Asset Allocation Dynamics of Pension Funds

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Abstract
We provide evidence on the pro-cyclical investment behavior of pension funds, which should follow long-term investing and benefit from short-term mispricing. Using an international database of pension funds that spans over 20 years, we study time variation in portfolio weights and focus on portfolio rebalancing. We find support for steadying risk exposure to overcome passive change in the portfolio due to realized returns. However, pension funds follow asymmetric rebalancing. They rebalance when the stock market is performing poorly but rebalance less when stock market is performing well. Pension funds are slow in incorporating changes in policy asset allocation in actual asset allocation. Analyzing the rebalancing within asset classes, we find that equities play more important role than alternatives in rebalancing of the risky portfolio.

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