Investment Committee

Agenda Item 7a

September 13, 2021

Item Name: Asset Liability Management: Adoption of Capital Market Assumptions

Program: Trust Level Portfolio Management and Implementation

Item Type: Action

Recommendation

For use in the 2021-22 ALM process, adopt the proposed baseline economic scenario CMAs, which include:

1. Projected returns, 5 years and 20 years
2. Projected volatility, 20 years
3. Asset class correlations, 20 years

Executive Summary

This agenda item puts forth for adoption the CMAs to be used in the CalPERS 2021-22 ALM process for the Public Employees' Retirement Fund. The CMAs have been developed from survey data for a baseline economic scenario and have been reviewed by the Investment Office to help ensure that the expected returns are appropriate for our asset classes and strategies. Economic scenarios (baseline, upside, downside) have been used with the CMAs to assess portfolios to understand a range of possible outcomes. This item includes supplementary information in the appendix about the economic scenarios and the CMAs associated with the upside and downside economic scenarios. CMAs for the Affiliate Funds will be presented at a future meeting.

Strategic Plan

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. This item provides information regarding the capital market assumptions, which are foundational to the ALM process, and supports the CalPERS Investment Committee in their oversight capacity.

Investment Beliefs

This agenda item supports CalPERS' Investment Belief 2: A long term investment horizon is a responsibility and an advantage and Belief 6: Strategic asset allocation is the dominant determinant of portfolio risk and return.

Background

CMAs for each asset class are critical inputs to the ALM process and have a direct impact on the portfolio allocation. Determining appropriate CMAs requires asset class expertise and an understanding of CalPERS' benchmarks and investment strategies. Given that there is uncertainty with CMAs, our process of surveying consultants and asset managers and reviewing the results with our research team and each asset class within Investment Office is intended to capture as much information as possible.

The CMAs are presented for 5 years and 20 years to incorporate both a long-term and near-term view of the market. While longer views are relevant to the discount rate, the near-term economic and market environment can be impactful. Assessing both timeframes for CMAs in constructing portfolios incorporates this dynamic.

To understand a range of possible outcomes when assessing portfolios, an upside and downside economic scenario are applied to the CMAs. This helps to evaluate possible portfolio performance in different economic and market environments, in addition to the baseline economic scenario.

Analysis

Not Applicable.

Budget and Fiscal Impacts

Not Applicable.

Benefits and Risks

CMAs are the essential inputs and starting points of the ALM process. The benefit of adopting the CMAs is that it allows the process to proceed with the evaluation of candidate portfolios. A risk of adopting the CMAs is that they are inherently uncertain and need to be evaluated with an understanding that they are not precision estimates. The risk of non-adoption would be more time and effort spent without a clear target for improvement.

Attachments

Attachment 1 – Asset Liability Management – Adoption of Capital Market Assumptions

Attachment 2 – Wilshire Opinion Letter

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