TEN INVESTMENT ACTIONS FOR DEFINED BENEFIT PLANS IN 2019:

A decade after the last major recession of the U.S. economy, many have been convinced that the current environment is the new normal. Soaring equities and low interest rates have been predominant features of investments; rising Pension Benefit Guaranty Corporation premiums, artificially smoothed discount rates and increasing settlement activity have also been present. While some of these features might become part of a new normal, some might be cyclical. To understand the future, we need to examine the past. In this paper, we will look at 10 investment actions and discuss what they mean for future planning.

1. Avoid surprises.

During the global financial crisis (GFC), the average plan saw its funded ratio fall by 25%. Businesses were stressed, and those with large pension obligations got an extra kick in the shin as they were forced to source extra cash for their plan. The good news is there are still tools that can be used to simulate different economic environments to help clients better understand the potential impacts of financial risks and develop strategies to manage them.

2. Reduce uncompensated risks.

Not all asset classes, managers and strategies struggled during the GFC. Some investment strategies â€” like reinsurance, merger arbitrage and momentum â€" came out of the period ahead. Going forward, it's unlikely that everything will implode at the same time, so diversity is key. Potentially reducing reliance on the high-flying equity portfolio should be explored.

3. Make every dollar work harder.

In the 1990s, before liability-driven investing became the dominant paradigm, most sponsors thought like endowments. They intended to keep plans open forever and targeting an 8% expected return seemed perfectly reasonable. With the shift toward closed, frozen and terminated plans with the potential transfer of risk to insurers, many portfolios have loaded up on long credit bonds, reducing their return potential. There is a delicate balance between building a powerful return generator and managing your liabilities, but it need not be one or the other. Through capital efficiency and diversification, we believe the appropriate balance can be achieved.

4. Concentrate your equity bets.

Before the 1970s, active management dominated equity strategies. Then, in 1975, Vanguard introduced passive management and later, in 1992, Fama & French introduced smart beta. Today, there is a well-documented flow of assets from active to passive strategies. But according to academic research from Brands, Brown and Gallagher, and Jiang, Verbeek and Wang, plan sponsors may be missing an opportunity to add value. To implement this research, we've partnered with a number of equity managers to build high-concentration mandates without all the extra fluff. And we have to say: We're very pleased with the results.

5. Be a bond market trendsetter.

At the end of 1989, the global bond universe represented $12 trillion; 61% of debt was issued in the U.S. Today, the bond market represents nearly $110 trillion with 36% issued in the U.S., 41% in developed markets and 21% in emerging markets. If your governance structure allows, (see item 9), we believe there are large opportunity sets in securitized credit, banks loans and private debt. Even for the less adventurous investor, it's worth exploring ways you can use the expanded bond universe to overcome the dwindling long credit supply or to build an attractive growth complement to equities. Remember: If you're going to dabble in more esoteric investments, diversification is crucial.

6. Revisit financial management strategies.

Sponsors may be seeing their highest plan funded status since the GFC. This could be due to accelerated contributions to capture higher deductions prior to tax reform, strong equity returns or higher interest rates. If you saw your funded status nosedive a decade ago, you have a second chance at locking in your improved position. Revisit your company's funding and accounting policies, the plan's strategic asset allocation, and progress along your de-risking glidepath and long-term forecasts of plan financials to confirm the path you're on is the right one for you.

7. Stay informed about the changing annuity marketplace.
Prior to 2012, the annuity purchase marketplace averaged $1.5 billion in transactions per year. In 2017, this figure was $23 billion. Increasing funding levels have further shifted the focus to the de-risking journey. The majority of the obligations that have been settled to date have been focused on retiree-only transactions. Insurance markets are continually evolving to meet plan sponsor demand, with more flexibility in how sponsors transact. When your investment consultant and actuary partner together, we believe you can better define the appropriate transaction size, manage the required liquidity and identify potential asset-in-kind transfer opportunities.

8. Focus on value-for-fees rather than the fees themselves.
In the year 2000, the average mutual fund or exchange-traded fund cost 100 bps for active and 25 bps for passive; today, those numbers are 72 bps and 15 bps. Sponsors are increasingly focused on reducing investment fees, and rightly so. However, at Willis Towers Watson we emphasize the value for fees, not the fees themselves. Many of the strategies we describe earlier might result in higher headline fees, but if they lead to significantly lower contributions for you, the value-add might just be worth the higher fee. All this said, managing headline costs and negotiating with high-conviction managers can get you the right product at the right price.

9. Consider your governance structure.
Sponsors have constantly faced too many decisions with insufficient time to vet them. That's why, in 1998, Willis Towers Watson ran its first "implementation consulting" mandate. Twenty years later, delegation â€" or outsourced chief investment officer â€" is everywhere; we manage over $116 billion in assets for our clients. Across all providers, there are almost $2 trillion in global delegated assets, and there's good reason why. Sponsors are continuing to find that delegation can potentially lead to better financial outcomes, better execution and better value and also help to provide an additional layer to fiduciary documentation and oversight that is critical to supporting fiduciary decisions.

10. Maintain your defined benefit (DB) plan if it's the right fit for your company.
While corporate pension plans were established as early as 1875, the modern pension plan took its form following the Great Depression, alongside Social Security. The main objectives were to help older employees to retire and to prevent poverty for the aged. Today, as more and more sponsors close or freeze their DB plans and switch to defined contribution (DC) only arrangements, their ability to accomplish these goals may be challenged. Despite the trend from DB to DC, many of our clients maintain commitments to open DB plans, working with us to construct risk managed and sustainable plan designs and portfolio solutions.

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