

Macro Monthly

Economic insights and asset class views

UBS Asset Management | December 2023

For global professional / qualified / institutional clients
and investors and US individual investors.
For marketing purposes



Evan Brown
Head of Multi-Asset Strategy
Investment Solutions



Luke Kawa
Director
Investment Solutions

Sticking the landing

Highlights

- A soft landing for the global economy is our base case.
- The labor market is cooling, but inflation is cooling faster. Positive real income growth should continue to support consumption.
- Robust private sector balance sheets reduce the likelihood of a sharp pullback.
- A soft landing is priced into the bond market much more than the stock market.
- We expect global equities to surpass all-time highs in 2024, and to outperform government bonds.

The surprising resilience of US growth has been the one constant throughout this unprecedented economic cycle. This time last year we viewed recession risk as low relative to consensus, due to the underappreciated strength of the underlying fundamentals, and have confidence this trend will continue into 2024. A soft landing for the US and global economy is our base case. To us, that means that the Federal Reserve will begin lowering interest rates for a good reason (the progress made in getting inflation lower), rather than a bad reason (a deterioration in growth large enough to require monetary stimulus).

Nominal growth has considerable room to slow from its Q3 pace of 8.9% quarter-on-quarter annualized without triggering recession concerns. In aggregate, the private sector is not overextended – neither households nor businesses are spending beyond their means. Inflation has slowed by enough for markets to price in an easing cycle from central banks, so financial conditions are much more supportive of growth than they were just six weeks ago. Progress on disinflation means real income growth is still positive, while household net worth remains in a strong position, which should allow for continued growth in consumer spending.

We anticipate that stocks will meaningfully outperform bonds if the US economy achieves a soft landing. In our view, pricing in the bond market is already much more consistent with this positive economic outcome than the stock market. In a soft-landing scenario, we believe global equities will comfortably ascend to new all-time highs in 2024 while it is unclear whether longer-term bond yields have much further to fall.

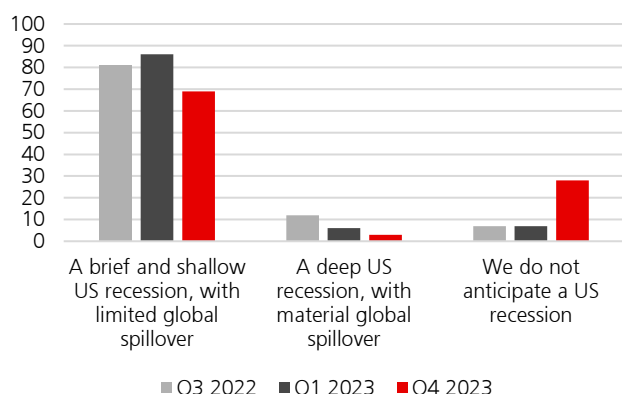
No major excesses

Recessions are typically caused by excesses that develop in the private sector that need to be corrected (mid-2000s real estate bubble or dot-com era capital spending) or major exogenous shocks (the coronavirus pandemic). We judge that there are few obvious imbalances in the household or business sector that need to be curbed.

On the contrary, corporate executives have spent the past 18 months preparing for a recession that has not arrived. There is little scope for further retrenchment. Only recently has their perception of recession risk receded somewhat, and this decrease in pessimism

Exhibit 1: Corporate sentiment is thawing

CEOs were asked: "Over the next 12-18 months, are you preparing for..."



Source: UBS Asset Management, The Conference Board, The Business Council. As of Q4 2023.

happened before the recent decline in yields, which in our view should further bolster corporate confidence.

We believe the US economy will continue to receive a favorable impulse from past spending incentives for corporations (from the Inflation Reduction Act, CHIPS Act, and infrastructure package) that may help lift business investment. We see scope for upside surprises as firms engage in delayed maintenance capex or expand operations in the face of end-user demand growth which, while slowing, is still positive. Success in achieving a soft landing would provide the potential to shift from the income-driven cycle that has marked the past three-and-a-half years to one where both income and credit are contributing to higher economic activity.

We've earned it

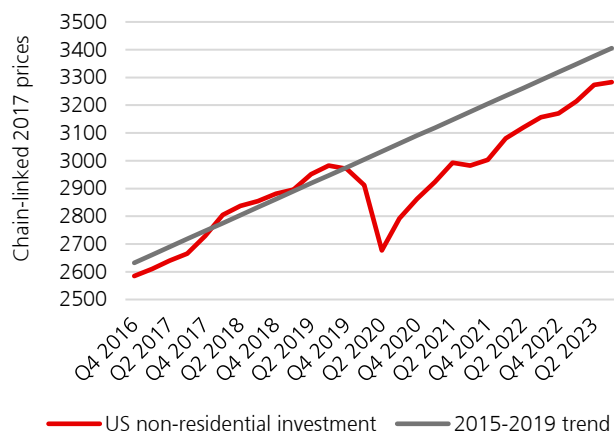
Financial conditions eased significantly in November as evidence of a cooling in US economic activity and inflation accumulated. The six-month annualized rate of core PCE inflation is running at 2.5% through October. A host of labor market metrics have also moved towards pre-pandemic norms. In the recent past the Fed has needed to push back when financial conditions have eased too much, because inflation was too far from target. There is less need to do so now because the economy has 'earned' the most recent easing of financial conditions.

As such, some of the "long and variable lags" from the Federal Reserve's tightening cycle have now been blunted, in our view. The effective interest rate paid by corporates on the looming "maturity wall" of debt will not rise as much as it otherwise would have. The drag on household disposable income and spending from higher interest rate expense should be less intense, while residential housing resales and mortgage applications are also likely to pick up steam if this interest rate environment is sustained.

The big "if"

Of course, maintaining this level of financial conditions, or seeing them ease further, is contingent on inflation remaining well-behaved or moving closer to central bank targets. A key risk to our view is that relatively sticky price pressures could

Exhibit 2: Business investment has room to catch up to trend



Source: UBS Asset Management, Bureau of Economic Analysis. As of Q3 2023.

reverse some of the improvements in financial conditions and push real income growth lower.

To be clear, the Federal Reserve is still likely to deliver some interest rate cuts in 2024 even if price pressures fail to decelerate further from their recent trend – but, in our view, not as much as markets are currently pricing. Substantial uncertainty remains as to whether inflation will allow for the 125 basis points in easing from the Federal Reserve in 2024 currently embedded in short-term interest rate markets.

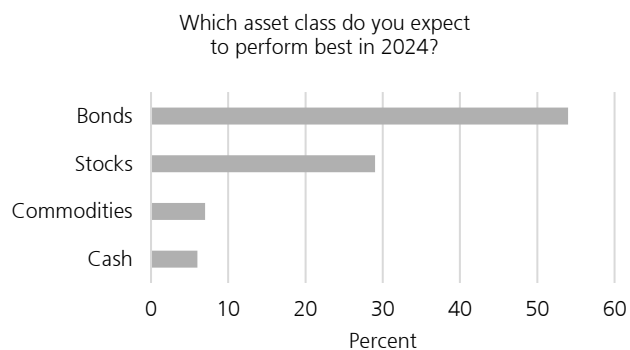
Separately, there is the risk that, as economic data continue to cool, more metrics will occasionally appear to be more consistent with a recession than a soft landing. We have seen in 2023 how quickly economic narratives can change and expect the path to a soft landing to be a bumpy one. In general, we believe there will be opportunities in 2024 to address extremes in valuations by adjusting positioning whenever markets lurch too far towards pricing in either persistently sticky inflation, an imminent recession or a soft landing.

Global disinflation

Importantly, major economic regions outside the US – such as China and the European Union – are relatively sluggish, which is helping to reinforce the broader disinflationary regime. Soft demand in these economies, along with healing supply chains, has helped to drive the deflation in global goods prices. We believe global inflation would be higher and the Federal Reserve's ability to consider interest rate cuts would be lower if Europe and China were firing on all cylinders.

In our view, both economies are poised to 'muddle through' in the near term, in part due to these easier financial conditions. There are some green shoots in European survey data, both for manufacturing and investor sentiment, though few signs of a decisive turn. In China, the data are stabilizing to improving in most areas of the economy – except for the property sector. Incremental policy support has largely been successful in putting a floor under activity, and recent measures to improve conditions in real estate suggest property will be less of a drag on growth in 2024 than in 2023. In both Europe and China, the

Exhibit 3: Fund managers are betting on bonds over stocks



Source: UBS Asset Management, Bank of America Global Fund Manager Survey. As of November 2023.

bottom-up profit revisions are underwhelming relative to other regions.

A global manufacturing recovery if easier financial conditions lift cyclical sectors could be a potential upside surprise to our global growth outlook, though this would also likely be accompanied by an increase in inflation risk, as well.

Asset allocation

Stocks and bonds are in the midst of a strong run to close out the year, leading to some concerns that a soft landing is fully priced in already. We disagree, mostly in terms of the stock market.

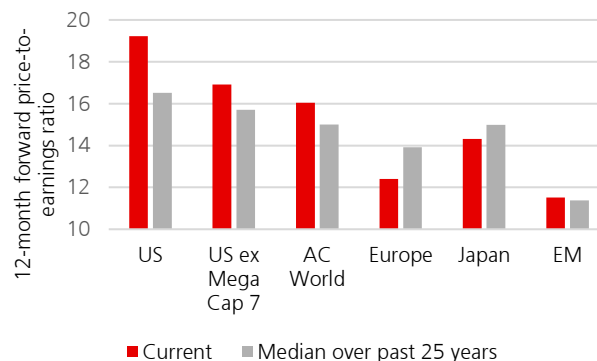
We believe the surprise in markets for 2024 will be an equity rally without much of a decline in bond yields, only a decrease in bond market volatility. Consensus expectations are for the outperformance of bonds vs. stocks. However, we believe 12-month forward earnings revisions still point towards equity upside and stock valuations are not that stretched outside of a handful of megacap US technology firms.

Importantly, there is a record USD 6 trillion in money market funds. As cash rates begin to decline and recession concerns dissipate, we suspect a good portion of these assets will be redeployed in search of higher returns. Return-seeking flows into stocks and credit could catalyze much stronger performance in risk assets than consensus expects.

As growth moderates, there will be times when investors get concerned that the soft landing may turn into a hard landing. For multi-asset portfolios, this has one important consequence: A shift from inflation risk to recession risk implies the positive stock-bond correlation should weaken. This means traditional portfolio structures may see strength in their fixed income holdings offset any episodic weakness in their equity exposures.

In our view, the US dollar is poised to perform well vs. other G10 currencies due to relative growth and rate differentials. The dollar is also a broad-based hedge that offers protection against the risk that inflation and growth are too high for the Federal Reserve to ease policy as much as is priced in, or if global economic conditions deteriorate more sharply than we anticipate.






Exhibit 4: Equity valuations not that stretched versus history



Source: UBS Asset Management, Bloomberg. As of November 2023.

Asset class views

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness as of 1 December 2023. The colored squares on the left provide our overall signal for global equities, rates, and credit. The rest of the ratings pertain to the relative attractiveness of certain regions within the asset classes of equities, rates, credit and currencies. Because the Asset Class Views table does not include all asset classes, the net overall signal may be somewhat negative or positive.

	Underweight	Overweight	
	  	 	
Global Equities			Profits growing, lower rate volatility should help support multiples.
US			Room to advance as earnings grow and rates volatility calms; more exposure to quality as activity moderates.
Europe			Cheap valuations balanced against lack of earnings and economic momentum.
Japan			Still inexpensive after recent gains, with solid earnings and ongoing corporate reform. Prefer to express in FX unhedged terms.
Emerging Markets			EM outperformance requires more evidence of China's strength. Asia ex China supported by tech goods rebound.
Global Government Bonds			Disinflation offset somewhat by decent growth and unfavorable technicals. Cuts priced in are too excessive.
US Treasuries			Growth is slowing, but downward trend in inflation may stall as well. Expect volatility to calm. Still the best hedge for recession.
Bunds			Deterioration in economic data and slowing inflation lays foundation for easing cycle.
Gilts			Bank of England policy rate path meaningfully lower amid more progress on inflation.
Global Credit			Attractive all-in yields amid decent growth and disinflation, but limited room for spread compression.
Investment Grade Credit			Spreads relatively narrow, so risk-reward confined to carry.
High Yield Credit			Slight preference for IG versus HY. Moving up in quality in context of broader risk-on positioning.
EMD Hard Currency			Valuations and macro data have become less supportive relative to DM credit.
FX			
USD			Strong carry and resilient growth limit scope for weakness vs G10 FX. Bearish against higher carry EMFX.
EUR			Core inflation slowing quickly, along with weak growth. Expect ECB to cut before Fed.
JPY			JPY is cheap vs. USD and the BoJ is moving towards tightening. Safe haven JPY is a good hedge against recession.
EM FX			Soft landing is a good environment for carry. Prefer MXN and BRL.
Commodities			Prefer oil to industrial metals on China property weakness, limited rebound in global manufacturing.

Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as of 1 December 2023. Views are provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

For marketing and information purposes by UBS. For global professional / qualified / institutional clients and investors and US retail clients and investors.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.

Americas

The views expressed are a general guide to the views of UBS Asset Management as of December 2023. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA

The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document. Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient. The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG. This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK

Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction. Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed. You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia

This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

China

The securities may not be offered or sold directly or indirectly in the People's Republic of China (the "PRC"). Neither this document or information contained or incorporated by reference herein relating to the securities, which have not been and will not be submitted to or approved/verified by or registered with the China Securities Regulatory Commission ("CSRC") or other relevant governmental authorities in the PRC pursuant to relevant laws and regulations, may be supplied to the public in the PRC or used in connection with any offer for the subscription or sale of the Securities in the PRC. The securities may only be offered or sold to the PRC investors that are authorized to engage in the purchase of Securities of the type being offered or sold. PRC investors are responsible for obtaining all relevant government regulatory approvals/licenses, verification and/or registrations themselves, including, but not limited to, any which may be required from the CSRC, the State Administration of Foreign Exchange and/or the China Banking Regulatory Commission, and complying with all relevant PRC regulations, including, but not limited to, all relevant foreign exchange regulations and/or foreign investment regulations.

Hong Kong

This document and its contents have not been reviewed by any regulatory authority in Hong Kong. No person may issue any invitation, advertisement or other document relating to the Interests whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Interests which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules made thereunder.

Japan

This document is for informational purposes only and is not intended as an offer or a solicitation to buy or sell any specific financial products, or to provide any investment advisory/management services.

Korea

The securities may not be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the Capital Market and Financial Investment Business Act and the Foreign Exchange Transaction Law of Korea, the presidential decrees and regulations thereunder and any other applicable laws, regulations or rules of Korea. UBS Asset Management has not been registered with the Financial Services Commission of Korea for a public offering in Korea nor has it been registered with the Financial Services Commission for distribution to non-qualified investors in Korea.

Malaysia

This document is sent to you, at your request, merely for information purposes only. No invitation or offer to subscribe or purchase securities is made by UBS Asset Management as the prior approval of the Securities Commission of Malaysia or other regulatory authorities of Malaysia have not been obtained. No prospectus has or will be filed or registered with the Securities Commission of Malaysia.

Singapore

This document has not been registered with the Monetary Authority of Singapore pursuant to the exemption under Section 304 of the SFA. Accordingly, this document may not be circulated or distributed, nor may the Securities be offered or sold, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor pursuant to Section 304 of the SFA.

Taiwan

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in the Republic of China (R.O.C.). This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in the Republic of China (R.O.C.). No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of the Republic of China (R.O.C.).

Source for all data and charts (if not indicated otherwise):
UBS Asset Management.

C-12/23 NAMT-400



ubs.com/am-linkedin

© UBS 2023. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.

www.ubs.com/am

Page 6 of 6