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Tel. +41 44 234 85 00

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News Release

UBS Year Ahead 2023: A year of inflections

As investors try to identify the turning points for inflation, rates, and growth against a complex geopolitical backdrop, UBS's Chief Investment Office looks ahead to a year of inflections, which will shape the investment landscape in the year to come. And, as the decade of transformation progresses, it sees long-term investment opportunities in themes such as the "era of security", within sustainable investments, and in finding value within private markets.

Zurich, 17 November 2022 – In the Year Ahead 2023, UBS Global Wealth Management's (GWM) Chief Investment Office outlines what investors should expect as one of the most challenging years in history for markets draws to a close.

The investment backdrop should become more constructive as 2023 evolves, as inflation falls and as investors start to anticipate rate cuts and higher growth. But as we enter 2023, high inflation, rising rates, and slowing growth expectations favor a relatively defensive stance on risky assets.

With that in mind, the report's core recommendations for the year ahead include:

- **Add defensives and value.** Defensive sectors should prove relatively insulated from a weakening economy, while value stocks tend to perform well when inflation is high. More attractive opportunities to buy cyclical and growth stocks may emerge later in the year, as inflation slows and global growth picks up.
- **Seek income opportunities.** Earning more predictable returns from income strategies is appealing against an uncertain backdrop, while high market volatility itself can also offer a means of generating income. Once rates and growth stabilize elevated yields among lower-rated issuers could present an attractive opportunity.
- **Shelter in safe havens.** Relatively high US rates and slowing global growth should help keep the US dollar strong in the coming months, and the Swiss franc's safe-haven appeal is likely to attract inflows. But investors will need to prepare for greenback weakness as Fed policy is expected to turn more dovish.
- **Seek uncorrelated hedge fund strategies.** Macro, low net equity-long short, and multi-strategy funds can help diversify portfolios in the context of periodically elevated equity-bond correlations, which are likely to persist as swings in monetary policy are expected to continue driving markets.

Mark Haefele, Chief Investment Officer at UBS GWM, says: "We see a year of inflections ahead and investors currently sheltering from volatility need to plan when, and how, to rotate back into recovery themes in 2023. Over the longer-term we see private markets as a way to grow exposure to secular trends of the decade ahead, notably in the areas of digitalization and energy security."

The decade of transformation continues

The decade of transformation has already brought significant changes to the global economic, political, societal, and environmental picture. But with central banks determined to bring inflation under control, a transition to green energy spurring investment, the era of security driving public spending on infrastructure and R&D, and the digitalization of business models gaining momentum – all amid lower asset class valuations – a more positive secular backdrop remains possible.

According to the report investment opportunities to capture value and growth in the decade ahead include:

- **Position for the "era of security".** Prioritization of energy security, food security, and technological security by governments and businesses will be a key driver of major sectors in the years ahead. Efforts to improve efficiency across the broader food supply chain, for example, are expected to drive opportunities in several areas. Smart agriculture is expected to cumulatively see its market size expand by 11% a year until 2030 from an estimated USD 13 billion today.
- **Invest sustainably.** Despite underperformance in the past year, long-term performance of sustainable investments remains strong on an absolute and relative basis and sustainability can be a key driver of corporate performance. However, investors need to pay particular attention to diversification by sector, style, and asset class.
- **Find value in private markets.** Private market investments not only help with portfolio diversification, but putting fresh capital to work in private markets in the years following declines in public markets has historically proven a rewarding strategy over the long term. Strategies that can take advantage of price dislocations are a compelling option for investors looking to build up their exposure to the asset class.

Scenario analysis

	Upside	**Base case**	**Downside**
Key drivers			
Central banks	Inflation falls faster-than-expected, allowing a tilt toward sooner rate cuts. The lagged effect of monetary policy could support inflation surprising to the downside.	Falling inflation should allow the Fed, the ECB, the SNB, and the BoE to complete their hiking cycles in 1Q23, or 2Q23 at the very latest. Inflation in the US and Europe are likely to be close enough to the 2% y/y targets toward end-2023 for rate cuts to be considered.	Inflation fails to fall back to target, delaying rate cuts or forcing further rate hikes. Central banks pause rate hikes too early, stimulating near-term growth and reigniting inflationary forces, in turn requiring further hikes.
Economic growth	Economic growth reaccelerates as e.g.: A détente between Europe and Russia, and/or a warmer winter alleviates the energy crisis, boosting growth. China revises its zero-COVID policy and / or adds more stimulus, boosting growth. Inflation falling quickly and lower borrowing costs supports US growth.	The US is still in expansion, but slowing, while the Eurozone and the UK are likely already in recession. China's recovery continues to be delayed. Growth in Europe should improve midyear 2023 as the energy crisis begins to ease after the winter. In China, provided zero-COVID policies are at least partially relaxed by mid-year, economic growth should also improve. In the US, a trough in economic activity is likely to come later, given the	Growth falls lower-than-expected as central banks overtighten and / or as developed countries' consumption contracts as inflation continues to outpace nominal wage growth. In Europe, a colder-than-expected winter disrupts energy supplies, deepening the economic downturn. China reopening is delayed to 2024.

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	Upside	Base case	Downside
		strength in the economy to date and the lagged impact of monetary policy.	A prolonged economic downturn prompts lower corporate earnings, rising default rates, and falling commodity prices.
Geopolitics and others	The war in Ukraine deescalates or is resolved.	The war in Ukraine is likely to drag on, adding volatility. Financial conditions tightening could increase the market's vulnerability to external shocks.	The war in Ukraine escalates and / or US-China tensions heighten. Financial conditions tighten further, causing stress in the financial system.
Market path			
	More favorable backdrop for riskier assets as investors see rate cuts and a trough in economic growth on the horizon.	Economic weakness ahead has not been fully priced in, as declines have been largely driven by higher real interest rates. Risk-reward over the next three to six months remains unfavorable, with stocks ending June 2023 near or at current levels.	A severe and prolonged market downturn, with riskier asset classes such as equities experiencing double-digit losses. Credit spreads widen, while safe havens benefit.

Key scenario targets for June 2023

Asset class	Upside	Base case	Downside
MSCI AC World	820	720	590
S&P 500	4,400	3,700	3,300
EURO STOXX 50	4,400	3,550	3,100
US 10y Treasury yield	1.50%	3.50%	4.50%
US 10y breakeven yield	1.50%	2.25%	3.00%
US high yield spread*	300bps	600bps	850bps
US IG spread*	60bps	150bps	200bps
EURUSD	1.05	0.98	0.92
Commodities (CMCI Composite)	2,200	2,000	1,600
Gold	USD 1,400-1,500 /oz	USD 1,600/oz	USD 1,800-2,100 /oz

* During periods of market stress, credit bid-offer spreads tend to widen and result in larger ranges.

Note: asset class targets above refer to the respective macro scenarios. Individual asset prices can be influenced by factors not reflected in the macro scenarios

Source: UBS, as of November 2022

Link

www.ubs.com/cio-yearahead

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UBS AG and UBS Switzerland AG

Media contact

Switzerland:	+41-44-234 85 00
UK:	+44-207-567 47 14
Americas:	+1-212-882 58 58
APAC:	+852-297-1 82 00

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