

Pension plan funded status rises as equity gains continue to recover

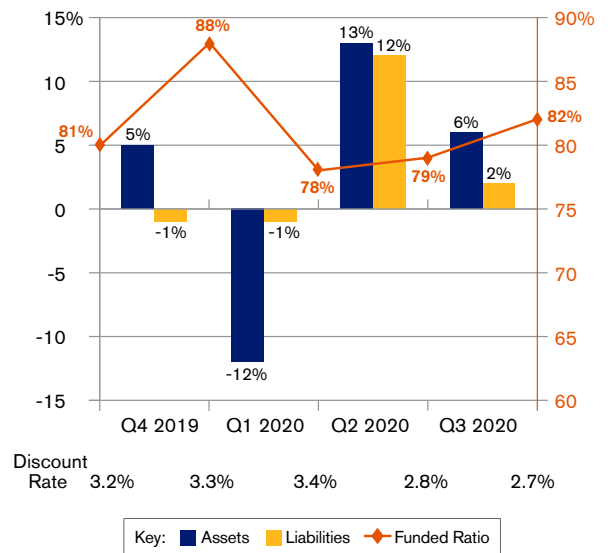
During the third quarter of 2020 (Q3), the funded status of the model pension plan examined in each issue of *Prism* improved by 3 percentage points, to 82 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 6 percent asset gain offset by a 2 percent increase in liabilities (related to a decrease in corporate bond yields, as illustrated in Graph 2).

Changes in the yield curve

High-quality corporate yields fell during Q3, decreasing by 10 basis points* — the net result of a 5 basis-point increase in U.S. nominal Treasury yields and a 15 basis-point decrease in credit spreads (see “Aspects of investment performance” on the next page for more details). This is illustrated by the above-median curves shown in Graph 2.

Any change in the shape of the yield curve could have a dissimilar impact on liabilities for plans with different maturities. (For background on yield curves, [read our primer.](#))

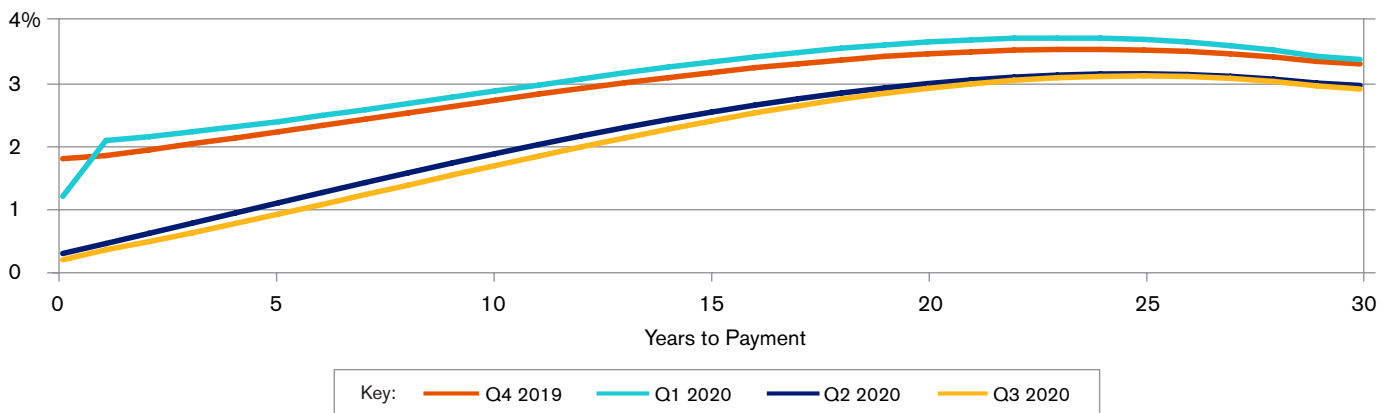
Graph 1: Change in Assets,¹ Liabilities and Funded Ratio²



¹ The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

² This is the ratio of a defined benefit (DB) plan's assets to accrued liabilities. The funded ratio data in the graph is the ratio on the last day of each quarter. In May, (after publication of the Q1 *Prism*), the funded percentage for the model DB plan was reset as of January 1, 2020, to reflect the average actual funded percentage of large pension plans.

Graph 2: Changes in the Yield Curve¹



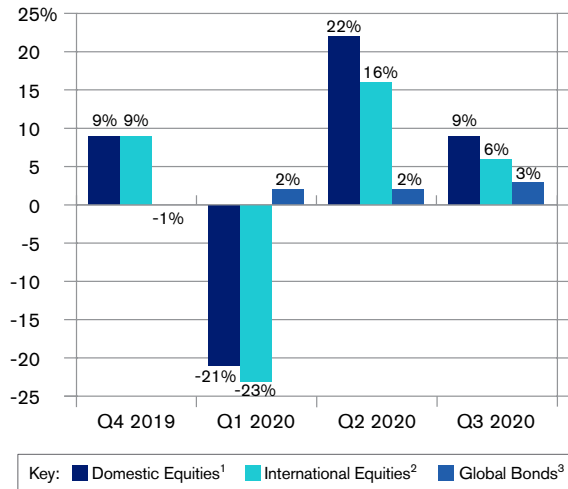
¹ This curve reflects the average yield, at each duration, for corporate bonds rated AA that have yields above the median for that duration.

* As a reminder, 10 basis points (bps) equals 0.1 percent.

Aspects of investment performance

This section discusses aspects of investment performance that contributed to the model plan's 6 percent gain in asset value in Q3.

Graph 3: Investment Performance



¹ Russell 3000

² Morgan Stanley Capital International All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.)

³ Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

During Q3, financial markets generally provided positive returns as business reopenings continued during July and August. Equity markets met some resistance in September as new COVID-19 cases surged in some parts of the country and Congress failed to agree on a new relief package.

Stock market performance was strong both domestically and internationally. U.S. equities had their best August in three decades before retreating somewhat in September. It finished the quarter up almost 10 percent, outpacing both developed international and emerging market equities. Internationally, emerging markets outperformed developed markets although both performed well. Domestically, large caps beat small caps, and growth stocks beat value stocks.

Fixed income returns were slightly positive domestically. Aided by a depreciating U.S. dollar, international bonds

outperformed U.S. bonds. U.S. Treasury yields were again remarkably stable over the course of the quarter, with yields ending the quarter slightly higher than where they began at most maturities. As a result, U.S. government bond returns were nearly flat for the quarter. U.S. investment-grade credit provided positive returns as credit spreads rallied during the quarter. The Federal Open Market Committee (FOMC) decided to maintain the target range for the federal funds rate at 0 to 0.25 percent. FOMC further signaled that the target range could remain near zero for an extended period. The yield on the 10-year Treasury note ended the quarter at 0.69 percent.

Important: examine your own DB plan's experience

Plan sponsors should examine changes in their own DB plans' assets, liabilities and funded ratios from the vantage point of both accounting and funding metrics.* Segal Marco Advisors and Segal can help employers project their DB plans' funded ratios through:

- **Deterministic modeling**, which projects results under a specific set of assumptions but does not offer insight into the likelihood of these outcomes; and
- **Stochastic asset-liability modeling (ALM)**, which offers a more complete view of the range of a plan's possible future statuses and can act as an early warning sign of potential challenges through a long-term time horizon.

* Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

For more information about how ALM can help you manage your plan, contact your Segal Marco Advisors investment consultant or your Segal retirement consultant — or get in touch with us via our websites: segalmarco.com and segalco.com.

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