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The Income Balancing Act

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The 'triple threat' to your pension scheme

Meet long-term liabilities	Understand risk
Recover scheme deficit	Generate growth
Meet short-term liabilities	Produce positive cash flow

You are not alone.. DB schemes are continuing to face a cash flow crisis

> Nearly 55% of UK DB schemes are currently cash flow negative.

Mercer, Portfolio Institutional May 2017

> FTSE 350 – the collective shortfall has already hit £20bn a year and will top £100bn by 2030.

Hymans Robertson

> Trustees need to be aware of impending cashflow and liquidity issues and start to plan for them.

TPR 2016

In the short term, how have schemes responded?

Use or maintain cash balances

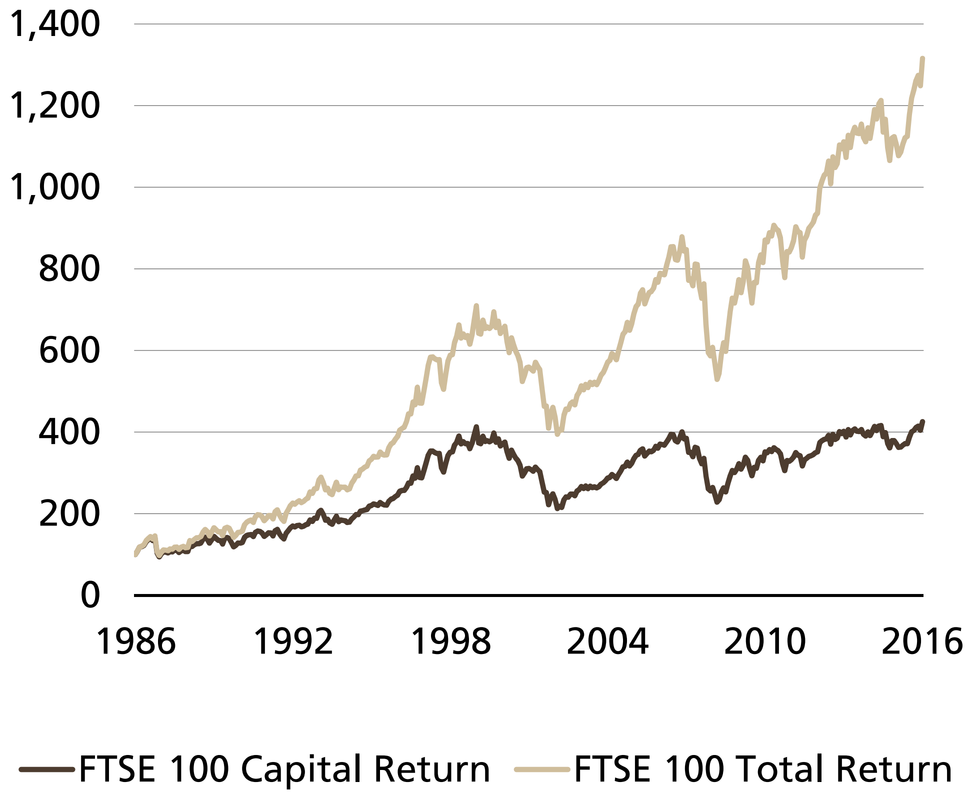
- Low cash rates means high opportunity cost
- Creates governance & oversight issues

Draw down investments

- Implicit active allocation decision
- Aim to avoid forced sales
- Biased towards liquid assets
- Creates governance & oversight issues

Strip income

- Inhibits compounding power of assets
- Creates governance & oversight issues



Source: DataStream as at 31 August 2017.

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Ideas for a long-term, dedicated income allocation

- Introduce an income-focused **equity** allocation
  - Designed to deliver reduced volatility relative to global equities
  - Targets a yield of 4-6% p.a. above the benchmark (typically 6-8% p.a.)

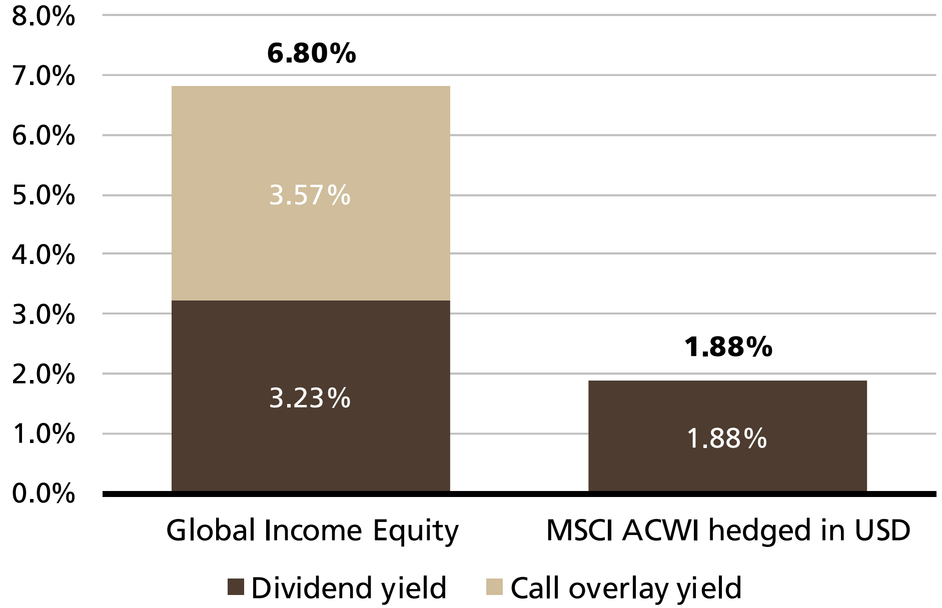
- Consider an allocation to real assets such as Long Income **UK property**
  - Long-term, contractual income with a degree of inflation protection
  - Targets a yield of 4-6+% p.a.

- Allocate to an income -focused **multi-asset** portfolio
  - Diversifying across asset classes to deliver sustainable income and potential capital growth
  - Targets yield of up to 6% p.a.

Attractive equity income from two sources

As of 31 August 2017

Indicative current equity yield[1] = dividend yield + call overwriting yield



This is an equity product with no capital / income guarantee

Source: UBS Asset Management

Note: Distribution yield will depend on share class and may differ from the indicative yield. Distribution yield may include capital as well as income. Depending on jurisdiction, investors may incur a higher tax rate for distributed capital. Investors should seek their own tax advice.

1 Yield is indicative and gross of fees. Equity yield is the sum of dividend distributions and premia from selling call options. Dividend yield is based on dividends of previous 12 months, **net of withholding tax**. Option premia are based on annualized sum of option premia collected over the past 12 months. Final equity yield can deviate significantly from indicative yield. This does not constitute a guarantee by UBS AG, Asset Management.

Meeting your requirements for growth and income

- Attractive yield compared to a equity income portfolio
- Diversified exposure to high quality equities globally
- More defensive characteristics than a typical equity investment

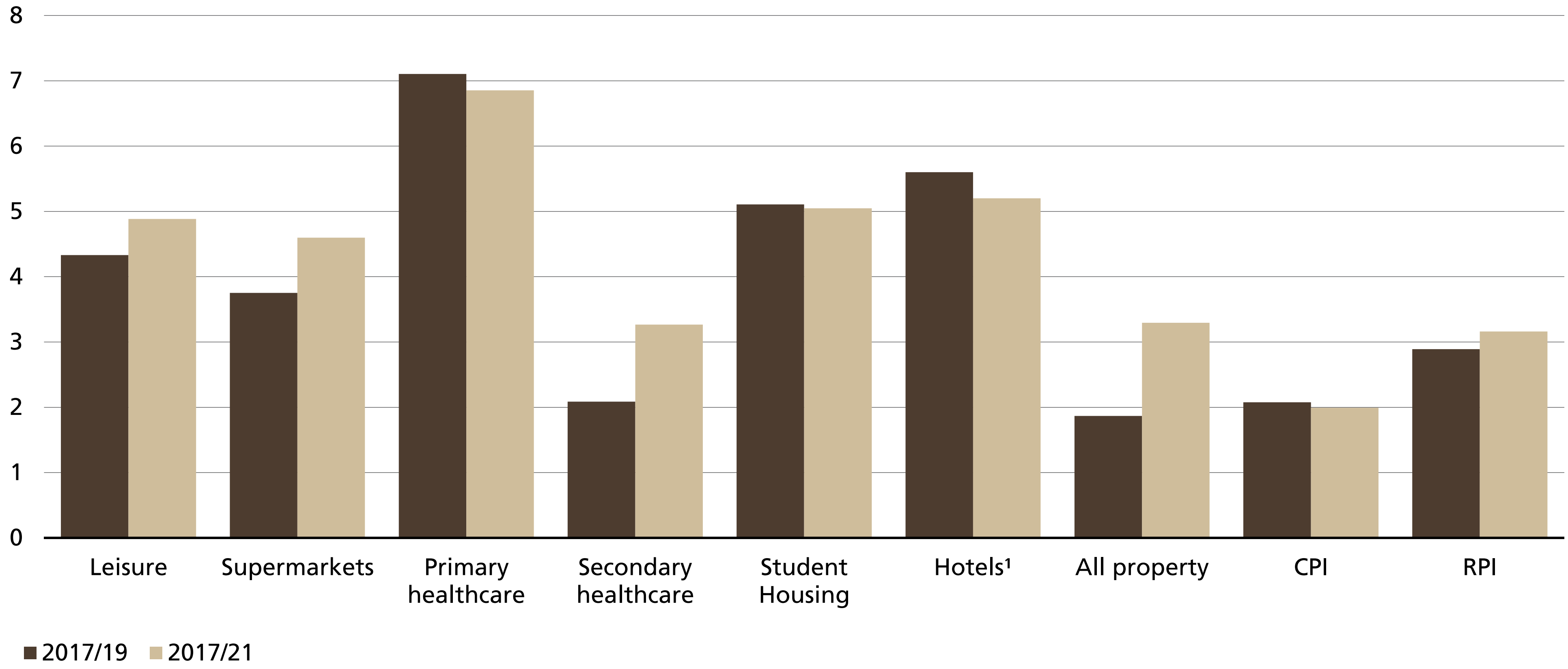
Long Income UK property can deliver…

- Secure, long-term cashflows with yields of 4 – 6+% p.a.
- Provides a degree of inflation protection
- Replacement for gilts and corporate bonds
- Low volatility

Source: UBS Asset Management, Real Estate & Private Markets (REPM) as at 30 June 2017.

Typical long-lease alternative sectors set to outperform

Forecast returns (% p.a. average)



Source: PMA, Spring 2017 Forecasts, Consensus Scenario; Oxford Economics; May 2017
1 Capital Economics forecast Q1 2017

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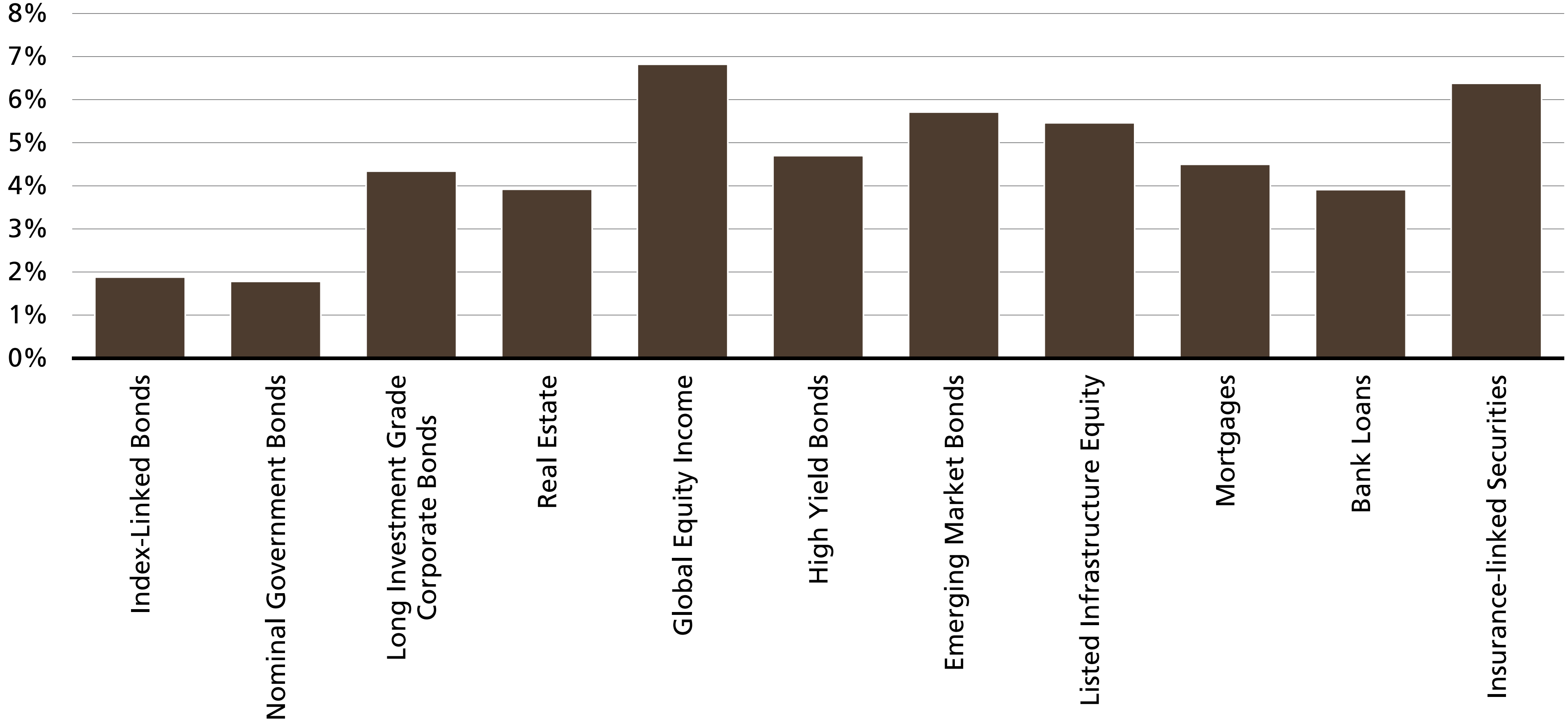
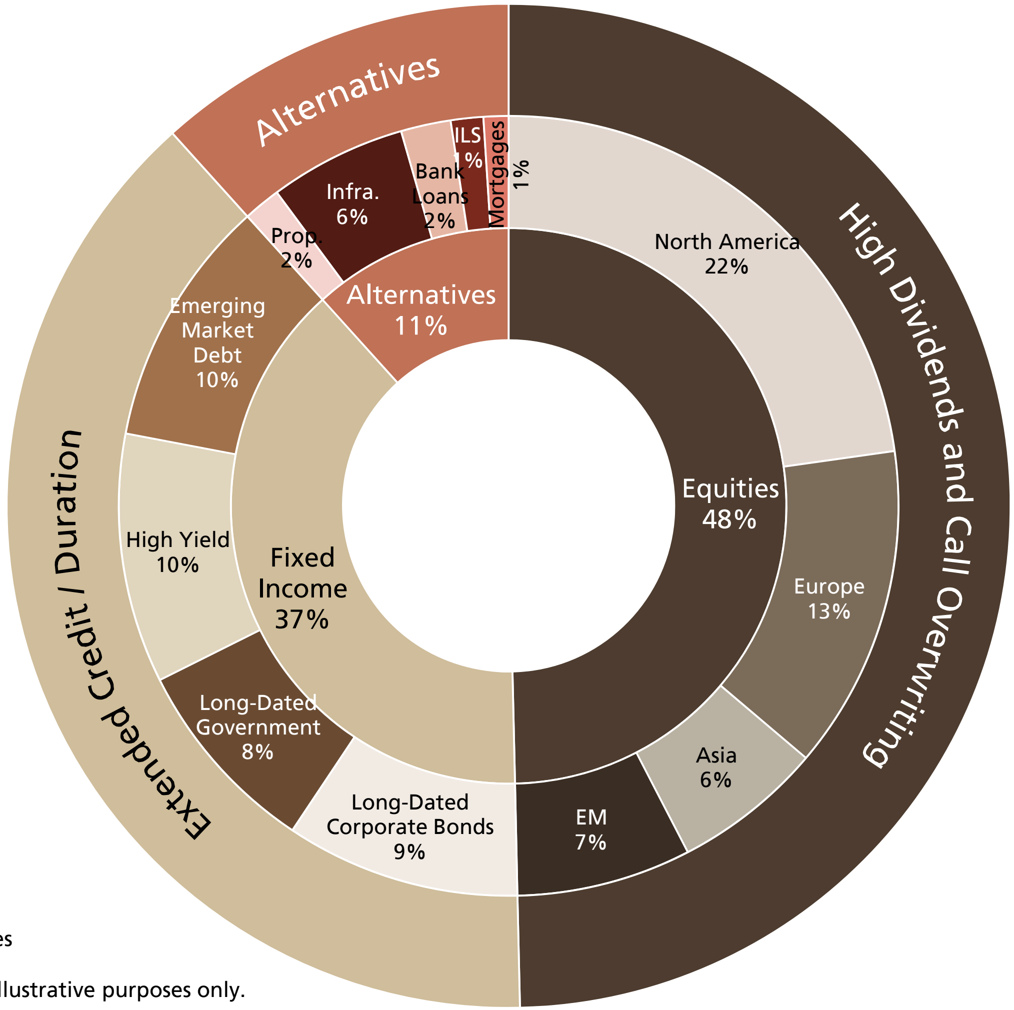
What levels of income do different asset classes offer?



Source: Bloomberg; 3 1 August 2017
Global equity income refers to a UBS high dividend equity strategy that uses liquid derivative strategies to enhance the level of yield available

Building a dynamic multi asset portfolio

Broad mix of assets targeting an income of 5% p.a.



Note: ILS refers to Insurance-linked Securities
Numbers subject to rounding
Source: UBS Asset Management. Note: For illustrative purposes only.

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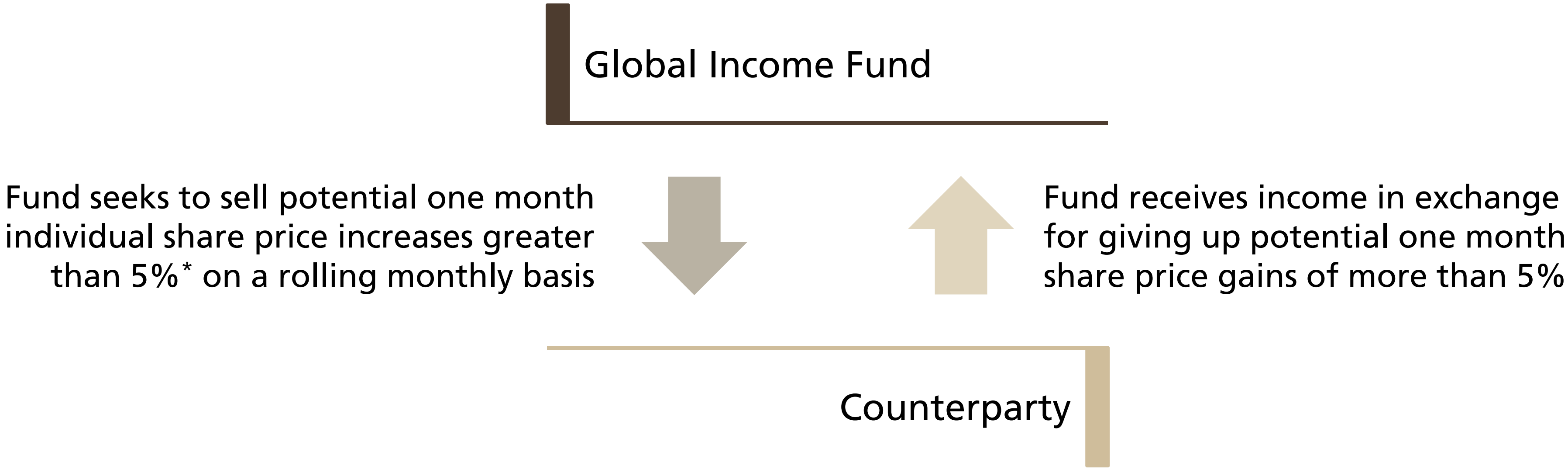
Conclusion

- Consider a dedicated income allocation to manage the balancing act between liability hedging, income and growth requirements and provide an income between 3-8% p.a.
- Take into consideration existing portfolio allocations and any costs
- Consider the scheme's governance needs
- Equity with an income focus can deliver a defensive equity portfolio with a yield of 6-8% p.a.
- Real Assets can provide secure, contractual cash flows between 4-6+% p.a. as well as inflation protection
- An income-focused multi-asset strategy can provide a diversified, conservatively managed range of income sources between 3-6% p.a.

Appendix

Additional information

Exchanging possible equity upside for extra income



The Fund keeps the income regardless of what happens to the underlying stock share price

So, for each stock in the portfolio (where the upside is sold above 5%[1]):

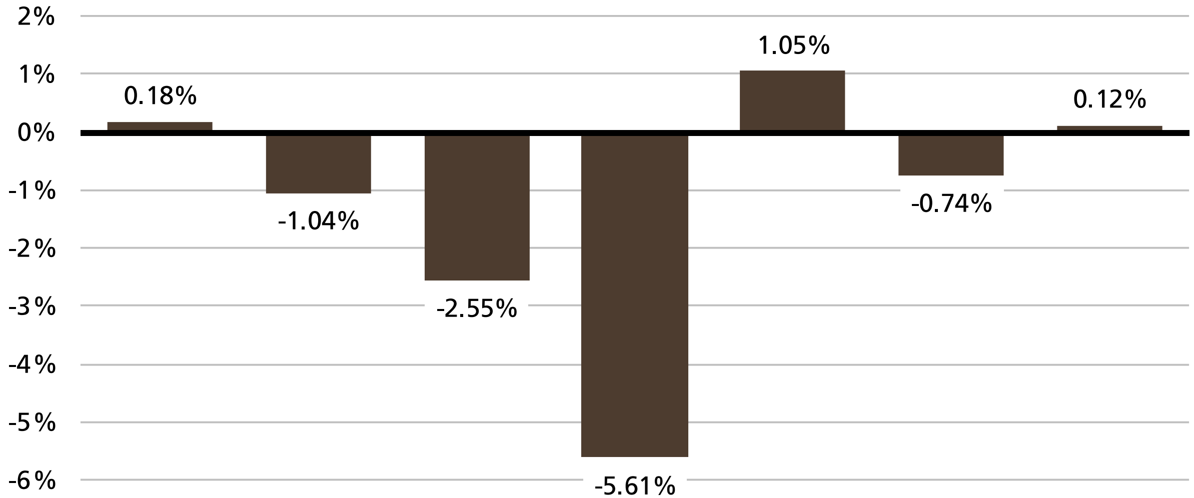
- If the share price falls over the month, the Fund keeps the income but loses on the stock share price
- If the share price rises up to 5% over the month, the Fund keeps the income and all of the share price rise
- If the share price rises > 5%, the Fund keeps the income but share price gains are capped at 5%

1 For illustrative purposes only; number subject to change at the investment manager's discretion

Composite performance: gross of fees

As of 31 August 2017

Relative return (in %, in USD)



	1 month	3 months	YTD	1 year	2Y (p.a.)	3Y (p.a.)	S.I. (p.a.)
Composite	0.59%	1.46%	9.04%	10.83%	12.59%	6.86%	8.66%
Benchmark	0.41%	2.50%	11.59%	16.44%	11.54%	7.60%	8.54%

Source: UBS Asset Management, GCS
Note: Data based on UBS Global Income Equity composite. Strategy inception date: 28 February 2014. Periods greater than 1 year are annualized. **Past performance is not indicative of future results.**

Composite summary (p.a.)

	3Y	S.I.
Return[1]		
Composite	6.86%	8.66%
Benchmark[2]	7.60%	8.54%
Risk[3]		
Composite	7.13%	6.77%
Benchmark	9.69%	9.08%
Sharpe ratio[4]		
Composite	0.90	1.22
Benchmark	0.74	0.89
Active risk[5]		
Composite	4.73%	4.60%
Information Ratio[6]		
Composite	-0.16	0.03
Beta[7]		
Composite	0.65	0.65

Notes:
1 Performance data in USD
2 Benchmark: MSCI ACWI hedged in USD
3 For periods greater than 1 year, the annualized standard deviation is based on monthly logarithmic returns.
4 Risk free rate: U.S. LIBOR 30 Day
5 Typical Active risk data are indicative only. Active risk is an ex-ante forecast calculated using MSCI Barra or other suitable system based on the final valuations of the last working day of each month. The ex-ante Active risk is an indicative forecast only and may not reflect the realized (ex-post) Active risk experienced by the Portfolio. Active risk levels are reported to clients on a quarterly basis.
6 For periods greater than one year, annualized returns are used to calculate the value added and the tracking error.
7 This is the slope of the linear regression between the composite return and the benchmark return.

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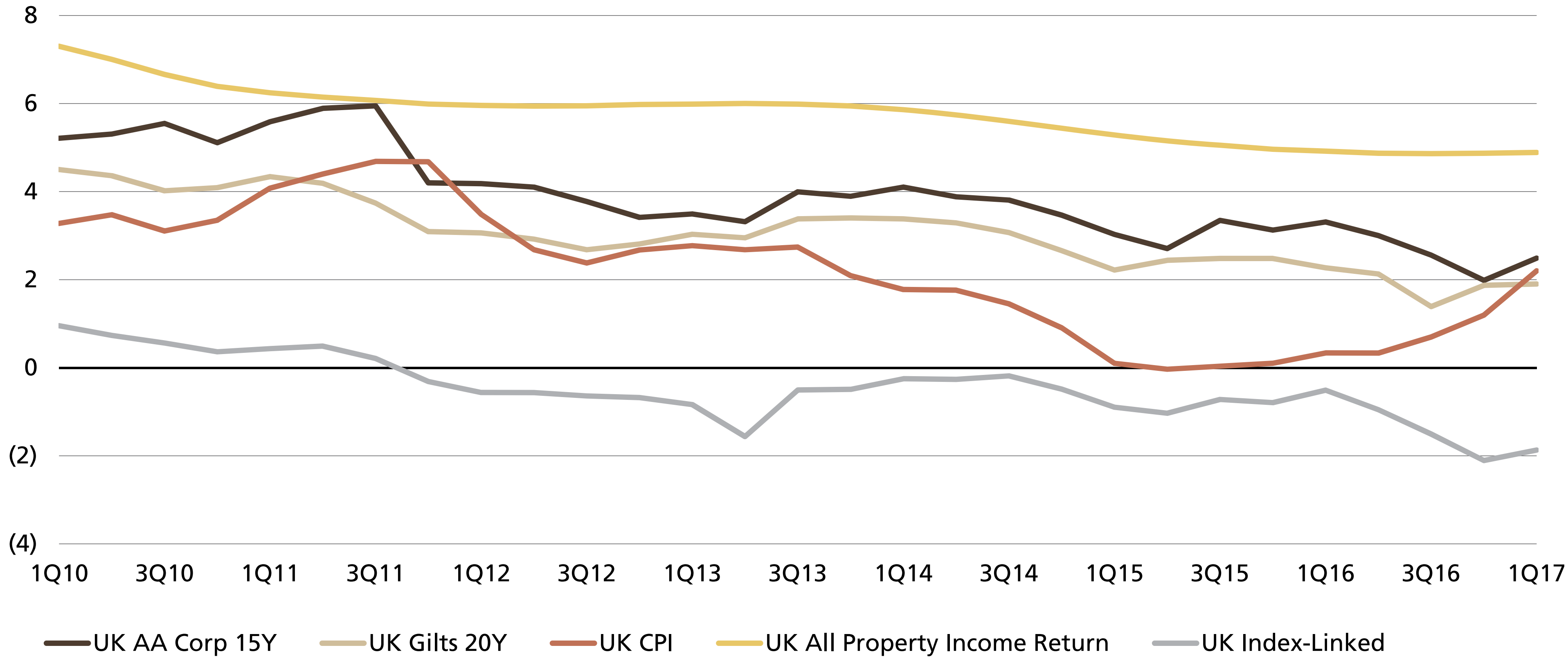
Property is an alternative to Gilts and Corporate Bonds

Yield comparison (%)



Source: UBS Asset Management, Real Estate & Private Markets (REPM) Research & Strategy, as at March 2017.
Note: All Property Income Return has been used as Long Income distribution data was not sufficient over this period to provide a comparison.

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