

# The *Ambachtsheer* Letter

*Research and Commentary on Pension Governance, Finance and Investments*

Letter # 215

December 2003

## **AN ANATOMY OF PENSION FUND BEHAVIOUR (1993-2002):**

### **WHAT CAN WE LEARN? (PART II)**

*“Seek, and ye shall find”*

Luke 11:9

#### **Explaining Pension Fund ‘Alphas’**

Last month’s *LETTER* ended with some important findings on pension fund ‘performance’ from *Cost Effectiveness Measurement (CEM)*’s 10-year database. These findings are summarized again in Figure I below. Based on 2,671 annual observations, the average ‘net implementation value added’ (NIVA) was a statistically significant 11 basis points (bps). Indeed, we observed, taking the pure passive implementation of an asset mix policy to not be free, but to cost an average 9 basis points annually, the average realized NIVA in the database jumps from 11 bps to 20 bps. When

NIVA is split into its three fundamental components, the total fund NIVA of 11 bps decomposes into an average within-asset class gross ‘alpha’ of +69 bps, an average annual mix-related negative alpha of -21 bps, and annual total fund operating costs of -37 bps.

We promised last month to explore these important findings in greater detail in following *LETTERS*, and start here by digging further into the three components of total fund NIVA: (1) the ‘in-category selection alphas’, (2) the ‘across-category mix alphas’, and (3) total fund operating costs.