

Pension Plan Funded Status Declines Due to Drop in Bond Yields in Q2 2019

During the second quarter of 2019 (Q2), the funded status of the model pension plan examined in each issue of *Prism* fell by 2 percentage points, to 86 percent. (See Graph 1.) This is a result of a 4 percent asset gain offset by a 7 percent increase in liabilities, due to a decrease in high-quality corporate yields, as shown in Graph 3 on the next page.

About Prism

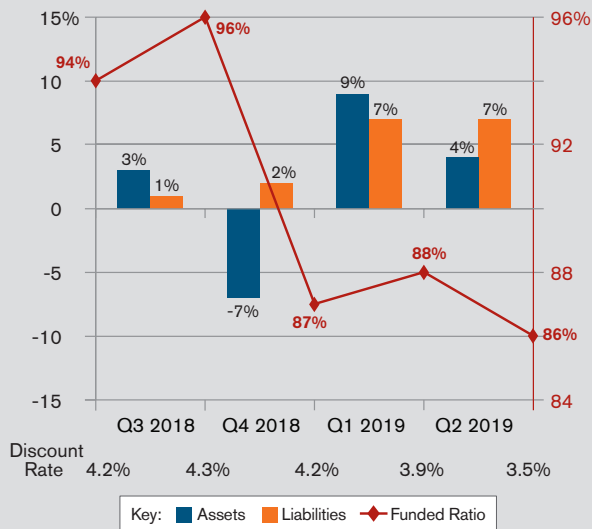
Prism examines the effect of changes in the assets and liabilities of a model pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on 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 4 percent gain in asset value in Q2:

- Equities followed a very strong first quarter with an up-and-down second quarter that ended in positive territory both domestically and internationally, as shown in Graph 2. During the quarter, April and June were positive months which more than offset the negative performance during May. Internationally, developed market stocks outperformed emerging market stocks, and both lagged U.S. stocks. Among U.S. stocks, large cap outpaced small cap for the quarter while growth topped value for the 9th time in the last 10 quarters.
- Fixed-income returns were positive both domestically and internationally. Longer duration bonds in particular were high performers during the quarter. The Federal Reserve Board's Federal Open Market Committee (FOMC) made no change to the Federal Funds Rate at their June meeting, maintaining the target range at 2.25 to 2.50 percent. U.S. Treasury yields fell across the maturity spectrum. The 10-year U.S. Treasury yield fell substantially during the quarter and ended June at 2 percent (its lowest level since 2016), perhaps signaling that the market expects a Federal Funds Rate decrease at one of the upcoming FOMC meetings.

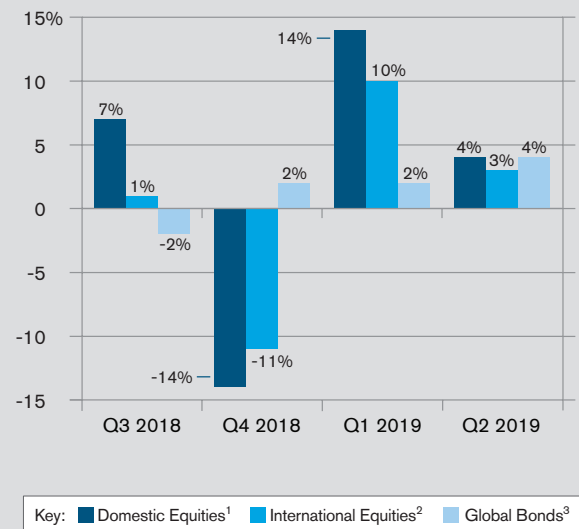
Graph 1: Change in Assets,¹ Liabilities and Funded Ratio²



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.)

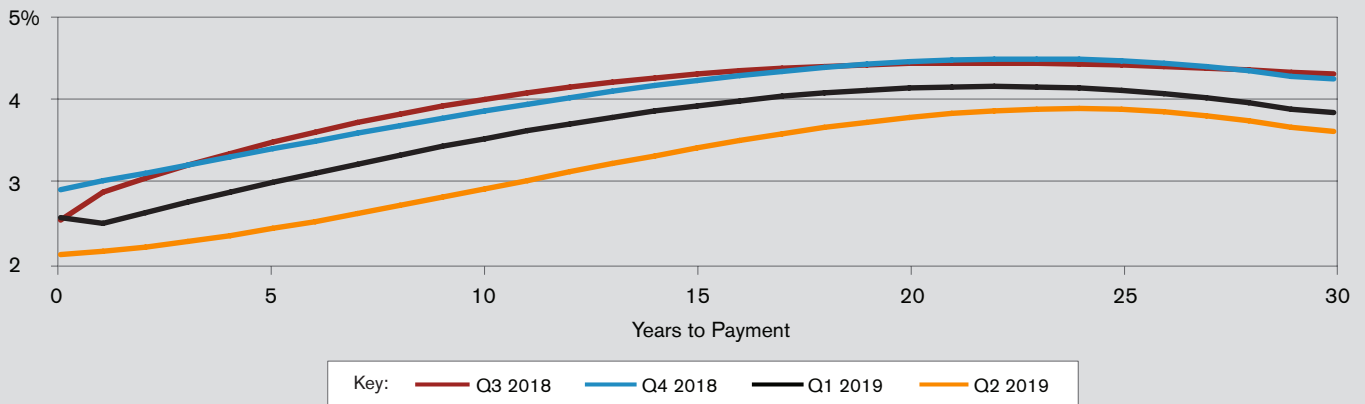
³ Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

Changes in the Yield Curve

High-quality corporate yields fell during Q2, declining by 45 basis points* — the net result of a 35 basis-point decrease in U.S. nominal Treasury yields and a 10 basis-point decrease in credit spreads. During the quarter, yields decreased significantly, resulting in a slightly steeper yield curve, 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 Curve¹



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.

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