Retirement News Highlights

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Some Public Pension Funds Are Pulling Back on Private Equity

Investment officials worry about private-market losses

By Heather Gillers
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Some U.S. public pension and investment funds are pulling back on private equity after a decade of state and local retirement systems aggressively pursuing the expensive, risky and hard-to-trade asset class.

Maryland's $65 billion retirement system is investing less new money in private equity. At Alaska's $77 billion state fund, the investment chief wants to cancel a planned ramp-up. And the $615 million pension fund of Mendocino County, Calif., last month opted against introducing private equity to its investment mix.

"We think you can get to the same destination with just public market assets and your real estate and infrastructure portfolios," Greg DeForrest, a senior vice president with investment consultant Callan, told the fund's board. "Without private equity, you don't have to deal with the costs, the fees, the administrative headache and the reporting headache associated with it."

Over the past decade, state and local officials committed more money to private-equity managers. Those managers offered supercharged returns on portfolios of private companies that they bought, overhauled and then sold. But public funds had to lock up their money, often for more than a decade, with limited visibility and limited options in the case of losses.

With yields at rock bottom, investment officials were willing to stomach the risk, particularly since many were counting on investment returns to cover benefits for teachers, firefighters and other public workers.

Now low-risk bonds are again offering a decent yield. Meanwhile, some pension officials and analysts are expecting the value of private-market assets to fall. In one high-profile example, Tiger Global marked down the value of its investments in private companies by about 33% across its venture-capital funds in 2022, The Wall Street Journal reported Thursday.

Also, after a year of public-market losses, private-equity portfolios make up an average of 10.8% of U.S. pension funds, above their average target of 10%, according to data provider Preqin.

U.S. pension and investment funds are part of a larger wave of institutional investors pulling back on private equity.

Global buyout deal value fell 35% last year, to $654 billion, according to Bain & Co., and secondary-market sales are up. Fewer investors plan to allocate more money to private equity this year than last year, and slightly more plan to allocate less, according to a Preqin survey.

To be sure, private equity continues to be a mainstay of institutional investment portfolios, with the most of those surveyed telling Preqin they intend to keep their level of investment steady long-term.

Investment in the asset class by large U.S. public pensions remains at a record high of around $500 billion out of a total of $4.5 trillion in assets, according to fiscal 2021 financial reports compiled by Boston College Center for Retirement Research. The $444 billion California Public Employees' Retirement System is building out its private-equity portfolio to 13% from 8%.

Maryland State Retirement and Pension System investment chief Andrew Palmer said the fund's planned reduction in annual private-equity commitments is aimed at bringing the 21.6% allocation closer to the 16% target. He said he expects the fund to be overweight private equity even if assets are marked down further. The San Bernardino, Calif., county pension fund made a similar cut in December.

For the Alaska fund investment chief, the uncertainty around valuations is one reason to cancel a planned private-equity expansion.

To determine how much private-equity assets are worth during the decade or so they take to fully pay out, public funds rely on quarterly estimates produced by private-equity managers. The managers assign values to the companies in their portfolio that might draw on internal or outside audits and comparisons with public companies.

So far, losses reported by private-equity funds have been minimal compared with public markets. In the first three quarters of 2022, the most recent data available, returns were minus 6.1% and minus 8.48% on private-equity indexes maintained by The Burgiss Group and Cambridge Associates respectively. The total return on the S&P 500 for the period was minus 23.87%.

Meanwhile, investors who bought private-equity assets on the secondary market last year paid an average 81% of the value assigned to those assets most recently, usually three to six months before, according to investment bank Jefferies LLC. That was the lowest figure since 2012.

At the Alaska Permanent Fund Corporation, which invests mineral revenue and other state money, investment chief Marcus Frampton told board members last month that a smaller private-equity portfolio would make it easier for him to stick to the most appealing opportunities—and leave the fund nimble to buy more.

Do you think public money should be invested in private equity? Why or why not? Join the conversation below.

"If we go into a bad recession and markets reset, we would have dry powder and then you would conversely lose that optionality if we keep going at the high end of the range," Mr. Frampton said. He is recommending board members call off a plan to expand private equity to 19% of assets from 17% over the next two years.

In Mendocino County, a coastal county north of San Francisco, retirement fund board chair Quincy Cromer said a key downside of adding a proposed 8% allocation to private equity was the additional work it would create. The proposal was first reported by Buyouts.

Mendocino County Employees Retirement Association staff would have to manage capital calls from private-equity funds and keep tabs on fees, cash flow and performance, fund officials said.

"Our staff time hours are pretty precious," said Mr. Cromer. "That's a huge concern of mine."

Callan predicted that the fund would add only one tenth of a percentage point to its 10-year return by moving money—mostly from the stock portfolio—into private equity.

Board members ended up deciding to pull about 4% of assets out of stocks but for a different purpose: They are planning to put the money in bonds.

Laura Kreutzer contributed to this article.

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