The Monthly Pension Review: July 2023

Funded status continues to increase as equities maintain torrid pace amid soft landing hopes*

July Market Summary

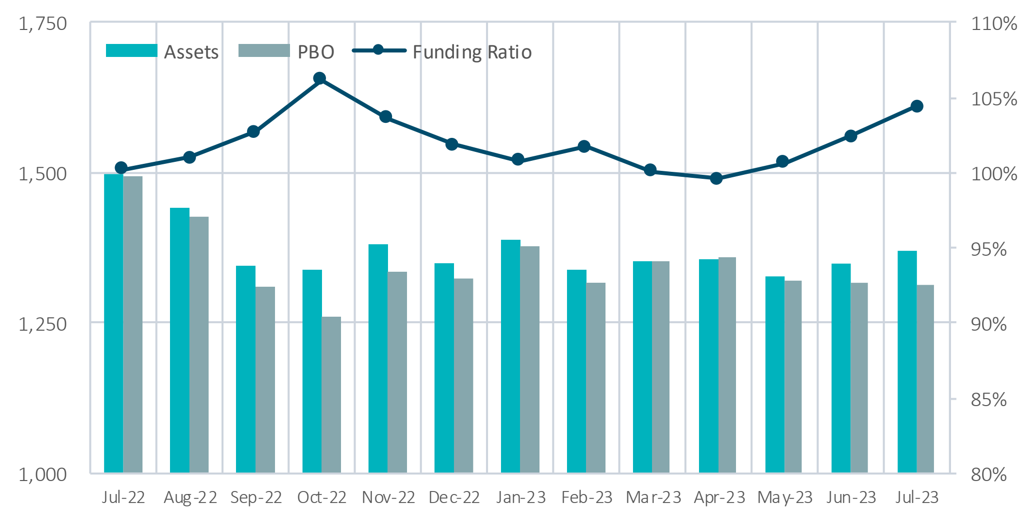
- **Funded status increases by 1.1% through July** – Assets returned 0.8% while liabilities returned -0.2%.[1]
- **Equities post fifth consecutive positive month** – The S&P 500 Index returned 3.1% in July, as excitement over artificial intelligence and a resilient U.S. economy continued to boost stocks.
- **The Long Credit Index yield rose by 5 basis points (bps) in July** – The yield increase was primarily rates driven as the 30-year Treasury rose 15 bps last month.

Market Watch [2]	Dec-21	Dec-22	Jun-23	Jul-23
Funded Status	97.9%	101.9%	102.5%	103.6%
FTSE Discount Rate	2.63%	4.95%	4.88%	4.96%
Long Credit Yield	3.10%	5.59%	5.42%	5.47%
US 30Y TSY Yield	1.90%	3.96%	3.86%	4.01%
S&P 500	4,766	3,840	4,450	4,589

SPOTLIGHT: U.S. DEBT DOWNGRADED BY FITCH

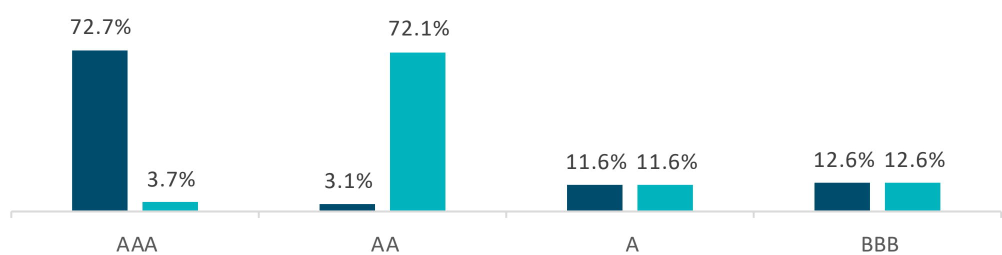
- The surprise downgrade of U.S. debt to AA+, from AAA, by Fitch Ratings seems unlikely to force any material sale of Treasuries. While not ideal for investor sentiment, it is unlikely to change the view that U.S. sovereign debt is still one of the most important and liquid global markets and a necessary tool for many plan sponsors in hedging long-dated liabilities.
- U.S. Treasury Secretary Janet Yellen commented that the rating change was based on "arbitrary and outdated data." This suggests that U.S. momentum and the forecasted view is in better shape than that the lookback period used in the decision.
- One important element in the Fitch decision is that it maintained its U.S. "country ceiling" at AAA. In other words, securities issued by municipalities, corporations or through structured products may still qualify for a AAA rating if their credit health supports it. They will not be capped at the AA+ sovereign rating the U.S. holds.
- In 2011, when S&P Global Ratings downgraded the U.S. there was some volatility in Treasuries but no significant cutback in holdings or appetite, and we expect this time to be no different. Risk markets slumped for a period following the 2011 downgrade, with the S&P 500 seeing a peak-to-trough decline of over 10%. Markets were much more muted in their response to the Fitch downgrade
- For plans holding significant allocations to Treasuries in their liability-driven investment portfolios, the only material concerns may be logistical. Plan sponsors with significant allocations to government bonds may want to check their investment management agreements to ensure that minimum ratings thresholds will likely not be breached due to the downgrade.

Milliman Pension Funding Index (July 2023)

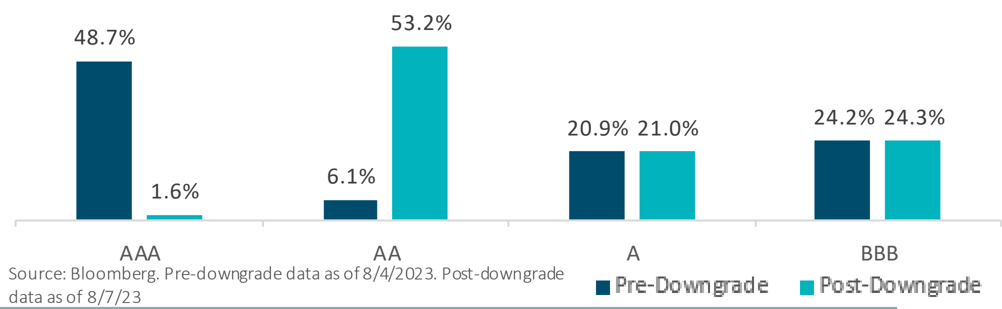


Credit rating breakout of bond indices pre- and post-downgrade

Bloomberg U.S. Aggregate



Bloomberg U.S. Long Government/Credit



Source: Bloomberg. Pre-downgrade data as of 8/4/2023. Post-downgrade data as of 8/7/23

*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.

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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.