Discussion: Looking for Alternatives

By: Victoria Ivashina and Josh Lerner

Gabriel Chodorow-Reich
Harvard University and NBER

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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

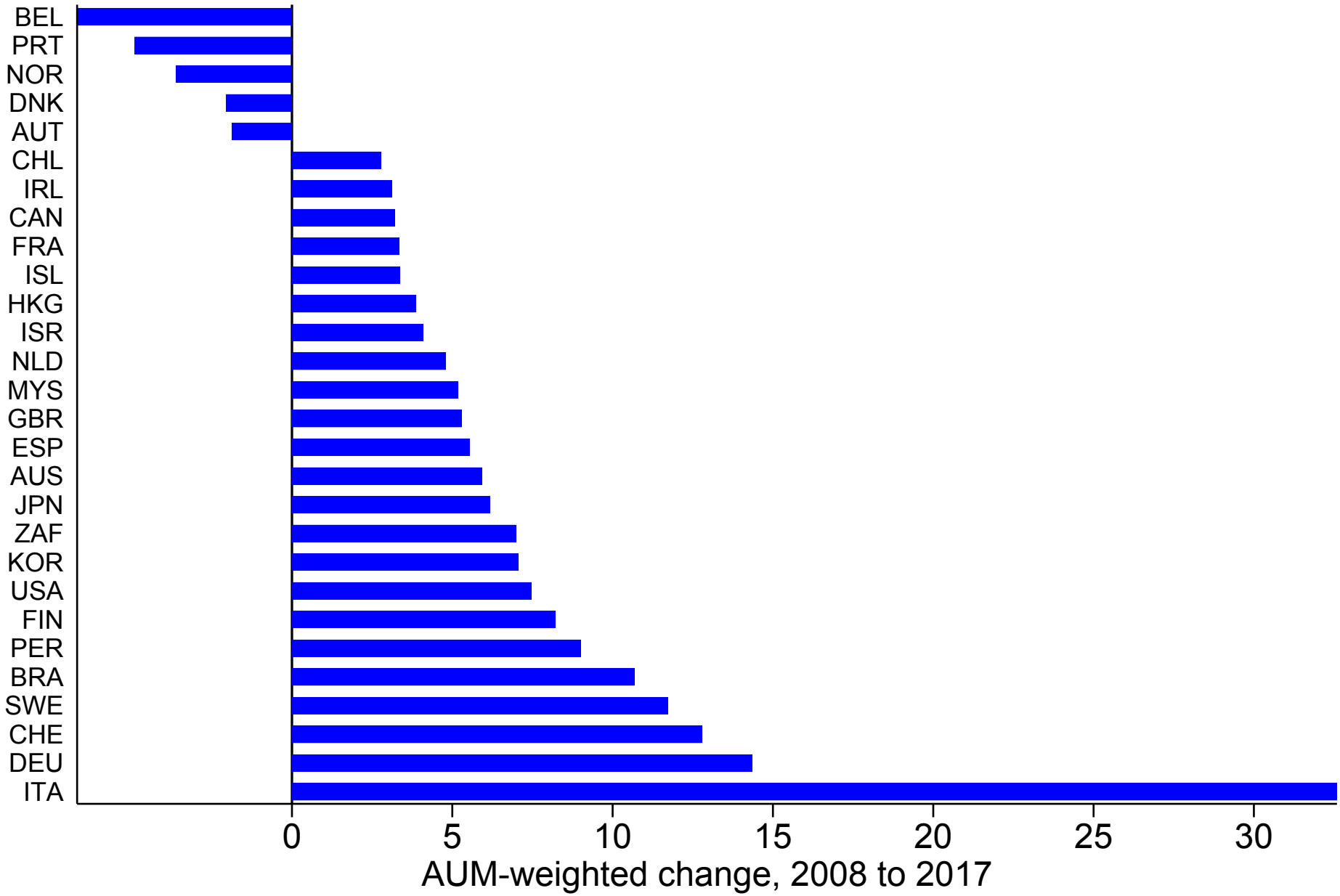
1. Important result documented in a very useful data set.
2. Role of interest rates.
3. Good? Bad?

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.

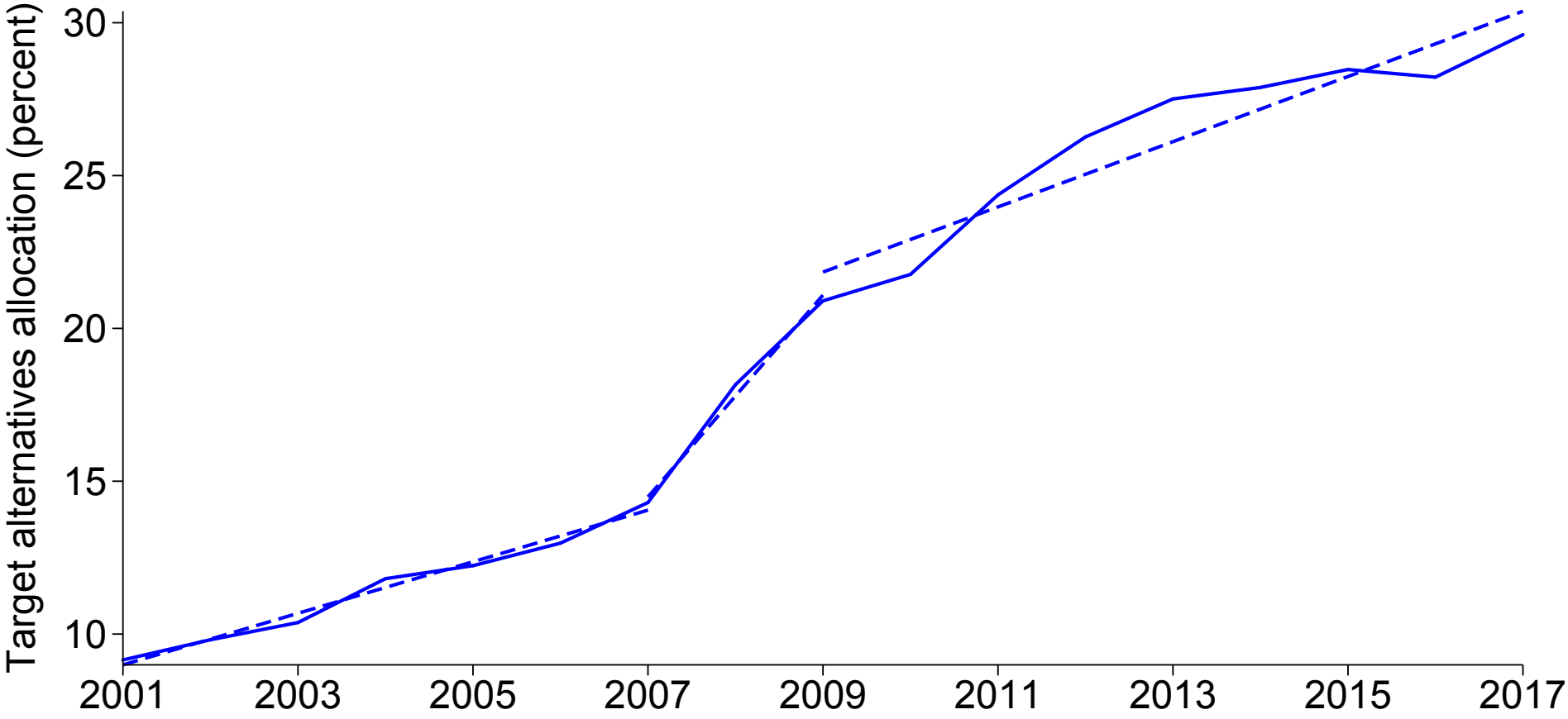
MAIN RESULT: CHANGE IN ALT. SHARE



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.

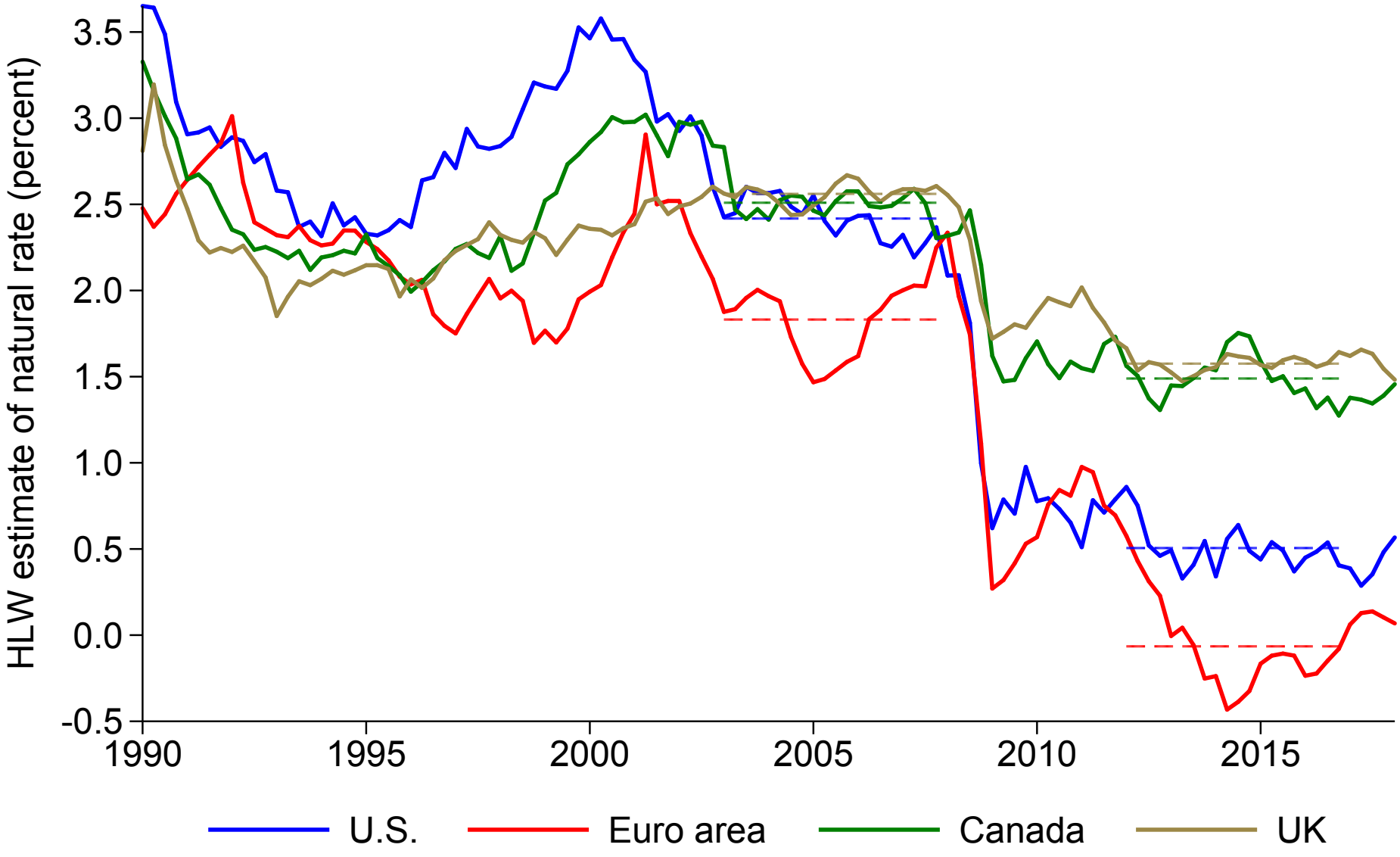
Is 2008-17 a trend break? U.S. S&L funds



- 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**	-0.3574*	-0.4938**	-0.5301**
	[0.179]	[0.190]	[0.202]	[0.232]
GDP growth	0.3058	0.3001	0.4140	0.4140
	[0.215]	[0.215]	[0.258]	[0.254]
Inflation	--	-0.2691	--	0.1237
		[0.265]		[0.357]
AUM	-0.0048*	-0.0050*	-0.0049	-0.0047
	[0.003]	[0.002]	[0.004]	[0.004]
Constant	0.8075	1.2191***	0.6658	0.4759
	[0.469]	[0.402]	[0.523]	[0.522]
Observations	867	867	1,595	1,595
R-sq.	0.048	0.050	0.037	0.037

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  - Key variable r^* is generated regressor. HLW: "estimates of the natural rate of interest are highly imprecise."

Comments On Interpretation

Interpretation

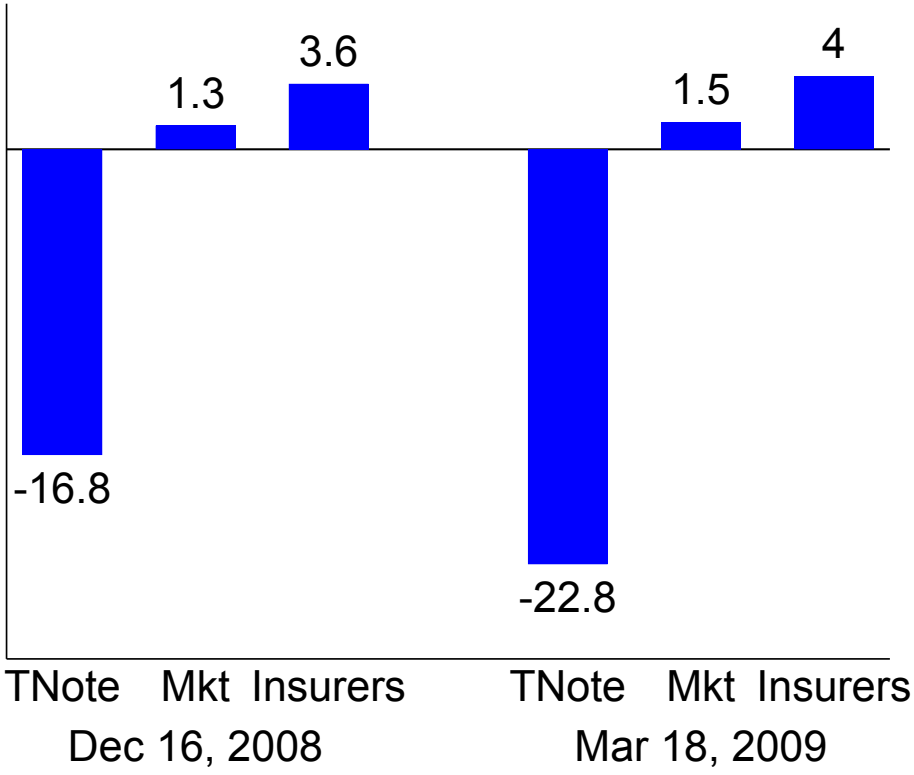
1. Low interest rates $\neq$ bad news for pension funds and life insurance companies.

2. Even if r^* declined, why shift into alternatives rather than equities? Something about comparative advantage of these funds.

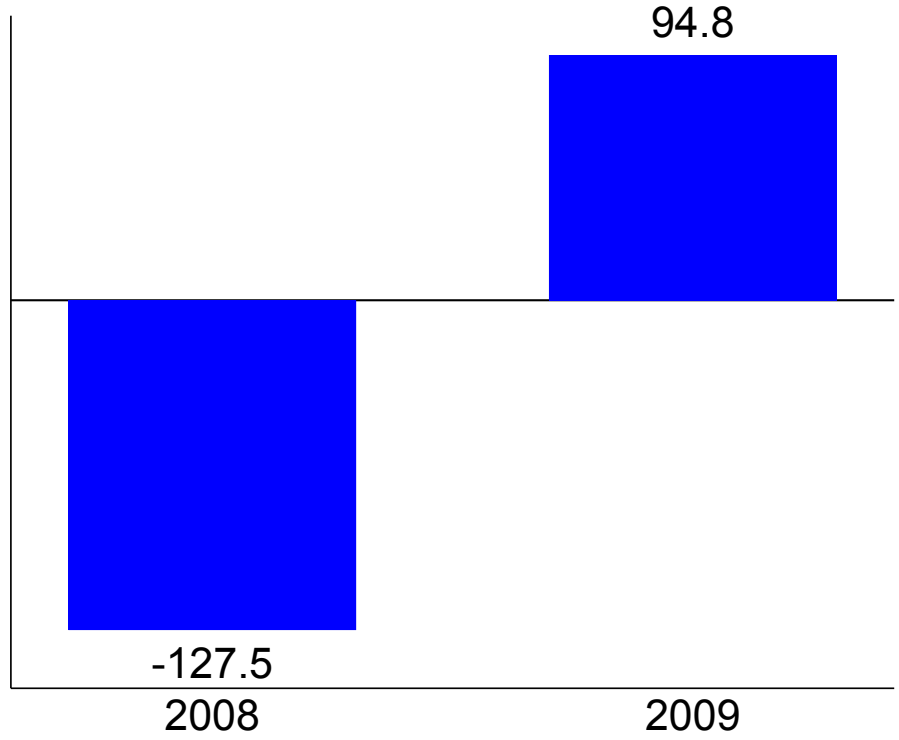
3. Social question: who is best suited to hold these assets?

LOW INTEREST RATES ≠ BAD NEWS FOR INSURERS

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

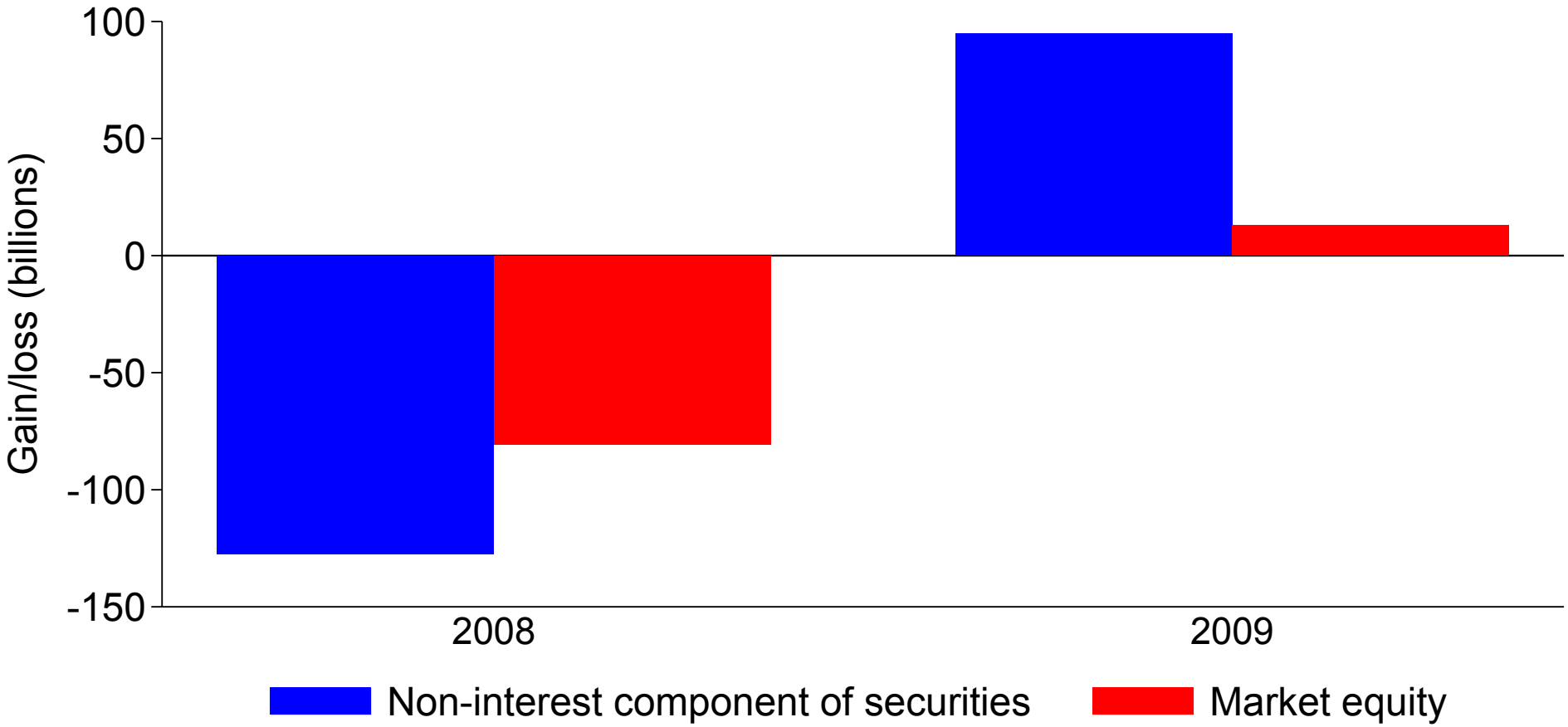


Non-interest valuation change on
securities portfolio (billions)



- 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