Overview

Pension funding ratios increased throughout the month of October, driven primarily by the rise in US Treasury yields and Global Equity performance. We estimate that the average plan’s funding ratio increased 1.0% to 80.2% through October.

Global equities

Equity markets closed out October at all-time highs on several positive signals, including the removal of a no-deal Brexit outcome, a US and China phase one trade deal, and (so far) immaterial impacts from various large-scale protests around the world. Additionally, returns were supported by many S&P 500 companies beating previously lowered earnings expectations.

While short-term performance has been strong, global central banks confirmed their dovish views in wake of slowing economic data. In the US, manufacturing indicators, such as the Institute for Supply Management’s manufacturing purchasing managers’ index (PMI), remain near three-year lows while both job growth and consumer confidence fell. The trade war, while producing positive headlines, has hurt countries in the EU, most notably Germany. Similar to the US, labor markets are experiencing deceleration and declining consumer confidence. Turning to Asia, China’s weaker growth outlook (evident in lower y/y real GDP growth) is fueling its own fall in imports, but China continues to receive ample support from the People’s Bank of China, mitigating negative trade war impacts thus far.

Interest rates

The US Treasury curve twist steepened in October, as the front-end rallied into month-end, while the long-end sold off on positive news related to US-China trade relations and Brexit sentiment. Although the month-over-month changes were relatively small, there was a decent amount of inter-month volatility. October got off to a rough start. After a selloff overnight during the Tokyo session due to the JGB auction, rates quickly reversed course as ISM manufacturing printed 47.8, its lowest level since June 2009. This figure indicates that the US economy might not be able to escape the effects of a global manufacturing slump. Data disappointment continued as ISM non-
manufacturing and UK/EU PMI numbers came in lower than consensus. Job growth continued at a steady pace and unemployment came in at 3.5%, 0.2% lower than anticipated. However, average hourly earnings failed to show any growth, dragging the year-over-year growth down to 2.9%. The 30-year Treasury rate rallied from the month-end level of 2.11% to 2.01%, while the 5-year Treasury rate rallied 20 basis points to 1.35%. Sentiment quickly reversed course as a steady stream of US-China trade related updates were released. The news is seemingly pointed towards a partial trade agreement, pushing the long-end rate up to 2.23%. From there, rates traded sideways until October 28, when it was announced that the UK had been granted another Brexit extension. This extension moved the deadline to January 31, 2020, and the 30-year rate sold off to 2.33%. Going into the FOMC meeting on October 31, rates rallied overnight from foreign buying, specifically in Japan. The Fed delivered another hawkish cut, lowering the target rate by 25 basis points and changing the phrasing related to their sentiment moving forward. Some interpreted this as the Fed hoping the accommodation up to this point would be enough to keep the economy growing at a modest pace.

**Credit**

Throughout October, the US Credit market rallied as the long credit index tightened seven basis points to 161. A confluence of higher Treasury yields, lighter than expected primary issuance, better than expected earnings, and developments on trade and Brexit all contributed to the rally. Although the beginning of the month reported weak ISM manufacturing and services numbers, a variety of other economic readings – such as strong private sector job growth and low inflation – contributed to a relatively more positive macroeconomic backdrop at the end of October.

The Fed cut rates by 25 basis points for the third time this year, but the decision was seemingly paired with a pause on further FOMC accommodation. Fed Chairman Powell was quoted stating it would take a “material reassessment” of the Fed’s economic outlook to justify additional rate cuts. December rate easing has been almost fully priced out of the market; however, another rate reduction is expected by consensus to occur by this time next year.
With respect to bond market technicals, $62bn U.S. Investment Grade supply was issued in October, down from $145bn in September. The decline in supply was also met with a lower amount of demand, as domestic investors were reluctant to add risk. However, bond funds and ETF investors continued to show appetite for IG credit, as weekly bond inflows have remained stable at a relatively high level. For November, a wide range of supply is expected with M&A issuance as the wild-card, where estimates range from $80-$120bn in issuance.

LGIMA estimates that pension funding ratios increased throughout October, with changes driven primarily by the rise in US Treasury yields and Global Equity performance. Our calculations indicate the discount rate’s Treasury component increased by five basis points while the credit component tightened seven basis points, resulting in a net decrease of two basis points. Overall, liabilities for the average plan increased 0.51%, while plan assets with a traditional “60/40” asset allocation increased by ~1.78%.

2: For the average plan LGIMA assumes a 60% allocation to MSCI AC World and a 40% allocation to Barclays Aggregate.
LGIMA can offer an attractive customized pooled fund solution to efficiently hedge interest rate and credit spread exposure at a competitive cost for smaller plans.

- Portfolio allocations are rebalanced on a quarterly basis to ensure the strategy continues to meet plan objectives.

**Client overview**

**Asset and Liability Summary**
- Liabilities: $100mm
- Assets: $100mm
- 30% RSA / 70% LHA
- Duration: ~11.5 years

**Target Hedge Rations**
- 40% CSHR
- 100% IRHR

**Client solution**

- Liability Corporate Fund 32%
- Liability Treasury Fund 0%
- Liability Treasury 3X Fund 20%
- Long Liability Corporate Fund 29%
- Long Liability Treasury Fund 4%
- Long Liability Treasury 2X Fund 16%

Target duration and credit exposure is achieved
Curve mismatch reduced

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