Allspring

U.S. Pension Plan Update

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September 2022

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01 Idea of the month: Intermediate credit for LDI

Most liability-driven investing (LDI) portfolios have used long government and corporate bonds. This is sensible in their initial build-out given the need to easily and effectively extend duration and fill the significant dollar duration shortfall almost all pension plans have had for decades. But with the maturing of pension plans (liabilities getting shorter) and progression along de-risking glidepaths (more fixed income in asset allocation), a refinement many are or should be considering is adding intermediate credit to their LDI benchmark. This is for five main reasons:

01	Improved term structure matching	Key rate fitted custom LDI benchmark for a mature plan contains around 10% to 20% intermediate credit
02	Good alpha opportunity	According to eVestment, in 70% of rolling 5-year periods ending in the past 10 years, over 90% of active intermediate credit managers have produced positive alpha, with median outperformance of 72 basis points (bps; 100 bps equals 1.00%) per annum. Adding a new specialist intermediate credit manager might be the best way to capture this alpha and benefit from alpha diversification to your current managers.
03	Issuer diversification	The Bloomberg Intermediate Credit Index includes 358 issuers that are not present in the Bloomberg Long Credit Index (adding significantly to the 710 issuers in that index).
04	Comparable return to long credit	Over the past 20 years, intermediate credit has delivered 109 bps of excess return over duration-equivalent Treasuries, compared with119 bps for long credit. The current investment grade credit option-adjusted spread curve is flat to inverted from the 10-year point onward.
05	Reduced carbon footprint	Intermediate credit has half the carbon intensity footprint of long credit. This enables a plan sponsor to limit the carbon and climate transition risk in their LDI portfolio and better align with corporate and stakeholder goals.

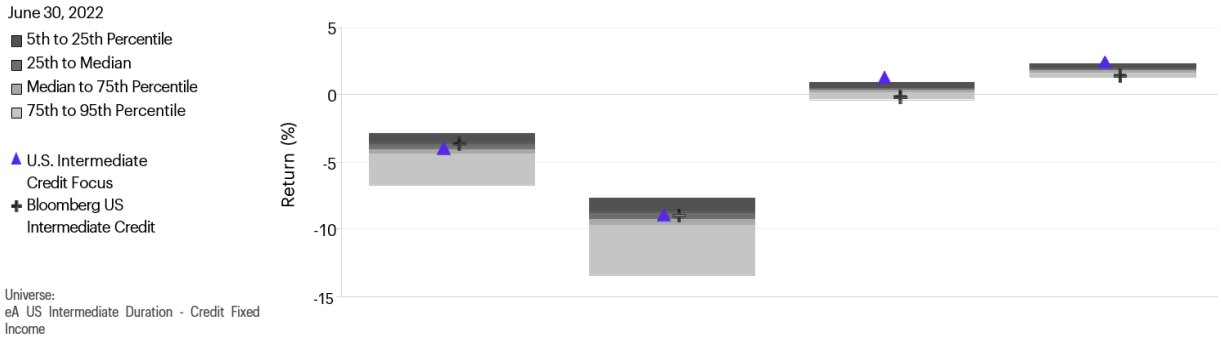
Sources:
Indices: Bloomberg Intermediate Credit index and Bloomberg Long Credit index
1 Allspring. Mature plan with duration of 9 years
2 eVestment. Gross of fees. Number of managers in composite ranges from 6 to 19 for different time periods. Includes 'live' and 'dead' managers.
3 Bloomberg, Allspring, 6/30/2022
4 Bloomberg, Allspring, returns 20 years to 8/30/2022. OAS curve: ICE/BAML
5 Trucost, 12/31/2021: Bloomberg Long Credit: 527 metric tons of CO2 equivalent/ $1m revenue. Bloomberg Intermediate Credit: 262 metric tons of CO2 equivalent/ $1m revenue

02 Key strategy highlight—Intermediate Credit Focus

Like many parts of the credit market, intermediate credit has been an area where inefficiencies have been identified and captured by successful active managers. Using our blend of rigorous fundamental research within a robust relative-value framework, Allspring sits firmly within this group. Since inception at the end of 2015, the U.S. Intermediate Credit Focus Composite has delivered strong alpha and peer-relative performance.

Annualized Return – Peer Universe Rankings

U.S. Intermediate Credit Focus vs. Bloomberg US Intermediate Credit Return



	QTD		1 Year		3 Years		5 Years	
	Return	Rank	Return	Rank	Return	Rank	Return	Rank
U.S. Intermediate Credit Focus	-4.09	57	-9.10	48	1.10	1	2.36	1
Bloomberg US Intermediate Credit	-3.63	27	-8.96	42	-0.14	88	1.43	94
# of Observations	24		24		21		19	
Universe(5%)	-2.85		-7.68		0.97		2.30	
Universe(25%)	-3.61		-8.75		0.59		2.07	
Universe(Median)	-4.05		-9.18		0.47		1.91	
Universe(75%)	-4.28		-9.63		0.23		1.76	
Universe(95%)	-6.68		-13.40		-0.34		1.35	

Source: eVestment Alliance Database via MPI. There may be a small return difference (1-2 bps) in charts generated by eVestment Alliance due to rounding. All returns annualized and in USD. Performance is gross and does not include fees or other expenses which will reduce returns. The GIPS® composite report can be found in the document linked below, including information on net returns
Past performance is not a reliable indicator of future results

Key features:

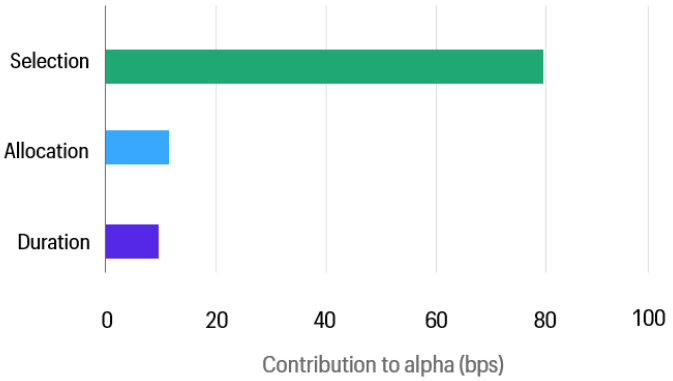
- $37.7 billion in team assets as of June 30, 2022
- Experienced team focused on investment-grade yield-enhanced approach for over 20 years
- A team that blends rigorous fundamental research within a robust relative-value framework
- Has security selection as the primary driver of alpha, delivering approximately 80% of alpha historically

Find more information click here.

Source: Allspring. Past performance is not a reliable indicator of future results.

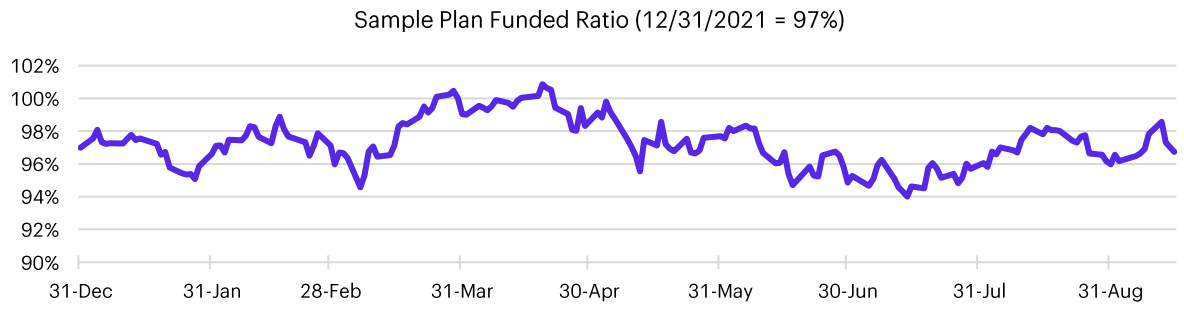
5-year performance attribution
Annualized alpha: +101 bps

June 30, 2022

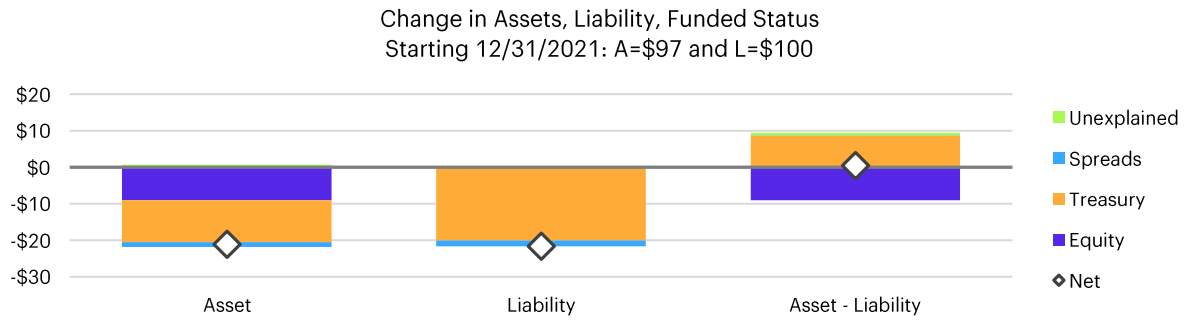


03 Funded ratio update: 9/15/2022

It will surprise no one when we say that the markets have become more volatile than they have been in recent years (COVID-19 shock apart). And this has been reflected in increased volatility in the funded ratio of many pension plans—certainly those that are not de-risked. The story of the year continues to be one of rising Treasury yields and a volatile downdraft in equities. The first of these is good news for plans that are not 100% hedged; the second is bad news. The net for our typical plan below is a rocky road, but one that has more or less returned to where we started the year—namely around 97% funded.



The attribution chart shows that absolute returns from Treasury and equity elements are both very poor but again shows their netting effect due to unhedged liabilities.



With the economic and, hence, investing outlook remaining highly uncertain, the result for many pension plan sponsors remains the same—stick with the progressive risk management approach that has been started and think about ways to mitigate risk while retaining desired expected return. Such strategies include risk management around equities (downside reduction), more effective liability hedging strategies (hedge more unintended risk), and more efficient implementation (garner alpha through diversified means).

Sources: Milliman PFI, Allspring, and Bloomberg data; 1/1/2021–9/15/2022
We use a simplified model of a "typical" pension plan. Liabilities modeled using PUMC = ICE BofA's liability index for a mature pension plan. Assets = 50% Bloomberg Long Government Credit + 50% MSCI ACWI global equities.
We started the plot at 97% at the beginning of 2022, which is broadly consistent with Milliman data and other industry sources. Estimated data is not a promise or guarantee of future results.

Contact us

Thank you from the Allspring Global Investments Pension Solutions and LDI team!

Please feel free to contact us with any questions or to let us know if you would like to be removed from this mailing list.

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