Sibson Consulting
Segal Marco Advisors

Prism
A QUARTERLY REVIEW OF FUNDED STATUS

Strategic HR Consulting Investment Solutions Third Quarter 2019 Pension Plan Experience

Pension Plan Funded Status Dives as Interest Rates Plummet in Q3 2019

During the third quarter of 2019 (Q3), the funded status of the model pension plan examined in each issue of *Prism* fell by 5 percentage points, to 81 percent. (See Graph 1.) This is a result of a 1 percent asset gain offset by a 7 percent increase in liabilities. The sharp rise in liabilities is attributable to a decrease in high-quality corporate yields, as shown in Graph 3 on the next page.

About *Prism*

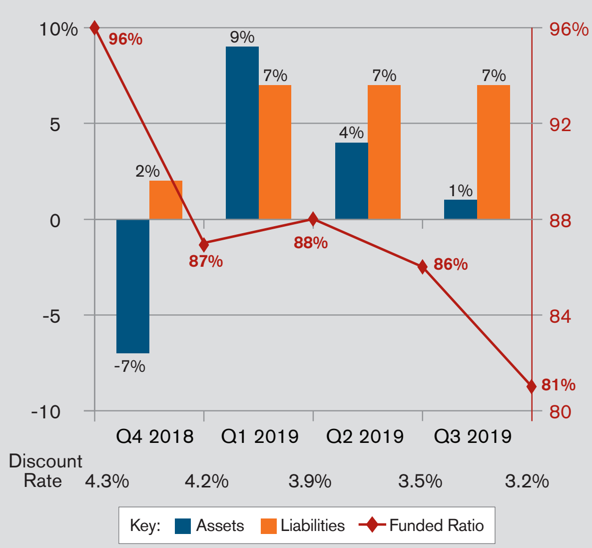
Prism examines the effect of changes in the assets and liabilities of a model pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on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

Aspects of Investment Performance

These aspects of investment performance contributed to the model plan's 1 percent gain in asset value in Q3:

- Following a strong first half of the year, U.S. equity growth slowed in Q3 and finished only slightly up from Q2, as shown in Graph 2. During Q3, positive returns during July and September offset losses during August. Internationally, developed market stocks outperformed emerging market stocks, although both lagged U.S. stocks performance and both finished the quarter in negative territory. A strengthening U.S. dollar during the quarter contributed to the negative performance in international markets. Among U.S. stocks, large cap materially outperformed small cap for the quarter while value barely edged growth.
- Fixed-income returns were positive for the quarter, particularly domestically, with yields on U.S. government bonds rallying substantially. Longer duration bonds in particular were high performers during the quarter. The Federal Reserve Board's Federal Open Market Committee cut the Federal Funds Rate twice during the quarter, making the target range 1.75 to 2.00 percent. U.S. Treasury yields fell across the maturity spectrum. The 10-year U.S. Treasury yield fell below 1.50 percent, while in mid-August, the 30-year Treasury yield dipped below 2.00 percent.

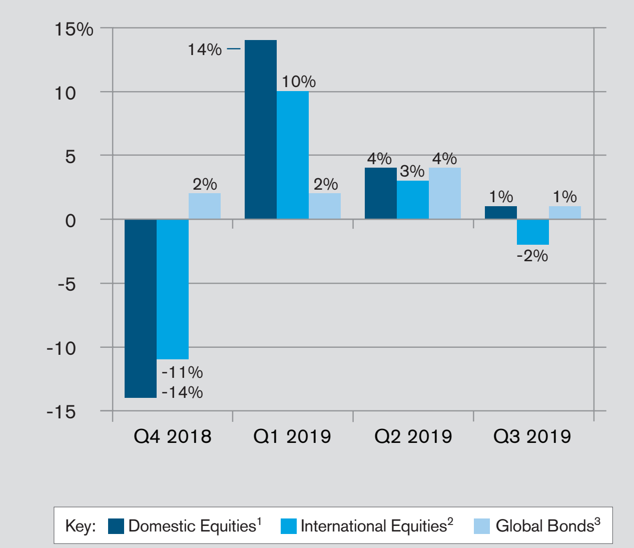
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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: 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

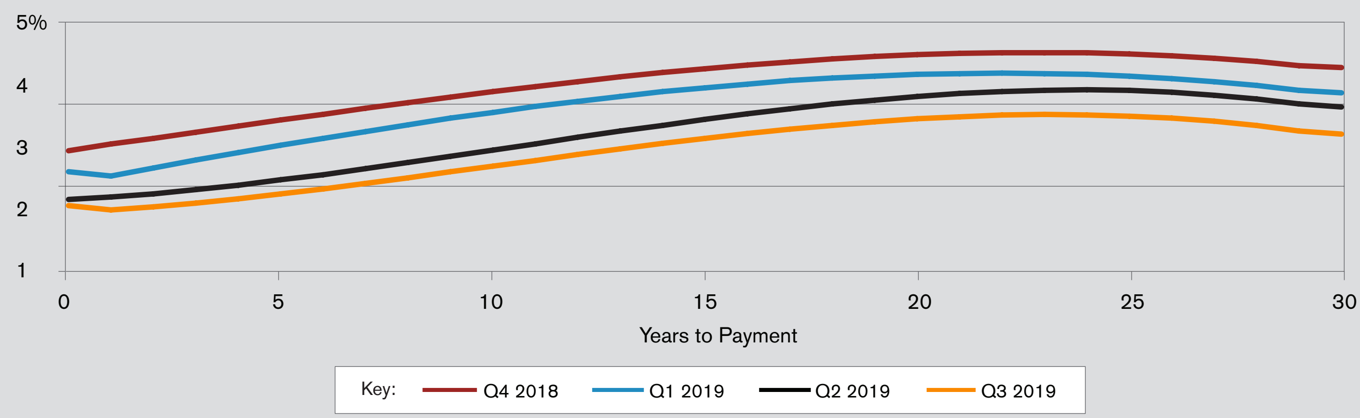
Sibson Consulting   Segal Marco Advisors

Changes in the Yield Curve

High-quality corporate yields fell during Q3, declining by 30 basis points* — the net result of a 35 basis-point decrease in U.S. nominal Treasury yields and a 5 basis-point increase in credit spreads. During Q3, yields decreased significantly, as illustrated by the above-median curves shown in Graph 3. The decline in yield-curve level resulted in a 7 percent increase 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 online primer.)

Graph 3: 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.

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 Sibson Consulting 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.

* As a reminder, 10 basis points (bps) equals 0.1 percent.
** Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

Sibson Consulting   Segal Marco Advisors

For more information about how ALM can help you manage your plan, contact your Segal Marco Advisors investment consultant or your Sibson retirement consultant.

To receive future issues of *Prism* and other publications of interest to employers as soon as they are available online, join our email list.

Sibson Consulting and Segal Marco Advisors are members of The Segal Group.

www.sibson.com   www.segalmarco.com