Institutional Investor

San Jose's Pension Funds Post Record-Breaking Returns

Investment chief Prabhu Palani credited the performance to smart allocation moves early in the pandemic.

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The City of San Jose Retirement System posted its highest returns in decades thanks to timely rebalancing amid the coronavirus pandemic.

The pension fund, which is split into two, returned 29.46 percent for its Federated City Employees' Retirement System and 26.49 percent for its Police and Fire Department Retirement Plan, according to its chief investment officer, Prabhu Palani.

Palani joined the city's pension funds as CIO in 2018, having spent the earlier part of his career in portfolio management. Since then, the plan has gone from the 99th percentile of performance relative to peers to the top quartile, Palani said.

Going into 2020, the fund had roughly a quarter of its assets allocated to fixed income.

"I thought assets across the board were expensive," Palani told *Institutional Investor*. "I thought that maybe there was a recession coming."

While he said he couldn't have predicted a pandemic, it turned out that the move was fortuitous. In March 2020, the markets tanked. "We had the swiftest bear market in history," Palani said. "This one lasted all of 12 trading days."

By the time the market fell by roughly 35 percent, Palani's team decided that it was time to redeploy capital into growth assets.

"We didn't know if we were going to time the bottom perfectly," Palani said. "I personally thought they would go down even more."

San Jose's investment team classifies assets into three categories. Growth, which the fund shifted toward in March 2020, includes public and private equities, other private asset classes, high yield credit, and emerging market bonds.

The other two categories are a low-beta bucket, which holds short-term fixed income and absolute return strategies, and an inflation protection category, which holds TIPS and commodities.

Earlier in 2021, San Jose revisited these allocation strategies. Amid broader market concerns that inflation was on the rise, the funds made the decision to make a small allocation to commodities.

“It has not manifested itself in asset prices yet,” Palani said of rising inflation. “You’ve certainly seen some other prices go up. If you look at the bond markets, they’re still indicating that it’s transitory. The problem is unanticipated inflation, and that’s something we’re guarding against.”

Palani credits his team as one source of the funds’ outperformance. Since he joined in 2018, Palani has grown the investment team, bringing on members who have portfolio management experience.

“When we’re talking to a manager, we know exactly what they’re thinking, and you cannot put a price on that,” Palani said. “We are very sympathetic to the managers, but we’re also very skeptical.”

The board also played a role, Palani said. San Jose requires some of its board members to have experience in the investment industry. Palani said the team is lucky in that regard: Three board members are venture capitalists, which is a boon for Palani’s bourgeoning venture program.

The investment team also has more freedom relative to some of its peers. The retirement system is independent of the city, and the team itself has delegation over the investments.

Moving forward, Palani has a sharp eye on inflation and the Delta variant of Covid-19, and, perhaps most importantly, is searching for yield. “I’m paid to worry,” he joked, adding that there are few asset classes that can beat the return hurdles necessary for a public pension fund to succeed.

“The past has been great, but have we borrowed from the future in terms of performance?” Palani said. “And how often can you get a 30 percent year?”