Prism

Pension plan funded status increases due to strong equity returns in Q4 2019

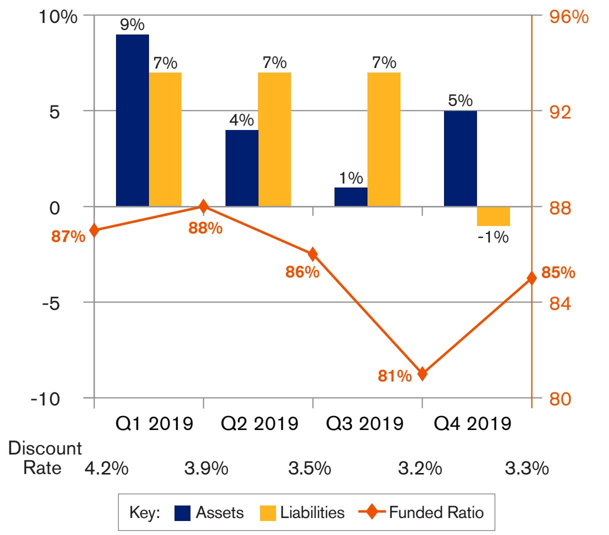
During the fourth quarter of 2019 (Q4), the funded status of the model pension plan examined in each issue of Prism rose by 4 percentage points, to 85 percent. (See Graph 1.) This is a result of a 5 percent asset gain and a 1 percent decrease in liabilities due to a slight increase in corporate bond yields, as illustrated in Graph 2.

Changes in the yield curve

High-quality corporate yields rose slightly during Q4, increasing by 5 basis points* — the net result of a 25 basis-point increase in U.S. nominal Treasury yields and a 20 basis-point decrease in credit spreads. This is illustrated by the above-median curves shown in Graph 2, and resulted in a 1 percent decrease in the model pension plan's liability.

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.)

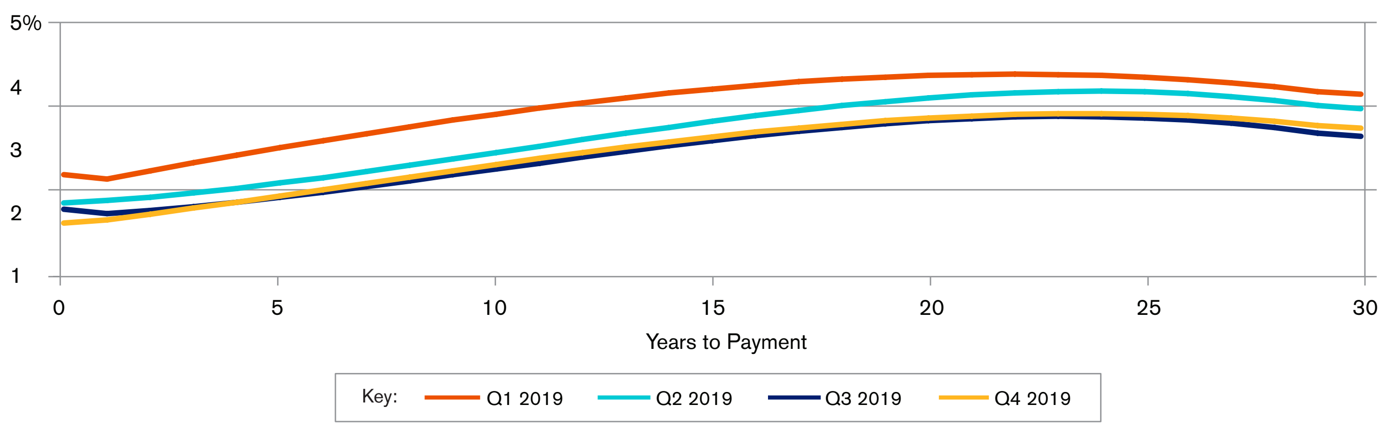
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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. The funded percentage for the model DB plan was reset as of January 1, 2019, 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*

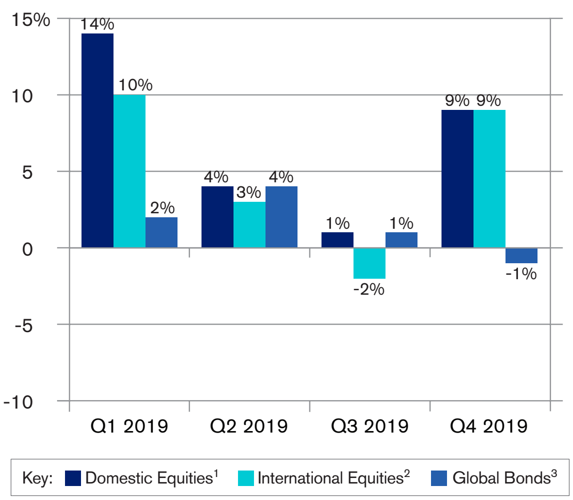
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 5 percent gain in asset value in Q4.

Equities across all geographies closed the year with strong Q4 performance. U.S. equities returned more than 9 percent for the quarter, as shown in Graph 3, and returned more than 31 percent for the year. Emerging market equities were the strongest performer during Q4, slightly edging developed international and U.S. stocks. A weakening U.S. dollar during the quarter contributed to the positive performance in international markets.

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

For the year, developed international stocks returned more than 22 percent while emerging market stocks returned more than 18 percent. Among U.S. stocks, growth outperformed value for both the quarter and the year (and for the third consecutive year), and small cap stocks outperformed large cap stocks for the quarter, but were beaten by large cap stocks for the year.

Fixed-income returns globally were slightly negative for the quarter, with U.S. fixed income providing slightly positive returns and international bonds providing slightly negative returns. Longer duration U.S. government bonds were the worst performers during the quarter with yields increasing modestly after three previous quarters of consistently falling yields. The Federal Reserve Board's Federal Open Market Committee cut the Federal Funds Rate once during the quarter, making the target range 1.50 to 1.75 percent. The 10-year U.S. Treasury yield closed the year at about 1.90 percent, about 80 basis points lower than where it opened 2019.

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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