



Agenda Item 10

September 17, 2014

ITEM NAME: Asset Liability Management – Affiliate Funds

PROGRAM: Asset Allocation and Risk Management

ITEM TYPE: Asset Allocation, Performance & Risk – Action

RECOMMENDATION

Adopt the proposed policy portfolios for the Affiliate Funds, outlined in Table 1 below, as recommended by the Investment Committee, and presented as Agenda Item 6a, September 15, 2014.

Table 1 – Affiliate Fund Recommended Portfolios

Recommended Portfolio	Affiliate Fund
100% Liquidity	Judges' Retirement System (JRS) Fund
P7	Judges' Retirement System II (JRS II) Fund
P2	Legislators' Retirement System (LRS) Fund
P8	California Employers' Retiree Benefit Trust Fund – Strategy 1 (CERBT 1)
P5	California Employers' Retiree Benefit Trust Fund – Strategy 2 (CERBT 2)
P2	California Employers' Retiree Benefit Trust Fund – Strategy 3 (CERBT 3)

EXECUTIVE SUMMARY

CalPERS' Board is responsible for the administration and investment of several trust plans independent of the Public Employees' Retirement Fund (PERF), referred to collectively as "Affiliate Funds."

This item includes the recommendations of the recent strategic asset allocation analysis for the following Affiliate Funds:

- JRS Fund
- JRS II Fund
- LRS Fund
- CERBT Fund

At the August 18, 2014 Investment Committee (IC) meeting, Agenda Item 7c presented outcomes and recommendations of the recent strategic asset allocation analysis for the JRS, JRS II, LRS, and CERBT funds. At the September 15, 2014 meeting, the Investment Committee reviewed Agenda Item 6a and recommended

the proposed policy portfolios for the Affiliate Funds. The recommendations aim to reduce the expected volatility of returns and add diversification where possible. The degree to which this expected outcome is achievable is impacted by the anticipated effect of any changes on the potential discount rate used to value liabilities. For CERBT, staff has attempted to maintain similar risk profile choices.

Overviews of each of the Affiliate Programs and the Capital Market Assumptions (CMAs), as well as the Consultant opinion letters from Wilshire Associates and Pension Consulting Alliance Inc. (PCA) are found in the Investment Committee's September 15, 2014 Agenda Item 6a.

STRATEGIC PLAN

This agenda item supports the CalPERS' Strategic Plan goal of improving long-term pension and health benefit sustainability.

BACKGROUND

Periodic review and analysis of strategic asset allocation is required by the Affiliate Funds' respective Statements of Investment Policy. These activities were last conducted in 2011. An overview of each of the programs, including their establishment, purpose, and status, can be found in the September 15, 2014, Investment Committee's Agenda Item 6a.

ANALYSIS

Staff analyzed three alternatives for each applicable Affiliate Fund to identify a recommendation for each fund. To the extent possible, the recommended portfolios reflected:

- Reductions in the overall levels of expected volatility;
- Maintenance of the existing discount rates for programs where CalPERS establishes the applicable discount rates (this excludes the CERBT);
- Broader diversification over the included asset classes; and
- Improvement in the actuarial risk considerations where applicable.

The four recommended asset allocations in Table 2 have had the segment weightings rounded to the nearest whole percentage. Assigning target weights using fractional percentages is believed to convey more precision than is warranted by the modeling process. The expected return and risk characteristics have been calculated based on rounded weights, resulting in only slight differences.

Table 2 – Affiliate Fund Recommended Portfolio Allocations

Asset Class Component		Recommended Portfolios			
		P2	P5	P7	P8
Global Equity		24%	40%	50%	57%
Fixed Income		39%	39%	34%	27%
Treasury Inflation-Protected Securities (TIPS)		26%	10%	5%	5%
Commodities		3%	3%	3%	3%
Real Estate Investment Trusts (REITs)		8%	8%	8%	8%
Expected Compound Return (1-10 yrs.) :		5.42%	6.12%	6.49%	6.71%
Expected Volatility :		7.14%	9.32%	10.76%	11.74%
Expected Cash Yield :		2.89%	3.00%	2.99%	2.92%
Expected Blended Return Net of Fees (1-60 yrs.):	CERBT:	6.12%	6.73%	N/A	7.28%
	LRS:	5.78%	N/A	N/A	N/A
	JRS II:	N/A	N/A	7.06%	N/A
Recommended for plans:		CERBT 3 & LRS	CERBT 2	JRS II	CERBT 1

The expected blended return is the combination of the short-term (1-10 years from CMAs) and the long-term (11-60 years from CalPERS' Actuarial Office) expected returns after deducting administrative fees.

BUDGET AND FISCAL IMPACTS

Not Applicable

BENEFITS/RISKS

Staff's recommendations for the JRS, JRS II, LRS and CERBT funds are believed to reflect the preferences expressed by the IC at the August 18, 2014 meeting. The recommended portfolios attempt to maintain similar choices for CERBT employers, and reduce drawdown risk and concentration risk to the extent possible while minimizing negative impacts to the existing discount rates for JRS II and LRS.

Risks associated with this recommendation are that the actual long-term market returns, volatilities, and correlations eventually experienced may diverge materially from the capital market expectations used in the modeling process. In addition, inflation rates may vary significantly from expectations. These risks are mitigated by the fact that staff will conduct a market valuation driven analysis biennially, and a comprehensive asset allocation strategic review coincident with the review of the actuarial methods and assumptions every four years.

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