UBS

Global Perspectives

Multi Asset | October 31, 2017

Overview

Equities: Overall the FTSE All World rose 2.7% in local currency terms with widespread gains across both developed and emerging markets. Japan was the best performing equity market among major developed nations for a second consecutive month. Technology and Energy sectors performed strongly, the latter boosted by a 6.2% rise over the month for Brent Crude oil.
Fixed income: Most major government bond markets posted small positive returns with the exception of the US, which fell 0.2% on speculation that the next Federal Reserve chair might be hawkish than current incumbent Janet Yellen.
Currency: Forex markets were generally quiet. The USD was the major mover over the month, recovering 1.7% on a trade weighted basis after recent falls.

The month in review:

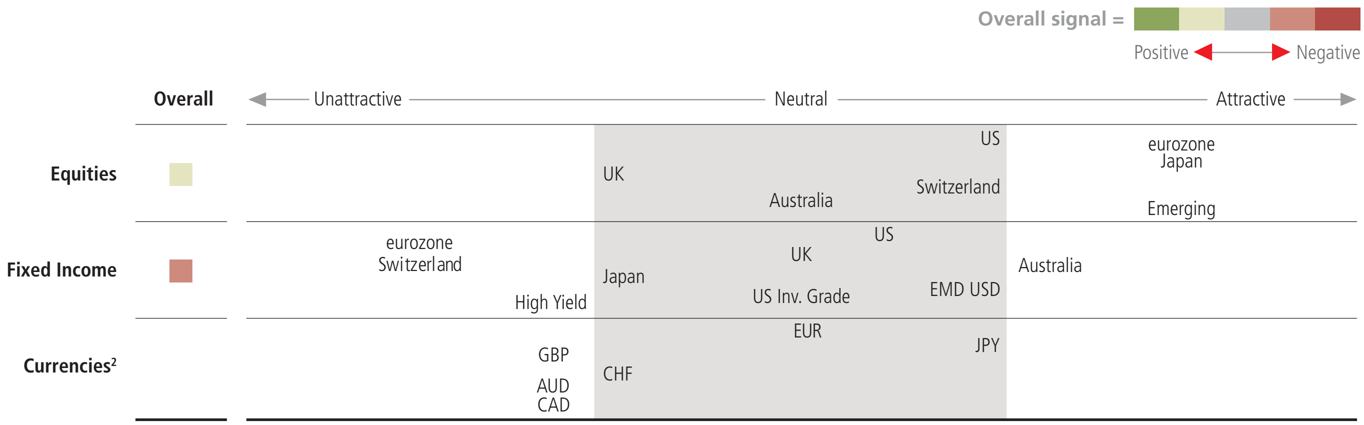
- Major events during the month included the 19th Party Congress of the Communist Party of China. The main headline was the emergence of Xi Jinping as China's strongest leader since Deng Xiaoping. In Japan, a crushing election victory for incumbent Prime Minister Abe boosted associated risk assets. The win was seen as giving the government a fresh mandate for its expansionary Abenomics policy.
- In the US, speculation over a potential new Federal Reserve chair occupied investors. Meanwhile, president Trump's tax reform plans passed their first hurdle in Congress but are likely to be subject to material wrangling and change before being passed into law. Economic data from the Eurozone continued in the recent positive vein with unemployment dipping below 9 per cent for the first time since 2009. On the political front, a controversial referendum on Catalonian independence led to considerable uncertainty and protests.
- Against a supportive macroeconomic backdrop and further boosted by a strong start to the quarterly corporate earnings season, investors were in bullish mood as the final quarter of the year got underway. The FTSE All World rose 2.7% in local currency terms. Emerging markets again led the way, extending the outperformance seen relative to developed markets over 2017 to date. Japanese equities were the best performing major developed market, as investors anticipated the continuation of monetary stimulus after the recent election. European markets also shook off the impact of the events in Catalonia to record further gains. Signs of co-ordinated efforts to reduce oil supply meant Brent Crude moved above USD60 a barrel for the first time in over two years.
- Bond markets again generally lagged their equity counterparts. US treasuries fell as markets digested the possibility of tighter monetary policy if the leadership of the Fed was to change. Other government bond markets saw small gains, and corporate and high yield debt saw further falls in spreads against the backdrop of positive economic news.

Outlook:

- The global economy is in the midst of the most synchronised expansion for a decade and we view the acceleration in global growth as supportive to equities in particular. The outlook for earnings remains constructive, with both the Eurozone and emerging markets at earlier stages of their recovery. The acceleration in capital expenditure investment is an important development in our view, suggesting a more stable and sustainable future growth rate. Monetary policy in aggregate also remains supportive to risk assets. The speed of any subsequent tightening relative to market expectations is likely to remain key to market prospects, but we believe that central banks will act carefully and gradually in their bid to unwind ultra loose monetary policy in developed economies.

Current views[1]

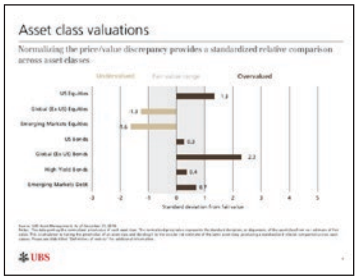
Asset allocation and currency attractiveness based on fundamental valuation and market behavior analysis



Asset Class	Overall signal	UBS Asset Management's viewpoint
US Equities		• On a number of measures US equities in aggregate look fully valued relative to their own history. But we do not see valuations as so stretched as to be concerning or to completely preclude further upside. • Supported by continued earnings growth and the prospect of a more stable economic backdrop, we believe equity valuations have scope to expand further. • Significant doubts remain around President Trump's ability to progress his pro-growth policy agenda. But with little priced in, we believe there is now optionality in US equities to tax reform upside. • On an earnings yield basis (inverse of the PE ratio) US equities remain attractively valued relative to bonds.
Global (Ex-US) Equities		• Outside of the US, we see attractive valuations and the improving growth backdrop as supportive to international equities. In Europe, we continue to believe that the European earnings recovery story has further to run. Earnings are still supported by the ECB's loose policy and with bank balance sheet restructuring now largely over, we see the recovery as advancing. The recent euro strength will only slightly moderate earnings momentum. • The economic recovery in Japan supports a constructive view of Japanese equities. There are positive signs with regard to improving corporate governance and efficiency and this trend supports equity prices.
Emerging Markets Equities		• Emerging market (EM) equities remain attractively valued relative to their international peers despite recent outperformance. • Better-than-expected trade continues to drive demand growth while more stable current account balances and lower currency volatility are key supports. Meanwhile, the recovery in commodity prices is providing a welcome boost to exporters including Brazil.
US Bonds		• While US Treasury yields remain low by historical standards, they look attractive relative to most other developed government bond markets. In the absence of a material pick-up in inflation, yields are likely to remain range bound. Our overall assessment is neutral.
Global (Ex-US) Bonds		• In aggregate, we see global bonds outside of the US as unattractive. • We have a preference for Canadian bonds which we see as an attractive hedge for lower oil prices given the importance of energy to the Canadian economy. We also believe that the Canadian economy has a long process of restructuring ahead as its reliance on the energy sector diminishes. In our view, the diverging fortunes of provinces make monetary policy very difficult for the Bank of Canada with the recent strength of the CAD putting unwelcome pressure on non-oil exports. The recent hike in rates looks anomalous in our view given these issues and the chance that the Bank of Canada has made a significant policy error is increasing.
Investment Grade Corporate Debt		• The yield pick-up on IG relative to developed world sovereign debt in particular has been diminishing as credit spreads narrow. We do not believe that a sharp demand slowdown is imminent. However, the reduction in global liquidity as QE programmes are unwound may place some upward pressure on credit spreads, albeit gradually, and make credit instruments more susceptible to volatility spikes. Overall we retain a neutral view.
High Yield Bonds		• Current default rates in High Yield are very low by historical standards. And given the supportive low rates and accelerating global growth backdrop we do not expect any material pick-up in US corporate debt defaults in the near-term. However, after the significant spread compression n recent years we do not view the risk/reward scenario as sufficiently attractive to warrant a more positive view than neutral.
Emerging Markets Debt US dollar Local currency		• While the spread between EM debt and US treasuries remains low by historical standards, we see continued strong demand for EM debt's attractive real yield. The improvement in current accounts and broader economic growth are also supportive. We view a subset of currencies within the broad local currency EM debt universe as attractive on a long-term basis.
Currency		• Among developed world currencies we continue to see the CAD as unattractive – for the same reasons as we view Canadian bonds in a positive light. We also see strong valuation support for the JPY. • In emerging markets we retain a constructive view on a number of EM currencies including the Indian rupee and Mexican peso.

[1] Source: UBS Asset Management. As of October 31, 2017.
[2] Attractiveness measured relative to USD.
Source: UBS Asset Management Investment Solutions Asset Allocation team as of October 31, 2017. Views are provided on the basis of a 12-18 month investment horizon, are not necessarily reflective of actual portfolio positioning and are subject to change.

Valuations plus one or more market behavior indicators provide an overall signal



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Market themes	Momentum and flow
Market stress	Macroeconomic landscape

=

Overall signal

Positive Negative

Market themes	Momentum and flow	Market stress	Macroeconomic landscape
Market opportunities that we believe will drive markets in the longer term but have an immediate impact. This helps put valuation into context. For example: "European debt crisis," "aging population" or "deleveraging."	Attempts to capture money flows and market appetite for risky assets from the perspective of professional asset allocators, such as mutual fund managers.	We created a proprietary stress index to help gauge price dislocations and investor risk appetite. It comprises several spread measures across credit markets, currencies and cash markets, as well as measures of market sentiment, such as the Chicago Board Options Exchange Market Volatility Index (VIX).	Understanding the current position (recovery, expansion, slowdown, recession) in the economic cycle of a country or region. We also consider the baseline and alternative economic scenarios of countries and regions and how asset classes may react differently in these scenarios.

US Equities example as of October 31, 2017

Valuation and market behavior indicators at work

Overall signal =

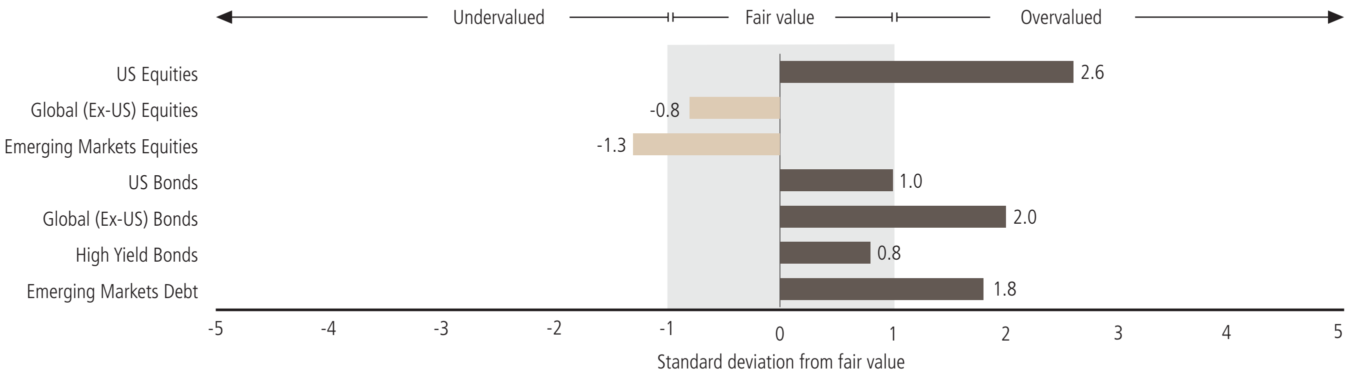
Positive ◄——► Negative

Valuation	+	Market themes	+	Momentum and flow	+	Market stress	+	Macroeconomic landscape	=	**Overall signal**
Negative		Slightly negative		Positive		Neutral		Slightly positive		Neutral

Note: The contribution each component has to the overall signal will vary from month to month.

Normalized asset class valuations[3]

Normalizing the price/value discrepancy provides a standardized relative comparison across asset classes



[3] Based on UBS Asset Management's views. As of October 31, 2017.

Definitions of metrics:

1. Asset Class/Benchmark: All investment expectations displayed here are modeled from the discounted cash flows as replicated by the relevant publicly available index. This bears mentioning because these expectations are developed assuming no benefit from active management (i.e. security selection) within the asset classes themselves.

2. Price/Value: An intrinsic value based on the cash flows that an asset class provides—discounted at an appropriate rate of return (the required rate of return)—is identified for each of the asset classes listed. The cash flows would be those that would be expected to pass through to the asset holder; in the case of equities, the relevant cash flows are earnings and non-reinvested earnings (including, though not exclusively, dividends). That intrinsic value is then compared to the market price for the proxy index, and the degree of over- or undervaluation is thereby calculated in percent.

3. Normalized Price/Value: The normalized price/value represents the standard deviation, or dispersion, of the asset class from our estimate of fair value. Normalizing the price/value discrepancy provides a standardized relative comparison across asset classes. The normalized price/value is calculated by taking the price/value of an asset class and dividing it by the secular risk estimate of the same asset class.

17-0887 C-1117 11/17
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