

RETIREMENT • INDEPENDENT THINKING

Why the Pension System Doesn't Share Your Interests

What the Institutional Machinery Behind Your 401(k) Is Actually Built to Do

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Key Takeaways

- Pension funds are forced buyers and sellers. They have fixed liabilities, so they must invest regardless of how stretched valuations are, which shapes the public markets you also own.
- To hit return targets near 7%, many public pensions have pushed large shares of their portfolios into illiquid private assets, taking on risks they cannot easily exit.
- The history of pensions, from the Studebaker collapse to ERISA, shows a recurring pattern: the institutional structure fails and the risk lands on individuals.
- Individual investors have advantages pensions lack: control over timing, taxes, and allocation. The goal is to engineer your own income rather than depend on someone else's promise.

Why This Matters

There is a multi-trillion-dollar partner sitting inside your portfolio that most investors never think about: the pension fund system, the institutional machinery that runs target-date funds and default 401(k) allocations for tens of millions of people. It does not share your goals, your time horizon, or your tax situation. Understanding how its incentives actually work reveals why decisions inside that system can run counter to the long-term interests of individual investors. This paper is educational and not a prediction of any specific market outcome.

Forced Buyers and Forced Sellers

A pension cannot simply sit in cash because it dislikes the market. It has liabilities: promises, and retirees showing up next month for a check. That math forces specific behaviors regardless of valuations. When stocks are expensive, pensions still buy, because they have to. And when they need income, they sell, regardless of conditions.

Consider what buying "the market" means today. A large share of the S&P 500 is concentrated in a handful of technology and technology-adjacent names. An index buyer is making a concentrated bet dressed up as diversification. Pensions know this and often buy anyway, because their mandates require

it. Reaching for return, many have pushed record shares of their portfolios into illiquid alternatives, private credit, private equity, infrastructure, and hedge funds, because traditional stocks and bonds may not get them to the roughly 7% they need.

A Story Every Investor Should Know: Studebaker

In December 1963, the automaker Studebaker shut its South Bend, Indiana plant. About 4,000 workers went home with a pension promise the company could not keep. Vested workers under 60 received roughly 15 cents on the dollar; younger workers with years of service received essentially nothing. It was not fraud. It was underfunding meeting reality, the math catching up with the promise.

That failure helped produce ERISA in 1974, the law meant to fix American pensions. Here is how it actually played out: ERISA made running a pension so expensive and legally risky that corporate America did the rational thing and stopped offering them, handing employees a 401(k) instead and transferring investment risk, longevity risk, and market-timing risk off the company balance sheet and onto the individual. ERISA did not solve the pension problem so much as privatize it.

Notice the pattern. The institutional structure fails, a fix is passed, the fix reshapes the system, and the individual absorbs the consequences. Waiting for the next institutional fix has a poor track record.

How This Applies to You

Your State of Residence Matters More Than It Has in Decades

Several states carry large unfunded pension obligations. Those gaps tend to be closed through higher taxes on high earners. If your retirement plan assumes you remain in a state with a structurally underfunded system, the long-run tax drag on a large portfolio is not a footnote; it is worth modeling explicitly.

A Pension Buyout Is Not a Coin Flip

Corporations are offloading pension obligations to insurers through the risk-transfer market. When a former employer offers a lump-sum buyout, they are pricing it at a number their actuaries can defend, not doing you a favor. Whether a lump sum beats the annuity depends on your other assets, your tax picture, your spouse, and your health. It is a real decision worth analyzing before you sign.

Your Allocation Should Not Look Like a Pension's

Pensions optimize for liability matching. You can optimize for risk-adjusted return over a horizon you actually control. You can take the long view they cannot, hold quality through volatility, be patient when they are forced to sell, and underweight the concentrated, expensive corners of the index instead of being forced into them. Capital allocation is freedom, and individuals have more of it than institutions do.

Build Your Own Pension

The idea is to engineer income rather than depend on someone else's promise: cash-flowing assets, Roth conversions that create tax-free buckets, thoughtful withdrawal sequencing, and a diversified portfolio designed to throw off income without being forced to sell at the wrong time. That is a structure you control, built by people whose only client is you.

The Bottom Line

Most people do not fail at building wealth because they lack information. They struggle because outsourcing the future feels easier than owning it. The discipline of lasting wealth is assuming no one is coming to save you, and then methodically building a structure that does not need them to. If you hold serious assets and no one has stress-tested your plan against the actual mechanics of the system you depend on, that is the conversation worth having.

References and Sources

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