The Monthly Pension Review: February 2023

Funded status increases despite poor asset performance

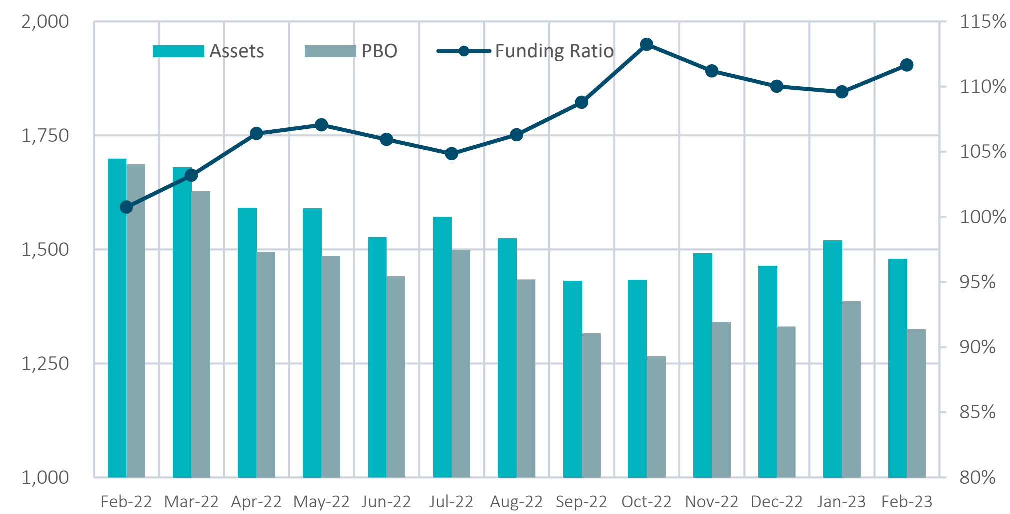
SLC Management

February Market Summary

- Despite negative performance across asset classes, funded status increased as liabilities fell – Assets returned -2.2% while liabilities decreased by -3.9%.[1]
- Equities fell while the market grappled with inflationary economic data – The S&P 500 Index returned -2.4% in February as the potential rose for continued tightening by the U.S. Federal Reserve through 2023.
- The Long Credit Index yield increased by 45 basis points (bps) in February after falling 47 bps in January – a combination of wider credit spreads and higher long term Treasury rates pushed all in Long Credit yields back to year end 2022 levels.

Market Watch [2]	Dec-21	Dec-22	Jan-23	Feb-23
Funded Status	97.9%	110.0%	109.3%	111.6%
FTSE Discount Rate	2.63%	4.95%	4.61%	5.02%
Long Credit Yield	3.10%	5.59%	5.12%	5.57%
US 30Y TSY Yield	1.90%	3.96%	3.63%	3.92%
S&P 500	4,766	3,840	4,077	3,970

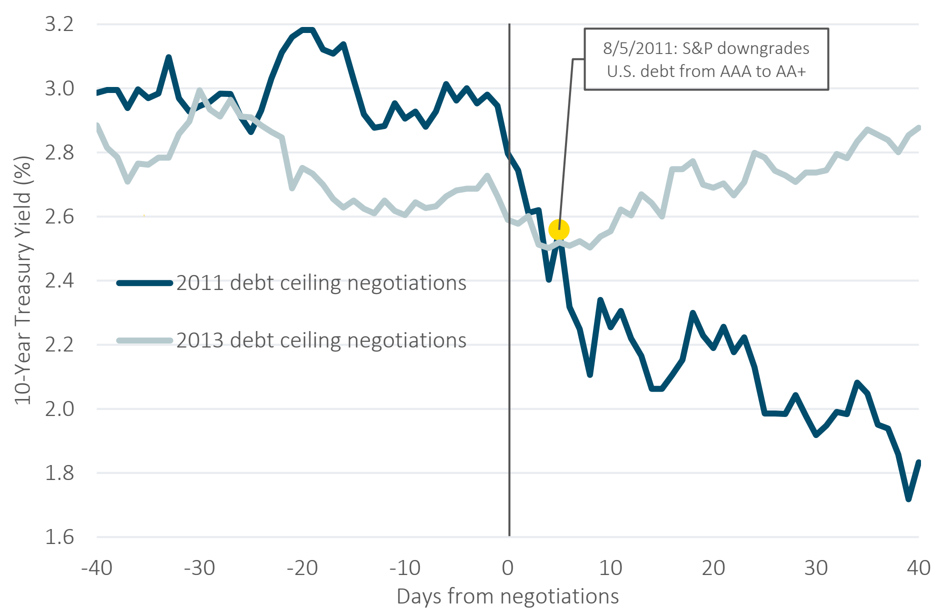
Milliman Pension Funding Index (February 2023)



SPOTLIGHT: DEBT CEILING CONCERNS FOR LDI INVESTORS

- On January 19, 2023, the U.S. hit the debt limit of $31.4 trillion, forcing the Department of Treasury to undertake “extraordinary measures” to keep expenditures flowing.
- With Republicans in control of the House and determined to receive spending cuts as part of their negotiation to raise the debt limit, this debate is very similar to the 2011 scenario.
- Compromise between the two parties seems unlikely at this point as the market appears to be ruling out a resolution until “extraordinary measures” run out sometime in late summer or early fall, possibly triggering a default as we hit the “X-date”.
- After the 2011 debate, S&P downgraded U.S. debt to AA+ from AAA, even without a missed payment. This time around, ratings agencies have implied that if the U.S. were to miss payments, the ratings would drop a notch from AA+/AAA/AAA (S&P/Moody’s/Fitch) to AA/Aa1/AA+.
- Within the U.S. Treasury market, Treasury bills and short duration notes have historically experienced the most stress as bondholders price in concerns about missed or delayed principal payments.
- Ironically, the intermediate and long part of the U.S. Treasury curve have historically rallied in reaction to these events as markets experience a flight to quality.
- For plan sponsors, the combination of a plan’s equity allocation falling as a result of the turbulence, in tandem with lower liability discount rates, could negatively impact funded status for those with large growth portfolios or unhedged duration risk.
- Carefully managing credit spread exposure will also be important as too much spread duration versus AA discount rates could result in additional funding volatility if credit spreads were to widen significantly.

10-Year Treasury rally as deadline to raise the debt ceiling approaches



Source: Bloomberg.

(1) Data from reference Bloomberg Indices. Funded status is in reference to 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. S&P 500 source: Bloomberg. Long Corporate Index source: Bloomberg.
(3) Source: J.P. Morgan Global Markets Strategy. Fund flows data from EPFR.

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Market Chart Indices:
- Long Credit Spreads sources: Bloomberg Long Credit Index
- AA pension discount rate sources: FTSE Pension Discount Curve
- Average funded status source: Milliman
- 10-Year Treasury yields source: 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.