October 2009

UBS global outlook

Fourth quarter 2009

The tough climb continues

Key investment views

Signs of a revival in economic activity continued to emerge throughout the third quarter, providing a catalyst for further gains in financial markets. Stabilization and improvement in the economic outlook are likely to underpin risky assets during the fourth quarter. Despite the impressive performance within financial markets since early March, valuations of most risky assets have not yet run ahead of economic fundamentals – even if we assume a rather shallow and anemic recovery.

Economic upturn to continue, despite structural risks

We think that the second half of 2009 and the early part of 2010 will be marked by a rebound in economic activity. Developed economies could experience a renewed bout of weakness heading into the middle of 2010, since many government stimulus programs are poised to end. That said, a renewed decline into a full-fledged recession is not part of our base case scenario. With the many risks to the long-term economic outlook, we should not forget that the near-term cyclical recovery, coupled with favorable liquidity conditions, remain generally supportive of financial markets and especially investments in corporate assets.

Government bond yields to move higher

Further improvement in the economic outlook is likely to reduce private demand for bond investments. The recovery phase will also stimulate discussions about so-called exit strategies for central banks, namely how they will reverse their currently very supportive near-zero interest rates or quantitative easing policies. We expect yields of the highest quality bonds to rise moderately over the next year in developed markets. As a consequence, we favor government bond investments with short- and medium-term maturities.

Corporate bonds attractive despite impressive run

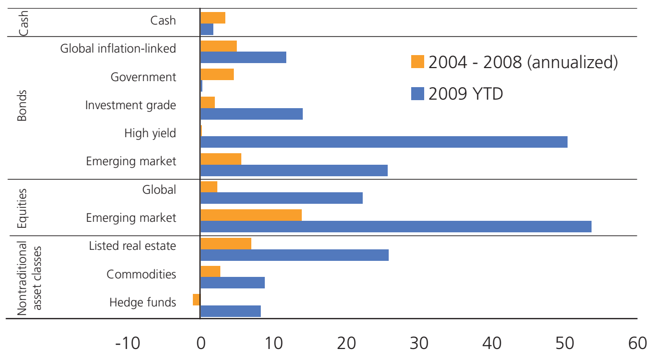
We expect corporate bonds to outperform government bonds for the next 12 months, although returns will not be as spectacular as they have been year-to-date, as tighter spreads are likely to be counterbalanced by rising government bond yields. Again, we would stress corporate bonds with short- to medium-term maturities.

Economic and earnings recovery to underpin equities

After the sharp rally in global equities, up by about 50% from the mid-March lows, we judge that equity market valuations do not look stretched. We find Eurozone equities particularly attractive at present. We also continue to like emerging markets from a longer-term perspective. Among the sectors, we prefer Energy and remain cautious on Healthcare.

Performance of main asset classes

Total return, in %



Note: Information through 22 September 2009. Returns over five years are annualized.
Source: Bloomberg, GPR, HFR, JP Morgan, Merrill Lynch, Thomson Financial, UBS WMR

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UBS Wealth Management

Commodity prices have room to rise

Our scenario for a sustained economic recovery in emerging markets and a moderate recovery in the US and the Eurozone has materialized in the third quarter and is surprising even optimistic forecasters. In particular, emerging markets, which generate most of the marginal demand for many important commodities are leading the recovery. We expect this to create upward price pressure for commodities, especially where little spare production capacity is available.

Carry trades and fundamentals weigh on US dollar

Economic recovery supports carry trades and therefore hurts the USD. This was the case in 2005–08, and conditions are similar today. Even positive US economic data hurts the greenback. Nevertheless, volatility may emerge in the fourth quarter, as investors take profits from their current carry positions before yearend. We recommend that investors take measures to protect their portfolios from strong currency swings.

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