Sibson Consulting — Segal Rogerscasey

Prism

A QUARTERLY REVIEW OF FUNDED STATUS

Pension Plan Funded Status Continues to Rise Due to Asset Increases in Q4 2013

During the fourth quarter of 2013 (Q4 2013), the funded status of the model pension plan examined in each issue of *Prism* increased by 5 percentage points: from 93 percent to 98 percent. This increase was driven by an asset return of 5 percent and a liability decrease of 1 percent. See Graph 1. The model pension plan's 98 percent funded status is a dramatic improvement from its funded status at the end of 2012: 77 percent.

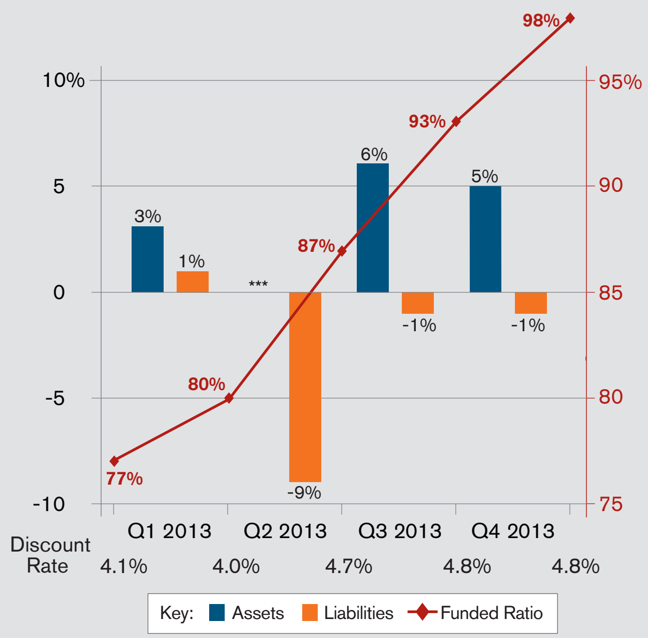
About *Prism*

Prism examines the effect of changes in the assets and liabilities of a model 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

Domestic equities ended Q4 2013 on a strong note and experienced double-digit gains, outperforming international equities, which had a positive quarter as well. See Graph 2. Small-capitalization stocks underperformed large-capitalization stocks, while growth stocks outperformed value. Emerging markets underperformed developed markets within international equities for the fourth consecutive quarter. Global bonds, as measured by the Citigroup World Government Bond Index (WGBI), posted a 1.09 percent loss for the quarter. Developed market equities experienced a very strong Q4 and 2013. Global macro conditions are improving, global stocks appear to be cheap relative to bonds and monetary policy conditions remain accommodative.

Graph 1: Change in Assets,* Liabilities and Funded Ratio**

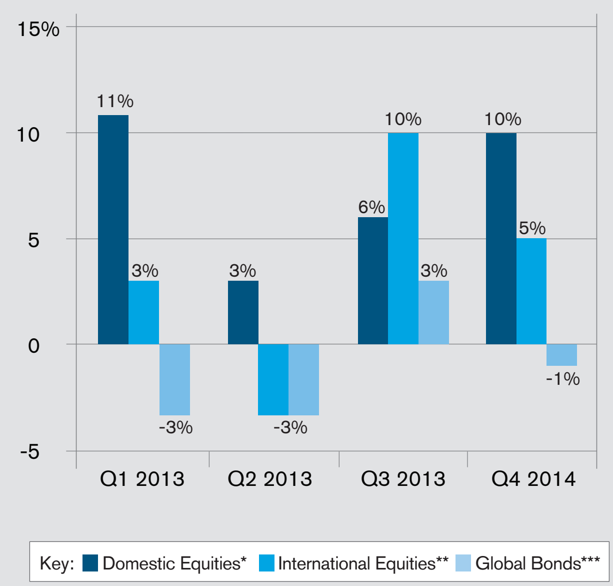


* The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

** 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 at a point in time at the beginning or end of the quarter. The funded percentage for the model DB plan was reset as of January 1, 2013 to reflect the average actual funded percentage of large pension plans.

*** In Q2 2013, assets decreased 0.4 percent.

Graph 2: Investment Performance



* Russell 3000

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

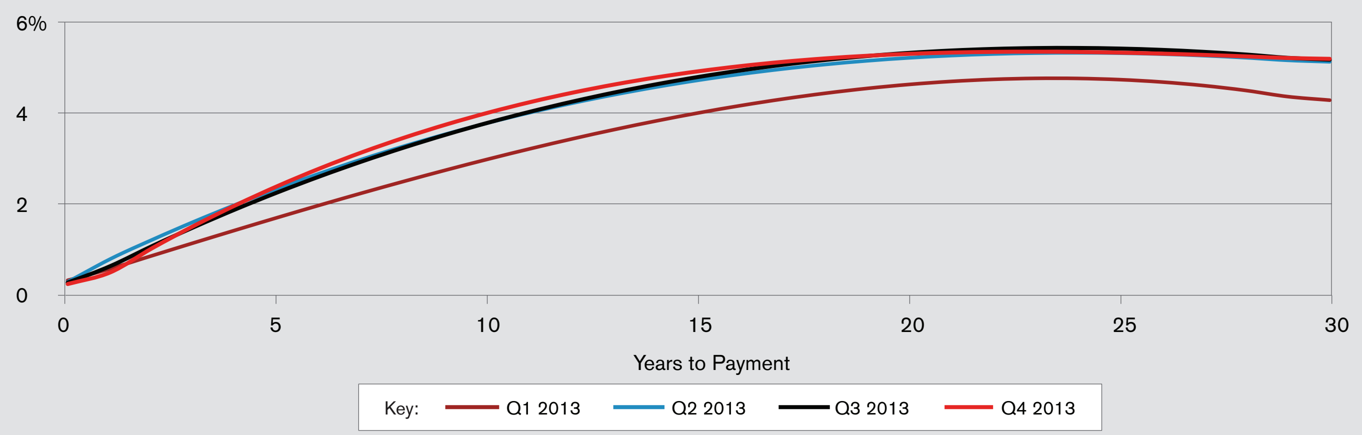
*** Citigroup World Government Bond Index (WGBI) Unhedged, which includes U.S. and international bonds

Changes in the Yield Curve

High-quality corporate yields increased slightly during Q4 2013. Treasury rates increased about 30 basis points,* and credit spreads tightened almost 30 basis points, resulting in very modest increase in rates. The overall shape of the yield curve remained similar to the previous quarter, reflecting an upward sloping yield curve which peaks at about 25 years, and then levels off, as illustrated by the above-median curves shown in Graph 3.

The modest increase in the yield curve level during Q4 2013 resulted in an increase in the effective interest rate and, consequently, decreased the model pension plan's liability by 1 percent. As in previous quarters, the shape of the yield curve will have different effects for plans with different maturities. (For background on yield curves, see the following web page: http://www.sibson.com/publications/presentations/PrismYCprimer.pdf)

Graph 3: 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.

Important: Examine Your Own DB Plan's Experience

Plan sponsors should examine changes in their own DB plans' assets, liabilities and funded ratios both from the vantage point of accounting and funding metrics. Individual plan results will differ from this model for a host of reasons, including different funded positions, liability duration and contribution patterns.

■ ■ ■

Segal Rogerscasey and Sibson Consulting can help employers to project their DB plans' funded ratios through asset-liability modeling (ALM). For more information about ALM, contact your Segal Rogerscasey investment consultant or your Sibson retirement consultant.

Sibson Consulting Segal Rogerscasey

To receive future issues of *Prism* and other publications of interest to employers as soon as they are available online, register your e-mail address via Sibson's website: www.sibson.com/register/

Sibson Consulting and Segal Rogerscasey are members of The Segal Group (www.segalgroup.net), which is celebrating its 75th anniversary this year.

www.sibson.com www.segalrc.com

* As a reminder, 10 basis points (bps) equals 0.1 percent.

Segal Rogerscasey provides consulting advice on asset allocation, investment strategy, manager searches, performance measurement and related issues. The information and opinions herein provided by third parties have been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. *Prism* and the data and analysis herein is intended for general education only and not as investment advice. It is not intended for use as a basis for investment decisions, nor should it be construed as advice designed to meet the needs of any particular investor. Please contact Segal Rogerscasey or another qualified investment professional for advice regarding the evaluation of any specific information, opinion, advice or other content. Of course, on all matters involving legal interpretations and regulatory issues, plan sponsors should consult legal counsel.

75 THE SEGAL GROUP Founded in 1939

Copyright © 2014 by The Segal Group, Inc. All rights reserved.