Pension Plans Deliver the Goods in Q2 2017

Description

According to **Royal Bank of Canada** (TSX:RY)(NYSE:RY), Canadian defined-benefit pension plans delivered a total return of 1.4% in the months of April through June — 330 basis points better than Canadian equities.

Did your investments match Canadian pension returns in the second quarter? I highly doubt it.

While retail investors were pouring money into Canadian equity ETFs and stocks, pension plans were moving funds elsewhere, and their members were the primary beneficiaries.

"Despite positive economic indicators of a healthy Canadian economy, depressed energy and commodities were amongst the poorest performing sectors to drag on domestic equities," said James Rausch, head of Client Coverage, Canada, RBC Investor & Treasury Services. "Nevertheless, Canadian pension fund managers have continued to prudently manage portfolio allocations, remaining underweight in Canadian equities compared to domestic fixed income and global equities and generating yet another positive overall return for the quarter."

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Canadian pension plans have now generated positive returns in 14 of the last 18 quarters — 4.5 years, if you're counting, going all the way back to January 2013 — putting a smile on the faces of government employees everywhere.

So, in the first six months of 2017, Canadian equities generated a 0.4% return compared to 8.5% for global equities, 2.8% for Canadian fixed income, and 4.3% for Canadian pension plans.

Down in the U.S., American pension plans for public workers achieved a median return for the 12 months ended June 30 of 12.4% — the best result since 2014.

Keeping up with the pensions

Much like keeping up with the Joneses, it's a futile exercise to try to match the returns of the big pension plans, because even when they externally manage the funds under their purview, they will still have a decent number of investment managers on the payroll to ensure performance isn't sacrificed through outsourcing.

Retail investors often don't stand a chance simply because of the lack of access to the private markets.

In fiscal 2017, the B.C. Investment Management Corporation (bcIMC) achieved a 12-month return of 12.4% to the end of March — 70 basis points higher than its benchmark.

What's the secret of its success? Illiquid assets.

In 2017, it committed an additional $9.9 billion to infrastructure, mortgages, private equity, real estate, and renewable resources. At the end of March, bcIMC's illiquid assets under management stood at $41.9 billion, or 31% of the total. Five years earlier, they were $26 billion, or 28% of the overall assets under management.

bcIMC five-year returns on illiquid assets

Asset	**Five-Year Return (annualized)**
Domestic Real Estate	7.5%
Global Real Estate	10.8%
Infrastructure	10.3%
Private Equity	18.2%
Mortgages	4.6%
Renewable Resources	9.7% (four-year return)
Canadian Equities	8.4%

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Source: bcIMC 2016-2017 annual report

Except for domestic real estate and mortgages, the bcIMCs illiquid assets outperformed its Canadian equities over the past five years.

Long term, that's likely to continue.

"Illiquidity pays a higher rate of return. As clients do not have an immediate need for cash to pay pensions, they are allocating funds into assets that are illiquid and longer term in nature," said bcIMC CEO Gordon Fyfe in the 2016-2017 annual report. "Our new investment approach will allow clients to increase their allocations to private equity, mortgages, real estate, renewable resources, and infrastructure."

If you can't beat them, join them

While you're not going to be able to replicate what bcIMC does, you can buy alternatives such as **Brookfield Asset Management Inc.**

(TSX:BAM.A)(NYSE:BAM) and **Onex Corporation** (TSX:ONEX) along with a core group of broad-market index ETFs. That will get you close but probably not all the way.

Close is good.

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