



## Investment Committee

# Agenda Item 8a

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**September 13, 2021**

**Item Name:** Asset Liability Management: Discussion of Candidate Portfolios

**Program:** Trust Level Portfolio Management and Implementation

**Item Type:** Information

### **Executive Summary**

This Agenda item presents several sample Candidate Portfolios for the Public Employees' Retirement Fund. The Candidate Portfolios have been designed to align with CalPERS objectives of minimizing costs, maximizing projected returns, minimizing potential losses, and maintaining sufficient levels of liquidity.

To compare and contrast the Candidate Portfolios, this item includes information about portfolio risk and return, discount rates, employer contribution rates and funding ratio risk, as well as pros and cons to consider for each portfolio. Also included are portfolio tests that measure portfolio performance in a variety of economic and market scenarios and several actuarial analyses for a sampling of employer plans representing high, medium, and low funded statuses.

The discussion and feedback on the sample Candidate Portfolios will be an important consideration in the evaluation of bringing back potential portfolios for adoption by the Board as a Policy Portfolio at the November 2021 Investment Committee meeting.

### **Strategic Plan**

This agenda item supports the CalPERS Strategic Plan goal to improve long-term pension and health benefit sustainability. As defined in CalPERS ALM policy, Asset Liability Management (ALM) is the process of balancing the expected cost of future pension payments with the expected future investment returns. Presenting and discussing sample Candidate Portfolios is an important step in the process and feedback gathered will be an important input into the next step of presenting portfolios for consideration by the Board as a Policy Portfolio.

### **Investment Beliefs**

This agenda item supports the following CalPERS Investment Beliefs:

- Investment Belief 2: A long term investment horizon is a responsibility and an advantage;

- Investment Belief 6: Strategic asset allocation is the dominant determinant of portfolio risk and return;
- Investment Belief 7: CalPERS will take risk only where we have a strong belief we will be rewarded for it; and
- Investment Belief 8: Costs matter and need to be effectively managed.

## **Background**

Governed by CalPERS Asset Liability Management Policy, the ALM process is a collaborative effort between the Actuarial Office (ACTO), the Financial Office (FINO), and the Investment Office (INVO) and currently occurs every four years with a mid-point review. This ALM cycle is the primary process by which investment portfolio and actuarial assumptions evolve to reflect the market opportunity set, demographic assumptions and experience, and plan status. The ALM decision frequency is supported by ACTO's annual actuarial valuation process that determines subsequent employer and employee contribution levels. This process establishes an amortization of each fiscal year's actual experience versus the assumptions underlying the ALM decisions, thus correcting annually for forecast and estimation uncertainty.

The discussion of Candidate Portfolios is a culmination of a significant body of work that has been undertaken by the ALM team during the past year and is a progression in the ALM process from the following presentations made earlier in the year to the Investment Committee:

- February 2021 – Asset Liability Management: Timeline, Concepts, and Framework
- March 2021 - Asset Liability Management: Risk Concepts and Examples
- June 2021 – Current Market Environment
- July 2021- Capital Market Assumption Education, Capital Market Assumptions: Survey & Methodology, and Creating and Assessing Candidate Portfolios

This agenda item, Asset Liability Management: Discussion of Candidate Portfolios, is intended to elicit feedback, both from the Investment Committee and from stakeholders that are impacted by CalPERS activities. As the ALM process progresses into the presentation of potential portfolios for adoption of a Policy Portfolio at the November meeting, this feedback will be an important part of the overall assessment and analysis.

## **Analysis**

Not Applicable.

## **Budget and Fiscal Impacts**

Not Applicable.

## **Benefits and Risks**

The benefits of the ALM process are:

1. It provides an ongoing review to ensure the strategic asset allocation is based on our best understanding of market risk and return projections.
2. It provides an ongoing review to ensure the actuarial analysis is based on our best understanding of actuarial assumptions and risks.
3. The ALM designs the strategic asset allocation to align with our actuarial objectives.

The risks of the ALM process are:

1. Capital market assumptions are uncertain and actual outcomes may differ significantly from our assumptions.
2. Extreme volatility in the short-term may lower confidence in the strategy.

## **Attachments**

Attachment 1 – Asset Liability Management: Discussion of Candidate Portfolios

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