
Public Pension Reckoning Delayed With Stimulus Pumping Up Stocks.

- **Pensions may return 2% for fiscal year, BNY Mellon estimates**
- **Retirement systems were on pace for 21% loss in March**

U.S. public pensions may have finished the fiscal year with small gains, a dramatic turnaround after losing about $1 trillion during the first quarter when the coronavirus pandemic triggered a stock market plunge.

In March, U.S. public pensions were on pace for an average investment loss of about 21% for the year ending June 30, according to Moody's Investors Service. Thanks to massive monetary and fiscal stimulus, state and local retirement funds, which invest about half of their assets in U.S. and foreign stocks, may have returned 1.9%, according to an analysis by Bank of New York Mellon Corp. Moody's estimates one-year returns at about 1%.

The $2.2 trillion stimulus package from Congress and a commitment by the Federal Reserve to lend as much as $2.3 trillion to support the economy, coupled with optimism about work toward developing a coronavirus vaccine and a gradual reopening of the economy have pushed U.S. stocks up 20%, their best quarter in more than 20 years.

The gains eased the risk that states and cities will be hit with a steep increase in pension contributions just as they're contending with the coronavirus recession that's promising to cut hundreds of billions of dollars from their tax revenue.

"It was definitely a roller-coaster," said Stephen Kolano, chief investment officer at BNY Mellon Investor Solutions. The volatility and plunging tax revenue resulting from the pandemic "make it an extremely uncertain time for how finances look like going forward for pensions."

Government retirement systems, which count on annual gains to cover all the benefits promised to retirees, have increased their allocations to riskier investments in stocks and private equity after a decades-long decline in interest rates and slow global economic growth made it harder for them to meet long-term targets. This has exposed them to greater volatility.

Public pensions assume an average annual investment return of 7.2% and taxpayers make up the difference when returns fall short. Governments don't make up the losses at once; instead they phase in additional contributions to cushion budget shocks.

Had New York City's five pensions lost 20%, for example, taxpayer contributions would have increased more than $400 million in the fiscal year beginning July 1, 2021, according to an estimate by the city's Independent Budget Office, equivalent to the annual budget for libraries.

With investment gains of 2%, the city would need to make an additional $76 million payment.

Strong second-quarter returns pushed the public pensions' funding ratios, or the amount of assets the retirement funds have to pay liabilities, to 71.3% in May from 66% in March, according to the Milliman 100 Public Pension Funding Index. The ratio was 75% at the end of 2019.

While retirement systems have far less than they need to pay pensioners, even the most poorly funded systems like Chicago and New Jersey won't exhaust their assets in the next five years, according to the Center for Retirement Research at Boston College. If funds run dry, state and local governments would have to pay pensions solely with taxpayer dollars.

Yet pensions are unlikely to be a catalyst for widespread municipal defaults, as is sometimes suggested, even as state and local governments deal with revenue hits from the coronavirus pandemic, according to Barclays Plc strategists led by Mikhail Foux. In recent history, only Vallejo, California's bankruptcy in 2008 was directly related to the city's rising pension obligations, the Barclays analysts said.

"We believe even the worst-funded plans can still cover benefit payments for numerous years," Barclays said.

To come up with its estimate for retirement systems' performance, BNY Mellon applied market index returns to median public pension asset allocations in the firm's database. The median allocation was 44% in U.S. and international stocks, 25% to bonds, 10.9% to private equity, 8.6% to both real estate and hedge funds and 3.3% to Treasury Inflation Protected Securities.

Pensions more heavily weighted to U.S. stocks than international equities likely performed better. The Russell 3000 Index, which represents 98% of the U.S. stock market, returned 4.5% for the 1-year period ending June 30. By contrast, non-U.S. stocks fell 7.1%.

U.S. bonds returned 8.7% for the one-year period ending June 30, according to the Bloomberg Barclays US Aggregate Bond Index.

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