Prism

Second Quarter 2022 Pension Plan Experience

Pension Plan Funded Status Dips Slightly as Poor Investment Performance Overshadows Rising Interest Rates

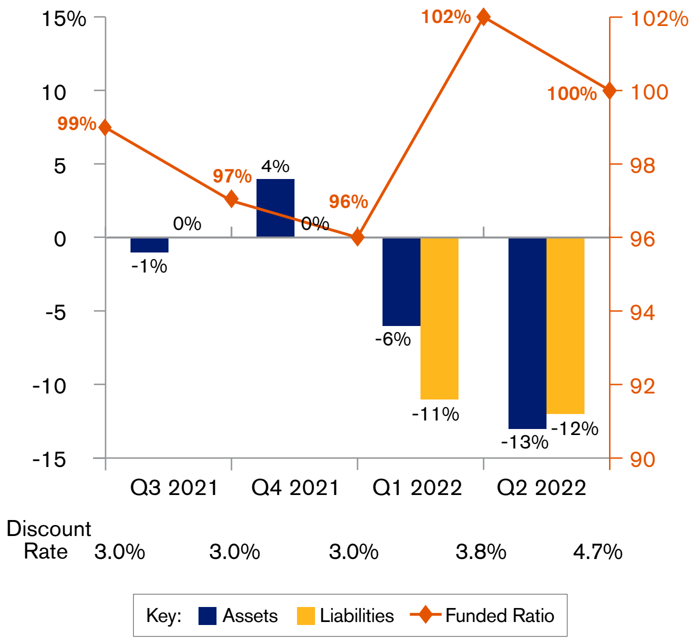
During the second quarter of 2022 (Q2), the funded status of the model pension plan examined in each issue of *Prism* fell by 2 percentage points, to 100 percent. (See Graph 1.) This decrease in funded status is primarily attributable to a 13 percent decrease in assets, partially offset by a 12 percent decrease in liabilities.

Changes in the yield curve

High-quality corporate bond yields rose materially by 90 basis points during Q2 — the net result of a 20 basis-point increase in credit spreads and a 70 basis-point increase in U.S. nominal Treasury yields (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.)

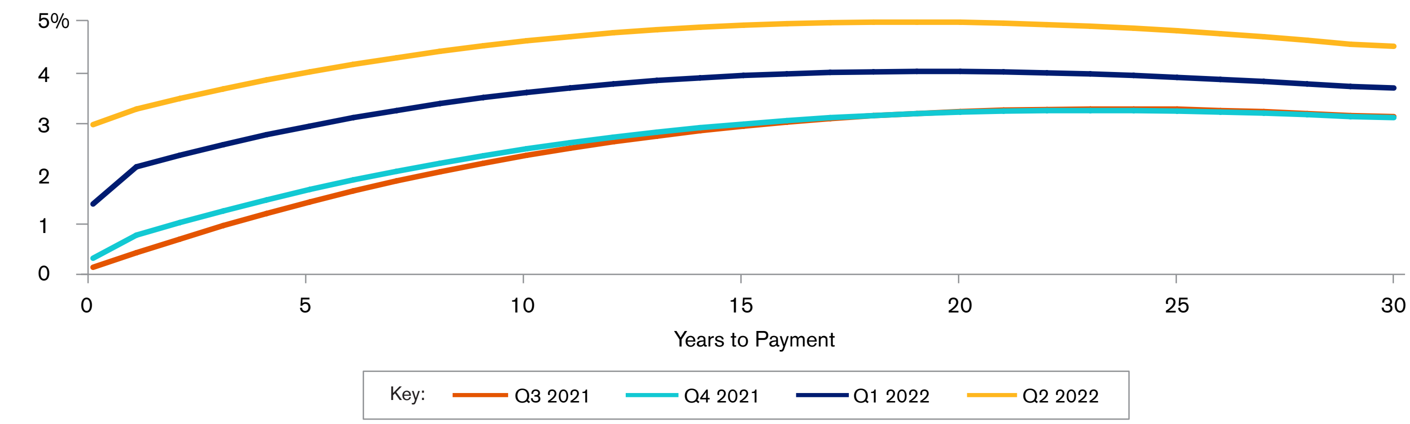
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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 2022 (after publication of the Q1 2022 *Prism*), the funded percentage for the model DB plan was reset as of January 1, 2022 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*

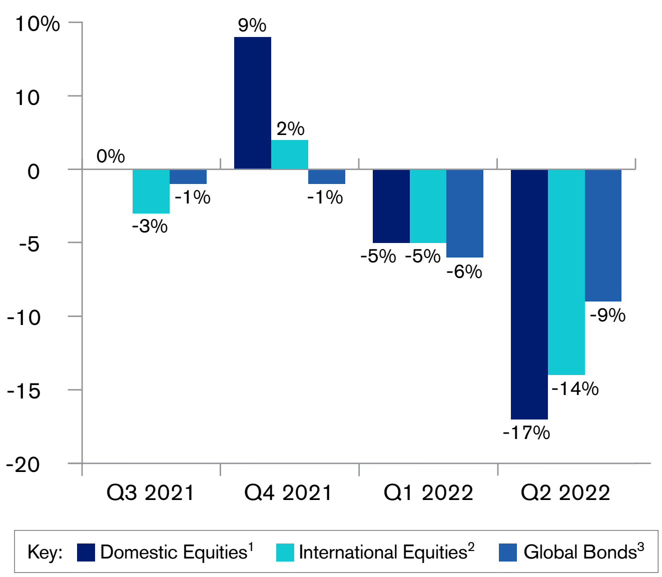
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 13 percent loss in asset value in Q2.

Equity and fixed income returns were again very poor across the board during Q2, as first-quarter losses accelerated into Q2. Russia's invasion of Ukraine continues to disrupt global markets, inflation continues to be surprisingly and persistently high around the globe, and China's zero-COVID policies continue to affect supply chains. U.S. equity markets entered bear market territory and are now more than 20 percent off their recent highs. Developed international and emerging market equities also performed very poorly but outperformed the U.S. Emerging markets was the best performer with a quarterly return of -12 percent, giving some indication to the extent of losses across geographies.

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 again hurt by the U.S. dollar's continued appreciation during Q2. Domestically, large-cap stocks outperformed small-cap stocks for the quarter, and value outperformed growth, although everything performed poorly in absolute terms.

Fixed income returns were also poor again this quarter, both domestically and internationally, as interest rates continue their upward trajectory. International bonds faced further headwinds due to the strengthening U.S. dollar.

U.S. Treasury yields moved higher across the maturity spectrum and investment-grade credit spreads widened. As a result, U.S. government and investment-grade bond returns performed very poorly again this quarter, particularly long-duration bonds. The Federal Open Market Committee (FOMC) increased the target range for the federal funds rate twice during the quarter, by 50 basis points in May, and then by 75 basis points in June. The June rate hike was the largest since 1994. FOMC guidance continues to indicate more rate hikes are expected during the remainder of 2022 in an effort to tame inflation. The yield on the 10-year Treasury note ended June at 2.98 percent, up 66 basis points during Q2 (and up 146 basis points year-to-date).

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.

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

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