UBS House View

Weekly

6 November 2017

United States
CIO Americas, WM

We welcome your feedback

Week ahead

- **Will the Eurozone match strong US earnings?** Spurred by very strong technology sector performance, a larger-than-average 71% of S&P 500 companies that have reported third quarter results have beaten earnings forecasts. In contrast, only 66% of Euro Stoxx 600 companies have done so. This week should provide a better indication of Eurozone strength, with 21% of all companies set to report earnings. We remain overweight Eurozone equities versus UK stocks within Europe.

- **Will the JOLTs report support rate hike expectations?** The Fed left rates on hold last week, but did nothing to deter market expectations for a rate hike in December. After a strong October payroll report, the US JOLTs report should provide further evidence that a rate hike is warranted as the labor market continues to tighten. Fed fund futures show the market has now priced in a 98% chance of a rate hike next month. Our base case is for a hike next month, followed by two in both 2018 and 2019.

- **Will trade data support global growth momentum?** This week brings import and export data from both China and Germany that should shed light on the extent to which stabilization in the Chinese economy is feeding through into import demand, on which Germany could capitalize. Signs of improving economic momentum would support our global equity overweight position.

Market moves

	Level	*1-w chg*	*YTD chg*
S&P 500	2,588	0.26%	17.13%
DJIA	23,539	0.45%	21.30%
Nasdaq	6,764	0.94%	25.89%
Eurostoxx 50	3,690	1.03%	12.14%
MSCI EM*	1,127	1.73%	30.74%
MSCI World*	2,043	0.87%	16.68%
MSCI EAFE*	2,014	1.09%	19.58%
DXY	95	0.01%	–7.12%
Gold	$ 1270/oz	–0.24%	10.70%
Brent crude oil	$ 62.1/bbl	2.80%	9.35%
US 10-year yield	2.331%	–8bps	–11bps
VIX	9.14	–0.66pts	–4.9pts

Source: Bloomberg, as of 3 November 2017, EST 4:30 pm.
Note: All returns are in local currency
* As of 2 November 2017

Key messages

For more key messages on the week ahead from Justin Waring, click here.

- **1. The October calm shouldn't spark investor skepticism.**
October is historically the most volatile month for US stocks, but this year October has been safely negotiated with an average daily swing of just 0.25%, and a maximum move of 0.81%. In fact, it was the least volatile month on record, according to the VIX. And with the index hitting five successive record highs in the week to October 20, it achieved the first perfect week since 1998. This might urge investors to take profits and leave the market. But the current equity rally seems well backed by economic fundamentals. In the third quarter, 71% of companies that have reported earnings have beaten forecasts, leaving the S&P 500 on track for 7% earnings growth, above our forecast of 5–6%.

  Takeaway: While we don't expect exceptionally low volatility to prevail, we do believe stocks can continue to edge higher. We remain overweight global equities.

- **2. Policy tightening still only gradual.**
The era of emergency monetary accommodation is drawing to a close. The Bank of England this week became the latest central bank to edge toward tightening when it raised rates for the first time in a decade. The Federal Reserve left rates unchanged, but left the door open for a December rate hike, and last month started to shrink its balance sheet. The ECB also recently announced it would taper its bond purchases next year. But the shift is likely to remain measured and gradual. The Bank of Japan this week kept policy steady and, in aggregate, central banks globally are still adding stimulus. Meanwhile, the nomination of Jerome Powell, considered the most dovish candidate, as Fed chair suggests continuity in accommodative policy.

  Takeaway: Central banks are likely to tighten policy only gradually – this should support financial asset prices.

- **3. US legislative focus turns to tax reforms.**
The House of Representatives unveiled a tax plan on 2 November, with proposed changes to corporate taxes, which would be slashed to 20%. The proposal would add about USD 1.5trn to the deficit over 10 years. The tax bill is now the Republicans' top priority ahead of next year's midterm elections. The UBS US Office of Public Policy estimates a 60% chance that tax cuts will pass by early 2018. Successful reforms of the proposed scale would provide an 8–10% boost to S&P 500 earnings. Furthermore, the tech sector, which has already outperformed the rest of the market by 21% this year, and constitutes 25% of the S&P 500, would be the biggest beneficiary of a repatriation of profits.

  Takeaway: Successful tax cuts would provide a further boost to the equity market rally.

Investor spotlight

- **Regional differences.** Japanese equities saw their largest inflows in seven weeks, while money flowed out of European equities for the first time in nine weeks.

- **Inactive investors.** Despite stock correlations at their lowest in a decade, investors poured USD 9.4bn into equity ETFs.

UBS

Deeper dive

Can US earnings growth be sustained?

Mark Haefele

David Lefkowitz

The US stock market's record-breaking run continues. The S&P 500 finished October with a total return of +2.33%. Total returns have been positive for all 10 months of this year, the first time this has happened in the 90 years for which data is available. After 15% growth in S&P 500 earnings in the first quarter, and 10% in the second, earnings per share (EPS) is set to grow by a still healthy 7% in the third quarter (with more than 80% of companies having reported).

Despite the recent strong earnings performance, there are reasons to believe that this trend can continue and that stocks can still benefit from sustainable corporate profit growth:

- This quarter suffered from one-offs. The main reason for decelerating earnings growth in the third quarter is more difficult comparisons for the energy and financials sectors, coupled with one-off, natural disaster-related costs for insurers. We estimate the drag on earnings growth from natural disasters was about two percentage points. Earnings growth should accelerate in the fourth quarter as storm- related costs give way to recovery and rebuilding benefits.
- Technology results should remain strong. Tech companies reporting so far have beaten estimates by 12%, and are on pace to report earnings growth of over 20%, driven by 9% revenue growth. These are impressive results for the S&P's largest sector – technology accounts for over 20% of S&P 500 EPS – and we expect them to remain strong: secular drivers such as cloud computing, online advertising and e-commerce should enjoy a long runway of growth. Short-term business spending on legacy equipment such as PCs also appears to be picking up.
- Economic growth and tax reform can provide further boosts to earnings. US and global growth are strong. The OECD is forecasting the fastest pace of growth since 2011, with all 35 member countries expanding, while the US recently posted back-to-back quarters of 3% GDP growth. Business confidence is high. The October ISM manufacturing purchasing managers' index eased back from September's 13-year high, but remains strong. And companies still have ready access to capital; the Chicago Fed National Financial Conditions Index currently stands at –0.91, indicating the loosest conditions since 1994. The Republicans have now revealed a first draft of their tax reform proposal, which, if enacted, would only add to the already solid earnings story.

We believe the uptrend in corporate profits remains well-supported and should continue to underpin our global equity overweight. Our 2017 and 2018 estimates for S&P 500 EPS are USD 131 (10% growth) and USD 146 (11% growth, which includes USD 5/share of tax reform benefits).

The very strong third quarter earnings performance by technology companies also supports our preference for these stocks. The sector is currently trading at a price-earnings ratio that is just 7% higher than the US market, versus its average relative valuation premium of 22% over the last 25 years. It has a total yield (share buybacks and dividends) of 3.7%. And with the largest overseas cash holdings of any sector, tech would also be one of the biggest beneficiaries of tax relief on the repatriation of overseas profits.

Mark Haefele
Global Chief Investment Officer WM

David Lefkowitz
Senior Equity Strategist Americas

Bottom line

US equities are still setting new records, underpinned by growth in corporate earnings. While the headline growth rate of S&P 500 earnings has slowed since the start of the year, this reflects tougher year-on-year comparisons and one-off costs related to natural disasters. Technology, which accounts for over a fifth of the market's earnings, is growing particularly strongly, and we see the upward trend being sustained into 2018.

Regional view

The stealth dividend

Mike Ryan, CFA
Chief Investment Officer Americas,
UBS Wealth Management

There has been a fairly active – and at times heated – debate over efforts to reform the current regulatory environment. After eight years of activist government, there was a general consensus among business owners that the regulatory burden had become not only challenging but also increasingly onerous. According to a recent *UBS Investor Watch* survey, 72% of small-business owners believe that regulatory relief is essential to sustain future growth. While the energy and financial sectors have been most obviously impacted by increased regulation, virtually every industry has faced both rising costs and business constraints.

President Trump's election was seen by many as a potentially liberating moment for business owners shackled by burdensome regulations. But some have expressed disappointment over the scope and scale of regulatory change. While there have been a few high-profile rollbacks of existing regulations, there hasn't been the sort of sweeping "tidal surge" that many had hoped for.

But the lack of flashy headlines obscures progress on regulatory reform and therefore largely misses the important progress being made. We continue to stress that regulatory reform has three elements to it: 1) rollback or repeal of existing regulation; 2) change in the interpretation and enforcement of existing regulation; and 3) curtailment of future regulation.

Let's explore all three.

First, with regard to regulations that have been overturned, rescinded, rolled back, or repealed, it's difficult to get an accurate or truly representative accounting. However, there are estimates that give some sense of both the scope and scale of regulatory repeal. For example, the Center for Progressive Reform has identified 131 regulations that the Trump administration has already moved to suspend or revoke. Areas of government impacted by these regulatory changes include the Environmental Protection Agency, and the Departments of State, the Interior, Justice, and of course the Treasury.

In terms of interpretation and enforcement, there is even less hard data and evidence for measuring progress and impact. However, the appointment of more business-friendly leaders in key administration posts is already leading to a change in the regulatory culture within government agencies and regulatory bodies. During the Obama administration, regulations were interpreted expansively and enforced strictly, while under the current administration regulations are being interpreted more narrowly and enforced a bit less rigidly.

But it is perhaps the future course of regulation that holds the most promise for business owners and therefore has the biggest potential impact on economic activity and corporate profits. Studies have shown that regulatory encroachment can negatively impact GDP growth by as much as 2% each year. The recent *UBS Investor Watch* reveals that 47% of small-business owners would invest *more* in their business and 33% would *increase* their hiring if there were fewer regulations.

It's clear that an overly burdensome regulatory environment negatively impacts both growth and commerce. But how do we measure the effectiveness of the current administration with regard to halting regulatory encroachment? One proxy for the level of pending and future regulations is the number of pages in the federal registry. During the Obama presidency, the number of pages in the registry expanded sharply, reaching a record high of 95,894 by the end of 2016. Over the past year, however, the number of pages in the registry has fallen by about 33% amid a tighter and more restrictive process for proposing new regulations.

It's still too early to determine the effectiveness of the administration's regulatory reform effort, but its three-pronged approach is more than just an "undoing" project; in addition to the headline-friendly repeal of existing regulations, growth may be bolstered by restrained interpretation and enforcement and by the simple act of curtailing regulatory creep.

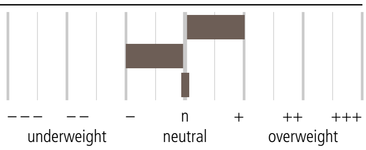
So while much of the focus right now is on the benefits from a potential reworking of the tax code, these regulatory changes are already providing an underappreciated "stealth dividend" for businesses and the economy.

Kind regards,
Mike Ryan

Strategy and performance

TAA and market returns: Cross asset and equities

Asset classes

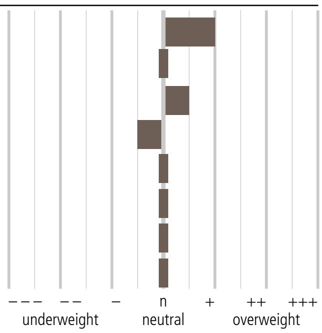


	MTD	YTD	2016
Equity	0.37	20.14	7.86
Fixed Income	0.09	5.95	2.09
Cash	NA	NA	NA

Total return indices in USD, in %

Note: Indexes used to calculate returns are MSCI All Country World (for Equity), Barclays Capital Global Aggregate Index (for Fixed Income), Dow Jones-UBS Commodity Index Total Return
Source: UBS, as of 3 November 2017

Equities



	MTD	YTD	2016
Global	NA	NA	NA
US	0.10	16.52	12.74
Large-Cap Value	0.39	9.12	17.34
Large-Cap Growth	0.56	26.10	7.08
Mid-Cap	–0.08	13.51	13.80
Small-Cap	–0.41	11.43	21.31
Int'l Developed	0.57	22.48	1.00
Emerging Markets	0.74	33.24	11.19

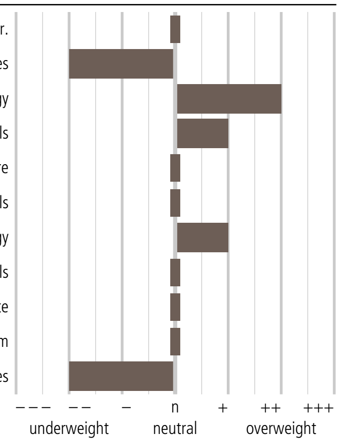
Total return indices in USD, in %

Note: Indexes used to calculate returns are MSCI All Country World (for Equity), Barclays Capital Global Aggregate Index (for Fixed Income), Dow Jones-UBS Commodity Index Total Return
Source: UBS, as of 3 November 2017

S&P 500 forecast	CIO-A WM
6-month rolling price target	USD 2600
2016 earnings per share actual	USD 119.1
2017 earnings per share estimate	USD 131.0
2018 earnings per share estimate	USD 146.0

Source: UBS, as of 2 November 2017

US equity sectors

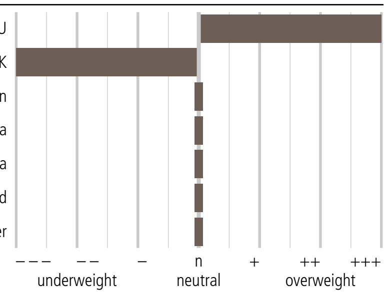


	Weekly	MTD	YTD	2016
Cons. Discr.	–1.13	–0.70	13.50	5.00
Cons. Staples	0.00	0.08	5.16	4.21
Energy	1.52	0.77	–6.53	27.79
Financials	0.41	1.15	17.11	21.68
Healthcare	–1.45	–0.22	19.13	–3.56
Industrials	–0.65	0.50	14.93	18.07
Technology	1.00	0.18	37.49	12.22
Materials	–0.38	–0.16	20.11	15.78
Real Estate	1.72	0.83	9.09	2.56
Telecom	–2.51	–1.45	–13.23	22.27
Utilities	–0.03	–0.14	16.08	15.06

Total return indices in USD, in %

Note: S&P 500 Sector Indexes used to calculate returns.
Source: UBS, as of 3 November 2017

International developed equities



	MTD	YTD	2016
EMU	0.72	29.74	1.16
UK	–0.68	15.65	–1.18
Japan	1.20	21.35	2.96
Australia	0.62	14.76	10.89
Canada	0.57	12.38	24.18
Switzerland	0.46	19.96	–5.07
Other	NA	NA	NA

Total return indices in USD, in %

Note: MSCI Region or Country Indexes used to calculate returns.
Preference in hedged terms (excluding currency movements).
Source: UBS, as of 3 November 2017

Tactical deviations from benchmark symbols

+	Moderate overweight vs. benchmark
++	Overweight vs. benchmark
+++	Strong overweight vs. benchmark
n	Neutral, i.e. on benchmark
–	Moderate underweight vs. benchmark
– –	Underweight vs. benchmark
– – –	Strong underweight vs. benchmark

Notes
These tables represent the tactical asset allocation for a moderate, taxable investor without alternative investments.

See the latest *UBS House View: Investment Strategy Guide* for an interpretation of the tactical deviations and an explanation of the corresponding benchmark allocation.

Tactical time horizon is approximately six months.
Total return market performance is from Bloomberg as of close of business on source date, using representative indices, and is provided for information only.

Past performance is no indication of future performance.

The overweight and underweight recommendations represent tactical deviations that can be applied to any appropriate benchmark portfolio allocation. They reflect CIO-A WM's assessment of market opportunities and risks in the respective asset classes and market segments. The benchmark allocation is not specified here. Please see the most recent *UBS House View: Investment Strategy Guide* for definitions/explanations of benchmark allocation. They should be chosen in line with the risk profile of the investor. Note that the Regional Bond Strategy is provided on an unhedged basis (i.e., it is assumed that investors carry the underlying currency risk of such investments). Thus, the deviations from the benchmark reflect our views of the underlying equity and bond markets in combination with our assessment of the associated currencies.

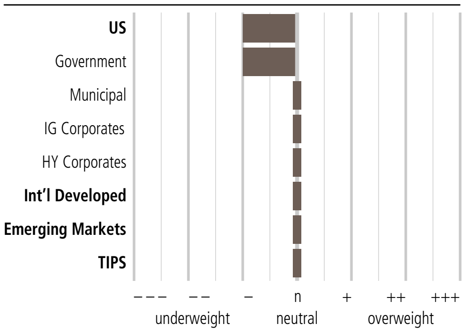
+ – Indicates +/– change

Terms and abbreviations
EMU = European Monetary Union and is comprised of European countries that have adopted the Euro as their currency. Int'l = international. YTD = year-to-date.
MTD = month-to-date. USD = US dollar. TAA = tactical asset allocation.

Strategy and performance

TAA and market returns: Fixed income and currencies

Fixed income

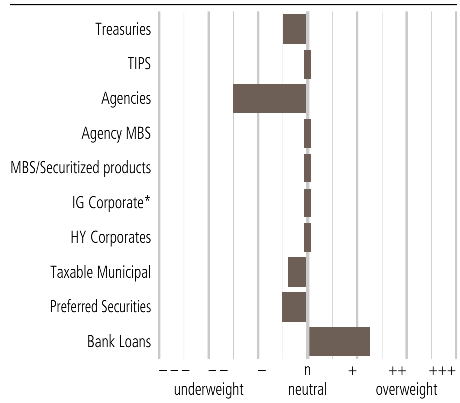


	MTD	YTD	2016
US	0.13	3.34	2.65
Government	0.17	2.31	1.05
Municipal	0.03	4.95	0.25
IG Corporates	0.15	5.59	5.63
HY Corporates	–0.01	7.44	17.13
Int'l Developed	0.07	8.00	1.49
Emerging Markets	0.16	8.32	9.44
TIPS	–0.22	4.16	4.80

Total return indices in USD, in %

Note: Indexes used to calculate returns are Barclays Capital (BarCap) US Aggregate, BarCap US Aggregate Government, BarCap Municipal Bond, BarCap US Aggregate Credit (for IG), BarCap US Aggregate Corp HY, BarCap Global Aggregate ex-USD (for Int'l Developed), BarCap Emerging Markets Government and BarCap Global Emerging Markets USD (50% of each for Emerging Markets).
Source: UBS, as of 3 November 2017

USD Taxable Fixed Income

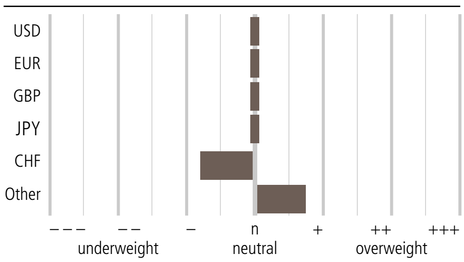


	MTD	YTD	2016
Treasuries	0.16	3.49	1.1
TIPS	–0.22	4.16	4.8
Agencies	0.06	2.93	1.5
Agency MBS	0.04	3.57	1.7
MBS/Securitized products	0.05	4.31	13.2
IG Corporate*	0.25	7.18	6.0
HY Corporates	0.15	8.16	17.5
Taxable Municipal	0.40	7.42	5.2
Preferred Securities	0.15	11.29	2.3
Bank Loans	0.12	9.22	10.2

Total return indices in USD, in %

Note: Indexes used to calculate returns are Bank of America Merrill Lynch (BoA ML) US Treasury, BoA ML US Inflation-Linked Treasury, BoA ML US Composite Agency, BoA ML US Mortgage Backed Securities, BoA ML US Corporate, BoA ML US High Yield Constrained, BoA ML Fixed Rate Preferred Securities. BoA ML CMBS Fixed Rate, S&P/LSTA Leveraged Loan Index, Barclays Taxable Municipal Index. See the latest Fixed Income Strategist for more information.
Source: UBS, as of 3 November 2017

Foreign exchange (FX)

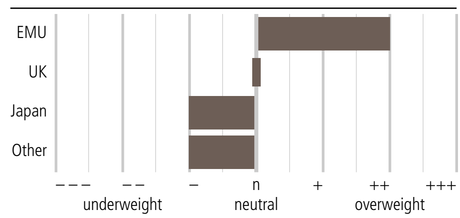


	MTD	YTD	2016
USD	NA	NA	NA
EUR	–0.29	10.41	–3.80
GBP	–1.54	5.99	–16.71
JPY	0.36	–2.49	–2.95
CHF	0.28	–1.83	3.05
Other	NA	NA	NA

Change against USD, in %

Source: UBS, as of 3 November 2017

International Developed Fixed Income



	MTD	YTD	2016
EMU	–0.23	11.42	–0.14
UK	–1.09	7.21	–7.46
Japan	–0.45	2.03	6.50
Other	NA	NA	NA

Total return indices in USD, in %

Note: BarCap Region or Country Indexes used to calculate returns.
Source: UBS, as of 3 November 2017

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Earnings calendar

The Earnings Calendar provides publicly announced reporting dates and times of companies covered by CIO Americas, WM. Reporting dates and times are subject to change by the reporting companies.

Date	Company	Ticker	Company	Ticker	Company	Ticker
06-Nov-2017	City Office REIT, Inc.	CIO	CVS Health Corp.	CVS	TD Ameritrade Holding Corp.	AMTD
06-Nov-2017	Plains All American Pipeline LP	PAA	Paramount Group, Inc.	PGRE	FMC Corp.	FMC
07-Nov-2017	Myriad Genetics, Inc.	MYGN	Welltower, Inc.	HCN	Cimarex Energy Co.	XEC
07-Nov-2017	DCP Midstream LP	DCP	Energy Transfer Equity LP	ETE	Energy Transfer Partners LP	ETP
07-Nov-2017	Marriott International, Inc.	MAR				
08-Nov-2017	Rockwell Automation, Inc.	ROK	Humana, Inc.	HUM	Regeneron Pharmaceuticals, Inc.	REGN
08-Nov-2017	AmeriGas Partners LP	APU	CenturyLink, Inc.	CTL		
09-Nov-2017	Macy's, Inc.	M	D.R. Horton, Inc.	DHI	Lions Gate Entertainment Corp.	LGF.A
09-Nov-2017	The Walt Disney Co.	DIS	Nordstrom, Inc.	JWN		

Source: FactSet, UBS, as of 2 November 2017

Key economic indicators

Date	Indicator	Period	Time (ET)	Unit	Consensus	Previous
07-Nov-17	Consumer Credit	September	3:00 PM	m/m	17.5bn	13.1bn
09-Nov-17	Jobless Claims	For week, November 4	8:30 AM	level	235k	229k
09-Nov-17	Wholesale Trade	September	10:00 AM	m/m	1.0%	0.9%
10-Nov-17	Consumer Sentiment	November	10:00 AM	level	101.0	100.7

Source: Bloomberg, UBS, as of 2 November 2017
UBS forecast estimates are published on Friday evenings in *Economic Perspectives* by economists employed by UBS Investment Research, a part of UBS Investment Bank.
m/m = month–over–month. q/q = quarter–over–quarter. y/y = year–over–year. k = thousand. mn = million. bn = billion.

Investing in Emerging Markets

Investors should be aware that Emerging Market assets are subject to, amongst others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and sociopolitical risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. CIO-A WM generally recommends only those securities it believes have been registered under Federal U.S. registration rules (Section 12 of the Securities Exchange Act of 1934) and individual State registration rules (commonly known as "Blue Sky" laws). Prospective investors should be aware that to the extent permitted under US law, CIO-A WM may from time to time recommend bonds that are not registered under US or State securities laws. These bonds may be issued in jurisdictions where the level of required disclosures to be made by issuers is not as frequent or complete as that required by US laws.

For more background on emerging markets generally, see the CIO-A WM Education Notes, "Emerging Market Bonds: Understanding Emerging Market Bonds," 12 August 2009 and "Emerging Markets Bonds: Understanding Sovereign Risk," 17 December 2009.

Investors interested in holding bonds for a longer period are advised to select the bonds of those sovereigns with the highest credit ratings (in the investment grade band). Such an approach should decrease the risk that an investor could end up holding bonds on which the sovereign has defaulted. Sub-investment grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher yielding bonds for shorter periods only.

Disclaimer