CITY OF CAMBRIDGE

INTEROFFICE CORRESPONDENCE

To The Honorable, The City Council **Date** January 8, 1987

From Joseph E. Connarton, City Clerk JEC **Reference**

Subject Retirement System Analysis Report

Please be advised on behalf of the Cambridge Retirement Board, I am forwarding the first investment analysis report of all retirement systems throughout the Commonwealth, as prepared by the Public Employee Retirement Administration (P.E.R.A.). This is the first time such a comprehensive analysis has been done and Cambridge is proud to come in second place at 31.97% rate of return on its investment portfolio out of 105 systems. As you recall, your honorable body has from time to time held discussions relative to the best alternative for investment practices. The Cambridge Retirement Board appreciates your past and continued support.

THE COMMONWEALTH OF MASSACHUSETTS

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JOHN J. McGLYNN
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FOR RELEASE ON JANUARY 6, 1987

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John J. McGlynn, Commissioner of Public Employee Retirement, has released the first comprehensive report on the investment activity of the 105 Massachusetts Contributory Retirement Systems.

PERA's INVESTMENT ANALYSIS REPORT summarizes and compares the performance of the Commonwealth's public employee pension funds during the period from December 31, 1984 through December 31, 1985.

On December 20, 1983, when Governor Dukakis signed Chapter 661 of the Acts of 1983 into law, he set in motion a major reform in the way public employee pension systems in Massachusetts manage their investment portfolios.

Long limited by a depression-era creation, the "legal list" of acceptable investments for public employee retirement systems (allowing only government, government agency, railroad, telephone and public service company bonds, and bank and insurance company stocks), the Massachusetts Public Employee Retirement Systems were at a competitive disadvantage with other public and private pension plans that could take advantage of a broader range of investment opportunities under a "prudent person" investment standard.

Immediately upon enactment of Chapter 661, the State Employees' and Teachers' Retirement Systems were freed from the state retirement statute's investment restrictions.

Chapter 661 established a statewide investment pool, the PRIT Fund, to provide sophisticated portfolio management for local systems who want to take advantage of the option to participate.

The new statute also authorized PERA to allow local retirement systems to move beyond the statutory investment restrictions if, by experience and resources, they could show the sophistication to handle broader opportunities.

During 1985, 59 systems qualified for investment waivers from PERA.

At this writing, over 92% of the $6.4 billion in public employee retirement system assets are being invested free of the antiquated statutory restrictions.

Commissioner McGlynn noted, "The performance of our public employee retirement systems, as described in this report, is encouraging. Overall, our retirement systems are performing well against standard market indices and against other public and private pension funds."

McGlynn cautioned however, that readers of the REPORT "not draw too strong a conclusion from a single year's performance, whether comparing our systems against other public and private funds or against each other."

"This is particularly true for Massachusetts in 1985," McGlynn noted, "where the investment environment for our public employee retirement systems was so dramatically changed by the implementation of Chapter 661."

He added, "All of the investment expertise which has been made available to our Pension Investment Advisory Unit has been unanimous on the critical need not to judge investment performance over short time horizons."

"We have been convinced, conclusively," he said, "that to effectively compare investment performance the investment managers being compared must be seen over a full business cycle."

A full business cycle typically runs from three to five years.

McGlynn concluded, "Some managers perform well in up markets. Others have greater success in down periods. The only true comparison is one that has been made after a full cycle including ups and downs."

"Systems that performed well in 1985 by continuing to invest as they had in the past under the legal list may have done well as a circumstance of the 1985 market or they may have done well through insightful investment."

"Systems restructuring portfolios to take advantage of new investment flexibility may have sacrificed near term performance in exchange for building long term appreciation, or they may have simply invested poorly."

"Only performance over time will give a reliable answer to these alternative explanations of system investment outcomes.

With that caveat, the Pension Investment Advisory Unit within PERA drew several conclusions about the investment activity and performance of the Commonwealth's 106 public employee pension systems and their $6.4 billion in assets:

--There has been a significant increase in the number of systems utilizing professional portfolio investment managers. Over 92% of the assets of our public employee retirement systems are now being managed by investment professionals.

--While the retirement systems (excluding the largest four portfolios and funds invested therein) only had 12% of their assets in equities ($250 million as of 12/31/85), their performance in this asset class was remarkable. The aggregate equity performance was 46.23%. Of the 106 Massachusetts systems, 76 outperformed the S & P 500 Index in the equity portion of their portfolios.

--Looking at the portfolio's performance as balanced funds, the aggregate performance for all but the largest four portfolios was 22.35%. This compares very favorably to a composite index created to match the aggregate asset mix of the Commonwealth's systems which registered 20.16%.

--Each of the four largest portfolios exceeded both the composite index and the aggregate performance of the other Massachusetts systems.

--The market value of all assets held by the Massachusetts Contributory Retirement Systems as of December 31, 1985 was $6,376,473,000.

--Asset growth (including employee and employer contributions and investment returns) in the four years between 1979 and 1983 was at an annual compound rate of 11.1%.

--In the three years beginning January 1, 1983, the retirement system assets have grown at a compound annual rate of 17.9%.

--The largest five pension portfolio's were:

Teachers Retirement System	$1.656 billion
State Employees	$1.366 billion
PRIT Fund	$1.070 billion
Boston Retirement System	$ 549 million
Middlesex County	$ 103 million

--The five systems with the best overall 1985 annual performance were:

Woburn
Cambridge
Somerville
Clinton
Plymouth (Town)

--The five systems with the best performance for their equity holdings in 1985 were:

Holyoke
Hampden County
Lowell
Athol
Lexington

--The five systems with the best performance for their fixed income holdings in 1985 were:

Woburn
Massachusetts Turnpike Authority
Fitchburg
Dedham
Gloucester

PERA initiated development of a centralized data base through which it can track the investment performance and regulatory compliance of all retirement system investment activities to protect the interests of employees, retirees and taxpayers in the new investment environment of expanded authority for the Commonwealth's 106 retirement systems.

Today PERA is reporting on investment performance for Calendar Year 1985. It has been nineteen months since PERA initiated this analysis of retirement system investment activity.

Work is already well underway on 1986 investment data, and PERA intends to report results for this calendar year by mid-summer.

PERA's ultimate goal is to provide quarterly reports on a timely basis that can be of assistance to the retirement boards, employees, retirees, taxpayers and others interested in our multibillion dollar pension systems.

With a report on Calendar 1986 performance before Labor Day, PERA will build on this data base to comment on, analyze, and critique the systems' investment performance in ever more timely and frequent reports as it begins to take greater advantage of the full capacity of the monitoring system.

When PERA's monitoring system is fully on line, the Pension Investment Advisory Unit expects to conduct investment audits of retirement system portfolios and transactions to ensure statutory and regulatory compliance by fund managers, and to offer constructive comments to the retirement boards so that they may best meet their fiduciary obligations.

At that point too, it will be possible to do special studies as appropriate (e.g. on the performance of systems' South Africa free holdings as opposed to those which are not divested, or on the activity of the brokers, managers or custodian banks who serve the retirement systems).

The INVESTMENT ANALYSIS REPORT is attached.

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Comm. from Joseph E. Connarton, City Clerk, on behalf of the Cambridge Retirement Board transmitting a copy of the 1st investment analysis report of all retirement systems throughout the Commonwealth as prepared by the Public Employee Retirement Administration (P.E.R.A.) stating that of the 105 systems in the State, Cambridge has come in second in rate of return on its investment portfolio.

In City Council,

January 12, 1987

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