LGIMA's Pension Solutions' Monitor

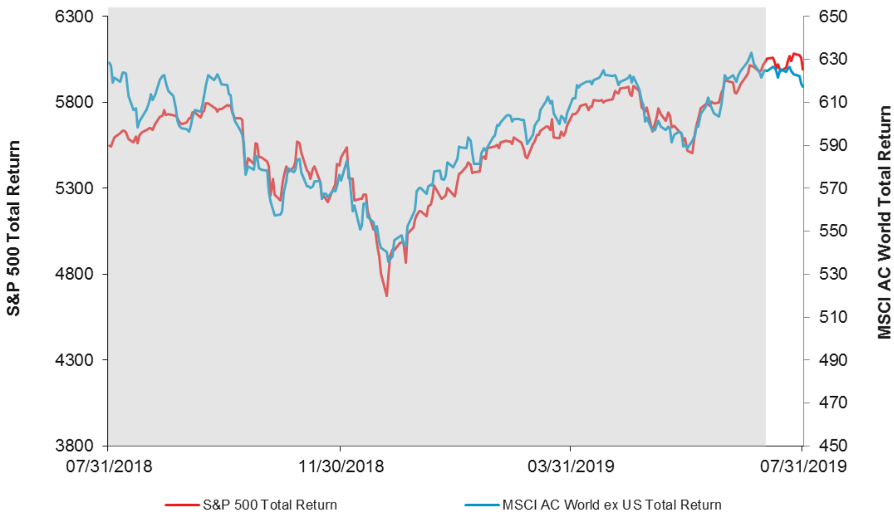
July 2019 Market Update

Overview

Pension funding ratios decreased throughout the month of July, primarily driven by tightening credit spreads, resulting in a decrease in the discount rate. We estimate that the average plan's funding ratio fell 0.8% to 82.3% through July.

Global equities

US equities continued their strong performance last month with the S&P 500 hitting all-time highs. Returns were accredited to improved economic data, stable initial reported corporate earnings, and the anticipation of the US Fed lowering rates and taking a more dovish approach moving forward. While the S&P 500 Total Return index closed the month up 1.4%, it fell by 1.1% on July 31 when Fed Chair Powell, after cutting rates 25 basis points, stated that this reduction was not the beginning of a "lengthy cutting cycle."



Source: Bloomberg/Barclays and LGIMA as of 7/31/19.

International equities fell over the month, with Europe digesting poor economic and business sentiment data, the UK consensus moving towards a no-deal Brexit expectation, and slowing growth data in China. While global central bank actions appear to be supportive of risk assets, most notably the ECB's soft signaling of more quantitative easing, the US reaction to Fed policy implies that much of this impact may already be priced into the market.

Interest rates

The rates market once again took its cues from the central bank. Echoing sentiments other members had voiced in June speeches, Fed Chair Powell's comments before Congress at the Humphrey Hawkins meeting emphasized concerns over trade issues, slowing global growth, and inflation trending below target. This testimony, coupled with the release of the June FOMC minutes, set the groundwork for the first Fed cut since the financial crisis. At the July 31 meeting, the Fed cut interest rates by 25 basis points and ended their balance sheet runoff two months earlier than planned. While this could be seen as a dovish signal, the ensuing press conference had a more hawkish tone, as Powell said the committee is "thinking of [the cut] as a mid-cycle adjustment."

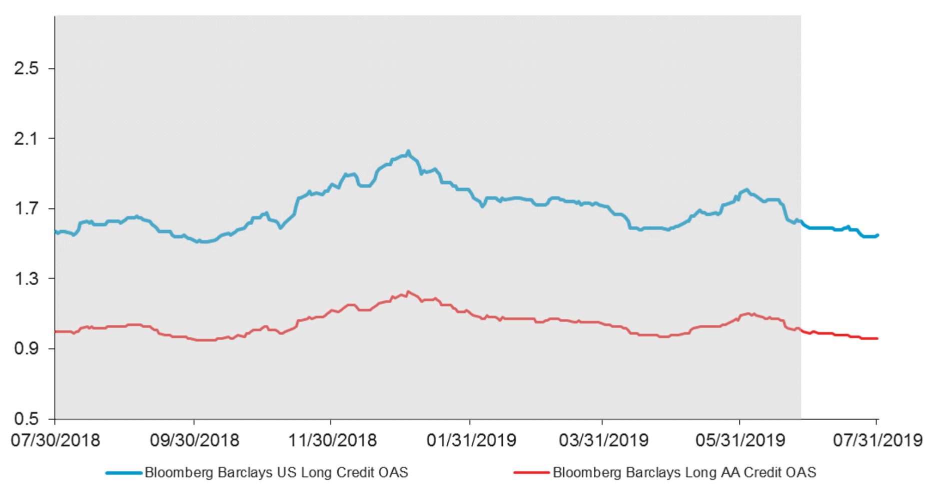
Additionally, two members dissented and opposed the rate cut. The front end sold off and the 2s30s curve flattened 8 basis points. The 30-year treasury rate closed out the month at 2.52 while the 2-year rate was at 1.87.

Data releases in July were mostly disappointing, including misses in factory orders, durable goods, ISM services, and Chicago PMI. Although the Fed stressed "contemplative" forward guidance, the market is already pricing in 1-2 additional cuts before the end of the year.

Source: Bloomberg/Barclays and LGIMA as of 7/31/19.

Credit

Investment grade credit has continued to trend in a positive direction throughout July, as the US Long Credit index has tightened to 155 basis points (6 basis points tighter through July). Credit spreads have been range-bound over the past few weeks as the market is currently uniquely positioned. Improved economic data with respect to retail sales and manufacturing surveys, in addition to a higher than expected Q2 GDP reading and high consumer confidence, is positive for the macro outlook. However, at the July FOMC meeting, the Fed cut rates by 25 basis points, even in the presence of strong fundamentals. Geopolitical risks further complicate the macroeconomic situation as a potential "No-Deal-Brexit" is on the horizon, the trade war with China looms on, and Iranian sanctions are still in place. Until there is further clarity on the direction of US/China trade developments, the market could remain in a holding pattern.



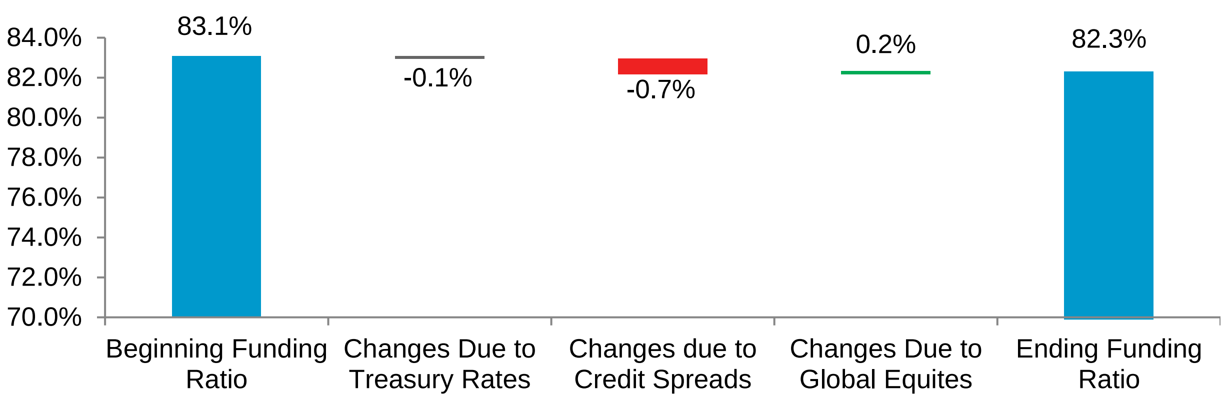
Source: Bloomberg/Barclays and LGIMA as of 7/31/19.

From a supply/demand perspective, the corporate bond market has been operating in a positive technical environment. Issuance over the month of July stood at $90 billion, bringing year-to-date supply to $664 billion, approximately 7%

behind last year's pace. The market saw less-than-expected issuance in the first two weeks of the month and technicals remain positive as foreign investor appetite has increased, mutual fund inflows remain elevated, and dealer inventory is relatively low to facilitate bond liquidity.

Funding status monitor

LGIMA estimates that pension funding ratios decreased throughout July, with losses driven primarily by tightening credit spreads. LGIMA estimates the discount rate's Treasury component increased by 1 basis point while the credit component tightened 7 basis points, resulting in a net decrease of 6 basis points[1]. The negative impact due to the change in Treasury rates is a function of positive carry of the liabilities. Overall, liabilities for the average plan increased 1.21%, while plan assets with a traditional "60/40" asset allocation[2] increased by ~0.28%.



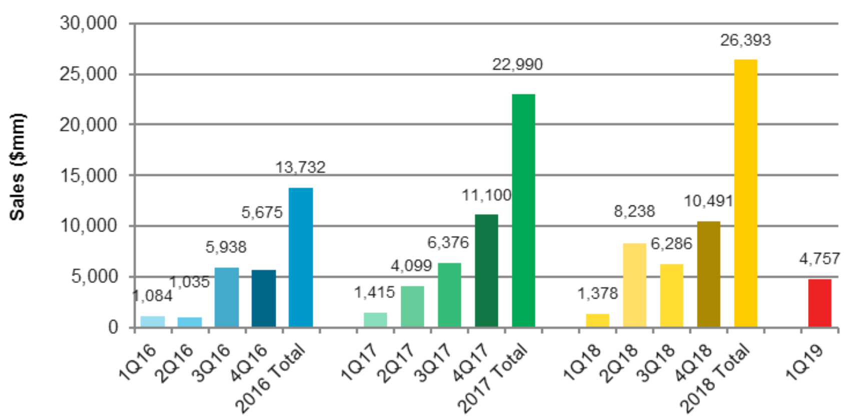
[1]Discount rates based on a blend of the Intercontinental Exchange US Pension Plan AAA-A and Intercontinental Exchange Mature US Pension Plan AAA-A discount curves

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

Market Trends in the DB Marketplace

- There has been a growing trend in pension risk transfer activity across the defined benefit space
- Plan sponsors want to proactively deal with the cost and volatility of their pension plans
- LGIMA has aggregated some industry data to provide a snapshot of the end-game market as it stands today
- We maintain a strong commitment to working with plans as they move towards and transition into either buyout solutions or self-sufficiency strategies

Annuity Buyout Activity*



*Source: LIMRA Secure Retirement Institute. As of March 31, 2019.