MARKETING DOCUMENT | JANUARY 2024

UBP House View

Union Bancaire Privée

Michaël Lok
Group CIO
and Co-CEO
Asset Management

Portfolio construction back to the forefront

2023 WILL REMAIN THE BENCHMARK YEAR POST-COVID

2023 was a year marked by an increased lack of visibility, whether on where inflation is going, general macroeconomic risks surrounding all asset classes, or rapid rotations. Despite all this, cash will have been the worst-performing asset class, clearly demonstrating that a wait-and-see attitude is rarely a good strategy.

There are clear conclusions that can be drawn and lessons that can be learned from the past year. The return of interest rates to their long-term averages puts portfolio construction front and centre. In other words, in 2023, we had to wait until the last two months of the year to see our market scenario crystallise, with record performances for equities and a complete change of direction for fixed-income assets. This assessment of the reallocation of risk premia is valid for the next few years, in accordance with each asset class's respective investment horizon, but it carries with it the risk of missing out on their performance potential.

We can now close the book on 2023 with a final end to the disastrous consequences of the Covid health crisis. Inflation is no longer the main cause for concern, central banks have been hands-on and effective, restoring a certain level of orthodoxy, and the markets have been efficient and have moved away from less credible actors (in this case, China). It now falls to investors to turn to diversification and uncorrelated performance drivers in order to generate returns that are in line with their expectations.

Key Takeaways

1 THE MACROECONOMIC BACKDROP CONTINUES TO IMPROVE

The recent decline in inflationary pressures pushed the Federal Reserve to pivot in anticipation of faster-than-expected interest rate cuts this year. This strengthens our message to stay invested in both equities and fixed income.

2 LAST CALL TO SWITCH CASH DEPOSITS INTO FIXED-INCOME ASSETS

Despite the 2023 year-end rally in bonds, expected returns for 2024 remain superior to cash deposits due to continuing disinflationary trends globally.

3 STAY ENGAGED IN EQUITIES

Given the constructive backdrop for equities, use any pullback to increase exposure to equities when they are quasi-absent from balanced portfolios, as running excessively low on equities is too costly performance-wise for long-term investors.

The opinions expressed in this document are as at 15 January 2024 and are subject to change without notice.

Macroeconomic environment

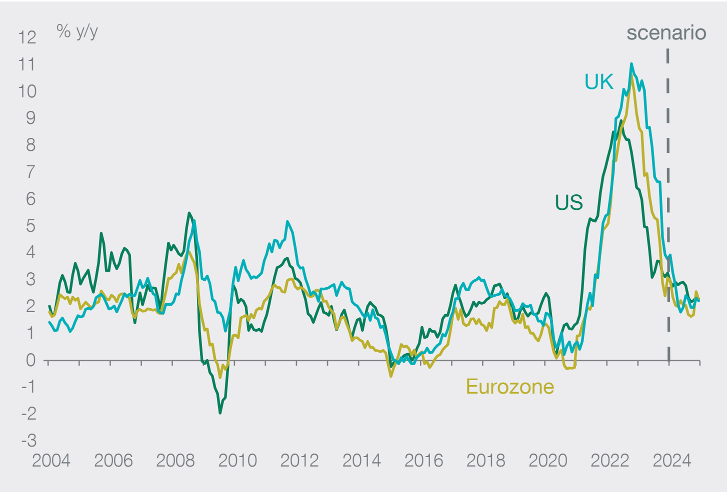
Global growth should moderate in 2024 to around 2.9%, but the decline in inflation should continue: it is anticipated to return to 2.5% at the end of the year in the US, the eurozone and the UK. At the end of last year, the drop in commodities accelerated the decline in growth and, therefore, after two years spent fighting inflation, the normalisation of economic activity could lead to the first cuts in key rates from the end of the first half of 2024.

NEW MONETARY REGIME IN SIGHT

The outlook points to a return of inflation in the range of 2–2.5% at the end of the year in the US

With the moderation of activity and slight rises in unemployment expected in several countries, the outlook points to a return of inflation in the range of 2–2.5% at the end of the year in the US, and from the end of the first half of the year in Europe. Inflation peaked in 2022 thanks to the fall in oil and gas prices, but in 2023, demand shifts led to two-speed inflation due to services holding up well, while deflation took hold for some industrial goods.

Since 2022, central banks have been shifting their monetary policies into restrictive territory by bringing their key rates above the neutral rate. Tensions in financial conditions have had an impact on credit and real estate, especially in Europe.



Sources: ECB, BLS, ONS, UBP
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

The easing of inflation and the normalisation of activity are allowing central banks to consider rate cuts without raising the spectre of recession. During their last meeting, Fed governors' expectations pointed to three potential cuts in 2024; at the same time, few BoE and ECB members have mentioned possible rate cuts.

By mentioning that the Fed had discussed a rate cut timetable during its meeting, Mr. Powell fuelled market expectations of a rapid rate cut; however, lowering key rates too early could be a mistake if the roots of inflation are not completely eradicated. By pointing to cuts from next March, markets are betting that inflation has been definitively defeated.

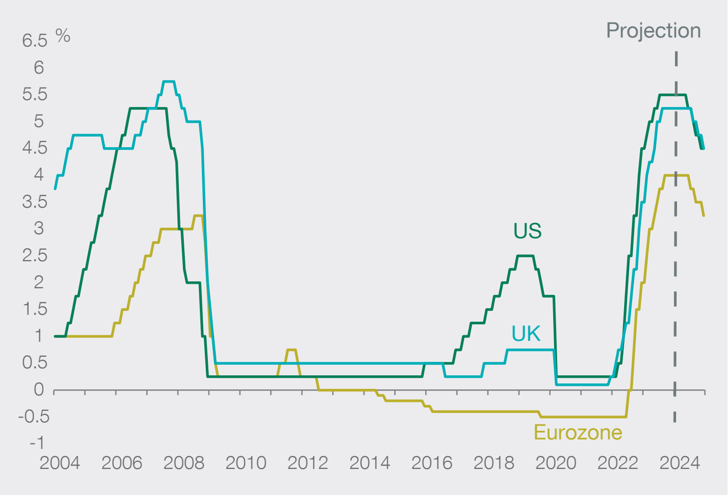
That said, a gradual decline in wage pressures and core inflation makes the first cuts more likely from May and June 2024. From then, positive base effects should push inflation towards 2.5% in the United States, and even below 2% in Europe; this constitutes an opportunity for central banks to adjust their strategies.

The initial rate cuts are more likely from May and June 2024

The magnitude of the rate cuts will be dictated by the inflation and activity figures in each major economic area. However, a return of rates to close to their neutral points would allow an adjustment of nearly 100 basis points in the US and 75 points in Europe in 2024.

RATE CUTS SHOULD BECOME WIDESPREAD

These changes will open a phase of lowering key rates in the second half of 2024 which should continue into 2025. In addition, other developed and emerging countries should fuel a downward cycle in rates, leading to generalised monetary easing.



Sources: Bloomberg Finance L.P., central banks
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

Nonetheless, China and Japan could still be exceptions. China had already relaxed its policy and is expected to continue this trend, whereas Japan maintained a loose policy in 2023 to promote a return to structural inflation which implies a gradual – but limited – normalisation of its policy in 2024.

These new strategies will have three consequences: the constraint of high real interest rates will ease on the cycle in 2024; debt and the real estate market will be less constrained; and countries whose debt servicing costs have increased significantly should benefit indirectly from these relaxed monetary policies while public spending and debt will remain high.

Strategy

CAN THE RALLIES CONTINUE?

2023 went out with a bang, with global bonds delivering nearly 10% total return and global equities earning investors almost 15% in November/December alone. As 2024 begins, the question facing investors is the following: Do the rallies still have steam?

Look more granularly, with a focus on credit selection to enhance income, and regions/sectors to maximise earnings growth prospects in 2024

While global equities are approaching historically high valuations, under the surface, we see that equally weighted US, Europe, Japan and emerging market equities are all trading near historic averages after having rebounded from near-cyclical lows in October 2023. This suggests that opportunities remain for those investors who can delve a bit deeper into regions and sectors within global equity markets in early 2024.

Equities will likely continue to enjoy a tailwind as central banks pivot to outright rate-cutting towards mid-2024. Indeed, falling bond yields (in anticipation of these cuts) and rising valuations have powered the equity rally so far.

The next step for equities will most probably be focused on an improving earnings picture in 2024. Indeed, as the earnings season is set to begin in late-January, the risk of disappointment – which was prevalent in 2023 – looks set to wane through 2024. For investors seeking some shelter from an uncertain cyclical earnings recovery, Japan (with accelerated buybacks and dividend payments) and India/Mexico (with re-shoring flows from China) look set to offer non-cyclical earnings growth in 2024.

Sources: Bloomberg Finance L.P.
Corporate profit data excluding financials and insurance.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

For bond investors, while sovereign yields should remain stable (4–4.5% in the US and 2–2.5% in Germany) as disinflation continues in early 2024, the bulk of the long-dated yield declines are, we believe, probably behind us. With cash yields set to fall on both sides of the Atlantic in 2024, moderate-duration credit exposures should offer enhanced carry/income for investors as the interest regime evolves through the year.

On balance, despite 2023's strong close, investors should seek to stay engaged in both equity and bond markets, looking more granularly at credit exposure to enhance income, and into regions/sectors to maximise earnings growth prospects in the year ahead.

Asset allocation

We are positive on the fixed-income asset class despite the year-end rally

The macro environment remains supportive of equities

Investors should not reduce risk in portfolios despite the significant rally in equity markets at the end of 2023

At the start of the new year, the investment backdrop for 2024 has been strengthened by recent disinflationary trends and an accelerating decline in interest rates following the indirect pivot by the Federal Reserve at its December meeting which opened the door to interest rate cuts in 2024. With US inflation now expected to reach a range of 2–2.5% by year end (vs. 2.5–3% previously), we see the investment environment remaining equally supportive for both equities and fixed income.

For fixed income, we previously expected the asset class to offer returns of 8–10% in 2024 (3–5-year investment grade), based on 6% carry and 4% capital gains with 2-year rates at 4% and US inflation at 3%. Now that we expect US inflation to fall to 2.5%, we expect the asset class to deliver returns of 6–8% this year, based on the current 5% carry and 2% capital gains with 2-year rates at 3.5%. This remains more attractive than a cash deposit rate of 5%. We are maintaining our positive stance on the fixed-income asset class despite the year-end rally (the aggregate global bond index rose by 6.6% in the last two months of 2023).

For equities, the macro environment also remains supportive of the asset class as inflationary pressures slow down and interest rates are expected to be adjusted down faster than previously thought. Current valuations of 19.5x forward earnings for the S&P 500 might look stretched, but the technology sector now represents 30% of the index and continues to offer faster earnings growth than the overall market. The “Magnificent 7” (Alphabet, Apple, Amazon, Meta, Microsoft, Nvidia and Tesla) are expected to grow their earnings by 26% in 2024, following a 75% increase last year. This justifies the premium valuation of the S&P 500 compared with historic levels, and explains why investors should not reduce risk in portfolios despite the significant rally in equity markets at the end of 2023.

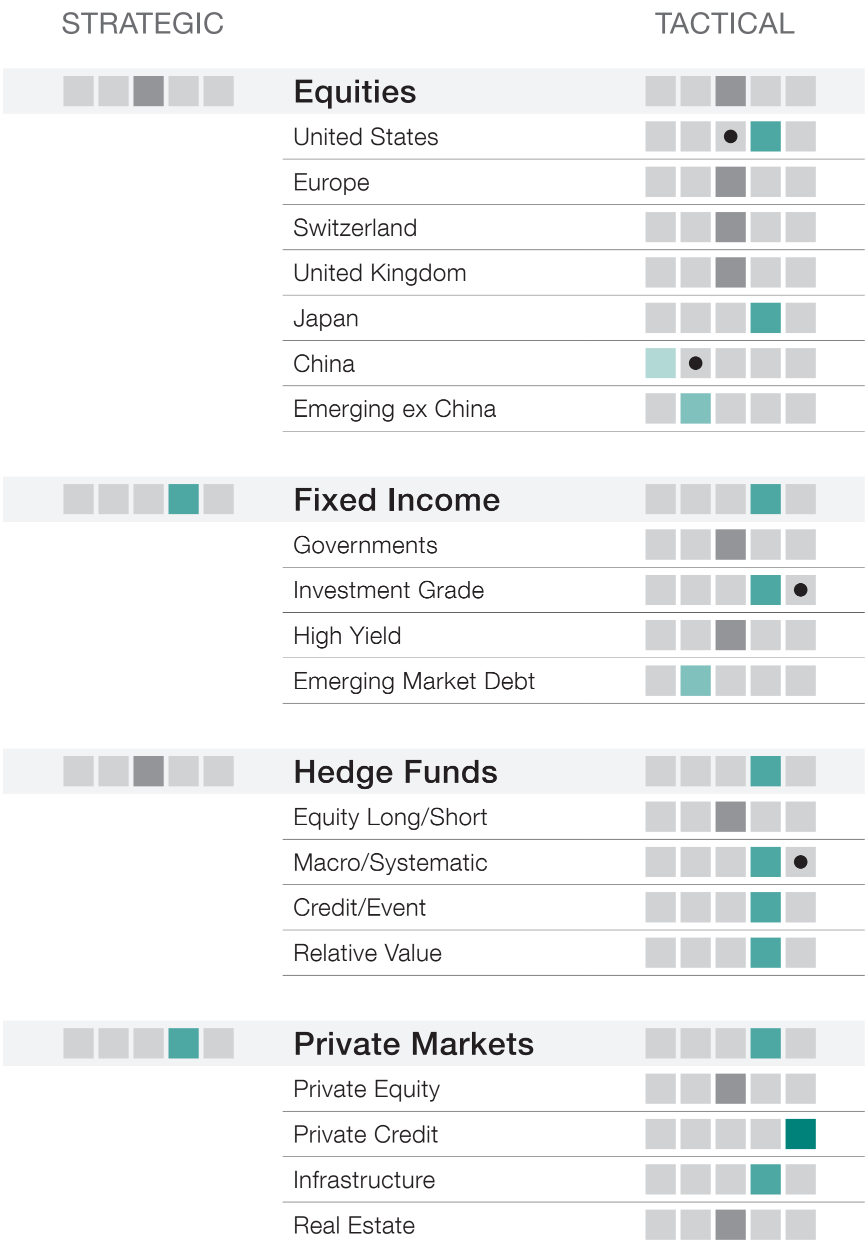
We are maintaining a neutral exposure to hedge funds and gold, as these asset classes have proven to be valuable sources of diversification within portfolios, particularly during periods when both bonds and equities simultaneously experience declines.

Directional views

LOW CONVICTION | BASE LINE ALLOCATION | HIGH CONVICTION

PREVIOUS VIEW ● (no dot means no change)

Strategic (long-term view) and tactical (1–6 month) on broad asset classes, December 2023



This material represents an assessment of the market environment at a specific time and is not intended to be a forecast of future events or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any particular fund, strategy or security. Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

Asset classes

EQUITIES

MACRO BACKDROP IS EQUITY-SUPPORTIVE

The 2023 year-end rally in equities was the second best in history, with the S&P 500 surging by 14% in November and December as inflation continued to decline, and the Federal Reserve pivoting and opening the door for interest rate cuts in 2024. Even if the powerful rally in equities leaves less upside for 2024, the macroeconomic environment remains very supportive of the asset class. We acknowledge that the rally in equities has mostly been driven by the expansion of multiples (from 18x P/E to 19.5x) based on declining long-term interest rates (the 10-year US rate has fallen from 5% to 4%). Current valuations are not a catalyst for a correction if the upcoming earnings season meets or beats expectations. Entering the Q4 earnings season, this looks achievable given the cautious consensus earnings-growth forecast of +5.2%, year-on-year (S&P 500). Should earnings disappoint, this would probably provide grounds for a pullback, as investor sentiment and positioning reached elevated levels at the start of this year. We remain neutral on the asset class with an overweight in US and Japanese equities. Sector-wise, we continue to favour technology and the US software sub-sector as core allocations to our strategy.

BONDS

THE WINDOW OF OPPORTUNITY TO LOCK IN YIELDS IS CLOSING

Even after the 2023 year-end rally, bond yields are still at attractive levels. We expect the yield-curve normalisation process to develop further, with limited risks for additional rate hikes from central banks.

Investors should continue to favour 3–5-year, high-quality, investment-grade bonds, which still represent the best risk-adjusted option in the fixed-income space.

The high-yield space and emerging markets are additional sources of carry, with a focus on short-duration, high-yield bonds and defensive emerging market issuers due to there currently being tight valuations in both spaces.

CURRENCIES

ALL EYES ON MARCH

Coming into Q1 2024, FX markets are in “wait-and-see” mode; they are waiting for key central bank meetings in March (Bank of Japan, Federal Reserve, ECB) to set out the path for the next steps in wider FX moves.

As we move towards March, we expect the USD/JPY to trade above 145, and likewise the EUR/USD to trade below 1.10. Once the trajectory of rate cuts becomes clearer, we will see more pronounced moves, on the downside for the USD/JPY and on the upside for the EUR/USD.

ALTERNATIVE INVESTMENTS

DIVERSIFIED SET OF OPPORTUNITIES AHEAD

For 2024, the outlook is more balanced than last year. For Relative Value managers, Convertible Arbitrage could post attractive returns due to high issuance. Fixed Income Arbitrage should benefit from higher rate volatility. Various asset-backed securities could benefit, as delinquency rates are rising. Within Equity Long/Short, low-net-exposure managers are favoured, but we are positive on specialists in sectors that have been out of favour for the past two to three years. For diversifying strategies, if rate-easing begins, this should be supportive for Global Macro and, more specifically, emerging market specialists, thanks to bond and currency opportunities.

PRIVATE MARKETS

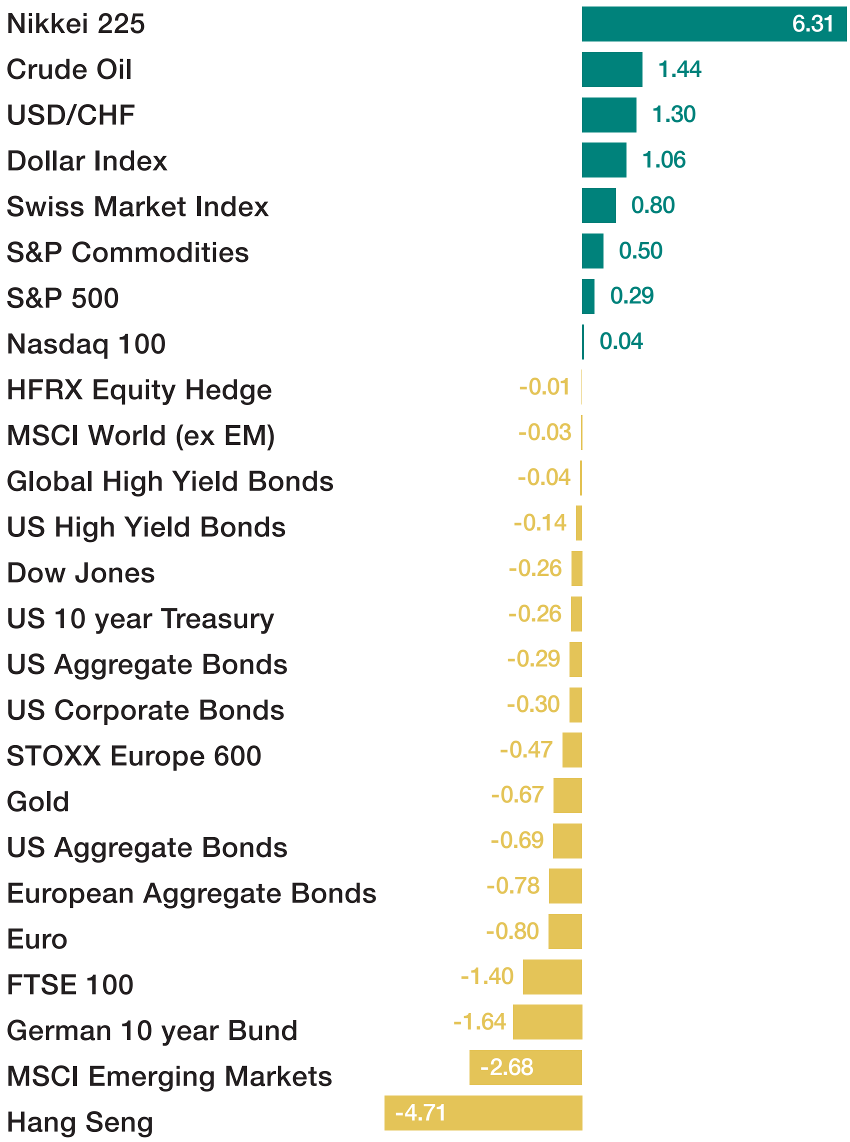
THOROUGH SELECTION MATTERS AGAIN

2024 will probably be a year that rewards thorough selection and differentiation. The rapid normalisation of rates reshuffled all risk premia, including those driving performance in private markets. Private equity and real estate could be more challenged in the shorter term, while credit and infrastructure continue to enjoy strong tailwinds thanks to structural supports, such as the development of megatrends in infrastructure.

In this context, our preference continues to be for private equity secondaries given the structural nature of the opportunity, and, in private debt, we favour non-sponsored structured opportunities on the back of a less competitive landscape and the continuation of the Bank's disintermediation trade.

Market performances

2024 YEAR-TO-DATE RETURNS (%)



Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and do not account for fees.
It is not possible to invest directly in an index. Sources: Bloomberg Finance L.P., UBP, and Refinitiv, as at 12 January 2024.
Past performance is not a guide to current or future results. Any forecast, projection or target, where provided, is indicative only and is not guaranteed in any way.

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.

© UBP SA 2024. All rights reserved.

MORE ON
UBP.COM

See additional
UBP House View
content on our
Newsroom page

Receive
UBP's newsletter
by signing up on
our website

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

Signatory of:
PRI Principles for Responsible Investment