

# "Not the end, but well beyond the beginning"

Outlook for the global economy and financial markets

---

Oliver Adler, UBS Wealth Management

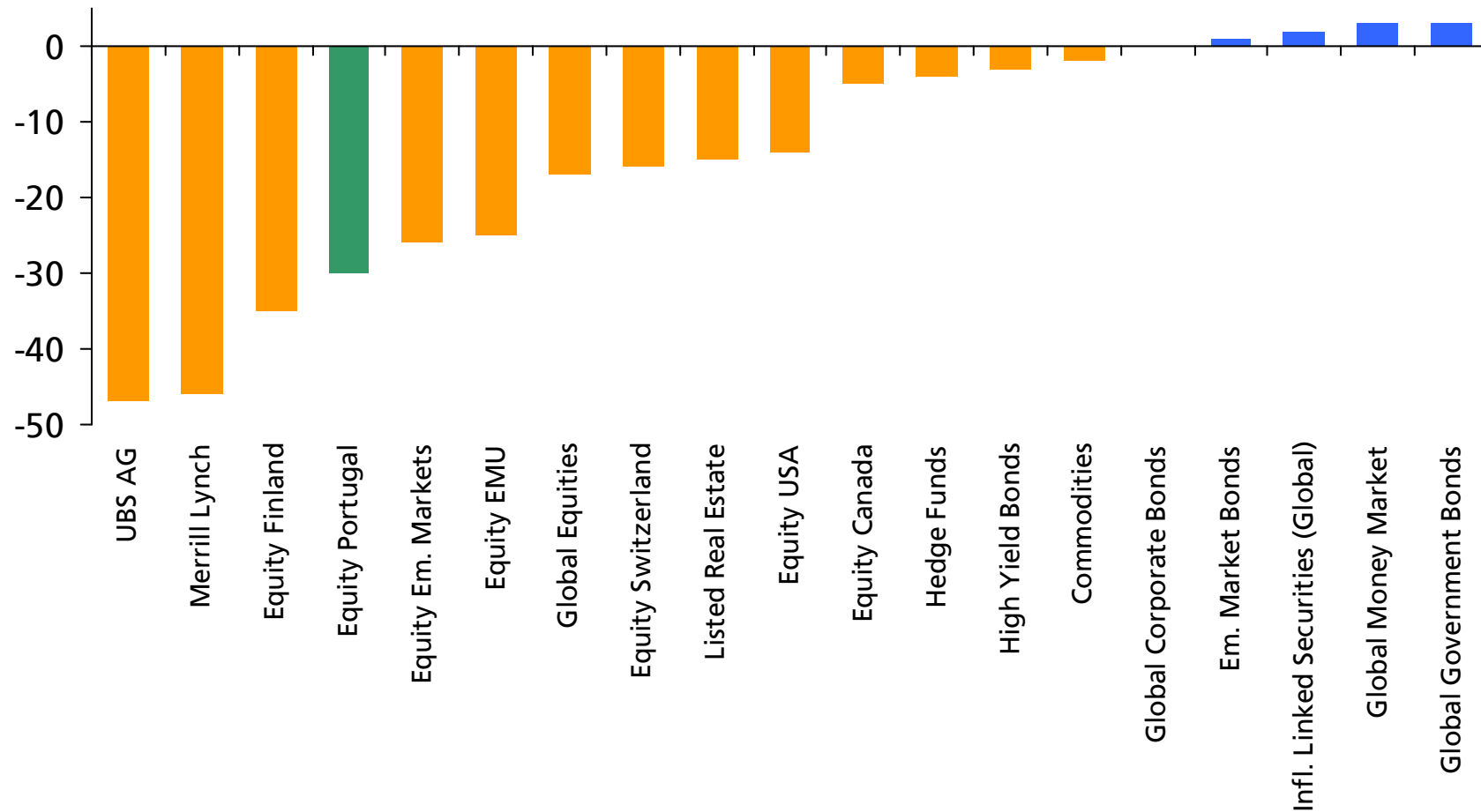
Lisbon/Oporto, September 2008

This is not the end -  
it is not even the beginning of the end -  
but it is the end of the beginning.

Winston Churchill after the battle of Dunkirk, 1940

# Do you find any exciting positive performers here ?

## Cross asset class performance, 2008 ytd (to Sept 5)



Sources: Bloomberg, Datastream

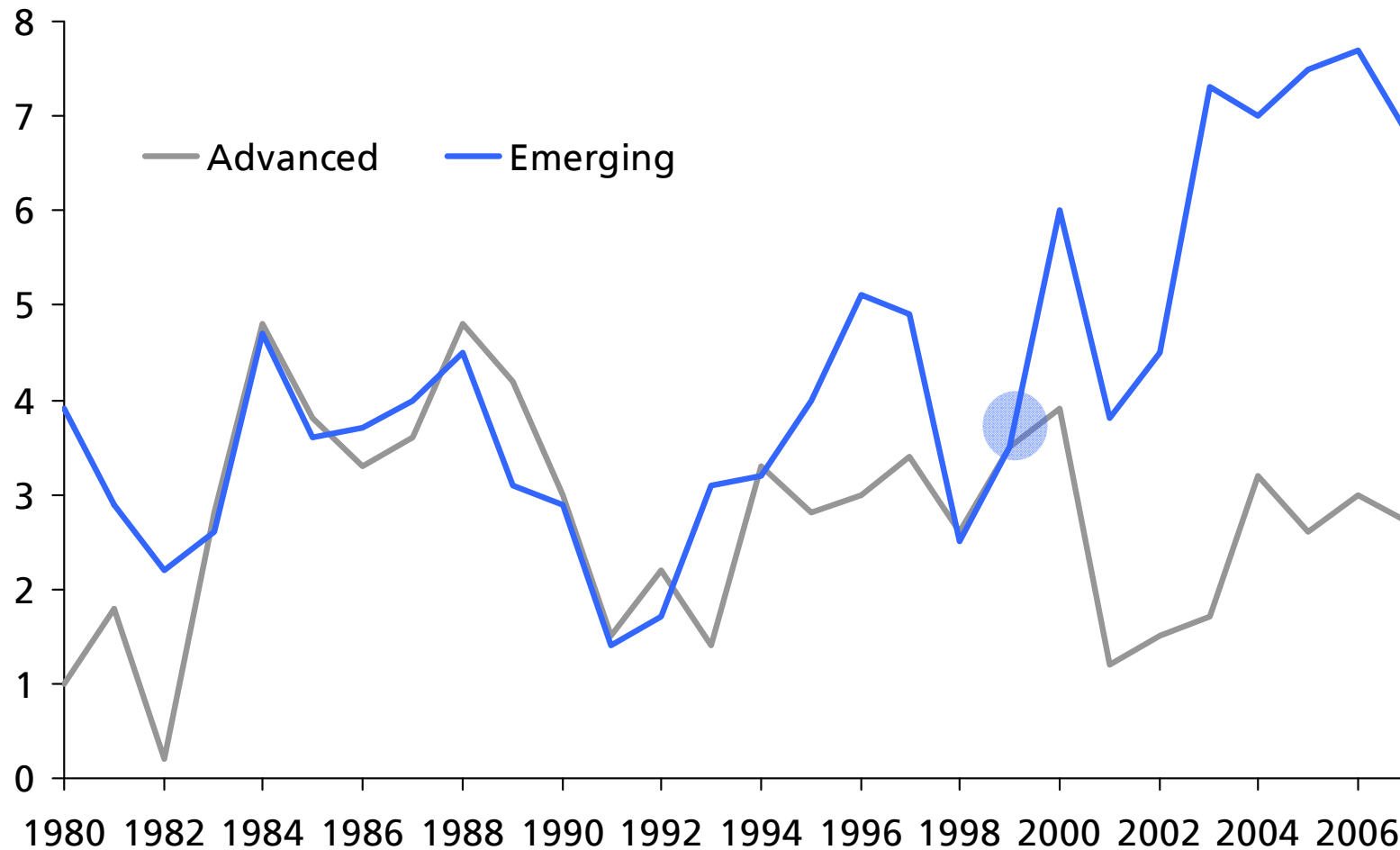
# Today's agenda

---

- ◆ How we got here ?
- ◆ Where we are now ?
- ◆ Where we go from here ?

# How we got here

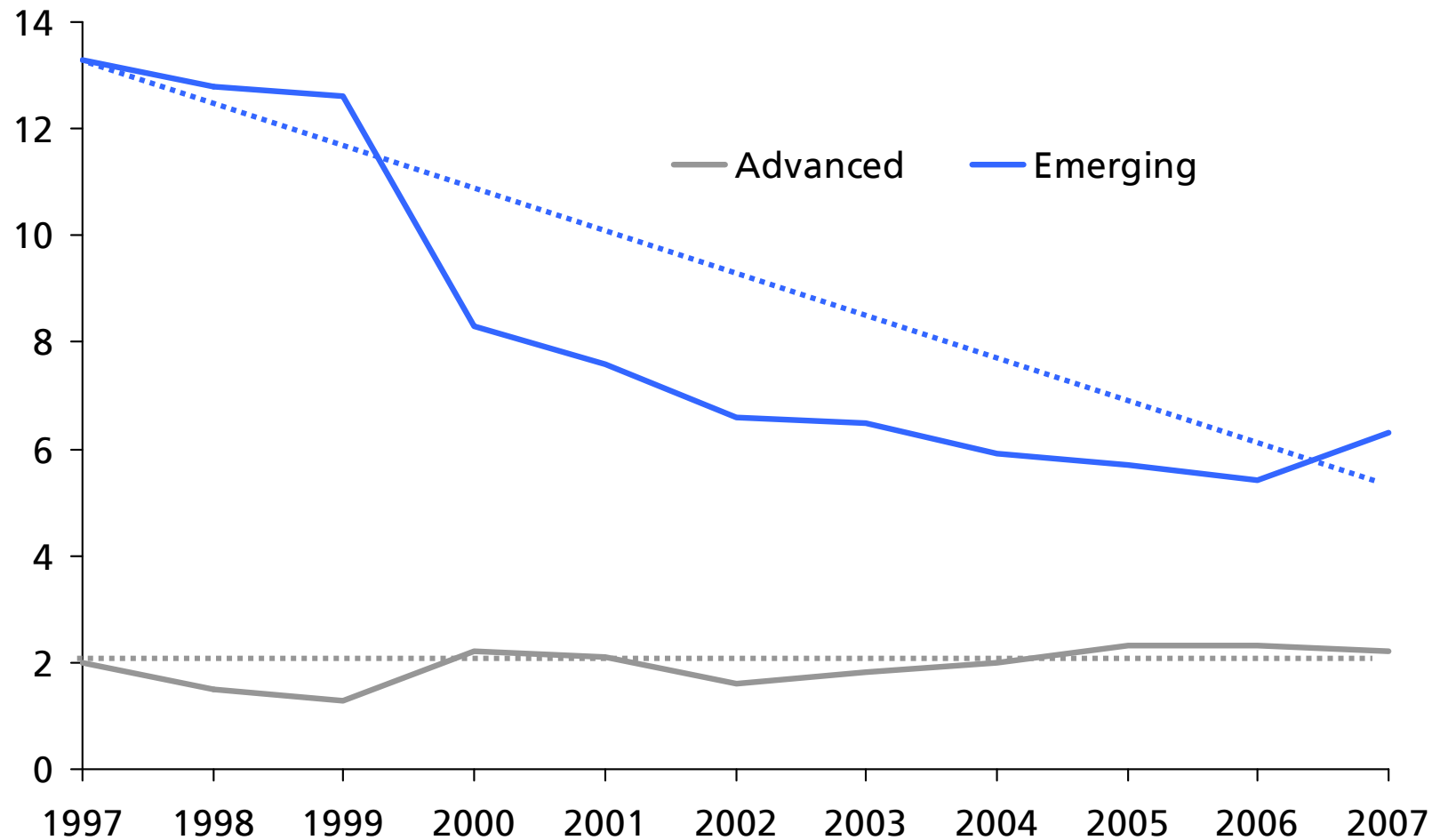
## Economic growth since 1980



Source: IMF

# How we got here

## Inflation since 1997



Source: IMF

# How we got here

---

## 2003 onwards - the goldilocks economy

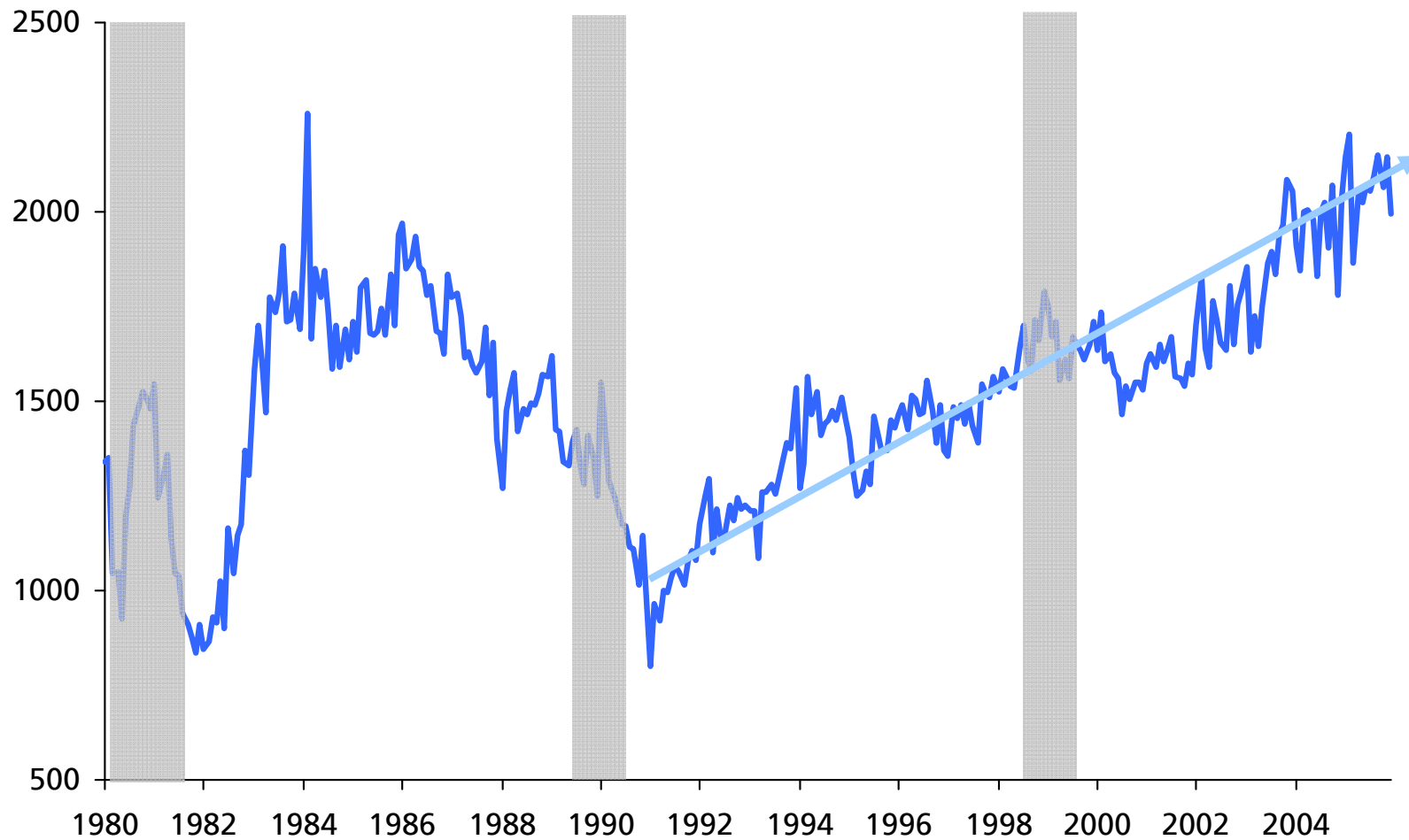


**"This porridge is too hot!" "This porridge is too cold!"  
"This porridge is just right!" Goldilocks ate all the porridge.**

Source: British Council

# How we got here

## US housing starts in '000s



Source: Bloomberg



# How we got here

---

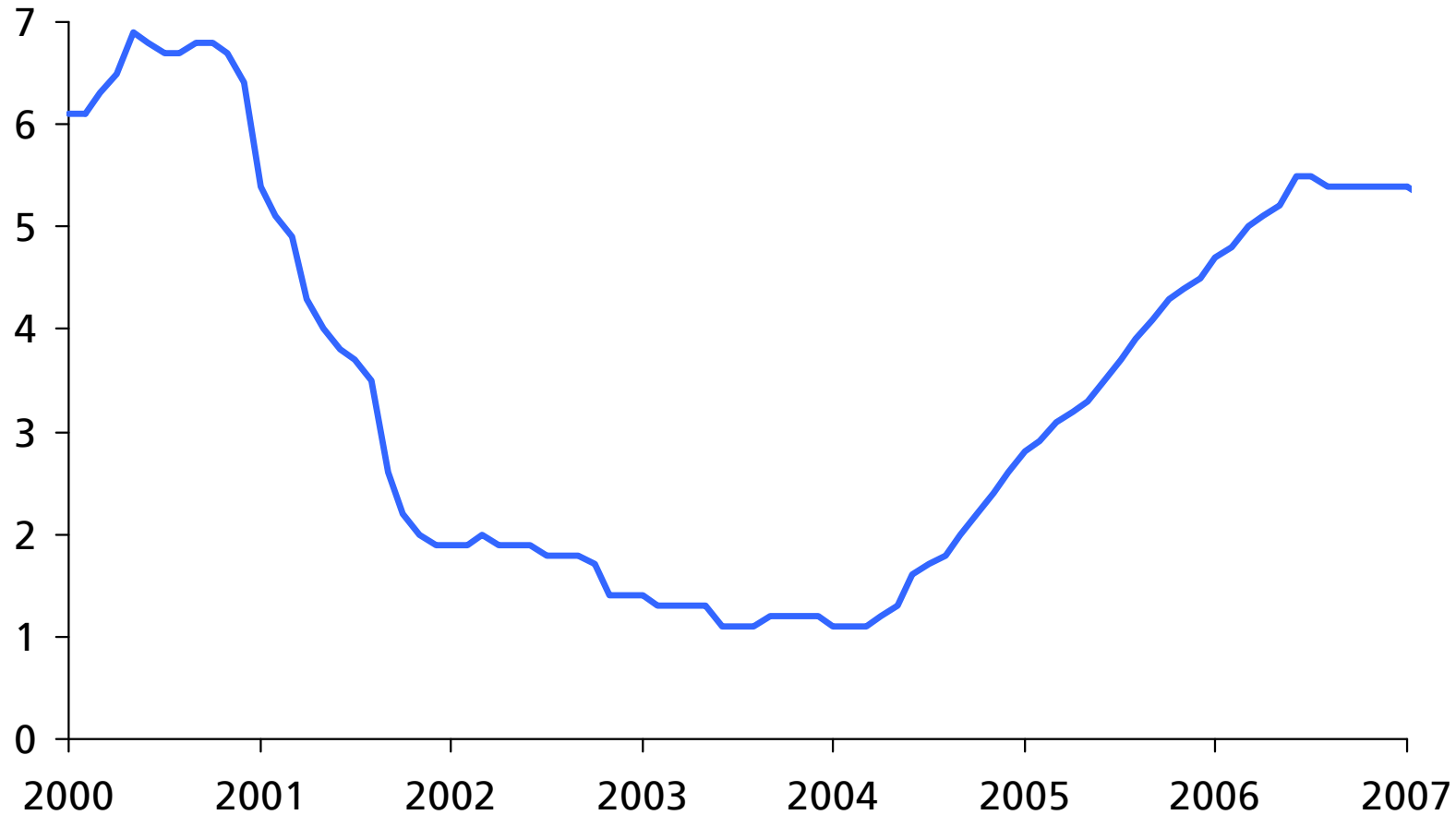
## The leveraging mechanism

- ◆ Rising home prices
- ◆ Increased borrowing
- ◆ Lax mortgage standards
- ◆ Securitization of mortgages
- ◆ Repackaging/leveraging of securitized mortgages
- ◆ "Shadow banking system"

# How we got here

---

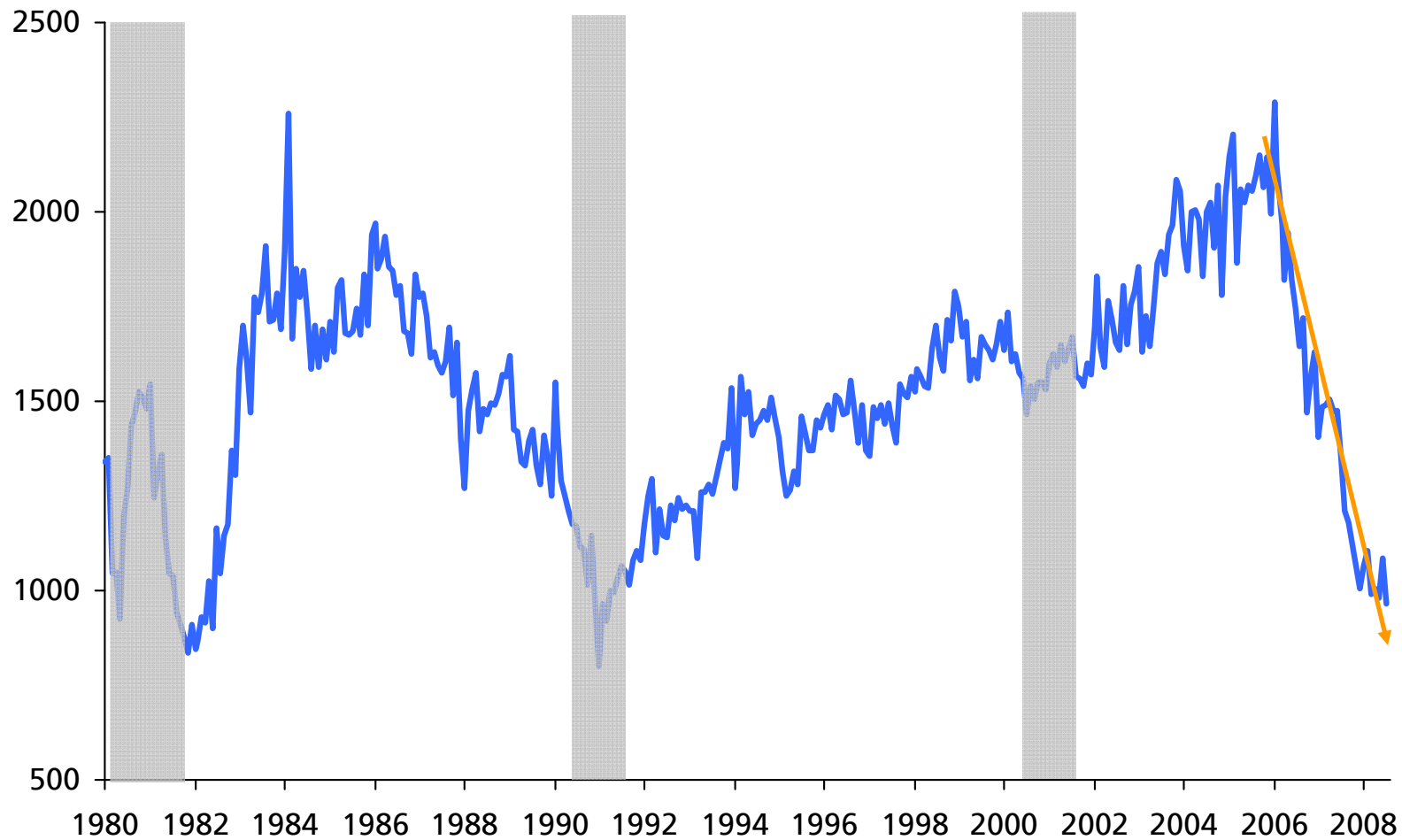
## US 3M Libor rate



Source: Bloomberg

# How we got here

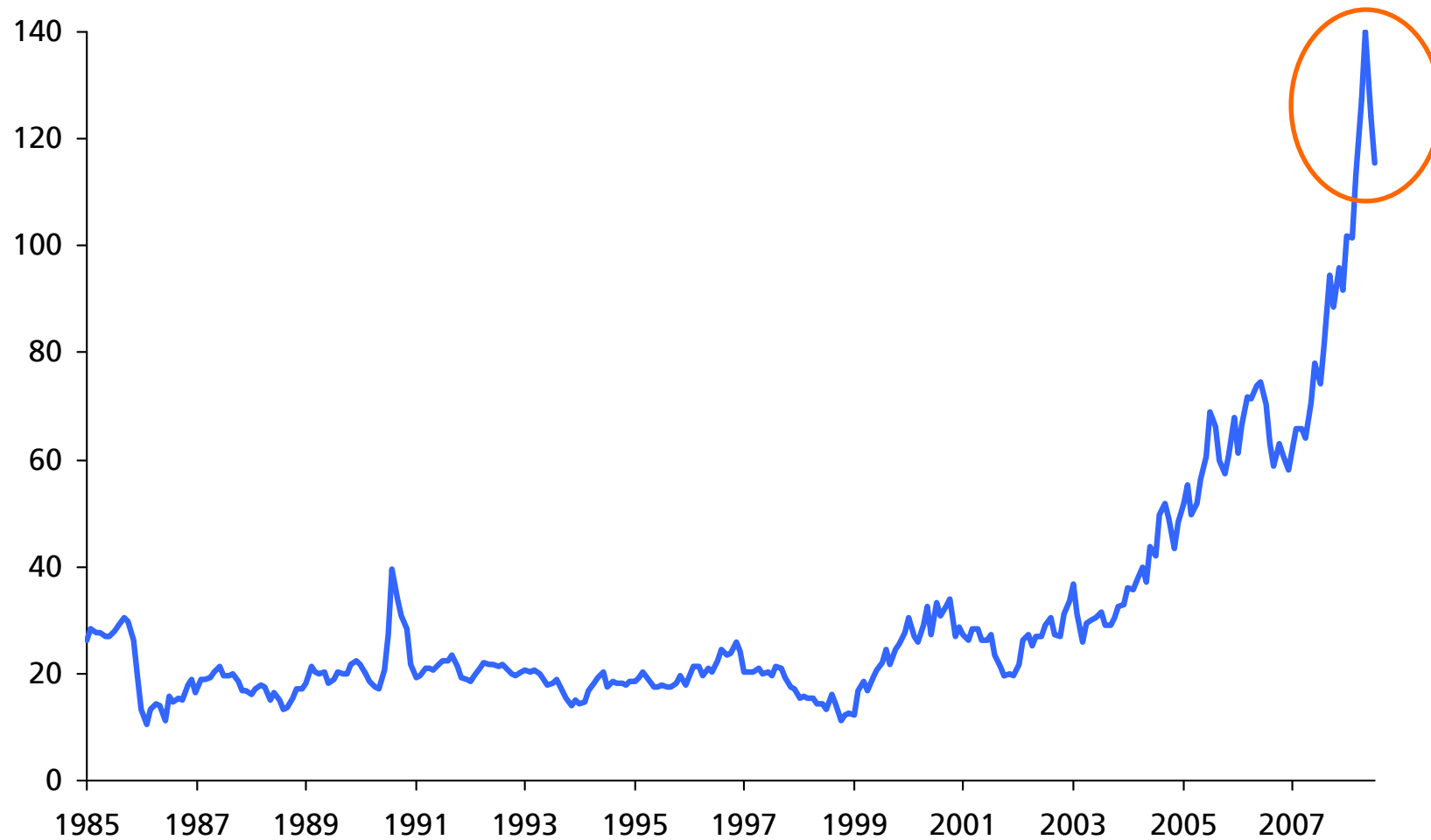
## US housing starts in '000s



Source: Bloomberg

# How we got here

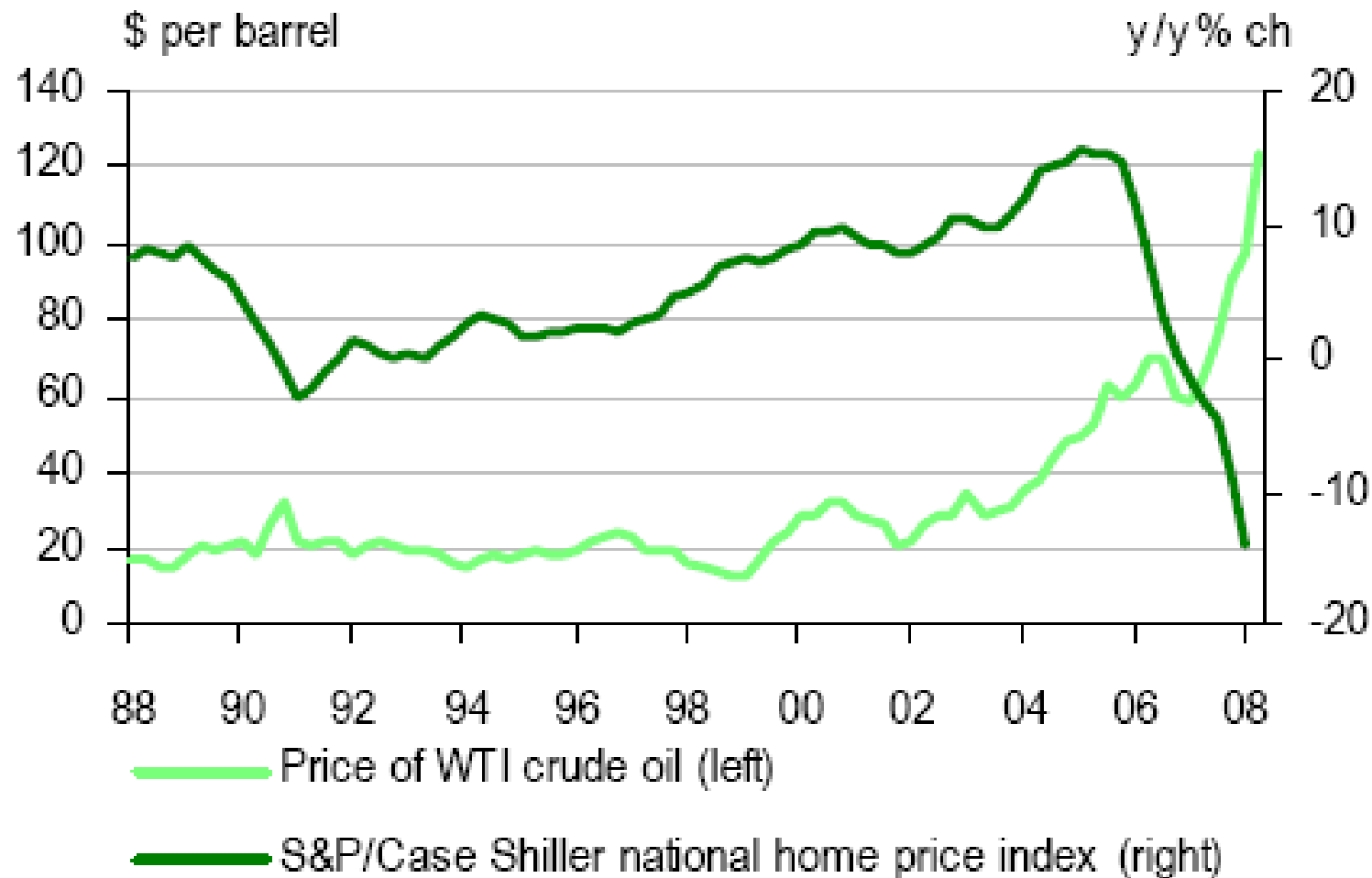
## Oil prices, WTI per barrel



Source: Bloomberg

# How we got here

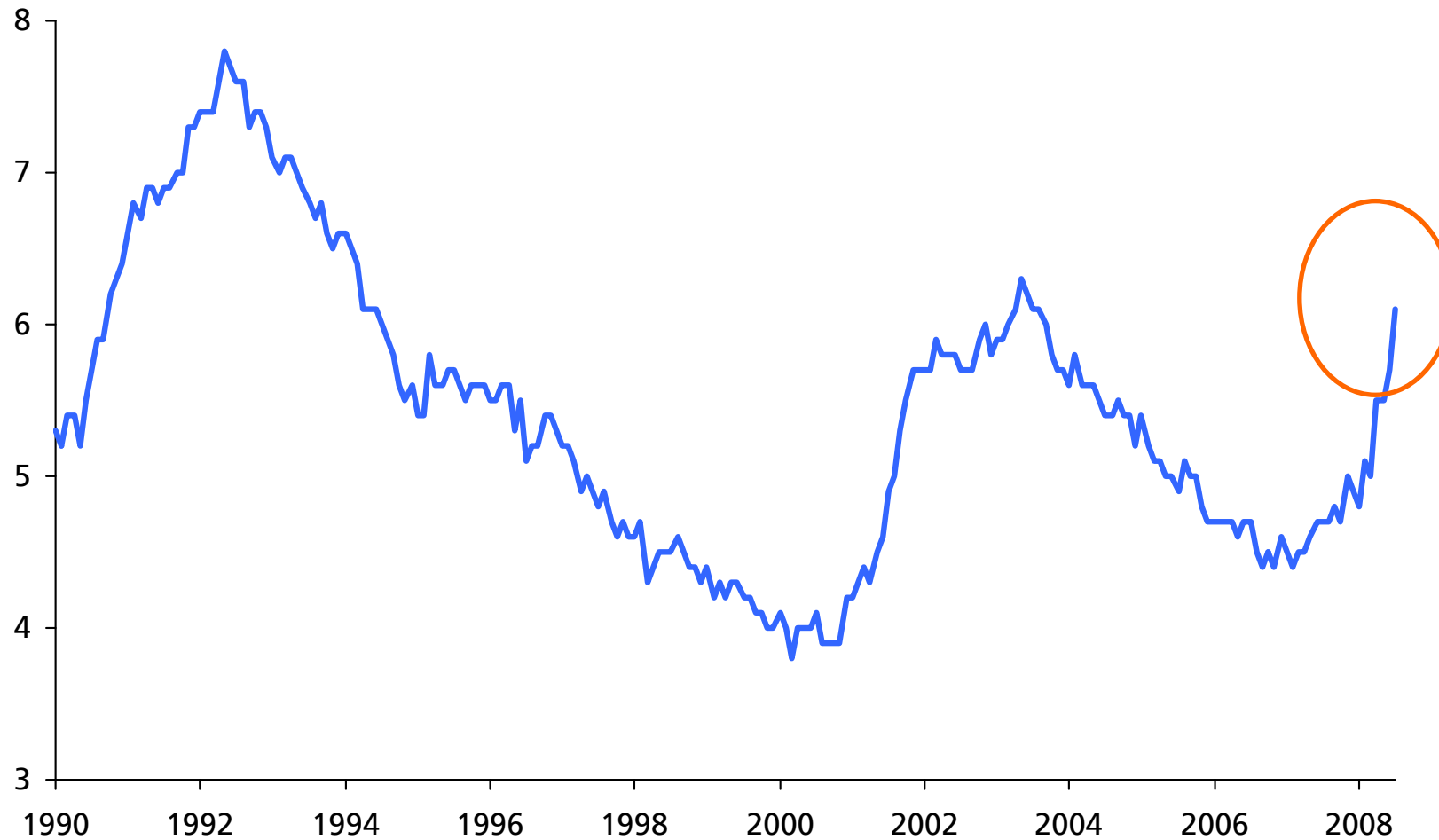
## The shocks hitting the US/global consumers



Source: UBS Investment Bank

# Where we are now

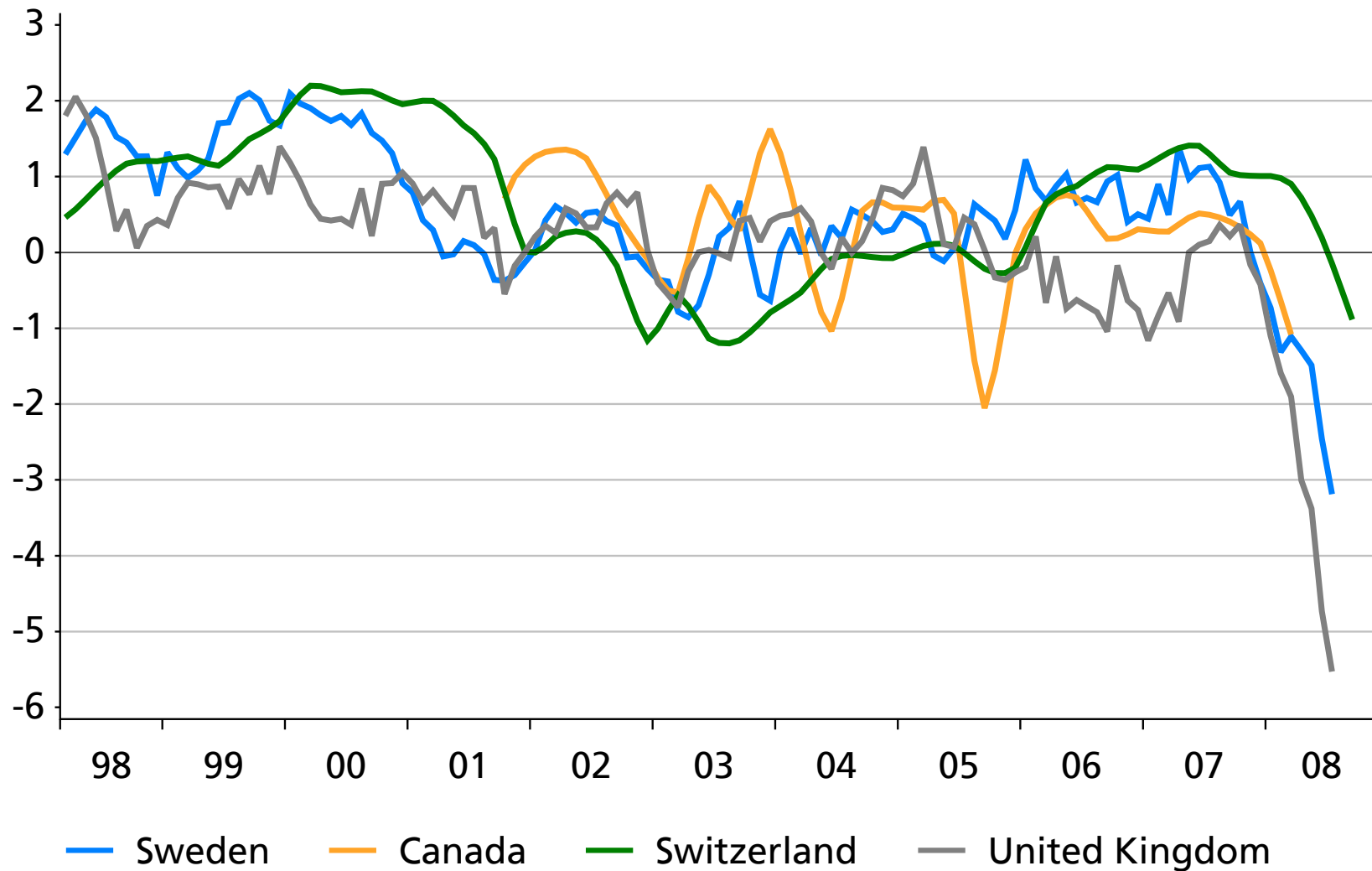
## United States: unemployment rate



Source: Bloomberg

# Where we are now

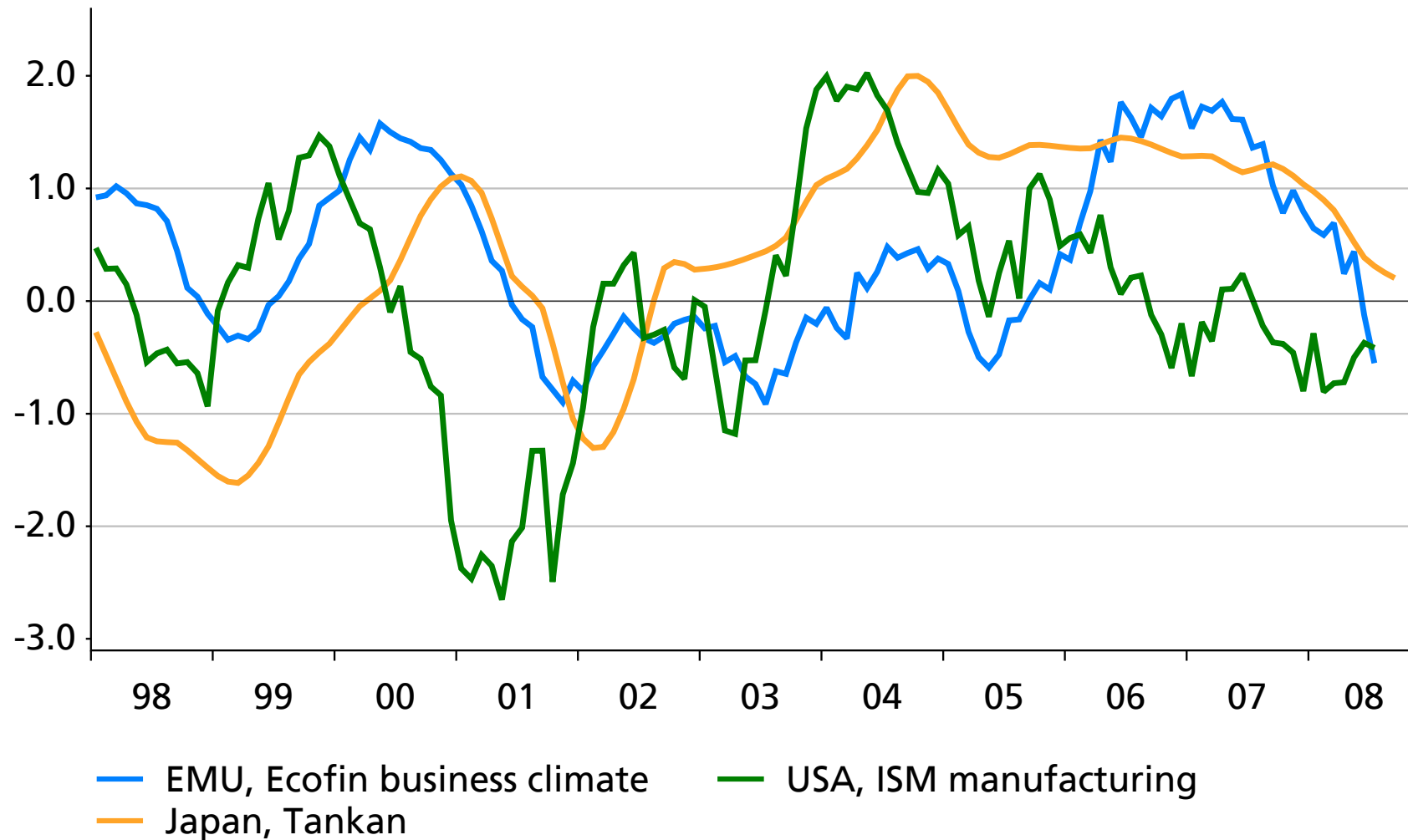
## Consumer sentiment indicators (standardized)



Source: Reuters EcoWin

# Where we are now

## Business sentiment indicators (standardized)

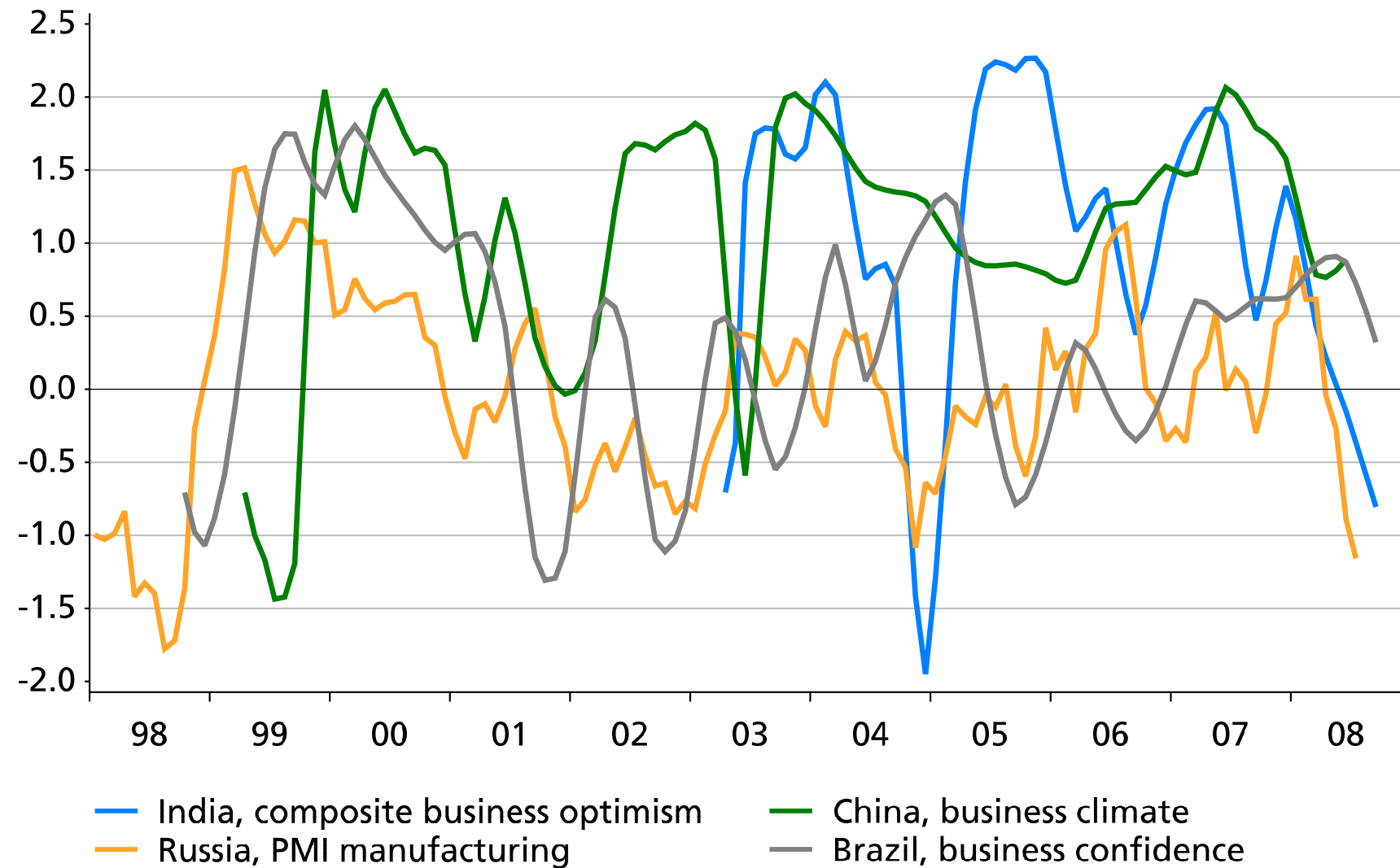


Source: Reuters EcoWin



# Where we are now

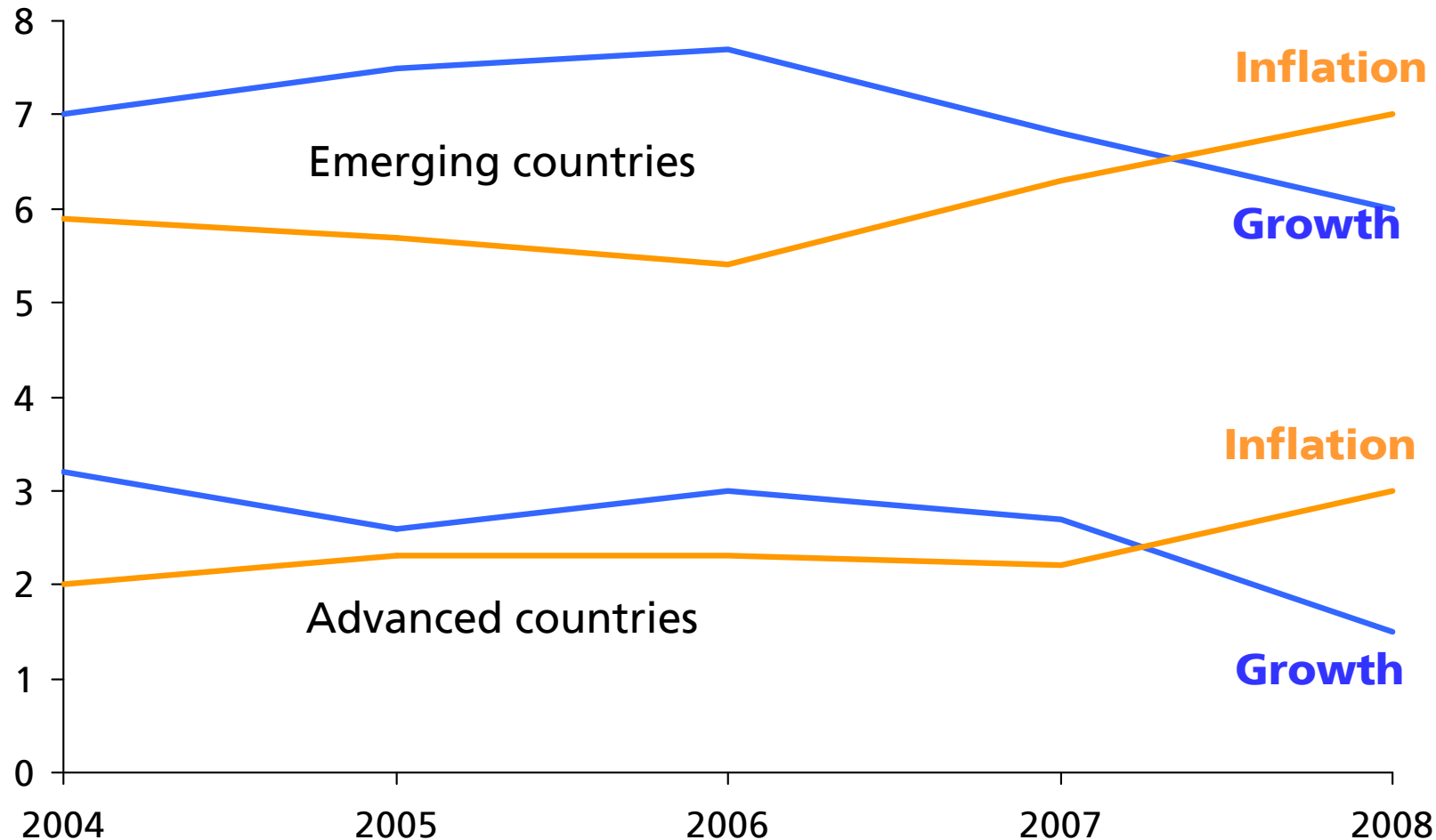
## Business sentiment in selected emerging markets



Source: Reuters EcoWin

# Where we are now

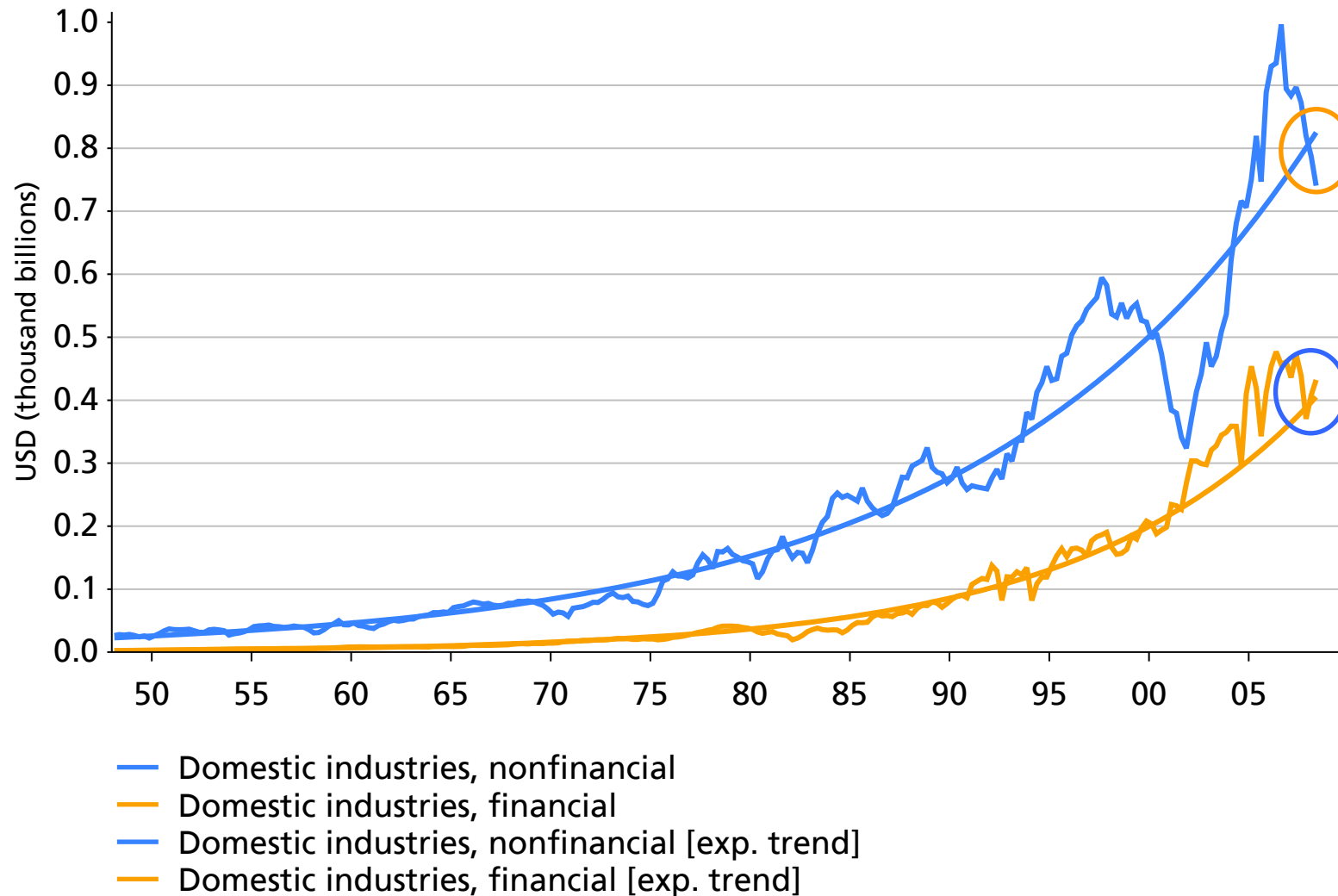
## Worse macro mix – no longer Goldilocks



Source: IMF

# Where we are now

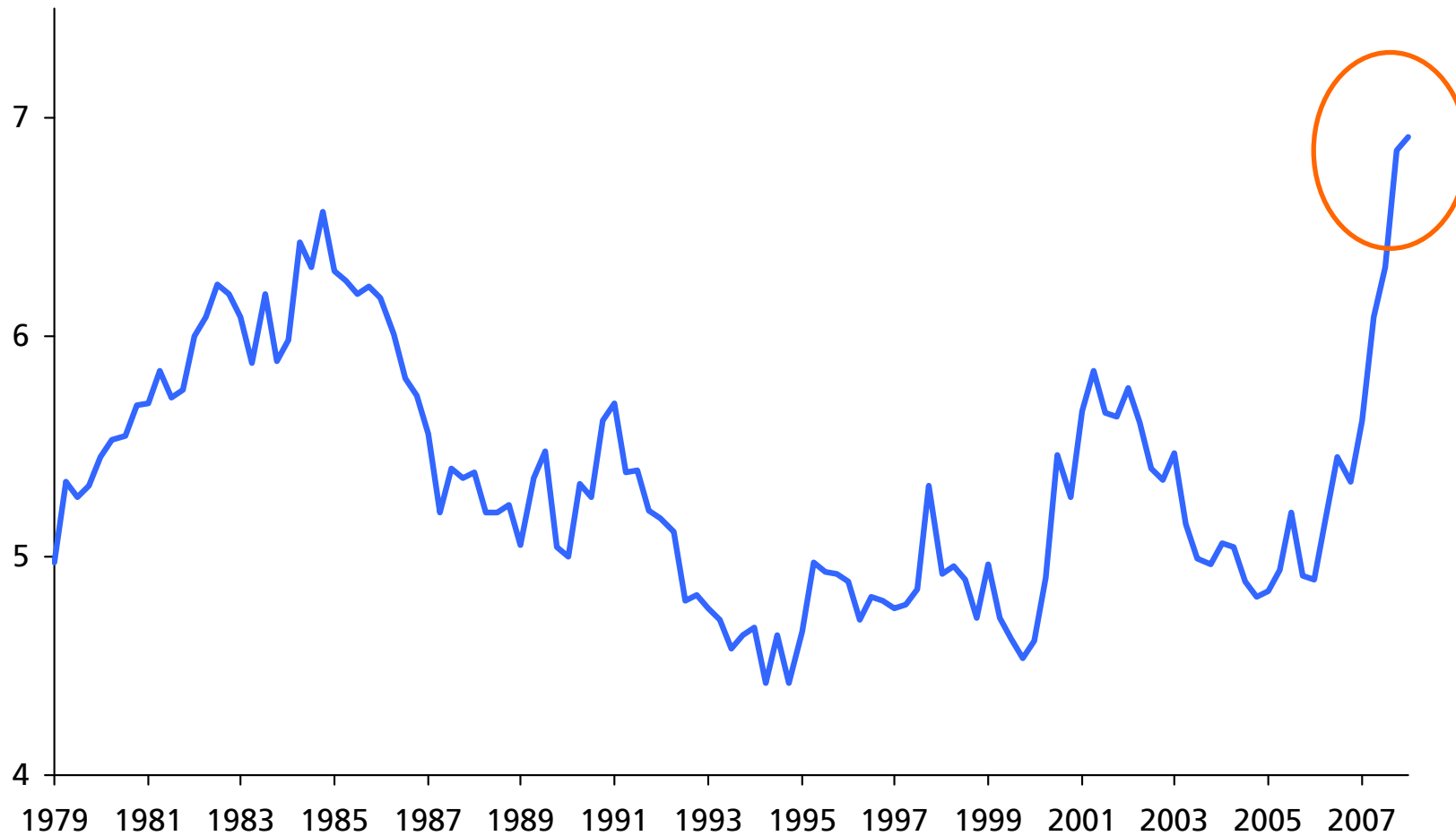
## US corporate profits



Source: Reuters EcoWin, UBS WMR

# Where we are now

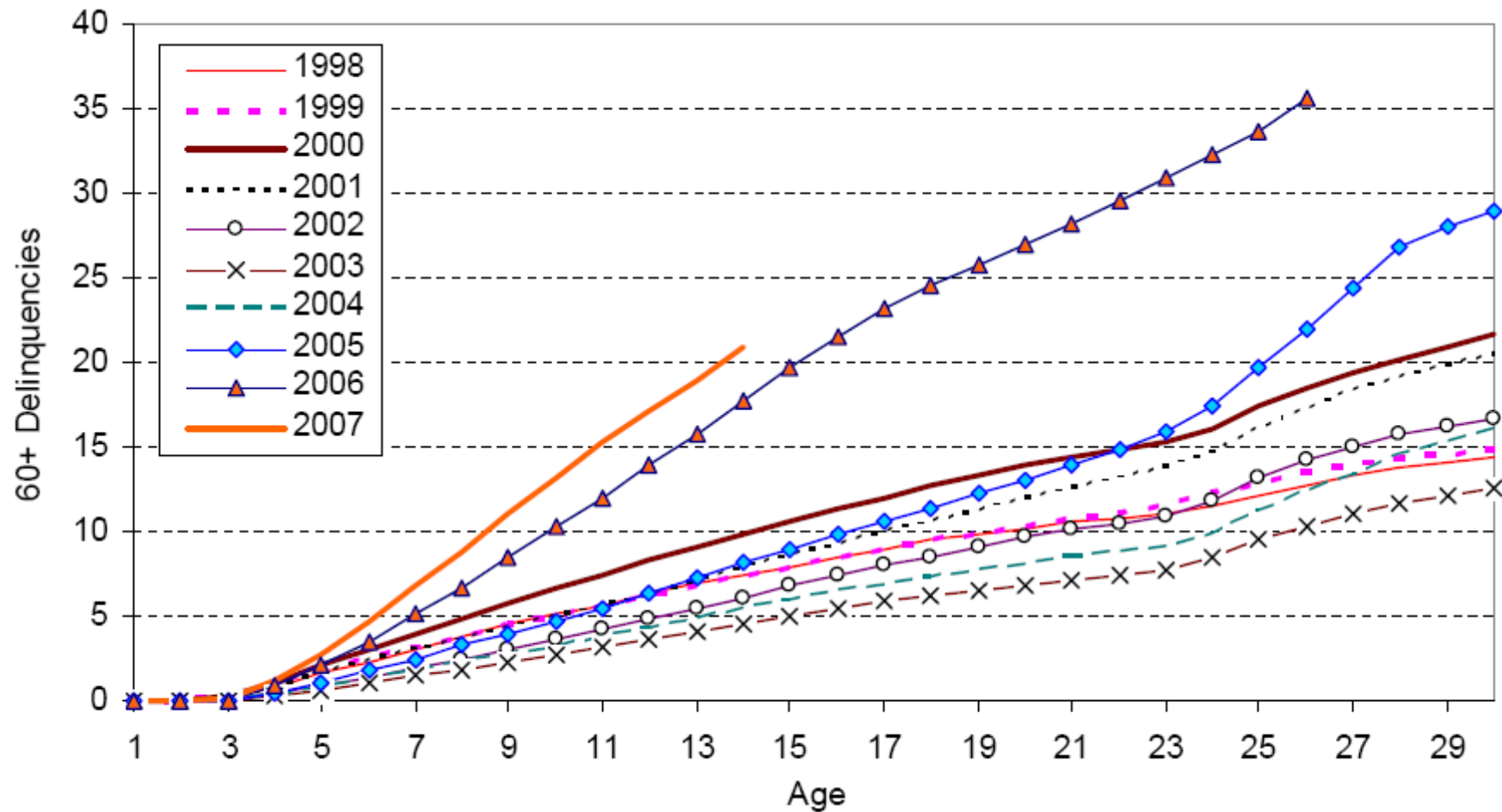
## United States: delinquencies on consumer loans



Source: Bloomberg

# Where we are now

## US sub-prime mortgages: 60+ days delinquencies



Source: UBS Investment Bank

# Where we are now

## Extreme levels of projected US mortgage loss rates

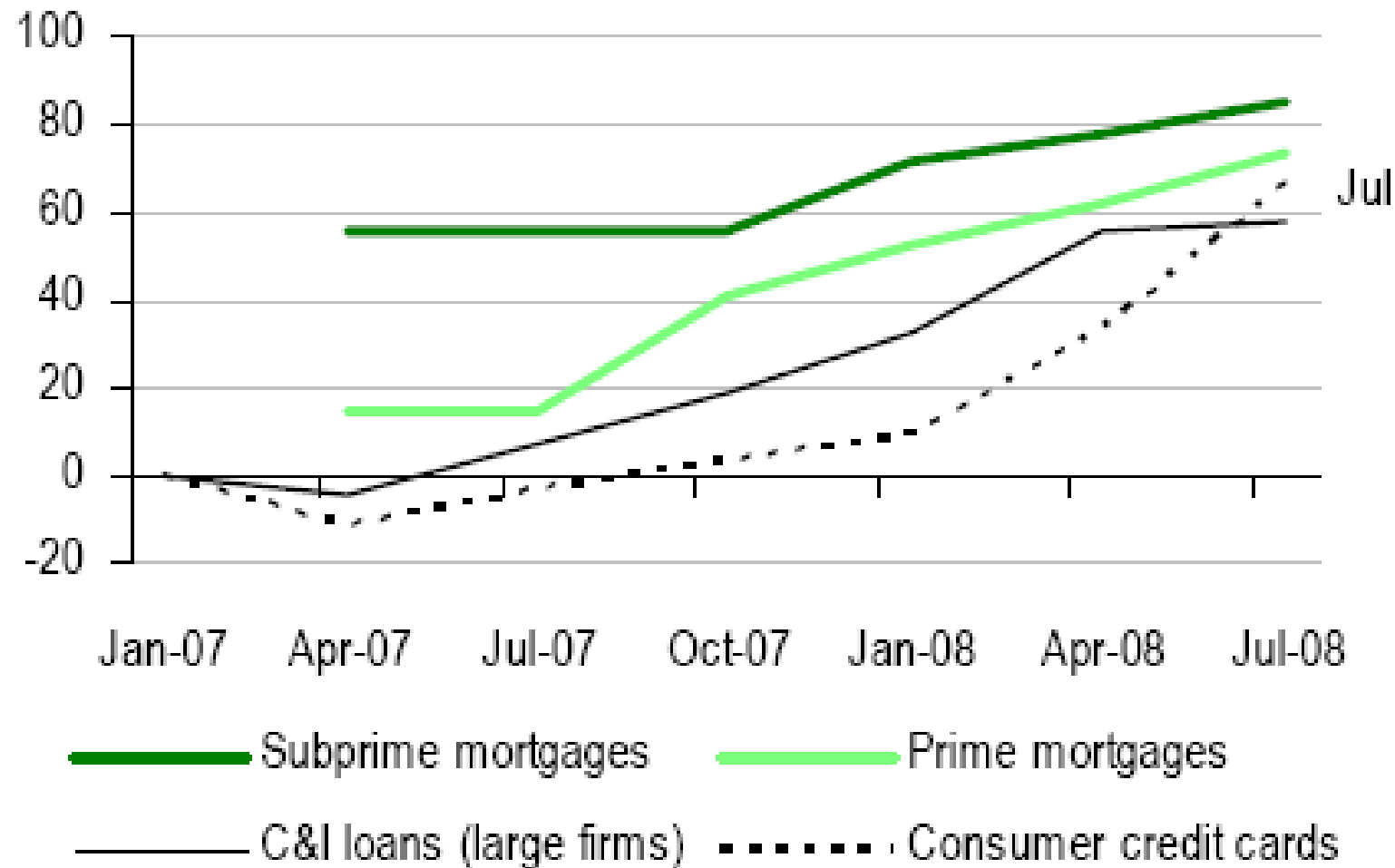
HISTORICAL			
	Prime	Alt-A	Subprime
1998	0.03	0.18	5.14
1999	0.04	0.37	5.26
2000	0.06	0.69	4.93
2001	0.02	0.39	4.19
2002	0.02	0.36	2.31
2003	0.02	0.13	1.37
2004	0.02	0.10	1.03
2005	0.01	0.06	0.75
2006	0.00	0.03	0.42

PROJECTED			
	Prime	Alt-A	Sbprime
2005	0.70	5.00	15.00
2006	1.30	12.00	28.00
2007	2.30	16.00	43.00

Source: UBS Investment Bank

# Where we are now

## US credit crunch: net percentage of banks tightening lending



Source: UBS Investment Bank

# Where we are now

---

## The de-leveraging mechanism

- ◆ Falling home prices
- ◆ Mortgage value > home value
- ◆ Delinquencies and defaults
- ◆ Impact amplified via bank balance sheets
- ◆ Huge write-offs for banks, need to raise capital
- ◆ Pressure to reduce balance sheets
- ◆ Lack of liquidity in market for securitized credit
- ◆ General credit crisis
- ◆ Feeding into global economy



## Where we are now

---

The stresses in the financial system today are  
by far the greatest seen in a generation, if not more.

Larry Summers, former US Secretary of the Treasury and Professor of Economics at Harvard University (March 3, 2008)

# Where we are now

---

## Extensive government intervention

- ◆ Repeated interest rate cuts by the Federal Reserve
- ◆ Substantial expansion of lending facilities by the Fed, ECB and others
- ◆ International lending agreements by the Fed
- ◆ Fed guarantee for rescue of Bear Stearns by JPMorgan
- ◆ Effective nationalization of the US mortgage agencies
- ◆ ....

# Where we are going

---

## Impact of government actions

- ◆ Prevents failure of big banks
- ◆ Nationalizes a part of the mortgage losses
- ◆ Helps increase the supply of mortgages at lower rates
- ◆ Re-establishes some liquidity in credit/asset backed markets
- ◆ Marginally helps reduce the overhang of houses
- ◆ Has very little immediate impact on the economy

# Where we are going

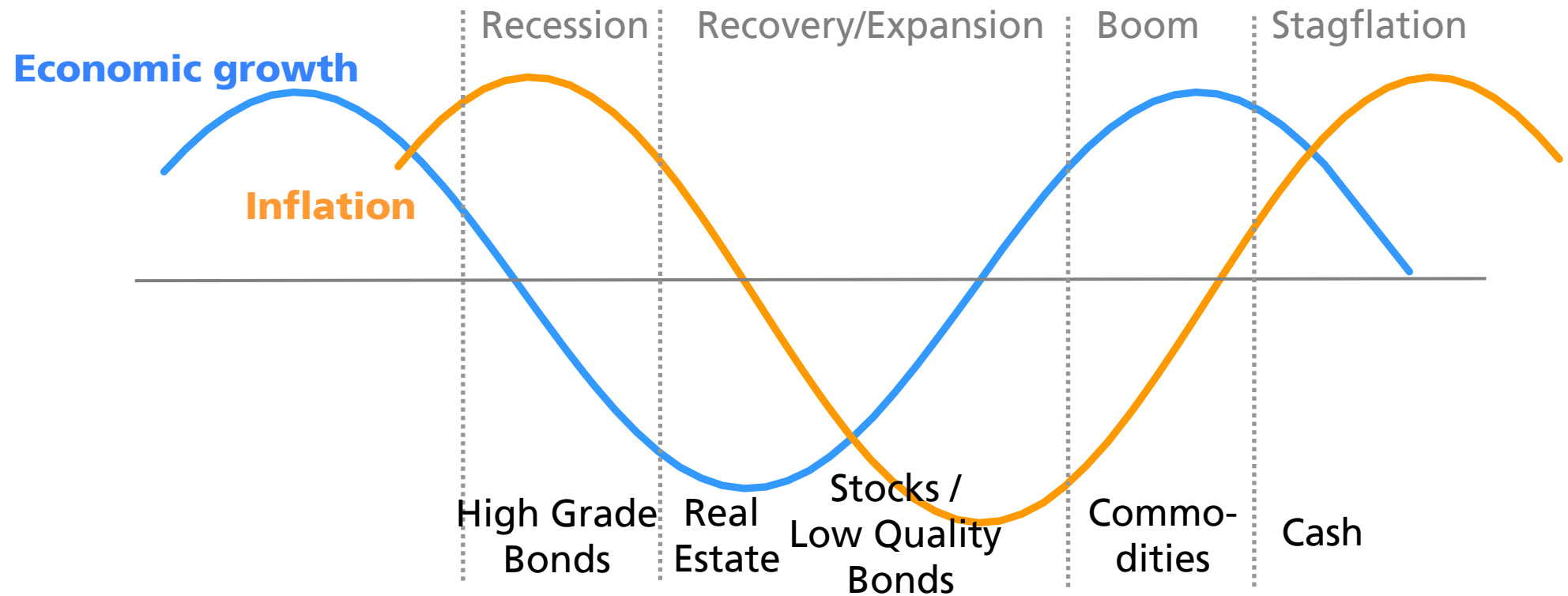
---

## Global economic trends into 2009

- ◆ The US housing market will only find a bottom in 2010
- ◆ US consumers will have to retrench more
- ◆ The US economy will thus remain weak
- ◆ The European economy is also close to recession
- ◆ Relief from the ECB will not come soon enough
- ◆ Banks around the world will remain in retrenchment mode
- ◆ Most emerging markets are slowing as well
- ◆ Expect very sluggish growth globally
- ◆ The positive: inflation risks are rapidly diminishing...
- ◆ ...so interest rates will stay low

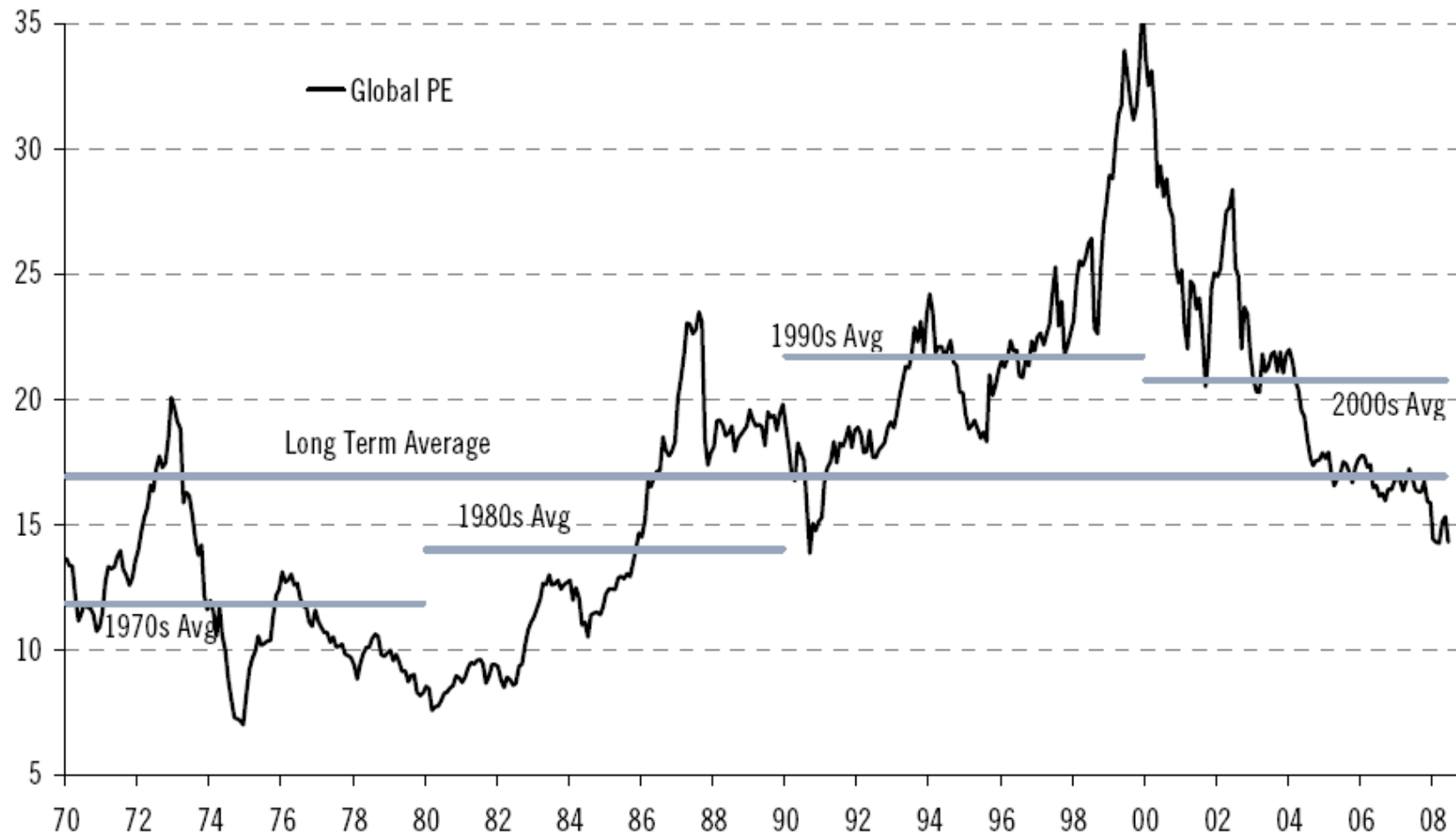
# Where we are going

## Best-performing asset classes over the business cycle



# Where we are going

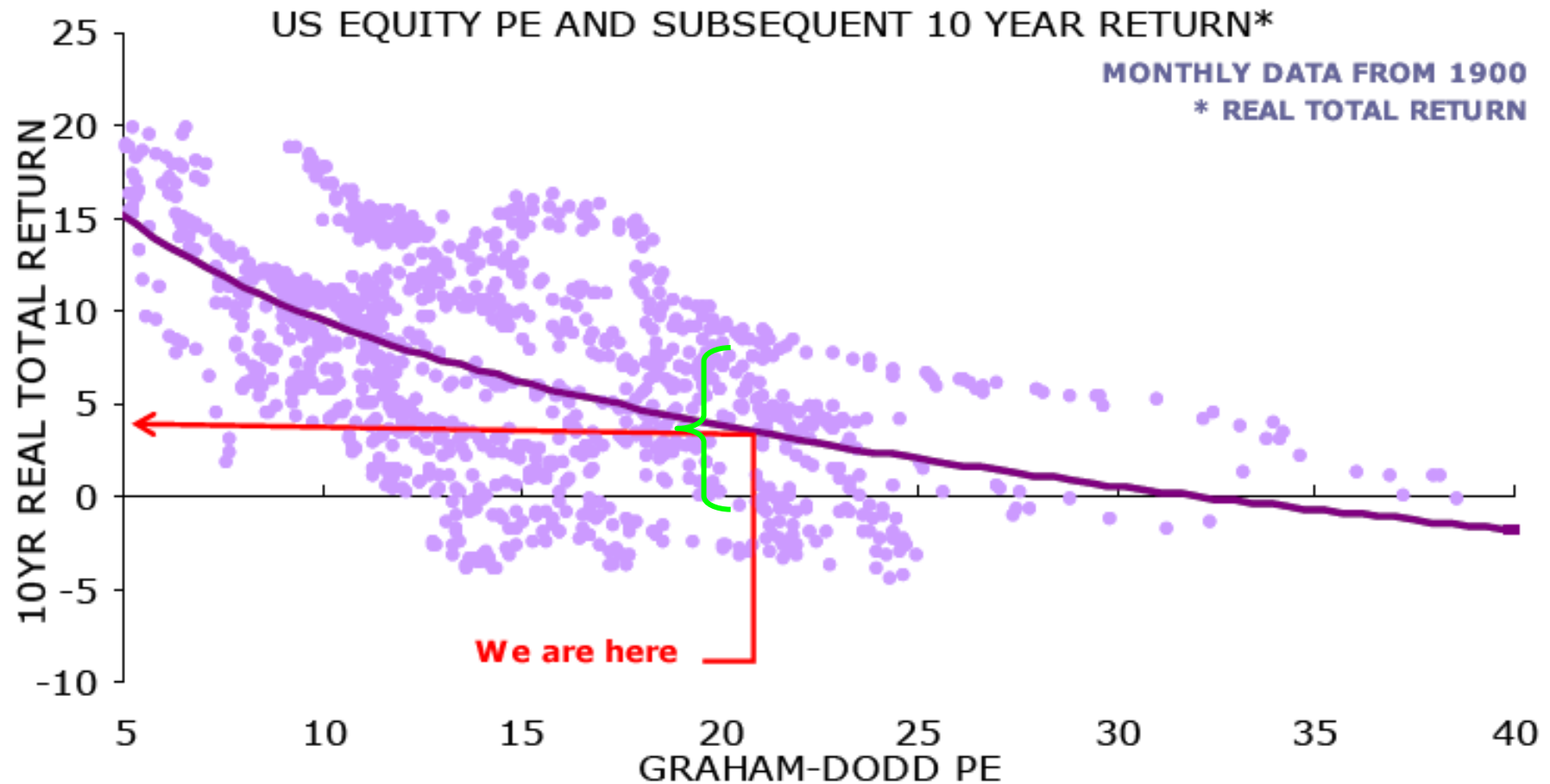
How high *might* future equity returns be ?



Source: Citibank

# Where we are going

How high *might* future returns be ?



Source: Morgan Stanley

# Where we are going

---

## Recommended portfolio positioning

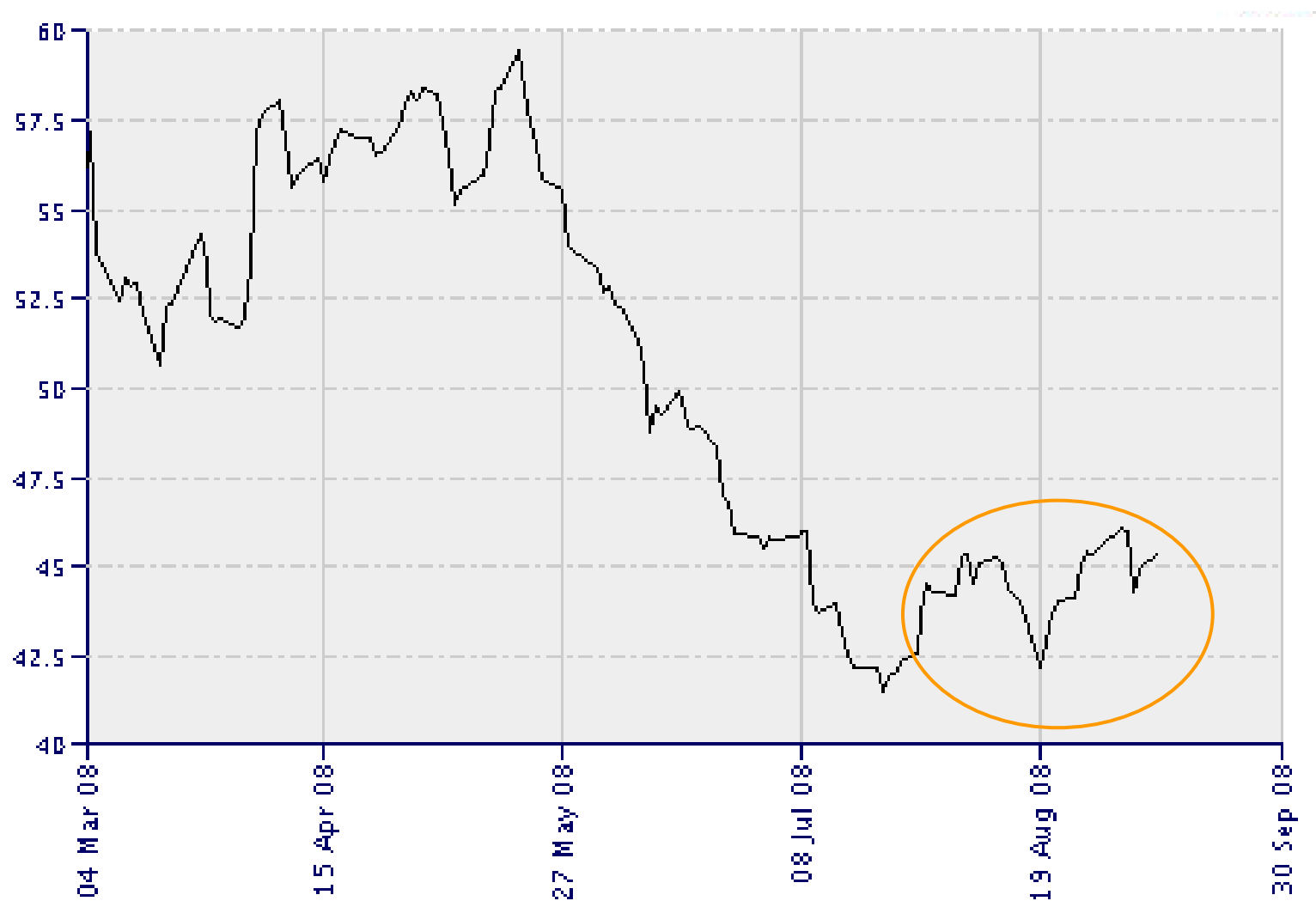
- ◆ Hold a normal equity allocation if long-term oriented.
- ◆ Be prepared for additional setbacks, but hopefully not new lows in major markets (US, EMU)
- ◆ Favor defensive equity markets (US, Switzerland); stay cautious on cyclical and commodity-related markets (e.g. emerging markets, Canada, Japan?).
- ◆ Favor bonds with somewhat lower quality and higher spreads (e.g. major banks) over highest quality where yields are generally unattractive.
- ◆ Amongst currencies, favor the USD and JPY and underweight the EUR and GBP. Stay cautious on most emerging market currencies.
- ◆ Don't jump back into commodities.
- ◆ Hold a neutral allocation to real estate.
- ◆ Favor hedge funds despite weak performance.



This is not the end -  
but we are well beyond the beginning!

# Where we are going

## ABX AAA index



# Where we are going

## US home builders' index

**S5HOME** 374.05Y as of close 9/ 8

Index **GP**



## UBS share price

UBSN VX EQUITY

Hide

GP - Line Chart

Page 1/40

Range

01/07/02 - 09/09/08

Upper

Trade Line

Mov. Avgs

Currency

CHF

Period

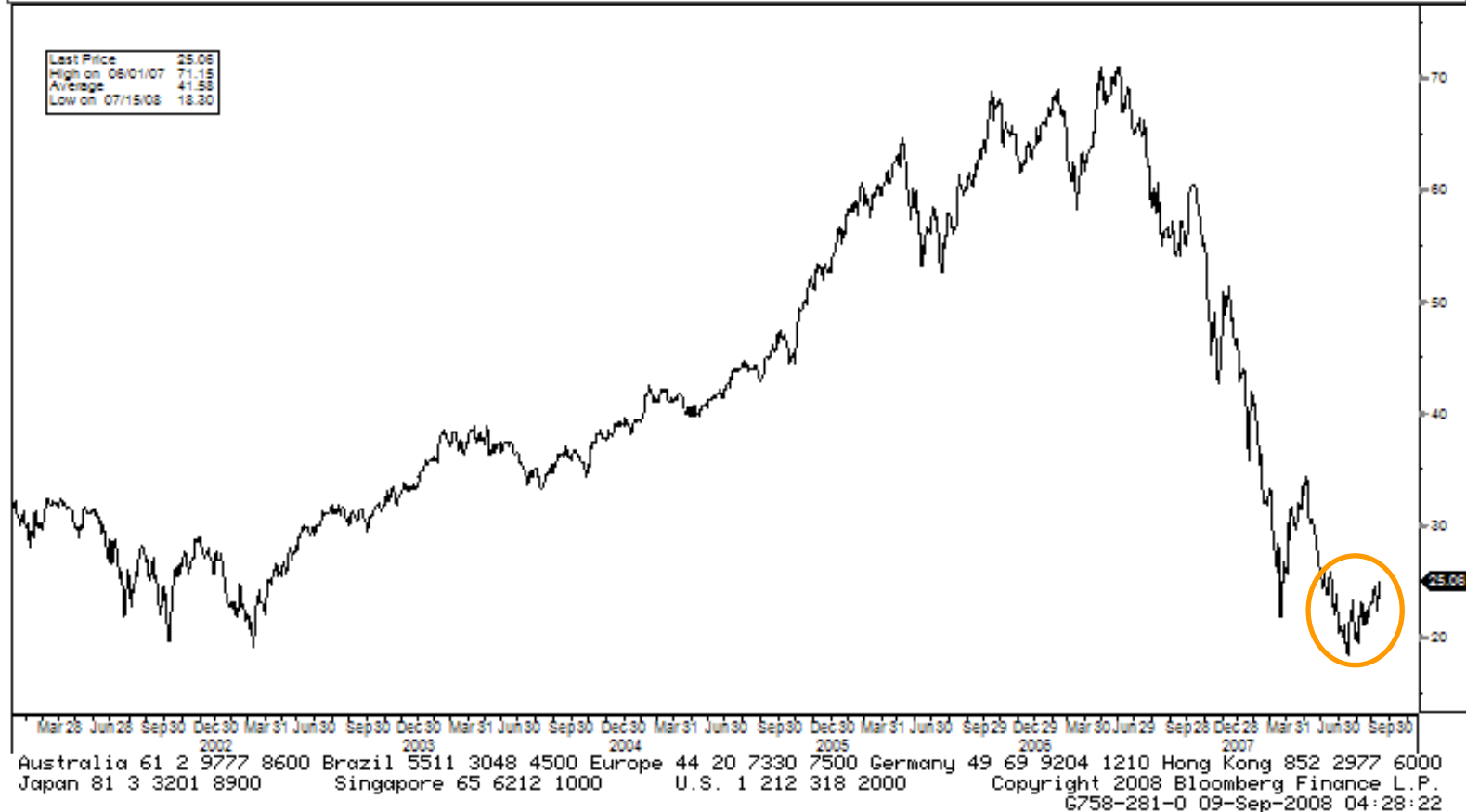
Daily

Lower

None

Mov. Avg

Events



# Contact

---

**UBS AG**

Dr. Oliver Adler  
Wealth Management &  
Business Banking  
P.O. Box  
CH-8098 Zürich

[oliver.adler@ubs.com](mailto:oliver.adler@ubs.com)

Tel: +41-1 234 6112  
Fax: +41-1 234 2599

[www.ubs.com](http://www.ubs.com)

# Disclaimer

---

This publication is for your information only and is not intended as an offer, or a solicitation of an offer, to buy or sell any investment or other specific product. Certain services and products are subject to legal restrictions and cannot be offered worldwide on an unrestricted basis. Although all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to its accuracy or completeness. All information and opinions as well as any prices indicated are subject to change without notice. At any time UBS AG ("UBS") and other companies in the UBS group (or employees thereof) may have a long or short position, or deal as principal or agent, in relevant securities or provide advisory or other services to the issuer of relevant securities or to a company connected with an issuer. Some investments may not be readily realisable since the market in the securities is illiquid and therefore valuing the investment and identifying the risk to which you are exposed may be difficult to quantify. Futures and options trading is considered risky and past performance of an investment is not a guide to its future performance. Some investments may be subject to sudden and large falls in value and on realisation you may receive back less than you invested or may be required to pay more. Changes in FX rates may have an adverse effect on the price, value or income of an investment. We are of necessity unable to take into account the particular investment objectives, financial situation and needs of our individual clients and we would recommend that you take financial and/or tax advice as to the implications (including tax) of investing in any of the products mentioned herein. For structured financial instruments and funds the sales prospectus is legally binding. If you are interested you may attain a copy via UBS or a subsidiary of UBS. This document may not be reproduced or copies circulated without prior authority of UBS or a subsidiary of UBS. UBS expressly prohibits the distribution and transfer of this document to third parties for any reason. UBS will not be liable for any claims or lawsuits from any third parties arising from the use or distribution of this document. This report is for distribution only under such circumstances as may be permitted by applicable law.

**UK:** Approved by UBS AG, authorised and regulated in the UK by the Financial Services Authority. A member of the London Stock Exchange. This publication is distributed to private clients of UBS London in the UK. Where products or services are provided from outside the UK they will not be covered by the UK regulatory regime or the Financial Services Compensation Scheme. **USA:** This document is not intended for distribution into the US and / or to US persons. **Canada:** In Canada, this publication is distributed to clients of UBS Wealth Management Canada by UBS Investment Management Canada Inc.. **Germany:** Issuer under German Law is UBS Deutschland AG, Stephanstrasse 14 - 16, 60313 Frankfurt am Main. UBS Deutschland AG is authorized and regulated by the Bundesanstalt für Finanzdienstleistungsaufsicht. **Bahamas:** This Publication is distributed to private client of UBS (Bahamas) Ltd and is not intended for distribution to persons designated as a Bahamian citizen or resident under the Bahamas Exchange Control Regulations. **Hong Kong:** This publication is distributed to clients of UBS AG Hong Kong Branch by UBS AG Hong Kong Branch, a licensed bank under the Hong Kong Banking Ordinance and a registered institution under the Securities and Futures Ordinance. **Singapore:** Distributed by UBS AG Singapore Branch, an exempt Financial Adviser under the Singapore Financial Advisers Act. **Australia:** Distributed by UBS AG (Holder of Australian Financial Services Licence No. 231087) and UBS Wealth Management Australia Ltd (Holder of Australian Financial Services Licence No. 231127), Level 27, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000. **Indonesia:** This material of research or publication is not intended and not prepared for purposes of public offering of securities under the Indonesian Capital Market Law and its implementing regulations. Securities mentioned in this material have not been, and will not be, registered under the Indonesian Capital Market Law and regulations. **UAE:** This research report is not intended to constitute an offer, sale or delivery of shares or other securities under the laws of the United Arab Emirates (UAE). The contents of this report have not been and will not be approved by any authority in the United Arab Emirates including the Emirates Securities and Commodities Authority or the UAE Central Bank, the Dubai Financial Market, the Abu Dhabi Securities market or any other UAE exchange. This research report must not be provided to any person other than the original recipient, and may not be reproduced or used for any other purpose. **France:** This publication is distributed to clients of UBS (France) SA, a duly authorized Bank under the terms of French "Code Monétaire et Financier", regulated by French banking and financial authorities as the "Banque de France" and the "Autorité des Marchés Financiers". **Luxembourg:** This publication is not intended to constitute an offer under Luxembourg law, but might be made available for information purposes to clients of UBS (Luxembourg) S.A., a regulated bank under the supervision of the "Commission de Surveillance du Secteur Financier" (CSSF), to which such publication has not been submitted for approval.

© UBS 1998-2006. The key symbol and UBS are registered and unregistered trademarks of UBS. All rights reserved.