UBS Municipal Bond Fund Update

UBS Asset Management | May 2017

Highlights
• Strengthening fundamentals drove robust gains in the US municipal bond market, which rose 0.73% for April and 2.32% year-to-date, as measured by the Bloomberg Barclays U.S. Municipal Bond Index.
• The release of the proposed tax reform plan by the White House at the end of April has increased speculation on the likely municipal market impact, but as of this writing, little market reaction has been seen.
• Further, to try to forecast the exact market impact (of proposed tax reform) at this premature stage is not prudent in our eyes given the many variables.

Market overview and outlook
Strengthening fundamentals drove robust gains in the US municipal bond market, which rose 0.73% for April and 2.32% year-to-date, as measured by the Bloomberg Barclays U.S. Municipal Bond Index. While previous periods of volatility have also been followed by periods of positive performance, we recognize that markets are unpredictable, making proactive management of municipal bonds essential.

For the month, rate moves across the municipal yield curve ranged from flat to declines of as much as 0.18% in the seven-year maturity. Year-to-date, the spread (from one- to 30-year maturities) has narrowed, with yields down up to 0.38% at the four- and five-year maturities. The curve flattened negligibly during April, with the spread narrowing by just 0.03% to 2.16%, from 2.19% at the end of March. It was 2.07% on December 31, 2016.

The release of the proposed tax reform plan by the White House at the end of April has increased speculation on the likely municipal market impact, but as of this writing, little market reaction has been seen. The proposal calls for a reduction in individual tax rates, a dramatic cut in corporate taxes, the elimination of many deductions—including state and local taxes for those who choose to itemize, and a repeal of both the Affordable Care Act taxes and of the AMT tax. Each of these proposals would impact the municipal market to varying degrees, and lacking the key details, it’s difficult to gauge the meaning to the muni market overall. The proposed tax reform plan contained no explicit commentary about eliminating the municipal bond interest exemption, although the Trump administration had previously voiced such support. The specifics of how the market may react going forward are widespread, and at this stage, largely speculative. Many market pundits have written that, muni-interest
exemption notwithstanding, the largest market impact is likely to be the reduction in corporate taxes. While some have stated that the municipal yield curve would likely steepen due to ‘downward pressure on demand from institutional buyers,’ in our view, this observation neglects where the bank and insurer buyer base of municipals has been concentrated, as well as the taxable ratios along the curve. Arguably, we believe the higher likelihood may be in a curve flattening in the face of such a change.

We recommend that municipal investors show caution in inferring that the Trump administration’s tax plan is an inevitability, particularly given the fractious political climate, the magnitude of the cuts themselves, the difficulty reaching consensus on tax reform has had historically, and the many interests/lobbying groups in play. Further, to try to forecast the exact market impact at this premature stage is not prudent in our eyes given the many variables. We will maintain our time-tested discipline that deliberately avoids predicting political outcomes.

Demand for municipals remains strong, as year-to-date, aggregate inflows into municipal bond mutual funds total roughly USD 2 billion, according to Lipper. Since mid-January, municipals have seen only four weeks of negative flows, per Lipper. By the same token, municipal ETFs have experienced four straight positive months while seeing their overall assets under management increase 5% year-to-date.

JP Morgan has maintained its outlook for USD -82 billion in net supply for 2017, as the pace for issuance has continued to decline. This forecasted drop in issuance comes in spite of increased opportunity for issuers to come to market with new money deals, given the lower rate environment compared to where the year began. Nevertheless, refunding volume’s marked decline in 2017 is very likely to keep the overall supply figure suppressed.

**Fund positioning**

We are maintaining our strategic, long-term duration posture, and will continue to avoid directional rate gambits. We have maintained exposure to cash and cash alternatives deliberately as a means of balancing more compelling exposure further out on the curve. This strategy also allows us to avoid extending duration beyond where we are comfortable or owning parts of the curve that we deem to be too rich. Furthermore, maintaining more liquidity affords our clients the ability to exploit new pockets of opportunity that may present themselves in the coming months.

From a credit perspective, generally, we continue to favor AA and AAA rated bonds at tighter spreads than reach for yield in the A and BBB categories, though A and BBB may be becoming more attractive if spreads widen further. While we maintain no exposure to Puerto Rico, we are closely following events on the island to determine if there exists any lesson to be learned for future investing in the market. Additionally, we have a heightened concern for general market reaction to the current credit cycle in which the State of Illinois currently finds itself, with further downgrades of the credit depending on action, or better inaction, by the governor and legislature. The need to be relative-value driven, selective and carry out an in-depth credit analysis when buying A and BBB credits remains.

Our targets are mostly driven by longer-term, strategic perspectives, as well as by dynamic yield curve selection and total return analysis.

**Past performance is no guarantee of future results.**

**For more information**

Mutual funds are sold by prospectus. You should carefully read and consider the Fund’s investment objectives, risks, charges and expenses before investing. The prospectus contains this and other information about the Fund. For a current prospectus, contact your Financial Advisor, call UBS Asset Management at 888-793 8637, or visit us on the Web at www.ubs.com/am-us. An investment in a fund is only one component of a balanced investment plan. Diversification and asset allocation strategies do not ensure gains or guarantee against loss.
Fund characteristics
As of April 30, 2017

### Maturity

- 14% 0–2 years
- 9% 2–4 years
- 12% 4–6 years
- 25% 6–8 years
- 21% 8–12 years
- 15% 12–17 years
- 5% 17–22 years

### Sector allocation

- 30% State general obligation
- 14% Other
- 12% Lease
- 9% Tolls
- 8% Local general obligation
- 8% Airport
- 7% Pre-refunded
- 4% Water (revenue)
- 3% Power (revenue)
- 3% Hospital
- 1% Transportation

### Credit allocation

- 29% AAA
- 41% AA
- 30% A

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All credits were positive for April

<table>
<thead>
<tr>
<th>April 2017</th>
<th>Last three months (2/1/17–4/30/17)</th>
<th>Last 12 months (5/1/16–4/30/17)</th>
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- Bloomberg Barclays U.S. Municipal Bond Index

- AAA
- AA
- A
- BBB

Source: Bloomberg.

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1 Subject to change. Percentages may not equal 100% due to rounding.

2 Please see the “Credit ratings” section on the next page for more information.
Views expressed:
The views expressed are as of May 9, 2017 and are those of UBS Asset Management. These views, and asset allocations, are subject to change at any time in response to changing circumstances in the markets, and are not intended to predict or guarantee the future performance of any individual security, asset class, the markets generally or the Fund.

This document is not an invitation to subscribe for shares in the UBS Municipal Bond Fund and is provided by way of information only. Subscriptions will only be received and shares issued on the basis of the current prospectus of the Fund. Shares are not FDIC-insured and involve risks such as possible loss of principal. The investment return and principal value of an investment will fluctuate so that an investor’s shares, when redeemed, may be worth more or less than their original cost.

Investor concerns and suitability:
Investors in the Fund should be able to withstand short-term fluctuations in the fixed income markets. The value of the Fund’s portfolio changes every day and can be affected by changes in interest rates, general market conditions, and other political, social and economic developments, as well as specific matters relating to the issuers and companies in whose securities the Fund invests. It is important to note that an investment in the Fund is only one component of a balanced investment plan. Shares of the mutual fund are not guaranteed.

Nothing contained herein constitutes investment, legal, tax or other advice. This should not be construed as a solicitation, offer, or recommendation to acquire or dispose of an investment, or to engage in any other transaction.

The Bloomberg Barclays U.S. Municipal Bond Index includes investment grade, tax-exempt and fixed-rate bonds with long-term maturities (greater than two years) selected from issues larger than $50 million. The index is unmanaged and does not reflect the deduction of any fees or expenses. The index returns reflect all items of income, gain, loss, and the reinvestment of dividends and other income. The index performance does not represent that of the UBS Municipal Bond Fund.

Risk information:
There are certain risks associated with investing in the Fund, which include: interest rate risk, credit risk, prepayment or call risk, political risk, focus risk, tax liability risk, US government securities risk, illiquidity risk, high yield bond risk, non-diversification risk, derivatives risk, leverage risk associated with financial instruments, management risk, and market risk. For detailed information about the Fund’s main risks, please refer to the Fund’s prospectus.

- Interest rate risk: An increase in prevailing interest rates typically causes the value of fixed income securities to fall. Changes in interest rates will likely affect the value of longer-duration fixed income securities more than shorter-duration securities and higher-quality securities more than lower-quality securities.

- Credit risk: The risk that the strategy could lose money if the issuer or guarantor of a fixed income security, or the counterparty to the guarantor of a derivative contract is unable or unwilling to meet its financial obligations. This risk is greater for lower-quality investments than for investments that are higher quality.

Credit ratings:
Unless otherwise noted, credit quality ratings shown are based on those assigned by Standard & Poor’s Financial Services LLC, a part of McGraw-Hill Financial (“S&P”), to individual portfolio holdings. S&P is an independent ratings agency. Ratings reflected represent S&P individual debt issue credit ratings. While S&P may provide a credit rating for a bond issuer (e.g. a specific company or country), certain issues, such as some sovereign debt, may not be covered or rated and, therefore, reflected as non-rated. Credit ratings range from AAA, being the highest, to D, being the lowest, based on S&P measures; ratings of BBB or higher are considered to be investment grade quality. Unrated securities do not necessarily indicate low quality. Further information regarding S&P’s rating methodology may be found on its Website at www.standardandpoors.com.

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17-0439 C-0517 S17
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