

Fixed income review

November 16, 2009

Interest rate forecasts: Higher yields

This month, we made several adjustments to our interest rate forecasts. Of note, we raised the rate path for 3-month LIBOR, based on our view that the market will begin to more assertively price in Fed tightening by mid-2010. As the economic recovery matures and becomes self sustaining next year, the need to unwind the abnormally low target fed funds rate will grow. Currently, the spread between 3-month LIBOR and the fed funds target rate is just 3bps. Historically, though, LIBOR has traded at a wider spread to the fed funds rate during periods of monetary tightening than in periods of easing. This suggests that once the tightening cycle begins, LIBOR will rise more quickly than the fed funds rate. As a result, we are raising our 6-month target by 0.20bps to 0.50bps and the 12-month target by 40bps to 1.00%.

We lowered our forecast for the 10-year Treasury yield and the 30-year bond in three months by 25bps and 30bps, respectively to 3.75% and 4.5%. The change was prompted by our belief that year-end window dressing is apt to prevent yields from rising as much as we previously forecast. Over a six-month horizon, we see further upward pressure on Treasury yields. The prospect of Fed tightening, ongoing heavy supply, and concern about an imperfect wind-down of quantitative easing have led us to raise our rate forecast by 50bps on the 10-year Treasury note and by 45bps on the 30-year bond to 4.00% and 4.75%, respectively.

US fixed income : November Update: One for the record books / November 4, 2009

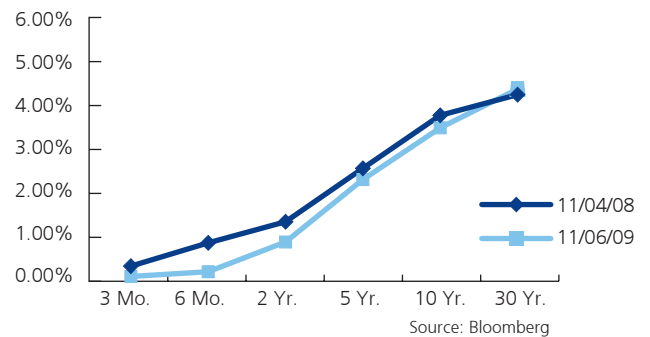
Key rates	Current	1 Year ago
Fed Funds	0.25%	0.34%
Prime	3.25%	4.00%
2 year Tsy	0.81%	1.21%
10 year Tsy	3.38%	3.73%
3 month	0.27%	4.23%

Source: Bloomberg

CD Term	Interest rate	Annual percentage yield
1 Month	NA	NA
3 Month	0.50%	0.5009%
6 Month	0.55%	0.5508%
9 Month	0.70%	0.7007%
1 Year	0.90%	NA

CDs present certain investment risks that you should discuss with a Financial Advisor prior to making an investment decision. Redemptions of CDs prior to the maturity date may result in significant loss of principal due to changes in interest rates and limited liquidity of the CDs in the secondary markets. Each CD is a deposit obligation of a U.S. depository institution and a minimum deposit of \$1,000 is required. Interest paid on the CD cannot remain on deposit at the depository institution and will be paid to the depositor according to the terms of the CD. CDs are FDIC insured up to a maximum of \$250,000 aggregate principal and accrued interest in non-retirement accounts and up to a maximum of \$250,000 in certain retirement accounts for all deposits held in the same legal capacity at the same depository institution.¹

U.S. Treasury yield curve



Municipal bond yields

	Yield	TEY*
10 Year	3.15%	4.85%
30 Year	5.02%	7.72%

Source: The Municipal Consensus™ 'Aaa' G.O. Yield Curve, courtesy of Municipal Market Advisors. Taxable Equivalent Yield (TEY) calculated using a 35% Federal income tax bracket. Yields are indicative of national tax-exempt rates. Actual yields available in the market may be lower or higher than those shown.

Municipal bonds

Rating (Moody's/S&P)	Issuer	Coupon	Maturity	Call feature	Price per bond	Yield	TEY*
Aa3/AAA FSA Insured	California State University Revs	4.125%	11/01/22	05/01/17@\$100	\$100.41	4.06% YTC	6.25%
Aa1/AAA	San Antonio TX COPs	3.50%	02/01/26	02/01/16@\$100	\$91.49	4.23% YTM	6.51%
Aa2/AAA AGC Insured	Pitt County NC Limited Obligation	4.50%	04/01/29	04/01/20@\$100	\$99.99	4.50% YTM	6.92%
Aa2/AAA AGC Insured	Greenwood SC School District 50	4.50%	12/01/32	12/01/17@\$100	\$97.89	4.65% YTM	7.15%
Aa3/AAA FSA Insured	Atlanta GA Water/Wastewater Revs	5.00%	11/01/34	11/01/14@\$100	\$100.48	4.89% YTC	7.52%
AA1/AAA	Florida Board of Education	4.75%	06/01/37	06/01/17@\$100	\$101.00	4.61% YTC	7.09%

Call features may apply. *Taxable equivalent yields (TEY) assume a 35% top tax bracket. Subject to prior sale or change in price.

All fixed income securities are subject to market risk and interest rate risk. If fixed income securities are sold in the secondary market prior to maturity, an investor may experience a gain or loss depending on the level of interest rates, market conditions and the credit quality of the issuer. Investors must consult with their personal tax advisor regarding the suitability of tax exempt investments for their portfolio. Income may be subject to state or local tax as well as alternative minimum tax. UBS Financial Securities Inc. and/or its directors, officers and employees may have or have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or UBS Financial Securities Inc. may act or have acted as market-maker, manager or co-manager of the public offering, in any or all securities or related financial instruments discussed in this circular. Federal agency securities, including agency discount notes, are not direct obligations of the U.S. government. *Yield to worst is the yield to maturity under the least desirable bond repayment pattern under the assumption that market yields are unchanged. If market yields are higher than the coupon, the yield to worst would assume no prepayment. If market yields are below the coupon, yield to worst assumes prepayment at the earliest call date.

Corporate Bonds

Rating (Moody's/S&P)	Issuer	Coupon	Maturity	Call Date	Price	YTW/YTM
Aaa/AAA	Johnson & Johnson ^{1,2,3}	3.80%	05/15/13	Non Callable	\$108.19	NA/1.39%
Aaa/AAA	Microsoft Corporation ^{1,4,5,6,7,8,9,10}	2.95%	06/01/14	Non Callable	\$103.74	NA/2.08%

Corporate bonds are subject to credit quality fluctuations. Should the business fundamentals of a corporate bond deteriorate, credit quality ratings and market value may be adversely affected. Make Whole Call—Call option that gives the issuer the option to redeem the bonds at any time, but pay a higher price if interest rates have fallen. Specifically, to redeem the bonds, the issuer must pay the greater of (a) par, or (b) a price that would give the bonds a yield-to-maturity equal to that of a comparable Treasury plus a make-whole yield spread.

Agencies

Issuer	Coupon	Maturity	Call Date	Price	YTC/YTM
Federal Home Loan Bank	1.625%	09/26/12	Non Callable	\$100.59	NA/1.41%
Federal Home Loan Bank	3.05%	05/12/14	02/12/10@\$100	\$100.50	0.93%/2.93%
Federal Home Loan Bank	3.80%	01/28/19	01/28/11@\$100	\$100.45	3.41%/3.74%
Federal Home Loan Bank	4.10%	06/10/19	06/10/11@\$100	\$100.90	3.50%/3.99%

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UBS Financial Services Ratings: Definitions
Corporate Bonds
UBS Financial Services Investment Opinion (Issuer)

Outperform—The issuer has a bond (bonds) that is (are) expected to outperform the sector peer group.; **Market Perform**—The issuer has a bond(bonds) that is(are) expected to perform in line with the sector peer group.; **Underperform**—The issuer has a bond (bonds) that is (are) expected to underperform the sector peer group.; **Sell**—The issuer has a bond (bonds) that is (are) expected to substantially underperform the sector peer group. Horizon—1 year.

UBS Financial Services Relative Value Ranking (bond)

1, 2, 3, 4, 5—Valuation of a bond relative to its sector peer group. 1,2=Cheap (1=cheapest), 3=Fair, 4,5=Rich (5=richest). Horizon—1 year.

UBS Financial Services Credit Rating (Issuer)

AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC+, CCC, CCC-, CC, C, D—Senior unsecured rating.

UBS Financial Services Credit Trend (Issuer)

Improving, Stable, Deteriorating—Direction of credit quality.

Preferreds

Buy—Securities have potential for outperformance relative to peer group; and the company is likely to meet dividend payment.

Neutral—Securities are likely to perform in line with peer group; and the company is likely to meet dividend payment.

Reduce—Securities have potential for underperformance relative to peer group; or the company is increasingly likely to defer or miss dividend payment.

Is it time for a conversation?

If you have questions about your fixed income holdings, or would like to discuss these investment ideas, please contact me.

- ¹ FDIC Insurance Maximum Coverage for Certain Retirement Accounts are insured up to a maximum of \$250,000 for all deposits per issuing institution and held in the same legal capacity in IRAs, self-directed 401(k) plans, Keogh plans and Section 457 plans.
- ² FDIC Insurance Maximum Coverage for Non-Retirement Accounts has been temporarily increased from \$100,000 to \$250,000 per depositor through December 31, 2013 for all deposits held in the same legal capacity at the same depository institution. After December 31, 2013, the maximum FDIC insurance coverage will revert back to \$100,000. Please note that CDs purchased before December 31, 2013 will only be insured for up to \$100,000 after December 31, 2013.
- ³ FDIC insurance coverage is limited for each depositor. Investors with Certificates of Deposit from the same institution but which are held in multiple accounts or firms must verify that they do not exceed their aggregate insurance limit for their combined deposits. Total deposits (principal plus interest) that exceed the specified maximum are considered uninsured for the excess. Furthermore, CDs purchased at a premium (a price above par) are only FDIC insured up to par value. Any premium paid over par value is not FDIC insured.
- ⁴ FDIC insurance coverage for Trust Accounts varies depending upon several factors, including but not limited to trust type, trust ownership, number of beneficiaries and relationship of beneficiaries to the trust owner. Trust owners should consult with their legal advisors to determine how FDIC insurance applies to their particular trusts. If you have a trust account, you and your legal advisor may contact the FDIC at 1-877-275-3342 for more information or visit their website at www.FDIC.gov

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