Pension CIOs: Guarding For Next Crisis a Tough Task

By Tim Sturrock April 29, 2014

No matter how careful they are, investors preparing for the next major economic shock may have limited success, said a group of pension and endowment CIOs speaking on a panel at last week's **Pension Bridge** conference. This is because the next bear market will play on unknown vulnerabilities and require different protections than the last.

"The next meteor in the sky isn't going to come from the same place as last time. It won't be a liquidity crisis. You have to brace for impact at all times because you don't know when it's coming," said **Paul Ballard**, CIO of the **Texas Treasury Safekeeping Trust Company**, speaking at the conference.

The group of CIOs emphasized diversification and risk reduction as ways of weathering disruptions. Given the need for returns, CIOs on the panel said they are increasingly moving money to emerging markets, various credit strategies and opportunistic strategies, but they all acknowledged the difficulty in creating a portfolio that can withstand future shocks when they obviously don't know what they will be.

"Within fixed income we're changing our mix so we no longer have the interest rate exposure that we had in the past. And we are looking at credit exposure to get the returns that we need," said **David Kushner**, CIO for the $40 billion **Los Angeles County Employees Retirement Association** (LACERA).

But, ultimately more funds will have trouble protecting themselves from another large draw-down because so many take on inherent risks when they seek 8% returns, said **Jon Braeutigam**, CIO of the **Michigan Department of Treasury**.

"The honest answer when I look across all pension funds – and I know their allocations pretty well – we're about in the same position as we were back [in 2008]," he said, adding that the**State of Michigan Retirement Systems** have protected themselves from short-term liquidity problems by keeping a year's worth of payments in cash.

The $45 billion Texas Treasury Safekeeping Trust Company, which oversees 12 state endowments, has diversified from a more traditional split of 35% fixed income and 65% equities to include more hedge funds and absolute return strategies that protect against downside risk and are intended to help the fund reach its goal of 5% returns plus inflation.

The Texas trust is currently focusing on event-driven investments that capitalize on opportunities created from the financial crisis like bankruptcies, mergers and legal settlements, said Ballard.

“The way to get a hold of those assets – which are totally uncorrelated with market beta – is through a specialized manager who runs very [niche] strategies,” he said.

Better governance has played a bigger role in how the **Oregon Public Employees Retirement Fund** handles risk, said **John Skjervem**, CIO of the Oregon Public Employees Retirement Fund. Oregon continued making riskier investments in 2007 even when it was well-funded, a strategy that has changed, he said.

“We could be guilty as anyone else of preparing to fight the last war. But I do believe we are better prepared in terms of governance,” he said, adding that Oregon has a “better and more intelligent appreciation for risk at the top of the house whereas before risk was looked at in isolation of the various asset class silos.”

High yield bonds, emerging market debt and bank loans have all found a place at the $13 billion **Los Angeles City Employee Retirement System**, said CIO **Rodney June**, noting that the fund is always on the lookout for new opportunities.

Market changes can quickly create opportunities and inefficiencies, so top-performing managers should stay aware of LACERS’ movements in case it decides to take advantage of a strategy, he said. “If you are one of the best performing managers out there, stay in contact with us, because things change very rapidly in today’s market.”