Public Pension Investment Policy – What's the Role for Alternative Investments?

NCSL August 27, 2014
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My own Transitional View

• As a public pension consultant with NEPC from 2008-2009 I supported the line of introducing alternatives into portfolios for diversity while not giving up returns.

• As a public pension trustee 2008-2012 supported alternatives at first but became more cynical toward the high fees and risks every year.

• From 2012-present as an independent consultant have become critical of high fees and the lack of transparency in alternatives.
Risks in Alternatives

• Stock Market risk
  – Low correlation lowers risk, high correlation increases it

• Risks liquidity
  – Real estate is classic illiquid, but Private Equity also

• Fee risks
  – SEC found half of sample of PE firms overcharged fees

• Headline risk

• Interest rate inflation risk
  – Blast from the past but could come back case for commodities
Changing Views

• Nomura, as part of an excellent report looking at various aspects of active versus passive investment management, have considered Warren Buffett’s famous bet that an index fund will beat a fund of hedge funds over ten years. Buffett is winning, and the bank’s conclusion is that this is very far from a fluke:
  – In our view, alternative assets as a group show consistently poor performance. Beta is high. Alpha is near zero, if not negative. Correlation with standard asset classes is high. Return and diversification benefits are negligible.

• Wall Street Journal- Public pensions from California to Ohio are backing away from hedge funds because of concerns about high fees and lackluster returns.- July 23, 2014
Headline Risk

• We all know about Bernie
• But how about Stephen A. Cohen (SAC capital) and his $155 million Picasso
In 2010, the SEC opened an insider trading investigation of SAC\(^5\) and in 2013 several former employees were indicted by the U.S. Department of Justice.\(^6\) In November 2013, the firm itself pled guilty to insider trading charges and paid $1.2 billion in penalties.\(^7\)

Feb 2014- Mathew Martoma, a former portfolio manager at was found guilty of engaging in what prosecutors called the most lucrative insider trading scheme in U.S. history on all three of the conspiracy and securities fraud charges

The verdict was the eighth insider trading conviction of a current or former employee at SAC Capital, the $14 billion hedge fund that has long been in federal authorities' cross-hairs. Martoma, 39, faces up to 45 years in prison.
Public Pensions in SAC capital?

- Many public pensions held SAC capital inside a hedge fund of fund vehicle which hides the names of the individual Hedge Funds.
- Media reported that the Blackstone Hedge Fund of Funds was one of the largest holders of SAC capital.
- Kentucky had listed the Blackstone Hedge Fund of Funds and a local reporter asked and they confirmed that they held SAC Capital.
- Other Public Funds in the Blackstone Hedge Fund of Funds include:
  - Texas Permanent School Fund State
  - Michigan Department of Treasury
  - Texas Municipal Retirement System
  - Cook County Pension Plan
  - Missouri State Employees' Retirement System
  - Indiana Public Retirement System
  - Arkansas Public Employees' Retirement System
• Kentucky
  – HB 546 by Jim Wayne calls for full disclosure of managers performance and fees

• North Carolina
  – Competing Bills
    • One for full immediate disclosure (employee Union and AEI)
    • One that conceal details for five years after a contract is completed. (Dem.Treas. And R legislators)
Chris Tobe

Christopher B. Tobe has worked for over 15 years with Public Pension plans and is the author of “Kentucky Fried Pensions”. He writes a Wall Street Journal Marketplace Column that regularly covers public pensions. With his firm Stable Value Consultants he has provided project consulting to a number of public pensions. From 2008-2012 he served as a Trustee and on the Investment and Audit Committees for the $14 billion Kentucky Retirement Systems. From 2008-2009 he was a Sr. Consultant with New England Pension Consultants and worked with a number of public pension plans in Oklahoma, Missouri, Michigan and the District of Columbia. From 1997-1999 with the Kentucky State Auditor he published a 40 page report on the investments of both major Kentucky Pension plans. National Public pension speaking engagements include January 2013 at the Public Pension forum at the Ohio State Law School, October 2013 at DePauw University in Chicago, and at the National Press Club for Governing Magazine in February 2014. As a public pension trustee he completed the Program for Advanced Trustee Studies at Harvard Law School and Fiduciary College held at the Stanford University.