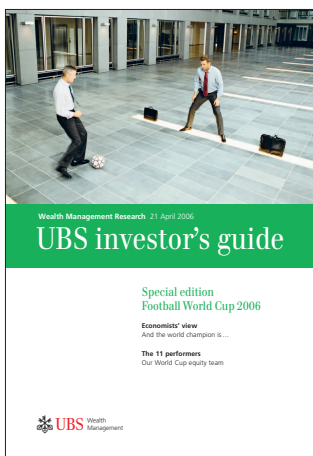


As predicted by WM Research: Italy are the World Champions

In the research publication “UBS investor's guide – World Cup 2006 special edition”, released on April 21, WM Research predicted that Italy would become football World Champions in 2006. Not all the forecasts turned out to be correct, but as for what was probably the most difficult one to make: Italy did actually win the 2006 World Cup.

As a forecaster you are naturally always delighted when you hit the bull's eye again. But amidst all the handshaking and back-slapping you have to keep a cool head and remind yourself that a good forecast consists of 50% luck and 50% skill. Even if you are right, you should also be asking why you arrived at this result.

Two weeks ago in the “UBS investor's guide” we drew attention to the forecasting quality of our model presented in April for the participants in the last sixteen (13 hits out of 16) and for the quarter-finalists (6 out of 8). This corresponds to historical experience with the model. We also emphasized that the quarter-finals were the most critical phase of the forecast. In this round we only managed to predict one winner (Italy) correctly out of four. The games between Argentina and Germany, Portugal and England, and Brazil and France were very close. For that reason it is also indicative that two of these games ended in over-time. Once the semi-finalists were known, we were on the right track again when we predicted the two semi-final winners: Italy and France.



What can we learn from this outcome? First of all that models do not forecast everything correctly, so there is no such thing as complete foresight. If something like that did exist, life would be really boring and neither the World Cup nor the financial markets would make any sense. Nevertheless, not everything is pure luck. Models narrow down the large number of possible occurrences into a significantly smaller number of plausible occurrences.

You can of course dream about Togo or Australia winning the World Cup, but the fact is that the six former World Champions were among the eight quarter-finalists. It is also a fact that since 1970 only six teams have contested the ten World Cup Finals between themselves. Finally it is a fact that even supposed underdogs normally cut a very fine figure as the home team in their World Championships (such as Korea in 2002). Anyone who laid money before this World Cup on Germany leaving the tournament at an early stage was engaging in a relatively risky strategy for that reason alone.

Can the model also be used for coming soccer events? As far as the methodology is concerned, you could employ a similar model for the European Championship in 2008. Only finding the correct explanatory factors will probably be more difficult. After all the European Championship is known for often allowing outsiders to win, such as Denmark in 1992 or Greece in 2004. The model ought to be usable again in its present form for the 2010 World Cup, though it will not be possible to make a definitive statement on that until April

2010. But it is possible to hazard a guess: the probability that the World Champion will come from South America is greater than that of a World Champion from Europe, and the probability of an African World Champion could continue to rise. For the time being, however, the score is a 9:9 tie between the two “traditional” continents, and we will have to be patient for another four years until the next global soccer festival.

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Disclosures

Enterprises

Beiersdorf 1. Canon 2. Coca-Cola Co. 2, 3, 4, 5, 6, 7, 8. Fuji Photo Film 2, 9. Heineken 2. Holcim 6, 10. Nintendo 2. Puma 2. Scottish & Newcastle 6, 10, 11. Tesco 2, 6, 12.

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11 performers: Making money with the World Cup

Our basket on the eleven selected stocks for the World Cup has been a success. The eleven stocks outperformed world equities by 5.8% or 580 basis points. As shown in Figure 1, since we published the Special edition of the Investor's Guide on 21 April 2006, the basket was up (+1.2%) while the markets were down in the same period (-4.6%).

This selection of stocks has proved its resilience, as it has had a positive performance under very difficult market conditions. Nintendo has been the winner of the lot. With a performance of 16.7% in less than three months, Nintendo has certainly capitalised on the teenager excitement of the World Cup. Heineken has also benefited from this excitement, in this case from the not-so-young, or at least so we hope.

If we put things in perspective, the three-month strategy has worked once again (see Figure 2). Remember that our quantitative model was set up for the three-month period leading up to the final day

of the World Cup. Measuring the performance this way, the eleven-stock basket was up 2.28% while the market was down 3.66%.

Figure 2: Back-testing results

Event	Dates	Our 11 selected players (%)	MSCI World index (%)
Sweden 1992	26 March – 26 June 1992	13.86	0.51
USA 1994	17 May – 17 August 1994	17.42	1.93
England 1996	30 March – to 30 June 1996	11.69	3.01
France 1998	12 May – 12 August 1998	-1.83	0.97
Netherlands 2000	2 April – 2 July 2000	4.82	-3.47
Japan-Korea 2002	30 March – June 2002	10.22	-8.99
Portugal 2004	4 April – 4 July 2004	6.99	-1.02
Germany 2006	9 April – 9 July 2006	2.28	-3.66
Average		8.18	-1.34

Source: Citigroup, UBS WMR

Figure 1: The 11 selected stocks

Company	Sector	Country	Performance*	MSCI World
Nintendo	IT	Japan	16.7%	
Holcim	Materials	Switzerland	-8.7%	
Heineken	Cons. Staples	Netherlands	9.2%	
Canon	IT	Japan	-3.3%	
Coca-Cola	Cons. Staples	US	3.9%	
Scottish & Newcastle	Cons. Staples	UK	-3.0%	
Fuji Photo Film	Cons. Discretionary	Japan	-0.6%	
Tesco	Cons. Staples	UK	6.4%	
Intercontinental Hotels	Cons. Discretionary	UK	0.2%	
Puma	Cons. Discret.	Germany	-4.7%	
Beiersdorf	Cons. Staples	Germany	-2.8%	
Total			1.2%	-4.6%

*from 21 April 2006 to 7 July 2006

Source: UBS WMR

This is the summary of the results of the last 8 major football events (four World Cups and four European Championships):

- seven times out of eight, the strategy has outperformed the broad index;
- seven times out of eight, the basket has had a positive performance, irrespective of how the market performed.

We will certainly re-launch this investment idea in two years, for the Euro 2008. We will run the tests again and we will give you the new eleven selected stocks. Until then, congratulations to Italy.

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Our World Cup line-up

