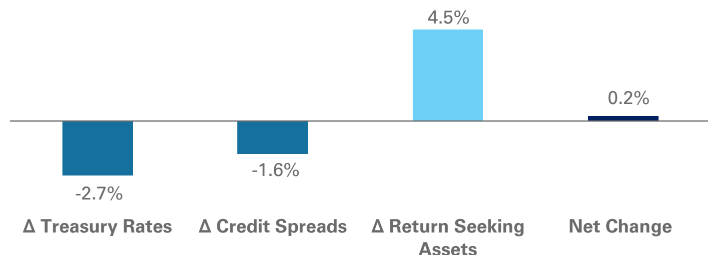
NEPC PENSION MONITOR

JULY 2022

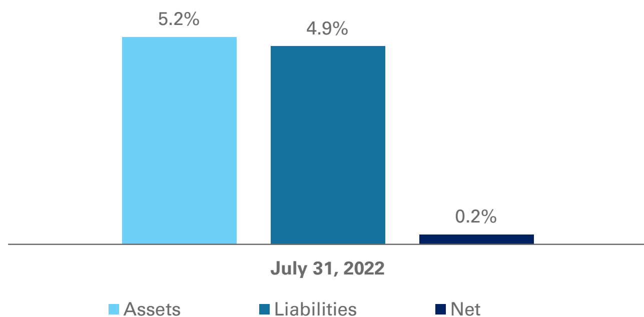
Corporate pension plans experienced modest increases in funded status in July driven by gains in equities that offset the impact of declining interest rates. Despite persistently high readings of inflation and two straight quarters of GDP contraction, U.S. stocks rallied sharply last month. The Federal Reserve hiked its benchmark rate by 75-basis points for the second consecutive time as it continues to fight inflation, leading to an inversion in the Treasury curve. LDI-allocated plans likely outpaced total-return plans due to a greater hedge amid falling discount rates for long-term Treasuries and credit spreads. NEPC's hypothetical pension plans experienced a funded status gain of 0.2% for the total-return plan compared to 1.1% for the LDI-focused plan.

HYPOTHETICAL OPEN/TOTAL-RETURN PLAN

Funded Status Attribution

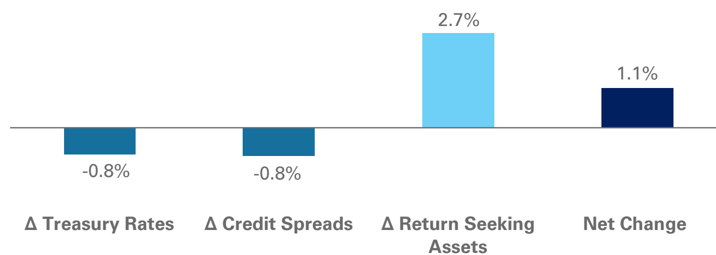


The funded status of the total-return plan stayed relatively flat as gains in equities were offset by higher liabilities.

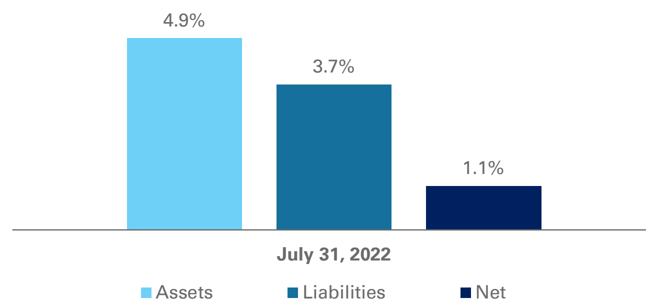


HYPOTHETICAL FROZEN/LDI-FOCUSED PLAN

Funded Status Attribution



The funded status of the LDI-focused plan increased by 1.1% due to equity gains and partial LDI hedging of the liability increase. The plan is 79% hedged, as of July 31.

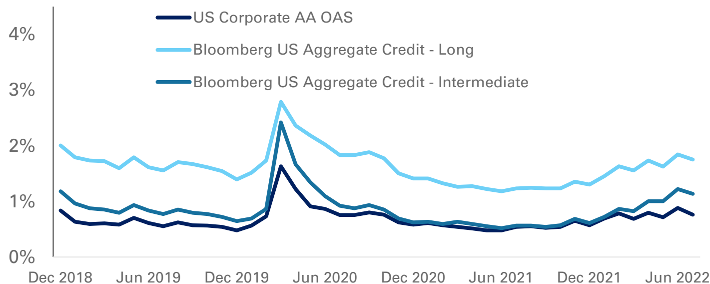


RATE MOVEMENT COMMENTARY

The Treasury curve declined at tenors greater than one year and inverted from the one-year bill to the 10-year bond in July. The 10-year yield fell 31 basis points to 2.67%, and the 30-year yield fell 14 basis points to 3%; long-credit spreads retreated nine basis points.

The movement in Treasury rates and credit spreads broadly resulted in a decline in pension effective discount rates. The discount rates for NEPC's hypothetical pension plans declined 32 to 36 basis points, with the open total-return plan rate falling to 4.34%, while the discount rate for the frozen LDI-focused plan decreased to 4.2%, respectively.

Credit Spread Movement



RETIREE BUYOUT INDEX

The Buyout Index for retirees is estimated to be approximately **103.6%** of PBO, as of July 31, 2022

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Taking Stock: Dealing with the Denominator Effect
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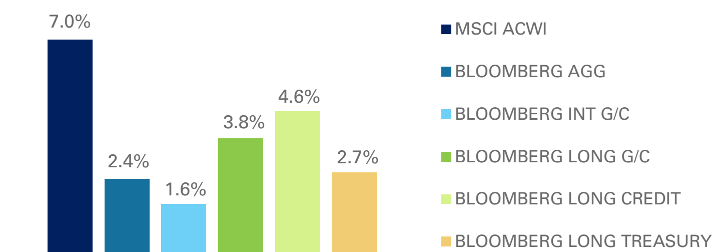
JULY 2022

PLAN SPONSOR CONSIDERATIONS

Equities were largely positive in July, bolstered by expectations that the Fed would revert to easing rates in 2023. The stock market gains were in contrast to continued high inflation, a second rate hike of 75 basis points, and a technical recession as U.S. GDP contracted for two straight quarters. At NEPC, we anticipate market volatility and the potential for disruption as the central bank continues to increase short-term rates to battle inflationary pressures. Plan sponsors should remain diligent about monitoring changes in funded status as equities and interest rates are likely to remain volatile. This includes closely watching hedge ratio ranges to avoid becoming overhedged to interest rates as yields increase.

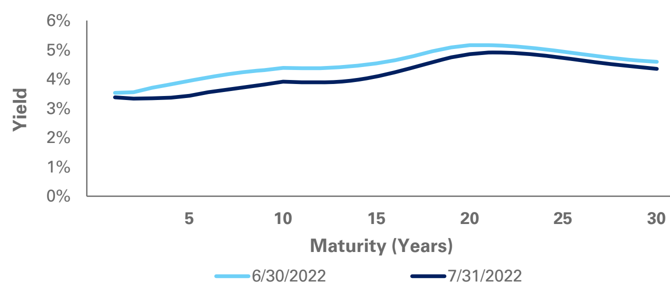
MARKET ENVIRONMENT AND YIELD CURVE MOVEMENT



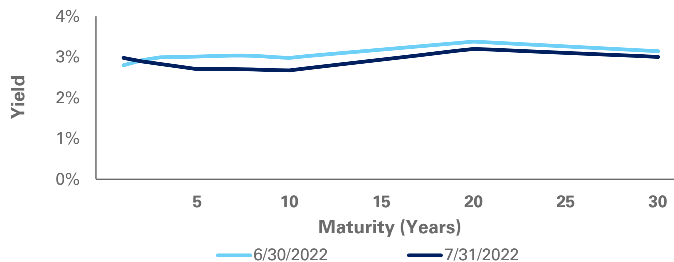
U.S. equities rallied sharply in July, with the S&P 500 Index gaining 9.2%; international developed markets also posted strong returns with the MSCI EAFE Index up 5%. However, emerging market equities decreased 0.2%, according to the MSCI EM Index; the MSCI ACWI Index returned 7% in July.

The Treasury curve flattened and inverted from the one-year to 10-year tenors as the Fed hiked short-term interest rates by 75 basis points in July. At tenors greater than one-year, the Treasury curve shifted downward and credit spreads also declined over the month. As a result, long-duration fixed income returned 2.7%, according to the Bloomberg Long Treasury Index, and the Bloomberg Long Credit Index was up 4.6% in July.

FTSE Above Median AA Pension Curve



Treasury Curve



DISCLOSURES

Liability returns are based on the FTSE Above Median Pension Discount Curve. Liabilities for the two hypothetical plans are based on sample benefit payments of two unique plans, set equal to stable duration targets as of December 31, 2018. The total-return plan reflects an open plan with a 15-year duration, while the LDI-focused plan represents a frozen plan with a 10-year duration. The benefit payments are not rolled forward each month to maintain the duration targets. No future benefit accruals or benefit payments are assumed in order to isolate the performance of plan's liabilities due to changes in interest rates. The funded status of each hypothetical plan was reset at 100% funded as of December 31, 2021.

The total-return plan assumes an allocation of 60% global equity, 40% core bonds. The LDI-focused plan assumes an asset allocation of 40% global equity and 30% long credit, 20% long Treasuries, 10% intermediate government/credit, with a greater emphasis on hedging liability duration. Monthly rebalancing is assumed. We do not assume any fees, expenses, benefit payments or contributions are made during the year in order to isolate the impact of market returns on the hypothetical allocations.

NEPC's Retiree Buyout Index is estimated using midpoint annuity purchase rates published by Brentwood Advisors, discounted against the cash flows of a sample retiree population, and compared with the same discounted cashflows using the FTSE Above Median Pension Discount Curve. Actual annuity pricing may vary substantially based on multiple factors.

Asset benchmarks used to measure asset returns are sourced from FactSet: MSCI ACWI Index, Barclays Aggregate Index, Barclays Intermediate Gov/Credit Index, Barclays Long Gov/Credit Index, Barclays Long Credit Index, Barclays Long Treasury Index, Barclays US Aggregate Intermediate Credit spread, Barclays US Aggregate Long Credit spread, and US Corporate AA Option-Adjusted Spread.

Past performance is no guarantee of future results.