Russell Investments

Q&A

Corporate pension outlook for 2017

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With: Rachel Carroll, CFA, Managing Director, Consulting

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Q: RACHEL, YOUR ROLE AS HEAD OF RUSSELL INVESTMENTS' CONSULTING PRACTICE GIVES YOU SPECIAL INSIGHT INTO THE MOST SIGNIFICANT ISSUES FACING CORPORATE PENSIONS AS WE LOOK TOWARD 2017. WHAT ARE YOU SEEING?

A: There's so much I could list. It's not one thing, it's many things.

Defined contribution (DC) issues are actually figuring pretty large. In part, plan sponsors are just learning how to respond to regulatory initiatives (for example, sorting out where record-keepers stand under the Fiduciary Rule). With the change of administration, the regulatory backdrop has become even more uncertain.

For example, I'm seeing some corporations reconsidering, or re-verifying, offering company stock in their DC plans. Do they want to keep allowing it? Should they halt new investments into that option? Do they need an independent fiduciary?

There has also been quite a bit of work being done to reconsider DC plan offerings – consolidating options, moving to white-labeled structures and making sure participants have an appropriate, but not overwhelming, list of available choices. Clients are juggling several issues on the DC side.

Q: AND DEFINED BENEFIT (DB)?

A: Same story; in a way, it's a lot of different things. Obviously, the interest rate backdrop is a big factor, and liability-driven investment (LDI) is huge. We're seeing a couple of different client situations here. On the one hand, you have those – typically the more mature plans – that are trying to reduce risk, to simplify their programs and consolidate manager relationships. They are taking the opportunity to move toward an end game whenever they can. The recent uptick in rates has had a positive impact on funded status and a few plan sponsors have begun to reopen the consideration of annuitizing a part of their plans.

Then you have others who are still more focused on generating returns. Given that most prognosticators are calling for a low-return environment in the future, some sponsors are considering how they could improve their diversification and return potential (for example, what asset mix is going to get them to their ELTRA?). Some sponsors are actually adding new asset class exposures: private equity, real assets and those sorts of things. They're looking at global equity structure (for example, how do emerging markets fit in?) and even at global bonds.

Then, for both DB and DC plans, there's a continuing conversation on active and passive investing. It has been a very challenging active management environment, and that has led some sponsors to rethink their active/passive outlook. Do they still have conviction that active management will work in the long run? It seems that there's always some area where active management isn't doing so well. For example, up through third quarter 2016, small cap had had a very difficult run, with nearly 75% of active small cap value managers underperforming the Russell 2000 index at one year. At the same time, small cap is an area that has been a relative strength for active management over the long run, and one area where there's been a good case for expecting superior research to pay off. But it's natural for investors to become doubtful when there's a poor run. As it happens, we believe there are a few things driving this. First, there's a quality bias among active managers, where they will generally avoid the cheapest stocks, or stocks they see as being cheap for a reason. Second, there has also been a proliferation of exchange-trade funds (ETFs) in the small cap space, which have served to push up the price of stocks that most active managers aren't buying.

This is normal – if it wasn't small cap, it would be something else. This highlights the importance of having a well-diversified asset allocation.

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