For marketing purposes
For professional / qualified / institutional clients and investors only

Bond Bites

UBS Asset Management | Fixed Income views
July 2020

Jonathan Gregory
Head of Fixed Income UK

Three emerging trends in a changing world

For global investors today an occupational hazard is to sometimes feel overwhelmed by a continual blizzard of daily data. At times we all struggle to get footholds in what is really meaningful. And daily distractions breed one of the most damaging mind-sets for long term wealth creation; a focus only on the very short term.

While the day-to-day hi-frequency noise can be all-consuming, my colleagues and I believe that it is the secular trends in politics, markets and economies that really matter to bond returns over time; the fall of the Berlin Wall and subsequent collapse of the Soviet Union; 9/11 and its aftermath; the integration of China into the global supply chain, the Global Financial Crisis and the subsequent reshaping of monetary policy. It is these events, and a handful of others, that have had the most profound impact on the global economy, and hence asset returns, over the past 30 years.

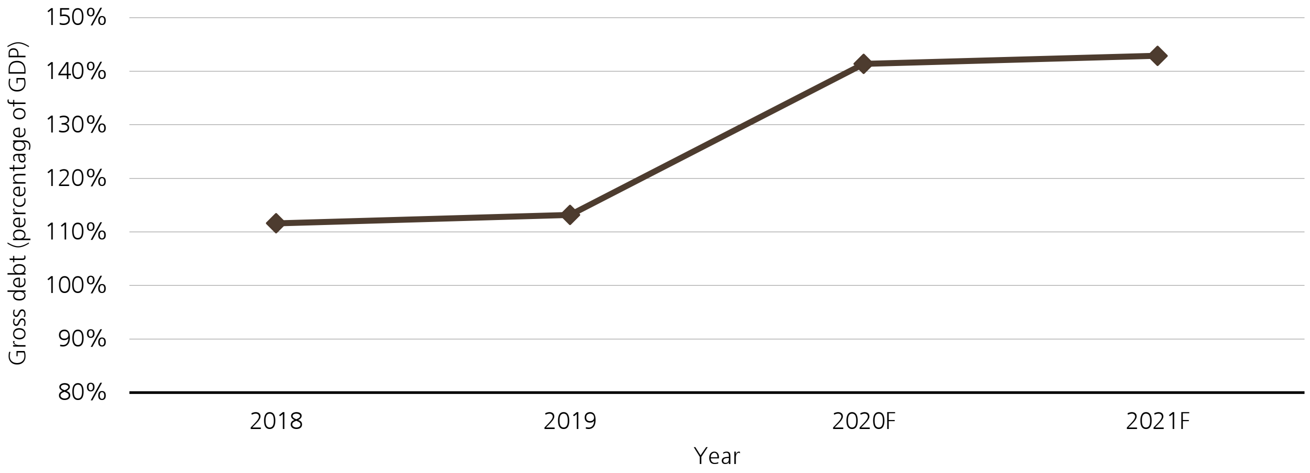
If we spend a few moments to tack away from the daily noise of market chatter, what might be the secular themes today that really matter; and what might they mean for investors? In our view, at least three movements bear close attention.

1. The end of fiscal austerity

Since the Great Financial Crisis, the prevailing political orthodoxy in many developed markets was one of fiscal rectitude; less debt and more balanced budgets. But in the aftermath of COVID-19 those policies have been consigned to history – and how. With USD 11 trillion and counting of government support so far, the International Monetary Fund (IMF) forecasts G20 debt/GDP levels to soon average around 120%, the highest levels in a generation, with budget deficits at 10% of GDP or higher.

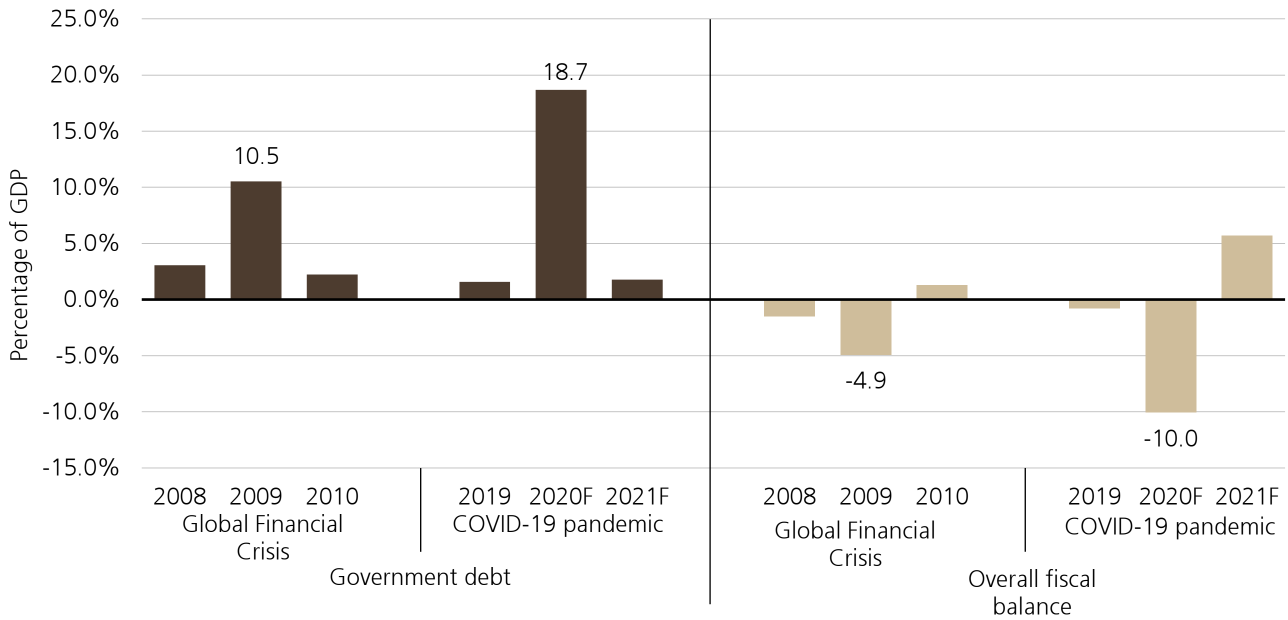
In fact, a meaningful shift in attitude towards higher fiscal spending in many countries was already underway before the global pandemic. With many economies stuck in a protracted phase of negligible real growth and falling productivity, the political pressure for more aggressive fiscal action was growing. The massive spending unleashed in response to COVID-19 means that political Rubicon has now been crossed. We should expect higher government spending, larger social programs and more politically driven allocation of capital than we have been used to in the past 10 years. This will be a profound change.

Gross debt (% of GDP) – advanced G20 economies



Source: International Monetary Fund, World Economic Outlook, June 2020

Change in Global Government debt and overall fiscal balance



Source: International Monetary Fund, World Economic Outlook, June 2020

2. The fading multilateral dream?

The fall of the Berlin Wall in 1989 and subsequent collapse of the Soviet Union fed widespread optimism that formerly communist countries would complete a rapid transformation into open market liberal democracies; and at the same time existing parliamentary democracies would embrace more open borders and closer integration. To an extent these dreams were fulfilled, certainly in Europe, where several formerly communist countries were integrated in whole or part into the European Union. At roughly the same time the rapid integration of China and other emerging market countries into the global supply chain drove a period of market-led globalization. It brought the world closer to a frontier-free single market than perhaps it had been for 100 years.

Whether or not the benefits of these developments were shared equally is open to debate, but for the owners of capital they certainly helped drive a lengthy period of strong asset price returns. It is evident though that over the past few years many of these trends have stalled, if not gone into outright reverse. The shift away from centrist politics in developed markets, a serious counter-revolution against a multilateral world order and a rise of more authoritarian regimes certainly seem to herald a rather different secular outlook from the one we have become quite used to.

3. The fight against social injustice

For all the attention lavished on the pandemic and its aftermath, by far the most enduring legacy of 2020 could be the brutal exposure of the daily reality of racial and social injustice for far too many people in the world today. Government, institutional and corporate diversity has been brought into critical and uncompromising focus. The challenge here is already well understood but today the determination to address the issues once-and-for-all is palpable; ignoring them is simply not feasible. And the demands for reform reverberate across governments, corporates, institutions, consumers and voters – in many countries sectors of the economy are ever more united in driving real and lasting change.

What might this all mean?

Well to begin with, destroying embedded inequality and social injustice in societies will be an unmitigated good for the global economy. In fact, those countries that can make real and lasting changes could enjoy meaningful improvements in labor force participation and most likely higher productivity and growth. If there is one reason to be optimistic about the future, this is it.
The impact of the dramatic fiscal expansion is more ambiguous. Yes it certainly has the potential to lift aggregate demand and therefore reduce output gaps in economies operating below capacity. But the upside risks for inflation will be greater than at any point in the past 10 years (fiscal austerity was probably a structural factor in keeping inflation low). And this is certainly the case for some policy proposals that advocate an even more dramatic fiscal expansion, central bank caps on bond yields and moving responsibility for managing inflation from the central bank to the government[1].

The impact of the challenge to the multilateral world order may also be double-edged but, at face-value, does imply less free movement of goods, capital and labor than we have become used to. In turn this could hurt global growth and pose upside risks for inflation.

We have highlighted just three secular themes out of several we believe will be instrumental in shaping real investment returns in the years ahead. We will explore in more detail the paths that some of them may take in future commentaries. In our experience it has often paid handsomely to spend time to identify these themes, reflect on how they will reshape the global economy and act accordingly. Too much focus on the short term can be seriously damaging to returns. For more information on how our current thinking shapes our Global portfolio construction please click here

1 The most obvious example today being Modern Monetary Theory. The idea that, where economies operate below full capacity and governments issue debt in their own currency, spending may be expanded dramatically and funded by central bank asset purchases. Inflationary effects would be managed by adjusting tax and spending policies

For further information please contact your client advisor. Investors should not base their investment decisions on this marketing material alone.

For marketing and information purposes by UBS. For professional clients / qualified / institutional investors only.

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 a general guide to the views of UBS Asset Management as of July 2020. 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, advertise¬-ment 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.

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 r ecipients 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. The key symbol and UBS are among the registered and and unregistered trademarks of UBS.

AMMA-3633 02/20
www.ubs.com/am

For professional / qualified / institutional clients and investors only.

UBS