Bringing the power of academia to asset owners

UC San Diego

KRONER CENTER FOR FINANCIAL RESEARCH

KCFR overview

Mission	*KCFR seeks to make asset owner research topics mainstream in academic research*. KCFR's strategy is guided by a focus on social good and improving living standards for retirees.
Solution	Allow asset owners to set research agenda and serve as broker between academia & industry to create salient research which asset owners use to serve the needs of their beneficiaries.
Staff	Michael Melvin & Graham Elliott, Executive Directors Joe Sturtevant, Managing Director

KCFR's solution to aligning agendas

Advisory councils

CIO council identifies research topics:

Chris Ailman, Chair, CalSTRS

Rod June, LACERS

Molly Murphy, OCERS

Amit Prakash, AIMCo

Ramy Reyes and Rob Blazey, BCI

Steve Sexauer, SDCERA

Betty Tse, ACERA

Michael Wissell, HOOPP

KCFR's solution to aligning agendas

Advisory councils

***Academic council advises on research team selection and research*:**

Andrew Karolyi, Chair, Cornell
Rob Engle, New York University
Itay Goldstein, University of Pennsylvania
Wei Jiang, Emory University
Kathleen McGarry, UCLA
John B. Shoven, Stanford University
Laura Starks, University of Texas

KCFR's solution to aligning agendas

Advisory councils

Industry Council advises on implementable research outcomes:

Robert Koenigsberger, Chair, Gramercy Funds Management

Rui de Figueiredo & Ted Eliopoulos, Morgan Stanley

Stephen McCourt, CEO, Meketa Investment Group

Current Call for Proposals

Measuring and modeling geopolitical risk. How should geopolitical risk be reflected in long-term capital market assumptions for pension plans and endowments?

Benchmarking benchmarks. How should pension plans and endowments ideally select benchmarks to fulfill their mandates?

Exploring potential unintended consequences of over-diversification. Understanding that diversification is essential to optimal risk/reward, have asset allocations become too complex or over-diversified? Are there techniques that permit other types of cross portfolio exposures to be identified, isolated and diversified to improve total portfolio properties?

Rethinking private markets as an asset class. What underlying risks, perhaps increased competition or the end of an era of low costs of leverage, are not sufficiently widely addressed in the study of private equity as an asset class?

2023 Research Projects

Choosing Pension Fund Investment Consultants
(Aleks Andonov, U. of Amsterdam; Matteo Bonetti, de Nederlansche Bank; & Irina Stefanescu, Federal Reserve Board 2023 Research Projects

Portfolio Design Issues for Institutional Investors: Asset Allocation in Public and Private Markets, Active Management, and Portfolio Concentration
(Keith Brown, U. of Texas and Cristian Tiu, U. at Buffalo 2023 Research Projects (cont)

What Drives Differences across Pension Funds in Portfolio Structure and Performance?
(Juliane Begenau, Stanford Business School and Emil Siriwardane, Harvard Business School) 2023 Research Projects (cont)

2022 Research Projects

The Cost of ESG Investing
(Laura Lindsey, Seth Pruitt, and Christoph Schiller, Arizona State University) [2022 Research Projects]

Is There a Performance Penalty to Sustainable Bond Investing
(Ji Min Park and Neil D. Pearson, University of Illinois)

The Cost of Sustainable Investing
(Hao Jiang, Michigan State University)

2021 Research Projects

Real Effects of Environmental Activist Investing
(S. Lakshmi Naaraayanan, London Business School; Kunal Sachdeva, Rice U.; and Varun Sharma, London Business School) *2021 Research Projects*

Environmental Externalities of Hedge Fund Activism
(Pat Akey, U. of Toronto and Ian Appel, Boston College) *2021 Research Projects*

Scale Economies, Bargaining Power, and Investment Performance: Evidence from Pension Plans 2021 Research Projects
(Tjeerd Devries, S. Yanki Kalfa, Allan Timmermann, UCSD; & Russ Wermers, U of Maryland)
1st place 2023 ICPM Research Award (CAD20,000)

2020 Research Projects

Portfolio Tilts using Views on Macro Regimes
(Redouane Elkahmi, U. of Toronto; Jacky S.H. Lee, HOOPP; & Marco Salerno, U. of Toronto) [2020 Research Projects]

Private Equity for Pension Plans? Evaluating Private Equity Performance from an Investor's Perspective
(Arthur Korteweg, USC and Stavros Panageas, UCLA)
[2020 Research Projects (cont)]

Diversity in California's Pension Funds: An In-depth Look at Emerging Manager Programs
(Prashant Bharadwaj, Amanda Bauer, and Frances Lu, UC San Diego) [2020 Research Projects (cont)]

Appendix

- **Kroner Center for Financial Research**
- **Research completed & underway, Nov 2023**

2023 Research Projects

Choosing Pension Fund Investment Consultants

(Aleks Andonov, U. of Amsterdam; Matteo Bonetti, de Nederlansche Bank; & Irina Stefanescu, Federal Reserve Board

- Financial intermediaries that possess an informational advantage and provide expertise
- Powerful gatekeepers to certain investment products and asset managers
- Shield against headline risk
- Turnover of general consultants is strongly linked to past performance.
  - Hiring a new consultant results almost immediately in asset allocation changes.
    - changes in asset allocation are concentrated in equity and alternatives.
    - terminate them in case of low peer-adjusted performance
    - Weak evidence that performance improves following a consultant replacement.
- PFs hiring specialized consultants for the 1st time already made investments in that asset class.
  - Provide scalability in alternative assets (real assets, private equity, or hedge funds) and access to oversubscribed private funds.
    - PF with a larger gap between target and actual allocation are more likely to hire
  - No evidence that using specialized consultants improves performance in private markets.
- Lack of expertise does not seem to be the main reason why pension funds rely on consultants.
- Results are more consistent with limited scalability and shield against headline risk reasons.
- Rising concentration of consultants and correlated investment decisions of pension funds are concerns

2023 Research Projects (cont)

Portfolio Design Issues for Institutional Investors: Asset Allocation in Public and Private Markets, Active Management, and Portfolio Concentration

(Keith Brown, U. of Texas and Cristian Tiu, U. at Buffalo)

- Analyze and document how the disparities in the investment problems faced by different asset owner types—defined-benefit pension plans and university endowment funds—lead to different outcomes regarding portfolio design judgments
- The mixture of public and private market asset allocations in the average endowment and the average pension fund has converged over the years, although endowment funds were the leader in the public-to-private migration trend
- Pensions and endowments both produced positive alpha return, on average, over the sample period. Large endowments outperform small endowments, with the reverse being true for pensions
- For both pensions and endowments, the benchmark allocation decision is the most important variable in explaining a fund's return variation over time, with the alpha return decision being the most important factor in the cross-section of funds at a given point in time
- For both pensions and endowments, active investment decisions are positive marginal contributors to the production of total returns while passive allocation decisions are negative marginal contributors
- Generally, endowment funds have adopted an optimal mixture of passive and active risks; conversely, depending on the way in which the investor's objective function is defined, pension funds could benefit from taking additional active risk

2023 Research Projects (cont)

What Drives Differences Across Pension Funds in Portfolio Structure and Performance?
(Juliane Begenau, Pauline Liang, Stanford Business School and Emil Siriwardane, Harvard Business School)

- Since 2001, public pension fund risk budgeting has fundamentally changed
  - Each \$1 out of fixed income→\$2.95 into alts + \$1.95 out of equities
    - Alts = private equity/credit + real assets + hedge funds
    - Risky share = 1 - (fixed income + cash share)
    - Alts/risky share increased from 0.13 to 0.4 since 2001
- *Why?*
  - Long-run changes in the alternative-to-risky share are unrelated to:
    - Initial level level of funding in 2002
    - Whether plan sponsors failed to make required contributions
    - Size
  - Risk aversion may have declined (e.g., reach-for-yield)
  - Constraints (like min fixed income share) may be binding
  - But beliefs are still necessary to explain the rise of alternatives
- Beliefs about the risk-return properties of alternatives have changed
  - The perceived "alpha" relative to public markets has increased
- How have consultant beliefs changed over time?
  - Examining capital market assumptions
- Initial results indicate consultant & peer effects important

2022 Research Projects

The Cost of ESG Investing

(Laura Lindsey, Seth Pruitt, and Christoph Schiller, Arizona State University)

- Yes we can adjust portfolios to improve ESG performance without sacrificing return performance (US equities)

Is There a Performance Penalty to Sustainable Bond Investing

(Ji Min Park and Neil D. Pearson, University of Illinois)

- Positive alpha's for HY bonds that score well on E and G criteria
- Negative alpha's for HY bonds that score well on S criteria
- No evidence of abnormal performance on IG bonds with the most careful benchmarking

The Cost of Sustainable Investing

(Hao Jiang, Michigan State University)

- EU Sustainable Finance Action Plan: A Natural Experiment identifying investor preferences for green ETFs & mutual funds
- A surge of flows into green funds tends to push up the prices of green stocks with large holdings by green funds. More than half of the price increases are reversed in the subsequent month.
- Implications for policy makers: Green policy initiatives increase the supply of capital for green investments, which may reduce their cost of capital.
- Implications for green investors: The aggregate impact of green investing can be large; Beware of endogenous risk accompanying lower expected returns

2021 Research Projects

Real Effects of Environmental Activist Investing
(S. Lakshmi Naaraayanan, London Business School; Kunal Sachdeva, Rice U.; and Varun Sharma, London Business School)
Does environmental activism have any real effects? What are the externalities? And, how do firms respond?

- NYC pension fund, 75 resolutions filed
- Toxic emissions fall 13% post engagement
- Production doesn't fall, but financial performance does—profits & operating income
  - Capital spending on abatement technology
- Beneficial health effects on local area
- Engagement good alternative to divestment

Environmental Externalities of Hedge Fund Activism
(Pat Akey, U. of Toronto and Ian Appel, Boston College)
Use HF activism campaigns (primarily from 13D filings)

- decrease in emissions
- not from plant divestment but from production changes
- effects not present for campaigns with objectives
  that are unlikely to directly effect firms' operations (e.g., targeting governance or financial policies)

2021 Research Projects

Scale Economies, Bargaining Power, and Investment Performance: Evidence from Pension Plans

1st place 2023 ICPM Research Award (CAD20,000)

(Tjeerd Devries, S. Yanki Kalfa, Allan Timmermann, UCSD; & Russ Wermers, U of Maryland)

- large plans internally manage a greater proportion of assets than smaller peers. Large plans allocate more of their holdings to less transparent asset classes such as private equity and real assets and less to (public) stocks and fixed income
- Large plan cost economies are particularly strong for passively managed accounts and public asset classes. Large plans, pay significantly lower fees per dollar invested than smaller peers
- Large plans do not earn higher net-of-cost return performance in the highly competitive public asset markets (stocks and fixed income), but there is strong evidence that larger plans earn economically large and significant abnormal returns in the markets for private assets compared to their smaller peers
- The scale disadvantages in investment management costs that we identify for smaller plans indicate that these plans may perform best when they embrace passive management which is widely available in public asset markets.
- large plans have the ability to manage private assets internally and negotiate lower external investment management fees. This helps explain why plan size (scale) is particularly important in determining investment performance in private asset markets and why private asset classes have become particularly important for large plans in recent years.

2020 Research Projects

Portfolio Tilts using Views on Macro Regimes
(Redouane Elkahmi, U. of Toronto; Jacky S.H. Lee & Marco Salerno, HOOPP)
Incorporate investors' views on the likelihood of economic regimes, instead of point estimates of returns or covariances, to enhance the investment decision process

- May be more aligned with how CIOs think about portfolio rebalancing
- Views on econ growth & inflation regimes ⇒ tilts
- Application to US equities, US fixed income, & commodities
- *JPM, Feb 2023*

2020 Research Projects (cont)

Diversity in California's Pension Funds: An In-depth Look at Emerging Manager Programs
(Prashant Bharadwaj, Amanda Bauer, and Frances Lu, UC San Diego)

Is there a performance penalty if emerging managers are hired?

- less than 1.3% of CA fund assets invested with diverse funds, defined as women or ethnic minority owned
- Emerging managers are young and small firms
- Women & minority-owned firms tend to be smaller, making EM programs one way to improve representation
- A firm or fund is *diverse owned* if at least 25% ownership is by women or minorities
- While somewhat limited, existing evidence suggests diverse-owned fund returns similar to non-diverse so no performance penalty

2020 Research Projects (cont)

Private Equity for Pension Plans? Evaluating Private Equity Performance from an Investor's Perspective

(Arthur Korteweg, USC and Stavros Panageas & Anand Systla, UCLA)

Evaluate PE performance with risk-adjusted returns specific to a pension fund and its particular risk preference

- use the return from an investor's overall portfolio — including alternative and publicly traded assets — as the rate to discount the cash flows of a private equity investment
- study 179 state and local US public pension plans
- focus on venture capital, buyout and real estate
- Overall, pension plans appear to have allocated their portfolios to long-only private equity optimally, in the sense that there was no benefit of investing more or less in a representative PE fund
- PE funds that were selected by public pension plans outperform the average PE fund of the same vintage year
- Evidence suggests that PE funds select their investors and give preferential access to the better PE investments
- different pension plans obtain very different returns on their PE portfolios
  - This contrasts with investments in publicly traded equities, which are highly correlated across pension plans
- Funds taking greater risk & earning lower risk-adjusted PE returns tend to be: more underfunded, with a larger fraction of state officials who serve ex-officio, and members of the public that were appointed by a government official