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Host: Eric Baggesen
Guests: John Cole, Don Pontes, Clayton Jue, Ken Grossfield, Adam Lawlor, Thurman White, Tina Williams, and Kevin Winter

Video Transcript

Eric Baggesen:
Hi folks, how are you all doing this afternoon or this morning I should say? It's still morning I think but we're getting close to lunchtime. I'm actually surprised we haven't filled this room. I thought this room was going to be packed, completely right up to the gills. Um, for those of you who don't know me, I'm Eric Baggesen. I'm a Senior Investment Officer for the public equity program CalPERS. That basically means that all the exposure that CalPERS has in a public equity traded securities regardless of their domicile ends up somehow or another within this asset class. Um, I'm joined up here with a number of folks uh, ranging from John Cole, who is one of our senior portfolio managers, in charge of what we do. Typically what we do with external managers but really John's job is to think through a lot of our whole portfolio strategy. And John is a relatively known employee to CalPERS. So, hopefully you'll take it easy on him a little bit for that. If there's nothing else, next to John we have Don Pontes. Don is a portfolio manager in our in our internal equity program. I think as Joe mentioned, we manage a lot of this money internally which obviously affects all of you in the opportunity set that's here. Don's job is really to run our trading operations. There are people in the room that are attached to equity brokerage so Don is going to have something to say briefly about that later on and will be available for communication I think before the lunchtime session that is coming up after this one. Next to Don we have Clayton Jue. Clayton is with uh, let's see, Clayton, you're a leading edge man right? I'm sorry. Clayton is one of our uh, external partners to help us in the emerging managers space. Next to Clayton we have Ken. And Ken, I'm sorry I don't have your last name in front of me.

Ken Grossfield:
Grossfield.

Eric Baggesen:
You know, I apologize for that. I don't have the entire roster of the folks that are speaking uh, from the different firms. But in essence, we have Leading Edge, we have Strategic, we have Thurman in from Progress, um, I think next to Thurman we have Adam.

Adam Lawlor:
Adam Lawlor.

Eric Baggesen:

There we go.

Adam Welder:
From Legato (Phonetic).

Eric Baggesen:
Legato? And then we have Tina Williams from FIS. All of these five firms are attached to our emerging manager efforts. And ultimately these are five firms that are engaged with us and trying to redefine something we are trying to do in that entire space in an effort to make it fit more with the entirety of our portfolio. So anyway, I'm going to have a, I'm going just going to use a couple of slides and give you a background information on the public equity portfolio. John's going to give you a little bit more information on the evolution of our emerging manager uh, programs. The five partners are just going to use a few minutes and give you a quick description of their organization. Um, and as I say, we're really in the process of redefining how they interact with CalPERS as an effort to um, change the whole focus of how they think of this program. And then I think Don is going to get up and talk briefly about some of the brokerage stuff that we do.

At lunch time there is going to be a number of tables that are set up where you can go and migrate to people that you are interested in speaking with. On one of the tables that will be set up during that session is actually going to be manned by Kevin Winter who is in the back here. Kevin is one of our senior portfolio managers attached to the fixed income area within CalPERS. And fixed income is a really interesting thing. Because you'll notice for example there's not a break out session targeted to that. And part of the reason for this as Joe mentioned, the fixed income, the great majority of that portfolio is internally managed, so that has a real indication as far as what are the business opportunities for emerging managers or emerging brokers um, to interact with that asset class. So Kevin will be able to provide you with some information at that point. And I think at this stage what I will do is open my first slide.

Here's a couple of little factoids about Global Equity. And I'm not going to be too exhaustive about this. Um, just before I even start this, one of the things I would say to every one of you is to the extent you're interested in what we do at CalPERS and how a program of public equities works, you can really go to the CalPERS website and look back into almost four years of historic agenda items that have been done in front of our board. We, we have ten board meetings a year along with a couple of offsite meetings. And almost everything that we do in this program is somehow or another put up in front of the CalPERS board. One of the things that's out there that I think is potentially a very useful body of material for you is that in September of 2012 we had a workshop for the CalPERS board members about what do we think about public equities. And there's probably 50 to 60 slides attached to the material represented in that. That material is all available to you on the website. So certainly if you go and look at that, that will provide you with some real back ground is to what do we think about the public asset class. So that you really understand you know, why we do some of the things that we do, which I'm sure can sometimes seem you know, just down right irrational and ideological. So, definitely take a look at that material.

The assets under management in the public equity space $119 billion dollars, that's the September number. Um, John will bring a little bit of context to that uh, piece of information when he does his slides in just a moment. Um, that number though has declined since, let's say 2007. And I think that this decline in assets, maturing of this plan is something that everybody in this room and everybody in the industry needs to recognize. CalPERS, when it has assets targeted for investment is typically fully invested all the time. We're not sitting on a pot of cash waiting to be moved into the market place. Another piece of reality that everyone needs to understand is that this plan is now cash flow negative. It pays out more in benefits that it spends taking in contributions. That is a huge change in the underlying conditions that exist for asset managers and intermediaries of all uh, shapes and forms. So you just need to understand that this is an evolving industry and I think that CalPERS is not unique in that position. To my knowledge almost 100 percent of public pension plans in the United States have now gone cash flow negative. The implication of that is that money is coming off of the table. And that's an implications that's evolved after we've had two, three, maybe four decades of solid growth and assets, money coming into savings systems. We're now entering a stage where we have the de-savings phase where we we're actually paying out money. That means that for us to invest in any kind of a new strategy we have to take money away from an existing strategy. We do not have new capital coming into this program. And that just, bucket of cold water is something that every single person that approaches CalPERS is looking for an allocation of capital needs to understand. Because it is the standard of reference for getting capital is it somehow what you represent is strong enough to cause us to defund something else. Whether that's an external strategy or an internal strategy. And really what we're talking about doing within the global equity framework is creating an environment that allows us to analyze and assess all of those opportunities in a way that is consistent with each other. It's really a holistic allocation model that I'll get to.

Another thing about the CalPERS equity portfolio is that it is based on a footsie, all-world, all capital benchmark. The board adopted that benchmark at the end of 2007. We started our migration to it in the 2008 timeframe. Obviously some market events took place to kind of you know, put a hiccup into that. Where we were coming from is a, is a structure where we had a tremendous home market bias. So 2/3 of the equity portfolio was targeted to US investments. When we adopted this benchmark at that time the waiting was at 52 percent, 50/50 something along that line but there was quite a significant migration of money out of US based assets into international assets. That migration is complete but that has definitely changed the opportunity set for example for domestic managers.

Another aspect of this in internal management. My first job at CalPERS was to expand the breadth and depth of our capabilities to internally manage um, if not actively, active strategize at least the beta component of our equity exposure. We now manage the entire breadth of this footsie all world, all bench mark. And that represents I think 47 countries. That's about 10,000 securities and Don and his team trade every single one of those names in every one of those markets. That capability has allowed us to have alternatives when it comes to management and it is really dramatically reduced some of the costs that attached to these assets. That's also a reflection of the fact that when we have taken active risks in the past we have not always been compensated for the risk which is something that we really need to become hardnosed about. If we're going to take active risks we need to be doing so with the expectation of somehow earning compensation for CalPERS and making the whole pension promise a bit more affordable.

The last little factoid I've got here is about the active risk. We currently have approximately 35 bases points of tracking variance attached to the entire global portfolio. That number is a fraction of what it was four or five years ago. That is a result of taking money away from any number of actively managed strategies, including some internally managed strategies. It is a reflection that we didn't; we're not obtaining compensation for out of that risk. I think they are changing my volume here. (Inaudible) a hard time with this. So, anyway, this active risk reduction has happened for an array of different reasons, through a whole array of different mechanisms, but it affects everybody in this room that aspires to be an active manager on behalf of CalPERS. The organization operates with an active risk budget across it's entire portfolio and that active risk budget being allocated to the areas where we think we get the greatest transfer efficient or the greatest compensation for taking that risk. That is an area where public equity managers have been struggling with. So you have seen all kinds of plans at CalPERS move greater and greater amounts of capital towards private assets, things like private equity and real estate and what not, alternatives, hedge funds and what not, in an effort to try to seek greater amounts of return for the active risks that they are taking. And we're not allowed, and neither would be if we were allowed, we are not going to explode the amount of active risk that we would take in the public equity program unless we believe that we can somehow or another transfer that risk into compensation for the organization. So that just a reality. You know this; you know I just want to level set everything for people a little bit.

Flip to my next slide, and this is a slide that I took from that uh, workshop that we did for the board in September. And I would refer you again to that. This has capital allocation in the center of everything that we do in the Global Equity Asset class. We've been working for the last couple of years and really trying to create the mechanism by which we assess every strategy and if you think of a strategy as being an asset, we're trying to create the framework where we can assess every single strategy that we could allocate capital to and make that capital allocation operate in this holistic fashion. And that's probably a radically overused term, this holistic concept. But we've really tried to make this come true. And the framework that we use for this body of word is a non-linear optimization framework. We can argue about the pluses and minuses of quantitative methods and all that but none the less the quantitative tool provides us with a uniform assessment of portfolio characteristics or strategy characteristics. And we're really trying to allocate this capital in a way that we understand the contribution that every strategy we allocate money to, that contribution to the overall portfolio outcome that we achieve for CalPERS. And this is really important because every strategy you would propose to this organization and that we would have a direct allocation of capital to somehow or another needs to operate in a way that is consistent with this capital allocation process.

Historically we had many siloed sub programs within the public equity space. So we have emerging managers. We had emerging manager fund to funds. We had our MDP program. We had activist managers. We had all kinds of different stuff going on. All of that different stuff led us to a place where 2/3 of the active risks that we were taking in the portfolio was an artifact of all of the little silos in contrast to intentional and hopefully informed risk taking with an expectation of earning a return due to it.

The last couple of years have been an exercise of reducing that unintentional risk to a point where we think we're seeing that pretty much in our portfolio and now with the arrival of John Cole we're challenging ourselves about this whole concept of taking active risks. And John's background is he was in charge of active management at Northern Trust. So he was in essence the Chief Investment Officer for that segment of their business. And John's job is to challenge me and the people in Global Equity to think about whether or not we've, we've taken down risk too far or are there opportunities in active management that we're now tending to ignore? And that's an evolutionary process we're really just getting started. But this is a really key concept that everybody here needs to understand and it's part of a transformation that we're attempting to make with all of our partners at the right end of this table, to make them in essence and extension of how we search for strategies and how those strategies can receive and allocation of capital from CalPERS. I need to be very circumspect to some extent about what I say about that because one, we're still trying to define what that even means and I think these people share a degree of consternation about what that means. And I see Thurman smiling, I know he does certainly, and I don't blame him. We're still trying to figure out what all this means. And we need to take this to the CalPERS board so that the board understands what it means, what we mean and they agree. We have not taken that step yet, so you need to understand that piece of what we're talking about has still got to be validated by our organization as we move through this migration. But I think with that, John I'm going to turn it over to you. I've said enough and I look forward to introductory individually later on.

John Cole:
Thanks Eric. I'd like to talk a little bit about how, how we can work together. And levels set and give you some statistics maybe to start us off. There's a great movie, Lincoln, out these days. If you haven't seen it, I recommend it highly. And Lincoln noted in one of his conversations with his cabinet, he says, my goal is to have this be a, a very short sermon unless I get lazy. So, I'm going to try not to be lazy and kind of get through a lot of material in a short period of time and then spend some time with our, our key advisors partners and have you hear from them what they are up to. I'll address two topics. First, what exists within Global Equity today and then where we're heading. This is slide illustrates the break down that Eric alluded to, 79 percent of our total Global Equity portfolio $119 billion dollars is managed internally and then the breakdown as you look on the next slide of the external assets is really split among three large categories traditional, external, corporate governed sometimes referred to as activists and emerging managers. A lot of statistics but we're spending just a moment on here taking a look versus five years ago we referenced the change from the financial crisis several times this morning and if you look at five years ago, our assets in Global Equity have gone from $144 to $119 billion. Our external commitment has gone from 55 to 25, our emerging manager program in the same period has gone from 1.8 billion to 2.3 billion, with our current roster of diverse managers and advisors being 20 of our 37 emerging managers and 20 of our 61 total external managers. So that just gives you a sense of a little bit of historical context and very much a where we are at this moment in time.

Eric alluded to where we're going. Let me expand on the thought. We concluded the traditional model of hiring a large number of active managers and expecting them or at least most of them to meet a benchmark as the way to add total value, just plain doesn't work. And there are a lot of reasons. The least of which is that they have benchmarks which are very diverse and they don't fit well when they are all put together. But even more important and maybe the biggest impact is what I'll call the interaction effect. What happens when you put two managers together is a little bit unpredictable. Think about what happens when you do it 61 times so that when a manager that is involved with a particular source maybe inadvertently, at least from the plan level, canceled out by what happens way over on another part of the portfolio, just because of a benchmark specification, a style difference, or any of a whole number of ideas, or reasons why that would happen.

So, we're acknowledging is that that canceling effect leads to unintended outcomes. And then in effect as a result when it gets to the aggregate portfolio there's way too much luck involved as to what ended up occurring as to whether we meet the benchmark. We have little control, little identification, and an understanding of where it came from. So with that in mind what we've done is to take a new look at how to manage $119 billion dollar Global Equity portfolio. We're in the early stages of building a framework that focused on that who portfolio. We're preparing to manage it from the top down based on comprehensive management and understanding of the many risks that are embedded in the whole portfolio. Now when I'm talking about it our geographic sector, style, capitalization, fundamental exposure, macroeconomic exposure etcetera. All those things that kind of define what happens when you put 61 external managers alongside over 20 internal strategies and have it all aggregate up. And armed with that information what we intend to do is to take advantage of the opportunity to put what I'll call controlled tilts in a top down fashion and on the portfolio. Tilts related to specific characteristics or factors that we can identify strategically, things that are going to change say over the next year or two or three even, what we can do as long term investors, and that maybe over price or mispriced in the global marketplace. We'll work very closely and therefore changes the relationship with our external managers, our advisors, our strategic partners to implement this capital allocation framework. It changes the relationship with our managers profoundly because it shifts away from a focus which is entirely about beating a subcomponent benchmark that doesn't necessarily add up to the total and towards the aggregate portfolio. Meaning what really matters and to fulfill our fiduciary responsibility is the return on $119 billion dollars. Having said that, a very key role and component of external management is access to a couple of very important ingredients. One is intellectual insight, what you do that informs your philosophy and process that gets translated into the portfolio is also valuable information that CalPERS as a capital allocator can use in order to identify these opportunities for tilts on the portfolio to add value at the aggregate level.

Additionally, you've got some systematic biases that define what you do. They kind of define why you believe what you believe and how you actually implement that in portfolios. And those are good tools and levers for CalPERS total fund to affect the same kind of tilts from a top down approach managing these risks and character factors in a way that add overall value. So, in now, we're in the midst of installing the plumbing. There's a good deal of it to understand what I've just described bringing in some key people to change the dialog in the relationship and looking forward to seeking, identifying, engaging, and ultimately exploiting that which you bring as active managers to a process that will help us overall. With that, I'm going to, and by the way I think in terms of timing we are in all of this, I believe that over the next 12 months, 12 months from now we will be in a, in a very different position than we are today. We're having an active dialogue with our advisors and our strategic partners now and been under way for some time and will continue to help get us there. So, it's, what I'm telegraphing is over the course of the coming several quarters is a really exciting, potential time to engage CalPERS in kind of the way we're going and the way you can best relate as external managers and a very important component to fulfilling that goal. What I'd like to do now is to allow a few moments or each of our advisors to spend, to introduce themselves, give you a little sense of who they are. They are important partners in many ways. They stand alongside us. They will increasingly provide us as an extension of our staff. They will be very involved in selecting and sourcing all, potentially all the external managers that we're involved in. So, it's a very key partnership that we have forged and will continue to expand over the coming years. So for about five minutes, I'll start with Tina Byles-Williams and talk a little bit about FIS and what they are about. Tina?

Tina Byles-Williams:
Hi there, my name is Tina. I am, I'm the girl on the panel but no about 16 years ago I founded FIS Group. It's an investment advisory company based in Philadelphia. We have about $3.5 billion on the management. And we've been thrilled to be a business partner of CalPERS for I guess about four years, four plus years. Currently the, it's as was mentioned earlier, the, the portfolio is on an evolutionary track I would say. It's currently benchmarked to the global footsie benchmark and one the, one of the considerable side benefits of having a client like CalPERS, and we have a lot of large sophisticated clients, is that there, they're always on the cutting edge of thought about alpha creation and the intersection of alpha creation and, and opportunity. And so, but so, so that for me anyway, I find that intellectually stimulating and then, and just fun. But what I also appreciate about the team here at CalPERS is that they are very collaborative about it. We've had several, I mean as they were thinking through this process we've had several meetings, I've lost count at this point about thinking about, how, how the new structure, what the new structure would look like and so I really appreciate that. You know it is a changing world. And so I appreciate the fact that they've been so collaborative about trying to get to the considerable fine solution for the considerable challenges that they are facing on a top dome level. So, my colleague Sam Austin is here, I know there a lots of managers to access us for the managers in the room. We do have proprietary database www.FISgroup.com, but would be happy to take cards to, to make sure that you're considered.

John Cole:
I note that each of us during the lunch breaks have separate tables for any who want to take advantage of the opportunity to sit and talk a little more detail. Next, I'll turn to Adam Lawlor from Legato.

Adam Lawlor:
Thank you. First I'd like to thank the board of CalPERS and the staff for organizing this event and giving us the opportunity to have an interaction with all the emerging managers out there that we already know and the ones that we don't know already. And we'd like to, CalPERS has been a pioneer in the area of investing with emerging managers and we look forward to with the new commitment and the allusion of the program for them to be a leading example for the industry and to help, help not just internally with, with emerging managers but encourage other plans to develop strategies similar to that because we, we strongly believe that emerging managers can add value to any portfolio. My name is Adam Lawlor along with Victor Hynes that cofounded Legato Capital based in San Francisco. Since 2006 we've been a strategic advisor for the MDP2

program where we manage a Global Equity portfolio. The Legato is 100 percent dedicated on discovering emerging managers and constructing customized portfolios of emerging managers for institutional clients. We manage portfolios across the cap spectrum, microcap, small cap, all cap, and customize portfolios. I thought I'd maybe pull back a little bit and talk a little bit about how we look at emerging managers and many of you sitting in the audience are wondering, this program in evolution. Other plan sponsors are in evolution and, and some of the things we think are important for emerging managers. First of all at Legato we look for talented, seasoned investment teams, clear and scalable processes, over line the interest with the clients, as well as diversity issues. We look for strong ethical and compliance programs and, and, and cultures, and the ability and willingness to take active risks. We're all firm believers in active management but we like to see a dedication and ability to, to provide a active risk. Some of the challenges that we're seeing currently in the market place within the, our current emerging managers and others that we're not currently working with. We're seeing, as we've heard all today in every meeting that we've probably gone to the de-risking of portfolios. It's adding enormous strain to new capital to the market. Emerging managers typically manage in the domestic equity space. If you look at all of our databases the majority of them are in domestic equity. So having those portfolios or allocation decreased, it adds an enormous challenge for the people, for us, as well as for the people here today. We're seeing the increased demands of regulatory requirements and risk management. That's also a strain on small firms. The scarcity of capital we heard earlier today about starting emerging managers about we all could agree up here we're not seeing the creation of emerging managers. Currently as we did five years ago obviously the market crisis has a shake out in that has distribution issues. Everyone is trying to raise, small farms don't want to be small forever. They want to grow their farms and provide alpha for their clients. What do we see going forward? We don't see any decrease in the regulatory environment. That demand and strain on small firms, they're going to have to find solutions for that outsourcing of compliance and infrastructure and technology will help, help ease some of those issues, the development of new strategies and asset classes where, where capital is being deployed. You know, starting a large cap corp. strategy in this market and environment is probably not going to get as much traction as international micro-cap or small cap or emerging markets where the dollars are flowing. However, value added strategy is in the small cap and micro-cap and are still in high demand. And if there is anyone out there, I'll wrap this up, who does not know who I am or our firm, please come and, and give a card to me. Visit our website, we have forms to fill out, submit your data, we're very responsive to taking meetings but we have a team located in San Francisco, we'd be more than happy to take your meetings. Thank you.

John Cole:
Thanks Adam. And representing Progress CEO, Thurman White.

Thurman White:

Thank you John. Thank you Eric for having us again. My name is Thurman White with Progress Investment Management Company based in San Francisco. Several of my colleagues are here in the audience. So for all of you who are trying to access progress, we've got several people here this morning and throughout the day who are here and we're happy to meet with you. For the past 22 years our firm has been focused on the niche managing emerging managers. That's our exclusive business, it's been our focus, it's our passion, it's really our purpose for being. I've been at the firm 21 years in February. We have a satellite office in New York. What we've always tried to do is really serve a catalyst, a facilitator, a bridge between this pool of talent that is often been overlooked, underutilized, come to be known as emerging managers and large plans like CalPERS and others who are trying to find and efficient and effective way to access this pool of talent. And so we really provide an intermediary function sourcing the tremendous talent that resides with emerging managers, selecting their talent, doing due diligence on the talent, putting together portfolios of emerging firms that are diversified by across capitalization and styles, actively monitoring those portfolios, managers, rebalancing those portfolios as necessary, working with the emerging managers in a hands on way to share best practices, to really coach and to nurture them, to be all that they can be in terms of managing their businesses, and ultimately facilitating their direct hire. In many cases buy plans directly. So that's the business we're in. Thirty-two employees, 32 institutional clients of which we are pleased to say CalPERS is one. $7.5 billion in assets under management and again and our strategies range all throughout US equity and the difference of asset classes with the difference of equity, none US equity, Global Equity, Extendcom, and beginning to do some work in hedge funds. So, I think if I were to trying to present progress to you, I think what I'd talk about is breadth as well as the ability to both share best practices with managers and help them to become all the can be. But that breadth of opportunity is really what I would commend to managers that are in the room and certainly my colleagues are all here to understand you better and the to direct you, of course, to our website www. Progressinvestment.com where you are able to get a questionnaire and to see the information that's important for us as due diligence managers.

We've had the privilege of really working with CalPERS in, in two capacities beginning in 2000. We worked with a small investment boutique in a joint venture to work in the manager development program engagement. We identified emerging firms, minority women owned firms that needed and wanted to have CalPERS as an equity partner in their firms and then provided assets with those firms to manage and so we had 11 firms throughout that relationship.

Most recently, beginning in 2010, we worked with CalPERS as a manager of managers or fund of funds if you will with a dedicated small caps strategy. So we began with $100 million dollar allocation and at the end of 2010 so it's a relatively short track record but who's to say now that market value, it's about $150 million dollars and we've had 350 basis points analyze our performance from inception. So as we begin to here inceptually about emerging managers. I know we're not alone in being able to demonstrate in a tangible way that particularness in dedicated small caps strategy we had been able to have performed. We had been able to have managers, three of which in that portfolio, three of which are what CalPERS is calling diverse. We would call minority women only firms and we're very pleased with those managers. I might say also from the MDP engagement in the MDP1 program, we had one, I guess you might call it, graduate of our Street Capital that is still part in a major way of the CalPERS external management portfolio. How we source managers through attending conferences like the one that we're here today, through personal referrals networks. We work with a variety of broker dealers across the country. They offer a good source of names. Head hunters if you will, executive search firms, just a variety of different contacts is what we typically hear about managers, also from our clients. Many times when you're contacting clients like CalPERS or CalSTRS or New York State Common Retirement Fund or any of the New York City plans, all of which are among our clients, they are in turn referring you to do managers. The managers like Progress of FIS or Leading Edge or Legato or Strategic. So, client referrals are an important source of how we find managers. Typically again we're looking to evaluate managers based on the, the integrity and effectiveness and the execution of their investment process. How talented are the people if you will. What level of experience they do have. What their performance has been in and finally the infrastructure if you will. Uh, Joe Dear referred to it as the plumbing. But we're also interested in plumbing if you will. The infrastructure that is so important. Starting with merging firms our experience has been fundamental risk, investment, certainly market risk, and then business risk. And so our work in helping the managers to best manage their businesses is really designed to have an infrastructure to consistently execute the investment process. But again, happy to engage in any questions that you have, thank you for having me.

John Cole:
Thank you Thurman. And Ken Grossfield representing Strategic Investment Group.

Ken Grossfield:
Thanks John. And I also wanted to echo the thanks to the board and staff for organizing this. I think this conference already has been very helpful. I ran into someone on the way up here that said that he's been trying to understand the structure and how CalPERS emerging managers for a long time now and the first two hours and he had learned in all of his efforts prior to this so, thanks for that.

Strategic Investment Group was founded in 1987. We've been around; we just passed our 25th anniversary. We're a little bit different in where we're not focused exclusively on emerging managers programs. Our firm was founded out of the senior pension team at the world bank. And so our core business is we're a manager of managers. It's referred now to and outsourced CEO firm. And so basically what we typically do is refer, we handle allocation asset class structuring and manager selection so in a lot of ways it similar to what CalPERS does on a daily basis all be it on a much smaller scale. We, one of the reasons why we're in this program is our founder recognized early on the potential the mangers have add value to, excuse me, global portfolios and so we have been a pioneer and including emerging managers in globally managed portfolios and today we manage about $32 billion dollars in assets that's for pension funds, typically corporate pension funds, foundations and endowments, and we have a very valued relationship with CalPERS dating back to 2000. We manage both the, in conjunction with CalPERS first iteration of the managers program and now we're managing the, the second version of the program.

In terms of what we look for in managers, a lot of the characteristics are what you've heard described for first and foremost is discipline repeatable investment process. All of the infrastructure issues that have been the plumbing as it's been referred to is very important. One of the things that we focus on a lot is how well a manger understands what that managers actually doing. We do put a lot of time and effort into constructing the investment managers portfolio, seeing how it's behaved over time, seeing the weights and allocations that manager's had over time, and seeing and trying to assess if it fits with kind of the strategy that's being articulated to us and whether we think that, that enhances the repeatability of the process or whether it's an accidental bias or something that we don't think is likely to be repeated. We also welcome the exercise that CalPERS is going through right now because we think it fits well with the way we look at portfolios because one of the, one of the primary factors that we're looking at is what is, what is the exploitable anomaly that a manager's looking to assess? And what we're trying to do again looking at the process is whether the process and the people there are poised to exploit that anomaly. And so kind of a top down global approach that looks at tilts that a manager wants or tilts that the investor wants to take and, and then looks at selecting managers that are best poised to exploit those or to, to, to implement those tilts we think is something to, is the right way to approach allocations to emerging managers and also would help us identify and help us access emerging managers that might not otherwise be accessed.

Chris Pond a colleague of mine and I are here. We welcome the opportunity to speak to all of you. We, our website is Strategicgroup.com. We also have an application there if you are interested in applying to the program and we really look forward to continuing the dialogue.

John Cole:
Thank you Ken. Clayton Jue from Leading Edge.

Clayton Jue:
Thank you. I, I'll try to add some comments that may be a little different because I think we all look for the same things. For those of you who don't know me I'm

Clayton Jue with Leading Edge Investment Advisors. We started the firm in 2005. We have a couple billion dollars in management. Either than that, many of you do know me in the investment programs at Northern Trust for two years, ran their management program as well as global programs. And then for the 11-1/2 years before that I was at Progress Investment Management CIO over there developing many of those programs. And then before that I was at Callum and Associates for many years. So, a couple of my colleagues are in the room, Kellan Roberts who's worked with me when she was at Callum and Associates. We both have 25 years' experience evaluating managers and as a result of that there are a lot of things that we look for or that we focus on. Now we probably sat in the offices of a thousand managers and that's not an exaggeration. We walked through the processes, tried to understand what they're doing, what they do different, what makes them unique and a few years ago emerging manager focus a new publication asked me to write an article on what I look for in mangers. And I wrote this article and I think many of you read it, the attributes of great performing managers. It's on our website.

This talks about what really goes into the portfolio that makes great performance. And there are things in there like what is alluding to having the advantage. What does that manger actually do that's different? How do they meet their peers? How do they beat consensus, things like that. How do you put the portfolio together and how do you manage risks. All of us are looking for performance. How you get that performance is very interesting to us, and it's also very interesting to us on how you continue to improve your process, how you continue to innovate because the world doesn't stand still. And this you know, I can, I think we can all say that the best performing manager ten years ago is not the same investment manager today because the world has changed. So we're interested in evaluating what that is that you do, that you do it with a level of consistency, you maintain your edge. Those are things that you have to work on. We're not going to tell you how to manage your money. I think that's an important point. You have your own velocity, your own process, and how you go about doing that.

The other aspects of why you get hired, you do have to manage that portfolio efficiently. You do have to be in compliance so the operational aspects of managing the portfolio, the compliance aspects, and even the business aspects of managing your firm. We know that you don't have it all together because you're emerging managers but we work with you. We provide you with some kind of feedback, some kind of background to get you on the right track. Now you have to implement and sometimes we can be very helpful and sometimes we see managers fail unfortunately. But that's a requirement that we work with and we do make a lot of effort to look at every manager and give them a fair, a fair review if you will.

So let's talk about track record, let's talk about AUM. We don't have a minimum AUM requirement. Now some of our clients do for various reasons. And so that may constrain us in terms of what we're able to do with you potentially. In terms of track record, naturally past performance is no guarantee to affect your performance but we knew, we need information to evaluate and we need to understand how you got your performance. So the more data there is, obviously it's better for us. We can make a better assessment with some kind of confidence. But in terms of minimum track record, I think 18 months of history is the minimum that we kind of need to understand what's going on with your portfolio. And then we can make some kind of judgment. And so we are, we're not shy about being first assets for a manager if we have that discretion given to us by the clients. I think that's a plus and we make, we understand the challenges that you go through to start a business. I've been through it a couple times and the second time it's not easier and easier than the first so, understand that completely.

With regard to the new approach we're always looking that CalPERS is implementing with the tilts. We're like Ken, we look for what you do, what factors, exposures you have, what makes you innovative, and this approach actually gives a lot more latitude to look at a lot of other managers. Because many times most institutional investors, they want the manager to fit in a certain box, some kind of style box and if it doesn't fit then they don't want to look. Well, I think this new approach gives us the chance to look outside of the box so we kind of welcome that.

John Cole:
Thanks Clayton. We're proud of our five advisors. I think you see quickly that they each bring multiple dimensions that, that I think add to our overall capabilities and I encourage you to spend time with them and, and to get a more of a clearer picture of them over time on what's going on within CalPERS. I think we're going to have about ten minutes left for questions so I want you to think about it a little bit but between now and then I want to introduce Don Pontes. Don is our head trader and he's going to spend a few moments talking about our minority brokerage program.

Don Pontes:
Thank you John. All right manager of head trading, equity trading for CalPERS. I do think the question opportunity at the end is key so I'll do my best to be efficient here but I will start off by saying I had a horrible bought of laryngitis over the weekend so I'll do my best to sound like a teenage boy up here. Here we go, so prior to 2008 CalPERS internal equity brokerage structure was substantially inefficient quite honestly. We had an excessive number of brokerage relationships. We had no real organized method for performance evaluation. And to compound matters this was during a commission of declining matters and trading volume. So what this lead to was really a number of relationships that were very thin, underdeveloped and, and obviously this relationship, it's all about interaction and engagement so having meaningful relationship was certainly lacking. Here we go; a current evaluation process is developed by CalPERS

internal equity trading and was Mosaic investment advisors. Mosaic was diversity consultants and an interval part of our process. The initial objective of the new process was to institute a merit based evaluation structure that would help us identify our top performers in the process and ultimately reduce our active roster down to a manageable size by identifying those who consistently underperformed for whatever reason. So with a more manageable roster inside, more manageable roster size in place the evaluation process would then focus on our underlying goals which were achieving best execution and providing opportunity for diverse set counterparties. So in this process Mosaics ongoing role had several dimensions. One they were to design and administer a questionnaire that would obtain information from a wide array of equity brokerage providers. Two, they were to perform ongoing assessments with providers to understand and explain the needs and objectives of CalPERS internal equity trading. This communication is key and its ongoing and it's obviously the responsibility of Mosaic. It's also the responsibility of CalPERS internal team to be as clear as possible and to have participated in the structure and our specific needs. Three there are to be a key broker in the evaluation process. That's our semiannual evaluation process and it's critical. It's where we sit down and obviously measure performance of those on our active roster, consider our areas of needs, and have an opportunity to look at the due diligence done by the folks at Mosaic. Make us aware of the folks out there who otherwise may go under the radar. And finally Mosaic is an advocate for diverse emerging firms. I think it's safe to say that over this period where we've created a consolidated roster, try to identify those with strengths that fit our needs. It's very easy to say that we've had a number of firms that have been very successful on the roster who I think would have gone under the radar without the assistance of Mosaic and the process.

So the broker evaluation process is repeated semiannually as I mentioned. It incorporates three key metrics in the evaluation process. One, obviously primarily being the execution performance. That's execution versus the stated benchmark of the trades, more importantly your peers versus the active roster. Second is an operational capability. That's the ability to settle in clear trades coming off the internal equity desk. No small feat and one that we try to put as much emphasis on as possible and stress the importance. And finally value add. Value add is what we always deemed to be basically that above and beyond peer execution. It's what folks bring to the table beyond just executing trades. That can be technology that can be accessed to securities offerings syndicate, relevant research capability, trade ideas, and the ability to respond to the one off request that may come off of the CalPERS internal desk. So once the scoring is complete brokerage firms in the active roster are assigned to one of three pools. We have the core pool, which is our top performers, top half of our roster. Those that have scored best in the prior six months and they'll be receiving the lions share, the majority of commission for the following six months. We have our development queue which is the bottom half, lower scores but they're still going to be in the active roster. They will have reduced activity in the following six months but obviously there is still opportunity to trade with CalPERS and to write the ship so to speak. Finally there's the queue. These are firms that are not in the active roster for whatever reason, a number of reasons. Maybe strengths and ability didn't fit out needs. But obviously we encourage folks to continue to participate in the process and then its incumbent upon CalPERS and Mosaic to provide as much clarity for specific reasons that a firm was not selected for the active queue.

So the process that started in 2008 has significantly changed characteristics of the firms that provide agency execution for CalPERS. Brokerage firms that are owned by disabled veterans, minorities, or women are identified for inclusion where there capabilities mesh our activity and our needs. This purely merit based structure has resulted in much improved environment for equity brokerage. Since 2008 the revised internal equity trading structure has realized many substantial improvements. We've seen a reduction in the use of executing firms from 78 down to currently 23, much more manageable, much more meaningful relationships as a result. So this substantial reduction has increased the materiality and obviously just the frequency of interaction which enable value add and enables just depth relationship deal.

We've also seen an improvement in all three metrics that we use in our assessment processes I mentioned. Execution and investment operations at value add. We've seen particular improvement in the space of execution. And that's versus both markets on close and arrival benchmark which are our two primary benchmarks. So we've also realized more representation as you can see the graph at the bottom for disabled veteran, minority, and women owned firms. Even in a consolidating brokerage roster that number has risen to ten firms which now constitute percent of our active roster. This is up from 12 percent prior to 2008. We've also seen commission allocated to this grouping increase by 400 percent. Prior to 2008 that group received about 11 percent of our commission allocation. We've been consistently over 40 percent allocation since then. So many lessons have been learned by CalPERS staffing and Mosaic as its process had evolved over the last several years.

But we do have some specific challenges as we move the process forward. And that would be an effective rotation cross core, development, and the queue must be maintained. It's key to provide opportunity to new firms. So the identification to those who consistently underperform, those folks are potentially removed from the roster which creates openings in our rotational aspect of our queue has been very active and very successful over the last several years. Also the questionnaire needs to be continuously modified in order to aid in broke selection. This in incumbent upon mosaic as well as CalPERS to make sure the roster reflects current market environment topics. Pretty dynamic updates, frequent updates, interview required.

And finally communication with the brokerage community. This is increasingly essential and it aids as I mentioned earlier in the participants understanding of the process. The understanding in the structure of CalPERS and ultimately the needs of the trading desk. So I hope this provided some clarity into our process, the success that has resulted from the process, kind of where we see things going forward. Thank you very much.

John Cole:
Thanks Don. It's, I thank each of the members on the panel today. It's as active managers many of us have gone into a presentation with an hour prepared and told could we get this done in 30 minutes. That's the challenge we laid out today and I think everybody did a pretty good job of transmitting a lot of information in short time. But we've got a few minutes left and we'd love to open up the floor for comments or questions before we break for lunch if there are any. Please? Here's one.

Audience Member:
If you were an emerging manager and you all have very fine firms, I've met with a number of you, would you suggest me hit every one of you up or just try to choose on one of you to try to associate with?

Tina Williams:
Where are you based? Where are you based?

Audience Member:
South Florida.

Tina Williams:
South Florida.

Audience Member:
And, and I work with your firm though.

Tina Williams:
I mean it seems to me someone mentioned distribution was a challenge. So that alone would say to me that I would try and get on all our platforms. You know, because alpha creation by definition and is a very hard thing to find and so if you have a process that generates alpha we'll all want to, to, to employ you. But there's some obvious limitations. People have different types of travel budgets etcetera. And so, and I don't know what your constraints are so, so it's sort of a more general comment. You know one of the wonderful things of today and age is there are things like Skype. There's things like teleconferencing. And so to the extent that that's a limitation I wouldn't think because we take advantage of all of the above. We're, you lessen the cost of reaching a broader audience.

Audience Member:

In the sense of the stated goal for CalPERS return of seven and a half percent does the global equity have an absolute return goal or is it based on the footsie benchmark?

Male Panlist:
It's a timely question. Let me try that one a little bit. Our last asset liability was in 2010. The return for Global equities was right around seven and a half percent number. We'll see where that evolves to during our next erosion of that work. We do this on a three year role cycle. So really our game in the public equity space is relatively a return game. CalPERS seven and a half percent is you know, the accumulation of the absolute target if you will for the organization.

Audience Member:
Just a quick basic question. Is there a reason you guys chose a footsie global benchmark versus an MCI aqui?

Male Panelist:
I'll stand right up here with John. That's a really interesting question. We've done this analysis a number of years. And this analysis for CalPERS on benchmarks went back, predated my arrival at brokerage for a long time. The organization has gone footsie for a very long time. Originally the footsie benchmark was elected because it had much deeper capitalization coverage then the MSCI benchmarks. Since that point in time we now have evolved to a benchmark that represents what we think is virtually every institutionally tradable security in the markets that are covered. And due to that, why would we go through a transition expense for me to migrate to another benchmark when basically all the security is in the market or all the security is in the market. So the distinguishing characteristics are sort of evolving down to flow and adjustments and things of that nature but we have not come up with a compelling reason to go for a transition.

Audience Member:
Okay, my question was basically a difficult one. But it's, have any of you found any factor that helps you predict when a manager will outperform in the future? Whether it's assets under management, whether that's a predictor factor or you know, we hear a lot that prior track record may not be that so great. I'm just curious if any of you have found anything that you could then quantify and pass it on to?

John Cole:
I might start us out and then you can jump in. I, we pay a lot of attention to the academic work in this area and we've also engaged several of the national consultants in, in the quest. I'll call it the quest. And the answer is no.

Tina Williams:
Let me step up into the brave new world.

Male Panelist:
There's no quantitative measure that we've identified. But there might be some qualitative measures we're not willing to share.

Tina Williams:
There is one thing that and there is academic work around this and that is but having said, the thing that seems to be, that we focus on quantitatively apart from all this other organizational things that my colleagues here have spoken about is active share. If you were, if one were to regress active share over a very long period of time with excess return it's typically positive. If one were to regret active share with AUM it's typically negative. Hence our raise on debt right? But the problem was that is over the last three years. That relationship for US large cap equity has degraded. It had persisted in small cap and none US equity. So that's why most non US equity and small cap portfolios look brilliant and large cap US equity looks less than brilliant. Some of it is simply structural. So I'm one that believes there is something called mean reversion. And that eventually relationships restore themselves. But the most predictable variable that I've seen and the most academically supported variable is active share. Apart from and then I would add to that, I'm not saying it's a panacea but it seems to be the most sustainable.

John Cole:
Other comments?

Audience Member:
I think Thurman referred to I think your mandate being small cap domestic. I was wondering if each of the panel member could describe their mandate and what allocation they have to international, versus domestic, versus small cap and if you can, I don't know if you can mention when the last time you got a new allocation from CalPERS?

Adam Lawlor:
Within our management development program, it's a little bit different then an straight allocation. We're taking equity stakes in those firms and providing capital and assets to manage and so we've got to our portfolio over the last six years. So we started with a large cap for a mandate to a large cap growth. We have a European equity strategy and last year we refunded and emerging market strategy. So it's, it's our mandate is a custom benchmark or our benchmark is custom based on the rolled up weights of the allocations to those managers. So we're a little bit different than trade. Here's your benchmark, hire the managers, manage the portfolio so the programs evolving and you know, we'll, we'll have different, different, different allocations going forward.

Tina Williams:

So our benchmark is a global, the global footsie equity benchmark. And so within that context there obviously some US equity but there are merging markets, they're iffy, the acquits, some of the regional specialists. It's a potpourri of managers within that broader opportunity set.

John Cole:
Thurman? You want to?

Thurman White:
I think as I mentioned earlier ours in a dedicated small cap portfolio and it evolved really because CalPERS had a couple of existing fund to fund strategies and emerging managing targeted investments. So in working with the staff our goal was to elaborate with them and kind of look at an emerging manager context where was there some opportunity where the other fund to fund marked. And so that was the evolution with a dedicated small cap strategy was kind of trying to fill a gap. Not only in a place where there was a not an overexposure but also where there was an alpha opportunity. So that's what drove the sort of dedication of the small cap.

Ken Grossfield:
Our structure is similar to Legato's in that it's a weighted average of manager weights and we can industry work globally.

Clayton Jue:
And ours is similar to FIS. We are asked to look at the best opportunities on a global basis. Were it to fall out at that point in time, we're 75 percent domestic equities, there is a, about 25 percent international within the domestic equities there's a probably 50 percent or more waiting in small cap. It was really into the best opportunity at the time and the benchmark is just rolled up and customized .

John Cole:
Okay maybe it's time to break for lunch. We've got one more maybe?

Audience Member:
My question is for Don Pontes and for all the brokers in the room. Could you please talk a little bit more about the value added component of you performance criteria? Exactly what is it? How do you evaluate it especially as you're looking at onboarding new brokers? Thank you.

Don Pontes:
You bet. It's actually yeah; I mean it's tough to predefine. The days we first started this process we had a list of things we needed to have and to grow and to get the desk to the vision we needed to have. Those days are gone. So now it's, it's really on a basis where our firm is not live yet with CalPERS but in queue and in looking to move to the active roster it's more of an explanation maybe what you've done with similar accounts historically. It is potential that you add. It's

really not a way that we can look out and, and, and deem anybody to be successful and eventually successful. We just want to see that you have some reach. Quite honestly it comes down to building a strong relationship. So it's one of those things that take time. And we've seen folks that on paper look like they can add value to the table and once put in the live roster it just doesn't happen. And we do everything we can to help build that relationship but I will stress that the one factor is a strong relationship and strong understanding of who we are and the first six months that our firm is live and our active roster for the trading team, we're very flexible and patient with that. We understand that it takes time. It takes interaction with trading and not to learn who we are, our sensitivities, our tolerance, and what we ultimately deem to be value add. So it's inevitable evolution. It's a process. But I will say that by that one year anniversary we really do need to state seeing value add in the relationship.

John Cole:
All right. Thanks everyone for being here. We look forward to the follow up. Thank you.