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Prism

A QUARTERLY REVIEW OF FUNDED STATUS

Strategic HR Consulting | Investment Solutions | Fourth Quarter 2015 Pension Plan Experience

Pension Plan Funded Status Rises Due to Equity Market Gains in Q4 2015

During the fourth quarter of 2015 (Q4 2015), the funded status of the model pension plan examined in each issue of *Prism* increased by 3 percentage points: from 82 percent to 85 percent. This increase was the result of a 3 percent asset increase and a 1 percent liability decrease during the quarter. See Graph 1.

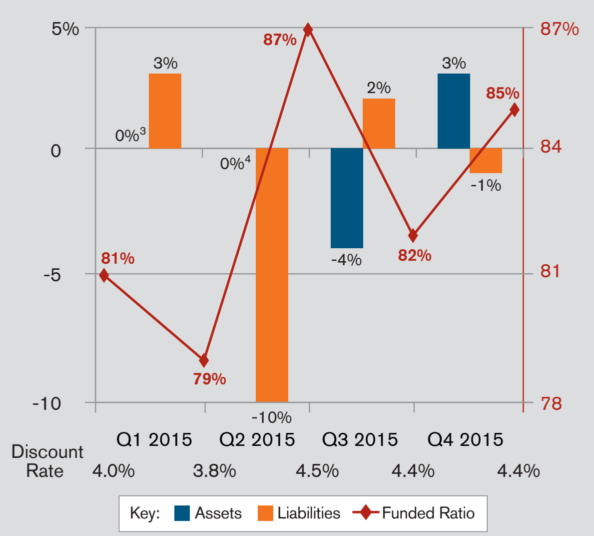
About *Prism*

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

Following the worst quarter for equities in four years, global equities rebounded during Q4, as shown in Graph 2. Domestic stocks outperformed international stocks (due mainly to a strengthening dollar during the quarter), and on the international side, developed-market stocks outpaced emerging-market stocks. In the U.S., large-cap stocks beat their small-cap counterparts, while growth stocks slightly outpaced value stocks. Fixed-income returns were in negative territory for the quarter. Treasury rates increased due in part to the Federal Reserve's decision to raise interest rates for the first time since 2006. International fixed-income markets were positive in local currency terms, but returns were negative when accounting for the strengthening U.S. dollar, with returns that were on par with those of the U.S. fixed-income market.

Graph 1: Change in Assets,[1] Liabilities and Funded Ratio[2]



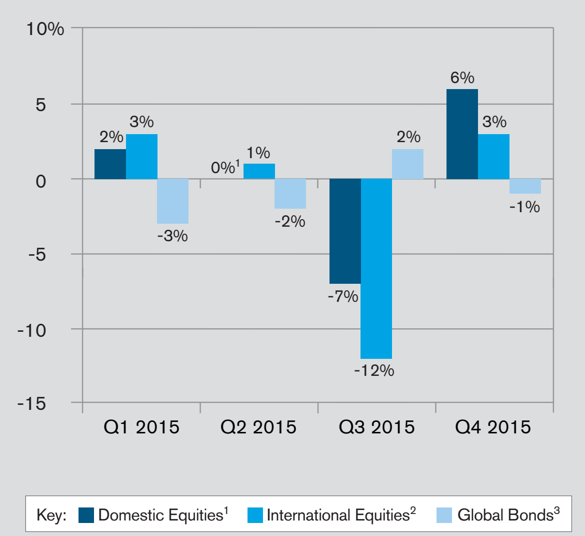
[1] The model plan's portfolio has a simple, passively invested asset allocation of 45 percent to domestic equities, 15 percent to international equities and 40 percent to global bonds.

[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 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, 2015, to reflect the average actual funded percentage of large pension plans.

[3] In Q1 2015, assets increased 0.3 percent.

[4] In Q2 2015, assets decreased 0.5 percent.

Graph 2: Investment Performance



[1] Russell 3000 (The return for domestic equities was 0.14 percent in Q2 2015.)

[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

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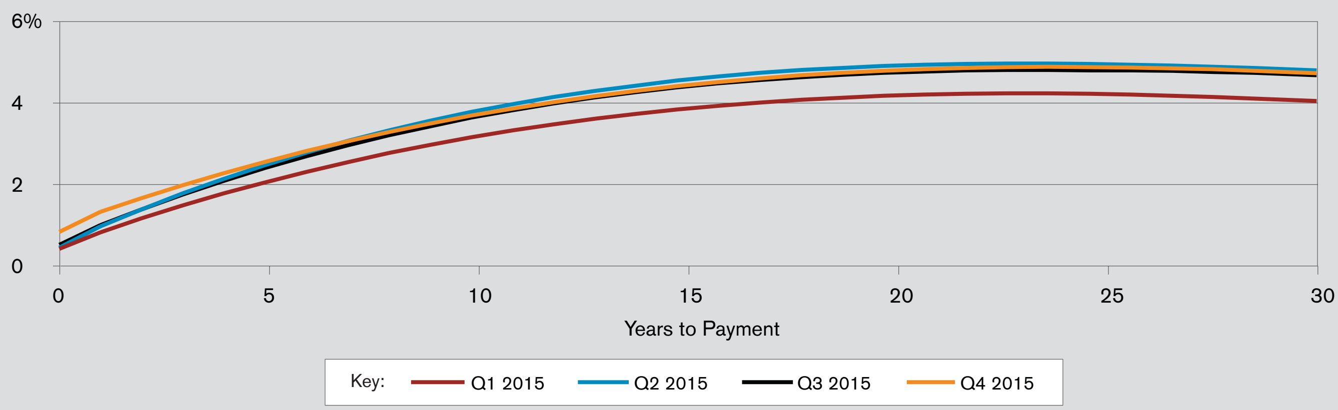
Changes in the Yield Curve

High-quality corporate yields increased by about 5 basis points* during Q4 2015. This increase is the net result of a 20-basis-point increase in Treasury rates and a partially offsetting 15-basis-point decrease in credit spreads. The yield curve flattened again during the quarter, with shorter-term yields rising to their highest levels in years. Longer-term yields only modestly increased, although the general shape of the yield curve remained similar to the previous quarters: an upward-sloping yield curve that peaks between 20 and 25 years and then levels off, as illustrated by the above-median curves shown in Graph 3.

The increase in the yield curve level during Q4 2015 resulted in a small increase in the effective interest rate and, consequently, a decrease in the model pension plan's liability by about 1 percent. Any change in the shape of the yield curve could have a different impact on liabilities for plans with different maturities. (For background on yield curves, read our online primer.)

Graph 3: Changes in the Yield Curve[1]



[1] 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 from the vantage point of both 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. As plan sponsors look toward 2016 (and the recent volatility seen in the market), this might be an appropriate time to examine their plan's risk-mitigation strategy.

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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.

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