Research insights from the CEM performance databases

Tom Scheibelhut
Managing Principal, CEM Benchmarking
tom@cembenchmarking.com
Insights come from the CEM’s global investment and administration performance databases.

**Investment database:**
- 25 year history
- US$10 trillion assets in 2017
- 350+ clients
- 150 of the world’s top 300 pension funds

**Administration:**
- 70+ clients
- Over 35 million members.
Total fund net value added averaged 15 bps from 1992 to 2017

- Based on 7,563 annual total fund annual fund performance observations
- Funds that did better than average were:
  1. More active
  2. Lower cost
1. Do not use fund of funds. Paying two levels of fees results in high costs that destroy value.
2. If your fund has less than $10 BN in assets, use public market alternatives to unlisted real estate and private equity.
Private equity and real estate do not have a diversification benefit. They correlate closely with public markets assets after adjusting for reporting lags.
Very few hedge fund portfolios had a diversification benefit. Most had high correlations with equity/debt blends.

- 105 of 148 fund portfolios (71%) had correlations in excess of 80% to equity/debt blends.
- The equity/debt blend was unique for each portfolio. On average, it was 40% stock, 60% 5-year-duration smoothed bonds.
3. Don’t invest in hedge funds. On average, most do well before costs, and horribly after.

- Don’t be fooled by bad benchmarks!
  - Most hedge fund portfolios had high correlations with unique portfolios of stock and smoothed bonds - on average 40% stock, 60% 5-year-duration bonds

- If you are a very big fund, you should consider replicating some hedge fund strategies internally.

- About 1/3 of hedge fund portfolios added net value. Characteristics include:
  - Less fund of funds
  - Long history in hedge funds
  - Lower correlations with stock and bond

Average hedge fund value added per annum - 2000 to 2016

- Gross Value Added: 1.44%
- Cost incl. perf. Fees: -2.72%
- Net Value Added: -1.28%
4. Understand which asset classes provide the most opportunity for active management, and why. Index efficient asset classes such as U.S. large cap.

Average net value added from active management 1996 - 2017

- U.S. large cap stock: -0.37%
- U.S. fixed income: 0.52%
- U.S. small cap stock: 0.53%
In summary, you can improve your fund’s performance by adopting the following 4 characteristics of top performing investment plan sponsors:

1. Do not use fund of funds.
2. Do not invest in hedge funds.
3. If your fund has less than $10 BN in assets, use public market alternatives to private equity and unlisted real estate.
4. Index efficient asset classes such as U.S. large cap stock.
IT costs for pension administration have grown 6% per annum since 2011 for the average plan. It has not resulted in cost reduction for other activities.
The good news is that members are benefiting from the IT investment. Secure web visits grew at 13% per annum.
Most California plans have high administration costs compared to other U.S. and Canadian plans

- Three reasons why:
  1. More complex regulations and rules.
  2. Cost environment
  3. “25 bps” budgets for county plans
Size matters. Economies of scale explain 70% of differences in administration cost per member.
Economies of scale are not linear. The smaller you are the greater your disadvantage.

<table>
<thead>
<tr>
<th>% Change in Members</th>
<th>Implied # of Members</th>
<th>Predicted Cost per Member</th>
<th>Increase/Decrease</th>
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<tr>
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<tr>
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Summary of benefit administration key takeaways

1. Don’t believe promises that investments in IT will result in lower costs.
   - IT costs are growing faster than inflation.
   - The cost of other activities are not declining.
2. Members are benefiting from investments in IT. Online volumes are exploding as members take advantage of 24/7 online services.
3. Economies of scale are substantial. Bigger plans have much lower costs than small plans.