

News and views

PACE Select Newsletter 2023: Third Quarter

Q3 2023



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Performance highlights Q3 2023

The third quarter got off to a strong start for equity investors, with the MSCI All Country World Index returning 3.7% over the month. The US market led the advance among developed markets with a 3.2% return for the S&P 500, building on an 8.7% gain in the second quarter. Notably, the equal-weighted version of the index—which dilutes the impact of the top tech stocks that have dominated the year-to-date rally—did better than the main index, returning 3.5%. The risk-on mood also helped riskier parts of the fixed income market, including US dollar emerging market sovereign debt and high yield bonds.

However, after a month of gains in July, global equity markets declined in August. Chief among market drivers was contradictory evidence—and conflicting interpretations—of economic data, asset pricing, and the outlook for Fed policy. In fixed income, US high-grade (government) and investment grade debt lost money in August, following rises in US government bond yields.

Risk-off sentiment continued in September, with global equities and high-quality bonds fell in tandem in September, capping off a difficult third quarter for investors. The main driver for losses came from central bank rhetoric and moves, with many making it clear that it remains too soon to declare victory against inflation by firmly signaling an end to monetary tightening. The third quarter was broadly negative for equity markets, with only the UK and Japan closing the quarter in positive territory.

PACE Select performance was mixed given the contrasting macro backdrop and volatile environment. Three of the seven equity funds (P-share) outperformed their benchmarks. Four of the seven equity funds ranked better than peer median compared to their respective Morningstar peers. Amongst the fixed income funds, four of the six funds (P-shares) outperformed their benchmarks. Four of the six funds ranked better than their Morningstar peer median.

Read more in [‘July 2023: Month in Review’](#), [‘August 2023: Month in Review’](#), and [‘September 2023: Month and Quarter in Review’](#) published by the Chief Investment Office GWM.

PACE on the move: The most impactful changes in Q3

Within **Alternative Strategies Investments** (“Fund”) the PACE portfolio management team (PM team) reallocated assets from PCJ, a market neutral equity strategy, to cash. As short-term rates increased meaningfully, with the UBS Money Market Fund yielding 5.23% at the end of the quarter, the PM team believes that “cash” offers reasonable return relative to PCJ.

Where was the highest alpha?

Small/Medium Co Value Equity: The fund (P-share, net of fund fees) outperformed the benchmark by 1.83% for the quarter (A-share, net of fund fees, outperformed by 1.80%), placing it at the 40th percentile within the Small Value Morningstar category, which is comprised of 489 funds in total. The fund rebounded from a more challenging Q2. All three managers outperformed in the quarter. Sapience, a relative value manager, outperformed due to stock selection in consumer discretionary and technology. Huber, a deep value manager, also meaningfully outperformed due to an overweight as well as stock selection in energy.

Intermediate Fixed Income: The fund (P-share, net of fund fees) outperformed the benchmark by 1.13% in the quarter (A-share, net of fund fees, outperformed by 0.97%), placing it at the 14th percentile within the Intermediate Core Bond Morningstar category, which is comprised of 478 funds in total. Outperformance was a result of an overweight to asset-backed securities and the deliberate choice of no allocation to mortgage-backed securities (MBS). Wider spreads and a muted demand from foreign investors and banks were significant headwinds to MBS. Investment-grade corporate bonds including senior loans and high yield bonds, also played a meaningful role in performance.

Where was the lowest alpha?

International Emerging Markets Equity: The fund (P-share, net of fund fees) underperformed the benchmark by 1.41% for the quarter (A-share, net of fund fees, underperformed by 1.51%), placing it at the 69th percentile within the Diversified Emerging Markets Morningstar category, which is comprised of 853 funds in total. Of the three sub-advisors, William Blair, a quality growth manager, struggled due to stock selection in financials, industrials, and technology. Furthermore, the MSCI Emerging Markets Growth Index underperformed the MSCI Emerging Markets Value Index in excess of 4%, which was an additional headwind.

Global Fixed Income: The fund (P-share, net of fund fees) underperformed the benchmark by 0.67% in the quarter (A-share, net of fund fees, underperformed by 0.72%), placing it at the 83rd percentile within the Global Bond Morningstar category, which is comprised of 195 funds in total. Driving this underperformance were two primary factors: duration and currency bets. Specifically, the overweight to U.S. duration, a bearish tilt towards the U.S. dollar, and a long position in the Japanese yen all detracted from performance.

Did you know...

...that the correlation relationship between Stocks and Bonds is currently positive?

The delicate balance between stock and bond returns plays a crucial role in the world of portfolio management and diversification. For much of the early 21st century this relationship was characterized by consistently negative correlation, providing investors with a reliable hedge in times of equity market turbulence. However, history tells us this wasn't always the case, and economic shifts, such as heightened uncertainty about inflation, can make a meaningful impact. For example, investors regularly experienced positive stock-bond correlations in the 1970's, 80's and 90's when inflation was relatively high. This shift carries profound implications for investors, potentially increasing portfolio risk or necessitating strategic asset allocation adjustments.

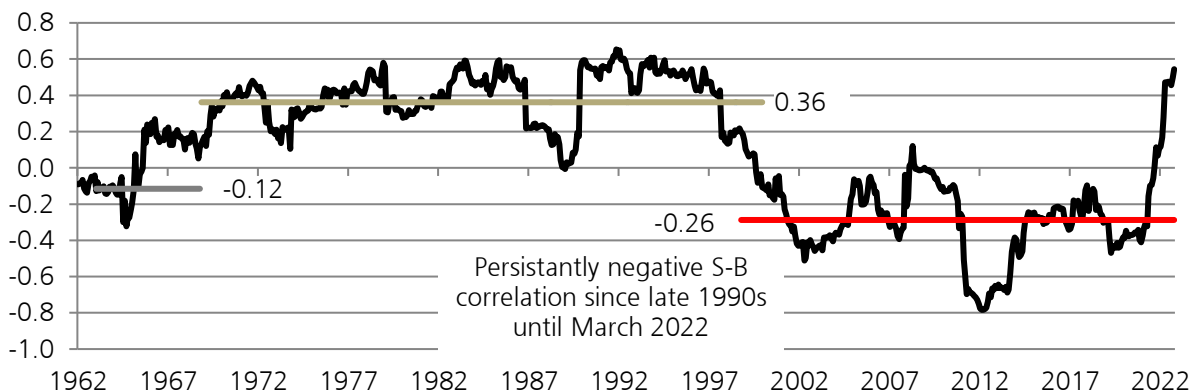
What causes stock-bond correlation to be positive or negative? Examining historical performance and macroeconomic metrics, a clear relationship between inflation and stock-bond correlations can be seen – The level of inflation is critical in determining this relationship. In the figure below, when Core CPI inflation is persistently above 2.5% (e.g., early 1970's through late 1990's), we generally see a positive stock-bond correlation. On the flip side, when Core CPI inflation is below that threshold (e.g., early 2000's through early 2022), we typically see a negative correlation relationship.

The implications for portfolio management change with the volatility and levels of inflation. A multi-asset portfolio thrives in an environment characterized by a negative correlation relationship between stocks and bonds, whereas a positive correlation creates potential risks with a diversification deficit in the event of drawdowns (e.g., 2022).

How should investors seek to protect themselves in a positive stock-bond correlation environment? In the current environment marked by this positive relationship, we see the role of alternatives acting as an effective hedge in a balanced portfolio. PACE Alternative Strategies Investments is our core liquid alternative fund that can act as a diversification tool in a multi-asset portfolio. It could help lower the overall volatility of the portfolio and augment the lack of diversification caused by positive stock-bond correlation.

Figure: Stock-Bond Correlation

Rolling 36 Month Values: S&P 500 with SBBI Long Gov



Data range from December 1962 - September 2023
Source: Morningstar Direct. Analysis by UBS Asset Management

Looking ahead

A few months ago, the US economy achieving a "soft landing" seemed challenging. Inflation was well above target, the labor market was extraordinarily tight, and the financial system was straining under the pressure of higher interest rates.

Today, while a 'soft landing' is not yet assured, the economy looks much closer to being "in balance." Inflation is receding, meaning major central banks are closer to the end of the tightening cycle. The US labor market has cooled, but not so much as to push the economy into a recession. Earnings have improved, with US-listed company profit expectations now back at all-time highs. Yet global equities are little changed over this period and bond returns have been muted. In our view, this creates an opportune moment for investors.

What should investors do? Over the next six to 12 months, we expect decent returns across asset classes and expect these returns to prove durable. Investors can tap into today's attractive opportunity set across asset classes in a diversified portfolio that is customized to their risk/return/time horizon profile such as the PACE Select Program. Balancing equities, bonds, and alternatives in a portfolio can increase the dependability of returns through market cycles.

Read more in '[4Q Outlook: Back in Balance?](#)' published by the Chief Investment Office GWM.

Disclosures:

PACE Funds Performance at a glance (%)

Average annual total returns for periods ended 09/30/23

	1yr	3yr	5yr	10yr
PACE Mortgage-Backed Securities				
Before deducting maximum sales charge				
Class A ¹	0.11	-5.52	-0.95	0.35
Class Y ²	0.26	-5.33	-0.72	0.59
Class P ³	0.36	-5.30	-0.71	0.59
After deducting maximum sales charge				
Class A ¹	-3.61	-6.72	-1.71	-0.03
PACE Intermediate Fixed Income				
Before deducting maximum sales charge				
Class A ¹	2.11	-5.05	0.02	0.56
Class Y ²	2.37	-4.81	0.27	0.80
Class P ³	2.47	-4.78	0.27	0.81
After deducting maximum sales charge				
Class A ¹	-1.69	-6.27	-0.74	0.17
PACE Strategic Fixed Income				
Before deducting sales charge				
Class A ¹	2.63	-4.49	0.60	1.49
Class Y ²	2.90	-4.25	0.85	1.73
Class P ³	2.90	-4.26	0.84	1.74
After deducting sales charge				
Class A ¹	-1.24	-5.71	-0.17	1.11
PACE Municipal Fixed Income				
Before deducting maximum sales charge				
Class A ¹	2.44	-2.20	0.81	1.63
Class Y ²	2.65	-1.97	1.07	1.87
Class P ³	2.61	-1.98	1.05	1.88
After deducting maximum sales charge				
Class A ¹	0.12	-2.95	0.36	1.40
PACE Global Fixed Income				
Before deducting maximum sales charge				
Class A ¹	0.33	-6.90	-1.93	-0.65
Class Y ²	0.58	-6.75	-1.76	-0.47
Class P ³	0.59	-6.72	-1.73	-0.46
After deducting maximum sales charge				
Class A ¹	-3.49	-8.08	-2.68	-1.02
PACE High Yield				
Before deducting maximum sales charge				
Class A ¹	11.25	1.59	2.10	3.46
Class Y ²	11.49	1.76	2.30	3.68
Class P ³	11.40	1.68	2.24	3.63
After deducting maximum sales charge				
Class A ¹	7.03	0.30	1.33	3.07
PACE Large Co Value Equity				
Before deducting maximum sales charge				
Class A ¹	19.18	14.38	5.49	7.73
Class Y ²	19.50	14.67	5.73	7.99
Class P ³	19.46	14.67	5.74	7.99
After deducting maximum sales charge				
Class A ¹	12.61	12.25	4.30	7.12

PACE Large Co Growth Equity

Before deducting maximum sales charge

Class A ¹	22.59	4.43	9.76	11.81
Class Y ²	22.94	4.70	10.04	12.10
Class P ³	22.91	4.69	10.03	12.09
After deducting maximum sales charge				
Class A ¹	15.82	2.48	8.52	11.18

PACE Small/Medium Co Value Equity

Before deducting maximum sales charge

Class A ¹	7.86	13.04	3.85	6.59
Class Y ²	8.07	13.28	4.08	6.80
Class P ³	8.08	13.25	4.04	6.76
After deducting maximum sales charge				
Class A ¹	1.93	10.93	2.68	5.99

PACE Small/Medium Co Growth Equity

Before deducting maximum sales charge

Class A ¹	8.75	4.10	3.79	7.30
Class Y ²	9.06	4.33	3.99	7.50
Class P ³	9.04	4.28	3.96	7.46
After deducting maximum sales charge				
Class A ¹	2.79	2.16	2.62	6.70

PACE International Equity

Before deducting maximum sales charge

Class A ¹	26.63	6.72	3.76	4.26
Class Y ²	26.88	6.99	4.03	4.55
Class P ³	26.96	6.99	4.04	4.55
After deducting maximum sales charge				
Class A ¹	19.65	4.74	2.59	3.68

PACE International Emerging Markets Equity

Before deducting maximum sales charge

Class A ¹	12.86	-0.43	1.34	1.37
Class Y ²	13.16	-0.18	1.60	1.63
Class P ³	13.14	-0.18	1.60	1.62
After deducting maximum sales charge				
Class A ¹	6.61	-2.30	0.21	0.80

PACE Global Real Estate Securities

Before deducting maximum sales charge

Class A ¹	2.21	1.32	-1.82	1.65
Class P ³	2.41	1.58	-1.55	1.90
After deducting maximum sales charge				
Class A ¹	-3.41	-0.56	-2.93	1.08

PACE Alternative Strategies

Before deducting maximum sales charge

Class A ¹	4.51	2.71	2.76	2.41
Class Y ²	4.79	2.96	3.03	2.68
Class P ³	4.91	2.98	3.04	2.68
After deducting maximum sales charge				
Class A ¹	-1.23	0.79	1.60	1.83

¹ Maximum sales charge for Class A shares on the fixed income Funds is 3.75%. Maximum sales charge for Class A shares on the Equity funds is 5.5. Maximum sales charge for Class A shares on the PACE Municipal fixed income fund is 2.2%. Class A shares bear ongoing 12b-1 service fees of 0.25 annually.

² The Portfolio offers Class Y shares to a limited group of eligible investors, including certain qualifying retirement plans. Class Y shares do not bear initial or contingent deferred sales charges or ongoing 12b-1 service and distribution fees.

³ Class P and Class P2 shares do not bear initial or contingent deferred sales charges or ongoing 12b-1 service and distribution fees, but Class P and Class P2 shares held through advisory programs may be subject to a program fee, which, if included, would have reduced performance.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. The holdings information above (and other related information involving such holdings) is as of the most recent quarter end and derived from the records of UBS Asset Management (Americas) Inc., investment manager to UBS Emerging Markets Equity Opportunity Fund (the "Fund").

The annualized gross and net expense ratios, respectively, for each class of shares as in the prospectuses dated November 28, 2022, were as follows:

PACE Alternative Strategies Investments: Class A—3.02% and 2.70%; Class Y—2.78% and 2.44%; and Class P—2.77% and 2.45%
PACE International Emerging Markets Equity Investments: Class A—2.78% and 2.44%; Class Y—1.44% and 1.20%; and Class P—1.65% and 1.45%
PACE International Equity Investments: Class A—1.77% and 1.69%; Class Y—1.52% and 1.44%; and Class P—1.49% and 1.44%
PACE Large Co Growth Equity Investments: Class A—1.13% and 1.13%; Class Y—0.87% and 0.87%; and Class P—0.88% and 0.88%
PACE Small/Medium Co Growth Equity Investments: Class A—1.20% and 1.20%; Class Y—0.96% and 0.96%; and Class P—1.04% and 1.04%
PACE Global Real Estate Securities Investments: Class A—1.58% and 1.45%; Class Y—1.53% and 1.20%; and Class P—1.56% and 1.20%
PACE Large Co Value Equity Investments: Class A—1.10% and 1.10%; Class Y—0.85% and 0.85%; and Class P—0.86% and 0.86%
PACE Small/Medium Co Value Equity Investments: Class A—1.20% and 1.20%; Class Y—0.98% and 0.98%; and Class P—1.01% and 1.01%
PACE Global Fixed Income Investments: Class A—1.18% and 1.03%; Class Y—1.03% and 0.87%; and Class P—0.98% and 0.84%
PACE High Yield Investments: Class A—1.16% and 1.06%; Class Y—0.86% and 0.86%; and Class P—1.01% and 0.91%
PACE Municipal Fixed Income Investments: Class A—0.87% and 0.82%; Class Y—1.32% and 0.57%; and Class P—0.62% and 0.57%
PACE Intermediate Fixed Income Investments: Class A—1.14% and 0.86%; Class Y—1.08% and 0.61%; and Class P—0.92% and 0.61%
PACE Mortgage-Backed Securities Fixed Income Investments: Class A—1.09% and 0.97%; Class Y—0.95% and 0.72%
PACE Strategic Fixed Income Investments: Class Y—0.86% and 0.65%; and Class P—0.71% and 0.65%

Net expenses reflect fee waivers and/or expense reimbursements, if any, pursuant to an agreement that is in effect to cap the expenses. The Portfolio and UBS Asset Management (Americas) Inc. ("UBS AM") have entered into a written fee waiver/expense reimbursement agreement pursuant to which UBS AM is contractually obligated to waive its management fees and/or reimburse expenses so that the Portfolio's ordinary total operating expenses of each class through November 30, 2023 (excluding dividend expense, borrowing costs, and interest expense relating to short sales, and expenses attributable to investment in other investment companies, interest, taxes, brokerage commissions, trustee elections, as well as other matters related to shareholder meetings (unless specifically agreed by UBS AM) and extraordinary expenses) would not exceed the respective ratios. The Portfolio has agreed to repay UBS AM for any waived fees/reimbursed expenses to the extent that it can do so over the following three fiscal years without causing the Portfolio's expenses in any of those three years to exceed these expense caps and that UBS AM has not waived the right to do so. The fee waiver/expense reimbursement agreement may be terminated by the Portfolio's board at any time and also will terminate automatically upon the expiration or termination of the Portfolio's advisory contract with UBS AM. Upon termination of the agreement, however, UBS AM's three year recoupment rights will survive.

The performance data quoted herein represents part performance. Past performance does not guarantee future results. The investment returns and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For updated performance data contact the National Sales Desk: 888-793 8637. The performance numbers assume reinvestment of all dividends and capital gains.

Fund short-term performance is not a strong indicator of its long-term performance.

The Fund's portfolio is actively managed and its composition will differ over time.

The views expressed are as of March 31, 2023 and are those of UBS Asset Management. These views are subject to change at any time in response to changing circumstances in the markets and are not intended to predict or guarantee the future performance of any individual security, market sector or the markets generally.

Mutual funds are sold by Prospectus. Investors should carefully read and carefully consider a Fund's investment objectives, risks, charges, expenses and other matters of interest before investing. The prospectus contains this and other information about the Fund. Contact your Financial Advisor, or UBS Asset Management (US) Inc., the Distributor, at 888-793 8637 for a current Fund prospectus or summary prospectus for PACE Alternative Strategies Investments. Performance quoted is past performance and no guarantee of future results. Results assume the reinvestment of all dividends and capital gains. Due to market volatility, current returns may be significantly higher or lower than those shown. See www.ubs.com/us-mutualfundperformance for current month-end performance. Investment return and principal value will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. You can lose money investing in the Fund.

The values of the PACE Select Portfolios change every day and can be affected by **changes in interest rates, general market conditions, and other political, social and economic developments, as well as specific matters relating to the companies or issuers** in whose securities the Portfolios invest. In addition, investments in **smaller-/medium-capitalization** companies and **foreign issuers** are subject to special risks. **Small and mid-cap companies** are typically subject to a greater degree of change in earnings and business prospects than are larger, more established companies. Therefore, they are considered to have a higher level of volatility and risk. The value of the fund's investments in **foreign securities** may fall due to adverse political, social and economic developments abroad. Investments in **foreign government bonds** involve special risks because the fund may have limited legal recourse in the event of default. However, because the fund's foreign investments must be denominated in US dollars, it generally is not subject to the risk of changes in currency valuations. These risks are greater for investments in **emerging market issuers** than for issuers in more developed countries. **High yield securities** are subject to higher risks than investment grade securities, including greater price volatility and a greater risk of loss of principal and nonpayment of interest. There are certain risks associated with investing in **fixed income** investments, including interest rate risk, derivative risk, futures risk and credit risk. There are certain risks associated with investing in **real estate** investments, including sensitivity to economic

downturns, interest rates, declines in property values and variation in property management. It is important to note that an investment in a Portfolio is only one component of a balanced investment plan. There are certain unique risks associated with the use of **short sales** strategies. When selling a security short, a fund will sell a security it does not own at the then-current market price and then borrow the security to deliver to the buyer. A fund is then obligated to buy the security on a later date so it can return the security to the lender. Short sales, therefore, involve the risk that a fund will incur a loss by subsequently buying a security at a higher price than the price at which the fund previously sold the security short. **Derivatives** involve risks different from, and possibly greater than, the risks associated with investing directly in securities and other instruments. If an investment advisor incorrectly forecasts the value of securities, currencies, interest rates or other economic factors in using derivatives, a fund might have been in a better position if the fund had not entered into the derivatives. While some strategies involving derivatives can protect against the risk of loss, the use of derivatives can also reduce the opportunity for gain or even result in losses by offsetting favorable price movements in other fund investments. Derivatives also involve the risk of mispricing or other improper valuation, the risk that changes in the value of a derivative may not correlate perfectly with the underlying asset, rate, index or overall securities markets, and counterparty and credit risk (the risk that the other party to a swap agreement or other derivative will not fulfill its contractual obligations, whether because of bankruptcy or other default). Gains or losses involving some options, futures and other derivatives may be substantial (for example, for some derivatives, it is possible for a fund to lose more than the amount the fund invested in the derivatives). Some derivatives tend to be more volatile than other investments, resulting in larger gains or losses in response to market changes. Derivatives are subject to a number of other risks, including liquidity risk (the possible lack of a secondary market for derivatives and the resulting inability of a fund to sell or otherwise closeout the derivatives) and interest rate risk (some derivatives are more sensitive to interest rate changes and market price fluctuations). Finally, a fund's use of derivatives may cause the fund to realize higher amounts of short-term capital gains (generally taxed at ordinary income tax rates) than if the fund had not used such instruments. There are certain risks involved in investing in certain open- or closed-end **investment companies**. The shares of other investment companies are subject to the management fees and other expenses of those companies, and the purchase of shares of some investment companies requires the payment of sales loads and (in the case of closed-end investment companies) sometimes substantial premiums above the value of such companies' portfolio securities).

Please see the prospectus for a more complete discussion of the risks associated with the PACE Select Funds.

The PACESM Select Advisors Program (Applicable to PACE Program Participants Only)

The PACESM Select Advisors Program is an investment advisory service pursuant to which UBS Financial Services Inc. provides clients with personalized investment allocation recommendations. UBS Financial Services Inc. does not have any investment discretion over your client's PACE Select Advisors Program account. Clients will make all the investment decisions.

Under the PACE Select Advisors Program, Financial Advisors assist clients in:

- identifying client financial characteristics, including their risk tolerance and investment objectives; and
- completing an Investor Profile Questionnaire, which clients may update from time to time with Financial Advisors' assistance.

UBS Financial Services Inc. uses an investment profile evaluation and asset allocation methodology to translate this information into a suggested allocation of a client's assets among different funds. Financial Advisors present the recommended allocation to clients initially. Financial Advisors also may, if clients so request, review with clients the monthly account statements and other information, such as quarterly performance data. Financial Advisors also monitor any changes in a client's financial characteristics that clients identify through a revised Investor Profile Questionnaire and communicates these changes to UBS Financial Services Inc. for reevaluation of a client's investment profile. Investors who no longer participate in the PACESM Select Advisors Program but continue to hold Class P shares will not be entitled to any of the services described in this section.

For the services provided to clients under the PACE Select Advisors Program, clients will pay UBS Financial Services Inc. a quarterly Program Fee at an annual rate of up to 2.50% of the value of the shares of the funds held in their account under the PACE Select Advisors Program. This quarterly fee is generally charged to your UBS Financial Services Inc. account.

Please note that past performance is not a guide to the future. Potential for profit is accompanied by the possibility of loss. The value of investments and the income from them may go down as well as up and investors may not get back the original amount invested.

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Indexes:

We provide performance measurements versus a benchmark to allow investors to evaluate the appropriateness of using a given model (or a combination of models) to fulfill a portion of an investor's overall asset allocation. Our selection and use of benchmarks for comparison purposes is not a promise or guarantee that your account will meet or exceed the stated benchmark. An investor may not invest directly in any index. Market indices are not actively managed portfolios; and therefore, do not reflect deductions of advisory fees, brokerage commissions or other expenses of investing, all of which will reduce the overall return. Index performance information has been obtained from third parties deemed to be reliable. We have not independently verified this information, nor do we make any representations or warranties to the accuracy or completeness of this information.

List of Pace Fund indices: US Treasury 1-3 YR: Bloomberg Barclays Series-E Govt 1-3 Yr Bond Index; US Treasury 7-10 YR: Bloomberg Barclays Serie-E US Govt 7-10 Yr Bond Index; US Investment Grade Bond: Bloomberg Barclays US Corporate Total Return Value Index Unhedged USD; US High Yield Bond: Bloomberg Barclays US Corporate High Yield Total Return Index Value Unhedged USD; Global Inflation-Linked Bond: Bloomberg Barclays Global Inflation-Linked Total Return Index Unhedged; US Aggregate Bond: Bloomberg Barclays US Agg Total Return Value Index Unhedged USD; Emerging Market Dollar-Denominated Sovereign Bond: Bloomberg Barclays Emerging Markets Sovereign TR Value Index Unhedged; Emerging Market Local Currency Sovereign Bond: Emerging Market Dollar-Denominated Sovereign Bond: EM Local Currency Government TR Unhedged USD Index; US Equity S&P 500: S&P 500 Index; US Equity Russell: Russell 2000 Index; Europe Equity: MSCI Europe USD Equity; Japan Equity: MSCI Japan Index; China Equity: MSCI China USD Price Return Index; Emerging Market Equities: MSCI Emerging Market Equity Index; Commodities: Bloomberg Barclays Commodity Spot Index: REITS; Dow Jones Equity REIT Index.

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