

# The Ambachtsheer Letter

Research and Commentary on Pension Governance, Finance and Investments

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## WHAT DRIVES PENSION FUND PERFORMANCE?

### INSIGHTS FROM THE CEM DATABASE

*Information is data endowed with relevance and purpose”.*

Peter Drucker

#### Turning Data into Information

With extensive DB and DC databases, the global measurement firm *CEM Benchmarking Inc.* is uniquely placed to provide insights into the drivers of pension fund performance. The firm showcased these insights at its recent client conference held in

Chicago, November 7-8. The key insights are set out in the two boxes below. The DB database goes back to 1991, and now contains data from U.S., Canadian, European, and Australian funds (2005 asset value \$3.5T). The DC database starts in 1998, and is made up of U.S. funds only (2005 asset value \$500B).

#### Key Insights from the DB Database

- The average annual total DB fund return (1991-2005) was 10.9% versus an average policy benchmark return of 10.3%. Thus average fund gross value-added was 0.6% per annum.
- Subtracting the average annual expense ratio of 0.4%, average fund net value-added is reduced to a still-positive 0.2% per annum.
- Much of this positive net value-added was earned in the post-bubble 2000-2001 period.
- Relatively higher net value-added results were positively associated with fund size, proportions internally and passively managed, proportions in non-domestic and small cap equities, and proportions in private equity.
- Asset mixes have shifted towards foreign and private equity at the expense of fixed income over the 15-year period.
- Asset class costs for standardized mandates have decreased marginally, but average total fund costs have increased from 0.3% in 1991 to 0.4% in 2005.
- Since liability-relative measurement began in 1998, asset mix policies have produced negative average excess returns and considerable year-by-year balance sheet volatility.

#### Key Insights from the DC Database

- The average annual total DC fund return (1998-2005) in the *CEM* database was 6.3% versus an average policy benchmark return of 5.7%. Thus the average fund gross value-added was 0.6% per annum.
- Subtracting the average annual expense ratio of 0.4%, average fund net value-added is reduced to a still-positive 0.2% per annum.
- Over the same 1998-2005 period, the comparable total DB fund return was a materially higher 8.0%, as was the average policy benchmark return at 7.3%. Why? Because DB funds had higher exposures to higher-return asset classes.
- Exposures to own-company stock resulted in significant fund-return volatility and variance in outcomes between funds.
- Relatively higher retail mutual fund exposure increased costs and hence lowered net returns.
- Low-return default options (e.g., stable value/GICs, or cash) also lowered net returns.
- The good news is that own-company stock exposures have been declining, and higher-return default options (e.g., balanced funds) have been increasing.