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Managing Director & Principal

April 29, 2014

Mr. Henry Jones
Chairman of the Investment Committee
California Public Employees' Retirement System
400 P Street, Suite 3492
Sacramento, CA 95814

Re: Statement of Investment Policy for Asset Allocation Strategy

Dear Mr. Jones:

We have reviewed the agenda item, recommendation, and revisions to the Statement of Investment Policy for Asset Allocation Strategy as presented by Staff. Our recommendation regarding this item is below, as well as further discussion.

Recommendation

We have reviewed the documents delineated above and recommend approval of the interim targets and the policy revisions.

Discussion

At the April 2014 Investment Committee meeting, we expressed our view that given the illiquidity of the Private Equity portfolio, we were opposed to a pre-programmed set of interim targets that could require overly aggressive commitments to new private equity funds over the next few years. In our opinion, if Staff's pacing models indicated that it would be virtually impossible to reach the asset allocation targets selected by the Investment Committee in February without a significant decrease in selectivity, then it made sense to simply adjust the asset allocation target for this asset class to a more realistic and achievable level, as was the case with the Real Estate allocation following the 2010 ALM process.

The agenda item and proposed policy revisions are in line with our recommendation at that time, setting an interim target of 10% with a mechanism to review the target annually but no requirement that the target automatically increase each year. Given that this is what we recommended at the February 2014 Investment Committee meeting, we are in agreement with this new approach and recommend approval of these policy revisions.

We note that the other significant change to the policy increases the time between asset allocation reviews from the current 3 year cycle to 4 years. We commonly recommend that clients review their asset allocation ***about*** every three years, but we do not consider that time frame immovable. Given that the other factors in a holistic approach to asset allocation decision making (including rate setting and demographic calculations) occur for CalPERS on a four year cycle, we believe that it is entirely appropriate to shift the ALM process and decision to every four years.

Staff has separately proposed reviewing the asset allocation targets formally every two years in an asset-only framework to reaffirm the asset allocation at the midpoint of the lengthened ALM cycle and we believe that this helps to mitigate the chance that major market movements or revisions of expectations will be overlooked due to an expansion of the cycle from 3 to 4 years.

If you have any comments or questions, please let us know.

Sincerely,

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