UBS

UBS Investment Strategy Guide

The US dollar strikes back

At a glance

Economic Outlook

- On average, first-quarter economic growth surprised positively and the US managed, just, to escape contraction.
- Forward-looking indicators are pointing downward, however, and we continue to expect economic growth to slow in 2008.

Investment Strategies

- We prefer attractively valued corporate bonds and we advise caution on commodities that have de-coupled from fundamentals.
- For equity investors, we suggest exposure to the US market and the US dollar (meaning no currency hedge for foreign equity investors).
- Risk-seeking investors should take an active position in Polish equities, our favored emerging equity market.

Focus: Currencies – The US dollar strikes back

- The USD is now inexpensive versus most currencies, and we position ourselves for its expected appreciation.
- UK growth is likely to disappoint markets in the second half of 2008, leading the GBP to depreciate against the USD.

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Global asset class returns[1]

in %	2007	YTD	next 12 months[2]
Money market	4.2	1.7	3.8
Government bonds	4.7	0.6	3.3
Corporate bonds	3.8	-0.9	7.5
Equities[3]	5.2	-5.9	8.0

[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 26 May 2008

Investment Opportunities

Equity markets have rebounded since mid-March, as financial market uncertainty has receded and US economic growth weakened, but did not collapse, as some expected it might. Equity valuation is in fair territory, in our view, and we recommend maintaining a neutral stance overall. This does not mean we see no opportunities for investors. In fact, we note many interesting investment opportunities at present.

Over a tactical 3-12 month horizon, we find the best value in corporate bonds, as we think the additional yield over government bonds more than compensates for the expected increase in corporate default rates. We caution against commodities, particularly energy-related.

Among developed equity markets, we prefer the US, and we would add USD currency exposure too. Despite being at the center of the economic slowdown, US companies operate in a global environment and are supported by a low-interest-rate environment. Across the Atlantic, we remove our active weight in EMU, after having recommended the region for several years. Among currencies, our high-conviction call is for USD to strengthen against GBP. A weakening UK economy should weigh on the GBP, which, in our view, is overvalued against the USD.

For investors with an investment horizon of a year or more, we have several high-conviction Strategic Calls that exploit longer-term trends in areas such as healthcare and agribusiness (please see the UBS Research Portal or consult your client advisor for more information).

Mark Andersen, Analyst, UBS AG

For intra-month updates, please see the UBS Investment Strategy Update

Core market views – hedged[1]

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

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

Source: UBS WMR, as of 26 May 2008

[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 affect performance). Currency considerations are treated separately (see third column).

Past performance is no indication of future performance. The market prices provided are closing prices on the respective principle stock exchange. This applies to all performance charts and tables in this publication.

Focus: Slowdown outside the US should lift the US dollar

Back to "At a glance"

This month, we have revised our currency strategy to favor North America's currencies over Europe's. We expect the EU and UK economies to catch up with the more advanced US downturn. As the British economy is weaker than Europe's, we see more pressure on the pound than on the euro in the next couple of weeks. However, we think structurally undervalued Asia-ex-Japan currencies are likely to appreciate versus the US dollar, as looming inflation compels Asian governments to let their currencies strengthen.

Recent currency developments

Recently, North American currencies showed their first signs of consolidating against European currencies. The appreciation trend of the euro (EUR) has ceased and the British pound (GBP) depreciated. Undervalued Asia ex-Japan (AXJ) currencies had stopped appreciating for some weeks before appreciating anew last week. Among them, the most striking development has been that of the Chinese yuan (CNY), which remained flat against the US dollar (USD) for about a month before strengthening again.

The recovery in global equities over the month has coincided with the return of carry trade strategies, which involve borrowing in currencies of countries with low interest rates, such as the Japanese yen (JPY) and the Swiss franc (CHF), to invest in currencies where the interest rates are high, such as the Australian dollar (AUD), for instance. As a result, the JPY and the CHF have significantly depreciated while the AUD, also supported by rising commodity prices, has appreciated.

Currency misalignments still significant

In our UBS Research Focus, "Currencies: a delicate imbalance," published in March, we discussed the current substantial misalignments in currency markets. They have been fuelled by the accumulation of large foreign exchange reserves by Asian and oil-exporting countries and have helped to finance the US current account deficit for years. In our view, these currency misalignments will continue to correct. Indeed, countries with managed currencies are facing mounting pressure to let their currencies appreciate in order to contain rising inflation.

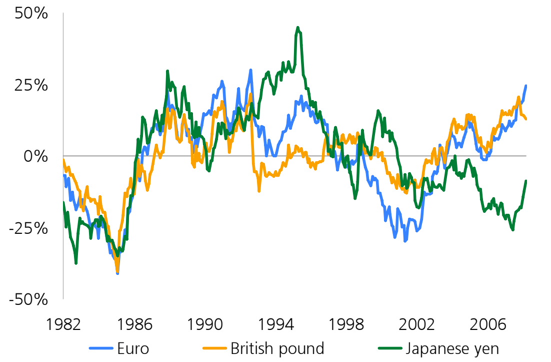
According to our estimates of purchasing power parity (PPP), a metric for an equilibrium exchange rate, major currencies are indeed drastically imbalanced. Versus the USD, the EUR is overvalued by 27% and the GBP by 13%. In general, AXJ currencies are also undervalued, as their substantial foreign exchange reserves suggest. In other words, the valuation signal is clear: over the long run, the USD and the AXJ currencies should appreciate against both the GBP and the EUR.

European economies facing a slowdown

We expect the European and the British business cycles to converge towards the more advanced US downturn. Recent economic indicators such as the Purchasing Manager Indexes (PMI) are pointing downwards. The US index has fallen below 50, which suggests a contraction in activity. We also expect indexes for the EMU and the UK to decline, indicating more weakness ahead. Thus, more negative news on growth looks likely from Europe.

European currencies are expensive

Valuation gaps in % vs. the USD

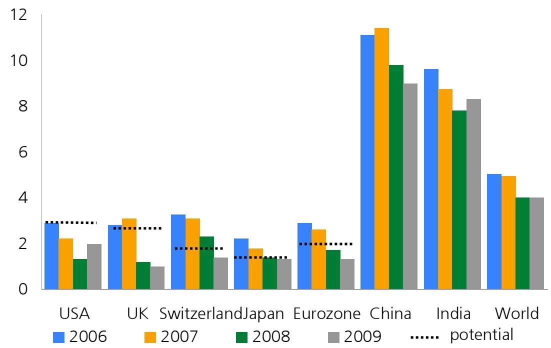


Note: Valuation gap is measured as deviation from purchasing power parity (PPP)

Source: UBS WMR, as of 26 May 2008

Growth well below potential

Real GDP growth, y/y in %



Sources: Bloomberg, UBS WMR, as of 26 May 2008

Weak US economic woes already discounted
The US economy is well advanced in the downturn and we think that the second quarter should see the low point. We expect the effects of the very accommodative monetary policy and the fiscal stimulus to be evident in the third quarter. Still, growth is likely to remain subdued in 2008 and 2009, as house prices are likely to remain under pressure for some time and credit conditions have tightened, limiting private consumption.

US economic indicators have surprised positively of late, even though they are still broadly down. The recently published minutes of the Federal Open Monetary Committee (FOMC) expresses the Fed's view that risks to growth and inflation are now balanced. Between the lines, the minutes suggest that the Fed is likely to cut interest rates again only if upcoming economic data really disappoint. Externally, at least, the US economy has improved recently and the current account deficit has fallen to 4.9% of GDP. These developments are supportive for the USD.

European slowdown likely to weigh on currencies
Contrary to the US, we think that markets have not yet fully anticipated the extent of the European and the British slowdowns. The current growth slowdown began in the US and, as any shock needs time to spread from the epicenter, its effects are now moving to the periphery.

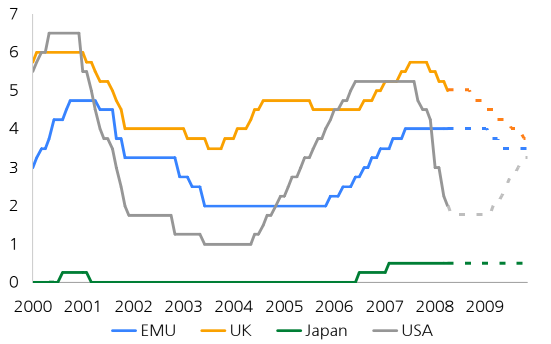
In the UK, the growth slowdown is firmly materializing. House prices have moderated substantially, the labor market is weakening and credit conditions are tightening. However, as inflation rose to 3% in April and is expected to creep up further in the next coming months, we now think the Bank of England (BoE) is likely to delay its next rate cut to November. We are pessimistic on Britain's economic outlook, as we expect growth to be well below potential both this year and next. We are convinced of the necessity for the BoE to cut rates sooner rather than later. And we think a sharp slowdown of the UK economy and its weighty financial sector will put the GBP under strong pressure in the coming months.

In the EU, growth was surprisingly robust in the first quarter and the European Central Bank (ECB) has maintained its 4% interest rate unchanged so far this year. After the latest decision, ECB President Jean-Claude Trichet even cited the term "vigilance," which means – if we decrypt correctly – that he does not utterly rule out a rate hike. As long as ECB officials maintain this tone, the EUR should find some support. But a slowing economy speaks for softer comments ahead, and rate cuts eventually. This could provide the trigger for an end to the considerable appreciation of the EUR versus the USD.

Inflation to revive currency appreciation in Asia
Central banks around the world are between a rock and a hard place. On the one hand, the weakening global economy encourages them to become more accommodative in order to support growth. On the other, rising food and commodity prices are putting upward pressure on inflation expectations and preventing them from becoming more accommodative.

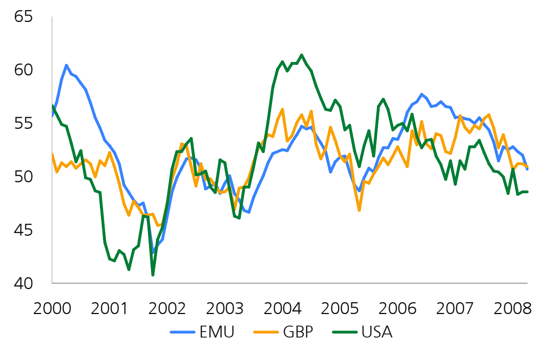
In general, AXJ central banks are not independent from their governments and they have so far chosen to support high economic growth domestically by keeping their currencies undervalued. And they have been very successful, as GDP has expanded rapidly throughout Asia in

Convergence of interest rates
Central banks target rates in %



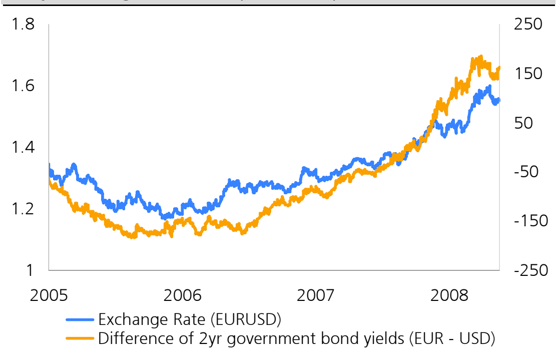
Sources: Thomson Financial, UBS WMR, as of 26 May 2008

European economies follow the US
Purchasing Manager's Index (PMI) leading indexes



Sources: Thomson Financial, UBS WMR, as of 26 May 2008

The USD has found some support
Daily exchange rate and spread in bp



Sources: Bloomberg, UBS WMR, as of 26 May 2008

recent years. The central banks have managed their currencies to remain undervalued in the aftermath of the Asian crisis of 1997-98, which has assured their international competitiveness. But when inflation rises, as is currently the case, central banks eventually have to de-emphasize high growth in favor of letting their currencies appreciate in order to contain upward price pressures.

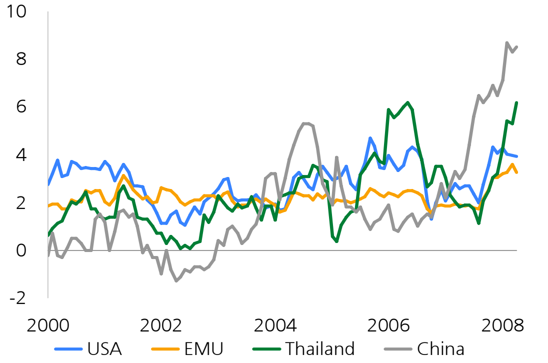
The AXJ currencies have already appreciated against the USD over the past couple of years. But in recent weeks most AXJ currencies have come under pressure, most likely because the growth outlook for Asia's economies has been questioned by the markets. However, in our view, inflation is the main problem in the region now, as inflation rates are significantly higher than in Europe and in the US. We therefore expect governments to let their currencies appreciate further in order to contain the inflation threat.

Within AXJ currencies, we prefer undervalued currencies with strong current account positions. The Chinese yuan (CNY), the Malaysian ringgit (MYR) and the Taiwanese dollar (TWD) are our favorites. We see less appreciation potential for the Korean won (KRW) and the Philippine peso (PHP) because South Korea has a current account deficit and we think the Philippines' trade balance is likely to deteriorate.

Yves Longchamp, Analyst, UBS AG

Inflation hurts Asia more than EMU and the US

Headline CPI inflation, y/y in %



Sources: Bloomberg, UBS WMR, as of 26 May 2008

Economic Outlook: Don't draw too many conclusions from the first quarter

Back to "At a glance"

With the exception of the US, global growth surprised positively in the first quarter. Aside from the larger emerging markets, Germany was especially noteworthy, posting a quarter-over-quarter annualized GDP growth rate of 6%, its highest since 1995. However, leading indicators there and in other major economies are pointing to a significant slowdown ahead.

Growth: All major economies have now released their growth rates for the first quarter of 2008. The US was definitively the laggard, with an estimated growth rate no higher than 1% q/q annualized. Both Germany and Japan continued to surprise positively, as did the Eurozone overall. However, several economies show early signs of severe downturns, notably the UK and Spain, or are already in dismal shape, namely, Italy. Looking at the leading indicators, we expect all major developed economies to slow in the coming quarters, while most emerging markets should continue to post solid growth rates.

Inflation: Despite ongoing pressure from high oil prices, inflation rates eased somewhat in developed countries, while still above central bank targets in most countries. Excessively high inflation, mainly caused by high commodity and food prices, continues to be the major economic problem for emerging markets. We note in particular the Chinese inflation rate, which was above 8% in April for the third month in a row.

Short-term interest rates: Although we still expect more rate cuts from the Fed, we now look for their next move in October and not in June after the rather hawkish minutes of the FOMC's April meeting, released last week. We expect the ECB to wait until the end of the first quarter of 2009 to start a cycle of lower interest rates, given its steady emphasis on inflation to date. Despite an economy that is rapidly slowing, we expect the BoE to wait until November for its next rate cut, as inflation continues to pose a major problem in the UK. In our view, the Bank of Japan should continue to stay on hold for the next 12 months, while we expect the Swiss National Bank to deliver a first rate cut after the summer.

Bond yields: The subdued growth outlook is struggling with increased inflation expectations to determine the direction of bond yields. We expect sideways to slightly higher yields over the next couple of months.

Andreas Hoefert, Economist, UBS FS. Inc.

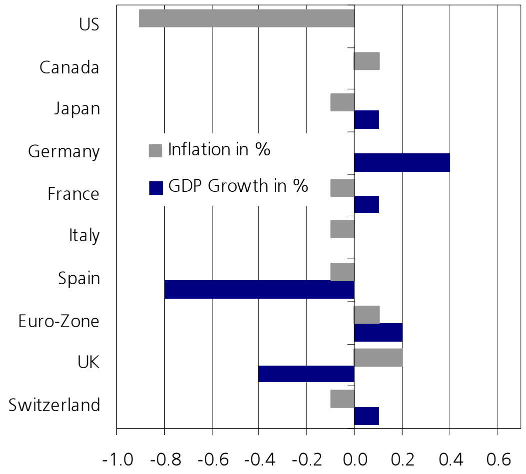
Growth and inflation forecasts

in %	GDP Growth			Inflation		
	'07	'08 F[2]	'09 F[2]	'07	'08 F[2]	'09 F[2]
World	4.9	4.0	4.0	4.0	5.1	4.2
US	2.2	1.3	2.0	2.8	2.9	3.0
Canada	2.5	1.3	2.6	2.4	1.8	2.0
Japan	1.8	1.4	1.3	0.0	1.2	0.5
Eurozone	2.6	1.7	1.3	1.9	3.2	2.1
Germany	2.7	2.1	1.5	2.0	2.6	1.8
France	1.8	1.6	1.1	1.4	2.6	1.8
Italy	1.8	0.6	0.6	1.9	2.9	2.1
Spain	3.8	1.3	1.1	2.5	3.8	2.6
UK	3.1	1.2	1.0	2.4	2.9	1.9
Switzerland	3.1	2.3	1.4	0.7	1.8	1.4
China	11.4	9.8	9.0	4.8	7.2	5.2
Asia / Pacific[1]	8.6	7.4	7.1	3.9	6.1	4.5

[1]Excluding Japan. [2]E: estimate, F: forecast.
Source: UBS WMR, as of 26 May 2008

Main economic forecasts

Deviations from consensus in %-points; for 2008



Sources: Consensus Economics, UBS WMR, as of 26 May 2008

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	2.00	2.20	3.90	4.10	1.00	1.00
Canada	2.20	2.20	3.70	3.90	1.08	1.15
Japan	0.90	0.90	1.70	1.80	105	110
Euro-Zone	4.30	3.90	4.30	4.30	1.50	1.39
UK	5.30	4.60	4.80	4.80	0.53	0.55
Switzerland	2.50	2.00	3.00	3.20	1.05	1.12

[1]USD exchange rate.
Source: UBS WMR, as of 26 May 2008

Extended Asset Allocation: Cautious on commodities

Back to "At a glance"

Commodities have been all-stars so far this year. Not only has the asset class contributed to portfolio diversification, but, with broad-based gains averaging 20%, it is the best-performing asset class year-to-date. However, in a world of slowing growth, we struggle to see the logic in the latest price developments and we maintain a cautious stance on commodities.

Money market (neutral): Last month, we recommended shifting money market investments into corporate bonds and we repeat this view this month.

Fixed-income bloc (moderate overweight): We continue to prefer corporate bond investments both from an overall portfolio perspective and within our fixed-income strategy. Credit spreads have started to narrow recently, and we think this trend is likely to continue for both investment-grade and high-yield rated corporate bonds. However, we find government bonds and emerging market bonds expensive and hold a moderate underweight as a consequence. In expectation of an increase in volatility from its current relatively low levels and a fall in credit spreads, we have decided to increase convertible bonds to a moderate overweight.

Equities bloc (neutral): Risky assets have performed well in recent months, as markets have taken comfort in a lower level of stress in the financial system and only a moderate slowing of overall economic indicators. As a consequence, valuation levels have moved from attractive toward a broader fair-value range for equities. We advise a neutral equity stance at this point in time.

Nontraditional assets bloc (moderate underweight): We advise to increase the underweight in commodities. Prices no longer reflect economic fundamentals, in our view, and seasonality is also turning against commodities as we enter the summer season in the northern hemisphere. Speculation remains high in commodities and could support current price levels for a time, but we caution against jumping on the bandwagon. We maintain our neutral allocation for listed real estate at present.

Mark Andersen, Analyst, UBS AG

Asset class performance

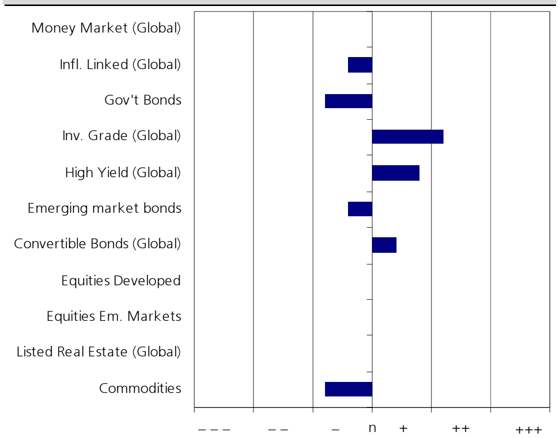
in %	Strategy[1]	2007	YTD[2]
Money market (global)	n	4.2	1.7
Fixed income			
Inflation-linked (global)	–	11.8	6.1
Government bonds (global)	–	4.7	0.6
Inv. grade (global)	++	3.8	-0.9
High yield (global)	+	2.2	1.6
Emerging market bonds	–	6.3	2.0
Convertible bonds (global)	+	8.9	-3.0
Equities			
Equities Developed Markets	n	5.2	-5.9
Equities Emerging Markets	n	33.5	-2.3
Nontraditional Assets			
Listed Real Estate (Global)	n	-12.4	-4.4
Commodities	–	16.1	19.6

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

Sources: Bloomberg, Thomson Financial, UBS WMR, as of 26 May 2008

Extended asset allocation strategy

Deviations from benchmark[1]



[1]Symbols: please see appendix.

Source: UBS WMR, as of 26 May 2008

Currency Strategy: We favor USD over GBP and EUR

Back to "At a glance"

We think the European and the British business cycles are likely to show more signs of weaknesses in the coming months. As growth is likely to slow, we expect both the BoE and the ECB to become more accommodative, which should put pressure on the GBP and the EUR versus the USD.

US dollar (moderate overweight): We think the USD is undervalued versus most currencies. The US economy is likely to see the low point this quarter in our view. And we think the Fed is likely to remain on hold in the coming months.

Canadian dollar (neutral): The Canadian economy posted supportive economic indicators, especially compared with the US. However, the CAD remains expensive against the USD, in our view.

Japanese yen (moderate overweight): The JPY is inexpensive against all major currencies. Notwithstanding the weak Japanese economic outlook, the JPY should benefit from ongoing risk aversion.

Euro (moderate underweight): We think the EUR is expensive relative to the USD. We expect the European economy to slow gradually and the ECB to become progressively more dovish.

Swiss franc (moderate overweight): From a fundamental standpoint, the CHF is inexpensive and should appreciate against the EUR, supported by the robust Swiss economy. Volatile financial markets should also support the franc.

Swedish krona (neutral): The SEK's valuation makes it attractive versus the EUR. Nevertheless, the Swedish economy is slowing and this should limit the SEK's further appreciation.

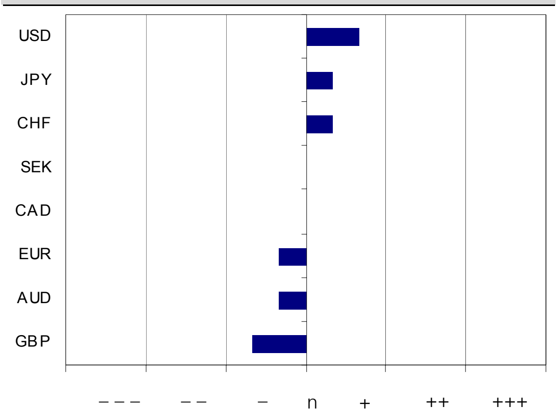
British pound (moderate underweight): The GBP looks relatively expensive and fundamentals speak for a further depreciation. A cooling housing market and the burden from the credit crisis are weighing on economic momentum.

Australian dollar (moderate underweight): The AUD is one of the most expensive currencies in our universe. In the context of a general global slowdown, the booming Australian economy is at risk as it largely depends on commodities.

Yves Longchamp, Analyst, UBS AG

Currency strategy

Deviations from benchmark[1]



[1]Symbols: please see appendix.
Source: UBS WMR, as of 26 May 2008

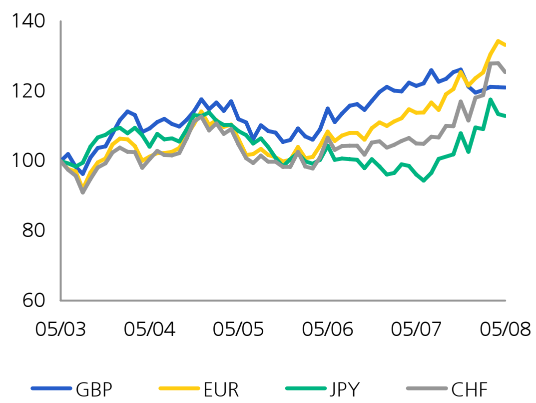
Currency market returns against the USD[1]

		Market returns (in %)	
	Strategy[2]	2007	YTD[3]
CAD	n	16.8	1.2
EUR	–	10.5	8.0
GBP	–	1.4	-0.3
CHF	+	7.5	10.3
SEK	n	5.9	9.4
JPY	+	6.6	7.8
AUD	–	10.9	9.6

[1]Exchange rate changes in %: a positive number indicates gains against the USD. [2]Symbols: please see appendix. [3]YTD = year-to-date.
Sources: Thomson Financial, UBS WMR, as of 26 May 2008

Exchange rate development

Normalized exchange rates versus USD



Sources: Thomson Financial, UBS WMR, as of 26 May 2008

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Equity Market Strategy: Downgrade EMU to neutral; reduce Australia underweight

We move EMU from a moderate overweight to neutral and reduce the underweight in Australia to a moderate underweight:

- **Despite its attractive valuation, we lower EMU to neutral in view of risks we see for earnings outlooks due to cyclical factors.**
- **In Australia, the earnings picture improved, which should limit downside risk. But valuation does not look particularly attractive, so that we implement a moderate underweight.**

North America

United States (moderate overweight): Given its more defensive nature, we are comfortable retaining our moderate overweight. Moreover, the earnings outlook for 2009 seems brighter, thereby supporting the US market. Valuations are fair, although we saw some re-rating recently.

Canada (neutral): Driven by the Energy sector, the Canadian market continued to outperform. Valuation does not look particularly attractive, neither when viewed historically, nor relative to the other markets we cover. Thus, we keep our neutral stance.

Europe

EMU (neutral): EMU continues to be attractively valued. Nevertheless, downward earnings revisions have gained momentum, eroding the earnings outlook for 2009. With the ECB on hold, commodity prices high and the euro still strong, we see considerable challenges ahead, despite mostly robust earnings at present. Thus, for cyclical reasons, we expect Eurozone equities to move rather in line with global equities and we adopt a neutral stance.

United Kingdom (moderate overweight): The UK market outperformed recently owing to its exposure to the Materials and Energy sectors. These sectors continued their strong upward moves against a backdrop of raising commodity prices. Looking ahead, we keep our moderate overweight mainly for valuation reasons and the UK's more defensive nature.

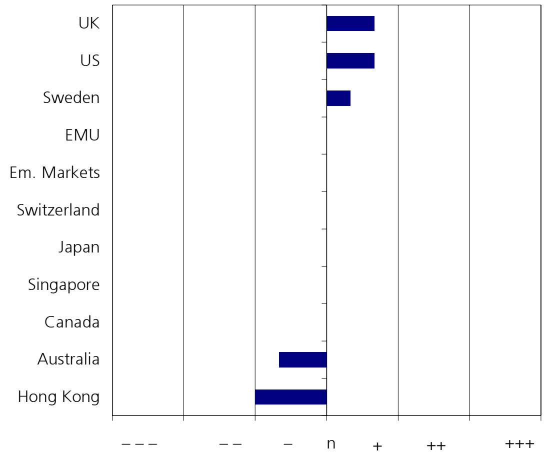
Switzerland (neutral): Swiss equities slightly underperformed global equity markets. Positive development in Healthcare was counterbalanced by the weak performance of Financials. We remain neutral.

Sweden (moderate overweight): Sweden moved in line with global equity markets. As the earnings outlook remained resilient and valuation is still in favor of the market, we retain our moderate overweight.

Markus Irngartinger, Analyst, UBS AG

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]Symbols: please see appendix.

Source: UBS WMR, as of 26 May 2008

Equity markets

		Market returns (in %)		
	Strategy[3]	2007	YTD[4]	next 12 m
US[1]	+	6.0	-5.1	8.0
S&P 500[2]		3.5	-6.3	6.0
DJ Industrial[2]		6.4	-5.9	5.9
Nasdaq[2]		9.8	-7.8	7.8
Canada[1]	n	10.5	9.2	1.5
S&P TSX comp.[2]		7.2	6.4	-0.2
EMU[1]	n	8.5	-11.2	9.5
Euro Stoxx 50[2]		6.8	-15.3	6.8
UK[1]	+	6.6	-4.0	9.0
FTSE 100[2]		3.8	-5.7	5.3
Switzerland[1]	n	-1.6	-9.8	6.5
SMI[2]		-3.4	-12.1	4.6
Sweden[1]	+	-4.2	-4.2	6.5
Japan[1]	n	-10.1	-6.4	5.5
Nikkei 225[2]		-11.1	-8.5	4.5
Australia[1]	–	16.5	-7.4	6.0
ASX[2]		11.9	-9.0	2.3
Hong Kong[1]	–	41.6	-13.6	4.0
Hang Seng[2]		40.4	-10.8	0.7
Singapore[1]	n	20.4	-8.0	5.0
Emerging Markets[1]	n	33.5	-2.3	4.0
Overall	n	5.2	-5.9	8.0

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

Sources: Thomson Financial, UBS WMR, as of 26 May 2008

Japan (neutral): After Japanese equities rallied in early spring, the market moved more in line with global equity markets recently. Companies gave a cautious earnings outlook in view of the strong yen. We remain neutral.

Australia (moderate underweight): Australia has performed solidly of late. The main driver was a sharp upward move in the Energy sector against the backdrop of rising oil prices. The earnings outlook for the market as a whole clearly improved and justifies cutting our underweight back to a moderate underweight, in our view.

Markus Irngartinger, Analyst, UBS AG

Emerging Markets (neutral): Overall, even in the light of global financial market uncertainty, emerging market fundamentals remain strong and, so far, economic indicators suggest only a slight moderation in economic activity ahead. However, valuation levels already reflect a large part of these positive fundamentals. Despite the increasing concerns about the US economy and the turmoil in financial markets, earnings growth expectations for emerging markets have only declined marginally since the beginning of the year. With weaker global growth ahead, we think earnings downgrades will be difficult to avoid. However, we are confident that emerging markets will continue to deliver robust growth in 2008.

Yves Bogni, Analyst, UBS AG

Valuation and profitability ratios

	P/E[1]	P/BV[2]	ROE[3]	DY[4]
Australia	13.34	2.55	17%	4.07
Canada	13.82	2.73	15%	2.25
EMU	10.88	1.84	15%	3.70
Hong Kong	17.71	1.96	12%	2.57
Japan	14.80	1.54	10%	1.70
Singapore	14.09	1.98	16%	2.82
Sweden	11.45	2.15	18%	3.95
Switzerland	13.90	2.55	15%	2.86
US	14.30	2.64	15%	2.05
UK	11.10	2.14	19%	3.77

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

Sources: I/B/E/S Thomson Financial, UBS WMR, as of 26 May 2008

Global Equity Sector Strategy: Still cautious on earnings growth

Back to "At a glance"

Given the deteriorating growth outlook, we remain cautious on sectors with cyclical earnings profiles. We prefer industries with stable earnings throughout the business cycle and those with high pricing power, like Consumer Staples.

Consumer Discretionary (underweight): We believe that current growth expectations for this cyclical sector are still too high and further downgrades are likely.

Consumer Staples (overweight): The sector possesses a relatively stable earnings profile throughout the business cycle. High pricing power enables companies to pass on higher input costs to consumers.

Energy (moderate underweight): We expect crude oil prices to decline in the near term. Moreover, decelerating growth in developed countries should slow demand for oil as well.

Financials (moderate overweight): The valuation of Financials remains attractive. The sector's recently demonstrated ability to raise substantial capital supports its good long-term growth prospects. But earnings risk remains high for the sector in coming quarters.

Health Care (moderate overweight): Earnings growth is resilient for the sector, and cost-cutting potential remains an additional possible profit-driver.

Industrials (moderate underweight): The global slowdown is a serious drag on this sector. Valuation presently does not sufficiently reflect earnings risk, in our view.

Information-Technology (neutral): Valuation is supportive for the sector. However, elevated earnings expectations are still a concern and negative surprises are possible.

Materials (moderate underweight): We expect near-term price corrections in several commodities, limiting earnings potential. Stretched valuation does not yet reflect this scenario, in our view.

Telecom (moderate overweight): Valuation remains attractive and earnings are likely to meet expectations globally.

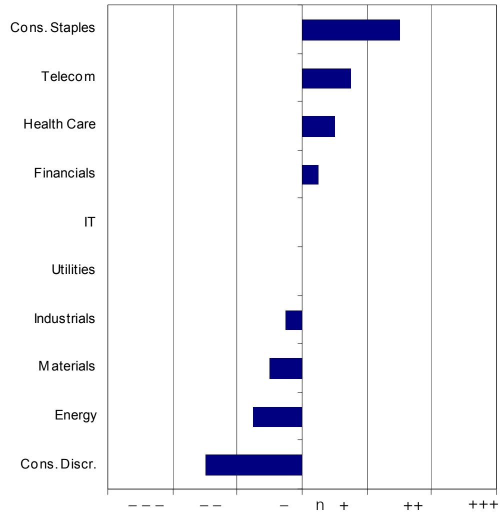
Utilities (neutral): The non-cyclical earnings profile is a clear positive for the sector and a key argument for the current valuation premium. However, we expect this premium to wane over the next quarters.

Oliver Dettmann, Analyst, UBS AG
Stephen Freedman, Analyst, UBS FS. Inc.

For intra-month updates, please see the UBS Investment Strategy Update

Equity sector strategy – Global

Deviations from benchmark[1]



[1]Symbols: please see appendix.
Source: UBS WMR, as of 26 May 2008

Equity sectors – Global

		Market returns (in %)		
	Strategy[1]	2007	YTD[2]	last 5 yrs
Consumer Discretionary	– –	-6.7	-10.1	48.1
Consumer Staples	++	15.0	-4.9	75.5
Energy	–	25.3	9.8	203.1
Financials	+	-12.0	-12.6	54.7
Healthcare	+	1.9	-9.7	28.9
Industrials	–	11.0	-5.2	115.5
IT	n	12.8	-8.1	62.0
Materials	–	25.3	7.5	227.2
Telecom	+	16.8	-12.5	58.0
Utilities	n	16.7	-6.4	136.8

[1]Symbols: please see appendix. [2]YTD = year-to-date; MSCI in local currencies.
Sources: Thomson Financial, UBS WMR, as of 26 May 2008

Valuation and profitability ratios

Global Sectors:	P/E[1]	P/BV[2]	ROE[3]	DY[4]
Consumer Discretionary	13.85	1.98	13%	2.22
Cons. Staples	16.30	3.25	18%	2.57
Energy	11.38	2.90	22%	2.02
Financials	11.13	1.45	12%	4.03
Health Care	13.56	3.14	18%	2.32
Industrials	13.76	2.51	16%	2.23
IT	16.70	3.44	16%	1.07
Materials	12.83	2.67	17%	1.87
Telecom	12.95	1.96	13%	4.22
Utilities	15.62	2.08	13%	3.21

[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 26 May 2008

Back to "At a glance"

Fixed Income Strategy: Rising inflation- and growth risks

Most recently, bond yields increased together with short-term interest rates, while credit spreads continued to decline. At the same time, rising oil prices fed higher inflation expectations. However, cyclical risks remain elevated, as credit availability wanes and declining consumer confidence points to slowing global consumption growth. As a consequence, we prefer staying close to neutral in the overall portfolio duration as cyclical risks generally balance expensive valuation, in our view.

Market strategy:

USD (moderate underweight): Expensive. Government bond yields are depressed by the cyclical slowdown. Most recently, consensus was surprised by relatively good labor market conditions and retail sales.

CAD (moderate underweight): Expensive valuation. Risk for rising yields comes mainly from USD yields, as Canadian growth has shown weakness, especially concerning private consumption.

AUD (moderate overweight): Slightly expensive. Growth indicators have declined recently, while inflation spiked temporarily.

JPY (moderate underweight): Expensively valued, but growth risks are high, for example, for consumption, industrial production. Therefore, it may take time until yields rise more significantly.

EUR (moderate overweight): The yield curve is flat and reflects a relatively resilient economy on the business side. But the risk is rather to the downside for growth and for yields.

SEK (neutral): Yields have been moving in line with yields in the Eurozone, but the market is somewhat less liquid.

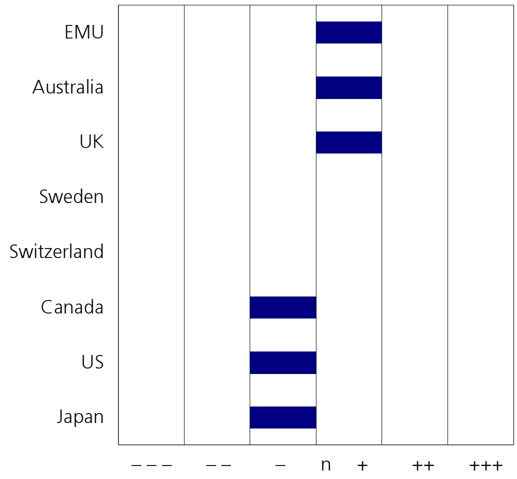
GBP (moderate overweight): Trends in housing indicators, business sentiment and retail sales point to lower growth and interest rates in the medium term.

CHF (neutral): Relatively more expensive than other European markets, but this is compensated by a slightly steeper yield curve.

Achim Peijan, Analyst, UBS AG

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]Symbols: please see appendix.

Source: UBS WMR, as of 26 May 2008

Bonds

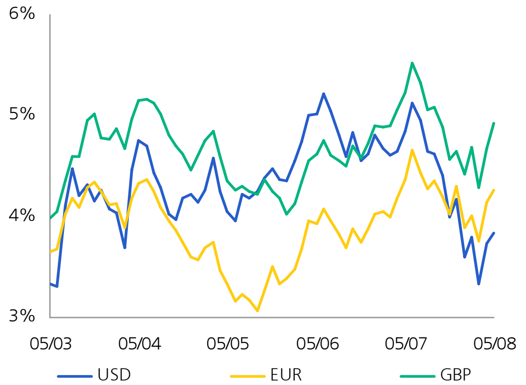
	Duration	Market Returns in %		
	Strategy[1]	2007	YTD[2]	next 12 m
US	– –	9.2	2.0	3.1
Canada	– –	4.9	2.8	2.4
EMU	n	2.0	1.1	4.3
UK	++	5.1	-1.3	4.9
Switzerland	n	-0.5	0.3	2.5
Sweden	n	1.6	1.5	5.1
Japan	–	2.7	-0.6	0.9
Australia	++	3.7	2.3	6.7
Overall	–	4.7	0.3	3.3

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

Sources: Bloomberg, UBS WMR, as of 26 May 2008

Bond market developments

10-year government bond yields (in %)



Sources: Bloomberg, UBS WMR, as of 26 May 2008

Credit Strategy: Corporate bonds continue to recover

Back to "At a glance"

Corporate bonds have delivered good performance over the last month as the credit risk premium continued to decline. Liquidity constraints in the credit markets also abated. Concerns about the negative impact of the slowing US and global economies persist. We think that corporate credit markets remain attractively valued at present and that investors grew overly pessimistic about the fundamental credit outlook.

Investment Grade (IG) Corporate Bonds (overweight): IG spreads narrowed as the systemic risk in the financial sector abated after significant recapitalization efforts and supportive measures by various central banks. As a result, IG bonds posted better performance compared with government bonds over the last month. We think that IG bonds remain attractively valued compared with government bonds. We continue to recommend an overweight allocation.

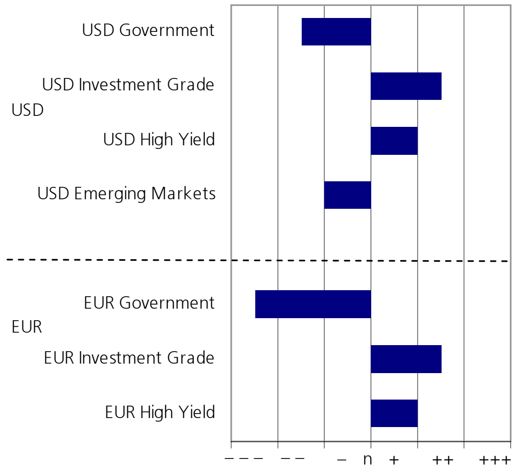
High Yield (HY) Corporate Bonds (moderate overweight): HY spreads decreased substantially and posted very good performance over the last month. US HY default rates continued their upward trend in April, but remain at very low levels, supported by still-solid company balance sheets. We think that speculative-grade default rates should increase to their long-term average towards the end of 2008 owing to slower economic growth and tighter financing conditions. Although uncertainty about the current situation remains, we believe that spreads are pricing in an excessively pessimistic outlook. We recommend a moderate overweight position.

Emerging Market Debt (EM) (moderate underweight): EM country risk premiums decreased somewhat over the past month, but their performance trailed corporate bonds. We think the valuation of USD-denominated EM bonds is expensive relative to US corporates, a premium that we think is unjustified in an environment of slowing economic growth and rising inflation in several emerging markets. We maintain EM debt at a moderate underweight.

Bernhard Obenhuber, Analyst, UBS AG

Credit Strategy

Deviations from benchmark in each currency block[1]



[1]Symbols: please see appendix.
Source: UBS WMR, as of 26 May 2008

Credit segments

		Market Returns in %		
	Strategy[1]	2007	YTD[2]	next 12 m
Investment Grade[3]				
US	++	4.7	0.6	7.8
EMU	++	0.2	0.4	7.2
High Yield[3]				
US	+	2.2	1.6	9.0
EMU	+	-2.2	0.5	9.3
Emerging Markets[4]				
USD	–	6.3	2.0	7.7

[1]Symbols: please see appendix. [2]YTD = year-to-date. [3]Merrill Lynch Indexes. [4]JP Morgan Index, global issues in USD.
Sources: Merrill Lynch indices, Bloomberg, UBS WMR, as of 26 May 2008

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Emerging Markets Strategy

Emerging Markets Equities: In line with our Asia ex-JP strategy, we moved Indonesia from neutral to a moderate underweight. Over recent weeks, Indonesia has seen a substantial worsening in valuations, while earnings momentum has weakened. In turn, we upgraded Russia from neutral to a moderate overweight. Russia is one of the most attractively valued markets, in our view, with robust domestic demand. And Russian oil companies, which account for a considerable part of the total market, are not very sensitive to oil prices owing to the high taxes in Russia. However, as Russia's oil production has been declining, we expect the government to cut these taxes. In Asia, we continue to favor Korea and Taiwan, where we see attractive valuations. However, we moderately underweight Malaysia and India. In Latin America, we are still positive on Brazil's long-term prospects, though we currently recommend only a neutral allocation on a tactical basis. We recommend an underweight position in Chile, which is facing a difficult situation, with slowing growth and increasing inflation. Besides Russia, we favor Poland in the EMEA region. Poland offers attractive valuations and should be less affected by weaker US growth than some other Emerging Markets, in our view.

Yves Bogni, Analyst, UBS AG

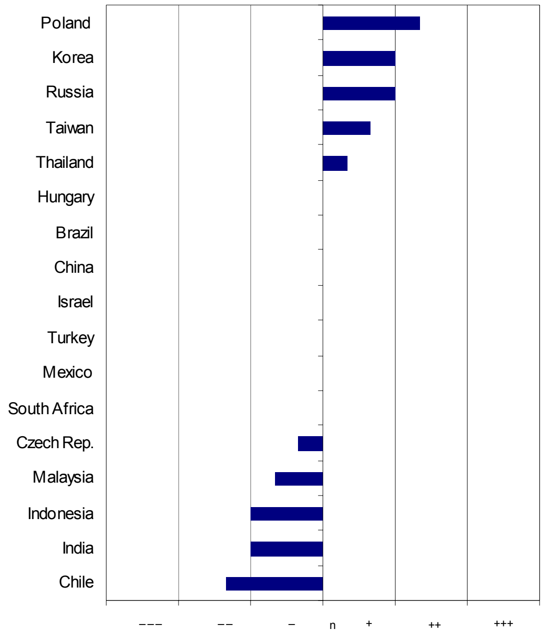
Emerging Markets (EM) USD Debt: Over the past month, the spread between the yields on US Treasuries and EM sovereign bonds denominated in USD has moved in the range of 2.7% to 2.9%. We have not yet seen any marked deterioration in the ability of most emerging market sovereigns to meet their foreign debt servicing obligations. On the contrary, foreign exchange reserve levels have continued to rise in several countries. However, given our outlook for slower global growth over the next 12 months, compounded by monetary tightening in the emerging markets, there is an increased risk of fiscal slippage and the prospect of more debt issuance in USD, as opposed to issuing in the local currency. This, in turn, could well slow the recent trend towards ratings upgrades. On balance, then, this does not speak for lower emerging market yields in the months ahead. In this environment, we believe that investors would be better served by selecting the USD bonds of those sovereigns with stronger fundamentals (as reflected in a commitment to fiscal prudence, a current account surplus, low levels of foreign indebtedness and adequate levels of foreign exchange reserves).

Costa Vayenas, Analyst, UBS AG

For intra-month updates, please see the UBS daily guide

Emerging markets equities – unhedged[2]

Deviations from benchmark[1]



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

Source: UBS WMR, as of 26 May 2008

Sovereign USD Bonds

Country	Strategy[1]	Moody's[2]	S&P[2]
Investment grade rating sovereigns			
Brazil	++	Ba1	BBB-
Chile	n	A2	A+
Malaysia	n	A3	A-
Mexico	-	Baa1	BBB+
Russia	+	Baa2	BBB+
South Africa	+	Baa1	BBB+
Speculative grade rating sovereigns			
Argentina	n	B3	B+
Colombia	n	Ba2	BB+
Ecuador	n	B3	B-
Indonesia	n	Ba3	BB-
Peru	-	Ba2	BB+
Philippines	-	B1	BB-
Turkey	-	Ba3	BB-
Ukraine	n	B1	BB-
Venezuela	n	B2	BB-

[1] Symbols: please see appendix

[2] Long-term foreign currency rating

For an explanation of what these ratings, as well as the symbols "+", "-" and "n" mean, please see the detailed explanation in the Appendix.

Sources: Bloomberg, UBS WMR, as of 26 May 2008

Commodity Strategy

Back to "At a glance"

We expect energy prices to decline from their current levels. The recent price increases in crude oil already reflect the deterioration of non-Opec supplies. Moreover, a firmer USD and a weaker growth outlook for Asia should add pressure on prices, in our view. That said, upward price momentum in energy commodities remains very strong and shows no sign of weakness yet. Other commodity sectors managed to gain only marginally at best, thus underperforming energy on a relative basis. We expect that gap to narrow.

Energy (underweight): Price momentum in crude oil has reaccelerated and the market switched from backwardation to contango. Although we acknowledge the supply-side challenges over the longer run, we still believe the market is well supplied at present. Given the economic environment, current price levels are overdone, in our view. This would not be the case if spare capacity (versus the peak potential oil supply) had narrowed substantially. We still favor natural gas over crude oil from a valuation standpoint.

Base Metals (moderate overweight): Although we have an overweight on this commodity sector, we expect divergent performance from individual metals. Power supply constraints, mine problems and tight inventories should support aluminum, copper and tin prices. But we remain cautious on nickel, lead and zinc in the short term.

Precious metals (moderate overweight): Ongoing inflation concerns should support gold prices over the coming weeks. Fresh uncertainty over supply from South Africa should add luster to gold. We remain cautious on silver, as the market is likely to continue in surplus. We expect gold to outperform silver.

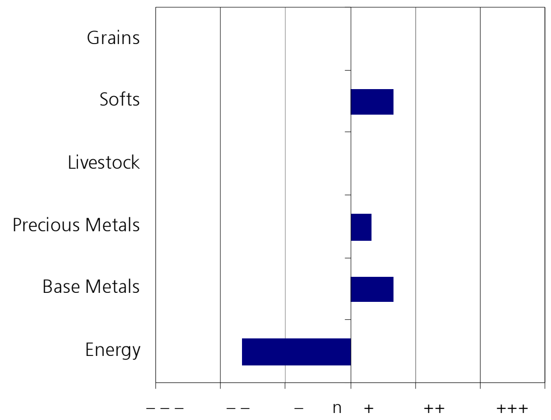
Grains (neutral): We remain neutral on grains. We switched our positive stance from corn to wheat. This is attributable to the strong relative underperformance of wheat to corn. Lacking any catalyst at present, we expect soybean prices to trade sideways.

Soft and Livestock (moderate overweight): Sugar prices should remain under pressure, as the market is in surplus. However, we remain positive on coffee and cotton on a relative basis – versus the crude oil. Coffee prices have adjusted towards a bigger coffee harvest in Brazil, thus leaving the market vulnerable to disappointments.

Dominic Schnider, Analyst, UBS AG

Commodity Strategy (USD)

Deviation from benchmark[1]



[1]Symbols: 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 26 May 2008

Commodity returns

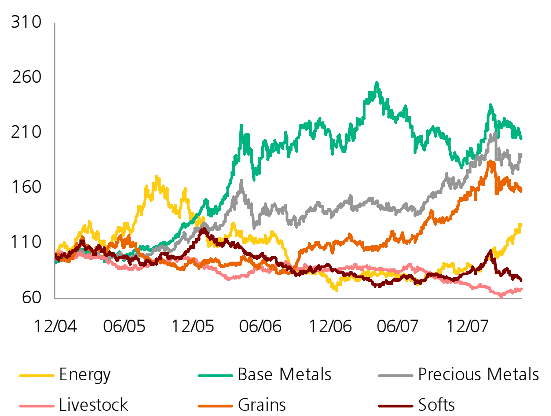
in %	2007	YTD[1]	last 5y
DJ AIG CI ER	11.0	18.7	84.7
AIG Energy ER	14.6	43.8	65.2
AIG Industrial Metals ER	-13.1	13.2	240.3
AIG Precious Metals ER	20.9	12.3	134.3
AIG Grains ER	36.0	7.0	38.9
AIG Livestock ER	-15.0	-6.4	-14.0
AIG Soft ER	-8.2	-8.8	-24.7

[1]YTD = year-to-date.

Sources: UBS WMR , Bloomberg, as of 26 May 2008

Dow Jones AIG Commodity Index

DJ AIG CI excess returns; rebased



Sources: Bloomberg, UBS WMR, as of 26 May 2008

Appendix

Back to "At a glance"

Symbols			
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

Emerging Market Sovereign USD bonds
Investors should be aware that Emerging Market assets are subject to, amongst others, potential risks linked to currency volatility, abrupt changes in the cost of capital and the economic growth outlook, as well as regulatory and socio-political risk, interest rate risk and higher credit risk. Assets can sometimes be very illiquid and liquidity conditions can abruptly worsen. UBS recommends only those securities it believes meet U.S. registration rules (per Securities Act of 1933 - Section 4(3) and Regulation S) and State registration rules (commonly known as "blue sky" laws); however, some bonds sold will not be federally registered.

For more background see the WMR Education Note "Investing in Emerging Markets (Part 2): EM bonds", 20 November 2007. Clients interested in gaining exposure to emerging market sovereign USD bonds may either buy a diversified fund of such bonds (preferably an actively managed portfolio of such bonds), or they may wish to select bonds from specific countries. In order to make it easier for investors to judge the suitability of the bonds from any particular country, the table includes the long-term foreign currency issuer rating by Moody's and Standard & Poor's. In this context, the key factor that investors need to be aware of is a sovereign's ability and willingness to service its debt. A country may be able to pay, but unwilling to so.

Accordingly, the sovereign credit ratings in the table are a guide by the rating agencies on the probability that a sovereign will default.

- Issuers rated 'A' offer good financial security. However elements may be present which suggest a susceptibility to impairment sometime in the future.
- Issuers rated 'Baa' or 'BBB' offer adequate financial security. However, certain protective elements may be lacking or may be unreliable over any great period of time.
- Issuers rated 'Ba' or 'BB' offer questionable financial security. Often the ability of these entities to meet obligations may be moderate and not well safeguarded in the future.
- Issuers rated 'B' offer poor financial security. Assurance of payment of obligations over any long period of time is small.

The benchmark for this strategy is the JP Morgan Emerging Markets Bond Index Global. That index currently consists of the sovereign USD bonds of 36 emerging market countries. We do not list all 36 countries in this publication.

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 minimize the risk that an investor could end up holding bonds on which the sovereign has defaulted. Sub-investment grade bonds are recommended only for clients that have a higher risk profile and who seek to hold higher yielding bonds for shorter periods only.

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