

UBS ETF *Market Matters*

Does "Equity Style" beat a "Plain Vanilla" approach?

- As a result of above-average dividend income, value stocks have delivered superior total return over standard portfolio and growth stocks (both in USA and EMU) in recent years.
- Given similar earnings levels, the dividend yield differential proves to be a key factor for a superior total return of the USA Value index over its USA Growth counterpart.
- Assuming a Eurozone recovery, current low earning levels may give a base effect for earnings growth that will favour the EMU Growth index over the EMU Value index.

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UBS WM Chief Investment Office currently favors USA and EMU equities and has over-weighted them in its tactical asset portfolio (UBS WM CIO Monthly, July 2014). In particular, US preferred stocks are those who return capital to shareholders (through dividends and buybacks), whilst EMU preferred stocks are those who are capable of delivering above-average during the Eurozone recovery. These equity investment themes can be "mapped" into *equity styles* and compared to standard (or plain vanilla) broad-market investments. In the passive investing space specifically, this involves the selection of pre-defined equity style indices and benchmarking against the corresponding parent index.

Table 1: MSCI classification of stocks

MSCI Value Stocks Features	MSCI Growth Stocks Features
book value to price ratio	long-term forward earnings per share growth rate
12-month forward earnings to price ratio	short-term forward growth rate
dividend yield	current internal growth rate
	long-term historical growth trend
	long-term historical sales per share growth trend

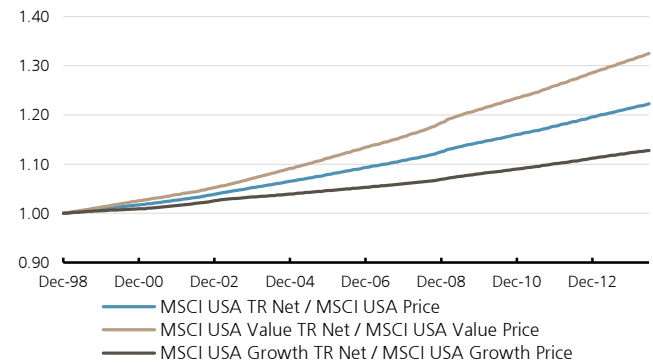
Source: MSCI Global Investable Markets Value and Growth Index Methodology

Filtering these two equity investment themes through the MSCI equity styles building blocks (see above table), it is evident that the US equity theme corresponds closely to the MSCI USA Value index, whereas the EMU preferred stocks closely matches the MSCI EMU Growth index. The MSCI Value index is comprised of companies classified as having high dividend rates (also low price to book value ratio), whereas the MSCI Growth index selects companies with high earning growth potential. As stocks have the potential for price appreciation and may pay dividends, investors should carefully examine the components of total return indices. Figure 1 shows the total return ratio (capital appreciation & dividend income) of price return indices for the MSCI USA standard and style indices, validating the high attribution of dividend payments originating from value stocks. In contrast, growth stocks often do not pay out earnings to shareholders in the form of dividends, resulting in only a modest value-add to the total return.

Equity Style vs. Plain Vanilla Benchmark

Figure 2 shows the relative monthly performance of an equity style index vs. its parent index, for both USA and EMU; in price terms (panel 2a) and in net total return terms (TR Net, panel 2b) for the period from December 1998 to June 2014. Both equity styles in both regions have converged on their parent benchmarks after a period of remarkable discrepancy between value and growth stocks in the years 2005-2007 (Figure 2a). Due to higher-than-average dividend payments, value stocks (USA & EMU) have returned in total more than growth and plain vanilla exposure (Figure 2b). This documents in detail a consistent enhancement of shareholder value through above-average dividend sharing.

Figure 1: Total Return to Price Return indices ratios, MSCI USA



Source: MSCI, UBS Global Asset Management, as of 30 June 2014

Figure 2a: Relative performance: style vs. benchmark (Price Indices norm. to 100, local currency)

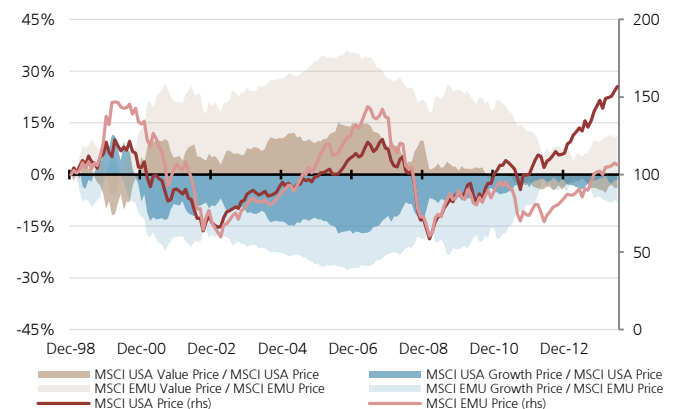
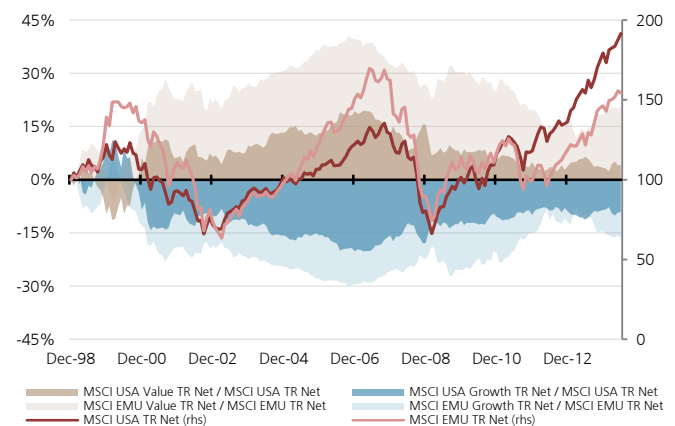


Figure 2b: Relative performance: style vs. benchmark (TR Net Indices norm. to 100, local currency)



Source: MSCI, UBS Global Asset Management, as of 30 June 2014

For all charts: Past performance is not a reliable indicator for the future.

Figure 3a: Dividend yields in % (MSCI USA, USD)

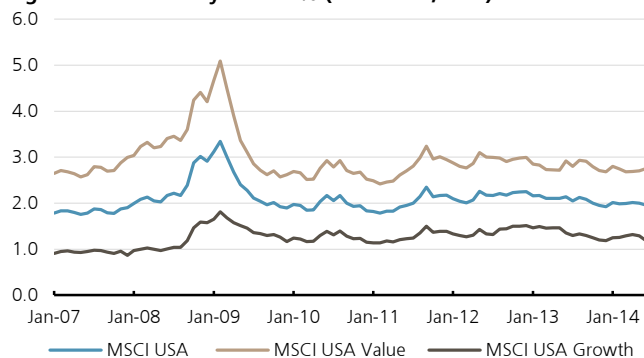


Figure 4a: Dividend yields in % (MSCI EMU, USD)

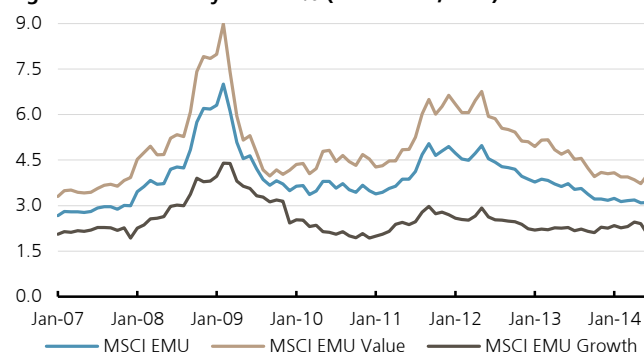


Figure 3b: 12mth trail EPS (MSCI USA, USD)

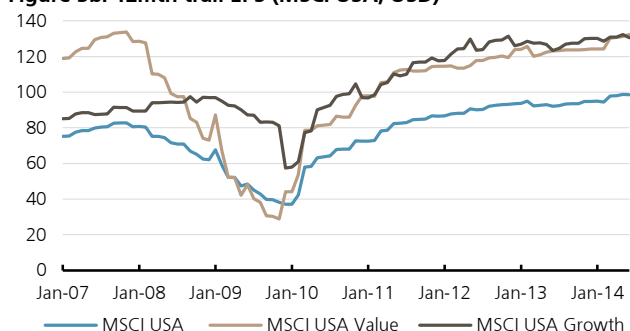
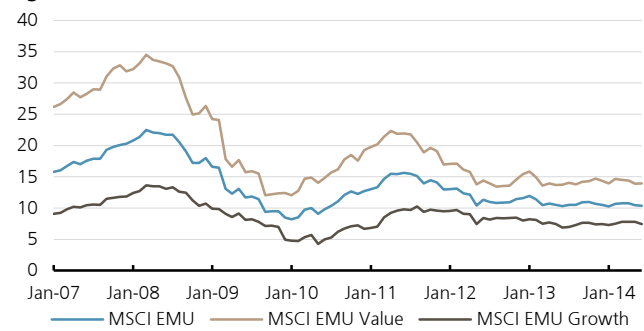


Figure 4b: 12mth trail EPS (MSCI EMU, USD)



Source: MSCI, UBS Global Asset Management, as of 30 June 2014

Source: MSCI, UBS Global Asset Management, as of 30 June 2014

For all charts: Past performance is not a reliable indicator for the future.

Timing Dividend and Earning Strategy

Once investment themes are mapped into equity style indices, investors may wish to look into the drivers of the underlying equity strategy. The key drivers are dividend yield for value stocks and earnings potential for growth stocks, shown on Figure 3a and Figure 3b for MSCI USA and Figure 4a and Figure 4b for MSCI EMU respectively. The dividend yield levels clearly differentiate the two styles, and currently yield differential between value and growth stocks is approx. 150bps for MSCI USA and 200 bps for MSCI EMU. Remarkably, the realised earnings (12 month trailing earnings per share) for USA equity styles are well above the broad market, tracking in parallel, reaching approx. 125 USD. Given similar earnings level, the dividend yield differential may prove to be a key factor for advanced total return of USA Value over USA Growth. Conversely, EMU Value realised earnings are currently above the market average, whereas EMU Growth trailing earnings are at low levels, favouring a base effect for earnings growth. Assuming a Eurozone recovery however, earnings growth and sales returns should follow. Any price appreciation in the MSCI EMU Growth index would need to be substantial to compensate for a lack of solid dividend payments in this equity segment (seen also in Figure 2b), if passively tracked in a TR Net index.

UBS ETFs incl. Equity Style (as of 30 June 2014)

Fund name	TER	AuM in USD m	NAV Repl- Cyc cation	Distri- bution	SIX	Listings / Key exchanges				
						XETRA	LSE	Borsa	ISIN	
EMU										
UBS ETF MSCI EMU UCITS ETF (EUR) A-dis	0.23%	1'817	EUR Physical	Yes	CHF/EUR	EUR	GBp	EUR	EUR	LU0147308422
UBS ETFs plc - MSCI EMU SF UCITS ETF (EUR) A-acc	0.02%	232	EUR Synthetic	No	EUR	EUR	GBp	EUR	EUR	IE00B5B1M258
UBS ETF - MSCI EMU Value UCITS ETF (EUR) A-dis	0.25%	49	EUR Physical	Yes	EUR	EUR	GBp	EUR	EUR	LU0446734369
UBS ETFs plc - MSCI EMU Growth SF UCITS ETF (EUR) A-acc	0.23%	7	EUR Synthetic	No			EUR	EUR	EUR	IE00B4MFIH03
UBS ETF - MSCI EMU 100% hedged to CHF UCITS ETF (CHF) A-acc	0.33%	129	CHF Physical	No	CHF					LU0950669175
UBS ETF - MSCI EMU 100% hedged to GBP UCITS ETF (GBP) A-dis	0.33%	196	GBP Physical	Yes	GBP		GBp			LU0937835733
UBS ETF - MSCI EMU 100% hedged to GBP UCITS ETF (GBP) A-acc	0.33%	37	GBP Physical	No	GBP		GBp			LU0950669688
UBS ETF - MSCI EMU 100% hedged to USD UCITS ETF (USD) A-acc	0.33%	409	USD Physical	No	USD					LU0950669415
USA										
UBS ETF - MSCI USA UCITS ETF A-dis	0.20%	1'789	USD Physical	Yes	CHF/USD/GBP	EUR		EUR	EUR	LU0136234654
UBS ETF - MSCI USA UCITS ETF A-dis	0.20%	21	USD Physical	Yes	CHF/USD	EUR	GBp/USD	EUR	EUR	IE00B77D4428
UBS ETF - MSCI USA SF UCITS ETF A-acc	0.15%	300	USD Synthetic	No	USD	USD	GBp	EUR	EUR	IE00B35C9K16
UBS ETF - MSCI USA Value UCITS ETF A-dis	0.20%	82	USD Physical	Yes	CHF/USD	EUR	GBp	EUR	EUR	IE00B78J5G98
UBS ETF - MSCI USA Growth SF UCITS ETF A-acc	0.59%	37	USD Synthetic	No			GBp	USD	EUR	IE00B55T4671
UBS ETF - MSCI USA hedged CHF UCITS ETF A-acc	0.30%	134	CHF Physical	No	CHF					IE00BD4TYL27
UBS ETF - MSCI USA hedged EUR UCITS ETF A-dis	0.30%	366	EUR Physical	Yes	EUR					IE00BD4TYF66
UBS ETF - MSCI USA hedged EUR UCITS ETF A-acc	0.30%		EUR Physical	No	EUR	EUR		EUR		IE00BD4TYG73
UBS ETF - MSCI USA hedged GBP UCITS ETF A-dis	0.30%	20	GBP Physical	Yes	GBP		GBp			IE00BD4TYH80
UBS ETF - MSCI USA hedged GBP UCITS ETF A-acc	0.30%		GBP Physical	No	GBP		GBp			IE00BD4TYJ05

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For more information on UBS ETFs: www.ubs.com/etf



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