Overview
Pension funding ratios increased throughout the month of September, primarily driven by an increase in US Treasury rates and Global Equity performance. We estimate that the average plan’s funding ratio increased 2.3% to 79.2% through September.

Global equities
Global equity markets remained strong (+2.15%) through a September of headlines heralding a variety of potential risks, many of which were either ignored by equity investors or have since abated - US repo market stress, Middle East tension, ECB monetary stimulus, equity factor return reversals, a discordant Fed, and impeachment talk. Amidst the news cycle chaos, US markets returned 1.9% and Chinese markets remained largely unchanged while equity markets in Mexico, Brazil, Germany, India, and Japan all returned over 2.5%. Over the month, global central banks continued to ease financial conditions and US retail sales and inventories stabilized, implying that the path to short-term global growth will likely be determined by the outcomes of Brexit (deal or no deal) and the US-China trade war.

Interest rates
In September, interest rate movements proved to be just as volatile in a selloff as they were in August’s rally. To recap the movements this year, the 30-year Treasury rate started the year at 3% and hovered around that level until March. From March to the end of July, this increased to 2.60% and by the end of August, it saw an all-time low of 1.90%. Since then, the 30-year Treasury rate sold off to an intra-month high of 2.38% before rallying back to close out the month at 2.11%.

September started with strong prints in ADP and ISM non-manufacturing coupled with an interview from Treasury Secretary Mnuchin highlighting progress in trade negotiations with China, causing a rise in rates. The following week, a new stimulus package from the ECB caused rates to (briefly) fall, until the President tweeted that he was open to negotiating an interim trade deal with China. Strong retail sales continued to push rates higher and the 30-year Treasury rate reached 2.38% by September 13. The following week, the repo markets experienced turmoil as a combination of lower reserve balances, corporate tax day, and the settlement of new Treasury issuance reduced liquidity.
Overnight repo traded as high as 10% while the SOFR rate hit a record high of 5.25%. Uncertainty in the market caused the NY Fed to step in and open a temporary repo operation (the first since 2008) to add necessary liquidity. The September FOMC meeting Wednesday produced another hawkish cut as the Fed cut their target rate range 25 basis points to 1.75-2.00 and lowered IOER 30 basis points to 1.80. The statement was little changed from last month and the Fed acknowledged that job growth remains solid and household spending is up, but business investment has weakened while inflation remains below target. More notable, however, was that while Bullard dissented in favor of a 50 basis point cut (rather than 25 basis points), two others dissented in favor of no change. This is the first time in recent memory that there have been dissenting opinions in opposing directions on a day the Fed took action. Since then, rates have been moving lower on weak data out of Europe and increased tensions over possible impeachment proceedings. US-China trade talks are set to resume in Washington in two weeks, which should be eventful for the rates market regardless of the outcome.

Credit
The US credit market was relatively range-bound throughout the month of September, as the Long Credit index tightened three basis points to 167. Heightened geopolitical tensions in the Middle East, negative economic readings in the Eurozone, and the US/China trade war escalation continued to fuel global growth concerns.

In September, the Fed delivered a 25 basis point cut and similar set of forecasts and statement as expected. Furthermore, the Fed gave little away about the threshold for future cuts. While the dot plot remains unchanged for the balance of 2019, during the press conference, Fed Chair Jerome Powell made a personal antidote stating that he sees “a high value in sustaining the expansion.”

As for supply/demand technicals, M&A volume notably declined throughout September; however, none of the six pending deals with enterprise valued greater than $10bn appear imminent due to market concerns or regulatory hurdles. Despite consistent strength in US fund and ETF IG Credit inflows throughout 2019, we saw a slight reversal as a result of the mid-month sell-off. It is also important to note that an unexpectedly larger amount of primary issuance hit the market - issuers took advantage of low interest rates and robust demand which resulted in $145bn of supply in September, surpassing the $125-$135bn anticipated. Compared to this time last year, issuance is down ~5% YTD. Looking ahead to the month of October, corporate bond technicals appear to be favorable as the ~$80bn of issuance expected is likely to be met by continued demand both from overseas buyers and mutual fund/ETFs flows.
LGIMA estimates that pension funding ratios increased throughout September, with increases driven primarily by the rally in US Treasury yields and global equity performance. LGIMA estimates the discount rate’s Treasury component increased by 15 basis points while the credit component tightened 1 basis point, resulting in a net increase of 14 basis points. Overall, liabilities for the average plan decreased 1.85%, while plan assets with a traditional “60/40” asset allocation increased by ~1.08%.

**Return breakdown**
- The net return on the Treasury TRS is equivalent to the total return on the underlying Treasury, minus the funding cost over the maturity of the contract

**Benefits of using Treasury Total Return Swaps**

- More precision against the liability
  - There are only 6 liquid futures contracts, but 100+ bonds and STRIPS, which can afford a better yield curve match, and better convexity exposures

**To take advantage of cheaper financing costs**
- From time to time, banks may be axed to offer cheap financing on TRS/bonds may trade special on repo. This may allow us to lock in cheaper financing costs than the futures

**To avoid the futures roll/futures optionality**
- Futures must be rolled, and there can be implicit/explicit costs to doing this
- The main “cost” is the fact that the old CTD bond (particularly for the Ultra contract) can cheapen into the roll (particularly when there is a big change in maturity of the CTD), while the new CTD richens – this is akin to selling low and buying high

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