CalPERS

Investment Committee

California Public Employees' Retirement System

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

BEN MENG
Senior Portfolio Manager
Asset Allocation

JOSEPH A. DEAR
Chief Investment Officer

Recommended Interim Asset Allocation Targets from January 1, 2013 to June 30, 2014

	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Policy Targets
Asset Classes							
Global Equity	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	49.0%
Private Equity	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%
Growth	64.0%	64.0%	64.0%	64.0%	64.0%	64.0%	63.0%
Income	17.0%	17.0%	17.0%	17.0%	17.0%	17.0%	16.0%
Infrastructure/Forestland	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%
Real Estate	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	10.0%
Real Assets	11.0%	11.0%	11.0%	11.0%	11.0%	11.0%	13.0%
Inflation	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Cash/Liquidity	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Interim Asset Allocation Targets Approved in August 2011

Asset Classes	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	Policy Targets
Global Equity	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	49.0%
Private Equity	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%	14.0%
Growth	64.0%	64.0%	64.0%	64.0%	64.0%	64.0%	63.0%
Income	19.0%	18.0%	17.0%	17.0%	17.0%	17.0%	16.0%
Infrastructure/Forestland	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%
Real Estate	8.0%	8.0%	9.0%	9.0%	9.0%	9.0%	10.0%
Real Assets	10.0%	10.0%	11.0%	11.0%	11.0%	11.0%	13.0%
Inflation	3.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Cash/Liquidity	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Michael C. Schlachter, CFA
Managing Director & Principal

January 28, 2013

Mr. Henry Jones
Chair, Investment Committee
California Public Employees' Retirement System
400 Q Street
Sacramento, CA 95814

Re: Interim PERF Asset Allocation Targets

You requested our opinion regarding the agenda item from Staff concerning the interim asset allocation targets.

Recommendation

Wilshire recommends that the Investment Committee approve the extension of the existing interim asset allocation targets, for use January 1, 2013 to June 30, 2014, as presented by Staff.

Discussion

Given the dislocation in the Real Estate market since 2007-2008 crisis, as well as the impact of significant demand for real estate by institutional investors on pricing for transactions, Staff has been unable to invest CalPERS' assets in accordance with the policy asset allocation targets since 2010 and has used interim asset allocation targets that more closely match the actual investment amounts. This has reduced the amount of tracking risk in the PERF that would result from the asset allocation mismatch.

Given that it is highly unlikely that Staff will be able to reach the policy targets in the next few quarters, we support Staff's request to continue to use the interim targets until a new policy target is selected at the Asset Allocation workshop this fall.

As we move through the asset allocation process in 2013, we furthermore recommend that the Investment Committee discuss the slow pace of Real Estate and Infrastructure investing with Staff and the potential for greater exposure over the next few years. If the inability to invest in Real Estate in the size required continues, this should be considered by the Investment Committee when selecting the new policy targets. It may be appropriate to make the interim targets permanent or even reduce the target allocation to Real Estate in recognition of market reality.

Should you require anything further or have any questions, please do not hesitate to contact us.

Best regards,