Prism

Second Quarter 2021 Pension Plan Experience

# Pension Plan Funded Status Drops Slightly as Interest Rates Decrease

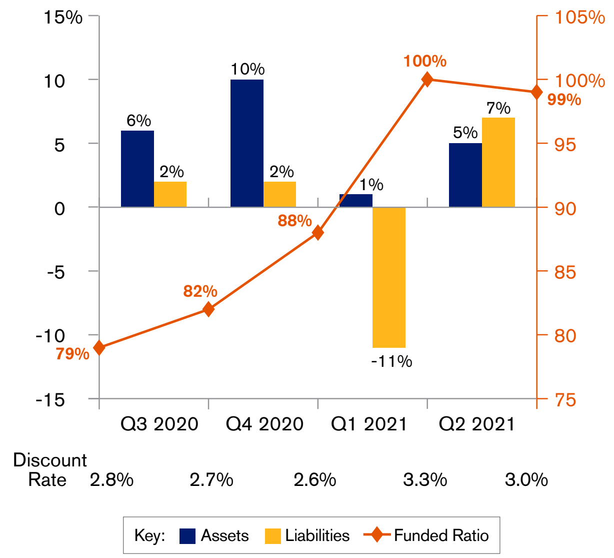
During the second quarter of 2021 (Q2), the funded status of the model pension plan examined in each issue of *Prism* dropped by 1 percentage point, to 99 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 7 percent return in liabilities (related to a decrease in corporate bond yields, as illustrated in Graph 2) partially offset by a 5 percent return on assets.

## Changes in the yield curve

High-quality corporate bond yields dropped during Q2 — the net result of a 30 basis-point decrease in U.S. nominal Treasury yields and credit spreads that were mostly flat (see "Aspects of investment performance" on the next page for more details). This is illustrated in Graph 2 by the above-median curves.

Changes in the shape of the yield curve may have varying impact on plans' liabilities based on their maturity. (For background on yield curves [read our primer](#).)

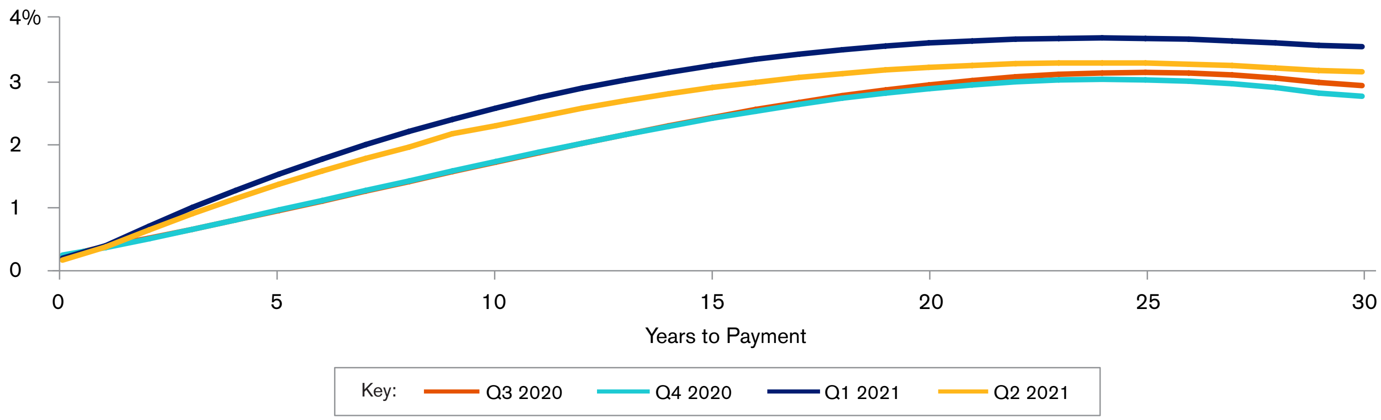
### Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]




[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, 2021, 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***

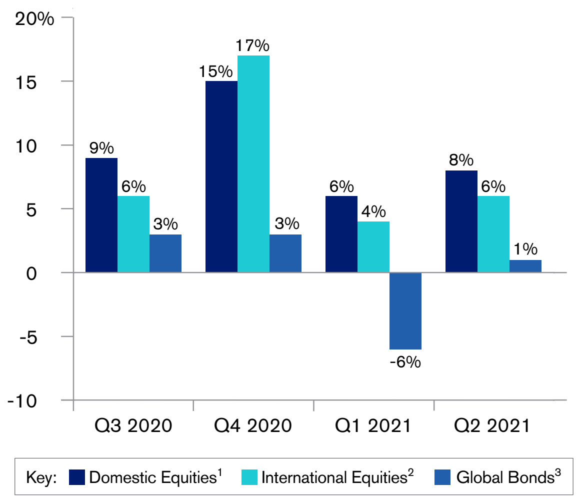
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 5 percent gain in asset value in Q2.

During Q2, financial markets continued to rebound, providing positive equity returns for a fifth consecutive quarter, as the percentage of fully vaccinated adults rose sharply and the number of COVID-related hospitalizations decreased materially. The U.S. Congress passed a $1.9 trillion economic stimulus bill during the prior quarter which continues to work its way through the economy.

### 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 strong both domestically and internationally. U.S. equities, developed international equities and emerging market equities all posted positive returns. Domestically, large caps beat small caps, and growth stocks beat value stocks.

Fixed income returns were positive during the quarter as yields fell, with longer duration bonds performing better than shorter maturity bonds. U.S. government bonds performed slightly better than international government bonds.

U.S. Treasury yields ended the quarter lower than where they began, while investment-grade credit spreads compressed mildly. As a result, U.S. government and investment-grade bond returns were up materially, particularly longer-maturity bonds. In June 2021, the Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 0 to 0.25 percent. The 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 1.45 percent, down 29 basis points from where it began.

## 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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