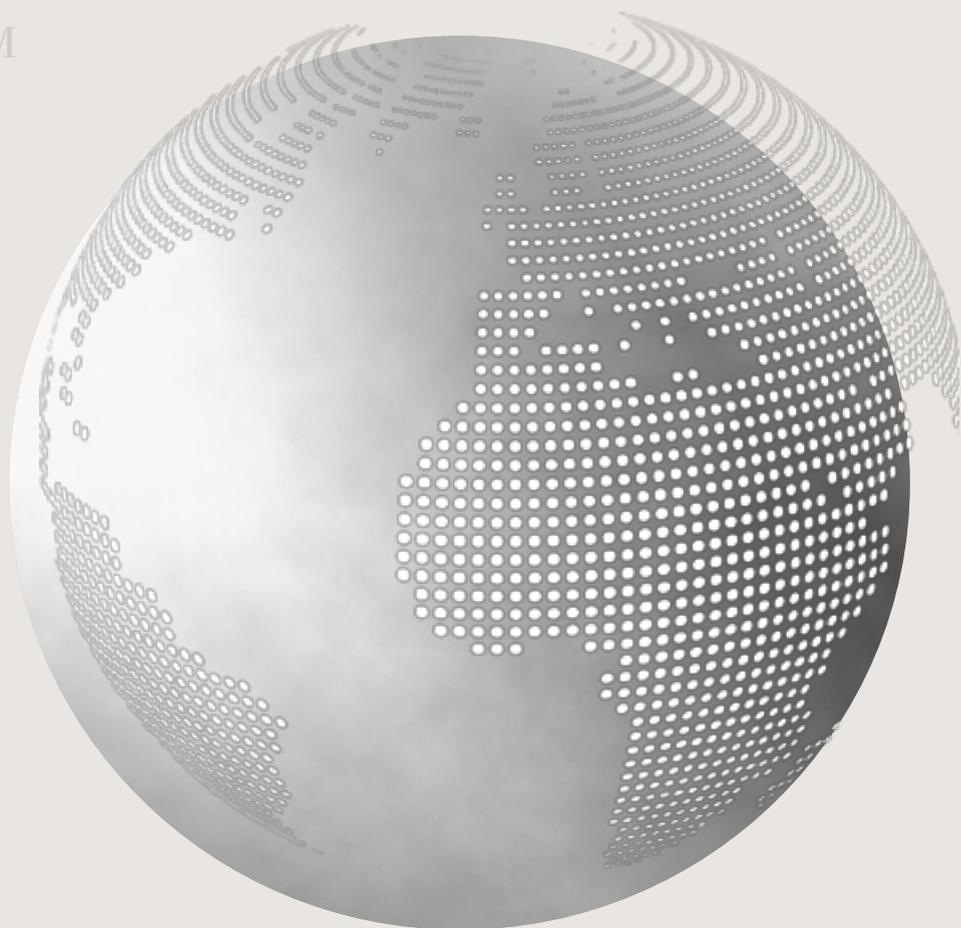


# CIO Year Ahead 2015

Chief Investment Office WM  
*December 2014*



The  
diverging  
world



# Foreword.

Dear reader,

This *CIO Year Ahead* comes at a critical time. Global economic growth is uneven, government policy is taking different paths, and geopolitical tensions have been rising. The title of this year's edition, "The Diverging World," reflects the investment future we must navigate.

Investing in this environment will – no doubt – prove challenging. But superior investment performance and advice is at the very heart of what we want to achieve. We want to be a partner to all of our clients as they make their most difficult financial decisions – delivering the right advice at the right time to ensure we fulfill our goal to protect and grow our clients' wealth.

This year, we place special emphasis on sustainability in investments and actions. This runs from considering our environmental impact, since for the first time this document is printed in accordance with carbon-neutral principles and is available on iPad, to assessing the aggregate societal benefit of our financial investments. In a diverging world, sustainability is likely to be one of the few enduring features.

Developed by our global team of specialists and informed by discussions with leading fund managers, this year's *CIO Year Ahead* aims to guide private investors through this diverging world.

Welcome to the *CIO Year Ahead 2015*.



Jürg Zeltner  
CEO UBS Wealth  
Management



Mark Haefele  
Global Chief  
Investment Officer  
Wealth Management



Caroline Anstey  
Global Head of  
UBS and Society

# Contents.

5

The  
diverging  
world.

- 6 Looking to the  
Year Ahead
- 10 Outlook

14

Region by  
region.

- 16 US
- 20 Europe
- 24 Asia and  
Pacific
- 28 Emerging  
markets
- 32 Switzerland

36

Investing.

- 36 The principles  
of investing
- 38 Asset  
allocation
- 42 Themes
- 46 Ultra-high  
net worth
- 48 Sustainable  
investing
- 50 Alternative  
investments

52

Asset  
classes.

- 54 Equities
- 56 Bonds
- 58 Alternatives
- 60 Currencies
- 61 Commodities

62

2015  
in short.

# “This is the diverging world.”

## The diverging world

The theme that runs throughout this *CIO Year Ahead 2015* is the diverging world that investors currently face. GDP growth is uneven, economic policy is taking different paths, and geopolitical tensions have rekindled. But divergences run even deeper – to contrasting levels of competitiveness within the Eurozone, gaps between reform agendas in emerging markets, and ultimately, we expect, to divisions in the performance of financial assets in 2015.

## Debate and challenge

This year, CIO debated such issues not only internally, but also with top investment professionals from inside and outside UBS at our inaugural UBS Year Ahead Investor Forum (p10). CIO's thoughts on the big investment questions of 2015, including a special section on sustainability, can be found in extensive interviews with our global and regional specialists (p16–51). These interviews, along with further insights from the Forum, are available for the first time on iPad in selected countries.

## Investment positioning

On page 52, readers also can find the key details of our investment positioning in each major asset class as we head into 2015. In short, we remain positive on equities and credit. We concentrate these overweight positions in the US, and have a bullish stance on the US dollar relative to the euro. We are underweight both emerging market equities and dollar-denominated corporate debt.

## Surprises for the year ahead

Finally, we ask our contributors what might surprise them in 2015, what excites and worries them, their top ideas for 2015, and their New Year's resolutions. Find out more on page 62.



# Looking to the year ahead.

Mark Haefele.  
Global Chief Investment  
Officer

## **What stood out in 2014?**

It's been an interesting year. The big surprise came in the high grade bond market. Despite already low yields, an end to QE, and a stronger US economy, US Treasury yields fell further over the course of 2014. German Bund yields saw even larger moves lower. From here we still think high grade bonds represent a good funding source given the low level of yields, but the markets are wondering what will ultimately be the catalyst for higher yields.

We benefited from US growth by being overweight US equities and US high yield. So far, diverging central bank policy has started to play out in the currency markets. We have been looking for a move down in the euro relative to the dollar, and it finally started to happen in the second half of the year.

## **What are the main risks that worry you for 2015?**

There are good divergences happening and bad divergences happening and we spend a lot of time thinking

about both. One bad divergence is the geopolitical turmoil in several areas around the globe.

Some of these risks remain extremely difficult to quantify and they have kept many investors away from the kind of long-term investment plans our Chief Economist Andreas Hoefert discusses (p36).

Even good divergences, and I would consider the self-sustaining growth developing in the US and UK to be of this kind, can be worrying because they raise questions about how this business cycle will play out now. We continue to sail deeper into uncharted waters with monetary policy.

We are not close to normalizing in large parts of the world. Something we were discussing at the Investor

**A major effect of the central bank policies seems to have been increased valuations of financial assets. Are they now too high?**

We don't think valuations are so stretched that you can't still see positive returns from financial assets this year. But people who expect financial assets to perform the way they have over the past three years are likely to be disappointed. There is certainly a good chance that if we look back, five years from now, that real returns will be sub-par relative to historical norms.

**Central bank action has so far not led to the high rates of inflation many expected. Is inflation dead or just dormant?**

Debtor nations have absolutely no incentive to see deflation take hold, since they benefit so much from inflation.

Head of our European Investment Office discusses (p20), the hopes of improvement in the Eurozone are very much tied to what the ECB can do to clean up the banks and boost lending. If both of those things happen, it is hard to see core inflation falling further from here.

**What can conservative investors do to earn higher returns?**

As Mark Andersen, our Co-Head of Asset Allocation has pointed out (p38), in today's environment, long-term returns for conservative investors are not likely to be much more than 1% per annum. As I mentioned just now, inflation is by no means dead, even if it is dormant. If and when it comes back, it could prove to be a big problem for some investors, given such low expected returns.

“There are good divergences and bad divergences, and we think about both.”

Forum was “where we are in the economic cycle” (p10). The consensus in the room was that the economic cycle has been redefined amid all these divergences in central bank policy. But one would assume that central bank support has to end at some point. And if we do see a slowdown in growth before central banks normalize policy, there are going to be big questions about whether central banks have already exhausted their tools to deal with any future crisis. This maybe isn't something for 2015, but is something to watch closely.

To say that inflation is dead is to say that central banks that control printing presses are unable to control the quantity of money in the system. That is clearly not true. Therefore it becomes a question of the velocity of money. Once again, there is good reason to believe that central banks are pushing for higher bank lending, so there are reasons to believe that the velocity of money can increase as well. Everyone talks about deflation in the Eurozone at the moment; it was one of the main points of debate at the Investor Forum. But as Themis Themistocleous,

So I think investors who consider themselves conservative should focus less on volatility, and more on protecting long-term purchasing power.

One way of investing long-term but still being “conservative” is to invest in some long-term themes with powerful and predictable drivers. Things like population growth, or the fact that as people become wealthier they eat more protein, or that they need clean water. Two of my colleagues, Simon Smiles and Philippe Mueller, have done a lot of

“I think investors who consider themselves conservative should focus less on volatility, and more on protecting long-term purchasing power.”



Mark Haefele. Global Chief Investment Officer

work looking at these areas (p46 and p42).

Even if short-term price swings are a big concern, we'd still recommend moving away from high grade bonds and diversifying. Diversification can enable greater returns for a given level of risk and volatility. Possible areas to diversify into could include alternatives like hedge funds or private equity, where investors can capture more of an illiquidity premium.

**“Deleveraging” has been on everyone’s lips for the past six years. Where do we stand?**

Everyone’s been talking about deleveraging, but public debt-to-GDP is still 230% in Japan, 110% in the US and “only” 80% in Germany. The reality is that deleveraging will occur, in part, through inflation, default, and wealth transfer. To invest successfully over a meaningful horizon requires us to acknowledge that results will be different in different places and that governments cannot afford to play “fair” in every case. That’s why global diversification is increasingly important for investors.

What we have seen is that countries that took more action earlier seem to have moved further through the crisis, for example the US and the UK. Having a reactive central bank is still very important, as Mads Pedersen, Co-Head of Asset Allocation, mentions in the asset allocation part (p38). Much of the positive growth story in the US right now is precisely because consumer balance sheets look healthier, and banks are recapitalized. Places that

haven't acted so quickly, like the Eurozone, are still suffering, and so we have this divergence.

**We're in a diverging world; is global growth too dependent on the US right now?**

I'd argue that the US is an important "contributor" to overall global growth, but the rest of the world isn't really "dependent" on the US as such. Our APAC Investment Office Head Min Lan Tan, makes an interesting point (p24) that we haven't really seen export growth in Asia pick up in the years since the crisis. The flip side of this is that the US consumer isn't really the driver of export growth around the world that he or she used to be.

So, yes, the risks increase if there is only one major contributor to improving growth rates in the world, but it is almost the case that there is one big contributor. Before it was China, now it's the US.

**One of the main discussion points from the Year Ahead Investor Forum considered the effects of a strong dollar. What are the potential ripple effects of a stronger dollar?**

As we start to see higher FX volatility, one of the things you can see is that people and/or nations that have funded debts in foreign currencies can experience pain.

Jorge Mariscal, Head of our EM Investment Office, makes a good point (p28) that the amount of pain they will feel will probably depend on the precise environment of dollar strength. If it's

an environment where the US is growing strongly, then maybe it isn't so bad. But if it's a "safe-haven" type flow into the US dollar, then things can be much worse.

**Long-term – new technologies and shale gas. Revolution or hype?**

On the drive to my sister's house in Texas, you can look out the car window and see the change. In the Midwest, there are places on the side of the road where fast food restaurants or houses have been replaced by new wells. That is not an unmitigated blessing, but it plays to a strength of the US, where natural gas has become dramatically cheaper than in the rest of the world. As Chief Investment Strategist for WM Americas Mike Ryan has discussed (p16), this is providing a huge boost to the US economy.

At a global level it's important too. Since 2010, the US has added three million barrels of oil per day, the equivalent of Venezuelan production. Remember, not so long ago a few Nigerian individuals could disrupt a pipeline and send ripple effects across the entire oil complex. Today we don't hear stories like that, and this is important for global economic stability.

**If you had to give investors one piece of advice for 2015, what would it be?**

One of the important trends that I have seen over my investment career is the realization that sustainability is more important to both individual company valuation, and to the way that countries spend their investment

dollars. One of my colleagues, Stephen Freedman, has been taking a pretty close look at sustainable investing and has some good advice for people looking in that area (p48).

Apart from that, the importance of applying the fundamentals of investing which include diversification, rebalancing, and a focus on risk, will remain true and important in 2015, just as in every other year.

# The diverging world.



## UBS Year Ahead Investor Forum participants

**Andrew Balls**

Head of European Portfolio Management, PIMCO

**Borut Miklavcic**

Founder, LindenGrove Capital

**Dave Fishwick**

Chief Investment Officer of Macro & Equity Investments, M&G

**Ewen Cameron Watt**

Managing Director and Portfolio Manager, BlackRock

**George Papamarkakis**

Co-founder, North Asset Management

**John Greenwood**

Chief Economist, Invesco

**Karl Dasher**

Chief Executive Officer North America, Schroders

**Mark Burgess**

Chief Investment Officer, Threadneedle

**Stephanie Flanders**

Chief Market Strategist, J.P. Morgan

**Vadim Zlotnikov**

Chief Market Strategist, AllianceBernstein

This is the diverging world. Growth is uneven, economic policy is taking different paths, and geopolitical tensions, both within and between countries, have rekindled.

Against this challenging backdrop, we recently held our inaugural UBS Year Ahead Investor Forum, a round-table discussion with a number of world-leading investment fund managers and strategists, to postulate the ways in which the diverging world could make itself felt in economies and financial markets in 2015 and beyond.

CIO's conclusions following these discussions are as follows:

First, the notion of a global economic cycle is redefined. The traditional concept of business cycle boom and bust driven by private sector credit creation, inflation, and interest rates is not applicable, and central banks are still the incremental providers of new

credit in parts of the world, while inflation is suppressed. Different countries and regions are in different stages in the transition away from central bank life support, and some are even heading deeper into it. Aggregate global growth seems set to remain slow and steady, if improving, yet the idea of a global business cycle is no longer apt. Divergences rule.

Second, with economic transmission channels impaired, the effects of the diverging world may result in highly concentrated outcomes. This applies both to the traditional transmission of monetary policy to the private sector, via the banking system, and to the transmission of economic growth across borders. Global trade and cross-border capital flows are still somewhat detached from growth. Therefore, divergences may be sharply felt in individual areas, but we also cannot wholly rely on effects transmitting in the ways one might traditionally expect.



## “Aggregate global growth seems set to remain steady, yet the idea of a global business cycle is no longer apt.”

Third, despite living in a diverging world of concentrated outcomes, the global base case expectations of many investors are clustered in worrying proximity. This is perhaps understandable in a world where aggregate growth is likely to improve and policymakers are attempting to corral investors in their asset class choices. But while government actions are intended to create a “steady” world of low return and low risk, we need to consider the possibility that as the market begins examining tail risk scenarios, the magnitude and frequency of turbulent market events may rise.

Fourth, inflation requires attention as a particular tail risk. On the one hand, at a global level giant demographic and technological forces, obscured in recent decades by the rise of the emerging markets, are placing significant downward pressure on global rates of inflation, as is deleveraging in parts of the world. In contrast, at a local level, a rise in nationalism, protectionism, and geopolitical risk already evident in 2014 could equally conspire to generate undesirably high rates of inflation, while a return of monetary transmission mechanisms to normal function could have a similar

## At a glance.

The idea of a global business cycle is no longer apt. Divergences rule.

Countries reliant on artificial external support, rather than genuine competitiveness and sufficient internal demand, will suffer.

With economic transmission channels impaired, the effects of the diverging world may result in highly concentrated outcomes.

Investors will need to offset the impact of a diverging world by ensuring their portfolios are well-diversified.

An environment of rising volatility and potentially outsized market moves will create tactical opportunities, but also increase risks.

“Economies that have enacted the proper reforms will fare best.”



effect. The outcome, either way, will have important consequences for monetary policy and financial portfolios.

Finally, with 2015 likely to see a number of central banks tighten monetary policy, and a stronger US dollar tightening effective financial conditions in many parts of the world, countries reliant on artificial external support, rather than genuine competitiveness and sufficient internal demand, will suffer. Those economies that have enacted the proper reforms will fare best, while the market is likely to reward those making steps in the right direction.

#### **Investing implications**

All of this will make investing in 2015 and beyond challenging but manageable, provided investors follow some key tenets:

First, portfolio risk needs to be reexamined. As divergences make themselves felt sharply in individual asset classes and regions, it will be critical for investors to try and offset the risks of a diverging world by ensuring their portfolios are well-diversified and are not overexposed to any individual asset, asset class, or region. At times this will represent a cost to performance, but the commensurate reduction in risk and volatility will more than compensate. Practically, portfolios will need to be hedged against potentially outsized currency moves, home biases should be avoided, and asset allocation must be examined for concentration risks.

Second, opportunities in short-term tactical investments will likely be more frequent in a diverging world. But so will the risks. On the upside, this should create greater potential for



“The effects of the diverging world may result in highly concentrated outcomes. Asset allocations must be examined for concentration risks.”

tactical positioning and investments to generate returns, and ample opportunities for alternative managers to create returns above benchmark. Indeed, with overall financial market upside likely to be limited from here, it will be essential for investors to take up such opportunities. However, investors need to ensure such positions are taken on in a risk-controlled manner. This is particularly important in an environment of rising volatility and potentially outsized market moves.

Third, holding cash is likely to represent a cost. The magnitude and frequency of turbulent market events is likely to rise, but with global growth still apparent overall, our base case should still be one of positive overall financial asset returns. Meanwhile, cash rates remain close to zero across most major currencies, and while this may be a diverging world, financial

repression continues to be one of the few features uniting it. Real interest rates remain close to or below zero in most major currencies.

Finally, if one thing above all else has been proven over recent years, it is that assessing sustainability is critical. The developed world debt bubble was not sustainable, and it is slowly and painfully correcting. China’s investment-driven growth was not sustainable, and it too is slowly and painfully correcting. In the diverging world, investors will need to begin considering sustainability in all aspects of their portfolios.

# A diverging world.



GLOBAL



US

## Growth

Steady growth, but **divergences** rule. Global growth will increase to 3.5% in 2015 from 3.3% in 2014. Among major economies, US growth will accelerate most rapidly (2.9% from 2.2%), and Eurozone growth will slowly improve (1.2% from 0.8%). China will slow (6.8% from 7.3%).

Growth will **accelerate** to 2.9% as consumer and business spending increases, and as fiscal policy stops dragging on growth.

## Inflation

The sharp decline in commodity prices means global inflationary pressure is low. **Divergences** in spare capacity in different economies will affect local dynamics. There are some hotspots in emerging markets.

Inflation will average 1.8%, and be close to the Fed's 2% target by the end of the year, as unemployment falls further and wage pressures steadily rise.

## Policy

2015 is the year when developed market policy **diverges**. The US and UK will begin raising interest rates. The Eurozone, Japan, and Switzerland could be forced to loosen policy further.

In response to increasing rates of inflation and declining unemployment, 2015 will be the year **tightening** arrives. The Fed will increase interest rates in the middle of the year, but will remain responsive to economic conditions.

## Investments

We expect an environment of steady **growth** to support both equities and credit, even if returns are more muted than in recent years. Global high grade bond yields should **rise steadily** from low levels.

We **overweight** US equities and US high yield credit, given strong corporate profitability and decent balance sheet health. Interest rates diverging from much of the rest of the world should support the US dollar.



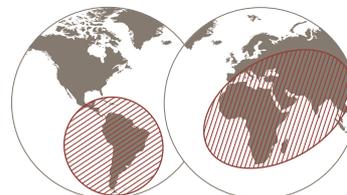
## EUROPE

Growth of 1.2%, supported by improved US growth, household consumption, and looser fiscal policy. The UK, Spain and Germany will **outperform**. Italy and France will **underperform** once again.



## APAC

China's growth will **decelerate** again, to a more sustainable pace below 7%. Most ASEAN economies will **slow**, but growth in India and Japan should **improve slightly**.



## EMERGING MARKETS

APAC will outperform LatAm and EMEA. Growth in Mexico will increase substantially (3.3% from 2.2%), while Brazil (0.6% from 0.3%) and Russia (0.2% from 0.5%) will continue to disappoint in part thanks to their respective political situations.

Inflation will increase but remain **low**, at 1.0% in the Eurozone. Amid a diverging world, rates of inflation within the region are actually converging, making competitiveness adjustments more difficult.

Japan's headline inflation will fall (2.0% from 2.9%) but **outstrip** China's (1.8% from 2.2%) again, boosted by sales taxes and other Abe government policies. India is bringing inflation under control (6.4% from 7.7%), inflation rates in parts of ASEAN will **increase**.

Inflation will rise from already **high** levels in both Russia (8.1% from 7.6%) and Brazil (6.8% from 6.4%), but will **fall** in Mexico (3.4% from 4.1%). Parts of emerging EMEA currently close to deflation will also see inflation **rise**.

The ECB will keep policy **loose** and could be forced into full quantitative easing if rates of inflation do not improve. Meanwhile, the UK will hike rates in August in response to increasing wage pressures.

The Bank of Japan will keep policy exceptionally **loose** and could intervene again if the economy shows weakness. China will use targeted stimulus measures to avoid any sharp downturn.

Higher global bond yields and a stronger dollar could lead to a **divergence** between the better prepared emerging markets and those that remain fragile (Indonesia, Brazil, South Africa).

We are **neutral** on Eurozone equities given that corporate earnings momentum remains poor. We prefer the financials and energy sectors. We are **underweight** the euro due to the possibility of new ECB policies.

A strong US dollar will have an **uneven** impact on APAC. The Chinese yuan and Taiwanese dollar should prove most resilient. The Indonesian rupiah could suffer. Thanks to improving cyclical momentum and reforms, we overweight Indian equities and the rupee.

We **underweight** EM equities and dollar-denominated corporate debt due to weak profitability trends. In equities we prefer those countries undergoing economic reforms – namely Mexico and India, and those which are positively exposed to US demand, such as Taiwan.

US

# Leading the way.

Mike Ryan. Chief Investment Strategist, WM Americas

## At a glance.

A recovery in the consumer sector, the recapitalization of the financial system, and the abatement of fiscal headwinds mean we are confident that the economic expansion will continue in 2015.

The main concern is that the US would become burdened with sustaining growth for the entire world.

Interest rate increases will likely begin in 2015, but they will be gradual in nature. The Fed will monitor the strength of the US dollar closely, and it does not want to jeopardize growth.

Based on positive fundamental economic factors, we prefer US equities, US high yield credit, and the US dollar in our tactical asset allocation.

### **Can we be confident that economic growth in the US will continue in 2015?**

I think we can be confident. What we are seeing is a broadening and a deepening of US growth drivers. In the initial stage after the crisis, the growth drivers were very narrow and the economic recovery process fragile. Now we see a recovery in the consumer sector based on the repair of personal balance sheets, the recapitalization of the financial system, and the abatement of fiscal headwinds. Against this backdrop we should continue to see gains in terms of employment growth and business investment spending.

### **What are the main worries you have about growth in 2015?**

The US can lead, but it can't carry. If the world continues to see diverging economic fortunes – with deflationary headwinds coming out of the Eurozone, and emerging markets failing to re-accelerate – there is a limit to how much the US can carry. So my concern is that the US would become burdened with providing growth for the entire globe.

### **What will influence the timing of interest rate increases, and how can we expect them to develop?**

The Fed has been fairly transparent on its focus, and it's pretty clear that the labor market conditions will top the Fed's priority list. We have seen good employment growth, but there are lingering concerns within the Fed

about "underemployment" and about those who may have dropped out of the labor market permanently. Another concern is inflation, which remains low.

Overall, this suggests that as the Fed goes through its process of raising rates, it will do so in a very pragmatic and cautious manner. Given the time, effort, and money that have been expended to get us to this point of the recovery, the Fed certainly doesn't want to undermine those efforts by tightening too quickly. There's a term from the medical profession that perfectly describes the Fed's current policy approach: *primum non nocere* (first, do no harm). It is the first standard for healthcare professionals and may well become the Fed's mantra.

### **What is your perspective on where we stand in the credit cycle in the US? Should investors be concerned about US high yield credit?**

There is always a concern that the start of the Fed's tightening process will lead to losses in fixed income markets. But we need to temper that in two ways. First, the rate increases will be gradual; the Fed is going to have a very deliberate pace with regard to this tightening cycle. Second, business conditions continue to improve, corporate balance sheets are in good shape, and we haven't yet gotten to the point where we are seeing a significant re-levering by corporate America. So high yield can continue to perform



Mike Ryan.  
Chief Investment  
Strategist,  
WM Americas

“We are seeing a broadening and a deepening of US growth drivers. We should continue to see gains in employment growth, lending activity and business investment spending.”

well through 2015 – even though the gains are going to be moderate.

**At the UBS Year Ahead Investor Forum in London, there was broad consensus that 2015 would be another year of US dollar strength. What are the implications for the US itself?**

The Fed is going to monitor the situation closely because what it doesn't want to see is a dollar rising to the point where it actually jeopardizes the recovery in the US. This reinforces the point I made earlier that the Fed is going to have to move very pragmatically and slowly. Because if significant rate differences with the rest of the

world continue to draw strength for the dollar, this could have significant implications for both domestic inflation and a dampening of growth.

**What is your thinking on US equities today?**

We still like US equities relative to equities elsewhere in the world, given the more favorable economic dynamics here. But markets are no longer cheap, and that suggests to me that gains will be more moderate in the year ahead. We therefore need to be more selective. We're looking to the types of companies, industries, and sectors that are 1) geared to where we are in the business cycle; 2) can take

advantage of growth drivers as we see them emerging; 3) are less sensitive to the beginning of Fed tightening; and 4) have relatively attractive valuations. The sectors that tend to fit that profile right now are industrials, technology, and financials.

**Any developments in municipal credit?**

We've seen cyclical improvement and I think municipalities have done a very good job of addressing budget shortfalls by raising taxes and cutting costs, so credit conditions are actually in relatively good shape right now. But the benefits that have been promised to municipal workers – past, present and

future – are likely to pose a big challenge for municipalities. As a result, municipal credit quality is going to be a focus for investors. It is not necessarily a 2015 story, but it is something we will have to deal with in the years ahead.

**The US has emerged as a major player in energy production and in developing new technologies. Equally, some seem worried about a "secular stagnation." What does the long term hold for the US?**

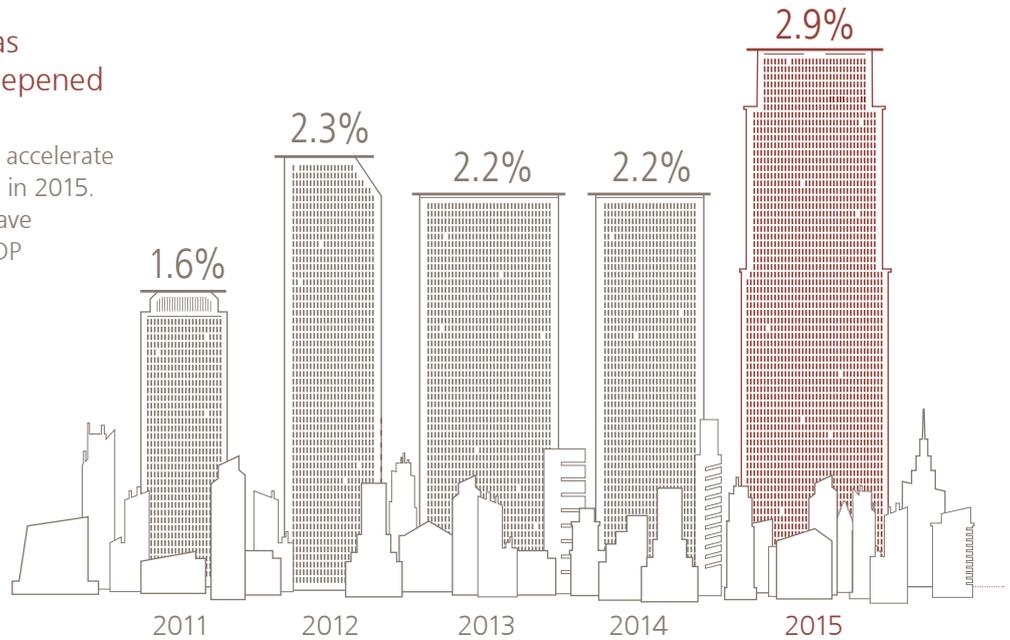
I believe that the US is the most flexible, dynamic, resilient, and adaptive economy in the world. The US has an ability to reinvent itself, and we tend to allocate capital where growth prospects are strongest.

But this is probably less true than it was a decade ago. The US economy has become less dynamic as the public sector has expanded and the private sector has not yet fully recovered. We have to strike a balance between what we want to solve from a social standpoint, and what will sustain us from

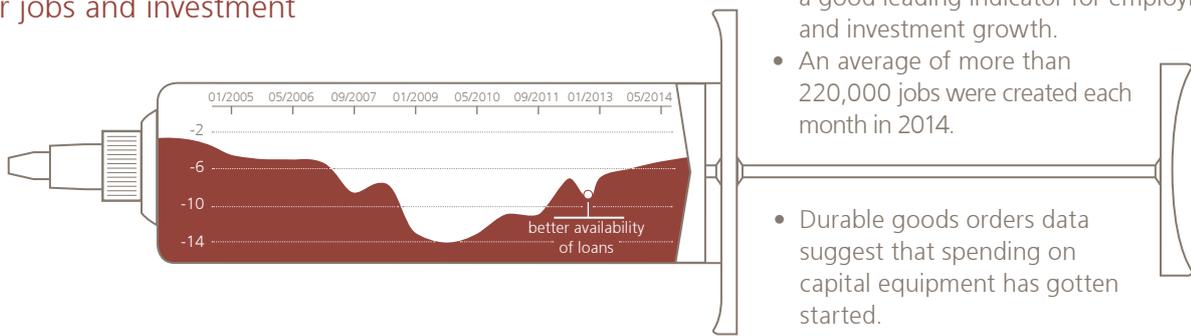
an economic growth standpoint. That said, the energy story currently playing out in the US is a potential game changer. It has the ability to stimulate demand through exploration and production, but there is also a very short cycle that goes from exploration and production, to distribution and storage, to infrastructure and conversion, and on to manufacturing. So all these things could represent a game-changing dynamic in the US that could help our balance of trade, our budget situation, employment growth, and personal income growth.

## US economic growth has both broadened and deepened

- We expect **GDP growth** to accelerate from 2.2% in 2014 to 2.9% in 2015.
- Consumer balance sheets have deleveraged – to 91% of GDP today from 115% in 2007.
- Banks now boast a Tier 1 capital ratio of 12.9%.
- Government spending cuts are no longer a drag on the economy.



## Credit conditions have eased, a boost for jobs and investment



- Increased **credit availability** is traditionally a good leading indicator for employment and investment growth.
- An average of more than 220,000 jobs were created each month in 2014.
- Durable goods orders data suggest that spending on capital equipment has gotten started.

## The Fed will raise interest rates in 2015

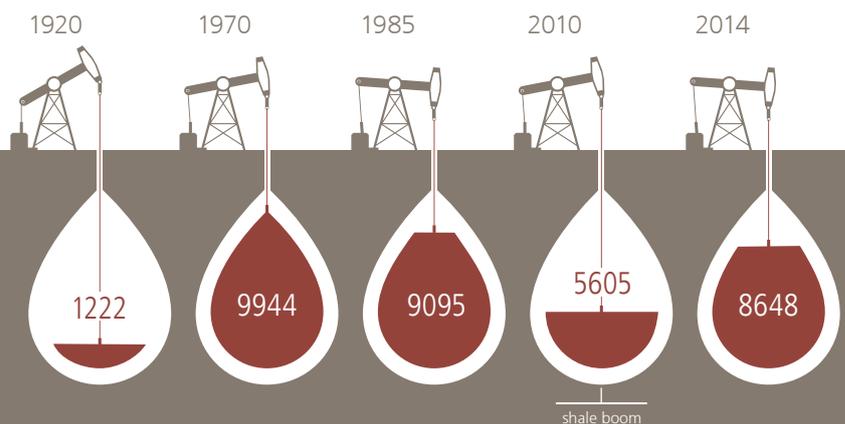
- The Fed will be pragmatic and cautious.
- Steady and responsive interest rate hikes are not likely to pose a risk to economic growth.
- The Fed will monitor the strength of the US dollar closely.

## Overweight US equities and high yield credit

- We overweight US equities, and expect 8% earnings growth for the S&P 500 Index.
- We prefer equity sectors exposed to capex, including financials, industrials, and technology.
- We overweight US high yield credit. Default rates are likely to remain below 2% in 2015.

## Long term, the US economy should be supported by secular trends

- **US oil production** has increased by 3 million barrels per day, the equivalent production of Venezuela, since 2010.
- The US stands at the center of new technological development in mobility, cloud computing, and additive manufacturing.



Europe

# Playing catch up.

**Themis Themistocleous.**  
Head of Europe Investment Office



Themis  
Themistocleous.  
Head of Europe  
Investment Office

**2014 began with plenty of optimism about economic recovery, but at the Year Ahead Investor Forum, the discussion was centered on low growth and fears of deflation. Do you think we will see anything in 2015 to change the outlook?**

Europe has been a disappointment in 2014. But for 2015 there are a number of elements that we think should be supportive of better growth. For starters we have the weaker euro, which moved from a peak of about 1.40 against the US dollar to a low of 1.25. Obviously we have also had the actions announced by the ECB. And if they don't have a significant impact on the economy, we could still potentially see sovereign quantitative easing. The other element that could help the economy in 2015 is banks. Demand for credit has turned from negative to positive in recent months. And the completion of the ECB's asset quality review should make banks more willing to extend credit, especially given the very low cost of borrowing. So we expect a better year in 2015 relative to 2014.

Growth rates are still not going to be stellar, however. For 2015 we are looking for GDP growth of around 1.2%, and that is recovering from a very low level. Long term, we have an aging population and mature economies. So for the next five years we would be looking for trend growth of around 1%–1.5%.

**Over the past two years, we have seen quite a calm political environment. Is there a risk of a return to the political and existential crises we had in 2011 to 2012?**

Clearly the risk has subsided, but has not necessarily been fully eliminated. A number of countries in Europe are still highly indebted, and are still growing their debt ratios. Even with economic growth, some countries will struggle to consolidate their debt. We have also seen some negative political developments with certain Euroskeptic parties gaining prominence.

But if we get better growth in 2015, it will help the economies of countries that are under pressure and start stabilizing debt to GDP. So for next year, we think the probability of the Eurozone coming under attack again is low.

**And where do we stand in terms of the economic reforms that were put in place since the crisis?**

Speaking of a diverging world, we've had quite a divergence in what has happened in Europe. We have seen quite a lot of progress in the peripheral countries that were under pressure during the crisis, like Ireland, Spain, Portugal, and Greece. We have seen deflation and an adjustment in labor costs, which have clearly made these economies more competitive.

But there are still some big economies like France and Italy, where we have seen much less in terms of reform. If you look at France, without substantial reforms I suspect we can expect growth somewhere between 0–1%. In Italy we have had some changes and there is the will to do more, but it has a complicated political set up as well.

**The UK seems to have performed well in 2014, despite disappointments in the Eurozone. Why do you think that is?**

The UK has always had a more flexible economy, and is a lot closer to the US model than to the rest of Europe. When we had the recession after the financial crisis it was deeper, but with

## At a glance.

European growth has been disappointing in 2014. But a weaker euro, new ECB measures, and signs of loan growth should be supportive of better growth in 2015.

The UK will be the fastest growing major economy in Europe once again.

France and Italy have been relatively slow to reform their economies, and growth will remain muted.

Growth in Germany and Spain will be stronger, given their more competitive economies.

2015 should be a good year for the banking sector, and energy stocks also have scope for re-rating.

a more flexible labor market and regulatory framework, the improvement was a lot quicker.

**What do the political tensions with Russia mean for Europe?**

If you look at trade between Europe and Russia, it's not that important, only 2.5% of Eurozone merchandise exports go into Russia. There are also links through gas supplies, but we don't expect significant interruptions. Of course, this depends on how bad tensions become, but for now our base case is still for a manageable development between Russia and Ukraine. But clearly the proximity to Europe means that tensions in Russia lead to a bigger impact on equity market sentiment there, than in the US.

**Over the past five years, we have seen European equities underperform the US quite substantially. Should we expect to see Eurozone equities catching up over the next five years?**

European companies are way behind the US in performance, but also in terms of earnings developments. US earnings are already at trend or above trend. If you look at Europe, earnings are around 25% below trend and about 30% below the previous peak. So you could argue that there is a lot of upside potential in Europe.

But Europe is a much riskier market with more economic problems, as we saw in the volatility we experienced at the end of 2014 and the repeated disappointments on economic growth. And for earnings to recover to trend, banks have to play a big role because the big gap between the previous peak and current earnings is largely due to lower profitability of financials. Although it is probably unreasonable to expect banks' profitability to recover to pre-crisis levels given the regulatory environment, we still expect the gap to narrow.

**For 2015, what do you think are the sectors and themes that people should be focused on?**

We think that 2015 should be a good year for the banking sector. The cost of borrowing has come down a lot, valuations are quite attractive, and the Asset Quality Review and stress tests are finished. The last hurdle in the recov-

“Speaking of a diverging world, we've had quite a divergence in what has happened in Europe.”

ery for the banking sector is litigation. We hope to get more clarity on that over the next couple of months, but once that is out of the way, we think that banks should perform much better.

One sector that is maybe a bit more controversial is energy, which sold off heavily in the second half of this year due to the weaker oil price. It has also underperformed a lot over the last couple of years, due to very high levels of capital expenditure. But we have seen increased signs of capex discipline from some companies in the sector, and the decline in the oil price should encourage more and more companies to review their capex plans. If they can reduce capex at the same time as the oil price recovers, we will get a sharp revival in free cash flow, and the sector could re-rate.

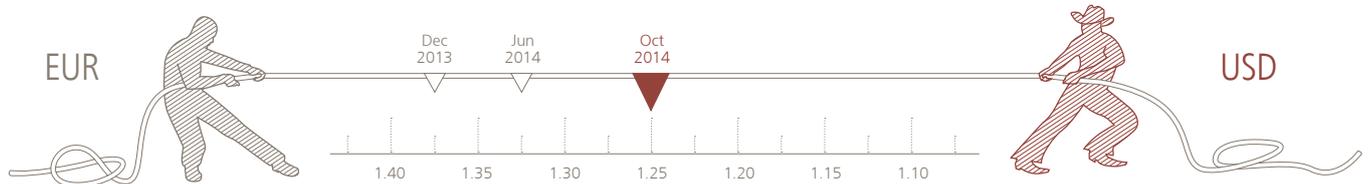
## Eurozone growth disappointed in 2014; we expect higher growth in 2015



- **GDP growth** should be supported by a number of factors.
- The benign results of the bank stress test should contribute to lower uncertainty.
- Low rates of inflation have been a major problem, but money supply data is pointing to an increase in core inflation.
- A weaker euro will support exports.

## We expect euro weakness to persist into 2015

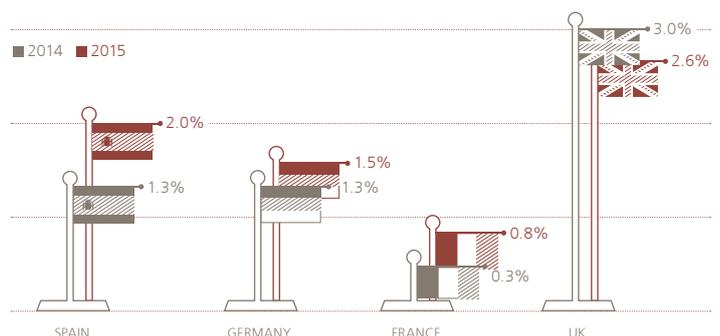
With Eurozone monetary policy diverging from the US and UK, **we expect the euro to remain weak in 2015.**



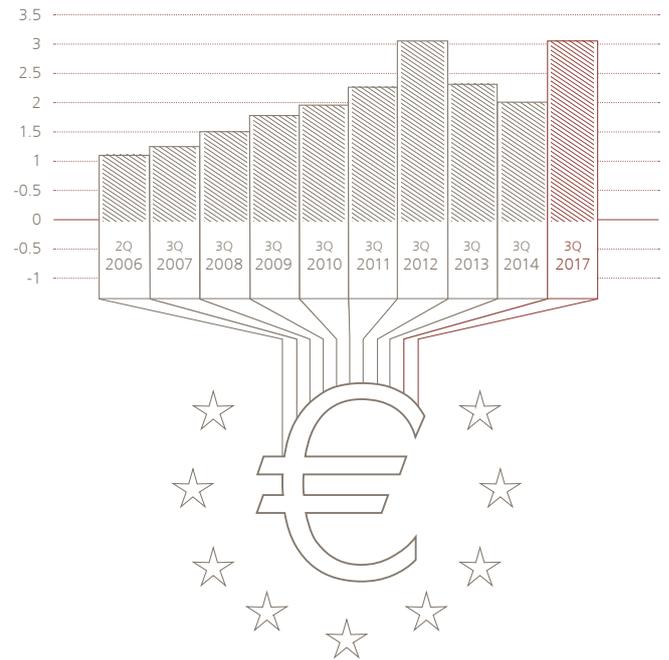
## UK – the fastest growing major economy

- UK **GDP growth** will outperform the Eurozone once again, with growth of 2.6%. This will be supported by rising business investment, falling unemployment, and increased consumer spending.
- We expect interest rate hikes in August 2015. Ahead of this, we prefer UK value equities.

Source: Bloomberg, UBS



## The ECB's actions will be critical in stimulating growth and inflation



- Deposit rates were cut into negative territory in 2014.
- The ECB has said it will look to expand its **balance sheet** back to levels reached in 2012.
- It may need to extend asset purchases into corporate, pan Eurozone, or sovereign debt to do this.

## Eurozone equity opportunities

- We are neutral on Eurozone equities, given weak earnings growth trends.
- We prefer financials, given low valuations and borrowing costs.
- The energy sector should benefit from a rising oil price and increased capex discipline.

# Asia and Pacific Driving on.

Min Lan Tan.  
Head of Asia-Pacific Investment Office

## At a glance.

China will continue performing a delicate balancing act between growth and reform. A growth rate of 6–7% would be more sustainable.

Asian exports will benefit from US business equipment investment. But export growth rates will remain below historical levels.

The Chinese yuan and Taiwanese dollar will stand up best to an environment of US dollar strength and renewed volatility, with the Indonesian rupiah likely suffering.

We are positive on India, given its cyclical recovery and significant macro adjustments since 2013. Japanese private sector demand will be stronger in 2015.

### **Do you think that China can maintain growth while driving on reforms in 2015, and when do we need to worry?**

It is difficult for China to maintain a growth rate of around 7.5% while driving on with structural reforms. Some of the reforms the government is looking to implement such as interest rate liberalization and local government finance reform would actually have a negative short-term impact on growth. So what is likely to happen in 2015 is that the government will tolerate lower growth and in the meantime will use targeted stimulus policies and measured interest rate cuts to avoid any sharp downturn. This does entail a delicate balance between growth and reform, but we think they can manage it.

What would cause them to back away from continuing reforms would be a domestic debt crisis or a really sharp slowdown in domestic demand. Then they would put reforms on the back burner and try to support growth.

### **What kind of long-term growth rates should we be expecting from China?**

I think a growth rate of 6–7% is more sustainable. The working age population in China is declining: even with the further reallocation of rural labor to the non-farm sector, the labor contribution to growth will fall. And demographics and improving social safety nets mean we think you'll start

seeing a gradual decline in savings, which essentially also implies slower capital accumulation.

### **Chinese equities look cheap on the face of it. Do you think that they are too cheap to ignore, and when would be the right time to buy?**

The apparently cheap valuation is very much driven by financials, while non-financials are trading very close to five-year average valuation levels. Given that there is no easy solution in sight for structural issues such as rising credit risk and non-performing loans, the depressed valuation of financial stocks could actually remain for quite a sustained period of time.

If we see a major and broad-based policy loosening, then the market would probably rally sharply. But this is not our base case, and our sense is that the government is not going to engage in broad-based loosening, only more modest measures to prevent growth from falling too much. In the medium to long term, sustained reforms of state-owned enterprises resulting in an improvement of the return on equity potential of the market would be the key to a long-term re-rating of the China market.

### **Can Asian export growth return to the levels of the past in 2015?**

Exports will benefit from stronger US business equipment investment. But our expectation is for Asian export growth to improve only modestly, to 7% in 2015, up from about 6% in



Min Lan Tan. Head of Asia-Pacific Investment Office

“The Chinese government will tolerate lower growth, and mainly use targeted stimulus measures to avoid any sharp downturn.”

2014. This pace of growth is still going to be sharply below the 14% trend growth rate that was seen in the past 10 years on average. The swing factor will be demand outside the US. With the diverging world meaning overall developed market demand is still relatively weak, it is hard to see how Asian exports could reaccelerate to the historical trend growth rate.

**What will a strong US dollar mean for Asia-Pacific?**

The correlation between Asian equities overall and US dollar strength has historically been negative. Now having

said that, we believe that the starting conditions by country will matter a lot and the impact of a strong dollar will not be felt evenly. So the starting conditions that we would look at include the health of the external sector, the degree of domestic leverage, and the level of domestic real interest rates. Our sense is that the two currencies that would be relative winners in an environment of dollar strength are the Chinese yuan as well as the Taiwanese dollar, simply because they are the currencies with the least volatility. On the other hand, the Indonesian rupiah is probably going to suffer given that

Indonesia has not made sufficient progress in reducing its current account deficit while the high level of foreign holdings in its local debt markets is also a concern.

**Do you think investors are right to be enthusiastic about India and its economic reforms?**

India was considered one of the “fragile five,” along with Indonesia. But in India’s case we have seen a significant improvement in the macro conditions. The current account deficit was running at 4.8% of GDP in FY2013. But this year we think it will come close to

1.5% of GDP. At the same time, real interest rates are rising in India as inflation has been surprising on the downside. So we do think that India is going to be a lot less vulnerable, and we are positive on India for cyclical reasons.

But the prospects for reform are also a tailwind. Growth is now the highest in two years and in the months and years ahead, Prime Minister Modi's reforms are going to support the manufacturing sector and foreign direct investment. Over the medium term, measures are now being put in to improve the flexibility of the labor market, and reduce red tape, which should help unleash productivity gains.

**Do you think that in 2015 we will start to see some genuine growth in Japan, or is it still going to be all about the Bank of Japan?**

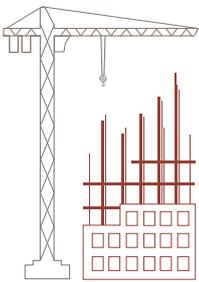
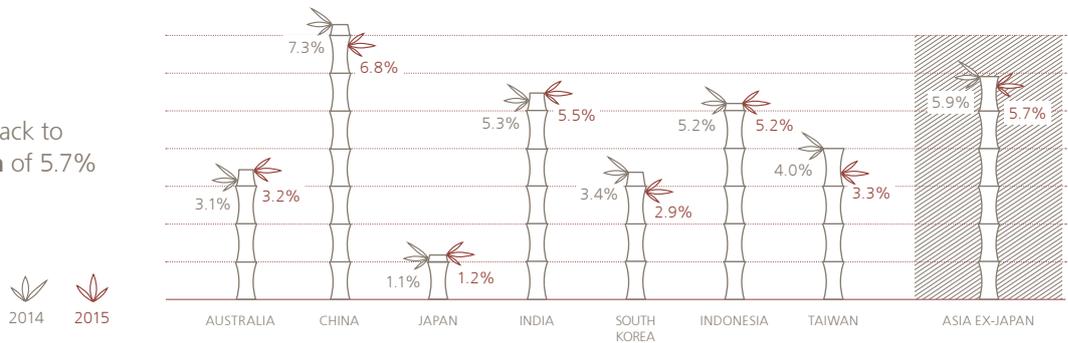
We have seen recently how important the BoJ is, and it will provide a key support to export competitiveness and corporate earnings. But we think that

private sector demand is also going to be stronger in 2015. Consumption should recover because of better employment and wage conditions. Tourist spending is picking up ahead of the 2020 Olympics. And because of the tight labor market, spending on labor-saving equipment is also showing signs of improving.

The key risk for Japan is likely to be the decision on a further VAT hike from 8 to 10%. If this transpires, we think there would be some sort of offsetting fiscal package. But obviously given the impact of the VAT hike this April, it is a risk event that one has to watch out for.

## Growth continues in 2015

The APAC region is on track to deliver real **GDP growth** of 5.7% in 2015, similar to 2014.



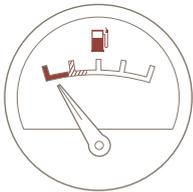
### CHINA

Policymakers will be under pressure to both reform and re-energize the economy. **Risks lie in the property sector** – prices are falling in almost every city.



### THAILAND

**Political instability continues.** Public spending is likely to be a key driver of growth in early 2015.



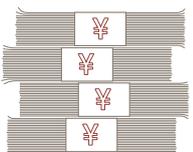
### INDONESIA

After the election, focus will turn to tackling bureaucratic inertia, and **cutting fuel subsidies**. We are cautious on the rupiah.



### INDIA

India is exhibiting promising reform momentum and earnings momentum is improving. We are **overweight Indian equities and the rupee**.



### JAPAN

The Bank of Japan's continued easing **will provide a good backdrop for Japanese exporters**.

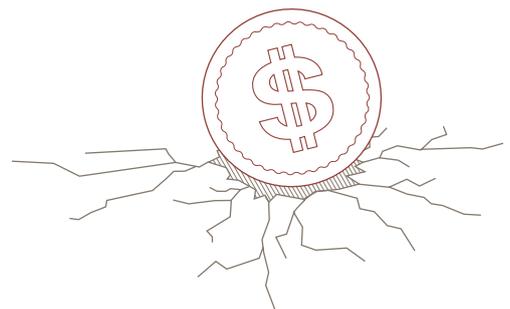


### TAIWAN AND KOREA

External demand, from the US in particular, should support exports. We **prefer Taiwan** due to **greater exposure** to electrical exports.

## A stronger US dollar will have an uneven impact

- The Chinese yuan and Taiwanese dollar will prove most resilient.
- Investors with Indonesian rupiah exposure should consider hedging against downside risks. Its bond market is **more than one-third foreign owned**.



Emerging markets

# Changing gears.

Jorge Mariscal.  
Head of Emerging Markets Investment Office



Jorge Mariscal. Head of Emerging Markets Investment Office

**The diverging world means unevenness in global growth. What does this mean for the emerging markets?**

The fact that Europe continues to be quite weak has implications not only for emerging Europe, but also for emerging markets as a whole due to the impact on commodity prices. The monetary policy response to try and arrest deflationary pressures isn't likely to help emerging markets much, given how low yields already are. So I'm afraid the emerging markets might feel a lot of the downside of lower growth and commodity prices, but not necessarily a lot of the benefits of loose monetary policy.

**At the Year Ahead Investor Forum there was a lot of discussion about what a stronger US dollar and higher yields might mean for emerging markets in 2015.**

**What's your perspective?**

Interest rates are often seen as the bogey man for emerging markets, but I disagree. I think that if higher interest rates come together with global growth, this isn't necessarily bad. Emerging markets did quite well back when the US 10-year yield was at 6% because growth was strong, and commodity prices were supported. So it's not the level of interest rates we should be worried about, it is the combination of high interest rates with potentially low growth.

It's similar with the dollar. If the dollar rises because there is strong US growth alongside relative stability in Europe and China, the effects can be more or less digested. But if the dollar rises because we have a flight to quality, then of course all bets are off and emerging market currencies and emerging market assets will be under pressure. So the growth context is important and risk appetite is important.

**We hear a lot about emerging market reforms. Is this something we should take seriously? When will we see the returns?**

It is early days, but the hope for the next 5-10 years is that reforms will inject a new degree of competitiveness. Emerging economies have to shift gears and rely less on an export-oriented

model. They have to free productive forces at a domestic level, attract foreign direct investment, promote domestic investment, create incentives for market mechanisms to work better, and foster a more inward-looking, self-reliant growth. The historical drivers of growth will not be there to the extent that they were in the past, so it is an economic necessity to move in this direction now. These changes will take some time, and in the short term they could have a negative impact on some large companies. But the payoff could be quite significant in the medium and long term if these reforms are executed properly.

**The diverging world also means higher geopolitical risks. Do these risks make Russia uninvestable?**

Not yet, but it is clearly moving in that direction. The sanctions are designed to have greater and greater bite as time goes on, so companies will increasingly find it difficult to refinance their debt and access international capital markets. Liquidity has been declining and the appetite among dollar investors for Russia in general has been diminishing. Unfortunately we don't think that there is going to be a quick resolution, and so the trend is probably going to continue that the market becomes less and less investable over time.

**Many countries in Latin America seem to be suffering from high inflation and low growth. Is this a return to the 1980s or can we be more optimistic?**

For the region as a whole, we are not going back to the stagflation years, but it's a bit like the old spaghetti Western – the Good, the Bad, and the Ugly. The Good are countries like Colombia, Chile, Peru, and Mexico, where the macro framework remains quite solid. Inflation is below 5%, deficits are relatively low, the overall drivers of growth are more or less sustainable, and a fair amount of structural reform is on the way. Then you have the Ugly, which are countries like Argentina and Venezuela, where the macro framework has been lacking for some years. Fortunately, I believe that these are outliers.

## At a glance.

Global growth is uneven, and some emerging markets will be negatively exposed to a stronger US dollar, higher global yields, and lower commodity prices.

Emerging market equities are cheap relative to developed markets. But this in itself will not trigger performance without stabilization in earnings.

With reforms underway, there is a "new emerging markets" developing within the emerging markets. You need to "look under the hood" to find companies exposed to this.

Within equities, we overweight the reformers Mexico and India, and those countries exposed to US growth such as Taiwan.

## “Emerging economies have to shift gears and rely less on an export-oriented model.”

And then you have the Bad, which is primarily Brazil. They have had moderately high inflation and in the past two quarters they have been immersed in recession.

The election was a close enough call that the government will have to listen to what the voters are saying – the people in Brazil want change. So I suspect we are going to see some adjustments ahead, but they are likely to be marginal. Brazil needs a big overhaul. Its large government is very bureaucratic, very interventionist in the setting or influencing of prices and credit allocation – and that affects entrepreneurs’ willingness to invest. Brazil has among the lowest investment-to-GDP ratios in the emerging markets, and that is not an accident. The second Rousseff government will have to review its approach.

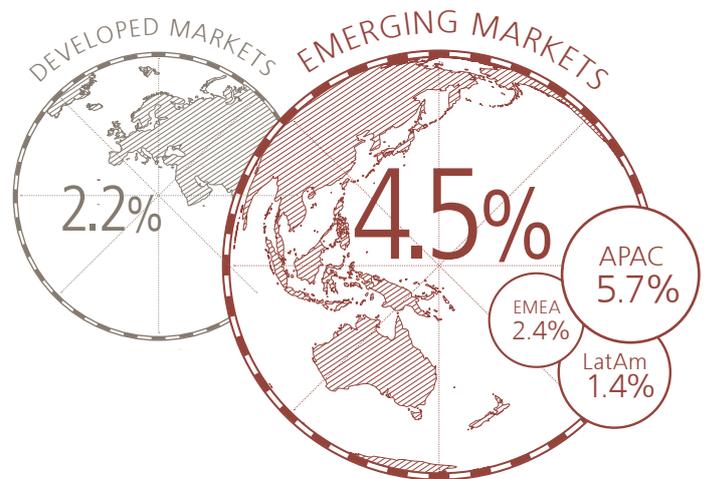
### **On aggregate, emerging market equities are cheap relative to the developed world. Is cheap really cheap enough?**

Probably, but that in itself is not what is going to trigger performance. You need a catalyst, and the number one catalyst for me would be a turn in the earnings outlook. Emerging market earnings had shown some signs of stabilizing, but the decline in commodity prices is likely to provide an additional negative.

While we wait, we need to remember that there are “new emerging markets” hidden within the “old” emerging markets. There are those sectors and companies positively impacted by the economic demands of the growing middle class in areas like healthcare, education, public infrastructure, electronic retailing and information technology. The old economy companies, which unfortunately are the largest weights in benchmarks, are likely to remain cheap until we see a strong global cyclical pickup. The new economy companies are not so cheap, but have been growing earnings rapidly and are probably going to continue doing quite well. So you have to be selective and look under the hood when you look at the emerging markets, because the benchmarks themselves do not present all the opportunities that are available.

## Growth in emerging markets will be uneven in 2015

- **Growth** is primarily coming from Asia, which we expect to grow at 5.7%. LatAm is expected to grow 1.4% and EMEA 2.4%.
- Growth in countries actively pursuing economic reform, such as Mexico and India, should improve.
- Growth in China and Russia will slow, and Brazil will remain weak.

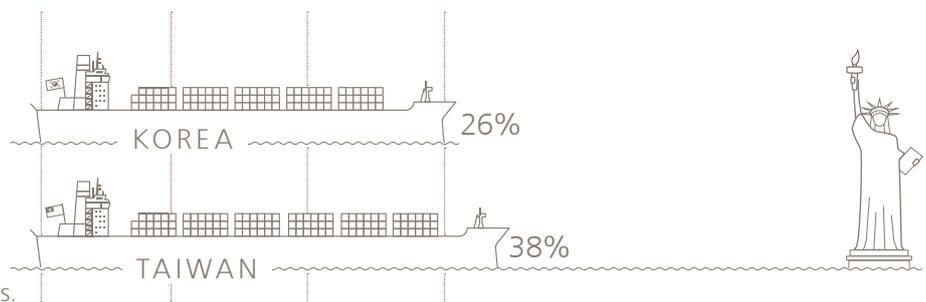


## Relatively cautious on the outlook for EM equities

- Corporate profitability is weak. Earnings have been stagnant for more than three years.
- The sharp declines in commodity prices and US dollar strength are unlikely to be helpful.
- Investors in emerging market equities will need to be selective.

## Parts of EM will benefit from US economic growth

Countries most leveraged to cyclical exports to the US stand to fare well. Taiwan in particular is highly leveraged to **exports of electrical machinery**, including semiconductors.



## The “new emerging markets” exposed to reform will also perform better

- We are overweight Mexican equities, after the country approved a transformational reform package in 2014 that is expected to bear fruit in 2015.
- India is also exhibiting promising reform momentum and earnings momentum is improving. We are overweight Indian equities and the rupee.

### RUSSIA

Financial sanctions will have an increasing effect over time and reduce market liquidity.

### BRAZIL

Following the election, business and investor confidence is likely to remain weak, and inflation high.

### CHINA

Reforms may be positive in the long run, but will have a negative short-term impact on growth.

# Switzerland Marching ahead.

Daniel Kalt.  
Head of Switzerland Investment Office

## At a glance.

The Swiss economy has benefited from high levels of competitiveness, low interest rates, strong immigration, and a booming property market. These conditions should hold despite still-muted Eurozone growth.

The mass immigration initiative will increase uncertainty for companies, and raise more general questions about integration with Europe. The macro-prudential measures the Swiss National Bank has implemented to cool the property market are working.

The EURCHF 1.20 floor will remain in place. Swiss high quality dividends represent an attractive investment opportunity at the turn of the year.

### **The Swiss economy has fared pretty well over the past three years. What would you say are the key strengths of the Swiss economy?**

First of all, the Swiss economy is very competitive. It has been ranked number one in terms of competitiveness by the World Economic Forum for the sixth year in a row this year. The country has a very flexible labor market, with limited regulations and employee protection. And Switzerland has a very solid fiscal balance – government debt is just 35% of GDP.

### **We have recently seen the referendum to curb immigration from the European Union. What is your view on what that means for Switzerland?**

This will increase uncertainty for companies in Switzerland. The big question will be whether there will be enough qualified people around after 2017, when the new quota system for immigration will be implemented. It creates a lot of political uncertainty not only about the labor market regime, but also about general integration with Europe, because bilateral treaties with Europe are at risk as a consequence of accepting the referendum.

### **This is a diverging world, but can Switzerland still fare well even in a world of weaker Eurozone growth?**

Switzerland has very strong trade relations with the Eurozone. Roughly 60%

of its exports go to the Eurozone. And exports account for roughly half of GDP. But the main driver of the Swiss economy over the last couple of years was not really trade but the domestic economy, because we had low interest rates, strong immigration, and a booming property market. These have been the pillars of the Swiss growth story. As long as the domestic economy continues marching ahead, I'm not too concerned. So there is some buffer for Swiss growth due to the fact that we have a very strong domestic economy.

### **The Swiss National Bank seems to have grown increasingly concerned about the booming property market and has instituted some macro-prudential measures. What do you think is the outlook for investors in Swiss property?**

We have to differentiate between the various segments of the market. The commercial segment, such as offices, is under ongoing pressure and has relatively high vacancy rates. On the other hand, multi-family homes are still in high demand, with relatively low vacancy rates, and these still have relatively attractive yields. On the listed real estate side, I think the story is the same; you have very stable dividend yields and cash flows. But the scope for appreciation in listed real estate is relatively limited.

Looking at prices, they have risen a lot over the past six or seven years, especially in the residential segment, but



Daniel Kalt.  
Head of  
Switzerland  
Investment Office

they are now cooling off. In that sense the macro-prudential measures the Swiss National Bank has implemented are showing signs of doing good.

**Do you think the EURCHF floor will remain in place in 2015?**

I see no chance for the SNB to exit this policy, given the developments in the Eurozone. The SNB already has a huge balance sheet, and this is a risk; if you let the floor go, then Swiss franc appreciation leads to substantial losses.

The only possible scenario in which the SNB will have a chance to exit this policy is if everything in Europe goes extremely well and the market regains confidence in the euro. Then the Swiss National Bank could gradually unwind its balance sheet and let the floor go. But today that seems some way off.

“As long as the domestic economy continues marching ahead, I’m not too concerned.”

**Given Switzerland’s large current account surplus, does Switzerland really need the floor?**

There are large structural elements in the current account surplus. The fact that Switzerland is a trade hub for commodities, for instance, adds to it, and helps explain why we have a surplus of over 10% of GDP. If EURCHF had remained at 1.00 in 2011, I’m sure Swiss exporters would have suffered and the unemployment rate would have doubled, or even worse.

**The Swiss National Bank’s large foreign exchange reserves can either be seen as a risk or a huge asset. Do you think this is good or bad?**

The Swiss National Bank has grown its balance sheet from below 10% of GDP to around 70%. You might look at it as an asset, but on the other hand, if you have a potentially problematic currency on the balance sheet it could be risky, and close to 50% of the SNB’s FX reserves are in euros. The

SNB signaled that the level of reserves was too low before the crisis, and would welcome a higher level. But I think they are now probably too high.

**Switzerland has an aging population. What are your thoughts on the pension system?**

Despite the fact that the Swiss system is seen as a role model by the OECD for how to organize a pension system – with three pillars of a basic state, occupational, and private schemes – we will also run into the same demographic problem as other Western countries. It is very clear that Switzerland has fallen behind the curve in adapting the system to these demographic challenges. There have been others including Scandinavian countries that have raised the pension age, but Switzerland is hesitant to change. We have looked at this more closely of late because it is of utmost importance to our clients. And we clearly see risks regarding its long-term

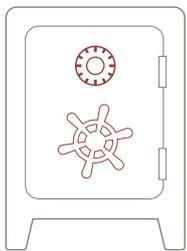
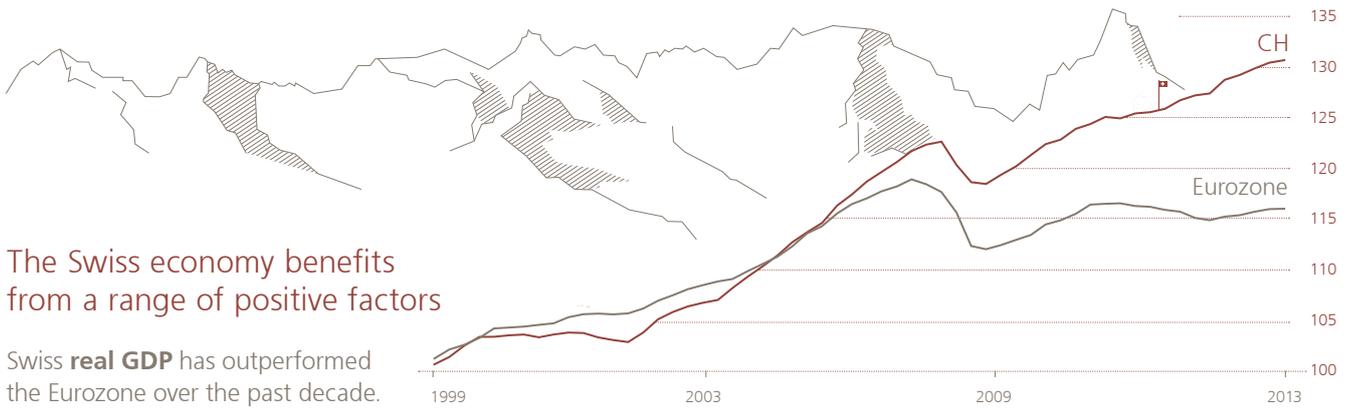
sustainability. It is very important that the currently planned reform by the Federal Council goes through parliament and also through a popular vote.

**In Swiss equities, what are your recommendations?**

We like high quality dividend stocks in Switzerland. By high quality dividends, we mean payouts that are sustainable and have the potential to rise over the long term.

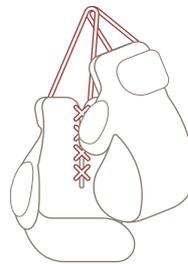
Over the long run, up to 50% of your stock performance comes from dividend payments, and we also like these stocks from a timing perspective.

Our analysis shows that seasonally, between roughly December and May or June, dividend stocks outperform the rest of the market. So it is a good time to enter these stocks around the year's end. For Swiss domiciled investors, there is also a certain segment of Swiss stocks that can pay dividends free of withholding tax.



Switzerland is the fourth-largest holder of net foreign assets globally...

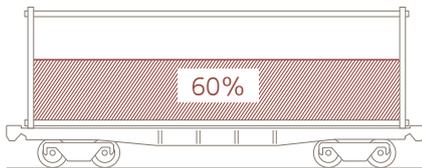
1. Japan
2. China
3. Germany
- 4. Switzerland**
5. Taiwan



...and ranks high in competitiveness.

- 1. Switzerland**
2. Singapore
3. US
4. Finland
5. Germany

## Uncertainties ahead



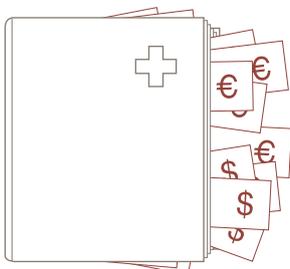
The Eurozone, representing some 60% of exports, is still suffering from weak economic growth.



House prices have risen sharply over the past six to seven years, but the market is showing signs of cooling.



Foreign relations are strained by tax issues and the mass immigration referendum.



The Swiss National Bank has substantial balance sheet risks as FX reserves have risen to CHF 460bn, or more than 70% of GDP.

## Among Swiss equities, we prefer quality dividend stocks

- Up to 50% of long-run stock performance comes from dividend payments.
- In the first half of the year, dividend stocks tend to outperform the rest of the market.
- There is also a segment of Swiss stocks that can pay dividends free of withholding tax to Swiss-domiciled investors.

# The principles of investing

# Analysis, strategy, and discipline.

Andreas Hoefert. Chief Economist

## At a glance.

Investors need to be conscious that economic and market forecasts are usually more wrong than right.

The most successful investors have sound analysis, strategy, and discipline.

Investment strategy should be personal to every investor, considering their financial objectives and their tolerance of risks.

It is critical for investors to try and avoid making sudden changes to their investment strategy based on emotions when, for example, markets get volatile, or when certain assets or sectors are hot.

### **Once again, toward the end of 2014, we saw a sudden resurgence in market volatility that it seems no one saw coming. Why do you think this happens?**

Plain and simple, we need to be conscious that forecasts are usually more wrong than right. We have so many examples of blunders in forecasts. Maybe the biggest forecast error ever made was by noted economist Irving Fisher, who claimed in September 1929 that "equities have reached a permanent plateau." More recently we had Federal Reserve Chair Ben Bernanke saying in 2008 that he thought the economy would be better in the second half than in the first half.

So it shows you basically that we don't know a lot about the future, and it seems quite impossible for us economists to correctly forecast a recession. So don't rely on forecasts too much when you build your investment strategy.

Despite this, many people still do. There's this anecdote by Kenneth Arrow, a Nobel Prize winning economist, which shows this phenomenon well. In World War II he was working as a statistician at the US Army weather office. He was looking at weather forecasts thinking, "they're always wrong, so why are we doing them?" He decided to write a memo to his superiors saying, "We put a lot of money into these forecasts and it's not worth it." The reply came back, "We all know the forecasts are wrong. But we need them for planning."

It's amazing, these human biases mean that even if you think the forecasts you use are wrong, they give a sense of security.

### **Why do you think we see these behavioral biases occurring?**

Most of the time these are emotional. People can actually act irrationally quite a lot of the time.

It's something that two famous psychologists, Kahneman and Tversky, have done a lot of work on. They show that despite the fact that we all think we are rational beings, we do a lot of things without reason. We often act based on intuitive "heuristics" in our brain so we can act and think very fast. This is something that served us well when we were cavemen, but doesn't serve us so well in this complex world.

Slower thinking usually leads to more rational decisions, but thinking can be very painful! Many people are attracted to thinking quickly, and it is basically unavoidable unless you have a clear, disciplined strategy, and always think twice and think slow before you make investment decisions.

### **Behavioral finance has developed a lot in recent years. What are the best ways for investors to avoid these biases?**

If you look at successful investors, they have sound analysis, strategy, and discipline.



Andreas Hoefert.  
Chief Economist

## “If you look at successful investors, they have sound analysis, strategy, and discipline.”

I always use the two examples of Warren Buffett and George Soros. Warren Buffett is a guy who has a strategy you can summarize by saying, “I buy things I understand, and I find cheap.” George Soros looks to invest against large macroeconomic disequilibria, and eventually expects the economy will go back to this equilibrium.

These are completely different approaches to investing, but both lead to success. So it’s not the approach they have in common, it is this combination of analysis, strategy, and discipline. They have sound analysis – if Buffett buys a company he knows exactly what he’s buying; if Soros is playing a currency he’s done his

homework and knows there’s a problem. They have a strategy. And, most important, they stick to it, they have discipline.

For example, in the late 1990s, Warren Buffett was not heavily invested in internet stocks, and his portfolio was underperforming the market quite substantially. But ultimately he was right and he didn’t suffer in the crash in 2000 and 2001. His strategy was that he did not invest in things he didn’t understand, and ultimately it worked.

**How can private clients employ an approach of analysis, strategy, and discipline?**

The analysis part we are very happy to help with in publications like this, and with the work we have done looking at the best combinations of assets to help improve returns relative to risk. For strategy, this is something personal to every investor and everyone needs to consider both their financial objectives, but importantly also their tolerance for risks. Then the discipline bit is the hard part. Investors need to try and avoid making sudden changes to their strategies based on emotions when, for example, markets get volatile, or when certain assets or sectors look hot. Sudden shifts based on “quick thinking” can really hurt performance over the long run.

Asset allocation

# Finding balance in a diverging world.

Mark Andersen and  
Mads Pedersen.  
Co-Heads of Asset Allocation



Mads Pedersen. Co-Head of Asset Allocation

## At a glance.

2015 is likely to see the Fed tightening, and this means volatility may go back to historical levels.

Portfolio returns are likely to be lower than those historically, due to the low level of yields across asset classes.

Higher allocations to hedge funds should help improve portfolio risk-adjusted performance.

Next year could be one when we get back to much larger performance differences between asset classes.

We are overweight US equities and US high yield credit.



Mark Andersen. Co-Head of Asset Allocation

**How is the investment environment in 2015 likely to be different from recent years?**

MP: One main difference is that we expect the US central bank to tighten in 2015. There was some implicit tightening in 2014 due to the lack of new easing, but in 2015 we are likely to see the first rate hike. And that means that volatility across asset classes should move back towards historical levels. This makes a balanced portfolio much more important, because if you have

only one asset class, even if it is a good one, you may get a lot of unpleasant days or months.

Another thing that is different is that equities simply do not have as much upside as they had two or three years ago. People need to have realistic expectations about return, but also about volatility relative to return. In 2013 volatility was half of returns. In 2015 it could easily be double. It will be a significantly more risky environment.

MA: It's important to look at some of the similarities as well. While we expect yields to move up a bit, overall interest rates and yield levels on government and corporate bonds are extremely low, so it is still a generally supportive environment in terms of investments as we enter 2015. While the Fed might be tightening, we are currently in a diverging world, so we will not experience synchronized global tightening. We also enter 2015 with some of the same structural questions about growth in China and some of the emerging markets that we entered 2014 with.

**Bond yields are close to all-time lows, and global equities have performed well in recent years. What can investors expect of return on a diversified portfolio from here, for 2015 and beyond?**

MP: It depends on how much risk investors are willing to take, but for a well-diversified, balanced portfolio, we're looking for a return of 4–6%. This return is lower than it has been in recent years, and that is because of the low level of yields we're starting with. Something we're doing to try and increase returns is looking to invest more in hedge funds – they are relatively stable in return and volatility, and represent a good substitute to some bonds which are offering low returns.

MA: Importantly for more conservative investors is that long-term returns are not likely to be much more than 1% per annum. Even if inflation is low today, even a small increase could easily make real returns for fixed income investors negative. If investors can tolerate the extra risk, a balanced

portfolio of equities, hedge funds, and bonds offers a better risk-return profile.

### **What are key risks to diversified portfolios in 2015?**

MP: For me, a key risk would be inflation. For now, we don't see it with commodity prices under pressure. But for diversified investors it is one of the biggest risks. If we saw a persistent rise in inflation above central bank targets, it would push up yields for bonds, and would at least initially be negative for equities too. Anything that pushes down equity and bond prices at the same time is bad for diversified investors.

And it might sound relatively obvious, but growth falling or an outright recession are risks too. Normally, in a slowdown, diversified portfolios get some insulation against declining equity prices, since bond prices rise in anticipation of interest rate cuts. But today, with interest rates and yield levels already so low, there is less room for them to go down.

### **Thinking more tactically, we've been talking about a diverging world. Do you think we're going to see a diverging world in market performance in 2015?**

MP: I expect to see much higher dispersion. One of the difficult things about doing tactical asset allocation in 2014 has been that for most of the year, most asset classes, ex commodities, have given similar returns, so there hasn't been so much to play relatively. Next year could easily be a year when we get back to much larger differences between asset classes.

### **At our Year Ahead Investor Forum there was a lot of discussion about which asset class might deliver the best return per unit of risk in 2015.**

**"As market volatility gets higher, a balanced portfolio becomes much more important."**

### **What is your view?**

MP: With current levels of spreads, we think high yield credit looks interesting, even if it delivers lower returns relative to risk than it has over the past few years. More conservative bond investors who don't want high yield can look to medium-duration investment grade. We think it is better to be short-duration and lower in the credit spectrum, for example medium-duration A-rated bonds, than to be long-duration high in the credit rating, for long-duration AAA-rated bonds.

MA: My top pick would be US high yield for the highest risk-adjusted return, followed by equities or hedge funds. I find it interesting how critical the investor community has become on lower-rated credit, when corporate balance sheets remain very strong, companies have funded themselves at low yield levels, and only have a small amount of maturing bonds in the coming years. I think this represents an opportunity for those who do not have allocations to US high yield credit.

**Where should investors turn for equity market returns? The US has high growth but tightening policy. The Eurozone has weaker growth but loose policy. Then there's EM, which has slowing growth and potentially tighter policy, but is cheap.**

MA: Pretty much all "value" markets are cheap for a reason. We'd put emerging markets, Europe, and to an extent, Japan, in that category. Of these markets, the Eurozone is probably in a better position, as some of the structural issues have been addressed over the past few years and we have a European Central Bank that is very willing to support an economic recovery. In Japan it is very difficult to predict what is going on, since it's all a bit of an experiment. For the emerging markets, there is a longer deleveraging story at play, and commodity prices are falling, which is bad for a number of them. The weakness in commodities this year has been interesting to see and really goes to show why we do not see commodities as a long-term buy-and-hold investment. In general they just do not adequately compensate their large volatility with a reasonable expected return.

MP: The safest bet of all of them is the US, and this is why it is our biggest overweight. It is a much more stable market and has a solid earnings growth picture. The US is where I'm most confident we'll get positive returns. It probably isn't the market with the highest potential upside, but the central bank has flexibility, and the companies have very easy financing and very good cost control.

Central bank flexibility is an important factor. I think there is much less risk in the US and the UK, because you have a unified dovish central bank with relatively high yields. The European Central Bank is not so united at the moment, but we could be at an important inflection point. If inflation in Germany is lower than people expect next year, there is very little room left before it actually becomes outright deflationary. This could encourage the Germans to buy their government bonds and do outright quantitative easing. In EM, you have a mix of local central banks and US-influenced central banks with diverging goals, and they don't have the kind of flexibility you have in the rest of the world.

currency risk. If investors want to stay in the Eurozone, leveraged loans could offer good risk-adjusted returns.

**What does a stronger US dollar mean for portfolios, and how should investors think about currencies in general?**

MA: We recommend that investors try and hedge the largest parts of the FX exposure in their portfolio, particularly in fixed income. You don't want to take currency risks that you're not being compensated for. We think we are in for a period of US dollar strength and we would not be surprised to see the US dollar being one of the best performing currencies in 2015.

and hedge funds. Impact investing is a relatively a new marketplace, so investors need to do things gradually – there is a lack of available product, so it is better to spread it around. If people want to do things Gates or Buffett-style they need to take the same amount of time that these people took. It's not good to rush in, better to build up exposure over a number of years.

“Something we're doing to try and increase returns is looking to allocate more to hedge funds.”

**How should fixed income investors deal with their portfolios, since low yields are a particular problem for Eurozone and Swiss investors?**

MP: We advise them to go to other markets and get higher returns outside the continent. This means holding some emerging market bonds, which have a decent spread and have less risk than emerging market equities. It also means looking to the US, where yields are higher, and hedging back

MP: It's simple. If you have a strong view in FX, play it in FX. Don't play it implicitly.

**How should investors think about sustainable investing in their portfolios?**

MP: They should think about impact investment and sustainable investing as a part of an existing asset class. For example, if it is a private market investment, it should be a substitute for existing holdings in private markets

Themes

# For 2015 and beyond.

Philippe Mueller. Head of Themes



Philippe Mueller. Head of Themes

## **Which themes are you most excited about for 2015?**

One of my favorites is “rising stars” in the area of credit. If you look at institutions and some other investors, they often are prevented from buying high yield bonds. So if a bond is downgraded from investment grade to high yield it suffers a lot as forced selling is observed. Now with solid fundamentals for credit, we are seeing more rating upgrades than downgrades. So now is a good time to be looking at those high yield bonds that are most likely to be upgraded. These bonds are called “rising stars,” and normally benefit from powerful technical buying pressures as they become eligible for more investors. This is a compelling story offering attractive risk-return characteristics. This theme is on the conservative side of high yield, so investors who are more cautious but still want an investment with a good yield can find very nice risk-return characteristics here.

Another theme that I like for the first half of 2015 is the Swiss high quality dividend theme. If I look over the last 20 years, dividends have been a very significant part of long-term equity performance, roughly one third to half of the performance in fact, depending on the stock. And if you look out for dividends which are of good quality – sustainable and rising – then you have some significant benefits. Dividends also usually have a lower volatility than the earnings. So it’s a quite interesting theme when you have

## At a glance.

"Rising stars," or companies seeing their credit rating upgraded from high yield to investment grade can see powerful technical buying pressures.

In Switzerland, high quality dividends typically get more attention around the turn of the year as we approach dividend season.

In Europe, investors should look to companies which can "self-help," or boost earnings even in a weak economic environment.

Long-term themes include the development of mass transit rail, water scarcity, and rising protein consumption.

tougher economic times as we are currently observing in Europe and other parts of the globe, and these names should also be attractive in the context of a low interest rate environment. The dividend season is starting soon, in February and March, and investors should be positioned for high quality dividends ahead of that period.

billion to more than nine billion by 2050. You are going to see a further big boost in the number of people living in mega cities in the coming decades. And with air quality problems observed in many of those cities, there is much need to work on that. Governments have recognized this in many countries, including India, Indonesia, Thailand and Malaysia, and have

### **is elsewhere in the world. What themes are we selecting in Europe to outperform in a sluggish macro environment?**

Selectivity is currently a very important aspect. We have to choose those companies that are able to increase their operating margin and that have stronger earnings growth over the next two to three years even amid

"With themes, you can find unique exposure to differentiated risk-return characteristics or performance drivers."

### **So rising stars and high quality dividends for 2015. And for the long term?**

If we look at longer term investments we should think about urbanization, population growth, and aging. These are drivers which are not too closely linked to short-term economic news but should endure through a cycle. Here we normally think about topics like water scarcity or rising protein consumption. But what I like most is our theme on mass transit rail. According to the United Nations, the global population is likely to grow from seven

decided to spend USD 200 billion over the next decade. I think here we have a compelling story to benefit from those public spending plans. Companies building mass transit rail systems or metros are likely to give us higher earnings visibility across the public spending cycle. But also in my view they should show above-GDP earnings growth, making mass transit rail an attractive long-term theme for a portfolio.

### **In the diverging world, growth in Europe is somewhat lower than it**

subdued economic growth. In this difficult environment these are usually companies that are so called "restructuring" candidates that are able to "self-help." So it lies in their hands to improve their EPS and their margin rather than just waiting for the economic cycle to help. We are already seeing early signs of this. Look at M&A volume this year, which has significantly increased compared with last year. IPOs have been on the rise too, and we see this as an indicator of corporate activity. We have more cost saving announcements and restructur-

ing announcements as well. But if you want to play a restructuring theme for above average earnings growth, it is crucial that you are well diversified, since there are often company-specific risks associated with restructuring.

### **Talking more generally, what are the advantages of investing in themes?**

With themes you can find unique exposure to differentiated risk-return characteristics or performance drivers, because you are not looking at just regions or asset classes in the traditional way. You group securities which might be completely different by common drivers, and therefore might add some diversification potential to a portfolio. I also think a portfolio can be “personalized” with themes. Last but not least, you can capitalize on some changes that are taking place in the world, which exploit for example disruptive innovations or revolutionary discoveries. It is a way to put something in a portfolio which might not yet be represented when just looking at traditional asset class benchmarks.

### **What are the risks of thematic investing?**

Geopolitical risks or simply an incorrect assessment of the drivers of themes and company performance

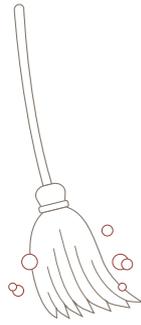
can be problematic. That is why a proper monitoring of theme performance is extremely important. I think it is very important that investors play themes with properly diversified instruments – you want to have an exposure to the drivers of the theme, and not to company-specific stories. A theme is not an asset class and not a single security, it is in between.

### **How should investors think about it in the context of their whole portfolio?**

Themes should not take up too much of a portfolio’s risk budget. It could often be considered as a satellite, just as an addition to an existing position. So if you hold US equities for example, you could add a theme in this segment to personalize your portfolio and add a high conviction idea. It is also important to consider the cyclical nature of the overall portfolio. One should not add a high beta theme when a portfolio already has high levels of risk. Individual discussion and consideration of each theme is therefore extremely important.

## Restructuring in Eurozone to increase value

- In an environment of weak growth, companies that can expand their margins through internal cost controls and restructuring measures should outperform the rest of the market.
- There is increasing evidence of corporate actions, and depressed margins provide plenty of scope for improvement.



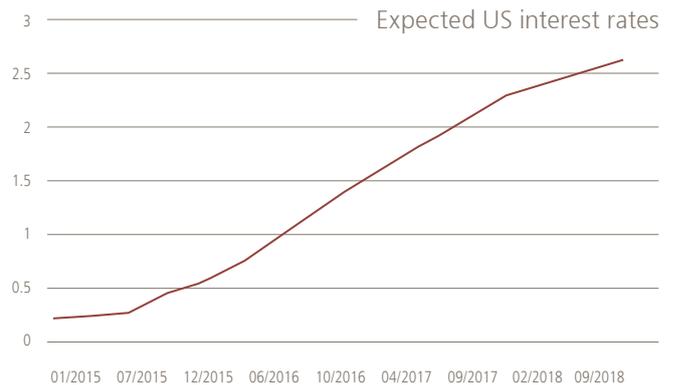
## Rising stars

- Credits that are upgraded from junk to investment grade can see strong performance, thanks to their newfound access to a larger investor base.



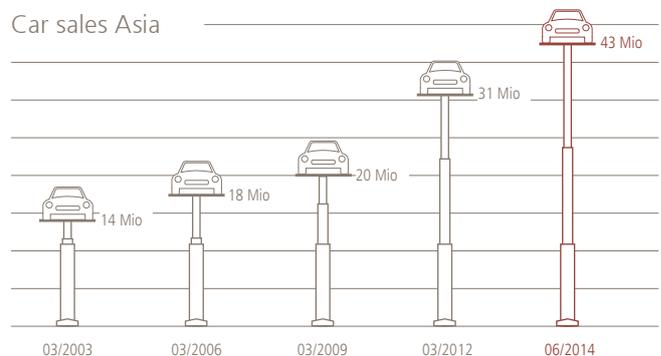
## US financials

- The earnings outlook for US financials is becoming more constructive.
- An improving economic environment should drive increasing loan volumes and credit performance. Housing market activity should improve on the back of steady gains in the job market.
- Higher interest rates should benefit banks and insurance companies. For banks, higher rates should drive net interest margin expansion. Insurance companies should be better able to earn their expected returns in a higher yield environment.



## Mass transit rail

- The number of Asians living in megacities of over 10 million is forecast to double by 2025, according to the United Nations.
- Sharply rising CO<sub>2</sub> emissions are adding to air quality problems in Asia's largest cities, with vehicle ownership doubling every five years.
- Asian countries, including the new governments in India, Indonesia, Thailand and Malaysia, are expected to spend over USD 200bn in greenfield mass transit rail systems in the next decade to combat rising urban congestion.
- Companies exposed to this spending should see above-GDP earnings growth rates.



## Swiss high quality dividends

- Companies that pay dividends that are both stable and growing tend to outperform the overall market.
- Over the past decade, the SMI has delivered a total return of more than 100%. Close to half of this return came from dividends.
- Dividends are particularly attractive given the exceptionally low yields on offer in Swiss franc bonds.
- The defensive characteristics of dividends should fare well in a diverging world, since their volatility is much lower than corporate earnings. In 2008, total net profits tumbled 52% but aggregated dividends only fell by 28%.



Source: Bloomberg, UBS

Ultra-high net worth

# Thinking for the long term.

**Simon Smiles.**  
Chief Investment Officer, UHNW

## At a glance.

Concentrated holdings, rising interest rates, and low cash yields are among the concerns most frequently aired by ultra-high net worth investors.

Global family offices are increasingly seeking systematic, institutional-type trading strategies, portfolio hedging techniques, and greater granularity in asset allocation.

Ultra-high net worth investors' ability and willingness to think long-term unveils unique investment opportunities in areas like protein consumption, death services, and investments into Africa.



Simon Smiles. Chief Investment Officer, UHNW

**You speak regularly with ultra-high net worth individuals. What investment-related concerns get aired most frequently?**

There are probably three things that come up. The first is risks associated with concentrated holdings – having a large proportion of one’s portfolio concentrated in just one asset. Secondly, the problems of rising interest rates come up in almost every conversation. And finally, the question of what to do with cash, or more specifically how to actually earn some yield in this environment.

There are two broad ways of dealing with concentrated holdings. One is to adjust the asset allocation that the client holds to take into account that concentrated holding with respect to the remainder of their portfolio. The second is to look to actively hedge the concentrated position. With respect to rising rates, it helps to look at past periods of rising rates. Obviously, history does not always repeat itself, but when we look through the four previous hiking cycles, rising rates weren’t actually bad for equities. In fact, equities actually went up.

Dealing with cash is much more difficult – interest rates are zero. And in that environment, trying to maintain purchasing power for cash is not trivial. There are only three ways to increase yields on cash, but all involve taking more risk – currency risk, duration risk, or credit risk. Only in that way can one generate a yield that can exceed inflation.

**How are the investment characteristics of UHNW clients similar to and different from other clients?**

There are a couple of similarities – home bias and large cash balances. Many of our clients have large proportions of their portfolios in cash, far beyond what we would recommend

from an asset allocation perspective. And the second similarity is home bias, the familiarity with assets from their own country or sector leads to a disproportionately high amount being allocated to those “known assets.”

Two areas of difference tend to be in the ability and willingness to think long-term, and the ability and willingness to lock up their investments for a longer period of time. That long-term focus is something that is actually quite unique to larger clients. The vast majority of institutional investors simply can’t take an outlook beyond the next three months, six months or 12 months. Being able to look instead at three, five, or 10-year cycles tends to unveil investment opportunities that our clients can exploit. And being able to earn an extra return by giving up the liquidity on your investment is a nice way to increase portfolio returns.

If you look at long-term trends in demographics, population growth, and urbanization – these are slow moving but very, very certain over time. So the kinds of areas we’ve looked at that benefit from all of those trends are things like protein consumption, milk and meat consumption in particular, death services and opportunities particularly with respect to direct investment in Africa.

**You also speak to a number of large family offices that are more institutional in nature – how do they differ?**

Four things tend to come up. The first is interest in “institutional-type” trading strategies, the type of strategies that hedge funds employ. Secondly, hedging: clever and cost-effective ways of hedging portfolios or risks to portfolios. The third thing that comes up increasingly frequently is “alpha strategies,” or ways of systematically generating typically less corre-

lated or uncorrelated yield. Finally, there is an interest in greater granularity with respect to asset allocations, and particularly strategic asset allocations – getting more granular with the types of asset classes and sub-asset classes to which portfolios allocate.

**Are you seeing any changes in the demands ultra-high net worth individuals have of their bank?**

One area is increased interest and demand for networking opportunities. There has been a whole raft of these across the globe. In Asia we have focused on sectors, and have run networking events for Asia-Pacific CEOs in the healthcare, consumer retail, and technology spaces. Some of our billionaire clients have attended an event we call “B:connected,” again a networking event where clients are able to gain exposure to senior management.

In addition, we are currently working on a project to systematically talk to some of our most senior entrepreneurial clients about how the world is progressing.

# Sustainable investing

# A coming of age.

Stephen Freedman. Investment Strategist



Stephen Freedman. Investment Strategist

## **What does sustainable investing mean?**

We define sustainable investing as a group of investment approaches that fulfill at least one of three types of goals, or often a combination of them. One motivation is to improve a portfolio's return and risk characteristics by better understanding how sustainability factors impact the value of securities. A second one is the desire to achieve a positive social or environmental impact through investments. Finally, the desire to align the content of portfolios with an investor's personal values is a third possible motivation.

## **The concept of sustainable investing has been around for some time now. How is it developing?**

We are seeing considerable growth in the interest in sustainable investing. This is coming as a result of a change in expectations throughout society and among different stakeholders of companies such as consumers, employees, investors or regulators. There is a growing realization that there are some global challenges, which the corporate sector can and must solve. This is forcing a focus on sustainability.

## **What are the different approaches to sustainable investing?**

The traditional approach to sustainable investing is what we call an "exclusionary approach." Here, an investor determines what type of activities he or she would like to exclude – very typical areas would include alcohol,

## At a glance.

Sustainable investing can help improve a portfolio's risk and return characteristics, achieve a positive social or environmental impact, or align portfolios with an investor's personal values.

Approaches that are focused on integrating the analysis of environmental, social and governance factors into portfolio decisions are gaining traction.

The evidence indicates that, on average, there is no trade-off between investing in a sustainable way and financial performance.

weapons, tobacco, or pornography. Then firms engaged in those activities are excluded from a portfolio. This approach traditionally has been used a lot by faith-based investors over time.

But the evolution is going more towards approaches that are focused on integrating the analysis of environmental, social and governance factors into portfolio decisions. And here the idea is to combine the understanding of those factors together with traditional financial considerations that determine the value of securities to obtain a fuller picture.

A third approach which is worth highlighting because it is also growing, albeit from a lower level, is called impact investing. Here, the predominant objective is to have a positive and measurable impact on either society or the environment. This can be done through a variety of structures, including private equity or through lending-based solutions such as variants of microfinance.

### **When you look at impact investing, is there a choice to be made between social gain and financial returns?**

As far as investing in financial markets and liquid investments are concerned, the evidence that has been gathered for the last 30 years does not seem to indicate that there is any trade-off between investing in a sustainable way and financial performance over full market cycles.

As far as impact investing is concerned, it is hard to generalize, because everything is very deal-specific. Some deals can offer very competitive returns, while for others there may be an explicit intention to accept a somewhat lower rate of return in exchange for having a stronger social or environmental impact. It has to be looked at on a deal-by-deal basis.

### **How do you measure the success of a sustainable investment given that it has these dual objectives?**

It is important to realize that sustainable investing is not the same as philanthropy – financial returns still matter and should be measured in the traditional way. As far as the social and environmental impact measurement is concerned, it gets more complicated, but it is important to focus on investments where you have the ability to track some kind of number. For example, if you have an investment opportunity that is focused on education, you may want to track the number of students that are graduating from a program.

### **What are the risks you see in sustainable investing?**

The risks depend on the approach. For instance, if you are using an exclusionary approach, there is always a question of how strictly it is going to be enforced. If the threshold is too strict, there is a risk that a portfolio becomes too concentrated in some industries, leading its risk-return behavior to become inferior to a more diversified portfolio.

In the case of the integrated approach, there is a risk of style bias. Often you end up with more small-cap exposure, where growth or quality factors are more prominent. That is not necessarily good or bad, but it does mean that depending on the phase of the market or business cycle you are in, such a portfolio may outperform or underperform relative to a standard benchmark.

Finally, a third risk may arise when investors try to embrace a more thematic approach to sustainability, focusing on such things as water or energy efficiency. Those are investments that can be quite attractive, and they are quite intuitive because there is a well-defined story behind them. But when taken in isolation those investments can be relatively risky, and there is also a danger that they may become overcrowded if a particular sustainability theme grows very popular. It is important to look at those in the context of an overall portfolio, making sure there is no excessive concentration on any one particular theme.

# Searching for alternate sources of return.

Andrew Lee. Head of Alternative Investments

## At a glance.

Given the continued lower-return, lower-yield environment, it's still important for investors to look for alternate sources of return.

In general, it's important that investors keep their hedge fund exposure balanced across strategies, and only tilt this balance within a portfolio context.

Within private markets, European bank deleveraging creates a number of opportunities for investors.

"Niche" opportunities, where return drivers are largely uncorrelated with markets, are increasingly compelling.

### **What do you think about when you look ahead in hedge funds?**

Given the continued lower-return, lower-yield environment, I think it's still important for investors to look for alternate sources of return. Some might have been disappointed with the performance from some funds in 2014, but it's important to remember that hedge funds have exposure to many factors beyond just equities, so in any given year, hedge fund performance won't necessarily align with equities. I think it is most important to evaluate risk-adjusted returns in a portfolio context over a multi-year horizon. That way, I'm confident that hedge funds will prove beneficial to most investors' portfolios.

### **How should investors think about including hedge funds within their portfolio?**

Overall, I think it's important that investors keep their hedge fund exposure balanced across strategies, to avoid performance being overly dependent on or subject to a limited number of return drivers. Some of the unique and attractive features of hedge funds result from their exposure to non-traditional factors such as illiquidity or volatility risk. These drivers deliver attractive risk-adjusted returns most of the time, but they are also asymmetric and can add tail risk to portfolios. Of course, there is also always the risk that individual managers fail to deliver against performance expectations, whether because of poor risk management or judgment.

We're in the process of introducing several analytical hedge fund tools, looking at systemic risk, liquidity risk, business cycle risk and market volatility. This "Hedge Fund Navigator," as we call it, helps assess to what degree current market conditions are supportive or not of hedge fund investments. But the best way to minimize negative portfolio impact from these risks is to diversify. We will at times recommend tilting this balance in favor of certain styles and away from others in order to capture observed or anticipated market dynamics, but always recommend doing this within a portfolio context. For example, we currently have a cautious view on macro hedge fund styles overall, and would recommend a lower-than-normal allocation to these funds, but generally not a zero allocation.

### **After a disappointing few years, it seems like macro funds have started to perform better recently. Is this a sign of a turnaround?**

Indeed, since August, the style has begun to show outperformance thanks to some of these diverging world trends we're seeing in currency, commodity and fixed income markets. The backdrop is clearly improving for discretionary thematic managers, who should be able to capitalize on currency and rates trades arising from increasingly divergent central bank policies. On the other hand, we maintain the view that many trend-following systematic strategies will continue to struggle. The historical reliance on



Andrew Lee. Head of Alternative Investments

fixed income exposure will no longer be a tailwind, and we believe most will not deliver consistent performance.

**What are the most compelling opportunities within private markets?**

One key theme that we continue to favor is European bank deleveraging. Following the asset quality review, we still think that European banks will continue rationalizing balance sheets and lending activity. This creates several types of opportunities for investors. First, as banks sell off non-performing loans or assets, opportunistic investors who have the expertise and platform to service and work out these investments will benefit. Selected and priced appropriately, these investments offer returns that should be less market correlated and cannot be found in liquid markets. And second, as European banks structurally reduce and refocus their lending activity in coming quarters, this dynamic creates

a funding gap that alternative lenders are increasingly filling. Alternative lending solutions can be short or long term depending on the situation, but given that managers select, conduct due diligence and negotiate pricing and terms for these credits directly, this should improve downside protection.

**What else in private markets are you excited about for 2015 and beyond?**

In general, we look for opportunities whose returns should be less correlated to markets. Our objective is to identify ideas where managers have a proven ability to have tangible strategic and operational impact on investment outcomes. Given current valuation levels, we have a somewhat less favorable outlook on broad-based generalist buyout strategies, though we know that the smartest managers are being cautious about deploying capital and focusing instead on harvesting investments. Instead, we are

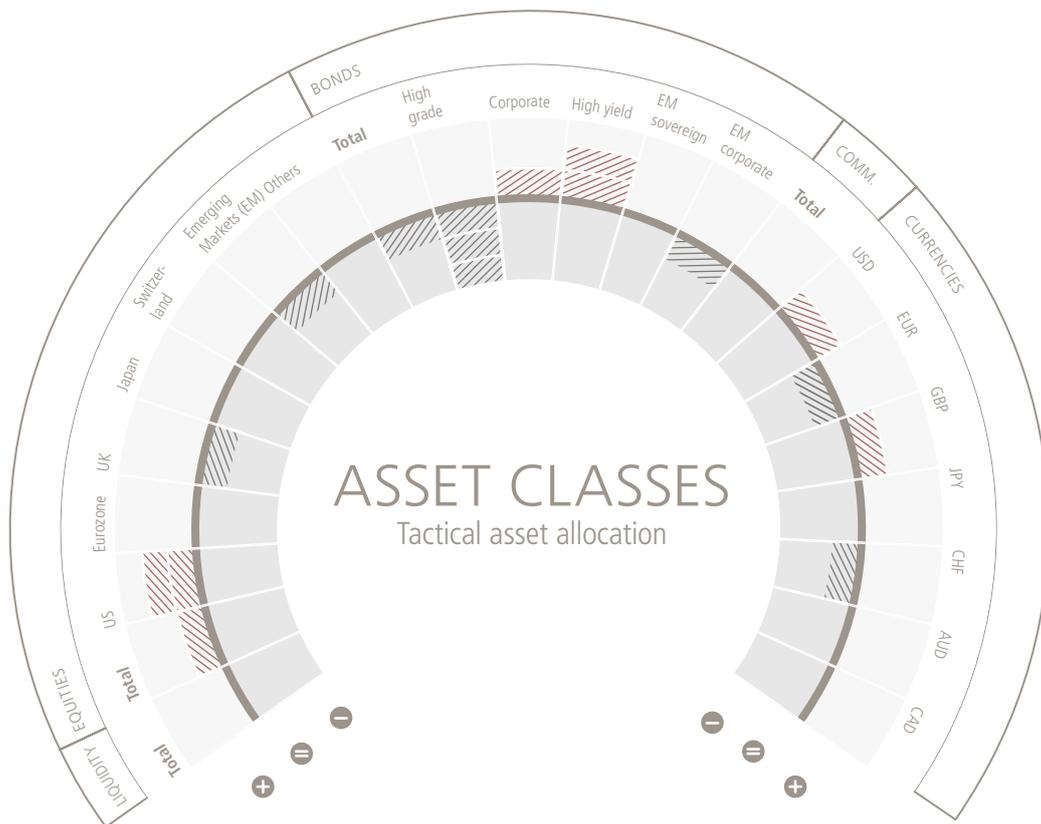
focused on identifying what we characterize as more “niche” opportunities, where return drivers are largely uncorrelated with markets. We look forward to sharing a few specific ideas in the near term. Of course, clients should evaluate and apportion such investments appropriately.

# Asset classes.

We believe investors holding a well-diversified strategic asset allocation of equities, bonds, and alternatives, stand the best chance of navigating the diverging world successfully, with comparably low levels of volatility.

In the context of a well-diversified portfolio, we also currently recommend a number of tactical deviations

to take advantage of some of the shifts taking place in this diverging world. In particular we **overweight US equities** relative to UK and emerging market equities, and we **overweight credit** relative to high grade bonds. In currencies we recommend **overweight** allocations to the **US dollar** and **British pound** relative to the euro and Swiss franc.



— Strategic Asset Allocation    ▨ Tactical Asset Allocation

Please note that this tactical asset allocation positioning is accurate at the time of writing, November 17. Please consult the latest UBS House View for updates.

## Long-term, strategic view

## Short-term, tactical view

### Equities

Valuations are no longer cheap, but corporate earnings growth should be sufficient to drive mid to high single-digit per annum returns over the medium to long term. These returns are attractive compared with other asset classes, even if they are lower than in the recent past, and come alongside comparably high short-term volatility.

We prefer US equities over emerging market equities. US equities have superior earnings growth, and the US economy is demonstrating solid growth. Emerging market corporate profitability is weak, and equity markets there may be more vulnerable at times of volatility.

### Bonds

Yields are low by historical standards, and so bonds are no longer likely to be a major driver of returns for portfolios. However, we believe they will continue to provide portfolio stability during periods of equity market volatility. Bond investors increasingly need to look to credit as a source of return.

We prefer credit over high grade bonds. With high grade bond yields low, we believe investors should seek higher yields in investment grade and US high yield credit. Both should be supported by the solid economic backdrop in the US, and low funding costs.

### Alternatives

Alternatives play an increasingly important role in providing returns which are lowly correlated with bonds and equities. As equity and bond returns moderate, returns from alternatives may appear comparably more attractive. Hedge fund managers may be well placed to take advantage of the diverging world, and private equity enables investors to harvest an illiquidity risk premium.

Within hedge funds, equity long-short funds should stand best placed to take advantage of a diverging world, and provide exposure to positive performance in US equity markets. Within private markets, private debt offers complementary exposure to existing credit holdings, and we like long-term energy infrastructure exposure.

### Currencies

In general, it is important for investors to hedge their foreign investments back into their domestic currency. Most currencies, over the long run, tend to add noise to portfolio performance without providing extra returns.

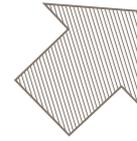
We currently see tactical opportunities in the US dollar and British pound, relative to the Swiss franc and the euro. The diverging world will see monetary policy taking different paths, with higher rates in the US and UK in 2015, while the ECB eases further.

### Commodities

Commodities should not, in our view, be considered a strategic part of a portfolio. We believe they add volatility to a portfolio without providing commensurate returns.

We currently have no tactical positions on commodities within the global tactical asset allocation. Within the commodity complex we prefer energy and grains over precious metals.

# Equities.



We believe an environment of solid growth in the US and monetary policy which is loose by historical standards should prove supportive of equities in 2015. We expect global earnings growth of circa 8%, and valuations of 16.6x trailing earnings are slightly below long-run averages.

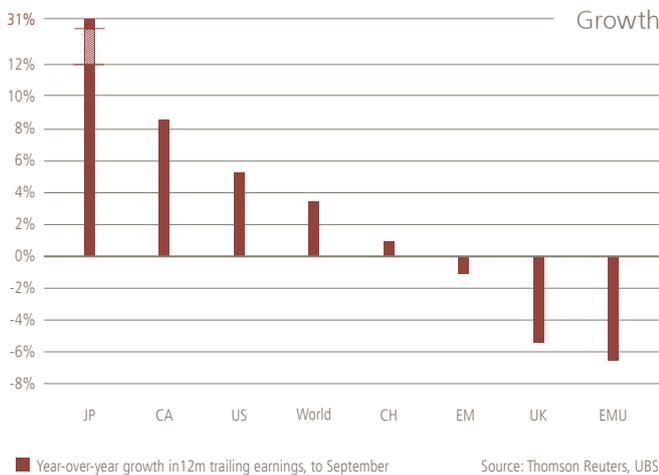
We recommend an overweight allocation to equities relative to high grade bonds.

## 2014 so far

Equity performance was positive in 2014, with steady performance upset by three periods of volatility, related to concerns over emerging markets, geopolitics, and global growth, respectively. Overall, the US and Switzerland performed best, and the Eurozone and the UK worst. Large caps outperformed small caps. Healthcare and utilities outperformed, while energy and materials underperformed. Growth and value styles delivered similar performance.

## Muted global earnings growth

Global 12-month trailing year-over-year earnings growth in September was 3.4%. Solid US growth helped support earnings in North America, while Japan continued to benefit from a weaker currency. A strong currency, and weak economic growth weighed on UK and Eurozone earnings respectively.



## Valuations below long-run averages

Global equities performed in line with earnings growth, so valuations end the year close to where they started. On 16.6x trailing earnings, global equities are slightly cheaper than long-run averages. The US and Switzerland are marginally more expensive than average, Japan and emerging markets are cheaper.



	Returns			Trailing P/E	Valuation		EPS growth		EBIT margin	
	2013	2014 ytd	5 year expectation (p.a.)		Prem/disc to long-run average	Div. yield	2014	2015	Current	Long-run avg.
Emerging Markets	-2.3%	3.8%	9.5%–10.5%	12	-19%	2.8%	-1%	8%	11.1%	15.7%
EMU	24.8%	2.9%	7%–8%	15.6	3%	3.4%	-7%	12%	8.1%	7.9%
Japan	54.5%	3.8%	6.5%–7.5%	15.5	-15%	1.9%	31%	9%	6.6%	5.9%
Switzerland	22.8%	9.6%	6.5%–7.5%	17.5	7%	3.1%	1%	7%	14.0%	11.1%
UK	17.8%	0.2%	7.5%–8.5%	14	-1%	5.0%	-5%	5%*	8.4%	10.7%
US	32.6%	10.8%	7%–8%	17.6	4%	1.9%	5%	8%	11.8%	11.6%
World	29.5%	7.5%	7.5%–8.5%	16.6	-8%	2.6%	3%	8%	9.9%	9.5%

\*consensus

Source: Thomson Reuters, Bloomberg, UBS

## We overweight US equities

- Strong US corporate profits should continue to underpin the bull market in US equities.
- With over two-thirds of S&P 500 revenues derived domestically, US companies should benefit from robust US economic growth.
- Valuations are only marginally above average levels, so cyclical momentum and earnings will be the primary driver of returns in 2015.

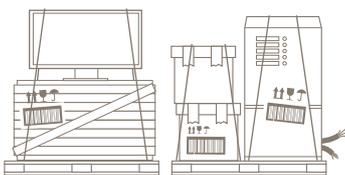


## We underweight EM equities

- The region's corporate profitability has been falling in 2014.
- The sharp declines in commodity prices and US dollar strength are unhelpful.
- Valuations are below long-run averages, but are not likely to prove a catalyst for performance.
- We remain somewhat cautious about the economic leading indicators in many of the large emerging markets.



## US capex recovery



As the US economic expansion deepens, we expect capital spending on manufacturing, technology, property, and energy infrastructure to improve. Easing bank lending standards, improving small business and corporate confidence and rising capacity utilization have historically led "capex" cycles. Sectors most exposed to a pickup in capital expenditures are industrials, technology and financials.

## Eurozone financials



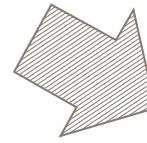
2015 should be a good year for the Eurozone financials sector. The cost of funding has fallen, and the completion of the Asset Quality Review should boost investor confidence in the sector, and confidence among the banks to boost lending. Litigation remains the key risk.

## Giants rising in emerging markets



Within emerging markets we prefer companies that can take on established players in developed markets thanks to their compelling business models, products, and cost advantages. Driven by innovation and improving brand awareness, these "global giants" from EM are likely to enjoy strong pricing power resulting in above-average earnings growth in the foreseeable future.

# Bonds.



Bond yields have rarely been as low as they are today. While a turning point in yields has been long expected and failed to arrive, what we can be more sure of is that low yields mean we can only expect meager returns from high-rated bonds in coming years. In this environment, we prefer lower-rated bonds. We have a tactical preference for investment grade and US high yield credit.

We recommend an underweight allocation to bonds as a whole. We overweight credit, in particular US high yield credit and global investment grade credit, relative to high grade bonds.

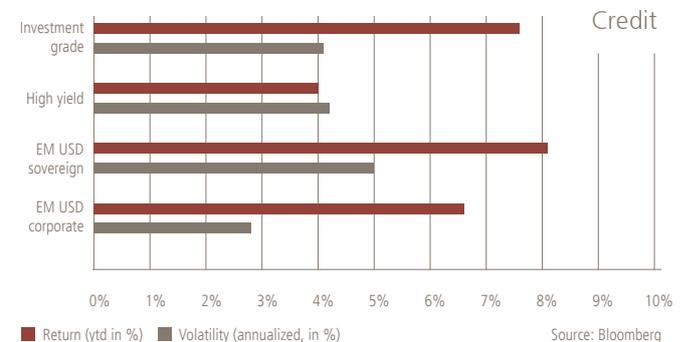
## High grade bonds in 2014

- Government bonds surprised in their strong performance in 2014.
- The rally came in spite of the Fed concluding quantitative easing and edging closer to interest rate hikes.
- Looser-than-expected policy from the European Central Bank, ongoing central bank balance sheet expansion, concerns over economic growth rates, low inflation, and structural buying from pension funds were key drivers.



## Credit in 2014

- Bond duration was a key driver of credit performance in 2014, with longer duration segments such as investment grade and EM sovereigns outperforming high yield and EM corporate.
- Spreads were broadly unchanged through the year. At the margin, investment grade and EM sovereign spreads tightened, and high yield spreads widened.
- Credit continued to exhibit low levels of volatility, allowing the segment to deliver attractive risk adjusted returns.



## Valuations – slightly tight

- Investment grade and US high yield credit spreads are marginally below average, but default rates are also below average. We continue to overweight both segments.
- EM sovereign and EM corporate spreads are more significantly below long-run averages, although ratings have improved over the past decade. We believe EM corporates are expensive relative to fundamentals and we thus underweight this segment.

	Rating	Spread (bps)	Av. (bps)	Default rate	Av.
Investment grade	A-	117	137	0%	0.1%
US high yield	B+	441	506	2.1%	4.3%
EM Sovereign	BBB-	308	460	0%*	0.5%
EM Corporate	BBB	323	360	0.6%	0.7%

\*+ Argentina

Source: UBS, Moody's, J.P. Morgan, Barclays

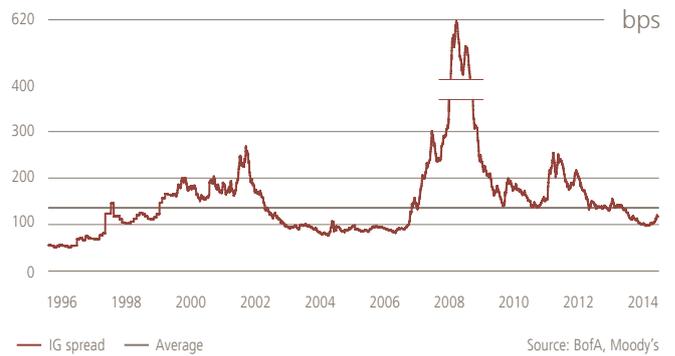
## Overweight US high yield credit

- With a spread over US Treasuries of 4.5%, and a total yield of more than 6%, we believe the outlook for high yield credit is positive.
- We expect default rates among US high yield issuers to remain low in 2015, thanks to robust corporate fundamentals and favorable funding conditions.
- We are currently in the middle of the credit cycle; corporate activity is close to average levels and leverage is rising.



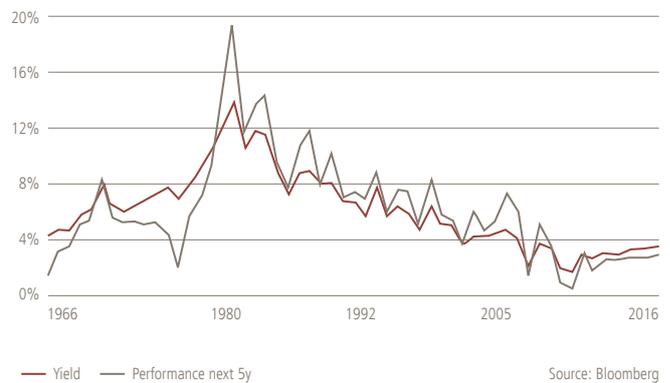
## Overweight investment grade credit

- Investment grade credit still provides an attractive yield pickup over high grade bonds, with default risks low.
- Solid economic growth in the US and the ECB's asset purchase program should prove supportive of the asset class.
- We prefer lower rated IG bonds (BBB), and selected subordinated bonds of non-financial issuers to pick up additional yield.



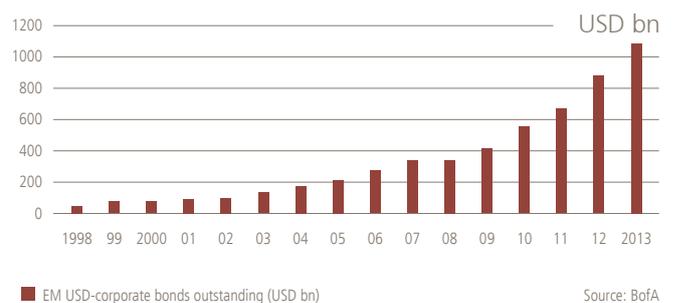
## Underweight high grade bonds

- With an extremely low starting point for yields, we expect low returns from high grade bonds in the years ahead.
- We expect higher rates of growth and inflation in the US and UK, in particular, to drive bond yields higher in 2015.
- We forecast US 10-year Treasury yields of 2.8% in the next 12 months.



## Underweight emerging market corporate debt

- The size of the EM corporate bond market has grown significantly in recent years, outstripping the EM sovereign bond market by a large amount.
- EM corporate default rates have been low because of the favorable funding environment for EM corporates, but default rates are expected to rise in 2015.
- We believe spreads are tight relative to fundamentals and we underweight the segment.



# Alternatives.

## Hedge funds

We recommend that investors consider hedge funds a means of improving the risk-return characteristics of an overall portfolio. A well-diversified portfolio of hedge funds offers mid single-digit return potential with low correlations to other assets.

Anticipating higher interest rates in the US, we foresee most hedge fund strategies still generating performance. The expected relative performance of these strategies is consistent with our positioning, with equity hedge anticipated to perform best.

## 2014 so far

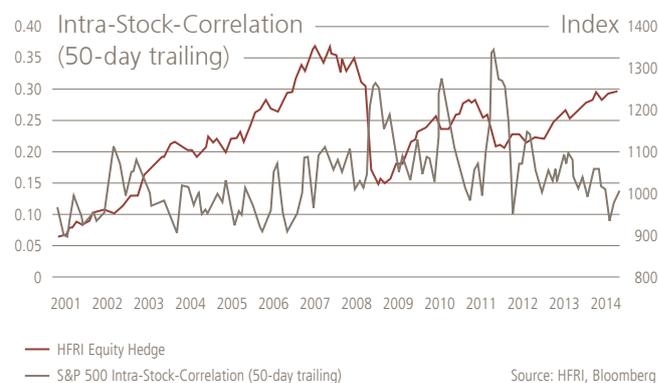
Through 3Q 2014, hedge fund strategies performed broadly in line with our expectations. The temporary volatility spike in October impacted some managers due to large macro moves, poor performance of crowded trades, and legislation against tax inversion deals.

Below-average volatility and abundant liquidity continued to provide a supportive environment for some "beta-oriented" alternative strategies. Nevertheless, entering 2015, we expect this environment to change in favor of "alpha-oriented" strategies driven by the normalization in liquidity and volatility.



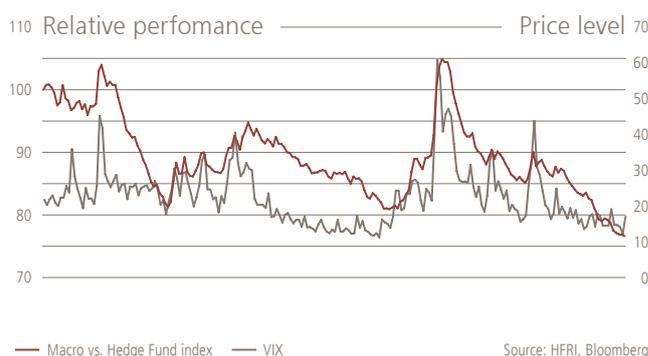
## Prefer equity hedge

- We expect positive US equity market performance to be supportive of the strategy.
- We prefer managers running lower gross and net exposures, with a strong focus on alpha generation through fundamental stock selection.
- The continuing divergence of global economies requires different regional equity hedge approaches. Asia, Europe and EM are still beta driven. In the US, alpha should start to dominate performance.



## Cautious on global macro strategies

- We favor discretionary macro funds over systematic trading strategies (CTAs).
- The diverging world and end of ultra-low market volatility should increase the opportunity set for discretionary macro.
- We are remaining cautious on systematic trading funds, since most trend-following managers still have relatively high long bond exposures.



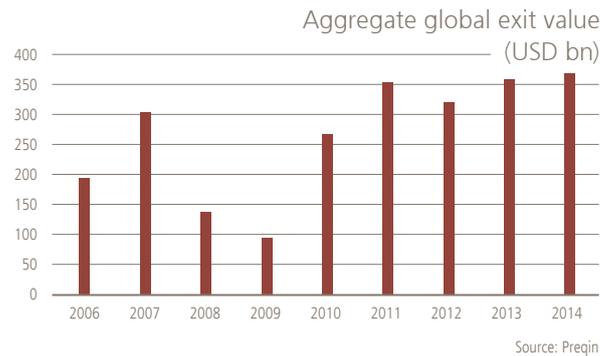
## Private markets

We still see opportunities in selected private market strategies. While credit availability and solid equity markets in 2014 drove a robust private equity exit environment, new deal activity was more constrained on valuation levels. Private debt can complement existing credit holdings, and we like long-term energy infrastructure exposure.

Investors accepting illiquidity can leverage private markets to diversify portfolio returns and achieve specific objectives. Locking up capital in private market funds grants access to differentiated investments organized around themes, assets and return drivers.

### 2014 so far

- 2014 is on track to reach or exceed record levels of realization.
- IPOs are the third exit path for private equity investments, behind trade sale and secondary buy-out.
- IPO activity might have peaked, as an increased number of offerings have been shelved.



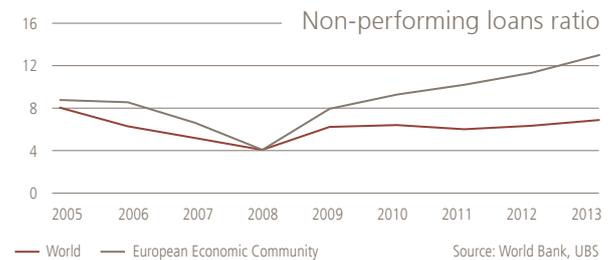
### Private equity

- High valuations, easy financing and significant dry powder drive acquisition multiples higher. We prefer small- and mid-cap to large-cap buyouts.
- Growth capital in emerging markets offers a way to enter sectors capitalizing on long-term shifts less accessible through liquid instruments.
- Due to high valuations, late-stage venture capital and secondary offerings are less attractive.



### Private debt

- Ongoing European bank deleveraging creates structural opportunities for careful alternative capital providers, notably through direct lending.
- European banks also continue rationalizing balance sheets, creating potential opportunities in NPLs and other non-core assets.



### Private market opportunities

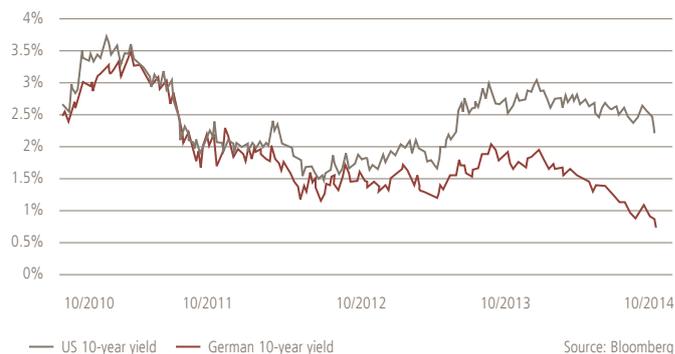
- New technologies have transformed energy supply and consumption trends in North America.
- We favor opportunities along **the energy value chain** in areas of energy infrastructure, renewables and energy efficiency.



# Currencies.

## The diverging world – monetary policy divergences will continue in 2015

- US and UK will begin normalizing their monetary policy. This will continue to support the US dollar and British pound.
- The ECB will need to ease monetary policy further to try and stimulate inflation and growth. This will weaken the EUR. Switzerland will continue defending the 1.20 EURCHF floor.
- The Bank of Japan will also keep an aggressive easing bias, given that Japanese inflation is still far away from the Bank of Japan's 2% target.



## The return of volatility

- FX market volatility has been structurally dampened in recent years as central banks around the globe have kept markets artificially calm with liquidity injections.
- The US Federal Reserve and the Bank of England, which are now normalizing their monetary policies, will allow bond yields to fluctuate more strongly. This is likely to increase currency volatility.
- Higher yielding currencies, which profited from subdued yields in major currencies and low currency volatility, will find the period of Fed and BoE tightening challenging. As the actual rate hikes, such currencies will likely see further weakness.



## Developed markets

- Currency trading has been dominated by big structural trades in recent years. For example, the weakness in the Japanese yen, and the big fall in the euro.
- We expect dollar strength relative to the euro to persist.
- But 2015 will also be about specific "alpha trades." The best opportunities will likely come in pair trades of similar economies, which show temporary diverging pictures in their economic developments. Candidates could include the Norwegian krone relative to the Swedish crown, or the Australian dollar against the Canadian dollar.

## Emerging market currencies

- Investors should look for divergences in growth-inflation dynamics. Mexico is seeing improving growth and will likely see a rate hike in 2015. Israel and Poland are less attractive due to weaker growth and inflation.
- The "fragile" countries (Brazil, Indonesia, South Africa) should be treated with caution. However, we see opportunities in India, where its current account balance has improved.

### 2014 returns

	Currency	return vs USD cash
Top 3	AUD	1.0%
	USD	0.2%
	NZD	-2.4%
Bottom 3	SEK	-12.5%
	NOK	-8.8%
	EUR	-8.7%

### Selected forecasts

	Spot	12m	PPP
EURUSD	1.25	1.18	1.30
EURCHF	1.21	1.24	1.27
USDCHF	0.96	1.04	0.98
USDJPY	112	118	72
AUDUSD	0.88	0.85	0.74
EURGBP	0.78	0.74	0.76
EURSEK	9.3	8.7	8.6
EURNOK	8.5	8.0	9.5

	Currency	return vs USD
Top 3	INR	8.5%
	IDR	7.7%
	TRY	5.1%
Bottom 3	RUB	-17.8%
	HUF	-10.6%
	CZK	-10.3%

	Spot	12m
USDCNY	6.1	6.2
USDTWD	30.4	29.8
USDINR	61.4	63
USDIDR	12085	12600
USDRUB	43	45
USDTRY	2.23	2.35
USDZAR	11.0	11.5
USDBRL	2.56	2.42
USDMXN	13.5	13.0

Source: Bloomberg

Source: Bloomberg, UBS

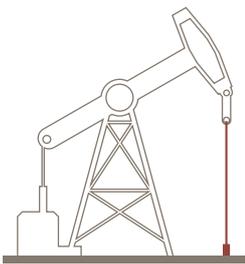
# Commodities.

## Headwinds persist

After a difficult year in 2014, many commodities are trading into their cost of supply curves. But decelerating demand growth from emerging Asia will remain a headwind. We favor energy and the grains, hold a neutral stance on base metals, and are cautious on precious metals. Overall, we expect low single-digit returns in 2015, but underlying commodities will likely be driven by a diverse set of factors.

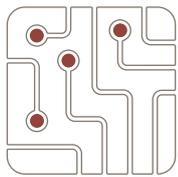
Commodity	Unit	Ytd performance	Price	12m forecast
Brent crude oil	USD/bbl	-22%	85.9	100
WTI crude oil	USD/bbl	-18%	80.5	95
Gold	USD/oz	-2%	1,168	1,050
Platinum	USD/oz	-10%	1,236	1,450
Copper	USD/mt	-8%	6,740	6,350
Corn	USD/bu	-11%	3.77	4
Wheat	USD/bu	-12%	5.28	5.5

Source: UBS, Bloomberg



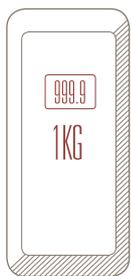
## We favor energy

- We expect crude oil prices to stabilize in 1H15 and recover in 2H15 as the supply and demand backdrop becomes more balanced.
- Excess supply growth by non-OPEC countries over global demand growth will likely moderate to 0.1 mbpd in 2015 from 0.7 mbpd in 2014.
- Considering that crude oil supply outside North America will likely remain challenged, OPEC's ability to guide prices higher should improve.
- Selling tail risk insurance represents the most attractive way of benefiting from a more stable crude oil price in 2015.



## Neutral on base metals

- In general, low base metals prices are required to motivate production discipline. But the base metals are not homogenous, given widely varied supply-side conditions.
- We favor zinc, nickel and lead, since the supply of these commodities cannot easily expand.
- Current aluminum prices are sufficient to motivate more supply.
- Our least preferred metal is copper, with mine supply growth still likely to outpace demand growth in 2015 and prices expected to decline to USD 6,350/mt.

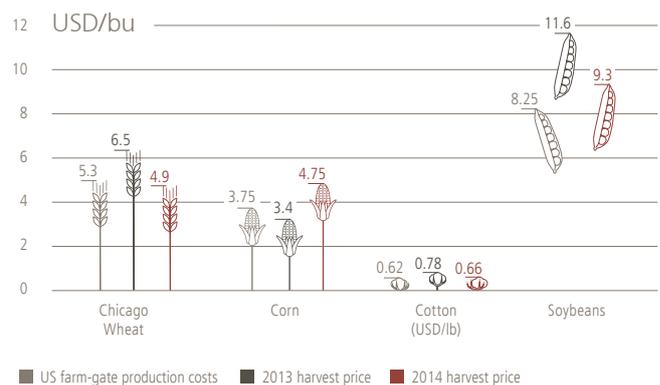


## Cautious on precious metals

- Rising interest rates in the US will increase the opportunity cost of holding gold.
- We expect ETF outflows in the range of 300–400 tons. This would bring gold down to USD 1,050/oz, at the marginal costs of production.
- At this point, Asian demand should increase, and we would likely see the first contraction in mine production since 2008.
- Gold and silver are not yet a buy. But if prices decline to marginal costs of production, gold could become an interesting underlying for volatility selling strategies.

## Agriculture

- Corn, wheat and cotton farm-gate prices are at or below their production costs, while soybean prices remain above the costs of production.
- We see crop area adjustment as the most likely scenario, coming most quickly from corn and to a lesser degree, cotton.
- A similar adjustment in soybeans will likely be delayed, perhaps until the planting season in Brazil at the end of 2015.
- We remain optimistic for a bounce in corn and sugar before other crops. We believe soybeans will clearly be depressed for a longer duration.



Source: Bloomberg, USDA, UBS

# 2015 in short.



MH: Mark Haefele



MR: Mike Ryan



TT: Themis Themistocleous



DK: Daniel Kalt



MP: Mads Pedersen



MA: Mark Andersen

## What might surprise us in 2015?

- MH: Inflation
- MR: Common ground between the President and Congress
- TT: Geopolitics will play a larger role in markets
- MLT: The pace of Asian reforms
- JM: If investors got even more negative on emerging markets
- DK: A Swiss solution to EU labor laws
- MP: The Fed might return to easing
- MA: A larger correction in China property
- PM: Long bonds may not react to rate hikes
- SS: No rate rises

## What won't?

- MH: Higher volatility
- MR: The Fed's cautiousness
- TT: Mediocre growth from France and Italy
- MLT: The Asian property market adjustment
- JM: The bankruptcy of populism
- DK: The EURCHF floor will remain in place
- MP: China won't accelerate
- MA: You will still be able to make money in a difficult environment
- PM: Divergence in central bank policy
- SS: US will grow stronger than Europe

## What excites you most about 2015?

- MH: Self-sustained growth in some countries
- MR: The potential for technology to change our lives
- TT: Market volatility creating investing opportunities
- MLT: Mutual market access possibly extending
- JM: Evidence that economic reforms are happening
- DK: The fact our clients can read this publication on iPad
- MP: The ski season
- MA: We're going to need to be more tactical in investing
- PM: My honeymoon
- SS: The range of new CIO initiatives



MLT: Min Lan Tan



JM: Jorge Mariscal



PM: Philippe Mueller



SS: Simon Smiles

## What worries you most about 2015?

- MH: Inequalities
- MR: The rise of radical world views and rising inequality
- TT: The fragility of the global economy
- MLT: Chinese property market declines
- JM: Global growth
- DK: A re-escalation of the Euro-zone crisis
- MP: Inflation with no growth
- MA: The possibility of stagflation
- PM: Geopolitical tensions
- SS: The threat volatility poses for clients with leveraged positions

## What's your New Year's resolution?

- MH: Always ask better questions
- MR: Take a view of the world that is not how I wish it but how it's going to be
- TT: Take time to think about the longer term
- MLT: Read widely, travel less; more time for contemplation
- JM: Making good investment calls in emerging markets
- DK: To spend more time with my family
- MP: To help our clients invest in a portfolio context
- MA: To help our clients stay invested in a diversified portfolio
- PM: Ensuring both portfolio and personal fitness and endurance
- SS: See my children more

## What's your top tip for investors?

- MH: Worry about the downside, and the upside will take care of itself
- MR: US equities
- TT: European banks
- MLT: Selected subordinated financials perpetuals
- JM: The Mexican peso
- DK: To invest more in your own education and health
- MP: If you see high yield yielding more than 7%, buy
- MA: Buy more alternatives
- PM: European leveraged loans
- SS: Look to sell rather than buy optionality

**CIO Year Ahead 2015**

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