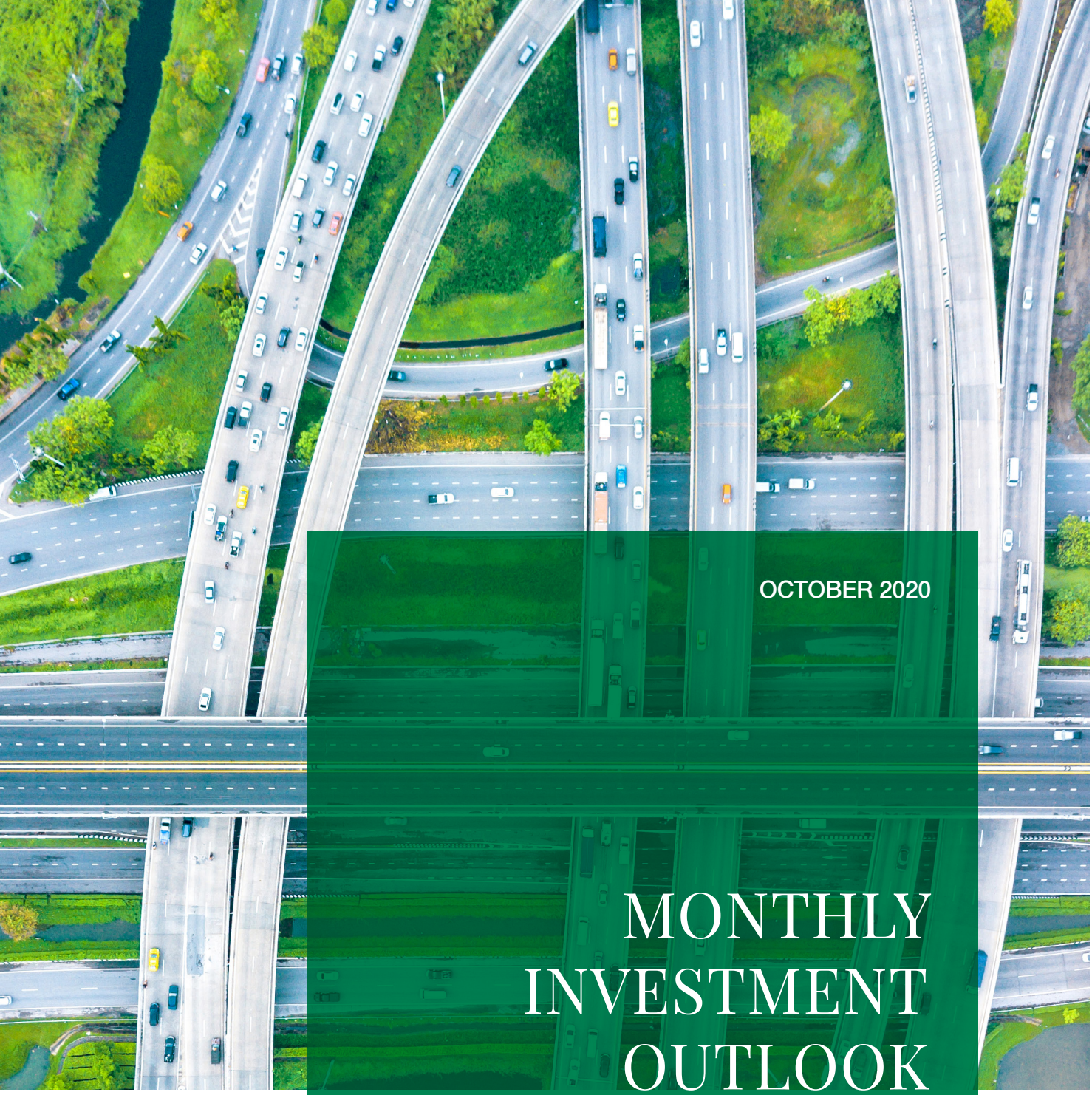


OCTOBER 2020

MONTHLY INVESTMENT OUTLOOK

UBP

UNION BANCAIRE PRIVÉE

MONTHLY INVESTMENT OUTLOOK

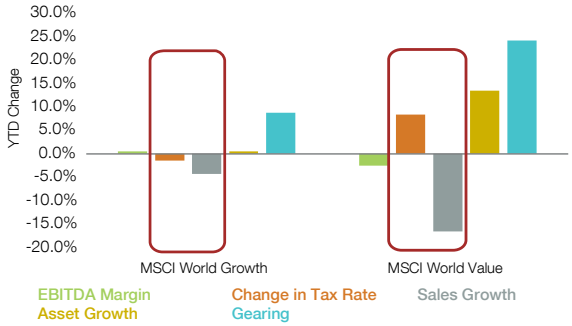
DISCRETION IS THE BETTER PART OF VALOR

- September saw risk assets succumb to their first bout of sustained selling with equities registering their first monthly loss and credit seeing spreads widening steadily for the first time since the March lockdown related lows.
- Selling came along with a rocky transition from central bank led policy support to still reluctant fiscal policy momentum in the face of political distractions on both sides of the Atlantic. Absent this support, investors should position for the prospect of further two-way risk in 4Q.
- However, 3Q corporate earnings visibility is high as improving economic momentum in the period combined with conservative expectations suggest another bout of upside earnings surprises is likely in the weeks ahead.
- Looking into 2021, the new year holds the prospect for increased economic visibility as the multi-trillion in fiscal spending gains traction in US/Europe though 2021 earnings visibility may become more clouded as expectations appear elevated even assuming an increased US tax burden does not emerge post-election.
- We continue to pair our long-cycle transformational growth positioning – focusing on technology, healthcare, and Asia/ China – across the portfolio with an increased focus on risk management entering 4Q. While the valuation gap versus value stocks remains wide, without a revenue/ earnings catalyst, we suspect this gap will remain intact.
- Further policy easing combined with an expected strengthening in the Chinese yuan leaves Chinese government bonds an attractive opportunity for income investors. This complements our recent additions to Asian investment grade credit as well as local Chinese A-share equities for Asian transformation looking ahead.
- Moreover, this continues a transformation of our fixed income exposure where we have sought positions that protect against the negatively asymmetric risk-return profile in the low risk bond space via European CoCos, long-short credit, and recent positions in Asian credit.
- Having already extended our protection to cover the 4Q political uncertainty on the horizon, we have increased the overall level of protection via a new futures position in portfolios. This should shield the strong returns garnered to date as the backdrop of sidelined policy makers pose a potential near-term risk looking through year-end. At the same time, we rotate our on-going options strategies to retain upside participation should the political risks not manifest or should policy makers shift to a more pro-active stance.

A failed handoff from monetary to fiscal policy makers drove the September sell-off

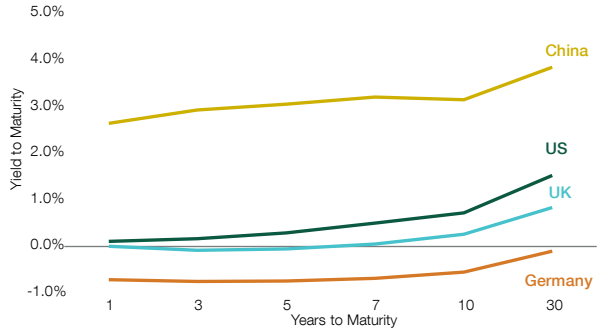
Sources: Standard & Poors, Bloomberg Finance and UBP

Fiscal stimulus/tax changes needed to tur the tide against transformational growth themes



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

China government bonds offer an attractive opportunity for income-oriented investors



Sources: Bloomberg Finance L.P. and UBP

GLOBAL TACTICAL ASSET ALLOCATION

STAY INVESTED IN A RISK MANAGED WAY

Global economy / Asset allocation

- After a strong rebound in Q3, global growth faces renewed near-term headwinds due to rising COVID cases, new local lockdowns in Europe, uncertainties on US politics and lack of new policy initiatives.
- Manufacturing and services recoveries are diverging manufacturing activity continuing apace while services sectors show renewed weaknesses. We expect the global recovery to remain intact, driven by sustained momentum in China, Germany and the US in 2021.
- Policy momentum entered a lull as it transitions from 2Q crisis management responses to more deliberate, fiscally-driven policies expected in 2021. Leaving increased two-way risk in markets.
- With economic clarity though earnings uncertainty in 2021 combined with near-term political uncertainty in the US and Europe, we continue to suggest investors stay invested in secular transformation themes with an active risk overlay.

Fixed income

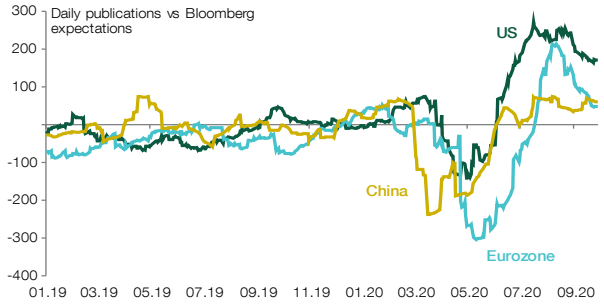
- We continue to transform our fixed income exposure where we have sought positions that protect against the negatively asymmetric risk-return profile among low risk bonds.
- For USD-referenced investors, we have increasingly found opportunities outside the US. European CoCo's offer yields comparable to high-yield credit with an implicit ECB backstop, providing an attractive risk-reward profile for investors.
- The premium yields offered by Chinese government debt combined with the prospect of FX strengthening complements our recent additions to Asian investment grade credit.

Equities/ Alternatives

- We continue to focus on medium-term recovery and transformation themes. With the Chinese economy moving into the sweet spot of its recovery phase, attractive risk reward opportunities have emerged in as domestic equities.
- Long / short hedge fund exposure was particularly valuable in generating alpha in a highly volatile market environment. Gold continues to be favoured with interest rates approaching zero and renewed monetary support expected in 2021.
- In light of the near-term political uncertainty as well as the potential that fiscal authorities disappoint in 2021, active futures and options strategies are increasingly important to our risk management approach.

After a strong recovery, risks are building up notably in Europe

Surprise index - daily



Sources: Bloomberg Finance L.P., UBP

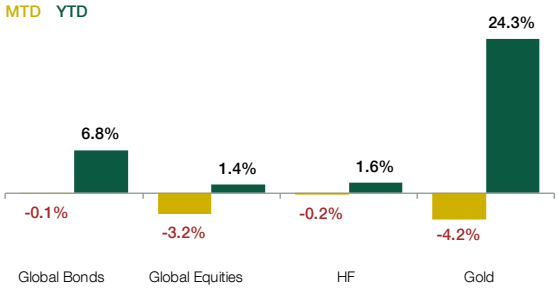
Equity valuations stay elevated

MSCI All country World: 12-month forward PER

Sources: Refinitiv, UBP

All assets gave back some gains

Major Asset Classes Performance



Performance is as end of September 2020
Sources: Refinitiv, UBP

UBP ECONOMIC OUTLOOK

ONGOING RECOVERY BUT FRAGILITIES REMAIN

Key points

- The 2021 recovery remains in sight, but its speed across sectors and regions should vary. Prospects of a vaccine could boost the global outlook in 2021.
- Global activity was stronger than expected in Q3, but downside risks and reduced visibility weigh down Q4 expectations.
- More decisions from the economic policy should be adopted after the US elections, while monetary policy should retain the accommodative stance in place.

Diverging trend across sectors

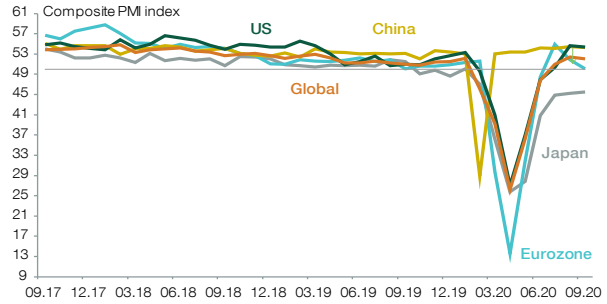
- The manufacturing sectors continues to benefit from resuming production, rebuilding orders and improving exports to Asia. Activity is still mainly driven by the consumer sector, but leading indicators point towards some rebound in private investment as business sentiment has improved further.
- The service sector was hit the most by the lockdown, and renewed downside risks are building with new social distancing measures in the UK and eurozone. Tourism, hospitality and culture sectors could face a double dip in activity if local lockdowns in some countries are tighter.
- Consumption has led the rebound; the end of the lockdown has revived up demand for cars and furniture, and the housing sector has benefited from low interest rates. Supports in place for labor underpinned disposable income growth and savings has sharply increased in Q2, only partly decreased in Q3.

Diverging trend across countries

- Some countries present a firmer outlook for 2021 while experiencing a more limited 2020 downturn than others, contributing to the global demand and supply rebound.
- The 2020 recession in Germany should be more limited (-5%) compared to other European countries, thanks to resilient industry, labor and strong support in place.
- China rebounded in Q2 thanks to measures favouring consumption and upturn in investment. Taiwan has benefited from the strong demand in technology products and should avoid recession in 2020 (1% expected).
- In the US, the 2020 recession should be more limited than feared, thanks to the strong rebound in Q3, but headwinds and political uncertainties are building up for Q4.

Business sentiment: moderation ahead post lockdown rebound

Business confidence



Source: Markit

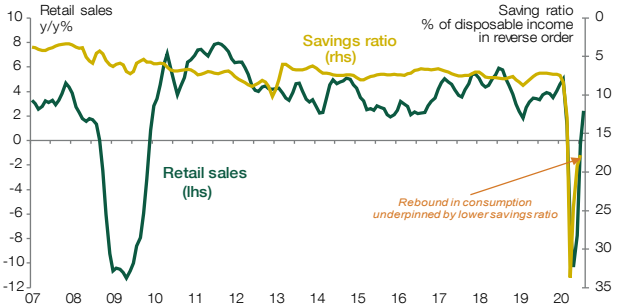
A 2021 recovery in sight, driven by US, China and Germany

GDP y/y %	2019	2020	2021
WORLD - *MER*	2.3	*-4.3*	*4.8*
*- on PPP basis**	*2.9*	*-3.2*	*5.0*
USA	2.2	-4.2	4.2
Japan	0.7	-5.1	2.5
Eurozone	1.3	-7.4	5.6
United Kingdom	1.5	-11.2	6.1
Switzerland	1.2	-4.9	3.6
Brazil	1.1	-5.5	3.8
Russia	1.3	-4.5	3.0
India	4.2	-5.7	6.0
China	6.1	2.0	7.5
Developed countries	1.6	-5.8	4.5
Emerging countries	3.7	-1.8	5.3

Sources: UBP - Economic & Thematic Research
*MER: market exchange rates; PPP: purchasing power parity

US: savings and net wealth underpinned rebound in consumption

US retail sales & household savings ratio



Sources: BEA / Census Bureau

UBP ECONOMIC OUTLOOK

NAVIGATING Q4 RENEWED RISKS

An incomplete recovery in Q3

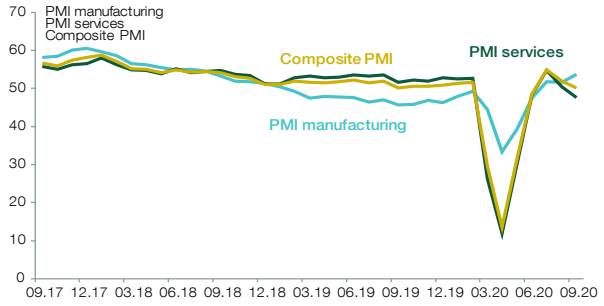
- After the end of the lockdown, activity rebounded strongly n all major countries, reaching an unexpected level of 85%-95% of pre-COVID activity in some countries.
- Fragilities though still exist: with only a few countries showing less severe recession than feared; services sector recoveries remain tepid; while the consumer sector is a key driver to recovery just as support is being withdrawn in the US and new cases emerge in Europe.
- These factors fuel an incomplete recovery, which looks different from the recoveries that followed past recessions.

Politics and virus cases cloud Q4 recovery

- The rebound of virus cases fuels downside risks to the pace of Q4 recovery; though stress to health systems remains absent, new restrictive measures (UK, France, Germany, few US States) and even partial lockdowns (Madrid, Marseille) pose a headwind to momentum.
- Services, particularly leisure, hospitality and culture are again exposed to even partial closures. Fears are rising about upcoming Christmas sales or even a potential double dip in services if the contagion is not contained.
- Nevertheless, no return to a global shutdown is in sight, but fluctuating local lockdowns could be imposed in several countries, until cases are limited and a vaccine available.
- US presidential elections temporarily reduce visibility further. Policy differences are a concern for markets. However, a contesting of the results may pose a yet unpriced risk in markets looking at the 2000 US elections as a reference.
- Once concluded, we expect more budgetary decisions should come after the elections, while the European Recovery fund enters the process of formal approval by the 27 member states and Brexit negotiations enter final stage.
- After strong Q3 rebound, a bumpier recovery is expected in Q4 in several countries. The 2021 recovery remains in sight, but it could take a longer time for some countries to recover to 2019 GDP level; Earlier news on vaccine or budgetary agreement in the US and Europe remain wildcards and could strengthen the recovery and fuel upside revision to the outlook.

Downside risks weighing particularly on eurozone ahead of Q4

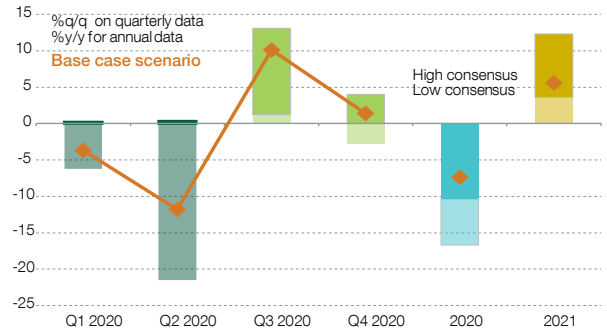
Eurozone: business confidence



Source: Markit

Eurozone: slower rebound expected in Q4

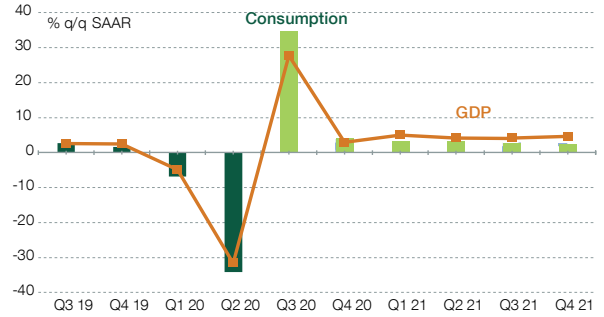
Eurozone GDP scenario



Sources: Bloomberg consensus, UBP

US: moderate quarterly growth expected post Q3 rebound

US GDP 2020-2021 scenario



Sources: US Bureau of Labor stats, UBP

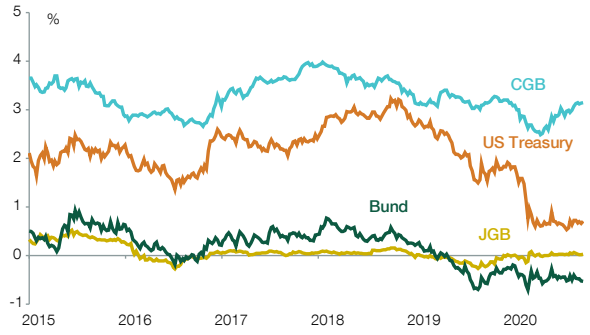
GLOBAL BONDS

CHINESE GOVERNMENT BONDS ADD DIVERSIFICATION

- Credit spreads widened marginally in September for the first time since the March lockdown-related lows but have been relatively resilient compared to the more substantial selldown in US equities. Direct support from central banks and lower refinancing risk after a new H1 record for issuance helped drive outperformance.
- Credit rating trends have diverged amongst segments and regions but overall downgrade ratios (the proportion of downgrades among total rating actions) have improved in Q3. In the high yield space, rating trends are encouraging and point towards a sharp slowdown in US and European credit deterioration compared to Q2.
- We continue to transform our fixed income exposure where we continue to seek positions that protect against the negatively asymmetric risk-return profile found across the the low risk bond space.
- With the China 10-year bond (CGB) yield premium relative to the 10-year US Treasury near the all-time high, we expect this yield differential is more likely to tighten than widen or alternatively, the Chinese yuan may strengthen, benefiting China government bond investors.
- Moreover, the PBoC remains one of the few major central banks that still have room to cut rates if the global economic slowdown persists longer than expected. CGBs offer more symmetric risk-reward profiles relative to the asymmetric profiles offered by western government bonds on top of the premium carry.
- These positions augment our diversification of our investment grade credit exposure into Asian investment grade credit. With Asian credit yields hear historical highs compared to their US counterparts combined with the more developed economic recovery moving through China, Asia's economic engine, Asian investment grade offers again, both diversification, carry, as well as more attractive risk-return profiles for investors looking into 2021.
- On the riskier bond front, we continue to believe that European bank hybrid securities offer an attractive risk-return profile for higher risk appetite fixed income investors. Offering premium yields to corporate high yield bonds, bank hybrid securities sit higher in the capital structure and carry, we believe implicit ECB support in light of the importance of the banking system to ensuring credit growth in the European economies.

CGBs offer higher yield than traditional safe haven assets

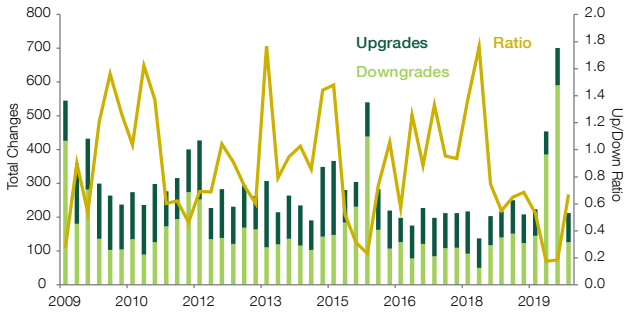
10-year government bond yields (%)



Sources: Bloomberg Finance L.P., UBP

Sharp slowdown of rating downgrades in the high yield segment

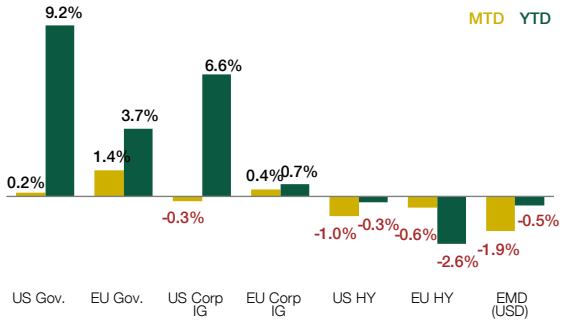
US High yield - Credit ratings trends



Sources: Moody's, UBP

Risky segments lost some ground in September

Fixed Income Performance



Performance is as end of September 2020
Sources: Refinitiv, UBP

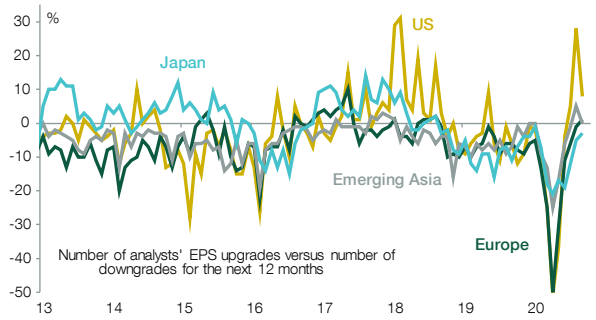
GLOBAL EQUITIES

EQUITY VOLATILITY LIKELY TO RISE

- Net earnings revisions remained positive in the US, but they were clearly off August's peak. Elsewhere, the number of upward revisions roughly matched negative ones but with significant disparities across sectors.
- As a result, the expected global earnings growth rate for both this year (-19%) and next year (+30%) remained roughly unchanged for the third consecutive month.
- In the US, the Q3 reporting season is already around the corner. All cyclical sectors are logically expected to post better year-on-year growth rate in Q3 than in Q2, but they remain deeply negative (industrials at -65%) with the energy still expected to lose money in aggregate. Overall, given the positive economic momentum in Q3, companies should again be able to easily beat expectations, which should support estimates for Q4.
- 2021 earnings expectations continue to appear optimistic, however. Our top-down model suggests that EPS growth should be significantly below the +28% expected for the S&P 500 index, even taking into account a constructive economic scenario.
- The US election represents another major uncertainty, especially with the prospect of higher corporate tax rates. Biden's current plan on corporate taxes, if fully enacted, could reduce EPS by about USD 20 for the S&P 500 index but other factors will play a role such as fiscal spending, trade policy and regulation.
- Equity valuations edged lower in September but remain elevated, particularly in view of the geopolitical uncertainty and potential earnings risk going into 2021. This has led us to expand our protection to be prepared for an increase in volatility in Q4.
- Moreover, we continue to look for catalysts which could lead to a re-rating of Value stocks going into next year. However, we believe the secular story of transformation of the global economy in the post-lockdown world will remain a durable one.
- Indeed, we expect new transformation opportunities to continue to emerge as fiscal stimulus momentum takes hold. Indeed, we have expanded our exposure to the expected Chinese transformation underway, adding A-share domestic equities which will be a critical funding vehicle as China shifts its focus for fund raising from global markets to domestic markets.

Stabilizing earnings revision ratios

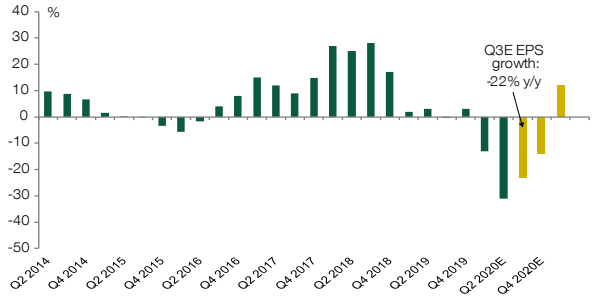
Earnings revision ratio: US, Europe, emgerging Aia & Japan



Sources: Refinitiv, UBP

Earnings expectations for Q3 and Q4 look reasonnable

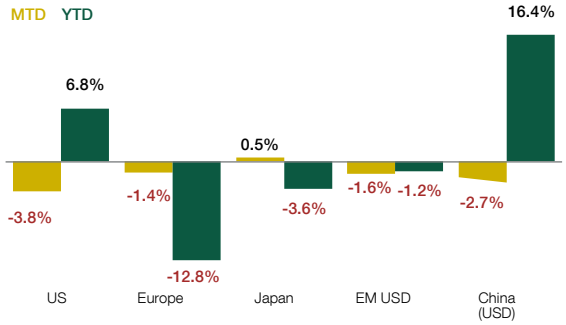
S&P 500: actual and estimated earnings growth rates (analysts' consensus)



Sources: Refinitiv, UBP

US and China led the correction during the month

Equities Performance



Performance is as end of September 2020
Sources: Refinitiv, UBP

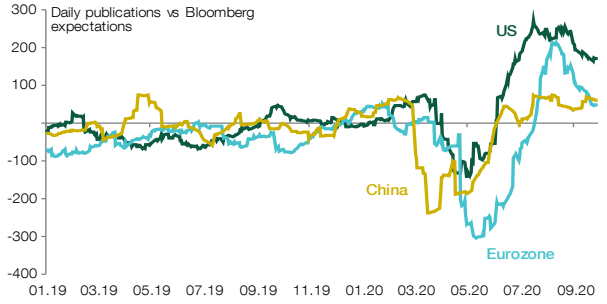
RECENT VIEW CHANGES

RESHUFFLING PROTECTION STRATEGIES AND ADDING CHINA GOVERNMENT BONDS

- With risk going forward more balanced than what we have witnessed this spring, we extended our existing protection strategies to almost fully cover equity exposure via futures.
- Indeed, the uncertainty around US elections, BREXIT as well as the pandemic situation could lead to short term volatility going into year-end, thus allowing us to lock into the strong performances achieved in a challenging year.
- On the other hand, sooner than expected stimulus or encouraging developments on the vaccine front could spur a rally into year end in spite of the political uncertainty.
- As a result, we added call options to portfolios to ensure investors can participate in these upside surprise scenarios should the potential risks do not manifest.
- In fixed income, we rotated some of our US investment grade bonds into China government bonds, which complements well our existing carry strategy positions in Asian high-grade bonds, European CoCos, short term high yield bonds as well as long-short credit hedge funds.
- China government bonds offer attractive yields for income-oriented investors, especially considering the prospect of further policy easing and an expected strengthening in the Chinese yuan.
- We stayed invested in gold despite the recent correction. The level of risk and uncertainty ahead, coupled with a backdrop of low interest rates and decreasing bond yields, should continue to provide support for further gold investment demand especially as monetary measures come to match the fiscal easing we expect in 2020.

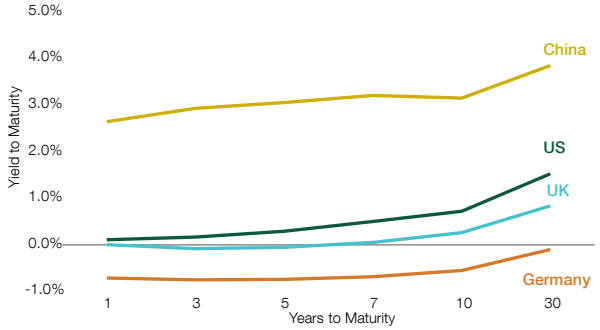
Economic surprises weakened in the main countries except in China

Surprise index - daily



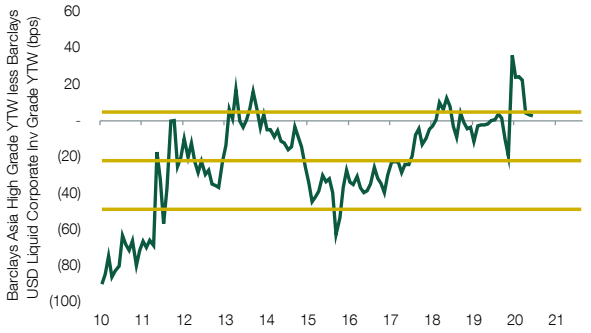
Sources: Citgroup Global Markets, UBP

China government bonds offer an attractive opportunity for income-oriented investrors



Sources: Bloomberg Finance L.P., UBP

Asian high grade bonds are still cheap compared US investment grade bonds



Sources: Bloomberg Finance L.P., UBP

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