LGIMA's Pension Solutions' Monitor

October 2018 Market Update

Overview

Pension funding ratios decreased slightly through the month of October due to the negative returns in both the US and the Global Equity Markets. These losses were somewhat offset by the increase in Treasury rates and credit spreads. We estimate that the average plan's funding ratio decreased 0.9% to 89.6% during the month of October.

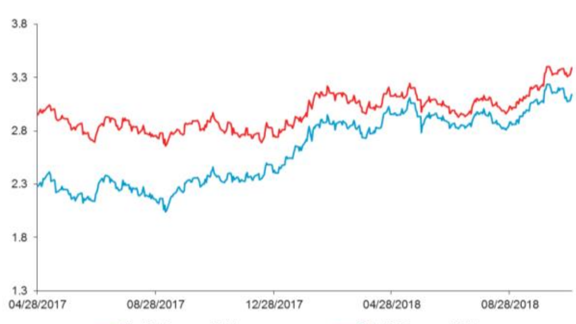
Global equities

Equity returns were negative across the globe over the month of October. The S&P 500 traded up or down 1% in a single day ten different times; for reference, this happened only eight times in all of 2017. Ultimately, the index was down 6.8% on the month, with a modest month-end rally capturing back some of the losses.

There is no consensus driver of the sell-off, as the US and global economies generally remain well-positioned for continued - albeit slowing - growth, with strong unemployment reports, strong corporate earnings and high consumer confidence. Some contribution likely came from investors rebalancing after a rise in interest rates coupled with an equity market near all-time highs. However, there is a mix of risks that certainly contributed to the drawdown, such as trade tensions with China and the impact on US corporate earnings, US midterm elections, political risks around Italy, and, perhaps most importantly, broader fears of the Fed hiking too rapidly. While the realization of a bear market comes into focus and volatility has certainly picked up, it is not near crisis levels.

Interest rates

Rates sold off to multi-year highs and the yield curve steepened in October. The 30-year Treasury rate closed out the month at 3.39 compared to the September month end level of 3.21. The 2s30s curve steepened out 14 basis points to end the month at 52 basis points while 10s30s was 10 basis points steeper on the month, ending at 24.5 basis points. The first wave of the selloff happened on October 3 on the



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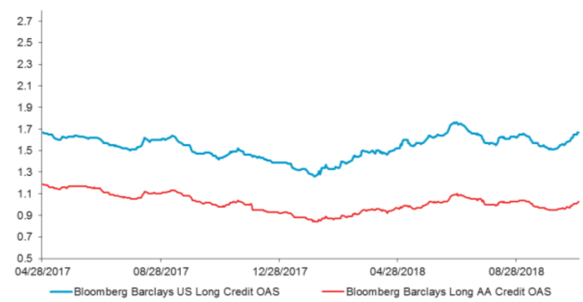
back of strong US data. The ADP employment survey surprised to the upside and ISM non-manufacturing index printed at 61.6 versus the 58.0 consensus, the highest print since 1997. Positive sentiment around US/Canada/Mexico trade deals helped further fuel the selloff. The 30-year rate closed the day at 3.34 and after the close Fed chair Powell gave a statement that real rates in the US are still accommodative and will continue to rise. Two days later the 30-year closed at a four-year high of 3.41 on the back of continued strong employment numbers. Although the headline change in nonfarm payrolls came in at 134k versus a 185k consensus, there were +87k of upward revisions to prior months. More importantly, average hourly earnings continued to show growth, increasing 0.3% month-over-month and the unemployment rate is now at 3.7%, the lowest level since 1969. Rates rallied back since then in the wake of a nearly 10% drop in the S&P. Additionally, CPI came in lower than anticipated, and 6m trailing core CPI is now below 2%. In November we look to the midterm elections and FOMC meeting for guidance on where rates will go from here.

Credit

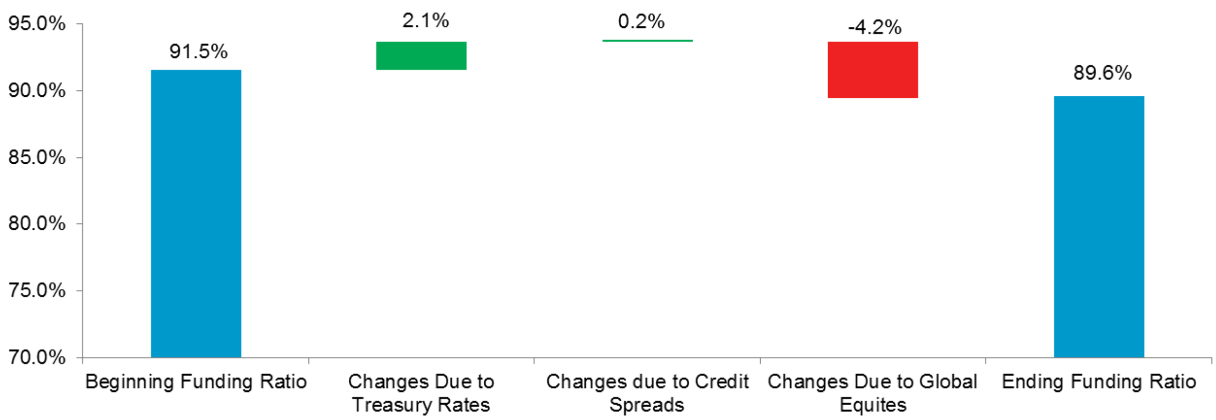


The US investment grade credit market suffered the second worst month this year of spread performance in October. While the Bloomberg Barclays US Credit index widened out 11 basis points to 111 basis points, credit outperformed the stock market as equity volatility spiked and the S&P 500 declined 6.8% on the month. Risk assets sold off as the combination of continued Fed tightening, escalating trade tariffs, and worries about future earnings growth concerned investors. As a result, October's total supply ($76bn) came in lower than expected, as issuers opted to wait on the sidelines until market volatility stabilizes. The most noteworthy deal that came to market was Comcast's jumbo $27b offering to fund its acquisition of Sky Plc. This large M&A financing was the fourth largest deal in the history of US debt capital markets. What's particularly impressive about this transaction is that management was able to defend the credit's single A credit ratings. A separate notable event this month was Moody's downgrade of General Electric to Baa1. Now that GE has high BBB ratings from two of the three main rating agencies, $48bn of the company's debt outstanding will fall out of the single A index at the end of the month. We expect November to be busy as the market will be focused on the latest jobs report, midterm elections, the upcoming G20 summit, and this month's FOMC meeting.

Funding status monitor

LGIMA estimates that pension funding ratios slightly declined throughout October, with losses driven primarily by negative global equity returns. LGIMA estimates the Treasury component increased by 18 basis points while the credit component increased by 5 basis points, resulting in the discount rate[1] increasing 23 basis points. Overall, liabilities for the average plan decreased ~2.7%, while plan assets with a traditional "60/40" asset allocation[2] declined by ~4.8%.

Funding Ratio Progression over the Month



[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

De-risking as funding level improves