Let's clarify our current views. (ddp)

Asset Allocation

Mike Ryan: What we are and are not saying

30 August 2019, 6:34 pm CEST, written by UBS Editorial Team

I was taken aback by an article in the financial press stating that UBS had "turned bearish" on global equities. The article generated enough attention that I was also asked about our "bearish view" while appearing on one of the news networks. I thought it might be helpful to provide some clarity around our current views.

What we aren't saying.

We are not recommending that investors indiscriminately sell stocks. We have opted for a modest tactical underweight on equities given the uncertainties stemming from the current trade conflict. Periods of volatility and market drawdowns of around 10% are fairly common during bull markets. Thus, reducing our tactical risk positioning to a modest underweight should not be equated with the dawn of a bear market.

We also do not see this as the beginning of a recession. While global economic activity has decelerated amid a contraction within the manufacturing sector, labor market conditions remain robust and consumer spending is still holding up rather well. Currently, we see only about a 30% chance of a recession starting before the end of 2020.

Last, we are not suggesting that investors raise and then maintain large cash balances within their investment portfolios. With the Federal Reserve having cut rates in July and likely to do so again in September, returns on money market instruments will continue to decline. We therefore see cash as a less attractive asset class, which is why we reduced our recommended cash allocation in our most recent portfolio changes.

So what is it that we really are saying?

First off, we are recommending that investors reduce their overall risk exposure by both lowering equity weightings and increasing the fixed income allocation within their investment portfolios. The economic outlook has become less certain and the return environment for risk assets less supportive amid escalating trade tensions. While we still see a pathway for the US and China to reach a trade agreement, it may be that things continue to get worse on the trade front before they get better. So trimming our risk positioning here makes sense.

We're also encouraging our clients to maintain modest underweight positions in non-US developed and emerging market equities, while cutting US equity market weightings in portfolios back to neutral. Increased economic uncertainty is likely to weigh more heavily upon more cyclically exposed emerging markets, while the approach of Brexit and Italian electoral risks create additional headwinds for Europe. Within US equities, we are advocating a more domestically focused defensive bias (consumer staples, communication services, and consumer discretionary) over more globally exposed cyclical positions.

We are advising investors to try to maximize income, while still protecting against inflation risk exposure as the Fed continues to ease policy. This means having a modest underweight for nominal coupon Treasury securities, while adopting overweights to both Treasury Inflation-Protected Securities (TIPS) and emerging market dollar-denominated debt. This leads to a modest overweight to fixed income overall, with portfolios focused around income generating "carry positions."

And most important, we *are* recommending that investors remain engaged and invested. While sensationalized titles might make for provocative headlines, my experience has been that they rarely make for prudent investment guidance.

See the House View Weekly, 30 August 2019.

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