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Hedge Funds Leave U.S. Pensions With Little to Show for the Fees.

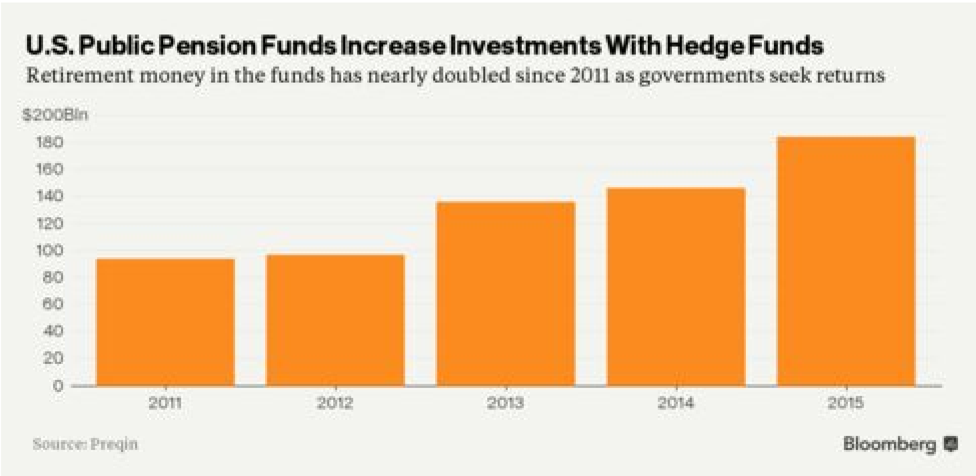
Here's what U.S. state and city pension funds are getting this year for the hundreds of millions of dollars in fees they're forking over to hedge funds: almost nothing.

The investment pools gained 0.4 percent through November, putting them on pace for the worst year since 2011, according to data compiled by Bloomberg. The industry's struggle was underscored over the past two months as BlackRock Inc., Fortress Investment Group and Bain Capital closed hedge funds after running up losses.

The low returns are dealing a setback to governments that boosted exposure to hedge funds, seeking windfalls to help close a $1.4 trillion shortfall that's facing public-employee retirement systems nationwide. The investment funds have underperformed stocks since 2008 as share prices rallied and volatility whipsawed global financial markets.

"The bull market of the last six years allowed public pension plans to become poor consumers," said South Carolina Treasurer Curtis Loftis, who has criticized the fees his state has paid firms including hedge funds. "The plans viewed hedge funds as an 'elite investment' and therefore neglected to perform strenuous and ongoing due diligence."

Public pensions count on investment returns of more than 7 percent a year, so anything less puts pressure on governments to set aside more to ensure they can cover all the benefits promised to employees. The retirement systems boosted their stakes in hedge funds to $184 billion this year from $94 billion in 2011, according to Preqin, which tracks the industry.



With their investments faltering, funds with more than $16 billion of assets have announced plans to shut down this year, including those run by some of Wall Street's most well-known firms, according to data compiled by Bloomberg. BlackRock decided to close its Global Ascent hedge fund following losses that triggered withdrawals by investors including the Arizona Public Safety Personnel Retirement System, Fort Worth Employees' Retirement Fund and the Maryland State Retirement and Pension System.

The Arizona fund doesn't discuss investment decisions, said Christian Palmer, its spokesman. Michael Golden, a spokesman for the Maryland system, and Mary Kay Glass, a spokeswoman for the Fort Worth system, declined to comment.

Averting Bigger Losses

The hedge fund investments have sheltered some retirement plans from steeper losses during the swings in stock and bond prices this year.

New York City's civil employees pension, with $52 billion of assets, saw its hedge funds lose 0.7 percent through September, which was less than the 2.26 percent loss for its entire portfolio. For New Jersey, hedge funds posted a 1.7 percent gain during the first nine months of the year, limiting the pension's losses, though they've posted about half the returns of its equity investments over the past five years.

"Over the long term, which is what we invest for, hedge funds have significantly outperformed stocks and bonds," Christopher Santarelli, spokesman for the New Jersey Treasury Department, said in an e-mail.

Not all pensions think it's worth it. The California Public Employees' Retirement System, the U.S.'s largest public pension, said last year it would liquidate its $4 billion hedge-fund portfolio because of the cost and complexity. Sam Won, managing director of Global Risk Management Advisors, said some pensions have used the lackluster returns to push for lower fees and more information about investment strategies.

"It continues to give investors more leverage," said Won.

The Cost

The firms typically charge investment fees of 2 percent and keep 20 percent of the gains. They're free to pursue strategies aimed at profiting even when stock or bond prices drop, allowing them to deliver gains to investors or protect them from losses elsewhere. In 2008, during the worst of the credit-market crisis, when the Standard & Poor's 500 Index tumbled 38 percent, hedge funds lost about half as much.

Since then, the investments have left some pension money lagging the broader markets as stock prices rallied, according to Jeff Hooke, a managing director with Focus Investment Banking in Washington. His study of five state pensions over five years found that the median return on hedge-fund investments was 7.3 percent, more than 6 percentage points less than the benchmark Vanguard Balanced Index Fund.

"Hedge funds have cost the states tens of billions in opportunity costs the last five years," said Hooke.
U.S. public pensions, after years of chronic under funding, by 2014 had 74 percent of the assets needed to pay retirees, according to the Center for Retirement Research at Boston College. Illinois and the state's largest city, Chicago, are both contending soaring bills to retirement systems after years of failing to make sufficient contributions. Such pressure helped push Detroit into the biggest municipal bankruptcy in U.S. history in 2013.

“Public pension funds are trying to achieve very high returns in an environment that makes this difficult,” said Donald Boyd, senior fellow at the Nelson A. Rockefeller Institute of Government, a public policy research arm of the State University of New York. “If they’re not successful, taxpayers and those who count on government services and investments will pay the price.”

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