Prism

Third Quarter 2023 Pension Plan Experience

3-Point Jump in Model Pension Plan's Funded Status

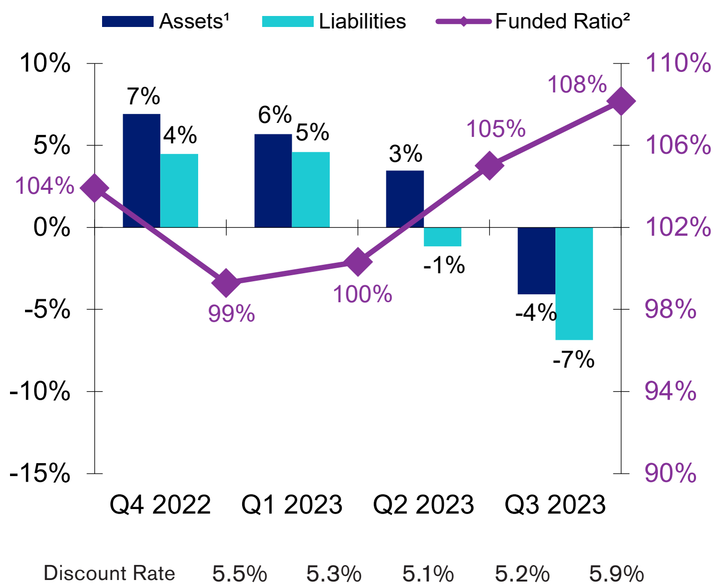
During the third quarter (Q3) of 2023, the funded status of the model pension plan examined in each issue of *Prism* rose by 3 percentage points, to 108 percent. (See Graph 1.) This increase in funded status is attributable to a 4 percent decrease in assets and a 7 percent decrease in liabilities.

Changes in the yield curve

High-quality corporate bond yields increased by 60 basis points during Q3 — the net result of a 15 basis-point decrease in credit spreads and a 75 basis-point increase 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].)

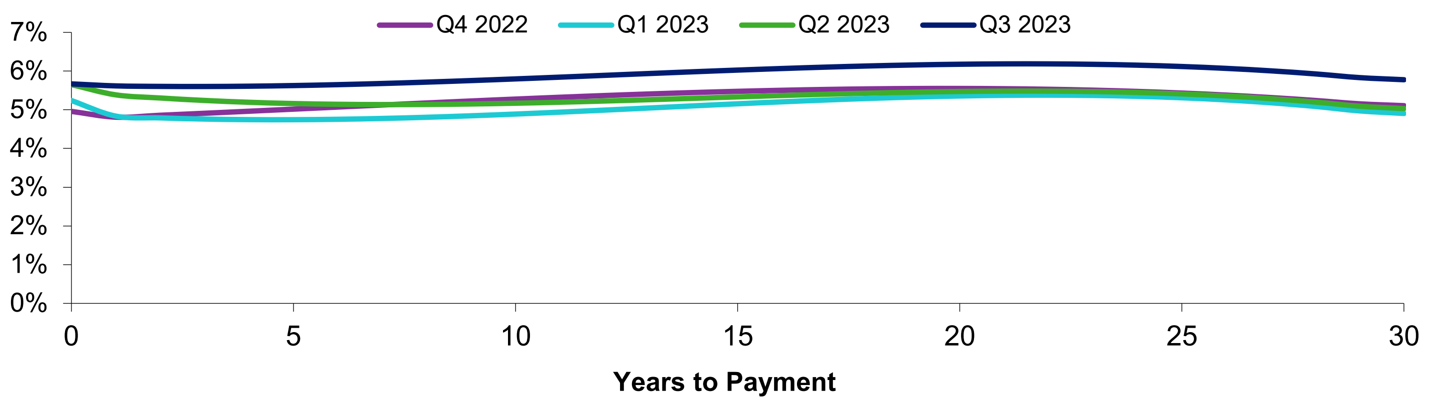
Graph 1: Change in Assets, Liabilities and Funded Ratio



[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. As a result, the asset and liability returns for Q4 do not align with the change in funded status as shown in the graph.

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*

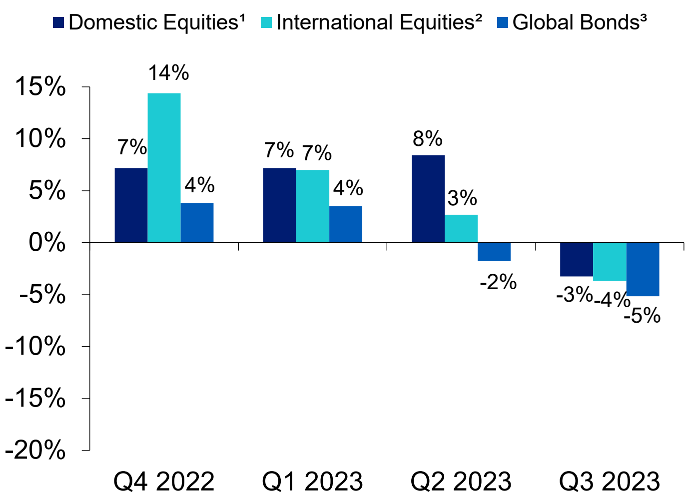
***Prism* examines the effect of changes in the assets and liabilities of a model private sector single-employer pension plan on its funded ratio over the four most recent quarters, viewing such changes through a marked-to-market lens. The primary focus is to understand the combined impact of asset movement 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 4 percent drop in asset value in Q3.

Both domestic and international equities had negative single-digit returns in Q3, the first negative quarter for equities this year. Emerging market equities outperformed both U.S. and developed international stocks, although all three posted negative returns. Rising bond yields were the key factor driving negative market performance. A last-minute resolution in Congress allowed federal government operations to continue until mid-November, but the drama weighed on markets. The continuing uncertainty regarding funding of governmental operations was a key factor leading to a decision by credit-rating agency Fitch to downgrade U.S. sovereign debt. Additionally, inflation that stubbornly refuses to return to pre-2022 levels was another factor causing bond yields to spike during the quarter. Domestically, growth stocks slightly outperformed value, and large-cap stocks outperformed small caps (though all four sub-categories were negative).

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 negative both domestically and internationally, with interest rates spiking higher during the quarter. The Federal Open Market Committee (FOMC) once again increased the target range for the federal funds rate by 25 basis points during the quarter (to a range of 5.25 to 5.50 percent) in response to continuing inflation readings above their 2 percent target and strong jobs data. A majority of FOMC voting members have indicated that a further rate hike will occur before year-end. The yield on the 10-year Treasury note ended Q3 up 78 basis points from the end of the second quarter, at 4.59 percent, a level last seen in October 2007.

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.

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