JUNE 2022

MONTHLY INVESTMENT OUTLOOK

UBP

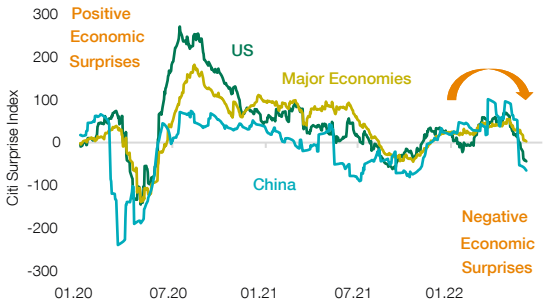
Union Bancaire Privée

MONTHLY INVESTMENT OUTLOOK

STARTING TO PRICE AN ECONOMIC SLOWDOWN

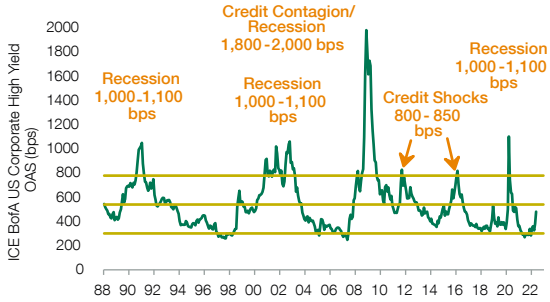
- May provided a reprieve for investors as a late-month rally in both equities and bonds recouped much of the losses seen early in the month.
- Economic surprises in the US began to miss consensus expectations in May with a sharp fall in the Citi Economic Surprise Index in the month highlighting the softening in growth momentum developing in the economy.
- Though recession in the US remains a risk scenario given the ongoing strength of the US consumer, softening US industrial data and tight financial conditions raise the threat of US recession. This adds to more pronounced recession concerns for both China and Europe.
- With global growth concerns building, the April-May declines in equity markets and widening spreads in credit markets have made partial progress in pricing the economic slowdown in progress.
- While these concerns have eased pressure on US 10-year yields, they have increased upward pressure on credit spreads in recent months. Indeed, while investment grade credit spreads have priced soft-landing prospects for the US economy well, high yield credit spreads remain short of pricing even a soft landing, suggesting an unattractive risk-reward profile for credit investors looking ahead.
- The late-May rally in equity markets has provided some respite to weary investors following the year-to-date equity sell-off. However, this rally – though sharp and swift – is consistent with bear market rallies seen since the 1950s.
- Indeed, the current bear market rally neared the depth seen in previous, recession-less bear markets. However, those market declines ended with the Fed pausing or even reversing its tightening cycle, a prospect we do not expect to be likely moving into the summer.
- As a result, the current bear market rally offers investors an opportunity to recalibrate exposure in light of the deteriorating economic backdrop.
- In particular, to price the ongoing economic slowdown more fully, investors should expect not only further P/E contraction in the months ahead, but also the likelihood that earnings expectations – which have remained firm all year – will begin to see downgrades moving into year-end.

US economic data increasingly surprising to the downside signalling softening growth momentum



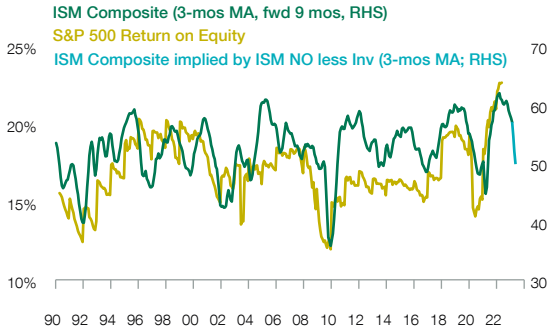
Sources: Bloomberg Finance L.P. and UBP

US High Yield Credit only starting to price the prospect of an economic slowdown



Sources: ICE BofA, Bloomberg Finance L.P. and UBP

Downgrades to earnings expectations may be the next stage to pricing an economic slowdown



Sources: Institute of Supply Management, Standard & Poor's; Bloomberg Finance L.P. and UBP

GLOBAL TACTICAL ASSET ALLOCATION

FOCUS ON INCREASING QUALITY WITH ACTIVE RISK MANAGEMENT

Global economy / Asset allocation

- Global growth looks weak in Q2-22 with only a moderate trend expected in H2-22 and 2023.
- After a subdued period of growth in H1-22, a stabilisation is expected in H2-22 but with risks of recession increasing as headwinds from war in Europe and high inflation may weigh more on activity.
- Inflation should plateau in the short run before declining in H2-22. Central banks will tighten further over the next few months and bring key rates back to neutral.
- In this environment, investors should favour quality both in bonds and equity allocations. Companies with strong balance sheets, earnings growth as well as cash flow generation should prevail in a deteriorating economic environment.
- Active risk management is particularly important with increasing recession risk. Investors could find some shelters in alternative strategies such as hedge funds and structured products. Put options should protect investors from a sharp sell-off in equity markets.

Fixed income

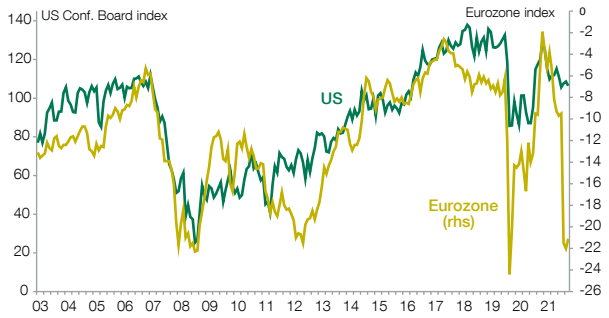
- Government bond yields have turned volatile on tighter policy from central banks, remaining inflation concerns and fears of a recession.
- Upside risks remained in place on US 10y which could reach 3%-3.5% over the next quarters. The ECB tightening expected in July and September could push German 10y bond yields close to 2%.
- Short duration investment grade corporate bonds and hedge fund strategies remain preferred within the fixed income allocation.

Equities/ Alternatives

- Investors should anticipate softer earnings expectations, driven by softening economic prospects, to accompany another leg of valuation declines in the months ahead.
- Hedge funds are particularly valuable in generating alpha in markets with rising volatility. Strategies such as credit arbitrage, CTA or global macro provide shelters for fixed income investors and equity long-short strategies for equity investors.

Weakening consumer confidence

Consumer confidence in the US and eurozone



Sources: US Conference Board, Eurozone DG ECFIN

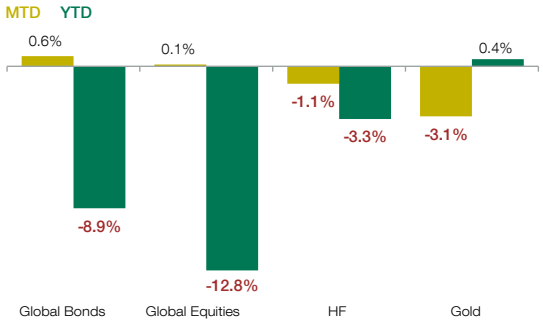
Valuation multiples still have room to decline should earnings disappoint

S&P 500: 12-month forward PER

Source: Refinitiv

Major asset classes ended flat in May while gold is no longer a shining spot

Major Asset Classes Performance



Performance is as end of May 2022
Sources: Refinitiv, UBP

UBP ECONOMIC OUTLOOK

DESYNCHRONISED SLOWDOWN

Key points

- A significant slowdown is underway in 2022, reinforced by war in Europe, ongoing inflation pressures and tighter monetary policy.
- The H2-22 and 2023 outlook appears highly uncertain as visibility remains poor; a stabilisation is expected later but headwinds have increased recession risks.
- The US economy still appears more solid compared to China and Europe; however, a too aggressive Fed tightening against inflation could potentially derail 2023 growth.

A managed slowdown for the time being

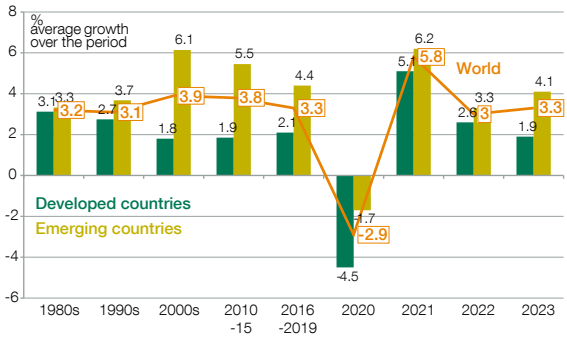
- The world economy faced several shocks in H1-22 with surging inflation, war in Europe, renewed lockdowns in China and a more aggressive tightening from the central banks. The progressive slowdown expected for 2022 has turned into a more pronounced one and growth now looks set to stay moderate in 2022 and 2023.
- Activity has desynchronised across regions: China fell into recession in Q2 due to renewed lockdowns. Europe is navigating in a low growth/high inflation- "stagflation" style, while the US economy has only faced weakening exports and soft data.
- After weak growth in H1-22, a stabilisation is expected in H2-22 based on the absence of any new shocks and the gradual removal of the constraints registered in the first part of the year. This should lead to a rebound in Chinese activity, a more stable US growth path and limited slowdown in Europe.

But underlying recession risks on the rise

- The global growth story continues to face active risks, notably on the geopolitical front. Renewed constraints from energy supply, persistent high inflation and more restrictive monetary regimes may weigh on activity and put the H2 expected stabilisation and 2023 scenarios at risk.
- Tighter financial conditions and lower credit supply are applying pressures everywhere, while high inflation has hit consumers' confidence and increased sector rotation in purchases despite still large savings balances in aggregate.
- Business confidence has decreased, but the leading PMI indicators remained above the threshold of 50, which means a significant slowdown is in process but not an imminent recession, notably for the US economy.

World growth: sharp slowdown expected in 2022

GDP growth by main region



Sources: IMF, UBP

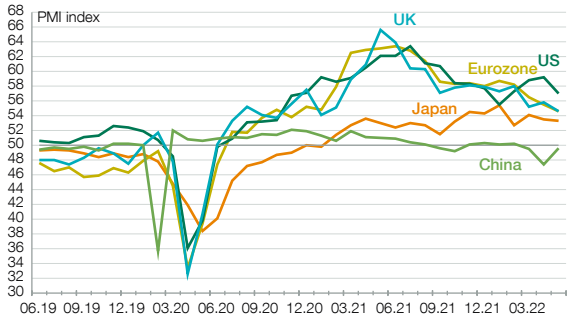
Moderate growth expected in 2022 and 2023

GDP y/y %	2021	2022	2023
WORLD - *MER*	5.6	2.8	2.9
- on PPP basis*	*5.8*	*3.0*	*3.3*
USA	5.7	2.7	2.0
Japan	1.8	2.2	1.8
Eurozone	5.3	2.1	2.0
United Kingdom	7.2	3.6	1.6
Switzerland	3.8	2.5	1.9
Brazil	4.8	1.0	1.5
Russia	4.7	(12.0)	(1.5)
India	8.5	7.0	6.5
China	8.1	3.7	5.0
Developed countries	5.1	2.6	2.0
Emerging countries	6.3	3.3	4.1

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

Business confidence points towards slowdown not recession

Business confidence in manufacturing



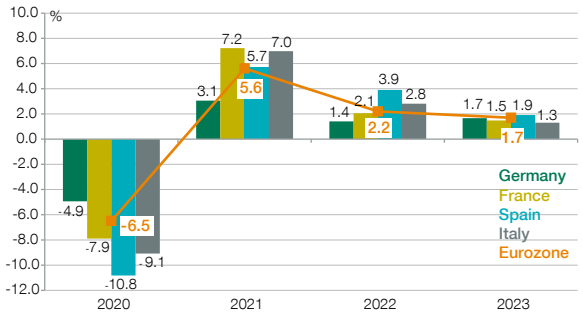
Source: S&P Global

UBP ECONOMIC OUTLOOK

EUROZONE VS US: HOW FAR FROM A RECESSION ARE THEY ?

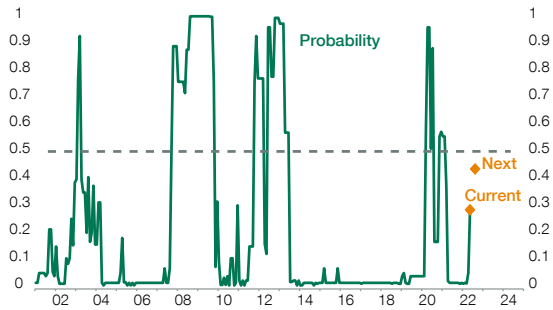
- Developed economies ended H1-22 being buffeted by large risks such a war in Europe, surging grain prices and a strong monetary tightening.
- All economies are not facing equal risks, and the eurozone looks the most exposed to shocks relative to other major economies. Its high dependence on Russian energy imports and on exports to China has a negative impact on its industry.
- Domestic demand remains resilient but the surge of inflation has destroyed confidence; moreover, the ECB was obliged to begin its adjustments in key rates and to end its liquidity injections rapidly.
- Consequently, recession probability has increased for the eurozone; German industrial leading indicators and global household confidence have deteriorated, while credit standards from banks have already tightened for firms.
- Hopefully, leading business indices in manufacturing and services have just slowed down since the start of the Russia-Ukraine conflict and remained well above recession level.
- All indicators point in favour of a significant slowdown in the eurozone; it is possible to see temporary contraction at a country level on a quarterly basis, in line with the 2% scenario expected in 2022.
- Obviously, if risks increase further, a larger contraction will occur on falling demand facing accumulated constraints. The ultimate risk could come from an open conflict with Russia or from an embargo on all energy imports from Russia.
- In the US, financial conditions have deteriorated on the back of rising inflation and tighter monetary policy, but economic indicators are still resilient; an orderly slowdown seems in process and the probability of a recession still looks remote compared to Europe.
- The European conflict has limited the demand from Europe and the Chinese zero-Covid policy restrained exchanges with Asia, but US domestic demand remained dynamic despite surging inflation; the decline in inflation expected in H2 and a resilient labour market should continue to support activity.
- Under such an environment, a US recession should only emerge in 2023 from a too tight Fed policy contrary to rising risks currently in Europe.

Sharp slowdown expected in the eurozone



Sources: Eurostat, UBP ETR

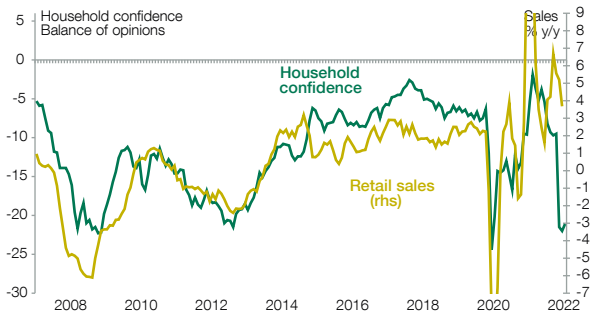
Eurozone: rising probability of a recession



Sources: UBP

Eurozone consumers : weakening confidence but still resilient consumption

Eurozone: household confidence & retail sales



Sources: Eurostat, ECB

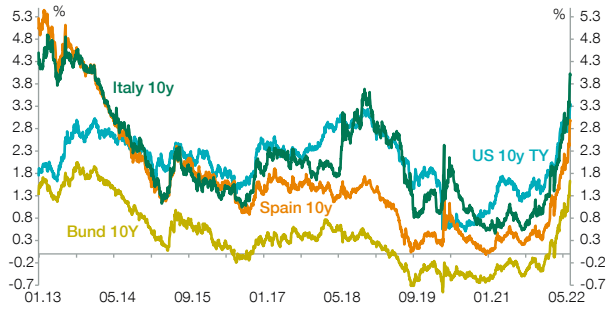
GLOBAL BONDS

PREFERENCE FOR HEDGE FUNDS AND INVESTMENT GRADE CREDIT

- Bond markets have turned highly volatile during the month, showing a temporary easing in yields, mainly in the US, but rapidly followed by a significant rebound in global government bond yields.
- Various factors underpinned these changing trends: war in Europe and fears about a potential recession in the US have driven some flows back into the government bonds segment after 10y US reached 3% mid-May. However, renewed concerns on inflation and more hawkish central banks globally have refuelled upside pressures on yields, driving US 10y treasury yields slightly above 3% early-June.
- The change in the ECB's communication, pre-committing two key rate adjustments over the next months and the announcement of the official end of the zero-interest rate policy have led to a severe repricing in European yields. Moreover, eurozone inflation has not yet stabilised and has still surprised markets with potential new highs to be seen in the coming months reflecting highly volatile energy costs and surging food prices.
- As a result, German bond yields have strongly rebounded, with the 10y passing above 1% and on its way to 1.5%. The mix of high inflation, ongoing tightening in key rates and the end of liquidity injections into bonds and money markets should fuel an ongoing repricing in European yields. Consequently, 10y German bonds yields may well reach 2% in the next quarters while pressures on peripheral spreads should continue, contributing to some fragmentation within the European bonds markets.
- Risks remain clearly tilted towards further rises in government bond yields in developed countries. Under such a scenario, bond portfolios remain underweight in government bonds with a short duration positioning.
- Credit spreads have widened but fundamentals remain positive for US investment grade corporate bonds, while spreads in high yields segments in the US and Europe probably do not reflect potential recession risks and do not offer an attractive risk-reward profile. Portfolios remain cautious on credit and focus on quality bonds via the investment grade segment.
- Emerging debt has suffered from rising inflation, capital outflows and significant key rates adjustments from the Fed and locally. A cautious and selective approach prevailed for portfolios.

Upside risks in government bond yields

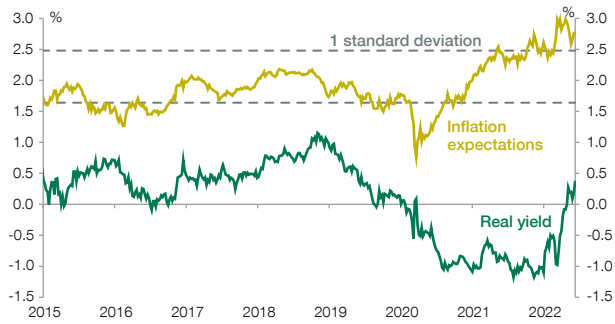
Government bond yields



Sources: Refinitiv, UBP

Inflation expectations have just stabilised but remain fragile

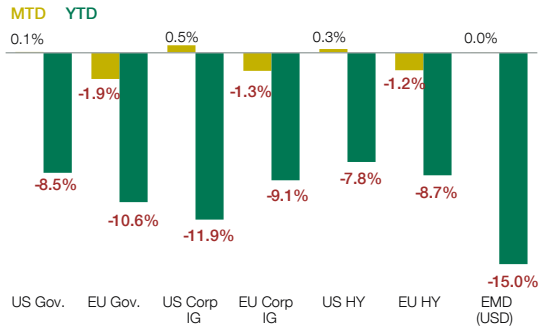
US inflation expectations and real yield (based on 10-year TIPS)



Sources: Refinitiv, UBP

Stabilisation in fixed income segments

Fixed income performance



Performance is as end of May 2022
Sources: Refinitiv, UBP

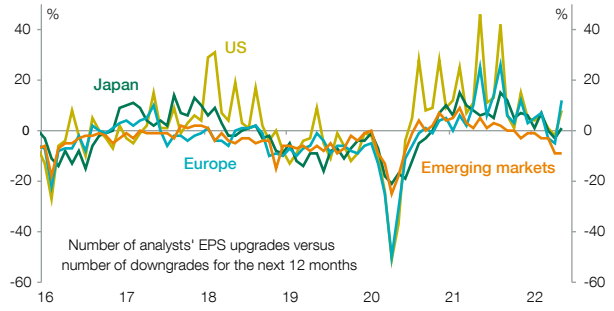
GLOBAL EQUITIES

DOWNSIDE RISKS BUILDING TO EARNINGS EXPECTATIONS

- In May, the market narrative started to move away from inflation scares to growth worries, triggering a sharp decline in equities. However, hopes that the Fed would adopt a less hawkish approach if the economy slowed sharply helped equity markets recover close to where they started the month.
- Following the solid Q1 results and generally reassuring guidance, the monthly earnings revision ratio moved back into positive territory in most sectors, both in Europe and the US.
- In Europe, the expected earnings growth rate for this year rose to 13% from 11% over the month. In the US, the 2022 and 2023 S&P 500 EPS remained basically unchanged with this year's growth rate at 9% followed by 10% next year.
- For earnings, the key risk now comes down to questions around corporate margins, which are expected by the consensus to stay at record-high levels. Since demand has been strong so far, companies have been able to raise prices and strongly benefited from significantly higher sales via operating leverage.
- Should demand slow down meaningfully because of inflation or any other factors, this ability to raise prices would fall quickly and margins would be squeezed by still rising input costs and other supply chain issues.
- As a result, current all-time high earnings expectations could well be revised downwards in the coming months.
- We therefore remain cautious on equities. Even if PER have derated, current valuations do not yet price in a potential recessionary scenario. In the US, a further increase in bond yields would also weigh on valuation multiples.
- In this uncertain environment, we continue to focus on companies with strong balance sheets, a predictable future earnings stream and solid dividend yields.
- We keep our asymmetric strategies that we had implemented via options and structured products in portfolios and closely monitor incoming economic data to gauge the risk of recession. We will increase protection further if this risk becomes even more meaningful in the coming weeks.

Earnings revisions came back into positive territory after Q1 earnings

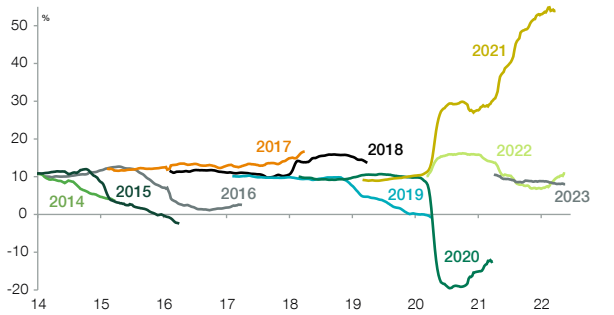
Earnings revision ratio: US, Europe, Japan & EM



Sources: Refinitiv, UBP

Earnings expectations look optimistic given substantial risks to activity

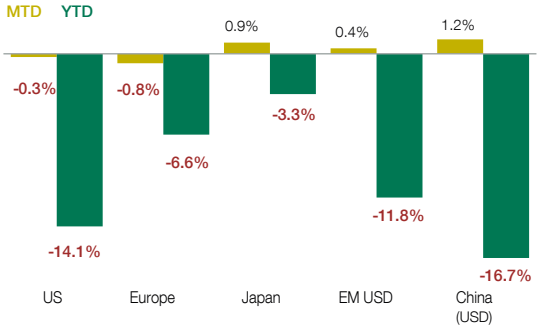
Consensus EPS growth expectations for global equities



Sources: Refinitiv, UBP

Asia and EM markets came back slightly

Equities' performance



Performance is as end of May 2022
Sources: Refinitiv, UBP

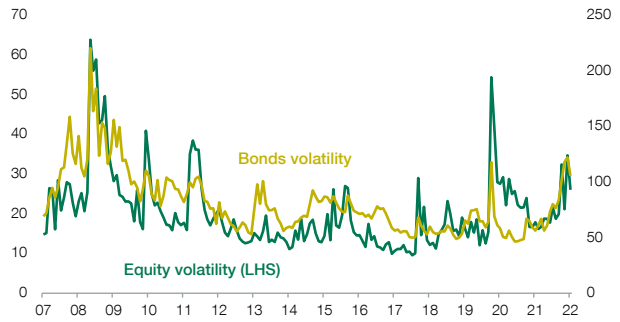
RECENT CHANGES

SEEKING TO ADD MORE ASYMMETRY AGAINST RISING RECESSION RISK

- Markets conditions stayed difficult despite a short-lived rebound at the end of May. Visibility remains low as recession risks are growing.
- High inflation combined with lower growth prospects pose policy risks for central banks to combat inflation without triggering a recession. Markets are increasingly worried by the growth outlook.
- In this context, both fixed income and equity investment could continue to suffer. Investors should stay sheltered in alternative strategies such as credit arbitrage, CTA and global macro as fixed income alternatives and long-short strategy for equity alternatives.
- In the fixed income space, short duration high quality bonds and capital protected structured products are attractive.
- In the equity space, we stay focused on high-quality companies with clear visibility in earnings growth and strong balance sheets, which should prevail in a slowing economy environment.
- We maintain oil related exposure through a structured product offering 150% upside on WTI with partial protection on the downside. The exposure provides us with some hedging in case of a prolonged commodity shock.
- We maintain our overweight of USD across all portfolios as a hedge against recession risk. US economy is the most resilient among developed markets and usually outperforms in cases of a sharp market sell-off.
- With increasing equity volatility and drawdowns, a proactive and dynamic risk management approach remains valuable. We are seeking to add more asymmetry against rising recession risk.

Elevated volatility in both equity and bond markets

Market implied volatility



Sources: Refinitiv, UBP

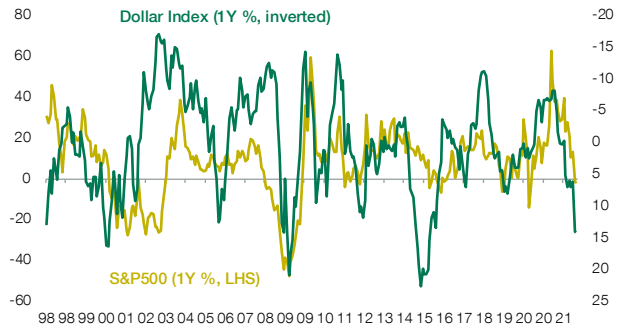
Quality should prevail in a slowing economy

MSCI US Quality vs ISM

Sources: Refinitiv, UBP

USD tends to appreciate during equity sell-offs

USD vs S&P 500



Sources: Refinitiv, Datastream, UBP

Disclaimer

This document is a marketing communication containing GENERAL INFORMATION on financial services reflecting the sole opinion of Union Bancaire Privée, UBP SA and/or any entity of the UBP Group (hereinafter "UBP") as of the date of issue. It is not and does not purport to be considered as an offer nor a solicitation to enter into any transaction with UBP, buy, subscribe to, or sell any currency, product, or financial instrument, make any investment, or participate in any particular trading strategy in any jurisdiction where such an offer or solicitation would not be authorised, or to any person to whom it would be unlawful to make such an offer or solicitation. This document is meant only to provide a broad overview for discussion purposes, in order to determine clients' interest. It does not replace a prospectus, KID, KIID or any other legal document relating to any specific financial instrument, which may be obtained upon request free of charge from UBP or from the registered office of the issuer of the instrument concerned, where applicable. The opinions herein do not take into account individual clients' circumstances, objectives, or needs.

UBP performs analysis on the financial instruments based on market offer and may maintain and/or seek to develop business affiliations with third parties for that purpose; furthermore, UBP may create its own financial instruments. This generic information is therefore not independent from the proprietary interests of UBP or connected parties, which may conflict with the client's interests. UBP has policies governing cases of conflicts of interest and takes appropriate organisational measures to prevent potential conflicts of interest.

The information contained in this document is the result neither of financial analysis within the meaning of the Swiss Banking Association's "Directives on the Independence of Financial Research" nor of independent investment research as per the EU's regulation on MiFID provisions. EU regulation does not govern relationships entered into with UBP entities located outside the EU.

When providing investment advice or portfolio management services, UBP considers and assesses all relevant financial risks, including sustainability risks. Sustainability risks are defined by the EU's Sustainable Finance Disclosure Regulation (2019/2088) as "an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of the investment". For further information on our sustainability risk management approach please visit [www.ubp.com].

Reasonable efforts have been made to ensure that the content of this document is based on objective information and data obtained from reliable sources. However, UBP cannot guarantee that the information contained herein and gathered by the Bank in good faith is accurate and complete, nor does it accept any liability for any loss or damage resulting from its use. Circumstances may change and affect the data collected and the opinions expressed at the time of publication. Therefore, information contained herein is subject to change at any time without prior notice. UBP makes no representations, provides no warranty and gives no undertaking, express or implied, regarding any of the information, projections or opinions contained herein nor does it accept any liability whatsoever for any errors, omissions or misstatements in the document. UBP does not undertake to update this document or to correct any inaccuracies which may have become apparent after its publication.

This document may refer to past performance which is not a guide to current or future results. All statements in this document, other than statements of past performance and historical fact, are "forward-looking statements". Forward-looking statements do not guarantee future performances.

The tax treatment of any investment depends on the client's individual circumstances and may be subject to change in the future. This document does not contain any tax advice issued by UBP and does not reflect the client's individual circumstances.

This document is confidential and is intended to be used only by the person to whom it was delivered. This document may not be reproduced, either in whole or in part. UBP specifically prohibits the redistribution of this document, in whole or in part, without its written permission and accepts no liability whatsoever for the actions of third parties in this respect. This document is not intended for distribution in the US and/or to US Persons or in jurisdictions where its distribution by UBP would be restricted.

Switzerland: UBP is authorised and regulated in Switzerland by the Swiss Financial Market Supervisory Authority (FINMA).

UK: UBP is authorised in the United Kingdom by the Prudential Regulation Authority, and is subject to regulation by the Financial Conduct Authority (FCA) and limited regulation by the Prudential Regulation Authority.

Dubai: This marketing material has been communicated by Union Bancaire Privée (Middle East) Limited, a company regulated by the Dubai Financial Services Authority ("DFSA"). It is intended for professional clients and/or market counterparties only and no other person should act upon it. The financial products or services to which this material relates will only be made available to a client who meets the professional client and/or market counterparty requirements. This information is provided for information purposes only. It is not to be construed as an offer to buy or sell, or a solicitation for an offer to buy or sell any financial instruments, or to participate in any particular trading strategy in any jurisdiction.

Hong Kong: UBP is a licensed bank regulated by the Hong Kong Monetary Authority (HKMA) and a registered institution regulated by the Securities and Futures Commission (SFC) for Type 1, 4 & 9 activities only in Hong Kong. The securities may only be offered or sold in Hong Kong by means of documents that (i) are addressed to "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO"); or (ii) are defined as "prospectuses" within the meaning of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) (the "CO") or constitute offers to the public within the meaning of the CO. Unless permitted to do so under the laws of Hong Kong, no person may issue or have in their possession for the purpose of issuing, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the securities, directed at, or likely to be accessed or read by, the public in Hong Kong, except where the securities are intended to be disposed of only to persons outside Hong Kong, or only to "professional investors" within the meaning of the SFO.

Singapore: UBP is a bank regulated by the Monetary Authority of Singapore (MAS), is an exempt financial adviser under the Financial Advisers Act 2001 of Singapore to provide certain financial advisory services, and is exempt under section 99(1) of the Securities and Futures Act 2001 of Singapore to conduct certain regulated activities. This document has not been registered as a prospectus with the MAS. Accordingly, this document and any other document or material in connection with generic recommendations may not be circulated or distributed, whether directly or indirectly, to persons in Singapore other than (i) institutional investors; or (ii) accredited investors as defined under the Securities and Futures Act 2001 of Singapore. This advertisement has not been reviewed by the Monetary Authority of Singapore.

Luxembourg: UBP is registered by the Luxembourg supervisory authority the *Commission de Surveillance du Secteur Financier* (CSSF).

Italy: Union Bancaire Privée (Europe) S.A., Succursale di Milano, operates in Italy in accordance with the European passport – held by its parent company, Union Bancaire Privée (Europe) S.A. – which is valid across the entire European Union. The branch is therefore authorised to provide services and conduct business for which its parent company, Union Bancaire Privée (Europe) S.A., has been authorised in Luxembourg, where it is regulated by the Luxembourg financial supervisory authority, the *Commission de Surveillance du Secteur Financier* (CSSF).

Monaco: This document is not intended to constitute a public offering or a comparable solicitation under the Principality of Monaco's laws, but might be made available for information purposes to clients of Union Bancaire Privée, UBP SA, Monaco Branch, a regulated bank under the supervision of the *Autorité de Contrôle Prudentiel et de Résolution* (ACPR) for banking activities and under the supervision of the *Commission de Contrôle des Activités Financières* for financial activities.

Union Bancaire Privée, UBP SA | Head Office
Rue du Rhône 96-98 | P.O. Box 1320 | 1211 Geneva 1 | Switzerland
ubp@ubp.com | www.ubp.com