Global Perspectives

Overview

- **Equities:** We retain our risk-on stance in equities. Our preference is for developed market equities outside of the US (MSCI EAFE Index), particularly the eurozone and Japan. In US equities, we are positioned for the outperformance of small- and medium-sized companies relative to their larger counterparts.
- **Fixed Income:** With the Federal Reserve widely expected to raise interest rates this year, we believe there is room for policy error and an inflation surprise. We are positioned short US duration and have a preference for global investment grade credit over government bonds.
- **Currency:** While we remain positive on the US dollar, we are becoming less bullish as there may be limited scope for further gains against the other major currencies. We expect the Swiss franc to depreciate versus the euro over the longer term. The franc has been supported in recent months by investor demand for perceived safe havens amid the developments in Greece.

The month in review: Greece falls off the risk radar—for now

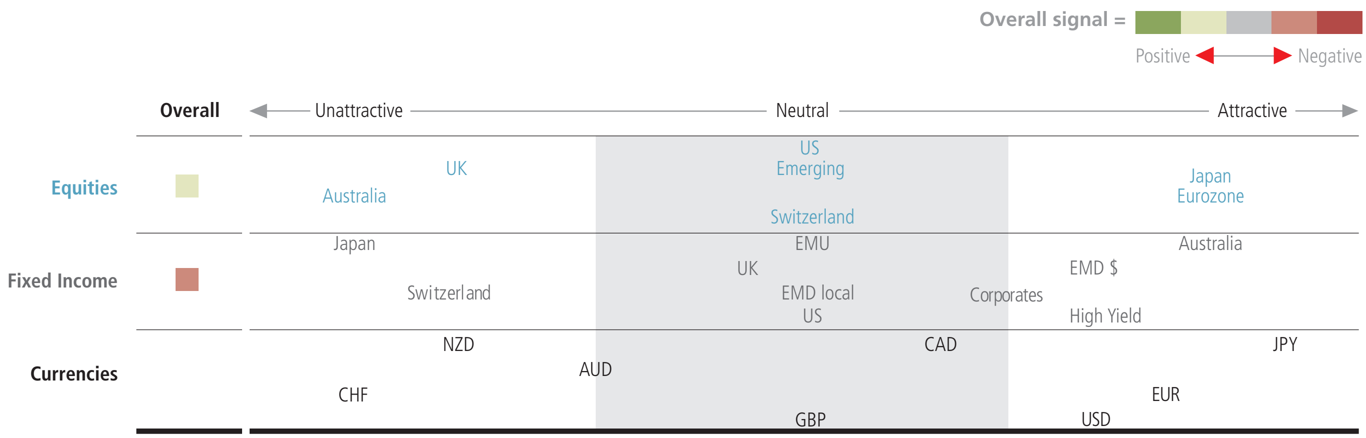
- Investors finally received some respite from Greece-related uncertainty in July. Eurozone finance ministers gave the green light to Greece's international creditors to start negotiations on a new three-year bailout program (to provide financing of an estimated euro 82 billion-86 billion) for the heavily indebted country.
- European equities bounced on news of the breakthrough. The Eurostoxx 50 Index was among the month's top performers, up 5.2% (all market returns in local currency terms). The German DAX (+3.3%) and the French CAC 40 (+6.2%) registered solid gains. The UK's FTSE 100 Index rose 2.8%, while positive investor sentiment also lent support to other developed equity markets: the US and Japan were up 2.1% and 1.8%, respectively. Meanwhile, Chinese equity markets remained incredibly volatile. The Shanghai Composite Index suffered the second-biggest drop in its history towards the end of July. Chinese authorities have intervened heavily in the markets in an effort to put a floor under further declines.
- In fixed income, developed market government bonds had a positive month, with yields on 10-year Treasuries finishing the month down 13 basis points (bps) at 2.20%, while UK gilt and German bund yields were down 15 bps and 16 bps, respectively. Peripheral eurozone debt markets were boosted by the Greek developments, with yields falling across the board. In the US, the Federal Reserve (Fed) remains on track to raise interest rates this year. Positive labor market trends are supportive of this, as is the bounce-back in US GDP following a disappointing first quarter. The US economy was estimated to have grown at an annual rate of 2.3% in the second quarter.

Outlook: Bracing for volatility ahead of Fed rate hike

- Our preference remains for developed equity markets outside of the US (MSCI EAFE), particularly the eurozone and Japan. In the eurozone, our risk-on stance has been underpinned by a conviction that the region's economic recovery would remain on track despite the developments in the Greek debt crisis. Although progress has been made this month in finding a viable solution, we expect there to be bouts of volatility ahead—and for the European Central Bank (ECB) to be prepared to undertake measures to prevent contagion during periods of heightened market stress.
- Meanwhile, ahead of the first Fed rate hike, we see potential for an inflation surprise and policy error. Markets appear to be underpricing the prospect of a September rate rise. Against this backdrop, we have been positioned short US duration. We are likely to see an uptick in volatility levels between now and the end of the year.

Current views[1]

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

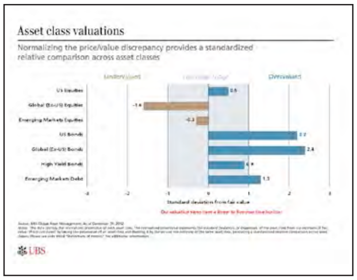


Asset Class	Overall signal	UBS Global Asset Management's viewpoint
US Equities		• We believe that US equities are relatively unattractive on valuation grounds, and our preference remains for developed market equities outside of North America (MSCI EAFE Index), particularly the eurozone and Japan. • US corporate earnings growth is losing momentum, while a strong dollar and continued low inflation environment means that there is limited scope for upward revisions to forecasts in the near term. • Small- and medium-sized companies are an interesting alternative based on expectations of increased M&A activity. This is largely motivated by large companies struggling to deliver earnings growth and looking at smaller targets, which tend to include companies with higher profit generation.
Global (Ex-US) Equities		• Developed equity markets (excluding the US) have been supported by several favorable developments. Among these have been signs of a strengthening economic recovery and resurgent corporate earnings growth, particularly in the eurozone and Japan. • With the Fed on a monetary policy tightening trajectory, the European Central Bank and the Bank of Japan are expected to continue providing ample global liquidity through their ongoing asset-purchase programs. This should continue to provide a supportive backdrop for risk assets.
Emerging Markets Equities		• While from a valuation perspective emerging markets appear broadly attractive, weakening margins relative to developed markets, no real relative productivity gains and a lack of structural reforms put them at risk. • Currently, North Asian markets look more attractive than the broader emerging market index as these countries are not, or are less, reliant on exporting oil and have lower exposure to geopolitical risk (Russia) and structural issues (Brazil). Healthier current account balances make them better positioned for US rate rises.
US Bonds		• US government bonds appear overvalued across all maturities, although to a lesser degree than global ex-US government bonds. The Fed remains on track to raise rates this year, which is expected to be followed by a very gradual pace of monetary policy normalization. • We believe that markets are underpricing the prospect of a September rate hike. Inflationary expectations are also low, dampened by the impact of oil price weakness, so there could be an inflation surprise. Room remains for Fed policy error. Against this backdrop, we have been positioned short US duration.
Global (Ex-US) Bonds		• A breakthrough in the Greece developments was positive for peripheral eurozone bonds in July. We have seen limited contagion effects in recent months, with peripheral (ex-Greece) bonds relatively well supported, in our view. The ECB has been expected to utilize the tools at its disposal to step in to calm any significant bouts of market volatility. • UK gilts offer a relatively attractive yield (2.0% on 10-year gilts) and have some potential for spread compression in the long term. Decline in Greece-related risk could lead to reduced gilt safe haven demand. • Amid negative real yields, Japanese government bonds look most overvalued among major sovereign bonds.
Investment Grade Corporate and High Yield Bonds		• The appeal of global investment grade corporates stems from the attractive spreads over sovereign bonds that they offer (currently around 115 bps), as well as positive liquidity conditions and solid investor demand. • Even though our view on high yield has become slightly more negative, current yield to maturity of 6.8% (USD HY) still compensates appropriately for the potential liquidity risk we see inherent in the asset class. Sector allocation remains key. The ongoing impact of weaker oil prices may lead to higher default rates among energy companies.
Emerging Markets Debt		• US dollar (USD)-denominated emerging market debt is currently offering an attractive yield (around 6.7%). Emerging market local currency debt, however, is at risk from a stronger dollar. • A granular country-by-country view remains important, while concerns about liquidity in certain areas of the emerging market debt universe remain. • Commodity exporting countries face an adverse impact on their current accounts and ability to service external debt based on lower commodity prices and weakening emerging markets currencies.
Currency		• While we remain bullish on the USD, most of the gains may lie behind us, with limited scope for further gains against the other major currencies (which are beginning to look undervalued on a long-term basis versus USD). • The euro (EUR) has weakened significantly as a result of the ECB's QE program. A more pronounced decline in the euro is possible, but this would require that the Fed tightens monetary policy more aggressively than the market is currently anticipating. • The EUR has long-run appreciation potential against the Swiss franc, now that Greece-related uncertainty has been reduced. The Swiss National Bank could be expected to step in again to cap the franc's gains against the euro (following its intervention in late June).

[1] Source: UBS Global Asset Management. As of July 31, 2015.

Market behavior analysis complements valuation

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



+

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 July 31, 2015

Valuation and market behavior indicators at work

Overall signal =

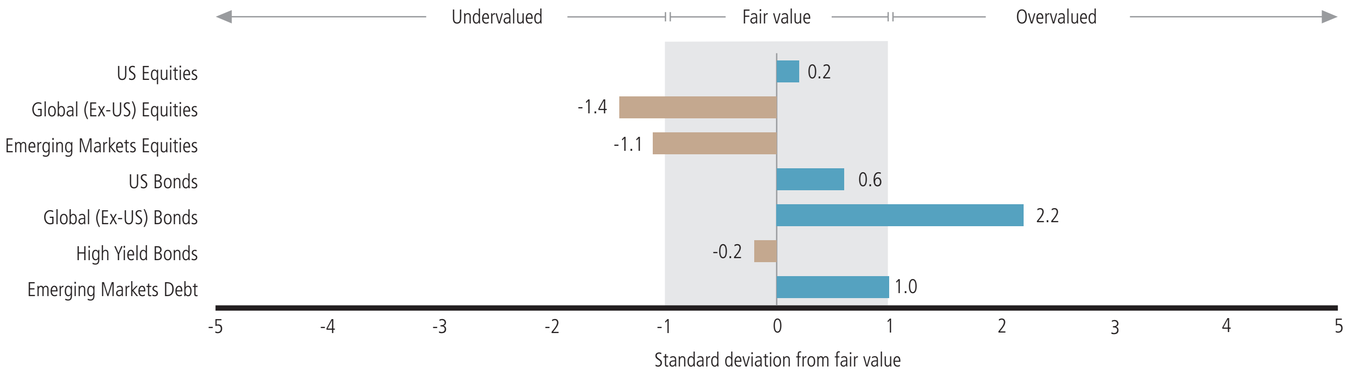
Positive ◄——► Negative

Valuation	+	Market themes	+	Momentum and flow	+	Market stress	+	Macroeconomic landscape	=	Overall signal
Neutral		Neutral		Neutral		Neutral		Negative		Neutral

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

Normalized asset class valuations[2]

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



[2] Based on UBS Global Asset Management's views. As of July 31, 2015.

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.

UBS815.6400C 15-0443 8/15
www.ubs.com/globalam-us

UBS Global Asset Management (Americas) Inc. is a subsidiary of UBS AG.

UBS