

## Liability-Driven Investing (LDI): Finding a Shorter, Different Path

The rise in corporate bond yields over the past few years caused several chain reactions affecting corporate defined benefit plans:

- The average plans' duration has decreased.
- The average funded status has vastly improved (helped by strong equity returns), racing through glidepath triggers and requiring increased fixed income allocations.
- Higher fixed income allocations are now driving two asset allocation decisions within fixed income:
  - The desire for alternatives to corporate credit - the top 10 issuers in the Bloomberg US Long Corporate and Long Credit Bond Indices represent ~15% of each Index.
  - A need to focus on hedging intermediate duration liabilities to mitigate curve risk.

*We believe plan sponsors can address these needs with an allocation to an Intermediate Aggregate strategy - the plan receives exposure to a broader opportunity set with diversification from the high quality securitized space.*

### Is it time to consider a shorter path?

- Plans often calculate the present value of their liabilities using discount rates based on high quality, mostly AA-rated corporate bonds. To reduce funded status volatility, many plans invest substantial portions of plan assets in long corporate bonds.
- However, corporate pensions' fixed income duration needs have been trending down. With most plans soft or hard frozen, liability durations will continue to decrease as plans age.
- Recent higher funded statuses and increased allocations to fixed income have also resulted in reduced duration requirements to maintain target hedge ratios, which now makes an intermediate allocation more attractive.
- An intermediate allocation can also help reduce curve risk without getting as precise as duration/cash flow matching or pure immunization.

*Adding an Intermediate Duration Index can help meet hedge ratios, while also providing broader curve exposure and improving the hedge with liabilities.*

### What path to take in the intermediate space?

- For most plans, the return-seeking component continues to be higher beta versus the liability return, usually coming in the form of equities or, in fixed income, lower-rated and/or illiquid credit.

### Authors



**Dmitri Rabin**

Managing Director,  
Fixed Income Rates and  
Securitized Portfolio  
Manager



**Jennifer Karpinski,  
CFA**

Managing Director,  
Client Portfolio  
Manager

- In our view, higher beta fixed income has disadvantages during periods of volatility as this allocation can reduce liquidity and cause higher negative skew versus liabilities.
- A pure Credit Index does not help mitigate these risks, and many plans already have large allocations to corporate credit. However, the securitized market offers a high quality, liquid, diversified, and lower volatility alternative to corporate credit in the intermediate part of the curve.

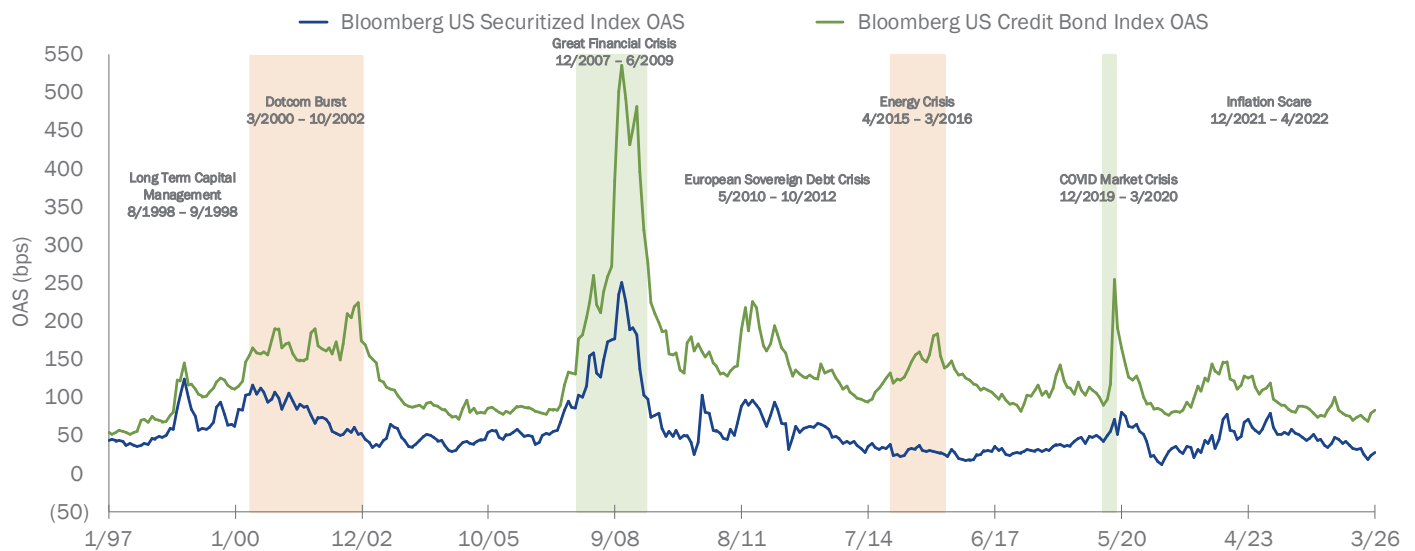
**An alternative to Intermediate Credit is allocating to the Bloomberg US Intermediate Aggregate Bond Index where securitized comprises ~31% of the underlying Index.**

### How to navigate the securitized market along an LDI journey?

- We define high quality securitized primarily as Agency MBS, AAA CMBS, and AAA Consumer ABS.
  - Agency MBS is a large market (~7.4T in market value^), offers good liquidity (especially in the TBA market), has an implicit/explicit government guarantee, and delivers diversification versus corporate credit.
  - AAA CMBS and AAA Consumer ABS offer very good liquidity and structural protections that can reduce both correlation and downside versus corporate credit.
  - Plan sponsors may consider limiting exposure to Non-Agency RMBS and Agency CMOs, due to weaker liquidity, as well as avoiding CLOs, Aircraft ABS, and other non-AAA securitized sectors, due to little diversification benefit versus corporate credit.
- Our analysis of high quality securitized has shown the following:
  - Securitized tends to widen with corporate credit during liquidity crises, but not when widening is credit specific (Exhibit 1).
  - Securitized shows a low correlation of excess returns to other spread sectors and very low correlation to equities (Exhibit 2).
  - Securitized has outperformed U.S. Treasuries and the risk-adjusted returns are attractive compared to high quality corporate credit (Exhibit 3).

**We believe by incorporating high quality securitized assets into an LDI asset allocation strategy a plan can achieve diversification, increase liquidity, and reduce funded status volatility (particularly on the downside).**

### Exhibit 1: Securitized tends to widen with corporate credit during liquidity crises (2008, 2020), but not when widening is credit specific (2002, 2015)



As of March 31, 2026. The orange shaded time periods represent when credit and securitized both widen, and the green shaded time periods represents specific credit widening periods shown by the date ranges in the call-out boxes above. The above time frame represents long term historical market cycles.

**Exhibit 2: Securitized Index shows a low correlation of excess returns to other spread sectors and very low correlation to equities\***

| 10 Year Excess Returns (%) as of March 31, 2026 | Bloomberg US Securitized Index** | Bloomberg US Intermediate Credit Bond Index | S&P 500 Index |
|---|----------------------------------|---|---------------|
| Bloomberg US Securitized Index**                | 1.00                             | 0.83  | 0.39          |
| Bloomberg US Intermediate Credit Bond Index     | 0.83                             | 1.00  | 0.56          |
| S&P 500 Index                                   | 0.39                             | 0.56  | 1.00          |

\*Statement based on table below. Past performance does not guarantee future results.

\*\*Bloomberg US Securitized Index is comprised of the Bloomberg US Mortgage Backed Securities Index, the Bloomberg US Asset Backed Securities Index and the Bloomberg US CMBS Index.

**Exhibit 3: Securitized has outperformed U.S. Treasuries and the risk-adjusted returns are attractive compared to high quality corporate credit**

| As of March 31, 2026       | Bloomberg US Securitized Index | Bloomberg US Intermediate Aggregate Bond Index | Bloomberg US Intermediate Credit Bond Index | Bloomberg US Intermediate Treasury Bond Index |
|----------------------------|--------------------------------|--|---|---|
| Average Quality (MDY/S&P)  | Aa1/AA+                        | Aa2/AA   | A3/A-                                       | Aa1/AA+                                       |
| Current Yield to Worst (%) | 4.82                           | 4.40   | 4.72  | 3.93  |
| Current Duration (years)   | 5.23                           | 4.21   | 4.09  | 3.58  |
| <b>Since 12/31/1999</b>    |                                |  |   |   |
| Annualized Return (%)      | 3.85                           | 3.85   | 4.59  | 3.35  |
| Standard Deviation (%)     | 3.73                           | 3.43   | 4.36  | 3.73  |
| Worst Monthly Return (%)   | (4.88)                         | (3.48)   | (5.90)                                      | (2.53)  |
| Sharpe Ratio (%)           | 0.52                           | 0.56   | 0.61  | 0.38  |
| Average Yield to Worst (%) | 4.08                           | 3.54   | 3.97  | 2.59  |
| Average Duration (years)   | 3.92                           | 3.84   | 4.24  | 3.67  |

Past performance does not guarantee future results. Average Quality computed using Bloomberg ratings methodology. Bloomberg ratings methodology reflects the ratings of Moody's, Fitch and S&P in such a way that if three different ratings exist for the same instrument, the median rating is used; if two different ratings exist, the lower of the two is used and if only one rating exists, then that rating is used. If the debt instrument has not been rated by any of the three rating agencies, the security is classified as "Unrated." Time frame shown above represents long term historical market cycles for each index.

## Where is the bump in the road?

- One of the main reasons LDI investors have shied away from securitized in an LDI framework is the negative convexity of Agency MBS, which results in fluctuating durations.
  - Agency MBS' price/rate relationship is negatively convex, due to the likelihood the homeowner will refinance into a lower-rate mortgage when yields fall, and conversely, the homeowner's tendency to remain in the mortgage when yields rise. As a result of prepayments, the expected maturity (duration) of the security shortens, as principal is returned sooner, and the investor will be faced with reinvesting at lower rates. When rates increase and prepayments slow, the duration extends.
- These risks can be managed through active portfolio management that utilizes sector rotation, security selection, portfolio hedges, and duration management.
  - For example, we evaluate changing Agency MBS durations in determining relative value and hedging. We keep the total portfolio duration neutral to the benchmark, and we utilize ten key-rates (1yr, 2yr, 3yr, 5yr, 7yr, 10yr, 15yr, 20yr, 25yr, and 30yr) to hedge our Agency MBS exposure versus the market practice of only using the 10yr key-rate.

## Does a shorter, different path fit your plans' objectives?

- We believe active investors in the securitized market, specifically in Agency MBS, have significant opportunities to generate alpha from sector rotation, security selection, and duration management.
- Historically, the risk-adjusted returns of the Securitized and Intermediate Aggregate Indices have offered a competitive alternative to corporate credit indices with a lower volatility profile.
- By allocating to an Intermediate Aggregate strategy, a plan gets additional diversification (via its securitized exposure) versus corporate credit and a low correlation to equities, especially during times of market stress.
- At Jennison, we have more than 40 years of experience partnering with our pension clients in crafting custom LDI solutions. We can help clients navigate the unique risks and opportunities of the market to determine if an Intermediate Aggregate strategy can help meet your plans' objectives.

## End Notes

Sources:

Jennison

Moody's Investor Services, Inc.

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All data provided is as of 03/31/2026.

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### Market Definitions:

**Beta** – a measure of the volatility of a security or portfolio compared to the market as a whole.

**Duration** – a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates.

**Excess Return** – is the additional return generated by the portfolio or composite relative to its benchmark.

**Maturity** – the date on which the life of a transaction or financial instrument ends, after which it must either be renewed or it will cease to exist. The term is most commonly used in relation to bonds but is also used for deposits, currencies, interest rate and commodity swaps, options, loans, and other transactions.

**Option Adjusted Spread (OAS)** – the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is then adjusted to take into account an embedded option.

**Sharpe Ratio** – a measure of an investment's risk-adjusted performance, calculated by comparing its return to that of a risk-free asset.

**Standard Deviation** – a statistic that measures the dispersion of a dataset relative to its mean and is calculated as the square root of the variance.

**To Be Announced (TBA)** – a term that describes the forward-settling of mortgage-backed securities trades, where the details are not known until later.

**Yield** – a general term that relates to the return on the capital you invest in a bond.

**Yield to Worst (YTW)** – a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.

**Benchmark Definitions:**

**Bloomberg US Credit Bond Index** includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The non-corporate sectors are Sovereign, Supranational, Foreign Agency, and Foreign Local Government.

**Bloomberg US Intermediate Credit Bond Index** includes securities in the intermediate maturity range of the US Credit Bond Index.

**Bloomberg US Long Credit Bond Index** includes securities in the long maturity range of the US Credit Bond Index.

**Bloomberg US Corporate Bond Index** is the corporate component of the US Credit Bond Index. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations.

**Bloomberg US Long Corporate Bond Index** includes securities in the long maturity range of the US Corporate Bond Index.

**Bloomberg US Securitized Index** is comprised of the Bloomberg US Mortgage Backed Securities Index, the Bloomberg US Asset Backed Securities Index and the Bloomberg US CMBS Index.

**Bloomberg US Mortgage Backed Securities Index** is a component of the US Aggregate Index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The MBS Index is formed by grouping the universe of over 600,000 individual fixed rate MBS pools into approximately 3,500 generic aggregates. Each aggregate is a proxy for the outstanding pools for a given agency, program, issue year, and coupon. The index maturity and liquidity criteria are then applied to these aggregates to determine which qualify for inclusion in the index. About 600 of these generic aggregates meet the criteria. The aggregates included in the index are priced daily using a matrix pricing routine based on trader price quotations by agency, program, coupon, and degree of seasoning.

**Bloomberg US Asset Backed Securities Index** is a component of the US Aggregate Index. The ABS Index has three subsectors: Credit and charge cards, Autos, and Utility. The index includes pass-through, bullet, and controlled amortization structures. The ABS Index includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche.

**Bloomberg US CMBS Index** has been designed to measure the performance of the commercial mortgage-backed securities (CMBS) market.

**Bloomberg US Treasury Bond Index** includes public obligations of the US Treasury with a remaining maturity of one year or more. The index is the US Treasury component of the US Government Bond Index.

**Bloomberg US Intermediate Treasury Bond Index** includes securities in the intermediate maturity range of the US Treasury Bond Index.

**Bloomberg US Aggregate Bond Index** includes securities that are US domestic, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

**Bloomberg US Intermediate Aggregate Bond Index** includes securities in the intermediate maturity range of the US Aggregate Bond Index.

**Standard & Poor's 500 (S&P 500) Index** is a market capitalization-weighted index of 500 companies primarily traded on the New York Stock Exchange.

2026-3861273