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Pension Fund Returns Will Only Get Worse in Alternative Assets

By Michelle Jones

As the pension crisis continues, data points are showing that the COVID-19 pandemic is worsening the already weak position many funds were in as far as returns. Pension funds have been trending toward alternative assets over stocks in recent years.

Pension funds supposedly chasing returns

Although pension fund managers have argued that they're chasing returns through their shift toward alternative assets, the numbers show that the strategy just isn't working. One expert explained to ValueWalk why this is happening and what could have been done to prevent the pension crisis in the first place.

Robert Zuccaro of the Golden Eagle Growth Fund has a strong track record from his pension fund management days. He is the only pension fund manager to rank number one in the INDATA universe among some 6,000 funds in two different years.

Zuccaro managed the Monsanto fund, which returned 40.1% in 1979 and the LA Fire and Police Pension Fund, which returned 79.2% in 1992. He told ValueWalk in a recent interview that the pension crisis is self-inflicted.

"The whole problem is self-induced and connected with conventional wisdom that holds stocks and fixed income securities should balance each other out in retirement plans," he said. "Alternative assets are a crazy idea to boost returns because there is little historic data that goes back to 1926 like we have for stocks."

Why alternative assets are a "crazy idea" for pension funds

Zuccaro noted that alternative asset returns have

lagged stock market returns as measured by the S&P 500 for years, which makes them a poor choice for pension funds.

"A real-world example is the Harvard endowment with its cadre of portfolio managers running hedge funds," he explained. "In 2005, their assets were \$26 billion and are now \$40 billion. If they simply had their assets invested in the S&P 500 since 2005, the endowment would have grown to \$90 billion."

Zuccaro argued in his 1982 paper entitled "The Real Risk is to Not Invest in Stocks" that since pension funds are perpetual entities, they should hold a much higher allocation to stocks. He said that stocks are safe if they are held for a very long time like 10 years. He believes if his advice in 1982 had been heeded, pension plans might be a lot closer to being full funded today.

Underfunding will only grow from here, and cutbacks are a certainty

Zuccaro pointed out that the average public pension fund uses a 7.75% return assumption. He also noted that government bonds are now yielding 0.64%, while T-bills are yielding 0.16%.

"It will take hundreds of years to double money at these rates," he said. "Averaging current yields for fixed-income investments, say at one-half percent with a 10% historic return for stocks, at most given the 13.6% annualized past 10-year return, which history tells us that stock returns will be less than 10% going forward, hinders every plan in reaching their actuarial goal. This means that underfunding is guaranteed to grow! At some point benefits will need to be cut back; make no mistake about this."

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