LGIMA's Pension Solutions' Monitor

October 2017 Market Update

Overview

October saw pension funding ratios increase over the month. A strong equity market overshadowed the fall in discount rates, which were driven by tightening credit spreads more than offsetting a modest increase in Treasury rates. As plan liabilities grew at a slower rate than plan assets, we estimate that the average plan's funding ratio increased 0.3% during the month of October.

Equities

Stocks continued their run in October, with several markets touching all-time highs. International equities were up 1.9%, with strong performance across regions. The S&P 500 returned 2.3%, with the rally led by a surge in tech while telecom and health care lagged. Equity volatility remained near record lows as sentiment was buoyed by high consumer confidence, strong job market data, GDP numbers, and generally positive earnings. International equities were led by Asia, with developed markets in the Pacific region and emerging markets such as China and India all up in the 3-8% range. Europe was up modestly and the post-summer sell-off in Latin American equities continued.

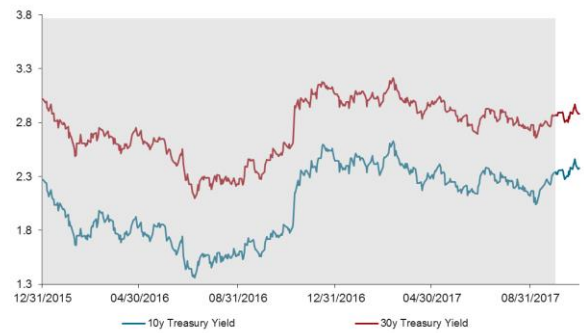
The increase in equities had a positive impact on pension funding ratios over the month.

Interest Rates

Treasuries experienced modest losses over the month of October, as the equity markets remained bullish, geopolitical tension dissipated, and a global environment of central bank tightening. As of October 31st, 2017, the market had priced in the odds of an FOMC rate hike at ~83% by year-end. Additionally, investors are keeping an eye on the announcement of a new Fed Chair, measuring the relative hawkishness or dovishness of each candidate.

Rate volatility had a short lived spike near the end of October as rates reached their highest levels since May. This rally in volatility was short lived and volatility has once again settled to near all-time lows.

The 10-year and 30-year rates rose 5basis points and 2 basis points to 2.38 and 2.88, respectively. The moves in rates have had a positive impact on pension funding ratios over the month.

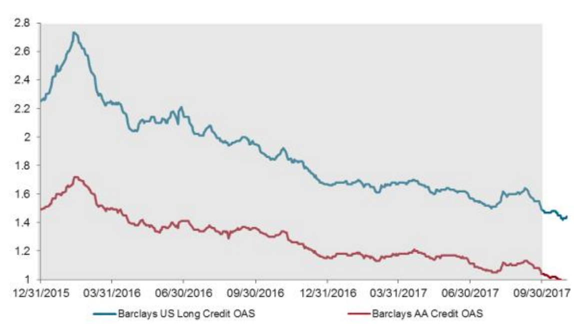


Credit

Three crosscurrents are running strong in the credit markets as year-end approaches.

The first is tax reform. Most importantly for credit markets, it appears that interest deductibility and foreign taxation are active areas of discussion. The second major current originates from the Fed, as reports suggest that President Trump will choose between three candidates: Jerome Powell, John Taylor, and Janet Yellen. Thirdly, M&A remains an active risk in credit markets with valuations so rich.

The Barclays US Long Credit OAS and AA Credit OAS both tightened 5 basis points. Overall, credit spreads had a negative impact on pension funding ratios over the month.



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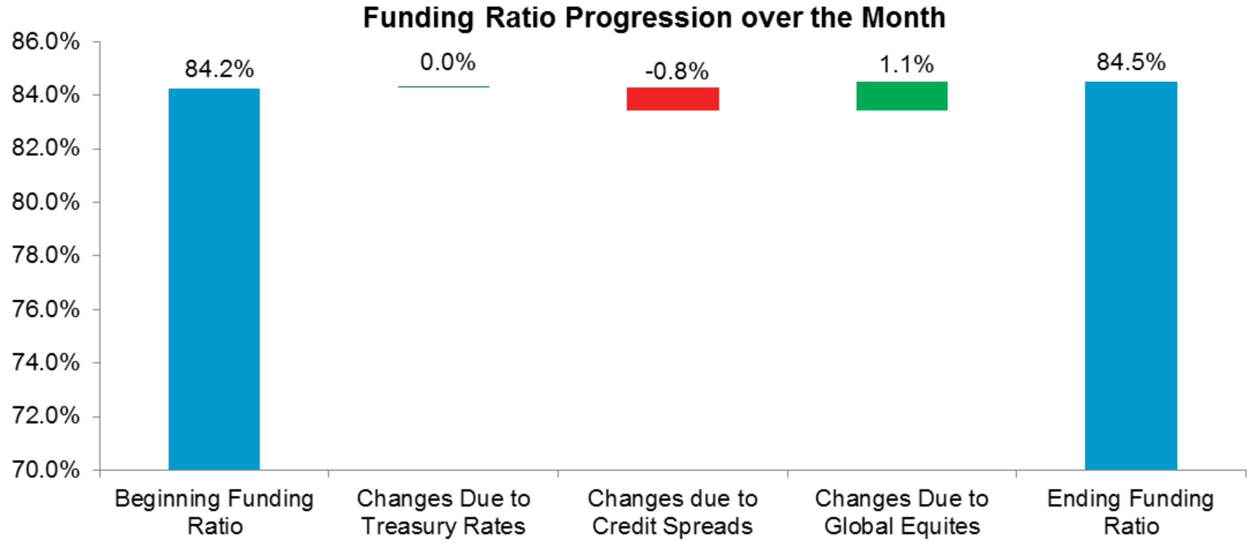
Funding Status Monitor

LGIMA estimates that pension funding ratios increased 0.3% over the month of October, driven primarily by gains in the equity market. LGIMA estimates Treasury rates increased 2 basis points while credit spreads tightened 7 basis points, resulting in the discount rate[1] falling 5 basis points. Overall, liabilities for the average plan were up 0.98%, while plan assets with a traditional "60/40" asset allocation[2] increased by 1.28%.



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

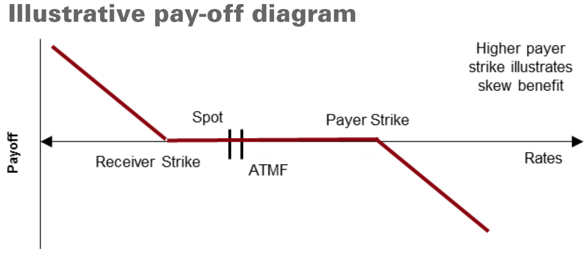
2: For the average plan LGIMA assumes a 60% allocation to MSCI AC World and a 40% allocation to Barclays Aggregate.

Strategies to benefit from recent market moves

Swaption Collar

- Implied interest rate volatility continues to move lower, however corporate defined benefit plans can take advantage of the current skew environment
- Plans can take advantage of the skew by selling high strike payer swaptions and utilize premium to purchase low strike receiver swaptions
- Should rates rise from current levels, plans will be legged into higher interest rate exposure and will be protected should rates fall from current levels

Illustrative pay-off diagram



1x2 Put Spread

- This strategy simultaneously buys a 95% put and sells two 85% puts in the 6-month maturity, giving plans downside protection at a reduced cost
- In this strategy, a plan would not lose money until the market fell more than 25% (minus low premium spent)

Illustrative pay-off diagram