The ‘new normal’

What is it and what does it mean for investors?

August 2020

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Introduction

The COVID-19 experience reminds us all that change can happen and it can come fast. These extraordinary times only add to the macro and political uncertainties we face. They also call on governments, policy makers, business leaders and investors to consider the range of potential future outcomes, both for the better and worse. As a result, there is no shortage of challenge to the status quo, or of creative thinking about the future, both of which are increasingly discussed in the context of a 'new normal'.

The fundamental idea behind the new normal is that the world will have changed, and will continue to change, because of the COVID-19 pandemic experience. This can mean many different things to different people. For investors there are potentially countless new normal scenarios that could impact their short- and long-term investment decisions.

As a result, we have developed a framework for thinking about the new normal with a focus on the areas we believe will most inform discussion and investment choices in the short term.

In particular, we explore the new normal in two broad contexts:

1. **New normal 'shifts'** — areas of high-probability change, on which there appears to be broad agreement and an expectation that the impact of these shifts will outlast the COVID-19 experience, however long or short it may be.
2. **New normal 'scenarios'** — areas of less certain, more structural change, with the potential for stronger and longer-lasting effects on economies and markets, whether or not they are adopted.

This paper outlines the deep-seated shifts that have probably already occurred, those that are stirring and others which may or may not emerge. With so many uncertainties, the role for scenario analysis is stronger than ever and our investment teams are available to support you to do this at the time that is right for your scheme.

In the meantime, please continue to consider the many and varied potential impacts of this challenging environment on your investment portfolios.

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Why a 'new normal'?

The fundamental idea behind the 'new normal' is that the world will have changed because of the COVID-19 pandemic experience. It seems intuitive to think that the longer it takes for COVID-19 to disappear from public and market consciousness, the more lasting its effects. In fact, the disease may not even disappear entirely, instead becoming something like winter flu, which has limited economic effect. However, the point of thinking about the new normal is that however short or long the COVID-19 experience turns out to be, the after-effects and shifts in approaches and attitudes will be unmistakable. In other words, even if the entire experience is quite short-lived — say 18 to 24 months to full containment (with a vaccine and/or effective treatments) and only three to six months in terms of the economic shock from lockdowns — what it leaves behind in its wake will be very apparent.

Two sorts of new normal shifts come into play: the first arises from some of the more obvious consequences that appear likely to become embedded into economies because of the COVID-19 experience. These have higher conviction, or probabilities, attached to them, finding agreement from many sides. The second sort are more variable and uncertain but potentially have far-reaching and more long-lasting effects on economies and markets. Whether they happen and how events play out, depend on several 'if's', which are largely to do with how governments, policy makers, businesses and consumers react and behave. Government and policy makers' actions in relation to economic, social, health and other public policies will be the most critical influences. They are likely to shape the behaviours of businesses and consumers.

The more agreed 'new normal' shifts of COVID-19

The more obvious shifts resulting from COVID-19 appear likely to last well beyond the COVID-19 pandemic cycle. These include significant increases in government spending, extended periods of low interest rates, an increased reliance on digital communications, a move towards 'localisation' and intensifying economic conflicts between the US and China.

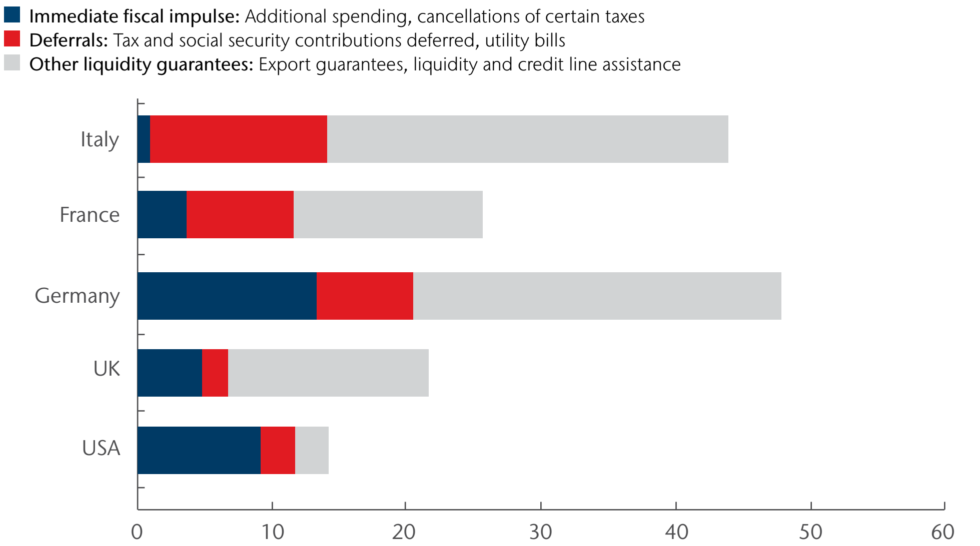
Currently, these appear to be more agreed on than disagreed on, representing a kind of 'consensus'. Arguably, several of these shifts represent reinforcements of existing trends rather than being brand new and caused by the pandemic. However, they are still no less powerful than those directly induced by the COVID-19 experience.

1. Government spending

There has been a substantial increase in government spending and involvement in the economy which has become necessary to protect employment and business. This is evident in the chart below (Chart 1) which tallies government commitments made to the end of May. It is hoped that some of the very sizeable fiscal commitments, made in the form of deferrals and liquidity guarantees, will be reversed over the next few years. However, it is thought likely that full reversal will be difficult and therefore increasing governments' involvement in economic activity for many years.

In turn, this implies business bailouts in one form or another, quite possibly debt for equity swaps on a large scale. Equally, the after-effects of this imply that tax revenues will need to increase, and government debt burdens will, at least for a time, be higher too. Governments will be hungry for tax revenue. Higher taxation all round, both through income taxes and corporation taxes (including the new digital tax), looks to be one significant impact of this massive fiscal expansion. This may negatively impact equity and credit in the short term and spur higher market volatility. However, it could be beneficial long term depending on the quality of government decision-making.

Chart 1: **The size of fiscal commitments so far to combat COVID-19 (% of 2019 GDP)**

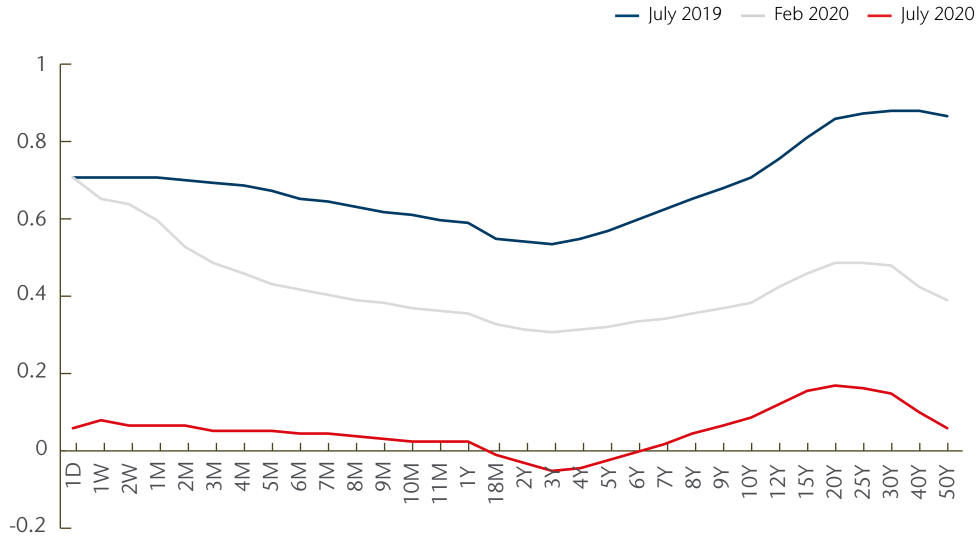


Source: Brueghel Institute, June 2020

2. Extended periods of low interest rates

Two legacies of COVID-19 are likely to be an acceleration of the trend towards still lower interest rates for a long period and reduced central bank independence. The global trend was already three decades old before the pandemic hit and has many drivers. The lasting economic scars of COVID-19, and its more deflationary impetus, obviously argue for a need for low interest rates. Since the outbreak, UK interest rate expectations have sunk to levels which not only suggest markets have little expectation of interest rate increases for the foreseeable future but also signal a potential move to negative interest rates in 2021. (See Chart 2)

Chart 2: **UK interest rate expectations have moved to new lows**



Source: Bloomberg

However, there is a more important connection to be made here. Low interest rates are necessary to ensure manageable financing of large budget deficits and ease concerns over the fiscal solvency of governments already threatened by so much new public debt on top of already precarious public finance positions. The need for central banks to finance national exchequers means that the independence of central banks is much weaker than before, though earlier successive waves of Quantitative Easing (QE) had already taken us in this direction[1]. We have now moved further along this road.

This trend of low interest rates puts governments and government policy into a more pivotal role for managing the aftermath of COVID-19. In contrast to the impact of government spending, this will support equities and credit in the short term. However, flat yield curves could see shares in financial organisations underperform, and any resulting inflation would be worse in the long term.

3. An increase in the reliance on digital communications

The third shift is a marked increase in reliance on digital communication and financial and business transactions. While this trend had been established well before COVID-19 struck, we have moved to a new level in the balance between more traditional forms of communication and transaction and those via digital means. Digital communications have performed remarkably well in their substitutive roles, meaning we are unlikely to see a full return to the patterns of 2019 and before. Even without the restrictions caused by the virus, the financial implications and gains of this trend are significant, making it one of the more lasting shifts resulting from COVID-19. This will also make digital sector spin-offs, such as automation and robotics, favourable, while reducing demand for others such as real estate, aviation and energy.

[1] *For example, the European Central Bank's attempts to protect Italy.*

4. A move towards localisation

The virus is also likely to accelerate the trend of shortening global production and supply chains, with a move towards 'localisation'. In a decade-long creep since the financial crisis, the previously strong trend towards globalisation (which was particularly marked between 1980 and 2007) has slowly reversed. This reversal accelerated under the moves towards the erection of more trade and foreign investment barriers that began in 2017 under the America First policy.

Though Brexit has so far not resulted in the formation of new trade barriers, it has raised uncertainty over the last few years. Many firms have reacted by delaying cross-border investment and globalised resource deployment plans that may not be viable under such localisation aims.

The trend towards localisation has been further accelerated by the reduction of cross-border travel because of COVID-19 and the further disruption of global supply chains and business concern over factors beyond national control, or influence. This, allied with greater awareness of the risks and costs from climate change, is likely to alter corporate business models significantly. While the investment impact may in be reduced profit margins for global organisations, it may also mean less disruption to supply chains due to severe shocks.

5. Intensifying economic conflicts between the US and China

The final of these more agreed-upon new normal shifts is a move to stronger bipolarity in the world order as the China-US economic conflicts intensify. US antipathy to China is not new but it has grown markedly in the wake of the pandemic, owing to China's alleged failure to be transparent about the progression of the virus in early 2020. This antipathy is now observed across the entire political spectrum in the US Congress and is resonating far more strongly with ordinary US households than before the pandemic.

Additionally, the stronger role of new technologies, and the sector's key corporate players, is heightening the technological rivalry between the two powers. This ratcheting up of the US-China conflict brings greater geopolitical and policy unpredictability, with the potential for widespread repercussions for the global economy.

Table 1: **New normal shifts**

New normal change	Economic implications	Investment impact	Actions
Substantial increase in government spending and involvement in economies	• Could be for the good or bad of the economy depending on the direction and quality of government decision-making. • Likely higher taxation. Corporation taxes more likely to rise (esp. in the US) — which will lower profits.	• Higher corporate taxes negative for equities and credit on intermediate horizons. • But could be beneficial longer-term depending on direction and quality of government decision-making.	• Prepare for continued higher market volatility but may be suppressed by low interest rates (see next row). • Caution on risky assets on intermediate horizons. • Longer-term outcomes could be very different if better foundations for sustainable growth built.
Lower for longer interest rates and reduced central bank independence	• Low interest rates cushion debtors (household, corporate and government). • Protects household net worth through holding up house prices and debt-financed spending. • Inflation returning needs to be looked out for.	• Supportive for equities and bonds near-term. Low rates help to suppress market volatility. • Could be worse later for both if inflation returns. • Financials may carry on underperforming owing to flat yield curve.	• Maintain high hedge ratios • Good idea to keep or add inflation hedges — inflation indexed bonds, gold. • Work on much lower investment returns from fixed income. • Avoid strategies overweighting financials.

New normal change	Economic implications	Investment impact	Actions
Greater digital penetration	• Overall economic impact depends on how governments manage growth in digitisation vis a vis regulating competition, taxation of technology companies and global cooperation to avoid technology wars.	• Less demand for real estate overall, though industrial logistics could partly compensate. • Greater market power of digital services technology and its spinoffs — automation / robotics etc.	• Favour technology / media and digital spinoff sectors, while watching for anti-trust and tax moves on providers. • This combined with business localisation (see below) benefits automation activities eg, robotics. • More caution on real estate, energy, aviation and cross-border travel and leisure.
Business localisation, shortening of production and supply chains	• Some business disruption, some cost escalation and lower profit margins as onshoring / reshoring gathers pace. • Global economy stands to lose from onshoring and localisation. • Likely continuation of trade wars and trade policy uncertainty encourages this trend.	• Takes profit margins lower, reducing valuation support for stocks / credit. • On the other hand, supply chains may be less disrupted by severe shocks. • Localisation reduces demand for shipping / freight but more logistics demand which strengthens digitisation as above. • Potentially damaging to emerging markets as scope for labour cost arbitrage reduces.	• Avoid complex multinationals instead favouring companies with localised and less complex production and supply chains. • Caution on lower income per head emerging markets exposure. • Negative for equities overall.
Intensifed China–US conflict	• Rivalry and conflict in trade, technology and territorial / military affairs. • Global trade and investment reorientation, higher geopolitical risks.	• An accelerant to the trend of this rivalry entering market radar for risk assets. • A further factor keeping interest rates lower for longer. • High potential for springing volatility shocks on markets.	• Factor China–US broader geopolitical conflict as a key portfolio risk to consider. • Equity outlook should allow a higher risk premium for these risks. • Holdings with greater exposure to China–US linkages to be treated with care.

Source: Aon

New normal scenarios

The more variable new normal structural shifts, or scenarios, have the potential for stronger and longer-lasting effects on economies and markets but they depend heavily on government approaches in the aftermath of COVID-19. This raises three important and interlinked questions:

1. Will the State look to reduce social, economic and health inequality in a 'levelling up' approach?
2. Will businesses behave differently to move to a more stakeholder-focused approach?
3. Will there be a step-up to a faster carbon transition?

The key element implied in these questions is whether governments take on a more activist role in tackling some of the fault-lines thrown up or exposed by the pandemic. If so, this would point to a major directional change for governments — a break with the past. Owing to governments wielding far more economic control in the new normal world, the scope for more activism has clearly risen.

But will it happen? In considering each of these three questions, we explore two potential paths:

1. Maintaining the status quo, with no changes in government responses (Path A)
2. The outcome, both in the short and long term, if governments takes steps to implement the changes (Path B)

The investment impact of these different scenarios is summarised in Table 2.

New normal scenarios

Structural shifts that depend on government responses

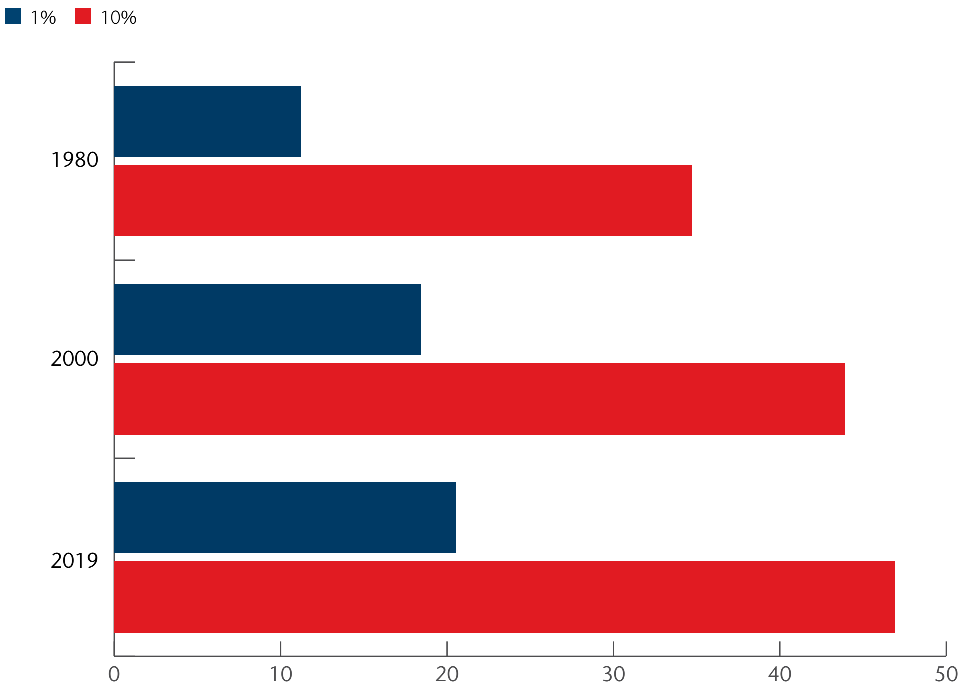
1. Will the State look to reduce social, economic and health inequality in a 'levelling up' approach?

We know that the virus and lockdowns have hurt poorer countries and poorer income groups within countries far more. Taking the UK example, the furlough and business support loan guarantees will have prevented some of the worst impacts on jobs. But, even after this is accounted for, there is little doubt that the virus effects have worsened already-high inequality in income and wealth. We can see that in the profile of those furloughed and in infection and mortality rates. Research from the UK's Resolution Foundation showed that a third of the lowest 20% of income earners had their jobs put in jeopardy compared with less than 10% of the top 20% of the income distribution. With death rates clearly linked to underlying health conditions, data from the Office for National Statistics (ONS) also suggests that, adjusting for age, deaths in more deprived areas have been more than twice those in the least deprived. Black, Asian and Minority Ethnic (BAME) populations, more strongly represented in lower income groups, have faced disproportionately worse economic and health impacts.

In the US, income and health inequality has risen much more strongly than in Europe or Asia and over a much longer period. The virus has exposed an even starker divide, with the rapid rise in unemployment and mortality rates strongly concentrated among lower income groups, particularly black Americans. Rising US inequality (see Chart 3) is thought to have contributed to a strong increase in economic and political fragility.

Chart 3: **How income distribution has become more unequal over time**

US Share of total income earned by top 1% and top 10%



Source: World Inequality Database

Many economists believe that rising global income and wealth inequality has been a causal factor in the gradual decline in economic growth rates in the last 20 years. Higher wealth and income groups have excess savings which have driven asset prices higher and cushioned their financial positions. However, most workers in advanced economies have seen no sustained rise in living standards for well over a decade, and in the case of the US for much longer.

Additionally, business investment has been weak. The higher savings from richer income groups against a backdrop of weak investment has driven interest rates lower. As a result, growth is both weaker and more reliant on low interest rates, fuelling the rise in debt and weakened public finances. This was already happening. COVID-19 has just made it worse.

Will the further rise in inequality and the problems it creates prompt policies to redress this issue and reduce disparities? For example, given the economic hardships suffered in the economic downturn, the topic of a Universal Basic Income is coming to the fore[2]. Such a policy is not the only way to build a stronger economic and social safety net — it is only one example. The question is whether this or other policies to directly tackle inequality and hardship happen or not? With government economic involvement now relatively high, the adoption of such an approach is possible.

This approach, and less tolerance of such unequal outcomes, is no longer an agenda of the left. The UK government, representing the right on the political spectrum, has adopted the language of inclusive capitalism and a 'levelling up' state. If such a new public policy approach comes to be widely accepted, this could amount to the effective setting up of a new 'social contract' between citizen and State, a stronger commitment at reducing economic, health and other disparities in a way which is accepted as being in the common good by a majority of the electorate.

The 'Path B' investment impact of reducing social and health inequality with a 'levelling up' approach may hurt risk assets in the near term and result in higher government debt. However, if this debt is correctly directed, public finances can become more sustainable as the economy improves, resulting in less reliance on debt in the long term to achieve growth, and potentially more opportunity to raise interest rates. By contrast, 'Path A' would result in continued reliance on debt and weak economic recovery, paired with growing inequality and ultimately less resistance to the next shock. While it may be more beneficial to corporates in the short run, the outlook over time becomes increasingly difficult for risky assets with more frequent market shocks from higher economic and political fragility.

2. Will businesses behave differently to move to a more stakeholder-focused approach?

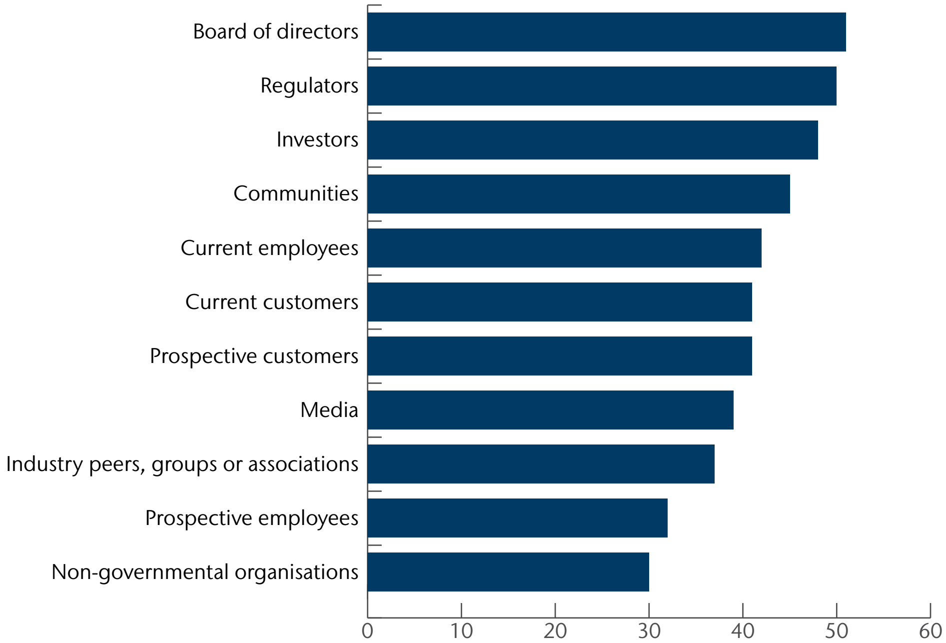
A levelling up State, seeking to shield its poorer citizens from bad economic conditions, will impact the business world. We have already seen the UK and several European governments urging banks not to pay dividends, to limit executive remuneration, and to use cash flow instead to support jobs and businesses. Additionally, the pandemic is widely thought to have further strengthened the move to a more stakeholder-focused approach given the adverse impacts on employees, customers and suppliers.

In recent years, many corporate leaders have expressed a view that a focus on narrow profit and share price maximisation targets is outmoded. Surveys of senior executives had suggested a move in this direction well before COVID-19 arrived, in particular when considering the impact of ESG programmes on their organisations. Similarly, CEOs of asset management companies, from Larry Fink of BlackRock, to Jamie Dimon at JP Morgan and Bridgewater's Ray Dalio, have also argued along much the same lines to build a fairer society by reducing inequality, a necessary rebalancing of shareholder versus stakeholder priorities in business behaviours and more broadly, an 'inclusive capitalism'.

[2] A payment made to all citizens regardless of means which protects individuals from outright poverty

Chart 4: **Respondents consider the impact of ESG programs on a breadth of stakeholders**

Stakeholder groups considered entirely or to a great extent (% of respondents)

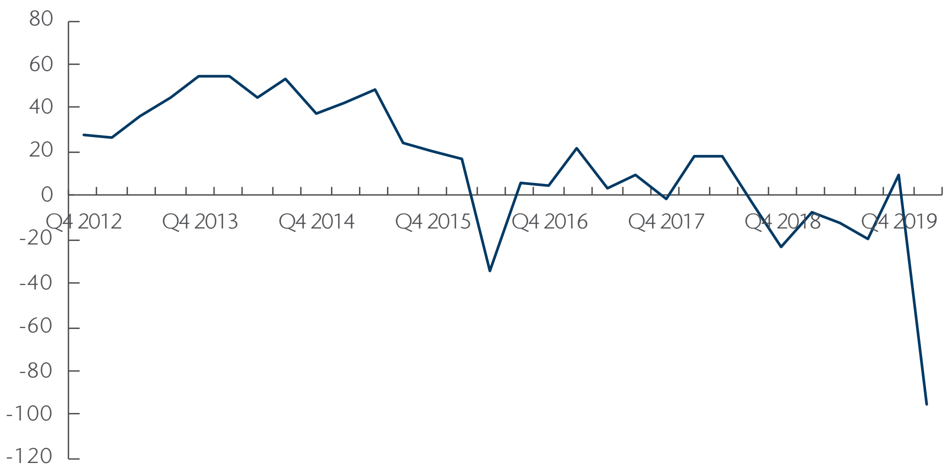


Source: McKinsey Global CEO and Investment Professionals Survey (2019)

This is significant for two reasons. Firstly, the asset management conduit for capital allocation is important for the economy because the emphasis on changing corporate behaviour will make a significant difference to the way trillions of institutional monies are allocated, monitored and voted on. Secondly, as these different approaches were emerging prior to the COVID-19 disruption, subsequent events can be argued to be taking it to a tipping point where quite far-reaching attitudinal changes are seen within the business world. Recent surveys, such as the Deloitte 2020 CFO Survey, suggest that shareholder primacy is going to be accorded lower priority for some time — if only because other financial objectives will take precedence (see Chart 5).

Chart 5: **Less reward for shareholders?**

% of UK corporates (net) likely to raise (+) or reduce (-) dividends and share buybacks



Source: Deloitte 2020 CFO Survey

How government policy reacts in its approach to business will be critical as an agent for such behavioural change. Various announcements from governments, central banks and financial regulators urging business to focus on 'resiliency' have been taken to mean planning for adverse events like accelerated climate change, or other major disruption from global events like pandemics or trade wars.

One of the questions we ask is whether this approach will now become more directive in the wake of the COVID-19 crisis, particularly given governments' increased ability to directly influence businesses after the extensive support they have been providing. Since some of this debt will not be repaid, many business loan guarantees and debt support schemes will potentially result in governments having to take equity stakes. This will increase government leverage over business directly, allowing it to make rescue programmes or other assistance conditional on entities and moving towards a more societal approach in its business affairs.

However, despite this, a 'levelling up' state could be doing things very differently vis-à-vis business. It could mean an attempt to encourage less disparity in employee compensation. How the government regulates competition could also be a new focus. It is generally felt that declining competition in the corporate sector has imposed costs on society. In the US, the growth of business concentration, and monopoly power in certain sectors, with the growth of super-sized 'winner takes all' companies are now seen as an adverse development by many. There is already evidence of increased shareholder activism since the pandemic emerged, and if government influence is in the picture, this trend could be reinforced.

The 'Path B' scenario, where businesses move to a more stakeholder-focused approach, could initially result in falling stock and credit performance. However, this could then pick up, with companies with better stakeholder awareness doing better in the aftermath, and financials closing the gap on the technology and healthcare sector.

3. Will there be a step-up to a faster carbon transition?

The decline in carbon emissions during worldwide lockdowns has been widely seen as offering an opportunity for governments around the world to pursue a stronger green agenda, and also for them to encourage business and the wider economy into a more environmentally sustainable path. But will they? If the aim is to build greater resilience to shocks like another pandemic or climate change, this increased leverage offers the potential for a successful clean energy transition and a better chance of meeting the Paris Agreement global temperature goals. If governments become more active in pushing economies into a more environmentally sustainable path, this means not just lessening the use of fossil fuels. It also means reducing environmental pollution, with its multifaceted and negative impact on biodiversity and natural capital.

The UK and Europe have made a commitment to eventual carbon neutrality, but progress is still gradual. So, the question is whether the 'new normal' forces a faster pace of change. In the US, some states have been much further ahead than others, but overall it is further behind in finding a consensus.

The post COVID-19 world could strengthen governments' incentives to pursue green agendas and to look to a faster carbon transition everywhere. An activist green agenda also holds the promise of boosting employment opportunities that would help an otherwise weak labour market. Estimates vary on how many new jobs will be generated by pursuing a clean energy transition and a wider environmental agenda. However, there is little dispute that such a drive can create many jobs just about everywhere. Business investment opportunities that come in the wake of such an approach could also make a big difference in improving economic outcomes. Governments would have to lead and there may be some upfront costs to pay, but the likelihood is that this kind of spending will be both job-creating and cost-effective for economies.

A stepped-up environmental agenda will lead to some opposition from consumers and business to higher carbon taxes and higher energy prices. This makes it a politically demanding shift – at least initially. However, it may be possible to at least partially offset higher carbon taxes, by some lowering of taxes on jobs and incomes while still not losing much tax revenue overall. This therefore has elements of a 'win-win'.

The 'Path B' scenario, if governments take the opportunity to step up the carbon reduction agenda, would be favourable to markets as a risk-reducing, rather than return-enhancing, impact. It may well be harmful to the transport and industrial sectors but would put the global economy back on track to meet the Paris Agreement global temperature targets, gradually reducing climate change risks.

Will such changes occur?

The underlying imperative in all three scenarios is the need to build a more durable and sustainable economic, social and environmental framework that better protects economies from some of the problems we have seen develop and grow in the past couple of decades.

The potential changes of direction imply government taking on a more activist approach on policy. However, it is uncertain whether governments will move in this way. The obvious problem — given short electoral cycles — is that there are major obstacles for governments in democracies, to move clearly and decisively in ways which might be a risk for them at the polls. However, the scope for change is certainly greater today. Democracies have managed to make some big changes in the past, and in today's environment, scarred by COVID-19, it may be possible again for big changes to happen.

The purpose of the new normal scenarios is therefore to explore what happens if such directional change does or does not happen. The ultimate reality may well be an intermediate set of outcomes: a bit of a push on one, less on another and so on. Overall, we do see some change coming, though not all of what is discussed here will happen, and certainly not at the same speed of implementation — which is fine. For now, these scenarios still help us frame the results that come from such new normal changes.

Table 2: **New normal scenarios for structural shifts**

Scenario 1: **Will the State look to reduce social economic and health inequality in a 'levelling up' approach?**		
	Path	**Investment impact**
No (Path A)	• State misuses or does not use its increased leverage over the economy. • Poor outcomes for the majority increase mistrust of the state; trust in the government and science wanes further. • Weakened governments seek to build alliances with elements of big business, encouraging rent seeking behaviour. • State emphasises military and national security.	• Failings of post Great Financial Crisis economic recovery continue, weak economy reliant on debt, weak business investment, limited employment opportunities, growing inequality, low resilience to future shocks. • Friendly to corporate incumbents and some asset owners. However, outlook over time increasingly difficult for risky assets with more frequent market shocks to come from higher economic and political fragility. **Favour government bonds over equities / credit, long volatility, target less portfolio risk**
Yes (Path B)	• Stronger economic, social and health safety nets brought in through a Universal Basic Income or by other forms. • Institutional quality and governance improves with more public trust in agenda to reduce income and quality of life disparities. • Higher general taxes to address needs of public services with higher corporation taxes et al. • State targets productivity improvement through social and economic infrastructure improvement.	• More labour-friendly approaches could hurt risk assets near term. • But better economic foundations on intermediate / longer horizons as imbalance between capital / labour is redressed. Economy-wide productivity improves, and business investment revives. • Investment returns pick up later as risk of big shocks lessen. • Government debt may rise but if spending is correctly directed, public finances become more sustainable over time as economy improves. Long term there will be less reliance on debt to achieve growth. • This could ultimately allow interest rates to rise. **Stocks and credit to do poorly initially. A pick-up then likely. Not so favourable for gilts and other government bonds.**

Scenario 2: **Will businesses behave differently to move to a more stakeholder-focused approach?**		
	Path	**Investment impact**
No (Path A)	• Share price maximisation remains key target. • Stakeholder imperatives are not addressed. Employees, suppliers and wider economic concerns are not accounted for. • No business push apparent towards greater environmental awareness or building protection from future shocks.	• Profit margins in protected sectors remain high, protecting investors overweight in these sectors. • Weak and fitful growth, with potential for shocks keeps business investment as weak as now. • Bond yields remain at very low levels given economic fragility and higher reliance on low interest rates to maintain growth. **Favour bonds over equities / credit, long volatility, target less portfolio risk. Existing market winners in technology / healthcare maintain their positions.**
Yes (Path B)	• Government leverage and lessons of COVID-19 prompt changed business attitudes. • More stakeholder emphasis to take employees, customers and suppliers into account. • Stronger competition regulation on business. • Less disparity in employee compensation. Share buybacks could fall. • Corporate ESG responsibilities are acted on (see below).	• Less friendly for capital owners initially. Profit margins could fall. • Strong competition regulation could hurt some established players. • Companies with better stakeholder / ESG aware approaches should do better. • Less concentration in markets makes for better resilience to shocks / surprises. • Better macro foundations for growth, stronger business investment less friendly for government bonds **Stocks and credit to do poorly initially. A pick-up is then likely but potentially different sector and stock winners to those pre-COVID-19. Financials could close the gap with technology / healthcare. Gilt (and other government bond) yields could rise.**
Scenario 3: **Will there be a step up to a faster carbon transition?**		
No (Path A)	• In the name of protecting economic growth, no steps taken to reinforce low emissions seen during the pandemic. • No attempt to push carbon transition in aviation, road transport, household energy generation. • Companies' environmental responsibilities not enforced.	• More costs likely to rack up from climate change-related economic disruption which bring heavy costs to companies and their insurers. • Though UK and Europe are already committed to carbon neutrality by 2050, progress is slow and very limited in the US. • Economic impacts will grow over time, with more shocks that disrupt corporate functioning and markets. Risk premiums in markets will rise. • Strong adverse impact from climate change over time on poorer emerging economies. • Extreme weather events likely to damage human health / productivity and hurt critical infrastructure, imposing high real estate costs. **Favour bonds over equities / credit, long volatility, target less portfolio risk. More negative impact on real estate and emerging markets.**
Yes (Path B)	• Scope for carbon taxation / carbon pricing markets expanded from currently minimal role. • Environmental safeguards strengthened on companies and households to put economies on to track to meet Paris agreement goals. • High carbon footprint sectors (aviation / shipping / long supply chains) are encouraged to move to more sustainable forms. • Government infrastructure spending steps up to favour green agenda — to keep emissions capped, reversing pollution and soil / water degradation. • Global fossil fuel demand and production falls to very low levels.	• Some adverse reaction from capital owners, businesses and consumers reflecting higher energy costs, greater costs of environmental compliance etc. • Green stimulus can attract private investment, producing a virtuous circle of higher employment, higher investment and ultimately improved public finances. • Putting the global economy back on track to meet Paris Agreement global temperature targets gradually reduces climate change risks and impacts on economies over time. • Risk of stranded assets as energy prices fail to recover. **Economic benefits and favourable market impact will be felt over an extended period as this is risk reducing rather than return enhancing. Energy and high carbon using transport / industrial sectors likely to de-rate. Beneficiaries of carbon transition to be favoured in portfolios.**

Source: Aon

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