



**2015 INVESTMENT ADVISOR REPORT**  
*January 2016*

*California Public Employees' Retirement System  
Lincoln Plaza – 400 Q Street – Sacramento, CA 95811*

## **Fiscal Year 2014-15 BUDGET CONTROL LANGUAGE INVESTMENT ADVISOR REPORT**

### **Introduction**

The Budget Act of 2015 includes control language regarding the System's expenditures for external investment advisors and requires an information purposes only report to be submitted to the fiscal committees of the legislature and the Joint Legislative Budget Committee. The control language also requires an estimate for these expenditures for Fiscal Year 2015-16.

- Attachment 1 contains a report on final expenditures for Fiscal Year 2014-15.
- Attachment 2 contains estimated expenditure information for Fiscal Year 2015-16.

The CalPERS Board of Administration (Board) has approved the use of external investment advisors to manage a portion of the investment portfolio. These managers and advisors are selected for their expertise in effectively investing in those asset classes where internal staff resources may not be available or the capacity and requisite skills are more easily obtained from expert investment firms. Key to the management of risk is diversification into a variety of asset classes, including having portfolios reflecting a mix of internal and external management, and portfolios that are actively and passively managed. When external managers are selected, fees are negotiated to ensure CalPERS receives an appropriate return for the dollars being allocated and spent. When managers do not perform to expectations, staff will address the performance issue with the manager and, if no improvement is made, terminate the contract.

### **Basis of Fees**

Fees paid to managers and advisors are governed by a formula contained in each contract. The fee is based on the amount of assets under management, committed capital, and, in some cases, the performance of the portfolio. Performance fees are paid when the manager exceeds certain performance criteria contained in the contract (a more complete discussion of performance fees follows).

### **Performance Fees**

Performance fees are earned when the manager or advisors fund's performance exceeds that of a predetermined benchmark for the performance period. The majority of performance fees are calculated using a rolling three year weighted average market value. Thus, a single very bad (or very good) year will be smoothed out over a period of three years. The others are calculated using a one year weighted average market value. There is a "maximum fee", or cap, on the performance bonus to avoid excessive risk-taking by the managers. The overall objective of the fee structure is to avoid paying for underperformance.

It should be noted that not all managers and advisors have performance-based fees in their contracts. For those managers who do not, the fees are generally based on the amount of assets under management or committed capital, which fluctuates according to market conditions and management style. Because of these factors, it is possible that the future actual expenditures may be materially different from the estimated expenditures shown in the attachments to this report. In addition, per accounting standards, performance fees presented in this report are a combination of actual expenditures and accruals reported by investment managers.

## **Cost Effectiveness**

Since 1992, CalPERS has retained CEM Benchmarking, Inc. (CEM) to analyze CalPERS' annual investment program cost structure as compared to other plan sponsors and to measure overall cost effectiveness (or the value added per dollar spent). CalPERS costs were compared to 14 members of a global peer group with assets ranging from \$117 billion to \$844 billion.

CEM's report for year ended December 31, 2014, notes that CalPERS actual cost of 41.1 bps was below its benchmark cost of 42.9 bps. This suggests that CalPERS was low cost. CalPERS was low cost in 2014 primarily because of its lower cost implementation style, and paid less than peers for similar services.

### External Manager Portfolio Performance (in Percent)

Portfolio net performance as of June 30, 2015 is shown below (in percentage terms) for external investment managers.

	Market Value (Billions)	% of Total Portfolio	Portfolio Return	Benchmark Return
Global Equity	23.0	8%	-0.2%	1.8%
Global Fixed Income	5.7	1.9%	-5.9%	-6.2%
Private Equity	29.9	9.9%	7.8%	6.1%
Absolute Return Strategies	1.2	0.4%	7.3%	5.3%
Real Assets	31.6	10.5%	14.2%	12.3%

Note: For the fiscal year ending June 30, 2015, CalPERS Total Fund (all asset classes) generated a net return of 2.4%. All figures are as of June 30, 2015. The nature and cost of investments are provided in CalPERS's Comprehensive Annual Financial Report. The Board affirms on an annual basis the extension of all Investment Adviser Standard 213 contracts for one year. In addition to Standard 213 contracts, INVO executes Non Standard 213 contracts, including but not limited to Limited Partnership Agreements. The duration of these investments typically range from seven to twelve years.

### External Manager Portfolio Performance (in Dollars)

As of June 30, 2015, portfolio net performance, benchmark performance and excess return over the benchmark are shown below for external investment managers. This excess return is attributable to active management of the portfolio over a passive alternative.

	Portfolio Performance in Dollars (000s)	Benchmark Performance in Dollars (000s)	Excess Return in Dollars (000s)
Global Equity	(47,680)	505,276	(552,956)
Global Fixed Income	(234,545)	(250,069)	15,524
Private Equity	2,568,805	2,018,051	550,754
Absolute Return Strategies	329,871	239,038	90,833
Real Assets	4,265,765	3,685,982	579,783
<b>Total</b>	<b>6,882,216</b>	<b>6,198,278</b>	<b>683,938</b>

Performance in dollars was generated by taking the beginning MV (July 1, 2014) for the year multiplied by the performance return for the year.

**ACTUAL EXPENDITURES  
FOR  
EXTERNAL INVESTMENT MANAGERS/ADVISORS AND CONSULTANTS  
(Including Performance-Based Fees)  
(Dollars in 000s)**

	2014/15 PROJECTED EXPENSE	2014/15 ACTUAL EXPENSE	EXPENSE IS OVER (UNDER)
Global Equity	\$ 140,300	\$ 144,047	\$ 3,747
Global Fixed Income	11,027	7,035	(3,992)
Private Equity	476,149	414,568	(61,581)
Absolute Return Strategy	115,735	62,674	(53,061)
Real Assets	273,273	620,292	347,019
Custodian	5,934	6,757	823
Consultants	22,150	18,102	(4,048)
<b>Total</b>	<b>\$ 1,044,568</b>	<b>\$ 1,273,475</b>	<b>\$ 228,907</b>

In addition to this annual report, investment expenditures are summarized and are included in the CalPERS Expenditure Report, which is submitted to the Legislature on a semi-annual basis. All investment related expenses are detailed in the footnotes within the Fiscal Year 2014/15 Comprehensive Annual Financial Report.

ESTIMATED EXPENDITURES  
FOR  
EXTERNAL INVESTMENT MANAGERS/ADVISORS AND CONSULTANTS  
(Including Performance-Based Fees)  
(Dollars in 000s)

		2015/16 ESTIMATES as of Jan-16
Global Equity	\$	160,078
Global Fixed Income		12,114
Private Equity		440,582
Absolute Return Strategies		21,984
Real Assets		295,968
Custodian		5,970
Consultants		21,760
<b>Total</b>	<b>\$</b>	<b>958,456</b>