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Fitch: Good 2018 Returns Are Little Help for US Public Pensions.

Fitch Ratings-New York-24 July 2018: Several public pension plans have announced solid investment returns as of fiscal year-end 2018, which for most pensions was on June 30, 2018, says Fitch Ratings. Fiscal 2018 gains for most are likely to be firmly ahead of their investment return targets. However, most public pensions still face an uphill climb to improve funding levels, due to the depth of past losses, a historically slow economic recovery, the continued use of favorable but unrealistic actuarial assumptions, and for many plans, inadequate pension contribution practices.

Indices for corporate stocks, the largest component of most pensions' asset portfolios, rose by double digits, as of fiscal year-end June 30, 2018, with the Russell 3000 rising by almost 13%. The California Public Employees' Retirement System (CalPERS), the nation's largest public defined benefit pension system, reported a fiscal 2018 portfolio gain of 8.6%, propelled by 11.5% growth in holdings of public equities, while the Florida Retirement System estimated a portfolio gain just below 9.0%, according to press reports. Investment gains in this range are modestly higher than pensions' own long-term targets for asset gains, the all-important investment return assumption, which pensions use to measure liabilities. As of fiscal 2017, this target averaged about 7.4% for major defined benefit plans, compared to the 6.0% level Fitch uses to reflect the magnitude of liabilities.

While fiscal 2018 returns will have a modestly positive effect on funding levels, they are unlikely to change broader pension funding challenges. The gap between projected liabilities and the value of asset portfolios remains stubbornly high, pushing the actuarially determined contribution (ADC) paid by participating governments higher. The median ADC for major plans was 74% higher in fiscal 2017 than in fiscal 2010. We expect ADCs to continue growing in the near term, as plans recoup past asset underperformance, shift gradually to less favorable but more realistic actuarial assumptions, and absorb rising retirement outlays.

Looking forward, pension portfolio returns face additional near-term uncertainty. Volatility in financial markets is notable with the Russell 3000 gaining just under 1.5% in the second half of fiscal 2018. The current economic expansion, even with the recent strong investment returns, has been weaker than in past cycles, and likely is closer to its end than its beginning. Market gains that fall short of pension targets, or outright market losses, would erode recent gains and leave participating governments susceptible to further contribution increases.

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