LGIMA's Pension Solutions' Monitor

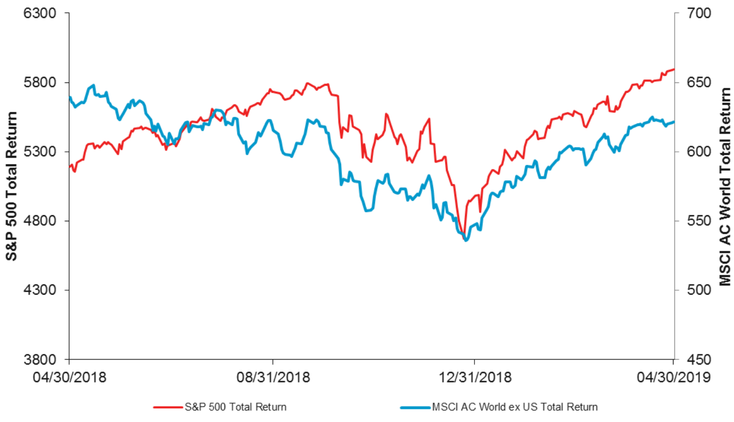
April 2019 Market Update

Overview

Pension funding ratios increased throughout the month of April, primarily driven by positive equity returns. Rising Treasury yields were broadly offset by tightening credit spreads, resulting in a relatively stable discount rate. We estimate that the average plan's funding ratio increased 1.8% to 87.4% through April.

Global equities

April was another very strong month for equities, with both US and global indices returning between 2.5% and 4%. Financials and Tech led the way with Healthcare and Utilities as notable underperformers. Gains were led by dovish communication—and, in some cases such as China, action—from central banks, which seems to be somewhat re-igniting a narrative of synchronized global growth and leading to persistently muted volatility.

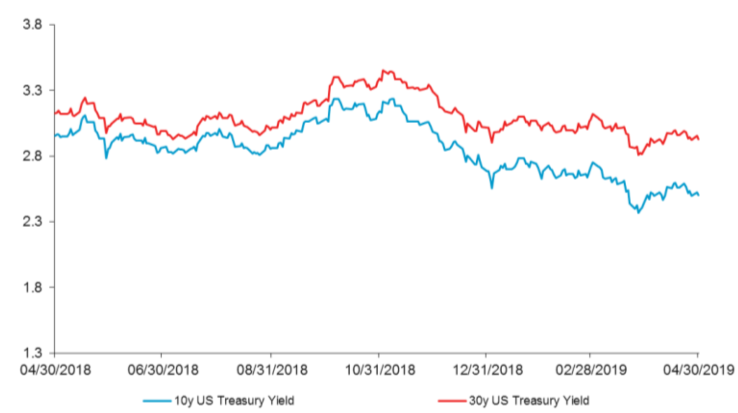


Source: Bloomberg/Barclays and LGIMA as of 4/30/2019.

Apart from the Fed's reinforced monetary position resulting in bullish sentiment for the US equity market, we note that equity buybacks and corporate tax cuts—rather than organic top line growth—have been a big source of support for equities in recent history. With margins already at elevated levels, support for equities from current valuation multiples, especially in the US, depends on avoiding significant wage pressures, refinancing debt cheaply, and/or finding new productivity gains. A meaningful uptick in inflation, especially on the wage side—and any subsequent reversal in the Fed stance from arguably overtly dovish perceptions among market participants—may therefore have multiple mutually reinforcing effects on equities. Overall, equities had a positive impact on pension funding ratios over the month.

Interest rates

Central bank commentary and data continue to drive rate movements in the US. After closing at a one year low of 2.81 at the end of March, the 30-year Treasury rate quickly reversed course on the first day of April. The market shrugged off weak retail sales numbers and instead focused on the strong ISM print (55.3 versus 54.5 consensus estimate) and rates sold off 8 basis points as the S&P climbed to a six month high. Rates sold off a few more basis points later in the week as the Financial Times reported the US and China were near a trade agreement, but were kept in check from a mixed employment report. Although payroll numbers surprised to the upside (196k versus 177k consensus and upward revisions to February), the average hourly earnings disappointed at 0.1% month-over-month growth compared to the 0.3% consensus. A week later the 30-year rate reached 2.98 as equities rallied on the back of the PBOC reporting higher than expected lending statistics, easing worries about slowing growth in China. Rates rallied once again on April 24 as the Bank of Canada kept rates on hold for the fourth consecutive meeting and, more importantly, removed references to further rate increases that they had included in their statements since the end of 2017. Despite some data from Europe surprising to the upside this week, rates stayed grounded going into month end, with the 30-year rate closing out April at 2.93. Fed fund futures are now pricing in a 50% chance of a cut by the September meeting and a 67% chance of a cut by year end. Overall, interest rates had a positive impact on pension funding ratios over the month.



Source: Bloomberg/Barclays and LGIMA as of 4/30/2019.

Credit

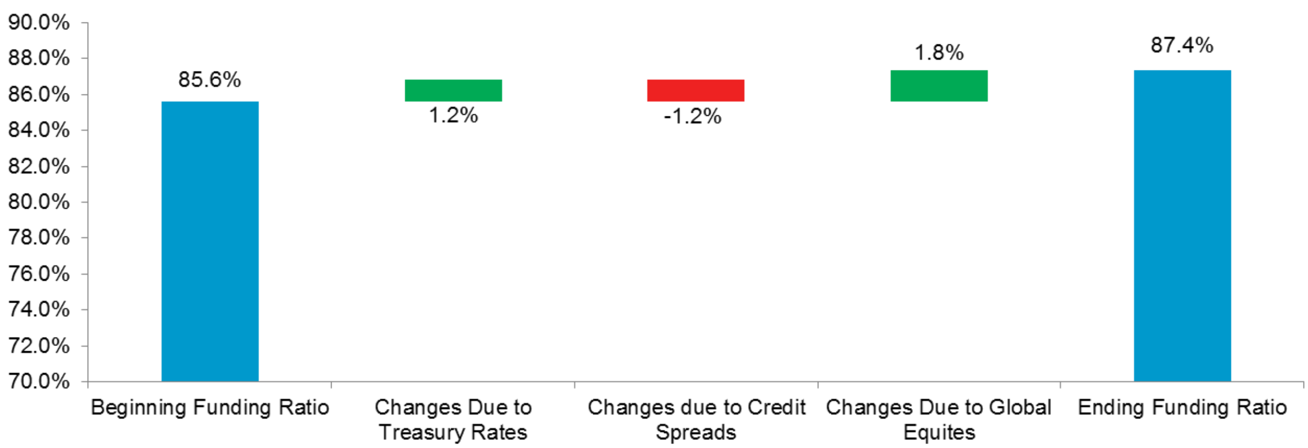
The rally in investment grade credit has continued throughout April. The Bloomberg Barclays US Credit index tightened 8 basis points during the month and year-to-date spread performance has reversed 88% of the widening from the fourth quarter of 2018. Macroeconomic conditions have improved both domestically and globally which has eased investor concerns regarding the growth outlook. A first quarter US GDP print of 3.2% and green shoots from both China and Europe have confirmed the economy remains healthy. From a technical perspective, a lower than expected amount of investment grade corporate bond supply came to market and was supportive of credit spreads. M&A issuance will be a wildcard in the primary market during May as the amount of supply to be digested by investors may prove to be challenging if several mega-deals are announced. Demand remains robust

Source: Bloomberg/Barclays and LGIMA as of 4/30/2019.

from both foreign investors and domestic mutual fund and ETFs buyers. Overall, credit spreads had a negative impact on pension funding ratios over the month.

Funding status monitor

LGIMA estimates that pension funding ratios increased throughout April, with gains driven primarily by positive equity returns. LGIMA estimates the discount rate's Treasury component increased by 12 basis points while the credit component decreased 9 basis points, resulting in a net increase of 3 basis points[1]. Overall, liabilities for the average plan decreased 0.15%, while plan assets with a traditional "60/40" asset allocation[2] increased by ~2.1%.



[1]Discount rates based on a blend of the Intercontinental Exchange US Pension Plan AAA-A and Intercontinental Exchange 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

Overlay Solutions for Pension Plans

As the demand for customization remains high within the pension industry, plan sponsors explore the benefits and considerations of using a Treasury overlay or an equity overlay