LGIMA's Pension Solutions' Monitor

April 2018 Market Update

Overview

April saw pension funding ratios experience a strong increase driven by a rise in Treasury rates and impressive equity returns. We estimate that the average plan's funding ratio increased 2.0% during the month of April.

Equities

The equity market posted strong gains over the month of April, both domestically and globally. Volatility persisted, as a potential US-China trade war looms, tensions continue to increase between the US and Russia in Syria, and uncertainty surrounding the Iran nuclear deal has reemerged in the news cycle. Balancing caution with opportunity, investors still experienced positive price action as earning, specifically in the US, exceeded expectations.

General confidence remains as global growth prospects appear steady. Notably, China printed strong annual growth while also cutting rates, and the Eurozone had a number of countries experience a decrease in unemployment. The US is also positioned well, as both manufacturing PMI and consumer confidence surprised on the month. Overall, April performance leaves equities broadly flat YTD.

The equity market had a positive impact on funding ratios over the month.

Interest rates

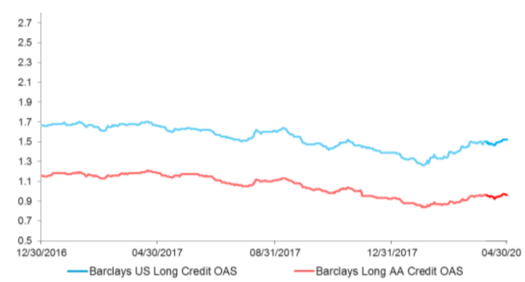
The US 10-year rate touched 3.0% for the first time since 2014, as both headline and core inflation ticked slightly higher. The US Fed remains focused on wage growth as a primary driver of inflation, which also increased. With unemployment steady for the past few months, it is clear that Fed action will be centered around the inflation print.

The market is currently pricing a 35% chance of a rate hike in May, but has priced in a June hike at a probability of ~93%. With strong earnings and a positive economic outlook, investors will be focused on developments in geopolitical tensions as a potential catalyst to drive rates higher.

Overall, the rates market had a positive impact on funding ratios over the month.

Credit

US Long duration credit continued to leak 4 basis points wider in March, ending the month at year-to-date wides of 152 basis points. New issuance was larger than expected in April, totaling $109bn. In the last few weeks there has been a noticeable improvement in demand for credit from some of the key buyers that went missing in 1Q. One might think that high demand would tighten spreads, but they continue to widen even as earnings continue to surprise to the upside.



Part of the problem may be that investors simply don't believe that the improvement in demand will persist. While Asian demand has increased notably in April, hedging costs remain elevated, and further Fed hikes will only continue to erode the situation. Essentially, corporate yields have needed to increase to offset the rise in hedging costs. The real problem may be that investors fear supply is set to surge. It will be important to watch the calendar closely next month as three larger M&A deals are expected, and how they perform will be a key barometer of market technical.

Overall, credit spreads had a minimal impact on funding ratios over the month.

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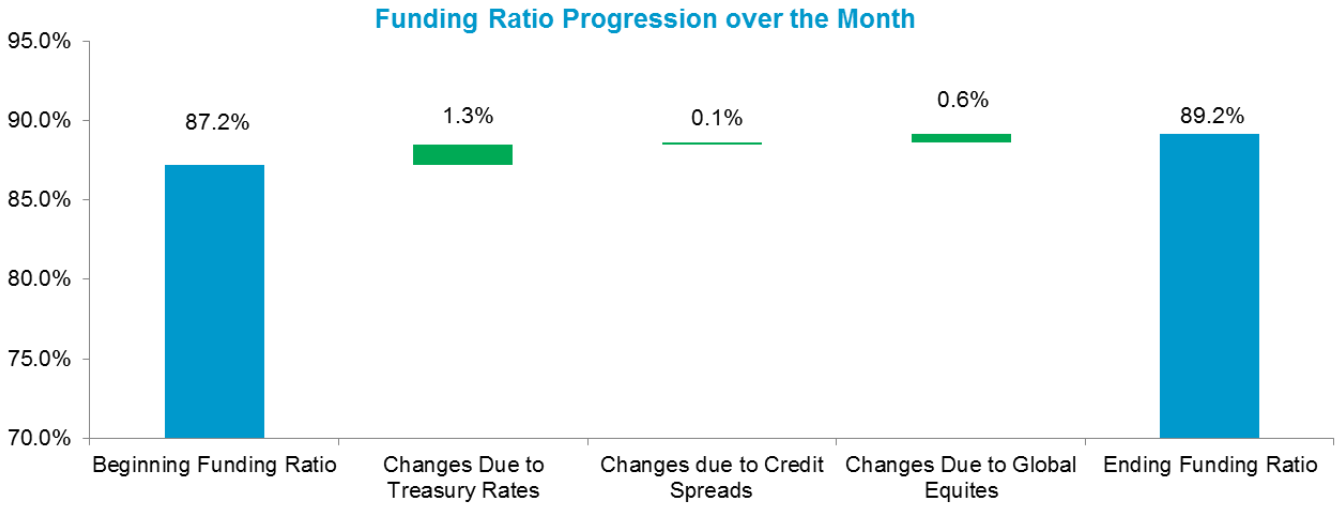
Funding status monitor

LGIMA estimates that pension funding ratios increased 2.0% over the month of April, driven by an increase in Treasury rates and positive equity returns. LGIMA estimates the Treasury component increased by 14 basis points, while the credit component remained largely unchanged, resulting in the discount rate[1] rising 14 basis points. Overall, liabilities for the average plan were down 1.9%, while plan assets with a traditional "60/40" asset allocation[2] increased by 2.0%.



[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 Bloomberg Barclays Aggregate

Pension market highlights

Themes	Why?
Customized liability strategies continue to have strong demand (liability benchmarking and completion management).	• The recent performance of equities and rise in Treasury yields have made entry points into more customized LDI strategies more attractive
Custom credit strategies are a growing area of interest by clients focused on the end-game objective, self-sufficiency or pension risk transfers.	• Focus on high quality, diversified credit portfolios with lower turnover, reduced costs and a better match to the plan liability • Monetize decisions already made within a glidepath
Derivative overlays have been a growing component of plans' investment strategies to help shape funded status outcomes.	• Dynamic protection strategies • Synthetic equity strategies: TRS, risk reversals, put-write strategies
Synthetic risk premia (alternative beta) strategies have also been a topic of interest to help replicate hedge fund exposure and/or for factor completion	• Institutional investors increasingly looking to alternative allocations for diversification rather than "alpha" • Synthetic risk premia strategies offer similar exposures with greater transparency, lower fees, and increased liquidity

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