

1H Pension Perspectives¹

Key Takeaways

- Single-employer defined benefit (DB) plans generally weathered market volatility well in the first six months of 2025, with aggregate funded ratios remaining above 100%.
- Although our base-case macro outlook calls for a gradual economic slowdown and an overall decline in interest rates over the next two years, we expect periodic bouts of volatility across capital markets, including interest rates. Consequently, we believe it is prudent to maintain target interest rate hedge ratios.
- After rapidly widening in April, investment-grade credit (IG) spreads returned to historically tight levels by quarter end. Plan sponsors may wish to tactically underweight IG credit; seek out high-quality, credit-adjacent assets; and rely on active management to outperform benchmarks and liabilities.
- Deploying legacy DB surpluses to fund ongoing defined contribution (DC) benefits may be an attractive option for plan sponsors with overfunded plans, as some recent plan changes and legislative proposals suggest.
- By lowering plan-sponsor investment risk, variable annuity and market-return cash balance designs may be particularly relevant to plan sponsors considering re-opening their DB plans.

Funded Status Drivers

Figure 1. Funded Status Drivers

	June 30, 2025	December 31, 2024
Milliman 100 Funded Status	105.1%	103.6%
Discount Rate (Aa)	5.52%	5.59%
U.S. 10-Year Treasury Yield	4.23%	4.57%
U.S. 30-Year Treasury Yield	4.78%	4.78%
Bloomberg U.S. Long Credit Spread (OAS)	102 bps ²	100 bps
Global Equities (MSCI ACWI Index) Net Total Return	YTD 2025: 10.05%	

Source: Bloomberg Index Services, Milliman, MSCI. The funded status and discount rate are for the Milliman 100 Pension Funding Index.

Although capital markets largely ended the first half of 2025 on a high note, the positive returns across a broad range of asset classes masked significant intra-period volatility as policy uncertainty, especially around tariff announcements, weighed on investors. Against this backdrop, 10-year U.S. Treasury yields traded in an 80-bp range, while Long Credit spreads executed a 35-bp near-round-trip during the six-month period. The S&P 500 Index returned -15.0% through April 8 but recovered handsomely and ended the

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first half of 2025 with a 6.2% return. Notably, the U.S. dollar fell against a broad basket of currencies, contributing to the strong outperformance of non-U.S. equities over U.S. equities.

Despite the volatility, in aggregate, corporate pension plans remained well funded, thanks to high hedge ratios, declining allocations to return-seeking assets, and diversified portfolios. Many plans, especially those with high allocations to return-seeking assets, achieved even higher funded status, as year-to-date equity market returns outweighed the increases in liabilities resulting from lower high-quality corporate bond yields. Valuation-focused investors had opportunities to rebalance and adjust their asset allocations, although some of the market dislocations were short-lived.

Expecting a Slowing Economy and Volatile Markets

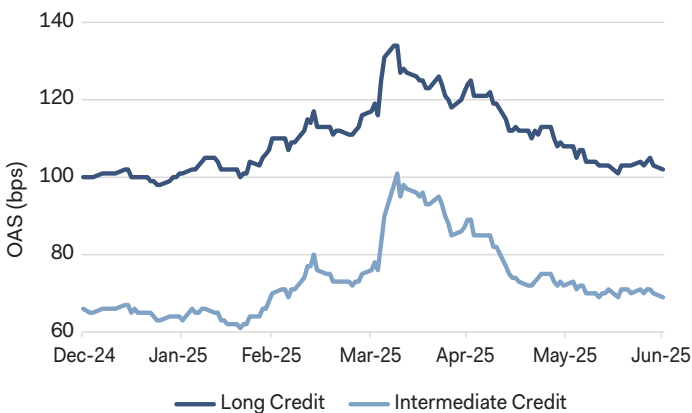
Broadly speaking, at the start of 2025, the markets expected the Trump administration to enact pro-growth policies, such as deregulation and reduction in business taxes. However, with the administration’s focus on tariffs and the passage of the One Big Beautiful Bill Act (“OBBA”), we believe global growth is likely to slow, the U.S. yield curve is likely to steepen, and bouts of policy-driven market volatility are likely to re-occur in the next few years. We expect inflation to rise in the next year or so on the back of higher tariffs and then return to the Federal Reserve’s target rate, allowing the Fed to address a slowing economy and cut interest rates. On the other hand, growth in the U.S. debt-to-GDP ratio, risks to Fed independence, and decreasing demand for U.S. Treasuries may pressure long-end rates to stay higher for longer.

Against this backdrop, we believe plan sponsors are best served by fully hedging their biggest pension plan risk and maintaining target interest rate hedge ratios. Plan sponsors with longer-term horizons and/or the ability to move quickly may also wish to consider underweighting risk assets in general and U.S. equities in particular.

Navigating the Credit Spread Environment

Based on our conversations with clients, many plan sponsors and liability-hedging (LH) investment managers, including Dodge & Cox, entered this year underweight credit spread risk relative to long-term targets. The spread widening occurring around the April 2 “Liberation Day” tariff announcements was sharp, but the subsequent tightening was more gradual (see Figure 2). For example, Long Credit spreads widened 18 bps in three trading days, but it took more than a month to tighten 18 bps. This dynamic, also evident in some prior event-driven, spread-widening episodes, provided ample time to add to credit, even without timing the exact top in credit spreads. In Dodge & Cox liability-hedging strategies, we added to credit, emphasizing defensive positioning either by maturity (i.e., intermediate rather than long) or quality (higher versus lower), but remain below our strategies’ typical credit exposure.

Figure 2. Credit Spread Valuations



Source: Bloomberg Index Services.

The widening was particularly acute in Intermediate Credit and below-IG credit (especially when measured in percentage terms), and the highs achieved on April 8 exceeded 20-year medians (see Figure 3). The difference in widening between Long and Intermediate Credit can be partly explained by greater liquidity and more efficient price discovery in the intermediate space, a larger “buy-and-hold” investor base in the long space (e.g., life insurance companies), and constrained new issue supply at the long end.

Speaking of supply, while gross IG corporate issuance year-to-date through June 30 exceeded the same period for 2024 by 4%, net supply was 24% lower. Moreover, issuance of IG corporate bonds with more than ten years to maturity fell to just 12% of all IG corporate issuance, compared to 17% in 2024.

Figure 3. Credit Spread Valuations

	Long Credit		Intermediate Credit		High Yield Corp	
	OAS (bp)	Percentile	OAS (bp)	Percentile	OAS (bp)	Percentile
Jun 30, 2025	102	2	69	12	290	7
Apr 8, 2025	134	24	101	54	453	58
Dec 31, 2024	100	1	66	8	287	6
20-Year Median	167	50	97	50	425	50

Source: Bloomberg Index Services. Percentile reflects 20 years of weekly observations ending June 30, 2025.

By mid-year, credit spread valuations essentially returned to their year-end 2024 levels, corporate fundamentals—such as interest coverage ratios—remain largely sound, and fixed income demand is still strong, supported by a broad range of yield-based (rather than spread-based) buyers. In other words, the market appears to be back to where it was six months ago, although some risks, such as fiscal and trade policy, are better defined. In this environment, plan sponsors seeking to outperform market benchmarks and pension liabilities may consider:

- Underweighting IG credit;
- Seeking credit-adjacent sectors that are less exposed to macroeconomic outcomes, including government-backed residential and commercial mortgage-backed securities, AAA tranches of credit-card and auto-loan asset-backed securities, taxable municipal bonds, and high-quality sovereign and quasi-sovereign bonds;
- Relying on investment manager security selection to avoid potential landmines and develop long-term conviction in specific issuers; and
- Preparing to re-allocate into credit should spreads widen and attractive opportunities arise.

A long-term orientation and patience are also critical, as credit spreads may remain range-bound for several quarters, though we believe the risk of widening is much higher than that of tightening further.

Deploying the Surplus: From DC to DB

With nearly two years of strong funding levels and growing surpluses, more plan sponsors are considering alternatives to plan termination, at least according to a recent Mercer survey.³ Further, Milliman estimates that at the end of 2024, 36 of the 100 largest corporate DB plans were frozen and overfunded. As discussed in our paper [Long-Term Solutions for Overfunded Plans](#), there are many potential ways to deploy this surplus, but perhaps the most attractive one today is funding *current, ongoing* retirement benefits from these *legacy* assets rather than from corporate cash.

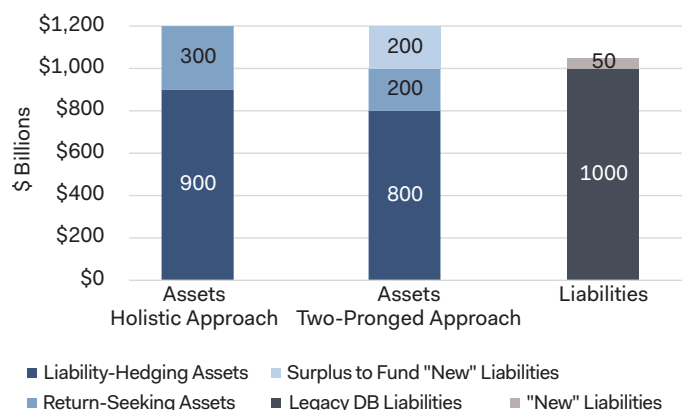
This is precisely what IBM did in 2024 when it re-opened its overfunded cash balance DB plan and shifted its employer-funded retirement benefit from the DC plan to the DB plan. This year, Eversource Energy, a utility in New England with a top-100 DB plan, announced a similar shift for a portion of its DC benefit. This approach also provides contribution timing flexibility: unlike in a DC plan, the plan sponsor can pre-fund contributions in profitable years and reduce contributions in unprofitable years, subject to DB funding requirements.

In both instances, the new DB benefit follows a cash balance formula. We believe this approach, especially with a market-return interest crediting rate, is often most attractive. From a participant perspective, the benefit looks very similar to a DC benefit and allows for market growth, while from a plan sponsor perspective, the annual contribution is fairly predictable, and the market-return interest crediting rate significantly reduces plan sponsor investment risk.

Prior to implementing this strategy, plan sponsors may wish to evaluate the size of the surplus relative to the annual contributions, one-time implementation costs, and ongoing administrative costs, including actuarial and audit fees for the re-opened DB plan and fixed-rate Pension Benefit Guaranty Corporation (PBGC) premiums for new participants.

The investment strategy may also need to change. At a high level, plan sponsors could take a holistic view of the entire plan, for example, implementing a 75%/25% liability-hedging/return-seeking allocation, at least as long as the new cash balance liability is small relative to the legacy DB liability. Alternatively, they could follow a two-pronged approach: a comprehensive liability-hedging strategy to support legacy DB benefits and an investment strategy aligned with the cash balance interest crediting rate for the remaining assets (see Figure 4).

Figure 4. Sample Plan Asset Allocation⁴



Source: Dodge & Cox.

Deploying the Surplus: Funding DC Directly

Implementing the approach outlined above requires plan amendments, employee education, and operational changes. In some instances, it may also require overcoming a historical institutional aversion to or lack of knowledge about DB plans. Much of this complexity would be eliminated if plan sponsors could simply fund their ongoing DC contributions from the DB surplus. However, this is not permitted under current law, unless the DB plan is terminated.

In May, the American Benefits Council, a public policy organization with over 400 members, proposed legislation to allow exactly that, provided DB funded status remains above a certain threshold (e.g., 110%). The proposal includes several other safeguards to protect both DB and DC benefits. A frozen, 110%-funded plan with a comprehensive liability-hedging strategy is very unlikely to become underfunded under a broad range of capital market scenarios, even after accounting for ongoing administrative expenses. Should this proposal become law, plan sponsors seeking to fund the DC plan directly from the DB surplus may consider either a holistic approach or a two-pronged approach, as shown in Figure 4.

While we have no insight as to the likelihood of this proposal passing in Congress, we encourage plan sponsors to consider a range of approaches for turning a "stranded" DB surplus into a useful one.

DB Momentum for Union Plans

Plan sponsors with unionized workforces may wish to note that in May, JBS, one of the world's largest meat processing companies, and the United Food and Commercial Workers Union (UFCW) announced the establishment of a brand-new DB plan for unionized JBS employees. This is the first new DB plan in nearly 40 years for U.S. meatpacking workers. In recent contract negotiations, unionized employees at Boeing and the big three automakers have also sought to re-open their pension plans; however, they were not successful.

The JBS/UFCW plan appears to follow a variable annuity design, where accrued benefits fluctuate with the investment returns on plan assets. Thus, like a market-return cash balance plan design, plan sponsor contributions are fairly stable and plan sponsor investment risk is relatively low. Implementing this approach may make re-opening or establishing new DB plans more palatable in future union negotiations.

Pension Risk Transfer

The Pension Risk Transfer (PRT) market remains strong, though its popularity may be declining among the largest plans. PRT activity totaled \$52 billion in 2024, 14% above 2023 levels and on par with 2022. As in prior years, the average transaction remained well below \$100 million, and there were only a handful of deals over \$1 billion. In the first quarter of 2025, PRT activity totaled \$7.1 billion, less than 50% of the volume for the same period a year ago but above the first quarters of 2023 and 2022. The decline may be explained by market volatility, expectations of an economic slowdown, ongoing PRT litigation, and, perhaps, shifting views around DB surpluses among larger plans.

As always, we welcome the opportunity to speak with you or your advisor about our pension risk management solutions as you progress along your pension journey.

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1. The information in this paper should not be considered fiduciary investment advice under the Employee Retirement Income Security Act. This paper provides general information not individualized to the particular needs of any plan and should not be relied on as a primary basis for investment decisions. The fiduciaries of a plan should consult with their advisers as needed before making investment decisions.
2. Basis points (bps).
3. Wadia, Zorast, Alan Perry, and Ryan Cook. "2025 Corporate Pension Funding Study." *Milliman*, April 30, 2025. <https://www.milliman.com/en/insight/2025-corporate-pension-funding-study>
4. Sample plan reflects \$1.05 billion in liabilities, consisting of \$1 billion in legacy DB liabilities and \$0.05 billion in "new" cash balance liabilities, and \$1.2 billion in assets. Holistic asset allocation reflects a 75%/25% liability-hedging assets (LHA)/return-seeking assets (RSA) split. Two-pronged asset allocation reflects an 80%/20% LHA/RSA allocation for the first \$1 billion in assets, supporting the legacy DB liabilities, and the remaining \$0.2 billion in assets invested in accordance with the "new" cash balance interest crediting rate.