LGIMA Pension Solutions' Monitor

Market Update

Overview

Global equity markets rallied modestly during the month of April despite mixed economic data and on-going earnings results. Credit spreads continued rallying with long duration credit tightening 18 basis points driven by technical factors and foreign demand. Overall funded status for the average plan decreased by 0.6% over the month of April despite higher equities and Treasury rates due to significant tightening in credit spreads.

Equities

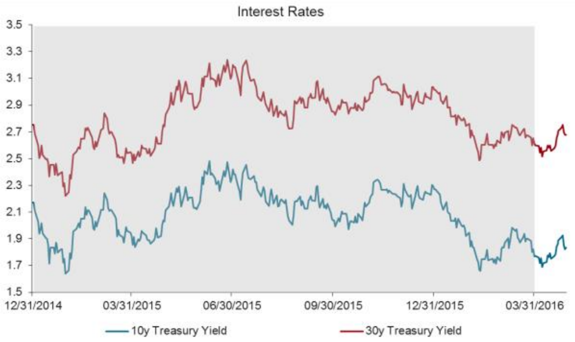
The S&P 500 reached all-time highs in mid-April before retreating due to mixed economic data, including slower 1Q US GDP growth.

The S&P 500 TR Index increased 0.39% and the MSCI AC World TR Index increased 1.54% over the month of April, positively affecting pension funding ratios.

Interest Rates

After a tumultuous first quarter, the rates market felt relatively quiet in April, rarely trading outside of a 15 basis point range. The FOMC minutes reinforced the recent dovish Fed speak emphasizing data dependence and reduced Fed expectations for rate hikes this year (something the market had been pricing in long before the actual March meeting even took place). The ECB meeting mid-month provided no surprises as they kept the benchmark rate unchanged and maintained the pace of the asset purchase program. The only interesting note from the FOMC meeting on April 27 was the removal of references to global developments continuing to pose risks to the outlook. But unless we see strong data prints in the US over the next few weeks, particularly on the inflation front, it is difficult to see a clear impetus for rates to move significantly higher.

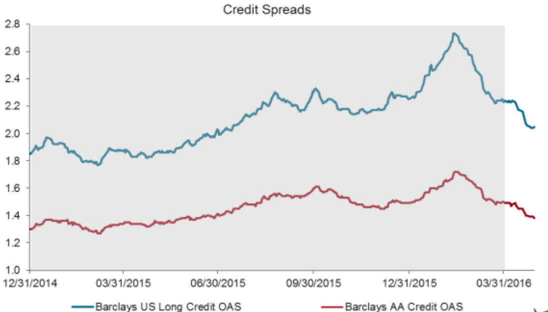
The 30-year Treasury rate increased 7 basis points while the 10-year Treasury rate increased 6 basis points over the month. The increase in interest rates had a positive contribution to pension funding ratios over April.



Credit

Credit spreads continued rallying into April driven by a very strong foreign demand for credit in the face of disappointing supply. The tightening over the month seemed to be less about fundamentals – top line growth, profits, leverage, etc. – and more technical.

The option adjusted spread (OAS) for Barclays Long Credit Index tightened 18 basis points to 205 basis points over the month while the Barclays Long AA Credit Index tightened 12 basis points to 138 basis points over the same period. The tightening in spreads had a negative contribution to pension funding ratios in April, and ultimately outweighed higher interest rates and equities, leading to slightly lower funded ratio outcomes.



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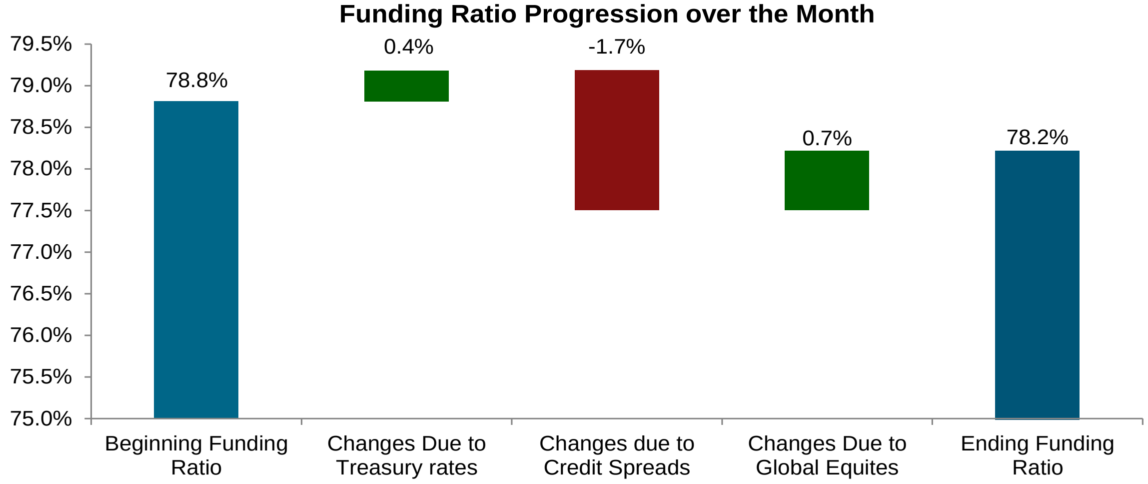
Funding Status Monitor

LGIMA estimates that pension funding ratios decreased over the month of April 2016. LGIMA estimates the average funding ratio fell from 78.8% to 78.2% over the month. Funding ratios decreased as liabilities for the average plan outperformed the traditional asset allocation return. Global equity markets increased 1.54% and the S&P 500 increased 0.39%. Liabilities for the average plan increased as the tightening in credit spreads more than offset the rise in Treasury rates. LGIMA estimates plan discount rates decreased 11 basis points, as Treasury rates rose 4 basis points while credit spreads tightened 15 basis points[1]. Overall, liabilities for the average plan were up 1.8%, while plan assets with a traditional "60/40" asset allocation[2] increased 1.1%, resulting in a funding ratio drop of 0.6%.



[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 attention 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)
    - Many plans exploring risk premia swaps for hedge fund replication or factor completion