Prism

Model Pension Plan Ends 2021 Fully Funded

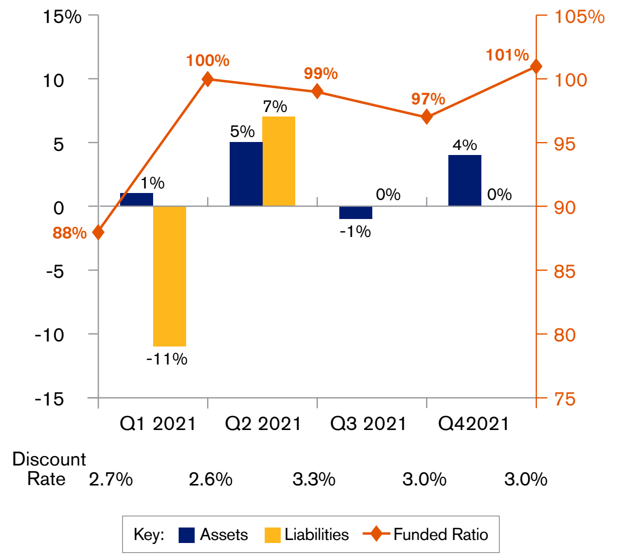
During the fourth quarter of 2021 (Q4), the funded status of the model pension plan examined in each issue of *Prism* rose by 4 percentage points, to 101 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 4 percent increase in assets.

Changes in the yield curve

High-quality corporate bond yields rose slightly during Q4 — the net result of a slight increase in credit spreads and U.S. nominal Treasury yields that were a bit higher at the short end of the curve, a bit lower at the long end of the curve and were flat on average (see "Aspects of investment performance" on the next page for more details). This is illustrated in Graph 2 by the above-median curves.

Plans' liabilities are measured with the yield curve, determined by reference to high-quality corporate bond yields. 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.)

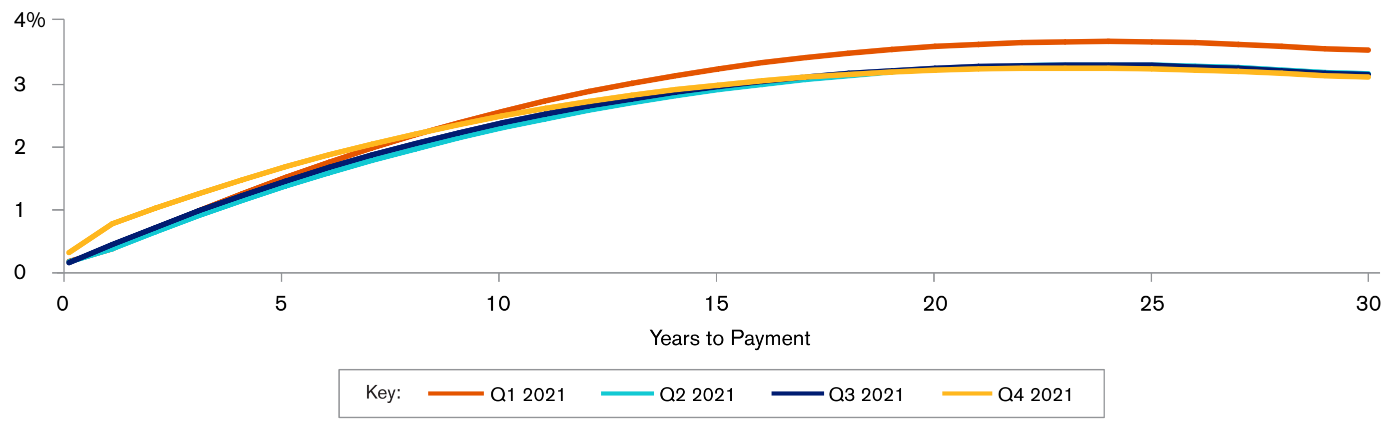
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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. In May 2021, 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*

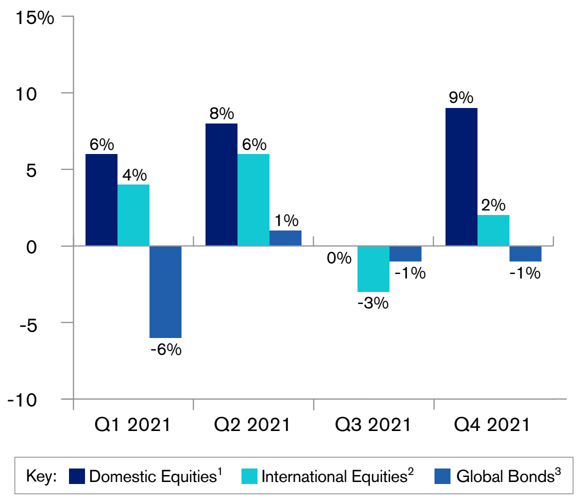
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 4 percent gain in asset value in Q4.

U.S. equity markets performed very well during Q4, to close out a third consecutive calendar year of above-20 percent returns. Although COVID-19 cases surged dramatically during the quarter (as the Omicron variant swept through the population), most leaders have shown little appetite for a return to strict lockdowns, as early data seems to indicate this variant presents less risk of severe illness than prior variants. Developed international equities also performed well for the quarter and the year, but trailed U.S. equities for a fourth consecutive quarter. Emerging markets were the laggard among equities both for the quarter and the year — with returns that were nearly flat for 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

Non-U.S. stocks were hurt a bit by the U.S. dollar's appreciation during the quarter. Emerging market equities faced further headwinds as certain markets (Turkey, in particular) dealt with soaring inflation, extremely volatile markets and low returns. Domestically, large-cap stocks outperformed small-cap stocks for the quarter, and growth outperformed value.

Fixed income returns were flat domestically (as yields were relatively stable) and slightly negative internationally — due partially to the strengthening U.S. dollar.

U.S. Treasury yields moved higher at shorter maturities but fell at longer maturities, while investment-grade credit spreads increased slightly. As a result, U.S. government and investment-grade bond returns were all nearly flat for the quarter, but longer maturity bonds performed well. In December 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 Treasury bond purchases would end sooner, and that the target range could increase sooner than previously expected because of mounting concern over the persistency of inflation. The yield on the 10-year Treasury note ended the quarter at 1.52 percent, 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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