Year Ahead 2024

A new world

Asia Pacific | Chief Investment Office GWM | Investment Research

Year Ahead 2024 – UBS House View

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Foreword

Welcome to the *Year Ahead 2024*.

2023 was a historic year for markets. Bond yields reached their highest levels in more than 15 years. The first trillion-dollar artificial intelligence company was crowned. The robust health of the US economy, despite major rate rises, confounded expectations.

Of course, the year was also a historic one for us at UBS, and I would like to take the opportunity to thank you for continuing to place your trust in us. It's our privilege to help you realize your financial goals in the coming year and beyond.

In this *Year Ahead*, we look ahead to what we call "a new world," one characterized by economic uncertainty and geopolitical instability, but also profound technological change.

We think it will pay to focus on quality in 2024. As interest rates fall, we expect quality bonds to deliver both attractive income and capital appreciation. And we believe it will be quality stocks, including many in the technology sector, that will be best positioned to grow earnings in a slowing global economy.

As the new world develops, and as the trends of deglobalization, demographics, digitalization, decarbonization, and debt have a growing impact on economies and markets in the years to come, we expect to see a wave of disruption across the technology, energy, and healthcare sectors in particular. We expect investment success over this time frame to be driven by identifying the "leaders from disruption," and the associated investment opportunities in both public and private markets.

We hope this *Year Ahead 2024* provides you with the right context, analysis, and ideas to help navigate your portfolio through a new world. We look forward to partnering with you on that journey.

Iqbal Khan
President, UBS Global Wealth Management

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To find out more about the *Year Ahead 2024*, visit ubs.com/yearahead


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A new world

The economic and political aftereffects of the global pandemic continue to reverberate, years after its onset. We are in a new world. It's time to build a plan, get in balance, and stay disciplined, yet agile.

Mark Haefele
Chief Investment Officer
Global Wealth Management

Never before in human history has a pandemic caused governments to forcibly and almost simultaneously shut down their economies and then shock them back to life. The result? The return of inflation, labor market stress, and a surge in interest rates, bond yields, and government debt. At the same time, wars in oil-producing regions, a maturing China, and the rise of national industrial and environmental policy are remaking the geopolitical sphere. And while the old threat of great powers at war seems to be returning, new developments in artificial intelligence (AI) might also transform humanity.

This leaves us in a new world, one defined by economic uncertainty and geopolitical and environmental instability, but also profound technological change.

What should we expect in the year ahead?

First, we expect slower growth for the US economy in 2024 as consumers face mounting headwinds. We expect European growth to remain subdued, and China to enter a "new normal" of lower, but potentially higher-quality, growth. We think this environment speaks in favor of tilting equity allocations toward quality stocks, including in the technology sector, that can deliver earnings growth even against a backdrop of slowing global growth.

Second, we expect central banks to start cutting rates in 2024. In our view, government bond markets are overpricing the risk that high interest rates will represent the new normal, and we also expect yields to fall in 2024. This speaks in favor of limiting cash allocations and locking in yields in quality bonds.

Third, we expect politics to have an outsized role in 2024. The US presidential election, the Israel-Hamas and Russia-Ukraine wars, and the ongoing rivalry between the US and China could all have global market repercussions. And political decisions to engage in large and unfunded fiscal spending create both upside and downside investment risks to base case economic forecasts. Investors should prepare to hedge market risks. We see capital preservation strategies, macro hedge funds, oil, and gold as hedges to focus on in 2024.

A decade of transformation

As we look to the decade ahead, we expect the effects of AI, China's maturing economy, the energy transition, and high global debt levels to grow larger still.

We think AI will spur meaningful value creation across a range of sectors. For now, investors have focused on the likely beneficiaries from AI hardware and platforms, but the potential spillover into applications will reach far and wide.

A new normal is coming into view for China. Constraints on old growth models will likely see slower growth than the norm over the past two decades. Investments aligned with the country's efforts to boost higher value-added manufacturing, drive a green transition, and develop greater self-sufficiency should be best positioned.

Concerns about climate change and national security will drive a global transition toward decarbonization. Achieving a complete transition to a carbon-zero economy is a complex undertaking. But significant investment in decarbonization projects should mean high growth potential for solution providers in the space.

Government investment in technological, environmental, energy, and physical security—as well as aging populations—means debt levels are likely to rise. We believe higher debt levels will contribute to higher volatility in fixed income, but also more opportunities for private investors to supply financing. These trends speak to the importance of building alternative assets into diversified portfolios for investors able to manage the specific risks associated with them.

What should investors do?

First, make sure you have a plan. In this new world, data has become more available but not necessarily more informative. The pervasiveness of social media means each data point is amplified more than ever before. The result? The power of stories to influence behavior has grown, information (or disinformation) can impact markets faster than ever, and popular opinion can flip in a matter of days. A clear plan, linking strategies with goals and values, can help investors stay focused on the bigger picture in an increasingly noisy world.

Second, investors should get in balance. In our base case, we expect positive returns for balanced portfolios in 2024, and our scenario analysis suggests that multi-asset diversification should also prove effective at hedging risk scenarios. Over the longer term, we believe that investors who keep a diversified multi-asset portfolio—traditional or sustainable—as a "core" investment strategy are most likely to successfully protect and grow real wealth over time.

Third, stay disciplined yet agile. Discipline is key to successful investing: Given the right "core" strategy, the adage of "time in the market, not timing the market" has held true over time. But equally, markets evolve and investors' needs change. Investors should therefore regularly review their plans for strategic allocations, tactical allocations, and "satellite" investment ideas.

Lessons from "the old world"

As we enter a new world, it would be easy to feel a sense of trepidation. Yet it's worth remembering that since 1900, the world has seen two world wars, nine pandemics, hundreds of civil or regional wars, more than 2,000 nuclear detonations, revolutions in both the world's largest and most populous countries, at least a dozen hyperinflations, over 15 bear markets, over 20 recessions, and almost 200 sovereign defaults or debt crises.

When it comes to investing, all these years of adversity have taught us three things: the value of global diversification, the virtue of patience, and, most important, the resilience and ingenuity of humankind.

We wish you a happy, healthy, and prosperous year ahead.

Redd F | Unsplash

What's the outlook for growth?

We expect the strength of the US economy in 2023 to give way to slower, though still positive, growth in 2024 as consumers face mounting headwinds. We expect European growth to remain subdued, and China to enter a "new normal" of lower, but potentially higher-quality, growth.

US

A long-awaited slowdown. US economic growth was more resilient than expected in 2023, with the support of excess consumer savings. In 2024, we think growth is likely to slow. High interest rates are likely to curb the propensity to spend: Items often purchased by borrowing, like houses and cars, are the least affordable they have been in years. Households are having to grapple with the end of childcare subsidies, the trimming of Medicaid rolls, and the resumption of student loan payments. And we think savings rates are likely to rise as confidence ebbs.

No significant contraction. While we expect a slowdown, we do not expect a significant contraction in activity. It would be historically unusual for the US economy to avoid a recession after a period of rate hikes, but we think there is cause for optimism this time. First, job security among the key spending group of middle-income households is likely to remain high. Second, we expect solid investment spending related to artificial intelligence, semiconductors, infrastructure, and green energy. Third, strong household and business balance sheets should mean a degree of resilience against negative shocks.

Europe

Some support. Real consumer incomes should rise because of falling inflation and a resilient labor market, and we expect those to translate into higher consumer spending. Households have already accumulated precautionary savings and reduced debt. Supportive fiscal policy, particularly in southern and eastern Europe, should also stimulate growth, as funds from the

NextGenerationEU fiscal plan drive investment in infrastructure and low-carbon energy production.

Headwinds remain. We expect European growth to remain sluggish overall. Monetary policy will likely stay restrictive through next year, even after the three rates cuts we expect. Bank lending will likely be constrained by pressure on bank profitability, less generous support from the European Central Bank (ECB), and concern over remuneration of reserves. Subdued external demand and high energy costs are likely to weigh on exporters and manufacturers.

China

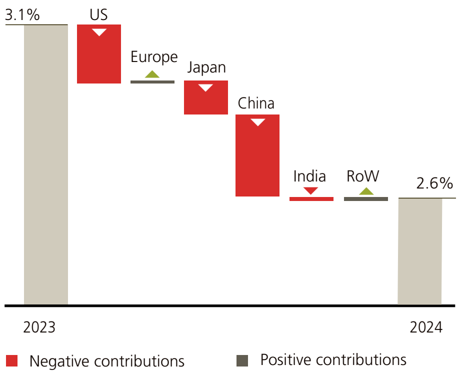
A new normal. We expect the Chinese economy to grow by 4.4% in 2024, below an estimated 5.2% in 2023, weighed down by muted consumption, slow external demand, and challenges in the property sector. Over the longer term, a shrinking labor force, structural limits to trade-driven growth, and a fragile geopolitical balance mean the era of over 6% annual growth for China is likely behind us.

Still a growth engine. A new normal for the Chinese economy is no reason to write it off, however. Beijing recently announced a CNY 1 trillion bond issuance program that could lift next year's GDP growth by 0.4–0.8 percentage points, and this could foreshadow more policy action in 2024. Longer term, we expect consumer spending, leadership in the carbon transition, and industrial supply chain upgrades to provide durable and quality growth drivers.

Figure 1

US and China to become drivers of slowing global growth

Global GDP growth forecasts and main contributors to the slowdown



Note: RoW = Rest of the world
Source: UBS, as of November 2023

What will China's new normal mean for the decade ahead?

Read more in the Decade Ahead section at ubs.com/yearahead

Investment implications

Buy quality bonds. We think slower growth will lead to lower interest rate expectations, and lower yields, in 2024, making high-quality bonds an attractive investment opportunity. For more, see page 27.

Buy quality stocks. We expect equity markets to rise broadly, but particularly like quality companies, including those in the technology sector, with the potential to grow earnings against a backdrop of less robust economic activity. For more, see page 28.

UBS real GDP growth forecasts

2023		2024	
2.4%	▶	1.1%	US
0.5%	▶	0.6%	Eurozone
5.2%	▶	4.4%	China

Source: UBS, as of 13 November 2023

Lessons from history

Can the Fed defy history and avoid causing a recession?

History suggests that aggressive monetary tightening often, but not always, leads to a recession.

Since 1971, there have been eight cycles of interest rate hikes before the current one in which the Federal Reserve raised rates by more than 200 basis points. A recession followed in five of those instances, including in all four when rates were hiked by 375bps or more. In two, 1983–84 and 1994–95, the Fed achieved a soft landing. The conditions that allowed this included future inflation expectations being well anchored, a tight labor market, and sizable household savings—three features that are present in today's environment. The recession in 2020 was triggered by the coronavirus pandemic.

Our base case remains that the US will achieve a "soft-ish" landing in 2024, thanks to robust labor demand, solid investment spending, and strong consumer and business balance sheets.

What's the outlook for rates and yields?

We expect central banks to commence rate-cutting cycles in 2024. In our view, government bond markets are overpricing the risk that high interest rates will represent the new normal, and we expect yields to fall in 2024.

Inflation and rates

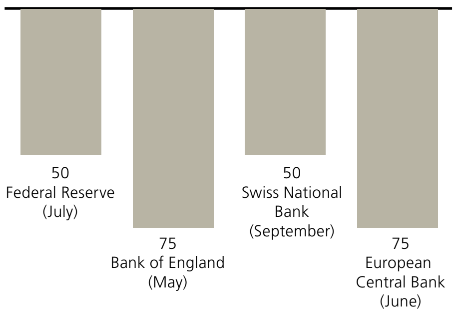
Back to normal. Inflation made progress toward central bank targets in 2023, and in 2024 we believe that journey will continue. In our base case, we expect US and Eurozone core consumer price inflation to end 2024 in the 2–2.5% range. Key drivers include falling homeowner-related inflation, weaker consumer demand, and slower wage growth.

Expect lower rates. We believe that the combination of lower growth and lower inflation should lead to interest rate cuts in 2024. Although inflation will likely remain above the 2% targets through most, or all, of the year ahead, we believe policymakers will be sufficiently confident by midyear that inflation is falling sustainably toward

Figure 2

Our expectations for central bank rate cuts

Cumulative rate cuts in 2024, in bps, and month of first rate cut (in parentheses)



Source: UBS, as of November 2023

target. Our base case is for the ECB and Bank of England each to cut rates by 75bps in 2024, while we expect the Fed and Swiss National Bank to ease by 50bps next year.

Yields

Markets pricing higher-for-a-lot-longer. Markets are implying that the Fed will not cut rates below 4.2% over the next five years. While it is possible that interest rates could stay higher for longer than we expect, we consider it highly unlikely that the Fed will not need to cut rates below 4%, or otherwise intervene in markets, within the next half-decade. Over that time frame, at least one recession, period of low inflation, or financial turbulence should be considered likely. Political decisions to engage in large and unfunded fiscal spending create risks to this view.

Expect bond yields to fall. We expect slower economic growth in 2024 to lower interest rate expectations, both over the short and longer term. Commensurate to this, we expect the 10-year US Treasury yield to fall to 3.5% by the end of next year. As we discuss in more detail in our bonus content (see link below), we estimate the equilibrium 10-year yield to be 3.5% (based on a combination of inflation of 2–2.5%, a neutral real interest rate of 0.5–1%, and a term premium of 0.5%).

Investment implications

Manage liquidity. With interest rates and rate expectations set to fall, we believe investors should ensure they don't hold too much cash, and look to optimize potential returns. For more, see page 25.

Buy quality bonds. We believe that quality bonds have attractive yields and the potential for capital appreciation if markets start to price lower expectations for interest rates in 2024. For more, see page 27.

Are higher debt and higher rates the new normal?

Read more in the Decade Ahead section at ubs.com/yearahead

Lessons from history

What does history suggest about the path for rates and yields?

Peak rates don't last long. In the 10 instances of Fed rate-hike cycles since 1970, interest rates stayed at the peak for a median of three months. The shortest "hold" was just one month, and the longest 15.

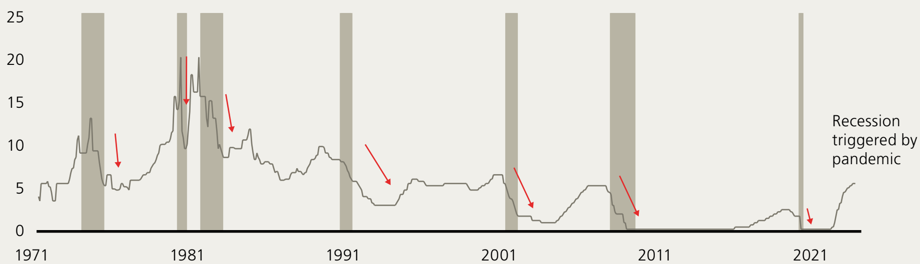
Cuts can be sharp. When the Fed started cutting rates, it cut by an average of 260bps in the first 12 months (excluding 1987 and 2006, when rates rose again after a pause) and 410bps within the first 24 months. Today, markets are pricing 150bps of easing within the next two years.

Yields come back to earth. While the recent rise in 10-year US Treasury yields has been swift, it is not without precedent: Since 1962, there have been 16 episodes in which the long yield has climbed by more than 100bps over six months. All but one of them (1979–80) were followed by a decline in yields over the following 12 months. We believe this time will be no exception.

Figure 3

Rate cuts can be sharp

Federal funds rate, in %, with US recession periods shaded



Source: Bloomberg, UBS, as of November 2023

How will politics shape markets?

We expect politics to play an outsized role in 2024. The US presidential election, the ongoing Israel-Hamas and Russia-Ukraine wars, and the rivalry between the US and China could all affect markets globally. Investors should prepare for bouts of politically driven volatility and consider hedges.

US presidential election

Sizing the odds. President Joe Biden and former President Donald Trump currently hold significant leads in their quest for the nomination from their respective political parties.

Betting markets ascribe a 70% chance of Biden becoming the Democratic nominee—an unusually small number for an incumbent seeking reelection. Meanwhile, although Trump has an 80% chance of securing the Republican nomination according to betting markets, legal obstacles could undermine his appeal to unaffiliated voters and reduce his chances of securing the presidency—the markets are putting this probability at 35% (and Biden at just 30%). An outside risk is that this dissatisfaction could lead to third-party candidates tipping the election or even preventing a candidate from winning the majority of the Electoral College votes, throwing the election decision to the House of Representatives.

A divided Congress is likely. We think a divided Congress is the most likely scenario after the elections in 2024. We expect the Republicans to assume control of the Senate because they have fewer seats to defend. However, we believe the Democrats have a higher chance of retaking control of the House, with some Republicans facing tough reelection campaigns in the aftermath of the ousting of former Speaker Kevin McCarthy.

A divided Congress would mean that legislation would need to be passed on a bipartisan basis. This would reduce the likelihood of sweeping domestic reforms—such as changes to tax or health policy, or a rollback of climate spending—being introduced, but the sitting president would retain discretion on foreign policy, including areas like trade relations with China and the US's stance with respect to the Russia-Ukraine and Israel-Hamas wars.

Israel-Hamas war

Amid a growing humanitarian crisis, the Israel-Hamas war remains highly fluid. At the time of writing, the conflict remains a contained confrontation confined to Hamas and Israel in the geographical areas under their control. The risks, however, appear tilted toward the downside case of a regional escalation that draws in other nations. Israeli ground operations in Gaza, and exchanges of fire between Israel and Hezbollah and other Iranian proxies, point to the risk of escalation.

Impact on oil markets. In our base case, we expect Brent to trade in a USD 90–100/bbl range. But if Iranian crude exports fall by around 500,000 barrels per day, this could push oil prices to USD 100–110/bbl. A broadening of the conflict across the region, involving other oil producers, could push oil prices above USD 120/bbl.

Russia-Ukraine war

At the time of writing, the war is having a relatively limited day-to-day impact on global financial markets. That said, the tightening in global oil markets has left the world more vulnerable to other supply shocks.

America first? If Biden were to secure re-election, we would expect a continuation of the status quo in which the US supplies financial and military support to Ukraine. However, if Trump runs on an "America First" platform and is victorious, we would expect US financial and military support for Ukraine to significantly decline. This would leave European governments needing to materially increase spending—a fiscal risk—or accept potential Russian military gains.

US-China rivalry

Trade and tech. US-China trade relations appeared to have found a new uneasy equilibrium in 2023, but China's efforts to become self-sufficient in semiconductor production are testing this balance. The White House is attempting to block Chinese access to foundational AI chips and chipmaking technology.

Taiwan. While we expect mutual interest in cross-strait and US-Taiwan cooperation to continue, heightened US-China tensions surrounding Taiwan could have material consequences on global supply chains, with second-round impacts on both global markets and diplomatic relations.

Investment implications

On page 34, we detail some of the primary ways investors can hedge portfolios in 2024, including through capital preservation strategies, oil, gold, and hedge funds.

Lessons from history

Do US presidential elections impact markets?

While the US presidential elections are important for domestic and foreign policy, our research shows that they do not have a reliable impact on markets. We recommend investors express their political preferences at the polls and not with their portfolios.

Don't vote with your portfolio

S&P 500 calendar-year total returns in election years since 1928, in %

*Excluding 2008, when the S&P 500 fell by 37% chiefly as a consequence of the global financial crisis.
Source: Bloomberg, UBS, as of November 2023

Scenarios

Base case scenario: Soft-ish landing

Probability: 60%
S&P 500: 4,700 I US 10-year: 3.5% I EURUSD: 1.12

We expect both equities and bonds to deliver positive returns in 2024. Slowing US economic growth, falling inflation, and lower interest rate expectations should mean lower yields, supporting bonds and equity valuations, while the absence of a severe US recession should enable companies to continue to grow earnings.

Upside scenario: Liftoff

Probability: 20%
S&P 500: 5,100 I US 10-year: 5% I EURUSD: 1.18

We expect positive returns for equities and flat returns for bonds. Strong economic growth buoys corporate earnings growth, investor sentiment, and ultimately equity prices. By contrast, resilient growth and persistently above-target inflation keep bond yields elevated or push them even higher, leading to flat bond returns.

Downside scenario: Hard landing

Probability: 15%
S&P 500: 3,500 I US 10-year: 2.75% I EURUSD: 1.00

We expect equities to deliver negative returns and bonds positive returns. A sharp slowdown in growth—possibly resulting from the cumulative effect of interest rate hikes enacted so far—results in a moderate or severe recession. Grim investor sentiment and sharply lower earnings expectations feed into equity price declines. Bonds fare well as interest rate expectations plummet and investors seek safe havens.

Alternative downside scenario: Bond vigilante

Probability: 5%
S&P 500: 3,800 I US 10-year: 6% I EURUSD: 1.10

We expect both equities and bonds to fare poorly. Bond yields continue to rise, potentially due to fears about excess budget deficits, higher energy prices, or a drawn-out period of above-target inflation. Higher bond yields also weigh on equities as higher interest rates pull down estimated fair valuations and as some investors reallocate away from stocks and toward bonds.


Paolo Sbalzer | pexels

How should I invest in 2024?

To navigate the year ahead, we believe investors should focus investments around five broad ideas.

Manage liquidity

With interest rates likely to fall, we believe investors should limit overall cash balances and take opportunities to optimize yields, using fixed term deposits, bond ladders, and structured solutions.

Buy quality

We expect positive returns for both equities and bonds, but focus on quality. We expect quality bonds to deliver both yield and capital appreciation. And we believe stocks with a high return on capital, strong balance sheets, and reliable earnings are best positioned to generate earnings despite weaker economic growth.

Trade the range in currencies and commodities

We expect US dollar stability as we enter 2024, yet USD weakness may emerge as the year progresses. We therefore think it is appealing to sell USD upside to generate yield. In commodities, we expect Brent crude oil to trade in a USD 90–100/bbl range through 2024.

Hedge market risks

Geopolitical uncertainty means investors need to prepare for volatility ahead. In addition to diversification, investors can further help insulate portfolios against specific risks through capital preservation strategies, using alternatives, or with positions in oil and gold.

Diversify with alternative credit

We expect elevated price and spread volatility in fixed income amid high global debt balances. This is a supportive backdrop for various credit strategies including credit arbitrage and distressed debt.

Manage liquidity

We believe investors should limit overall cash balances and optimize yields in the year ahead. War and geopolitical uncertainty may increase the perceived safety of cash, but we expect interest rates to fall in 2024, reducing the return of cash and increasing reinvestment risks. Investors should use a combination of fixed term deposits, bond ladders, and structured solutions to cover expected portfolio withdrawals over the next five years.

Fixed term deposits

Interest rates on cash are poised to fall in 2024, in our view, as global growth and inflation moderate. With this in mind, we believe investors should use fixed term deposits to lock in currently high yields on cash, and cover potential expenses and liabilities up to 12 months out. Investors concerned about issuer and counterparty risks can diversify their deposits. Investing in fixed term deposits of different maturities can also help match liabilities and reduce interest rate and reinvestment risks.

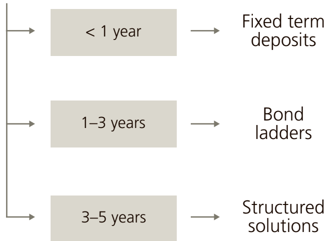
Bond ladders

Bond ladders can help provide investors with added certainty over future returns. A bond ladder involves buying a series of individual short-duration bonds of varying maturities, staggered to provide a steady stream of income, and aligned with the size and timing of expected portfolio withdrawals over the next 12–36 months. We see current yields on short-duration bonds as attractive, and do not expect current yields to last if central banks cut rates. Holding quality bonds may also offer scope for gains in downside economic scenarios.

Structured solutions with capital preservation features

For cash intended for use in 3–5 years' time, liquidity and safety concerns need to be balanced with the opportunity costs from potential stock market rallies. Investors concerned about limiting losses but also participating in equity gains can consider structured solutions with capital preservation features. Lower bond prices and lower equity market volatility in 2023 have improved the pricing of such strategies, which should mainly be focused on covering longer-term liabilities, since costs may apply if investors need to sell before maturity.

How to structure your liquidity



Source: UBS, as of November 2023

Changes in interest rates, implied volatility, and dividend levels can also influence the pricing of structured solutions. Investors should be aware of the additional risks borne when using structured solutions or other options-based strategies, including that the issuer fails to meet its obligations or repay an investor's principal at maturity.

Buy quality

We expect positive overall returns for both equities and bonds in the year ahead. But within each asset class, we believe investors should focus on quality. In fixed income, quality bonds offer attractive yields and should deliver capital appreciation if interest rate expectations decline, as we expect. In equities, quality companies with strong balance sheets and high profitability, including those in the technology sector, appear best positioned to generate earnings in an environment of weaker growth.

▸ The outlook for bonds

We expect government bond yields to fall in 2024, supporting positive returns for the asset class.

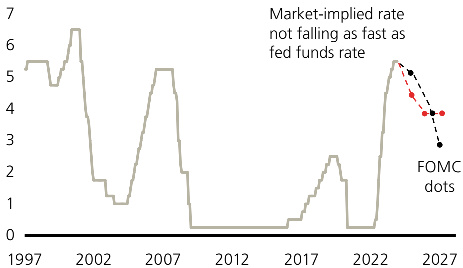
We think weaker growth should contribute to lower interest rate expectations. Market expectations that the Fed will not cut rates below 4% within the next five years are overly hawkish, in our view. And in an uncertain world, we believe government bonds could periodically attract safe-haven flows.

Quality bonds. We think this is an opportune time to add to high-quality bonds—specifically high grade (government) and investment grade. Current yields should

Figure 4

The market is overly hawkish

Federal funds rate, market pricing based on forwards, in %



Source: Bloomberg, UBS, as of November 2023

provide attractive returns, with positive returns possible across a range of scenarios (see page 22), and particularly in downside economic scenarios.

We see value in the 1- to 10-year duration segment, and particularly the 5-year duration point. We believe this middle part of the yield curve offers an appealing combination of higher yields and greater stability than the longer end, as well as some sensitivity to falling interest rate expectations. We are somewhat more cautious on longer-term bonds due to their greater sensitivity to technical factors, including currently high Treasury supply.

We do see select opportunities in riskier credit segments, including high yield credit and emerging market bonds. However, tighter lending standards, higher refinancing costs, and slower economic growth suggest higher default risks. Liquidity risk premiums may also rise as global money supply shrinks. As a result, we see high yield spreads as vulnerable to widening relative to investment grade and high grade.

The outlook for equities

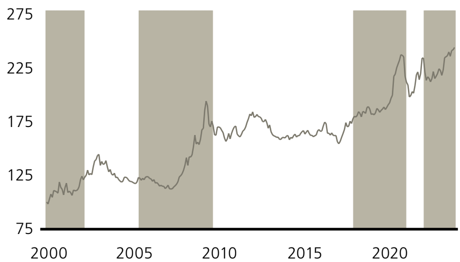
We expect a moderate rally in global equity indexes in 2024 as earnings grow, and as interest rates and bond yields fall. In our base case, we see the S&P 500 rising to 4,700 by December next year.

We also see a 9% rise in earnings per share for S&P 500 companies next year after a flat outcome in 2023. We think that leaner inventories, one-off base effects in healthcare, and earnings contributions from the technology sector and other quality companies should offset cyclical headwinds

Figure 5

In the current environment, focus on high-quality stocks

Performance of high ROIC (top third of Russell 1000) relative to low ROIC (bottom third), sector neutral, indexed to 100



ROIC = Return on invested capital
Note: Shaded areas denote periods when the yield on 10-year Treasury minus the yield on 2-year Treasury is less than 0.75% or the economy is in recession.

Source: Bloomberg, UBS, as of November 2023

from slower US economic growth. We expect 3% growth for European companies and 16% from emerging markets.

We also believe that lower interest rates and bond yields should provide a tailwind for stocks, provided we avoid a meaningful contraction in economic growth. In 2023, the equity risk premium deteriorated as bond yields rose, making equities progressively less appealing relative to bonds. We expect that trend to reverse in 2024.

Of course, uncertainty around the broader macroeconomic and geopolitical outlook creates higher uncertainty around our earnings estimates, and the MSCI All Country World Index (ACWI) is trading at 15.9 times 12-month forward price-to-earnings, roughly 10% above its 15-year average. Hence, we maintain a neutral stance on equities overall, while we await opportunities to change our allocation to stocks.

Regionally, we like emerging market equities and view UK equities as least preferred.

Quality stocks. These are among our highest-conviction calls in the equity market. We believe that companies with strong returns on invested capital, resilient operating margins, and relatively low debt on their balance sheets will be best positioned to continue generating profits in an environment of weaker growth.

A proxy for these stocks, the MSCI ACWI Quality Index, has historically outperformed the MSCI ACWI by 1 percentage point over six-month periods in which growth has been slowing but staying positive (as measured by the Atlanta Fed GDPNow survey)—the environment we expect in 2024.

Also, quality stocks have historically outperformed in the late stages of the business cycle, including in periods of economic contraction, which should offer portfolio protection if the economy slows more than we expect. The quality tilt also aligns with our preference for US technology companies, which should be among the key beneficiaries of AI-related demand for both hardware and software.

Quality stocks typically have higher valuations than the overall index, but we think that quality is worth paying for in 2024. Investors can find quality stocks within US tech; stable quality-income and high-quality cyclical stocks in Europe; and in select names in Asia.

Focusing on sustainability in fixed income and equities

Investors can invest in fixed income and equities while aligning with sustainability objectives.

Multilateral development bank (MDB) bonds, which channel capital into development projects with environmental and social goals, are rated AAA and offer slightly higher yields than benchmark government bonds.

Sustainable bonds—comprising green, social, sustainability, and sustainability-linked bonds—offer comparable yields to otherwise identical traditional bonds while delivering transparency on the projects financed from their proceeds.

"ESG leaders" strategies within equities and bonds focus on companies with top metrics across environmental, social, and governance criteria. Some empirical research supports a link between companies with better sustainability management and financial performance, and ESG leaders' portfolios correlate strongly with "quality" factors, and typically enjoy valuation premiums across both equities and bonds.

Trade the range in currencies and commodities

As we enter 2024, the US dollar should be stable around current levels. But as the year progresses, USD weakness may emerge, which makes selling USD upside for a yield pickup attractive. In commodities, investors can position for potential carry returns while hedging against geopolitical or weather risks. We like yield generation strategies, or those that enable investors to systematically buy currencies at cheaper levels.

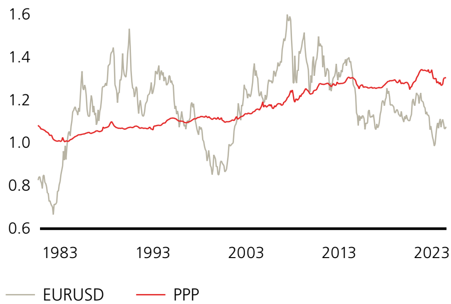
‣ The outlook for currencies

We expect the US dollar to stay stable in the first months of the year due to robust US economic growth and high US interest rates relative to the rest of the world. However, strong US economic performance and high relative rates are already priced in at current valuations. At the same time, gains by the euro, the British pound, and the Swiss franc are likely to be limited amid lackluster growth and data-dependent central banks. As a result, we favor yield pickup strategies within these currencies.

Figure 6

The USD remains overvalued

EURUSD and EURUSD purchasing power parity value



Source: Bloomberg, UBS, as of November 2023

The Australian dollar is our preferred currency as the Reserve Bank of Australia should be one of the last major central banks to cut interest rates. Favorable fiscal and external account positions add to an attractive currency mix.

We also like the Japanese yen given that the Bank of Japan is tightening monetary policy, and the authorities may step in to limit further yen weakness. That said, yen gains will likely be impaired by the currency's negative carry, requiring investors to focus on exchange-rate momentum.

We expect the Chinese yuan to bottom out against the US dollar in the early part of 2024. Nevertheless, we see limits to any CNY rebound considering China's structural challenges and ongoing geopolitical risks. We think this makes it hard for pro-growth currencies in Asia to perform unless economic growth outside the region surprises very positively.

Risks to our view include the US economy continuing to exceed expectations and deliver robust growth. On the flip side, economic activity in the Eurozone or China could come under further pressure, preventing their currencies from reaping the benefits of a dip in US growth. Geopolitical risks also abound—any escalation could make the US dollar's safe-haven characteristic shine again, likely only eclipsed by the Swiss franc.

Navigating currencies in 2024. For investors whose base currency is the US dollar, we think selling the dollar's upside potential for yield pickup or selling the dollar on rallies, is an attractive strategy. We think upside risk for the USD is limited in the short run, and that strong US economic growth is already priced in at current valuations.

For investors based in euro, the British pound, the Swiss franc, or select other currencies, we recommend finding range-trading opportunities in the crosses (see table).

Currency crosses	**Buy at lower end of range**	**Sell at upper end of range**
EURUSD	1.0–1.05	1.10–1.12
USDCHF	0.85–0.87	0.92–0.94
EURCHF	0.94	1.0
GBPUSD	1.19–1.21	1.26–1.30
USDJPY	137–140	152–155
AUDUSD	0.63–0.64	0.70–0.72

Source: UBS, as of November 2023

Meanwhile, we like the AUD from a carry perspective, and believe selling downside risks in the JPY, the Norwegian krone, and the AUD are appealing strategies from a spot risk and volatility perspective.

The outlook for commodities

With GDP growth likely staying subdued in China, hovering around zero in Europe, and declining in the US, the potential for commodity price gains is relatively limited.

But total returns should be supported by yields on cash collateral of more than 5%, and roll gains from downward sloping futures curves in energy and parts of agriculture. These should add 1–2 percentage points per annum to broad index returns (based on the UBS CMCI index).

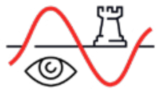
Overall, we expect broad commodity indexes to deliver low-teens percentage returns over the next 12 months. We think this strategy provides an attractive risk-reward trade-off to investors who continue to hold their positions, while also providing some protection against geopolitical and weather risks that threaten supply.

Trading the range. We like strategies that take advantage of the trading ranges within commodities, selling the upside in some cases, and the downside in others.

In energy, by restricting production, OPEC+ has created an artificial market deficit, although much higher prices would likely result in both a supply response and demand destruction. We see Brent crude oil prices fluctuating in a USD 90–100/bbl range, but with risks tilted to the upside given the potential for oil supply disruptions.

We expect gold to rise further to a record USD 2,150/oz by end-2024 if potential US rate cuts become a reality. However, in the short term, opportunity costs attached to holding gold remain elevated, so we favor buying on dips.

Hedge market risks



Investing against a backdrop of war and geopolitical uncertainty can be challenging, and investors need to prepare for volatility ahead. We believe that investing across asset classes and regions should be most investors' first defense against potential market turbulence. But investors can also further help insulate portfolios against specific risks through defensive structured investments, alternatives, or positions in oil and gold.

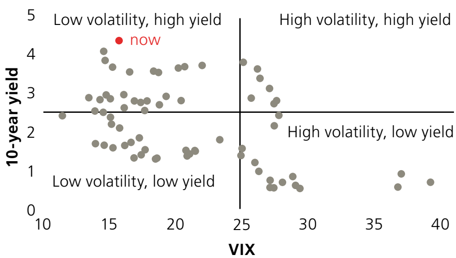
▸ Defensive structured investments

We expect positive returns for equities in 2024. But with geopolitical and economic risks likely to be prominent, investors looking to hedge against the risk of losses can make use of structured investments with capital preservation features. Such strategies are particularly attractive in times of higher bond yields and average or below-average implied equity market volatility. Another option to reduce direct exposure is through yield generating strategies, a strategy which is attractive when volatility is high—as in the fixed income markets at present.

Figure 7

Higher yields and low volatility a boost for capital preservation

Past 5 years 12-month trailing VIX average vs. 10-year US bond yield, based on quarterly data, and current level



Source: Bloomberg, UBS, as of November 2023

Oil and energy stocks

Investors worried about the potential market impact of further escalation in the Israel-Hamas or Russia-Ukraine wars can consider hedging portfolios through oil market investments or energy stocks. Investors with a high risk tolerance can consider adding exposure via longer-dated Brent contracts, which currently trade at a discount to spot prices, or selling the risk of Brent prices falling.

Gold

We think gold can provide a potentially effective portfolio hedge against rising geopolitical tensions. Current interest rate and geopolitical uncertainty may lead to choppy gold prices in the near term. But investors looking to add gold can consider buying the metal using options (buying below USD 1,900/oz). We think investors with existing long gold positions should hold onto them in anticipation of a recovery over the next 6–12 months.

Hedge by positioning for a steeper US yield curve

Investors concerned about widening US fiscal deficits could consider a steepening trade on the US government bond yield curve, buying 5-year Treasury bonds and selling 10-year ones (on a duration-adjusted basis). This takes advantage of the relatively flat yield curve to enact a "low cost hedge" against higher longer-dated bond yields. We would expect this position to perform well if investors demand more compensation for holding long-dated Treasuries, or if recession fears lead to lower short-term interest rate expectations.

Macro and multi-strategy hedge funds

Macro funds could also be an effective hedge and diversifier in 2024. They take advantage of macroeconomic volatility, using their top-down approach to navigate shifts in the economic landscape, central bank policies, and market conditions.

Meanwhile, multi-strategy funds, combining various hedge fund approaches, are also a potentially attractive way to diversify portfolios. These funds are typically highly diversified, reallocate dynamically, and exercise advanced risk management strategies. Investors should be aware of the risks inherent in alternative investments. These include liquidity risk, use of gearing, and limited disclosure requirements.

Diversify with alternative credit

We expect high global debt balances to contribute to elevated price and spread volatility, driving investors to seek ways to benefit from dispersion. This is a supportive backdrop for various alternative credit strategies including credit arbitrage and distressed debt.

Credit arbitrage

US credit markets have been in recovery since the fourth quarter of 2022. But lower-rated credit segments have underperformed, largely due to refinancing fears. Widening dispersion between borrowers makes credit arbitrage strategies a potentially attractive addition to portfolios.

In the current market, about a third of the US ICE BofA high yield index are trading at spreads below 300bps relative to the benchmark, 15% between 501bps and 800bps, and 9% above 800bps. This presents opportunities for discerning managers to make single-name credit choices based on fundamental analysis.

There are risks to consider when investing in this strategy. Alongside illiquidity and lower transparency than public markets, credit arbitrage portfolios are subject to near-term losses arising from higher levels of corporate distress, even if such distress may open up long-term opportunities. This underlines the importance of managing risk in stressed single-name credit and considering index portfolio hedges.

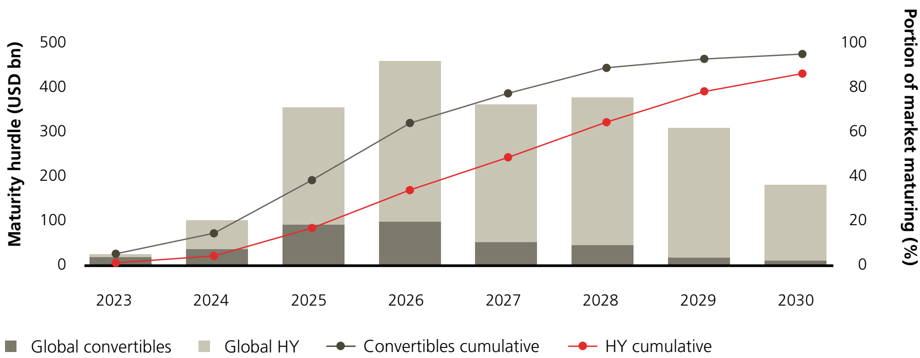
Distressed debt

We also see good strategic opportunities in distressed and special situation funds. Higher interest rates could put pressure on companies' ability to refinance. This should provide a consistent source of deal flow for distressed and special situation funds. The distressed opportunity is likely to be focused in areas of the market that have already seen some dislocation, with properties in bankruptcy and tenant distress. In other sectors, distressed funds could find opportunities in overly indebted businesses that struggle to cover interest costs.

Figure 8

Higher rates and the impending maturity wall put pressure on firms to repay loans, creating opportunities in distressed debt

Maturity wall of convertible and high yield bonds, in USD bn, vs. portion of respective market maturing



Source: BofA Securities, Bloomberg, UBS, as of November 2023


Kacper Peciak | Unsplash

The Decade Ahead

The economic aftermath of the pandemic has been wide-ranging and often unexpected. Inflation soared and stayed high. Interest rates jumped to levels not seen in more than 15 years. Yet despite rising rates, unemployment stayed low and growth remained robust.

The unusual mix of economic outcomes in recent years begs the question of whether the "new world" post-pandemic has also brought with it a new macroeconomic regime, in which the global economy shifts from one characterized by muted demand and excess supply, to one of constrained supply and robust demand.

The answer to that question will be defined by developments in what we call the "Five Ds": deglobalization, demographics, digitalization, decarbonization, and debt.

Deglobalization

A new world will likely be one in which economies are less integrated. We think trade as a share of global GDP has likely already peaked—with reduced trade accelerated by the US, Europe, and China becoming accustomed to exchanging sanctions, tariffs, and export controls. Tensions between the US and China also risk splitting the world into incompatible financial, trade, and technological blocs.

But precisely how deglobalization shapes the world economy in the decade ahead depends less on whether it happens and more on why it happens.

Should deglobalization occur mainly for political reasons—for example, due to increased trade restrictions or subsidies—it would likely constrain the overall supply of goods, reduce potential growth, or periodically lift inflation.

However, if deglobalization occurs mainly for economic reasons—a result of companies leveraging automation; focusing on integrated manufacturing; reassessing costs in light of rising wages in emerging markets; or building more resilient supply chains—the consequences are likely to be different. In this scenario, the net result is likely to be higher supply, lower inflationary risks, and higher potential growth.

Demographics

Demographics pose an increasing potential headwind in our new world. Half of the world economy measured by official GDP now has a declining population. Populations are shrinking in Japan, China, and several European countries. The ratio of retired to working-age people has risen globally from 11.8% to 14.8% in just the past decade, up more sharply in high-income countries from 23.2% to 29.1% over the same time period.

These trends represent a supply constraint. Economic growth is a function of growth in the labor force, capital investment, and productivity, so all else equal, lower labor force growth will mean lower potential economic growth. A higher proportion of retirees relative to workers will likely mean higher debt. In service-heavy economies, in which the potential for productivity growth is more limited, rising old-age dependency ratios could also contribute to higher inflation.

Whether the world economy can escape the negative supply-side effects of an aging population could depend largely on developments in our third D: digitalization.

Digitalization

The rise of artificial intelligence could presage an era of higher productivity. We see potential for an incremental annual increase of between 0.3% and 2% in the US alone.

If the full potential of AI is realized, it could help alleviate demographic challenges—supporting growth and driving disinflation in certain goods and services, despite shrinking working-age populations. Meanwhile, upfront investment in AI and related industries like semiconductors could boost demand in the near term.

However, the impact of AI may not be as profound if the technology mostly boosts supply in industries less affected by demographic challenges (e.g., chatbots supporting professional services) and fails to boost supply in areas facing greater pressures (e.g., physical robots supporting healthcare).

Either way, for investors, we think the rise of AI should support overall corporate earnings growth and opportunities in companies enabling, offering, or benefiting from AI technologies.

Decarbonization

The drive toward clean energy and zero carbon emissions has been reinforced by fears over energy security and extreme weather events. In the years ahead, we expect public and private capital to continue to support the energy transition.

In the short to medium term, we believe the energy transition could disrupt supply, as energy storage and grid connectivity obstacles constrain the reliability of renewable energy even as costs and operational risks for fossil fuels rise. At the same time, investments in the sector could help keep global demand robust.

In the longer term, we see the drive toward decarbonization as a net positive for global supply. Enabling a more abundant supply of energy at lower cost should contribute to higher potential growth, lower inflation, and more robust supply chains. For investors, solution providers as well as early adopters should stand to benefit most.

Debt

The future for the fifth D—debt—may depend on how the other four contribute to different growth, inflation, and interest rate outcomes. Global total debt has risen as a share of GDP since the global financial crisis in 2008, as the world has grappled with weak demand. Fortunately, abundant supply and low interest rates have meant that interest payments in proportion to government revenue have so far stayed close to all-time lows.

Looking ahead, demographic challenges and investment needs related to decarbonization, digitalization, and deglobalization look likely to mean rising government debt as a share of GDP. If rates and yields do not fall in the way we expect in the coming years, higher interest payments could start to pose a challenge for governments in the second half of this decade.

Debt will need to remain affordable, not least because many voters prefer low borrowing costs. The preferred path to achieve this is through robust economic growth, which could materialize with the widespread use of AI, abundant green energy, and localized supply chains. Failing these, then some combination of financial repression, taxes, surprise inflation, or default may be needed. Here, the answer may be less about markets and economics and more about politics, with different countries likely to choose different paths.

Scenarios

As we consider the decade ahead, we see four potential scenarios for the new macroeconomic normal in our new world.

Roaring '20s
Moderate inflation and high growth

Drivers could include high rates of investment linked to digitalization (AI), decarbonization, and defense. In this scenario, we would expect strong earnings growth and good performance from equities, but more muted initial performance from bonds as investors price interest rates staying higher for longer.

Brave new world
Low inflation and high growth

Potential drivers of this scenario include a prominent role for AI or a swing back toward globalization. We think this scenario would be favorable for both equities and bonds. We would expect good earnings growth to support equities, and lower interest rate expectations to support bonds.

Secular stagnation redux
Low inflation and low growth

Potential drivers include aging populations or the promise of AI and renewable energy not meeting expectations. This scenario would likely be initially positive for bonds as financial repression is used to manage rising debt burdens. Equity multiples could be supported by central bank stimulus, but companies could also struggle to deliver earnings growth.

Stagflation
High inflation and low growth

Drivers of this trend could include deglobalization, geopolitical tensions, and climate change. In this scenario, we would expect both bonds and equities to perform poorly (at least in real terms) as higher rate expectations and challenges to real earnings growth weigh on performance. Nominal returns for equities could still be positive.

Asset class expectations

Over the coming decade, we believe that cash will underperform other major asset classes, particularly in scenarios in which central banks return to financial repression. We see the highest returns in equities. Prospective fixed income returns should continue to improve. Good returns in underlying equity and bond markets should be supportive for the returns of alternative assets.

Cash

Cash rates are currently attractive, but we believe that interest rates are likely to fall in the year ahead. We also expect that cash, over the long term, will underperform other major asset classes like stocks and bonds, especially in scenarios in which central banks use financial repression to manage rising debt burdens. We recommend that investors hold no more than two to five years of expected net portfolio withdrawals in a liquidity strategy.

Government bonds

High yields bode well for government bond returns over the long term, and we also expect good returns in the near term as inflation and growth fall from today's levels. But while we expect yields to drop, we still expect them to stay higher than the pre-pandemic era, as increased investment needs related to deglobalization, digitalization, and decarbonization contribute to greater bond supply and higher estimates for the real neutral rate. We think this means an environment of consistent, attractive total returns for government bonds.

Credit

Credit spreads are currently relatively tight compared to historical norms. While we expect spreads to widen in the near term as growth slows, we still believe credit exposure is valuable in the context of a long-term diversified portfolio to benefit from both carry and diversification. Refinancing risks, slower growth, and less certainty about central bank intervention may contribute to higher fixed income volatility in the years to come, favoring an active approach to the asset class.

Equities

We expect equities to deliver the highest return among major asset classes in the decade ahead. Aggregate earnings growth should be well supported by robust growth in companies driving technological, energy, and healthcare disruption. That said, like-for-like, equity valuations are likely to be lower than in the past decade, given higher interest rates than pre-pandemic norms. Global diversification will be important to navigate a deglobalizing world. Emerging market stocks, for example, are trading at sizable discounts to historical levels, and we expect them to deliver the highest rates of return over the next decade.

Alternatives

We estimate that allocating a 20% exposure to alternatives in a balanced portfolio could increase expected returns by about 50bps a year over the long term, for an equivalent level of portfolio volatility. An environment of higher rates and attractive returns for traditional assets bodes well for hedge funds, which we think will remain an important portfolio diversifier in the years to come. We also see attractive opportunities in entering private markets today, where secondaries are trading at a compelling 16% discount to net asset value (NAV), while new private loans are yielding 12.5%. Investors should be aware of the added risks borne in alternatives, including illiquidity, the use of gearing, and less transparency than in public market investments.

Currencies

We expect the US dollar to depreciate over the longer term due to its elevated valuation and concerns over deficit financing. However, this view is largely compensated for by USD interest rates, so our expected returns for most asset classes are similar in hedged or unhedged terms. We also expect the JPY to catch up in the years to come given its significant undervaluation.

Commodities

We think prices will stay high over the decade ahead amid higher climate, supply chain, and defense spending. Given the cyclicality of the asset class, we favor investing in commodities via active approaches, or via equity sectors or in countries and currencies with high commodity exposure.

What will generative AI mean for markets and economies?

Generative artificial intelligence isn't a new concept—the broad idea has been around since the 1960s, and the transformer architecture that makes it more effective was detailed in 2017. But the launch of ChatGPT has shown its potential impact when combined with a platform with strong consumer adoption. Currently, we see AI-related opportunities across a range of software, internet, and semiconductor stocks.

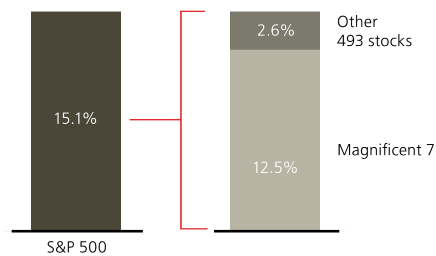
History shows that the advent of new technologies can create value across a range of sectors.

We use a four-part framework to help identify common ways that technological developments create value in adjacent sectors through time.

Figure 9

Contribution to S&P 500 performance

Magnificent 7 vs. remaining 493 S&P 500 stocks, year-to-date, in percentage points



Source: FactSet, UBS, as of 3 November 2023

Generative AI is the latest technology creating value across sectors

The innovation value chain: Breakthrough technology is powered by infrastructure and inputs, creating new hardware running on platforms of operators and enablers, benefiting the economy at large

Technology	Infrastructure / inputs	Hardware manufacturers	Operators and enablers	Application beneficiaries
Steam engine	Steel, coal	Trains, ships	Railroad and ship operators	Trade
Telephone	Telecom cables, electricity	Telephones	Network operators	Services, trade
Internal combustion engine	Steel, oil, auto parts	Car manufacturers	Service, insurance, dealerships	Retail, leisure, commuters
Television	Towers, satellites	Television sets	TV networks	Advertising, subscription business models
Computer	Semi-conductors	Mainframes	IBM	Professional services, manufacturing, aerospace
Internet	Routers, data centers	PCs	Windows, Internet Explorer	Search, e-commerce, cloud
Mobile internet	Towers, semiconductors	Smartphones	iOS, Android	Social media, e-commerce, gig economy
Generative AI	Cloud	Graphics processing units	Large language models	Text generation, programming, image/video generation

Source: UBS, as of November 2023

What does history tell us about technology innovation?

Infrastructure and input providers. Demand for necessary infrastructure and inputs understandably often booms in the immediate aftermath of innovation—think steel and the railway, oil and the automobile, semiconductors and the smartphone. But history shows that while providers of key inputs can earn high profits initially, over time their products can become commoditized. Infrastructure and input providers therefore may eventually need to learn to run at a high scale and with lower profit margins.

Hardware manufacturers. Innovative technologies can often drive the adoption of new consumer hardware (e.g., cars, TVs), and hardware manufacturers can therefore benefit from a surge in demand. At the early stages of a technology boom, hardware manufacturers may benefit from the uniqueness, quality, and novelty of their hardware. But sustaining leadership is often harder. Hardware can also become commoditized over time, and successful hardware companies often must learn to differentiate their products, potentially by integrating hardware with a leading operating system.

Operators and enablers. The largest and most enduring value creation derived from new technologies has historically tended to accrue to their operators and enablers. Railroad companies, radio and TV networks, software operating system developers, and digital platform companies are all examples of such enablers. In many cases, they have become the largest companies in the world at some point in time.

Application beneficiaries. Innovative technologies often create ecosystems of beneficiaries that may not be directly involved in the development of a technology, but may be well positioned to use them to build new businesses or improve the profitability of existing ones. Companies that increased cross-country trade following the advent of the steam engine, retailers that boomed due to mass car adoption, or businesses that engage in e-commerce and social media as a result of the internet are all examples.

Where does AI stand today?

We can see this historical framework at play in the early stages of the AI revolution:

Infrastructure and input providers (cloud). Cloud computing is a crucial input for generative AI because it provides the computing power needed to both train and make generative AI applications work. Much like historical "inputs" into other key technologies, cloud computing is in some sense commoditized—it is a standardized service with a low unit cost. That means there are significant economies of scale, and the largest cloud platforms are already run by the largest technology companies. Cloud providers are also able to "lock in" customers through bundled services.

Hardware manufacturers (GPU manufacturers). Graphics processing units (GPUs) are chips that are crucial to the training of neural networks, a cornerstone of AI, and are therefore seeing a strong surge and significant share price appreciation for the leading manufacturers. In the short term, we expect this demand surge to continue. In the medium term, we may see a period of "digestion" in which buyers identify and refocus on only the most promising use cases. Over the longer term, it remains to be seen whether chipmakers can continue to develop, evolve, and innovate their products to maintain pricing power, or if GPUs will become commoditized, forcing manufacturers to run at a higher scale and with lower margins.

Operators and enablers (large language models). Large language models (LLMs) can be thought of as among the key "enablers" of the AI ecosystem. Developing an effective large language model requires significant scale in data, computing power, and talent, and while models may be better suited to a specific application (e.g., generating text, code, or images), they are generally not specific to an individual domain (e.g., finance, law, or marketing). Ultimately, there may only be a few LLMs on which most generative AI applications are built. So far, the most notable have mostly been built by, or in a joint venture with, the largest technology companies.

Application beneficiaries (text generation, programming, image/video generation). ChatGPT has been a clear example of how generative AI can exhibit human-like text-generation capabilities. It can also be used to generate computer code, images, or video. We see significant opportunities over the next few quarters in the integration of AI "copilots" in office productivity software, in the rising demand for AI analytics, and in AI integration in image, video, and other enterprise applications.

Investment implications

An unusual feature of generative AI is that, right from the onset of the new technology, many of the same companies are already operating in multiple stages of the value chain—from cloud, to the ownership of LLMs, to the development of end-user applications.

With that in mind, it is perhaps understandable why the Magnificent 7 in the S&P 500, mostly AI beneficiaries, have seen their market capitalization grow by 67% (or USD 4.6 trillion) so far in 2023. With the significant resources needed to build and benefit from complex AI models, we expect the large players to grow larger still.

We believe that investors looking for exposure to AI should seek broad exposure across the value chain, including in cloud, semiconductor, software, and internet names. Related semiconductor companies should continue to see robust demand in the near term; key generative AI product launches across many of the Magnificent 7 are likely to keep the momentum high; and internet stocks should benefit as AI becomes more integrated in consumer applications like gaming, entertainment, and advertising.

While the long-term growth potential is large, investors should be prepared for potential short-term volatility or drawdowns. As with other technology booms, an initial surge in demand can often be followed by a digestion period for consumers and businesses. For long-term investors, such periods could present attractive entry points to increase exposure.

Economic implications

We think AI should meaningfully improve efficiencies and worker productivity, but the implications for economic growth are less clear. Depending on how AI is ultimately applied, it may result in unchanged output but increased leisure time.

Some jobs will become obsolete because of AI—few offices today have "typing pools," for example—but we should not necessarily expect a surge in unemployment. AI is likely to create at least some new jobs that were not previously thought of. Historically, roughly 10% of the labor roles that existed at the end of any given decade did not exist at its start. For example, employment in the entertainment industry has increased over the past decade as social media and streaming increased consumption of entertainment and reduced barriers to entry.

Over the longer term, AI will likely be disinflationary for prices in some sectors, but the extent of the economy-wide impact will depend heavily on the magnitude, location, and timing of AI's use. It is already becoming clearer how AI text, image, and video generation could put downward pressure on pricing for sectors including customer services, computer programming, legal, and entertainment.

Finally, periods of economic upheaval tend to create social tensions as those who see their income and status decline seek someone or something to blame. These tensions can lead to populist and prejudice politics. AI could also further escalate geopolitical tensions as countries enter an AI "arms race" as a defense against the potential applications of AI by their rivals. This trend is already evident in the recent restrictions on AI technology introduced by the US, and other retaliatory measures by China.

Antoine Bussy | Unsplash

Pick leaders from disruption

We expect some of the highest returns in equity markets over the decade ahead to come from those companies that can harness new technologies to grow markets, dislodge incumbents, or slash costs. Successfully identifying these "leaders from disruption" is critical to boosting long-term portfolio potential. We expect the decade ahead to see a wave of disruption rippling across industries from technology to energy to healthcare.

Technology disruption

The arrival of mainstream AI services accessible to consumers has driven significant investment into the world's largest technology leaders, crowning the first trillion-dollar AI company in the process. The Magnificent 7, mostly AI beneficiaries, have seen their market capitalization grow 67% so far in 2023. With access to all the computing, financial, human, and data resources they need to grow and exploit the potential of generative AI, the largest players could grow even larger over the coming decade, in our view.

13 June 2023

Nvidia becomes the first AI company with a market capitalization of

USD 1 trillion

But this is not a story limited to mega-cap tech. We think technological disruption will be an enduring theme that spawns new opportunities and leaders across sectors in the decade to come.

As discussed on page 45, from an investment perspective, the beneficiaries of AI can be broken down into four areas: infrastructure and input providers (cloud), hardware (GPU manufacturers), operators and enablers (large language models), and application beneficiaries (text generation, programming, image/video generation).

We therefore see AI-related opportunities across a range of software, internet, and semiconductor stocks. Based on Bloomberg Intelligence data, we now expect global AI demand to grow from USD 28 billion in 2022 to USD 300 billion in 2027—a 61% compound annual growth rate. In that time, we think the infrastructure segment will grow by 38%, and the applications and models segment by 139%.

Recent company product and earnings announcements in the software sector have provided a peek into AI's monetization potential. For example, new copilots are being rolled out rapidly. These are AI companion tools integrated within office workflow software to boost employee productivity, performing tasks that range from finding information to creating content. The ability to charge additional monthly fees for copilot add-ons gives subscription-based software companies an expanded scope for AI monetization.

Energy disruption

Concerns about climate change, national security, and advancing technology are driving global decarbonization. Creating an economy free of carbon emissions and transitioning to clean fuels is a complex undertaking. It will require investment in power generation, energy infrastructure, transport, industry, buildings, and heating and cooling systems, with the adoption of green technologies to achieve net-zero targets. We think investors will gain most through exposure to a number of these themes given the different stages of development across countries and sectors.

We expect global solar capacity to triple in the coming years from the current 1,000 GW, increasing the share of renewables in the global power mix. The share of renewables in electricity generation has already risen from 20% to 30% over the past decade. Investors can tap solar opportunities through diversified exposure to greentech, long-term exposure to the energy efficiency value chain, or more concentrated exposure to smart energy solutions.

We expect electrified vehicles (including battery electric and hybrid) to make up around 30% of global auto sales by 2025 and more than 60% by 2030, driven by incremental technological developments. The electric vehicle value chain is integral to greentech investment themes, especially in Asia and Europe.

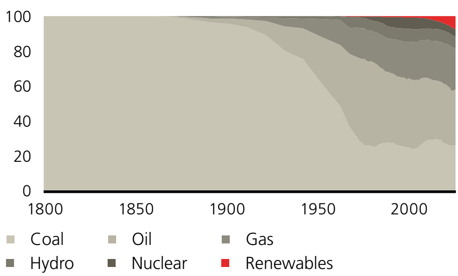
Meanwhile, decarbonizing the heating and cooling systems of buildings and factories will require strong emphasis on energy efficiency investment. When the limits of hardware are reached, software can often be used to enhance energy efficiency. This opens up opportunities for companies that gather digital data and provide enabling technologies.

Beyond public markets, investors can tap into energy disruption opportunities in private markets, including in renewable infrastructure development, energy networks, storage, carbon capture, energy efficiency, and circular economy solutions.

Figure 10

The transition to renewables is under way

Primary energy consumption by fuel source, share of total, in %



Source: Energy Institute Statistical Review of World Energy 2023, UBS, as of November 2023

Healthcare disruption

The healthcare sector will be a key source of disruptive innovation over the next decade. Aging populations will increase the demand for healthcare services and treatments, while tighter government budgets will necessitate new approaches to care delivery.

We see biological innovation and healthcare technology application as prime areas. Diversified exposure makes particular sense given that many companies in this field are small- or mid-cap.

In addition to obesity remedies, which grabbed investors' attention in 2023, we see opportunities in cancer treatment, rare diseases, immunology, and neurology. Companies have developed various new treatments that are now either reaching the market or close to approval, including antibody-drug conjugates, bispecific and multi-specific antibodies, and even cell therapy approaches for immunological conditions.

Meanwhile, increased connectivity and computational power are also leading to significant development. Trends include miniaturization, robotics, greater ease of interaction with patients, and improved access. The biopharma industry is also exploring AI-driven approaches to increase the output of the drug discovery process, develop new diagnostic approaches, or personalize medicines, although it is too early to see any tangible changes in drug discovery and approval rates.

When investing in healthcare disruption, we think it is important to keep a diversified exposure to various areas of innovation. Most of the disruptors are small companies, and tighter financial conditions can disproportionately affect short-term stock performance of those companies. Combining investments in the "disruptors" with investments in the "adopters"—more established companies that are using the new technologies—can be a lower-risk way of capturing the benefits of innovation.

We also see opportunity for investors to diversify across major subsectors (biopharma, medtech and tools, and services), and by geography, potentially enabling them to capture the growth in emerging market healthcare. Investors able to lock up capital for longer can also diversify beyond listed companies, given the significant role of private markets in funding early-stage research. Allocations to health-related investments across private and public markets could also benefit sustainability-focused portfolios.

Capture growth with private markets

A new world will see significant investment in healthcare, digitalization, and energy. But high government debt levels mean public funding for innovation is likely to be constrained. Private market managers, with their ability to provide equity or debt capital to companies at different lifecycle stages, have a key role to play. The asset class offers attractive return potential and direct access to the real economy, in exchange for lower liquidity.

Private markets provide access

Gaining exposure to fast-growing and innovative businesses through listed equities is becoming harder due to the shrinking supply of new listed firms. More companies are choosing to stay private, delay listings, or avoid them altogether, a trend we do not expect to reverse in the decade ahead. Similar dynamics apply in the debt markets, where traditional lenders' market share is declining in favor of private debt, particularly in funding small and midsize businesses.

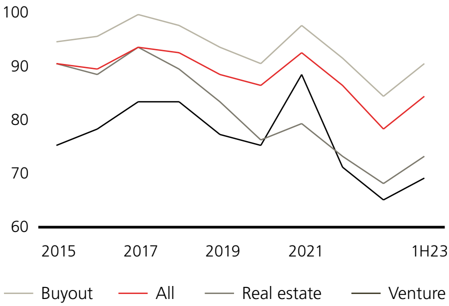
Private equity

Value and middle-market buyout. In the middle market, entry multiples for acquisitions have declined to 10.3 times enterprise value relative to EBITDA year-to-date (as of 2Q23), down from 12.8 times on a trailing-12-month basis and below the average since 2008 (11.4 times). Add-on strategies, meanwhile, remain a powerful tool in offsetting growth and interest rate pressures given their potential for multiple arbitrage, cost-revenue synergies, and growth acceleration. We also expect carveout and divesti-

Figure 11

Secondaries are trading at unusually deep discounts

Pricing as % of NAV across private strategies



Source: Jefferies Global Secondary Market Review 1H23, UBS, as of November 2023

ture volumes to pick up further as the economic environment slows and companies spin out noncore or underperforming assets at potentially compelling acquisition prices.

Secondaries. With many investors still seeking to generate liquidity, secondary market managers that specialize in acquiring stakes in existing funds or portfolio companies that are, or are close to, generating cash flows remain attractive, in our view. Discounts are still above historical norms (16% to NAV as of June), bid-ask spreads have narrowed, and transactional activity is picking up.

Thematic growth. For investors seeking to capture long-term secular trends in areas such as software, health, education, and climate, thematic growth private equity funds present an opportunity as improved pricing offers an attractive entry point.

Private credit

Direct lending strategies are likely to be a good source of income in the coming decade. Debt-to-cash ratios have deteriorated, and defaults could rise, especially given the lagged effect of higher interest rates on the economy. But while defaults could lead to potential credit losses on existing loans, private lenders can dictate better terms on new loans and negotiate stronger lender protections which may include stricter covenants, lower leverage levels, and higher equity contributions. At current levels, private loans yield close to 12.5% on an unlevered basis and offer an attractive carry pickup over high yield and leveraged loans that should compensate for potential credit losses. We recommend focusing on experienced managers who are prudent at underwriting. Managers with turnaround capabilities or experience in taking equity ownership may also have an edge in this environment. Investors should consider the risks inherent to private markets before investing, including illiquidity, long lockup periods, leverage, and overconcentration.

Real assets

We are selective on the real estate market, maintaining a focus on quality and resilience. Fundamentals in the industrial, logistics, and multifamily sectors are sound, in our view, supported by favorable trends such as e-commerce and demographics. While uncertainty is high, the current challenges in the US office market will provide interesting investment opportunities in the decade ahead. Should some office properties further correct in price, we see conversion and refitting as a potential opportunity.

In infrastructure, developing new assets and modernizing existing ones is key to several structural trends, including digitalization, decarbonization, and deglobalization. Governments around the world are trying to spur capacity expansion (notably in renewables) while enhancing current and future project economics and competitiveness. Apart from being a thematic opportunity, infrastructure assets have unique characteristics—high barriers to entry, demand inelasticity, and consistent cash flows linked to inflation—that can be a strategic source of capital appreciation and income in multi-asset portfolios.

Getting in balance in the year and decade ahead

A new world will mean complexity and volatility, but also opportunity to grow wealth. To navigate this new world effectively, investors can build a plan using the Liquidity. Longevity. Legacy.* framework, get in balance through a globally diversified multi-asset portfolio, and stay disciplined yet agile by complementing their long-term portfolio with tactical trade ideas.

Liquidity. Longevity. Legacy.

The Liquidity. Longevity. Legacy. or 3L approach is designed to help investors explore and pursue their wealth goals over different time frames, and involves segmenting wealth into three strategies:

Liquidity.
This strategy is to ensure investors have enough liquid assets to meet their short-term spending needs and is typically invested in cash or cash-like securities. With interest rates likely to fall in the year and years ahead, we recommend limiting this portion to two to five years of expected portfolio withdrawals and taking action now to optimize yields using certificates of deposit, bond ladders, or structured solutions.

Longevity.
This strategy is about investing in assets that can provide income over the course of an investor's lifetime. Amid heightened uncertainty in our new world, we believe this strategy is best invested in a well-diversified global portfolio, balancing return requirements with risk management, and complemented with many of the tactical ideas discussed in this *Year Ahead*.

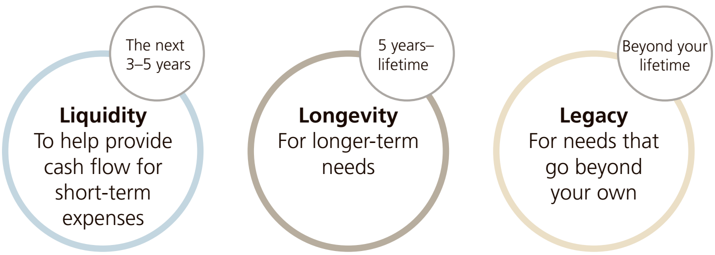
* Time frames may vary. Strategies are subject to individual client goals, objectives and suitability. This approach is not a promise or guarantee that wealth, or any financial results, can or will be achieved.

Legacy.
This strategy is about investing for needs that go beyond an investor's own lifetime and potentially maximizing the value of assets for inheritance or philanthropy. Many of the ideas discussed in the Decade Ahead may be suitable for this strategy, including leaders from disruption and private markets. Impact investing, sustainable investing, and philanthropy can also be appropriate for Legacy strategies.

Investors can get started with the 3L approach by first considering how much they need to draw from their portfolios to meet their spending needs over the next two to five years; their spending plans for the next five years and beyond; and how much they intend to leave behind.

Mapping these sums into the Liquidity. Longevity. Legacy. investment strategies, in consultation with an advisor, can help investors clarify why they are investing and therefore boost their chances of achieving their goals. The Liquidity strategy can offer investors peace of mind during periods of market volatility, and a disciplined process of drawing on, and then refilling the strategy during bear markets can help generate meaningful outperformance over time.

The Liquidity. Longevity. Legacy. approach



Source: UBS

Strategies are subject to individual client goals, objectives and suitability.

Get in balance

We believe that holding a core position in a balanced portfolio is the most effective way for investors to both protect and grow wealth over time. The concept of a balanced portfolio is rooted in the principle of diversification, spreading investments across a variety of assets to earn returns and manage risks.

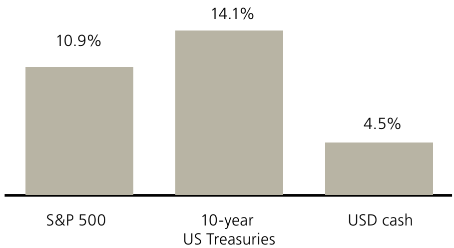
Diversification is often thought of as being about risk reduction, and it is: Spreading investments broadly can allow investors to earn equivalent returns with lower risk than they would be able to take on in individual investments.

But it is important to remember that diversification is at least as much about not missing the right stocks as it is about avoiding overexposure to the wrong ones. For example, we know that picking future performance is hard: A study by Arizona State University professor Hendrik Bessembinder showed that just 0.3% of firms accounted for half of US stock market wealth creation between 1926 and 2019. Diversification is the only way investors can make sure they do not miss those very few outperformers—particularly important in an era of change.

Figure 12

Positive returns expected across asset classes

December 2024 total return expectations for select asset classes



Source: UBS, as of November 2023

Building a clear financial plan, thinking about required rates of return, and understanding one's tolerance for volatility and risk is a way to get started. Balanced portfolios can be built to cater for a range of risk tolerances and return objectives, and we also think investors with sustainability-related objectives can earn comparable risk-adjusted financial returns to traditional portfolios with a sustainable balanced portfolio.

There is never a bad time to invest in a balanced portfolio, but given our positive outlook for broad equity and bond markets and alternatives over the next year, as well as the potential for equities and bonds to effectively diversify each other in our key risk scenarios, we believe now is a good time for investors to get in balance.

Asia Outlook 2024

Nick Fewings I Unsplash

Asia is increasingly shaping the world. But it also means the region is more exposed to global risks than before.

Asia's new normal

Min Lan Tan
Head Chief Investment Office APAC
Global Wealth Management

The first three years of this decade have brought about extraordinary change. A global pandemic, war, rapid inflation, unprecedented policy tightening, energy shortages, trade competition, and transformative tech advances—in one way or another, Asia has played an integral role in many of these disruptions.

That's in large part due to the region's collective rise. Now accounting for around half of the globe's GDP growth, middle class population, energy consumption, foreign direct investment (FDI) inflows, and granted patents, Asia is increasingly shaping the world. But while that brings opportunities for the region's economies and markets, it also means Asia is more exposed to global risks than before.

The region also enters 2024 in a great transition of its own. China's economy is shifting from old to new growth drivers. Economic growth and capital are relocating from advanced Asia to younger, emerging economies in the south. Trade is adjusting from globalization to regionalization; geopolitics from bilateral to multipolar competition.

These mega-trends are measured over decades but are playing out today, creating openings and challenges along the way. That means investors now find themselves in Asia's new normal—a new complex world of growth, opportunities, and risks that looks very different from the past.

China 3.0 and its challenges

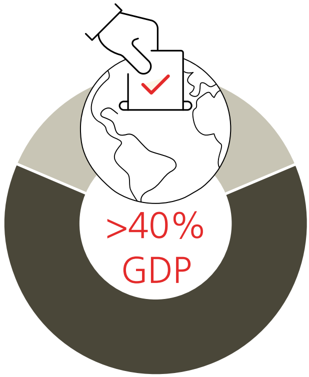
China's evolution is at the forefront of the change. Beginning as the world's factory in the early 2000s (version 1.0), followed by a debt, infrastructure, and digital boom in the aftermath of the global financial crisis (version 2.0), China 3.0 is getting underway as the economy attempts to transition from old-world growth drivers—property and lower-value manufacturing—to a new-world trinity of mass consumption, the green transition, and tech innovation.

But the rebalancing will not be easy, as highlighted by 2023's property and debt challenges. Potential GDP growth could moderate to 4–4.5% over the next 5–10 years, with wide variability across shorter periods. Policy support, however, can help smooth the fluctuations—ongoing easing, for instance, may boost growth to around 5% in 2024 in an upside scenario.

> The pandemic, geopolitical scrutiny, and a looming demographic deficit have further turned Beijing's focus inwards toward the quality of its domestic growth in recent years. These developments suggest another remaking of China has begun—version 3.0.

In 2024, nearly half of the world's top 20 largest economies, representing over 40% of global GDP, will experience leadership elections.

Source: World Bank, UBS, as of November 2023



The changing power arena

The geopolitical arena is also changing for Asian powers. In 2024, nearly half of the world's top 20 largest economies, representing over 40% of global GDP, will experience leadership elections. In Asia, votes in Taiwan, India, South Korea, and Indonesia could add to the growing fault lines—or create new ones—between the Global South, led by mainland China, and the West, where the US and the UK are also set to cast ballots.

Globalization is reshaping the region as well. Industrial policies, such as the US Inflation Reduction Act and the Chip and Science Act, are rearranging and regionalizing supply chains and capital flows. South and Southeast Asia are key beneficiaries—China's FDI in the region is now 4x the size ten years ago as it seeks to sidestep trade curbs from the West. But this is also leading to less efficient investments, rising government debt burdens, inflationary pressures, and shifts in strategic allies.

The centers of regional growth are changing, too. India is expected to be the world's fastest-growing major economy in 2024 and become the third-largest economy by 2030. Meanwhile, Southeast Asia boasts a demographic dividend of 678 million, pointing to a burgeoning middle class. And after three lost decades, wage growth and sustainable inflation mean Japan is likely to be the only developed economy to grow above trend in 2024. So, while China will still be the biggest economic contributor in Asia during this era, growth beyond mainland China has become the new focus.

Bigger is better in the next era

If the past decade was defined by Asia's "app economy," we think the coming 10 years or so will be the "AI economy," creating an even larger impact across jobs, productivity, inflation, and geopolitics and further accelerating the shift toward new economy sectors. But AI's high capex intensity means industry leaders with a first-mover advantage and deep pockets should disproportionately benefit.

The same holds true for the green transition. While climate risk is rising everywhere, Asia is arguably the world's most disaster-prone region and represents some of the most vulnerable countries and populations. The region also accounts for half of the world's new investments in clean energy and renewable energy capacity. We think larger industry leaders that are better prepared for the capex, R&D, and major strategic shifts needed will emerge from the transition to a low-carbon economy as frontrunners.

2024: A fuller recovery

Such longer-term mega-trends should shape a brave new world over time. But Asia enters this chapter facing some immediate concerns. Indeed, global risks ranging from a higher-for-longer Federal Reserve and soaring yields to accompanying US dollar strength and elevated oil prices have all had an outsized impact in 2023. These, and El Nino-related weather risks, could carry over into early 2024, which could lead to an uptick in inflation and delay the start of policy easing in the region.

By mid-year, however, we expect the US economy to have slowed but avoided a recession, and global central banks to begin pivoting. These changes should kickstart a fuller recovery in Asia ex-Japan and China to around 5% real GDP growth in 2024—a bounce of around 50bps from 2023 at a time when the world economy is set to slow by that amount. China's stimulus measures, a moderate trade recovery, and the beginning of a monetary easing cycle should all support this process.

Should inflation continue to moderate over the coming quarters?

Read more on page 101
("How will Asian currencies fare in 2024?")

Asia is truly shaping up to continue being the world's oyster. Nowhere is this more clear than in its contribution to global GDP growth, which we expect to remain dominant at around 40% (2018–28).

How to position in the year ahead

We forecast double-digit returns in Asian equities in 2024, reinforced by favorable valuations and strong high-teen earnings growth (double the global average, thanks largely to a tech rebound). The IT, consumer discretionary, materials, and industrials sectors offer the best mix of attractive earnings and valuations, in our view. In China, we shift our focus to domestic-oriented sectors with leading capabilities in the consumer, green (EVs), and tech (AI beneficiaries in software, hardware and leading internet portals) sectors.

As growth shifts beyond mainland China, we also like consumer segments, beneficiaries of the supply chain reshuffle, and banks in India, Indonesia, and the Philippines. Early AI beneficiaries include leading IT companies in Taiwan, South Korea, and Japan, as well as new economy industry leaders in ASEAN and India. And ESG leaders should outperform in times of systemic change. Thematically, the biggest and highest-quality companies across the region—or Asia's titans—offer time-tested track records, solid foreign inflows, and strong fundamentals, which could help them continue to outperform the broader MSCI Asia-ex Japan index in a volatile future.

Outside of equities, we see high-single digit returns for Asia investment grade (IG) bonds in 2024. But we are mindful that a downshift in rates will likely be the biggest driver of IG returns in 2024—in a tail risk where 10-year yields move up to 5.25–5.5%, Asia IG could return about 3%. Meanwhile, Asian currencies may stay range-bound in 1Q24 as USD strength persists. But from 2Q24 onwards, we expect the start of a more prolonged downtrend in the USD, alongside policy easing, to give a cyclical boost to export-oriented Asian currencies.

Uncertainty and change can be unsettling, and the variability of outcomes will be elevated as investors enter a new world. Still, in the year ahead, we think Asia will be home to both a cyclical recovery and structural opportunities that can help balanced portfolios successfully navigate the complex transition.

Asia's macroeconomic outlook

Getty images

How will Asia fare in a brave new macro world?

We see a stronger year of growth for Asia in 2024 versus 2023. But the adjustment to a new economic regime also comes with a new set of inflation, growth, and policy risks.

Like the rest of the global economy, Asia too has entered a brave new macroeconomic world. Spurred by large and overlapping shocks in recent years—namely, the pandemic and the war in Ukraine—this new economic regime has seen persistently low inflation and interest rates quickly morph into inflationary risks, higher-for-longer monetary policy, and volatility-inducing aftershocks.

These global forces have had an outsized impact on regional financial conditions in 2023. Indeed, the Federal Reserve's tightening, soaring yields, US dollar strength, and elevated oil prices all continue to hold back a tentative recovery in Asia after economic growth reached a bottom in 1H23.

But the good news is that the external headwinds should gradually fade. As the US economy reaches its nadir, while avoiding a recession, and global policy rates decline, we believe a fuller recovery can

Our outlook sees headwinds in 2023 turning into tailwinds in 2024.

1. China is turning the page on its growth story.
2. Trade will likely see a moderate uplift.
3. Monetary easing should begin.

emerge across Asia ex-Japan and China in 2024. The net result will likely be real GDP growth of around 5% for the full year—a bounce of around 50bps from 2023 at a time when we expect the global economy to slow by 50bps. To us, this presents an opportunity to profit from regional cyclical themes in the year ahead.

Turning headwinds into tailwinds

Importantly, our outlook sees headwinds in 2023 turning into tailwinds in 2024. First, continuous policy support in China—including the late-year issuance of CNY 1tr in special central government bonds—should help GDP growth exceed the official target in 2023.

But the bulk of the additional fiscal spending will likely be felt in the quarters ahead, boosting infrastructure investment and potentially contributing 0.4–0.8pps to GDP growth in that time. That suggests growth in 2024 could reach ~5% in an upside scenario. More active policy support, however, is still needed to reduce the property drag and assuage debt concerns, keeping a moderation to mid-4% growth our base case. Over the longer term, China is likely settling into a new normal that poses new growth opportunities and challenges (see page 77).

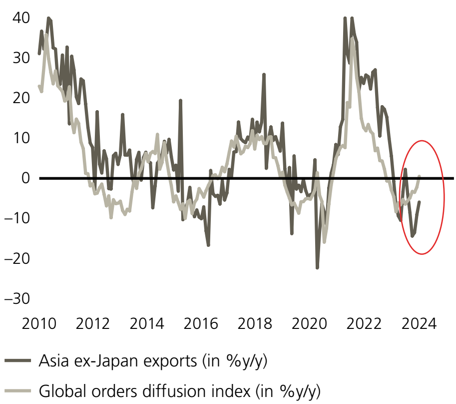
Second, trade will likely see a moderate uplift. Improving fundamentals in tech segments like semiconductors should swing regional export growth back into positive mid-single digit territory in 2024, benefiting tech-heavy economies like Taiwan, Korea, and Singapore. In major end-markets like the US, legislative support and the rush to implement AI are also reinforcing robust tech-related investments. In addition, producer pricing power is rising as supply dynamics tighten and we pass the worst of the inventory overhang.

Finally, monetary easing. A hawkish Fed has delayed the start of Asia's rate-cutting cycle, even as regional inflation has returned to 3% on average in 2023. But while there is likely only limited scope for Fed rate cuts in 2024, a period of subdued US growth should still soften US yields and the USD by enough to

Figure 1

Recovering global cyclical indicators signal export recovery

Actual machinery/manufacturing/tech orders (USD) for US, Japan, Germany, Switzerland (PMI new orders)



Source: CEIC, UBS, as of November 2023

allow policy easing across Asian economies from mid-year onwards. We forecast 50bps of rate cuts on average in 2H24, which should support a real spending recovery in the region. Key to this is tight policy limiting the pass-through of inflationary pressure from any oil and energy price spikes.

The strong and the vulnerable

Our base case sees high US interest rates, a strong US dollar, and rising oil prices as risks that will fade by mid-year. But these trends could also easily intensify and spread, particularly in a world of increasing economic complexity and geopolitical instability. A soft landing in the US is by no means inevitable either.

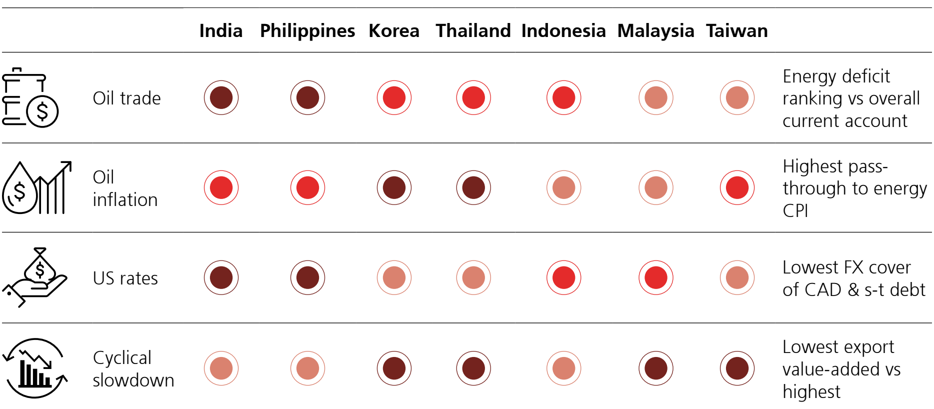
But while that forms a full body of risks in the year ahead, Asian economies face these challenges from a position of relative strength compared to previous cycles. Real rates are the highest they have been for many years, fragile current accounts have been repaired, and foreign direct investment is flowing into South and Southeast Asia.

Moreover, large economies like India, Indonesia, and the Philippines are also in a position to supply the region's highest structural growth in the coming years due to their younger demographic profile and higher average investment rates. Their relatively larger economic size and domestic

Figure 2

Where are Asia's strengths and vulnerabilities?

Macroeconomic risks and their impact across economies



Legend: Most vulnerable, Least vulnerable
Source: CEIC, UBS, as of November 2023

orientation also make them generally less vulnerable to global cyclical downturns, which has helped them deliver some of the highest growth among major economies and relatively strong risk returns in 2023—a trend we expect to continue in 2024.

However, there are weak spots if the risks persist longer than we expect. In terms of pressure on GDP growth and currencies, the most vulnerable Asian economies to an extended rates shock include Malaysia, the Philippines, and Indonesia—those with larger current account deficits, foreign local bond holdings, and short-term foreign debt to foreign reserves.

Meanwhile, higher oil prices, potentially from geopolitical shocks, would directly lift headline CPI in Asia. The transmission tends to be much quicker in the advanced Asian economies (North Asia, Singapore, and Thailand), making them the most vulnerable should oil prices rise to USD 125/bbl. India, the Philippines, and Indonesia have higher food and fuel weightings in their price baskets, but they typically also do more to cushion the blow using fiscal policy.

Higher oil prices can also damage trade accounts. India, the Philippines, and Indonesia are most vulnerable here, though Indonesia can offset high oil costs if coal, gas, and palm oil prices also join the rising trend. The least vulnerable economies are either naturally hedged (Malaysia) or have significant manufacturing trade surpluses to pay for the oil (Taiwan). The rest of Asia lies somewhere in between.

Taken together, we estimate that these external risks could shave 50–100bps off regional GDP growth in 2024 in a downside scenario. The degree of the impact, however, would vary widely across Asian economies.

Key takeaways

- Stronger growth across Asia as global risks fade. We expect real GDP growth of around 5% for Asia ex-Japan and China in 2024.
- Headwinds turning into tailwinds. Chinese stimulus, a mild trade lift, and policy easing should support the regional recovery.
- Vulnerabilities if global risks persist. Higher-for-a-lot-longer rates, USD, and oil prices could shave 50–100bps off regional growth.

What will reshape the world order?

Geopolitics isn’t the only reason for a growing global divide, with globalization altering relations across multiple spheres. That said, investors should brace for a more unpredictable 2024 as elections across the world heat up.

Geopolitical tensions are ratcheting up again with renewed force, following Russia’s invasion of Ukraine in February 2022 and Hamas’s attack on Israel in October 2023. Such tensions are already affecting trade and financial flows, as well as asset prices.

Looking ahead, the increasing fault lines between two major blocs—the Global South versus the West—will have major implications for the macroeconomic and investment outlook of both developed and emerging economies.

Greater uncertainties from the geopolitical and policy angles will likely accelerate the pace of supply chain diversification, with efficiency usually sacrificed.

In short, investors need to be prepared for geopolitically induced volatility. This can be done by hedging market risks—not just through diversification, but also shielding portfolios against particular risks through asset-specific strategies such as alternatives, oil, and gold.

Globalization reshaped

But geopolitics is not the only factor behind the increasing divide. Globalization is reshaping along multiple dimensions.

For instance, the rise of robotics, artificial intelligence, and automation means that more production can be done by machines in advanced economies, where infrastructure is more advanced.

This—coupled with the fact that mainland China is no longer the low-cost manufacturing base it once was—means that we are witnessing an acceleration of manufacturing activities shifting into markets like Vietnam, Cambodia, and Indonesia.

This has a downside. In our view, the global economy is worse off when companies shift or “re-shore” their operations not due to cost considerations—but for risk management, encouraged by protectionist industrial policies.

Election season

Complicating matters further, in 2024, nearly half of the world's top 20 largest economies, representing over 40% of global GDP, will experience leadership elections. The most impactful elections for geopolitics globally will likely be in the US, Russia, Taiwan, India, South Korea, Indonesia, and the UK (no later than January 2025).

Over the short term, political elections are often a source of volatility. But the prospect of deep polarization, rising populism, and nationalism has raised the level of uncertainty typically associated with elections even higher.

Figure 3

Some of the world's largest economies will hold elections in 2024

Top 20 economies in the world

Economy	2022 Nominal GDP (USD mn)	% of Global GDP	Key elections in 2024?
United States	25,462,700	25.2%	Yes
China	17,963,171	17.8%	No
Japan	4,231,141	4.2%	Yes
Germany	4,072,192	4.0%	No
India	3,385,090	3.4%	Yes
United Kingdom	3,070,668	3.0%	Yes
France	2,782,905	2.8%	No
Russia	2,240,422	2.2%	Yes
Canada	2,139,840	2.1%	No
Italy	2,010,432	2.0%	No
Brazil	1,920,096	1.9%	Yes*
Australia	1,675,419	1.7%	No
South Korea	1,665,246	1.6%	Yes
Mexico	1,414,187	1.4%	Yes
Spain	1,397,509	1.4%	No
Indonesia	1,319,100	1.3%	Yes
Saudi Arabia	1,108,149	1.1%	No
Netherlands	991,115	1.0%	No
Türkiye	905,988	0.9%	Yes*
Switzerland	807,706	0.8%	No

* indicates regional elections
Source: World Bank, UBS, as of November 2023

In fact, a study conducted by the US's National Bureau of Economic Research[1] shows that uncertainty rises significantly in the months leading up to elections.

1 Baker, Scott R., Aniket Baksy, Nicholas Bloom, Steven J. Davis, 2020.

Moreover, the increase is much higher for polarized elections, with the volatility reflected in asset prices and a slowdown in investment, as the option value—of waiting to decide whether to invest or not based on the outcome of the election—is higher. In short, investors should brace for a more ambiguous and unpredictable world in 2024.

Key takeaways

- Greater geopolitical uncertainties are reshaping the world, with major investment implications.
- Not the good kind of globalization. As supply chain diversification accelerates, efficiency is being sacrificed. But there are select beneficiaries in Asia.
- 2024 will see elections in economies representing 40% of global GDP. Prepare for bouts of volatility with appropriate hedges.

How do US-China tensions change investments in Asia?

Geopolitical tensions between mainland China and the US could spike around the 2024 Taiwan and US elections, in our view. For example, the US could further tighten restrictions on imports of advanced chips into mainland China, or impose higher/new tariffs on the mainland's exports to the US. If such scenarios arise, investors should be prepared to reduce their exposure to companies heavily reliant on exports, particularly in markets like China. Such protections can include focusing on companies with significant domestically driven revenues, or those with resilient cash flows. For the latter, we think recurrent cash flows or active capital management can result in outperformance amid heightened market volatility.

An escalation in tensions in the year ahead would likely also draw attention to areas that can benefit from supply chain shifts and "China+1 strategies." Please refer to page 92, "Where are Asia's less-explored growth opportunities beyond China?" for related investment ideas.

Key themes

Getty images

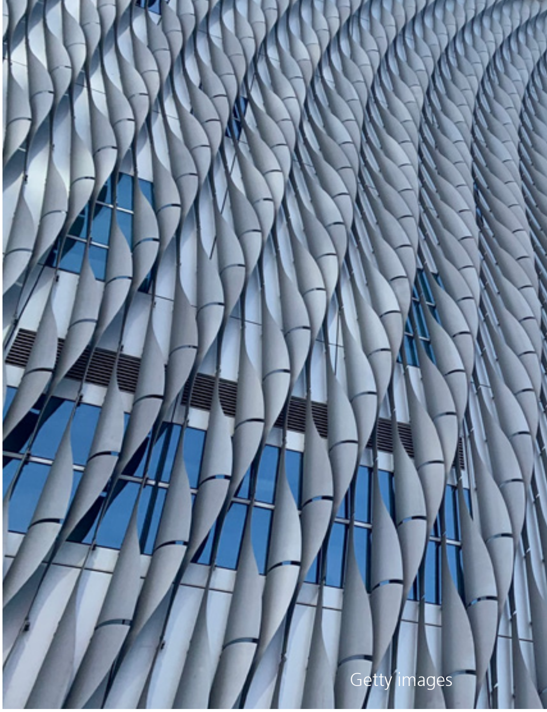
What should investors expect in China's new normal?

Helped by policy stimulus measures, we expect China to exceed its official GDP growth target in 2023 and settle in the mid-4% range in 2024, with upside risk. Beyond that, trend growth will likely slow as a new normal brings new growth drivers and challenges.

Over the past four decades, China's growth has been nothing short of an economic miracle. In that time, GDP growth has averaged nearly 10% per year and GDP per capita has jumped by more than a hundredfold—elevating the world's second-largest economy firmly into the middle income ranks.

But a new economic reality is setting in. Even though we expect China to exceed its official 2023 growth target of around 5%—thanks to continuous policy stimulus—it comes at a time when the property drag has not diminished and debt risks are mounting.

Looking into 2024, we expect GDP growth to settle around mid-4% as property weakness continues, though upside to around 5% is possible if active policy easing continues into the new year, the consumption recovery fully runs its course, and the property market stabilizes. But while that would likely represent the second fastest growth rate among major economies in 2024 behind India, it would still mark China's slowest three-year expansion in three decades.



China version 3.0

This marks a pivotal moment in China's economic evolution, especially on the heels of two transformative changes since the turn of the century. The early 2000s saw China 1.0 emerge as the world's factory following its entry into the World Trade Organization, with the economy contributing 40% of all global growth at its peak. A post-global financial crisis boom in debt-driven infrastructure and property investments then kicked off China 2.0, which also featured a digital revolution that gave birth to the nation's internet platform giants in the 2010s.

But as the credit and export-fueled growth engines decelerate, imbalances in the real estate sector, public debt, and private sector confidence have been laid bare. The pandemic, geopolitical scrutiny, and a looming demographic deficit have further turned Beijing's focus inwards toward the quality of its domestic growth in recent years. These developments suggest another remaking of China has begun—version 3.0.

However, the transition to a new growth model will not be painless. As 2023 has made clear, policymakers must first resolve the real estate and local government debt challenges, while continuing to bridge the gap with active policy support. Such a process could see potential growth moderating to 4–4.5% over the next 5–10 years (from about 6% in the past decade and about 10% in the early 2000s). But if the transition goes as planned, China's sheer size means it should still contribute a third of all global growth in that time, with GDP per capita doubling to around USD 25,000 by 2035 (from USD 12,720 in 2022).

Out with the old, in with the new

In this new normal, old drivers of Chinese growth—property and lower-value manufacturing—would be gradually supplanted by a new trinity in mass consumption, the green transition, and tech innovation.

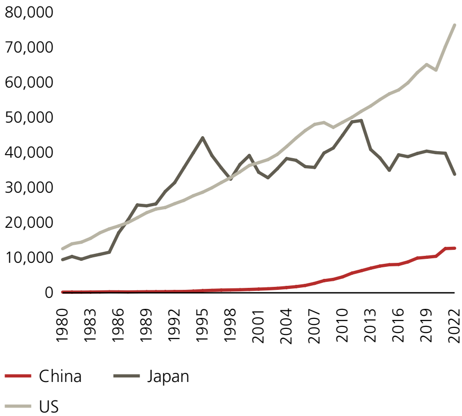
First, China's consumption power is too big to ignore. The size of the domestic middle-income class has surpassed 400 million and is set to grow further with GDP per capita. New trends have also emerged in recent years. Consumers are focusing on local quality and cultural elements, as evidenced by the rise of home-grown Chinese brands or "Guochao." Services spending has also quickly rebounded after the pandemic, while online shopping has registered double-digit growth over the past 5–10 years. The silver economy is set to shine as well, with the elderly population reaching 280 million strong (~19% of total population) in 2022 and the pension market doubling to CNY 12tr from 2014 to end-2020.

Second, the green transition is gaining traction (see page 84). On renewable energy, China has rapidly scaled up its clean solar, wind, and nuclear capacity, and is targeting an 80% electricity mix from non-fossil fuels by 2060 (from about 30% currently). The economy also dominates the production of many key minerals for green products, including rare earths, cobalt, lithium, copper, and nickel. This includes, for example, about 60% of all global lithium processing, resulting in a cost advantage of 20–25% versus Western markets.

Figure 4

China's GDP per capita has much room to grow

GDP per capita in USD, nominal terms



Source: CEIC, UBS, as of November 2023

Finally, tech innovation and industrial upgrades. In response to tightening tech restrictions, China has made boosting self-sufficiency a strategic priority, especially in the areas of semiconductors, 5G, and AI. Over CNY 2.1tr has been allocated to semiconductor-related investments in the past two years alone, based on a JW Consulting estimate. Total R&D spending, meanwhile, has climbed steadily to CNY 3.1tr, or 2.6% of GDP from below 2% a decade ago, with Beijing targeting a minimum 7% annual increase.

A new investment order

In our view, aligning with this next generation of growth drivers is key to generating accretive Chinese equity returns in the year ahead and beyond. This is particularly important as broader Chinese corporate earnings are expected lag other Asia-Pacific markets in 2024, given a higher base effect and moderating economic growth.

To start, we project China's total AI market size to grow more than 20% annually over the next few years. Initially, Chinese software and hardware companies manufacturing cloud servers should be the main beneficiaries from an increase in AI-related capital expenditures. Over the longer term, we see greater growth potential in China's leading internet portals as they integrate AI functions into their platforms (see page 83).

In the consumer sector, investors should focus on players with strong product capabilities and efficient distribution channels as downgrade and premiumization trends remain in place. One particular bright spot has been EV demand. We expect local EV original equipment manufacturers (OEM) to continue seeing strong domestic growth as well as rising export penetration in the EU and ASEAN. Chinese EV sales could rise another 24% y/y in 2024, driving robust earnings growth for leading names.

Industrials also find themselves on the right side of policy. We believe a focus on industrial automation will boost the supply technology and automation industries. In a more volatile future, there is also value in Chinese banks offering attractive dividend yields over 9% and a high degree of defensiveness. We see opportunities in select names that have already priced in concerns over lower net interest margins.

Key takeaways

- China's GDP growth is likely to moderate to mid-4% in 2024, with upside risk.
- China 3.0 is underway. As growth shifts to consumption, the green transition, and tech innovation, potential growth could settle around 4–4.5% over the next decade.
- Align with China's new normal. We like AI beneficiaries, EV names, consumer sectors, industrials, and select banks.

Why bigger is better in Asia's changing future

Powerful trends favoring bigger sectors and quality companies are emerging in Asia across all time horizons. On a 6–12-month horizon, big cyclical industries should lead Asia ex-Japan's strong earnings growth in 2024; in the medium term, investing in Asian titans should be rewarding. Finally, AI is a long-term mega-trend, favoring deep-pocketed industry leaders with a first-mover advantage.

Asian equities are primed for a return to the time-tested strategy of investing in large, established companies. While the Asia ex-Japan markets (AxJ) delivered muted returns in 2023, we see scope for double-digit returns—supported by favorable valuations and strong high-teen earnings growth.

Despite a potentially robust earnings recovery in 2024, volatility should be elevated, given ongoing geopolitical tensions, higher-for-longer rates, and election-related uncertainties. In such an environment, focusing on quality with a large-cap bias should be rewarding.

Moreover, we see powerful trends emerging in the region, making "bigger" the better investment opportunity across time horizons, in our view.

Near-term growth in cyclicals

On a 6–12-month basis, Asia ex-Japan's growth recovery should be driven by four key cyclical sectors: IT, consumer discretionary, materials, and industrials. Together, they represent more than half of the region's benchmark index.

As Asia's economic growth in 2024 is likely to be driven by these big sectors, we're comfortable with a high-teen earnings growth forecast for AxJ. This enviable projected growth is two times the global average. Positioning in these larger sectors that offer strong growth should tactically reward investors, given the additional valuation support.

Lean on Asian titans

Meanwhile, in the medium term (i.e., over the next few years), we prefer focusing on quality—through our new investment theme: Asian titans. The theme invests in 10 benchmark heavyweight stocks (the largest by index weight) across the MSCI AxJ index's 10 markets.

Crucially, the theme is compelling because of these companies' strong track records and solid fundamental outlooks. These strong track records are not just driven by the Asian titans' benchmark leadership and solid foreign inflows, but are also supported by strong fundamental factors.

Our analysis shows that these Asian titans have a solid foundation, such as a dominant market share position supporting pricing power, above-average earnings growth (3-year CAGR of 10.3% during 2023–25 versus 6.5% for the region), high free cash flow margins (6.8% versus the regional average of 5.3%), a sustainably higher return on equity (median ROE of 15.8% versus the regional average of 11.2%), and favorable valuation multiples (1.9x P/B versus fair value P/B of 2.1x).

Considering the current volatile backdrop, Asian titans should continue to outperform the broader MSCI AxJ index in the foreseeable future.

The AI megatrend

In the longer term, we're witnessing a megatrend around artificial intelligence (AI) that is set to create significant broader implications for a growth region like Asia.

2023 has shaped up to be a year of inflections for artificial intelligence, as generative AI (a segment of AI allowing users to leverage trained data models to "generate" content in the form of text, images and audio/video) took the world by storm.

If this sounds familiar, that's because we see parallels in how smart devices previously drove major technology disruption for many traditional business models in the region, such as retail, entertainment, banking, and transport, among others.

In fact, we think AI will take technology disruption to the next level—presenting both significant opportunities and risks.

So, if the past decade has been defined by Asia's "app economy," where the region's jobs, inflation, and GDP growth saw a significant impact, the next 10 years or so should be mostly about the "AI economy," creating an even larger impact—across jobs, productivity, inflation, and geopolitics—and further accelerating the shift toward new economy sectors.

Here, AI's strong growth potential is likely to offer vast opportunities, as we expect the global AI revenue opportunity to grow from USD 28bn in 2022 to USD 300bn in 2030.

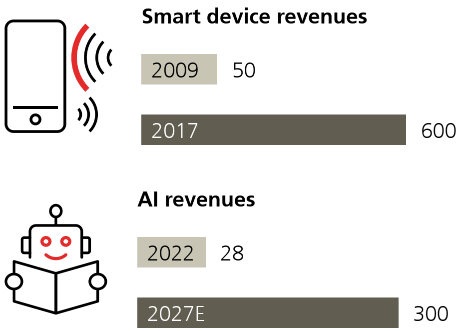
This is similar to the exponential growth in the global smart device industry, which grew from USD 50bn in 2009 to USD 600bn in revenues in 2017, providing solid investment opportunities in new economy sectors and IT supply chain companies in Asia.

However, due to AI's high capex intensity, we think technology disruptors and industry leaders with a first-mover advantage and deep pockets should disproportionately benefit, driving this "big will get bigger" trend. In this regard, we believe leading IT companies in Taiwan, South Korea, and Japan, as well as new economy industry leaders in mainland China, ASEAN, and India are well-positioned to ride the AI wave within the region in the longer term.

Figure 5

Leading IT companies in Taiwan, South Korea and Japan, and new economy leaders in mainland China, ASEAN and India to reap AI dividends, after benefiting from the previous smart-device boom

In USD bn



Source: Company reports, Bloomberg Intelligence, UBS, as of 2023

Key takeaways

- Double-digit returns expected for Asia ex-Japan equities in 2024—supported by favorable valuations and strong earnings growth.
- Bigger is better amid powerful trends and uncertainty. High-quality regional heavyweights should outperform the benchmark.
- Asia's AI decade. Industry leaders with a first-mover advantage and deep pockets will likely disproportionately benefit.

How to invest in Asia's green transition?

To achieve a global net-zero economy, the world will have to undergo one of the most radical economic transitions in history. The progress, challenges, and investable opportunities are particularly evident across Asia.

While climate risk is rising everywhere, Asia remains arguably the world's most disaster-prone region. It also represents some of the most vulnerable countries and populations to climate change, as well as half of global annual GDP growth. Together, these factors highlight the considerable challenges—and opportunities—in the region's green transition. In particular, we think three major arcs will shape the year ahead in Asia.

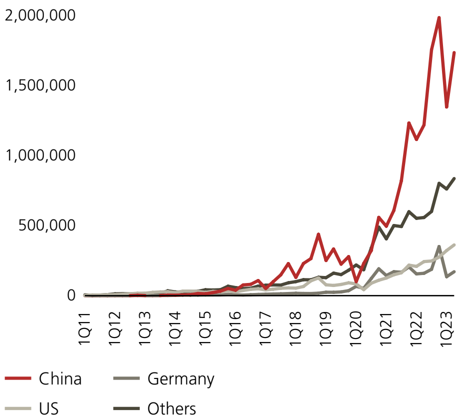
Arc #1: China's excess capacity—the green edition

China is the global leader in the electric vehicle (EV) and solar industries, driven by the aggressive targets in its 2060 carbon neutrality pledge. In fact, these domestic industries will likely enter their most dynamic growth phase this decade as the rest of the world lags behind.

Figure 6

China has surpassed the world in electric vehicle sales

We expect competitive leadership to continue



Source: BloombergNEF, UBS, as of 2023

For starters, China is already well ahead of its EV penetration goal of 20% of all sales by 2025, having achieved an estimated 34% in 2023. By end-2024, we think this is likely to reach 40%—or double its initial target.

Similarly, the economy has likely already reached its 2025 goal to double wind and solar output from 2020 levels (534GW) following an aggressive capacity expansion over the past two years. This expansion, however, comes with oversupply along the entire domestic solar supply chain, from polysilicon to wafers, cells, and modules. By our estimates, this will exacerbate the solar module glut from an estimated 64% excess capacity in 2023 to almost 100% in 2024.

As in other sectors, China will have to find overseas buyers for this excess capacity, keeping us cautious on the solar sector. Despite heightened geopolitical tensions and rising protectionist rhetoric, China's solar exports still grew 34% y/y to 114GW in 1H23, or the equivalent of the total installed capacity in the US, with more than half of these exports destined for Europe.

Arc #2: Regionalization and expanding markets

Cheap solar panels from China also present an opportunity for emerging Asia to simultaneously address its growing power demand and decarbonization ambitions.

India, which has a 2070 net-zero target but remains heavily reliant on coal, ranks third globally in the pace of its solar energy deployment. CRISIL projects green infrastructure investment spending will jump 5x to USD 44bn by 2030, with imports fulfilling equipment demand.

ASEAN, too, is pivoting toward renewable energy. The bloc aims to increase its share of renewable energy from the current 14% of total installed power capacity to 23% by 2025 and 35% by 2035. Vietnam has led the region's expansion into renewable energy, with Thailand and the Philippines increasingly following suit. We expect ASEAN's renewable energy capacity to more than double by 2027, implying annual investments of US 20bn from 2022 to 2027.

While domestic supply chains are growing, commoditization and the availability of cheap imports throw questions over the profit outlook. Listed renewable energy equities have also de-rated alongside their global peers amid supply chain disruptions and project delays. But while the sector's valuation multiples remain lofty relative to history, we think the recent retracement could provide entry opportunities for long-term investors.

Arc #3: Business unusual

In Asia, decarbonization looks different from more developed regions as economic growth—as well as basic consumption demand from food to electricity—is still rising. Sustainable development is not only a nice-to-have in the region, but a necessary solution to meet basic needs.

External pressures are also considerable. A global focus on sustainability will challenge complex supply chains and business as usual in the region. Already, the EU has passed a law making brands and importers liable to any environmental or labor rights violations within the supply chain. Local regulatory responses will only further fuel industry action.

The result is a rapidly changing business landscape. According to KPMG, Asian companies' sustainability disclosure rates have almost doubled in the past decade and are now among the highest in the world. UBS CIO Sustainable Investing scores show that issuers in this region have demonstrated the fastest improvement rates in sustainable performance globally over the past two years.

ESG leaders—companies that demonstrate better sustainability management than their peers—will be more prepared for this systemic change. Investing in Asia's ESG leaders also pays, with the MSCI Asia ex-Japan ESG Leaders index outperforming its non-SI parent in five out of the past eight years at an annual average rate of 0.5pps.

Conclusion: Winner takes all?

Climate action will drive fundamental business change, not only in themes such as clean energy and transportation, but also across every industry and sector in Asia's economy. Within both ESG thematic and ESG leaders strategies, we think larger industry leaders that are better prepared for the capex, R&D, and major strategic shifts needed along the way will continue to outperform in the year ahead and beyond.

Key takeaways

- China's green lead. Pole position in the EV and renewable energy sectors presents opportunities—but challenges as well.
- Renewable regionalization. Renewable investments in emerging Asia are on the rise, and longer-term entry points for listed renewable names are improving.
- Business unusual. As climate change spurs business change, bigger quality companies that are more prepared should outperform.

Jonas Togo | Unsplash

Asset class views

A new investment order for Asian assets

An uncertain world calls for a new investment order in Asia. Tactically, we prepare by positioning in quality across assets and capitalizing on relative opportunities in equities.

2023 has been a year of stabilization for Asian assets. Asia ex-Japan equities are roughly flat, while Asian investment grade bonds have delivered a slightly positive return. Growth markets like Taiwan and Korea and secular markets like India and Indonesia have outperformed their regional peers like mainland China, Malaysia, Thailand, and Hong Kong.

We think 2024 will bring stronger growth in Asia versus 2023, and more uncertainty as well. Asian central banks are likely to hold policy tighter for longer alongside the Fed to limit capital exits and FX weakness. Later in the year, however, we see relief via a generally weaker greenback and a soft landing for the US consumer. This backdrop should allow Asia to supply 50bps in policy rate cuts on average in 2H24, representing a key tailwind for regional equities. From a bottom-up perspective, Asia ex-Japan valuations are below their 5-year average at a time when we expect high-teen earnings growth for 2024, led by tech-heavy markets like Korea and Taiwan.

But until global risks fade, we continue to position for relative opportunities in Asia instead of taking directional calls. Tactically, we think select markets like India and mainland China will outperform markets like Singapore. Given Indonesia's sensitivity to US rates, we downgrade the market from most preferred to neutral. By contrast, we upgrade Malaysia from least preferred to neutral due to its relative resilience in previous higher-for-longer episodes.

Ranking relative opportunities

The investment case for India continues to stand out because of its strong domestic economy and foreign interest. But there are near-term risks: Food CPI has bounced and another rate increase from the Fed or aggressive oil price rallies could spur a final hike from the Reserve Bank of India. Still, consumption and construction demand remain healthy, funded by vigorous bank credit. We expect earnings to be the main driver of the market, with a potential re-rating catalyst if deposit rates peak.

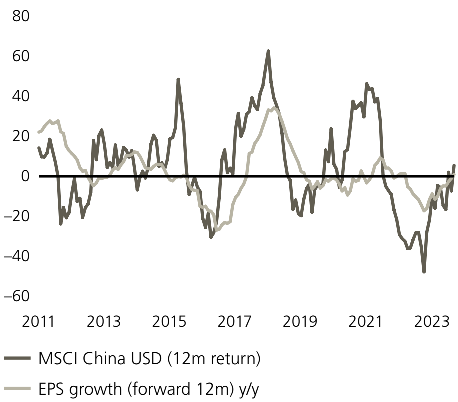
In China, policy implementation continues to be a near-term catalyst. In addition to capital market and property easing, we expect more support to address the local government bond challenges. Indeed, the surprise issuance of special China government bonds in October has already given the market a jolt of life. The macro recovery, on the other hand, needs more time and support, with October PMIs coming in weaker month-over-month. From a bottom-up perspective, a recovery in EPS growth (MSCI China forward 12m EPS) is underway, valuations on a P/E basis for MSCI China look attractive at 1 standard deviation below the 5-year average, and allocations from global investors are currently very low. We keep our most preferred view on China for tactical outperformance opportunities.

Singapore, meanwhile, is sensitive to the global trade cycle, which is still weak. Its financial sector—50% of the market—should have limited upside even in a higher-for-longer rate environment. Potential risks to our least preferred view stem from domestic tech and REIT names—the former should benefit from a global tech rally and the latter should benefit from lower US rates. From a macroeconomic perspective, a turn in the global trade cycle should also be positive for Singapore, and negative for our positioning. In our view, these upside risks are manageable for now.

Figure 7

China earnings growth recovery continues

MSCI China EPS FTM (y/y change) vs performance, in %



Source: Factset, Bloomberg, UBS, as of 30 September 2023

Buy quality in bonds

Outside equities, we believe fixed income investors should stay positioned in quality. Asia investment grade (IG) bonds still present solid risk-reward, given attractive yields and high credit quality. While IG spreads are now relatively tight compared to the past three years, we think any risk-off environment could provide a good entry point for the asset class. On the other hand, sentiment toward Asia high yield (HY) has been cautious, even as the share of China property in the segment has fallen to just 5%. We continue to remain very selective in the space until we see a significant improvement in funding and liquidity conditions for distressed property developers.

Key takeaways

- 2024 should be a year of stronger growth, and more uncertainty, in Asia.
- Focus on relative opportunities. We think India and China (most preferred) should outperform Singapore (least preferred).
- Buy quality in bonds. Asia investment grade (IG) bonds still present solid risk-reward, given attractive yields and high credit quality.

How should investors position in China from a Strategic Asset Allocation (SAA) perspective?

In the long term, we expect Chinese equities to deliver a higher expected return than developed market equities. That means the market should continue to have a place in global portfolios, offering both diversification and exposure to higher growth. For global investors with a balanced risk profile, we think direct and indirect exposure to Chinese equities should be around 1.6% of the total portfolio. For global investors with an Asia bias and a balanced risk profile, exposure to Chinese equities should be at about 6.1%.

Where are the less-explored opportunities beyond China?

With economic growth in Asia shifting beyond China, we think compelling equity opportunities can be found in less-explored markets. We like consumer names and banks in economies with high growth potential, as well as companies benefiting from Asia's supply chain diversification.

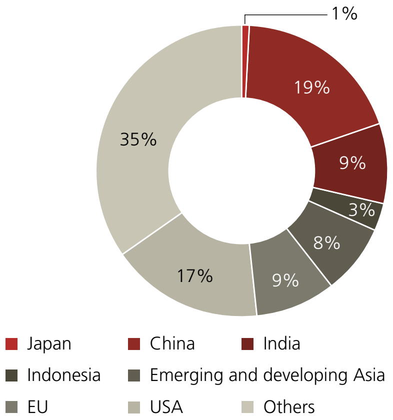
Asia is truly shaping up to continue being the world's oyster. Nowhere is this more clear than in its contribution to global GDP growth, which we expect to remain dominant at around 40% (2018–28). Growth as a style has come back to Asia, and investors seeking broad exposure can consider diversified growth vehicles, or opportunities such as the "Asia new economy leaders" theme.

But we also know dynamics in the region are shifting. For example, while China still contributes the most, India, Indonesia, and others are expanding their share significantly, fortifying the case for diversification. Yet, while China still contributes the most, India, Indonesia, and others are expanding their share significantly, fortifying the case for diversification.

Figure 8

Rising importance: India, Malaysia, and other emerging Asia countries

Contribution to world GDP growth in 2028E



Note: Region data is as per IMF regional seggregation.
Others is residual after US, EU and Emerging Asia
Source: World Economic Outlook, UBS, as of October 2023

To capitalize on this, investors should be guided by quality, and companies that can generate steady earnings. One way to express this is through the "Asian growth in addition to MSCI China" theme, underpinned by Asia artificial intelligence (see page 81: Why bigger is better in Asia's changing future), "banks for the next billions", and structural consumption growth pillars.

Consumption surfing the demographic wave

First, Southeast Asia's continued demographic advantage is one to watch. ASEAN's young population of 678 million, dominated by Indonesia (40% of total), the Philippines (17%), and Vietnam (15%), is the bulwark for a formidable and dynamic labor force, and an expanding consumer market.

The same can be said for India, with its population of 1.43 billion having surpassed China's in 2023. ASEAN and India's demographic profile, with a population median age of 29.6 and 27.3 respectively, confers a distinct economic advantage over China (37) and Japan (48) due to their burgeoning middle class with increased purchasing power. Within this region, we like consumer names exposed to premiumization and durable longer-term growth, and have robust free cash flow generation.

Banks as growth proxies

Banks play an important role in economies—to transmit monetary policy, safeguard wealth, and provide credit to meet people's needs, to name a few. We particularly favor banks in India, Indonesia, and the Philippines, as they act as a proxy to the economic growth potential in these countries.

Moreover, the three markets are still underbanked, with debit or credit card ownership in the adult population at only 31%—far below Japan (90%), the US (91%), and China (78%). In a similar vein, these domestic banks' credit-to-GDP ratios are relatively low, in our view.

Looking to 2024, we expect these banks to continue recording loan growth in the low-teens, supported by a healthy appetite for consumer lending, capex investments, and relatively stable mortgages. After three years of decline in credit-cost provisioning, we see limited further upside from this lever, but expect a limited boost from improvements in net interest margin, even though we acknowledge that the bulk of these gains have been realized in recent quarters.

Among the banks in India, Indonesia, and the Philippines, we prefer large-cap names that are well-positioned to outpace their industry's loan growth rates. These banks generally trade at an attractive 2.0x price-to-book ratio, below the typical historical average of 2.1x. Beyond attractive valuations, these companies have also gradually raised their dividend payouts to bolster shareholder returns.

The "China+1" shift is real

Many international companies have sought to diversify their supply chains in the wake of COVID-induced disruptions and steepening geopolitical risks. In Asia, this is evident from the growing number of "China+1" supply chain diversification strategies, with South and Southeast Asia (particularly India, Indonesia, and Vietnam) appearing to be the biggest beneficiaries of this move.

Indeed, these countries' cost competitiveness, political stability, and in Vietnam's case, a land border with China make them good options in such a strategy.

China's foreign direct investment (FDI) into the region has also risen dramatically to catch up with the US—as part of a strategic move to sidestep tariffs and rule-of-origin regulations in the US and Europe, which penalize direct exports from China. In fact, China's FDI in the region is now 4x its size ten years ago.

Moreover, these supply chain reshoring and FDI trends should contribute to a structural improvement in current account balances over time, particularly in India and Indonesia. We view companies in construction, energy, transportation, and telecommunications as beneficiaries of rising infrastructure FDI.

Elsewhere, industrial and logistics real estate and industrial REITs in the region, especially Singapore, offer opportunities—as do select solar panel manufacturing and electric vehicle supply chain companies. Here, these regional supply chain shifts from China to ASEAN have been a pillar of our "ASEAN: Extending the China platform" thesis.

Key takeaways

- Growth beyond mainland China. South and Southeast Asia are expanding their share of global growth as China slows.
- Buy quality growth proxies. We like regional consumer names backed by "premiumization" and cash flows, as well as banks in India, Indonesia, and the Philippines.
- The "China+1" shift is real. South and Southeast Asia are the biggest beneficiaries, benefiting upstream and downstream sectors.

Will Japan's new dawn continue?

While we remain neutral on Japanese equities in our global allocation, we think the quality value segment will rise and shine in Japan's first sustainably inflationary environment in the coming decades.

2023 has been a bright year for Japan. The economy is finally awakening from three post-bubble decades filled with distinct, but troublesome, firsts—the first to experience sustained deflation in the developed post-World War Two world, the first to cut interest rates below zero, and the first to cap bond yields. Indeed, in 2022 alone, core inflation reached the highest level since the early 1980s and real growth in 2023 has outpaced most other major developed markets. These developments have helped Japanese equities outperform the rest of Asia by more than 10pps YTD in 2023 (in USD terms).

We think this new chapter is only just beginning. Though inflation could moderate back to around target in 2024, robust wage growth and an ongoing reopening boost for the service sector should keep price growth above the levels seen in the last few decades. Such a reflationary environment means Japan will also likely be the only developed economy growing above trend in 2024, with two important implications for investors:

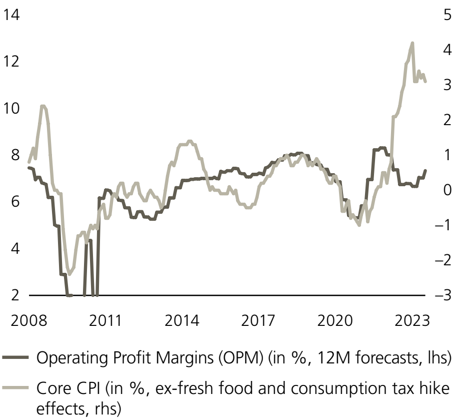
- First, corporate governance reforms will likely accelerate over the next 6–12 months. An aggressive set of edicts from the Tokyo Stock Exchange (TSE) has set the groundwork for Japan Inc. to improve governance and shareholder returns. But that will likely only happen if corporations are confident in their earnings outlook. The good news is that we see strong annual EPS growth over the current two-year period—including 9% for FY2023 (ending March-2024) and 7% for FY2024, versus 0% and 7% respectively for the global equity market—as a result of the improving growth backdrop, which should encourage companies to utilize their cash and increase share buybacks, unwind cross-shareholdings, and deploy capex in the year ahead.

- Second, the Bank of Japan will likely normalize…slowly. We think the BoJ's response to accelerating wage growth and moderate inflation could include an end to its yield curve control and negative policy rates in 1H24, leading to a rise in 10-year JGB yields to around 1%. But despite the current wage developments, keeping inflation at a sustainable 2% level is still a high hurdle for Japan, in our view, making it unlikely to hike policy rates above zero anytime soon. Our base case continues to call for a prudently accommodative monetary policy in 2024, providing a favorable investment environment for risk assets like stocks.

Figure 9

Higher inflation supports higher margins

Operating Profit Margins (OPM) (%, 12M forward, lhs), core CPI (%, ex-fresh food, rhs)



Source: Bloomberg, UBS, as of November 2023

Bank on quality value

In the year ahead, we see quality value stocks standing out as clear beneficiaries in Japan. While they have already outperformed the broader Japanese equity benchmark over the past few months, the positive inflation cycle, higher JGB yields, and the TSE's ROE push will make the segment even more attractive over the coming quarters, in our view.

For starters, value stocks tend to have a high correlation with inflation expectations. But we still favor quality as Japanese consumers turn more selective in light of rising prices, which pressure companies to refocus on providing product and pricing differentiation as well as more value-add. For quality companies, pressure to boost their ROE should also ensure that improvements in profitability translate to higher shareholder returns.

Meanwhile, banks remain one of the main beneficiaries of policy normalization and higher yields. While banking stocks have outperformed the benchmark index in 2023, they are still laggards since the BoJ first introduced its negative interest rate policy in 2016. Also, P/BV valuations remain stuck below pre-2016 levels, leaving more headroom for a near-term re-rating as profitability improves in the quarters ahead. Potential share buybacks are also near-term catalysts, while a relatively high dividend yield of 3.5–4% should mitigate downside risk.

Key takeaways

- New dawn to continue. Japan will likely be the only developed economy growing above trend in 2024 as inflation remains at three-decade highs.
- Reforms and normalization. Corporate reforms are set to accelerate, while the BoJ slowly normalizes policy. Together, we see a favorable investment environment.
- Bank on value. Quality value stocks stand out in a reflationary Japan, particularly large banks.

Can Asian credit perform in a higher-yielding universe?

For Asian bonds, what's past is prologue—we think the rise in global yields to decade-highs sets the stage for Asian investment grade credit to deliver high-single digit returns in 2024. But an uncertain world continues to call for quality.

After plenty of pain in 2022, Asian bond investors were certainly hoping for better gains in 2023. The results, however, have been far more lackluster: Asian investment grade credit has only delivered slightly positive total returns, while Asian high yield has been flat YTD.

The muted performance can be largely pinned on a prolonged US rate cycle that's pushed yields to new cycle highs. In fact, from April to mid-October, 10-year US Treasury yields soared 180bps to a peak of 5%—heights previously unheard of in the post-global financial crisis era—driving yields in most global fixed income sectors to within the ninth percentile of their range since 2007. In Asia too, investment grade yields rose to multi-year highs around 6.5%, even as spreads stayed stable.

Heading into 2024, we think such levels offer both a compelling entry point and a sizable income cushion against the risk of further rate hikes or spread widening. Macroeconomic and policy conditions are also becoming more bond friendly on balance: Inflation and growth are gradually easing and the Fed's tightening cycle is likely over, even if the timing of rate cuts remains uncertain. Indeed, market expectations that the Fed won't cut rates below 4%, look overly hawkish to us.

Buy quality in an uncertain world

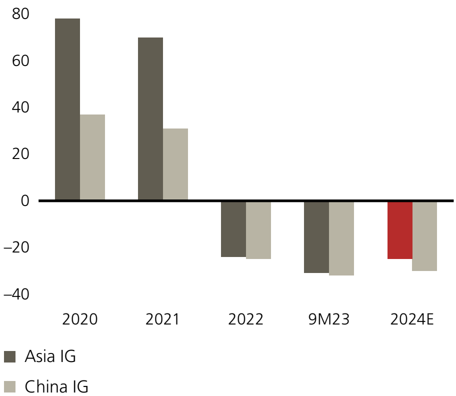
These dynamics suggest rates will remain the biggest driver of Asian investment grade returns in the year ahead. From current levels, we think the higher-quality segment could deliver high-single digit returns in 2024 as interest rates fall, with upside potential if the US economy slows more than expected.

Moreover, we expect spreads to stay resilient thanks to a supportive technical backdrop. Supply remains tepid as issuers enjoy access to cheaper onshore funding, with net USD IG issuance in Asia at –30bn as of end-September. On the demand front, around USD 80bn of IG corporate bonds mature in 2024 and will need to be redeployed. Fundamentals in this space are intact with some sovereign issuers such as Indonesia expecting a positive rating action.

Figure 10

Asia IG net issuance should stay negative in 2024

This should keep the demand-supply picture supportive of credit spreads, in USD bn



Source: Bloomberg, UBS forecasts, as of November 2023

Avoid low-quality segments

Meanwhile, Asia high yield enters 2024 with structurally different sector and country risk profiles than in recent years. After elevated default rates of about 18.2% in 2023, we expect this to decline in 2024 to mid- to high-single digits, though most of this is still due to remaining China property issuers trading at distressed levels.

These defaults have also reduced the Chinese property allocation in the high-yield index to low-single digits, although broad exposure to China remains sizable at 24%.

In contrast, non-China segments have bolstered high yield returns in 2023, but tightening spreads reduce the appeal of these issuers entering 2024. If we exclude China and sovereigns from the high yield index, yields plunge from 16% to around 10%, largely in line with other HY markets globally. With the high yield market effectively shut for most issuers, we see refinancing as the biggest risk for the segment in 2024, especially with close to USD 29bn of HY corporate bonds set to mature in 2024. All things considered, we don't see adequate risk-reward in having broad Asia high yield exposure and instead prefer to focus on very select bottom-up opportunities.

Where to position

We favor Asia investment grade over high yield in 2024. Within IG, senior financials and Indonesia are our preferred sub-segments given we expect spreads to stay resilient. Our picks in high yield are primarily bottom-up driven, focusing on improving fundamental stories such as Macau gaming. We continue to stay away from mainland Chinese property (IG and HY) and mainland Chinese high yield names in general as access to funding appears highly challenging.

As for duration, history indicates that the period immediately after hiking cycles conclude tend to be more lucrative for longer-dated bonds, which significantly outperform the total return from repeatedly re-investing in shorter maturities. For now, we see value in the middle part of the yield curve, which offers an appealing combination of higher yields and greater stability than the longer end, as well as some sensitivity to falling interest rate expectations. In Asia, a barbell strategy can also directly capture these benefits by pairing long-dated (7–10 years) high-quality bonds (single-A or higher) for upside potential with short-dated credits (1–3 years) with more credit risk for the attractive yield carry.

Key takeaways

- Driven by rates. We see high-single digit returns for Asian IG in 2024, driven mostly by rates.
- Buy quality in an uncertain world. Within IG, senior financials and Indonesia are our preferred sub-segments. Pair higher-quality duration with short-end bonds for upside.
- Avoid low-quality credits. With refinancing the biggest risk for high yield in 2024, we do not see adequate risk-reward in the segment.

How will Asian currencies fare in 2024?

Asian currencies may continue to struggle against the greenback in 1Q24, but the outlook should improve from 2Q24 onwards. Investors can consider trading the range, buying on dips, and focusing on select near-term beneficiaries.

Asian currencies are likely to struggle heading into 1Q24, as USD strength should persist against a backdrop of strong US growth dynamics, elevated US yields, and safe-haven demand driven by geopolitical tensions.

That said, from 2Q24 onwards, we expect the greenback to pare its gains when the US economy is expected to slow, and when US yields consequently trend lower.

Additionally, should inflation continue to moderate over the coming quarters, we also expect global central banks to dial back on policy restrictiveness in 2H24, and provide a cyclical growth boost to export-oriented Asian economies.

Near-term beneficiaries

Amid ongoing market uncertainty, we favor the AUD, THB, and CNY over the IDR, MYR, PHP, and INR in the near term. In the coming months (late-2023 and 1Q24), we expect outperformance for the AUD (hawkish central bank), THB (seasonal tourism boost), and CNY (growth stabilization).

We believe that the Reserve Bank of Australia has a relatively more hawkish bias than both the Reserve Bank of New Zealand and the Monetary Authority of Singapore.

For starters, Thailand's inbound tourist flows tend to peak between late November and March, which has historically led to seasonal THB appreciation. Over the past two decades, the THB has strengthened by an average of 2.2% (versus USD) and 2.1% (in trade-weighted index terms) between November and March.

Elsewhere, the AUD has received a renewed tailwind from strong domestic growth and inflation dynamics, keeping the Reserve Bank of Australia on a hawkish bias. We also see the CNY benefiting from the People's Bank of China's efforts to lean against the weakness in the CNY, as well as signs that China's economic activity has bottomed out.

Figure 11

Certain currencies (IDR, MYR, PHP, INR) are relatively vulnerable to USD strength and rising US yields

Items in red indicate areas of weakness

	FX reserves		**Balance-of-payment**		**Foreign holdings of local currency govt debt**			**USD-denominated local govt debt**	
Currency	**USD bn**	**% GDP**	**CA % GDP (latest 3 months)**	**Trade balance (3mma, USD bn)**	**USD bn**	**% market**	**% FXR**	**USD bn**	**<1Y maturity**
SGD	337	71.4%	19.0%	3.8					
TWD	564	77.2%	12.2%	9.1					
CNY	3115	17.5%	1.6%	75	293.3	8.2	9.4%	16.0	1.0
THB	211	42.3%	0.6%	0.2	25.9	11.6	12.2%		
KRW	414	25.2%	1.7%	2.2	152.4*	20.0	36.8%		
INR	586	17.4%	–1.1%	–21.4	27.6	1.6	4.7%		
PHP	98	23.6%	–3.4%	–4.1	3.2	1.9	3.2%	40.8	2.0
MYR	109	27.6%	2.1%	4.3	53.6	22.9	49.2%	4.3	0.0
IDR	135	10.0%	–0.5%	2.6	51.9	15.0	38.4%	52.5	2.2

*Foreign holdings in KRW local currency govt bonds are likely FX-hedged
Source: Asian Development Bank, Bloomberg, UBS, as of October 2023

Meanwhile, we expect the IDR, MYR, PHP, and INR to underperform, as we see lingering downside risks—due to worsening current account deficits amid high oil prices, and elevated US yields eroding the appeal of these high-yielding currencies.

Buying on dips

As for buying on dips, we think the KRW and TWD look appealing, despite near-term concerns over the KRW's high sensitivity to USD strength, and the TWD's potential volatility in the run up to Taiwan's presidential election in January 2024.

Indeed, pullbacks in these two currencies can be used to add exposure, as we see attractive rebound potential over a 6–12 month horizon. These currencies should be key beneficiaries of an improving global manufacturing cycle, led by a recovery in semiconductors and electronics.

Exposure to the KRW and TWD can be expressed via owning domestic equities on an currency-unhedged basis, in our view.

Getty images

Where to position

Investors have several options to consider. First, we suggest range-trading solutions for G10 currencies. With USD strength likely to persist in the near term, we recommend range-trading structures for currency pairs such as EURUSD (1.04–1.10), AUDUSD (0.62–0.67), USDJPY (145–152) and USDCHF (0.86–0.92).

Another option would be a USD loan cheapener. Investors seeking to mitigate the high cost of USD borrowing (and are willing to assume some FX risk) can engage in selling the downside risk on USDCHF on a 3-month basis. The likelihood of a sharp USDCHF decline in the near term looks contained, with the Swiss National Bank signaling it is likely done with tightening.

Finally, consider going long AUD (versus the NZD and SGD). For investors with higher risk tolerance, we believe the AUDNZD and AUDSGD exchange rates are trading at attractive levels, and suggest positioning for a medium-term rebound.

We believe that the Reserve Bank of Australia has a relatively more hawkish bias than both the Reserve Bank of New Zealand and the Monetary Authority of Singapore. Speculative net-short positioning in AUD is also close to historical extremes, and an unwinding of these positions could reinforce an AUD rebound.

Key takeaways

- Stuck in a near-term range. But as the USD weakens from 2Q, Asian currencies should see a modest recovery of 4% in 2024.
- Near-term outperformers. These include the AUD (relative central bank hawkishness, THB (seasonal tourism), and CNY (growth stabilization) in the coming months.
- Over the longer term, the KRW and TWD could rebound on an improving global manufacturing cycle.

How is APAC's real estate recovery shaping up?

Divergent fortunes across Asia Pacific's real estate markets continue to be driven by idiosyncratic factors. While North Asia continues to stay volatile, Singapore, Tokyo, and Sydney should see moderate price increases.

Low financing costs were the lifeblood of global housing markets for many years. The abrupt end of the low interest rate environment has shaken this foundation. Inflation and higher interest rates have resulted in a real price drop of 5% on average across cities surveyed in the UBS Global Real Estate Bubble Index report, the sharpest decline since the global financial crisis.

In the most sought-after post-pandemic destinations where prices actually rose, fundamentals largely improved as rents boomed and households deleveraged amid soaring mortgage rates. Taken together, these sturdier foundations mean the world's financial centers are now the most balanced they have been since the pandemic began.

In Asia Pacific, Hong Kong has moved down from bubble risk to overvalued, while Singapore has moved down from overvalued to fair valued. Only Tokyo—where financing conditions continue to be attractive—remains in bubble territory.

Prefer REITs over developers in Singapore

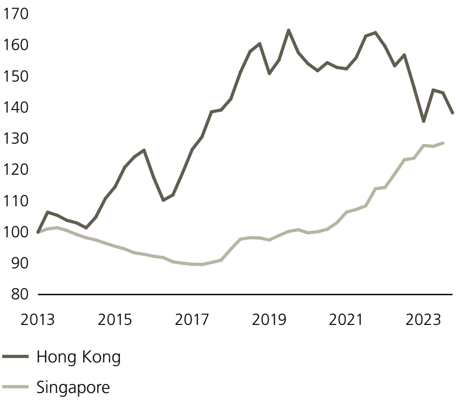
In Singapore, we expect the growth in private home prices to moderate. After rising 8.6% in 2022, we expect prices to grow by 4–6% in 2023 and low-single digits in 2024. This moderation in price inflation is largely driven by growing supply of physical housing completions, coupled with multiple rounds of macroprudential policy measures which have kept demand in check.

The risk of further property cooling measures remains an overhang, especially if home prices outpace income and economic growth. For this reason, we favor REITs over property developers in our Singapore equity strategy. REITs stand to benefit from declining bond yields and positive rent reversions. We estimate that every 10bps decline in the 10-year Singapore bond yield correlates with a 2.1pps increase in REITs' share prices, all else being equal. Our preference is for high-quality REITs with resilient dividends, stable asset values, and well-managed balance sheets. Industrial REITs are our preferred sub-sector, followed by retail and then office.

Figure 12

The gap between Hong Kong and Singapore home prices has narrowed

Singapore and Hong Kong residential price indexes, 2013 - current



Source: Centaline, URA, UBS, as of September 2023

Price gains in Tokyo and Sydney

In Tokyo, price gains have been spurred by attractive financing conditions and population growth. In fact, after moderate low- to mid-single digit increases in the past five years, the average price per square meter surged by 30% y/y in the first eight months of 2023 as limited supply and some luxury residential units pushed prices up. While incomes and rents have not kept pace with price inflation, accommodative financial conditions are likely to support moderate price increases over the next few years. We prefer property developers over REITs in Japan in view of an impending rise in JGB yields.

Australia's housing market recovery is firmly underway, with bellwether Sydney recording an 8.8% increase in dwelling values since its trough in 2023. Sydney's home prices should rise by mid-single digits over the next 12 months, supported by favorable supply-demand dynamics. Demand has been supported by robust net overseas migration to Australia, while supply has been constrained by slowing housing construction. That said, weak housing affordability and poor buyer sentiment are likely to dampen the pace of price inflation. In the listed equities space, we prefer select residential and industrial REITs and developers with resilient earnings, healthy balance sheets, and attractive dividend yields.

North Asia's mixed outlook

In contrast, Hong Kong's home prices have dropped by around 6% over the last 12 months amid rising mortgage rates and a slower-than-expected economic recovery in mainland China. Hong Kong's prime rates have so far lagged those of the US. Potential hikes in Hong Kong's lending rates could continue to exert downward pressure on home prices, where we see low- to mid-single digit downside. For this reason, we prefer to invest in community REITs with resilient earnings and developers with recurring cash flows and strong balance sheets.

Similarly, mainland China's secondary home prices have corrected by about 8% year-to-date. Weaker income growth, lower price expectations, and private developers' credit crunch have all weighed on homebuyer sentiment. Supportive policy measures should benefit Tier 1 and 2 cities, where we expect home prices to stay flattish, more than lower-tier cities. Volatility is likely to persist among listed property developers. We prefer to engage this sector via proxies such as home appliance makers and property agencies.

Key takeaways

- Singapore REITs preferred over developers, as government bond yields decline.
- In Japan, we prefer developers over REITs as JGB yields rise, while select residential/ industrial REITs and developers look attractive in Australia.
- With volatility likely to persist for Chinese developers, we prefer proxies such as home appliance makers and property agencies.

Mitchell Luo I pexels

2023 in review

Growth

We expected economic growth to decelerate in 2023. It did, though not as much as we expected. Developed economies are on track to grow by 1.7% in 2023 versus our initial estimate of 0.4% (and 2.4% in 2022), and emerging economies to grow by 4.3% versus our estimate of 3.5% (and 4.1% in 2022).

Inflation

We thought that 2023 would see inflation fall, and it did, albeit slightly less than we expected. US consumer price inflation looks set to end the year at 3.7%, versus our original expectation of 3.6%.

Rates

We expected central banks to be in a position to cut interest rates by the end of 2023. While they are at, or close to, the end of rate hikes, tighter labor markets have precluded looser policy for now. We now expect the first rate cuts to start in late spring or early summer 2024.

Bonds

Surprisingly resilient economic growth and labor markets allowed bond yields to continue to rise, contrary to our expectations. We thought 10-year US Treasury yields would decline from 3.9% in 2022 to 3% in 2023. They are at 4.6% at the time of writing.

Stocks

We had a neutral stance on equities as we entered 2023. An unexpected AI-fueled rally among a handful of stocks supported broad equity indexes during the year. In the 12 months through this time of writing, the S&P 500 is up 10.5%, Stoxx 600 3.3%, and MSCI Emerging Markets 1.8%.

Currencies

The US dollar is approaching the end of 2023 marginally weaker than it started against the euro, the pound, and the Swiss franc, directionally in line with our forecasts for the full year, but to a smaller degree than envisioned. We did not expect the prolonged weakness of the yen, a result of the Bank of Japan's continued loose monetary policy.

Commodities

Gold overshot our expectations as investors sought hedges against geopolitical risks despite high interest rates. By contrast, oil prices fell short of our initial expectations, though the efforts by OPEC+ to limit supply allowed prices to almost test the USD 100/bbl mark in the third quarter.

Asset class forecasts

Commodities

	Spot	June 24	Dec 24
Brent crude oil (USD/bbl)	83	95	95
WTI crude oil (USD/bbl)	78	91	91
Gold (USD/oz)	1,950	1,950	2,150

Source: UBS, as of 13 November 2023

Rates and bonds

	2-year yields (%)			10-year yields (%)		
	Spot	June 24	Dec 24	Spot	June 24	Dec 24
USD	5.03	3.75	3.25	4.64	3.75	3.50
EUR	3.08	2.50	2.00	2.71	2.25	2.25
GBP	4.64	4.00	3.50	4.31	3.75	3.50
CHF	1.31	0.75	0.70	1.09	0.90	0.90
JPY	0.10	0.20	0.25	0.87	1.00	0.80

Source: Bloomberg, UBS, as of 13 November 2023

Currencies

Developed markets	Spot	June 24	Dec 24	PPP
EURUSD	1.07	1.10	1.12	1.29
GBPUSD	1.23	1.25	1.27	1.59
USDCHF	0.90	0.88	0.87	0.78
USDCAD	1.38	1.34	1.32	1.21
AUDUSD	0.64	0.69	0.72	0.69
EURCHF	0.96	0.97	0.97	1.00
NZDUSD	0.59	0.61	0.62	0.61
USDJPY	152	143	140	84

Source: UBS, as of 13 November 2023

Emerging markets	Spot	Mar-24	Jun-24	Sep-24	Dec-24
USDCNY	7.29	7.30	7.20	7.10	7.00
USDIDR	15701	15900	15700	15500	15300
USDINR	83.3	83.50	83.00	82.00	81.50
USDKRW	1322	1320	1280	1260	1240
USDMYR	4.71	4.75	4.65	4.60	4.50
USDPHP	56.1	57.0	56.5	56.0	56.0
USDSGD	1.36	1.35	1.34	1.32	1.31
USDTHB	36.0	34.8	34.5	34.2	33.8
USDTWD	32.3	32.0	31.6	31.2	30.8

Source: Bloomberg, UBS, as of 14 November 2023

Economic forecasts

	GDP growth (%)				Inflation (average, %)			
	2023E	**2024E**	**2025E**	**2026E**	**2023E**	**2024E**	**2025E**	**2026E**
Americas								
US	2.4	1.1	1.7	1.8	4.2	2.7	2.0	2.3
Canada	1.1	0.2	1.3	2.1	3.9	2.5	2.1	2.0
Europe								
Eurozone	0.5	0.6	1.2	1.1	5.5	2.4	2.1	2.0
UK	0.6	0.6	1.5	1.3	7.4	2.6	2.1	2.0
Switzerland	0.7	1.2	1.5	1.6	2.2	1.8	1.7	1.4
Developed markets	1.7	1.1	1.6	1.6	4.6	2.5	2.0	2.0
Emerging markets	4.3	3.9	4.3	4.2	7.6	8.7	5.1	4.1
World*	3.1	2.6	3.1	3.0	6.3	6.0	3.8	3.2

E= Estimate; * Excludes Venezuela for inflation
Source: UBS, as of 13 November 2023

	GDP growth (%)				Inflation (%)			
	2023E	**2024E**	**2025E**	**2026E**	**2023E**	**2024E**	**2025E**	**2026E**
Australia	1.9	1.6	2.2	2.1	5.7	3.6	3.0	2.9
New Zealand	1.6	2.2	2.9	2.7	5.7	3.1	2.3	2.1
China	5.2	4.4	4.6	4.2	0.4	1.2	1.6	1.8
Indonesia	5.0	4.8	5.1	5.0	3.7	2.8	3.1	2.8
Malaysia	4.2	4.0	4.3	4.3	2.6	2.2	2.2	2.1
Philippines	5.1	5.3	5.8	6.0	6.0	3.6	3.0	2.8
Thailand	2.4	3.4	2.9	2.9	1.4	1.9	1.6	2.0
South Korea	1.3	2.0	2.2	1.8	3.7	2.3	2.0	2.1
Taiwan	1.1	3.1	2.9	2.3	2.5	2.2	1.9	1.9
India	6.3	6.2	6.2	6.5	5.5	4.8	4.5	4.5
Singapore	0.7	1.8	3.1	2.7	4.8	3.3	1.8	2.1
Hong Kong	3.6	2.5	2.8	2.1	1.8	1.8	2.1	1.9
Japan	1.9	0.7	1.0	0.8	3.3	2.3	1.5	1.6
Asia ex-Japan	5.0	4.6	4.8	4.6	2.2	2.3	2.4	2.6
APAC	4.6	4.2	4.4	4.2	2.4	2.3	2.4	2.5

E= Estimate
Source: UBS, as of 13 November 2023

Impressum

Year Ahead 2024 – UBS House View
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