

Lawrence S. Speidell, Stefan Abrams, Robert D. Arnott, Sarah H. Ketterer and Christian Wignall were the participants in this year's Pensions & Investments' investment outlook roundtable.

but they expect the second half of the year to be stronger than the first half.

They also expect interest rates to continue to inch down in the first half, and for inflation to remain low.

Stock market returns in the United States are expected to be far below those of 1995 but still positive, and non-U.S. markets are expected to provide significantly better returns.

These are the consensus views of five top investment professionals gathered for *Pensions & Investments'* annual investment outlook roundtable, held Nov. 30 in Los Angeles.

- The participants were:
- Stefan Abrams, chief investment officer for asset allocation, TCW Group, Los Angeles.
  - Robert D. Arnott, president, First Quadrant Corp., Pasadena, Calif.
  - Sarah H. Ketterer, portfolio manager, Hotchkis & Wiley Inc., Los Angeles.
  - Lawrence S. Speidell, partner and director, global systematic management and research, Nicholas

vestment officer-equities, GT Capital Management, San Francisco.

**PENSIONS & INVESTMENTS:** Christian, what are your expectations for the U.S. economy in 1996? Will it be accelerating? Slowing? Or continuing on an even keel?

**CHRISTIAN WIGNALL:** I think the U.S. economy is still slowing, and it will continue to slow in the first half of 1996. I would expect that during the first half of 1996 we will have several cuts in interest rates by the Fed and a reacceleration in the second half of the year.

So whereas the U.S. economy in 1995 was strong in the first half and weak in the second half, I think we will have the flip situation in 1996. It probably all comes out about the same number.

**P&I:** What would that be?

**MR. WIGNALL:** 2.5% to 3%.

**P&I:** Sarah, what are your expectations for the year's economy?

**SARAH KETTERER:** We expect the economy to remain healthy.

*Continued on page 18*

# Downsizing spurs push to pension fund outsourcing

By Fred Williams

Several large pension sponsors have outsourced the complete management of their defined benefit pension funds to a single outside fiduciary.

Industry experts expect the trend to continue in the wake of the continuing wave of corporate cost-cutting and downsizing.

At least \$18 billion in pension assets is overseen by management organizations that take full responsibility for asset allocation and the selection and monitoring of investment managers. Some also offer plan administration and benefits payments services.

While outsourcing of investment, plan administrative and

benefits services has been growing rapidly for defined contribution plans, it is getting a new look by defined benefit plan sponsors unable or unwilling to develop internal pension investment staffs, and as the legal, economic and regulatory environment becomes more complex.

The first major pension fund to outsource the complete investment management and oversight process was the Teamsters, Central States, Southeast & South-west Areas Pension Fund, Rosemont, Ill. Under an agreement with the Labor Department in the late 1970s, the fund gave full discretion first to Equitable Life Insurance Co. and later to Morgan Stanley Asset Management.

More recently, Square D Co., Palatine, Ill.; Kaiser Aluminum and Chemical Corp., Pleasanton, Calif.; the city of Greenwich, Conn.; and reportedly Brown & Williamson Tobacco Co., Louisville, Ky., have outsourced their defined benefit plans. Others are expected to follow suit.

Establishing investment guidelines, plan design, asset allocation, manager selection, performance measurement, trust and custody services, benefit administration and record keeping are among the functions being outsourced. The asset management function usually uses a manager-of-managers approach.

In effect, the outside fiduciary serves as the sponsor's pension staff. The sponsor retains ultimate fiduciary responsibility and usu-

ally has significant input into and veto power over decision-making by the outside fiduciary.

As interest grows in defined benefit outsourcing, several major financial and benefits consulting firms are starting to offer one-stop pension management services. State Street Global Advisors, Boston; Frank Russell Trust Co., Tacoma, Wash.; and Morgan Stanley Group Inc., New York; all offer some form of defined benefit outsourcing services. Strategic Investment Management, Arlington, Va., provides defined benefit outsourcing as its sole line of business, according to Michael Duffy, managing director.

Watson Wyatt Worldwide, Washington, and State Street Global Advisors are forming a

joint venture to provide benefits outsourcing services in a deal set to close early next year; investment management will be added to the mix in the future.

Strategic Investment Management handles total pension plan management activities for nine tax-exempt client with assets totaling \$3.75 billion, said Mr. Duffy. Two of those plans have assets of \$1 billion or more, he said. Mr. Duffy declined to identify the clients.

He said the firm is limited in the number of clients that can be served because "this is a very labor-intensive business."

Companies that turn to outsourcing usually are "without large internal pension staffing ca-

*See Outside on page 30*

# Outside

*Continued from page 3*  
 pabilities and the size of the plan has grown beyond the capabilities (of) the current staff," he said.

The cost of outsourcing "should not be higher" than a sponsor would spend overseeing and directing the plan internally, although some industry sources claim cost saving is not the sole reason for outsourcing pension plan oversight.

"Ultimately, there will be increasing pressure in the pension area to save costs, and some corporations feel they shouldn't have to grow and develop the talent to manage pension funds and will farm that function out much as they do insurance, medical and other services," Mr. Duffy said.

He said Strategic Investment tries to use a plan's existing managers "to the extent" they fit into the risk structure as determined

by Strategic's staff.

He said 50% to 60% of the domestic equity allocations are passively managed, as are about 25% of the non-U.S. equities.

"We view the ultimate risk attributes of the portfolio as most important and the type of managers used as a secondary attribute," he said.

While Frank Russell Trust has offered total pension outsourcing for several years, Kelly Haughton, director of client services, said pension plans are showing renewed interest in outsourcing.

"What we are observing are situations where the chief financial officer believes the company is not well suited to picking managers, pension management is not part of their core business, and would rather focus his attention on the core business operation," said Mr. Haughton.

"We've seen a couple of situations where the head of pensions at an organization is coming up for retirement and the company decided rather than hire another, the investment committee already exists and would rather outsource the management to us," he said.

Russell's clients are Square D, the city of Greenwich and Kaiser Aluminum, Mr. Haughton.

He said there is a definite trend toward outsourcing of defined benefit plan management "and we fit nicely with this trend ... because we already offer a multi-manager, multiasset class approach and the plan sponsor has one point of contact."

Mr. Haughton said "in many cases" plan sponsors cut pension management costs by outsourcing "but not all."

"That (cost cutting) is not the only reason this is going on; a lot of it is by companies where they say they don't want to worry about this (pension management) and want to try and focus on their core business operation," he said.

He said Frank Russell Trust has about 25 clients in which Russell manages everything but administrative and actuarial services. He said Russell has about 1,700 money managers in its database and actively follows 300 to 400 and another 70 to 80 in its commingled funds.

Mr. Haughton said he expects total plan outsourcing to grow among plan sponsors that are downsizing and trying to limit staffing needs.

John Serhant, managing director at State Street Global, said his firm manages the pension fund of one major client with assets of about \$1.4 billion but is gearing up to attract other funds.

Mr. Serhant said State Street manages about 45% of the assets internally in an active core strategy. Outside managers are used for the rest.

"The company, which he declined to identify, decided nearly two years ago "that it needed to

change they way they do business and focus more on its core business and was going through a downsizing."

"The company decided to outsource all of its benefit plan management, not only the 401(k) plan (with assets of \$800 million) but everything," said Mr. Serhant.

State Street's mandate included management of the pension and 401(k) plans, including benefit calculation and payments as well as maintaining the firm's database of retirees and active employees.

"It's a daunting responsibility," he said.

Mr. Serhant said he is the company's sole point of contact with State Street and he reports to a three-member committee that monitors State Street's activities. "We are like their (pension) staff," he said.

During the third quarter of 1995, the first quarter State Street had responsibility for the full plan, Mr. Serhant said performance was "well above" the median as measured against the universe of the Trust Universe Comparison Service.

Mr. Serhant said he believes defined benefit outsourcing will continue to grow. State Street has established a new unit to capture what it sees as a growth area.

"A lot of what we have learned with this client will serve well for other plans," he said.

One investment manager who plans to enter the outsourcing business said marketing the service to plan sponsors is difficult because "you have an assistant treasurer who likes having a lot of outside managers and service providers reporting to him. This type of service is one that is best marketed to CFOs and CEOs and at the board of trustee level. That will be the target for our efforts. This is definitely a line of business."

Scott Gildner, managing director at Wyatt Preferred Choice, a Jacksonville, Fla.-based Watson Wyatt subsidiary that specializes in outsourcing, said it is likely that the firm's proposed benefits outsourcing alliance with State Street will include investment management, trust and custody services for defined benefit plans in the future.

"Things are changing very quickly in this area," said Mr. Gildner.

"We see this bundling of services as critical for pension plans for all the same reasons bundling has been so successful in the defined contribution area," he said. "Clients haven't had an alternative. . . . Now outsourcing is getting better and more cost-effective and efficient than doing it internally. By outsourcing they can take advantage of more technology, automation and systems and the sharing of resources. Outsourcing is maturing very rapidly."

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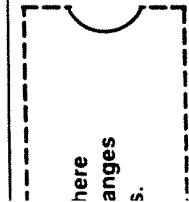
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# Stocks

*Continued from page 2*  
 it has a long-term horizon for investing in international equities,

and the Swiss franc.  
 The benchmark for the program is the unhedged return of the five currencies. The weights given each currency will be based on the proportionate weight in the underlying EAFE index and rebal-