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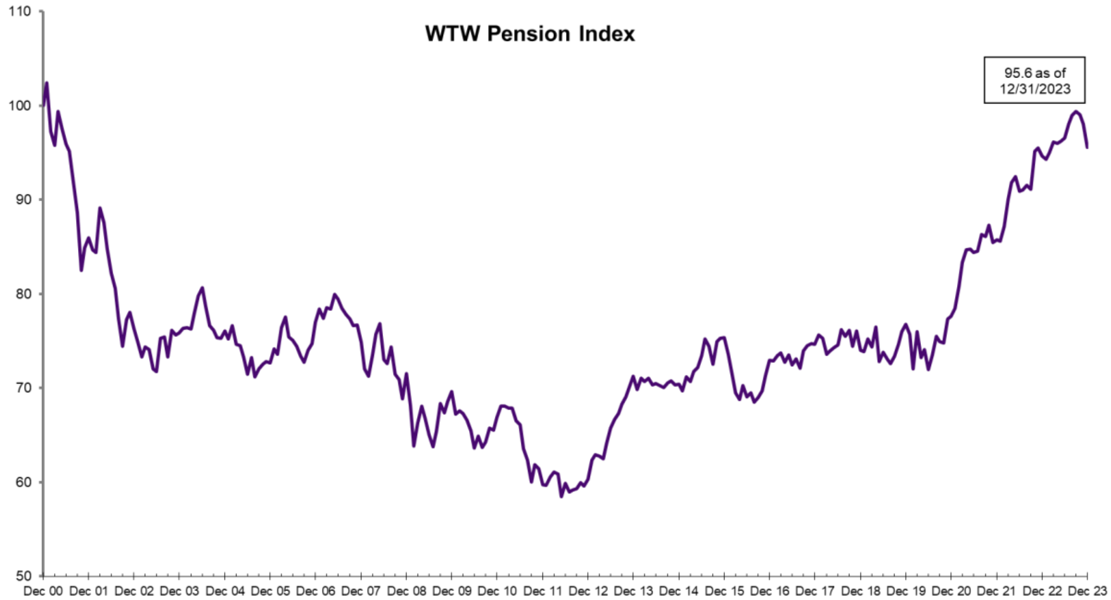
Pension Finance Watch

Fourth Quarter 2023

Results for Canadian defined benefit pension plans

The WTW Pension Index has decreased in the fourth quarter, as an increase in accounting liability measures was only partially offset by positive asset returns. The net effect on our benchmark plan was a decrease of 3.8% in the WTW Pension Index (from 99.4 to 95.6) for the quarter.



About this report

This report reviews how capital market performance affected Canadian defined benefit pension plans, with a focus on linked asset/liability results. Specific plan results depend on liability characteristics, portfolio composition and actual investment results, among other factors.

This information has been prepared for clients of WTW. For information on how this issue affects your organization, please contact your consultant, or one of the following consultants:

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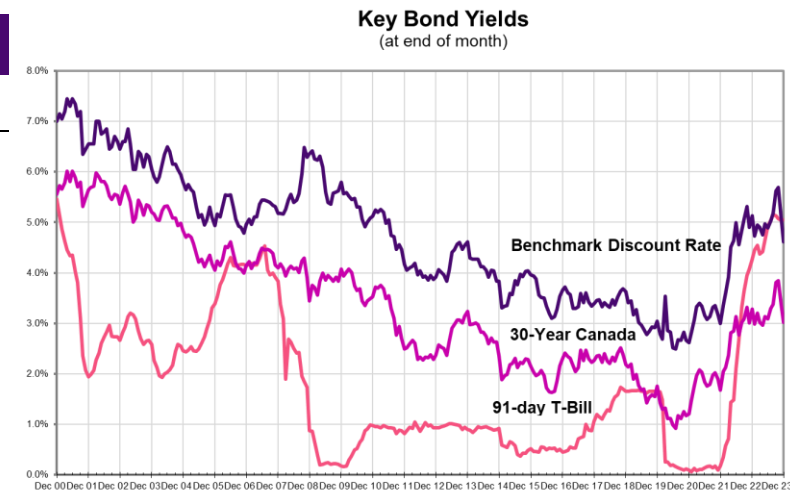
Canadian interest rates

The Bank of Canada held its overnight lending rate at 5.0% through the end of 2023. It maintained the rate at this level through the fourth quarter while continuing its policy of quantitative tightening. On inflation itself, the central bank cited the drop in the CPI to 3.1%, and the “broadening” of the cooling trend in inflation, both positives, but it remains concerned about shelter inflation’s escalation and the fact that its preferred core measures have been in the 3 ½% to 4% range (most recently at the lower end of that). While interest rates hit a peak in October they began to drop precipitously through November and December. The yield on 30-year Canada treasuries finished the quarter 79 bps lower than it started. Credit spreads also dropped during the quarter, contracting by 12 bps. The benchmark discount rate determined under the RATE:Link methodology used to determine defined benefit obligations decreased by 101 bps, which combined with the effect of interest accumulation led to an increase in accounting liability measures over the quarter.

Canadian Bond Yields (End of Period)			
	Dec. 2023	*Sep. 2023*	*Dec. 2022*
Canada Treasuries[1]			
30-year	3.02	3.81	3.28
10-year	3.10	4.03	3.30
91-day T-bill	5.05	5.13	4.27
Corporate Bonds[1]			
FTSE	4.77	5.90	5.27
Benchmark Discount Rate	4.62	5.63	5.13



(1) Source: Information prior to June 2015 and FTSE Corporate bond yield provided by FTSE Global Debt Capital Markets Inc. Copyright © FTSE Global Debt Capital Markets Inc. All rights reserved. The information contained herein may not be redistributed, sold or modified or used to create any derivative work without the prior written consent of FTSE Global Debt Capital Markets Inc. Effective June 2015, Canada 10 and 30 year yield were obtained from the Bank of Canada; the 91-day T-bill yield was obtained from Scotiabank.

Investment returns

Global equity markets had a great last quarter of 2023 overall seeing high single digit positive returns. The quarter saw its ups and downs with equity markets worldwide experienced a sluggish beginning in October, however in November, led by the U.S. Federal Reserve's perceived dovish remarks with softening inflation, declining bond yields and economic resilience, saw a surge that carried through December. Canadian equities saw high single digit positive returns (8.1%). However, with material outperformance of technology stocks and due to Canada’s smaller weighting in the Information Technology sector (one of the best performing sectors of the quarter, +24%), it was shy of US equities (11.7%) but still outperformed international equities (5.0%), both in local currency terms. It’s noteworthy that while the S&P 500 closed the 2023 year with a 26% return in USD, a substantial part of this success was attributed to the Magnificent 7. The persistent outsized impact on the overall index return of the mega-cap tech stocks showing the concentration risk of market-capitalization weighted index.

The CAD weakened relative to major global currencies in Q4, other than to the USD, leading unhedged Canadian investors to see CAD returns dampened on US equity investments but improved on international equity investments during Q4.

All parts of the yield curve saw sharp decreases during the quarter, leading to positive returns in major Canadian bond indices. With their higher duration and decreasing yields, long term bonds were most positively impacted over the quarter. Due to their shorter duration corporate bonds underperformed relative to government bonds even with their higher yields, in a contracting credit spread and falling yield environment.

Asset Class Returns

	Q4 2023	*YTD*	*Last 12 months*
Stock Returns			
Canadian Equities – S&P/TSX Composite [(2)]	8.1%	11.8%	11.8%
U.S. Equities – S&P 500 (Canadian dollars) [(3)]	8.9%	23.3%	23.3%
Non-North American Equities – MSCI EAFE (Canadian dollars) [(4)]	7.7%	15.4%	15.4%
Canadian Fixed Income Returns			
91-day T-Bills	1.3%	4.7%	4.7%
FTSE Universe Bonds	8.3%	6.7%	6.7%
FTSE Long Bonds	14.8%	9.5%	9.5%

(2) Source: Bloomberg LP. All S&P/TSX Composite indices are registered trademarks of The Toronto Stock Exchange Inc. and Standard & Poor's Corporation.
(3) Source: Bloomberg LP. All S&P indices are registered trademarks of Standard & Poor's Corporation
(4) Source: Bloomberg LP. All MSCI indices are registered trademarks of Morgan Stanley Capital International Inc.

The benchmark plan's 50% equity / 50% fixed income portfolio increased 11.5% for the quarter. The more conservative 30% equity portfolio increased 12.8% for the quarter, and the more aggressive 70% equity portfolio increased 10.2% for the quarter.

Pension plan liabilities under Canadian, International and U.S. accounting standards are measured using a discount rate based on yields available on high-quality corporate bonds as of the measurement date. Using the same RATE:Link methodology as we use for the WTW Pension Index in other countries, the discount rate for our benchmark plan decreased over the quarter by 101 basis points to 4.62% at December 31, 2023. Among other factors, the selected discount rate depends on projected plan cash flows, the bond data and the methodology utilized for constructing the yield curve. The RATE:Link approach represents one possible methodology; other acceptable methodologies may result in higher or lower discount rates, and consequently lower or higher plan liabilities.

WTW tracks the monthly change in its Pension Index in a series that dates to December 31, 2000. Like bond prices, pension liability values move in the opposite direction to interest rates. The WTW Pension Liability Index increased by 15.9% for the quarter, reflecting the combined effect of interest accumulation and the benchmark discount rate change.

The increase in accounting liability measures were partially offset by positive investment returns resulting in a net decrease in the WTW Pension Index over the quarter, from 99.4 to 95.6 as at December 31, 2023. The change in the WTW Pension Index does not reflect any contributions made to reduce the size of any deficit or any contribution holiday taken on account of any surplus.

Canadian Pension Index Results			
	Q4 2023	*YTD*	*Last 12 Months*
Portfolio Returns			
30% Stocks/70% Fixed Income	12.8%	12.1%	12.1%
50% Stocks/50% Fixed Income	11.5%	13.7%	13.7%
70% Stocks/30% Fixed Income	10.2%	15.4%	15.4%
Benchmark Plan Liability Results			
Change in Pension Liability Index	15.9%	12.7%	12.7%
Percentage Change in Pension Index	-3.8%	0.9%	0.9%

A note to our readers

This publication tracks the asset/liability performance of a hypothetical Canadian benchmark pension plan, based on a 50/50 asset mix and a typical liability profile. The index is not intended to represent an average funded ratio. Rather, the intent is to provide plan sponsors with a consistent and relevant measure to serve as a general indicator of the effects of capital market events on pension plan financing.

Definition of terms

Bond yields

- The 30-year Canada semi-annual bond yield reflects the yield on the actively-traded Government of Canada bond maturing in 30 years.
- The 10-year Canada semi-annual bond yield reflects the yield on the actively-traded Government of Canada bond maturing in 10 years.
- The 91-day T-Bill semi-annual yield refers to the yield on Government of Canada treasury bills which mature in 91 days.
- The FTSE Corporate semi-annual bond yield reflects the yield on the FTSE Corporate Bond Index composed of corporate bonds with varying maturity.

Asset class returns

- Total return incorporates the combined effect of price changes and interest or dividend income. This will typically differ from the daily results published in financial journals, which are based only on price changes.
- S&P/TSX Composite refers to the “S&P/TSX Composite Index”, which tracks larger companies in the Canadian market.
- S&P 500 refers to the “S&P 500 Index”, which tracks the largest 500 companies in the U.S. based on the market value of their equity. Total return is reported in terms of the Canadian dollar and therefore includes the effect of currency changes.
- MSCI EAFE refers to the “Morgan Stanley Capital International Europe, Australasia, Far East Index” of equity securities. Total return is reported in terms of the Canadian dollar and therefore includes the effect of currency changes.
- 91-Day T-bill returns are based on the “FTSE 91-day Treasury Bill Index”.
- FTSE Universe Bonds refers to the “FTSE Universe Bond Total Return Index” for government and corporate bonds of all maturities in excess of one year.
- FTSE Long Bonds refers to the “FTSE Long Term Bond Total Return Index” for government and corporate bonds with maturities in excess of 10 years.

Portfolio returns

- The WTW Pension Index 50% / 50% portfolio return is based on a diversified portfolio of 50% equity (10% Canadian, 20% U.S. and 20% MSCI EAFE) and 50% fixed income (FTSE Long Bonds).
- The 30% and 70% equity portfolios are constructed with similar composition within their equity and fixed income components.

Benchmark discount rate

- The discount rate is determined each month for this benchmark pension plan based on observed yields for high-quality corporate bonds and the benchmark plan's projected cash flows. Higher or lower discount rates may be more appropriate for other plans with different expected cash flows.* Furthermore, a variety of methodologies may be used to interpret the data available on long-term Canadian corporate bonds. This calculation uses the same RATE:Link methodology as we use for the WTW Pension Index in other countries. Other acceptable methodologies may result in higher or lower discount rates, depending on market conditions.

WTW Pension Liability Index

- The Pension Liability Index tracks the change in the benchmark plan's obligations due to the accumulation of interest and changes in financial assumptions. For this purpose, the obligations are measured based on the requirements of U.S. and International accounting standards.*
- Contributions are set equal to the level of benefit payments for the benchmark plan.

WTW Pension Index

- The WTW Pension Index is the ratio of market value of assets to accounting obligations for the benchmark plan. Assets change from month to month based on the investment performance of the 50% / 50% portfolio, assumed contributions and benefit payments. Liabilities change from month to month due to accumulated service cost and interest, benefit payments and the effects of any other changes in the WTW Pension Liability Index. The WTW Pension Index is an accounting measure, not a funding measure. As such, it is not appropriate to consider this as a measure of a pension plan's funding, which is based on statutory requirements.

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* The discount rate assumption is adjusted to reflect changes in market interest rates. Our benchmark plan is a traditional final-pay pension plan with approximately half of the liabilities in respect of active employees and half of the liabilities in respect of terminated vested and retired employees. Plans with different designs or demographic characteristics will see different results in terms of both the level of appropriate discount rate and the plan's response to changes in financial assumptions.