THE DAILY CHECK-IN WITH GOLDMAN SACHS

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Liz Bowyer: Hi, Mike.

Michael Moran: Hi, Liz.

Liz Bowyer: Coming out of the volatility of 2020, let's talk about how retirement plans have fared. Maybe starting with corporate defined benefit pension plans.

Michael Moran: Well, 2020 was certainly a wild ride for all investors, and corporate defined benefit pension plans were not immune to that. If we think back to the first quarter of last year with equity values falling quite dramatically, that really lowered the funded ratios -- the difference between the assets and liabilities of these plans -- quite dramatically. However, as we all saw during the last three quarters of 2020, financial asset prices came back quite strong.

Now, that's the good news. The challenge for many of these organizations, though, is with interest rates remaining quite low, their liabilities were elevated. Now, over the next couple of weeks, Liz, companies will start to report their annual results when they file their 10(k)'s with the Securities and Exchange Commission. But our modeling would guest that when we think about funded ratios of these plans, they really didn't change that much in 2020 despite those strong financial asset returns. And again, a lot of it comes back to the low interest rate environment and what that means for their liabilities. So certainly that has been a source of frustration for many plan sponsors in 2020. But quite honestly, it's been a source of frustration for the last 10 years. Really, if we think back all the way post financial crisis, financial asset returns have been quite strong across many asset classes, but yet funded ratios really haven't risen that much. And it's predominantly due to that low interest rate environment what it means for pension plan liabilities.

Liz Bowyer: So let's talk more about the low interest rate environment. How are you talking with plan sponsors about how to think about that?

Michael Moran: Well, certainly in the first few weeks of 2021 we've seen interest rates start to rise, and we've seen increased concern around potentially higher inflation in the future. And that has caused a lot of consternation for some investors as they think about how higher interest rates and inflation may affect the valuation of different asset classes. But for corporate defined benefit pension plan sponsors, higher interest rates would actually be welcome news. As we've talked about, lower interest rates and falling interest rates have been the biggest headwind for these plans over the last 10-15 years as they inflated the value of their liabilities. So if interest rates were to rise, that would lower the value of their liabilities and allow them to increase their funded ratios.

The key question becomes then, if their funded ratios go up because of higher interest rates, can they take advantage of that by shifting their asset allocation to lock in those gains? One of the biggest mistakes we've seen client sponsors make over the past 10-15 years is not taking advantage of de-risking opportunities within their asset allocation when they had the opportunity to do so because funded levels had risen.

Liz Bowyer: And what else are you focused on when it comes to corporate pension plans?

Michael Moran: So, Liz, I focus on two other themes. And one of them is not germane to corporate defined benefit pension plans. It's really something that's applicable to all of our institutional investing clients -- corporate plans, public plans, endowments, foundations. And it's really how to think about where to find return in what will likely be a low-return environment not just in 2021 but really over the next several years. When we think about low interest rates that are potentially now rising and what that may mean for fixed income returns and how that may translate into the valuation of other asset classes, many are concerned about if I have a 6-7% nominal return target, how am I going to achieve that over the next couple of years given where we're starting from at the beginning of 2021?

And then the other thing I might talk about and it really ties into that is governance. If we think back to early 2020 and what happened during the beginning of the pandemic, some sponsors may have realized we're not set up to actually have the right asset allocation to deal with that type of environment, and they may not have been nimble enough to take advantage of dislocations. Now, as we think about 2021, potentially rising interest rates, maybe having to shift asset allocation if my funded level rises, and how do I find return in the low-return environment? Many may be looking for other sources of help, other strategic partners to help them navigate what will likely be a difficult environment.

Liz Bowyer: And so what does all of this mean for asset allocation strategies?

Michael Moran: So I'd focus on three things, Liz. And the first is if we come back to it's going to be a difficult return environment going forward, if what we're going to get from public equity and public fixed income going forward is likely to be lower than what we've achieved in the past, you're seeing many investors look more increasingly into the private markets -- private equity, private debt, and real estate. And this is certainly not a new trend but is a trend that has really accelerated given the current environment. And we don't see it slowing down anytime soon.

The second strategy I would talk about is active equity management. We certainly all know post financial crisis there was a strong move to passive equity strategies, and that worked out quite well for investors. But now when we look at the environment today, it may be quite ripe for active equity management. When you look at the increased dispersion of returns, when we look at increased dispersion around analyst earnings estimates, the opportunity set may be better today than it has been. And again if I come back to not only trying to generate extra return to meet that 6-7% return target that many investors have, but also looking at how do I just justify that number? If public equity beta, public fixed income is not going to get me there, I need to layer in some alpha assumptions to get to that higher number.

The last strategy I would talk about is leverage, and this comes back to corporate pension plans. Many of them are focused not only on generating returns but on hedging their liability. Beauty potentially using interest rate swaps and futures as a way to get that hedge on the immunizing part of their portfolio, they can allocate more capital to the return-granting side of the portfolio. And hopefully that can be additive to returns.

Liz Bowyer: And how about individual savers? How did last year's volatility affect their ability to invest in their 401(k)'s and IRAs?

Michael Moran: So the good news for many individual investors last year is many of them didn't do much. And I say that's a good thing because, as we all know, many individual investors tend to buy high, sell low, chase performance, jump in and out of the market. And by staying the course, many of them were able to reap the benefits of that bounce back in financial asset prices over the last three quarters of 2020. Now, part of the reason why many of them may be staying the course and not doing much is the increased use of target date funds and manage to cast that we've seen over the last 10-15 years. They have professional management rebalanced appropriate, and so investors don't have to worry about making any changes or are not making any changes because it's being managed in that way.

So when we look at the returns that we achieved in 2020 combined with contributions that many participants continue to make, many defined contribution balances increased by double digit percentages last year. So it was certainly a stressful year from a financial market perspective, but for those that stayed the course, continued to invest, stayed with their strategic asset allocation, they certainly were able to reap the benefits of that.

Liz Bowyer: And what are the big issues to watch for individual investors this year?

Michael Moran: So, Liz, one of the things we're really focused on in 2021 that is likely to be another active year for retirement-related legislation. If we think back to pre pandemic, late 2019, congress had passed the Secure Act, which was the most significant piece of retirement legislation in about 15 years. And one of the things the Secure Act focused on was increasing retirement plan coverage. A lot of participants in this country or employees in this country are not covered by any sort of retirement program, whether that be defined benefit or defined contribution. About one third of private sector workers are not covered by a defined contribution program, and that percentage rises to about 50% when we look at smaller employers.

So as we think about 2021, while there's a number of things that Washington is working on right now and I'm certainly not here to say retirement is going to be number one on their agenda, there is a lot of bipartisan support for additional retirement-related legislation that will potentially again continue to increase coverage, increase ways for participants to save. And we're already talking about Secure Act 2.0, sort of building on that

Secure Act 1.0. What else can we do to help participants? And again this ultimately is good for individuals as they think about greater access to savings vehicles as well as greater ways to save within those retirement programs.

Liz Bowyer : And finally, Mike, for individual retirement savers who are thinking about their allocation strategies in 2021 and beyond, what are the things that should be top of mind?

Michael Moran: Well, I'd say the first thing, Liz, is just as 2020 showed us that there's a benefit to staying invested, staying with your long-term strategic asset allocation and rebalancing, for a lot of investors and defined contribution participants it'll be another case of staying the course and being in it for the long haul.

But the second thing I would say is at the beginning of the year is usually a good time in many ways to reassess a number of different things, and one of them could be an investor's risk tolerance. Some of them my a have realized in 2020 when we had a lot of volatility that maybe they had too much risk in their portfolio. And conversely, some others, especially younger investors, may have realized they didn't have enough risk and they were not reaping the benefits that we saw in the last three quarters of the year when financial asset prices rebounded. And in some cases, this reevaluation of tolerance of risk may also lead some to consider maybe they need additional help in managing their own defined contribution plan portfolio. Maybe they need to take advantage of a managed account offering that a plan sponsor may offer.

The third thing I would focus on is retirement income. The reality is that every year more and more participants are retiring that are not covered by defined benefit programs. So they're relying on their defined contribution program and Social Security. So how to turn that pool of assets into retirement income stream is increasingly important. And certainly the Secure Act provided access to annuities in retirement programs, but outside of annuities, other participants, plan sponsors are thinking about what else they can put on that menu to generate income and retirement. And certainly as an asset management industry we're also focused on what solutions we can make to plan sponsors and participants in this area.

Liz Bowyer: Thanks, Mike.

Michael Moran: Thanks, Liz.