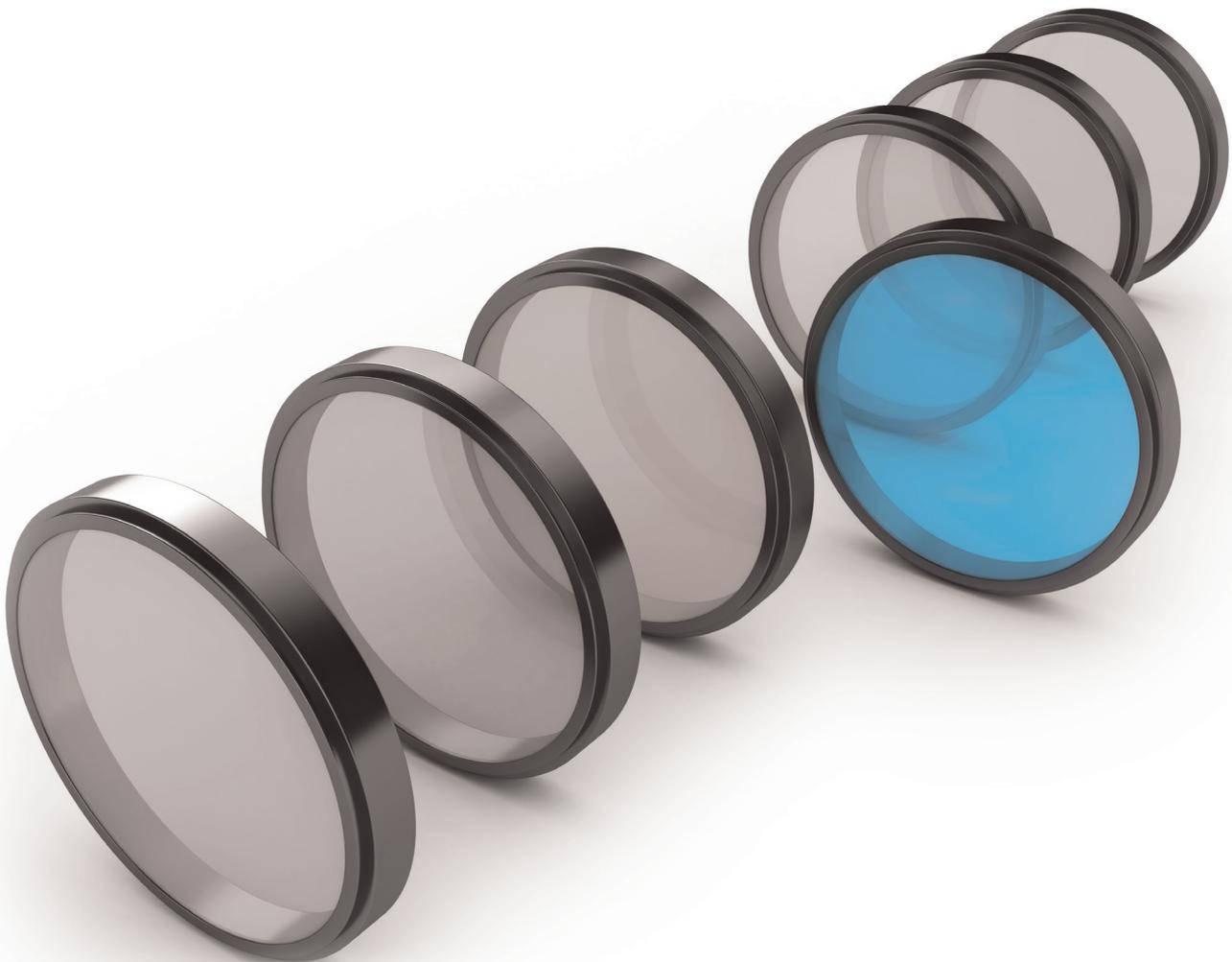


# Alternatives to beta?



# What is alternative beta?

Alternative beta strategies are referred to by many different names – smart beta, strategy indices, customised indexing – but, simply stated, encompass any strategy that tracks an index whose methodology is driven by some rule or factor(s), other than simple market capitalisation.

Traditional indices, those which are weighted on a market capitalisation basis, carry many advantages – simplicity, transparency, broad diversification/ economic representation, scalability, low turnover, and reduced transaction costs. However they have a systematic flaw. As a stock’s price increases, so does the weight of it within the index. Unless the market is perfectly efficient (i.e. the market correctly prices all companies), investors using market capitalisation weighted indices may end up holding more stock that is overvalued and less of those undervalued – the opposite of what is most sensible.

Due to these drawbacks, in recent times, there has been a significant move away from the mainstream indices to non-market capitalisation weighted and other alternative indices.

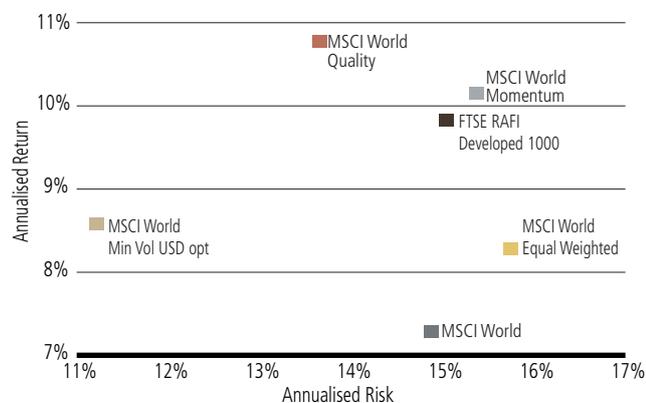
## Equity factors captured by alternative indices

As shown in Table 1, there are a number of equity factors which can be considered as part of an alternative index. The size factor tends to be embedded in some alternative indices; by construction they typically comprise smaller companies compared to market cap indices. Momentum has outperformed value, size and market factors historically, but is characterised by very high turnover, high volatility and times of significant under-performance. Value, volatility and quality factors have persisted through time, based on strong theoretical and empirical foundation. They have significant academic research backing and display low correlations with one another, thus providing potential for reduced performance cyclicality.

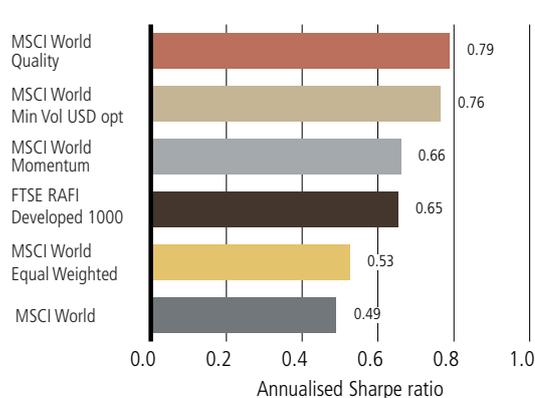
Overall, historical evidence shows alternative indices have outperformed the market over the long term (see Chart 1), but each factor typically experiences a different performance pattern. Thus choosing a blend of alternative indices can provide diversification benefits.

**Chart 1: Indices annualised performance: 31 May 1988 – 31 December 2016**

Global indices: annualised return and risk



Global indices: annualised sharpe ratio



Source: UBS Asset Management, Bloomberg, FTSE Russell, MSCI, Research Affiliates, RIMES. TR gross index performance data in USD to 31 December 2016. Note: Annualised data from 31 May 1988 (earliest date when data is available for all examined indices) to 31 December 2016. Annualised monthly standard deviation of index returns is used as a measure of risk. Data for alternative indices contains live and back-tested data sourced from index providers (see 'Index data' page). Past performance is not a reliable indicator of future results.

**Table 1: Equity factors captured by alternative indices**

<b>Value</b>	Undervalued stocks, as measured by fundamental metrics (e.g. Book Value/Price, Earnings/Price, Dividend/Price), tend to outperform overvalued stocks
<b>Volatility</b>	Low volatility stocks tend to outperform high volatility stocks: known as 'low volatility anomaly' because it contradicts conventional finance wisdom of risk-return trade-off
<b>Quality</b>	High quality stocks, as measured by fundamental metrics (e.g. profit margin, earnings growth, return on equity, debt-to-equity), tend to outperform low quality stocks
<b>Size</b>	Small cap stocks, as measured by market capitalisation, tend to outperform large cap stocks
<b>Momentum</b>	Stocks with recent (3-12 months) high price performance tend to continue their high price performance in the near term (3-12 months)

# Introducing our alternative beta offering

The UBS Indexing team have been managing portfolios benchmarked to alternative beta indices since early 2010. In addition to our funds listed opposite, we can custom blend alternative beta indices depending on clients' individual requirements. Our focus is on innovative solutions and we continually review our offering to ensure we are meeting your needs.

## The benefits of index blending

We believe that alternative beta indices that exploit value, volatility and quality factors could provide investors with significant benefit.

Our detailed proprietary research has shown that over time blending alternative beta indices exploiting different equity return factors can provide investors with a more efficient risk / return profile and diversification benefits than simply by investing in one. Why? Each factor typically experiences a different performance pattern. For instance, indices with value-based methodology such as the Research Affiliates Fundamental Index (RAFI) series tend to outperform the market in a rising or strong macro environment, whereas indices that exploit quality and low volatility factors tend to be more defensive.

"Our proprietary research suggests that investors can benefit from a blended approach. We believe what sets us apart is utilising this research with clients in order to deliver the optimal blend for their needs."

Ian Ashment, Co-Head of Systematic Investments

We appreciate that each investor's needs are different. This is where we believe our expertise and experience may be most beneficial. By working in partnership we aim to deliver a diversified blend of indices to meet your desired objective. This will include not only agreeing the blend, but other factors such as when to rebalance in order to maintain the agreed target allocation in the most efficient manner possible.

New alternative beta indices are frequently being launched and we continuously research the market to ensure we are able to offer access to these new and innovative solutions.

## Value

### UBS Life Developed World Equity Fundamentally Weighted Index Fund†

→ Benchmarked to FTSE RAFI Developed 1000 Index

### UBS Life All World Equity Fundamentally Weighted Index Fund

→ Benchmarked to FTSE RAFI All-World 3000 Index

### UBS FTSE RAFI Developed 1000 Index Fund

→ Benchmarked to FTSE RAFI Developed 1000 Index

- FTSE RAFI Index Series selects and weights index constituents using four fundamental metrics: dividends, cash flows, sales and book value
- FTSE RAFI Developed 1000 Index comprises 1000 companies with the largest RAFI fundamental scores selected from the FTSE Developed All Cap Index universe
- FTSE RAFI All-World 3000 Index comprises 3000 companies with the largest RAFI fundamental scores selected from the FTSE Global All Cap Index universe
- Value exposure embedded in stock selection and index construction methodology
- Simple and transparent construction methodology, high scalability
- Tends to display pro-cyclical performance patterns and historically has outperformed the market when the macro environment is rising or strong

## Volatility

### UBS Life World Equity Optimised Volatility Index Fund

→ Benchmarked to MSCI World Minimum Volatility GBP optimised Index

### UBS MSCI World Minimum Volatility Index Fund

→ Benchmarked to MSCI World Minimum Volatility GBP optimised Index

- Aims to deliver market return with less volatility
- Historically has performed as expected, i.e. has reduced volatility by 20-25% vs. market cap without materially compromising returns
- MSCI Minimum Vol indices have the longest live track record (since 2008) in the low volatility index space
- Tends to display defensive performance patterns and historically has outperformed the market when the macro environment is falling or weak

## Quality

### UBS Life World Quality Companies Index Fund

→ Benchmarked to MSCI World Quality Index

- Quality score based on three fundamental metrics (return on equity, earnings growth and leverage) which characterise high quality growth companies
- Comprises 300 stocks with the highest quality score from the MSCI World Index universe
- Tends to display defensive performance patterns and historically has outperformed the market when the macro environment is falling or weak

## Why UBS for alternative beta?

- Over 30 years' experience of managing passive portfolios with total AuM for passive assets of over GBP 199 billion<sup>1</sup>
- Managing portfolios benchmarked to alternative beta indices since early 2010 and with AuM of over GBP 13 billion<sup>1</sup>; during this time we have seen significant growth into our alternative beta offering
- In-house alternative beta analytical framework, the 4 keys, allowing us to research, analyse, blend and implement efficiently alternative beta portfolios for our clients
- Our alternative beta fund blends outperformed the market by more than 1.5% p.a. on average since inception,<sup>2</sup> in line with our research
- Highly experienced, stable and well-resourced team
- Supported by a globally integrated investment platform
- Proven investment process
- Consistent, long-term track record demonstrating added-value with downside risk controls
- Strong collaboration with FTSE Russell, MSCI, Research Affiliates and other leading index providers

## Interested?

For further information on our alternative beta offering, or our indexing capabilities generally, please do not hesitate to contact us.

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† Includes currency hedged version

<sup>1</sup> Source: UBS Asset Management, as at 31 March 2017.

<sup>2</sup> Source: UBS Asset Management, annualised data since inception on 31 March 2014 to 31 March 2017.

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