Early Reviews of PIMCO’s Payout Funds

By Editor Test *Wed, Sep 16, 2009*

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The PIMCO Real Income 2019 and 2029 funds are still so new that few people know much about them. But the off-the-bat reaction from academics, retirement consultants and advisors ranged from skepticism to enthusiasm to uncertainty about the costs.

Cary Stamp, CFP, a financial advisor in Chicago and Palm Beach Gardens, Florida, said the PIMCO funds “offer a reasonable alternative to investors who don’t want to use fixed annuities,” said. “But high net worth investors could get the same protection by buying TIPS directly and the same income stream by laddering maturities.”

He also cautioned that inexperienced investors—like plan participants—might misunderstand how the products work, and expect to get income plus return of principal at the end of 10 or 20 years. “Investors have to understand that their monthly distribution includes interest and principal. At the maturity of the fund, they will not receive their original investment back because it has been paid out along the way,” Stamp said.

Rick Miller, a fee-only advisor in Cambridge, Mass., said that he would probably offer the product to his clients if he could get it at 19 basis points—PIMCO’s cost of production—but that they wouldn’t be attractive at 79 basis points. That’s the cost of Class D shares, the most expensive. (The explanation of fees in the prospectus is not highly transparent or definitive.)

“In principle I think TIPS-based annuities like the PIMCO product meet an important need of retirees,” said Zvi Bodie, the Boston University pension expert. “The team at PIMCO discussed them with me in the design stage, and I told them this. The question is whether the cost is too high. That question can only be answered by competition from other providers of the same product.”

Retirement income expert Garth Bernard, CEO, Sharper Financial Group LLC, a former MetLife executive who speaks and writes frequently about the benefits of income annuities, offered a somewhat skeptical view.

“There is nothing particularly innovative about these PIMCO funds. It’s a laddered bond strategy. Their only meaningful differences from other laddered bond strategies are that they invest primarily in TIPS and they attempt to provide a distribution by a formula of last distribution times amount of monthly inflation, ” he said.

“So they’ve essentially rolled up the laddered bond strategy in nice packaging. As with many of the distribution/goal-oriented funds, the investment advice is embedded within the fund and the investor doesn’t have to take any active management steps. They’ve taken the laddered bond strategy to the next level.

"At the end of the day, however, nothing is guaranteed—not even the distributions themselves. If the funds incur significant capital losses, as many of the goal-oriented funds did in the past year, the distributions could disappoint the buyers. The big risk is the interest rate risk going forward, but the laddering mitigates that," Bernard said.

"These are laddered TIPS. In other words," Bernard added. "It's a bond fund using primarily TIPs. The only advantage over a period-certain SPIA with an inflation/compound adjustment is that it has full liquidity. But it's just a bond fund with a fancy name."

Moshe Milevsky, of York University in Toronto, had not yet seen the PIMCO prospectus. "I have heard about [these funds], but haven't seen the details. It's not easy for the individual investor to extract regular inflation-adjusted payments from pure TIPS, and even the ETF versions," Milevsky noted.

"In fact, I manage a portfolio with some iSHARE ETF (TIP)," he added. "I spent quite a bit of time on the phone last year with one of their managers trying to understand why they didn't declare and pay any dividends for a few months, even though some of the TIPS they held made coupon payments.

"The managers have much more control and the process is much more subjective than people assumed. So, from that perspective I can see the benefit of engineering something that pays constant inflation-adjusted income," he said.