Prism

First Quarter 2022 Pension Plan Experience

Pension Plan Funded Status Rises as Decrease in Liabilities Outpaces Poor Investment Performance

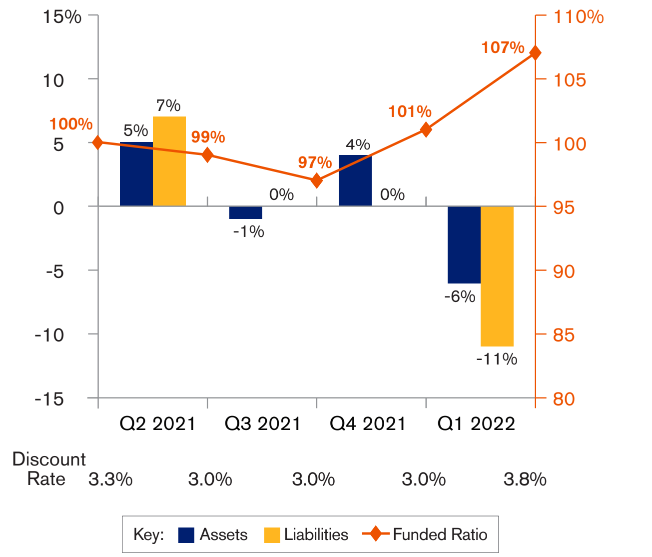
During the first quarter of 2022 (Q1), the funded status of the model pension plan examined in each issue of *Prism* rose by 6 percentage points, to 107 percent. (See Graph 1.) This increase in funded status is primarily attributable to a 11 percent decrease in liabilities, partially offset by a 6 percent decrease in assets.

Changes in the yield curve

High-quality corporate bond yields rose by 95 basis points during Q1 — the net result of a 15 basis-point increase in credit spreads and a 80 basis-point increase in U.S. nominal Treasury yields (see "Aspects of investment performance" on the next page for more details). This is illustrated in Graph 2 by the above-median curves.

Plans' liabilities are measured with the yield curve, determined by reference to high-quality corporate bond yields. Changes in the shape of the yield curve may have varying impact on plans' liabilities based on their maturity. (For background on yield curves, read our primer.)

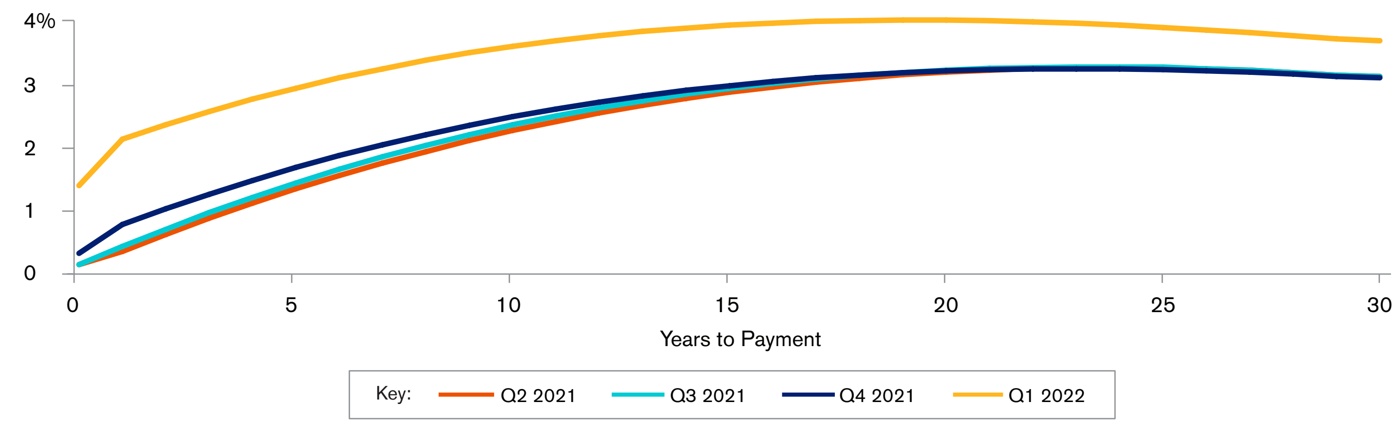
Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



[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 2021, the funded percentage for the model DB plan was reset as of January 1, 2021, to reflect the average actual funded percentage of large pension plans.

Graph 2: Changes in the Yield Curve[1]



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

About *Prism*

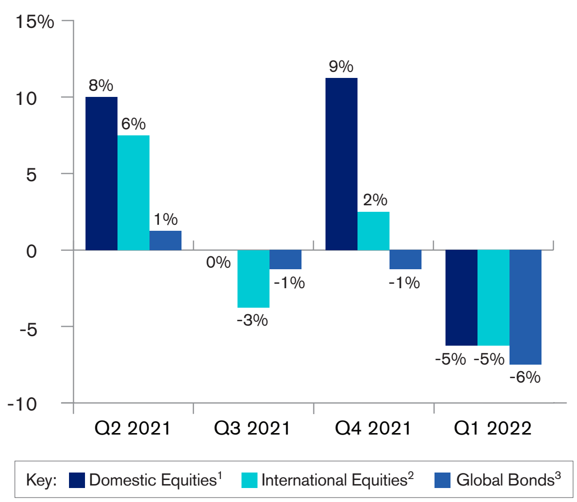
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on perhaps the most important financial metric to plan sponsors: the plan's funded status.**

Aspects of investment performance

This section discusses aspects of investment performance illustrated in Graph 3 that contributed to the model plan's 6 percent loss in asset value in Q1.

Equity and fixed income returns were negative across the board during Q1, as Russia's invasion of Ukraine and relentlessly increasing inflation readings globally dominated headlines. U.S. equity markets had their worst performance since Q1 2020 (when COVID-19 lockdowns began), with March providing slightly positive returns, which could not offset the negative returns during the first two months of the quarter. Developed international and emerging market equities also posted their worst quarter since the onset of the COVID-19 pandemic, with both geographies underperforming U.S. equities for a fifth consecutive quarter. Emerging markets were the laggard among equities for the quarter as both Russian and Ukrainian stocks were hit hard.

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

Non-U.S. stocks were hurt a bit by the U.S. dollar's appreciation during the quarter. Domestically, large-cap stocks outperformed small-cap stocks for the quarter, and value outperformed growth.

Fixed income returns were poor both domestically and internationally as interest rates soared across the globe. International bonds faced further headwinds due partially to the strengthening U.S. dollar.

U.S. Treasury yields moved higher across the maturity spectrum, and investment-grade credit spreads widened slightly. As a result, U.S. government and investment-grade bond returns performed very poorly, particularly long-duration bonds. In March 2022, the Federal Open Market Committee (FOMC) decided to increase the target range for the federal funds rate to 0.25 to 0.50 percent. This was the first rate hike since 2018. FOMC forward guidance indicates aggressive rate hikes during the remainder of 2022 in an effort to curb inflation that is higher than it has been in 40 years. The yield on the 10-year Treasury note ended March at 2.32 percent, up 80 basis points during Q1.

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
- **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.

To receive future issues of *Prism* and other publications of interest to employers as soon as they are available online, join our email list.

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