As We See It

Market Viewpoint

Economics
Employment growth reaccelerated in September with 110k non-farm payroll jobs added during the month helping to ease fears that the economy is not slipping into recession. In addition, August’s numbers were revised significantly higher from an initial reported loss of 4k to a gain of 89k jobs, with seasonal adjustment problems for educational professionals being cited for depressing the initial figures. This data coupled with the still positive ISM business climate indices, which remain above 50 and still point to moderate growth support our view that the economy will grow close to 2% annualized in 2H07, but is unlikely to slide into a recession. However, the stronger than expected data—particularly the revisions to August’s data—does raise the question if the Fed would have moved so aggressively with a 50 basis point cut last month if the real numbers had been known at the time, suggesting they might have moved more in line with our initial 25 basis point forecast. In the coming months we will likely see weaker payroll numbers in the 50k to 75k range on average as layoffs in the financial sector following the credit market issues during the summer begin to filter through. Despite the stronger than expected data, we have not changed our view that employment growth will continue to trend lower and we forecast a gradual rise in the unemployment rate from 4.7% to 5.3% by the end of 2008.

Equities
Equity markets continue to move higher, supported by the solid economic data. The S&P 500 and other major indices have regained all the losses suffered during the summer turmoil, with the S&P and Dow again at all-time highs above 1,550 and 14,000, respectively. The biggest problem the market is grappling with is trying to assess the extent of the economic slowdown. Our view is that we will not enter a recession, and while we expect real GDP to slow to below trend 2% growth next year, in this environment we expect nominal earnings to remain positive supported by faster growing economies overseas. With payroll data for September out of the way, investors will now focus their attention on the third-quarter earnings season, which begins in earnest mid-October. Despite massive one-off write-offs from the Financial sector, we still expect positive earnings growth in the low single-digit range.

Fixed Income
Although most of the commentary before the Fed rate cut centered on the need for an easing in monetary conditions, much of the post-Fed commentary revolves around whether the Fed’s bold move amounted to a bailout of unwise investors and an endorsement by Fed chair Ben Bernanke of the “Greenspan put.” Market sentiment swung abruptly from fear of recession (in early September) to fear of inflation and the yield curve steepened 20 bps to a spread of 60 bps, as the yield on the 2-year Treasury note fell 15 bps and the yield on the 10-year note rose 5 bps. We believe the yield curve is poised for additional steepening, with short-term yields falling but long-term yields rising. With the yield curve likely to pivot around the 5 to 7 year area, we recommend maintaining a neutral duration exposure. With credit markets stabilizing and relatively attractive valuations, we have upgraded investment grade corporate bonds to moderate overweight from a neutral allocation.

Michael P. Ryan, CFA
Head Wealth Management Research – America
**Investment Outlook**

**Global Core Asset Allocation**

Deviation from Benchmark

- Equities
- Cash
- Fixed Income

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

**Regional Equity Strategy**

Deviation from Benchmark (not currency hedged)

- EMU
- USA
- Emerging Mkts.
- UK
- Japan
- Other Developed

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

**US Equity Sector Strategy**

Deviation from Benchmark

- Cons Discretionary
- Materials
- Energy
- Telecom
- Utilities
- Health Care
- Financials
- Industrials
- Technology
- Cons Staples

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

**US Fixed Income Strategy**

Deviation from Benchmark

- Agencies
- Investment Grade
- Preferreds
- Mortgages
- High Yield
- TIPS
- Treasury

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

**US Equity Size and Style**

Deviation from Benchmark

- Large Cap Growth
- Small Cap Growth
- Large Cap Value
- Small Cap Value

Labels: + = moderate overweight, ++ = overweight, +++ = strong overweight, n = neutral, - = moderate underweight, -- = underweight, --- = strong underweight, n.a. = not applicable. Source: UBS WMR
## Key Forecasts

### US Economics

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007F</th>
<th>2008F</th>
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<tbody>
<tr>
<td>Real GDP (y/y)</td>
<td>2.5</td>
<td>3.6</td>
<td>3.1</td>
<td>2.9</td>
<td>2.0</td>
<td>2.0</td>
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<tr>
<td>CPI (y/y)</td>
<td>2.3</td>
<td>2.7</td>
<td>3.4</td>
<td>3.2</td>
<td>2.9</td>
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<tr>
<td>Core CPI (y/y)</td>
<td>1.5</td>
<td>1.8</td>
<td>2.2</td>
<td>2.5</td>
<td>2.4</td>
<td>2.6</td>
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<tr>
<td>Unemployment rate*</td>
<td>6.0</td>
<td>5.5</td>
<td>5.1</td>
<td>4.6</td>
<td>4.7</td>
<td>5.3</td>
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<tr>
<td>10-year yield*</td>
<td>4.27</td>
<td>4.24</td>
<td>4.39</td>
<td>4.70</td>
<td>4.50</td>
<td>N/A</td>
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<tr>
<td>Fed funds rate*</td>
<td>1.00</td>
<td>2.25</td>
<td>4.25</td>
<td>5.25</td>
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*Year-end level. Sources: Datastream, UBS WMR

### USD FX Forecasts

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<tr>
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<th>10/5/2007</th>
<th>3 m</th>
<th>6 m</th>
<th>12 m</th>
<th>Equilibrium*</th>
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<tr>
<td>EURUSD</td>
<td>1.41</td>
<td>1.40</td>
<td>1.33</td>
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<tr>
<td>USDJPY</td>
<td>117.15</td>
<td>115.0</td>
<td>115.0</td>
<td>112.0</td>
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<td>USDCHF</td>
<td>1.18</td>
<td>1.17</td>
<td>1.20</td>
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*Estimates of equilibrium exchange rates based on Purchasing Price Parity calculation. Sources: Bloomberg, UBS WMR

### Commodity Price Forecasts

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<th>2005</th>
<th>2006</th>
<th>2007F</th>
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<tbody>
<tr>
<td>WTI Crude Oil $/bbl</td>
<td>34.00</td>
<td>41.50</td>
<td>58.00</td>
<td>66.10</td>
<td>63.80</td>
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<tr>
<td>Gold $/oz</td>
<td>364</td>
<td>410</td>
<td>443</td>
<td>604</td>
<td>690</td>
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<tr>
<td>Silver $/oz</td>
<td>4.88</td>
<td>6.66</td>
<td>7.20</td>
<td>11.6</td>
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<tr>
<td>Copper $/mt*</td>
<td>1780</td>
<td>2868</td>
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<td>6725</td>
<td>6964</td>
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<tr>
<td>Aluminum $/mt*</td>
<td>1431</td>
<td>1717</td>
<td>1875</td>
<td>2480</td>
<td>2850</td>
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<td>Zinc $/mt*</td>
<td>828</td>
<td>1048</td>
<td>1350</td>
<td>3275</td>
<td>3715</td>
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Note: All prices are yearly averages. *mt=metric ton. Sources: Datastream, UBS WMR

### Technical Levels

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<th>DJIA</th>
<th>NASDAQ</th>
<th>10-Yr. Treasury</th>
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<tbody>
<tr>
<td>Support</td>
<td>1490-1505</td>
<td>13400-13500</td>
<td>2625-2635</td>
<td>4.3%-4.4%</td>
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<tr>
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<td>1460-1470</td>
<td>13000-13100</td>
<td>2540-2560</td>
<td>4.0%-3.8%</td>
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<tr>
<td>Resistance</td>
<td>1556</td>
<td>14000-14100</td>
<td>2725-2750</td>
<td>4.7%-4.9%</td>
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<tr>
<td></td>
<td>1585-1600</td>
<td>14500-14600</td>
<td>2900-3120</td>
<td>5.2%-5.3%</td>
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</tbody>
</table>

Source: UBS WMR