

## Volatility Pushes Corporate Pensions to Alts

August 29, 2011

By **Matt Gunn**

Alternative investments are becoming more popular among corporate pensions, an investor class that has not traditionally embraced hedge funds, private equity and other alternatives. But new research from SEI finds that changing, and Jon Waite, the firm's director of investment management advice and chief actuary, says that while a smaller portion of portfolios are being dedicated toward alternatives, a great number of pensions are using alternatives.

"I think this is something that's new," Waite says. "And I actually think it's consistent with the information that's saying more plans are using alternatives. Plan sponsors are struggling with how to properly structure their portfolios to get as much return as they can, but to manage that volatility."

Some corporate pensions have already moved into alternatives, including the \$773 million defined benefit plan for Kennametal, a metalworking company based near Pittsburgh. The pension recently reduced its equity investments and added alternative investments as part of its liability-driven investment strategy. It undertook the move "in order to reduce the volatility of the funded status of these plans and to meet the obligations at an acceptable cost over the long term," according to the corporation's 2010 annual report.

*"SEI's Waite says that, from this perspective, a pension is looking for something that fits its long-term strategy, rather than simply trying to make a lot of money in the least amount of time."*

Waite says more private pensions are doing the same, though he was unable to disclose any SEI clients. "More pensions are using [alternatives]," Waite says. "I would expect the market volatility is pushing plan sponsors to look for better ways to balance their portfolio."

That appears to be the trend among public pensions as well, says Bob Parise, managing director for JPMorgan Asset Management. "We've been seeing kind of an uptick around the alternative usage among pension plans for a couple of years," he adds. "It's a diversification play."

The \$23.2 billion TexasEmployees Retirement System outlined a Texas-sized alternatives play earlier this week, as officials adopted a tactical move that would see a 5% allocation – or nearly \$1.2 billion – toward alternatives, with the purpose of creating a portfolio of absolute return investments to enhance the pension's long-term investment performance. Ultimately, the pension is after "equity-like returns with bond-like risk," according to pension documents.

This requires a good amount of work by the pension and its manager to ensure transparency and to avoid the frauds that have hit some alternative investments in recent years.

Pension trustees “don’t want to run into the fraud, but they also want to make sure that the [alternative] funds that they are considering meet that criteria,” Waite explains. “They’re not looking for high fliers; they’re looking for a more stable pattern of returns over a period of time.”

JPMorgan’s Parise says the trend toward alternatives has been more prevalent among public pensions, where under-funding tends to be more pronounced. However, the types of investments that comprise alternatives are different with every investor; there’s no easy way to bucket different asset classes under the umbrella of alternatives.

“Plan sponsors have looked across numerous alternative bases, and a lot of it comes down to how they define alternatives. There are some sponsors who define it very specifically – hedge funds, for example – and others that will really broaden it out.”

In the case of Texas ERS, the pension will allocate \$358 million to alternatives in 2012, \$500 million in 2013 and \$300 million in 2013, across four strategies: relative value, event driven, long/short equity and tactical/directional. If all goes according to plan, within three years the pension will go from have no alternative investments to more than \$1 billion.

Waite believes the market turmoil of recent weeks will impact how institutional investors look at alternatives, too. “I would expect the market volatility is pushing plan sponsors to look for better ways to balance their portfolio,” he says. “This summer’s been a perfect example of how volatile the market’s been over the past couple years. I think plan sponsors are eager to get into that space, but they want to do it in a more measured form.”