PENSION PERFORMANCE REBOUNDS

The Wilshire Trust Universe Comparison Service, which tracks state and local pension plans, reported recently that public pensions booked a median gain of 12.4% for the fiscal year ending June 30th. This is up from 1.07% in 2016 and increases the annualized 20-year median to 7.0%.

This data confirms that recent returns posted by some of the largest pension plans in the U.S. were generally experienced across the whole sector. Over the last month we've seen a number of noteworthy plans and municipalities announce strong fiscal 2017 pension investment returns (Figure 1).

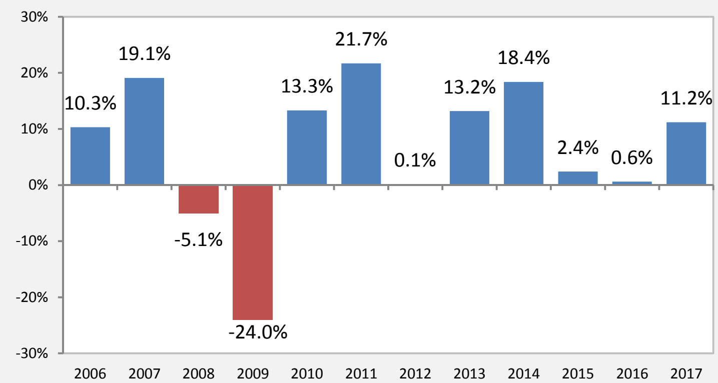
The news provides a short-term reprieve for both the pension plans and the municipalities that fund them, especially after relatively weak returns in both 2015 and 2016. For example, CalPERS' 5-year annualized return is now 9.0% compared to the plan's newly revised 7.0% investment target. However, the negative effects of the financial crisis continue to weigh on funded ratios, and just as one year of bad returns does not doom a plan, one year of good returns results in only modest improvement in funding. CalPERS' 10-year annualized return is now 4.3% (Figure 2). Even with the 11.2% investment return in fiscal 2017, CalPERS' funded ratio only increased to 68% from 65% the prior year.

FIGURE 1: FY2017 PENSION RETURNS

CalPERS	11.2%
CalSTRS	13.4%
Connecticut	14.2%
Rhode Island	11.6%
Kentucky	12.5%

Sources: California Public Employees' Retirement System; California State Teachers' Retirement System; Denise Nappier, Connecticut State Treasurer; Seth Magaziner, Rhode Island General Treasurer; Kentucky Retirement Systems

FIGURE 2: CALPERS INVESTMENT PERFORMANCE RECOVERS IN FY 2017



Source: California Public Employees' Retirement System, Facts At a Glance

RETURNS ARE POSITIVE BUT NOT A PANACEA

We also note that investment returns are just one piece of the puzzle – contributions from state and local governments play a major role in determining whether unfunded liabilities are being paid down or are allowed to expand. In a recent report* Moody's projects that the median "tread water" contribution – or the amount needed to prevent the unfunded liability from growing – will increase by 8.3% a year through 2019, far outpacing projected government revenue growth. Moody's notes that of the 50 largest local governments, measured by debt outstanding, only 25 of them contributed enough in fiscal 2015 to "tread water."

While investment return performance over the last 12 months is a positive for pension plans, analyzing returns over a multi-year period provides a better analysis of whether a plan's assumptions are considered conservative or aggressive. The median 20-year annualized return of 7.0% reported by Wilshire still trails the average return assumption of 7.45% (National Association of State Retirement Administrators). In addition, the continued commitment of state and local governments to making the full actuarially determined contribution will be a strong determinant of future growth in pension liabilities.

*Source: Moody's Investors Service, "Pension Burdens to Rise Through 2020.", June 20, 2017