Prism

Second Quarter 2020 Pension Plan Experience

Pension Plan Funded Status Improves Slightly as Double-Digit Equity Gains Edge Large Increase in Liabilities

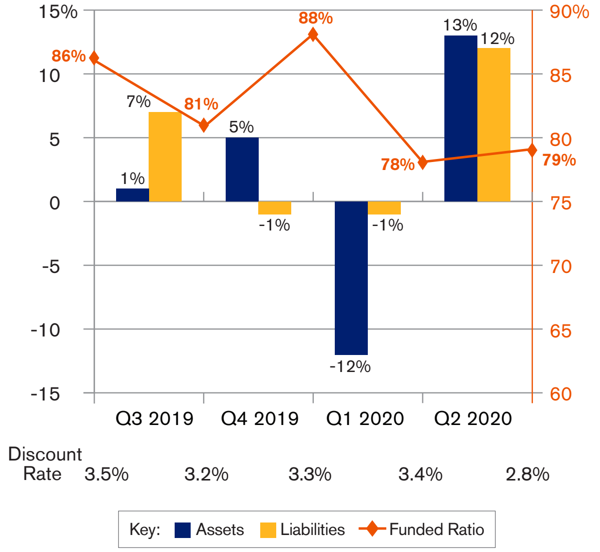
During the second quarter of 2020 (Q2), the funded status of the model pension plan examined in each issue of *Prism* improved by 1 percentage point, to 79 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 13 percent asset gain offset by a 12 percent increase in liabilities (related to a decrease in corporate bond yields, as illustrated in Graph 2).

Changes in the yield curve

High-quality corporate yields fell during Q2, decreasing by 63 basis points* — the net result of U.S. nominal Treasury yields that were flat for the quarter and a 63 basis-point contraction in credit spreads (see "Aspects of investment performance" on the next page for more details). This is illustrated by the above-median curves shown in Graph 2, and resulted in a 12 percent increase in the model pension plan's liabilities.

Any change in the shape of the yield curve could have a dissimilar impact on liabilities for plans with different maturities. (For background on yield curves, read our primer.)

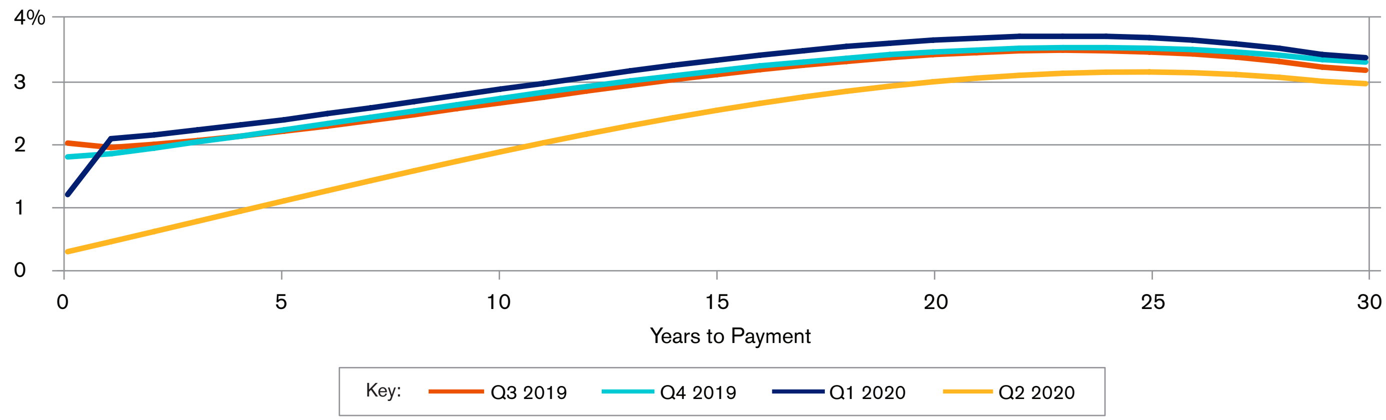
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[1] The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

[2] This is the ratio of a defined benefit (DB) plan's assets to accrued liabilities. The funded ratio data in the graph is the ratio on the last day of each quarter. In May, (after publication of the last *Prism*), the funded percentage for the model DB plan was reset as of January 1, 2020, to reflect the average actual funded percentage of large pension plans.

Graph 2: Changes in the Yield Curve[1]



[1] This curve reflects the average yield, at each duration, for corporate bonds rated AA that have yields above the median for that duration.

* As a reminder, 10 basis points (bps) equals 0.1 percent.

About *Prism*

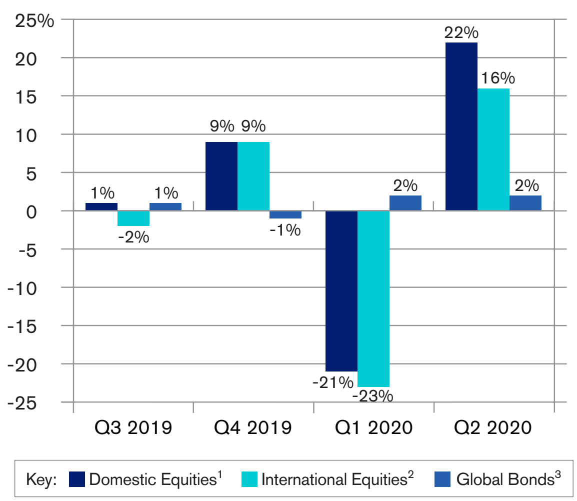
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on perhaps the most important financial metric to plan sponsors: the plan's funded status.**

Aspects of investment performance

This section discusses aspects of investment performance that contributed to the model plan's 13 percent gain in asset value in Q2.

During Q2, equity markets bounced back strongly as municipalities and businesses began the process of reopening following swift and comprehensive COVID-19-related shutdowns that occurred during the first quarter. Additionally, central banks around the globe acted quickly and decisively with various forms of stimulus. For example, the U.S. Federal Reserve began to purchase massive amounts of financial securities (to restore liquidity to markets that had become dysfunctional since the onset of COVID-19), and saw its balance sheet increase to about $7 trillion (from $4 trillion) over the first half of the year.

Graph 3: Investment Performance



[1] Russell 3000

[2] Morgan Stanley Capital International All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.)

[3] Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

Stock market performance was very strong both domestically and internationally. U.S. equities had their best quarter in more than 20 years and outperformed both developed international equities and emerging market equities. Internationally, emerging markets outpaced developed markets. Domestically, small caps beat large caps and growth stocks beat value stocks — but all provided superior returns during the quarter.

Fixed income returns were slightly positive both domestically and internationally. U.S. Treasury yields were remarkably stable over the course of the quarter, with yields ending the quarter about where they began at most maturities. As a result, U.S. government bond returns were nearly flat for the quarter, but U.S. investment-grade credit had solidly positive returns as credit spreads rallied during the quarter. The Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 0 to 0.25 percent. FOMC further signaled that the target range could remain near zero for an extended period. The yield on the 10-year Treasury note ended the quarter at 0.66 percent.

Important: examine your own DB plan's experience

Plan sponsors should examine changes in their own DB plans' assets, liabilities and funded ratios from the vantage point of both accounting and funding metrics.* Segal Marco Advisors and Segal can help employers project their DB plans' funded ratios through:

- **Deterministic modeling**, which projects results under a specific set of assumptions but does not offer insight into the likelihood of these outcomes; and
- **Stochastic asset-liability modeling (ALM)**, which offers a more complete view of the range of a plan's possible future statuses and can act as an early warning sign of potential challenges through a long-term time horizon.

* Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

For more information about how ALM can help you manage your plan, contact your Segal Marco Advisors investment consultant or your Segal retirement consultant — or get in touch with us via our websites: segalmarco.com and segalco.com.

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