Technical Analysis

Technical Outlook 2012

Global

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1/3/2012

Fasten Your Seatbelt 2.0 …

2011 was a year with numerous external shocks on the macro side and unprecedented volatility across all asset classes. The title of our 2011 strategy was, fasten your seatbelt. Our key message for 2012 is very similar to last year. We expect another dramatic year in terms of volatility, and 2012 we see splitting between a very challenging first half for risk assets, whereas the second half of the year should take on a much more positive background as we expect risk assets to move into an important bottom in summer 2012. Here are our key calls:

- Last year we expected the 2009 cyclical bull markets in equities and commodities to head into a major peak, and in line with our cyclical models the first bear wave in risk assets moved into an important tactical low in early Q4. We have no evidence that the early October low represents an important long-term bottom. The consequence is that the Q4 recovery in global equities only represents a bear market rally and this suggests that we are going to see at least one more bear leg in risk assets this year.
- Presidential election years actually have a bullish background for US equities but we see 2012 in the same context as 2011, with the decennial cycle having a negative impact on risk assets. Following our cyclical models we expect a negative surprise in equities in H1. However, in 5 out of the last 11 decades the US market has set an important long-term bottom in a year ending in “2” and with the Juglar cycle and the Kitchin cycle moving into a major trough later this year our key message is that at the latest in H2 2012 we see risk assets moving into an important bottom and it should be the basis for a new but limited bull cycle into 2013.
- Tactically we expect a weak January followed by another but final bounce from a second half January low into later Q1 to complete the October countertrend rally. From a March top we anticipate the start of a new significant bear wave into lat Q2/early Q3, which is our preferred timing for a major cycle bottom. From a Q1 top we see the risk of a 20% to 25% correction in global equities into the summer, before starting a new bull cycle into 2013.
- After last year’s outperformance, defensive sectors are substantially over-owned globally and technology is a consensual long theme. Following our cycle work we expect a negative surprise in technology in H1 2012 and on the back of a stronger US dollar we generally see the risk of a negative surprise in US mega caps, so that the S&P-500 and Dow Jones Industrials should lose their safe haven status. If we are correct in moving into a major bottom for risk, then Q3 2012 will be the time to buy banks/broker stocks and sell defensives. From a summer low we expect financials to start an impressive comeback into 2013!!
- Each and every one is bearish on Europe but in relative terms the Stoxx-600 is moving into major support versus the S&P-500. Sooner or later we expect Europe to start outperforming the US and on a 12-month basis we expect a positive surprise of Europe over the US.
- In line with our cycle work, the US dollar met a major bottom in Q2 2011 and believing in another risk-off wave we expect more US dollar strength into summer 2012. However, a major bottom in risk assets in H2 2012 suggests: 1) the US dollar moving into an important top later in the year, and 2) an important low in global bond market yields in H2 2012. So although in H1 we see the risk of a negative surprise in the AUDUSD, emerging markets, commodities, and related themes our key message for 2012 is clear. In early Q3 2012 we expect the US dollar to move into an important top and this should be the basis for commodities, emerging markets, and risky currencies starting another limited bull cycle into 2013!
- Gold has hit a 2-year cycle top in September 2011 at $1920 but the current correction does not change the underlying structural bull case. Following our cyclical models we expect gold moving into an important bottom in 2012 and it is the next candidate for starting a major overshooting into 2013/2014. So even if we should see a negative tactical surprise into summer we would see this as a big buying opportunity for gold/silver and the mining sector, where we have see a huge sentiment washout over the last few weeks.

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First … the pain before hitting bottom??

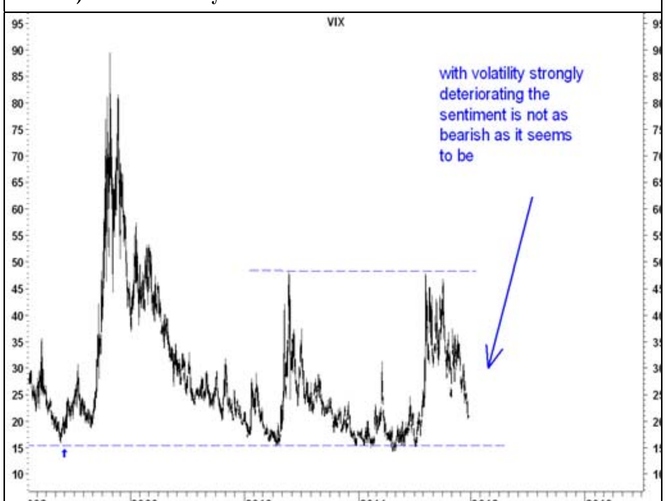
Twelve months ago volatility was low and the consensus towards equities was very bullish and the year 2011 was supposed to be THE year for equities. After a year with unprecedented volatility and numerous shocks on the macro side the reality looks different. In the US the S&P-500 was still able to show a flat year thanks to the amazing outperformance of large caps but with Asia, emerging markets, and Europe underwater the MSCI World ($) closed down 8%, so for the world ex US, 2011 was an outright bearish year. What are the investment themes for 2012 and where, from a technical perspective, could we see positive/negative surprises?

Basically, in contrast to 2011 we are starting on a relatively poor sentiment basis into 2012 after such a volatile and frustrating year. Given the high cash positions of investors and the extreme positioning in defensive themes one could even see this as a contrarian indication for a much better year 2012. Be careful, if we look at the various year-end surveys we have a surprisingly bullish bias for equities. In the Barron's survey, the majority of investment banks are forecasting a 2012 year-end target for the S&P-500 at 1360, which is some 9% higher than today. In Germany in the Handelsblatt survey 36 international banks are forecasting the DAX 12% higher at the end of 2012. Of course, given the high cash positions of investors the sentiment is definitely cautious and to a certain standpoint maybe bearish but it doesn't mean that it can't get worse before it gets better and this is the credo for our 2012 outlook.

The sentiment isn't as bearish as it seems to be

Given the unsolved situation on the macro side we expect again to see very high volatility on both sides. The pressure from the financial markets on politicians and central banks is increasing and in this context 2012 is likely to bring us important decisions that we expect to be the basis/trigger for new trend moves in equities, bonds and currencies into 2013. Following our cyclical models we expected a new cyclical bear market starting in risk assets in Q2 2011, and we do not have one single piece of evidence that the October low 2011 represents a more important bottom in the historical context. So from a technical perspective the stage for a second bear leg in equities and commodities is set.

Chart 1.) VIX Index Daily Chart



Source: UBS Technical Research

Last year we saw defensive stocks strongly outperforming and supporting large cap indices such as an S&P-500 and the Dow Jones Industrials. In Europe, a FTSE and a Swiss Market index could profit from this sector trend. Together with a strong US dollar, in 2012 we see the incremental risk that US mega caps (technology in particular) and the "safe" and high yielding defensive stocks in general could take a hit, as they are over-owned. This is, in our view the main risk behind getting another 20% to 25% correction leg in the major US headline indices and finally also in Europe. So from a macro perspective we could face particularly in H1 2012 a period with a quite deflationary background. In this context it is correct that from a pure pattern standpoint the SPX still looks very similar to the H1 2008 pattern but does this mean that we will see the same kind of melt down as in 2008?

At the end of the day the question is how much pain we'll see before the central banks step into the pitch and/or before we get the ultimate solution on the macro side. Whether we like it or not, all that we have learned over the last few years is that central banks will do everything to avoid a new 2008 meltdown. So sooner or later the likelihood is high that in 2012 the central banks will initiate a new round of a concerted quant easing exercise. Believing in this kind of reflex as well as in our long-term cycle work was one reason (see chart 2.) why in early 2009 we expected the start of a new bull cycle in risk assets: with our cycles suggesting another major low this year we are making the same call as we remain a strong believer in the continuation of the 2009 started reflationary policy of the central banks.

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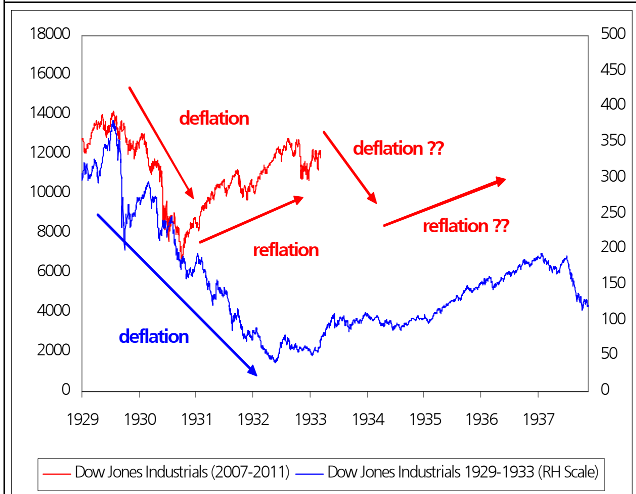
Cycles are suggesting an important low in risk!!

From a cyclical perspective the most important message for our 2012 outlook is that we expect an important bottom in risk assets later this year. With respect to the decennial cycle in 5 out of the last 11 decades, the US market has set an important market bottom in years ending in “2” (1932, 1942, 1962, 1982 and 2002) and with the Juglar Cycle and the Kitchin cycle running into a trough in the second half of 2012 we are moving into a classic buying setup for risk assets this year. From a pure cyclical perspective we favor an important low in later Q2/early Q3 and if this is correct it would mean that we will see a year with two completely different faces. After a bearish first half for risk assets we could see H2 having a much more bullish shape, which would be in line with the presidential election cycle where the last 7 months of an election year usually have a quite bullish background. One consequence of all this would again be a year with dramatic volatility but this also implies that if we are correct in getting an important bottom in 2012 it is likely that we will see a sharp V-Shape reversal instead of undergoing a regular and classic bottom building process.

Chart 2.) Dow Jones Industrials Index 2007 – 2011 versus 1929 - 1938



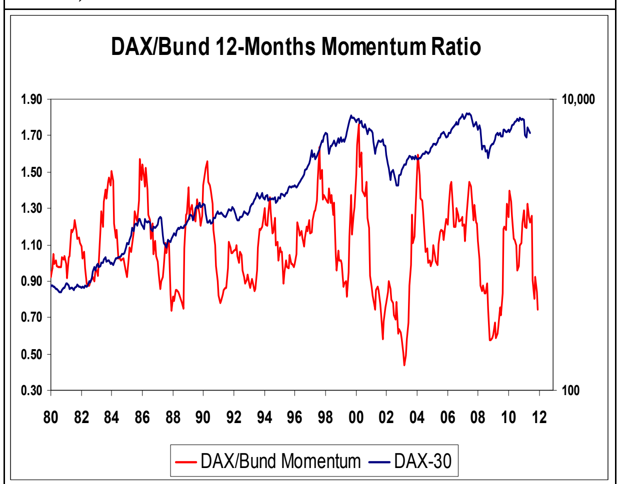
Source: UBS Technical Research

Next buying opportunity for gold and commodities … sell bonds!!

This kind of pattern/scenario would have important consequences from a cross-asset class perspective. After a final bounce into later Q1 we see risk assets weak into summer, which implies that after a pullback in the US dollar into later Q1 we should see a quite bullish US dollar and if so, it would obviously be bearish emerging markets, commodities, and related themes. However, if we are correct in moving into an important risk bottom at the latest in early Q3, it means that in H2 2012 we will get an important top in the US dollar and this implies a big buying opportunity coming up for commodities, emerging markets, and emerging market currencies.

The same applies to the bond market. In later Q1 we expect getting a final tactical buying setup for bonds but all in all our key message is that we expect to see an important yield bottom in global bond markets in summer 2012. In this context we think that in particular, the German Bund will be vulnerable to start a sharp bear move from a summer top down into 2013 and looking at the low equity/bond momentum ratio (chart 3.) we are getting the indication that from an asset allocation standpoint we are moving into a set up in later 2012 where it will be time to sell German bonds and buy equities.

Chart 3.) DAX-30/German Bund 12-Months Momentum Ratio



Source: UBS Technical Research

What does all this mean for gold? Our key call in 2011 was to expect gold to move into a 2-year cycle peak. With the September 6th top at $1920, this cycle peak is in place and since then gold has been undergoing a corrective process. We strongly believe that the current correction does not change the underlying structural bull case for gold. On the contrary, in EUR and CHF terms gold is just correcting sideways, which is still constructive from a patterns standpoint. Furthermore, we always said the likelihood is high that this structural bull market will finally end up in a classic bubble case and fact is that we still haven’t seen a bubble in gold. So if we see a kind of bubble event then

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Chart 4.) Gold in CHF Terms Weekly Chart

Source: UBS Technical Research

from a pure cyclical perspective, 2013 is the next candidate for a massive overshooting in the precious metals area. If this is correct then the key message is that in 2012 we will again see an important strategic/tactical buying opportunity for gold, silver, and the mining sector and this bottom could be the basis for dramatic gains into 2013 and/or first half 2014.

Where's the risk in our 2012 outlook?

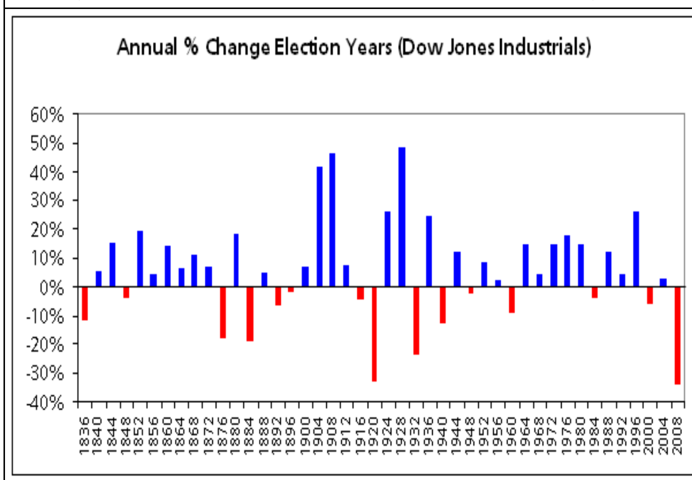
Clients are always asking where we see the biggest risk of being wrong in our outlook/analysis. Given the whole setup we have high conviction in getting another significant down wave in risk assets. Where we could be wrong is the timing of such a second bear wave, which means that a potential bounce from a January tactical low could last longer into Q2. In this case the consequence would be that a following decline could be also postponed, which means that at the end of the day our anticipated major cycle bottom in risk could move into very early 2013. So the whole pattern and scenario would not be offset, it would actually "just" shift another 2 to 3 months into the future before getting a change into a more bullish regime.

A second risk is that a potential decline in risk assets is much milder than the expected 20% to 25% correction. In this case more or less all headline indices would "just" continue to trade sideways in a very volatile manner and in particular the SPX would not break its early October low from last year. From a pure cyclical standpoint we would still believe that we wouldn't get the next major buying setup before summer 2012. Nonetheless, this would obviously be a better way of being wrong and personally we wouldn't complain.

Cycles … 2012 hot candidate for a long-term low!!

Last year we highlighted the mixed picture in our cyclical work, where on the one hand we had the bullish indication of a pre-election year but on the other hand the headwind coming from the decennial cycle and the bearish secular structure in equities. This picture has not changed: 2012 is an election year, which in theory should be supportive if not bullish for the US market but with the decennial cycle and the bearish secular picture we still have 2 weighing factors on equities. **This year, the big difference versus 2011 is the setup in the Juglar cycle and the Kitchin cycle. In the first half of 2012 both cycles are still going down hand in hand and from a pure cyclical standpoint this is usually the timeframe where we have the biggest risk to see negative surprises in risk assets. The last time both cycles went down simultaneously was in 2008 and in 2001. However, the key message is that both cycles are moving into a trough in H2 2012, so the likelihood is high that in H2 2012 or at the latest, very early 2013, risk assets are moving into a major bottom as the basis for a new bull cycle into deeper 2013**. It fits in this context where according to the decennial cycle in 5 out of the last 11 decades the US market has set an important market bottom in years ending in "2" (1932, 1942, 1962, 1982 and 2002). So although H1 2012 could be quite dramatic and bearish for risk we have evidence that in H2 2012 equities and risk assets in general could pass an important cycle low and if so, then it should be the basis for a new bull cycle into 2013.

Chart 5.) Annual % Change Dow Jones Industrials in Election Years (1836 – 2008)



Source: UBS Technical Research

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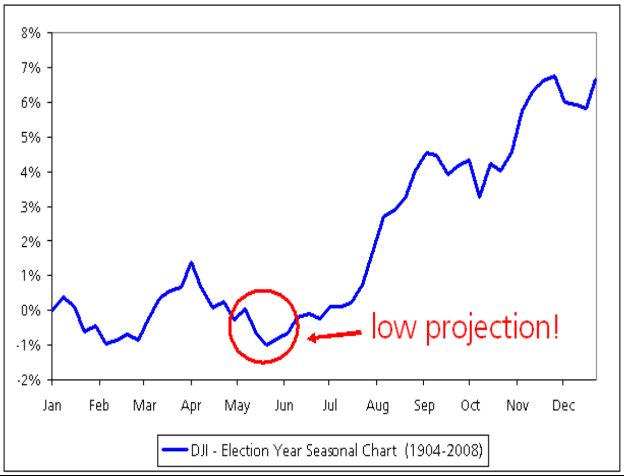
Chart 6.) Seasonal Chart of Election Year



Source: UBS Technical Research

Election years usually bullish

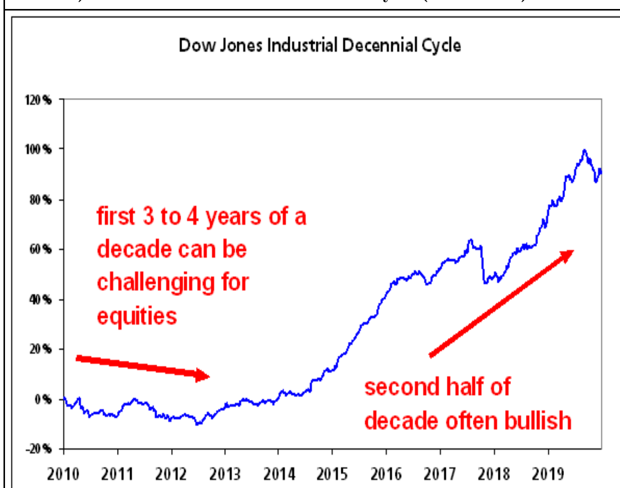
2012 is an election year, and presidential election years usually have a bullish track record for the obvious reason that each administration tries to set up a framework in the economy that is supportive for getting re-elected. **Since 1900, 19 out of 30 presidential election years ended bullish with an average performance of 18.3% in the DJI.** Of course, particularly in these times where a state is overloaded with debt, one could say that this offsets the classic cycle as the government is simply not able to initiate a relevant fiscal spending program. Nonetheless, one should never underestimate the power of this cycle and last year was probably a good example for this. After WWII it is actually the pre-election year that has the best track record in the whole election cycle with an average performance of +16.5% in the DJI. Last year we said that this fact should certainly support the market and with a potential Q4 rally we could end up okay on a 12 months basis. Given our underlying bear market scenario, however, we definitely doubted getting a super bullish 2011. At the end of the day the picture in the US was quite mixed. The Russell-2000, as the measure for the broader market closed down by some 4% but it's interesting to see that despite all the dramatic volatility throughout the year, the Dow Jones Industrials was still able to post a gain of +6%, whereas other parts of the world experienced an outright bearish year in 2011. **Looking at our cycle work we could see a very similar picture in 2012, and with the seasonal chart of election years our filter is giving us a first indication of a potential road map for 2012. A flat to negative indication from January into May means that this will also be the timeframe where we could see a potential negative surprise, whereas the last 7 months of a presidential election year usually have a quite bullish background**. The numbers behind this pattern are amazing!! According to Jeffrey Hirsch's Trader's Almanac, since 1952 the SPX has posted just 2 losses (2000 and 2008) in the last 7 months of an election year, whereas the markets posted a reasonable gain in 13 cases. So just looking at the seasonal chart of presidential election years we expect an important low in early summer, and H2 2012 should be already bullish across the board. The problem is that we have several cycles acting on the market and here we see the decennial cycle coming into play.

Decennial cycle still bearish in H1 2012 but moving into major trough!!

Again, the decennial cycle is one of the most stable and solid cycles we have in equities. With regards to the big picture, the first 3 to 4 years of a decade are very often challenging for equities and in this context it is fascinating to see how precise this cycle has been running for most of 2010 and particularly for last year. In 2011 we had in general a very high correlation between the cyclical framework and the reality. According to the seasonal chart for years ending in "1" we had a Q2 top projection followed by a decline into early October before the market stabilized and bounced. The reality was that in Q2 we got our top followed by a 20% correction into early October and from our projected early October low we got a significant bounce in risk assets.

Last year we reasoned it was the decennial cycle that made us cautious in putting too much emphasis on the super bullish pre-election year indication. This year we have a similar setup. Basically, the rationale behind the decennial cycle is the Juglar cycle and it is interesting to see that both the Juglar cycle and the next lower cycle, which is the Kitchin cycle are moving into a trough in H2 2012, at the latest early 2013.

Chart 7.) Dow Jones Industrials Decennial Cycle (1901 – 2011)



Source: UBS Technical Research

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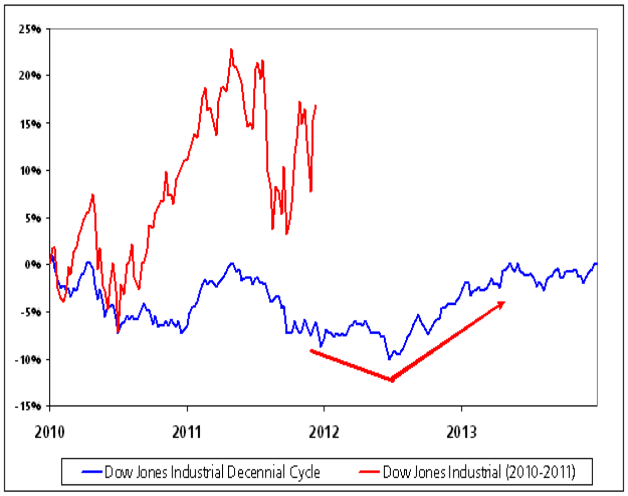
Chart 8.) Dow Jones Industrials Decennial Cycle (1901 – 2011)



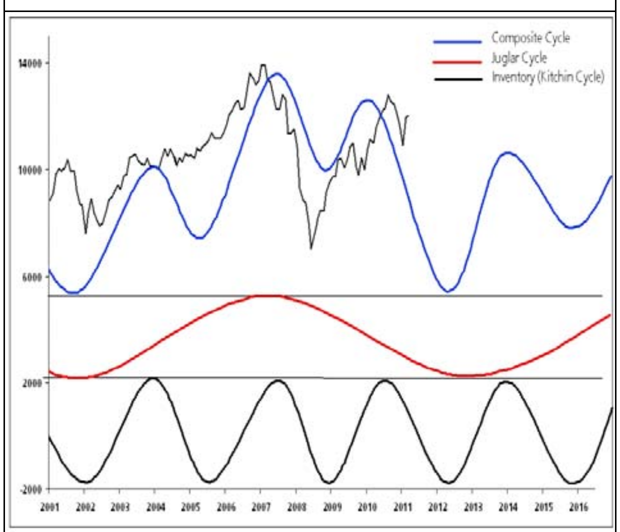
Source: UBS Technical Research

In the decennial cycle the low indication is in early Q3 (chart 8.), which is somewhat later than the indication we are getting from the election cycle (chart 6.). However, if we believe in a kind of composite cycle work, it suggests that in deeper summer 2012 we should move into an important bottom in risk assets. The question is of course how much of a correction we see on the way into this low? The problem is that **in H1 2012 both the Juglar and the Kitchin cycle (chart 9.) are moving down simultaneously and translated it means that particularly in these timeframes we have a negative surprise in risk assets setup developing.** The last two examples where both cycles went down hand-in-hand were 2008 and 2001. In 2004 and into 2005, the Kitchin cycle was also negative but given the bullish background of the Juglar cycle, the market effectively just went sideways before starting the next and final bull wave into 2007/2008, where both cycles moved into their bust phase.

Conclusion:

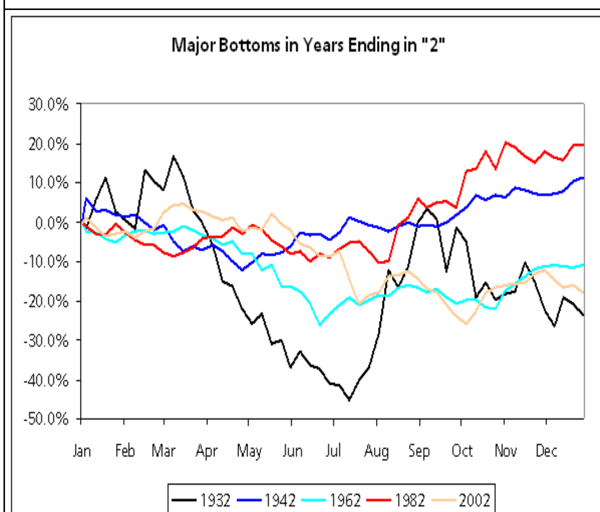
In 2012, our cyclical work offers the same kind of mixed picture as in 2011. Tactically, we see the risk of a negative surprise in H1, whereas the cyclical background for H2 2012 and in particular 2013 looks much more constructive if not even bullish. Generally, time cycles are the connection between the two dimensions of time and price but it's important to understand that if we have the indication of getting a negative surprise in H1, it initially doesn't tell us anything about a specific price target. The point is, **when several cycles are at the same time in their down phase then in an integrated cycle model it is this the phase where we have the biggest risk of seeing a negative surprise in the price chart**. Technicians constitute this phase as a potential "crash" window, which however doesn't mean that we automatically see such an extreme event. Basically, **the same applies to a major cycle trough**. **So when we have several cycles moving into an important low at the same time (principle of cycle synchronicity) then these lows are usually quite powerful and from a pattern perspective these bottoms are very often sharp instead of showing the classic and time consuming bottom building process.** As stated before, in this context it is worth highlighting that in 5 out of the last 11 decades in the decennial cycle, the US market has set an important market bottom in years ending in "2" (1932, 1942, 1962, 1982 and 2002). The bottom in 1932, 1942 and 1982 were very sharp (chart 10.), whereas in 1962 the US market underwent a classic double bottom and in March 2003 the SPX re-tested the October 2002 bottom.

Chart 9.) Dow Jones Industrials with Juglar and Kitchin Cycle



Source: UBS Technical Research

Chart 10.) Dow Jones Industrials With Major Bottoms



Source: UBS Technical Research

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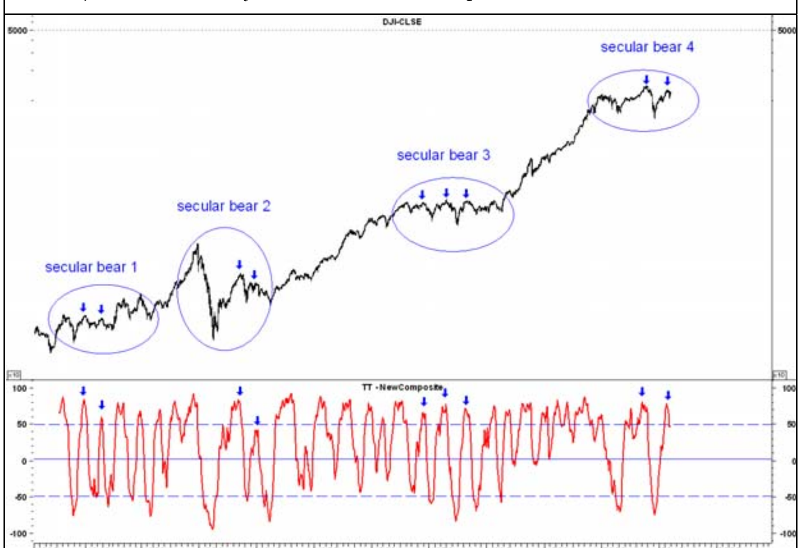
So if we put everything together, the key message for this year's outlook is that we expect risk assets to move into an important cycle low in 2012 and this low could also play an important role in the longer-term since we basically see the US market moving into the last 1/3 of its secular bear market. **If we are correct, then it is likely that we will get this year's bottom in early Q3 and from a pattern perspective the style of this bottom should be quite sharp, which means that depending on how deep the correction into summer 2012 will be, the entire 2012 could finally end up with a better sentiment background than 2011. Tactically, after a potential good start into the year we anticipate a significant set back/correction into deeper January, where most markets in Europe are likely to test their pivotal September/October lows. In the second half January, we expect risk assets to move into another important tactical bottom, as the basis for a final and potential strong bounce into a March top before sending down equities into our anticipated summer bottom.**

A new long-term sell signal is in place!!

It is a good custom for us to highlight the TT-New Composite* in our yearly outlook piece. Our regular readers know that this indicator is a key study for us to identify major cycle tops and bottoms in our cyclical models. In 2009, it was one of a few reasons why we turned bullish for equities when the TT-New Composite hit extreme oversold readings, which usually correlates with major market bottoms. Last year we anticipated this indicator to move into a major peak and turn bearish and if so it would be the confirmation that a new cyclical bear market has started.

In this context it is important to understand in which kind of secular environment we are getting this sell signal, and here it is obvious that we are still trading in a secular bear market. This is crucial, since if we compare the current indicator pattern/behavior with the pattern of the last major three structural bear markets of the last century, it becomes relatively clear that **after generating a sell signal in overbought territory this indicator usually moves down the full range into oversold territory before generating a new buy signal and marking the beginning of the next cyclical bull market. In this case we are talking here about a monthly indicator, which means moving down the full indicator range usually takes a few months. The minimum downside to expect is a 10 to 13 months decline from the top.**

Chart 11.) S&P-500 Monthly Chart With TT-New Composite



Source: UBS Technical Research

Last May we got our sell signal, which is just another confirmation that the October low last year would be way too early from just a time perspective. The more important finding is that with a 10 to 13 month correction pattern we would land exactly in summer 2012, which is the low projection we are getting from our cycle work.

Another key message is that even if we should see any kind of temporary positive surprise in the S&P-500 into later Q1, we would see this as a potential false break or bull trap and therefore wouldn't chase the market!!

* TT New Composite is a composite of 12 equally weighted indicators (MACD, Stochastic, Pring Daily, Buy/Sell Pressure, Money Flow Index, Stochastic Momentum, Rate of Change, RSI, Slow Stochastic, Aroon, 38-Day Moving Average and DMI)

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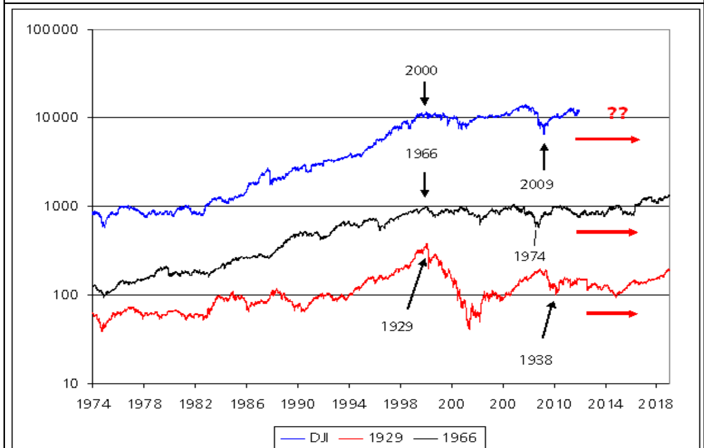
Secular structure still bearish

With regards to the pattern set up in our long-term indicator work, we have highlighted the secular structure in equity markets and unfortunately the picture is unchanged as to what we have been saying over the last few years. Reality is that since the 2000 peak, Western equity markets have been trading in a secular bear market and within this bear market trend **it is still amazing to see the similarity in terms of price and time towards all three major secular bear markets of the last century.** We still see **the highest correlation towards the secular bear market from the mid 1960s into the early 80s and to the one at the beginning of the 1900s.** **The reason behind this analogy is pretty obvious: the macro environment we have today is very similar to that of the beginning of the last century and as that of the 1970s.**

In the 1970s there was a structural bull market in commodities underway as it is today. At the end of the 70s and in the early 80s the Western economies were stuck in stagflation. If we put everything together then, to our understanding the likelihood is high that we are moving straight into a similar economic environment represented by low or zero growth but a relatively high inflation. We have been bullish on commodities for a long time, which is the main reason why we have always preferred looking at the analogy to the 70s. This high correlation was another reason why, in 2009, we turned bullish in expecting a similar cyclical bull market starting from the 1974 price bottom (see chart 13.) and it was one of our key arguments last year of why we saw equities moving into an important peak; and if we look at the analogy we see that the correlation is still very high.

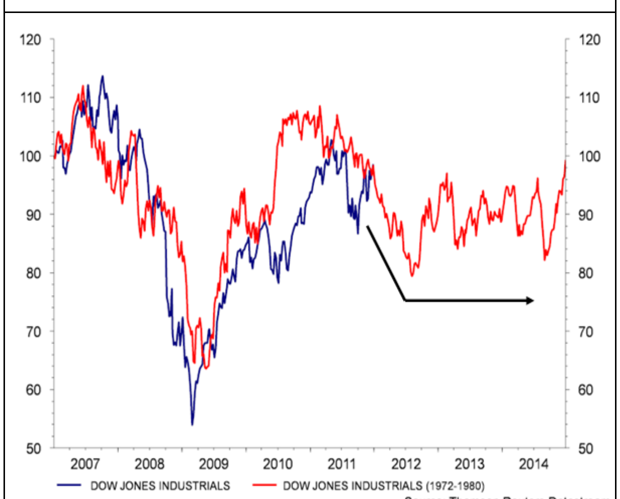
Chart 12.) Dow Jones Industrial Overlay with Secular Bear Market 1966 and 1929



Source: UBS Technical Research

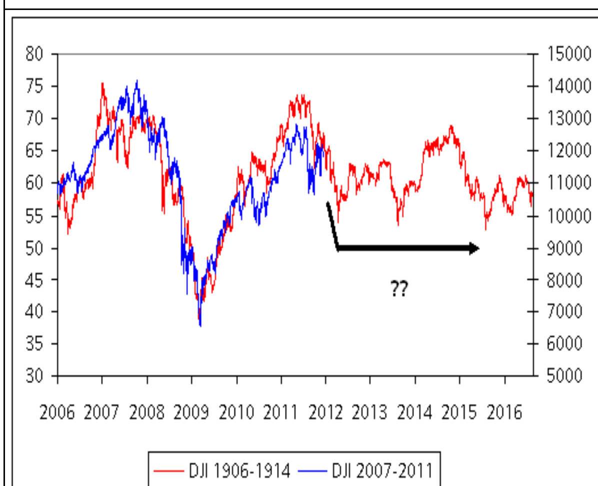
In this context it is also important to highlight the very high correlation of the current market pattern versus the November 1907 (see chart 14.) panic bottom and here we also find a lot of parallels between today's macro background versus the environment at the beginning of the last century. At the beginning of the last century, commodities had also been trading in a secular bull market that lasted 26 years - from 1894 until its ultimate peak in 1920. However, the more important parallel is the huge financial crisis of 1907, as a result of bankers panic, including a bank run and a bail out, organized by J.P Morgan, which at the end of the day can be seen as the birth of the Federal Reserve system. The parallel to the financial crisis of 2008 and the following bail out is pretty obvious and the fascinating consequence is a very high correlation of the current market pattern versus the 1907 bottom.

Chart 13.) Dow Jones Industrial (2007 – 2014) versus (1972 – 1980)



Source: UBS Technical Research

Chart 14.) Dow Jones Industrial (2006 -2016) versus (1905 – 1914)



Source: UBS Technical Research

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2012…the beginning of the end of a secular bear market!

So what is the outcome of all this? **Both of the above-mentioned analogies/patterns are giving us the indication of moving into an important bottom in summer 2012,** which on the other hand is also confirmation for our bear case in H1 2012. However, the more important message is that following these patterns, **2012 could also be the beginning of the end of the current structural bear market as according to the decennial cycle the US market has set an important long-term bottom within the first 4 years of EACH decade in the last century.** It is a fascinating pattern without exception and therefore underpinning the significance of the whole cycle and the Juglar cycle in general. The problem is that if we look at all three secular bear markets of the last century (chart 13) we can see that **in the final stages of these patterns the US market underwent a bottoming phase lasting several years before starting the next major secular bull market**. **So although we could see an important market bottom in 2012, we think it is too early to get aggressively bullish for equities and this is something that we can also measure in the sentiment.**

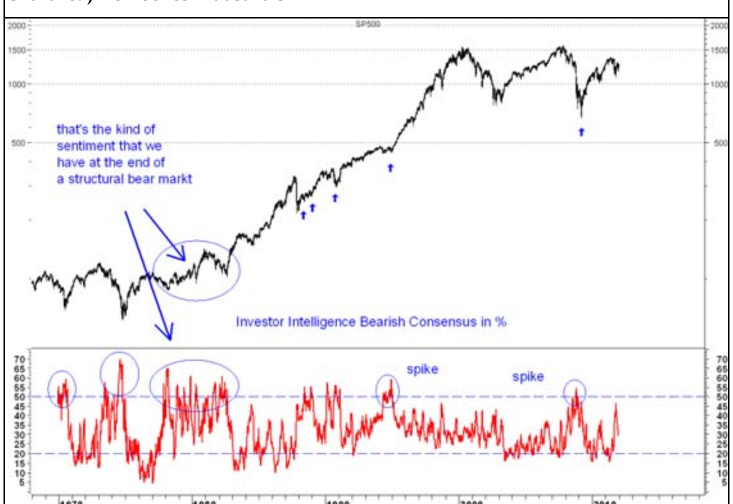
Chart 15.) Dow Jones Industrials Decennial Cycle Major Low

Source: UBS Technical Research

Sentiment yet not bearish enough!!

The sentiment indicator where we have the longest record is the Investor's Intelligence, which polls the sentiment among the independent newsletter writers. Apart from the eventual spikes in sentiment that we can use as a contrarian indicator, it is interesting to see that **we have underlying trends in the sentiment as a reflection of the secular trend in the overall market**. Particularly in the second half of the 1990s and into the middle of this decade, we saw a trend of gradual deterioration in bearishness, with a sequence of lower highs in bearish sentiment spikes. This picture has started to change since 2008 and last October where we saw initial spikes in bearishness. The point is that **if we look back into the ultimate end phase of the last major secular bear around 1980 we can see several years with a continued high bearishness in sentiment before the new super bull cycle started in 1982 and where we got a structural break towards a more bullish sentiment. What can we learn from this? If one thinks that 2011 was a horror year in terms of sentiment, then one should probably look for an alternative job outside of the financial industry since we think the sentiment is simply not bearish enough to mark the ultimate low or end phase of a structural bear market. If we see only a similar development as that of the early 1980s then it is likely that we are only at the beginning of a quite frustrating market phase, where in price terms we could see several years with no real or longer lasting trends in the markets.**

Chart 16.) Dow Jones Industrials



Source: UBS Technical Research

Conclusion:

We expect this year another bearish spike in sentiment but on the back of this it is maybe more realistic to expect only a first and limited bull cycle into 2013 before we could see another cyclical bear to complete the whole secular bear around 2014, which would finally mean that **this market is going nowhere in the next 2 to 3 years.** The only chance for this picture to change is, in our view, with a macro environment where we get an external shock on the inflation side, so that in the next 2 years inflation gets out of control, where in nominal terms equities would do quite well but in real terms we nonetheless would all lose money.

Technical Strategy 2012

Patterns and internal structure still bearish

If we look at the technical constellation in terms of wave and chart patterns as well as taking into account the technical internals, the picture at the beginning of 2012 is relatively clear for the US market and for more or less the rest of the world. After a several months lasting distributive top building phase all headline indices in the US, Europe, and Asia have completed obvious major price tops. The following decline was impulsive (chart 17.) which is underlying bearish from an Elliott Wave perspective and after being extremely oversold and hitting our anticipated tactical cycle low in early October the world equity landscape has started a significant bounce, which we see as a classic countertrend rally. Initially the bounce was very strong but the longer it goes the more obvious it gets that the overall momentum of the move is weak. In the underperforming markets (Europe) the whole bounce is just developing into a sideways pattern, whereas in the outperforming markets such as in the US, we have a bit of a more bullish bias after posting a higher low in late November.

Chart 17.) MSCI World ($) Daily Chart

Source: UBS Technical Research

Starting into 2012 our key message is that we have absolutely no evidence that the early October low in the MSCI world represents a more important low in the historical context. The volatility over the last few months has been very high, which is far from being bullish. The early October low has not been accompanied by any bigger bullish divergence or non-confirmation in any of our strategic indicators. Of course, the sentiment in October was bearish but we did not see an extreme spike in sentiment that would justify calling a major bottom. Furthermore, looking at the sector trends and on the inter-market analysis we didn't get any non-confirmation, which we usually see when moving into an important price bottom. Defensive themes are trading in intact outperformance trends. We saw no divergence in October between the early cyclical semiconductors versus the SPX and China, which is very often leading but is still weak across the board. So all in all we are sticking to our comments of the last few weeks and months as well as to our 2011 base case scenario. The current move is just a bear market rally and as such, it means that from a pattern standpoint we should see at least one more down leg before we can expect an important bottom in equities.

2011 base case still on track!

In our 2011 outlook we said that from a Q2 top we expect the SPX starting a limited and selective cyclical bear market, which from a pattern standpoint should undergo a classic A-B-C corrective process (see chart 19.). On time with our cyclical projection, wave A hit a low in early October and since then we have had a corrective countertrend rally underway. In Europe, some markets are forming triangle patterns. In the US, thanks to the outperformance of mega caps we have a more constructive setup short-term. Nonetheless, if we look at broader market measures in the US such as the Russell-2000 we have a quite similar picture in place for more or less the rest of the world. After completing an impulsive wave A decline, we have a corrective wave B countertrend rally underway and if our timing continues to be correct then this wave B should finally top out in March before starting the second and final bear wave C that should send equities down into summer 2012.

Chart 18.) Russell-2000 Daily Chart

Source: UBS Technical Research

Technical Strategy 2012

Chart 19.) S&P-500 Weekly Chart

Source: UBS Technical Research

In early 2011, we said that from its 2011 top into 2012 we would expect the SPX to correct "just" 20% to 25%. Given the outperformance of the mega cap indices (SPX/DJI) one would think this call is still intact. However, we have reason to believe that in a second bear wave into summer this year we could see at least a temporary negative surprise in mega caps, which means that the DJI and SPX, in particular, could also be vulnerable for a negative surprise, so that the SPX could fall below 1000.

Head & Shoulder top forming in the MSCI World?

Basically, from a pure price point of view it is important to understand that the October low represents a key support in terms of retracement levels for all major markets. For the SPX, the October low at 1**074 represents the 38% Fibonacci retracement of the 2009/2011 bull cycle. For the MSCI World this low marks the 50% retracement, which alone shows how important these levels are.** Following our base case scenario we do in fact favor a break of the October low at the latest in Q2. **A break of 1074 in the SPX would theoretically imply a next strategic target at 1020 and 934, which is the 62% retracement of the 2009/2011 bull cycle**. However, if we look at the MSCI World we can really see into what kind of a setup we are heading in Q2. **From a pure pattern standpoint one could easily interpret the current countertrend rally in the MSCI World as the right shoulder of a major head & shoulder top formation**. So if we are correct in starting another down wave into Q2, the question will be if this is the beginning of a wave 3 decline. If so, will the head & shoulder top formation unfold its whole potential or will we "just" see a wave C correction (our preferred scenario), which at the end of the day would lead into a huge bear trap as the projected target of a head & shoulder top would not be reached. The measured move target of the H&S pattern is at 770, which is some 35% lower as today's price level. Obviously, if we were to see this bear wave it would imply that from a macro perspective we would be simply heading into a new deflationary meltdown with all its ugly consequences. Again, the question is whether this kind of meltdown would be accepted by the central banks or if the FED, the ECB and/or China would step in and initiate a wave of quant easing to support asset prices. We definitely favor the latter, so that a bear wave down towards 770 in the MSCI World would be in our view too bearish. At the end of the day the remaining question would be, which sectors and stocks could push the markets down to these kinds of suppressed price levels?

Watch US Mega Caps in 2012

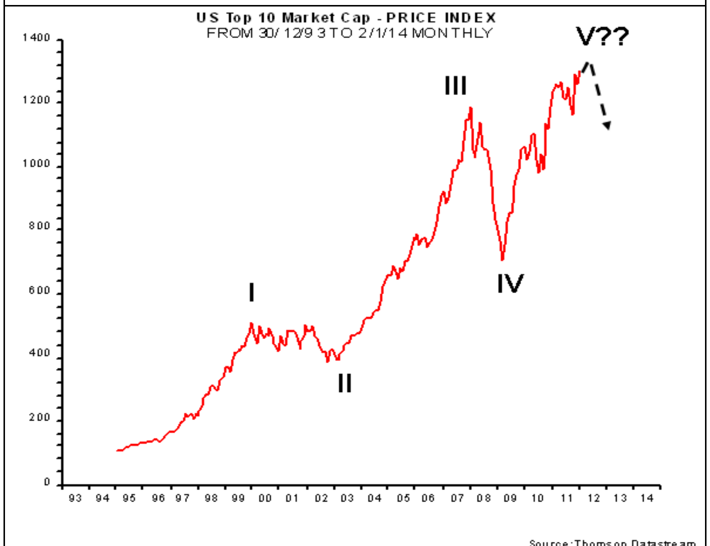
The performance of technology and defensive stocks will be one of the key factors as to what kind of year we will see in equities and if it's negative, what kind of potential downside we can expect for our projected second bear wave. Of course, if one expects another major macro event in 2012 then financial stocks will again be among the key drivers on the downside, and if you are very pessimistic about the outcome of the current debt crisis you could easily construct a domino effect similar to the 2008 meltdown in banks. Nonetheless, the key question is how stocks such as Apple, IBM, Procter& Gamble, Exxon, Chevron or McDonalds perform in 2012?

Chart 20.) MSCI World ($) Weekly Chart

Source: UBS Technical Research

Technical Strategy 2012

Chart 21.) US Mega Cap Index *Own Calculation



Source: UBS Technical Research

These were the stocks that gave the US market support with their tremendous outperformance and which buffered the losses in financials and cyclical sectors. The same picture we saw and still see in Europe, where food, tobacco and pharma stocks outperformed massively and which was a great support for the FTSE; and after the SNB announced the EURCHF floor it was also quite supportive for the Swiss market. Basically, **from a pure sentiment perspective it is questionable whether banks and cyclicals will again have the potential to push the markets 20% or 25% down, for the simple reason that banks and broker stocks are already the most hated sectors and cyclical sectors are certainly also not over-owned. However, the key consensus long theme for 2012 is technology and everyone is invested in the "safe" and high yielding defensive themes on both sides of the Atlantic.** We don't expect an abnormal behavior in terms of relative performance, so in a potential second bear wave we should see defensives still outperforming. **The key point is that we don't think that investors will be able to make absolute money in all these over-owned stocks such as in 2011. O**ur key argument is the pattern setup in US mega caps. To get a better idea of how these stocks are looking and how they could impact the S&P-500 we have constructed an equally weighted mega cap index (chart 21.) of the 10 biggest US stocks measured by market cap. If we just look at the pattern of the last 2 years what is striking is that this synthetic index * has been trading sideways since February. From a pattern standpoint this looks highly distributive.

The key take-away is the long-term structure of this index. It is also important to understand that this picture looks completely different as to what we see in other headline indices let alone a Dow Jones Industrials or an S&P-500, which are trading in a secular sideways trading bear market since 2000. **From an Elliott Wave perspective this synthetic mega cap index is forming an absolutely textbook-like 5 wave cycle from the mid 1990s and the fascinating and also frightening point is that within this cycle the correction waves II and IV are fulfilling the principle of alternation. Wave II (2000-2003) has a complex structure, whereas the meltdown in 2008 was sharp. If this Elliott Wave structure/count is correct then the key message is that these mega caps -- and here we are particularly talking about Apple, IBM and the oil majors -- are trading in the latter stages of a major wave 5, which means they are vulnerable for a negative surprise in 2012.** If so it could be the beginning of a longer lasting correction, which would of course weigh on indices such as the S&P-500 and the Dow Jones Index and for Europe we could expect the same for particularly a Swiss Market Index. So if these stocks are correcting then the question is whether we'll see a rotation into other stocks or if the correction will just contribute to the correction in other key sectors (financials and cyclical sectors). If so, it would be highly deflationary and in this case we would really get into trouble.

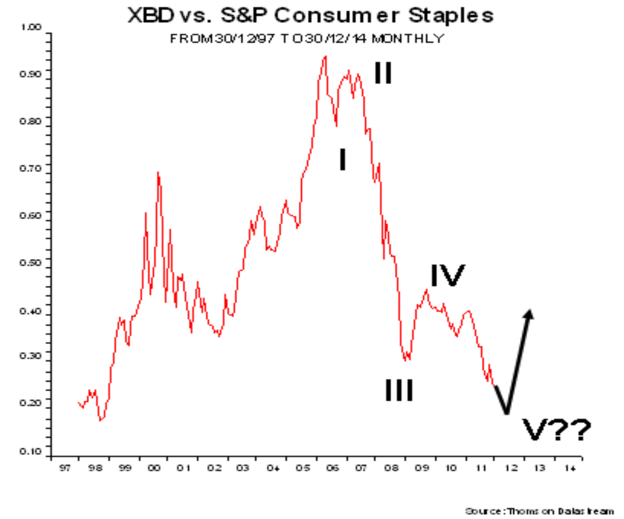
* The cap index includes the following 10 US stocks. Apple, Exxon, Microsoft, IBM, Google, Chevron, Wal Mart, Berkshire Hathaway, General Electric and Procter & Gamble

Underperformance in financials is moving into final stage!!

Basically, looking at the sector trends of 2012, it is in our view a quite likely scenario that deeper in the year we'll see a big rotation in the leadership. If we look at the long-term structure of the spread chart of the broker dealer index versus the S&P consumer staples, we can see another one of these impulsive bearish wave structures (chart 22.) and here we see broker stocks trading in a final wave 5 of its long-term underperformance pattern versus consumer staples, which is a key sector in the defensive camp. The consequences of all this would be far-reaching and certainly against any consensus, which makes this and a general rotation out of defensives to a key point in the list of potential surprises in 2012!!

Technical Strategy 2012

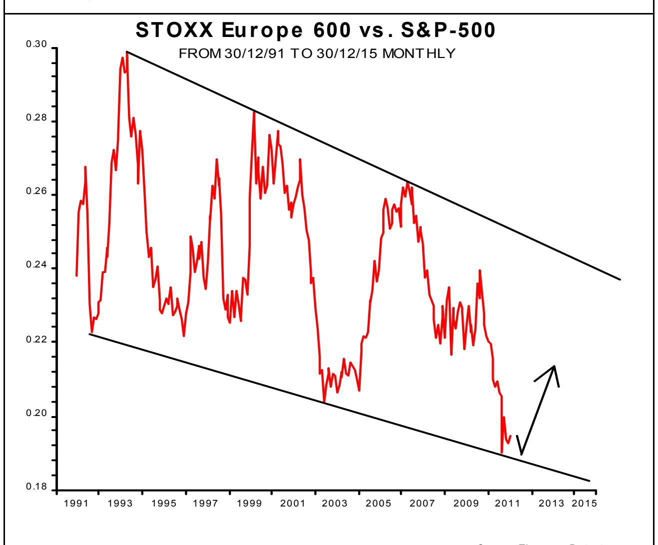
Chart 22.) Broker Dealer Index (XBD) versus S&P Consumer Staples



Source: UBS Technical Research

- **A correction in mega caps and in particular technology stocks would imply that our anticipated wave C correction scenario into summer 2012 could be stronger than most investors expect, so we don't rule out a temporarily break of 1000 in the SPX.** From a macro perspective this kind of environment would be highly deflationary so that in Q2 we should see a very strong US dollar, which by itself should be the main reason why US large caps could suffer in 2012.
- **A strong US dollar suggests weak commodity prices and in this context we expect oil stocks starting a second significant correction leg from a Q1 top into summer**. From a pattern standpoint the XOI (chart 24.)has the potential to re-test its October 2011 low, the underperforming oil service sector could even test its 2010 low at around 160 before starting its next significant bull cycle into 2013.
- **Pressure in technology stocks could also mean that from an index construction standpoint Europe starts outperforming the US**. Keep in mind, each and everyone is bearish on Europe and expects Europe to continue to underperform the US for reasons we know all too well. Of course, when we get a second bear leg into summer 2012 then it's likely that Europe will move down hand-in-hand with the US. The point is, looking at the Stoxx-600 moving into major support versus the S&P-500 (chart 23.), **we strongly believe that Europe will start stabilizing versus the US and at a certain point, preferably after hitting a bottom, we would definitely expect Europe to start strongly outperforming the US market and this is a process/trade that we would expect to last into 2013!!**
- While expecting a second bear market leg in risk, financials will continue to be in the eye of the storm but on the day we see risk assets hitting THE low, preferably in deeper summer, it will be time to switch reigns and sell defensives versus buying/chasing banks and broker stocks. **We are a strong believer in a big comeback of financials in later 2012 and this trade should continue into deeper 2013.**

Chart 23.) STOXX Europe-600 versus S&P-500



Source: UBS Technical Research

Conclusion:

The biggest bets and the highest consensus 2012 we have on the sector front and this is the reason why exactly at this point we could see also the biggest surprises this year. From a sector perspective we see a high risk that a lot of investors will lose money in defensive stocks into late Q2/early Q3 and on top of this they could underperform in a potential following risk rally in H2.

Technical Strategy 2012

Chart 24.) XOI Weekly Chart

Source: UBS Technical Research

Chart 25.) OSX Weekly Chart

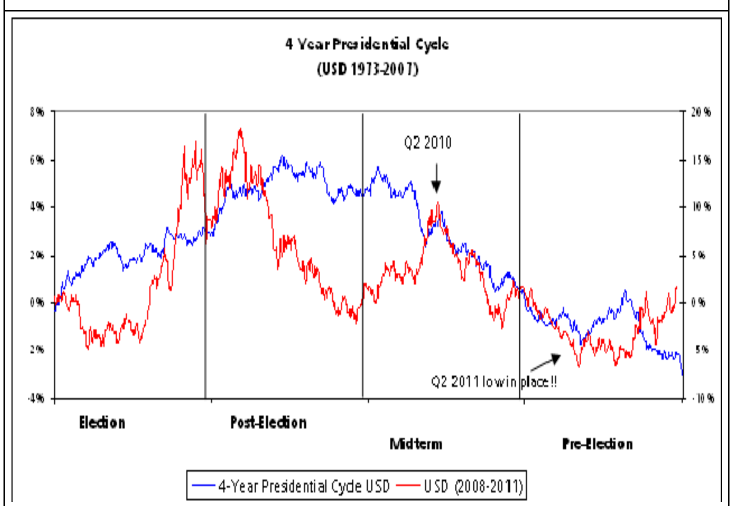
Source: UBS Technical Research

More US Dollar bullishness before hitting a top!

On the back of the 4-year presidential cycle it was a key call of our 2011 strategy to expect the US dollar to move into an important long-term bottom as the basis for a significant recovery into deeper 2012. Another important argument behind this call was the expectation of the AUDUSD completing a major wave 5 bull sequence, which started in Q4 2008 and if so, it would be the beginning of a longer lasting correction in one of the classic key indicators for risk assets. In this context we said last year that that the US dollar was and will continue to be THE key variable for more or less everything. From a cross-asset class perspective, a new bull cycle in the US dollar would obviously suggest headwind for commodities and related sector themes and sooner or later it was also clear that gold would get a problem. Following our cyclical work, we expected the start of a new cyclical bear in commodities; we expected gold to move into a 2-year cycle top and we anticipated seeing a negative surprise in the emerging markets complex.

Given the current picture in which the US dollar is gaining momentum we have no reason to change any of our views or calls from last year. 2012 is a presidential election year and according to the presidential cycle, election years are usually US dollar bullish. Of course, on a short-term basis the dollar looks increasingly overbought, which we see as a trigger for a setback from later January into deeper Q1. Nonetheless, the key message for our 2012 outlook is that by expecting another negative surprise in risk assets into summer everything other than a bullish US dollar into later Q2/early Q3 wouldn't make sense. However, the second part of the story is that if we are correct and risk assets are moving into an important bottom at the latest in Q3 then the US dollar should also move into an important top in summer and start a longer lasting correction into deeper 2013!!

Chart 26.) 4-Year Presidential Cycle Trade Weighted Dollar Index



Source: UBS Technical Research

Technical Strategy 2012

Chart 27.) AUDUSD Weekly Chart

Source: UBS Technical Research

Tactically we said last year we would favor the US dollar moving into a Q2 low on the back of our tactical top projection for equities and the AUDUSD but against the presidential cycle that actually opted for a major low at the end of the year (chart 26.). We finally got our anticipated dollar bottom in May. **This is important, since from a cyclical perspective it means that it is likely that the next 4-year cycle peak in the US dollar could come in also earlier than usual. Following the presidential election cycle we should actually expect the US dollar topping out in the first half of a post-election year but following our inter-market analysis we finally favor this top coming in hand-in-hand with our low projection in risk assets in deeper summer this year. Does this mean that 2012 will be the beginning of a new major bear market in the US dollar? We don't think so. Looking at equities we said that we expect the US market to enter the final stages of a secular bear market and that within this timeframe equities could actually go nowhere over the next 2 to 3 years. We wouldn't be surprised to see exactly the same kind of pattern on the currency side, so that despite the possibility of seeing a weak US dollar into 2013, we could probably just be at the beginning of a large and volatile sideways trading range!! From a cross-asset class perspective this would nonetheless have significant consequences!!**

Euro will see a litmus test into the summer!!

On a sort-term basis the EURUSD is increasingly oversold, so from a tactical standpoint we shouldn't be too far away from starting an oversold bounce from a second half January low into deeper Q1. Nonetheless, a potential bounce we would see as limited in price and time since the key focus for 2012 will be the test of the obvious major long-term support at 1.20 to 1.16, which is our preferred target for a litmus test in the Euro into the summer, before starting a significant recovery into 2013. **One point investors have to keep in mind, with starting into 2012 the sentiment towards the Euro is already quite bearish. Last year was supposed to be THE year for equities and today we hear that 2012 should be THE year for the US dollar. All this makes it quite likely to see a surprise on a 12-month basis and we think it will be towards a better Euro.**

One of our 2011 key calls was to expect the AUDUSD to complete a major wave 5 bull cycle. In this context we see the first correction wave from the top at 1.1080 into early October as a wave A of a classic A-B-C corrective pattern that should unfold into mid 2012 (see chart 27.). **The current weak bounce we label as wave B and if this count is correct then we should see at least one more correction leg (wave C) into summer before starting a new bull cycle and this call remains intact as long as the AUDUSD trades below last year top at 1.1080!!** If we imply that wave A and wave C are equal in price we should see at least a test of the 200-week moving average, which has some relevance as a long-term support at around 0.90. Worst case would be a decline to 0.86, which is the 50% retracement of the 2008/2011 bull cycle.

However, our key message for 2012 is that in summer this year we will see a superb tactical buying opportunity for risky currencies and/or Asian currencies such as the Singapore dollar (chart 29.) where we expect to see another lower high (wave c) in 2012 as the basis for resuming the underlying US dollar bear trend.

Chart 28.) EURUSD Weekly Chart

Source: UBS Technical Research

Technical Strategy 2012

Chart 29.) SGDUSD Weekly Chart

Source: UBS Technical Research

Chart 30.) Correlation AUDUSD versus MSCI Emerging Market

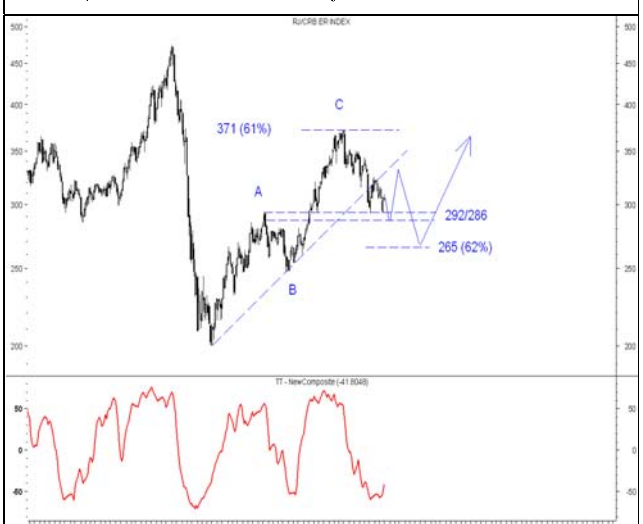
Source: UBS Technical Research

Summer bottom in commodities and emerging markets expected!!

When we talk about trends in commodities it is important to understand the different timeframes we are looking at. Since 1999/2000 commodities are trading in a secular bull market but within this long-term bull market trend we said last year we expect commodities moving into a cyclical top followed by a new limited cyclical bear market into 2012 before resuming the underlying long-term bull market pattern. Tactically, further US dollar strength into H1 suggests further headwind for commodities and finally also emerging markets (chart 30.) before both assets classes should move into an important tactical buying opportunity in summer 2012.

The CRB Reuters Jeffries index has topped out at the 62% retracement of the 2008 meltdown, which is a key resistance level that could play an important role in 2013. With the following decline, the CRB has broken its 2009 long-term bull trend, which was the ultimate confirmation that commodities are trading in a new cyclical bear market. On a short-term basis we see a lot of commodities getting oversold (-22% extension to 200-day moving average in silver) or already stabilizing (initial rally in agricultural) so from a January low in risk we could see a significant bounce into deeper Q1 before we expect a final decline into summer, into which both the CRB Index and Copper could test the 62% retracement of their 2009/2011 bull cycle as the basis for a new bull run into 2013. Generally, with this kind of scenario we have two key messages for 2012 and beyond.

Chart 31.) CRB Reuters Jeffries Weekly Chart



Source: UBS Technical Research

1) In summer 2012, we expect to get a superb tactical buying opportunity for commodities and related sector themes.

2) An important low in commodities this year will have far-reaching consequences for the macro trends in 2013 and beyond. Obviously, particularly H1 2012 will have nothing to do with inflation. On the contrary, if we are correct than particularly in Q2 we could face an outright deflationary trade/environment. However, we think that this will only be a temporary phenomenon. **Despite the current challenging environment for commodities it is very likely that the next bull cycle will start from a significant higher level than in 2008, which means into 2013 we are getting a huge base effect for inflation.**

Technical Strategy 2012

Chart 32.) Copper Weekly Chart

Source: UBS Technical Research

On the back of the geopolitical tensions in the Middle East, oil is still trading at a rather high price level but even if we ignore a significant premium it is important to understand that for this kind of macro environment commodity prices in general are still at a very high level from a historical standpoint. **Today we are talking about a recession in Europe and China is in a down turn as well but copper is still trading some 160% higher than in 2008. Crude oil is 210% higher than in Q4 2008 and corn trades 110% above its major 2008 low. So even if we would see another significant correction into summer, from a historical standpoint high commodity prices will continue to play an important role on the macro side over the next few years, which finally means that in 2012 we could get another important low in inflation expectations.** This also means that in gold and the precious metals we should see another important low in 2012.

2012 … the next big buying opportunity for gold!!

On the back of our major US dollar low projection it was a key call of our 2011 strategy to expect gold to move into an important top last year. From a timing standpoint we favored the peak in Q3 and given the projection of a 2-year cycle top we expected a classic buying climax/overshooting as we saw in similar events in 2006 and 2008. Generally believing in the strength and the increasing momentum of the underlying secular bull market and in the theory that at the end of this secular bull market we could see a bubble event, we said that we could see a sharp and several months lasting correction but we wouldn't see an 8-month lasting correction as in 2008, where gold moved into its last major 8-year cycle trough. This view is unchanged.

From a pattern standpoint, the decline of the last few weeks has the character of a classic wave C and the impulsive sub structure of the November/December decline suggests that both gold and silver may have already seen an important low last week at $1523 and $26.20. Of course, the technical damage in gold and silver has been increasing with the break of the 2009 bull trends. Our point is that the shape of the current correction is very similar to the corrective A-B-C patterns of 2006/2008 (see chart 34.) and also in these two cases important trend lines have been broken. At the end of the day it didn't change the underlying bull case. On the contrary; the only effect of these trend breaks was a huge wash out in terms of sentiment and speculative positioning and this is something we have also seen over the last few weeks as **the sentiment towards gold and silver is approaching contrarian territory**.

Tactically and from a correlation standpoint we are probably getting another down test short-term into deeper January together with a set back in risk assets but all in all we would use further weakness to buy/add tactically as well as strategically.

It is a key call of our 2012 strategy that this year we expect another important long-term low for gold, silver and the mining sector, so we would use any weakness to buy/add. What's the rationale for this call?

Chart 33.) Gold Weekly Chart

Source: UBS Technical Research

Technical Strategy 2012

Chart 34.) Gold Weekly Chart

Source: UBS Technical Research

1) In 2008, gold passed an 8-year cycle bottom as the last major long-term buying opportunity (chart 35.). Half-way into the 8-year cycle is the 4-year cycle, which is due to set a low in 2012 and is obviously the reflection of a potential 4-year cycle peak in the US dollar.

2) In our comment about commodities we highlighted the fact that into 2013 and finally also 2014 we should clearly see inflation coming back on the agenda, which means real interest rates are likely to deteriorate further and this is bullish gold.

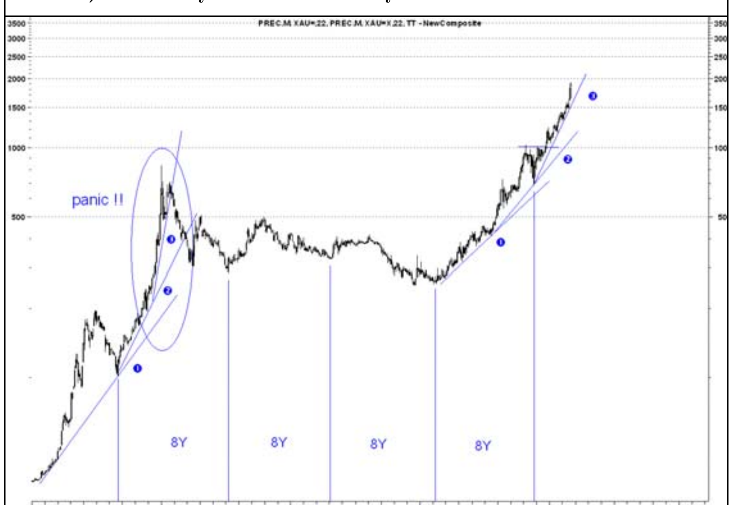
Again, tactically we expect gold to hit an important low very early in January if we have not already seen the low last week and this bottom should be the basis for a first strong bounce/recovery into March. **The ultimate question this year is what happens with gold in Q2, when we expect risk to come under significant pressure and when the US dollar should be quite strong, which from a macro environment would have a deflationary background?** For most of the time last year, gold was a safe haven and was strong despite a strong US dollar. This pattern/correlation broke in September as gold was extremely stretched in terms of speculation. **However, we see a good chance that in a potential risk-off scenario in Q2, gold could again become a safe haven, which should at least support the yellow metal and prevent gold hitting a new low compared to the current low or the bottom we will complete in deeper January. In terms of speculative long positioning we have seen a huge washout over the last few weeks. According to the COT report of the CFTC we have in silver a similar low speculative long positioning as in December 2008 (chart 36.) and at the beginning of the whole structural bull market. So all in all gold and also silver should be in a much better position in Q2 this year compared to Q3 last year. Nonetheless, worst case this year is that gold moves down hand-in-hand with risk and all based on a strong US dollar, so that at the end of the day we get our anticipated major cycle bottom only in summer. If so, it will be very difficult to hold the early Q1 low and in this case we have to take into account a negative surprise down to $1300, which is the 50% retracement of the 2008/2001 bull cycle. Our strong believe is that for both gold and silver we would see this as a big buying opportunity!!!**

Conclusion:

Based on our cycle work we expect gold to be moving into an important cycle bottom this year. From a timing standpoint we have only two windows for this low and this is a low/bottom very early in January or a potential negative surprise into summer where at the latest we should get an important long-term buying opportunity for gold, silver and the mining sector. **Given the recent huge washout in sentiment we favor getting our anticipated bottom in January and expect to only see a re-test of gold in summer as a setup for a very sharp and strong bull run into later 2013/first half 2014, where we expect the next major top.**

With the regards to the big picture we always said that at the end of this structural bull market gold could move into a classic bubble scenario. We are sticking to this view as we strongly

Chart 35.) Gold Weekly Chart With 8-Year Cycle



Source: UBS Technical Research

Technical Strategy 2012

Chart 36.) Silver Weekly Chart With Speculative Long Positioning

Source: UBS Technical Research

believe that we have still not seen this bubble although the long-term chart in gold looks extended (chart 35.) and on the sentiment side we have some worrying signs among retail investors last year. **The point is that from a pure technical perspective we can actually quantify a bubble chart and this is something we have already highlighted in our 2011 outlook. A chart gets a bubble chart when a market breaks out of a moderate bull trend (see chart 37/38.) and goes vertical for a couple of months and usually we see in this relatively short timeframe a market doubling its price. This is something we definitely haven't seen in gold so far.**

Furthermore, if we look at classic asset bubbles we can see that from low to top these markets/assets performed between 1200% and 4000%. Since the low in 1999 into last year's peak gold had a performance of "only" 770%, which is also still far away from being labeled a bubble.

Major Asset Bubbles		
Dow Jones Industrials	1903-1929	1200%
NIKKEI	1970-1989	2000%
NASDAQ	1980-2002	4100%
GOLD	1970-1980	2400%
current GOLD Bull Market	1999 - ??	so far 770%

Source: UBS Technical Research

So all in all we are still sticking to our ultra long-term base case and in this context we think that a bubble in gold is still ahead of us. The point is that after 11 years of a bull market **this bubble event shouldn't be too far away.** So when is the most likely timing for this potential event? **From a pure cyclical perspective we have actually only two time windows left for this extreme event. The next major 8-year cycle low in gold we can expect between 2015 and 2016, which means that we either see a bubble in gold developing in the next 2,5 years before we see a first collapse into 2015/2016 or it is increasingly likely that the whole bubble will take place only at the end of the decade, which wouldn't be a too unusual behavior**. It is amazing to see that in history a lot of bubbles burst at the end of a decade or the beginning of a new decade, which is again an important pattern in the context of the decennial cycle. **This years low in gold will give us a first idea of when we can expect a potential bubble event. A negative surprise of gold into summer would still be a big buying opportunity but it would in our view make it unlikely that we see a bubble in the next 2 years.**

Chart 37.) Gold Bubble 1976 – 1980

Source: UBS Technical Research

Chart 38.) Nasdaq Bubble 1998 – 2000

Source: UBS Technical Research

Technical Strategy 2012

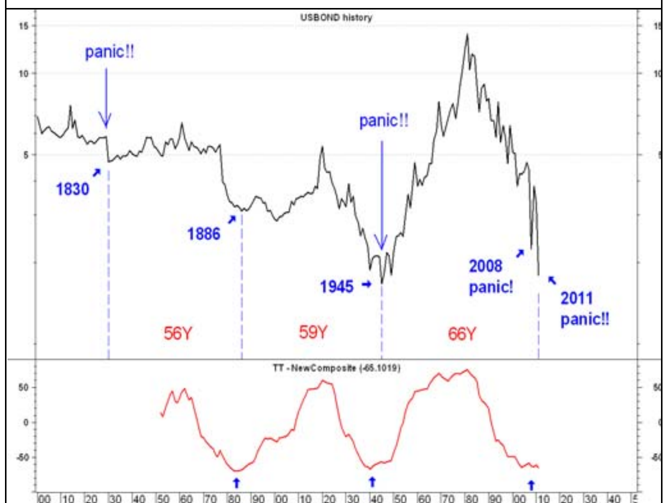
We expect a major low in yields in 2012!!

Based on our risk-off scenario we have been tactically bullish for bonds in 2011 but what we have certainly not expected was a move to this extent with new historic lows in yields in the US and in Germany. Looking at the 30-year cycle it was our strong belief that with the buying panic of December 2008 we have seen the lows in yields and in this context we should be at the beginning of a new secular bear market. We always said that for the ultimate bear call it would be probably still too early, as it was and still is our base case to see a several years lasting bottoming phase in yields, similar to the 1940s where the FED initiated the wartime peg that ended only in 1951 and exactly at this time the super bear market in US bonds started. So despite the new low in yields in the US and in some parts of Europe we don't think we are moving into a kind of Japanese scenario.

The structure in the European bond market is already beginning to break up (higher yields in the periphery) and sooner or later the interest rates in Germany will also rise significantly as this will be one price Germany has to pay for holding up the Euro.

The key question is what happens with the US bond market? Of course we got a new low in yields but **we do not expect a fundamental change in the underlying scenario that over the next few years we should see a bottoming phase instead of seeing a further gradual decline of yields. Within this scenario 2012 could mark an important fix point. While believing in an important bottom in risk assets, we also strongly believe that in summer 2012 we will see an important low in yields.**

Chart 39.) US Long Bond Yearly Chart With 30-Year Cycle (1800 – 2009)



Source: UBS Technical Research

Tactically, this means that in later Q1 we could see a very final rally attempt starting in bonds as a safe haven but we would see this potential final rally only as part of a distributive top building process that from a correlation standpoint should be completed in summer this year where we also anticipate a major low in risk assets. The lower end of the current bear trend in the 10-year US Treasury we see between 2% and 1.5% and from level we expect a move up in yields into 2013 towards 3%.

Sell German Bunds into final buying panic!!

In particularly the German Bund we see vulnerable for a sharp correction into 2013 and this is one of our key calls of our 2012 technical strategy. The rally last year in the bund was exhaustive and with trading at the upper end of its long-term bull trend (chart 41.) we see further upside as limited. **What is still missing to confirm a major top is a monthly momentum top out, which suggests a final rally attempt before starting a significant correction if not even a trend change**. **Into a potential final overshooting into summer we don't rule out a spike/throw-over towards 143 but it is our strong believe that following this potential overshooting we will see a sharp correction into 2013 starting this year. We've highlighted the equity/bond momentum ratio at the beginning of this report on page 3 (chart 3.). From an asset allocation standpoint 2012 will be the year to sell bonds and buy equities and from a timing standpoint we favor late Q2/early Q3 as the ultimate turning point in this trade.**

Chart 40.) US 10-Year Treasury Weekly Chart

Source: UBS Technical Research

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Chart 41.) Bund Future Monthly Chart

Source: UBS Technical Research

Short-term Picture US market … sell into Strength!!

In our last regular weekly comment (December 13) we highlighted the supportive seasonal factor for the US market and inline with our cyclical models we saw a classic year end rally. With the December 19 reaction low at 1202 we have basically a new reflection point in place as this represents the next higher low of the October rebound pattern. Basically, as long as the SPX trades above 1202 the market structure remains bullish. From a cyclical perspective we are sticking to our recent comments and expect the market heading into an important tactical top near-term and start a stronger set back into deeper January as the next bigger tactical buying opportunity and set up for a final rally attempt into March. On a short-term basis the market is getting increasingly overbought. On the upside we can still see a re-test of the October top at 1292 and the 1300 resistance area. A daily break below 1249 would be initially bearish and generate a tactical sell signal. Into the third week of January we expect a re-test of the November reaction low at 1158.

Conclusion: On a short-term basis we wouldn't be surprised to see a fake on the upside in the first trading week this year and if so aggressive traders can use the first meaningful daily reversal candle to start selling/short. A break of 1249 would represent a high conviction sell signal. **We wouldn't chase the market on the upside!!**

Chart 42.) S&P-500 Daily Chart

Source: UBS Technical Research

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Chart 43.) Stoxx Europe-600 Weekly Chart

Source: UBS Technical Research

Europe:

Where are the big levels in Europe? The current rebound from the September low we label as a wave B counter trend rally, which we would expect a top out between 250 and 260. Into summer this year we expect a re-test and in a potential overshooting a temporary break of the September low at around 210. If wave A equals wave C in price terms we would get a potential target projection at 190 into early Q3 and which we would see as the basis for a new bull cycle into 2013.

On a very short-term basis the Euro Stoxx-50 is rallying to its early December top at 2400 and a break of this level would suggest a test of the 2011 trend as well as the late October high at 2480. Into the third week of January we expect to see a re-test of the late November low at 2100, which means volatility over the next few weeks should remain high!!

Chart 44.) Euro Stoxx-50 Daily Chart

Source: UBS Technical Research

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Chart 45.) DAX-30 Monthly Chart

Source: UBS Technical Research

DAX-30:

One of the key charts in Europe in 2012 will be the German DAX-30, which in the longer-term context is heading into the apex of a huge triangle formation. IF we are correct in getting another significant down test into summer this year then it is very likely that this market will see a test of its 1982 structural bull trend, which this year comes in at around 4500. Given our underlying scenario we definitely do not expect a break of this trend, which means this area should serve later this year as the basis for a new bull cycle into 2013, where we can expect a re-test of the 2011 high. Fasten your seatbelt!!

Swiss Market Index:

The SMI profits currently from the extreme outperformance in defensive sectors and on the back of this move we can't rule out a positive surprise short-term. A key level on the upside is at 6200, which represents the 2007 long-term downtrend and which we expect to be tested short-term. However, the market is increasingly overbought and also the defensive mega caps are strongly overbought short-term, so at the end of the day we wouldn't chase the market in the current position. Our weekly momentum work is moving into overbought extremes, which we finally see as the basis for an important tactical top in later Q1. If we are correct in getting another significant bear leg into summer this year then we expect a re-test of the August low at around 5000. Keep in mind, it is a key of our 2012 strategy to expect a negative surprise in mega caps this year and if so, then this will be obviously a factor that should weigh on the Swiss market.

Chart 46.) Swiss Market Index Weekly Chart

Source: UBS Technical Research