LDI Highlights

• Corporate pension funded status fell by 3.9% during August, closing the month at 83.8%.
  • The decline was primarily driven by a dramatic decrease in long yields, which led to a 0.44% drop in discount rates.
  • Falling equity prices also contributed to a worsening average funded status, as the S&P 500 Index returned -1.8% in August.
• Long duration supply totaled over $18 billion, below the 2019 monthly average of $25 billion but in line with the five-year August average.
• Despite light supply, long corporate spreads moved in sympathy with a risk-off tone and widened 16bps to 170bps.
• Over $4 billion of 20+ year Treasury bonds were stripped in August, the highest total since October 2018.

IR+M LDI Corner: Getting Active With Convexity

• With the pronounced drop in long yields in August, the duration of many indices extended due to positive convexity, or the change in duration as rates move.
  • The durations of the FTSE Pension Liability Indexes extended by 0.5 to 0.8 years. Comparatively, the durations of the Bloomberg Barclays Long Corporate and Long Credit Indexes both extended 0.3 years.
• The convexity of individual pension plans can vary based on participant options, however, general liability indices can be used as proxies. With liability indices extending more than market indices, it suggests liabilities may be more positively convex than market indices commonly used by plan sponsors.
• For sponsors looking to reduce funded-status volatility, we believe it is important to consider the impact of convexity. Market indices work well to capture most duration changes relative to plan liabilities. However, actively managing portfolio convexity can help plan sponsors maintain a better hedge throughout their de-risking journey.

LDI MONITOR
August 31, 2019

FTSE Pension Liability Index Discount Rate vs. S&P 500 Index

Sources: Milliman (Historical numbers revised as of 8/31/19); FTSE Russell (formerly Citigroup), Bloomberg Barclays, Bloomberg, and JPMorgan
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