INVESTMENT OUTLOOK 2021

MARKETING DOCUMENT

A BRAVE NEW WORLD

UBP

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A BRAVE NEW WORLD

2020 provided investors with a challenging roadmap which required both agility and conviction to navigate.

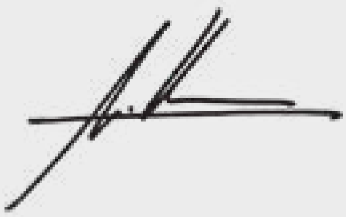
An already slowing economy combined with a reluctantly accommodative Federal Reserve early in the year left investors facing elevated valuations against a weakening earnings backdrop even before the global pandemic fully took hold. The cautious stance we adopted in January and February paid off, allowing UBP managed portfolios to contain the damage wreaked by the shortest, sharpest sell-off in equity market history.

With fiscal policy-makers joining central banks in the largest globally coordinated easing ever, we were able to swiftly align our portfolios' positioning with that reflationary stance in the spring. Recognising that the effects of the 'corona crisis' and low yields were set to last led to a large-scale adjustment of both our bond and equity allocations as we offloaded the traditional ballast of multi-asset portfolios.

Similarly, amid the deepest recession since the Great Depression, a focus on balance sheet strength and corporate quality helped us navigate the early days of the crisis. Anticipating a wholesale transformation of the structure of the global economy, we have favoured transformation themes in healthcare and technology to drive our equity allocations through much of 2020. Those secular trends should continue to spread as economies seek to pick up in the new year. The development of 21st-century infrastructure to address climate change and a new digital landscape should take centre-stage in this transition.

In 2021, a move from monetary-led to fiscal-led policy means shifting political landscapes in the US, the UK, Europe and China will create both opportunities and risks for investors. For bond investors, a risk-managed approach will be prudent in the new year as defaults resulting from the health crisis continue to materialise. Meanwhile central banks are expected to be active, leading to a continuing US dollar bear market and a gold bull market.

With low-risk government bonds no longer offering the same protection as in previous recessions, investors will need to adopt a dynamic risk management approach. Options, futures, and structured product strategies remain an active part of the UBP arsenal in addition to hedge fund, precious metal and forex strategies, to maintain our commitment to preserving and growing our clients' wealth in challenging market conditions.



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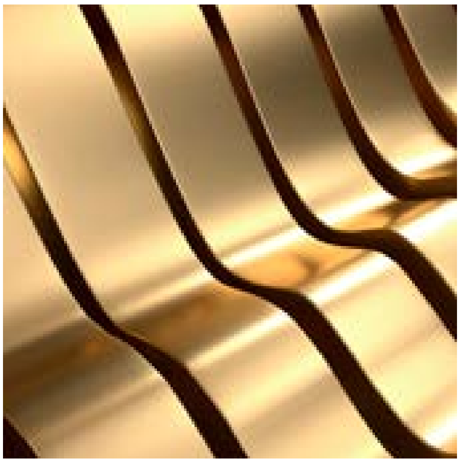


1

MACROECONOMIC OUTLOOK

THE RISE OF FISCAL ACTIVISM

Global growth should recover in 2021, with China, the US and Germany being the main drivers. Monetary and fiscal policies are coming together to support a sustained recovery; fiscal activism is likely to dominate with public spending driving efforts to kick-start the economy.

According to our scenario, all countries should see renewed growth in 2021. Economies have seen a gradual upturn since summer 2020, although the resurgence of Covid-19 cases and new local restrictions are hampering the recovery at the end of the year. After a deep recession, all countries should bounce back in 2021, and we expect global growth of around 5% after a contraction of 3.2% in 2020.

However, not all countries will recover to the same extent. China (+2% in 2020 and +7.5% forecast for 2021), the United States (-4.2% in 2020 and +4.2% in 2021) and Germany (-5% in 2020 and +5% in 2021) have already rebounded more quickly than other countries, allowing them to make a larger contribution to the recovery. In the rest of the world, economies are more fragile – with a contraction of 4.7% expected in 2020 outside the three aforementioned countries, followed by growth of 4.3% in 2021 – and the resources to underpin the upturn are more limited.

The political landscape should be more settled in 2021 after the final result of the US presidential election is established, giving us renewed clarity on the direction of US economic policy and the global economic cycle. In Europe, the vote in favour of the Recovery Fund – amounting to EUR 750 billion or 5% of European GDP – will result in effective support for struggling countries and industries.

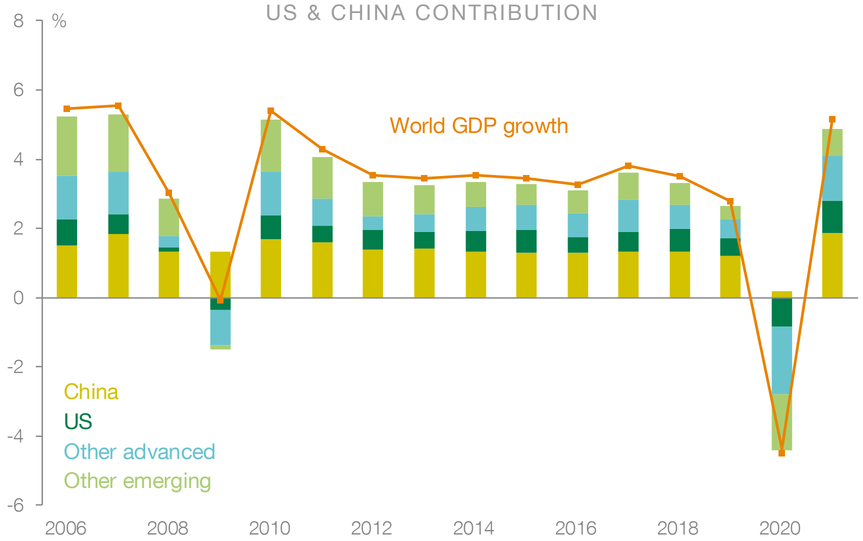
New fiscal stimulus plans will be required to support the recovery in 2021.

In China, medium-term economic development targets will clarify the country's new policy direction in 2021.

China, Germany and the US are likely to see growth driven more by investment and global trade. The recovery from recession has been driven by firm consumer spending and buoyant real-estate markets. The gradual fall in unemployment in 2021 should keep consumer spending on a positive trend.

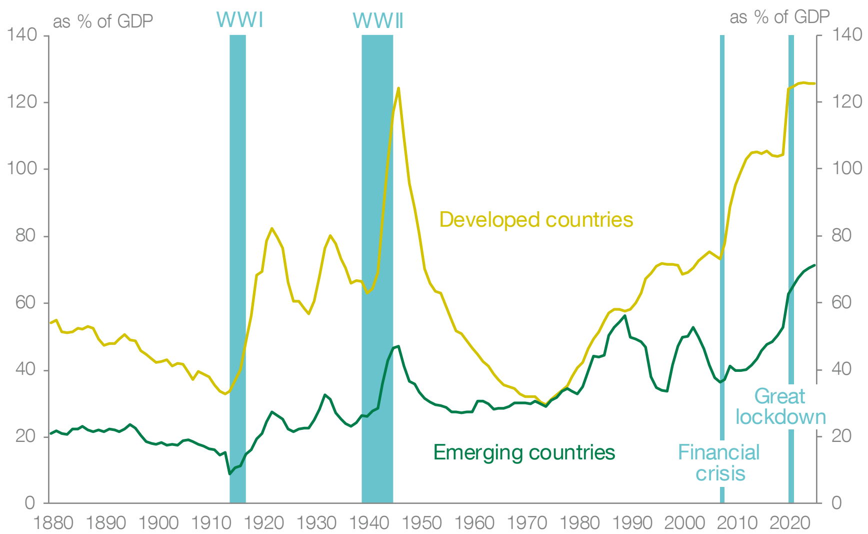
The growth outlook depends on how well the pandemic is kept under control and on the early arrival of a vaccine, which would improve visibility on the economic cycle and prompt a reassessment of the economic scenario.

WORLD GDP GROWTH
US & CHINA CONTRIBUTION



Sources: IMF, UBP

GOVERNMENT DEBT



Sources: IMF, Maddison Database Project

However, growth remains fragile, uneven between countries and between manufacturing and services, and still needs to be carefully nurtured by economic policy. Sustained growth in the global economy requires further fiscal support, especially in developed countries.

A new era of economic policy

In 2020, central banks cut their policy interest rates to zero or pushed them further into negative territory, injected liquidity, increased their purchases of financial assets and extended the list of assets they can buy. There has been aggressive monetary stimulus, avoiding a financial crisis by ensuring access to credit and the normal operation of financial markets.

Fiscal policy then picked up the baton, with plans intended to support public health, jobs and struggling industries. However, those measures appeared insufficient to address the slump in global output, so governments increased their support, extended their plans (to more than 12% of GDP in total) and offered state guarantees for certain business loans (almost 10% of GDP in developed countries).

As we approach the end of the year, monetary and fiscal policies are co-ordinated, with the adoption of common goals. Efforts to boost economies now involve expansionary fiscal policies, which will be partly monetised by central banks until there is a return to full employment or until inflation rises above 2%. As a result, there has been a major shift in economic policy, which is likely to remain in place until 2025.

Long-term growth prospects

The pace of the recovery and the duration of the growth phase are therefore likely to be determined by fiscal decisions taken in 2021. Following on from emergency

Fiscal consolidation has been postponed until after 2024.

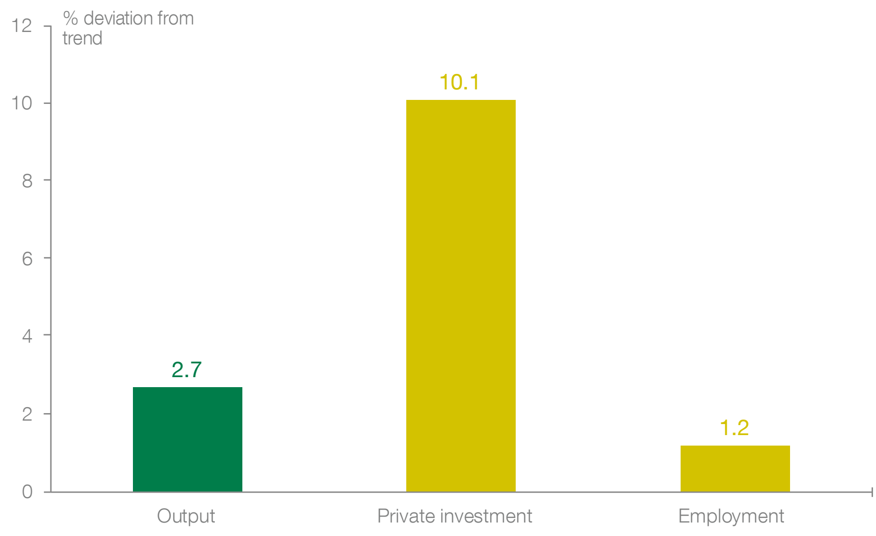
measures, we expect upcoming initiatives to focus on structural spending that will have a knock-on effect on medium-term growth.

In practical terms, governments could allocate less money to providing direct, short-term support to households and certain sectors, and more to stimulating investment. Public-sector deficits should be lower next year (6% in 2021 after 12% in 2020 in developed countries) as certain exceptional aid plans come to an end, but fiscal efforts will continue, easing the fears of the IMF and central banks regarding a sudden withdrawal of support.

In the US, each candidate is proposing additional spending (potentially a net USD 2 trillion with Biden and USD 1.0–1.5 trillion with Trump) and reforms if elected president. In Europe, several countries have announced that they will maintain support for furloughing plans and certain sectors. EU countries will present new stimulus plans in order to access money from the European Commission's Recovery Fund: France has already put forward a EUR 100 billion plan, Germany is proposing more than EUR 90 billion of new debt, and Spain is preparing an EUR 80 billion programme. Other measures are expected in China and in Japan, and in the United Kingdom to accompany its departure from the European Union. Fiscal consolidation has been postponed until after 2021–2024 in the major countries, including Germany.

Public debt levels are bearable because of central-bank action.

MULTIPLIER EFFECTS OF PUBLIC INVESTMENT
if increased by 1% of GDP



Source: IMF

In 2021, we expect a shift towards structural programmes within public spending, with a focus on investment in infrastructure, new technologies, environmental and climate protection, and public–private partnerships. These priorities feature in the European stimulus plan, the Biden programme and also, to a lesser extent, the Trump programme, which retains a commitment to new infrastructure projects from his first term.

Efforts to restore growth are vital to counteract the fall in potential growth that has taken place since the 2008 crisis. As we emerge from the current crisis, public spending will spearhead a sustained recovery because of its knock-on effects on output, private-sector investment, jobs and productivity. Government stimulus is therefore shaping a new post-Covid global economy, speeding up shifts that were taking place before the pandemic hit.

This new phase of fiscal stimulus will keep budget deficits high for the foreseeable future, with public debt levels remaining well above 100% of GDP in all developed countries. Such debt burdens are bearable since monetary policy will finance part of the debt through purchases of government bonds, as well as keeping interest rates low, beneath the rate of growth. As a result, debt servicing will not be a problem if investor trust is maintained, accepting low yields in return for the hope of a stronger recovery in the medium term, while waiting for a vaccine to become available.

VOLATILE BUT RISING INFLATION

Inflation has been very volatile in 2020. It fell significantly in the second quarter due to lower commodity prices and the economic shutdown, before rebounding in all countries as lockdowns were eased and oil prices stabilised. Transport, security and health-related costs rose sharply because of the pandemic. There was also firm demand for certain consumer goods such as sport, leisure and vehicles. At the end of the year, VAT cuts in Germany and the United Kingdom have added to the volatility in inflation indices by pushing prices temporarily lower. Disinflation risk lingers because demand remains fragile, and central banks are still wary of this risk.

Our outlook for 2021 includes a gradual rise in inflation in developed countries in aggregate from 0.7% to 1.3% in 2021. The United States is expected to see an increase from 1.2% to 1.8% on average, with variations between an expected low of 1.1% and a high of more than 2.5%, providing retrospective justification for the Fed's decision to focus on average inflation. If large-scale fiscal stimulus measures are adopted, the upturn in US inflation could be sharper than expected.

In the United Kingdom, inflation is expected to average 0.9% in 2020 and 1.6% in 2021, but the likely increase in transport prices and trade tariffs due to Brexit could push it up more than anticipated.

In the eurozone, inflation has moved into negative territory in late 2020 because of lockdown measures, VAT cuts and the strong euro. It is expected to recover slowly in 2021, rising from 0.25% on average this year to 0.6% next, still well below the ECB's target.

In emerging countries, aggregate inflation is likely to average 3% in 2020 and 2.5% in 2021. It should stay moderate after some currencies (e.g. the Turkish lira and some Latin American currencies) saw significant depreciation in 2020. In China, it is likely to average around 2% after jumping sharply because of higher pork prices.

In 2021, inflation will be volatile, showing an upward trend in developed countries as the year goes on. In addition, the effect of currency movements on imported inflation could amplify differences between geographical zones.

2

CURRENCIES

THE US DOLLAR BEAR MARKET CONTINUES

We believe that the US dollar bear market, which started in March this year, is set to continue into 2021 and even to accelerate. In particular, we expect the currency to drop against the euro, Swiss franc, Chinese yuan and Japanese yen. Gold will benefit from continuing dollar weakness, although emerging-market currencies are unlikely to see any major appreciation against the dollar.

In March, the US Federal Reserve cut its Fed funds target range to 0.00–0.25%, from 1.50–1.75% at the beginning of the year. The Fed also adopted a new quantitative easing programme, although there are significant differences relative to previous programmes, since the current one is open-ended and includes purchases of corporate bonds. Crucially, the Fed also opened foreign exchange swap lines with both advanced-economy and emerging-market central banks to improve liquidity conditions outside the United States. Over the following months, the dollar lost ground against most G10 currencies – with those showing higher interest-rate profiles outperforming – while its performance against emerging-market currencies was more mixed.

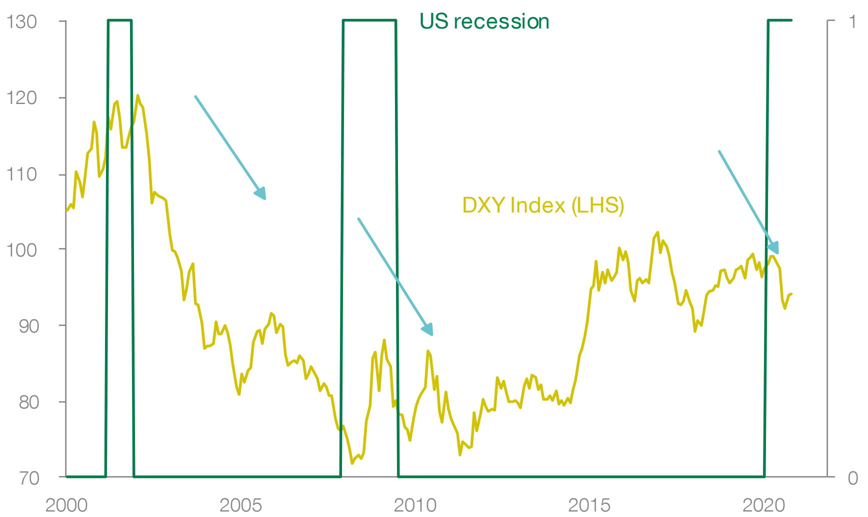
Coming into 2021, we anticipate that the dollar may continue to suffer from Fed policies announced in late 2020. Not only does the Fed intend to keep rates on hold until at least 2023, it has now adopted average inflation targeting. Even before the pandemic, the US was one of the few economies producing inflation. If it continues to do so after the pandemic, but without a policy response from the Fed, the resulting periods of inflation overshoot will reduce the US dollar's purchasing power and it is likely to weaken gradually.

The Fed also has additional tools it can deploy to ease financial conditions further, such as explicit yield curve control. This strategy, currently pursued by the Bank of Japan, would suppress bond yields within tight ranges across the yield curve, preventing them from rising as a result of increasing inflation expectations, and so weaken the dollar even further. In the absence of a political agreement on fiscal stimulus, the Fed may also activate its private loan facilities, which may turn into a guarantee programme for consumers and small businesses, like the one in the UK: this could further expand its balance sheet, also causing the dollar to depreciate.

One of the main reasons for dollar weakness in the year ahead will be a rapid deterioration in the US current account. The deficit is close to 3% of US GDP, and is likely to widen rapidly during 2021. Because the US budget deficit is set to remain large, close to the current 13% of GDP, further economic recovery is likely to cause the current-account deficit to increase sharply. Since the dollar is fully valued according to most measures, it could easily weaken materially in the next 12 months. In the past, similar scenarios have seen it fall by between 20% and 30% on a trade-weighted basis over subsequent years.

Indeed, when US growth is moderate and global growth is resurgent – the scenario that is most applicable to

THE USD WEAKENS FOLLOWING US RECESSIONS



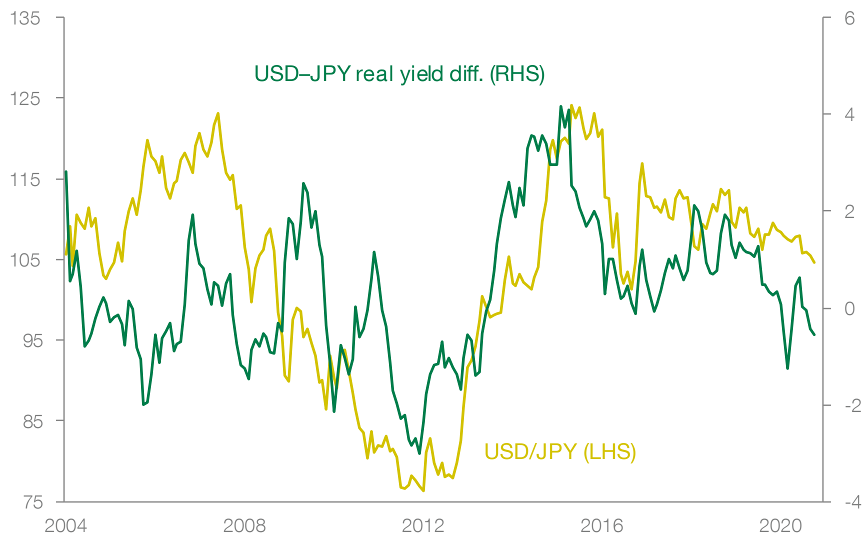
Sources: UBP, Bloomberg Finance L.P., NY Fed

A worsening US current account deficit and political forces will weigh on the dollar.

2021 – the dollar has historically been weak. The risk of the dollar appreciating could emerge in two scenarios. The first is when the US enjoys a large growth premium over the rest of the world. With the Chinese economy already transitioning from recovery to expansion and co-ordinated fiscal stimulus set to emerge in Europe in early 2021, this scenario appears unlikely.

The second scenario for dollar appreciation is when risk aversion rises to extreme levels, as in the 2008–09 global financial crisis and the initial stages of the Covid-19 pandemic (January–March 2020). Given the proactive nature of global fiscal and monetary policymakers, this risk is likely to be modest and transient.

USD/JPY FAIR VALUE IS BELOW 100



Sources: UBP, Bloomberg Finance L.P.

There are also substantial political factors weighing on the dollar. Politicians and monetary authorities will use all of their clout to keep the dollar down, since stronger USD exchange rates tend to be deflationary and there is a close correlation between an excessively strong US dollar and emerging-market debt defaults. A stronger dollar would also further widen the US trade deficit, which is already considerable even after oil imports are stripped out. In a demand-deficient world, no-one wins from stronger USD exchange rates.

Global manufacturing PMI figures bode well for currencies highly exposed to global growth. The likes of the Australian, New Zealand and Canadian dollars, as well as the Swedish krona and the euro, will fare well in this scenario.

However, if global growth proves weaker than anticipated, safe-haven currencies should outperform. Even if it does not, the Swiss franc and Japanese yen will strengthen against the US dollar due to dollar weakness, but any deterioration in risk sentiment will accelerate the dollar's decline against these currencies. We see USD/CHF dropping to near 0.81 by the end of 2021, and USD/JPY to close to 101.00.

Unlike in the period following the global financial crisis, we do not expect significant dollar weakness against emerging-market currencies, which are demonstrating limited carry this time around in both nominal and relative terms. Indeed, many of them, including the Brazilian real, the Turkish lira and the South African rand, are showing substantially negative real interest rates. Because the Fed will keep rates low for at least the next two years, emerging countries' central banks will be reluctant to raise rates given weak global demand. In our view, therefore, their currencies will struggle to appreciate against the dollar in 2021.

3

FIXED INCOME

WHERE TO NOW FOR FIXED INCOME INVESTORS?

With the approaching end of the bond bull market that began in the early 1980s as the battle with the 'Great Inflation' of the 1970s was won, investors should be cautious: the transition into an outright bond bear market will likely be fraught with volatility as the global economy is pulled between post-lockdown deflationary pressures and fiscal and monetary reflationary efforts.

The high government and private debt levels that have culminated in the unprecedented fiscal spending of 2020 will serve to contain the rise in risk-free 10-year yields even if growth returns as expected in 2021. Negative inflation-adjusted yield curves, we expect, will be a policy objective to assist in the deleveraging process just as the Federal Reserve did in the 1940s as the US entered World War II.

This should leave US 10-year Treasury yields capped near 1%, at least until inflation accelerates beyond the Fed's 2% target. At the same time, should a renewed demand shock materialise, we suspect American policy-makers will apply the lessons learned from Japan: they will seek to maintain a positively sloping yield curve and keep the benchmark US bond yield anchored above 0.5% in support of the US banking system and financial markets.

Benchmark German yields should follow a similar pattern though anchored below the zero bound that has been in place since early 2019. With the benefits of negative rates apparently largely exhausted and with the US central bank adamant that it will not pursue a negative nominal interest rate policy, German yields even lower than the -0.8% low seen in March 2020 should underlie euro area yields in 2021.

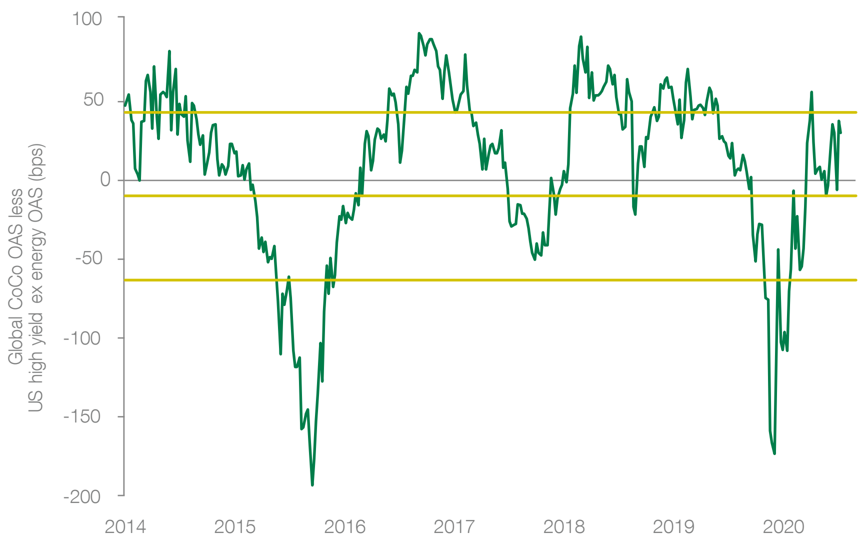
Though inflation-linked bonds might be attractive as the world transitions away from past disinflationary decades, we suggest caution. Post-lockdown demand scares should offer opportunities to build positions when inflation becomes underpriced.

An approach focused on quality credit should secure modest returns in 2021.

Near 1.5% should be an adequate inflation assumption even if an extended tug of war between deflationary forces and inflationary policies lies ahead.

With negative inflation-adjusted yields expected and a rebound in inflation well priced into low-risk government bonds, fixed income investors will need to look further afield for returns. Already in recovery and the early stage of expansion, the Chinese economy has seen domestic government yields rising from the March 2020 all-time lows. At 3–3.5%, Chinese government bond yields offer near historic pick-ups versus US and German yields in a currency that, in particular against the US dollar, should strengthen in the year ahead.

LOOK TO EUROPEAN HYBRID SECURITIES INSTEAD OF US HIGH-YIELD CREDIT

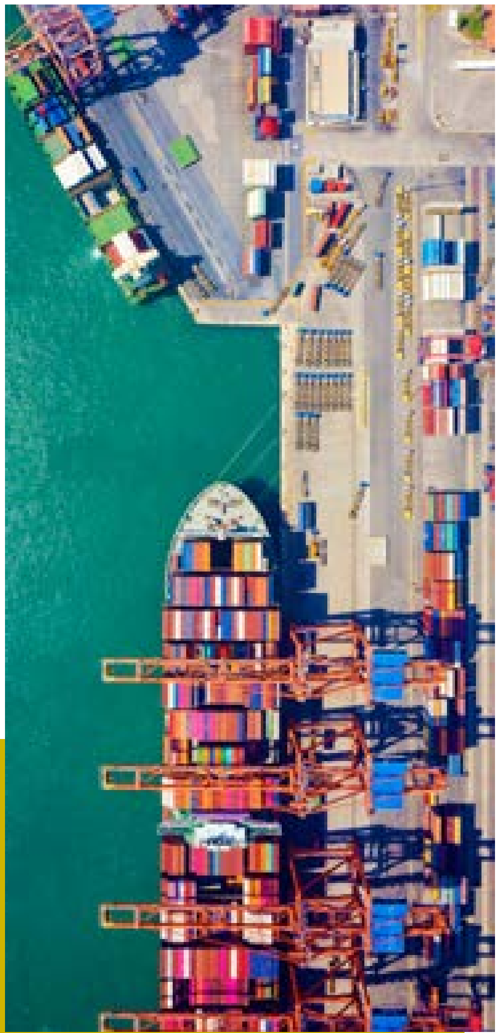


Sources: Barclays, Bloomberg Finance L.P. and UBP

Credit investors, though, should be increasingly selective in 2021 as the default cycle that typically follows a global recession has not played out fully, having been extended by government intervention. This should favour active credit selection rather than the passive investment approaches that have worked well over the past decade. A focus on quality while looking through what will likely be near-term volatility to hold quality credits to maturity should be valuable during this transition phase.

Like in government bonds, investors can find respite by looking outside the US and Europe, we expect. Despite being further along in the recovery cycle, Asian investment-grade credit still offers investors cyclically wide spreads relative to US credit. USD-referenced investors can similarly look to European banks' hybrid securities which offer premium yields to high-yielding securities despite an implied backstop from the European Central Bank. Once again, active credit selection will be critical in both of these arenas in the year ahead.

On balance, an approach focused on quality credit should allow investors to look beyond a further pick-up in corporate defaults and the attendant near-term volatility to secure modest returns in 2021. Alternatively, long/short credit or equity market-neutral strategies may offer approaches to generating return that are less correlated to the vagaries of a fixed-income market in the midst of a long-cycle transition.



A BULL IN CHINA'S BOND MARKET

China government bonds offer fixed-income and multi-asset investors an ability to invest as they had prior to the zero interest-rate regimes proliferating around the world. They provide both high nominal and positive inflation-adjusted yields in an economy that is still running relatively traditional monetary policy.

At more than 3%, 10-year local-currency government yields have rebounded following their lockdown-induced declines to levels last seen in early January 2020, nearly 130 bps above China's recent consumer price inflation trends as well as its 5-year average. This is in marked contrast to the near- or below-zero nominal and inflation-adjusted yields offered by major economies' sovereign bonds in North America and Europe.

China's central bank, the People's Bank of China, continues to run traditional, interest rate-driven policies in contrast to the quantitative easing strategies now at the forefront of policy in the US, the euro area, Japan and the UK. For investors, this means that, should another negative shock occur and threaten China's economic growth, government bond investors can still benefit from the prospect of falling yields to drive potential capital gains.

Admittedly, with the Chinese economy transitioning from the recovery phase of recent quarters into broader-based expansion, investors do face the prospect of a further rise in China's benchmark yields. However, much as US yields were anchored by European investors fleeing negative yields following the eurozone financial crisis, we suspect the historically wide spreads between China and US/European government yields may serve to prevent Chinese yields from rising too quickly.

Moreover, should the more durable Chinese economic expansion we expect materialise, this historically wide gap between China and US 10-year yields should allow investors in local currency to benefit from an appreciating currency to augment their local currency income. This, combined with ongoing opening up of local bond markets to foreign investors, should support the Chinese currency.

Thus, just as the global and eurozone financial crises pushed conservative investors further down the credit spectrum to generate positive returns, fixed-income and multi-asset investors should now look further afield to China government bonds to serve the same purpose, in the shadow of the 2020 coronavirus crisis.

4

EQUITIES

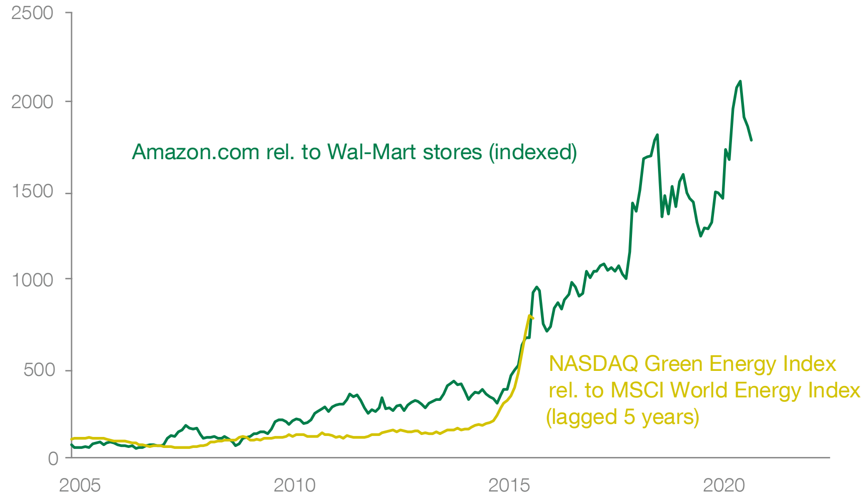
INVESTING IN TRANSFORMATION

The months since the start of the global pandemic have spurred changes to the global economy that, even with a vaccine and a return to 'normal', will likely not reverse. Themes like fintech, green tech, and China's economic transition, in addition to biotech and online services, will be key for investors in 2021.

The extent to which transformative growth themes have outpaced more traditional economic segments in the 2020 equity market rally has understandably left investors cautious about its sustainability. However, they should not overlook the cyclical and structural collapse in earnings (chart) that has resulted from pronounced sales declines among sectors being left behind in the transformation of the global economy.

Much like the internet and mobile computing served as transformative growth themes amidst the volatility of the technology bubble at the turn of the century, we expect a number of long-cycle themes will be integral parts in this cycle's global, post-pandemic economic reshaping.

GREEN ENERGY FOLLOWING RETAIL'S PATTERN BUT WITH VOLATILITY



Sources: NASDAQ, MSCI, Bloomberg Finance L.P. and UBP

In retrospect, the collapse of the technology bubble in 2001 provided only a temporary, though painful, detour from the secular trends at the time, including the transition from desktop to mobile computing and from offline to online activity. We expect a number of trends in the current era will likewise have staying power.

Though consumer-oriented technology and the biotech sectors have been at the forefront of investors' minds amidst the work-from-home pandemic economy of 2020, investors should broaden their scope to other key themes that will be integral to reshaping the world in the decade ahead. While online shopping and entertainment will likely continue gaining share from offline consumer activities, other aspects of day-to-day life are still at a comparatively early stage of their online transition, much like shopping and entertainment were in the early 2000s.

Investors should broaden their scope to key themes reshaping the world.

In the West, the penetration of fintech at the expense of traditional banking relationships remains in its infancy and provides investors with a pivot from more mature transformation stories. Similarly, while opportunities remain in biotech, the pandemic has also accelerated the need for alternative service delivery options in the medical arena, including telehealth and remote, robotic surgery.

The green transformation of the global economy also offers opportunities spurred on not only by the broader environmental movement, but now increasingly by government funding and regulation to accelerate this process (see page 22).

China is once again in transformation mode, shifting its focus from

exports to improving the quality, sustainability, and independence of its domestic growth profile. The transformation of China's domestic capital markets will likely be an important story for the coming decade, creating investment opportunities in its burgeoning domestic equity and bond markets (see page 16).

Undoubtedly, as the global economy recovers, boosted by the prospect of rising fiscal policy dominance (see page 6), periodic bouts of outperformance may be provided by a cyclical turn in sales growth momentum combined with the greater leverage to global recovery that some of these traditional sectors offer.

Here, though, investors should focus on quality cyclical companies that have substantially completed their transformations and restructurings. Strong balance sheets are a good starting point. However, sectors which, pre-pandemic, were already in prolonged downturns that forced deleveraging, consolidation and underinvestment may offer attractive cyclical opportunities as these reversals occur. Select industrial segments share some of these characteristics, as does mining around the world (see page 19).

With equity valuations high as we enter 2021, like in 2000, risk management will be key. A quality-biased, risk-managed approach focused on sustainable earnings momentum in the context of traditional long-only or even long/short strategies in particularly volatile sectors should provide a good foundation.

CAN SOARING EQUITIES RISE EVEN HIGHER?

With equity valuations globally, and particularly in the US, at levels last seen in the midst of the 1999–2000 technology bubble, the rise in valuations behind much of the rally from the 2020 market lows no longer appears to be a likely driver of returns in the years ahead.

That said, it is worth recalling that the historic crash following the technology bubble at the turn of the century, during which global equities fell by half, came after nearly two and a half years in which valuations remained above 22x forward earnings, where markets sit today.

Indeed, the collapse in valuations from an ultimate peak of 27x earnings to a trough of 14x earnings did not begin until October 2000, shortly after the US Federal Reserve's final rate hike. However, a more important factor behind the subsequent decline was the turn in earnings momentum – where growing earnings became falling earnings – that began in earnest in 2001.

As a result, while the 2001–02 experience highlights the fact that high valuations can limit returns, events in 1999–2000 show that valuations can remain high for an extended period, leaving earnings growth as the key driver for total returns even in the context of a wider bubble in equity market valuations.

Looking ahead to 2021, this distinction is important, since investors are potentially facing a different landscape from the one they saw back then. While valuations are at similar levels, the earnings cycle, instead of peaking, appears to have bottomed out in the second quarter of this year; in the second half, earnings have begun to recover steadily from the damage caused by the global pandemic, in particular the lockdowns that took place early this year and that have resumed in some parts of the world in late 2020.

With earnings still contracting year-on-year in this second half, investors are likely still in the early stages of this rebound in earnings. Of course, an economic upturn will be important for the next phase of the earnings recovery. However, as highlighted in our discussion on the economic outlook for 2021, expected fiscal activism should help provide the catalyst for that next phase in the coming year.

Undoubtedly, the upcoming earnings recovery will be patchy, as some sectors may see permanent damage in the decade ahead from the new world that is taking shape. However, this probably means that active, thematic and stock selection-focused investors will continue to hold the key to returns, instead of the passive, index-oriented approach seen in the last decade.

5

CHINA

THE RISE OF CHINA

2021 represents not only the transition from recovery to expansion in the post-lockdown Chinese economy, but more importantly for investors, the final runway as China approaches the symbolic 100th anniversary of the establishment of the People's Republic of China in 1949.

Since introducing economic reforms that began in 1978 to open its economy up to the world, with its ultimate ascension to the World Trade Organization in 2001, China has been seen as an export engine to the world.

Looking to the last couple of decades of the People's Republic of China's (PRC) first century, investors should expect this outward focus on growth to turn increasingly inwards, towards quality and sustainable domestic growth, with a number of important implications.

The first is a shift in foreign exchange policy. After its devaluation shock in 2015 and its trade war with the US in 2018–19, assuming US–China tensions remain contained, the prospect has emerged of a strengthening yuan as a tool for China to manage potential domestic inflationary pressures (chart).

The second implication is a further opening up of the previously restricted domestic capital markets to foreign investors. The still substantially positive nominal interest rates, in a currency that is expected to strengthen, offers sovereign bond investors a haven from the low returns across the global fixed income segment.

Thirdly, the domestic focus will likely also come with the need to contend with past credit excesses. Defaults, though non-systemic in nature, should become more commonplace as the clean-up of the financial system once again picks up pace. Combining select credits with Chinese government bonds will offer investors a balanced risk–return profile in a shifting Chinese fixed income arena.

China is increasingly turning inwards, towards quality and sustainable domestic growth.

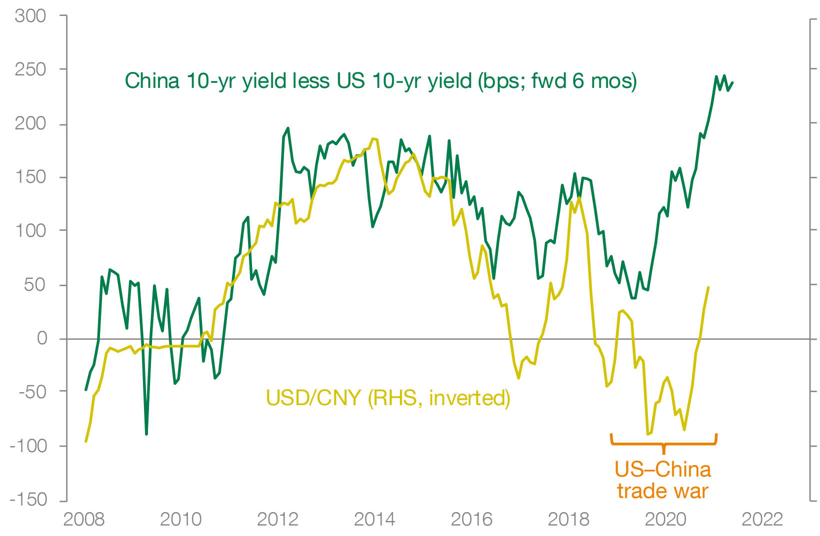
With China set to unveil its 14th five-year plan, investors should continue the tried and tested approach of aligning themselves with the objectives of the ruling party as it seeks to strengthen the foundation of its economy.

Technology is one key theme, as China's recent announcement of its ambitious target of carbon neutrality by 2060, along with its efforts in 5G as well as artificial intelligence, highlight its pursuit of leadership in key 21st-century technologies. This includes the digital payments segment where China looks set to be the first major nation to launch a central bank digital currency.

Stemming rising income inequality and a focus on the quality of domestic economic growth should take increasing focus as well in the coming five-year plan. The accelerating take-up of online education, healthcare and other services due to lockdowns should deepen the penetration of the virtual economy in China.

These ambitious aspirations are not completely without risks, admittedly. Cyclically, equity valuations are elevated though earnings expectations are likely to fail to capture the economic recovery that lies ahead. In fixed income, recovery suggests

FURTHER YUAN STRENGTH WOULD SUPPORT DOMESTIC REFORM POLICIES



Sources: Bloomberg Finance L.P. and UBP

cyclically rising yields but we expect the anchor of low rates in the US and Europe to slow this rise. As a result, we believe thematic and stock-selection approaches are preferable to passive, index-oriented strategies within China.

Beyond these cyclical challenges, modest efforts to reform and restructure China's domestic financial system have been derailed by economic shocks in the past, leaving policy-makers once again to resort to traditional debt-focused infrastructure spending to stabilise the economy.

Moreover, with continuing tensions with Taiwan and recent forays on its border with India and in the South and East China Sea, it appears clear that the PRC is seeking to clarify its territorial claims. Thus, while the recent US–China trade war upended the WTO-led world trade order, a more pronounced shift in the geopolitical status quo in these theatres could be even more destabilising for the global economy.

Given these geopolitical struggles and the risk of escalation, we prefer a portion of Chinese exposure via high-quality long/short equity hedge fund strategies allowing investors to remain engaged in long-term transformation themes while maintaining active risk management (see page 23).

BACK TO FAMILIAR SHORES?

The pandemic and the shutdown of the global economy have hit trade and revealed weaknesses in production chains: industrialised countries have been shown to be highly dependent on products made in emerging countries, including medicines, medical equipment, automotive components, food, rare earths and technological hardware.

This has prompted certain Western governments to resume policies seeking to entice production back onto their own shores with the aid of subsidies. Is this combination of events resulting in significant reshoring?

In 2018, the escalation of the trade war between China and the US started to slow the growth in trade. Facing the return of certain constraints and tariff barriers, international companies started to relocate their production.

According to a recent study[1], China's share of US manufacturing imports fell in 2018 and 2019, and the decline has continued in 2020 due to the general slowdown in trade, with companies moving some of their Chinese production to other Asian countries and Mexico. High-profile companies like Google, Omnidex, Microsoft, Apple and GoPro have left China. However, they have remained close to both China and the US – two key markets – by choosing countries that have signed trade deals with them.

In fact, production had already started to shift away from China before trade tensions increased, because of rising Chinese wages: Vietnamese wages are half as high, while Mexican ones are 30% lower. In addition, leaving China is not easy for companies that want exposure to the market growth driven by the rise of the Chinese middle class.

Moving production back to developed countries is also no simple task: studies show that this tends to involve heavy use of robot process automation, which requires highly qualified staff. The need to access the right technology and highly specialised labour, and to rebuild a network of subcontractors, may slow down the reshoring process.

While waiting for greater clarity about US trade policy, large corporations are likely to continue diversifying production, securing their supply chains and seeking opportunities in various countries. As a result, the reindustrialisation of developed countries may prove partial, with only a limited withdrawal of international companies from China.

[1] "Trade war spurs sharp reversal in 2019 Reshoring Index, foreshadowing COVID-19 test of supply chain resilience", Kearney 2020 Reshoring index

6

COMMODITIES

PRECIOUS METALS: VARYING TINTS

Prevailing trends look set to continue in 2021, with gold benefiting from the usual factors like geopolitical tensions and silver boosted by the recovery in industrial manufacturing, while platinum falls out of favour as demand shifts and technologies evolve, particularly in the auto sector.

Gold – Continuing upside

In 2021, gold will continue to benefit from many of the same factors which drove it to new all-time highs in 2020, reaching USD 2,200 or more by year-end.

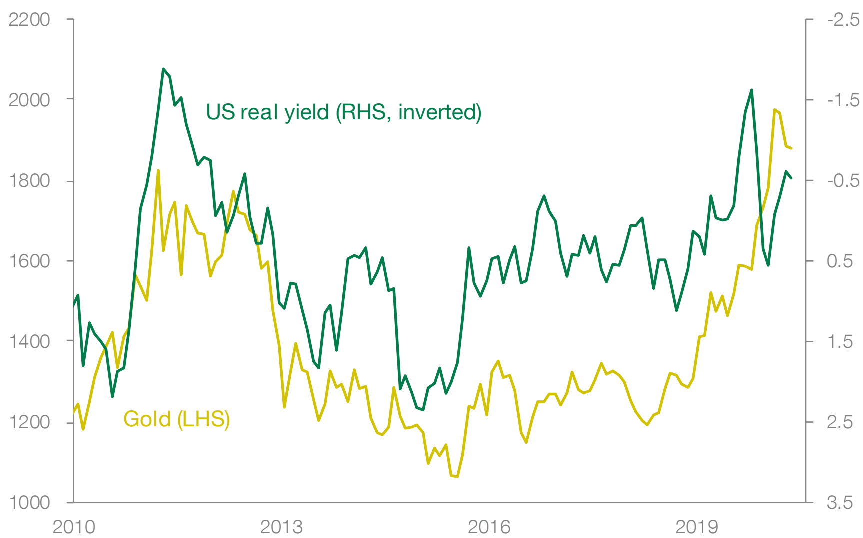
This is consistent with future growth in US M2 money supply, and monetary policy should remain supportive: central banks around the world are now effectively running policies involving negative real interest rates, and intend to keep them that way over the coming years. In addition, the prospect of further quantitative easing, negative deposit rates and negative-rate tenders is increasing the upside for gold.

> Investors are maintaining sizeable long gold positions but will continue to prioritise physical gold.

Geopolitical tensions, particularly between the US and China, are now a feature of the new global landscape and are working in gold's favour because of its safe-haven status. Even if economies reopen following the introduction of a Covid-19 vaccine, we expect gold to benefit from the revival in consumer demand, particularly in Asia.

The risk to our gold price forecast is on the upside. Investors are maintaining sizeable long gold positions, but as in 2020, they will continue to prioritise physical gold over financial gold, meaning that we can expect strong underlying demand.

NEGATIVE REAL YIELDS WILL DRIVE GOLD HIGHER



Sources: UBP, Bloomberg Finance L.P.

Silver – Higher beta to global growth

For silver, we see little chance of a material price decline in 2021, instead expecting a rise towards USD 32 per ounce by the end of the year, with risks firmly to the upside. Silver should be underpinned by a gradual recovery in the global economy, the proliferation of green policies across major economies, and the same monetary factors as those supporting gold.

Improving industrial demand since May, combined with the fiscal stimulus we anticipate in early 2021, point to a steady recovery in global manufacturing. This is positive for silver, which is used in a large number of industrial processes.

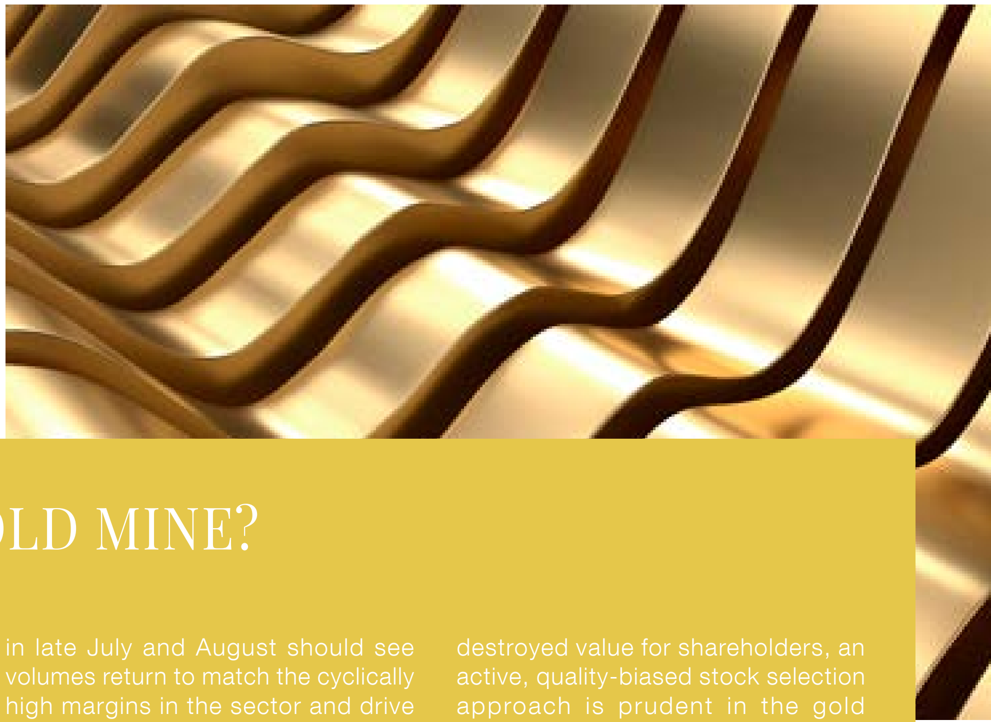
We expect stimulus measures to have a substantial green bias (see page 22), providing a medium-term tailwind for silver, which is a key component in solar panels. Moreover, with the gold–silver price ratio still above its 30-year average, silver remains undervalued relative to gold.

Platinum – Underperformance despite industrial recovery

In 2020, platinum was one of the worst-performing precious/industrial metals, failing to match the rally seen by the likes of gold, silver and palladium. Platinum's poor performance is explained by a large decline in jewellery demand, the auto sector slowdown and significant excess supply. Together with a shift away from diesel vehicles, these same factors mean that platinum is unlikely to see any material rally in 2021.

The World Platinum Investment Council now anticipates a 2020 surplus of around 247,000 ounces, more than 120,000 ounces above its previous estimate. While supply is down modestly in 2020 due to Covid-related shutdowns, demand has fallen more.

In terms of demand from the auto sector, the secular transition away from diesel is likely to remain a drag on the platinum price, since around 40% of demand has come from diesel vehicles in recent years. Over the long term, the promise of hydrogen fuel-cell technology is positive, but for the short term, this is unlikely to fill the gap left by weak auto demand.



SITTING ON A GOLD MINE?

The correction in precious metals prices since the third quarter of 2020 has provided investors with an opportunity not only to continue building positions in physical metals, but also to refocus on the gold mining sector, which should see multiple drivers beyond rising metals prices in 2021.

Unlike in typical gold bull markets, low energy prices and falling local currency production costs mean that gold miners will see their costs fall by as much as 13% to close to USD 900 per ounce, or more than 50% below current spot gold prices. This expansion in profitability has been key to the gold bull market from the March 2020 lows.

Beyond this, with mine capacity having shut down for much of the second quarter of 2020, reopenings in late July and August should see volumes return to match the cyclically high margins in the sector and drive the next leg of earnings growth in 2021.

Indeed, despite the near all-time high in physical gold prices, sales per share among leading gold miners still sit near levels last seen in 2008–09 when physical gold prices were below USD 1,000 per ounce, compared with the USD 1,800–1,900 currently.

Even without this rebound in sales, high margins have allowed leading producers to initiate or raise existing dividends as free cash flow grows within the sector, potentially enhancing total returns to shareholders.

For conservative investors in a sector that has historically, in aggregate, destroyed value for shareholders, an active, quality-biased stock selection approach is prudent in the gold mining sector.

Royalty companies can offer a comparatively lower risk entry point into the sector. They provide producers with upfront financing in exchange for a share of gold production or revenue generated from specific projects, leaving them less exposed to operational risks than direct producers.

On the whole, large, well-run, diversified producers offer investors greater leverage to rising gold prices with their diversification and long-term track record providing protection against poor capital allocation decisions seen among newer entrants into the sector.

7

US ELECTIONS

A BRAVE NEW UNITED STATES

The unexpectedly close race for United States president presages an accelerating shift in the geopolitical landscape that poses greater risks for investors. Active risk management is increasingly important while a pivot towards transformational local rather than global trends is key to preserving and building wealth in this new regime.

The world has sighed with relief now that, after several days of vote-counting, it appears that Democrat Joe Biden will take over in the White House and, above all, that the Trump administration will come to an end on 20 January 2021. Yet the tightness of the race and the lingering uncertainty as to which party will control the Senate speak to how heavily the change in the US will affect the world and investors.

Remember that the election of the 45th President of the United States in 2016 came amidst a populist wave that included the UK's vote to leave the European Union, the rise of the Five Star Movement in Italy, and victories by populist candidates to high office in Austria and the Philippines. Thus, investors cannot be faulted for thinking that the US had simply been caught up temporarily in a global populist movement that began to fade with the closely watched defeat of one of its proponents, right-wing Marine Le Pen, in France in 2017 and with only modest gains in the elections for the European Parliament in 2019.

However, the 2020 US presidential election largely dispels this notion. Instead, the very fact that the race went down to the wire, that polling errors arguably occurred more than in the contentious 2016 election which brought President Trump to power, and that more Americans voted for Donald Trump in 2020 than in 2016 suggests that America's centrist foundations have at a minimum been challenged and, at least in the eyes of America's key allies, may have been irreparably broken.

Indeed, the four years of Donald Trump's presidency have already challenged bilateral relationships in Europe and Asia in particular. Even a return to a more moderate 46th president in the form of Joe Biden may not be sufficient to dampen the distrust and restore belief in the US as a 'reliable partner' [1].

Undoubtedly, a Biden administration will seek to reverse many measures taken by its predecessor domestically and internationally, including perhaps returning to the Paris Climate Accords, the Iran Nuclear Deal, and the World Health Organization. However, the narrowness of the rebuke of America's 45th president will likely leave concern among international allies that the US' dalliance with populism was something other than fleeting.

Indeed, across the key US–China and US–Europe axes, this doubt built up over the past four years has already prompted countries to take steps to protect themselves. China, the most populous nation in the world, appears to have already chosen a path towards self-sufficiency judging by the early drafts of its upcoming five-year plan. With Biden likely to eschew the belligerent policies of outright bans on technology sales or even on access to US capital markets that President

Americans voting for Trump

2016
63 mn

2020
72.4 mn

Source: Associated Press

Polling error underestimating Trump vote

2016
1.1%

2020
5.0%

Sources: Associated Press and UBP

Who will be more powerful coming out of the crisis?

China	US	Europe
37%	6%	5%

Source: Lowy Institute

Trump appeared to be moving towards, China will have a chance to patch up the vulnerabilities exposed by the damaging US–China trade war of 2018–19.

For Europe, it has come in the form of a dialogue to drive the next rounds of reform in the long-running "Ever Closer Union" experiment, much like the global pandemic has set the stage for the early steps towards shared fiscal policy. However, Europe's comparatively protracted decision-making process and reliance on global trade may make it more difficult for it to follow the same path as China at a comparable pace. Instead, Europe will likely gradually transition its relationship with the US, forged on the battlefields of World War II, to one that is more balanced and independent from the US as it begins to build up its own continent-wide policy agendas. Undoubtedly, China will seek to influence this pivot with both incentives and deterrents aligned to its own interests.

Though monetary policy strategies in the developed world have been converging, the traditional lens through which we look at the world will likely have to evolve as well, with markets increasingly driven by domestic rather than US-centric fiscal policies and political priorities. This, combined with the zero interest-rate regimes prevalent across Western economies, means the prospect and consequences of local policy errors are substantially higher than they have been in previous cycles.

Indeed, the narrow victory by not only the incoming President but also in the US Senate raises the risk that the US will follow in the footsteps of its European counterparts and go back to an era of fiscal paralysis like the post-Global Financial Crisis period. However, this time, with more limited Federal Reserve capabilities, more extreme monetary policy choices may need to be made alongside fiscal action, though only in response to a new crisis facing the global economy, like that in March 2020.

Thus, an increasingly active risk management regime is needed in this new, multi-polar world (see page 23) in the absence of the implicit US 'put option' that has served to protect investors from such policy errors in decades past. Moreover, while the globalisation of the world economy has moved investors away from their natural home bias, this new world will require them to become increasingly local again. This is how they can capitalise on the trends which began to reshape global economic and geopolitical relationships under President Trump and are likely to accelerate under President-elect Biden.

[1] Angela Merkel stated after a G7 summit in May 2017, "Recent days have shown me that the times when we could rely completely on others are over to a certain extent."

The fact that the race went down to the wire suggests that America's centrist foundations have been challenged.

8

RESPONSIBLE INVESTMENT

EQUIPPED FOR THE WEATHER

2021 should see climate change move centre-stage as China – the world's largest carbon emitter – and Europe look to implement meaningful policies to address this growing challenge for the global economy, while progress could also happen in the US, which ranks second behind China in terms of carbon emissions.

The European Commission's proposals aim to reduce EU-wide net greenhouse gas emissions by at least 55% by 2030. China is seeking to become carbon-neutral by 2060 with ambitious targets likely to feature in its five-year plan, set to be finalised in March 2021.

While the US has yet to match either Europe's or China's ambition, progress may still come following Joe Biden's election victory and in the event of Democrats taking control of the US Senate in the January run-off elections in Georgia.

The world appears on the cusp of a long-cycle transition from fossil-fuel dependency towards a future that relies on renewables. The European Union's sustainable finance taxonomy and the upcoming frameworks created by China's five-year plan are providing the catalyst for the current wave of transformation.

Just as computing has transitioned from desktop to mobile and retail from in-person to online shopping in the 21st century, investors should expect a multi-decade shift from fossil fuels to renewables. However, as with those transitions in computing and retail, this climate-change transition is set to come in waves.

The rally in green energy stocks in 2020 suggests that markets have priced in a faster transition. While moves by Europe, China and potentially the US do indeed suggest an accelerating timetable, investors should anticipate occasional pauses in long-term outperformance. This has been seen in the aforementioned computing and retail transitions, which show that such interludes should be viewed as opportunities to build positions further.

Experience tells us that companies and industries that are slow to adapt will at best be challenged and may end up being sidelined, while those that adjust rapidly will present opportunities for investors. This now applies to carbon-intensive industries such as power generation, heavy manufacturing and transportation: stock-picking will be key in these legacy segments.

The obvious beneficiaries are wind, solar, hydro and other alternative energies, along with transportation options like electric vehicles. However, many other opportunities are also emerging. New agricultural practices and increasing demand for a reduced carbon footprint across the food value chain are already changing the farming landscape. Climate-related themes, such as biodiversity, scarce materials, healthy ecosystems, sustainable communities and basic needs should also present long-cycle opportunities for investors.

Generating investment returns and adding social value do not have to be mutually exclusive. Investing in companies that facilitate the transition to a resilient, net-zero emissions society by 2050 could make everyone a winner.

The world is on the cusp of a transition from fossil-fuel dependency towards renewables.

9

ALTERNATIVE RISK MANAGEMENT

STAYING ACTIVE IN RISK MANAGEMENT

As in 2020, active risk management will be crucial for investors in 2021, especially as US and European government bonds no longer offer the protection they did in previous cycles. The experience of euro-based investors after risk-free German Bund yields fell below 1% – just as US Treasury yields have done in 2020 – is instructive.

By mitigating risks we can exploit transformational themes as they emerge in this new global economy.

When German Bund yields were above 1%, they helped offset as much as 25–30% of equity market declines of 10% or more. When they fell below 1% and even before they turned negative, they could no longer be relied upon to offset equity market volatility in any meaningful way. The same is true of US Treasuries now that they yield less than 1%, as shown during the September correction in global equity markets.

Investors should therefore increase exposure to alternative assets such as hedge funds, structured products, options and futures to add some asymmetry to traditional equity and fixed income, long-only-biased investment portfolios .

We use hedge funds to reshape the risk–return profiles of these traditional asset classes where they may otherwise be skewed against investors. For instance, some corporate bond issuers have proven vulnerable in the current pandemic. This has created substantial opportunities for long/short credit hedge funds able to capitalise on the resulting dispersion.

Similarly, within equities, long/short emerging equity managers can provide exposure to the long-cycle Asian consumer theme, while shielding investors from the volatility typically associated with this asset class.

Structured products allow us to express views on underlying assets while reducing downside risks on those assets, delivering an asymmetric performance outcome to portfolios, particularly in the event of adverse market movements. The use of these products has been highly beneficial, especially in 2020 as they have substantially cushioned sharp market declines.

We have used futures and options strategies periodically in 2020, and they have been critical during challenging periods. In particular, put option strategies have been vital in shielding portfolios during the testing conditions seen so far in 2020. They have been an effective and efficient way for us to hedge underlying portfolios against downside risks while retaining upside exposure in a risk-managed way.

Looking ahead to 2021, investors still face risks. The financial markets remain uncertain, with extreme measures being taken on the monetary and fiscal front, and several political and pandemic-related tail risks looming. Our active risk management approach allows us to contain some of these risks, especially in the context of the capital-preservation preference of many of our clients. More importantly, by mitigating these risks we can increase our ability to capitalise on the opportunities that markets present during periods of volatility, and exploit longer-term transformational themes as they emerge in this new global economy.

MICHAËL LOK

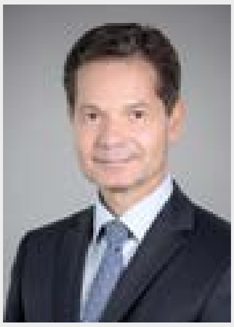
Group CIO and Co-CEO Asset Management

Michaël Lok, who has over twenty years of experience in wealth and asset management, joined UBP in 2015 as Head of Investment Management. Previously, he was Global Head of Asset Management with Indosuez Wealth Management (Crédit Agricole Group), where he developed a range of UCITS funds for Private Banking and a set of UHNWI mandates and dedicated investment solutions with a focus on Asia and Latin America. This followed his roles as Head of Investment and Head of Risk and Quantitative Portfolio Management. Before that, he was Portfolio Manager at Banque Martin Maurel and HSBC France (ex-CCF). Michaël Lok holds two Master's degrees, one in Finance (DESS) and one in Banking and Finance (DEA), from the University of Aix-en-Provence.

NORMAN VILLAMIN

Chief Investment Officer (CIO) Wealth Management

Norman Villamin joined UBP in November 2015 as Head of Investment Services and Treasury & Trading of UBP Zurich. He was appointed Chief Investment Officer Wealth Management in 2016. With over twenty years of experience managing wealth both on an advisory and discretionary basis, Norman Villamin has been Chief Investment Officer for Coutts International, Head of Investment Analysis & Advice for Citi Private Bank in Asia-Pacific as well as the Head of Asia-Pacific Research for HSBC and the Head of Asia-Pacific Strategy for Morgan Stanley based in Hong Kong and Singapore. Norman Villamin holds a Bachelor's degree in Business Administration from the University of Michigan and a Master's in Business Administration from the University of Chicago.



PATRICE GAUTRY

Chief Economist

Patrice Gautry joined UBP in Geneva in February 2000 and heads the Bank's Economic and Thematic Research department. Prior to that, from 1991 to 1999, he worked in the Institutional Asset Management department of HSBC Group in Paris as head of economics and investment strategy. From 1988 to 1991, he was a manager of European diversified SICAV and mutual fund portfolios for the Ecofi-Finance Group. Patrice Gautry holds a Research Master's degree (Diplôme d'Etudes Approfondies) in economics from the HEC-CESA Paris and the University of Orléans, with specialisations in currency, finance and banking.

PETER KINSELLA

Global Head of Forex Strategy

Peter Kinsella, who has over 14 years of experience in wealth management and investment banking, joined UBP in November 2018. Previously, he was Head of Emerging Market Research at Commerzbank, where he managed an international team covering all of the key emerging market economies (Russia/CIS, EMEA, China and LatAm). Peter Kinsella has significant experience with advanced currency hedging and risk management techniques, gained from his position as FX and Derivatives Trader at Pioneer Investments/Amundi. Peter Kinsella holds two master's degrees, one in economics from the London School of Economics (UK) and one in Law & Economics from the University of Bologna (Italy).

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November 2020

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