

# LGIMA Pension Solutions' Monitor

## Market Update

### Overview

July saw stronger returns from global equity markets, helped by an increased expectation of further easing of monetary policy across the main central banks. After a short lived sell-off earlier in the month, US rates ended the month lower following further concerns over global growth. US Credit spreads continued to tighten, led by stronger international flows into US fixed income and technical factors.

### Equities

Equity markets were up across the board in July, with Asia Pacific leading the way and energy stocks the only notable exception. July has been the fifth consecutive month of gains for the S&P 500, its longest winning streak since 2014. US stocks have been supported by slightly better than expected earnings and economic data. On a global basis, subsidence of fears about the economic impact of Brexit and expectations of continued dovish central bank policies have also contributed to the rally in equity markets.

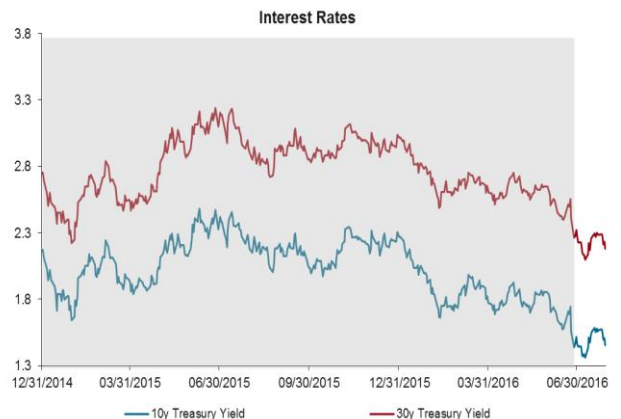
The S&P 500 TR index increased 3.69% and the MSCI AC World TR index increased 4.34% over the month of July, positively affecting pension funding ratios.



### Interest Rates

The US rates market calmed considerably over July post-Brexit. July payrolls exceeded expectations which led to a sell-off in rates after the market took the weekend to digest the news. The selloff was further aided by strong retail sales numbers and higher than expected PPI data during the week. This strong data put a September Fed hike back on the table. Fed funds futures took note and the probability of a hike by December went from 11% at the end of June to 42% mid-month before settling on 37% at the end of July. However, the move higher in rates was short lived as several banks released research saying global growth / recession concerns linger and the likelihood of central bank quantitative easing remains high, even in the US; ultimately leading to lower rates on the month.

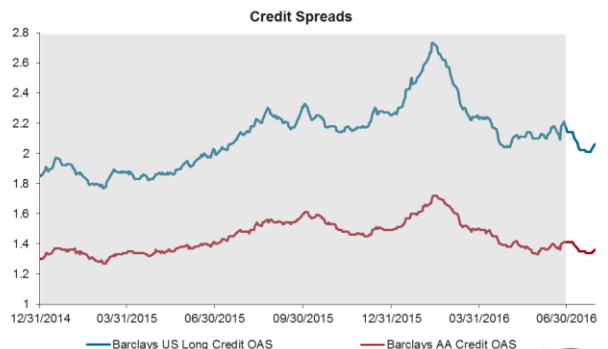
The 30-year Treasury rate decreased 10 basis points while the 10-year Treasury rate decreased 2 basis points over the month. The decrease in rates had a negative contribution to pension funding ratios over July.



### Credit

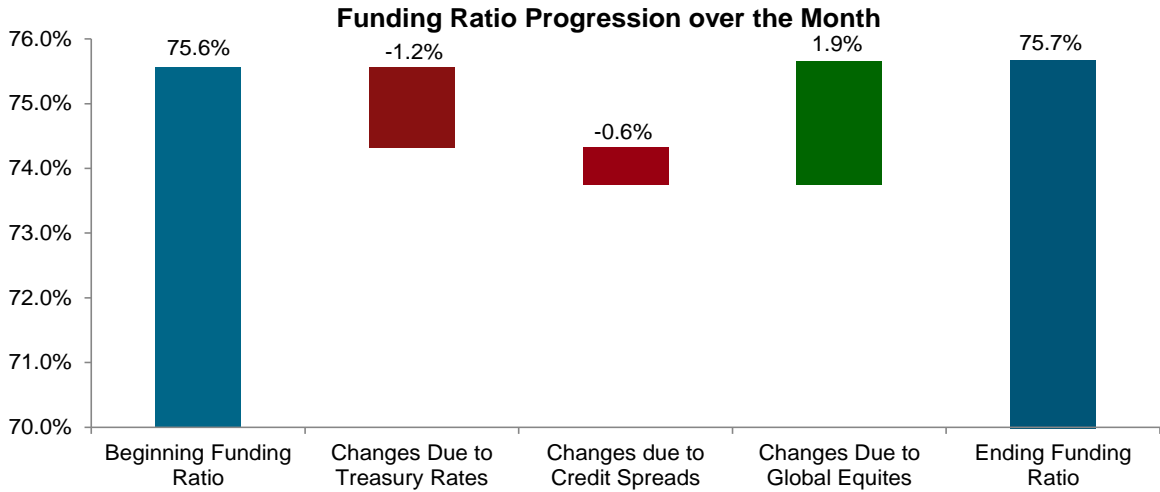
The US credit market continued to exhibit remarkable strength post-Brexit as international demand for US assets continued due to negative yields elsewhere. Some of the spread tightening is purely mechanical - the downgrade of a handful of energy names to high yield mathematically resulted in a lower spread on the index, with new issues having the same effect. However, the roundtrip in the index spread over the year is impressive and naturally elicits some caution around where valuations can go from here.

The option adjusted spread (OAS) for Barclays Long Credit Index tightened 5 basis points to 206 basis points while the Barclays Long AA Credit index tightened 5 basis points to 136 basis points over the month. The overall tightening in spreads (within the discount rate) had a negative contribution to pension funding ratios over July.



## Funding Status Monitor

LGIMA estimates that pension funding ratios marginally improved over July 2016. Global equity markets increased 4.34% and the S&P 500 increased 3.69%. LGIMA estimates plan discount rates decreased 17 basis points, as Treasury rates fell 10 basis points while credit spreads tightened 7 basis points<sup>1</sup>. Overall, liabilities for the average plan were up 2.73%, while plan assets with a traditional “60/40” asset allocation<sup>2</sup> increased by 2.86%.



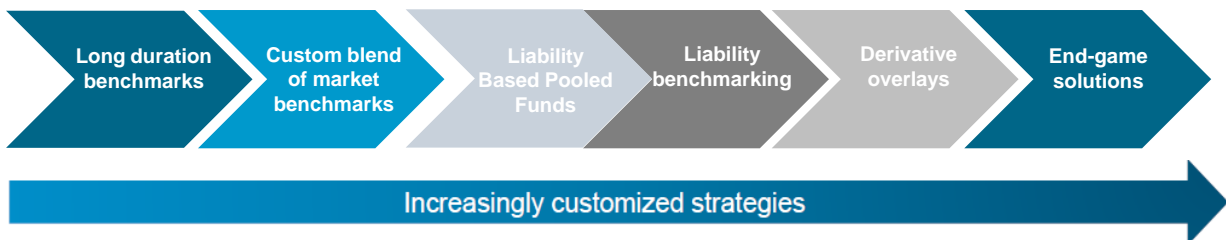
1: Discount rates based on a blend of the Bank of America Merrill Lynch Average US Pension Plan AAA-A and Bank of America Merrill Lynch Mature US Pension Plan AAA-A discount curves  
 2: For the average plan LGIMA assumes a 60% allocation to MSCI AC World and a 40% allocation to Barclays Aggregate.

## Strategy

### What Clients Are Doing

- Continued interest in de-risking solutions including but not limited to extending duration utilizing market-based benchmarks (15+ STRIPS etc.) and customized liability benchmarking/completion management frameworks
- Increased interest in LGIMA’s liability based pooled fund offering for plans seeking a customized pooled fund solution
- Greater attention in end-game solutions as ongoing costs of administering a pension plan increase (i.e. higher PBGC premiums)
- 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
  - More easily 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

### How LGIMA works with clients



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