LGIMA's Pension Solutions' Monitor

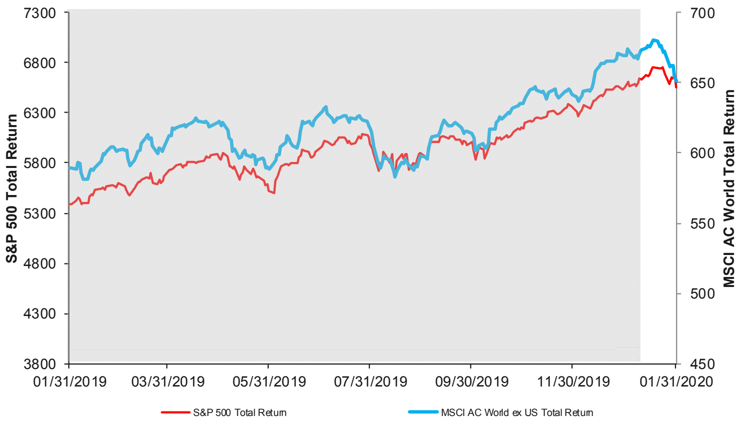
January 2020 Market Update

Overview

Pension funding ratios decreased throughout the month of January, with changes mainly attributed to lower Treasury yields. We estimate that the average plan's funding ratio decreased 3.5% to 79.7% throughout the month.

Global equities

Equity investors of late are not accustomed to months of negative (or even flat) performance - prior to this month, 29 of the last 36 months closed positive with 22 having returned more than 1%. On the month, the S&P 500 returned -0.04% while still convincingly outperforming both international stocks and domestic small caps. Most notably, Chinese and Asian indices felt the pain of the coronavirus and fears of slowing growth.

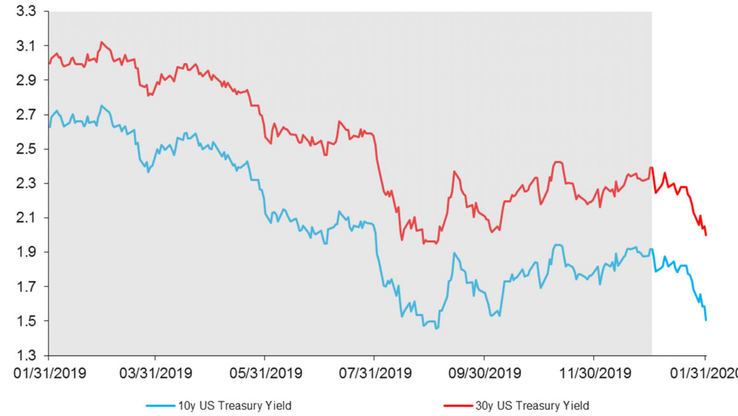


Source: Bloomberg/Barclays and LGIMA as of 01/31/20.

While stock markets have fallen from highs this past month, financial conditions, as measured for instance by the Bloomberg or Goldman Sachs U.S. financial conditions indices, remain (and continue to trend more) accommodative, while PMIs appear to be tentatively turning the corner both domestically and globally. That said, these developments do not fully account for the coronavirus, the impact of which on China and – through its share of global commodity demand and importance in inter-connected global supply chains – the rest of the world is yet to unfold and flow through economic data. Reflecting such concerns, implied volatility has picked up meaningfully, trading in the +80th percentile (rolling one-year) across a range of strikes and maturities.

Interest rates

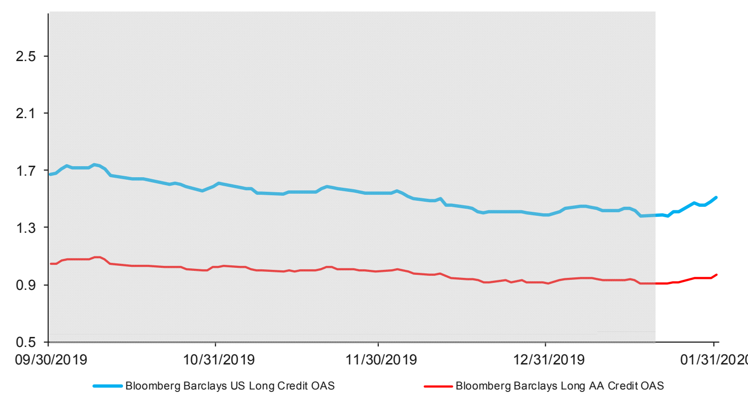
Long-end rates in the U.S. dropped nearly 40 basis points in January, fueled by geopolitical events, weak data, and most importantly, uncertainty around the coronavirus. The 30-year Treasury rate closed out 2019 at 2.39 as rates rose on a reflationary note with President Trump's announcement that the U.S. would sign a Phase One trade agreement on January 15th. 2020 got off to a rocky start as a U.S. drone strike in Baghdad killed Iranian General Soleimani, sparking fears of retaliation as the U.S 30-year rate dropped to 2.24 and oil jump 3-4% higher. ISM printed at 47.2, the lowest since 2009, hourly earnings growth in the December employment report came in at 0.1% versus the 0.3% consensus, and both CPI and PPI prints were disappointing. Although the Phase One deal was signed as planned on January 15th, there are already worries about reaching an agreement for Phase Two and virtually all tariffs are still in place. Rates dropped steadily once the coronavirus headlines started hitting around January 21. New coronavirus headlines have been steadily streaming in on a daily basis. Infections in the U.S. and in other countries have been confirmed, along with person-to-person disease transmission. China shut down their stock market for over a week. Major airlines have suspended flights to/from China. There was a brief respite from the rally when a company in Hong Kong announced they may have a vaccine, but it will still take time to test it. The January Federal Open Market Committee (FOMC) meeting was essentially a non-event, particularly in light of the coronavirus news. The Fed stayed on hold as expected and raised IOER 5 basis points to 1.6%. They also announced that they will continue buying Treasury bills into Q2 and extend their repo lending “at least” through April. A day after the FOMC meeting the World Health Organization declared the coronavirus a global health emergency. On the last day of the month the 30-year Treasury rate dipped below 2% intraday for the first time since October and closed out the month at 2%.



Source: Bloomberg/Barclays and LGIMA as of 01/31/20.

Credit

While the month of January was full of global fears, the investment grade credit market remained resilient up to a certain point. However, the outbreak of the coronavirus was the straw that broke the camel’s back. The month also provided headwinds via geopolitical headlines, which ranged from escalating Middle East tensions to the U.S. Presidential impeachment trial. Strong U.S. economic data and robust corporate bond demand helped keep credit spreads intact; however, the spreading coronavirus pushed the market significantly wider thereafter. The U.S. long duration credit index widened 12 basis points over the month, ending at 151 basis points as of January 31st. Although January didn’t offer as bright of an outlook as we would have liked, the headline risk has recently slowed. Tensions between the U.S. and Iran have softened, and the coronavirus outbreak in Wuhan is currently showing signs of deceleration. With the Fed confirming rates on hold for the foreseeable future and the U.S. economy growing at a ~2% trend pace, investors appear to be back in rally mode.

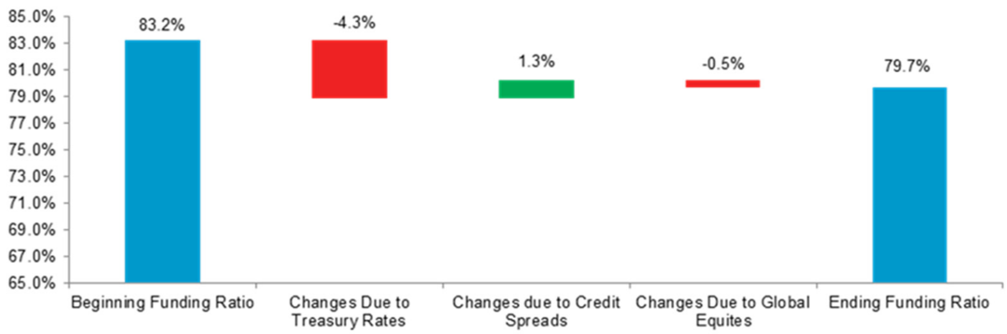


Source: Bloomberg/Barclays and LGIMA as of 01/31/20.

Approximately two-thirds of U.S. IG public issuers have reported 4Q19 results, and earnings growth is currently tracking close to flat at -0.2%. The current earnings growth is tracking noticeably higher than the initial -1.7% estimated loss in the beginning of the season. In terms of market technicals, supply for January had outpaced 2019’s issuance by ~19%. This increase in supply, however, was met with a strong appetite for fixed income, as robust bond fund inflows to U.S. IG Credit throughout January have been supportive of the market. Looking to February, estimated issuance is expected to range from $100-110 billion, while demand for IG credit should remain strong. It's possible to see some yield sensitive buyers on the sidelines as interest rates plummeted in January; however, investors can't forgo the U.S. corporate bond market entirely in an environment of ~$14 trillion global negative yielding debt.

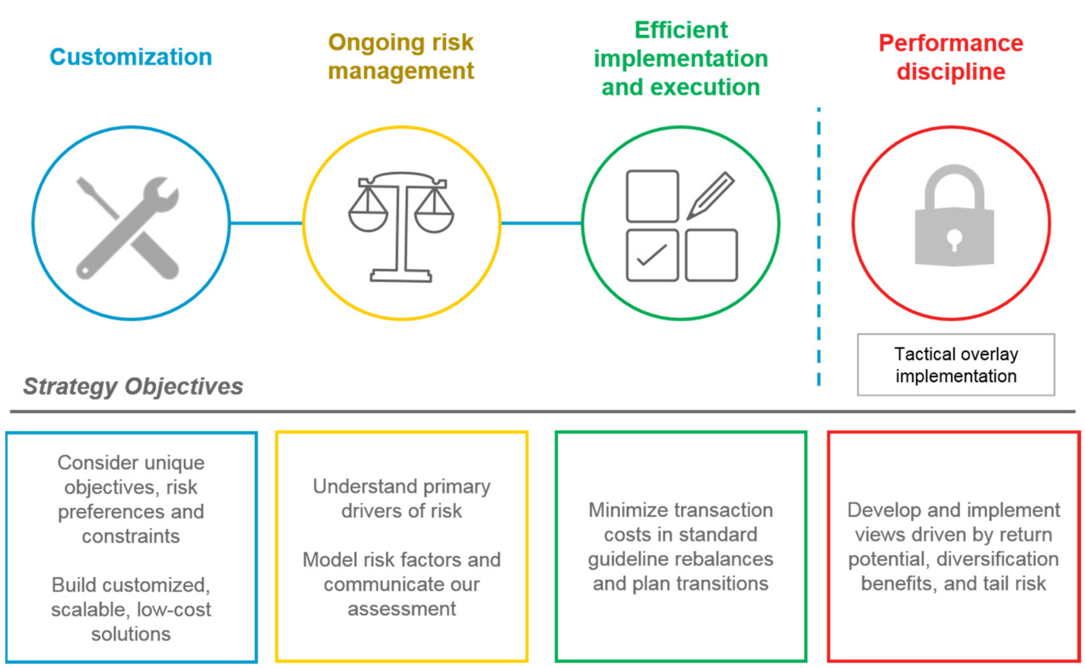
Funding status monitor

LGIMA estimates that pension funding ratios decreased throughout January, with changes attributed to decreasing Treasury yields. Our calculations indicate the discount rate's Treasury component fell by 38 basis points while the credit component widened 10 basis points, resulting in a net decrease of 28 basis points.[1] Overall, liabilities for the average plan increased 4.56%, while plan assets with a traditional "60/40" asset allocation increased by ~0.12%.[2]



1 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.
2 For the average plan, LGIMA assumes a 60% allocation to MSCI AC World and a 40% allocation to Barclays Aggregate.

Overlay investment process



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