



Actively seeking return

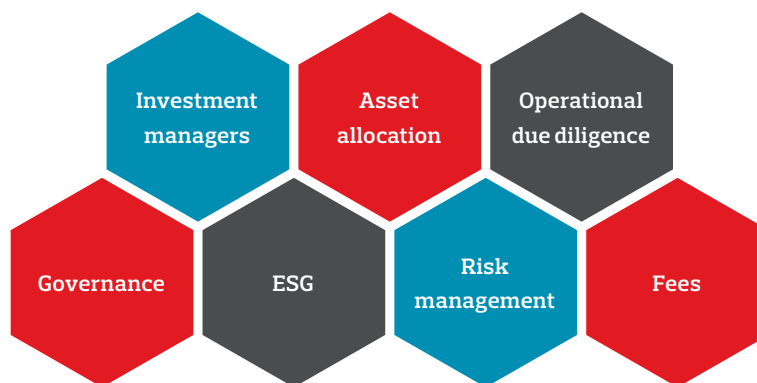
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Overview

In the current low-return environment it is important for your investment strategy to actively seek return. This is more than a debate about active versus passive management.

The next step is to consider whether you want to be active or whether you want someone to be active on your behalf on a much wider range of areas including:



This does not mean you should forget about risk but...

For a DB trustee: if you have already managed to set an appropriate level of risk that can be supported by your employer's covenant then you are ready to focus your time and effort on seeking return.

For a DC trustee: if you have already managed the risk for your members by selecting an appropriate default and a range of lifestyle options to target different decisions at retirement then you are ready to focus your time and effort on seeking return.

Asset allocation

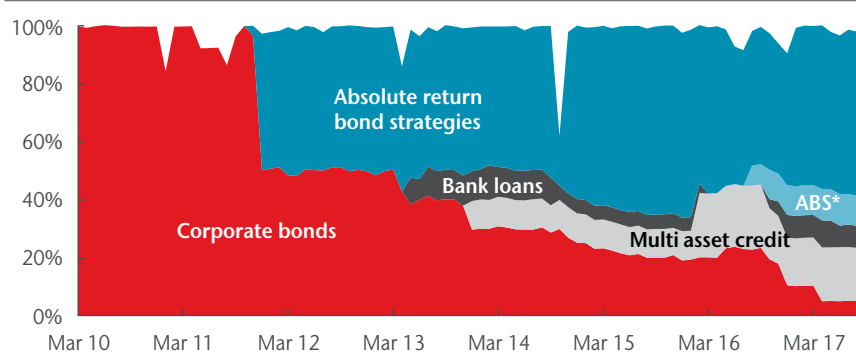
Asset allocation has a significant impact on the returns achieved so when seeking returns it is an obvious area to think about how you can get more active.

Are you on top of developing market opportunities?

Strategy allocations need to evolve as markets evolve. This is true whether you are focusing on your return-seeking assets or your matching assets.

The chart to the right shows an example matching portfolio and the strategies used (white area on the chart shows money that was held in cash).

Example client liquid credit portfolio



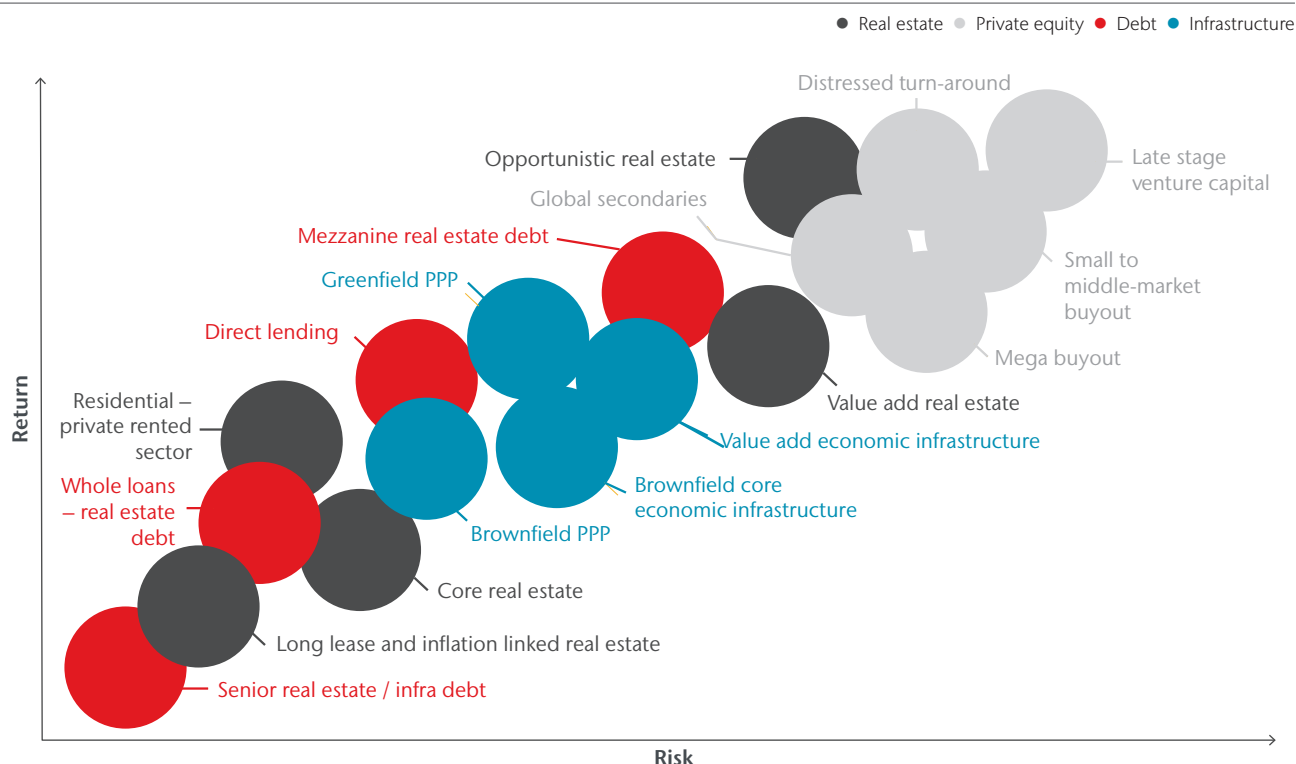
Source: Aon
* Asset Backed Securities

Asset opportunities — example illiquidity

There are lots of opportunities we could have mentioned in this section, but in the current low-return environment there is significant interest from pension schemes and insurers in harvesting the illiquidity premium.

There is a wide range of illiquid assets available, some focused more on stable income and others on higher risk with greater growth potential. The chart below illustrates some examples.

Illiquid opportunity set



Source: Aon

The average target property allocation by global institutional investors now exceeds 10%. We feel that this is such an exciting area that to misquote the words of the famous 1970s Remington Shaver advertisement ‘Aon like this area so much we bought the leading company who focuses on advice on real estate and real assets — The Townsend Group’.

Townsend’s position as a leader in the real estate and real asset space is a great complement to Aon’s existing alternative investment offering and global scale. The combined Aon and Townsend organisation now has:

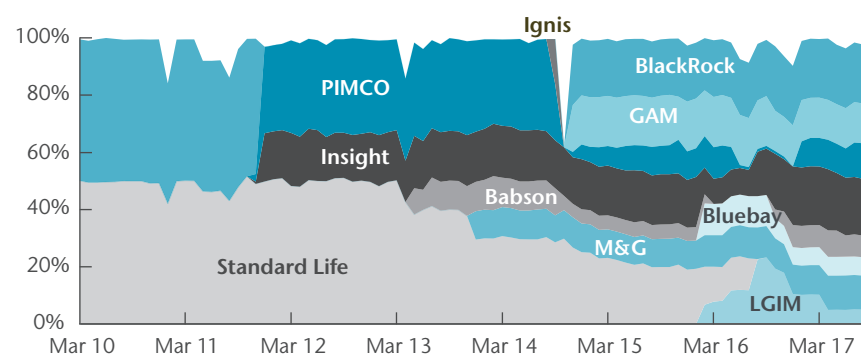
- Nearly 1,000 experienced investment colleagues worldwide
- More than \$130 billion in assets under management
- More than \$240 billion in real estate assets under advisement

Investment managers

How active are you in manager selection?

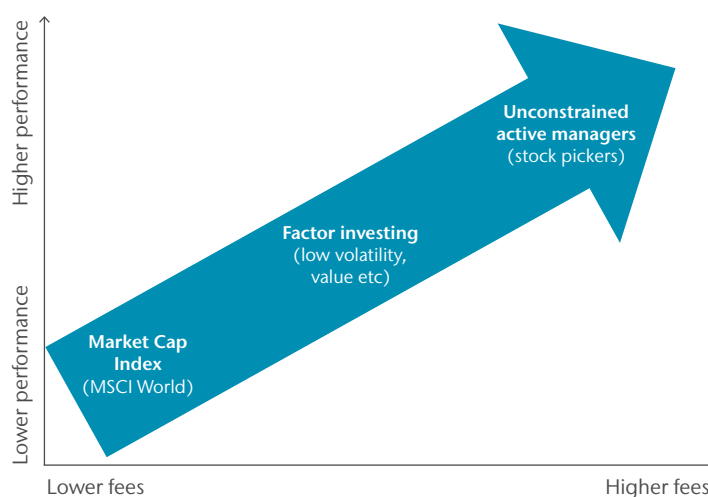
Whether you are thinking about your return-seeking or matching assets, you need to regularly review your fund managers. Change may be needed to include a new asset idea, to provide additional diversification or because of changes at the investment manager. Aon’s manager research team adopts an active process, helping to ensure that your investment managers remain best in class.

The chart below shows the same matching portfolio as we used in the asset allocation example but focuses on the managers used:



Source: Aon/BNYM

What can active management mean?



For illustration purposes only

Are your active managers active?

We believe that active managers should be truly active and unconstrained. They should be able and willing to invest your money with conviction in their approach. Aon's research shows that high conviction managers do on average outperform, and we can help you avoid the closet trackers where you would be paying active management fees but not receiving active performance.

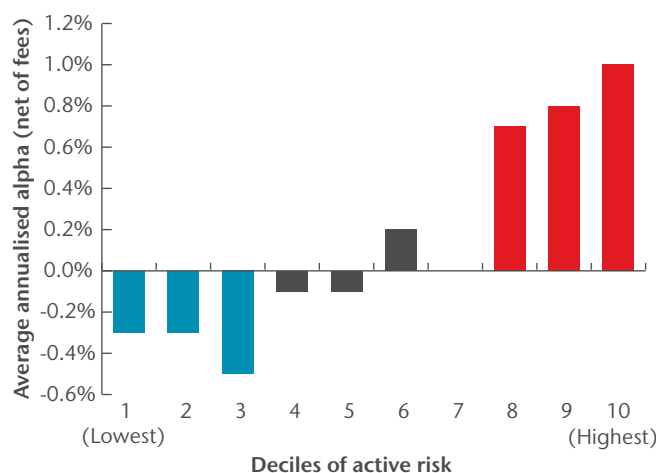
The challenge with unconstrained investing is sticking with it, as the volatility is higher and so the journey can feel more uncomfortable.

Factor investing

In its simplest form, a factor is a persistent, robust and well-documented driver of risk and return which has the potential for long-term return enhancement through factor risk premiums or the exploitation of market inefficiencies. Factor investing aims to capture this outperformance through rules-based, transparent strategies, at a lower cost than traditional active management.

Factor investing has experienced a sharp rise in prominence in recent years. Also known as 'smart beta', many clients are looking at the best way to invest in this area of equities, but are often quite rightly confused by the plethora of options and approaches.

Alpha by level of active risk (manager's chosen benchmark)



Source: Hewitt ennisknupp ("Conviction in Equity Investing" published paper)

Aon's research over the last five years shows the best approach is to create or use a multi-factor portfolio, containing four key factors:

- **Low volatility**
- **Value**
- **Quality**
- **Momentum**

To learn more see our paper *The Rise of Factor Investing*.

Operational due diligence

Many chief investment officers cite operational due diligence as their biggest potential blind spot, that could have a significant drag on the performance of a manager if they get it wrong. It is a dry area that many trustees do not want to be active in, but it is important that you understand who is looking after this on your behalf.

Who is checking that each manager:

- is obeying any trading limits?
- has appropriate checks and balances between traders and the back office?
- has appropriate cyber security?
- has appropriate disaster recovery?
- has appropriate background checks on its staff?

Governance

In order to seek returns, trustees need to be active in relation to their own governance. This is key to being able to act nimbly and efficiently or to decide when to ask someone else to be nimble on your behalf. Aon can offer trustee governance tools to assist you in this process including;

- Reviewing current trustee effectiveness
- Understanding the balance of personalities
- Understanding the personal attributes, skills and experience of your trustee board
- Improving trustee group decision making
- Organising trustee meeting agendas and maximising the time between meetings
- 10 practical tips on how to challenge advisers

For more information see

www.aon.com/trustee-effectivenessuk

"The Pensions Regulator welcomes the development of tools like this, which provide ways for trustees to assess their current levels of governance and set targets for improvement. As part of our work on 21st Century Trusteeship we would like to encourage trustees to regularly assess their board effectiveness and we welcome initiatives developed by industry to support TPR's drive to improve governance."

Lesley Titcomb, Chief Executive at the Pensions Regulator

Responsible investing and ESG

ESG integration is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns.

This subject is primarily about risk and return, only in some less familiar territory, generally untouched by traditional fundamental financial analysis. Such non-financial risks are also financial opportunities.

We believe it is about being active in encouraging better long-term behaviours in the companies that you and your members invest in. Being active in this area can involve

- Raising awareness among stakeholders
- Understanding beliefs, including those of your DC members
- Documenting your policy and objectives
- Modelling scenarios
- Engaging with your managers to understand their approach.

Fees

You could argue that net-of-fees performance is all that matters because this is the return you or your members receive; however we all know that what you measure gets thought about more carefully. We are not arguing for the lowest fee but for schemes to consider the value for money they receive and the best way they can achieve cost reductions for the same product or service. The FCA is keen to see investment managers provide more disclosure (and is regulating in this area) and the Pensions Regulator is expecting trustees to challenge for greater disclosure.

To be active in this area, start asking the questions in the chart to the right.

At Aon we support the agenda of transparency and disclosure and are publishing more information about our performance [read more](#).

Achieving fee savings across all providers



Risk management

At its heart, the Pensions Regulator wants trustees to think about risks together, prioritise them, and then:

- Apply better integrated risk management strategies – combining covenant, funding and investment; and
- Develop contingency plans for the main risk factors

At Aon, we believe you should tackle risk management with a three step approach: **understand; measure** and **mitigate or accept**.

Being active

In 2018 we are challenging trustees to consider their approach to investment – where can you be more active and where can you challenge others to be more active on your behalf? Whether you are managing a DB deficit or deciding the default investment strategy for your DC members, you need to think about how you can seek returns.

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About Aon

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For further information on our capabilities and to learn how we empower results for clients, please visit <http://aon.mediaroom.com>.

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