Agenda Item 6a

February 19, 2013

ITEM NAME: Extension of Interim Asset Allocation Targets

PROGRAM: Asset Allocation

ITEM TYPE: Asset Allocation, Performance & Risk – Action

RECOMMENDATION

Approve the extension of the existing interim asset allocation targets for use from January 1, 2013 to June 30, 2014 as outlined in Attachment 1.

EXECUTIVE SUMMARY

The CalPERS Investment Committee (IC) adopted new strategic asset allocation targets in December 2010 after the 2010 Asset Liability Management (ALM) workshop. The new Policy Targets shifted 3% weight from Global Fixed Income to Real Assets. Due to the illiquidity of investments in Real Assets, interim asset allocation targets were approved for the period from July 1, 2011 to December 31, 2012 in August 2011. This time would enable Real Assets staff to prudently deploy the capital. Strategic Policy Targets were expected to become effective starting at calendar year 2013. However, given the market conditions, Asset Allocation staff recommends that interim asset allocation targets be extended until June 30, 2014 when IC adopts new strategic asset allocation targets after the 2013 ALM workshop.

STRATEGIC PLAN

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. Maintaining appropriate asset allocation targets is important as Investment Office staff work to achieve the System's investment objectives and enhance risk-adjusted returns for the Total Fund.

BACKGROUND

The IC conducts an in-depth Strategic Asset Allocation Decision Process every three years to review asset and liability management. These triennial processes culminate in the selection of a Policy Portfolio which is then used to guide and define the strategic asset allocation across the Total Fund.

Following the last Strategic Asset Allocation Decision Process conducted in November 2010, new asset allocation Policy Targets, ranges, and asset classifications, were adopted in December 2010.

A revised Statement of Investment Policy for Asset Allocation (Asset Allocation Policy) incorporating the new Policy Targets, ranges, and asset classifications, was approved by the Investment Committee in May 2011 and became effective July 1, 2011.

The newly adopted Policy Targets shifted our investments from relatively liquid public fixed income instruments to less liquid real assets, thus a transition period was needed to reach the Policy Targets. In August 2011, the Committee approved interim asset allocation targets for the period Q3 2011 to Q4 2012 (Attachment 2). It was expected then that Policy Targets would become effective starting at calendar year 2013.

As of June 30, 2013, we expect investments in Real Estate to be closer to existing interim targets than to Policy Targets. Since 2011, there has been a migration towards real assets among institutional investors increasing buyer interest in real estate. The market has not responded by increasing inventory of assets for sale. In addition, there have been few high quality large portfolios on the market and banks have been careful in selling non-performing properties. CalPERS partners have been exercising discipline in committing CalPERS capital in this environment. Staff is signing new partnerships in the Real Estate Strategic Portfolio. For the year ending June 30, 2012, staff closed seven new partnerships. For the year ending June 30, 2013, staff will close five new partnerships bringing the total active partnerships in the strategic portfolio to twelve.

BENEFITS/RISKS

Extending the current interim asset allocation targets would result in reduced costs and avoid disruptions in investment program management.

Applying the asset allocation Policy Targets at this time would introduce a large active tracking error and is not recommended.

ATTACHMENTS

Attachment 1 – Recommended Interim Asset Allocation Targets for 2013
Attachment 2 – Interim Asset Allocation Targets Approved in August 2011
Attachment 3 – Consultant Opinion Letter

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