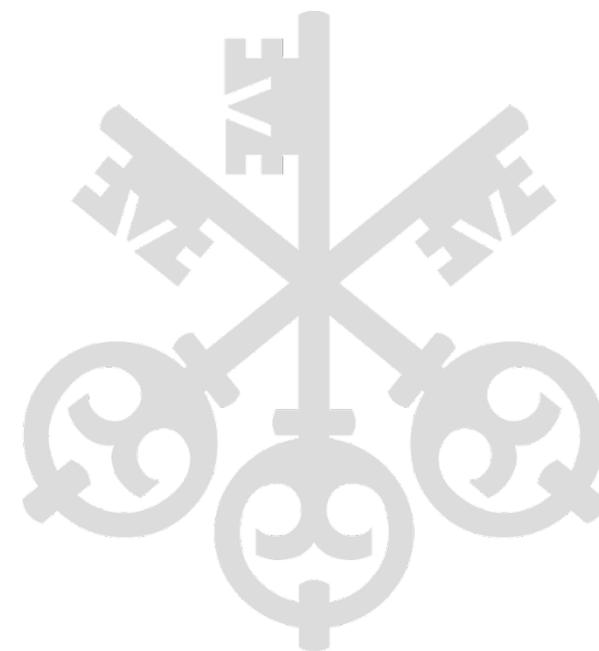


# UBS Annual Reserve Manager Survey 2018

## 24<sup>th</sup> Reserve Management Seminar

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Strategy & Advice, Global Sovereign Markets



# 24<sup>th</sup> Annual Reserve Management Seminar Survey

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With 24 years of comprehensive surveys, we believe the following data is among the most authoritative depictions of official reserve management activities available

- Central banks and sovereign wealth funds around the world have continued to adjust their reserve management practices to meet their goals while keeping a close eye on the risks and opportunities they see playing out on the global stage.
- That is one of the key takeaways from UBS Asset Management's 24th annual Reserve Management Seminar survey of global central banks. This year's survey was conducted during the first half of 2018 and collected responses from close to 30 central banks and sovereign wealth funds from all regions globally. Questions covered a range of topics related to official reserve management investment views.
- Results were presented at the 24<sup>th</sup> UBS Reserve Management Seminar, held June 24-28 in Thun, Switzerland. In addition, an on-site survey of current economic and market views was conducted during the seminar, which was attended by close to 70 sovereign investors from leading institutions. On-site voting results are included in the second part of this presentation.

Source: UBS Annual Reserve Manager Survey, results as of July 2018.

# 24<sup>th</sup> Annual Reserve Management Seminar Survey

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## Highlights from our 2018 survey (I): FX Reserves

- Nearly 90% of central banks consider their level of reserves as adequate given their mandate
- More than half of the respondents say that their level of reserves increased over the last 12 months, signaling that the period of falling reserves which started in 2016 with the drop in commodity prices, is now over
- Central banks use several measures to determine the adequacy of their reserves, with the majority measuring against short-term external debt, months of imports as well as GDP and monetary aggregate
- More than half of the respondents split their assets in different tranches to better tailor their asset allocation
- Three surveyed entities are planning to establish an SWF



Source: UBS Annual Reserve Manager Survey, results as of July 2018.

# 24<sup>th</sup> Annual Reserve Management Seminar Survey

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## Highlights from our 2018 survey (II): Macro and economic issues

- The top three concerns this year all revolve around political developments, with the potential for trade wars ranking as the top concern. Not a single respondent cited worries about potential deflationary shocks. Fears of a hard landing in China have eased from previous surveys
- When it comes to the investment of FX reserves, the most-frequently mentioned concerns (50%+) among respondents are elevated asset price valuations and rising US interest rates.
- The majority of central banks (75%) expect the ECB to raise interest rates in 2019 whilst only a quarter expect it to be later than 2019. More than half of respondents consider the combination of FED balance sheet reduction and rising US debt issuance a potential risk for the US Treasury market
- Our live poll among more than 70 on-site participants using our event app revealed that the vast majority of participants expects the terminal US policy rate to be no higher than 3.5% this cycle. At the same time, the majority does not believe the US to go into recession before 2021

Source: UBS Annual Reserve Manager Survey, results as of July 2018.

# 24<sup>th</sup> Annual Reserve Management Seminar Survey

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## Highlights from our 2018 survey (III): Asset Allocation

- FX reserve diversification is continuing with the majority of central banks pursuing increased allocations to non-government-bond assets .
- Central banks continue to increase their holdings of corporate debt and mortgage- and asset-backed securities.
- Infrastructure as an investment gained traction with 15% saying they increased their holdings last year and 10% saying they plan to increase infrastructure holdings in the coming year.
- Central banks slightly reduced equity and emerging market debt holdings; still, already one in four of participating central banks is allowed to invest in equities.
- The biggest gainers when it comes to currency allocations by central banks last year were the Euro and the Renminbi, but the US dollar remains the default currency to invest new reserves.

Source: UBS Annual Reserve Manager Survey, results as of July 2018.

# 24<sup>th</sup> Annual Reserve Management Seminar Survey

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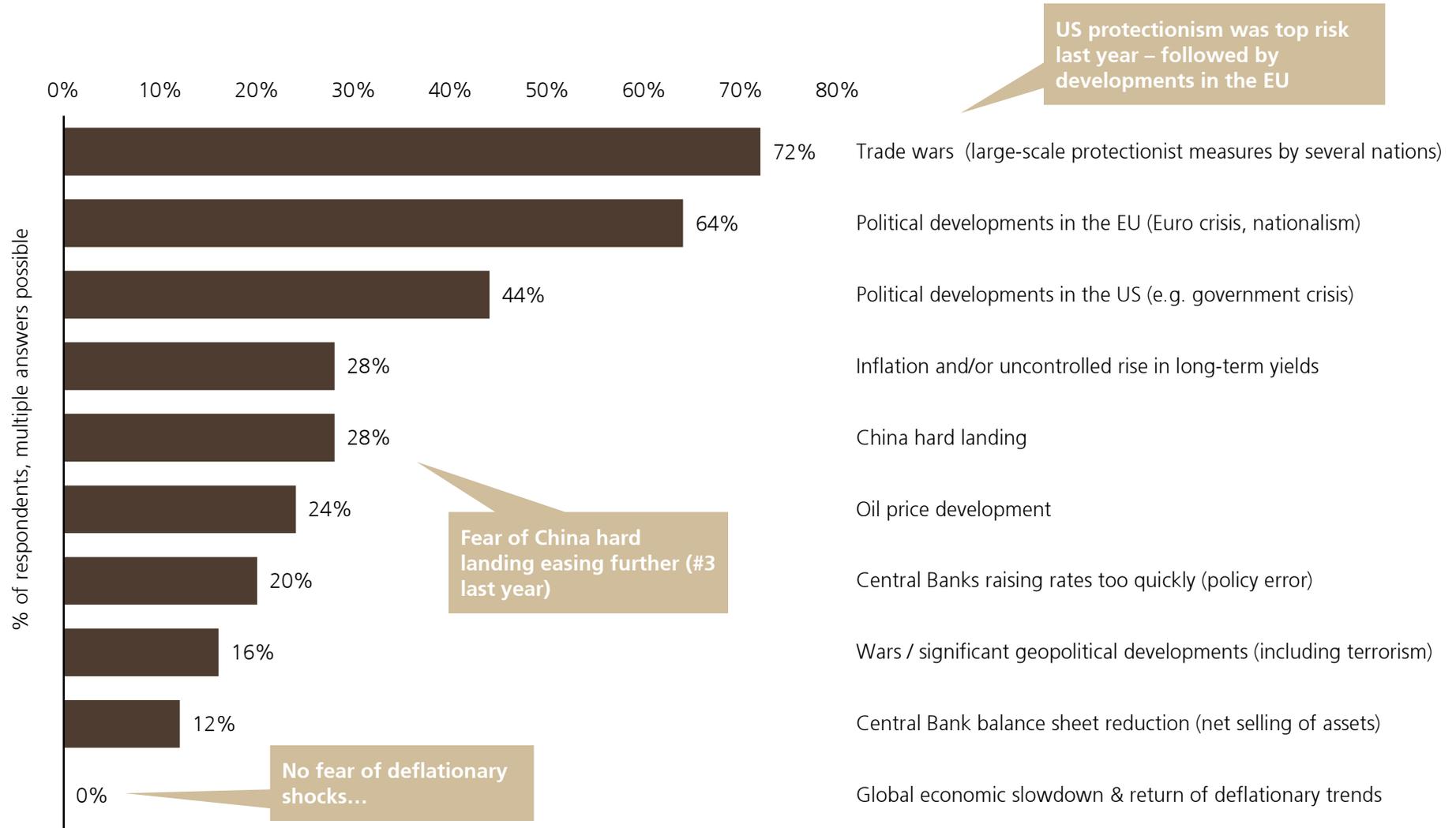
## Highlights from our 2018 survey (IV): Currency

- The average share of USD holdings among all the participants was about 71.5% which is slightly higher than IMF data on the currency composition of global reserves suggests.
- The biggest net gainers in currency allocation by central banks last year were the Euro and Renminbi. This is the first time in several years that the Euro has seen an uptick once again
- The increased attractiveness of the RMB is also of importance, as over the last few years, and in particular following the mini-devaluation of 2015, interest in the Chinese currency cooled down, and reserve allocations stagnated.
- The average long-term target allocation to the RMB is around 3.2% which means a doubling from current levels. With allocated reserves currently standing at around USD 145bn in 1Q 2018 (IMF COFER), this would translate roughly into additional USD 200bn flowing into RMB-dominated assets

Source: UBS Annual Reserve Manager Survey, results as of July 2018.

# Main concerns impacting the global economy

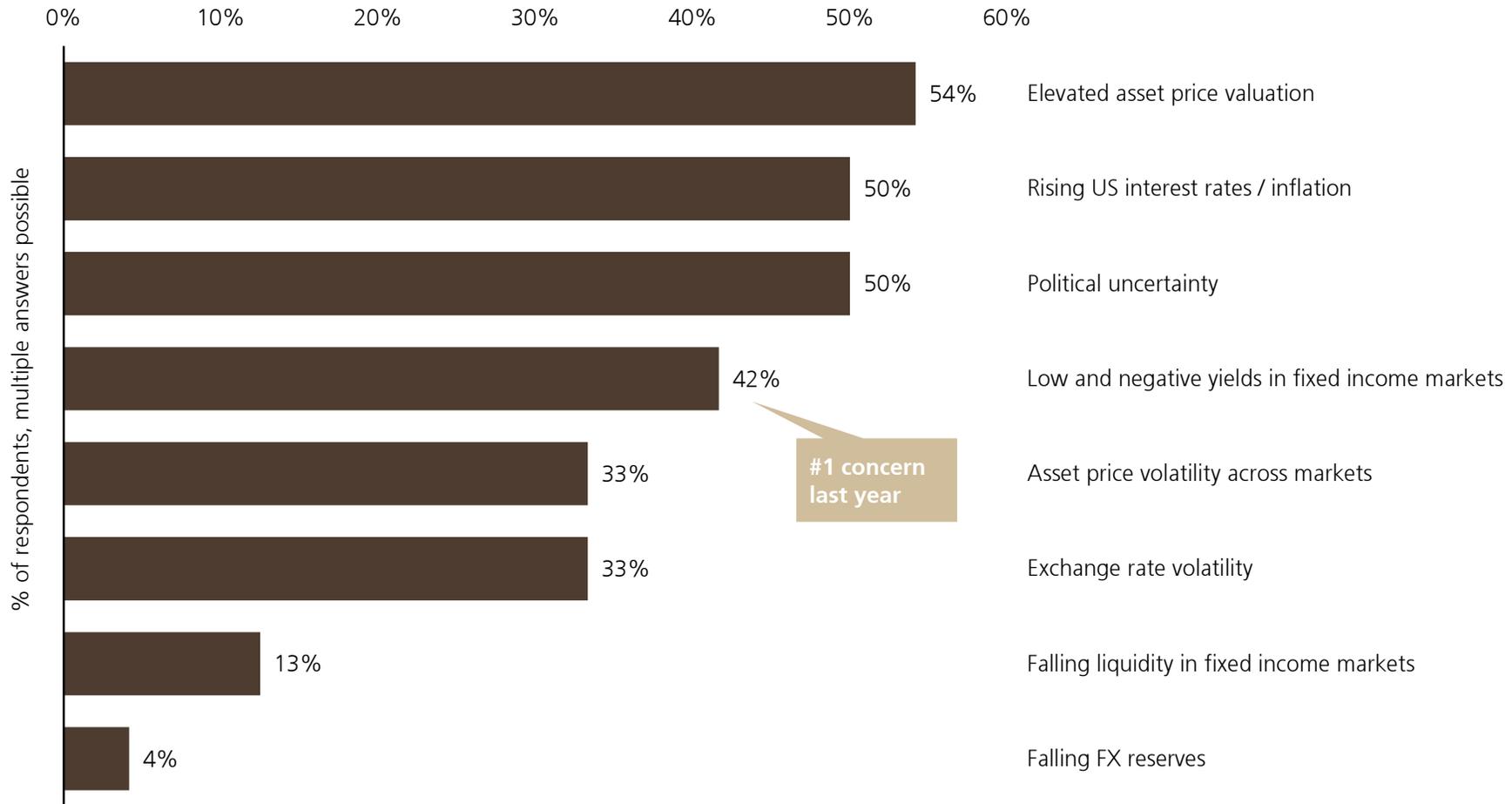
What are the main risks the global economy is currently facing?



Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Main concerns impacting the levels of FX reserves

What are currently your main concerns when it comes to the investment of FX reserves?

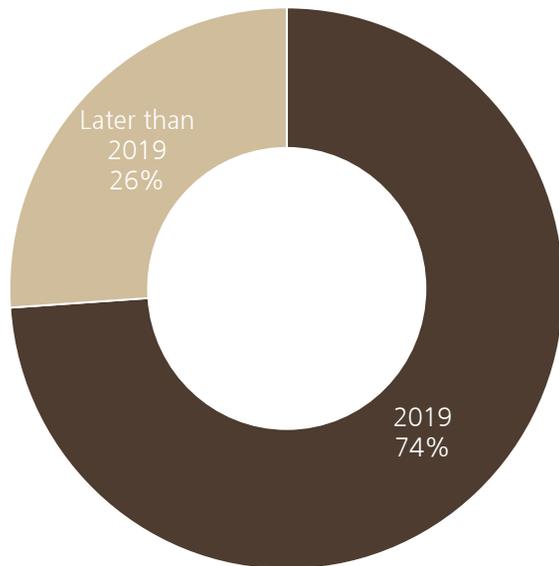


Source: UBS Annual Reserve Manager Survey, results as of June 2018.

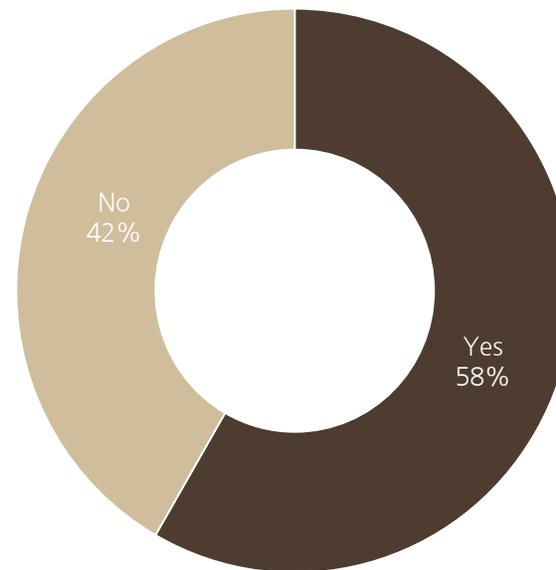
# The end of unconventional monetary policy

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**By when do you expect the ECB to raise interest rates?**



**Is the combination of Central Bank net asset sales and increased US debt issuances an underrated risk for the US Treasury market?**

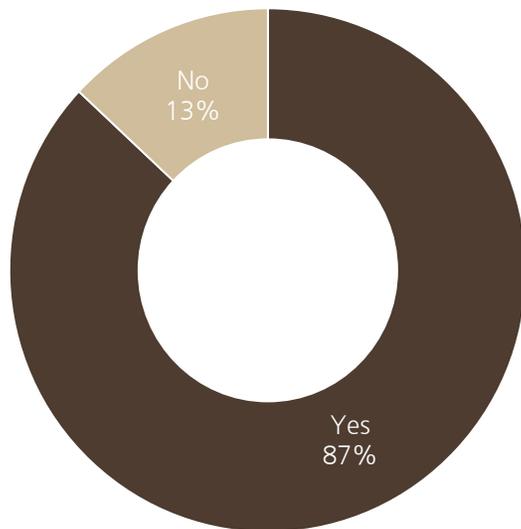


Source: UBS Annual Reserve Manager Survey, results as of June 2018.

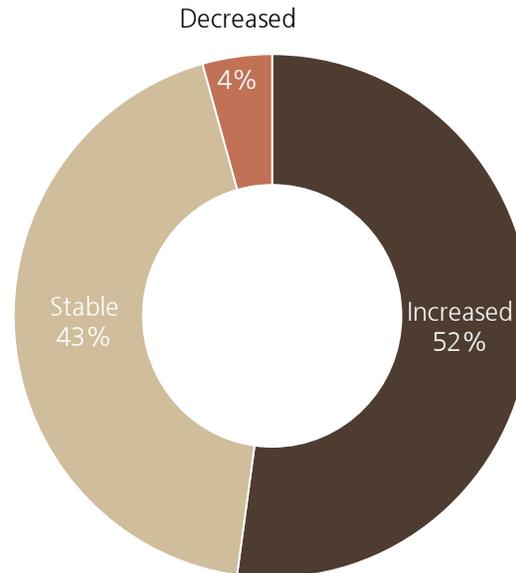
# Level and adequacy of FX reserves

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## Do you see your current level of FX reserves as adequate?



## How has the amount of your FX reserves changed over the last 12 months?



## How do survey participants assess their FX reserves?

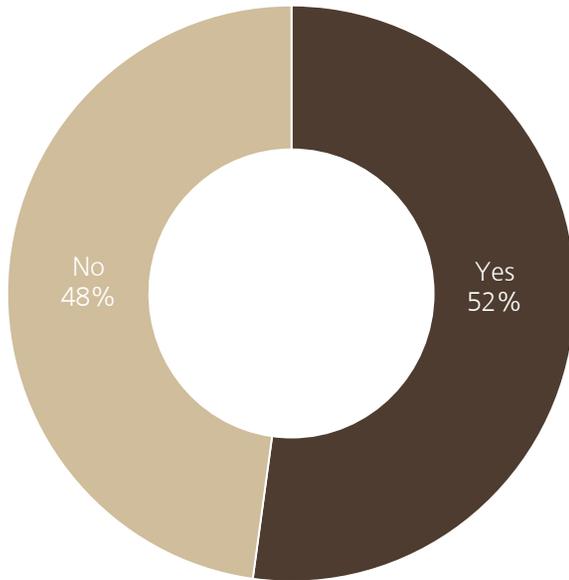
- Percentage of survey participants that see their level of FX reserves as not adequate is slightly down from 15% last year
- The number of participants who reported increased FX reserves is up from 41% last year
- Majority of participants uses several measures to determine the adequacy of their reserves, with the majority measuring against short-term external debt, months of imports as well as GDP and monetary aggregate.

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Tranching and institutional setup

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Do you segment / tranche your reserves (e.g. in liquidity, liability and saving/total return/wealth portfolios)?



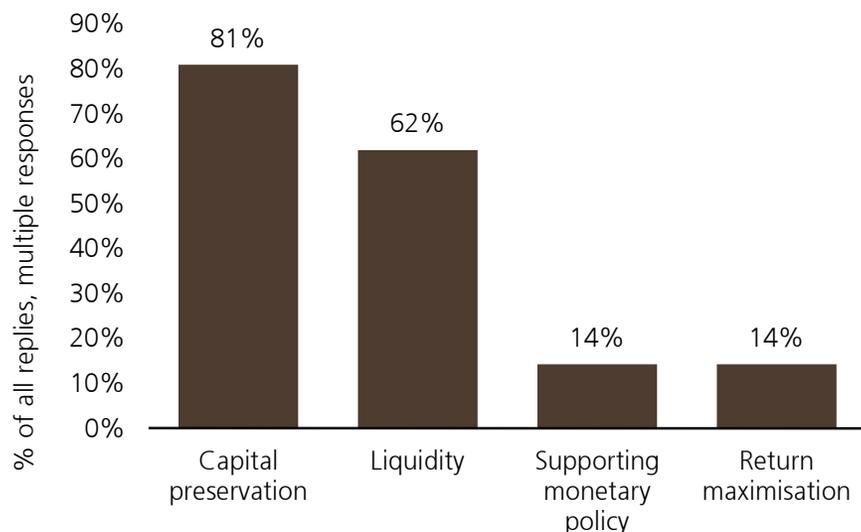
**Three survey participants indicated that they recently considered setting up a separate entity (e.g. Sovereign Wealth Fund) to manage assets**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

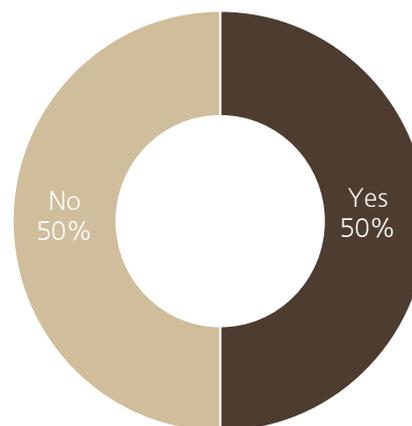
# Key asset allocation objectives

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## What are your primary investment objectives?



## In recent years, has your institution increasingly diversified away from traditional reserve assets?



- Several participants stressed that they consider return objectives to be important, but only as long as liquidity and capital preservation targets are fulfilled
- Overall, half of the participants altered their Strategic Asset Allocation over the last 12 months and a further 48% indicated that they wish to implement further changes to their asset allocation in the next 12 months
- Half of all survey participants replied that their institution diversified away from traditional reserve assets recently
- 21% indicated that they now consider investing in illiquid asset classes (for example infrastructure debt or real estate) to enhance returns
- Interestingly, 29% responded that they recently moved or considered moving passively-managed assets to active management strategies

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Trends in approved asset classes

Which of the following instruments are approved at your institution?

Asset Class	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002	2001	2000	1999	1998
Supranationals	95	93	90	89	94	82	87	76	70	68	70	72	70	74	63	62	60	62	54	63	60
Sovereign eurobonds	86	89	93	92	90	78	73	64	68	65	66	66	64	60	60	58	58	61	60	66	66
US agencies	76	74	83	74	49	54	69	55	65	71	84	86	84	82	76	78	75	71	62	68	54
Inflation protected bonds	62	76	70	61	49	48	40	44	47	45	38	33	28	16	9	na	na	na	na	na	na
Covered bonds	43	48	53	34	43	40	45	30	38	40	53	58	50	48	44	38	35	37	34	28	12
Bank debt	43	48	40	42	41	26	33	20	31	29	48	44	48	41	21	24	21	26	20	16	4
Corporates	57	56	48	42	43	34	33	31	29	26	38	41	40	38	38	32	28	22	20	15	10
MBS / ABS	57	52	40	39	25	20	22	37	27	38	46	52	44	39	39	27	22	17	19	12	2
Emerging Market debt	24	26	30	21	18	12	11	22	24	16	16	10	na								
Equities	24	30	33	26	18	16	24	18	19	14	18	22	18	5	3	2	na	na	na	na	na
Private Equity	5	19	na																		
Hedge Funds	0	11	na																		

**In % of total respondents, multiple responses possible.**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Trends in approved asset classes

Which of the following instruments are approved at your institution?



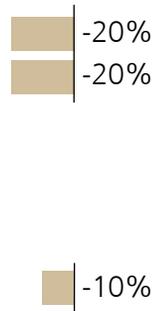
**In % of total respondents, multiple responses possible.**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

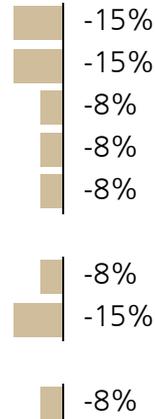
# Key changes in asset allocation

Which of the following instruments have you increased/decreased in your portfolio in the past year?  
Which of the following instruments would you want to own more or less over the next year?

% of respondents that plan a **decrease** in the coming year

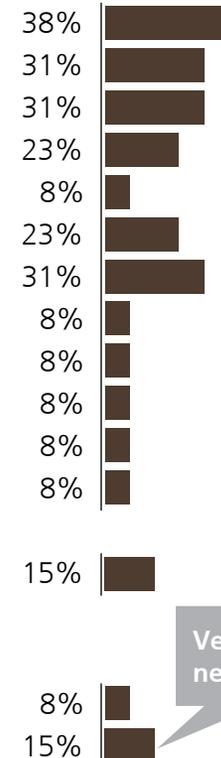


% of respondents that reported a **decrease** in the past year

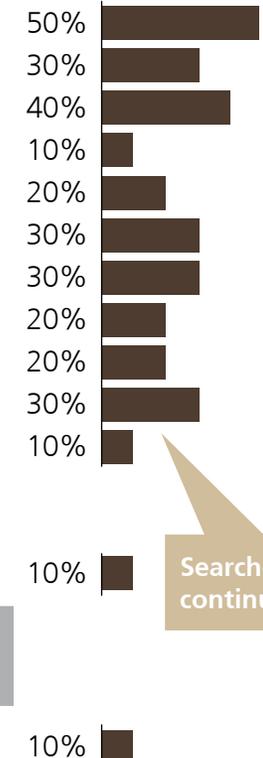


- Supranationals
- Sovereign eurobonds
- US agencies
- Inflation-protected bonds
- Covered bonds
- Bank debt
- Corporates
- MBS / ABS
- EM hard currency debt
- EM local currency debt
- Equities passive
- Equities active
- Multi-asset products
- Gold
- Commodities (excl. Gold)
- Hedge Funds
- Private Equity
- Infrastructure (equity & debt)

% of respondents that reported a **increase** in the past year



% of respondents that plan an **increase** in the coming year



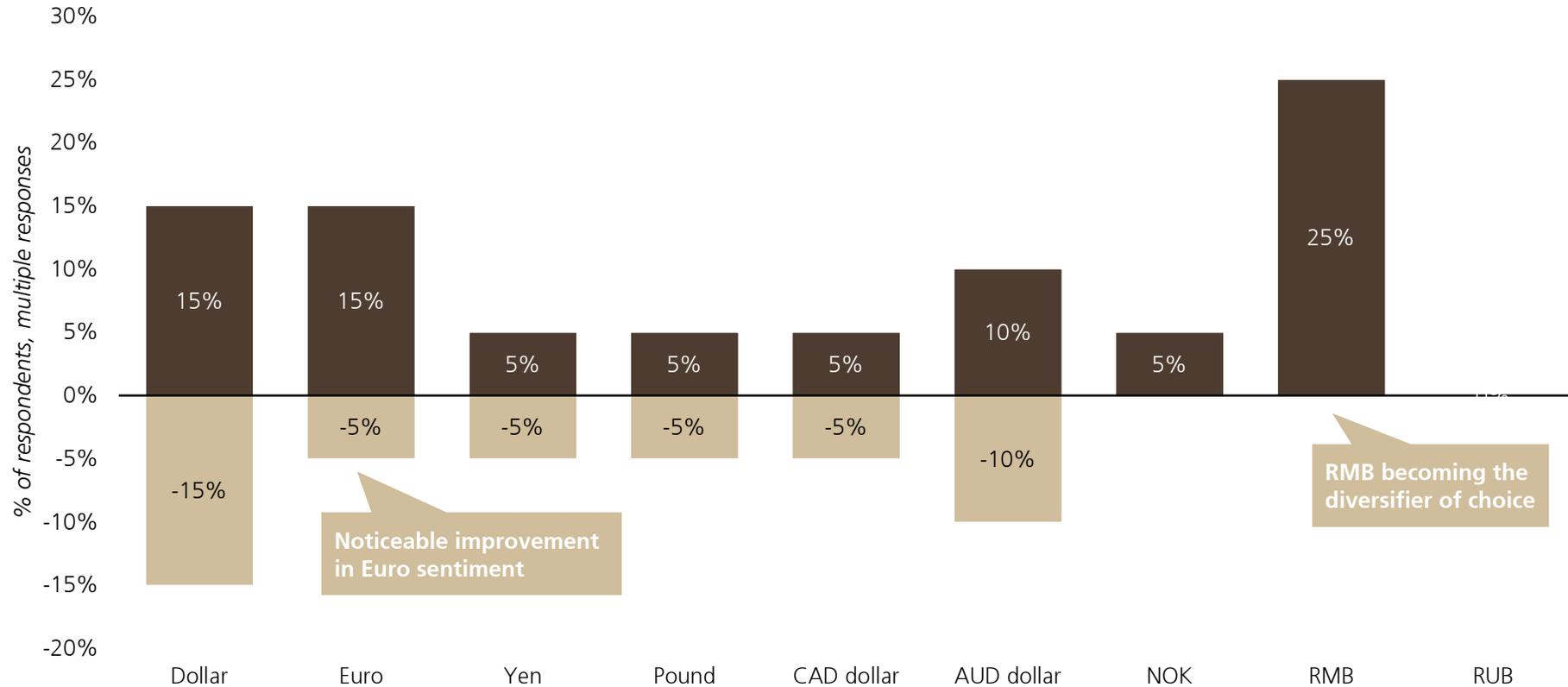
Venturing in new areas

Search-for-yield continues

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Currency focus: Changes in 2017/18

If you have altered your currency allocation during the last year in a significant way, please specify how!

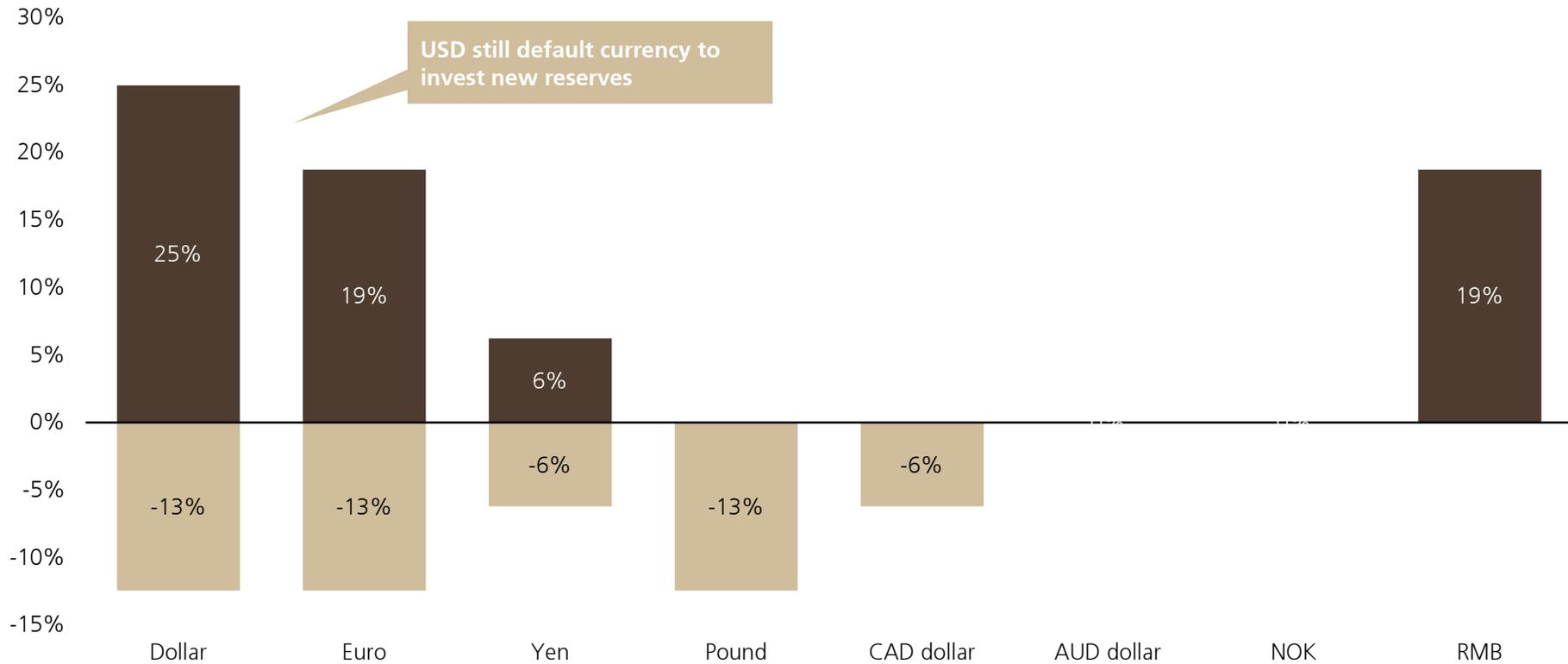


**The average share of USD holdings among all participants was about 71.5%**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Currency focus: Outlook

Going forward, how do you expect your currency allocation will be adjusted?



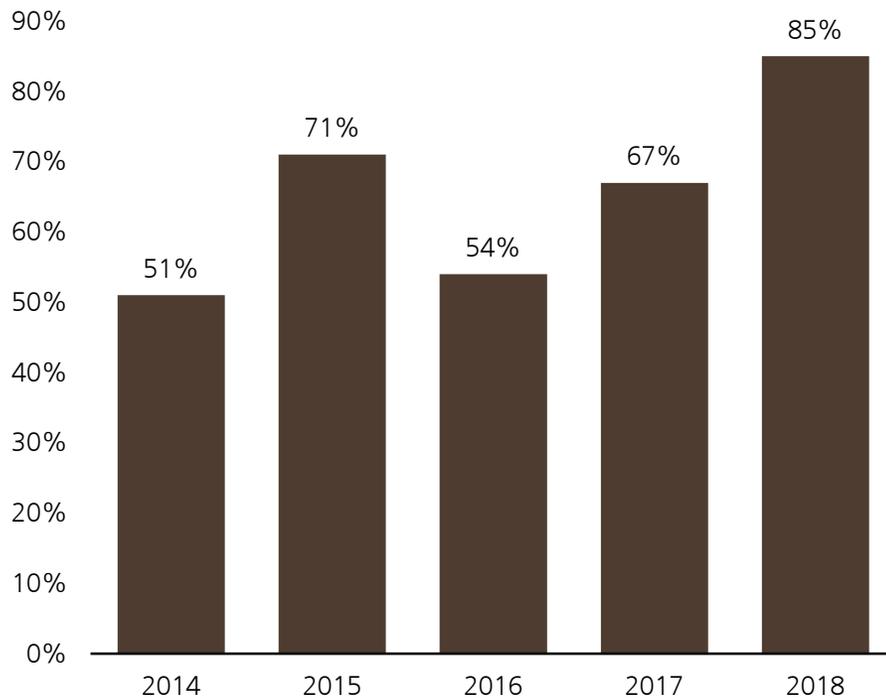
**Like in 2017, survey participants remain convinced that the US Dollar will play an increasing role in their reserves going forward, but sentiment towards the Euro has improved, bringing allocation plans more in line with the SDR basket.**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Currency focus: RMB

Please describe your attitude towards the RMB!

**% of survey respondents that are invested, or consider investing, in the RMB (last 5 surveys)**



Source: UBS Annual Reserve Manager Survey, results as of June 2018.

**Significant increase in number of participants that are invested, or consider investing, in the RMB.**

The average long-term target allocation to the RMB is around 3.2%, with values ranging from 0% to 15%

**Remaining challenges raised by survey participants**

- Clarity on rules and regulations and access to onshore investments.
- Direct access to government bond trading and custody/safekeeping of securities with an international depository institution
- 'Cross-border or offshore RMB liquidity and transaction/clearing infrastructure'
- 'The capital account in RMB remains restricted, making direct investment into China still difficult'

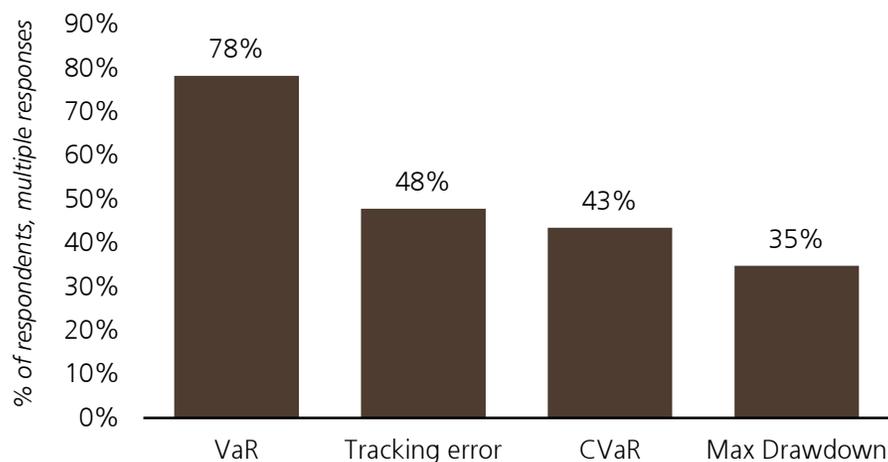


*UBS has issued the White Paper "RMB's march to reserve currency status - A reality check" on the occasion of the Reserve Manager Seminar 2018.*

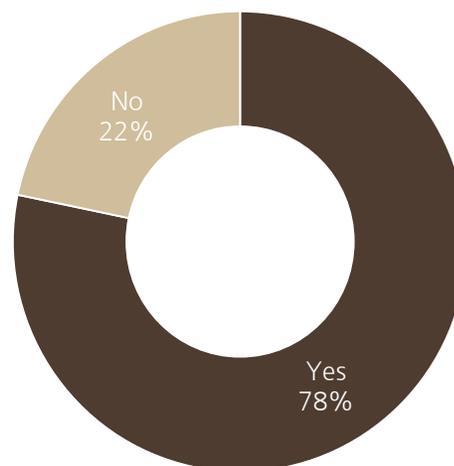
# Performance and Risk management

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## How do you measure risk in your portfolios?



## Do you take any tactical positions compared to benchmark?



## Risk and performance measurement

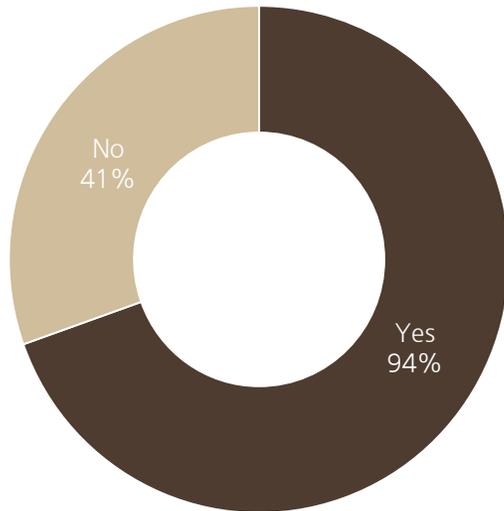
- Slightly more than half of the survey respondents review their investment policy annually, with the other half using more frequent intervals or review on an ad-hoc basis.
- 2/3 of survey participants indicated that they rely only on internal risk management systems, a considerable change from last year where more than half of participants disclosed that they use external risk management systems as well.
- No survey participant increased maximum drawdown levels to enhance returns in the past year
- Of those participants that are invested in equities, ~70% consider their fixed income portfolio as 'hedge' for the equity portion (due to the historical tendency to be negatively correlated in times of crisis)

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

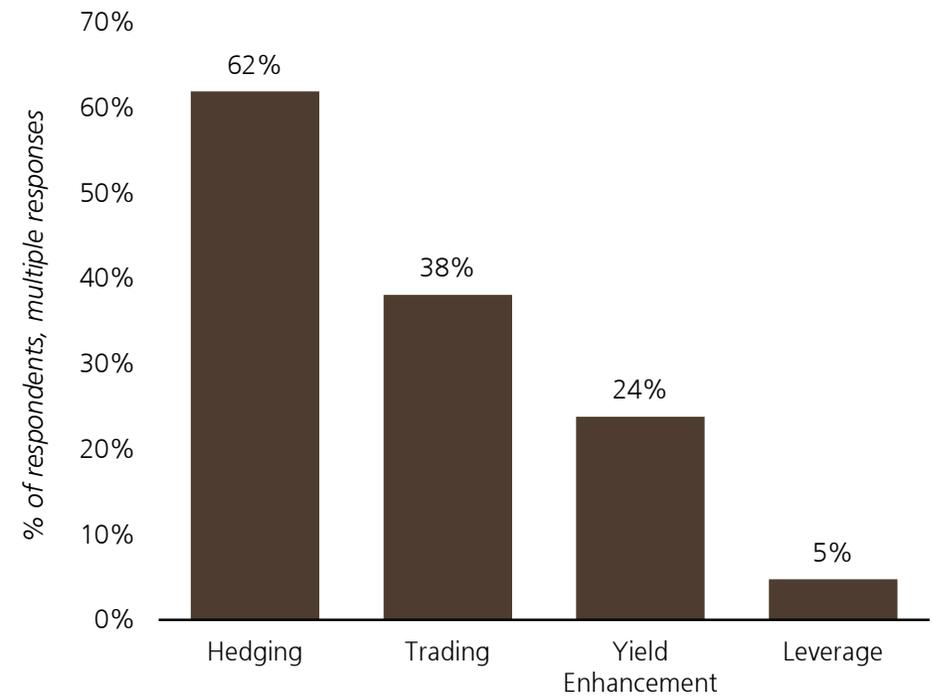
# Derivatives

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Do you use derivatives within your reserve portfolio?



If you use derivatives, what are the main objectives for using them?

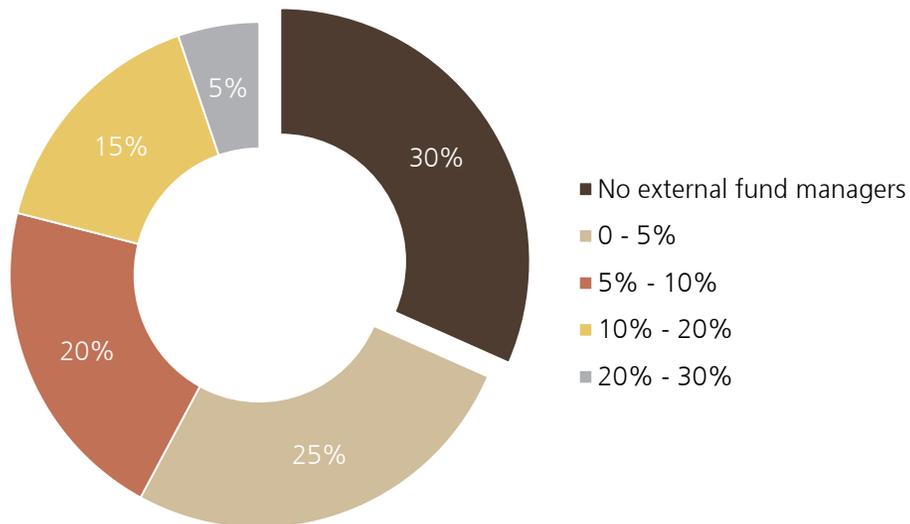


**Additional survey participants reported the use of derivatives to reduce FX risk, but not to manage reserve assets.**

Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# External asset management

## What percentage of your reserves are currently externally managed?



## What assets are externally managed?

- External mandates currently exist mainly in the area of DM sovereign and corporate debt, as well as inflation-protected bonds, short-term liquidity products and ABS/MBS/CMBS.
- More than half of respondents indicated that they are interested in tail-risk hedging strategies-

## What asset classes of external fund management interests you the most?



Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Sustainable investing: Is CB interest rising?

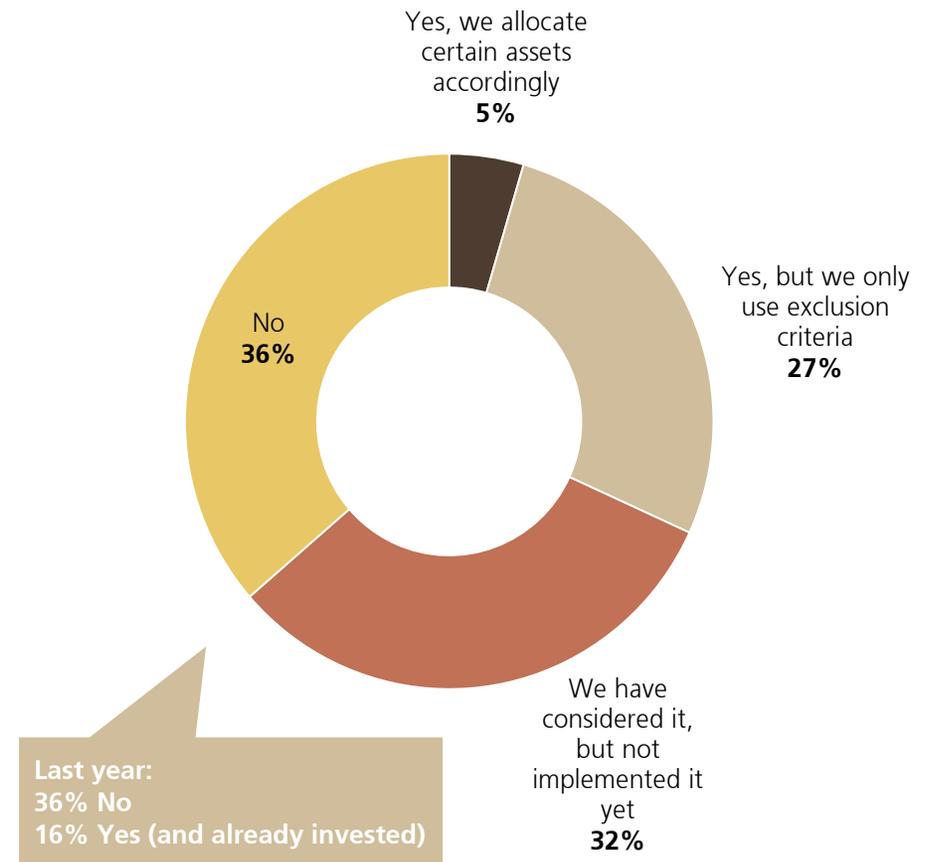
Have you considered sustainable and responsible investment aspects in your investment process?

## The case for sustainable investing

- The concept of sustainability is one which is ideally placed to align the long-term mandate of Sovereign wealth entities with trends in society, as well as the evolving objectives of government sponsors and the public in general.
- In particular, in a world that is moving away from fossil fuels, sustainability can be considered a key tool in re-focusing the assets of Sovereign investors in a way that is consistent with long-term financial and social objectives of their nations.

## Survey results

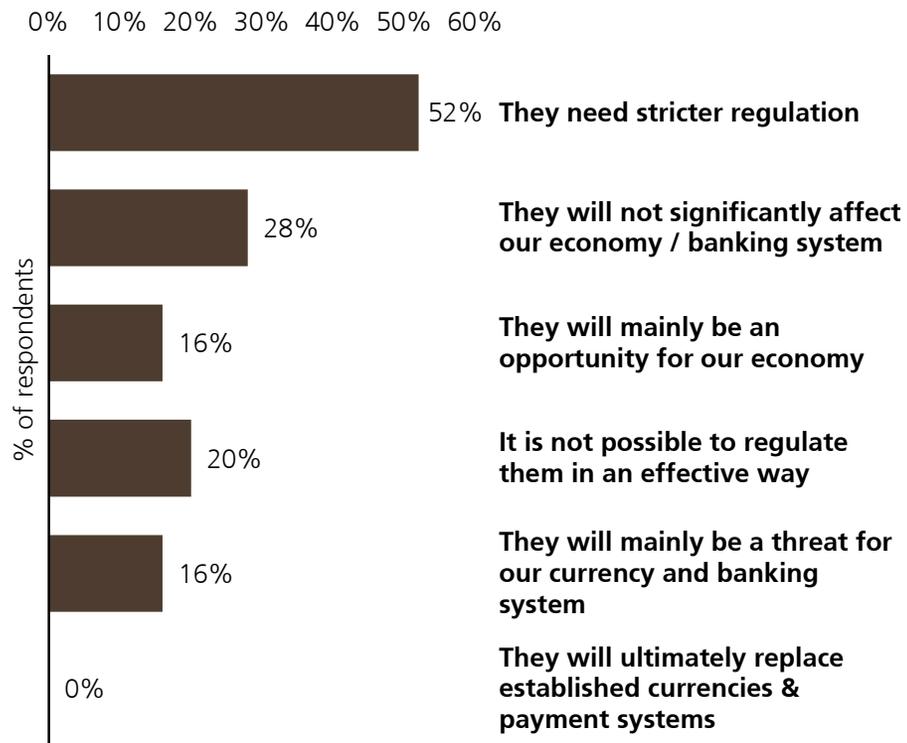
- While ideally suited for sovereign investors, only a small percentage of participants already actively allocate assets according to this concept.
- A small number of participants practices socially responsible investing (SRI), which traditionally has a narrower focus and mainly works via excluding assets and companies.



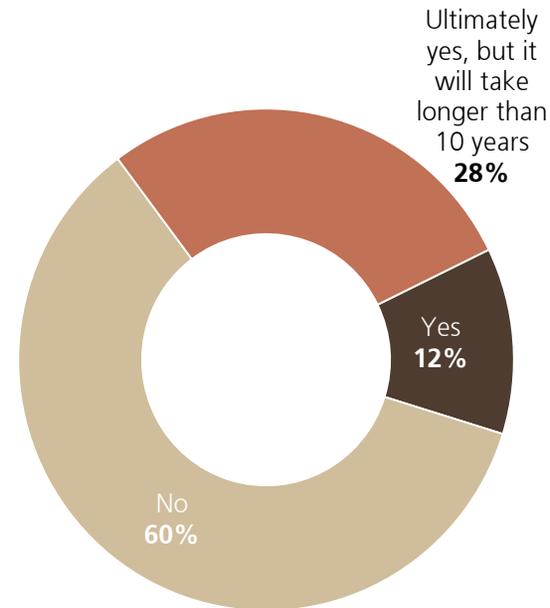
Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Recent topics – Cryptocurrencies

Do you agree with the following statements about cryptocurrencies?



Will cryptocurrencies be included in the official reserves of some central banks in the next ten years?



In % of total respondents, multiple responses possible.

Source: UBS Annual Reserve Manager Survey, results as of June 2018.



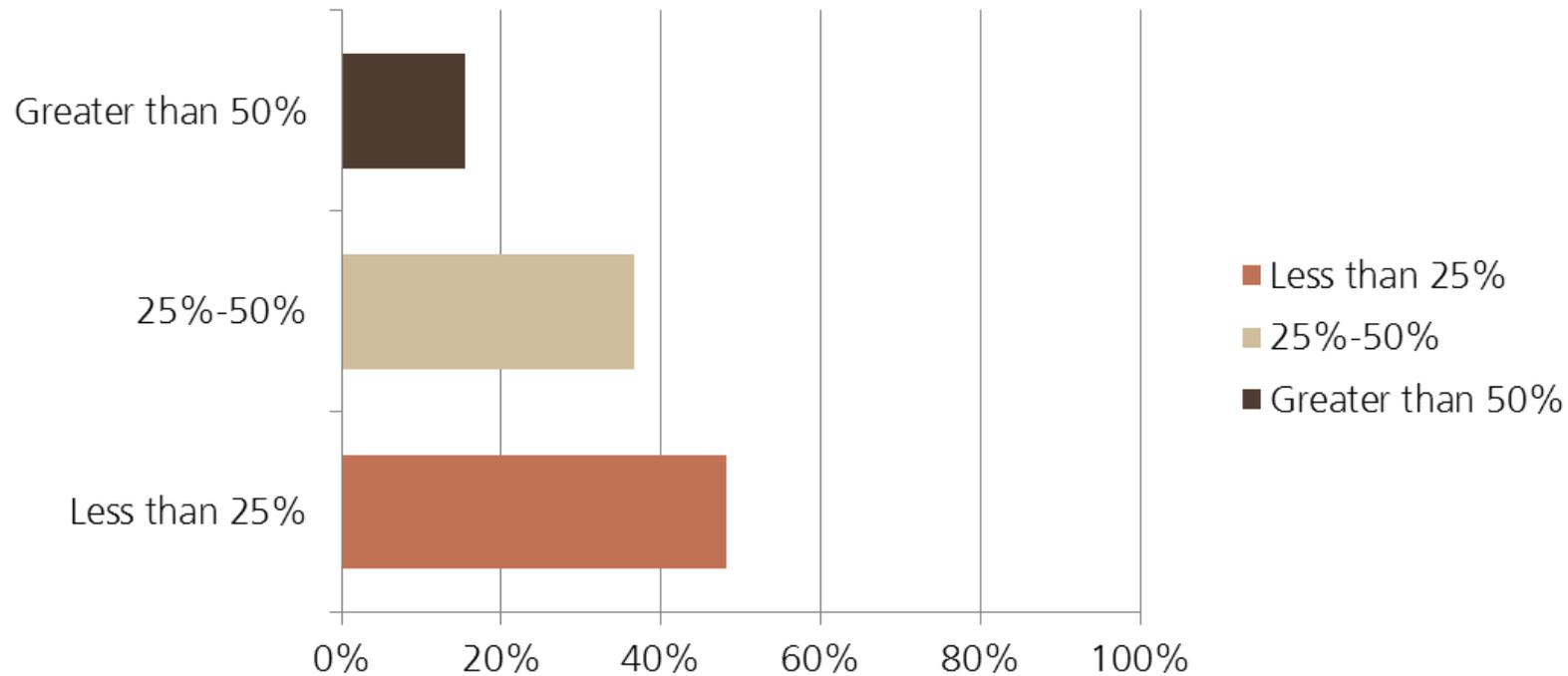
# On-site voting results

24th Reserve Management Seminar



# What's the probability of the US entering a recession before end 2020?

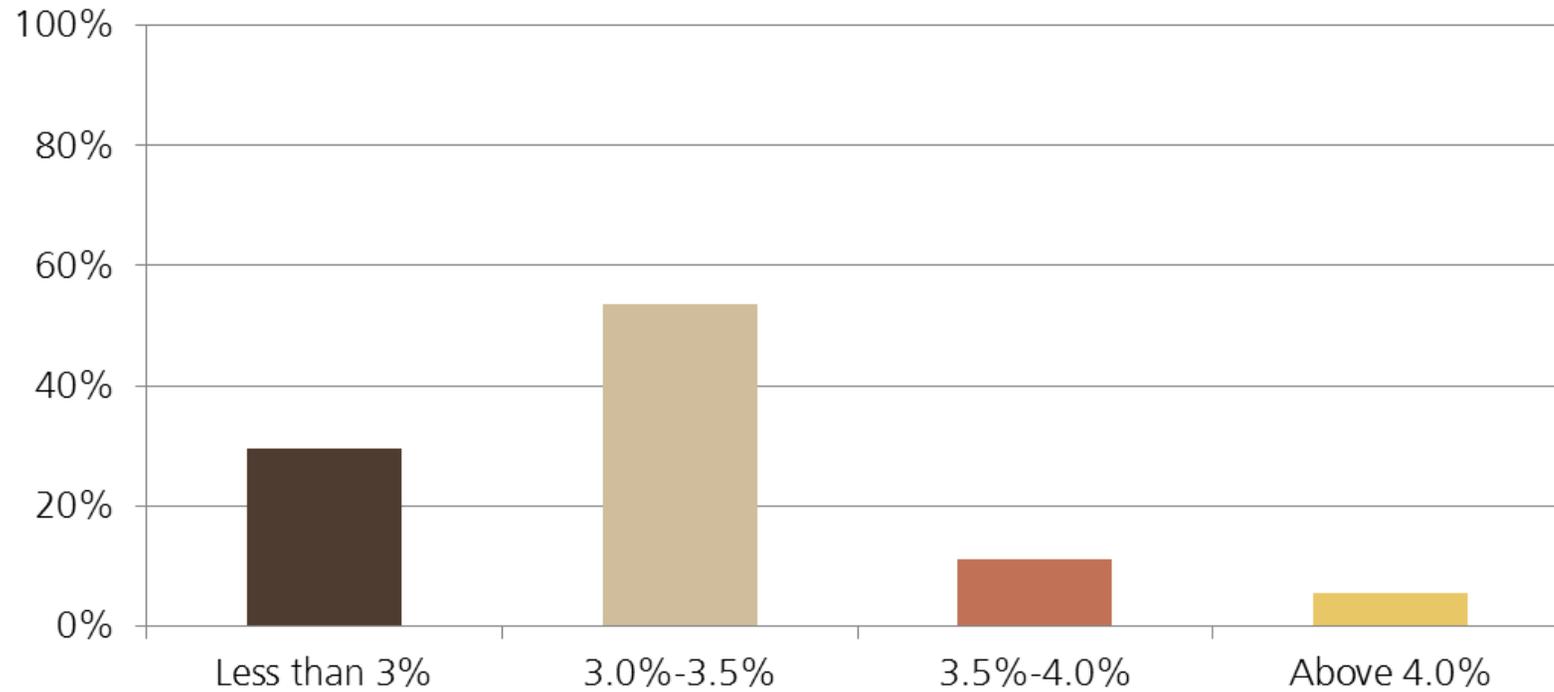
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# What will the US terminal policy rate be at the end of the current Fed's hiking cycle?

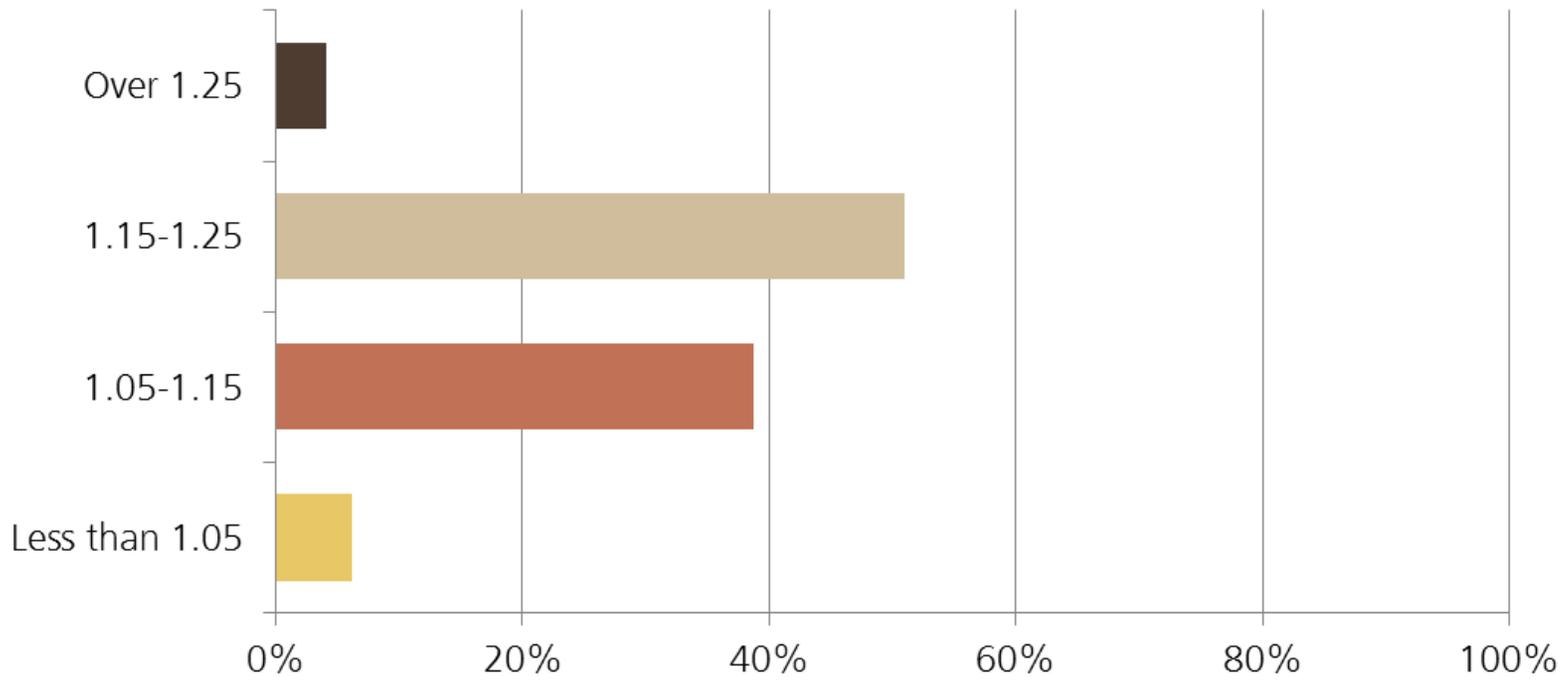
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# What will be the level of EUR/USD in a year's time?

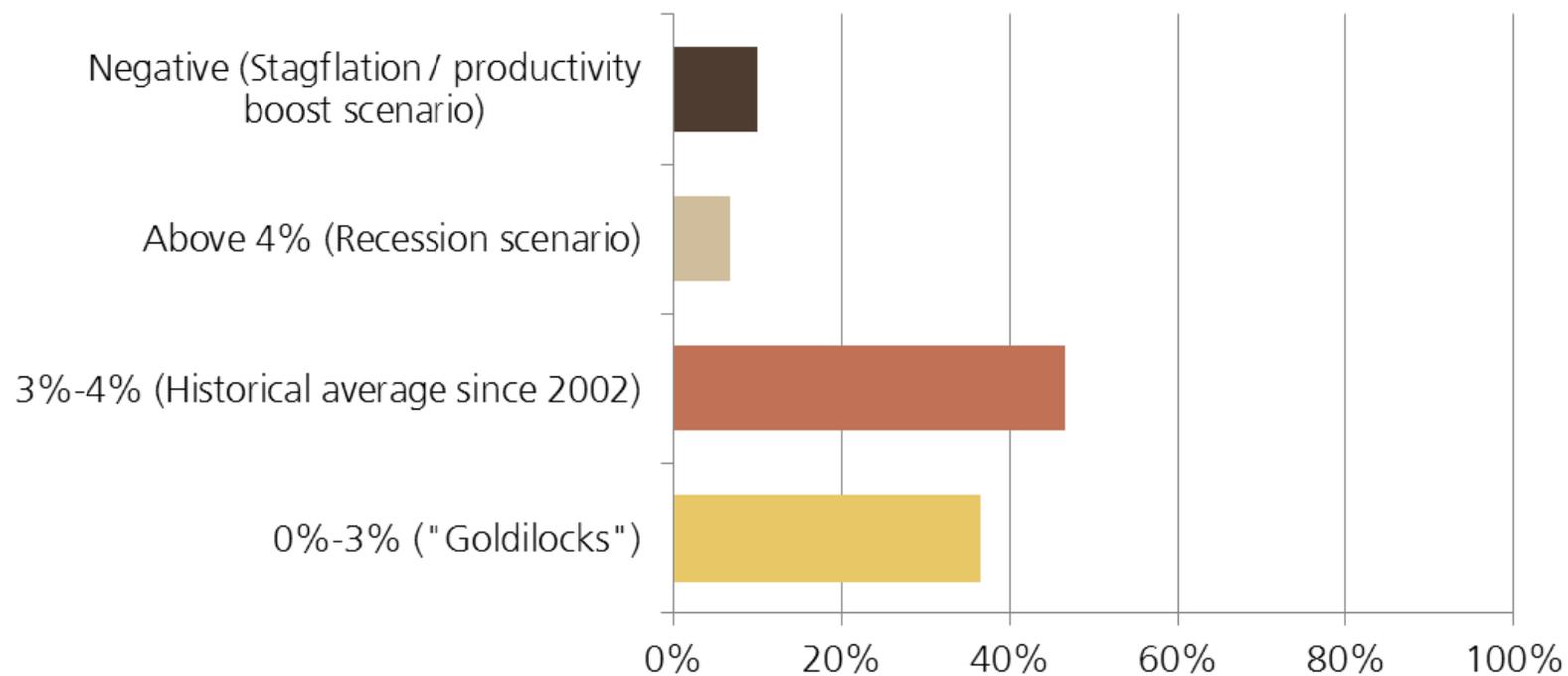
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# What do you expect the average annual return on a global bond portfolio over the next five years will be closest to?

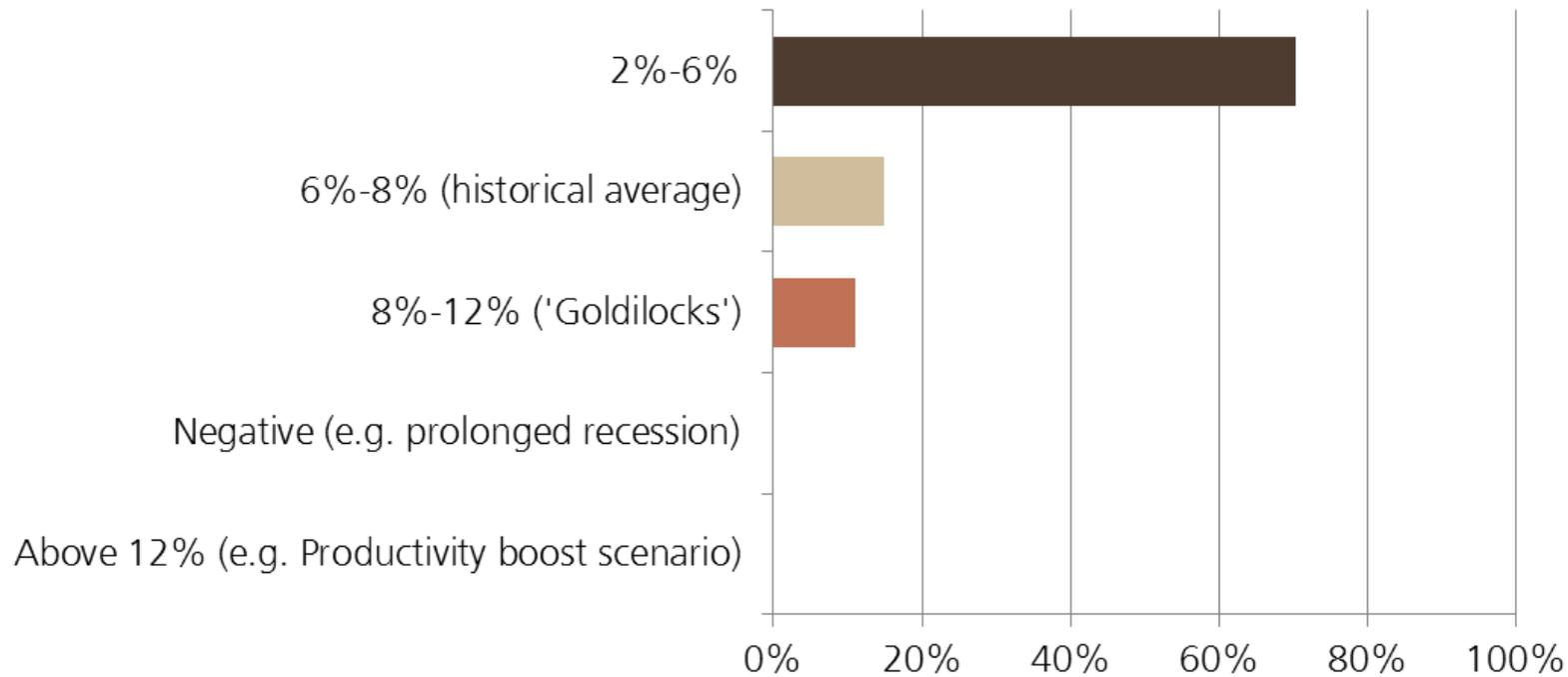
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

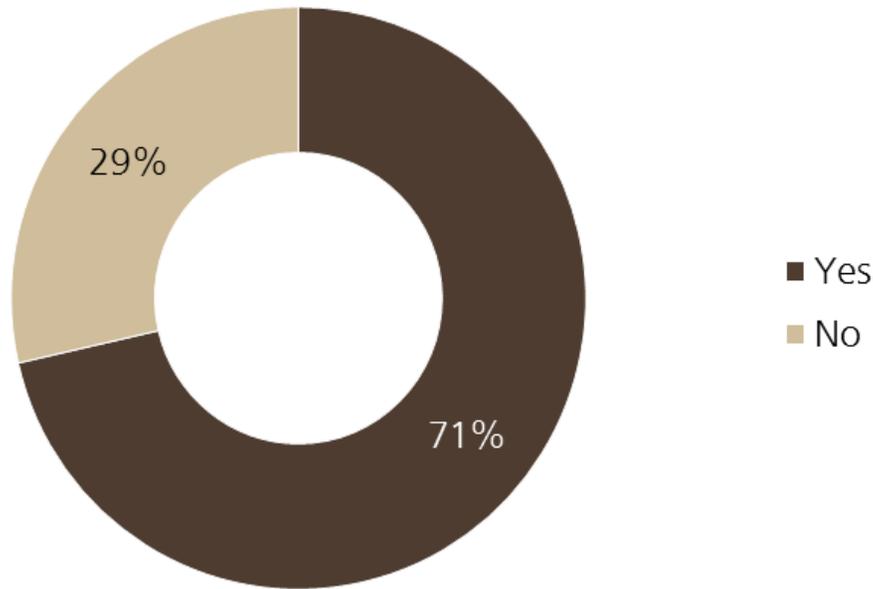
# What do you expect the average annual return on a global equity portfolio over the next five years will be closest to?

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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

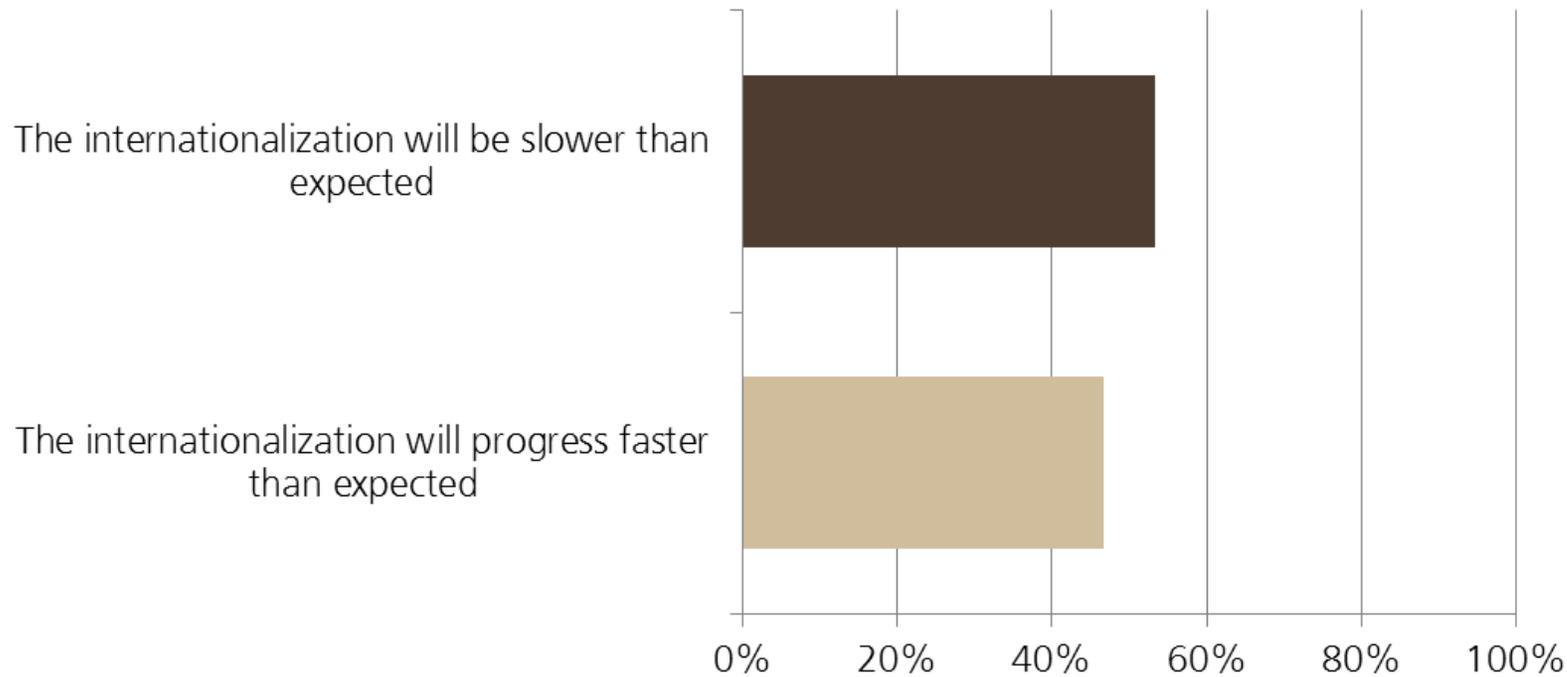
Will the historical 'natural hedge' correlation between equities and bonds continue to persist during the next 5 years (i.e. bonds going up during prolonged stock market corrections)?



Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# How do you expect the internationalization of the RMB to develop over the coming years?

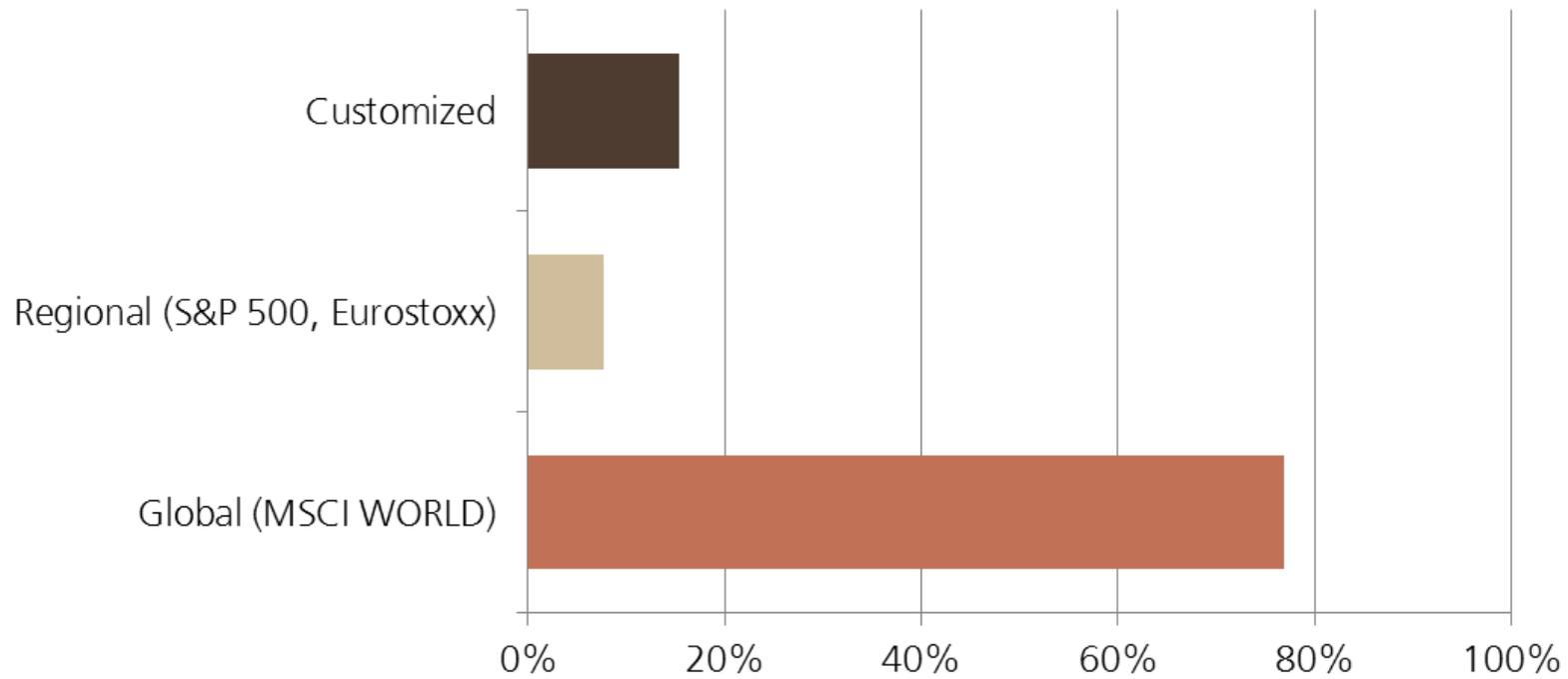
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Which benchmark do you use for Equity?

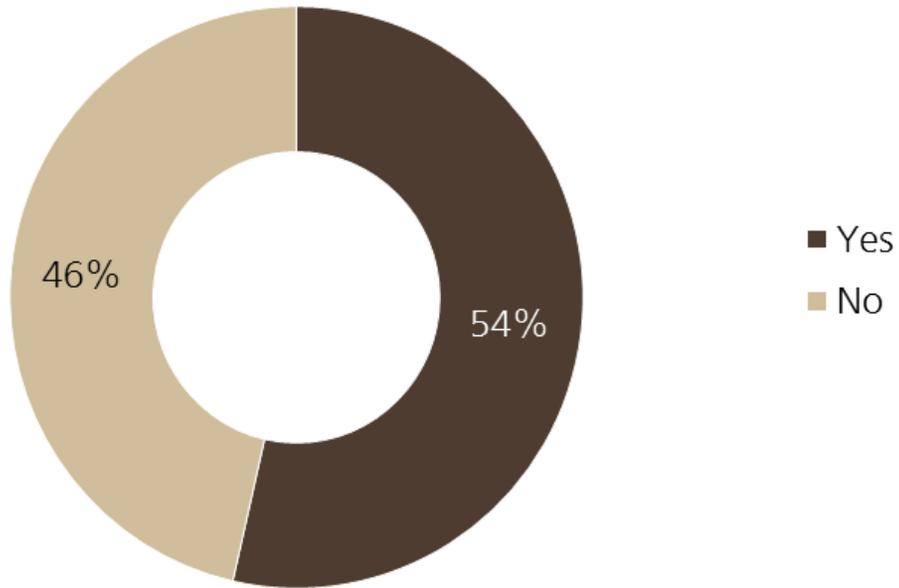
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Do you believe that fixed income liquidity has declined post GFC?

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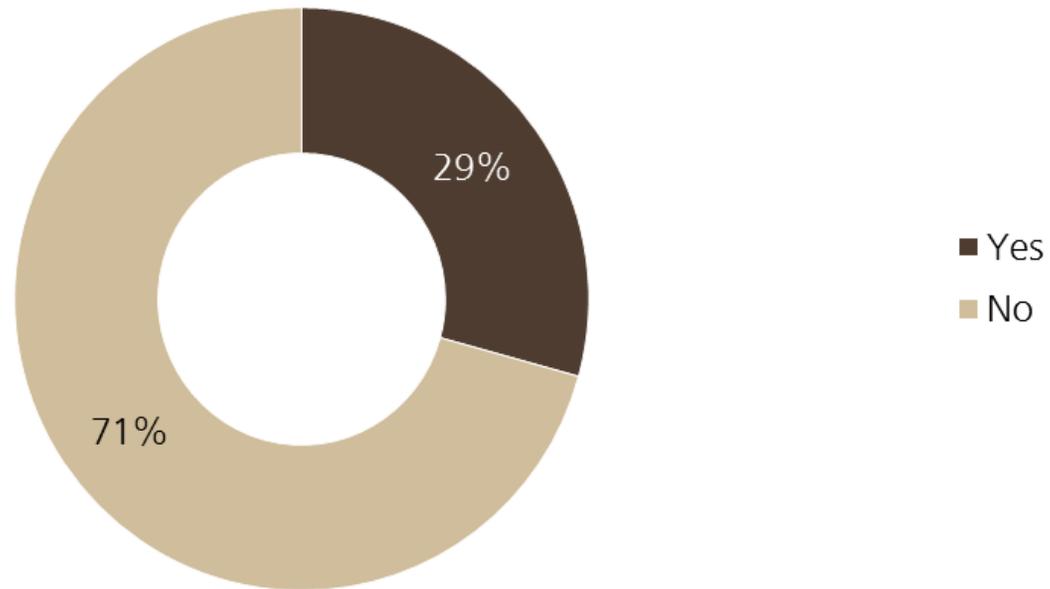


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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Should central banks invest in illiquid asset classes such as real estate and infrastructure?

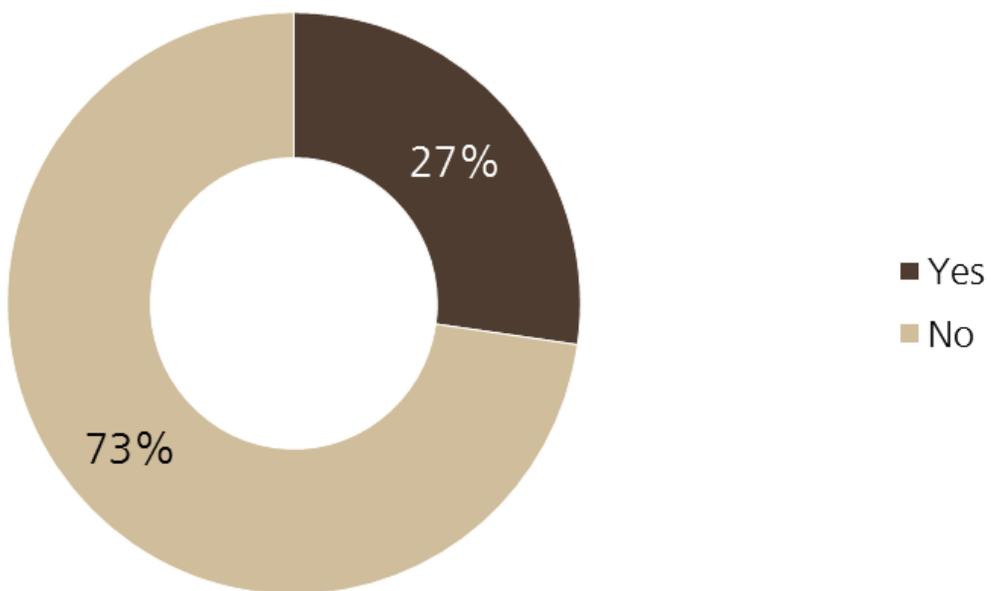
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Do you invest in Smart Beta?

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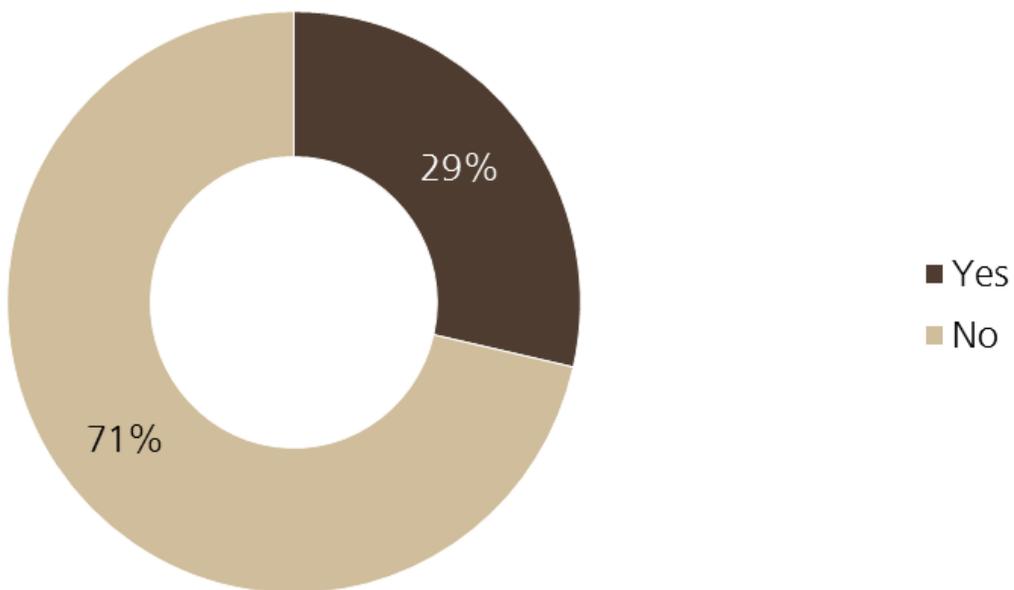


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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Do you use ETFs?

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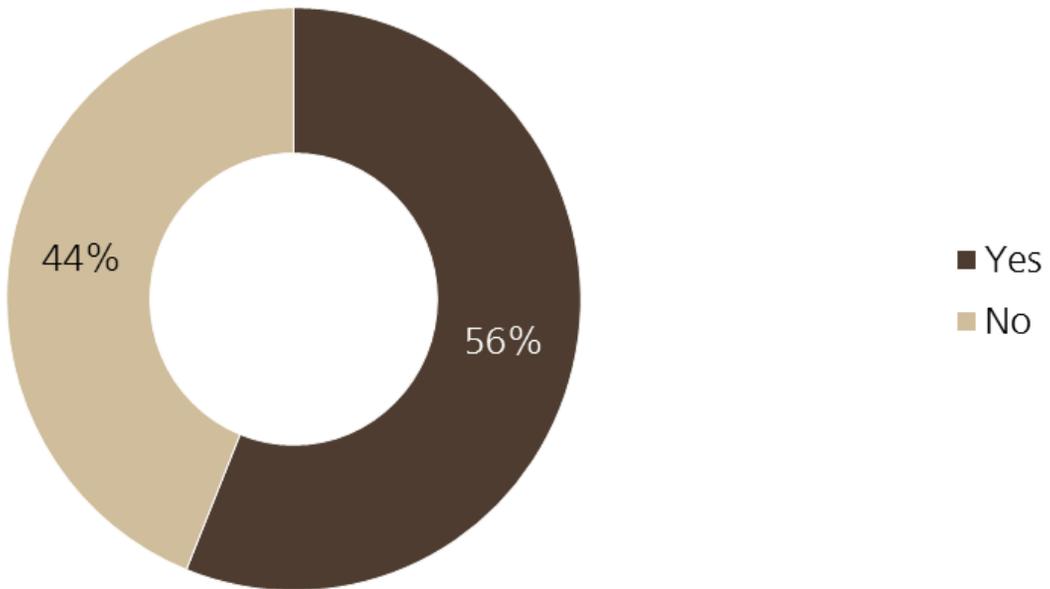


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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Are central banks too risk averse?

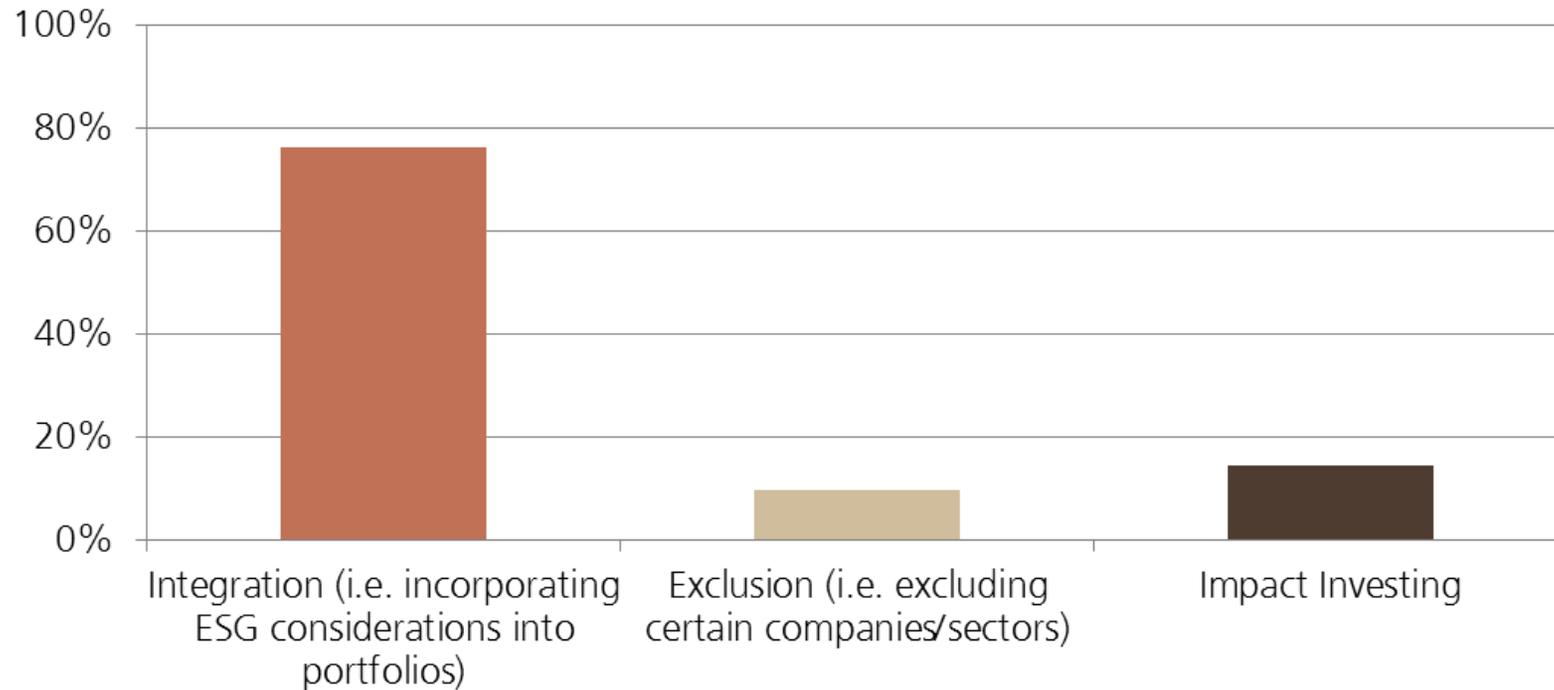
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Which approach to sustainable investing are you considering?

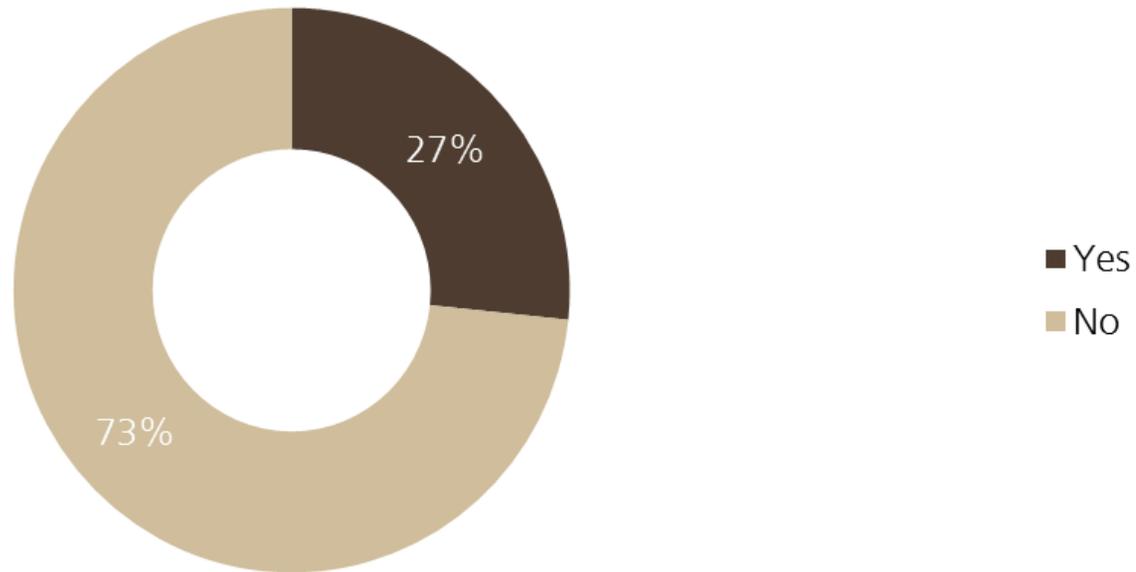
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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Do you invest in green bonds?

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Source: UBS Annual Reserve Manager Survey, results as of June 2018.

# Contact information

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