Sustainable Investments

The Sustainability Newsletter of J. Safra Sarasin Asset Management

October 2016

Editorial

Sustainable investments become mainstream

Dear Reader

At first glance, the communication reads like a pamphlet written by a pressure group. On the first page alone, the word “sustainable” features five times, alongside the terms “social”, “ecological”, “balanced” and “inclusive”. But in fact, this communiqué has been signed by the heads of state and government of the world’s biggest countries, the Group of Twenty (G20). The “Hangzhou Consensus”, named after the Chinese city where the summit was held, marks the start of a new era in policy coordination. It heralds a fundamental change in our thinking on economic growth.

Nations need to deliver on their promises

But what are the next steps? The agreed targets for climate change imply a radical change of direction. This is already reflected in the tougher regulations adopted by the European Union to reduce the level of emissions from carmakers’ vehicle fleets. China has actually set even more stringent targets in its latest five-year plan. If Hillary Clinton becomes President, the USA is likely to tighten up rules and follow the example of California, which has imposed some of the world’s strictest regulations on greenhouse gas emissions. The automotive industry is facing unprecedented challenges.

The Hangzhou Consensus also confirmed the 17 Sustainable Development Goals agreed by the UN in New York. We must now expect incentives to be created for the investment needed to achieve these overarching goals, such as improving health and well-being, ensuring a clean water supply and promoting responsible consumption and production. Such investments are vital for nurturing the innovative forces needed to overhaul the global economy. Since the Hangzhou Consensus also acknowledges the estimate for investments stated in the Addis Ababa Action Agenda of USD 11,500 billion per year, we expect a vast number of private-public partnerships to appear to tender to the ambitious projects in this area.

Action plan for investors

Investors must make sure they are adequately prepared for the risks and opportunities created by the Hangzhou Consensus, and perform a health check on their portfolios. The energy sector presents the greatest risk in a portfolio. Caution should be exercised if the assets carried on a company’s balance sheet include large fossil fuel reserves, power stations with high CO2 emissions or gigantic projects exploring dubious energy sources. New regulations introduced in France in 2016 require all pension funds to disclose the risks associated with these potentially “stranded assets”.

Since Mark Carney, Governor of the Bank of England and Chairman of the Financial Stability Board at the Bank for International Settlements (BIS) issued a warning in September 2015 that climate risks are a major threat to financial stability, insurance companies should also be subject to a thorough sustainability analysis. In addition, the shares of companies that violate international standards should be avoided. The focus is particularly on consumer goods companies that do not have full control of their supply chains, since exploitative business practices are detrimental to “inclusive growth” both in industrialised or emerging-market countries.

At the same time, it is worth considering technology leaders in the field of energy efficiency. E-mobility is set to become more important and will benefit companies that provide high-performance batteries and infrastructure for recharging electric vehicles. The need to provide a reliable clean water supply will also give a boost to water utilities, manufacturers of water treatment systems and the relevant infrastructure, as well as water metering equipment. Pharmaceutical companies that generate their profits in industrialised countries and provide low-cost access to medicines in developing countries will also profit. One thing is clear, however: Hangzhou has definitely helped sustainable investment move into the mainstream.

Best wishes,
Jan Amrit Poser
Chief Strategist and Head Sustainability

Fostering acceptance of the Principles for Responsible Investment (UN PRI principle 4)

Bank J. Safra Sarasin plays an active role in Swiss Sustainable Finance (SSF) & the Swiss Climate Foundation

As Switzerland's leading provider of sustainable investments, senior managers at Bank J. Safra Sarasin sit on the decision-making bodies of two key industry bodies for promoting sustainable development and the market for sustainable investment. On this page we describe our role in these two prominent Swiss networks.

Active in Swiss Sustainable Finance (SSF)

SSF strengthens the position of Switzerland in the global marketplace for sustainable finance by informing, educating and catalysing growth. To this end, it organises events, coordinates publications and produces market reports. Apart from offering courses with universities, SSF also provides support for institutional investors and private banks in the area of sustainable investing. Its mission is to position Switzerland as a leading centre for sustainable finance by fostering a political dialogue and international presence.

Pierin Menzli on the SSF Board

Bank J. Safra Sarasin is a founding member of SSF. At its AGM in June 2016 Pierin Menzli, Head Sustainable Investment Research, was elected to the SSF Board. This appointment enables our bank to take an active role in setting SSF's strategic direction.

Interview with Pierin Menzli

Pierin Menzli
Head Sustainable Investment Research and member of the SSF Board

Mr Menzli, what's the motivation for being actively involved in SSF?

Menzli: SSF has set itself ambitious goals aimed at developing Switzerland into a leading centre for sustainable finance. I have actively and personally supported this mission for many years. As Swiss market leader in sustainable investments, we also have a responsibility to promote public discussion and drive market growth.

What objectives and activities are you particularly interested in?

Menzli: I will be concentrating my efforts chiefly on private and institutional investors. I have already devoted a lot of time to SSF over the past 12 months, working on an application study offering many case histories for institutional investors. The study will be published at the end of 2016.

How do sustainable investments in Switzerland stand up in an international comparison?

Menzli: Switzerland has good private and institutional solutions in the area of sustainable investments. However, I note that other regions such as France, the Netherlands and Scandinavia, seem to be enjoying more dynamic growth on the demand side. There are many different reasons for this, including pressure from the asset owners, criticisms from the media and NGOs and, last but not least, stricter regulatory requirements.

Swiss Climate Foundation fosters sustainable development

The Swiss Climate Foundation supports small and medium-sized enterprises (SMEs) that make a positive contribution to climate protection. The Foundation comprises well-known providers of financial services. These companies pool their net gains from CO_2 rebates and reinvest them to promote projects by Swiss and Liechtenstein SMEs in three key areas. The first initiative is to improve the energy efficiency of companies. The second is to help companies save energy. The third involves innovation projects that contribute towards climate protection.

BJSS active on the Board and Advisory Council

Bank J. Safra Sarasin is a founding member of the Swiss Climate Foundation and thus plays a prominent role in its decision-making bodies. **Dr Agnes Neher**, Corporate Responsibility Manager at Bank J. Safra Sarasin, is involved in the Advisory Council. The Council discusses and assesses the proposed efficiency and innovation projects and passes a vote on them at the end of this process. This vote is then reviewed and eventually approved by the Foundation's Board at one of its six-monthly meetings. One of the members of this highly experienced Board comprising leading lights from the Swiss financial community is **Dr Jan Amrit Poser**, Chief Strategist and Head Sustainability at Bank J. Safra Sarasin.

Swiss Climate Foundation

Dr Jan Amrit Poser, Board member, summarises the Foundation's recent success:

"The Swiss Climate Foundation can look back on a number of successful projects. For example, it has helped a leading producer of steel mesh to install a new plant control system that provides better temperature regulation and uses recycled heat to warm the interior during winter. This provides savings both in energy costs and CO_2 emissions. Another project involved a module capable of combining energy from the updraft on a roof edge and the sun's rays to generate electricity. This technology allows buildings with flat roofs to cover the bulk of their own energy requirements. Another successful project was the development of an efficient method for growing lettuces using innovative technologies. The greenhouses use special LED lighting and have made it possible to cut water consumption by a factor of 100. The lettuces are grown without any pesticides. In this way, our involvement makes an effective contribution towards climate protection."

Investing in the financial sector: still many challenges and risks ahead

Since the financial sector is the largest sector by market capitalisation, and is especially exposed to interest-rate movements, a special attention is required. The challenges, beside low interest rates, are numerous and of magnitude. This complexity highlights the value of our comprehensive sustainable investment research approach for the financial sector. It enables us to incorporate relevant insights from the industry, along with sustainability and fundamental investment analysis, in order to identify risks and avoid the losers going forward.

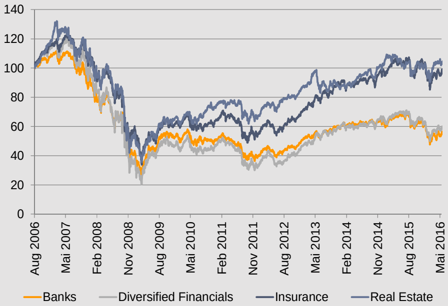
Understanding the industry characteristics and the biggest sector challenges

The financial sector has an important function and is of high relevance for society. It is crucial to understand how the "financial humus"- the soil on which a strong financial "plant" could best develop - of certain regions is constructed and how macroeconomic factors affect investment decisions. We place special emphasis on the identification of country risks and prefer financial companies that operate in regions with strong macroeconomics as well as good country sustainability ratings. Our analysis shows that some financials companies seem to be better prepared to address the three most critical business challenges that we identified:

1) ***Low interest rates***

Overall, the low interest-rate environment is less harmful for the insurance and real estate sector than for banks.

Diverging performance within Financials



Source: Bank J. Safra Sarasin,based on Bloomberg, 2016

Considerably better risk/reward patterns have enabled insurance and real-estate companies to consistently outperform banks and diversified financials in the past 6 years. We believe that this differentiation could persist in the future and at least until interest rates start to rise.

2) Regulation

Banks will continue to feel the regulatory pressure, whereas insurers are already a step ahead and display much stronger capital ratios.

3***) FinTech***

On top of that, insurers have more financial resources available to invest in FinTech activities and to benefit from the progress in this area. In contrast, banks are not in a good position to invest in innovation, since their current IT budgets are mainly allocated to the maintenance of the current infrastructure.

Sustainability at the core of Bank J. Safra Sarasin's investment process

We systematically integrate environmental, social and governance (ESG) aspects that are under-researched by the market into our investment process. The sustainability analysis provides us with an additional angle to our investment cases. In the past years, this approach has enabled us, for example, to avoid capital-intensive investment banking business models. In general, the sustainability approach helps us to identify companies which have more future-oriented and resilient business models, better preparedness for regulatory developments and less reputational and legal risks.

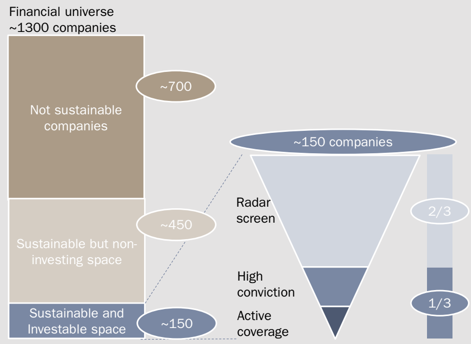
Need to focus on avoiding risks

Financial market volatility is set to persist and volatility is poison for share prices. The only antidote against this volatility is for shareholders to focus on companies with a low risk profile, with a strong cushion of capital and with healthy balance sheets.

In-depth investment analysis to find the best risk-return opportunities

We take a very risk-aware and structured approach in our bottom-up analysis built on several proprietary quality and traditional valuation metrics.

Proprietary selection methodology



Source: Bank J. Safra Sarasin, 2016

The quality metrics are derived from our macro-economic, sector trend, and sustainability analyses. Since financial companies are typically highly leveraged, we focus on their resilience and on understanding the specific company risks in detail. Moreover, we differentiate stocks by their risk-return profiles and acknowledge their respective roles within a client portfolio.

Implications for investors

Overall, investments in the financial sector are challenging. The Bank J. Safra Sarasin sustainable investment approach contributes to identifying and reducing such risks by incorporating them into the investment decision-making process.

Fabrizio Croce
Sustainable
Investment Analyst

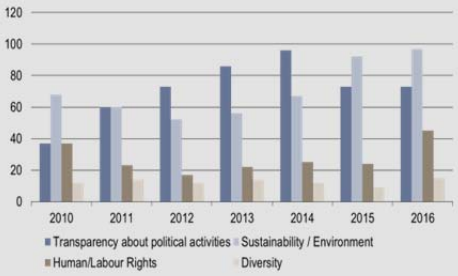
Shareholder engagement and proxy voting

An active dialogue, in the form of shareholder engagement and proxy voting, is becoming increasingly important for sustainable investors – and consequently for companies as well, not least due to mounting pressure from industry regulators on institutional investors to exercise their voting rights. The main purpose of our shareholder engagement and voting activities is to have a positive impact on the long-term growth in enterprise value. To do so requires an integrated approach that is a fixed component of our investment process.

Growing interest

In recent years there has been a sharp increase in the number of votes on environmental, social and governance (ESG) issues at annual general meetings (AGMs). Since the start of this year, there has been regular support of up to 40% for shareholder resolutions. It seems that shareholders are no longer voting in isolation, but are discussing agenda items with other investors. This trend is particularly evident with large institutional investors. A new form of "virtual" shareholder meetings, as recently pioneered by the UK company Jimmy Choo, will also make it easier for investors to become more involved. In particular, there has been a significant increase in the participation of big institutional investors. The media is also showing more interest in AGM voting outcomes. Whether it be the *Financial Times,* the *Wall Street Journal* or the *Neue Züricher Zeitung* in Switzerland: in recent months they have all carried reports on various topics to do with the exercising of voting rights. There are also more regular reports about engagement activities, such as when Norway's sovereign wealth fund gets together with other investors to put pressure on the management of certain companies - and as a result possibly even sells some of its shares.

Figure 1: Voting trends on agenda items



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Source: Sustainable Investment Institute (Si2), in: ESG Magazine, 2016

Mounting regulatory pressure

Across Europe there is a growing number of regulatory requirements intended to promote active dialogue with companies on the one hand and on the other hand to impose an obligation on investors to vote on certain issues, such as executive salary packages. Their common purpose is to strengthen the rights of shareholders. Switzerland, for example, has implemented the Ordinance against excessive compensation in Swiss listed companies (VegüV), which was introduced in response to the "Minder" popular initiative in 2013. This requires companies to take an annual vote on the overall compensation packages offered to the board of directors, for example. On top of that, pension funds are required to exercise their voting rights on listed shares and to report on how they voted.

Dialogue and exercising of voting rights as an integral part of the sustainable investment approach

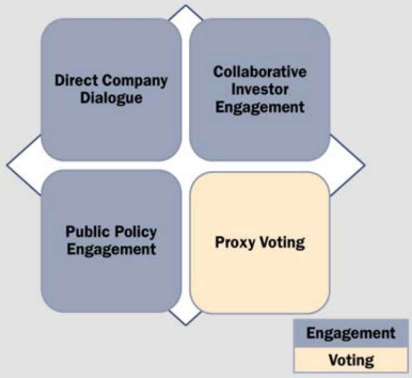
Shareholder engagement and exercising of voting rights have long since been an integral part of our sustainable investment philosophy. We are convinced that complying with the rules of good corporate governance and fostering good environmental and social practices can benefit a company's share price in the longer term. The objectives of our dialogue and voting activities are as follows:

- Providing an opportunity for our clients to exert their influence as active shareholders,
- Strengthening our investment decisions,
- Reducing the negative impact of investments on society and the environment and
- Promoting sustainable development over the long run.

With all our initiatives in this area, we want our actions to be focused, effective and transparent. This approach ties in with our sustainable investment philosophy and takes into account numerous international guidelines and standards (United Nations Global Compact, the conventions of the International Labour Organization (ILO) and many others).

In concrete terms, our activities are split into four relevant areas, as shown in Figure 2.

Figure 2: Overview of shareholder engagement activities and exercising of voting rights



Source: Bank J. Safra Sarasin, 2016

We strongly believe that the combination of these activities will enable us to achieve our various goals, such as minimising investment risks and consistently increasing the value of our investments in the long term. All our activities are covered by the relevant reporting.

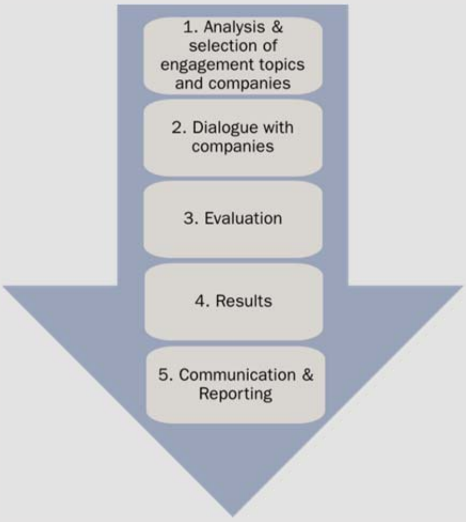
Engagement activities at Bank J. Safra Sarasin

Numerous engagement activities have already been carried out in 2016. Both our sustainable investment analysts and portfolio managers are directly involved in this.

<u>On the company level</u>

Every year, Bank J. Safra Sarasin's sustainable investment analysts and portfolio managers meet with the management of around 400 companies to discuss ESG issues, amongst other themes. There is also specific and more extensive dialogue to address individual ESG concerns, for example, or to increase transparency and improve sustainability reporting. The procedure adopted here is outlined in the next figure:

Figure 3: Process for dialogue with companies



Source: Bank J. Safra Sarasin, 2016

Recent successes include, for example:

- An insurance company that has drawn up a sustainability strategy and for the first time has consciously addressed material ESG risks.
- A paper and packaging materials manufacturer who was persuaded to adopt greatly improved sustainability reporting.
- A real estate company that carried out a review of its buildings portfolio to assess their sustainability credentials.

Collaborative investor engagement

Bank J. Safra Sarasin collaborates with other investors in order to maximise the impact of engagement initiatives. At present, for instance, we are active as lead investor in an initiative coordinated by the Principles of Responsible Investment (PRI) to look into the water risks in the agricultural supply chain of corporations. For several years now we have also been participating in the "Access to Medicine Foundation", which is an active dialogue with pharmaceutical companies and rates them according to their ability to offer access to health services in developing countries. In this context Bank J. Safra Sarasin acts as lead investor for one of the big Swiss pharmaceutical companies.

Public policy engagement

Bank J. Safra Sarasin actively participates in the political dialogue in many different ways, often in collaboration with other asset managers and banks. Through our involvement in leading initiatives and organisations such as Eurosif and Swiss Sustainable Finance, we foster contacts with political groups to press for ESG themes to be considered and integrated at regulatory level as well. In addition, the Bank's representatives fulfil their responsibilities as members of the SSF Board, for example, or contribute to industry-wide publications, such as the SSF Toolkit for Institutional Investors.

Exercising of voting rights at Bank J. Safra Sarasin

Bank J. Safra Sarasin exercises votes for sustainable investment funds in accordance with its individual proxy voting guidelines. In the past 9 months we have voted on more than 3,400 agenda items at over 220 AGMs worldwide. Figure 4 shows those countries where the Bank has voted. Most of the votes (by a long chalk) were cast in the USA, followed by the UK, Japan and Switzerland.

At these AGMs, Bank J. Safra Sarasin voted against one or several of the management's recommendations over 24% of the time. Common topics where the Bank voted against management recommendations included, for example, executive pay or a lack of cultural or gender diversity in the composition of the Board. On the other hand, the Bank tended to vote in favour of initiatives to improve transparency, such as the publication of an environmental report. The Bank also took part in votes to disclose political lobbying activity by companies.

Examples of specific voting behaviour

- **Voting against 'fat cat' salaries**
  Bank J. Safra Sarasin votes against management recommendations if the proposed remuneration packages are not compatible with the management's long-term performance or no transparent information is disclosed regarding the salary components.
- **Voting for transparency**
  For example, Bank J. Safra Sarasin always votes in favour of the publication of sustainability reports, strategies or associated themes.

Numerous benefits for clients

Active dialogue and the exercising of voting rights considerably improves benefits to clients and allows them to …

- … fulfil their responsibility and use the opportunity to exert their influence.
- … satisfy legal requirements.
- … vote on environmental, social and governance themes in line with the comprehensive sustainable investment approach of Bank J. Safra Sarasin.

Dr Agnes Neher
Corporate Sustainability Manager

Andrea Weber
Sustainable Investment Analyst

Figure 4: Global voting activity of Bank J. Safra Sarasin

Source: Bank J. Safra Sarasin, 2016

Bank J. Safra raises its sustainability profile at international conferences

As Swiss market leader in sustainable investments, Bank J. Safra Sarasin is both a pioneer and thought leader. This is highlighted by our strong presence and active participation in major industry gatherings such as the SIBOS financial services event in Geneva and the Responsible Investor 2016 Conference, where we acted as main sponsor for the Reporting Awards.

Responsible Investor (RI) Europe 2016

RI Europe 2016 is the world's most important conference on sustainable investments. It was the ideal stage for Pierin Menzli, Head Sustainable Investment Research, to present Bank J. Safra Sarasin's approach to the link between "ESG and Big Data". In the ensuing podium discussion, he discussed the advantages of our investment philosophy, which combines the findings of systematic ESG data analysis with financial analysis. Our active involvement in the biggest international conference on sustainable investments raises the awareness of institutional investors of our brand and strengthens our standing as market and innovation leader.

Menzli on the podium at RI Europe

RI Awards: Host and jury member

The Bank was also the main sponsor and jury member for the RI Reporting Awards. This prize is awarded to institutional investors such as pension funds and public-sector superannuation funds that are commended for providing the most progressive and comprehensive reporting of their commitment to sustainable investments. The Bank invited the prize-winners, which came from France, the Netherlands, Scandinavia, the UK and also Australia in the USA, to a special gala dinner. This event provided the ideal opportunity to discuss trends and developments in the field of sustainability and to strengthen the Bank's links with leading sustainable investors.

Jan Poser talks about sustainability

SIBOS: The world's major financial services event

Since its inauguration 38 years ago, the SIBOS conference has established itself as the biggest gathering of the financial services industry. Every year, over the course of just one week, SIBOS brings together 8,000 decision-makers, top executives and experts from financial institutions across the globe. It provides the opportunity to keep up with the latest technological developments, discuss the most important industry trends and share experiences. At hundreds of talks and podium discussions, the 200 exhibitors showcase their evolving business strategies and shape the financial industry of the future.

Sustainability as a strategic cornerstone

As part of the SIBOS series of talks on corporate culture, Jan Amrit Poser, Chief Strategist and Head Sustainability, made it clear that a business strategy built upon sustainability principles encourages more long-term thinking and raises risk awareness. Gearing the entire organisation to the strategic goals of sustainable development not only makes the Bank more stable, but also more profitable. On top of that, embedding sustainability in the Bank's brand creates a USP that increases the loyalty not only of clients, but also employees.

Investment Innovation Benchmark Award

Bank J. Safra Sarasin's Sustainable Investment Research team received the Investment Innovation Benchmark (IIB) Award. The independent international jury of the IIB project is composed of academics and international investors. Their mission is to promote high-quality investment innovation. IIB organises semi-annual events where international banks and asset managers, together with research and service providers, have the opportunity to present their innovations to the IIB jury. After a thorough evaluation process, the award is then decided over the course of the following months. Our Sustainable Investment Research arm was represented by Tomasz Godziek, who presented the second generation of the Sarasin Sustainability Matrix. The second generation of this methodology incorporates many findings from data science, enabling more than 5,500 companies to be regularly assessed. This means we are able to meet the demands of sustainably minded investors regarding quality, sustainability and performance.

Third round of the IIB Awards in Stockholm

The Bank, represented by Pierin Menzli, Head Sustainable Investment Research, also attended the third round of the IIB Awards in Stockholm, taking part in the podium discussion on the topic of educating the younger generation – or "millennials" – about the features of sustainable finance. There was also an opportunity for eight other innovation projects to be showcased and assessed. Another highlight of the event was the presentation on "Artificial intelligence and the attainment of sustainable development goals". The Bank will continue to be actively involved in future Investment Innovation Benchmark events, in order to foster an exchange with innovative companies and strengthen links with investors and academics.

Selected sustainability profiles and rating updates in the third quarter of 2016

Clariant: developing green chemicals
Clariant is a specialty chemicals company offering products for industrial, agricultural and personal care applications. The company is a best-in-class player in managing chemical safety through a close monitoring of hazardous substances with a clear commitment to develop alternatives, therefore reducing the risk of seeing its products banned from the European market under the developing REACH regulation (Registration Evaluation Authorisation and Restriction of Chemicals). Besides, the company manages a broad portfolio of chemicals with enhanced sustainability characteristics (e.g biodegradability) or applications (e.g in photovoltaic technology or biofuels generation). Progress is however possible in the management of emissions related to the production process. Hence, Clariant scores above average in the sustainability matrix.

Medtronic: a technology leader facing quality challenges
Medtronic is a medical technology company marketing products for surgical and diabetes applications. With high production volume and a focus on chronic diseases and high-end technology including the current development of an artificial pancreas (for diabetes treatment), Medtronic is exposed to regulatory and reputational risks relating to product quality and safety. A high number of product recalls indeed highlight difficulties in implementing adequate quality assurance measures although the trend is improving. On the other hand Medtronic is one of only a few companies in the peer set with a relatively strong focus on developing countries, thus contributing to the enhancement of access to healthcare while benefiting from related opportunities. Overall, Medtronic's sustainability rating is average.

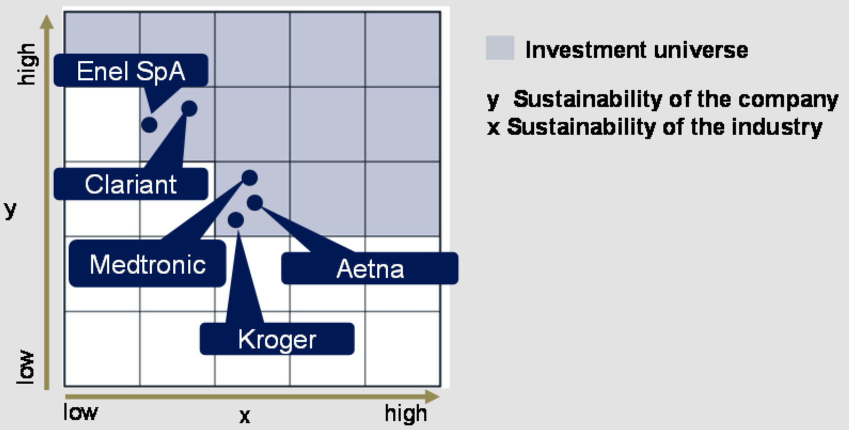
Aetna: a mixed ESG performance
Aetna offers a diverse set of health insurance plans and services to professionals and individuals. The company displays a mixed sustainability performance. Indeed, although the company addresses all issues relevant to its business, efforts and results are uneven. The company is notably involved in several pending lawsuits regarding reimbursement practices despite its efforts which generates liabilities and can erode customer confidence. By contrast, Aetna has implemented best practices in terms of data privacy and security, another business critical topic. Besides that, the company is comprehensively addressing corruption risks but its governance practices have raised concerns related to management's long tenure. Aetna is considered as average sustainable.

Enel SpA: on a path to sustainable power generation
Enel SpA is an integrated energy distributor focused on gas and electricity markets, with a fast growing renewables segment operating in primarily in Europe. Enel has demonstrated a clear commitment to become a sustainability leader through its orientation towards high environmental standards, employee safety and wellbeing, and a cleaner power generation portfolio. The company has set some of the most ambitious emission reduction targets in the industry, aiming to curb particulate matter intensity by 70% over 5 years, and CO2 intensity by 25% in the same period - and most ambitious of all - reaching carbon neutrality by 2050. Enel has also committed to substantial employee training, development and feedback programs to improve safety and reduce turnover. Following the disposal of a substantial stake in nuclear assets based in Slovakia, Enel is now eligible for the Sustainable Investment Universe and scores highly versus its peers.

Kroger: growth in organic product offering
The American retailer has significantly increased the sales figures for organic and artificial ingredient-free products (the "Simple Truth" product line is now the largest natural food brand in the US) and can therefore benefit from the trend of healthy living. On the positive side, we also note the fact that Kroger's workforce is mostly unionised and the health care coverage for part-time workers is better than the one offered by the US retail peers. Since the company is one of the largest US food retailers, there is a significant exposure to product quality & safety issues. Kroger has implemented programs to address such risks. Despite this, some products were recalled recently. There are a few corporate governance concerns related to the composition of the board. One of them is the fact that the CEO is also chairman of the board. Overall this leads to an average sustainability rating for Kroger.

Sustainable Investment Research

Sarasin Sustainability Matrix®



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Bank J. Safra Sarasin AG
Elisabethenstrasse 62
POB
4002 Basel
Switzerland
Phone + 41 (0)58 317 44 44
Fax + 41 (0)58 317 44 00

Bank J. Safra Sarasin (Deutschland) AG
Taunusanlage 17
60325 Frankfurt am Main
Germany
Phone +49 (0)69 71 44 97 100
Fax +49 (0)69 71 44 97 199

Imprint
Bank J. Safra Sarasin AG
Asset Management
Elisabethenstrasse 62
POB
4002 Basel
Switzerland
Phone + 41 (0)58 317 44 44
Fax + 41 (0)58 317 44 00

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