LGIMA's Pension Solutions' Monitor

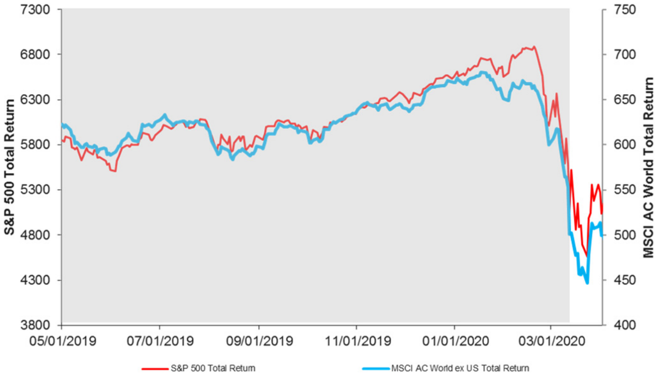
April 2020 Market Update

Overview

Pension funding ratios decreased throughout the month of April, with changes primarily attributed to tightening credit spreads and lower treasury rates. We estimate that the average plan's funding ratio decreased 0.1% to 73.4% throughout the month.

Global equities

Heavy equity drawdowns in March were followed by a strong bounce in April as COVID-19 continued its spread amidst the economic shutdown. The rally was fueled by global central bank action to provide extensive stimulus measures while some crucial regions saw the daily new infection rates fall and established plans to gradually reopen their economies. The Federal Reserve committed to unlimited government bond purchases, additional investment grade corporate bond and high yield bond purchases, including ETFs. The European Central Bank (ECB) continued its existing bond buying program with an increased emphasis on those governments most impacted by the virus, such as Italy and Spain, as well as easing collateral requirements on high yield securities.



Source: Bloomberg/Barclays and LGIMA as of 04/30/20.

With the rally, volatility fell from extreme levels in both risk and safe haven assets. U.S. stocks (12.8%) outperformed international stocks (7%), developed markets outperformed emerging, growth stocks outperformed value stocks and small cap (13.7%) outperformed large cap (12.8%; though, still trailing substantially year-to-date). These results are largely due to investors anticipating recoveries where the central banks have provided the most support (U.S. and developed nations) and where the support will have the greatest impact (large cap and growth stocks).

In the U.S., consumer discretionary (17.0%) and energy (16.2%) sectors led the S&P 500, followed closely by materials (13.7%), tech (13.6%) and telecom (12.1%).

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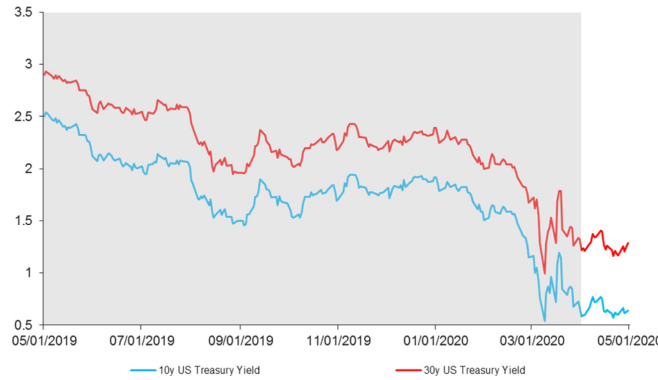
Interest rates



Source: Bloomberg/Barclays and LGIMA as of 04/30/20.

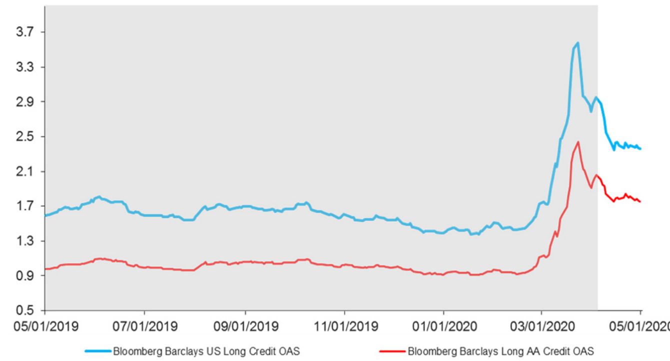
The rates market in April felt boring and uneventful despite long-end rates delivering an average of 5.8 basis points of volatility per day. Of course, almost anything would feel boring after March when long-end rates were delivering 18 basis points of volatility per day. The 30-year Treasury rate stayed in a 24 basis point range in April, starting the month at 1.32, selling off to 1.41 mid-month, rallying to 1.17 the following week and closing out the month at 1.28. Data continued to disappoint – global PMIs printing below expectations, U.S. Q1 GDP coming in at -4.8% vs -4.0% estimates, initial jobless claims continuing to come in at 3.3 million -6.8 million each week – but at this point the market seems numb to any single data point, including crude oil trading negative. The all-out effort by the Fed to calm the markets seems to be working so far.

Although the rates markets are trading wider than normal, it's no longer difficult finding bids for off the runs bonds like it had been in mid-March. And while the Fed has started slowing their asset purchases, the buys thus far have alleviated much of the balance sheet pressure the banks were feeling as asset managers sold Treasuries to move risk into equities and credit. The Fed has also made it clear they will not hesitate to scale the purchasing back up if market conditions warrant it. At their April meeting, they left everything unchanged – rates, IOER, forward guidance – and in their statement said, "Committee expects to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goals."[1] At the end of the month they also expanded their Main Street Lending program by lowering their minimum loan size to $500 thousand and increased the cap on employee and revenue size to qualify for the program.

The ECB followed suit and stepped up their efforts to increase liquidity in the European markets as well. Forecasts for the April unemployment report are for a nonfarm payrolls to contract by over 21 million jobs and the unemployment rate to jump to a great-depression-like 16%. Still, deaths and new cases of COVID-19 in the U.S. seem to have started to plateau and outside of NYC, most hospitals do not seem to have hit their maximum capacity as many had feared, very likely due to aggressive social distancing measures taken across the country. Some states, Georgia most notably, have started to relax their forced closures in an effort to get their economies going again. A new drug, Remdesivir, has some promise in treating coronavirus patients and its maker, Gilead, hopes to have widely available in May. As weather improves and more and more people begin suffering from quarantine burnout, it seems likely that social distancing will start to get scaled back, which some fear could lead to a second wave of cases. Even if the worst is behind us, it's still too early to realize the full impact of the economic fallout of the past two months.

1 The Federal Reserve, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315a.htm

Credit



Source: Bloomberg/Barclays and LGIMA as of 04/30/20.

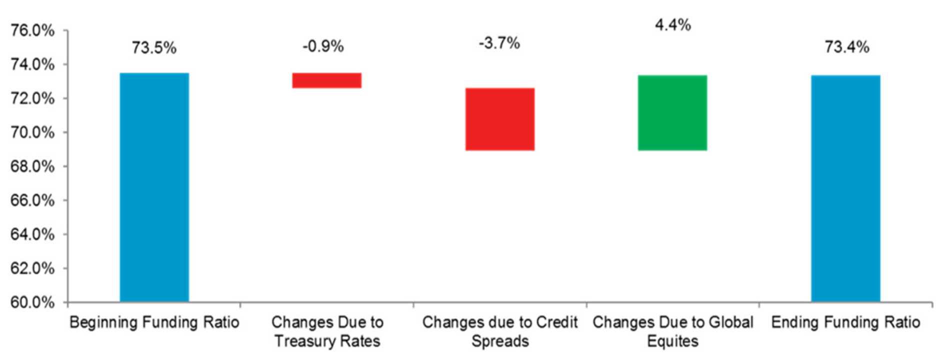
As talks around economic re-openings begin to surface throughout the United States, markets seem to have adopted a more optimistic sentiment. The Fed has continued to be accommodative, while fiscal policy has kept the consumer afloat, recently unveiling a new version of its $600 billion Main Street Lending program. Even in the midst of a 4.8% annualized decline in first quarter U.S. GDP, unemployment claims in excess of 30 million, and a contracting PMI reading of 41.5, the Bloomberg Barclays U.S. Long Credit index tightened 43 basis points, ending the month at 236 basis points.

The beginning of earnings season has been exceptionally volatile, as ~70% of S&P 500 companies have reported. Companies have continued to revise their yearly outlook, while around 20% of corporates have withdrawn earnings guidance altogether. Analysts now expect a 16% YoY EPS decline and a 0.1% sales decline. Year to date, downgrades have swelled to $120 billion of fallen angels. Consensus full-year estimates range from $200-250 billion.

The month has seen a record amount of issuance as well, with $268 billion coming to market, bringing the year-to-date total to $747 billion. This is 88% ahead of 2019's pace of issuance. Inflows into U.S. IG bond funds and ETFs continue to remain strong, a reversal from the record outflows experienced in March. Excess volumes are expected to continue into May, with issuance expectations ranging between $200 and $250 billion. We remain moderately optimistic in the near term; however, supply indigestion may overwhelm demand if the Fed doesn't step in by purchasing bonds in the primary and secondary liquidity facilities sooner rather than later.

Funding status monitor

LGIMA estimates that pension funding ratios decreased ~0.1% throughout April, with changes primarily attributed to lower plan discount rates. Our calculations indicate the discount rate's Treasury component fell by 7 basis points while the credit component tightened 39 basis points, resulting in a net decrease of 46 basis points.[2] Overall, liabilities for the average plan increased ~7.4%, while plan assets with a traditional "60/40" asset allocation increased by ~7.2%.[3]



Source: Bloomberg/Barclays and LGIMA as of 04/30/20.

2 Discount rates based on a blend of the Intercontinental Exchange U.S. Pension Plan AAA-A and Intercontinental Exchange Mature U.S. Pension Plan AAA-A discount curves.

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

LGIMA’s approach to ESG Investing

Integration

Environmental, social and governance (ESG) criteria are important components for long-term risk management, hence form part of our investment process.

Stewardship

Companies are intrinsically linked to the economies (and societies) in which they operate, hence the importance of working with them through effective stewardship.

Solutions

As active owners we design innovative products and solutions that directly address some of society’s biggest challenges.

Help people and institutions positively influence change to achieve financial goals

Disclosure:
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