



Consent

Agenda Item 3d

April 15, 2013

ITEM NAME: Revision of the Absolute Return Strategies Program Policy

PROGRAM: Absolute Return Strategies

ITEM TYPE: Policy & Delegation – Consent Action

RECOMMENDATION

Approve the revised Absolute Return Strategies (ARS) Program Policy as provided as Attachment 1. Wilshire Associates' opinion letter is provided as Attachment 2.

EXECUTIVE SUMMARY

The revised ARS Policy was presented to the Investment Committee for initial review on March 18, 2013.

The revised ARS Policy includes the following changes based on feedback from the initial review by the Investment Committee:

- The re-institution of "Event Driven" as an investment strategy in section V.B.1
- The re-institution of "Distressed Security" as an investment style in section V.B.2.

Changes made to the ARS Policy based on the Investment Committee's feedback are denoted with yellow highlighting within Attachment 1.

Staff seeks approval of the revised ARS Policy to include program parameters consistent with the ARS Strategic Plan presented to the Investment Committee in February 2013.

STRATEGIC PLAN

This item supports the CalPERS Strategic Plan goal to improve long-term health benefit and pension sustainability. This goal is supported by the development of policies and programs which aim to improve the risk-return profile of the CalPERS Total Fund.

BACKGROUND

In March 2012, the ARS team presented the Investment Committee with a workshop on absolute return investing. At that time four key questions with respect to the ARS Program were posed:

- What is the role of absolute return investing, and the ARS Program, in the CalPERS portfolio?
- What should the ARS Program's benchmark be?
 - This incorporates not just return targets but also risk and liquidity parameters
- What should the ARS Program's capital source be?
- What should the ARS Program's size be?

A fifth question was subsequently posed by senior Investment Office staff:

- How should the ARS Program be resourced? Should more of the ARS Program's functions be brought in-house?

At the December 2012 Investment Committee meeting, it was determined that the primary role of the ARS Program would be to act as a diversifier to the growth risk factor. The growth risk factor is predominantly found within the Global Equity and Private Equity programs and is the dominant risk factor in the Total Fund.

ANALYSIS

At the February 2013 Investment Committee meeting, it was determined that the return and risk parameters for the ARS Program should be as follows:

- A return target of Treasury bills plus 5% per annum (unchanged from the current return target)
- Annualized volatility of 6-8%
- Equity beta of 0.2 or less
- Maximum decline in net asset value in any one month of 7%

The ARS Program Policy has been revised to reflect these updated parameters.

The capital source and ARS Program size decision will be determined through the 2013 Strategic Asset Allocation Decision Process.

BENEFITS/RISKS

There are investment risks associated with any program deploying capital to external managers. The ARS Program is exposed to manager-specific risks which cannot be entirely mitigated through manager selection and investment structuring. However, the ARS "Three Pillars" framework, which focuses on alignment of interests, control of assets, and transparency of risks and exposures, increases the likelihood of effective investment risk-taking and manager-specific risk mitigation.

A properly executed ARS Program provides an additional means of diversification to the Total Fund by prudently taking exposure to risks distinct from those currently within the Total Fund. The net benefit should be a Total Fund portfolio with an improved risk-return profile without sacrificing potential return. This improves the likelihood of meeting Total Fund performance goals.

ATTACHMENTS

Attachment 1 – Proposed Revised Absolute Return Strategies Program Policy

Attachment 2 – Wilshire Associates' Opinion Letter

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