

Annual UBS investment Lecture

Thursday 17 November 2016

Welcome

Economic and Investment Outlook

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Economist

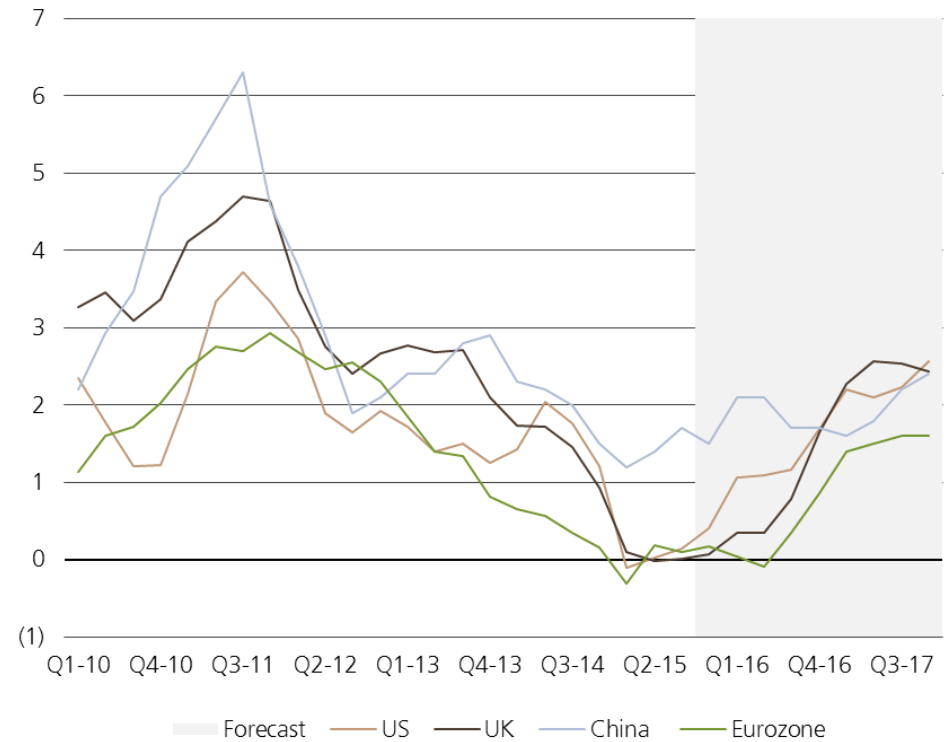
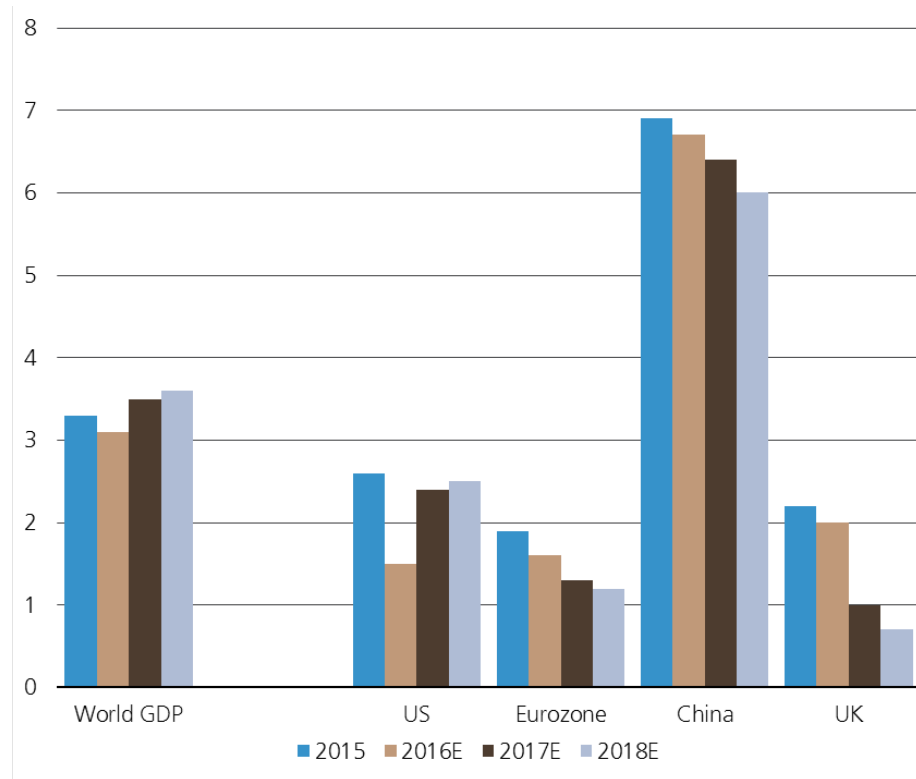
Chief Investment Office, WM

November 2016



Global growth set to increase, and so is inflation

UBS economic forecasts



What does a Trump presidency mean for markets?

- Republican majority in both houses of Congress, the President-elect will have some latitude to implement executive decisions that can alter the status quo of US economic and social policy.
- The promise of an expansionary fiscal policy
 - Tax cuts, tax reform, higher public spending on infrastructure and military
- The pledge to enact pro-business policies, reducing regulation and the tax burden.
 - Boost economic growth by scrapping intrusive federal regulations, reducing the cost of regulatory compliance, and lowering corporate taxes.
- The threat to trade and immigration.
 - A tougher negotiating stance with US trading partners. If this translates into policy, it could prove to be a serious economic challenge for Mexico, which relies on the US for 80% of its exports and 98% of the remittances it receives from Mexican workers abroad.

Source: UBS as of November 2016

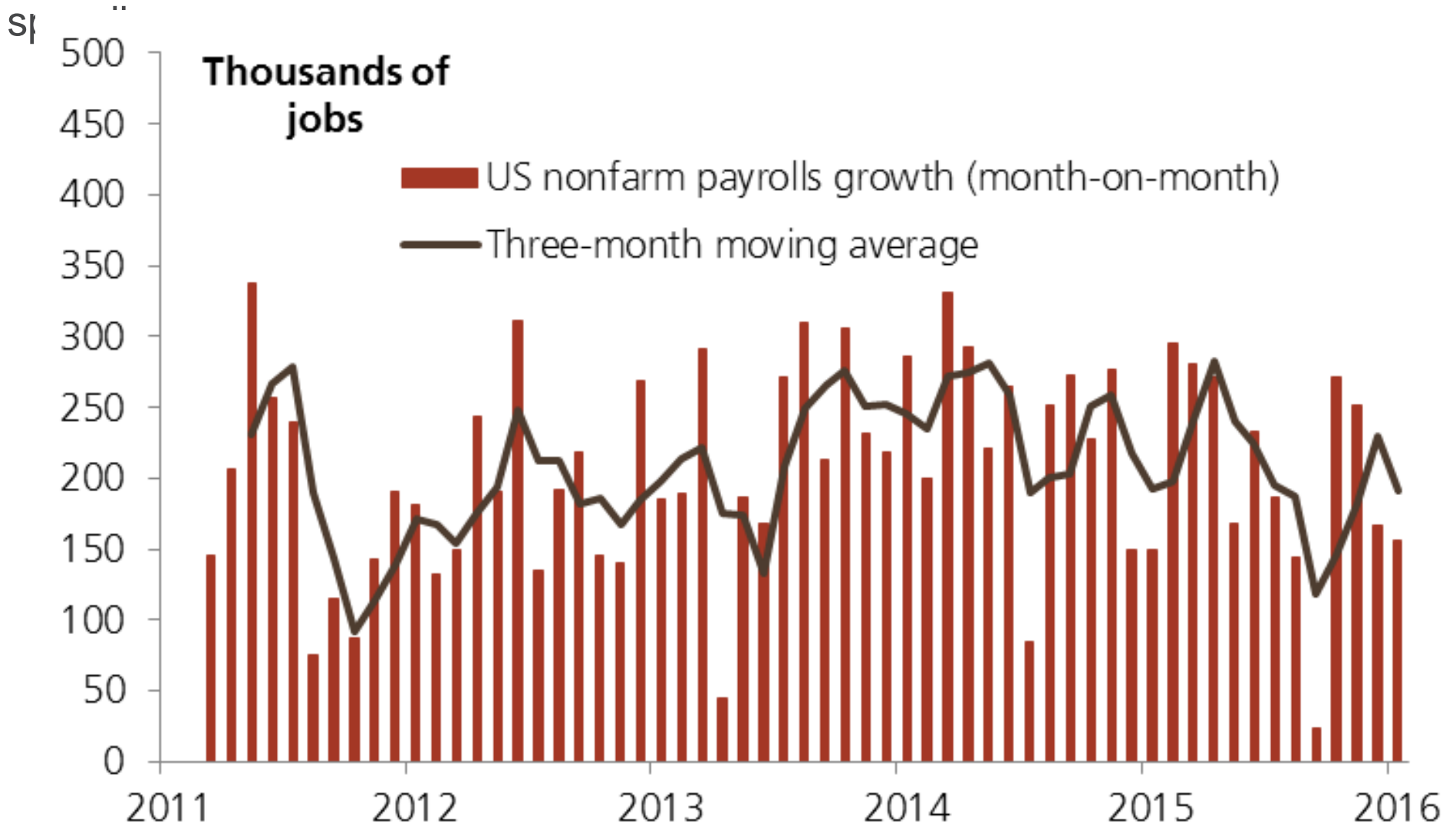
Political uncertainty masks pick up in US growth indicators...

Leading indicators of US manufacturing and non-manufacturing rebounded



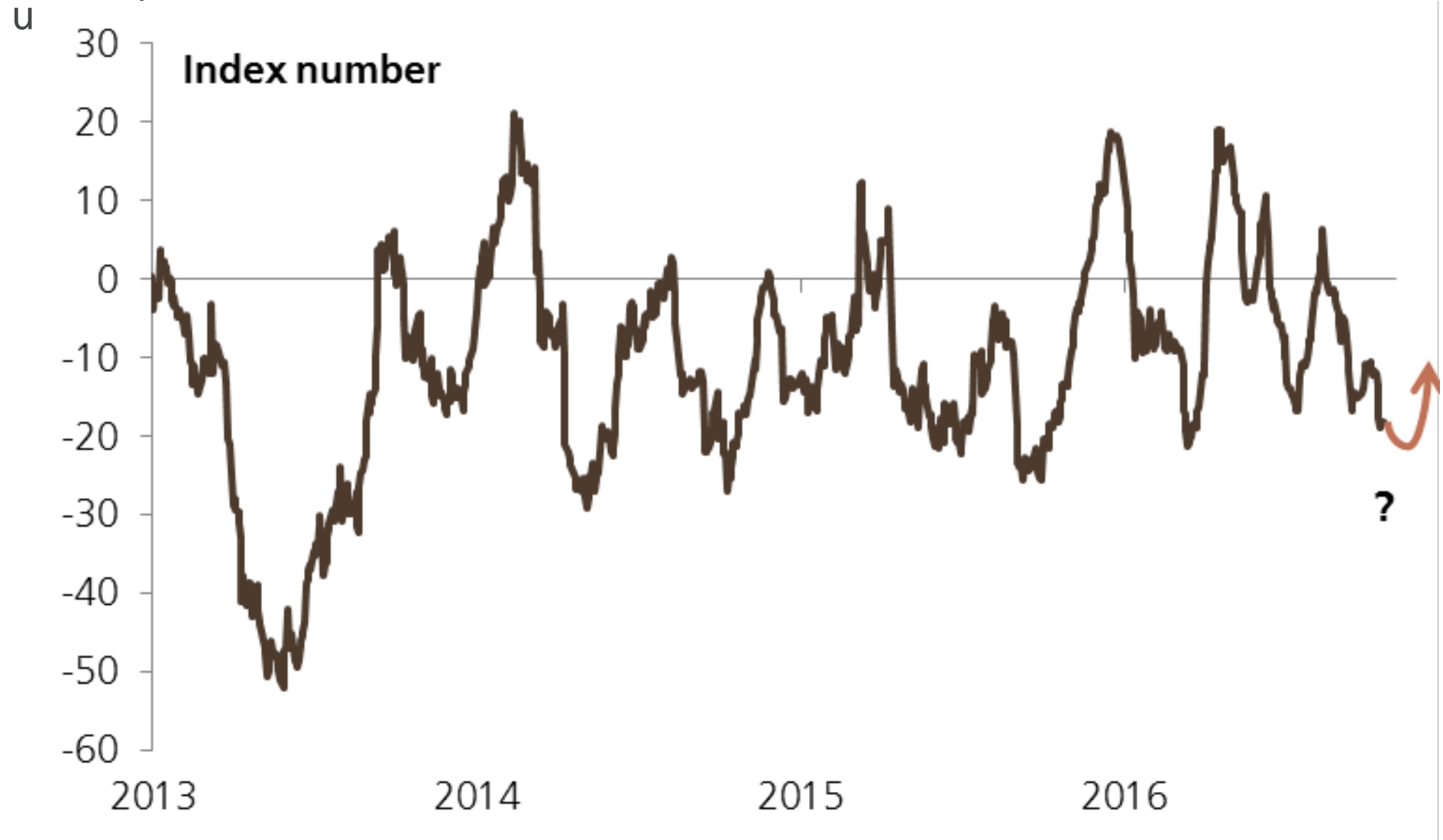
...and still strong jobs growth underpins consumption

Nonfarm payrolls growth slowing, but still strong enough to boost wages and



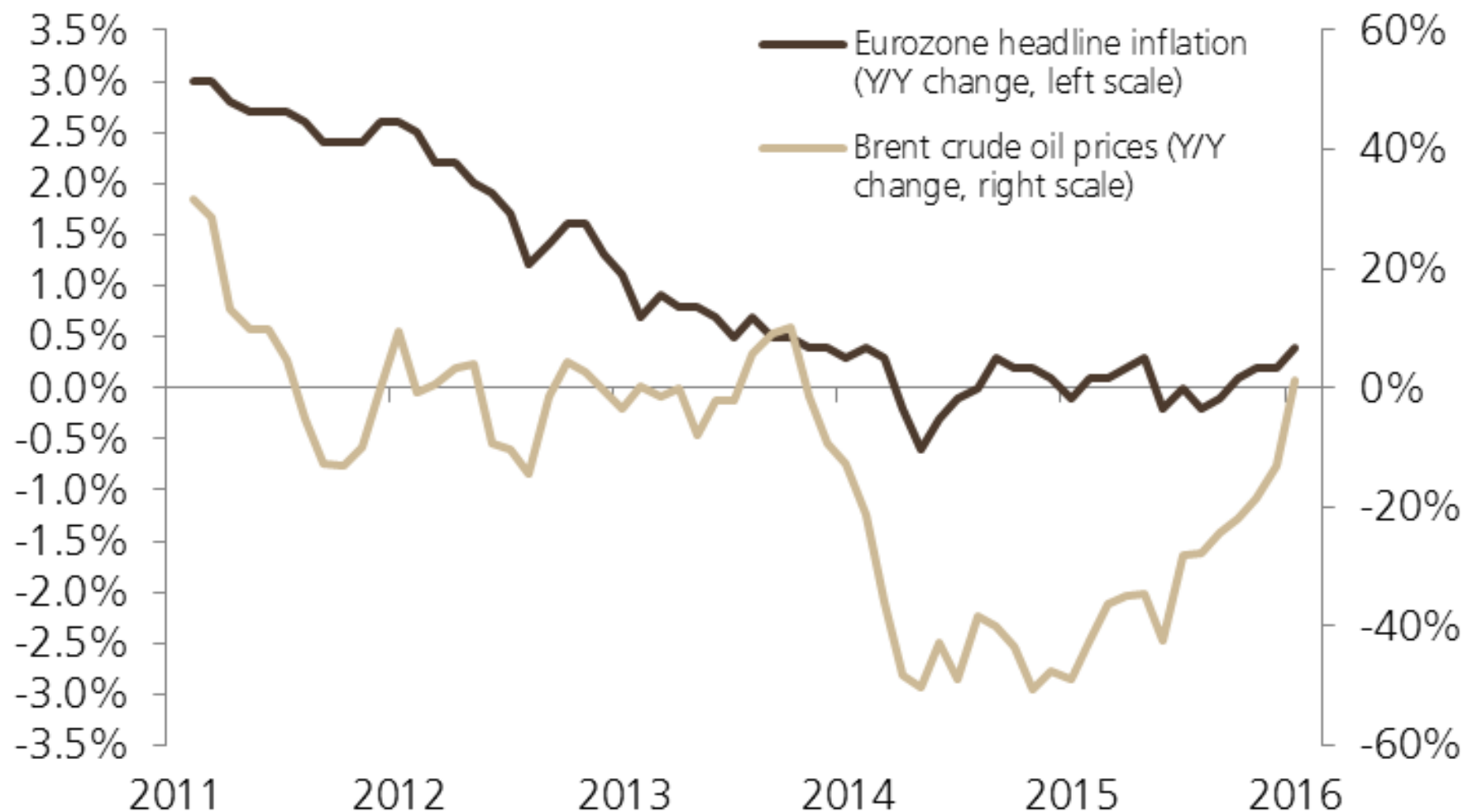
Emerging market economic surprises may have troughed

The Citi FX Economic Surprise Index for emerging markets may be turning



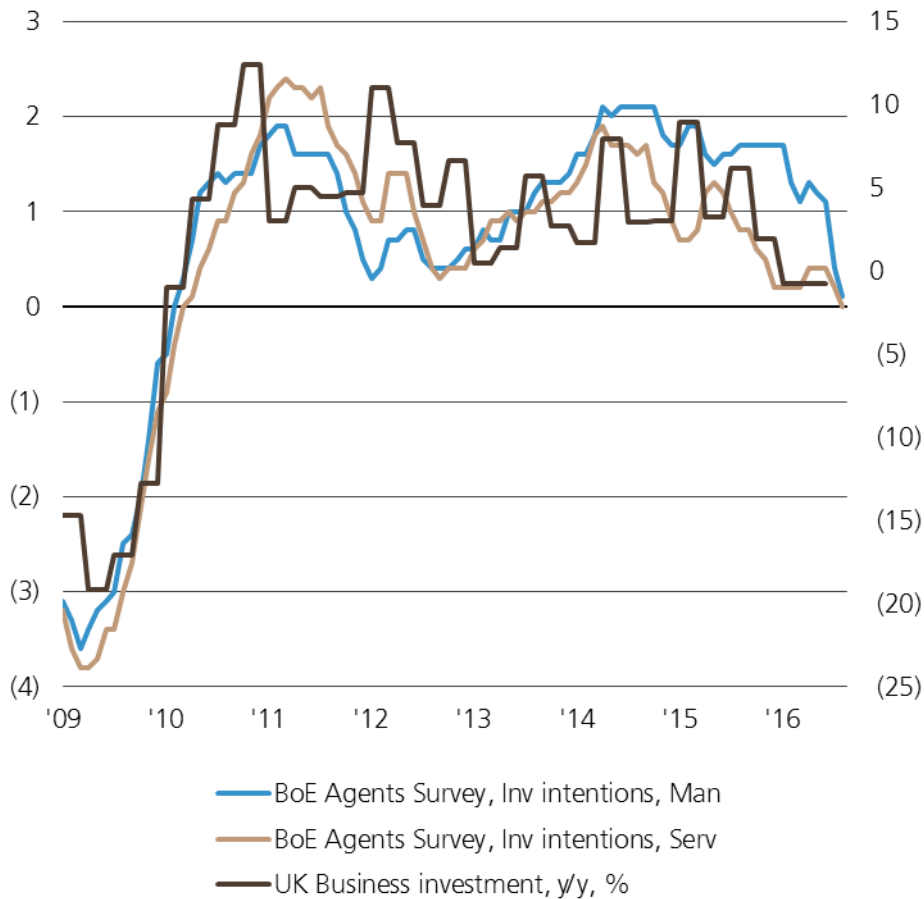
Inflation is rising (even in Europe) as oil prices steady

Eurozone headline inflation can rise if oil prices steady or rally further

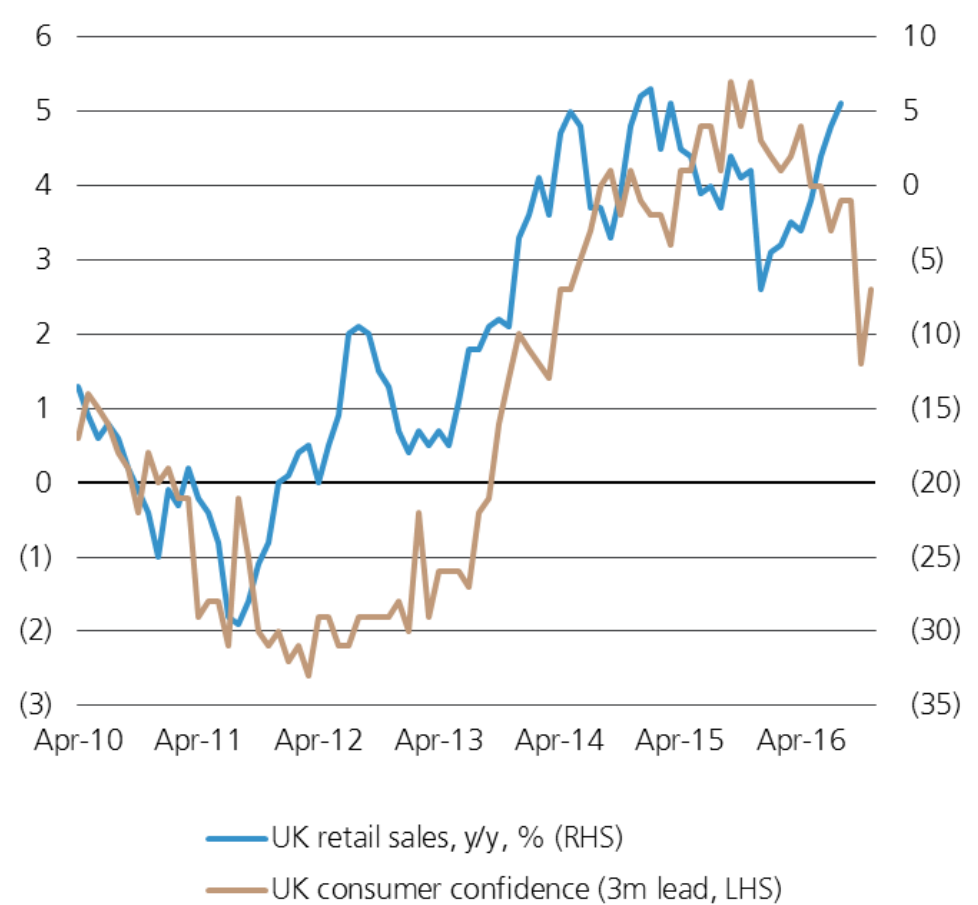


UK: What has happened to project fear?

Business sentiment is responding to referendum result...



...but the consumer doesn't seem to have noticed... yet

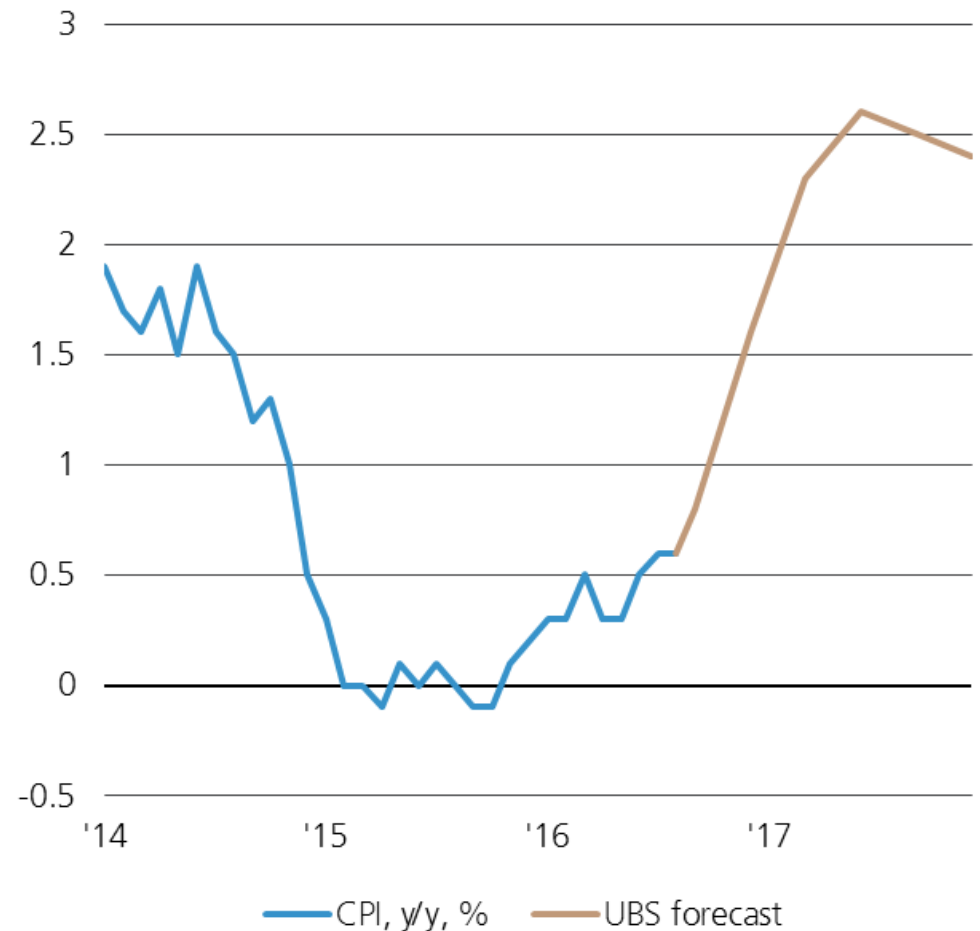


Life likely to get tougher for the UK consumer

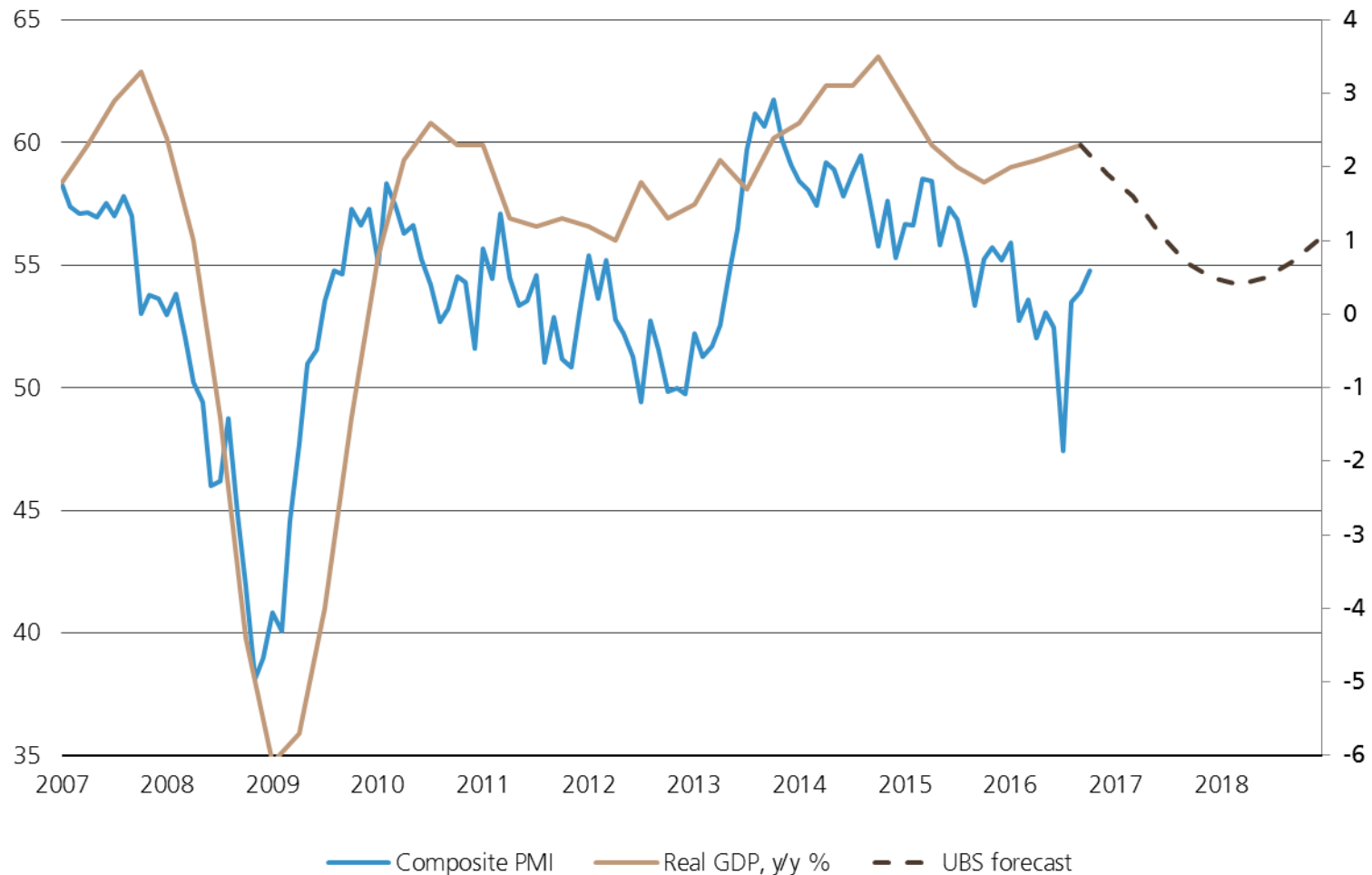
Real wage growth has been positive for a couple of years...



...the fall in sterling will soon be seen in inflation

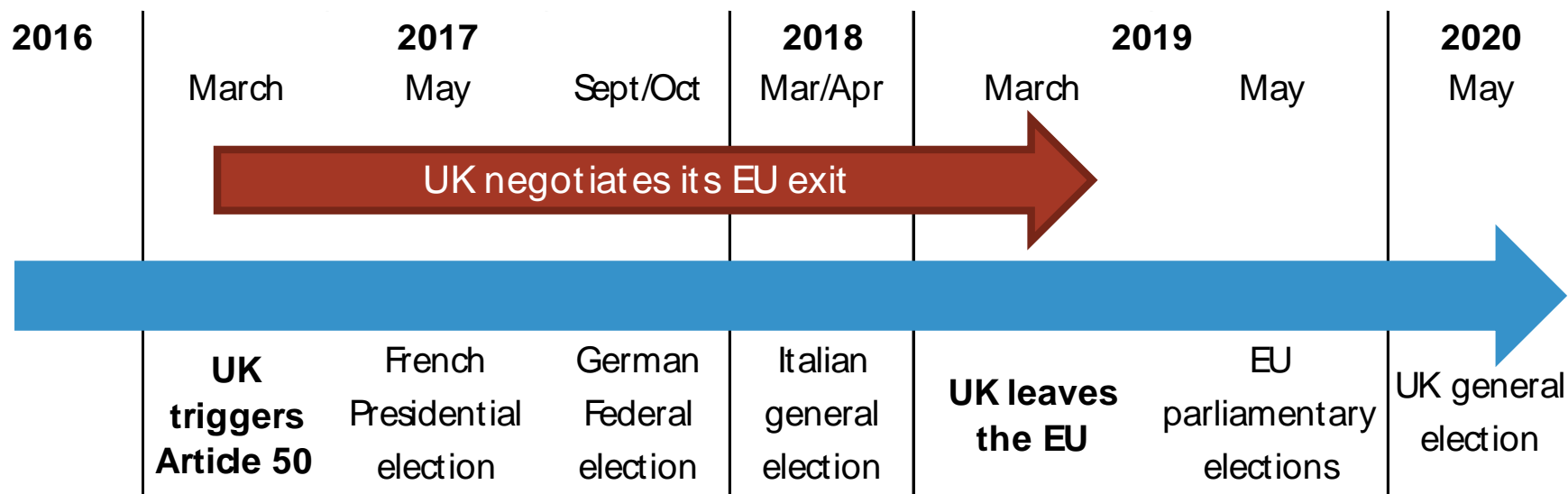


Recession likely to be avoided, but growth outlook is weak



Brexit: we have date, but little else...

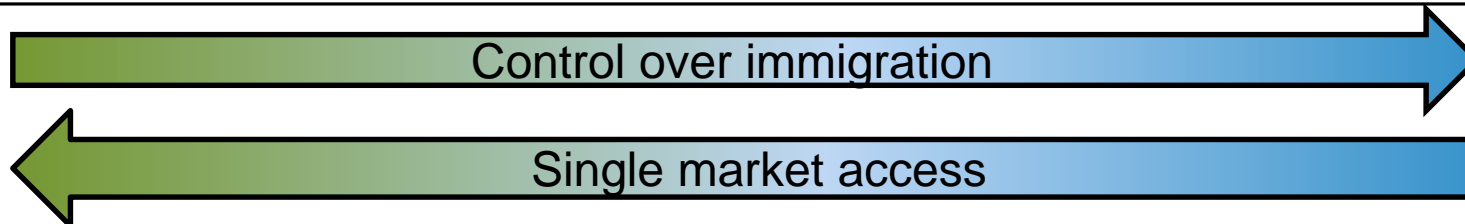
The political calendar is busy...



...two year window overlaps many events, and **negotiations unlikely to be complete in this time frame.**

Key thing to watch out for is a ***transitional agreement*** from Article 50 to signing of final deal.

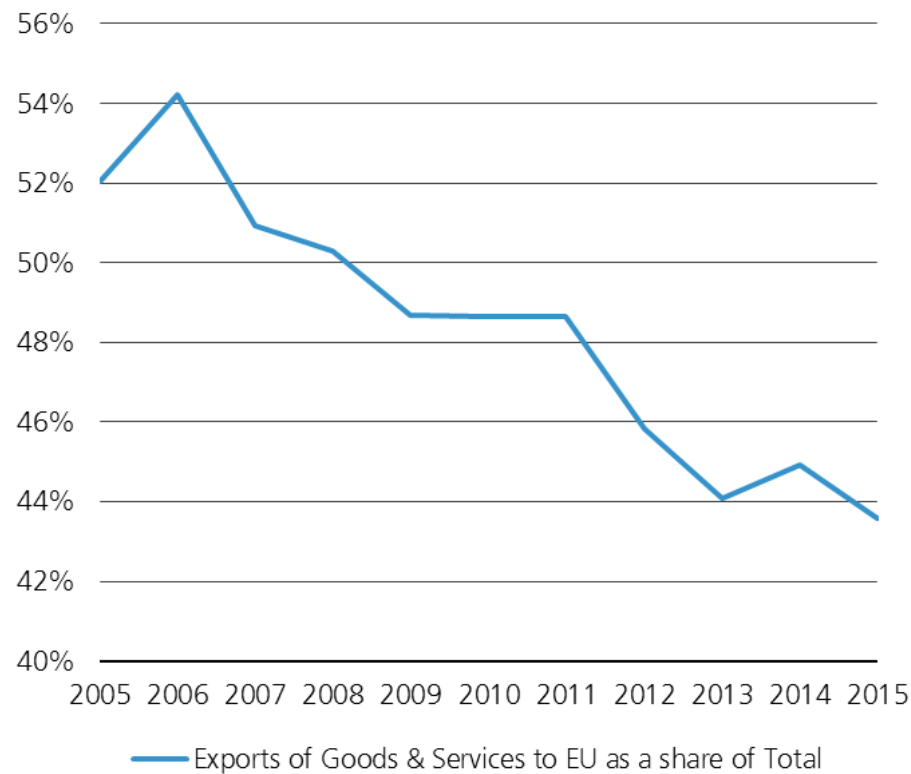
Brexit means...?



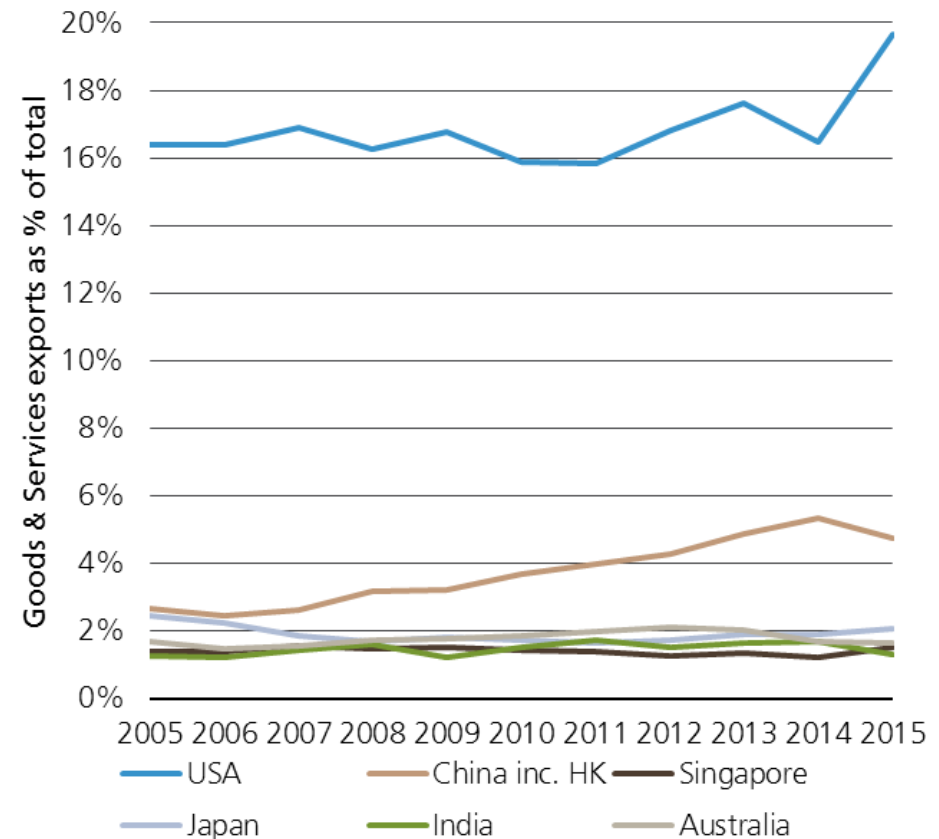
| | EEA (e.g. Norway) | Bilateral Agreements (e.g. Switzerland) | Customs Union (e.g. Turkey) | FTA (e.g. South Africa) | World Trade Organisation access |
|----------------------------------|--------------------------------|---|-----------------------------|---|---------------------------------|
| Trade tariffs | x | x | x | x | ✓ |
| Full access to the single market | ✓ | Yes on goods, unlikely on services | x | Yes on goods, unlikely on services | x |
| Independent trade agreements | x | ✓ | x | ✓ | ✓ |
| Independence from EU regulations | x | Possible, but regulations will have to have equivalence with EU | x | Possible, but regulations will have to have equivalence with EU | ✓ |
| Control over immigration | x | Possible - depends on agreement | ✓ | ✓ | ✓ |
| Contribution to the EU budget | ✓ | ✓ | x | x | x |
| Political and policy influence | Consultation - no voting power | x | x | x | x |

Where are the opportunities?

Trade with the EU is declining, but it is still 44% of total...



...opportunities exist elsewhere, but they will need to see rapid growth



Source: ONS Pink Book 2016, UBS as of September 2016

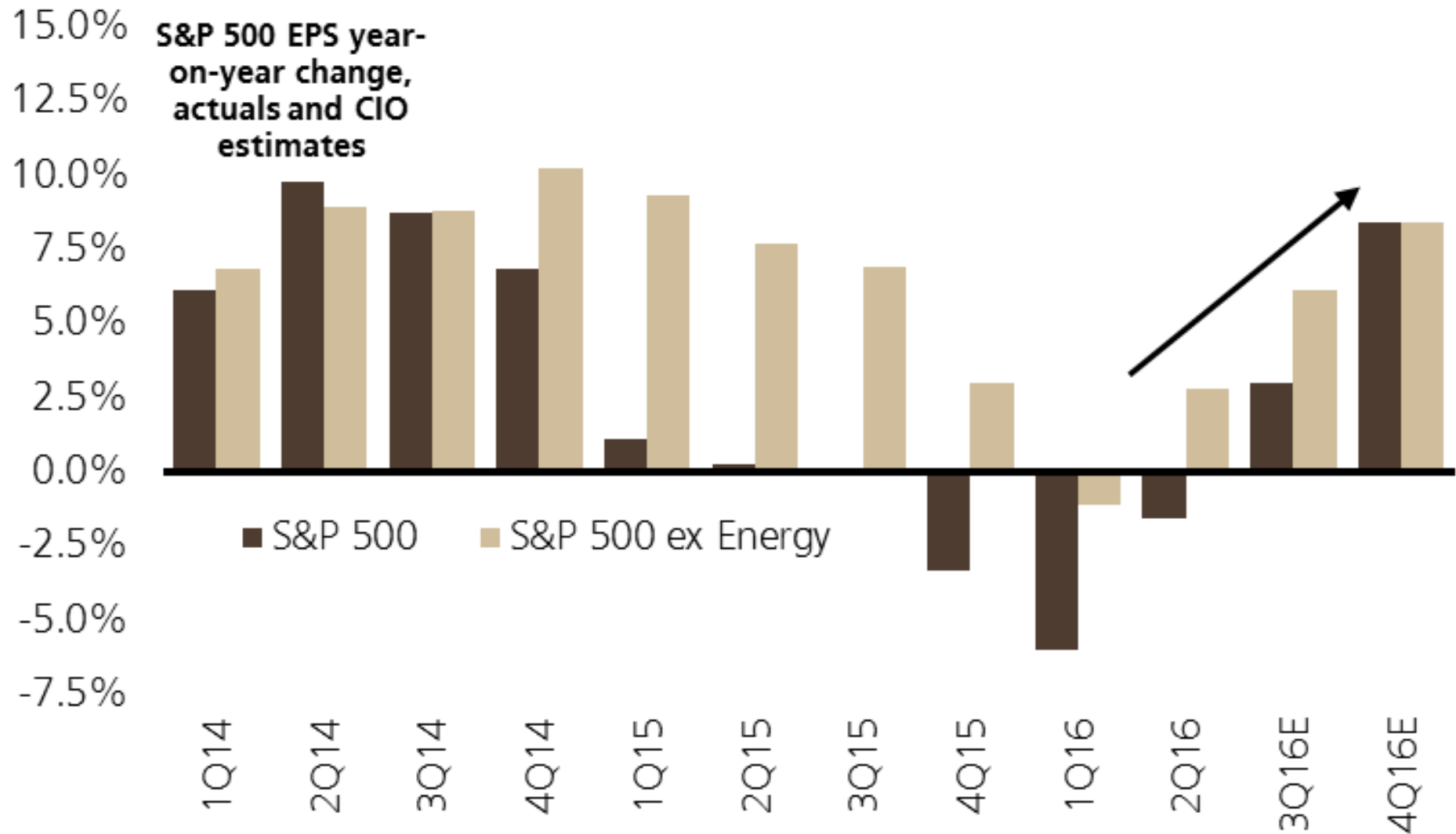
UK outside the EU

- Freedom to set own regulatory standards, but will still be bound by the rules of the markets we wish to trade in.
- Freedom to negotiate free-trade deals outside of the EU.
- More nimble decision making to react to global trends.
- Disruption to foreign direct investment flow, which could require a current account adjustment. Disruption to investment may also be negative for productivity.
- Greater focus on industrial strategy – a necessary rebalancing of activity in the economy.
- A greater emphasis on regional strategy with further devolution and infrastructure investment.
- Slightly lower levels of immigration, which will weigh on the potential growth rate of the UK in the years ahead.
- Fiscal position will remain uncomfortable for the government, which at some point could inhibit government spending and affect potential growth.

Source: UBS as of September 2016

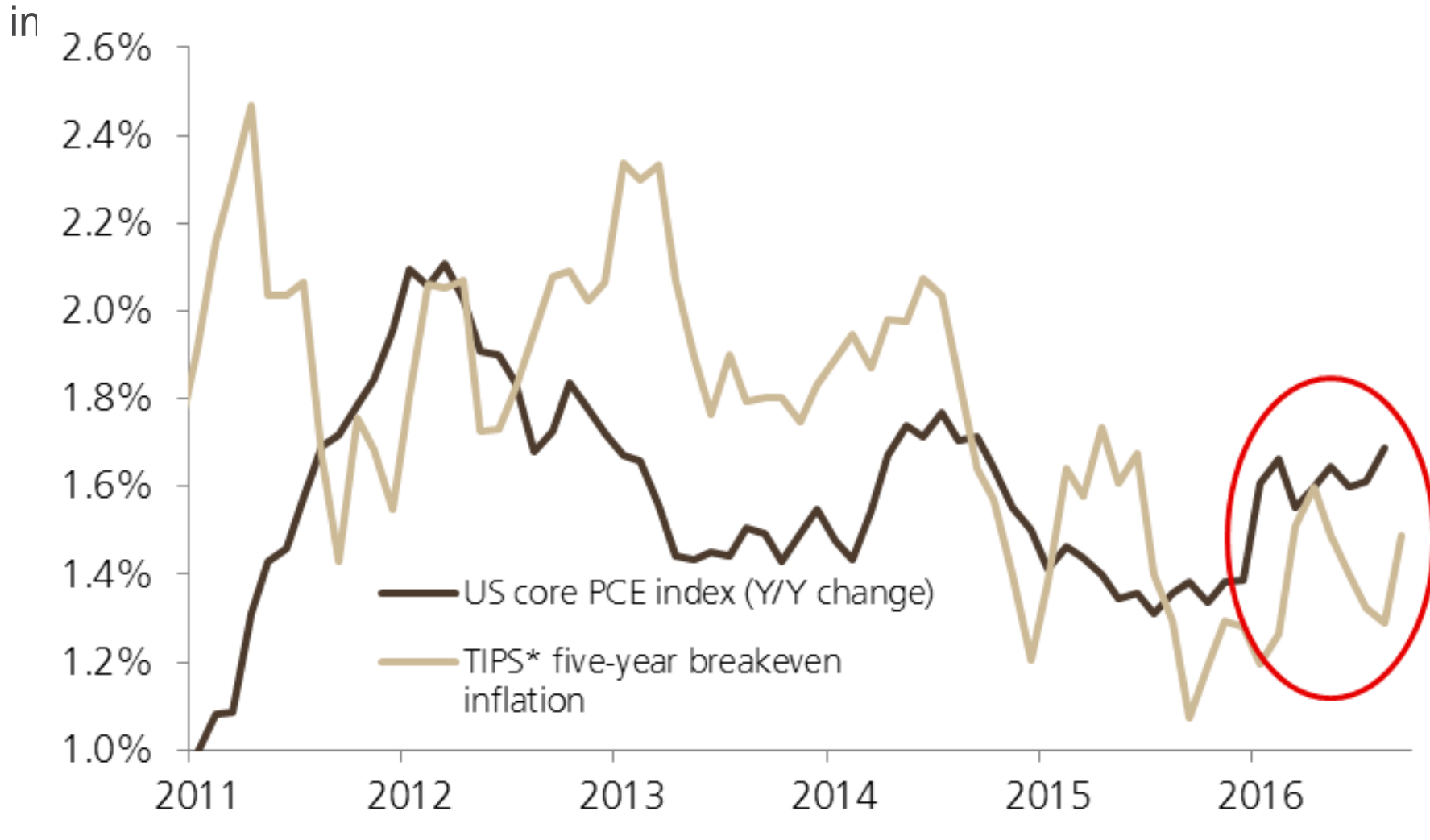
Overweight US equities as earnings growth resumes

After four quarters of flat or falling earnings, 3Q season looks better in the US.



Overweight US TIPS* versus high grade – inflation up

Sustained increases in US inflation have yet to be fully priced in breakeven

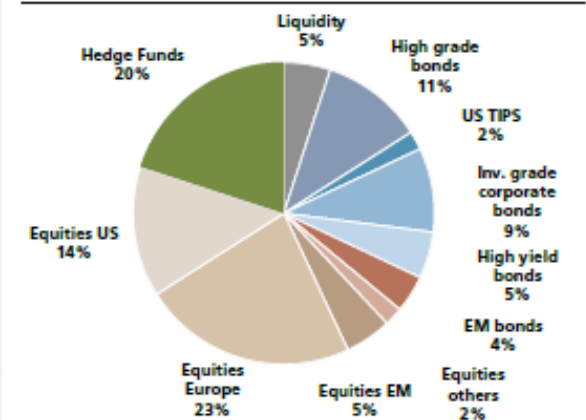


Cross-asset preferences

| | Most preferred | Least preferred |
|--|--|--|
| Equities | <ul style="list-style-type: none"> ● US equities ● US share buybacks and dividends ● US technology ● Emerging markets ● Sustainable value creation in EMs | <ul style="list-style-type: none"> ● Switzerland |
| Bonds | <ul style="list-style-type: none"> ● US investment grade ● Corporate hybrids ● US leveraged loans ● US TIPS (↗) | <ul style="list-style-type: none"> ● Developed market high grade bonds (↘) ● Replacing "well-worn" bonds (↘) |
| Foreign exchange | <ul style="list-style-type: none"> ● EM FX (BRL, INR, RUB, ZAR) | <ul style="list-style-type: none"> ● DM FX (AUD, CAD, SEK) |
| Hedge Funds | <ul style="list-style-type: none"> ● Event-driven strategies | |
| Precious Metals & Commodities | | |

↗ Recent Upgrade ↘ Recent Downgrade

Global model portfolio (EUR)



As of 20 October 2016

Note: Portfolio weightings are for a EUR model portfolio, with a balanced risk profile (including TAA). We expect a balanced portfolio (excluding TAA) to have an average total return of 4.2% p.a. and volatility of 8.2% p.a. over the next five years.

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