

INVESTMENT OUTLOOK 2023
MARKETING DOCUMENT

WALKING THE TIGHTROPE



UNION BANCAIRE PRIVÉE



Michaël Lok

Group CIO
and Co-CEO
Asset Management

Walking the tightrope

Investors were buffeted throughout 2022, first by the shock of Russia's invasion of Ukraine and then by the fastest rate-hiking cycle by the US Federal Reserve in a generation.

As we had anticipated 2022 would be a volatile year in both equities and fixed income, our allocations to hedge funds provided some relative shelter from the storm that engulfed markets. Our expectation of US dollar strength during the year also proved justified, though we were surprised by the persistence of the appreciation over the course of 2022.

Looking ahead, the agility that was required to navigate markets in 2022 will remain an asset in 2023 as the global economy treads a fine line between developed economies entering recession and emerging ones seeking to consolidate recoveries. Hedge funds should continue to be a refuge for equity investors in particular, as high interest rates, elevated volatility, and the broadest single-stock dispersion since 2007 provide multiple return drivers in the new year.

This should make up for the muted equity returns we expect for 2023 as recessions bite on both sides of the Atlantic, weighing on earnings expectations. These recessionary headwinds should also slow the pace of rate hikes and inflation in the new year, allowing bond investors to generate moderate returns and create select opportunities in credit.

Encouragingly, the 2022 turmoil has served to accelerate the transformation across energy and infrastructure sectors, and to increase the reliability and sustainability of key supply chains around the world. Admittedly, such change does not come without cost, with global food supplies set to be challenged in 2023 and beyond. Just as in energy in 2022, elevated food prices will accelerate investment in the ongoing and future transformation of the segment.

While geopolitical conditions are leading this transition in the short term, climate and biodiversity concerns will take over, driving the quest for more sustainable food systems. Beyond this, we see considerable scope to strengthen our focus on investing sustainably as an essential way to secure long-term returns.

Overall, these paradigm shifts will require investors to walk a tightrope between new opportunities and risks associated with the transition of the global economy. As a result, in 2023 we expect to continue to rely on active and dynamic risk management to help us maintain our commitment to both preserving and growing our clients' wealth.

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Paradigm and cycle shifts

Rebuilding the cycle will be the challenge in 2023 at a time when activity is falling due to inflation, the energy crisis and tight monetary policies. Developed countries will enter recession, while emerging countries must consolidate their recovery.

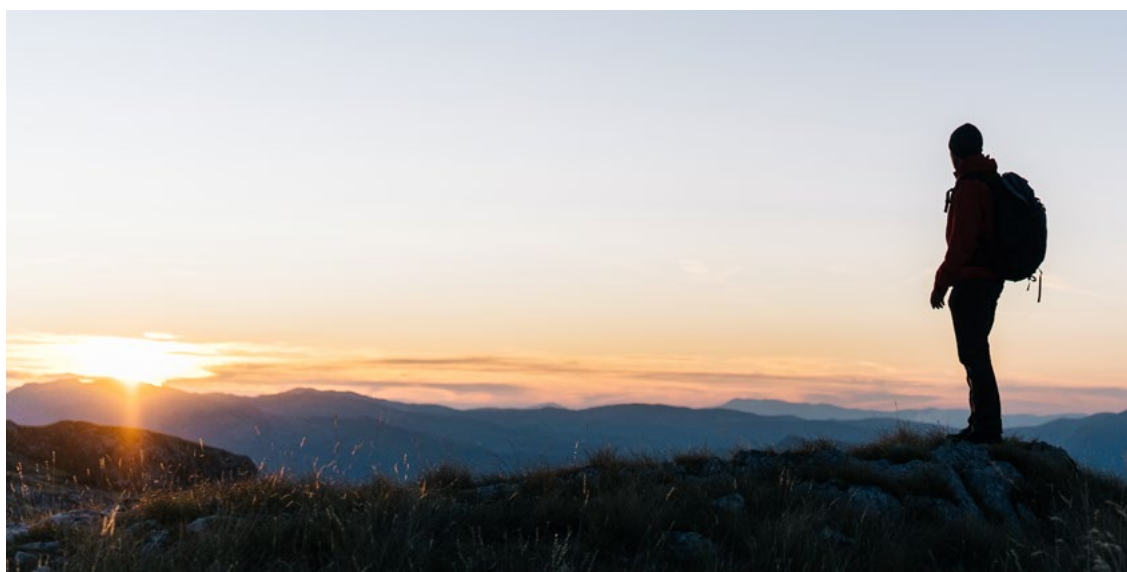
Subdued global growth while waiting for inflation to fall from its peak

The growth phase of the cycle has come to an abrupt halt due to tight monetary policies adopted to combat persistent inflation, and because of the energy crisis gripping economies alongside the increase in geopolitical risks caused by the war between Russia and Ukraine.

In 2023, the global economy is likely to see weak growth of between 2% and 2.5% after 3% in 2022, with developed economies flirting with recession. However, Asia should confirm its recovery and China is likely to overcome the obstacles that have appeared in 2022.

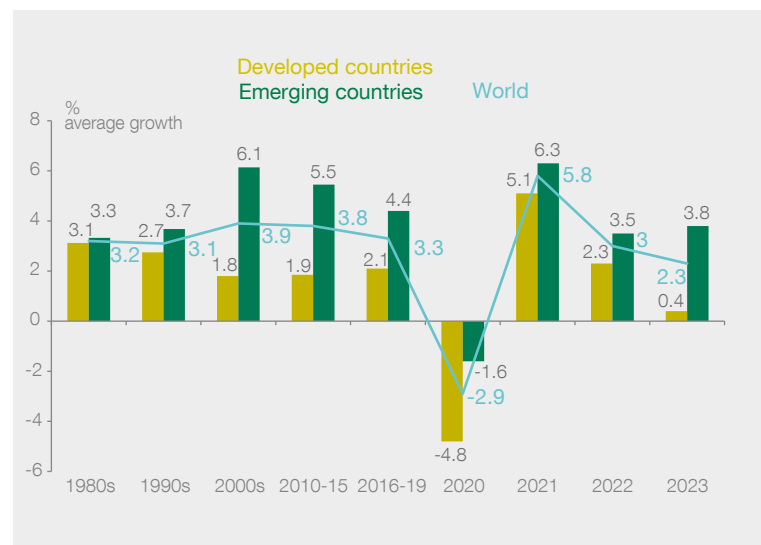
Developed countries are set to see a decline in domestic demand in 2023. Europe, and Germany in particular, seem to be the most fragile because of the major challenges arising from the energy crisis (see p. 20). Price increases and possible gas rationing will damage consumer demand, and energy-saving measures will adversely affect output in the manufacturing sector. The German growth model now needs to be adjusted. Europe also needs to rethink its energy dependency and redefine the way in which countries work together as seen in the post-Covid recovery plan (EU New Generation).

In the US, consumer spending and the real-estate sector are likely to see a sharp slowdown due to pressure from rising interest rates, while





GDP GROWTH BY MAIN REGION



Sources: International Monetary Fund and UBP

manufacturers will have to deal with ongoing cost increases and could be held back by limited growth in global trade.

Growth in developed countries is unlikely to top 0.5% on average in 2023 and certain countries could see recessions of varying severity lasting for several quarters. US growth should be positive but weak (0.6% on average), with some negative quarters, while the eurozone and UK economies are expected to contract by around 0.5%.

Recession lies ahead leading to paradigm and cycle shifts.

In Asia, the outlook is better, since China is likely to bolster its recovery and achieve growth of close to 5% in 2023. Decisions taken by the authorities to boost strategic industries should enable the country to recover from Covid restrictions and the real-estate crisis (see p. 16). Neighbouring countries should see a rebound in activity as constraints arising from inflation and monetary tightening start to ease.

The recessions expected in 2023 are not a new phenomenon, but a paradigm shift is on the horizon and will influence

the next cycle. This means that the growth gap between developed and Asian countries could take time to close if Europe does not overcome its energy problems. In addition, global trade is becoming more regional: we are seeing greater competition and even clashes between economic blocks, with opposing views about how societies should be organised in the background.

Consumers are the ones facing the greatest risk during this recessionary phase, while economic policies will favour

industries involved in energy transition, new technology and security. The challenge for any new supply-side policy is to generate potential growth in excess of levels seen in the last decade.

Inflation set to fall, but at varying rates

Inflation is likely to ease gradually, particularly in the US. On average in 2023, it could remain higher than the 2% targeted by developed-country central banks, although the trend should be more favourable. In emerging countries, inflation is also likely to decline, but it remains dependent on commodity and food prices.

In Europe and the US, we could see a two-speed inflation scenario. Inflation will peak and decline over the next few quarters, but it could still be close to 3% at the end of 2023. The fall in inflation will be helped by reduced pressure on commodities and price moderation in sectors set to see lower demand, such as manufactured goods. However, core inflation, i.e. excluding energy and food, could take longer to come down because of service prices being more reluctant to fall, but also because of structural changes. Demand for personal services, healthcare and real estate has undergone deep-seated change. Similarly, although wage inflation is unlikely to return to the levels seen in the 1970s and 1980s, rising wages are reflecting new behaviours on the part of employees and companies. New energy sources and reindustrialisation will also involve higher costs in the near term. This means that 2023 looks set to be a transitional year, with 2024 bringing inflation figures that will finally converge towards central-bank targets.

Return to a monetary regime of positive real interest rates

Developed-country central banks took some time to realise the extent of the surge in inflation, underestimating the strength of fiscal stimulus. They are now having to take rapid action, raising official interest rates into restrictive territory and withdrawing liquidity injected during the pandemic. This is likely to remain the case for as long as inflation remains high, even if economies fall into recession and unemployment rises. We will not see any pivot in monetary strategy before the end of the first half of 2023. Rate cuts are unlikely in the eurozone and should be very limited in the US and UK during the year. In addition, the reduction in central-bank balance sheets – due to assets being sold or reaching maturity – is likely to add to the tightening in financial conditions.

A new monetary regime is taking shape and will continue in 2023, characterised by the return of monetary orthodoxy. As a result, real interest rates will move back into positive

territory and remain there, putting a drag on growth as was the case in 2018–19 and in the 1980s. The rapid rise in real rates is putting pressure on financial assets and heavily debt-dependent sectors, but also on companies' investment decisions and governments' debt ratios. Unlike during the pandemic, the selection of profitable investments is narrowing and risk premiums are rising. Meanwhile, savings will fetch higher returns while the cost of capital will rise, creating the risk that idle savings will increase just when greater productive investment is needed.

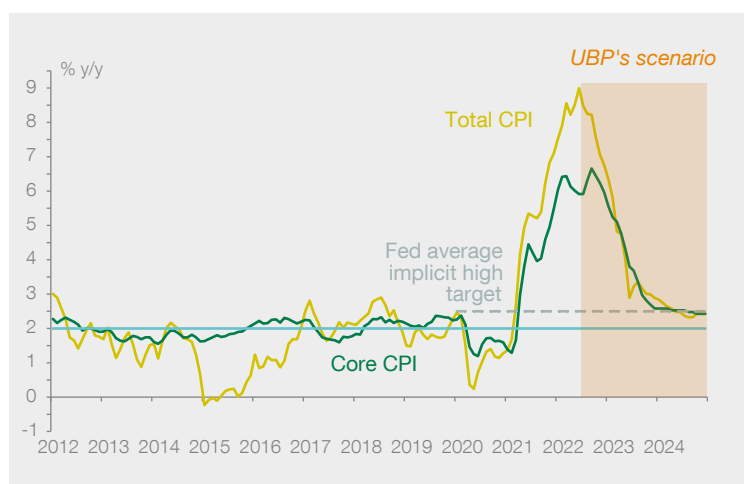
Fiscal policy watched closely in developed countries

Fiscal policy will continue to support economic activity in 2023 but will no longer be backed up by negative or low government bond yields in Europe or the US. Governments must steer a course between the need to respond to the energy crisis on the one hand, and the requirement to keep public debt on a sustainable trajectory on the other.

European governments have continued to offer aid to the economy to limit the effects of the energy crisis. After the rebound in activity and lower budget deficits in 2021, the latest measures being adopted for 2023 are targeting a narrower range of households and companies and will not be enough to prevent a contraction in demand. Alongside these one-off measures, plans for energy transition, defence, strategic industries, and infrastructure have also been adopted via structural funds. This will result in governments raising large amounts of money in the bond markets (EUR 200 bn in Germany), public-sector deficits remaining high in 2023 and debt continuing to rise after shooting up during the Covid years. The European Commission could also provide

Core inflation is proving slow to fall.

US INFLATION



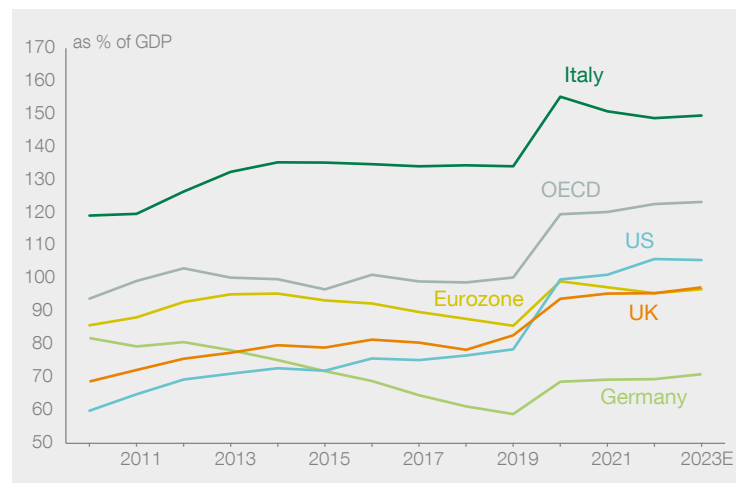
Sources: Bureau of Labor Statistics and UBP

support similar to pandemic recovery measures, granting loans for each country to use for the purposes of energy transition and for industrial redeployment.

In the US, fiscal policy in 2022 has included support for the semiconductor industry and loans to support climate transition. Measures for households are limited, while taxes levied on certain companies should in theory rise in the medium term to reduce budget deficits and debt levels.

consolidation will become a necessity in 2024. In developed countries, governments will have to keep public debt under control, failing which they could see it backfire in the shape of higher market interest rates.

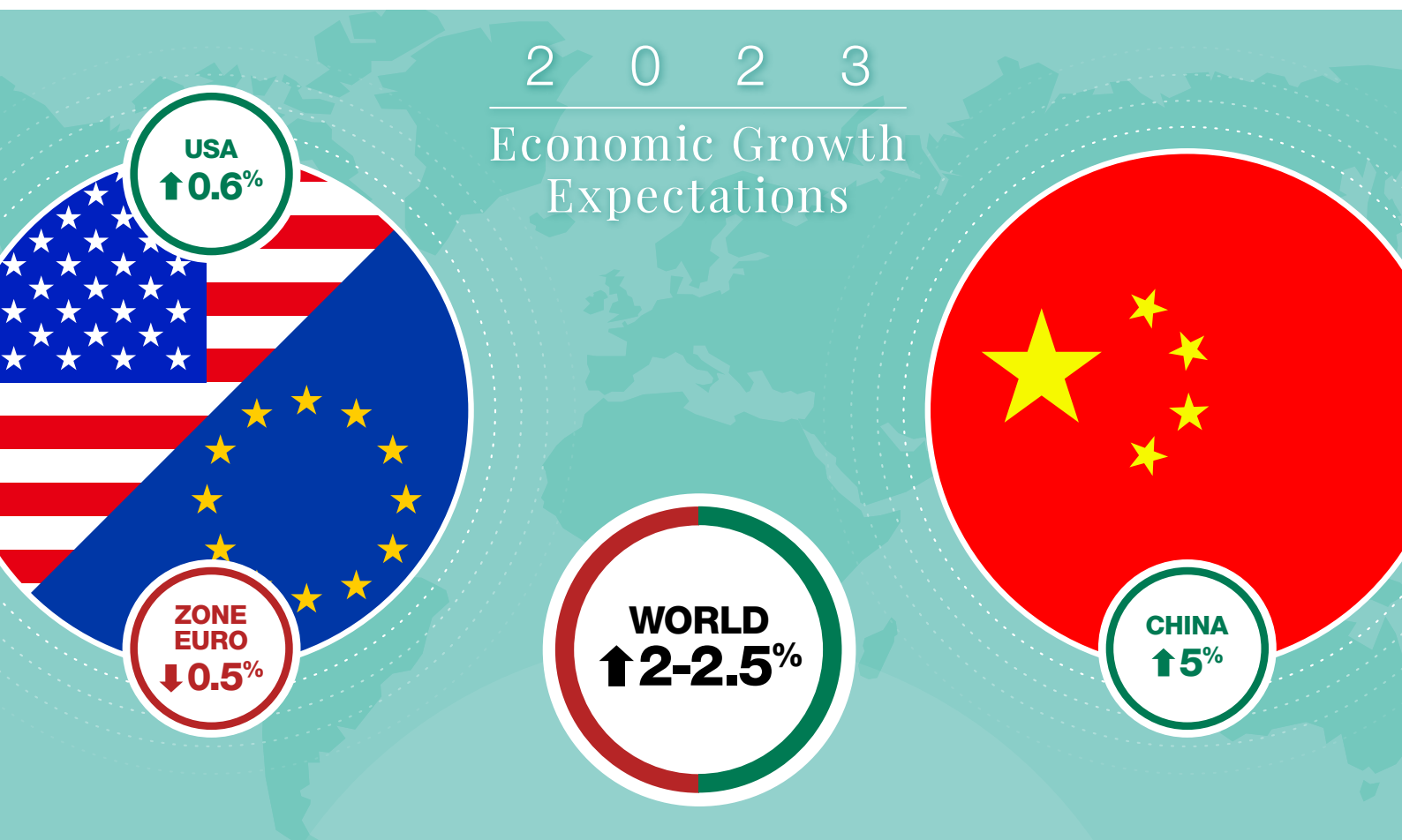
PUBLIC DEBT IN DEVELOPED COUNTRIES



Sources: OECD and UBP

Positive real interest rates are hampering the growth phase of the cycle.

The risk for developed countries is that renewed economic support measures could delay the paradigm shift and interfere with monetary policy, without raising potential growth. Fiscal



Positioning for modest USD weakness in 2023

After USD outperformance in 2022, several factors are set to converge in the first quarter of 2023 to trigger a depreciation in the US dollar against most currencies. The path of USD weakness is set to unfold in stages, starting with a drop against safe-haven currencies, generally an indication of a slowdown in global growth.

In 2022, the US dollar outperformed both advanced and emerging market currencies. The US Dollar Index rose by 15%, which made 2022 the best year for the greenback in nearly 40 years. Its rally had several causes including the Fed's aggressive rate-hiking cycle (see p. 8), higher front-end US bond yields and a strong safe-haven bid following the outbreak of the war in Ukraine. Energy prices also gave the dollar a boost: global oil and gas revenues surged from an average of USD 1.4 trillion in the 2015–19 period to a run rate of around USD 2.7 trillion in 2022, and most of these petrodollars were settled in USD and recycled into USD-denominated assets.

Coming into year-end, we think that there is a chance of continued USD appreciation, reflecting ongoing stresses in advanced economy bond markets and a substantial deterioration in liquidity conditions.

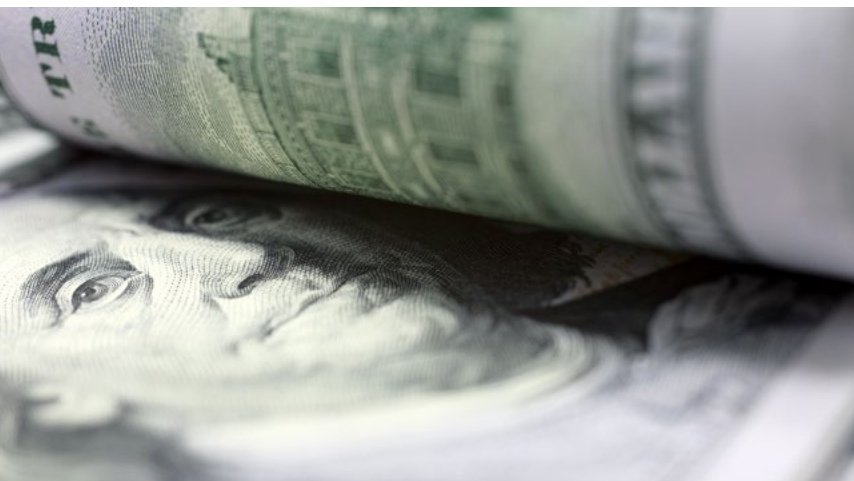
However, we believe that this will be short-lived and that by Q1 2023 the USD will see its one-way appreciation trend come to an end and trade with increasing two-way risks. The combination of a peak in Fed rate pricing, falling inflation, excessive valuations and a widening US current account deficit will slowly weigh on the dollar. Yet the path will not be linear – we expect the USD to weaken first against the likes of CHF, JPY and the main commodity currencies before it loses ground against the other major currencies – notably EUR and GBP.

Peak Fed rate pricing & narrowing rate spreads

Overnight index swaps (OIS) have priced in the Fed Funds rate getting to around 4.75% by Q1 2023, a level which markets seem to have adequately anticipated as US two-year yields are trading at around 4.50%. Given that both growth and inflation risks look skewed to the downside over the coming quarters, we do not expect market interest rates to rise beyond current levels. We also note that most of the other major central banks are set to continue raising rates over the coming quarters, meaning that the USD's interest rate advantage will narrow, causing the currency to drop.

Falling inflation

USD appreciation in 2022 reflected higher nominal interest rates in the US, which was a reaction to higher-than-expected inflation readings. Forward-looking inflation readings in the US and elsewhere have now started to decline. Freight costs have fallen materially, suggesting that Covid 19-related



supply bottlenecks are being unwound. Goods price inflation is also starting to wane, and if the labour market begins to slow in the US, then core inflation will inevitably soften over the coming quarters. These reduced inflation pressures will relieve appreciation pressure on the USD, particularly from Q1 onwards.

Excessive valuations

In 2022, the USD surged towards multi-decade highs both in trade-weighted and in real effective exchange rate (REER) terms. The greenback has also diverged significantly from bilateral fair-value estimates against all of the major currencies. Its incredibly elevated valuation profile implies that there is very little chance that it will appreciate much more, and that it is more likely to trade with two-way risks and weaken from current levels over the medium term.

USD weakness should begin against traditional safe-haven currencies.

The latest positioning data show that investors still maintain a sizeable long USD position. As US inflation and growth dynamics start to wane over the coming quarters, we anticipate that they will reduce them, resulting in modest USD weakness.

Current account deficit

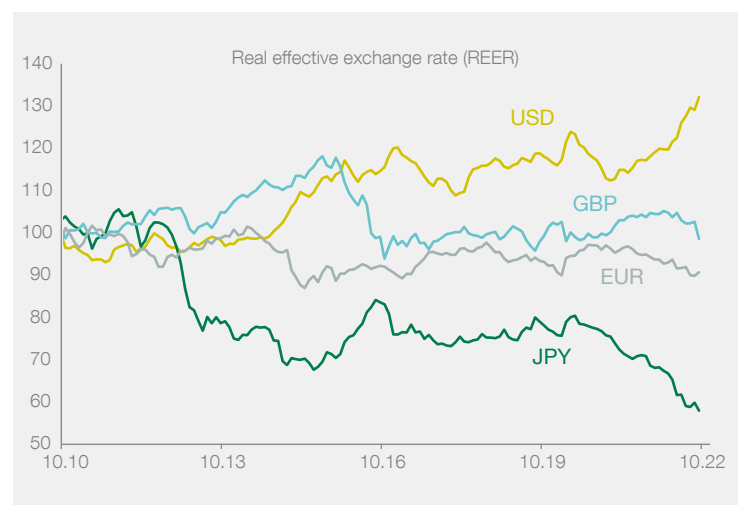
The USD's elevated valuation profile has led to a huge widening in the US current account deficit, which reached USD 1 trillion in 2022. Its current run rate points to a deficit of around USD 1.2 trillion by the end of the year – equivalent to over 5% of US GDP. This is a source of vulnerability for the USD, particularly once the Fed reaches an eventual plateau or pivot in its hiking cycle.

The expected path of USD weakness

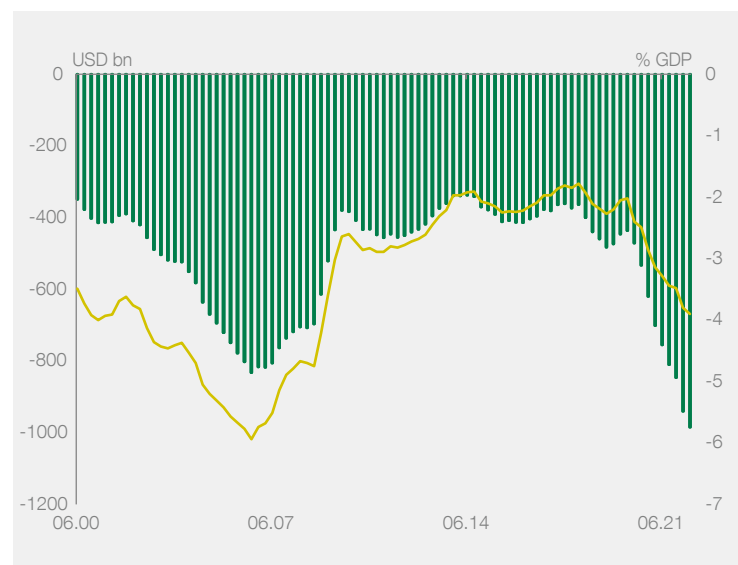
Coming into 2023, USD weakness is likely to first manifest itself against traditional safe-haven currencies, which is consistent with a deteriorating global growth profile. In this context, we expect downside in both USD/CHF and USD/JPY. The latter will also benefit from any change to the Bank of Japan's (BoJ) yield curve control (YCC) program. Once global growth appears to have troughed in Q1 2023, the dollar should weaken against traditional commodity currencies such as AUD and NZD, both of which will be boosted by any

cyclical pick-up in activity. Thereafter, USD weakness against the traditional major currencies will follow. The majors are unlikely to appreciate aggressively against the USD unless there is a material decline in energy prices – this is particularly pertinent to both the EUR and GBP – which have experienced a severe deterioration in their respective terms of trade in 2022.

USD SKY HIGH



US CURRENT ACCOUNT DEFICIT A VULNERABILITY



Stepping back into bonds

Falling inflation expectations and high absolute coupons are offering bond investors strong tailwinds for moderate fixed income returns in 2023 while an accelerating credit default cycle should create opportunities for distressed credit investors.

With 2022 bond markets set to close with the worst losses in 50 years, US bonds have unwound the total return performance they had built up since 2017 and reversed the sequential yield declines since the onset of the Global Financial Crisis of 2008–09.

However, the US monetary tightening that brought about the 2022 bond bear market has only driven inflation expectations to the upper end of the pre-pandemic range, suggesting that policy may remain tight to fight inflation until expectations fall below the Fed's 2–2.5% target (see p. 8).



US Treasuries and US corporates are offering the highest yields since 2006–2007.

Fortunately, the sharp back-up in Treasury yields in 2022 leaves five-year yields, adjusted for inflation expectations, near the high end of their pre-GFC range. This suggests that opportunities to shift from shorter-dated floating-rate bonds to longer-dated bonds should begin to emerge in the new year when five- and ten-year Treasury yields are between 4% and 4.5%.

For euro investors, the ECB will need to balance policy tightness against recession risk, likely

keeping Bund yields high, near 2–2.5% until inflation breaks decisively lower.

Whereas interest rate risk was the main drag on returns in 2022, we expect deteriorating credit quality and widening spreads to pose the key risk in 2023. Indeed, historically, deterioration in credit quality has accelerated over three to four quarters following the Fed's first rate hike, which is therefore the pattern investors should expect into the new year.

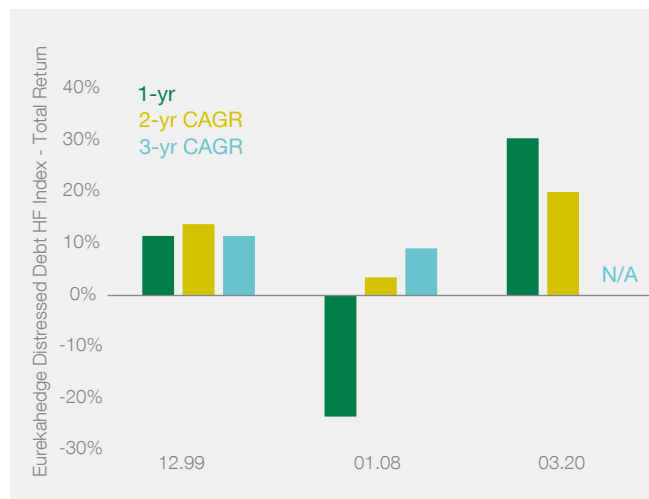
Fortunately, the low coupons offered by US Treasuries and corporates in the past decade, which provided little shelter against credit quality deterioration, have given way to the highest yields since 2006–07. We therefore believe that a hold-to-maturity, quality-focused US dollar credit strategy can provide attractive opportunities in early 2023 as the market shifts its focus from inflation to recession risks.

An opportunity may also develop in riskier segments of the credit markets, with the highest yields breaching 10% as we approach year end. However, with spreads only near historical averages, we would like to see risky bonds better price in a default cycle ahead, to tilt the risk–reward balance more decidedly in favour of investors.

While stabilising Bund yields and spreads – which are nearing their 2020 wides – should normally create an opportunity for euro bond investors, structural challenges are facing the euro area. These include a new regime of high energy costs as well as a reliance among both corporates and households on fiscal support, at least through the winter and potentially beyond. This, in turn, raises the tail risk of a wave of defaults that could be more than cyclical in nature.

As a result, proactive credit selection, a key driver to performance in normal cyclical slowdowns, will be even more critical in 2023 in the eurozone as it navigates its ongoing transformation. Investors able to take a medium-term perspective can look to distressed credit

HY BOND YIELDS SUPPORT DISTRESSED DEBT



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

investing (see box) to seek to capitalise on the potential challenges of such a credit cycle.

Overall, while the clouds have not fully cleared for bond investors following a tumultuous 2022, falling inflation expectations and high absolute coupons are converging to offer them opportunities for moderate returns in 2023.

Distressed credit investing: An opportunity amidst economic turmoil

After an extended period of low interest rates, high and rising corporate valuations, and easy access to credit, debt has once again built up after the shock and deleveraging that followed the Global Financial Crisis more than a decade ago.

Indeed, the global pandemic has made this debt build-up more protracted as government fiscal programmes have sought to buy time for borrowers affected by lockdowns and the disruptions that ensued. Central banks facilitated this by driving interest rates to all-time lows around the world, easing pressure on households and corporates alike while at the same time creating, in many cases, simply the illusion of debt sustainability.

Now, however, with the most intense inflationary pressures in a generation, companies in Europe, Asia and even the United States are beginning to experience growing levels of financial stress. Having been left overleveraged as a result of

the multiple shocks and subsequent policy responses, they are now faced with the cost of borrowing repricing to levels not seen in more than a decade.

Indeed, companies in Europe are also being buffeted by the ongoing energy crisis and their counterparts in Asia are having to manage amidst the slowest economic growth in China since its reopening more than forty years ago. As a result, the pressure on heavily leveraged corporates is more multi-faceted than in previous cycles. This has given rise to a growing number of 'zombie' companies, or companies whose operating profits are no longer sufficient to service their heavy debt burdens.

Having endured the rising interest rates and widened credit spreads of 2022, investors could capitalise upon the troughing and rising default rates in the year ahead kicking off the sixth distressed debt cycle in the past 25 years. This should provide opportunities for distressed debt investors as the cycle matures.

Finding opportunities in an inflationary world

High inflation episodes have been challenging for investors since 1900. Lessons from past occurrences have shown investment strategies capitalising on cyclical peaks in inflation, targeting the re-allocation of spending within the economy, and income-oriented strategies to enhance total returns.

With inflation in Western economies reaching levels not seen in a generation, investors can draw on history to incorporate several investing strategies as a way of coping with this new high-price regime.

Strategy 1: Treat high but falling inflation as a tactical opportunity

Since 1900, the US has experienced three episodes of inflation over 5% – 1916–1921, 1945–1951, and

the Great Inflation of the 1970s – just as is taking shape in late 2022.

When inflation has been high and rising, US equity investors have earned an average of 6% over the following 12 months, though lagging behind the nearly 10% average inflation during these episodes. Admittedly, nearly one third of the time investors lost money amidst high and rising inflation, with drawdowns averaging -14%.

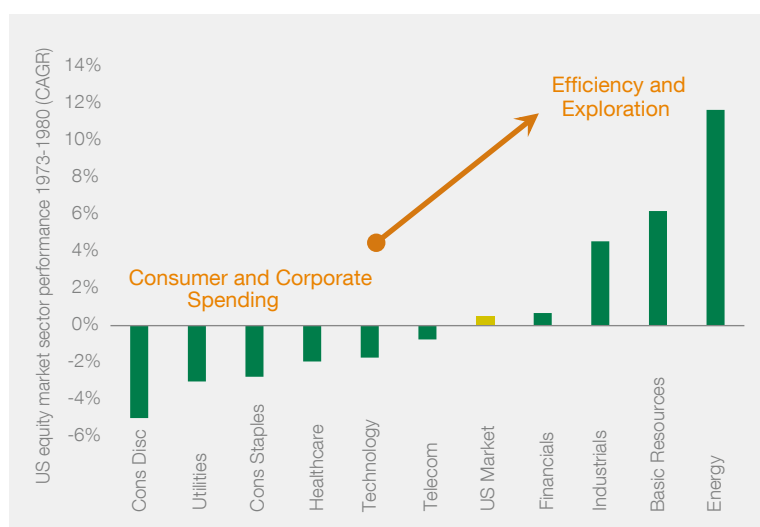
However, once inflation peaks cyclically and begins to fall, even from elevated levels, the risk–reward profile changes. In high but falling inflation periods, returns rise to an average of 9.3%, in excess of the 8% average inflation during these episodes. Furthermore, drawdowns have averaged 7.6% overall since 1900, which is modest compared to those in high and rising inflation periods.

Strategy 2: Focus on profits resulting from forced reallocation of spending

Investors will recall that the S&P 500 delivered less than 1% CAGR returns before dividends from early 1973 to the end of 1980, the height of the 1970s Great Inflation.

As inflation and the high nominal GDP growth should have translated into higher earnings for companies, the poor overall performance of US equities during that period can be attributed to the key impact of

OPPORTUNITIES FROM REALLOCATION OF SPENDING IN RESPONSE TO INFLATION



Sources: Datastream and UBP

inflation on consumers' and corporates' reallocation of spending within the economy.

This shifting of spending drove a wide dispersion of performance within the US equity market, with seven of the ten Datastream sectors delivering negative returns and only three positive – industrials, basic materials, and energy, the latter delivering nearly 12% per annum over the period.

Though high energy prices themselves likely account for some of this outperformance, the focus on seeking new energy sources, energy efficiency, and self-sufficiency amidst the 1970s energy shock meant that capital investment and tax incentives focused capital spending on a concentrated group of sectors, much like today (see p. 20).

High but falling inflation meant 9.3% equity returns, more than average inflation during these periods.

Strategy 3: Shift to dividends and income as a key driver of total returns

Though seeking tactical opportunities as inflation inevitably peaks and targeting the reallocation of spending/investment during inflation episodes can be valuable, longer-term investors likewise can increase focus on income-oriented returns.

Looking back at the three inflationary episodes since 1900, data from Professor Robert Shiller at Yale University indicates that dividends accounted for substantially all of the returns in 1916–21 (as the S&P fell sharply). From 1942 to 1949, it was a more modest 30%, while in the 1970s the proportion was 66%. In comparison, during the 2011–2021 decade, investors earned only 16% of their total returns from dividends.

Moreover, the high volatility that has accompanied inflation since the early 2000s can likewise provide income opportunities for equity investors. Indeed, market conditions in late 2022 are opening windows in structured product strategies with yields close to those seen in US high-yield bonds.



Opportunity amidst uncertainty

While investors can navigate within the equity universe to adapt to the challenging environment in 2023 (see p. 14), three tailwinds have developed to allow hedge funds to offer investors an alternative for delivering returns.

Admittedly, hedge funds have underperformed global equities since the end of the 2008–09 Global Financial Crisis. This has been driven by the zero interest rate regimes pursued by global central banks which not only suppressed volatility across asset classes, but also limited the spread of performance between individual securities within asset classes, effectively limiting return opportunities available to active hedge fund managers.

These headwinds are likely to fade before the end of 2022 as the high inflation, even if it recedes in 2023, has effectively ended the zero interest rate regimes in the US and Europe. This will generate interest income on hedge fund managers' substantial pools of liquidity, rather than the near zero percent returns they have been earning since 2009.

This new interest rate backdrop has already seen fixed income and foreign exchange volatility move to levels not seen in over a decade, joining the elevated equity volatility that has been prevailing since the pandemic. This volatility across and within asset classes also creates return opportunities for active hedge fund strategies that have not been available in over a decade.

Lastly, according to Standard & Poor's, dispersion in performance among global equities (and in the US in particular) is near the highest level since 2007, suggesting that stock-picking acumen should be rewarded more handsomely than at any time since before the Global Financial Crisis.

Thus, with returns in global equities likely challenged amidst a weak earnings backdrop, the return of three key profit drivers for the hedge fund asset class in 2023 offers investors a complementary investment both to navigate the uncertainty ahead and to secure returns in 2023.

Navigating the transition to Common Prosperity

Investors must adopt a new investing paradigm in China focused not only on cyclical prospects ahead but also on the shifting corporate governance and geopolitical landscape.

The 20th Communist Party Congress in October 2022 formally heralded a new era of “Common Prosperity” as China, the world’s second-largest economy, seeks a fundamentally new growth model.

Cyclically, China will shift its focus to the quality rather than the quantity or overall pace of growth, likely shifting the emphasis away from the GDP growth targets that have been a visible part of its economic planning process for decades.

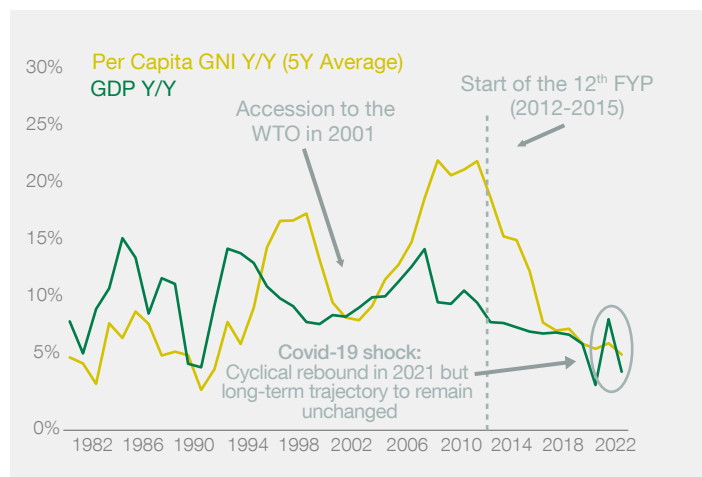
This situation is not sustainable and has prompted authorities to implement targeted stimulus to boost activity and the housing sector. Continued, though incremental, policy support and a gradual re-opening should allow economic growth momentum in China to improve steadily in 2023 just as it did in Europe in 2021.

The People’s Bank of China is expected to be the only major central bank to continue policy easing in early 2023, against an unprecedented pace of tightening elsewhere. Fiscal measures announced in August 2022 will also start to encourage economic activity, allowing for a more stable cyclical foundation for the Chinese economy in the new year.

The US CHIPS Act is the first salvo in a rising economic conflict between the US and China.

While explicit growth targets will fade, we do expect an implicit growth floor near 4.0% per annum to avoid social instability and structural vulnerabilities, which makes the current rate too slow. The Chinese economy decelerated sharply in 2022, weighed down by the “Dynamic Zero-Covid” policy, which left domestic consumption persistently weak, urban unemployment soaring to 5.5%, and the housing sector contracting by 30%.

CHINA: ECONOMY FACES NEW GROWTH TREND



Sources: World Bank and UBP

The slowdown is consistent with an enduring structural trend that started in 2012, a growing reliance on households to boost domestic consumption as the next driver of growth, drawing upon China's 46% household savings rate, the second-highest in the world. The composition of Chinese consumption will evolve towards higher quality and themes that tap China's regional disparities, with sectors such as hospitality, consumer discretionary and consumer durables set to benefit.

The passenger vehicle market highlights such a realignment of regional disparities. Penetration rates remain low in China's less affluent tier-2 and tier-3 cities, in which Common Prosperity policies are therefore focused on promoting electric vehicles (EVs). Nearly one in every four new passenger cars sold has been a new energy vehicle in 2022. The strategic push for EVs also realises a wider set of objectives under the Common Prosperity regime. It allows the country to make progress on cutting back carbon emissions while at the same time reducing its reliance on fuel oil imports, increasing its global competitiveness, building a national energy storage system, and preparing for intelligent mobility.

Indeed, China has become the largest EV market and exporter in the world, with a fully vertically integrated EV and battery supply chain. It has the largest production capacity for EV lithium-ion batteries, accounting for 70% of global capacity in 2021. Large battery companies have established technical barriers, cost advantages, and close cooperation with the world's leading new-energy automakers, and are well positioned to benefit from the global expansion of EV demand.

With cyclical support for growth ahead, investors will still require a new risk premium for investing in the growth sectors of the past. Recall, among the earliest casualties of the Common

Prosperity era in China were the large technology "platform" companies, at the hands of new and intrusive regulations. Such scrutiny was instigated in order to address the new domestic security architecture as well as to better serve the needs of the Common Prosperity objectives.

As a result, consumer-tech companies in e-commerce, local online services, digital entertainment, and social media have entered a new operating paradigm where pursuing growth at all costs is no longer tolerated. This new landscape will challenge large incumbents to deploy capital in a more targeted and efficient manner, even as firms grapple with the higher costs of regulatory compliance and increased expectations of corporate social responsibility.

Recent moves to return capital to shareholders are encouraging. However, investors should not underestimate the prospect of steeper costs for private companies to achieve broader Common Prosperity objectives in the future, as well as the long-cycle constraints those costs may bring for shareholders as the new growth model takes shape.

Beyond this, while cyclical factors grow supportive in China, the reshaping of global supply chains and of the geopolitical order looks set to put up new barriers for China investors. Indeed, the passing of the US CHIPS Act, which seeks to contain China's ambitions in high technology sectors, likely represents the first salvo in this stage of a deepening rivalry between the world's largest economies (see p. 24).

Overall, while cyclical tailwinds have emerged, investors will eventually have to contend with corporate governance and geopolitical hurdles requiring them to adopt a new investing paradigm in the world's second-largest economy.



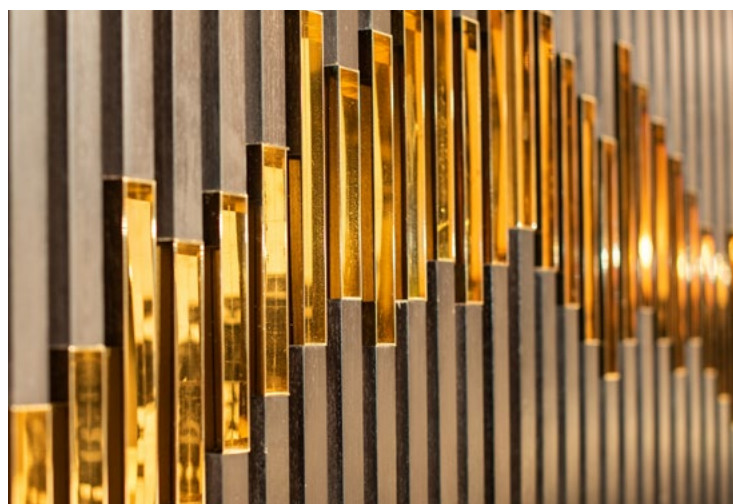
Precious metals: A mixed outlook

We anticipate that both gold and silver will grind higher in 2023, reflecting a combination of modest USD weakness, an apparent peak in real interest rates and increasing consumer demand. The outlook for platinum and palladium is mixed amidst the switch to battery-powered electric vehicles.

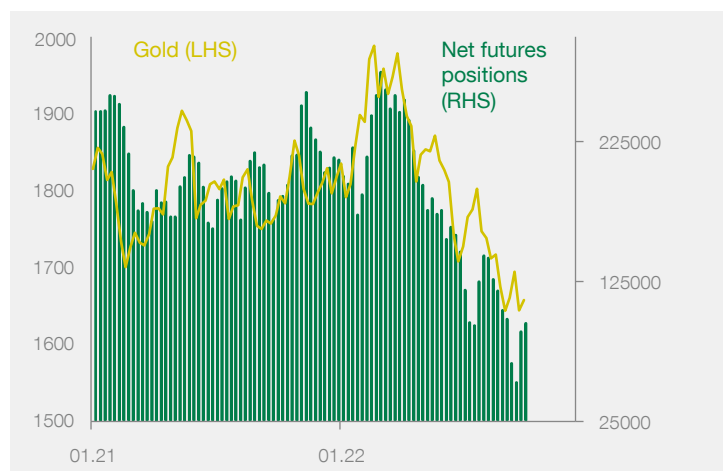
Gold: Modest upside

In 2022, the gold price has defied consensus expectations as it struggled to rise, despite increasing inflation pressures and high levels of geopolitical tension. There were three reasons for gold's disappointing performance. Firstly, rising front-end interest rates in both advanced and emerging-market economies increased the opportunity cost of holding gold. Secondly, those higher interest rates pushed up longer-term real rate expectations, with which gold has a long-standing inverse relationship. So as real rates have risen throughout 2022, this has put further downside pressure on the gold price. Thirdly, medium-term inflation expectations have drifted lower throughout the year, reflecting investors' belief that rate hikes and slowing growth will restrict inflation. Gold's disappointing performance has led investors to reduce allocations steadily during the year, further weighing on the price.

Coming into 2023, we anticipate that the gold price will rise slowly. We think that US real rate expectations have peaked, and as they decline gradually, this will result in upside pressure on gold. This trend will benefit from modest USD weakness – typically, a 1% decline in the US Dollar Index is consistent with a USD 7 per ounce rise in the gold price. The combination of both factors will enable gold to rise to levels of around USD 1,800 per ounce by year end. This is consistent with our estimates of gold's fair value, which we put at



INVESTORS REDUCED GOLD POSITIONS IN 2022



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



SILVER HISTORICALLY CHEAP RELATIVE TO GOLD

around USD 1,900 per ounce. Investor positions are currently limited, which will also support gold's rise, since marginal buyers will have a positive impact on prices.

Silver: High beta will kick in

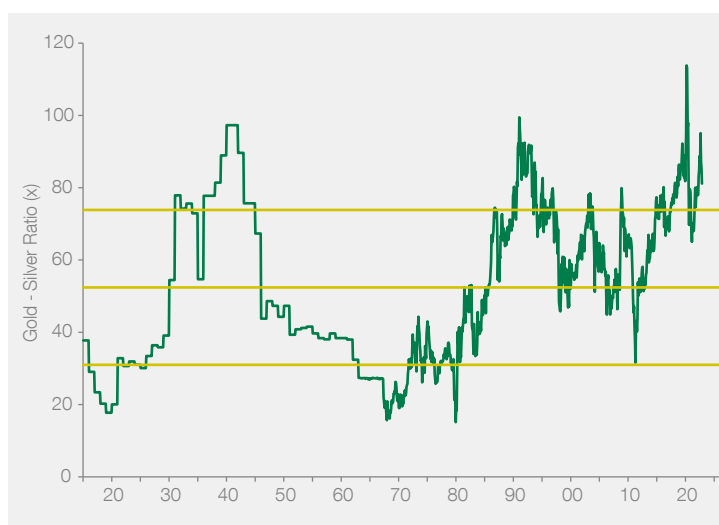
We anticipate that silver will rise over the course of 2023, which is a big shift from our previous expectation of a modest decline. There are several reasons for our change of view.

Firstly, as gold rises back to levels of around USD 1,800 per ounce, silver's traditional high beta to gold will kick in, and this will drag silver higher. The gold-silver ratio is in line with historical averages, suggesting that silver is neither over- nor undervalued. Consequently, we think that gold's rise will also lead to upside pressure on silver.

Secondly, we think that most if not all of the bad news on the manufacturing and industrial production side has been priced in, meaning that we are unlikely to see major downside below current levels. Most PMI and industrial surveys are close to crisis levels, indicating that pricing pressure is already depressed. It will not take much for these circumstances to change. Thirdly, we note that investor positioning is at multi-year lows, both in the CFTC and COMEX futures markets, suggesting that investors are underinvested in a wider sense. The implication is that even modest buying interest will give a material boost to prices. We think that a rise to around USD 22 or even USD 24 per ounce is feasible over the course of the year.

Platinum: Constructive outlook

As we approach 2023, we anticipate that platinum will follow the broader trend in both gold and silver. We are unlikely to see any big upward moves given that auto production remains subdued and there is an expectation of a wider economic contraction. The positive longer-term outlook remains in place, due to declining supply and increasing demand, particularly as substitution effects with palladium increase. We believe that a move back towards levels of around USD 1,100 per ounce is feasible, but major upside beyond these levels is less likely.



Sources: Bloomberg Finance L.P., macro trends.net and UBP

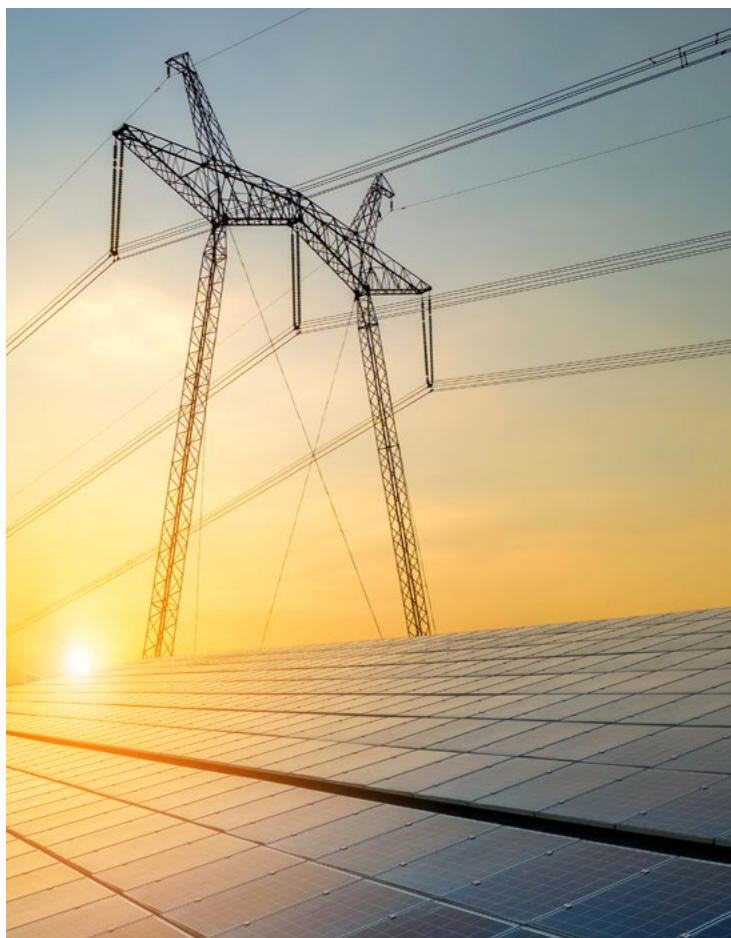
**Investor positions
are currently limited,
which will also
support gold's rise.**

Palladium: Longer-term decline

The longer-term outlook for palladium is crystal-clear: decreasing demand due to the shift towards battery-powered electric vehicles against a backdrop of growing supply suggests that prices have room to fall back to levels of around USD 1,600 per ounce. However, in the short term there are clear supply risks due to the Russian sanctions regime, since 60% of global supply comes from Russia. Consequently, investors should expect a large decline, albeit with the potential for volatile upside moves as markets react to developments in the broader Ukraine-Russia war.

Themes for a changing global paradigm

The investments that laid the foundations for globalisation in the 1990s are in the process of being reshaped as supply chains localise and climate pressures build, giving rise to similar long-cycle investment opportunities to those globalisation itself spurred in the 1990s.



Though peak globalisation likely occurred as much as a decade ago, the Trump trade wars, the pandemic, and Russia's 2022 invasion of Ukraine have served to accelerate the shift from a "just-in-time" to an increasingly "just-in-case" global economy.

In the transition to this new global paradigm, the investments that established the infrastructure for globalisation in the 1990s are in the process of being reshaped, creating not only increasing inflation and instability, but also giving rise to long-cycle investment opportunities similar to those globalisation itself spurred in the 1990s.

The global energy transition: Keeping the lights on

At the root of the global economy as we know it was the global energy market that took shape following the fall of the Soviet Union in 1989, which brought low-cost Russian energy and broader commodity exports to feed global factories.

Russia's 2022 invasion of Ukraine and the associated sanctions have disrupted and potentially broken this model, leaving the world, and Europe in particular, challenged to meet energy demand in the near term without locking in inefficient energy sources and technologies for the long term.

As a result, coal and oil are making a comeback, benefiting energy-exporting nations and companies to the detriment of energy consumers.

The global energy market disruption is leading to major policy responses to drive the energy transition.

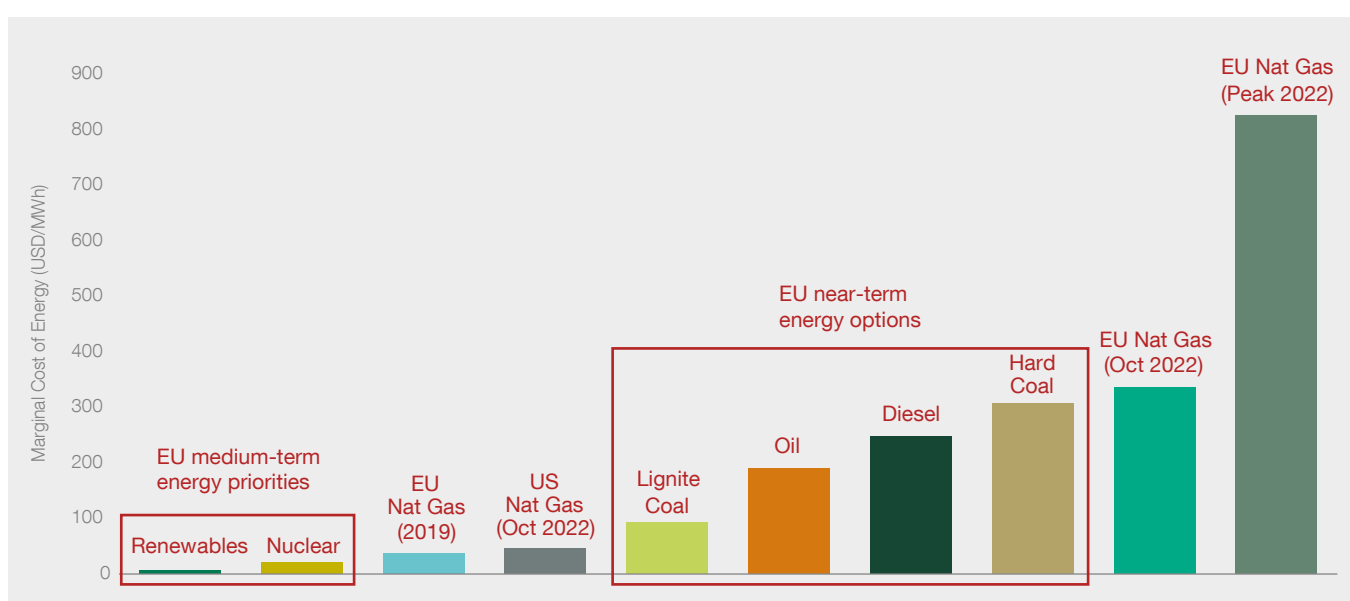
Strategically, this is leading to major policy responses to drive the energy transition, even in the US, which has been a laggard in renewables initiatives. However, even for

governments with ambitious plans, a number of challenges must be tackled:

- Supply chains and engineering are insufficiently scaled, resulting in losses and limiting investment
- Regulatory impediments to deployment which, for example, can reach 10–12 years in France, are too long
- The need to deal with rate increases and their impact on both consumers and investments is holding up progress

In the near term, ultimately the world is short of energy and so exposure to energy supplies appears structurally important. High prices and inadequate supply have moved governments to take immediate action to increase energy security and independence rather than simply aiming to meet long-term climate objectives. They have therefore started implementing stimulus measures and scaling up

EUROPE'S HIGH POWER COSTS REMAIN A COMPETITIVE CHALLENGE



Source: UBP

infrastructure, as well as applying administrative pressure to lift regulatory obstacles and change pricing, household support and corporate tax frameworks.

Infrastructure investing: Building a more efficient foundation for the future

While expanding supply will be important for increasing energy security and independence, energy efficiency will likewise be a critical feature in the global energy transition.

Governments throughout Europe are seeking to upgrade and electrify their public transportation networks, while looking to invest in decarbonising industrial sectors, including aviation and freight.

Traditional/renewable energy, infrastructure, and food are opportunities arising from deglobalisation.

The US has already budgeted for an expansion of electric vehicle (EV) charging networks to support the growth of this segment. However, the greater focus of efficiency efforts there has been on older stocks of transportation assets, especially in aviation. The redevelopment of airport hubs across the US alone is estimated to offer a USD 100 billion infrastructure investment opportunity.

Indeed, in order to achieve the goals of the Paris Agreement, the IPCC Working Group estimates that as much as USD 500 billion per year in low-carbon and energy-efficiency infrastructure spending will be required.

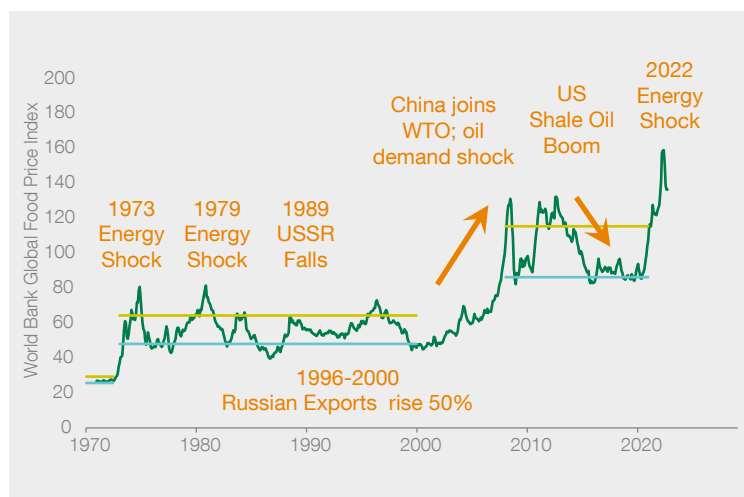
With government budgets already bloated from the pandemic-related support, the growth in private funding for replacing previously government-built and -owned infrastructure has become the only alternative to address the energy and security crises, creating an opportunity for investors in the years ahead.

Global food supply disruption: From soil to supermarket

Just as the inefficiency of infrastructure has been exposed by the energy crisis, a worldwide food crisis is also evolving as a result. As much as 50% of farming costs in the US are tied to energy prices, from fertilisers needed for raising crop yields to fuel for farming, processing, or transporting production. Meanwhile, biofuels are also being turned to as a remedy not only for climate change but also for conventional fuel shortages.

Climate change has aggravated not only the energy crisis as drought has impaired hydroelectric generation plants and the transport of fuel via barge, but also the ongoing food supply disruption by impacting harvests around the world.

HIGH ENERGY PRICES LEAD TO HIGH FOOD PRICES



Sources: World Bank and UBP

Though the global food sector has experienced periodic droughts previously, the CEO of Bunge, a leading global agribusiness company, notes that it will take nearly two years of strong harvests to rebalance the market and normalise prices.

Increasing spending to support fertiliser manufacturers and seed technology providers will be critical to restoring a sustainable global food equilibrium.

However, the energy crisis itself is an impediment to a return of strong harvests. With fertilisers coming at a high cost and, in some cases, being unavailable (as Russia and also-sanctioned Belarus are major global suppliers), their use has already declined in 2022, putting 2023 crop yields at risk.

Thus, while energy and infrastructure may be the most direct and visible beneficiaries of the energy shock arising from deglobalisation, increasing spending to support fertiliser manufacturers and seed technology providers will be critical to restoring a sustainable global food equilibrium and should provide investment opportunities in the era that lies ahead.



Deglobalisation risks on the rise

Economically, a pivot towards positive inflation-adjusted interest rates raises debt sustainability risks amidst historically high debt-to-GDP ratios. Meanwhile, the reshaping of global supply chains could turn into outright deglobalisation as tensions rise between China and the US.

The dawn of the 21st century coincided with China's accession to the World Trade Organization, giving Western economies their first taste of deflation.

These shocks brought both inflation and interest rates steadily lower around the world as China's low-cost production followed on from the low-cost raw materials that had entered the global economy a decade earlier with the fall of the Soviet Union and Russia's arrival as the world's pre-eminent commodity exporter (see p. 20).

The Trump trade wars of 2017–18 began unravelling this equilibrium, as the US's reliability

as the primary customer of the world's largest manufacturer – China – came into question for the first time. These issues were exacerbated by the global pandemic that followed, forcing countries around the world to prioritise reliability and security of supplies over their cost.

And just as Russia kicked off the globalisation of the raw materials supply chain in the 1990s, its invasions of Ukraine – first in 2014 and then again in 2022 – have caused this focus on reliability and security to be applied to the entire global supply chain.

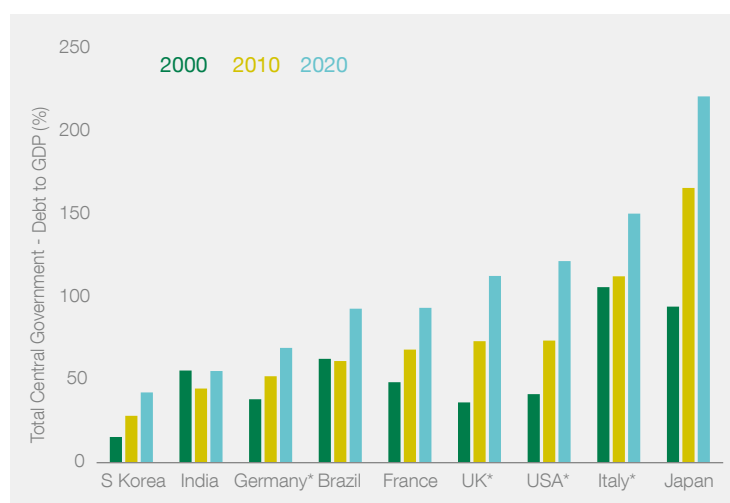
These shocks have produced an array of risks that investors have not faced in a generation. Central among them in economic terms is the inflation that has resulted, along with the rising yields and the pivot away from negative inflation-adjusted interest rates aimed at combating rising prices.

For investors, the biggest risk stemming from the re-emergence of high inflation and the prospect of sustained positive real interest rates relates to the debt that has built up as interest rates have fallen over the past 15 years.

Indeed, according to the IMF, the world's largest economies have seen central government debt-to-GDP ratios increase sharply over the past 10–20 years, from below 50% of GDP in most cases to above 100% almost across the board in 2020–21.

However, even though a select few nations have seen deleveraging in the private sector over the past decade, the world's largest developed economies all have total debt equal to 150–500% of GDP according to the IMF.

50% GOVERNMENT DEBT RISE
IN LARGEST COUNTRIES SINCE 2010...



Sources: International Monetary Fund, Bloomberg Finance L.P., and UBP
*Data is for end-2021

Accordingly, if interest rates stay close to late-2022 levels around the world, debt-servicing costs for these governments may prove increasingly challenging, forcing some combination of fiscal austerity, tax increases and yield-curve control policies.

Unless governments choose and markets accept yield-curve control frameworks such as that adopted in Japan, the rising interest burden associated with the current debt levels raises the prospect of fiscal authorities being prevented from spending in the face of an economic slowdown, such as the one currently taking shape (see p. 6–9). This would create the risk of deeper, more prolonged slowdowns.

Geopolitically, the reshaping of global supply chains could turn into outright deglobalisation, driven primarily by rising tensions between the world's two largest economies in the world: China and the US.

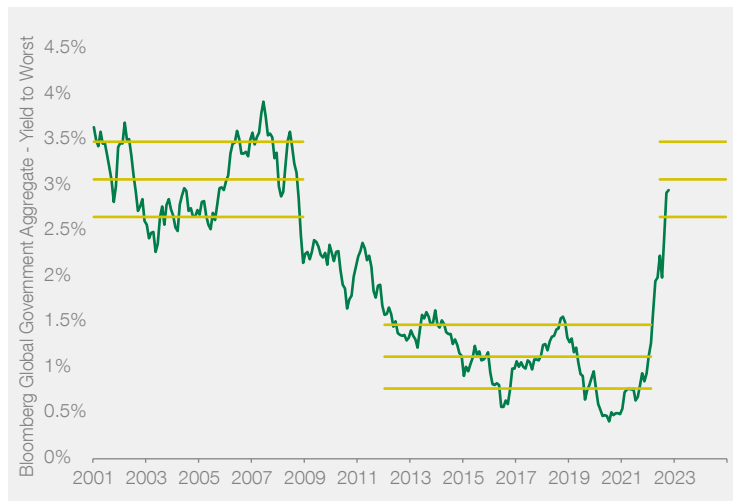
Interest rates last seen a decade ago leave governments constrained as economies slow.

Though US–China tensions have been running high since Donald Trump weaponised trade in 2017–18, the 45th American president's departure from office has not eased the strain between the two nations.

Instead, President Biden has maintained the tariffs implemented under his predecessor and has begun forging alliances in East and South Asia in a more overt effort to contain a rising China.



...AND 6X INCREASE IN GOVERNMENT BOND YIELDS SINCE 2020



Sources: Bloomberg Finance L.P. and UBP

And while most of the world's attention has focused on the prospect of China's using force against Taiwan in view of Russia's 2022 hostilities against its neighbour, the US CHIPS Act – Which became law in August 2022 – highlights an already rising risk of economic conflict between the nations.

Indeed, the CHIPS Act follows through on threats originally made under the Trump administration to limit China's access to American intellectual property, especially within the high-tech sector. It therefore presents a direct challenge to Chinese President Xi Jinping's aim to "join the ranks of the world's most innovative countries, with great self-reliance and strength in science and technology", outlined most recently at the October 2022 Communist Party Congress.

This is in line with the hints given by the US, as the Trump trade wars came to a close in 2019, that the next stage of the battle between these nations would be fought on global technological and financial terrain, given China's reliance on the USD- funding for its economy.

As a result, a US conflict with China may or may not result in outright hostilities over Taiwan. However, some aspects of the ongoing tension could worsen the economic situation – via trade, intellectual property and potentially USD funding – and could be as disruptive as the economic war that has erupted alongside Russia's battle with the West over Ukraine.

Overall, deglobalisation risks, whether economic or geopolitical, pose a significant threat to the frameworks that have guided the worldwide economy and global investors since the 1990s. With these risks continuing to build on the horizon, proactive and dynamic risk management approaches will be necessary for clients in 2023.



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 15 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 and one in Law & Economics from the University of Bologna.

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