

# US Rates Watch

## Private pension fund rebalancing update

### Rough estimate for direction of rebalancing needs

We use the framework introduced in the [Pension fund rebalancing and UST demand](#) report, to estimate expected September quarter-end rebalancing flows. The rebalancing needs of a portfolio that contains two assets (with allocation weights  $w_1$  and  $1-w_1$ ) and  $N$  assets under management is a function of the relative total return performance of the two asset classes ( $r_1-r_2$ ):

$$\text{Rebalance} = N * w_1 * (1-w_1) * (r_1-r_2)$$

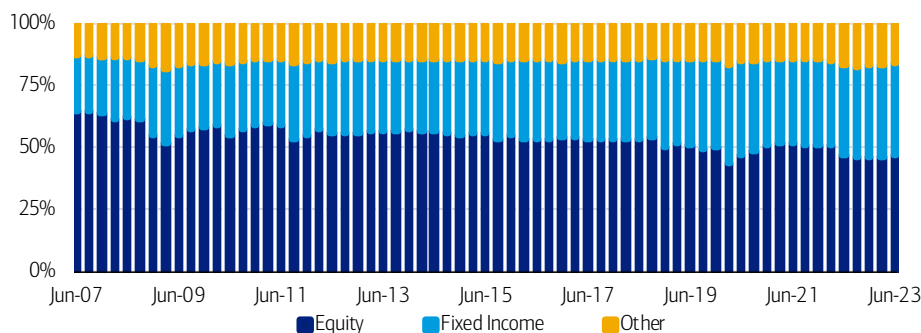
With the S&P total return month to date at c.-1.1%, and 10y+ UST index c.-2.6% total return over the same period, the expectation is for a rebalancing out of equities and into fixed income. For the quarter, the performance is c.0.4% and c.-7.1%, respectively, supporting a more significant rebalancing out of equities.

### Our expectations for rebalancing flows

Assuming only c.1/3 of the July and August rebalance was performed at the respective month ends, we see c.\$13bn flows out of equities and into FI (standard deviation of monthly rebalance over the last 3y is c.\$22bn for equities & 8bn for USTs). In the FI space, the flows break down as: c.\$12bn into Treasuries, c.\$2bn into Corporates, c.\$1bn out of Agency & GSE-backed securities, and unchanged Mortgages.

#### Exhibit 1: Allocation breakdown for private pension funds obtained from the FRB Z.1 release

Equity allocations c.46-47% over the last 5 quarters, UST allocations >10% for the first time since 2Q20



Source: BofA Global Research, FRB Z.1 Release

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### Passive rebalancing vs structural demand

Beyond passive rebalancing, we continue to expect some structural demand for duration from pension funds (see [Pension de-risking opportunity may narrow with lower rates](#)), particularly as funded ratios reach levels above 100% (currently c.103.3%). In the de-risking process, the broader pension fund allocation profile converges over time to a target allocation with significantly higher fixed income contents and lower equity exposures. This structural demand is likely to persist medium/longer term.

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c.: circa

FI: fixed income

GSE: Government-Sponsored Enterprise

UST: US Treasury

N: Assets Under Management

r: Return

w = Allocation Weight

10y = 10-year

c. = circa

FI = fixed income

## Methodology

The data sources we use in our framework are pension fund allocation weights obtained from the Federal Reserve Board (FRB) Z.1 release and total return performance for each of the asset classes. Critical to this process is the choice of the appropriate benchmarks that define the performance of each asset class.

The FRB Z.1 release segregates private pension fund assets into (1) checkable deposits and currency; (2) time and savings deposits; (3) money market fund shares; (4) security repurchase agreements; (5) open market paper (also known as commercial paper); (6) Treasury securities; (7) agency and GSE-backed securities; (8) corporate and foreign bonds; (9) loans (mortgages); (10) corporate securities; (11) mutual fund shares; (12) unallocated insurance contracts; (13) assets of private pension plans held at life insurance (LI) companies; (14) contributions receivable; and (14) claims of pension fund on sponsor (unfunded defined benefit pension entitlements).

In our approach, we aggregate these into equities (10+11), fixed income securities (6+7+8+9), and other assets. Together, the first two generally amount to 70-80% of total assets (5-10% in Treasuries). For each of these assets (6 to 11 above), we assign a benchmark to calculate their expected performance – for example, the S&P total return for the equity portion of the allocation (10+11) and the total return on the ICE BofA 10+ Year US Treasury Index for the Treasury portion (6).

In this framework, we assume that the allocation weights are kept constant from the last information available and calculate the monthly and quarterly rebalancing needs based on the performance of assets and the assumption of convergence back to target allocation. Because there are clear trends in allocation weights over time, we correct the rebalancing weights by the average allocation drift seen over the last two quarters.

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