Macro Quarterly

For global professional / qualified / institutional clients and investors and US retail clients and investors. For marketing purposes.

Macroeconomic themes and tactical asset allocation opportunities
3Q2021 I UBS Asset Management

Evan Brown
Head of Multi-Asset Strategy
Investment Solutions

Ryan Primmer
Head of Investment Solutions

Luke Kawa
Director
Investment Solutions

Losing momentum, staying strong

Highlights

- Investors are navigating an environment in which economic momentum is slowing to one where the rate of growth stabilizes well above trend.
- Historically, these inflection points can be a source of market volatility. The stage of the cycle and Treasury market regime also contribute to our tactically cautious stance on equity beta.
- We maintain our conviction in procyclical relative value trades in ex-US developed market equities, which have relatively attractive earnings outlooks and valuations.
- In our view, the Federal Reserve's responsiveness to inflation risks should leave the US dollar in a more rangebound environment, but select emerging market currencies can still outperform.
- We believe that some asset classes, like global sovereign bonds, trade at levels that imply too much pessimism about the likely strength of the global expansion, providing opportunities for investors.

After pricing in an economic recovery from the pandemic, investors are facing more difficult questions: What's next? What kind of expansion will this be? And how will inflation and growth outcomes be similar or different to previous cycles?

From a market perspective, in answering these questions it is important to differentiate between the rate of change and momentum. We expect the former, the rate of growth, will remain strong, in part because monetary and fiscal policy will remain accommodative. However, we believe that momentum will slow, because monetary and fiscal policy will soon be less supportive of growth than they are right now. In addition, pent-up demand following economic reopening should normalize to a more sustainable level.

Markets are forward-looking and in the process of navigating this change from an accelerating to decelerating growth environment. Historically, these inflection points can cause market volatility as investors try to assess the extent of the loss of momentum and the future equilibrium for the growth rate of activity. Typically, asset prices over-react to the underlying negative changes in the fundamentals during this period.

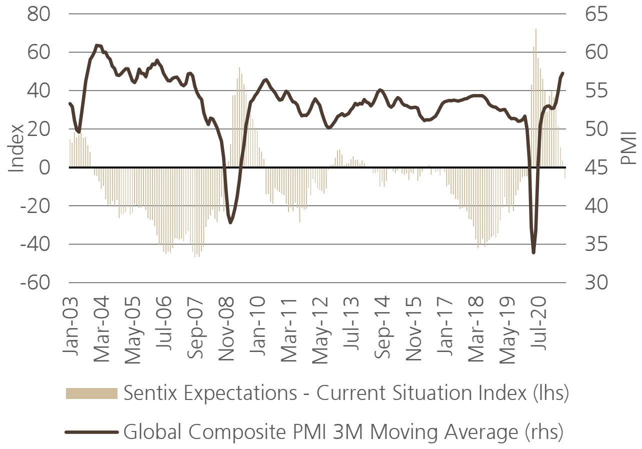
Outside of equities at the headline level, and particularly US stocks, there are indications that prices reflect this reassessment of the growth backdrop across various asset classes, though to widely different degrees. In our view, these cross-asset signals need to be taken seriously, which leaves us tactically cautious on equity beta. However, we suspect it will soon be time to fade these growth fears and increase equity exposure once cross-asset warning signals wane. In the meantime, we maintain our core, relative value

UBS

Exhibit 1: Economic data no longer surprising to the upside in China and US

Source: UBS-AM, Bloomberg, Citigroup. Data as of 9 July 2021.

Exhibit 2: Change in confidence surveys suggests global momentum peaking



Source: UBS-AM, Macrobond. Data as of July 2021.

procyclical equity positions in anticipation that ex-US developed market stocks have already more than discounted the extent of the loss in growth momentum and will meaningfully outperform once this transition phase runs its course.

Approaching the peak

The world's two largest economies, China and the US, led the surprisingly strong global recovery from the virus-induced recession. But in these nations, economic data is now failing to beat analysts' estimates – and in the case of China, falling far short of them. For this reason, as well as their more attractive coupons, Chinese bonds are our most preferred among sovereigns.

Pessimism turning into over-optimism is a common feature of the progression from recession to recovery. It is a sign that these economies have exited the early-cycle environment and expectations – and asset prices – need to be recalibrated.

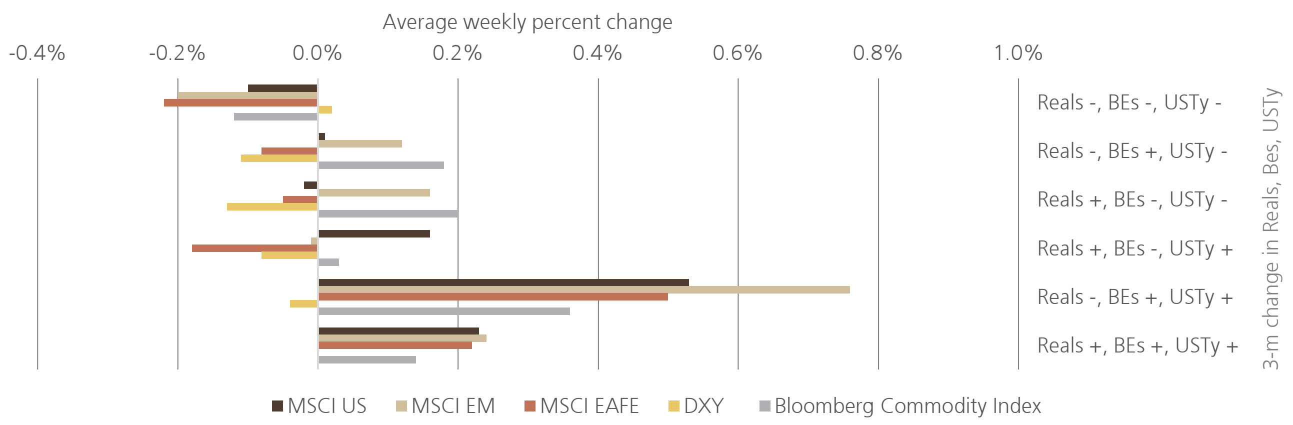
These two economies are driving the loss of momentum at the global level. Confidence surveys show a significant narrowing of the gap between assessments of current conditions compared to economic expectations. On the one hand, this development is a testament to the strength of the global recovery. But historically this is also associated with a peak in global purchasing managers' indexes and waning economic momentum thereafter.

Tactically cautious

Many asset prices – such as copper and the US dollar – have adjusted in a manner consistent with a looming shift from accelerating to decelerating activity.

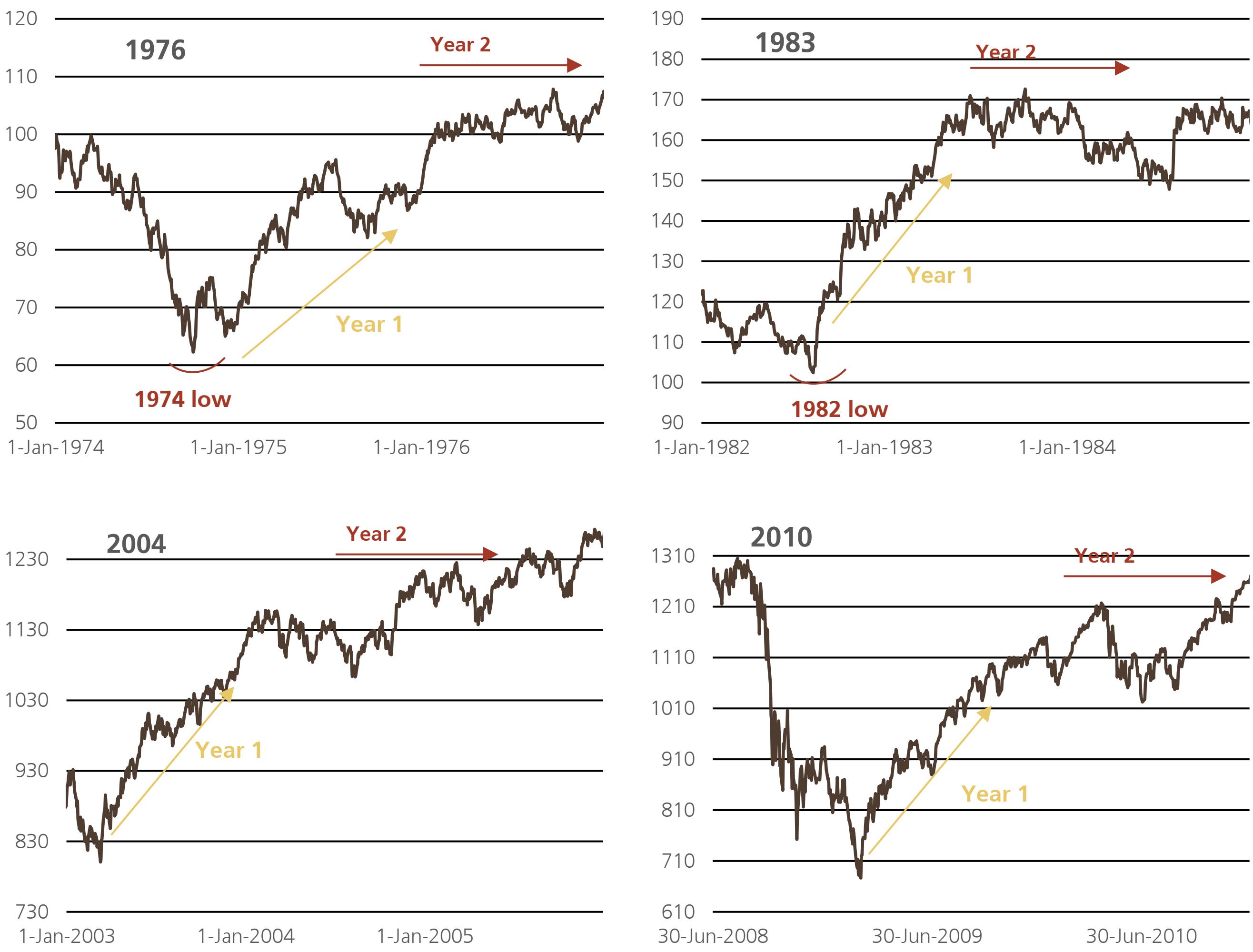
Global equities, and in particular US equities, are among the outliers in this regard. The stage of the cycle and Treasury market regime are suggesting that investors should be cautious on equities at the index level.

Exhibit 3: The worst Treasury market backdrop for equities
Nominals, reals, and breakevens all down over past three months



Source: UBS-AM, Bloomberg. Data from 1998 through July 2021.

Exhibit 4: Year two of a bull market is often choppy
Major S&P 500 bottoms have been followed by a one-year resurgence and subsequent consolidation



Source: UBS Asset Management, Macrobond, All Star Charts. Data as of 9 July 2021.

The second year following a major market bottom and start of a bull market – which we believe this is – tends to include a period of consolidation in US equities. Investors, having weathered a negative shock, reach a point at which enthusiasm about the rally gives way to a reappraisal of the likely trajectory of earnings growth required to justify those equity valuations.

Moreover, the three-month rates of change for US 10-year Treasury yields, breakevens, and nominals have all recently turned negative. Of all the different permutations of these variables, this particular mix has historically been the worst regime for performance in equities and the highest for volatility (see Exhibit 3).

Soon time to fade the growth fears
Estimates for 2022 GDP growth in the US and Eurozone have remained firm even as US Treasury yields retraced a significant portion of their year-to-date advance. These forecasts, if realized, would mark the strongest annual growth for either region in the 21st century (excluding 2021).

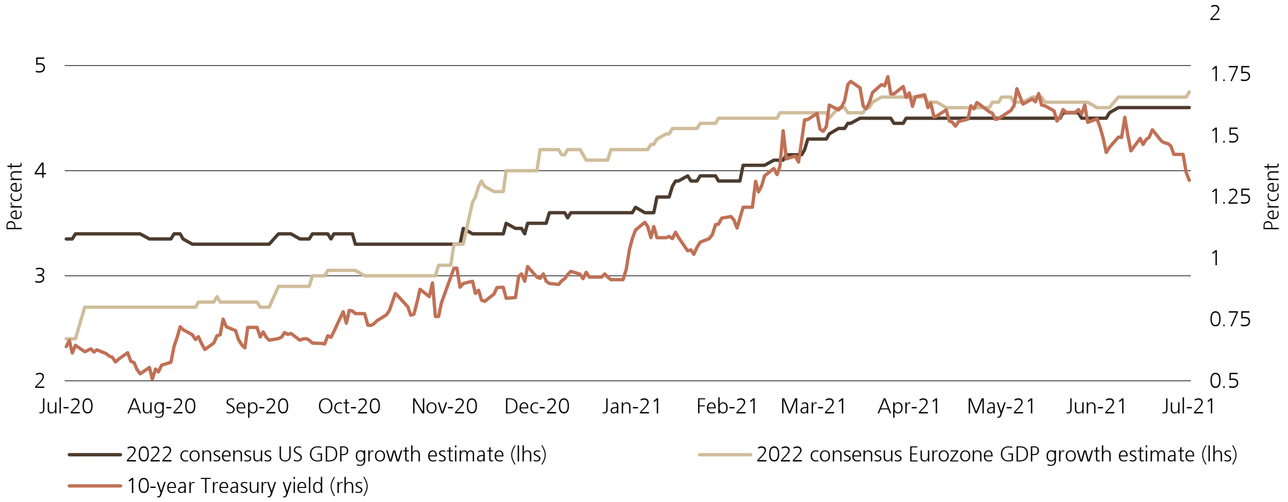
The amount of fiscal stimulus to date is larger than it was in the aftermath of the 2007-2009 financial crisis, and the ensuing retrenchment will likely be neither as sudden nor severe. Household balance sheets are in a healthier position, and buoyed by excess savings. The outlook for capital spending is also robust given the magnitude of the growth in corporate profits.

In our view, sovereign bond yields stand out as an asset class that may have overshot to the downside in light of the vigor this economic recovery is likely to retain. However, we have to consider the implications for our broad multi-asset positioning if the warning being sent by bonds is indeed accurate, and have reduced risk at the margin accordingly.

Part of the rally in longer-term yields is attributable to the Federal Reserve's heightened sensitivity to price pressures. This has seemingly reduced right-tail outcomes for both inflation and growth in the eyes of market participants, and we believe only the former is justified. Given our positive macro outlook,

Exhibit 5: Growth looks to stay strong in 2022

10-year Treasury yield tracked against 2022 consensus GDP growth estimates



Source: UBS-AM, Bloomberg. Data as of 9 July 2021.

we are examining opportunities to go more underweight global duration. Looking to the cross-asset backdrop for broad signs of stability across asset classes – the dollar no longer going up, and copper and bond yields no longer going down – will guide us as to when it may be appropriate to add equity risk more aggressively at the headline level.

Asset allocation

Investors are adjusting to a new phase of the expansion. We can't say with certainty how long this transition period will last. While it is ongoing, different assets will over or under-react to the change of global economic momentum.

Global equities at the headline level have yet to register a meaningfully negative reaction to this inflection point. Therefore, we do not believe it is a prudent time to increase equity risk until other cyclically sensitive assets, such as copper and developed market sovereign bond yields, show more concrete signs of stabilization.

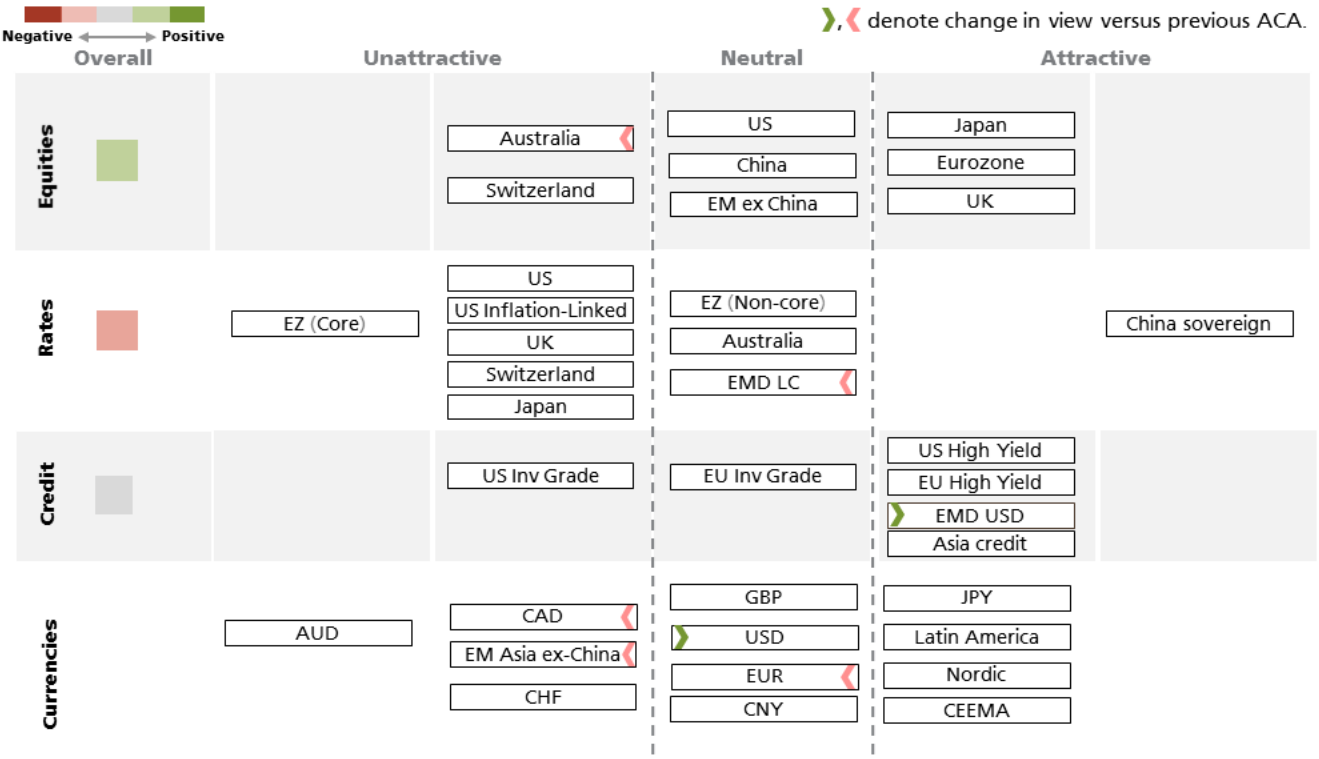
However, we retain our core relative value positions in procyclical equities such as Europe and Japan. Unlike global equities at the headline level, these positions have lagged recently. In our view, any future underperformance would be modest even in the event that investors remain preoccupied with peak growth and peak stimulus. Ultimately, we have confidence that global growth will stabilize above trend in the coming quarters, and that these are the regions that will outperform as we emerge from this transition period and investors' focus shifts to the robust run rate for economic activity. We believe that their recent underperformance is not a function of a deterioration in their underlying earnings outlooks relative to US equities. This fortifies our preference for these regions on a going forward basis.

We are actively looking for opportunities in other asset classes, like global sovereign bonds, where we believe that yields now embed too much pessimism about the shape and strength of the expansion.

In our view, the US dollar should be more rangebound, especially against G10 currencies, due to the Fed's responsiveness to inflation risks. Since Asia is leading the loss of economic momentum, we stay short cyclical Asian currencies, as well as select G10 commodity exporters. Some emerging market currencies, such as the Russian ruble and Brazilian real, are well-supported by monetary tightening and retain the capacity to perform even in a trendless USD environment.

Asset class attractiveness (ACA)

The chart below shows the views of our Asset Allocation team on overall asset class attractiveness, as well as the relative attractiveness within equities, fixed income and currencies, as of 12 July 2021.



Source: UBS Asset Management Investment Solutions Macro Asset Allocation Strategy team as at 12 July 2021. Views, provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

Negative ⟷ Positive

Asset Class	Overall signal	UBS Asset Management's viewpoint
Global Equities		– Our outlook for stocks over the next 12 months remains positive. The economic recovery is likely to continue this year on the back of additional global fiscal stimulus, still accommodative financial conditions, and progress on the broad administration of effective COVID-19 vaccines. – However, in the near term we expect a choppier environment for equities at the headline level, as is common during the second year of a new bull market. The equity risk premium is near the floor of the previous cycle, which may cap upside as policy risks start to become more two-sided and growth momentum peaks. – Given the magnitude of the equity rally in recent months, we see more upside in relative value opportunities that offer attractively priced exposure to what will still be a very robust global growth backdrop compared to beta exposures.
US Equities		– US equities continue to command premium valuations. The sectoral composition drives this dynamic, with a higher weighting towards acyclical defensive technology than other markets. This characteristic may not prove a boon in the event that investors aim to boost cyclical exposure. Accordingly, we prefer US equal weight to market cap indexes. – Continued strong earnings, robust balance sheets, and unprecedented support from the Federal Reserve should continue to support US equities, but fiscal/tax policy risks are becoming more two-sided.
Ex-US Developed market Equities		– Non-US developed market equities are attractively valued and have significant exposure to the global economic recovery. – Earnings growth in Europe and Japan is poised to outstrip that of US, and this superior outlook is not well reflected by the recent relative performance of these regions. – Both earnings and valuations have more room to run in ex-US developed market equities. – Europe and Japan lagged on vaccine administration but are catching up, which should improve investor sentiment.
Emerging Markets (EM) Equities (ex-China)		– Robust growth in China even as stimulus ebbs, one of our macroeconomic themes, is a positive for the asset class, particularly for countries with the tightest economic and financial linkages. Resilience in industrial metals, even during a rally in sovereign bonds, is another leading indicator that points to a solid foundation for real activity. – However, EM equities continue to face near-term challenges that include a negative turn in forward earnings growth relative to DM, and less access to the most efficacious vaccines.
China Equities		– We expect gains in Chinese equities so long as there is no abrupt withdrawal of accommodation, but prefer international equities where the recoveries are less mature. – Policy actions designed to limit the power of major internet companies may linger as a headwind for this important pocket of the equity market. – The well-telegraphed deceleration in China's credit impulse warrants close watching, as it constitutes a key downside risks to commodity prices and procyclical positions across asset classes. – The recent RRR cut may be an indication that the peak in credit tightening has passed. – The new US administration will be more predictable in its relations with China, while continuing the process of economic decoupling in areas of strategic importance.
Global Duration		– Long-term bond yields have retraced aggressively ahead of the turn in global growth momentum and signs of incremental hawkishness from the Federal Reserve. However, inflation risks remain tilted to the upside and global economic activity is poised to remain robust well into 2022. – As such, we expect increases in real rates and market-based measures of inflation compensation to contribute to a renewed rise in yields. – Sovereign fixed income continues to play an important diversifying role in portfolio construction, and remains particularly effective in hedging downside in procyclical relative value equity positions.

Negative ←→ Positive

Asset Class	Overall signal	UBS Asset Management's viewpoint
US Bonds		– US Treasuries remain the world's preeminent safe haven and top source of risk-free yield. The Fed's responsiveness to inflation risks has undermined the appeal of curve steepeners until such a time that price pressures recede and economic activity remains elevated. – The looming peak in global growth, concerns about a potential Fed policy mistake, strong foreign demand, and over-extended short positioning have contributed to a sharp decline in US Treasury yields and flattening of yield curves. – We expect this to reverse going forward, with a combination of strong growth and inflation driving Treasury yields higher across the curve. – The Federal Reserve will likely lay out formal plans to taper its asset purchasing program by year end, and the extent of the deceleration in price pressures during the fourth quarter will play a key role in determining whether the removal of stimulus is expedited or delayed.
Ex-US Developed-market Bonds		– We continue to see developed-market sovereign yields outside the U.S. as unattractive. The Bank of Japan's domination of the Japanese government debt market and success in yield curve control diminishes the use of the asset class outside of relative value positions. The potential for European fiscal integration and solid commitment to supporting economies during the pandemic are factors that may compress periphery spreads, but perhaps at the expense of rising core borrowing costs, as well.
US Investment Grade (IG) Corporate Debt		– Spreads have fully retraced thanks to policy support and an improving economic outlook, while all-in borrowing costs are well below pre-pandemic levels. US IG is one of the few sources of quality, positive yield available and therefore a likely recipient of ample global savings. However, the duration risk embedded in high-grade debt as the economy recovers as well as the potential for spread widening should threats to the expansions arise serve as material two-sided risks that weigh on total return expectations for this asset class.
US High Yield Bonds		– We expect carry, rather than spread compression, to drive total returns in HY going forward. The coupons available will continue to attract buyers in a low-yield environment. – The asset class is more attractively valued and has less sensitivity to rising interest rates than IG bonds.
Emerging Markets Debt US dollar Local currency		– We have a positive view on emerging market dollar-denominated bonds due to the balance of carry opportunity and duration risk. – Asian credit is enticingly valued and poised to perform well in environments in which growth expectations improve or plateau, so long as highly adverse economic outcomes fail to materialize. – The more rangebound environment for the US dollar removes one previous tailwind for the outlook for total returns in EM local bonds.
Chinese Bonds		– Chinese government bonds have the highest nominal yields among the 10 largest fixed income markets globally as well as defensive properties that are not shared by most of the emerging-market universe. We believe that cooling domestic economic growth and inclusions to global bond market indices should put downward pressure on yields during the next 3-12 months.
Currency		– The Federal Reserve's signal of concern about inflation risks, as seen by the increase in the 2023 median for the dot plot, puts a higher floor under the dollar and meaningfully reduces the prospect of a retest of its late-May lows in the near term. – EM FX like RUB and BRL, which are supported by continued monetary tightening, are well-positioned to outperform even in a rangebound USD environment, while cyclical Asian currencies and select G10 commodity exporters are poised to struggle.

Source: UBS Asset Management. As of 12 July 2021. Views, provided on the basis of a 3-12 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

A comprehensive solutions provider

UBS Asset Management Investment Solutions manages USD 149.1 billion (as of 31 March 2021). Our 100+ Investment Solutions professionals leverage the depth and breadth of UBS's global investment resources across regions and asset classes to develop solutions that are designed to meet client investment challenges. Investment Solutions' macro-economic and asset allocation views are developed with input from portfolio managers globally and across asset classes.

For more information, contact your UBS Asset Management representative or your financial advisor.

For marketing and information purposes by UBS. For global professional / qualified / institutional clients and investors and US retail clients and investors.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.

Americas

The views expressed are as of July 2021. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA

The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document. Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient. The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG. This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK

Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction. Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed. You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia

This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

China

The securities may not be offered or sold directly or indirectly in the People's Republic of China (the "PRC"). Neither this document or information contained or incorporated by reference herein relating to the securities, which have not been and will not be submitted to or approved/verified by or registered with the China Securities Regulatory Commission ("CSRC") or other relevant governmental authorities in the PRC pursuant to relevant laws and regulations, may be supplied to the public in the PRC or used in connection with any offer for the subscription or sale of the Securities in the PRC. The securities may only be offered or sold to the PRC investors that are authorized to engage in the purchase of Securities of the type being offered or sold. PRC investors are responsible for obtaining all relevant government regulatory approvals/licenses, verification and/or registrations themselves, including, but not limited to, any which may be required from the CSRC, the State Administration of Foreign Exchange and/or the China Banking Regulatory Commission, and complying with all relevant PRC regulations, including, but not limited to, all relevant foreign exchange regulations and/or foreign investment regulations.

Hong Kong
This document and its contents have not been reviewed by any regulatory authority in Hong Kong. No person may issue any invitation, advertisement or other document relating to the Interests whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Interests which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules made thereunder.

Japan
This document is for informational purposes only and is not intended as an offer or a solicitation to buy or sell any specific financial products, or to provide any investment advisory/management services.

Korea
The securities may not be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the Capital Market and Financial Investment Business Act and the Foreign Exchange Transaction Law of Korea, the presidential decrees and regulations thereunder and any other applicable laws, regulations or rules of Korea. UBS Asset Management has not been registered with the Financial Services Commission of Korea for a public offering in Korea nor has it been registered with the Financial Services Commission for distribution to non-qualified investors in Korea.

Malaysia
This document is sent to you, at your request, merely for information purposes only. No invitation or offer to subscribe or purchase securities is made by UBS Asset Management as the prior approval of the Securities Commission of Malaysia or other regulatory authorities of Malaysia have not been obtained. No prospectus has or will be filed or registered with the Securities Commission of Malaysia.

Singapore
This document has not been registered with the Monetary Authority of Singapore pursuant to the exemption under Section 304 of the SFA. Accordingly, this document may not be circulated or distributed, nor may the Securities be offered or sold, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor pursuant to Section 304 of the SFA.

Taiwan
This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in the Republic of China (R.O.C.). This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in the Republic of China (R.O.C.). No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of the Republic of China (R.O.C.).

Source for all data and charts (if not indicated otherwise):
UBS Asset Management.

www.ubs.com/am-linkedin

AMMA-6820 07/21
www.ubs.com/am

UBS