Prism

Fourth Quarter 2023 Pension Plan Experience

Model Pension Plan's Funded Status Experiences 2-Point Decline

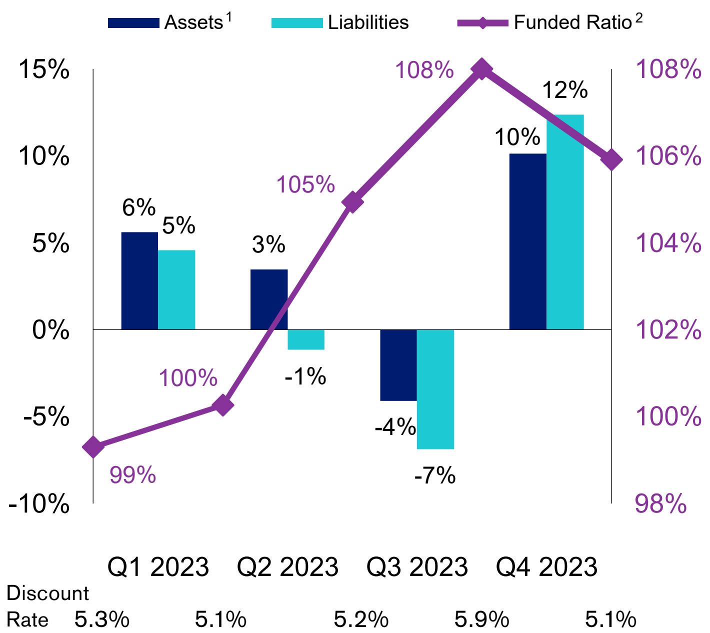
During the fourth quarter (Q4) of 2023, the funded status of the model pension plan examined in each issue of *Prism* fell by 2 percentage points, to 106 percent. (See Graph 1.) This decrease in funded status is attributable to a 12 percent increase in liabilities, outpacing a 10 percent increase in assets.

Changes in the yield curve

High-quality corporate bond yields decreased by 80 basis points during Q4 — the net result of a 10 basis-point decrease in credit spreads and a 70 basis-point decrease in U.S. nominal Treasury yields (see "Aspects of investment performance" on the next page for more details). This is illustrated in Graph 2 by the above-median curves.

Plans' liabilities are measured with the yield curve, determined by reference to high-quality corporate bond yields. Changes in the shape of the yield curve may have varying impact on plans' liabilities based on their maturity. (For background on yield curves, [read our primer](#).)

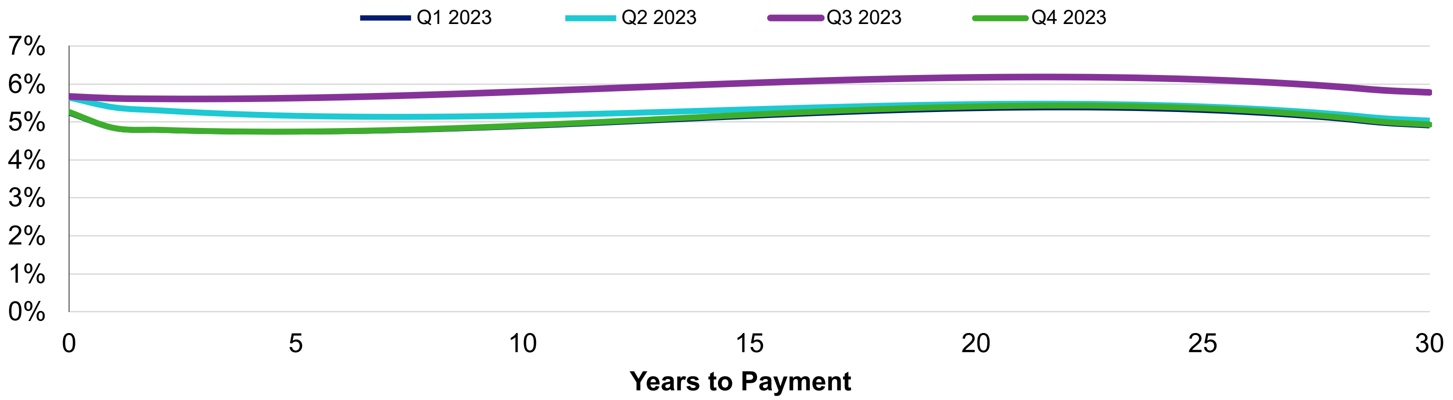
Graph 1: Change in Assets, Liabilities and Funded Ratio



[1] The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

[2] This is the ratio of a defined benefit (DB) plan's assets to accrued liabilities. The funded ratio data in the graph is the ratio on the last day of each quarter. In May 2023 (after publication of the Q1 2023 *Prism*), the funded percentage for the model DB plan was reset as of January 1, 2023 to reflect the average actual funded percentage of large pension plans.

Graph 2: Changes in the Yield Curve*



* This curve reflects the average yield, at each duration, for corporate bonds rated AA that have yields above the median for that duration.

About *Prism*

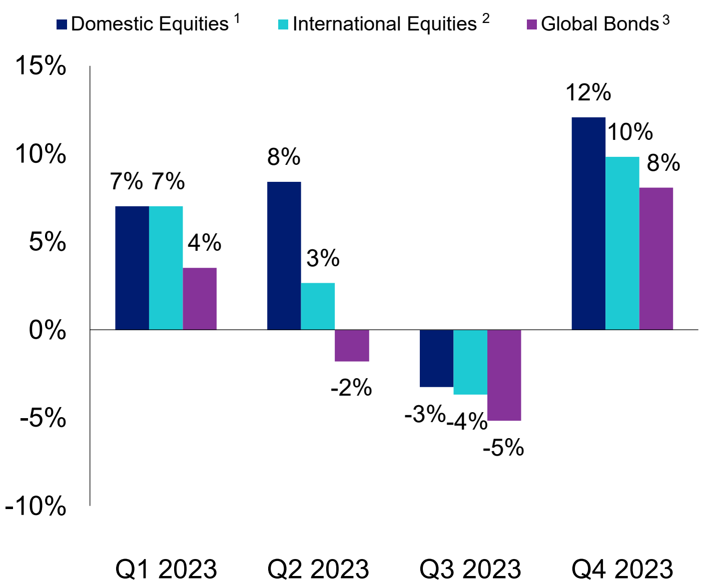
Prism examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement and interest rate shifts on perhaps the most important financial metric to plan sponsors: the plan's funded status.

Aspects of investment performance

This section discusses aspects of investment performance illustrated in Graph 3 that contributed to the model plan's 10 percent increase in asset value in Q4.

Both domestic and international equities had double-digit positive returns in Q4 to close out a blockbuster calendar year of return(s) for both — with domestic equities returning 26 percent for the year and developed international equities returning 19 percent. Emerging market equities were the laggard this quarter (and this year), underperforming both U.S. and developed international stocks, although emerging markets also posted positive returns. Strong economic growth data buoyed equity markets, as real GDP growth came in at 4.9 percent for the prior quarter. Declining bond yields were another key factor driving positive equity market performance, as investors anticipated an earlier pivot to rate cuts by the Federal Open Market Committee (FOMC) than they had been expecting previously — given the surprisingly dovish Fed guidance during the quarter. Year-over-year inflation readings came in lower this quarter (than previous quarters) and ended the year at about 3 percent. Domestically, growth stocks outperformed value and small-cap stocks outperformed large caps for the first time this year, a year where the so-called "Magnificent Seven" stocks (the seven largest stocks in the index) provided an outsized portion of the exceptional domestic equity market's performance.

Graph 3: Investment Performance



[1] Russell 3000

[2] Morgan Stanley Capital International All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.)

[3] Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

Fixed-income returns were also stellar both domestically and internationally, with interest rates retreating around the globe during the quarter. U.S. Aggregate Bonds returned 7 percent during Q4 and the Global Aggregate Index posted an 8 percent return, its best quarter in more than 20 years. The FOMC failed to increase the target range for the federal funds rate during the quarter (so the rate remains in a range of 5.25 to 5.50 percent) for a third consecutive meeting. A majority of FOMC voting members now see rate-significant cuts happening in 2024, perhaps as early as mid-year. The yield on the 10-year Treasury note ended Q4 down 71 basis points from the end of Q3, at 3.88 percent, after peaking at 5.00 percent in mid-October.

Important: examine your own DB plan's experience

Plan sponsors should examine changes in their own DB plans' assets, liabilities and funded ratios from the vantage point of both accounting and funding metrics.* Segal Marco Advisors and Segal can help employers project their DB plans' funded ratios through:

- **Deterministic modeling**, which projects results under a specific set of assumptions but does not offer insight into the likelihood of these outcomes
- **Stochastic asset-liability modeling (ALM),** which offers a more complete view of the range of a plan's possible future statuses and can act as an early warning sign of potential challenges through a long-term time horizon

*Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

For more information about how ALM can help you manage your plan, contact your Segal Marco Advisors investment consultant or your Segal retirement consultant — or get in touch with us via our websites: segalmarco.com and segalco.com.

To receive future issues of *Prism* and other publications of interest to employers as soon as they are available online, join our email list.