

In OCIO Space, Corporate Pensions Get Short End of Volatility Stick

Recently-released returns from a top OCIO index indicated that defined benefit plans have had more trouble than other institutions. Much of it has to do with how their portfolios are structured.

By Justin Mitchell

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Defined benefit pension plans have seen the sharpest drawdowns among clients of outsourced chief investment officer, or OCIO, firms this year, according to numbers from the Alpha Nasdaq OCIO Index, run jointly by OCIO search firm **Alpha Capital Management** and **Nasdaq**.

The index, made up of 1,272 investors, includes 527 defined benefit pension plans. In the quarter ending Sept. 30, the defined benefit pension plans had a -6.46% return, well below the index's return of -5.4%. The best returns that quarter were for endowments and foundations, which came in at -4.6%.

Rough Waters

Investors that use OCIOs had a rough year amid 2022's volatility.

Index	Recent Quarter	1 yr	3 yr	5 yr	7 yr	10 yr
Broad Market Index	-5.40%	-16.62%	1.95%	3.37%	5.21%	5.58%
Defined Benefit Pension Plans Index	-6.46%	-19.33%	0.11%	2.57%	4.76%	5.32%
Endowments & Foundations Index	-4.60%	-14.51%	3.57%	4.19%	5.75%	6.06%
Health Care Operating Reserves Index	-4.90%	-14.87%	2.09%	3.07%	4.89%	5.15%
Insurance Reserves Index	-4.69%	-15.84%	1.25%	*	*	*

Source: Alpha Nasdaq OCIO Index as of Sept. 30, 2022.

* indicates less than 15 observation points for that time period.

Over a one year period ending Sept. 30, defined benefit pension plans returned -19.33%, compared to -16.62% for the index and -14.51% for endowments and foundations.

Corporate pensions, and the OCIO index overall, also fared worse than the S&P 500, which returned -4.88% over the third quarter and -15.47% in the twelve month period ending Sept. 30.

The poor relative performance of defined benefit pension plans has a lot to do with how their portfolios are allocated, said **Brad Alford**, founder of Alpha Capital Management.

“[Defined benefit pensions] don’t use alternatives in the same amounts that endowments and foundations do,” he said. “So, they’re not as diversified.”

Many of the pensions that use OCIOs are corporate plans, Alford added. When the defined benefit pensions get close to fully funded, an OCIO is often hired to “babysit” the pension and ensure it can continue to meet its liabilities. So, even though foundations, endowments and other nonprofits are where the greatest growth is for OCIOs, pensions continue to a major client base.

Moreover, a common move after a corporate pension hits full funding is “de-risking,” when assets are shifted from equities or alternatives to fixed income, as reported. Since a major aspect of the recent drawdowns have been the simultaneous drop in both equities and fixed income returns, that has hit corporate pensions hard.

This dynamic was particularly pronounced in the third quarter, said **Jon Pliner**, the head of delegated portfolio management for consultant **WTW**.

“Those pension funds that held a significant amount of long duration fixed income to hedge out the interest rate risks of their liability will have experienced drawdowns in those assets more so than perhaps some more absolute return-oriented investors, which will have less exposure,” he said.

In the short term, pensions will need to focus on diversifying their assets, Pliner said. While not having as diversified a portfolio may have worked for the last decade or so, that will not be the case going forward.

Portfolios overseen by WTW’s OCIO service have held up “fairly well,” he added, due to a focus on diversification. Asset classes that WTW uses as diversifiers include real assets, real estate, infrastructure, natural resources, absolute return strategies and alternative credit.

“Our view is that diversification is always incredibly important,” Pliner said. “We continue to think that’s the best way to get a stable path from here and reduce some of the uncertainty amid forward-looking returns.”

Angeles Investments’ defined benefit pension clients, which are all corporate pensions, performed in line with its other clients, said Chief Investment Officer **Michael Rosen**, but the structural issues with allocation may have something to do with the disparities in the index.

“Defined benefit pension funds have less in private equity than endowments, so perhaps that was a relative detractor,” he wrote in an email.

Overall, an OCIO with full discretionary authority should perform better than a non-discretionary consultant, said **Brian Schroeder**, founder of **OCIOMonitor**, a firm that tracks OCIO’s performance for clients.

“Things are streamlined and they’re moving at a real time pace as opposed to the speed or quarterly of monthly meetings,” he said.

When investors experience underperformance, they need to understand why that happened, and whether it was actually tied to market forces or the performance of the OCIO itself, Schroeder added.

“2022 is a great obstacle course for judging all of your OCIO’s abilities, and if they were able to add value in a very saw-tooth market,” he said.