



CIO monthly **video**

For smartphone users: scan the code with an app like "scan"

UBS CIO Monthly **Extended**

May 2013

Published
25 April 2013

This report has been prepared by UBS AG.

Please see important disclaimers and disclosures at the end of the document. Past performance is no indication of future performance. The market prices provided are closing prices on the respective principal stock exchange. This applies to all performance charts and tables in this publication.



Table of Contents

Section 1	Base slides	3
Section 2	Asset class views	13
2.A	Equities	14
2.B	Fixed income	24
2.C	Foreign exchange	32
2.D	NTAC: Commodities, listed real estate, hedge funds and private equity	36

Section 1

Base slides

Summary

"We stick to a moderate overweight in equities and US high yield. We shift our overweight EM equities to Japan and go long USD and CAD."

- **Economy**

Recent US growth indicators have weakened, with the ISM, non-farm-payrolls, and retail sales disappointing in March. However, we believe the weakness can partly be attributed to tax hikes and sequester spending cuts, which are expected to fade. As such we believe it is likely to prove temporary. Meanwhile, we expect the Fed to taper, but not halt, QE asset purchases in 4Q13. Despite some better-than-expected economic data points in the Eurozone, such as February industrial production, recent forward-looking PMIs suggest that the Eurozone economy remains on a weak footing, and we expect the ECB to cut its refinancing rate in May. The Bank of Japan (BoJ) recently surprised with more monetary stimulus than previously expected. We foresee economic growth rising on higher government and private consumption, and core inflation climbing slowly toward positive territory. Recent regulatory measures in China are likely to weigh on sentiment in the short term but will not derail economic growth, which we expect to come in around 8% in 2013.

- **Equities**

We are sticking to our moderate overweight in equities, and remain overweight in the US, where we believe the weakness in data is likely to prove temporary. We are replacing our overweight position in emerging markets with an overweight position in Japan. Uncertainties over global growth, Chinese policy, and commodity prices could weigh on EM, while the Bank of Japan's aggressive easing policies should help support the Japanese economy and drive earnings upgrades.

- **Fixed Income**

We expect a tapering in QE from Q4 to push global yields somewhat higher. German and Japanese yields are close to historical lows, and we expect them to rise moderately along with inflation in the coming year. Within fixed income, the best investment opportunities are to be found in corporate bonds. Investment grade bonds offer a yield pickup over government bonds and low volatility, although absolute returns will likely be only modest. High yield and emerging market corporate bonds still offer potential for tighter spreads, making them attractive from a risk-return perspective. We remain overweight credit.

- **Commodities**

Precious metals have come under severe pressure recently. Gold is down 14% since the beginning of April, and silver is down 18%. The Fed signaling that it is considering tapering QE later this year, together with speculation over potential gold sales by the Bank of Cyprus, triggered the negative sentiment. We are sticking to a neutral view on commodities, given the high volatility on the asset class.

- **Foreign Exchange**

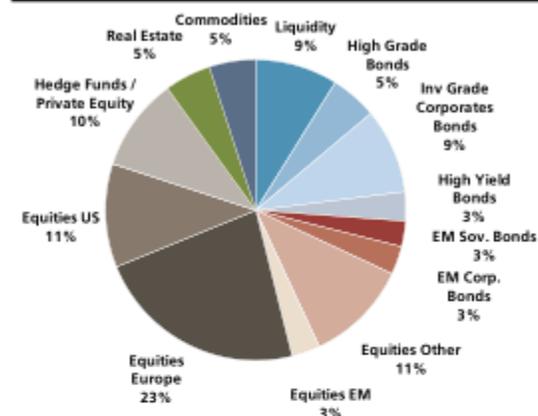
We continue to favor GBP against EUR. This week's announcement of an extension to the Funding for Lending scheme could see some MPC members back away from calls for more QE, and concerns over a change in Bank of England policy should continue to recede following March's budget. We are also overweighting USD, using CHF for funding. The US has a clear advantage in economic momentum over the Eurozone. Furthermore, we are upgrading CAD to overweight against an underweight in AUD. Recent economic indicators suggest that Canadian growth is likely to improve while we expect more economic disappointments in Australia. Furthermore, the AUD remains highly overvalued based on Purchasing Power Parity.

Cross-asset preferences

	Most preferred	Least preferred
Equities	<ul style="list-style-type: none"> • US • Japan (↗) • US mid caps • US housing • Japanese exporters • Western winners from EM growth • Water-linked investments (↗) • Relative value and equity long/short hedge funds 	<ul style="list-style-type: none"> • Canada • European telecoms
Bonds	<ul style="list-style-type: none"> • US high yield • Global investment grade credit • EM corporate bonds • Corporate hybrids • Relative value hedge funds 	<ul style="list-style-type: none"> • Too expensive government bonds
Foreign exchange	<ul style="list-style-type: none"> • Emerging markets • GBP • CAD (↗) • USD (↗) 	<ul style="list-style-type: none"> • EUR • CHF (↘) • AUD (↘)
Commodities		

↗ Recent upgrades ↘ Recent downgrades

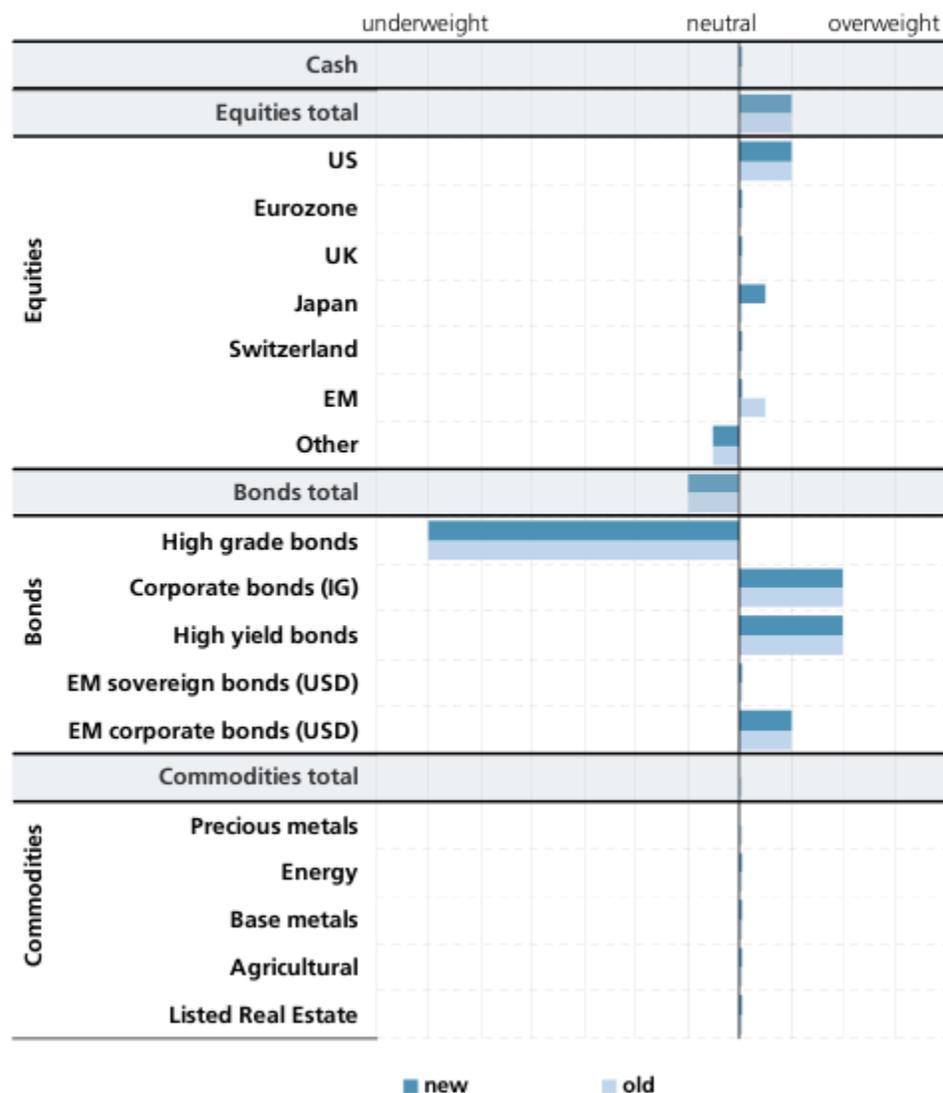
Portfolio weightings



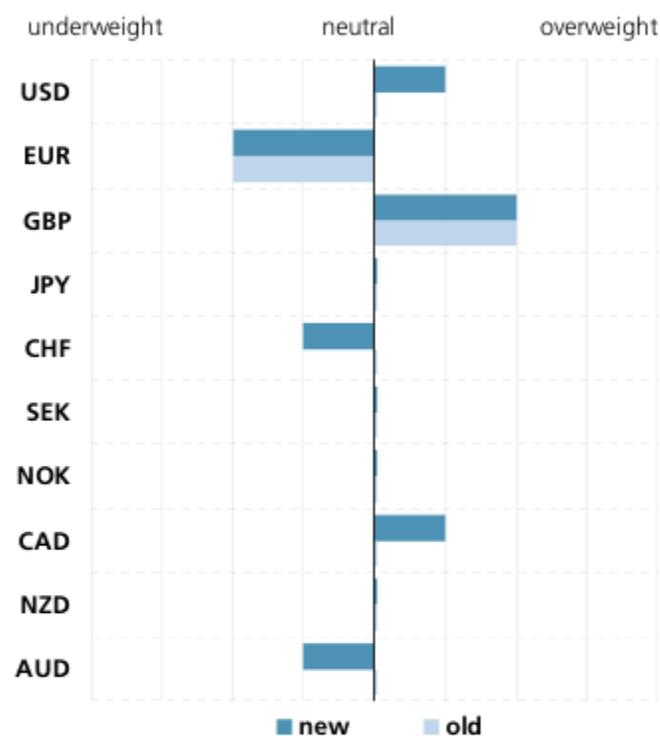
Note: Portfolio weightings are for an advisory client with a "EUR moderate" profile. For portfolio weights related to other risk profiles or currencies please contact your client advisor.

Recommended 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.

The UBS Investment House view is largely reflected in the majority of UBS Discretionary Mandates and forms the basis of UBS Advisory Mandates. Note that the implementation in Discretionary or Advisory Mandates might deviate slightly from the "unconstrained" asset allocation shown above, depending on benchmarks, currency positions and other implementation considerations.

Source: UBS CIO WM Global Investment Office – as of 25.04.2013

CIO preferred investment themes (1/2)

Liquidity & Foreign Exchange

- **Emerging market currencies: An underappreciated asset class**
The currencies of EM countries, collectively as an asset class and measured using total returns (i.e. including interest received), have the potential to contribute positively to the longer term returns of a well-diversified portfolio. We believe that this is especially relevant now that the developed world is settling into an extended period of very low interest rates.
- **GBP – the best of the majors**
The pound had come under pressure after speculation earlier in the year over potential changes to monetary policy targets. This week's announcement of an extension to the Funding for Lending scheme could see some MPC members back away from calls for more QE, and concerns over a change in Bank of England policy should continue to recede following March's budget statement. As a result, the pound is our preferred major currency.

Fixed Income

- **Yield pickup with corporate hybrids**
The corporate hybrid segment is a lesser known segment of the investment grade credit world that has lagged the broad-based spread recovery. As a consequence, we see attractive opportunities for investors with a suitable risk tolerance or a trading orientation. We expect mid to high single-digit returns on selected instruments over a 12-month period.
- **US high yield corporate bonds**
Positive economic growth, robust corporate earnings, and healthy balance sheets provide support to US high yield (HY) corporate bonds. Current yield spreads of ~478 basis points still price in a more dire economic outcome than we expect. Historically, US high yield bonds have delivered similar returns to US equities with lower volatility. We continue to believe that US high yield corporate bonds have a favorable risk/return and expect mid-single-digit returns over the next six months. Senior loans are exposed to similar positive fundamentals and offer an attractive, floating rate alternative to US HY.

- **Emerging market corporates: A growing asset class**
Within EM hard currency debt, we prefer corporate to sovereign due to its more attractive valuation and higher overall yield. Moreover, our relatively constructive current view on risk is another reason to prefer EM corporate over sovereign debt. Over a six-month horizon, we expect EM corporate bonds to deliver total returns of more than 3.5%.
- **Government bonds too expensive**
Improving economic data has already led to an increase in government bond yields in most major markets. While tight fiscal budgets and high debt burdens in the US and Europe are unlikely to allow for a large increase in interest rates, even a small further rise would lead to negative total returns on benchmark government bonds, and we believe that the risk-reward in the bonds of most weaker countries is currently poor. We therefore recommend switching out of the affected bonds, which are identified in this theme.

Equities

- **REMOVED: Emerging market equities**
On a tactical basis we are downgrading emerging market equities to neutral, and so removing them from *CIO preferred themes*. With near-term uncertainties over global growth, the future of Chinese policy, and the outlook for commodities, we foresee no catalyst to help emerging markets realize their significant longer term valuation potential.
- **Water: thirst for investments**
The demand for clean water should increase with a growing global population. However, the supply of clean water is constrained by the lack of water infrastructure in emerging markets. Climate change, urbanization and emerging markets' stronger focus on the industrial sector are also damaging the water supply. Furthermore, we have identified three short-term trends that should add earnings power for water-exposed companies – ship ballast water treatment, US shale development and desalination.

The CIO preferred investment themes represent the CIO's highest conviction, thematic investment ideas. We aim to recommend ideas that are attractive on a risk-reward basis and expected to deliver positive absolute returns. It will include the best investment themes for each of our TAA overweights, further aligning the asset allocation and themes recommendations, along with a range of other short, medium and long-term, as well as SRI, themes.

CIO preferred investment themes (2/2)

Equities

- **US mid caps: The sweet spot**

US economic data has begun to stabilize and forecasts now show an acceleration of growth in 2013. The greater domestic sales exposure of US mid caps, and their more cyclical sector make-up, give greater leverage to the US recovery. For these reasons we believe that mid-cap companies will outperform large caps in the US over the next 6–12 months.

- **REMOVED: Swiss high-quality dividends**

With the 2013 Swiss dividend payment season largely behind us, we are removing this theme from *CIO preferred*. In particular, the attraction of high dividend yielders will fade for the next few months, although high-quality companies with strong cash flows and steadily rising dividends remain attractive.

- **Japanese exporters supported by a weaker yen**

We believe that the impact of an approximately 10% weaker yen over the first quarter should start emerging in earnings results, supporting exporters' outperformance until the national election in July. Given the recent underperformance of Japanese exporters vs. domestic companies, we believe the theme of Japanese exporters is now even more attractive in a Japanese context.

- **Western winners from emerging market growth**

Despite recent concerns, emerging economies continue to grow faster than developed economies. With little need to deleverage and repair their balance sheets, Asian economies are also well positioned to continue outpacing their Western peers in the years ahead. We have identified companies from a variety of sectors in Europe, the US and Japan with significant exposure to the rapidly growing emerging regions. We believe a diversified portfolio of them will reward investors seeking to profit from the robust demand growth in emerging economies.

- **No turnaround for European telecoms**

We expect further relative downside in European telecoms in the coming months. Operating results, free cash flows, and dividends will likely stay under pressure, and further adjustments to consensus forecasts are required, in our view. Share price developments are likely to remain erratic and we recommend continuing to avoid the sector.

- **US housing: The long grind higher**

US housing activity has been recovering for about a year. We believe that the recovery is sustainable and will not be hampered by the negative forces arising from fiscal austerity and sequestration. We are also slightly more optimistic than consensus regarding the speed of recovery. A sustainable US housing recovery provides opportunities for equity investments in companies with high exposure to the housing market that are still valued attractively.

Hedge Funds & Private Equity

- **The place to be in hedge funds**

The favorable conditions for relative value remain unchanged in 2013. A continued improvement in global growth and the supportive monetary policy backdrop support spread products such as corporate bonds and securitized loans. Moreover, the decline in the number of market participants due to the Volcker rule should provide more opportunities for strategies such as fixed income arbitrage. *We also like equity long short*, which should benefit from stronger equity markets. The associated lower stock correlations should enable managers picking under- and overvalued stocks to perform well.

Commodities

- **REMOVED: Platinum: Attractively valued**

Platinum remains our most preferred precious metal. The lack of supply growth and an improving economy in 2H13 should enable platinum prices to move higher later this year. That said, volatility could remain elevated in the near term given platinum's exposure to gold's sell-off and the ongoing uncertainty regarding gold's investment demand. We are removing it from our *CIO preferred themes* due to changed risk/return characteristics.



= New investment theme

Global economic outlook – *Summary*

Key points

- We expect moderate US growth over the next six months after a dismal 4Q12 performance and 1Q13 rebound.
- In the Eurozone we think that economic activity is slowly recovering.
- In the emerging markets we expect real GDP growth of around 5% in 2013, with moderately rising inflation to 2H13.

CIO view (Probability: 70%*)

- We expect US growth to stay moderate over the next six months after a dismal 4Q12 performance followed by growth acceleration in 1Q13. Stronger private sector demand and reaccelerating inventory accumulation will be offset by fiscal tightening and fiscal policy uncertainty. In conjunction with the debt ceiling debate in July/August and the expected passage of the FY2014 budget by September, we expect further budget agreements to add more flexibility to the implementation of the sequester spending cuts, but we don't expect any additional cuts. We estimate the 2013 fiscal drag at 1.5%, with a 1.2% GDP impact as households can lower their savings to buffer the drop in after-tax income. We expect the Fed's open-ended QE3 program to last until mid-2014 with some tapering off in 4Q13. Total purchases will likely amount to USD 1.3tn, bloating the Fed's balance sheet to USD 4tn at year-end 2013.
- Latest economic data in the Eurozone points to a modest weakening of quarter-on-quarter economic growth in the second quarter. This dynamic is mainly driven by lower business surveys following the Italian elections and the Cyprus crisis. It remains to be seen how strong the impact will be. Our base case of a stabilizing economy in 1H remains intact (in line with consensus) given economic data so far. The ECB is hesitant to cut rates and wants first to see more evidence of weakening growth in the second quarter and thus remains in wait-and-see mode for now. Due to the weakening of the business surveys, the risk of a rate cut in the second quarter has increased substantially though.
- We cut our GDP growth forecast for Brazil to 3.3% (from 4% previously) for 2013 and to 3.4% for 2014 (from 3.6%) due to a less benign external environment and weaker household consumption. In China, we expect growth of around 8% in coming quarters, with slightly better sequential growth in 2Q13. Inflation will gradually rise in 2H13 and could trigger a more neutral policy stance. Modest headwinds may come from real estate, credit, and liquidity policies. Indian inflation is on a slowing trend and we expect some more rate cuts in the coming months. We see growth of around 6% over the next 12-18 months. In Russia, growth is slowing, but lower inflation provides room for some monetary policy support in the coming months. We expect Russian growth of 3.5% in 2013.

➤ Positive scenario (Probability: 15%*)

- The Eurozone crisis abates. Financial market conditions recover, mitigating the drag from fiscal austerity.
- Growth in Western Europe accelerates and the US economy grows above its 2.5% trend.

⚡ Negative scenario (Probability: 15%*)

- There are three key downside risks to the global economy: 1) a significant escalation of the Eurozone debt crisis; 2) a protracted government shutdown and a sharper fiscal contraction in the US; and 3) a sharp deceleration of the Chinese economy. Each of these risks could precipitate a significant downturn in the global economy.

Key dates

1 May	US: FOMC monetary policy decision
2 May	Eurozone: ECB press conference
3 May	US: Nonfarm payrolls and unemployment rate for April
10-15 May	China: New bank loans, total social financing, money supply (April)
22 May	Eurozone: EU Council

Sluggish expansion

Global growth expected to be 2.9% in 2013

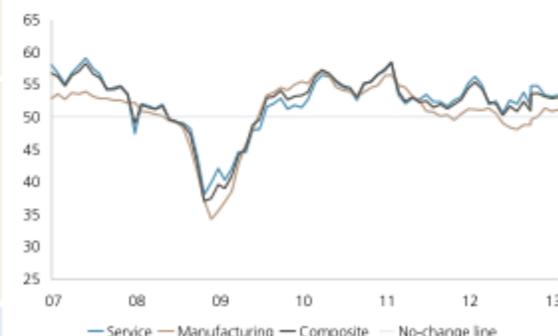
	Real GDP growth in %			Inflation in %		
	2012F	2013F	2014F	2012F	2013F	2014F
Americas						
US	2.2	2.3	3.0	2.1	1.7	2.3
Canada	2.0	2.0	2.9	1.6	1.9	2.5
Brazil	0.9	3.3	3.4	5.8	6.2	6.5
Asia/Pacific						
Japan	2.0	1.0	1.6	0.0	0.1	1.8
Australia	3.6	2.8	3.8	1.8	2.4	2.6
China	7.8	8.0	8.0	2.7	3.5	4.0
India	5.0	6.5	7.0	8.5	7.4	7.0
Europe						
Eurozone	-0.5	-0.4	0.7	2.5	1.7	1.6
Germany	0.9	0.7	1.3	2.1	1.7	1.6
France	0.0	-0.3	0.7	2.0	1.0	1.3
Italy	-2.4	-1.2	0.3	3.3	1.8	1.8
Spain	-1.4	-1.7	0.0	2.4	2.4	1.5
UK	0.2	0.7	1.1	2.8	3.1	3.2
Switzerland	1.0	0.9	1.3	-0.7	0.0	0.8
Russia	3.4	3.0	4.0	5.1	6.5	5.6
World	2.6	2.9	3.4	2.9	2.8	3.2

Source: UBS, as of 23 April 2013

In developing the CIO economic forecasts, CIO economists worked in collaboration with economists employed by UBS Investment Research. Forecasts and estimates are current only as of the date of this publication and may change without notice.

Global purchasing manager indices consolidating at expansionary levels

Global PMIs



Source: JP Morgan, Bloomberg, UBS; as of April 2013
 Note: Past performance is not an indication of future returns.
 *Scenario probabilities are based on qualitative assessment.

Key financial market driver 1 – *Eurozone crisis*

Key points

- We expect the Eurozone to gradually emerge from recession. Fiscal policy will be less restrictive than in 2012.
- The ECB provides a credible backstop to contain debt crisis-related break-up risk. The rate cut probability has increased.
- We think that Spain is at risk of needing external support and Italy will likely call early elections in late 2013 or early 2014.

CIO view (Probability: 70%*)

Austerity and weak growth

• Economic data so far suggests that the recession in the Eurozone has eased since the beginning of 2013, with France a key exception, though business surveys weakened following the Italian elections and the Cyprus crisis. Real activity data so far supported our base case of a stabilizing economy in the first half of the year (in line with consensus), but the impact on business confidence has created downside risks for the second quarter and could delay the fragile recovery. The ECB prefers to keep its policy rate unchanged despite a fall in consumer price inflation to 1.7% in March. The risk of a rate cut in the second quarter has increased substantially though following the weaker business surveys.

• We believe that the risk of Spain requiring a support program in 1H13 remains high. The continuing recession, a much higher than initially planned budget deficit of 5.5-6%, and record-high funding needs of more than EUR 130bn are contributing to the risk. We see an about even chance of Moody's downgrading the country's credit rating to junk over the next three months, which may impair the country's access to funding at affordable rates.

• Italian bond yields remain vulnerable to contagion from other peripheral countries due to the uncertainty over the timing and outcome of early elections. With a pro-reform government, Italy should remain investment grade rated.

• Ireland and Portugal continue to recover gradually, but are highly indebted. A failure to fully return to the bond markets later this year may lead to the need for a second support program. We think that Greece requires a large further debt haircut and exit risks will increase if the current government loses its majority over additional austerity demands from the IMF, possibly in 2H13. We expect France to deliver negative headlines in 1H13 because of rising concerns about its fiscal slippage on the back of economic weakness.

• Even with OMT support, longer term peripheral yields should stay sensitive to countries' debt trajectories as debt levels remain very high. Banking supervision at the ECB will likely be operational by 2014, but a banking union is unlikely to be formed in the next few years, with the most controversial aspect being joint deposit insurance.

➤ Positive scenario (Probability: 15%*)

Growth and fiscal stabilization

• Bond yields converge further as peripheral countries consolidate their budgets and economic activity recovers faster than expected. Italy forms a government that continues the reform path.

⚡ Negative scenario (Probability: 15%*)

Major shock

• Major shocks include Spain and Italy being cut off from bond markets, i.e. requiring all new funding through ESM/IMF loans, with European rescue funds only able to cover them until the end of 2013; resistance from core countries against further support; a near-term Portuguese debt restructuring; a Greek euro exit in 1H13; massive fiscal slippage in France; or a major external shock.

Key dates

2 May	ECB press conference
22 May	EU Council
23 May	PMI Composite for May (flash)

Purchasing managers' indices still signal economic weakness



Source: Bloomberg, UBS; as of 23 April 2013

Spreads of Spanish and Italian 5-year bonds In %



Note: Past performance is not an indication of future returns.
* Scenario probabilities are based on qualitative assessment.

Key financial market driver 2 – *US economic outlook*

Key points

- US growth should remain moderate, with accelerating private sector growth partially offset by fiscal tightening.
- Inflation is expected to stay slightly below the Fed's target of 2% over the next six months.
- The Fed's open-ended QE3 has dampened the risk to growth but has not dramatically boosted activity.

CIO view (Probability: 70%*)

Moderate expansion

- We expect the economy to stay on a moderate growth path and the unemployment rate to come down gradually over the next six months. UBS forecasts real GDP growth of an annualized 3.0% in 1Q13 (consensus: 2.9%) and 2.9% in 2Q13 (consensus: 1.6%), as private sector demand remains solid and very lean inventories give way to faster inventory accumulation. Inflation should stay slightly below the Fed's target of 2%.

- Relative to 2012 policy, Congress has raised taxes and is cutting spending. We estimate the total federal budget effect to be 1.5% of GDP in 2013. However, the 2013 GDP growth impact will likely be more muted as households can lower their savings to offset the drop in after-tax income caused by higher tax rates. We estimate a real GDP growth impact of 1.2% in 2013. So far the impact from higher taxes has been negligible as households significantly lowered their savings rates, which we expect to be increased moderately in the future.

- We think the sequester spending cuts will remain in place but that new budget negotiations related to a necessary increase in the debt ceiling in July/August will provide more flexibility in implementing them. The possible political rift and insufficient cuts to stabilize the medium-term debt-to-GDP ratio will likely lead to another US sovereign rating downgrade.

- The Fed's open-ended QE3 program linked to labor market conditions – USD 85bn in Treasury and agency MBS purchases per month – mitigates risks to growth, but has not dramatically boosted growth prospects. We expect QE3 to last until mid-2014 with some tapering off in 4Q13 and total purchases of USD 1.3trn.

➤ Positive scenario (Probability: 15%*)

Strong expansion

- Growth accelerates above 3%, propelled by expansive monetary policy, a resolution to the US long-term debt problem or less austerity, strong growth in housing investment, and improved business and consumer confidence. This leads to higher inflation, which the Fed responds to by halting QE3 and raising rates sooner than in our base case.
- Faster-rising tax collection enables the government to cut deficits more aggressively. Fiscal policy tightens by more than 1.5% of GDP in 2013.

➤ Negative scenario (Probability: 15%*)

Growth recession

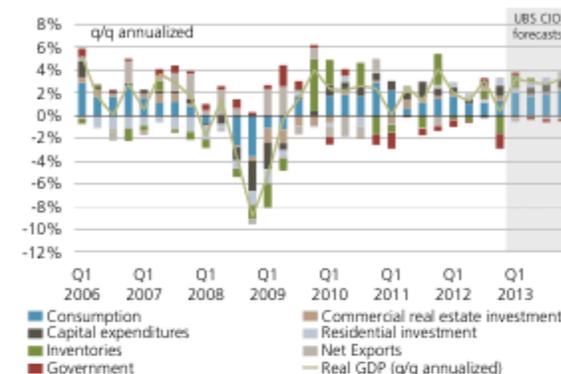
- US fiscal deleveraging and an escalating Eurozone crisis weigh on the cyclical recovery. Falling profit margins weigh on business capital expenditures. Real GDP growth deteriorates. The Fed makes massive purchases of agency MBS and Treasuries under its QE3 program.
- Political gridlock makes the government dysfunctional, leading to a technical Treasury default or a protracted government shutdown. The US credit rating is downgraded by multiple notches.

Key dates

1 May	FOMC monetary policy decision
1 May	ISM manufacturing purchasing managers' index for April
3 May	Nonfarm payrolls and unemployment rate for April
13 May	Advance retail sales for April
17 May	University of Michigan consumer sentiment for May (preliminary)

US growth to rebound after 4Q12 slump

US real GDP and its components, quarter-over-quarter annualized in %



Source: Thomson Datastream, UBS; as of 23 April 2013

US Current Activity Index (CAI) consistent with some growth moderation in March

US real GDP growth, actual and implied by US CAI, in %



Note: The US Current Activity Index (CAI) is a composite of 25 growth indicators that correlate strongly with real GDP growth.

Source: Bloomberg, UBS; as of 8 April 2013

Key financial market driver 3 – *China growth outlook*

Key points

- We expect stable Chinese growth of 8% with downside risks this year.
- Stable growth and low inflation may delay the expected tightening measures in the near term.
- Inflation will rise only gradually and could trigger more neutral monetary policies later this year.

CIO view (Probability: 70%*)

Stable growth

- We expect stable Chinese growth in the coming quarters. New starts in investment have been on the rise since the government reshuffle and the start of the construction season in April. Consumption is likely to recover due to the fading influence of government anti-corruption and frugality campaigns. The robust total social financing growth (TSF, a measure of total credits) in recent months should create more economic momentum as well. That said, given the disappointing performance in 1Q13 and the slow progress in economic reforms, we see downside risks to our full-year GDP growth forecast of 8%.
- On the policy front, we believe stable growth and low inflation may delay the expected tightening measures in the near term. A number of key cities have announced details of local property tightening measures in response to the "national five measures" first released by the State Council in February. Overall, the local execution details are more relaxed than expected, with the exception of Beijing, which saw higher home price increases this year. We continue to expect a targeted tightening in tier one and two cities, which should have a limited impact on the economy.
- On the credit/liquidity side, the new rules on wealth management products will improve regulatory oversight and sustain long-term financial development. The extent of the new regulatory measures will still depend on the growth outlook. We do not expect any interest rate or reserve requirement ratio hike in the coming six months, but the central bank will continue to use repo operations to manage relatively low interbank rates.
- Inflation should not trigger immediate policy tightening in the near term, in our view, provided stable growth and low upstream price pressure prevail. We have trimmed our CPI inflation forecast for 2013 to 3% from 3.5%. Inflation will rise only gradually higher, which could trigger a more neutral monetary policy stance later this year.

➤ Positive scenario (Probability: 15%*)

Growth acceleration

- Economic momentum accelerates in 2013. This would require more substantial and effective fiscal, monetary and credit policy support from the government and possibly also a fast improvement in the Eurozone debt crisis and the US fiscal and debt issues.

⚡ Negative scenario (Probability: 15%*)

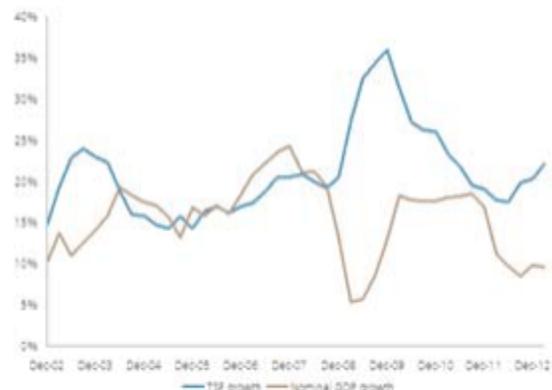
Sharp economic downturn

- Another round of global financial stress or recession, likely due to the Eurozone debt crisis or a fiscal policy-induced downturn in the US, would weigh on Chinese exports and investments.
- Despite soft aggregate demand and economic activity, residential property prices and/or consumer prices rise rapidly, which constrains policy maneuverability and its effectiveness in stimulating economic growth.
- A major crackdown on shadow banking tightens liquidity and credit conditions and hence depresses growth.

Key dates

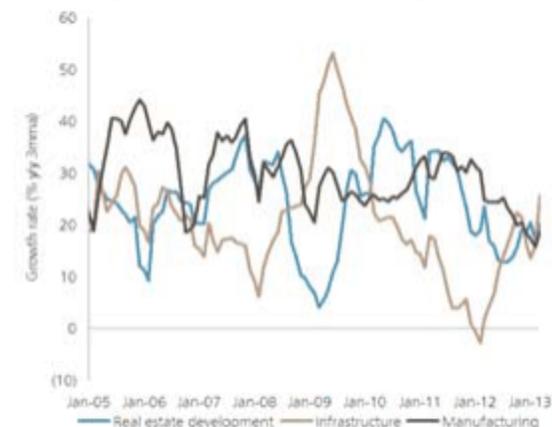
08 May	Trade data (April)
10-15 May	New bank loans, total social financing, money supply (April)
13 May	Industrial production, fixed asset investment, retail sales (April)

The potential deceleration in TSF growth should not detract from economic growth



Source: Bloomberg, UBS; as of April 2013. Total social financing includes credits outside of the banking sector

Investment, especially in infrastructure and property, will continue to drive growth



Source: Bloomberg, UBS; as of April 2013

Note: Past performance is not an indication of future returns.
* Scenario probabilities are based on qualitative assessment.

Section 2

Asset class views

Section 2.A

Asset class views

Equities

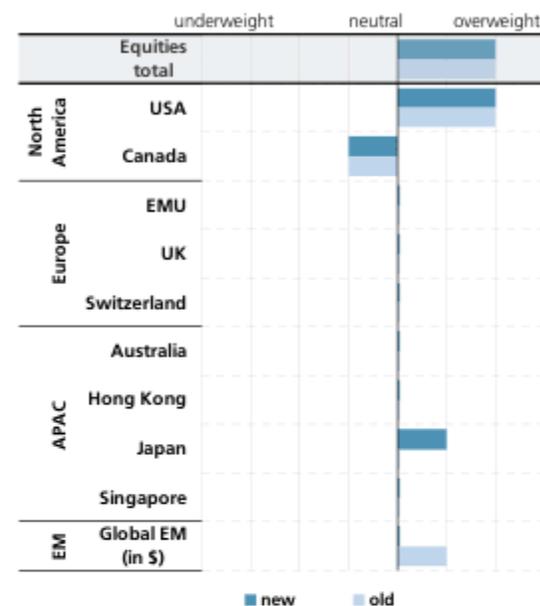
Equities overview

Global equity markets – Key points

- We recommend an overall **overweight allocation in equities** (see summary on slide 3).
- We are keeping our **preference for US equities**. Company earnings keep moving higher. Despite some volatility in recent economic data domestic demand is holding up solidly, underpinning revenue growth. With the labor market recovering only gradually wage pressure remains muted. Thus, margins hold up well as the Q1 earnings season shows.
- We are maintaining our **neutral stance on Eurozone equities**. Value is attractive compared to global equities, but economic growth and therefore earnings dynamics remain relatively weak.
- We **have a neutral stance on emerging market equities**. Corporate earnings have remained depressed lagging especially the dynamics in the US and Japan. Economic data in key countries has failed to show an acceleration. The earnings weakness is balanced by attractive valuations.
- We **prefer Japanese equities relative to global equities**. The bold monetary policy easing announced by the Bank of Japan at the beginning of April is expected to lead to further rises in Japanese risk assets. The sharp drop in the yen since autumn last year supports strong earnings growth.
- We are keeping a **cautious position on Canadian equities**. Slowing loan growth keeps Financials' margins under pressure. The recent slump in the gold price caps the earnings upside of mining companies. Oil price weakness is a headwind for the energy sector which comprises a quarter of Canada's market capitalization.
- We remain **neutral on Australian equities**. The earnings dynamics of Australian companies continue to lag those of other markets. While the market is expensive relative to global equities investors like its high dividend yield.
- We **are neutral on Swiss equities**. We like the solid earnings generation and sound balance sheets of Swiss companies. The market is already trading at a premium to global equities.
- We are keeping a neutral view on **UK equities**. While recent currency weakness supports earnings, the fall in commodity prices provides a headwind with Energy and Materials representing 30% of the market capitalization. The market currently trades at a slightly higher discount to global equities than it did over the last ten years.

- **We have a preference for the Consumer Discretionary** sector. It should benefit from solid consumer demand in major countries. Revenue and earnings growth should continue to be superior driven by increased consumer spending in EM which we view as structural. The current macro environment favors the high-end consumers.
- We are **overweight the IT sector globally**. While current price momentum is weak, the valuation is very attractive and cash flow generation is strong. We think IT should benefit from increased corporate and consumer spending.
- We are **overweight Consumer Staples and Healthcare** which offer superior and long-term earnings growth with low volatility and high free cash flow generation. Both sectors have strong balance sheets, and attractive dividend yields as well as dividend growth prospects. Within Healthcare, we prefer European companies over US ones.
- We have an **underweight position in Telecoms and Utilities** where revenue growth is weak and the earnings outlook muted. While pricing/margin pressure is high for telecoms, utilities suffer from a tough business environment (weak demand, regulatory pressure, and lower power prices).
- With expected gradual improvement in leading indicators and early signs of a better global macro-economic environment, **Industrials** should benefit. However, we **remain neutral** as the current sector valuation is fair.
- Despite some headwinds (e.g., regulatory risks, low interest rates) in major regions, earnings trends for **Financials** are improving. We have **neutral stance globally**.
- We are neutral on **Materials and Energy**. Free cash flow yield is relatively low and margins are under pressure.

Preferences (six months)



Note: Preference in hedged terms (excl. currency movements)

Sector preferences within global equity markets

Current most preferred sectors	Current least preferred sectors
Cons Discretionary	Telecom
Consumer Staples	Utilities
Health Care	
IT	

Source: UBS

S&P 500 (24 April): 1,579 (last publication: 1,559)

S&P 500 (six-month target): 1,625

UBS view

- We are maintaining our preference for US equities relative to other developed equity markets. The US economy is forecast to expand at a solid pace even if the strong economic dynamics of the first quarter is unlikely to last in coming months. The recovery in the housing market keeps supporting the domestic economy.
- The unemployment rate remains high, keeping wage pressure low. By keeping costs under control firms are forecast to hold up margins in 2013 at historically high levels.
- We continue to forecast solid earnings growth of 5–7% for 2013 due to a mix of positive revenue growth and some margin expansion.
- The Fed's pro-growth monetary policy stance is a clear advantage for the local equity market. We expect the bond buying by the Fed to continue, supporting risk assets.
- US equities are forecast to gradually advance with earnings growth. US equities currently trade at about 15.0 times realized earnings. We foresee some further revaluation upside to slightly above 15 times by year-end.

➤ Positive scenario

S&P 500 (six-month target): 1,750

- Accelerating US and global economy reduce risks to company earnings. Investors begin to shift funds into more cyclical sectors such as Industrials, IT and Materials in light of better growth prospects. In this scenario, we would expect earnings to grow by around 10% in the next 12 months, and the trailing P/E multiple to expand to around 16x.

⚡ Negative scenario

S&P 500 (six-month target): 1,325

- The US and global economy slide into a recession; failed debt ceiling negotiations might add additional drag. Given such an outcome, corporate earnings would fall over the coming 12 months, and we would expect risk aversion to rise sharply. We would also expect the P/E multiple to contract towards 12.7x trailing earnings.

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

Business sentiment

The ISM is the key indicator for US manufacturing and services. **Key dates: 1 May, ISM manufacturing; 3 May, ISM non-manufacturing**

Labor market

Improvement in the labor market supports stronger consumption. **Key date: 3 May, US labor market report for April**

The Fed

Hints on its monetary policy stance influence equities. **Key date: 1 May, FOMC rate decision**

Earnings season

Earnings reporting season for Q1 2013: About 219 companies are still reporting from 29 April onwards.

Recommendations

Tactical (six months)

- We trim our exposure to cyclical companies by downgrading Materials to neutral but remain overweight Industrials and IT, which should benefit from low valuations and a moderate pickup in global economic activity.
- We raise Consumer Discretionary to overweight in order to gain more exposure to improving US housing and emerging market consumer growth.
- We remain cautious on Utilities, Healthcare and Telecoms, where valuations have been pushed to lofty levels and the risk / reward is unattractive.

Strategic (one to two years)

- We like medium-sized US companies, which are more exposed to the US domestic economy than large-sized companies and should post good longer term earnings growth.

Current most preferred sectors

Industrials
IT
Materials

Current least preferred sectors

Health Care
Telecom
Utilities

Source: UBS

Note: Past performance is not an indication of future returns.

Euro Stoxx (24 April): 271 (last publication: 274)

Euro Stoxx (six-month target): 277

UBS view

- We are maintaining a neutral stance on Eurozone equities. Weak earnings growth is balanced by attractive valuation.
- While the sovereign debt crisis keeps lingering, risks have been clearly reduced through ECB's conditional bond-buying program (OMT) (see slide 9).
- Further support by the ECB through a rate cut seems likely after the recent deterioration in leading economic indicators.
- As Spain has major refinancing needs this year, problems in issuing bonds could weigh on Spanish equities. However, the OMT is clearly limiting downside risks.
- Trailing earnings of Eurozone companies still do not show signs of recovery. The recession in large parts of the Eurozone poses a difficult environment for companies. Earnings dynamics are therefore lagging other regions – especially the US.
- Consensus earnings growth expectations for 2013 (bottom-up) have moved up to 8% year-over-year for the Euro Stoxx companies on aggregate. This increase in the growth rate stems from a lower base for comparison as realized earnings for 2012 came down further. Still, we only forecast 3% to 5% earnings growth in 2013.

➤ Positive scenario

Euro Stoxx (six-month target): 330

- Global economic growth reaccelerates and Eurozone growth starts to recover, enabling mid-single-digit earnings growth over the next six months. The trailing P/E ratio could re-rate to close to 15x from the current reading of 12.7x.

⚡ Negative scenario

Euro Stoxx (six-month target): 200

- Recession and the debt crisis lead to renewed market pressure. However, downside risks due to the debt crisis have become less severe since the ECB has put its bond-buying program (OMT) in place.
- Earnings could fall about 5% to 10% from current levels in the coming six months, and the trailing P/E ratio could drop to a level of 10.5x over a six-month period.

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

Growth indicators

Economic growth is important to avoid a flare-up of the debt crisis.

Key dates: 1 May, final PMI manufacturing, EMU; 3 May, final PMI services, EMU; 23 May, preliminary PMI manufacturing and services, EMU; 24 May, Ifo business sentiment index, Germany

Policy action

Decisions by European politicians and the ECB affect the course of the debt crisis.

Key date: 2 May, ECB interest rate decision

Recommendations

Tactical (six months)

- We reiterate or overweight on Consumer Staples and Healthcare, which offer good free cash flow generation and solid balance sheets. Earnings and dividends should continue to grow while dividend yields are attractive.
- We continue to like Consumer Discretionary as we see evidence of strengthening global growth in the second half of the year, which should support sector earnings.
- We confirm our underweight on Materials as valuations are too high.
- We are negative on Utilities and Telecoms with earnings trends negative, balance sheets stretched and dividends at risk.

Strategic (one to two years)

- We have a preference for stocks paying high-quality dividends.
- We like companies with high revenue and earnings exposure to faster growing emerging markets.

Current most preferred sectors

Cons Discretionary
Consumer Staples
Health Care

Current least preferred sectors

Materials
Telecom
Utilities

Source: UBS

Note: Past performance is not an indication of future returns.

FTSE 100 (24 April): 6,432 (last publication: 6,433)

FTSE 100 (six-month target): 6,515

UBS view

- We are maintaining our neutral stance on UK equities. Earnings are not falling anymore. The stabilization over the last three months in the earnings dynamics is broad based across sectors with especially Financials and Healthcare seeing improvements.
- The recent weakness in the British pound supports corporate earnings as FTSE 100 companies generate over 70% of earnings overseas (translation effect).
- We see overinvestment in the mining industry as a structural headwind to earnings for the Materials sector. Short-term, the recent fall in commodity prices weighs on earnings of Materials companies, which comprise about 12% of the market capitalization.
- Earnings dynamics in the Energy sector – the second largest sector in the UK – are lackluster. Due to a 15% drop in the Brent oil price since February the earnings picture is not expected to improve over the next months.
- UK equities offer a relatively high dividend yield, and the P/E multiple of 12.4 times realized earnings is below the P/E of global equities. However, UK equities have traded at such a discount to global equities for most of the past 10 years. The cheapness of UK equities is balanced by a relatively weak earnings outlook. We keep a neutral stance.

➤ Positive scenario

FTSE 100 (six-month target): 7,300

- A rapid strengthening in global growth and recovering demand from emerging markets leads to fast-rising commodity prices, helping the Energy and Materials sectors lead the market higher. The market could re-rate to a P/E multiple of 13.5x, and we would expect earnings growth of close to 10% over 12 months.

➤ Negative scenario

FTSE 100 (six-month target): 5,025

- A global recession drags down UK earnings by 15% to 20% over 12 months. The market's traditionally defensive characteristics would only partly offset its strong exposure to commodity-related sectors. We would expect the trailing P/E multiple to drop toward 10.5x.

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

Growth indicators

Business survey indicators and consumer spending data provide information on economic developments in the UK. **Key dates: 1 May, PMI manufacturing; 3 May, PMI services**

Commodity prices

Energy and Materials together comprise about 30% of the UK market. Developments in commodity prices affect earnings estimates.

Policy action

Loose monetary policy by the Bank of England supports equities. **Key date: 9 May, Bank of England policy meeting**

Recommendations

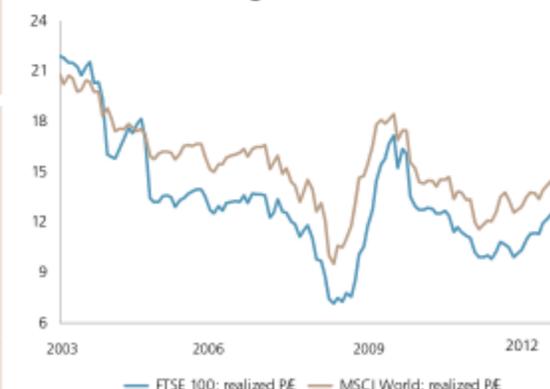
Tactical (six months)

- Dividends offer an attractive real income stream in a low-yield environment. We continue to highlight our preference for companies with high-quality dividends, given the recent decline in government bond yields. In our view, those companies offering sustainable well covered dividends along with the potential for dividend growth will outperform.
- We like companies with strong sales exposure to the higher growth regions, like the US and emerging markets.

Strategic (one to two years)

- The UK's dividend yield of close to 4% will continue to look attractive to income-seeking investors.
- Companies with pricing power remain a preferred theme.

UK market trades at a P/E discount, based on realized earnings



Source: Thomson Reuters, UBS; as of 26 April 2013

Note: Past performance is not an indication of future returns.

UBS view

- We are neutral on Swiss equities relative to global equities. Swiss companies are internationally well diversified, with almost two-thirds of revenues generated in the US and emerging markets. This provides a basis for solid revenue and earnings growth, despite challenging economic conditions in Europe.
- Swings in global manufacturing activity or commodity prices affect Swiss companies' earnings less than those of companies in other countries because the Consumer Staples and Healthcare sectors comprise half of the market capitalization.
- Since last year, currency movements are no longer a drag on Swiss corporate earnings. Nonetheless, unlike in 2012, we currently expect only minor currency support for 2013 corporate profit growth.
- In an environment of moderate economic growth, we like companies with decent earnings growth and solid balance sheets. Unfortunately, these characteristics have their price. Swiss equities trade at a higher valuation than their global peers. Still, the dividend yield of around 3% remains attractive, especially on a historical basis.

SMI (24 April): 7,860 (last publication: 7,848)

SMI (six-month target): 8,000

➤ Positive scenario

- Eurozone economic growth reaccelerates considerably, providing further relief to Swiss financials and exporters. Defensive sectors would likely be left behind in a strong global relief rally. In this scenario, we would expect the equity market P/E to trade at around 16x and earnings to grow by 6% over the next six months.

SMI (six-month target): 8,425

⚡ Negative scenario

- The global economy slides into a recession. Despite offering less cyclically sensitive products, Swiss companies would also feel the drop in global demand. In this scenario, corporate earnings are likely to drop slightly over the next six months and we would expect P/E to contract toward 13x.

SMI (six-month target): 6,325

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

Interest rates and exchange rates

Announcements of domestic interest rates and exchange rate decisions: **1 May, SNB meeting**

Economic indicators

Announcements of key domestic economic indicators: **2 May, PMI manufacturing index; 31 May, KOF Swiss leading indicator**

Corporate announcements

Important corporate result announcements: **30 Apr, Clariant, Geberit & UBS; 2 May, Swisscom & Swiss Re; 5 May, Transocean; 7 May, Adecco, OC Oerlikon & Panalpina; 8 May, Holcim; 15 May, Julius Bär; 16 May, Gategroup, Richemont & Zurich; 21 May, Sonova; 23 May, Swiss Life**

Recommendations

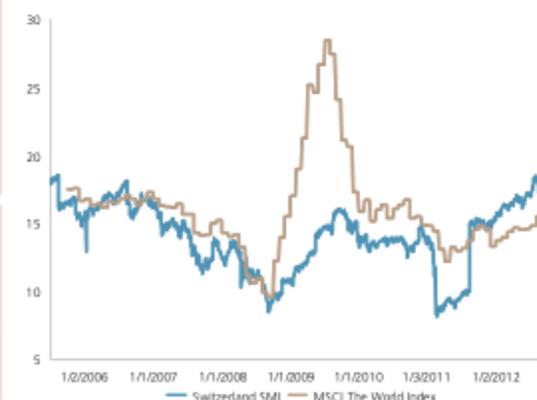
Tactical (six months)

- We like stocks paying high-quality dividends, including companies paying income tax-exempt dividends.
- We favor mid caps over large and small caps.
- Within defensives, we favor the Healthcare and Consumer Staples sectors.
- Among the cyclical companies, we prefer those with broad emerging market exposure and/or cheap valuations.

Strategic (one to two years)

- We favor leaders regarding the two key Swiss success factors: innovation and globalization.

Swiss market valuation relative to world equities based on P/E ratio



Source: FactSet, UBS; as of 15 April 2013

Note: Past performance is not an indication of future returns.

Japanese equities

Preference: **overweight**

Topix (24 April): 1164 (last publication: 1046)

Topix (six-month target): 1225

UBS view

- We expect earnings growth of 40% over the upcoming 12 months. This relatively high year-over-year growth rate reflects to a large extent the sharp weakening of the yen from 80 yen/US-dollar to near 100 yen/US-dollar since last autumn. The three arrows of Abe's policy (monetary policy, fiscal policy and structural reforms) should stimulate economic growth in the coming months and thereby support a strong earnings dynamics of Japanese companies.
- On April 4, the Bank of Japan introduced its new quantitative and qualitative monetary easing program. The bold easing aims at ending Japan's deflationary period and achieve 2% inflation within two years. The measures include doubling BoJ's monetary base and JPY 50 trillion JGB purchasing every year. We expect the BoJ's action to influence asset prices positively via three channels: 1) compression of interest rates and risk premia, 2) portfolio rebalancing towards real assets and 3) inducing expectations of inflation.
- The Abe administration's expansionary fiscal stimulus is expected to create an economic uplift and inflation for the next two years, though we do not expect these measures to lead to sustainable higher GDP growth in the long run.
- We expect the TOPIX (trailing) P/E to drop to around 18.7 over the coming months, mainly due to the earnings recovery; the strong earnings recovery should lead to further outperformance of Japanese equities.

➤ Positive scenario

Topix (six-month target): 1,365

- Stronger global demand and stabilizing European markets lead to increased risk taking. Falling risk aversion might lead to a further weakening of the yen, providing an additional boost to earnings. We would expect about 60% earnings growth over the coming twelve months with the TOPIX target based on 20x trailing P/E.

⚡ Negative scenario

Topix (six-month target): 850

- Sluggish global economic growth leads to weak exports and yen strengthening, triggering negative earnings surprises. The US dollar/Japanese yen rate strengthens below 90 on a sustained basis. As the BoJ committed to bold quantitative easing we see downside risk to the yen as more limited. Heightened risk aversion would then lead the P/E ratio to contract to 17x and earnings to fall during the upcoming six months.

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

BoJ's monetary policy changes

The policy meeting on 26 April will be the second one under the new BoJ governor Mr. Kuroda. We do not expect the Bank to change its monetary policy, but Kuroda's statement may give us the BoJ's intention. **Key date: 26 April, BoJ policy meeting**

Domestic economy's recovery

BoJ will release April Tankan Survey, which includes Japanese companies' funding situation and business sentiment. **Key date: 1 May, BoJ's Tankan Survey**

Recommendations

Tactical (six months)

- Since a weaker yen directly contributes to the earnings of Japanese exporters (translation effect), we prefer them. Higher inflationary expectations would not boost domestic companies' earnings in the near term.
- After the recent strong performance of Japanese equities, we are now focusing on the laggard sectors/stocks. Since money inflows from international investors seem to be continuing, laggards with positive catalysts should be attractive investment opportunities.
- We also like trading companies that have continued to invest in mining and other energy resources for the last 10 years. With a weaker yen, the trading companies' net asset values should increase in yen terms.

Strategic (one to two years)

- Yen weakness increases the competitiveness of Japanese exporters, but increases the import costs, energy costs in particular. We believe Japanese exporters and energy companies are best positioned to take advantage of the trend.

Weaker Yen supports TOPIX rebound



Source: Thomson Reuters, UBS; as of 25 April 2013

Note: Past performance is not an indication of future returns.

Emerging market equities

Preference: neutral

UBS view

- Real GDP growth in the emerging markets (EM) is expected to accelerate moderately in 2013 to above 5%. Recent economic data has been mixed, however, suggesting that the emerging economies are currently in a softer patch. China's first quarter GDP numbers, released in mid-April, disappointed.
- The earnings dynamics in the emerging markets have remained weak, clearly trailing developments in the US and Japan. Lower commodity prices are weighing on the Materials and Energy sectors. The weaker yen has negatively affected the competitiveness of Korean and Taiwanese exporters.
- The silver lining is that weakness in earnings is balanced by a relatively attractive valuation compared to global equities. While the valuation discount of emerging market equities compared to global equities is now slightly higher than it has been over the last 10 years, it is the largest since the financial crisis.
- We see the P/E multiple of the MSCI EM Index close to current levels at around 11.5x trailing (i.e. realized) earnings over the next six months. Over the next 12 months, we expect EM earnings to improve and to grow at around 11% (below the latest consensus estimate of 14%).

MSCI EM (24 April): 1018 (last publication: 1,068)

MSCI EM (six-month target): 1,040

➤ Positive scenario

- The outlook for the global economy improves, boosting EM's ability to grow more strongly in 2014. This stronger economic growth leads to earnings growth above 15%. Investor confidence improves, leading to a better P/E multiple of 13x trailing earnings.

MSCI EM (six-month target): 1,225

⚡ Negative scenario

- A significant escalation of the Eurozone debt crisis, and a big deceleration in Chinese growth could each hit EM's economic prospects. In such a scenario, we would expect a 20% decline in earnings over 12 months. More defensive Malaysia would do better, while more cyclical South Korea and Russia would underperform. We assume, however, that the market would also be expecting some recovery in earnings for 2014, helping the P/E multiple to stabilize at around 10x trailing earnings.

MSCI EM (six-month target): 785

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Why it matters

Industrial production

Investors are trying to figure out in which emerging market economies growth is accelerating and where it might be stagnating. **Key dates: PMI manufacturing surveys for China, India, South Korea (1 May), Brazil, Turkey, South Africa, Russia (2 May)**

Inflation

The Achilles heel of the emerging economies is inflation. Over a six-month view, we do not see sustained inflationary pressure that would require a big change in the stance of EM monetary policy from what is currently priced in. But markets will continue to look very closely for evidence that this could change later in 2013 or in 2014.

Recommendations

Tactical (six months)

- Within emerging markets, we see three main drivers: first, despite the current softer patch, a gradual pick up in growth, supporting some of the higher-beta markets (like Russia, South Korea and Brazil); second, a focus on local recovery stories (like Brazil and India); and third, some rotation away from those markets that have done exceptionally well over the past year toward markets that have lagged and started the year under-owned and out of favor (like Russia and Brazil).
- In the case of South Africa, valuations are on the high side and we see limited potential for earnings growth. We expect some rotation out of Turkey after a strong run, and valuations have become more demanding.

Strategic (one to two years)

- Strategically, we would advise that EM portfolios tilt toward cash-rich and faster-growing Asia.

Country preferences within emerging markets (relative to MSCI EM)

Current most preferred markets

Brazil
India
Russia
South Korea

Current least preferred markets

South Africa
Turkey

Asian equities (ex-Japan)

MSCI Asia ex-Japan (24 April): 541 (last publication: 538)

MSCI Asia ex-Japan (six-month target): 555

UBS view

- We have a neutral stance on China. The policy outlook has become more unsure and is likely to weigh on Chinese equity performance relative to Asian equities (ex-Japan; AxJ). The weakness in 1Q13 GDP growth data is likely to weigh on market sentiment over the near term.
- The Indian market is preferred in light of its more benign macroeconomic outlook and the central bank's greater capacity to ease rates due to subdued inflation.
- We have a neutral stance on Malaysia as the market has largely priced in a Barisan Nasional victory but one with a lower majority.
- We have a preferred rating on South Korea as we believe the current tensions with North Korea should subside and not have a prolonged impact on its equity market performance. MSCI Korea is the most under-owned market by foreign investors at the moment.
- Asian equities (ex-Japan) are attractively valued, trading at around 1.56x P/BV, just 15% shy of its lowest level over the last three years of 1.33x P/BV (weekly data). The five-year average is 1.75x. Compared to MSCI World equities, AxJ is relatively attractive, trading at a 12-month forward P/E of 11.1x, compared to the MSCI World's 13.6x, with earnings growth for AxJ higher at 13.9% compared to the MSCI World's 11.2%.

➤ Positive scenario

MSCI Asia ex-Japan (six-month target): 630

- More supportive monetary and fiscal policy, stable inflation, sustained domestic demand growth, and an improved global growth outlook lead to a better earnings outlook. In such a scenario, we would expect earnings growth of 13% and a trailing P/E of about 14x.

⚡ Negative scenario

MSCI Asia ex-Japan (six-month target): 415

- A significant escalation of the Eurozone debt crisis, or a sharp deceleration of the Chinese economy could precipitate a significant downturn in the global economy and lead to AxJ trading down to 1.5x P/BV.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Why it matters

Earnings growth	Consensus foresees earnings growth of 14.6% for FY2013 for Asia ex-Japan, which might be a tad optimistic should GDP growth disappoint, especially in China.
USDJPY	Sustained USDJPY weakness would be a concern for other major exporters in Asia, particularly South Korea and Taiwan.
Politics	Decisions made about the US debt ceiling are important. The US is still Asia's main trading partner. We remain watchful as weaker US growth would hurt Asian exports.
Policy responses	Some other countries in the region have near-term macroeconomic issues to face due to fiscal and current account deficits, as well as hiccups in market and economic reforms. Policy responses often come on an ad-hoc basis.

Recommendations

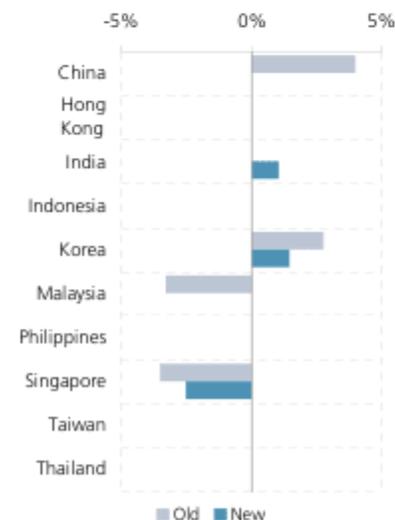
Tactical (six months)

- Given the more favorable macro backdrop in 2013 and attractive valuations, we are positive on Korean and Indian equities. Korean earnings are expected to grow by 23% in 2013 and stay resilient, led mainly by the country's dominant technology companies, due to market share gains and margin expansion.

Strategic (one to two years)

- The current negative to low real yields environment is positive for high-yield stocks. We favor a portfolio mix of high-yield stocks largely found in Singapore, Taiwan and Hong Kong, complemented by growth-oriented stocks in the rest of Asia.

Country preferences within Asia ex-Japan (relative to MSCI Asia ex-Japan)



Equity styles

UBS view

- We believe that medium-sized companies (mid caps) will outperform large caps in the US. US economic data has been improving and we forecast an acceleration of growth in the second half of 2013 and in 2014. The greater domestic sales exposure and more cyclical sector composition of US mid caps make them a purer way to gain exposure to the US and will give greater leverage to a US recovery. There is also potential for large caps, which are currently very cash-rich, to put this cash to work and "buy growth" through acquisitions of mid-cap companies.
- Globally, high-quality dividend-paying stocks provide a real and stable income stream to investors in the current low-yield environment. Furthermore, they give exposure to the long-term potential of equity markets while tending to suffer less in declining markets. Importantly, we focus not on those stocks with the highest yield, but instead look for high-quality dividend-paying stocks, which are still able to grow and have less risk of a dividend cut.

Prefer mid caps in US

Regional differentiation

- In the US, we prefer mid to large caps. Moderate economic growth should support their earnings generation.
- In the US, there are selected opportunities in value names that also show strong growth.
- Globally, we like high-quality dividend-paying stocks.

➤ Positive scenario

- Leading indicators continue to move higher, and risks related to the Eurozone debt crisis continue to subside. In this case, add deep cyclical value (cheap price/book, price/earnings) regardless of the sector, with high beta and high leverage. In such an environment, small and mid-cap stocks should also perform well. A dividend strategy would be too defensive to outperform the market.

Prefer value, low quality and small caps

⚠ Negative scenario

- The global economic picture deteriorates markedly. In this case, buy high-quality growth companies and large caps. Do not look for value opportunities, but be as defensive as possible with your equity exposure. Look to high-quality dividend-paying stocks for yield.

Prefer quality and large caps

Strategic (one to two years)

- We expect value strategies to outperform the European market over a multi-year time horizon.
- Globally, mid-cap stocks provide attractive opportunities over the longer term.

Improving earnings revisions point to mid-cap outperformance

US mid-cap performance relative to large caps vs. earnings revisions



Source: FactSet, UBS; as of 21 April 2013

Note: Past performance is no indication for future returns.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Earnings revisions – see chart (three-month moving average upgrades vs. downgrades)

US and Eurozone PMIs

Why it matters

Watch for signs of improvement in earnings revisions (aggregated from stock level). An improved earnings outlook would cause investors to add more risk – influencing our preferences among equity styles.

PMIs are important leading indicators for earnings generation and accordingly preferences for value, growth and size. **Key dates: 1 May, PMI manufacturing Eurozone (final); 1 May, US ISM manufacturing**

Section 2.B

Asset class views

Fixed Income

Bonds overview

High-grade corporate and emerging market bonds – Key points

- We prefer investment grade (IG) and US high yield (HY) corporate bonds over high-grade bonds (bonds with a credit rating of AA or higher; mostly government bonds). A strong US corporate sector, the ongoing moderate recovery of the US economy and determined central bank assistance are likely to further support credit segments. The partial solution to the US fiscal cliff and ongoing backing from cyclical indicators provide a positive backdrop for risk assets in the months ahead.
- US HY bonds continue to offer attractive value. The risk premium over US Treasuries is still appealing. We think lower spreads are justified by the favorable default outlook and central bank action. Investor appetite for yield assets is expected to further support US HY bonds in the coming months. While low liquidity remains a key risk for HY bonds, current market liquidity is at a healthy level. US HY thus remains one of our preferred asset classes.
- IG corporate bond spreads have traded in a tight range since the start of the year – in line with our forecast. While we do not see much potential for tighter spreads, IG bonds will likely continue to outperform high-grade bonds due to the yield pick-up. We are keeping our overweight position, expecting modestly positive absolute returns.
- Emerging market (EM) bonds should continue to benefit from better fundamentals than those of developed markets over the medium term. However, valuations of EM sovereign bonds (in USD) are close to fair levels, especially the investment grade issuers in Latin America and Asia. For EM corporate bonds (in USD), there is still potential for spreads to trend lower in the quarters ahead as these bonds should benefit from a cyclical recovery in EM. We maintain our preference for EM corporate bonds over developed market government bonds and EM government bonds.

Duration – Key points

- We expect high-grade bond yields to move to slightly higher ranges over the next six months. This is likely to have a negative effect on most developed market high-grade bond prices, and should result in slightly negative total returns.
- The moderately growing US economy is currently the most important driver that speaks for higher yields. However, the yield increase should remain muted as long as the recovery does not lead to higher inflation, the unemployment rate remains high and central banks remain very accommodative.
- There are also several risk factors that could even lead to a reversal of the recent yield increase. For example, the recovery could lose momentum as it did during the spring/ summer of the last two years, triggered by the recent fiscal tightening in the US. Also the euro crisis could return if Italy does not get a euro-supportive government in the next couple of months.
- High-grade bond yields have the potential to increase somewhat in the coming months, but we expect the move to be contained. For investors with a long investment horizon, we recommend avoiding long-term bonds and focusing on short and medium-term maturities.

Preferences (six months)



Source: UBS CIO WM Global Investment Office

US rates

US 10-year (24 April): 1.7% (last month: 2.0%)

US 10-year (six-month forecast): 2.2%

UBS view

- US 10-year yields trended decidedly lower over the month. The temporary soft spot in domestic economic data and the aggressive liquidity injection by the Bank of Japan weighed on US rates.
- Yields will trend sideways to slightly higher within their old range (1.9–2.3%) over a six-month horizon. We expect a final compromise to be reached regarding the 2014 budget and the debt ceiling in early summer. Over the course of the year, the Fed's QE3 stimulus will enable the domestic economy to remain on a moderate growth path with gradually declining unemployment. In addition, the tapering off of QE buying in Q3 and the end of QE by mid-2014 could push yields higher. Similarly, the reiterated willingness of the Fed to remain accommodative in support of the domestic labor market will increase inflation expectations over the medium term. Consequently, this could trigger a rise in longer dated nominal yields.
- However, US yields should remain rather stable over the short term due to possible further intervention by the Fed and weaker Q2 economic growth. Furthermore, domestic growth is structurally weak and the economy still vulnerable to spillover effects from the Eurozone; should uncertainties persist.

➤ Positive scenario for US economy/negative scenario for US bonds **US 10-year (six-month range): 2.3–2.6%**

- US growth recovers, with a rapidly improving labor market and discussions and/or tapering off or the end of QE possibly resulting in significantly higher yields.
- A moderate Eurozone economic recovery with Spain/Italy ahead on their austerity plans represents an upside risk.

➤ Negative scenario for US economy/positive scenario for US bonds **US 10-year (six-month range): 1.4–1.6%**

- A possible US government shutdown in October weighs on the cyclical recovery and is a drag on yields.
- A further reescalation of the European debt crisis weighs on yields. Risks in the ECB framework remain, in particular given continued uncertainties in the Eurozone (Italy, Cyprus, Malta, Spain). In addition, Greek debt sustainability could come under scrutiny again in 2013. These uncertainties should result in peripheral spread widening.
- The labor market fails to recover, increasing the likelihood of even more MBS and Treasury purchases or alternative measures, and yields stay low or fall further.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Fed policy/ labor market

Inflation expectations

2014 budget and debt ceiling

Why it matters

The Fed's assessment of the labor market determines its stance on quantitative easing / tapering off and is key for yields. **Key dates: 1 May, Fed FOMC meeting; 3 May, US nonfarm payrolls;**

Continuous rise in breakeven inflation expectations could trigger a rise in longer yields

The sequester spending cut effects and fiscal uncertainty will weigh on cyclical growth.

Outlook

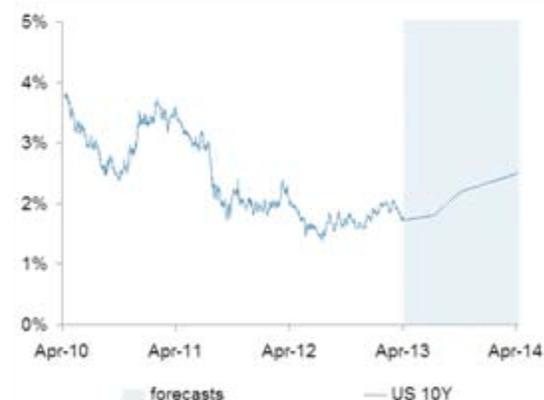
Tactical (six months)

- Yields have the potential to increase somewhat in the coming months. However, upcoming fiscal tightening in the US, ongoing bond market support from central banks and the lingering euro crisis are likely to limit the yield increase.

Strategic (one to two years)

- Yields have significant upside potential in the next couple of years given the extraordinarily low current level of real interest rates in particular.

US 10-year yields and forecasts



Source: Bloomberg, UBS; as of 15 April 2013

Note: Past performance is not an indication of future returns.

European rates

EUR (DE) 10-year (24 April): 1.2% (last month: 1.5%)

EUR (DE) 10-year (six-month forecast): 1.8%

UBS view

- Bund yields trended lower over the month, plunging in response to uncertainties surrounding the bail-in of Cyprus bank depositors, the Bank of Japan's aggressive QE program and a lack of immediate action by the ECB. The yield grab therefore continues to overshadow tentative signs of improving financial conditions. The OMT program has thus far improved money market conditions and reduced fragmentation and volatility. Nevertheless, the ECB hinted at possible policy action stating it is "monitoring closely" conditions in Europe. Thus, the bar for further stimulus fell.
- Over a six-month horizon, we expect yields to rise slightly, returning to the old range (1.6–1.9%). This is due to the decline in excess liquidity, reduced tail risks resulting from central bank backstops, and the expected medium-term improvement in quarterly Eurozone growth rates. Given recent developments, the likelihood of an ECB rate cut has increased. However, at the same time, there is a cap on yields in the short term as growth is still structurally weak, and short-term uncertainties remain (US debt ceiling and 2014 budget, Spain, Italian election aftermath, Cyprus, Malta).
- In the UK, economic data should stabilize, and we expect the BoE to remain on hold and 10-year yields to trade slightly higher.
- In Switzerland, yields have remained remarkably resilient to safe haven inflows. Given the remarkably low level of interest rates and the EURCHF floor, we believe Swiss yields will gradually move toward normalization and higher levels.

➤ Positive scenario for Eurozone economy/negative scenario for bonds 10-year (6-month range): 1.9–2.3%

- A moderate Eurozone economic recovery kicks in. Spain and Italy are ahead on their austerity commitments. This reduces safe haven inflows, driving Bund yields higher.
- Alternatively, Germany gives additional guarantees and the Eurozone moves toward a transfer union.

➤ Negative scenario for Eurozone economy/positive scenario for bonds 10-year (6-month range): 1.2–1.5%

- Risks in the ECB framework remain, given recent Eurozone developments and a possible downgrade of Spain. These uncertainties would result in peripheral spread widening. In addition, Greek debt sustainability could be questioned.
- US sequester effects/tax hikes and possible government shutdown weigh on the cyclical recovery and drag on yields.
- Further non-standard policy measures by the Fed and/or ECB are supportive for Bunds and speak for lower yields.

Note: Scenarios refer to global economic scenarios (see slide 8)

What we're watching

Political risks

Central banks

Economic variables

Eurozone yield spreads

Why it matters

Questioning of the implementation risks of the OMT, large deposit flights within the Eurozone periphery, increased fragmentation and Greek debt sustainability.

Key dates: 2 May ECB meeting; ongoing European commission reports on the periphery; weekly LTRO repayments

Economic growth and credit conditions (ECB bank lending survey)

The level of peripheral spreads to German bunds reflects risk aversion and thus the safe haven discount placed on Bunds.

Outlook

Tactical (six months)

- If the ECB were to intervene with new nonstandard policy in the peripheral markets, Bund yields could rise more significantly. However, for the time being, we expect Bund yields to increase only gradually.

Strategic (one to two years)

- Yields have significant upside potential over the next couple of years. Thus investors with a long time horizon should focus on bonds with short and medium maturities.

Europe 10-year yields and forecasts



Source: Bloomberg, UBS; as of 15 April 2013

Note: Past performance is not an indication of future returns.

High-grade bonds

Preference: **underweight**

UBS view

Current USD / EUR / CHF AA+ 5y yield: 1.2 / 0.7 / 0.6 (last month: 1.2 / 0.9 / 0.5)

Yield target (six-month): 1.5 / 1.2 / 0.9; Expected 6m return -1% / -2% / -1%

- High-grade bonds (HG; based on Barclays AA+ Index) with, on average, five years to maturity have delivered slightly positive total returns since the beginning of the year.
- In USD / EUR / CHF HG bonds, the spread component (i.e. the additional yield compared to government bonds) has moved only by a few basis points and has remained overall close to levels at the beginning of the year (30–40 bps).
- The potential for further spread compression is limited and we expect government bond yields to drive performance. With an anticipated moderate upward drift in yields, the performance of high-grade bonds is expected to be slightly negative over the next six months. However, the largest part of the decline is expected to happen after three months.
- HG bonds remain less attractive compared to other fixed income alternatives that offer a higher credit spread in an environment characterized by expected further spread tightening (positive global growth, extraordinary central bank support measures and ongoing investor appetite for higher yields).

➤ Positive scenario for economy / negative for HG bonds Yield target USD / EUR / CHF (six-month): 1.7 / 1.4 / 1.0

- Forceful recovery of global growth and early tapering off of Fed's QE causes yields to increase substantially.

➤ Negative scenario for economy / positive for HG bonds Yield target USD / EUR / CHF (six-month): 1.0 / 0.6 / 0.5

- Economic data continues to disappoint, e.g. nonfarm payrolls do not recover materially from the 88k March print.
- Anti-European sentiment gains more influence in the European periphery.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Why it matters

Core market yields

Developed market sovereign yields are only expected to increase gradually. Signals of more restrictive monetary policy could lead to a more significant increase in yields that would lead to negative performance in HG bonds. **Key dates: 1 May, US ISM Manufacturing index; 5 May, US labor market data**

Euro crisis

A liquidity crisis originating, for example, from a re-emerging Eurozone crisis is a major risk factor for HG bonds. Thus we are following the attempt to build a government in Italy very closely.

Recommendations

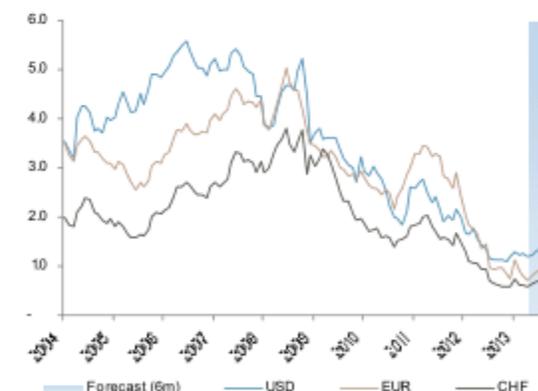
Tactical (six months)

- We are underweight HG bonds (Barclays AA+ Index) in relation to investment grade, high yield and corporate emerging market bonds as we expect additional performance from credit spreads in these asset classes.
- Expected HG performance is slightly negative over six months.

Strategic (one to two years)

- We prefer credit and cash to high-grade bonds as the expected yield increase is likely to result in negative performance for HG bonds. Credit such as IG, HY and CEMBI are better protected in such a case by the higher credit spread.

High-grade yields expected to rise



Source: Barclays, UBS; as of 19 April 2013

Note: Decline of yields over the last months was also driven by Italy and Spain Govt bonds dropping out the index. Past performance is not an indication of future returns.

Investment grade corporate bonds

Preference: **overweight**

UBS view

Current global spread (24 Apr): 142bps (last month: 143bps)
Spread target (six-month): 140bps; Expected 6m return 0.5%

- Spreads of investment grade (IG) corporate bonds have been trading in a tight range between 140 and 150 basis points since the start of the year – in line with our forecast. We don't expect this pattern to change over the next six months. Consequently, total returns will be mainly driven by coupons and changes in the underlying benchmark rate. Over the last month global IG bonds achieved a total return of 1.3%, mainly due to a sharp fall in benchmark yields (e.g. US 10-year Treasury -25bps), thereby mildly outperforming government bonds.
- We think that IG bonds will deliver more attractive returns than high-grade bonds. Absolute returns are expected to be modest due to record-low yields and limited potential for tighter spreads. We expect a total return of roughly 0.5% over the next six months, and an excess return over government bonds of around 1%.
- We expect IG bonds to find continued support from sluggish but positive global growth, extraordinary central bank measures, and ongoing investor appetite for "low risk" alternatives to low-yielding government bonds.
- Non-financial corporates: Spreads are expected to remain around current levels. The credit cycle has passed its peak in terms of "balance sheet healthiness" and leverage is picking up. But the starting position is very robust for most companies. Balance sheets can still absorb additional leverage without a strong deterioration in credit quality.
- Financial corporates: We believe that determined central bank action provides a backstop for financials and supports modest spread tightening. Bonds of the most robust banks in Europe are now trading at expensive levels and offer only a minimal yield pickup by now.

➤ Positive scenario

Spread target (six-month): 110bps

- Global growth accelerates more than expected. This could compress spreads closer to pre-crisis levels. However, in this case, rising benchmark yields would likely lead to slightly negative absolute total returns over six months. Relative to government bonds, IG corporate bonds will do well.

➤ Negative scenario

Spread target (six-month): 380bps

- Major risks include a sharp slowdown of the US economy. Also, risks in the Eurozone persist. Still, we would be unlikely to see the spread levels reached in 2009, given companies' superior balance sheet positions. An additional risk to European financial issuers is a bail-in of senior bondholders, which we think is unlikely to happen before 2018.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Core market yields

Why it matters

Developed market sovereign yields are only expected to increase gradually. A sudden rise and high volatility would hurt IG credit. **Key dates: 1 May, Fed FOMC meeting; 2 May, ECB meeting**

Corporate fundamentals

Robust corporate earnings and low leverage on corporate balance sheets should help prevent defaults.

New issuance

As financial companies continue to deleverage, net supply on the IG market is expected to remain close to zero. A strong increase in net supply would be a technical headwind.

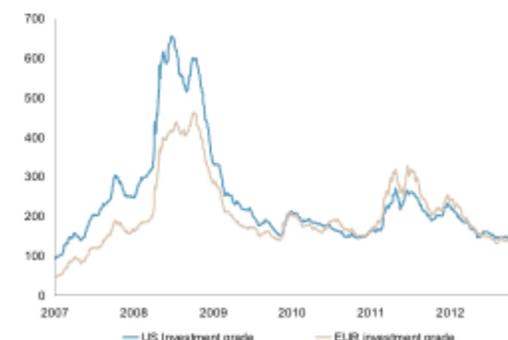
Recommendations Tactical (six months)

- We are keeping an overweight in IG corporate bonds relative to government bonds. Total returns of corporate bonds will likely be modest.
- Financials in the US are in a better position than their European peers.
- We recommend bonds from the lower IG rating segments (BBB and A) over higher rated issuers.
- Subordinated (hybrid) bonds of high-quality issuers offer a good opportunity to increase yield income at a moderate risk.

Strategic (one to two years)

- We prefer corporate over sovereign debt given robust company balance sheets vs. the structural weakness of public finance in many DM countries.
- Absolute total returns will be limited due to gradually rising benchmark rates.

Yield spreads over government bonds (bps)



Source: Bloomberg, UBS; as of 24 April 2013
 Note: Past performance is not an indication of future returns.

High yield corporate bonds

Preference: **overweight**

Spread USD HY (24 Apr): 466bps (last month: 475bps)

USD HY spread target (six-month): 450bps; Expected 6m return 3-4%

UBS view

- Total returns of US HY bonds were strong over the last month at 1.2%, lifting the year-to-date number to 3.6%. Major contributors to the good return were stable coupon income, persistently low default rates and the recent fall in benchmark rates.
- Over the next six months, we expect low default rates, favorable demand from yield-seeking investors, and the commitment of major central banks to providing strong monetary support, which taken together provides a strong backdrop for US high yield (HY) corporate bonds. We thus still see potential for tighter spreads around 450bps. A "great rotation" out of HY looks unlikely at this stage. HY bonds tend to perform well even when benchmark rates rise gradually. While total returns this year are very likely to fall short of the extraordinarily strong performance of 2012 (+16%) we expect attractive total returns of 3–4% over the next six months.
- The default rate of US high yield issuers fell to 1.3% in March (US dollar par-weighted), far below its long-term median of 4%. We expect only a gradual increase in defaults through 2013. A heavy load of new issuance in recent months means that HY companies will face a lower risk of failed re-financing (e.g. in the case of an unexpected economic slump). So far this year 66% of issuance was used to re-finance existing debt.
- US HY bonds therefore continue to offer attractive value. The risk premium over US Treasuries is still at appealing levels. Aggregate credit metrics for US HY companies remain very healthy. Good earnings and lower interest expenses provide a good backdrop for credit quality.

➤ Positive scenario

- Even in the positive economic scenario, spreads are unlikely to tighten to pre-crisis lows below 300bps due to a higher liquidity premium priced into the asset class. Benchmark yields would rise in this scenario, limiting HY returns to around 6% over six months.

➤ Negative scenario

- A US recession is the major risk for US HY bonds. Based on the robust state of the US corporate sector, we would not expect spreads to surpass "usual" recession levels of around 1,000bps. Short-term spikes are possible due to liquidity suddenly drying up, but we would expect a quick normalization. Such spikes could present a buying opportunity, depending on our economic outlook at that stage.

USD HY spread target (six-month): 330bps

USD HY spread target (six-month): 850bps

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Credit quality/
default cycle

New issuance

Bank lending standards

Why it matters

Balance sheets are backed by high cash levels and high coverage ratios. Against this backdrop the default rate will likely remain below its long-term average. Recent US company earnings were sufficient to maintain stable leverage and coverage ratios.

For now, favorable conditions in the primary market have mainly been used for refinancing. More aggressive issuance activities should be monitored.

Bank lending provides an important source of funding. US banks continued to relax standards in 4Q 2012 according to the Fed's latest senior loan officer survey.

Recommendations

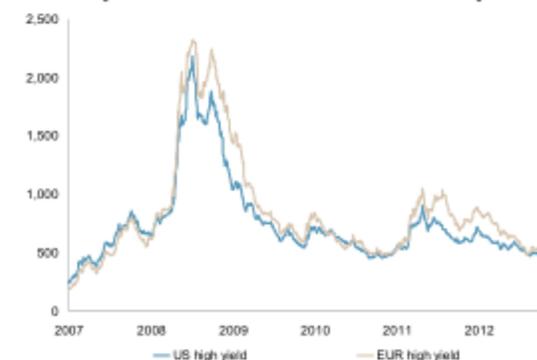
Tactical (six months)

- US HY corporate bonds offer an attractive return outlook and should be overweight.
- We prefer US over European issuers given the high proportion of peripheral and financial issuers in the European HY universe, the poorer economic outlook in Europe and the strong decline in European HY spreads in recent months.
- The primary market remains solid with new issuance of USD 80bn (US issuers only). 66% of proceeds were used for refinancing.

Strategic (one to two years)

- We expect US defaults to remain at below-average levels longer. Significant re-leveraging is unlikely in the medium term.
- We believe US high yield corporate bonds will provide good returns both relative to other fixed income and for absolute return-oriented investors.

Yield spreads over US Treasuries in bps



Source: Bloomberg, UBS; as of 24 April 2013

Note: Past performance is not an indication of future returns.

Emerging market bonds

Preference: **overweight**

EMBI Global/CEMBI spread (24 April): 294bps / 332bps (last month: 279bps / 309bps)

UBS view

EMBI Global/CEMBI spread target (six-month): 250bps / 270bps; Expected 6m return 1.5% / 2.5%

- Spreads of emerging market (EM) sovereign bonds have traded sideways over the past month, whereas EM corporate bond spreads widened by roughly 20bp. As a result, EM sovereign bonds outperformed EM corporate bonds over the last month. However, EM corporate bonds have performed significantly better than sovereigns on a year-to-date basis.
- Overall, we continue to think that EM corporate bonds offer a more attractive opportunity for investors than EM sovereign bonds. The gradual economic recovery in EM that we expect in the coming quarters should favor the performance of EM corporate bonds over that of EM sovereign bonds, and the shorter average duration of EM corporate bonds should offer better protection against rising US Treasury yields in the quarters ahead.
- However, absolute returns of EM bonds will be lower than last year, we think, as the room for spreads to tighten further has become more limited. We expect total returns of less than 1.5% for EM sovereigns and around 2.5% for EM corporate bonds over the next six months.

➤ Positive scenario

EMBI Global/CEMBI spread target (six-month): 235bps / 230bps

- Yield stability in Europe's core markets and higher-than-expected growth in the US provide a favorable backdrop for EM fixed income spreads. In such an environment, issuers of lower credit quality would likely fare better. Average spreads could tighten to below 240bps in such an environment.

⚡ Negative scenario

EMBI Global/CEMBI spread target (six-month): 555bps / 750bps

- An environment of greater risk aversion in Europe, deteriorating EM funding markets, weakening global growth prospects, and lower commodity prices could affect EM credit negatively. Liquidity in emerging market bonds could dry up and spreads could spike.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Why it matters

Core market yields

The direction of US Treasury and German Bund yields are important for EM fixed income spreads, especially for US dollar and euro-denominated bonds.

Key dates: 1 May, FOMC rate decision; 5 May, ECB interest rate decision

Capital flows

The European debt crisis may lead to further periods of outflows and weaker prices, which could offer attractive entry levels for investors.

Monetary policy cycles

Inflationary conditions and monetary policy remain a key topic for local currency bonds. We look for inflation data releases in key markets. Upcoming **key policy rate decisions: Russia (6-15 May), Poland (8 May), Turkey (16 May), South Africa (23 May)**

Recommendations Tactical (six months)

- EM corporate bonds are particularly attractive due to their favorable valuation, solid fundamentals, and relatively short duration. We advise investors to focus on investment grade bonds in the current environment. We recommend taking profit on selected EM sovereign bonds. Please refer to our EM bond list for issuer and bond-specific guidance.

Strategic (one to two years)

- EM bonds are attractive for longer term investors looking for higher yields.
- Local markets in Asia offer interesting opportunities for longer term investors because of a supportive currency outlook.

EM sovereigns expensive compared to EM corporates

Spreads of EM bonds over US Treasuries, in bps



Source: JP Morgan, UBS; as of 23 April 2013

Note: Past performance is not an indication of future returns.

Section 2.C

Asset class views

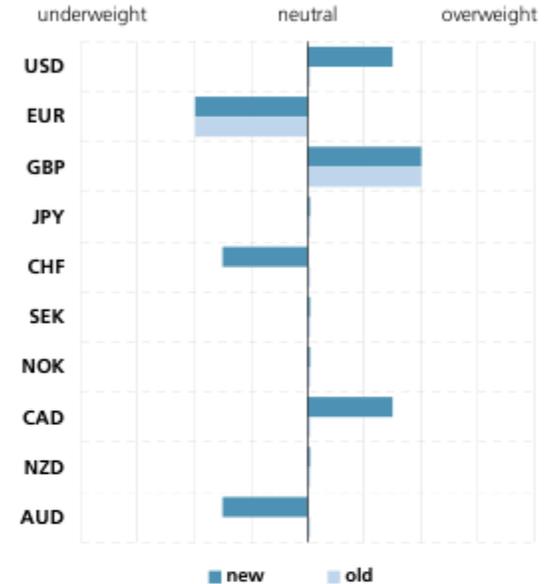
Foreign Exchange

Foreign exchange overview

Foreign exchange – Key points

- Given the persistently weak economic data and the fact that some ECB board members already favored a rate cut at the last meeting, we expect the policy rate to be cut to 0.5% in May. This should keep the EUR under pressure. The next big election looming is in Germany in September. We are maintaining an **EUR** underweight.
- The **GBP** recovered from its lows with investors taking profit from short positions after the budget presentation brought no radical change to the Bank of England's inflation target. We are keeping our overweight in GBP against an EUR underweight. Negative data surprises have started to fade. Following a weak fourth quarter UK economic growth improved again in early 2013. In particular, the service sector showed signs of strength. Growth data needs to be watched carefully, as it will determine whether the Bank of England engages in further easing, which we don't expect.
- We expect **EURUSD** to fall to 1.26 in the coming months. The fact that the US Federal Reserve is likely to continue with QE until year-end at least should support EURUSD at that level. However, the US Congress is more constructive on budget negotiations than was expected, which supports the USD, while European political processes will weigh on the EUR.
- We overweight the **USD** against the **CHF**. The Swiss currency remains tied to the euro, thus our negative view on the single currency extends to the Swiss franc. The US economy on the other hand continues to do well and visibility on political developments is higher than in Europe.
- The **CAD** has weakened year to date, as the Bank of Canada (BoC) pushed expectations of first rate hikes further out. We see this only as a short-term drag, as it doesn't change the general view that the BoC will be among the first major central banks to start hiking rates. The Canadian economy is expected to improve, supported also by the ongoing US recovery. We are overweight relative to AUD.
- The commodity currencies **AUD** and **NZD** have been well supported by improving growth in Asia and the US and the need for diversification out of the euro. At current highs investors should be somewhat cautious, especially after the disappointing Q1 GDP figure in China and weaker commodity prices. The "Aussie" is massively overvalued; based on purchasing power parity it trades more than 30% above its fair value towards the Canadian dollar. The current weakness in the Australian domestic economy and the possibility of further policy rate cuts should weigh on the AUD. Clients should prefer the CAD at current levels.
- Sweden and Norway stand out for their low debt-to-GDP ratios and current account surpluses. As a consequence, both the **SEK** and the **NOK** remain expensive. In March the SEK lost some momentum due to a worsening of the economic momentum in Germany. On the other hand, Norwegian data is starting to improve.
- The **JPY** dived into the 95-100 range against the USD after the announcement of more drastic monetary policy measures. We cannot rule out a spike above 100 to the dollar, but at that level the JPY is already 20% undervalued versus the USD so we would expect such moves only to be temporary.
- Our most preferred **emerging market currencies** are currently SGD and TWD in Asia, MXN and BRL in LatAm, and RUB and ZAR in EMEA. We are cautious for now on IDR and PHP, COP, and CZK and HUF.

Preferences (six months)



Source: UBS CIO WM Global Investment Office

G10 currencies

UBS view

See table for current exchange rates and CIO forecasts

- We expect EURUSD to fall toward 1.26 in the coming months. Over the longer term, an economic recovery in the Eurozone could lead to renewed upside. In the near term the US has a clear advantage in economic and political momentum. We overweight the **USD** against the **CHF**. The Swiss currency remains tied to the euro, thus our negative view on the single currency extends to the Swiss franc. The US economy on the other hand continues to do well and visibility on political developments is higher than in Europe.
- The **GBP** has rebounded after considerable weakness. As negative economic surprises should begin to fade and speculation about a change in BoE policy has ceased since the 20 March Budget Statement, we believe the rebound of the pound will continue. We maintain overweight GBPEUR.
- The **AUD** is massively overvalued; based on purchasing power parity it trades more than 30% above its fair value towards the **CAD**. A weak domestic economy as well as disappointing Chinese growth in Q1 and falling commodity prices should weigh on the AUD. We see a better economic outlook in Canada and are long CADAUD.
- A sound consolidation brought **USDJPY** back to the 95-100 range, where we expect the pair to stay.

➤ Positive scenario

FX targets: EURUSD >1.35 / EURJPY >135

- A stronger-than-expected acceleration of global growth or further European integration supports EURUSD. The yen should get weaker as the Bank of Japan intervenes by increasing its asset-purchase program.

⚡ Negative scenario

FX targets: EURUSD <1.20 / EURJPY <110

- The European growth outlook deteriorates again, and the EU remains in recession in 2013. The euro could rapidly fall below 1.20. A European debt default cascade (triggered by a disorderly euro exit by Greece or for example political turmoil in Italy) is a tail risk for the single currency. Risk aversion would lead to a USD and JPY rally.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Why it matters

Chinese growth

We expect Chinese growth to gradually pick up. In the base case, a Chinese recovery should support the AUD in the medium term. If China's recovery disappoints, then risk-unwinding would support the USD and the JPY vs. risk-taker currencies – especially the AUD.

European sovereign crisis, ECB policy

The main question continues to be whether Spain or Italy needs to apply for ESM/ECB help, which could weaken the EUR. Germany will host the next big election in Sept.
Key dates: Coalition building in Italy; German elections September 22

US growth and Fed policy response

If the economy cannot keep up the 1Q pace in 2Q and employment data starts to worsen again, the Fed will most likely change its tone and keep QE longer.
Key dates: Debt ceiling in June/July; Employment data in Q2

Recommendations

Tactical (six months)

- GBP remains our most preferred currency, against an underweight in EUR.
- We overweight USD against CHF.
- We overweight CAD against AUD.

Strategic (1 to 2 years)

- We recommend that investors diversify from large USD and EUR exposures into minor currencies. Structural financing issues are weighing on all the major currencies.
- We continue to have a longer term preference for the GBP, as it benefits from diversification out of the EUR.
- The best diversifiers based on long-term macroeconomic fundamentals are the CAD and the SEK. The AUD, NOK and CHF should only be added at better entry levels.

UBS CIO FX forecasts

	23-04-13	3M	6M	12M	PPP
EURUSD	1.298	1.26	1.30	1.34	1.32
USDJPY	98.68	98	98	97	78
USDCAD	1.0272	0.98	0.96	0.94	0.95
AUDUSD	1.0239	1.02	1.00	1.00	0.76
GBPUSD	1.5218	1.60	1.65	1.70	1.70
NZDUSD	0.8382	0.82	0.82	0.82	0.61
USDCHF	0.9401	0.96	0.93	0.92	1.00
EURCHF	1.2204	1.21	1.21	1.23	1.31
GBPCHE	1.4307	1.54	1.54	1.56	1.69
EURJPY	128.1	123	127	130	103
EURGBP	0.8526	0.79	0.79	0.79	0.78
EURSEK	8.5837	8.20	8.00	8.00	8.68
EURNOK	7.6707	7.30	7.20	7.20	8.43

Source: Thomson Reuters, UBS; as of 23 April 2013
Note: Past performance is not an indication of future returns.

Emerging market currencies

UBS view

See table for current exchange rates and CIO forecasts

- We like emerging market (EM) currencies over a medium-term horizon. We think monetary policies of major central banks will remain loose for longer whereas the easing cycle in several emerging markets is over. This should support EM currencies relative to major currencies (USD, EUR, and JPY). Long-term investors should therefore diversify into EM currencies, using surplus exposure in USD, EUR or JPY for funding.
- Higher yielding currencies like the Russian ruble (**RUB**) and the South African rand (**ZAR**) look attractive over the medium term, although ZAR-investors should be willing to tolerate periods of volatility due to a cyclical slowdown and risks for negative headlines. We remain cautious on the Hungarian forint (**HUF**) due to weak fundamentals and on the Czech koruna (**CZK**) due to low interest rates.
- In Asia, we like the Singapore dollar (**SGD**) for the central bank's policy of gradual currency appreciation and the Taiwanese dollar (**TWD**) due to supportive foreign direct investment inflows and prospects of a monetary policy normalization later in the year. We are more cautious on the Indonesian rupiah (**IDR**) due to a persistent high current account deficit and on the Philippine peso (**PHP**) because of central bank interventions to curb FX appreciation.
- In Latin America, the Mexican peso (**MXN**) continues to offer exposure to structural reform prospects and an attractive yield pickup over the USD. Valuation has declined from attractive to fair, however. In Brazil, an attractive carry and prospects for monetary policy tightening should support the **BRL** in the near term. In the longer term, however, we think structural imbalances point towards the BRL weakening against the USD.

➤ Positive scenario

> 5% outperformance of EM FX against G4 currencies over a six-month horizon

- Macroeconomic data comes in stronger than expected and Europe stabilizes further. EM exchange rates could appreciate swiftly against major currencies (USD, EUR, and JPY).

➤ Negative scenario

> 5% depreciation of EM FX across regions against USD over a six-month horizon

- Global growth prospects suffer a prolonged deterioration and the European debt crisis intensifies. EM exchange rates could see a significant, although likely temporary, sell-off across regions.

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Why it matters

Inflation dynamics in EM

Inflation dynamics are important for the forecasting of central bank policy rate decisions. Monetary easing typically weighs on EM currencies, while rate hikes tend to be supportive. **Upcoming key policy rate decisions: Russia (6–15 May), Poland (8 May), Turkey (16 May), South Africa (23 May)**

European sovereign crisis

Setbacks in sentiment will likely lead to bouts of EM currency depreciation, providing attractive entry points for longer-term investors.

Growth

Growth in the US, Europe and China is key for sentiment and growth prospects in EM. **Key dates: 1 May, FOMC rate decision, 2 May, ECB interest rate decision**

Recommendations

Tactical (six months)

- Several EM currencies look attractive at current levels and we advise tactical investors to keep existing holdings while increasing exposure to our currently preferred EM currencies (SGD, TWD, RUB, ZAR, BRL, MXN), using surplus exposure to EUR, USD, and JPY as a source of funds.

Strategic (1 to 2 years)

- We recommend EM currencies backed by stable fundamentals to diversify currency exposure out of major DM currencies.
- Our long-term favorites include the Chilean peso, Mexican peso, Czech koruna, Polish zloty, Chinese renminbi, Korean won, Malaysian ringgit and Singapore dollar.

UBS CIO EM FX forecasts

	24.04.2013	3-month	6-month	12-month
Americas				
USDBRL	2.02	1.95	1.95	2.02
USDMXN	12.2	12.2	12.0	11.8
Asia				
USDCNY	6.18	6.20	6.15	6.10
USDINR	53.9	54.0	53.0	52.0
USDIDR	9'709	9'700	9'400	9'400
USDKRW	1'118	1'110	1'100	1'080
USDSGD	1.24	1.23	1.21	1.18
EMEA				
EURPLN	4.11	4.20	4.10	4.00
EURHUF	298	300	300	300
EURCZK	25.8	26.0	25.5	25.0
USDTRY	1.80	1.78	1.80	1.85
USDZAR	9.17	9.00	8.70	8.50
USD RUB	31.6	30.5	30.5	30.5

Source: Thomson Reuters, UBS; as of 24 April 2013

Note: Past performance is not an indication of future returns.

Section 2.D

Asset class views

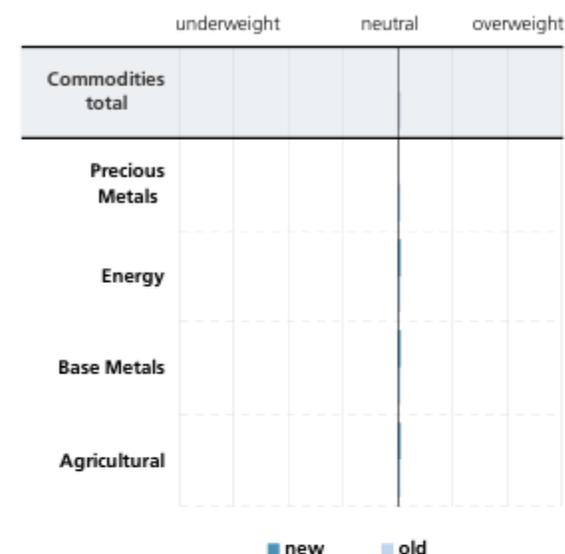
NTAC: Commodities, listed real estate, hedge funds and private equity

Commodities overview

Commodities – Key points

- Broadly diversified commodity indices have been under renewed pressure, weakening by around 5% m/m. The price decline brought spot indices to levels not seen since July 2012 and has led to a steady underperformance versus global equities.
- Disappointing recent global macro data could soften prices further in 2Q13. Nevertheless, 2Q13 should bring the trough in commodity prices.
- Our expectations regarding the economic growth trajectory for 2013 and monetary policy have remained unchanged since last month. We are therefore keeping most of our six-month forecasts unchanged, which shifts up the expected return for the UBS CMCI Composite Index (TR) over the next six months to 3%.
- With regards to **precious metals**, fading inflationary pressure, the perception that the US Fed will taper off QE until mid 2014 and that equities offer a better alternative should keep gold under pressure. We therefore advise gold investors to search for protection over the next 3–6 months.
- Since the world remains highly dependent on reflationary monetary policy, a higher **gold** price in the longer term is still in the cards. Within precious metals our preferred positions relate to industrially sensitive metals like platinum and palladium that would benefit from stronger economic data in 2H13. The PGMs are also challenged on the supply side with lower South African production and fewer Russian government stock sales (for palladium).
- **Brent crude oil** prices tested the USD 100/bbl mark. Any price dip below this threshold should be used to start building some long positions. Stronger oil consumption in 2H13 is likely to make the oil market more vulnerable to geopolitical concerns, as OPEC needs to step up crude oil production to balance the market.
- An expected pickup in industrial activity, more infrastructure investments and firm credit growth out of China should set the conditions for **base metal** demand to gather strength. The uplift in Chinese demand could be enhanced by Europe's demand weakness coming to an end and the US adding marginally to global metal consumption. Given our improved demand profile and the fact that prices have slid sharply to levels not compatible with a global GDP profile of close to 3% for 2013, we expect some recovery in base metal prices over the next six months, but we are remaining neutral due to the high volatility.
- The poor performance of **agricultural commodities** is likely to continue. Weaker grain demand than envisaged by markets in conjunction with our expectations of a solid corn and soybean harvest for 2013–14 (in both South America and the US) suggest that the early April price decline will not be the last one. That said, structurally low US inventories in corn and soybean mean considerable forecast uncertainty, while the forward curves in corn and soybeans already factor in a meaningful price decline. For softs, we still believe that coffee and sugar are in the process of finding a floor.

Preferences (six months)



Source: UBS CIO WM Global Investment Office

Gold (23 Apr): USD 1,414/oz (last month: USD 1,603/oz)

Gold six-month target: USD 1,525/oz

UBS view (gold)

- Investment demand for gold has fallen short of our expectations. ETF and non-commercial futures holdings have declined more than 370 tons this year – too large for jewelry and central banks' purchases to counterbalance.
- With inflation concerns off the table in the short term, expectations that the Fed will end QE by year-end and equities en vogue, investor interest in the metal is likely to stay weak. Investment demand, on the other hand, is clearly required to keep prices stable or rising. We estimate that close to 400 tons of investment demand in gold per quarter is needed to balance the market.
- The potential demand shortfall in 2Q13 leaves room for weaker prices in the short run. We therefore advise investors to hedge their gold position over the next 3–6 months.
- The structural story for a higher gold price remains in place. We doubt that the sharp accumulation of debt in the developed world can be reduced without ongoing negative real interest rates.
- Abandoning the current QE-infinity program by the US Fed might therefore be a challenging exercise when price pressure starts to build and growth fails to take off. Alternatively, it might be difficult to drain all the injected liquidity fast enough when the money multiplier starts to rise again.
- We therefore think that prices can still move upward towards our six-month target at USD 1,525/oz from today's price levels.

➤ Positive scenario

- Investors start to realize that ongoing Fed stimulus is needed and that a QE exit in 2013 is unlikely. Alternatively, the ECB surprises investors by changing its policy stance by providing more liquidity or inflation in G3 countries.

six-month target: USD 1,800/oz

➤ Negative scenario

- The Fed backs off from its current monetary policy stance by signaling the end of QE and providing guidance towards higher interest rates in 2014. Weak Chinese economic data and too tight monetary policy conditions stall gold demand.

six-month target: USD 1,100/oz

What we're watching

Physical demand/supply

Why it matters

- Central bank purchases need to come in at 45 tons a month in order to meet our expectations. We are also tracking India's jewelry demand, which is expected to recover with prices having declined meaningfully. Key dates: mid-May (WGC 1Q13 report)
- Supply-wise, South Africa's mine problems are unsolved and should command extra attention, especially for platinum and indirectly for palladium.
- With the gold price below USD 1,500/oz, scrap supply should drop by up to 5% y/y and help to balance the market in the coming quarters.

Investment flow

- Demand for bars/coins and ETF products needs to clock in at 120 tons per month this year to push prices up.

Monetary policy

Key dates: 1 May Fed meeting, and **monthly** US and EM inflation readings. A change in the 10-year TIPS yields should be tracked as they showed a diverging trend to gold.

Recommendations

Tactical (up to six months)

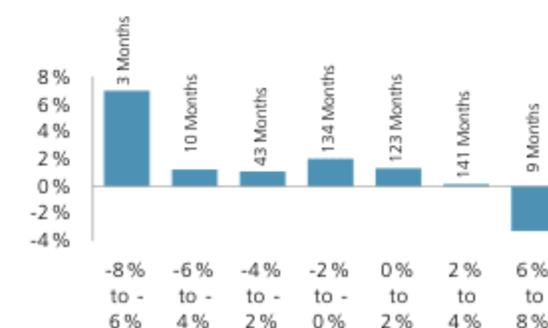
- Platinum remains our most preferred precious metal. No supply growth and firmer economic growth in 2H13 should enable platinum prices to move toward USD 1,800–1,850/oz later this year. We estimate a market deficit of 4.5% for the full year. Risk-seeking investors can opt for palladium, which should be in deficit by almost 9% in 2013. With a 12-month forecast at USD 925/oz, palladium offers a higher expected return, but with more risks.

Strategic (1–2 years)

- Holding some gold exposure is a viable and attractive strategy to hedge against excessive fiscal spending and the monetary debasement of the USD, EUR and JPY in order to protect investors' portfolios from unorthodox monetary policy measures.

The gold price performance under different US real interest rate environments

Time series ranges from 1971–March 2013, 3-month real interest rates



Source: Bloomberg, UBS, as of April 2013

Note: Past performance is not an indication of future returns.

Brent (23 Apr): USD 99/bbl (last month: USD 107/bbl)

Brent six-month target: USD 110/bbl

UBS view (crude oil)

- Seasonally weak demand in 2Q13 has pressured crude oil prices, with demand expected to rise by less than 0.5mbpd y/y. On the supply side, the prospects of South Sudan's return to markets tilts the bias toward an adequately supplied market and higher global oil inventories in the short run.
- We reiterate our view that price dips below USD 100/bbl for Brent should be used to start building some longs. Refineries restarting after the recent maintenance, an increase in Saudi domestic oil demand during the summer, and reaccelerating GDP growth imply that global incremental demand is likely to be above 1mpbd y/y in 2H13.
- A stepup in OPEC crude oil production to meet additional demand is required and spare capacity is likely to decline as a consequence in 2H13, making the oil market more vulnerable to supply outages and geopolitical concerns.
- The latest talks surrounding Iran's nuclear program ended with no agreement and scant signs of progress. While the Western world is likely to pursue further talks, the process is unlikely to be indefinite. Tighter sanctions reducing Iran's oil exports and a possible call for tougher action from the Israeli government could again increase the geopolitical risk premium on oil prices, which is probably close to zero at present.
- Hence, we expect Brent crude oil prices to move up to USD 110-115/bbl in 2H13.

Positive scenario

Brent six-month target: USD 140-165/bbl

- Iranian oil exports are subject to a complete embargo, draining another 0.75-1 mbpd out of global crude oil supply. Alternatively, a military confrontation affecting the supply of crude oil via the Strait of Hormuz or Venezuela generating serious social conflicts that bring crude oil production to a halt could lead to swift price spikes.

Negative scenario

Brent six-month target: USD 75-80/bbl

- Economic activity in the Eurozone does not stabilize and leads to meaningful weakness in global trade and in crude oil consumption. A restoration of Iranian exports and a sharp increase in US tight oil production push oil inventories up firmly and weaken Brent prices toward USD 80/bbl.

What we're watching

Middle East tensions

Why it matters

International sanctions have caused Iranian oil exports to drop to 1mbpd from 2.4mbpd before. We are also tracking MENA oil flows.

Supply

According to EIA, unplanned production outages in non-OPEC countries were 0.9mbpd in March 2013, driven by Syria, Yemen, and South Sudan. Non-OPEC supply should rise, due to higher US and Canadian oil supply in 2013. Saudi production levels are likely to stay above 9mbpd, keeping OPEC production above the "call on OPEC" in 1H13.

Demand

One-off factors that supported Chinese crude oil demand in 4Q12 are likely to weigh on demand in 1H13 – visible after Chinese New Year data. We are closely monitoring oil demand as we expect GDP activity to accelerate in 2H13.

Oil market reports

Key dates: 8 May, EIA short-term energy outlook; 14 May, IEA oil market report

Recommendations

Tactical (six months)

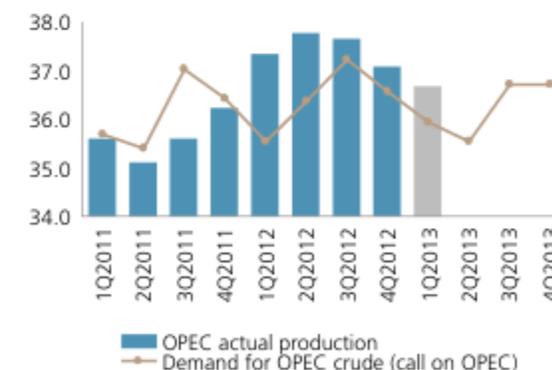
- Price setbacks to or below USD 100/bbl for Brent should be used to start building some long positions. Refinery restarts after maintenance, an increase in Saudi domestic oil demand during the summer and reaccelerating GDP growth imply stronger incremental demand on a global level (above 1mpbd y/y in 2H13) and higher prices

Strategic (3-5 years)

- To satisfy emerging market demand in the long run, long-dated crude oil prices around USD 90-95/bbl for Brent are unlikely to secure the needed investments to keep supply growing. This gives strategically oriented crude oil investors the opportunity to build up some long-term crude oil exposure over the next three to five years.

Call on OPEC to raise production in 2H13

Values are in mbpd



Source: IEA, UBS, as of April 2013

Note: Past performance is not an indication of future returns.

Current (23 Apr) (last month): **Copper USD 6,907/mt** (7,622); **Nickel USD 15,227/mt** (17,084); **Aluminum USD 1,865/mt** (1,915)

UBS view

Six-month target: Copper: USD 8,300/mt; Nickel: USD 18,750/mt; Aluminum: USD 2,100/mt

- The latest GDP figures from China (+7.7% y/y in 1Q13) underpin a weak economic demand backdrop for base metals, which has been reflected in falling base metal prices and soaring warehouse inventories. Furthermore, positioning data in copper futures stand at multi-year highs as investors have turned bearish on the metal.
- Nevertheless, the downside in base metal prices is likely to halt in 2Q13. As for aluminum, zinc and nickel, current prices are unsustainable from a production cost perspective and copper still faces a structurally constrained supply side.
- Given where prices are trading, a pickup in metal demand in 2H13 can allow prices to recover by 10%–15%. Firm credit activity in China suggests that industrial activity has room to gain some traction from disappointing levels below 10% y/y in 1Q13 towards 13% y/y. For a metal like aluminum this should allow China's demand to accelerate by a multiple of 1.2–1.5 times GDP.
- To be clear, the uptick in metal prices in 2H13 should be cyclical in nature only as China's economic growth is in a structural deceleration process. Moreover, the supply side in base metals is in good shape to react to higher prices in 2013 and 2014. Any market deficit over a quarter should therefore not be sustained.
- According to Brook Hunt, since June 2011, annualized production of 1.5mn tons of aluminum has already been curtailed (3.2% of 2012 global production). However, another 1–1.2mn tons of capacity cuts are required in 2013 to bring production capacity to adequate levels. In copper, mine supply growth is on track to reach 6% y/y in 2013 vs. 2012. That said, the latest mine accident at Rio's copper mine in Utah (US) might tweak this figure to the downside. In the case of zinc, production capacity is available to increase refined zinc output by 10% if prices give the right incentive to refineries. A similar picture can be found with regards to nickel and lead.

➤ Positive scenario

Upside potential for the sector: + 25%

- China eases monetary policy aggressively, thereby allowing money growth to reach 20% y/y in 2013. Central banks and politicians stabilize economic growth in Europe and provide a lift to US industrial activity.

➤ Negative scenario

Downside potential for the sector: - 15%

- Chinese authorities act too passively by keeping GDP growth on a constant deceleration path. An escalation of the Eurozone crisis or a military confrontation in the Strait of Hormuz could affect global trade and metal prices severely.

What we're watching Why it matters

CFTC positioning data, to gauge sentiment of speculative accounts. LME/SHFE exchange inventories: We monitor copper stock levels as a proxy for base metals, since any pickup in global PMIs should lead to a topping out of inventories over the next three months.

Supply Mine production outages due to strikes in Chile or technical factors (mine disruptions in the US) could tilt the bias towards a balanced market. Treatment charges for zinc in China; the industry could be loss-making again this year. For nickel – supply disruptions of new projects. As for aluminum, further production cutbacks by smelters.

Economic data

Key dates: 1–3 May, Chinese/US leading indicators; 10–15 May Chinese trade data, China 1Q GDP

Recommendations Tactical (six months)

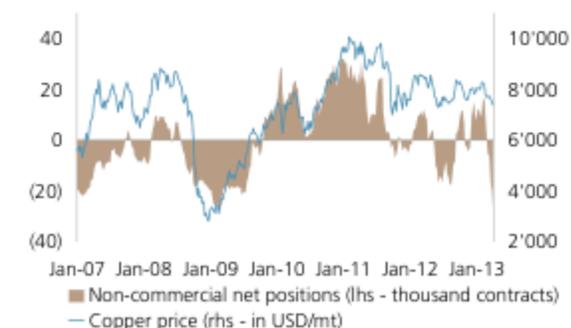
- We see room for higher base metal prices over the next six months. The key drivers relate to stronger Chinese industrial activity and a general pull (restocking) from EM countries. The pickup in demand should be visible in lower LME warehouse inventories topping out in 2Q13. The increase in base metal prices should be 10–15% and cyclical in nature only.

Strategic (two years)

- Zinc and lead could be among the strongest price performers over the next two years, as mine supply tops out in 2014-15 and 2015-16 due to aging mines. To compensate for mine closures and structurally higher demand, new zinc/lead mine capacity will be needed. At current price levels we are unlikely to see this expansion in supply. Hence we see prices trending toward USD 2,750/mt and 2,600/mt in the long run.

Investors have turned very bearish on copper – and on metals in general

Short positions in copper futures



Source: CFTC, Bloomberg, UBS, as of April 2013

Note: Past performance is not an indication of future returns.

Current (23 Apr) (last month): **Soybeans, USD 14.23/bu** (14.41); **Corn, USD 6.43/bu** (7.26); **Wheat, USD 6.97/bu** (7.30)

UBS view

Six-month target: Soybeans, USD 11.5/bu; Corn, USD 5.8/bu; Wheat, USD 6.2/bu

- The latest USDA WASDE report again surprised markets with a 4% smaller US grain ending stock than markets had initially expected following the release of the quarterly grain stocks report on 28 March. However, the world's grains inventories have been revised 3% higher than consensus, offsetting moderately bullish US inventory numbers.
- For corn, old crop stocks are still tight, but strong output from South America should be able to ease the tightness in the months ahead. Other areas of focus are the planting progress and weather conditions in the US. A strong rebound in the corn yield to 155 bu/acre could replenish the stocks in US and global markets alike, leaving room for corn prices to fall to USD 5.8/bu. As for soybeans, increasing exports from South America combined with a strong production outlook in the US should result in price setbacks to USD 12/bu or lower. Although wheat is not looking as weak as other grains due to lower output estimates in the US and improving US exports in the near term, prices are likely to follow other grains prices lower. Moreover, the forward curve for wheat is in contango, whereas the forward curve in soybeans and corn already reflects a steep decline in prices in 2H13.
- For softs, we still believe that coffee and sugar are in the process of finding a floor. Nearly 50% of the coffee area in Central America is affected by leaf rust, confirming the production losses will be extended in coming years. This should support the prices in 2H13. For sugar, support should come from more sugarcane being allocated to ethanol in Brazil, pushing the sugar price above USD 0.20/lb in the coming months.

➤ Positive scenario

Corn six-month USD 7.5/bu; Soybeans six-month USD 16/bu

- Poor soil moisture in the US can potentially undermine yield prospects for the grains in the coming quarters. Ethanol production to ramp up in the US and any delay in South American exports should support corn prices.

➤ Negative scenario

Corn six-month USD 4.9/bu; Soybeans six-month USD 10/bu

- A higher-than-expected South American crop and US export slowdown. Strong supply outlook for next year's crop due to higher acreage and normalizing yields. Weak Chinese protein demand due to bird flu concerns is also a factor.

What we're watching

USDA WASDE report (monthly)

US grain stocks report (quarterly)

USDA acreage report (annual)

COT (weekly, Friday)

Why it matters

The May WASDE report will be important for the market as it includes the first global supply-demand estimates for the next crop year. We expect it to show better supply numbers for 2013/14. **Key date: 10 May**

The latest grains stocks report revealed weaker demand during Dec'12–Feb'13 than market expectations. **Key date: 28 June**

We see some upward revisions in the final acreage estimates in June especially for soybeans. **Key Date: 28 June**

Investors' net long positions remain sensitive to US weather conditions and export activities in South America. Over the next 6–12 months we expect a decline in long positioning. These figures could decline faster with bird flu concerns in China spreading.

Recommendations

Tactical

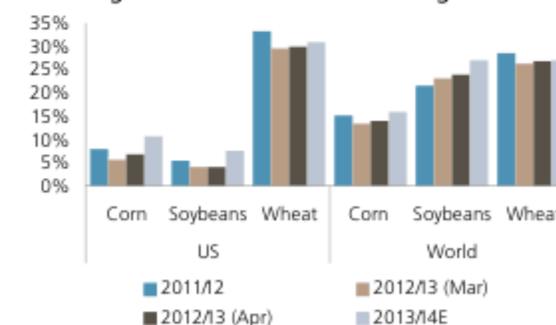
- Investors should not hold any outright long positions in grains as the market focus will now shift to ample supply over the next 3–6 months. A bumper harvest in South America and normalizing yields should further weigh on prices in the months ahead – especially on soybeans and corn.

Strategic

- Our expected spot move for grains stands at around –10 to –15 % over the next 12 months. Given current prices, the supply side is very likely to expand considerably in 2013-14 and put pressure on prices in coming quarters. Until we do not see another round of price weakness, we recommend no long positions.

Old crop inventories not as tight as expected

US and global stock-to-use ratios for grains



Source: USDA, UBS, as of April 2013

Note: Past performance is not an indication of future returns.

UBS Global Index DTR (24 April): 1,835 (last month: 1,701)

UBS Global Index DTR (six-month target): 1,850

UBS view

- Listed real estate performed in line with global equities over the past month as investors sought fewer risks. We continue to see low financing costs, low supply and a good yield pick-up relative to investment grade corporate bonds. Listed real estate is not cheap but is still attractive compared to other investment options.
- Ongoing loose monetary policies in the developed world and reflationary efforts in Japan are keeping refinancing rates low, flattening the yield curves, providing cheap financing for REITs and supporting slight ongoing value appreciation. Public real estate companies still refinance their debt at lower yields and with longer durations. The global supply remains comparatively low. Improving leasing activities should help rents rise slightly.
- Both the implied property yield spreads to bonds and the earnings yield spreads over five-year swap rates remain attractive. Property yields are broadly at historically average levels and offer healthy spreads. Growth surprises would be a plus, but an ongoing economic recovery still supports the asset class.
- We prefer the US and Asia over the UK on valuation concerns and over Continental Europe, where market fundamentals are still weak and rental growth is at risk despite diminishing tail risks. The Hong Kong, Chinese and Singaporean governments continue to fight overheating residential property markets using various measures that should predominantly affect developers and less so the landlords. We watch the strong outperformance of JREITs closely, but still expect ongoing support from the BoJ and maintain an overweight in Japan.

➤ Positive scenario

- Ongoing reflationary monetary policies across the world push investors towards risky assets, and the expectation of an increase in inflation favors real estate as an inflation hedge, while attracting more loss-making bond investors. Real estate provides good exposure to the recovery of risky assets and performs in line or only slightly below equities.

➤ Negative scenario

- Global growth rates disappoint investor expectations and new recession risks trigger a tightening of credit standards that cut real estate companies off from the capital market, making listed real estate more dependent on bank financing. Real estate underperforms global equities.

UBS Global Index DTR (six-month target): 1,900

UBS Global Index DTR (six-month target): 1,500

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Global transaction volumes and rental growth in direct markets

Capitalization rates and rental yields

Credit markets and financing costs

Why it matters

Global real estate markets are expected to deliver around USD 500bn in commercial transactions in 2013, a pick-up of 10–15% versus 2012. We see upside in Asia and in the best secondary US markets, where the market is hitting a turning point. Increased optimism should translate into renewed growth in leasing activities with modest prime rent increases of 2–3%. A shortage of high quality and low levels of construction support a gradual decreasing office vacancy rate to below 13%.

We expect capitalization rates to stay supportive at low levels or to even decrease further but slightly. Decreasing bond yields have already pushed down rental yields, but they remain favorable compared to current bonds yields, while prime yields are increasingly below their historical levels. Yet, a flat interest curve continues to help long-term refinancing in a low-growth, low interest rate environment.

Lending conditions are still challenging for developers and private investors. Public real estate companies in contrast have very good access to credit and capital.

Recommendations

Tactical (six months)

- We are staying neutral on listed real estate as it is expected to go on profiting from the global non-inflationary economic recovery. It is supported in the current low interest rate and low growth environment and benefits from earnings stability and income visibility. We overweight the US and Asia and underweight the UK and continental Europe due to soft fundamentals.

Strategic (1–2 years)

- The asset class should deliver comparatively solid returns on investment. Refinancing conditions are supportive; we expect slowly rising payout ratios coupled with portfolio optimizations and dividend growth. Weak economic growth and rightsizing limit rental income growth, but companies with sound balance sheets trading at a premium can make accretive acquisitions.

Our market preferences (six months)

For listed real estate relative to global real estate*

Current most preferred	Current least preferred
Australia	Continental Europe
Emerging Asia	UK
Hong Kong Landlords	
Japan Property	
Japan REITs	
US REITs	

* This is our relative preference within the global real estate markets based on UBS Global Real Estate Index domestic total return, which is not the overall sector view

Source: UBS, as of 19 April 2013

Note: Past performance is not an indication of future returns.

For further information please contact CIO asset class specialist Thomas Veraguth, [REDACTED]

Please see important disclaimer and disclosures at the end of the document.

Hedge funds

UBS view

- HF managers attempt to capture most of the upside of risky assets while limiting drawdown. Capital protection is crucial to the process as large losses are detrimental to the rate at which capital compounds. Some HF strategies have proven to be less tied to stocks and bonds, offering important diversification in times of equity distress and rising interest rates.
- The recovery of the US housing market and cyclical upswings in most regions are now underway, with China and the rest of Asia rebounding. These trends benefit **equity long-short**, notably net long. Falling intra-stock correlations add to the positive environment for bottom-up fundamental equity long-short strategies.
- **For relative-value**, the stable macroeconomic backdrop supports (non-Treasury) spread products such as corporate bonds, emerging markets and securitized products (e.g. residential mortgage-backed securities). Long-short credit managers could allocate away from duration-sensitive products over time into securities not tied to the interest rate cycle. Market participant numbers have declined significantly following the adoption of the Volcker rule, which forced firms to exit from proprietary trading desks conducive to fixed income arbitrage strategies.

Prefer relative-value and equity long-short strategies

➤ Positive scenario

- Robust economies drive up risky assets, including equities; lower intra-stock correlation and volatility, and boost the **equity** cycle. These developments help bottom-up fundamental strategies such as equity long-short and event-driven managers the most.

➤ Negative scenario

- Short-term reversals due to central bank interventions and stimulus effects continue to plague the market – an obstacle for trend-following managers. Still, unmanaged European deleveraging (or the US fiscal deficit) could threaten risky assets. Trading can do well if such a scenario unfolds.

Prefer equity long-short and event-driven

Prefer trading (Global Macro + CTA)

Note: Scenarios refer to global economic scenarios (see slide 8).

What we're watching

Global equity direction/
economic cycle

Correlation

Leverage

Volatility

Liquidity

Regulation

Why it matters

The outlook for global equities is an important HF performance driver. The economic cycle affects strategies differently.

Correlation is an important performance/alpha driver for equity long-short, the primary HF strategy according to assets under management.

Gross and net leverage are key to monitoring risk.

The direction influences certain HF strategies (e.g. convertible arbitrage).

Important in particular for large, less nimble HFs, as it enables them to enter and exit their strategies.

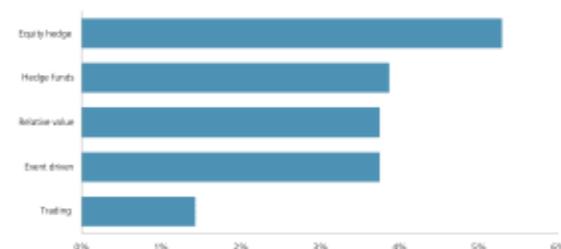
Volcker rule, USCITS III/IV

Recommendations

Strategic (1–2 years)

- **Recommendation:** We recommend equity long-short and relative-value strategies. We are positive about global equities with intra-stock correlations falling, an environment conducive to equity long-short strategies. The stable macroeconomic backdrop and diminishing competition from bank proprietary traders help relative-value arbitrageurs.
- **Value proposition:** Hedge funds should achieve robust performance over an extended horizon while displaying limited volatility vis-à-vis equities and other risky assets. Hedge funds try to minimize downside losses in adverse market conditions (through active risk management), which plays a crucial role in wealth appreciation. Similarly, hedge fund managers attempt to capture most of the upside of risky assets owing to a valid value proposition.

Performance comparison



Source: HFRI, Bloomberg, as of 8 April 2013

Note: Past performance is not an indication of future returns.

Private equity

UBS view

- Global ██████ volume has continued its downward trend since 2010, falling 3% on 2011 and still 41% below the peak achieved in 2007. However, 2H12 was up 13% vs. 1H, driven by a strong fourth quarter, the highest figure in two years, showing improved confidence for deal makers. Private equity investors are also more active again, with deal volumes in 2H12 up 40% vs. 1H12. Exit activity also continues at a healthy pace, with diversified private equity investors obtaining attractive distributions from their mature portfolios.
- We prefer buyout strategies in North America given liquid debt markets and our house view of economic outperformance vs. Europe. Emerging markets offer compelling opportunities for PE investors, especially outside the main hubs (China, Brazil), which have become expensive. Direct lending to companies is also attractive in Europe, where debt markets are less liquid and still dominated by banks.

Prefer small-/mid-cap buyouts in US/emerging markets; distressed debt in Europe

➤ Positive scenario

- An abating Eurozone debt crisis and improved business confidence increase deal flow and exit opportunities for private equity managers, but also increase entry prices. In such a positive scenario, we would perceive commitment strategies to secondary funds as attractive for building exposure to an invested private equity portfolio.

➤ Negative scenario

- A renewed escalation of the debt crisis significantly impacts deal activity, the availability of debt and company owners' willingness to sell. At the same time, it would offer even more attractive opportunities within distressed strategies and lower entry prices for long-term private equity investors.

Note: Scenarios refer to global economic scenarios (see slide 8).

Prefer small-/mid-cap buyouts and secondaries

Prefer distressed debt

What we're watching

Why it matters

Credit markets

In 2012, leveraged loan issuance, an important component of PE activity, grew 34% y/y in the US, but fell by more than 34% in Europe. The US debt market is much deeper than Europe's, raising over EUR 360bn of leveraged debt while Europe raised only EUR 29bn with more restrictive debt structures.

Exit activity

Exit activity is an important indicator of the health of the PE market and a key return driver for investors. Despite the difficult macro environment, 4Q 2012 distributions from portfolio sales (USD 73bn) have held up, and grew >65% y/y.

Prices for LBOs

Average purchase prices for new buyouts in the US are at 8.3x EBITDA (full-year 2012 figures), in line with the 10-year average (8.2x); Europe is more expensive (9.3x), 5% above 2011 and 10% above the 10-year average (8.5x).

Recommendations

Strategic (1–2 years)

- The current economic environment of global deleveraging, banking disintermediation in Europe and emerging market growth offers attractive opportunities for illiquid private equity strategies.

Private equity preferences

- Global **private equity secondaries** to capitalize on regulation-driven sales by banks and insurance companies at attractive discounts of 15–20% to net asset value.
- Direct lending** to companies in Europe, where debt markets are less liquid than in the US and still dominated by banks, which are reducing lending.
- Growth and buyout capital** in emerging markets, to access superior growth and attractive consumer dynamics.
- Within real assets, we like **opportunistic strategies** in US real estate and lending strategies within European commercial real estate, which are attractive as banks shrink their loan portfolios.

Investment preferences (new PE commitment strategies)

Current most preferred strategies

Current least preferred strategies

Secondaries (global)

Large-cap buyout (Europe)

Direct lending (Europe)

Venture capital (Europe)

Small-cap buyout (Latin America, South-East Asia)

For further information please contact CIO asset class specialist Stefan Brägger, ██████████

Please see important disclaimer and disclosures at the end of the document.

Note: We emphasize the equal importance of fund manager selection and the commitment strategy. Please note that private equity is an illiquid asset class and must be held at least until the end of the fund (10+ years). Please note that UBS might not have a product available which reflects our UBS CIO private equity recommendations. Private equity is only suitable for qualified investors (> USD 5m investable assets).

Contact list

UBS WM Global Chief Investment Officer

Alexander Friedman
[REDACTED]

UBS WM Global Head of Investment

Mark Haeefele
[REDACTED]

UBS CIO WM Global Investment Office

Asset Allocation Advisory

Mark Andersen
[REDACTED]

Asset Allocation Discretionary

Mads Pedersen
[REDACTED]

Chief Investment Officer, UHNW

Simon Smiles
[REDACTED]

Alternative Investments

Andrew Lee
[REDACTED]

Research Co-Head

Loris Centola
[REDACTED]

Research Co-Head

Philippe G. Müller
[REDACTED]

UBS CIO WM Regional Chief Investment Officers

Europe

Andreas Höfert
[REDACTED]

Switzerland

Daniel Kalt
[REDACTED]

Asia-Pacific

Yonghao Pu
[REDACTED]

Asia-Pacific (South)

Kelvin Tay
[REDACTED]

Emerging Markets

Jorge Mariscal
[REDACTED]

Disclaimer

UBS CIO WM Research is published by Wealth Management & Swiss Bank and Wealth Management Americas, Business Divisions of UBS AG (UBS) or an affiliate thereof. In certain countries UBS AG is referred to as UBS SA. This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis and/or may not be eligible for sale to all investors. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness (other than disclosures relating to UBS and its affiliates). All information and opinions as well as any prices indicated are current as of the date of this report, and are subject to change without notice. Opinions expressed herein may differ or be contrary to those expressed by other business areas or divisions of UBS as a result of using different assumptions and/or criteria. At any time UBS AG and other companies in the UBS group (or employees thereof) may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realizable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. UBS relies on information barriers to control the flow of information contained in one or more areas within UBS, into other areas, units, divisions or affiliates of UBS. Futures and options trading is considered risky. Past performance of an investment is no guarantee for its future performance. Some investments may be subject to sudden and large falls in value and on realization you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein. This document may not be reproduced or copies circulated without prior authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law. In developing the Chief Investment Office economic forecasts, CIO economists worked in collaboration with economists employed by UBS Investment Research. Forecasts and estimates are current only as of the date of this publication and may change without notice.

External Asset Managers / External Financial Consultants: In case this research or publication is provided to an External Asset Manager or an External Financial Consultant, UBS expressly prohibits that it is redistributed by the External Asset Manager or the External Financial Consultant and is made available to their clients and/or third parties. **Australia:** 1) **Clients of UBS Wealth Management Australia Ltd:** This notice is distributed to clients of UBS Wealth Management Australia Ltd ABN 50 005 311 937 (Holder of Australian Financial Services Licence No. 231127), Chifley Tower, 2 Chifley Square, Sydney, New South Wales, NSW 2000, by UBS Wealth Management Australia Ltd.: This Document contains general information and/or general advice only and does not constitute personal financial product advice. As such the content of the Document was prepared without taking into account the objectives, financial situation or needs of any specific recipient. Prior to making any investment decision, a recipient should obtain personal financial product advice from an independent adviser and consider any relevant offer documents (including any product disclosure statement) where the acquisition of financial products is being considered. 2) **Clients of UBS AG:** This notice is issued by UBS AG ABN 47 088 129 613 (Holder of Australian Financial Services Licence No 231087): This Document is issued and distributed by UBS AG. This is the case despite anything to the contrary in the Document. The Document is intended for use only by "Wholesale Clients" as defined in section 761G ("Wholesale Clients") of the Corporations Act 2001 (Cth) ("Corporations Act"). In no circumstances may the Document be made available by UBS AG to a "Retail Client" as defined in section 761G of the Corporations Act. UBS AG's research services are only available to Wholesale Clients. The Document is general information only and does not take into account any person's investment objectives, financial and taxation situation or particular needs. **Austria:** This publication is not intended to constitute a public offer or a comparable solicitation under Austrian law and will only be used under circumstances which will not be equivalent to a public offering of securities in Austria. The document may only be used by the direct recipient of this information and may under no circumstances be passed on to any other investor. **Bahamas:** This publication is distributed to private clients of UBS (Bahamas) Ltd and is not intended for distribution to persons designated as a Bahamian citizen or resident under the Bahamas Exchange Control Regulations. **Bahrain:** UBS AG is a Swiss bank not licensed, supervised or regulated in Bahrain by the Central Bank of Bahrain and does not undertake banking or investment business activities in Bahrain. Therefore, Clients have no protection under local banking and investment services laws and regulations. **Belgium:** This publication is not intended to constitute a public offering or a comparable solicitation under Belgian law, but might be made available for information purposes to clients of UBS Belgium NV/SA, a regulated bank under the "Commission Bancaire, Financière et des Assurances", to which this publication has not been submitted for approval. **Canada:** In Canada, this publication is distributed to clients of UBS Wealth Management Canada by UBS Investment Management Canada Inc.. **Dubai:** Research is issued by UBS AG Dubai Branch within the DIFC, is intended for professional clients only and is not for onward distribution within the United Arab Emirates. **France:** This publication is distributed by UBS (France) S.A., French "société anonyme" with share capital of € 125.726.944, 69, boulevard Haussmann F-75008 Paris, R.C.S. Paris B 421 255 670, to its clients and prospects. UBS (France) S.A. is a provider of investment services duly authorized according to the terms of the "Code Monétaire et Financier", regulated by French banking and financial authorities as the "Banque de France" and the "Autorité des Marchés Financiers". **Germany:** The issuer under German Law is UBS Deutschland AG, Bockenheimer Landstrasse 2-4, 60306 Frankfurt am Main. UBS Deutschland AG is authorized and regulated by the "Bundesanstalt für Finanzdienstleistungsaufsicht". **Hong Kong:** This publication is distributed to clients of UBS AG Hong Kong Branch by UBS AG Hong Kong Branch, a licensed bank under the Hong Kong Banking Ordinance and a registered institution under the Securities and Futures Ordinance. **India:** Distributed by UBS Securities India Private Ltd. 2/F, 2 North Avenue, Maker Maxity, Bandra Kurla Complex, Bandra (East), Mumbai (India) 400051. Phone: +912261556000. SEBI Registration Numbers: NSE (Capital Market Segment): INB230951431, NSE (F&O Segment) INF230951431, BSE (Capital Market Segment) INB010951437. **Indonesia:** This research or publication is not intended and not prepared for purposes of public offering of securities under the Indonesian Capital Market Law and its implementing regulations. Securities mentioned in this material have not been, and will not be, registered under the Indonesian Capital Market Law and Regulations. **Italy:** This publication is distributed to the clients of UBS (Italia) S.p.A., via del vecchio politecnico 3, Milano, an Italian bank duly authorized by Bank of Italy to the provision of financial services and supervised by "Consob" and Bank of Italy. UBS Italia has not participated in the production of the publication and of the research on investments and financial analysis herein contained. **Jersey:** UBS AG, Jersey Branch, is regulated and authorized by the Jersey Financial Services Commission for the conduct of banking, funds and investment business. **Luxembourg:** This publication is not intended to constitute a public offer under Luxembourg law, but might be made available for information purposes to clients of UBS (Luxembourg) S.A., a regulated bank under the supervision of the "Commission de Surveillance du Secteur Financier" (CSSF), to which this publication has not been submitted for approval. **Mexico:** This document has been distributed by UBS Asesores México, S.A. de C.V., a company which is not subject to supervision by the National Banking and Securities Commission of Mexico and is not part of UBS Grupo Financiero, S.A. de C.V. or of any other Mexican financial group and whose obligations are not guaranteed by any third party. UBS Asesores México, S.A. de C.V. does not guarantee any yield whatsoever. **Singapore:** Please contact UBS AG Singapore branch, an exempt financial adviser under the Singapore Financial Advisers Act (Cap. 110) and a wholesale bank licensed under the Singapore Banking Act (Cap. 19) regulated by the Monetary Authority of Singapore, in respect of any matters arising from, or in connection with, the analysis or report. **Spain:** This publication is distributed to clients of UBS Bank, S.A. by UBS Bank, S.A., a bank registered with the Bank of Spain. **UAE:** This research report is not intended to constitute an offer, sale or delivery of shares or other securities under the laws of the United Arab Emirates (UAE). The contents of this report have not been and will not be approved by any authority in the United Arab Emirates including the UAE Central Bank or Dubai Financial Authorities, the Emirates Securities and Commodities Authority, the Dubai Financial Market, the Abu Dhabi Securities market or any other UAE exchange. **UK:** Approved by UBS AG, authorized and regulated in the UK by the Financial Services Authority. A member of the London Stock Exchange. This publication is distributed to private clients of UBS London in the UK. Where products or services are provided from outside the UK, they will not be covered by the UK regulatory regime or the Financial Services Compensation Scheme. **USA:** This document is not intended for distribution into the US and / or to US persons. UBS Securities LLC is a subsidiary of UBS AG and an affiliate of UBS Financial Services Inc., UBS Financial Services Inc. is a subsidiary of UBS AG.

Version 1/2013.

© UBS 2013. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.