

DISCUSSION:
LOOKING FOR ALTERNATIVES
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SUMMARY

- ① Large shift of pension funds into alternatives (private equity, real estate, infrastructure, hedge funds, natural resources).
- ② Active decision by fund managers.
- ③ Shift occurred across countries, fund sizes, and public and private funds.
- ④ Role of low global interest rates.

MY COMMENTS

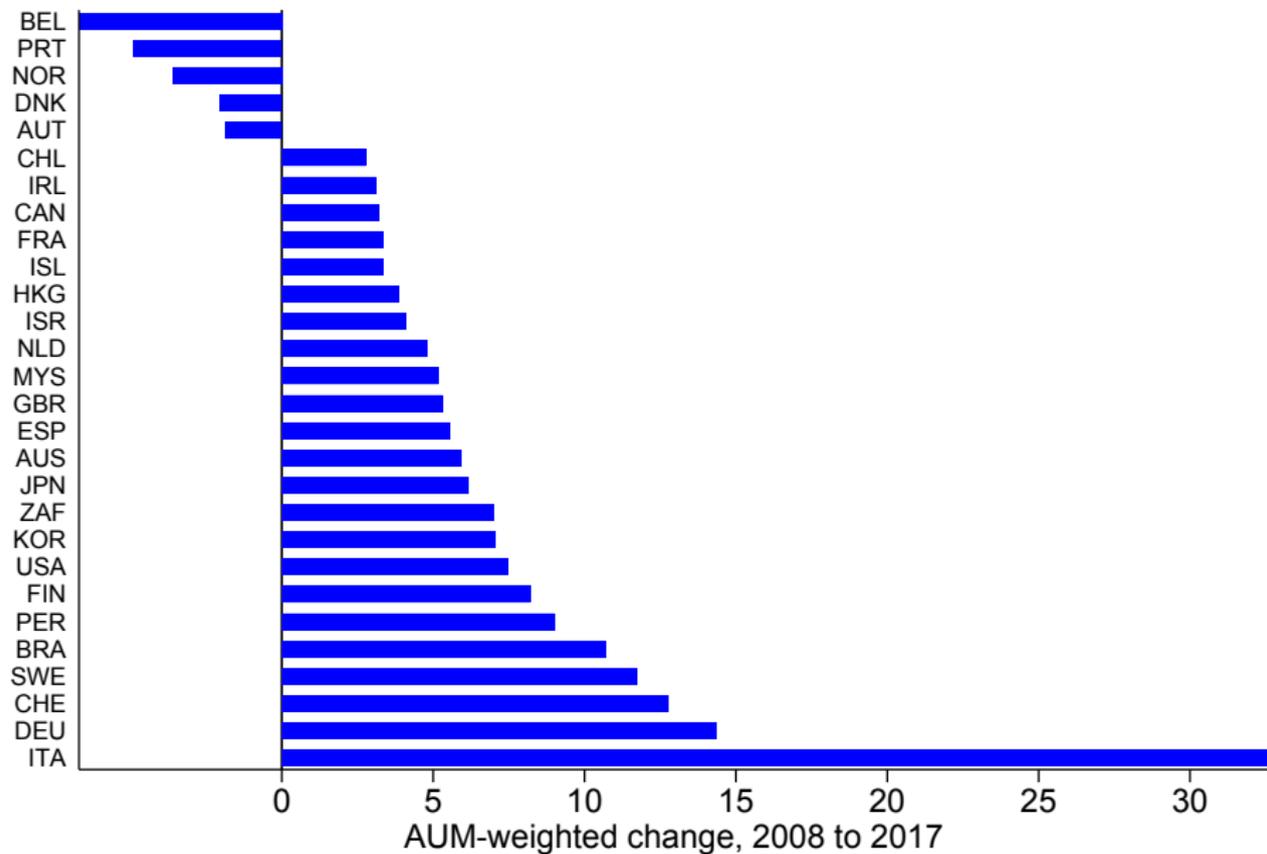
- ① Important result documented in a very useful data set.
- ② Role of interest rates.
- ③ Good? Bad?

Comments On Summary Statistics

IMPRESSIVE COVERAGE

- International aspect very welcome.
- I suspect within-country coverage *better* than paper claims:
 - ▶ Table 2 compares to pension assets reported by OECD.
 - ▶ OECD includes IRAs and pension-like liabilities of life insurance sector.
 - ▶ Preqin U.S. sample covers 28.5% of OECD pension assets but 49% of actual AUM in U.S. pension funds.
 - ▶ Preqin Canadian sample has \$1.40T AUM while OECD reports \$2.40T of pension assets. Statistics Canada National Balance Sheet Accounts reports \$1.39T in pension funds.
- Alternatives not discernible in many data sets.
 - ▶ Example: U.S. Census ASPP (source data for FAUS) groups private equity, venture capital, and leverage buyouts under corporate stocks.
- One important drawback: data start in 2008.

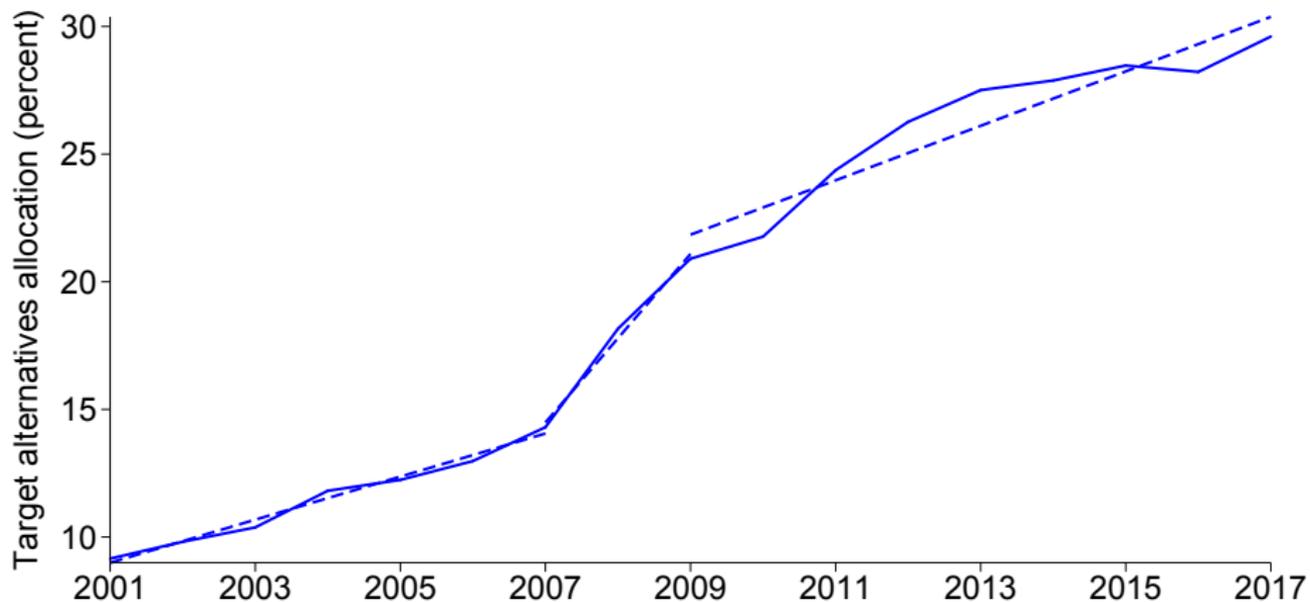
MAIN RESULT: CHANGE IN ALT. SHARE



ACTIVE CHOICE?

- Similar shifts across large and small funds, public and private.
- New commitments, not draw-downs of existing commitments.
- Not plausibly due only to capital gains.
 - ▶ Paper estimates required return to account for increase.
 - ▶ Even if returns high, managers can rebalance. But uncommitted capital rising.

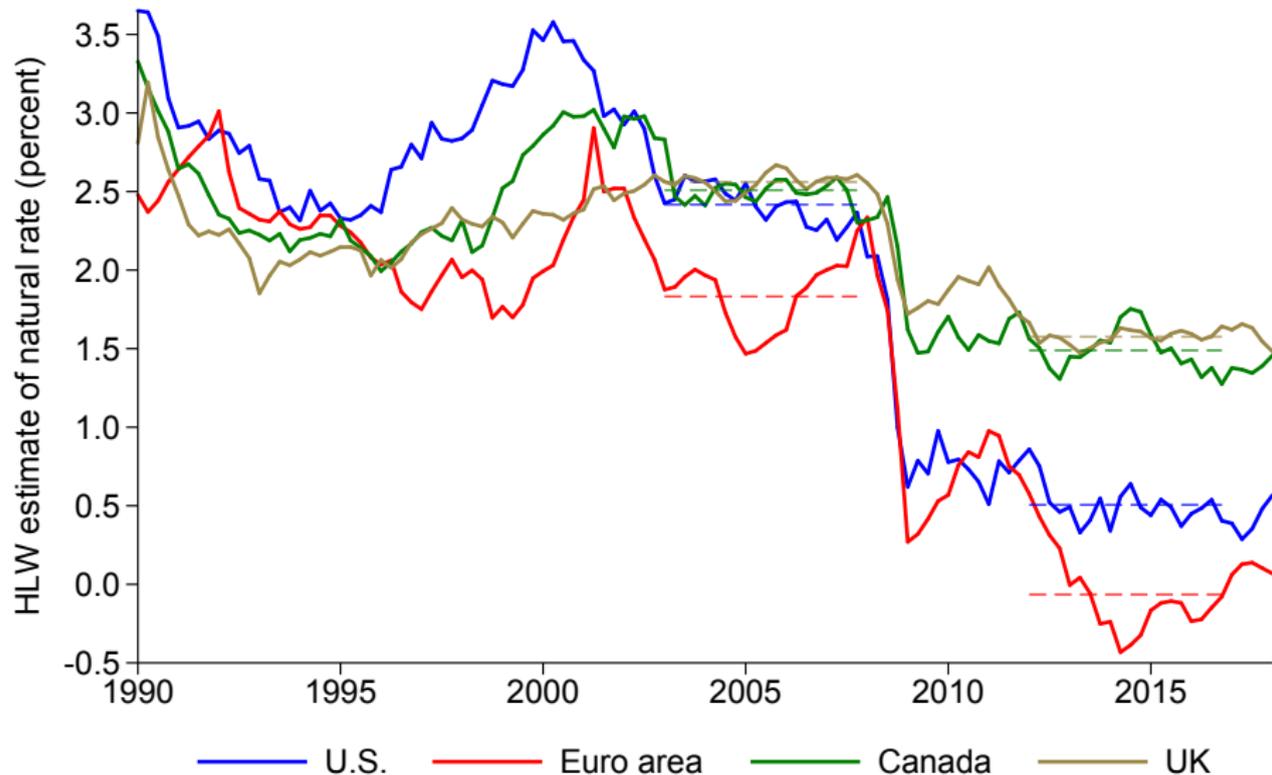
IS 2008-17 A TREND BREAK? U.S. S&L FUNDS



- Value-weighted allocation to alternatives in U.S. S&L pension funds.
- Source: Center for Retirement Research at Boston College Public Plans Data.

Comments On Interest Rate Sensitivity

BACKGROUND: r^* DECLINING



RESULTS REVIEW

Dependent variable	Average annual change in Alts share (% AUM), 2008-2017			
	(1)	(2)	(3)	(4)
Natural rate	-0.4602** [0.179]	-0.3574* [0.190]	-0.4938** [0.202]	-0.5301** [0.232]
GDP growth	0.3058 [0.215]	0.3001 [0.215]	0.4140 [0.258]	0.4140 [0.254]
Inflation	--	-0.2691 [0.265]	--	0.1237 [0.357]
AUM	-0.0048* [0.003]	-0.0050* [0.002]	-0.0049 [0.004]	-0.0047 [0.004]
Constant	0.8075 [0.469]	1.2191*** [0.402]	0.6658 [0.523]	0.4759 [0.522]
Observations	867	867	1,595	1,595
<i>R</i> -sq.	0.048	0.050	0.037	0.037

INTERPRETATION OF COEFFICIENT

- Multiply regression coefficient by change in r^* and cumulate over 10 year horizon: $0.5 \times 1.5 \times 10 = 7.5p.p.$ change in alt. share. Big effect!
- Decline in r^* is global and falling rates in one country may affect investment allocation in another.
 - ▶ Perfect international diversification \Rightarrow regression coefficient is 0.
 - ▶ Practical impediments to perfect diversification: currency mismatch, information acquisition, regulatory barriers.
 - ▶ Conjecture: higher cross-border investment \Rightarrow more attenuated cross-sectional coefficient.
 - ▶ Bigger effect!

CAVEATS

- No claim of causality.
- Driven by small funds? Weight or interact r^* with fund size.
- Key regressor r^* in levels or differences? Matters a bit:

	U.S.	Euro area	Canada	UK
2012-2016 level	0.51	-0.07	1.49	1.58
Difference from 2003-07	-1.91	-1.90	-1.02	-0.98

- Inference challenging:
 - ▶ Standard errors clustered by country \Rightarrow 14 clusters. Should cluster at currency union level \Rightarrow 5 clusters. Asymptotic cluster formula over-rejects with few (14 or 5) clusters. Solution: wild-t bootstrap or LZ2.
 - ▶ Key variable r^* is generated regressor. HLW: “estimates of the natural rate of interest are highly imprecise.”

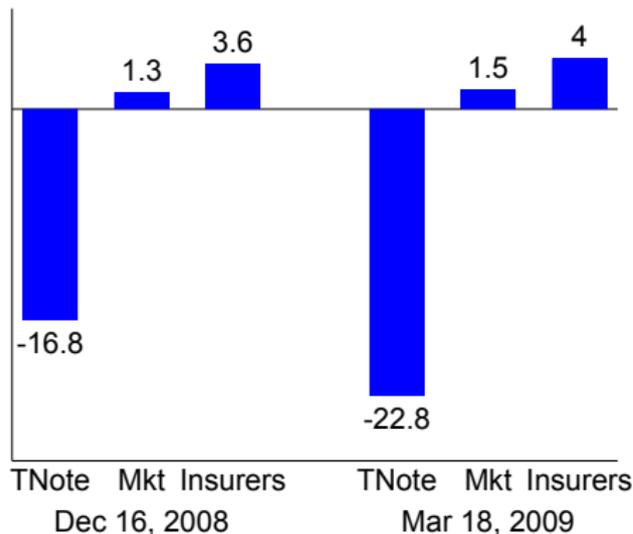
Comments On Interpretation

INTERPRETATION

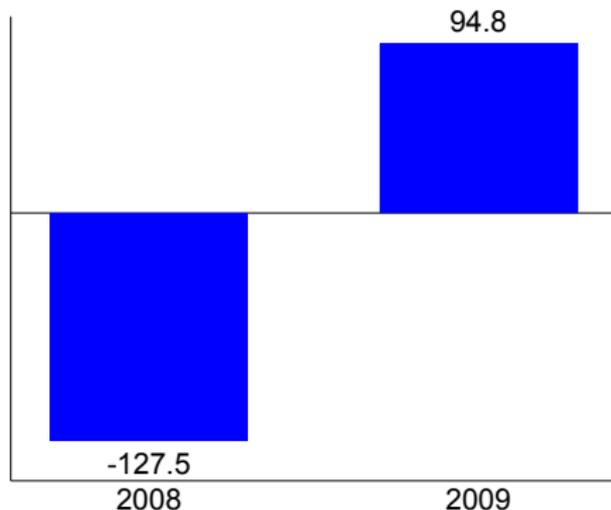
- 1 Low interest rates \neq bad news for pension funds and life insurance companies.
- 2 Even if r^* declined, why shift into alternatives rather than equities? Something about comparative advantage of these funds.
- 3 Social question: who is best suited to hold these assets?

LOW INTEREST RATES \neq BAD NEWS FOR INSURERS

High-frequency returns
(b.p. or p.p.)

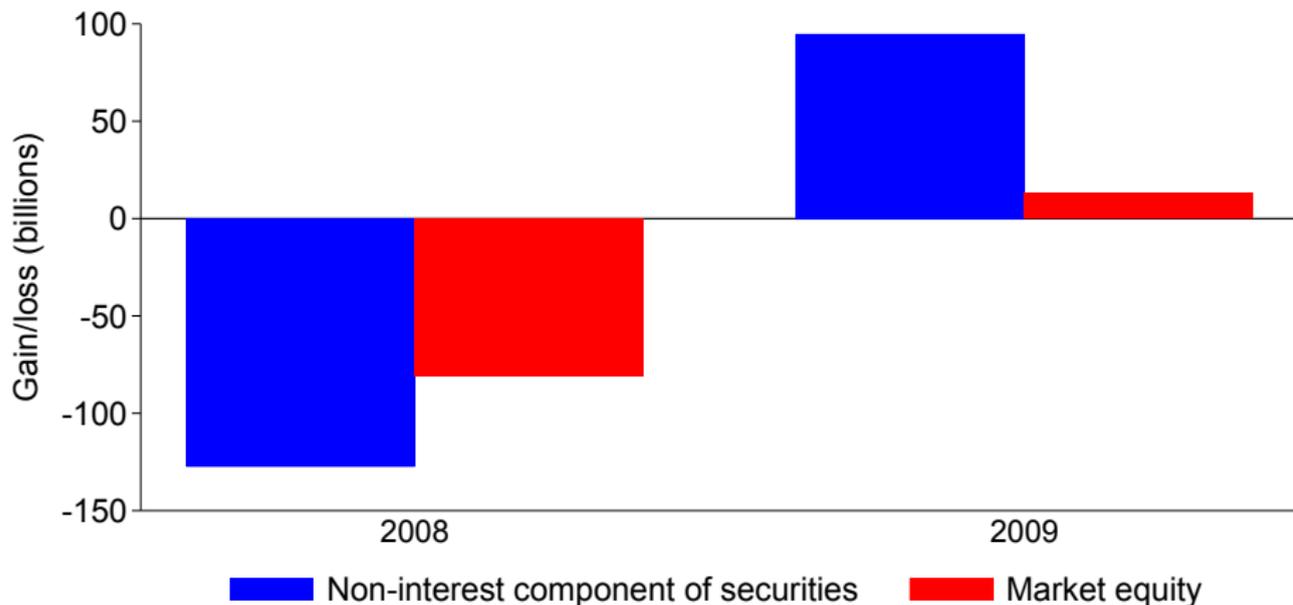


Non-interest valuation change on
securities portfolio (billions)



- Sources: Chodorow-Reich, “Effects of Unconventional Monetary Policy on Financial Institutions”; Chodorow-Reich, Ghent, Haddad, “Asset Insulators.”

INSURERS' COMPARATIVE ADVANTAGE



- Market equity of life insurers partially insulated from change in value of asset holdings.
- Source: Chodorow-Reich, Ghent, Haddad, "Asset Insulators."

SHOULD PENSION FUNDS HOLD ILLIQUID ASSETS?

- In equilibrium someone must bear risk of holding illiquid assets.
- Institutions with long and predictable liabilities naturally suited to bear this risk.
- Reason for pension funds to invest in alternatives rather than equities.
- Caveats (I agree with authors):
 - ① Long-term investors must act like long-term investors and not dump assets at inopportune moments.
 - ② Illiquid assets come with increased informational frictions, raising the risk of mismanagement. Reason for economies of scale.

Appendix slides