UBS House View

Investment Strategy Guide

November 2016

CIO Wealth Management Research

US edition

The debate that wasn't

In Context: Fact-checking our assumptions

In Focus: Shifting probabilities

Videos: Jeremy Zirin on positioning for rising inflation

UBS

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Mostly satisfied?
Neutral?
Mostly dissatisfied?

An email message will open, where we encourage you to write additional comments. Thank you!

A MESSAGE FROM THE REGIONAL CIO

Dear reader,

Counting from the first candidacy announcement, the 2016 US election season has already lasted 578 days. In addition to being one of the longest campaigns in history, the vitriolic tone of this year's contest has made it all the more wearying. But the end is mercifully now in sight, with early voting having already started across much of the country and Election Day now only 18 days away.

In the **Feature** article, we imagine what a drama-free presidential debate might have looked like, exploring the substantive drivers underlying the candidates' worldviews and policy prescriptions. These range from the issues of income inequality, to immigration, to free and fair trade. One can only look back upon the lack of substantive debate on these critical issues as yet another lost opportunity of this election.

Shifting gears a bit to more practical matters, this month's **In Context** article outlines our most recent Tactical Asset Allocation (TAA) changes, where we are introducing a position in US Treasury Inflation Protected Securities (TIPS), an overweight to financials (along with a reduction to our industrials allocation), and a return to a neutral allocation for non-US developed market bonds. We also perform some fact-checking on two key assumptions – namely accelerating inflation and a weakening US dollar – that underpin our thesis.

The Top Themes **Spotlight** focuses on two changes this month: upgrading *US senior loans* to Top Theme status and increasing the Master Limited Partnerships (MLPs) allocation within our *North American energy independence: reenergized* theme. Both changes reflect our belief that accelerating growth and inflation will support Federal Reserve rate hikes.

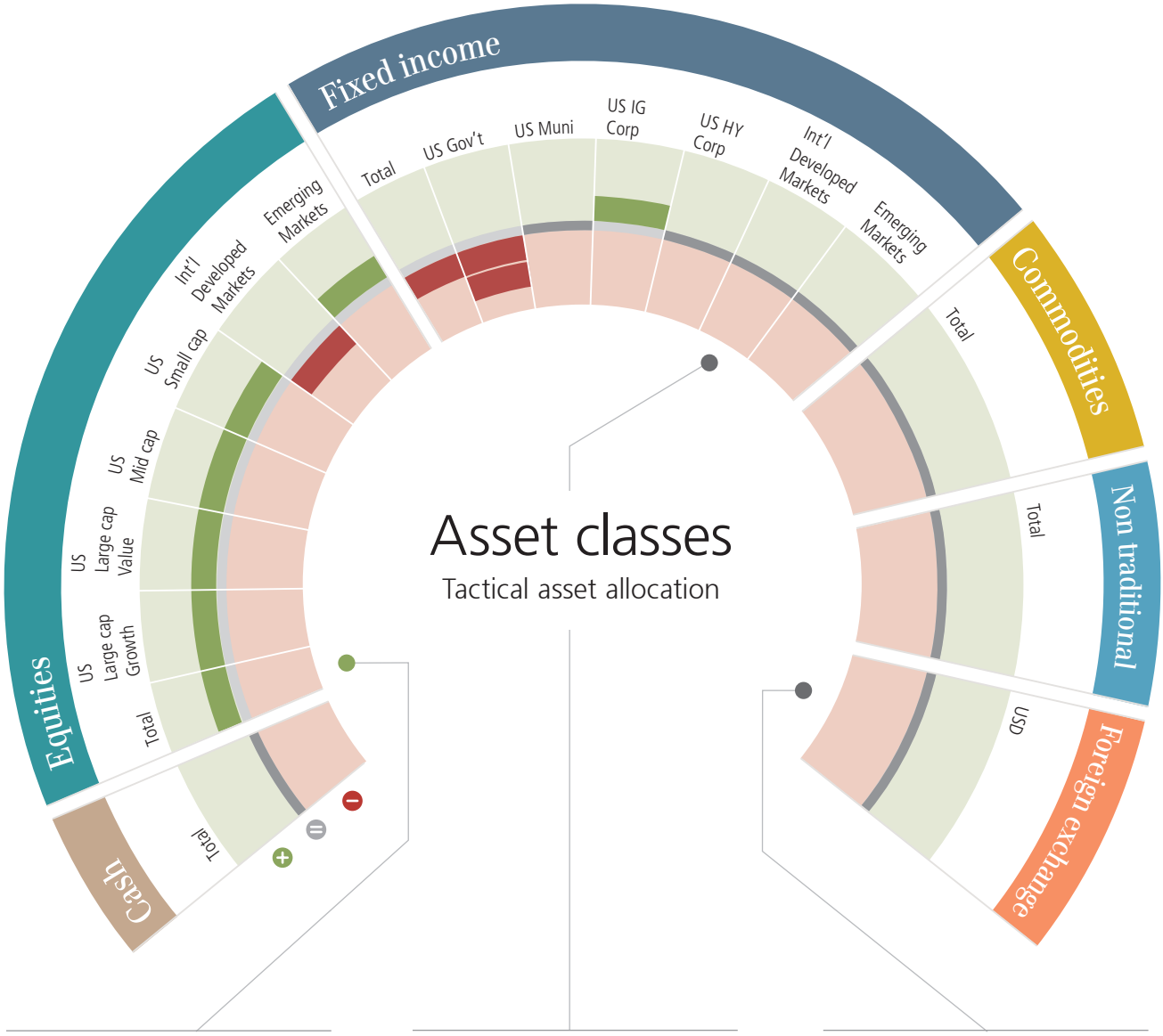
In the **In Focus** we return to the issue of domestic politics with an update on the US election, where the race has taken yet another quirky turn amid some additional missteps by Donald Trump. But while we have increased the probability of a Clinton presidency, we still expect market-friendly gridlock in the form of a divided Congress.

With many voters (most, if you count the candidates' unfavorable ratings) likely to be unhappy regardless of the outcome, it will be a relief to put this election behind us. But if this election proves anything, it is the timeless wisdom of our founding fathers for never entrusting the care of this great republic to any individual or single institution.

And that, at last, is something we can all agree upon and be grateful for in this election…

Mike Ryan, CFA
Chief Investment Strategist, WMA

We prefer US equities, corporate bonds, and TIPS vs. Treasuries, and favor emerging markets over Swiss equities.



Equities

We remain overweight US and emerging markets, and underweight Swiss stocks.

Fixed income

We introduce an overweight on US inflation-linked bonds and upgrade non-US developed bonds to neutral.

Currencies

We favor a basket of emerging market versus developed market currencies.

LEGEND

- ⊕ Overweight: Tactical recommendation to hold more of the asset class than specified in the moderate risk strategic asset allocation (see page 25)
- ⊖ Underweight: Tactical recommendation to hold less of the asset class than specified in the moderate risk strategic asset allocation (see page 25)
- ⊜ Neutral: Tactical recommendation to hold the asset class in line with its weight in the moderate risk strategic asset allocation (see page 25)

Each bar represents a +/- 2% tactical tilt or part thereof (i.e., one bar = 0.5% to 2%, 2 bars = 2.5% to 4%, 3 bars = over 4%). **NOTE: TACTICAL TIME HORIZON IS APPROXIMATELY SIX MONTHS**

The debate that wasn't

US election
A divisive US presidential race has not always done justice to the policy choices the nation faces. In this letter, I imagine what a more rigorous TV debate might have sounded like.

Diversification
More polarized policy debates around the world have underlined the importance of a diversified investment approach, to limit exposure to the political and social choices of any single nation.

Inflation
We are introducing an overweight position in US Treasury Inflation Protected Securities versus standard government bonds. Markets are underestimating the outlook for inflation in the US.

Asset allocation
We are overweight US equities versus government bonds. We are also overweight emerging market equities versus Swiss equities.

Mark Haefele
Global Chief Investment Officer
Wealth Management

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"This was expected to be the most watched debate ever. The ratings were expected to rank up with the finale of *Cheers*, and the finale of *M.A.S.H.* Makes sense, in a way this election feels like the series finale of America." –Jimmy Kimmel, US talk show host.

The underlying economic themes in this presidential race – weak real wage growth, high levels of government debt, rising inequality, and an aging population – are not problems that were created by any single US president. Nor will they be solved by the next. So we should moderate our expectations for the impact – positive or negative – that Donald Trump or Hillary Clinton might have on the story of our age.

The divisive US election campaign highlights different visions for how the US should address its economic problems, and we can expect the debates to continue long after 8 November. Furthermore, divergent economic choices are being debated by nations all around the world. As we are learning from Brexit and other political events, differing visions of how to organize societies may impact investors who are too concentrated in one currency or asset class. Faced with this challenge in the years ahead, I believe global diversification is an investor's best defense against any single nation's social and political decisions.

In our tactical asset allocation, we have opened an overweight position in US inflation-linked bonds against conventional government debt. The market is underpricing the risk of higher inflation, in our view. Tightening job markets should support wages and prices, and this month Federal Reserve Chair Janet Yellen indicated a tolerance for above-target inflation to improve labor participation. We are also overweight US equities versus government bonds, and emerging market equities versus Swiss stocks. In addition we favor a basket of emerging market currencies versus a group of developed market peers.

What could have been

In this presidential campaign, it has not been easy to look beyond the rhetoric. But as stewards of wealth, the CIO has a responsibility to identify the key issues affecting the world economy, the policy choices these issues create, and the potential impact and likelihood of subsequent political decisions.

In this vein, I wondered what a debate focused on the issues might look like, stripped of the "drama." What follows is a light take on how we imagine the two candidates would have answered debate questions on a range of topics.

Moderator: Mr. Trump, the US economy is now 10% larger in real terms than it was before the financial crisis (Fig. 1), and a net 5.7 million jobs have been created. Why do we need to change course?

Donald Trump: These economic figures only tell part of the story. Ordinary working Americans have not been feeling this apparent prosperity. The economy has grown and jobs have been added, but the median wage is still just USD 30,240, and real wage growth for the average worker has been just 3% since 2009, according to the US Census Bureau and the Bureau of Labor Statistics. The reason I'm here rather than a more traditional Republican candidate is because I realized that this election could be decided by the half of the people in this country who have seen almost no real wage growth in the past decade, and earn below that median[1] (Fig. 2).

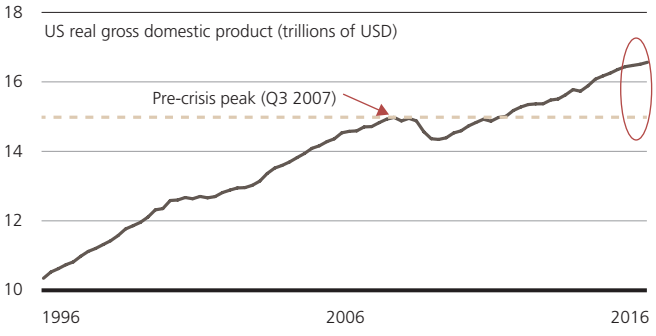
My rich friends around the world might not want to face it, but the fate of this election will be determined by people far less wealthy than they imagine. And this issue extends beyond the US. Almost every developed nation faces a version of the same problem[2].

I believe that globalization is costing us. Unfair global competition is the key contributing factor to stagnant wages, and I want to level the playing field. Maybe if every

1 U.S. Census Bureau, Current Population Survey, *2016 Annual Social and Economic Supplement*.
2 Edward Luce, "The Life and Death of Trumpian America," *Financial Times*, October 9, 2016, https://www.ft.com/content/96ff6958-8d7d-11e6-8df8-d3778b55a923

Fig. 1: The US has recovered from the financial crisis… hasn't it?

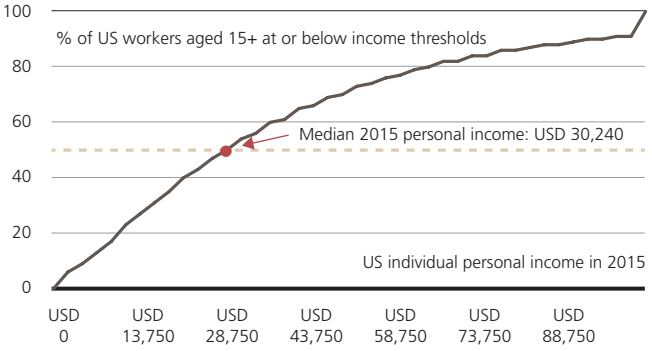
US real gross domestic product (GDP), trillions of chained 2009 USD, seasonally adjusted annual rate.



Source: US Federal Reserve Bank of St Louis, UBS. Data as of end second quarter 2016.

Fig. 2: For half of US workers, security of well-paid jobs is a critical election issue.

Personal incomes for US workers aged 15 and above, cumulative distribution by labor earnings in 2015, in %.



Source: US Census Bureau, UBS. Data as of 18 October 2016.

country had free-floating exchange rates, harmonized environmental legislation, and outlawed state-driven industrial policy or subsidies, all these inequalities would work themselves out. But they don't. So there are a lot of countries whose labor and manufactured goods are cheaper than ours (Fig. 3)[3]. We have to protect our nation by limiting the negative impact on lower-skilled jobs here due to trade, outsourcing, and immigration. And we need to encourage American companies to manufacture and employ domestically.

Moderator: Let me now turn to you, Secretary Clinton. Do you also believe that we need to "level the playing field"?

Hillary Clinton: Absolutely, and I, too, see that this election could be decided by the half of the working population that makes less than USD 30,000. But my analysis of the situation is different. Donald Trump is wrong that globalization is costing us. Globalization is making our country richer, but more unequal. The stock market is up by more than 200% in real terms since March 2009, which primarily benefits our wealthier citizens. On the other hand, some lower earners have suffered greatly. For those without a high school diploma, real wages are lower now than they were in 1980.

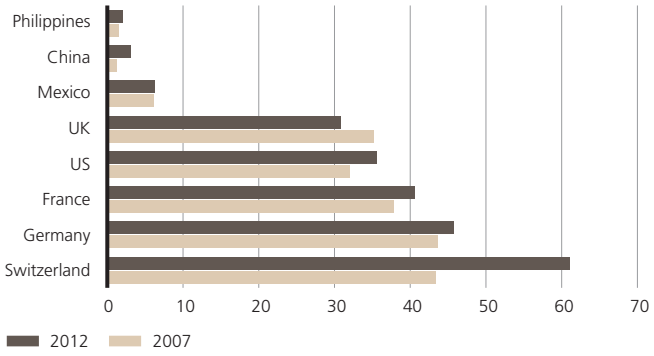
We also need to remember that this trend does not come purely from globalization. The fourth industrial revolution – the sharing economy, artificial intelligence, and robotics – makes for a very exciting time, but also a potentially very threatening one for people caught on the wrong side of it.

That's why I believe we need to use tax policy more actively to make sure that the gains of globalization and the fourth industrial revolution do not accrue purely to capital with little left for the labor that forms the majority of our population.

3 The Conference Board (International Labor Comparisons program), *International Comparisons of Hourly Manufacturing and Sub-Manufacturing Industries: Update to 2014 with preliminary estimates for 2015.* https://www.conference-board.org/ilcprogram/compensation/datatables

Fig. 3: US manufacturing is losing its competitive edge internationally.

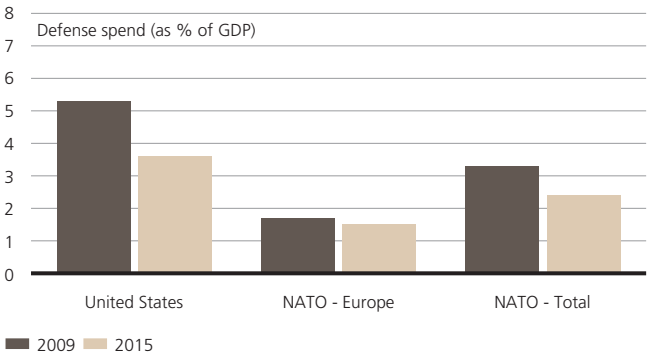
Hourly manufacturing compensation costs, in US dollars, in 2007 and 2012.



Source: The Conference Board (International Labor Comparisons program), UBS. Data as of end 2012 (latest available). NB Data for China is not strictly comparable with other countries.

Fig. 4: US presidential candidates are rethinking spending at home, and abroad.

Defense spending by the US and other NATO members, as a percentage of GDP.



Source: NATO, UBS. Data as of 1 July 2016.

Trump: I'm not surprised she is the favored candidate outside the US – her policy is to tax Americans, while I want to make our allies and trading partners pay more. Taxing companies can help in the short term, but a free world means they can increasingly choose to leave the US and locate anywhere. And there are simply not enough rich Americans to bear a greater tax burden – the top 2.7% of earners already pay 51.6% of individual income taxes[4]. So in the end most of her spending proposals would be paid for by the middle class.

We can also look at some of the things we offer the rest of the world "for free." We spend 3.5% of GDP on defense, whereas our NATO allies pay an average of 2.4% (Fig. 4). And Europe still has countries where workers can retire before Americans can. We have to fix these structural imbalances to make every tax dollar count.

Moderator: Now what about the domestic economy? One clear area of difference between your visions of the future is in your attitudes toward the Federal Reserve.

Trump: After so many years of an almost free-money policy that has failed to materially improve conditions for most Americans, we don't know how the Fed will deal with future recessions – start buying equities as the Bank of Japan has done, in effect nationalizing the stock market? And the Fed's forecasting has been terrible, continually marking down its forecasts toward the market price (Fig. 5). So what makes us think that it has the right policy now?

We're supposed to have an independent central bank to help protect us from governments that want to give away free money to win elections. Well that's exactly what the Fed, European Central Bank, and Bank of Japan are doing. I don't think we should end up like Japan; the government can spend whatever it wants, and the central bank will hold 10-year interest rates at 0%. It's all about letting the government increase the national debt.

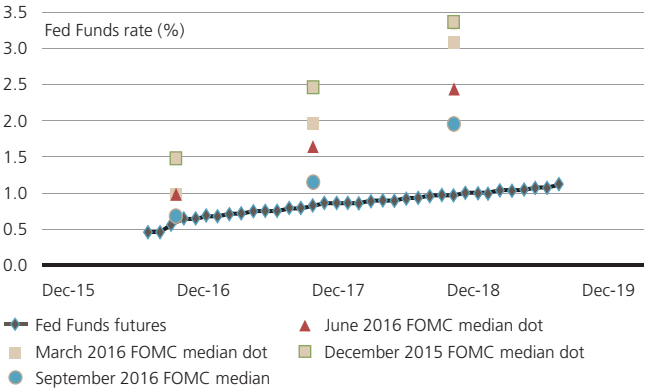
The fiscal plans proposed by both candidates, if implemented, would increase budget deficits, according to independent studies.

Clinton: It's true that the Fed's forecasts haven't been great. But at least they listen

4 http://www.pewresearch.org/fact-tank/2016/04/13/high-income-americans-pay-most-income-taxes-but-enough-to-be-fair/

Fig. 5: Fed rate forecasts have consistently fallen.

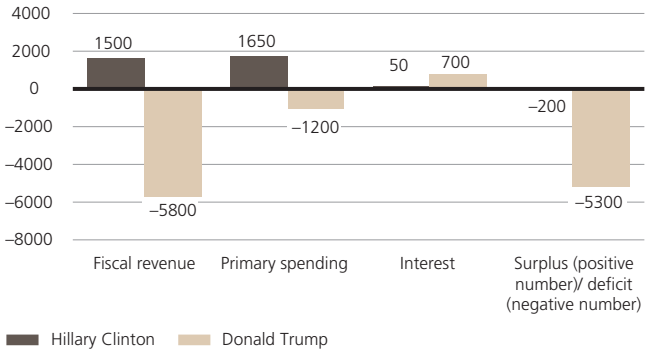
Fed funds futures and dots from FOMC Summary of Economic Projections, in %.



Source: Bloomberg Finance L.P., Federal Reserve, UBS. Data as of 17 October 2016.

Fig. 6: Both candidates are expected to increase US debt and deficit levels.

Announced fiscal policies of both US Presidential candidates and expected impact, in billions of USD.



Source: Committee for a Responsible Federal Budget, UBS. Data as of 22 September 2016. All figures rounded to the nearest USD 50 billion.

to the market and to economic data. What if the market is right, and a Fed move to raise rates causes slower economic growth or recession? Then neither of us could run the policies we want. If we don't work with the Fed, you can't cut taxes, I can't spend on social policy, and neither of us can spend on infrastructure. Both of our economic plans are, according to independent sources, likely to increase budget deficits in the short and medium term (Fig. 6)[5]. The "side effect" of the Fed's policies – a soaring stock market and a "fix" for rich people with capital to invest – may not be optimal. But it may be something we can live with if we redistribute more of the wealth.

Moderator: Thank you, both. Unfortunately, we're out of time. This debate shows there are important economic, societal, and financial consequences to the way we, and other nations, adapt to a lower-growth "new normal."[6, 7] I'm glad we were able to discuss these important issues objectively, clearly, and openly. In one of the world's most closely watched unpopularity contests (Fig. 7), may the least bad candidate win.[8]

Tactical asset allocation

Over our tactical six-month horizon, we believe a moderate risk-on positioning is warranted. Leading indicators are improving, US job creation is strong, averaging 200,000 per month, and US consumption spending is still solid.

We are introducing an overweight in US Treasury Inflation Protected Securities versus government bonds.

We have opened an overweight position in US Treasury Inflation Protected Securities (TIPS) versus standard government bonds. Fed officials seem willing to accept a period of above-target inflation to ensure that economic growth and job market momentum is maintained. This was underlined in Yellen's comments on 14 October that the Fed was considering "temporarily running a 'high-pressure economy.'"

5 Committee for a Responsible Federal Budget, *Promises and price tags: A Preliminary Update,* 22 September 2016. http://crfb.org/papers/promises-and-price-tags-preliminary-update

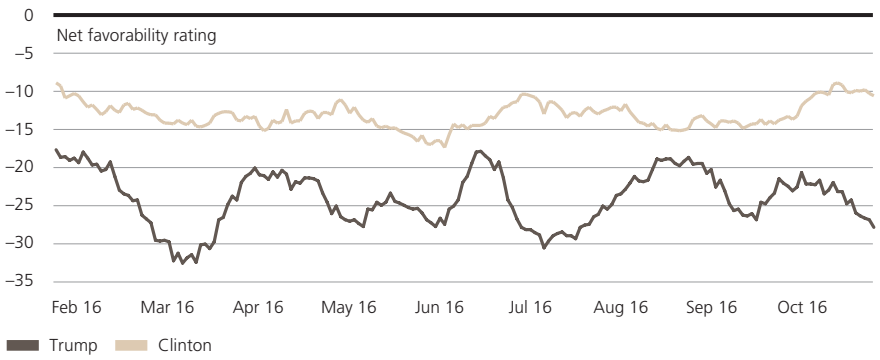
6 Governor Lael Brainard, "*The 'New Normal' and What It Means for Monetary Policy.*" Speech at the Chicago Council on Global Affairs, September 12, 2016. https://www.federalreserve.gov/lnewsevents/speech/brainard20160912a.htm

7 Marc Levinson, "Why the Economy Doesn't Roar Anymore," *Wall Street Journal,* October 14, 2016, http://www.wsj.com/articles/why-the-economy-doesnt-roar-anymore-1476458742

8 Huffpost Pollster, average of 10 last polls, as of October 18, 2016. http://elections.huffingtonpost.com/pollster/

Fig. 7: The race for the White House still an unpopularity contest.

Net favorability scores for Hillary Clinton and Donald Trump, ten poll moving average.



Source: Huffpost Pollster, UBS. Data as of 18 October 2016.

The market is currently pricing medium-term inflation at around 1.4% to 1.6%. The Fed's inflation target of 2% is referenced to the personal consumption expenditures (PCE) index, while TIPS are linked to the consumer price index for all urban consumers (CPI-U), which typically runs 0.3 of a percentage point higher. As long as PCE inflation runs above 1.25% or so, TIPS should outperform nominal bonds. Given the steady economic backdrop and the Fed's attitude, we believe this is likely.

We are overweight US equities versus government bonds. The third-quarter earnings season to register the first year on year earnings per share increase since mid-2015.

We are overweight US equities versus government bonds. The third-quarter earnings season is now under way, and we expect S&P 500 earnings per share to rise year on year for the first time since the second quarter of 2015, thanks to more favorable US dollar and oil base effects. This should mark the start of an earnings recovery.

We are also overweight emerging market equities versus Swiss equities. Economic and earnings indicators in emerging markets improved over the past month. Easy global financial conditions and stronger demand should underpin an ongoing recovery in emerging market earnings. Swiss equities are tilted toward less growth-sensitive sectors, and may underperform as global economic momentum improves.

In currencies, we favor a basket of emerging market currencies (the Brazilian real, Indian rupee, Russian ruble, and South African rand) against a basket of developed market currencies (the Australian dollar, Canadian dollar, and Swedish krona) given the attractive relative carry of emerging market currencies in a low-interest-rate world. The emerging market leg of this trade is roughly flat since we initiated the position. Diversification has helped offset a politically driven fall in the rand. Among the developed market currencies there has been a fall in the krona, due to lower inflation and declining industrial production in Sweden.

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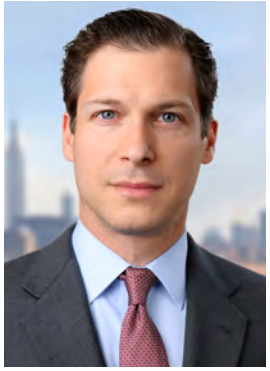
UBS Investor Forum Insights

At this monthly gathering, we invite thought leaders to debate the key topics affecting financial markets, and to challenge the UBS House View.

- The US presidential election was a key focus topic this month. A victory for Donald Trump was seen as unlikely. Should this occur, however, most participants felt markets would experience heightened volatility.
- A victory for Hillary Clinton was considered the base case by all participants. Should the Democrats also win the House of Representatives and the Senate, the potential for more significant policy shifts would increase.

Fact-checking our assumptions

Facts are stubborn things; and whatever may be our wishes, our inclinations, or the dictates of our passions, they cannot alter the state of facts and evidence.
– John Adams, 1770



Jeremy Zirin, CFA
Head of CIO
Investment Strategy
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The distance between facts and statements from politicians has grown so uncomfortably wide that fact-checking websites have become a growth industry. But I promise that this comment and the reference to our second president in the above quote will be the only mention of politics or the current US presidential election in this article. (Hopefully, some of you will find that as refreshing to read as I did to write.)

Amid this backdrop, investors need to remain focused on the facts, current market fundamentals and their portfolio implications. At the end of the day, whether talking about politics or financial markets, the facts matter.

For the remainder of this article, we highlight two facts and how they currently influence our market views and asset allocation positioning. I'm highly confident that neither of these facts will be labeled as "pants on fire" by Politifact or another fact-checking site.

Fact #1: Inflation is low, but rising.
Over the past several years in the post-GFC (Great Financial Crisis) era, inflation has remained stubbornly low, sparking fears of outright deflation. Despite the fact that central banks cut interest rates to zero (and in some cases, outside of the US, into negative territory) and have aggressively bought longer-duration bonds, inflation in developed markets has remained well below policymaker targets. Deflationary forces, such as household sector deleveraging, high labor market slack, collapsing oil prices, and slowing Chinese industrial activity, have been the driving forces sparking deflationary concerns.

But the data show that leading indicators, as well as actual readings of domestic inflation are rising. Headline CPI rose by 1.5% in September, its highest reading in 22 months. To be sure, the base effects from slumping oil prices in late 2015 are lifting year-over-year comparisons. But the increase in inflation appears to be genuine and corroborated by other inflation measures that exclude energy prices. The Federal Reserve's preferred inflation gauge, the change in the US personal consumption expenditure core price index is at 1.7% – its highest level since late 2014 – and has moved close to the Fed's 2% target over the course of 2016.

Going forward, deflationary forces appear to be abating. US labor markets have tightened, as evidenced by the drop in the unemployment rate from 10.1% in October 2009 to 5.0% today. Wage growth is finally starting to rise as well. Monthly readings of US average hourly earnings have increased by at least 2.3% in each of the last 12 months after failing to surpass that level since the financial crisis. The combination of reduced labor market slack, rebounding commodity prices, and increasing evidence of a "soft landing" in China gives us confidence that inflation should cyclically rise over the next several months.

Fact #2: Dollar appreciation recently has already been "yuge."
Kidding aside, the trade-weighted dollar major currency index has appreciated by

over 30% since mid-2011, making the current dollar bull run the third strongest in the past 50 years. With the US current account deficit once again widening, the ECB more actively discussing its exit strategy from its asset purchase program, and the US dollar already trading well above our (and the OECD's) estimate of fair value versus most currencies, our currency strategy team now believes that the dollar bull market is over.

Among the major currency pairs, we now expect:

- the euro to appreciate from 1.09 to 1.14 in six months, and to 1.20 in 12 months (versus fair value of 1.25)
- the pound sterling to appreciate from 1.23 to 1.28 in six months, and to 1.36 in 12 months (versus fair value of 1.58)
- the yen to appreciate from 103 to 102 in six months, and to 98 in 12 months (versus fair value of 78)

Investment implications

We look for headline CPI inflation in the US to continue to rise over the next several quarters. Markets are skeptical of this development; market-derived intermediate-term inflation breakeven levels remain well below 2.0%. As Mark Haefele discussed in his monthly letter, we have opened a position in US Treasury Inflation Protected Securities (TIPS) to take advantage of this mispricing.

A related portfolio shift is our upgrade of the US financial sector to a moderate overweight stance (from neutral) in our US sector strategy. Low inflation and near-zero short-term interest rates have been significant headwinds for the financial sector's earnings power since higher-yielding assets mature and are replaced with lower-yielding assets. Since 2010, there has been an 80% correlation between the relative performance of financials versus the S&P 500 and the US 10-year government bond yield. With inflation rising, we look for the Fed to raise short-term interest rates by 25 basis points in its December FOMC meeting and twice in 2017. This should drive stronger earnings for US financials, particularly relative to subdued expectations with the sector trading at a price-earnings ratio (P/E) of just 12.2 times forward earnings.

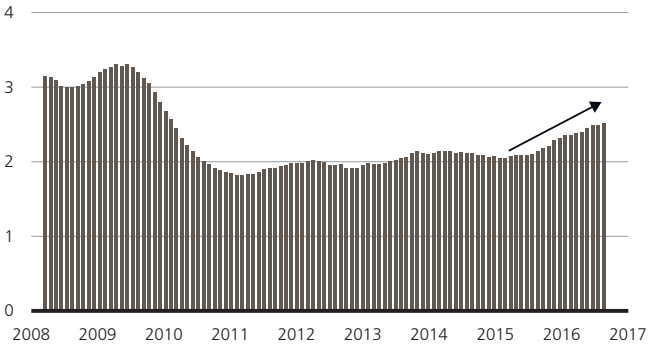
To offset our financial sector overweight, we downgrade the industrial sector to a moderate underweight as global industrial end-markets remain soft, earnings growth is weak, and valuations appear full.

Finally, a weaker outlook for the dollar increases the appeal of non-dollar assets for US investors. As such, we close our underweight on non-US developed market bonds.

Video feature Jeremy Zirin discusses this article. *Click to play.*

Fig. 1: Accelerating wage inflation to prompt Fed hikes…

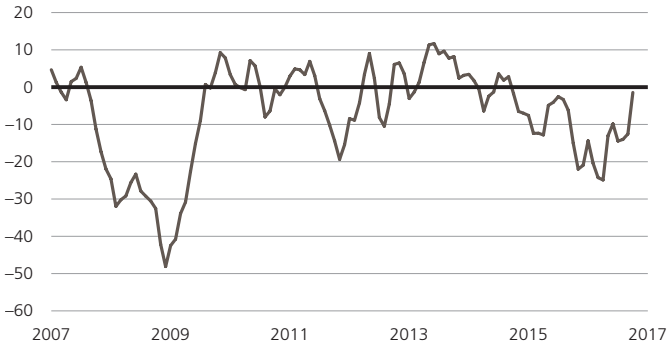
Average hourly earnings, 12m moving average, in %



Source: Bloomberg, UBS, as of 19 October 2016

Fig. 2: … and Fed rate hikes to lift Financials earnings

S&P 500 financials sector earnings momentum, in %



Note: Momentum defined as positive less negative revisions to forward one-year consensus estimates as a percent of total revisions, last 3 months
Source: Bloomberg, UBS, as of 19 October 2016

Preferred investment views

↑ Recent upgrades
↓ Recent downgrades

Most preferred	Least preferred
Equities	
• US • Emerging markets • North American energy independence • Transformation technologies • e-Commerce • Golden years for Baby Boomers	• Switzerland
Bonds	
• US investment grade • US TIPS 1–10 years ↑ • US senior loans ↑ • Avoid Counties at risk	• US government bonds ↓
Currencies	
Cash	

As of 20 October 2016

At a Glance

Economy

We expect the global economic recovery to continue at a gradual but relatively solid pace. With the US labor market continuing to tighten, credit spreads significantly lower than a year ago, and financial markets relatively stable, we expect the Fed to continue its gradual tightening before year-end. This is in our view appropriately priced in financial markets. Additionally, US earnings are expected to start growing soon, and we maintain tactical overweight positions in US equities and US investment grade bonds against government bonds. We furthermore prefer emerging market (EM) equities over Swiss stocks and a basket of EM currencies over developed market (DM) currencies. We are opening an overweight in US Treasury Inflation-Protected Securities (TIPS) against government bonds.

⊕ Equities

Our overweight in US equities remains supported by solid US data. In particular, US private consumption is holding up well, while leading business indicators recovered significantly over the past month. In addition to our overweight in US equities, we hold an overweight in EM against Swiss stocks. Earnings of EM companies have turned positive over the past six months, while economic data in the region has stabilized. Meanwhile, Swiss equities are likely to underperform due to their defensive sector mix and the ongoing drag of negative interest rates on financials' earnings.

⊖ Fixed income

Government bonds remain a key diversifier of our global portfolios, but tactically we find better opportunities in US investment grade bonds, providing a yield of 2.4%. We furthermore recommend shifting some government bond exposure into US Treasury Inflation-Protected Securities (TIPS) as we think inflation is underpriced. Qualified investors, who can tolerate somewhat lower liquidity, should overweight US senior loans, offering an average yield of 6% and floating interest rates.

Foreign exchange

We favor a basket of EM currencies (BRL, INR, RUB, ZAR) over DM currencies (AUD, CAD, SEK) to harvest the attractive interest rate carry. The cyclical nature of our DM basket helps to reduce the risk of this position to some extent (e.g., compared to using the USD).

Month in Review

US economic data was mixed this month. The ISM Non-Manufacturing PMI jumped to 57.1 in September from 51.4 in the previous month, a new record month-over-month increase. Nonfarm payrolls increased by 156,000 month-over-month in September, below the 172,000 consensus. The unemployment rate ticked up to 5.0% despite robust job growth as more people joined the labor force.

Deutsche Bank dominated the headlines in Europe early this month following news that the US Department of Justice was seeking a USD 14 billion fine over allegations of mortgage mis-selling. Pressure eased on reports that the bank will negotiate a smaller penalty. Sterling tumbled more than 6% in September on speculation that the UK could be heading toward a "hard" Brexit, the currency having previously hit a 31-year low earlier in the month.

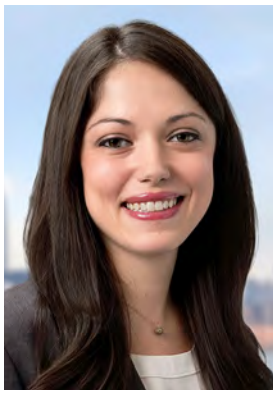
In Asia, Chinese FX stockpiles hit their lowest point since 2011, down 0.6% to USD 3.17tr, coming in below consensus and marking the third consecutive month of contraction. The Caixin China PMI edged up to 50.1 in September from 50 in August, indicating an expansion.

WTI crude rose to a 15-month high on October 19 after a US Energy Information Administration (EIA) report showed that US crude inventories decreased by 5.25mn bbl the previous week. Oil fluctuated near USD 50/bbl throughout the month amid uncertainty about whether OPEC will be able to implement an accord to reduce output at its next official meeting on 30 November.

Of MLPs and senior loans

Stephen Freedman, PhD, Head of Thematic and Sustainable Investing Strategy
Laura Kane, CFA, Thematic and Sustainable Investing Strategist

Stephen Freedman, PhD, CFA
Head of Thematic and Sustainable Investing Strategy



Laura Kane
Thematic and Sustainable Investing Strategist

This month, *US senior loans* replaces *Beyond benchmark: fixed income investing* on our Top themes list, and we increase our exposure to MLPs within the *North American energy independence: reenergized* theme.

Upgrading US senior loans

The US credit market has broadly benefitted from a continued search for yield since the middle of the first quarter, as global monetary policy remains accommodative and US macro data points to resilient economic growth despite late-cycle trends, including tightening lending standards. Against this backdrop, we see several reasons to expect demand for US senior loans to remain strong, and deem current valuations as attractive relative to other fixed income assets, in part due to their higher coupon payments.

Most US loans have a LIBOR floor of 98 basis points on average, which is a trend that emerged after the financial crisis. With LIBOR rates under that floor over the past few years, loans have exhibited some fixed duration behavior, and coupon cash flows have not reset higher. This is set to change with LIBOR poised to rise above this 0.98% floor (see Fig 1). LIBOR has crept up to 0.88% after the Fed's first rate hike in December 2015 and due to money market reform rules. We expect the Fed to raise rates this December and look for two more rate hikes next year. We forecast for LIBOR to rise toward 1.4% over the next six months, which should support loan demand.

The US loan market is primarily owned by retail funds and separately fed by institutional demand through collateralized loan obligations (CLOs). CLO demand has firmed from the levels seen earlier in the year. We believe CLO issuance should remain steady enough to maintain supply and demand in balance, even as managers consolidate due to new risk retention rules that go into effect next year. Retail flows, the other main source of US loan demand, have also shown modest inflows recently.

Loans also exhibit lower volatility than high yield bonds and equities, which may be beneficial during potentially disruptive upcoming market events, including Fed tightening and the US presidential election. For example, loans outperformed during the 2013 taper tantrum with a 1% drawdown versus 5% for high yield bonds. Loans were also identified in our report, "Global risk radar: Event season and US election," as an asset class that can perform well in either election outcome scenario.

Over the next 12 months, we expect senior loans to deliver total returns of 3-5%, driven mostly by coupon income. Even if interest rates were to remain at

their current low levels for longer, we believe that loan valuations are attractive at current levels versus other fixed income segments. For example, they offer a yield pickup of 4% over investment grade corporate bonds with maturities of 1 to 5 years.

Overall, we think that senior loans are an attractive addition to a diversified taxable fixed income portfolio, providing for strong risk-adjusted returns, an appealing yield, and diversification benefits. Due to the speculative-grade nature of the issuers that borrow in the loan market, we recommend that senior loans only be considered by investors with an adequate risk profile, and some tolerance for illiquidity, as secondary markets can be illiquid at times.

The *US senior loans* theme will replace *Beyond benchmark: fixed income investing* on our Top themes list. While we still advocate the benefits of diversification and flexibility in fixed income portfolios over the long term, we have greater conviction in senior loans over the next 12 months.

Increasing our exposure to MLPs

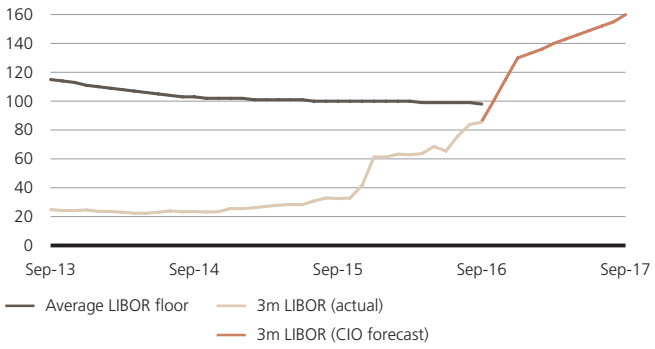
Turning to our equity themes, we identified another opportunity to access higher yields and position portfolios for a changing market landscape. This month, we are increasing our exposure to energy infrastructure – master limited partnerships (MLPs) specifically – within our theme *North American energy independence: reenergized*, which highlights investment opportunities stemming from North America's declining reliance on foreign energy sources (see Fig 2). While the oil price downturn has put significant pressure on US producers over the past couple of years, oil market fundamentals appear to be improving, and commodity prices are rising. Over the next 12 to 18 months, these trends should support resumption of growth in all phases of the US oil and gas business, which will necessitate more investment in energy infrastructure.

While the pace of growth in the energy infrastructure subsector will unlikely return to levels of the recent past, infrastructure providers play a vital role in gathering, storing, processing and transporting crude, natural gas, and other energy products throughout North America. We target MLPs that have competitive advantages in the basins they serve. We focus on basins where infrastructure capacity remains tight, and where resumption of drilling activity will require more infrastructure development.

Our increased exposure to MLPs within this theme is in line with our overall favorable view of the MLP sector. We expect fundamentals to continue to improve, supporting infrastructure investment, and cash flow and distribution growth. This positive outlook underpins our belief that investors seeking attractive current income, a double-digit total return (yield plus growth) prospect, exposure to improving energy industry fundamentals, and tax advantages should consider incremental exposure to the MLP sector.

Fig 1: 3m LIBOR should soon exceed floor values

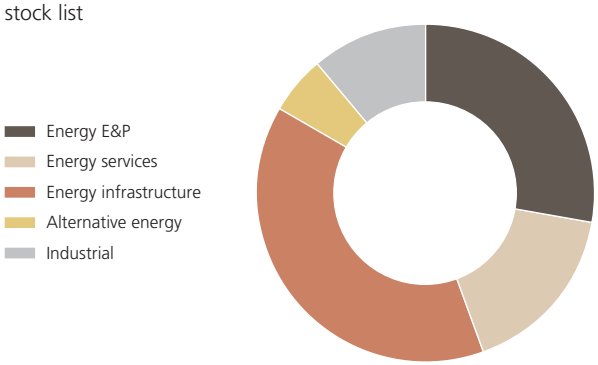
In basis points



Source: S&P LCD, UBS, as of 14 October 2016

Fig 2: We are increasing our exposure to energy infrastructure

Subsector allocation within North American Energy Independence stock list



Source: UBS, as of 19 October 2016

Global economic outlook

The US economy is growing at a moderate pace led by consumer spending. With the labor market tightening and inflation gradually rising, we expect the Fed to hike rates in December. The Eurozone recovery is continuing at a steady pace, while Japanese data has been weak. Emerging market economies are mostly looking better than they did early in the year, and growth in China has been stable. Inflation is subdued and monetary policy is extremely accommodative in most countries.

Global growth in 2016 expected to be 2.9%

	Real GDP growth in %			Inflation in %		
	2015	2016F	2017F	2015	2016F	2017F
US	2.6	1.4	2.4	0.1	1.2	2.3
Canada	1.1	1.2	2.3	1.1	1.5	1.8
Brazil	-3.8	-2.8	1.6	10.7	6.9	4.7
Japan	0.6	0.5	1.2	0.8	-0.2	0.3
Australia	2.4	2.9	3.0	1.5	1.1	1.8
China	6.9	6.6	6.3	1.4	1.9	2.0
India	7.6	7.4	7.6	4.9	5.1	4.5
Eurozone	1.6	1.5	1.3	0.0	0.3	1.5
UK	2.2	1.9	0.7	0.0	0.8	2.5
Switzerland	0.8	1.4	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: Reuters EcoWin, IMF, UBS, as of 19 October 2016
Note: 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.

Central bank policy

Brian Rose, PhD
US Economist

Ricardo Garcia-Schildknecht
Economist

House view

Probability: 70%

Ideological divisions within the US Federal Reserve have been evident in both public appearances by members of the FOMC and in the minutes of recent policy decisions. The market focus continues to emphasize the monetary policy pillar, and we believe a 25bps increase in the fed funds rate in December 2016 is warranted by higher inflation and the relatively tight labor market. The quantitative policy position (measured by the Fed's balance-sheet-to-GDP ratio) continues to moderately tighten. One possible political issue for 2017 is the risk of more aggressive regulation on the financial sector.

↗ Positive scenario

Probability: 15%

Worse macro backdrop
The Fed is forced to stay on hold, but a rate cut remains unlikely. The ECB launches more policy easing than expected by the markets, with a focus on stabilizing or increasing bank credit growth. The Bank of Japan comes under pressure to engineer currency depreciation.

↘ Negative scenario

Probability: 15%

Macro risks fade
Diminished risks allow the Fed to signal more aggressive policy tightening in 2017, with the debate between a faster pace of monetary tightening and a move toward a faster pace of quantitative tightening. The ECB reacts to the increase in inflation by giving stronger signals of a less accommodative mindset, raising questions about the future direction of quantitative policy. The Bank of England slows quantitative policy measures. Better growth prospects limit the impact of policy tightening on emerging markets.

Crude oil market rebalancing

Giovanni Staunovo Analyst
Dominic Schnider Analyst
Wayne Gordon Analyst

House view

Probability: 70%

OPEC surprised us and the market in late September by departing from its volume-maximizing strategy in favor of actively managing supply. The deal faces many hurdles, some of which could be fatal, such as a lack of information on how a cut would be split among members. Even if an agreement is reached, we don't expect the deal to be implemented before 1Q17. Until then, we expect OPEC supply to stay high. Meanwhile, non-OPEC supply is expected to rise from 3Q16 to 4Q16. We expect improved supply availability to result in an inventory build in 4Q16. Therefore we remain cautious on oil prices in the short term.

↗ Positive scenario

Probability: 10–20%

Sharper-than-expected contraction
Prices could rise quicker than expected due to destabilizing geopolitical events in oil-exporting regions like Venezuela, Africa, or the Middle East, thus triggering additional outages, a faster contraction in US crude production, and/or a full-endorsed OPEC production cut. On the demand side, a cold winter could stimulate demand growth.

↘ Negative scenario

Probability: 10%

Resilient production
More resilient non-OPEC production, or fewer OPEC production outages, could keep the market oversupplied. A lasting ceasefire in Nigeria and Libya could result in a return of 1mbpd or more of disrupted supply. Cost reductions and ongoing efficiency gains could lead to more resilient US tight oil production, while the latest oil price increase could moderate US production declines and/or stimulate supply growth early next year. On the demand side, a broader economic crisis in Asia (particularly in China) could slow incremental demand for oil and keep the market in surplus.

US earnings growth to resume

Jeremy Zirin, CFA
Head, Investment Strategy, WMA

David Lefkowitz, CFA
Senior Equity Strategist

House view

Probability: 60%

Earnings growth is improving as the huge drags from poor energy sector results and the strong dollar begin to dissipate. Earnings fell 6% in 1Q, but only 2% in 2Q. We look for growth to turn positive after more than a year of flat-to-down earnings. We are currently expecting an increase of 3% in 3Q.

↗ 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. 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 stagnation

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

28 October 2016
GDP for 3Q 2016
GDP growth appears to have accelerated in the third quarter as consumer spending has continued to rise at a robust pace, while headwinds from inventories and energy sector investment have abated.

28 October 2016
Employment Cost Index for 3Q 2016
Average hourly earnings is the most commonly used measure of wage growth, but the Employment Cost Index has the advantage of adjusting for the changing composition of the labor market.

31 October 2016
Personal income and spending for September
In addition to the important data on income and spending, this report includes the personal consumption expenditures (PCE) price index, the primary inflation measure on which the Fed focuses.

1 November 2016
ISM Manufacturing PMI for October
The ISM Manufacturing PMI rebounded back above 50 in September, a reassuring sign that the sector will at least not act as a drag on growth.

2 November 2016
FOMC rate decision
Coming just six days before the elections, we expect the Fed to remain on hold. However, the Fed may use the FOMC statement to hint at a December rate hike.

Equities

Jeremy Zirin, CFA; David Lefkowitz, CFA; Markus Irngartinger, PhD, CFA

Performance has been mixed year-to-date. US equities are near record highs, and emerging markets (EM) have surged, but the stronger yen has restrained the Japanese market, negative interest rates have weighed on Eurozone financials, and the weaker pound has hurt UK returns when measured in dollars. We are overweight US and EM equities, and underweight Swiss equities. Easier comparisons from oil prices and the dollar should help S&P 500 earnings-per-share (EPS) advance in the quarters ahead.

Eurozone

neutral

We are neutral Eurozone equities. Solid domestic consumer demand and ongoing monetary easing support a continued economic recovery. Leading economic indicators – especially for manufacturing activity – have stabilized in expansionary territory. While currency depreciation supported earnings last year, the euro has appreciated modestly this year. Earnings dynamics remain rather weak compared to other regions. Our most preferred sectors are energy, materials, technology, and utilities.

EURO STOXX (index points, current: 330)	Six-month target
House view	**340**
↗ Positive scenario	375
↘ Negative scenario	270

Japan

neutral

We are neutral on Japanese equities. We expect earnings growth of 3% in FY16 (which ends in March 2017) and in the low single digits in FY17. The yen has strengthened by over 15% this year, and USDJPY is currently trading around 104. We believe that the downside risk for the Japanese equity market is somewhat mitigated by the relatively large purchases from domestic investors like the Bank of Japan (BoJ). The BoJ has maintained its easy monetary policy with a new focus on yield curve control. We prefer share-buyback and high-dividend-yield stocks.

TOPIX (index point, current: 1,357)	Six-month target
House view	**1400**
↗ Positive scenario	1500
↘ Negative scenario	1100

Emerging markets

overweight

We are overweight on emerging market equities in our global portfolio. EM economic activity numbers are stabilizing, and manufacturing sentiment is turning more positive from low levels. Corporate earnings growth is improving, especially compared with several developed markets. The recent rise in commodity prices is encouraging, and the global liquidity backdrop remains supportive. Also, EM equities are trading at a discount to their developed market counterparts. We prefer China, Brazil, South Korea, and India to the Philippines and Taiwan.

MSCI EM (index points, current: 913)	Six-month target
House view	**950**
↗ Positive scenario	1075
↘ Negative scenario	725

UK

neutral

We are neutral on the UK. We expect a weakening economic backdrop for the UK into next year, which may lead to downgrades in the earnings of cyclical and domestic areas, including financials. However, the bigger near-term drive has and will continue to be international companies, which are seeing upgrades to earnings based on the benefits from the weaker pound. We believe the FTSE 100 has a 10% currency boost to earnings from the pound's decline. Earnings are likely to be slightly negative this year, but we expect them to return to a double-digit growth rate next year.

FTSE 100 (index points, current: 7022)	Six-month target
House view	**7225**
↗ Positive scenario	7800
↘ Negative scenario	5750

Note: Current values as of 19 October 2016

US equities

We are overweight US equities. US stocks look poised to benefit from a resumption of corporate earnings growth as headwinds from the rout in energy prices and the strong dollar begin to fade and as consumer fundamentals remain healthy. A slow normalization of interest rates by the "data-dependent" Fed should not derail the economic expansion or the US bull market. Within sectors, we upgrade financials and downgrade industrials this month.

US equities overview

overweight

Third quarter S&P 500 earnings-per-share (EPS) should rise by 3%, marking the first quarter of positive growth since mid-2015. With domestic economic activity resilient and the profit headwinds from low oil prices and the strong dollar fading, we expect earnings growth to accelerate in Q4 and for S&P 500 EPS to reach USD 130 in 2017. Valuations are somewhat above long-term averages, but do not appear excessive in a moderate growth and low inflation environment. Election uncertainty may spark bouts of market volatility over the next few weeks, but a divided government (our base case) should ultimately be favorable for markets. We maintain our six-month S&P 500 price target of 2,225.

US sectors

Since 30 June 2016, the tech sector has delivered the strongest gains. We continue to overweight tech as valuations appear reasonable and earnings growth should be well-supported by solid enterprise technology spending and consumer demand for tech products. This month, we upgrade financials to a moderate overweight. Earnings momentum is improving as capital market activity has picked up and interest rates have started to climb. Despite sluggish industrial end-markets, the industrial sector has outperformed in 2016. We downgrade industrials to a moderate underweight, expecting global manufacturing to remain soft.

US equities – size

We spread our tactical overweight to US equities equally across size segments. Thus far in 2016, small- and mid-cap stocks have very modestly outperformed large-caps. While a benign credit environment and stronger relative earnings growth should favor smaller sized segments, above-average downside risks also exist for small-caps given their higher leverage.

US equities – style

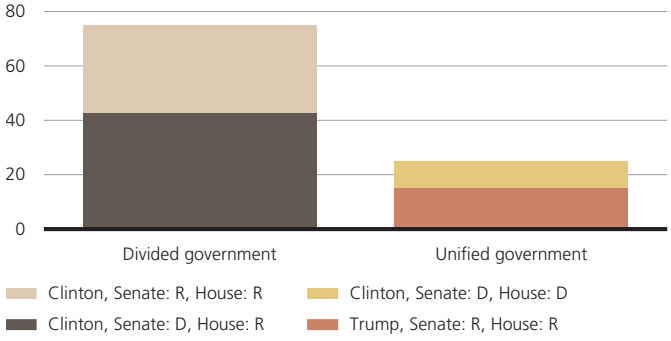
We maintain our neutral view between growth and value stocks. Value has outperformed growth by 4.3% year-to-date (after growth outperformed by 9.5% in 2015), but we do not believe that the stage is set for an extended outperformance cycle for value. Our sector strategy – particularly our overweight allocation to technology, healthcare, and consumer discretionary – supports a growth tilt. However our upgrade of financials should benefit the broader value index.

S&P 500 (index points, current: 2,144)	Six-month target
House view	**2225**
↗ Positive scenario	2450
↘ Negative scenario	1875

Note: Current values as of 19 October 2016

Fig. 1: High likelihood of divided government limits policy uncertainty

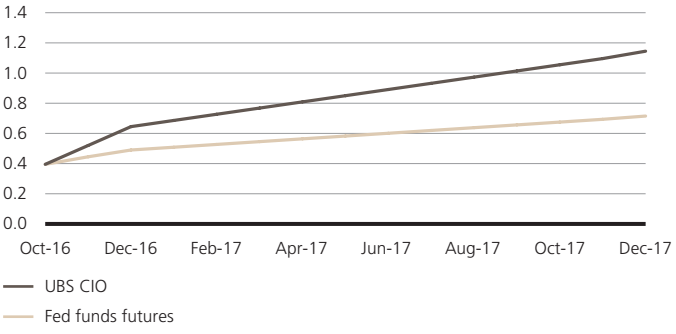
UBS CIO election outcome probabilities, in %



Source: UBS as of 19 October 2016

Fig. 2: Fed fund rate hikes (which could be greater than expected) should boost financial sector earnings

Fed funds: UBS estimates and futures prices, in %



Source: Bloomberg, UBS, as of 19 October 2016

Bonds

Leslie Falconio; Kathleen McNamara, CFA, CFP; Barry McAlinden, CFA; Philipp Schoettler; Frank Sileo

We expect yields to move modestly higher as the US economy grows and as the Fed gradually raises rates. A healthy labor market and steady consumer spending suggest that the economy is in good shape, and inflation should reach the Fed's target. Risks include market disruptions due to the implementation of Brexit or a slowing Chinese economy. Somewhat higher rates will result in minimal returns to US Treasuries. We are underweight US government bonds versus US equities and US IG corporate bonds.

Government bonds

underweight

Interest rate sentiment has shifted since the summer with the 10-year yield reaching 1.82%, the highest level since early June. The recent strength in the economic data, such as ISM and the payroll report, leaves investors reexamining the lower for longer view. Although CIO does not anticipate a large rise in interest rates, with the Fed on track to hike come December, we see a neutral duration view as the prudent strategy.

US 10-YEAR YIELD (Current: 1.7%)	Six-month target
House view	**1.7%**
Positive scenario	1.2–1.5%
Negative scenario	1.9–2.1%

US high yield corporate bonds

neutral

We keep a neutral position on US high yield (HY), which has returned a very strong 16% year-to-date and 12% ex-commodities. While price gains are unlikely to be repeated, we look for HY to deliver coupon-driven returns over the next six months. Moody's trailing 12-month default rate was down to 5.4% in September from 5.7% in August, which was the highest rate since 2010. We expect this rate to decline to 3-4% over the next 12 months as defaults outside of the troubled commodities sectors remain relatively low, while commodity sector defaults to gradually decline.

USD HY SPREAD (Current: 466bps*)	Six-month target
House view	**550bps**
Positive scenario	400bps
Negative scenario	1,100bps

*Data based on BAML High Yield indexes

Note: Current values as of 19 October 2016

US investment grade corporate bonds

overweight

US investment grade corporate bonds outperformed Treasuries over the month as a narrowing of credit spreads partially offset the rise in US Treasury yields. We maintain a tactical overweight position. The global search for yield will keep foreign demand elevated as overseas investors take advantage of the scale and liquidity that US IG offers. Among IG sectors, we see better relative value in US IG financials where spreads are wide relative to their lower duration. Along the IG curve, we favor intermediate credit maturities in the 5- to 10-year range.

US IG SPREAD (Current: 135bps*)	Six-month target
House view	**150bps**
Positive scenario	125bps
Negative scenario	275bps

*Data based on BAML IG corporate index

Emerging market bonds

neutral

Stable-to-improving emerging market (EM) economic fundamentals and accommodative global liquidity should continue to support the asset class. However, relatively tight valuations and lingering EM-specific and macro risks limit the room for further spread tightening, in our view. We believe EM sovereign and corporate credit spreads will trend sideways to slightly tighter in the next six months, and recommend a neutral allocation within globally diversified portfolios. That said, the HY segment should outperform its IG counterpart due to yield carry and positive idiosyncratic developments.

EMBIG div / CEMBI div SPREAD (Current: 337bps / 335bps)	Six-month target
House view	**320bps / 320bps**
Positive scenario	280bps / 280bps
Negative scenario	500bps / 530bps

Municipal bonds

neutral

Following a lengthy period where powerful technical factors pushed muni prices higher, the market is now exhibiting some price weakness. Over the past two months, munis have lost over 1.0%, reducing the sector's year-to-date total return to 3.1%. We attribute the weaker performance in large part to robust new issuance. Meanwhile, municipal mutual funds continue to attract assets, but at a slower pace. At current levels, tax-exempt paper holds value versus US Treasuries, in our view. Current AAA 10-year muni-to-Treasury yield ratio: 98.9% (last month: 93.0%).

Non-US developed fixed income

neutral

Over the past month, bond yields moved modestly higher in most countries outside of the US, and overall, the dollar gained against other major currencies, hurting the value of non-US assets when measured in dollars. As a result, non-US developed fixed income generated negative returns. Non-US bond yields remain at very unattractive levels with many bonds offering negative yields. However, we expect the dollar to weaken over the next 6-12 months, offsetting the yield disadvantage. We therefore recommend a neutral position on the asset class.

Additional US taxable fixed income (TFI) segments

Agency bonds

The Agency market had held in over the past few weeks as volatility has increased. Year-to-date, Agency debt has returned 3.3%, a respectable return for a low-risk asset class. Investors await an increase in volatility to reenter the callable market and to pick up incremental yield. CIO remains overweight spread product versus the safe haven of Agency debt. The recent rise in interest rates has left the longer end of the Agency market underperforming Treasuries, with the demand remaining in the 1- to 5-year. Current spread is +13bps to the 5-year (versus +18bps last month).

Preferred securities

Through mid-month, preferred valuation had improved somewhat, although spreads appear to be rapidly tightening again. As the Fed normalizes rate policy, volatility may occur. This could lead to spread widening. Meanwhile, although they've slowed, ETF flows remain positive. A shift toward outflows could exacerbate pressure. We maintain a neutral outlook given the potential for rate and spread volatility, and tight valuation. We continue to favor preferreds with call protection and either fixed-to-floating rate coupons and high back-end spreads or high coupon fixed-rates.

Mortgage-backed securities (MBS)

Since the beginning of 2016, we cited that the fair value spread band for MBS is 95bps to 115bps. The current coupon MBS spread versus the underlying Treasury has remained in this band for all of 2016, shielded from declining yields, volatile oil prices, referendums, or politics. We have advised investors to buy MBS at 115bps and sell MBS at a spread of 95bps – a successful strategy we deployed last year. Currently, we are holding our neutral stance as we head into year-end. Current spread is +96bps to the 5-year and 10-year Treasury blend (versus +100bps last publication).

Treasury inflation-protected securities (TIPS)

TIPS breakeven inflation rates finally caught up to the market's belief that inflation will slowly grind higher. The recent rise in oil prices has pushed 5-year and 10-year breakeven inflation rates to their four-month high. CIO has opened an overweight on 1–10 year TIPS against government bonds. We are now more positive on the asset class as we look for inflation to rise into 2017. Current 10-year breakeven inflation rate is 1.69% (1.48% last month).

Note: Current values as of 19 October 2016

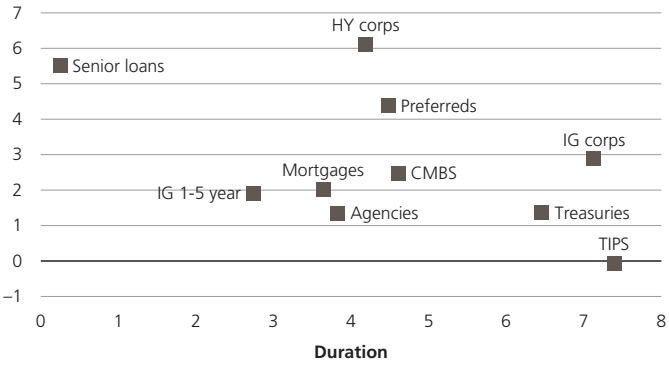
CIO WMR interest rate forecast

Americas	19-Oct-16	3 mths	6 mths	12 mths
USD 3M Libor	0.9	1.3	1.4	1.6
USD 2Y Treas.	0.8	0.9	1.0	1.1
USD 5Y Treas.	1.2	1.2	1.3	1.5
USD 10Y Treas.	1.7	1.5	1.7	1.9
USD 30Y Treas.	2.5	2.3	2.5	2.7

Source: UBS, as of 19 October 2016

US fixed income opportunity set

Yield, in %, and duration, in years



Source: BAML, UBS, as of 18 October 2016

Commodities and other asset classes

Dominic Schnider, CFA, CAIA; Giovanni Staunovo; Thomas Veraguth; Wayne Gordon

Broad-based commodity indices have failed to perform since May. Our near-term outlook remains cautious: We forecast a mid-single-digit negative return due to a modest spot decline and negative roll yield returns over the coming three months. Most of the weakness relates to energy; we expect temporary crude oil and US natural gas price setbacks of about 10-15%. Near-term softness may also come from agriculture due to oversupply and insufficient demand in grains, and in precious metals, as a pending US Federal Reserve rate hike will continue to weigh on the sector in the short run.

Commodities

neutral

Precious metals Gold prices have benefitted from three factors this year: higher financial market volatility, political uncertainties, and lower US real rates. More recently, the rising probability of a Fed rate hike in December and the reduction of elevated speculative positioning weighed heavily on gold. That said, we still like its insurance qualities and see longer term prices as better supported with US real rates dipping further into negative territory. As a result, we expect gold to trade at USD 1,350/oz in six and 12 months.

GOLD (Current USD 1,269/oz)	Six-month target
House view	**USD 1,350/oz**
↗ Positive scenario	USD 1,450/oz
↘ Negative scenario	USD 1,150/oz

Crude oil We remain cautious on oil prices in the short term. OPEC's production cuts are all talk and no action for now. September crude output rose to a record 33.6mbpd, and October production could approach 34mbpd. In the 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. This should prompt Brent oil prices of USD 55/bbl or higher in 12 months. Hence, we like to sell downside protection for a premium versus money market rates, with strikes close to USD 40/bbl.

BRENT (Current: USD 52.7/bbl)	Six-month target
House view	**USD 45/bbl**
↗ Positive scenario	USD 70/bbl
↘ Negative scenario	USD 30/bbl

Base metals An expected pickup in economic activity globally sets the stage for tighter market balances across the base metal sector. Base metals that are supply challenged, like zinc, nickel, and lead, should see another 10-15% rise in prices. Supply considerations call for an underperformance of copper and aluminum, but the underlying stories for both metals are improving; any price setbacks in either metal should be short-lived and worth a buy considering next year's outlook for the almost balanced copper and aluminum markets.

Agriculture Agriculture's fundamentals remain heavy as benign US weather and a step-up in Brazil soybean planting keeps soybean prices under pressure. Wheat's spectacular net-short positioning leaves the grain in a precarious position, given the elevated weather risks as we approach the Australian harvest. Heavy rainfall is threatening grain quality along the eastern seaboard; any downgrades would be a bullish signal for prices despite the near-record inventories.

Other asset classes

Listed real estate Expected earnings growth remains solid at 4.7% p.a. for 2016-18. A 4.0% dividend yield makes an 8% full-year return possible provided overall bond yields stay low amid weak economic growth. Listed real estate has delivered a 6% annualized return this year. It trades at a 6% discount to net asset value compared to -6.4% historically, which gives some support to valuations. We have judged financing conditions for real estate as stable and favorable despite some gradual worsening. The contraction of property yields versus bond yield spreads presents the biggest risk at these extremely low bond yields.

FTSE EPRA/ NAREIT Developed TR USD (Current: 4,545)	Six-month target
House view	**USD 4,500**
↗ Positive scenario	USD 4,800
↘ Negative scenario	USD 4,000

Note: Current values as of 19 October 2016

Foreign exchange

Thomas Flury

The events in the upcoming months will be crucial for the USD. The US elections and the Fed monetary policy decision could expose the greenback to larger swings. We continue to expect the Fed to hike interest rates in December, while money markets are only fully pricing in a rate hike for 2Q17. We continue to expect the AUD and NZD to weaken in the near term, as the Australian and New Zealand central banks ease policy to keep their currencies weak against the USD.

USD

neutral We continue to expect the Fed to hike interest rates in December. Thereafter, the market should not expect another rate hike to come too soon, and the USD should start to fall back closer to its fair value. Our working assumption is that Hillary Clinton will win the presidential election. A Donald Trump victory may strengthen the safe-haven function of the USD in the very short term, but is likely to lead to an even faster depreciation than we currently expect.

EUR

neutral Sometime in 2017, we expect the European Central Bank to discuss the exit strategy for its current quantitative easing (QE) program. Right now, with many open questions concerning Brexit, the US election risk, and other risk factors impacting markets, we think it is still too early for the ECB to do so. However, once the ECB announces any plans to taper or to end its QE, we would expect the euro to enter an appreciation path. This should be very similar to the US dollar's appreciation when the Fed tapered its own QE program.

GBP

neutral The UK is preparing for exit negotiations with the EU. The prime minister has announced an intention to trigger Article 50 by March 2017. By then, we would expect more clarity about Brexit's impact on the British economy. At current levels, the pound is so strongly undervalued that we see some rebound potential against the USD and a stabilization against the euro over the next 12 months.

CHF

neutral The CHF is near equilibrium against the USD, but it is strongly overvalued against other G10 currencies. We see some room for the USD to rise this year, as the Fed is expected to tighten. In the coming year, we expect the USDCHF exchange rate to remain in the 0.95–1.00 range, and both to weaken against the EUR.

JPY

neutral The Bank of Japan fixed the yield curve by setting the target for the 10-year rate close to zero and by keeping the policy rate at negative 10 basis points. In our view, asset purchases are a better tool to influence the exchange rate than steering the yield curve, simply because manipulating the prices of bonds reduces business opportunities. In particular, it does not promote yen carry trades, which normally would weaken the currency.

Other developed market currencies

neutral We expect the AUD to weaken when the Fed raises rates in December and as coal and iron ore prices fall on rising supply. In light of low Australian inflation, Reserve Bank of Australia (RBA) policy should remain on a dovish tilt. However, the AUD's attractive carry should keep the AUDUSD around 0.74 over the next 12 months. We have closed the preference for the NOK against the EUR as we believe the risks of Norges Bank pushing back against the NOK's strength have increased.

UBS CIO FX forecasts

	3M	6M	12M	PPP*
EURUSD	1.10	1.14	1.20	1.25
USDJPY	104	102	98	78
USDCAD	1.30	1.28	1.25	1.21
AUDUSD	0.72	0.74	0.74	0.70
GBPUSD	1.22	1.28	1.36	1.58
NZDUSD	0.68	0.71	0.71	0.61
USDCHF	0.98	0.98	0.97	1.00
EURCHF	1.08	1.12	1.16	1.25
GBPCHF	1.20	1.26	1.31	1.59
EURJPY	114	116	118	98
EURGBP	0.90	0.89	0.88	0.79
EURSEK	9.50	9.30	9.00	8.99
EURNOK	9.00	8.70	8.70	9.83

Source: Thomson Reuters, UBS, as of 19 October 2016
Note: Past performance is not an indication of future returns.
*PPP = Purchasing Power Parity

Shifting probabilities

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With less than three weeks to go, this year's campaign season is finally drawing to a close amidst widespread voter fatigue. Unfortunately, the incendiary rhetoric has escalated to a level rarely seen in presidential campaigns, while the quality of the policy debate has deteriorated.

We believe the probability of a victory by Hillary Clinton in the November election has increased markedly in recent weeks. Concerns regarding her health have dissipated in the wake of unforced errors by Donald Trump. His vulgar comments regarding unwelcome sexual contact with women over the years undermined efforts to broaden his political base and overshadowed the release of embarrassing e-mails from Hillary Clinton to her advisors. Barring the release of information that would disqualify Secretary Clinton from a national security perspective, we now believe that she will handily defeat Mr. Trump on 8 November.

No sweep

However, we do not expect that a Clinton victory will presage a Democratic sweep of Congress. Republicans have their largest majority in the House of Representatives since 1929. In order for the Democrats to control the House, they would need to win in almost all of the 30 or so competitive congressional districts. This would be a pretty tall task even with a stronger candidate at the top of the ticket. But with Secretary Clinton's high unfavorable ratings and her inability to fully energize the coalition of millennials and minorities who swept President Obama into office, it's likely that her "coattails" will be fairly short ones.

But it's also important to note that there appears to be an impulse to "split-the-ticket" that is clearly reflected in a recent survey of voter preferences. In one poll, a majority of voters said that they would prefer a Republican Congress as a check on a Clinton Administration. This would presumably serve as a means of limiting any tendency to lurch further left after the election and suggests there will be less of a willingness to simply vote the straight party line on 8 November. So while we do expect the GOP to lose some seats in the House, the party can withstand significant losses before their practical control of the legislative agenda is threatened.

The outlook for the Senate is far less certain. Many races are still too close to call. Regardless of which party ekes out a majority, the upper chamber of Congress will be narrowly divided. Taken together, we still believe the prospects for a divided government are exceptionally high. So despite recent speculation that Trump's missteps could open the door for a Democratic "sweep," we still see only a 10% probability that Democrats will gain control of both the executive and legislative branches following the November election. This view is largely validated by the election betting markets, which show an 83% probability of Republicans holding the House.

The Gender Gap widens

While both candidates have ardent supporters, neither is highly regarded by a majority of the American electorate. Secretary Clinton is better positioned than Donald Trump, but as we alluded to earlier, recent polling data suggests that most voters still hold negative views of both individuals. According to the RCP average poll results, Clinton's net favorability rating is -10; Trump's is an extraordinary -26.

Clinton derives an advantage, at least on a relative basis, from a larger base of support among female voters. According to the Pew Research Center, women have voted for Democratic presidential candidates at greater rates than men for the past 35 years. While the disparity in voting preferences has varied over time, Pew reports that women are more likely to support the Democratic ticket by an average margin of eight percentage points. And that 'gender gap' is poised to widen further in this election, to the detriment of the Republican candidate.

One recent poll, whose results were published in *The Atlantic*, showed a 33-point gap among likely female voters. The absence of support for Mr. Trump was particularly stark among women with college degrees. But even among women without a post-secondary education, he garners no more support than does Hillary Clinton. The impact on this year's election is also greater because women vote in greater numbers than do men. The proportion of eligible female voters who actually turned up at the polls has exceeded the rate at which men vote by four percentage points in the last two presidential elections.

The impact is still limited

Despite market concerns of a Democratic sweep, it remains our view that the two parties will still share power following the November elections. And as we discussed in recent editions of *ElectionWatch*, that is not necessarily a bad thing for investors. Since there will be only a few policy areas where the two parties can find common ground, the prospects for abrupt policy shifts that would undermine market stability are also limited.

For more information on how the scenarios in the table below could potentially impact asset classes and sectors, go to our click here.

Summary of the six election outcomes and their impact analyzed in our ElectionWatch series

Scenario	Probability *Current*	Probability *Previous*	President	Senate	House	US equities	US fixed income
1	42.5%	45.0%	Clinton	D	R	+	++
2	15.0%	30.0%	Trump	R	R	– –	– –
3	10.0%	5.0%	Clinton	D	D	– –	–
4	32.5%	19.0%	Clinton	R	R	n	n
5	0.0%	1.0%	Trump	D	R	–	+
6	0.0%	0.0%	Trump	D	D	–	+

Legend

++	Positive
+	Modest positive
n	Neutral
–	Modest negative
– –	Negative

Note: UBS, as of 21 October 2016. UBS US Office of Public Policy, which is separate from UBS CIO Wealth Management Research, provided both the scenarios and the legislative agenda. A probability of 0% is meant to convey our view that the likelihood of this scenario occurring is negligible.

Top themes overview

Our Top themes list represents our currently recommended thematic ideas

e-Commerce: Beyond Amazon

As consumers of traditional retail shift their shopping and spending online, opportunities abound for true omnichannel retailers and related companies. We believe that long-term positive drivers of digital growth, including the rapid adoption of mobile devices, will continue to hasten market share shifts online. We recommend taking a look at select opportunities in consumer-focused industries that take an omnichannel approach and that utilize digital marketing strategies to complement their online efforts.

Short | *Medium* | *Long* | **Decade**

Click for full report

e-Commerce: Beyond Amazon

Golden years for Baby Boomers

The Baby Boomers – who represent almost a quarter of the US population – are aging and entering their retirement years. This generation, by its sheer size, has always had an outsized influence on society. As the Boomers enter into their hard-earned retirement and set out to enjoy their golden years, we expect various segments of the economy to benefit disproportionately, particularly in the healthcare, consumer, and financial sectors.

Short | *Medium* | *Long* | **Decade**

Click for full report

Golden years for Baby Boomers

India – A land of many (re)turns

We believe that Indian equities have the potential to outperform broader emerging markets over the next year. Recent economic data points to a gradual pickup in growth, which should create an environment conducive for a corporate profit revival. Further, valuations look attractive, as markets have priced out any major benefits from reform efforts. We see the potential for a moderate re-rating in recognition of the many credible efforts that the Narendra Modi-led government has already made.

Short | **Medium**

Click for full report

India – A land of many (re)turns

North American energy independence: Reenergized

We see investment opportunities around North America's emerging energy independence. The oil price downturn has been deep and long, but we believe that US producers are competitive on the global stage. We focus on the strongest, best-positioned operators. Oil market fundamentals appear to be improving, which in time, should support resumption of growth in all phases of the US oil and gas business, including energy infrastructure, where capacity is lacking in some regions. Alternative energy suppliers and developers of technologies designed to consume energy more efficiently should also continue to experience growth.

Short | *Medium* | *Long* | **Decade**

Click for full report

North American energy independence: Reenergized

Transformational technologies

We believe there are two areas of technological innovation that will be driving forces behind productivity gains during the next decade. The first is the set of business opportunities around the explosion of digital data. The second is automation and robotics. Both have the potential to transform the structure of our economy, disrupt existing business models, and create opportunities for those well-positioned to participate. Security underpins both digital data and industrial automation, and in our view, is the key enabling technology for the next wave of innovation across both information technology and the industrial sector.

Short | *Medium* | *Long* | **Decade**

Click for full report

Transformational technologies

Top themes overview

Counties at risk

We believe that heightened attention to US local government credits is warranted in an era when the growth in fixed costs associated with pensions and employee healthcare benefits often outpaces revenue growth. While we expect credit ratings to be stable for most county governments as long as the economy continues to gradually grow, we find the credit risks to be unevenly distributed. We recommend repositioning portfolios to limit exposure to county governments with narrow financial positions whose credit may be deteriorating.

Short | *Medium* | **Long**

A copy of this report can be found on the Online Services Research website under Thematic Research.

NEW US senior loans

Our outlook for gradually rising LIBOR rates provides the backdrop for senior loans to perform well in the current environment. Ninety percent of US loans have a LIBOR floor of 98bps, on average. Coupon rates should soon adjust higher as LIBOR increases above that threshold, based on CIO's forecasts (current level: 88bps, six-month forecast of 1.4%). Loans offer a yield of 5.5%, which compares favorably with other fixed income alternatives. Loans also exhibit lower volatility than high yield bonds and equities, which may be beneficial amidst both the upcoming US election and the central bank meetings.

Short | **Medium**

Click for full report
US senior loans

Drivers behind Top themes

Theme name	Resources/ Environment	Innovation/ Technology	Demographics/ Society	Int'l trade and investment	Government/ Regulation	Cyclical factors	Financial industry trends
e-Commerce: Beyond Amazon		✓	✓			✓	
India – A land of many (re)turns	✓			✓	✓	✓	
North American energy independence: reenergized	✓	✓		✓	✓	✓	
Transformational technologies	✓	✓	✓				
US senior loans					✓	✓	
Golden years for Baby Boomers		✓	✓		✓		
Counties at risk			✓		✓	✓	

Source: UBS

Key forecasts

As of 19 October 2016

⊕ Overweight
⊖ Neutral
⊖ Underweight

Asset class	TAA[1]	Change	Benchmark	Value	m/m perf. in %[2]	6-month forecast House View	Positive scenario	Negative scenario
EQUITIES	⊕							
US	⊕	–	S&P 500	2144	-1.0%	2225	2450	1875
Eurozone	⊖	–	Euro Stoxx	330	0.5%	340	375	270
UK	⊖	–	FTSE 100	7022	-0.4%	7225	7800	5750
Japan	⊖	–	Topix	1357	4.4%	1400	1500	1100
Switzerland	⊖	–	SMI	8094	1.2%	8300	9000	7000
Emerging Markets	⊕	–	MSCI EM	913	-0.5%	950	1075	725
BONDS	⊖	–						
US Government bonds	⊖	↘	10yr Treasury yield	1.7%	-0.4%	1.7%	1.2 - 1.5%	1.9 - 2.1%
US Corporate bonds	⊕	–	BAML IG spread	135 bps	-0.6%	150 bps	125 bps	275 bps
US High yield bonds	⊖	–	BAML US HY spread	466 bps	0.0%	550 bps	400 bps	1100 bps
EM Sovereign	⊖	–	EMBI Diversified spread	337 bps	-0.6%	320 bps	280 bps	500 bps
EM Corporate	⊖	–	CEMBI Diversified spread	335 bps	-1.6%	320 bps	280 bps	530 bps
OTHER ASSET CLASSES								
Gold	⊖	–	Spot price	1269 /oz.	-0.6%	1350	1450	1150
Brent crude oil	⊖	–	Spot price	52.67 /bbl.	-8.0%	45	70	30
Listed real estate	⊖	–	RUGL Index	4545	-1.7%	4500	4800	4000
CURRENCIES			Currency pair					
USD	⊖	–		NA	NA	NA	NA	NA
EUR*	⊖	↗	EURUSD	1.10	-1.2%	1.14	NA	NA
GBP	⊖	–	GBPUSD	1.22	-0.3%	1.28	NA	NA
JPY	⊖	–	USDJPY	104	0.1%	102	NA	NA
CHF	⊖	–	USDCHF	0.98	1.4%	0.98	NA	NA

Source: Bloomberg, UBS
[1] TAA = Tactical asset allocation, [2] Month over month
*See CIO Note: *Close Norwegian krone vs. euro position*, 4 Octoboer 2016
Note: Current values as of 19 October 2016. Norwegian krone vs. euro position closed on 4 October 2016.
Past performance is no indication of future performance. Forecasts are not a reliable indicator of future performance.

Detailed asset allocation

taxable with non-traditional assets

Change this month	Investor risk profile	Conservative				Moderately conservative				Moderate				Moderately aggressive				Aggressive			
	All figures in %	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]
	Cash	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
	Fixed Income	**69.0**	**-2.0**		**67.0**	**57.0**	**-2.0**		**55.0**	**46.5**	**-2.0**		**44.5**	**41.0**	**-2.0**		**39.0**	**33.0**	**-2.0**		**31.0**
▼	**US Fixed Income**	**62.0**	**-2.0**	**-2.0**	**60.0**	**51.0**	**-2.0**	**-2.0**	**49.0**	**40.5**	**-2.0**	**-2.0**	**38.5**	**34.0**	**-2.0**	**-2.0**	**32.0**	**26.0**	**-2.0**	**-2.0**	**24.0**
▼	US Gov't	7.0	-4.0	-3.0	3.0	5.5	-5.5	-4.0	0.0	4.0	-4.0	-2.0	0.0	3.5	-3.5	-1.5	0.0	2.0	-2.0		0.0
▲	US TIPS 1–10 years	0.0	+1.0	+1.0	1.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0
▼	US Municipal	50.0	+0.0		50.0	39.0	+0.0		39.0	30.0	-2.0	-2.0	28.0	24.0	-2.5	-2.0	21.5	17.0	-4.0	-4.0	13.0
	US IG Corp	4.0	+1.0		5.0	3.5	+1.5		5.0	3.0	+2.0		5.0	2.5	+2.0		4.5	2.0	+2.0		4.0
	US HY Corp	1.0	+0.0		1.0	3.0	+0.0		3.0	3.5	+0.0		3.5	4.0	+0.0		4.0	5.0	+0.0		5.0
▲	**Int'l Fixed Income**	**7.0**	**+0.0**	**+2.0**	**7.0**	**6.0**	**+0.0**	**+2.0**	**6.0**	**6.0**	**+0.0**	**+2.0**	**6.0**	**7.0**	**+0.0**	**+2.0**	**7.0**	**7.0**	**+0.0**	**+2.0**	**7.0**
▲	Int'l Developed Markets	6.0	+0.0	+2.0	6.0	4.0	+0.0	+2.0	4.0	3.0	+0.0	+2.0	3.0	3.0	+0.0	+2.0	3.0	2.0	+0.0	+2.0	2.0
	Emerging Markets	1.0	+0.0		1.0	2.0	+0.0		2.0	3.0	+0.0		3.0	4.0	+0.0		4.0	5.0	+0.0		5.0
	Equity	**16.0**	**+2.0**		**18.0**	**27.0**	**+2.0**		**29.0**	**34.5**	**+2.0**		**36.5**	**45.0**	**+2.0**		**47.0**	**55.0**	**+2.0**		**57.0**
	US Equity	**9.0**	**+2.0**		**11.0**	**15.0**	**+2.0**		**17.0**	**20.0**	**+2.0**		**22.0**	**26.0**	**+2.0**		**28.0**	**31.0**	**+2.0**		**33.0**
	US Large cap Growth	2.5	+0.5		3.0	4.5	+0.5		5.0	6.0	+0.5		6.5	8.0	+0.5		8.5	9.5	+0.5		10.0
	US Large cap Value	2.5	+0.5		3.0	4.5	+0.5		5.0	6.0	+0.5		6.5	8.0	+0.5		8.5	9.5	+0.5		10.0
	US Mid cap	3.0	+0.5		3.5	4.0	+0.5		4.5	5.0	+0.5		5.5	7.0	+0.5		7.5	8.0	+0.5		8.5
	US Small cap	1.0	+0.5		1.5	2.0	+0.5		2.5	3.0	+0.5		3.5	3.0	+0.5		3.5	4.0	+0.5		4.5
	International Equity	**7.0**	**+0.0**		**7.0**	**12.0**	**+0.0**		**12.0**	**14.5**	**+0.0**		**14.5**	**19.0**	**+0.0**		**19.0**	**24.0**	**+0.0**		**24.0**
	Int'l Developed Markets	4.0	-0.5		3.5	7.0	-1.0		6.0	8.5	-1.0		7.5	11.0	-1.0		10.0	14.0	-1.0		13.0
	Emerging Markets	3.0	+0.5		3.5	5.0	+1.0		6.0	6.0	+1.0		7.0	8.0	+1.0		9.0	10.0	+1.0		11.0
	Commodities	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**5.0**	**+0.0**		**5.0**	**5.0**	**+0.0**		**5.0**
	Non-traditional	**11.0**	**+0.0**		**11.0**	**12.0**	**+0.0**		**12.0**	**15.0**	**+0.0**		**15.0**	**9.0**	**+0.0**		**9.0**	**7.0**	**+0.0**		**7.0**
	Hedge Funds	11.0	+0.0		11.0	12.0	+0.0		12.0	10.0	+0.0		10.0	3.0	+0.0		3.0	0.0	+0.0		0.0
	Private Equity	0.0	+0.0		0.0	0.0	+0.0		0.0	5.0	+0.0		5.0	6.0	+0.0		6.0	7.0	+0.0		7.0
	Private Real Estate	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0

"WMR tactical deviation" legend: Overweight Underweight Neutral "Change" legend: ▲ Upgrade ▼ Downgrade *Refers to moderate-risk profile.
[1]The current allocation column is the sum of the strategic asset allocation and the tactical deviation column.

Source: UBS and WMA AAC, 20 October 2016. See appendix for information regarding sources of strategic asset allocations and their suitability, investor risk profiles, and the interpretation of the suggested tactical deviations from the strategic asset allocations.

Detailed asset allocation

taxable without non-traditional assets

Change this month	Investor risk profile	Conservative				Moderately conservative				Moderate				Moderately aggressive				Aggressive			
	All figures in %	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]
	Cash	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
	Fixed Income	**80.0**	**-2.0**		**78.0**	**66.0**	**-2.0**		**64.0**	**54.5**	**-2.0**		**52.5**	**44.0**	**-2.0**		**42.0**	**33.0**	**-2.0**		**31.0**
▼	**US Fixed Income**	**72.0**	**-2.0**	**-2.0**	**70.0**	**58.0**	**-2.0**	**-2.5**	**56.0**	**47.0**	**-2.0**	**-2.0**	**45.0**	**36.0**	**-2.0**	**-2.0**	**34.0**	**26.0**	**-2.0**	**-2.0**	**24.0**
▼	US Gov't	8.0	-4.0	-3.0	4.0	7.0	-5.5	-4.0	1.5	5.0	-5.0	-3.0	0.0	3.0	-3.0	-1.0	0.0	2.0	-2.0		0.0
▲	US TIPS 1–10 years	0.0	+1.0	+1.0	1.0	0.0	+1.5	+1.5	1.5	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0
▼	US Municipal	58.0	+0.0		58.0	45.0	+0.0		45.0	35.0	-1.0	-1.0	34.0	26.0	-3.0	-3.0	23.0	16.0	-4.0	-4.0	12.0
	US IG Corp	4.0	+1.0		5.0	3.0	+2.0		5.0	3.0	+2.0		5.0	2.0	+2.0		4.0	1.0	+2.0		3.0
	US HY Corp	2.0	+0.0		2.0	3.0	+0.0		3.0	4.0	+0.0		4.0	5.0	+0.0		5.0	7.0	+0.0		7.0
▲	**Int'l Fixed Income**	**8.0**	**+0.0**	**+2.0**	**8.0**	**8.0**	**+0.0**	**+2.5**	**8.0**	**7.5**	**+0.0**	**+2.0**	**7.5**	**8.0**	**+0.0**	**+2.0**	**8.0**	**7.0**	**+0.0**	**+2.0**	**7.0**
▲	Int'l Developed Markets	6.0	+0.0	+2.0	6.0	5.0	+0.0	+2.5	5.0	4.0	+0.0	+2.0	4.0	3.0	+0.0	+2.0	3.0	2.0	+0.0	+2.0	2.0
	Emerging Markets	2.0	+0.0		2.0	3.0	+0.0		3.0	3.5	+0.0		3.5	5.0	+0.0		5.0	5.0	+0.0		5.0
	Equity	**16.0**	**+2.0**		**18.0**	**30.0**	**+2.0**		**32.0**	**40.5**	**+2.0**		**42.5**	**51.0**	**+2.0**		**53.0**	**62.0**	**+2.0**		**64.0**
	US Equity	**9.0**	**+2.0**		**11.0**	**18.0**	**+2.0**		**20.0**	**23.0**	**+2.0**		**25.0**	**29.0**	**+2.0**		**31.0**	**36.0**	**+2.0**		**38.0**
	US Large cap Growth	3.0	+0.5		3.5	5.0	+0.5		5.5	7.0	+0.5		7.5	9.0	+0.5		9.5	11.0	+0.5		11.5
	US Large cap Value	3.0	+0.5		3.5	5.0	+0.5		5.5	7.0	+0.5		7.5	9.0	+0.5		9.5	11.0	+0.5		11.5
	US Mid cap	2.0	+0.5		2.5	5.0	+0.5		5.5	6.0	+0.5		6.5	7.0	+0.5		7.5	9.0	+0.5		9.5
	US Small cap	1.0	+0.5		1.5	3.0	+0.5		3.5	3.0	+0.5		3.5	4.0	+0.5		4.5	5.0	+0.5		5.5
	International Equity	**7.0**	**+0.0**		**7.0**	**12.0**	**+0.0**		**12.0**	**17.5**	**+0.0**		**17.5**	**22.0**	**+0.0**		**22.0**	**26.0**	**+0.0**		**26.0**
	Int'l Developed Markets	4.0	-0.5		3.5	7.0	-1.0		6.0	10.0	-1.0		9.0	12.5	-1.0		11.5	15.0	-1.0		14.0
	Emerging Markets	3.0	+0.5		3.5	5.0	+1.0		6.0	7.5	+1.0		8.5	9.5	+1.0		10.5	11.0	+1.0		12.0
	Commodities	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**5.0**	**+0.0**		**5.0**	**5.0**	**+0.0**		**5.0**	**5.0**	**+0.0**		**5.0**

"WMR tactical deviation" legend: Overweight Underweight Neutral "Change" legend: ▲ Upgrade ▼ Downgrade *Refers to moderate-risk profile.
[1]The current allocation column is the sum of the strategic asset allocation and the tactical deviation column.

Source: UBS and WMA AAC, 20 October 2016. See appendix for information regarding sources of strategic asset allocations and their suitability, investor risk profiles, and the interpretation of the suggested tactical deviations from the strategic asset allocations.

Detailed asset allocation

non-taxable with non-traditional assets

Change this month	Investor risk profile	Conservative				Moderately conservative				Moderate				Moderately aggressive				Aggressive			
	All figures in %	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]
	Cash	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
	Fixed Income	**68.0**	**-2.0**		**66.0**	**56.0**	**-2.0**		**54.0**	**46.5**	**-2.0**		**44.5**	**39.0**	**-2.0**		**37.0**	**33.0**	**-2.0**		**31.0**
▼	**US Fixed Income**	**60.0**	**-2.0**	**-2.0**	**58.0**	**49.0**	**-2.0**	**-2.0**	**47.0**	**40.0**	**-2.0**	**-2.0**	**38.0**	**32.5**	**-2.0**	**-2.0**	**30.5**	**26.0**	**-2.0**	**-2.0**	**24.0**
▼	US Gov't	47.0	-4.0	-3.0	43.0	36.0	-5.0	-3.5	31.0	28.0	-6.0	-4.0	22.0	19.5	-6.0	-4.0	13.5	13.0	-6.0	-4.0	7.0
▲	US TIPS 1–10 years	0.0	+1.0	+1.0	1.0	0.0	+1.5	+1.5	1.5	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0
	US Municipal	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0
	US IG Corp	9.0	+1.0		10.0	7.0	+1.5		8.5	5.0	+2.0		7.0	4.0	+2.0		6.0	2.0	+2.0		4.0
	US HY Corp	4.0	+0.0		4.0	6.0	+0.0		6.0	7.0	+0.0		7.0	9.0	+0.0		9.0	11.0	+0.0		11.0
▲	**Int'l Fixed Income**	**8.0**	**+0.0**	**+2.0**	**8.0**	**7.0**	**+0.0**	**+2.0**	**7.0**	**6.5**	**+0.0**	**+2.0**	**6.5**	**6.5**	**+0.0**	**+2.0**	**6.5**	**7.0**	**+0.0**	**+2.0**	**7.0**
▲	Int'l Developed Markets	6.0	+0.0	+2.0	6.0	4.0	+0.0	+2.0	4.0	3.5	+0.0	+2.0	3.5	2.5	+0.0	+2.0	2.5	2.0	+0.0	+2.0	2.0
	Emerging Markets	2.0	+0.0		2.0	3.0	+0.0		3.0	3.0	+0.0		3.0	4.0	+0.0		4.0	5.0	+0.0		5.0
	Equity	**17.0**	**+2.0**		**19.0**	**28.0**	**+2.0**		**30.0**	**34.5**	**+2.0**		**36.5**	**42.0**	**+2.0**		**44.0**	**53.0**	**+2.0**		**55.0**
	US Equity	**10.0**	**+2.0**		**12.0**	**16.0**	**+2.0**		**18.0**	**20.5**	**+2.0**		**22.5**	**24.0**	**+2.0**		**26.0**	**31.0**	**+2.0**		**33.0**
	US Large cap Growth	3.0	+0.5		3.5	5.0	+0.5		5.5	6.0	+0.5		6.5	7.5	+0.5		8.0	9.5	+0.5		10.0
	US Large cap Value	3.0	+0.5		3.5	5.0	+0.5		5.5	6.0	+0.5		6.5	7.5	+0.5		8.0	9.5	+0.5		10.0
	US Mid cap	2.5	+0.5		3.0	4.0	+0.5		4.5	5.5	+0.5		6.0	6.0	+0.5		6.5	8.0	+0.5		8.5
	US Small cap	1.5	+0.5		2.0	2.0	+0.5		2.5	3.0	+0.5		3.5	3.0	+0.5		3.5	4.0	+0.5		4.5
	International Equity	**7.0**	**+0.0**		**7.0**	**12.0**	**+0.0**		**12.0**	**14.0**	**+0.0**		**14.0**	**18.0**	**+0.0**		**18.0**	**22.0**	**+0.0**		**22.0**
	Int'l Developed Markets	4.0	-0.5		3.5	7.0	-1.0		6.0	8.0	-1.0		7.0	10.0	-1.0		9.0	13.0	-1.0		12.0
	Emerging Markets	3.0	+0.5		3.5	5.0	+1.0		6.0	6.0	+1.0		7.0	8.0	+1.0		9.0	9.0	+1.0		10.0
	Commodities	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**5.0**	**+0.0**		**5.0**	**5.0**	**+0.0**		**5.0**
	Non-traditional	**11.0**	**+0.0**		**11.0**	**12.0**	**+0.0**		**12.0**	**15.0**	**+0.0**		**15.0**	**14.0**	**+0.0**		**14.0**	**9.0**	**+0.0**		**9.0**
	Hedge Funds	11.0	+0.0		11.0	12.0	+0.0		12.0	10.0	+0.0		10.0	8.0	+0.0		8.0	3.0	+0.0		3.0
	Private Equity	0.0	+0.0		0.0	0.0	+0.0		0.0	5.0	+0.0		5.0	6.0	+0.0		6.0	6.0	+0.0		6.0
	Private Real Estate	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0

"WMR tactical deviation" legend: Overweight Underweight Neutral "Change" legend: ▲ Upgrade ▼ Downgrade *Refers to moderate-risk profile.

[1]The current allocation column is the sum of the strategic asset allocation and the tactical deviation column.

Source: UBS and WMA AAC, 20 October 2016. See appendix for information regarding sources of strategic asset allocations and their suitability, investor risk profiles, and the interpretation of the suggested tactical deviations from the strategic asset allocations.

Detailed asset allocation

non-taxable without non-traditional assets

Change this month	Investor risk profile	Conservative				Moderately conservative				Moderate				Moderately aggressive				Aggressive			
	All figures in %	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]
	Cash	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
	Fixed Income	**78.0**	**-2.0**		**76.0**	**65.0**	**-2.0**		**63.0**	**55.0**	**-2.0**		**53.0**	**46.0**	**-2.0**		**44.0**	**36.0**	**-2.0**		**34.0**
▼	**US Fixed Income**	**69.0**	**-2.0**	**-2.0**	**67.0**	**57.0**	**-2.0**	**-2.0**	**55.0**	**47.0**	**-2.0**	**-2.0**	**45.0**	**38.0**	**-2.0**	**-2.0**	**36.0**	**29.0**	**-2.0**	**-2.0**	**27.0**
▼	US Gov't	55.0	-4.0	-3.0	51.0	42.0	-5.0	-3.5	37.0	32.0	-6.0	-4.0	26.0	23.0	-6.0	-4.0	17.0	13.0	-6.0	-4.0	7.0
▲	US TIPS 1–10 years	0.0	+1.0	+1.0	1.0	0.0	+1.5	+1.5	1.5	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0	0.0	+2.0	+2.0	2.0
	US Municipal	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0	0.0	+0.0		0.0
	US IG Corp	10.0	+1.0		11.0	8.0	+1.5		9.5	6.0	+2.0		8.0	4.0	+2.0		6.0	3.0	+2.0		5.0
	US HY Corp	4.0	+0.0		4.0	7.0	+0.0		7.0	9.0	+0.0		9.0	11.0	+0.0		11.0	13.0	+0.0		13.0
▲	**Int'l Fixed Income**	**9.0**	**+0.0**	**+2.0**	**9.0**	**8.0**	**+0.0**	**+2.0**	**8.0**	**8.0**	**+0.0**	**+2.0**	**8.0**	**8.0**	**+0.0**	**+2.0**	**8.0**	**7.0**	**+0.0**	**+2.0**	**7.0**
▲	Int'l Developed Markets	7.0	+0.0	+2.0	7.0	5.0	+0.0	+2.0	5.0	4.0	+0.0	+2.0	4.0	3.0	+0.0	+2.0	3.0	2.0	+0.0	+2.0	2.0
	Emerging Markets	2.0	+0.0		2.0	3.0	+0.0		3.0	4.0	+0.0		4.0	5.0	+0.0		5.0	5.0	+0.0		5.0
	Equity	**18.0**	**+2.0**		**20.0**	**31.0**	**+2.0**		**33.0**	**41.0**	**+2.0**		**43.0**	**50.0**	**+2.0**		**52.0**	**59.0**	**+2.0**		**61.0**
	US Equity	**10.0**	**+2.0**		**12.0**	**18.0**	**+2.0**		**20.0**	**23.0**	**+2.0**		**25.0**	**28.0**	**+2.0**		**30.0**	**33.0**	**+2.0**		**35.0**
	US Large cap Growth	3.0	+0.5		3.5	5.5	+0.5		6.0	7.0	+0.5		7.5	8.5	+0.5		9.0	10.0	+0.5		10.5
	US Large cap Value	3.0	+0.5		3.5	5.5	+0.5		6.0	7.0	+0.5		7.5	8.5	+0.5		9.0	10.0	+0.5		10.5
	US Mid cap	3.0	+0.5		3.5	5.0	+0.5		5.5	6.0	+0.5		6.5	7.0	+0.5		7.5	9.0	+0.5		9.5
	US Small cap	1.0	+0.5		1.5	2.0	+0.5		2.5	3.0	+0.5		3.5	4.0	+0.5		4.5	4.0	+0.5		4.5
	International Equity	**8.0**	**+0.0**		**8.0**	**13.0**	**+0.0**		**13.0**	**18.0**	**+0.0**		**18.0**	**22.0**	**+0.0**		**22.0**	**26.0**	**+0.0**		**26.0**
	Int'l Developed Markets	4.0	-0.5		3.5	8.0	-1.0		7.0	10.0	-1.0		9.0	12.0	-1.0		11.0	14.0	-1.0		13.0
	Emerging Markets	4.0	+0.5		4.5	5.0	+1.0		6.0	8.0	+1.0		9.0	10.0	+1.0		11.0	12.0	+1.0		13.0
	Commodities	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**4.0**	**+0.0**		**4.0**	**5.0**	**+0.0**		**5.0**

"WMR tactical deviation" legend: Overweight Underweight Neutral "Change" legend: ▲ Upgrade ▼ Downgrade *Refers to moderate-risk profile.
[1]The current allocation column is the sum of the strategic asset allocation and the tactical deviation column.

Source: UBS and WMA AAC, 20 October 2016. See appendix for information regarding sources of strategic asset allocations and their suitability, investor risk profiles, and the interpretation of the suggested tactical deviations from the strategic asset allocations.

Detailed asset allocation

all equity and all fixed income models

	All equity				All fixed income, taxable				All fixed income, non-taxable			
All figures in %	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]	Strategic asset allocation	CIO tactical deviation	Change this month	Current allocation[1]
Cash	**5.0**	**-2.0**		**3.0**	**5.0**	**+0.0**		**5.0**	**5.0**	**+0.0**	▼	**5.0**
Fixed Income	**0.0**	**+0.0**		**0.0**	**95.0**	**+0.0**		**95.0**	**95.0**	**+0.0**	▲	**95.0**
US Fixed Income	**0.0**	**+0.0**		**0.0**	**82.0**	**+0.0**	▼	**82.0**	**81.0**	**+0.0**	▼	**81.0**
US Gov't – total market	0.0	+0.0		0.0	9.0	-9.0	▼	0.0	16.0	-2.5	▼	13.5
US Gov't – 1~3 years	0.0	+0.0		0.0	0.0	+0.0		0.0	6.0	-1.5		4.5
US Gov't – 3~7 years	0.0	+0.0		0.0	0.0	+0.0		0.0	14.0	-2.5		11.5
US Gov't – 7~10 years	0.0	+0.0		0.0	0.0	+0.0		0.0	10.0	-1.5		8.5
US TIPS 1~10 years	0.0	+0.0		0.0	0.0	+4.0	▲	4.0	0.0	+4.0	▲	4.0
US MBS	0.0	+0.0		0.0	0.0	+0.0		0.0	9.0	+0.0		9.0
US Munis – total market	0.0	+0.0		0.0	28.0	+0.0	▼	28.0	0.0	+0.0		0.0
US Munis – short duration	0.0	+0.0		0.0	11.0	+0.0		11.0	0.0	+0.0		0.0
US Munis – long duration	0.0	+0.0		0.0	22.0	+1.0		23.0	0.0	+0.0		0.0
US Investment Grade	0.0	+0.0		0.0	5.0	+4.0		9.0	10.5	+4.0		14.5
US High Yield	0.0	+0.0		0.0	7.0	+0.0		7.0	15.5	+0.0		15.5
Int'l Fixed Income	**0.0**	**+0.0**		**0.0**	**13.0**	**+0.0**	▲	**13.0**	**14.0**	**+0.0**	▲	**14.0**
Int'l Developed Markets	0.0	+0.0		0.0	7.0	+0.0	▲	7.0	7.0	+0.0	▲	7.0
Emerging Markets	0.0	+0.0		0.0	6.0	+0.0		6.0	7.0	+0.0		7.0
Equity	**95.0**	**+2.0**		**97.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
US Equity	**54.0**	**+2.0**		**56.0**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
US Large-cap Growth	7.0	+0.5		7.5	0.0	+0.0		0.0	0.0	+0.0		0.0
US Large-cap Value	7.0	+0.5		7.5	0.0	+0.0		0.0	0.0	+0.0		0.0
US Large-cap Total Market	19.0	-3.0		16.0	0.0	+0.0		0.0	0.0	+0.0		0.0
Healthcare	0.0	+3.0		3.0	0.0	+0.0		0.0	0.0	+0.0		0.0
US Mid-cap Equity	14.0	+0.5		14.5	0.0	+0.0		0.0	0.0	+0.0		0.0
US Small-cap Equity	7.0	+0.5		7.5	0.0	+0.0		0.0	0.0	+0.0		0.0
International Equity	41.0	+0.0		41.0	0.0	+0.0		0.0	0.0	+0.0		0.0
Int'l Developed Markets	**23.5**	**-1.0**		**22.5**	**0.0**	**+0.0**		**0.0**	**0.0**	**+0.0**		**0.0**
Global EM Equity	17.5	-5.0		12.5	0.0	+0.0		0.0	0.0	+0.0		0.0
China	0.0	+3.0		3.0	0.0	+0.0		0.0	0.0	+0.0		0.0
India	0.0	+3.0		3.0	0.0	+0.0		0.0	0.0	+0.0		0.0

"WMR tactical deviation" legend: Overweight Underweight Neutral

[1]The current allocation column is the sum of the strategic asset allocation and the tactical deviation column.

Source: UBS and WMA AAC, 20 October 2016. See appendix for information regarding sources of strategic asset allocations and their suitability, investor risk profiles and the interpretation of the suggested tactical deviations from the strategic asset allocations.

Publication note

The All Equity and All Fixed Income portfolios complement our balanced portfolios and offer more granular implementation of our House View. While we generally do not recommend that investors hold portfolios consisting of only stocks or only bonds, the All Equity and All Fixed Income portfolios can be used by investors who want to complement their existing holdings. It is also possible to combine the All Equity portfolio with one of the All Fixed Income portfolios to generate a balanced portfolio. The tactical tilts in the portfolios are based on the corresponding tilts in our balanced portfolios (moderate risk profile, without alternative investments).

A special feature of the All Equity portfolio is that it includes "carve-outs": 3% allocations to our preferred sectors within US large-caps as well as our preferred countries within both international developed markets and the emerging markets. A maximum of two sectors/countries of each type may be selected for carve-outs. The amount of cash in the All Equity portfolio will vary one-for-one with the overall overweight/underweight on equities in the balanced portfolio, subject to a 3% maximum. This allows us to express a tactical preference between stocks and bonds.

The All Fixed Income portfolios include both taxable and non-taxable versions. These are based on the fixed income portion of the balanced portfolios, with the non-taxable version incorporating an additional allocation to Mortgage Backed Securities. In addition, the All Fixed Income portfolios include allocations to government bonds (Munis in the taxable version, Treasuries in the non-taxable version) of different maturities, allowing views on duration to be expressed. Cash is set at 5% of the portfolios, with small deviations possible due to rounding.

Portfolio analytics

The portfolio analytics shown for each risk profile's benchmark allocations are based on estimated forward-looking return and standard deviation assumptions (capital market assumptions), which are based on UBS proprietary research. The development process includes a review of a variety of factors, including the return, risk, correlations and historical performance of various asset classes, inflation and risk premium. These capital market assumptions do not assume any particular investment time horizon. The process assumes a situation where the supply and demand for investments is in balance, and in which expected returns of all asset classes are a reflection of their expected risk and correlations regardless of time frame. Please note that these assumptions are not guarantees and are subject to change. UBS has changed its risk and return assumptions in the past and may do so in the future. Neither UBS nor your Financial Advisor is required to provide you with an updated analysis based upon changes to these or other underlying assumptions.

In order to create the analysis shown, the rates of return for each asset class are combined in the same proportion as the asset allocations illustrated (e.g., if the asset allocation indicates 40% equities, then 40% of the results shown for the allocation will be based upon the estimated hypothetical return and standard deviation assumptions shown below).

You should understand that the analysis shown and assumptions used are hypothetical estimates provided for your general information. The results are not guarantees and pertain to the asset allocation and/or asset class in general, not the performance of specific securities or investments. Your actual results may vary significantly from the results shown in this report, as can the performance of any individual security or investment.

Risk Profile ==>>	Conservative	Moderately conservative	Moderate	Moderately aggressive	Aggressive
Taxable with non-traditional assets					
Estimated Return	4.4%	5.1%	5.9%	6.4%	7.0%
Estimated Risk	5.6%	7.4%	9.6%	11.5%	13.5%
Taxable without non-traditional assets					
Estimated Return	4.0%	4.8%	5.5%	6.1%	6.8%
Estimated Risk	5.4%	7.5%	9.5%	11.5%	13.5%
Non-taxable with non-traditional assets					
Estimated Return	4.3%	5.0%	5.8%	6.4%	7.0%
Estimated Risk	5.5%	7.4%	9.5%	11.4%	13.4%
Non-taxable without non-traditional assets					
Estimated Return	4.0%	4.8%	5.5%	6.1%	6.8%
Estimated Risk	5.4%	7.5%	9.5%	11.4%	13.5%

Asset Class	Capital Market Assumptions	
	Annual total return	Annual risk
US Cash	2.5%	0.5%
US Government Fixed Income	2.2%	4.3%
US Municipal Fixed Income	2.9%	4.7%
US Corporate Investment Grade Fixed Income	3.5%	5.9%
US Corporate High Yield Fixed Income	5.6%	11.7%
International Developed Markets Fixed Income	4.0%	9.0%
Emerging Markets Fixed Income	4.9%	9.1%
US Large-cap Equity	7.5%	16.8%
US Mid-cap Equity	8.4%	19.6%
US Small-cap Equity	8.6%	21.8%
International Developed Markets Equity	8.5%	19.7%
Emerging Markets Equity	10.0%	25.5%
Commodities	6.4%	18.9%
Hedge Funds	6.2%	6.7%
Private Equity	11.8%	24.4%
Private Real Estate	8.5%	11.8%

Additional asset allocation models

US equity sector allocation, in %

For US equity subsector recommendations please see the "Equity Preference List" for each sector. These reports are published on a monthly basis and can be found on the Online Services website in the Research > Equities section.

	S&P 500 Benchmark allocation[1]	CIO WMR tactical deviation[2]				Current allocation[3]
		Numeric		Symbol		
		Previous	Current	Previous	Current	
Consumer Discretionary	12.5	+1.0	+1.0	+	+	13.5
Consumer Staples	9.8	-1.0	-1.0	–	–	8.8
Energy	7.4	+1.0	+1.0	+	+	8.4
Financials	13.1	+0.0	+1.0	n	+	14.1
Health Care	14.4	+2.0	+2.0	++	++	16.4
Industrials	9.7	+0.0	-1.0	n	–	8.7
Information Technology	21.4	+1.0	+1.0	+	+	22.4
Materials	2.9	+0.0	+0.0	n	n	2.9
Real Estate	3.0	+0.0	+0.0	n	n	3.0
Telecom	2.6	-2.0	-2.0	– –	– –	0.6
Utilities	3.3	-2.0	-2.0	– –	– –	1.3

Source: S&P, UBS, as of 20 October 2016
Note: The benchmark allocation, as well as the tactical deviations, are intended to be applicable to the US equity portion of a portfolio across investor risk profiles.

International developed markets (non-US) equity module, in %

	Benchmark allocation[1]	CIO WMR tactical deviation[2]		Current allocation[3]
		Previous	Current	
EMU / Eurozone	28.0	+2.0	+2.0	30.0
UK	20.0	+2.0	+2.0	22.0
Japan	19.0	+2.0	+2.0	21.0
Australia	7.0	+2.0	+2.0	9.0
Canada	9.0	+0.0	+0.0	9.0
Switzerland	8.0	-8.0	-8.0	0.0
Other	9.0	+0.0	+0.0	9.0

Source: UBS, as of 20 October 2016

International developed markets (non-US) fixed income module, in %

The US Taxable Fixed Income Allocation table appears in Fixed Income Strategist, which is published on a monthly basis and can be found in the Fixed Income section of the Online Services Research website.

	Benchmark allocation[1]	CIO WMR tactical deviation[2]		Current allocation[3]
		Previous	Current	
EMU / Eurozone	42.0	-5.0	+0.0	42.0
UK	9.0	+0.0	+0.0	9.0
Japan	32.0	+0.0	+0.0	32.0
Other	17.0	+5.0	+0.0	17.0

Source: UBS, as of 20 October 2016

Footnotes
[1] For the first table on this page, the benchmark allocation is based on S&P 500 weights. For the second and third tables on this page, the benchmark allocation refers to a moderate risk profile and represents the relative market capitalization weights of each country or region.
[2] See "Deviations from strategic asset allocation or benchmark allocation" in the appendix for an explanation regarding the interpretation of the suggested tactical deviations from benchmark. The "current" column refers to the tactical deviation that applies as of the date of this publication. The "previous" column refers to the tactical deviation that was in place at the date of the previous edition of *UBS House View* or the last *UBS House View Update*.
[3] The current allocation column is the sum of the CIO WMR tactical deviation columns and (the S&P 500 benchmark allocation for the first table on this page) (the benchmark allocation for the second and third tables on this page).

Tactical asset allocation performance measurement

The performance calculations shown in Table A commence on 25 January 2013, the first date upon which the Investment Strategy Guide was published following the release of the new UBS WMA strategic asset allocation (SAA) models. The performance is based on the SAA without non-traditional assets for a moderate risk profile investor, and the SAA with the tactical shift (see detailed asset allocation tables where the SAA with the tactical shift is referred to as "current allocation"). Performance is calculated utilizing the returns of the indices identified in Table B as applied to the respective allocations in the SAA and the SAA with the tactical shift. For example, if US Mid Cap Equity is allocated 10% in the SAA and 12% in the SAA with the tactical shift, the US Mid Cap Equity index respectively contributed to 10% and 12% of the results shown. Prior to 25 January 2013, CIO WMR published tactical asset allocation recommendations in the Investment Strategy Guide using a different set of asset classes and sectors. The performance of these tactical recommendations is reflected in Table C.

The performance attributable to the CIO WMR tactical deviations is reflected in the column in Tables A and C labeled "Excess return," which shows the difference between the performance of the SAA and the performance of the SAA with the tactical shift. The "Information ratio" is a risk-adjusted performance measure, which adjusts the excess returns for the tracking error risk of the tactical deviations. Specifically the information ratio is calculated as the ratio of the annualized excess return over a given time period and the annualized standard deviation of daily excess returns over the same period. Additional background information regarding the computation of the information ratio figures provided below are available upon request.

The calculations assume that the portfolios are rebalanced whenever changes are made to tactical deviations, typically upon publication of the Investment Strategy Guide on a monthly basis. Occasionally, changes in the tactical deviations are made intra-month when warranted by market conditions and communicated through an Investment Strategy Guide Update. The computations assume portfolio rebalancing upon such intra-month changes as well. Performance shown is based on total returns, but does not include transaction costs, such as commissions, fees, margin interest, and interest charges. Actual total returns adjusted for such transaction costs will be reduced. A complete record of all the recommendations upon which this performance report is based is available from UBS Financial Services Inc. upon written request. Past performance is not an indication of future results.

Table A: Moderate risk profile performance measurement (25 January 2013 to present)

	SAA	SAA with tactical shift	Excess return	Information ratio (annualized)	Russell 3000 stock index (total return)	Barclays Capital US Aggregate bond index (total return)
25 January 2013 to 31 March 2013	0.79%	0.83%	0.04%	+0.9	5.59%	0.11%
2Q 2013	-2.18%	-2.14%	0.04%	+0.3	2.69%	-2.33%
3Q 2013	3.60%	3.86%	0.26%	+2.4	6.35%	0.57%
4Q 2013	3.05%	3.23%	0.18%	+2.9	10.10%	-0.14%
1Q 2014	2.56%	2.53%	-0.03%	-0.2	1.97%	1.84%
2Q 2014	3.44%	3.49%	0.05%	+0.3	4.87%	2.04%
3Q 2014	-1.54%	-1.71%	-0.16%	-1.2	0.01%	0.17%
4Q 2014	0.47%	0.73%	0.26%	+1.3	5.24%	1.79%
1Q 2015	1.38%	1.69%	0.31%	+2.1	1.80%	1.61%
2Q 2015	-0.18%	-0.19%	-0.01%	-0.1	0.14%	-1.68%
3Q 2015	-4.67%	-5.08%	-0.41%	-2.4	-7.25%	1.23%
4Q 2015	1.61%	1.67%	0.06%	+0.5	6.27%	-0.57%
1Q 2016	2.11%	1.72%	-0.39%	-3.7	0.97%	3.03%
2Q 2016	2.81%	2.88%	0.08%	+1.1	2.63%	2.21%
3Q 2016	2.50%	2.60%	0.10%	+1.5	4.40%	0.46%
4Q 2016 to date	-0.79%	-0.73%	0.06%	+6.4	-1.16%	-0.39%
2016 year to date	6.74%	6.59%	-0.16%	-0.6	6.92%	5.38%
Since inception (25 January 2013)	15.57%	16.03%	0.46%	+0.2	53.53%	10.26%

Source: UBS, as of 19 October 2016

Tactical asset allocation performance measurement

Table B: SAA for moderate risk profile investor, and underlying indices (all figures in %)

25 Jan 2013 to present	
US Large Cap Growth (Russell 1000 Growth)	7.0
US Large Cap Value (Russell 1000 Value)	7.0
US Mid Cap (Russell Mid Cap)	6.0
US Small Cap (Russell 2000)	3.0
International Dev. Eq. (MSCI EAFE)	10.0
Emerging Markets Eq. (MSCI EMF)	7.5
US Government Fixed Income (BarCap US Agg Government)	5.0
US Municipal Fixed Income (BarCap Municipal Bond)	35.0
US Investment Grade Fixed Income (BarCap US Agg Credit)	3.0
US Corporate High Yield Fixed Income (BarCap US Agg Corp HY)	4.0
International Dev. Fixed Income (BarCap Global Agg xUS)	4.0
Emerging Markets Fixed Income (50% BarCap EM Gov and 50% BarCap Global EM (USD))	3.5
Commodities (Dow Jones-UBS Commodity Index)	5.0

Source: UBS

The performance calculations shown in Table C, which start on 25 August 2008 and end on 24 January 2013, have been provided for historical information purposes only. They are based on prior SAAs (referred to as benchmark allocations) with non-traditional assets for a moderate risk profile investor, and on prior SAAs with tactical shifts as published in the Investment Strategy Guide during the same time period. Performance is calculated utilizing the returns of the indices identified in Table D as applied to the respective allocations in the SAA and the SAA with the tactical shift. See the discussion in connection with Table A, previous page, regarding the meanings of the "Excess return" and "Information ratio" columns and how the "Information ratio" column is calculated.

From 25 August 2008 through 27 May 2009, the Investment Strategy Guide had at times published a more detailed set of tactical deviations, whereby the categories "Non-US Developed Equities" and "Non-US Fixed Income" were further subdivided into regional blocks. Only the cumulative recommendations at the level of "Non-US Developed Equities" and "Non-US Fixed Income" were taken into account in calculating the performance shown in Table C opposite. Prior to 25 August 2008, WMR published tactical asset allocation recommendations in the "US Asset Allocation Strategist" using a less comprehensive set of asset classes and sectors, which makes a comparison with the subsequent models difficult.

Note: The performance of our tactical overweight on TIPS will be measured by the Bloomberg Barclays US Inflation Linked Bonds 1 to 10 Year Total Return Index.

Tactical asset allocation performance measurement

Table C: Moderate risk profile performance measurement (25 August 2008 to 24 January 2013)

	Benchmark Allocations (SAA)	Benchmark Allocation (SAA) with tactical shift	Excess return	Information ratio (annualized)	Russell 3000 stock index (total return)	Barclays Capital US Aggregate bond index (total return)
25 Aug 08 to 31 Dec 08	-16.59%	-15.64%	0.96%	+2.0	-29.00%	3.33%
2009 Q1	-5.52%	-5.45%	0.07%	+0.3	-10.80%	0.12%
2009 Q2	11.18%	11.37%	0.18%	+1.0	16.82%	1.78%
2009 Q3	10.44%	11.07%	0.63%	+2.1	16.31%	3.74%
2009 Q4	2.99%	3.30%	0.31%	+1.1	5.90%	0.20%
2010 Q1	2.74%	2.56%	-0.18%	-0.9	5.94%	1.78%
2010 Q2	-4.56%	-4.87%	-0.31%	-1.4	-11.32%	3.49%
2010 Q3	8.34%	7.99%	-0.35%	-2.1	11.53%	2.48%
2010 Q4	5.18%	5.17%	-0.01%	-0.1	11.59%	-1.30%
2011 Q1	3.23%	3.15%	-0.08%	-0.4	6.38%	0.42%
2011 Q2	0.62%	0.47%	-0.16%	-0.9	-0.03%	2.29%
2011 Q3	-7.65%	-8.56%	-0.90%	-2.5	-15.28%	3.82%
2011 Q4	4.66%	4.39%	-0.27%	-0.8	12.12%	1.12%
2012 Q1	5.89%	5.41%	-0.48%	-2.3	12.87%	0.30%
2012 Q2	-1.59%	-1.57%	0.02%	+0.2	-3.15%	2.06%
2012 Q3	4.18%	4.08%	-0.10%	-1.1	6.23%	1.59%
2012 Q4	0.69%	0.65%	-0.04%	-0.7	0.25%	0.21%
01 Jan 13 to 24 Jan 13	2.17%	2.20%	0.03%	+2.5	5.19%	-0.23%
Since inception	24.86%	24.10%	-0.76%	-0.1	31.81%	30.76%

Source: UBS

Table D: SAAs for moderate risk profile investor, and underlying indices (all figures in %)

25 Aug 2008 to 23 Feb 2009		24 Feb 2009 to 24 Jan 2013	
US Large Cap Value (Russell 1000 Value)	12.5	US Large Cap Value (Russell 1000 Value)	11.0
US Large Cap Growth (Russell 1000 Growth)	12.5	US Large Cap Growth (Russell 1000 Growth)	11.0
US Small Cap Value (Russell 2000 Value)	2.0	US Mid Cap (Russell Midcap)	5.0
US Small Cap Growth (Russell 2000 Growth)	2.0	US Small Cap (Russell 2000)	3.0
US REITs (FTSE NAREIT All REITs)	1.5	US REITs (FTSE NAREIT All REITs)	2.0
Non-US Dev. Eq. (MSCI Gross World ex-US)	10.5	Developed Markets (MSCI Gross World ex-US)	10.0
Emerging Markets Eq. (MSCI Gross EM USD)	2.0	Emerging Markets (MSCI Gross EM USD)	2.0
US Fixed Income (BarCap US Aggregate)	30.0	US Fixed Income (BarCap US Aggregate)	29.0
Non-US Fixed Income (BarCap Global Aggregate ex-USD)	8.0	Non-US Fixed Income (BarCap Global Aggregate ex-USD)	8.0
Cash (JP Morgan Cash Index USD 1 month)	2.0	Cash (JP Morgan Cash Index USD 1 month)	2.0
Commodities (DJ UBS total return index)	5.0	Commodities (DJ UBS total return index)	5.0
Alternative Investments (HFRX Equal Weighted Strategies)	12.0	Alternative Investments (HFRX Equal Weighted Strategies)	12.0

Source: UBS

Investment committee

Global Investment Process and Committee description
The UBS investment process is designed to achieve replicable, high quality results through applying intellectual rigor, strong process governance, clear responsibility and a culture of challenge.

Based on the analyses and assessments conducted and vetted throughout the investment process, the Chief Investment Officer (CIO) formulates the UBS Wealth Management Investment House View (e.g., overweight, neutral, underweight stance for asset classes and market segments relative to their benchmark allocation) at the Global Investment Committee (GIC). Senior investment professionals from across UBS, complemented by selected external experts, debate and rigorously challenge the investment strategy to ensure consistency and risk control.

Global Investment Committee composition
The GIC is comprised of 12 members, representing top market and investment expertise from across all divisions of UBS:

- Mark Haefele (Chair)
- Mark Andersen
- Jorge Mariscal
- Mads Pedersen
- Mike Ryan
- Simon Smiles
- Tan Min Lan
- Themis Themistocleous
- Paul Donovan
- Dawn Fitzpatrick (*)
- Bruno Marxer (*)
- Andreas Koester (*)

(*) Business areas distinct from Chief Investment Office/Wealth Management Research

WMA Asset Allocation Committee description
We recognize that a globally derived house view is most effective when complemented by local perspective and application. As such, UBS has formed a Wealth Management Americas Asset Allocation Committee (WMA AAC). WMA AAC is responsible for the development and monitoring of UBS WMA's strategic asset allocation models and capital market assumptions. The WMA AAC sets parameters for the CIO WMR Americas Investment Strategy Group to follow during the translation process of the GIC's House Views and the incorporation of US-specific asset class views into the US-specific tactical asset allocation models.

WMA Asset Allocation Committee composition
The WMA Asset Allocation Committee is comprised of five members:

- Mike Ryan
- Michael Crook
- Richard Hollmann (*)
- Jeremy Zirin
- Stephen Freedman

(*) Business areas distinct from Chief Investment Office/ Wealth Management Research

Explanations about asset classes

Sources of strategic asset allocations and investor risk profiles
Strategic asset allocations represent the longer-term allocation of assets that is deemed suitable for a particular investor. The strategic asset allocation models discussed in this publication, and the capital market assumptions used for the strategic asset allocations, were developed and approved by the WMA AAC.

The strategic asset allocations are provided for illustrative purposes only and were designed by the WMA AAC for hypothetical US investors with a total return objective under five different Investor Risk Profiles ranging from conservative to aggressive. In general, strategic asset allocations will differ among investors according to their individual circumstances, risk tolerance, return objectives and time horizon. Therefore, the strategic asset allocations in this publication may not be suitable for all investors or investment goals and should not be used as the sole basis of any investment decision. Minimum net worth requirements may apply to allocations to non-traditional assets. 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 the strategic asset allocations were derived is described in detail in the publication entitled "UBS WMA's Capital Markets Model: Explained, Part II: Methodology," published on 22 January 2013. Your Financial Advisor can provide you with a copy.

Deviations from strategic asset allocation or benchmark allocation
The recommended tactical deviations from the strategic asset allocation or benchmark allocation are provided by the Global Investment Committee and the Investment Strategy Group within CIO Wealth Management Research Americas. They reflect the 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 strategic allocation. The current allocation is the sum of the strategic asset allocation and the tactical deviation.

Note that the regional allocations on the Equities and Bonds pages in *UBS House View* are provided on an unhedged basis (i.e., it is assumed that investors carry the underlying currency risk of such investments) unless otherwise stated. Thus, the deviations from the strategic asset allocation reflect the views of the underlying equity and bond markets in combination with the assessment of the associated currencies. The detailed asset allocation tables integrate the country preferences within each asset class with the asset class preferences in *UBS House View*.

Scale for tactical deviation charts

Symbol	Description/Definition	Symbol	Description/Definition	Symbol	Description/Definition
+	moderate overweight vs. benchmark	–	moderate underweight vs. benchmark	n	neutral, i.e., on benchmark
++	overweight vs. benchmark	– –	underweight vs. benchmark	n/a	not applicable
+++	strong overweight vs. benchmark	– – –	strong underweight vs. benchmark		

Source: UBS

Appendix

Emerging Market Investments
Investors should be aware that Emerging Market assets are subject to, among others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and sociopolitical 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 US 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," 27 August 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. Subinvestment-grade bonds are recommended only for clients with a higher risk tolerance and who seek to hold higher-yielding bonds for shorter periods only.

Nontraditional Assets
Nontraditional asset classes are alternative investments that include hedge funds, private equity, real estate, and managed futures (collectively, alternative investments). 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. Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments; there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

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-US securities and illiquid investments.
- **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 US dollars, changes in the exchange rate between the US 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 US investor.

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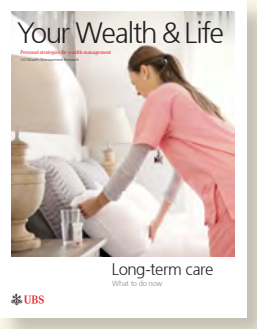

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