The Monthly Pension Review: June 2024

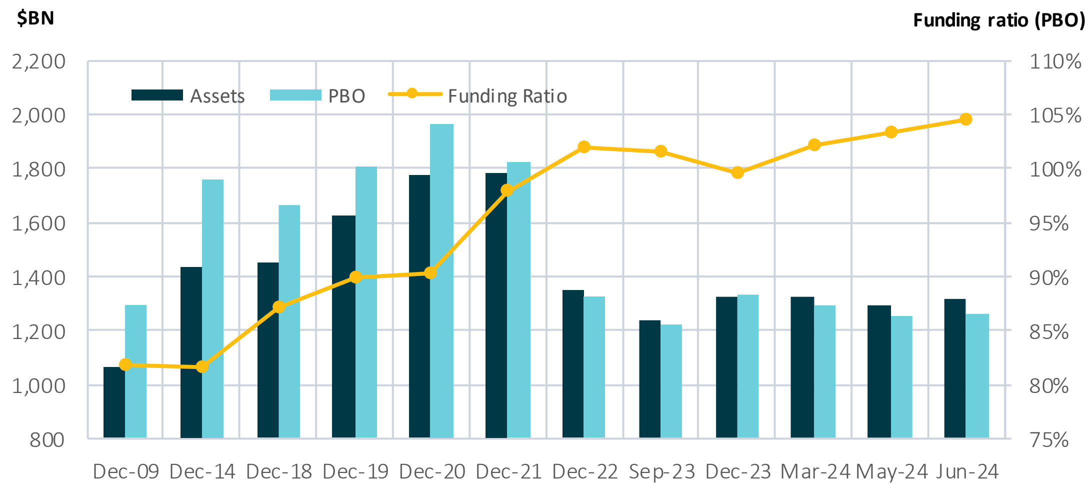
BETTER-THAN-EXPECTED INFLATION REPORT DROVE INTEREST RATES LOWER AND EQUITIES HIGHER IN JUNE

June Market Summary

- **Funded status increased by 1.1% through June** – Assets returned 1.7% while liabilities returned 0.7%.(1)
- **Equities performed well as inflation slowed** – The S&P 500 Index rose 3.5%, as investors exhibited optimism about rate cuts amid lower-than-expected inflation.
- **The Long Credit Index yield fell 1 basis point (bp) last month** – Treasury yields fell and credit spreads widened, leaving the Long Credit Index yield lower.

Market Watch	Dec-22	Dec-23	May-24	Jun-24
Funded Status (1)	101.9%	99.5%	103.4%	**104.5%**
FTSE Discount Rate	4.95%	4.76%	**5.36%**	5.29%
Long Credit Yield (2)	5.59%	5.22%	**5.71%**	5.71%
US 30Y TSY Yield	3.96%	4.03%	**4.65%**	4.56%
S&P 500	3,840	4,770	5,278	**5,460**

Milliman Pension Funding Index (June 2024)[1]



FIXED INCOME PORTFOLIO POSITIONING IMPLICATIONS FOR PENSION PLANS

The primary fixed income investment levers bond investors focus on are duration, credit, complexity and liquidity. In the current uncertain economic environment, we believe it is important to analyze how the market is compensating investors for pulling these various levers and base portfolio allocation decisions accordingly.

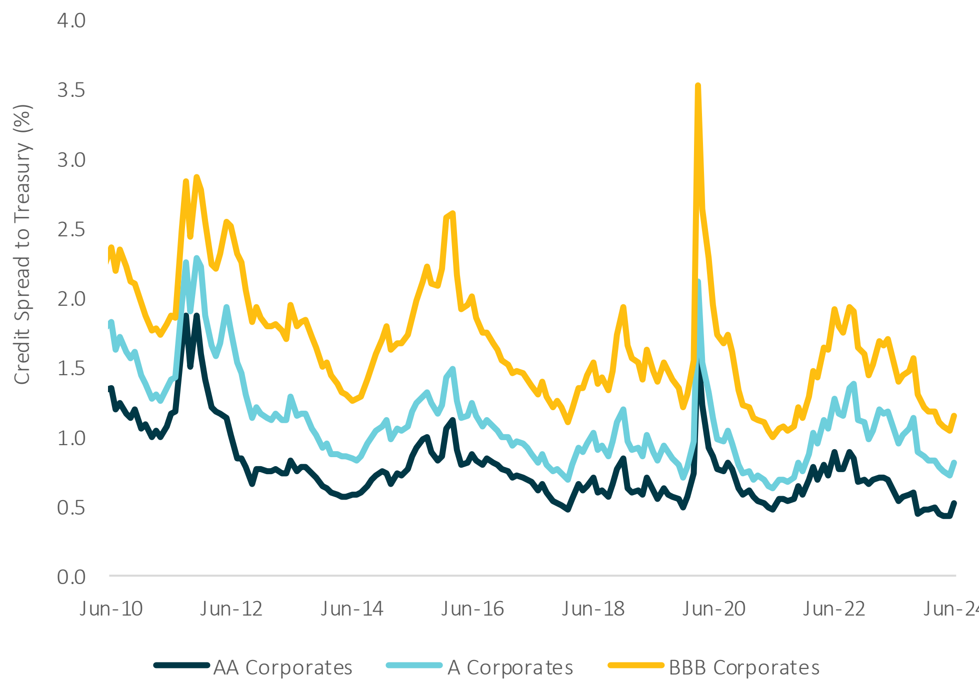
Duration: The duration lever has been challenged since the Federal Open Market Committee began hiking interest rates in March 2022. Since then, short rates have risen to a greater extent than long rates. The 2-year Treasury closed May at 4.87%, while the 30-year finished the month at 4.63%. Typically, we view the duration target for pension investors as an output of their liability hedging goals. Despite being compensated less for extending duration, we still see an appetite from plan sponsors to lock in funded status gains by buying long duration fixed income assets.

Credit: Within corporate bonds, the spread between credit ratings is tight relative to history, as displayed in the chart to the right. In the past, investors could expect a 50–70-bp pickup in credit spreads from trading out of A-rated corporates and into BBBs. That value currently sits at 33 bps. Bond investors are seeing low levels of yield pickup by adding incremental credit risk to portfolios, which may point to benefits of remaining up in credit quality, given macroeconomic uncertainties.

Complexity: We view the complexity lever as the potential for earning higher returns by investing in more complex fixed income sectors, like securitized products. Non-agency CMBS, ABS and CLOs are among such options to capture the complexity premium, as investors require expertise to properly underwrite underlying risk exposures. These sectors have performed well in 2024, and we believe there are opportunities here to increase overall asset yield while remaining in IG-rated securities.

Liquidity: Investors typically get compensated for allocating to less liquid sectors, and we currently view IG private placements as one of the most effective options to take on additional illiquidity risk. The premium for investing in IG privates is typically 30–100 bps above comparable public corporate bonds. We believe the illiquidity premium for investing in the asset class remains strong, and that DB pension plans may be able to selectively increase the average yield of their portfolios accordingly.

IG CORPORATE CREDIT SPREADS HAVE COMPRESSED



[1] Data from reference Bloomberg indices. Funded status is in reference to Pension Funding Index of the top 100 U.S. corporate pension plans sourced from Milliman. Funded Status source: Milliman. FTSE Discount Rate source: FTSE. Long credit, US 30Y TSY yield, S&P 500 index value source: Bloomberg.

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Market chart indices:

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

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