Retirement News Highlights

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Pension Funds Face Narrower Investing Prospects

By Heather Gillers
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State and local pension funds are reaping a historic windfall thanks to billions of dollars in record market gains and surplus tax revenues. Now they need to decide what to do with the money.

It is a bittersweet dilemma that the chronically underfunded retirement systems share with many household and institutional investors around the country. Just when they finally have cash to play around with, every investment opportunity seems perilous.

Leave the money in stocks, and a pension fund becomes more vulnerable to the type of losses suffered in the 2008-09 financial crisis. Move the money into bonds for safekeeping, and the fund risks losing even minimal gains to inflation. Seek out alternative assets to help diversify and drive up returns, and the fund enters a crowded competition for private equity and real estate where it can take years for money to be put to work.

Pension funds and other institutional investors lost 0.06% for the quarter that ended Sept. 30, according to Wilshire Trust Universe Comparison Service data released last week, their first negative return since the early days of the pandemic. After a year of stimulus-fueled economic gains on the heels of a decadelong bull market, it is hard to find bargains anywhere. That means investment chiefs are choosing where to park their unprecedented windfall in an increasingly volatile and unpredictable world.

“There are things going on that I’ve never seen, ever—people leaving the labor market, office buildings being vacant, ships in the middle of the ocean with cargo,” said Angela Miller-May, chief investment officer for the $55 billion Illinois Municipal Retirement Fund. “Even if you’ve had years and years of investment experience, you’ve never experienced anything like this.”

Ms. Miller-May’s fund swelled by more than $10 billion over the past fiscal year, between market gains and contributions from the towns, cities, school districts and other governments it serves. The fund has bought close to $1 billion worth of bonds and, since a board decision to increase alternative investments in December, allocated an additional $1.54 billion to private equity and real estate, Ms. Miller-May said. She said about $140 million of that money has been put to work so far.

Around the country, pension managers are competing to reinvest blockbuster gains from the 2021 fiscal year, which injected around $800 billion into state retirement systems alone, according to an estimate by the Pew Charitable Trusts. The funds, which serve police, teachers and other public workers, still have hundreds of billions of dollars less than needed to cover promised benefits. Even so, they grew more in the 12 months ended June 30 than in any of the past 30 years.

Some pension funds are also getting injections of cash from 2021 state tax collections supercharged by federal stimulus programs.

California transferred an extra $2.31 billion to its teachers' and public workers' pension funds after stock gains and the economic recovery bolstered income tax collections, according to budget documents. Connecticut Treasurer Shawn Wooden is transferring an additional $1.62 billion to that state's teachers' and workers' pension funds in accordance with a mandate that excess revenue be used to pay down debt.

This year New Jersey is making the full pension payment recommended by its actuaries for the first time since 1996, plus an extra half-billion dollars, funneling a total of $6.9 billion to the state's deeply underfunded retirement plan, the New Jersey treasurer's office said.

Asked how the money would be used, a spokeswoman for the state's division of investment said it "will continue to move forward toward the previously established allocation targets." The $101 billion fund's private equity, private credit, real estate and real assets portfolios each contained between $1 billion and $3 billion less than the goal amount as of Aug. 31, records show.

New Jersey's investment division said this fall that it intended to start reinvesting gains from one of its private-equity investments as a way to deploy capital into the asset class more quickly after the fund earned nearly 48% on its private-equity portfolio for the year ended June 30.

Some funds are branching out into new assets. In May, the Jacksonville, Fla., Police and Fire Pension Fund approved the first investment in a recently created $200 million private credit portfolio, a $100 million allocation to Ares Management Corp. The Houston Firefighters' Relief and Retirement Fund in October bought $25 million worth of bitcoin and ether.

One of the most common moves pension funds are making amid the current windfall, however, isn't an investment at all. Instead, retirement systems from South Carolina to Idaho are surveying the market landscape and lowering their investment-return projections at a pace never seen before, said Keith Brainard, research director of the National Association of State Retirement Administrators.

Pension funds have been slowly rolling back those targets for years as a decadeslong drop in bond rates has driven down the amount they can earn on safe fixed-income investments. Several pension officials also said the pandemic-prompted federal funding and market intervention early last year accelerated stock-market gains that otherwise would have unfolded more slowly, reducing expectations for the coming decade.

"There are a lot of questions as to whether the returns are front-loaded and whether they can be sustained," said Kevin Olineck, director of the Oregon Public Employees Retirement System, which lowered projections to 6.9% from 7.2% last month.

Such reductions aren't popular with employers and workers, who end up having to pay more into their pension fund to make up the difference, so last year's windfall makes now a good time to pull the trigger. Oregon's move will cost employees and employers about half as much as it otherwise would as a result of the recent gains, Mr. Olineck estimated, assuming no major losses through the end of the fiscal year.

Back to top