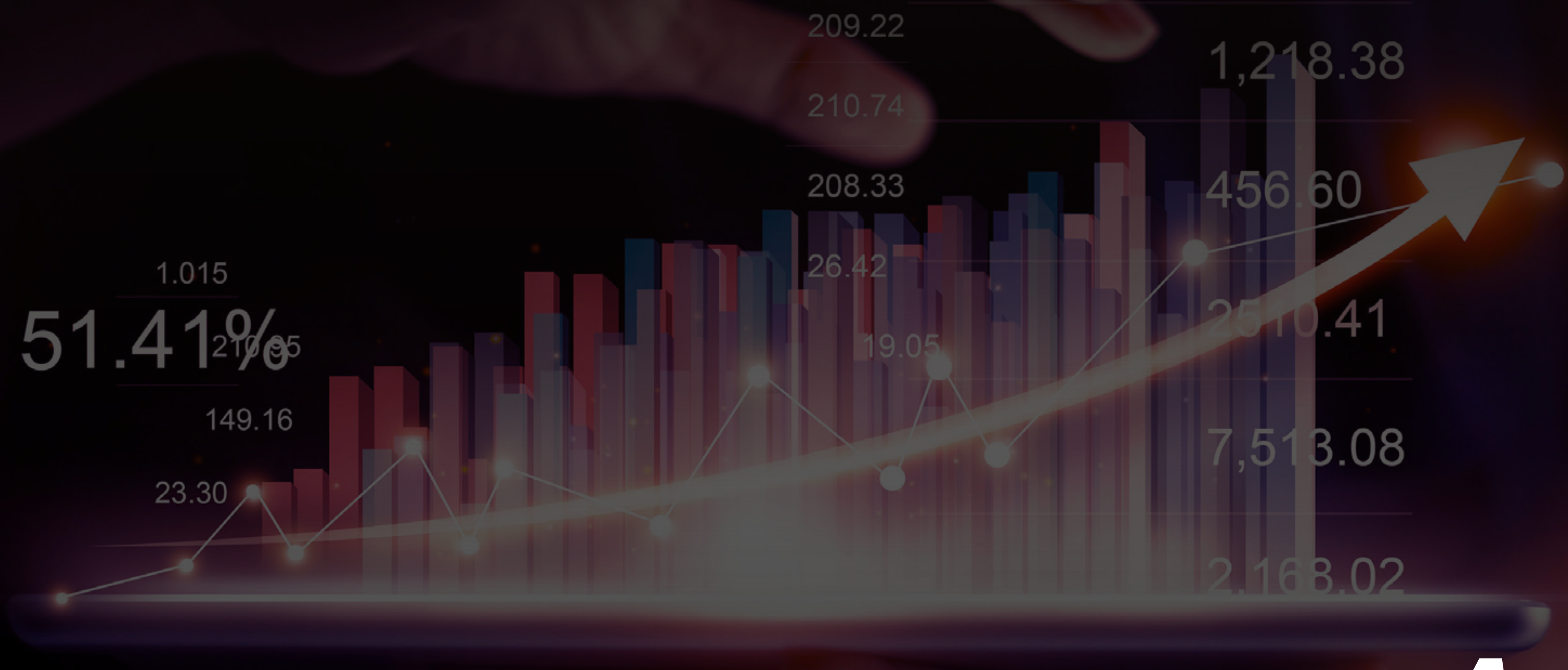
Covid-19

How Aon managed investments through a crisis



Aon
Empower Results®

For professional client only

Stay safe

Overview

In market turmoil, benefits of delegated come to the forefront

Reduced equity risk exposure

Our active management of strategic weightings meant that you were better protected from equity falls and gained from exposure to safe haven assets

Increased diversification

The portfolio holds a high allocation to alternative assets which provide alternative sources of return, not dependent on the direction of equity markets

High liability hedging

The portfolio would have proper protection against liabilities growing and therefore have a more stable funding level experience

Strong governance

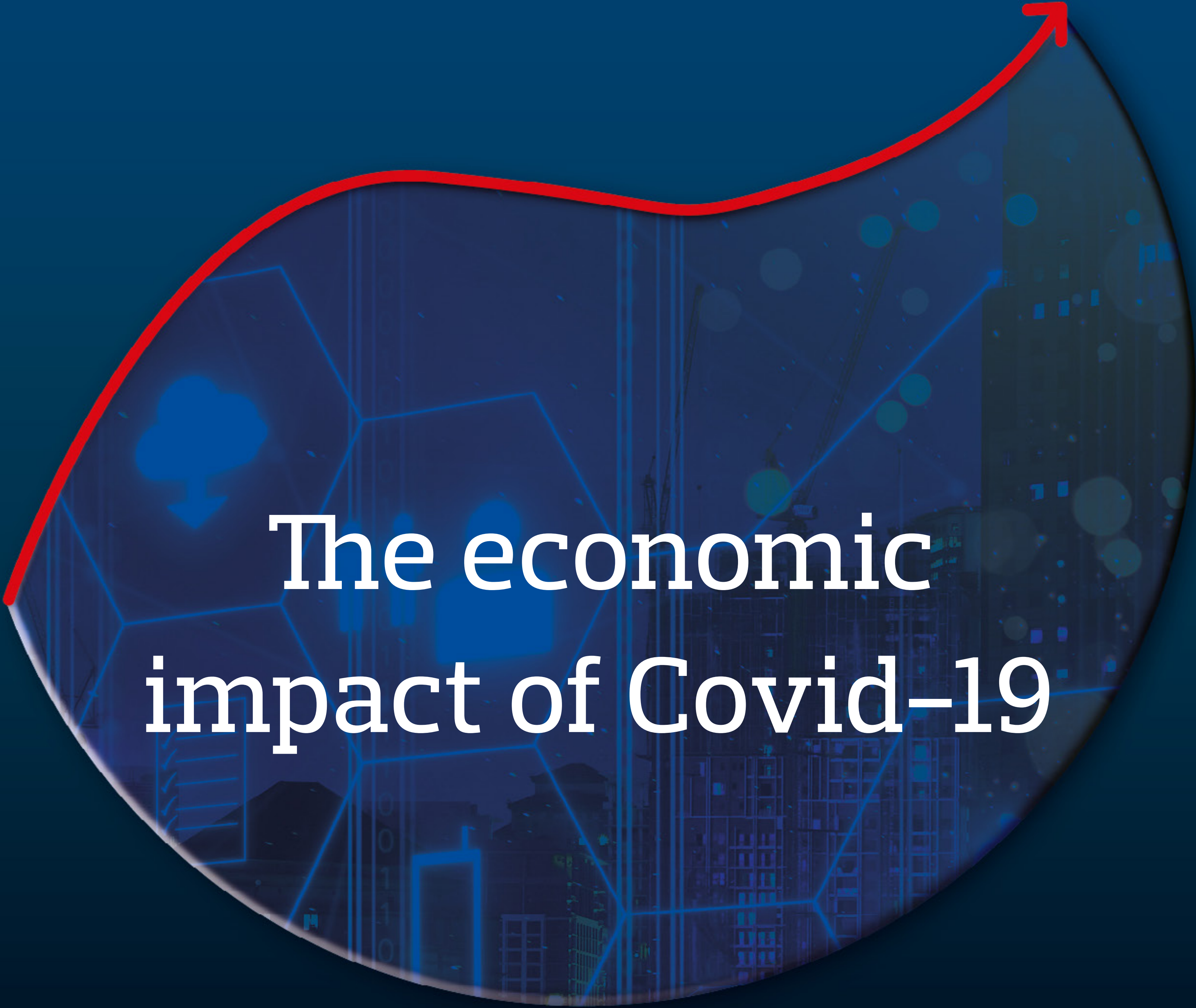
We managed the risk/return payoff and cashflow implications of recent events on your behalf, reacting promptly and reducing your workload

Pro-active agility

We were nimble enough to identify and take advantage of fleeting market dislocation opportunities

Extensive preparation

Our resilient Business Continuity Plan allowed us to manage portfolios through the market turmoil without worrying about logistics



The economic impact of Covid-19

Market impact

When equity markets initially viewed Covid-19 as an emerging market problem, developed market equities were little changed.

When it became clear that the virus would be widespread, global equity markets fell dramatically.

Governments globally introduced lockdowns in a bid to halt the Covid-19 spread which hampered economic activity.

Central banks simultaneously introduced support packages to dampen the economic fall-out which caused equities to rebound considerably.

We are seeing increased volatility across asset classes as investors shy away from riskier assets in favour of safer havens, triggering liquidity challenges in certain credit sectors.

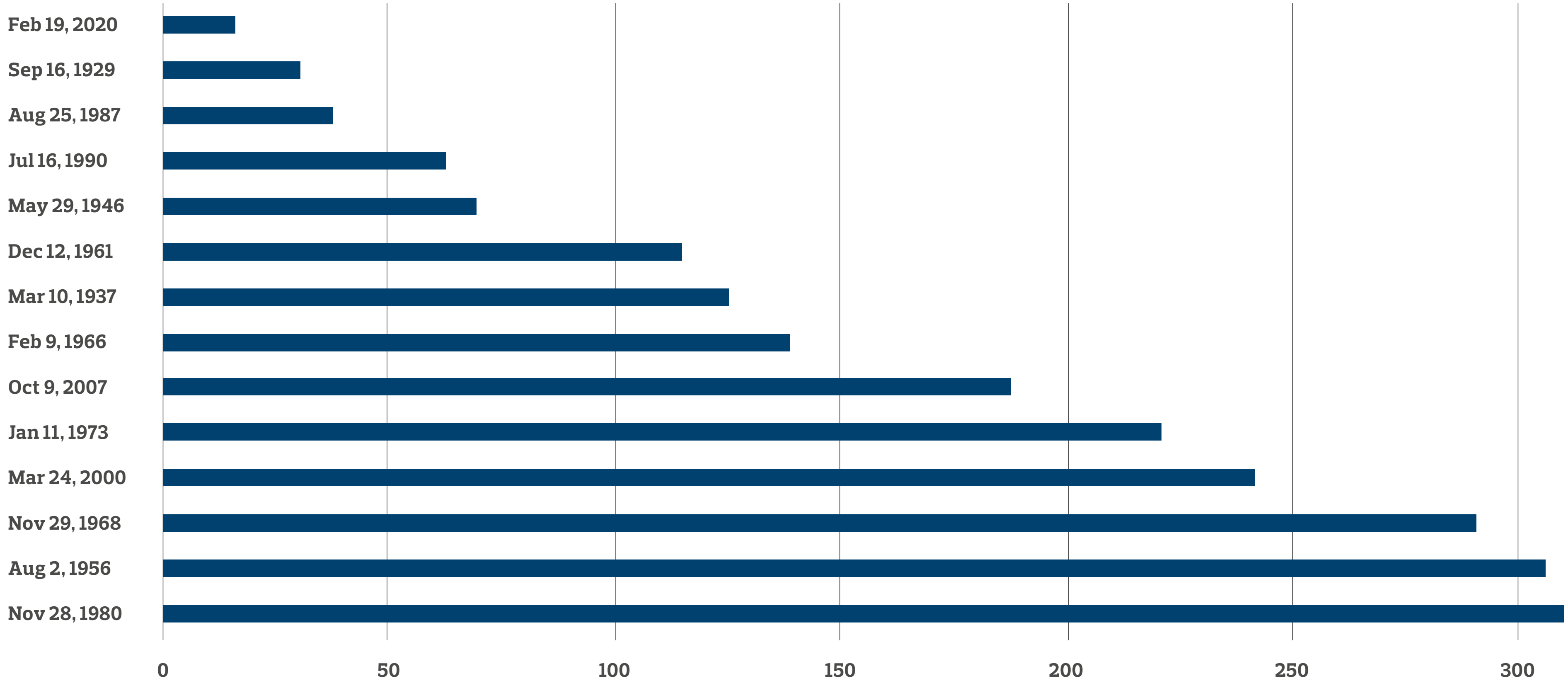
Uncertainty remains on the horizon as the full impact on economic and earnings data feeds through.

The fastest Bear Market Ever

The S&P 500 took 16 days to close in a bear market

Number of trading days to close down 20% or more from its peak

Date of Market Peak

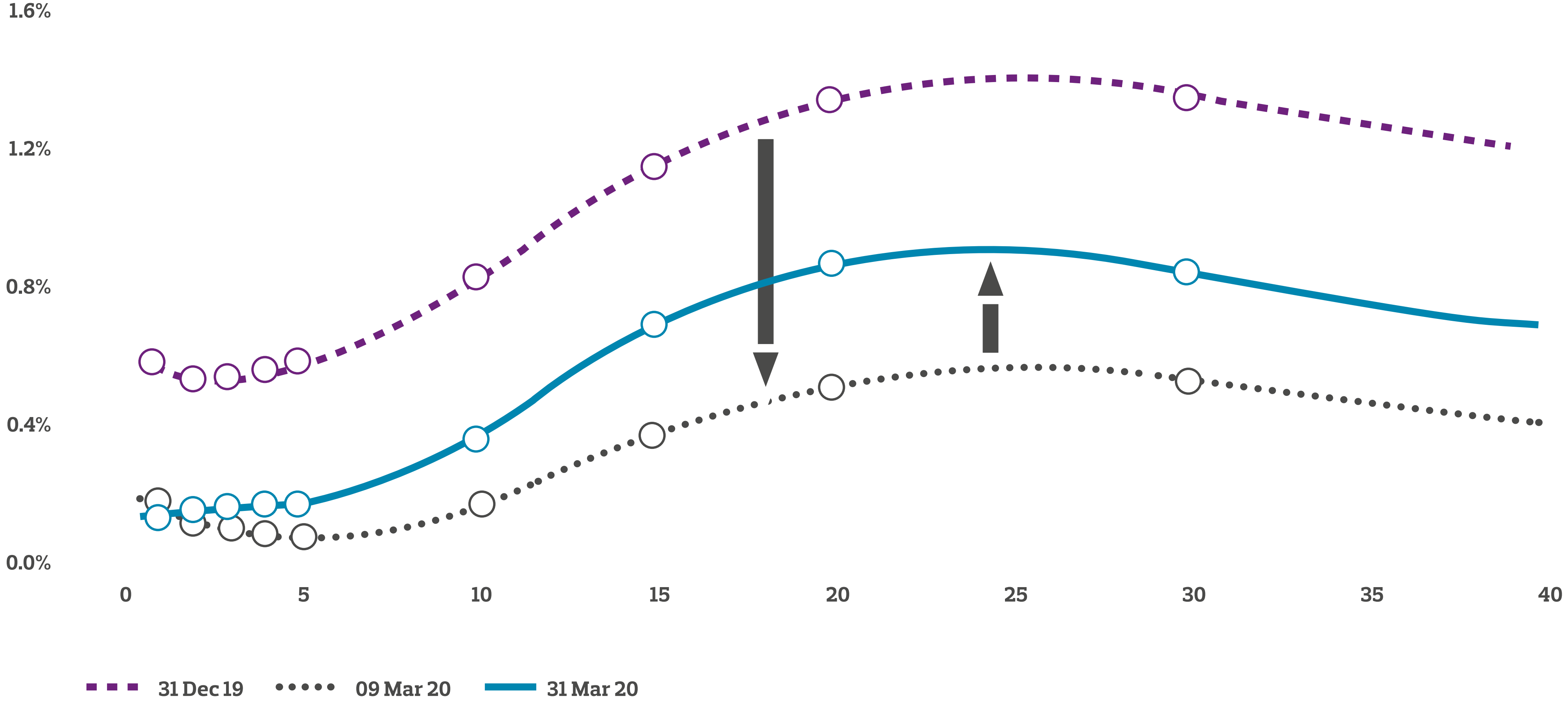


Source: Aon Calculations, S&P, FactSet

Whipsawing gilt yields

- Pension scheme liabilities may have risen by nearly 20% and then fallen by 10% in a few days
- Due to the volatility, experiences varied greatly depending on the timeframe and liabilities' characteristics

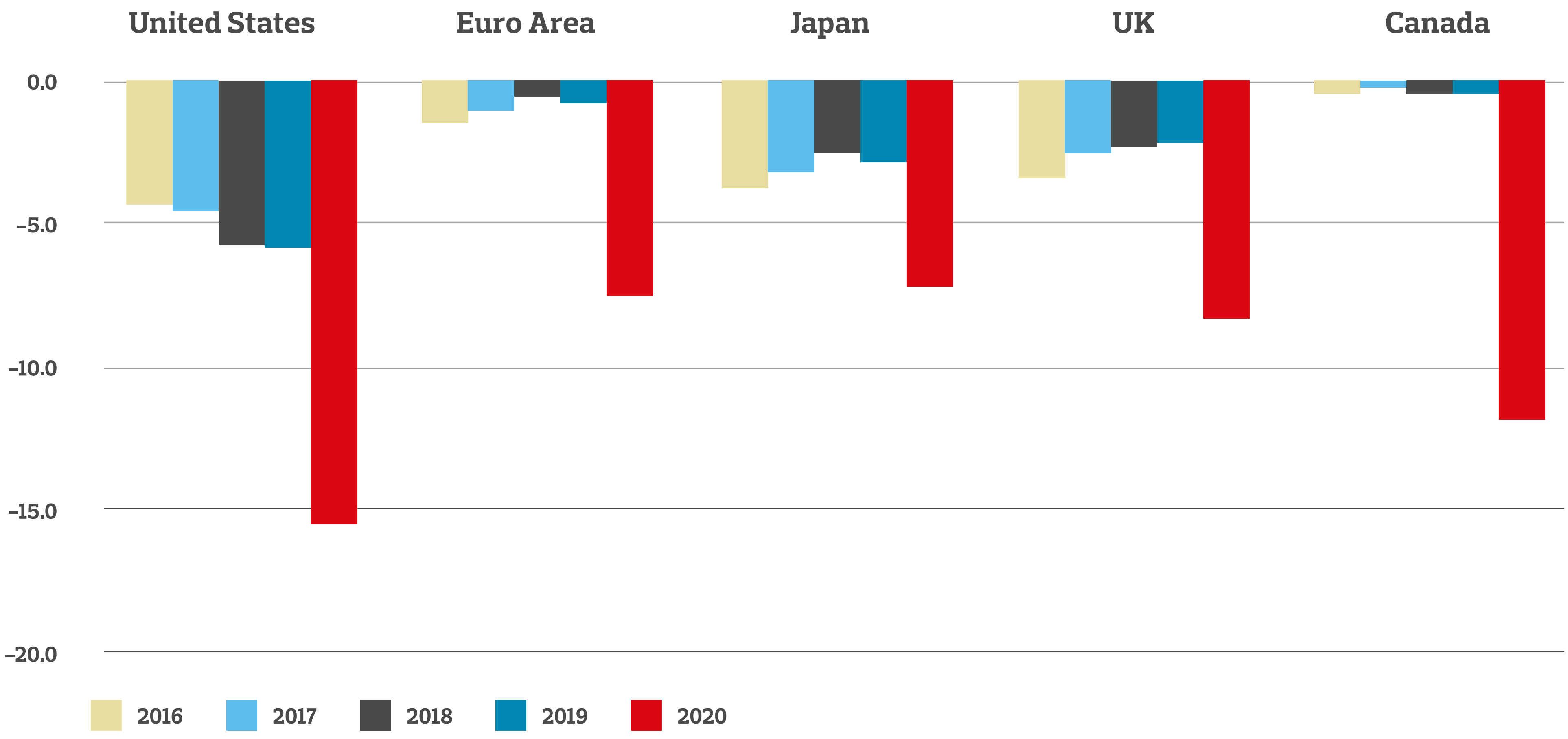
UK Fixed Gilt Curve



Extent of central bank support is not trivial

Budget Deficits Soaring:

General government deficit forecasts as % of GDP



Source: IMF World Economic Outlook, April 2020

Investment outlook

Uncertainties around the extent of Covid-19 impact

Covid-19 represents a significant uncertainty given its tail risk. Markets will adjust their expectations as the extent of its impact on economic and earnings data come to light, which will prove to be a bumpy ride.

As the impact of the virus becomes more globally widespread, there is greater potential for a huge demand shock.

Diversification from traditional asset classes will help smooth returns. High levels of liability hedging will also protect your portfolio from falls in gilt yields. Our ability to adapt your portfolio promptly, efficiently and appropriately in response to market conditions will help from a governance perspective.

Diversification and liability hedging are key

Being nimble with market dislocation opportunities

Move to "reduced-risk" portfolio positioning in October 2019

1

Market outlook

- As at October 2019 equity market valuations were **high**, pricing in a strong recovery in corporate earnings
- Recent bouts of market strength offered scope to **reduce equity exposure**

What we thought

- As markets progress towards the end of an economic cycle, they react in increasingly volatile fashion (particularly to negative news)
- **Performance** to October 2019 had been **strong**
- Sensible time to crystallise gains and take some unnecessary **risk** out of portfolios

What we did

- **Reduced** allocation to riskier assets (client allocations varied depending on investment objective but very broadly reduced return-seeking bonds and about a third of equities)
- Redistributed proceeds primarily to low-risk fixed income managers
- Trading took place in **mid-October**

The portfolio was in a "reduced risk" position at the start of the year

Monitoring and retaining our reduced-risk position until mid-March

2

Market outlook

- During January, US earnings beat expectations, trade war risk reduced and US inflation expectations lowered
- However, **Covid-19 fears** began to develop and the US election was proving a distraction

What we thought

- Increasing tail risk with impact of Covid-19 and US election uncertainty
- Sensible to remain in **de-risked** position until equities were better valued

What we did

- Kept our **de-risked** position until mid-March
- Looked to restore some risk to portfolios if and when equities fell further

Retained portfolio defences until mid-March to reduce impact of market volatility

Nimble Investment Strategy Committee ("ISC") oversight provided downside protection and opportunistic partial re-risking

During the market turbulence, the ISC was monitoring markets more closely than ever, looking for opportunities to increase risk at more attractive valuations. Extraordinary meetings of the ISC were convened at short notice as needed:

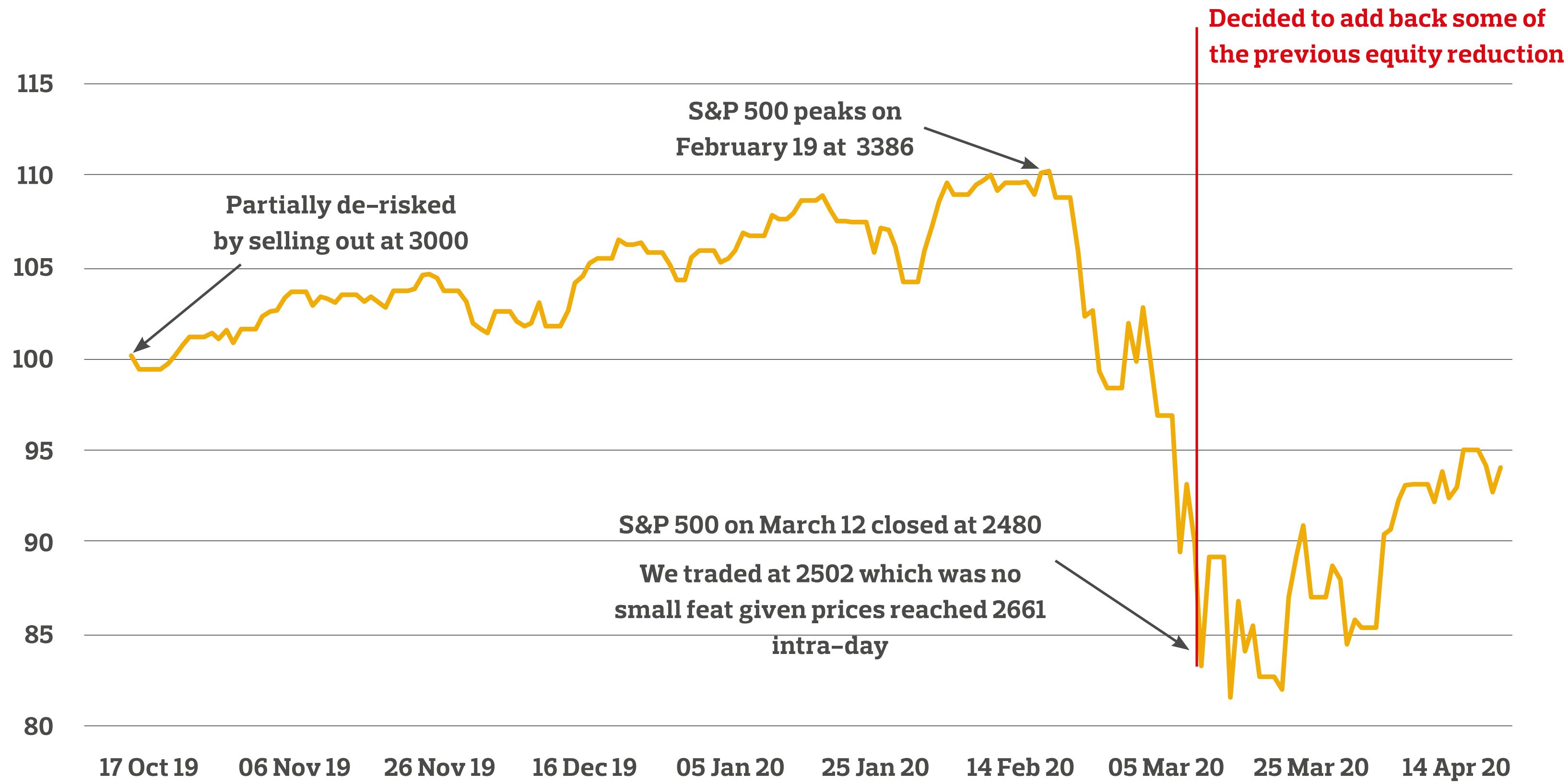
- On 9 March, the ISC agreed to rebalance the equity underweight (relative to historical levels) as and when an established trigger level was hit (attractive on a 3y horizon) for **agile implementation**
- On 12 March, the trigger was reached, the ISC reconfirmed their decision and **equity exposure was put in place on the same day**. After this, the portfolio was still underweight equities, but to a lesser extent than before
- On 24 March and 7 April, the ISC agreed to:
  - **maintain the current strategic allocations** given the discrepancy between the optimistic pricing in markets and likely disappointment in forthcoming economic data releases. Global economic activity has stopped to halt the coronavirus spread and the economic impact is yet unknown
  - **convene when triggers to consider buying** (10% fall in equities from rebalancing level or VIX falling below 30) **or selling** (20% rise in equities from rebalancing level) **are reached**

Speed is essential during the swiftest bear market on record

Adding riskier asset exposure back into portfolios

Update as at 22 April 2020

MSCI World Index - Total Return in GBP



We saw some value in equity markets and based on this, we decided to add some risk back into portfolios on 12 March 2020

We still remain underweight to equities relative to historical portfolio weights, leaving us with plenty of "dry powder" to take advantage of any further equity falls

Source: BNY Mellon. Data as at 22 April 2020. Past performance is not an indicator of future performance.

Responding to the medium term opportunities in credit

- While the market environment was challenging, market dislocations from the impact of Covid-19 have created strong opportunities in the credit market
- We have been exploiting these opportunities within our bonds and illiquids portfolios
- Within our bond portfolios, we have started to rotate away from absolute return bond (ARB) managers towards more directional credit managers. We have also seen some of the underlying managers rotate their holdings into credit
- Within the active fixed income strategy, we increased the allocation to multi-asset credit via M&G, which has begun to deploy cash and re-risk where it has found value
- Within the low-risk bonds strategy, we rotated towards Investment Grade (IG) short-dated credit and Asset Backed Securities
- Within illiquids, our distressed debt managers are on the front-foot seeking to capitalise on mispriced debt assets

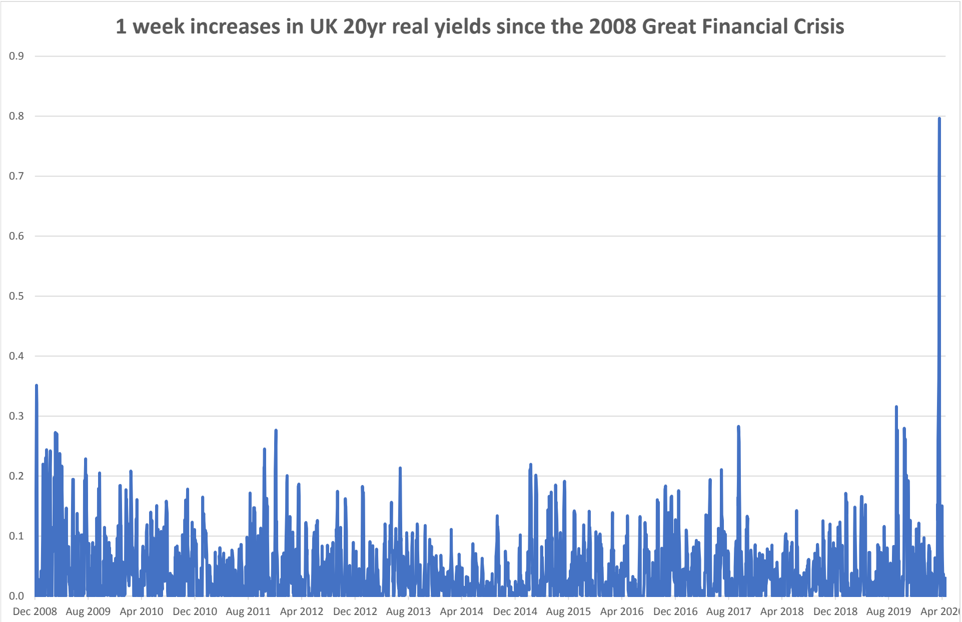
Credit Bear Market (BAML indices OAS, bp)	Spread pre-scare*	Spread highs*	Spread Apr 7	Move from pre-scare
US Investment Grade	105	408	292	+187
US long credit (10+ years)	143	375	296	+153
US AA	56	276	170	+114
US BBB	131	488	383	+252
US Asset backed (ABS/CMBS)	71	470	284	+213
US High Yield	356	1087	888	+532
US CDX (North America)	44	151	112	+68
UK Non-Gilt Investment Grade	105	225	197	+92
UK Corporate Investment Grade	122	285	241	+117
UK AA	59	138	122	+63
UK BBB	158	335	286	+128

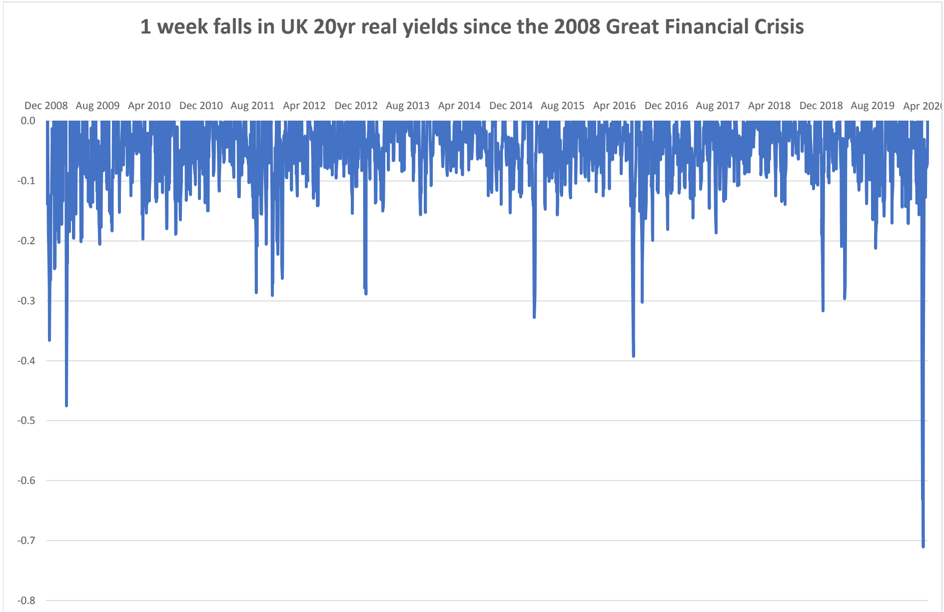
Spread pre-scare approx. 21 Feb, Spread high approx. 23 March

- We started committing capital to illiquid distressed debt strategies well before the current crisis, knowing that these funds typically have a three year period in which to make investments and that there was a reasonable chance that the long-running bull market in equities would end during that time
- Most of our managers have not fully drawn down the committed capital and so are well-placed to take advantage of the current dislocation in credit markets

Robust liquidity management

Quarter-on-quarter data masks substantial intra-quarter moves in gilt yields





Source: Aon, Datastream.
Data to 16 April 2020.

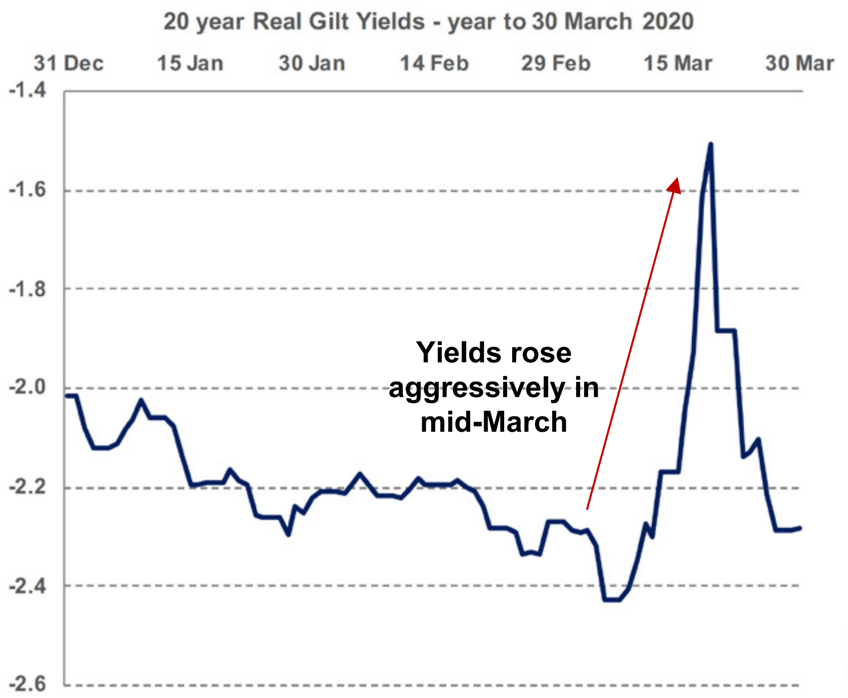
- Gilt yield movements are typically the largest driver of funding level experience
- Relatively higher volatility and substantial movements in gilt yields over Q1 2020 resulted in relatively higher funding level movements
- Clients reviewing funding level positions quarterly may not have realised the substantial moves intra-quarter

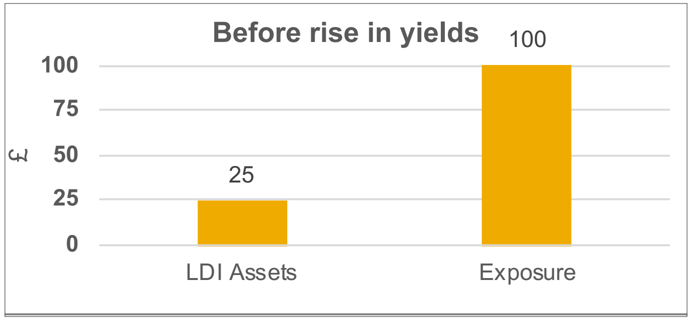
Liquidity management can be a testing experience

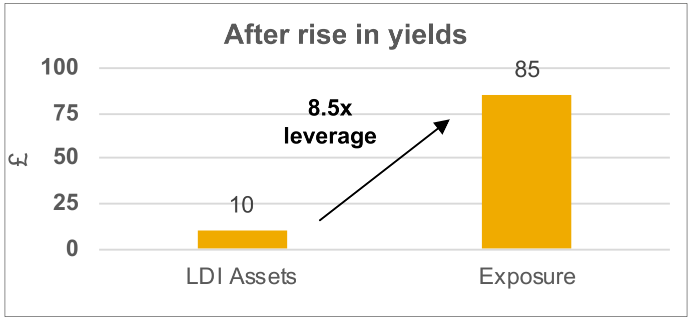
- In a fast-moving environment, continuous oversight meant we were able to deal with collateral calls without compromising
- Our portfolios are designed to help reduce forced seller risk. Yields could rise significantly before the portfolio managers are required to look to the growth assets to fund any collateral calls
- Even then, they would look to assets at the lower end of the risk spectrum (e.g. low risk bonds strategy). These assets act as an important source of collateral and prevent us from being forced to sell equities when they have just fallen
- However, we saw liquidity become increasingly challenged in these lower-risk areas with bid/offer spreads widening dramatically, as investors globally have been looking to sell assets for cash
- We dealt with this significant illiquidity by coordinating with our underlying managers to extract cash as and when liquidity emerged
- Much work and analysis went into ensuring our portfolios are sufficiently liquid, including stress-testing our portfolios for interest rate and growth market shocks. Clients are now benefitting from this work paying off during the extreme market volatility we are witnessing now
- We can proudly say all client redemptions have been met in full and on time over this period
- Managing liquidity can be a significant governance burden for clients, encompassing meeting cashflows (pensions or transfer values), ensuring sufficient collateral within the LDI portfolios, meeting illiquid asset drawdowns and rebalancing. We remove this responsibility from our clients; each client has two dedicated portfolio managers who have undertaken this burden

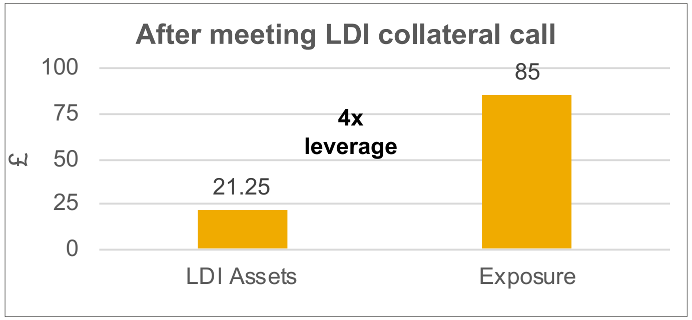
LDI needed additional cash to maintain protection from adverse liability movements

- If the hedge was removed at the mid March peak, the rapid fall in gilt yields could mean liabilities increasing but without LDI assets following suit
- This would mean a dramatic fall in the funding level
- In this volatile environment, it is even more crucial that hedges remain in place and do not fail due to a governance issue or inability to raise cash, given the swiftness at which the liabilities could increase and funding levels fall
- This coincided with the UK going into lockdown mid-March and liquidity drying up in certain credit sectors
- As set out previously, we managed these challenges successfully on behalf of our clients









Source: Aon, Datastream. Returns are in GBP. YTD to 30 March 2020. Charts on the right hand side are designed to illustrative.

Creating a viable working option: Business Continuity Plan

Business Continuity

Our GEOC has been **closely coordinating with local health authorities around the world** to refine our approach

We implemented **remote working** on Friday 13 March

On Monday 16th, we experienced over **30,000 global concurrent users** connected via VPN

There were **14,300 EMEA colleagues online** at once

Due to time zones we are never likely to see all of our **55,000 staff online** at any one time but could **handle every one of them** if needs be

We continue to deliver **high standards** of service

COVID–19

Operational Crisis

The outbreak of COVID-19 has had a significant impact on markets; however, the impact of COVID-19 has not just been limited to markets. It has led to a **major operational crisis** across the financial industry with the UK government imposing lockdown and social distancing rules. Since 16 March, all Aon UK investment colleagues have been asked to work remotely.

During this period, our ability to service our clients and manage their assets has been fully maintained throughout due to the resilience of our business model.

Business as usual

Tools at our disposal

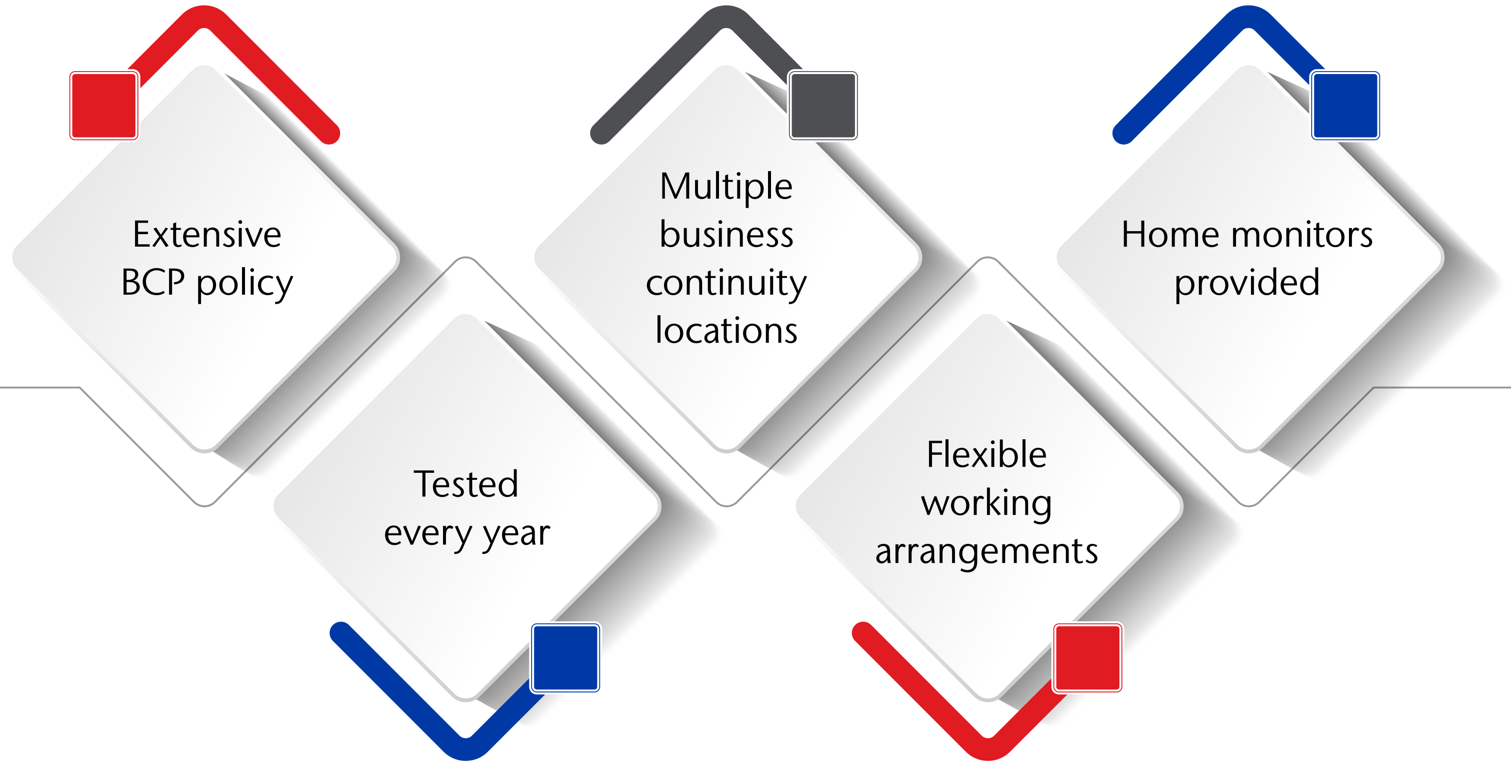
- WFH equipment
- Encrypted laptops
- Bloomberg Anywhere
- WebEx & Skype
- DocuSign
- Secure VPN - Okta
- Flexible working

We have an extremely resilient business model, underpinned by an effective combination of robust working practices and modern technology. These arrangements were **tested constantly, informally through colleagues working from home at least once a week prior to the lockdown and formally**, through annual testing of our Business Continuity Plan which was most recently executed in December 2019.

Business Continuity

The process

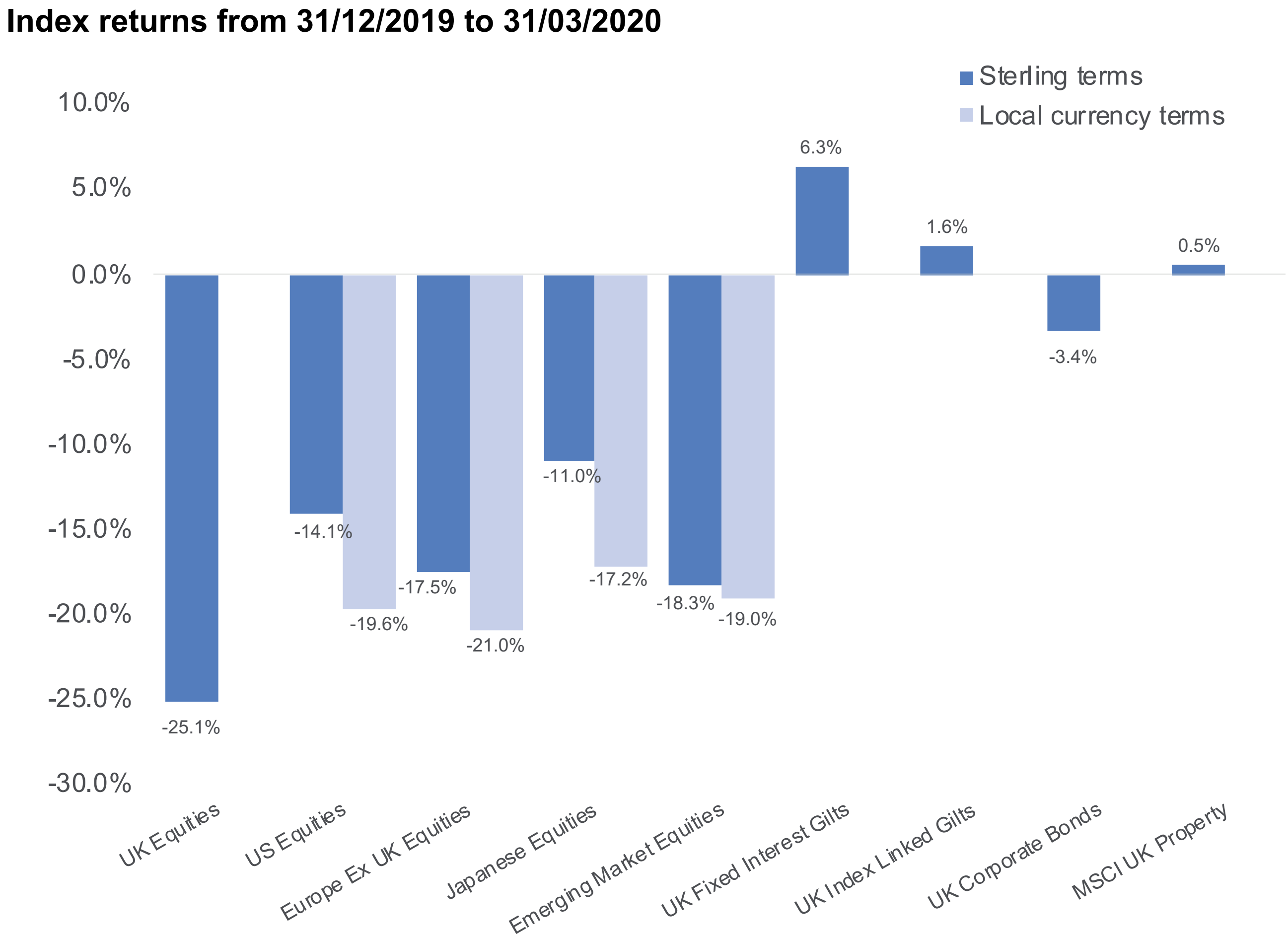
Working virtually has been an integral part of our culture for years



The importance of strategic asset allocation (and getting it right)

High levels of diversification helped mitigate equity downside

High levels of hedging translated volatility into funding level stability



Given record-breaking equity bear market swiftness, diversification away from equities immediately meant stronger returns and reduced portfolio volatility

Liquid alternatives and Illiquids will have provided further diversification to your portfolio.

Leadenhall (Insurance Linked Securities) achieved 0.6% in the absence of catastrophe claims.

Our defensive fund of hedge funds strategy is estimated to have posted -4.2% (unlagged), outperforming its benchmark by 0.3% which was remarkable given the much larger falls of its opportunity set.

Source: Factset, MSCI. *MSCI UK Property Returns from 31 Dec 2019 to 28 Feb 2020

Dynamic LDI Hedging

Overview

Tactical

Tactical LDI views are operationally complex, but there are gains to be made.

Innovative

Aon exclusive fund operated by Insight. Launched early July 2019.

Systematic

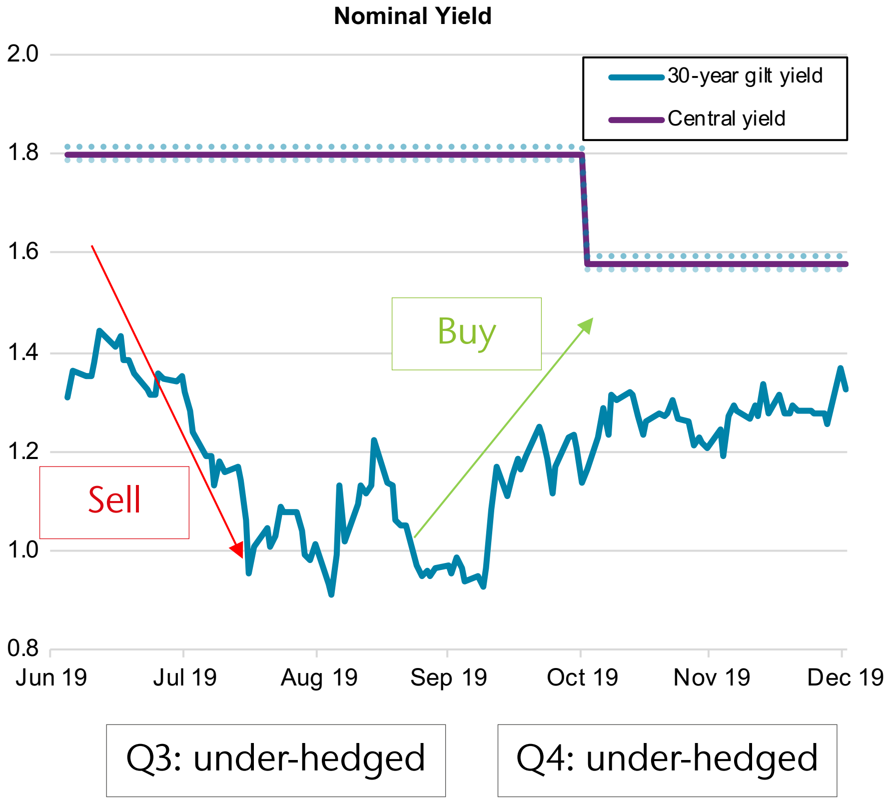
Automated hedging adjustments, within range, allows for quicker reaction to market movements.

Low Cost

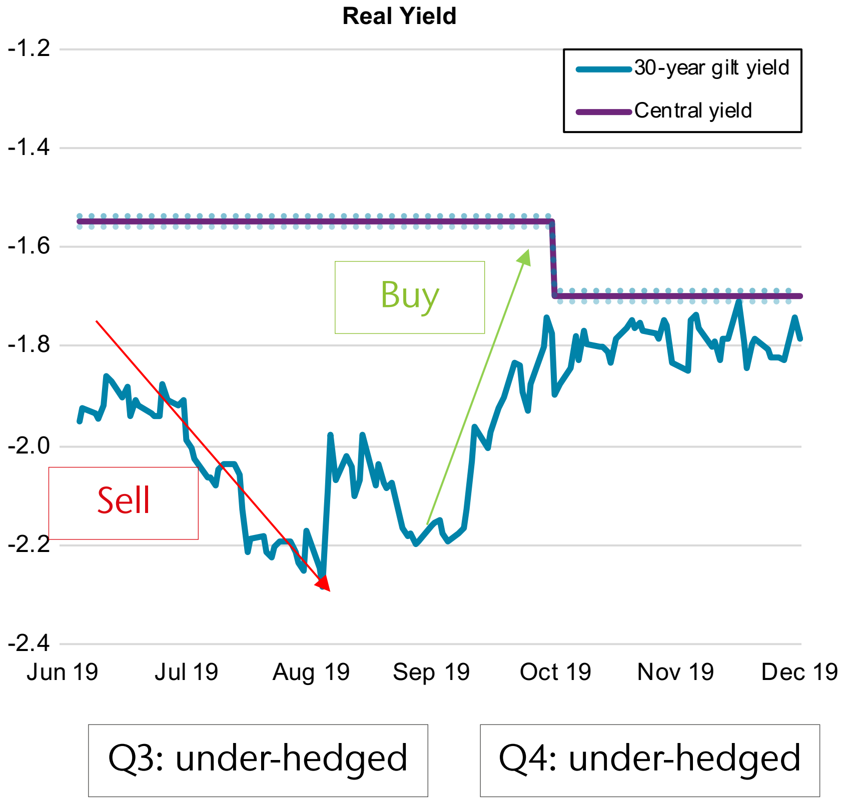
Trading gilts does not incur high costs. We expect additional dynamic returns to outperform costs.

Dynamic LDI Hedging added value

Buy low, sell high



Central yield was re-calibrated in October 2019. Source: Insight



Central yield was re-calibrated in October 2019. Source: Insight

Our dynamic LDI strategy helps Trustees get value when yields are volatile

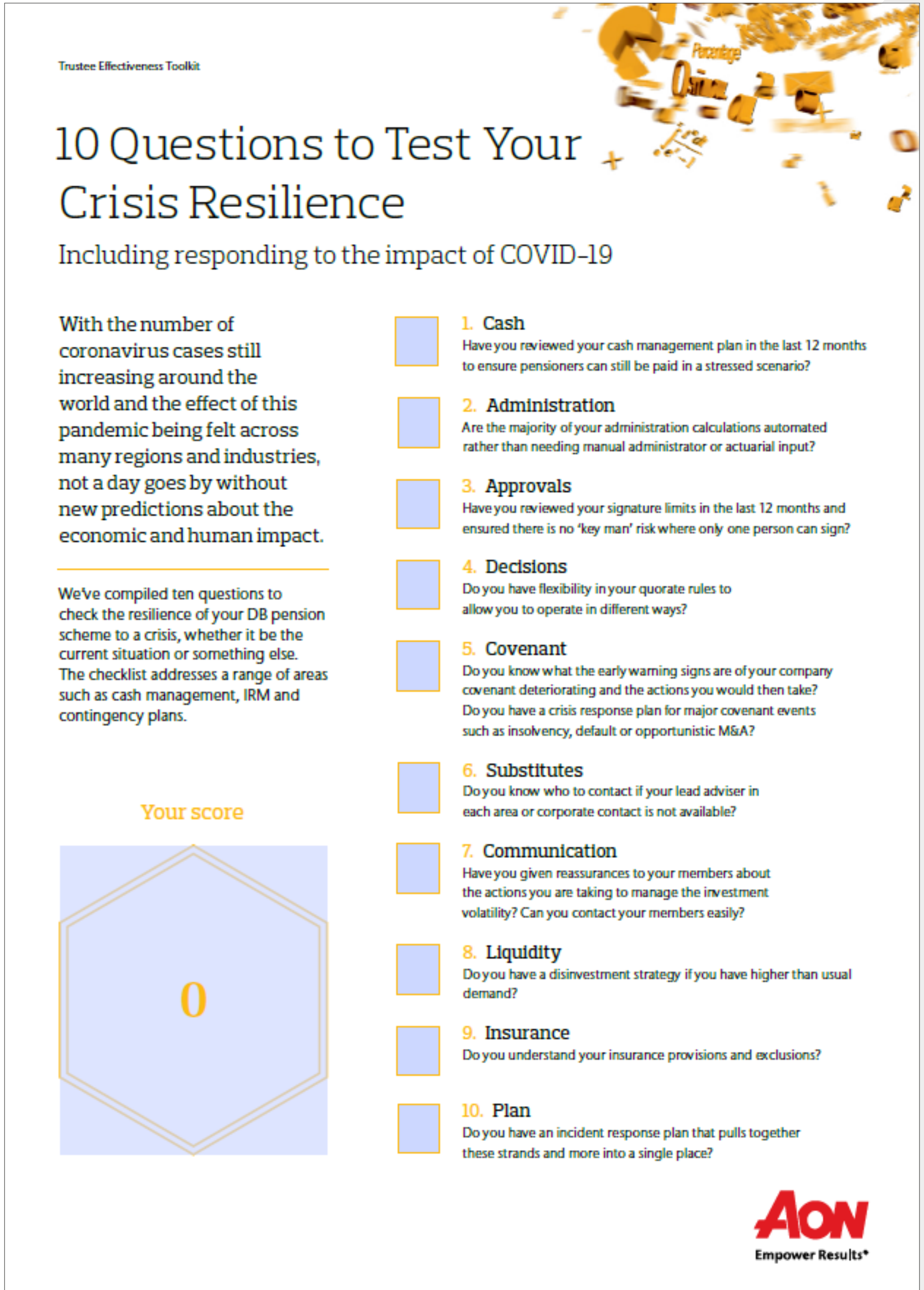
Distressed debt – York Distressed Asset Fund

Having diversifiers that will benefit from the move to a new economic cycle

York Distressed Asset Fund IV

- We began allocating to this fund in 2019, in line with our view that the economic cycle was nearing its end
- Fund Summary: the fund seeks to capitalise on dislocations in global capital markets where investment opportunities have arisen due to the balance sheet stress of traditional financial institutions. York will apply its fundamental, research intensive approach to purchase assets undergoing credit-oriented restructurings and lend against government-backed receivables
- Since mid-February, the strategy that was employed to access credit opportunities generated positive returns by hedging the portfolio through buying the European iTraxx Crossover index (a credit default swap index that comprises liquid sub-investment grade entities). The hedge was placed when spreads reached 280bps
- As the index contains many cyclical names with a high likelihood of default in the case of macroeconomic shocks, spreads rapidly increased due to the Coronavirus pandemic and York exited the position when spreads reached 600-700bps, generating c.$45m profit for the fund
- York expects that the returns made through this hedging should offset short term portfolio mark downs resulting from the Covid-19 pandemic
- Furthermore, amidst recent market liquidity issues, York found opportunities to exploit in the public investment-grade corporate bond market. York identified a basket of 15 high quality companies, such as Microsoft, Kellogg's, Verizon and Anheuser-Busch, whose IG bonds usually trade at low and stable spreads vs Government bonds
- However, selling pressure from large institutional investment firms in moves to generate liquidity has caused the spreads on these high-quality bonds to increase dramatically. For example, York purchased Microsoft bonds at 200bps spread compared to the spread before the crisis of 60bps
- These are short term opportunities and the manager expects to trade these in the next 3-6 months while the markets are distressed. Currently this opportunistic basket stands at c. $115 million and will be recycled as long as the opportunity exists in the market

Trustee crisis management checklist



Trustee Effectiveness Toolkit

10 Questions to Test Your Crisis Resilience

Including responding to the impact of COVID-19

With the number of coronavirus cases still increasing around the world and the effect of this pandemic being felt across many regions and industries, not a day goes by without new predictions about the economic and human impact.

We've compiled ten questions to check the resilience of your DB pension scheme to a crisis, whether it be the current situation or something else. The checklist addresses a range of areas such as cash management, IRM and contingency plans.

Your score

0

1. Cash
Have you reviewed your cash management plan in the last 12 months to ensure pensioners can still be paid in a stressed scenario?

2. Administration
Are the majority of your administration calculations automated rather than needing manual administrator or actuarial input?

3. Approvals
Have you reviewed your signature limits in the last 12 months and ensured there is no 'key man' risk where only one person can sign?

4. Decisions
Do you have flexibility in your quorate rules to allow you to operate in different ways?

5. Covenant
Do you know what the early warning signs are of your company covenant deteriorating and the actions you would then take? Do you have a crisis response plan for major covenant events such as insolvency, default or opportunistic M&A?

6. Substitutes
Do you know who to contact if your lead adviser in each area or corporate contact is not available?

7. Communication
Have you given reassurances to your members about the actions you are taking to manage the investment volatility? Can you contact your members easily?

8. Liquidity
Do you have a disinvestment strategy if you have higher than usual demand?

9. Insurance
Do you understand your insurance provisions and exclusions?

10. Plan
Do you have an incident response plan that pulls together these strands and more into a single place?

AON
Empower Results®

- **Cash**
  All payments met
- **Administration**
  Time to check – no portfolio management distractions
- **Approvals**
  Not required to keep portfolio solvent
- **Decisions**
  Not required to keep portfolio solvent
- **Covenant**
  Time to check – no portfolio management distractions
- **Substitutes**
  Not required to keep portfolio solvent
- **Communication**
  Time to check – no portfolio management distractions
- **Liquidity**
  Not required – delegated
- **Insurance**
  Time to check – no portfolio management distractions
- **Plan**
  Not required to keep portfolio solvent

Portfolio performance

Performance to 31/3/2020

	Q1 2020	1 year
Unconstrained client	–5.6%	–1.0%
Global equities (FTSE AW All-world)	–15.9%	-6.2%

We offer a complete range of options, bespoking portfolios to meet client needs.

We've shown our "unconstrained" client model on the left. This allows investment in the complete range of asset classes. These portfolios contain sophisticated investments, and are often more expensive and less liquid than other portfolios, but in times of stress do offer greater protection from equity and credit market falls.

CONTACT US

Please get in touch if you have any feedback or would like to discuss any of this in more detail

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