

February 6, 2014

Mr. Henry Jones, Chairman  
Investment Committee  
California Public Employees' Retirement System  
Sacramento, California 95814

Re: Strategic Asset Allocation Recommendation

Dear Mr. Jones,

The purpose of this letter is to provide the Investment Committee with Pension Consulting Alliance's (PCA's) opinion regarding Agenda Item 11 for the February Investment Committee meeting. In summary, PCA (1) supports the staff's recommendation to select the "Portfolio A" option, and (2) believes that the staff has presented a reasonable number of portfolio options that address the board's desire to see alternative allocations. The final set of candidate portfolios focuses on a subset of alternative allocations that fall within a tight range of expected risk and return. Given this caveat, PCA believes the Committee has been provided with a reasonable range of risk / return options over the course of the Asset Liability Management (ALM) process from which to make a decision.

Over the last year or so, CalPERS' staff and consultants have engaged in a rigorous process to assist the Investment Committee in the consideration of a new/alternative strategic investment policy. The ALM process has covered a wide array of topics, from risk allocation to liquidity management to sustainable investing and benchmarking. PCA supports the outcome of the ALM process and believes the staff has done a good job in framing the tradeoffs of the various strategic policy choices, presenting new areas of investment thinking, as well as responding to the input from the Board.

The final array of choices presented in staff's January 13, 2014 memo to the Investment Committee is reasonable and prudent. There are minor differences among the alternative strategic allocations, driven by different allocations between growth (public equity), fixed income, and inflation-sensitive classifications. Viewed through a macroeconomic risk factor allocation prism, we note that both Current Policy and staff's recommended "Portfolio A" policy exhibit biases toward economic growth. In other words, regardless of the final choice selected,

the success of the strategic policy will be dictated largely by global economic growth trends – if economic growth is generally favorable, the portfolio will likely perform well over time, if economic growth falters, the portfolio may underperform expectations, possibly by a material amount.

Given the above context and the various tradeoffs CalPERS faces, PCA believes that the Committee can make an informed decision on the basis of the information provided in the agenda item.

Regardless of the final selection of the Investment Committee, there should be recognition that the final approved choice represents a long-term strategy. Along those lines, actually shifting CalPERS' sizable actual portfolio to the long-term policy should take place in a deliberate and prudent manner. This concern is particularly important given CalPERS' large proportional allocation to the private markets and that these specific portfolios involve tens of billions of dollars of actual and committed assets that cannot be altered quickly. In this context, PCA believes steady, systematic dollar-cost-averaging approaches to new policy allocation levels among the classes warrant serious consideration.

We look forward to addressing any questions or clarifications on this matter at the Investment Committee meeting.

Respectfully,



Allan Emkin