LGIMA Pension Solutions' Monitor

Market Update

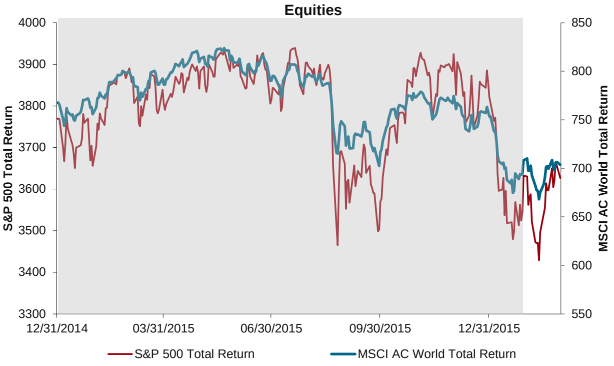
Overview

Investor sentiment continued to remain mixed through the month of February given the uncertainty around global economic growth, commodity markets, and global monetary policy. Overall, equity markets were slightly negative for the month while uncertainty around the next Fed hike led to a rally in interest rates. Credit spreads significantly rebounded off the wides reached in mid-February.

Equities

US equities continued their decline into the early weeks of February with the S&P 500 falling over 12% since the beginning of the year. Since mid-February equities rallied off their lows given the improved US macroeconomic data – S&P 500 ended the month slightly negative.

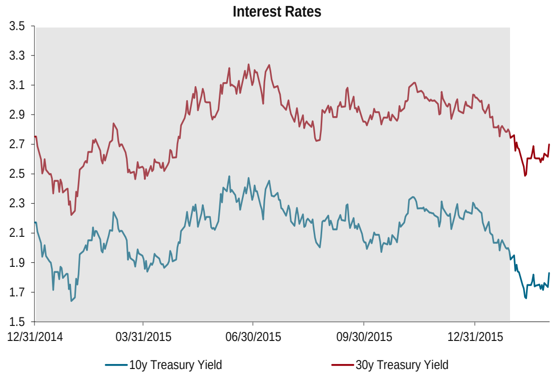
The S&P 500 TR Index decreased 0.13% and the MSCI AC World TR Index decreased 0.63% over the month of February negatively affecting pension funding ratios.



Interest Rates

Mid-February saw some of the largest moves in rates in recent memory. Volatile global equities, growth concerns, Fed Chair Yellen discussing the possibility of negative rates in the US, and poor corporate performance (particularly among European banks) came to a head and exacerbated the volatility. In the week following the US release, rates rallied 15-35 basis points, and the 30-year swap rate hit a new all-time low of 1.85. As markets stabilized around mid-month, rates sold of significantly.

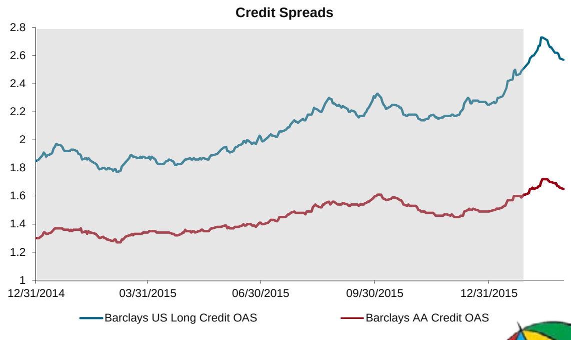
The 30-year Treasury rate decreased 19 basis points while the 10-year Treasury rate decreased 13 basis points over the month. The decrease in interest rates had a negative contribution to pension funding ratios over February.



Credit

Credit spreads continued widening into mid-February (long credit reached its widest level in the last five years at 273 basis points) before rebounding amid modestly better US economic data, oil price stabilization, and lagging concerns around European bank stability.

The option adjusted spread (OAS) for Barclays Long Credit Index widened 5 basis points to 257 basis points over the month while the Barclays Long AA Credit Index widened 4 basis points to 165 basis points over the same period. The widening in spreads had a positive contribution to pension funding ratios over February.



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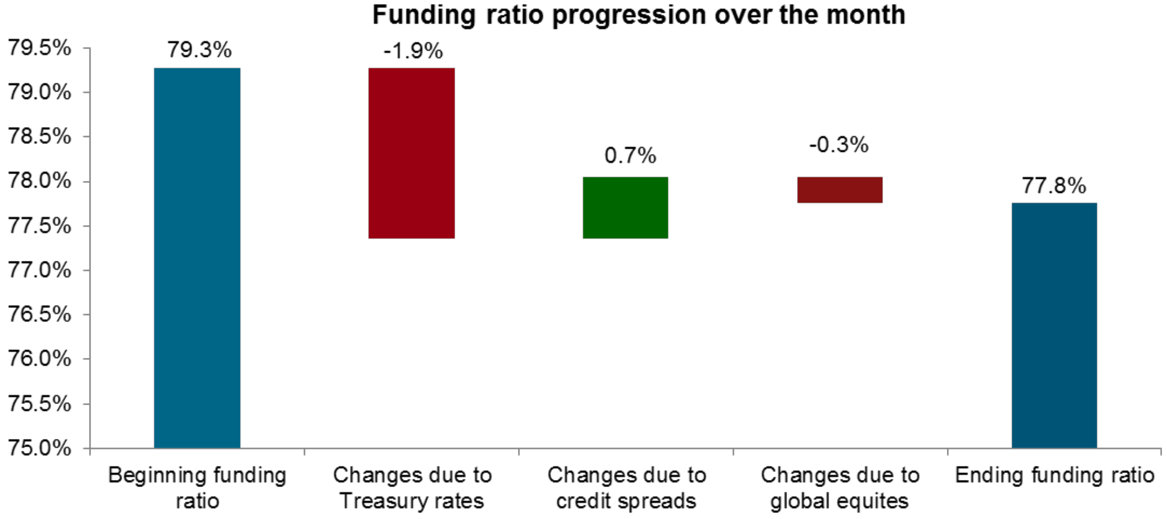
Funding Status Monitor

LGIMA estimates that pension funding ratios decreased over the month of February 2016. LGIMA estimates the average funding ratio fell from 79.3% to 77.8% over the month. Funding ratios decreased over the month as liabilities for the average plan outperformed the traditional asset allocation return. Global equity markets decreased 0.63% and the S&P 500 decreased 0.13%. Liabilities for the average plan increased as the fall in Treasury rates offset the widening in credit spreads. LGIMA estimates plan discount rates decreased 11 basis points, as Treasury rates fell 16 basis points while credit spreads widened 5 basis points[1]. Overall, liabilities for the average plan were up 1.9%, while plan assets with a traditional "60/40" asset allocation[2] decreased 0.1%, resulting in a funding ratio drop of 1.5%.



[1] Discount rates based on a blend of the Bank of America Merrill Lynch Average US Pension Plan AAA-A and Bank of America Merrill Lynch Mature US Pension Plan AAA-A discount curves
[2] For the average plan, LGIMA assumes a 60% allocation to MSCI AC World and a 40% allocation to Barclays Aggregate.

Strategy

What clients are doing

- Wider adoption of de-risking decisions resulting in continued strong flows to customized LDI solutions
- Increased implementation of liability benchmarking/completion management frameworks as fixed income allocations increase
- Greater interest in end-game solutions as ongoing costs of administering a pension plan increase (i.e. higher PBGC premiums)
  - Increasing demand for annuity aware solutions as plans focus on ultimate goal of a Pension Risk Transfer
- Strong demand for derivative strategies to help shape funded status outcomes which can be used to:
  - Monetize decisions already made within a glide path using swaption and synthetic equity strategies
  - Easier to gain equity exposure synthetically and gain discount rate exposure through cash bonds
  - Benefit from market pricing dislocations (i.e. skew and calendar events)