INCOME RESEARCH + MANAGEMENT

# LDI MONITOR

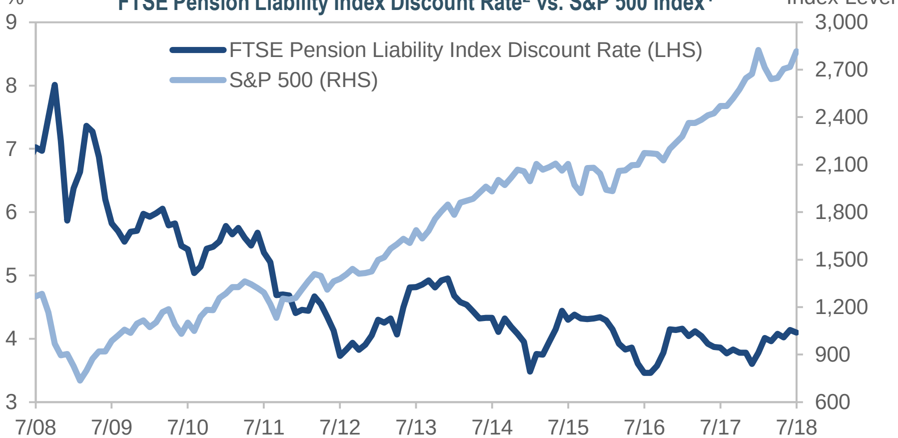
July 31, 2018

## LDI Highlights

- Corporate pension funded status rose 0.6% during July to close the month at 93.4%, setting a new post-crisis high.[1]
    - The increase was driven by rising equity markets, which benefited from easing trade tensions and strong earnings.
    - A risk-on tone led to equity market strength, and the S&P 500 Index returned over 3.7%, while discount rates fell 4bps.[2,4]
- Supply lightened up in July, as long corporate issuers priced approximately $13 billion, solely from A-rated and BBB-rated issuers[5]
- Long corporate spreads rallied, moving 22bps tighter during July to close the month at 155bps, the tightest level since May[3]
- Corporate spread curves flattened modestly after steepening during the second quarter, as the difference between long corporate and intermediate corporate spreads narrowed to 68bps.[5]

| Rates Monitor | 7/31/18 | 6/30/18 | 12/31/17 |
|---|---|---|---|
| FTSE Pension Liability Discount Rate[2] (%) | 4.10 | 4.14 | 3.60 |
| Bloom Barc Long Corporate Yield[3] (%) | 4.60 | 4.69 | 4.02 |
| Bloom Barc Long Corporate A+ Yield[3] (%) | 4.28 | 4.34 | 3.69 |
| Bloom Barc Long BBB Corp Yield[3] (%) | 4.94 | 5.07 | 4.37 |
| 30 Year Swap Spread[4] (bps) | -4 | -6 | -20 |

FTSE Pension Liability Index Discount Rate[2] vs. S&P 500 Index[4]

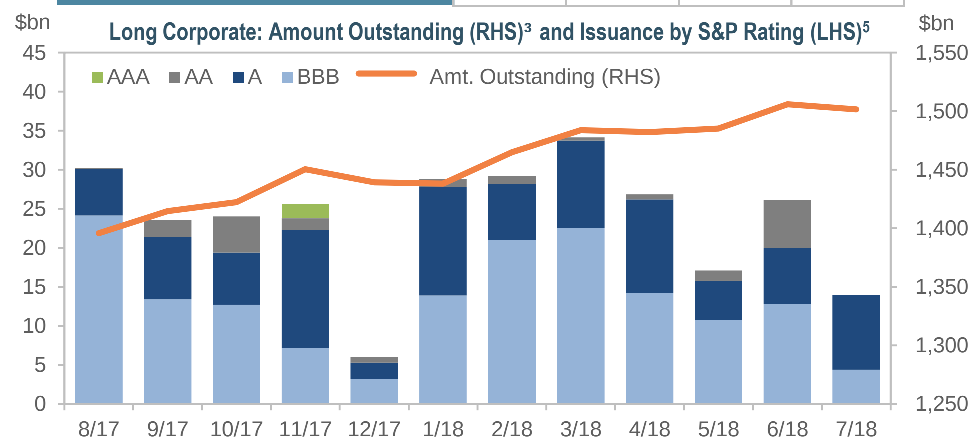



## IR+M LDI Corner: Keeping an Eye on Supply

- As more plan sponsors look to derisk, we are often asked about the potential supply/demand imbalance in long corporate markets. Given the recent uptick in LDI activity, it is worth reviewing how the market reacted to increased demand from plan sponsors during the first half of 2018.
- Strong LDI demand persisted through the first half of the year, as plan sponsors locked in funded status gains. However, despite robust demand, long spreads widened by about 50 basis points from their tights in February to the end of June.[3]
- Spread widening reflected a few factors; the STRIPS market absorbed some LDI demand, which reduced the pressure on corporate markets. Outside of LDI buyers, we saw lighter demand from overseas investors due to rising currency hedging costs. On the supply side, long issuance was up despite many predictions to the contrary.
- These factors combined to create a favorable environment for de-risking through June. In July, issuance slowed, and strong demand led to a rally in corporate spreads. With LDI activity likely to continue into the second half of the year, it will be interesting to see if supply again rises to meet demand.

| Glidepath Monitor | 7/31/18 | 6/30/18 | 12/31/17 | 12/31/14 |
|---|---|---|---|---|
| Funded Status[1] (%) | 93.4 | 92.8 | 87.6 | 81.5 |
| Long Corporate Spreads[3] (bps) | 155 | 175 | 137 | 186 |
| Curve[3] (Long Corp - Int. Corp) (bps) | 68 | 76 | 64 | 79 |

Long Corporate: Amount Outstanding (RHS)[3] and Issuance by S&P Rating (LHS)[5]




Trailing 12 Month Long Corporate New Issuance[5] (bn)

| AAA | AA | A | BBB | *Total* |
|---|---|---|---|---|
| $1.7 | $19.8 | $103.7 | $160.3 | *$285.6* |

[1]Milliman (Historical numbers revised as of 3/31/18); [2]FTSE Russell; [3]Bloomberg Barclays; [4]Bloomberg; [5]JP Morgan