Building the Future: The Business Case and Strategy Behind Emerging Manager Investing

CalPERS Board Education Series | July 2025

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Executive Summary

Background	• With a 30+ year legacy in emerging manager (EM) investing, CalPERS now concentrates exclusively on private markets strategies in this space.
	• Domestic Emerging Manager (DEM) I, II, and III are in the harvesting phase. TPG Next and GCM Elevate are in the investment period, with full deployment expected by Q2 2026 and Q4 2026, respectively.
	• Current EM Fund of Fund (FoF) Net Asset Value (NAV) is at $1.3B. Total EM NAV $6B* with 65 managers in line with our peers.
	• **Success Stories:**
	    • Private Equity (PE): Vista, Clearlake, Valor, Grain, Stellex, and Siris, and funds DEM II, DEM III and CCF I.
	    • Public Equity: Arrowstreet, Golden Capital, Stux, SourceCap / Hermes, Tobam and Huber.

Overview	• **SI Team Role:** Coordinate Emerging Manager Fund of Fund strategies across asset classes—covering manager outreach, reporting, and stakeholder engagement. Began co-monitoring EM Fund of Fund investments in Private Equity (DEM, Elevate and Next) in 2023.
	• **Recent Updates:**
	    • Conducted an in-depth review of the CalPERS Emerging Manager strategies by analyzing industry research alongside CalPERS' historical performance.
	    • Presented key observations to the Operating & Advisory Committee (March) and thereafter presented the research to each private asset classes.
	    • Co-hosted the Catalyst Conference with 600+ attendees and expert-led panels, offering a unique opportunity to network and exchange ideas on cutting-edge industry topics.
	• **Challenges:** EM strategies face challenges including high resource needs, wide return dispersion, elevated costs, limited portfolio impact, and vulnerability to leadership turnover.

CalPERS FoF Performance	• **PE:** DEM II and DEM III have outperformed the PE policy benchmark and the asset class (3, 5 & 10 yr); however, prior, there was general EM under-performance. • **RE:** EM FoF performance in Real Estate has been mixed with some funds significantly underperforming. • TPG Next and GCM Elevate are still early in their investment periods and remain deep in the J-curve.
Research	• Third party data shows EMs can outperform established managers across private markets. This aligns with our recent performance in PE. • EMs are well-positioned to capitalize on inefficiencies in less crowded markets (Lower Middle Market and/or Middle Market) given less competition and better exit opportunities. • EMs in private markets have shown a wider dispersion of returns but also higher median returns, placing a greater emphasis on manager selection.
Investment Approach	• Historically, CalPERS has utilized Fund of Funds strategies like DEMs & Canyon Catalyst strategies to gain exposure to emerging managers. • CalPERS introduced a seeding and staking strategy with TPG and GCM—enabling larger commitments across fewer managers compared to traditional FoF strategies. • PE has strategically shifted to the middle market, investing directly in emerging managers without intermediaries—deploying $4B, representing the majority of our EM NAV.

*Preliminary figures as of June 30, 2024

I. Emerging Manager Overview

Program History

CalPERS has had emerging manager programs for over 25 years and has committed $9.1B with EM Programmatic Structures (FoFs)

1996
Proposition 209 Passed

1999
CalPERS invests in Private Equity and Real Assets first-time funds

2000
Global Equity Emerging Manager Program established

2007
Absolute Return Strategies (ARS) Emerging Manager Program established.

Private Equity Emerging Manager Program established

2011
Senate Bill 294 Legislation Chaptered

2012
Legislative Emerging Manager Program Five-Year Plan established

Private Equity Emerging Manager Program restructured

Real Assets Emerging Manager Program formally established

2013
Global Equity Emerging Manager Program restructured

2014
ARS Program and Emerging Manager Program terminated

Private Equity allocation

2015
Global Equity Emerging Manager Program restructured

Transition Manager Program created

2017
Emerging/Transition Manager 2020 Plan established

Real Assets additional allocation & programmatic expansion

2018
Real Assets launched Transition Manager search

Final Annual Report to Legislature on Emerging Manager Five-Year Plan

2019
Global Equity Emerging Manager Program restructured

Private Equity allocation & programmatic changes

2020
Real Assets additional allocation & programmatic expansion

Real Assets Transition Manager Programs established with Meadow Capital

Global Equity & Private Equity Emerging Manager Program adjustments

2021
Emerging Manager Program ongoing evaluation

Assembly Bill 890 Legislation Passed

2023
CalPERS commits $1B – MOSAIC

CalPERS terminates Global Equity EM Program

2025
EM Strategy Update

SI efforts to support investing with Emerging Managers

Different Workstreams that fall under Emerging Managers

Research and Reporting

- Analyzing Third Party EM Data
- Board Presentations
- Legislative (Reports, Info requests)

Initiatives and Engagement

- Internal Stakeholder (PAOF, LAD, Asset Classes – PE,RA,PD)
- External Stakeholder Engagement
- Conference Participation & Hosting (Catalyst)
- Partnership Insights Survey (Lenox Park External Manager Survey)
- New Manager Meetings & Screening (>200/yr.)

SI Collaboration

- Tracking FoFs Active Pipeline and Referrals
- Co-monitoring FoFs (TPG Next, GCM Elevate - & DEM I, II, III)
- Establish relationships with underlying managers
- Collaboration with private asset classes through direct referrals.

Ad-hoc requests

II. CalPERS Performance

Private Equity Current EM Performance (Net of fees)

- The below table compares Private Equity program return vs Private Equity policy benchmark; and Current EM Fund of Fund Performance vs Private Equity policy benchmark.
- Recent performance (DEM II, III) aligns with external research indicating that EMs can outperform the benchmark (net of fees), while other funds have underperformed. It's too early to draw conclusions on GCM Grosvenor Elevate (or TPG Next).

EM FoFs vs. PE ex. EM - Performance Summary (as of 12/31/24) - (Net of Fees)

Emerging Manager	Ending Asset Value ($ mm)	10 - Yr Net Return (%)	10 - Yr Excess (bps)	5 - Yr Net Return (%)	5 - Yr Excess (bps)	3 - Yr Net Return (%)	3 - Yr Excess (bps)	1 - Yr Net Return (%)	1 - Yr Excess (bps)
Private Equity	**$89,031**	**11.1**	**(109)**	**13.3**	**(88)**	**6.0**	**(374)**	**11.9**	**(2,178)**
Private Equity ex. Emerging Managers	**$81,572**	**11.2**	**(101)**	**13.2**	**(93)**	**5.7**	**(398)**	**11.4**	**(2,226)**
Capital Link I	$38	3.4	(877)	3.1	(1,107)	(5.3)	(1,497)	5.0	(2,870)
Capital Link II	$13	12.1	(7)	12.5	(167)	9.7	(4)	55.7	(2,200)
Capital Link	**$51**	**6.6**	**(556)**	**5.6**	**(854)**	**(1.5)**	**(1,121)**	**14.2**	**(1,947)**
GCM Grosvenor DEM I	$34	8.2	(394)	7.5	(667)	4.2	(548)	(4.5)	(3,813)
GCM Grosvenor DEM II	$198	12.5	31	17.0	283	10.4	70	4.4	(2,931)
GCM Grosvenor DEM III	$656			18.2	406	22.9	1,320	12.8	(2,084)
DEM I, II, and III	**$887**	**13.0**	**76**	**18.5**	**438**	**17.5**	**783**	**10.0**	**(2,369)**
GCM Grosvenor Elevate	*$61*							*(33.3)*	*(6,697)*

Legend: Red/Green: Underperformance/Outperformance compared to policy benchmark; Red with Blue Shading – underperformance compared to policy benchmark but outperformed PE asset class.

Real Estate Current EM Performance (Net of fees)

- The below table compares Real Estate program return vs Real Estate policy benchmark; and Current Emerging Manager Fund of Funds vs Real Estate policy benchmark.
- The Canyon Catalyst Fund (CCF) strategy has largely underperformed, with some positive performance. Following the success of Canyon Catalyst Fund (CCF) I (15.86%), CCF II underperformed, and early projections for CCF III returns are trending closer to target.

EM FoFs vs. RE ex. EM - Performance Summary (as of 12/31/24)

Emerging Manager	Ending Asset Value ($ mm)	10 - Yr Net Return (%)	10 - Yr Excess (bps)	5 - Yr Net Return (%)	5 - Yr Excess (bps)	3 - Yr Net Return (%)	3 - Yr Excess (bps)	1 - Yr Net Return (%)	1 - Yr Excess (bps)
Real Estate	**$50,065**	**4.9**	**(25)**	**1.9**	**(17)**	**(2.0)**	**(97)**	**(6.3)**	**164**
Real Estate ex. Emerging Managers	**$49,578**			**1.9**	**(9)**	**(1.9)**	**(86)**	**(6.2)**	**171**
CCF II INDUSTRIAL	$2					(17.6)	(1,662)	25.0	3,295
CCF III INDUSTRIAL	$184					12.6	1,355	(3.2)	475
Canyon Catalyst Fund II	$102			(15.0)	(1,702)	(28.4)	(2,738)	(10.9)	(301)
Canyon Catalyst Fund III	$200					(11.2)	(1,022)	(21.6)	(1,372)
Canyon	**$487**			**(3.9)**	**(593)**	**(10.5)**	**(948)**	**(12.6)**	**(472)**

Incept Date	End Date	Name	Return (%)
Jul-2013	Nov-2017	Canyon Catalyst Fund I	15.86

Legend: Red/Green: Underperformance/Outperformance compared to policy benchmark.

Challenges and Lessons Learned of Investing with Emerging Managers

- **Resource Constraints:** The global universe of emerging managers is larger than that of mature managers and continues to grow with evolving opportunities.
  - **Mitigant:** SI brings substantial resources and deep sector experience needed to manage direct (non-intermediary) and/or outsourced implementation approach.

- **Wider Dispersion:** Wider dispersion of returns among emerging managers increases the potential for both outperformance and underperformance.
  - **Mitigant:** Return dispersion underscores the importance of manager selection—as reflected in our Private Equity track record.

- **Cost:** CalPERS leverages external advisors to source, mentor, and develop emerging managers—resulting in variable costs and relatively higher base fees on a NAV basis compared to broader asset class costs.
  - **Mitigant:** Utilizing both "direct" investments and Seeding & Staking strategies can provide preferential economics.

- **Negligible Impact:** EM strategies represent a small share of the Total Portfolio and may have a negligible impact on overall performance.
  - **Mitigant:** Emerging managers not only have the potential to outperform, but also bring innovative strategies, portfolio diversification, and a pipeline of next-generation investment talent.

- **Difficult to Assess:** Investing with emerging managers requires a higher degree of subjectivity and judgment
  - **Mitigant:** EMs require more qualitative assessment – increasing difficulty in selection and emphasizing manager selection and ongoing monitoring.

III. Research

Research Summary

- Research shows that emerging managers have often outperformed larger firms by focusing on smaller, more specialized investments, in less crowded parts of the market.
  - This aligns with our recent fund of fund performance in Private Equity (DEM II, DEM III).

- While EMs exhibit greater return dispersion, they also achieve higher median returns across all private market Asset Classes, making manager selection critical.

- Limited Partners are putting more money into large investment firms, which makes the bigger end of the market more crowded. This opens up better opportunities in the smaller end of the market, where there is less competition, and smaller funds tend to operate.

- Research further highlights that smaller and mid-sized investment opportunities often cost less to buy, making them potentially more attractive in private equity, real estate, and infrastructure.

- Smaller investment funds (under $500 million) are more likely to be top performers than larger funds (over $2 billion). First-time and early-stage managers perform even better on average than small funds.
  - Historical data shows, Private Equity and infrastructure EMs have a higher proportion of top-quartile managers compared to non-EM funds

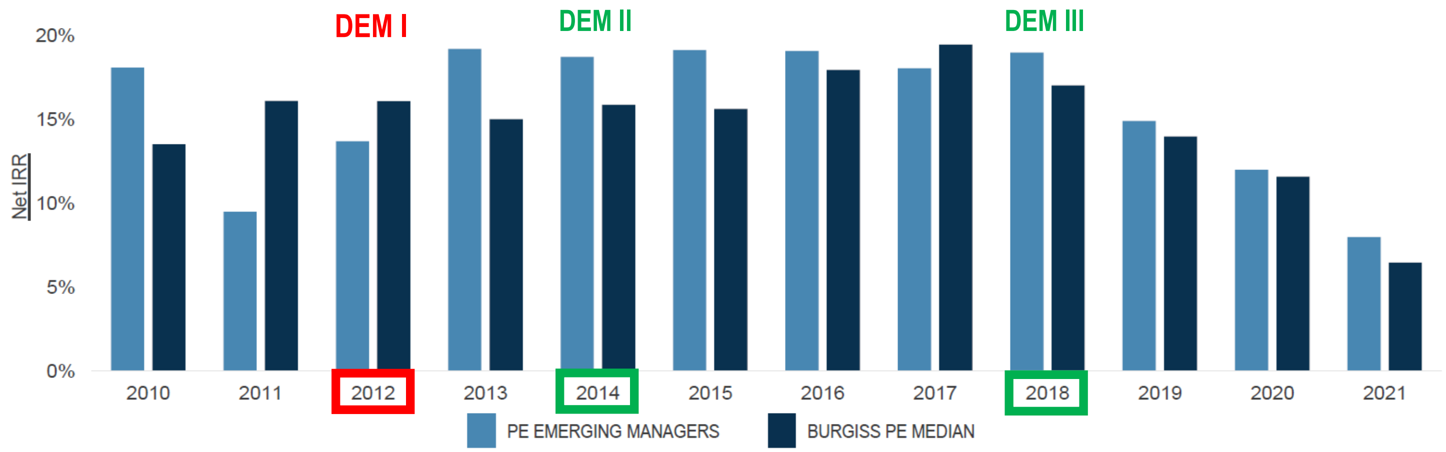
Please note: The data set is based on “private market” data, and hence significantly harder to access than public markets information. The data does have some limitations; however, we have worked with the data providers to close any data gaps as much as possible (including size bias).

Historical Performance – EM vs Burgiss Median

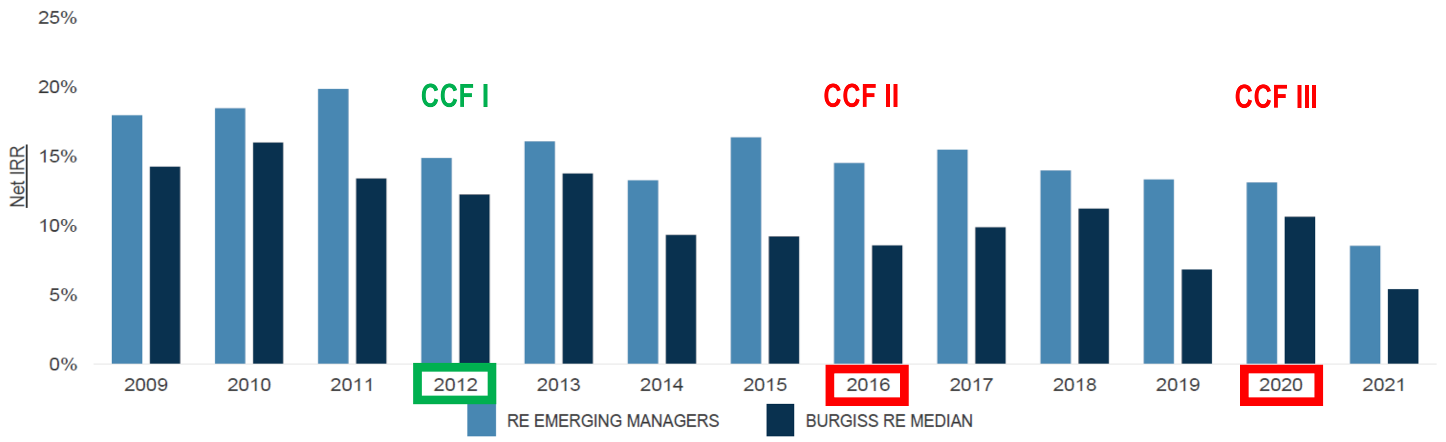
Emerging Private Equity Managers have consistently outperformed the Burgiss PE Median, 9 out of 12 years.

Emerging Real Estate Managers have consistently outperformed Burgiss RE Median, 13 out of 13 years.

Private Equity EM Performance VS. Benchmark



Real Estate EM VS. Benchmark

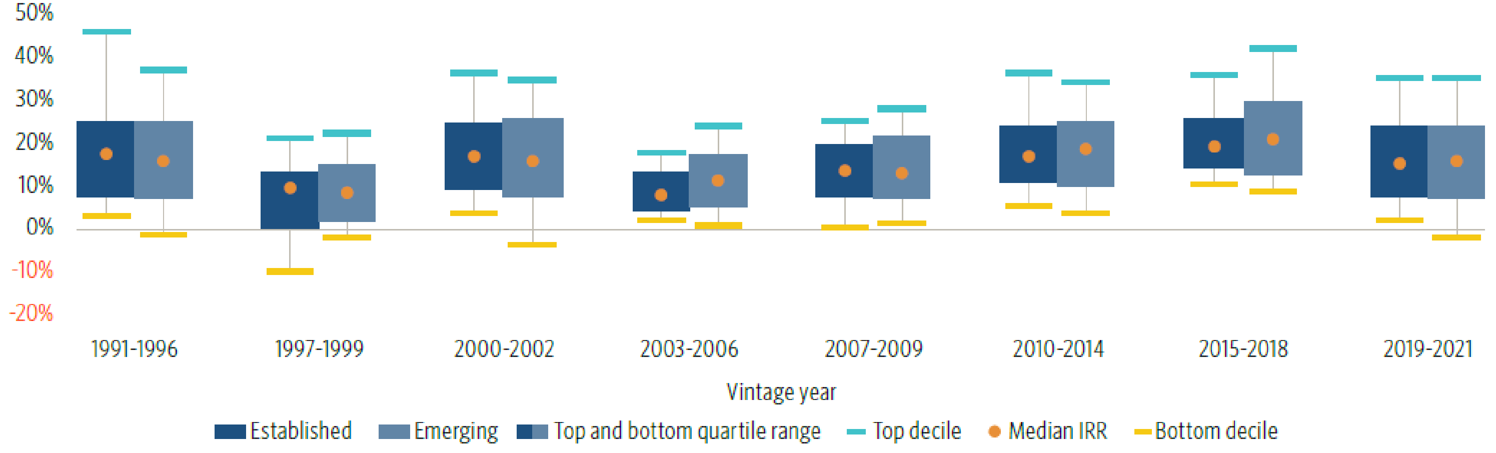


Sources: Preqin (as of Oct. 2024), BURGISS (as of June 2024 and downloaded Oct. 2024). This chart is taken from GCM Grosvenor Report.

Wider Dispersion but Higer Median Returns

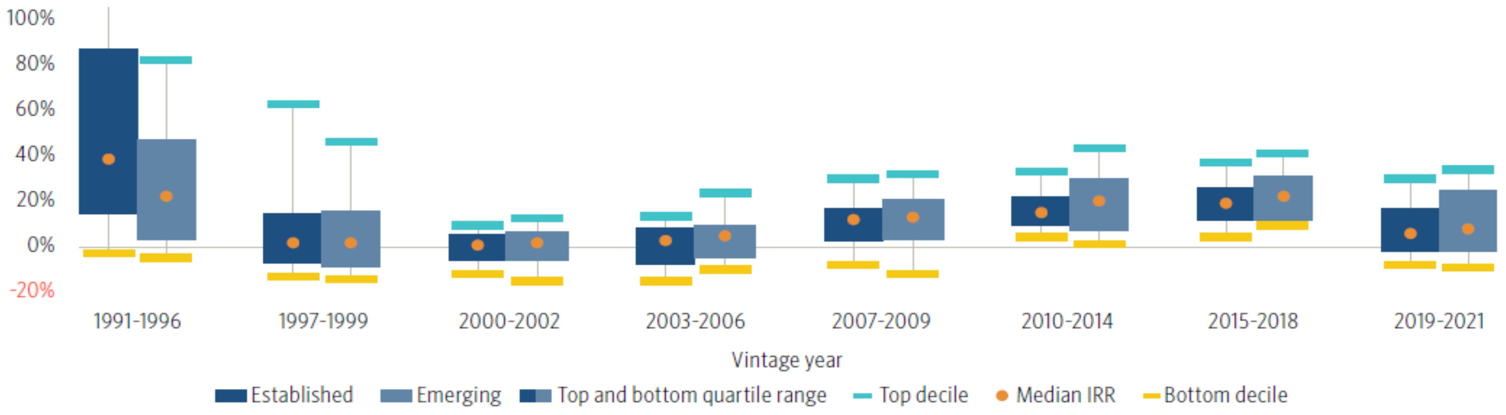
PE Buyouts – EMs show higher dispersion but have consistently generated higher median returns compared to established managers, making manager selection critical.

PE Buyout Net IRR Dispersion by Vintage year (1991-2021)



PE Venture Capital, EMs have consistently outperformed since the late 1990s. However, returns from emerging VC managers are similarly more volatile than their established peers.

VC Funds Net IRR Dispersion by Vintage Year (1991-2021)



*Vintage year buckets are created mostly by macroeconomic conditions & events

Source: Pitchbook (2024, reflecting data as of 3Q23**). VC Note:** The top decile for established managers in the 1991-1996 vintage cohort is 129.0%. This chart is taken from Pitchbook report.

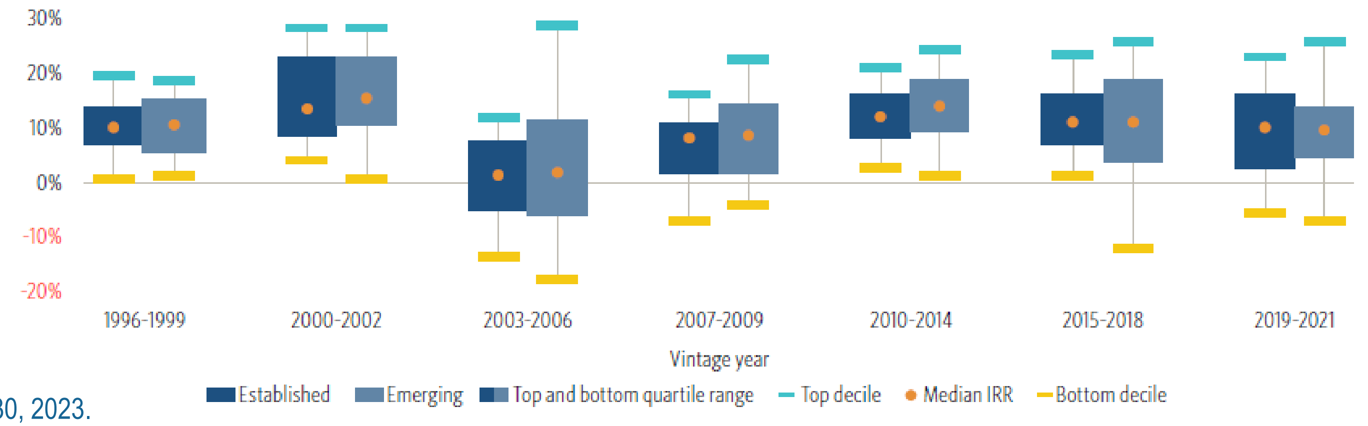
Wider Dispersion but Higer Median Returns – 2

Similar trends exist in Private Credit as EMs have higher median IRR in recent vintages.

Private Credit Fund Net IRR Dispersion by Vintage Year (1996-2021)

Similar trends in Real Estate.

Real Estate fund Net IRR Dispersion by Vintage Year (1996-2021)



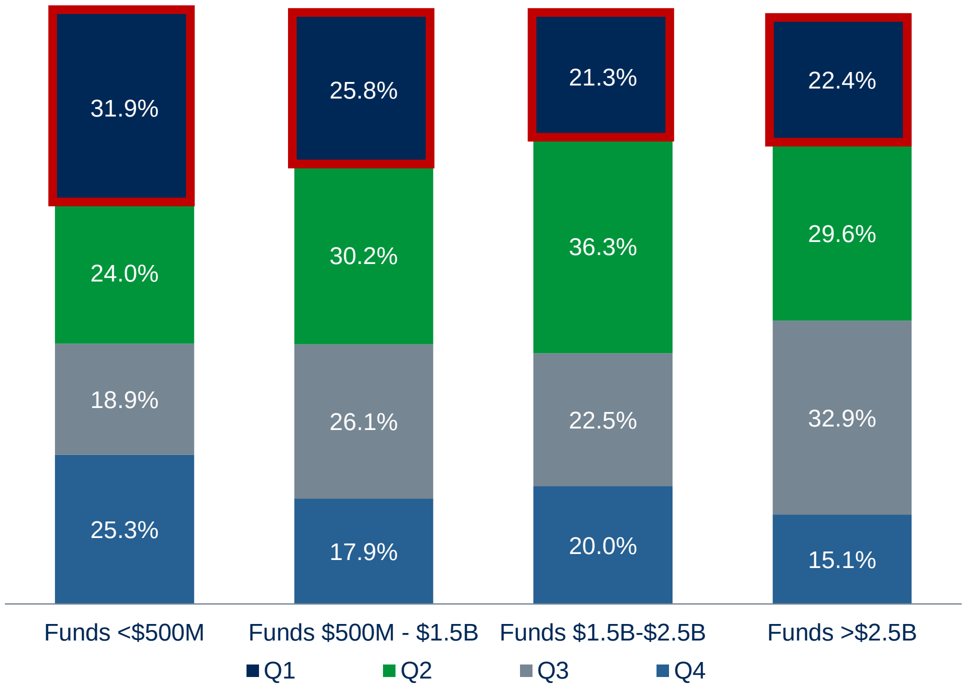
Source: Pitchbook • Geography: US. This is taken from Pitchbook Report. As of September 30, 2023.

Where is the opportunity? Smaller funds < $500M

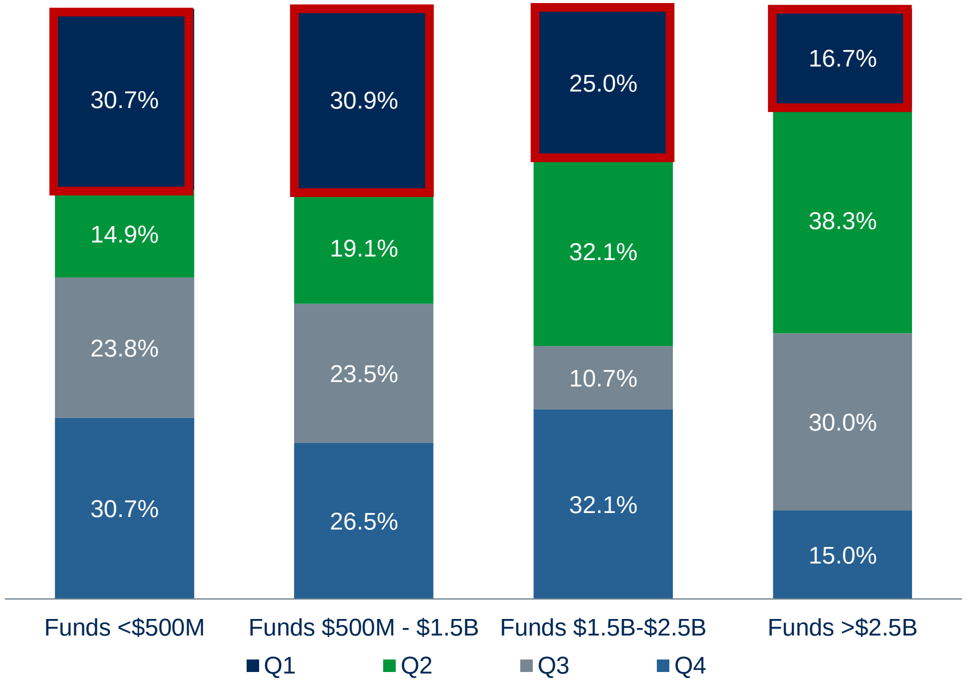
- Research shows that in PE and infrastructure funds < 500M have higher percentage of top quartile managers. However, as these funds grow larger and more established, performance gravitate toward second or third quartile.

- These funds operate in LMM and/or MM where they invest in less efficient (*more specialized / niche*) corners of the markets where the size of large funds often precludes their ability to participate.

Quartile Performance Distribution by Fund Size
Private Equity, Fund Vintage Years 2004–2021, Global



Quartile Performance Distribution by Fund Size
All Infrastructure, Fund Vintage Years 2004–2021, Global



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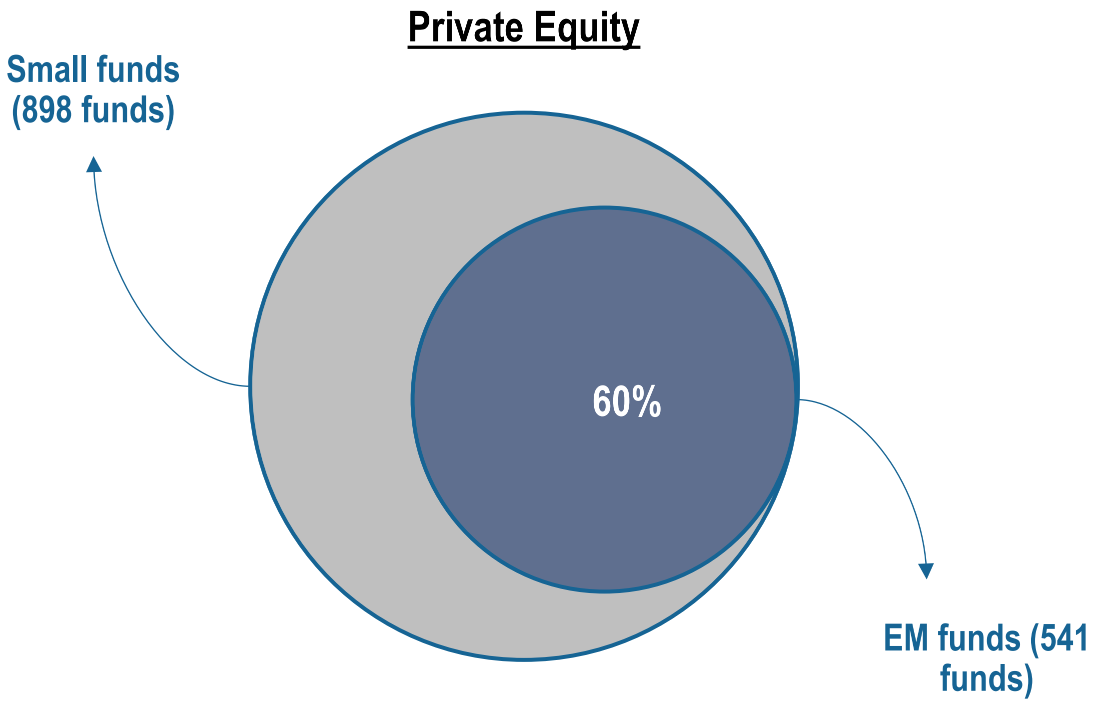
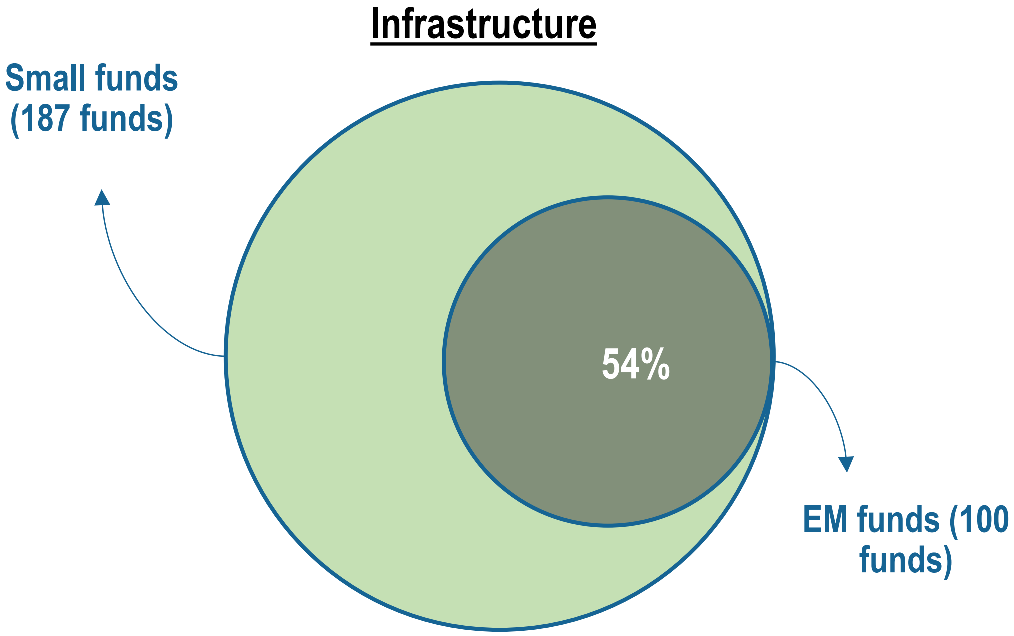
Source: Private Equity: Barings and Pitchbook. As of March 1, 2023. Data set includes primary funds (i) employing buyout, growth, diversified private equity and turnaround/distressed strategies; (ii) with vintages between 2004 and 2019; and (iii) domiciled in the United States. Funds must have performance data and fund size to be considered. Sample set includes 1,047 funds. **Infrastructure:** Barings, Pitchbook. As of March 1, 2024. Data set includes primary funds (i) employing infrastructure strategies, (ii) with vintages between 2004 and 2021, and (iii) domiciled globally. Funds must have performance data and fund size to be considered.

Significant Overall between small and emerging managers

- In previous slide, research indicated that PE and infrastructure funds < 500M have a higher percentage of 1st quartile managers. Therefore, we could explore ways to increase our allocation to small managers.
- Data shows a decent degree of overlap between small and emerging managers. Generally early-stage funds are smaller in size and target smaller companies to get appropriate amount of diversification in their portfolio.



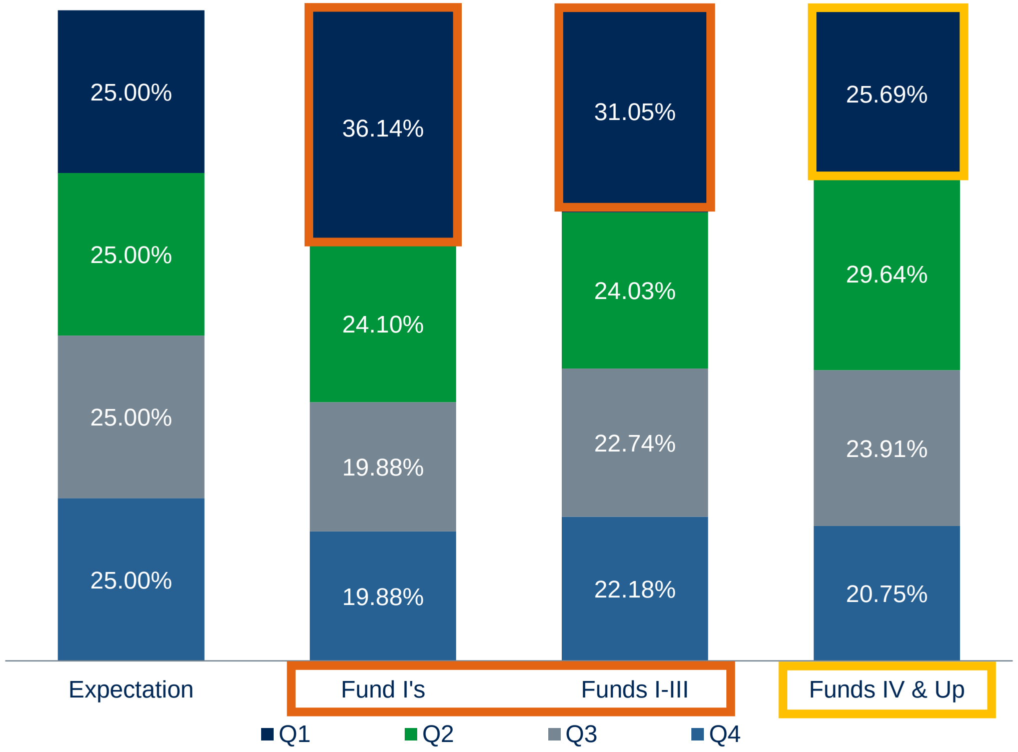


Definition: Small managers – Funds<$2B, with no limit on the fund number
Exceptions 1: small managers >fund III. Exception 2: There could be some EMs that are targeting upper/Large cap market with the help of large amount of co-investments from LPs

EMs have outperformed established PE managers

Data suggests EMs have an even higher percentage of top quartile managers compared to established managers (non-EMs) irrespective of their size – large or small.

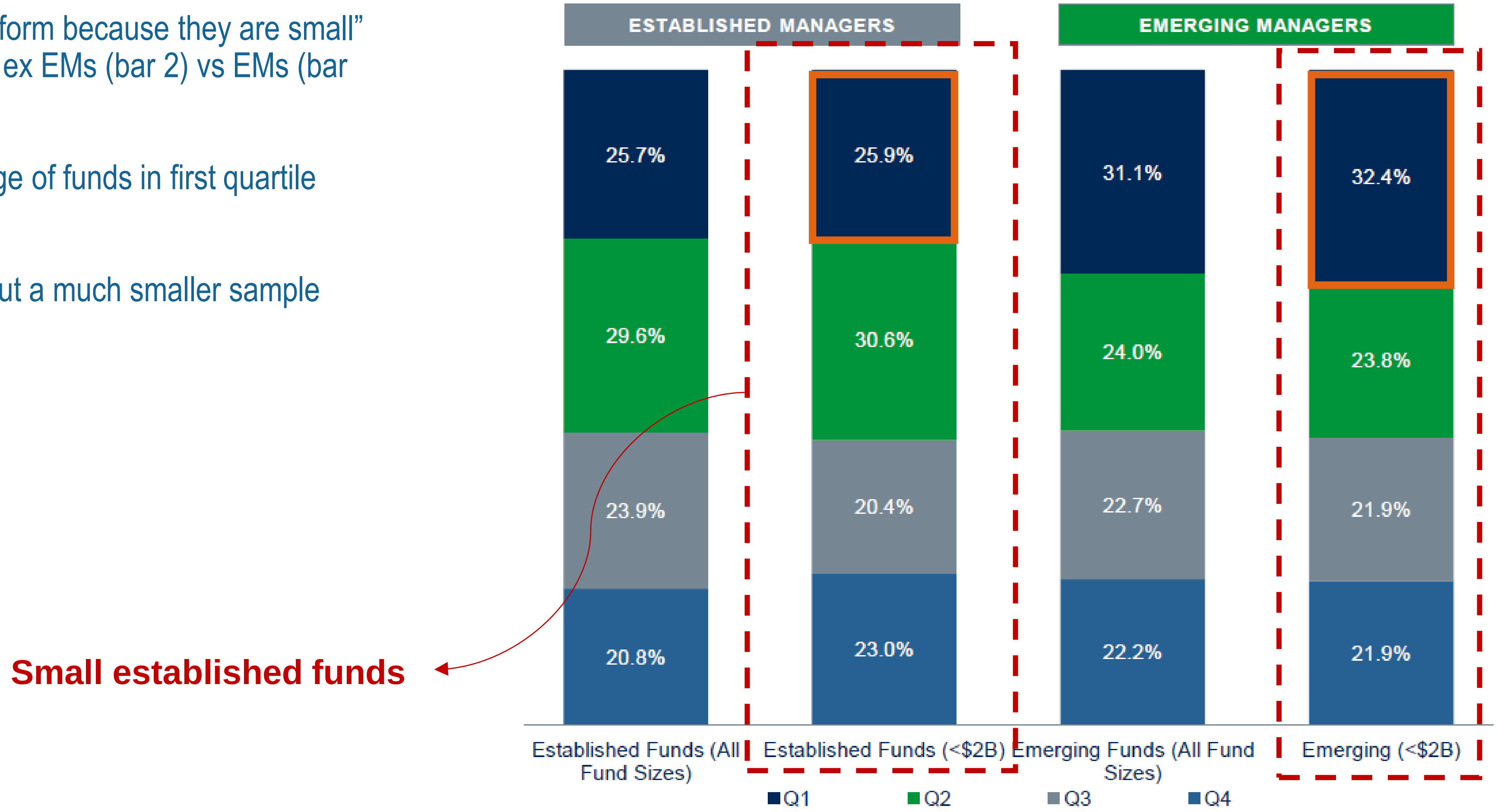
Quartile Performance Distribution **by Fund Number**
Private Equity, Fund Vintage Years 2004–2021, Global



Source: Private Equity: Barings and Pitchbook. As of March 1, 2023. Data set includes primary funds (i) employing buyout, growth, diversified private equity and turnaround/distressed strategies; (ii) with vintages between 2004 and 2019; and (iii) domiciled in the United States. Funds must have performance data and fund size to be considered. Sample set includes 1,047 funds.

EMs have outperformed small, established PE managers ex EM

- To address the size bias – "EM outperform because they are small" we compared small established funds ex EMs (bar 2) vs EMs (bar 4).
- EMs shows an even greater percentage of funds in first quartile compared to small established funds.
- Similar trends exist in Infrastructure, but a much smaller sample size.



Bar 2 – Small established funds (<$2B and >=Fund IV)
Bar 4 – Emerging funds (<$2B and <=Fund III)

Source: Private Equity: Barings and Pitchbook. As of March 1, 2023. Data set includes primary funds (i) employing buyout, growth, diversified private equity and turnaround/distressed strategies; (ii) with vintages between 2004 and 2019; and (iii) domiciled in the United States. Funds must have performance data and fund size to be considered. Sample set includes 1,047 funds.

IV. Investment Approach

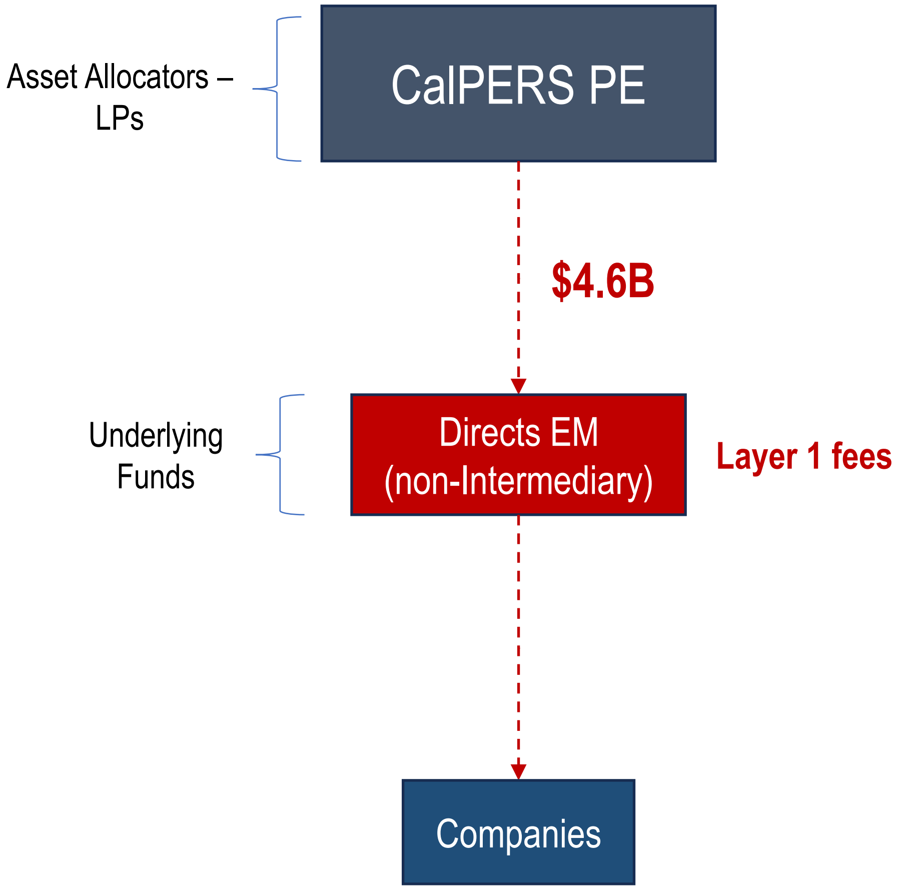
How CalPERS invest in Emerging Managers?

- Directs (Non-intermediary)
- GP Seeding/Staking
- Fund of Funds

How are "Directs" structured?

CalPERS' Private Equity team commits capital directly to underlying funds (as shown in red), bypassing the FoF structure.

This approach reduces fees and allows the team to focus resources on larger, more meaningful commitments.



<u>Private Equity EM Observations</u>

- **Strategic Shift to Middle Market, Growth and Venture Capital:** Moved away from large buyouts to access undercapitalized, less efficient market segments with higher alpha potential—where large funds typically can't participate.
- **Manager Selection is Critical:** Targeted funds offer higher median returns but come with greater return dispersion; many emerging and diverse managers operate in these niche strategies.

Difference between FoFs, GP Seeding & Staking

	GP Seeding & Staking	Fund of Funds (FoFs)
Overview	Provides early capital and support to launch new GPs (Fund I–III) in exchange for a share in their economics, along with the option to acquire a minority equity stake in the management company for long-term upside.	The FoF raises capital from LPs and invests that capital into a portfolio of underlying funds. Those underlying funds, each managed by their own fund managers, deploy capital into their respective portfolio companies or assets.
Use of Proceeds	• Provide GP's management company working capital to fund operations, help build infrastructure, reserves for co-investments and to anchor commitment to Fund I • GP's management company (equity stake only)	Underlying GPs' funds (as a LP)
Pros	• Preferential economics (access to steady fee & carry income) • Strategic influence • Capacity in future funds • Long-term exposure to franchise value • Fewer, larger allocations to select GPs, enabling greater impact at the portfolio level.	• Diversification • Extension of staff • Smaller bite size deals allowing for more commitments in smaller funds managers.
Cons	• High failure risk • Dependent on GP's success • Long lock-in periods • Complex structuring	• Double layer of fees and carry • Scaling issues • Negligible impact on the main portfolio.

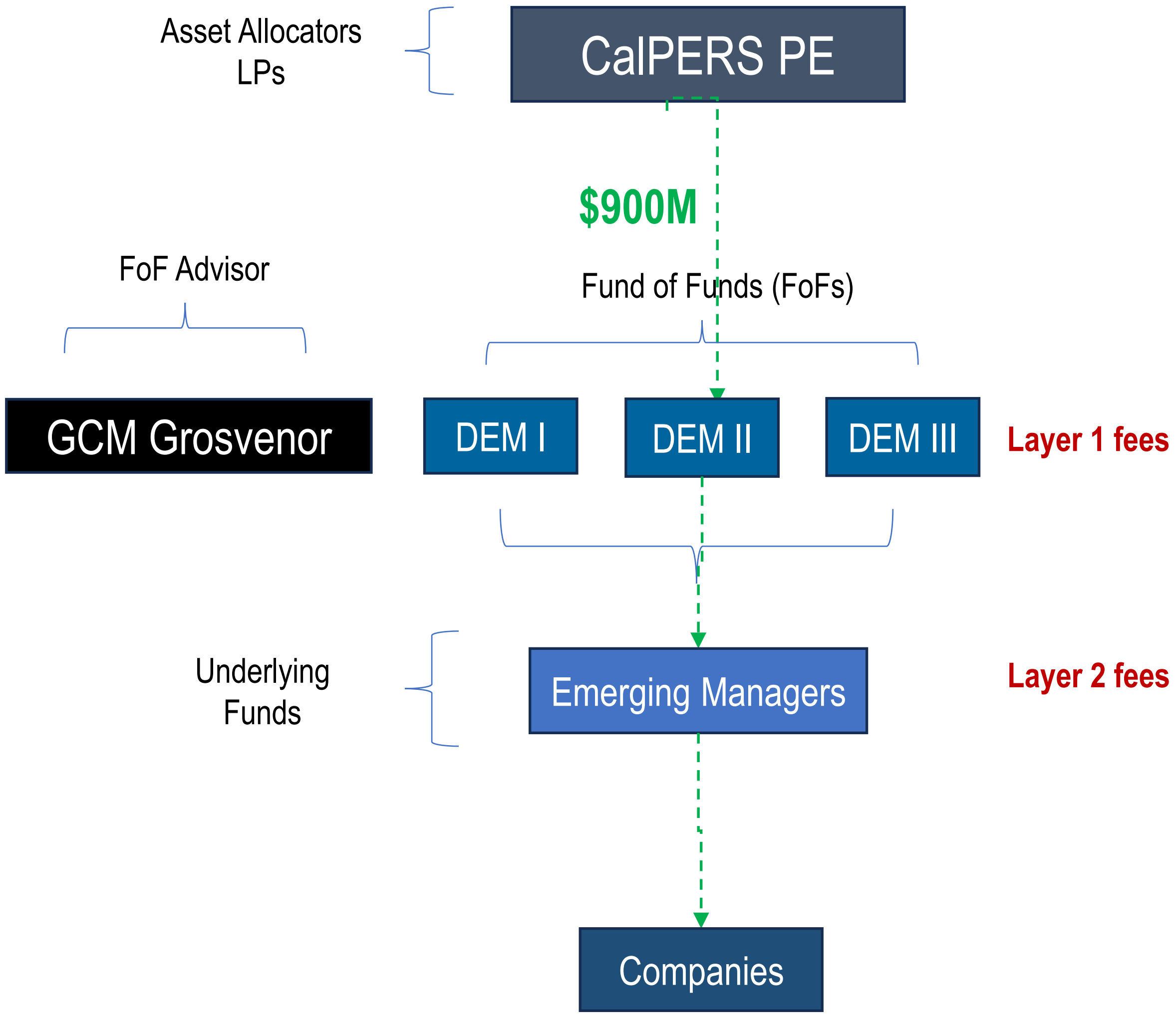
How are FoFs structured?

- **Engage:** Asset allocators like CalPERS engage fund-of-funds advisors—such as GCM in our case—to access specialized strategies within asset classes that focus on investing in emerging managers.

- **Investment Flow:** CalPERS commits capital to GCM-managed fund-of-funds vehicles (DEM I, II, and III), which in turn invest in underlying funds managed by emerging managers.

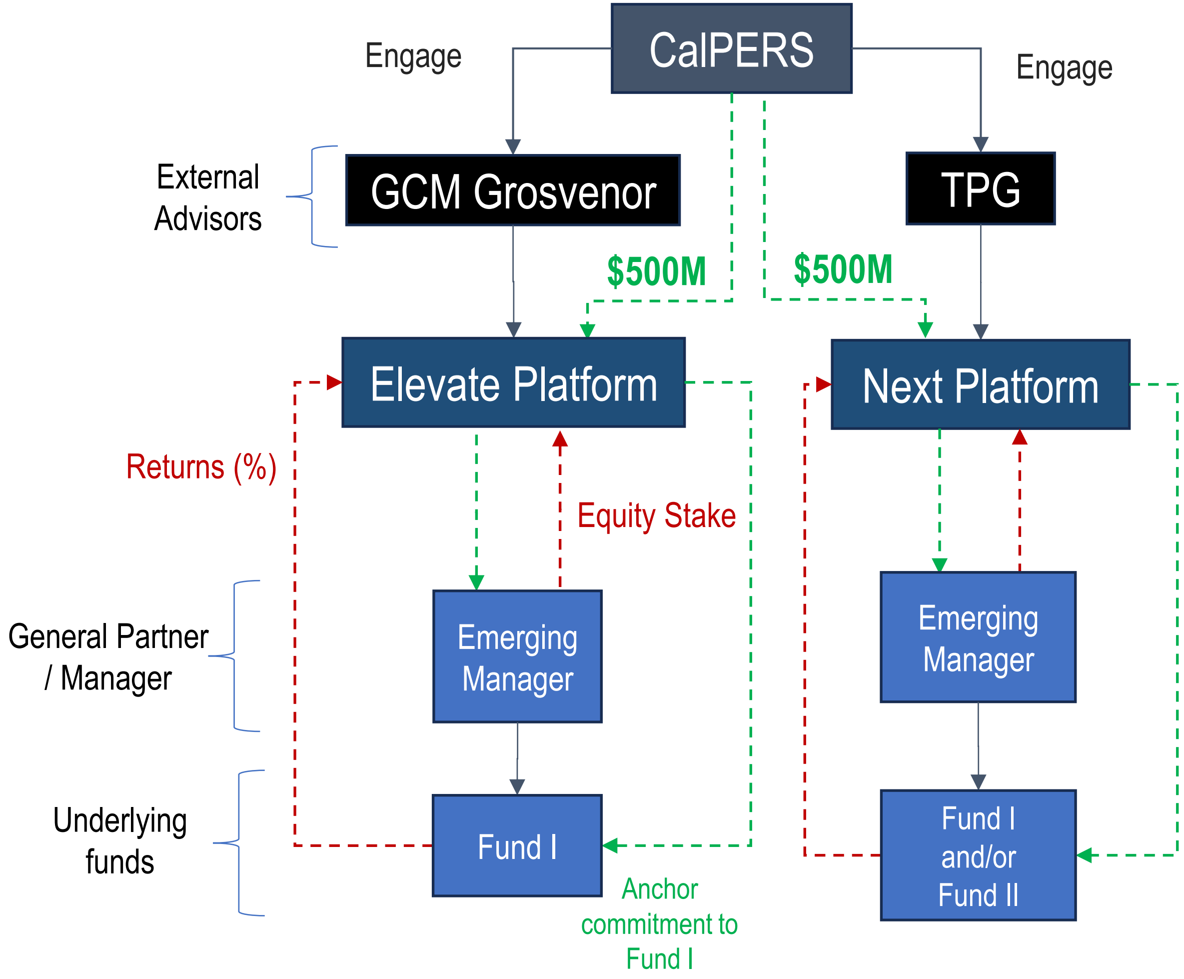
- **Benefit:** This structure has allowed CalPERS to make smaller, bite-sized commitments across a broader set of managers—particularly where direct commitments by internal teams may not be feasible due to limited portfolio impact.
    - It creates a pathway for high-potential, smaller managers to scale and eventually graduate into the main portfolio.

- **Costs:** While effective for access and diversification, this structure introduces a second layer of fees—not a full "2 & 20" twice, but still meaningfully higher than direct commitments.



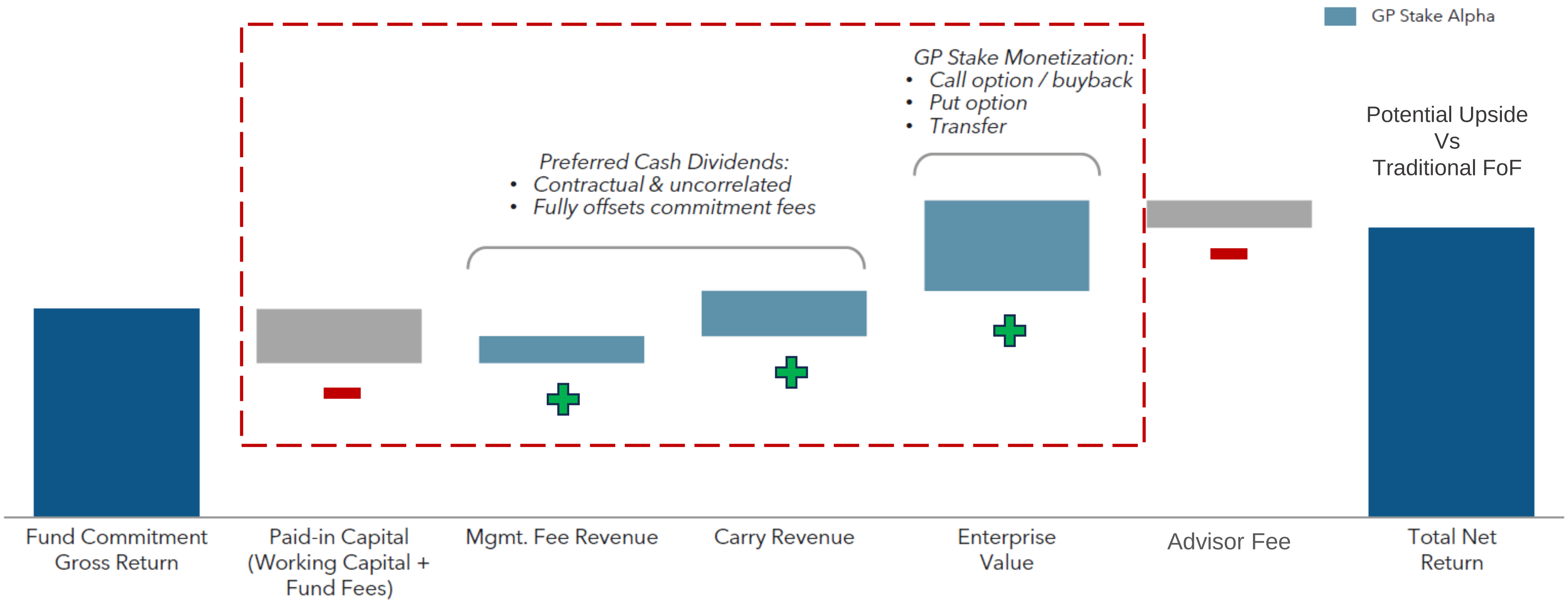
How are GP Seeding and Staking structured?

- **Engage:** Asset allocators like CalPERS engage external advisors—such as GCM Grosvenor (Elevate platform) and TPG (Next platform)—to gain exposure to emerging managers through seeding and staking strategies.
- **Investment Flow:** CalPERS commits capital to GCM and TPG-managed platforms, which in turn use the funds to seed and/or purchase equity stakes in the underlying GPs' management company, in exchange for a share of GP economics (management fees and carry).
- **Benefit:** This structure requires larger, more meaningful commitments across a fewer set of managers.
    - **Seeding** offers early access to rising GPs, with preferential economics and future capacity.
    - **Staking** provides long-term exposure to GP franchise value and diversified revenue streams (fees and carry).
- **Costs:** These are illiquid, passive investments with long lock-in periods, making outcomes highly dependent on the overall success of the GP—not just a specific fund.



Fee difference between Seeding/Staking Vs FoFs

Seeding / Staking allows for three additional sources of potential revenue streams in exchange for working capital.



Next Steps

- PE will continue with its strategy to invest with emerging managers on a direct basis. PE will consider additional intermediated strategies after GCM Elevate and TPG Next commitments are fully deployed.
    - Discussions with SI regarding evaluation of external partners to select emerging managers will begin in 2026.

- INVO is actively exploring ways to expand emerging manager investments, similar to our approach in Private Equity, across all private asset classes.
    - The effort will be designed to work within the Total Portfolio Approach, ensuring that emerging manager investments are aligned with our broader risk, return, and diversification objectives across the Total Fund.

- SI is collaborating with the private asset classes to evaluate the cost-benefit of adding internal staff versus relying on fund of fund strategies to support smaller-scale emerging manager commitments.
    - We expect to have an analysis with a recommendation on our approach.

- SI will continue to lead CalPERS Emerging Manager strategy across the private asset classes, supporting implementation through research, engagement, and manager evaluation.
    - In November SI will have an update on our latest FY commitments to emerging and diverse managers with our AB 890 Report, as well as an update on the Lenox Park Partnership Insights Survey.