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Investors can learn from PERA's investment strategy

Much has been written about the Colorado Public Employees Retirement Association's (PERA) woes. Little has been written about the fund's future investment objectives.

PERSONAL FINANCE

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It seems PERA faces the same problems that many individual investors experience – extremely aggressive investment expectation (even possibly unrealistic) in order to meet their long-term needs.

PERA trustees recently chose to continue with 8.5 percent as their actuarial assumption, one of the highest assumptions for any state plan in the country. We believe that in order to capture an annual rate of return of 8.5 percent, the investment portfolio will need to be extremely aggressive.

Reducing expectations would make their situation seem worse, but the risks involved in attempting to capture 8.5% percent can be far greater than the political risk that PERA is trying to minimize.

With interest rates at today's low levels, most pension funds have been forced to ratchet back their actuarial assumptions and return expectations.

Charles Ellis, former managing partner of Greenwich Associates, and considered by many as the father of modern investment policy, generally believes that if an investor or pension fund is "overfunded" - in other words, they have more than enough to meet their - goals, the investor's bias should be toward being aggressive with the portfolio allocation (more assets allocated to equities because they can "afford" to take risks).

However, if a fund or investor is significantly underfunded (like PERA), prudence calls for being more conservative (more assets into bonds).

Ellis argues the investor is already behind and can't take the volatility associated with an aggressive allocation. It appears as if PERA, along with many investors, is facing an important decision.

The first step in solving any problem is recognizing there is one. A variety of recommendations have been offered to PERA's board for consideration, with little response other than "We have no crisis."

Fiduciaries are personally liable to meet reasonable objectives through prudent analysis and a procedural process. Defined benefit plans have had poor press lately, but it's not too late for PERA. (By the way there are many solid defined benefit plans that don't make the papers).

It's a big problem, especially for future trustees and participants. We have no doubt that PERA's problems can be solved by a reasonable investment objective, and must include a significant increase in future contribution rates, a decrease in benefits, or a combination of both.

Individual investors often face the same problem: too little saved and a history of bad investment decisions.

What has passed has passed. Investors, whether institutional or retail, often need a reality check that can be a solid baseline for looking to the future.

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