



Agenda Item 5a

October 15, 2012

ITEM NAME: Adoption of the Multi-Asset Class Partners Program Policy

PROGRAM: Multi-Asset Class Partners Program

ITEM TYPE: Policy & Delegation – Action

RECOMMENDATION

Adopt the Statement of Investment Policy for the Multi-Asset Class Partners Program.

EXECUTIVE SUMMARY

This item seeks adoption of a formal investment policy for the Multi-Asset Class Partners (MAC) Program and provides an update on the Program's implementation.

BACKGROUND

In 2010 and 2011 CalPERS staff performed extensive research into the benefits of more dynamic approaches to asset allocation and risk budgeting. This research involved extensive discussions with a variety of market participants such as pension plans and asset managers. This research led to the development of the MAC Program.

In September 2011 CalPERS initiated a solicitation for external managers to implement investment mandates known as Multi-Asset Class partnerships. This program has two key components for the external managers:

1. The management of portfolios which, utilizing public market assets such as equities, fixed income, commodities, and currencies, attempt to outperform the CalPERS assumed rate of return with less risk than the Total Fund.
2. The engagement in a strategic partnership with CalPERS to facilitate meaningful information transfer and guidance on the development of scalable, sustainable, and efficient methods of increasing the likelihood of meeting CalPERS investment return goals over the long term.

On July 2, 2012, CalPERS issued a "Notice of Intent to Enter into Negotiations and to Award Contracts" to four firms: AlphaSimplex Group, LLC; AQR Capital Management, LLC; PIMCO; and Standard Life Investments (USA) Ltd. The negotiation and contracting process is underway. The development of a formal investment policy is an important step in determining the specific parameters of each partnership.

ANALYSIS

Over the course of the MAC Program solicitation process, staff assessed the viability of two return targets:

1. The CalPERS Total Fund policy benchmark.
2. An absolute return benchmark approximating the CalPERS assumed rate of return.

Staff determined that the second return target, the absolute return benchmark, was the appropriate choice because CalPERS paramount investment objective is to satisfy its return targets.

The MAC Program's risk parameters defined in the proposed Policy call for volatility and downside risk less than the CalPERS Total Fund. These parameters speak to the desire to arrive upon allocation solutions which both manage risk prudently and reduce the likelihood of outsize losses which could significantly impair CalPERS ability to meet its obligations.

At the outset, staff expects MAC Partners' return targets to be at least 7.5% annualized and volatility limits to be approximately 12% annualized. Specific return and risk parameters may vary depending on each MAC Partner's unique investment approach.

Capital will be allocated to the MAC Program from all Asset Classes on a Pro Rata basis and will be attributed to the Opportunistic 3% Total Fund allocation limit. Although the MAC Program has a direct relationship to the Opportunistic Policy, that policy is not the best vehicle for formalizing the MAC Program's structure and expected implementation approach; hence the need for development of the MAC Program Policy.

Management of the MAC Program will reside with the Absolute Return Strategies team, as the MAC Partners will be implementing absolute return rather than relative return-oriented mandates. However, MAC Partners will be expected to maintain a consistent dialogue with a broad cross-section of CalPERS staff as appropriate. The knowledge transfer component achieved through this dialogue will be especially valuable for the Asset Allocation team as it determines whether the approaches

utilized by the MAC Partners are generally scalable across a portfolio of CalPERS size.

BENEFITS/RISKS

The MAC Program is the only investment program which specifically asks external managers to answer, through actual investment implementation, how they would address the return and risk targets for the CalPERS Total Fund. The potential benefits of both the performance and knowledge transfer components of the MAC Program include both performance enhancement and a better understanding of how to allocate capital more efficiently and effectively across asset classes, geographies, and time horizons.

The risks resulting from the MAC Program are primarily related to the impact on Total Fund returns in the event of underperformance. There are no risks associated with adoption of the MAC Program Policy.

ATTACHMENTS

Attachment 1 – Multi-Asset Class Partners Program Policy

Attachment 2 – Wilshire Associates Opinion Letter

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