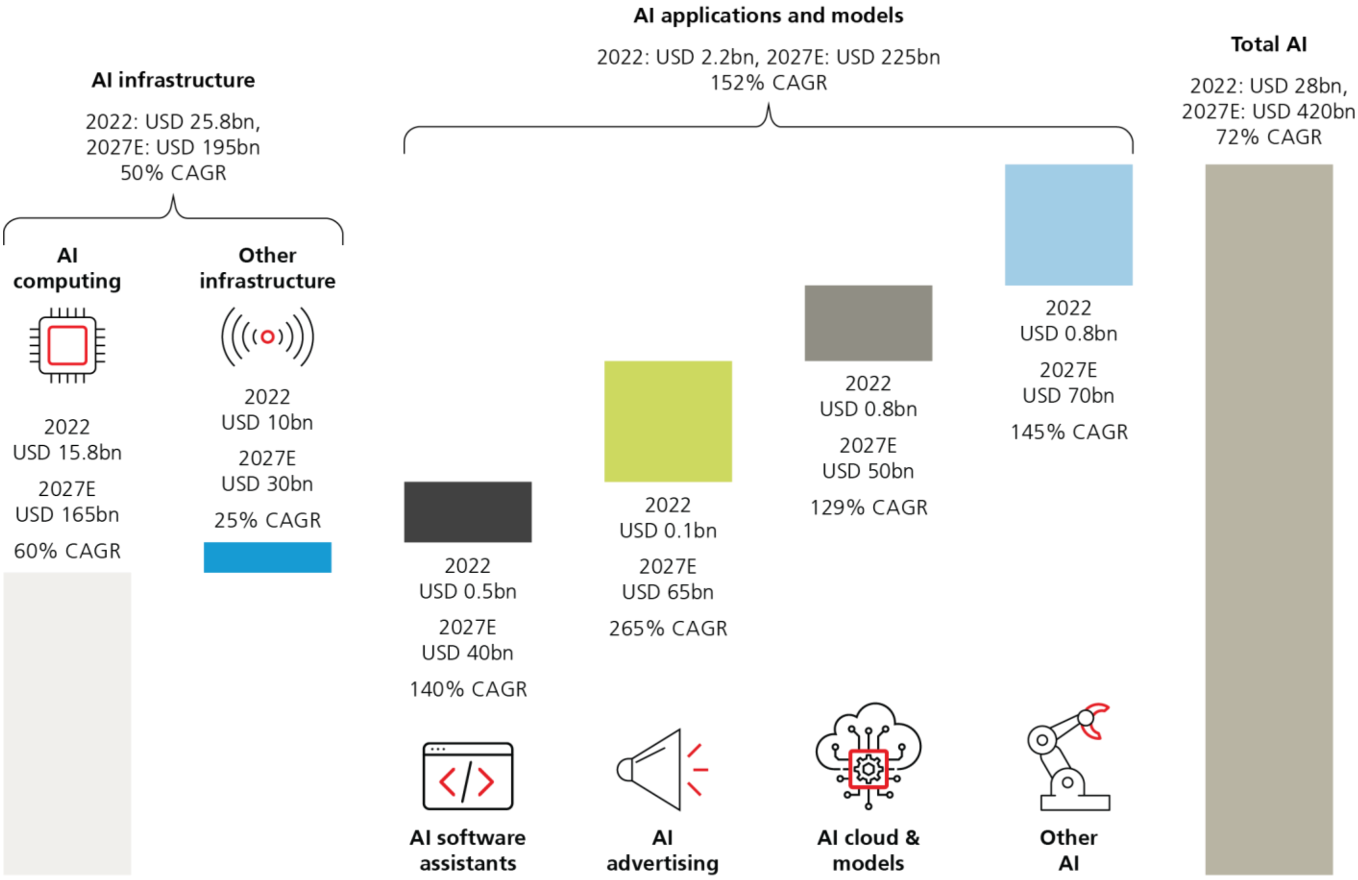
Staying constructive on AI beneficiaries

Our strong positive view on artificial intelligence (AI) is based on our belief that the two most important factors for the AI bull case remain intact. First, on monetization, we clearly see cloud revenues accelerating across leading hyper-scaler vendors, thanks to rising contributions from AI, which suggest AI monetization is picking up. Additionally, we're witnessing a broad-based increase in AI-related capex, with improving visibility for AI infrastructure spending.

Industry-wise, we've also recently raised our revenue estimate by 40%. We believe AI could be one of the fastest-growing and largest segments within global tech and arguably the "tech theme of the decade", as we don't see similar growth profiles elsewhere in tech. We now expect AI industry revenues to grow 15x between 2022 and 2027, expanding from USD 28bn in 2022 to USD 420bn in 2027, or a 72% CAGR.

Semiconductors and software are best positioned to ride the AI wave

15x growth expected in AI demand from 2022–27E based on our revised estimates, in USD bn



Source: Bloomberg Intelligence, UBS estimates, as of 2024

In fact, our forecast of USD 420bn in revenues in 2027 is conservative at 0.3–0.4% of global GDP, given the significant cost savings and new business opportunities AI offers. Meanwhile, our confidence in strong end-demand for AI stems from improving visibility for the infrastructure segment and broadening demand for AI applications and models.

Here, AI infrastructure primarily includes spending to train and run the related AI models and applications. These include computing—like graphics processing units (GPUs) and other chips—and other infrastructure spending on hardware, including networking and edge AI devices, among others. On a consolidated basis, we expect the AI infrastructure segment to grow from USD 25.8bn in 2022 to USD 195bn in 2027—a 50% CAGR, much higher than our previous estimate of a 38% CAGR.

This stronger outlook is also consistent with the guidance from leading AI suppliers in Asia, where we see additional drivers like GPU cloud and AI edge computing on top of strong demand for training and inferencing.

AI edge spending to benefit tech supply chains

While we believe the majority of near-term spending in generative AI computing will focus on data center investments (which are GPU-intensive), we think end-device AI chips and AI edge-computing can provide low latency and personalized generative AI services that are less resource-intensive. For instance, some basic image generation and translation services may not need a model with trillions of parameters, and may instead only require training a few billion parameters. Today, many smaller and dedicated AI chipsets can perform such tasks. We think they can be easily integrated inside end-devices like smartphones and PCs, and other segments like autos and Internet of Things (IoT) devices.

Here, we believe the ability to process data locally without being exposed to external data security risks could force many consumer electronics companies to explore such opportunities as they can still participate in the generative AI opportunity by integrating AI edge-computing chips in end-devices. In certain situations, the ability of edge devices to offload some basic computation from the GPU-intensive cloud-based computation can come in handy.

Similarly, we see smartphones and PCs as low-hanging fruit, and select Asia tech supply chain names exposed to these segments should likely see incremental demand. In these consumer devices, we see significant pick-up in the penetration of dedicated AI chips. In the medium to longer term, other consumer and industrial devices—including autos—should integrate AI edge chips to take advantage of the proliferation of generative AI applications. Overall, we believe the revenue from AI edge-computing devices has the potential to reach USD 30bn in 5–10 years. This is still only a low-single-digit share of overall semiconductor industry revenues, and may hence prove to be conservative.

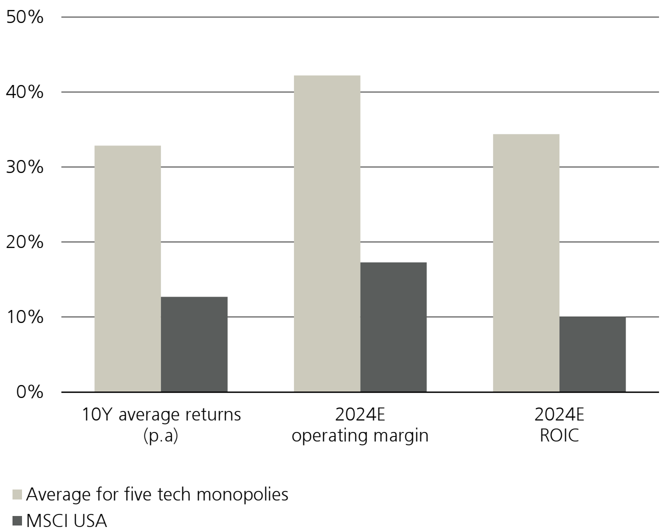
Attractive risk-reward for tech leaders

Investing in certain tech leaders with a significant market share has been highly rewarding, at least from an investment point of view. We have identified several such examples within tech that enjoy more than 80% market share in their respective addressable markets.

Indeed, as seen in chart below, they continue to offer compelling risk-reward. First, the historical 10-year returns have been highly impressive, with average annual returns of 32.9% versus MSCI USA's (a market known for high-quality companies) average annual returns of 12.7% over the past decade. Second, such tech leaders exhibit strong pricing power with average operating margins of 42.2% versus 17.3% for MSCI USA, and also almost twice the global tech average. From a quality point of view, these tech monopolies exhibit significantly high quality, with an average return on invested capital (ROIC) of 34.4% versus the MSCI USA average of 10.1%.

Envious performance record and strong margin and ROIC profile for the five tech monopolies we track

10Y average returns (%), 2024 operating margin (%), 2024 ROIC

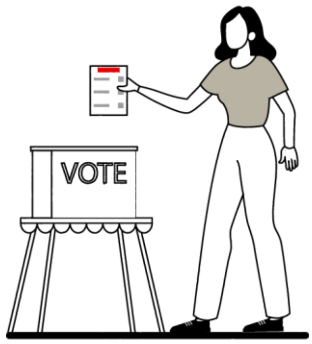


Source: Factset, UBS, as of 2024

Question 4

What impact will polls and populism have on Asia?

Authors: Hartmut Issel, Carl Berrisford



Trade ideas: South Korean and Taiwanese chip producers, select mainland Chinese semiconductor equipment makers with mature node processes, Indonesian banks and real estate, Indonesian IG bonds, India banks, short CNYJPY tactical trade (FX).

Volatility is on top of investors' minds as 2024's election supercycle continues. Countries comprising 60% of the world's economic output are going to the polls this year, with some already concluded.

But no election is more closely watched than the US presidential election, with its result likely to be deeply felt globally. We think there are three important areas to watch, particularly for APAC investors: 1) Imposition of tariffs; 2) fiscal support for green energy and mobility; and 3) fiscal spending.

Tar and feather

First, the imposition of tariffs. This is an area where US presidents generally have a high degree of autonomy. Should a Biden government prevail, we don't expect major changes, as history provides a clue—for instance, Trump administration tariffs on China have not been repealed under Biden but neither have they been raised. The Trump camp is currently calling for at least 10% in tariffs for any country exporting to the US and 60% for China's US exports, whereas under Trump 1.0, these tariffs were either not imposed or were lower.

Indeed, further technology restrictions on mainland China were not explicitly mentioned but remain a distinct possibility. If these materialize, it would benefit Taiwanese foundries and South Korean memory suppliers. We like these segments as they reflect the global semiconductor cycle rebound. In response, Beijing could restrict delivery of critical minerals, but it's debatable if this could sufficiently deter US restrictions. Tighter restrictions in mainland China would also hurt most semi companies, but select companies working on mature node processes, especially equipment makers, may benefit from domestic demand and policy support.

If Trump 2.0 occurs, the economic context will be different.

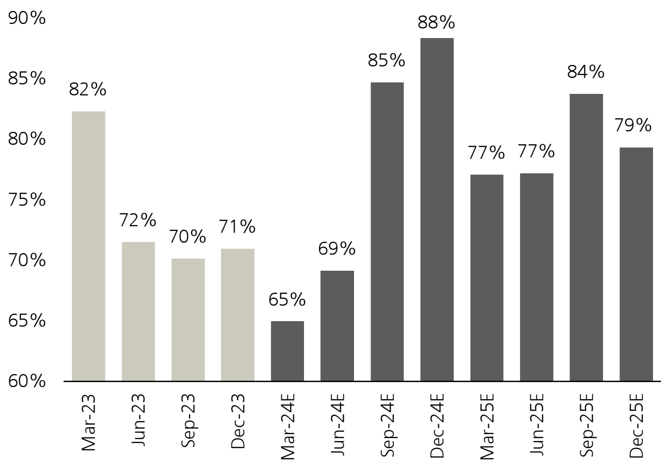
Green light to red

Next, if a Trump government is in place, we think green energy and mobility-promoting policies such as the Inflation Reduction Act would be called into question, and fiscal support for green energy and mobility could be withdrawn.

That said, this might have less of an effect versus Trump 1.0 for China's and Asia's solar and EV/battery supply chains. On the car and battery side, Chinese producers are already effectively blocked via high tariffs and exclusion from consumer incentives. Chinese solar companies would likely see an impact if their production in Southeast Asia starts to be constrained under tariffs, yet this only accounts for about 10% of their export capacity. Indeed, the overarching issue we see here is current global overcapacity, regardless of US elections.

Foundry business likely reached the trough

Example of expected capacity utilization for TSMC



Source: Company data, UBS, as of February 2024

Fiscal largesse unlikely

Third, we're watching closely if any US presidential candidate desires to revive large fiscal spending, following the uptrend in US debt-to-GDP levels in recent years. If so, higher yields could affect bonds and currencies (regional central bank behavior), as well as stock market valuations. However, potential resistance from Congress and the general public should render significant increases in budget deficits less likely.

Moreover, if Trump 2.0 occurs, the economic context will be different. Trump 1.0 took place when the US was in an early economic cycle, with rate hikes deployed due to rapid inflation. Now, the US economy is in a mid-to-late cycle, with moderating growth and inflation. The ability for fiscal stimulus looks more constrained now (fiscal deficit 6.4% of GDP, gross debt 124% of GDP) versus 2016 (fiscal deficit 2.7% of GDP, gross debt 105% of GDP), which limits the upside risk of US bond yields.

Overall, a potential Trump 2.0 doesn't significantly alter our view for a gradual slowdown of the US economy and rate cuts from the Fed. Our view for medium-term USD weakness versus APAC currencies remains intact. To hedge against US-China trade tensions under Trump 2.0, we favor a short CNYJPY tactical position. The CNY came under significant selling pressure during the escalation in trade tensions between June 2018 and November 2019, which prompted a peak-to-trough decline in CNYJPY of around 15% during this period.

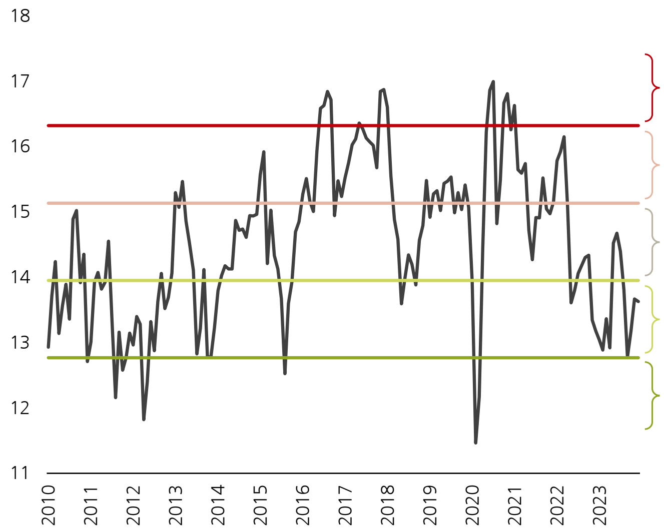
APAC policy continuity expected

As for elections in Asia, we generally see a preservation of the status quo ahead. In Indonesia, policy continuity, typically favored by investors, should ensue, with an ongoing focus expected for downstream projects, renewable energy, and infrastructure development. We expect the JCI index to reach 7,800 by year-end. We favor banks and real estate, along with potential election beneficiaries in the consumer and palm oil industries. We hold a constructive view on Indonesian IG bonds. The rupiah is still vulnerable to near-term volatility, but a broad-based weakness in the USD and lower US yields should provide a tailwind, driving USDIDR toward 15,300 by end-2024.

India's general election during April/May also points toward the same continuity. The latest opinion polls suggest the ruling NDA coalition might comfortably end up 23–34% above the required seat number (272). It even looks plausible that Prime Minister Narendra Modi's BJP party could secure a majority by itself and hence be less reliant on its coalition partners. This matters predominantly for the optically high market valuation, which has traded on a higher multiple since the BJP took power. Assuming this scenario works out and multiples remain steady after the election, the low double-digit upside we see for India is based on expected solid earnings growth in FY2025.

Indonesia's forward P/E is trading at an attractive level

Forward P/E and historical forward returns



Valuation range	Historical 6M forward relative returns (USD %)	Hit ratio (%)
More than 1.5 standard deviation	3%	31%
0.5 to 1 .5 standard deviation	0%	62%
–0.5 to 0.5 standard deviation	1%	57%
–1.5 to –0.5 standard deviation	8%	70%
Less than 1.5 standard deviation	15%	88%

Source: Bloomberg, Factset, UBS, as of 2024

Tactical views

Asset allocation

Asia ex-Japan equities

Japanese equities

Australian equities

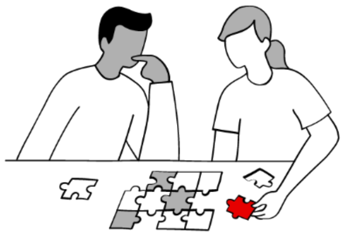
Bonds

Currencies

Commodities

Tactical view

Asset allocation



Authors: Adrian Zuercher, Chun Lai Wu

Current positions and changes

We remain focused on relative value opportunities in the Asia ex-Japan region.

Within equities, we keep India, China, and Indonesia as most preferred.

Singapore and Malaysia are maintained as least preferred.

Asia investment thesis

- **Macro environment remains stable.** Inflation in the region has worked its way down to around 3%, opening the door for Asian central banks to cut policy rates after the Fed in 2Q24. Growth in Asia is also returning to trend with help from recovering global orders, which favors North Asia for now. PMIs, however, are mixed, with no decisive tendency emerging yet. As a result, we believe it is still too early for a directional trend in Asian ex-Japan equities to form. We remain focused on relative opportunities, and keep our most preferred view on China, India, and Indonesia and our least preferred view on Singapore and Malaysia.

- **After last month's upgrade, Indonesia is kept as most preferred.** Quick counts of Indonesia's presidential election suggest there is no need for a second-round election, which should largely remove any political overhang and boost market sentiment. The macro picture also remains supportive: PMIs are consistently above 50 and key factors we track including construction spending and consumer spending are improving. Given high policy rates, moderating inflation, and healthy FX reserves, Indonesia could be one of the first markets in the region to deliver a rate cut. Fundamentally, 60% of the Indonesian equity market is financials, which should benefit from the high NIM guidance and healthy loan growth in the country.

- **India remains most preferred.** India's macro conditions are still supportive. Domestically, GDP has been strong and PMIs remain above 50. Although vehicle sales have been a tad softer recently, we think the overall macro environment is healthy. Externally, FX reserves are being rebuilt and balance of payment conditions don't seem to be a headwind for the INR. Since inflation is still high at 5.1%, we don't expect policy rate cuts in 1H24. Fundamentally, we think Indian earnings will keep trending upwards. The general election in April/May is a potential risk to watch, particularly given the stock market's valuation is slightly expensive, with a forward P/E at +0.9 standard deviation (std) above the 5-year average. But overall, we believe the downside risks for India look manageable for now.

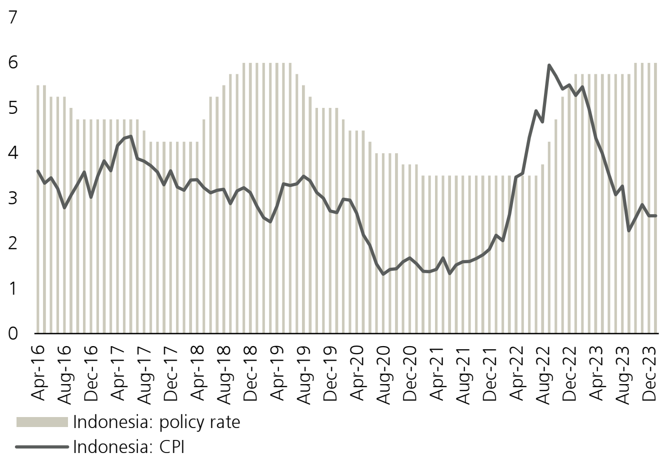
- **China also remains most preferred.** Equities have rebounded since late January, triggered by a potential CNY 2tr market stabilization fund, a 50bps RRR cut, and stronger regulatory actions. But PMIs and the CPI are tilted to the weak side, while credit data and Lunar New Year activities were stronger than expected. Given low stock valuations and the government's supportive policy stance, we stay most preferred and will watch early March's "Two Sessions" for stimulus clarity.

- **Singapore is kept as least preferred.** Macro conditions are recovering but continue to face headwinds. About 50% of the market comprise financials, with NIMs expected to fall in 2024. Earnings may be stabilizing, but valuations aren't cheap, with P/B at +0.1std above the 5-year average. The upside risk could come from a faster-than-expected recovery in global orders. We keep Singapore as least preferred until more upside catalysts emerge.

- **Malaysia is also kept as least preferred.** Its weak macro foundation sees PMI consistently below 50. Manufacturing export data is reasonable, but not strong. With a weak balance of payments and low policy rate of 3%, the room to cut rates is limited. Fundamentally, 40% of the market comprise financials, which expect NIMs of just around 2% in 2024. As a result, despite cheap valuations, the near-term upside appears limited.

Indonesia could be the first in the region to deliver rate cuts, given its high policy rates and moderated inflation

Indonesia policy rate (BI 7d reverse repo rate) vs Indonesia CPI y/y, in %



Source: Bloomberg, UBS, monthly data as of 31 January 2024

Tactical view

Asia ex-Japan equities

Authors: Sundeep Gantori, Delwin Kurnia Limas, Hartmut Issel

Key trends

- **Turbulent start to 2024.** Asia ex-Japan equities have had a mixed start to the year, with a low single-digit decline in the regional index. Mainland China, Hong Kong, and Thailand have been the key underperformers amid mixed macroeconomic data, weak consumer sentiment in China, and a potential delay in fiscal stimulus in Thailand. India, Indonesia, and the Philippines have been relatively resilient, partly thanks to strong earnings and positive management guidance in the banking sector for the latter two markets. Notwithstanding potential rate cuts over the next 6–12 months, we believe the risk-reward for these banks for the next billions remains attractive given their robust loan growth outlook and relatively stable asset quality.

- **Management guidance points to a recovery.** Around half of Asia ex-Japan companies have reported their 4Q earnings. Overall, the results were mixed: Only 30% of companies beat earnings estimates while 46% of companies missed. That said, constructive management guidance on an earnings recovery in 2024 was a key positive. Following an estimated 8% earnings decline in 2023, we expect Asian corporate earnings to rebound 18% in 2024. Tech will likely be a key driver for this turnaround, and should contribute nearly 80% of the overall rebound. Our positive view on the sector is reaffirmed by the upbeat management guidance, particularly from the leading foundry, AI server ODM, and memory companies.

- **Asia tech supply chain is well placed to benefit from the rise of edge AI.** While we see most of the near-term spending in generative AI computing focusing on data center investments, which are GPU intensive, end-device AI chips and AI edge-computing can provide low latency and personalized generative AI services and address data security risks. Smartphones and PCs are likely low-hanging fruit, and select Asia tech supply chain names exposed to these segments should benefit from incremental demand. In these consumer devices, we see a significant pickup in the penetration of dedicated AI chips. Looking further ahead, other consumer and industrial devices, including autos, could integrate AI edge-chips to take advantage of the proliferation of generative AI applications. Overall, we believe the revenue from AI edge-computing devices has the potential to reach USD 30bn in 5–10 years, which would still only represent a low-single digit share of overall semiconductor industry revenues. That means these estimates may prove too conservative.

Where to invest

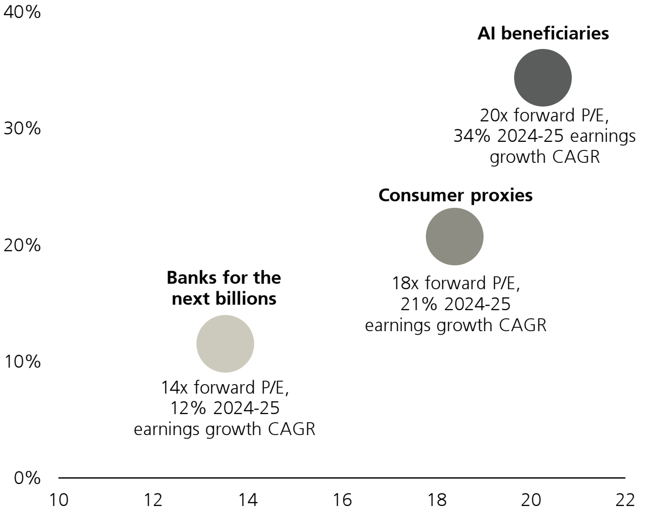
China's medium- to long-term opportunities. Value-driven retail trends, increasing global presence, and strengthening technology supply chains are three core drivers that will likely dominate the investment landscape in China's new normal of moderating growth. We advise investors position in names that benefit from these investment drivers in the autos, consumer, healthcare, technology, and gaming sectors.

Select growth opportunities in Asia. Within Asia tech, we like AI beneficiaries that are trading at reasonable valuations, China's software and cybersecurity segments, and IT services. In addition, banks for the next billions and select Asia ex-China consumer proxies offer resilient growth at attractive valuations, in our view.

Investing in Asian titans: We have a clear preference for quality and large caps in Asia. In particular, we favor a benchmark-heavyweight driven strategy, given Asian titans hold solid market share positions, resilient growth outlooks, and other fundamental supports.

Three key Asia ex-China growth opportunities

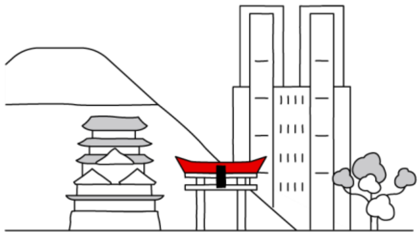
Valuation (Forward P/E, X-axis) and 2024–25 earnings growth (CAGR, Y-axis)



Source: Bloomberg, Factset, UBS, as of February 2024

Tactical view

Japanese equities



Authors: Chisa Kobayashi, Daiju Aoki

Key trends

- **The TOPIX has rallied by more than 10% YTD in JPY terms.** As was the case in 2023, a weaker JPY has been a key support with USDJPY once again pushing above the psychological 150 mark (from the low 140s). The 30 largest stocks by market capitalization have contributed to more than 60% of the performance this year, with beneficiaries of JPY weakness and AI-related stocks playing an oversized role.

- **Corporate governance reforms accelerate.** Non-life insurers recently indicated they will reduce cross-shareholdings to zero or significantly accelerate the pace of their exit, marking an important milestone in Japan's corporate governance push. These companies have over 500 holdings across different sectors, and unwinding these means share buybacks as a countermeasure will likely broaden into an EPS growth driver for Japanese equities over the medium term.

- **The Shunto labor union wage proposal in March is key to BoJ policy.** Japan unexpectedly slipped into a technical recession in 4Q23 as GDP growth shrank by 0.4% annualized (vs. the consensus estimate of 1.1%) following a revised 3.3% contraction in 3Q23. That said, we expect solid wage growth this year compared to 2023 (+3.6% y/y), allowing the BoJ to lift its short-term policy rate to 0% from –0.1% in 2Q24. However, we expect it will keep its JGB purchasing policy, and a rate hiking cycle is unlikely in 2024.

- **While corporate earnings remain strong, valuations are no longer cheap.** After solid December quarter results, we upgrade our corporate earnings forecasts to 12%/5% for FY23 (year-end March 2024)/FY24 from 9%/7%. Forward P/E is at 15.5x, reaching last year's high and above the historical average of 13.7x. But that looks fair compared to the MSCI ACWI (17.3x) and S&P 500 (20.6x), with the P/E discount to both markets still above the long-term average.

- **Focus on fundamentals and quality** given potential JPY appreciation due to the start of the Fed's easing cycle and normalization by the BoJ expected in mid-2024. We continue to prefer large-cap banks that are key beneficiaries of the BoJ's policy normalization, a rebound in the domestic economy, and corporate governance reform. We also like cyclical growth stocks.

Where to invest

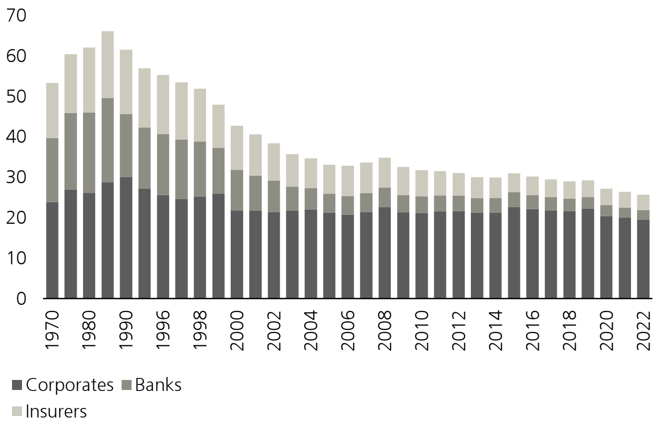
Large-cap banks. While Japanese banks outperformed the benchmark index in 2023, the sector's P/BV at 0.7x is still below pre-2016 levels when the BoJ first introduced negative interest rates. We think Japanese banks can re-rate higher as the BoJ normalizes and profitability improves amid a supportive macroeconomic environment. Meanwhile, potential share buybacks and a relatively high dividend yield of 3.5–4% are attractive.

High dividend stocks seasonally tend to perform well over the next few months as we approach Japan's fiscal year-end in March. Stronger expectations on corporate governance reforms are likely to lead to higher dividend payouts or share buybacks from companies trading at low P/BV and ROE.

Laggard growth stocks with an above-average earnings growth outlook in FY24, given expected lower 10-year US yields.

Over 20% of Japanese equities are held for non-investment purposes

Japanese equity holders by investor type, in %

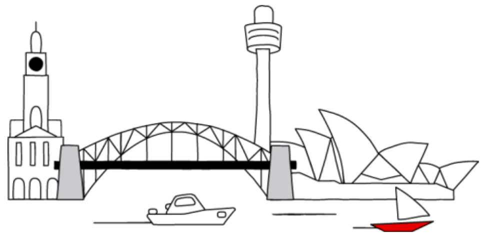


Source: Tokyo Stock Exchange, Bloomberg, UBS, as of February 2024

Tactical view

Australian equities

Authors: Wayne Gordon, Kayden Lee



Key trends

- **Bond rally pushes equities higher.** MSCI Australia extended gains in January (+1% in AUD terms), supported by investor confidence that the consumer slowdown is at its trough. However, in USD terms, Australia (–1.6%) lagged overall developed markets (+2%) but outperformed emerging markets (–3.9%). The top-performing sectors were financials (+4.5%), healthcare (+3.4%), and consumer discretionary (+3.2%), while the laggards were materials (–4.6%), IT (–3%), and consumer staples (–1.9%).
- **The moment of truth.** Australia is in the middle of its interim FY24 results season, with around half of all companies having reported (as of 21 February). The share of beats and misses stand at 44% and 34%, respectively. The standout so far has been better-than-expected results from discretionary retailers and financials versus weaker consumer, credit, and property-related macro indicators. Still, we hold a more cautious view, underpinned by a central bank that's unlikely to pre-emptively cut (we do not expect the RBA to cut until November 2024) and risks to greater margin compression ahead. We forecast low-single-digit EPS growth for 2024 given muted earnings growth and derating risks in 1H24 after the recent runup in multiples.
- **Global and domestic monetary policy signals are key factors.** Higher-for-longer interest rates will be a headwind for households over much of 2024, in our view. This has been reinforced by hawkish comments from RBA Governor Michelle Bullock at her inaugural press conference and again in her parliamentary testimony. With the pace and composition of inflation a risk in the year ahead, we think GDP growth will remain below trend and that a further deterioration in the labor market seems likely. However, in 2025, still-low unemployment, buoyant housing markets, strong public spending, and improvements in the global industrial backdrop (supporting commodities) should underpin a modest cyclical recovery.
- **Selective positioning is key.** We acknowledge investors traditionally "look through cycles," but we question whether they can sustain the current elevated levels of optimism as conditions deteriorate before an expected turnaround in 2025. We remain optimistic about the recovery next year as tailwinds strengthen from the redesigned Stage 3 tax cuts, a supportive budget, and the kick-off of the policy easing cycle—these are anticipated to lift household income, boost real purchasing power, and underpin a recovery in private demand. But in the short term, we believe some segments of the market could find themselves in a sort of "twilight zone," and so, we remain wary of stock prices being left in an air pocket after the current results period.

Where to invest

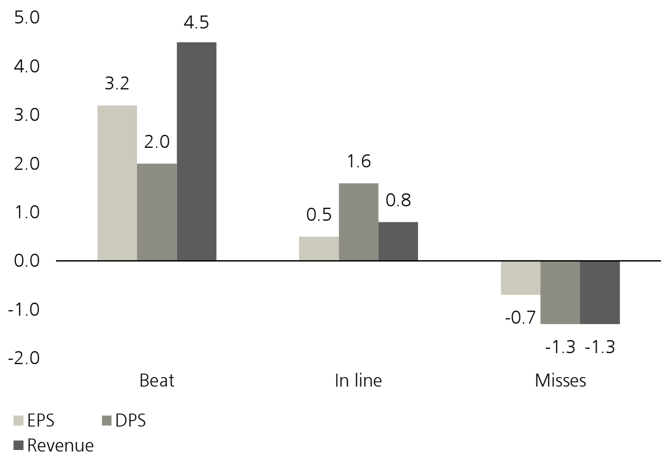
Quality income and defensive growth sectors preferred. We remain constructive on sectors such as insurance, infrastructure, and REITs. These are exposed to structural growth drivers and offer attractive dividend yields in the current environment, particularly as we expect 10-year yields to peak and the equity market to trend sideways. We also like select defensive growth names in IT and healthcare with solid fundamentals and growth drivers.

Constructive on select energy and mining. We continue to believe in further upside for these sectors, which we see as underappreciated by the market. There are particular pockets where valuations are attractive versus our forecast for higher industrial and precious metal prices in 2H24. The recent price correction has opened an attractive entry point to gain exposure to structural growth drivers.

Staying cautious on discretionary retail and select financials. We retain a degree of defensiveness and caution as some multiples have been pushed too far ahead of earnings. We question the resilience of current margins, particularly in the discretionary segments as job market conditions soften and wage growth slows.

On average, beats have been rewarded more than misses were punished on results announcement

1-day price reaction on results announcement relative to ASX200



Source: Bloomberg, UBS, as of February 2024

Tactical view

Bonds

Authors: Timothy Tay, Devinda Paranathanthri, Clarissa Chow

Key trends

- **Recovery in Asia/China HY lacks fundamental support.** Asia high yield has had a surprisingly strong start to the year (+3% YTD). The recovery is largely driven by several distressed names in China, India, and Indonesia. For China, policy has been supportive with initiatives supporting developer financing, but we believe it'll take time to alleviate credit stress in the property sector. Property sales in January were down 36% y/y and do not bode well for internal cash generation for developers. In India and Indonesia, several supportive corporate actions have driven bond prices, but these are more idiosyncratic cases and we think they are unlikely to repeat. Therefore, we don't expect such a strong performance to sustain in the coming months, and see little value in being exposed to broader Asia HY risk. Instead, we see select bottom-up opportunities in oil and gas, and Macau gaming.

- **Thai and Indian banks report decent earnings.** Indian bank earnings in the first nine months of FY2024 were resilient, driven by y/y net interest margin expansion and robust loan growth. Asset quality improved significantly as gross NPA ratios declined, while provision coverage ratios remained stable. Going forward, we expect loan growth to be constrained by funding, potentially leading to higher funding costs but stable capital ratios. India bank senior bond valuations look largely fair. Thai banks also reported robust 4Q23 earnings with higher NIMs and better asset quality. Across the capital structure, we retain our preference for Tier 2 bonds versus senior bonds issued by Thai banks, as we view the spread pickup as attractive.

- **Continue to stay positive on Indonesia IG after the election.** We believe Indonesian sovereign fundamentals are on a solid footing due to a few reasons: 1) The fiscal deficit improved materially in 2023 (1.7% of GDP) and is likely to be close to 2% in 2024; 2) Debt-to-GDP level of 39% in 2023 was one of the lowest in the rating category; and 3) Indonesia's current account is likely to stay relatively stable, close to being balanced. If the sovereign can sustain these improvements in 2024–25, we believe a positive outlook change by rating agencies may be on the cards. Indonesian sovereign and quasi-sovereign valuations already reflect these improvements to a large degree. But given the stable fundamentals, we continue to prefer playing duration in this space for now.

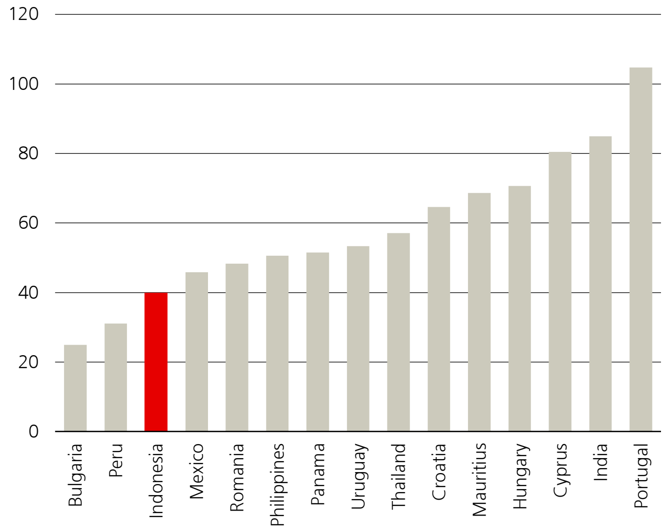
Where to invest

Within IG, we prefer a barbell strategy of IG combining short duration and high quality long bonds. Indonesia IG and select Thai T2s also offer value.

Very selective in HY. We prefer select fundamental improvement stories, such as Macau gaming.

Indonesian debt levels compare favorably to BBB-rated peers (2023E)

Debt to GDP (%)



Source: JP Morgan, UBS, as of February 2024

Tactical view

Currencies

Authors: Dominic Schnider, Teck Leng Tan, Wayne Gordon

Key trends

- **Markets are no longer pricing in aggressive Fed rate cuts.** Following a series of strong US economic data (nonfarm payrolls and January CPI), the interest rate futures market is currently pricing in less than four rate cuts this year, with the first expected in June. This marks a sharp turnaround from the start of this year when markets priced in nearly 170bps of rate cuts in 2024, with the first cut expected in March.

- **Room for further near-term USD strength has diminished.** The US dollar index has rebounded by around 3.5% year-to-date, helped by the sharp repricing of Fed rate cut expectations. Market pricing of Fed rate cuts now look more consistent with our view for 75bps of cuts in 2024, with the first likely in June. Barring further upside surprises in US data, we believe room for more USD upside looks limited versus Asian currencies.

- **We expect APAC currencies to rebound by 3–4% on average versus the greenback this year.** Within Asia, we expect a rebound in GDP growth for electronic export-oriented economies such as Singapore, Korea, and Taiwan thanks to a recovering global manufacturing cycle, which should provide a tailwind for these currencies. High-yielding currencies such as the INR and IDR also look attractive, as investors look for yield carry amid easing global bond yields. On the other hand, we expect the CNY to underperform regional currencies as the PBoC keeps policy settings accommodative amid ongoing growth challenges.

- **We also expect the JPY to rebound once the Fed signals its readiness to cut rates toward mid-2024.** Having underperformed significantly between 2021 and 2023 while the BoJ remained on the sidelines as other central banks engaged in a rate-hiking cycle, we believe the tide is now starting to turn for the yen. We expect the yen to appreciate toward 140 against the USD by end-2024 as the Fed cut rates while the BoJ proceeds with gradual policy normalization.

Where to invest

Position for medium-term JPY strength by being outright long the yen versus low-yielders (e.g., TWD, CNY) instead of the high-yielding USD. A less prohibitive cost-of-carry provides holding power to capture an eventual lift in the yen. Sell downside risks in the yen for yield pickup (e.g., USD, CNY, SGD).

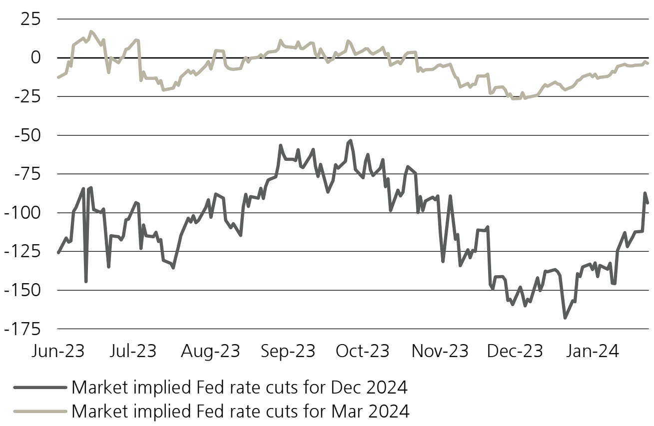
Long AUD (vs. EUR, CHF). We maintain a long AUD position versus the EUR and CHF in our global portfolios. The Reserve Bank of Australia should be the last major central bank to cut rates, which should allow the AUD to outperform the European currencies. The CHF stands out as an attractive funding currency.

Long INR, IDR (vs. CNY, TWD). Yield-carry strategies should do well this year given global central banks are likely to cut rates and global bond yields should fall. So, we favor buying high-yielding INR and IDR relative to low-yielding currencies like the TWD and CNY.

Long KRW, SGD (vs. CNY). The KRW and SGD are key beneficiaries of an electronic export recovery and medium-term USD weakness. The CNY's upside potential looks constrained by ongoing growth challenges.

Fed rate cut expectations have been significantly pared back

Market-implied Fed rate cuts for March 24 and December 24 (in bps)



Source: Bloomberg, UBS, as of 14 February 2024

Tactical view

Commodities

Authors: Dominic Schnider, Giovanni Staunovo, Wayne Gordon

Key trends

- **Sideways so far in 2024.** Our benchmark UBS CMCI total return index is flat this year, but there is a dispersion within the sector, with livestock and energy rising by more than 5% and industrial metals down by more than 4%. Our return outlook for commodities remains positive, and we expect broadly diversified commodity indexes to appreciate by mid-to-high single-digit rates, with a total return of around 10% for the full year.

- **Large drop in visible oil inventories.** January saw visible crude and refined product inventories falling by 60mn barrels, according to the International Energy Agency. With oil demand holding up, and lower supply from OPEC+ countries, we see the oil market staying undersupplied and lifting Brent crude oil to USD 86/bbl by mid-year.

- **Silver linings emerge in base metals.** We see further supply disappointments and structurally low exchange inventories providing conditions for higher prices in industrial metals this year. While prices will likely remain volatile in the near term on global growth concerns, structural demand drivers for the sector are still in place, which we think should drive a recovery over the coming quarters.

- **Gold – a hedge with benefits.** Gold prices temporarily dropped below the USD 2,000/oz level as US CPI data beat to the upside. In the short term, prices will likely remain range-bound, but with a Fed rate cut mid-year as our base case, a revival in gold ETF demand remains a key catalyst, which should support gold toward our USD 2,250/oz target by end-2024. Also, we expect another year of solid demand from central banks after reserve managers purchased over 1,000 metric tons in 2023 (the second year in a row). We continue to like gold as a portfolio hedge against risk events. We recommend an allocation of around 5% in diversified and balanced USD-based portfolios.

- **Agriculture has been bifurcated,** with the grain sector stepping down by 10%+ YTD while soft commodities, led by cocoa and cotton, have rallied by 11%+. We remain least preferred on grains and most preferred on softs in our active strategy. For grains, weather-related risks have eased this year, with expectations of higher production in South America, improved US wheat conditions, and the chance of another Russian crop exceeding 100mn tons. Among softs, cocoa has been the standout as El Nino-related damage means deficits will likely persist over 2024–25. Livestock, in aggregate, has risen by around 10% this year; we hold a moderate overweight to the sector in our active strategy.

Where to invest

Opportunities in longer-dated oil contracts. Longer-dated oil contracts are trading cheaper than spot prices. While commodity markets tend to price in the "now," futures curves, as a rule, don't hold much predictive power. So, vanishing available spare capacity should support longer-dated contracts, in our view.

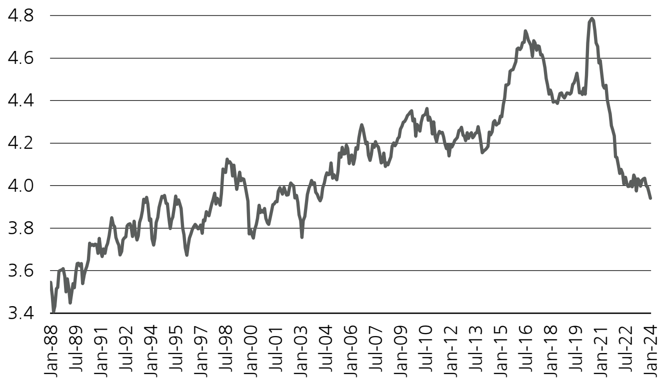
Gold still a good hedge. We continue to recommend investors use gold as a hedge despite being neutral in the global asset allocation—within a balanced USD portfolio our analysis shows around a mid-single digit percentage is most optimal.

Volatility-selling strategies. On an individual commodity level, we see opportunities to engage in selling downside in crude oil, copper, gold, and platinum.

Long select critical metal miners. Recent share price setbacks in producers of metals and materials vital to the low-carbon transition offer opportunities to buy select companies on a five-year view. We prefer quality companies with high revenue exposure to the commodities of aluminum, copper, and rare earths.

OECD commercial and strategic oil inventories

Values are in billion barrels



Source: IEA, UBS, as of February 2024

Asset class preferences

As of 22 February 2024

	Least preferred		Most preferred
Liquidity		⊜	
Global equities			
Equities total		⊜	
United States		⊜	
Eurozone		⊜	
Switzerland		⊜	
Emerging markets			⊕
Japan		⊜	
United Kingdom	⊖		
Asian equities			
Asia ex-Japan equities		⊜	
China			⊕
Hong Kong		⊜	
India			⊕
Indonesia			⊕
South Korea		⊜	
Malaysia	⊖		
Philippines		⊜	
Singapore	⊖		
Taiwan		⊜	
Thailand		⊜	
Bonds			
Bonds total			⊕
High grade bonds			⊕
High yield bonds		⊜	
Investment grade bonds			⊕
Emerging market bonds		⊜	
Asian investment grade bonds (USD)		⊜	
Asian high yield bonds (USD)		⊜	
Chinese government bonds		⊜	

Asset class preferences

As of 22 February 2024

	Least preferred		Most preferred
Commodities			
Commodities total		=	
Oil			+
Gold		=	
Foreign exchange			
USD		=	
EUR		=	
JPY		=	
GBP		=	
CHF	−		
AUD			+

Note: These preferences are designed for a global investor who can hedge foreign currency fluctuations. For models that are tailored to US investors, please see *UBS House View: Investment Strategy Guide*.

Least preferred: We expect this asset class to deliver the least attractive risk-adjusted returns over the next 12 months within our asset class universe.

Most preferred: We expect this asset class to deliver the most attractive risk-adjusted returns over the next 12 months within our asset class universe.

Source: UBS

UBS APAC forecasts

APAC economic forecasts

% change y/y

	GDP				CPI			
	2022	**2023E**	**2024E**	**2025E**	**2022**	**2023E**	**2024E**	**2025E**
Australia	3.8	2.0	1.5	2.1	6.6	5.6	3.4	3.1
New Zealand	2.4	0.8	1.3	2.5	7.2	5.7	3.0	2.3
China	3.0	5.2	4.6	4.6	2.0	0.2	0.8	1.6
Indonesia	5.3	5.0	4.8	5.1	4.2	3.7	3.0	2.8
Malaysia	8.7	3.8	4.0	4.4	3.4	2.5	2.2	2.8
Philippines	7.6	5.6	5.7	6.0	5.8	6.0	3.6	3.1
Thailand	2.5	1.9	2.8	3.3	6.1	1.2	0.8	1.7
South Korea	2.6	1.3	2.0	2.2	5.1	3.7	2.3	2.0
Taiwan	2.4	1.1	3.1	2.9	2.9	2.5	2.2	1.9
India	7.2	7.3	6.2	6.2	6.7	5.3	4.5	4.5
Singapore	3.6	1.2	2.4	3.2	6.1	4.8	3.2	1.7
Hong Kong	-3.5	3.6	2.5	2.8	1.9	1.8	1.8	2.1
Japan	1.0	2.0	0.6	1.0	2.5	3.3	1.9	1.6
Asia ex-Japan	**4.2**	**5.2**	**4.7**	**4.8**	**3.6**	**2.1**	**2.0**	**2.4**
APAC	**3.9**	**4.8**	**4.3**	**4.4**	**3.6**	**2.3**	**2.0**	**2.4**

Source: UBS, as of 20 February 2024

UBS APAC forecasts

APAC currencies versus the USD

We expect a medium-term recovery of APAC currencies versus the USD

	22-Feb-24	**Jun-24**	**Sep-24**	**Dec-24**	**Mar-25**
USDCNY	7.19	7.20	7.15	7.15	7.15
USDIDR	15610	15700	15500	15300	15300
USDINR	82.9	83.00	82.00	81.50	81.50
USDKRW	1329	1300	1280	1260	1240
USDMYR	4.79	4.70	4.65	4.60	4.60
USDPHP	55.9	56.0	55.5	55.0	55.0
USDSGD	1.34	1.34	1.32	1.31	1.30
USDTHB	35.8	36.0	35.8	35.5	35.0
USDTWD	31.5	31.3	31.0	30.5	30.5
USDJPY	150	145	142	140	138
AUDUSD	0.66	0.69	0.71	0.72	0.72
NZDUSD	0.62	0.61	0.62	0.62	0.62

Source: Bloomberg, UBS, as of 22 February 2024

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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.

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- 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 no-tice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
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