

UBS House View

Monthly Base **September 2016**

Chief Investment Office WM

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This document is a snapshot view. We update the tactical asset allocation
as changes occur and resend it to subscribers. For all other forecasts and
information, we advise you to check the Investment Views section in your E-
Banking or in Quotes.

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Summary

"The fundamental improvements and our outlook for EPS growth supports our continued tactical overweight in US equities against high grade bonds."

- **Asset allocation**

Economic momentum in the US has advanced since Q2, supported by solid consumer spending as labor market conditions continue to strengthen. Meanwhile, leading indicators point to ongoing improvement in the manufacturing sector. Emerging market economic activity is stabilizing. Global monetary policy remains highly accommodative, with new easing measures recently introduced by the BoE and the BoJ. We expect the first rate hike by the US Fed is likely to take place in December. Markets have started to price in Fed rate hikes again and while we are late in the cycle, the fundamental improvements and our outlook for EPS growth supports our continued tactical overweight in US equities against high grade bonds. Positive earnings growth is expected in 2H amid fading headwinds from the strong dollar and weak oil prices. Topline growth is bottoming and margins are stabilizing.

- **Equities**

We also hold a tactical overweight in emerging market (EM) equities against Swiss equities. Emerging markets are showing signs of stabilizing economic activity while earnings are improving. Swiss equities are expected to benefit less from improving global growth than the more cyclical emerging markets, while Swiss financial sector earnings face the challenge of low interest rates. We are removing our underweight position in Australian equities against EM equities, where applicable, following surprisingly weak news flow on Australian banks and the stronger AUD pressuring already weak earnings growth further. Investors who previously held an underweight in Australian equities should underweight Swiss equities against EM equities instead.

- **Bonds**

Improving global growth prospects and continued accommodative monetary policies have supported a search for yield, benefiting risky credit assets in particular. We maintain a tactical preference for USD investment grade (IG) corporate bonds over high grade (HG) bonds. USD IG bonds benefit from an attractive yield pickup with a current yield-to-maturity of 2.2%, while credit risks are compensated for at current spread levels. Meanwhile, HG bond yields remain close to historical lows, with flat returns expected over the next six months. We maintain a neutral position in euro and US high yield and EM bonds, as we consider the extent of further credit spread tightening, and price upside, limited.

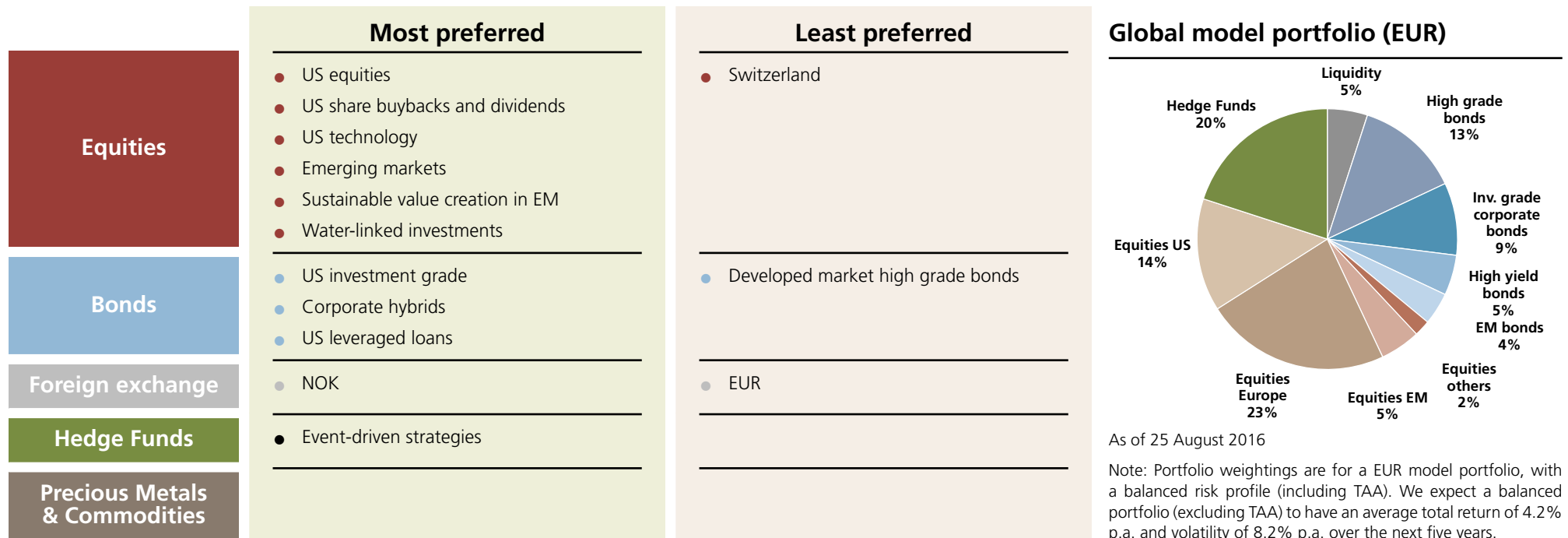
- **Foreign exchange**

We maintain a tactical overweight position in the Norwegian krone over the euro. The Norwegian economy continues to show strong momentum, with rising growth and inflation supporting our case that the easing cycle in Norway is ending. Meanwhile, Eurozone inflation remains far from the ECB's 2% target, and we expect the ECB to engage in further monetary easing.

- **Alternative investments and precious metals & commodities**

Following a weak start this year, diversified hedge fund returns have stabilized in recent months. The asset class should play an important role in portfolios as it provides access to alternative drivers of risks and returns and thus increases diversification. The outlook for broadly diversified commodity indices remains unattractive, with negative total returns expected over the next three to six months. We currently do not recommend any direct commodity exposure. We recommend investors with very long investment horizons (beyond a decade) to include illiquid assets in their portfolios, including private equity, private debt and illiquid real estate.

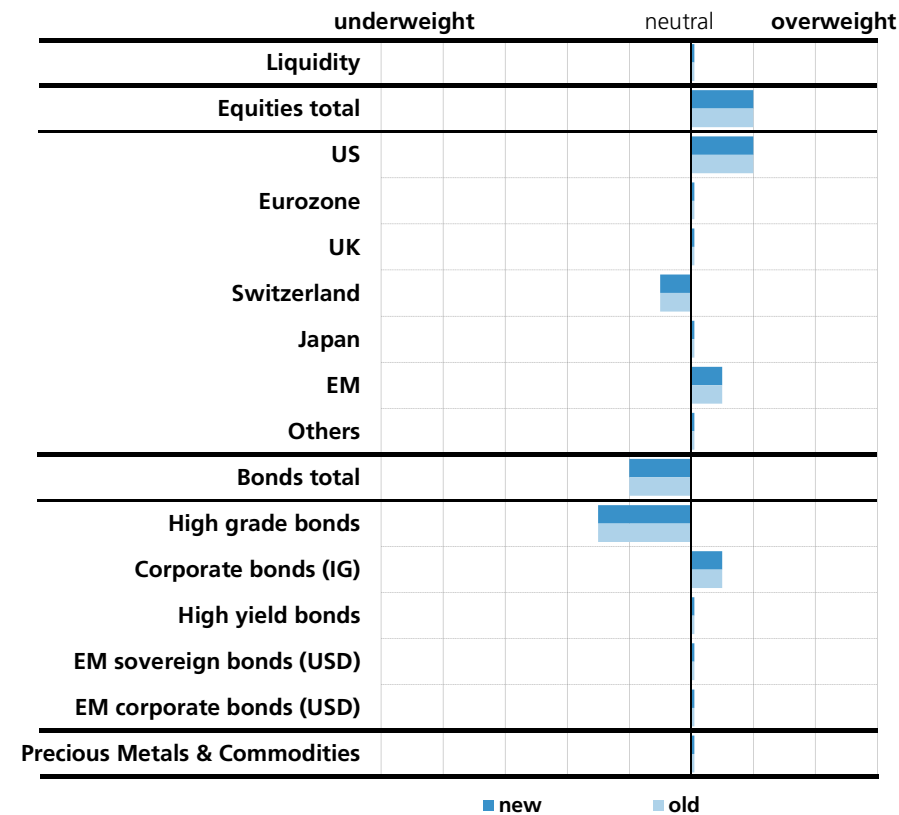
Cross-asset preferences



↗ Recent Upgrade ↘ Recent Downgrade

Global tactical asset allocation

Tactical asset allocation deviations from benchmark*

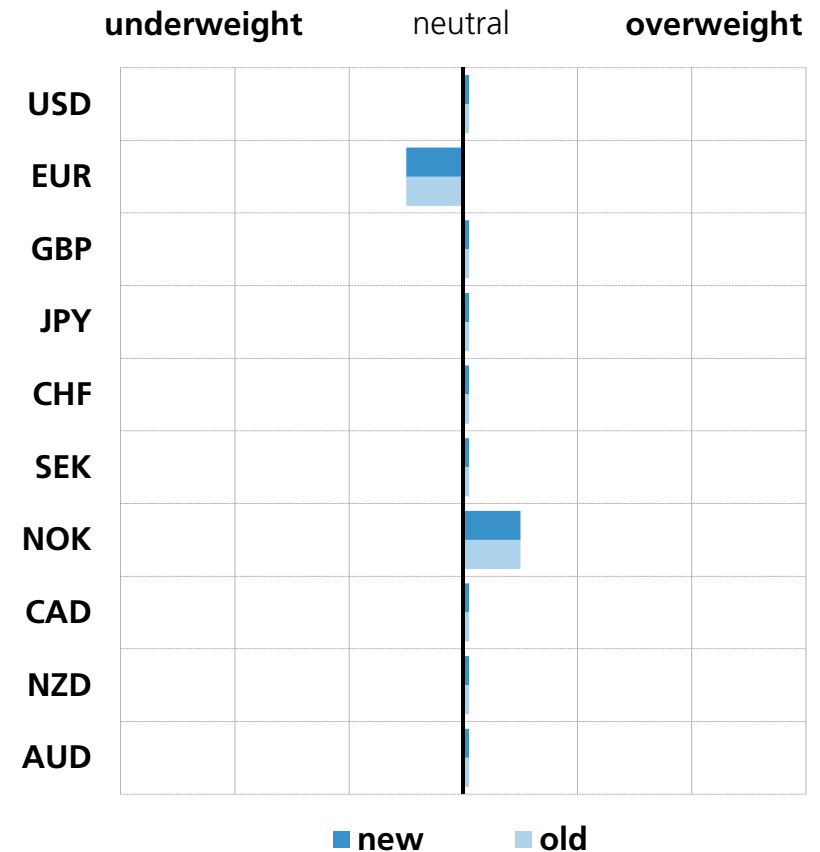


Source: UBS, as of 25 August 2016

*Please note that the bar charts show total portfolio preferences. Thus, it 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 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.

Currency allocation



CIO themes in focus

Equities

- **US technology: Secular growth, on sale**

Secular growth drivers (online advertising, cyber security, cloud investments) are likely to propel US technology sector earnings over the coming years. More tactically, we expect the sector to continue to benefit from resilient business spending and ongoing labor market gains. Relative valuations are near 20-year lows and companies are returning large sums of cash to shareholders without increasing leverage.

- **Profit from US share buybacks and dividends**

US companies are generally in good shape: they generate high free cash flow, have plenty of cash on their balance sheets and enjoy cheap financing costs. The stock market has rewarded investors in companies that return capital through dividends and share buybacks. These companies offer attractive yields in the current low-growth, low-interest-rate environment. On average, S&P 500 companies returning cash to shareholders via dividends and/or share repurchases offer investors a total yield of 5-6% (when combining share buyback and dividend yields). Around two-thirds of this yield come from share buybacks. With borrowing costs low, companies have an incentive to return cash to shareholders, and good free cash flow generation is a key factor for this theme. As buybacks are made at management's discretion, we recommend investing in a diversified basket of stocks.

- **Sustainable value creation in emerging markets**

EM equities offer investors the opportunity to add value to their portfolios by incorporating environmental, social and corporate governance (ESG) considerations into their investment decisions. We argue that the wide disparity among individual companies on ESG performance, in particular with respect to governance issues, necessitates focusing on those with strong management to reduce tail-risk events such as severe environmental accidents or weak corporate governance (e.g. accounting/audit issues). As corporate emerging market governance rules are often less strict than those in developed countries, risks and opportunities are hard to quantify, which suggests that understanding how companies are exposed to ESG risks and opportunities and how they manage them should factor in highly when determining corporate value.

- **Water: Thirst for investments**

A growing global population increases the demand for clean water. However, climate change and urbanization pressure supply, which in emerging markets is constrained by insufficient water infrastructure and a greater focus by governments on the industrial sector. We have identified two short-term trends that should add to the earnings power of water-exposed companies: ship ballast water treatment and desalination.

Bonds

- **US loans – Attractive floating yield**

We believe US senior loans are an attractive alternative to more traditional fixed income segments. Loans provide exposure to the most senior part of a company's capital structure and are often secured by the company's assets, leading to higher recovery rates than for bonds. Also, loans offer a floating coupon rate, which would benefit from a rise in short-term US interest rates. The yield (to 3-year takeout) at roughly 6.2% is attractive. We expect the default rate to moderately increase towards its long-term average of 3% in 12 months. With an index weight of 4.2%, exposure to the oil and gas sector is much more limited than in US high yield bonds. We think US loans present an attractive investment opportunity for qualified investors who are comfortable holding less liquid asset classes.

- **Yield pick-up with corporate hybrids**

Corporate hybrid is a niche segment in the corporate bond market. At current spread levels, investors with a suitable risk tolerance are well compensated for assuming the risks associated with these bonds. We expect mid-single-digit percentage returns on selected instruments over 12 months.

CIO themes in focus

Alternative investments

- **Exploring the benefits of equity event-driven strategies**

The environment for mergers and acquisitions continues to look compelling amid high corporate cash levels, elevated executive confidence and companies' willingness to buy targets that meet their strategic/growth objectives. Annualized deal spreads offer attractive opportunities and hint at high rates of return for merger arbitrage strategies and to a certain extent for special situations funds. For the latter, we acknowledge that renewed equity market turbulences could affect performance in the short term.

This selection of themes is a subset of a larger theme universe. The selection represents the highest conviction themes of the UBS Chief Investment Office WM, taking the current market environment and risk-return characteristics into account.

Key financial market driver 1 - *Central bank policy*

Key points

- We expect the Federal Reserve to raise rates by 25 basis points in December.
- The ECB is likely to extend its asset purchases beyond March.
- The Bank of England eased policy following the Brexit vote and may cut rates again.

CIO view (Probability: 45%)

Policy is diverging

- The Brexit vote has had little direct impact on the US economy, and contagion via financial markets has not been an issue. Recent US data has been mixed, with strong job and weak GDP growth, but the former is more important for the Fed. The economy is approaching full employment and inflation is not far from the 2% target. Uncertainty will likely prevent the Fed from raising rates at its next couple of meetings, but we expect a rate hike in December.
- The ECB is waiting for economic data to reveal the impact of Brexit on the Eurozone economy. Meanwhile, the inflation rebound that just started remains on track. Against this background, the impact on the economy needs to be more than moderate for the ECB to introduce further substantial monetary easing. For now, we expect its QE program to be extended with EUR 80bn or less of monthly bond purchases beyond the current end date of March.
- Following the Brexit vote, the Bank of England eased monetary policy in August, cutting rates in half to 25 basis points and announcing GBP 70bn in new bond purchases. We expect rates to be cut to 10 basis points by the end of the year. The Swiss National Bank continues to struggle against deflationary forces. We expect it to keep rates deeply negative for at least another 12 months. Japan's economy is struggling as prices continue to fall. The Bank of Japan is likely to ease its ultraloose monetary policy even more.

➤ Positive scenario (Probability: 40%)

Worse macro backdrop

- The Fed is forced to stay on hold, but a rate cut remains unlikely. The ECB launches additional monetary easing rapidly to address the downside risks emanating from the UK referendum. This may include more QE, a deposit rate cut, etc.

⚡ Negative scenario (Probability: 15%)

Macro risks fade

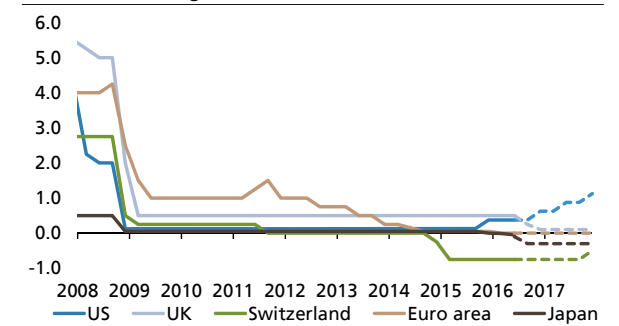
- Diminished risks allow the Fed to hike rates twice by year-end. The ECB ignores the fallout from Brexit and refocuses rapidly on the inflation rebound, signaling a full exit from its QE program.

Key dates

Aug 26	Yellen speaks at Jackson Hole
Sep 8	ECB press conference
Sep 21	FOMC meeting
Sep 21	Bank of Japan policy meeting

Central bank policy to diverge

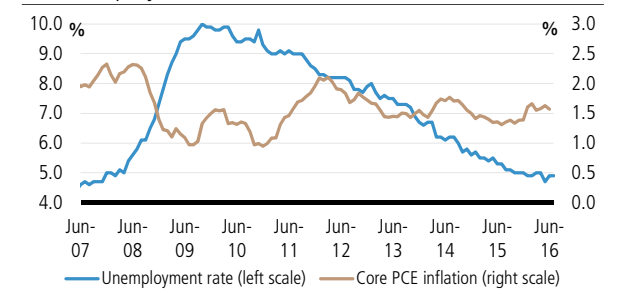
Central bank target rates and UBS forecasts, in %



Bloomberg, UBS, as of 18 August 2016

Fed close to fulfilling its dual mandate

US unemployment rate and core PCE inflation



Bloomberg, UBS, as of 18 August 2016

Key financial market driver 2 - *Crude oil market rebalancing*

Key points

- Supply availability of crude oil has improved with the return of disrupted Canadian oil supply and OPEC crude production at its highest level since 2008. Unless supply is disrupted again, oil prices are vulnerable to falling, in our view, due to counter-seasonal oil inventory buildup in 2H16.
- Medium to longer term, we remain confident that a combination of contracting non-OPEC supply and rising oil demand in emerging markets will result in a balanced oil market next year, which should bring with it Brent oil prices of USD 55/bbl or higher in 12 months.
- Price setbacks offer an opportunity to increase exposure to the oil market, in our view.

CIO view (Probability: 70%)

- The oil market is rebalancing and still has a ways to go since OPEC crude output is at its highest since 2008 and disrupted Canadian supply has returned. Expected counter-seasonal oil inventory buildup in 2H16 should make oil prices vulnerable to falling in the near term.
- The oversupplied oil market, which started in 2014, will soon end, we think. Contracting non-OPEC supply and rising demand should balance the oil market next year. Cuts in capital spending worldwide of 24% last year and likely another 20% this year should cause non-OPEC supply to fall 0.8mbpd in 2016 – the first contraction since 2008. Production in non-OPEC nations is likely to contract next year as well. Meanwhile, global demand should rise 1.2mbpd this year, slightly above the 10-year average annual growth rate, and low prices should still support demand growth. Next year we think oil demand growth will come in near 1mbpd, with higher prices limiting it.
- Short-term setbacks in oil prices are unlikely to last over a 6-12 month time horizon. Over 12 months, we expect Brent prices to trade at USD 55/bbl or higher, which offers investors an opportunity to build medium to longer-term oil exposure after a likely near-term correction.

↗ Positive scenario (Probability: 10-20%)

- Along with geopolitical events, political destabilization in oil-exporting countries like Venezuela and those in the Middle East, and/or an emergency OPEC meeting that leads to a production cut are factors to consider. Alternatively, US crude oil production could contract more sharply than projected by key energy agencies.

↘ Negative scenario (Probability: 10%)

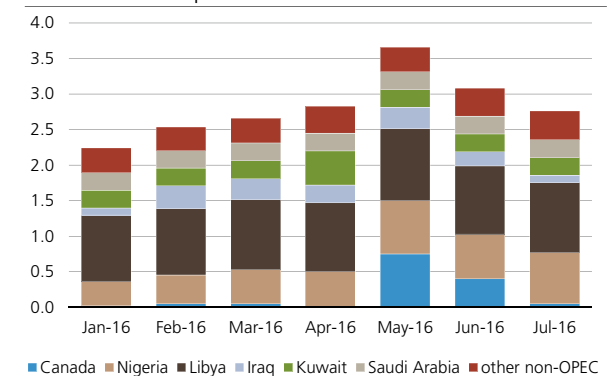
- Cost reductions, efficiency gains and industry consolidation could lead to more resilient US oil production, keeping the oil market oversupplied and inventories on the rise – potentially reaching storage capacity limits. Also, receding unplanned crude production outages in OPEC countries like Libya could exacerbate the short-term production surplus.

Key dates

Aug 31	US oil supply and demand data for June
Sep 7	EIA short-term energy outlook, providing global demand and supply data
Sep 13	IEA oil market report, providing global demand and supply data
Sep 26	Informal OPEC session in Algiers
Nov 30	OPEC's ordinary meeting in Vienna

Large volumes of disrupted oil supply have returned

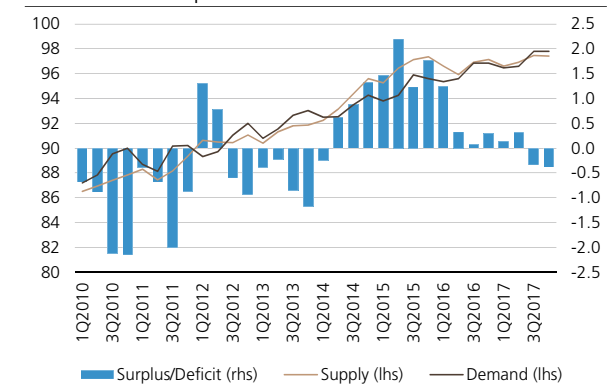
Values are in mbpd



Source: EIA, UBS, as of 17 August 2016

Global oil demand/supply balance

Values are in mbpd



Source: IEA, EIA, UBS, as of 17 August 2016

Key financial market driver 3 - *US earnings growth to resume*

Key points

- We expect positive year-over-year S&P 500 EPS growth in 2H16 and 2017.
- Earnings headwinds from depressed oil prices and the strong dollar are fading.
- High profit margins can be sustained until the next recession.

CIO view (Probability: 60%)

Core earnings trends improving

- While headline 2Q16 S&P 500 EPS likely contracted slightly by 2-3% on a year-over-year basis, results compared favorably to the 6% decline experienced in the first quarter. This improving trend should continue with headline S&P 500 earnings growth resuming in the second half of the year.
- The huge drag on profits from the strong US dollar and poor energy sector results have largely run its course. Excluding the energy sector, 1Q16 was the only quarter over the past two years with negative year-on-year earnings (down just 1%). S&P 500 EPS ex-energy grew by 2% in 2Q16.
- With US economic momentum improving – the ISM manufacturing index is near a 16-month high and consumer spending surged in 2Q16 – earnings trends excluding the distortions from the energy sector and the dollar should brighten as US and global economic growth remains resilient.
- We look for stable profit margins over the next several quarters and expect a moderate acceleration in revenue growth to drive the anticipated earnings rebound.
- CIO forecasts 2016 and 2017 S&P 500 EPS of USD 122 (+3%) and USD 130 (+7%), respectively.

Positive scenario (Probability: 20%)

Business confidence accelerates

- Higher interest rates and rising commodity prices driven by improving global growth prospects could produce stronger-than-anticipated S&P 500 EPS growth as energy and financials experience meaningful gains. Increased confidence in the global economic expansion could spur greater capital investment, improving the outlook for industrials. Technology end-markets improved in 2Q16 and continued strength could result in earnings upside. Regardless of the November presidential election outcome, tax reform momentum is expected to build. Lower taxation on repatriated foreign earnings could boost S&P 500 EPS via higher share buybacks.

Negative scenario (Probability: 20%)

Growth slump or stagflation

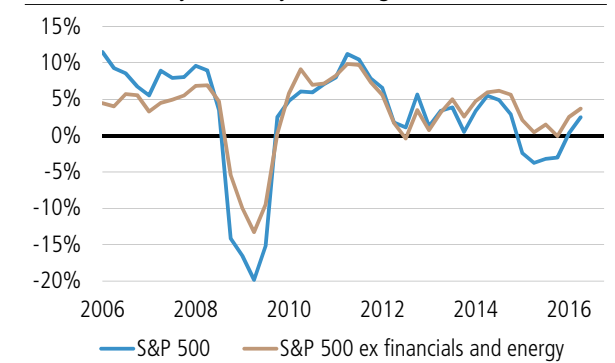
- A downturn in US and global growth could lead to weaker-than-projected revenues for S&P 500 companies. Wage pressures unaccompanied by improving consumer and business demand could pressure profit margins and earnings growth rates. Persistently low short-term interest rates and continued declines in long-term interest rates could pressure financial sector earnings.

Key dates

Sep 19 Third quarter "early reporters" begin to deliver results

Sales trends have picked up

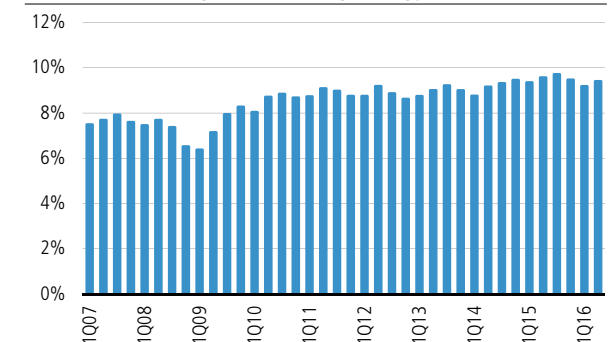
S&P 500 sales, year-over-year change



FactSet and UBS, as of 18 August 2016

Core profit margins have been fairly stable

S&P 500 net margins, excluding energy and financials



FactSet and UBS, as of 18 August 2016

Global economic outlook - *Summary*

Key points

- We expect global growth to vary. The US and Eurozone are growing at a moderate pace and emerging markets should gradually improve as they continue to stabilize.
- The policies of major central bank are expected to deviate. The Fed will raise rates in December, in our view, while the ECB is ready to act to contain Brexit spillover effects.
- We believe inflation will remain subdued globally despite increasing divergence between countries.

CIO view (Probability: 60%*)

Stable world growth in 2016

- We expect global economic growth to hold up this year, with most developed nations faring well and emerging markets (EMs) stabilizing at lackluster levels relative to their historical growth rates. EM growth should improve in 2017.
- Moderate US economic growth is expected. In the Eurozone, sound domestic fundamentals should limit negative spillovers from Brexit. Within EMs, Asia is still the strongest region despite slowing growth in China. EMEA and Latin America are lagging due to weakness in Russia and Brazil, but both should recover next year.
- Inflation in the developed world should reaccelerate in the second half of the year due to stabilizing oil prices, while relatively subdued growth is expected to restrain inflation in EMs.
- We believe the Fed will raise rates in December and maintain an accommodative policy. The Bank of Japan will likely continue with its expansive monetary policy. And the ECB remains vigilant and ready to act if needed following the UK referendum.

↗ Positive scenario (Probability: 20%*)

Return to above-trend growth

- The US economy grows above 2.5%, spurred by robust consumer spending. Political risks fade in the Eurozone and growth and inflation from the European periphery beat forecasts.
- Emerging markets are able to attract capital inflows due to improving growth prospects and credible reform measures. Higher commodity prices support exporters.

↘ Negative scenario (Probability: 20%*)

Global growth disappointments

- The Eurozone crisis deepens as worsening deflationary pressure and economic disappointments push the ECB to ease monetary policy further.
- China's economy weakens abruptly due to a sharper downturn in investment and manufacturing, widespread credit events and/or tighter liquidity conditions. EM currencies plunge and several central banks have to tighten monetary policy to stabilize exchange rates.
- Geopolitical tensions (in Ukraine and the Middle East) intensify, weighing on risk sentiment.

*Scenario probabilities are based on qualitative assessment.

Key dates

Aug 31	Eurozone inflation (August)
Sep 1	China PMIs (August)
Sep 2	USA: Non farm payrolls (August)
Sep 8	ECB press conference
Sep 19	China: property prices (August)

Global growth broadly stable in 2016

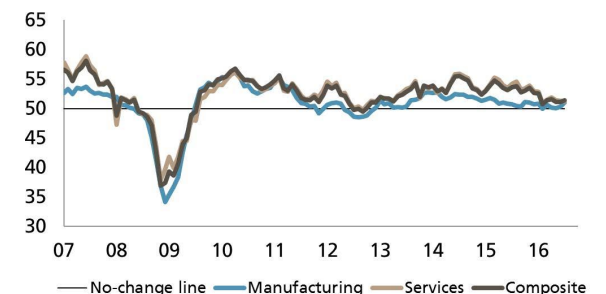
		Real GDP growth in %			Inflation in %		
		2015	2016F	2017F	2015	2016F	2017F
Americas	US	2.6	1.4	2.4	0.1	1.3	2.2
	Canada	1.2	1.9	2.5	1.1	1.7	1.9
	Brazil	-3.8	-3.4	0.8	10.7	6.4	4.7
Asia/Pacific	Japan	0.6	0.5	1.2	0.8	-0.2	0.5
	Australia	2.5	2.8	3.0	1.5	1.2	1.8
	China	6.9	6.6	6.3	1.4	1.9	2.0
	India	7.6	7.4	7.6	4.9	5.4	4.5
Europe	Eurozone	1.6	1.5	1.3	0.0	0.3	1.5
	UK	2.3	1.3	0.5	0.0	0.8	3.4
	Switzerland	0.8	0.9	1.3	-1.1	-0.3	0.4
	Russia	-3.7	-0.6	1.5	15.5	7.1	5.0
World		3.2	2.9	3.3	2.7	2.7	2.8

Source: UBS, as of 22 August 2016

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 composite PMI in expansionary territory

Global purchasing managers' indices (PMIs)



Source: Haver Analytics, UBS, as of July 2016

US economy - *Moderate growth in the US*

Key points

- We expect the US to grow at a moderate pace over the next 12 months.
- Inflation should gradually trend higher as the recovery continues.
- We expect the Fed to raise rates by 25 basis points in December.

CIO view (Probability: 70%*)

Moderate expansion

- We expect the US economy to grow at a moderate pace over the next 12 months. The labor market is still improving, with the unemployment rate below 5% and signs that labor shortages are promoting faster wage growth. Rising household income and low energy prices should enable robust consumer spending.
- Housing starts and home prices should remain on an upward trend, contributing modestly to overall economic growth.
- Energy sector fixed investment appears to be bottoming out following the rebound in oil prices. The manufacturing sector has been restrained by weak global demand and the strong US dollar but is now stabilizing, with the PMI remaining above 50 since March.
- An inventory correction cycle has been a drag on growth since the second half of last year, but appears to be nearing its end.
- Personal consumption expenditure (PCE) price inflation has been held in check by the strong US dollar, low energy prices and smaller-than-usual increases in healthcare costs. These factors are fading, and with the labor market getting tighter inflation should gradually trend higher.
- Fiscal policy will be slightly positive for growth this year as politicians agreed to spending increases and tax cuts ahead of the presidential election. Major policy reforms are unlikely until after the new president takes office in January. Political uncertainty is a potential downside risk for growth.
- With progress being made toward the Fed's dual mandate of full employment and price stability, we expect a 25 basis point rate hike in December.

➤ Positive scenario (Probability: 15%*)

Strong expansion

- US real GDP growth rises above 2.5%, propelled by expansive monetary policy, strong household spending and subsiding risks overseas. The Fed raises policy rates significantly more than markets anticipate.

⚠ Negative scenario (Probability: 15%*)

Growth recession

- US growth stumbles. Consumers save rather than spend the windfall from lower energy prices, while businesses lack the confidence to hire workers and boost investment spending. The Fed stays on hold this year.

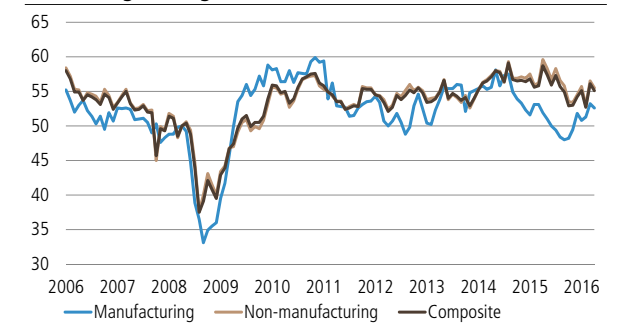
*Scenario probabilities are based on qualitative assessment.

Key dates

Aug 29	Personal income and spending for July
Sep 1	ISM manufacturing for August
Sep 2	Labor report for August
Sep 6	ISM non-manufacturing for August

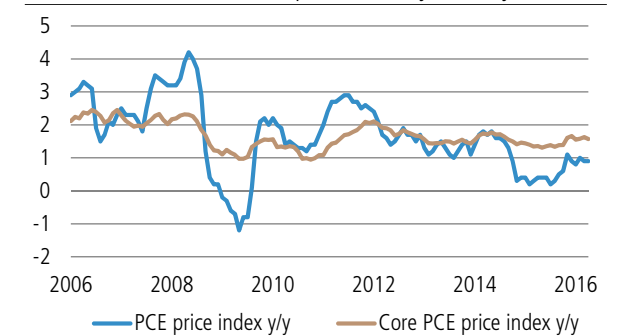
PMIs consistent with moderate growth

Purchasing managers' indices



Inflation should gradually move toward the Fed's 2% target

US headline and core PCE price index, year on year in %



Eurozone economy - *Solid growth*

Key points

- We expect economic growth to remain solid despite global hindrances and the UK vote to leave the EU.
- Inflation should continue to rebound until the winter.
- The ECB is closely monitoring Brexit spillovers and would intervene if needed.

CIO view (Probability: 50%*)

Solid growth

- We expect the Eurozone economy to weather growth concerns thanks to a positive fiscal stance and a strong monetary impulse, allowing it to limit the negative impact of the UK referendum over the coming quarters. Inflation is set to continue rising through early next year. The ECB is in wait-and-see mode. It is closely monitoring the fallout of the UK referendum on the economy and inflation, and ready to act if needed.
- In Germany, fundamentals such as consumer confidence and capital-expenditure planning remain robust. The immigration situation is helping the economy grow through greater-than-expected government spending. In France, better dynamics in construction and investments are helping solidify growth.
- In the periphery, Italian growth should consolidate, supported by the construction sector. Spain, in turn, is still posting strong growth. But this should moderate given the uncertain political situation and upcoming fiscal adjustments.

↗ Positive scenario (Probability: 20%*)

Better-than-expected growth

- The global economy reaccelerates and the euro declines more than expected. Eurozone loan demand and the economy recover faster than envisaged. Political risks fade further.

↘ Negative scenario (Probability: 30%*)

Deflation spiral

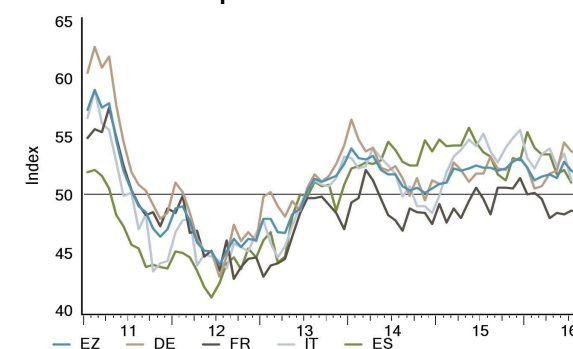
- The Eurozone slips into a deflationary spiral due to a shock, such as Greece leaving the Eurozone, a sharp escalation in the Ukraine conflict or China suffering a severe economic downturn.

*Scenario probabilities are based on qualitative assessment.

Key dates

Aug 31	Inflation estimate (August)
Sep 8	ECB press conference
Sep 14	Industrial production (July)
Sep 22	Consumer confidence (September)
Sep 23	Eurozone PMIs (September)

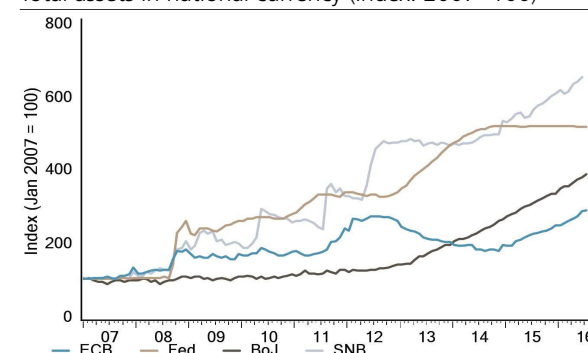
Eurozone PMIs expected to remain solid



Source: Haver Analytics, UBS, as of August 2016. Note: PMI = purchasing managers' index

ECB balance sheet boosted by QE and TLTROs

Total assets in national currency (Index: 2007=100)



Source: Haver Analytics, UBS, data, as of July 2016 (SNB, as of June 2016)

Chinese economy - *Orderly deceleration in China*

Key points

- China is striking a balance between economic stability and mild reforms as GDP growth continues to decelerate gradually.
- We expect inflation to grow mildly and PPI inflation to improve but remain negative.
- Both fiscal and monetary policy should stay accommodative to ensure economic and financial stability.

CIO view (Probability: 80%*)

Balance between economic stability and mild reforms

- China's economy will continue its orderly deceleration as the government balances between maintaining economic stability and implementing mild reforms. China's 1H16 GDP grew 6.7% y/y, the lowest since the 2009 financial crisis; deep adjustments in the old economy will keep the economy on a downward trend.
- Investment, dragged down by manufacturing and real estate, will continue to fall. July fixed asset investment (FAI) growth slowed to 8.1% y/y from 9.0% in 1H16. Private investment growth, accounting for over 60% of total FAI growth, decelerated to 2.1% y/y in July from 2.8% y/y in 1H16 (but from 10.1% in 2015). Slowing private investment growth is considered to be a top risk in China.
- Retail sales are expected to slow at a mild pace. Retail sales growth in July edged down to 10.2% y/y from 10.3% in 1H16. The sector will face downward pressure through 2H16.
- Exports are expected to contract in 2016. July exports sunk -4.4% y/y from -7.0% in 1H16 on weaker external demand. Imports plunged -12.5% y/y from -10% over the same period.
- We expect CPI inflation to rise mildly and PPI inflation to improve but remain negative. July CPI inflation edged down to 1.8% y/y from 2.1% in 1H16, mainly driven by food prices. July PPI inflation improved to -1.7% y/y compared with -3.9% in 1H16, mainly due to the low base and recovering commodity prices.
- Fiscal policy will play a more critical role in supporting small and medium-sized firms, promoting new manufacturing sectors and resolving overcapacity. The 2016 fiscal deficit is expected to reach 4% of GDP, which is about CNY 20trn in fiscal spending. But tax deductions were postponed.
- Monetary policy will remain accommodative. China's central bank prefers liquidity injection via open market operations and short- and medium/long-term lending facilities. Further required reserve ratio cuts are possible, but interest rate cuts are limited due to rising inflation.

➤ Positive scenario (Probability: 5%*)

Growth acceleration

- GDP growth rises above 7%, fueled by robust policy stimulus packages and/or a strong pick-up in external demand.

➤ Negative scenario (Probability: 15%*)

Sharp growth downturn

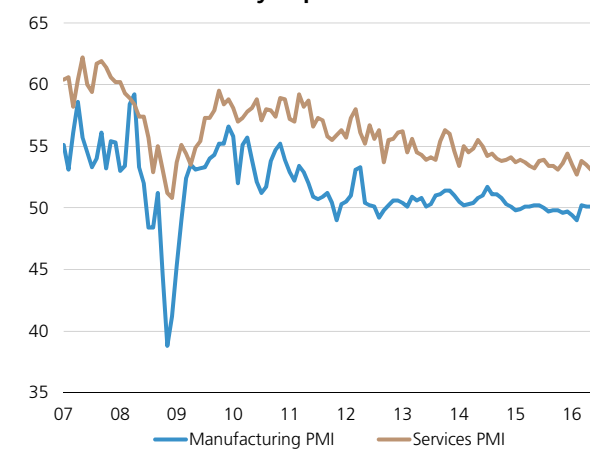
- An abrupt economic downturn sets in as real GDP growth drops below 6% for more than two quarters, driven by a sharp fall in investment and accompanies by widespread credit defaults.

* Scenario probabilities are based on qualitative assessment.

Key dates

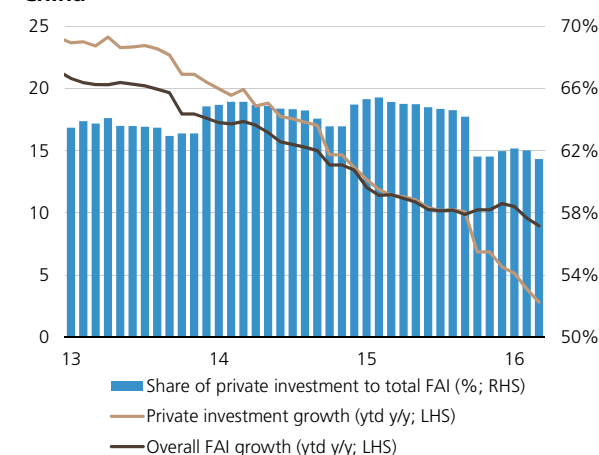
Sep 8	Trade data for August
Sep 9	CPI, PPI inflation for August
Sep 10-15	Monetary and credit data for August
Sep 13	Industrial production, fixed asset investment, retail sales for August

China manufacturing PMI to remain weak while services PMI modestly expands



Source: CEIC, UBS, as of 15 August 2016

Plunging private investment growth is a top risk in China



Source: CEIC, UBS, as of 15 August 2016

Swiss economy - *Swiss economy set to recover, but Brexit a risk*

Key points

- The Swiss economy is set to gradually recover in 2H 2016 as Swiss companies are learning to deal with the strong Swiss franc.
- The UK's decision to leave the EU has increased economic uncertainty significantly and may exert a drag on Swiss growth via slowing demand from Europe.
- If necessary, the SNB will try to prevent a sharp appreciation of the franc by: 1) intervening in the FX market; and 2) cutting the target rate if interventions don't suffice.

CIO view (Probability: 60%*)

Moderate recovery despite Brexit

- The Swiss economy grew at 0.1% in 1Q16. Private consumption, investment and exports supported growth. An inventory correction exerted a drag on activity.
- Swiss companies are learning to deal with the strong Swiss franc but the adjustment process is painful and is dragging on GDP growth, which we expect to reach only 0.9% this year. Growth will approach its potential of 1.5% to 1.75% only next year when Swiss exporters have completely adapted to the strong franc.
- The Swiss manufacturing PMI fell sharply in June and July as Brexit unsettled Swiss manufacturers. Despite the recent setback the PMI still points to greater GDP growth ahead.
- Despite a strong rebound of CPI inflation in 2Q16, the July reading remains in negative territory. Inflation is expected to revive in the coming quarters as the effects of the weaker oil price and the stronger franc begin to fade.
- The main goal of the Swiss National Bank (SNB) in the short term is to prevent a sharp appreciation of the franc to safeguard the fragile recovery. To achieve this goal the SNB would first intervene in the FX market. Only if intervention does not work would it resort to a further rate cut. A rate hike is not in the cards in the next 12 months. The SNB will not have the opportunity to raise rates until the ECB stops its QE program.
- The initiative against mass immigration has to be implemented by February. As the EU has to deal with UK-related problems it seems unlikely that Switzerland will be able to negotiate an acceptable solution with the EU by then. This reduces political leeway considerably and raises the risk of a new popular vote on this issue (which could also include the bilateral treaties).

↗ Positive scenario (Probability: 20%*)

No Impact from Brexit

- Export growth gathers momentum in 2H 2016 and in 2017 as the UK exit has significantly less impact on the real economy than feared.

↘ Negative scenario (Probability: 20%*)

Stagnating Swiss economy in 2H16

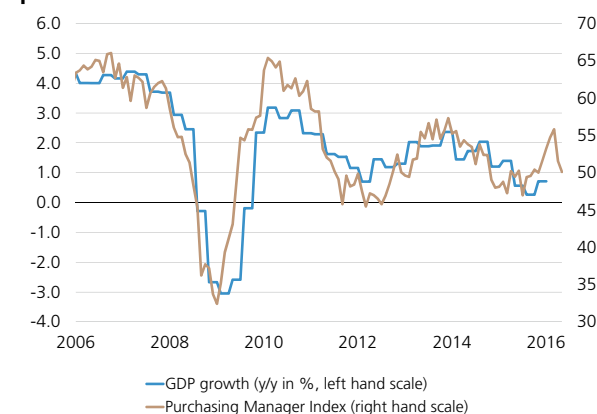
- The Swiss recovery stalls with demand from Europe falling off a cliff as the impact of Brexit on the real economy is stronger than currently indicated by Eurozone PMIs.

* Scenario probabilities are based on qualitative assessment.

Key dates

Aug 31	UBS Consumption Indicator for July
Sep 1	PMI manufacturing for August
Sep 6	2Q16 GDP report
Sep 15	SNB quarterly monetary assessment

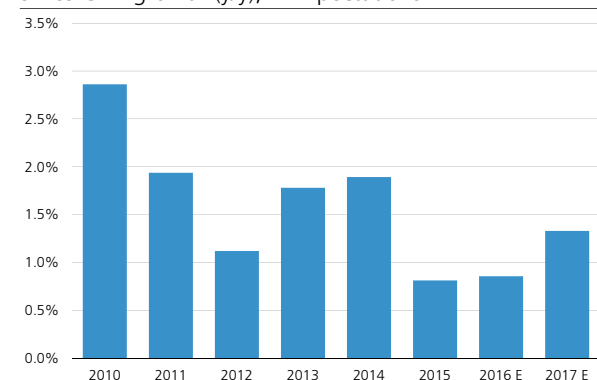
Brexit weighs on PMI – but recovery remains in place



Source: procure.ch, UBS, as of 24 August 2016

Swiss GDP growth improving only gradually

Swiss GDP growth (y/y), E: Expectations



Source: Seco, UBS, as of 24 August 2016

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