UBS

Panorama: Investing in 2018

Challenge and opportunity ahead

UBS Asset Management | Executive Summary

As we move into 2018, senior investors from UBS Asset Management assess the global investment landscape, highlighting the risks and opportunities across their respective asset classes. Among the topics explored in this edition are:

The quest for attractive risk-adjusted income
- Income returns across the traditional asset classes
- Income opportunities within the real asset classes
- Private credit, as viewed by both our single and our multi-manager hedge funds
- A solutions based approach to income generation

The quest for attractive risk-adjusted capital growth
- Demographics and markets
- The changing face of emerging markets
- Sustainability and performance
- Smart beta

Read more at ubs.com/panorama

The asset management industry is changing quickly. Technology and regulation are driving much of that change, but the market environment and the sheer scale of the challenges facing our clients are important drivers as well.

We see those challenges increasing in intensity in 2018 rather than changing fundamentally. The rationale for this viewpoint is straightforward. Investors in equities have enjoyed another year of strong returns globally in 2017. Realized volatility, though picking up, has remained exceptionally low. Credit markets have enjoyed robust conditions with spreads close to or at historic lows. Outside the US, government bond yields in the developed world have generally edged higher in 2017, but remain low in an historical context and are likely to stay low amid still accommodative monetary policy and structurally low growth and inflation.

Against this backdrop, the challenge of building genuinely diversified portfolios capable of delivering growth and income efficiently and on an attractive risk-adjusted basis is becoming both more complex and acute.

This issue of Panorama sees senior members of our investment teams address the on-going quest for growth and income via the risks and opportunities within their respective worlds. Encouragingly, across both traditional and alternative asset classes there is a high level of conviction that attractive opportunities on a risk-adjusted basis still exist, and with a healthy awareness of the potential threats to broader market equanimity.

With the equity bull market in its ninth year, our senior investors are hardly alone in looking for signs of complacency or dislocations that might preface a broader market sell off. We see this as contrasting sharply to the 'blue sky' consensual assumptions that have characterized the peak of many previous market cycles.

Nonetheless, in the search for evidence of complacency, a lot of discussion has focused on the very low levels of realized and implied volatility across developed markets.

We believe that there are both structural and cyclical forces at work in the current low volatility regime and that the cyclical drivers will abate only slowly over an extended period. The argument that risk assets are likely to become more vulnerable to short-term spikes in investor risk aversion as Quantitative Easing (QE) is reversed in the US has clear logic. But the roll-off of QE is a very gradual process and one that is likely to take several years. We therefore do not expect the reversal of QE to be the catalyst to a meaningfully higher volatility regime in 2018. It is also important to note that the US Federal Reserve (Fed) is maintaining a significantly larger balance sheet than existed prior to the financial crisis, withdrawing only a third of the liquidity it created since 2008. Moreover, the

QE reversal process in the US has been explicitly communicated to ensure that market expectations are managed.

More traditional monetary policy tools – interest rates – are also likely to edge higher in the US in 2018. Yet in a world where technology and demographic forces appear to be disrupting the effectiveness of monetary policy tools to drive inflation higher, central bankers face a difficult task. We therefore expect the rise in US rates to be gradual, not least because monetary policy around most of the globe remains accommodative.
Nonetheless, the failure of monetary policy to drive wage growth is putting growing pressure on politicians to deliver via fiscal initiatives what monetary policy seemingly cannot. It is no coincidence that income growth via tax cuts is being debated in a number of major developed economies to address the rise of populism.

Looking forward, it seems self-evident that the double digit local currency returns enjoyed by index investors across developed markets in recent years cannot continue ad infinitum. But while we might caution over the scale of likely returns in the coming years there is little from a macroeconomic perspective to suggest an elevated probability of a major drawdown in 2018. The likelihood of a global recession is low. Demand growth has accelerated rather than slowed. Equity valuations, while full on some measures, remain compelling versus bonds. Earnings growth forecasts have been rising, not falling. Importantly, having largely completed the process of deleveraging, bank balance sheets are in much better shape than they were prior to the last recession.

If there is major disruption coming in global equity markets in 2018, we ascribe a greater probability to an abrupt reversal of the sustained outperformance of Growth sectors over Value sectors in developed markets since 2008 than to a significant drawdown. Broadly speaking we believe the environment will be an attractive one for high conviction, active managers and fully expect active managers to continue their recent outperformance. The sharp decline in stock correlations, both realized and implied, supports this view.

The search for attractive yield and improved diversification in a "lower for longer" environment is also likely to remain at the core of investment decision making in 2018. After the strong flows and capital raisings of 2017, we see continued strong investor demand for alternative asset classes in 2018 including infrastructure, real estate, private equity and hedge funds.

In part because of the likely increase in interest in how to optimize the use of alternatives within broader portfolios, but also due to the scale and complexity of the challenges facing investors, we expect a continued increase in demand for tailored solutions. The lower return environment is likely to provide further support to cost-efficient, systematic flows and to a focus on specific risk premia and factors via smart beta. Finally, we see the sustainability narrative further evolving and the integration of ESG factors into the analytical mainstream accelerating.

In this issue of Panorama you will find insights on all of these key investment themes from senior investors across UBS Asset Management. It is precisely this depth and breadth of expertise across capabilities that differentiates us. It is also at the heart of our ability to combine these capabilities to address each client's unique investment challenges effectively and efficiently in 2018 and beyond.

For marketing and information purposes by UBS. For professional clients / qualified / institutional investors only.

This document does not replace portfolio and fund-specific materials. Commentary is at a macro or strategy level and is not with reference to any registered or other mutual fund.

Americas
The views expressed are a general guide to the views of UBS Asset Management as of November 2017. The information contained herein should not be considered a recommendation to purchase or sell securities or any particular strategy or fund. Commentary is at a macro level and is not with reference to any investment strategy, product or fund offered by UBS Asset Management. The information contained herein does not constitute investment research, has not been prepared in line with the requirements of any jurisdiction designed to promote the independence of investment research and is not subject to any prohibition on dealing ahead of the dissemination of investment research. The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith. All such information and opinions are subject to change without notice. Care has been taken to ensure its accuracy but no responsibility is accepted for any errors or omissions herein. A number of the comments in this document are based on current expectations and are considered "forward-looking statements." Actual future results, however, may prove to be different from expectations. The opinions expressed are a reflection of UBS Asset Management's best judgment at the time this document was compiled, and any obligation to update or alter forward-looking statements as a result of new information, future events or otherwise is disclaimed. Furthermore, these views are not intended to predict or guarantee the future performance of any individual security, asset class or market generally, nor are they intended to predict the future performance of any UBS Asset Management account, portfolio or fund.

EMEA
The information and opinions contained in this document have been compiled or arrived at based upon information obtained from sources believed to be reliable and in good faith, but is not guaranteed as being accurate, nor is it a complete statement or summary of the securities, markets or developments referred to in the document. UBS AG and / or other members of the UBS Group may have a position in and may make a purchase and / or sale of any of the securities or other financial instruments mentioned in this document.

Before investing in a product please read the latest prospectus carefully and thoroughly. Units of UBS funds mentioned herein may not be eligible for sale in all jurisdictions or to certain categories of investors and may not be offered, sold or delivered in the United States. The information mentioned herein is not intended to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. Past performance is not a reliable indicator of future results. The performance shown does not take account of any commissions and costs charged when subscribing to and redeeming units. Commissions and costs have a negative impact on performance. If the currency of a financial product or financial service is different from your reference currency, the return can increase or decrease as a result of currency fluctuations. This information pays no regard to the specific or future investment objectives, financial or tax situation or particular needs of any specific recipient.

The details and opinions contained in this document are provided by UBS without any guarantee or warranty and are for the recipient's personal use and information purposes only. This document may not be reproduced, redistributed or republished for any purpose without the written permission of UBS AG.

This document contains statements that constitute "forward-looking statements", including, but not limited to, statements relating to our future business development. While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.

UK
Issued in the UK by UBS Asset Management (UK) Ltd. Authorised and regulated by the Financial Conduct Authority.

APAC
This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in APAC. This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in your jurisdiction. No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of your jurisdiction.

Using, copying, redistributing or republishing any part of this document without prior written permission from UBS Asset Management is prohibited. Any statements made regarding investment performance objectives, risk and/or return targets shall not constitute a representation or warranty that such objectives or expectations will be achieved or risks are fully disclosed. The information and opinions contained in this document is based upon information obtained from sources believed to be reliable and in good faith but no responsibility is accepted for any misrepresentation, errors or omissions. All such information and opinions are subject to change without notice. A number of comments in this document are based on current expectations and are considered "forward-looking statements". Actual future results may prove to be different from expectations and any unforeseen risk or event may arise in the future. The opinions expressed are a reflection of UBS Asset Management's judgment at the time this document is compiled and any obligation to update or alter forward-looking statements as a result of new information, future events, or otherwise is disclaimed.

You are advised to exercise caution in relation to this document. The information in this document does not constitute advice and does not take into consideration your investment objectives, legal, financial or tax situation or particular needs in any other respect. Investors should be aware that past performance of investment is not necessarily indicative of future performance. Potential for profit is accompanied by possibility of loss. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Australia
This document is provided by UBS Asset Management (Australia) Ltd, ABN 31 003 146 290 and AFS License No. 222605.

China
The securities may not be offered or sold directly or indirectly in the People's Republic of China (the "PRC"). Neither this document or information contained or incorporated by reference herein relating to the securities, which have not been and will not be submitted to or approved/verified by or registered with the China Securities Regulatory Commission ("CSRC") or other relevant governmental authorities in the PRC pursuant to relevant laws and regulations, may be supplied to the public in the PRC or used in connection with any offer for the subscription or sale of the Securities in the PRC. The securities may only be offered or sold to the PRC investors that are authorized to engage in the purchase of Securities of the type being offered or sold. PRC investors are responsible for obtaining all relevant government regulatory approvals/licenses, verification and/or registrations themselves, including, but not limited to, any which may be required from the CSRC, the State Administration of Foreign Exchange and/or the China Banking Regulatory Commission, and complying with all relevant PRC regulations, including, but not limited to, all relevant foreign exchange regulations and/or foreign investment regulations.

Hong Kong
This document and its contents have not been reviewed by any regulatory authority in Hong Kong. No person may issue any invitation, advertisement or other document relating to the Interests whether in Hong Kong or elsewhere, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Interests which are or are intended to be disposed of only to persons outside Hong Kong or only to "professional investors" within the meaning of the Securities and Futures Ordinance (Cap. 571) and the Securities and Futures (Professional Investor) Rules made thereunder.

Japan
This document is for informational purposes only and is not intended as an offer or a solicitation to buy or sell any specific financial products, or to provide any investment advisory/management services.

Korea
The securities may not be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the Capital Market and Financial Investment Business Act and the Foreign Exchange Transaction Law of Korea, the presidential decrees and regulations thereunder and any other applicable laws, regulations or rules of Korea. UBS Asset Management has not been registered with the Financial Services Commission of Korea for a public offering in Korea nor has it been registered with the Financial Services Commission for distribution to non-qualified investors in Korea.

Malaysia
This document is sent to you, at your request, merely for information purposes only. No invitation or offer to subscribe or purchase securities is made by UBS Asset Management as the prior approval of the Securities Commission of Malaysia or other regulatory authorities of Malaysia have not been obtained. No prospectus has or will be filed or registered with the Securities Commission of Malaysia.

Singapore
This document has not been registered with the Monetary Authority of Singapore pursuant to the exemption under Section 304 of the SFA. Accordingly, this document may not be circulated or distributed, nor may the Securities be offered or sold, whether directly or indirectly, to any person in Singapore other than (i) to an institutional investor pursuant to Section 304 of the SFA.

Taiwan
This document and its contents have not been reviewed by, delivered to or registered with any regulatory or other relevant authority in the Republic of China (R.O.C.). This document is for informational purposes and should not be construed as an offer or invitation to the public, direct or indirect, to buy or sell securities. This document is intended for limited distribution and only to the extent permitted under applicable laws in the Republic of China (R.O.C.). No representations are made with respect to the eligibility of any recipients of this document to acquire interests in securities under the laws of the Republic of China (R.O.C.).

Source for all data and charts (if not indicated otherwise): UBS Asset Management

© UBS 2017. The key symbol and UBS are among the registered and unregistered trademarks of UBS. All rights reserved.