Retirement News Highlights

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Blockbuster Gains Have Public Pensions Dialing Back Projections

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- New York, California, Maryland cut investment targets
- Funds post best one-year returns in more than three decades

One of the most worrisome risks for state and local governments just got a little more manageable.

Blockbuster stock market gains are allowing U.S. public pensions to lower their assumed investment return and the chance that taxpayers have to make up any shortfalls.

On Wednesday, New York's $270 billion retirement fund, the third-largest in the U.S., cut its annual target to 5.9% from 6.8% after posting a record 33.5% gain in the most recent fiscal year. California's Public Employees' Retirement System -- the biggest in the nation -- along with funds in Maryland, Maine and Idaho have also lowered investment projections in the last two-months, but by smaller amounts.

"We feel taking a more conservative outlook as far as expectations on performance will help us weather whatever the next downturn will be," New York State Comptroller Thomas DiNapoli, said in a telephone interview. "We have a unique opportunity to better position the funds for the long term because of the outsized returns that we've had in the past year."

Government retirement systems, which count on annual gains to cover all the benefits promised to retirees, have increased their allocations to riskier investments in stocks, private equity and high-yield bonds after a decades-long decline in interest rates and slow global economic growth made it harder for them to meet long-term targets.

Reducing Risk

While pensions were rewarded last year, it has exposed them to greater volatility and the chance that investment values can plummet such as after the 2008 global financial crisis. And since investment earnings make up almost two-thirds of public pension funding, a shortfall in long-term expected earnings must be made up by higher contributions or reduced benefits.

"If we have another 2008, that's going to devastate a lot of plans," said Gene Kalwarski, chief executive officer of Cheiron, an actuarial consulting firm. "These plans are paying out more in benefits than they are collecting in contributions, and so you have a down year, you have less assets to recover."

Easy monetary policy and the global economic recovery from the Covid-19 pandemic turbocharged stock and bond prices, boosting pensions' annual returns to almost 27%, their best since 1986, for the one-year period ending June 30, according to the Wilshire Trust Universe Comparison Service.

Past performance is no guarantee of future results and Wall Street and pension managers expect future returns to fall based on forecasts for continued low interest rates and slowing economic growth. More than half of 131 public pension reduced their return assumptions since fiscal 2018, resulting in a median assumed return of 7%, according to the National Association of State Retirement Administrators.

"Market prices are high, that makes it less likely that you're going to have comparable returns at least in the near term," said Martin Noven, executive director of the Maryland State Retirement and Pension System. "We didn't believe we'd be able to sustain or actually beat our 7.4% [assumed return], so we reduced it to a level that we think we've got a better than 50/50 chance of achieving."

Maryland's pension returned 26.7% after fees for the 12-month period ending June 30. The state lowered its assumed return to 6.8% from 7.4%

Calpers, with about $470 billion in assets, reported a preliminary 21.3% gain on investments after fees for the 12-month period ending June 30. The windfall triggered an automatic reduction in the fund's assumed rate of return to 6.8% from 7%, the first time since the fund adopted the trigger cut policy in 2015.

Idaho's $24 billion pension this month lowered its return target to 6.3% from 7%.

New York's outsize gains last year are the result of timing. The pension fund's last fiscal year began April 1, 2020, eight days after U.S. stocks fell to their lowest since late 2016 as investors fled from risky assets in the face of Covid-19. U.S. stocks roared back, buoyed by $5 trillion in federal stimulus.

Absent other changes, a lower investment return assumption increases a pension's unfunded liabilities and annual cost. Since the market value of New York's investments rose $60.5 billion last year, it was able to offset the increased cost of annual contributions that would result from lowering the return.

New York's pension is 99.3% funded and has a 8.96% return over 30 years, according to the state comptroller's office.

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