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Global version

Investing for generations to come

UBS Climate Aware – Rules-based equity investing

At the end of this century, our planet will likely be warmer than at any other time in human history. The impact this will have on our ecosystem, our lives and the economy will be dramatic. The UBS Active Climate Aware Equity strategy aims to address climate change as a systemic problem and invests in companies that will be successful in a low-carbon economy.

The climate challenge
The consequences of climate change can no longer be ignored. Action is needed from both the financial industry and investors to help combat this crisis. To limit global warming to 2° Celsius, a vast amount of capital is required to create a climate-smart economy. Policy is calling for:
– Annual investment of USD 3.8 trillion by 2050[1]
– Resulting in a low-carbon economy that could potentially generate USD 26 trillion in opportunities[2]

Portfolios benefit from a better climate
In 2019, a report from Mercer modelled a wide range of outcomes arising from different climate scenarios. They concluded that investing in a 2°C scenario leads to enhanced projected returns versus 3°C or 4°C for nearly all asset classes, regions and timeframes.[3]

Setting a new standard
Climate investing has become the new normal. Regulatory requirements, such as the Task Force on Climate-related Financial Disclosures (TCFD) and the Paris agreement, are pushing climate change to the forefront.

What would a low-carbon economy look like?
Our investment team takes a balanced view of how our economy will evolve towards a low- carbon future by investing in attractively valued companies that exhibit leadership in three categories:

Climate Mitigation: Companies that are addressing climate change in their own operations

Climate Adaptation: Companies with products and services that provide solutions to a low-carbon future

Climate Transition: Companies in carbon-heavy industries that are transforming their existing business models

Why UBS Equity Climate Aware strategy
Our new, low cost solution aims at providing investors with an innovative, rules-based strategy, designed to capitalize on the long-term transition to a low GHG emissions economy and invest more in companies at the heart of this transition, as well as those adapting their operating models.

1 The strategy applies positive and negative 'tilts' related to climate change that guides portfolio construction

2 Engaging directly with company's management to educate about best practices and encourage reporting of sustainability metrics

3 Incorporating sustainability in the investment process may lower the cost of capital and limit downside risks

1 Source: https://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2019
2 Source: https://www.wri.org/blog-series/the-26-trillion-opportunity
3 Source: Source: Mercer "Investing in a time of climate change – the sequel" 2019

A strategy that tilts toward climate change
This new strategy aims to deliver returns broadly in line with the reference index with an expected maximum tracking error of 1.00%.

A 'negative' tilt is used to reduce the size of the investment in companies that:
- have worse than average GHG emissions when converted to tons of CO_2 equivalent
- produce energy from coal
- have reserves of coal, oil and gas

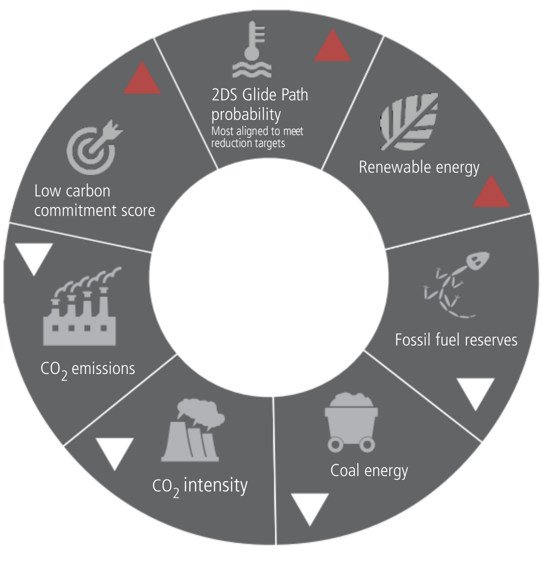
A 'positive' tilt is used to increase the size of the investment in companies that:
- provide renewable energy or supporting technology
- perform in line with globally agreed climate change goals (the beyond 2°C scenario temperature increase limit)

This positive tilt also constitutes a differentiator with respect to products solely relying on reducing a portfolio's carbon emission. UBS Equity Climate Aware Strategy offers:
- Low costs
- Lower carbon intensity than benchmark
- Tilt to renewable energy
- Low tracking error and low turnover
- Not excluding entire sub-sectors
- Alignment to forward-looking carbon reduction targets

Philosophy
Our model is constructed and based on four core elements or building blocks. By combining this multi-dimensional group of metrics, we guide portfolio construction toward a set of exposures aimed at reflecting the low GHG emission economy and the beyond 2°C scenario. Our approach is innovative and forward- looking, implementing a probabilistic framework to capture the inherent uncertainty surrounding carbon data.

Process
Glide path probability: We build a quantitative model that compares a company's carbon footprint trend with the required emission reduction implied by the beyond 2°C scenario. This approach allows us to estimate the likelihood that a company will achieve those glide path targets.

UBS climate aware rules-based portfolio



Qualitative overlay: we improve the estimates of our quantitative model with a qualitative framework. We take into account whether carbon emission is reported under the Carbon Disclosure Program (CDP) and the company's disclosure related to implementation of policies, objectives and/or initiatives on carbon efficiency.

Current carbon intensity and renewable energy: We consider information about a company's direct and indirect carbon footprint (measured as intensity levels). In order to partially capture the substitution of energy sources under the beyond 2°C scenario, we incorporate information related to both the production of renewable energy and the delivery of technology to the sector.

Fossil fuel reserves and energy production: we allow underweighting companies generating electricity from coal power stations and the reduction of exposure to companies that hold proven reserves of coal, oil or gas.

These four processes combine to form a multi-dimensional set of metrics that guide portfolio construction toward a set of exposures that aim to reflect the low GHG emissions economy.

Why UBS-AM?
Our quality indexing approach: research, innovation, efficient implementation

Stability and expertise
- Over 35 years' indexing experience, around USD 480 billion AUM (as of 31 March 2021)
- Indexing portfolio managers have been at UBS for 13 years on average

Robust, proven investment process
- Strong technology
- Close tracking and adding value
- Size advantage: not too big to face liquidity constraints on index rebalance

Wide product range, broad client base
- 300+ funds, 200+ indices
- Clients in 30+ countries
- ETFs, pooled funds, segregated mandates: focus on customization

Ian Ashment is Head of Systematic & Index Investments at UBS Asset Management. In addition to this role, he is a member of the UBS Asset Management Investment Management Committee, the EMEA Management Committee and the UK Management Committee.

> "Quantitative and qualitative factors drive construction of the portfolio to capitalize on the transition to a low GHG emissions economy."

Opportunities

- A focus on climate change, aiming to provide a lower carbon intensity than benchmark
- Highly diversified global equity strategy with focus on energy transition and reduced carbon exposure compared to its benchmark
- Not excluding entire sub-sectors, instead tilting towards renewable energy
- The strategy is aligned to forward-looking carbon reduction targets with a focus on companies performing in line with the globally agreed climate change goals (beyond 2°C scenario temperature increase)
- An active voting policy at the general meetings of companies around the world that need to adapt their business, strategy, and corporate governance in order to reduce climate risks and meet globally agreed climate change goals

Risks

- The strategy invests in equities and may therefore be subject to high volatility
- This requires an elevated risk tolerance and capacity
- Due to market volatility, the unit price may fall below the purchase price paid
- May be influenced by currency fluctuations
- May be subject to geopolitical risks

Investment guidelines

Expected maximum tracking error vs. Index	1.00% (typically 0.50%)
Active stock weight[1]	± 0.20% carbon related groups ± 0.075% rest of industry groups
Sector and country exposure[1]	± 0.50%
Industry exposure[1]	± 0.50% carbon related groups, ± 0.25% rest of industry groups
Maximum 1-way turnover[2]	10% p.a.
BARRA style factor active exposures[1]	± 0.50
Active Beta[1]	± 2%
Approximate number of stocks[1]	Close to full replication

[1] Constraints related to investment guidelines at rebalance.
[2] Maximum turnover is indicative and assumes normal market conditions. It may not reflect the realized turnover and is not a guide to the future.

Glossary

Greenhouse gases: Greenhouse gases or carbon dioxide equivalents are generally viewed as a cause of global warming potential relative to carbon dioxide. The six greenhouse gases covered by the UN Kyoto Protocol are: carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), sulfur hexafluoride (SF_6) hydrofluorocarbons (HFCs) and perfluorocarbons (PFCs). Each gas has a global warming potential (GWP) measured as the ratio of heat trapped by one metric tonne of the gas to that of one tonne of CO_2 over a specified time period.

Rules-based strategy: The UBS-AM climate aware rules-based strategy uses indexing, quantitative and sustainability research capabilities to construct a rules-based strategy that applies positive and negative 'tilts' related to climate change aspects, while aiming to deliver returns broadly in line with the underlying global equity index.

IEA scenarios: 6DS extends business as usual. Energy demand and CO_2 emissions increase by 60 percent 2013 to 2050. Average global temperatures rise by about 4°C by 2100 relative to pre-industrial levels, and continue to rise.

4DS incorporates recent pledges by countries to limit emissions and improve energy efficiency, thereby limiting long-term temperature increases to 4°C and to 3°C by 2100. It will require significant policy and technology changes compared with the 6DS.

The beyond 2DS presents an energy system transformation and emissions reductions up to 60 percent by 2050 (compared with 2013) to achieve at least a 50 percent chance of limiting average global temperature increase to 2°C.

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