The Monthly Pension Review: December 2023

Late 2023 rally extends into December, pushing both fixed income and equities higher

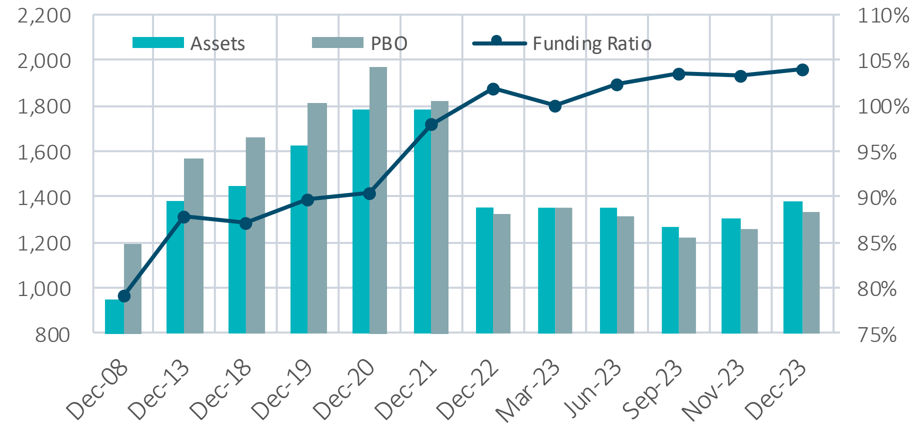
December Market Summary

- Funded status increased by 0.7% through December – Assets returned 6.1% while liabilities returned 5.4%.[1]
- Equities continue strong run – The S&P 500 Index returned 4.4% in December, as investors anticipate U.S. Federal Reserve rate cuts in the spring of 2024.
- The Long Credit Index yield fell by 52 basis points (bps) in December – Long Treasury yields fell 47 bps and credit spreads continued to tighten.

2023 Recap

- A volatile year for financial markets – Treasury yields fluctuated greatly, plummeting in March following the regional banking crisis, before climbing all summer to reach new 15-year highs in October, then falling sharply again on the back of an end-of-year rally. Long credit spreads tightened 42 bps on the year and U.S. equities gained 24.7%. The Milliman Pension Funding Index average funded status finished each month of 2023 over 100% for the first time since 2000.

Milliman Pension Funding Index (December 2023)

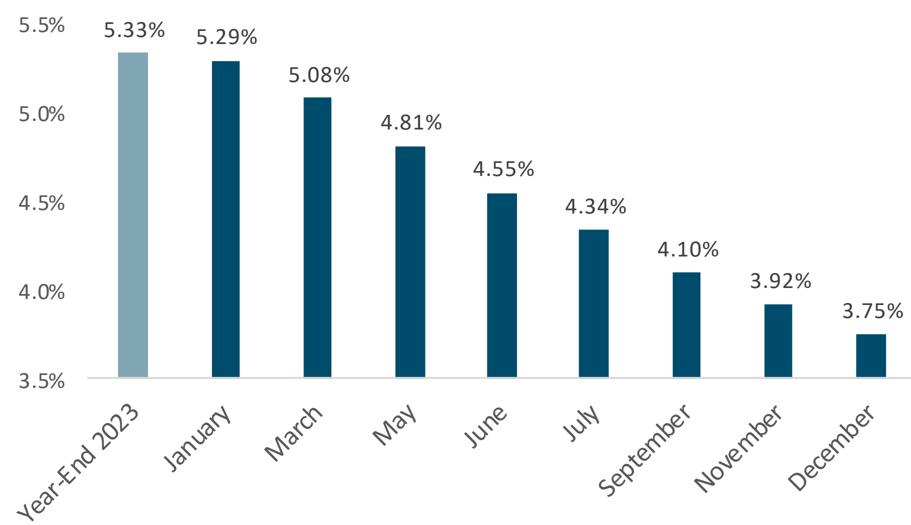


KEY THEMES FOR PLAN SPONSORS IN 2024

- Heading into 2024, macroeconomic and market outlooks are mixed, and the higher-volatility, higher-rate regime persists. We've identified four key themes for plan sponsors to focus on over the next 12 months:
- **#1 – Note the opportunity to lock in funded status gains may be limited** – As inflation moderates and the economy continues to show signs of strength, bond markets anticipate lower interest rates in 2024. Survey data reflect market expectations averaging 5.5 rate cuts next year, with the first expected at the March Federal Open Market Committee (FOMC) meeting. The implied overnight rate, which ended 2023 at 5.33%, is projected to finish 2024 at 3.75%. With the potential for rates to fall and the resultant negative impact on funded status for under-hedged plans, the opportunity to lock in recent gains may prove fleeting.
- **#2 – Identify concentration risk within portfolios** – As plan sponsors de-risk and increase fixed income allocations it is important to be aware of potential concentration risk across sectors and individual issuers. Increasingly we have seen sponsors look to asset classes outside of traditional public fixed income that still retain strong correlations to pension liabilities to add diversification within liability driven investment (LDI) portfolios – the investment grade private credit space allows plan sponsors to invest in high quality, fixed rate debt with minimal name overlap with public credit indexes.
- **#3 – Consider alternative fixed income asset classes in the intermediate duration space** – As plans de-risk and increase overall bond allocations, the duration of the fixed income portfolio typically shortens, as there is less equity exposure to offset. There are several different sectors of the intermediate duration space that plans can leverage to increase their overall asset yield. Investors may consider structured credit, private fixed income and real assets – including real estate and infrastructure debt.
- **#4 – Think about the long-term life of the plan and structure asset allocation accordingly** – Volatility remains elevated heading into 2024, as uncertainty remains about the strength of the global economy and central banks' next steps. Plan sponsors should take a long-term view when deciding on next steps for their plans. When looking to de-risk without the use of pension risk transfer (PRT), investors may consider the asset allocation framework of large insurance companies who compete in the PRT market. Global insurers have taken advantage of the illiquidity premium present in private credit and alternative investment markets. As a result, many have seen increases in their asset yields, total returns and investment income levels.

Market Watch	Dec-21	Dec-22	Nov-23	Dec-23
Funded Status (1)	97.9%	101.9%	103.2%	103.9%
FTSE Discount Rate	2.63%	4.95%	5.26%	4.76%
Long Credit Yield (2)	3.10%	5.59%	5.74%	5.22%
US 30Y TSY Yield	1.90%	3.96%	4.49%	4.03%
S&P500	4,766	3,840	4,568	4,770

Market-Implied Overnight Borrowing Rate by 2024 FOMC Meeting



*Based on monthly performance of the S&P 500 Index. Data from Bloomberg.

(1) Data from reference Bloomberg Indices. Funded status is in reference to Pension Funding Index of the top 100 US corporate pension plans sourced from Milliman.

(2) Funded Status source: Milliman. FTSE Discount Rate source: FTSE. Long Credit Yield source: Bloomberg. US 30Y TSY Yield source: Bloomberg. AAA Non-Agency CMBS and A Corporate source: Bloomberg.

(3) Past performance is not a guarantee of future results

SLC-20240109-3313316

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Market chart indices:
- AAA Non-Agency CMBS and A Corporate source: Index data from Bloomberg.

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(1) Funded Status for the current month is estimated and subject to change as final numbers are released. Data from reference Bloomberg Indices.
(2) The Long Credit yield corresponds to the Bloomberg Long Credit Index.