Global Market Outlook

Investing at the crossroads

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Chief Investment Strategist

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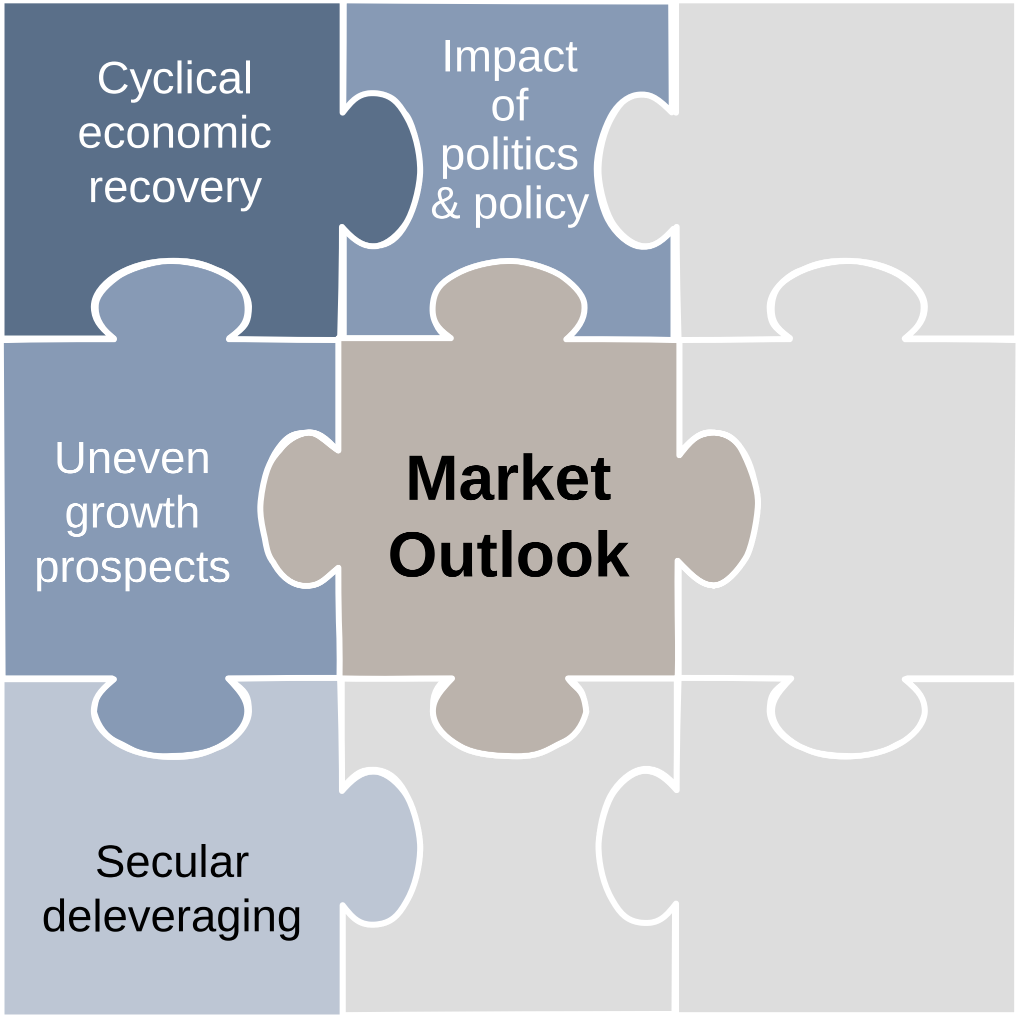
March 2012

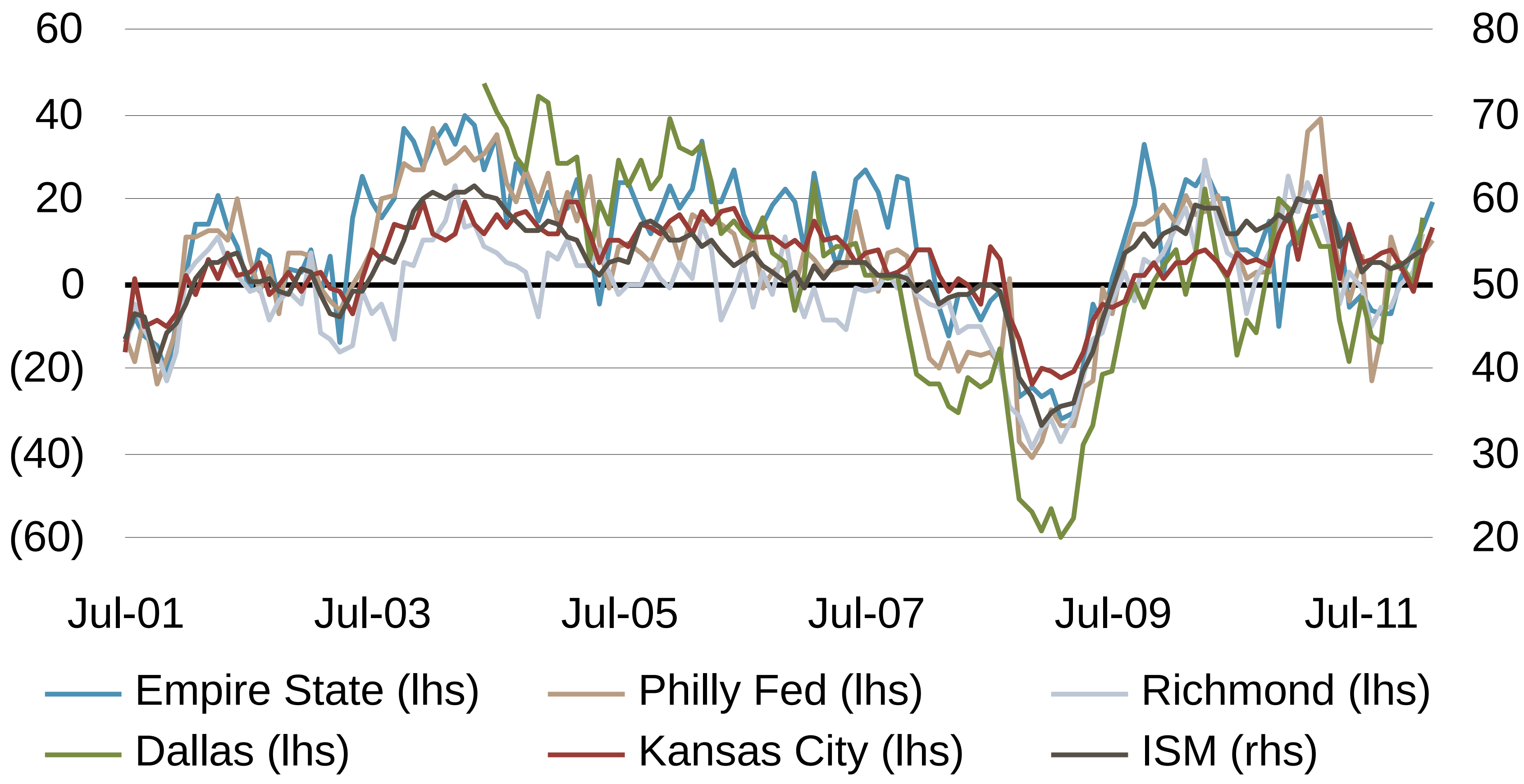
Key Macro Themes

- Cyclical economic recovery
- Secular deleveraging
- Uneven growth prospects
- Impact of politics & policy



Broad rebound in regional manufacturing indices

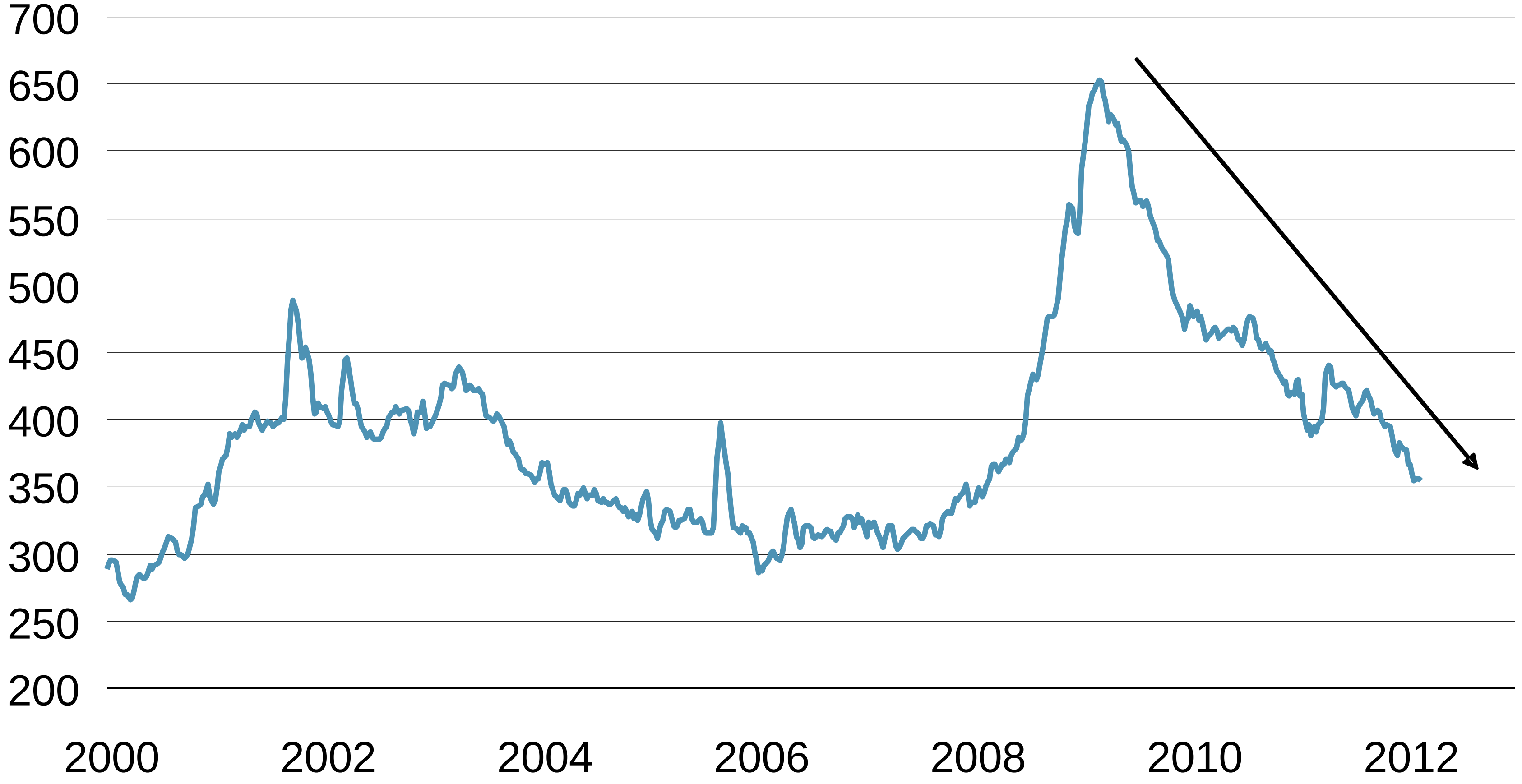
Select US regional manufacturing indices



Source: Bloomberg, UBS WMR

Labor market improvement has shown broad improvement

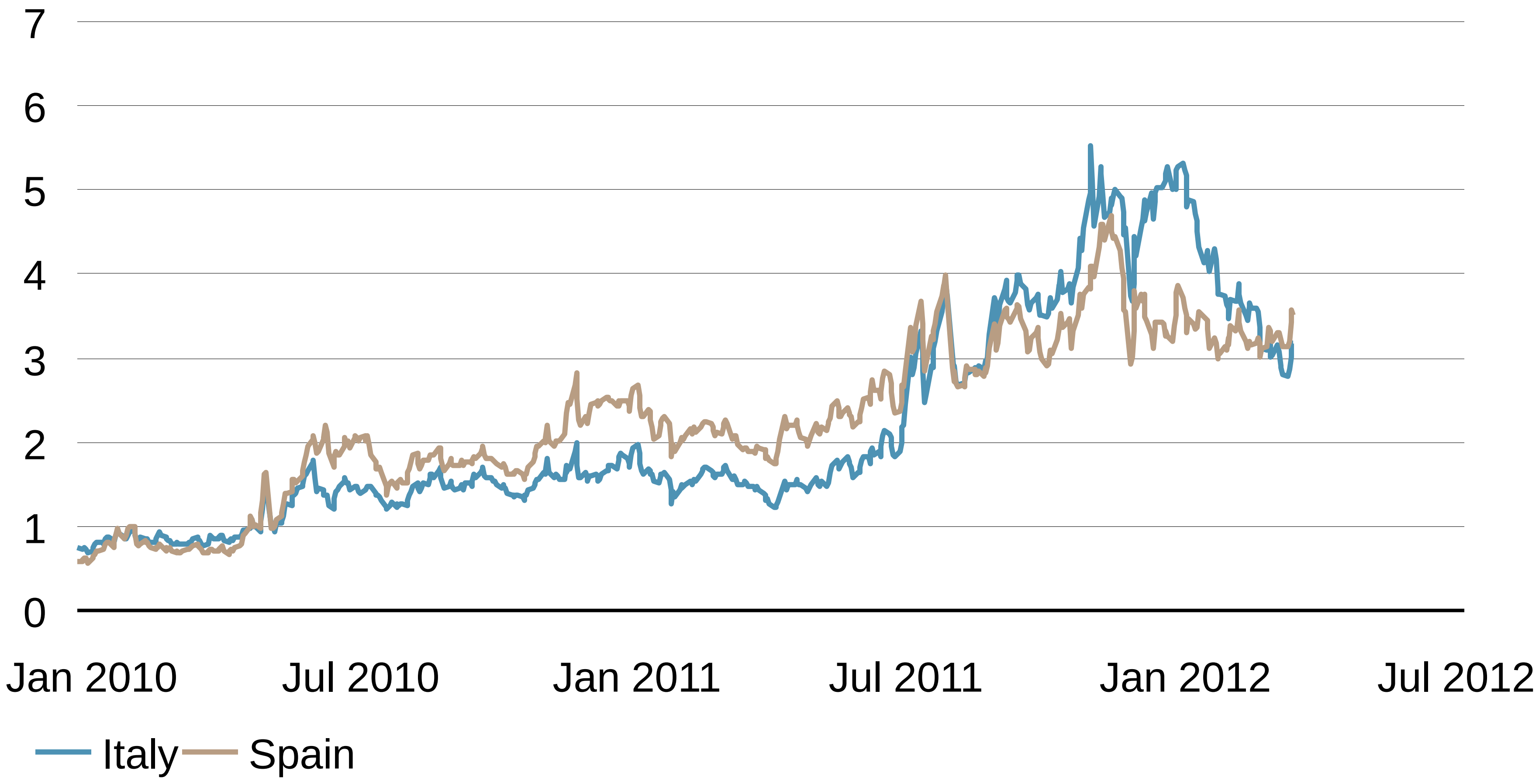
US initial jobless claims, in thousands, 4 week moving average



Source: Bloomberg, UBS WMR

European sovereign fears abating

Italian and Spanish 10yr gov't bond yields less German 10yr bond yields, in %



UBS

Source: Bloomberg, UBS WMR

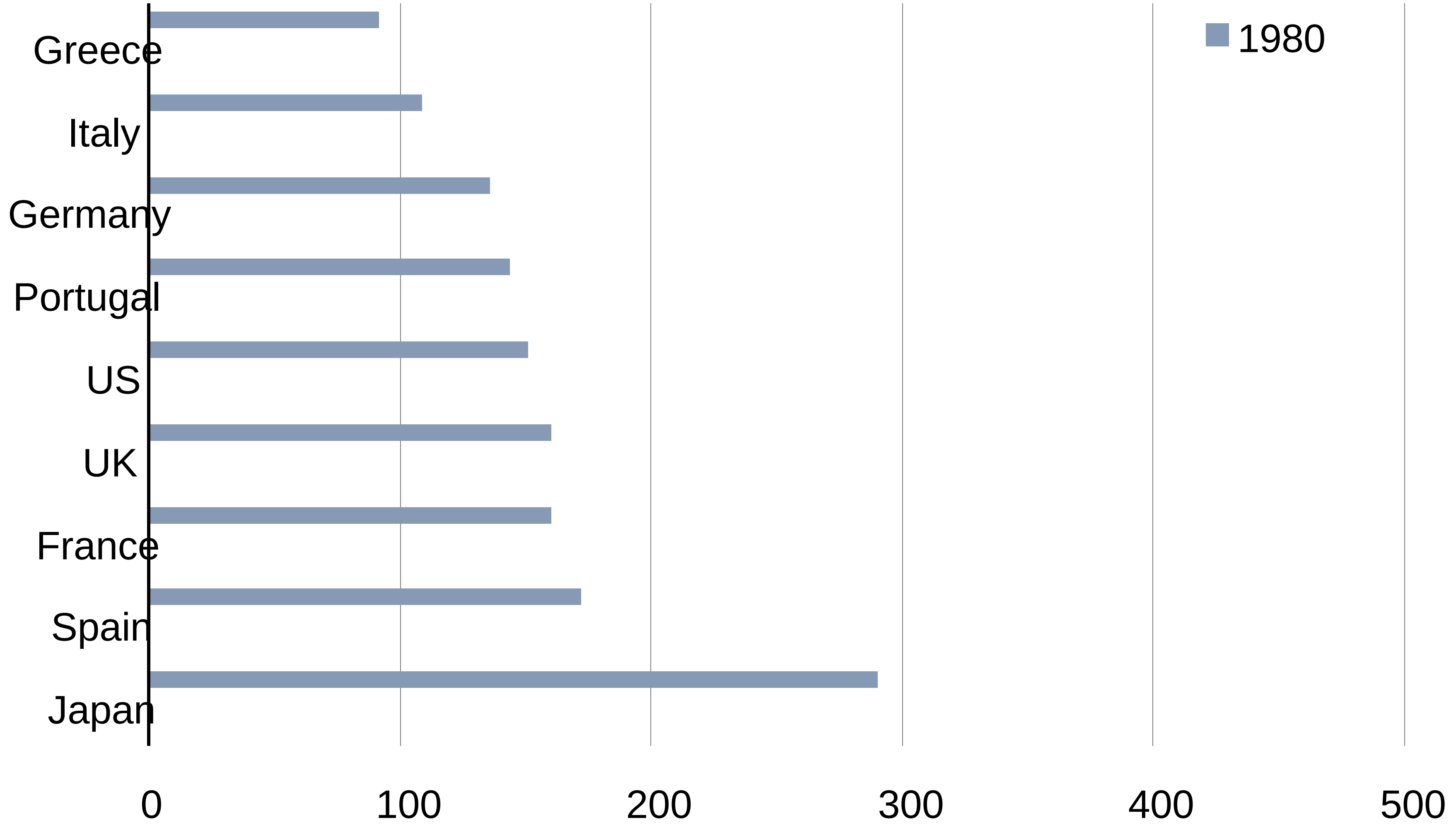
Oil prices incorporating a “Persian premium”

WTI crude oil price, in USD

Source: Bloomberg, UBS WMR

Sharp rise in developed country debt burdens

Sum of household, corporate and government debt as a share of GDP, in %



Source: Cecchetti, Mohanty and Zampolli, “The real effects of debt”, BIS, Working Paper #352, September 2011

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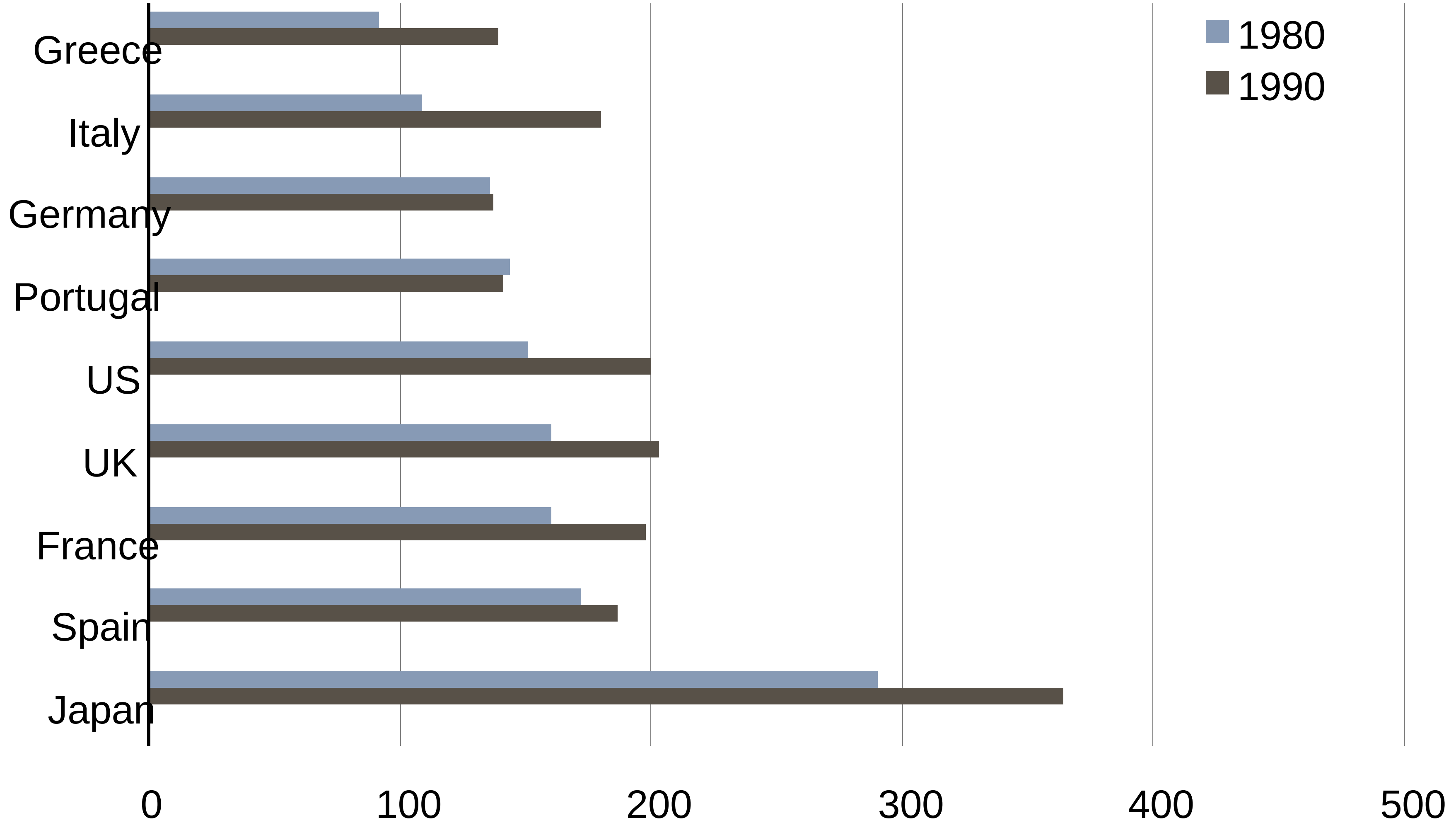

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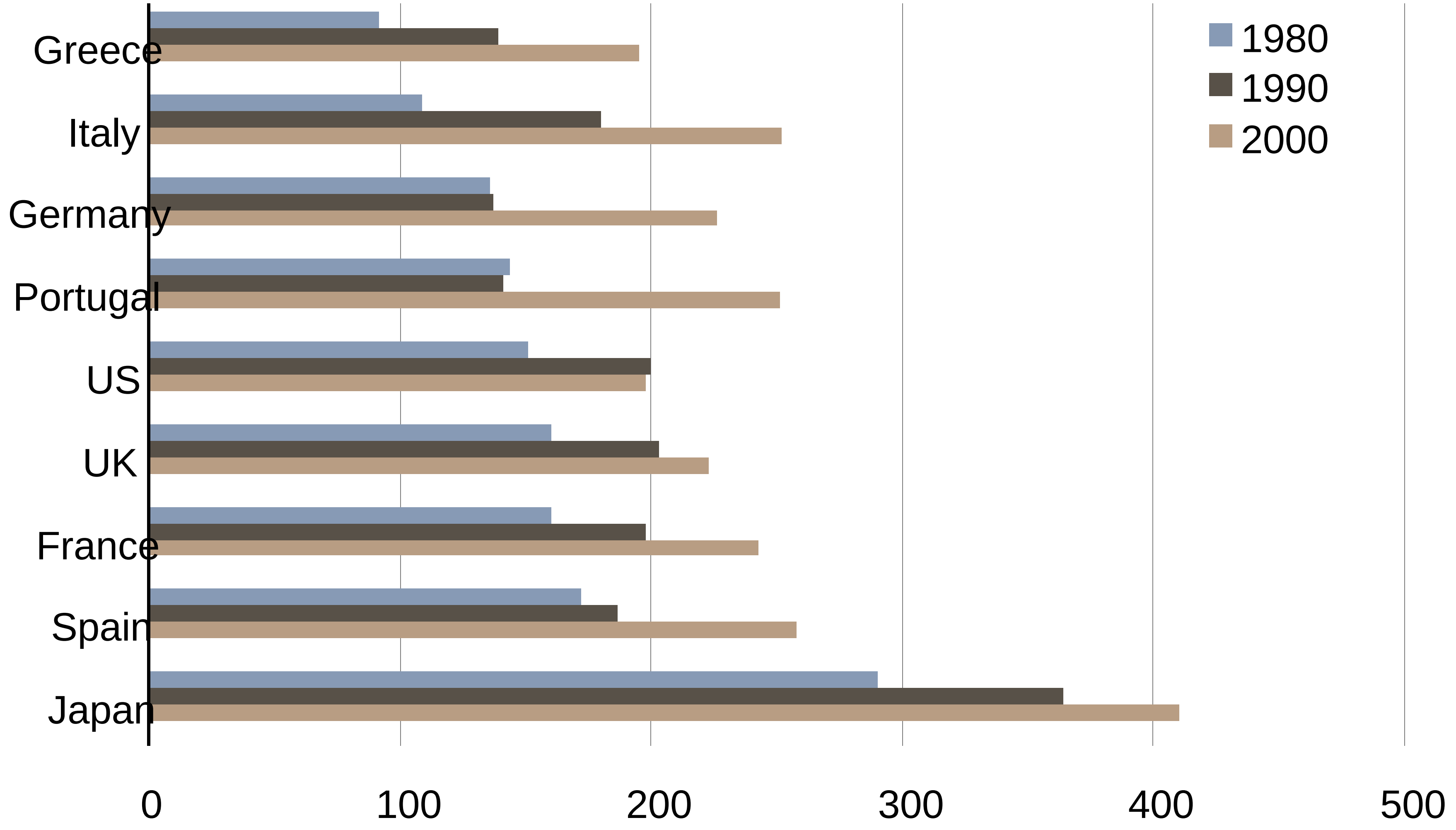

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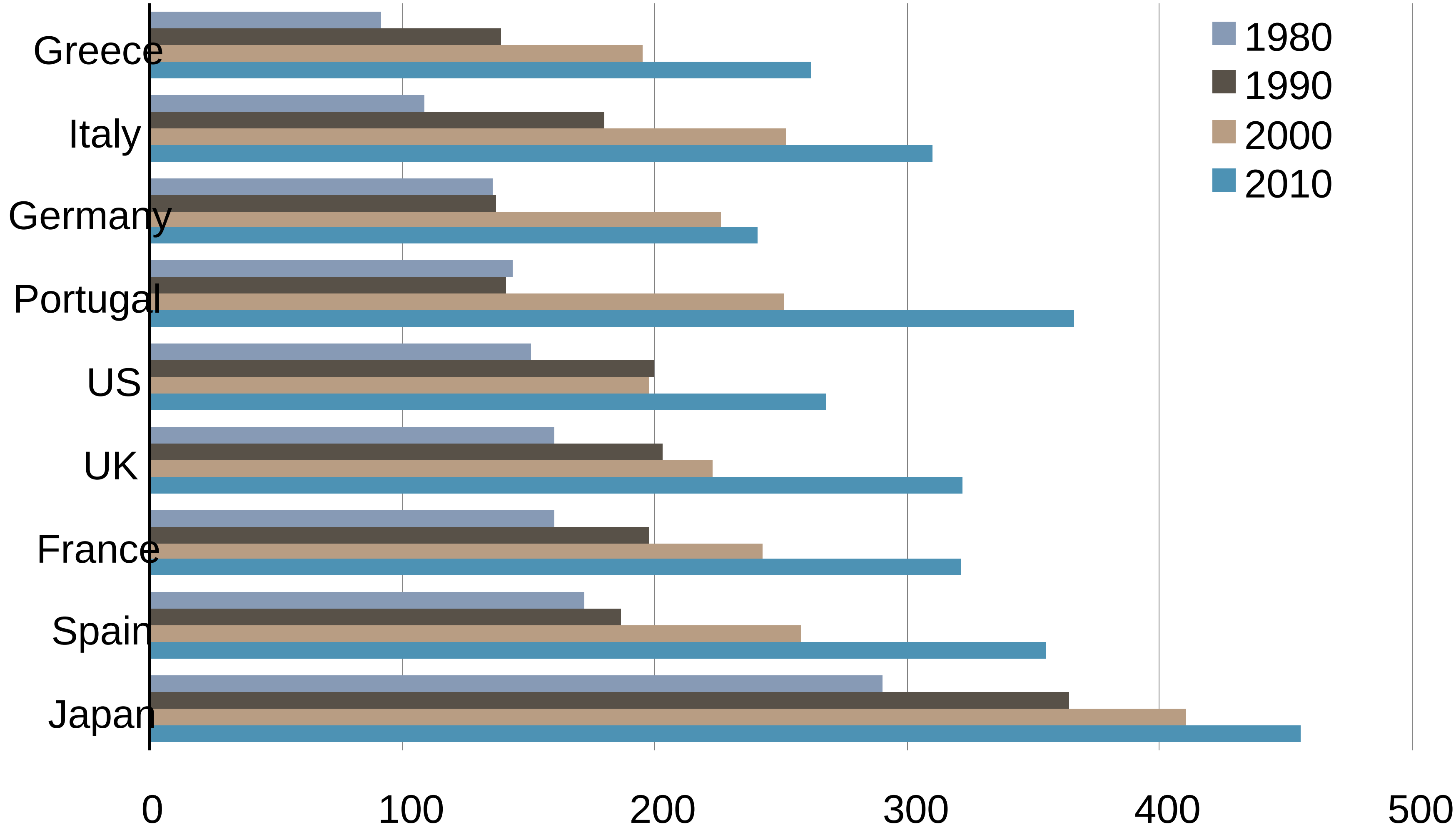
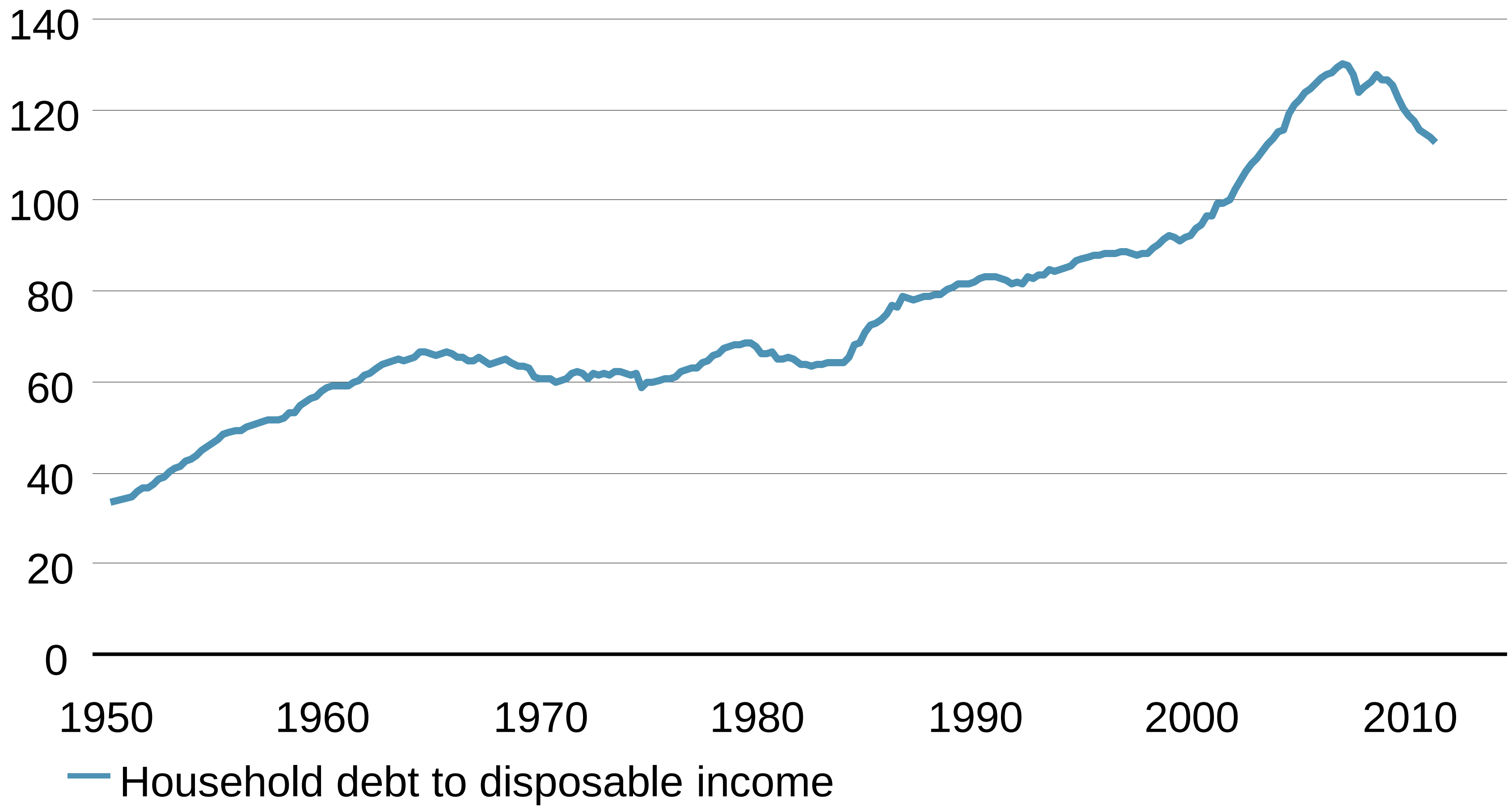


Source: Cecchetti, Mohanty and Zampolli, “The real effects of debt”, BIS, Working Paper #352, September 2011

Households sharply deleveraging

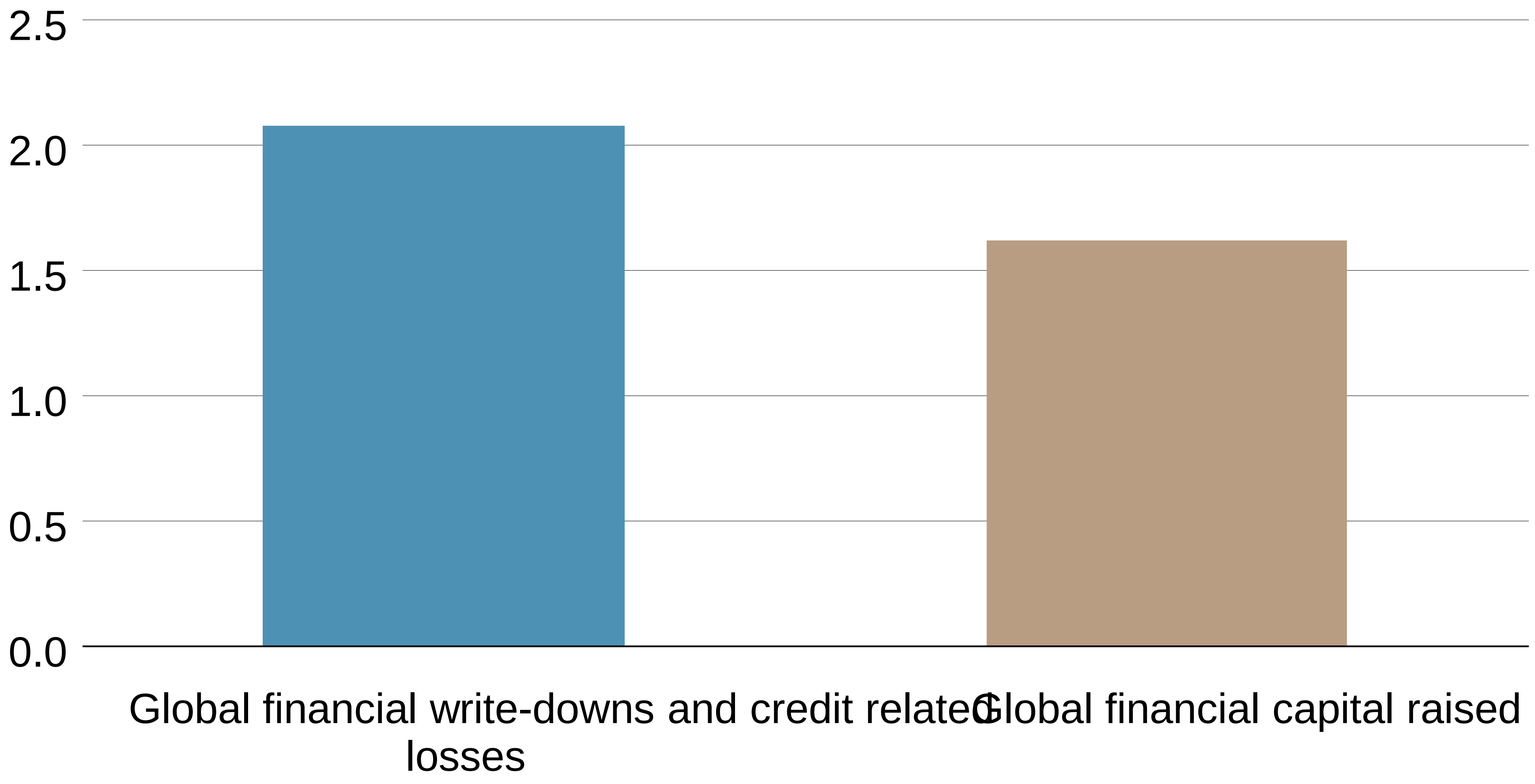
US household debt as a share of disposable income, in %



Source: Federal Reserve Board, UBS WMR

Bank re-capitalizations likely to be ongoing

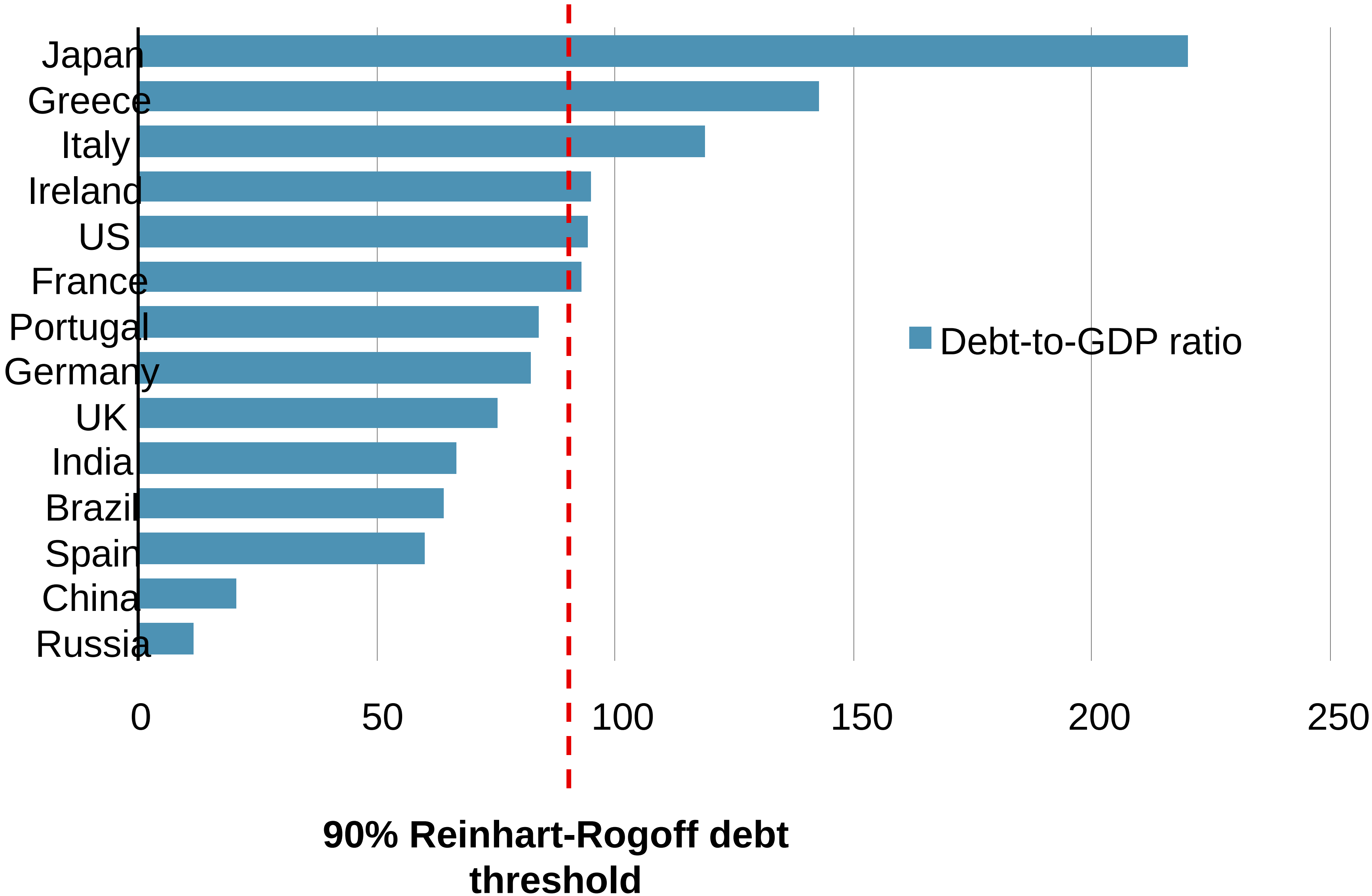
Losses and capital raised 2007 – present, in trillions of USD



Source: Bloomberg, UBS WMR

High government debt levels lead to slow (or no) growth

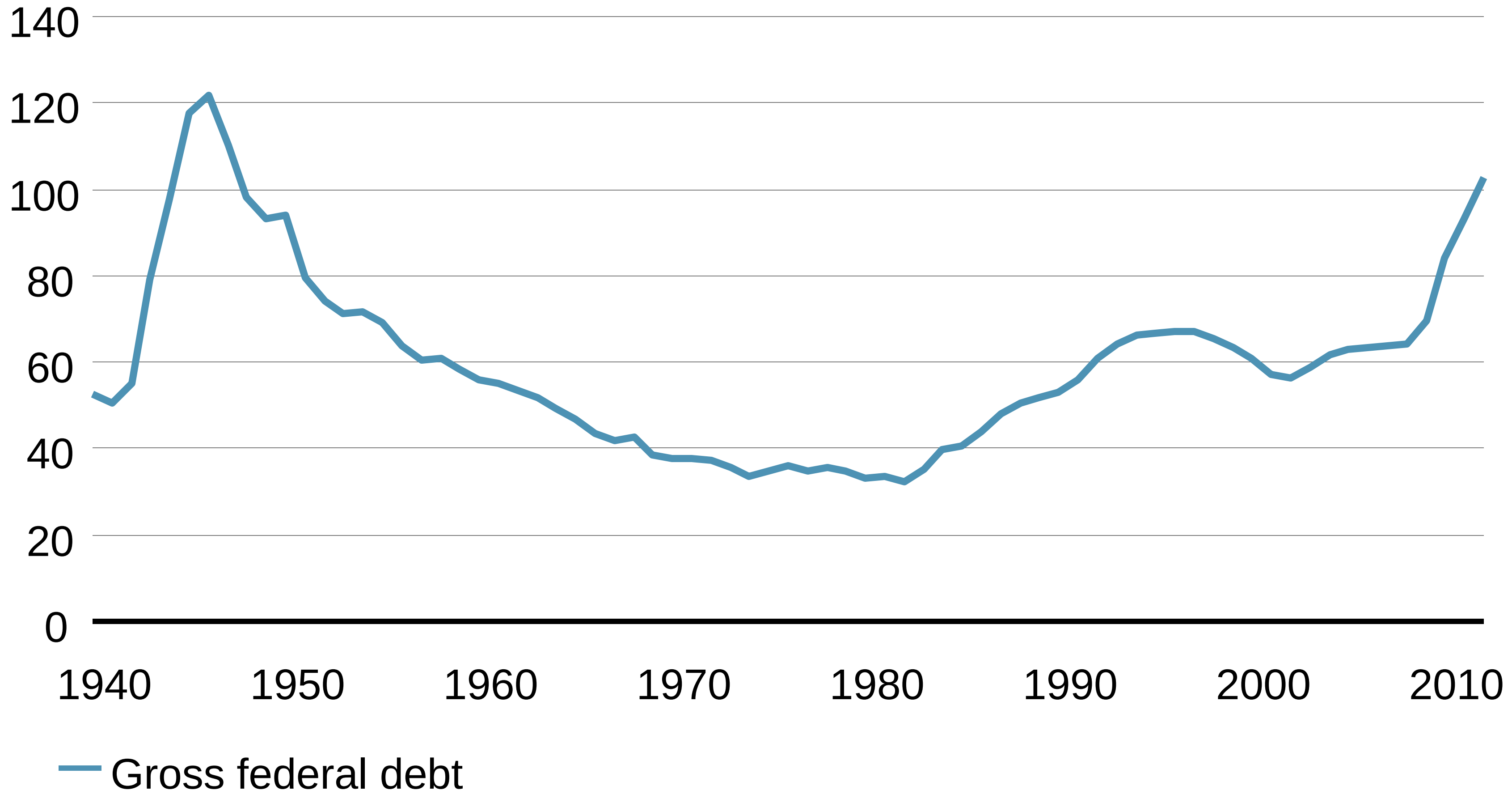
Estimates of general government gross debt-to-GDP ratio in 2011, in %



Source: IMF, World Economic Outlook, UBS WMR

US public debt reaching unsustainable levels

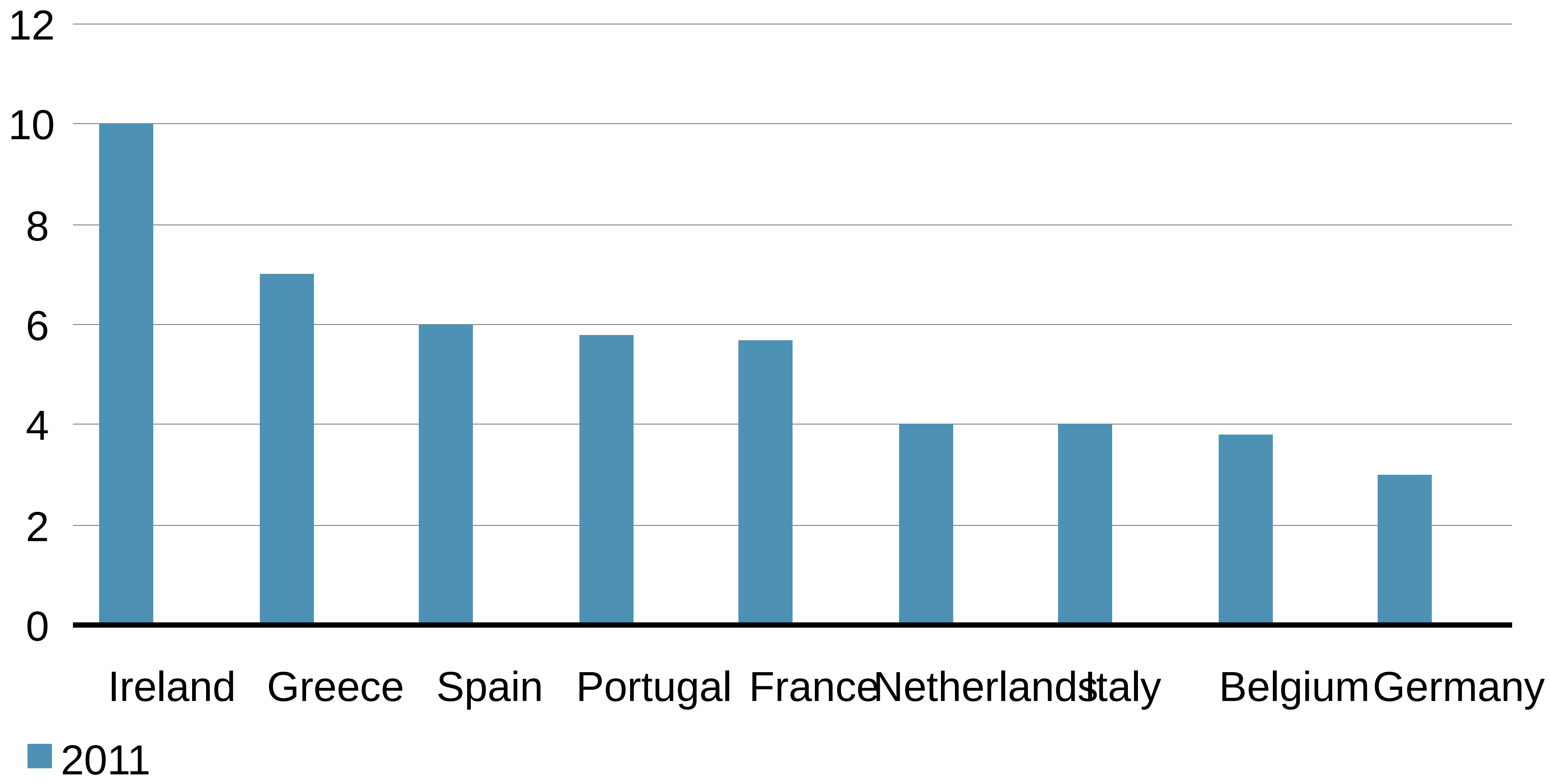
Gross federal debt, in % of nominal GDP



Source: Datastream, U.S. Office of Management and Budget, UBS WMR

Government austerity in Europe set to accelerate

Public deficits in the euro zone, in % of GDP



Source: Haver, Eurostat, UBS WMR

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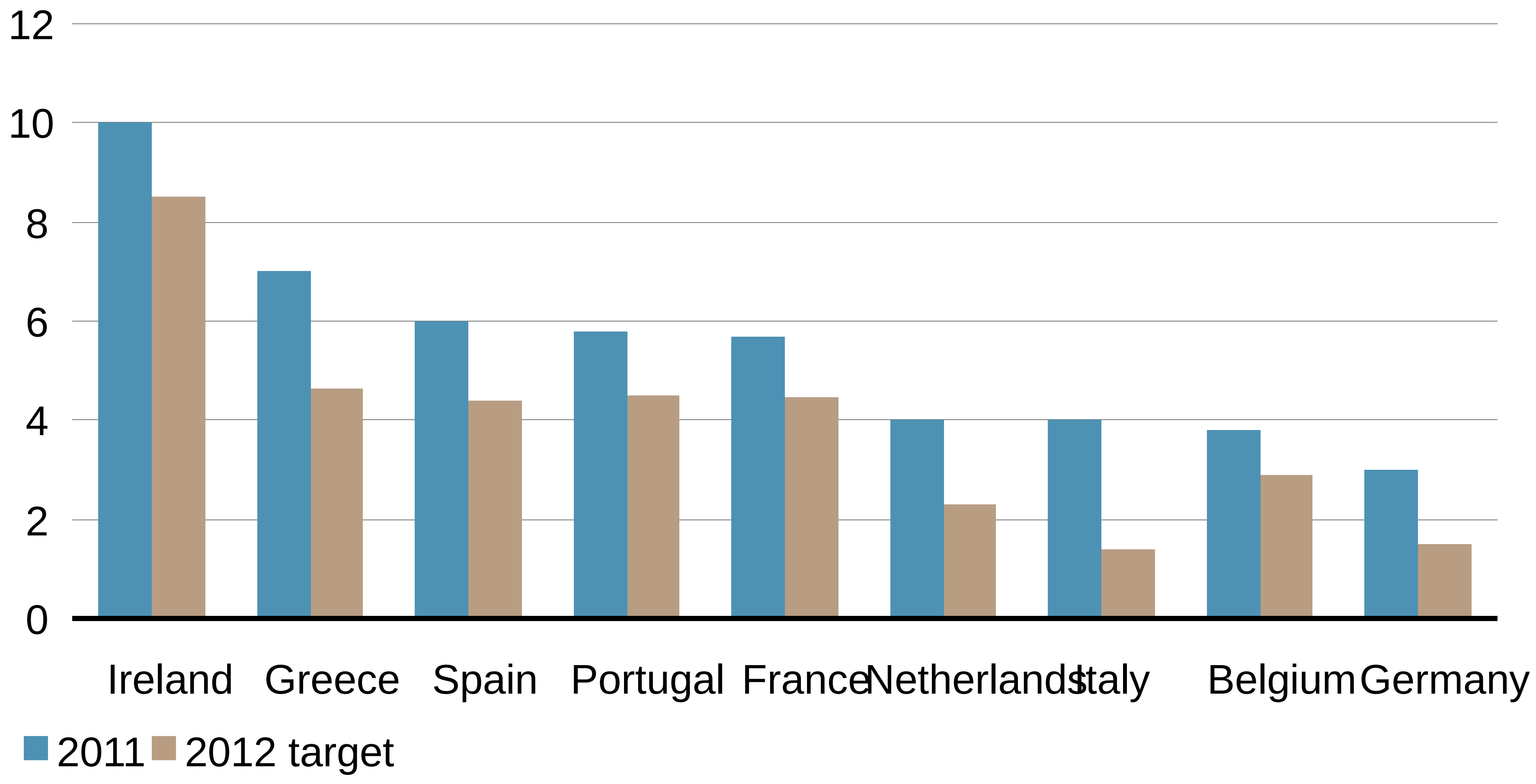
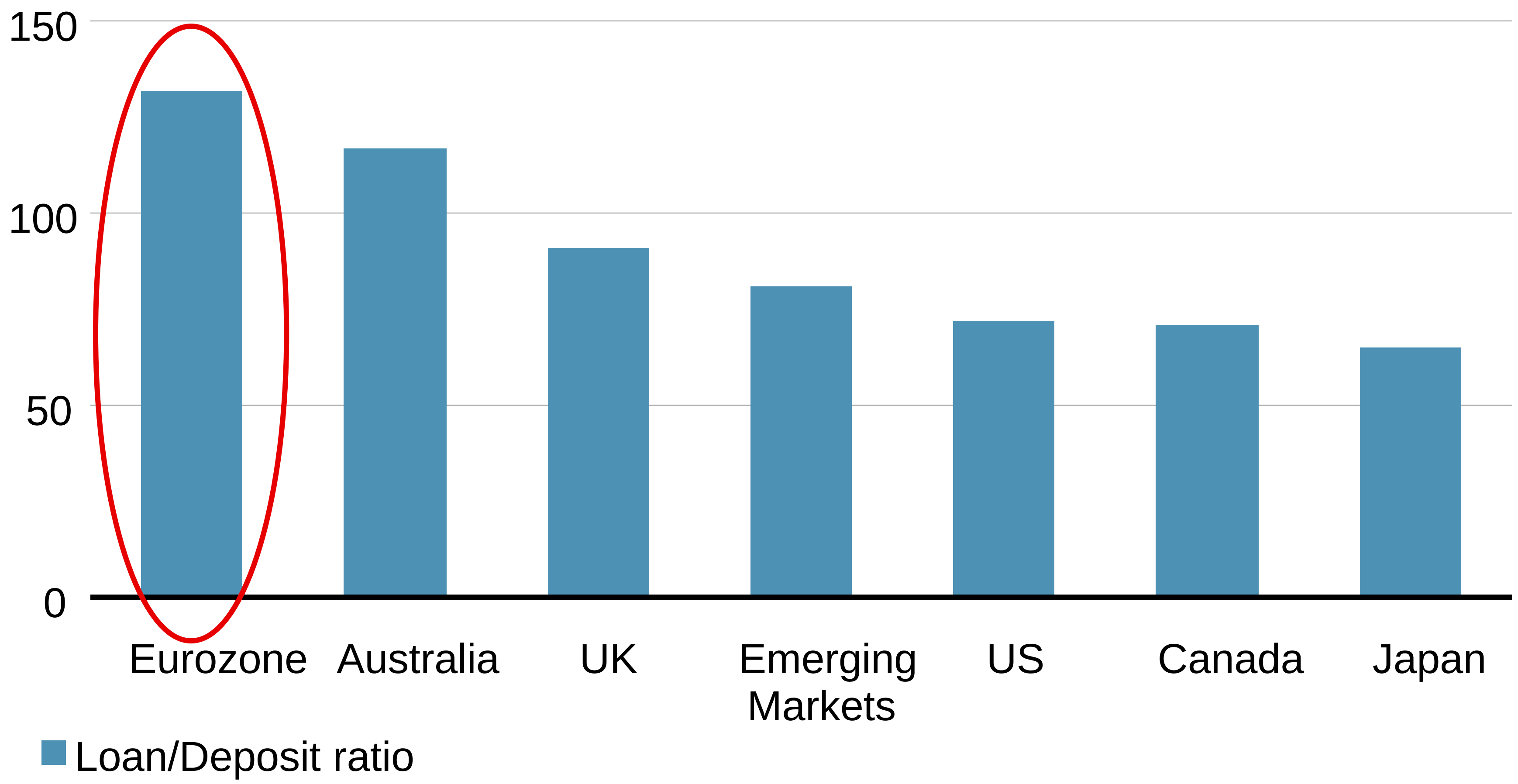


Source: Haver, Eurostat, UBS WMR

Euro zone deleveraging will hurt growth

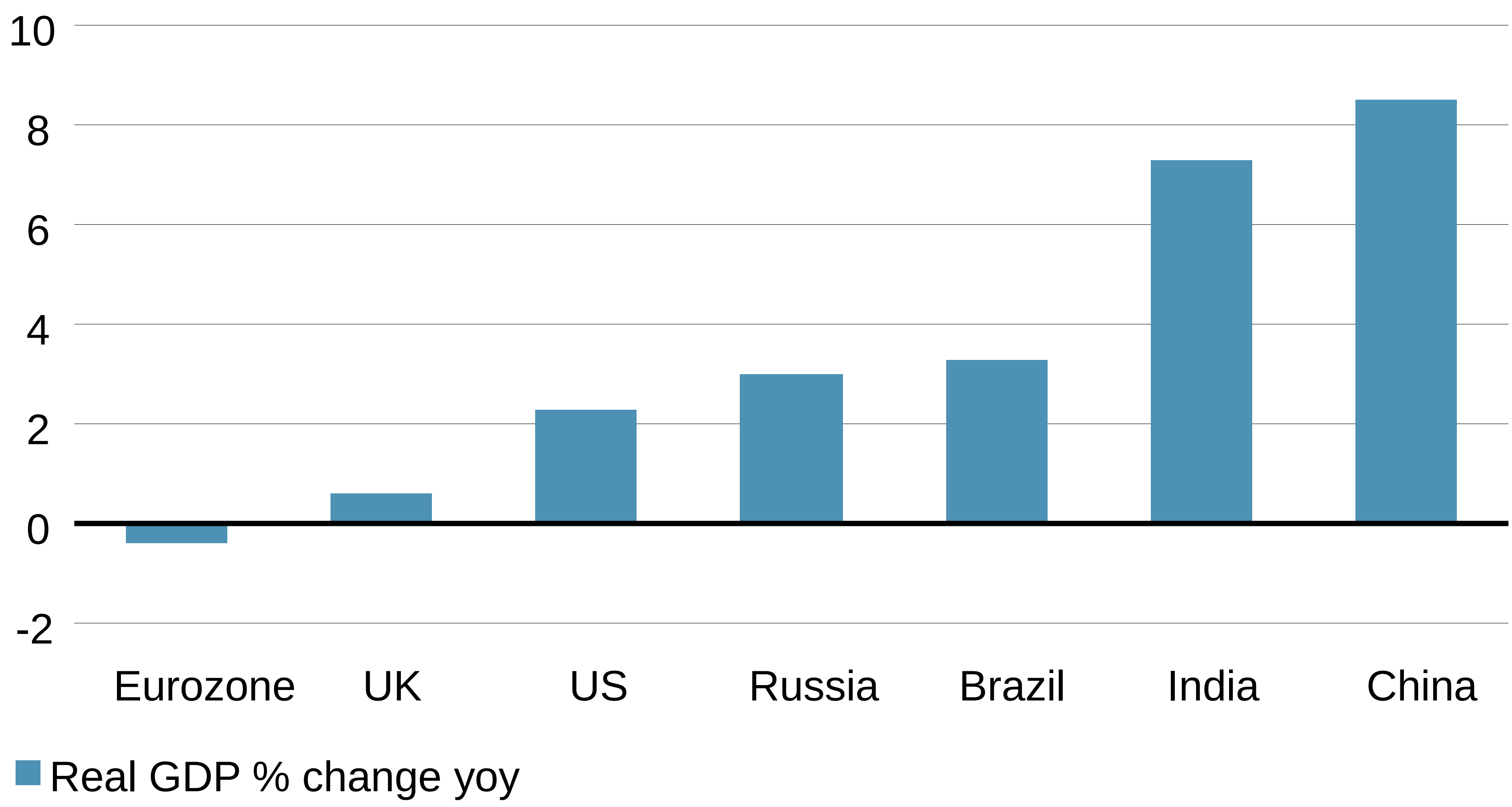
Loan to deposit ratio, in %



Source: Bloomberg, UBS WMR

Economic slowdown won't be uniform in 2012

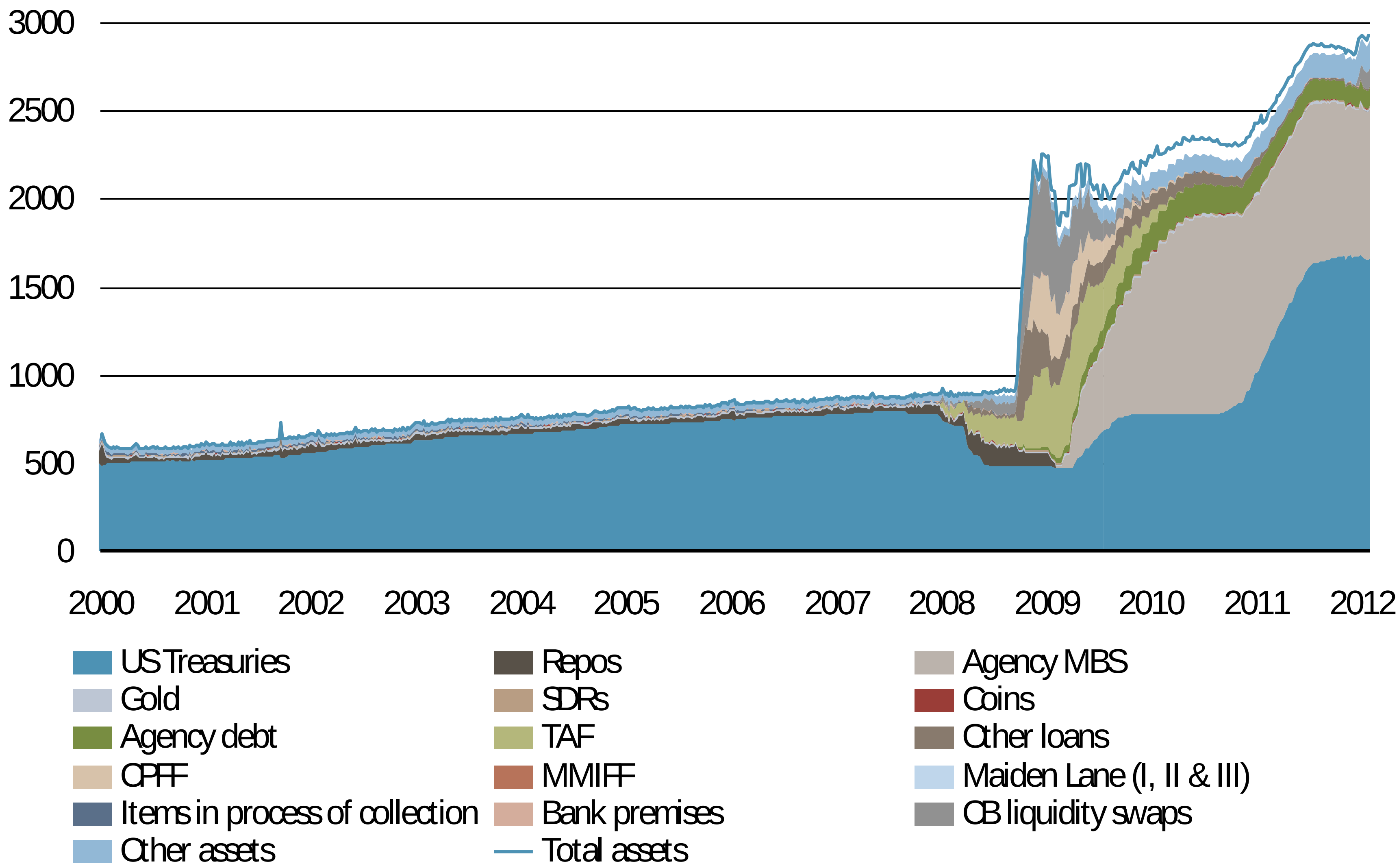
UBS WMR economic growth forecasts 2012, real GDP change yoy, in %



Source: Bloomberg, UBS WMR

Monetary policy to remain very accommodative…for now

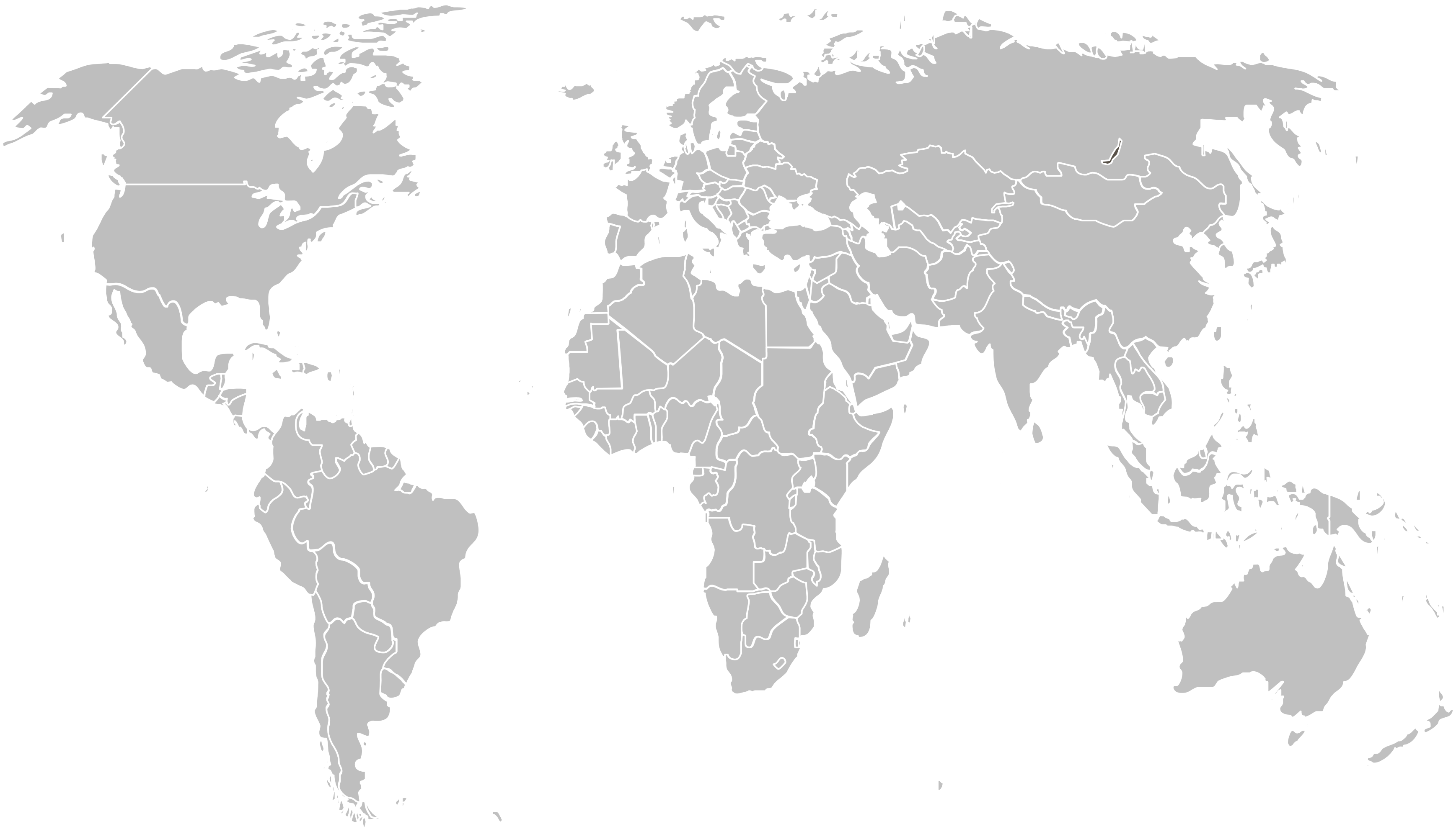
Federal Reserve Balance Sheet, in billions of USD



Source: DataStream, UBS WMR

Global leadership changes continue

Countries with potential leadership transitions in 2012



Source: UBS WMR

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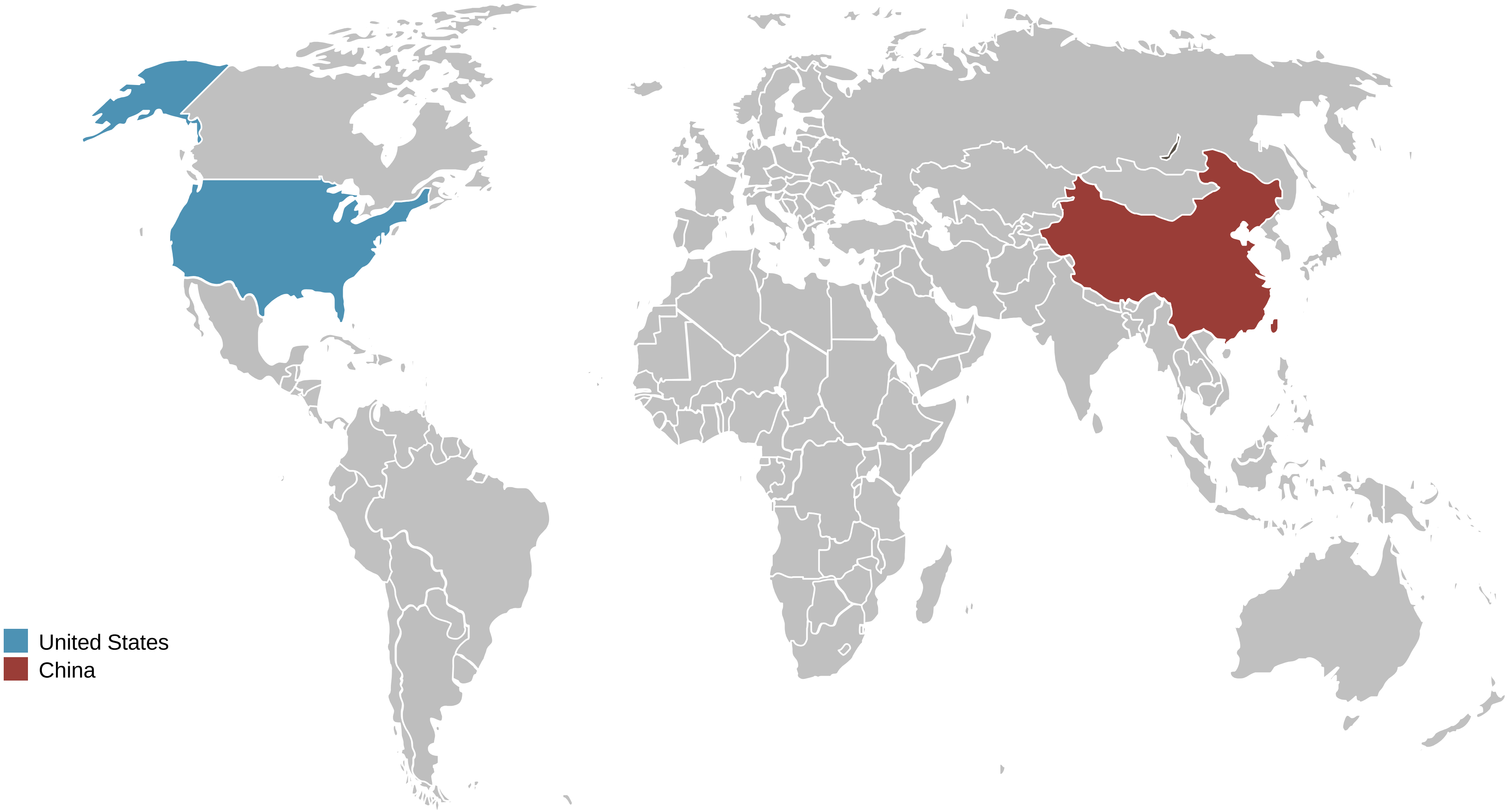

Source: UBS WMR

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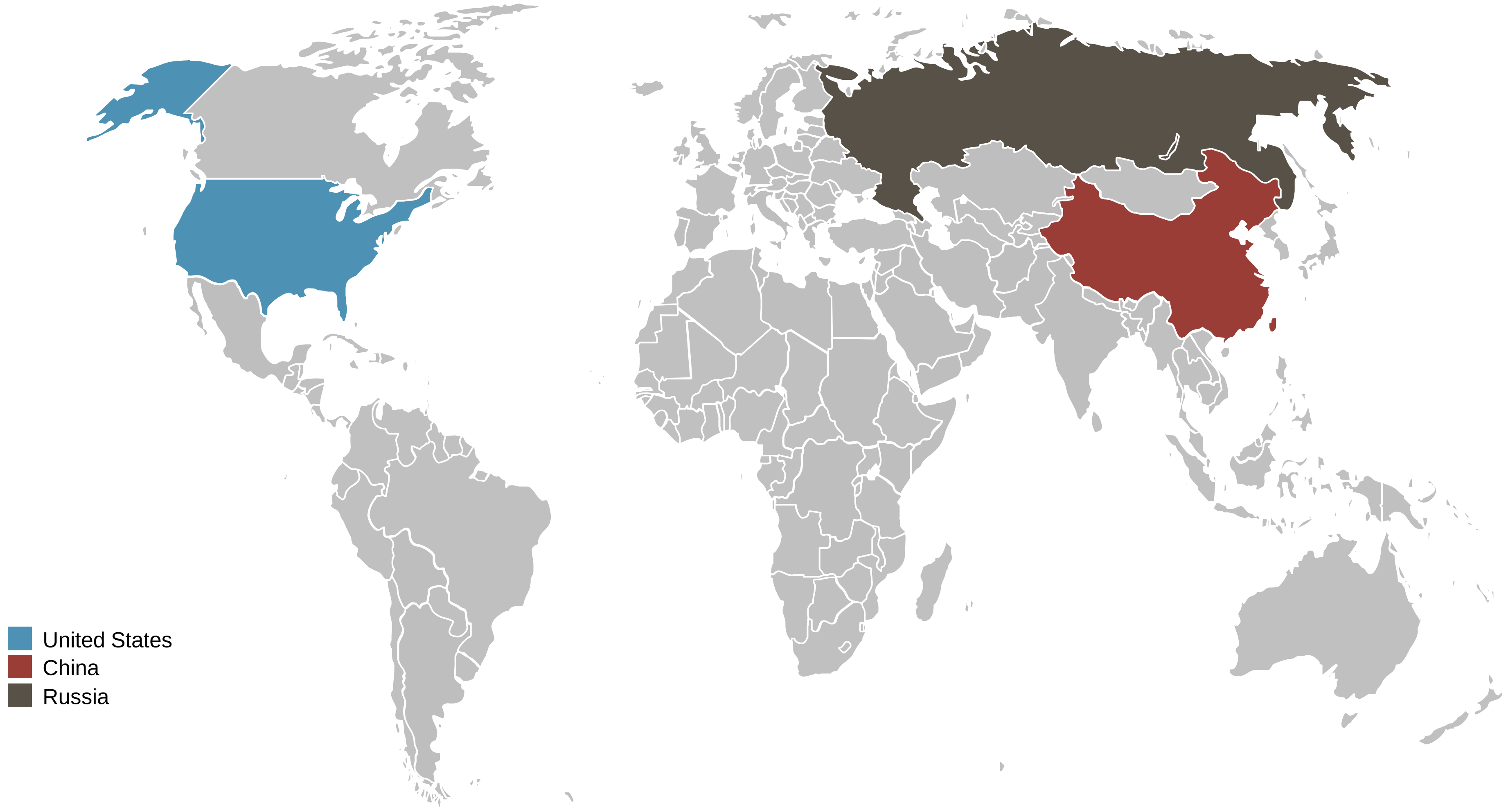

Source: UBS WMR

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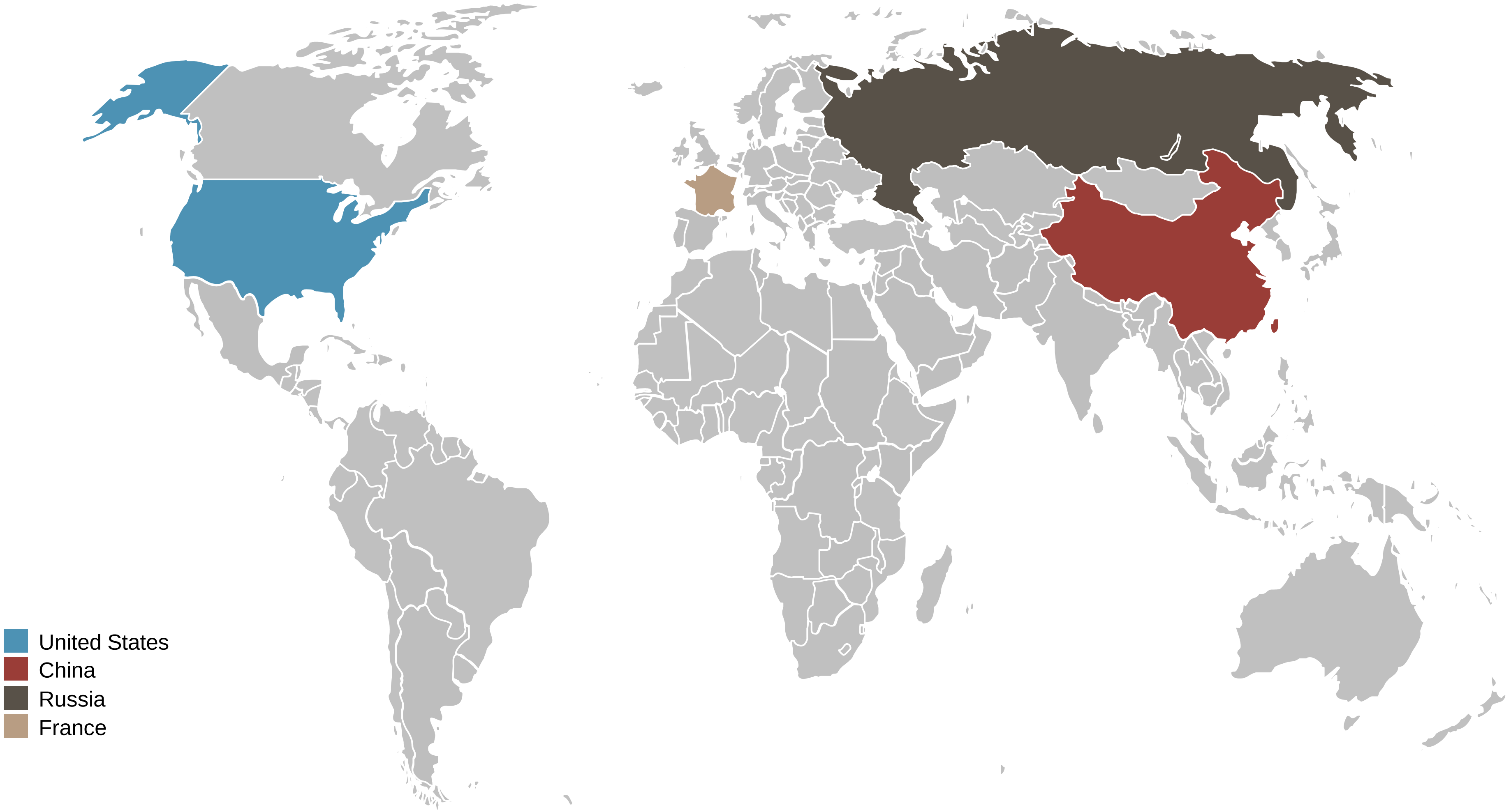

Source: UBS WMR

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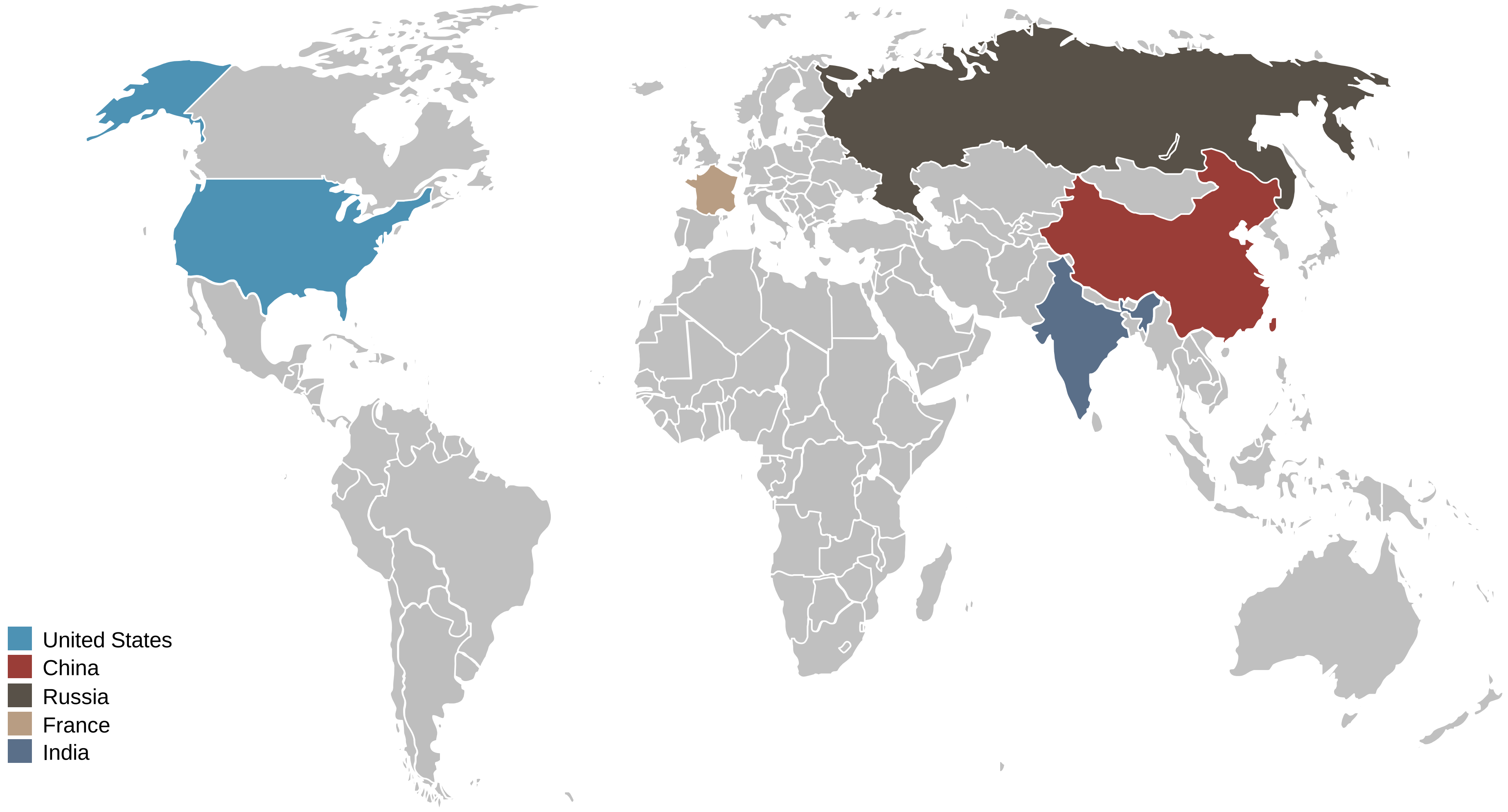

Source: UBS WMR

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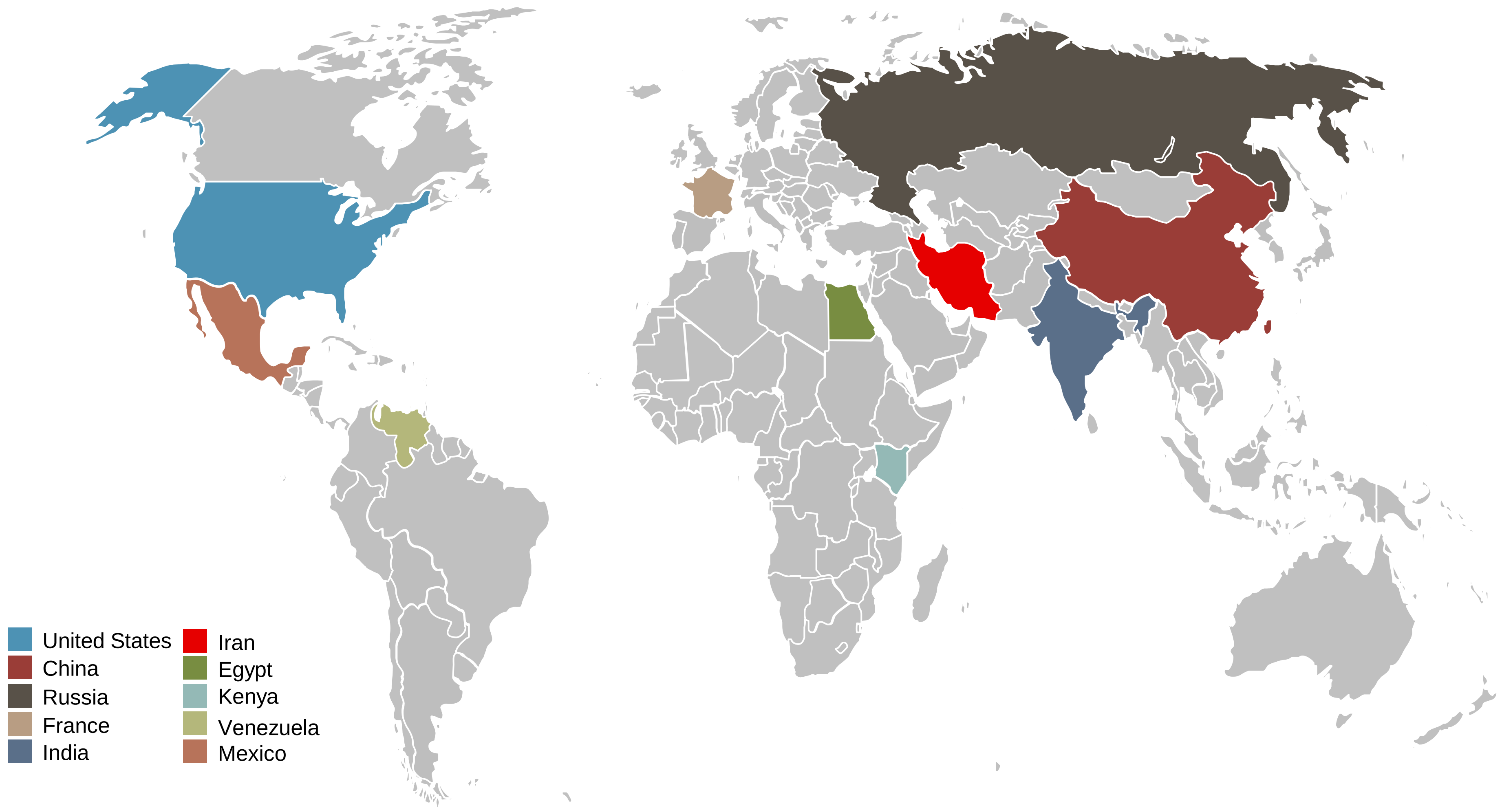
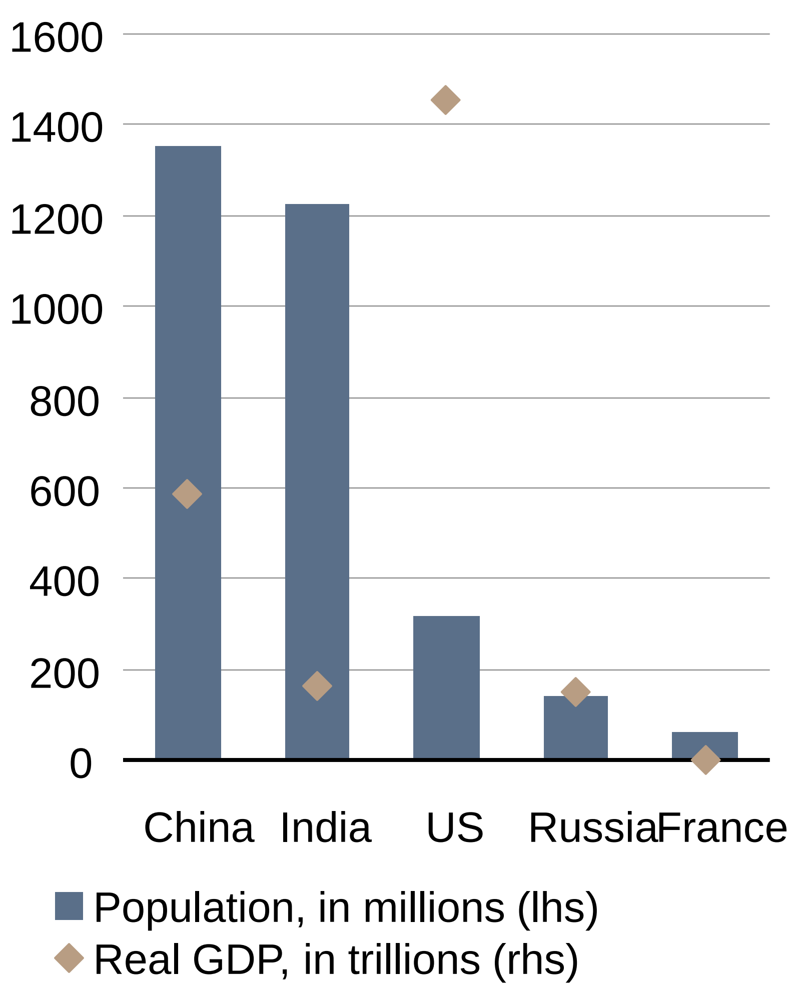


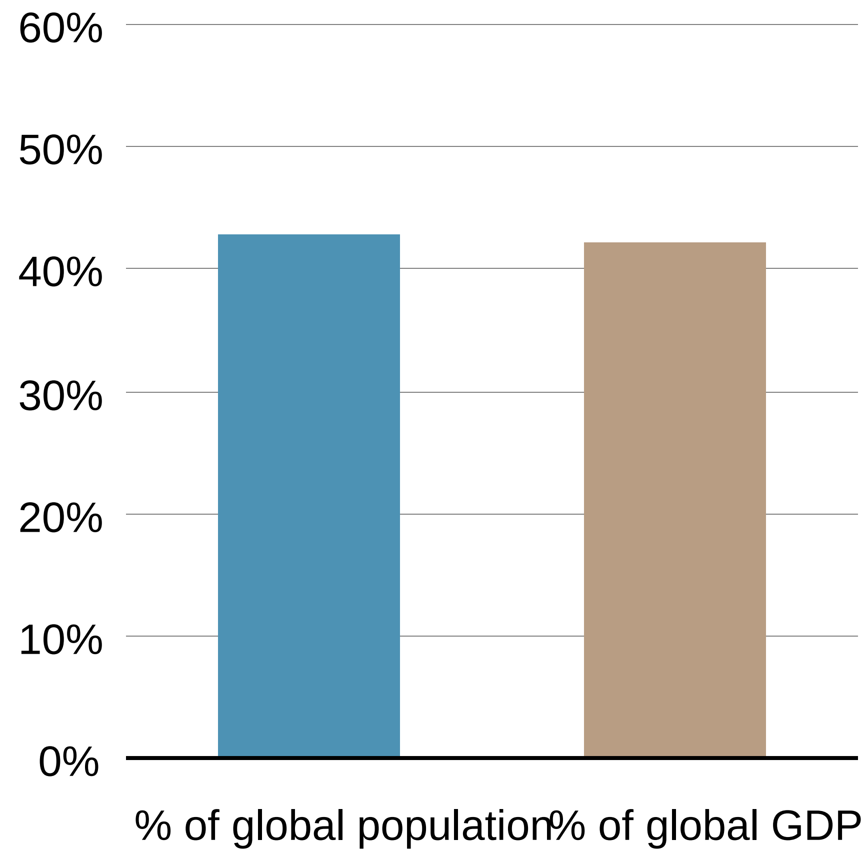
Source: UBS WMR

countries

Five countries of interest…



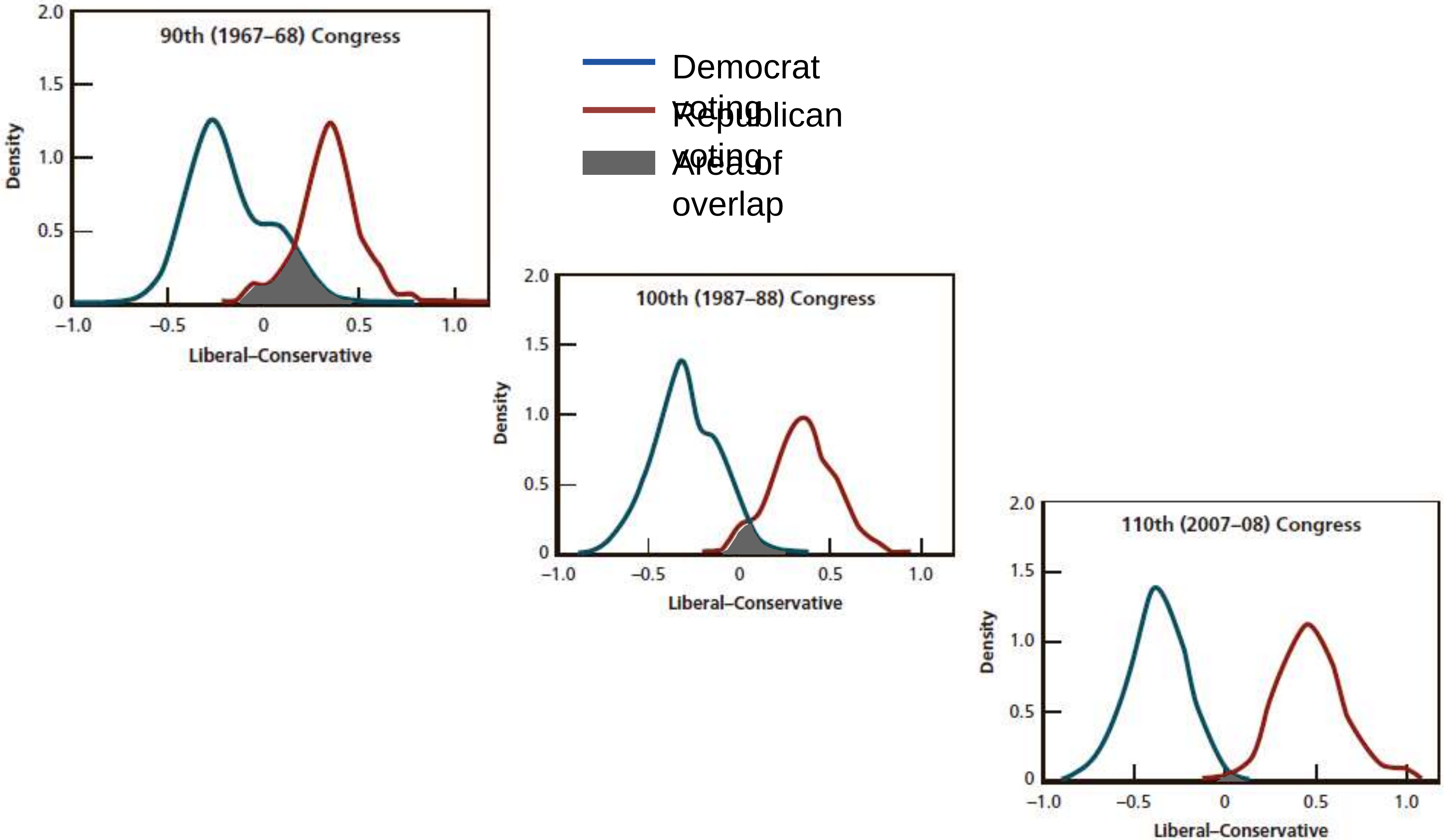
…stacked against rest of the world



Source: IMF, World Economic Outlook Database, UBS WMR

Hyperpolarization and the shrinking middle

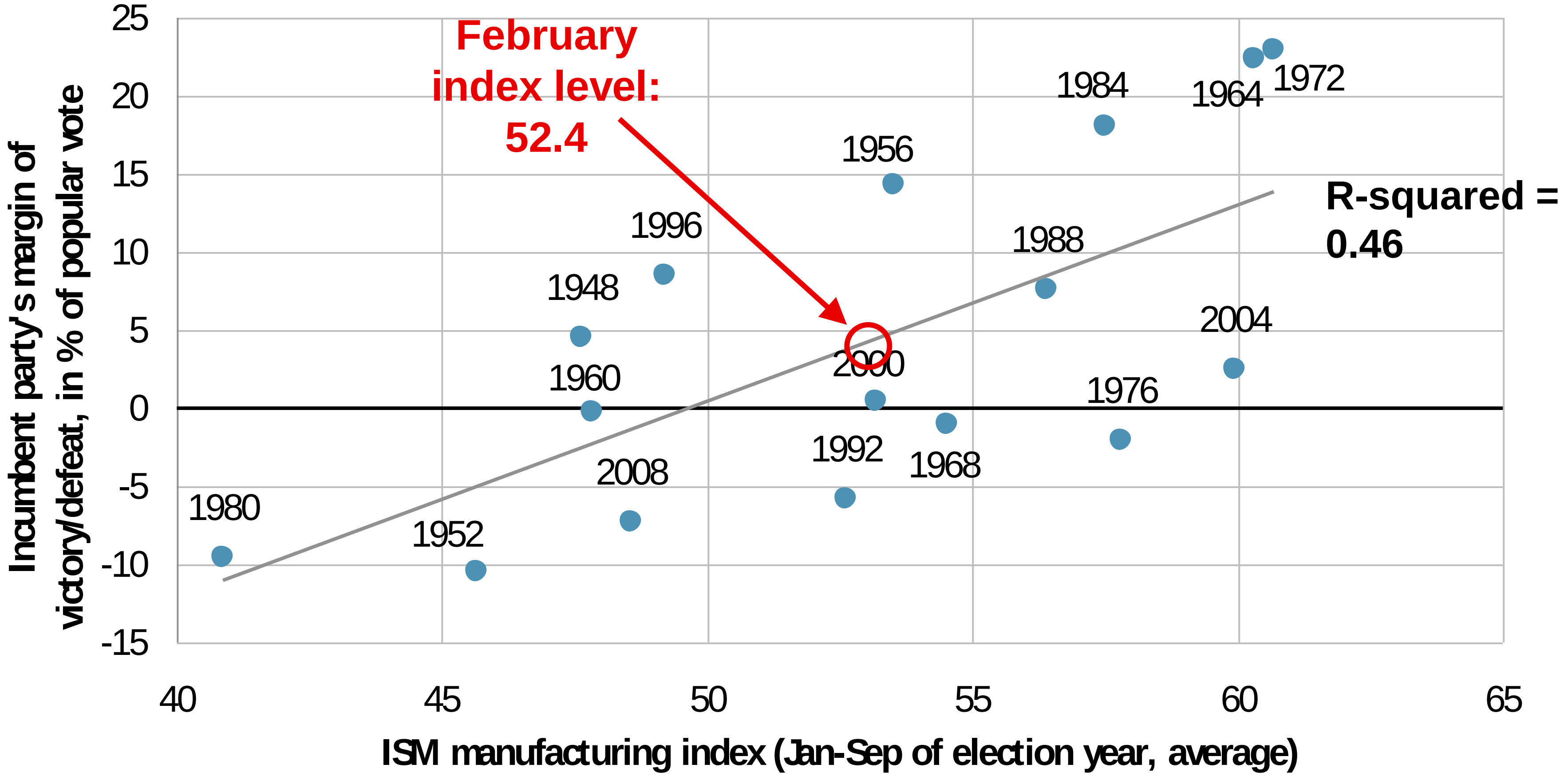
Voting patterns in 90th, 100th, and 110th Congresses



Source: “A House Divided: Polarization and Its Effect on RAND”, James A. Thomson (2010)

Incumbent's success tied to manufacturing momentum

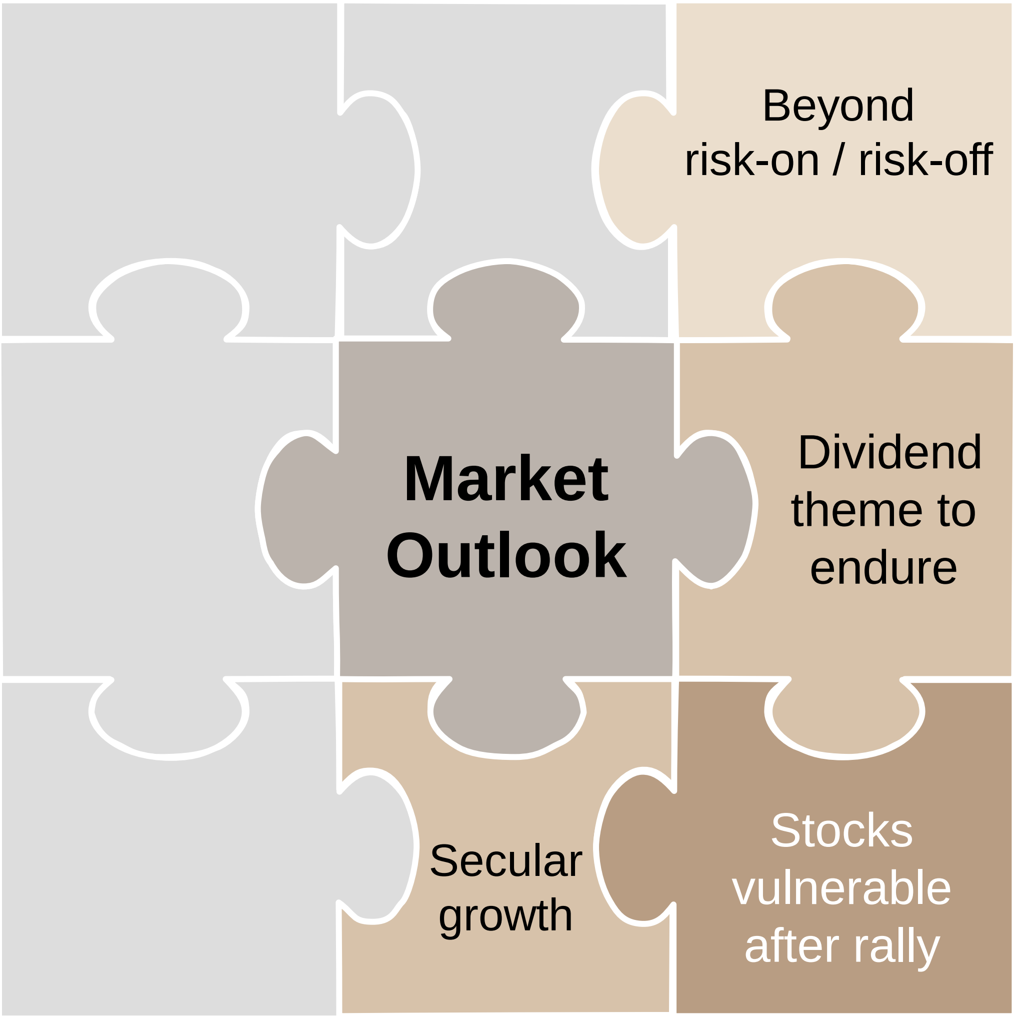
Incumbent party margin of victory vs. ISM manufacturing index



Source: Bureau of the Census, Federal Reserve Board UBS WMR

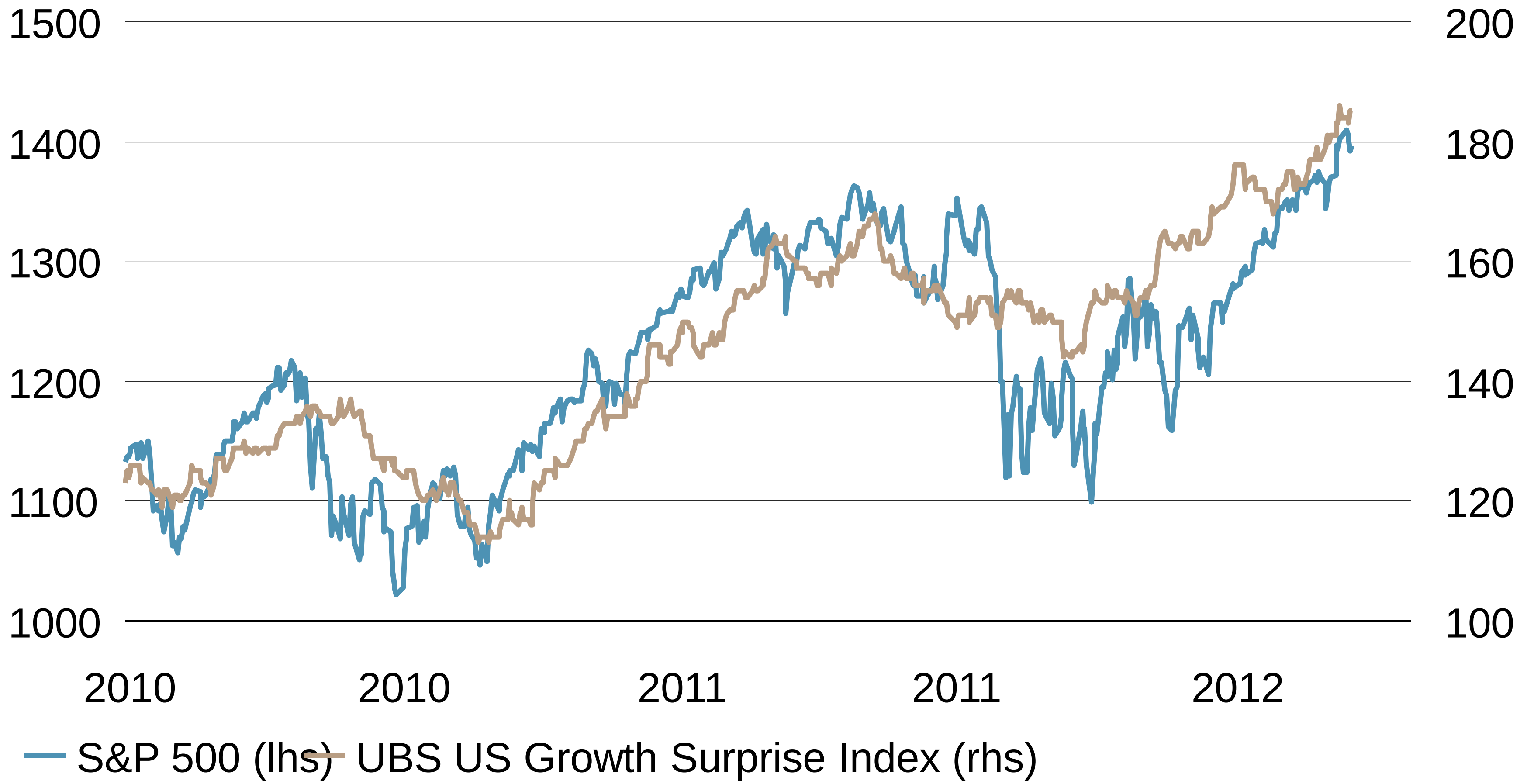
Key Investment Themes

- Stocks vulnerable after rally
- Beyond risk-on / risk-off
- Dividend theme to endure
- Secular growth



Better than expected economic data bolsters markets

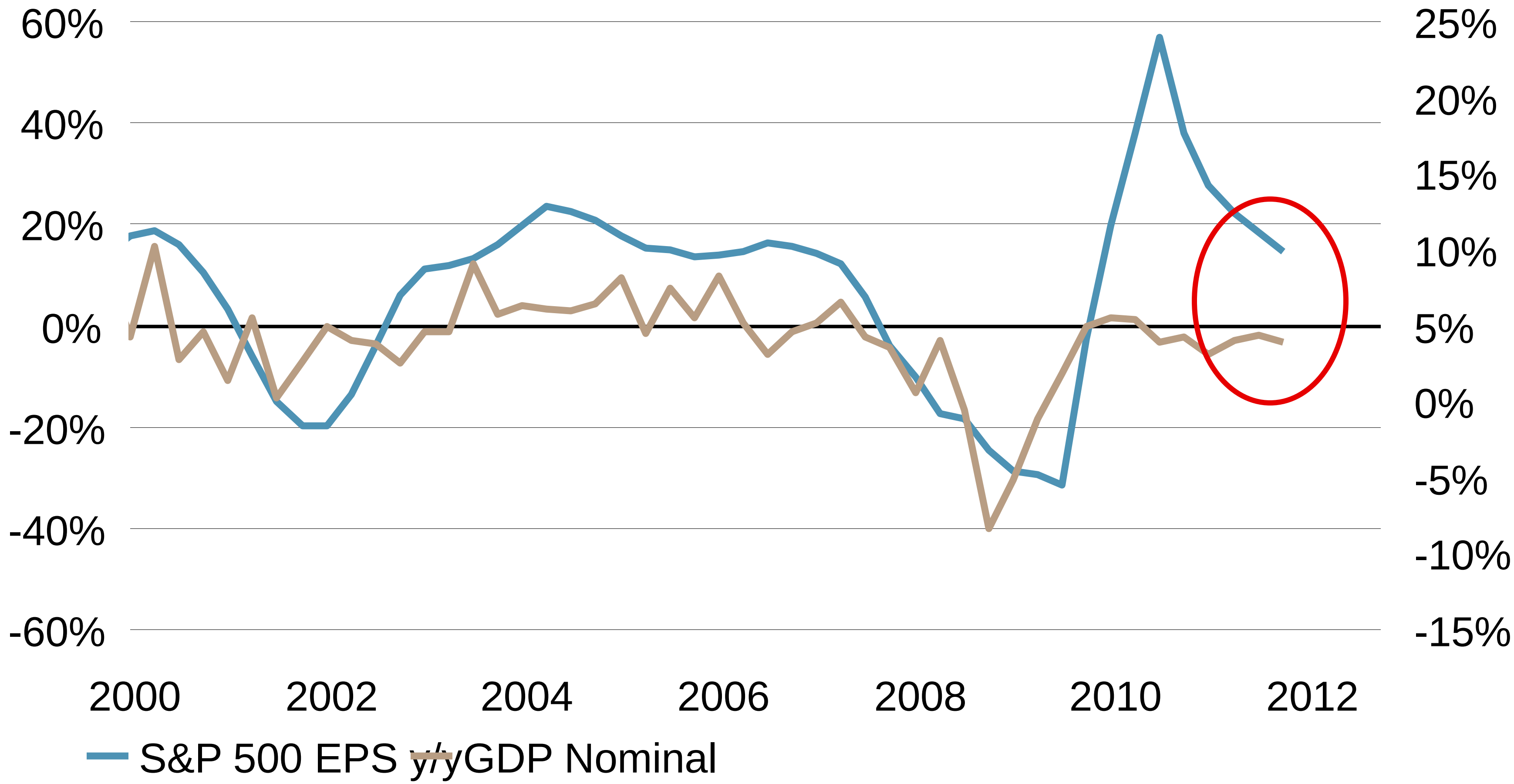
UBS US Growth Surprise Index and S&P 500



Source: Bloomberg, UBS WMR

Earnings have outperformed the economy up till now

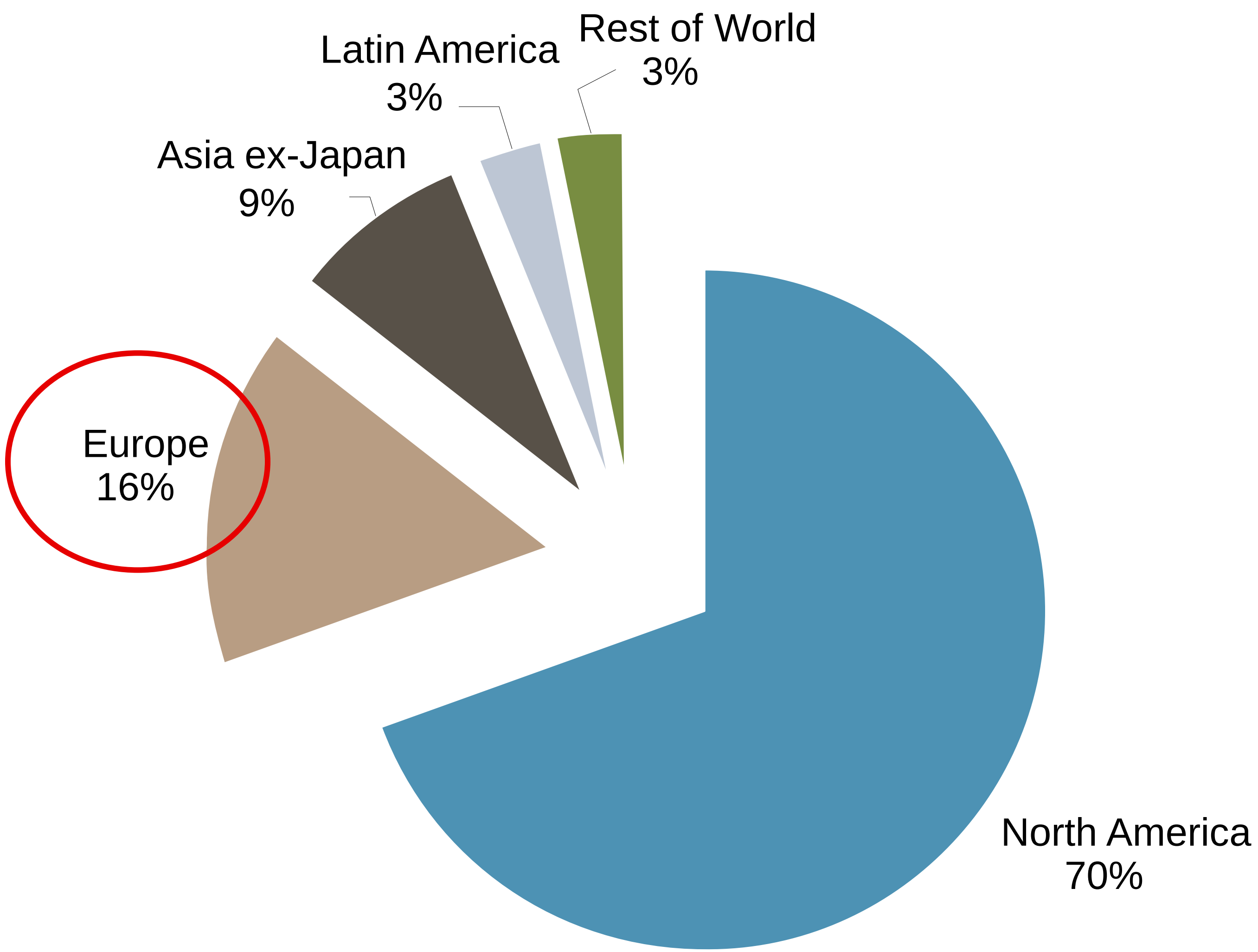
US GDP and S&P 500 EPS growth, 2000-2011



Source: Bloomberg, UBS WMR

Europe matters for S&P 500 profits

Roughly 16% of S&P 500 sales come directly from Europe (indirect exposure is higher via USD, commodity price impact)

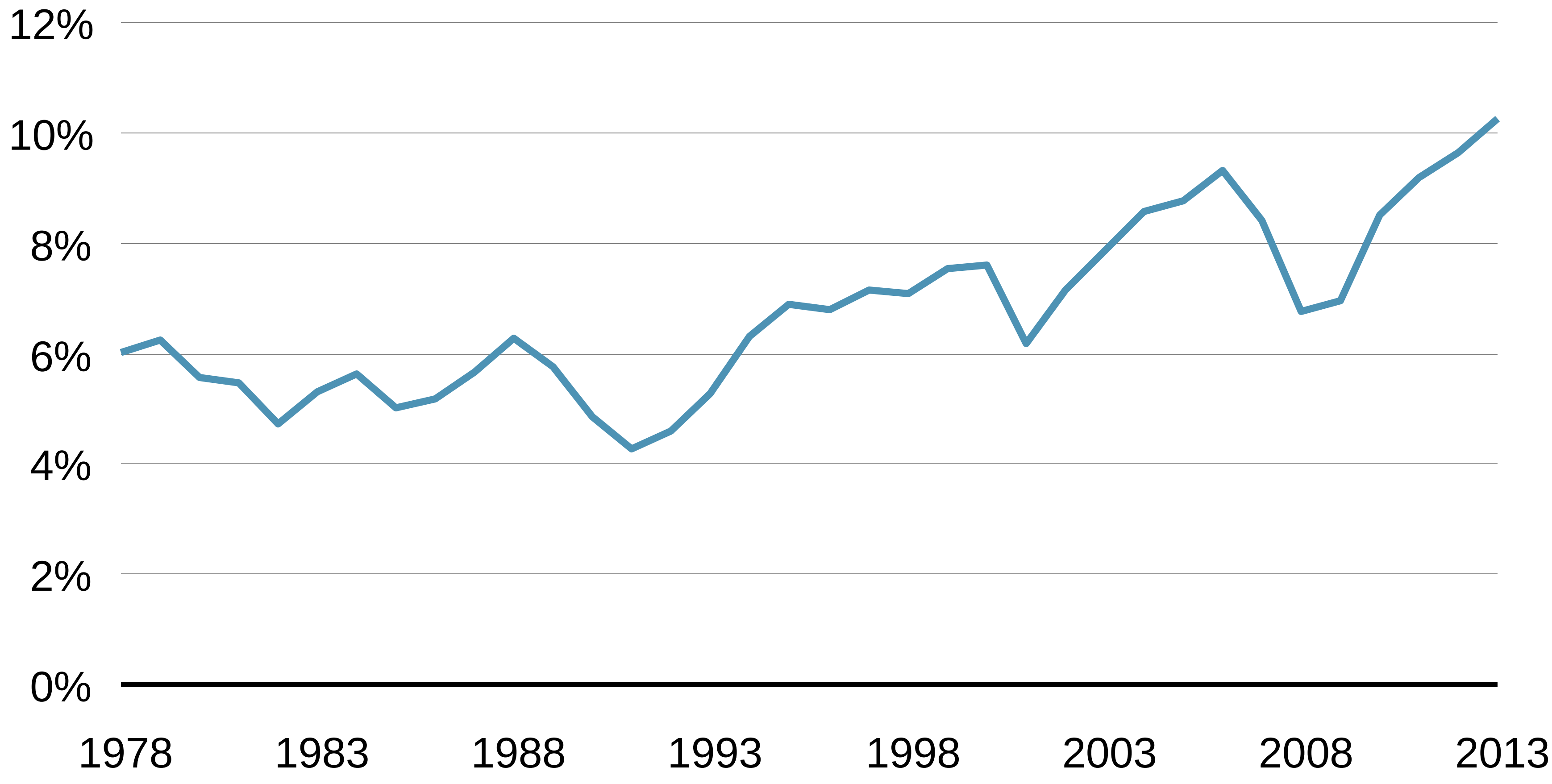


UBS

Source: FactSet, UBS WMR

Profit margin estimates are quite optimistic

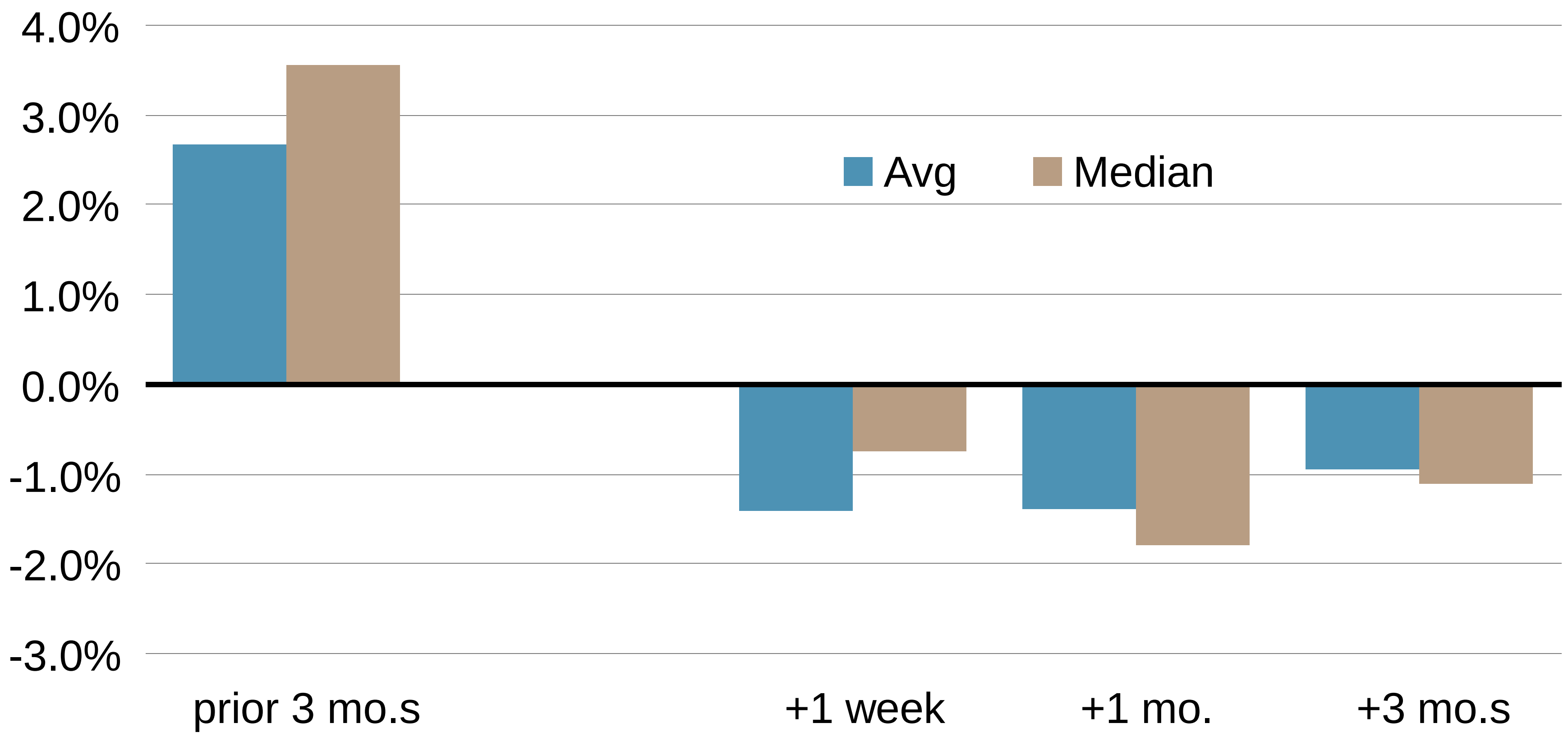
S&P 500 profit margins, actual and consensus estimates 2012 and 2013



Source: Bloomberg, DataStream and UBS WMR

Oil price shock poses a risk to equity markets

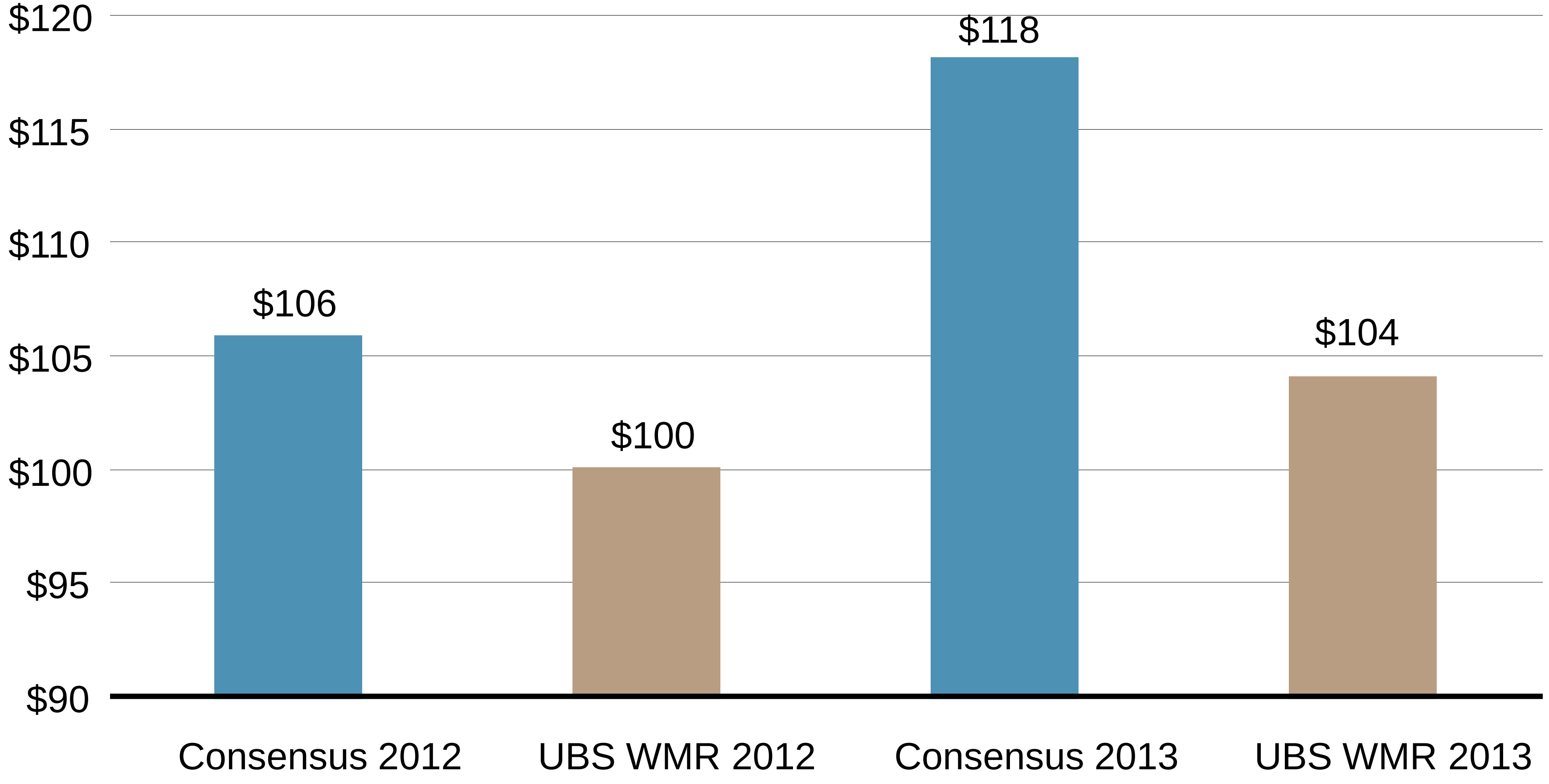
Equity market returns after short-term rise in regular unleaded gas price



Source: Bloomberg, UBS WMR

Further earnings estimate cuts likely

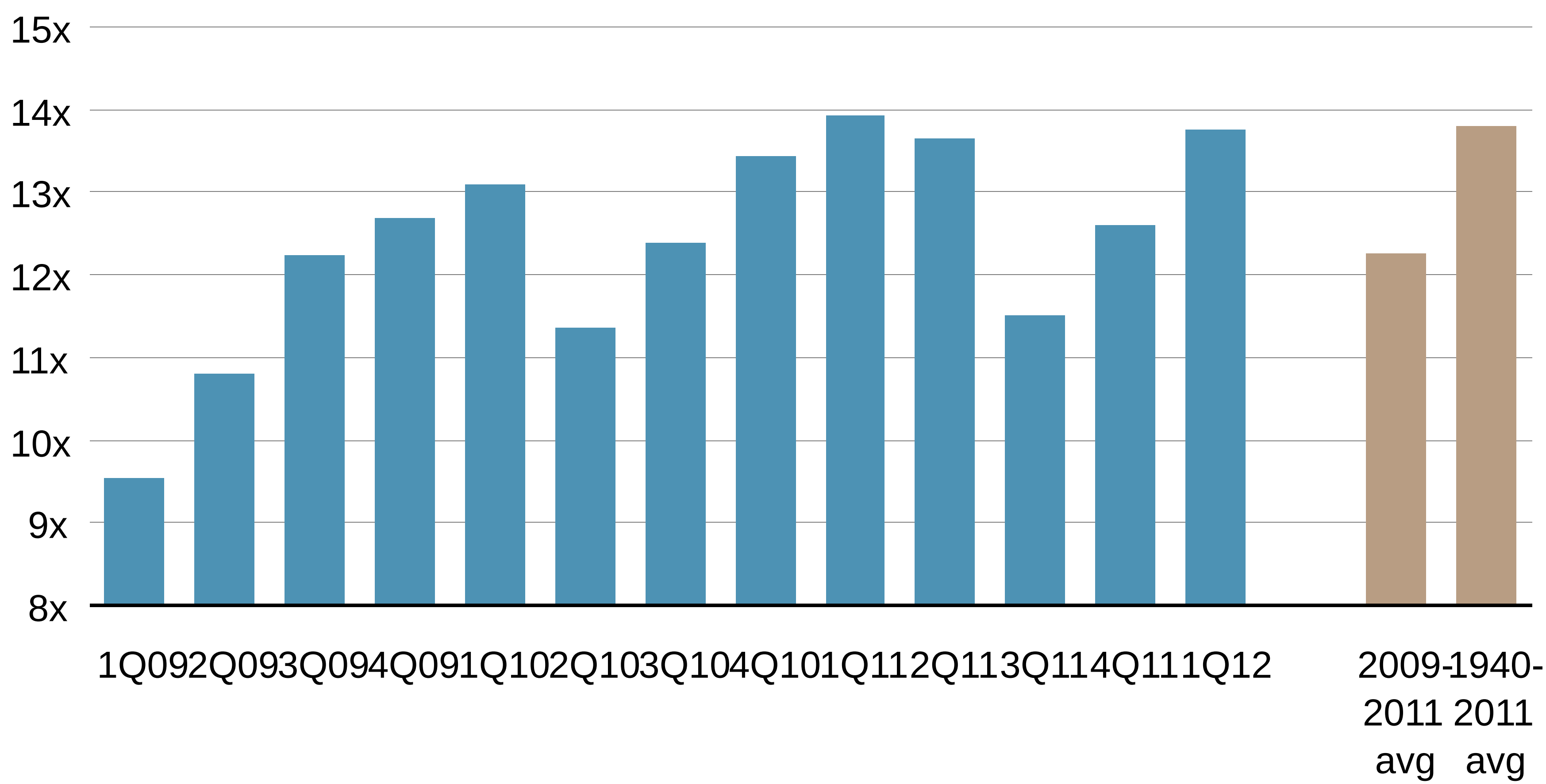
2012 and 2013 S&P 500 EPS estimates, consensus and UBS WMR



Source: FactSet, UBS WMR

S&P 500 valuation at high end of the post-financial crisis range

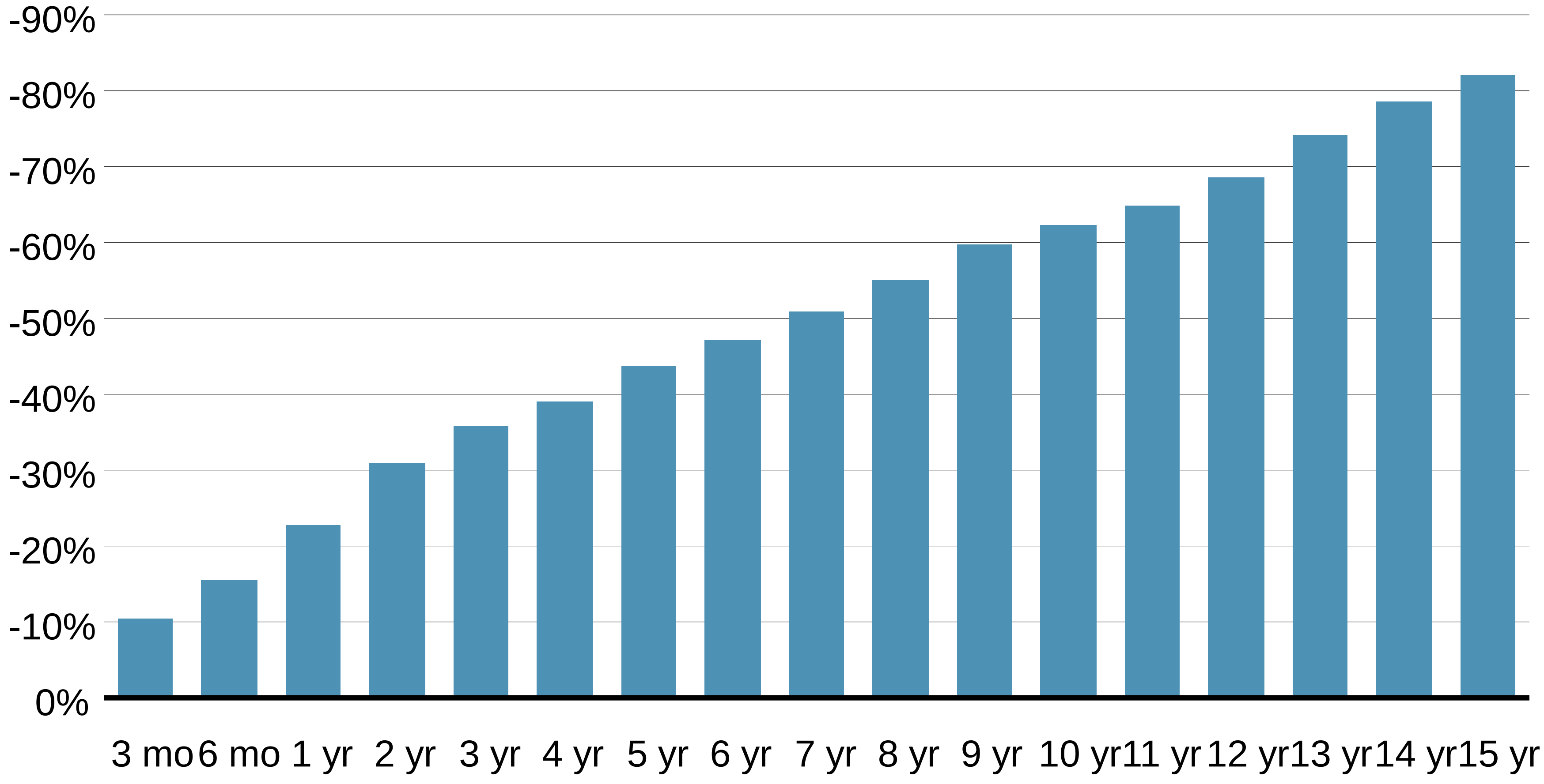
S&P 500 P/E on trend (or normalized) earnings per share



Source: Bloomberg, UBS WMR

Valuation matters in the long-run

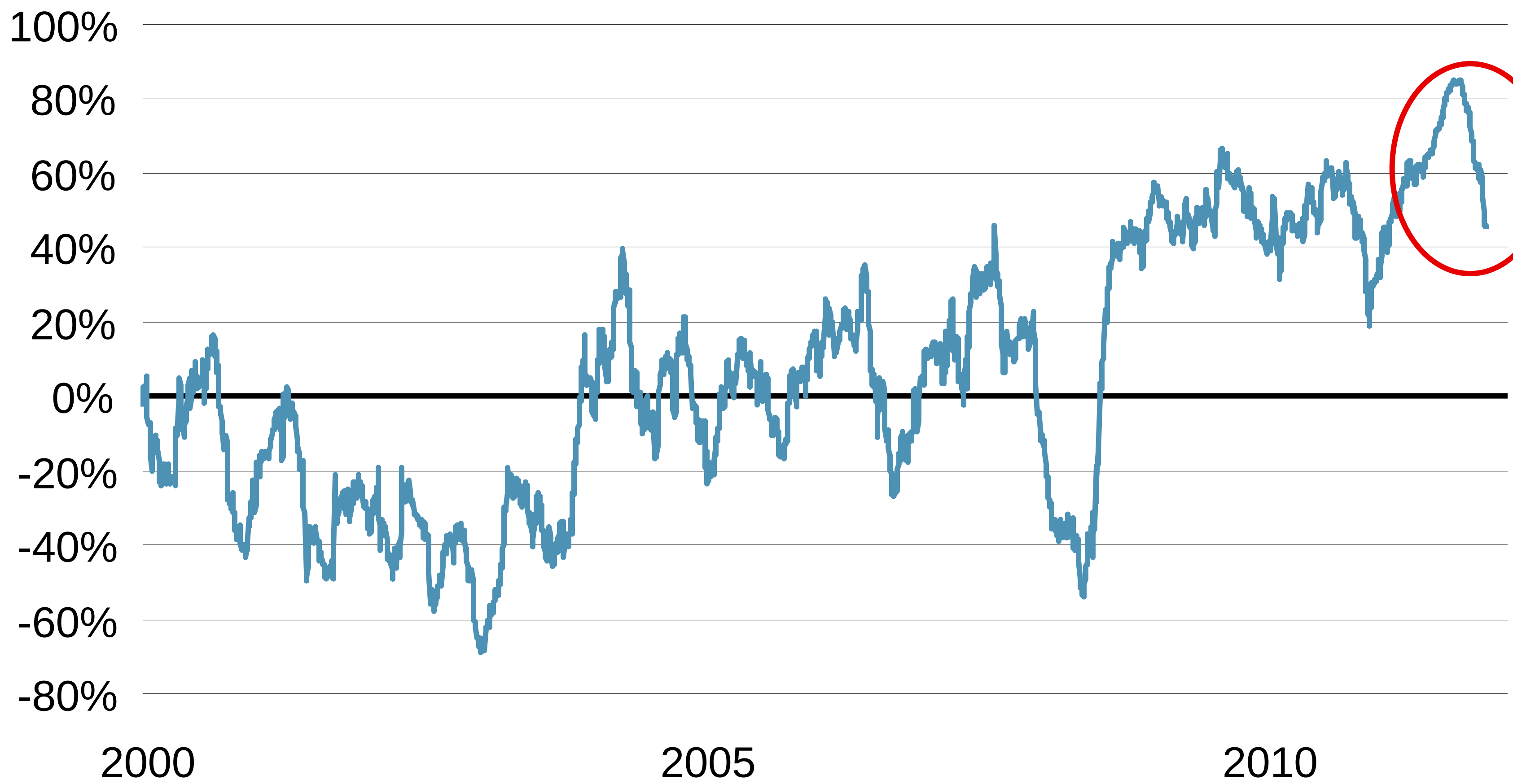
Correlation between valuation and market returns, since 1920



Source: Shiller (2012), Standard and Poor's, UBS WMR estimates

The "macro trade" continues to weaken, need to be more selective

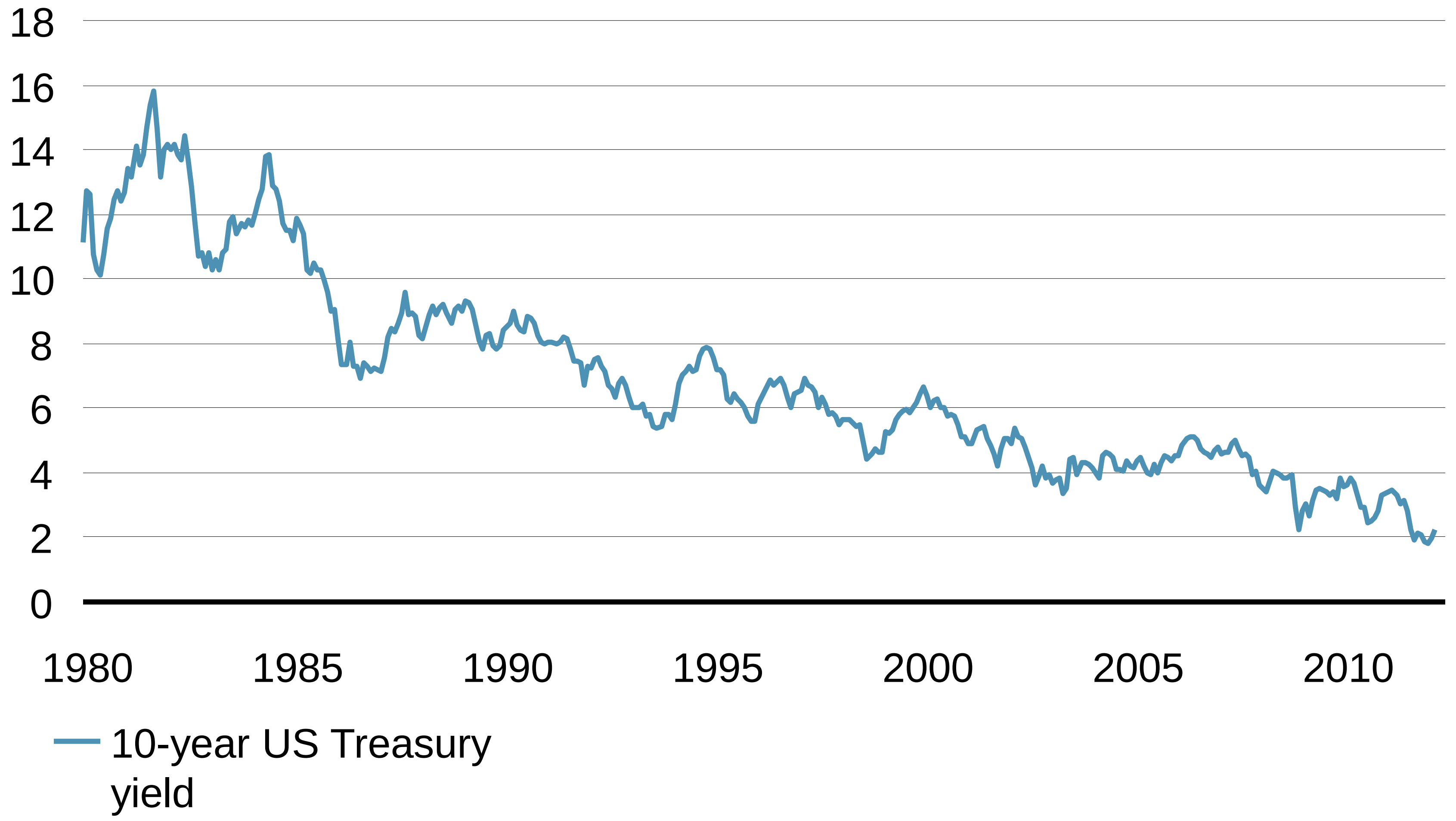
Correlation between stocks and EURO/USD



Source: Bloomberg, UBS WMR

Despite recent pickup, yields remain near historical lows

10-year US Treasury yield, in %

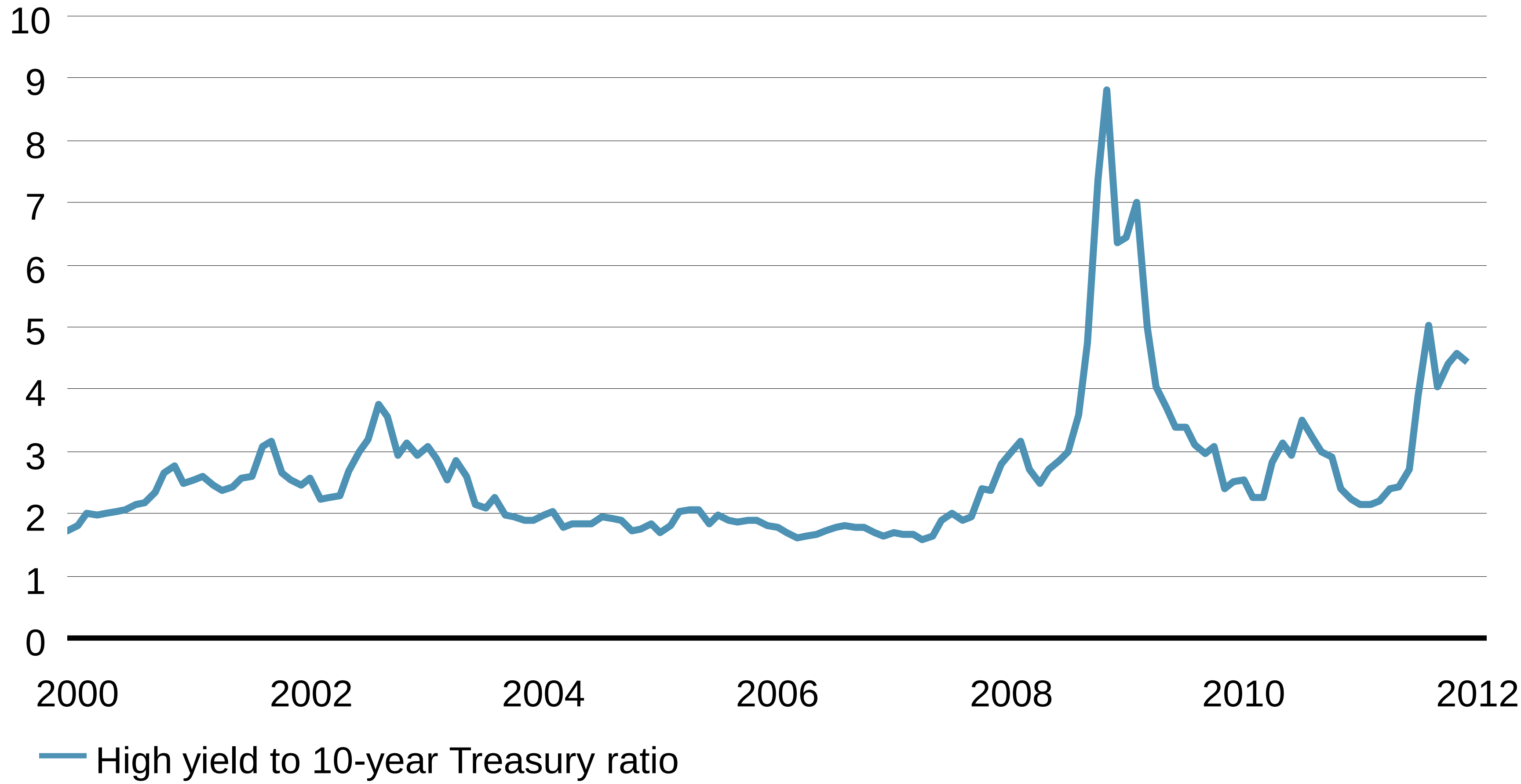


UBS

Source: Bloomberg, UBS WMR

Attractive yield pick-up in high yield

High yield bonds yields to 10-year Treasury yields

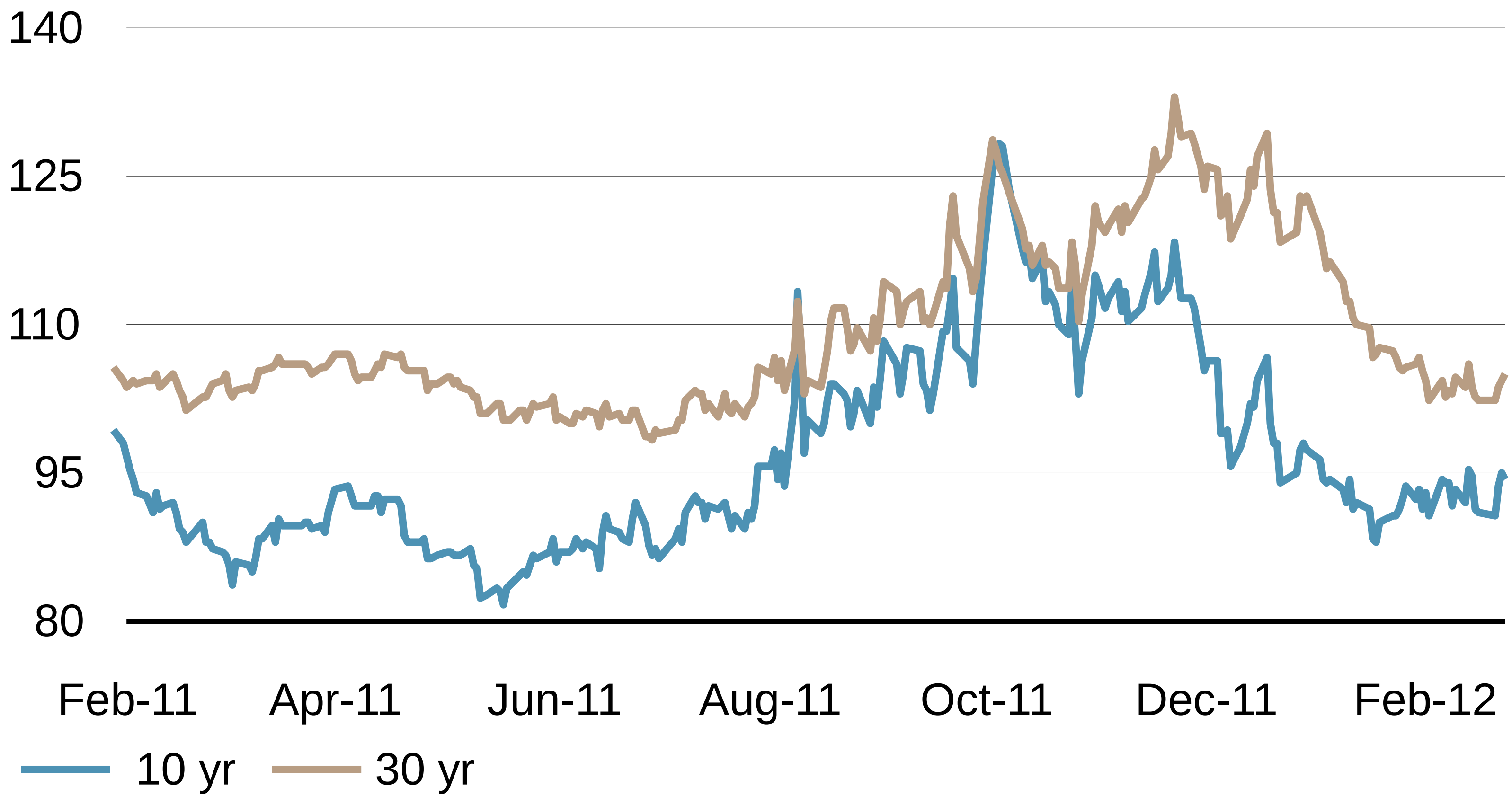


UBS

Source: Bloomberg, BoAML, UBS WMR

Munis outpace Treasuries

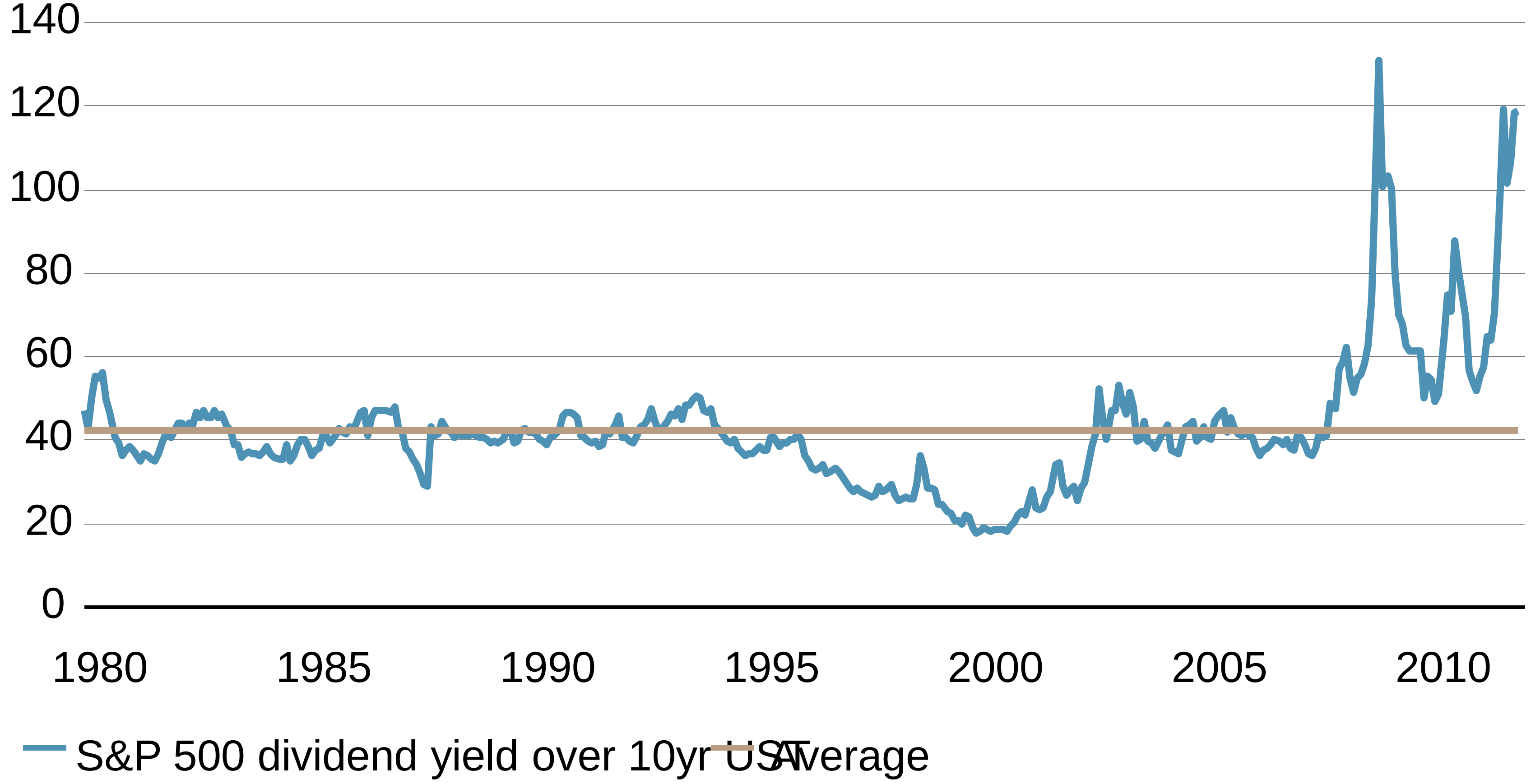
AAA muni-to-Treasury yield ratios, in %



Source: MMD, UBS WMR, as of 24 February 2012

Dividend yields are attractive versus interest rates

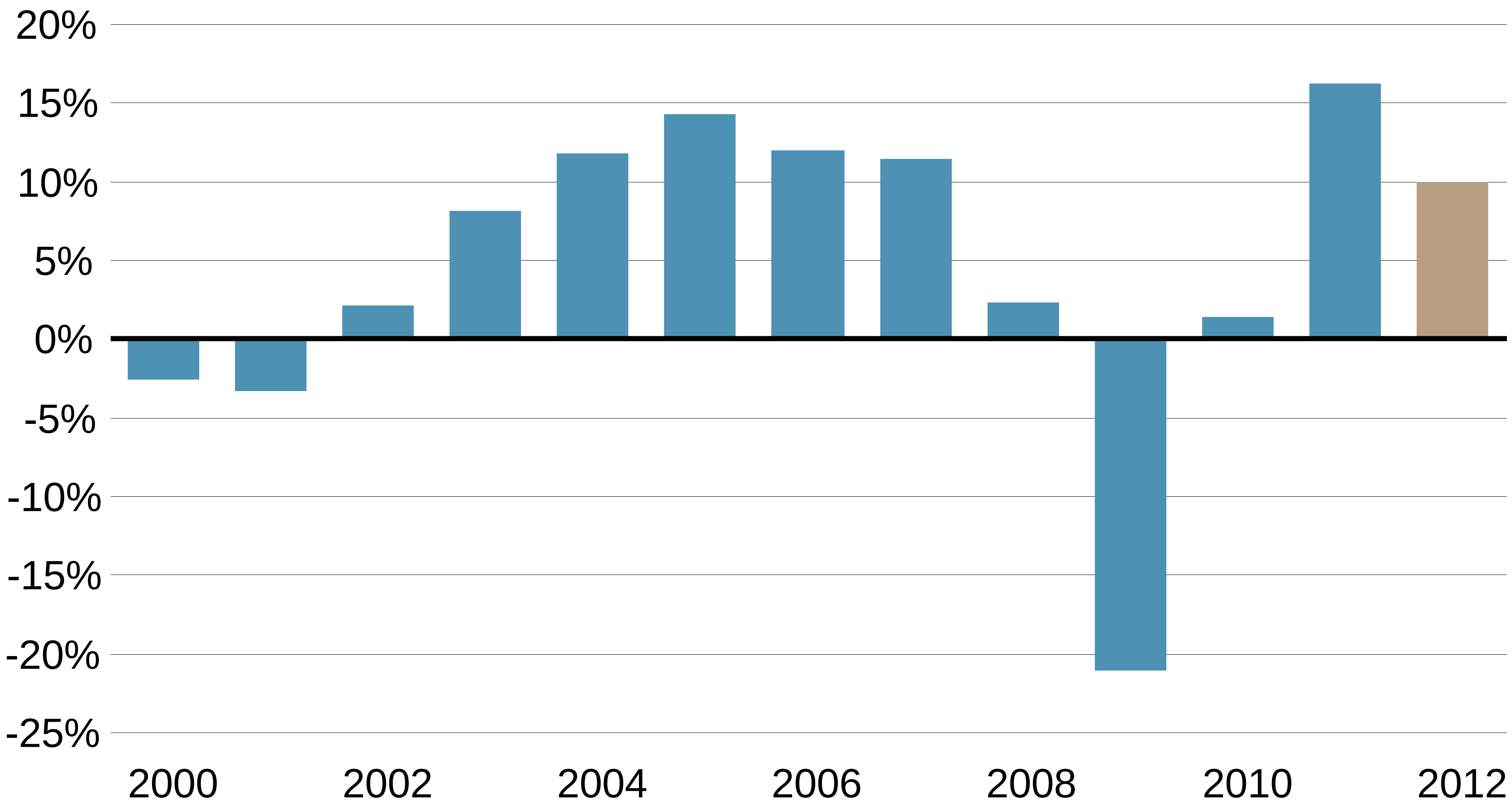
S&P 500 dividend yield as a proportion of 10-year Treasury rates, in %



Source: Thomson Financial, UBS WMR

Dividend growth to continue to rebound

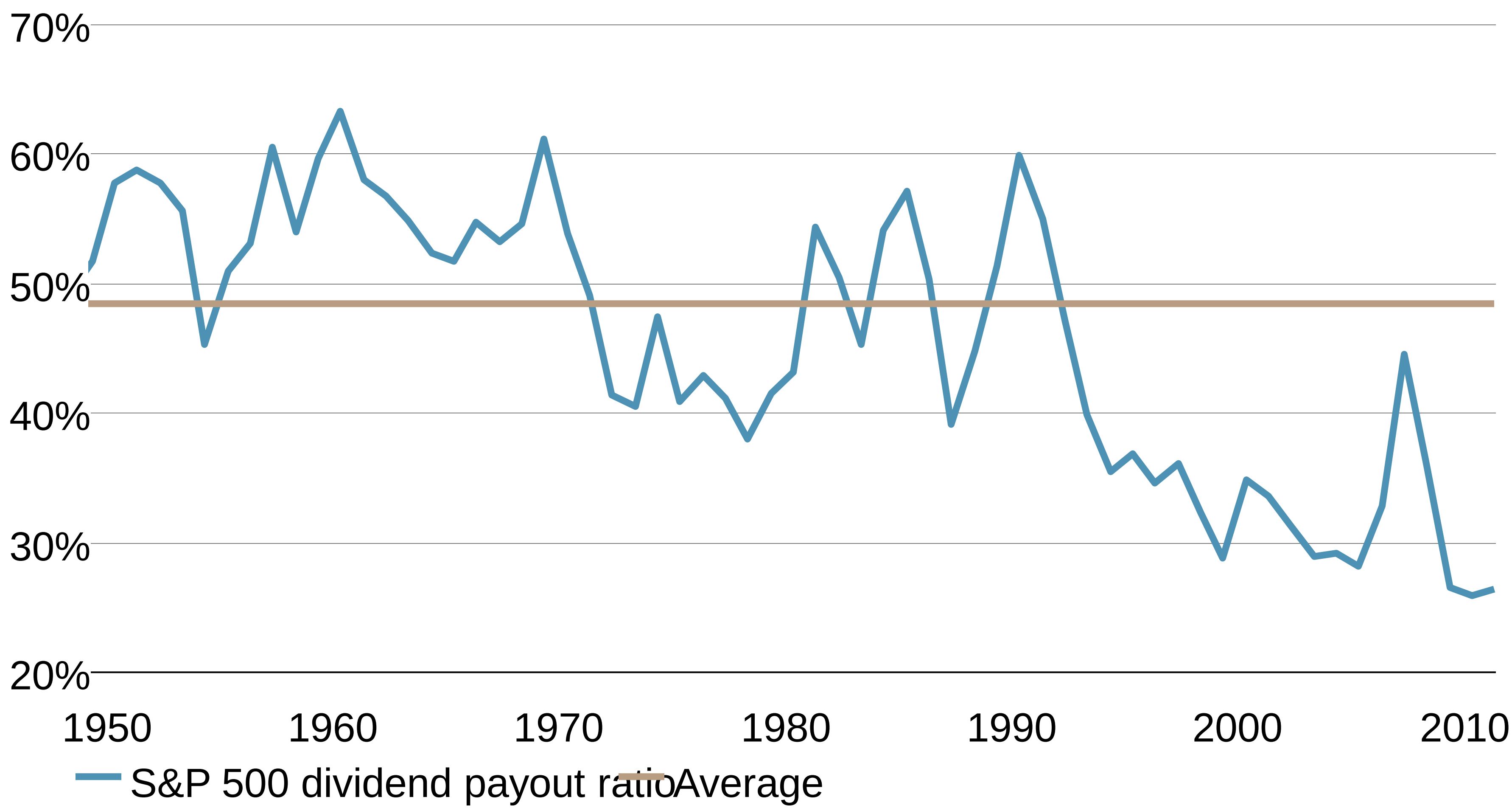
S&P 500 dividends per share, annual change



Source: FactSet, UBS WMR estimates

Companies can easily fund future dividend increases

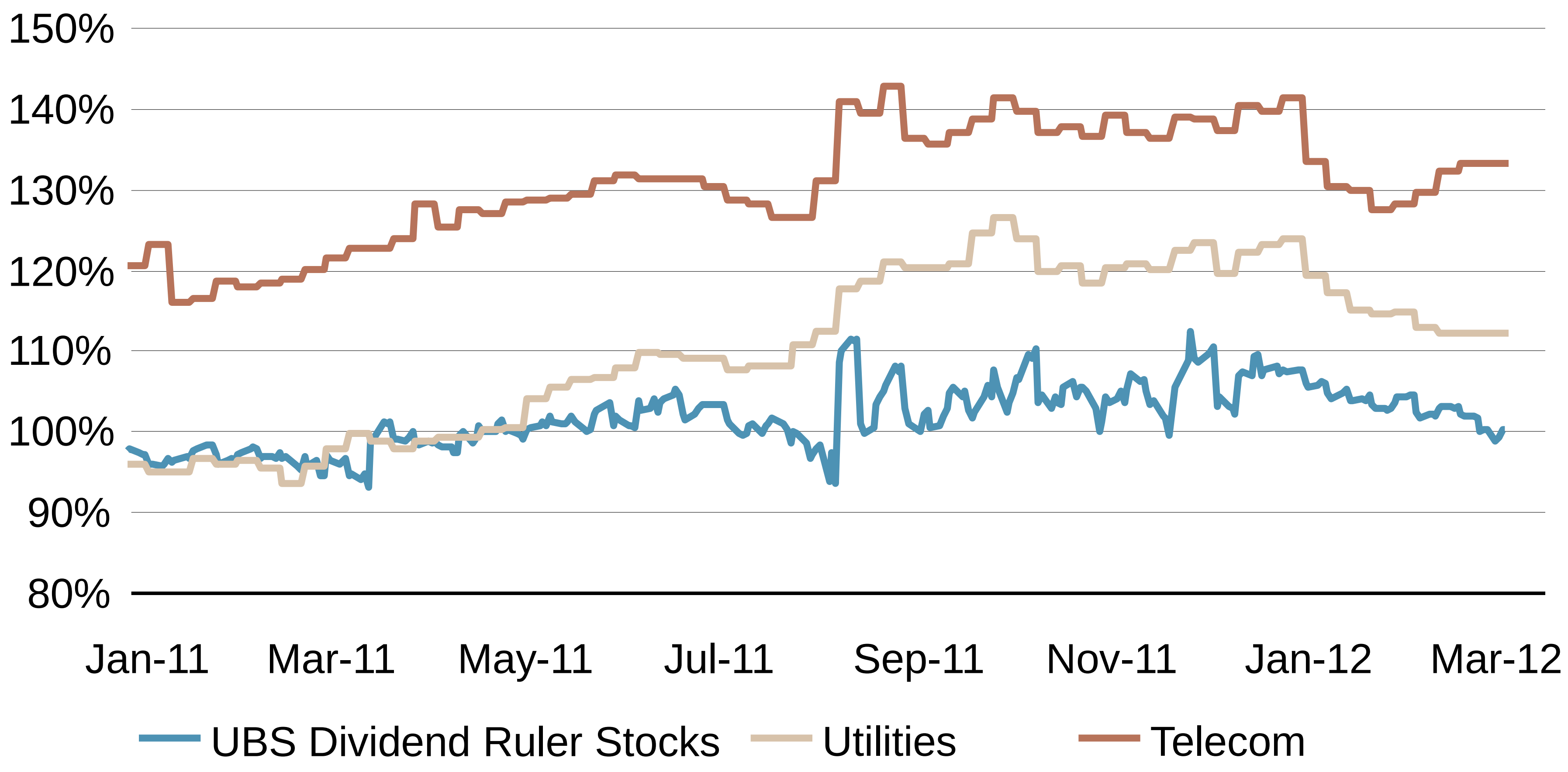
S&P 500 payout ratio (dividend as percentage of earnings)



Note: S&P 500 non-Financial current constituents.
Source: FactSet, UBS WMR

Dividend growth valuations do not appear stretched

P/E premium relative to S&P 500

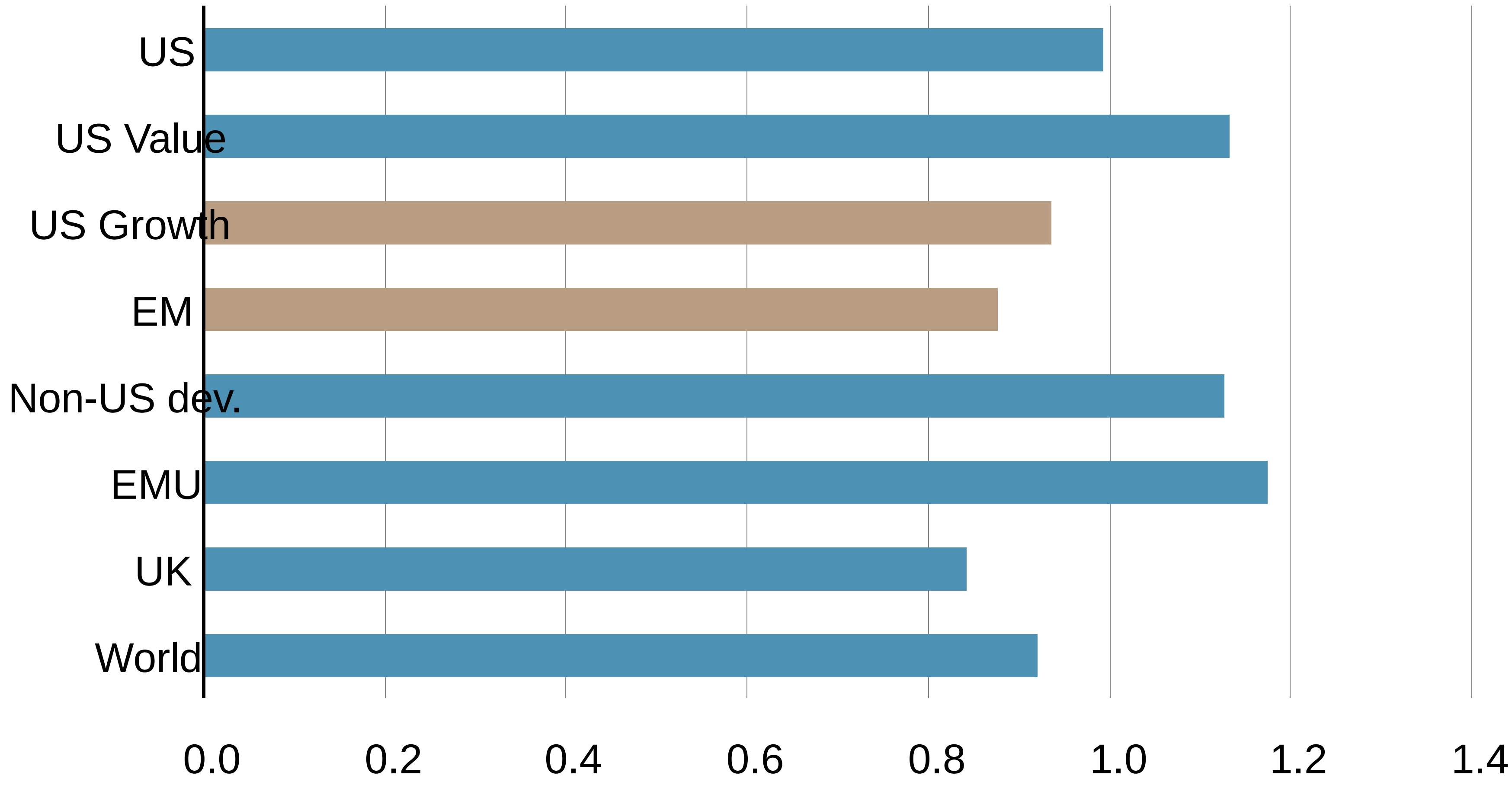


UBS

Source: DataStream, UBS WMR

Growth premiums currently low

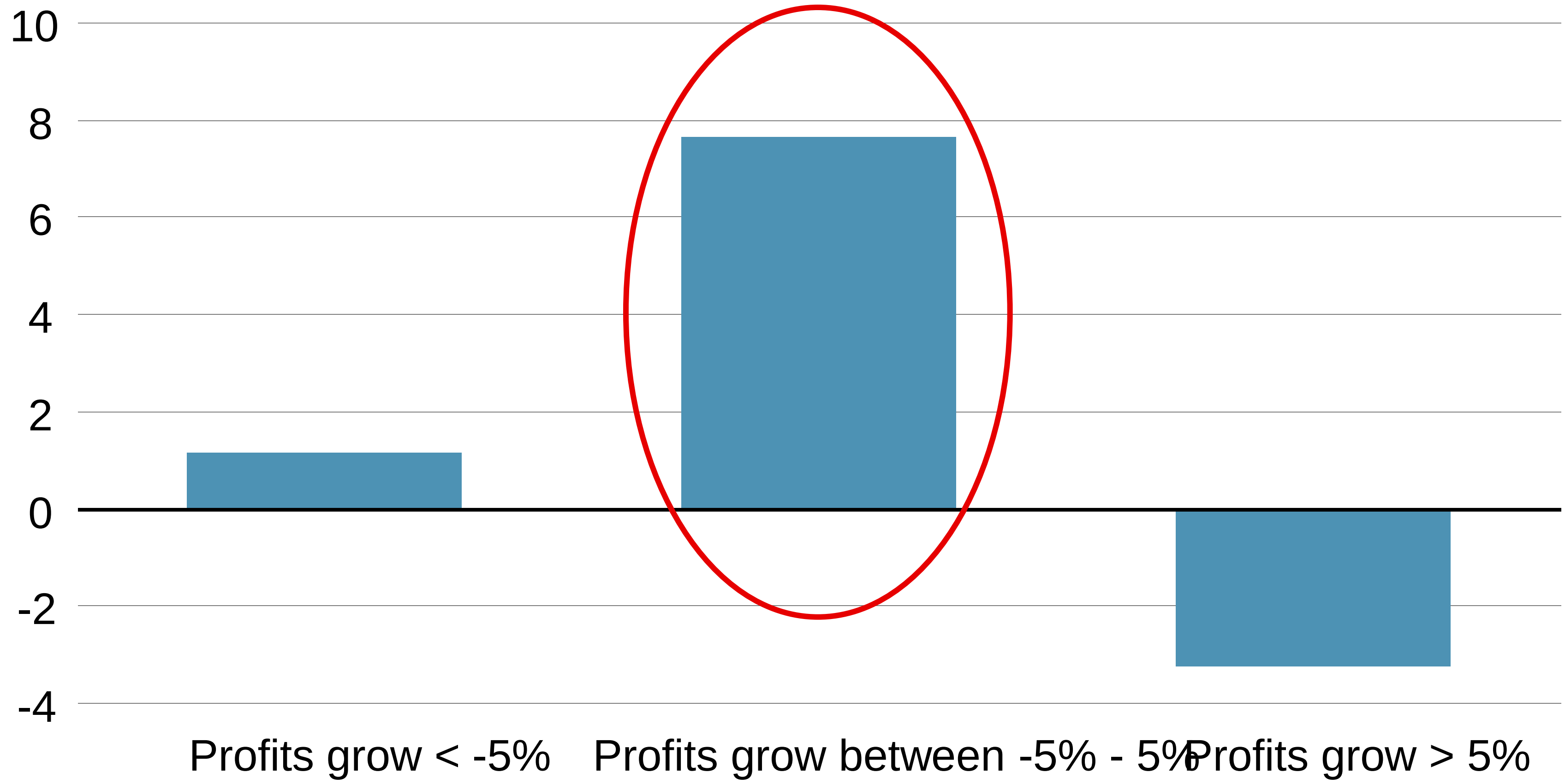
PEG ratio: price-to-earnings ratio divided by 5-year growth rate



Note: Brown indicates overweight in UBS WMR allocation.
Source: Thomson Financial, UBS WMR

Growth outperforms when profits are "flattish"

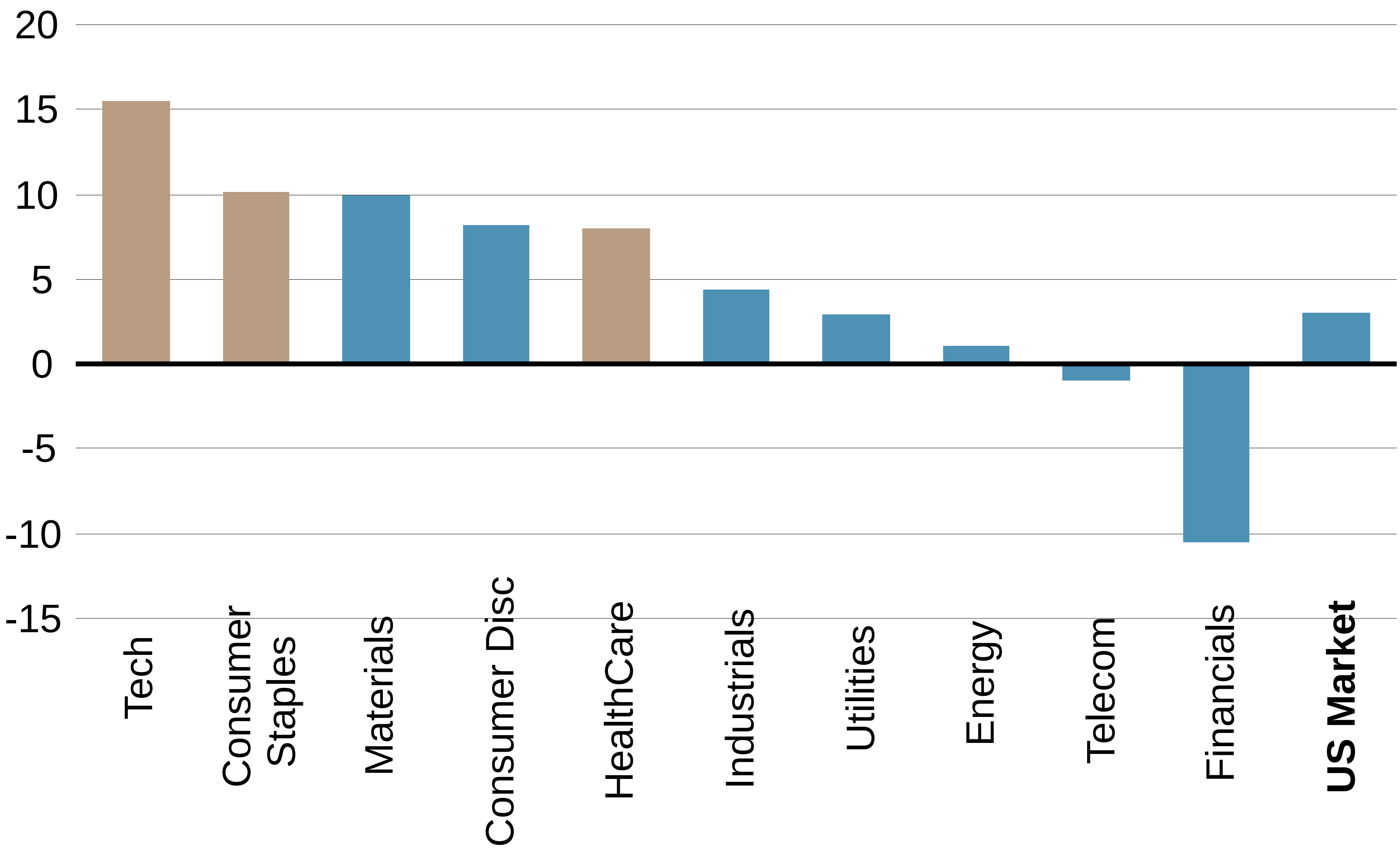
Average relative performance of Russell 1000 Growth vs. Value, in %



Source: DataStream, UBS WMR

Technology and Consumer Staples top growth sectors

Annualized earnings growth, last five years, in %

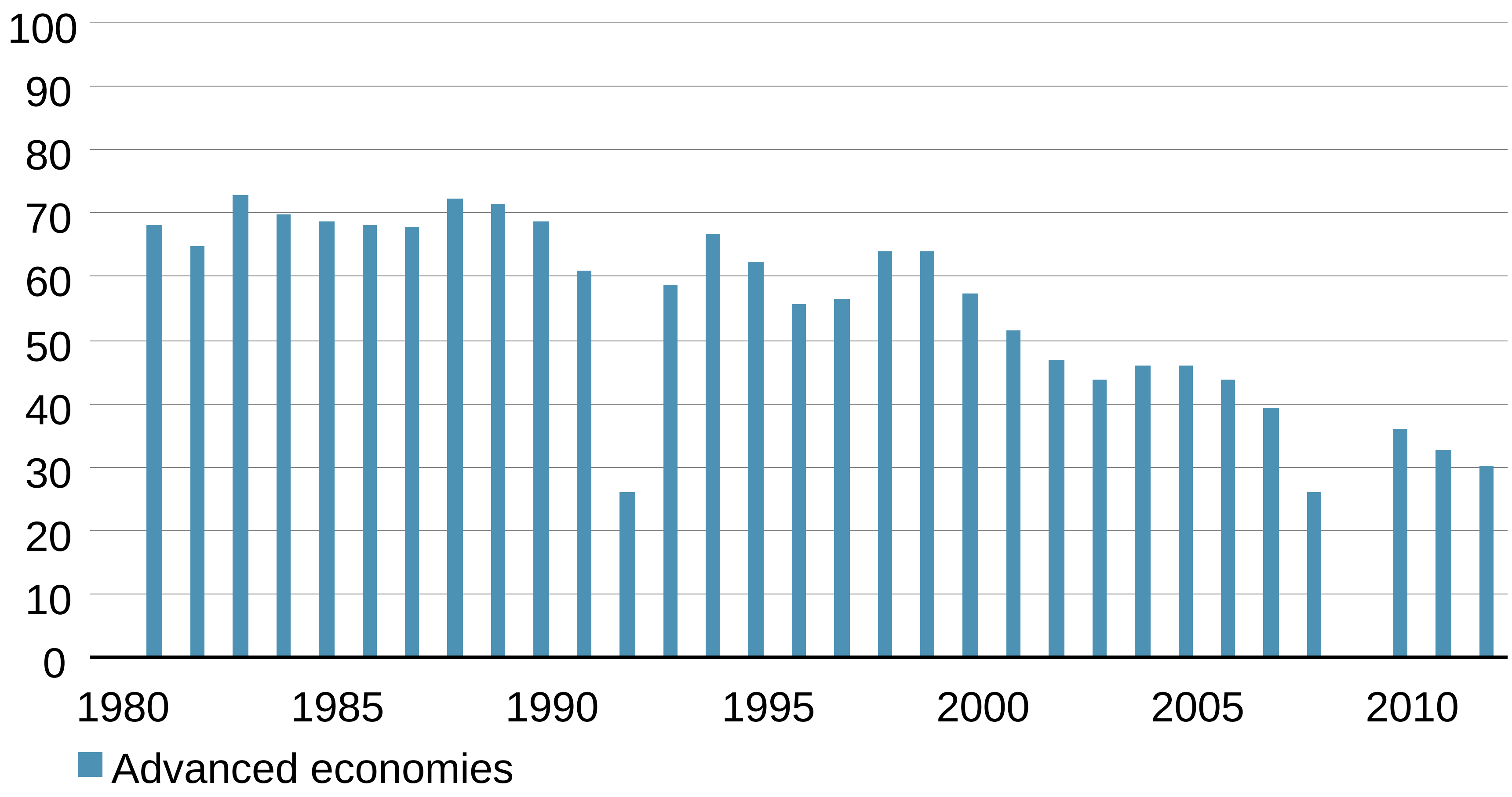


UBS

Note: Brown indicates overweight in UBS WMR allocation.
Source: DataStream, UBS WMR

driver

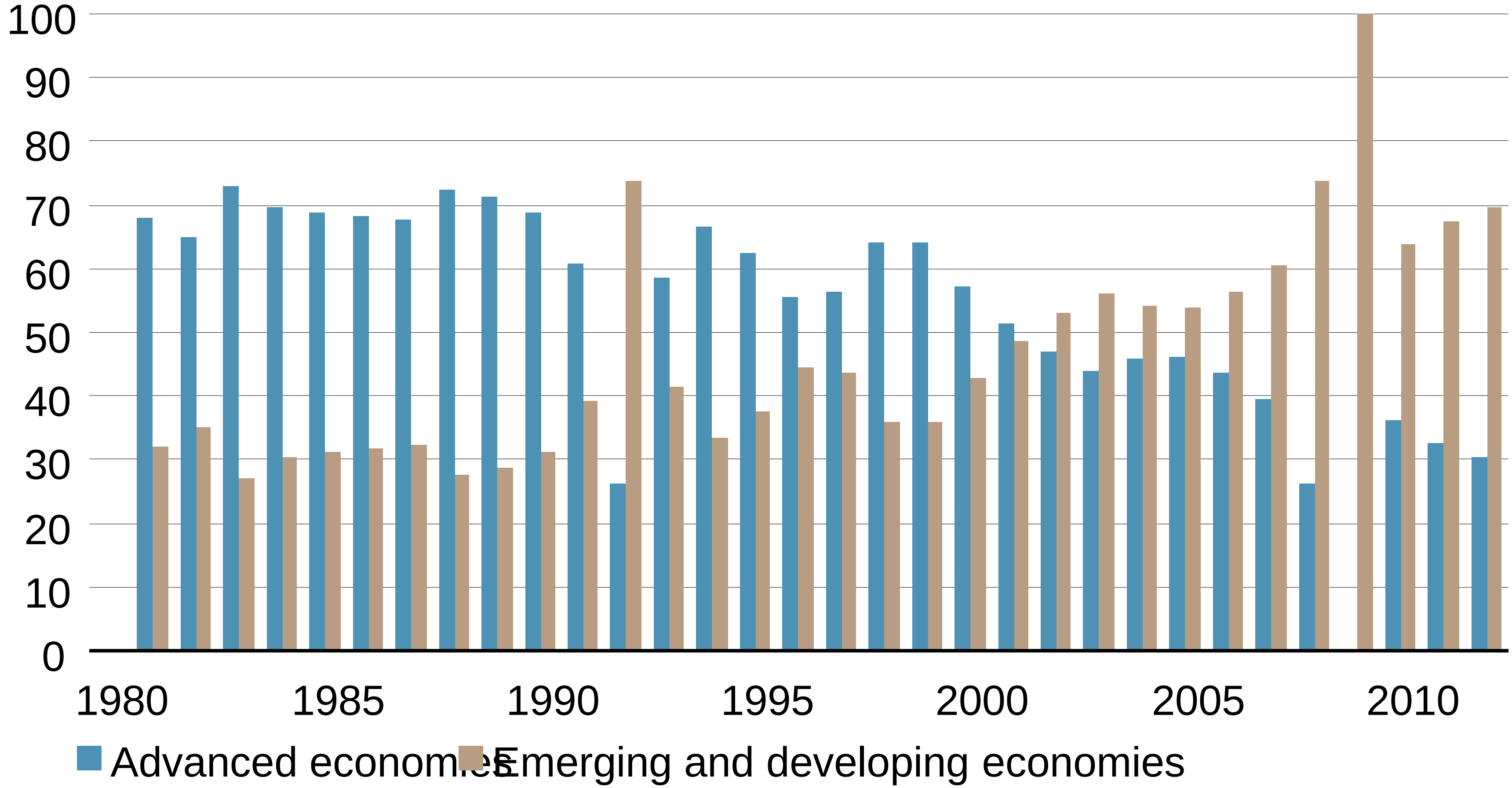
Contribution to global GDP growth, in %



Source: IMF World Economic Outlook, UBS WMR

driver

Contribution to global GDP growth, in %



Source: IMF World Economic Outlook, UBS WMR

Outlook in review

Key Macro Themes

- Cyclical economic recovery
- Secular deleveraging
- Uneven growth prospects
- Impact of politics & policy

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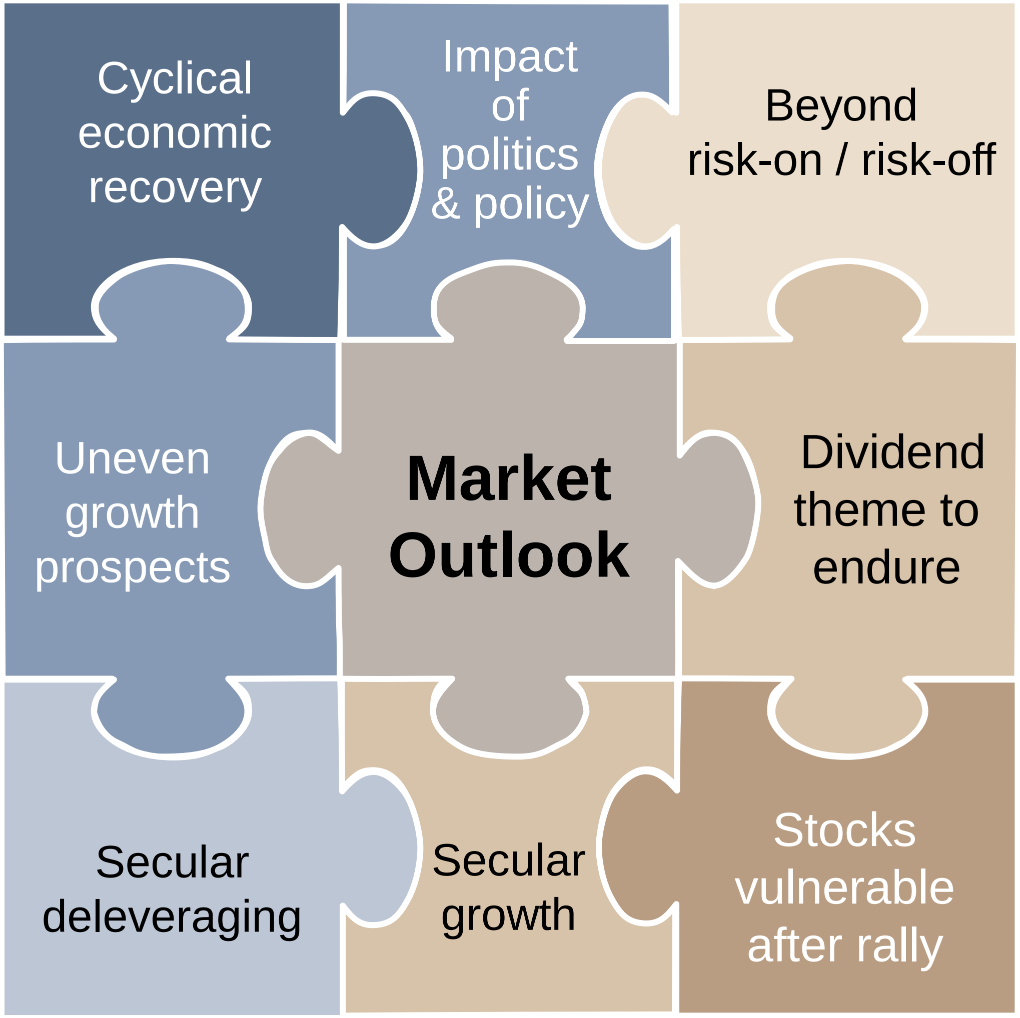
- Secular growth



UBS

Appendix

Table labeled detailed asset allocations without non-traditional assets (NTAs)

1 See "Sources of Benchmark Allocations and Investor Risk Profiles" on next slide regarding the source of investor risk profiles.

2 See "Sources of Benchmark Allocations and Investor Risk Profiles" on next slide regarding the source of benchmark allocations and their suitability.

3 See "Deviations from Benchmark Allocation" on next slide regarding the interpretation of the suggested tactical deviations from benchmark.

4 The current allocation row is the sum of the benchmark allocation and the WMR tactical deviation rows.

Table labeled detailed asset allocations with non-traditional assets (NTAs)

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4 The current allocation row is the sum of the benchmark allocation and the WMR tactical deviation rows.

5 UBS WMR considers that maintaining the benchmark allocation is appropriate for alternative investments. The recommended tactical deviation is therefore structurally set at 0. See "Sources of Benchmark Allocations and Investor Risk Profiles" regarding the types of alternative investments and their suitability.

Emerging Markets Investments

Investors should be aware that Emerging Market assets are subject to, amongst others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and socio-political risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. WMR generally recommends only those securities it believes have been registered under Federal U.S. registration rules (Section 12 of the Securities Exchange Act of 1934) and individual State registration rules (commonly known as "Blue Sky" laws). Prospective investors should be aware that to the extent permitted under US law, WMR may from time to time recommend bonds that are not registered under US or State securities laws. These bonds may be issued in jurisdictions where the level of required disclosures to be made by issuers is not as frequent or complete as that required by US laws.

For more background on emerging markets generally, see the WMR Education Notes "Investing in Emerging Markets (Part 1): Equities", 30 July 2007, "Emerging Market Bonds: Understanding Emerging Market Bonds," 12 August 2009 and "Emerging Markets Bonds: Understanding Sovereign Risk," 17 December 2009.

Investors interested in holding bonds for a longer period are advised to select the bonds of those sovereigns with the highest credit ratings (in the investment grade band). Such an approach should decrease the risk that an investor could end up holding bonds on which the sovereign has defaulted. Sub-investment grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher yielding bonds for shorter periods only.

Deviations from benchmark allocation

The recommended tactical deviations from the benchmark are provided by WMR. They reflect our short- to medium-term assessment of market opportunities and risks in the respective asset classes and market segments. Positive / zero / negative tactical deviations correspond to an overweight / neutral / underweight stance for each respective asset class and market segment relative to their benchmark allocation. The current allocation is the sum of the benchmark allocation and the tactical deviation.

Note that the fixed income and equity and regional allocations on the WMR Investment Strategy slide are provided on an unhedged basis (i.e., it is assumed that investors carry the underlying currency risk of such investments). Thus, the deviations from the benchmark reflect our views of the underlying equity and bond markets in combination with our assessment of the associated currencies. The two bar charts, "Regional Equity Strategy" and "Regional Bond Strategy," represent the relative attractiveness of countries (including the currency outlook) within a pure equity portfolio, respectively. In contrast, the detailed asset allocation tables integrate the country preferences within each asset class with the asset class preferences. As the tactical deviations at the asset class level are attributed to countries in proportion to the countries' market capitalization, the relative ranking among regions may be altered in the combined view.

Appendix

Non-traditional assets include commodities and alternative investments (AI). AI, in turn, include hedge funds, private equity, real estate and managed futures. Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. An investment in an alternative investment fund is speculative and involves significant risks. Alternative investment funds are not mutual funds and are not subject to the same regulatory requirements as mutual funds. Alternative investment funds' performance may be volatile, and investors may lose all or a substantial amount of their investment in an alternative investment fund. Alternative investment funds may en-gage in leveraging and other speculative investment practices that may increase the risk of investment loss. Interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer. Alternative investment funds may not be required to provide periodic pricing or valuation information to investors. Alternative investment fund investment programs generally involve complex tax strategies and there may be delays in distributing tax information to investors. Alternative investment funds are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits. Alternative investment funds may fluctuate in value. An investment in an alternative investment fund is long-term, there is generally no secondary market for the interests of a fund, and none is expected to develop. Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:
Hedge Fund Risk: There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds,“ derivatives, distressed securities, non-U.S. securities and illiquid investments.

Hedge Fund of Funds: In addition to the risks associated with hedge funds generally, an investor should recognize that the overall performance of a fund of funds is dependent not only on the investment performance of the manager of the fund, but also on the performance of the underlying managers. The investor will bear the management fees and expenses of both the fund of funds and the underlying hedge funds or accounts in which the fund of funds invests, which could be significant.

Managed Futures: There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.

Real Estate: There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.

Private Equity: There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.

Foreign Exchange/Currency Risk: Investors in securities of issuers located outside of the United States should be aware that even for securities denominated in U.S. dollars, changes in the exchange rate between the U.S. dollar and the issuer’s "home" currency can have unexpected effects on the market value and liquidity of those securities. Those securities may also be affected by other risks (such as political, economic or regulatory changes) that may not be readily known to a U.S. investor.

Options: Options are not suitable for all investors. Please read the Options Clearing Corporation Publication titled "Characteristics and Risks of Standardized Options Trading" and consult your tax advisor prior to investing. The Publication can be obtained from your Financial Services Inc., Financial Advisor, or can be accessed under the Publications Section of the Option Clearing Corporation's website: www.theocc.com.

Appendix

Description of Certain Alternative Investment Strategies

Equity Hedge: Investment managers who maintain positions both long and short in primarily equity and equity-derivative securities. A wide variety of investment processes can be employed to arrive at an investment decision, including both quantitative and fundamental techniques; strategies can be broadly diversified or narrowly focused on specific sectors and can range broadly in terms of levels of net exposure, leverage employed, holding period, concentrations of market capitalizations and valuation ranges of typical portfolios. Equity hedge managers would typically maintain at least 50% and may, in some cases, be substantially entirely invested in equities, both long and short.

Event Driven: Investment managers who maintain positions in companies currently or prospectively involved in corporate transactions of a wide variety including, but not limited to, mergers, restructurings, financial distress, tender offers, shareholder buybacks, debt exchanges, security issuance or other capital structure adjustments. Security types can range from most senior in the capital structure to most junior or subordinated, and frequently involve additional derivative securities. Event-driven exposure includes a combination of sensitivities to equity markets, credit markets and idiosyncratic, company-specific developments. Investment theses are typically predicated on fundamental characteristics (as opposed to quantitative), with the realization of the thesis predicated on a specific development exogenous to the existing capital structure.

Credit Arbitrage Strategies: Employ an investment process designed to isolate attractive opportunities in corporate fixed income securities. These include both senior and subordinated claims as well as bank debt and other outstanding obligations, structuring positions with little or no broad credit market exposure. These may also contain a limited exposure to government, sovereign, equity, convertible or other obligations, but the focus of the strategy is primarily on fixed corporate obligations and other securities held as component positions within these structures. Managers typically employ fundamental credit analysis to evaluate the likelihood of an improvement in the issuer's creditworthiness. In most cases, securities trade in liquid markets, and managers are only infrequently or indirectly involved with company management. Fixed income: corporate strategies differ from event driven; credit arbitrage in the former more typically involves more general market hedges, which may vary in the degree to which they limit fixed income market exposure, while the latter typically involves arbitrage positions with little or no net credit market exposure, but are predicated on specific, anticipated idiosyncratic developments.

Macro: Investment managers who trade a broad range of strategies in which the investment process is predicated on movements in underlying economic variables and the impact these have on equity, fixed income, hard currency and commodity markets. Managers employ a variety of techniques, both discretionary and systematic analysis, combinations of top-down and bottom-up theses, quantitative and fundamental approaches and long- and short-term holding periods. Although some strategies employ relative value techniques, macro strategies are distinct from relative value strategies in that the primary investment thesis is predicated on predicted or future movements in the underlying instruments, rather than realization of a valuation discrepancy between securities. In a similar way, while both macro and equity hedge managers may hold equity securities, the overriding investment thesis is predicated on the impact movements in underlying macroeconomic variables may have on security prices, as opposed to equity hedge, in which the fundamental characteristics of the company are the most significant and integral to investment thesis.

Distressed Restructuring Strategies: Employ an investment process focused on corporate fixed income instruments, primarily on corporate credit instruments of companies trading at significant discounts to their value at issuance, or obliged (par value) at maturity, as a result of either a formal bankruptcy proceeding or financial market perception of near-term proceedings. Managers are typically actively involved with the management of these companies, frequently involved on creditors' committees in negotiating the exchange of securities for alternative obligations, either swaps of debt, equity or hybrid securities. Managers employ fundamental credit processes focused on valuation and asset coverage of securities of distressed firms. In most cases, portfolio exposures are concentrated in instruments which are publicly traded, in some cases actively and in others under reduced liquidity but, in general, for which a reasonable public market exists. In contrast to special situations, distressed strategies primarily employ debt (greater than 60%) but also may maintain related equity exposure.

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Relative Value: Investment managers who maintain positions in which the investment thesis is predicated on realization of a valuation discrepancy in the relationship between multiple securities. Managers employ a variety of fundamental and quantitative techniques to establish investment theses, and security types range broadly across equity, fixed income, derivative or other security types. Fixed income strategies are typically quantitatively driven to measure the existing relationship between instruments and, in some cases, identify attractive positions in which the risk-adjusted spread between these instruments represents an attractive opportunity for the investment manager. Relative value position may be involved in corporate transactions also, but as opposed to event driven exposures, the investment thesis is predicated on realization of a pricing discrepancy between related securities, as opposed to the outcome of the corporate transaction.

Sources of benchmark allocations and investor risk profiles

Benchmark allocations represent the longer-term allocation of assets that is deemed suitable for a particular investor. Except as described below, the benchmark allocations expressed in this presentation have been developed by UBS Investment Solutions (IS), a business sector within UBS Wealth Management Americas that develops research-based traditional investments (e.g., managed accounts and mutual fund options) and alternative strategies (e.g., hedge funds, private equity, and real estate) offered to UBS clients. The benchmark allocations are provided for illustrative purposes only and were designed by IS for hypothetical US investors with a total return objective under seven different Investor Risk Profiles ranging from very conservative to very aggressive. In general, benchmark allocations will differ among investors according to their individual circumstances, risk tolerance, return objectives and time horizon. Therefore, the benchmark allocations in this presentation may not be suitable for all investors or investment goals and should not be used as the sole basis of any investment decision. As always, please consult your UBS Financial Advisor to see how these weightings should be applied or modified according to your individual profile and investment goals.

The process by which IS has derived the benchmark allocations can be described as follows. First, an allocation is made to broad asset classes based on an investor's risk tolerance and characteristics (such as preference for international investing). This is accomplished using optimization methods within a mean-variance framework. Based on a proprietary set of capital market assumptions, including expected returns, risk, and correlation of different asset classes, combinations of the broad asset classes are computed that provide the highest level of expected return for each level of expected risk. A qualitative judgmental overlay is then applied to the output of the optimization process to arrive at the benchmark allocation. The capital market assumptions used for the benchmark allocations are developed by UBS Global Asset Management, a subsidiary of UBS AG and an affiliate of UBS Financial Services Inc.

In addition to the benchmark allocations IS derived using the aforementioned process, WMR determined the benchmark allocation by country of Non-US Developed Equity and Non-US Fixed Income in proportion to each country's market capitalization, and determined the benchmark allocation by Sector and Industry Group of US Equity in proportion to each sector's market capitalization. WMR, in consultation with IS, also determined the benchmark allocation for US dollar taxable fixed income. It was derived from an existing moderate risk taxable fixed income allocation developed by IS, which includes fewer fixed income segments than the benchmark allocation presented here. The additional fixed income segments were taken by WMR from related segments. For example, TIPS were taken from Treasuries and Preferred Securities from Corporate Bonds. A level of overall risk similar to that of the original IS allocation was retained.

AI include hedge funds, private equity, real estate, and managed futures. The total benchmark allocation was determined by IS using the process described above. The Wealth Management Americas Investment Committee (WMA IC) derived the AI subsector benchmark allocations by adopting IS' determination as to the appropriate subsector benchmark allocations with AI for the following risk profiles: conservative, moderately conservative, moderate, moderate aggressive and aggressive. The WMA IC then developed subsector allocations for very conservative and very aggressive risk profiles by taking the IS subsector weightings for conservative and aggressive risk profile investors and applying them pro rata to the IS AI total benchmark allocations for very conservative and very aggressive, respectively. Allocations to AI as illustrated in this report may not be suitable for all investors. In particular, minimum net worth requirements may apply.

The background for the benchmark allocation attributed to commodities can be found in the WMR Education Note, "A pragmatic approach to commodities," 2 May, 2007.

Appendix

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