MAY 2023

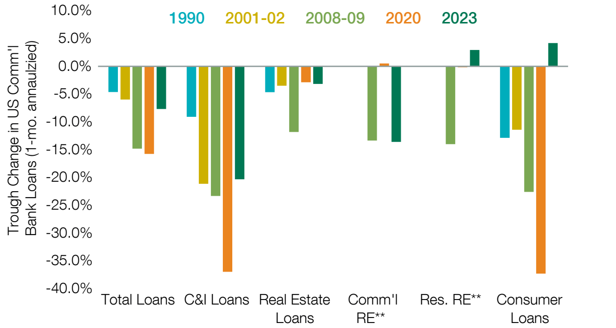
MONTHLY INVESTMENT OUTLOOK

UNION BANCAIRE PRIVÉE

THE GLOBAL LIQUIDITY CYCLE LOOKS SET TO TURN

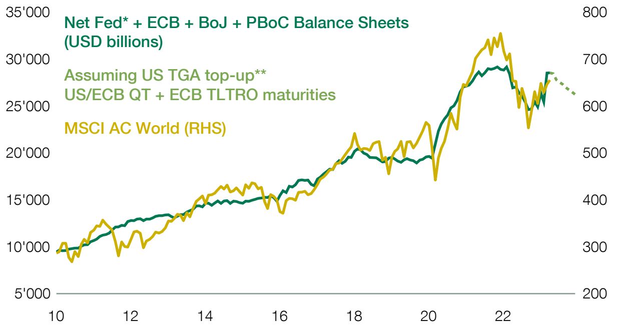
- Global equities and bonds were flat in April as markets digested the global liquidity injections following the March liquidity crisis in the US banking sector and the Swiss support for the UBS acquisition of Credit Suisse.
- Signs of credit tightening are emerging in the US banking system driven by annualised contractions in commercial & industrial lending and commercial real estate lending on a par with the pace of the Global Financial Crisis. Admittedly, it remains to be seen whether the caution among lenders continues and spreads to consumer lending.
- More concerning is the prospect of a turn in global liquidity. As we have highlighted since November 2022, expanding central bank balance sheets have provided a temporary backstop to global equities and risk assets. With the ECB set to withdraw over EUR700 billion in liquidity via TLTRO maturities and quantitative tightening and the US Treasury potentially withdrawing USD200-400 billion as it replenishes its coffers once the debt ceiling is raised, the liquidity tailwind is set to become a 2H2023 headwind.
- All of this should come as growth in the US economy in particular looks set to continue moving only slowly into mid-year creating the prospect for outright recession heading through mid-year.
- Also coming between June-August is the height of the 2023 US debt ceiling crisis. Though we expect to it be resolved, investors can look to the experience of the 2011 debt ceiling crisis to see the stabilisation and subsequent rise in equity and bond volatility in 2011 that appears to provide a roadmap for 2023 volatility.
- If correct, we expect that our recently increased exposure to volatility carry strategies via structured products may offer investors shelter amidst the elevated volatility should negotiations come down to the wire as in 2011.
- This complements the carry earned within portfolios via traditional credit strategies, alternative hedge fund strategies and even EM FX carry while sheltering from the expected pick up in equity volatility through summer.
- As an end to the US rate hiking cycle takes shape, we continue to expect non-USD currency strength to offer an additional return driver, especially in USD referenced portfolios. Gold should likewise continue to benefit as the rate hiking cycle matures.

US C&I*/CRE* loan growth declining sharply but residential RE/consumer lending still growing



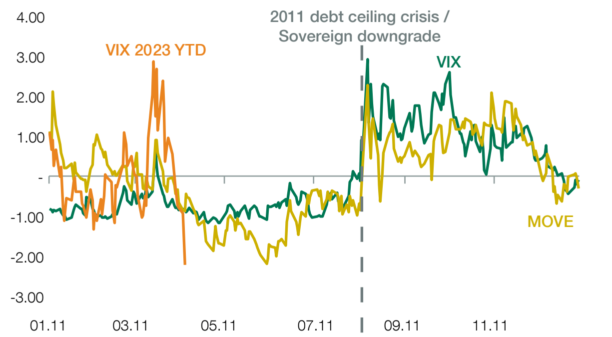
Sources: US Federal Reserve, Bloomberg Finance L.P. and UBP
* Commercial & Industrial and Commercial Real Estate
**data only available since 2004

The liquidity tailwind since late-2022 is set to become a headwind in 2H2023



MSCI, Bloomberg Finance L.P. and UBP
* Net Fed = Fed balance sheet less increase in US TGA less increases in US Reverse Repo bal,
** Assumes US TGA is replenished following a debt ceiling agreement to pre-pandemic levels relative to average monthly outlays

The debt ceiling may bring a temporary surge of volatility even after it is resolved



Chicago Board Options Exchange, BofAML, Bloomberg Finance L.P. and UBP

FOCUS ON INCOME STRATEGY

Global economy / Asset allocation

- Activity was stronger than expected in Q1-23 in all main regions, but activity poised to weaken in developed countries in H2-23.
- Headline inflation expected to decline further over the next months, but core inflation still looks resilient.
- Fears of a major bank crisis have receded, and no rate cuts are expected soon. Monetary policy likely to remain restrictive after last adjustments in key rates in May-June.
- In this environment, we prefer non-directional and carry strategies within fixed income and alternative investments.
- We added volatility carry strategy via structured products by selling volatility on equities as an additional source of income.

Fixed income

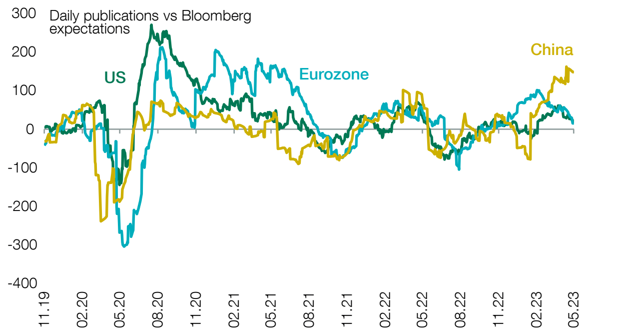
- Government bonds remained volatile with ongoing stress on US banks, fears of deteriorating macro trend while inflation pressures remain.
- Government bonds yields regained some strength late April after their fall in March. Upside risks remain due to persistent core inflation, early deadline on US debt ceiling and further rate hikes by major central banks.
- Credit remains the preferred asset class within fixed income; carry strategy, with a focus on credit quality, offers attractive returns adjusted to risk.

Equities/ Alternatives

- Current equity valuations, which are particularly elevated in the US, are at odds with our view that the US is likely to endure a recession in H2, which is going to impact corporate profitability. The weakening dollar is another reason to favour non-US equities.
- Hedge funds are valuable in providing cushion to elevated equity volatility. Credit long-short strategies should benefit from the high absolute carry, elevated fixed income volatility and increased single credit dispersion.
- The current environment is particularly favourable to gold. Demand has increased on the back of sticky inflation and elevated geopolitical risk while headwinds are easing with US policy rates most likely at close to a peak and an expected weakening USD looking ahead.

Downside risks to growth outlook in developed countries

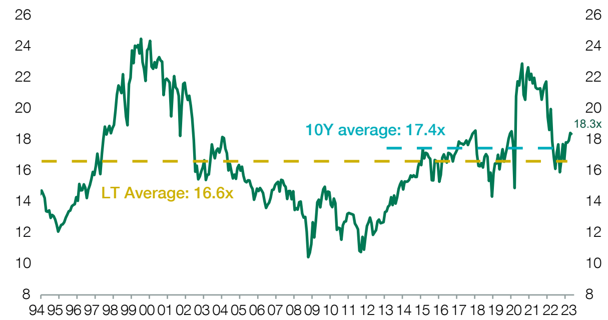
Surprise index - daily



Source: Citigroup Global Markets

US equities remain particularly expensive

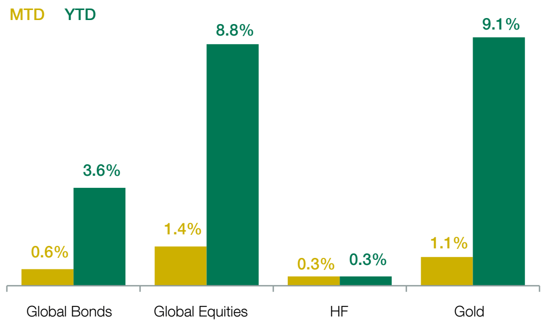
S&P 500: 12-month forward PER



Sources: Refinitiv, BofAML, UBP

Slightly positive performance for all assets

Major Asset Classes Performance April 2023



Sources: Refinitiv, UBP

UBP ECONOMIC OUTLOOK

LARGE GROWTH GAP BETWEEN DEVELOPED AND EMERGING COUNTRIES

Key points

- Moderate global growth is expected in 2023; the strong recovery in Asia will be balanced by recession risks in developed countries in H2-23.
- US faces a mild recession in H2-23, while growth in Europe looks set to stagnate, with some countries flirting with recession risks. Tighter credit conditions will weigh on domestic demand.
- Inflation to decline further in H2-23, but core inflation remains resilient; inflation to remain above 2% at year end.
- Central banks now pausing their tightening rates cycle with their final adjustments expected in May-June.

US: recession risks are building up

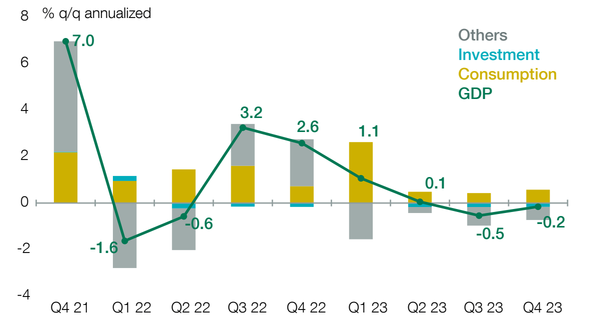
- Growth was firmer than expected in Q1, thanks to consumption in services. Industrial activity remained weak, and orders and exports have deteriorated during the quarter.
- Growth should weaken from Q1-23 and recession risks are building for Q3-23: tighter credit supply and ongoing restrictive monetary policy combine to weigh down on demand and investment while housing expected to contract further in parallel.
- Employment was solid in Q1, but signs of a weakening trend have built up: lower jobs openings, rising jobless weekly claims and announcements of large layoffs in several industries. A rise in the unemployment ratio from its low level is expected next year.

Europe navigating risks of stagnation and technical recession

- Europe has escaped in Q1-23 from major cuts in energy delivery and benefited from lower bottlenecks in industry. Strong labour market and healthy savings supported consumption, notably in services. Q1 GDP growth was better than expected thanks to strong performances in Spain and Italy versus weak growth in Germany.
- Activity still remains weak and could approach stagnation and technical recession in H2-23 in some countries. Tighter credit conditions will weigh down on firms and consumption decisions. The gap in confidence between services and manufacturing sectors appears abnormally large with potential to narrow on lower trend in services in H2-23.

US to face mild recession after relatively strong Q1-23 GDP growth

US GDP sector contribution to GDP growth



Sources: BEA, UBP

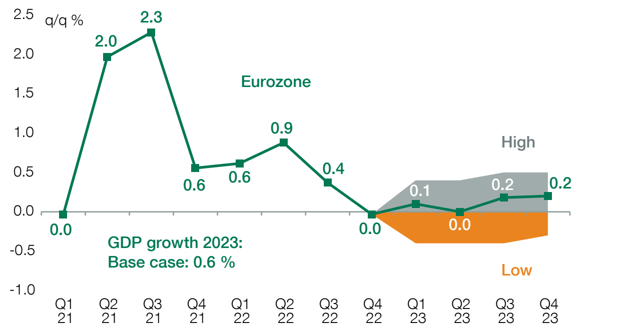
Weak growth outlook for developed countries

GDP y/y %	2021	2022	2023
WORLD - *MER* *- on PPP basis**	5.8 *6.0*	3.0 *3.2*	2.0 *2.9*
USA	5.9	2.1	1.0
Japan	2.3	1.1	1.2
Eurozone	5.3	3.4	0.6
United Kingdom	8.5	4.3	-0.4
Switzerland	4.3	2.2	0.6
Brazil	5.2	2.7	1.0
Russia	5.6	-3.0	-2.0
India	8.7	7.2	6.5
China	8.4	3.0	6.0
Developed countries	5.4	2.6	0.8
Emerging countries	6.4	3.6	4.0

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

Eurozone navigating stagnation and recession risks

Eurozone GDP scenarios



Sources: Eurostat, UBP

CHINA: DOMESTIC DEMAND DRIVES SUSTAINED GROWTH IN 2023

- Chinese authorities have rapidly pivoted to reopen the economy in favour of domestic demand. Domestic activity weakened in Q4-22 following shutdowns in major cities and large fall in exports to developed markets, especially the US and Europe. However, Q1-23 GDP rebounded strongly to 4.5% y/y, up from 2.9% y/y in Q4-22 and led by consumption and services.
- Excess savings are estimated to have reached around 13% of GDP (13 Tr RMB). China has a lower marginal propensity to consume than developed markets, so the pickup in demand will take place gradually, starting from services and gradually rotating towards goods.
- The housing sector was a major drag in 2022. Authorities proactively implemented measures to stabilise the sector and restore confidence. These include monetary support for first time homeowners and state intervention to ensure the delivery of pre-sold units.
- The other area that is critical from a confidence standpoint is the labour market. Authorities have pledged to prioritise stronger job creation to reduce unemployment.

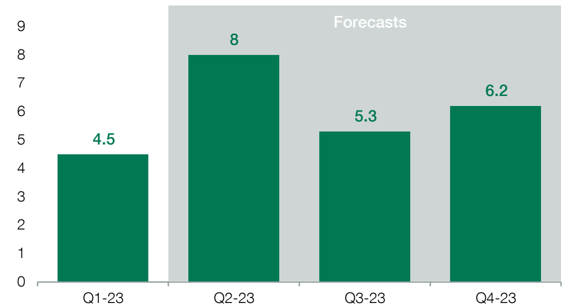
Growth outlook

- GDP growth should accelerate further in Q2-23 (8.0% y/y), aided by a large base effect due to the Q2-22 Shanghai lockdown. Excluding this base effect, our scenario points to growth above potential in 2023 and to progressively converge towards a 4.5-5.0% range in 2024.
- Firmer growth in China is a tailwind for Asia. We expect that Chinese demand for Asian goods and services will at least partially offset declining demand from developed markets. The main beneficiaries include Hong Kong, Thailand, Singapore and Malaysia.

Major risks

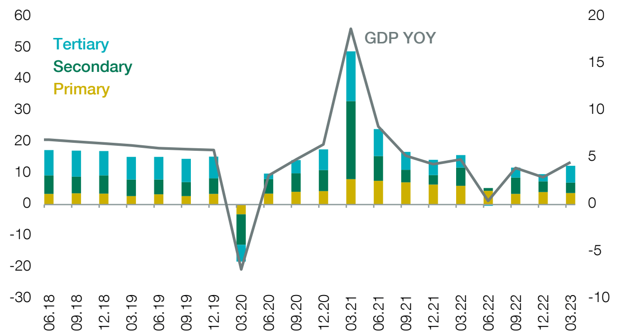
- Although subdued inflation (CPI: 0.7% y/y; PPI: -2.5% y/y) is positive news for consumption, excessive deflation is problematic, as it entails smaller profits for industrial companies and slower job creation.
- Weaker external demand may obstruct the broadening of the economic recovery from the tertiary to the secondary sector. A sharper recession in developed markets would drag on exports, hindering manufacturing.
- US-China tensions and technological decoupling may continue to trigger bouts of volatility in 2023. Supply chain relocations out of China could also drag on activity via weaker foreign direct investment.

China: UBP Scenario for 2023 (GDP , % y/y)



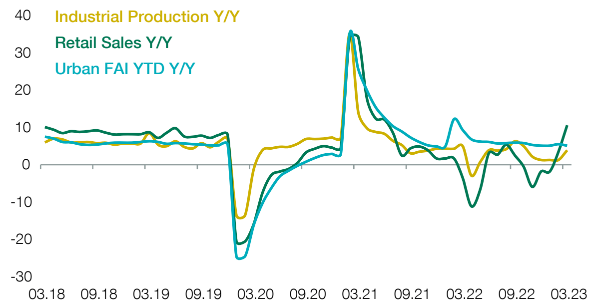
Source: NBS, UBP

China: Real GDP by sector (%, y/y)



Sources: NBS, Bloomberg and UBP

China: March activity indicators (%, y/y)



Sources: NBS, Bloomberg and UBP

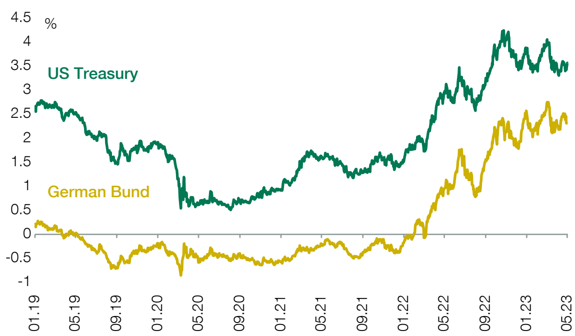
GLOBAL BONDS

CARRY STRATEGY FAVOURED, WITH FOCUS ON QUALITY

- Governments bond yields evolved in a range after their fall in March related to the crisis in banks. Yields remained volatile as uncertainties around some US regional banks and fears of recession were balanced by a hawkish Fed and the ECB's communications based on a still resilient core inflation.
- As a result, US 10y yields stayed between 3.4% and 3.60%, driving German 10y Bund in a 2.30%-2.50% range at the end of April.
- With remaining concerns on inflation, major central banks expected to hike further in May. Money markets futures point toward a rapid reversal in the Fed's strategy, which is not in line with our base case scenario.
- After temporary liquidity injections in the US, and the reopening of USD swap lines among major central banks, a tighter outlook on liquidity is building up for the coming months.
- On the ECB front, past TLTRO borrowing will be reimbursed over the next quarters. Banks have already reimbursed ahead of the maturity operations (EUR 930 bn since Nov.22), and another circa EUR 500 bn should mature in June, followed by remaining EUR 600 bn to expire in H2-23 and in 2024. This creates tougher market conditions and further liquidity constraints for small and peripheral banks which have limited excess liquidity.
- In the US, the debt ceiling is becoming an issue for markets as Treasury could face financing problems in early June. A government shutdown may result if no agreement is found; in the case of a "last minute" agreement or any decision to postpone the debt ceiling by six months, one year or two, the Treasury will have to borrow USD 500-600 bn on long and medium-term maturities over the next quarters, adding volatility and upside pressures on government bond yields.
- In terms of allocations, our preference remains in favour of investment grade corporate bonds, with a reinforced focus on credit quality. Tensions in spreads in this category could create some opportunities to capture attractive yields even for risk adverse investors.
- The outlook on high yields is limited as spreads do not offer attractive risk returns ahead of a potential US recession.
- Hedge fund strategies could benefit from volatile interest rates and dispersion in performances across segments in credit and asset classes.

10y government bond yields in a range but upside pressures remain in place

10-year government bond yields



Sources: Bloomberg

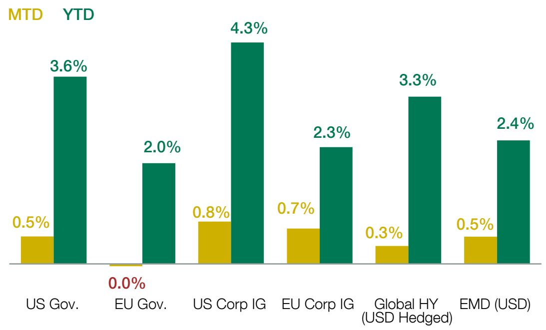
Attractive yields on US investment-grade corporate bonds

US Investment-grade OAS yield

Sources: BoAML, UBP

Muted performance in global bonds

Fixed Income Performance April 2023



Sources: Refinitiv, UBP

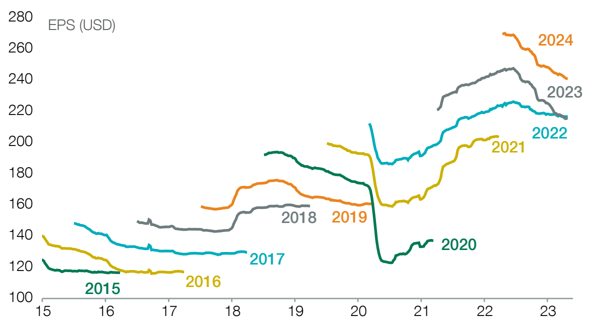
GLOBAL EQUITIES

THE PAUSE IN EARNINGS DOWNGRADES IS ONLY TEMPORARY

- Market volatility fell significantly in April, with equities broadly flat over the month as bond yields stabilised and Q1 results came as a relief for investors.
- At the end of the month, equities were supported by better-than-feared Q1 earnings with beats above average. After the significant downgrade cycle seen since the start of the year, the bar was sharply lower.
- Top-line growth has slowed but remained positive both in Europe and in the US.
- For the S&P 500 index, Q1 EPS growth came in at about -2% versus the -5% expected at the start of the reporting season but +1% forecasted in early January. Revenue growth stands at 2.3%.
- Margin pressures and negative operating leverage remain the key issue for companies. Technology and materials were the most heavily impacted, delivering double-digit EPS contraction on declining sales. On the opposite side, industrials and energy are bucking the margin pressure trend so far.
- The estimated EPS growth rate for Q2 has remained basically unchanged since the start of the reporting season at -4% (-0.4 pp, which is significantly better than the -2.5pp to -3.5pp cut seen over the past three quarters).
- Globally, guidance was relatively cautious on activity and demand, but managements proved to be more optimistic on energy, raw material prices and supply chains. However, wage costs remain as significant headwinds for margins.
- 2023 EPS growth projections for global equities remained steady over the last month at very close to 0% in all major regions, including for EM as a whole (-2%) but with a wide gap between China (+18%) and Latin America (-17%).
- Despite the recent banking turmoil, equities have held up well on hopes of a soft landing and a belief that central banks will cut rates in H2. This contrasts with our view that there will be a mild recession in the second half weighing heavily on earnings. Current expectations for significant rate cuts by the Fed also appear too optimistic, which means that there are downside risks on valuations.
- We therefore remain cautious equities overall with a preference for non-US markets, which trade at more attractive valuations and which should benefit from a weakening dollar.

2023 earnings estimates have recently stabilised…

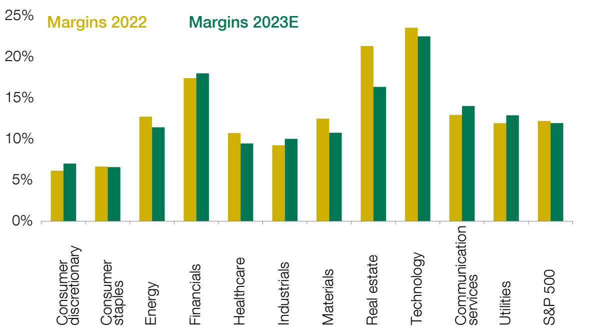
Consensus estimates for S&P 500 EPS by calendar year



Sources: Refinitiv, UBP

… but consensus assumptions on margins are still much too optimistic in our view

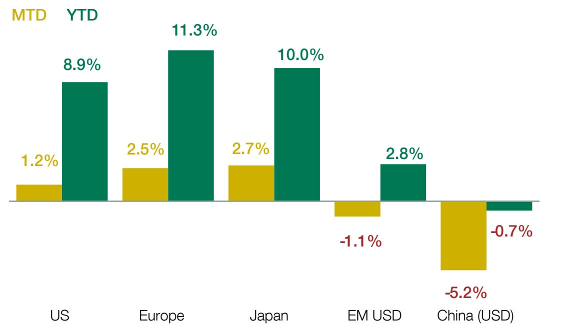
US net income margins



Sources: Refinitiv, UBP

Mixed returns in equities with China underperforming

Equities Performance April 2023



Sources: Refinitiv, UBP

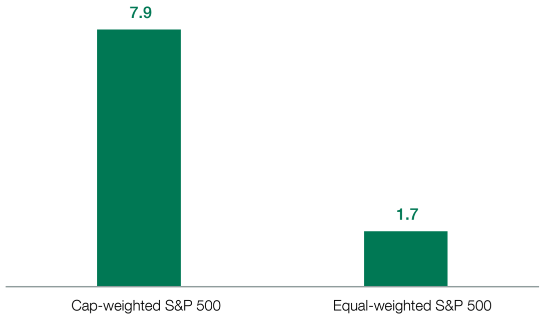
RECENT CHANGES

ADDING CARRY THROUGH STRUCTURED PRODUCTS

- Despite the strong rally in equity markets since the start of the year, we stay defensive by favouring non-directional and income strategies in fixed income and alternative investments.
- In fact, the robustness of the rally is not convincing, and participation is poor. The year-to-date performance is mainly a January feature and markets have hardly moved since. Furthermore, at individual stock level, a dozen companies made up 90% of the performance of S&P500.
- We recently increased further carry strategies through structured products by selling volatility on equities as an additional source of income for our clients.
- Earlier in the month, we tilted our equity allocation towards more defensive stocks by adding in the healthcare sector and reducing industrials. After having rallied sharply on the hype around electrification, global reshoring and China opening, the upside potential of industrials now seems limited. On the other side, the healthcare sector underperformed significantly since the start of the year on hopes for a quick easing on inflation and Fed interest rate cutting that we believe are misplaced.
- We also purchased gold last month to add further diversification to portfolios. Indeed, the current environment is particularly favourable to the asset class as a hedge to sticky inflation, elevated geopolitical tension or financial market stress. In addition, interest rates are now close to their peaks and the USD is on track to continue its bear market following its temporary respite in March. We reduced China equities back to neutral as a risk management move in the event that a credit shock manifests in the months ahead.
- Since the start of the year, we gradually extended duration in our fixed income portfolios via the high-quality credit space to lock in attractive yields. We are seeking to increase duration should 10-year rates reach 3.8-4% in the US and 2.8-3% in Europe.

A dozen companies in S&P 500 contributed 90% of its performance

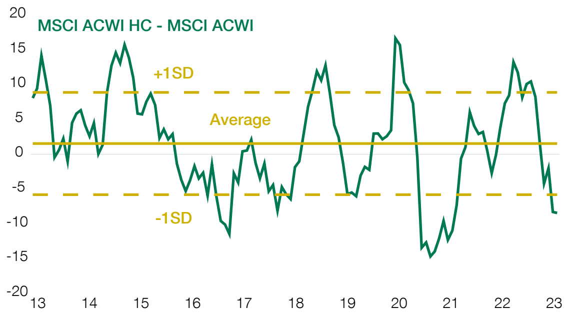
Cap vs equal-weighted: S&P 500



Sources: Refinitiv Datastream, UBP

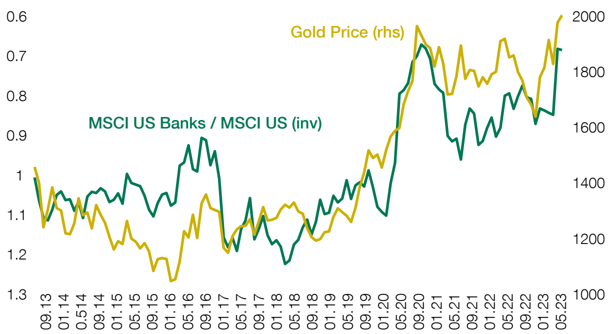
Healthcare sector underperformed significantly

Global Health Care 6 Month rolling performance gap



Sources: Refinitiv Datastream, UBP

Gold is a good hedge against financial stress



Sources: Refinitiv, UBP

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