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Defensive Equity Solutions

Preparing for equity market volatility

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UBS Asset Management, Investment Solutions

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Section 1

Introduction

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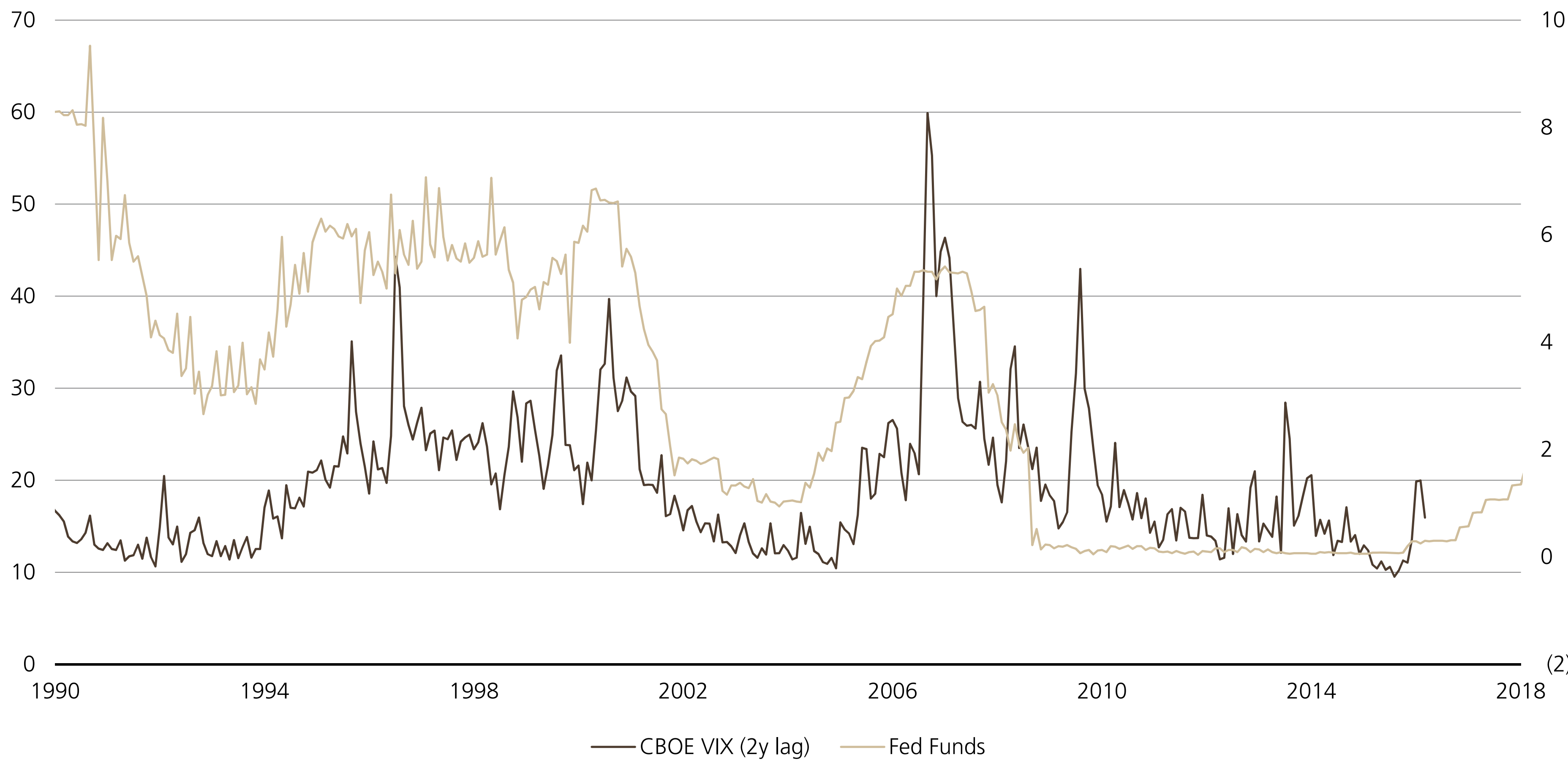
Why are investors rethinking their equity holdings?

The range of possible macroeconomic outcomes is getting broader

CBOE S&P 500 Volatility index (LHS, 2y lag) v Fed Funds Rate (RHS, %)



Source: Datastream, UBS Asset Management as at April 30, 2018

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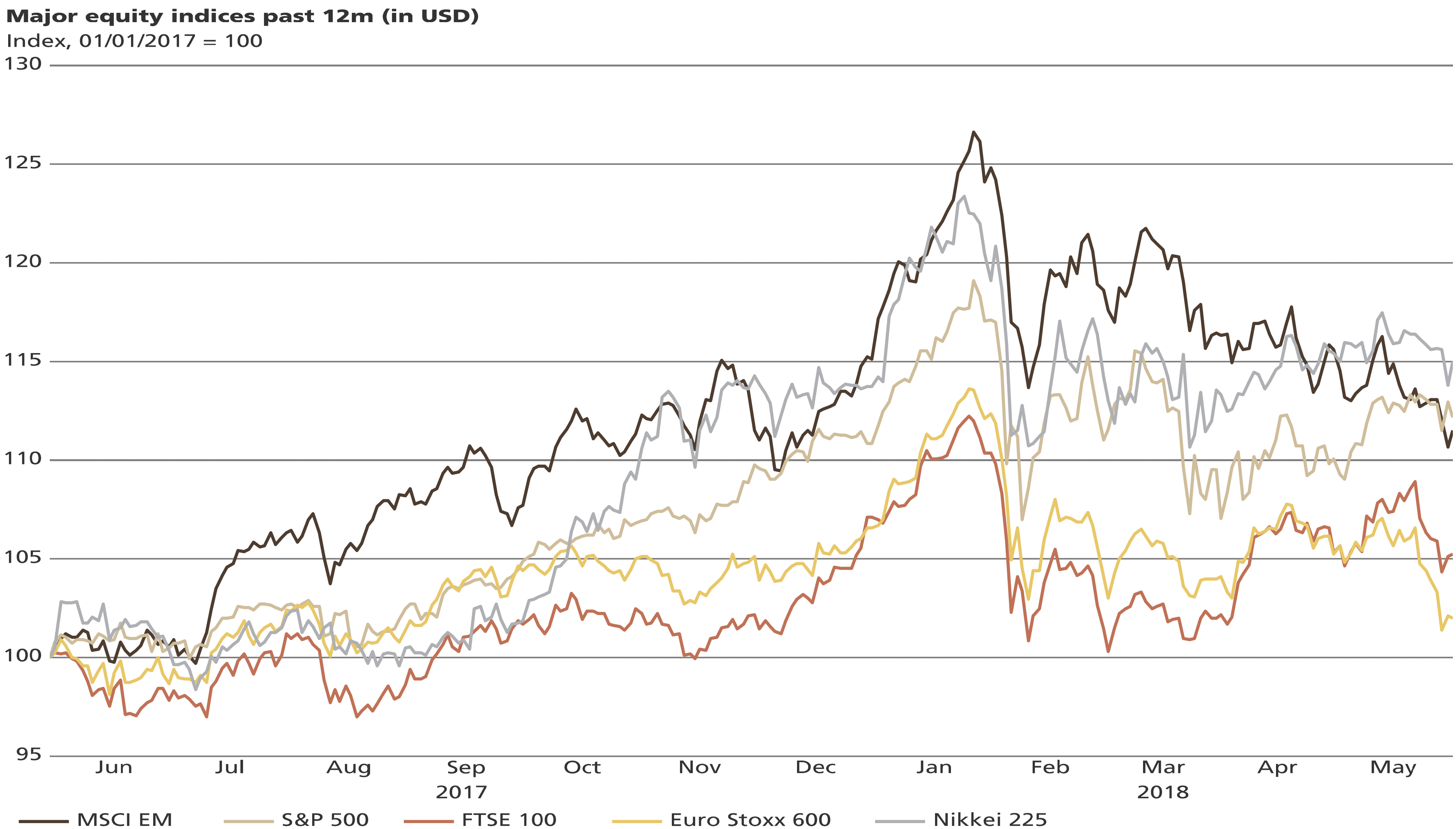
How have equity markets fared in the last year?



Source: Datastream, UBS Asset Management as at May 31, 2018. Returns are in US dollars.

Potential ways to manage volatility while achieving growth

Global Income strategy – *Increased expected income with less volatility*

- Exchanges possible equity upside on a portfolio of high quality stocks for extra income
- Attractive level of total income while maintaining total return expectations
- Income premium has a dampening effect on volatility

Defensive Equity strategy – *Reducing downside while achieving growth*

- Combines a global equity portfolio with a systematic hedging overlay
- Meaningful downside protection diversified across different levels and maturities
- Exchanges possible equity upside to largely cover hedging costs, especially when volatility is high

Source: UBS Asset Management; For illustration purposes only; the offered services do not constitute a guarantee

Section 2

Global Income strategy

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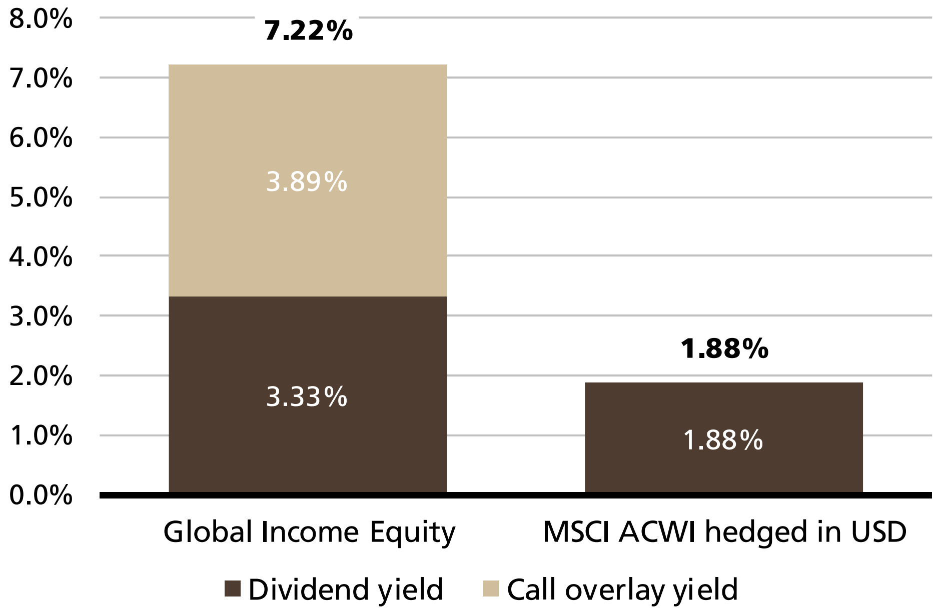
Targeting an attractive level of equity income

As of 30 April 2018

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



This is an equity product with no capital/income guarantee

Source: UBS Asset Management

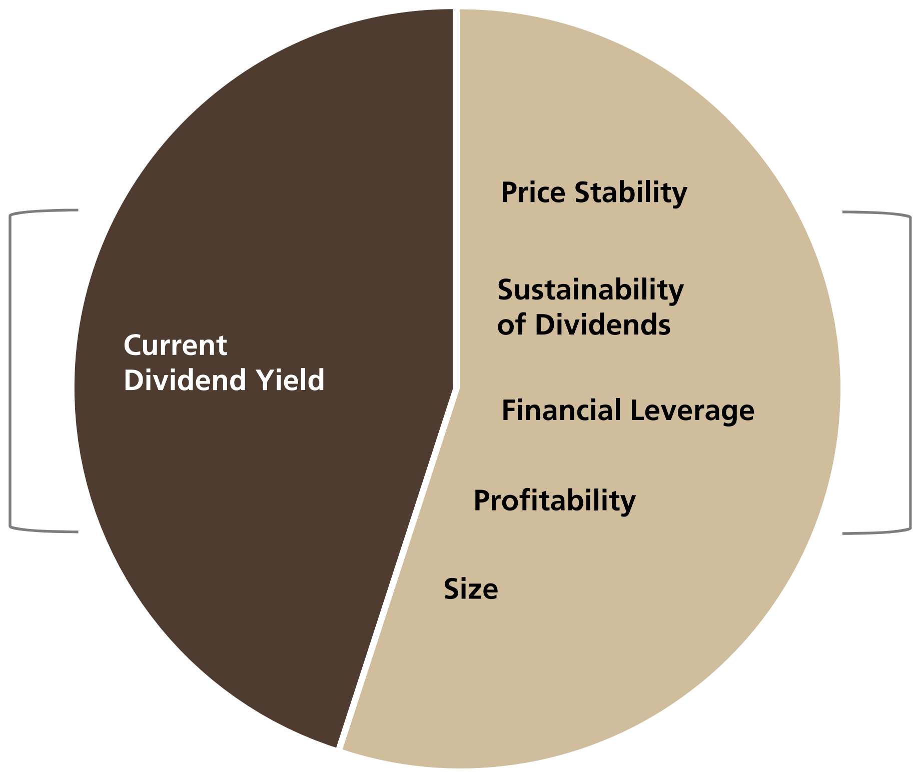
1 Yield is indicative and gross of fees. Equity yield is the sum of dividend distributions and premia from selling call options. Dividend yield is based on dividends of previous 12 months, **net of withholding tax.** Option premia are based on annualized sum of option premia collected over the past 12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

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.

Building a high quality equity portfolio

Quality criteria are weighted higher than dividend yield criteria

Dividend Yield:
Criteria 45%



Quality:
Criteria 55%

Source: UBS Asset Management
Note: For illustrative purposes. List of stock selection criteria is not conclusive and subject to change.

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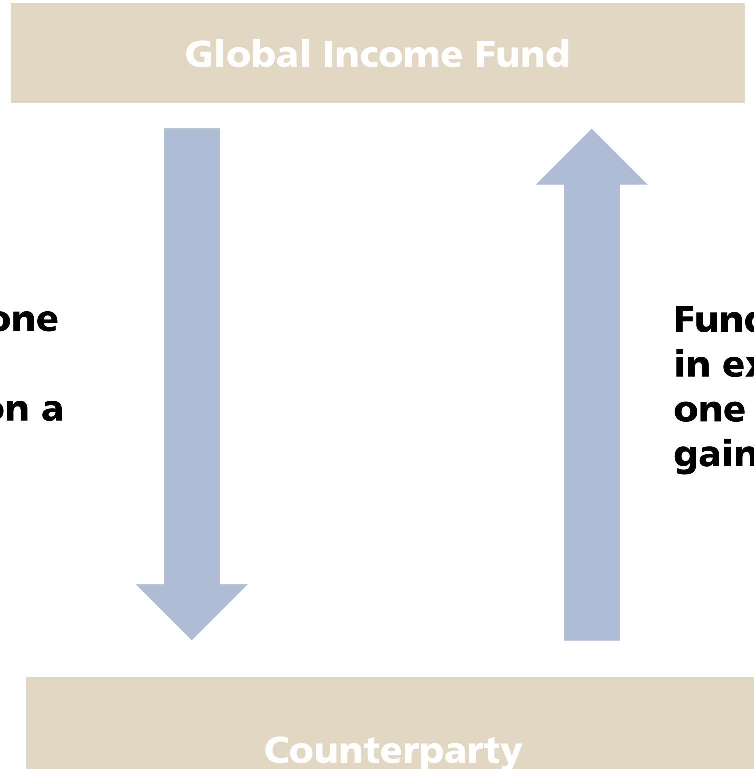
Exchanging possible equity upside for extra income



Fund seeks to sell potential one month individual share price increases greater than 5%* on a rolling monthly basis

Fund receives income in exchange for giving up potential one month share price gains of more than 5%

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%*):

- 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%

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

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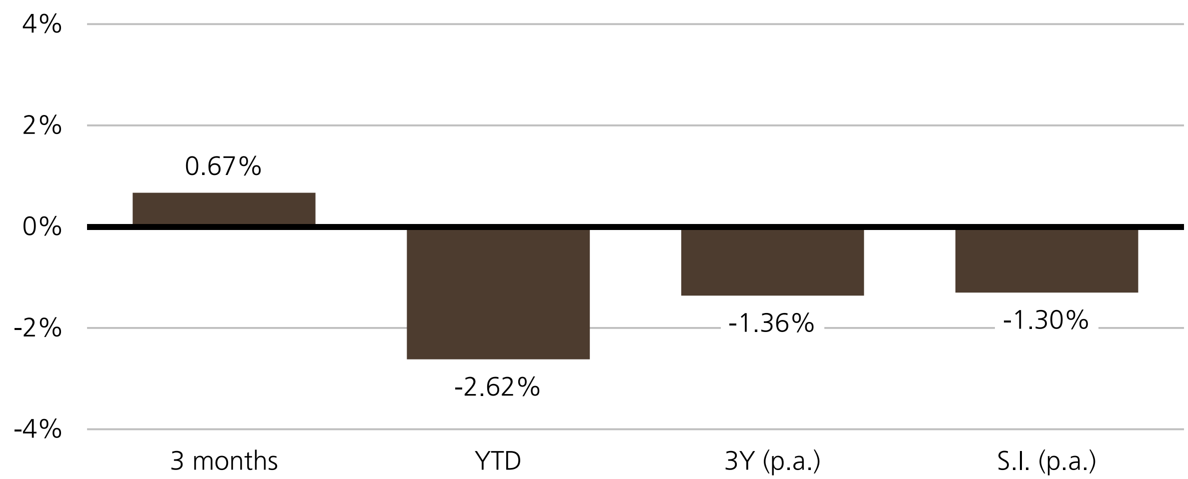
Exchanging possible equity upside for extra income

Strategy performance as at 30 April 2018

Relative return (in %, in USD)



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	6.28%	7.78%
Benchmark[2]	7.64%	9.08%
Risk[3]		
Composite	7.44%	6.65%
Benchmark	9.88%	8.97%
Sharpe ratio[4]		
Composite	0.74	1.08
Benchmark	0.70	0.95
Active risk[5]		
Composite	4.79%	4.61%
Information Ratio[6]		
Composite	-0.28	-0.28
Beta[7]		
Composite	0.67	0.64

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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Why this strategy is of interest for pension funds

Issues

- Desire to increase income achieved from the investment portfolios
- Looking to improve risk-adjusted returns versus a global equity investment
- Want to demonstrate reduced beta to wider equities, particular in times of market stress

Solution

- Global equity portfolio with a focus on generating high quality, sustainable yield
- Income enhancement strategy built and managed at the stock level
- Global firm managing derivative strategies since 1992, managing over $3 billion in such solutions

Client Benefit

- Attractive income from a more defensive equity portfolio
- Aims to provide some downside cushion in market corrections, at the expense of some upside in rising markets
- More volatile markets mean greater opportunities to deliver income

Source: UBS Asset Management, as at March 2018.

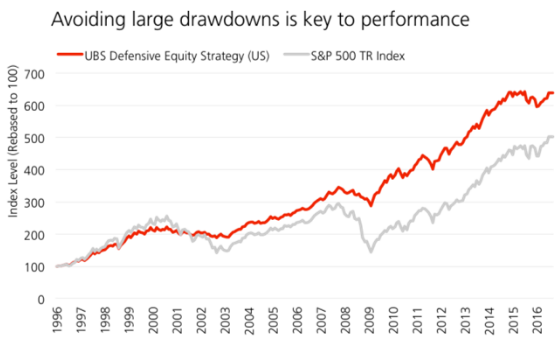
Section 3

Defensive Equity strategy

Building the UBS Defensive Equity strategy

Combining a global equity portfolio with a systematic hedging overlay

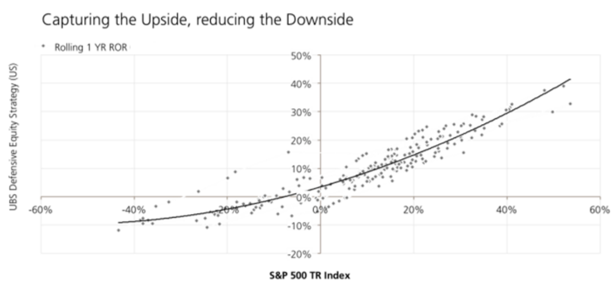
Equity Portfolio



Approach can be tailored to your **specific equity portfolio**

Hedging addresses market risk, but not active manager risks as indices are used

Downside protection

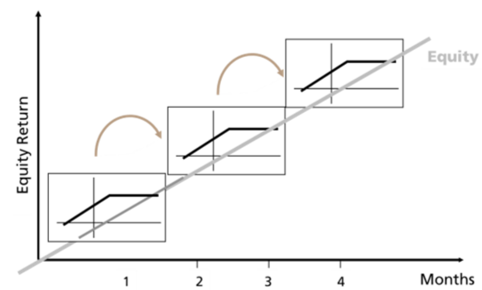


Portfolio of longer-dated put options, diversified across different strikes and maturities (up to 2 years)

Systematically rebalance put options as market conditions evolve

Adjust strike prices to preserve a meaningful downside protection

Generating premium income



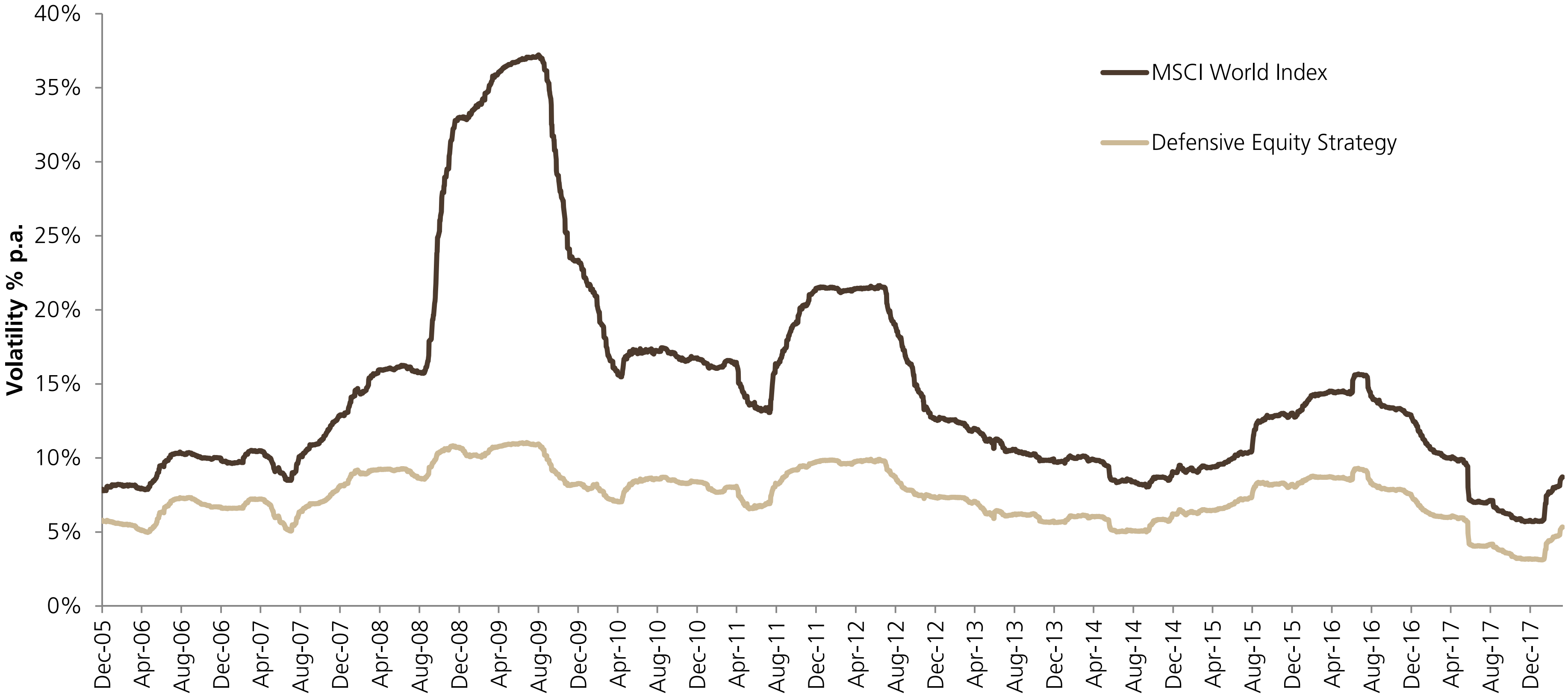
Systematic selling of **short-dated call** options (up to 3 months)

Generating premium income to balance put option premiums

Discretion to omit call overlay in case of extremely low volatility environments

Source: UBS Asset Management. For illustrative purposes only.

Looking to deliver a more stable equity portfolio



- The hedging overlay seeks to help stabilize the volatility of your equity portfolio through time.

For illustrative purposes only. Please always read in conjunction with the glossary and the risk information at the end of the document.
Calculation period: 31.10.2006 – 30.03.2018
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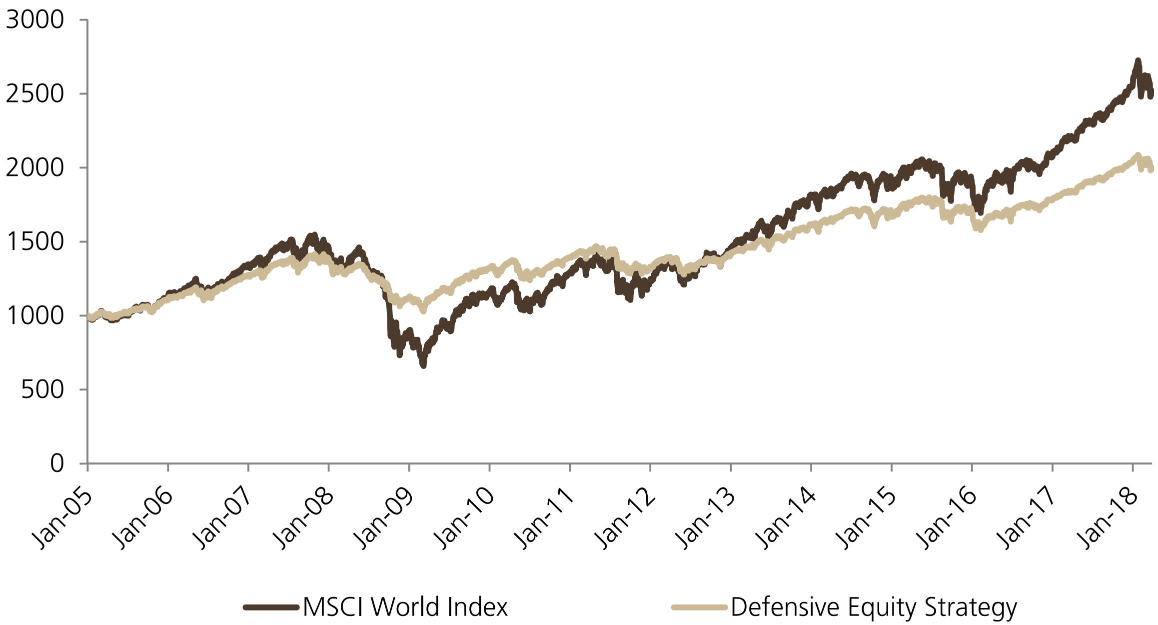
Aim to balance downside protection with opportunity cost

Results from simulated return series



	UBS Defensive Equity Strategy	MSCI World TR Index
Cumulative Return (%)	**5.2**	7.0
Volatility (%)	**7.6**	16.0
Sharpe Ratio	**0.47**	0.34
Maximum Drawdown (%)	**-27.4**	-57.4

Statistics based on daily data, gross of management fees

For illustrative purposes only.
Source: UBS Asset Management, Bloomberg; 3/1//2005 – 3/30/2018. **Past performance is not a reliable indicator of future performance**.
Please always read in conjunction with the glossary and the risk information at the end of the document.

Dealing with the caveats of hedging strategies

Active management aiming to provide tangible benefits to investors

Problem	Solution
No protection if equity markets fall but remain above protection level	**Diversify** protection levels
Timing risk; performance will vary depending on market level on exact start and end dates	**Diversify** start and end dates and invest in medium to long term protection
As market performance evolves the effective protection level may change significantly	**Adjust** protection level dynamically to balance upside potential and downside protection
Protection costs may detract too much from performance	**Optimize** these costs and retain flexibility
Changing market conditions	Discretion to **adapt** overlay strategies

Source: UBS Asset Management; for illustrative purposes only

Why this strategy is of interest for pension funds

Issues

- Desire to gain more drawdown aware exposure to equity markets
- Looking to improve risk-adjusted returns versus a global equity investment
- Want to demonstrate reduced beta to wider equities, particular in times of market stress

Solution

- Global equity portfolio with a systematic hedging overlay
- Evolving hedging positions as market conditions change
- Global firm managing derivative strategies since 1992, managing over $3 billion in such solutions

Client Benefit

- Seeks to generate attractive risk-adjusted results by avoiding large drawdowns
- Hedging strategy combining systematic approach with discretionary input
- Aims to generate premiums to meet costs of providing downside protection

Source: UBS Asset Management, as at March 2018.

Section 4

Summary

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Potential ways to manage volatility while achieving growth

Global Income strategy – *Increased expected income with less volatility*

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Appendix

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Michael Walsh FIA, CFA, CQF

Senior Strategist
Director

Years of investment industry experience: 15

Education: University College Dublin (Ireland), BAFS

Michael is a Senior Strategist, providing prospects, clients and investment consultants with strategic thinking, market and investment views across our multi-asset capabilities. He also plays an important role in designing innovative products and solutions for wholesale, institutional and DC clients with a major focus on the UK marketplace.

Michael joined UBS Asset Management in January 2016. Previously, Michael worked in senior Strategy positions across active equities, multi-asset and liability driven investments at Barclays Global Investors/Blackrock, Legal and General Investment Management and Old Mutual Global Investors. Michael started his career as an investment analyst at Mercer.

Michael is a Fellow of the Institute of Actuaries, a CFA charterholder and holds the Certificate in Quantitative Finance from the Wilmott Institute.

Note: As at March 2018

UBS Defensive Equity Strategy - Simulated returns

Equity Downside Risk Management Strategy: simulated returns

Potential for profit is accompanied by possibility of loss. The performance information presented for Equity Downside Risk Management represents simulated performance results. Simulated performance results were created by combining a passive MSCI World Index exposure with an MSCI World index put option protection strategy and a MSCI World index call option overwriting strategy for the time period January 2005 through March 2018. The portfolio composition is rebalanced on a monthly basis such as to match the notional of the protection strategy and the notional of the overwriting strategy with the passive exposure to the Index. Simulated performance results reflect hypothetical retroactive application of models and do not represent the results of actual trading using client assets. The models may not reflect the impact that material economic and market factors might have had on UBS Asset Management's decision-making if UBS Asset Management were actually managing clients' assets during the period portrayed. Simulated results are developed with the benefit of hindsight and have inherent limitations. The simulated results portrayed are not compared to a benchmark, although clients may choose to compare performance to a benchmark. The simulated performance results reflect the reinvestment of dividends or other earnings. The model results do not reflect other costs or fees such as advisory fees, custody fees, brokerage or other commissions, or other expenses that a client would have paid. A client's return will be reduced by advisory fees and other expenses incurred by the client. Clients should not assume that simulated results of a strategy will provide any indication of how their portfolio of securities might perform over time.

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Put Option Protection Strategy Model:

The Put Option Protection Model is designed to mitigate the impact of negative equity market performance on Equity Downside Risk Management model. The model invests in a portfolio of 12 put options on the MSCI World index. The option expiries are staggered such that every quarter a put option expires. Expiring options are replaced with a new 3 years put option. To maintain an effective protection level, the existing options are rolled on a quarterly basis if the aggregate market exposure increases above the predefined maximum market exposure or drops below the predefined minimum market exposure.

Call Option Overwriting Strategy Model:

The Call Option Overwriting Model is designed to partially or fully offset the costs of the Put Option Protection Model. On a monthly basis the Call Option Overwriting Model sells a one month call option with a strike level chosen such as that the premium income finances the quarterly purchase of 3 years put options. The strike is subject to a minimum strike level in order to maintain an attractive market upside potential. The call premium raised is invested into a money market account earning 1 month USD LIBOR rate. At expiry of the short call option any payout is offset against balance of the money market account. Any balancing amount will be invested into or disinvested from the passive equity exposure.

The Equity Downside Risk Management models shown are for simulation purposes only and could be subject to change depending on final portfolio implementation. Factors that could have a significant influence on the actual implementation proposal include but are not limited to the inclusion of active portfolio protection and overwriting selection which were not included in the simulated return calculations. The simulated Equity Downside Risk Management model includes specific option strike levels, minimum and maximum market exposure figures that are subject to change for the final portfolio implementation and could significantly impact the expected outcomes in the future.

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UBS Asset Management sources model parameters from recognized data providers and relevant market participants in deriving modeled returns.

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