Personal Finance

What's inside Intel's retirement plans? Hedge funds. Lots of 'em.

Updated Jan 10, 2019; Posted Aug 30, 2014

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I recently looked inside Intel's workplace retirement fund. My logic board just about locked up.

Intel Corp. is Oregon's largest private employer and, as a result, carries a big burden. Nearly 18,000 employees in the state rely heavily on the company's three retirement plans to ensure they will be able to enjoy their twilight years.

Some of the plans' features would be the envy of any worker, with a generous employer contribution and a traditional pension that kicks in if an employee doesn't save enough in his or her 401k.

Unfortunately, Intel's 401k-type plans are unusual in a couple of ways that aren't comforting to some investors and financial advisers. It's embarked, essentially, on an experiment with nearly $14 billion in worker retirement money for more than 63,000 participants. We won't know the results for years. Thus far, the performance isn't reassuring.

I'm talking mainly about Intel's decision in 2007 to begin using expensive, opaque and potentially risky hedge funds in its main 401k investment options. I'm also talking about its practice, in most cases, of forcing company contributions into them.

About one-quarter of the money in Intel's

retirement funds and its

global diversified fund

is invested in hedge funds – more than $2.4 billion overall. Not just a couple hedge funds, mind you, but

21 of them

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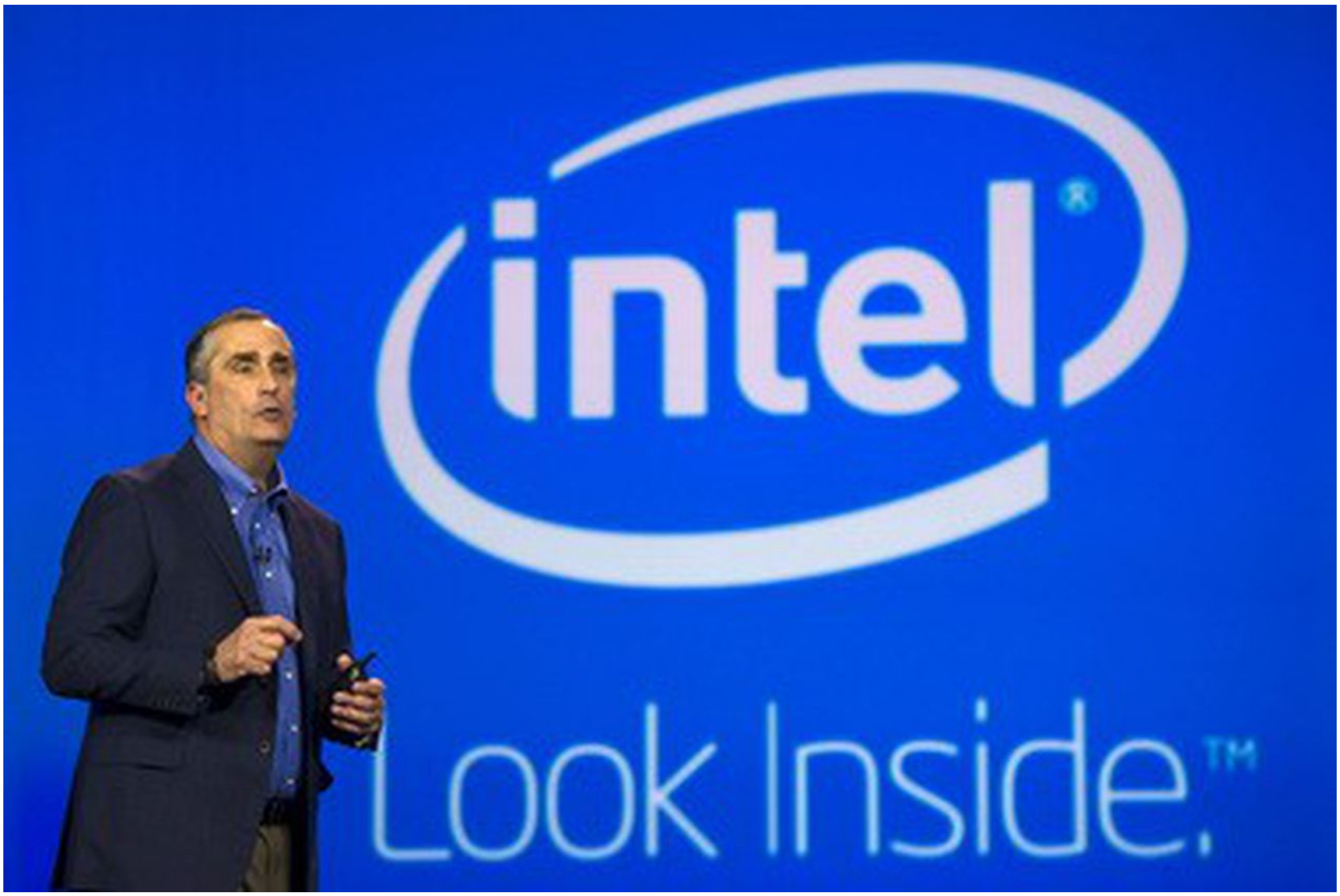
Workers know little about these notoriously secretive beasts because Intel's "

fact sheet

" on the funds doesn't name them. Rather, it lists them by letter (A through U) along with a one-sentence description, some of which might make you shudder.

Fund Q, for example, is "a multi-strategy event driven fund that allocates capital across merger arbitrage, distressed/high yield debt and value equity investments." Not your mother's retirement fund.



Brian Krzanich, chief executive officer of Intel Corp., speaks at the 2014 Consumer Electronics Show (CES) in Las Vegas.

There's only so much most employees can do if they're uncomfortable with this arrangement. When Intel makes company contributions to employees' retirement savings – at least those hired before 2011 -- it directs the money into its Retirement Contribution Plan, separate from the 401k plan. It also invests the contributions entirely in its global diversified fund, which allocates nearly 25 percent to hedge funds.

Employees can't move money out of this fund until they're 50. Even then, their options are limited. They can move into a target date fund, still underpinned by hedge funds, or an ultra-safe but low-return

Stable Value Fund

. (For employees hired in 2011 or later, Intel directs all contributions into the 401k plan, and there's no traditional pension as a backup).

Stuart Odell, Intel's assistant treasurer for retirement investments, said he and the company's investment committee members strongly believe that hedge funds can reduce the ups and downs of traditional stock and bond markets. That, in turn, will help preserve savings whenever an employee might need to retire and draw on it.

"It's about diversification and lowering risk," Odell said in an Aug. 26 interview.

Pension plans and hedge funds

How does Intel's allotment to hedge funds compare with public pension plans?

The Wall Street Journal recently reported that the California Public Employees' Retirement System, the nation's largest public pension plan, this year reduced its stake in hedge funds, which amounted to only 1.5 percent of its $302 billion in holdings.

Currently, less than 2% of Oregon's $70 billion Public Employees Retirement Fund is invested in hedge funds and other "alternative" investments, though the Oregon Investment Council's goal is to boost that to 10%.

But some financial advisers and employees have objected to these practices.

"It's a black box," said Tim Kober, a certified financial planner at Cedar Financial Advisors in Portland and a former Intel employee. He said he moves clients out of the funds when he can.

"With limited transparency of the underlying investments, it is hard for employees to know what they really own," said Doug Post, a certified financial planner with Vista Capital Partners in Portland.

Bill Parish, an investment adviser in Portland and investor in Intel stock, said he thinks the practices could open the company to lawsuits by employees, especially if the hedge-fund strategy falters.

“You are currently gambling with a big chunk of your employees’ life savings,” Parish warned Intel executives earlier this year in an email, “and paying outrageous fees.” Intel chairman Andy Bryant responded, promising to pass Parish’s concerns to executives overseeing the plans.

Hedge funds were the rage a decade ago, delivering double-digit returns for elite investors and university endowments. With few public-disclosure requirements, their managers used secretive strategies – sometimes with borrowed money -- to try to reduce risks and generate returns that offset the performance of traditional assets such as stocks, bonds and real estate. They also charged steep fees for their services.

For several years, they’ve been angling to get into the growing 401k space. In this case, Intel is way ahead of the crowd. As fund-rating provider Morningstar said

in a review

of Intel’s Target Date 2030 fund: “This fund has vital differences” from more than 150 target-date funds. “None of its peers own hedge funds.”

But since the crisis, hedge-fund performance generally has underwhelmed. Intel’s hedge fund portfolio lost 17 percent in 2008,

the company says

. That’s far less than the Standard & Poor’s 500 stock market index, which slid 37 percent, but worse than the Barclays U.S. Aggregate Bond Index, a proxy for the broader bond market, which gained 5.2 percent.

“It didn’t provide as much protection on the downside as we would’ve liked simply because it wasn’t sized the way we’ve sized it today,” Odell said. “There were only about 10 to 12 managers in the portfolio during the crisis period. Today there are 21.”

Still, the returns of 19 of those hedge funds are lower since Intel began investing in them than they were before, Intel’s fact sheet shows -- sometimes significantly lower.

Since its May 2007 inception, the portfolio

has returned

an annualized 4.2 percent through May 2014. Seven years does not make or break a retirement. But a simpler portfolio such as Vanguard’s LifeStrategy Moderate Growth Fund (Ticker:

VSMGX

), which invests 42 percent in a U.S. stock index fund, 18 percent in an international stock index fund and 40 percent in bonds index funds, returned 4.7 percent over the same period, according to Morningstar. Its performance was more volatile, however.

One great thing about Intel's 401k is that it provides access to index funds like Vanguard's at extremely low cost. Intel's index funds

charge

between 20 cents and $1 for each $1,000 invested -- practically unheard of in a private-sector 401k plan.

As this column has said before, controlling costs is one of the few ways investors can directly impact their returns. Research by Morningstar in 2010 showed that over time, on average, low-cost funds outperform higher-cost funds.

Unfortunately, Intel's

annual plan financial report

filed with the U.S. Department of Labor show that those low-cost funds are the least popular among participants. That's likely because Intel's plans emphasize the funds with hedge-fund exposure.

What to do? After all, Kober, the planner, recommends clients avoid the hedge-fund laden funds and use the index funds instead. He also uses a relatively new option – called a brokerage link -- to access a large menu of low-cost funds through plan manager Fidelity. That would include Fidelity's low-cost Freedom Index target date funds and Vanguard's LifeStrategy fund mentioned above.

But that might not be a good option for Intel employees who have little experience, or interest, in researching funds or allocating assets.

Fortunately, Intel has announced a much-needed change. In April, the same month Parish sent his email, Intel's fund oversight committee decided to allow employees the option of moving company contributions into low-cost index funds. That opportunity will likely start in January, Odell said.

"We do recognize that philosophically some participants don't believe in asset management in the way we've embraced them in our portfolios," Odell said.

I'm glad the company came to its senses and stopped forcing and locking employer contributions in these funds. It's fine to give employees the chance to "beat the market." But at least give them a choice.

Because Intel is doing the opposite of other employers such as Nike that have embraced low-fee funds in their employee retirement plans. It's shuttling employee savings into higher-fee, actively managed, alternative investments.

If you're an Intel employee, follow the company's slogan. "Look inside" your retirement funds. Make sure you're comfortable with what you see. Your retirement could depend on it.

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