UBS Investment Strategy Guide

Re-adjusting our equity exposure

Over the past weeks, we have seen a strong recovery in global equity markets, validating our decision to raise equity exposure in early March. Now, as prices have climbed even somewhat above pre-correction levels in most markets, we have adjusted our equity exposure downwards. We maintain a moderate overweight, but given reduced return expectations as prices have increased, we think that a less aggressive positioning is warranted now.

Core Asset Allocation

During the sell-off in late February and early March, we decided to upgrade our equity exposure, as improved valuations had signaled a more favorable return outlook. We judged that the problems in the US subprime markets and related risks to US growth and earnings did not justify such a strong correction. With hindsight, the decision to upgrade equities proved beneficial as markets have rallied strongly since then. Most markets have even topped their previous highs, with global equities up about 7% from their lows, and some European markets even up more than 10%. Markets in Asia and Latin America also posted strong gains. Looking ahead, these gains have eaten away some of the extra upward potential in equities we identified in early March. We have therefore decided to reduce our equity exposure, but retain a moderate overweight in our asset allocation.

Strategy Changes

Besides the reduction in our equity overweight, we have made some changes to our equity market strategy. We reduced our overweight in emerging markets and the Eurozone, and downgraded Singapore to neutral. These changes were balanced by reduced underweights in Canada and Japan. In fixed income, we adjusted our overall duration allocation upwards, thus reducing our preference for shorter maturities. However, we keep an overall moderate below benchmark duration, which is mainly concentrated in the JPY, CHF, EUR, and SEK markets. For USD bonds we have increased duration to neutral.

Walter Edelmann, Strategist

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Global Asset Class Returns[1]

in %	2006	YTD	next 12 m[2]
Money Market	3.0	1.2	4.1
Government Bonds	0.9	0.4	3.5
Corporate Bonds	3.5	0.7	3.2
Equities[3]	15.5	6.0	7.5

[1]Total returns in local currency, weighted averages of main markets. [2]Expected return in the next 12 months. [3]MSCI.

Sources: Thomson Financial, Bloomberg, UBS WMR, as of 24 April 2007

Core Market Views – hedged[1]

	Bond Portfolio	Equity Portfolio	Currency Overlay
US	+	+	–
Canada	–	–	–
EMU	–	+	+
UK	+	+	n
Switzerland	–	n	+
Sweden	–	n	n
Japan	–	– –	+
Australia	+	–	–
Hong Kong	n.a.	n	n.a.
Singapore	n.a.	n	n.a.
Em. Markets	n.a.	+	n.a.
		Cross asset class	
Global Equities		+	
Global Bonds		-	

Labels: + = moderate overweight, ++ = overweight, +++ = strong overweight, n = neutral, - = moderate underweight, -- = underweight, --- = strong underweight, n.a. = not applicable.

Source: UBS WMR, as of 24 April 2007

[1]Note: The table indicates the relative attractiveness of countries/regions within internationally diversified pure bond and pure equity portfolios respectively. The currency exposure of foreign investments is assumed to be fully hedged (which implies that changes in currencies do not impact performance). Currency considerations are treated separately (see third column).

This report has been prepared by UBS Financial Services Inc. ("UBSFS") and UBS AG

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

Focus: Australia and Global Investment Trends

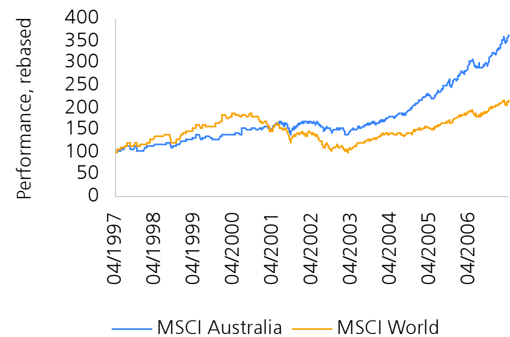
Real Estate Boom, Commodity Boom, Asian Growth: Many of the current global investment trends have impacted the Australian economy more than other countries. In this Focus article we take a closer look how these global themes have worked in the past, and what impact these trends may have in the rest of 2007 – both for Australia and the global markets.

Big performance in a small market

The Australian stock market may be overlooked by many international investors. For example, when Europeans think of Australia, it is often as a great place for a vacation, but not necessarily a great place to invest. However, over the last ten years, the Australian stock market has outperformed the global stock market by more than 5% per year (Fig. 1). At the same time, the volatility of Australian stocks was slightly lower than the volatility of the global market. Even during the latest equity market correction in early March, Australian stocks continued to outperform global stock markets.

Fig. 1: Australian Stock Market Outperformed

Performance of MSCI Australia vs. MSCI World



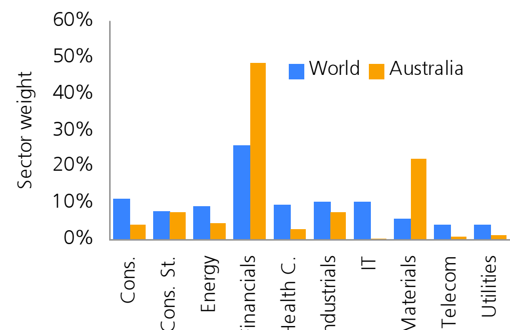
Sources: MSCI, UBS WMR, as of 13 April 2007

Australian stocks helped by real estate and commodity boom

One of the reasons for Australia's strong performance in the past can be seen in Fig. 2. The Australian stock market is overly exposed to the sectors which performed well globally in recent years, and underexposed to those sectors where performance was weak. The commodity boom of the last several years led to very strong performance in the materials sector, and the ongoing boom in listed real estate markets globally also lifted Australian listed real estate companies. These companies make up a significant part of the Financials sector, also shown in Fig. 2, accounting for 11% of the equity market's total capitalization. In a sense, the Australian stock market itself can be seen as a diversified portfolio of underlying exposures to real estate, commodities as well as the more traditional sectors.

Fig. 2: Australian vs Global Sector Composition

Australian market with large exposure to listed real estate and materials companies



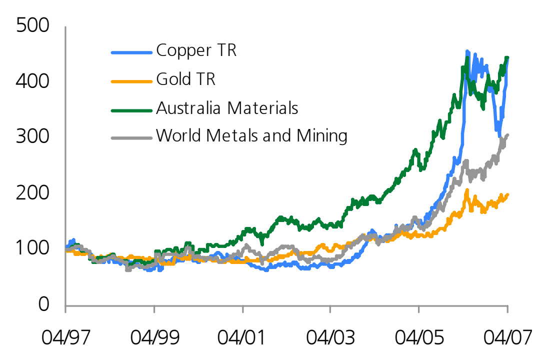
Sources: MSCI, UBS WMR, as of 13 April 2007

Commodity stocks and commodity prices

To be sure, there are important differences between commodity stocks (companies) and direct investments in commodities like copper, zinc, etc. Fig. 3 compares the performance of Australian materials companies – mostly mining companies – with the global mining industry and with a direct investment in gold or copper over the last ten years. It is obvious that while commodity stocks follow the long-term commodity boom, in the short run the performance of commodity companies can be vastly different from direct investments in commodities. This is because share prices of materials companies not only depend on current commodity prices, but finally on their expected earnings streams. Earnings are generated from the sale of commodities but at the expense of production costs, and may depend for example on softer issues like the quality of management. These factors tend to dilute the link between commodity prices and commodity stock performance.

Fig. 3: Commodity Stocks vs Commodity Returns

Commodity stocks do not always mirror commodity prices



Sources: Dow Jones AIG, MSCI, UBS WMR, as of 13 April 2007

Commodities outlook

We expect commodity prices generally to remain elevated in 2007. We think metals' prices should continue to rise as inventories at the London Metal Exchange (LME) remain at critically low levels and we think supplies are likely to remain constrained. Demand for copper and other metals has remained firm, especially due to increased buying by China. While, at the beginning of the year, the prospects of a US economic

slowdown eroded the market's confidence in the demand prospects for base metals, the fundamental conditions for base metals have remained firm.

Regarding energy commodities, we note that relatively high US crude oil inventories are due to imports and not a lack of supply. OECD inventories are at their lowest levels in the last 10 years. Finally, we think that weather related factors, such as the hurricane season, could add a premium to energy prices, irrespective of whether a heavy storm season materializes or not. We expect no change in the price premium stemming from potential geopolitical tensions in the Middle East.

Listed real estate stocks boom

Listed real estate companies have experienced strong investment inflows lately from institutional and private investors around the world, who wanted to diversify into this asset class. As a result, global real estate has become pricey, and investor sentiment about growth prospects seems to be playing a role, especially during the past two years. Investors seem more optimistic, as seen by the widening blue area in Fig. 4, which shows the increasing value ascribed to future growth as part of the total investment in Australian listed real estate.

However, many listed real estate companies learned their lessons from previous boom and bust cycles. In the 1980s Australia experienced a real estate boom as interest rates declined, making it more attractive to develop new property. Other factors such as market deregulation also added to this boom. As a result, more developments were made than were actually needed in the market. This oversupply, together with gradually rising interest rates and other local factors, led to declining real estate markets and a burst of the Australian real estate bubble in the 1990s.

What is different in this real estate boom

Today, global listed real estate companies face a similar boom-like situation in that low global interest rates are spurring construction activities and more aggressive financing. However, we think that construction activity is not excessively speculative in most regions. Indeed, we think that additional office space in Australia, and globally, will meet growing demand from financial institutions and other service businesses around the world. Furthermore, listed real estate companies increasingly are changing their business model to become less dependent on traditional sources of income such as rents, thus increasing their future growth opportunities (Fig. 5). New sources of income changes company risk profiles, making them less sensitive to declining rental income. Hence we think that, despite elevated valuations, listed real estate companies may still be an interesting asset class throughout the rest of 2007.

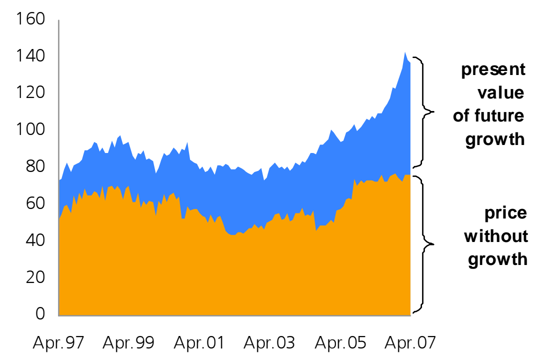
Economic strength drives the Australian stock market

Another important reason for the resilience of the Australian stock market has been extraordinary macroeconomic stability. In 2007 Australia will be heading into its sixteenth year of economic expansion. While other industrialized countries have experienced one or two recessions in the same period, Australia kept on growing at a positive rate. In a global rating of economic resilience, Australia has ranked at the top spot for several years now (Fig. 6).

This stability has partly been a result of the strong growth in Asia and the shift it has brought about in Australia's in exports throughout the last decade. Australia's main exports are commodities from the coun-

Fig. 4: Australian Listed Real Estate

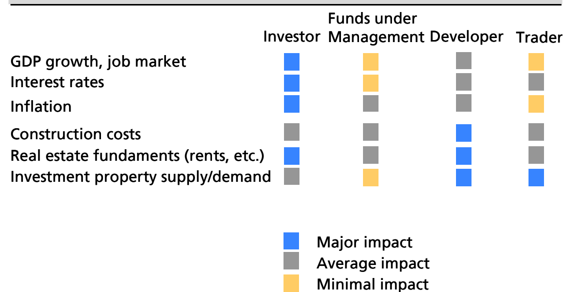
A lot of future growth opportunities are already priced in



Sources: Thomson Financial, UBS WMR, as of 13 April 2007

Fig. 5: Real Estate Business Models

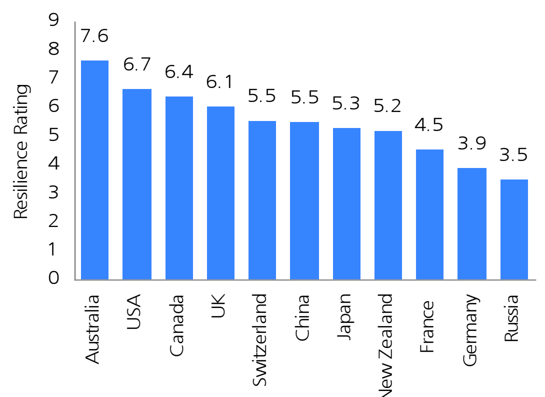
Four different business models and the impact of economic drivers on these business models



Source: UBS WMR, as of 13 April 2007

Fig. 6: Resilience of Economy to Economic Cycles

Australia ranked best of 51 countries

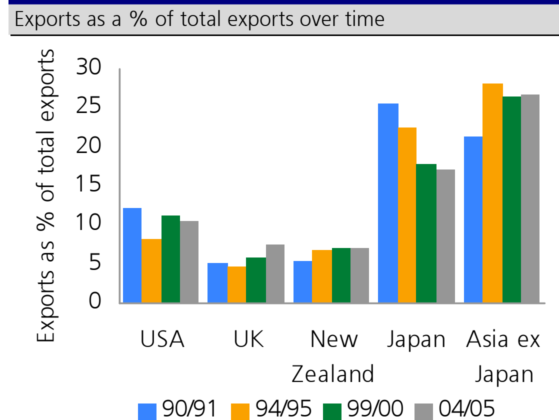


Sources: IMD World Competitiveness Yearbook 2005, UBS WMR, as of 13 April 2007

try's mines, which make up about one third of total exports. The rapidly growing economies of Asia, rather than Japan or the US, have been consuming more of Australia's exports over the last decade (Fig. 7). We think this trend is likely to continue in the future as well.

Fig. 7: Exports to Asia Dominate

Exports as a % of total exports over time



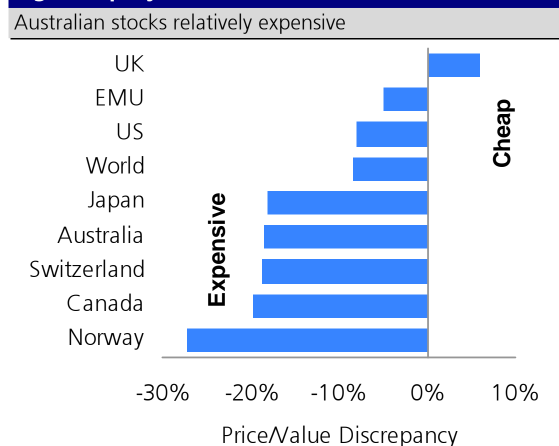
Sources: ABS, DFAT, UBS WMR, as of 13 April 2007

Valuations stretched for Australian equities

Of course, everything has its price and economic success has already had an impact, stretching the valuations of Australian stocks. Our dividend discount model shows that Australian stocks are among the most expensive globally, together with Canada and Norway, both markets that have profited strongly from high energy prices. This expensive valuation leads us to underweight Australia and Canada in our global equity market strategy.

Fig. 8: Equity Market Valuation

Australian stocks relatively expensive



Source: UBS WMR, as of 13 April 2007

Future Fund as additional demand factor

However, any eventual underperformance in Australia may be mitigated by new demand for Australian equities from the future fund. In response to the under-funded governmental superannuation liabilities and evolving demographic changes, the Australian government established the Future Fund with the purpose of offsetting governmental liabilities by 2020. Except for an AUD 9bn stake in the country's largest telecommunication company, the fund currently holds AUD 41bn AUD in cash and should start investing as soon as next month. Depending on the asset allocation of the fund, this might result in additional AUD 14bn flowing into the market, which is approximately 1% of total market capitalization.

Conclusions

Listed real estate investments and commodities are likely to continue to do well in 2007, albeit growing at a somewhat slower pace than in the last few years. We also note that due to more demanding price levels, risks for temporary setbacks have increased. As a special case, Australia is likely to profit indirectly from the ongoing commodity boom and the growth in Asia as well as in the real estate sector. Yet one should be careful not to confuse a good economy with a good (equity) investment.

We are convinced that current expensive valuations for Australian equities, as well as other, commodity-driven countries like Canada, will be brought back in line with global levels over time. Special demand factors in Australia like fund-buying may counteract these effects in the short-run but we do not think they are likely to dominate in the longer term.

Overall, we recommend that investors interested in investing in commodities to pursue direct investments rather than indirect structures via equity market exposure. Given continued growth in the global economy, we think real estate and commodities remain opportunities which should be explored in the context of a well-diversified portfolio.

Joachim Klement, Strategist
Ioannis Drikos, Strategist

Economic Outlook: Asia is strong

While the US should record a rather tame first-quarter growth rate in 2007 and Europe is doing fine, China continues to boom. We have also revised our Japanese growth rate upward.

Growth: We have not changed our growth forecasts for the US and Europe. As we predicted, the US continues to show signs of weakening and we should see a growth rate below 2% in Q1 2007, which will be the fourth quarter in a row with sub-trend growth. The Eurozone data are more or less in line with our current solid 2.5% growth forecasts for 2007. We had to revise Japan slightly upward due to better–than-expected activity indicators in the first three months of the year. Now we expect Japan to have the same 2% growth rate as the US. It may well be that, for the first time since 2001, both the Eurozone and Japan post higher growth than the US in 2007. The single outperformer in terms of growth, however, remains China, which grew by 11.1% in Q1 2007. This astonishing result has led us to revise the Chinese growth upward to 10.4% in 2007 and 10.6% in 2008.

Inflation: We are far less concerned about inflation than most market participants, especially with regards to the US. While currently we still see above-average inflation there, even in the core rate, the base effects that may materialize in the coming months should restrain this rate to 2%. In Europe, inflation seems well under control. The only area of major concern we currently have is China, where inflation accelerated from 2.2% in January to 3.3% in March. This led us to revise our inflation outlook upward for the whole of 2007, and we now expect 3.1% on average.

Short-term Interest Rates: We expect far more rate cuts from the Fed than the current market consensus. Fed fund rates could go as low as 3.75% by the end of 2008, in our view. The trigger for this will be an increase in the unemployment rate, which always lags a little bit behind the rest of the business cycle, but we believe this will occur in the next couple of months. We forecast more rate-hiking by the European Central Bank than the markets generally expect: two hikes as opposed one in the next twelve months.

Bond Yields: In our view bond yields should continue evolving in tight ranges over the next twelve months. Both retreating or stabilizing inflation rates as well as slowing growth rates support this scenario. A more restrictive Chinese monetary policy represents another risk factor, we note, given the accelerating inflation there. This could lead to some selling of international bonds held by China as part of its foreign reserves or at least a reduced demand for them.

Andreas Hoefert, Economist

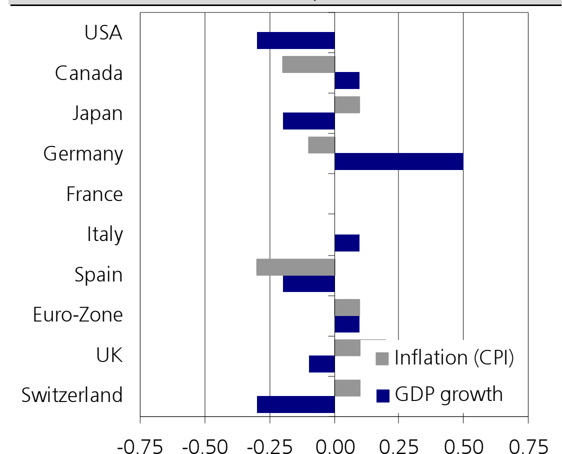
Growth and Inflation Forecasts

in %	GDP Growth			Inflation		
	'06	'07 F[2]	'08 F[2]	'06	'07 F[2]	'08 F[2]
World	5.2	4.6	4.8	3.6	3.4	3.4
US	3.3	2.0	2.0	3.2	2.1	2.4
Canada	2.9	2.5	2.7	2.1	1.8	1.8
Japan	2.1	2.0	1.8	0.2	0.1	0.5
Euro-Zone	2.7	2.5	2.2	2.2	1.9	1.8
Germany	2.7	2.6	2.0	1.7	2.0	1.5
France	2.0	2.0	1.8	1.7	1.5	1.7
Italy	2.0	1.9	1.4	2.1	1.9	2.1
Spain	3.8	3.3	2.7	3.5	2.8	2.6
UK	2.7	2.5	2.2	2.3	2.1	1.8
Switzerland	2.8	1.8	2.0	1.1	0.4	0.8
China	10.7	10.4	10.6	1.4	3.1	3.3
Asia / Pacific[1]	9.0	7.8	7.8	6.0	5.5	4.0

[1]Excluding Japan. [2]E: estimate, F: forecast.
Source: UBS WMR, as of 24 April 2007

Main Economic Forecasts

Deviations from consensus in %-points; for 2007



Sources: Consensus Economics, UBS WMR, as of 24 April 2007

Interest Rate and Exchange Rate Forecasts

in %	Short rates (3m) in		Bond yields (10y) in		USD rate[1] in	
	6 m	12 m	6 m	12 m	6 m	12 m
US	4.70	4.00	4.50	4.70	1.00	1.00
Canada	4.20	4.30	4.20	4.20	1.16	1.18
Japan	0.90	1.10	1.80	1.90	114	110
Euro-Zone	4.50	4.50	4.20	4.30	1.36	1.30
UK	5.70	5.50	4.80	4.70	0.52	0.53
Switzerland	2.50	2.50	2.70	2.80	1.18	1.20

[1]USD exchange rate.
Source: UBS WMR, as of 24 April 2007

Extended Asset Allocation: Reducing our equity overweight

In March, we tactically increased our exposure to equities as we did not find the scale of the sell-off in equity markets justified. After the most recent rally in equities, we have re-adjusted our equity overweight to a moderate overweight.

Money market and inflation-protected securities: Given that we expect to see inflation risk moderating with a slowing global economy, we do not see added value in inflation-linked securities currently. For money markets, we recommend a neutral allocation.

Fixed Income: We have an overall moderate underweight for fixed income classes. For High Yield we recommend a slightly larger underweight position as it is relatively expensive. Less rapidly growing earnings and tightening lending standards for US companies indicate the risk of some deterioration in credit fundamentals, which should feed into rising credit spreads.

We have convertible bonds on a moderate overweight. This reflects our preference for equities as opposed to fixed income investments. Furthermore, implied volatility levels have already returned to low levels after the most recent spike.

Equities: The exposure to equities was tactically increased in March following the large sell-off in global equity markets. As markets rallied strongly over the last month, we now reduce our equity overweight to a moderate overweight, in line with our core asset allocation. However, we continue to view equities as the most attractive asset class for 2007.

Non-traditional assets: Listed Real Estate performed strongly in recent years. We view valuations in this asset class as being stretched now, but, as demand continues to be high, we recommend a neutral allocation. We also continue to recommend a neutral allocation in commodities. Seasonal patterns are turning in favor of commodities and inventory levels have fallen, but roll-yields are currently unfavorable for commodity investments, in our view.

Mark Andersen, Strategist

Performance Asset Classes

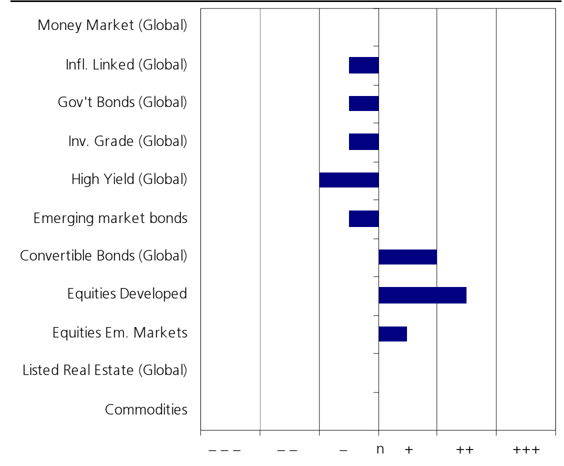
in %	Strategy[1]	2006	YTD[2]
Money Market (Global)	n	3.0	1.2
Fixed Income			
Infl. Linked (Global)	–	7.1	2.1
Gov't Bonds (Global)	–	0.9	0.4
Inv. Grade (Global)	–	3.5	0.7
High Yield (Global)	–	11.8	3.9
Emerging market bonds	–	9.9	3.3
Convertible Bonds (Global)	+	15.3	5.4
Equities			
Equities Developed	++	15.5	6.0
Equities Em. Markets	+	28.6	7.0
Non-traditional Assets			
Listed Real Estate (Global)	n	36.9	6.4
Commodities	n	2.1	5.9

[1]Labels: please see appendix. [2]YTD=year-to-date. MSCI total return indices for equities, JP Morgan indices for govt. bonds, Merrill Lynch for corporate bonds; all data in local currencies..

Sources: Bloomberg, Thomson Financial, UBS WMR

Extended Asset Allocation Strategy

Deviations from benchmark[1]



[1]Labels: please see appendix.

Source: UBS WMR, as of 24 April 2007

Currency Strategy: Still against carry

We maintain our moderate anti-carry stance as valuations for high yielding currencies are streched. Good growth news outside the US translated into a strong appreciation of the AUD and CAD relative to the USD. We maintain the view that European currencies should still somewhat outperform North American ones.

US Dollar (moderate underweight): We think the USD looks undervalued versus the CAD and the EUR, and overvalued versus the JPY. However, the weak economy should continue to weigh on the USD, mainly against Asian currencies.

Canadian Dollar (moderate underweight): We find the CAD is still somewhat expensive. A CAD position is, with a slight time lag, an indirect exposure to a weakening US economy and to the oil market.

Japanese Yen (moderate overweight): The JPY is relatively cheap. We think the yen's popularity for financing carry trades should wane as interest rates finally rise in an expanding economy. Current JPY weakness looks overdone in our view.

Euro (moderate overweight): We think the EUR is expensive relative to the USD. However, we expect it to show some strength in the early part of the year relative to the USD due to better cyclical momentum.

Swiss Franc (moderate overweight): From a fundamental standpoint, the CHF is inexpensive and should appreciate against the EUR. Price pressure and higher yields in the rest of Europe are risks to this positioning.

Swedish Krona (neutral): The SEK's valuation remains modestly attractive. In addition, we expect the interest-rate differential with the euro to probably tighten.

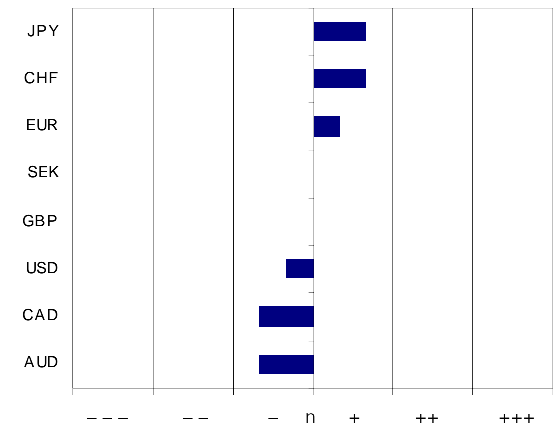
British Pound (neutral): The GBP looks expensive relative to the USD. Although the GBP now offers a higher yield than the USD, this might not be sufficient to compensate for the valuation gap. The GBP’s valuation relative to the EUR is slightly expensive.

Australian Dollar (moderate underweight): We expect monetary policy in Australia to be less supportive of its currency than assumed by consensus. The AUD offers a high yield, though this is likely not enough to compensate for the currency related risk; given stretched valuations.

Sebastien Galy, Strategist

Currency Strategy

Deviations from benchmark[1]



[1]Labels: please see appendix.
Source: UBS WMR, as of 24 April 2007

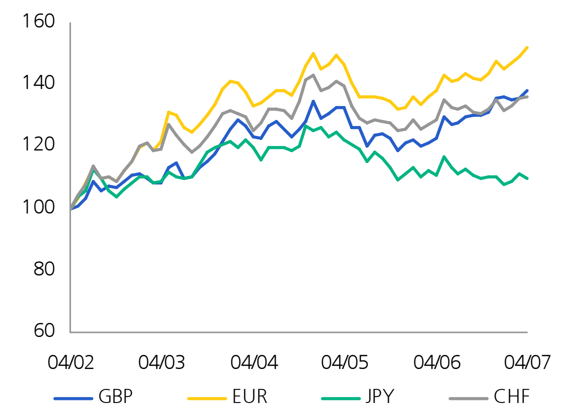
Currency Market Returns against the USD[1]

	Strategy[2]	Market Returns in % 2006	YTD[3]
CAD	–	-0.2	3.9
EUR	+	11.5	2.9
GBP	n	13.6	2.1
CHF	+	7.9	0.8
SEK	n	16.0	1.2
JPY	+	-1.0	0.4
AUD	–	7.7	5.5

[1]Exchange rate changes in %: a positive number indicates gains against the USD. [2]Labels: please see appendix. [3]YTD = year-to-date.
Sources: Thomson Financial, UBS WMR, as of 24 April 2007

Exchange Rate Development

Normalized exchange rates vs. USD



Sources: Thomson Financial, UBS WMR, as of 24 April 2007

Equity Market Strategy: Stick to value

We have slightly adjusted our equity market strategy, but continue to prefer the more attractively valued markets in Europe and the US over the relatively more expensive markets of Canada, Australia or Japan.

North America

United States (moderate overweight): We find the US market is trading at slightly stretched valuations. Earnings continue largely to meet expectations, with no signs of further deterioration. The market now seems to price in a scenario that is close to our expectations for single-digit earnings growth in 2007. We think that Fed easing in the summer could trigger possible expansion in P/E ratios.

Canada (moderate underweight): The Canadian market is expensively valued. Corporate earnings are above trend and vulnerable to a deteriorating macroeconomic environment in Canada and the US. Despite higher oil prices over the past month, Canadian equities performed roughly in line with global markets.

Europe

EMU (moderate overweight): Despite good relative performance, EMU equity valuations are still attractive in comparison to the other regions. Earnings momentum is still strong, but earnings expectations have become too upbeat recently. We have slightly reduced our relative preference for the market, as earnings sentiment is now tending towards rather optimistic levels, in our view.

United Kingdom (moderate overweight): We think the UK market is one of the most attractively valued markets globally. However, as some companies still seem to be less competitive than their international counterparts, we retain only a moderate overweight.

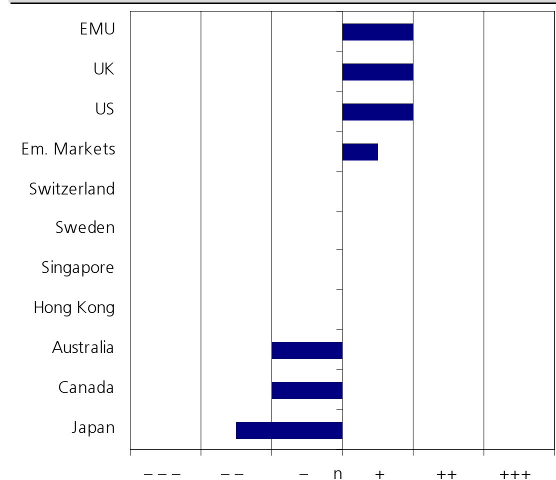
Switzerland (neutral): While Swiss valuations are becoming demanding, this is compensated by significant exposure to globally operating companies in our favorite sectors: Health Care, Consumer Staples, and Financials. Company earnings have remained solid.

Sweden (neutral): The Swedish market is one of the more expensive markets according to our valuation model. At the same time the market is very export oriented and is likely to profit from current strong economic environment in Europe and Asia.

Joachim Klement, Strategist

Equity Market Strategy - hedged[1]

Deviations from benchmark[2]



[1]These strategy weightings are currency hedged; i.e. they do not take into account risks due to the related currency exposure. [2]Labels: please see appendix.

Source: UBS WMR, as of 24 April 2007

Equity Markets

	Strategy[3]	Market Returns in % 2006	YTD[4]
US[1]	+	14.8	5.3
S&P 500[2]		13.1	4.4
DJ Industrial[2]		15.6	3.7
Nasdaq[2]		8.9	4.5
Canada[1]	–	17.5	5.7
S&P TSX comp.[2]		14.3	5.6
EMU[1]	+	21.8	8.6
Euro Stoxx 50[2]		13.9	6.8
UK[1]	+	14.2	5.7
FTSE 100[2]		10.3	4.2
Switzerland[1]	n	18.2	8.6
SMI[2]		15.3	7.4
Sweden[1]	n	23.7	13.6
Japan[1]	– –	6.5	2.3
Nikkei 225[2]		5.4	1.3
Australia[1]	–	23.0	10.8
ASX[2]		18.0	9.5
Hong Kong[1]	n	29.7	4.4
Hang Seng[2]		42.8	3.4
Singapore[1]	n	35.6	14.9
Em. Markets[1]	+	28.6	7.0
Overall	+	15.5	6.0

[1]MSCI total return index in local currency. [2]Price indices excluding dividend payments. [3]Labels: please see appendix. [4]YTD = year-to-date. All data in local currencies.

Sources: Thomson Financial, UBS WMR, as of 24 April 2007

Japan (underweight): We maintain our underweight position on Japan given that valuation multiples in Tokyo exceed those in the rest of the world and earnings in Japan are not growing any faster than in the US or Europe. Finally, the Japanese market barely moved in recent weeks despite renewed net buying by foreign investors on a substantial scale.

Thomas Kruemmel, Strategist

Australia (moderate underweight): We find valuations in the Australian equity market expensive and we think these high valuations should correct in the medium term. However, the Australian equity market faces substantial inflows due to regulatory changes and investments by the government "future fund," which poses some risk to our moderate underweight.

Joachim Klement, Strategist

Valuation and Profitability Ratios

	P/E[1]	P/BV[2]	ROE[3]	DY[4]
Australia	15.46	3.04	19%	3.55
Canada	15.52	2.77	17%	2.04
EMU	13.48	2.28	15%	2.79
Hong Kong	15.37	1.98	10%	2.62
Japan	17.51	2.07	10%	1.10
Singapore	17.62	2.27	13%	2.02
Sweden	15.44	3.06	20%	2.55
Switzerland	14.91	3.13	18%	1.83
US	15.59	2.87	17%	1.83
UK	13.06	2.70	20%	3.26

[1]Price-to-earnings ratio (12m forward). [2]Price-to-book value. [3]Return on equity. [4]Dividend Yield.

Sources: I/B/E/S Thomson Financial, UBS WMR, as of 24 April 2007

Volatility Outlook

After the market turbulences in early March, implied volatility has settled down again while realized volatility remains rather elevated in Europe and Japan. We expect realized volatility to decrease from its current high levels, but we do not anticipate seeing it return to its former, historically low levels. In the US, realized volatilites are likely to increase if the Fed starts cutting interest rates in summer.

Joachim Klement, Strategist

Volatility Outlook

in % p.a.		Model Forecast		
Implied Volatility	Current	in 1 m	in 6 m	in 12 m
S&P 500	12.7	18.3	17.8	18.1
Dax	15.2	18.4	19.5	20.3
SMI	12.5	15.8	16.6	17.2
Nikkei 225	16.8	18.9	15.7	18.8
Realized Volatility				
S&P 500	9.3	11.8	12.9	13.2
Dax	16.6	13.9	16.1	17.3
SMI	15.7	13.0	13.9	14.3
Nikkei 225	18.0	15.6	18.3	18.9

Sources: Thomson Financial, Bloomberg, UBS WMR, as of 24 April 2007

Global Equity Sector Strategy: Eyes on earnings

We favor Health Care and Consumer Staples for their attractive valuations and improving relative earnings growth. We also believe there are opportunities in one of the most cyclical equity sectors, Information Technology, where we expect earnings to grow above the market average.

Consumer Discretionary (underweight): Expensive valuations and high earnings expectations imply the risk that downward revisions will continue.

Consumer Staples (moderate overweight): Consumer Staples is attractive due to its defensive growth characteristics. Within the sector, we favor Household and Personal Products.

Energy (moderate overweight): Attractive valuations. Rising costs challenge earnings growth, but we believe that the current discount to the market is too wide.

Financials (moderate overweight): Q1 07 solid earnings delivered by US Financials have reduced the concerns stemming from the subprime sector. In Europe, M&A activity has driven prices higher.

Health Care (moderate overweight): Health Care is attractively valued. Earnings growth expectations for 2007 are solid and improving relative to the market average.

Industrials (neutral): We overweight US Industrials, as we believe they should provide consistent earnings and dividend growth. We underweight EMU Capital Goods based on expensive valuations.

Information-Technology (overweight): We favor Semiconductors. They are currently trading at relatively attractive valuations. We expect earnings growth to remain healthy this year.

Materials (moderate underweight): We think Materials are particularly expensive. In fact, the sector is giving signs of decoupling from its fundamentals at present.

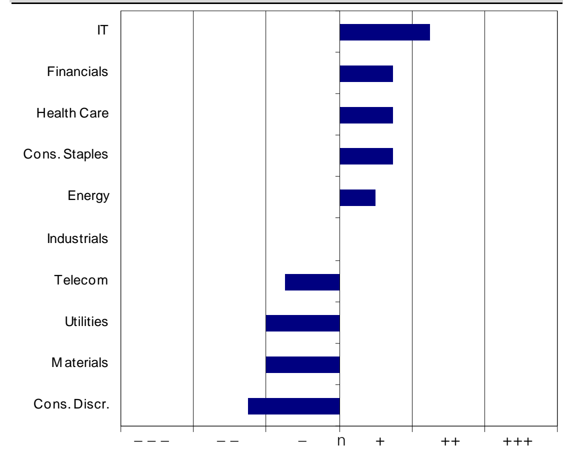
Telecom (moderate underweight): Valuations are expensive and we believe earnings expectations might not be met by actual results.

Utilities (moderate underweight): The sector is trading at unattractive levels. Earnings estimates are in line with the market average and revisions have flattened out.

Silvia Quaglinibarbi, Strategist
Julio Giro, Strategist

Equity Sector Strategy – Global

Deviations from benchmark[1]



[1]Labels: please see appendix.
Source: UBS WMR, as of 24 April 2007

Equity Sectors – Global

		Market Returns in %		
	Strategy[1]	2006	YTD[2]	last 5 y
Cons. Discr.	– –	16.8	5.0	40.0
Cons. Staples	+	15.1	7.9	41.9
Energy	+	13.1	5.6	93.4
Financials	+	18.3	3.8	68.0
Health Care	+	6.8	6.7	27.0
Industrials	n	14.7	9.0	75.3
IT	++	7.5	3.3	23.2
Materials	–	22.1	11.0	113.2
Telecom	–	24.8	6.6	46.5
Utilities	–	29.5	9.2	99.9

[1]Labels: please see appendix. [2]YTD = year-to-date; MSCI in local currencies.
Sources: Thomson Financial, UBS WMR, as of 24 April 2007

Valuation and Profitability Ratios

Global Sectors:	P/E[1]	P/BV[2]	ROE[3]	DY[4]
Cons. Discr.	17.82	2.50	11%	1.51
Cons. Staples	18.21	3.86	19%	2.13
Energy	12.14	2.77	25%	2.26
Financials	12.55	2.00	15%	2.84
Health Care	17.07	3.69	19%	1.84
Industrials	15.93	2.92	16%	1.86
IT	19.27	3.66	15%	0.84
Materials	13.52	2.73	18%	1.77
Telecom	15.60	2.19	12%	3.42
Utilities	16.44	2.39	13%	3.09

[1]Price-to-earnings ratio (12m forward). [2]Price-to-book value. [3]Return on equity. [4]Dividend Yield.
Sources: I/B/E/S, Thomson Financial, UBS WMR, as of 24 April 2007

See also our Equity Strategist publications available for EMU and US

Fixed Income Strategy: Reduce short duration stance

Long-term interest rates increased over the last month. In Europe, this is mainly a reflection of strong economic indicators and signals from the central banks that point to further rate hikes. In the US, the Fed emphasized inflation risk, which increased inflation concerns.

We expect that the market's focus shifts back to more forward-looking indicators like order statistics and consumer and business sentiment in the coming weeks. Especially in the US, these indicators have been somewhat below consensus recently. As a consequence, we have reduced our global duration underweight position. Duration in USD bonds is increased to benchmark level (neutral allocation).

USD (moderate overweight): If the US economy weakens further, as we expect, the market might anticipate more Fed cuts soon. However, given the fairly low level of long-term interest rates, return potential is limited.

CAD (moderate underweight): Expensive valuation. CAD rates are below USD rates. Convergence of economic growth and interest rates with USD numbers is unfavorable for CAD bonds, in our view.

AUD (moderate overweight): Neutral valuation. Although, retail sales and the labor market were strong, bond investors might still be expecting too much tightening by the central bank.

JPY (moderate underweight): Expensive valuation. The market expects any future rate increases by the Bank of Japan to be very gradual, which opens up room for upward surprises.

EUR (moderate underweight): We think the spread between USD and EUR bonds should continue narrowing as growth rates converge. This is unfavorable for EUR bonds, in our view.

SEK (moderate underweight): SEK and EUR bonds are close substitutes and we think this is unlikely to change in the foreseeable future. Valuation is somewhat more favorable for SEK than for EUR bonds.

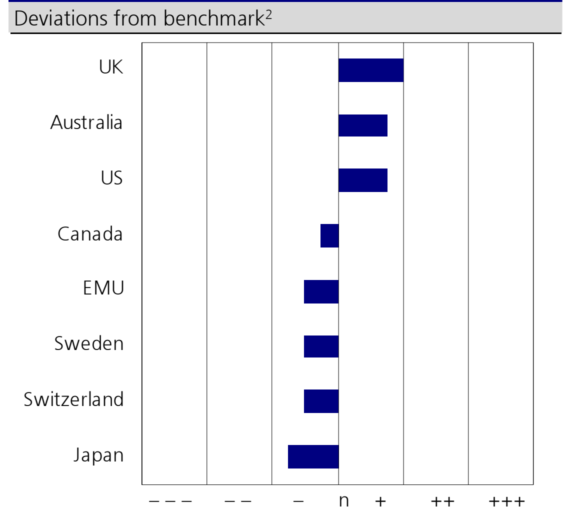
GBP (moderate overweight): GBP bonds are fairly valued, in our view. Credit growth and the housing market have been strong. However, we think cyclical risks are already well priced into the market.

CHF (moderate underweight): CHF bonds are expensive. CHF and EUR bonds are close substitutes, especially in a hedged strategy.

Achim Peijan, Strategist

Fixed Income Market Strategy - hedged[1]

Deviations from benchmark[2]



[1]These strategy weightings are currency hedged; i.e. they do not take into account risks due to the related currency exposure. [2]Labels: please see appendix. Source: UBS WMR, as of 24 April 2007

Bonds

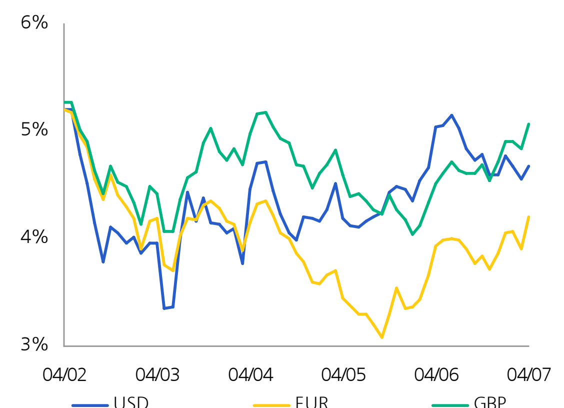
	Duration Strategy[1]	Market Returns in % 2006	YTD[2]
US	n	3.0	1.8
Canada	–	3.6	0.5
EMU	–	-0.2	-0.2
UK	–	0.2	-1.0
Switzerland	–	-0.1	-0.5
Sweden	–	1.1	-0.2
Japan	–	0.5	0.4
Australia	–	2.0	1.5
Overall	–	0.9	0.2

[1]Labels: please see appendix. [2]YTD = year-to-date; JP Morgan indices in local currencies.

Source: UBS WMR, as of 24 April 2007

Bond Market Development

10y government bond yields in %



Source: UBS WMR, as of 24 April 2007

Credit Strategy: Spreads not compensating for risks

As risk appetite returning to financial markets over the past month, high yield and emerging market bonds outperformed their high grade counterparts. With valuations appearing excessively high, we recommend a defensive stance relative to corporate credit risk in fixed income portfolios.

Investment Grade (IG) Corporate Bonds (moderate underweight in USD and EUR): Corporate credit fundamentals remain solid and signs of deterioration are rather muted. Spreads on IG bonds in the US benefited the least from renewed risk appetite in other segments and remained persistently high, while EUR IG spreads narrowed. In view of high M&A and buyout activity, and as we expect credit quality to deteriorate looking ahead, we remain cautious on IG corporate bonds.

High Yield (HY) Corporate Bonds (moderate underweight in USD and EUR): Credit spreads tightened in the USD and EUR HY segments, leading them to outperform treasuries. Spreads are back to their February lows in the Eurozone, but have not retreated as far in the US. Valuations are back at levels that we consider unattractive, as spreads do not appear to compensate investors medium-term for the risks of holding HY bonds. Thus although credit rating trends have not yet become clearly negative, we recommend maintaining a defensive stance.

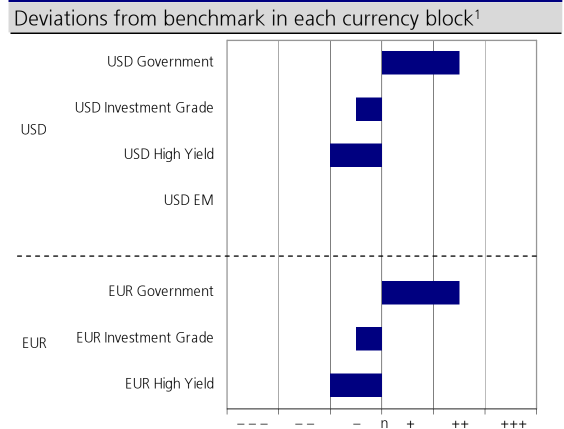
Emerging Market (EM) Debt (neutral): EM bonds continue to rally and spreads have actually fallen to levels below those observed before the late February correction. The valuation of USD-denominated EM bonds is now expensive relative to US corporates and even more so relative to US treasuries. With the rating outlook of the largest EM countries stable to somewhat positive, we believe that the trend in country fundamentals offsets unattractive valuations, thus leading us to a neutral stance.

Convertible Bonds: In the wake of strong equity market performance, global convertible bonds were able to post positive returns despite rising bond yields and a decline in volatility. Looking ahead, we think that convertibles still have the potential to outperform high grade bonds, in line with our positive view on global equities.

Stephen Freedman, Strategist

Credit Strategy

Deviations from benchmark in each currency block[1]



[1]Labels: please see appendix.
Sources: UBS WMR, as of 24 April 2007

Credit Segments

		Market Returns in %	
	Strategy[1]	2006	YTD[2]
Investment Grade[3]			
US	–	4.3	2.1
EMU	–	0.7	0.6
High Yield[3]			
US	–	11.8	3.9
EMU	–	11.1	2.3
Emerging Markets[4]			
USD	n	9.9	3.3
Convertible Bonds[5]			
Global	n.a.	12.8	4.9

[1]Labels: please see appendix. [2]YTD = year-to-date. [3]Merrill Lynch Indexes. [4]JP Morgan Index, global issues in USD. [5]UBS Global Convertible Bond Index, hedged in EUR.
Sources: Bloomberg, UBS WMR, as of 24 April 2007

Commodity Strategy

We continue to overweight gasoline, while we keep the rest of the energy complex at neutral. We also continue to overweight precious metals in view of their continuing uptrend. We underweight corn since the sentiment changed after the US Department of Agriculture's announced that the plantation area will increase considerably.

Energy (moderate overweight): We continue to overweight gasoline as US gasoline inventories continue to decline at a fast pace ahead of the US driving season. Supportive fundamentals, a term structure in backwardation (with positive roll yields) and a favorable technical picture buttress our overweight in gasoline. We keep the rest of the energy group at neutral.

Base metals (neutral): London Metal Exchange (LME) inventories continue at very low levels as supply constraints continue and demand remains firm. While copper, zinc and nickel have traded higher lately, we prefer to remain cautious for the time being, as we think these metals can be characterized as being overbought in the short-term.

Precious metals (moderate overweight): The weak US macroeconomic data and consequently a weaker USD have lifted gold to its current levels. We expect this trend to continue as investment demand for the metals continue to grow. We continue to overweight precious metals.

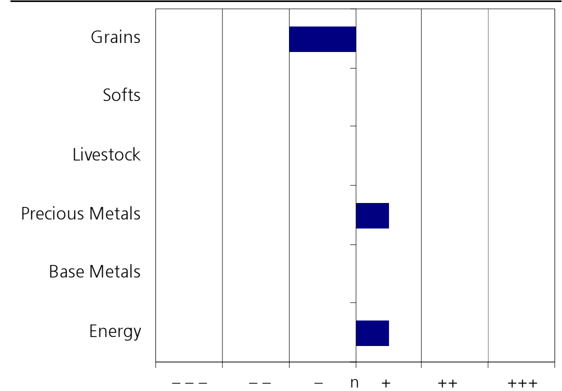
Grains (underweight): We underweight corn. The US Department of Agriculture announced that they will increase their plantation area for corn, impacting the price outlook, as more supply is expected.

Soft and Livestock (neutral): We keep our weights on neutral.

Jeremy Baker, Strategist
Ioannis Drikos, Strategist

Commodity Strategy in USD

Deviation from benchmark[1]



[1]Labels: please see appendix; Benchmark weights of the DJ AIG Commodity Index: Energy 33%, Industrial Metals 18%, Precious Metals 8%, Livestock 10.5%, Grains 18.4%, Softs 11.8%.

Source: UBS WMR, as of 24 April 2007

Commodity Returns

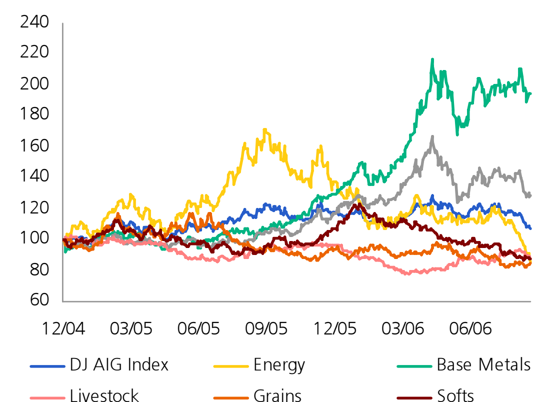
in %	2006	YTD[1]	last 5y
DJ AIG CI ER	-2.7	4.2	75.4
AIG Energy ER	-44.2	7.4	47.2
AIG Industrial Metals ER	64.3	16.3	306.3
AIG Precious Metals ER	21.2	6.9	110.3
AIG Grains ER	17.8	-4.9	9.7
AIG Livestock ER	-10.5	1.6	10.5
AIG Soft ER	-16.1	-17.1	-16.4

[1]YTD = year-to-date.

Source: UBS WMR , Bloomberg, as of 24 April 2007

Dow Jones AIG Commodity Index

DJ AIG CI excess returns; rebased



Source: UBS WMR, as of 24 April 2007

Appendix

Labels			
Abbreviation	Description / Definition (for Bond duration)	Abbreviation	Description / Definition
+	moderate overweight (moderately long duration)	-	moderate underweight (moderately short duration)
++	overweight (long duration)	--	underweight (short duration)
+++	strong overweight (very long duration)	---	strong underweight (very short duration)
n	neutral (neutral duration – Benchmark)	n.a.	not applicable

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