



Investment Committee

# Agenda Item 7a

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**November 15, 2021**

**Item Name:** Asset Liability Management: Adoption of Affiliate Funds' Capital Market Assumptions

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

**Item Type:** Action

## **Recommendation**

For use in the 2021-22 ALM process for the Affiliate Funds, adopt the proposed baseline economic scenario Capital Market Assumptions (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 following Affiliate Funds<sup>1</sup>:

- Legislators' Retirement Fund
- Judges' Retirement Fund
- Judges' Retirement Fund II
- California Employers' Retiree Benefit Trust Fund
- California Employers' Pension Prefunding Trust Fund
- Public Employees' Healthcare Fund
- Public Employees' Deferred Compensation Fund
- Supplemental Contributions Program Fund

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<sup>1</sup> The Public Employees' Long-Term Care Fund is not listed, as its ALM was completed earlier in 2021.

The Affiliate Funds' CMAs have been developed using the same process that was used for the Public Employees' Retirement System CMAs that were adopted in September 2021. The CMAs are derived from survey data for a baseline economic scenario and are reviewed by the Investment Office to help ensure that the expected returns are appropriate for the asset classes and strategies. Economic scenarios (baseline, upside, downside) have been evaluated to understand a range of possible outcomes, and supplementary information about the economic scenarios and associated CMAs can be found in the appendix of Attachment 1.

### **Strategic Plan**

This agenda item supports the CalPERS Strategic Plan goal to strengthen the long-term sustainability of the pension fund. This item provides information regarding the capital market assumptions, which are foundational elements of 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, to capture as much information as possible, our process includes surveying consultants and asset managers, comparing the survey results against internal CMAs developed by our research team, and reviewing the CMAs with each asset class team in the Investment Office.

The CMAs are presented for 5 years and 20 years to incorporate both long-term and near-term views of the market. While longer views are relevant to the discount rate, the near-term economic and market environment can be impactful.

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**

CMA's are the essential inputs and starting points of the ALM process. The benefit of adopting the CMA's is that it allows the process to proceed with the evaluation of candidate portfolios. A risk of adopting the CMA's 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 Affiliate Capital Market Assumptions

Attachment 2 – Wilshire Opinion Letter

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