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Is Fed Pumping Stocks To Keep Pensions Solvent?

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> *The pension crisis is inching closer by the day. @CalPERS just voted to increase the amount cities must pay to the agency. Cities point to possible insolvency if payments keep rising but CalPERS is near insolvency itself. It may be reform or bailout soon.* - Steve Westly, former California controller and CalPERS board member.

1.5 MILLION RETIREES AWAIT CONGRESSIONAL FIX FOR A PENSION TIME BOMB

In a story buried in the business section of the February 18th NY Times, it was reported that the spending budget passed by Congress included a provision that creates a 16-member bipartisan congressional committee to craft legislation that would provide for the potential bailout of as many as 200 multi-employer pension plans. Like most State public pension plans, most of these multi-employer plans are about to hit the wall of insolvency. A multi-employer plan is a union pension plan that covers employees of union working at different companies. This minor little detail was not reported anywhere else.

A good friend of mine who works at a public pension did an internal study of all major State pension plans and determined that a 10% or more decline in the stock market for an extended period of time would blow up every single public pension in the country. "Extended period of time" was defined as more than 3-4 months. Every pension fund he studied is a monthly net seller of assets in order to fund beneficiary payouts - i.e. the cash contributions from current payees into the fund plus investment returns on capital is not enough to fund current beneficiary payouts. Think about that for a moment.

As such, State pensions have dramatically ramped up their risk profile and most now invest at least 40-50% of their assets in stocks. If you include private equity allocations, the overall exposure to equity investments is 70-80%. CalPERS allocates 50% of its AUM to the stock market; the State of Kentucky is now at 60%. Historically, pension stock allocations have typically - and prudently - ranged from 25-35%.

The stock market has now experienced three 9-10% drawdowns since August 2015. Assuming the "V" move higher from the latest market plunge continues, each drawdown has been aggressively and swiftly negated by obvious Fed intervention. The Fed does not

deny this allegation and even subtly alludes to a non-explicit goal of targeting asset prices.

With pensions now 50% or more invested in stocks, it seems pretty obvious that one way to inflate away the looming pension catastrophe is for the Fed to inflate the stock market. Two weeks ago, the Fed reflated its balance sheet by increasing its SOMA holdings with $11 billion in mortgages. The SOMA account is the Fed's QE account. An $11 billion SOMA injection to the banks translates into $100 billion in liquidity - through the magic of the fractional banking system - that can be pumped into the stock market. Who needs retail stool pigeons to chase extreme valuations even higher?

Most, if not all, pensions are quickly reallocating their equity investments for active to passive funds. "Passive" = indexing. This means that the Fed only has to worry about inflation in the broad indices like the Dow, SPX and Nasdaq. That's why an increasingly few number of stocks, like Amazon (NASDAQ:AMZN) and Boeing (NYSE:BA), are driving the indices. There's still plenty of stocks that continue to decline - GE (NYSE:GE), for instance.

I laugh and sometime sneer at those who think new Fed Head Jerome Powell will impose monetary discipline by raising interest rates at least up to the real rate of inflation and reduce the Fed's balance sheet according to the schedule as laid out by Yellen. After all, Powell is heavily invested in Carlyle Group, which owns many companies that are covered by union pension plans. He's incentivized personally to keep the monetary gerbil running on the wheel.

And better yet, if the Fed can keep the pensions thinly solvent by pumping up the stock market, Congress and State Governments can defer the inevitable taxpayer bailout of public pension funds - for now.