Prism

Fourth Quarter 2020 Pension Plan Experience

Pension plan funded status returns to pre-pandemic levels as equity investments soar

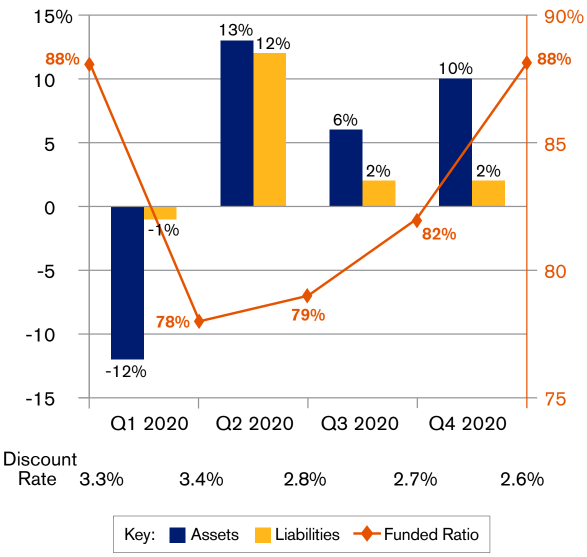
During the fourth quarter of 2020 (Q4), the funded status of the model pension plan examined in each issue of *Prism* improved by 6 percentage points, to 88 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 10 percent asset gain offset by a 2 percent increase in liabilities (related to a decrease in corporate bond yields, as illustrated in Graph 2).

Changes in the yield curve

High-quality corporate yields fell during Q4, decreasing by 5 basis points — the net result of a 20 basis-point increase in U.S. nominal Treasury yields and a 25 basis-point decrease 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.

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.)

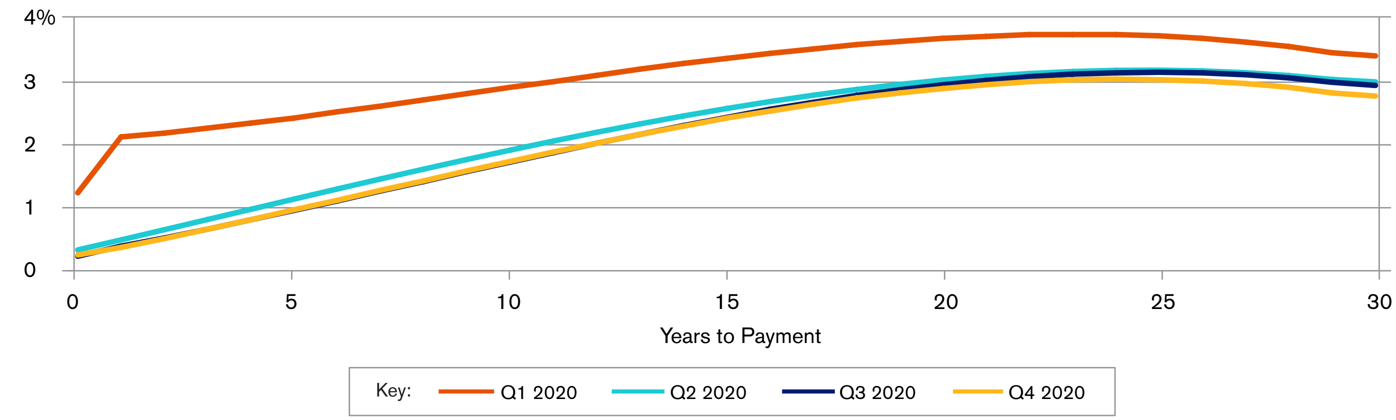
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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 Q1 2020 *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.

About *Prism*

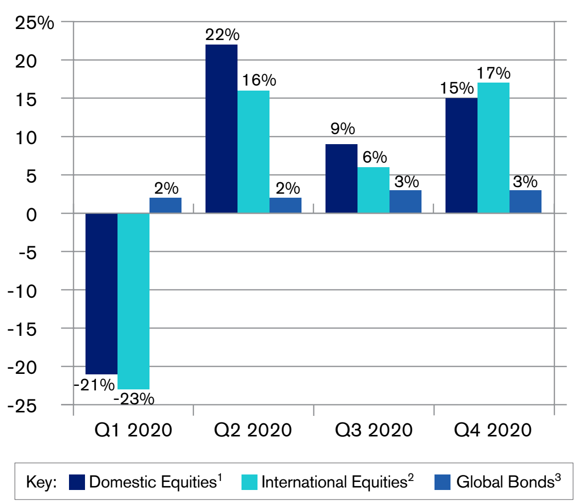
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 illustrated in Graph 3 that contributed to the model plan's 10 percent gain in asset value in Q4.

During Q4, financial markets continued to rebound, providing positive returns for a third straight quarter. Even as COVID-19 cases climbed globally and some leaders reinstituted lockdowns, there was some positive news. Two separate COVID-19 vaccines were approved for use by U.S. regulators in December, and Congress passed a long-awaited second COVID-19 relief package just before the end 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, developed international equities and emerging market equities all posted double-digit positive returns. International stocks outperformed U.S. stocks thanks, in part, to a depreciating dollar. Domestically, small caps beat large caps (with small cap stocks posting their best quarterly return in more than three decades), and value stocks beat growth stocks — as positive vaccine news resulted in investor optimism over stocks that were most adversely affected by the pandemic.

Fixed income returns were slightly positive domestically. Again, aided by a depreciating U.S. dollar, international bonds outperformed U.S. bonds.

U.S. Treasury yields ended the quarter a bit higher than where they began, while investment-grade credit spreads tightened a bit. As a result, U.S. government bond returns were slightly negative for the quarter, and U.S. investment-grade credit provided slightly positive returns. In December 2020, 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 0.93 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
- **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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