

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
GLOBAL EQUITY**

**November 13, 2012**

*This Policy is effective immediately upon adoption and supersedes all previous Global Equity policies.*

**I. PURPOSE**

The California Public Employees' Retirement System ("CalPERS") Total **Fund** Statement of Investment Policy adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Global Equity program. The design of this Policy ensures that investors, **managers**, consultants, and other participants selected by CalPERS take prudent and careful action while managing the program. Additionally, use of this policy assures sufficient flexibility in managing investment **risks** and **returns** associated with this program.

**II. STRATEGIC OBJECTIVE**

There are a set of investment beliefs that govern how Global Equity is structured and managed. These beliefs are:

- Global Equity investment returns will reflect a diversified **exposure** to global economic growth.
- Global Equity is managed from the perspective of relative return and risk as compared to the overall strategic **benchmark** for the asset class.
- Forecasted **tracking error** is the primary risk attribute used to describe the degree of risk relative to the benchmark being deployed within the asset class or any individual **strategy**.

- Global Equity is managed as an overall composite portfolio combining an index-oriented core with actively managed portfolios. Each portfolio has a role such as reducing risk, producing excess return, providing a systematic risk exposure or a combination of these attributes.
- The size of the Global Equity asset class exposure provides both challenges and opportunities (challenges to make material tactical shifts and opportunities to gain access to intellectual capital to make informed strategic investment decisions).
- Global Equity shall incorporate CalPERS' values in how investing is conducted in order to influence sustainable change in areas such as Environmental, Social, and Governance (ESG).

### **III. RESPONSIBILITIES**

A. CalPERS Investment Staff ("Staff") is responsible for the following:

1. Monitoring internal and external managers in the implementation of, and compliance with, the Policy. Staff shall report material changes, and all violations of Policies at the next Committee meeting, or sooner if deemed necessary. These reports shall include explanations of any policy violations and appropriate recommendations for corrective action.
2. Designing and implementing a process for Capital Allocation within the asset class.
3. Sourcing, researching, selecting and terminating investment strategies to fulfill the Global Equity mission.
4. Contracting with investment managers and vendors to achieve alignment of interests in key aspects of business relationships (e.g. fees, benchmarks, constraints, measures of success).
5. Portfolio management and trading of internally implemented strategies.
6. Monitoring, analyzing and reporting on all strategies and relationships to provide the basis for assessment and the feedback loop for capital allocation.

7. Reporting to the Committee at least annually, on the structures, metrics, and plans for the overall Global Equity Composite Portfolio. Global Equity will also report on [specific risk](#) parameters as identified in section V.B. Specific Risk Parameters.
  8. Coordinating information with other asset classes (research, relationship information, market intelligence) that contribute to overall [Asset Allocation](#) for the total fund.
  9. Assuring overall compliance with policy and procedures through interaction with the Board Consultant, Investment Compliance and Internal Audit.
- B. The Board Consultant is responsible for providing independent perspective and counsel to the Board which includes routine communication with each asset class and periodic reviews of processes and procedures.

#### **IV. PERFORMANCE OBJECTIVES AND BENCHMARKS**

The overall Global Equity asset class strategic benchmark is specified in the Statement of Investment Policy for Benchmarks.

All individual Global Equity strategies have benchmarks that are supportive of the overall asset class objectives. The benchmark for each strategy category is documented within Growth Policies Program Benchmarks (Attachment C of the Statement of Investment Policy for Benchmarks) or within procedure documents or investment guidelines for smaller, individual strategies. Benchmarks are assigned to appropriately assess and analyze relative performance by representing the universe and characteristics of each investment strategy.

The primary performance objective for the asset class is to obtain the return generated by global public equities as represented by the benchmark. A secondary objective is to utilize active management in an effort to earn a rate of return in excess of the benchmark. The degree of active management deployed is constrained by an overall risk limit for the asset class.

#### **V. INVESTMENT APPROACHES AND PARAMETERS**

##### **A. Approach**

In the management of the overall [Global Equity portfolio](#), investments are made with a specific purpose. Included strategies

may be index-oriented (which closely replicate an index selected as the benchmark), or active strategies (which take significant tracking error risk relative to a benchmark). All strategies shall be categorized as “index” or “active” at the time of their inception.

Index-oriented strategies seek to generate a return and risk profile similar to the public equity market segment as defined by the benchmark. Typical attributes of index-oriented strategies are:

1. Investment universe substantially constrained to the assets contained in the underlying benchmark and derivatives thereof.
2. Non-benchmark exposures are limited to those acquired by corporate action, anticipated index reconstitution, effects of CalPERS restricted list activity and derivatives.
3. Forecast tracking error limited to 50 basis points, for each portfolio.

Active strategies are deployed with the expectation of earning rates of return in excess of the relevant benchmark segment. Active strategies result in significant amounts of forecasted tracking error often exceeding 300 basis points. The risk taken within active strategies are based on several investment techniques including, but not limited to:

1. Individual stock or security selection.
2. Concentrated security positions enabling company engagement on topics such as business strategy, governance and capital usage.
3. Out of benchmark exposure.
4. Allocation variations to specific factors or parameters such as geographic region, market capitalization segment (large versus small companies), economic sector, industry group, investment style (value versus growth) or fundamental parameters (high quality versus low quality).
5. Substitution such as using derivative instruments.

The analytic framework underlying the active investment techniques may be based on fundamental, quantitative or technical analysis, either individually or in combination.

Each strategy is monitored and evaluated using several criteria:

1. Conformance with all investment guidelines, policies and restrictions.
2. Contribution to overall objectives (e.g. market exposure, excess return generation, specific systematic risk exposures, diversification, or proprietary input to the capital allocation process).
3. Stability of investment process and key decision makers (designated role in the overall composite asset class portfolio).
4. Performance versus benchmark (judged over time, in context of the investment environment and risk attributes).

All active strategies will be engaged and encouraged to consider ESG factors in their process. Staff will survey and encourage broad diversity among CalPERS investment managers in the belief that both diversity and ESG awareness contribute to long term sustainable competitive advantage, and improve opportunities for future investment outperformance.

#### B. Specific Risk Parameters

Investing in global public equity markets brings attendant risks including market and currency **volatility**, varying regulatory environments, foreign investor restrictions, liquidity and potential operational issues. Many of these risks are systemic and unavoidable. Specific risk categories and limits include:

1. CalPERS Investment Office Policies – Global Equity shall be managed to comply with all overarching policies established for the Investment Office.

2. Investment Opportunity Set – The universe of allowable investment assets within Global Equity shall be publicly traded equity securities and derivatives thereof. Any potential investment involving assets identified as being primarily associated with another CalPERS asset class shall only be undertaken upon:
  - a. Being reviewed by the Chief Investment Officer and Investment Strategy Group.
  - b. Being reviewed by the CalPERS Investment Committee.
3. Asset Class Tracking Error – The limit on the amount of aggregate forecast tracking error for Global Equity shall be 75 basis points as measured by the CalPERS Risk Management system.
4. Leverage – Global Equity will not use debt to increase net exposures.
5. Notional Leverage – Derivatives are permitted as described in the Derivatives Policy. Investment in non-cash like collateral shall be limited to 10% of the overall asset class exposure.
6. Liquidity - Global Equity assets are typically considered to be liquid. The allocation to assets deemed to be illiquid shall be limited to 15% of the asset class exposure at the time of any specific allocation.

Monitoring of the specific risk parameters is undertaken within the asset class as well as involving INVO Risk Management and Investment Compliance functions. Should any breach of a specific risk parameter be identified, the identifying team shall notify the other monitoring teams, the Chief Investment Officer and the Chief Operating Investment Officer. Following identification these steps shall be completed:

1. Activity Hold – Any pending or ongoing activity capable of exacerbating a breach shall be stopped or paused. Activity which mitigates a breach may continue.
2. Analysis - An analysis of the situation shall be completed and include these components:
  - a. Cause – The circumstances underlying a breach may

include:

- i. Specific investment action including changes to the allocation of assets within the asset class or overall plan.
  - ii. Change in market conditions.
  - iii. Change in definitions or model specifications.
- b. Risk Assessment – Estimation of the risks associated with a breach.
- c. Mitigation Plan – Identification of steps and timetable which may mitigate the risks associated with a breach. These steps may include:
- i. Disposal or changing the allocation of assets.
  - ii. Continued monitoring of the situation allowing time to elapse and conditions to change.
  - iii. Modification of the specific risk parameters within the policy document.
3. Notification - The CalPERS Investment Committee shall be apprised of the situation and the complete analysis presented at the next available opportunity. A staff recommendation requesting Investment Committee action shall accompany the analysis.

#### C. Investment Selection

The Capital Allocation Committee within Global Equity is responsible for the allocation of capital to and from the internal and external strategies forming the pool of applicable alternatives.

The mechanism for sourcing and selecting new external strategies shall be the Alternate Solicitation Process which incorporates the Investment Proposal Tracking System (“IPTS”) as a solicitation and data collection vehicle. The Alternate Solicitation Process includes a structured due diligence approach, and consideration of all the criteria mentioned in the Investment Approach and Parameters section of this Policy.

#### D. Investment Parameters

All investment strategies shall have specific, written guidelines. The guidelines shall outline the investment philosophy and approaches, representative portfolio characteristics, permissible and restricted activities and a performance objective which is commensurate with the strategy’s purpose.

**VI. CALCULATIONS AND COMPUTATIONS**

Investors, managers, consultants and other participants selected by CalPERS shall make all calculations and computations on a market value basis, which shall be recorded by the CalPERS [Custodian](#).

**VII. GLOSSARY OF TERMS**

Key words used in this policy are defined in CalPERS Master Glossary of Terms.

Asset Class Glossary: Equities  
Policy: Global Equity

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**Asset Allocation**

The process of dividing investments among different types of assets to optimize risk and return.

**Benchmark**

A set of securities with associated weights that provides a passive representation of a market segment. A benchmark's return is often used as a comparative measure of a manager's performance results in an active portfolio.

**Beta**

A measure of the volatility, or systematic risk, of a security or a portfolio in comparison to the market as a whole.

**Capital Allocation**

The process of distributing resources among different types of strategies.

**Custodian**

A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.

**Exposure**

The amount of funds invested in a particular type of security, sector, industry, or strategy.

**External Manager**

An asset management firm retained by CalPERS to manage a portfolio of securities for a fee. The external manager usually has full discretion to manage CalPERS' assets, consistent with investment management guidelines provided by CalPERS and fiduciary responsibility.

**Fund**

A portfolio specifically managed for CalPERS by an external investment manager or managed internally.

**Leverage**

A condition where a portfolio's market obligation may exceed the market-value-adjusted capital commitment by the amount of borrowed capital (debt).

**Liquidity**

The ability to quickly convert a particular investment into cash at a low transaction cost.

**Manager**

A professional responsible for managing the securities portfolio of an individual or institutional investor. In return for a fee, the money manager has the fiduciary responsibility to choose and manage investments prudently for their clients. In CalPERS' case, an internal manager is a portfolio manager on the staff, while an external manager is an outside money management firm.

**Global Equity Portfolio**

Referring to the aggregate of all Global Equity Funds.

**Return**

A measure of the total performance of an investment over a designated time period.

**Risk**

A measurable probability of losing or not gaining value. Risk is differentiated from uncertainty, which is not measurable. Risk in this context is also referred to as "standard deviation", which is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

**Specific Risk**

The component of total risk that is unique or idiosyncratic to an individual security.

**Strategy**

Broadly refers to or describes an investment product; or, when used in the context of trading, describes a plan of action for constructing a portfolio or an exit strategy. An example of a strategy would be a domestic large cap growth "strategy" or an active or passive "strategy".

**Tracking Error**

The annualized standard deviation of the difference between the total return of the portfolio and the total return of the benchmark. The term tracking error is frequently used to describe return deviation, the total return of a portfolio, minus the total return of a benchmark index.

**Volatility**

Expected or historical annualized standard deviation of returns. Returns can be total returns or the differential returns between a portfolio and its benchmark.