For the sixth year in a row, the author compares the asset allocations of large and small Taft-Hartley defined benefit pension plans. He discusses why large plans outperformed small plans this year.

by | Robert J. Waid
This is the sixth consecutive year that Wilshire Analytics has examined Wilshire Trust Universe Comparison Service® (Wilshire TUCS®) data to analyze asset allocation differences in large versus small Taft-Hartley defined benefit (DB) plans and examine whether those differences drove returns higher for the year ending March 31, 2018. This installment extends analysis of the strategy to overweight equities in order to determine whether that strategy paid off.

Wilshire TUCS is a cooperative effort between Wilshire Associates Incorporated (Wilshire®) and a consortium of major custodian banks and trust companies. Custodians and plan consultants blind-submit to Wilshire their clients’ trust plan performance, asset allocation and holdings information. Wilshire then combines that data to create robust benchmarks based on various like universes used by individual plans to make relevant comparisons.1

Methodology
A universe of Taft-Hartley DB plans with five years of quarterly asset-level data (as of March 31, 2018) was selected and separated into large- and small-plan universes based on total plan assets. Large plans are defined as those with more than $1 billion in total assets, and small plans are defined as those with total assets less than $1 billion.

Observations
The traditional asset allocation starting point for a pension plan is 60% equities and 40% fixed income (60/40); therefore, it is not surprising to see many plans structured similarly, including small Taft-Hartley DB plans. These plans have an average2 “equity-like”3 allocation of 60% and “fixed income-like”4 allocation of 40%. Meanwhile, the average large Taft-Hartley DB plan continues to have significantly higher exposure, roughly 74%, to equitylike assets. (Figure 1)

The equity bull market, as well as a diversification strategy, is most likely responsible for the 74/26 equity-to-fixed ratio for large Taft-Hartley DB plans, which nearly matched historical ratios of 73/27 for the past five years.

Large Taft-Hartley DB plans contin-
ue to be more likely to invest in alternative investments (Figure 2), including investments such as hedge funds and private equity, which are funded by a reduction in fixed income. The difference in exposure between large and small plans once a plan decides to invest in alternatives continues to be surprising. Figure 3 shows that large Taft-Hartley DB plans have continued to increase exposure to alternatives, but allocations to alternatives by small Taft-Hartley DB plans have remained relatively flat. The difference between allocations has grown from 10.7% in 2012 to 18.6% in 2018.

More than 90% of large Taft-Hartley DB plans tracked invest in alternatives, compared with just 16% of small Taft-Hartley DB plans, with median allocations of 18.2% and 5.4%, respectively. Real estate, the original alternative investment, has a similar story. Nearly three-fourths (73%) of large Taft-Hartley DB plans allocate to real estate, compared with just 42% of small plans. The difference in real estate exposure between large and small plans is significant, however, with larger plans reporting a smaller exposure to real estate at 2.1% compared with 4.3% for smaller plans. In addition, 88% percent of large plans with real estate exposure also invested in alternatives, while only 25% of small plans did. This means that most large Taft-Hartley DB plans have invested in both real estate and alternatives, whereas most small plans typically allocated to just one or the other.

Historically, more small plans invested in alternative investments until recently. The percentage dropped from 49% to 40% between 2015 and 2016 and declined again from 37% to 16% between 2017 and 2018. This year, small plans with alternatives increased their average exposure from 3.5% to 5.4% yet

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**FIGURE 2**

Plans With 2018 Q1 Assets in Alternative Investments and Real Estate

![Alternative Investments and Real Estate](source)

**FIGURE 3**

Annual Q1 Average Percent of Assets in Alternative Investments

![Alternative Investments](source)
Large Taft-Hartley defined benefit (DB) pension plans (those with more than $1 billion in assets) continue to have a significantly higher exposure to equitylike investments when compared with small plans.

More than 90% of large Taft-Hartley DB plans invested in alternatives during the 12 months ending March 31, with a median allocation of 18.2%. Only 16% of small Taft-Hartley DB plans invested in alternatives, with a median allocation of 5.4%.

Large plans outperformed small plans 10.8% to 8.32%.

Asset allocation and diversification are the main reasons behind large plans outperforming small plans.

large behind the large plan average allocation of 18.2%. Large plans have been diversifying equitylike risk by increasing allocation to other equitylike asset classes, such as alternatives, real estate and international equity; meanwhile, average exposure for small Taft-Hartley DB plans has remained relatively constant.\(^5\)

**Did Larger Equity Allocations Pay Off?**

The answer is a resounding yes. Large Taft-Hartley DB plans outperformed small plans last year with median returns of 10.8% and 8.32%, respectively, and both asset allocation difference and diversification explain why. Given a simple 60/40 portfolio (using the Wilshire 5000 Total Market Index to represent the broad U.S. stock market and Wilshire Bond Index to represent the U.S. bond market), with returns of 13.69% and 1.76% respectively, the 60/40 portfolio lost to a 74/26 portfolio, with returns of 8.9% and 10.6%, respectively.

If average or median allocations (Table I) are factored into other asset classes, then plan returns would be similar to realized plan returns. Using average allocations and major asset class returns to create large and small plan proxy asset allocation portfolios, small plans should have returned close to 8.7%, while large plans should have returned 11.0% for the year. Median allocations produced similar results. Actual large plan returns were between proxy returns, and small plan returns were slightly below both proxy returns. Asset allocation and diversification explains most of the large plan outperformance. Table II illustrates how, for each of the standard asset classes with a di-
versification subasset class, the main diversification, subasset class outperformed, with the exception of U.S. equities.

Given that large plans tracked their proxy portfolio returns while small plans underperformed, the most likely asset allocation answer is a lack of diversification into subasset classes.

Figure 4 shows that, unlike last year when small plans significantly outperformed in U.S. equities, for the year ending March 2018, both plan types nearly matched the U.S. equity market portfolio.

Conclusion

Partly due to the bull market in U.S. equities, diversification has been working against so-called prudent investors for the past few years, especially large Taft-Hartley DB plans. For the year ending March 31, 2018, however, diversification and overweighting to equitylike assets worked in favor of large Taft-Hartley DB plans with outperformance of subasset classes and equities overall. The diversification promise of reaching long-range financial goals while minimizing risk indicates that large Taft-Hartley DB plans will maintain their greater-than-60/40 equity exposures, especially in utilizing alternative investments. Time will tell whether large plans will continue to be rewarded.

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Endnotes

1. Wilshire TUCS® is the world’s largest and most widely accepted benchmark for institutional plan performance and allocation. It includes approximately 1,000 plans representing over $3.6 trillion in assets.
2. The median and average allocations are similar.
3. “Equitylike” investments include the combined Wilshire TUCS asset classes of U.S. equity, non-U.S. or international equity, real estate and alternative investments.
4. “Fixed income-like” investments include the combined Wilshire TUCS asset classes of U.S. fixed income, non-U.S. or international fixed income, guaranteed investment contracts (GICs), mortgages and cash.
5. Average exposure includes plans with no exposure to alternative investments.

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### TABLE II

**12-Month Returns Ending March 31, 2018**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Return</th>
<th>Subasset Class</th>
<th>Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wilshire 5000 Total Market Index</td>
<td>13.69%</td>
<td>Wilshire U.S. Small Cap Index</td>
<td>10.13%</td>
</tr>
<tr>
<td>MSCI AC World ex U.S. Index</td>
<td>16.53%</td>
<td>MSCI Emerging Markets Index</td>
<td>24.93%</td>
</tr>
<tr>
<td>Wilshire Bond Index</td>
<td>1.76%</td>
<td>Bloomberg Barclays U.S. Corporate High Yield Index</td>
<td>3.78%</td>
</tr>
<tr>
<td>Wilshire U.S. Real Estate Securities Index</td>
<td>-3.43%</td>
<td>Wilshire Global ex U.S. Real Estate Securities Index</td>
<td>12.89%</td>
</tr>
</tbody>
</table>

*Source: Wilshire Index Calculator, Wilshire Perspectives.*