Public Funds: 5-Year Asset Allocation Trends

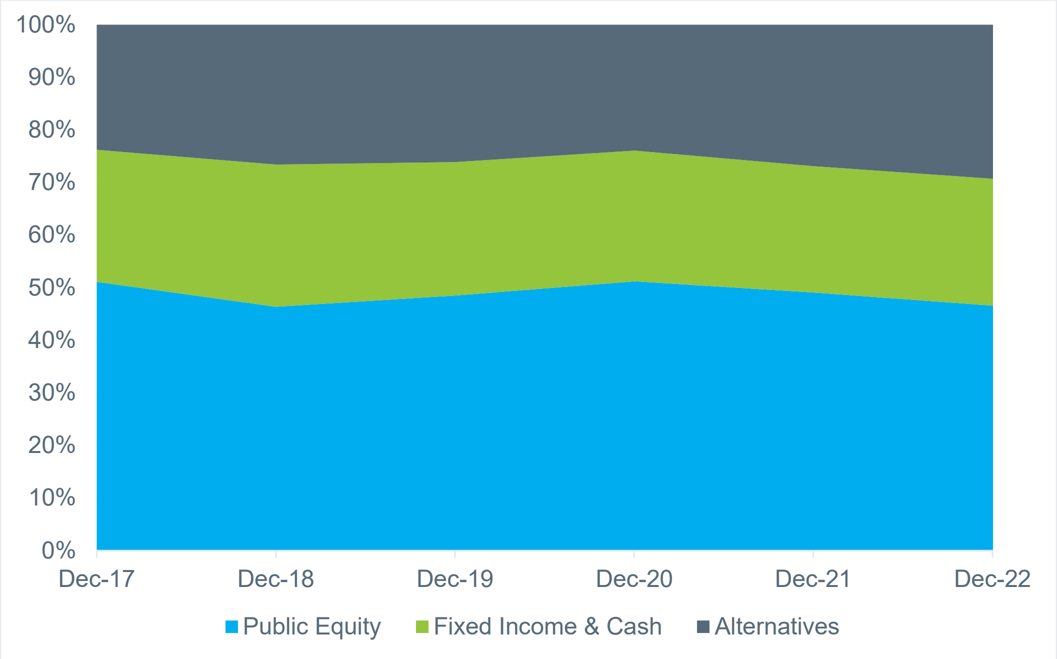
For over 30 years, RVK has published a semiannual *Public Funds Report*, summarizing survey data from public pension plans ("public funds") across the US. The public funds included in our reports range in size from less than $500 million to over $20 billion, providing a comprehensive view of the public funds landscape. Our most recent report is as of December 31, 2022, and includes data from over 60 public funds.

Examining our historical and current *Public Funds Reports*, we have identified a few notable asset allocation trends over the past 5 years.

1. Alternatives Increase Subtly, Partially Due to Denominator Effect

Asset class exposures across public equity, fixed income, and alternatives have not strayed far from where they were at the end of 2017. As shown in **Figure 1**, the average public equity allocation has declined modestly from 51% to 47%, while the average allocation to alternatives has increased from 24% to 29%. The average fixed income allocation has remained relatively unchanged. The data implies that the average public fund has steadily shifted a corresponding portion of the public equity portfolio into alternative assets over the past 5 years. However, this shift has been modest—even more so when you consider the "denominator effect" impacting most institutional investment portfolios in 2022 by significantly increasing alternative investment allocations as a percentage of the total portfolio.

Figure 1: Historical Average Public Fund Asset Allocation

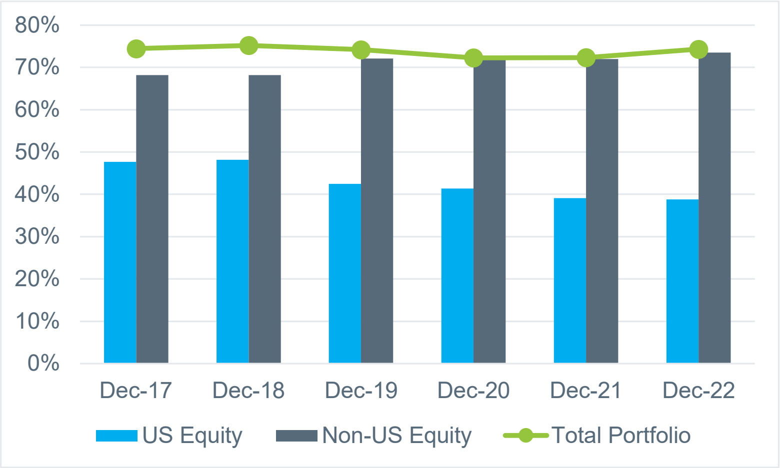


Source: *RVK Public Funds Report*. A compilation of data provided to RVK, Inc. by public funds throughout the US. Core Funds Universe, Excluding Permanent Funds. Chart uses annual periodicity.

2. Use of Active Management Has Shifted

At the total portfolio level, the average percentage of active management is virtually unchanged from the end of 2017, at 74%. While the total use of active management remains the same, there has been a shift in where active management is being deployed within the portfolio **(Figure 2)**. US equity has experienced a large decline in the use of active management over the past 5 years, from 48% to 39%. Conversely, increases in active management can be seen in non-US equity and alternatives (by way of the modest allocation increase noted on the prior page, as alternatives are almost always actively managed).

Figure 2: Historical Average Percentage Active Management

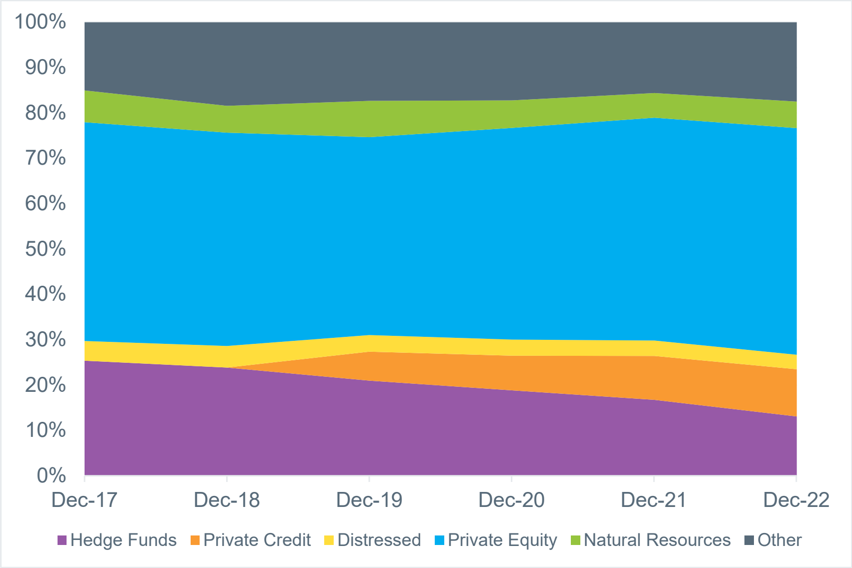


Source: *RVK Public Funds Report*. A compilation of data provided to RVK, Inc. by public funds throughout the US. Core Funds Universe, Excluding Permanent Funds. Chart uses annual periodicity.

3. Hedge Fund Exposures Have Declined

At the end of 2017, hedge funds comprised 25% of the average alternatives portfolio (excluding real estate). These exposures have continued to decline year after year, ending at 13% on average by the end of 2022 **(Figure 3)**. Although our report did not break out private credit until 2019, there has been a notable uptick in the use of private credit from 2019 onward, suggesting most public funds have been replacing some of their hedge fund exposures with private credit.

Figure 3: Historical Average Alternatives Allocation (Excluding Real Estate)



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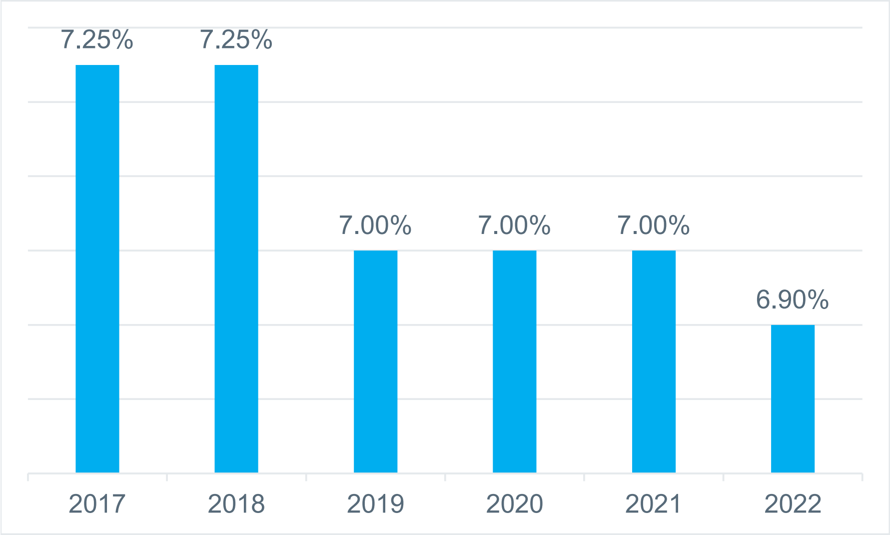
4. Median Assumed Rate of Return (ARoR) Falls Below 7%

At the end of 2017, the median assumed rate of return (ARoR) was 7.25%. The median return assumption has fallen to 6.90% as of December 31, 2022 **(Figure 4)**. Because these return assumptions are generally "sticky" and usually do not change materially year over year, even a modest decline of 0.35% represents a material shift in future return expectations for public funds and their actuaries.

As public funds have been decreasing their ARoRs over the past 5 years, the average asset allocation has remained similar, as noted in the beginning of this article. This implies that, on average, public funds have generally been assuming lower future returns with a similar level of standard deviation (risk).

Figure 4: Historical Median Assumed Rate of Return (ARoR), as of December 31



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