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Public Pension Insights

09 May 2018

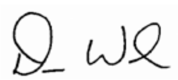
Have you got the time (horizon)?

This quarter, Public Pension Insights—Nuveen Solutions' quarterly newsletter for public pension plans—focuses on aligning assets & liabilities. Public Pension Insights shares ideas and addresses issues faced by government pension plan sponsors, and we can't think of anything more important for this audience than understanding your assets and your liabilities together. This quarter we focus on the investment time horizon and why that's important for the investment strategy.

David R. Wilson, CFA
Head of Solutions Design
Nuveen Solutions

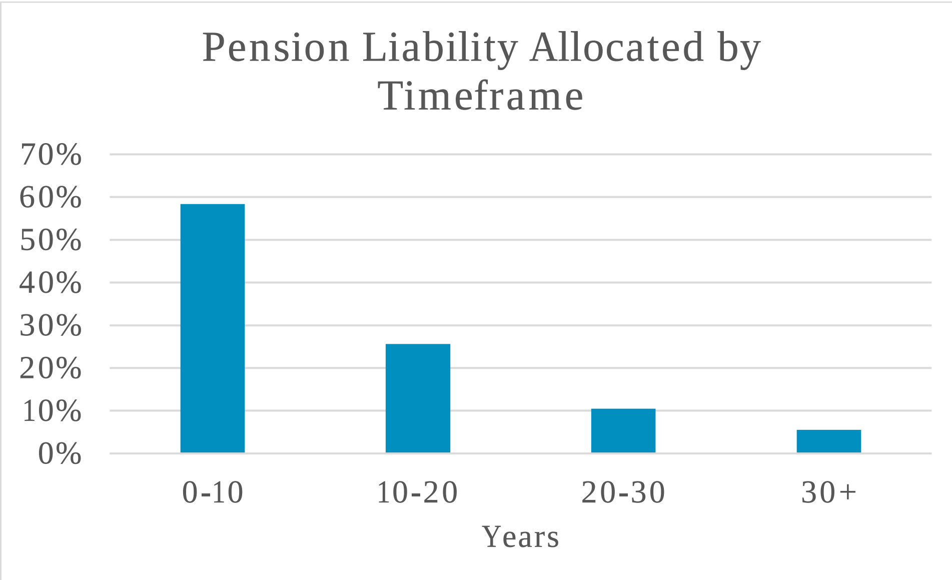
Evan Inglis, FSA, CFA
Senior Vice President,
Senior Actuary
Nuveen Solutions

We'd love to hear from you about topics that are of interest. Let us know what challenges you are facing and what topics you would like to hear more about. Feel free to contact Dave directly at dave.wilson@nuveen.com or (312) 917–6826 or Evan at evan.inglis@nuveen.com or (312) 917-8310.



Picture Highlight – Time Horizon for Typical Pension Plan

The chart below shows the payment timing for a fairly mature, but not atypical public pension plan. The majority of the pension liability will be paid out in the first 10 years and the vast majority of it will be paid out within 20 years! This isn't consistent with the decades-long timeframe that we typically associate with pension investing, but it's an important factor for understanding the right tradeoff between risk and seeking return.



Source: Nuveen

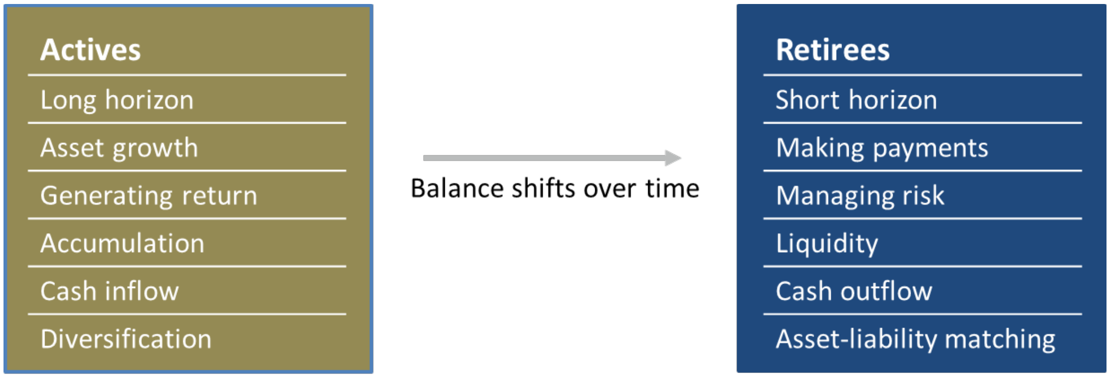
Q1 2018 Commentary: Your Investment Time Horizon Keeps on Slippin, Slippin, Slippin into the Future

By Evan Inglis, FSA, CFA

Investment time horizons are important because it makes sense to invest in different assets over different time horizons. We usually think of the investment time horizon for a pension plan as spanning many decades. However, while it's true that the last payment to be made to a current participant will be many decades in the future, on average the benefit payments for current participants are coming sooner than you may think (as shown in our Picture Highlight above). It makes sense for your investment strategy to reflect the time horizon of the benefit payments and that time horizon is getting shorter.

If an investor needs her funds next year, she should invest in more fixed income than in equities. If an investor needs her funds in 20 years, she may prefer equities, especially if her need in 20 years is inflation-sensitive. We see this concept applied in target date funds (aka target retirement funds) as a glide path that reduces risk as the need to spend the funds in retirement gets closer. The objective shifts from growth (think equities) to securing spending (think fixed income) as time passes.

The same idea applies for a pension plan, since the time horizon for spending gets closer as the plan population matures. Of course, we're talking about an average time horizon that gets shorter as the active members age and the retiree population grows. The graphic below illustrates the evolution of investment objectives that ideally will happen as a pension plan population evolves over time.



It's fairly straightforward to get the pension investment strategy aligned with the evolution of the plan population. This is what we do with an approach called Demographic-Based Investing. The key issue is not how much risk is being taken today, but how the level of risk will evolve over time. At Nuveen, we help investors design long-term pension investment strategies that seek to stand the test of time. The investment strategy needs to do that so the plan itself will be deliver on its benefit promise for many decades to come.

Current Nuveen Forecasts

Equities: Trade fears continue to dominate the markets. We think these issues will remain in the headlines for some time, and could represent a significant risk to the economy and financial markets. A possible slowdown in economic growth, however, may represent an even more serious risk. We expect the U.S. economy to reaccelerate, but the data bear close scrutiny. We think equity markets are in the midst of a consolidation phase and expect stock prices to remain volatile and range bound for some time. Read More

Fixed Income: Fed Chair Powell's comments reinforced the current path of normalization with modest rate hikes and a continued balance sheet runoff. Current market-based probabilities show less than a 30% chance of a hike at the next meeting in May, but more than an 80% likelihood of a 25 bps rate increase at the June 13 meeting. We continue to believe that the Fed's gradual adjustment in interest rates and its balance sheet will not derail U.S. economic growth. We are driving fixed income returns by focusing on income generation using bottom-up selection within the credit-related sectors. Read More

Related Research

Ten predictions for 2018: 1Q Update, Equity markets on a wild ride to nowhere

Our overall theme for the year is that we expect 2018 to be "less perfect" than last year, as we see continued decent economic growth and corporate earnings, as well as low but rising inflation and yields.

Robert Doll, CFA

Senior Portfolio Manager and Chief Equity Strategist
Nuveen Asset Management

Positioning equity portfolios for when rates rise

The current equity bull market is now more than eight years old and has survived several calls for its demise. The interest rate environment has been volatile, but rates have been rising unevenly over the past year, and we expect that trend will persist.

Robert Doll, CFA

Senior Portfolio Manager and Chief Equity Strategist
Nuveen Asset Management

Saira Malik, CFA

Head of Equities

Jim Boothe, CFA

Chief Investment Officer and Portfolio Manager
Santa Barbara Asset Management

Positioning bond portfolios for rising interest rates

Stronger growth and a tightening fed set the stage for higher long-term rates.

William (Bill) Martin

Head of Fixed Income Portfolio Management
TIAA Investments

Stephen MacDonald, CFA

Client Portfolio Manager
TIAA Investments

Upcoming Events

Date	Location	Event
May 1	East Peoria, IL	IPPFA 2018 Illinois Pension Conference – Gordon Telfer speaking
May 13 - 16	New York, NY	NCPERS Annual Conference – Evan Inglis speaking on plan sustainability vs. solvency
May 15	Washington, D.C.	Mid-Atlantic Institutional Forum – Dave Wilson speaking on asset allocation
May 19 – 22	Mt. Pleasant, MI	MAPERS 2018 Spring Conference
June 24 – 27	Orlando, FL	FPPTA Annual Conference - Exhibitor

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