Technical Analysis

Technical Outlook 2013

Global

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The Endgame of a Structural Bear ...

2012 was a highly volatile and selective year for equities and it was again a year with an amazingly high correlation to market cycles. Who would have thought that - despite the European debt crisis and worries about the world economy the S&P 500 posted a gain of 14%, which even tops the average performance of presidential election years. We have evidence that the March 2009 cyclical bull market is moving into a mature stage and in this context we see the S&P 500 and risk assets moving into a major top in 2013 followed by a new cyclical bear into 2014. For equities it should be the last cyclical bear as part of the structural bear that is moving into its ultimate endgame … here are our key calls for 2013!

- It was a key call of our 2012 strategy to expect risk assets moving into an important bottom as the basis for a limited bull cycle into 2013. For the S&P 500, last year's June/July bottom represents the continuation of the March 2009 cyclical bull market. Looking at our technical indicators and market patterns, we have evidence that this bull market is reaching a mature stage, which indicates an important market peak for equities in later 2013.
- In the Presidential cycle, we have in post election years and mid-term years the highest risk (73% probability) of seeing a bear market. Over the last 2 years the correlation of the S&P 500 to the election cycle was amazingly high. Following this cycle and given our indicator setup we see the risk of starting another bear market at the latest in Q3 2013 heading into 2014, where we have the next long-term low projection for equities!
- Tactically, after the aggressive December rally, we expect a somewhat weaker January, followed by more upside into late Q1. We see a potential March top as the beginning of a distributive top building phase, which should be completed in July/August, so that H2 2013 in particular, could be a tough time for risk assets.
- Structural market trends in equities and commodities tend to last 15 to 20 years. With a potential new cyclical bear market starting in later 2013, we see US and European equities moving into the ultimate endgame of their structural bear market, which implies that the second half of the decade should be much more bullish for equities based on a new mega trend, which is selling bonds and commodities versus buying equities.
- Given the underlying asset class correlations, the end of a structural bear in equities implies that the structural bull in bonds and commodities would come to an end. From a cross-asset class perspective we see a high likelihood that in 2013 commodities will move into a very important long-term top. Final moves in commodities are very often erratic so we expect commodities overshooting and topping out later than equities in H2 2013 or Q1 2014.
- Last year we expected an impressive comeback in financials, and defensives to start underperforming. We see financials and other early cyclicals such as semiconductors topping out in late Q1, whereas believing in a final overshooting in commodities our top sectors for 2013 are the late cyclical energy, materials and gold mines.
- After the impressive Q4 comeback and a completed bottom in China, we expect Emerging Markets to continue to outperform into summer. From a Q3 peak we anticipate Asia and the Emerging Market complex to start a new bear cycle into 2014. In Q4 2012 the JPY completed a major long-term top as the basis for a multi-year bear market. From a trend perspective this is structurally bullish Japan. Tactically, we remain bullish Japan into summer. However, we also expect the Nikkei to start a new cyclical bear from a later 2013 top into 2014, which should produce a higher low versus 2008 and the 2012 bottoms.
- In line with our 2012 strategy, gold marked a 4-year cycle bottom last May. From a late December/early January tactical low we expect gold starting a new bull cycle into finally Q3 2013, where we anticipate gold to move into an important tactical top. A break of the 2011 high at $1920 would indicate a next target at $2150.
- The July 2012 top in the USD represents our anticipated 4-year cycle peak. Tactically, we expect more USD weakness into Q1 and into later summer where a significant bullish reversal could be the beginning of a new USD bull leg into 2014, which from a macro perspective could be the beginning of a quite deflationary period.

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The 2009 Bull Matures!

Fasten your seatbelt was the credo of our 2012 outlook, and driven by a number of external shocks last year was indeed the presumed highly volatile year for financial markets. After 2011, which was already a year with an extreme divergence in performance between Asia, Emerging Markets, Europe, and the outperforming US markets, in 2012 we also saw a very selective year in terms of country and sector performance. On the back of the European debt crisis, Europe and the Emerging market complex have been massively underperforming the US market as a safe haven; and in June, where risk assets hit a bottom, the SPX was still 2% in plus territory. At the end of the day, in 2012 we saw our anticipated major cycle bottom in risk assets, and although initially we had some problems identifying and trusting the bottom, the June/July low in the S&P 500 was pretty much in line with the cyclical roadmap of the presidential cycle and the decennial cycle.

Intact reflationary environment is bullish risk assets

Chart 1.) S&P-500 versus MSCI World Daily Chart

Source: UBS Technical Research

From a cross-asset class perspective, we saw in June/July significant trend changes in all asset classes. After the anticipated minor bear market from Q2 2011 into summer last year, **commodities are trading in a new cyclical bull as part of the still intact structural bull market. The July top in the US dollar represents a 4-year cycle peak and the EUR started a comeback based on a record high bearishness of investors.** On the equity side, **China has bottomed out in Q4. Emerging markets are outperforming**. **In the US and in Europe we saw big comebacks in financials and cyclical sectors, whereas defensive sectors have been mostly underperforming since July.** And last but not least, on the back of a completed long-term peak in the JPY, we see **Japan gaining significantly strength versus the world. Together with more or less all central banks in accommodative stance this means that since the summer lows, we are *de facto* back in a reflationary macro environment and this is bullish risk assets.** However, last year we said that this new bull cycle should have just a limited duration into 2013, maximum early 2014. With entering the last third of the 2000 structural bear market we thought and still think that equity markets have entered a very volatile sideways trading range, where it is not likely to see similar strong cyclical bear and bull trends developing such as in the period from 2000 into 2007**.** If we look into the world´s equity landscape we see the US market still in its intact March 2009 cyclical bull trend. For most markets in Europe, Asia, and the Emerging Market complex the long-term patterns are looking completely different. Since Q4 2009 most of these markets have been trading volatile sideways and this is a pattern that we do not expect to change dramatically in the next 2 years.

Chart 2.) Election Cycle (1941 – 2010)

Post Election - Mid Term Years	
1941-1942	bearish period over both years
1945-1946	bear in 1946
1949-1950	no bear
1953-1954	no bear
1957-1958	bear in 1957
1961-1962	bear in 1962
1965-1966	bear in 1966
1969-1970	bearish period over both years
1973-1974	bearish period over both years
1977-1978	bear in 1977
1981-1982	bear in 1982
1985-1986	no bear
1989-1990	bear in 1990
1993-1994	no bear
1997-1998	bear in 1998
2001-2002	bearish period over both years
2005-2006	no bear
2009-2010	continued bear into March 2009

Source: UBS Technical Research

73% likelihood to see a bear market in next 2 years!

So our 2012 view has not changed and although this year should start on a bullish note, we have several reasons to believe that 2013 could be finally a roll-over year for risk assets followed by a new cyclical bear that should last into 2014, where we have the next major long-term bottom projection for equities. Our key argument behind this call is again the cyclical background of the US market. **Since 1941 we had 18 presidential cycles. In 13 out of 18 cycles we saw a bear market in either the post election or the mid-term year, so statistically we have a 73% probability of seeing a bear market in the next 2 years.** After the massive rallies in equities, in H2 2012 we are basically starting on a rather high basis into 2013. So tactically for us, it’s not a question of if, but of when we move into an important market peak and here the question is obviously whether we peak out in 2013 or if the bull market extends into

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early 2014 followed by a new bear cycle. **We have increasing evidence that already this year we could see an important market peak and from a cyclical perspective we have with March and August two candidates that we see as potential turning points for equities and risk assets in general.**

Tactically still room for surprises on the upside in H1 BUT ....

Chart 3.) S&P-500 with Stock Trading Above 200-Day Moving Average

Source: UBS Technical Research

If we were to put everything together we could see a quite **good start into 2013, and given our bullish scenario for commodities we could in fact still see the one or other bullish surprise and overshooting this year, preferable in H1**. On the back of further central bank intervention we saw a very sharp sentiment change in Q4 towards a more bullish attitude to risky assets and we think the process of breaking up the cognitive dissonance between positioning and view has still some way to go. **"Investors are too much invested in safe assets" and the "re-pricing of growth" are likely to be the top sentiment themes in Q1**. We think this sharp change in sentiment will sooner or later end up in extreme bullishness and too much complacency, and somewhere in 2013 it will be the basis for a classic contrarian sentiment call. Ironically, it is interesting to see that whenever the sentiment and market mood is at its best we see selectivity increasing and the growing divergences in US market breadth as well as the rising wedge formation in the S&P 500; we label as an indication, that **for an increasing number of stocks and sectors a potential late Q1 top could be already an important turning point this year**. However, **no bull market tops out in one day, so we expect 2013 to be a year with further increasing selectivity where the outperformer and late cyclicals should finally top out in later summer as the basis for a challenging H2,** which at the end of the day we would see as the beginning of a new cyclical bear market. Basically, in a **new potential bear cycle into 2014, top to low we see the risk of a 25% to 30 % correction in the S&P-500, which suggests from a potential top of around 1550 to 1570 we could see the market correcting to 1180/1100. From a secular perspective this potential new bear market could bring us a very important long-term low for equities in 2014!**

Commodity overshooting as a trigger for a new bear cycle in equities?

Chart 4.) Crude Oil Monthly Chart

Source: UBS Technical Research

Over the last 2 years we said that we see the US market trading in the final stages of its secular bear market. So what does a secular bear market bottom look like? We've put some work into this and we think a final cyclical bear in equities is still missing to complete the 2000 structural bear in equities. This would have far-reaching implications from a cross-asset class perspective. **Secular market trends in equities and commodities are negatively correlated.** From a cyclical perspective these trends tend to last 15 to 20 years **and the secular turning points are highly correlated. So a final cyclical bear in equities would imply that commodities are also trading in the very late stages of its 1999 structural bull market. This is one reason why we think a potential overshooting in commodities this year could mark a very important and maybe even THE structural top in commodities.**

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Furthermore, from a cross-asset class perspective a potential overshooting in commodities this year would be latently inflationary, as another potential key topic and surpr**ise factor for 2013. So although initially an overshoot in commodities would be bullish for risk assets, further down the road we would see this as a trigger for problems in equities. Keep in mind, historically seen commodity prices are on very high levels and even if we were to see a fundamental recovery in H1 2013, given the overall fragile position of the economies, an overshooting in commodities would very quickly start biting the real economies. So at the end of the day an overshooting in commodities could trigger a new bear cycle in equities, which anticipates a new cool down in the real economy into 2014. Ironically we would see this as the start of the ultimate endgame of the structural bear market, so that the second half of the decade should be much more bullish for equities based on a new mega trend, which is selling bonds and selling commodities against buying equities!!!**

Where's the risk for being wrong in our 2013 outlook?

Following our cycles and on the back of the overall indicator setup we have ONE high conviction call and this is to see a new cyclical bear market in equities in the next 24 months. However, with regards to the tactical timing we have a few inconsistencies in our cycle work, so we think we have 3 scenarios where we could be wrong this year.

- From a pattern standpoint the S&P 500 is trading in a rising wedge (see chart 3.) just 8% below its 2007 all-time high. In Europe the German DAX is trading near the upper end of a huge triangle as a classic breakout formation and the DAX, as a performance index, is trading just 4% below its July 2007 all-time high. A rising wedge is usually a trend reversal formation. The only way we see wedges resolving into the dominant trend direction is a massive overshooting. So one potential risk for being wrong is that we see a broad-based high momentum breakout in the S&P 500 and the DAX. One consequence would be that we are in a new major bull market and this would also mean that the secular bear market in the US and in Europe would definitely be over. From a wave perspective such a high momentum breakout can only be justified by a wave 3 extension, and the basis for such a bull-run could only be justified by a kind of inflationary driven bull market on the back of too aggressive money printing by central banks (crack-up boom). We think such an extreme scenario is very unlikely.
- Another risk in the timing of a potential top. After the sharp bull moves in December and after avoiding the fiscal cliff the markets are starting on a very overbought position into 2013. It's very likely that in January we will sooner or later see a pull back starting, which brings down the momentum to a more sustainable basis before moving higher into March, which is our preferred time target for a first important top in equities. The problem is, that if a potential pullback at the beginning of the year should extend in price and time and the markets would correct into February/March, we could see a completely different tactical scenario for 2013. In this case the seasonal pattern of post-election years and the decennial cycle would come on top of the agenda with the consequence of seeing a new tactical rally from March into August, which nonetheless remains an important tactical top projection for equities in later 2013. A changed tactical road map/scenario would not negate the risk of seeing a new bear cycle into 2014. However, with regards to the start of a potential new bear market it would be very likely that following a top in August we would still need to see a longer distributive top building process before we see real weakness developing, and this also means that the likelihood of seeing a new bear market scenario would clearly shift into 2014!!
- Another potential risk for being wrong is that our favored March top already represents THE top of the year and in this case Q2 in particular could be a very weak quarter for equities and risk assets. The key indication for this scenario is the rising wedge in the S&P 500 (chart 3), which points to an important trend reversal in Q1. The way we usually see wedges breaking is a sharp

Chart 5.) AUDUSD versus S&P-500

Source: UBS Technical Research

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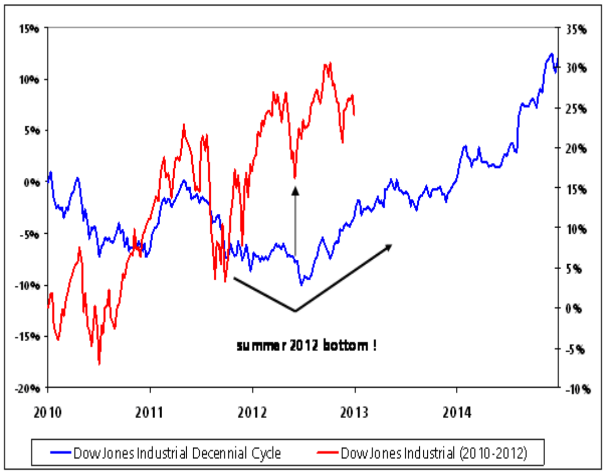
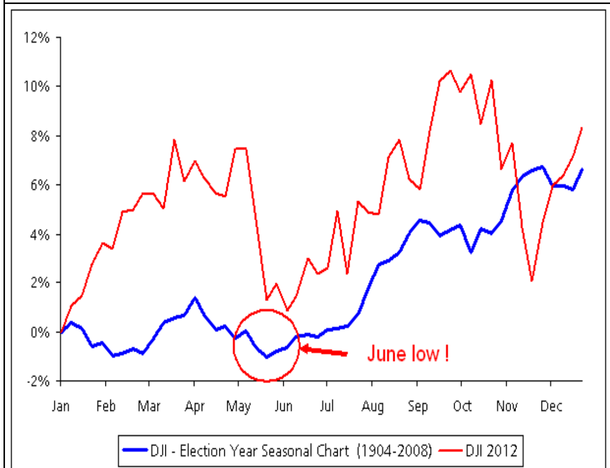
move against the dominant trend. This would also have consequences for the timing of a potential bottom of a new bear market, since in this case it would be likely to also see the bottom earlier in late 2013 instead of 2014! From a cross asset class perspective this would imply that our favored final overshoot in the commodity complex would also fail. In this context we see the AUD (chart 5.) as another key indicator for our 2013 strategy. The AUD has been forming a huge triangle formation over the last 2 years and these patterns have usually a bullish trend continuation character. However, in case of a failure on the upside the character of this pattern would turn into a top formation and a break of 0.98 would already strongly question any bigger bullish breakout scenario, which in consequence would be strongly bearish risk assets.

Chart 6.) Dow Jones Industrials Decennial Cycle (1900 – 2012)



Source: UBS Technical Research

Chart 7.) Seasonal Chart Election Years with 2012 S&P-500 Perf.



Source: UBS Technical Research

Cycles…risk of another bear until 2014!

Since 2010 we've had a rather high correlation between the effective market swings of the S&P 500 versus the presidential cycle and the decennial cycle, and last year we had an amazingly high correlation of the US market to these market cycles (chart 6./7.). After a good start into the year we got our projected Q1 top followed by a weak Q2 and more importantly, both the presidential cycle and the decennial cycle had been indicating a summer bottom in equities as the basis for a new bull cycle into 2013. Who would have thought that - despite all the worries about the European debt crisis and the cooling down of the world economy, the German DAX closed 30% higher and the Greek market, as one of the problem candidates of 2012 closed 33% higher. In the US the S&P 500 posted a gain of 14%, which even tops the average performance of 5.3% in presidential election years. The problem is that with the post-election year and the mid-term year we are now approaching the most challenging period of the presidential cycle.

We are approaching the most challenging part of the presidential cycle

By definition, a cyclical bear market is usually described by a correction of 20% and more. Since 1941 a bear market occurred in 13 out of 18 presidential cycles (chart 2.) in either the post-election year or the mid-term year. So statistically we have a 73% likelihood of seeing a bear market of 20% and more in the next 24 months in the S&P 500! However, last year we said in our 2012 strategy report that according to the decennial cycle we could see an important long-term bear market low for equities in summer 2012 and that this could even play a more important role in the longer-term context. So there seems to be a conflict between the presidential and the decennial cycle, which suggests that last year's summer bottom could be probably an important long-term bottom for equities.

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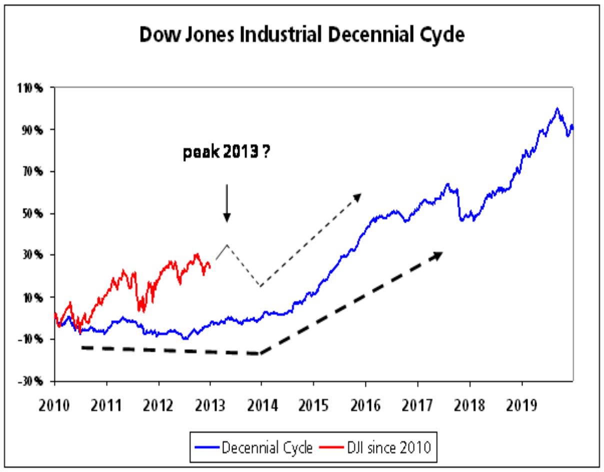
Chart 8.) Dow Jones Industrials Decennial Cycle (1900 – 2011)



Source: UBS Technical Research

Chart 9.) Major Equity Bottoms In The First 4 Years Of Each Decade

Source: UBS Technical Research

The problem is that last year we saw no bear market in the US. On the contrary, although over the last 4 years we saw 4 significant corrections of 10% to 15%, the March 2009 cyclical bull market in the S&P 500 is per definition still intact and this implies that it is very unlikely that last year's June low in the S&P 500 represents an important long-term bottom. Again, with regards to the decennial cycle we have a fascinating pattern in US equities and we see this pattern as a key instrument for the timing of the ultimate end of the current structural bear market. Since 1900 the US market has marked an important long-term bottom in the first 4 years of EACH decade (chart 9.), without exception. The underlying force behind this pattern/phenomena is the Juglar Cycle, which is a fundamental cycle and which translates into the pattern that the first 3 to 4 years of a decade are very often quite challenging for equities (chart 8.), whereas the second half of a decade is usually bullish for equities.

The point now is, the last major low in the S&P 500 we saw in March 2009, which obviously belongs to the last decade. So either we see in the current decade the first failure of this pattern in more than 100 years or we will see another bear market and subsequent bottom in the next 2 years, which would then fit to both, the presidential and the decennial cycle. In this context it is very interesting that if we combine both cycles and look into the past, we are getting again a consistent picture of having a high probability for seeing a new bear market in the next 24 months. Since 1941 we had 7 presidential election cycles where the post-election and mid-term year fell into the first 4 years of a decade. In 5 out of 7 cycles (72% probability) we saw significant bear markets and more importantly, they were among the most painful bear markets of the last century!

Bearish indication if we combine the Decennial and Presidential cycle!

If we combine both, the presidential cycles and the decennial cycle we have statistically a 72% probability of seeing a bear market in the next 24 months. One can see these statistics as voodoo. But it remains fact that particularly after WWII a very efficient political system in the US has been established, where an administration looks to put as much bad news and painful actions and even wars into the first 2 years of the presidency to form a good basis for getting re-elected or paving the way for the predecessor of its own party. With regards to this it is and remains amazing to see how high the correlation between the effective reality and the presidential and the decennial cycle was over the last few years. Of course, at the end of the day we are "just" talking about probabilities and a potential roadmap, but if these cycles fit to the pure technical picture, the probability that we will follow this pattern is in our view clearly increasing. In this context we have to take into account that the March 2009 cyclical bull market in the US is now almost 4 years old and looking at our technical indicators we have the classic patterns in charts, sentiment, and breadth forming that we usually see at the end of bull markets. So unfortunately, we are getting a quite consistent picture that suggests the risk of seeing a new bear market in the next 24 months in equities is high. The only question is whether we will see this bear market in 2013 or only in 2014? So how does the tactical roadmap look like for 2013?

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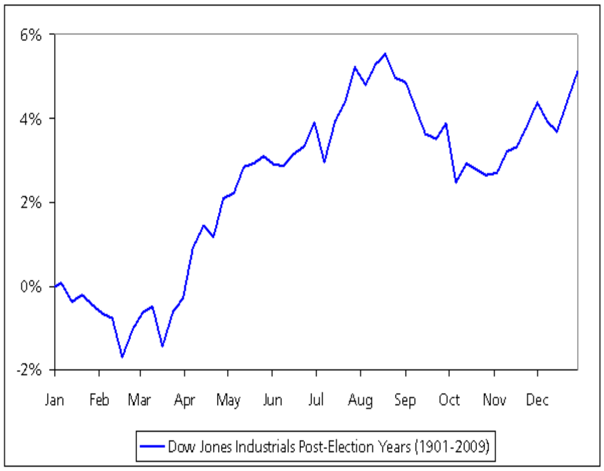
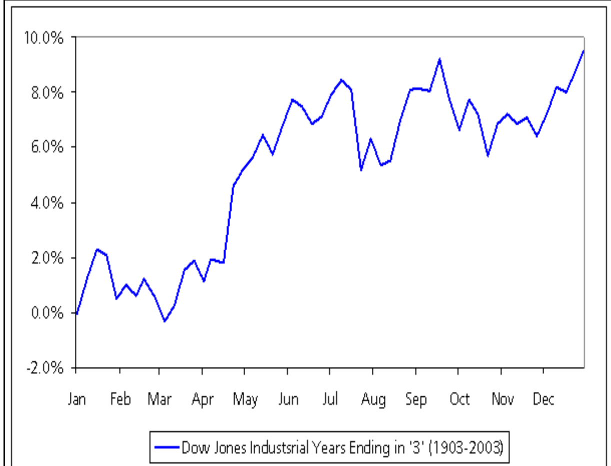
Chart 10.) Dow Jones Industrials Seasonal Chart Post Election Years



Source: UBS Technical Research

Chart 11.) Dow Jones Industrials Seasonal Chart Years Ending in "3"



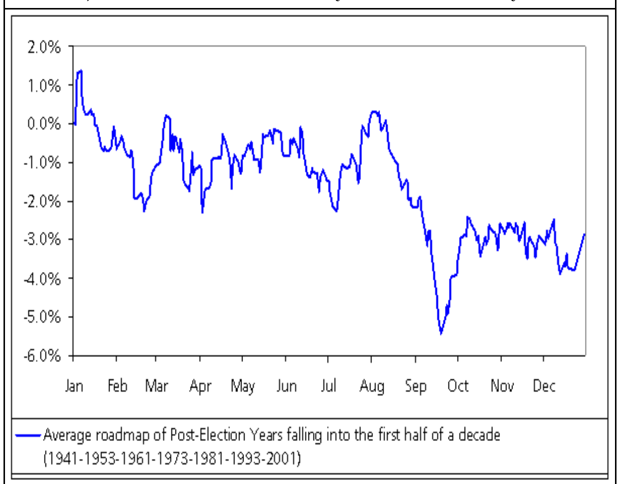
Source: UBS Technical Research

Over the last 3 years we had a relatively consistent picture in our cycle work and therefore high conviction in our tactical market calls. This year unfortunately looks different!! Whereas the isolated seasonal chart for post-election years and for years ending in "3" are giving us a relatively consistent picture for this year (chart 10./11.), they are in conflict to a couple of other cycles we follow. Over the last few months we stated that we expect the June/July 2012 bull cycle to continue at least into March, where we have an important cyclical top projection for equities, a low projection for the USD, and where we have also an important low projection for the US T-Bond future. From a cross-asset class perspective this remains in conflict to the seasonal chart for post-election years and the seasonal chart for years ending in "3" as part of the decennial cycle. Both cycles are pointing to a tactical February/March bottom followed by another significant rally into a July/August top, which is more or less completely the opposite with the rest of our cycle work. If we look into the seasonal chart of the combination of post-election years and mid-term election years occurring in the first 4 years of a decade we get a third potential tactical roadmap for 2013. It indicates that after a weak January/February we get a failed rally into March followed by a volatile sideways trading range and a final top in August before going down hard into September.

Conclusion:

Our preferred scenario for 2013 is that we see an important March top in equities, followed by a distributive summer top building phase before seeing significant weakness from a potential August top developing into Q4. However, we have some inconsistencies in our cyclical work and these divergences are a risk of our 2013 outlook as described on page 4. Fact is that with March and the July/August timing we have two important tactical projections for 2013. Given the inconsistency in our cycle work we have to see the March top projection as a low conviction call, whereas in the August top projection we have significantly higher conviction! Again, tactically the markets are starting on a very high position into 2013, the sentiment has turned rather bullish in December/early January and equities are now even more overbought after avoiding the fiscal cliff. All this suggests the risk of a pullback in later January. The longer a potential consolidation/correction in early Q1 lasts, the more likely it is the market follows the roadmap of the presidential cycle and the decennial cycle (chart 10./11.). If so we would get another important tactical buying opportunity in March followed by a final rally into an important August top. This potential roadmap would also mean that despite the risk of a negative surprise in Q4, the likelihood would be high that the real bear scenario would shift into 2014.

Chart 12.) Combination Presidential Cycle and Decennial Cycle



Source: UBS Technical Research

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Chart 13.) S&P-500 with NYSE 52-Week Highs **Weekly Chart**

Source: UBS Technical Research

Chart 14.) S&P-500 with NYSE 52-Weeky High **Daily Chart**

Source: UBS Technical Research

Increasing selectivity … a late cycle phenomena!!

History repeats itself is one of the premises of technical analysis. Although we think that in the fundamental world we have exactly the same principle, where analysts primarily look into patterns of previous economic cycles to get guidance for the future, particularly in technical analysis, pattern analysis on price charts and structural indicators are one of the most important disciplines. In this context major market bottoms and important market peaks in equities follow certain characteristics. So if we see the risk of the US market moving into an important top this year, what does a major cycle top in equities look like and do we have evidence that such a top is already underway?

The most important phenomenon we see in the mature stages of a bull market is the gradually increasing selectivity, so the market breadth in the last 10% of a bull market is usually deteriorating. Looking at key indicators such as the number of new 52-week highs at the NYSE it is amazing to see that since the 1932 bottom, 16 out of 18 major market peaks (89% probability) were led by a bigger bearish divergence forming over a longer timeframe. So in the end phase of a bull market we usually see fewer and fewer stocks participating and pushing the market into its ultimate top. The only exceptions were the peaks in 1980 and 1983, where the market topped out without forming such a non-confirmation (chart 13.). We see the same leading divergence in other breadth indicators such as the number of stocks that are trading above their 200-day moving average (chart 3.). In the final stages of a bull market we have obviously already an increasing number of stocks that had been rolling over earlier and breaking their 200-day moving average, so that into the ultimate top we usually see fewer and fewer stocks trading above their 200-day moving average. So where are we now? In both the number of new 52-week highs and the stocks trading above their 200-day moving average we already have a bigger non confirmation forming. However, in the larger context we have to make a distinction between a structural divergence that can form over 1 or 2 years and a tactical divergence that we usually see developing into the ultimate top of the market. Structurally, the September peak in the S&P 500 produced a significant lower number of 52-week highs versus the peak in 2010, which means the 2009 bull market seems to have definitely reached a mature stage. What is still missing is a bigger tactical divergence (chart 14.)!!

Tactically there is minimum one further top missing in the S&P 500

This missing tactical divergence was just one reason why after the healthy breadth spike into September we said that after a potential 5% to 8% correction into Q4 we should see at least one more rally leg hitting a new high into 2013 before seeing a more important market top. By anticipating further increasing selectivity we should see a lower number of new 52-week highs into Q1 and if so, it would theoretically give us the indication that a potential Q1 top fits the characteristic of an important cycle peak. Again, what is necessary to see is a new index high, which means an S&P-500 target of at

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Chart 15.) S&P-500 Weekly Chart

Source: UBS Technical Research

Chart 16) Europe STOXX-600 Daily Chart

Source: UBS Technical Research

least 1500 to 1550 before we could identify this top as a potential major market peak. So regardless of how long we correct into early Q1, after this setback it is highly likely to see at least one more rally leg with hitting a new high in the S&P 500, and this also means that tactically a pullback into early Q1 would still represent a buying opportunity for aggressive traders.

Distributive price top still missing!

Another important characteristic of an important market top is the forming of a classic distributive top formation. Whereas bottoms in equities can be very sharp, major market peaks usually take some time to form. In the S&P-500 the top in 2000, 2007, and 2011 took around 6 months of distribution before breaking down. Even last year's Q2 top had been forming over 3 months before the S&P-500 corrected into the June bottom. This phenomena/pattern is important for the logic and the rational of our tactical roadmap this year! Since we expect to see at least one more top in the S&P 500 this year (missing tactical divergence in breadth indicators), we can assume that after this potential top we would still have to undergo a several-months lasting distributive top building phase before a real bear move starts and for Europe we have the same implication. With hitting new reaction highs the STOXX-600 is still far away from any kind of distributive price top. This is important as 1) it means that 2013 could actually be more a roll-over year for equities, so that we should only see the real pressure in 2014, and 2) from a sector allocation standpoint we usually still see a nice outperformance of late cyclical sectors during a distributive top building phase, whereas other sectors are already rolling over.

Cheerleaders of the 2009 bull market acting as a cap for the market?

In this context we see the cheerleaders of the 2009 cyclical bull market as key indicators for the overall market. A lot of these stocks (such as AMZN, GOOG, T, KO, GE, IBM, MCD, MRK and AAPL) have experienced significant corrections into the November low and in the one or other of these stocks the Q4 correction could already be the beginning of a bigger top building process, where the November low represents an absolutely pivotal tactically support!! The most important message is that all these stocks will be very likely capped on the upside this year, since most of them have broken their 2009 bull trends. If so, this will also act as a cap for the overall market, which is one fact that in our view makes a major overshooting and a sustainable breakout of the S&P-500 above the 2007 all-time high very unlikely (see scenario 1 of the risks for our 2013 outlook page 4.).

Apple and Coca Cola (chart 17./18.) are in this context maybe the best examples. With the Q4 correction, AAPL has broken its 2009 bull trend and even if we were to see a significant and longer lasting recovery into deeper 2013, from a wave perspective AAPL is either at the beginning of a longer lasting volatile and complex sideways trading range, or after a wave B countertrend reaction it is very likely to see a second correction leg down (wave C) into deeper 2013. So from a scenario perspective it's unlikely that AAPL will be again a bullish performance contributor for the US market in 2013. On the contrary, from a wave perspective we see in this stock a significant risk on the downside over the next 24 months, which means as an investor we would use strength to sell.

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Chart 17.) Apple Daily Chart

Source: UBS Technical Research

Chart 18.) Coca Cola Daily Chart

Source: UBS Technical Research

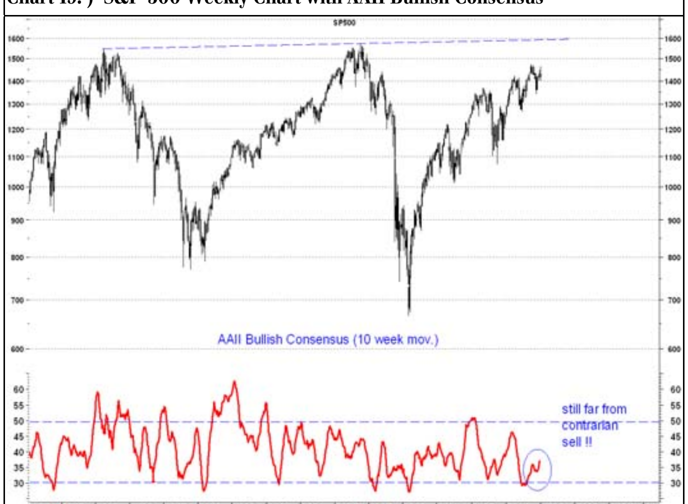
Risk sentiment strongly improving!!

Sentiment-wise we have to make a distinction between the tactical sentiment and the structural sentiment in equities. To both sentiment layers, 2012 was an extreme year. The flight to safety and the continued redemption of equity funds we see as part of a structural phenomenon, and it is in our view just the beginning of the ultimate demise of the endgame of the 2000 structural bear market (see page 14.). Hand in hand with the structural demise of equities and on the back of the European debt crisis we also saw the tactical sentiment moving into extreme pessimism into summer. Last year, the Bullish Consensus of the American Association of Individual Investors (AAII) stayed 13 week's below 35%, which is extreme in the historical context and which is usually the basis for significant rallies/bull moves. There were enough excuses not to buy equities and not to follow this bull market, and in 2012 this consistent pessimism was the basis of a classic behavioristic phenomena, which we describe as the "climbing a wall of worry". The 10-week moving average of the AAII Bullish consensus is still at relatively low levels, so the market is still far from a classic contrarian signal.

2012 … capital preservation was the consensus!

In 2012, the key themes for investors were capital preservation and to hide in "safe assets". Gold was again a key topic, real estate and related sectors have been booming and following the trend of turning away from equities, investors have been heading into safe haven bond markets (US, Germany) and/or corporate bonds. Given the strongly improving risk sentiment over the last few months, we have obviously passed the peak of this safe haven sentiment trend. Given the extreme sentiment/positioning on the sector basis it was one of our key calls of our 2012 strategy to expect an impressive comeback in financials, whereas we saw defensives to be vulnerable for a negative surprise and to start underperforming after the June/July bottom in risk assets. We think that investors are still latently overinvested in defensives and safe assets and this ongoing process of reallocation should give us the potential for further upside into at least Q1.

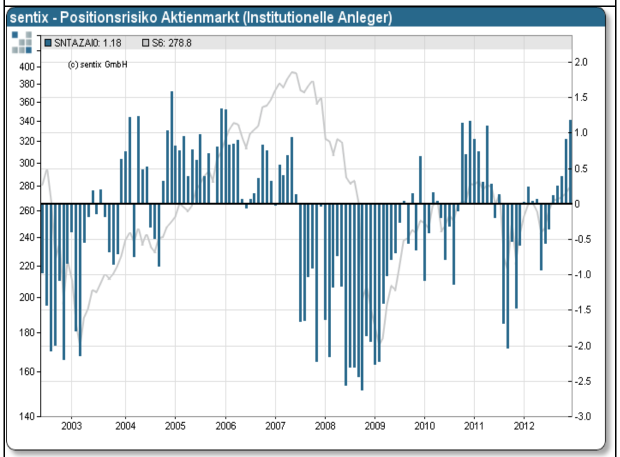
Chart 19.) S&P-500 Weekly Chart with AAII Bullish Consensus



Source: UBS Technical Research

Technical Strategy

Chart 20.) SENTIX Positioning Data of Institutional Investors



Source: SENTIX GmbH (www.sentix.de)

Chart 21.) Dow Jones Industrials Monthly Chart

Source: UBS Technical Research

2013 … will re-pricing of growth be the consensus?

Tactically, after a permanently pessimistic sentiment in July/August and an increasing bearishness into the October/November correction, we have seen the beginning of a big sentiment shift in late Q4 and a lot of the bears have been capitulating over the last few weeks. One result of this capitulation is that equities are starting on a very overbought position into 2013 and according to SENTIX (www.sentix.de) the positioning in the institutional camp is hitting extremes! With this set up we see the markets vulnerable for a pull back in later January, so that we could see a somewhat bumpy start into the year. In the bigger picture the sentiment topics of H1 2013 should be "the re-pricing of growth", "investors are too much invested in safe assets" and "equities are the only alternative in a low interest rate environment". Trend wise this should be still bullish risk assets as we think we are still only somewhere in the middle of a re-allocation trend towards riskier assets. Again, the 10-week moving average of the AAII Bullish Consensus (chart 19.) is still at relatively low levels. Nonetheless, at the end of day we expect these sentiment topics to get consensual themes very soon and this will be the basis for a classic contrarian sentiment call in later 2013. From a pure technical perspective we usually see this phenomena linked to the break of big price levels in the major headline indices.

Dow, S&P and DAX will be challenging big levels in 2013!

In this context it is important to understand that a Dow Jones Industrials, a German DAX and the S&P-500 are not far away from their all-time highs. It's very likely that in the process of re-allocation towards risky assets these markets will break their all time highs. Bear in mind, the DAX is a performance index and with a dividend yield of around 3% it will be very difficult for the market not to break the 8000 threshold in 2013. The question is whether we can expect decisive and sustainable breakouts? Given our underlying cyclical scenario, the long-term patterns in the market (see page 16.) and taking into account the increasing divergences in price indicators (chart 21.) and breadth indicators we doubt these breakouts will be decisive. On the contrary, the implied volatility in the SPX and the DAX is reaching extreme low levels and staying at these low levels for a longer time frame can only be justified by moving into a strong bull market. Given all the above reasons we think this is very unlikely, so we see a high risk that a potential breakout in these indices will finally just push the sentiment into contrarian territory: This however implies that the risk is high to see in 2013 classic bull traps and false breakouts developing, which analytically would be the beginning of a new bear market.

Chart 22.) DAX-30 Daily Chart

Source: UBS Technical Research

Technical Strategy

Chart 23.) S&P-500 Daily Chart with VIX Index

Source: UBS Technical Research

Similar to the German VDAX, the VIX index in the US is reaching quite low levels and in this context the market is moving into the same position and discussion as in early 2011 or Q1 2012. After avoiding the fiscal cliff the VIX is again heading down towards 14. It is important to understand that long-term we have two major support levels in the VIX index, which is at around 15 and the all-time low around 10. At 16 to 14 we have seen in the US several bull markets and prominent rallies topping out in the last 30 years. So what´s the difference between a VIX moving to 14 or to its all-time lows at around 10? It is the underlying structure in the market, which is obviously also linked to the macro environment. A VIX moving to 10 suggests that 1) we are trading in a bull market and 2) we are heading into a kind of "risk-free" macro environment.

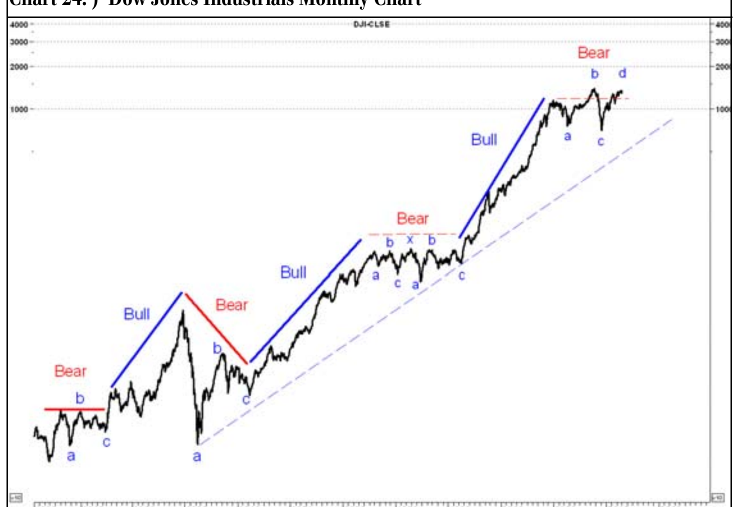
One can indeed argue that with the clear commitment of central banks to do everything to defend a currency, to bail out banks and to bring life back into the economies and labor markets, we are running into an era with no macro risks, which would then justify significant lower volatility. However, one can also argue that with this mechanism it's just a matter of time before we see new market anomalies developing as the basis for a new boom and bust cycle. Again, cyclically and pattern-wise we see a high likelihood of an overshooting process in commodities in 2013 and if so, this would have an impact on inflation expectations, interest rates, at least verbally also on central bank action. The longer this bull market in commodities lasts the more painful it gets for the real economies. Sentiment-wise this could be one of the negative surprises in later 2013 or at the latest in 2014. Consequently, we do not expect to move into a "risk free" macro environment and in this context one of our 2013 key calls is to expect higher volatility H2 2013 and into 2014!!

The endgame of a structural bear ....

Japan has lost 82% from its secular peak in 1989 into 2008. Most of the Emerging Markets are trading volatile sideways since 2007, and in China, while the real economy has been booming and recently cooling down a bit, the Shanghai Composite has lost 68% of its value from the 2007 peak into its December 2012 low! What about the Western markets? The US and most European markets are trading volatile sideways since 2000, the Swiss Market Index is trading sideways since 1998 and whereas in absolute terms the S&P-500 is just 1% below its peak of 2000, inflation adjusted the US market has lost around 26% of its value within 12 years, depending on how you calculate inflation.

We've always telling our clients that we expect this structural bear market in equities to last at least into the first half of this decade. In the last 2 years we stated we thought equities had reached the last third of its structural bear market and that Japan could even start earlier with its next structural bull than the Western hemisphere. Our calls are unchanged. We have increasing evidence that we are trading in the latter stages of the current structural bear. So how does a major long-term bottom in equities look and when do we know that the bear is over?

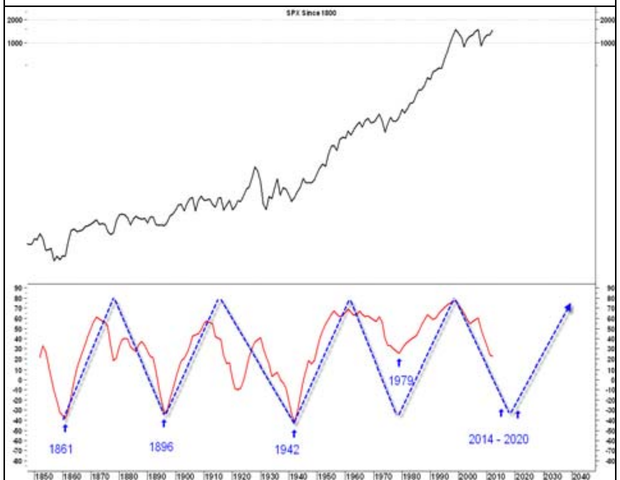
Chart 24.) Dow Jones Industrials Monthly Chart



Source: UBS Technical Research

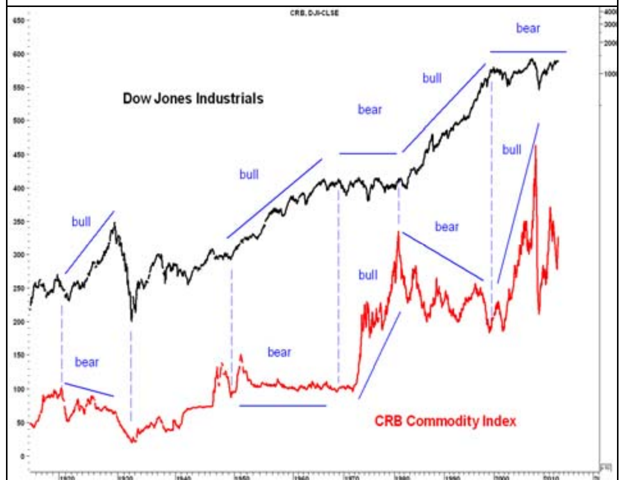
Technical Strategy

Chart 25.) S&P-500 Yearly Chart with 30/40-Year Cycle



Source: UBS Technical Research

Chart 26.) Dow Jones Industrials versus CRB Commodity Index



Source: UBS Technical Research

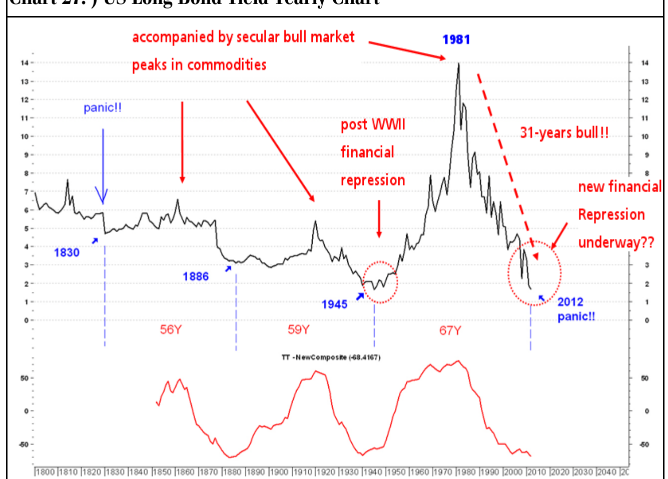
The most important point we have to understand is the cyclical nature and the intermarket relationship between equities, commodities, and the bond market. Secular bull and bear markets tend to last between 15 and 20 years. A cycle is getting measured from low to low, so a 15/20 years bull market and 15/20 years bear market brings us a 30 to 40-year cycle in equities. If we look into the current 30-year cycle in the S&P-500, we can see that the yearly momentum is approaching levels where the last structural bear hit its bottom, and including the idealized cycle with trading in the first half of this decade, we are trading within the early timing of a potential structural bear market bottom. The amazing thing is that in commodities and the bond market we have similar patterns and cycles, so that major long-term turning points in equities are highly correlated to major long-term turning points in bonds and commodities. So in our daily business, intuitively, commodities and equities are positively correlated but looking at the long-term trends it is exactly the other way around.

Most of the secular peaks in commodities have been accompanied by secular bottoms in equities or vice versa, there was just one exception and that was in 1932, where after the 1929 peak in the DOW commodities have been extending their losses and went down hand in hand with equities in the deflationary meltdown. From the 1932 bottom both commodities and equities underwent a longer lasting recovery, which was a kind of back to normal reaction of the asset classes. However, in all other cases, structurally, equities and commodities have been negatively correlated and in the current 30-year cycle, the secular peak in equities in 2000 was the basis for the secular bottom in commodities in 1999/2000.

Structural turning points in asset classes are highly correlated!!

We have the same phenomena in the bond market, with the only exception that bonds tend to move 30 years into one direction, which brings us a 60-year cycle. Last year, and in line with our 2012 strategy, the US long bond hit its lowest level since the 1940s, which means from the yield peak in 1981 the US bond market is now in a 32-year old structural bull market. So from a pure cyclical standpoint this is an aging structural bull market and it´s very likely that we are either trading in the very final stages of this bull or that we are already at the beginning of a major structural turning point. Tactically, and this is in our view a very likely scenario, the US bond market has maybe just started with a several- years lasting bottoming phase, similar to the 1940's, where the market has formed a 10-years lasting bottom formation on the back of the war time pack induced by the FED.

Chart 27.) US Long Bond Yield Yearly Chart



Source: UBS Technical Research

Technical Strategy

However, from a pure cyclical standpoint and also from a sentiment and positioning perspective it is important to understand that it´s very likely that we have reached an extreme point in the secular bull in bonds, which means the biggest bubble of all financial bubbles is coming to an end. But if this is the case then, from a cross-asset class perspective, it is very likely that also the secular bear in equities and the secular bull in commodities are mature and on the way into a major turning point. Our regular readers know that structurally we have always been underlying bullish for commodities since 2000. We have to take into account that the secular bull in commodities could be on the way into a very important long-term peak in the next 12 months, and it could even be THE secular peak for most of the commodity spectrum. From a macro perspective it would be the beginning of a new mega trend and this is selling bonds and selling commodities versus buying equities.

How does a secular bottom look in equities?

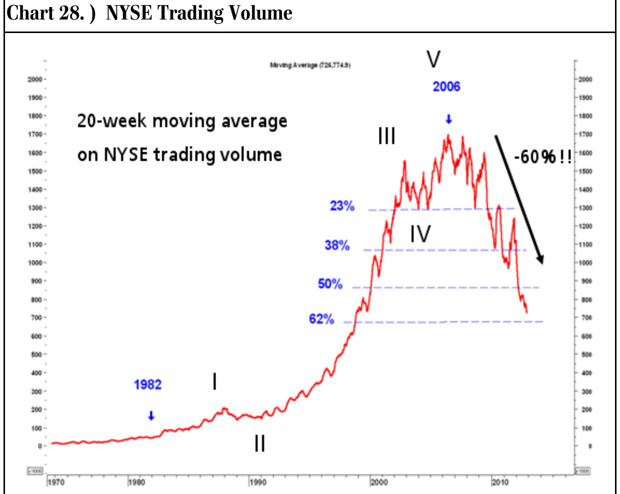
From a macro perspective we have learned that a major bottom in equities should be closely linked to major turning points in commodities and the bond market. But how does a secular bottom in equities look? It has a lot to do with sentiment and therefore with market volume. It is basically not a big surprise that in a secular bear markets the market volume and therefore the interest of investors in stocks declines dramatically. In previous secular bear markets the market volume declined up to 90% from its relevant volume peak. Currently, from the 2006 peak, which was also the peak of the banking industry, the market volume has been deteriorating by 60%.

90% volume decline in previous secular bear markets!

Pattern-wise it´s amazing to see that from the secular bottom in 1982 the volume bull market into the peak 2006 has developed in a classic and textbook-like wave 5 sequence, and that from the top we are now on the way into the 62% retracement of the previous volume bull cycle, which from a pure technical perspective represents an important support! If we were to break that threshold, we would have to take into account an even larger volume decline, similar to what the US market has experienced in previous structural bear markets such as from 1929 into 1942. How likely is that? We see a good chance that 60% to 70% volume decline could be the end of the demise in equities in the current structural bear market.

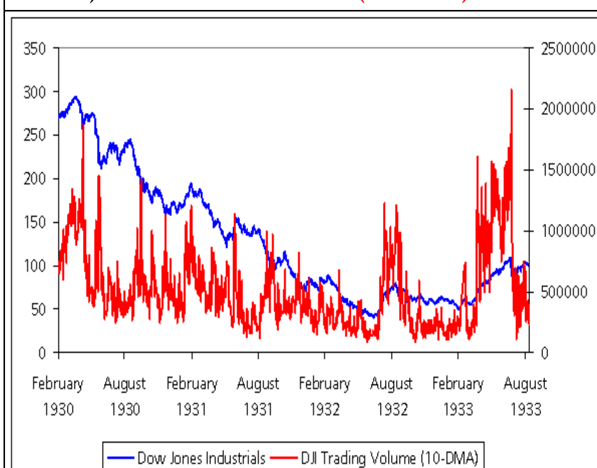
1) In Europe, the private investor has been more or less squeezed out of equities after experiencing 3 cyclical bear markets in the last 12 years. Over the last 2 years retail investors have been looking for safe havens and bought gold, bonds or real estate. Of course, we can always see tactical/cyclical swings in retail flow but it is very likely that the money that has been heading into real estate and into gold, where you have an emotional anchor, is out of reach for equity markets for the foreseeable future. You do not buy a house today and sell it 2 years later just to reallocate your money back into equities. This takes a long time and a new structural bull to build the confidence that brings the retail investor back into equities. This is at least one factor why we are very cautious versus the argument that the only way in equities is up, since the retail investor as a contrarian is not in the market.

Chart 28.) NYSE Trading Volume



Source: UBS Technical Research

Chart 29.) Dow Jones Industrial Volume (1930 – 1933)



Source: UBS Technical Research

Technical Strategy

Chart 30.) S&P-500 with 20-Day NYSE Volume (1973 – 1975)

Source: UBS Technical Research

Chart 31.) S&P-500 with 20-Day NYSE Volume (2008 – 2010)

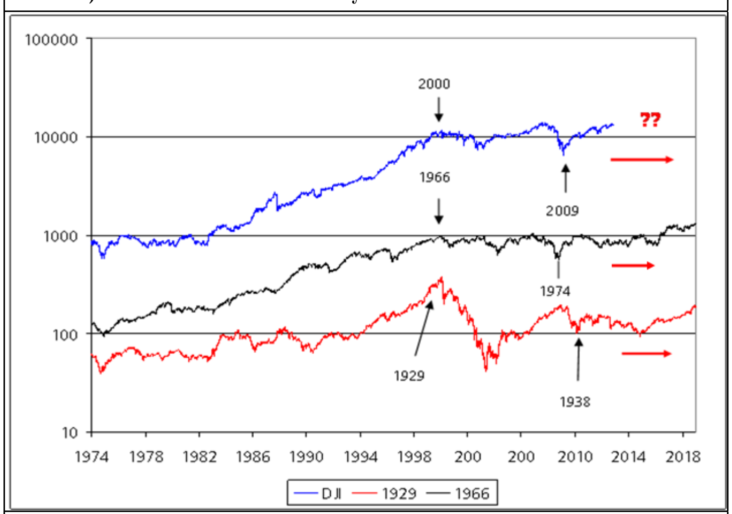
Source: UBS Technical Research

2) Nonetheless, our key argument why we could be very near to a secular volume low in equities is the extreme positioning between bonds and equities that got even more extreme in 2012. From a cross-asset class perspective this is obviously related to the bubble phenomena and the described mature stages of the secular bull market in bonds. The world is completely overinvested in bonds and underinvested in equities and this kind of extreme positioning is usually a leading indicator for trend changes. So YES, we think that this extreme positioning will be sooner or later the basis of the beginning of a new mega trend and this is selling bonds versus buying equities. The only question is, whether this mega trend will start easily with just a switch and then move into a trend or if the trend change will take a more complex form. Unfortunately, we think the latter is the more likely scenario.

Secular bears do not end with fireworks!

Over the last few years a lot of clients have asked us whether we see the risk of breaking the March 2009 lows into a potential final cyclical bear. Following the rationale of the 1970s pattern, where the 1974 low was the nominal low of the 1966 -1982 secular bear market and taking into account the current wave patterns in the various markets as well as given the commitment of the central banks to do everything to avoid deflation, we said and we still think the likelihood to break the March 2009 low is in our view low. Nonetheless, we have one argument and it is maybe THE key argument why we believe that there is still one final cyclical bear missing to complete the 2000 secular bear. It is interesting to see that the ultimate and final fall into all major 4 secular bottoms (1921, 1932, 1942, 1982) in the last century has been accompanied by deteriorating volume, whereas in the first bull move after this bottom the volume has started picking up.

Chart 32.) Dow Jones Industrials Overlay with Secular Bear Markets 1966 and 1929



Source: UBS Technical Research

Particularly with regards to the final fall, this is intuitively a quite unusual market behavior given that in cyclical bears and/or bigger corrections we very often see in the final move down the classic washout and capitulation of the investors, which causes volume spikes. With moving into the ultimate bottom of a secular bear this seems to be different as we can see in the 1932 bottom (chart 29.) and also if we look into the 1974 meltdown, which marked the nominal low of the 1970s secular bear (chart 30.).

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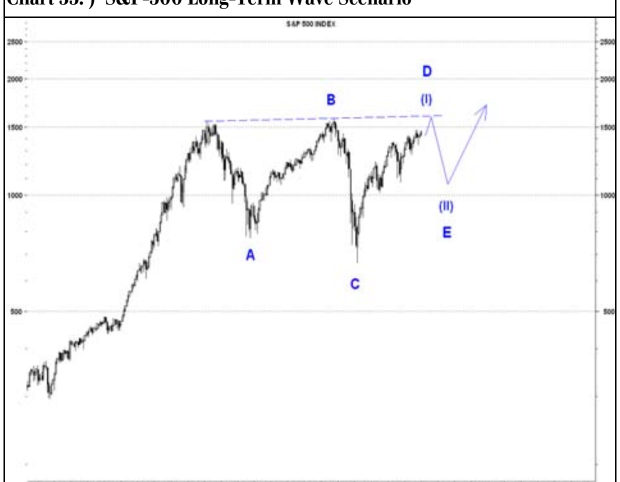
During the 1974 meltdown the volume deteriorated until August, whereas in the initial bull phase of 1975 the market volume started picking up significantly. Sentiment-wise this kind of market action marks in fact the ultimate peak of the disinterest of investors in equities and it would mark the ultimate low in the structural trend of deteriorating volume. The problem is, so far we haven’t seen this market behavior in the current secular bear. The deflationary melt down (similar to the 1930’s scenario) into the March 2009 bottom (Chart 31.) and even during the minor corrections in 2011 and 2012, the market volume increased during the fall, whereas in the following recoveries the volume has been deteriorating across the board. This does NOT fit with the characteristics of a secular bear market bottom!!

Conclusion:

- Following the 30-year cycle we are in the end phase of the relevant secular trends in equities, commodities and bonds, which *de facto* means that in particular for bonds we are at the eve of a 30-year lasting super bear market. However, looking at the characteristics of how secular trends usually end, we think that in all asset classes there is still something missing to finally complete these trends.
- In the bond market it´s likely to see a several years lasting bottom building phase in yields before a real bear market can start. Within this potential bottom building phase (which should ensure that real interest rates remain negative), we still see the chance to get a bubble phenomena in the precious metals area to push down the DOW/Gold ratio into historically extreme territory. Theoretically, one could say that as long as this bottom building phase in bonds has not been completed, the underlying structural trends in equities and commodities could continue. If we put everything together we see a higher likelihood that already in the next 2 to 3 years we could see the final end and therefore the ultimate turning points of these trends.
- In terms of positioning it will be difficult to top the already extreme relationship between equities and bonds. If we include the decennial cycle and presidential cycle in equities and look at the patterns in the relevant markets we see the risk of moving into a final cyclical bear wave to complete a complex correction pattern of a larger degree. Our monthly indicator work for the S&P 500 and DJI are toppish and diverging (chart 21.) which shows a mature stage of the 2009 bull cycle.
- From a pattern standpoint we think the S&P 500 trades in a complex A-B-C-D-E correction pattern, where the market should complete wave d in 2013, followed by a final bear wave e into 2014. This scenario makes sense in the context of patterns in Europe as well as in the Emerging Markets. Early this year we are getting a lot of super bullish comments on the German DAX, which is not far from breaking its 2007 all-time high. We shouldn’t forget the DAX is a performance index and includes dividends. So the market can do nothing over the next 12 months and it nonetheless ends 3% higher, which has however nothing to do with wave patterns. If we look into the price chart of the DAX or the broader CDAX (as a price index) we can see that the German market actually forms a huge symmetrical triangle and also here we see the risk of seeing at least one final correction leg ‘E’ to complete this complex structure, before a new structural bull and major breakout move starts.

Chart 33.) S&P-500 Long-Term Wave Scenario



Source: UBS Technical Research

Chart 34.) DAX-30 Long-Term Wave Scenario

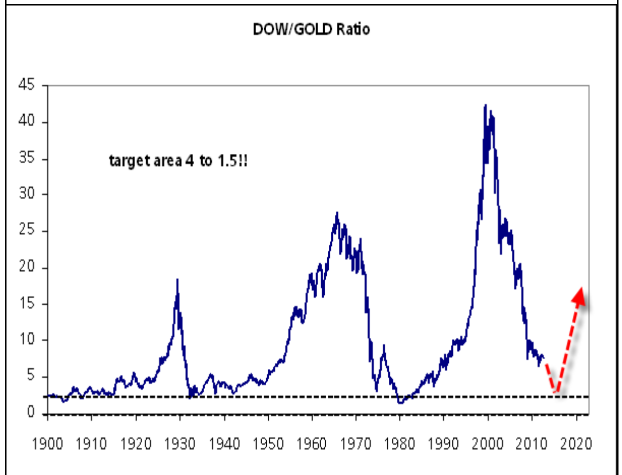
Source: UBS Technical Research

Technical Strategy

Chart 35.) MSCI Emerging Market Weekly Chart

Source: UBS Technical Research

Chart 36.) Dow/Gold Ratio



Source: UBS Technical Research

- In the Emerging Market complex the bull cycle from the March 2009 lows into the 2011 peak has a classic wave 5 structure, which is long-term bullish. However, after the impulsive 2011 bear wave the whole rebound structure from the October 2011 low has so far only a corrective shape. We see a high likelihood for completing this corrective rebound structure of a larger degree in 2013 and see the risk for another but final wave c correction leg before a new larger bull cycle can start.
- The most likely timeframe for all this should be in the next 24 months. Again, from a cyclical perspective, the US market has set an important long-term low in equities in the first 4 years of EACH decade. A potential final bear wave in equities accompanied by commodities topping out structurally would also push key asset ratios such as the DOW/gold ratio into position, which would fit the secular turning points between gold and equities. Sentiment-wise and in terms of volume, a final bear wave would be the ultimate endgame of the demise in equities, since a final cyclical bear will very likely be accompanied by even lower volumes than we have today. If so, it would be the final piece of evidence that we are through and at the beginning of a new major bull market in equities.
- What if we are wrong with all this? We think we have just 1 realistic scenario for this and it is that the whole structural bear in equities continues for another 8 to 10 years in which equities and bonds just go volatile sideways and gold moves into a bubble scenario, which sees its peak in the late stages of this decade.

US Dollar … a new 4-Year Cycle Peak is in Place!

From a cross-asset class perspective the US Dollar remains a key variable for risk assets. Strategically, in Q2 2011 we expected the US dollar starting a limited bull cycle into H2 2012 and this move was the trigger for the anticipated temporary bear cycle in risk assets and in particular in commodities. On track with our 2012 strategy, the US dollar marked another important top last year and from a cyclical perspective the July top represents a 4-year cycle peak (chart 37.). The consequence is that as long as the trade-weighted dollar index trades below the July 2012 top at 84.09 the US dollar remain strategically in bear mode, which is important, since from a trend perspective this is bullish equities, commodities, and actually also gold, which also hit our anticipated 4-year cycle bottom last May.

We expect a test of the 2011 lows!

Strategically, the trade-weighted dollar index (DXY) is trading volatile sideways in a range of 90 to 72 since 2008. With the new strategic short signal in place and looking at the long-term pattern, which one can easily interpret as a huge triangle formation, the question is obviously whether we see the 2008/2011 lows (70.60/72.60) at risk?

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Chart 37.) Trade Weighted Dollar (DXY) Index 4-Year Cycle

Source: UBS Technical Research

Chart 38.) Trade Weighted Dollar (DXY) Daily Chart

Source: UBS Technical Research

Strategically we think there is a high risk of re-testing these levels in the next 12 months but we do not necessarily favor a break of the 72/70 key support. With yields in Europe and the US at extreme low levels and both currency blocks having the same debt problems with central banks trying to keep everything under control with the same set of tools, it is in our view unlikely to see one currency block devaluing dramatically against another block. So in the bigger picture we favor the US dollar continuing to trade in a very volatile sideways range between 72 and 90. This means that at least for the next 2 years we do not expect to see any bigger and longer lasting trend moves. However, from a cyclical standpoint as well as from a pattern perspective we think the US dollar is trading in a huge bottom building phase (similar to the first half of the 1990s and 1978/1981) that suggests a significant higher dollar into minimum 2016/2017, where we have the next major 4-year cycle peak projection. The question is when we see the bottom in the Dollar to start this bull move. From a cyclical perspective we think the US dollar will bottom out in a time frame between Q3 2013 and Q1 2014.

Tactically bearish as long as trading below 81.50!

Tactically the DXY has set a significant lower high in early September at 81.45 versus its 4-year cycle July top. After completing a classic corrective a-b-c countertrend pattern this development is outright dollar bearish as long as the DXY does not break its pivotal September high! More importantly, from a pattern standpoint the September/November countertrend rally can be interpreted as the right shoulder of a huge head & shoulder top with key support at around 79, which underpins the bearish character for 2013. Basically, from a cyclical perspective we have two key timing points for the currency side this year, and this timing we can obviously also apply to several other pairs such as the EURUSD, AUDUSD and JPYUSD. Tactically, we expect an important inflection point in later Q1 as well as in early Q3. Consequently, following our cyclical models and apart from any short-term bounces we remain US dollar bearish into later Q1, whereas in Q2 we could see a temporary bounce. However, the key question for 2013 is when we could see the dollar moving into a more important bottom and according to our cycles, the most likely timeframe for this is deeper Q3 and if we are correct this potential bottom could be the start of a new US dollar bull cycle into 2014.

Conclusion: From a cross-asset class perspective the key message behind the head & shoulder formation in the US dollar is clear. As long as we do not get any fundamental breakup in the inter-market correlations and the DXY does not break its September top at 81.50, the US dollar is bearish biased for at least into later Q1, which is underlying bullish risk assets.

Technical Strategy

Chart 39.) AUDUSD Weekly Chart

Source: UBS Technical Research

Chart 40.) AUDUSD versus MSCI Emerging Markets

Source: UBS Technical Research

AUD has been forming a major breakout pattern over 2 years!

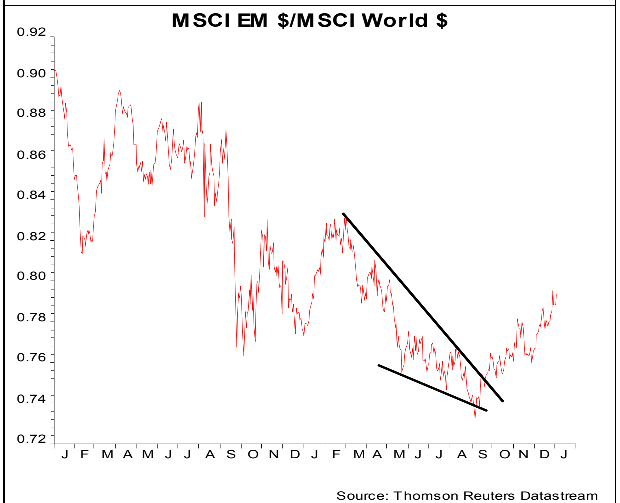
In particular for our potential overshooting scenario in the commodity area, the US dollar and the commodity currencies are obviously playing a key role this year. In this context it is important to understand the character and the technical implications of the pattern that has been forming in the AUD over the last 2 years. In Q2 2011 we called an important long-term top in the AUD, and according to our cycle work we expected a larger and complex correction developing into a H2 2012 bottom as the basis for a new bull cycle into 2013. At the end of the day the second tactical down leg in the AUD into June last year was significantly milder than favored, which in the bigger picture has the consequence that the AUD has been forming a huge symmetrical triangle over the last 2 years. A symmetrical triangle is a classic breakout pattern, which means in 2013 we will see a new directional breakout in the AUD, and according to our US dollar strategy we obviously favor a breakout to the upside. Generally, one of the strengths of technical analysis is that in particular in the field of pattern analysis, analytically there are no gray zones existing. There is only black or white, and translated it means a triangle is either a trend continuation pattern or a major top formation. From a cross-asset class perspective the character and the implication of this pattern are very important. In most cases triangles are bullish trend continuation with a clear defined measure move target. A break of the July 2011 downtrend would imply a strategic target at 1.21, which is in fact an ambitious target!! From a cross asset class perspective and analytically, ONLY this ambitious target makes in fact sense to get a potential overshooting scenario in commodities, otherwise there would be something wrong in the system!

Conclusion:

The AUD represents a key indicator for our commodity call in 2013. Triangles are usually bullish trend continuation but with a break of 0.97 the whole character of the pattern would make a U-turn and the formation would get an increasingly toppish character. In this case the risk of seeing a negative surprise in the AUD would increase significantly. It is in our view not a very likely scenario but it would be nonetheless an early warning indicator that we would take seriously. With a break of 0.97 the background for risk assets would deteriorate and it would 1) be increasingly questionable to see an overshooting scenario in commodities and 2) it would indicate that our anticipated bear scenario for equities in 2013 would come earlier than favored.

Technical Strategy

Chart 41.) MSCI Emerging Markets versus MSCI World



Source: UBS Technical Research

Chart 42.) Shanghai Composite Weekly Chart

Source: UBS Technical Research

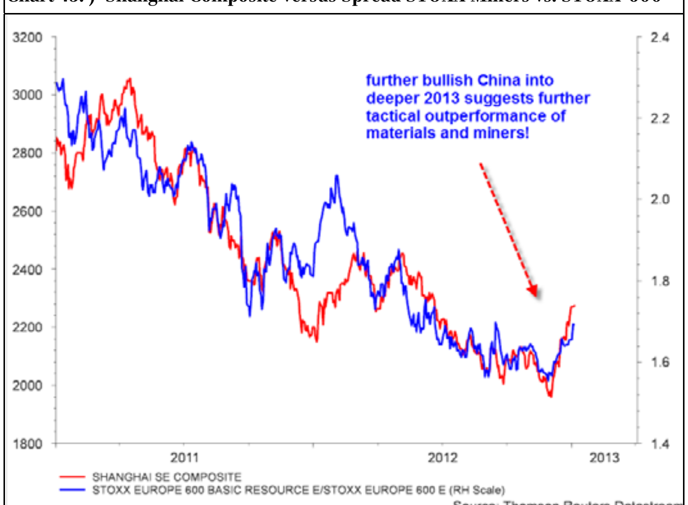
More strength in Emerging Markets into summer

The correlation of the AUD to Emerging Markets is obviously high (chart 40.). In early September we've highlighted a clean breakout of the MSCI Emerging Market versus the MSCI World. In the meantime we saw significant rallies across the board and particularly the move from the November low was very aggressive. Tactically we see the risk of starting a pull back in early January that could last into the month end or into early February before we should see more strength into later Q1.

In China, after a false breakout on the downside we finally got our anticipated major reversal in the Shanghai Composite that completes the 2012 bear cycle. Basically, we see a bullish Chinese stock market as another important support factor for the global risk sentiment and it is particularly bullish commodity-related sectors such as materials and miners! With anticipating more US dollar weakness and therefore more AUD strength into deeper 2013 we are sticking to our H2 2012 tactical allocation call in which we favored Asia and Emerging Markets over Europe over the US.

However, according to what we said structurally on the MSCI Emerging Market (see page 17.), from the October 2011 low, the whole recovery in the Emerging Market complex so far only has a corrective shape, which at the end of the day limits the upside in these markets this year. So in line with our call on the US market we also expect the Emerging Markets moving into an important top in later 2013 and this potential peak should be the basis for a new cyclical bear into 2014.

Chart 43.) Shanghai Composite versus Spread STOXX Miners vs. STOXX-600

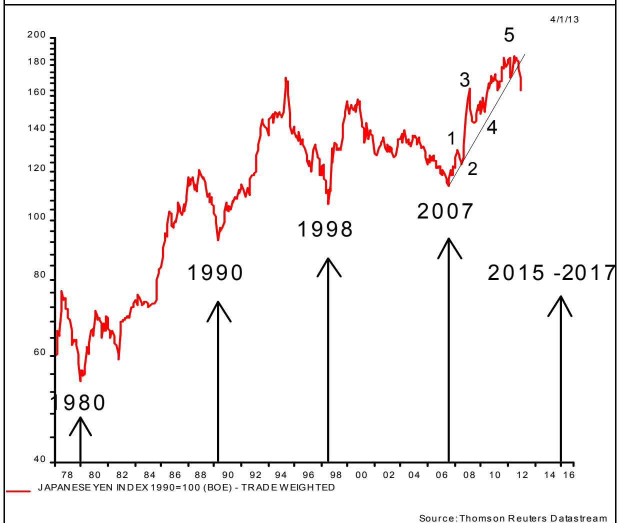


Source: UBS Technical Research

China and the cross asset class impact on commodities and commodity related sectors such as materials and miners was one of our Q4 key calls. The major reversal in the Shanghai Composite we see as the basis for a sharp but only limited bull cycle into Q3 2013. From a price perspective we have a target for the SSEC at 2500 to 2630, which low to top would imply a 33% bull market. Nonetheless, inline with our overall strategy on equities and risk assets in general, from a later 2013 top we expect to see a new bear cycle in China developing into 2014.

Technical Strategy

Chart 44.) JPY Index with 8-Year Cycle



Source: UBS Technical Research

Chart 45.) USDJPY Weekly Chart with ADX Indicator

Source: UBS Technical Research

JPY at the beginning of a multi-year bear market!

It was one of our key calls in 2012 to expect significant and broad based weakness coming into the JPY. With the Q1 2012 impulsive breakout the USDJPY has broken its 2008 long-term bear trend and the following correction phase into Q3 has formed the right shoulder and huge and classic inverted head & shoulder bottom, which has been complete with the impulsive Q4 bull-run. Although we are short-term skeptical that the JPY can hold up its amazing bearish momentum, the price action of 2012 represents a long-term game changer on the currency side, which has consequences on the secular structure of the Japanese stock market.

Over the course of 2012, we highlighted the long-term cyclical nature of the JPY several times. With last year's price action the JPY has completed a huge price top, which from a cyclical standpoint represents the beginning of a multi-year bear market that follows an 8-year cycle with the next major low projection at around 2016. From a wave perspective, the last bull cycle of a larger degree has started in 2007 and this 5 wave structure was completed last year. Consequently, from a pure wave structure this would imply that a new bear cycle of a larger degree could wipe out the whole previous bull cycle, which would suggest a target at 110 in the JPY index into 2016. Top to low this would represent a 35% bear cycle into 2016!! Of course, no bull or bear market is a straight line or a one way street, so that tactical bounces and even longer lasting recoveries within that bear market will be very likely.

In October we highlighted the very low weekly ADX indicator in the USDJPY pair (chart 45.) and we said that into Q4/Q1 this implies a trend move and a potential positive surprise in the Japanese stock market. After the break of 87 we basically have a next major target projection at 95 in the USDJPY pair. However, the weekly ADX is on the way into extreme territory, which basically suggests the risk of moving into an important tactical top in later Q1 followed by a significant correction.

Nikkei-225 ... set up for a new structural bull!!

From the 1989 top into the 2008 low the Nikkei has lost 82% of its value in a 20-years lasting (232 months) secular bear market. Over the last 2 years we said in our various client meetings that a potential JPY bear market would be a game changer for the Japanese stock market so that we could see the Nikkei-225 starting its next structural bull market earlier than in the Western hemisphere. With the Q4 impulsive bull move, the Nikkei-225 is in a situation, where for the first time since 1989, the market sets a significant higher bottom versus its previous 2008 bottom. This is the minimum form of a major trend change and translated it suggests that the Japanese stock market is about to complete a 20-year lasting secular bear market!!

Technical Strategy

Chart 46.) Nikkei-225 Monthly Chart

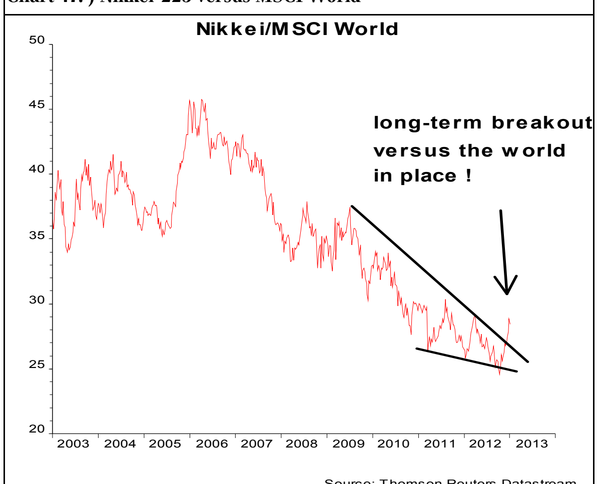
Source: UBS Technical Research

But also here it is important to emphasis that no bull market is a one way street and over the course of 2013 and in particularly into 2014 we expect to see significant corrections in the Nikkei. However, the key message of last year's trend change in the JPY is that any kind of bounce in the JPY should produce a lower high, which implies that tactical corrections in the Nikkei, even if they last longer than anticipated, should produce a higher low versus the 2012 bottom at 8200. Relative to the world the Nikkei has broken initial long-term underperformance trends, which means with a potential multi-year bear market in the JPY the Nikkei moves into a systematic outperformer. The sector trends in Japan are turning as well. Relative to defensives the Nikkei is breaking out (chart 48.), which suggests that the deflationary spiral is breaking in which defensives have been THE outperformers in the market.

Conclusion:

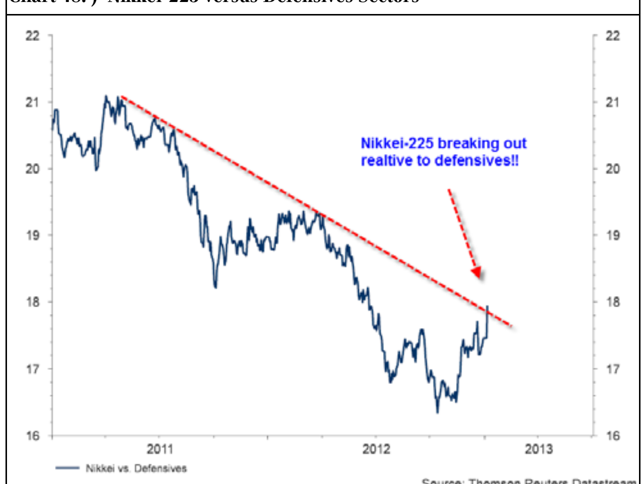
The weak JPY is a long-term game changer for the Nikkei and we think the Japanese stock market is on the way into a systematic outperformer versus the MSCI World for the next few years. However, tactically we have seen over the last few weeks a very sharp sentiment swing towards a more bullish Japan and a bearish JPY, which sooner or later will be the basis of corrections. Apart from short-term pullbacks we remain tactically bullish Japan and bearish JPY into at least later Q1. Into Q2 we could see a first significant correction in the Nikkei (JPY bounce) followed by more strength into deeper 2013, as part of a bigger tactical top forming. Strategically the key resistance in the Nikkei represents the April 2010 high at 11400. A break would imply a next target at 12700, which represents the 50% retracement of the 2006/2008 bear cycle. Following our strategy on the US equity market, we also expect the Nikkei to move into an important price top in later 2013 followed by a bear cycle into 2014. So although into later summer we could see a positive surprise in Japan we don't think that tactically the market will be a bullish no-brainer in 2013. Nonetheless, the key message is that, even if we should see a negative tactical surprise in later 2013 and probably into 2014, with the changing structure in the JPY, the Nikkei should form a next higher price bottom into 2014, and if so, it will bring us another long-term buying opportunity.

Chart 47.) Nikkei-225 versus MSCI World



Source: UBS Technical Research

Chart 48.) Nikkei-225 versus Defensives Sectors



Source: UBS Technical Research

Technical Strategy

Chart 49.) Dow Jones Industrials versus CRB Commodity Index

Source: UBS Technical Research

Chart 50.) CCI Future Weekly Chart

Source: UBS Technical Research

Commodities … a final overshoot into a secular top?

Structurally we see US and European equity markets trading in the final stages of its secular bear market and we have learned that from a cross asset class perspective this would imply that also commodities are in a maturing secular bull cycle. So how does a secular bull market top look like? From a correlation standpoint there was a time span of 1 and 2 years between the major turning points in equities and commodities in the past. So theoretically this would not stand in conflict with our theory to see an important top in commodities this year, whereas in equities we would expect a final cyclical bear into 2014 to complete a secular bear market. The most important point is the difference how secular peaks and bottoms look like from a sentiment standpoint. Earlier in the report (page 15.) we said that a secular bottom in equities does not end with a fire work in terms of volume, which is ultimate endpoint of the disinterest of investors in equities. The same we saw in 1999/2000 where the secular bottom for gold and commodities has formed. In 1998/1999 we have see gold funds closing due to the lack of perspective. This picture has changed significantly over the last 12 years.

Speculative excesses are still missing to confirm a secular top!

However, major long-term peaks in financial markets are usually accompanied by speculative excesses and bubble phenomena’s that produce vertical moves on the back of the pure greediness of investors. Have we seen any kind of bubble charts so far? No – we definitely haven’t seen this but if our thesis about a not too far away secular bottom in equities is correct then we shouldn´t be too far away from a speculative overshooting in the commodity complex. If so, and only then we would have strongly increasing evidence that this could be the final move of the 1999 secular bull. We have reasons to believe that in 2013 we could see at least selective overshooting in the commodity space.

Commodities are trading in wave 5 of 5!!

Tactically, it was a key call of our 2012 strategy that after the limited 2011/2012 cyclical bear event we would expect another important tactical bottom in commodities in H2 2012 as the basis for a new bull cycle into at least H2 2013. In September the UBS Commodity index and the CCI Index Future (Equally Weighted Continuous Commodity Index) have broken their May 2011 bear trends (chart 50./51.). Following our cyclical roadmap and given the fresh buy signals on the larger time frame, commodities are now trading in a new cyclical bull as part of a secular bull. More importantly is the long-term wave structure in the CCI Index. **From a wave perspective we can clearly identify 5 waves from the 1999 low. Wave 5 has started in December 2008 after the Lehman collapse induced deflationary shock wave.** Into April 2011 the CCI Index has hit a new all time high, which confirms that the underlying structural bull cycle is in place. The whole correction

Technical Strategy

Chart 51.) CCI Future Daily Chart

Source: UBS Technical Research

Chart 52.) Crude Oil Monthly Chart

Source: UBS Technical Research

from the April 2011 top into last years summer low has a classic a-b-c corrective structure, which suggests that this represents wave 4 of wave 5. If this count is correct then it is clear that currently **the commodity complex is trading in midst of wave 5 of 5, which means in the bigger picture it could be ultimate final bull wave of the 1999 secular bull cycle.** In this context it is important to understand that **final waves in commodities are very often extended**, which would fit the over speculation induced overshooting. If we look into the commodities spectrum we have **crude oil trading in a triangle pattern since its 2011 top. Copper is trading in a huge triangle formation and since its September 2011 top, gold is trading in a sideways trading range, where the May 2012 low at $1529 represents our anticipated 4-year cycle bottom. If we really see an overshooting in commodities this year it is very likely that all these commodities will see a new breakout on the upside. Tactically, we have seen significant pullbacks in commodities since the September top and in December commodities and gold have underperformed significantly versus the rally in equities.**

Gold moving into a new tactical buying set up!

The December down leg in gold was not our favoured tactical scenario. We nonetheless think the move just represents a wave c extension of a corrective counter trend move after the impulsive May/October bull cycle. However, in terms of sentiment we have a potential negative constellation forming, which could at least temporarily provide a negative surprise for gold. As outlined earlier (see page 10.) we think sentiment wise the topics in Q1 will be "the re pricing of growth" and "selling safe assets" and if we look into the isolated gold sentiment it strikes that for 2013 the investors have quite a bullish bias for 2013. Furthermore, tactically and following our cyclical profile the bond market is short into later Q1, which means yields are rising. With rising real interest rates and at least a temporary re-allocation away from safe assets we cannot rule out to see a negative surprise in gold into later Q1. What does this mean?

Chart 53.) Gold Weekly Chart

Source: UBS Technical Research

We do not expect a break of the $1529 May 2012 low but what we could see over the next few weeks is a continuation of the volatile sideways trading range, which means in local currencies we could see more underperformance/weakness into March before a new significant and broad based bull cycle could start.

Technical Strategy

Chart 54.) XAUJPY Weekly Chart

Source: UBS Technical Research

Chart 55.) XAUEUR Weekly Chart

Source: UBS Technical Research

Given the fact that our weekly momentum work has reached oversold extremes in early January we nonetheless think that gold is a tactical buy and we are sticking to our key call that into later 2013 we should see another significant rally, which is very likely to break the September 2011 all time high at $1920. Keep in mind, with a confirmed major top in the JPY we have a new natural demand source in play. **Gold in JPY terms has broken out of a huge triangle pattern that has been forming over nearly 2 years. This is structurally bullish and indicates a next target at 167135 (chart 54.). So for the Japanese investor we have a new big buy signal in gold in place. For the EUR and CHF investor the current situation is more frustrating, since in October gold has failed to break its €1373 all time high. The recent correction was significant and given the current underperformance we still cannot rule out more weakness into March, where we have a next important low projection for gold in EUR terms before we see a new significant bull cycle starting.**

Gold mines moving into another buying opportunity

After 2011 we had with 2012 another very frustrating year for gold mines. With the gold mining complex underperforming gold significantly the correction into the May low was also much harder as the correction for gold. After completing a double bottom in August, the HUI index has broken its 2011 bear trend, which is basically underlying bullish. However, the following correction from the September top into late December was again stronger than favoured, which underpins the underlying underperformance of the sector.

Chart 56.) HUI Weekly Chart

Source: UBS Technical Research

From a pure technical standpoint the HUI nonetheless just pulls back on its broken 2011 bear trend, which should give the sector support. Following our call on gold, we see the gold mining sector in a short-term bottom building process where a break of 455 would trigger a new bigger tactical buy signal. In particularly relative to gold we see the gold mining sector as very attractive and the depressed sentiment situation in this sector is just another indication why we think we have so far not seen any kind of bubble scenario in particularly in gold. This is NOT the sentiment how a secular bull market ends!!

Technical Strategy

Chart 57.) 10-Year US Treasury Yield

Source: UBS Technical Research

Chart 58.) US Long Bond Monthly Chart

Source: UBS Technical Research

Bonds Tactically Bearish into later Q1

Hand in hand with another bear move in equities into summer last year, it was a key call of our 2012 strategy to expect a final move down in yields to complete a major wave 5 sequence of a larger degree. Last year we said that i**n 2012 the time will come to make a major switch away from safe haven bond markets back into equities as the basis of the anticipated limited bull cycle in risk assets into 2013**. Our strategy and therefore also our key calls have not changed. **Structurally, after completing a major wave 5 sequence in the US long bond and after panic buying in safe haven bonds in the US and core Europe we see a high chance that the 31-year lasting secular bull market in bonds has seen its ultimate yield low. However, given what we said earlier (page 13.) we see a high likelihood that the bond market in the US as well as in Europe has finally just started a volatile and longer lasting bottoming phase in which we have the next major low projection for yields in 2014!.**

Tactically, over the last few months we have been arguing that following our cyclical profile we see the bond market bearish biased into late Q1 and from a price target we have been looking for 2.40% target in the 10-year US treasury yield. With the break of 1.85% the US bond market is on track with our cyclical roadmap and also the German Bund has generated a new tactical sell signal, which even more weighs since the Bund has failed the second time to break its June top at 146.88. **With generating a new weekly sell signal we continue to expect a negative surprise in the Bund into later Q1 with a target projection at 138 to 137 and worst case 133!!.**

Chart 58.) German Bund Weekly Chart

Source: UBS Technical Research

The key message is that tactically, in late Q1 we have an important low projection for the T-Bond and the Bund, which implies an important top in risk assets. The question is, whether this potential late Q1 low represents already the basis for another significant bull move or if we see just a short bounce into Q2 followed by more losses into Q3, where we would at the latest expect a more important bottom as the basis for a new significant tactical bull move into 2014? **Even if were to see a temporary negative surprise into deeper 2013, the 200-week moving average in the 10-Year US Treasury we do not expect to be broken and a failure at this level in late Q1 or deeper 2013 we would see as a good basis to expect another move down in yields into 2014, which from a cross asset class perspective would be bearish risk!!**

Technical Strategy

Chart 59.) S&P-500 Daily Chart

Source: UBS Technical Research

Chart 60.) MSCI World Weekly Chart

Source: UBS Technical Research

Conclusion:

- Given the increasing number of divergences in our indicator work we see the March 2009 cyclical bull market in the S&P-500 maturing and therefore moving into an important top in later 2013. Statistically we have a 73% probability to see a bear market in equities in post election and/or mid-term years, so a potential 2013 top in S&P-500 would be very likely the basis for a new bear cycle into 2014, where we could see a very important long-term bottom for US equities. According to the decennial cycle a 2014 market bottom could be THE low of the decade or the S&P-500.
- Tactically our preferred scenario for 2013 is that apart from short-term set backs we see the S&P-500 moving into an important March top, followed by a distributive summer top building phase before seeing significant weakness developing from a late July/August top into Q4. However, we have some inconsistencies in our 2013 cyclical work and the longer a potential consolidation/correction in early Q1 lasts, the more likely it is the market follows the roadmap of the presidential cycle and the decennial cycle. In this case we would have a changed cyclical scenario with moving into another important tactical buying opportunity in March, followed by a final rally into a major August top. This would also mean that despite the risk of a negative surprise in Q4, the likelihood would be high that the real bear scenario would shift into 2014.
- From a price perspective the S&P-500 trades in an intact bullish trend as long as the market holds the mid November low at 1343 as new pivotal support. After avoiding the fiscal cliff the market has rallied to its September/November top at 1470, which together with the broken 2011 bull trend represents a massive resistance. Given the overbought market stance we see the risk of a pull back into later January before starting a next rally attempt. Into a potential March top we can expect to see 1570 with risk to overshoot to a new all time high.
- From a pattern standpoint the S&P-500 is forming a rising wedge in the bigger picture. Regardless of any cycles, a break up of this pattern to the downside would indicate a sharp correction to the bottom of the pattern, which implies correction targets at initially 1266 and worst case 1100. A target of 1266 we would see as a potential correction target for 2013 and 1100 would be a likely target of a bear cycle into 2014.

Technical Strategy

Chart 61.) CRB Reuters versus S&P-500

Source: UBS Technical Research

Chart 62.) European Cyclicals versus Defensives

Source: UBS Technical Research

- Our commodity scenario represents a cornerstone of our 2013 strategy. What are the none-consensus themes for 2013 and where could we see surprises that nobody has on the radar screen? The chain reaction developing from a commodity overshooting has in our view the potential to deliver a big surprise in the financial markets this year. Historically seen, commodity prices are on very high levels relative to the health of the Western economies. In Asia, China has bottomed out and if we should really see the picture in Europe and the US improving in Q1, this would very soon give commodities a big sentiment boost with 3 consequences.

  1) A potential overshooting in commodities would be highly inflationary, which is bearish bonds, where we see the risk of a negative surprise into late Q1 and eventually into Q3. Ironically, given our underlying top scenario for equities/risk assets for 2013 we see a good tactical buying opportunity coming up in bonds in later 2013 for another move down in yields into 2014.

  2) An overshooting in commodities would bring central banks under pressure to react although this would be problematic for the financial system and the real economies. So sooner or later the too high commodity prices would start biting the improving but still fragile real economies.

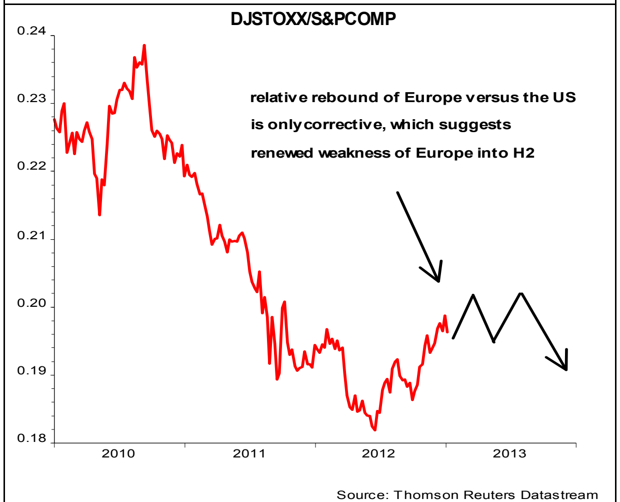
  3) Commodities are late cyclical. In 7 out of 9 major cycle peaks in equities over the last 30 years, commodities have peaked out later than equities (chart 61.), which is important for our sector allocation in 2013, since it implies that late cyclical miners/materials and energy would be among the outperformers in 2013 before at the latest in Q3 we could also see the commodity themes peaking out.

- If 2013 is a rollover year for equities then it is very likely to see a further increasing selectively this year. In early August last year we have highlighted the broad based bottom building process and the following breakouts of cyclicals versus defensives in the US and in Europe (chart 62.). Generally, on the way into a potential later 2013 top, defensive sectors should continue to underperform significantly, whereas in the cyclical camp we expect the one or other sector rolling over earlier compared to late cyclical commodity-related themes.

- Last year it was a key call of our strategy to expect an important long-term bottom in financials but we did not say that we see this bottom already as the beginning of a major long-term bull market. Tactically, if our March top timing this year is correct we see a high chance that financials and other early cyclicals such as semiconductors could already top out in late Q1. Although in H1 we expect to see another negative surprise in the relative performance of defensives, ironically the sentiment shift towards more risk we see as a contrarian signal, which suggests that in H2 2013 and into 2014 we could see a significant comeback in defensive sectors and safe assets!

Technical Strategy

Chart 63.) DJ STOXX-600 versus S&P-500



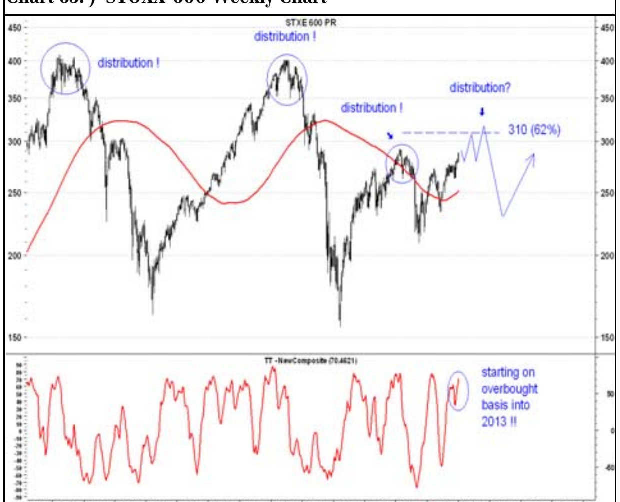
Source: UBS Technical Research

Chart 64.) Swiss Market Index Monthly Chart

Source: UBS Technical Research

- It was a key call of our 2012 strategy to expect a major trend reversal in the relative underperformance of Europe versus the US. In Q1 we expect Europe to continue to outperform the US but with a potential Q1 top in financials and by anticipating a stronger EUR (weak USD) into deeper 2013 we see Europe sooner or alter peaking out relative to the US. A too strong EUR is bearish Europe and in particularly the periphery.
- Nominally the Swiss Market Index has been trading in a structural bear market from 1989 into the March 2009 low and after the impulsive wave structure of the 2009/2010 bull cycle we see the 2009 low as THE nominal long-term bottom of the Swiss market. However, since the 2010 top the market has been trading in corrective cycles, which suggests that at least one major correction cycle is missing to complete a corrective structure of a larger degree. The Swiss market is overbought on a weekly and monthly time frame, so the air on the upside is getting thin in 2013. After the break of 6900 we have a 2013 top projection at 7500, which we expect to reach in either late Q1 or at the latest in August before we see the risk of starting a bear cycle into 2014 with a target at 6100 to worst case 5800.
- The STOXX-600 is testing its February 2011 peak at 292. After the aggressive November/December rally Europe is overbought and we can expect a pull back into later January before we anticipate more upside into a March top, which we would see as the beginning of a longer lasting distributive top building process. Our targets on the upside for 2013 are at 310 to 320. Into 2014 we see risk of a 20 to 25% correction before starting a next significant bull cycle into 2015!

Chart 65.) STOXX-600 Weekly Chart



Source: UBS Technical Research

Weekly Technical Indicators: (Source: Pinnacle Data, Datastream, Market Maker) Charts: Metastock