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Investment Risks and Returns in the Current Environment

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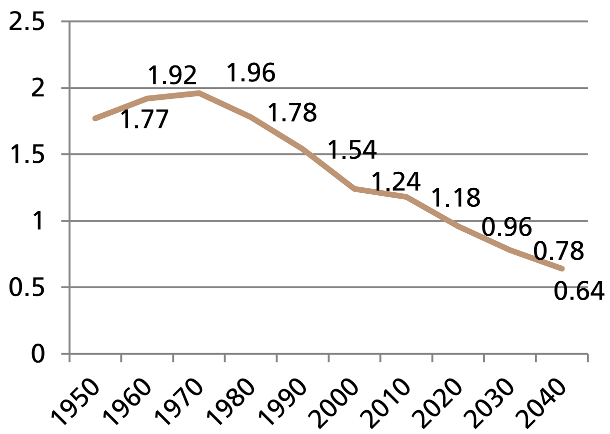
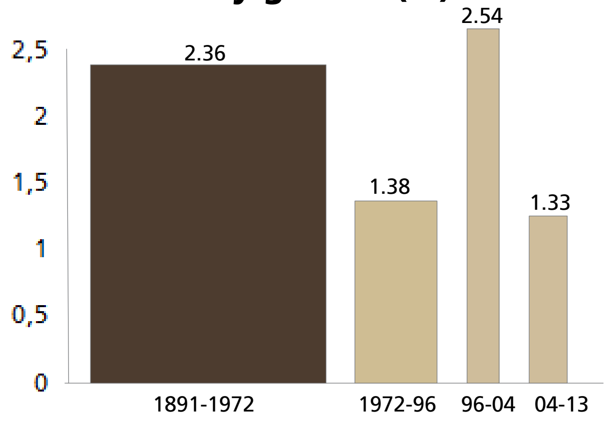
Low growth & low return: Cyclical or structural?

Is the world economy suffering from a secular stagnation?

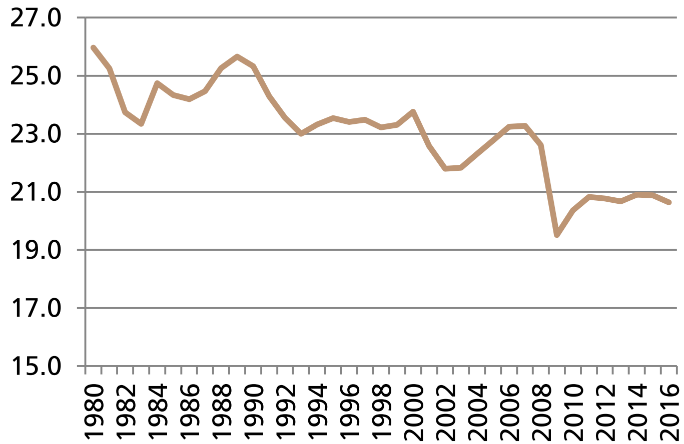
Population growth (%)



Productivity growth (%)



Investment rate (%) Advanced econ



Scenario A: Normalization

Scenario A scenario assumptions:

- **Inflation** across the globe is expected to remain muted in the 1.5% to 2.2% range;
- **US T-Bills** begin to rise in 2016 and are expected to reach 3.1% in five years;
- **10-year Treasury yield** rises about 30 basis points per year over the next five years;
- **Global interest rates** are expected to rise about 35 basis points per year over the next five years
- **US equities** are slightly overvalued. Non-US equities are undervalued and expected to outperform in the next 5 to 10 years

Scenario B: Lower-for-longer

Scenario B scenario assumptions:

- **Inflation** across the global at around 1% in the majority of advanced economies
- **US T-Bills** will only rise to 0.5% in five years and 1.0% in ten years;
- **10-year Treasury yield** will be 2.0% in five years and 3.0% in ten years
- **Global interest rates** will remain lower for longer over the next five years
- **US equities** are expected to experience only a small revaluation in this scenario with global returns falling to around 6%

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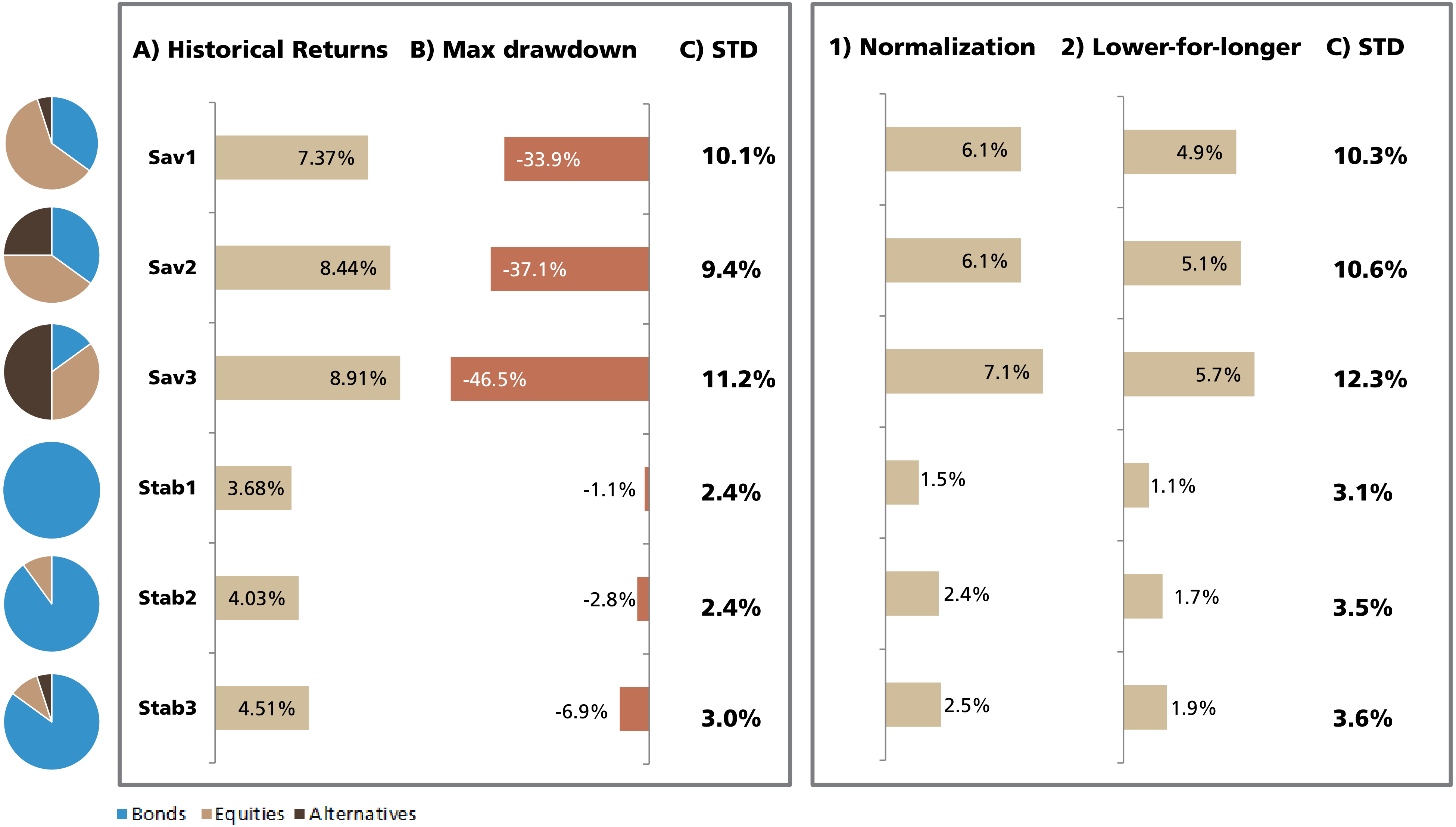
Source: United Nations, IMF 2016. UBS AM 2016.

Lower expected returns across scenarios

The past (2002-2016YTD) | The future (10-y Forecast)



UBS Source: UBS AM. Please note that past performance is not a guide to the future. Data as of end of September 2016.

More or less risk? More or less illiquidity?

How to invest going forward – and which questions should SWFs address to meet current and future challenges

1

- Increase or decrease risk?

Lower-for-longer might imply the need to go even further out on the risk curve – but what maximum loss is an institution willing to take?

Political and governmental / regulatory backing for changes in risk appetite and investment style?

2

- More illiquidity premium?

Data suggests that illiquid assets will continue to offer superior returns and SWFs without current liquidity needs are uniquely positioned to take advantage – what happens in case of forced selling?

Do institutions and sponsoring governments have a fiscal rule that governs investment horizon and withdrawal rules?

3

- Establish a tactical / cyclical investment framework?

An ongoing low-return environment or more challenging investment regimes than in the past (e.g. stagflation) will require much more active investment styles

Factor investing with related TAA, use of derivatives. Are SWFs ready from an organisational point of view?

4

- Implement alternative portfolio construction techniques?

Move towards a hedge-fund style investment framework relying on extensive use of derivatives, leverage, sophisticated risk models and more generally more sophisticated investment engineering

Required level of professionalism very high and will political sponsors support such an investment style?

Source: UBS Asset Management. For illustrative purposes only.

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- As Head of Strategy he analyses the market trends affecting the investment behavior of central banks, sovereign wealth funds and other state-controlled investment institutions and work closely with the investment teams in providing investment advice and developing tailored investment solutions for this client segment
- Max established himself as a global thought leader on the macroeconomic, financial and political trends in sovereign wealth management. He has often been called in by leading institutions as an expert on global economic and financial matters. Max has recently published The New Economics of Sovereign Wealth Funds in the Wiley Finance Series, a book providing a thorough guide to sovereign wealth funds, covering the drivers of the industry, how it operates and grows, the interest from and in Western markets and the pivotal role that sovereign wealth funds play in the world economy
- In his fifteen year long international professional career, Max has been Head of governmental affairs for UBS in Europe, Middle East and Africa, Senior Economist for the Middle East region at UBS and consultant advising governments and corporates in emerging markets on behalf of international institutions
- Max holds a PhD in Economics from the University of Rome where he lectured and a Msc in Economics from the University of London.

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