

Opportunistic Strategies Annual Program Review

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Annual Program Review Outline

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Executive Summary | Opportunistic Strategies (OS)

1. Strong Performance

- Low Liquidity Enhanced Return Program contributed 6 basis points (bps) of return to Global Equity in FY18-19

2. Executed Strategic Asset Allocation Transition

- Transitioned over \$150bn of assets at significantly lower than expected cost

3. Advanced Total Fund Leverage and Liquidity Management

- Secured senior leadership agreement on leverage and liquidity governance
- Implemented more optimal funding mix

Executive Summary | Accomplishments & Initiatives

2018-2019 Major Accomplishments

- Partnered with Trust Level Portfolio Management (TLPM) to evolve Total Fund leverage and liquidity management initiatives
- Developed trust-level framework for managing funding sources to support Enhanced Beta and Opportunistic Strategies
- Initiated investments in Asset-Based Lending and Trade Finance

2019-2020 Major Initiatives

- Continue implementation of Total Fund leverage and liquidity management framework
- Establish internal trust level Liquidity Management Program
- Complete Active Risk Management Roadmap Initiative to improve Total Fund risk/return objectives
- Advance formation of Research & Strategy Group (RSG) business model



I. Program Overview

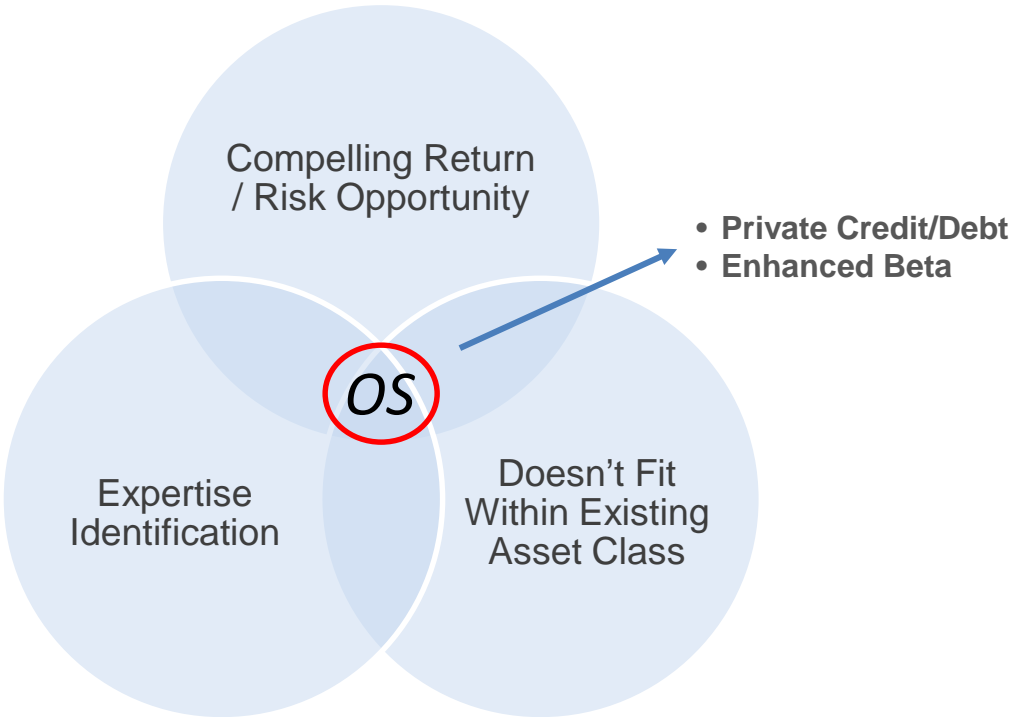
II. Investment Review

III. Business Review

Program Role | Opportunistic Strategies

Deliver added value to the Total Fund, by implementing investment strategies across the entire capital structure that do not fit into existing asset classes.

- *Enhanced Beta to add value to the Total Fund*
- *Invest in strategies that do not or cannot fit into other asset classes*
- *Work closely with asset allocation and other asset classes to source ideas and capital*



Investment Beliefs | Alignment and Integration

The Investment Beliefs are not a checklist to be applied by rote to every decision. They are a guide for making judgmental decisions that often require balancing multiple, inter-related decision factors.

	Short Name	Investment Belief
1	Liabilities	Liabilities must influence the asset structure
2	Long-Term Horizon	A long time investment horizon is a responsibility and an advantage
3	Stakeholders	CalPERS investment decisions may reflect wider stakeholder views
4	Three Forms of Capital	Long-term value creation requires effective management of three forms of capital: financial, physical, and human
5	Accountability	CalPERS must articulate its investment goals and performance measure, and ensure clear accountability for their execution
6	Strategic Allocation	Strategic asset allocation is the dominant determinant of portfolio risk and return
7	Risk Reward	CalPERS will take risk only where we have a strong belief we will be rewarded
8	Costs Matter	Costs matter and need to be effectively managed
9	Multi-faceted Risk	Risk to CalPERS is multi-faceted and not fully captured through measures such as volatility or tracking error
10	Resources / Process	Strong processes and teamwork and deep resources are needed to achieve CalPERS goals and objectives



Governance & Sustainability | OS Integration

- OS external investment manager expectations include:
- Exercise best judgment to integrate environmental, social, and governance (ESG) considerations into their investment philosophy, strategies, and processes.
- Conduct annual performance assessments to report on and describe any changes to how ESG considerations are integrated into the Firm's investment philosophy or strategy.

Program Overview



Investment Review

Business Review

Investment Objective

OS is managed in alignment with the CalPERS Total Fund Investment Policy's investment objectives as follows:

1. Identify and facilitate greater investment in assets and innovative portfolios perceived to be substantially undervalued.
2. Performance Objective: Outperform the program benchmark over rolling three-year periods, net of all program costs and fees.

Investment Philosophy

To function as a respected investment partner and implement disciplined and dynamic opportunistic investment strategies that have a material impact on Total Fund risk and return.

Enhanced Beta

- Attractively priced risk
- Long-term investment period; weather short-term price volatility
- Forego liquidity when appropriately compensated for
- Leverage existing resources/skillsets
- Low probability of capital loss

Opportunistic

- Attractively priced risk
- May be available only for short time
- Investments that don't fit other mandates or are constrained by size, policy, or benchmark
- Leverage existing resources/skillsets
- Take advantage of our long time horizon

Execution Services & Strategy

- Centralized multi-asset execution
- Liquidity and leverage implementation
- Securities Lending
- Advisory and strategy support

Investment Performance | Contribution to Global Equity

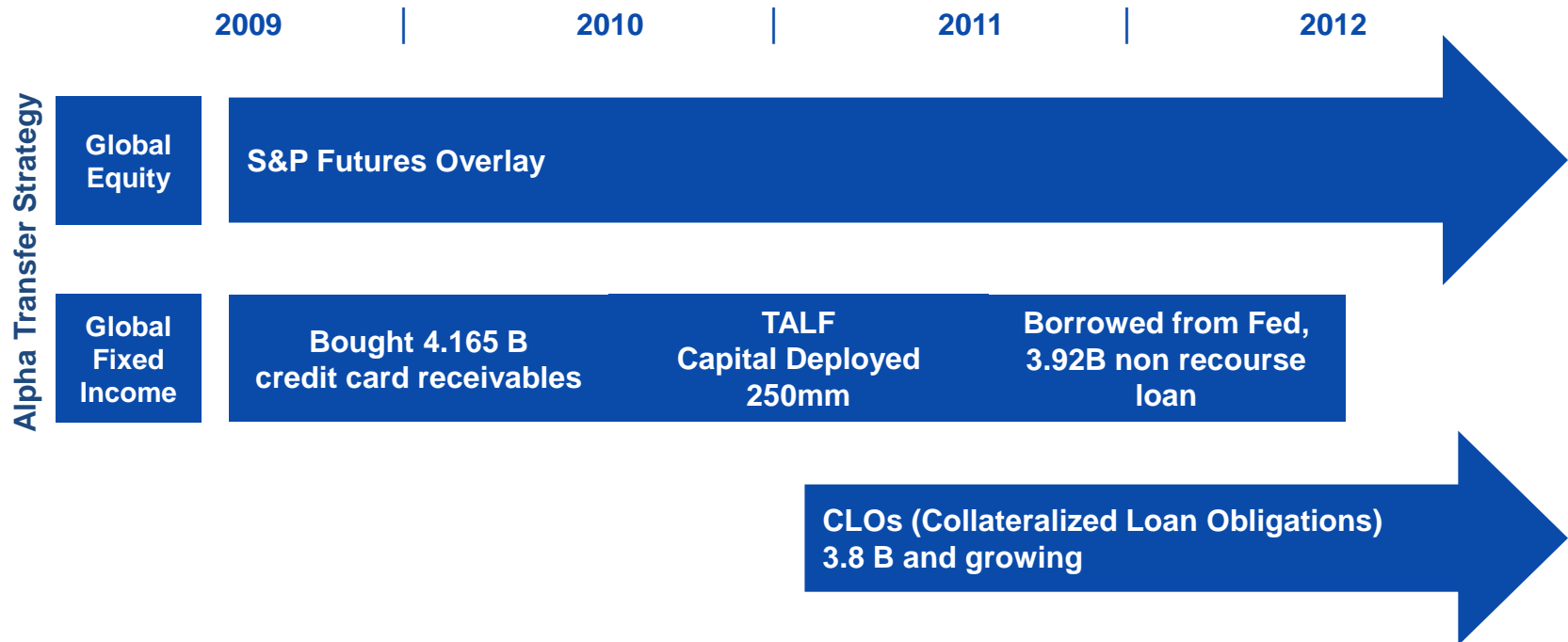
On average the Low Liquidity Enhanced Return (LLER) program has contributed 6-7 basis points (bps) of return to the Global Equity (GE) program.

LLER Performance Contribution (as of 6/30/19) (Net of financing costs)		
1-year average weight (%) to GE		6.4%
Weighted Active Return Contribution to GE	1Yr	6 bps
	3Yr	7 bps
	5Yr	6 bps

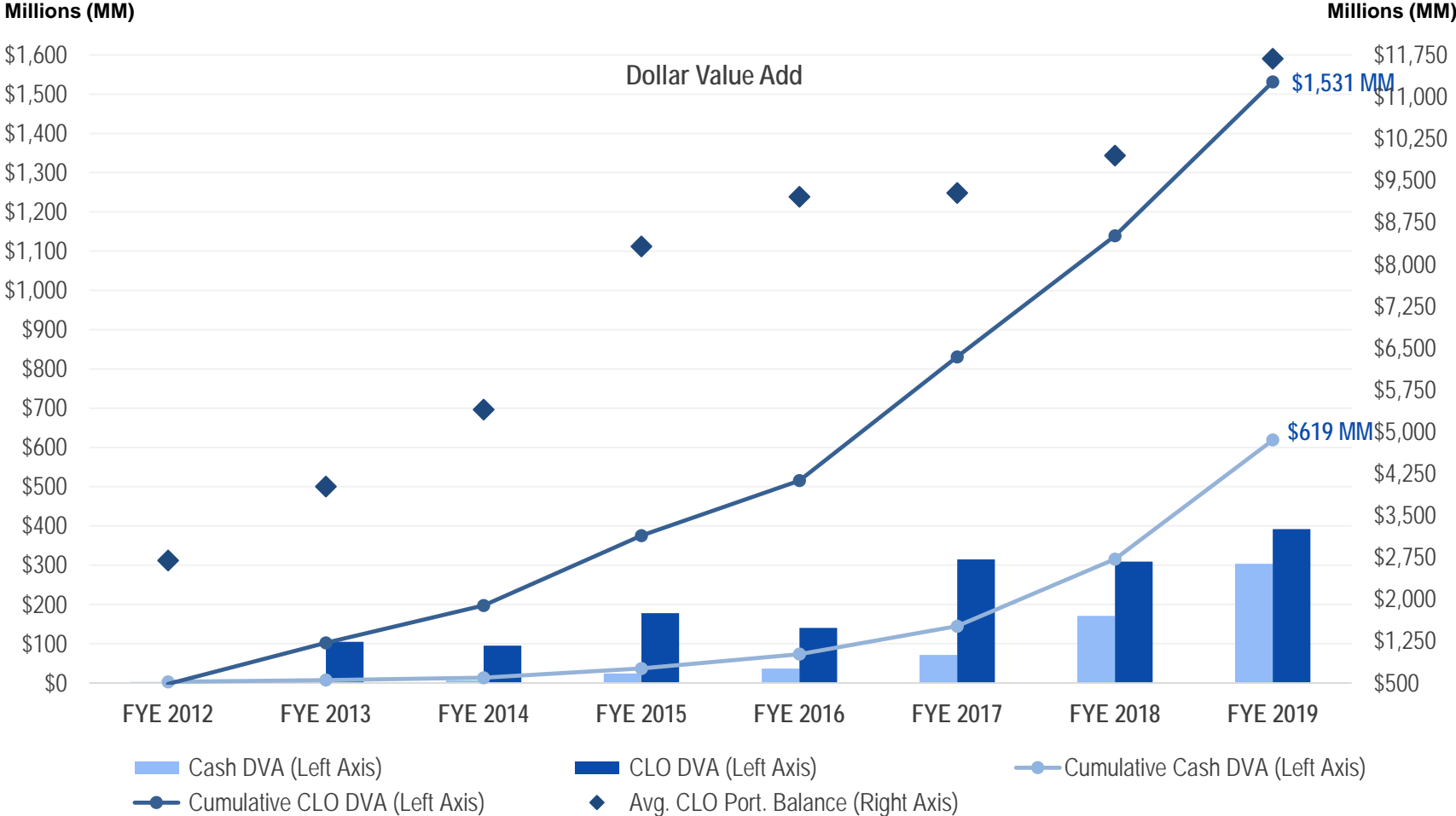
Enhanced Beta

Enhanced Beta refers to portfolios that can synthesize portfolio positioning (instead of holding physical securities), after taking care of liquidity needs (e.g. margin call), and can carve out a portion of the cash underneath the synthetic position to reinvest in securities with a low probability of capital loss. This will enable the portfolio to have exposure to its benchmark while at the same time generating additional return.

History of Enhanced Beta Strategy



Enhanced Portfolio Dollar Value Add (DVA)



Investment Office
Opportunistic Strategies

- Data Source: StateStreet for SWUQ portfolio (IRP pulled data for period prior to FYE 2019). For data for FYE 2012-2014 DVA and Average Portfolio Balance were proxied using data from the CLO portion of the SWKZ portfolio
- Average CLO portfolio value only includes SWUQ (Broadly Syndicated Loan) portfolio

Enhanced Beta

1. Synthetic Enhanced Portfolio: Serves Global Equity and Global Fixed Income
 - Exposure to portfolio strategy determined by each asset class

2. Looking Ahead: Partner with Trust Level Portfolio Management
 - Financing strategies for trust-level leverage and liquidity management

	Board Authorized Limit (10%) ^(a)	Internal Cap Placed by Asset Class	Current Position ^(b)	Utilization Rate
Global Equity	\$18.6 B	\$11.5 B	\$9.5 B	51%
Global Fixed Income	\$10.6 B	Run-off mode	\$3.0 B	28%

Note: GFI also owns ~\$0.4B SWUQ as an outright asset without beta overlay

(a) Based on the market value of the Global Equity and Global Fixed Income market value as of 6/30/19

(b) The current exposure also includes exposure to both SWUQ (Broadly Syndicated Loan CLO) and SWV9 (Middle Market CLO)

Execution Services and Strategy

Function	Description	Examples
1. Multi-Asset Execution	Managing the Trade Lifecycle	<ul style="list-style-type: none"> • Planning → Pre-Trade → Execution → Post-trade → Settlement • Execution Platform Management
2. Leverage & Liquidity Implementation	Efficient trust-level implementation of leverage and liquidity framework	<ul style="list-style-type: none"> • Centralized funding / financing desk • Centralized derivatives execution
3. Return Enhancement	Finding opportunities to enhance returns	<ul style="list-style-type: none"> • Securities lending – physical and synthetic • Hedged foreign bills for enhanced cash • Cash reinvestment opportunities • Trade ideas for portfolios
4. Advisory & Strategy Support	Helping portfolio managers better manage their portfolios	<ul style="list-style-type: none"> • Market intelligence • Risk management advisory • Idea generation • New portfolio/product support • Execution advisory

Strategic Initiatives

Liquidity Governance

Transparent and accountable decision-making (includes use of Cash Desk Concept), application of “Borrowed Liquidity” with trust-level leverage management, and within pre-defined resource constraints

Leverage Governance

Transparent and accountable decision-making (includes Financing Desk Concept: “how much, how to deploy, how long/duration”), differentiation between structural long-term and short-term (bridge loan) leverage application, all within pre-defined resource constraints

Active Risk Governance

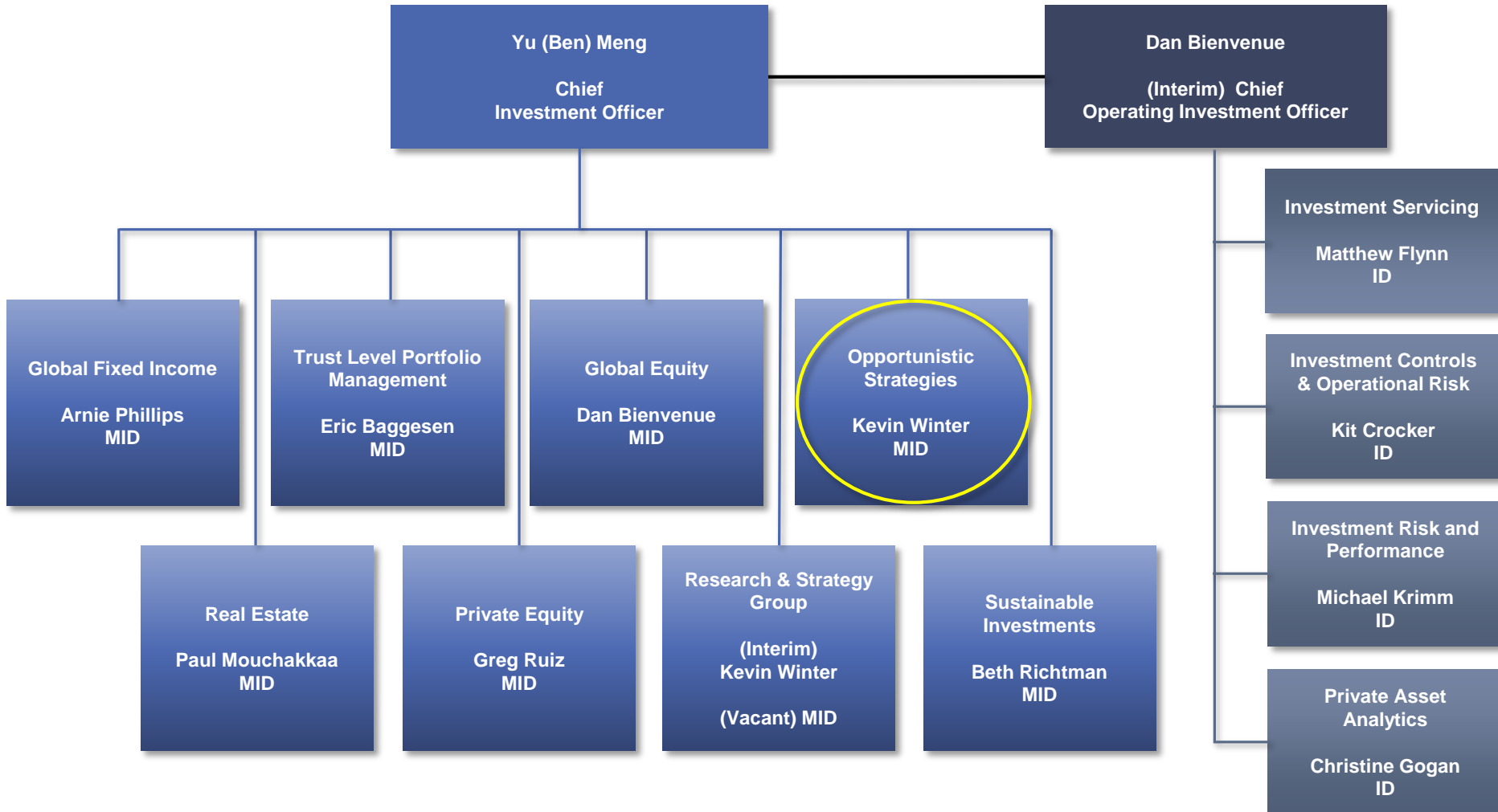
Transparent and accountable decision-making framework of Total Fund active risk budgeting for all asset types within pre-defined analytical constraints

Program Overview

Investment Review

Business Review

Investment Office Organization Chart



Functional Organization Chart



Staffing Overview



Opportunistic Strategies Staff

- 1 Managing Investment Director (MID)
- 3 Investment Directors (ID)
- 5 Investment Managers (IM)
- 2 Associate Investment Managers (AIM)
- 11 Investment Officers (6-IO3s, 3-IO2s, 2-IO1s)
- 1 Seasonal Clerk (SC)



Position Updates

- 1 New ID (Jonathon O'Donnell)
- 1 New IO (Meng-jie Li)
- 1 Exited IO (Accepted Position Outside CalPERS)



Recruitments

- 1 IM Position Target Start Date: By 9/30/18
- 2 IOIII Positions Target Start Date: By 9/30/18
- 1 IOI Position Target Start Date: By 9/30/18

Business Overview | Enhanced Beta and Opportunistic

Opportunistic Strategies | Enhanced Beta & Opportunistic

Kevin Winter, Managing Investment Director

Jean Hsu, Investment Director

Tom McDonagh, Investment Director

Leadership

Jonathan Chen, Investment Manager

Key Resources

Ryan Ong, Associate Investment Manager

Laura Hopkins, Investment Officer II

Marina Kong, Associate Investment Manager

Internal Expertise

CLO AAA/AA for Enhanced Beta

- \$12 Billion portfolio serving GE and GFI

Direct Lending Financing

- \$400 Million serving GE

Replicating PE Benchmark in Overlay Portfolio

- \$15 Million serving TLPM

CLO Equity Tranche

- Approved for OS/Total Fund

External Partners

Trade Finance

- External Partnerships, Alternative Solicitations

Business Overview | Execution Services & Strategy (ESS)

Opportunistic Strategies | Execution Services & Strategy

Kevin Winter, Managing Investment Director

Jonathon O'Donnell, Investment Director

Leadership

Dan Kiefer, Investment Manager

Brian Leu, Investment Manager

Alan Seater, Investment Manager

Key Resources

Mike Johnson, Investment Officer III

Joy Pathak, Investment Officer III

Amrish Pattni, Investment Officer III

Scott Whelan, Investment Officer III

Egle McCaffrey, Investment Officer II

Michael Woodward, Investment Officer II

Meng-jie Li, Investment Officer I

Frank Angeles, Seasonal Clerk

Securities Lending / Collateral Management

- *Maximize value of lendable assets*
- *Optimize daily collateral posted and received*
- *Manage funding cost through securities finance*

Equities & Related Derivatives/Volatility

- *Advise on trading and implementation strategy*
- *Execute trades across all equity products*

Government Rates, Currency, & Related Derivatives

- *Advise on trading and implementation strategy*
- *Execute trades across all government interest rate and currency products*
- *Assist asset classes with currency and interest rate risk management*