

The ownership of real estate equities would appear to be a natural avenue of investment. Sale and leaseback financing has been, in fact, a growing outlet. The tax-exempt status of a private pension plan, however, can be impaired by engaging in an unrelated business. The operation of income-producing property, especially if the purchase is financed with borrowed funds and only an equity position is retained, is susceptible to being considered such an unrelated business. The tax benefits from accelerated depreciation to a real estate operator, and his ability to introduce substantial financial leverage, usually justify his paying a higher price for property than a pension fund is prepared to pay without these possibilities. Hence, pension fund ownership of true real estate equities is not likely to grow rapidly in the years ahead.

Corporate equity securities, we have seen, are likely to continue to occupy a major position in privately organized pension programs and to become increasingly important in State and local government retirement systems. Common stocks have historically produced a higher total yield than bonds or mortgages for the holder in a position to accept price volatility and irregularity in the realization of long-term rates of return. Pension funds are particularly well situated to accept these disadvantages of corporate equity securities. The principal limitation on their role is the need to support guaranteed annuity contracts and the problems with stocks as an investment medium for employee contributions subject to withdrawal and borrowing privileges.

In the accumulation of pension fund assets for the provision of future benefits of indeterminate amount, common stocks have especially desirable characteristics. The recent changes in life insurance operations to provide for separate accounts for corporate stocks should stimulate the rate of accumulation over the immediate future. Whether the benefits of equity investment will be more widely shared with present and future pensioners by use of the variable annuity contract is less certain. The 15-year record of the College Retirement Equities Fund in providing variable benefits for educators is persuasive of the merits of this approach, but many employee groups are not anxious to trade off the certainty and stability of retirement income for the possibility of a materially higher but fluctuating average level of benefits. There are also communication problems involved, and CREF's experience may not be readily transferable to other situations. Nevertheless, a trend toward the greater use of variable annuity arrangements is the most important single factor which might affect our projected capital market flows.

Our projections show modest purchases of U.S. Government securities at some point in the future and an early cessation of net liquidation. This reflects the assumption that in the course of an orderly approach to public debt management of the $4\frac{1}{4}$ percent interest rate ceiling on long-term bonds will be removed and that the Treasury will find occasions to offer securities which are attractive in comparison with alternative investments in terms of yield, freedom from an early call provision, and marketability. There is always room for marketable securities, especially as the concentration in direct placements, mortgages, and common stocks limit flexibility in portfolio management at times.