Investment Committee

Agenda Item 11a

November 18, 2019

Item Name: Affiliate Trust Fixed Income Benchmark Update

Program: Trust Level Portfolio Management

Item Type: Information

Executive Summary

This agenda item, upon advisement from Wilshire Associates (Wilshire), provides an update to the Investment Committee (Committee) regarding a modification to the Affiliate Funds' Fixed Income Long Liability (AFFI) benchmark. In alignment with recent changes made to the Global Fixed Income (GFI) benchmark of the Public Employees' Retirement Fund (PERF), the AFFI benchmark has been revised to exclude Treasury Inflation Protected Securities (TIPS) and Agency Debt from the U.S. Treasury benchmark segment.

Staff presented findings in June 2019 from the Strategic Asset Allocation (SAA) implementation process initiated by the Board's adoption of the Asset Liability Management (ALM) Policy Portfolio in December 2017. One of the recommendations for the PERF GFI benchmark was to streamline the U.S. Treasury benchmark segment to include only U.S. Treasuries and exclude TIPS and Agency Debt. The recommendation was designed to better align the investment strategy deployed with the strategic role of GFI, as adopted by the Committee during the ALM process, which is to serve as an economic diversifier to equity risk and be a reliable source of income. The Committee approved the benchmark revision at the June 2019 meeting. These findings are applicable to the Affiliate Funds and staff determined that the benchmark change was appropriate to be applied to both the PERF and Affiliate Funds.

Strategic Plan

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

Investment Beliefs

This agenda item is consistent with the following CalPERS Investment Beliefs:

- Investment Belief #6 - *Strategic asset allocation is the dominant determinant of portfolio risk and return*: Modifying the AFFI benchmark to better diversify against equity risk reduces vulnerability to market drawdowns.

- Investment Belief #7 - *CalPERS will take risk only where we have a strong belief we will be rewarded for it*: Excluding TIPS and Agency Debt is expected to reduce liquidity risk and drawdown risk.

Background

At the December 2017 Committee meeting, Agenda Item 5a, the Committee adopted the new SAA targets for the PERF. During the implementation process that followed, staff identified some areas for improving the PERF GFI benchmark and those changes were approved by the Committee in June 2019.

Historically, the PERF and the Affiliate Funds have utilized certain shared benchmarks, as is the case for the U.S. Treasury segment. When PERF GFI benchmark segment was changed to exclude TIPS and Agency Debt, the AFFI also reflected this modification. Staff determined that the modified benchmark is appropriate for the Affiliate Funds, as the rationale for a U.S. Treasury only benchmark applies to the PERF and Affiliate Funds, and the change does not materially impact the Capital Market Assumptions that were used for the Affiliate Asset Allocation Strategic Review completed in 2018. Table 1 outlines the AFFI benchmark modification.

Table 1: Affiliate Funds' Fixed Income Long Liability Benchmark Modification

Benchmark Segment & Subcomponents	Prior Weights	Current Weights
U.S. Treasury Segment	100%	100%
U.S. Treasuries	80.7%	100%
Treasury Inflation Protected Securities (TIPS)	16.7%	-
Agency Debt	2.6%	-

The following Affiliate Funds utilize the modified benchmark:

- California Employers' Retiree Benefit Trust (CERBT)
- Legislators Retirement System (LRS)
- Judges Retirement System II (JRS II)
- Long-Term Care Fund (LTC)

Analysis

As part of the work previously presented by staff during the change to the PERF GFI benchmark, TIPS, and Agency Debt were found to reduce liquidity. TIPS and Agency Debt historically offered less diversification during equity drawdowns than U.S. treasuries and this is expected to hold true in the future. The changes made to the PERF GFI U.S. Treasury segment is in alignment with, and appropriate for the Affiliate Funds.

Budget and Fiscal Impacts

None.

Benefits and Risks

The primary benefits of the benchmark modification are expected increased liquidity and diversification against equity drawdown risk.

The primary risk of the benchmark modification is a decrease to inflation protection within the U.S. Treasury segment. This is mitigated by having a historically separate TIPS allocation for the Affiliate Funds, which is evaluated during each SAA review.

Attachments

None.

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