

# Sustainable Investing

'Sustainability Focus' Fixed Income strategies



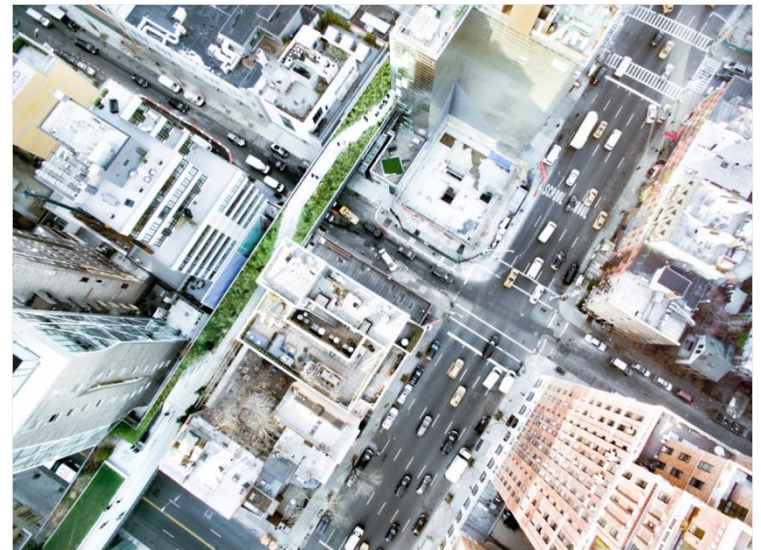
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Section 1

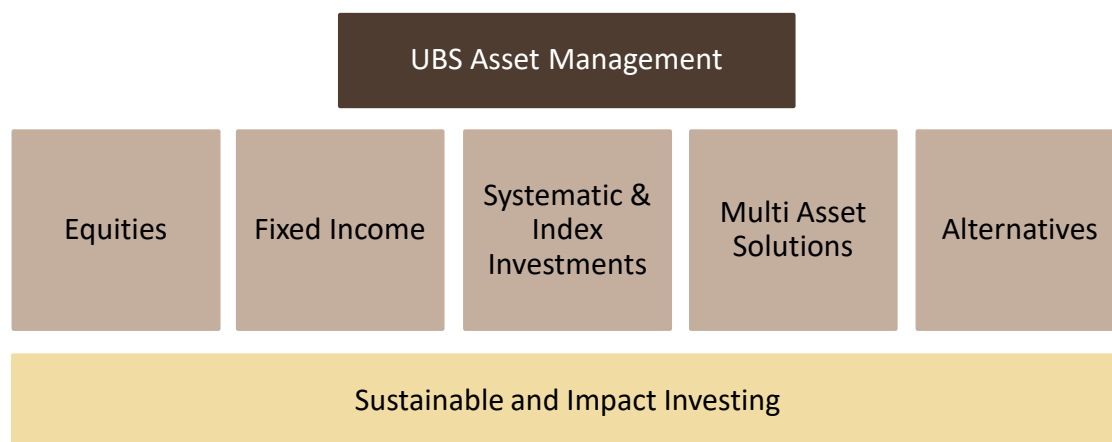
# What is Sustainable Investing in Fixed Income?



# Sustainable Investing (SI) at UBS Asset Management

## UBS' center of excellence for sustainable investing

The Sustainable and Impact Investing team works closely with portfolio managers, research analysts and investment specialists across asset classes to systematically integrate ESG in our investment processes and develop sustainable and impact solutions for clients



**+18 employees**  
dedicated to SI



**~920 investment**  
professionals



**~CHF 17 bn** SI-Focused  
**>CHF 200 bn** ESG Integrated  
assets under management<sup>1</sup>



**20 years** of SI  
business history

Notes: 1. Assets under management as of September 2018, not including mandates with value-based exclusions.





Source: UBS Asset Management, for illustrative purposes only.

# SI approaches: market size and growth rates

	<b>Exclusion</b>	<b>ESG Integration</b>	<b>Sustainability Focus</b>	<b>Impact</b>
<b>Definition</b>	Exclusion of certain sectors or companies based on specific ESG criteria	Integration of material ESG factors into the financial analysis used by Portfolio Managers	Strategies with sustainability playing a significant role in the investment process	Investment in companies and projects with positive social and environmental impacts
<b>Key requirements</b>	Norms-based or values-based exclusions	Access to and consideration of material ESG information	Tilts toward SI themes, negative and/or positive screening	Measure and understand impacts of investments
<b>Market size</b> (USD trillion)	<b>15.0</b>	<b>10.4</b>	<b>1.4</b>	<b>0.2</b>
<b>Market growth</b> (CAGR 2014-16)	<b>+12%</b>	<b>+17%</b>	<b>+15%</b>	<b>+57%</b>
<b>Stewardship</b>	Exercising shareholder rights by proxy voting and (pro-)actively engaging with companies to discuss material ESG issues			
<b>Measurement and reporting</b>	Measure and report ESG and/or Impact performance of companies and investment portfolios			

Source: UBS Asset Management, for illustrative purposes only. Global Sustainable Investment Alliance, 2016 Global Sustainable Investment Review; The sum of these individual strategies, after adjusting for double counting since some assets are subjected to more than one category. "Sustainability Focus" includes the sum of "Positive/best-in-class screening" and "Sustainability themed investing" categories as defined in the GSIA report.

# UBS-AM Sustainable Fixed Income offering

	<b>Exclusion</b> <i>'Exclusionary strategies'</i> 	<b>ESG Integration</b> <i>'Integrated strategies'</i> 	<b>Sustainability Focus</b> <i>'Focus strategies'</i> 	<b>Impact</b> <i>'Impact strategies'</i> 
<b>Index strategies</b>	<ul style="list-style-type: none"> <li>Customized lists</li> </ul>	<ul style="list-style-type: none"> <li>Not applicable</li> </ul>	<ul style="list-style-type: none"> <li>UBS ETF - Barclays MSCI US Liquid Corporates Sustainable</li> <li>UBS ETF- Barclays MSCI EUR Area Liquid Corporates Sustainable</li> </ul>	<ul style="list-style-type: none"> <li>World Bank Bonds</li> <li>World Bank Long term Bonds</li> <li>UBS ETF Sustainable Development Bank Bonds</li> </ul>
<b>Active strategies</b>	<ul style="list-style-type: none"> <li>Customized lists</li> </ul>	<ul style="list-style-type: none"> <li>All active fixed income strategies that use analyst recommendations</li> </ul>	<ul style="list-style-type: none"> <li>UBS EUR Corporate Sustainable</li> <li>UBS USD Corporate Sustainable</li> <li>UBS CHF Bond Sustainable</li> <li>UBS SD High Yield Sustainable</li> </ul>	<ul style="list-style-type: none"> <li>Currently no offering</li> </ul>

Source: UBS Asset Management. As at 31 December 2018

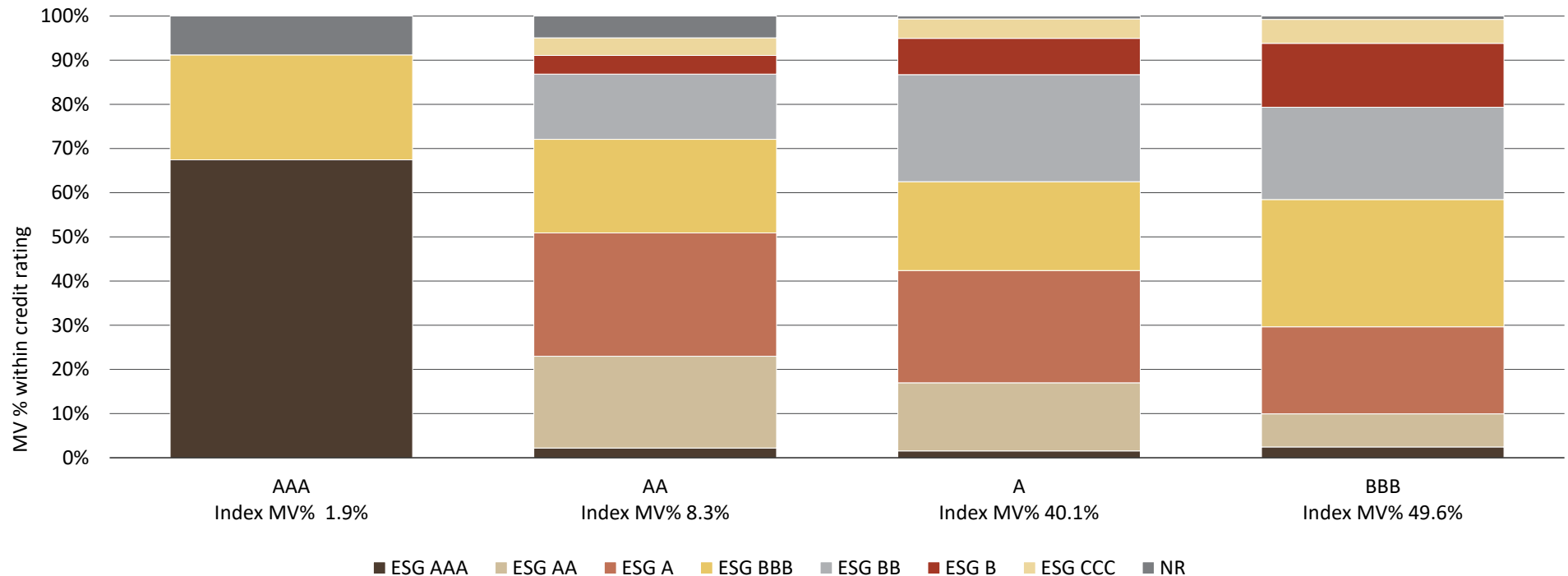
Section 2

# Why invest in Sustainable Fixed Income?

# Universe analysis shows dispersion of ESG rating within credit rating bands

Bloomberg Barclays US Corporate Index

## ESG quality varies within the same credit rating band



Source: MSCI ESG, Bloomberg Barclays, UBS Asset Management. As at October 2018

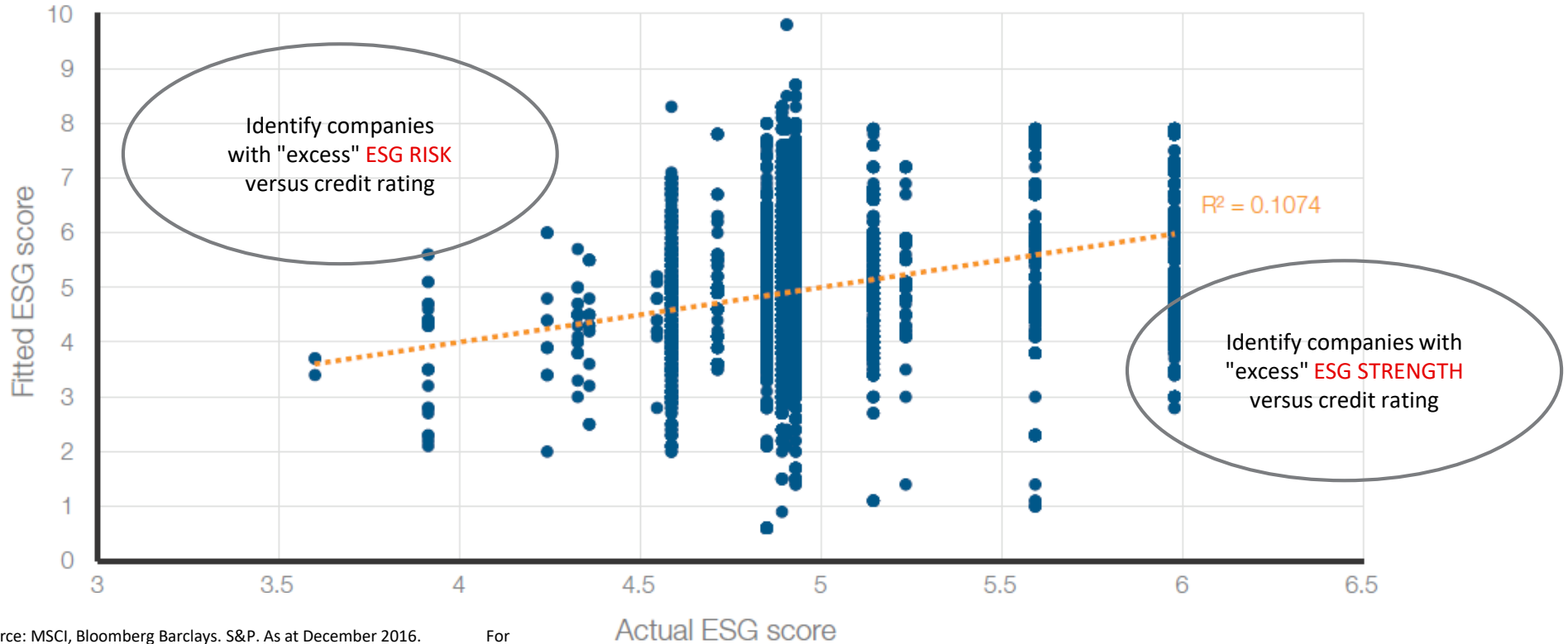
Dispersion of ESG ratings within a rating band indicates that embedding ESG factors in research may provide a more holistic view on an issuer and enhance credit recommendations



# Digging deeper into credit analysis

Assists in identifying strengths and weaknesses of companies not captured by the market's current assessment

## ESG quality varies within the same credit rating scale



Source: MSCI, Bloomberg Barclays, S&P. As at December 2016. illustrative purposes only.

For

Actual ESG score

Combining fundamental credit research and relative value assessment with ESG criteria should lead to better risk adjusted return for your portfolio

# Empirical study shows ESG considerations may reduce downside risk

Period 1, Cumulative excess returns (bp) between 2007-06-01 to 2008-11-28

	US Corp Index	US Corp ESG-rated	Restricted Bond universe	
Cumulative Excess Return (bp)	-2693	-2659	-2204	
	ESG	ENV	SOC	GOV
High	-2163	-2300	-2137	-2282
Low	-2129	-2196	-2179	-2116
High vs Low	-33	-104	42	-166

Period 2, Cumulative excess returns (bp) between 2011-07-01 to 2011-11-30

	US Corp	ESG-rated	Restricted Bond universe	
Cumulative Excess Return (bp)	-507	-510	-448	
	ESG	ENV	SOC	GOV
High	-388	-418	-373	-396
Low	-508	-431	-488	-472
High vs Low	120	13	115	76

Period 3, Cumulative excess returns (bp) between 2014-08-01 to 2016-02-29

	US Corp	ESG-rated	Restricted Bond universe	
Cumulative Excess Return (bp)	-598	-577	-497	
	ESG	ENV	SOC	GOV
High	-450	-393	-488	-448
Low	-498	-528	-476	-495
High vs Low	48	135	-11	47

## Reading guide:

- Euro Sovereign & Banking Crisis(July - November 2011)
- US Corp, ESG rated and Restricted Bond had cumulative excess returns of -507bps, -510bps and -448 bps respectively
- **All four High ESG portfolios outperformed their Low ESG counterparts**
- The outperformance was highest for the overall ESG tracking portfolio, followed by the Social (SOC) and the Governance (GOV)
- The performance differences were 120bps, 13bps, 115bps and 76bps respectively

## Main findings:

- ESG considerations would have helped to **reduce the downside risk** during 2 out of 3 of the recent market turmoil periods (see table)
- Authors show that there are indications that:
  - A significant increase in ESG rating is needed to achieve outperformance
  - **E, S & G scores can have different implications and impacts for different sectors and in different crisis**

Source: Bloomberg 2018 , Analyzing the Performance of ESG-based Corporate Bond Portfolios, Application to the US and Euro Corp Indices, Portfolio & Index Research, David Mendez-Vives  
Data: 11+ years of data to evaluate performance of MSCI ESG applied to the Bloomberg Barclays US Corp index (Investment Grade) & Bloomberg Barclays Euro Corp Index.

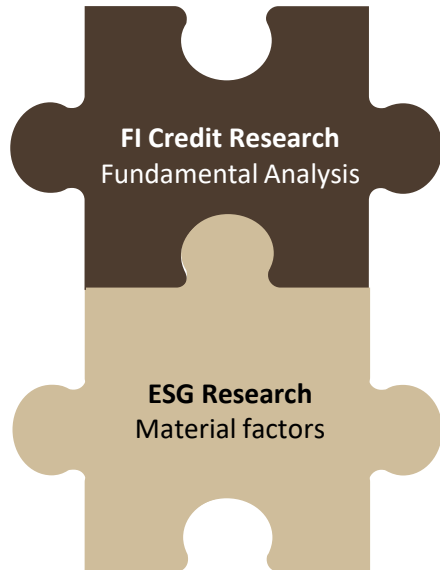
Section 3

# SI Integration at UBS-AM Fixed Income

# Our philosophy and key differentiators

We believe sustainable investing (SI) will become the new norm of investing so we aim to be at the forefront of this change

## ESG<sup>1</sup> meets Fixed Income Credit Research...



### ...and should lead to:

- A more **holistic** and **comprehensive** view on credit risk
- A better way to **anticipate issuer specific event risks**
- **Foresight into broader sustainability issues** that are not yet fully reflected in the market. As such, forecasting changes in credit ratings may be more accurate and effective
- A **better risk/ return profile** by having a cautious stance towards issuers exposed to those risks



### UBS-AM FI Approach is differentiated by:

- Assessing credit relevant, **material** ESG factors
- Assigning **proprietary UBS ESG Score** embedding **forward-looking** views
- Providing oversight by the **UBS SI FI Advisory Board**

Source: UBS Asset Management  
ESG (Environmental, Social, Governance criteria)

# Integrating ESG into Fixed Income

UBS SI FI Advisory Board oversees the process and advices on our SI approach

UBS-AM

Sustainable Investment Research

~18 SI Specialists

**Materiality**

Identify material ESG factors and issues for credit assessment

**Top-down views**

Long term sustainable expertise with trend analysis

**Bottom- up research**

Ongoing collaboration for credit analysis

**Engagement**

Pro-active engagement with companies

UBS-AM

Fixed Income Credit Research

25+ Fixed Income Credit Analysts

**In-depth sector and company knowledge**

Dedicated buy side fixed income analysts

**Top-down**

Fundamental industry recommendations integrating ESG themes

**Bottom-up**

Fundamental issuer recommendations integrating ESG  
Relative value recommendations integrating ESG

**UBS ESG Score**

Assign forward-looking ESG scores

UBS-AM

Fixed Income Strategy

100+ Fixed Income Investment Professionals

**Asset Allocation**

Market  
Currency

**Duration**

Overall duration, Yield curve

**Top-down Credit**

Market Beta, Rating, Industry, Country, Subordination

**Bottom-up Credit**

Issuer selection, Issue selection

UBS-AM

Portfolio Management

60+ Fixed Income Portfolio Managers

Portfolio Construction  
Portfolio Implementation  
Portfolio Risk Monitoring

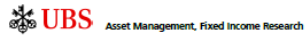
**Sustainable FI Strategy options**

Negative screening; Sustainable focus; Best –in-class; Impact

Source: UBS Asset Management. As at 31 December 2018

# ESG research template – an example

## ESG fundamental bottom-up analysis



High Yield Corporate — ESG Analysis



Jennifer Haidu 28-Sep-18

UBS			
ESG Credit Score	Direction	Changes the Credit Opinion?	Equity Score
2	Stable	No	6.0

MSCI	
Overall	Rating
7.0	A

**Change in Internal or External Opinion?** Initiation of UBS Sustainability Opinion

**Rationale**  
 Ashtead has a strong ESG profile. Ashtead is a provider of rental-equipment and related services to the commercial construction industry. Health & Safety (Human Capital) and Governance are key considerations within the Services sector. Ashtead compares very favorably relative to peers on those two metrics. Management compensation is tied to Health & Safety metrics, demonstrating the company's commitment to Human Capital. The development of equipment that qualifies as "clean tech" would likely push Ashtead to the top of its rental peers. Ashtead's strong ESG credit score does not improve its already-strong credit profile.

ESG Drivers:	Strengths	Risks
	<b>Governance:</b> Ashtead ranks in the top quartile compared with industry peers, as the company's corporate governance practices are generally well aligned with shareholder interests. <b>Health &amp; Safety:</b> Ashtead ranks in the top half of its peer group, given its group-wide policy, dedicated risk manager, and accountability of senior management.	<b>Corruption &amp; Instability:</b> Ashtead ranks in the bottom half of its industry peer group, as it has failed to demonstrate policies regarding anti-corruption of suppliers and facilitation payments.

**Recent Controversies:**  
 No material recent controversies.

**Industry Specific ESG Topics:**  
 Ashtead falls in the Commercial and Professional Services industry classification, which highlights Human Capital and Governance as high impact components of the ESG credit score.

**MSCI Summary:**  
 Ashtead Group's executive compensation system is linked to performance on health and safety metrics which signals a strong structure to manage employee health and safety issues. Further, the company has an independent board majority, which enables it to effectively fulfill its critical function of overseeing management on behalf of shareholders. However, the company lags its peers in developing investment plans and improving its research capabilities to capitalize on the growing opportunities in the clean technology field.

**Follow-up Points:**  
 Ashtead has not demonstrated investments/developments in clean technology. We will also watch for improved disclosure/evidence of anti-corruption policies related to suppliers. Progress in either area could lead to a higher credit score.

### ESG Scores and Ratings (Internal and Third Party)

#### UBS:

Credit analyst assigns:

- UBS ESG Score from 1 – 5 (best to worst).
  - A future direction to the ESG issuer profile (positive, stable or negative).
- A change in relative value opinion will be noted with a Yes should it be rated 1 or 5. The UBS equity group proprietary score.

#### MSCI:

Industry-relative ratings and scores from our third-party provider.

### ESG Credit Score Rationale

The credit analyst explains UBS ESG Score and communicates its impact on the overall credit profile, including whether the materiality of the score (1 or 5) has led to a change in credit opinion.

### Key ESG Drivers

#### Strengths and Risks:

The credit analyst focuses on the magnitude of these drivers to assess the relative strength and risks of the issuer's ESG profile.

#### Industry Specific:

ESG related industry recommendations and themes are provided by the SI research team.

#### Recent Controversies & Follow-up Points:

Recent controversies and ESG issues that might change the UBS ESG score in the future are highlighted and monitored.

Source: UBS Asset Management. For illustrative purposes only. Information is intended as representative of our research process. The information contained herein should not be considered a recommendation to purchase or sell any particular security



# UBS ESG scoring system

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Assigns ratings to coverage universe that is consistent with the fundamental credit scoring

## UBS ESG scoring system

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- 1** Very strong sustainability profile and positive impact on fundamental credit assessment
  - 2** Positive sustainability profile but no material change on fundamental credit assessment
  - 3** Neutral sustainability profile, but no change on fundamental credit assessment
  - 4** Weak sustainability profile but no material change on fundamental credit assessment
  - 5** Very weak sustainability profile and negative impact on fundamental credit assessment
- 

Source: UBS Asset Management

# Bottom-up analysis: integrating ESG into research

A consistent process combining fundamental credit and ESG analysis to provide a relative value assessment

## Fundamental bottom-up analysis

Credit Research

Key points:

- Quantitative analysis (e.g. operating results, cash flow, ratios)
- Qualitative analysis (e.g. management quality, human capital, governance aspects)
- Other factors (e.g. event and headline risk, contingent liabilities)

### UBS Fundamental Ranking (RFR)

1 Best in class

2

3

4

5 Worst in class

## ESG Fundamental bottom-up analysis

Credit and Sustainable Research collaboration

Key points:

- Consider material ESG issues
- Develop ESG investment rationale
- Assign forward-looking ESG scores

### UBS ESG Rating

Score	Profile	Impact	Direction
1	Very Strong	Yes, positive	
2	Positive	No material Impact	Positive
3	Neutral	No material Impact	Neutral
4	Weak	No material Impact	Negative
5	Very weak	Yes, negative	

1

Very Strong

Yes, positive

2

Positive

No material Impact

Positive

3

Neutral

No material Impact

Neutral

4

Weak

No material Impact

Negative

5

Very weak

Yes, negative

## Relative value

Credit Research and Portfolio Managers

Key points:

- Include UBS ESG ratings into the relative value decision making process

### UBS Relative Value Recommendation

✓ Strong overweight

✓ Overweight

✓ Neutral

✓ Underweight

✓ Avoid

Source: UBS Asset Management



# UBS-AM 's Proprietary Sustainability Credit Assessment

Our assessment goes beyond third party ratings and overcomes their limitations

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## Third-party ESG ratings

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### **Historical in nature**

Based on reported metrics and known controversies



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## UBS Proprietary ESG Scoring

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### **Forward looking**

Based forward-looking assessment of the direction and anticipated change

### **Too broad**

Assessing many different topics and issues



### **Materiality focused**

Focused on the most material sustainability issues from an investment perspective.

Proprietary UBS materiality framework for 34 industries.

### **Not linked to the investment case**

Used for screening but not leading to investment recommendations



### **Linked to the investment thesis**

Based on the material impact of sustainability on the investment case. Sophisticated assessment linking sustainability to the financial case

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Source: UBS Asset Management. As at 31 December 2018

Section 4

# UBS 'Sustainability Focus' Strategies

# 'Sustainability Focus' FI Strategies

'Sustainability Focus' strategies have investment guidelines with sustainability criteria



## UBS 'Sustainability Focus' fixed income strategies

- Aim to deliver attractive returns with a better sustainability profile relative to their investment universe
- The UBS ESG research adds an additional dimension for assessing the credit quality of corporate issuers. We will consider the sustainability characteristics of the underlying investments, and have an orientation towards issuers that we believe better manage their ESG challenges and opportunities
- Managed by our experienced teams following a proven investment process integrating risk management as an integral part of the process
- Strategies will include negative ethical screens so would be suitable for SI investors that do not want to invest in certain controversial sectors

## Strategy guidelines

- The strategies will take into consideration proprietary UBS ESG scores for security selection and apply negative screening on controversial sectors when constructing the portfolio to ensure a better sustainability profile
  - Guidelines set with UBS ESG Scores (1-5 best to worst)
  - Excluded sectors: controversial weapons, antipersonnel mines, cluster munitions, adult entertainment, tobacco, thermal coal (>30% revenue)

# 'Sustainability Focus' Fixed Income Funds

## Key characteristics

	UBS (Lux) SICAV 2 EUR Corporate Bond Sustainable (EUR)	UBS (Lux) SICAV 2 USD Corporate Bond Sustainable (USD)	UBS (Lux) SICAV 2 CHF Bond Sustainable (CHF)	Short Duration High Yield Sustainable (Model portfolio)
Yield to Worst	1.27%	4.00%	0.46%	4.50%
Option Adjusted Spread	142	129	103	190
Option Adjusted Duration	4.99	7.18	5.12	1.52
Average Rating	BBB+	BBB+	A2	BB3
Weighted UBS ESG Rating	2.3	2.3	2.7	2.5
Number of Issues	175	81	135	153
Benchmark	Bloomberg Barclays Euro Aggregate 500mio+ Corporate Index	Bloomberg Barclays US IG Corporate Index	SBI Foreign AAA-BBB Index	--

Source: UBS Asset Management. Data as at end of February 2019

# In summary

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## UBS: committed to being at the forefront of sustainable investing

- Sustainable Investing is a significant trend
- UBS-AM is **committed to SI integration** across asset classes
- Allows a more **holistic view** and enables **better informed** investment decisions
- **Fixed income** investors are focusing on **ESG Integration**

## How we deliver SI within Fixed Income

- We integrate **material** sustainability issues to fundamental **credit analysis** embedding a **forward-looking** view
- **Fixed Income SI Advisory Board** provides oversight and advice
- **Engagement** with issuers on material topics underpins the process
- Close **collaboration** between our Investment and Sustainability teams

## Global coverage of strategies

- ESG integration **supports all** of our strategies
- We plan to continue to **innovate offering solutions** to meet our clients' SI investment challenges

# Disclaimer

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