Navigating the crisis
Attractive asset classes

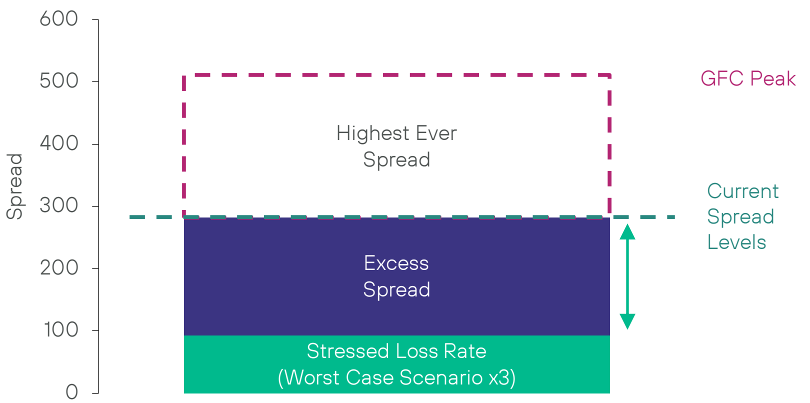
15 April 2020

Attractive asset classes – short to medium term

High Quality Credit

- Following the widespread market sell-off, **credit spreads have widened dramatically** to levels last experienced during the Global Financial Crisis. High performing credits have been caught up in this **indiscriminate selling** in recent weeks.
- Global Investment Grade Credit spreads have **widened c.180bps (1.8%) since the beginning of the year**. Similarly AAA Collateralised Loan Obligations (CLOs) widened from c.130 bps to 400bps towards the end of March.
- These spread levels provide good risk adjusted returns even after adjusting for significant increases in defaults.

Global Investment Grade Credit – Current Positioning

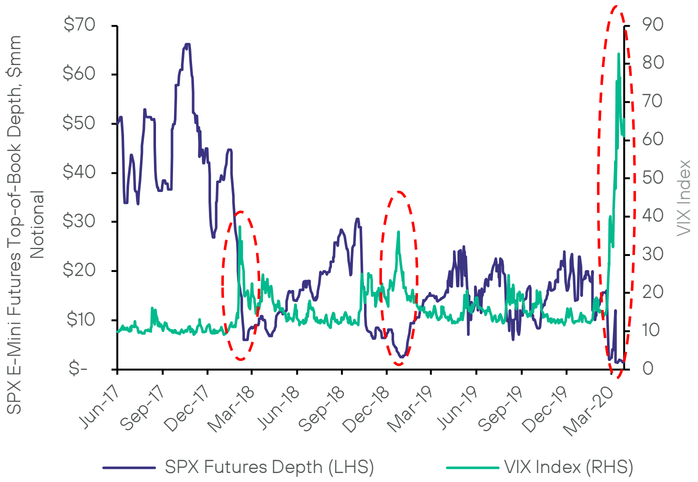


Note: As at 1 April 2020

Opportunistic Capital

- The opportunity has arisen for skilled credit managers to purchase high quality, performing credit from **forced sellers** (e.g. ETFs), taking advantage of the **current market stress** and **diminished liquidity** levels.
- We believe that Opportunistic Capital funds, who utilise a **bottom-up selection** process to identify **high performing credits**, are best placed to take advantage of the opportunity within the high quality credit space.

Liquidity levels dry up as volatility spikes

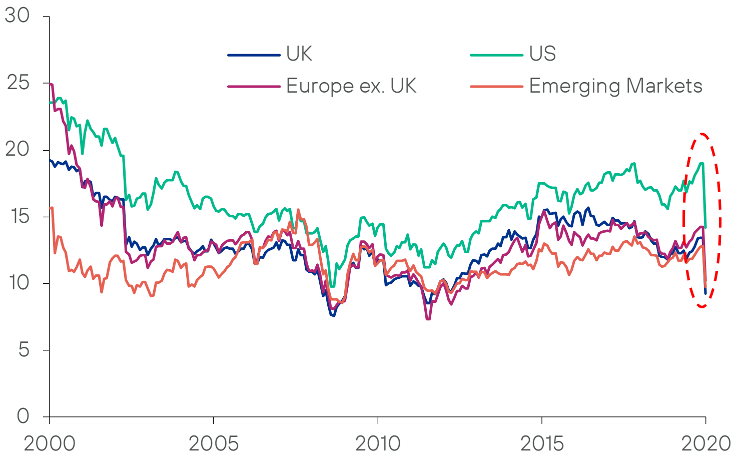


Source: Apollo Global Management

Equity – Wait and Watch

- The equity markets are likely to be **extremely volatile** in the coming months and **could see further downside** from the current depressed levels. However, we are not recommending any reductions at this point.
  - We will monitor this market closely and come back with further recommendations when we have **more clarity** on how this crisis unfolds
- If schemes are significantly underweight relative to their strategic benchmark, depending on market conditions providing attractive entry points, consideration could be given to phasing capital into equities over the next 3 to 6 months.

12 month Forward PE Ratios – below 20 year averages



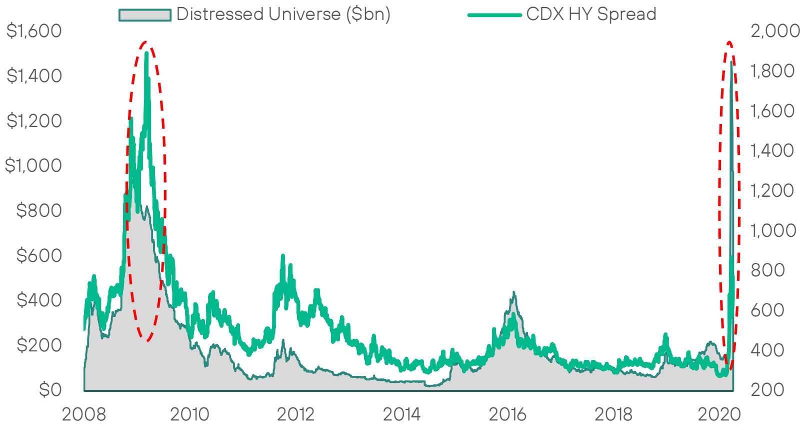
Note: Data as at 31 March 2020 unless otherwise stated.
Source: DataStream, Thomson Reuters, Isio investment research

Asset classes to watch – next 6 months

Distressed Debt

- Distressed Debt funds invest in debt instruments which are purchased at a **significant discount to their face value**, with the aim of generating high returns as securities pay high coupons, recover in price, or provide equity upside post restructuring.
- The current market environment is pushing **many higher quality** businesses into distressed status, providing Distressed Debt managers with a much broader opportunity set to pick from.
- As the full economic impact of the downturn is yet to be known, the potential for further defaults still remains at large.

Distressed debt universe – Expanded to 2008 Levels

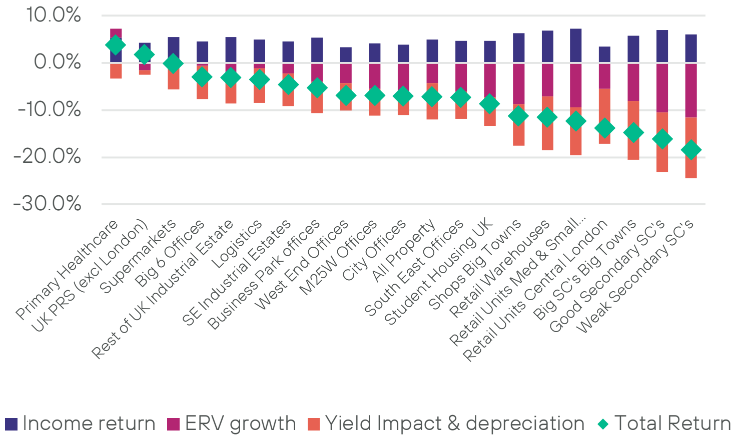


Source: Cerberus Capital Management

Global Real Estate and Infrastructure Secondaries

- Some sellers may be forced to liquidate assets in order to raise capital. This presents the opportunity for investment within **mature funds or direct assets**, with the aim of attaining low-mid teen returns through acquiring assets at a **discount to NAV** and **adding value** through operational improvements / providing additional financing.
- Investment managers have indicated that some secondary pricing opportunities are beginning to appear at **20-30% discounts**, relative to 2 months ago.

1-year return forecast for property sectors under 'crisis' scenario



Source: PMA, BlackRock

Note: Data as at 31 March 2020 unless otherwise stated.
Source: DataStream, Thomson Reuters, Isio investment research

Sources of capital

- An important step will be to determine a source of capital that can be used to capture some of these opportunities. This will depend on your specific situation. We have identified certain asset classes that could be considered as part of this discussion:
  - Cash or surplus LDI collateral: Gilt yields have been volatile but the general expectation is for Gilt yields to trend lower in a risk off environment. This source is particularly relevant for segregated LDI mandates where investors have the ability to move capital in and out of the LDI collateral pool.
  - Absolute Return strategies in DGF and / or Credit: Some of these strategies have provided good downside protection during the market downturn and could be used as a partial source of capital.
  - Synthetic Equity and Credit: For those able to take greater risk, there is the option of converting physical equities to synthetic equity to release cash and use the proceeds to invest in the opportunities identified here. We note that using synthetic credit as a source of capital requires more consideration.