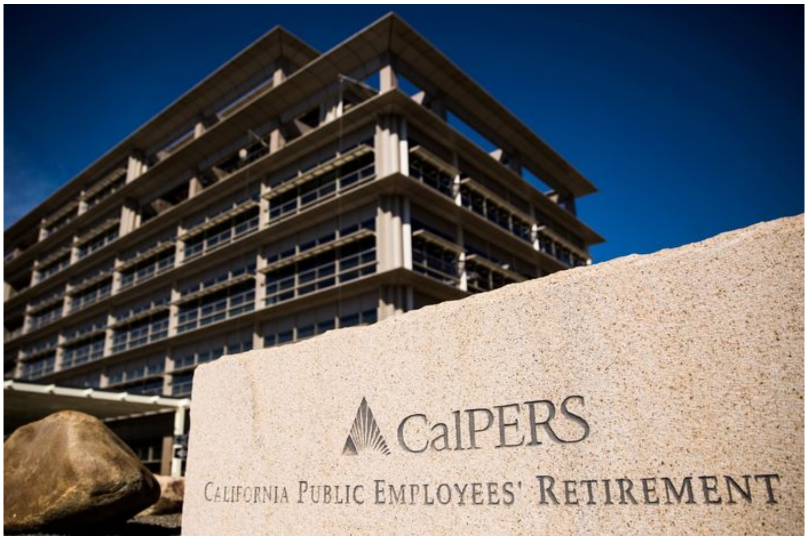
https://www.wsj.com/articles/pension-cash-dwindles-risking-liquidity-crunch-11637537168

FINANCE

Pension Cash Dwindles, Risking Liquidity Crunch

Cash allocations have dropped to a seven-year low, with pensions seeking greater returns in private markets



Calpers plans to invest more in private markets and keep less cash on hand to meet its target.

PHOTO: MAX WHITTAKER/REUTERS

By *Heather Gillers*

Nov. 22, 2021 5:30 am ET

Bigger private-market bets, inflation fears and a surge of retirees are putting public retirement funds at risk of a cash crunch that would force them to sell assets at losses to pay pension checks.

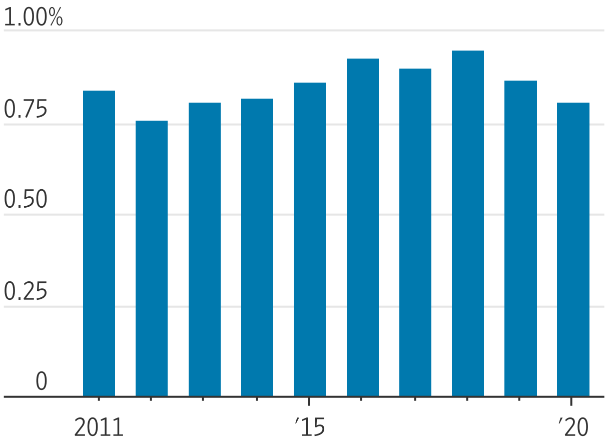
Cash allocations have dropped to a seven-year low at the funds that manage more than $4.5 trillion in retirement savings for America's teachers, police and firefighters. Public pension funds, which have increasingly turned to illiquid private markets to drive up returns, are now aiming to keep about 0.8% of their holdings in cash, according to data from the Boston College Center for Retirement Research.

These funds are managing a juggling act faced by many institutional and household investors who want to put their money to work but also want easy access to it in a pinch.

Low on Cash

Facing inflation fears and high return expectations, pensions have reduced the share of assets they aim to keep in cash.

Average pension cash allocation target



Source: Boston College Center for Retirement Research

"The first report I look at every day is our cash report," said Jonathan Grabel, investment chief of the $75 billion Los Angeles County Employees Retirement Association, which aims to keep 1% of its assets in cash. "We have plenty of liquidity across the portfolio, but you never know when and if markets are going to seize up."

Mr. Grabel's fund in May reduced its target allocation to investment-grade bonds to 12% from 19% and increased the amount it wants to keep in private equity, infrastructure, and illiquid credit to a combined 29% from 16%. The fund's long-term expected annual return of 7% is the average for state and local government retirement funds, according to the National Association of State Retirement Administrators.

The $496 billion California Public Employees' Retirement System, despite aiming for a slightly more conservative 6.8%, still plans to invest more in private markets, borrow against up to 5% of the fund, and keep less cash on hand, to meet that target, under a plan the board approved this month.

Meanwhile, smaller pension funds serving school employees in Ohio, city workers in Illinois and other public employees across the country are putting more of their money into real estate, private equity or private debt.

Public pension funds have hundreds of billions of dollars less on hand than the amount they will need to cover promised benefits after two decades of underfunding, unrealistic demands from public-employee unions, and losses during the 2007-2009 financial crisis.

Over the same period, their cash-flow margins have thinned as retirees have multiplied relative to the number of current workers. In Connecticut, for example, more than a quarter of the state workforce are eligible to retire between June 2020 and June 2022, Boston Consulting Group found.

Public pension funds have historically been able to access cash when equity markets faltered by selling bonds. But over the past two decades, fixed income portfolios shrank to 24% of assets from 33%, according to the Boston College data, as falling rates turned bonds into a drag on returns. Now inflation threatens to further erode the value of fixed-income investments.

But assets that promise rapid growth—from common stocks to complex alternative investments—also carry the risk of losses when sold into rocky markets or before maturity. After the Pennsylvania Public School Employees' Retirement System last year decided to shrink its private equity allocation, in part to increase liquidity, consultants warned that selling assets early would mean accepting an average discount of 15% of net asset value.

SHARE YOUR THOUGHTS

How are you finding a balance between increasing your savings and making sure you have access to the money? Join the conversation below.

Some growth strategies can also require sudden diversions of cash in the form of capital calls and margin calls, often at inconvenient times.

When markets cratered in 2008, some of the biggest U.S. pension funds sold stocks to raise cash and fund capital calls from private-equity firms. In the aftermath many, including Calpers and the California State Teachers' Retirement System reviewed their allocations to alternatives.

A Calpers spokesman said the fund has improved liquidity management since the financial crisis and as a result was able to take advantage of low prices during the market dislocation in March 2020 at the start of the Covid-19 pandemic.

Calpers staff said at a meeting earlier this month that the fund uses a dashboard to closely monitor liquidity, which is a measure of how easily holdings can be converted to cash without losses. The retirement fund, which is the nation's largest, eliminated its target of holding 1% of its assets in cash as part of the new asset allocation approved this month, which takes effect July 1, 2022.

Finding a strategy that can accomplish what bonds once did, providing yield in good times and accessible cash in bad, is "not a problem with an easy solution," said Ash Williams, who recently retired as executive director and chief investment officer of the State Board of Administration, which manages investments for the Florida Retirement System.

"Everybody's wrestling with this same thing," he said.

Write to Heather Gillers at heather.gillers@wsj.com