U.S. PUBLIC SECTOR PENSION PLANS BRACE FOR MORE ECONOMIC SHOCKS

- 90% will spend more on scenario modeling and stress testing as funded ratios take the strain
- Up to 81% expect to increase their risk profile as inflation fears ease

U.S. public sector pension plans are planning ahead for the potential impact of further economic and market shocks, a new report from Ortec Finance, the leading global provider of risk and return management solutions for pension funds and other institutions, shows.

Its report based on a study* of U.S. public sector pension plan managers at U.S. public sector pension plans who collectively help manage over $1.315 trillion, found 90% plan to increase spending on scenario modeling and stress testing in the next two years to help manage the increased risk of market shocks.

The research found strong support for scenario modeling and stress testing - 44% say they are very effective and 56% say they are mostly effective at asset liability management (ALM).

The increased emphasis on scenario modeling and stress testing builds on recent experience, including the rise of inflation and interest rates following the COVID-19 pandemic which has put funded ratios at U.S. public sector pension plans under strain.

Analysis** by Ortec Finance, which has clients with over $15 trillion in assets under management and, among others, an office in New York, shows 14% of U.S. public pension plans had funded ratios of 60% or less last year and just 12% had funded ratios of 100% or more. Average funded ratios – which express the ratio between available assets and liabilities and effectively whether it has enough reserves to pay pension benefits to members – were 77.89% last year.

The Ortec Finance study shows pension plans have shifted their risk profiles in response, with 81% of those questioned expecting to increase risk profiles in the next 12 months. Around 32% expect a dramatic increase.
They are now less concerned about inflation – managers questioned say the US economy is on the path to inflation moderation with 90% confident that inflation is on the decline.

Around half (52%) of the public sector pension plans questioned believe inflation could be 3.3% or lower within a year. Just 10% of public sector pension plan professionals interviewed believe the rate will be over 6% within a year.

Around 86% say their plan is well hedged against inflation – more than a quarter (26%) believe their plan is 'very well' hedged. Just 12% believe the hedging at their plan is average.

The confidence in inflation hedging is not leading to complacency – managers are still active in changing asset allocations to hedge against inflation. Around two out of three (66%) think they will increase allocations to commodities to help with this, while 50% will boost allocation to infrastructure investing. Some 32% will increase allocations to inflation linked bonds and 38% will increase allocations to gold to hedge against inflation.

Marnix Engels, Managing Director, Pension Strategy Ortec Finance said: "Many pension plans saw the value of their assets fall last year in what was a tough time for markets and are clearly preparing for future market shocks.

"The degree of uncertainty is extremely high for U.S. public sector pension plan sponsors but there is genuine optimism that lower inflation will become well-established with very few managers expecting it to be as high as it currently is within a year or two.

"The major challenge, however, remains that funded ratios are under pressure. This stresses the importance of asset-liability management to improve the long-term financial position of the plans.

"The stochastic models currently available to sponsors and their advisors, including Monte Carlo simulations, are too simplistic and may generate results that do not fully account for major economic and market shock events - such as COVID-19. It makes sense to increase spending on advanced tools that offer more realistic and useful insights in changing market conditions."

Ortec Finance models and maps the relevant uncertainties in order to help pension funds monitor their goals and decisions. It designs, builds, and delivers high-quality software models for asset-liability management, risk management, impact investment, portfolio construction, performance measurement and attribution, and financial planning.

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Notes to editors:
*Independent research company PureProfile interviewed 50 US public sector pension fund managers responsible for a collective $1.315 trillion assets under management. The survey was conducted during February 2023.
** Ortec Finance analysis of Equable data

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About Ortec Finance
Ortec Finance is the leading provider of technology and solutions for risk and return management. It is Ortec Finance's purpose to enable people to manage the complexity of investment decisions.

This is accomplished via the delivery of leading technologies and solutions for investment decision-making to financial institutions around the world. Ortec Finance's strength lies in an effective combination of advanced models, innovative technology, and in- depth market knowledge. This combination of skills and expertise supports investment professionals in achieving a better risk-return ratio and thus better results.

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