

# Global Perspectives

Multi Asset | April 30, 2016

## Overview

**Equities:** Improving investor sentiment about global growth in general, and China in particular, helped commodity prices (including oil) garner strong gains and global equity markets to reap a second consecutive month of positive returns in April. The absence of further stimulus measures from central banks meant overall global equity gains were limited.

**Fixed Income:** Within fixed income, credit spreads tightened and high yield debt rallied while developed world sovereign bonds fell – reflecting the overall “risk on” backdrop.

**Currency:** The major move over the month was the strengthening of the Japanese yen (JPY) in the wake of the Bank of Japan’s (BoJ) April meeting. Elsewhere the British pound (GBP) rallied while on a trade-weighted basis, the euro (EUR) and US dollar (USD) both weakened.

## The month in review:

- The FTSE World Index rose 0.8% in local currency terms in April. Improving investor sentiment about global growth in general, and China in particular, helped equity markets post another month of gains. However, those gains were limited by the failure towards the end of the month of the BoJ to provide the additional policy stimulus that markets were expecting. A particular characteristic of the month was the continued outperformance of cyclically sensitive stocks, sectors and countries. Mining was the best performing sector globally, mirroring the strong performance of underlying commodity prices, including oil, while banks also enjoyed a rare month of outperformance.
- None of the major developed world central banks made policy changes over the month, although both the European Central Bank (ECB) and BoJ left the door open in their announcements to additional stimulus measures in the future. In the US, the Federal Reserve confirmed that its policy remained data dependent but did not mention external conditions or financial risks in its statement.
- Within fixed income, credit spreads tightened and high yield debt rallied, benefiting from the rising oil price and increase in investor risk appetite. In a lackluster month for developed world government bonds, UK gilts and Italian BTPs were the worst performing.
- In currency markets, the major move over the month was the strengthening of the JPY against a host of major currencies in the wake of the BoJ’s decision not to broaden its stimulus

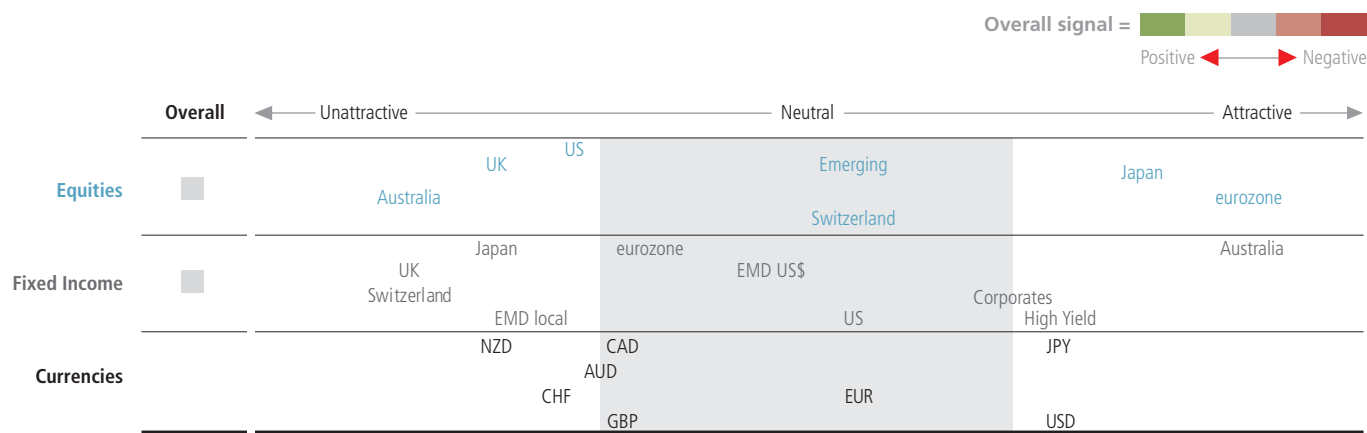
package despite recent weak data. Elsewhere, the GBP rallied after President Obama lent support to the “Remain” campaign ahead of the June 23rd UK Referendum on EU membership. On a trade-weighted basis, the EUR and USD both weakened.










## Outlook:

- While overall sentiment has improved since the start of the year, markets continue to be sensitive to economic data and the actions of central banks. Our view is that this is unlikely to change in the near term and that volatility is therefore likely to remain a feature in the coming months. Other potential catalysts to higher asset price volatility include heightened geopolitical risks ahead of the UK referendum, US presidential elections and debt negotiations in Greece. Although concerns about an imminent hard landing in China have dissipated due to the positive impact of recent fiscal stimulus, long-term challenges still remain a concern in the country.
- Global equity valuations in aggregate do not currently give a strong valuation signal, but with a muted growth backdrop and a bias to earnings downgrades, we believe the outlook for equities as a whole remains challenging.
- This broadly neutral view on equities in aggregate disguises some high conviction views at the individual country level. Supported by more attractive valuations and more obvious positive catalysts within equity holdings, we continue to prefer European and Japanese equities over the US. Overall, we believe the risk/return trade-off to be more attractive in credit than in equities.

## Current views<sup>1</sup>

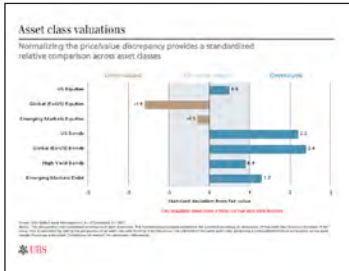
Asset allocation and currency attractiveness based on fundamental valuation and market behavior analysis



Asset Class	Overall signal	UBS Asset Management's viewpoint
<b>US Equities</b>		<ul style="list-style-type: none"> <li>Our analysis shows US equities at the very upper end of fair value and close to overvalued in a historical context. With US corporate margins at historic highs, the outlook for profits relative to expectations remains challenging.</li> <li>We see a tightening policy environment as a headwind to further equity market gains, albeit the demand backdrop currently warrants only gradual increases.</li> <li>Data over the past month reveal continued labor market strength, signs of emerging inflationary pressures and mixed signals from the manufacturing sector. Overall, we see little opportunity for any meaningful short-term positive catalyst to equities from the current domestic macroeconomic environment.</li> </ul>
<b>Global (Ex-US) Equities</b>		<ul style="list-style-type: none"> <li>We retain our preference for developed equity markets outside of the US, particularly the eurozone and Japan.</li> <li>Within the eurozone, we see a more compelling valuation and earnings recovery story among more domestically focused smaller companies than more export-oriented large caps.</li> <li>While neither the BoJ nor the ECB added to existing stimulus measures at their April meetings, overall policy in both countries remain loose and broadly supportive to equities in our view.</li> <li>Overall, the latest data, though uneven, reinforces our view that the eurozone recovery remains on track. Initial estimates of 1Q16 GDP came in above expectations at 0.6% quarter-over-quarter versus 0.4% expected.</li> </ul>
<b>Emerging Markets Equities</b>		<ul style="list-style-type: none"> <li>Emerging markets equities look attractively valued on pure earnings measures, but this is not enough in isolation to drive a positive stance. The growth and profits outlook in many emerging economies is held back by excess industrial capacity and sizable external debt loads. Our preference is for the equity markets of the stronger current accounts of oil-importing North Asian economies.</li> <li>We see Latin American markets as overly reliant on commodity exports. After the very strong recent outperformance of Brazilian equities, we have a clear preference within the region for the healthier fundamentals and more stable economic growth outlook offered by Mexico.</li> </ul>
<b>US Bonds</b>		<ul style="list-style-type: none"> <li>With low yields and a rising interest rate backdrop we see nominal US government bonds as unattractive.</li> <li>With the year-over-year base effects of oil rolling off and emerging wage pressures, there appears to be an unwarranted asymmetric outcome probability priced in to the wider market's dovish expectations on medium-term US inflation risks. We, therefore, prefer US Treasury Inflation-Protected Securities (TIPS).</li> </ul>
<b>Global (Ex-US) Bonds</b>		<ul style="list-style-type: none"> <li>In aggregate, we see global bonds outside of the US as unattractively valued with German bunds standing out as one of the most overvalued markets.</li> <li>We have a preference for Canadian bonds, which we see as an attractive hedge for lower oil prices and high yield distress given the importance of energy to the Canadian economy. We also believe that the Canadian economy has a long process of restructuring ahead as its reliance on the energy sector diminishes. The diverging fortunes of provinces make monetary policy very difficult for the Bank of Canada.</li> </ul>
<b>Investment Grade Corporate Debt</b>		<ul style="list-style-type: none"> <li>Our positive view on investment grade bonds relative to developed world sovereign debt is largely predicated on valuations and the former's attractive yield pick-up. We do not believe that a sharp rise in defaults at the higher quality end of corporate debt to be likely and see global investment grade corporates as continuing to offer an attractive risk and return profile compared with government bonds.</li> </ul>
<b>High Yield Bonds</b>		<ul style="list-style-type: none"> <li>We continue to like European high yield. Supported by the European recovery story and loose ECB policy, spreads over European government bonds are attractive and quality remains high.</li> </ul>
<b>Emerging Markets Debt</b>		<ul style="list-style-type: none"> <li>Our overall view on external (USD-denominated) emerging market government bonds remains neutral.</li> </ul>
US dollar		<ul style="list-style-type: none"> <li>While we continue to be negative on local currency-denominated emerging market sovereigns in aggregate, a number of currencies within this broad universe now look attractive on a long-term basis.</li> </ul>
Local currency		
<b>Currency</b>		<ul style="list-style-type: none"> <li>Among developed market currencies, we find the USD attractively valued and the Swiss franc to be among the most expensive currencies globally on our long-term analysis. We see a number of catalysts for the reversal of short-term USD weakness as Fed policy normalizes while the Swiss National Bank embraces negative rates.</li> <li>Within emerging markets we see both Korean and Taiwanese economies as vulnerable to a Chinese slowdown. In contrast, India seems to be an outlier in Asia with good policies, stronger growth, rising real interest rates and a relatively low exposure to China. We see the Indian rupee as attractive versus the Korean won and the Taiwan dollar.</li> </ul>

<sup>1</sup> Source: UBS Asset Management. As of April 30, 2016.

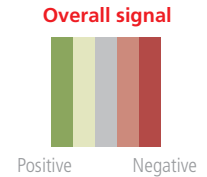
**Valuations plus one or more market behavior indicators provide an overall signal**



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**Market themes**

Market opportunities that we believe will drive markets in the longer term but have an immediate impact. This helps put valuation into context. For example: "European debt crisis," "aging population" or "deleveraging."

**Momentum and flow**

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

**Market stress**

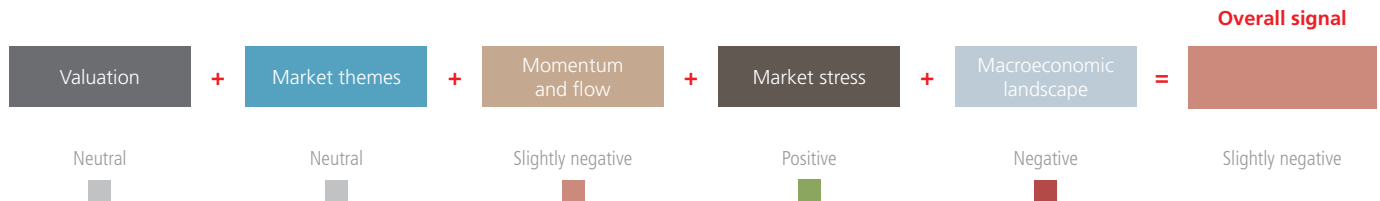
We created a proprietary stress index to help gauge price dislocations and investor risk appetite. It comprises several spread measures across credit markets, currencies and cash markets, as well as measures of market sentiment, such as the Chicago Board Options Exchange Market Volatility Index (VIX).

**Macroeconomic landscape**

Understanding the current position (recovery, expansion, slowdown, recession) in the economic cycle of a country or region. We also consider the baseline and alternative economic scenarios of countries and regions and how asset classes may react differently in these scenarios.

**US Equities example as of April 30, 2016**

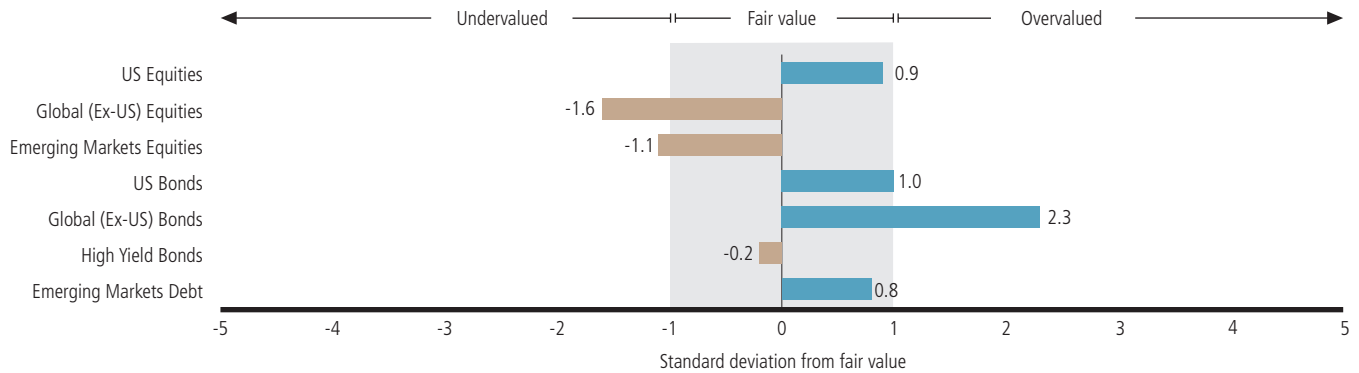
Valuation and market behavior indicators at work



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

## Normalized asset class valuations<sup>2</sup>

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



<sup>2</sup> Based on UBS Asset Management's views. As of April 30, 2016.

### Definitions of metrics:

- 1. Asset Class/Benchmark:** All investment expectations displayed here are modeled from the discounted cash flows as replicated by the relevant publicly available index. This bears mentioning because these expectations are developed assuming no benefit from active management (i.e. security selection) within the asset classes themselves.
- 2. Price/Value:** An intrinsic value based on the cash flows that an asset class provides—discounted at an appropriate rate of return (the required rate of return)—is identified for each of the asset classes listed. The cash flows would be those that would be expected to pass through to the asset holder; in the case of equities, the relevant cash flows are earnings and non-reinvested earnings (including, though not exclusively, dividends). That intrinsic value is then compared to the market price for the proxy index, and the degree of over- or undervaluation is thereby calculated in percent.
- 3. Normalized Price/Value:** The normalized price/value represents the standard deviation, or dispersion, of the asset class from our estimate of fair value. Normalizing the price/value discrepancy provides a standardized relative comparison across asset classes. The normalized price/value is calculated by taking the price/value of an asset class and dividing it by the secular risk estimate of the same asset class.

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