Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 20

MEETING DATE: December 8, 2021

SUBJECT: Asset Class Restructuring: Global Equity

SUBMITTED FOR: ___ Consent _X_ Deliberation and Action __ Receive and File

RECOMMENDATION

Staff recommends the Board approve the proposed implementation plan and revisions to the structure of the Global Public Equity (Global Equity) asset class as presented by Verus and SCERS' Investment Staff (Staff). The specific recommendations include:

- Approve a range of +/- 4% around the Global Equity target allocation of 40% (36% - 44%), and sub-asset class ranges as described below.
  - The Global Equity asset class was approved as part of the revised Strategic Asset Allocation in August, and consolidates the Domestic and International Public Equity asset classes into a Global Public Equity asset class.
- Adopt the MSCI ACWI Investable Market Index (IMI) as the Global Equity benchmark for SCERS' Policy Index.
  - Current Public Equity benchmarks for SCERS' Policy Index are the Russell 3000 index for Domestic Equity and the MSCI ACWI ex USA index for International Equity.
- Maintain 20% target allocation for Domestic Equity sub-asset class.
  - Adopt 50% Large Cap Passive target allocation.
  - Adopt 40% Large Cap Active target allocation.
    - Remove dedicated 12% target allocations to named large cap active strategies (Fundamental, 130/30, and Systematic Multi-Factor) from IPS.
  - Maintain 10% Small Cap Active target allocation.
- Adopt 16% target allocation for International Equity sub-asset class.
  - Adopt target allocation of 70% for Developed International Equity markets.
  - Adopt target allocation of 30% for Emerging Markets.
  - Approve changing the International ACWI ex USA mandate to a Developed Large Cap Core International mandate, and retain current investment manager Lazard Asset Management to manage this revised mandate.

- Add Global/Unconstrained Equity sub-asset class with a target of 4%.
    - Approve recommendation to initiate search for Global Equity manager(s).
- Maintain existing managers within the structure, adjusted for revised targets weights.
- Direct staff to make conforming changes to the Growth Asset Category and Master Investment Policy Statements for approval by the Board at a future meeting.

PURPOSE

This item supports the implementation of the revised strategic asset allocation, which calls for Staff and consultants to identify structuring considerations and implementation plans for each major asset class.

PUBLIC EQUITY STRATEGIC CHANGES

SCERS' Board approved a revised strategic asset allocation for SCERS in August 2021, which resulted in the consolidation of the Domestic and International Public Equity asset classes into a Global Equity asset class with a 40% target allocation. At the August Board meeting, it was communicated that Staff and Verus would present an updated structure for the Global Equity asset class to the Board at a future date, comprising the underlying targets and ranges for the sub-asset classes within the overall Global Equity asset class. The table below shows the revised target allocations for asset classes within the Growth asset category.

Asset Class	Prior Target Allocation	Revised Target Allocation	Actual Allocation
Growth Asset Category	58.0%	58.0%	
Global Equity	0.0%	40.0%	40.3%
Domestic Equity	20.0%	0.0%	
International Equity	20.0%	0.0%	
Private Equity	9.0%	11.0%	
Public Credit	2.0%	2.0%	
Private Credit	4.0%	5.0%	
Growth Absolute Return	3.0%	0.0%	

The Global Equity portfolio, which combined the 20% target allocations for the Domestic and International Equity asset classes, is just slightly overweight the 40% target allocation at 40.3% as of September 30, 2021. Primarily due to performance differences between asset classes, the Domestic equity portfolio has been overweight the 20% target allocation, while the International equity portfolio has been underweight the 20% target allocation. As discussed below, the overweight and underweight positions of the sub-asset classes will be updated based on the recommended structure of the Global Equity portfolio.

The 'Implementation Plan' section for Global Equity below will cover the future steps to implement the proposed structure, including new manager searches and rebalancing of the portfolio, as appropriate.

RECOMMENDED POLICY BENCHMARK FOR GLOBAL EQUITY

Staff and Verus recommend adopting the MSCI ACWI Investable Market Index (IMI) as the Policy Index benchmark for SCERS' public equity exposure. Currently, SCERS' Policy Index reflects the prior allocation targets of 20% Domestic Equity, benchmarked to the Russell 3000 Index, and 20% International Equity, benchmarked to the MSCI ACWI ex USA Index. With the approved consolidation of the public equity asset classes into a single Global Equity asset class, it is recommended that SCERS update the Policy Index to a single benchmark that represents the global equity investment opportunity set. The MSCI ACWI IMI "captures large, mid and small cap representation across 23 Developed Markets (DM) and 27 Emerging Markets (EM) countries"[1] and includes over 9,000 constituents covering approximately 99% of the global equity investment universe. With the update to a global benchmark, the recommended structure for SCERS' Global Equity asset class, presented in the sections below, will help align SCERS' public equity portfolio with the global opportunity set and weightings represented by the global benchmark. Index characteristics for the MSCI ACWI IMI are shown below.

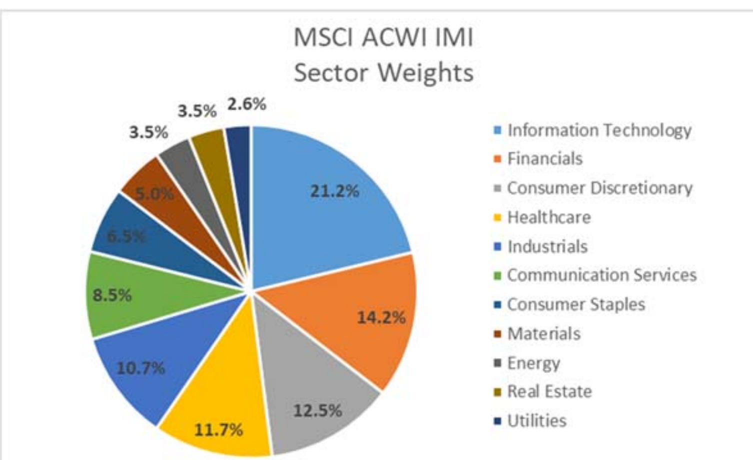
MSCI ACWI IMI

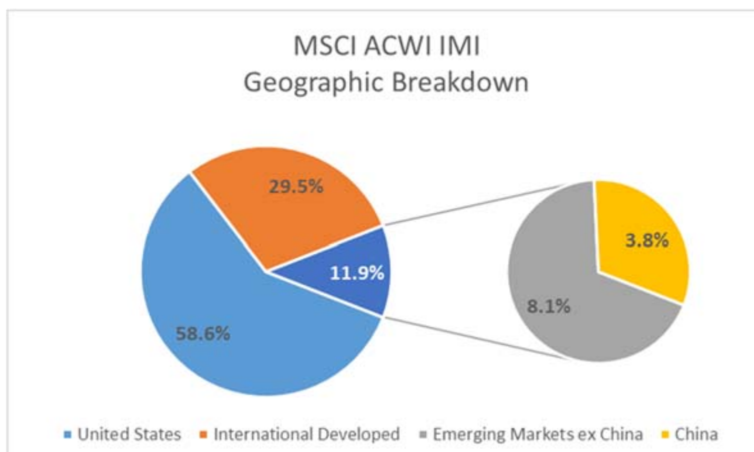
INDEX CHARACTERISTICS

Number of Constituents	9,226
Market Cap (USD Millions)	
Index	75,332,149
Largest	2,361,300
Smallest	10
Average	8,165
Median	1,320

FUNDAMENTALS

Div Yield	P/E	P/E Fwd	P/BV
1.77	22.24	17.72	2.8





[1] Source: MSCI ACWI IMI monthly factsheet, as of September 30, 2021.

RECOMMENDED GLOBAL EQUITY STRUCTURE REVISIONS

Recommendations related to the structure of SCERS' Global Equity asset class are shown below. The recommended changes will go into effect upon Board approval; however, they will not be reflected in the investment policy statement until a later date. Global Equity resides within a broader Growth asset category IPS, along with Private Equity, Private Credit, and Public Credit allocations (the Growth Absolute Return allocation is being eliminated as part of the updated strategic asset allocation). Staff will present a revised Growth asset category IPS at a later date that incorporates the proposed revisions to the Global Equity asset class, as well as the other Growth asset classes, once they are all approved by the Board. The Master IPS will also be updated accordingly.

Global Equity Target and Range:

The Global Equity asset class has a target allocation of 40%, and Staff and Verus recommend a range of +/- 4% around the 40% target as shown below:

Asset Class	Target %	Range
Global Equity	40%	36% - 46%

Prior to consolidation into a Global Equity asset class, the Domestic and International Equity asset classes each had a range of +/- 2% around their target of 20%. The combined Global Equity asset class maintains the relative size of the range around the target allocation, which is equivalent to 10% of the target allocation. The range allows for flexibility in managing the portfolio across market cycles, recognizing that market values for liquid market assets such as public equity can change rapidly and lead to shifts in the relative weight of asset classes. Additionally, SCERS utilizes its Overlay program to adjust asset class exposures back in line with policy targets. Therefore, while the physical exposure may shift due to changing market values, the Overlay program will bring SCERS' actual exposure close to the target on a quarterly basis. As of September 30, 2021, the Global Equity portfolio was approximately 40.3% of the total SCERS portfolio, just slightly above the target allocation approved for the asset class.

Global Public Equity Structure

As detailed within the Growth asset category IPS, specific asset class guidelines are established to meet investment objectives and to control for risks inherent to each specific asset class. For Public Equity, portfolio construction guidelines with specific target allocations for each sub-asset class (previously Domestic and International equity) are established to diversify portfolio exposure and risk across market capitalization, investment style or strategy, and geography. The following sections will detail the recommended portfolio structure updates for SCERS' Global Equity asset class, including the sub-asset class targets. The recommended targets and ranges for each sub-asset class within Global Equity are shown below. The target and range for Domestic Equity is unchanged from the prior structure. The range for International Equity is updated for the new target, with additional capacity at the high end of the range to allow International Equity to be overweight as the Global/Unconstrained segment is implemented. As discussed in the sections below, Global/Unconstrained will be funded from International Equity, with an initial 2% allocation. Therefore, the low end of the range should allow for fluctuation in market values without the need for immediate rebalancing.

Asset Class	Target %	Range	
Global Equity	40%	36% - 44%	
Sub-Asset Class	Prior Target %	New Target %	New Range
Domestic Equity	20%	20%	18% - 22%
International Equity	20%	16%	14% - 20%
Global/Unconstrained Equity	-	4%	1% - 6%

Domestic Equity

Recommended Domestic Equity Structure

The charts below present the recommended domestic equity structure, which includes consolidating the large cap and small cap segments. These recommended changes will be discussed in greater detail in the following sections.

Current Domestic Equity Structure

Asset Class	Target Allocation	Target Allocation
Domestic Equity		
Domestic Equity Large Cap	90.0%	
Large Cap Passive		54.0%
Large Cap Active - Fundamental		12.0%
Large Cap Active - 130/30 Extension		12.0%
Large Cap Active - Systematic Multi-Factor		12.0%
Domestic Small Cap	10.0%	
Small Cap Value		5.0%
Small Cap Growth		5.0%

Recommended Domestic Equity Structure

Asset Class	Target Allocation	Target Allocation
Domestic Equity		
Domestic Equity Large Cap	90.0%	
Large Cap Passive		50.0%
Large Cap Active		40.0%
Domestic Small Cap	10.0%	
Small Cap Active		10.0%

SCERS' Domestic Equity portfolio is a mix of passive and active exposures across large cap and small cap market capitalizations. SCERS established the passive component of the domestic equity portfolio many years ago, with a target of 54%, recognizing that the large cap domestic equity segment is a relatively efficient component of the public equity universe with less opportunity to generate excess returns (alpha). Staff and Verus recommend updating the target allocation to passive strategies to 50%, benchmarked to the large cap Russell 1000 index. The segment will provide large cap market returns, with essentially no tracking error or deviation from the index, at an extremely low management fee. As shown in the implementation section below, the 50% target allocation to passive closely reflects the current allocation, with active strategies outperforming over the past year. Additionally, active strategies (as a whole) have been able to outperform passive over the past year, despite the strong performance of large cap equities and the extreme concentration at the index level. Market cap weighted indices are more highly concentrated than at any point in history, with the top ten companies in the S&P 500 representing over 29% of the index, versus the historical average of approximately 20% over the past 40 years. The top five companies in the S&P 500 alone represent over 22% of the index. The indices are also highly concentrated by sector, with the Information Technology sector representing approximately 28% of the index, the highest weight ever for the sector and up from just 20% in 2018. The passive component of SCERS' domestic equity portfolio, which mimics the benchmark index, is heavily weighted towards the companies that have grown to have extremely high market capitalizations and weights in the index (versus history), albeit due to strong recent performance. Slightly reducing the weight to passive strategies, and increasing the weight to active strategies, allows SCERS' domestic equity portfolio to have less concentration risk, as currently represented by the index.

During the prior strategic asset allocation review in 2017, the active segment of the large cap domestic equity portfolio was structured to consist of a core mix of systematic and fundamental active strategies (fundamental, 130/30, systematic multi-factor), designed to have less variability than prior allocations to dedicated growth and value oriented strategies, which had underperformed their category benchmarks. The large cap core active strategies, despite having lower overall tracking error, are still expected to generate outperformance versus the passive component of the large cap portfolio, and enhance total portfolio returns. Performance of this segment over the past several years has been mixed, with the quantitative strategies generally underperforming and the fundamental based strategies generally outperforming, resulting in a slight outperformance for the large cap portfolio overall over most time periods.

Domestic Equity Portfolio	YTD	1-Year	3-Year	5-Year
SCERS	15.8%	34.6%	16.3%	17.2%
Russell 3000 Index	15.0%	31.9%	16.0%	16.9%
Large Cap Portfolio	16.4%	33.6%	16.4%	17.4%
Russell 1000 Index	15.2%	31.0%	16.4%	17.1%
Small Cap Portfolio	11.4%	44.2%	15.3%	18.2%
Russell 2000 Index	12.4%	47.7%	10.5%	13.4%

As of September 30, 2021

At the Investment Policy Statement level, Staff and Verus are recommending simplifying and consolidating the active large cap core components into one segment, which would group the existing separate allocations to fundamental, 130/30, and systematic multi-factor into one 40% allocation to active large cap core strategies. With the mixed performance across active strategies, consolidating the active large cap core into one segment will allow Staff and Verus greater flexibility to potentially make changes to underlying mandates/strategies within this segment of the portfolio, without being compelled to fill an allocation if it doesn't offer an attractive opportunity to add value to the portfolio. This additional flexibility will allow Staff and Verus to consider additional actively managed strategies, which may not currently have a role in the current structure, but could add value going forward. While no specific changes to the existing mandates or managers in the portfolio are planned at this time, Staff and Verus would present any future recommended changes to the portfolio through the approved implementation protocol for the public equity asset class.

The small cap segment of the domestic equity portfolio is entirely actively managed. Small cap equities have proven to be less efficient compared to the large cap segment, with active managers able to deliver alpha above the small cap index benchmarks. Despite some level of underperformance in the near term, SCERS' small cap managers have delivered significant outperformance over the longer term, as shown in the table above. Staff and Verus recommend maintaining the 10% target allocation to the actively managed small cap segment of the domestic equity portfolio, but combining growth and value into a single actively managed segment, rather than having two separate 5% allocations to growth and value. Staff and Verus recommend maintaining allocations to the current small cap growth and value managers; however, having a single actively managed segment would allow for greater flexibility in allowing for future allocations to other actively managed strategies that could add value to the portfolio, such as a core investment strategy that could actively manage exposure across various investment styles. Within the actively managed small cap segment, the objective is for SCERS to maintain diversification across investment styles (growth vs. value) and across sectors and industries. While style specific individual managers will still be benchmarked against style specific benchmarks (i.e., growth/value), the overall small cap portfolio will continue to be benchmarked to the Russell 2000 index.

International Equity

Recommended International Equity Structure

The charts below present the recommended international equity structure, which includes consolidating the large cap and small cap segments, and increasing the target weight to emerging markets. These recommended changes will be discussed in greater detail in the following sections.

Current International Equity Structure

Asset Class	Target Allocation	Target Allocation
International Equity	**20.0%**	
International Equity Developed Markets	80.0%	
Developed Markets Large Cap Value		25.0%
Developed Markets Large Cap Growth		25.0%
Int'l All Country World (ACWI) ex-US		20.0%
Developed Markets Small Cap Value		5.0%
Developed Markets Small Cap Growth		5.0%
International Equity Emerging Markets	20.0%	
Emerging Markets All Cap		20.0%

Recommended International Equity Structure

Asset Class	Target Allocation	Target Allocation
International Equity	**16.0%**	
International Equity Developed Markets	70.0%	
Developed Markets Large Cap Active		60.0%
Developed Markets Small Cap Active		10.0%
International Equity Emerging Markets	30.0%	
Emerging Markets Active		30.0%

SCERS' International Equity portfolio is actively managed across all segments of the portfolio, which includes developed large cap, developed small cap, and emerging markets. SCERS has maintained active management across international public equity markets, benefiting from less efficient markets to deliver outperformance versus broad market benchmarks. The overall international equity portfolio is benchmarked against the MSCI ACWI ex USA Index, with various underlying benchmarks for different segments and strategies included in the portfolio. The table below shows performance for different segments of the portfolio versus benchmarks assigned to each segment.

	YTD	1-Year	3-Year	5-Year
SCERS Total Int'l Equity	5.8%	23.5%	10.2%	10.9%
MSCI ACWI ex USA	6.3%	24.4%	8.5%	9.4%
SCERS Int'l Large Cap Developed	8.9%	24.7%	9.8%	11.3%
MSCI World ex USA	9.7%	27.1%	8.4%	9.4%
SCERS Int'l Small Cap Developed	9.8%	29.3%	12.4%	11.8%
MSCI World ex USA Small Cap	11.0%	30.6%	9.9%	10.8%
SCERS Emerging Markets	-5.6%	16.5%	10.4%	10.1%
MSCI Emerging Markets Index	-1.0%	18.6%	9.0%	9.6%

As of September 30, 2021

International Developed Large Cap

Within the large cap developed segment of the international portfolio, SCERS currently has dedicated allocations to mandates with growth and value style tilts. While recognizing the style tilts associated these mandates, both allocations are benchmarked to the MSCI World ex USA index, with the expectation that the manager can deliver outperformance versus a core benchmark over a full market cycle. The current managers in this segment of portfolio have been able to deliver outperformance, over the long-term, versus both core and style specific benchmarks.

In addition to the large cap developed mandates in the international portfolio, SCERS also has an allocation to an international all-country world ex USA mandate, which utilizes a core approach and can invest across international developed and emerging markets. Utilizing a global approach provides an active manager an additional lever to generate excess returns, in addition to sector/industry weighting and stock selection, by shifting market exposures to countries and regions that offer the most attractive return opportunity. While this approach provides an active manager a wide range of markets to generate returns, by excluding the U.S., this strategy has not held an allocation to the most attractive global equity market over the past several years. Therefore, this strategy is most appropriately suited for a global manager, which can allocate across all global markets, including the U.S., providing the full range of markets to allocate to and potentially generate returns above the global equity benchmarks. As detailed below, adding a Global/Unconstrained segment is a new component of the recommended Global Equity structure, which will include a proposed dedicated global equity mandate(s).

Staff and Verus recommend changing the international all-country world ex USA mandate (referenced above) to a developed markets large cap core mandate. This segment would be benchmarked to the MSCI World ex USA benchmark, the same index the other large cap developed mandates are currently benchmarked against. With this change, the international developed large cap segment of the portfolio would consist of the existing growth and value mandates, and a new core mandate, with a single benchmark index. At the Investment Policy

Statement level, similar to the approach taken in the large cap active segment within the Domestic Equity portfolio, Staff and Verus are recommending simplifying and consolidating the large cap developed markets components into one segment, which would group the existing separate allocations to growth, value, and core into one 60% allocation to large cap developed strategies. Consolidating the large cap developed strategies into one segment will allow SCERS and Verus greater flexibility to potentially make changes to underlying mandates/strategies within this segment of the portfolio, without being compelled to fill an allocation if it doesn't offer an attractive opportunity to add value to the portfolio.

In the current structure, SCERS' international all-country world ex USA mandate is managed by Lazard Asset Management and its Lazard Strategic International Equity Plus (ACWI ex USA) strategy. Lazard has managed this strategy for SCERS since June 2012, delivering solid long-term performance, outperforming the MSCI ACWI ex USA benchmark by 2.3% on an annualized basis since inception. The strategy is implemented through a combination of direct investments in developed market equity securities (through a separately managed account), and a segment of the portfolio invested in the Lazard Emerging Markets Equity Mutual Fund to add emerging markets exposure. With the recommended change to the structure, from an ACWI ex USA mandate to an international developed markets large cap core mandate, Staff and Verus have evaluated the performance of the Lazard portfolio excluding the emerging markets allocation. As shown below, the Lazard portfolio excluding EM, has delivered significant outperformance versus the MSCI World ex USA benchmark, with only two years of underperformance versus the benchmark over the past 11 years (including 2021 YTD), including outperformance across both positive and negative market environments.

	1-Year	3-Year	5-Year	10-Year
Lazard International Strategic Equity Plus ex Emerging Markets	25.6%	9.9%	11.1%	11.8%
Benchmark: MSCI World ex US	26.5%	7.9%	8.9%	7.9%
Excess Return	-0.9%	2.0%	2.2%	4.0%

	2021 YTD	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Lazard ISQ Plus ex EM	7.0%	13.7%	23.5%	-9.0%	28.7%	-4.1%	5.5%	0.5%	32.0%	23.4%	-6.4%
Benchmark: MSCI World ex US	9.2%	7.6%	22.5%	-14.1%	24.2%	2.8%	-3.0%	-4.3%	21.0%	16.4%	-12.2%
Excess Return	-2.2%	6.1%	1.0%	5.1%	4.5%	-6.9%	8.5%	4.8%	11.0%	7.0%	5.8%

The historical performance for Lazard places the strategy in the top third and top quartile versus comparable managers over the past 5- and 10-year periods, respectively. Additionally, the Lazard ex EM strategy has generated strong statistical results including, high Sharpe and Information ratios, good upside and downside capture ratios, with beta and standard deviation similar to the market index. Given the review of Lazard and its strong historical performance, **Staff and Verus recommend retaining Lazard to manage the updated international developed markets large cap core mandate**, and adjusting the Lazard strategy to exclude emerging markets from the mandate. Lazard will be able to conduct this adjustment cost effectively, without the need to utilize the services of a transition manager.

International Developed Small Cap

Similar to international developed large cap and domestic equity small cap, the international small cap segment of SCERS' public equity portfolio is entirely actively managed. The portfolio is currently allocated to two managers, which employ growth and value styles in their investment strategy. Despite the growth and value styles employed by the active managers, both strategies are benchmarked to the same benchmark, with the expectation that the managers can outperform the core benchmark over the long term. As shown in the performance table above, the international developed small cap portfolio has delivered excess returns over the MSCI World ex USA Small Cap benchmark. Similar to large cap equities, growth has significantly outperformed value over the past several years, with spreads between the two strategies at extreme levels versus history. With the same core benchmark and the segment differentiated primarily by the market cap exposure, Staff and Verus recommend maintaining the 10% target allocation to the actively managed small cap segment of the international developed portfolio, but combining growth and value into a single actively managed segment rather than having two separate 5% allocations to growth and value. Staff and Verus recommend maintaining allocations to the current small cap growth and value managers; however, having a single actively managed segment would allow for greater flexibility in allowing for future allocations to other actively managed strategies that could add value to the portfolio. The international developed small cap segment will continue to maintain diversification across investment styles (growth vs. value) and across sectors and industries, with any future changes communicated through the established implementation protocol.

Emerging Markets

SCERS' emerging markets portfolio currently has a 20% target allocation, emphasizing an all-cap approach, versus dedicated large and small cap allocations. Additionally, the Growth asset category IPS doesn't specify dedicated growth or value style allocations for emerging markets, although SCERS does employ separate growth and value EM all cap managers in the segment. The segment also has a single benchmark, the MSCI Emerging Markets index. The current structure for the emerging markets segment is already consistent with the recommendations made across other segments of the Global Equity asset class, therefore, no changes to the structure are recommended.

However, a recommendation that Staff and Verus are making is to increase the target allocation to emerging markets to 30% of the international equity portfolio, up from the current 20% target allocation. Increasing the target allocation for emerging markets to 30% will bring the structure in line with the overall benchmark for international equity, the MSCI ACWI ex USA index, which has an approximate 30% weight allocated to emerging market countries.

The current allocation to emerging markets within SCERS' international equity portfolio is approximately 19.2%, as of September 30, 2021. The weight to emerging markets recently declined below the 20% target allocation due to negative relative performance of emerging markets in the third quarter of 2021. This weight does not include the emerging markets allocation within the Lazard International Strategic Plus (ACWI ex USA) mandate, which is recommended to be eliminated. Therefore, with an increased target weight, SCERS would be below the target and need to evaluate alternatives to bring the exposure in line with the revised

30% target. Potential alternatives to increase the allocation to emerging markets, which will be discussed further in the Global/Unconstrained segment below, include:

- Adding a global equity mandate (which includes emerging markets exposure).
- Adding a direct allocation to a specific emerging markets country.
- Increasing the allocation to SCERS' existing emerging markets managers and/or conducting a search for an additional emerging markets manager.

Upon approval to increase the emerging markets target allocation to 30%, Staff and Verus will explore the alternatives and present a recommendation, at a later date, for the preferred approach to increase emerging markets exposure.

Global/Unconstrained Equity

Staff and Verus recommend adding a Global/Unconstrained segment to the public equity structure, with a 4% target allocation.

The chart below presents the recommended structure for a newly recommended Global/Unconstrained Equity segment. These recommended changes will be discussed in greater detail below.

Global/Unconstrained Equity - Proposed Structure

Asset Class	Target Allocation	Target Allocation
Global/Unconstrained Equity	4.0%	
Global Equity		>/= 50%
Sector or Country Concentrated		</= 25%
Non Beta 1 (Long/Short)		</= 25%

Under the previous strategic asset allocation, prior to the revised structure approved in August 2021, SCERS' public equity allocation had separate domestic and international equity allocations, each with a 20% target allocation. The updated strategic asset allocation, which created a single global equity allocation, created an opportunity for SCERS to evolve the underlying structure and add a segment that could allocate to a broader range of strategies not available under the previous structure. For example, if a top-tier global equity manager that invests across both international and U.S. equity markets was identified, this type of manager did not fit within the prior structure. Adding a Global/Unconstrained segment to the public equity structure introduces flexibility in the asset allocation, allowing SCERS to invest in a broader range of strategies that have the ability to potentially generate excess returns above the broad public equity benchmark (MSCI ACWI IMI).

The recommended name for this segment, "Global/Unconstrained", was chosen to align with potential strategies that could be included within this segment of the portfolio.

Staff and Verus recommend that the primary allocation within this segment (at least 50%) be comprised of a global equity mandate that would have flexibility to allocate across a wide range of global equity markets, including U.S., developed international, and emerging markets. When initially considering the recommendation for a global equity allocation, Staff examined the public equity allocations of comparable public pension plans, as well as the investment universe and track records of global equity managers. A dedicated global segment within the public equity structure is quite common for institutional public equity investment portfolios. Additionally, there is a broad universe of global equity managers, which include a wide range of investment strategies and implementation methods that have a track record of generating strong returns. Staff and Verus believe the addition of an active global equity manager can add value to the portfolio, enhancing the ability to earn excess returns above the global equity benchmark.

Therefore, **Staff and Verus recommend authorizing Staff and Verus to initiate a manager search for a global equity manager(s). The target investment amount for this segment of the portfolio is approximately 2% (or half of the Global/Unconstrained segment of the portfolio), which is approximately $250 million.** Depending on the outcome of the search, this could be invested in a single manager, or multiple managers. Upon approval, Staff and Verus would initiate the manager search, and complete the investment through the approved implementation protocol, which includes bringing the recommended manager(s) in front of the Board for approval.

The other potential investments that may be included in this segment of the portfolio include “unconstrained” investment strategies, which would be more benchmark agnostic compared to traditional public equity investments. Potential strategies included in this segment would be categorized as “unconstrained” because the manager may have more flexibility to implement their investment strategy and/or they invest in a specific segment of the market that doesn’t fit within the other domestic and international segments of the portfolio, where a traditional public equity allocation and benchmark would be applicable. Examples of investment strategies that may fit this segment include:

- Sector Specialist Strategies (ex. Technology or Healthcare)
- Country Specific Strategies (ex. China A-share mandate)
- Long/Short Strategies (ex. Non-Beta 1 strategies)

Unconstrained strategies are expected to predominantly invest in publicly traded equities, but could opportunistically allocate to other market segments (such as credit) if the manager believes they can earn equity like returns with less risk at certain points in a cycle. Unconstrained strategies would not have a target allocation, but could comprise up to 50% of the 4% Global/Unconstrained segment’s target allocation. Unconstrained strategies could also receive no allocation if no compelling investments are identified. Allocations to these types of strategies would be utilized to either 1) capitalize on specific investments opportunities that can generate attractive returns and/or 2) with managers that have a proven track record of implementing an investment approach, unique from traditional long-only investing, that can generate excess returns above SCERS’ public equity benchmarks. While the individual investment strategies would have a benchmark that is specific to the manager and strategy, the aggregate Global/Unconstrained segment would be benchmarked against the Global Equity policy index, the MSCI ACWI IMI, and will be expected to generate returns in excess of this benchmark.

Additionally, allocations to unconstrained strategies will be evaluated in the context of the overall Global Equity asset class, to determine that the investment opportunity provides complimentary and value-added exposure to SCERS' overall public equity portfolio. Staff and Verus will evaluate SCERS' overall public equity exposure, including allocations to Domestic, International, and Global/Unconstrained mandates, to determine how SCERS' public equity exposure (if an unconstrained strategy was added) compares to global public equity benchmarks, to ensure the portfolio maintains geographic, sector, and style diversification. It is anticipated that the implementation of the upcoming portfolio analytics and risk management software, which Staff is currently in the process of evaluating, will help improve the oversight and analysis of SCERS' public equity portfolio, as well as the total portfolio. Initially, Staff and Verus anticipate that allocations to unconstrained investment strategies will be less than 50% of the total Global/Unconstrained segment. No specific recommendations are being made at this time, and Staff and Verus will communicate with the Board prior to recommending any investments in this segment of the portfolio.

To fund the 4% allocation to the Global/Unconstrained segment of the portfolio, the recommended target allocation for International Equity was reduced from 20% to 16%. The adjusted target allocations for domestic and international equity help align the overall global equity portfolio with the revised benchmark, MSCI ACWI IMI, which has approximately 60% U.S. and 40% international exposure. Until the Global/Unconstrained segment is fully implemented, the International Equity segment will remain overweight the target allocation, with that segment rebalanced towards the target in conjunction with funding of Global/Unconstrained mandates.

Global Equity Asset Class Benchmarks

As discussed previously, Staff and Verus recommend changing SCERS' policy benchmark for the Global Equity asset class to the MSCI ACWI IMI. Within the sub-asset classes of Domestic Equity and International Equity, Staff and Verus have recommended a simplified structure to be included in the Growth asset category IPS. In conjunction with the recommended structure, the benchmarks have been reviewed and updated to align with consolidated underlying segments of each asset class. For the Global/Unconstrained segment being recommended, the benchmark is the same as that for the overall Global Equity asset class, the MSCI ACWI IMI, with the collective goal for strategies in this segment to enhance returns for the overall public equity portfolio. The following tables highlight the current and recommended benchmarks for each sub-asset class.

Current Domestic Equity Benchmarks

Asset Class	Benchmark
Domestic Equity	Russell 3000
Domestic Equity Large Cap	Russell 1000
Large Cap Passive	Russell 1000
Large Cap Active - Fundamental	Russell 1000
Large Cap Active - 130/30 Extension	Russell 1000
Large Cap Active - Systematic Multi-Factor	Russell 1000
Domestic Small Cap	Russell 2000
Small Cap Value	Russell 2000 Value
Small Cap Growth	Russell 2000 Growth

Recommended Domestic Equity Benchmarks

Asset Class	Benchmark
Domestic Equity	Russell 3000
Domestic Equity Large Cap	Russell 1000
Large Cap Passive	Russell 1000
Large Cap Active	Russell 1000
Domestic Small Cap	Russell 2000
Small Cap Active	Russell 2000

Current International Equity Benchmarks

Asset Class	Benchmark
International Equity	MSCI ACWI ex-US
International Equity Developed Markets	MSCI EAFE
Developed Markets Large Cap Value	MSCI World ex-US
Developed Markets Large Cap Growth	MSCI World ex-US
Int'l All Country World (ACWI) ex-US	MSCI ACWI ex-US
Developed Markets Small Cap Value	MSCI World ex-US Small Cap
Developed Markets Small Cap Growth	MSCI World ex-US Small Cap
International Equity Emerging Markets	MSCI Emerging Markets
Emerging Markets All Cap	MSCI Emerging Markets

Recommended International Equity Benchmarks

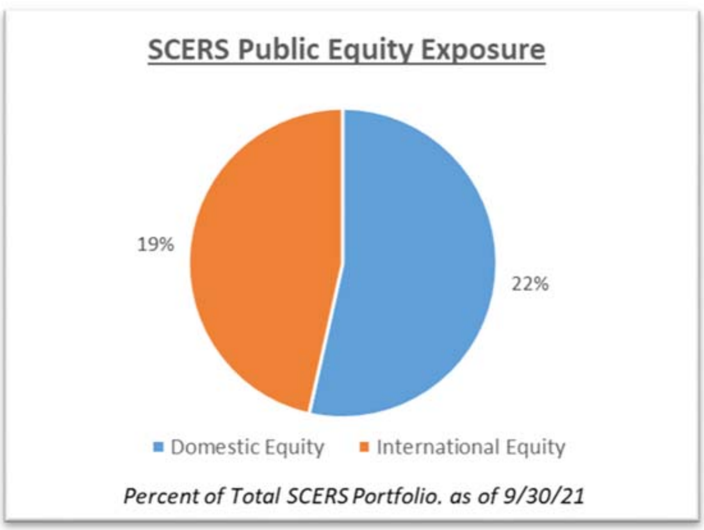
Asset Class	Benchmark
International Equity	MSCI ACWI ex-US
International Equity Developed Markets	MSCI World ex-US
Developed Markets Large Cap Active	MSCI World ex-US
Developed Markets Small Cap Active	MSCI World ex-US Small Cap
International Equity Emerging Markets	MSCI Emerging Markets
Emerging Markets Active	MSCI Emerging Markets

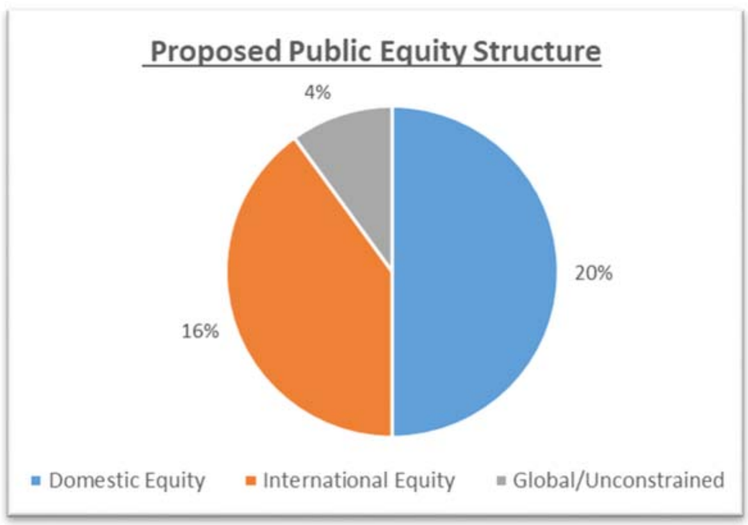
Recommended Global/Unconstrained Benchmark

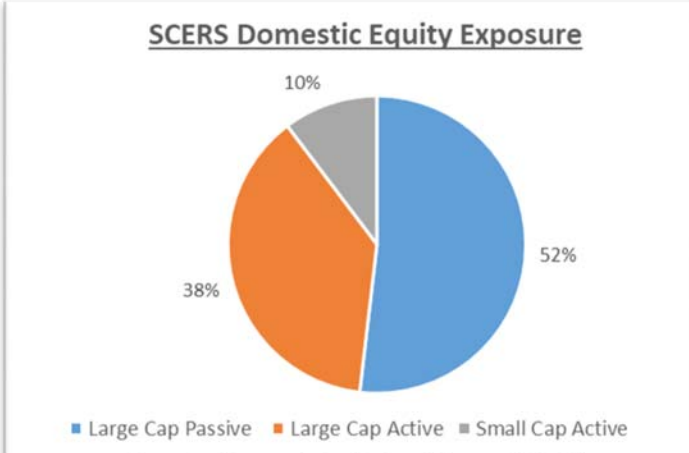
Asset Class	Benchmark	Prior Benchmark
Global/Unconstrained Equity	MSCI ACWI IMI Index	N/A

GLOBAL EQUITY IMPLEMENTATION PLAN

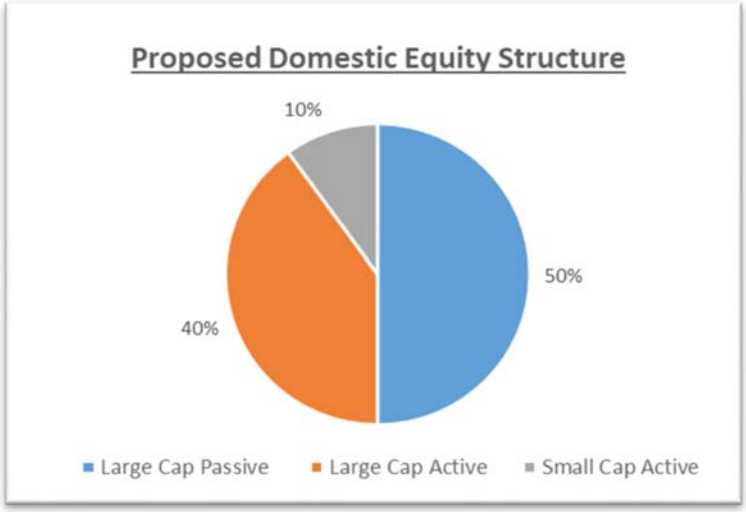
Upon approval of the recommended structure and actions for the Global Equity asset class, Staff will begin implementation of the recommendations. The first step in the implementation process is to compare the current domestic and international equity exposure to the target allocations within the revised structure. The following charts compare current actual exposure to that of the proposed target allocations, starting at the asset class level and working down through the sub-asset class categories.

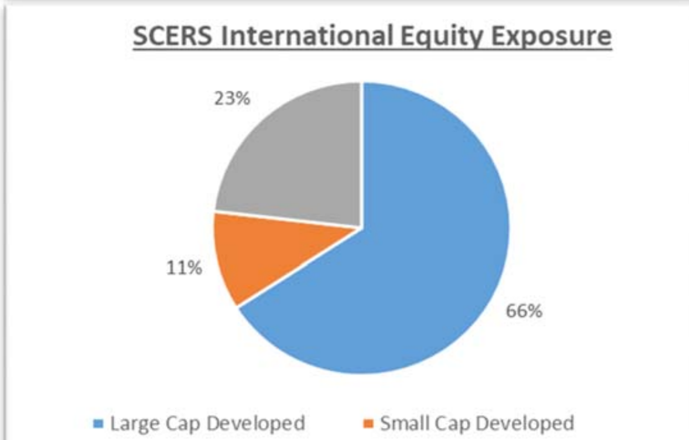




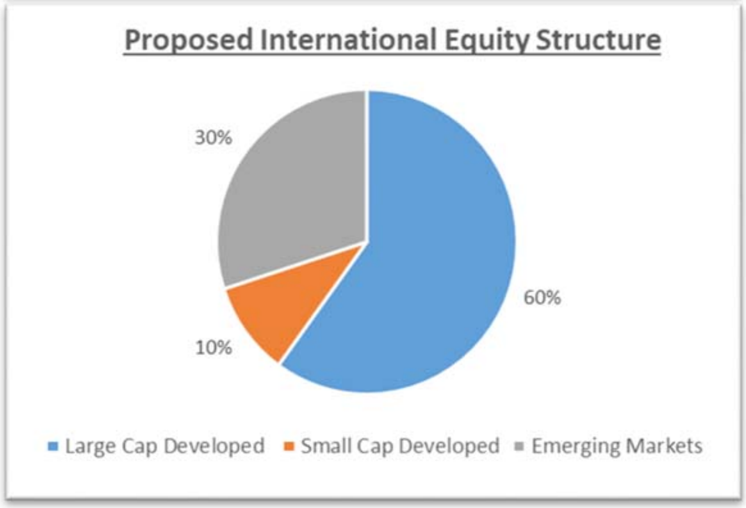


Percent of Domestic Equity Portfolio, as of 9/30/21





Percent of Int'l Equity Portfolio, as of 9/30/21



While SCERS' overall equity exposure is just slightly above the Global Equity target (40.3% versus 40% target), the Domestic Equity portfolio is above the target allocation (21.6% versus 20% target). Additionally, the International Equity portfolio's current allocation of 19% is above the recommended 16% target allocation (reduced from current 20% target allocation). SCERS' Overlay program currently adjusts for the overweight and underweight exposure to Domestic and International Equity, respectively, and the Overlay program will continue to maintain balanced exposure until SCERS modifies the Overlay Program to the revised strategic asset allocation structure, which is expected in early 2022. Staff expects the Overlay Program to convert to utilizing a global equity proxy for public equities, in line with the move toward a Global Equity asset class.

Upon Board approval of the new structure, Staff and Verus will work to implement the recommendations over the next several quarters. The priority in the implementation process will be as follows:

- Initiate search for global equity manager(s) for Global/Unconstrained segment
- Implement SCERS' International Equity portfolio to align with revised structure

  - o Convert the International ACWI ex USA mandate to an International Developed Large Cap Core mandate
  - o Evaluate emerging markets equity managers and exposure for the revised 30% target
- Rebalance Domestic and International equity portfolios for to align with the revised structure and targets

Funding for the proposed global equity manager within the Global/Unconstrained segment will come from a combination of restructuring the international equity portfolio and rebalancing of both domestic and international portfolios toward their proposed targets.

Future steps in the implementation process include evaluating potential unconstrained strategies that could be included in the portfolio and evaluating the emerging markets segment, with the goal of developing a path towards meeting the recommended allocation targets. For the Global/Unconstrained segment, Staff and Verus have already evaluated potential investment options and held some preliminary discussions with investment managers across a wide range of investment strategies, which meet the overall objectives for that segment of the portfolio.

NEXT STEPS

- Upon Board approval, convert the international ACWI ex USA mandate to an international developed large cap core mandate
- Upon Board approval, conduct a search for a global equity manager(s).
- Begin implementation of the revised Global Equity structure, including rebalancing of existing mandates.
- Incorporate approved Global Equity structure changes into the Growth asset category and Master IPSs.

ATTACHMENTS

- Board Order
- Verus Global Equity Structure and Implementation Presentation

Prepared by:

/S/

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Brian Miller
Senior Investment Officer

Reviewed by:

/S/

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Eric Stern
Chief Executive Officer

/S/

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Steve Davis
Chief Investment Officer

Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
December 8, 2021

MOTION:

Asset Class Restructuring: Public Equity

THE BOARD OF RETIREMENT hereby accepts the recommendation of staff to approve the implementation plan and make the following revisions to the structure of the Public Equity asset class:

- Approve a range of +/- 4% around the Global Equity target allocation of 40% (36% - 44%), and sub-asset class ranges as described below.
  - The Global Equity asset class was approved as part of the revised Strategic Asset Allocation in August, and consolidates the Domestic and International Public Equity asset classes into a Global Public Equity asset class.
- Adopt the MSCI ACWI Investable Market Index (IMI) as the Global Equity benchmark for SCERS' Policy Index.
  - Current Public Equity benchmarks for SCERS' Policy Index are the Russell 3000 index for Domestic Equity and the MSCI ACWI ex USA index for International Equity.
- Maintain 20% target allocation for Domestic Equity sub-asset class.
  - Adopt 50% Large Cap Passive target allocation.
  - Adopt 40% Large Cap Active target allocation.
    - Remove dedicated 12% target allocations to named large cap active strategies (Fundamental, 130/30, and Systematic Multi-Factor) from IPS.
  - Maintain 10% Small Cap Active target allocation.
- Adopt 16% target allocation for International Equity sub-asset class.
  - Adopt target allocation of 70% for Developed International Equity markets.
  - Adopt target allocation of 30% for Emerging Markets.
  - Approve changing the International ACWI ex USA mandate to a Developed Large Cap Core International mandate, and retain

current investment manager Lazard Asset Management to manage this revised mandate.

- Add Global/Unconstrained Equity sub-asset class with a target of 4%.
    - Approve recommendation to initiate search for Global Equity manager(s).
- Maintain existing managers within the structure, adjusted for revised targets weights.
- Direct staff to make conforming changes to the Growth Asset Category and Master Investment Policy Statements for approval by the Board at a future meeting.

I HEREBY CERTIFY that the above order was passed and adopted on December 8, 2021 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

Richard B. Fowler II Board President	Eric Stern Chief Executive Officer and Board Secretary

Verus

PERSPECTIVES THAT DRIVE ENTERPRISE SUCCESS

DECEMBER 2021

Global Equity Implementation

Sacramento County Employees’ Retirement System

Table of contents

Verus

VERUSINVESTMENTS.COM

SEATTLE 206-622-3700
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SAN FRANCISCO 415-362-3484

I. Introduction

Summary

— In August, the Board approved the new asset allocation which kept the existing Global Equity allocation at 40% of the Total Plan.

— Within global equities, SCERS has held an equal allocation to domestic and international equities. Until now, SCERS has been limited to explicit domestic strategies or international strategies as there was not a policy allowance for global equity strategies or products that have a flexible mandate.

— Staff and Verus are proposing to keep the existing domestic and international mandates but with a carve-out of 4% from international equities to allow for a mix of global equity strategies and/or unconstrained products.

— We also recommend changing the asset class benchmark for global equities.

Current	Proposed
50% Russell 3000/50% MSCI ACWI ex US	100% MSCI ACWI IMI

Global Equity allocation – Current Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
Global Equity	**40%**	
Domestic Equity		20%
International Equity		20%

Global Equity allocation – Proposed Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
Global Equity	**40%**	
Domestic Equity		20%
International Equity		16%
Global/Unconstrained		4%

Recommendation

- Approve a range of +/- 4% around the Global Equity target allocation of 40% (36% - 44%)
- Adopt the following allocations with Global Equity:
  - 20% target to Domestic Equity sub-asset class
    - 50% allocation to Large Cap Passive
    - 40% allocation to Large Cap Active
      - Remove the dedicated 12% target allocation to large cap active strategies from the IPS
    - 10% allocation to Small Cap Active
  - 16% target to International Equity sub-asset class
    - 70% allocation to Developed Intl Equity
    - 30% allocation to Emerging Markets
    - Approve changing the Lazard ACWI ex US mandate to a Developed Large Cap Core mandate with the same manager, removing emerging markets from the portfolio
  - 4% target to Global/Unconstrained sub-asset class
    - Approve a recommendation to initiate a search for Global Equity managers
- Adopt the MSCI ACWI Investable Market Index (IMI) as the Global Equity policy benchmark
- Direct Staff to make conforming changes to the Growth Asset Category and Master Investment Policy Statements for approval by the Board at a future meeting

II. Implementation

Domestic equity implementation

— The proposed changes within domestic equity are around the margin and seek to simplify the target exposures between active and passive management and the investment policy statement

— Within large cap domestic equities, we are proposing a 50/40 split between passive and active management from the previous 54/35 split

— We also propose to simplify the investment policy statement by eliminating the 3 categories of large cap active management (seen below) and consolidate them into a single large cap active category that will allow Staff and Verus some flexibility to add/remove strategies and weight them accordingly

— Within small cap domestic equities, we recommend simplifying the Investment Policy Statement by removing the explicit investment style categories and having a single small cap active bucket

Domestic Equity allocation – Current Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
Domestic Large Cap	**90%**	
Large Cap Passive		54%
Large Cap Active - Fundamental		12%
Large Cap Active – 130/30		12%
Large Cap Active – Systematic		12%
Domestic Small Cap	**10%**	
Small Cap Value		5%
Small Cap Growth		5%

Domestic Equity allocation – Proposed Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
Domestic Large Cap	**90%**	
Large Cap Passive		50%
Large Cap Active		40%
Domestic Small Cap	**10%**	
Small Cap Active		10%

International equity implementation

- Within international equity, we are proposing a reduction in the target allocation from 20% to 16%, in order to fund the new global/unconstrained allocation at 4%
- The target allocation between international developed and emerging markets would shift to a 70/30 split vs 80/20 which would bring the target portfolio more in line with the asset classes benchmark weights
- Similar to domestic equities, we propose to simplify the sub-asset class allocations. International Developed would consolidate investment styles into a single large cap active and small cap active category
- We propose to eliminate the investment style allocation within emerging markets, as well
- Lastly, we recommend changing the international ACWI ex US mandate to a developed market large cap core mandate (eliminating emerging market securities from the strategy portfolio)

International Equity allocation – Current Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
International Developed	**80%**	
Developed Markets Large Value		25%
Developed Markets Large Growth		25%
Intl ACWI ex U.S.		20%
Developed Markets Small Value		5%
Developed Markets Small Growth		5%
International Emerging Markets	**20%**	
Emerging Markets All Cap Value		10%
Emerging Markets All Cap Growth		10%

International Equity allocation – Proposed Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
International Developed	**70%**	
Developed Markets Large Active		60%
Developed Markets Small Active		10%
International Emerging Markets	**30%**	
Emerging Markets All Cap Active		30%

Lazard Intl Equity

- SCERS' current international equity portfolio has an allocation to the international all-country world (ACWI) ex US mandate that is managed by Lazard Asset Management
- The benchmark and Lazard strategy include exposure to emerging markets which is not accounted for in the proposed equity structure. In addition, Lazard has delivered meaningfully higher returns within its international core product which does NOT have emerging markets exposure.
- The emerging markets mandate within the Lazard portfolio has a value-oriented approach. Combining the Lazard emerging markets exposure with SCERS' other emerging markets managers, has tilted SCERS' emerging markets style exposure towards value, versus a more desirable neutral approach.
- With the recommended addition of the Global/Unconstrained segment, SCERS will seek to add exposure to a manager that has a Global mandate, including U.S. markets, which is more appropriate mandate for delivering alpha versus SCERS' global equity benchmark.

Strategy Performance:

	1-Year	3-Year	5-Year	10-Year
Lazard International Strategic Equity Plus ex Emerging Markets	25.6%	9.9%	11.1%	11.8%
Benchmark: MSCI World ex US	26.5%	7.9%	8.9%	7.9%
Excess Return	-0.9%	2.0%	2.2%	4.0%

	2021 YTD	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Lazard ISQ Plus ex EM	7.0%	13.7%	23.5%	-9.0%	28.7%	-4.1%	5.5%	0.5%	32.0%	23.4%	-6.4%
Benchmark: MSCI World ex US	9.2%	7.6%	22.5%	-14.1%	24.2%	2.8%	-3.0%	-4.3%	21.0%	16.4%	-12.2%
Excess Return	-2.2%	6.1%	1.0%	5.1%	4.5%	-6.9%	8.5%	4.8%	11.0%	7.0%	5.8%

Global/Unconstrained equity implementation

- Global/Unconstrained is a new segment of the public equity portfolio that will allow for more flexible mandates with the goal of delivering a higher risk/adjusted return
- Global/Unconstrained will have a 4% target out of the 40% global equity allocation. We chose to take 4% from international equities, instead of a pro-rata share from both domestic and international, as the policy benchmark (MSCI ACWI IMI) has a meaningful overweight to domestic equities, and this would bring the portfolio closer to the benchmark allocation
- Given the flexible nature of this portfolio, the underlying strategies will vary but should primarily include long-only global equity products, which will potentially be complemented with sector focused or country specific products and/or long biased products that may have a beta less than 1 to the broader equity market

Global Equity allocation – Proposed Policy

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
Global/Unconstrained Equity	**100%**	
Global Equity		>/= 50%
Sector or Country Specialist		</= 25%
Long/Short (Beta < 1.0 strategy)		</= 25%

Initiating a search

- Staff and Verus are seeking approval to initiate a Global Equity manager(s) search to fund the first allocation within the Global/Unconstrained portfolio
- The target investment amount for the global segment of this portfolio is 2% (or ~$250 million) of the total 4% allocation
- The goal for the search is to identify a manager (or managers) that have demonstrated ability to invest on a global basis, capitalizing on the complete global equity opportunity set, to deliver excess returns above SCERS' global equity benchmark (MSCI ACWI IMI)
- Ideally, the manager(s) identified will offer differentiated exposure and unique drivers of returns, compared to existing exposure within SCERS' public equity portfolio

Unconstrained:

- Staff and Verus may come back to the Board at a later date to initiate a search within the "Unconstrained" segment. Some possible strategies could include, sector specialist strategies (ex. Healthcare, Technology) country specific strategies (ex. China, Pan-Asia) and/or long/short strategies.

Global equity allocation

	SCERS Current Mix	SCERS 4% Global	CMA's (10 Yr) Return (g)	Return (a)	Standard Deviation	Sharpe Ratio (a)
US Large	45.0	45.0	*5.1*	*6.3*	*15.7*	*0.38*
US Small	5.0	5.0	*5.2*	*7.3*	*21.4*	*0.33*
Total Domestic Equity	***50***	***50***				
International Developed	35.0	24.0	*5.2*	*6.7*	*17.9*	*0.36*
International Developed Small	5.0	4.0	*4.4*	*6.7*	*22.4*	*0.29*
Emerging Markets	10.0	12.0	*5.4*	*8.3*	*25.5*	*0.32*
Total Int'l Equity	***50***	***40***				
Global Equity	0.0	10.0	*5.2*	*6.6*	*17.3*	*0.37*
Total Equity	***100***	***100***				
Total Allocation	**100**	**100**				

	SCERS Current Mix	SCERS 4% Global
Mean Variance Analysis		
Forecast 10 Year Return	***5.4***	***5.4***
Standard Deviation	17.0	17.1
Return/Std. Deviation	*0.3*	*0.3*
1st percentile ret. 1 year	*-27.2*	*-27.2*
Sharpe Ratio	0.37	0.37

When expected returns across asset classes are as compressed as they are today, small allocation differences will not materially change the model's output

IV. Conclusion/Next Steps

Conclusion/Next Steps

- Upon Board approval, the immediate next steps to implement the revised structure will be:
  - Convert the international ACWI ex USA mandate managed by Lazard to an international developed large cap core mandate
  - Conduct a search for a global equity manager(s).
  - Begin implementation of the revised Global Equity structure, including rebalancing of existing mandates.
  - Incorporate approved Global Equity structure changes into the Growth asset category and Master IPSs.
- Future steps in the implementation process include further evaluation of potential unconstrained strategies and evaluation of the emerging markets segment, with the goal to develop a path towards meeting target allocations.