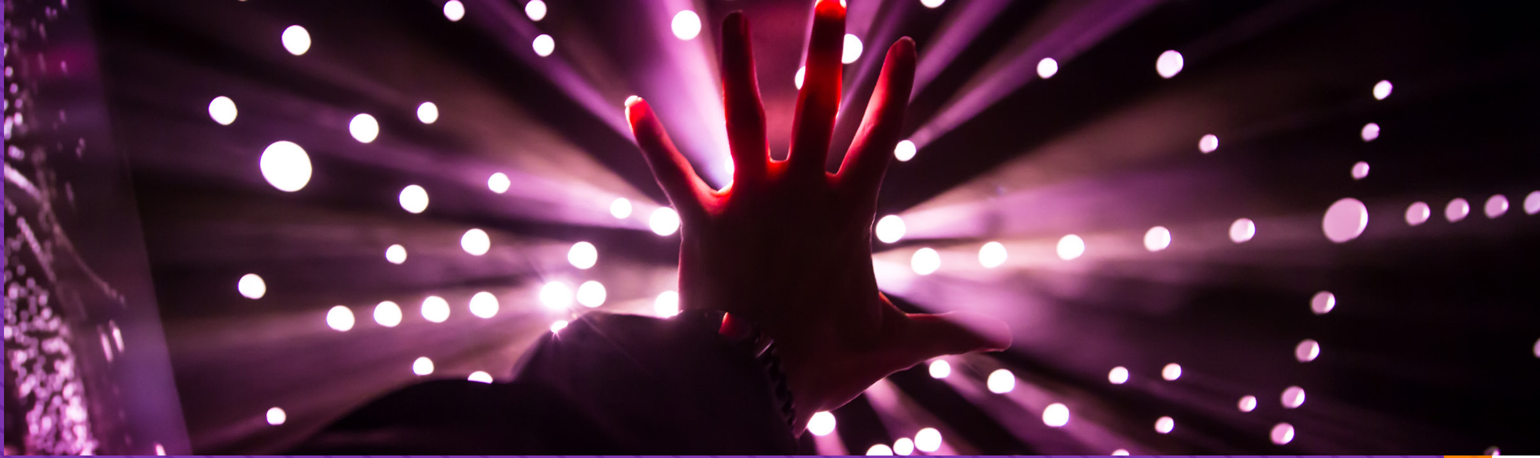


Top investment actions in 2023

We've entered a fundamentally different market environment. Is your strategy out of date?

The turmoil of 2020 tested our resilience against myriad financial, social and public health crises. In the two years since, a tidal wave of new challenges has arrived — from the onset of the "great resignation" to soaring inflation and rapidly rising interest rates — that is unlike anything we have seen in decades. While we expect many long-term trends to continue in 2023 — such as the continued focus on defined contribution (DC) plans over defined benefit (DB) plans as the primary retirement benefit for many employees — these recent developments are having a dramatic impact on the way retirement plans need to be designed, to be managed and to engage participants in order to remain effective in this new era. Plan sponsors and their fiduciary committees should take note of these changes and reevaluate whether their historical objectives and strategy remain relevant in this new environment.

> **Where are you headed?**

1. Reevaluate your primary objectives and long term goals.

DB plans entered the year with funding levels not seen since 2008 while also contemplating the impact of new pension funding rules, via the American Rescue Plan Act and Infrastructure Investment and Jobs Act, which led many sponsors to begin planning for their eventual exit strategy. The dramatic shift in markets during 2022 has left many plans short of their goals, but the new funding rules offer an attractive path to use asset returns — instead of contributions — to help close the gap.

DC plans are replacing pensions and increasingly becoming the primary source of savings, in general, for many employees. With this shift, the effective management of employee saving and investing toward retirement is now becoming even more critical, and there is a direct link to organizational workforce planning and business strategy. The sharp rise in litigation has been a headwind to innovation, but a range of new legislation intends to help employees and employers in the future with provisions intended to increase retirement savings, encourage plan sponsorship and expand access to pooled employer plan (PEP) arrangements.

Action: With new legislation and big changes to pension funding rules, DB sponsors should evaluate a "hibernation" strategy that seeks to minimize risk while still leveraging asset returns to reduce the cost of exiting the plan over the long term. DC sponsors should embrace the meaning of a DC "retirement plan" and kick off the new year by considering ways to move the needle on DC plans.

> **Investing in a new era requires a new approach.**

2. Update your strategy in light of higher interest rates and inflation.

While average balance sheet funding levels have held steady for many pension sponsors, the value of both assets and liabilities has declined significantly as a result of the dramatic rise in discount rates and risk asset sell-off. Despite the reduction in pension liabilities, higher discount rates will increase the interest cost of liabilities going forward, which — in addition to ongoing service costs — means that liabilities will now grow much faster from here. Pension assets, now smaller, will have to work significantly harder to keep pace with the faster liability growth on top of ongoing costs, including PBGC premiums, in the years ahead.

Meanwhile, DC plan participants have been dealt a serious one-two punch this year as they contemplate the impact of soaring inflation on their retirement spending needs while simultaneously watching account balances shrink rapidly amid the sell-off. Half of U.S. employees face retirement risks, while three in 10 do not expect to retire before age 70 — if ever — so it should come as no surprise that retirement is the one benefit that employees want their employers to prioritize the most. The research is clear that overall wellbeing is critical to individuals and therefore to companies' sustained success, and those closest to retirement are the most at risk today.

Action: Assets must work harder to keep up as liabilities grow faster and spending needs soar. Update return targets for pension assets and add financial wellbeing resources and income solutions to support DC participants.

> **Get more from your assets.**

3. Broaden the opportunity set to improve your chances of success amid a challenging future environment.

At a time when pension investors need their assets to work harder, many plans continue to face artificial limitations that restrict access to the most valuable investment tools available. For example, we often see plans restrict the use of derivatives for liability hedging and risk management purposes, but these instruments, when properly utilized, can be a powerful tool to reduce risk while freeing up capital for return-seeking objectives. Further, derivatives can prove critical to investors looking for more consistent liability hedging across the yield curve. Plans relying on long-term bonds are particularly exposed to changes in short-term rates, which now pose a significantly greater risk following rate hikes this year.

Further, we believe that skilled active management is more valuable than ever during times of uncertainty and market volatility, and we see particularly attractive opportunities away from the crowds in private markets. Unafflicted by short-term volatility, private market investors have an incredible advantage, as they can take the long-term view and harvest return opportunities in areas that short-term investors would shun. We see an especially ripe opportunity set in the smaller end of the market for skilled managers to drive value creation through systematic and operational improvements. And — while often perceived as a reason to avoid private markets — we believe many investors underestimate the liquidity of these assets.

Action: Don't limit your potential. Take advantage of the rich opportunity set in private markets and utilize more-efficient hedging instruments.

> It's all about income.

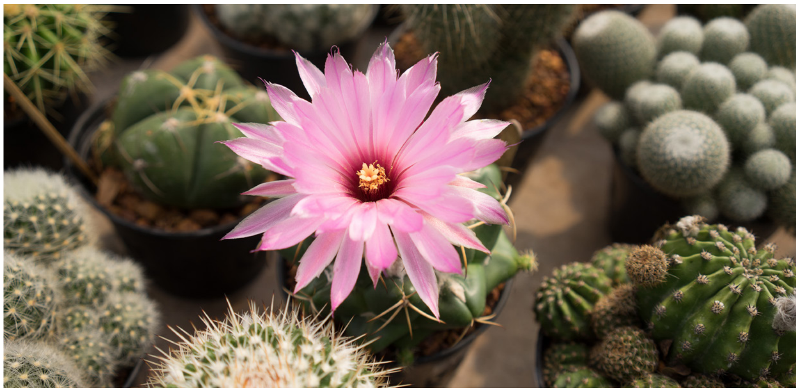
4. Tilt your portfolio toward income-generating assets.

Risk assets face multiple headwinds as growing recessionary risks put downward pressure on cash flow and earnings prospects while higher real interest rates simultaneously reduce the present value of this future income. Having a reliable source of income today — especially from a broadly diversified mix of high-quality and reliable cash flow sources available through **real assets** and **diversified credit** portfolios — can provide greater stability and predictability while helping to buffer against the volatility of other growth-oriented asset classes.

Some investors are hesitant to explore new assets classes, perhaps concerned about the implementation effort or the expertise needed to evaluate the unique risk, return and cost dynamics of a new asset classes; however, we regularly help our clients, regardless of plan size or in-house expertise, to find a suitable implementation option so they don't miss out on the potential benefits of a more diversified portfolio.

While particularly attractive for pension investors, we also believe DC participants would benefit from access to this income potential. Fortunately, recent guidance from the Department of Labor appears to reduce the risk for DC sponsors to leverage alternative assets within their Qualified Default Investment Alternatives in order to increase diversification and return potential for participants. Further, we believe the use of custom white label funds is a particularly attractive way to blend multiple managers or asset classes in order to give participants access to a range of manager styles and alpha sources within a single investment vehicle.

Action: With uncertainty ahead, stable income from high-quality cash flows can increase stability and resilience. Increase your exposure to private real assets and diversified credit.



Don't lend where it's crowded and where risks overlap with equity portfolios. Expand your diversified credit assets beyond corporate lending to include consumers, sovereigns, emerging market and private debt. Diversify across capital structure and collateral backing and remember that credit market dynamics can evolve quickly — so nimbleness is key. A dynamically managed portfolio with a deep bench of diverse credit specialists can provide great opportunities for identifying and capturing value across a range of markets.

Real assets can provide long-term contractual income (often with inflation linkages), diversification from broader public markets and meaningful growth potential. We recommend specialists targeting assets poised to benefit from key themes such as the energy transition, demographic shifts, and the continued integration of technology and connectivity in our everyday lives.

> Prepare for the unknown.

5. Build a robust portfolio that can withstand a broad range of market environments.

Portfolios masquerading as appropriately diversified too often continue to rely heavily on conventional asset classes, which tend to exhibit a high degree of correlation in periods of market stress. To access true diversification, a well-constructed portfolio of specialist liquid diversifier managers can generate returns across a broad range of market environments with much lower correlations to traditional assets. These strategies can either provide alpha through highly skilled management or by providing systematically managed exposures to attractive alternative betas — typically at lower fees than traditional hedge funds — which seek to isolate and capture widely recognized behavioral biases and nontraditional risk premiums.

The hedge fund industry continues to grab headlines — and all too frequently in a negative light. Unfortunately, this negativity is often warranted as a result of issues ranging from bad performance and excessive fees to outright fraud. What is less frequently noted is the strong performance (returns over 10% each year for the HFRI Fund Weighted Composite in 2019, 2020 and 2021 — three very different market environments) and the encouraging trends in the industry, including innovation, sustainable investing and better value for investors.

We wrote a paper in 2019 (Hedge funds: A new way) lauding the benefits of hedge funds — if invested in the correct way — and we are pleased to see that the hedge fund portfolios we have helped our clients construct under this approach have consistently added value. Not only have they generated stronger absolute returns than we've seen in the past decade or two, but they have provided significant protection when investors have really needed it.[1] While the industry performance is one of less downside rather than full capital protection, with (successful) active selection and portfolio construction there has been scope to build hedge fund portfolios delivering positive performance through these challenging periods.

Action: Find out how the new generation of hedge funds can help you access true diversification. Add specialist liquid diversifier strategies for return potential in any environment.

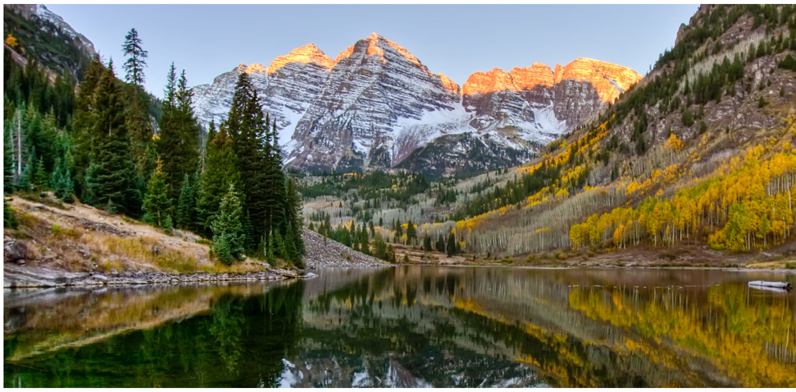
[1] Past performance is not a reliable indicator of future returns.

> Think sustainably.

6. Evaluate the long-term sustainability of your investment strategies and managers.

Events of the past few years have led to some dramatic societal changes while also drawing considerable attention to the investment risks — and opportunities — related to our climate transition, the culture and diversity within businesses, and the impact of strong governance and effective stewardship on financial outcomes for investors. Incorporating a long-horizon mindset while integrating environmental, social and governance (ESG) factors and effective stewardship, sustainable investing drives improved outcomes: It can protect and enhance portfolio outcomes. Far from being a complicated or controversial topic — after all, who wants to invest in **unsustainable** assets? — at WTW, we have long believed in the importance of sustainable investment, and we believe that integrating sustainable investment into each step of the investment process is key to maximizing long-term investment potential.

Action: Sustainable investing drives improved outcomes and can protect and enhance portfolio outcomes. Act now to learn more, establish a stance and measure your portfolio.



Sustainable investing action plan

1. **Learn more.** Undertake training on sustainable investment, including the regulatory and legal context.
2. **Establish a stance.** Conduct a sustainable investment beliefs exercise to examine and benchmark your current beliefs. Then articulate a sustainable investment stance and planned actions and incorporate these into your investment policy documents.
3. **Measure your portfolio.** See how your managers perform on ESG integration and stewardship practices, and then measure the carbon footprint of your assets and your exposure to climate transition risks. Ask your WTW consultant about Sustainable Investment reporting to better understand where you stand today.

Inclusion and diversity is a critical consideration in any investment decision, but it takes on many different forms. That's why we feel it's more important than ever to figure out what it means to your asset manager. Ask these five key questions today.

To support our stakeholders, WTW has partnered with STOXX to create the Climate Transition Index (CTI) — a family of indices — to offer a systematic and transparent way for investors to incorporate climate transition risks and potential opportunities into their investment decisions.

> Work smarter, not harder.

7. Outsource the implementation and day-to-day management of your assets.

Research shows a strong connection between investment success and the quality of investment governance[1] — which may be worth as much as 2% of additional return, each year! With an outsourced chief investment officer (OCIO), plan sponsors that lack the dedicated in-house investment capabilities of the world's leading institutional investors can retain control of the strategy while outsourcing execution of the day-to-day implementation to full-time professionals. With nearly $2 trillion now managed by OCIO firms, many plans have already taken advantage of this opportunity to enhance their governance — and therefore investment — potential. In fact, 50% of plan sponsors with $500 million or less in assets have already decided it is the right answer for them.[2]

Finally, we think all DC plan sponsors should take time this year to learn about the exciting new options available through a pooled employer plan. Facilitated by provisions of the SECURE Act, PEPs are designed and managed by industry specialists who can reduce the administrative burden on employers and seek cost savings through their scale while staying on the cutting edge of retirement trends, regulatory developments, cybersecurity and technological innovation.

Action: Don't let resource constraints limit your return potential. Leverage a team of full-time investment professionals to manage the details while you focus on the big picture. DC sponsors should go a step further and investigate the potential benefits of a PEP.

[1] Source: Ambachtsheer, K., 'How Much is Good Governance Worth?', The Ambachtsheer Letter 245, KPA Advisory Services Ltd., June 2006
[2] ai-CIO, 2020 Outsourced-Chief Investment Officer Survey. Survey conducted from January 24, 2020, through February 10, 2020, with 86 participants.