Large Taft-Hartley Defined Benefit Plans: Did Larger Equity Allocations Pay Off Again?

by Robert J. Waid

This annual look at the asset allocations of large and small Taft-Hartley defined benefit (DB) pension plans discusses why small plans performed significantly better than large plans for the 12-month period ending March 31, 2017.
This is the fifth consecutive year Wilshire Analytics has used the Wilshire Trust Universe Comparison Service® (TUCS®) to examine differences in the asset allocations between large Taft-Hartley defined benefit (DB) plans compared with small Taft-Hartley DB plans and whether those differences paid off in the form of higher returns for the 12-month period ending March 31, 2017. This installment continues to examine the overweighting of equities to determine whether that strategy pays off.

Wilshire TUCS is a cooperative effort between Wilshire Associates Incorporated (Wilshire®) and major custodian banks and trust companies. Custodians and plan consultants blind-submit to Wilshire their clients’ trust plan performance, asset allocation and holdings detail. Wilshire combines the submitted data for plan comparison with universes of like-styled plans.1

Methodology

A universe of Taft-Hartley DB plans with five years of quarterly, asset-level data ending March 31, 2017 was selected and separated into large- and small-plan universes based on the total assets of the plan. Large plans are defined as those with total assets in excess of $1.0 billion, and small plans are defined as those plans with total assets less than $1.0 billion.

Observations

The classic starting point for a pension plan asset allocation is 60% equities and 40% fixed income, so it is not unexpected to see that many plans have asset allocations near these numbers. This continues to be the case for small Taft-Hartley DB plans. They have an average1 “equitylike” allocation of 60% and “fixed income-like” allocation of 39%. (Less than 1% was lost to rounding and the catchall “other” asset class.) On the other hand, the average large Taft-Hartley DB plan continues to have a significantly higher exposure to equitylike assets of 73%. (See Figure 1.)

The equity bull market, as well as a diversification goal, is most likely responsible for the equity-to-fixed ratio of 73/26 for large Taft-Hartley DB plans, which matched the historical ratio of 73/27 for the past five years.

Large Taft-Hartley DB plans continue to be more likely to invest in alternative investments (Figure 2), including investments like private equity and hedge funds, which are funded by a reduction in fixed income. The exposure difference between large and small plans, once a plan decides to invest in alternatives, continues to be surprising. Figure 3 shows that not only do larger Taft-Hartley DB plans continue to have larger exposures to alternative investments than small Taft-Hartley DB plans that also invested in alternative investments, but that the difference continues to grow.

All of the tracked large Taft-Hartley DB plans are invested in alternative investments, with a median allocation of 12.6%, while only 37% of small Taft-Hartley DB plans are invested in alternatives, with a median allocation of 3.5%. Real estate, the original alternative investment, has a similar story. Eighty-one percent of large Taft-Hartley DB plans have an allocation to real estate compared with 57% of small.

### FIGURE 1

**Average 2017 Q1 Equity-Type Asset Allocations**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Large Plans</th>
<th>Small Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alternatives</td>
<td>12.6%</td>
<td>3.5%</td>
</tr>
<tr>
<td>International Equity</td>
<td>24.0%</td>
<td>19.1%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>29.8%</td>
<td>17.9%</td>
</tr>
<tr>
<td>U.S. Equity</td>
<td>33.6%</td>
<td>49.5%</td>
</tr>
</tbody>
</table>

*Source: Wilshire TUCS.*
Taft-Hartley DB plans. Similar to the case with alternative investments, large and small Taft-Hartley plans with real estate exposure had significantly different allocations but in the other direction, with large plans at 3.0% and small plans at 6.9%. More telling is that 100% of large plans with real estate also had exposure to alternative investments, while only 45% of small plans with real estate also had exposure to alternative investments. This means that large Taft-Hartley DB plans usually invest in both real estate and alternatives, while a significant number of small plans invest in only one or the other.

Historically, more small plans had invested in alternative investments until last year when the percentage dropped from 49% to 40%. This year the percentage dropped again to 37%. The small plans that were invested in alternatives increased their average exposure as a group from 2.9% to 3.5% but lag the allocation of large Taft-Hartley DB plans at 12.6%. Large plans have been diversifying their equitylike risk by increasing investments into other equitylike asset classes, such as alternative investments, real estate and international equity. Meanwhile, the average exposure for small Taft-Hartley DB plans has remained relatively constant.5

**FIGURE 2**

*Plans With 2017 Q1 Assets in Alternative Investments and Real Estate*

![Graph showing asset allocation between alternatives and real estate for large and small plans.]

*Source: Wilshire TUCS.*

**FIGURE 3**

*Annual Q1 Average Percent of Assets in Alternative Investments*

![Graph showing annual Q1 average percent of assets in alternative investments for large and small plans.]

*Source: Wilshire TUCS.*

**Did Larger Equity Allocations Pay Off Again?**

The answer is no. After large Taft-Hartley DB plans finally outperformed small Taft-Hartley DB plans last year, median small plan performance was significantly better than median large plan performance, 11.36% to 10.59%. What’s missing this year is the asset allocation and diversification explanation because, from an asset allocation per-
Spective, small plans should have significantly underperformed large plans. Using the Wilshire 5000 Total Market Index and the Wilshire Bond Index returns of 18.35% and 2.92% respectively, a simple 60/40 portfolio loses to a 73/27 portfolio, 12.2% to 14.2%, respectively.

Even factoring in the average or median allocations (Table I) to other asset classes, large plans should have performed better. Using average allocations to create large and small plan proxy asset allocation portfolios to the major asset classes, small plans should have had a one-year return close to 11.1%, and large plans should have had a one-year return close to 13.1%. This proxy return was close to the small plan realized return; using median allocations produced similar results. What happened to large plans to make them underperform? The asset allocation answer is not diversification within the asset class. Table II shows that with the exception of real estate, in each of the standard asset classes with a diversification subasset class, the subasset class outperformed.

Since small plans tracked their proxy portfolio returns and large plans did not, the most likely asset allocation answer is the asset exposure to alternatives.

Large plans underperforming their proxy portfolio can largely be attributed to their underperformance in U.S. equities. Using U.S. style indexes, Fig-

<table>
<thead>
<tr>
<th>U.S. Equity</th>
<th>International Equity</th>
<th>U.S. Fixed Income</th>
<th>Real Estate</th>
<th>Alternatives</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Plans</td>
<td>47</td>
<td>11</td>
<td>22</td>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>Small Plans</td>
<td>48</td>
<td>8</td>
<td>30</td>
<td>1</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Wilshire TUCS.

**FIGURE 4**

One-Year U.S. Equity Plan and Wilshire U.S.-Style Index Returns Ending March 31, 2017

Source: Wilshire TUCS.

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International Foundation. 2016.
Visit [www.ifebp.org/glossary](http://www.ifebp.org/glossary) for more details.
ure 4 shows how large plans underperformed every equity style type for the 12-month period ending March 2017.

Conclusion

Partly due to the bull market in U.S. equities, diversification has been working against “prudent” investors for the past few years, especially large Taft-Hartley DB plans. For the 12-month period ending March 31, 2017, diversification overweighting to equity type assets should have worked in favor of large Taft-Hartley DB plans with the outperformance of subasset classes and equities overall. This year’s failure to do so can be attributed mostly to exposure to alternatives. With the implied diversification promise of reaching long-range financial goals while minimizing risk, there is no indication that large Taft-Hartley DB plans will reduce their equity exposures, especially in alternative investments. Time will tell if large plans get rewarded but, until then, as far as returns for the last few years are concerned, it is only a promise.

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Endnotes

1. Wilshire Trust Universe Comparison Service (TUCS®) is the world’s largest, and one of the most widely accepted, benchmarks for the performance and allocation of institutional assets. It includes nearly 1,300 plans representing more than $3.6 trillion in assets.
2. The median and average allocations are similar.
3. “Equitylike” investments are the combination of the TUCS asset classes of U.S. equity, non-U.S. or international equity, real estate and alternative investments.
4. “Fixed income-like” investments are the combined TUCS asset classes of U.S. fixed income, non-U.S. international fixed income, guaranteed investment contracts (GICs), mortgages, and cash.
5. Average exposure includes plans with no exposure to alternative investments.

Robert J. Waid is managing director of Wilshire Analytics, having joined Wilshire Associates Inc. in 1983. He oversees investment market services, which include the Wilshire Indexes, Wilshire TUCS®, Wilshire Cooperative℠ and Wilshire Compass InSite℠ products. Waid previously led Wilshire Index research and analytics vendor relations and was responsible for the development, implementation and management of domestic long/short programs in the proprietary investment department. Waid earned a B.S. degree in finance from the University of Southern California.

takeaways

• While small Taft-Hartley plans (those with less than $1 billion in assets) maintain asset allocations very close to the traditional allocation of 60% equities and 40% fixed income, large DB plans had a higher exposure to equitylike investments of 73% for the 12 months ending March 31.
• All large plans invested in alternative investments, with a median allocation of 12.6%. Only 37% of small plans invested in alternatives, with a median allocation of 3.5%.
• Small plans outperformed large plans 11.36% to 10.59%.
• Large plans’ failure to outperform small plans can be attributed mostly to exposure to alternatives.

bio

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