



UBS Asset Management
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Who's afraid of rising rates?

Advisers' Big Day Out

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Fixed Income

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March 2018

Agenda

1. Rates are rising
2. Implications for bond market returns
3. Navigating the transition
4. How UBS can help



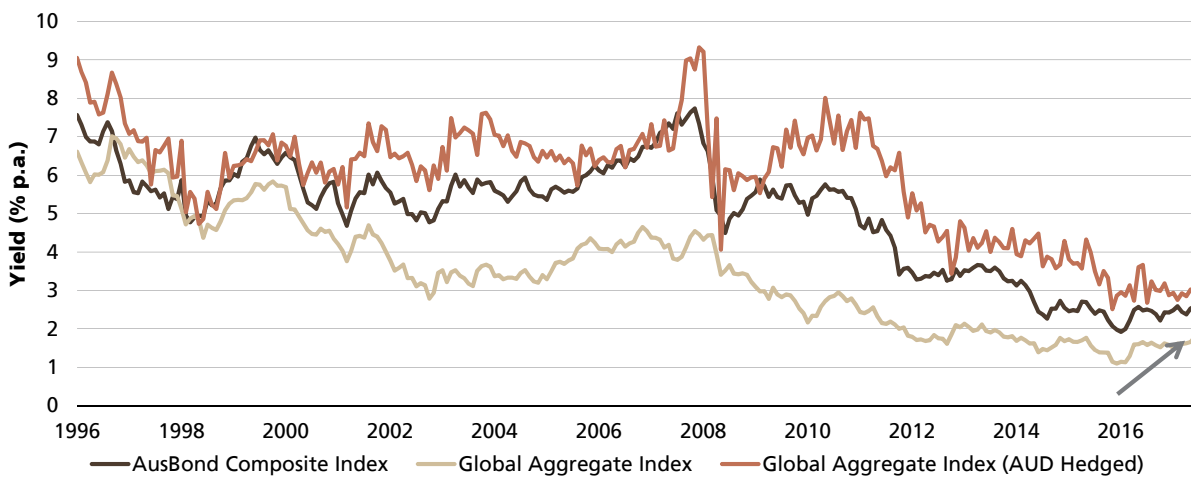
Section 1

Rates are rising



The economic and rates cycle has turned

Bond yields have been rising for over 18 months now

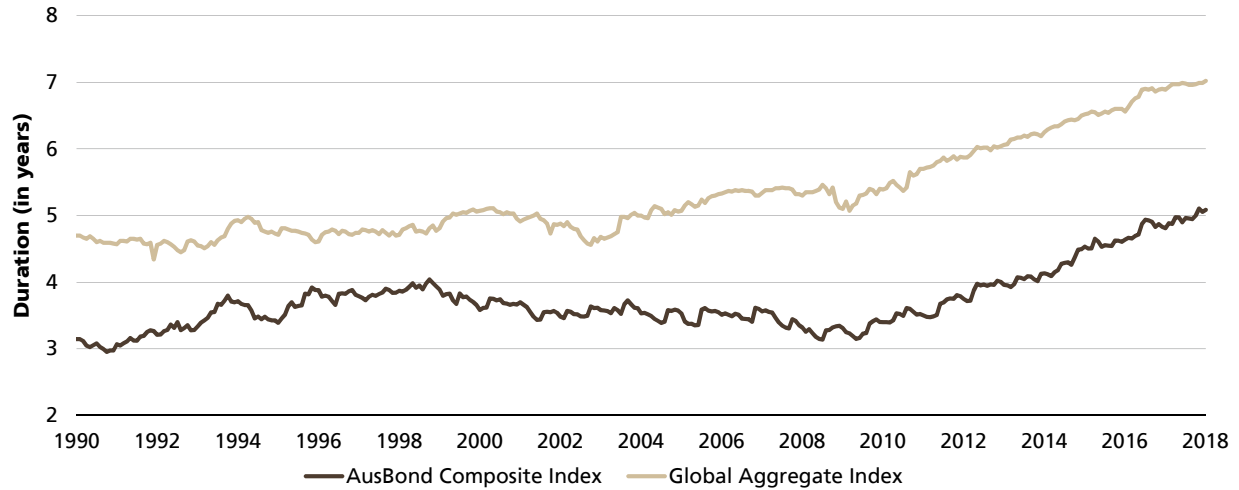


Source: UBS; Barclays; Bloomberg. Data as at 31 January 2018.



Bond prices remain very sensitive to rising rates

Market duration is still at a record high, despite the rise in global bond yields since 2016



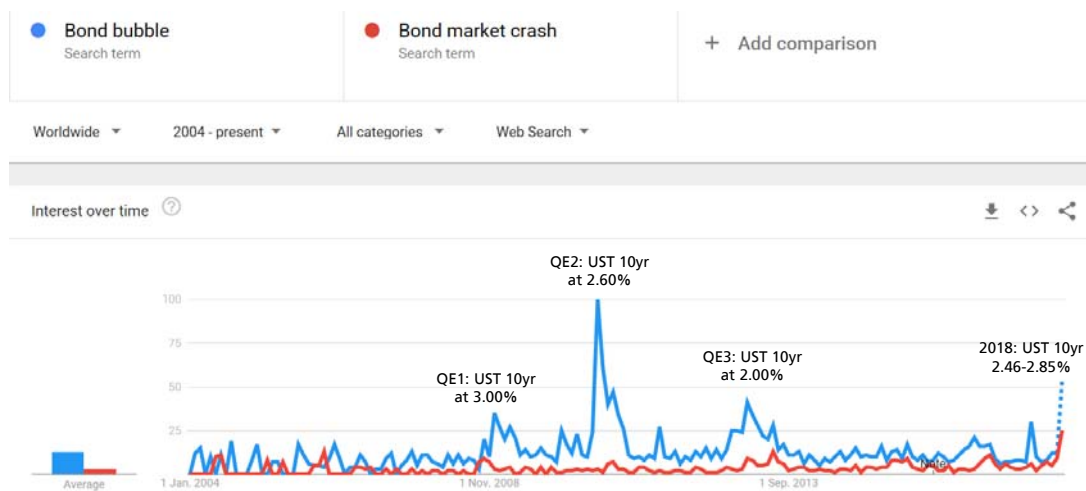
Source: UBS; Barclays; Bloomberg. Data as at 31 January 2018.



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Investors also remain sensitive to rising rates

Negatively inspired searches on Google have spiked in 2018, as interest rates have risen



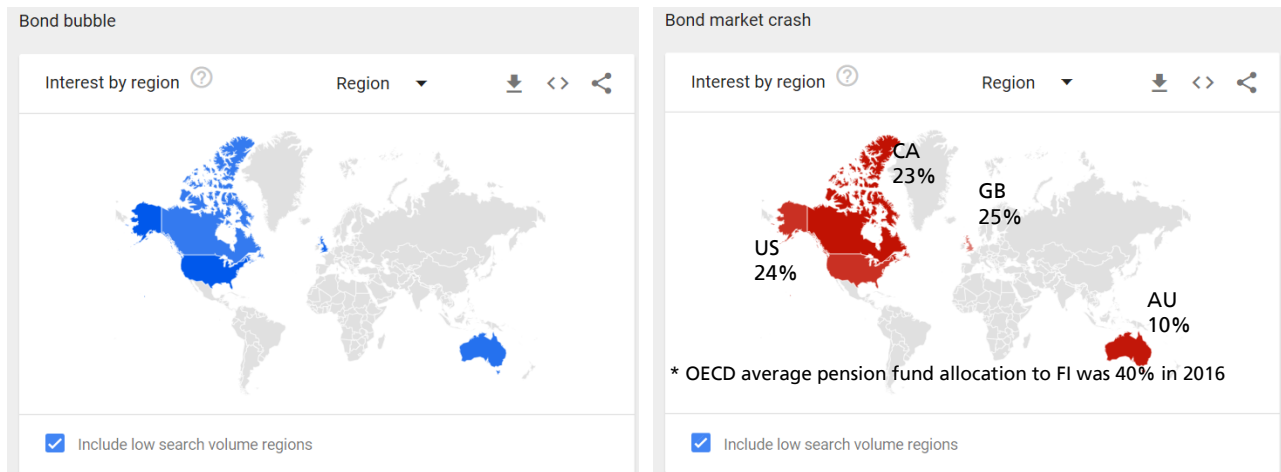
Source: Google Trends, as at 6 February 2018.



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Who's afraid of rising rates?

A limited sub-set of countries, who just happen to have lower-than-average bond holdings!



Source: Google Trends, as at 6 February 2018; OECD Pension Fund Statistics 2016.



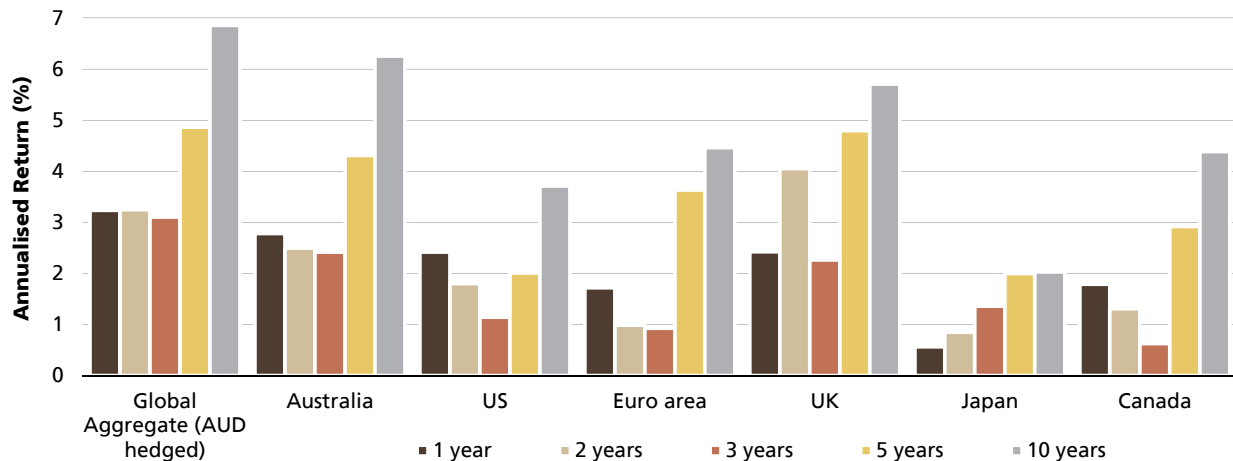
Section 2

Implications for bond market returns



Positive outcomes across the board

Despite rising yields, G7 bond markets have continued to deliver positive absolute returns



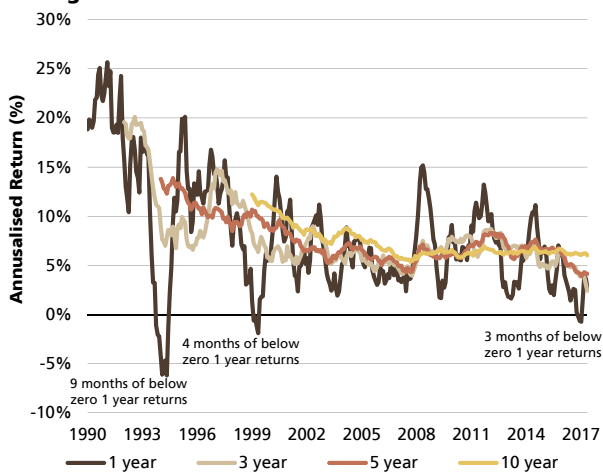
Source: UBS; Barclays. Data as at 31 January 2018. All indices depicted are expressed in local currency terms, apart from the Bloomberg Barclays Global Aggregate Index, which is hedged into AUD. Performance can be volatile and future returns can vary from past returns.



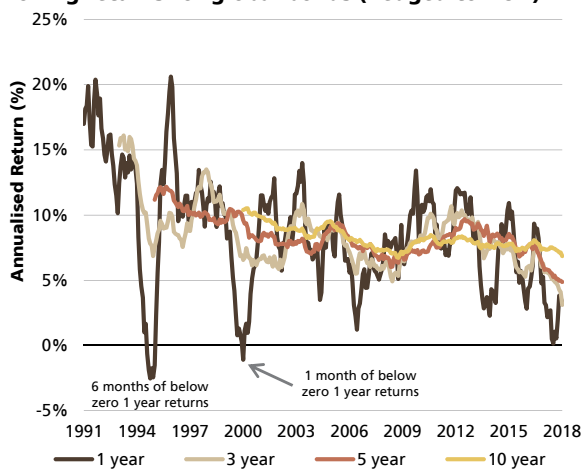
Longer term investors have seen this before

A medium-term focus for bond investing remains key, to abstract from short-term volatility

Rolling returns for Australian bonds



Rolling returns for global bonds (hedged to AUD)

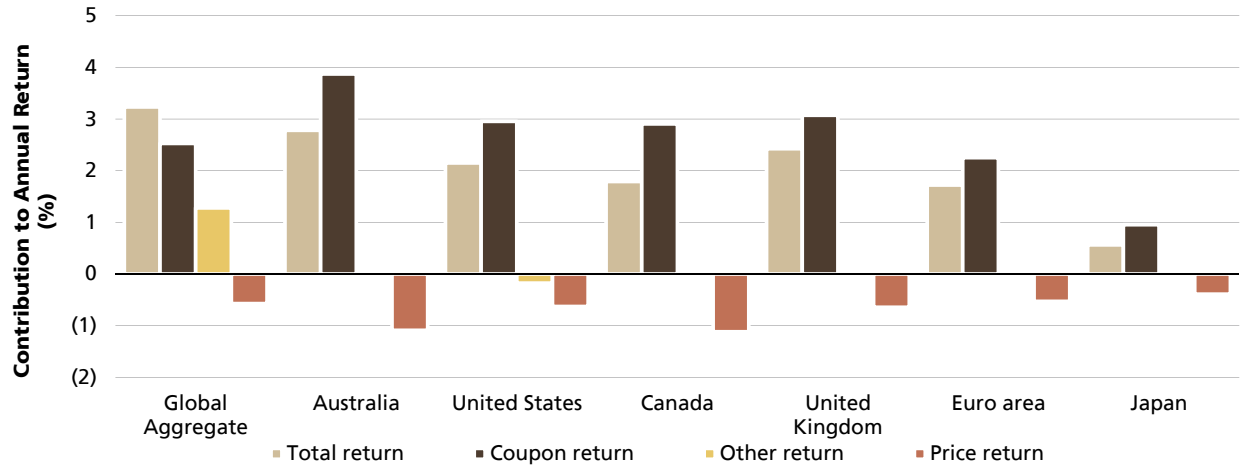


Source: UBS; Barclays; Bloomberg. Data as at 31 January 2018. Performance can be volatile and future returns can vary from past returns.



How did bond returns withstand the rise in rates?

Income has cushioned total returns, and been the key defence against price declines



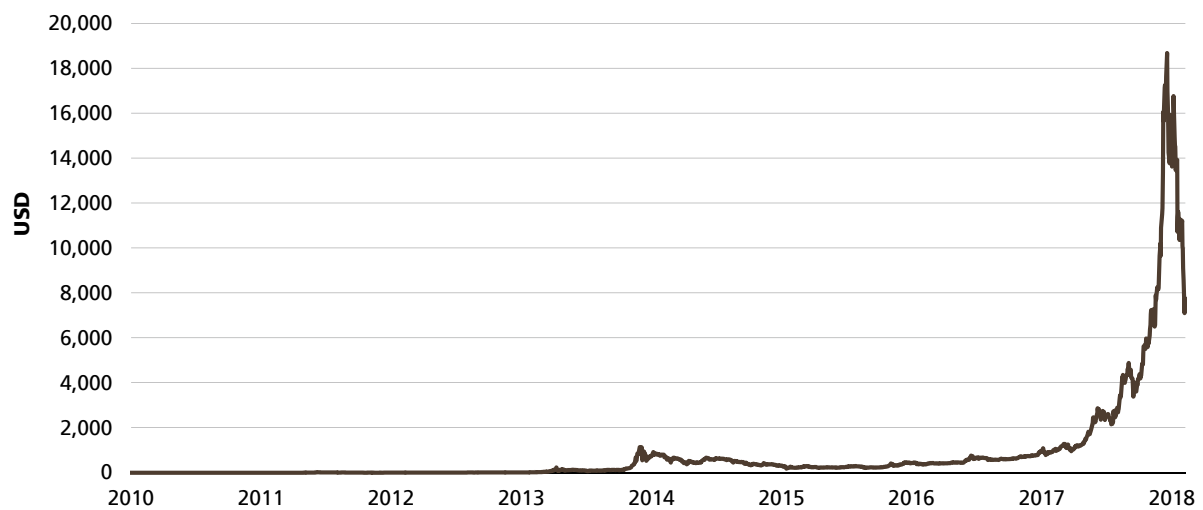
Source: UBS; Barclays. Data as at 31 January 2018. Performance for the Bloomberg Barclays Global Aggregate Index is hedged to AUD; all other markets are expressed in local currency terms. Performance can be volatile and future returns can vary from past returns.



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Assets without income have no in-built cushions

Bitcoin / U.S. Dollar exchange rate



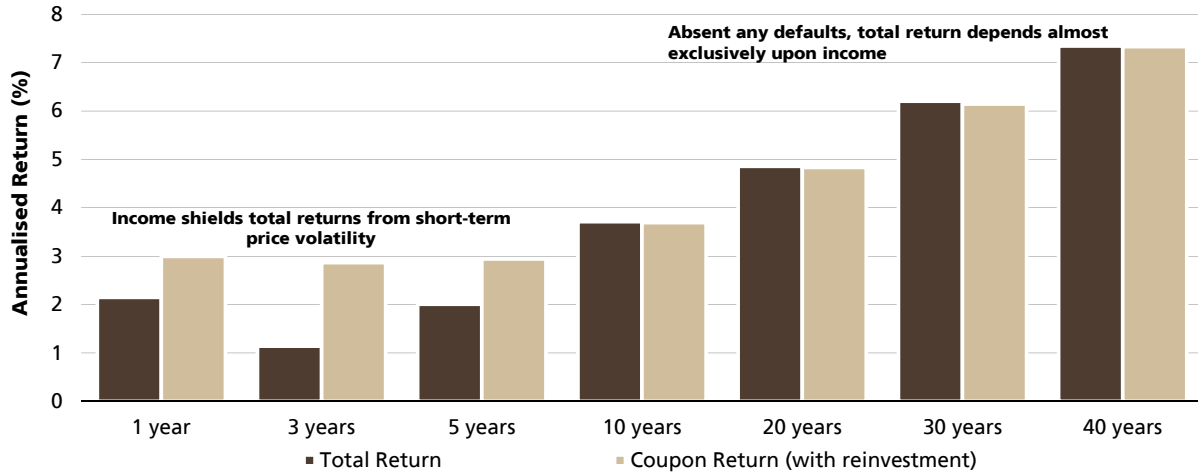
Source: Bloomberg. Data as at 7 February 2018.



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In the long run, income drives bond returns

Sources of return for the Bloomberg Barclays U.S. Aggregate Index



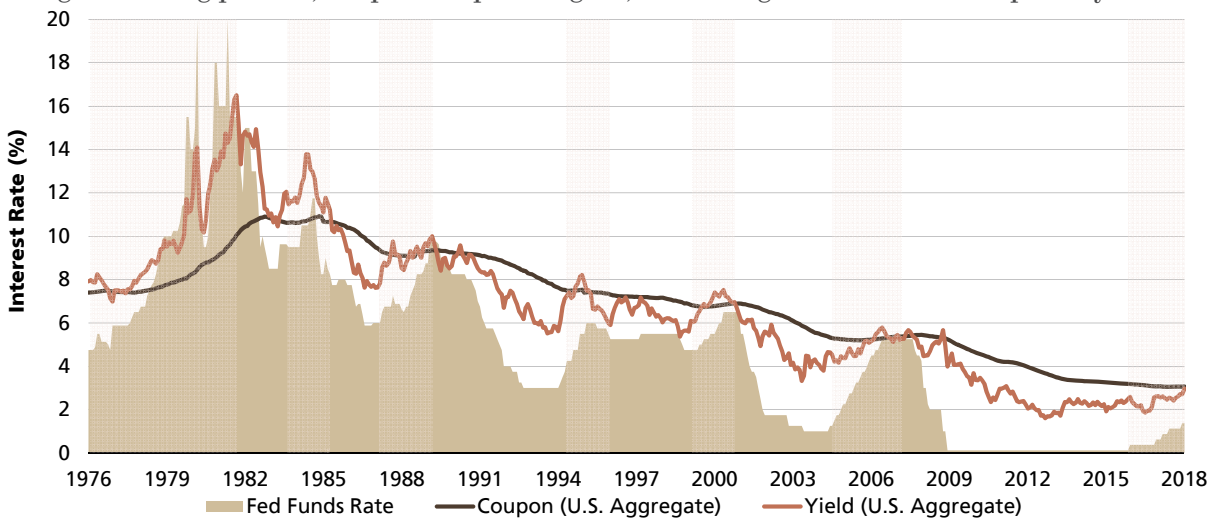
Source: UBS; Barclays. Data as at 31 January 2018. Performance can be volatile and future returns can vary from past returns.



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Rising interest rates equals higher income

During Fed hiking periods, coupons re-price higher, and cash gets reinvested at superior yields



Source: UBS, Barclays, Bloomberg. Data as at 31 January 2018.



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Section 3

Navigating the Transition



Navigating towards a higher income world

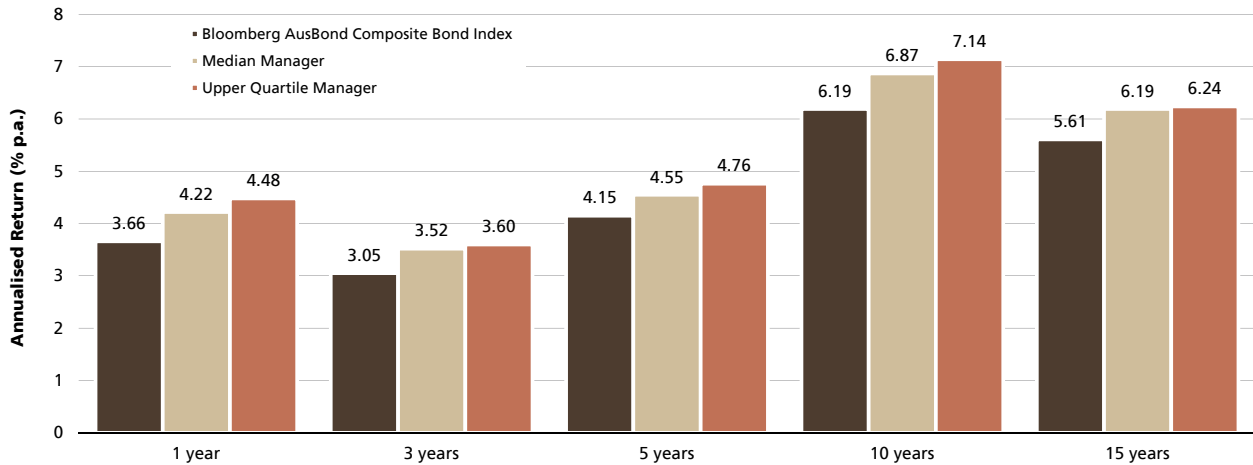
Short-term adjustment of bond prices will pave the way for **higher future income**



The need for active management, right now

An active manager is the best partner to have as we transition to a higher income world

Performance outcomes for Core Australian Fixed Income



Source: Mercer Investment Performance Survey, December 2017.

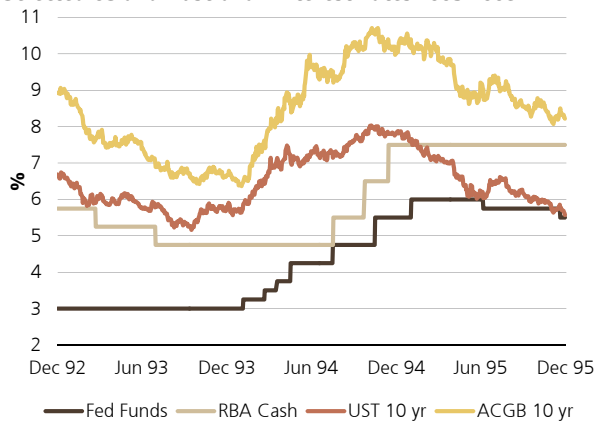


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The ghosts of 1994...

Central bank action was aggressive; market expectations were re-adjusted forcefully

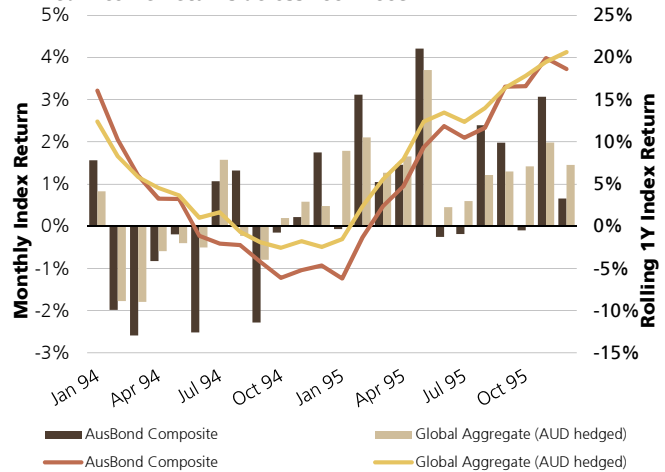
Selected US and Australian Interest Rates 1993-1995



Source: UBS; Bloomberg.



Fixed Income Returns across 1994-1995

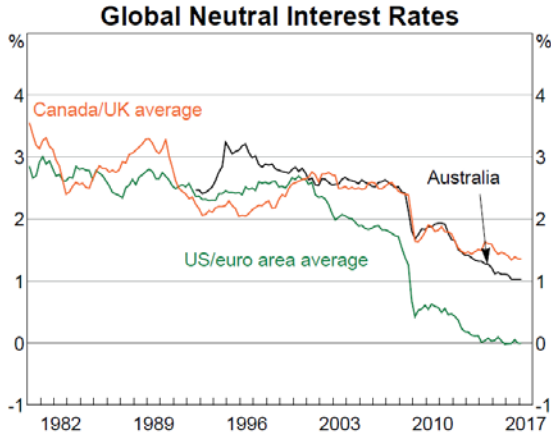


Source: UBS; Bloomberg.

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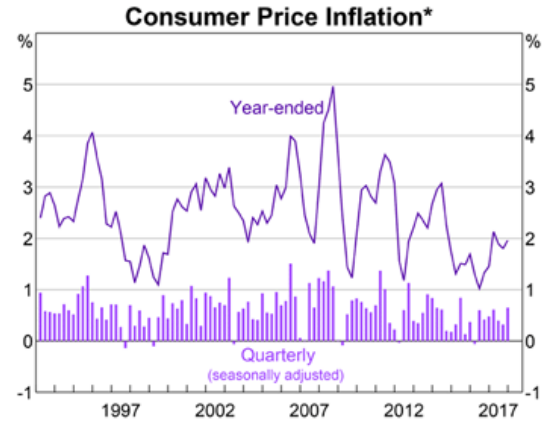
The ghosts of 1994... should finally be laid to rest!

Why history won't repeat itself, and cash rates are not going back above 5%



Sources: Holston, Laubach and Williams (2016); Laubach and Williams (2015); Lubik and Matthes (2015); RBA

Source: RBA Bulletin, September Quarter 2017



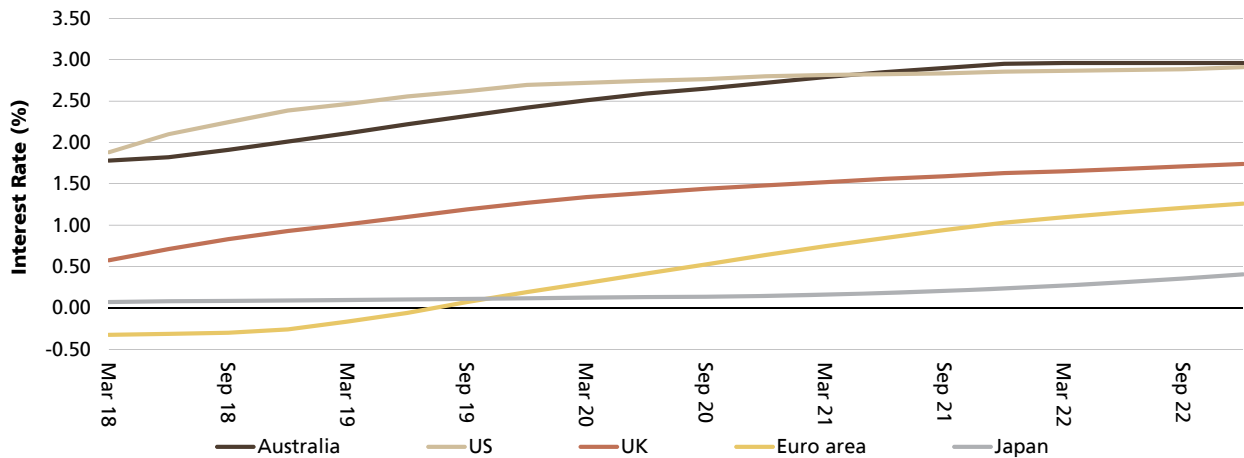
* Excluding interest charges prior to the September quarter 1998 and adjusted for the tax changes of 1999-2000
Sources: ABS; RBA



Looking forward, who's still afraid of rising rates?

Markets are already priced for higher global interest rates, cash peaks under 3%

Implied 3-month yields from futures markets



Source: UBS; Bloomberg. Data as at 31 January 2018.

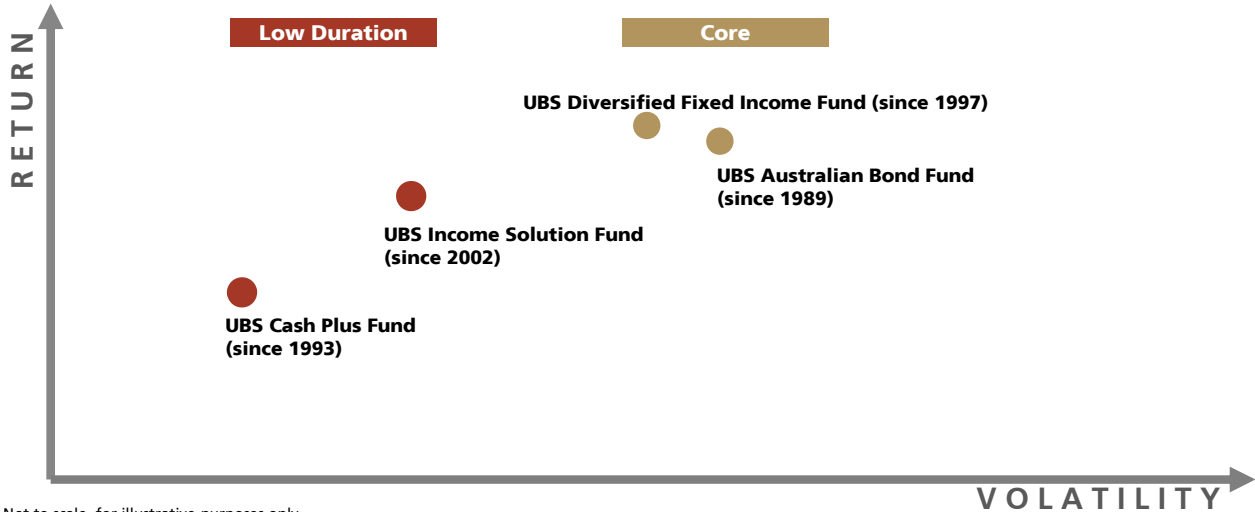


Section 4

How UBS can help



Fixed income solutions at UBS

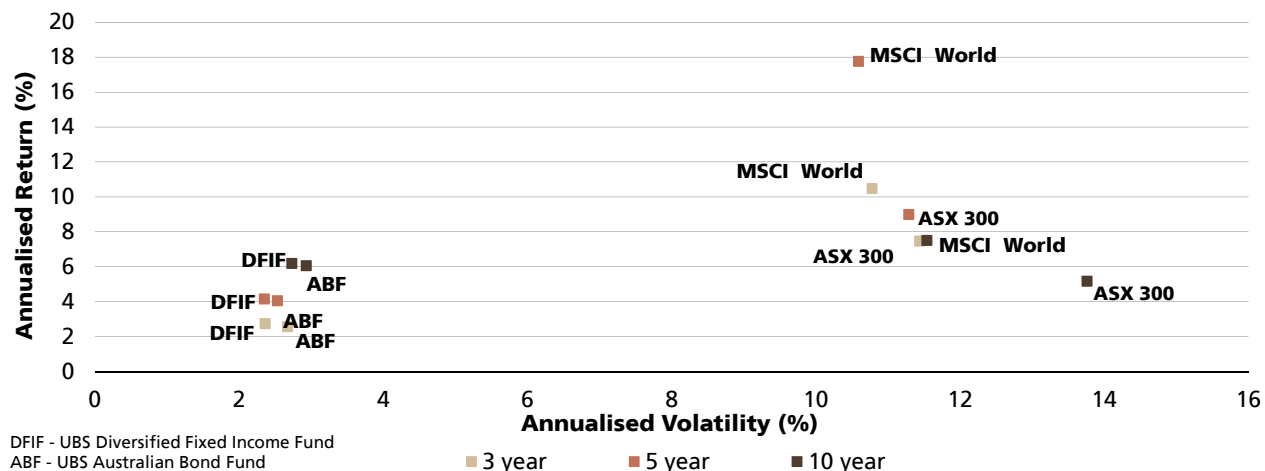


Not to scale, for illustrative purposes only



UBS bond funds provide a core defensive anchor

Bonds add the balance to a balanced portfolio, dampening volatility across the cycle



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A long and distinguished pedigree

Performance (net) as of 31 January 2018

	1 Year %	3 Years % pa	5 years % pa	Since Inception* % pa
UBS Cash-Plus Fund	2.40	2.49	2.78	5.01
Bloomberg AusBond Bank Bill Index	1.75	2.02	2.32	4.91
Added Value	0.65	0.47	0.46	0.10
UBS Income Solution Fund^ (including Franking credits)	5.31	4.29	4.46	5.59
RBA Official Cash Rate**	1.50	1.93	2.27	4.34
Added Value	3.81	2.36	2.19	1.25
UBS Australian Bond Fund	3.30	2.57	4.06	8.04
Bloomberg AusBond Composite 0+ Yr Index	2.75	2.41	4.14	7.98
Added Value	0.55	0.16	(0.08)	0.06
UBS Diversified Fixed Income Fund	3.91	2.75	4.16	6.23
50% Bloomberg AusBond Composite 0+ Yr Index / 50% Bloomberg Barclays Global Aggregate (\$A hedged)	3.00	2.76	4.50	6.63
Added Value	0.91	(0.01)	(0.34)	(0.40)

*Inception dates –UBS Cash-Plus Fund: 6 April 1993; UBS Income Solution Fund: 17 April 2002; UBS Australian Bond Fund: 30 November 1989; UBS Diversified Fixed Income Fund: 31 January 1997.

**Prior to 1 February 2017, the benchmark was the Bloomberg Ausbond Bank Bill Index.

^Formerly UBS Diversified Credit Fund.

Performance figures are net of ongoing fees and expenses. Performance has been prepared in accordance with 2016 GIPS standards. The performance figures quoted are historical, calculated using end of month redemption prices, and do not allow for the effects of income tax or inflation. Total returns assume the reinvestment of all distributions. Performance can be volatile and future returns can vary from past returns.



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Accessing the breadth of UBS fixed income solutions

Platform	Cash	Cash Plus	Income Solution	Australian Bond	Diversified Fixed Income
ANZ Grow Wrap	Yes		Yes	Yes	Yes
Asgard			Yes	Yes	Yes
BT Wrap			Yes	Yes	Yes
CFS FirstChoice					Yes
CFS FirstWrap	Yes		Yes	Yes	Yes
Hub 24	Yes	Yes	Yes	Yes	Yes
IOOF	Yes	Yes	Yes	Yes	Yes
Macquarie Wrap	Yes	Yes	Yes	Yes	Yes
MLC Navigator	Yes	Yes	Yes	Yes	Yes
Netwealth					Yes
North	Yes	Yes	Yes	Yes	Yes
Oasis			Yes	Yes	Yes
OneAnswer			Yes	Yes	Yes
mFunds			Yes	Yes	Yes
Direct investment	Yes	Yes	Yes	Yes	Yes

Source: UBS Asset Management, as at 31 January 2018.



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Summary

1. Bond market returns are driven by income, not capital, in the long run.
2. Active managers, like UBS, can help investors to navigate the transition.
3. Higher rates now = higher future income = higher long-term returns.



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