J. SAFRA SARASIN
Sustainable Swiss Private Banking since 1841

Sustainable Investments

The Sustainability Newsletter, J. Safra Sarasin Asset Management

April 2017

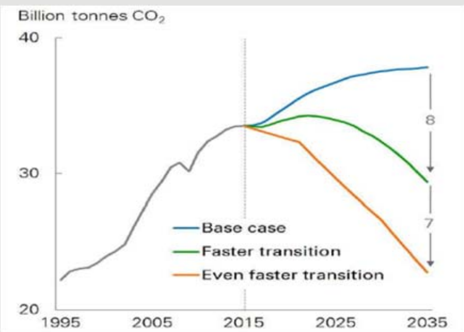
Editorial

How the energy transition will attract financing

Dear Reader

The 2015 Paris Agreement on climate change, which has since been ratified by 196 countries and which limits global warming to well under two degrees Celsius, was only the first step on the path towards more sustainable development. To achieve the climate goals, global carbon dioxide emissions not only have to be contained, but significantly reduced over time. The latest BP Energy Outlook puts forward three potential scenarios. In the base scenario, CO2 emissions will continue to rise.

Energy transition scenarios and CO2

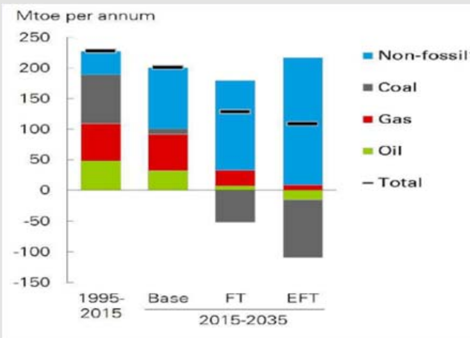


Source: BP Energy Outlook 2017

Weakening demand for fossil fuels

If the transition to renewables is faster, BP expects demand for oil to stagnate by 2035, while demand for coal will even decline. In such a scenario, only non-fossil fuels would enjoy rising demand up to 2035. Since the United Nations are aiming to reduce carbon dioxide emissions, additional measures will be required. Over the coming years, we expect extra incentives to be offered to promote renewables, and regulations to be introduced that restrict the use of fossil fuels even further.

Energy demand trends, depending on scenario



Source: BP Energy Outlook 2017, FT: Faster Transition

Doubts about the funding of the transition

Recently, however, concerns have been voiced that the energy transition might fail to attract the necessary financing. Britain's Economist magazine thinks this is due to the nature of the renewables market: subsidised fixed costs, intermittent energy supply and low variable costs. The price drop triggered by renewables would call into question energy security and prevent investments, the magazine claims. We take a different view.

1) The adjustment of relative energy prices simply reflects the higher external costs and negative side-effects of fossil fuels.
2) Volatility in energy supply does not pose a threat for investments in the energy sector, but rather acts as a driver for innovation in the area of energy storage.
3) Low variable costs make renewables more profitable and attract more capital.

Incentives need to be set at the right level

As long as 100 years ago, the British economist Arthur Cecil Pigou developed the market economy based instrument of the Pigovian incentive levy. He concluded that the environment has to be given a price. If the costs of green-house gases are correctly internalised, there is no need for regulation or for a call to finance "green" infrastructure. Instead, investors will come up with the financing for the energy transition for the simple reason of self-interest, because it is profitable for them. Adam Smith's "invisible hand" works wonders!

Best wishes,
Jan Amrit Poser
Chief Strategist & Head Sustainability

Interview with Pierin Menzli, Head Sustainable Investment Research

„China wants to be world leader in climate protection – and will benefit from it“

In the following interview Pierin Menzli, Head Sustainable Investment Research at Bank J. Safra Sarasin, discusses some points raised in the recently published report "Keep it cool – how to invest in a 2°C world", and also talks about his personal ecological footprint.

What findings are in the recently published study that may be of interest to investors?
Over the coming years, the political agreements on the 2°C global warming target would lead to significant economic changes in many sectors, especially in the energy and utilities sector, but also in the industrial goods segment. Investors who get to grips with these developments and trends today will reap rewards in the medium and long term, as sectors and companies with an unsustainable business model (e.g. coal mining) will vanish from the market and be replaced by new industrial sectors such as robotics and electromobility.

That sounds plausible. But these findings are not exactly new, are they?
What is new is that we now offer investors a systematic investment concept based on four pillars which aims to prepare client portfolios for the 2°C climate target.
First, we recommend withdrawing investments in certain industrial branches (e.g. coal) that are not compatible with the 2°C target.
Second, we have refined our existing best-in-class and integration approach, by systematically analysing climate risks and assessing how well companies are equipped to deal with the future.
Third, we have strengthened our "Active Ownership" approach and are encouraging direct dialogue with companies and the active exercising of shareholder voting rights.
Fourth, we actively invest in solutions providers, such as technology firms working in the area of data processing, robotics and electro-mobility.

Why do investors need to get to grips with such long-term trends and developments?
Major changes are currently happening very quickly. For example, the Chinese government has made climate protection its top political priority. As recently highlighted at the World Economic Forum 2017 in Davos, China is looking to become the world leader in climate protection. Such a scenario was un-imaginable even two years ago. China is mainly doing this out of its own economic and social self-interest. To put it another way, China wants to buy cutting-edge environmental technology for its manufacturing industry, or develop it in house. At the same time, China's political leadership wants – indeed is obliged – to show the people visible and noticeable progress in the area of climate protection, in order to satisfy mounting social pressure in this domain. These political and economic changes in China alone have far-reaching consequences for many international companies. On the one hand, they open up new areas of business, but on the other hand they give rise to highly competitive, technologically advanced and locally anchored Chinese companies with an ambition to become global leaders.

Can similar developments be expected in Europe as well?
In Europe, France is striving to become a leader in climate protection and is sending out strong political signals, for example by imposing new transparency requirements on large institutional investors. Now these investors are being asked to identify, analyse and report on climate risks. Similar regulatory developments are also planned within the EU. Technology companies such as Google (Alphabet), as well as traditional carmakers such as Volkswagen and Ford, have recently been investing significant amounts in electrical and driverless vehicles. Particularly in densely populated European countries, this will lead to major changes in mobility and will also affect the carbon footprint.

What is Switzerland's position in this dynamic landscape?
In the wake of the Fukushima nuclear disaster in 2011, the Swiss government has ordered the drafting of a new energy strategy. A vote is due to be taken in May 2017. Roughly speaking, the goal is to assess the suitability of individual energy forms for future use and the role of the government in order to ensure that energy is made available to Swiss consumers in a safe, economical and environmentally friendly manner. Obviously these questions, along with the promotion of individual energy forms, are directly connected with the future use of fossil fuels by our economy and society.

What personal contribution do you make towards helping to achieve the 2°C target?
I have a pretty accurate idea of my ecological footprint and the associated CO2 emissions. This is only an initial, but very important step. We are also doing well when it comes to our personal lifestyle and mobility. We live in the centre of town and only use our car at the weekends. We are model citizens when it comes to what we eat, and specifically the meat we consume. We generally buy locally produced meat direct from the farmers (or hunters) who we know personally. Not only are we are proud of this, but the meat tastes much better! The only fly in the ointment is my business travel, which is part of my job. Several times a year I travel by air to attend international conferences and client meetings. This aspect is not good for my carbon footprint. Even so, I try to take the train for any business trips of less than six hours, which pays off in many ways, and not purely from an environmental perspective.

Pierin Menzli
Head Sustainable
Investment Research

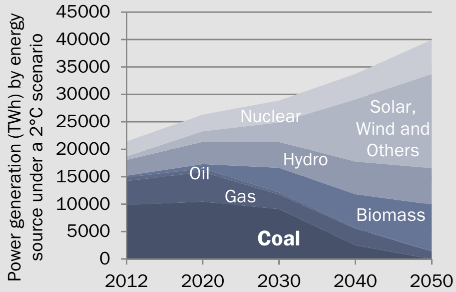
Sustainable Investment Spotlight

Keep it cool – how to invest in a 2° world

The current global climate commitments and related actions imply that coal should disappear from the world energy mix by 2050. Consequently, Bank J. Safra Sarasin recently added coal to its divestment policy for all sustainable investment strategies.

Coal: a black evil?
Coal is currently a major and unavoidable source of energy (see chart 1).

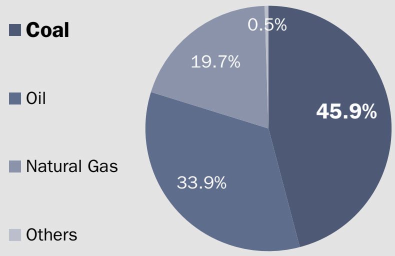
Chart 1: Phase-out of coal in the world power mix under a 2°C scenario



Source: CarbonTracker, Bank J. Safra Sarasin, 2017

Given its carbon-intensive nature, it therefore comes as no surprise that coal is also a major contributor to CO2 emissions from fuel combustion (see chart 2), which represent the bulk of global CO2 emissions besides less important categories such as industrial processes and agriculture.

Chart 2: Current share of coal in global C02 emissions from fuel combustion

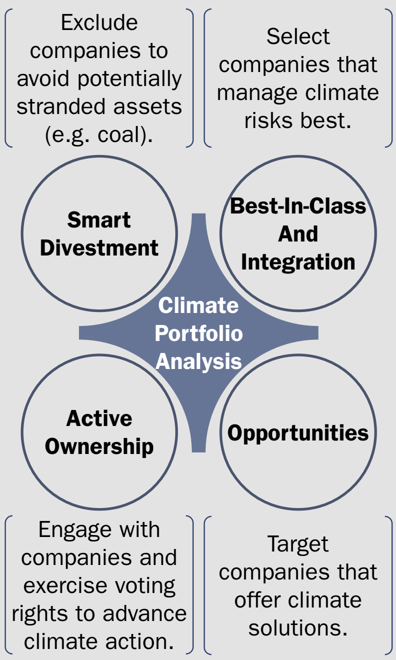


Source: IEA, Bank J. Safra Sarasin, 2017

Consequently, (thermal) coal has become a key target of climate action which has gained and sustained a strong momentum following the 2015 Paris Agreement – a global agreement to mitigate climate change and keep global temperature increase below 2°C; practical implications of this objective are referred as the 2°C scenario.
Climate action is indeed visible at all levels, from governments to the private sector through to civil society. The Government of Canada for example, plans to abandon coal as a source of energy by 2030, while Ireland recently voted to be the world's first country to fully divest public money from fossil fuels. Various investor efforts likewise impact the future of coal and coal companies.
Reactions from civil society, embodied in initiatives such as the *keep it in the ground* campaign – champion the idea of ceasing future exploitation of fossil fuels – add to the global scale and scope of climate action.

The recipe to keep it cool
Embracing this global trend, we have decided to introduce stricter standards when it comes to coal, as part of our climate investment strategy.

Chart 3: Bank J. Safra Sarasin's 4-pillar climate investment strategy



Source: Bank J. Safra Sarasin, 2017

Indeed, as a sustainable investor, we are committed to addressing climate change. To fulfil this pledge, we have developed a strategy based on 4 pillars: 1) **Smart Divestment**: selectively excluding companies, 2) **Best-in-Class & Integration**: in-depth investment analysis with a Best-in-Class focus 3) **Active Ownership**: engagement and voting activities, and 4) **Opportunities**: related to climate solutions. Comprehensive climate portfolio analysis further helps to make decisions and enhance resilience with regards to climate change considerations.

Welcome to the low carbon economy!
As the evidence strongly suggests (see chart 1), the share of coal in the global power mix is on a structural decline. Companies therefore need to adapt, while investors can encourage them and benefit from a more sustainable development.
By embracing the transition towards a low carbon economy through mitigation and adaptation efforts, exposed companies will depart from coal and align with a 2°C scenario to secure their future.
Likewise, by analysing companies' strategies, engaging with them and divesting smartly, investors can send a strong message to companies and encourage the transformation of the coal industry, while avoiding the highest climate-related investment risks.
Furthermore, by targeting climate solutions, investors can also benefit from strong opportunities both in the area of emissions mitigation and alternative energies.
With an integrated climate investment strategy, Bank J. Safra Sarasin is thus well positioned to accompany its clients on a successful journey towards a low carbon future.

Authors

Andrea Weber
Sustainable Investment Analyst

Guillaume Krepper
Sustainable Investment Analyst

Yohann Terry
Sustainable Investment Analyst

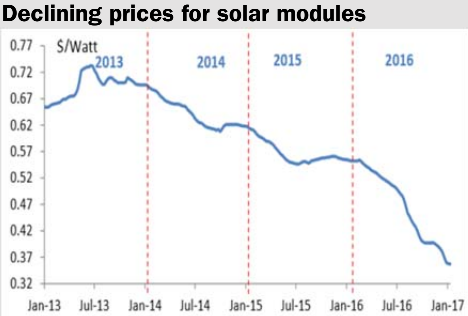
Interview with Giles Money, Portfolio Manager Thematic Equity Strategies

"Using less energy and producing it cleanly will dominate the future of power markets globally"

Significant change in the way how consumers consume and how producers produce power will have seismic implications for investing in a world where 2 degree global warming is an almost unequivocally agreed upon global threat, says Giles Money.

What are the biggest debates surrounding investing in a New Power strategy?
We have seen a huge change in how the world looks at climate change over the last ten years. 2007 was the year where the 2 degree global warming scenario became mainstream with the UK government sponsored Stern Review. This review detailed for the first time the impact across all industries and sectors and provided the basis for investors to target. It certainly broadened the debate from just thinking around new sources of power to targeting a much more diverse set of opportunities such as energy efficiency. These are the themes we heavily focus on.

Declining prices for solar modules

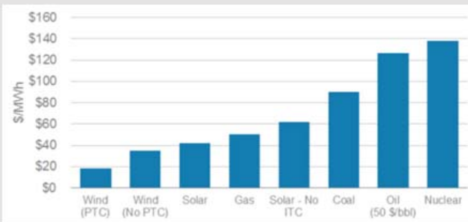


Source: Morgan Stanley

Why have companies which are focusing on new power technologies experienced so much volatility and will that ever change?
I think it is key to separate a good theme from a good investment. The Chinese have added more carbon emissions in recent years since their ascension to the WTO than most developed countries produce annually. This has created political interest in at least looking like they will mitigate some of the significant increase in carbon tonnage. That position led to them subsidizing development of new power technologies with billions of dollars, effectively flooding the world with cheaper solar panels and wind turbines. As a consequence, the prices for these devices have declined sharply.

Despite this volatility the markets are increasingly becoming more consolidated and returns are gradually improving, particularly in wind which has higher barriers to entry. Further the Levelized Cost of Energy (LCOE) taken as a proxy for break-even cost of generation has also made them more attractive in many places of the world including the US (see graph below). Despite the drop in energy prices in recent years, it seems like the response from consumers, corporates and governments to tackling carbon emissions is gaining momentum despite some questions about the new US administration's stance of energy policy.

Energy costs favour renewable energies



Source: Morgan Stanley Research

How would you position portfolios in the face of lower energy prices and increasingly complicated geo-political backdrop?
We have a strong focus on protecting the downside while making sure to keep an option on participating in upside. This means that we would stay relatively minimally positioned in the pure capacity providers such as wind turbines or solar panels. The supply glut is real and prices are still falling. There are a few technology winners which could be considered for investment, but we stay away from the volume players. This means that our focus remains on energy efficiency providers with strong internal rates of return (IRR) even into lower energy prices. In this respect we favour investments in global leaders in the field of home insulation. Insulation provides one of the highest paybacks when it comes to investments in heating. Some of those companies have significant exposure to the US housing recovery and improving environmental building codes which are both relatively immune from weaker energy prices.

How do you deal with political uncertainty?
We currently live in a tumultuous political environment, not only because many traditional political views are being challenged,. This political landscape lends itself more to the extremes and this is an uncomfortable period for negotiations on how to tackle long-term issues such as man-made climate change. Protectionist tendencies in the US, geopolitical tensions with Russia, the European migrant crisis, and Chinese involvement in the South Sea mean the political backdrop is uncertain. At the same time there are lots of positive commitments by countries in their own right. We are cautiously optimistic the Paris Agreement can be followed up on in a more positive way and certainly see that the Chinese may open up a leadership role in global negotiations and we are well positioned for that.

What is your outlook for 2017?
Whilst prima facie this might be one of the toughest years to call on record, what is relatively simpler is the fact that populations grow, energy demand increases, and the world is replacing fossil fuels with renewable power at an accelerated rate as costs are falling. We are well positioned for rising global investments and believe energy efficient solutions will be at the forefront.

Giles Money
Thematic Portfolio Manager

Reporting of Bank J. Safra Sarasin's Active Ownership activities in 2016

As a sustainable, long-term oriented asset manager, Bank J. Safra Sarasin understands its role as the advocate of its investors. We have a fiduciary duty to make investment decisions that are in our clients' best interests and seek to maximise the value of their investments. Active Ownership, comprising of Engagement and Proxy Voting activities, is an integral part of this process. This approach aims to foster robust corporate governance structures and ensure shareholder rights are upheld, as well as strong social and environmental performance and transparency. On the following pages we report about our Active Ownership activities in 2016.

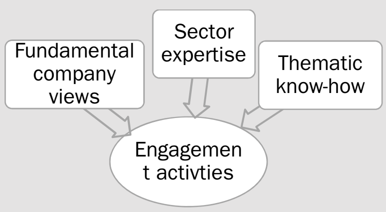
Proxy Voting approach of Bank J. Safra Sarasin

Bank J. Safra Sarasin exercises its voting rights for the majority of in-house sustainable investment funds on behalf of its clients. We aim to broaden the scope of our proxy voting activities and roll this out for more investment strategies throughout 2017. In 2016, we voted for the holdings of 23 investment funds (CHF 1.8 bn AuM).

The Bank has its own customised Proxy Voting Guideline that is fully aligned with our overall sustainable investment approach. The Proxy Voting Guideline encompasses our specific views on topics such as board structure, experience and effectiveness, executive pay practices, the ownership structure and shareholder rights in general as well as certain environmental and social aspects.

Overview of recent voting activities

Our active ownership activities are predominantly coordinated and conducted by the Sustainable Investment Research Team (with support from additional parties, such as Portfolio Management). This integrated set-up allows us to make best use of the in-depth company, sector and thematic know-how for our voting decisions and engagement dialogues.



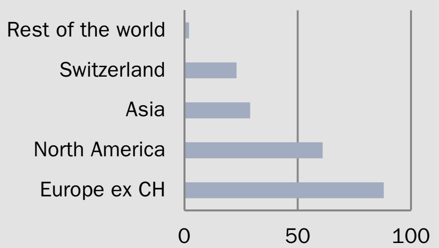
Source: Bank J. Safra Sarasin, 2017

Over the course of the most recent year, we voted during 203 annual general meetings. In 24% of the cases, we voted *against* management (at one or more ballots).

Overview of voting activity of Bank J. Safra Sarasin in 2016	
Number of annual general meetings (AGMs)	203
Number of ballots	295
Number of proposals	2'032
AGAINST the management	24%
Environmental and social proposals	30

The following chart shows that during this timeframe our proxy voting activities were mainly concentrated in Europe (incl. Switzerland) and North America.

Geographical voting split



Source: Bank J. Safra Sarasin, 2017

Following this general overview on our proxy voting activities, we present a selection of recent voting instructions for invested companies in our sustainable investment strategies.

Insights into single voting results

FOR

Example I: A Norwegian energy company and its approach to climate change

A shareholder handed in a proposal asking the board to present a revised strategy reflecting the company's responsibility to help meet energy demand within the climate change framework of the Paris Agreement. Due to already existing renewable energy initiatives and the understanding that the business strategy should be determined by the board of directors, the board recommended to vote against this shareholder proposal.

Definition of "Active Ownership" at Bank J. Safra Sarasin = Engagement + Proxy Voting

Engagement is defined as the active dialogue with companies and the public – either in collaboration with other investors or by ourselves.

Proxy Voting is the practice of exercising our voting rights at companies' Annual General Meetings. The investor uses the right to vote for various agenda points.

ISS (Institutional Shareholder Services), one of the largest proxy voting advisors followed this recommendation. However, since we consider the ability of the company to address climate change issues as material, we voted in favour of this proposal.

AGAINST

Example II: A Swiss luxury goods company and board independence

The company's percentage of independent board directors at the time of the 2016 annual general meeting was at a low 16%. We voted against the addition of more non-independent directors since we favour boards that consist of 51% or more independent directors. We also voted against the election of a non-independent board member to the audit committee. Audit committee members should be considered independent in order to be able to fulfil their supervisory duty in the best interest of shareholders.

AGAINST

Example III: An American industrial company and executive pay practices

One agenda item related to the ratification of an executive officer's compensation which included a housing-related perquisite due to re-location (including the compensation of a home sale loss). Less than 1% of S&P 500 companies grant such perks and the amount of compensation related to this perquisite significantly exceeded the median value of peers. The company denied our request for additional disclosure regarding this item. Consequently, we voted against the remuneration report.

Overview of our engagement activities

Bank J. Safra Sarasin is actively pursuing three different types of engagement:

- Direct company engagement
- Collaborative engagement
- Public policy engagement

Every type of engagement has different spheres of influence. Whilst direct dialogue with companies is targeted at supporting our investment cases, collaborative engagement activities address more systemic environmental, social or governance issues. Our public policy engagement aims to promote sustainable investment practices and contribute to society's sustainable development in general. Subsequently, we share insights into some of our engagement activities, on direct company and a broader level.

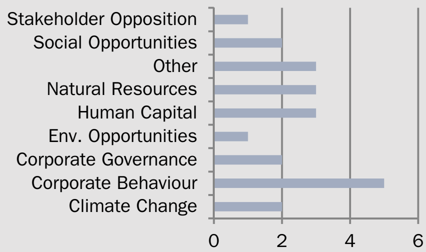
Direct company engagement of Bank J. Safra Sarasin in 2016	
Number of company engagements	23
Status	
- Initiated	1
- On-going	3
- Finished	19
Success rate	
- Successful	10
- Partially successful	4
- Not successful	5
- Open	4

In 2016, we conducted 23 extensive engagement dialogues with companies. Overall, we were able to close more than half of the engagements with a satisfying outcome. Our engagements revolved around different topics, covering environmental, social and corporate governance themes (cf. table "engagement themes"). We also addressed concerns around controversies. In addition, the Bank J. Safra Sarasin Sustainable Investment Analysts and Portfolio Managers met over 400 companies throughout 2016 to discuss various business issues, whereby ESG topics are discussed on a standard basis.

Engagement project on chemical safety by Bank J. Safra Sarasin

In 2016, we engaged with 47 companies about chemical safety. Our objective was to evaluate companies' chemical footprint and to identify and implement alternatives. We realised that few companies had estimated their revenue at risk and had launched convincing programs to identify substitutes. Besides, almost none had approached the issue from an opportunity angle although regulatory evolutions on chemical safety also offer new opportunities. While directly informing our investment decisions, this also gave us the opportunity to emphasize the importance of the topic to investors.

Engagement topics



Source: Bank J. Safra Sarasin, 2017

Update on selected direct company engagements in 2016

<u>Discussion around carbon risks with a German cement company</u>

An engagement process was started due to our concerns around the growing carbon intensity of the company which related to recent acquisitions and has an impact on operational costs (potential carbon pricing). We learned about on-going developments that include the upgrading of existing assets to meet environmental objectives, R&D efforts around carbon capture and use projects as well as the further use of alternative energy sources. Overall, we gained confidence that the company has implemented best practice initiatives to address risks stemming from insufficient carbon emissions management and that this will pay off going forward. Nevertheless, relating results will be monitored closely over the coming months.

<u>A Swiss insurer lagging international peers with regards to material ESG risks?</u>

In 2015, various ESG data points raised doubts about the company management's ability to address relevant ESG risks. We therefore decided to introduce a formal discussion around demographic risks, the responsible management of assets as well as data and privacy security issues. In addition to insights into the mentioned points, we acknowledge that the company set up a sustainability department and published its first sustainability report in 2016. We believe that our engagement (among other factors) led the company to consider relevant ESG risks and opportunities on a more strategic level and to enhance according disclosure. We expect these efforts to have a positive impact on the relative sustainability rating of the company in the future.

Update on selected collaborative and public policy company engagements in 2016

Bank J. Safra Sarasin is an active member of collaborative and public policy initiatives. A small selection of such activities is presented subsequently.

PRI-coordinated* Engagement on Water Risks in Agricultural Supply Chains

In collaboration with 40 other PRI signatories, we engage with companies to address our concerns about suppliers' water risks. The Bank acts as a lead investor for five companies.

*Principles for Responsible Investments

Climate change investor letter to the G20

Together with other investors, we signed a letter to the G20 asking them to ratify the Paris Agreement quickly and to prioritise the implementation of the nationally determined targets as well as to ensure financing needs for clean energy.

Swiss Sustainable Finance

Bank J. Safra Sarasin is an active member of the association and fosters the position of sustainable finance in the Swiss marketplace. In 2016, the Bank actively contributed to the "Handbook on Sustainable Investments" which helps asset owners to consider sustainability for their investment decisions.

For more information about our Active Ownership approach and Policy, please contact <u>sustainableinvestments@jsafrasarasin.com</u>

Dr. Agnes Neher
Corporate Sustainability Manager

Andrea Weber
Sustainable Investment Analyst

Selected sustainability profiles and rating updates in the first quarter of 2017

Inditex/Zara: Better than you think
Inditex is one of the largest fashion retail groups in the world with brands like Zara, Bershka, Massimo Dutti, Pull&Bear, and others. The group has over 1'700 suppliers with more than 6'000 factories in 50 countries. The biggest difference to its main competitors, which source most of their inputs in Asia, is that 60% of production is performed by suppliers from areas close to the headquarters and logistical centres in Spain which increases the flexibility to react to fashion trends. Inditex earns the highest sustainability score among apparel retailers in our assessment. Despite a comprehensive code of conduct, over 4'000 supplier audits per year as well as several other measures, violations of standard rules cannot be completely ruled out. That said, it is essential how well the company handles any incidents. In this respect, Inditex takes a leading role within the industry.

NTT: Enhanced data breach protection
NTT, Japan's largest telecommunication company, has improved data protection procedures, including strong executive oversight of privacy issues and comprehensive employee training. This should reduce the risks associated with data breaches and consumer privacy. The company is also proposing cybersecurity services to its business customers. However, there are still important corporate governance issues, including the lack of executive pay disclosure and the absence of an independent board majority. Nine of the company's eleven directors are NTT executives and the board is strongly influenced by the Japanese government, who owns 35% of the shares. Overall, NTT receives an above average sustainability rating.

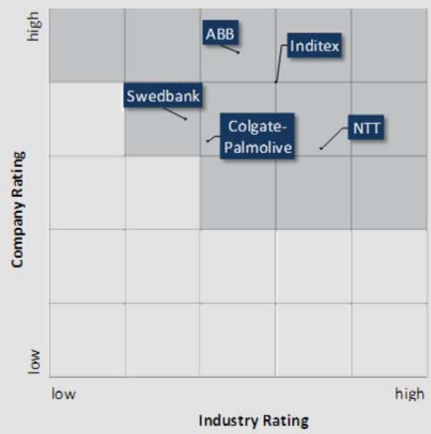
Swedbank: Challenges for the board
After conflict of interest allegations involving the former CEO and his real estate deals, the company's independent board made important changes to management in 2016. While the occurrence of this alleged market abuse is problematic in itself, this shows that the board of directors acted and fulfilled its' function on behalf of shareholders. The fact that the board at first only appointed an "acting" CEO leads us to believe that a more strategic approach to succession planning would be meaningful going forward. In general, the corporate governance set-up is well aligned with shareholders' interests though. On the environmental side, a dedicated sustainability committee developed guidelines for sectors that face high environmental risk. There is also a continuous assessment of environmentally sensitive financing activities. Furthermore, Swedbank fosters employee loyalty by offering profit sharing plans and development opportunities. Taking all material environmental, social and governance criteria into account, we assign an above average sustainability rating for Swedbank.

Colgate-Palmolive: Sourcing raw materials sustainably
The company stepped up its commitment to the sustainable sourcing of palm oil. As a member of the Roundtable on Sustainable Palm Oil (RSPO), the ambitious target is to achieve full traceability of the palm oil to the plantation. Furthermore, the company uses an internal product sustainability scorecard to improve the profile of its products with regards to raw materials, energy, greenhouse gases, waste and water use. From a corporate governance perspective, we note several board directors that are current or former CEOs of other large corporations. While such profiles bring valuable experience to a board, this approach to board composition might lead to pay practices that favour management's interests over those of shareholders. Overall, Colgate-Palmolive receives an above average sustainability rating.

ABB: Fueling the clean tech revolution
ABB is a Swiss electrical equipment company providing power and automation technologies for utility and industrial applications worldwide.
The company addresses the full scope of sustainability issues typical to its business with convincing measures. Indeed, on the operational side, environmental impact of operations and work safety risks are mitigated through adequate mechanisms including independent external reviews and certifications. Likewise, ABB's broad clean tech positioning provides significant sustainability opportunities already accounting for half of the company's revenue. Progress is nevertheless possible to better manage operational continuity and quality risks related to labor issues. The company is indeed compliant in this regard, but faces higher challenges given its scale (c. 140 000 employees worldwide). Finally, governance practices are in line with peers. Overall and on a relative basis, ABB displays high sustainability credentials and is therefore eligible to the sustainable investment universe.

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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Sarasin Investmentfonds SICAV is is an Undertaking for Collective Investment in Transferable Securities (UCITS) organised as an open-ended investment company (société d'investissement à capital variable – "SICAV") under Luxembourg law and regulated by the national regulator, Commission de Surveillance du Secteur Financier ("CSSF"). This fund is a sub-fund of Sarasin Investmentfonds SICAV and has been authorised for public sale in Germany by the Federal Financial Supervisory Authority (BaFin). Copies of the current prospectus, the key information for investors (KIID), the articles of association, as well as the most recent annual and semiannual reports are available free of charge from the paying agent (Bank J. Safra Sarasin (Deutschland) AG, Taunusanlage 17, D-60325 Frankfurt am Main) and the representative in Germany (Bank J. Safra Sarasin (Deutschland) AG, Investment Fund Division, Lenbachplatz 2a/6th Floor, D-80333 Munich).