UBS House View

Investment Strategy Guide:
Four things no great portfolio can do without

March 2024 | Chief Investment Office GWM | Investment research

In this report

March

CIO Monthly Livestream

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Dear reader

The first few months of the year have brought both good and bad news for investors trying to gauge whether we are headed toward a soft landing, or maybe even a more favorable Goldilocks outcome for the economy. Nonfarm payrolls surged by 353,000 in January, surpassing expectations, while 4Q23 GDP came in at 3.3%, far above most economists' forecasts. But at the same time, inflation surprised to the upside, with a January core CPI of 3.9% versus 3.7% expected.

A consequence of this combination of resilient growth and stronger-than-expected inflation has been a rapid readjustment of Fed expectations. While investors had high hopes for rate cuts this year, with almost 175 basis points priced in for 2024 at one point, that figure now sits at just 90bps. We agree that recent data implies a delay in the beginning of the easing cycle, and we recently adjusted our forecast from 100bps to 75bps of easing by December.

Alongside this change in Fed expectations, the 10-year US Treasury yield has moved up 40bps in February, which in our view presents yet another golden opportunity for fixed income investors. As we outline in our **feature article**, we see high-quality bonds as one of the four core building blocks of portfolios. In particular, we see opportunities right now in TIPS, investment grade corporate bonds, agency MBS, CMBS, and municipal bonds, which should each benefit from both a higher starting point in yields and potential price appreciation given our view that the 10-year yield will trend toward 3.5% by year-end.

On the equity side, this month provided yet another reminder of the power of artificial intelligence, with Nvidia's recent earnings boosting the S&P to yet another all-time high. We remain most preferred on the technology sector, which is supported not only by AI but also by its high return on invested capital and a bottoming in PC and smartphone end-markets. That said, as we discuss in the **asset allocation implementation section**, investors should optimize their tech exposure to ensure they have appropriate allocations—not too high or too low—while also avoiding overconcentration risks. We also continue to favor small-caps, which look very cheap relative to large-caps on a historical basis.

Outside of tech, this month we made a number of changes to our US equity sector preferences. We've upgraded healthcare and industrials to most preferred from neutral, while downgrading consumer staples and energy to neutral from most preferred.

As always, we encourage you to reach out to your UBS financial advisor for any questions on our latest positioning, and how it relates to your own portfolio.

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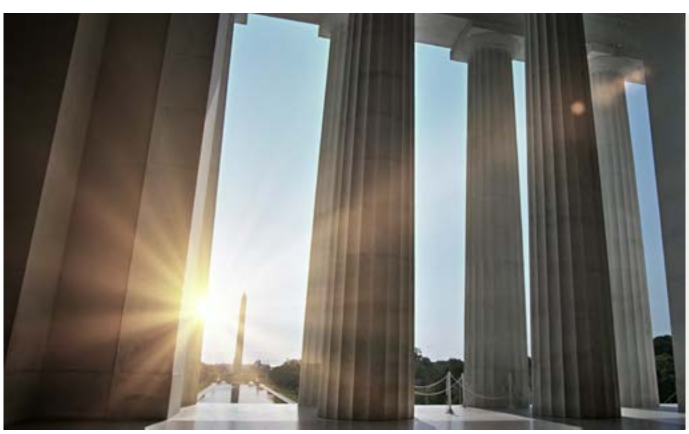

ElectionWatch 2024

UBS Road to the Election

CIO launched a new weekly video series "UBS Road to the Election." New episodes will air every Thursday at 4:30 p.m. ET. For additional election-related content, we encourage you to visit the ElectionWatch hub.

Four things no great portfolio can do without

US large-caps

Despite recent big gains, we think investors still need a core allocation to US large-caps as a key building block of their portfolio.

Diversify exposure

International stocks and small-caps offer exposure to a broader range of potential growth drivers.

Opportunities beyond equities

We see quality bonds and alternative assets as additional building blocks that can help smooth portfolio returns.

Asset allocation

We prefer quality fixed income. Within equities, we like quality stocks, US technology, and emerging markets including India.

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Our views, live with Q&A
The next CIO global monthly livestream will take place on 27 February. Join here.

The big US tech firms are at the forefront of the AI revolution.

In the popular imagination, a bull market brings a mixture of optimism, excitement, and exuberance. Yet a sense of unease can often override the glee. Those sitting on paper gains wonder whether it's time to realize profit, and those holding excess cash alternate between feelings of FOMO (fear of missing out) and FOLO (fear of losing out).

These emotions are very much at play today. The S&P 500 is up by around 40% since its October 2022 lows, while the tech-related "Magnificent 7" stocks are up by close to 140% on average over the same period.

Dealing with this requires keeping a strong focus on strategy as well as tactics. In that context, in this letter I discuss why, despite these big gains, we think investors still need to have a core allocation to US large-cap stocks. Yet, with the future for many portfolios being increasingly dependent on developments at only a handful of highly valued companies, I also discuss why US large-caps should represent just one of four building blocks investors should hold in their portfolios.

Technological change, overconcentration, shifting rate expectations, and geopolitical uncertainty are some of the factors that make now a critical time for investors to review their allocations to these four building blocks—and address shortfalls or excesses where they exist. We believe that the right balance of US large-caps, international and small-cap stocks, quality bonds, and alternative assets can allow investors to position for long-term returns while navigating near-term risks.

Building block #1: US large-caps

US large-cap stocks should make up a substantial portion of equity allocations.

Why?
US tech companies are leading the AI revolution. We believe generative artificial intelligence will be the growth theme of the decade, and we estimate AI revenues to grow around 70% a year until 2027. Most recently, Nvidia's strong fourth-quarter results and guidance point to overall solid AI infrastructure spending trends.

Generative AI is unusual in history because right from its onset, many of the companies in the industry are already present across multiple stages of its value chain, from the cloud and connected hardware to large language model development and applications. These companies are almost exclusively giants in the US technology sector.

With such an advantage, we believe the largest players today are poised to grow larger still. Last year's earnings of the Magnificent 7 were already around USD 340 billion—only slightly less than the USD 367 billion earned by all Swiss and UK companies in the SPI and FTSE 100 indexes—and we think this year's earnings could rise a further 20% or more. In our view, investors can't afford not to have at least some exposure to AI. We believe software and semiconductors offer the best way to gain exposure in the near term.

The US accounts for almost two-thirds of global equity market capitalization.

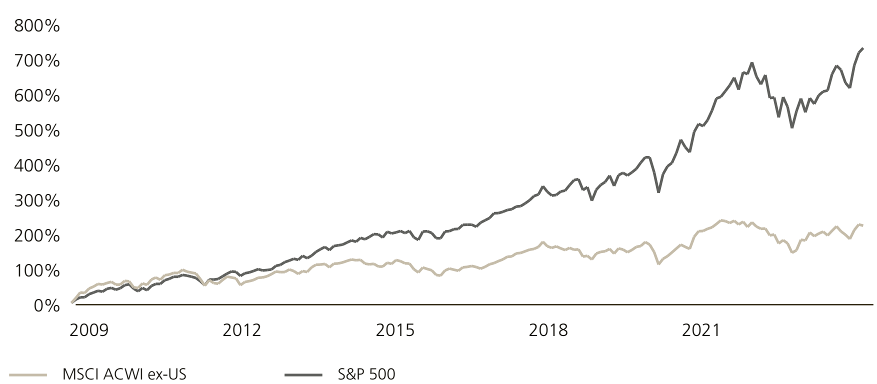
The US is home to a broad range of opportunities. US large-caps offer a larger pool of investable stocks than any other region, accounting for 63% of the global equity market cap based on MSCI data. A healthy allocation to US equities provides exposure to both the country's resilient and valuable consumer market (US consumption is around USD 19 trillion annually) and its largest multinationals (about 35% of S&P 500 sales are generated outside the US).

The US equity market is also a key destination for technology companies looking to sell or raise capital. In the second half of 2023, software company Klaviyo debuted on the New York Stock Exchange, and UK-based chipmaker ARM Holdings launched on the Nasdaq. Meanwhile, generative AI startups raised about USD 27 billion in 2023—according to PitchBook data—around USD 18 billion of which came from Amazon, Microsoft, and Google.

Figure 1

The US has outperformed significantly

S&P 500 and MSCI ACWI ex-US in USD, total return, percentage change March 2009–January 2024



Source: Bloomberg, UBS, as of February 2024

A record of success. Between March 2009 and the end of January 2024, US stocks have gained 712%, versus 216% for ex-US stocks (S&P 500 and MSCI ACWI ex-US in USD indexes; or a 15% vs. 8% average annualized total return), with this performance differential backed by earnings growth. Since March 2009, S&P 500 earnings have grown by around 300%, compared to 86% for the European Stoxx 600 index, and 31% for the MSCI Emerging Markets index. Past performance is no guarantee of future success, but this history of wealth creation shows that US companies can deliver results for investors.

Why now?

US large-caps have performed very well in recent months. While taking some profit on excess exposure to these stocks may be prudent for some investors, many in Europe and Asia remain well below strategic target weightings to US large-cap stocks, and there is a risk this underweight could become costly in the months ahead.

We see scope for the US equity rally to continue.

A "Goldilocks" scenario could drive further US upside. In our base case scenario, we expect the S&P 500 to trade moderately higher than current levels by year-end. We have revised our December 2024 target for the index to 5,200 (from 5,000) on the back of stronger-than-expected earnings in the fourth quarter of 2023. If incoming data further support a Goldilocks outcome for growth, inflation, and rates, an upside scenario could see the S&P 500 end the year around 5,500.

Long-term gains could get front-loaded. It can often be easier to assess the long-term potential of a new technology like AI than to determine when the market will aptly price that potential. Given sufficient market confidence, we think much of the pricing for the long-term gains from AI could occur early on. In this scenario, investors sitting on the sidelines waiting for a better entry price risk missing what could be the investment opportunity of the decade.

US equity market valuations are fair in light of the supportive economic backdrop.

US equity valuations reflect strong fundamentals. Overall US equity valuations are higher than other regions. The S&P 500 is trading on a forward price-to-earnings (P/E) ratio of 20 times. Some of this premium is driven by the technology sector, which represents 30% of the US market versus 13% globally ex-US, and trades on a forward P/E of 28x. Yet tech valuations are fair, in our view, given the very strong earnings growth expected in the coming years. For example, on our earnings estimates, AI infrastructure companies (based on the MSCI ACWI IT index) are trading at around 20x 2027 P/E. If we look at US valuations excluding tech, they are still relatively high at 18x P/E, but a level we think appropriate in the context of robust US growth, falling inflation, and a strong labor market.

How?

Investors need to optimize their exposure to technology and the US large-caps more generally. This means increasing their allocation if necessary and diversifying appropriately.

For those underinvested in large-caps. Building up strategic US large-cap exposure after such a large rally can be psychologically challenging. Investors looking to mitigate timing risks can consider phasing investments on a disciplined schedule while accelerating during market sell-offs. Strategies that offer a degree of capital preservation can also help investors get upside exposure while mitigating their fear of regret.

Investors should take steps to mitigate concentration risk.

For those managing existing exposure. The risk of overconcentration in individual companies is often high, particularly for investors managing portfolios of individual securities. Investors looking to retain upside exposure and lock in some profits can consider replacing some direct equity exposure with equivalent exposure that offers a degree of capital preservation.

We also recommend investors ensure that a high allocation to US large-caps doesn't come at the cost of our other key portfolio building blocks.

Managing home bias to optimize your equity allocation

Home bias is a common tendency among investors that leads them to make high allocations to domestic stocks relative to those overseas.

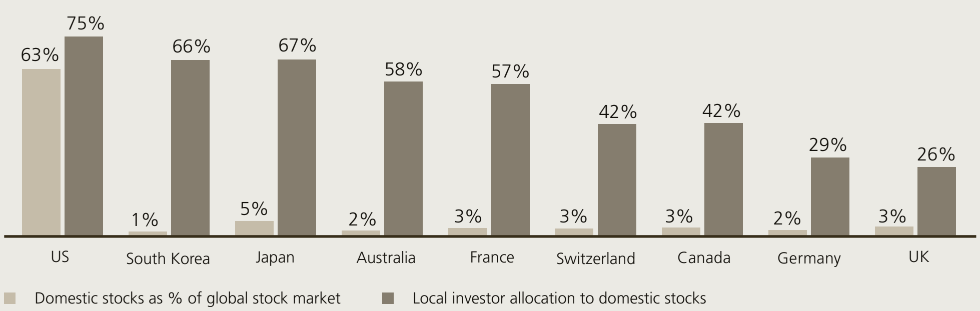
While there may be good reasons for some home bias (for example, due to tax and regulatory considerations), too large a home bias can result in poorly diversified portfolios. Localized crises, like the Asian financial crisis of the late 1990s and the Eurozone sovereign debt crisis of the late 2000s, illustrate how regional challenges can hurt investors whose portfolios are heavily tilted toward the countries in which they live.

The challenge is greatest for investors based in jurisdictions with small equity markets. Given that the US accounts for 63% of the global equity market capitalization, home bias generally means that non-US investors have too little exposure to the US market.

Figure 2

The average investor tends to have a home bias, which leaves them more exposed to domestic risks

Domestic stocks as a percentage of global stock market, local investor allocation to domestic stocks



Source: Bloomberg, IMF Coordinated Portfolio Investment Survey (December 2022), UBS, as of 8 February 2024

Building block #2: Diversified equity exposure

Global diversification helps ensure investors don't miss the potential next portfolio growth engine.

Stock market returns outside of the US large-caps have not been strong in recent years. However, we believe that a mix of stocks in Europe, Asia Pacific, the emerging markets, and small-caps should represent another core building block of portfolios.

Why?

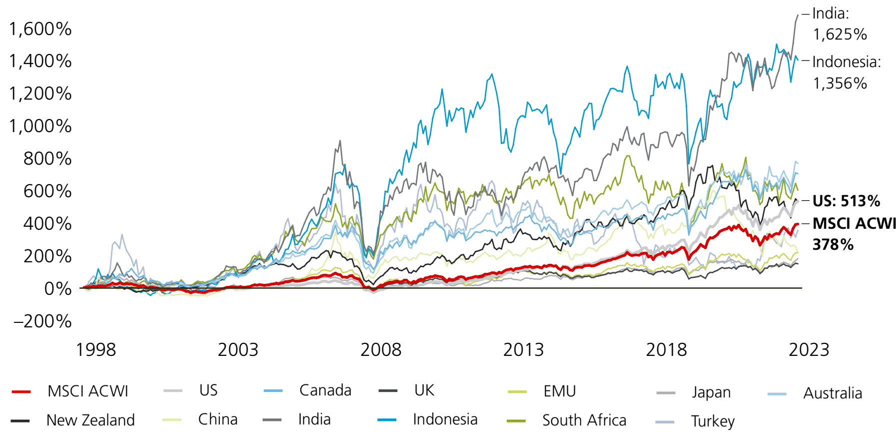
The next big thing? Many leading companies in sectors including semiconductors, pharmaceuticals, consumer goods, automobiles, engineering, and renewable energy count Europe or Asia Pacific, not the US, as their home. Meanwhile, for some companies in emerging markets, exposure to economic growth and favorable demographics creates a fertile backdrop for growth in the years ahead. Ensuring that investors don't miss these potential portfolio growth engines requires diversified exposure to stocks around the world.

The US market hasn't always led. Historically, market leadership has rotated over time. For example, while the S&P 500 has outperformed substantially since 2007, it returned just 38% between 1999 and 2007 compared with 97% for MSCI EAFE (which includes developed markets in Europe, Australasia, and the Far East) and 420% for MSCI Emerging Markets. A shift in regime can't be ruled out in the future—and in case of such a rotation, international markets that have lagged in recent years could benefit.

Figure 3

The US doesn't always outperform everywhere

Select MSCI indexes, total return, in USD, since the end of 1998 to January 2024, monthly data



Source: Bloomberg, UBS, as of February 2024

Equity valuations are lower in most markets outside the US.

Lower valuations. Equity valuations in most markets outside the US are currently cheaper based on their 12-month-forward P/E ratios. The MSCI EAFE index is trading at 13.7x, a 5% discount to its 10-year average, while the MSCI EMU index is at its cheapest level relative to the S&P 500 in almost four decades. For MSCI Emerging Markets, its valuation of 11.6x is an unusually deep 44% discount to US stocks. Investor positioning in international markets is still light, and valuations in most regions have scope for a catch-up if the global economic backdrop improves and the equity rally broadens.

Small-caps. Apart from casting a wider geographic net, investors can also consider diversifying through small-cap stocks, which account for roughly 6% of total US equity market capitalization (and about 11% globally). Valuations are appealing here, too. The forward P/E for the S&P SmallCap 600 index is only 14x, lower than its 10-year average of 17x and a 30% discount to the large-cap S&P 500 valuation. In the Eurozone, the ratio for small- and mid-caps is at 11.1x, the largest discount to large-caps in more than 20 years.

Lower interest rates in 2024 should create a supportive environment.

Why now?

Beneficiaries of lower rates. Most major central banks—including those in the Eurozone, Switzerland, and the UK—are likely to cut interest rates this year. Historically, lower rates have been supportive of global stocks and small-caps. Since 1989, emerging market stocks have delivered an average of 10% and 20% total returns in the six and 12 months, respectively, following the first Federal Reserve rate cut. US small-caps should also benefit from lower interest rates: Nearly half of the debt of Russell 2000 companies is floating-rate, compared with about 10% for large-caps. Conversely, higher-for-longer rates would likely present a risk for small-caps.

Earnings should start to recover. We expect positive earnings growth across international markets and small-caps. Consensus expectations are for 14% growth for US small-caps this year, and in emerging markets we forecast a solid mid-teens increase in US dollar terms. Both compare favorably with our 9% forecast for the S&P 500.

How?

For investors looking to quickly boost portfolio diversification and get exposure to this key building block, a variety of strategies can offer broad exposure to entire regions like Europe or emerging markets, or market segments like small-caps.

Building exposure to overlooked areas of the market can yield benefits.

But a more granular and gradual approach focused on progressively building up exposure to overlooked individual companies, countries, regions, or market segments can also yield benefits. Such an approach can allow investors to isolate risks, invest in individual markets with different approaches, and time entry into markets in alignment with current fundamentals.

For example, we can identify high-quality growth stocks in Europe that, on our estimates, offer similar earnings growth prospects as the Magnificent 7 in the US.

We see opportunities in Indian equities.

Within emerging markets, India is among our most preferred. We think Indian stocks can deliver low-to-mid-teens total rates of return over the next 12 months, driven chiefly by robust earnings growth. We expect 18.5% earnings growth for the Nifty stock index in fiscal year 2024 and nearly 12% in 2025. While some investors may balk at Indian stocks' roughly 20x P/E ratio, this is still below their average of 22x over the last decade.

Building block #3: Quality bonds

Quality bonds, including high grade (government) and investment grade corporate bonds, are another key building block for portfolios.

Quality bonds can help stabilize portfolio performance.

Why?

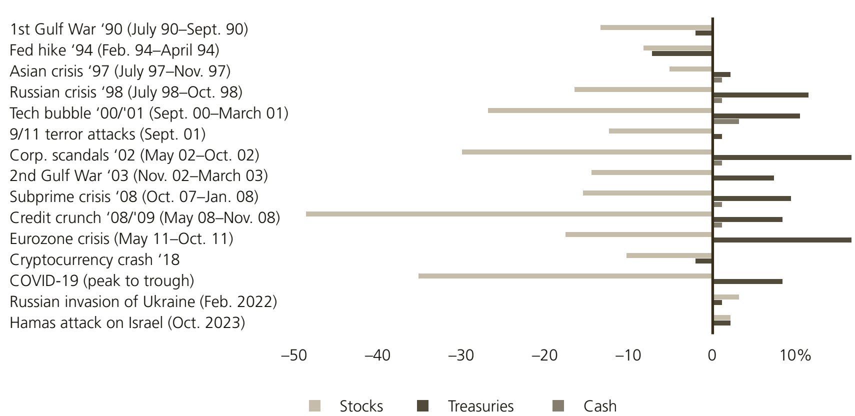
Safe and liquid. High-quality bonds are among the safest investments based on the creditworthiness of their issuers. That makes them an effective way of preserving capital, reducing volatility, and stabilizing portfolios, in our view. US Treasuries can also be bought and sold easily, even in times of crisis.

Reliable income and higher returns versus cash. Quality bonds offer a steady stream of income. While we think cash rates are likely to fall, current bond yields can be locked in, providing a more durable source of portfolio income over time. Historically, bonds delivered higher returns than cash over the long term, and their probability of outperforming cash rises with longer holding periods—from 65% over 12 months to 82%, 85%, and 90% over five, 10, and 20 years, respectively.

Figure 4

Bonds reduce portfolio stress better than cash

10-year US Treasuries' total returns in periods of stress, in %



Source: Bloomberg, UBS, as of February 2024

A record of effective diversification. Bonds have historically insulated portfolios effectively during periods of equity market turbulence. In all but three of the past 98 years, bonds have delivered positive performance in years when equities fell, a relationship we think will continue in the future.

Why now?

Yields are likely to fall this year.

We expect yields to fall. The current risk-reward proposition for quality bonds is especially attractive, in our view. At 4.3%, the 10-year US Treasury yield is appealing, and we see the potential for capital appreciation as inflation recedes, growth slows, and the Fed cuts rates this year. We expect the 10-year yield to fall to 3.5% by December in our base case scenario. This would imply 10% returns for current holders of 10-year Treasuries.

A hard-landing hedge. If economic growth slows more abruptly than we expect, global benchmark yields could fall faster as central banks ease policy quickly. In a hard-landing scenario, we would expect the US 10-year yield to decline to 2.5% by the end of this year. This would imply an 18% return for current holders of 10-year Treasuries by the end of December.

Investors should act soon to lock in bond yields.

Opportunity to lock in returns. We see the reinvestment risk from holding cash as being greater than the potential gains from waiting for better bond prices. We see a clear asymmetry in the potential path for cash rates. While the Fed could raise rates again if inflation reaccelerates, its intention and economic projections point to rate cuts starting this year. We therefore recommend investors act soon to lock in currently attractive bond yields.

How?

Medium duration. We favor the 1- to 10-year duration segment, particularly the 5-year duration point. We believe this middle part of the yield curve offers the best combination of high yields, stability, and sensitivity to falling interest rate expectations.

Buying short- or medium-duration bonds while selling longer-duration bonds (on a duration-neutral basis) can also be an effective way of hedging risk scenarios. We think such an approach would perform well in our base case, in the event of rapid rate cuts, or if longer-term bonds sell off due to excess supply.

Munis. In addition, we expect municipal bonds to deliver positive returns for investors in 2024. With rate cuts still on the table, we expect US government benchmark yields to trend lower by year-end, boosting muni performance. Sell-off episodes in equities are often a reminder that investors can benefit from portfolio diversification. Bear in mind that tax-exempt municipal bonds are highly rated, with an average credit rating of AA, and have low correlation with equity securities.

Actively managed fixed income strategies can tap into a broader range of opportunities.

Active strategies. Beyond single bonds, investors should also consider exposure to actively managed fixed income strategies to improve diversification, gain the convenience of automatic reinvestment, and take full advantage of the breadth of opportunity in the asset class. High yields, volatility, dispersion, and shifting interest rate expectations should increase the potential for active managers to outperform.

Building block #4: Alternatives

Stocks and bonds aren’t the only building blocks needed for an optimal portfolio. While investors should consider the risks inherent to alternative assets—including illiquidity, long lockup periods, high fees, leverage, and concentration—we think alternatives should be a core component of portfolios.

Alternatives can help investors diversify sources of return.

Why?

Potentially higher returns. We estimate that adding diversified exposure to alternative investments, including hedge funds, private equity, private debt, private real estate, and private infrastructure, could add 1–2% of return per year to a portfolio for a similar level of expected portfolio volatility. Hedge funds generate these excess returns by using a wider toolkit than simple exposure to stocks and bonds. Meanwhile, private markets' return advantage arises from a combination of active improvement of how their portfolio companies do business and effective use of leverage.

Smoother portfolio returns. Alternatives can help investors diversify sources of return at times when equities and bonds are moving together like they are today. The six-month rolling correlation between stocks and high-quality bonds currently stands at close to eight-year highs. Global discretionary macro hedge funds have historically shown low or negative return correlations to bonds and credit, delivering positive returns when fixed income assets are selling off.

Broader exposure. Alternatives provide access to some investments that can't be found in public markets. In 2000, there were three times more companies listed on the New York Stock Exchange and Nasdaq than companies backed by private equity firms. Today, private-equity-backed companies outnumber publicly listed firms by a factor of three to one. This less efficient marketplace tends to create more opportunities for long-term outsize returns than public markets.

Why now?

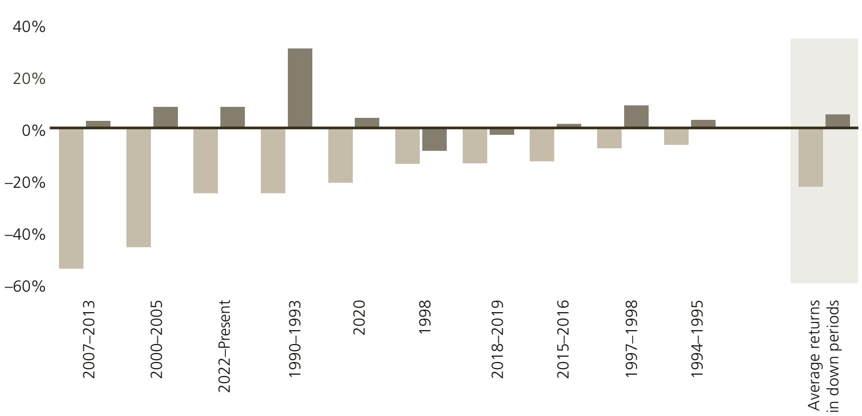
High dispersion, low correlation. The S&P 500 intra-index correlation is currently below average, while dispersion is above average. We think this is a good environment for equity long/short hedge fund managers to create alpha. We particularly like equity market-neutral hedge funds with low net exposure, which aim to mitigate portfolio volatility and deliver steadier returns than stocks.

Similarly, high dispersion within the high yield credit universe is creating opportunities for specialized credit hedge fund managers to generate performance. The gap in spreads within the weakest segment of credit markets (rated CCC or lower) is in the 70th percentile since 1998 and rising (according to ICE BofA index data).

Figure 5

Macro hedge funds offer a degree of protection in down periods

Global macro vs. global equities, during equities' worst down periods



Source: Bloomberg, Cambridge Associates, UBS, as of February 2024

Private equity purchase price multiples have declined.

Low purchase price multiples. Private equity purchase multiples have fallen to 10.8x EV/EBITDA from highs of 12x in 2022. We think the current environment looks particularly interesting in middle-market buyout and secondaries, which are trading at around 15% discounts to net asset value. We see most potential in managers with a record of boosting operational performance in sectors supported by structural growth including software, healthcare, education, and climate tech.

How?

There is no "one-size-fits-all" approach to investing in alternative investments. But, as a general rule, investors with a diversified and liquid multi-asset portfolio may put wealth to work in illiquid assets as long as these allocations are in line with their desired investment time horizon, risk preference, and tolerance for illiquidity. Investors with more moderate cash flow needs may have the capacity to allocate more to alternatives than those with a greater reliance on their portfolio for income or raising cash.

For investors who value simplicity, liquidity, and broad diversification, fund-of-hedge-funds or perpetual capital funds may be more appealing than building up exposure to single manager funds.

But for investors with the willingness and ability to build up exposure over time, a more granular approach can also be rewarding. In addition to diversified funds, these investors can also consider single-manager strategies in hedge funds and private markets that allow them to tailor their exposures to their main financial objectives, be they income, long-term capital creation, or a diversified mix of both.

Why all four building blocks make sense

Allocating across all four building blocks helps investors position effectively for a range of scenarios.

We do not think investors have the luxury of taking an "either/or" approach to picking from these portfolio building blocks. Technological change, portfolio concentration, shifting rate expectations, and geopolitical uncertainty require us to think about the global outlook in terms of scenarios, not linear paths. Only by allocating across all these components can investors most effectively position themselves for the base-case soft-landing scenario, as well as upside and downside scenarios.

Committing to all four of the building blocks can also help investors manage the tension between building long-term portfolios and navigating short-term market dynamics. For example, the relative cheapness of international and small-cap equities can help offset the apparent richness of US mega-cap tech. Holding sufficient high-quality bonds can help dampen portfolio swings from the more growth-sensitive equities. An allocation to alternatives can help smooth portfolio returns, particularly in years of high equity-bond correlations.

Mark Haefele
Chief Investment Officer
Global Wealth Management

Global forecasts

Economy

Real GDP y/y, in %

	2023	2024E	2025E
US	2.5	1.6	1.6
Canada	1.1	0.2	1.3
Japan	1.9	0.3	1.1
Eurozone	0.5	0.6	1.2
UK	0.1	0.6	1.5
Switzerland	0.7	1.2	1.5
Australia	2.0	1.5	2.1
China	5.2	4.6	4.6
India	7.3	6.2	6.2
EM	4.5	4.0	4.3
World	3.2	2.8	3.1

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

	2023	2024E	2025E
US	4.1	3.0	2.2
Canada	3.9	2.5	2.1
Japan	3.3	1.9	1.6
Eurozone	5.4	2.3	2.1
UK	7.3	2.7	2.1
Switzerland	2.1	1.4	1.2
Australia	5.6	3.4	3.1
China	0.2	0.8	1.6
India	5.3	4.5	4.5
EM	7.5	8.3	5.1
World	6.2	5.8	3.8

Source: Bloomberg, UBS, as of 21 February 2024. Latest forecasts available in the *Global forecasts* publication, published weekly.

Asset classes

	Spot	Dec-24
Equities		
S&P 500	4,982	5,200
Eurostoxx 50	4,775	4,900
FTSE 100	7,663	7,780
SMI	11,429	11,640
MSCI Asia ex-Japan	638	685
MSCI China	54	59
Topix	2,627	2,680
MSCI EM	1021	1,100
MSCI AC World	903	940
Currencies		
EURUSD	1.08	1.12
GBPUSD	1.26	1.3
USDCHF	0.88	0.87
USDCAD	1.35	1.31
AUDUSD	0.66	0.72
EURCHF	0.95	0.97
NZDUSD	0.62	0.62
USDJPY	150	140
USDCNY	7.19	7.15

	Spot	Dec-24
2-year yields, in %		
USD 2y Treas.	4.67	3.25
EUR 2y Bund	2.85	2.00
GBP 2y Gilts	4.61	3.50
CHF 2y Eidg.	1.01	0.70
JPY 2y JGB	0.15	0.25
10-year yields, in %		
USD 10y Treas.	4.32	3.50
EUR 10y Bund	2.45	2.25
GBP 10y Gilts	4.10	3.50
CHF 10y Eidg.	0.85	0.70
JPY 10y JGB	0.72	0.80
Commodities		
Brent crude, USD/bbl	83	82
Gold, USD/oz	2,022	2,250

Source: Bloomberg, UBS, as of 21 February 2024. Latest forecasts available in the *Global forecasts* publication, published 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
Manage liquidity	Investors have held more cash than usual as global central banks have taken interest rates sharply higher. 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
Buy quality	We expect positive returns in both equities and fixed income this year, though we believe investors should focus on quality. Within fixed income, quality bonds offer attractive yields and should experience price appreciation if yields fall as we expect. In equity markets, we look for quality companies with strong balance sheets and that can grow earnings in a weaker economic environment.	• Quality stocks (incl. US IT) • Quality bonds (incl. US TIPS, IG, Munis, agency MBS, CMBS) • Sustainable equivalents (ESG leader equities, sustainable munis, MDBs)
Trade the range in currencies and commodities	We expect most major currency pairings to continue to trade in established ranges in the months ahead, creating opportunities for investors to earn additional income by "trading the range." Meanwhile, we expect oil prices to fluctuate in the USD 80–90/bbl range in 2024, creating opportunities for investors to sell downside risks or navigate the range.	• Range-trading in USD, EUR, GBP, and CNY • Trade the range in crude oil
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 credit strategies, including credit arbitrage and distressed debt. We also see opportunities in convertible arbitrage, a strategy in which we expect to see more opportunities as companies refinance maturing debt.	• Credit arbitrage • Distressed debt • Convertible arbitrage
Anticipate a "Goldilocks" scenario	In our upside scenario, preemptive rate cuts and still-robust economic growth will drive strong performance across equities and fixed income. In such a scenario, we recommend investors position in parts of the market that are able to capture the most upside. In particular, we see small-cap and emerging market equities as especially well positioned to outperform in such a scenario.	• US small-caps • European mid- and small-caps • Emerging market equities (incl. India)

MIFs	Elevator pitch	Investment ideas
Capture upside and protect downside	The mix of low implied equity volatility and high bond yields makes this an attractive time to consider capital preservation strategies to hedge against market risks. Gold would be a major beneficiary of lower interest rates and heightened risk aversion in a downside scenario, and we also see upside for gold in our base case. We expect macro hedge funds, which have historically delivered consistent performance in times of market turbulence, to act as an effective portfolio diversifier.	• Capital preservation strategies (including on technology and China) • Gold • Macro and multistrategy hedge funds
Optimize tech exposure	The AI revolution is here, and investors' future performance will likely rest heavily on their level of exposure to the technology sector. We believe investors cannot afford to be underinvested in AI—we expect rapid earnings growth and think that the big will get bigger. Equally, investors need to be wary of overconcentration and overexposure. Structured and diversified solutions can help investors grow exposure while mitigating downside risks, and we also see various diversification opportunities for investors managing US tech concentration risks.	• Structured solutions on technology stocks • Diversified technology • Energy and healthcare disruption
Capture growth with private markets	In a world where government debt levels constrain spending on innovative technology, private market managers have a key role to play in providing capital. Private markets offer attractive return potential and differentiated access to the real economy, in exchange for lower liquidity. They can also be an effective vehicle for investors focused on driving positive change through impact and sustainability.	• Secondaries • Value and middle market buyout • Thematic growth • Private infrastructure • Private credit

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

- Fixed income
- TIPS
- US agency MBS
- US CMBS
- US investment grade corporate bonds
- US small-cap equities
- Emerging market equities
- Oil

Least preferred

- US large-cap equities
- UK equities

Implementation guidance

Data releases in the first months of 2024 have continued to show the resilience of the US economy, with 4Q23 GDP coming in at 3.3%, far above economists' expectations of 2%. Inflation has been similarly strong, with the core CPI for January coming in at 3.9%, above expectations of 3.7%. This tension between resilient growth and inflation pressure, all while the Fed prepares for rate cuts, will likely lead to bouts of volatility across markets in the coming months. Emblematic of this dichotomy, the 10-year Treasury yield has jumped over 40bps so far in February as markets have further pushed out the start of rate cuts.

The impressive economic resiliency supports our expectation for a soft landing and no recession in the next 12 months. With inflation running below wage growth, real incomes are recovering, providing more support for the consumer. In addition, manufacturing and housing, two of the most interest-rate sensitive sectors in the economy, have likely already experienced cycle troughs. That said, after the recent strong pace, growth should moderate to around trend later in the year as the tailwind of looser financial conditions that began in 4Q starts to fade. Inflation trends, such as in rents, point to the core measures continuing to head back to 2%. Despite job growth being very strong, wage growth has continued to moderate. With growth likely to moderate and monetary policy still restrictive, inflation is unlikely to reaccelerate.

Looking ahead, the we expect the Fed to start cutting rates at the June FOMC meeting, assuming incoming economic data continues to support slowing but positive economic activity without sharp increases in unemployment. Recent comments from Fed officials indicated that they expect rates to stay at currently restrictive levels for a number of months, providing them with further optionality on the timing and magnitude of any cutting cycle. We expect three 25bps rate cuts in 2024, which is in line with Fed expectations and market pricing.

With our macro outlook for a soft landing, we keep bonds as most preferred and equities as neutral. We maintain our year-end target of 3.5% for the 10-year Treasury yield, but caution that in the near term the yield is likely to be range-bound between roughly 3.8% and 4.3% as markets trade around incoming economic data and any potential changes to the Fed reaction function. After a strong 2023, we think US equity returns will be more muted for the rest of 2024. Our year-end price target on the S&P 500 is 5,200, implying mid-single-digit returns from the current level. After a modest earnings recession last year, we forecast earnings growth for the full year of around 9%.

We maintain our regional equity preferences, with emerging markets most preferred. Within US equities, we are neutral on value versus growth, and have a relative preference for small-caps versus large-caps. While we expect small-caps to perform well in our base case, it is our highest conviction idea for investors who **anticipate a "Goldilocks" scenario**. In this upside scenario, robust economic activity coupled with more Fed rate cuts due to rapid disinflation than the market is currently pricing should boost equity returns, most significantly for the highest beta segments of the market. Additionally, the relative valuation discount that small-caps have today versus large-caps is the largest in years, providing a cushion against further valuation deviations from here.

Within fixed income, our message remains to **buy quality**. We expect high-quality bonds to deliver good total returns in 2024, as economic growth gradually decelerates and inflation falls closer to target. Specifically, we see good value in TIPS, investment grade corporate bonds, agency MBS, CMBS, municipals, and sustainable bonds.

With the Fed likely at the end of the hiking cycle, but comfortable with rates at current levels for some time, we reiterate our message to **manage liquidity**. As inflation continues to decline, the Fed has room to cut rates very quickly in response to a growth scare. This would be particularly painful for depositors who haven't locked in higher rates for the next few years.

This month we make a number of changes to our US equity sector preferences. We upgrade healthcare and industrials to most preferred from neutral. Healthcare is our preferred defensive sector due to faster earnings growth relative to other defensives. Industrials should benefit from resilient economic growth, improving manufacturing sentiment, a bottoming in cyclical activity, and more structural tailwinds around reindustrialization of US economic activity. This month we also downgrade consumer staples and energy to neutral from most preferred. As inflation cools, companies lose pricing power, which will impact consumer staples companies, which are also fully valued in our view. While the oil market is slightly undersupplied, higher-than-expected production remains a risk, and we shift our view to neutral on the sector. Elsewhere, we remain most preferred on US information technology and least preferred on real estate and utilities.

We still like US tech even as the sector has grown significantly over the past year. With the AI revolution upon us, investors' future performance will likely hinge on their level of exposure to the technology sector. Thus, we recommend that investors **optimize tech exposure** to ensure that they are appropriately exposed to the sector as a whole, though they must also avoid the pitfalls of overconcentration. While the Magnificent 7 already account for 18% of the global equity market (per MSCI ACWI), we expect the big to get bigger due to rapid earnings growth accreting to AI leaders.

Looking beyond public markets, we continue to advise investors to **capture growth in private markets**. Our future should see significant investments made in realms like healthcare, digitalization, and energy efficiency. But already-high government debt levels suggests public spending for innovative solutions will be constrained. Private market managers with the ability to provide debt or equity capital at different company lifecycle stages will have a key role to play. Additionally, with the majority of firms in the US now privately held, accessing private markets is essential to achieve enhanced portfolio diversification and improve longer-term risk-adjusted returns.

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	−		
US Growth Equity		=	
US Value Equity		=	
US Mid Cap		=	
US Small Cap			+
Int'l Developed Markets		=	
UK	−		
Eurozone		=	
Japan		=	
Australia		=	
Emerging Markets			+
Other			
Commodities		=	
Gold		=	
Oil			+
MLPs		=	
US REITs		=	

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 Extended* published on 22 February 2024.

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.

Asset allocation: Themes implementation

With alignment to our Messages in Focus (MIFs)

Asset class	Theme and description	Buy quality	Anticipate a "Goldilocks" scenario	Diversify with alternative credit	Optimize tech exposure
		MIF alignment			
US fixed income	**Taxable Munis**	✓			
	Taxable municipal bonds offer incremental yield pickup vis-à-vis corporate debt along the curve.				
	Quality IG credits present an income opportunity	✓			
	We believe investment grade issuers offer attractive yields and exhibit balance sheet strength and earnings resilience.				
EM fixed income	**Short-duration Pan-American bonds**	✓			
	We believe this list offers relative value in short-end investment grade corporate bonds.				
	EM Bond Top Picks	✓			
	We believe that our selected basket of emerging market bonds offers US investors the opportunity to enhance total returns in exchange for a modest increase in risk.				
Global equities	**Greentech goes global**		✓		✓
	This equity list has significant ex-US exposure and should benefit from infrastructure spending plans.				
US equities	**Tactical US Equity Themes**	✓	✓		
	Our tactical themes offer exposure to high-quality companies, and those that should benefit from a Goldilocks scenario, including a new "Housing recovery" theme.				
Hedge funds/ alternatives	**Opportunities in dislocated credit markets**			✓	
	Credit market stress has expanded the opportunity for hedge fund and private managers to deploy capital.				

Themes to fulfill your portfolio's needs

Michelle Laliberte, CFA, Thematic Investment Strategist; **Nadia Lovell,** Senior US Equity Strategist;
Barry McAlinden, CFA, Fixed Income Strategist

In this month's letter, we identified four things no great portfolio can do without: US large-caps, international stocks and small-caps, quality bonds, and alternatives. The good news is, if your portfolio happens to be lacking one of these four things, our investment themes can help with that.

US large-caps

Exposure to the United States, home to the world's largest stock market, should be a crucial part of any portfolio. Despite US large-caps performing well in recent months, investors with underweights to the asset class should consider aligning more closely with strategic target weightings and optimizing their exposure to technology. Optimizing tech exposure will largely depend on the portfolio's current allocation, but several of our themes offer a starting point for ideas. "E-commerce" is one of CIO's top five themes this month and has exposure to several US large- and mega-caps. Similarly, "Enabling technologies" covers a range of opportunities in the tech space, from artificial intelligence to cloud service providers. For investors interested in a tactical approach, our tactical US equity themes are focused primarily on US large-caps across sectors.

International stocks and small-caps

The US might be a dominant stock market historically, but regional diversification is still mission critical, and there have been periods in the past where the US has lagged other markets significantly. Diversifying regionally helps prevent outsize losses in the case of unpredictable "black swan" events. Above, we highlight the "Greentech goes global" theme, which maintains exposure across regions, including Europe, Asia, and the US. The theme has been well positioned against the current backdrop, benefiting from the structural growth inherent in greentech industries and supportive government policies.

We don't break out small-caps in our thematic asset allocation above, but several of our longer-term investment (LTI) themes span across the market-cap spectrum and can be a helpful way to diversify beyond common benchmark holdings. "Frontier markets," another top LTI theme this month, isn't a pure play on small cap, but it does skew mid-cap at the benchmark level and offers international diversification beyond the US.

Quality bonds

Currently high yields are already appealing, but with yields expected to fall moving forward, we also see the potential for capital appreciation. The "Quality IG bonds" theme highlighted above is a good starting point for investors looking for high-quality exposure to fixed income. This list of quality IG credits could be a way for investors to lock in longer duration with Treasury yields near the upper end of CIO's near-term estimated range.

Alternatives

Exposure to alternatives can offer a number of benefits, including smoother portfolio returns, broader exposure beyond public market opportunities, and the potential to improve returns. Themes can be implemented in a variety of ways, but many LTI themes describe the opportunity in innovative, structural developments, that often center on niche or emerging industries. This means that a large portion of the opportunity set may lie in private markets, and may be more easily captured within alternative investments.

Longer-term themes

Top 5 favorite LTI themes

1. Frontier markets
2. E-commerce
3. Emerging market infrastructure
4. Family businesses
5. Water scarcity

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

Our base case remains a soft landing, with the Fed starting to trim rates in 2Q as the growth data cools off. Real disposable income should rise in 2024, helping to sustain growth in consumer spending.

Brian Rose, PhD, Senior US Economist

Overview

2023 was a "Goldilocks" year for the economy, with inflation cooling off despite stronger-than-expected growth. The most recent data has been more mixed. Nonfarm payrolls for January rose by 353,000, far more than expected, and came on top of upward revisions to the prior two months. As shown in the chart, this suddenly makes the underlying trend look much stronger, with the 3-month moving average standing at 289,000 versus 165,000 a month ago. CPI for January also rose at a faster pace than in recent months, driven by rising services prices, even as core goods prices fell. On the other hand, there were some surprises to the downside in the data for January, such as the 0.8% month-over-month drop in retail sales and the 0.5% decline in manufacturing output. At this point, it isn't clear if these moves represent the start of a new trend, or simply reflect noise in the data. Our base case remains a soft landing, with more moderate GDP growth in 2024 and inflation close to the Fed's 2% target at year-end.

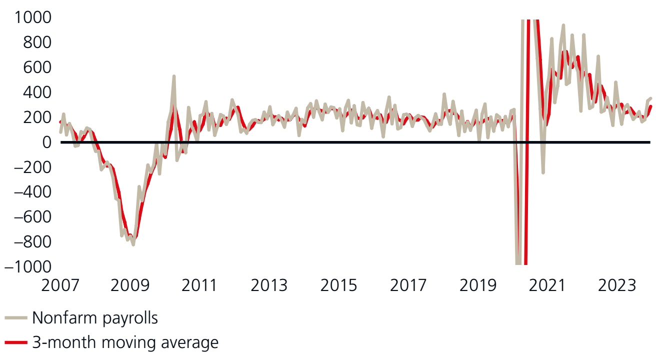
Growth

As shown in the chart, economic growth has remained above our 1.8% estimate of the potential GDP growth rate since 3Q22. As of this writing, the Atlanta Fed's GDPNow tracking estimate for 1Q24 stands at 2.9%. This long period of "above-trend" growth was achieved in spite of much higher interest rates. Growth has been led by consumer spending. The combination of robust job growth, rising wages, and slowing inflation has supported real disposable income. Further, despite some signs of increasing financial stress, for example rising delinquencies on consumer loans, in aggregate household balance sheets are still strong. Higher-income households have seen a big increase in wealth driven by rising home and equity prices, and as long as these households continue to spend, overall consumption should remain on a rising trend. However, with the savings rate hovering at very low levels in recent months, it is likely that the savings rate will move higher over the course of the year.

Figure 1

Payroll growth suddenly looks much stronger

Nonfarm payrolls, monthly change in thousands

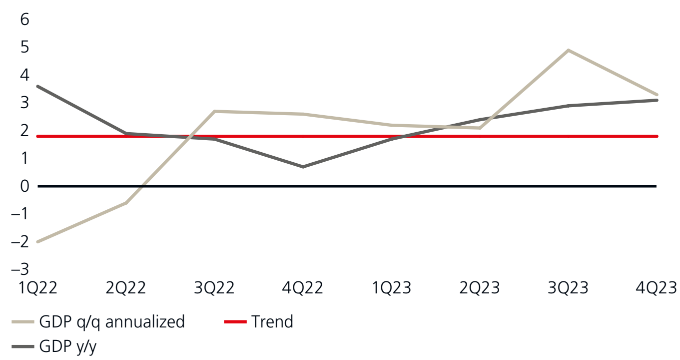


Source: Bloomberg, UBS, as of 21 February 2024

Figure 2

Growth has been above trend since 3Q22

GDP, q/q annualized rate and y/y change, in %



Source: Bloomberg, UBS, as of 21 February 2024

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

Read the report ›

Inflation

Inflation surprised to the upside in January, with headline CPI rising 0.3% month-over-month and core CPI, which excludes food and energy prices, rising 0.4%. Some of this rise appears to have been driven by one-off price increases at the start of the year. However, recent data has also looked less favorable at the producer level, which will likely feed through into retail prices in the months ahead. At least some transitory factors were helping to bring inflation down last year, which could mean that the underlying trend was not as favorable as it appeared on the surface. We feel confident that shelter inflation, which is by far the biggest component of the CPI, will continue to slow. This should keep overall inflation on a downward trend, but many other service prices could continue to rise, and goods prices may stop falling. We still expect the year-over-year inflation rate for core PCE to be near the Fed's 2% target at the end of 2024.

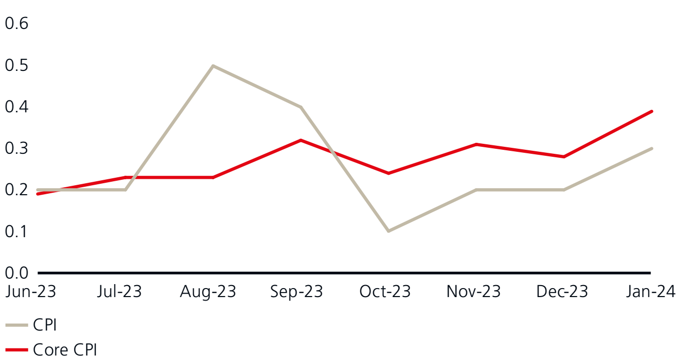
Policy

In light of the stronger-than-expected payroll and inflation data for January, we pushed back the timing of the first Fed rate cut from May to June, and our base case now calls for 75 basis point of cuts this year rather than 100. In our view, it will be important to keep an eye on wage growth in the months ahead. While markets tend to be obsessed with monthly data and short-term trends, the Fed needs to worry about the medium-term outlook, and it will be difficult for inflation to sustainably hit the Fed's 2% target unless wage growth slows further. The Atlanta Fed Wage Tracker slowed to 5% year-over-year in January, breaking a stall over the previous three months, and we take this as a sign that wage growth remains on a downward trend. This should help to create the right conditions for the Fed to start trimming rates. On the fiscal side, it is looking increasingly likely that a continuing resolution in Congress will be needed for the rest of the fiscal year, and it is also possible that automatic spending cuts will be implemented, creating a small drag on the economy in the second half of the year.

Figure 3

Monthly inflation was higher in January

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

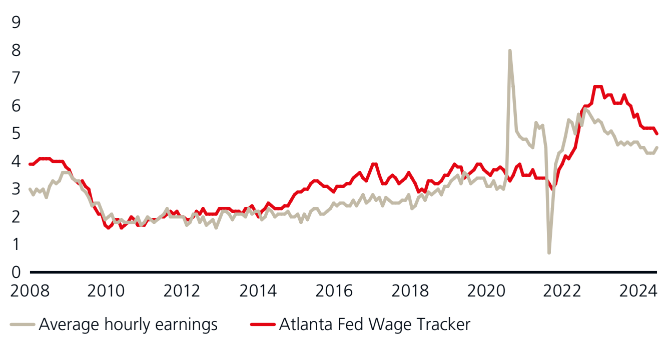


Source: Bloomberg, UBS, as of 21 February 2024

Figure 4

Wage growth still a bit too high for Fed

Average hourly earnings, Atlanta Fed Wage Tracker, y/y change in %



Source: Bloomberg, UBS, as of 21 February 2024

Equities

We maintain a neutral view on global equities. Global equities have posted solid gains in the first stages of 2024, following robust results from large-cap and high-quality companies. Despite early signs of a resurgence in US inflation and soaring yields, stock markets have stayed resilient. All in all, we still expect global equities to deliver mid-single-digit returns by end-2024. Equities are already at elevated valuations and face pressure from interest rates volatility, but the earnings outlook for 2024 is promising.

Eurozone

NEUTRAL

EURO STOXX 50 (index points, current: 4,775)	December 2024 target
House view	**4,900**
↗ Positive scenario	5,400
↘ Negative scenario	3,800

Note: All current values as of 22 February 2024

We maintain our neutral stance on Eurozone equities and see modest upside into the year-end. The potential start of a monetary easing cycle in combination with bottoming manufacturing activity is supportive, but equities have performed well in anticipation of some of this, so further gains from here should be modest, in our view. We believe the earnings backdrop remains broadly supportive. Falling inflation, easing financial conditions, bottoming manufacturing activity, light investor positioning, and reasonable equity valuations present a relatively favorable backdrop.

Emerging markets

MOST PREFERRED

MSCI EM (index points, current: 1,021)	December 2024 target
House view	**1,100**
↗ Positive scenario	1,200
↘ Negative scenario	820

Note: All current values as of 22 February 2024

We view emerging market (EM) equities as most preferred. The macroeconomic picture in emerging markets remains healthy. Economic activity continues to expand, with aggregate manufacturing PMIs remaining strong, while inflation continues to normalize. In our view, emerging market companies look set to deliver solid mid-teens earnings growth in 2024. Valuations for the MSCI EM index are largely in line with their 10-year average, yet stand at an above-average discount to US and developed market stocks.

Japan

NEUTRAL

TOPIX (index points, current: 2,627)	December 2024 target
House view	**2,680**
↗ Positive scenario	2,840
↘ Negative scenario	2,000

Note: All current values as of 22 February 2024

We are neutral on Japanese equities in our global strategy. TOPIX is off to a good start with a 10% gain year-to-date, supported by better sentiment particularly in the US equity market. Both the TOPIX and S&P 500 are up 10% since the beginning of December. A weaker yen has also supported the rally, with USDJPY rebounding to over 150 from 141 at year-end. The top 30 large-cap stocks, especially beneficiaries of the weaker yen and AI-related stocks, have contributed more than 60% of the year-to-date rally.

UK

LEAST PREFERRED

FTSE 100 (index points, current: 7,663)	December 2024 target
House view	**7,780**
↗ Positive scenario	8,400
↘ Negative scenario	6,000

Note: All current values as of 22 February 2024

The combination of easing monetary policy, bottoming earnings, and reasonable valuations should support UK equities at current levels. We have UK equities as least preferred in our global asset class preferences, as we see more upside for emerging markets where valuations are relatively attractive, and we anticipate double-digit earnings growth this year—versus around 2% earnings growth for the FTSE 100. Looking ahead to 2025, the picture should brighten: We forecast 6–7% earnings growth next year, driven by fading headwinds to energy and banks' profits alongside an improving economy.

US equities

Despite recent mixed economic signals, we think the backdrop for US equities remains supportive, driven by healthy economic growth, moderating inflation, a Fed pivoting to rate cuts, and a strong surge in AI investment. With some sentiment and positioning measures looking elevated, a modest pullback is possible, which could offer investors a better opportunity to add to equity positions.

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

US equities overview

NEUTRAL

Fourth-quarter earnings season is wrapping up and the results have been substantially better than expected. Additionally, the guidance was solid. This led us to raise our 2024 and 2025 S&P 500 EPS estimates to USD 245 (+9% y/y) and USD 260 (+6% y/y), respectively. After the more than 20% rally since the October low, a modest pullback may be in store in the coming months. However, with key equity market drivers still largely in place, we expect further upside through year-end. Our June and December S&P 500 price targets are 5,100 and 5,200.

US equities: Sectors

Healthcare is our preferred defensive sector due to faster earnings growth relative to other defensives. Industrials should benefit from resilient economic growth, an improvement in manufacturing business sentiment, and a bottoming in cyclical areas such as transports. Tech should benefit from its higher quality bias, AI-driven growth, and a pickup in key end-markets. For real estate, growth in adjusted funds from operations this year will likely lag S&P 500 profit growth. Resilient economic data is usually a headwind for the relative performance of the utilities sector.

US equities: Size

Relative valuations for small-caps are attractive, in our view, and the Fed's clear pivot to rate cuts increases our conviction in a likely improvement in key indicators such as the ISM Manufacturing New Orders index, which typically corresponds to small-cap outperformance. Nearly half of Russell 2000 debt is floating-rate, offering these companies a clear benefit from potential Fed rate cuts. In addition, valuations for small-caps are very appealing.

US equities: Style

The AI spending boom has been a key driver of the increase in relative valuations for growth stocks, which are now double their historical average versus value stocks. However, this premium may persist given a stronger earnings growth outlook for growth stocks. While the prospect for Fed rate cuts could be positive for value stocks, we prefer to take advantage of this opportunity via small-caps as their balance sheets should get a bigger benefit from Fed rate cuts compared to large-caps.

S&P 500 (index points, current: 5,087)	December 2024 target
House view	**5,200**
↗ Positive scenario	5,500
↘ Negative scenario	3,700

Note: All current values as of 22 February 2024

Figure 1

Remain balanced, but shifting exposures

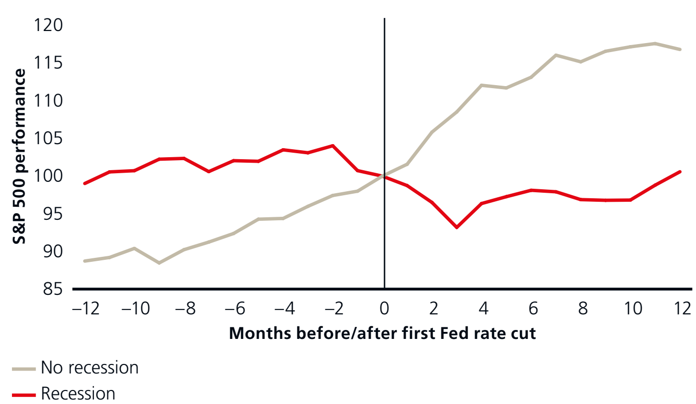
	Least preferred	Neutral	Most preferred
US equities			
Communication services		=	
Consumer discretionary		=	
Consumer staples		=	←
Energy		=	←
Financials		=	
Healthcare			→ +
Industrials			→ +
Information technology			+
Materials		=	
Real estate	–		
Utilities	–		

Note: Tactical preferences from benchmark (S&P 500).
Source: UBS, as of 22 February 2024

Figure 2

If no recession, rate cuts should support equities

S&P 500 average performance (indexed to 100) following first Fed rate cut



Source: Bloomberg, UBS, as of 21 February 2024

Bonds

We think the current risk-reward proposition for quality bonds is attractive, and we see the potential for capital appreciation as inflation and growth slow. With Fed rate cuts expected to begin in June, we look for the 10-year US Treasury yield to fall to 3.5% by December in our base case, from 4.3% today. Within fixed income, we keep US investment grade corporate bonds, TIPS, CMBS, and agency MBS most preferred, advising an "up-in-quality" allocation.

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%)	December 2024 target
House view	**3.5%**
Positive scenario	2.5%
Negative scenario	4.0%

Note: All current values as of 22 February 2024

Stronger-than-expected CPI and PPI data forced a market repricing of inflation expectations, fed funds easing, and timing of the first rate cut. With this, 10-year yields moved higher, reaching as high as 4.33%. The rate has now settled near 4.3%, within our 4–4.5% short-term range. Seeing 4.5% is possible if the data continues to be strong and as the market adjusts inflation and Fed expectations. But it is not likely to be sustained, and we still see yields trending toward 3.5% by year-end as rate cuts begin and growth slows.

US investment grade corporate bonds

MOST PREFERRED

US IG SPREAD (current: 94bps)	December 2024 target
House view	**110bps**
Positive scenario	85bps
Negative scenario	200bps

Benchmark: Bloomberg Barclays US Int. Corp.
Note: Current values as of 22 February 2024

We hold a most preferred view on investment grade bonds. On spread valuation, IG bonds are not cheap at a current index spreads levels of 94bps, but are reflective of benign issuer fundamentals and very strong investor demand for historically attractive yields. We continue to favor a barbell approach consisting of short-end (1–3-year) and intermediate (7–10-year) exposure. The main distinction that stands out among IG industry sectors is the cheapness of financials relative to nonfinancials. We find good relative value in bonds issued by US G-SIB banks.

Emerging market bonds

NEUTRAL

EMBIG DIV. / CEMBI DIV. SPREAD (current: 379bps / 276bps)	December 2024 target
House view	**425bps / 350bps**
Positive scenario	340bps / 260bps
Negative scenario	600bps / 550bps

Note: Current values as of 22 February 2024

We keep emerging market credit as neutral. Valuations look slightly stretched, and we expect wider spreads by year-end. However, our soft-landing base case scenario implies that the asset class should still deliver high-single-digit returns this year. Key risks include negative growth and inflation shocks in the US and other key countries, softer commodity prices, escalating geopolitical tensions, or rising defaults, whether in developing or developed markets, triggering a flight to safety.

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

US high yield corporate bonds

NEUTRAL

USD HY SPREAD (current: 334bps)	December 2024 target
House view	**400bps**
Positive scenario	325bps
Negative scenario	800bps

Benchmark: ICE BofA
Note: All current values as of 22 February 2024

We are neutral on high yield, reflecting our view that spreads are tight but yields provide ample carry. Fundamentals weakened in 2023, but remain at healthy levels, while the outright levels of yield provide a buffer to total returns. We think HY default rates could rise to mid-single-digits, which would be lower than in past default cycles; and barring a major economic slowdown, HY issuers should be able to refinance their maturities in 2024.

Municipal bonds

NEUTRAL

The strong muni rally at the end of last year has stalled. Thus far in 2024, the muni index yield has trended higher by 20bps to now sit at 3.42%. That said, tax-exempt paper has held up better than their taxable counterparts year-to-date. As a result, yields on AAA munis now sit at rich levels vis-à-vis taxable debt, particularly through the 10-year spot. In the weeks ahead, we expect increased issuance to prompt better buying opportunities. AAA 10-year muni-to-Treasury yield ratio: 57% (last publication: 57%).

Non-US developed fixed income

NEUTRAL

Over the past month, bond yields in non-US developed markets were mostly higher as stronger data made central bank rate cuts less urgent. On foreign exchange markets, the dollar overall gained slightly against other major currencies, reducing the value of non-dollar bonds when measured in dollars. These factors combined to produce negative returns. With US bonds still offering higher yields than in most other developed markets, we do not recommend a strategic asset allocation position on the asset class.

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

We recently added CMBS as a most preferred sector. High-quality CMBS offers attractive relative value to IG and should benefit from the same market dynamics as agency MBS, including declining rate volatility and a steepening yield curve. Much of the negative headline risk surrounding CMBS has been priced in; however, selectivity and caution will be key. We recommend funds with expertise and low office allocations. We continue to hold agency MBS as most preferred. Yields have fallen 100bps from their 52-week highs, and we expect that trend to continue as investors seek high quality and lower risk.

AGENCY MBS SPREAD (current: 158bps)	December 2024 target
House view	**110bps**
↗ Positive scenario	100bps
↘ Negative scenario	185bps

Note: Current values as of 22 February 2024

Preferred securities

NEUTRAL

Rates have moved higher in recent weeks, but preferreds have posted just marginal losses in February and are holding on to gains so far this year. Therefore, valuation has tightened and spreads have narrowed. The sector may experience near-term headwinds as rates potentially continue drifting higher or if there is a reversal in spreads. Looking out into 2024, we expect generally lower-trending interest rates to support the sector and produce solid 12-month returns.

Treasury Inflation-Protected Securities (TIPS)

MOST PREFERRED

While 5-year real yields have fallen from our 2.25% assumption when we initiated our preference, we maintain our position. With the market pricing expectations of increased TIPS supply, and with the Fed likely staying on hold for longer than first anticipated, we believe the current pricing of breakeven inflation appears too low. Forward inflation expectations continue to hover around 2.4–2.6%. Given housing market strength, elevated wage growth, and CIO's outlook of rising oil prices in the next several months, we believe holding TIPS within a diversified portfolio is prudent.

US 5-YEAR YIELD (current: 1.87%)	December 2024 target
House view	**1.75%**
↗ Positive scenario	1.50%
↘ Negative scenario	2.40%

Note: All current values as of 22 February 2024

Figure 1

UBS CIO interest rate forecast

In %

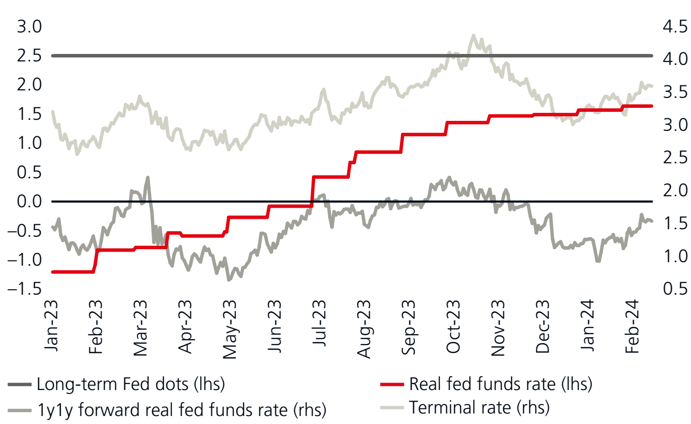
UST	Current	Jun-24	Sep-24	Dec-24	Mar-25
2-year	4.7	3.8	3.3	3.3	3.3
5-year	4.3	3.5	3.5	3.3	3.3
10-year	4.3	3.8	3.5	3.5	3.5
30-year	4.5	4.0	4.0	3.8	3.8

Source: Bloomberg, UBS, as of 21 February 2024

Figure 2

The real fed funds rate remains restrictive, ultimately bringing down demand

Yield, in %



Source: Bloomberg, UBS, as of 20 February 2024

Commodities and listed real estate

We hold a neutral view on commodities overall as well as on gold, but remain most preferred on crude oil. Our benchmark UBS CMCI total return index is flat this year, but there is dispersion within the sector. Livestock and energy have risen by more than 5%, while industrial metals are down by more than 4% this year. Our return outlook for commodities remains positive, and we expect broadly diversified commodity indexes to appreciate by mid- to high-single-digit rates, with a total return of around 10% for the full year.

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 2,026/oz) — December 2024 target

NEUTRAL

House view	USD 2,250/oz
Positive scenario	USD 2,000/oz
Negative scenario	USD 2,500/oz

Note: All current values as of 22 February 2024. Gold is a safe-haven asset whose price tends to rise when risk assets, such as equities, fall, and vice versa.

Precious metals

Gold prices temporarily dropped below the USD 2,000/oz level as US CPI data beat to the upside. With a midyear Fed rate cut being our base case, we think a revival in gold ETF demand remains the main catalyst, boosting gold to USD 2,250 by end-2024. We continue to see gold as a portfolio hedge against risk events. We recommend an allocation of around 5% in diversified and balanced USD-based portfolios.

Base metals

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

Agriculture

Easing weather-related risks saw the CMCI grains sub-index decline by 10% while the soft commodities sub-index, led by cocoa and cotton, moved higher by a similar magnitude. Meanwhile, market positioning has reflected these price dynamics with short positions held by hedge funds at a more than three-year high. Adding to the bearish sentiment was industry wheat estimates that signaled Russia may produce another 100 million metric tons this year, alongside the first estimate from the USDA for the 2024–25 US planted areas—US corn area is forecast to contract by 3.6 million acres while soybean area is projected to rise by nearly 4 million acres. Within softs, cocoa has been the standout as El Nino-related damage means deficits will likely persist over 2024–25. Livestock, in aggregate, has risen by around 10% this year; we hold a moderate overweight to the sector.

BRENT (current: USD 83.03/bbl) — December 2024 target

MOST PREFERRED

House view	USD 82/bbl
Positive scenario	USD 120–140/bbl
Negative scenario	USD 40–60/bbl

Note: Current values as of 22 February 2024

Crude oil

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

Listed real estate

RUGL Index (current: USD 5,476) — December 2024 target

House view	USD 7,100
Positive scenario	USD 7,300
Negative scenario	USD 6,900

Note: All current values as of 22 February 2024

We like companies with strong pricing power, a large pipeline, attractive yield gaps, and robust cash flows, and those that are acquisitive. While volatile, stocks trading at large discounts may also offer above-average returns as interest rates should continue to come down gradually. Historically, the sector has started to rally 18 to 24 weeks before the first actual Fed rate cut, with the good performance continuing after. We like Japanese developers' attractive valuations and robust fundamentals. Singapore REITs and developers still suffer from low yield spreads, but Hong Kong and mainland China may be nearing a bottom in valuations. European and UK firms are increasingly dependent on central bank decisions despite improved balance sheets. Well-capitalized US companies have robust fundamentals, in our view.

Foreign exchange

We prefer the Australian dollar and lower the Swiss franc to least preferred.

Thomas Flury, Strategist, UBS Switzerland AG

Price action and economic conditions suggest EURUSD is likely to stay in a 1.05 to 1.10 range. We believe the pairing may test the lower edge of that trading band in the coming weeks, as surprisingly good US data pave the way for the dollar to appreciate. Still, we see limits to dollar strength. Markets are expecting most G10 central banks to cut interest rates by 150 to 200 basis points over the next two years. This should provide solid support for risk-on currencies like the EUR, the GBP, and the commodity bloc (AUD, CAD, and NZD).

The pound should hold steady against the EUR. The UK and the Eurozone are at a very similar stage in the economic and monetary policy cycle. Just like the euro, the GBP would need a stronger global growth backdrop and a more stable geopolitical outlook to rally sustainably. A rebound of GPBUSD to 1.30 cannot be ruled out in light of easing global monetary conditions and improving risk sentiment.

The Swiss franc is on a weakening trend in response to Swiss inflation dropping into the Swiss National Bank's (SNB) target band, reducing the need to shield Switzerland from imported inflation. This backdrop suggests to us the CHF should decline a bit further from here, and we are now least preferred on the franc. We think the currency is well suited to finance carry trades in the coming months. In contrast to this short-term least preferred view, we continue to see long-term value in CHF positions.

USDJPY has been rocked by significant moves in the past few months, falling from around 152 last November to nearly 140 in late December, before rebounding quickly to around 150 currently. We see current USDJPY levels as toppish, as Fed rate cut expectations have been trimmed and speculative net-short JPY positions have fallen back to extreme levels. So, we still favor selling yen downside risks for yield pickup.

For the CAD, NOK, AUD, and NZD, we anticipate only benign changes in the crosses. However, the AUD is likely to profit the most as the Reserve Bank of Australia will likely join the rate cut cycle only in 4Q in view of its stronger domestic economy. The pullback in oil prices should be transitory, and any rebound may support the CAD and NOK. We expect EURCAD to move lower and the NOK to outperform the SEK again.

Emerging market currencies first came under pressure in mid-January as markets digested the higher-than-expected US inflation release, but have fared better going through the Fed outlook repricing period in February so far. Positioning indicators for many currencies moved away from the rather stretched levels, and we think selective engagement in higher carry currencies is attractive again—we like the Brazilian real. We are still looking for opportunistic yield enhancement for short tenors, first and foremost in pairings including the South African rand. For China, we expect limited upside potential for the yuan, because of weakening Chinese growth momentum, which speaks for further easing measures.

FX strategy

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

FX forecasts

	Current	Jun-24	Sep-24	Dec-24	Mar-25
EURUSD	1.08	1.08	1.10	1.12	1.14
USDJPY	150	145	142	140	138
GBPUSD	1.26	1.25	1.28	1.30	1.33
USDCHF	0.88	0.90	0.88	0.87	0.85
USDCAD	1.35	1.33	1.32	1.31	1.30
AUDUSD	0.65	0.69	0.71	0.72	0.72
NZDUSD	0.62	0.61	0.62	0.62	0.62
USDSEK	10.38	10.46	10.18	9.91	9.65
USDNOK	10.49	10.56	10.27	10.00	9.74

Sources: SIX Financial Information, UBS, as of 22 February 2024

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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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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.

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Nontraditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments).
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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.

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– **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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