Letter of Comment No. 159
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From: Lawrence Littlefield
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To: Director - GASB
Subject: Re: Comment : Pension Rate of Return

The dilemma is this: using past rates of return as a guide would force massive increases in public employee pension contributions after a bust, while encouraging a repeat of the retroactive pension enhancements and underfunding of the past 16 years during the next stock market bubble. But ignoring the reality that rate of return expectations were inflated by the bubble, and by soaring debt levels across our economy, would allow the problems to be swept under the run and burden (poorer in the U.S.) future generations even more.

My view is that a rule should be in place to reduce the prospective rate of return when asset values are inflated, and increase them when asset values are low. Unfortunately, asset values are now high, particularly for stocks. You can tell that by a dividend yield of just over 2.0%, and low interest rates. So expected returns should be low also, until asset values go down.

Future stock market returns should be based on the sum of three figures: the average S&P 500 dividend yield over the previous quarter, the expected inflation rate over a decade based on the difference between 10 year U.S. Treasury Bonds and 10-Year TIPS over the past quarter, and the historic real (inflation-adjusted) price appreciation of the broad stock market over long periods measured from historic peak to historic peak or historic trough to historic trough (ie. 1929 to 2000 or 1932 to 2009).

Future bond market returns should be based on past yields blended into current yields on the assumption that past bonds will gradually come due and have to be replaced.

Also, as the question of who is to be sacrificed and to what extent for past pension sins comes to the fore, guidance should be issued on retroactively determining the cost of past retroactive pension enhancements. These were fraudulently described when enacted.

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