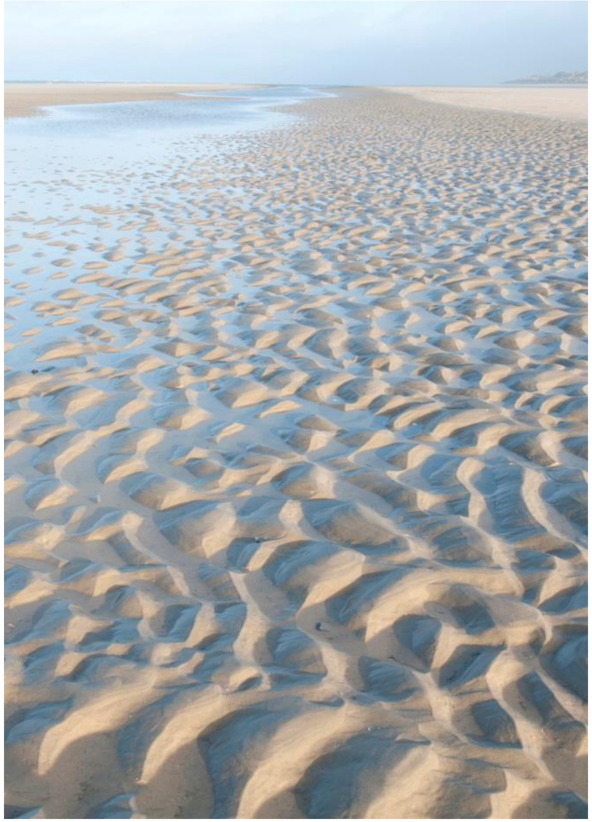
UBS House View

Chief Investment Office WM

Treasurers Forum – the year ahead



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Making sense of macro: conflicting forces at work

Emerging (EM) vs. Developed Economy (DM) Growth → China slowdown dampens EM activity. Yet low interest rates, declining oil prices and investment revival supports DM.

Supply vs. Demand Dynamics → US and UK approaching full capacity – so greater reliance on productivity to drive growth. Meanwhile, EM supply side connected to failure of reform drive

Disinflation vs. Growth Resilience → China shocks also a broader commodity shock- intensifying disinflation and challenging DM central banks where inflation already well below target

Source: UBS CIO WM Global Investment Office, as of 19.10.2015

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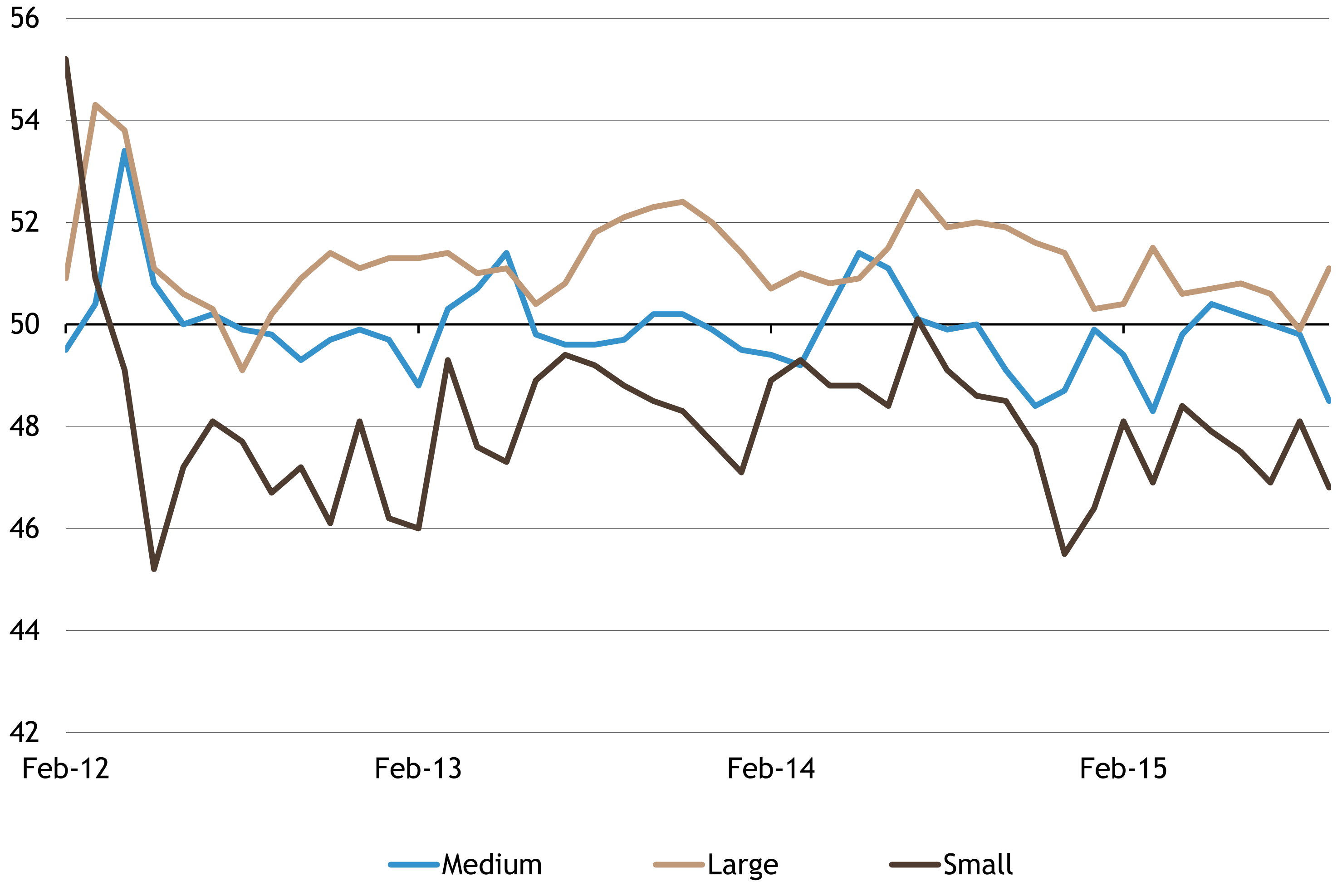
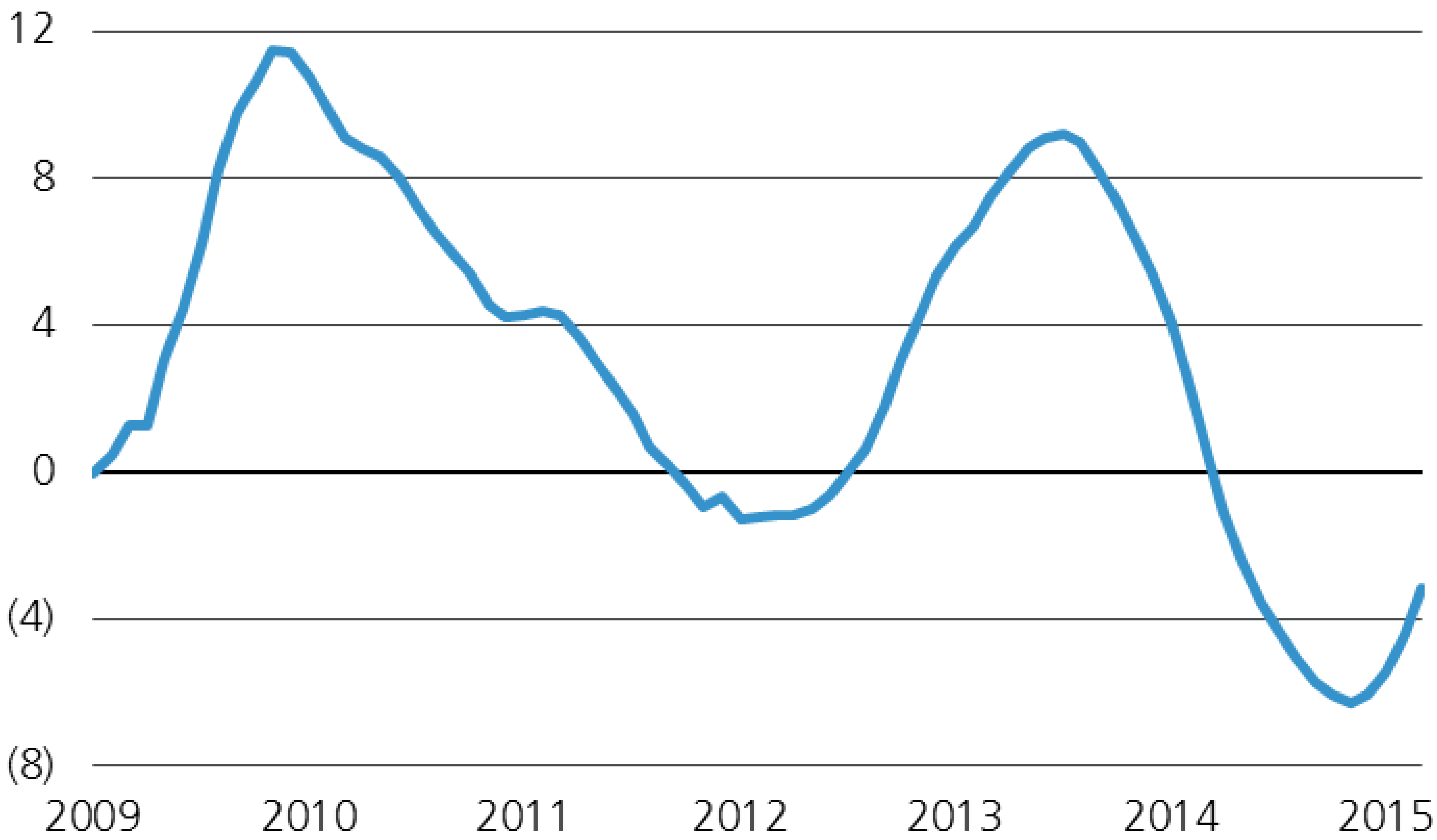
Large Chinese companies respond to stimulus

Manufacturing Purchasing Managers Indices



Turning housing prices will support the Chinese economy

China 70 cities newly built residential buildings prices, year-on-year in %



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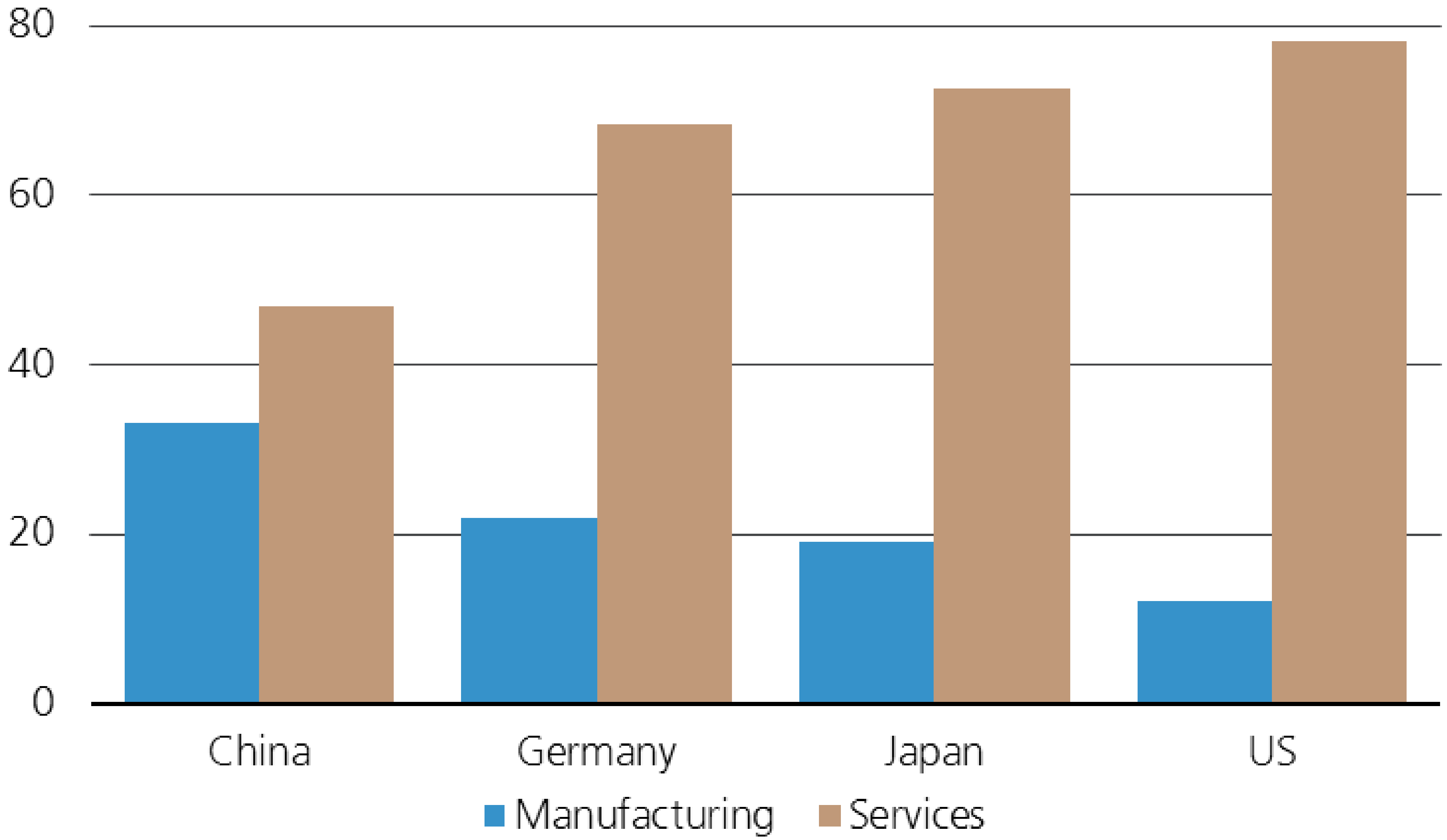
Source: Bloomberg, UBS

Services – not manufacturing - make up the lion's share of GDP…

Value added for sector as of % of GDP for 2013



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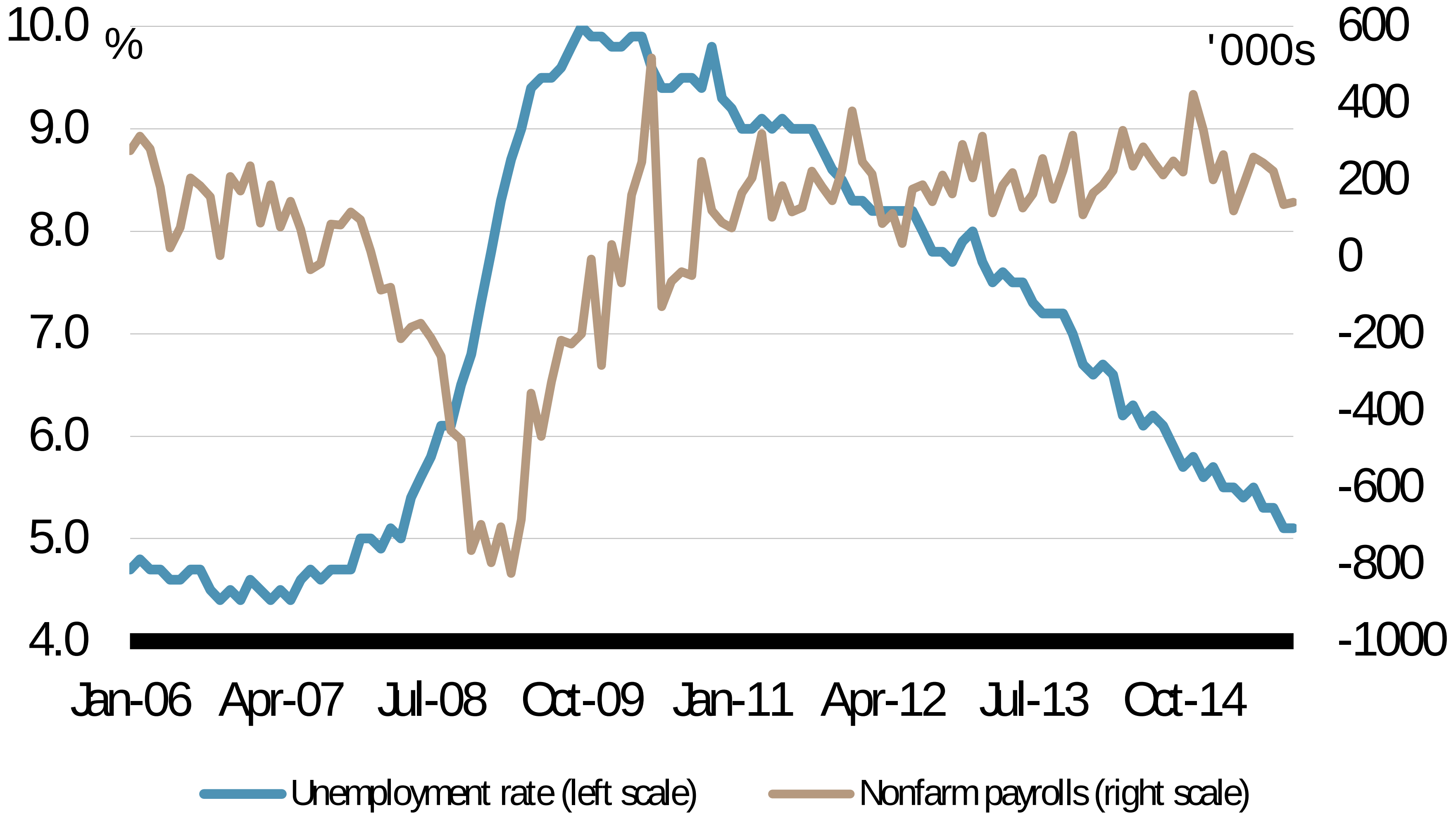
Source: World Bank, UBS

US: Nearing maximum employment…..?

Unemployment rate and nonfarm payrolls



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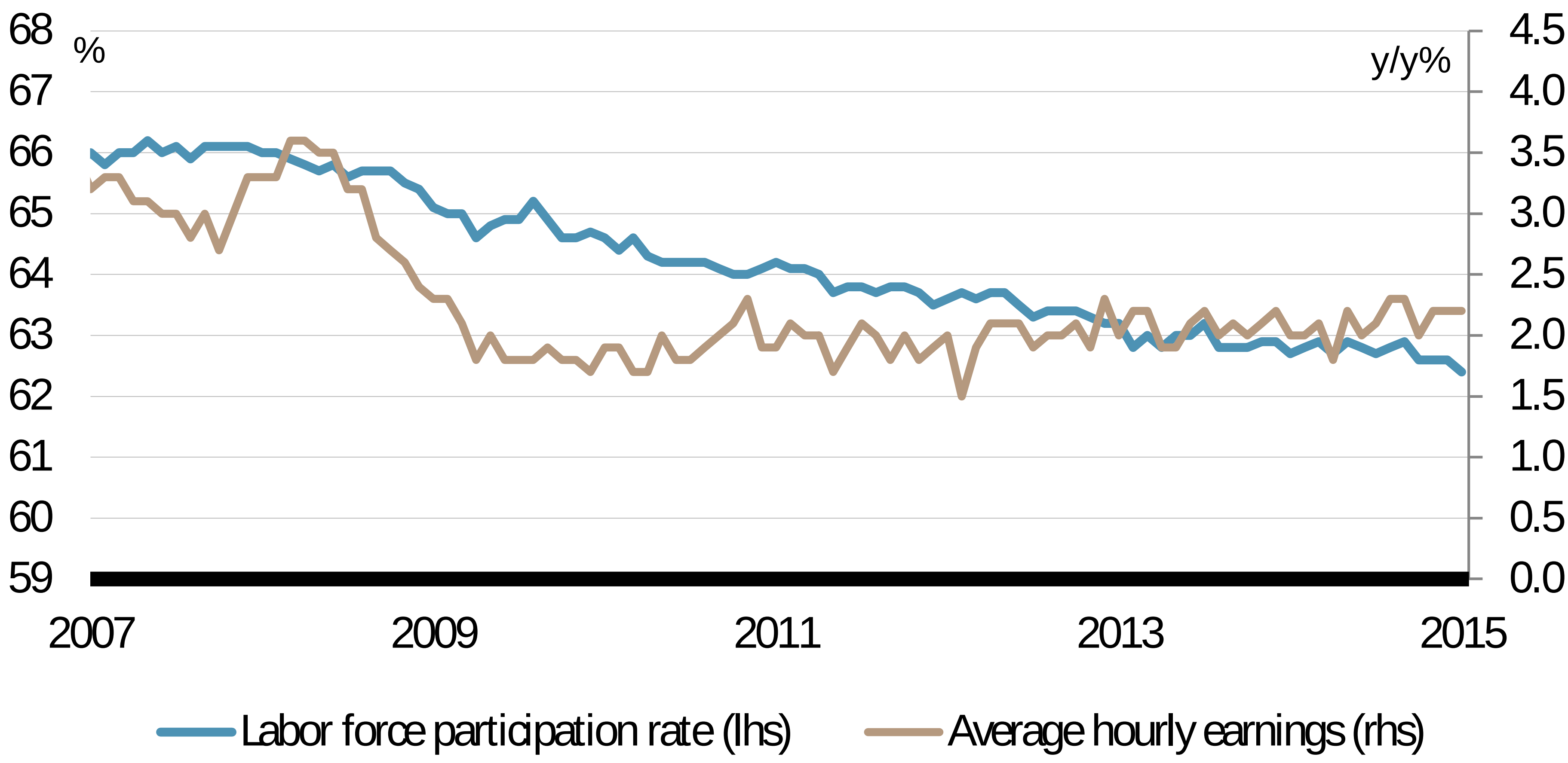
Source: UBS CIO WM Global Investment Office, as of 5 October 2015

…but this doesn't look like a labor shortage

Labor force participation rate and average hourly earnings



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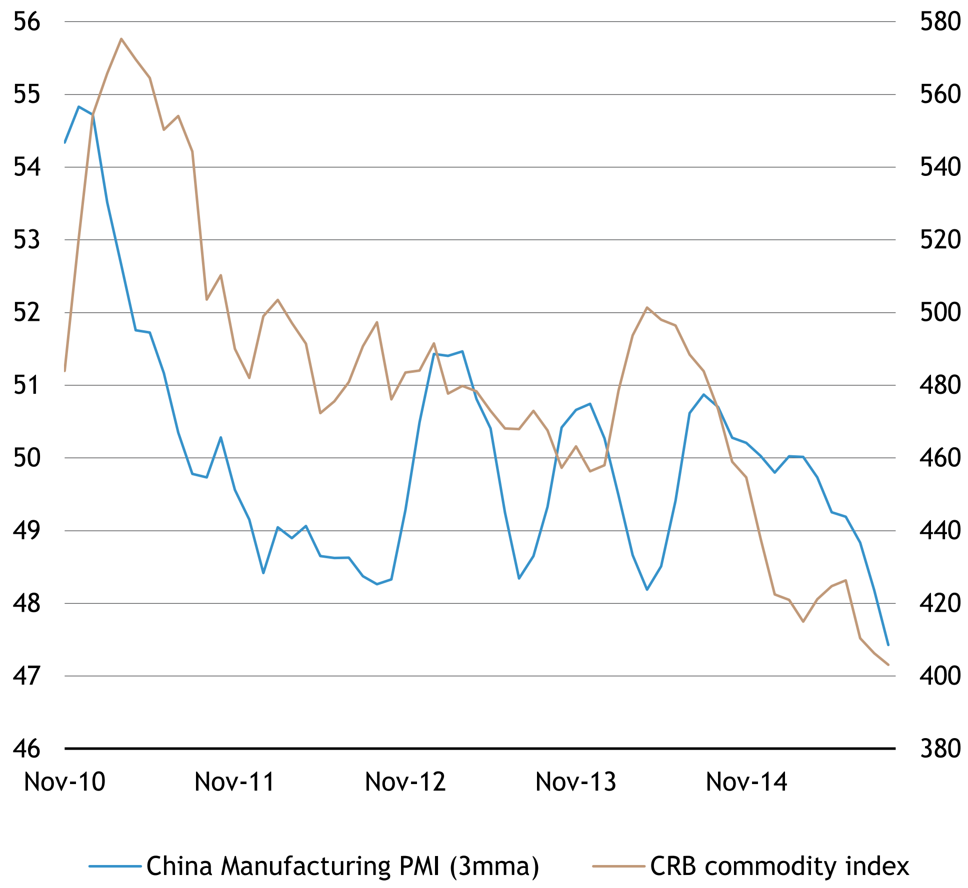
Source: UBS CIO WM Global Investment Office, as of 5 October 2015

Commodity prices still driven by China

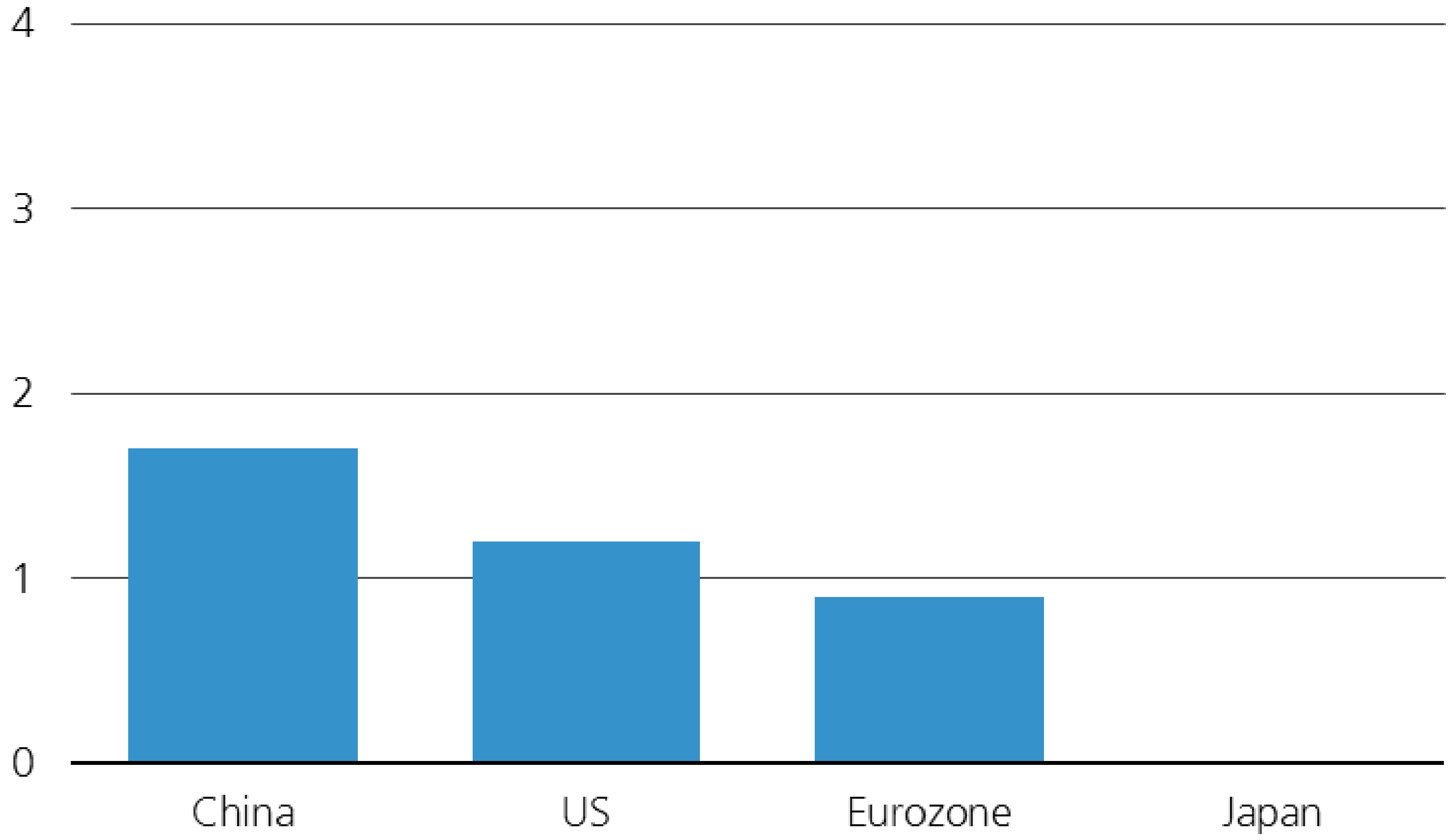
China Manuf. Purchasing Managers Index and Commodity Research Bureau Index



Source: Haver Analytics, Bloomberg LP., UBS as of October 15 2015

Consumer price inflation is nowhere near central banks' targets

Core inflation, year-on-year in %

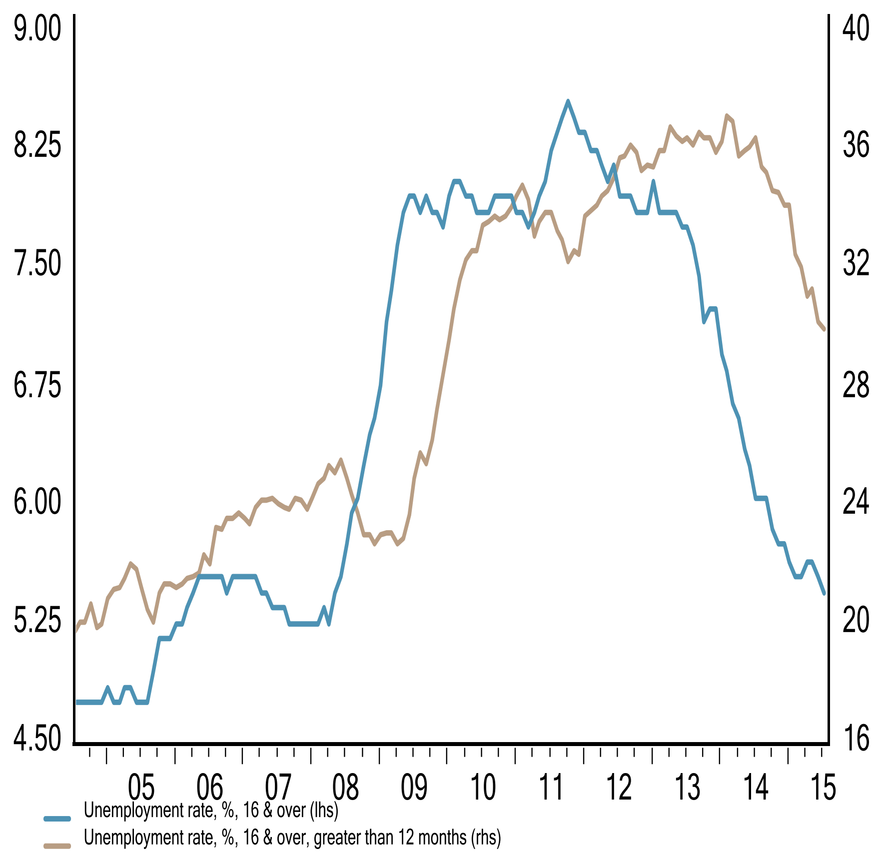


Source: Bloomberg, UBS

UK: much to be optimistic about-rate hike start in 2Q next year

Labour market continues to tighten…

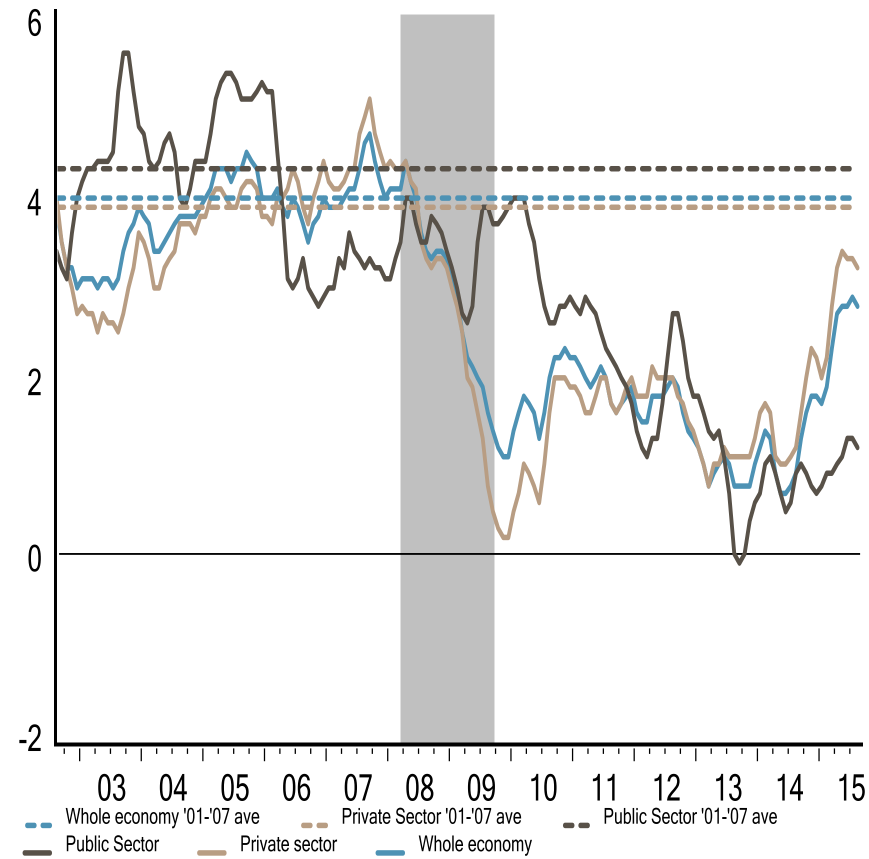
Unemployment rate, SA, %



Source: Haver Analytics, UBS as of 14 October 2015

…resulting in wage growth

Average weekly earnings, y/y, %



Source: Haver Analytics, UBS as of 14 October 2015

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Three to watch: Chinese reserves, Fed policy and Euro earnings ..and reasons to be positive

There are **three** big questions related to recent weakness that we continue to watch closely.

1. China's capital account – Yuan depreciation as a threat to markets and flexibility
2. Fed policy – reducing the confusion and getting 'on-message'.
3. Corporate earnings – what is the size of the EM impact; how resilient are western companies

There are positive signs emerging:

There are signs of stability in China:

Western consumers are still spending.

Central banks remain willing and able to support growth and stabilize markets:

- CIO also expect a US rate hike in December with a signal of 'lower for longer'.
- The Bank of England is still expected to hike in 2Q 2016
- The ECB is expected to extend its EUR 60bn worth of monthly purchases by another 3-6 months while Bank of Japan continues its policy of ongoing and pre-committed asset purchases

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Source: UBS as of September 2015

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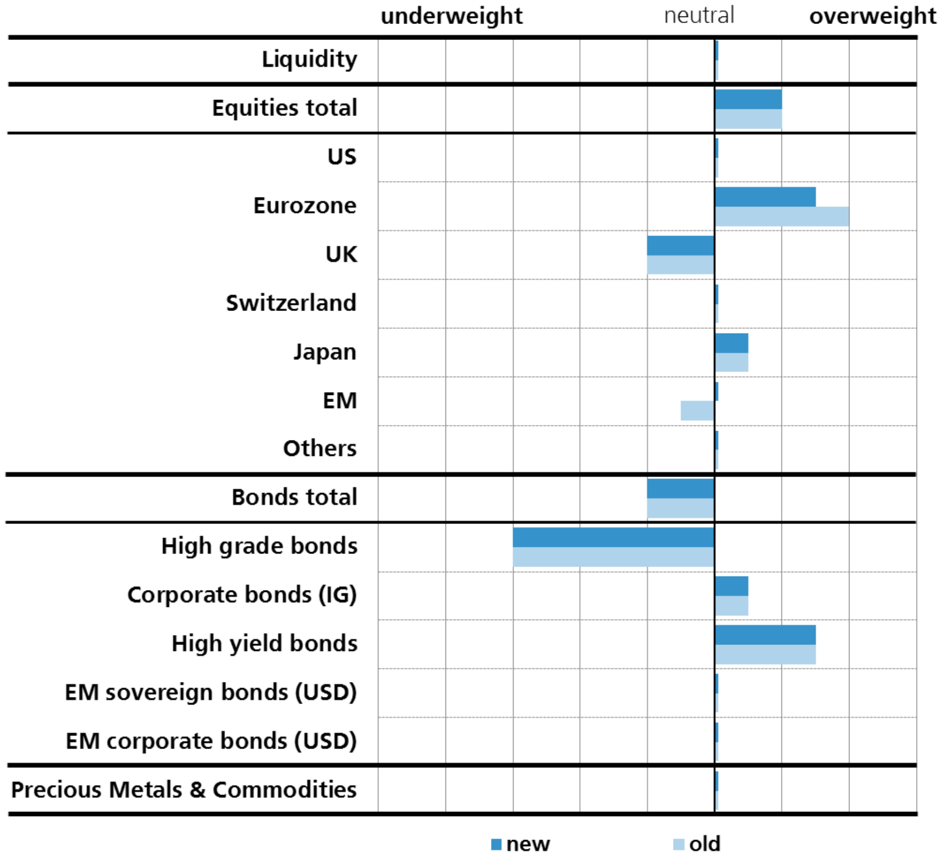
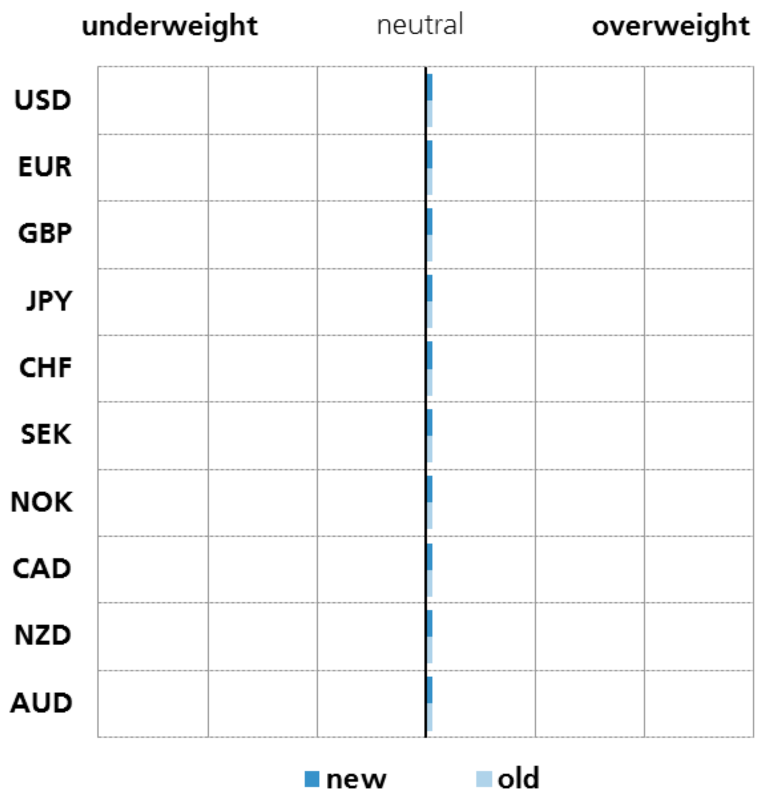
Global tactical asset allocation

Tactical asset allocation deviations from benchmark*



Currency allocation



*Please note that the bar charts show total portfolio preferences and thus can be interpreted as the recommended deviation from the relevant portfolio benchmark for any given asset class and sub asset class.

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Source: UBS CIO WM, as of 22 October 2015

Lower returns and higher volatility

MSCI AC World index, trailing returns and volatility

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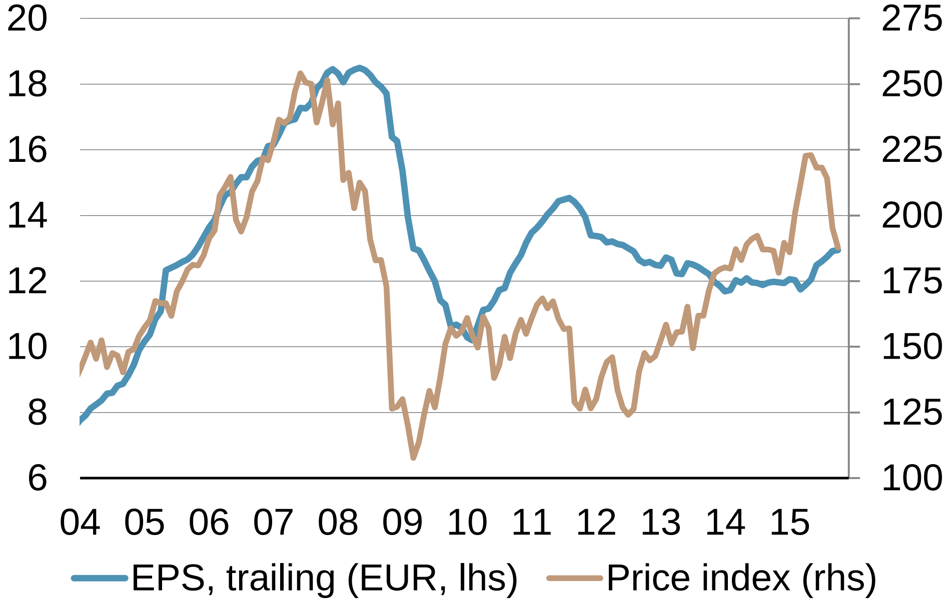
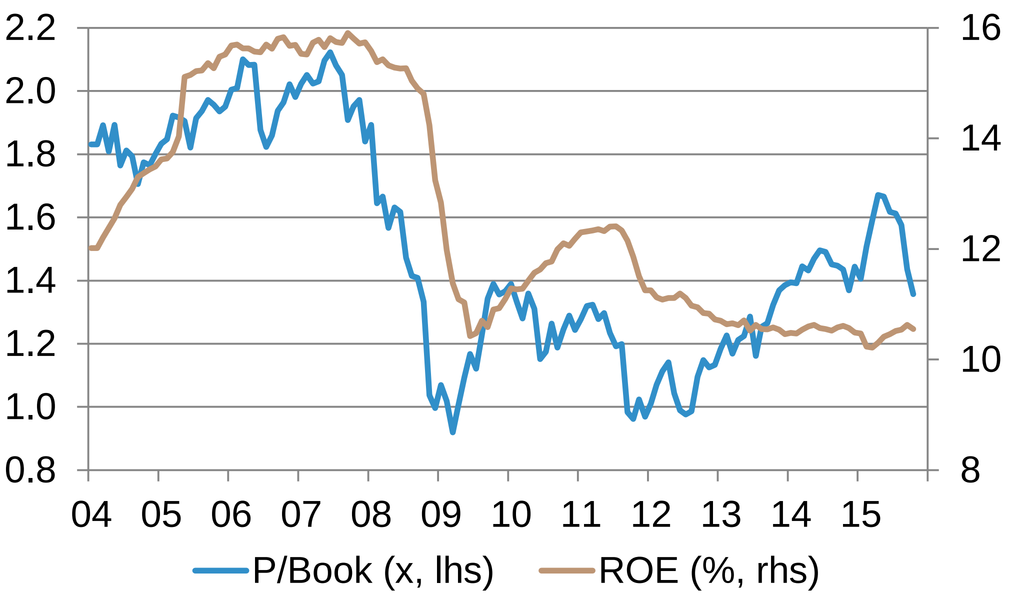
Source: Bloomberg, UBS

Euro equities – 'back in line'

MSCI EMU – Price and EPS*



MSCI EMU – valuation and profitability



* Trailing.

Source: UBS CIO WM, Datastream

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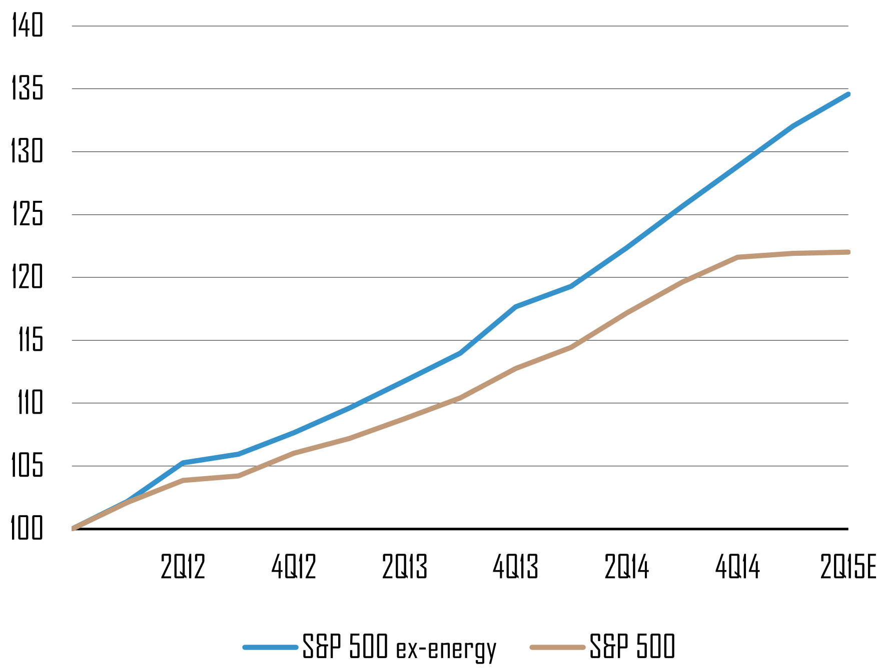
US earnings cycle (ex-energy) still intact

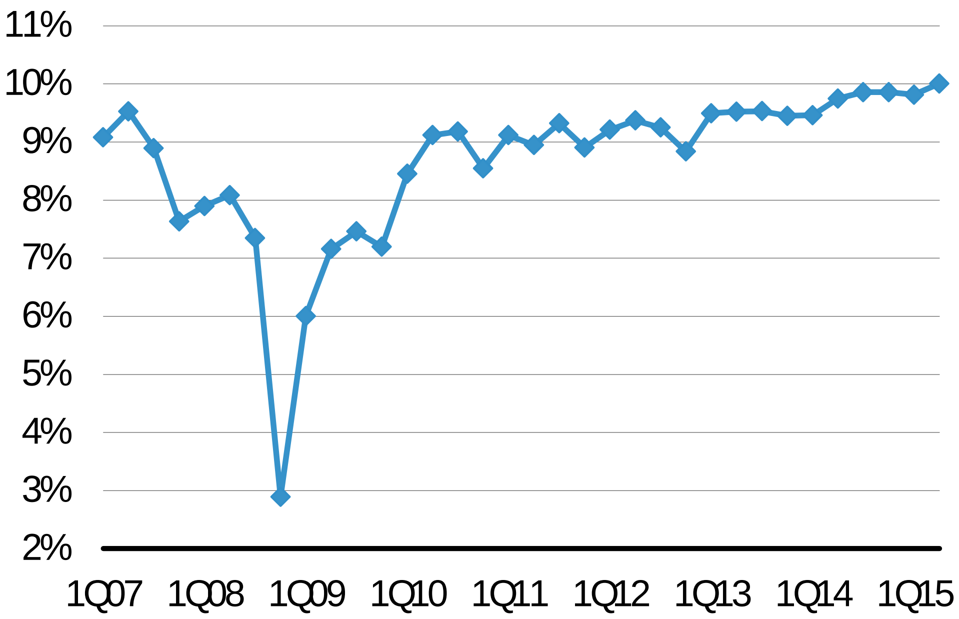
No weakness in S&P 500 ex-energy

EPS indexed to 2012/Q1 = 100



Ex-energy, net margins continue to climb

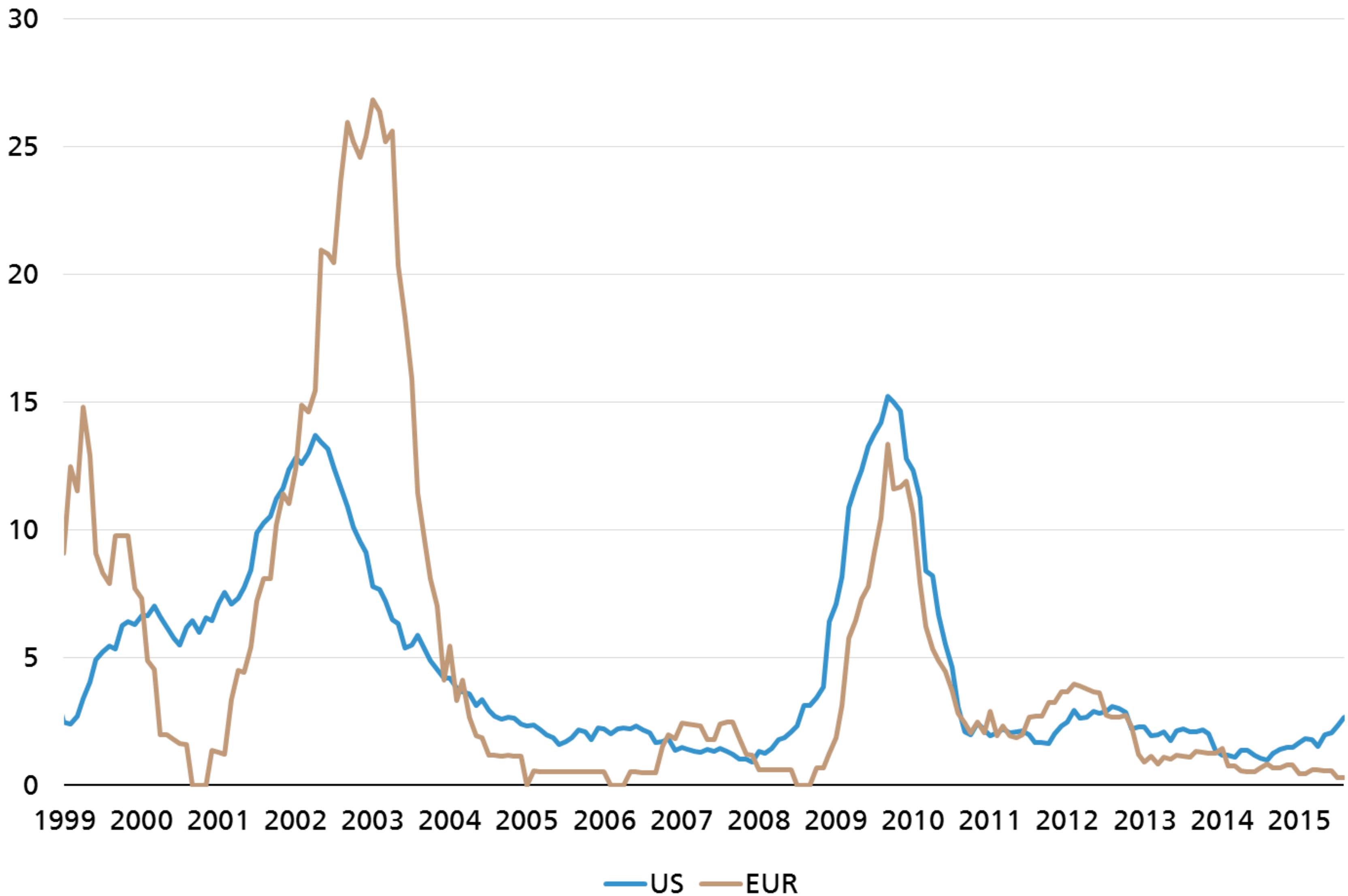
S&P 500 ex-energy net margins, quarterly



Source: FactSet, UBS, as of 19 October 2015

High Yield : US vs. Euro default rates start to diverge

12-month trailing default rates in %



Source: BoAML, UBS CIO WM, as of September 2015

'higher volatility and more modest returns are here to stay' *(Monthly Letter, October 22 2015)*

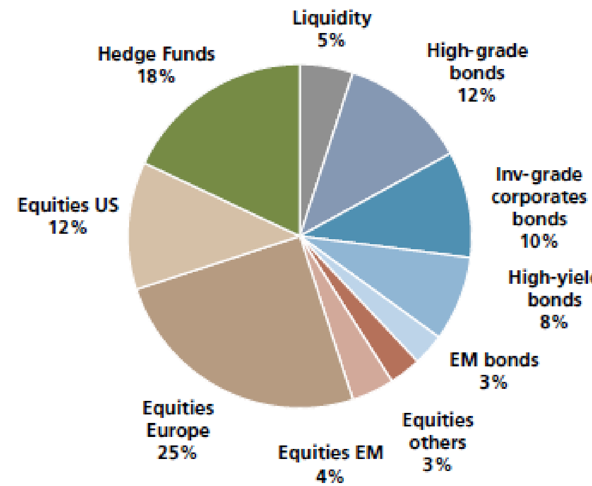
- We expect the growth/inflation mix in the major developed markets to provide a favourable backdrop for **risk assets**
- Low **inflation** readings will allow the central banks in the major developed markets to maintain very easy liquidity conditions over our forecast horizon.
- We **overweight Eurozone equities** as we expect the ECB to maintain its pace of quantitative easing (QE) despite the economic recovery. The strong commitment by the ECB to lift inflation over the medium term is causing a mix of favorable macro factors for Eurozone equities as well as credit instruments.
- We **overweight Japan equities**, as companies continue to show strong earnings growth in comparison with those based in other regions.
- We **underweight UK equities** due to a relatively weak earnings outlook.
- We prefer developed market corporate bonds over high-grade (HG) ones. We **overweight European high yield bonds** (HY), which offer an attractive yield pickup over HG ones.
- We are neutral emerging market bonds, where fundamentals look weaker than in the developed world.

Cross-asset preferences

	Most preferred	Least preferred
Equities	• Eurozone (↘) • Japan • US share buybacks and dividends • Eurozone "value" stocks • Japanese share buybacks • Water-linked investments	• UK
Bonds	• Global investment grade • European high yield • Corporate hybrids • Rising stars • European leveraged loans	• Developed market high grade bonds
Foreign exchange		
Hedge Funds & Private Markets	• Hedge funds: Favoring equity hedge	
Precious Metals & Commodities		

↗ Recent upgrades ↘ Recent downgrades

Global model portfolio (EUR)



as of 22 October 2015

Note: Portfolio weightings are for a EUR model portfolio, with a balanced risk profile (including TAA). We expect a balanced portfolio (excluding TAA) to have an average total return of 4.3% p.a. and volatility of 7.9% p.a. over the next five years.

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Source: UBS CIO WM as of October 2015

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