Institutional Spotlight

Switzerland Edition | September 2019

Dear Reader

Today's low growth environment is expected to become the norm over the next few decades, partly due to shrinking labour forces and over-leveraged economies. At the same time, countries have to cope with the rapid depletion of natural resources and surging carbon emissions. Faced with these growth challenges, it is even more crucial for investors to find attractive returns for their investments.

We believe one of the best ways of doing so is to combine sustainable and thematic investing. Integrating sustainability into an investment framework helps to capture valuable insights that would have otherwise been overlooked. Meanwhile, applying a thematic approach helps to harness long-term structural growth opportunities. It is the powerful combination of sustainability and thematic investing that leads to finding high quality growth companies. Valuations of such stocks may seem expensive; but one must not forget the effect of compounding returns, which is especially crucial in a low-growth environment.

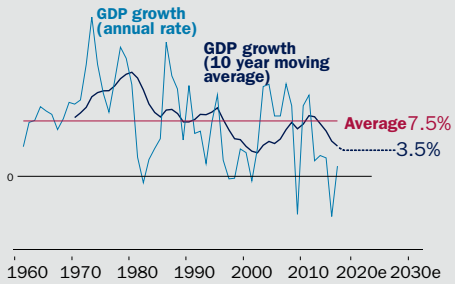
Additionally, we look for situations where market inefficiencies allow us to find quality companies at attractive prices, thus helping to capture excess returns.

Kind regards,
Daniel Graf / Bernhard Speiser
Heads of Institutional Clients

Sustainable Thematic Returns in a Growth-challenged World

The investment landscape of 2019 is truly unique in the context of any period in history. Despite the continued efforts of central banks around the world to stimulate the economy with quantitative easing policies, most countries are still showing little signs of persistent inflation and growth. In April, the International Monetary Fund published a gloomy assessment of the world economy and cut its forecast for global growth to 3.3% in 2019, making it the weakest annual growth rate since 2009. We believe this sluggish growth is the new normal and forecast global growth rates to drop to 3.5% from an average of 7.5% in the previous decades (Figure 1).

Figure 1: Forecast of Global Growth Rates



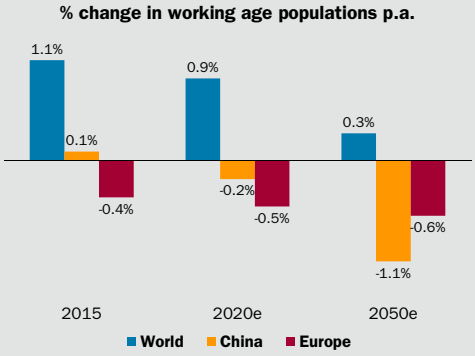
Source: Macrobond, Sarasin & Partners LLP, June 2019

Past GDP growth rates are no indication of current or future GDP growth rates.

Demographics, Debt and Carbon

In our view there are three main reasons why growth will struggle to reach previous levels. First, the working age population is shrinking globally, leading to muted growth. Defined by the United Nations as people aged 15-64 years old, the working age population had been growing comfortably at approximately 2% a year for decades. Since the Global Financial Crisis in 2008, this rate has dropped and is projected to fall further to less than 1% by 2020 and a mere 0.3% by 2050 (see Figure 2).

Figure 2: Working Age Populations, annual % growth



Source: Macrobond, UN projections, June 2019

Even in China, which is the largest contributor to global growth today, the working age population has already stagnated and begun to show signs of decline, much like in Japan and Europe. Labour force growth, a key driver of the global economy, is slowing and unless technology is able to incrementally boost productivity, global growth is likely to

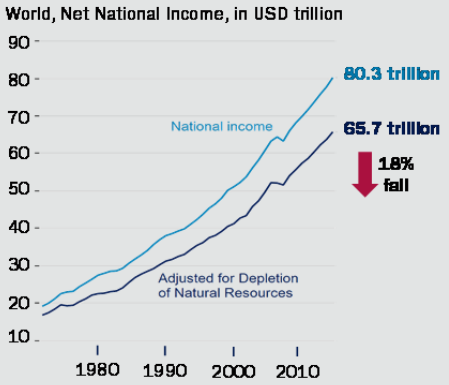
be materially lower than in previous decades.

Second, our global financial system is overleveraged. Corporate debt as a percentage of GDP in the US is at a multi-decade peak of 46% while in China, state-owned enterprises have debt-to-assets of well above 60%[1]. The UK's household debt-to-GDP stands at over 80%, while France, Japan and Germany are all seeing levels above 50%[2]. Although in the near-term the use of debt could help boost spending, in the longer run, as the level of indebtedness rises, interest payments could balloon to a level that eventually stifles growth. As with any balance sheet, including the consumer's, at some point unless the wage or income growth generated dramatically rises above the interest cost incurred, growth will stagnate.

Last but not least, one of the factors that will weigh on future growth is the depletion of natural resources. Today, climate change is one of the most pressing global issues of our time and to address this, countries have adopted the Paris Agreement pledge to strive and limit global temperature rise to 1.5 degrees Celsius. To do this, carbon emissions must be dramatically reduced. Additionally, the future impact of deforestation, the real cost of air pollution and the depletion of minerals and fossil energy are all real world problems that are not captured in GDP data. If they were, then growth would be even lower still. The World Bank illustrates this dynamic in Figure 3. The possibility of seeing economic growth that is 18% lower than today's level is especially frightening, given the amount of debt in the global economic and financial system at this point in the cycle.

These growth challenges are also happening against a backdrop of rising forces of populism and nationalism, which threaten to upend the post-war order of globalisation and free trade. We have already seen some negative impacts from a potential trade war, and any further escalation of trade tensions will affect global economic growth.

Figure 3: World Bank Adjusted Net National Income



Source: Macrobond, World Bank, June 2019

Finding Attractive Returns from Sustainable and Thematic Investing

Because of these future growth challenges, it is even more crucial for investors today to find attractive returns for their investments. We believe one of the best ways to do so is to combine sustainable and thematic investing.

Why sustainability is increasingly important for investors

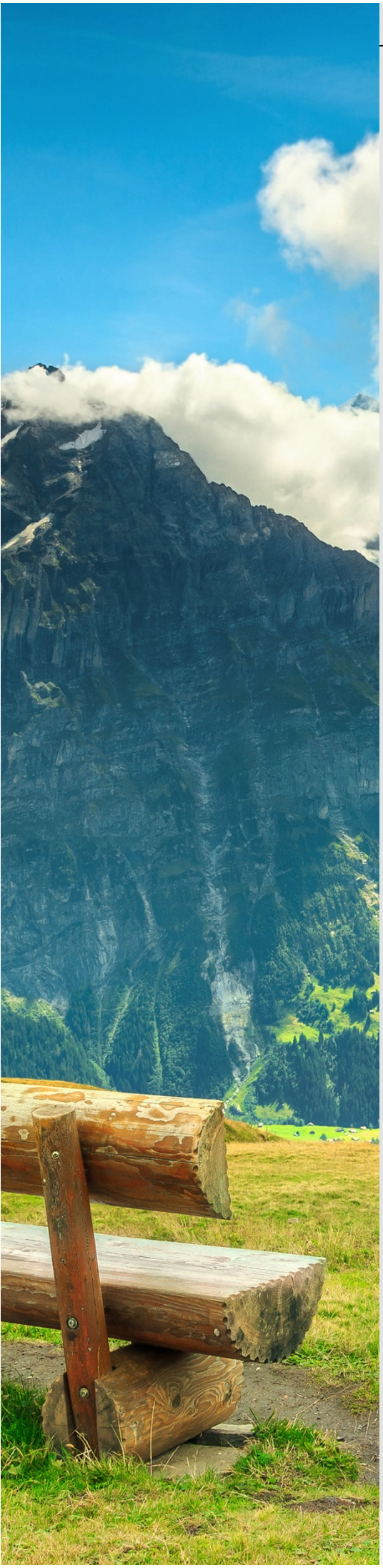
Sustainability as an investment theme first emerged towards the end of the 1990s. At the time, the main motivation was that sustainable investing is good for your conscience, but not necessarily for the performance of your portfolio.

Yet, since we started integrating sustainability into our investment framework 30 years ago, we have found that this approach has helped us to capture valuable insights that we would have otherwise overlooked by only relying on traditional financial analysis. By incorporating a sustainability mindset throughout an investment process, factors that are often overlooked by traditional investment frameworks (e.g. corporate governance, environmental issues) are taken into account. This increases the overall quality of analysis and raises the level of investment insights.

Moreover, adopting a sustainability perspective helps to harness transformational trends to find attractive thematic opportunities, and invest in businesses that provide the right solutions for the future. Ultimately, sustainable investing should lead to investing in companies with better balance

[1] Source: Haver Analytics, Gluskin Scheff, December 2018

[2] HSBC report, 2018

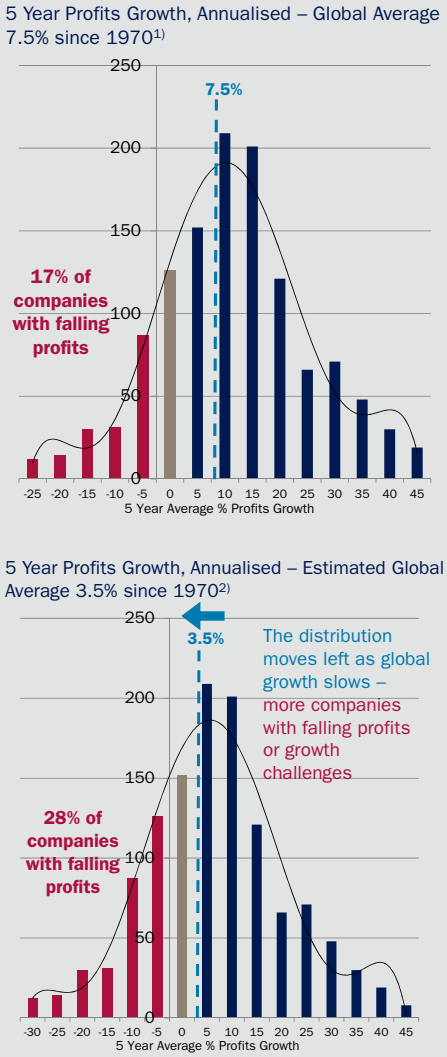


sheets, more stable earnings growth and better relative growth opportunities. This in turn, should result in a better overall performance for the portfolio, especially in the longer-run.

How Thematic Investing Helps to Identify Structural Growth

If you take our view that growth may be pegged at a much lower boundary for the foreseeable future, then we expect to see a scenario where an average of 28% of companies will see shrinking profits, compared to just 17% before (Figure 4).

Figure 4: Historic and future distribution of company profits growth



Source: Sarasin & Partners LLP– Model uses data from US S&P 500, all 5 year periods since 2004. 1) Bloomberg/MSCI ACWI data. 2) Assumes future global profits growth in line with global GDP growth forecast

With fewer companies expected to turn in a profit in future, the investment opportunity set also becomes smaller. In such a low-growth environment, one has to question the validity of investing in ETFs (exchange traded funds), which merely track a benchmark's performance. Instead, investors should be more specific about where they put money to work. We believe that higher returns can be found by looking at the investment universe with a thematic approach. Simply put, this means identifying pervasive structural changes that are forecastable, using a variety of inputs to build these themes, ranging from academia and the scientific community, to expert networks. Below we give two examples of how structural trends and themes can translate into an investable opportunity set.

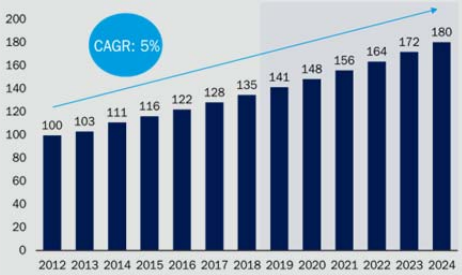
One of the most important trends shaping the future is demographic change and within this, there are several sub-themes that offer interesting potential investment opportunities. An example is the pet industry, which has seen strong growth, largely helped by changing demographic shifts. According to a study by the American Pet Products Association, millennials account for 35% of pet ownership in the US, compared to 27% for baby boomers. Increasingly with younger generations, pets are seen as an important member of the family unit, and many are more inclined towards pet adoption instead of having children. As these millennials come into adulthood, they will also have greater disposable income and a willingness to spend on pet care. The annual revenues of pet-related products and services in Europe surged 52% to reach EUR 16 billion in 2017, compared to EUR 10.5 billion in 2010[3]. In particular, an area that stands to benefit from this trend is pet healthcare. Globally, the veterinary medicine market is projected to see an average growth of 8.1% a year between 2017 and 2023[4]. As demand rises, we have seen more innovation in pet medicine and the development of new categories of therapies, such as anti-itching for psoriasis. We believe that companies like Zoetis* who are at the forefront in this niche market stand to benefit from such trends.

Another thematic opportunity with wide implications is the growth and empowerment of women as a consumer group. Women are

[3] FEDIAF as of June 2018
[4] Market Research Future, March 2019

growing their wealth at 1.5 times that of men and have doubled their financial assets in the last 10 years[5]. This disproportionate growth in female income is fuelled by structural drivers like greater female participation in the workforce, especially in emerging economies. In the developed world, more women are benefitting from tertiary education, delayed and lower frequency of child birth as well as a narrowing gender pay gap. These dynamics have helped to boost the overall financial clout of women and significantly altered growth prospects in the consumer space, from sporting goods to skin care. For instance, the global skin care market is projected to rise from USD 134.5 billion in 2018 to over 180 billion by 2024[6]. Unsurprisingly, the majority of this is driven by women, with 65% of women surveyed in the US using skin care products daily, compared to just 37% of men[7]. An example of a company that we believe stands to benefit from this trend is Shiseido*, a Japanese cosmetics firm that has a large market position.

Figure 5: Size of global skin care market 2012-2024 (in USD bn)



Source: Trefis.com as of December 2017.

On the other hand, it is also important to highlight that growth should not be the only consideration when making an investment decision. There are many sectors enjoying high growth opportunities driven by long-term structural trends, but are also facing financial or sustainability challenges that cannot be easily solved. For instance, despite the many fundamental reasons driving the future growth of electric vehicles, we expect the sector to struggle with profitability for some time to come. Although demand for electric vehicles is expected to boom, buoyed by improved technology and strong regulatory support, its return prospects are poor. One of the main reasons for this is the stiff competition within the sector. In China alone, there are over 480 electric vehicle manufacturers, and according to a report by Goldman Sachs, nearly 150 models of electric vehicles are expected to come into the market by 2025. These dynamics make it even harder for investors to find excess returns in this sector.

Nevertheless, it is still important to invest with a thematic perspective, as this will guide investors to long-term structural growth trends and help identify important opportunities in the key growth areas for the future economy.

Combining Sustainability and Thematic Investing Helps to Identify High Quality Growth Companies

Thus far, we have shown that viewing investments through the lens of sustainability helps to shed light on new and valuable insights, while a thematic approach leads to harnessing long-term growth opportunities. However, it is the powerful combination of both sustainability and thematic investing that leads to finding truly **high quality companies with strong growth potential**. These companies typically generate high profits, invest in R&D (research & development) spending, have strong management teams aligned with the right incentives and most importantly, have a clear and defined set of objectives.

Even though these high quality companies often come at a price, we believe one should not underestimate the ability of these businesses to compound returns over the long-term. For instance, a stock with a P/E ratio of 20x and facing a 3% long-term growth rate can be more attractive than a stock with a P/E ratio of 10x with a 2% long-term growth. We find that there is often a fundamental, emotional and quantitative response to stocks that appear to be "expensive", and the ability of companies to compound returns is often misunderstood and undervalued by the market.

At the same time, it is also important to understand that building a portfolio consisting only of such high quality growth companies would cause to miss out on some attractive opportunities. We believe there are two in-

[5] Reuters, 07.03.2019, "Snail's pace:BAML says economic gender gap to endure for centuries"
[6] Trefis.com as of December 2017
[7] Statista survey May 2017

teresting situations where quality companies can be found at attractive prices, thus helping to capture additional returns.

1. Opportunistically Contrarian

These are quality growth businesses that are exposed to the peaks and troughs of a business or industry cycle. When this happens, the market tends to overestimate the bleakness of the near-term outlook, ignoring many of the factors that determine the company's true intrinsic value. This usually leads to an undervalued company, and finding such opportunities can be a source of additional return.

2. Special Situations

In this category, we search for more uncorrelated returns in companies that have quality growth potential, but are suffering from highly specific short-term problems that can be solved. This could for instance, be cases where new management is required, incentives are changed or in some instances, an industry consolidation brings about fundamental changes in intrinsic value, which can be analysed based on own industry expertise and before other research is published.

Exploiting these situations of market inefficiencies is a powerful way to generate additional returns, since they benefit from the effect of compounding returns. Focusing on high quality and profitability allows for the reinvestment of those profits. Similarly, targeting high growth companies enables investors to potentially compound returns over time.

Conclusion

Looking ahead, many trends and signs point to a world where we will see structurally sluggish growth. This poses a great challenge for investors looking to achieve their target returns. Instead of settling for lower average returns or yields, we believe investors can capture excess returns by looking for attractive opportunities using the lens of sustainability, combined with a thematic approach. We believe the world is beginning to understand that investing globally gives you the best chance of buying the best quality companies and investing thematically helps you to pick the winners of the future while avoiding industries with a poor outlook. Moreover, integrating sustainability helps investors to find quality companies with sound business models and strong balance sheets. In the event of an economic downturn, this should also better protect investors.

How to invest in Sustainable Thematic Global Equities

JSS OekoSar Equity – Global

Fund domicile	Luxembourg
Legal structure	SICAV
ISIN	I USD acc / LU1111703390 / 25494806 I EUR acc / LU0405184523 / 4889559 I EUR dist / LU1732171456 / 39415318

Strategy can also be made available as a segregated account.

Gross performance[1)]	1 year	3 year p.a.	5 year p.a.	Since inception[2)]
Fund	14.58%	14.19%	11.48%	192.31%
MSCI World NR	8.89%	10.58%	11.06%	156.18%

Source: Bank J. Safra Sarasin Ltd, Bloomberg. Data as of 31.07.2019. Past performance is no indication of current or future performance. The performance data do not take account of the commissions and costs incurred on the issue and redemption of units. 1) Rolling Period. Gross performance is shown gross of management fees. 2) Since inception date is 30.09.2005. This publication does not constitute a request or offer, solicitation or recommendation to buy or sell investments or other specific financial instruments, products or services. It should not be considered as a substitute for individual advice and risk disclosure. Interested parties are kindly requested to get in touch with our local Bank J. Safra Sarasin representatives for further information about our products and services.

*The company examples given above are for illustrative purposes only. They do not constitute a request or offer, solicitation or recommendation to buy or sell investments or other specific financial instruments, products or services. They do not take into account individual investors' circumstances and should not be considered as a substitute for individual advice and risk disclosure by a qualified financial, legal or tax advisor.

Important legal information

This marketing publication has been prepared by Bank J. Safra Sarasin Ltd ("Bank") for the sole use of the eligible recipient only. The information and descriptions of the investment product contained in this marketing publication are intended purely for information purposes and do not constitute financial, legal or tax advice and/or any other recommendation, offer or solicitation to acquire or sell investment products, to engage in a transaction, or to conclude any type of business, nor are they any substitute for, in each individual case, obtaining the necessary advice and information on risk from your professional advisor to an extent which you consider appropriate and reasonable, in order to ensure that the transaction is appropriate and suitable to your financial goals and circumstances. This marketing publication contains selected information only and does not claim to be complete or exhaustive.

This marketing publication is based on publicly available information and data ("the Information") believed to be correct, accurate and complete. The Bank has not verified and is unable to guarantee the accuracy and completeness of the Information contained herein. Possible errors or incompleteness of the Information do not constitute legal grounds (contractual or tacit) for liability, either with regard to direct, indirect or consequential damages. There is no obligation on the part of the Bank or any other person to update the content of this marketing publication. The views and opinions contained in this marketing publication, along with the quoted figures, data and forecasts, may be subject to change without notice.

The price and value as well as any income that might accrue of any financial instrument mentioned in this marketing publication may move upwards or downwards. Past performance is no indication of current or future performance. The performance shown does not take account of any commissions and costs incurred on the issue and redemption of shares/units. Such costs and commissions have a negative impact on the performance of the financial instrument. There is no assurance that the target net return can be achieved. Information containing forecasts are intended for information purpose only and are neither projections nor guarantees for future results and could differ significantly for various reasons from actual performance. Investments in foreign currencies are subject to exchange rate fluctuations. Exchange rate risk will apply if the investor's reference currency is not the same as the investment currency.

The Bank and/or an affiliate of the J. Safra Sarasin Group, its clients and/or officers may hold a position or engage in transactions in any of the financial instruments mentioned.

The Bank does not accept any liability whatsoever for losses arising from the use of the Information (or parts thereof) contained in this marketing publication. In particular, neither the Bank nor its shareholders and employees shall be liable for the views contained in this marketing publication.

This publication is intended only for investors in Switzerland. It may only be distributed in countries where its distribution is legally permitted. This information is not directed to any person in any jurisdiction where (by reason of that person's nationality, residence or otherwise) such offering is prohibited. Shares/Units of the financial instruments mentioned may not be offered, sold or delivered to persons domiciled in the USA, US nationals or US person as defined by FATCA-rules. Consequently, services and/or products mentioned in this marketing publication may not be available in all countries. Interested parties should contact the local J. Safra Sarasin Group-representative to be informed about the services and products available in their country of residence.

Further Important Information on JSS OekoSar Equity – Global

Investing in this fund entails risks which are outlined in the prospectus. The latest available prospectus as well as the Key Investor Information Document "KIID" should be carefully read and an independent consultant should be consulted before considering any investment. The above mentioned documents as well as the annual and semi-annual reports are available free of charge from the paying agent (Bank J. Safra Sarasin Ltd, Elisabethenstrasse 62, P.O. Box, CH-4002 Basel, Switzerland) or the Swiss representative (J. Safra Sarasin Investmentfonds Ltd, Wallstrasse 9, CH-4002 Basel, Switzerland).

Bank J. Safra Sarasin Ltd.
Elisabethenstrasse 62
P.O. Box
CH - 4002 Basel
T: +41 (0)58 317 44 44
F: +41 (0)58 317 44 00
E-Mail: ic@jsafrasarasin.com
https://am.jsafrasarasin.com