The Monthly Pension Review: January 2023

Funded status falls 0.7% despite rebound in risk assets

SLC Management

January Market Summary

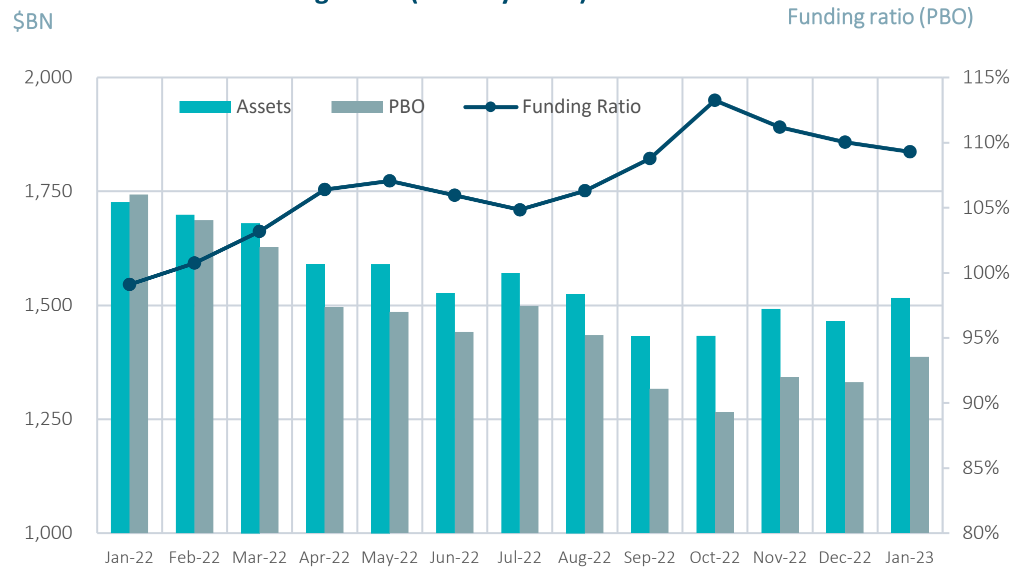
- Funded status fell for the third straight month in January despite positive investment performance – Assets returned 4.0% while liabilities increased by 4.7%.[1]
- Equities rebounded in January after a tough December to end 2022 – The S&P 500 Index returned 6.3% in January, the highest January return since 2019 and the second highest January return since 1989.
- The Long Credit Index yield declined 47 basis points (bps) in January 2023 – Credit spreads decreased 13 bps while the underlying Treasury basis fell by 35 bps.

Market Watch [2]	Dec-20	Dec-21	Dec-22	Jan-23
Funded Status	90.3%	97.9%	110.0%	109.3%
FTSE Discount Rate	2.23%	2.63%	4.95%	4.61%
Long Credit Yield	2.78%	3.10%	5.59%	5.12%
US 30Y TSY Yield	1.64%	1.90%	3.96%	3.63%
S&P 500	3,756	4,766	3,840	4,077

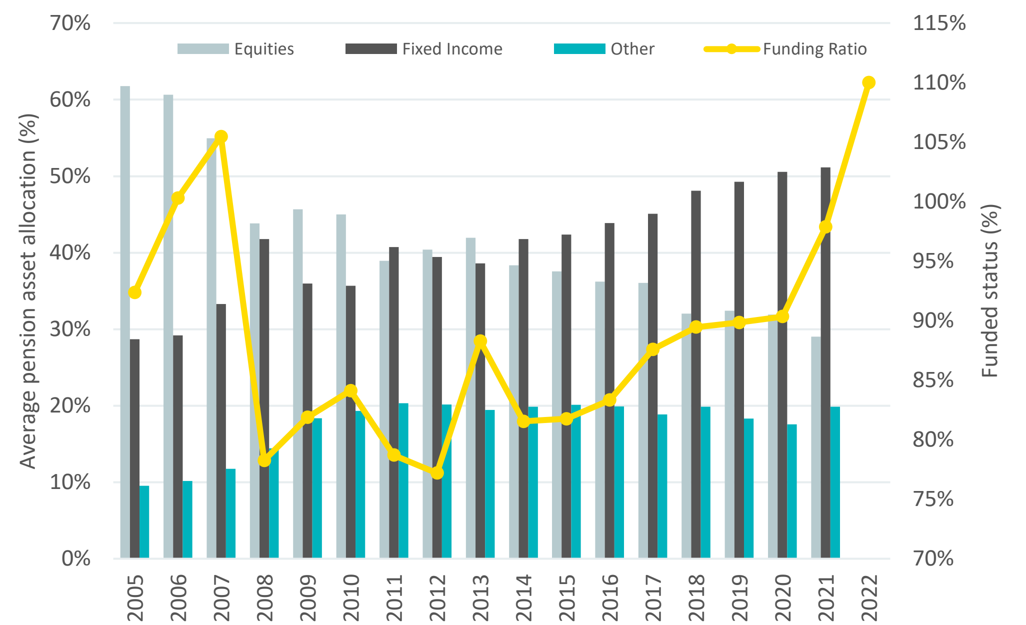
SPOTLIGHT: FIXED INCOME TAILWINDS IN 2023

- As we enter 2023, there are high expectations for a substantial reallocation from equities to fixed income as plan sponsors look to lock in the 20% jump in funded status over the last two years.
  - The average fixed income allocation of the top defined benefit plans has increased each year since 2014. Estimates put the likely reallocation at almost $1 trillion of bond buying throughout the year as plans look to move 3%–4% of their portfolios from equities to fixed income[3].
  - 2022 saw a record year of bond fund outflows of over $230 billion across investment grade, high yield and leveraged loans. However, so far in 2023 inflows are close to $20 billion, possibly signaling a reversal of last year[3].
  - With bond index yields reaching 10+ year highs in Q4 2022 as the U.S. Federal Reserve's hiking cycle started to slow, investors are looking to take advantage of the peaks.
- While corporate pension plans and insurers are usually the lead runners, as they look to lock in higher yields to match their liabilities, we are also seeing a significant uptick in cash flow matching strategies from historically underfunded multiemployer pension plans. These plans are estimated to receive $94 billion as part of the Special Financial Assistance Program component of the American Rescue Plan Act of 2021, of which 67% is required to be allocated to investment grade fixed rate bonds.

Milliman Pension Funding Index (January 2023)



Fixed Income allocations continue to follow the increase in funded status



Source: Milliman.

(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

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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.

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