

Emerging Markets

An out of favor asset class **gains momentum**

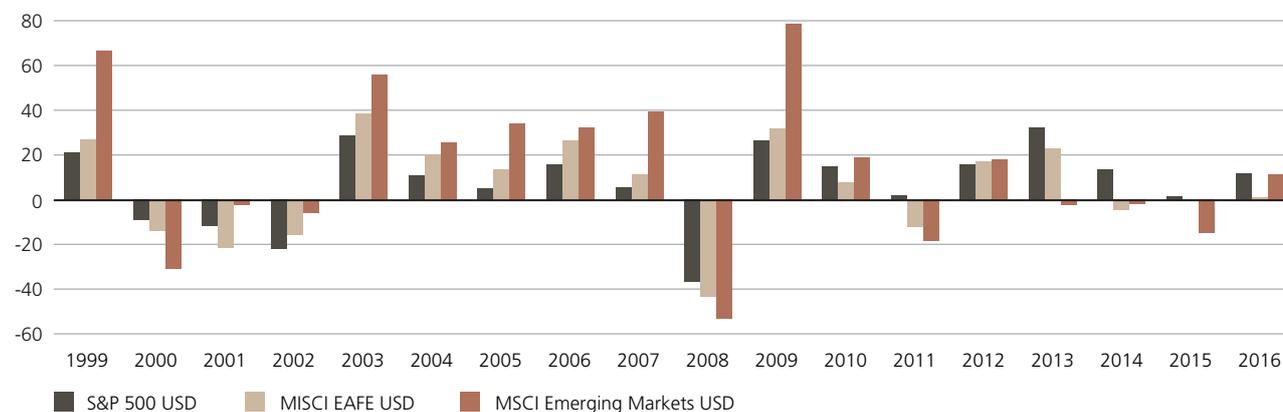


Emerging market equities have been an unloved asset class in recent years. While major US equity indices repeatedly reached and surpassed historic highs, emerging market equity returns languished. But is it time to take a closer look?

After suffering through a long dry spell, emerging market equities staged a recovery in 2016, with the MSCI Emerging Markets Index posting an 11.1% annual return, just short of the 11.9% for the S&P 500 (see Figure 1). This coincided with economic growth bottoming out in emerging markets. This positive streak has continued into 2017, with the MSCI Emerging Markets Index already up 11.4% for the first quarter, compared with 5.5% for the S&P 500. Several important factors may bode well for the performance of emerging market equities over the next few years:

- Improvement of key indicators such as economic growth, corporate earnings and profitability.
- The potential for rising incomes and consumption growth.
- Rapid adoption of technology/Internet helping to surpass traditional consumer channels.
- Attractive valuations relative to developed market equities.

Figure 1. After languishing for several years, emerging markets are starting to recover
 Calendar year returns for S&P 500, MSCI EAFE and MSCI Emerging Markets Indices (1999-2016)



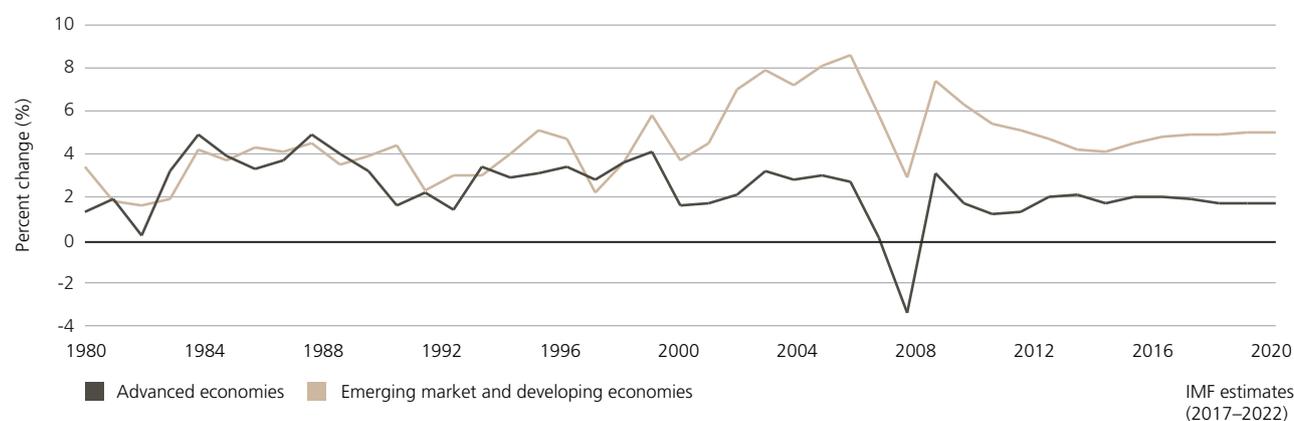
Source: Morningstar. As of December 31, 2016.

Faster growth in a slow growth world

In the years following the financial crisis of 2008-2009, global economic growth slowed considerably. Yet despite the slowdown in the developed world, emerging market economies surfaced as a bright spot, even posting 2.9% growth in gross domestic product (GDP) in 2009 during the worst of the economic crisis. In contrast, advanced economies slipped by 3.4% for the same year.¹ And despite current global uncertainty amid last year's surprise outcomes in the Brexit vote and the US presidential election, emerging markets GDP grew 4.1% in 2016 compared with 1.7% for advanced economies.

Going forward, the International Monetary Fund (IMF) also expects emerging and developing markets to grow 4.5% and 4.8% in 2017 and 2018, respectively. That's more than twice their estimates for the advanced economies, which are expected only to grow by approximately 2% in both 2017 and 2018 (see Figure 2). Emerging economies now account for more than 75% of global growth in output and consumption, almost twice their share 20 years ago.² As emerging markets continue to develop, these trends are expected to continue, with the IMF estimating that the share of global GDP from emerging markets could increase from 38.8% (in USD terms) today to 60% by 2035.

Figure 2. Actual and estimated percent change in gross domestic product for developed and emerging markets



Source: IMF, 2017.

¹ Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a region's borders in a specific time period and is commonly used as an indicator of economic health.

² International Monetary Fund, "World Economic Outlook, April 2017: Gaining Momentum?"

Favorable demographics: an engine for growth

While some investors may have concerns about a slowdown in the developed economies, emerging markets may present regional opportunities that are not overly dependent on overall global economic growth. Given favorable demographics and rising incomes, increased personal consumption by their own populations may be a significant factor driving regional economic growth in emerging markets. The IMF estimates that 80% of the world's population lives in emerging markets. While many of them are poor, collectively they are getting a little bit richer every day. This means more spending and evolving consumption trends toward discretionary items like healthcare, education and leisure. Not only are the populations in emerging markets larger and growing, they are also younger than those in developed markets, which may contribute to an expanding middle class.

In 2009, the size of the "global middle class" was approximately 1.8 billion, representing 27% of the world's population, and is expected to grow to 3.2 billion by 2020 and 4.9 billion by 2030.³ Much of this increase will occur in developing countries, such as China and India. In fact, by 2030, it is estimated that all of Asia could represent as much as two-thirds of the global-middle class population.⁴ Households just entering the middle class often seek to buy consumer durables (e.g., washing machines, air conditioners, automobiles, etc.), as well as services including tourism, entertainment, health, education and transportation. As a result, the burgeoning middle class in emerging markets can be an important engine for economic growth in the decades to come. While there are other factors—such as productivity growth, foreign exchange rate fluctuations, and changes in developed markets demand—that affect emerging markets equities, the growth dynamics in emerging markets appear promising alongside slower growing developed economies.

The combination of these structural underpinnings, stronger economic growth and attractive valuations make emerging markets equities an attractive long term proposition. Emerging markets offer investment opportunities that aren't overly dominated by the "new normal" of sluggish economic growth. That's why long-term, investors might want to consider adding an allocation to emerging markets equities within an overall diversified portfolio. Your Financial Advisor can help you select investment solutions that provide appropriate, diversified exposure to a range of asset classes, including emerging markets.

www.ubs.com/assetmanagement

The views and opinions expressed were current as of July 2017. They are not guarantees of performance or investment results and should not be taken as investment advice. Investment decisions reflect a variety of factors, and we reserve the right to change our views about individual securities, sectors and markets at any time. We cannot provide any assurance that we will be able to achieve our return target. As a result, the views expressed should not be relied upon as a forecast of any portfolio's future investment intent. All information and opinions are subject to change without notice. We encourage you to consult your financial advisor regarding your personal investment program.

Index definitions:

The S&P 500 Index is an unmanaged, weighted index comprising 500 widely held common stocks varying in composition. Returns consist of income, capital appreciation (or depreciation) and currency gains (or losses).

The MSCI Emerging Markets Index is a market capitalization-weighted index composed of different emerging market countries in Europe, Latin America and the Pacific Basin.

The MSCI EAFE Index is an index of stocks designed to measure the investment returns of developed economies outside of North America.

³ OECD, 2017.

⁴ Brookings Institute, 2017.

For marketing and information purposes by UBS.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.

Americas

The views expressed are a general guide to the views of UBS Asset Management as of July 2017. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA

The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document.

Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient.

The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG.

This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK

Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in any jurisdiction. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in any jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of any jurisdiction.

Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any

obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed.

You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia

This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

China

The securities may not be offered or sold directly or indirectly in the People's Republic of China (the "PRC"). Neither this document or information contained or incorporated by reference herein relating to the securities, which have not been and will not be submitted to or approved/verified by or registered with the China Securities Regulatory Commission ("CSRC") or other relevant governmental authorities in the PRC pursuant to relevant laws and regulations, may be supplied to the public in the PRC or used in connection with any offer for the subscription or sale of the Securities in the PRC. The securities may only be offered or sold to the PRC investors that are authorized to engage in the purchase of Securities of the type being offered or sold. PRC investors are responsible for obtaining all relevant government regulatory approvals/licenses, verification and/or registrations themselves, including, but not limited to, any which may be required from the CSRC, the State Administration of Foreign Exchange and/or the China Banking Regulatory Commission, and complying with all relevant PRC regulations, including, but not limited to, all relevant foreign exchange regulations and/or foreign investment regulations.

Hong Kong

This document and its contents have not been reviewed by any regulatory authority in Hong Kong. No person may issue any invitation, advertisement or other document relating to the Interests whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Interests which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules made thereunder.

Japan

This document is for informational purposes only and is not intended as an offer or a solicitation to buy or sell any specific financial products, or to provide any investment advisory/management services.

Korea

The securities may not be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the Capital Market and Financial Investment Business Act and the Foreign Exchange Transaction Law of Korea, the presidential decrees and regulations thereunder and any other applicable laws, regulations or rules of Korea. UBS Asset Management has not been registered with the Financial Services Commission of Korea for a public offering in Korea nor has it been registered with the Financial Services Commission for distribution to non-qualified investors in Korea.

Malaysia

This document is sent to you, at your request, merely for information purposes only. No invitation or offer to subscribe or purchase securities is made by UBS Asset Management as the prior approval of the Securities Commission of Malaysia or other regulatory authorities of Malaysia have not been obtained. No prospectus has or will be filed or registered with the Securities Commission of Malaysia.

Singapore

This document has not been registered with the Monetary Authority of Singapore pursuant to the exemption under Section 304 of the SFA. Accordingly, this document may not be circulated or distributed, nor may the Securities be offered or sold, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor pursuant to Section 304 of the SFA.

Taiwan

This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in the Republic of China (R.O.C.). This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in the Republic of China (R.O.C.). No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of the Republic of China (R.O.C.).

Source for all data and charts (if not indicated otherwise): UBS Asset Management

© UBS 2017. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.

