UBS

Global Perspectives

Global Investment Solutions | October 31, 2015

Overview

Equities: Resurgent risk appetite in October was driven by the monetary easing measures of several central banks and the Federal Reserve (Fed) signaling that it retains its conviction in the US economic recovery. Both developed and emerging market equities rallied following the previous months' significant losses. The eurozone and Japan saw some of the biggest gains

Fixed Income: The Fed continued to shape investor sentiment in the fixed income markets. Its surprisingly hawkish statement towards the end of the month led to US and UK government bond yields rising in anticipation of higher interest rates. Corporate bond markets, meanwhile, rallied across the credit spectrum in a risk-on environment.

Currency: European Central Bank (ECB) president Mario Draghi gave a strong hint that the ECB would enhance its quantitative easing program, possibly in December. This is likely to exert downward pressure on the euro against the other major currencies. Although the US dollar remains in a strengthening environment, we favor the Japanese yen over both the dollar and the euro on valuation grounds.

The month in review: Easier monetary policy stokes investor risk appetite

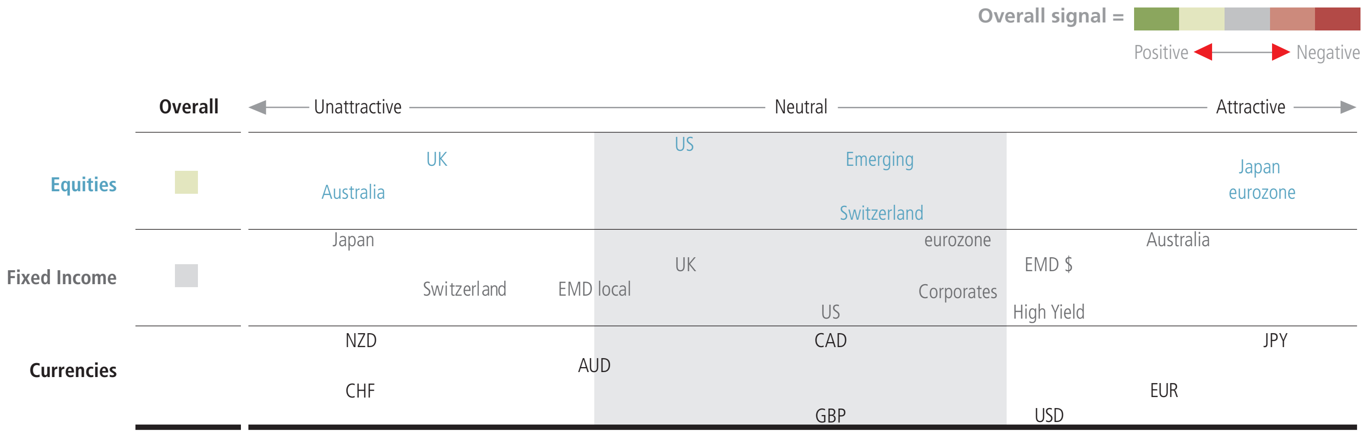
- Global equity markets staged a strong rebound in October following the sharp losses registered in the previous two months. Emerging market equity returns turned positive, while eurozone and Japanese equities saw some of the biggest gains.
- Investors regained their risk appetite as the ECB hinted that it could enhance its QE program in December, while Sweden's Riksbank announced an increase to its ongoing asset purchases. The People's Bank of China also undertook new easing measures, sooner than many had expected.
- The Fed provided an element of surprise towards the end of the month by signaling that a December rate hike may still be on the cards. This was implied in the Federal Open Market Committee's October 28th statement, which made explicit reference to "determining whether it will be appropriate to raise the target rate at its next meeting."
- Equity investors welcomed this development as it was perceived to reflect the Fed's confidence in the US economic recovery, despite the potentially negative developments elsewhere in the global economy. Sentiment was also supported by signs that the US third-quarter corporate earnings season would be better than many had anticipated.

Outlook: Volatility is the only certainty

- The developments of recent months have increased the risks faced by the global economy. While this has meant that the investment environment has become slightly more challenging, our base-case scenario remains broadly unchanged. Our preference is for riskier assets such as Japanese and eurozone equities over government bonds.
- We scaled back the equity exposure in some of our portfolios in October with a view to taking profits following the period of strong performance. In fixed income, we closed our short US duration position. This was achieved by investing in a mix of Treasuries, US corporate bonds, and long-dated Italian and Spanish government bonds, depending on the portfolio.
- Our view is that we are likely to see further bouts of market volatility and will position our portfolios accordingly. Conditions of heightened volatility often provide attractive investment entry and exit points.

Current views[1]

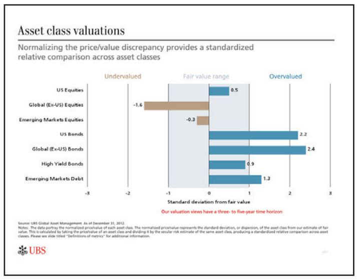
Asset allocation and currency attractiveness based on fundamental valuation and market behavior analysis



Asset Class	Overall signal	UBS Asset Management's viewpoint
US Equities		• The US third-quarter corporate earnings season was slightly better than anticipated. Overall, company earnings surprised to the upside while sales did not. • We continue to find the broad US equity market unattractive on valuation grounds. The Fed raising rates is likely to increase the costs, including wages, faced by US companies and a strong dollar continues to weigh on exporters. • Our conviction in the long US small- and medium-sized companies (Russell 2000 Index) and short large companies (S&P 500 Index) position remains intact. However, we are closely monitoring the trends in US mergers and acquisitions activity, which we have been expecting to benefit Russell 2000 companies.
Global (Ex-US) Equities		• Following two months of sizeable losses, global equity markets outside of the US staged an impressive rebound in October. Gains were supported by the enhanced stimulus provided by central banks, as well as investor confidence in the global economic recovery. Eurozone and Japanese equities were very strong performers. • Many of our portfolios have added a long Dutch equities and short UK equities relative value trade, which aligns with our preference for the eurozone over the UK. While not underpinned by a strong valuation case, we have added the trade to benefit from the likely divergence in the monetary policies pursued by the ECB and the Bank of England. Furthermore, the corporate earnings growth outlook is more favorable for Dutch companies.
Emerging Markets Equities		• We would need to see strong signs of stabilization in the Chinese economy for the fortunes of other emerging market economies to take a turn for the better. While trading at what we view as attractive valuations, we do not yet see the case for adding exposure to emerging market equities. • We find attractive investment opportunities in the North Asian equity markets, including Korea and Taiwan, which export technology equipment and products to China, and demand for which should remain healthy. On the other hand, heavily resource-dependent economies such as Brazil and Russia could see their equity markets suffer as Chinese commodity demand wanes further.
US Bonds		• The latest comments from the Fed suggest that a rate hike in December still remains in the cards. In late October, the Fed failed to make the explicit remark that it was considering the impact of global economic developments on its policy trajectory, as it had done in the previous month. This was taken as a hawkish signal by investors. • We closed our short US duration trade by investing in a mix of Treasuries, US corporate bonds, and long-dated Italian and Spanish government bonds. This was not driven by a belief that US rates will not rise, but that we expect movements in the 10-year Treasury to be rather neutral in the medium term.
Global (Ex-US) Bonds		• Further signs of divergence in the monetary policy trajectories of the Fed and the ECB continued to suppress eurozone government bond yields. • Our outlook for the long Italian and Spanish government bonds versus cash position that we have implemented in some of our portfolios remained positive against the backdrop of encouraging regional growth trends. The recovery in the eurozone peripheral economies appeared to be outpacing the improvement seen in the core economies such as Germany.
Investment Grade Corporate Debt		• Corporate bond markets had a positive month in October, with spreads tightening across the credit spectrum in the developed bond markets. • The attractiveness of the investment grade segment of the market is primarily stemming from the positive carry, market liquidity and capital flows as investors are taking the closest substitute to sell government bonds. However, developments in the third quarter raised some concerns about liquidity in the credit markets.
High Yield Bonds		• Sector allocation remains key as the ongoing impact of weak oil prices may lead to higher default rates among energy companies, and increase the risk of retail outflows in a market potentially short of sufficient demand. • Given the very low level at which developed government bond yields languish, spread products can offer relatively attractive returns in our view.
Emerging Markets Debt US dollar Local currency		• Our preference remains for US dollar- over local currency-denominated emerging market debt, in an environment of Fed rate rises on the horizon and weak global growth. In the US dollar debt market, a granular country-by-country assessment of economic conditions in emerging markets is crucial. • The prospect of further US dollar strengthening provides a headwind for the local currency-denominated debt markets in the emerging economies.
Currency		• Our view is that the Japanese yen is more attractive than both the US dollar and the euro, on valuation grounds.

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

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



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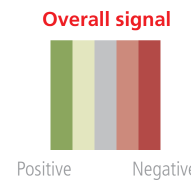


Market themes

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."

Momentum and flow

Attempts to capture money flows and market appetite for risky assets from the perspective of professional asset allocators, such as mutual fund managers.

Market stress

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).

Macroeconomic landscape

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, 2015

Valuation and market behavior indicators at work

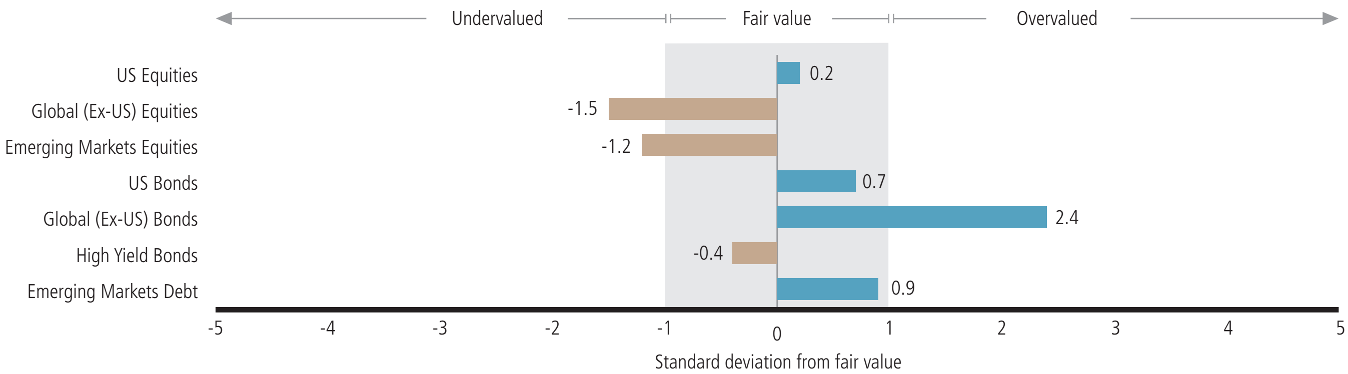
Overall signal =

Valuation	+	Market themes	+	Momentum and flow	+	Market stress	+	Macroeconomic landscape	=	Overall signal
Neutral		Neutral		Neutral		Negative		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 Asset Management's views. As of October 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.

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