



Pension Finance Update

As of 8/31/2010

Aon Consulting

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Brief Description: Through August, 2010 has been a difficult year for pension finances. While assets have mostly treaded water, liabilities have climbed by more than 10%, as interest rates have declined this year, increasing underfunding issues for pension sponsors.



August was another difficult month in what is shaping up to be a difficult year for pension finance, with pension plan funded status for a traditional 60/40 portfolio declining 5%-7% in August, leaving plans 12%-15% worse off than at the end of 2009.

Assets

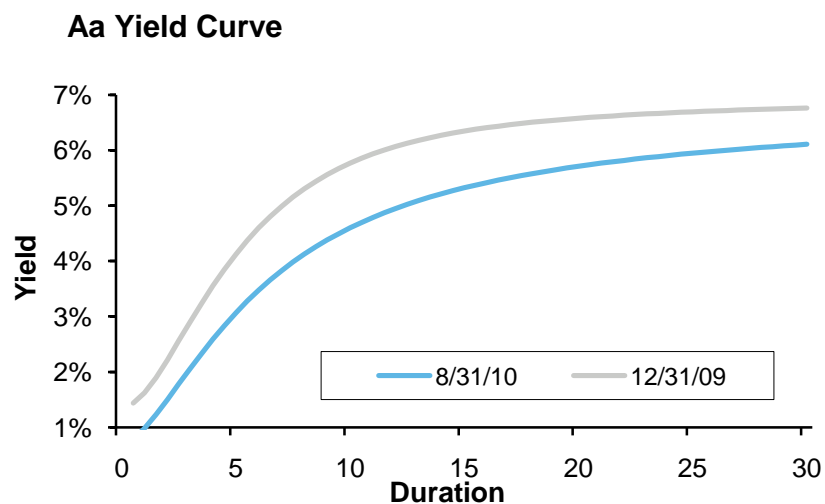
Stocks gave back most of July's gains during August, with most flavors of equities dropping about 5%. Year-to-date, the S&P is down 5%, NASDAQ is down 6%, the small-cap Russell 2000 has lost 3%, and the overseas EAFE is off 8%. A typical diversified stock portfolio has lost about 5% for the year through August.

Treasury rates dropped about 0.50% at intermediate and long maturities during August, producing returns of 5% or more in August for long-duration portfolios. Short-duration portfolios, by contrast, added only about 1% for the month. Corporate bonds also rallied, to a lesser extent. Rates dropped about 0.30% through August, reflecting a widening of credit spreads versus Treasuries. Short-credit portfolios gained more than 1% for the month, while long-credit portfolios added 3%-4%. Year-to-date, bonds have earned about 6% at shorter maturities, while long-duration investors have been rewarded with double-digit returns, about 13% for long credit and 16% for long Treasury portfolios.

In summary, a traditional 60/40 portfolio lost 2-3% during August, and is up roughly 1% for the year through August.

Liabilities

Both funding and accounting liabilities are now driven by high-quality corporate bond yields. The chart below compares yields for an Aa corporate bond yield curve at December 31, 2009, and August 31, 2010:





As shown above, rates have declined at all maturities during 2010, a trend that continued in August. Discount rates are now 0.75%-1.00% lower than at year-end 2009, increasing pension liabilities 12%-16% for the year, with long-duration plans seeing the largest increases.

Summary

With two-thirds of 2010 in the books, the year is looking pretty grim for pension sponsors, with pension-funded status 12%-15% below year-end 2009 levels for a typical sponsor with a traditional 60/40 asset allocation.



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