UBS House View

Investment Strategy Guide: Weather report

June 2024 | Chief Investment Office GWM | Investment research

In this report

June

CIO Monthly Livestream

6 June 2024 1:00 p.m. ET

- Tune in to the event here
- Add to calendar

Erratum: *On page 22, our current Negative Scenario on the ICE BofA US high yield spread is 500, not 800 as originally published. Also, the Positive / Negative scenarios originally published for government bonds on page 22 were incorrect and have been removed.*

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Dear reader

After a sour April, May has brought an improvement in investment sentiment and equity market performance, with the S&P 500 setting a fresh all-time high. The rising optimism stemmed from a series of developments that reduced both the probability of negative tail risks for the economy and also rekindled expectations for rate cuts before year-end.

Notably, Fed Chair Jerome Powell recently clarified that it would be "unlikely" for the FOMC to enact further rate hikes. This was followed by another key inflection point, April's CPI report, in which headline and core data showed signs of deceleration after three consecutive months of upside surprises.

In aggregate, we believe the economy is progressing in line with our base case for a soft landing. We continue to see reassuring signs of a better-balanced labor market, which should allow for wage growth to continue slowing. We stand by our call that the Fed will cut rates twice this year, with the first 25-bps move likely in September.

In this context, in the fixed income space, our message is still to buy quality. We expect quality bonds to deliver solid total returns in 2024, as the decline in yields becomes more pronounced in the second half of the year. Specifically, we see good value in US TIPS, investment grade corporate bonds, Agency Mortgage-Backed Securities, Commercial Mortgage-Backed Securities, municipal bonds, and sustainable bonds.

Within US equities, stocks remain supported by favorable macro conditions. As the 1Q reporting season comes to an end, there was healthy earnings growth and robust artificial intelligence spending, with Nvidia's earnings report putting to rest any doubts regarding the durability of the AI tailwind. We subsequently increased our year-end S&P 500 target to 5,500, up from 5,300 previously. We continue to have a relative preference for small caps versus large caps. And within our sector strategy, we still favor information technology and industrials, while we've downgraded healthcare from most preferred to neutral.

Finally, in this month's Thematic Spotlight, we discuss the potential for power outages as summer weather sets in the northern hemisphere. Rising global temperatures and nature-related shocks pose risks to an aging electric grid. The probability of problems becomes more pronounced when accounting for the rise in electricity demand that now is being propelled by the build-out of data centers. We therefore continue to prefer a diversified but selective near-term approach across the energy transition supply chain, with exposure to semiconductors and input materials such as copper.

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.

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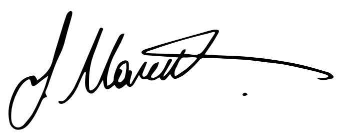
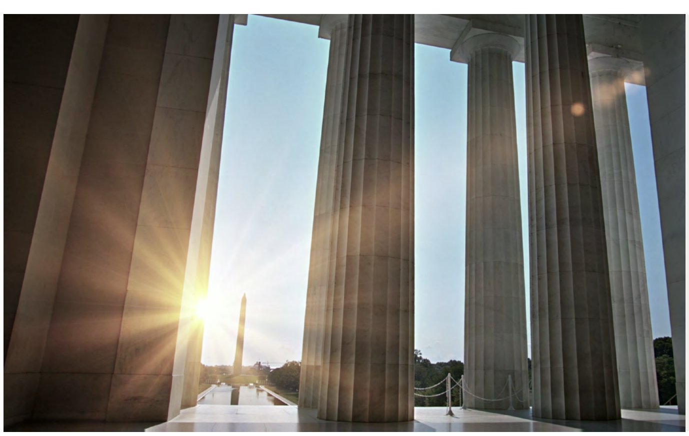


Solita Marcelli



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.

Weather report

Cash returns set to fall

With the global rate-cutting cycle set to gather pace, investors should consider opportunities to put cash to work.

AI growth case intact

Increasing investment in AI capabilities by big tech firms should drive profit growth in the "enabling layer" of the AI value chain.

A broadening rally

The broadening of the global equity rally should widen the opportunity set for investors looking to diversify beyond tech.

Asset allocation

Fixed income remains our preferred asset class. Within equities, we like the US IT sector, and see value in UK equities and US small-caps.

Mark Haefele
Global Chief Investment Officer
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Our views, live with Q&A
The next CIO global monthly livestream will take place on 28 May. Join here.

"You don't need a weatherman to know which way the wind blows." Bob Dylan

Sometimes it can be all too easy to get lost in the details and miss some of the big trends that are impacting markets:

- Inflation is falling and interest rates are already being cut in some countries
- AI-related capital investment is booming
- The equity market rally has broadened globally
- The US election is approaching, and both the result and potential implications are uncertain

What do they mean for investors?

First, lower inflation and lower interest rates should support stocks and bonds. Higher interest rates have led many investors to hold more cash or money market investments than usual. Lower interest rates will likely lead at least some of that money to a new home. Fixed income is a natural destination, while carry strategies using currencies are likely to rise in appeal. We also expect stocks to benefit, especially if the US economy achieves the soft landing we envision.

Second, we think increasing investment in artificial intelligence capabilities by technology firms will contribute to significant profit growth in the "enabling layer" of the AI value chain—notably in the semiconductor industry. Eventually, artificial intelligence should lead to value creation across a broad range of industries and applications. For now, we see "AI enablers" as the most tangible and profitable opportunity for investors.

Third, the broadening of the equity market rally—both in terms of earnings and performance—should widen the opportunity set for investors looking to diversify sources of return beyond technology.

Finally, investors need to be cognizant of the potential for political and geopolitical risks to drive volatility and impact markets as the year progresses.

How to position?

We continue to prefer quality bonds.

Fixed income remains our preferred asset class, within which we favor quality bonds. We expect quality bond yields to fall in the months ahead as markets start to price a more convincing central bank rate-cutting cycle. Complementing a core holding in quality bonds with a satellite in riskier credits can improve overall portfolio yields. Decent economic growth means default rates are likely to remain contained, even if spreads are tight.

In equities, we see modest upside overall, and focus on capital preservation strategies and selectivity. In technology, positioning for upside via options or structures can be an effective way to manage sentiment, valuation, and idiosyncratic risks. At an index level, such strategies can also help investors mitigate potential policy and geopolitical risks. Looking beyond tech, we like exposure to some more lowly valued parts of the equity universe, including the UK market and US small-caps.

Lower rates: "Money blues"

Investors should prepare portfolios for lower interest rates.

The global rate-cutting cycle is under way.

In March, the Swiss National Bank cut rates by 25 basis points. Sweden's Riksbank followed in May. By the time I write my next letter, it is likely that the European Central Bank will have cut rates as well. Bank of England Governor Andrew Bailey said he expects UK inflation to fall "close" to the central bank's target level in the next couple of months. And, with the US economy now showing signs of cooling, we expect the Fed to start easing policy in September. US core CPI rose by 3.6% year-over-year in April, the lowest rate since April 2021, and US GDP growth slowed to 1.6% in the first quarter.

We think this pivot in central bank policy will prove a key moment for many investors. Cash has just delivered its best annual return in more than two decades (based on the 12-month return on the Bloomberg T-bill index), and assets in money market funds have surged to around USD 6 trillion today from just USD 4.5 trillion before the Fed started hiking rates in March 2022. But, as interest rates fall, cash will deliver progressively lower returns, and we expect this to trigger flows out of cash and money market funds.

We believe that investors looking to put cash to work should consider building exposure to fixed income. Bonds have lagged in recent years as central banks hiked rates, but we expect a turn in the global rate cycle to mark an inflection point for the asset class. Bonds have already started performing better in response to cooling US inflation, but the 10-year US Treasury yield still trades at around 4.4% at the time of writing.

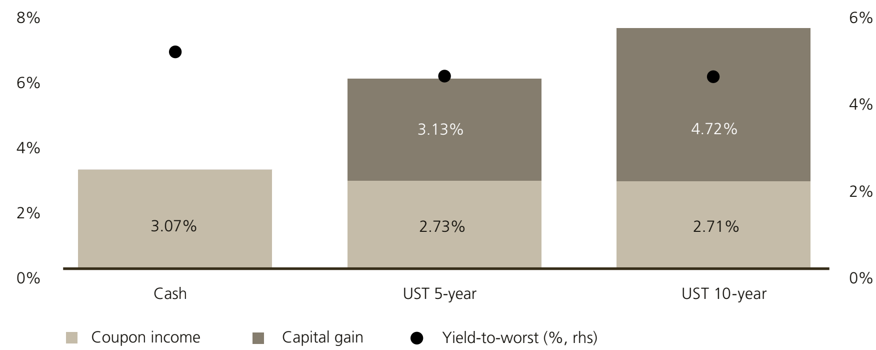
The opportunity to lock in near-peak yields on fixed income is unlikely to last indefinitely.

For investors, the opportunity to lock in near-peak yields on fixed income is unlikely to last indefinitely. We think yields are likely to fall further in the months ahead, especially once the first US rate cut looks more certain and investors price a more meaningful easing cycle. In our base case, we expect the 10-year US Treasury yield to fall to 3.85% by year-end and to 3.5% by March of next year.

Figure 1

Bonds offer the potential for higher total returns, as yield declines result in capital gains

Treasuries' total returns (coupon income + capital gain) vs. cash based on our forecasts* of declining yields by year-end



* Our forecast is for 5yr and 10yr yields to decline to 3.75% and 3.85% respectively by year-end.
Source: Bloomberg, UBS, as of May 2024

Strategically, we recommend that investors hold diversified exposure across fixed income to realize the full return potential of the asset class. Tactically, we continue to favor high-quality segments—valuations look fairer compared to the higher-credit-embedded sectors that have outperformed year-to-date. In addition, if global growth slows abruptly, quality bonds would likely rally sharply.

The global rate-cutting cycle is likely to create opportunities in the currency space.

The rate-cutting cycle should also create opportunities in the currency space. The Australian dollar remains our preferred currency, given our expectation that the Reserve Bank of Australia is likely to keep rates higher for longer than most other G10 central banks, and our outlook for further strength in commodities. With our year-end forecast at 0.68, we advocate selling the AUDUSD's downside risks. We see carry opportunities in the Brazilian real thanks to high local interest rates. Investors can also consider volatility-selling strategies in the US dollar and using periods of near-term dollar strength to reduce exposure ahead of likely US rate cuts later in the year.

Meanwhile, the Swiss franc has weakened materially in response to lower interest rates in Switzerland, and rising risk appetite has led to an exceptional increase of short positions. The risk of a reversal has therefore increased, in our view, and we move the Swiss franc from least preferred to neutral. In the longer term, we expect fewer rate cuts from the Swiss National Bank than the ECB or the Fed.

First-quarter tech results reinforce our conviction in the AI growth case.

Technology: "The times they are a-chAIngin'"

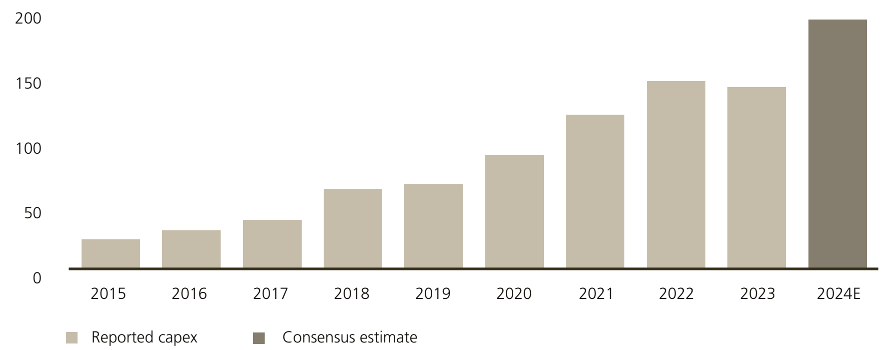
Strong first-quarter earnings from big tech companies underline our conviction that the AI growth case remains intact. Tech giants like Microsoft, Alphabet, Meta, and Amazon announced significant increases in AI infrastructure investments, with their combined capex projected to hit USD 205 billion this year, a 40% increase from 2023, according to

FactSet consensus. The 262% year-over-year increase in NVIDIA's first-quarter revenues demonstrates how this capex can drive significant growth along the value chain. Cloud services are also seeing rapid growth, with revenue acceleration in the first quarter suggesting enhanced AI monetization.

Figure 2

Increased capex should provide robust support to AI

Aggregate reported capex for Microsoft, Alphabet, Amazon, and Meta for calendar years 2015-2023, FactSet consensus estimate for 2024, in USDbn



Source: FactSet, UBS, as of May 2024

We think it is important that investors hold strategic exposure to the tech sector.

The global tech sector is not cheap, with the MSCI AC World IT index trading at around 24x 2025 earnings. However, with artificial intelligence demand remaining robust, we forecast 20% earnings growth this year and 16% in 2025. And, with the technology likely to be a key driver of growth in the years ahead, we think it is important that investors hold strategic exposure to the sector. The technology sector comprises close to 30% of the global equity market, and investors should allocate a similar proportion of their long-term equity allocations to the sector. Investors looking to build exposure can consider structured strategies to position for potential gains while mitigating near-term potential downside risks.

Tactically, our preferred area within technology is semiconductors. The semis industry is well positioned within the "enabling layer" of the AI value chain, still trades at a 10% discount to global tech, and should benefit from rapid earnings growth (we forecast 50% profit growth this year and 25% in 2025), continued strong pricing power, and strengthening balance sheets. We also see opportunities in China's internet sector amid improving earnings prospects.

The global equity rally has broadened in recent months.

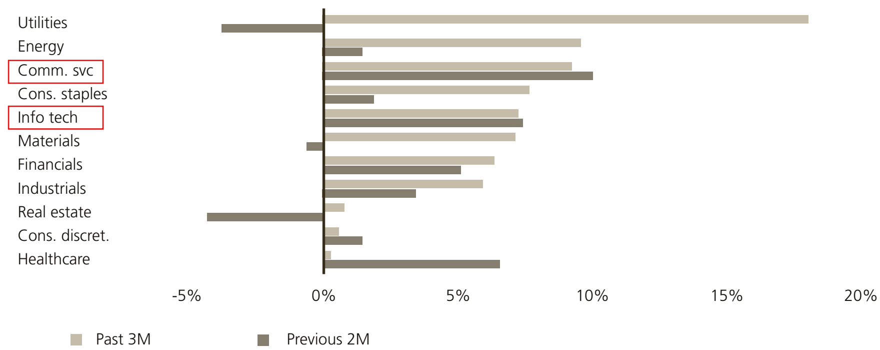
Equities beyond technology: "Pressing on"

While the US technology sector has remained a key contributor to the rally in global equities so far in 2024, it is not the only game in town. The US equity rally has been helped over the past few months by sectors like utilities—amid expectations for rising power demand—and energy. Meanwhile, globally, equity indexes in emerging markets—led by China—the UK, and the Eurozone have delivered robust performance in recent months.

Figure 3

The rally has broadened at a sector level

S&P 500 sector performance in the past three months vs. previous two months, ranked by best in past three months, in %

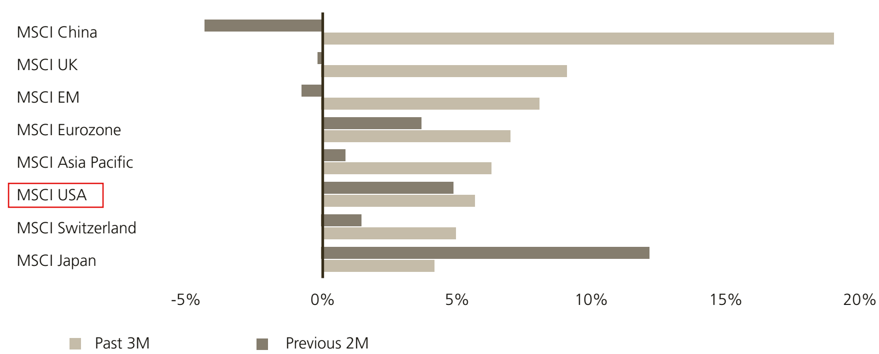


Source: Bloomberg, UBS, as of 23 May 2024

Figure 4

The rally has broadened regionally

Select regional markets' performance in the past three months vs. previous two months, ranked by best in past three months, in %



Source: Bloomberg, UBS, as of 23 May 2024

US earnings growth ex-Magnificent 7 is likely to strengthen throughout the year.

This broadening performance partly reflects earnings trends. Year-over-year earnings growth for S&P 500 companies ex-Magnificent 7 (i.e., the S&P 493) is improving. Excluding some one-offs in the healthcare sector, the first three months of 2024 marked the first quarter of (slightly) positive year-over-year earnings growth for the S&P 493 since the fourth quarter of 2022. We expect the earnings growth rate differential between the Magnificent 7 and the S&P 493 to narrow further throughout the year.

We now expect S&P 500 earnings to grow by 11% this year.

And overall, the S&P 500's first-quarter earnings season was better than we expected. With the US economy on a solid footing and investment in AI rising rapidly, we now expect 11% earnings growth for the S&P 500 this year (compared with our previous estimate of 9%), and have raised our year-end price target to 5,500. In an upside scenario of faster disinflation and AI growth, we think the index could reach 5,700 by the end of the year.

The broadening of the global equity rally is good news for diversified equity investors. It is also creating a range of specific opportunities for investors looking to diversify sources of return beyond tech.

In the US, we see a particular opportunity in small-cap stocks. The S&P 600 small-cap index trades at a discount of roughly 30% to the large-cap index (based on forward price-to-earnings), and we continue to believe that rate cuts should be a positive catalyst for small-cap performance to catch up. Earnings performance for small-caps is highly correlated to large-caps—with larger swings on the upside and downside—and we expect a pickup in small-cap earnings growth over the course of the year.

Beyond the US, we see opportunities in "Europe's Magnificent 7," consumer companies, and UK equities.

In Europe, we see opportunities in the region's own "Magnificent 7" stocks, consumer companies, and UK equities. Our "Europe's Magnificent 7" selection focuses on profitable, innovative, global firms with market leading positions, a strong structural growth outlook, and resilient earnings. We think consumer-related sectors will prove well-supported by a robust labor market, falling inflation, and central bank policy easing. More broadly, recent results in the Eurozone show signs that earnings have bottomed and should improve from here.

Our most preferred view on UK equities is supported by accelerating domestic growth, our positive view on oil and industrial metals, and relatively attractive valuations. The FTSE 100's forward price-to-earnings valuation of 11.6x is below its long-run average of 12.8x. We expect UK earnings to rebound from an 11% contraction last year to growth of 4% this year and 7% in 2025. In our base case, we see around 8% upside for the FTSE 100 by year-end. Expectations for a relatively stable policy outlook, and low uncertainty about the election outcome, should mean that the UK election will not have a major effect on the performance of the FTSE 100.

In Asia, we believe the outlook for Chinese equities is improving amid encouraging internet earnings and coordinated property support. First-quarter results thus far from the heavyweight internet sector—which makes up 40% of the MSCI China index—suggest past efforts to gain market share, improve operating leverage, and spend on technological progress are starting to pay off. We also think internet companies' capital management plans, including an increasing focus on dividends and share buybacks, should offer investors a degree of protection against downside risks. We have lifted our 2024 MSCI China earnings growth forecast to 9.5% (1.5ppt higher than our previous estimate). Our new year-end target for the index, at 69, translates into high-single-digit upside from current levels.

Market volatility is likely to pick up as the US election approaches.

Regardless of which candidate wins the US presidential election, we expect to see more protectionism.

US elections, trade, and tariffs: "Tangled up in blue" (or red)
Investors don't like uncertainty, so we shouldn't be surprised if we see a pickup in equity market volatility as November's US election nears. In addition, geopolitical tensions, including the ongoing wars in Gaza and Ukraine, have the potential to trigger market volatility. The rise in gold prices following the death of Iranian President Ebrahim Raisi in a helicopter crash this month serves as a reminder of this potential.

As the election nears, market focus on specific policy measures is likely to increase. In the past month, US President Joe Biden announced new tariffs on imports of Chinese electric vehicles, advanced batteries, solar cells, steel, aluminum, and medical equipment. Duties on EVs are to be increased to over 100%. China vowed retaliation, with the Ministry of Commerce saying Beijing would take measures to defend its interests.

With only 4% of US imports from China and less than 1% of China's total exports impacted, the economic ramifications of the latest tariffs are small. However, the wider trend is that, regardless of which candidate wins the US presidential election, we expect to see more protectionism, more obstacles to free trade, and a fracturing of the *status quo ante*. We note that while former President Trump initially introduced several tariffs, President Biden retained most of those when he assumed office.

That said, there are likely to be some differences in the way in which protectionism is implemented. We would expect Biden to continue using tariffs on a more targeted basis, with a focus on China and a limited number of other countries. Trump may use tariffs more broadly as a point of leverage to extract concessions, and while his primary focus may be on China, he would likely not exempt geopolitical allies, including in Europe. (For our analysis of the potential outcomes under different scenarios for control of the White House and Congress, see our *ElectionWatch* report, "Politics beyond borders," published March 2024.)

Portfolio construction is best treated as an apolitical exercise, but differing policies are likely to mean a different impact on markets depending on the victor. With stock market volatility currently at low levels, this speaks to considering capital preservation strategies within equities, as well as being both selective and diversified in international market exposure.

Gold and oil remain valid geopolitical hedges, in our view. Gold should additionally benefit from strong central bank demand and falling rates. We expect gold prices to reach USD 2,600/oz by the end of the year, as the aforementioned market dynamics likely drive fresh exchange-traded fund inflows. We also see upside for oil prices (we forecast Brent crude at around USD 87/bbl by the end of the year) amid solid demand and efforts by OPEC+ to balance the market. Risk-tolerant investors can consider selling Brent's downside price risks for yield.

Summary: "Bringing it all back home"

The current environment is constructive for investors across asset classes.

We see a variety of specific opportunities to engage and earn returns in today's markets. Overall, we see this as a constructive environment for investors across asset classes, with expected total returns of around 5% for global equities and 7% for bonds (based on the MSCI ACWI in local currency and 10-year Treasuries, respectively) by the end of 2024. By diversifying across asset classes, and with the specific ideas presented, we believe investors can position for upside both in the near and longer term while mitigating volatility.

Mark Haefele
Chief Investment Officer
Global Wealth Management

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	Rate cuts are here, with the first deductions by major European central banks over the summer likely to be followed by the US Federal Reserve later in 2024. As rates fall, cash and cash-like investments will deliver progressively lower returns, and investors holding cash or money market funds (or those with expiring fixed term deposits) need to manage liquidity accordingly. We believe that quality bond ladders, or structured solutions with capital preservation features can offer investors some of the certainty provided by cash but with higher return potential as rates fall.	• Bond ladder • Capital preservation structure investments
Buy quality bonds	Yields are high, Inflation is falling. Central bank rate cuts are starting. And economic growth is robust, keeping default rates low. We therefore see this as an attractive time to build active and diversified fixed income exposure. Tactically we hold a preference for quality bonds, which offer potential capital gains if yields fall (as we expect), and can help diversify portfolios against equity market risks. Specifically, we see opportunities in investment grade corporates, US TIPS, Agency MBS, CMBS, Municipals and sustainable bonds.	• Quality bonds (incl. US TIPS, IG, munis, agency MBS, CMBS) • Sustainable bonds incl. MDBs • Active and diversified bond exposure
Optimize tech exposure	With AI representing a key driver of growth, we see upside for the broad tech sector in both the short- and long-term, and think technology stocks should compose around 30% of investors' long-term equity portfolios. We see the biggest tactical opportunity in semiconductors, which are well-positioned in the "enabling layer" of the AI value chain, still trade at a 10% discount to the broader sector, and we expect 50% sector profit growth this year.	• Semiconductors • Diversified technology (including technology disruption) • Structured strategies on technology stocks
Opportunities in a broadening rally	We expect mid-single digit upside for global equity indices, driven by positive performance in the tech sector and beyond. We upgrade China to most preferred amid signs of resurgence in the country's equity market. In the US, beyond tech, we see opportunities in small caps, where valuations are low and robust economic growth and falling interest rates should be tailwinds. In Europe we like "Europe's magnificent 7" and consumer-related sectors, as well as UK stocks.	• Quality stocks (incl. "Europe's Magnificent 7") • US small caps • China • Alternative growth themes (energy transition, healthtech)

MIFs	Elevator pitch	Investment ideas
Generate income from currencies and commodities	Carry trades currently look appealing, including in the Australian dollar - where rates are likely to stay higher for longer - and in select EM currencies. Elsewhere, we like volatility-selling strategies, and in particular using periods of strength to decumulate USD ahead of potential rate cuts later this year. In commodities we like strategies that take advantage of the trading ranges in gold and crude oil, and position for further upside in copper.	• Sell volatility in USD, EUR, GDP • Carry opportunities in AUD and BRL • Structured solutions on oil, gold and copper
Get in balance	We see this as a constructive environment for investors across asset classes, with mid-single digit upside forecast for global equities and bonds by the end of 2024. Being in balance is a key principle. By diversifying across asset classes, regions and sectors, investors can position for upside across a range of asset classes both in the near-term and the longer-term, while mitigating potential volatility.	• Balanced portfolios
Diversify with alternatives	Alternative assets are a key building block of portfolios, enhancing return and diversifying risk. We see particular opportunity in strategies with unique return sources, or that provide access to fast-growing companies. We also like strategies that align with disruptive long-term trends such as digitalization and decarbonization.	• Infrastructure • Hedge funds • Private equity

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
- UK equities
- Oil

Least preferred
- US large-cap equities

Implementation guidance

Growth and inflation continue to show signs of moderation, with the latest Q1 GDP growth reading of 1.6%, down from 3.4% prior. Markets have responded by pricing in an additional 25bp rate cut by year-end and now are looking for about 40bps of cuts in 2024. This softer data has allowed the Fed to keep the door open for rate cuts, and supports our view of an economic soft landing in the US. We maintain our view of two cuts in 2024, but this will only be realized with further progress on the growth and inflation front.

While some recent data have come in hotter than expected, we keep our expectation for an economic soft landing in the US. Our view is largely driven by expectations that growth and inflation will eventually moderate because 1) consumer spending is unlikely to stay at this pace; 2) real-time rent data points to a decline in the lagging indicator of shelter inflation, which is roughly a third of the CPI basket; and 3) the labor market is getting back into balance with almost all indicators of wage growth continuing to decline, which makes the threat of an inflation re-acceleration a low risk.

Given our outlook, we keep bonds as most preferred and a neutral view on equities. We keep our year-end target for the 10-year Treasury yield of 3.85%. On the equity front, we raise our year-end price target on the S&P 500 to 5,500 from 5,200, after raising our full-year earnings estimates to USD 250 from USD 245 previously. The new price target suggests low to mid-single-digit returns for the remainder of 2024.

Within fixed income, our message remains to **buy quality bonds**. We expect high quality bonds to deliver good total returns in 2024 as economic growth gradually decelerates and inflation falls closer to target with yields falling in tandem. Now is a great time to lock in attractive yields, benefit from potential capital gains as rates fall, and diversify against portfolio risks. Specifically, we see good value in US TIPS, investment grade corporate bonds, Agency MBS, CMBS, municipals, and sustainable bonds.

With the Fed likely to begin rate cuts in coming quarters, we reiterate our message to **manage liquidity**. As inflation continues to moderate, the Fed has room to cut rates quickly if growth begins to falter. This would be particularly painful for depositors who haven't locked in higher rates for the next few years.

Within US equities, we are neutral on value versus growth, and have a relative preference for small caps versus large caps. This month we make a number of changes to our US equity sector preferences. We upgrade utilities to neutral from least preferred and downgrade healthcare from most preferred to neutral as the relative attractiveness of utilities versus healthcare has improved amongst the defensive sectors of the market. We also downgrade consumer discretionary to least preferred from neutral. Elsewhere we remain most preferred on industrials, which should benefit from resilient economic growth, improving manufacturing sentiment, a bottoming in cyclical activity, and more structural tailwinds around reindustrialization of US economic activity. We remain least preferred on real estate, which looks slightly expensive relative to real interest rates.

We are still preferred on US technology, even as the sector has grown significantly over the past year. With the AI representing a key driver of growth, we see upside for the sector in both the short and long term. It is critical for investors to **optimize tech exposure** to benefit from these growth drivers. We currently see the biggest opportunity in semiconductors, which are well-positioned in the "enabling layer" of the AI value chain, trade at a 10% discount to the broader sector, and should benefit from our expectation for 50% sector profit growth this year.

While technology is one of our most preferred sectors, we also believe investors should be wary of concentration risks and over-exposure. Outside of the technology sector, we see a number of attractive **opportunities in a broadening rally**. Within US equities, we continue to advocate for small-cap stocks, which should benefit from the tailwinds of lower rates and attractive valuation discounts versus other segments of the market. We continue to see value in quality companies, especially among those that will be able to grow earnings in the event of a harder-than-expected landing. Within emerging markets we have moved China equities to most preferred on the back of stronger earnings expectations and policy adjustments related to the housing sector. Lastly, we see opportunities within alternative growth themes, such as the ongoing energy transition and in healthtech.

Looking beyond public markets, we continue to advise investors to **diversify with alternatives**. Our future will 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.

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	−		
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		=	

Asset allocation: Themes implementation

With alignment to our Messages in Focus (MIFs)

Asset class	Theme and description	MIF alignment: Buy quality bonds	MIF alignment: Opportunities in a broadening rally	MIF alignment: Diversify with alternatives	MIF alignment: Optimize tech exposure
US fixed income	**Taxable munis** Taxable municipal bonds offer incremental yield pickup vis-à-vis corporate debt along the curve.	✓			
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.	✓			
EM fixed income	**Short-duration Pan-American bonds** We believe this list offers relative value in short-end investment grade corporate bonds.	✓			
EM fixed income	**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 invests along the entire energy transition supply chain, and has exposure across sectors and regions.		✓		✓
US equities	**Tactical US equity themes** Our tactical themes cover a variety of topics, including opportunities beyond the tech sector, such as the "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.			✓	

Summer power outages are on the way

Michelle Laliberte, CFA, Thematic Investment Strategist; **Nadia Lovell,** Senior US Equity Strategist; **James Dobson,** US Energy & Utilitie Equity Strategist

The trees are green, flowers have bloomed, and thunderstorms are already booming. For those In the northern hemisphere, the official start of summer is just around the corner. While winter storms pose a serious outage threat particularly for those with electric heat, summer comes with its own power grid perils. During the summer season the grid must grapple with hurricanes, wildfires, extreme heat and the associated demand spikes, and more – even drought can affect the power grid by restricting the supply of hydropower. Increased wildfire risk in the summer can cause proactive outages too, which intend to prevent ignition. For example, intense wind storms can take down power lines and spark a fire if the wire is live, so utilities are increasingly choosing to turn power off ahead of time.

These challenges come at a time when the electric grid is aging, an increasing amount of coincident renewable power is being added to the load, and after years of relatively stable electricity demand, the rapid buildout of data centers is propelling significantly higher electricity demand. The duration and frequency of major power outages has trended higher on average, and it's likely to be costly. The US Department of Energy estimates power outages cost US businesses about USD 150 billion a year.

Energy storage has been a bright spot...

A lack of sufficient backup power might come as a surprise then. Estimates range from roughly 3% to 6% penetration of residential backup power, but either end of the range indicates a vast majority of US residents do not have access to a backup power system. Demand for battery storage and backup power generation should continue to rise, and energy storage has actually been one bright spot in the clean energy space, otherwise bogged down by numerous challenges.

... but broader industry headwinds persist

Despite government policies to intended to reduce carbon emissions, the economic backdrop has not been easy for the solar and wind industries. Higher rates have pressured project cost economics, and cheaper foreign competitors threaten to dent the opportunity for US players. That has resulted in more support for tariffs that can benefit select US companies that have unique advantages. However, they could also raise costs for other US developers. Furthermore, the industry is still healing from the repercussions of changes to net metering laws, which essentially lowered the payout US homeowners receive from feeding solar power back into the grid. This means the index as a whole is facing a mixed bag of performance drivers, and security selection is likely to be important in the months ahead, especially as the election approaches, which introduces headline risk for companies seen as positively exposed to the Inflation Reduction Act.

Investment takeaways

Renewables are going to be battling the election overhang, and a number of ongoing trade disputes could materially impact supply chains. While energy storage has been a bright spot, it hasn't been enough to propel the industry forward again after two years of headwinds. In the near term, we continue to prefer a diversified but selective approach across the energy transition supply chain. This is the approach we've taken in the *Greentech goes global* theme, with exposure to semiconductors and input materials such as copper. Investors with adequate time horizon and risk tolerance can consider building positions in energy transition longer term themes with sufficient battery exposure, though we'd advocate for selectivity in either case. We also see a near-term tactical opportunity in independent power producers that are benefitting from AI tailwinds and higher electricity demand estimates. Investors can read more about the opportunity via our tactical theme, *Artificial intelligence.*

Longer-term themes

Top 5 favorite LTI themes

1. Consumer experience
2. Diversity & equality
3. Water scarcity
4. Space economy
5. Food revolution

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 as growth and inflation cool off. Rising income should help to sustain growth in consumer spending.

Brian Rose, PhD, Senior US Economist

Overview

After a steady stream of stronger-than-expected data in April, growth and inflation data released so far in May have mostly surprised to the downside. As shown in the chart, the ISM PMIs, which provide a timely snapshot of current economic conditions, are now well below their longer-run averages. This suggests that growth may have already slowed to a below-trend pace. The NFIB survey of small businesses similarly showed weaker than normal conditions, and the University of Michigan Survey of Consumers showed sentiment tumbling in the latest release. Industrial production was another disappointment, with growth in manufacturing output falling back into negative territory. We view this data as compatible with our base case forecast of a soft landing. As growth and inflation cool off, the Fed will be in a position to start trimming rates. If more troubling signs develop, the Fed has plenty of room to provide support with aggressive cuts.

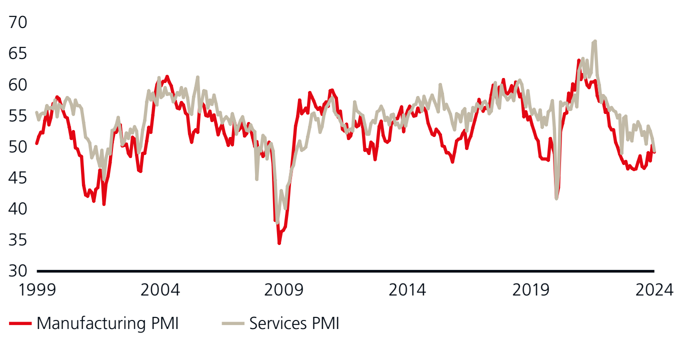
Growth

Recent data has mostly surprised to the downside, suggesting that economic growth is broadly slowing. One of the key drivers supporting the economy up until now has been household spending, which has risen faster than income over the past 12 months, With the savings rate already at historically low levels, this trend cannot go on forever. Weaker-than-expected retail sales in April may be a hint that consumers are finally taking a breather. Our view remains that the economy is heading for a soft landing, with a period of sub-trend growth helping to reduce inflationary pressure, rather than a hard landing where consumers severely curtail their spending. The labor market is cooling off and wage growth is trending lower, but we still expect enough support from labor income to keep real disposable income on a rising trend, providing a base of support. Lower-income households are struggling amid higher than normal interest rates and inflation, but wealthier households are benefitting from rising asset prices and we expect their spending to continue increasing.

Figure 1

PMIs are below their long-run averages

Institute of Supply Management Purchasing Manager Indexes, neutral = 50

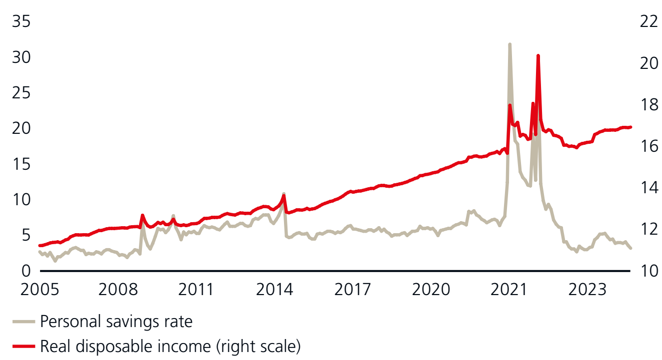


Source: Bloomberg, UBS as of 17 May 2024

Figure 2

Falling savings rate has supported growth

Personal savings rate in % and real disposable income in USD tn



Source: Bloomberg, UBS as of 17 May 2024

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

Read the report ›

Inflation

Core CPI, which excludes food and energy prices, rose 0.3% month over month in April, the smallest monthly increase so far this year. As shown in the chart, in year-over-year terms, the core inflation rate continues to trend lower, slowing to 3.6% in April, the lowest in three years. Goods inflation has turned negative, helped by falling prices of both new and used vehicles. However, service price inflation remains high, boosted by shelter (up 5.5% year over year in April) and motor vehicle insurance (up 22.6%), which is keeping inflation well above its pre-pandemic level. In our view, these service prices are lagging indicators, and more timely information strongly suggests that price increases will slow over the remainder of 2024. Combined with moderating consumer demand, this should help to keep overall core inflation on a downward trend.

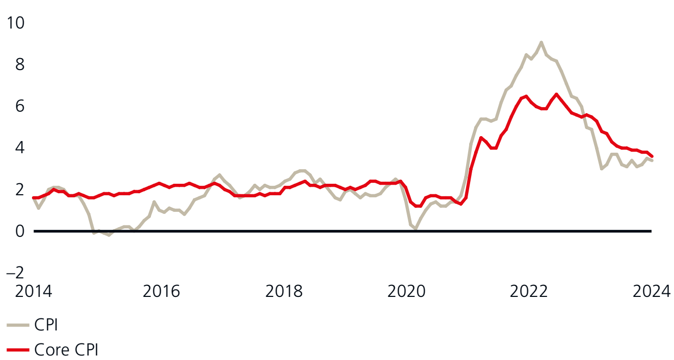
Policy

Fed rate cuts have been delayed by the higher monthly inflation prints in 2024. As noted above, the April print was softer than in prior months, but in our view this data was still a bit too high to support an early rate cut. Public comments from FOMC members following the April CPI release did not indicate a significant shift in the timing of cuts. The basic message remains that rates will likely remain at their current level for longer than previously expected in order to give the Fed confidence that inflation will slow toward their 2% target in a timely fashion. Our base case remains that the Fed will cut rates twice this year starting in September, and we expect the next dot plot, due on 12 June, to align with this view. Relative to a month ago, our perception is that risks are more evenly balanced, with better chances for a July cut if we get some downward surprises in the data. On the fiscal side, we do not expect significant policy changes until after the election.

Figure 3

Core inflation continues to trend lower

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

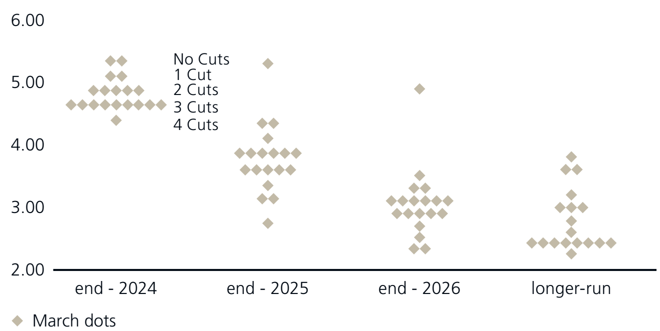


Source: Bloomberg, UBS as of 17 May 2024

Figure 4

End-2024 dots likely to be raised at June FOMC

Appropriate level of interest rates at year-end, in %



Source: Fed, UBS, as of 20 March 2024

Equities

After taking a breather in April, global equities rallied in May to reach fresh all-time highs. A robust 1Q earnings season and lower yields were the main catalysts. Earnings should continue to recover in the coming quarters. Valuations are elevated but not extreme, in our view. Inflation is a near-term risk but should keep declining in the medium term. Lower yields are likely to follow, which should support equity valuations. The equity outlook is constructive but well priced in, in our view, which limits the risk-reward of chasing the rally.

Eurozone

NEUTRAL

EURO STOXX 50 (index points, current: 5,025)	December 2024 target
House view	**5,200**
↗ Positive scenario	5,600
↘ Negative scenario	4,200

Note: All current values as of 23 May 2024

We maintain our neutral stance on Eurozone equities. An improving economic outlook coupled with expectations of easing interest rates provides a supportive backdrop for Eurozone equities. However, after strong performance, we expect further gains from here to be more modest. We believe Eurozone equities remain well supported by a favorable backdrop of accelerating earnings, falling inflation, easing monetary policy, and improving global manufacturing activity. We view current valuations as fair and therefore see only modest equity returns from here.

Emerging markets

NEUTRAL

MSCI EM (index points, current: 1,095)	December 2024 target
House view	**1,150**
↗ Positive scenario	1,190
↘ Negative scenario	960

Note: All current values as of 23 May 2024

We rate emerging market equities as neutral in our global strategy. Although economic activity in emerging markets continues to surprise to the upside, the delay in the Federal Reserve's interest rate cutting cycle will likely constrain emerging market central banks' ability to ease. Supportive policy announcements coming out of China and better-than-expected 1Q24 earnings and guidance from companies in North Asian markets in particular will likely help the overall MSCI EM index trend higher for the remainder of the year, in our view.

Japan

NEUTRAL

TOPIX (index points, current: 2,737)	December 2024 target
House view	**2,800**
↗ Positive scenario	2,950
↘ Negative scenario	2,300

Note: All current values as of 23 May 2024

We are neutral on Japanese equities in our global strategy. The TOPIX is up 5% from its low on 19 April, recouping half of its losses since mid-March on strong announcements regarding shareholder returns. The FY23 results season saw 51% of companies announcing plans to increase dividends in FY24 and a record of JPY 6.3 trillion in share buybacks announced. Corporate guidance for FY24 remains conservative based on a USDJPY assumption of 140–145, leaving room for upward revisions over the next six months. Earnings revisions continue to be positive, and we now forecast 8% profit growth in FY24.

UK

MOST PREFERRED

FTSE 100 (index points, current: 8,370)	December 2024 target
House view	**9,000**
↗ Positive scenario	9,200
↘ Negative scenario	7,000

Note: All current values as of 23 May 2024

We rate the UK market as most preferred. With the improving global manufacturing outlook, we have positive views on oil and industrial metals, which should boost profits for the UK's commodity-linked sectors. In addition, the outlook for domestic consumption is likely to improve amid a resilient labor market and normalizing inflation. The latter should allow the Bank of England to start cutting rates from August on, which should help equity valuations recover from currently low levels.

US equities

US equities hit all-time highs in May on softer inflation data, lower rates, and a good first-quarter earnings season. In our view, the current environment remains supportive and four key positive equity market drivers remain largely in place: 1) solid earnings growth, 2) disinflation, 3) a Fed pivot, and 4) surging AI investment.

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

US equities overview

NEUTRAL

US equities

The first-quarter earnings season results were better than we expected. We were especially encouraged by the guidance and the fact that earnings growth is starting to broaden out beyond the Magnificent 7. We therefore increased our 2024 and 2025 S&P 500 EPS estimates by USD 5 each to USD 250 (+11% growth) and USD 265 (+6% growth). Given our improved profit outlook, we additionally increased our year-end S&P 500 price target to 5,500 and initiated a June 2025 target of 5,600. Although we increased our price targets, our view on the markets has not materially changed. Our main message is that the backdrop is constructive and investors should have a full allocation to US equities.

US equities – sectors

Industrials should benefit from resilient economic growth, an improvement in manufacturing business sentiment, and a bottoming in cyclical areas such as transport. 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. Consumer discretionary may experience further downside on somewhat sluggish spending on goods, which may not improve until the Fed starts cutting rates later this year.

US equities – size

We expect small-caps to outperform driven by a pickup in earnings growth, Fed rate cuts, and an improvement in the ISM manufacturing new orders index. In our view, relative valuations for small-caps are attractive, which presents a favorable long-term outlook and should help mitigate any near-term downside. On a relative basis, a larger concentration of Russell 2000 debt is floating rate, offering these companies a clear benefit from potential Fed rate cuts.

US equities – style

The valuation premium for growth relative to value remains extended versus the historical average. Still, AI excitement and a stronger earnings growth outlook for growth stocks suggests that this premium may persist. 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: 5,268)	December 2024 target
House view	**5,500**
↗ Positive scenario	5,700
↘ Negative scenario	4,400

Note: All current values as of 23 May 2024

Figure 1

Maintaining balance in our sector positioning

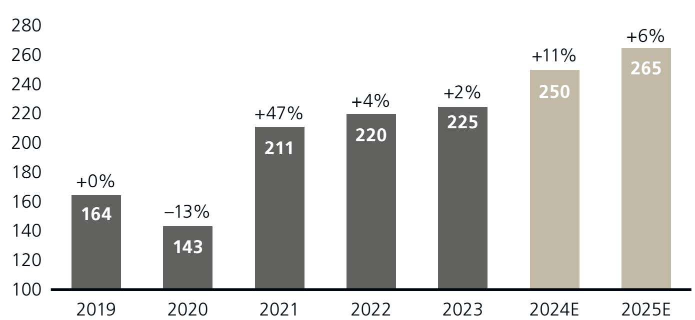
	Least preferred	Neutral	Most preferred
US equities			
Communication services		=	
Consumer discretionary	–	←	
Consumer staples		=	
Energy		=	
Financials		=	
Healthcare		=	←
Industrials			+
Information technology			+
Materials		=	
Real estate	–		
Utilities	→	=	

Note: Tactical preferences from benchmark (S&P 500).
Source: UBS, as of 23 May 2024

Figure 2

Earnings outlook brightening

S&P 500 earnings per share (EPS in USD), actuals and UBS CIO estimates



Source: FactSet, UBS, as of 23 May 2024

Bonds

We believe the current risk-reward proposition for quality bonds is attractive, and we see the potential for capital appreciation as inflation recedes and growth moderates. Our base case is that the Fed will cut rates by 50bps by year-end, with the first cut occurring in September, and we look for the 10-year US Treasury yield to fall to 3.85% by year-end, from 4.5% currently. Within fixed income, we keep US investment grade (IG) 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: 4.47%)	December 2024 target
House view	**3.85%**
↗ Positive scenario	
↘ Negative scenario	

Note: All current values as of 23 May 2024

We extended duration when 10-year yields reached 4.66%, as we have likely seen the peak in rates for this year. At the May FOMC meeting, the Fed removed the tail risk of additional hikes. Coupled with benign inflation data, Treasury yields have rallied but they continue to remain sensitive to economic data and rate cut expectations. At the June FOMC meeting, we expect the Summary of Economic Projections to reflect two rate cuts for 2024, coming into line with market expectations. Our view remains for 50bps of cuts starting in September. We see growth slowing from weakening labor and consumer demand and recommend adding duration at current levels as 10-year yields trend toward 3.85% by year-end.

US investment grade corporate bonds

MOST PREFERRED

US IG SPREAD (current: 89bps)	December 2024 target
House view	**110bps**
↗ Positive scenario	85bps
↘ Negative scenario	200bps

Benchmark: Bloomberg Barclays US Int. Corp.
Note: Current values as of 23 May 2024

We hold a most preferred view on IG corporate bonds. Although spreads are tight, the outright level of yields remains appealing and provides a reasonable buffer against the potential for a renewed rise in near-term rate volatility. Furthermore, fundamentals generally remain solid, and we expect limited credit quality deterioration in our base case. The total return outlook for US IG remains supported by our expectation of lower government bond yields over the coming quarters. We see value in financials relative to industrials and find opportunities in both A-rated and BBB-rated issuers.

Emerging market bonds

NEUTRAL

EMBIG DIV. / CEMBI DIV. SPREAD (current: 368bps / 259bps)	December 2024 target
House view	**400bps / 275bps**
↗ Positive scenario	340bps / 260bps
↘ Negative scenario	550bps / 500bps

Note: Current values as of 23 May 2024

We keep emerging market credit as neutral. Valuations look moderately expensive, and we expect wider spreads by year-end. However, our US economic soft-landing base case scenario should allow the asset class to deliver positive total returns this year. Key risks include negative growth and inflation shocks in the US and/or 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: 311bps)	December 2024 target
House view	**400bps**
↗ Positive scenario	300bps
↘ Negative scenario	500bps

Benchmark: ICE BofA
Note: All current values as of 23 May 2024

We are neutral on high yield, as we believe spreads are tight but yields provide ample carry. Fundamentals in HY remain healthy with defaults rates at 2.3% and new issue volumes up by 95% year over year. We think HY default rates could rise slightly as we head into the second half of the year, but they would be lower than in past default cycles. Barring a major economic slowdown, HY issuers should be able to refinance their maturities in 2024, while the outright levels of yield provide a buffer to total returns.

Municipal bonds

NEUTRAL

Muni yields are off their year-to-date highs but continue to look attractive based on our expectation for lower rates later this year. In the near term, we encourage investors seeking income opportunities to place assets into the muni market ahead of a heavy wave of seasonal bond redemptions expected this summer. We favor longer dated high quality bonds in the 17-year to 22-year area for a more durable source of income with capital gains potential. AAA 10-year muni-to-Treasury yield ratio: 65% (last publication: 59%).

Non-US developed fixed income

NEUTRAL

Over the past month, bond yields in non-US developed markets moved mostly lower on prospects for central bank rate cuts. On foreign exchange markets, the dollar moved lower against most other major currencies, boosting the value of non-US bonds in dollar terms. These factors combined to produce positive returns for the month. 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 on Agency debt, with preference for agency MBS.

Mortgage-backed securities (MBS)

MOST PREFERRED

Tailwinds continue to improve for the sector, with the next policy move confirmed to be a cut. Higher carry (yield), favorable supply/demand dynamics, and increased money manager focus supportive of performance. The disappointment year-to-date stems from the higher interest rate volatility and the sharp repricing of the fed funds path. The improving dynamics have also been supportive for CMBS, which has had some of the strongest YTD performance. With attractive relative value, our expectation of a soft-landing, dovish Fed, and falling 10-year yields, we expect agency MBS and CMBS to outperform into year-end.

AGENCY MBS SPREAD (current: 137bps)	December 2024 target
House view	**110bps**
↗ Positive scenario	100bps
↘ Negative scenario	185bps

Note: Current values as of 23 May 2024

Preferred securities

NEUTRAL

After April losses brought on by a sharp rise in rates, preferreds have rebounded in May. The rate backdrop improved with messaging from the Federal Reserve that lowered the risk of an additional Fed rate hike, and inflation data that was as expected. Still, yield premiums are at the lower end of historical ranges and that tight valuation makes the sector vulnerable to continued rate-driven volatility. In the second half of 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

We shifted our TIPS preference to the 7-10 year area of the curve from the 5-year when 10-year real yields reached 2.26%. Rising real yields have been the driver of higher nominals, as long end breakeven rates have remained largely anchored. With inflation expectations staying elevated and nominal yields trending lower, we expect real yields to outperform. We think locking in higher inflation adjusted income is prudent for a diversified portfolio.

US 10-YEAR REAL YIELD (current: 2.16%)	December 2024 target
House view	**1.50%**
↗ Positive scenario	0.75%
↘ Negative scenario	2.30%

Note: All current values as of 23 May 2024

Figure 1

UBS CIO interest rate forecast

In %

UST	Current	Sep-24	Dec-24	Mar-25	Jun-25
2-year	4.87	4.25	3.75	3.25	3.25
5-year	4.46	3.75	3.75	3.25	3.25
10-year	4.42	3.95	3.85	3.50	3.50
30-year	4.54	4.25	4.00	3.75	3.75

Source: Bloomberg, UBS, as of 22 May 2024

Figure 2

Yields are attractive; many sector spreads are near all-time tights

	Yield (%)	Spread (bps)	Yield %-ile	Spread %-ile
MBS	5.71	133	93%	82%
IG	5.53	89	92%	1%
IG 1-5Y	5.46	64	92%	15%
IG AAA	4.99	37	96%	2%
IG AA	5.12	49	95%	1%
IG A	5.41	74	93%	6%
IG BBB	5.72	110	90%	1%
HY	7.98	307	76%	1%
HY BB	6.61	177	82%	0%
HY B	7.94	292	72%	0%
HY CCC	13.35	846	67%	31%
Tax Muni	5.32	74	94%	0%
Pref	6.54	86	86%	38%
CMBS	6.71	206	94%	88%
Agency	4.91	9	95%	12%
Sr. Loan	9.31	491	85%	47%

Source: Bloomberg, ICE BofA, UBS, as of 16 May 2024

Commodities and listed real estate

Our benchmark, the UBS CMCI total return index, has rallied by more than 11% year to date. Industrial and precious metals have been the main drivers of the rally so far, with energy also contributing to positive returns despite recent setbacks. We maintain a positive outlook for the asset class, expecting total returns of around 10% for broad indexes over the next six to 12 months. We believe global industrial activity will begin a more sustained upturn, particularly with prospects of lower interest rates and a modest restocking cycle. On the supply side, constraints in industrial metals and oil should lift prices, while La Niña's return raises the risk of tighter grain and oilseed balances in 2024–25. We keep our preference for oil and recommend managing commodities actively.

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 2,371/oz) NEUTRAL	December 2024 target
House view	**USD 2,600/oz**
Positive scenario	USD 2,350/oz
Negative scenario	USD 2,850/oz

Note: All current values as of 23 May 2024. Gold is a safe-haven asset whose price tends to rise when risk assets, such as equities, fall, and vice versa.

BRENT (current: USD 81.8/bbl) MOST PREFERRED	December 2024 target
House view	**USD 87/bbl**
Positive scenario	USD 120–140/bbl
Negative scenario	USD 40–60/bbl

Note: Current values as of 23 May 2024

Precious metals

Gold sets new records, silver surges. Gold has rebounded in May from earlier setbacks, with a dovish Fed and weaker than anticipated US CPI. Gold has hit a new record price of USD 2,450/oz, and we believe it can go higher still, to USD 2,600/oz by year-end. Silver has also surged, with the white metal reaching a decade high. We believe silver can outperform gold further, as sluggish mine production growth and strong industrial demand may push the gold-silver ratio below 70x.

Base metals

Copper gets squeezed. Copper prices touched all-time highs last week in COMEX and SHFE exchanges, with the rally now exceeding 20% year to date. The metal's strong fundamentals remain in place, with little progress on resolving the supply challenges that have seen the physical market tighter than expected. Moreover, China's renewed policy emphasis on stabilizing housing is another positive element that sparked renewed investor interest. We forecast prices at USD 11,500/mt by year-end.

Agriculture

Weather can be a two-way risk. While moderating weather-related concerns in Africa has led to profit taking in cocoa, dry conditions in key wheat growing areas of Australia, Russia and Western Europe has resulted in a +30% spot price rally since the March lows. Corn and soybean prices also rose, but by much less, and despite the rising probability of La Niña toward year-end, we see it's too early to position for this event (more for 4Q24). As such, we expect setbacks in grains as prices have risen to rapidly. Beyond grains, we look to sell downside price risks in sugar while live cattle is preferred.

Crude oil

Oil demand remains strong. As in recent years, we see a mismatch between market sentiment toward oil and what demand-side tracking data indicates. So, despite sentiment among generalist market participants remaining cautious as higher-for-longer interest rates add risks around the soft-landing view, real-time mobility data indicates that oil demand growth broadly remains healthy, although regional variations have been evident. Meanwhile, OPEC+ voluntary production cuts are likely to get extended, which means the oil market should stay undersupplied. As such, we target Brent crude oil rising to USD 91/bbl over the coming months.

Listed real estate

RUGL Index (current: USD 5,555)	December 2024 target
House view	**USD 7,100**
Positive scenario	USD 7,300
Negative scenario	USD 6,900

Note: All current values as of 23 May 2024

We prefer companies with strong pricing power, large pipelines, attractive yield gaps, and robust cash flows, as well as those that look to expand via acquisition. Stocks trading at large discounts may selectively offer above-average returns. Historically, the sector has started to rally 18–24 weeks before the first actual Fed rate cut, with good performance continuing after the cuts. We like Hong Kong (China) markets as fundamentals stabilize. Singapore REITs should also benefit from a decrease in rates. Continental Europe remains relatively cheap following a period of underperformance but is now rebounding. The UK market is leading in this respect. US REITs look well capitalized but have already had a good run.

Foreign exchange

We prefer the Australian dollar and the Swiss Franc is least preferred.

Thomas Flury, Strategist, UBS Switzerland AG

Solid economic growth in the US, higher Federal Reserve rates for longer, and geopolitical risks in Europe, the Middle East, and Asia all speak for US-linked assets and therefore robust USD demand. We maintain our guidance to keep USD longs unhedged and look for incremental strength from here.

The biggest risk to our short-term USD view is a rapid fall in US GDP growth, which would put investor focus on structural USD negatives and the currency's elevated valuation. The speed at which the US economy slows matters. If it doesn't slow because consumer demand or fiscal spending comes in strong ahead of the US presidential election, current market expectations for lower US rates could still be revised higher.

Conversely, a hard landing for the US economy with risk assets under downward pressure could support the USD beyond the ranges that we currently promote. The USD tends to perform positively in a risk-off environment, while risk-on currencies (the EUR, GBP, commodity-related currencies, and emerging market currencies) tend to depreciate. Still, a hard landing would likely lead to a strong reaction from the Fed. Therefore, we think any major USD rally could be sharp initially, but would ultimately be watered down by expansive central bank action.

In our base case, we still see relative growth dynamics converging—i.e., US growth moderates, while growth in the Eurozone picks up in 2H. The growth convergence should be modest, but sufficient to keep EURUSD at the upper end of the 1.05-1.10 trading range.

This topping out of dollar strength into 3Q allows USD investors to engage in volatility-selling strategies to pick up additional yield. The rise in option volatility across the asset class is clearly helpful in deploying such strategies. Still, the shifts higher have been rather modest so far. This leaves currency markets with a still-depressed volatility backdrop. So, where should investors sell volatility, then? We see scope for this strategy in AUDUSD, USDNOK, USDJPY, and XPTUSD.

As for other G10 currencies, we believe the JPY will continue to struggle short term. CHF, on the other hand is running the risk of a corrective appreciation. Short positions are large and could lead to stop-loss buying of Swiss franc in any disturbance hitting financial markets, be it geopolitical uncertainty or adverse data out of the US. We continue to expect strong returns of the AUD and to some degree in the GBP. Investors see value in both of these currencies as a diversification tool.

Emerging market currencies broadly clawed back the losses sustained in April going into the US CPI and retail sales data releases. With the latest data showing some cooling and markets pricing more Fed easing this year back in, emerging market currencies benefited. We believe the carry backdrop has reasserted itself amid the Fed rate-cutting cycle being delayed, but not canceled. We continue to like high-yielding currencies like the Brazilian real, where the external balance seasonality should add support, the Turkish lira, which benefits from more orthodox policies, and the Egyptian pound, where external funding needs have largely been met with the latest investment deals. Key risks stem from a more hawkish than expected Fed, geopolitics escalating again, and idiosyncratic political or policy headwinds.

The narrative for the CNY is different. With upside risks to USDCNY to 7.35 and the CNY offering a negative carry, we advise investors to hedge their long CNY exposure.

FX strategy

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

FX forecasts

	Current	Sep-24	Dec-24	Mar-25	Jun-25
EURUSD	1.08	1.07	1.09	1.11	1.13
USDJPY	157	153	150	148	146
GBPUSD	1.27	1.26	1.30	1.32	1.35
USDCHF	0.91	0.91	0.89	0.86	0.85
USDCAD	1.37	1.39	1.36	1.34	1.32
AUDUSD	0.66	0.67	0.68	0.69	0.70
NZDUSD	0.61	0.60	0.60	0.60	0.60
USDSEK	10.73	11.03	10.64	10.36	10.09
USDNOK	10.69	10.93	10.64	10.36	10.00

Sources: SIX Financial Information, UBS, as of 24 May 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 House View Investment Meeting (HVIM). Senior investment professionals from across UBS, complemented by selected external experts, debate and rigorously challenge the investment strategy to ensure consistency and risk control.

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- Mark Haefele (Chair)
- Solita Marcelli
- Paul Donovan
- Min Lan Tan
- Themis Themistocleous
- Bruno Marxer (*)
- Adrian Zuercher
- Mark Andersen

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- 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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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.

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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.

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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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