UBS House View

Investment Strategy Guide: Back in balance?

October 2023 | Chief Investment Office GWM | Investment research

In this report

This report has been prepared by UBS AG, UBS Switzerland AG, UBS AG Singapore Branch, UBS AG Hong Kong Branch, and UBS Financial Services Inc. Please see important disclaimers and disclosures at the end of this document.

Publisher
UBS Financial Services Inc.
CIO Global Wealth Management
1285 Avenue of the Americas
8th Floor
New York, NY 10019

This report was published
on 15 September 2023

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Dear reader

As we head into fall, the US economy has come into better balance. While August data showed a slight uptick in headline and core CPI, inflation has come down sharply from its peak last June, as it heads back toward the Fed's 2% target. At the same time, labor markets continue to cool in a healthy way, giving the Fed less incentive to hike further from here.

As a result, we believe the US economy will likely avoid a recession over the next 12 months, and think a soft landing is the most likely outcome. Market fundamentals also now look in better shape, with second-quarter US corporate earnings beating expectations and management teams guiding for future earnings growth beyond estimates. Taking this all together, we see an environment that supports decent returns across classes—a supportive backdrop for investors in a well-diversified portfolio.

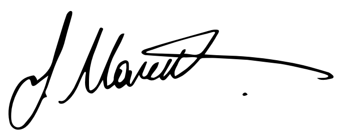
In terms of our specific preferences, we continue to favor fixed income over equities, with yields still attractive and the Fed set to pause soon. Within the asset class, we remain focused on high-quality bonds, given our view that investors are not being compensated adequately for taking on additional credit risk this late in the cycle. Specifically, we see good value in US Treasuries (including TIPS), investment grade corporate bonds, agency MBS, municipals, and sustainable bonds.

Within equities, we still prefer areas that have lagged to date. This includes equal-weighted indexes versus cap-weighted indexes and value stocks, as well as our most preferred sectors such as consumer staples, energy, and industrials. This month, we also upgrade the technology sector to neutral from least preferred given continued strong AI spending, rising earnings revisions, and a bottoming of demand in certain end-markets like cloud and software.

From a longer-term perspective, we believe investors can also benefit from picking leaders from disruption. Within technology, this includes select opportunities as AI spending broadens out to areas like software and internet. But as discussed in our Thematic Spotlight, we also see innovation taking shape in sectors like healthcare, where we hold a tactical theme around the treatment of diabetes and obesity. And we also like themes at the cross-section of our Messages in Focus on "Investing in infrastructure" and "Go sustainable," in areas like water infrastructure, electric grid infrastructure, and cybersecurity.

As always, we encourage you to reach out to your UBS financial advisor with questions on how our views fit in with your goals and portfolio.

Regards,



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October

CIO Monthly Livestream
5 October 2023 at 1:00 PM ET

Tune in to the event here

Back in balance?

Better balance

Inflation has receded, the US labor market has cooled, and the corporate earnings outlook has improved.

Opportune moment

Against a supportive backdrop for stocks and with bond yields high, we expect decent returns across asset classes.

Why invest?

Current high returns make cash look appealing. But returns on bonds and equities should be more durable.

Asset allocation

Bonds remain our preferred asset class. We move the technology sector to neutral and see opportunities to tap into disruptive growth trends.

Mark Haefele
Global Chief Investment Officer
Wealth Management

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In our second-half outlook, published in June, we characterized global markets as facing a balancing act. Our view was that for markets to rally further, the Federal Reserve would need no more than two additional rate hikes, the US recession would need to be averted, and the rally in stocks linked to artificial intelligence would need to be sustained.

In the three months since, inflation has receded, meaning the Fed and other major central banks are closer to the end of their tightening cycles. The US labor market has cooled, but not so much as to push the economy into a recession. Earnings have improved, with US-listed company profit expectations now back at all-time highs. Yet global equities are little changed over this period, and bond yields remain elevated.

In our view, this creates an opportune moment for investors. Against a supportive backdrop for stocks and with bond yields high, we expect decent returns across asset classes: 8–10% for major global stock market benchmarks and 10–15% for major high-quality bond indexes in US dollars, sterling, Swiss franc, and euro by June 2024. And by diversifying, investors can also earn these returns while reducing exposure to potential risks.

Of course, cash offers good current yields. But while we expect bond and stock returns to prove durable, the high interest rates on cash today are likely to drop in the next 12 months. Taking a longer-term view, we expect cumulative cash returns of just 5–14% depending on currency over the next five years, versus cumulative returns of 15–25% in bonds, 40–55% in stocks, and 25–65% in alternatives, based on our Capital Market Assumptions.

Risks remain. Inflation is still above official targets, and rising oil prices threaten to keep it elevated over a longer period. It is unclear if or when the interest rate hikes that central bank have enacted will begin to have a larger effect. China's economy has disappointed. And yet another US government shutdown is possible in October.

Investors can tap into attractive opportunities and mitigate risks.

But for investors who carefully construct multi-asset portfolios, these risks are navigable. By reviewing and balancing exposures, investors can tap into today's attractive opportunity set across asset classes, position for durable returns for years to come, and mitigate the effect of potential risks.

In the remainder of this letter, I will review the macro backdrop as we see it today, outline our tactical views on key asset classes, address the question of why invest now when cash rates are so attractive, and review our preferred areas within each asset class.

Back in balance – the macro backdrop

While a soft landing is not yet assured, the economy looks much closer to being in balance.

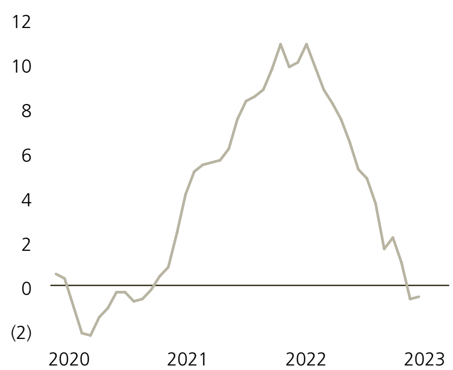
A few months ago, achieving an economic "soft landing" in the US seemed a challenging task. Inflation was well above target, the US labor market was extraordinarily tight, and the financial system was straining under the pressure of higher interest rates. Today, while a soft landing is not yet assured, the economy looks much closer to being in balance.

Most critically, inflation measures and indicators of future inflation are pointing down. PCE goods prices are in deflation, coming in at –0.5% year-over-year in July. The declining trend in housing rents has started to be reflected in the official housing inflation gauge. And the number of employees leaving their existing jobs—often to seek equivalent jobs with higher pay—has fallen.

Figure 1

Goods prices in deflation

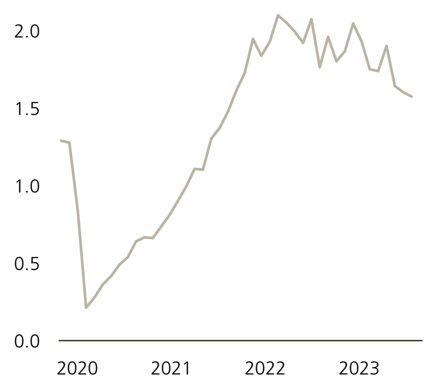
US PCE goods price inflation, y/y, in %



Source: Bloomberg, UBS, as of September 2023

Labor market tightness has eased

US job openings to unemployed ratio



Source: Bloomberg, UBS, as of September 2023

Recent activity data have also indicated resilience. The labor market has cooled enough to reduce upward pressure on inflation, but not so much as to provoke fears of recession. Job vacancies were double the number of unemployed in April; that ratio has now fallen to 1.5x. Nonfarm payroll growth has slowed to the 100,000–200,000 range in recent months, a level closer to the growth in the labor force.

Meanwhile, consumer dollars are coming less out of excess savings built up during the pandemic and more out of real wage growth. Rising spending and flat income had caused the savings rate to fall to an unsustainably low 3.5%, but with real wage growth turning positive in March and increasing 0.2% month-over-month in July, the average consumer should be able to maintain real spending without having to draw down savings.

Risks

Risks to the soft landing remain, including slowing progress on inflation.

Risks to the soft landing do remain, of course. The steady rise in oil prices in recent weeks will lead to higher headline inflation, and being a highly visible price to consumers, may undo some of the progress made in reducing inflation expectations. In our base case, however, we don't expect oil prices to move past USD 100/bbl on a sustained basis over the next 12 months, as that would likely induce strong US supply growth and hurt demand growth in 2024.

An exogenous shock is also possible. Disappointing growth in China has raised concerns about possible spillover effects into the global economy. However, even for a trade-oriented region like the Eurozone, China accounts for only around 8% of exports; for the US, that figure is 7.5%.

Separately, the start of a new federal fiscal year in October challenges the US Congress to avoid a government shutdown. But unlike the recent debt ceiling debate, which posed an existential threat to financial markets, the risk of long-term adverse consequences from a temporary closure of US government offices is minimal, in our view.

Overall, we think the macro backdrop suggests a combination of higher growth and lower inflation than had seemed possible a few months ago. The Fed now faces less pressure to hike rates further, and rising real wages are reducing the economic pain from earlier rate hikes.

The market outlook

Range-bound equity and bond markets create an opportunity for investors.

The macroeconomic backdrop has improved, and we see an increasing likelihood of a "softish" landing being achieved. But both equities and bonds have been broadly range-bound for the past three months. We think this creates an opportunity for investors, and we expect positive returns across both markets over the next six to 12 months.

Bonds

Bond performance has been muted so far this year, as resilient US economic growth and steadily increasing oil prices have led to expectations that interest rates will stay higher for longer. Year-to-date returns through the end of August for US and European high grade bonds have been just 0.7% and 2.8%, respectively.

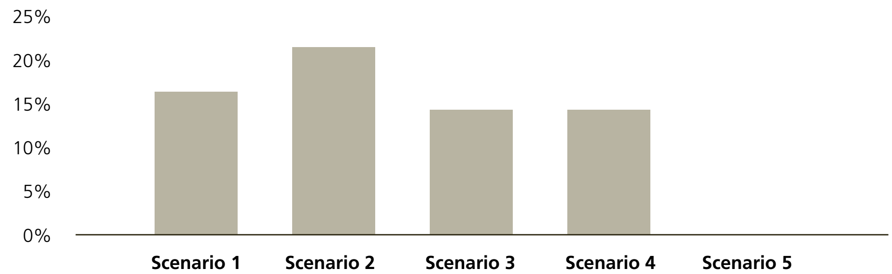
Still-high bond yields provide investors with an opportunity to lock in attractive interest rates.

The good news is that still-high bond yields provide investors with an opportunity to lock in attractive interest rates. In most scenarios, we expect bonds to outperform cash over both 12-month and five-year time horizons. We also see the risk of absolute mark-to-market losses in quality bonds as limited; for investors in 5-year US Treasuries (currently yielding 4.4%) to lose money over a one-year horizon, we would have to assume a further increase in yields of 100 basis points.

Figure 2

We expect high returns for Treasuries across most interest rate scenarios

Estimates for 1-year total returns (in %) for 10-year US Treasuries under different scenarios



Scenario 1: Hike to terminal rate of 5.25%, hold for 6mths, then cut back to 2.5%
Scenario 2: Hike to terminal rate of 5.25%, hold for 6mths, then cut back to 0%, hold for 12mths, hike back to 2.5%
Scenario 3: Hike to terminal rate of 5.5%, hold for 12mths, then cut back to 2.5%
Scenario 4: Hike to terminal rate of 6%, hold for 6mths, then cut back to 2.5%
Scenario 5: Hike to terminal rate of 5.5%, hold for 12 mths, then cut back to 3.5% (new inflation target of 3%)

Source: Bloomberg, UBS, as of September 2023

Furthermore, in our base case, we expect quality bonds to deliver front-loaded capital appreciation, as economic growth decelerates and inflation falls closer to target. Considering the long and variable lags of monetary policy transmission, we expect US growth to slow down into early 2024 as various measures of inflation are falling. PCE goods prices are in deflation; housing inflation has likely peaked; and while core services inflation ex-housing is elevated, US labor markets are now cooling in response to monetary tightening.

Overall, we expect total returns of 10–15% for both high grade and investment grade bonds* over the next six to 12 months, and bonds are our most preferred asset class.

Equities

In the US, while most of this year's S&P 500 gains have been driven by valuation expansion, profit dynamics are now more supportive.

After a strong first half of 2023, largely driven by expanding valuation multiples, global equity indexes have delivered muted performance over the past three months. In our base case, we expect 8–10% total returns across MSCI developed and emerging market indexes over the next six to 12 months, potentially reaching 17–19% in an upside scenario where AI-driven optimism drives further upside in earnings expectations.

In the US, while most of this year's S&P 500 gains have been driven by valuation expansion, profit dynamics are now more supportive. Bottom-up 12-month forward earnings per share (EPS) expectations have staged a notable rebound and are now back to all-time highs. We expect flat S&P 500 earnings for 2023 and 9% growth in 2024.

* Bond expectations are based on indexes from Bloomberg, ICE BofA, JP Morgan, Bloomberg Barclays, Solactive, and S&P LCD. For more details on how we derive these returns estimates, please consult our Capital Market Assumptions or speak to your advisor.

In the Eurozone, companies have benefited from higher inflation, with greater pricing power supporting earnings. After earnings growth of 20% in 2022, this tailwind is fading as inflation recedes. We expect flat EuroStoxx 50 earnings for 2023 and 3% growth next year. That said, valuations are cheap, with the EuroStoxx index trading at 11.5x 12-month forward earnings, compared with a 10-year average of around 14x.

And in emerging markets, while we now expect earnings to decline 6% this year (in USD terms), we see a potential recovery in 2024, led by Asia ex-Japan as domestic demand improves, industrial production gets a boost from the tech sector, and easing input costs allow an expansion in profit margins. We expect 16% growth overall—18% in Asia ex-Japan—compared to 7% growth for developed markets. Valuations are also cheap. The MSCI Emerging Markets index is trading on a 11.8x 12-month forward P/E, largely in line with its 10-year average and at a 30% discount to the MSCI World index. On a price-to-book basis, the discount is even deeper at 49% versus its 10-year average of 36%.

There are, however, more significant downside risks to stocks than to bonds, in our view, and we have a neutral overall stance on equities. In the event of a sharp economic slowdown, we would expect 22% downside for the S&P 500, 13% for MSCI Europe, and 16% for MSCI Emerging Markets.

Why invest at all?

We expect returns from stocks and bonds to prove durable over the long term, while returns on cash are likely to fall from current high levels.

A question we frequently get from clients in the current interest rate environment is, “Why invest at all?” Even if the macro backdrop is decent, overall risks are lower, and the base-case outlook for markets is favorable, why take any downside or mark-to-market risk, when the returns available on cash look good?

The short answer is durability. While returns from stocks and bonds may be uncertain over the short term, we expect them to prove durable over the long term. By contrast, cash may pay a certain and high return in the near term, but today’s high interest rates are likely to drop in 12 months, presenting reinvestment risk. Overall, we expect cumulative cash returns of just 5–14% over the next five years, versus cumulative returns of 15–25% from high grade bonds, 40–55% from global stocks, and 25–65% from alternatives, based on our Capital Market Assumptions.

In addition, investors often underestimate how well a combination of stocks, bonds, and alternatives can reduce the volatility inherent in holding any of those asset classes individually. For example, in our downside scenario, global stocks would fall by 17%, but 10-year US Treasury bonds would rally by 21%. Equally, in our upside scenario of positive growth surprises, bond markets might return a modest 7% compared with equities’ 17–19%.

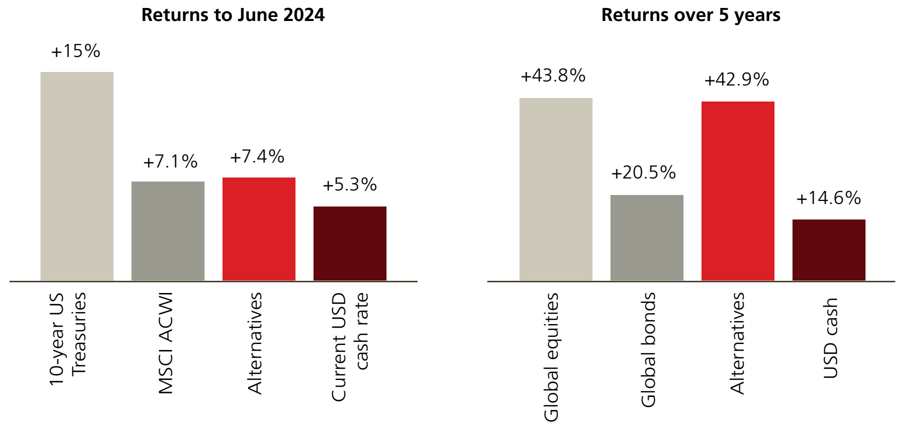
Last year’s simultaneous annual losses for equities and bonds were unusual.

Last year’s simultaneous annual losses for equities and bonds were unusual; since 1926, this has only occurred three times. But if it were to occur again, we think a healthy allocation to alternatives can mitigate portfolio downside: In 2022, diversified alternatives indexes delivered performance between –6% and +17%.

Figure 3

We expect cash to underperform other asset classes

Expected total returns to June 2024 and over 5 years for cash vs. equities, bonds, and alternatives



Note: 1-year equity and bond estimates based on CIO's base case June 2024 forecasts. 1-year alternatives forecast based on long-term capital market assumptions. 5-year forecasts based on long-term capital market assumptions

Source: UBS, as of September 2023

We believe that by developing a core allocation of investments carefully balanced across asset classes, investors can both position to earn attractive returns over the short and longer term, and effectively protect themselves against potential market risks. This approach can also provide them with the freedom to pursue opportunistic or satellite strategies, or passion investments, while staying on track to grow wealth steadily over time.

Investment ideas

The prospect of decent returns across asset classes makes it an opportune time to invest in a balanced portfolio.

Alongside this *Monthly letter*, we have also published our *Quarterly outlook*, also entitled "Back in balance?" In that publication, we have detailed some of our key investment ideas that we believe investors should consider today. I encourage you to read it for a more comprehensive view. Below is a summary of our key ideas:

First, get in balance. We are at a rare moment when earning returns can be relatively simple. In our base case, we expect bonds, stocks, and alternatives all to deliver reasonable returns over the next six to 12 months and over the longer term. Investors need to review portfolios to ensure an effective balance across asset classes to manage potential risks and ensure that returns are durable.

Cash is not an attractive long-term investment.

Second, manage liquidity. Part of getting in balance means not overallocating to cash. Cash rates are attractive. But we expect such high rates to be short-lived as the central bank tightening cycle ends. We recommend that investors hold no more than two to five years of expected net portfolio withdrawals in a Liquidity* strategy. The remainder should be put to work in a balanced portfolio of equities, bonds, and alternatives, which can offer more durable returns than cash. Within Liquidity portfolios, investors can optimize and future-proof yields by using a combination of certificates of deposit, bond ladders, and select structured solutions.

* 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.

Figure 4

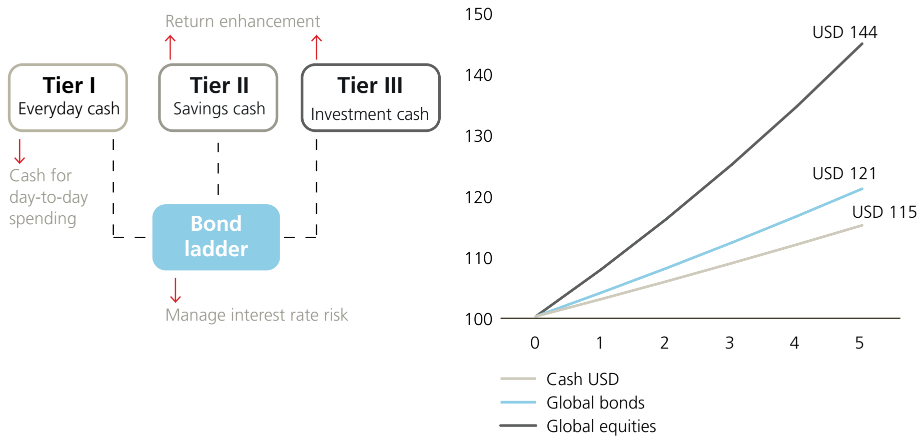
There's a place for cash, but not as a long-term investment

Cash has a role to play as part of a Liquidity strategy…

It is used to meet expenses and avoid selling assets at a loss to meet spending needs

…but it won't improve portfolio returns

Expected 5-year returns of cash vs. equities and bonds, based on CIO's Capital Market Assumptions



Source: UBS, as of September 2023
Strategies are subject to individual client goals, objectives, and suitability.

It is highly unlikely that quality bonds will deliver negative returns over the next 12 months.

Third, buy quality bonds. We expect high-quality bonds to deliver total returns of 10–15% over the next six to 12 months, as economic growth gradually decelerates, inflation falls closer to target, and investors begin to expect future interest rate cuts. Within fixed income, we focus on quality bonds. At current yield levels, we see it as unlikely that quality bonds will deliver negative returns over the next 12 months. Our preferred duration stance is in the 5–10-year range; although yields are lower than at the short end, we see the income durability and greater scope for capital appreciation as attractive. We are less positive on emerging market and high yield bonds given that the additional yield in these asset classes is limited for the additional risks borne.

We see opportunity in the parts of the market that have lagged global indexes this year.

Fourth, look for equity laggards. With stock market gains this year concentrated in a few individual companies, an economic "soft landing" looking more likely, and more investors seeking cheaper stocks, we see opportunity in the parts of the market that have lagged global indexes this year. In US equities, we prefer equal-weighted indexes to cap-weighted indexes. In Europe, we like small- and mid-caps. And within emerging markets, which have lagged global markets, we focus on India and Indonesia. We also like value stocks.

Technological disruption across industries is creating compelling opportunities for investors.

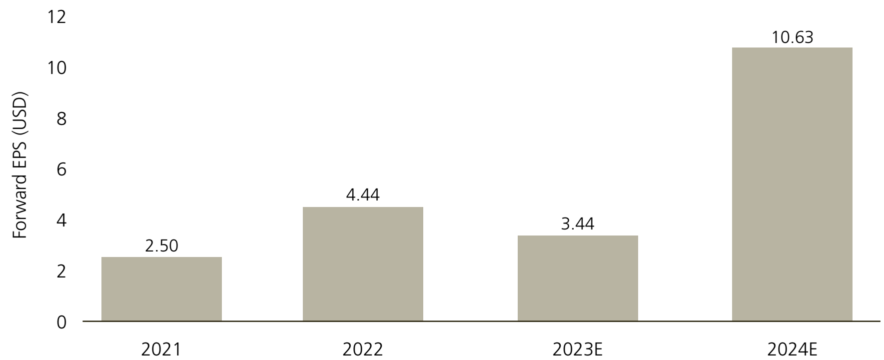
Fifth, pick leaders from disruption. Technological disruption across industries is creating compelling opportunities for investors looking for longer-term portfolio growth potential. In the technology sector, among disruptors, we like platform companies with network effects in industries like internet and software, as the impact of artificial intelligence broadens. We also like enablers exposed to trends like cloud, big data, and AI, including software and solution providers. In energy, we see opportunity in the transition to renewable energy, including carbon reduction and energy efficiency.

This month, we move the global and US information technology sectors to neutral from least preferred. The surge in AI applications and investments has created a powerful new narrative for the broader tech sector. We forecast a 61% compound annual growth rate (CAGR) for AI end-demand during 2022–27.

Figure 5

Demand for AI expected to rise

Consensus earnings forecasts for AI chipmaker Nvidia illustrate unabated demand for AI technology



Source: Bloomberg, UBS, as of September 2023

Alongside these AI developments, we are more constructive on the tech sector due to improving earnings revisions as key end-markets appear to trough; the strength of US tech company balance sheets, a positive driver in a period of high interest rates and slowing economic activity; and the fact that quality growth stocks typically perform well during the later stages of the business cycle.

Implied and realized volatility across equities and commodities has fallen to the lowest level since the start of the pandemic in 2020.

Sixth, benefit from low volatility. Implied and realized volatility across equities and commodities has fallen to the lowest level since the start of the pandemic in 2020. If sustained, this should improve the stability of overall portfolio returns and present opportunities for investors. In equities, investors can now cheaply mitigate downside risks. In commodities and currencies, investors have opportunities to take advantage of market ranges. Fixed income volatility remains elevated compared with prepandemic levels, creating opportunities for cash and bond yield enhancement.

The current market environment also offers compelling individual hedge fund and private markets opportunities.

Seventh, diversify with alternatives. Alternative asset classes are a key part of long-term portfolios, for both risk-adjusted performance and potential diversification when stocks and bonds move together. The current market environment also offers compelling individual hedge fund and private markets opportunities, particularly in specialist credit hedge fund strategies and secondaries in private equity. Higher interest rates can also support return potential for alternative asset managers, given higher yields and returns on offer in underlying assets, including in private debt. Investors should be aware of the unique drawbacks involved in investing in alternatives, like illiquidity.

Infrastructure benefits from digitalization, deglobalization, and decarbonization

Finally, invest in infrastructure. The theme benefits from powerful structural tailwinds driven by digitalization, deglobalization, and decarbonization trends. Government support is likely to spur capacity expansions and enhance current and future project economics and competitiveness, more notably for renewables. In a portfolio context, we think the asset class is a valuable source of steady and inflation-linked income with lower sensitivity to economic growth and broad market movements.

For investors focused on sustainability, each of these investment ideas can be implemented in a sustainable way, including through sustainable multi-asset class portfolios, sustainable bonds, sustainable equities, sustainable themes including in education and biotechnology, and a growing universe of sustainable hedge funds and private market funds.

Mark Haefele
Chief Investment Officer
Global Wealth Management

Global forecasts

Economy

Real GDP y/y, in %

	2022	2023E	2024E
US	2.1	2.1	0.4
Canada	3.4	1.4	0.5
Japan	1.0	2.0	0.8
Eurozone	3.5	0.5	0.7
UK	4.1	0.2	0.6
Switzerland	2.7	0.7	0.9
Australia	3.7	1.9	1.6
China	3.0	4.8	4.2
India	7.2	6.2	6.0
World*	3.4	2.8	2.5

Inflation (average CPI), y/y, in %

	2022	2023E	2024E
US	8.0	4.1	2.2
Canada	6.8	3.5	2.3
Japan	2.5	3.0	1.9
Eurozone	8.4	5.5	2.4
UK	9.0	7.4	2.4
Switzerland	2.8	2.2	1.8
Australia	6.6	5.7	3.2
China	2.0	0.5	1.2
India	6.7	5.6	5.0
World*	8.4	6.1	4.8

*Excludes Venezuela
Source: Bloomberg, UBS, as of 14 September 2023. Latest forecasts available in the Global forecasts publication, published weekly.
Note: In developing the CIO economic forecasts, CIO economists work in collaboration with economists employed by UBS Investment Research. Forecasts and estimates are current only as of the date of this publication and may change without notice.

Asset classes

	Spot	Dec-23	Jun-24
Equities			
S&P 500	4,467	4,500	4,700
Eurostoxx 50	4,223	4,500	4,700
FTSE 100	7,526	8,000	8,200
SMI	10,976	12,000	12,400
MSCI Asia ex-Japan	618	680	700
MSCI China	60	68	71
Topix	2,379	2,300	2,400
MSCI AC World	821	840	870
Currencies			
EURUSD	1.07	1.12	1.16
GBPUSD	1.25	1.29	1.35
USDCAD	1.35	1.32	1.30
AUDUSD	0.64	0.66	0.70
EURCHF	0.96	0.97	0.97
USDCHF	0.89	0.87	0.84
USDJPY	147	142	138
USDCNY	7.27	7.40	7.20

	Spot	Dec-23	Jun-24
2-year yields, in %			
USD 2y Treas.	4.97	3.75	2.75
EUR 2y Bund	3.17	2.50	2.00
GBP 2y Gilts	4.97	4.50	3.50
CHF 2y Eidg.	1.11	1.10	0.75
JPY 2y JGB	0.02	0.05	0.05
10-year yields, in %			
USD 10y Treas.	4.25	3.50	3.00
EUR 10y Bund	2.65	2.00	2.00
GBP 10y Gilts	4.34	3.75	3.25
CHF 10y Eidg.	0.98	1.10	0.90
JPY 10y JGB	0.71	0.80	0.80
Commodities			
Brent crude, USD/bbl	91.9	95	95
WTI, USD/bbl	88.5	91	91
Gold, USD/oz	1,907	1,950	2,100

Source: Bloomberg, UBS, as of 14 September 2023. Latest forecasts available in the *Global forecasts* publication, updated weekly.

Messages in Focus

The Messages in Focus (MIFs) are a set of high-conviction investment narratives from CIO. These narratives combine our top views across asset class preferences, short-, medium-, and longer-term themes, and alternatives.

MIFs	Elevator pitch	Investment ideas
Get in balance	While currently high rates on cash are likely to fall in the years ahead, we expect attractive returns across stocks, bonds, and alternatives both over the next six to 12 months, and over the longer term. Investors should review their portfolios to ensure an effective balance across asset classes to manage potential risks and ensure returns are durable. As well as convenience, professionally managed balanced portfolio solutions provide systematic rebalancing, broader diversification, and access to attractive underlying investments.	• Balanced asset allocation (including alternatives) • Balanced sustainable asset allocation (including alternatives)
Manage liquidity	Investors have held more cash than usual as global central banks have taken rates sharply higher recently. With rates likely nearing a peak, we think now is an appropriate time for investors to review their liquid assets, consider diversifying exposures, and lock in attractive yields.	• Bond ladder • Certificates of deposit • Capital preservation structured investments • Money market funds • Bond funds
Buy quality bonds	We expect high-quality bonds to deliver total returns of 10–15% over six to 12 months, as economic growth gradually decelerates and inflation falls closer to target. At current yield levels, we see it highly unlikely that quality bonds will deliver negative returns over investment horizons of 12 months or more. Our preferred duration stance is in the 5–10-year range (12–20 year for munis) where we see the income durability and greater scope for capital appreciation as attractive	• Government bonds (including TIPS) • Investment grade corporate bonds • Municipal bonds • Sustainable bonds • Actively managed fixed income strategies
Look for equity laggards	Year-to-date global equity gains look inconsistent with a slower second-half growth, a likely earnings contraction, and appealing risk-reward in bonds. This year's leaders linked to artificial intelligence (AI) look vulnerable to correction, at valuations of more than 30x price-to-earnings multiples. Capital preservation strategies on US secular winners can limit corrections, while better earnings and valuations can support emerging markets, select parts of Europe, lagging sectors across defensives and cyclicals, and value.	• US equal-weight vs. cap-weight • Value vs. growth • Capital preservation strategies • Emerging markets • Quality income
Pick leaders from disruption	Technological disruption across industries is creating opportunities for investors looking for longer-term portfolio growth potential. In the technology sector, among disruptors, we like platform companies with network effects in industries like internet and software as the impact of AI broadens. In energy, we see opportunity in the transition to renewables. We also see opportunities in the healthcare sector, as advances in drug development in areas like diabetes and weight loss are driving significant industry growth.	• Technology disruption • Energy transition • Healthcare innovation

MIFs	Elevator pitch	Investment ideas
Diversify with alternatives	Uncertainty about whether the US economy experiences a soft, hard, or no landing may mean higher volatility and mispricing across assets. Hedge funds, especially discretionary macro, can seize mispricings to generate returns while reducing portfolio drawdowns. Valuation differences and active ownership can help private equity deliver returns above public markets, while private assets in debt and real estate can offer an alternative income source for the long run.	• Hedge funds (discretionary macro, equity low-net, credit, multi-strategy) • Private markets (private equity, private credit, real estate)
Invest in infrastructure	Inflation and a slower growth outlook have not derailed business spending plans in key areas linked to upgrading infrastructure and supporting the net-zero carbon transition. Longer-term inflation uncertainty is likely to remain elevated, favoring exposure to assets that have a degree of inflation protection built in. Infrastructure assets can be less correlated to stocks and bonds in periods of volatility. Private infrastructure delivered mid-single-digit returns in 2022 when public markets and private equity turned negative.	• Infrastructure (including green-tech) • Industrials (including automation and robotics)
Go sustainable	Green investment, decarbonization commitments, consumer sentiment, and regulations will continue to drive the case for investing sustainably. We like sustainable bonds, ESG leaders, and innovative companies that can do more with less, including within energy and water efficiency, as well as in the transition to renewable energy, where we think investors should balance traditional with sustainable exposure. We also see opportunities to gain exposure to sustainable themes such as health and education through private market vehicles.	• Sustainable bonds • Sustainable equities • Private market impact investing

Asset allocation implementation

The UBS House View is our current assessment of the global economy and financial markets, with corresponding investment recommendations. The asset allocation implementation of this view can vary based on the portfolio types and objectives.

Jason Draho, PhD, Head of Asset Allocation Americas; **Michael Gourd,** Asset Allocation Strategist; **Danny Kessler,** Asset Allocation Strategist

Our tactical asset class preferences

Most preferred
- **New** TIPS
- **New** US large-cap value equities
- Preferreds
- Fixed income
- US agency MBS
- US investment grade corporate bonds
- EM equities
- Oil

Least preferred
- US equities

Neutral

Upgraded from least preferred
- **New** US large-cap growth equities

Implementation guidance

The US economy continues to trend to a soft-ish landing, and a recession starting in the next 12 months remains a risk case, not our base case. Consumer spending is holding up well, and major retailers are expecting that to be maintained into 2024. This should be supported by rising real incomes into 2024, and a labor market that has cooled and is closer to being in balance, without showing worrying cracks. That said, we expect growth to slow from its above-trend pace in 3Q in the next two quarters, weighed down by the lagged effect of high rates and drags on consumption from the UAW strike, the restart of student loan repayments, and a possible government shutdown. Concerns about the economy reaccelerating are overstated, in our view. Disinflation is progressing and should persist, though progress is likely to slow from here.

With a rate hike at the September FOMC meeting very unlikely, the market is focused on whether the Fed will hike one final time in early November and the potential for rate cuts in 2024. Another rate hike is possible, but highly data-dependent. The disinflation and labor market rebalancing thus far should be enough for the Fed to be done. Regardless of whether or not the Fed hikes in November, the market will very likely perceive the Fed as being done. This will reduce upside risk for Treasury yields across the curve, which should decline as the economy slows. Any weak data will likely see the markets pull forward potential rate cuts, whether warranted or not. That can have the effect of providing a floor for risk assets into year-end and early 2024.

Based on this macro outlook, we keep our main asset class preferences unchanged this month, with bonds most preferred and equities neutral. At the current level for the S&P 500 (near 4,460), our June 2024 price target of 4,700 implies a total return of about 6%. While decent, we expect high-quality, longer-duration bonds to produce returns at least that high with lower risk. TIPS are included in this group, and were upgraded to most preferred this month. Real interest rates across the Treasury curve are near multi-year highs, and we expect the decline in nominal yields to be led by lower real rates. The 5-year point is our preferred spot on the curve, but the preference for real rates over nominal is general. When adding TIPS to portfolios, we recommend targeting duration at least as long as the current fixed income allocation, whether shorter in conservative portfolios or long in aggressive ones.

Our regional preference for equities did not change, with emerging markets remaining most preferred and the US least preferred. Within US equities, we moved large-cap growth to neutral from least preferred and large-cap value to most preferred from neutral. This change reflects our continued preference for value over growth stocks, while being less negative on growth after upgrading the tech sector to neutral. This value tilt is also one reason why we continue to recommend **looking for equity laggards**. One way we have been recommending investors express the preference for value and equity laggards is through the equal-weighted S&P 500 index. Growth equity's larger share of the market-cap-weighted index is neutralized when allocating to equal-weight, and the equal-weight S&P 500 has meaningfully lagged its cap-weighted counterpart this year, a trend we expect to reverse. Other equity laggards that are appealing include quality-income stocks and emerging markets.

Within fixed income, our message remains to **buy quality bonds**. We expect high-quality bonds to deliver total returns of 10–15% over six to 12 months, as economic growth gradually decelerates and inflation falls closer to target. At current yield levels, we see it highly unlikely that quality bonds will deliver negative returns over investment horizons of 12 months or more. Specifically, we see good value in US Treasuries (including TIPS), investment grade corporate bonds, agency MBS, municipals, and sustainable bonds. Given the evolving rate environment, we recommend investors consider actively managed fixed income strategies to take advantage of tactical opportunities. We also see value in inflation-protected securities. We are less positive on emerging market and high yield bonds, given their relatively low spreads versus quality bonds considering the additional risks. With the Fed near the end of the hiking cycle, but likely on hold for a long time, we reiterate our message to **manage liquidity**. With inflation continuing to decline, if we get a growth scare, the Fed has room to cut rates very quickly. This would be particularly painful for depositors who haven't locked in these higher rates for the next few years.

From a long-term perspective, we recommend investors to consider sectors and industries experiencing innovative changes. Our recommendation to **pick leaders from disruption** highlights opportunities in technology, energy, and healthcare. In the tech space, we expect AI beneficiaries to broaden beyond the enablers and platforms to software and internet firms. In energy, the ongoing shift to a renewable economy will be further supported by fiscal investment in the US and Europe, providing investors opportunities to participate in this transition. And in healthcare, recent advances in drug development in the fields of diabetes and weight loss are driving significant industry growth, a trend we expect to continue as demand remains high. Beyond these disruptors, we continue to recommend to **invest in infrastructure**. Still-high inflation and potentially slower growth ahead haven't stopped business plans to spend on infrastructure investments, and these plans are supported by substantial fiscal backing, which we explore further in our report "Made in America." We think infrastructure can provide strong returns amid elevated inflation, while also diversifying sources of portfolio return due to their low correlation with stocks and bonds. Within the commodities space, oil remains most preferred. Oil is not pricing in as optimistic an outcome as equities, while supply constraints should become more binding as the year goes on, especially if US growth continues to beat expectations.

Within US equity sectors, this month we upgraded information technology to neutral from least preferred. Our previous least preferred view on the sector was predicated on downside earnings risks, but end-markets appear to be bottoming, enterprise IT budgets are resilient, AI is unleashing a spending surge, and earnings revisions are improving. Valuations are stretched, but this isn't itself a near-term downside catalyst. Elsewhere, we remain most preferred on consumer staples, industrials, and energy, and least preferred on real estate and utilities. Tighter oil supplies in the second half of the year should support prices and allow US energy stocks to rally, while industrials offer exposure to secular growth and some cyclical upside. Consumer staples could lag the market if we do indeed get a soft-landing economic scenario, but the sector provides an attractive hedge given its low valuation. High rates and sluggish growth in funds from operations are likely to weigh on the real estate sector, while utilities tend to perform best when economic growth concerns are highest.

Note: See explanations about asset classes in the Appendix. Changes are based on the US asset class preferences table found in the UBS House View Investment Strategy Guide published 18 August 2023.

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

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

Our preferences

	Least preferred		Most preferred
Cash		=	
Fixed Income			+
US Gov't FI		=	
US Gov't Short		=	
US Gov't Intermediate		=	
US Gov't Long		=	
TIPS		(=) →	+
US Agency MBS			+
US Municipal		=	
US IG Corp FI			+
US HY Corp FI		=	
Senior Loans		=	
Preferreds			+
CMBS		=	
EM Hard Currency FI		=	
EM Local Currency FI		=	
Equity		=	
US Equity	−		
US Large Cap Growth	(−) →	=	
US Large Cap Value		(=) →	+
US Mid Cap		=	
US Small Cap		=	
Int'l Developed Markets		=	
UK		=	
Eurozone		=	
Japan		=	
Australia		=	
Emerging Markets			+
Other			
Commodities		=	
Gold		=	
Oil			+
MLPs		=	
US REITs		=	

Asset allocation: Themes implementation

With alignment to our Messages in Focus (MIFs)

Asset class	Theme and description	Manage liquidity	Buy quality bonds	Look for equity laggards	Diversify with alternatives	Invest in infrastructure	Go sustainable	Pick leaders from disruption
		MIF alignment						
Cash	**Enhancing liquidity strategy return: MLCDs** Market-linked CDs can offer upside exposure to stocks while providing downside protection.	✓						
US fixed income	**Quality IG credits present an income opportunity** We believe investment grade issuers offer attractive yields and exhibit balance sheet strength and earnings resilience.		✓					
US fixed income	**Short-dated high yield bonds** 1–3-year maturity BB rated high yield bonds can provide over 100bps of spread pickup relative to similar-duration IG bonds, offering yields of around 6.5–7%.		✓					
EM fixed income	**Short-duration Pan-American bonds** CIO has a preferred view toward short-end investment grade corporate bonds. We believe this list offers relative value.		✓					
Global equities	**Greentech goes global** This list has significant ex-US exposure and should benefit from infrastructure spending plans.					✓		✓
US equities	**Investing in self-help** We believe companies with self-help measures to enhance profitability and increase margins are likely to be rewarded by investors.			✓				
US equities	**Diabetes and obesity** Innovative new obesity treatments are spurring opportunities in the healthcare sector, and we believe the recent pull-back in diabetes-related stocks offers an attractive entry point.							✓
US equities	**Made in America** This stock list invests in opportunities stemming from US infrastructure and government spending plans.					✓		
EM equities	**ESG matters in emerging markets** This theme provides leverage to CIO's preferred view on emerging markets.			✓			✓	
Hedge funds/ alternatives	**Opportunities in dislocated credit markets** Credit market stress has expanded the opportunity for hedge fund and private managers to deploy capital toward dislocations.		✓		✓			

Themes in focus: Disruption, infrastructure, and sustainability

Michelle Laliberte, CFA, Thematic Investment Strategist; **Nadia Lovell,** Senior US Equity Strategist

This month we introduce the "Pick leaders of disruption" Message in Focus. One sector facing disruption is healthcare, with recent innovation in weight loss treatments taking the sector by storm. With the number of obese adults expected to increase by over 50% by 2030, we've identified Obesity as a longer-term theme, but we also see a tactical opportunity. Several diabetes-related stocks have pulled back recently, offering a more compelling entry point. To capitalize on this, we launched a new tactical thematic stock list, "Diabetes and obesity." More information is available in the full report.

The "Invest in infrastructure" and "Go sustainable" Messages in Focus are not new this month, but these, too, have ties to disruption. Under the hood, they relate to longer-term investment themes that we've identified as being driven by durable, disruptive forces: "Water scarcity," "Energy efficiency," and "Security and safety."

Three sub-themes in particular are embedded in both infrastructure and sustainability initiatives, highlighting the connection between critical infrastructure and sustainable economic development. US infrastructure has healthily outperformed the S&P 500 over the last 12 months, but we think there are more gains to be made as the country rolls out one of its largest infrastructure spending plans in decades.[1]

[1] Indxx US Infrastructure Development Index, Bloomberg, UBS as of 14 September 2023

[2] American Civil Society of Engineers, Infrastructure Report Card 2021

1. **Water infrastructure**
   There is a water main break about every two minutes in the US, resulting in a loss of about 6 billion gallons of treated water per day.[2] Water infrastructure is due for an upgrade, and funding has been allocated to address this, but "Water scarcity" more broadly is a theme we've identified as having potential ties to the UN Sustainable Development Goal 6: Clean water and sanitation.

2. **Electric grid infrastructure**
   More than 70% of the nation's grid transmission and power transformers are over 25 years old, and to modernize the system, the Department of Energy's Building a Better Grid Initiative dedicates over USD 20bn of investment in the years ahead. Furthermore, the Inflation Reduction Act allocates about USD 3bn for new high-capacity lines. To meet global sustainability goals on emissions reduction, electric grid infrastructure will be needed to facilitate a higher amount of variable energy sources and higher demand for electricity overall.

3. **Cybersecurity**
   As infrastructure becomes increasingly digital, cybersecurity becomes paramount, and even the electric grid is susceptible to hacks. The National Institute of Standards and Technology has dedicated an entire program to cybersecurity for smart grid systems. With breaches becoming costlier, cybersecurity practices also impact the bottom line, and we see protection of consumer data specifically as a key sustainability matter.

For more information on how the United States is investing in resiliency, please visit ubs.com/madeinamerica.

Longer-term themes

Top 5 favorite LTI themes
1. Education services
2. Frontier markets
3. Diversity and equality
4. Clean air and carbon reduction
5. Emerging market infrastructure

Longer-term themes are expected to unfold over a longer time horizon, perhaps over the course of a decade or longer. These themes are based on secular trends that, CIO anticipates, will endure over multiple business cycles. Longer-term themes extend beyond the time frame of our strategic asset allocation. Learn more about the longer-term themes and our thematic investment framework based on three megatrends in our "Thematic guide."

US economic outlook

Recent data offers hope that the economy is headed for a soft landing. Inflationary pressure has cooled off, and the labor market is showing a better balance between the supply and demand for workers. Downside risks remain, as the lagged impact of higher interest rates feeds through, excess savings are used up, and student loan payments restart. We also see a considerable risk of a partial government shutdown.

Brian Rose, PhD, Senior US Economist

Overview

So far in 2023, the economy has achieved a combination of growth and inflation that most economists would have ruled out as a possibility given the magnitude of Fed rate hikes since last March. Normalization following the pandemic has been a big part of the story, but in our view this process has largely played out. As shown in Fig. 1, households have used up most of the excess savings built during the pandemic. Signs of financial stress, for example delinquencies on consumer loans, have been increasing, and credit card debt has soared over the past two years. The resumption of student loan payments from October will add to the pressure on household finances, and at the same time, labor market conditions are softening. It appears inevitable that consumption growth will slow in the quarters ahead. On the positive side, inflation should continue to trend lower, keeping real disposable income on an upward trend and giving the Fed room to start trimming interest rates next year.

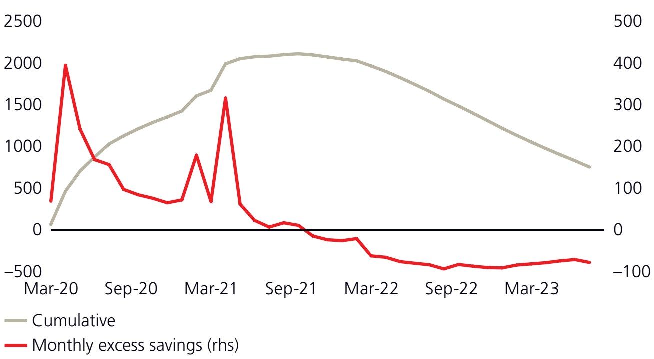
Growth

Economic growth has remained above our 1.8% estimate of the potential GDP growth rate since 3Q22. However, we expect growth to slow from here. Job growth has slowed over recent months, and there are few workers left still on the sidelines following the pandemic. As shown in the chart, employment rates (i.e., the percentage of the population that is working) by age and gender are now mostly at or above their pre-pandemic levels. Men over the age of 65 are an exception, but we do not expect these former workers to return in large numbers. Business investment, spurred by the Inflation Reduction Act and CHIPS Act, has surged recently, but given the high level of borrowing costs, this pace of growth is unlikely to be sustained. Government spending on infrastructure should continue to provide support, and residential investment appears to have bottomed out despite the high level of interest rates. Our base case calls for a soft landing rather than a recession.

Figure 1

Post-pandemic normalization will provide less support

UBS estimates of excess savings, in USD bn

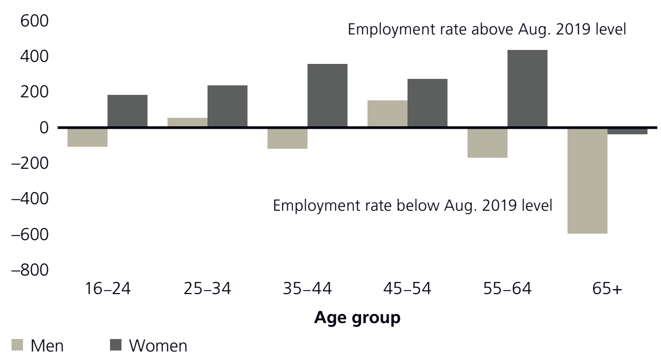


Source: Bloomberg, UBS, as of 13 September 2023

Figure 2

Few workers left on the sidelines

Impact of changes in employment rates since 2019, in '000s



Source: Bureau of Labor Statistics, UBS, as of 13 September 2023

For our global economic forecasts,
please see our report *Global forecasts*.

Read the report ›

Inflation

Inflation has been trending lower in recent months despite robust economic growth. Headline CPI jumped 0.6% month-over-month in August, driven by higher gasoline prices, but core inflation was modest for the third month in a row. The Fed's battle against inflation has been helped by easing of supply-side bottlenecks associated with the pandemic. Tighter monetary policy and weakness in the goods sector globally have also been a factor. Shelter is the biggest item within the CPI basket, and data on new rental leases, which leads CPI shelter prices by around 12 months, suggests inflation will continue to slow. Excluding shelter, inflation was only 1.9% year-over-year in August. Wage growth is still too high to be compatible with the Fed's 2% inflation target, but this is a long-term relationship and does not preclude lower inflation in the near term. Recent oil price increases are unhelpful but should have relatively little impact on core inflation.

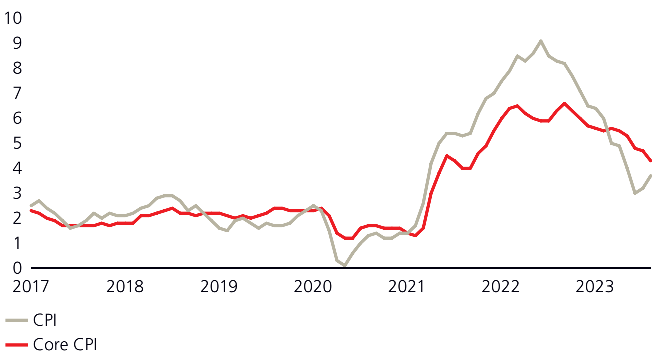
Policy

We expect the Federal Reserve to leave rates unchanged at the upcoming FOMC meeting on 19–20 September. Given our outlook for growth and inflation, we believe that the Fed won't raise rates again in this cycle. However, it is still too soon for the Fed to declare an end to the cycle, and markets are pricing in around a 50% chance of one more rate hike by the end of the year. A period of subtrend economic growth and further softening of labor market conditions will be needed before the Fed feels confident on the inflation outlook. The Fed may be willing to start trimming rates at some point next year as long as inflation continues to trend lower. On the fiscal side, there is still no deal in place to fund the government from the start of the new fiscal year on 1 October. Congress may be able to pass a short-term continuing resolution in late September, providing funding for a few weeks and giving the two sides more time to negotiate. Even in this case, there would still be a considerable risk of a partial government shutdown.

Figure 3

Core inflation remains on downward trend

CPI and core CPI, year-over-year change in %

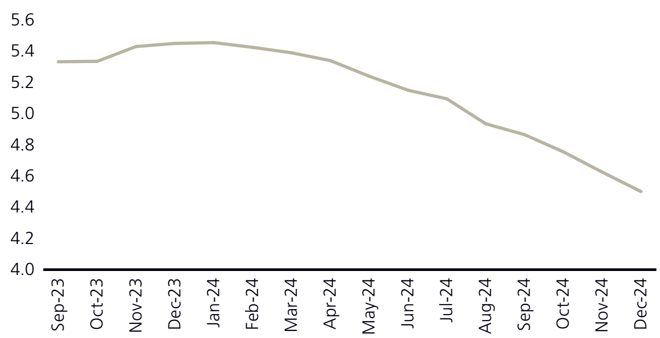


Source: Bloomberg, UBS, as of 13 September 2023

Figure 4

Fed expected to trim rates next year

Market-implied federal funds rate, in %



Source: Bloomberg, UBS, as of 13 September 2023

Equities

The earnings outlook has improved, and on the back of US economic resilience we maintain a neutral stance on global equities. But valuations remain unattractive and we see limited room for a rerating by year-end. So we continue to prefer high-quality bonds to equities. By sector, in our global asset allocation, we upgrade information technology to neutral. Elsewhere we keep utilities, energy, consumer staples, and industrials as most preferred. Global healthcare and materials remain least preferred. Across styles, we prefer value and quality income to growth.

Eurozone

NEUTRAL

EURO STOXX 50 (index points, current: 4,280)	June 2024 target
House view	**4,700**
↗ Positive scenario	5,100
↘ Negative scenario	3,700

Note: All current values as of 14 September 2023

We maintain our neutral stance on Eurozone equities. Valuations look fair to us given modest downside risks to consensus earnings estimates and above-average interest rates. At 11.7x forward P/E, Eurozone equity valuations are relatively attractive, at a 10% discount to their long-run average. We see some upside to valuations by mid-2024, but more meaningful upside is limited given the slow earnings recovery that we anticipate. We favor market laggards and in particular like the materials sector, German equities, and Eurozone small- and mid-caps.

Emerging markets

MOST PREFERRED

MSCI EM (index points, current: 982)	June 2024 target
House view	**1,100**
↗ Positive scenario	1,200
↘ Negative scenario	820

Note: All current values as of 14 September 2023

We keep emerging market (EM) equities as most preferred. Aggregate manufacturing PMIs in emerging economies have improved, mostly due to China's sequential recovery, and the growth gap with developed economies persists. EM central banks' easing bias should continue to be a positive for local stocks. Valuations for the MSCI EM index at 11.8x are in line with 10-year averages and stand at a discount of 38% to the S&P 500. In our view, the gap does not factor in better earnings growth prospects for emerging markets relative to developed markets next year.

Japan

NEUTRAL

TOPIX (index points, current: 2,406)	June 2024 target
House view	**2,400**
↗ Positive scenario	2,600
↘ Negative scenario	2,000

Note: All current values as of 14 September 2023

We are neutral on Japanese equities in our global portfolio. The TOPIX has rebounded from August lows, in line with the S&P 500. While we had expected range-bound trading during the summer due to a lack of domestic catalysts, sentiment has started to recover earlier than anticipated. We see a more favorable macro environment that should support Japanese equities into 2024. We expect corporate earnings to grow 6% for fiscal year 2023 (ending March) and 3% for FY2024. We continue to like domestic-oriented sectors that should benefit from reopening spending and wage growth into next year.

UK

NEUTRAL

FTSE 100 (index points, current: 7,673)	June 2024 target
House view	**8,200**
↗ Positive scenario	8,500
↘ Negative scenario	6,700

Note: All current values as of 14 September 2023

We are neutral on UK equities within our global equity preferences. We expect UK earnings to fall around 7% in 2023 as tailwinds from high oil prices, strong pricing power, and a weaker sterling fade. But current valuations appear to already reflect expectations of soft earnings growth this year. The FTSE 100 trades on a 12-month forward P/E of 10.3x—around 20% below its long-run average—with a 4% dividend yield, which is a reflection of its value-heavy sector makeup.

US equities

US equities have performed well this year driven by resilient economic data, improving inflation, better-than-expected corporate profits, and enthusiasm about AI. While we expect a softish economic landing, economic growth will likely slow and further improvements in inflation will be more incremental. This suggests a somewhat range-bound market in the near term, with some potential upside into 2024.

David Lefkowitz, CFA, Head of US Equities; **Nadia Lovell,** Senior US Equity Strategist; **Matt Tormey,** US Equity Strategist

US equities overview

LEAST PREFERRED

While year-to-date market gains have been primarily driven by valuation expansion, profit expectations are also contributing. Bottom-up forward EPS estimates for the S&P 500 have been rising since the spring and are now hitting all-time highs (Fig. 2). Looking at quarterly EPS growth, after three quarters of year-over-year declines, growth should turn positive in 3Q and accelerate to a high-single-digit pace into 2024. While valuations are high, we think they are justified by falling inflation and a low unemployment rate. Our December 2023 and June 2024 S&P 500 price targets remain 4,500 and 4,700, respectively.

US equities: Sectors

This month we upgrade the tech sector from least preferred to neutral. While valuations are high, we don't see a catalyst to drive underperformance amid growing evidence that end-markets are improving. Oil prices are rebounding driven by OPEC actions and continued economic growth, both of which have led to a tightening in the oil market. Industrials offer exposure to secular growth and some cyclical upside. Among defensives, we prefer consumer staples to utilities. Utilities tend to perform best when growth concerns are elevated. High rates and sluggish growth in funds from operations are likely to weigh on the real estate sector.

US equities: Size

We remain neutral across size segments. Small- and mid-cap stocks remain cheap and could be a good soft-landing trade if the downside risks continue to diminish. However, it may still be too early to anticipate an inflection in the cyclical outlook, and earnings revisions for small- and mid-caps are worse than for large-caps. Smaller companies are also more leveraged and have greater headwinds from higher interest rates.

US equities: Style

We maintain a small preference for value over growth. Growth stocks have benefited from the banking sector turmoil and AI spending, lifting relative valuations to more than double their historical average. Any hiccup in the outlook for select mega-cap growth companies could prompt a rotation into value stocks. History suggests that value stocks outperform over the next one to two years after periods of dramatic underperformance like we have witnessed this year.

S&P 500 (index points, current: 4,467)	June 2024 target
House view	**4,700**
Positive scenario	5,200
Negative scenario	3,500

Note: All current values as of 14 September 2023

Figure 1

Upgrading IT to neutral

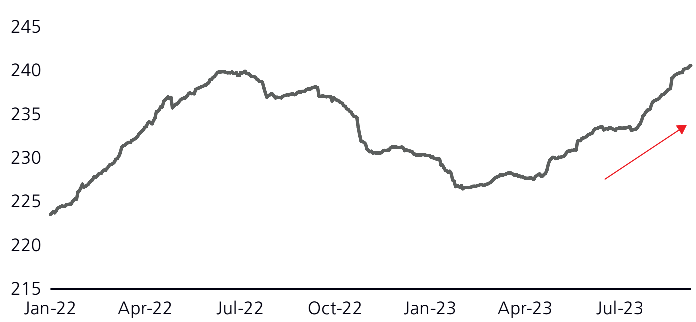
	Least preferred	Neutral	Most preferred
US equities			
Communication services		=	
Consumer discretionary		=	
Consumer staples			+
Energy			+
Financials		=	
Healthcare		=	
Industrials			+
Information technology	– →	=	
Materials		=	
Real estate	–		
Utilities	–		

Note: Tactical preferences from benchmark (S&P 500)
Source: UBS, as of 14 September 2023

Figure 2

S&P 500 profit expectations are back to all-time highs

S&P 500 next-12-months EPS, bottom-up consensus estimate, in USD



Source: FactSet, UBS, as of 13 September 2023

Bonds

Yields have risen in recent months as the US economy has proven more resilient than expected. We think this provides a good opportunity for investors to put their excess cash to work by locking in attractive yields, as the Fed nears the end of its rate-hiking cycle, and before markets start to price lower rates in the future and turn their attention to rate cuts. The more defensive, higher-quality segments of fixed income look most appealing to us, given the all-in yields on offer and the potential for capital appreciation.

Alejo Czerwonko, Chief Investment Officer Emerging Markets Americas; **Leslie Falconio,** Head of Taxable Fixed Income Strategy; **Kathleen McNamara,** CFA, CFP, Municipal Strategist; **Barry McAlinden,** CFA, Fixed Income Strategist; **Frank Sileo,** CFA, Fixed Income Strategist

Government bonds

NEUTRAL

US 10-YEAR YIELD (current: 4.3%)	June 2024 target
House view	**3.0%**
↗ Positive scenario	2.0%
↘ Negative scenario	3.7%

Note: All current values as of 14 September 2023

Ten-year US Treasury yields finished the day at 4.35% on 21 August, their highest level since 2007. The repricing of Fed easing, issuance, and upside economic surprises have all put upward pressure on 10-year yields. For those that locked in their rates last October or during these recent sell-offs, we anticipate rates to rally into year-end and into 2024 as Fed tightening begins to meaningfully slow economic growth.

US investment grade corporate bonds

MOST PREFERRED

US IG SPREAD (current: 124bps)	June 2024 target
House view	**145bps**
↗ Positive scenario	80bps
↘ Negative scenario	200bps

Benchmark: Bloomberg Barclays US Int. Corp.
Note: Current values as of 14 September 2023

We hold a most preferred view on investment grade bonds. On fundamentals, current credit metrics look solid to us, but there are downside risks as spread levels are not pricing in much deterioration. That said, we think the higher level of yields is appealing and should provide a reasonable buffer against near-term market volatility. Average US IG yields are at historically elevated levels of over 5.5% while spreads are sitting slightly above their long-term average. We foresee IG delivering coupon plus price appreciation potential over longer holding periods.

Emerging market bonds

NEUTRAL

EMBIG DIV. / CEMBI DIV. SPREAD (current: 424bps / 335bps)	June 2024 target
House view	**425bps / 300bps**
↗ Positive scenario	340bps / 280bps
↘ Negative scenario	600bps / 550bps

Note: Current values as of 14 September 2023

We keep emerging market credit as neutral as valuations look fair on average. While spreads may further tighten if a US soft-landing scenario materializes, our base case calls for sideway trends over the foreseeable future. Key risks include a global recession, a reacceleration of inflation requiring tighter policy in the US and other key markets, softer commodity price, a stronger USD, and various idiosyncratic risks, such as US-China tensions and further escalation of the war in Ukraine.

EMBIG = hard-currency sovereign bonds
CEMBI = hard-currency corporate bonds

US high yield corporate bonds

NEUTRAL

USD HY SPREAD (current: 388bps)	June 2024 target
House view	**500bps**
↗ Positive scenario	370bps
↘ Negative scenario	850bps

Note: Benchmark: ICE BofA. All current values as of 14 September 2023

We are neutral on high yield, reflecting mainly our view of relative value rather than an expectation of soaring defaults. HY spreads, which are close to year-to-date tights, are already pricing in an economic soft landing and continued balance sheet strength, in our opinion. Yields, however, remain wide and provide carry for the asset class and a buffer to total returns. Issuer-weighted default rates stand at 3.1% and we think could rise to mid-single-digits, but that would be lower than in past default cycles.

Municipal bonds

NEUTRAL

The heavy pace of reinvestment capital witnessed in July and August has now diminished. Despite this near-term headwind, we expect tax-exempt municipal bond yields to trend lower by year-end, taking their cues from US Treasury securities. Thus, we see an opportunity for income investors to lock in attractive after-tax yields on longer-dated high-quality munis (12-year to 20-year range). AAA 10-year muni-to-Treasury yield ratio: 70% (last publication: 65%).

Non-US developed fixed income

NEUTRAL

Over the past month, bond yields in non-US developed markets moved mostly higher as central banks maintained a tightening bias. On foreign exchange markets, the dollar mostly gained against other major currencies, reducing the value of non-dollar bonds when measured in dollars. These factors combined to produce negative returns. We do not recommend a strategic asset allocation position on the asset class, but if the dollar weakens as we expect, it could potentially boost returns over the next 6–12 months.

Additional US taxable fixed income (TFI) segments

Agency bonds

We continue to have a least preferred view in agency debt, with preference for agency MBS.

Mortgage-backed securities (MBS)

MOST PREFERRED

Current coupon spread widened with rising Treasury yields amid the resilient economy and uncertainty around the Fed rate path. Investors took note as the widening momentum turned to tightening at the end of August. While investors have remained focused on IG corporates, agency MBS spreads at 166bps are near BBB levels while offering more liquidity and higher quality. As higher-for-longer begins to slow the economy, we believe these spreads will only tighten further.

AGENCY MBS SPREAD (current: 166bps)	June 2024 target
House view	**125bps**
Positive scenario	100bps
Negative scenario	185bps

Note: Current values as of 14 September 2023

Preferred securities

MOST PREFERRED

After consecutive, though modest, monthly gains in June and July, the preferred sector posted a loss of 0.6% in August and is tracking a similar, mild loss for September. Thus, preferreds have reestablished a mostly sawtooth pattern of alternating monthly gains and losses so far in 2023. Though posting a year-to-date gain of about 3.5%, the sector has still not recovered from the March pullback brought on by regional bank sector concerns. So as a result, valuations remain generally favorable. And current valuations against a backdrop of lower-trending interest rates could lead to impressive performance. Resilient fundamentals and favorable technicals have the potential to lend support as well. We remain constructive on the preferred securities sector and believe that current conditions could contribute to solid 12-month returns.

Treasury Inflation-Protected Securities (TIPS)

Five-year real yields reached 2.22% in August on the repricing of Fed easing in 2024 and 2025, before rallying. Although we see about 40% chance of a rate hike in November, we do not see much risk higher for 5-year real yields. We favor the 5- and 10-year real yields at current levels on the expectation that they will decline as growth slows and that real yields will rally following a Fed pause.

US 5-YEAR YIELD (current: 2.15%)	June 2024 target
House view	**1.75%**
Positive scenario	1.50%
Negative scenario	2.40%

Note: All current values as of 14 September 2023

Figure 1

UBS CIO interest rate forecast

In %

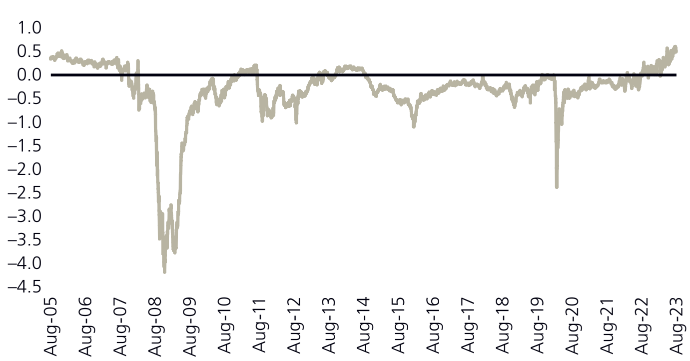
UST	Current	Dec-23	Mar-24	Jun-24	Sep-24
2-year	5.0	3.8	3.0	2.8	2.5
5-year	4.4	3.5	3.0	3.0	2.8
10-year	4.3	3.5	3.3	3.0	2.8
30-year	4.3	3.8	3.5	3.5	3.3

Source: Bloomberg, UBS, as of 13 September 2023

Figure 2

Current coupon MBS versus Corporate spreads are at 17-year wide

In %



Source: Bloomberg, UBS, as of 31 August 2023

Commodities and listed real estate

Our benchmark UBS CMCI index fell 0.6% during the past month, driven by lower metal prices. Energy was the only sector with a positive performance. Therefore, within the asset class, we keep our preference for oil. The asset class has, however, delivered a positive return in the first few days of September, with the UBS CMCI Total Return standing at the highest level since June 2022. We see further gains for commodities as a whole into year-end and target low-teens total returns on a 12-month basis. We also continue to recommend actively managing commodity exposure.

Dominic Schnider, CFA, CAIA, Strategist, UBS Switzerland AG; **Giovanni Staunovo,** Strategist, UBS Switzerland AG; **Thomas Veraguth,** Strategist, UBS Switzerland AG; **Wayne Gordon,** Strategist, UBS AG Singapore Branch

Commodities

NEUTRAL

GOLD (current: USD 1,911/oz) — June 2024 target

NEUTRAL

House view	**USD 2,100/oz**
Positive scenario	USD 2,300–2,400/oz
Negative scenario	USD 1,800–1,900/oz

Note: All current values as of 14 September 2023. Gold is a safe-haven asset whose price tends to rise when risk assets, such as equities, fall, and vice versa.

Precious metals

Near-term headwinds like higher US yields and USD strength are pressuring ETF demand. But we think central bank buying will counterbalance these pressures—likely buying another 700 metric tons this year—while we await easier policy guidance from the Fed. An annual amount of this magnitude would be the second-highest since the 1960s (after 2022). So, we reiterate gold's diversification benefits in a portfolio context and expect prices to rise toward USD 2,200/oz by mid-2024. We continue to recommend using gold as a hedge despite being neutral in our global strategy. Within a balanced USD portfolio, our analysis shows exposure of around a mid-single-digit percentage is most optimal.

Base metals

Exchange inventories at multiyear lows, supply-side disappointments, and structural demand drivers have offset weaker global manufacturing and underwhelming Chinese activity data. We believe these longer-term dynamics will help shield metal prices from larger pullbacks. Our supply and demand estimates still point to an undersupplied market for most metals this year, which favors higher prices into 2024 as industrial activity stages a modest recovery.

Agriculture

Record-breaking global temperatures, attacks on Black Sea grain infrastructure, and regional supply mismatches did not prevent grain prices from tumbling to new year-to-date lows. We believe elevated Russian and Brazilian inventories have bred complacency among consumers. But supply downgrades across key producers should drive higher grain prices (by around 10%), while soft commodities will likely stay elevated amid persistent El Niño risks.

BRENT (current: USD 93.7/bbl) — June 2024 target

MOST PREFERRED

House view	**USD 95/bbl**
Positive scenario	USD 120–150/bbl
Negative scenario	USD 40–70/bbl

Note: Current values as of 16 August 2023

Crude oil

Saudi Arabia is curbing its production by an extra 1mbpd, and Russia is reducing its crude exports by 0.3mbpd. With OPEC+ signaling it wants to remain in control of the oil market, the voluntary extra cuts will be reviewed monthly. With the production cut extended, we anticipate a market deficit of more than 1.5mbpd in 4Q23. So, with oil inventories set to fall further over the coming months, we expect Brent to rise to USD 95/bbl by year-end. Longer-dated oil contracts are trading cheaper than spot prices. While commodity markets tend to price in the "now," futures curves, as a rule, don't hold much predictive power. So, vanishing available spare capacity should support longer-dated contracts, in our view.

Listed real estate

RUGL Index (current: USD 5,250) — June 2024 target

House view	**USD 7,000**
Positive scenario	USD 6,600
Negative scenario	USD 5,400

Note: All current values as of 14 September 2023

We like companies with strong pricing power, attractive implied yield gaps, robust cash flows, and selectively those trading at large discounts. Earnings visibility continues to improve as uncertainty around potential rights issues fades. We like Japanese developers and REITs. Singapore REITs and developers may slightly lag, as fundamentals are fully priced in, while Hong Kong and China still suffer from market uncertainty. We favor pan-European exposure, as we expect investors to gradually return amid appealing valuations. UK real estate firms are comparatively attractively valued, and well-capitalized US companies take advantage of comparatively rather robust fundamentals.

Foreign exchange

The US dollar remains least preferred in our global strategy. We keep the euro at most preferred.

Thomas Flury, Strategist, UBS Switzerland AG

The Fed is likely at the inflection point we have been looking for in 2023, although uncertainty has been mounting given upside surprises in some of the data releases. As disinflation seems to be well in place, markets are still waiting for the Fed to signal a clearer shift in its policy stance. Still, the USD should weaken further once we see a softer labor market and signs of stabilization of economic activity outside the US. As excess savings run out, monetary policy should weigh more sizably on spending activity. And lower inflation should leave enough room for US rates to fall back. As this happens, international investors will have a strong incentive to move funds out of the US and into higher-yielding emerging market or formerly negative-yielding G10 currencies.

We keep the euro at most preferred despite disappointments in China and lackluster growth in Europe. We still expect investors moving away from the US dollar to look for a liquid alternative asset market, and the euro is an obvious option, in our view. Inflation in Europe remains well above target, and the healing of the current account balance has helped the euro to recover and should continue improving. We still expect to see yield decompression from the Fed and the European Central Bank to keep rates on hold. The delta of relative growth and rates should come from the US and not Europe, and the euro's current levels remain attractive for long-term investors who have been looking to diversify considerable USD long positions. The expected shift in US monetary policy would be a good time to do so, in our view.

We keep the Japanese yen at neutral. Adjustments to the Bank of Japan's yield-curve control should help the yen, but we see limited catalysts that will outweigh the negative 5% carry that a long yen, short dollar position entails. Our end-2023 USDJPY target of 142 implies fairly moderate upside potential for the yen, and we would recommend positioning for USD weakness via being long the EUR instead. We keep a neutral position on the British pound and Swiss franc, both of which have been strong outperformers this year and are now consolidating. From current levels, both could outperform the USD, which justifies the one-notch difference to the least preferred USD.

Emerging market currencies continued to struggle going into September as US yields stayed at high levels and worries over China's growth outlook persisted. Central and Eastern European currencies felt the pressure of a weaker euro against the dollar. Central banks' decisions in light of lower inflation but persistent inflationary pressure will be key for emerging market currencies' performances in the coming months, especially given the higher-for-longer expectations for the Federal Reserve.

FX strategy

	Least preferred	Neutral	Most preferred
USD	−		
EUR			+
JPY		=	
GBP		=	
CHF		=	
AUD		=	

FX forecasts

	Current	Dec-23	Mar-24	Jun-24	Sep-24
EURUSD	1.07	1.12	1.14	1.16	1.16
USDJPY	148	142	140	138	134
GBPUSD	1.25	1.29	1.33	1.35	1.36
USDCHF	0.89	0.87	0.85	0.84	0.84
USDCAD	1.35	1.32	1.31	1.30	1.29
AUDUSD	0.64	0.66	0.68	0.70	0.72
NZDUSD	0.59	0.60	0.62	0.62	0.63
USDSEK	11.12	10.71	10.44	10.17	10.09
USDNOK	10.70	10.27	9.82	9.48	9.31

Sources: SIX Financial Information, UBS, as of 14 September 2023

Investment committee

The UBS investment process is designed to achieve replicable, high-quality results through applying intellectual rigor, strong process governance, clear responsibility, and a culture of challenge.

Based on the analyses and assessments conducted and vetted throughout the investment process, the Chief Investment Officer (CIO) formulates the UBS Wealth Management Investment House View at the Global Investment Committee (GIC). Senior investment professionals from across UBS, complemented by selected external experts, debate and rigorously challenge the investment strategy to ensure consistency and risk control.

The GIC comprises top market and investment expertise from across all divisions of UBS:
- Mark Haefele (Chair)
- Solita Marcelli
- Paul Donovan
- Min Lan Tan
- Themis Themistocleous
- Bruno Marxer (*)
- Adrian Zuercher
- Mark Andersen

We recognize that a globally derived house view is most effective when complemented by local perspective and application. As such, UBS has formed a Wealth Management Americas US Investment Strategy Committee:
- Solita Marcelli
- Alejo Czerwonko
- Jason Draho (chair)
- Leslie Falconio
- David Lefkowitz
- Brian Rose
- Daniel Scansaroli

(*) Business area distinct from Chief Investment Office Global Wealth Management

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Our preferences do not assure profits or prevent against losses from an investment portfolio or accounts in a declining market.

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

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

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

Appendix

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

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

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

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

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

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

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

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

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Version C/2023. CIO82652744

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