



Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 21

MEETING DATE: February 21, 2024

SUBJECT: Education: Global Equity and Fixed Income Asset Classes

SUBMITTED FOR: Consent Deliberation and Action Receive and File

RECOMMENDATION

Receive and file presentations on Global Equity and Fixed Income asset classes.

PURPOSE

This item supports the Strategic Management Plan by contributing to the effective management and oversight of investment activities.

DISCUSSION

At the January 2024 meeting, Verus and Staff reviewed the upcoming asset liability modeling (ALM) study and process which will start in the second half of 2024.

Prior to the start of the ALM process, Staff and consultants will be providing an education series with an overview SCERS' various asset classes through the first half of 2024. The objective of the asset class educational series is to:

- Assist the Board in understanding the role and objective of each asset class
- Review asset class construction
- Provide an overview of asset class performance in meeting their objectives
- Discuss asset class trends and considerations

The asset class overviews will provide a backdrop for the Board as Verus conducts the ALM study and presents the Board with asset class mixes for consideration which will include varying weights for the underlying asset classes. Staff is starting the education at the February meeting with the Global Equity and Fixed income asset classes, which both serve different roles in the SCERS portfolio, though both trade in the public markets.

The schedule for the asset class education is as follows:

- February – Global Equity and Fixed Income
- March – Absolute Return
- April – Private Equity and Private Credit
- May – Real Assets
- June – Real Estate

ATTACHMENTS

- Board Order
- Fixed Income Overview presentation
- Global Equity Overview presentation

Prepared by:

/s/

Steve Davis
Chief Investment Officer

Reviewed by:

/s/

Eric Stern
Chief Executive Officer

/s/

Brian Miller
Senior Investment Officer



Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
February 21, 2024

AGENDA ITEM:

Education:

Global Equity and Fixed Income Asset Classes

THE BOARD OF RETIREMENT hereby approves Staff's recommendation to receive and file presentations on Global Equity and Fixed Income asset classes.

I HEREBY CERTIFY that the above order was passed and adopted on February 21, 2024 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES:

(Present but not voting)

James Diepenbrock
Board President

Eric Stern
Chief Executive Officer and
Board Secretary



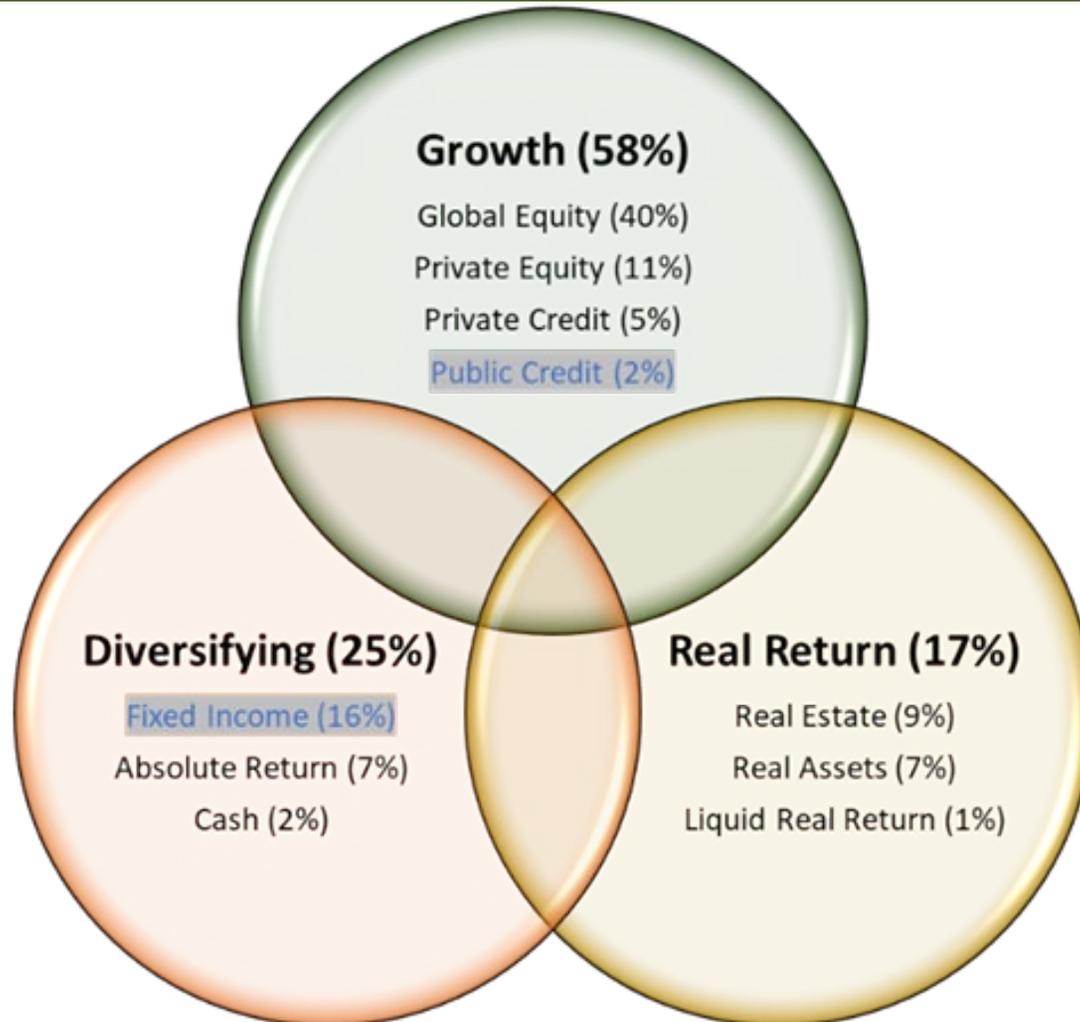
Education – Fixed Income Overview

February 21, 2024

Introduction

- Portfolio fit
- Roles and objectives
- Fixed Income timeline
- Portfolio construction
- Performance
- Asset class trends and considerations

Portfolio Fit



- Fixed Income portfolio resides within two asset categories; serves multiple roles within the portfolio

Portfolio Construction

Asset Class/Segment	Asset Category	Minimum	Target	Maximum
Total Fixed Income Portfolio		13%	18%	23%
Fixed Income	Diversifying	12%	16%	20%
Core Plus Fixed Income		9%	12%	15%
U.S. Treasuries		3%	4%	5%
Public Credit	Growth	1%	2%	3%

Roles and Objectives

Moderate income and cash flow generation

Diversification for SCERS' portfolio - "anchor to safety"

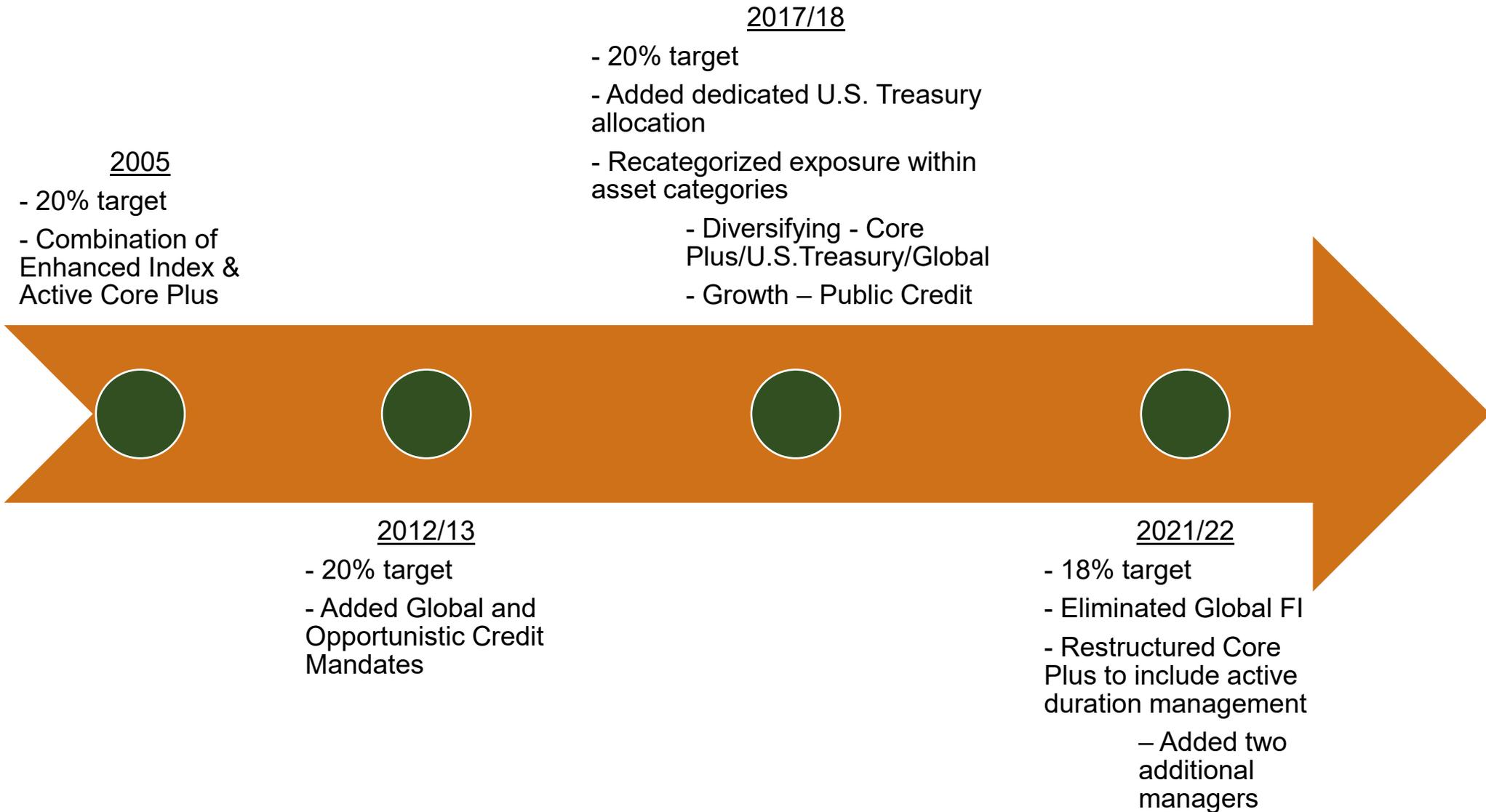
Return enhancement

Liquidity

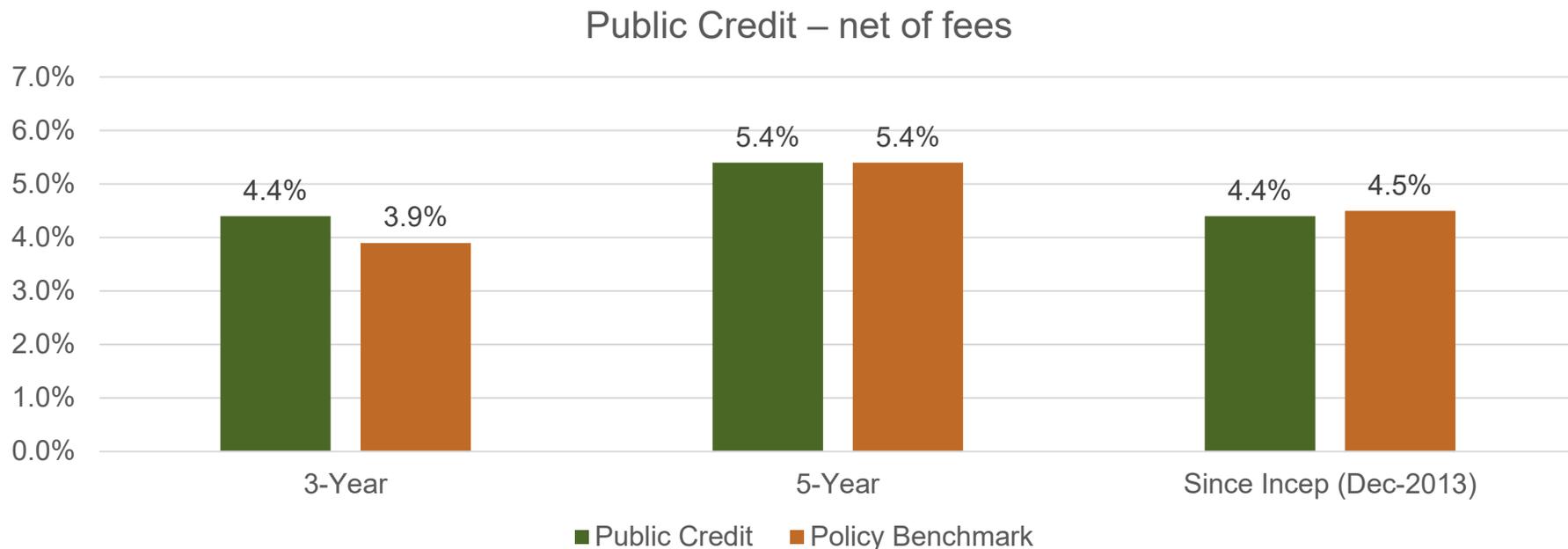
Governance

- Traditional assets/public markets protocol
- Includes Public Equities; Fixed Income; Public Credit; Liquid Real Return
 - Delegates the most time-intensive elements of the process to Staff and consultant, including screening and evaluation leading to the recommendation to engage or terminate a particular investment manager
 - Board provides oversight of these segments and makes final decision regarding engagement or termination of investment managers

Fixed Income Timeline

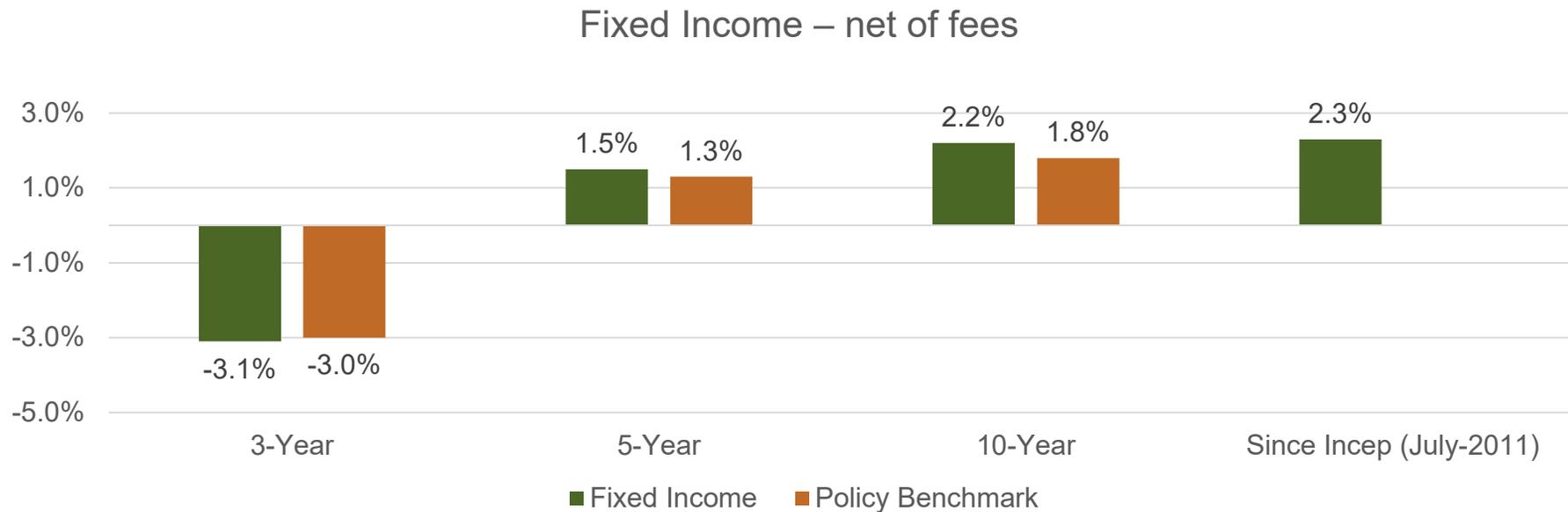


Public Credit Performance – Growth Asset Category



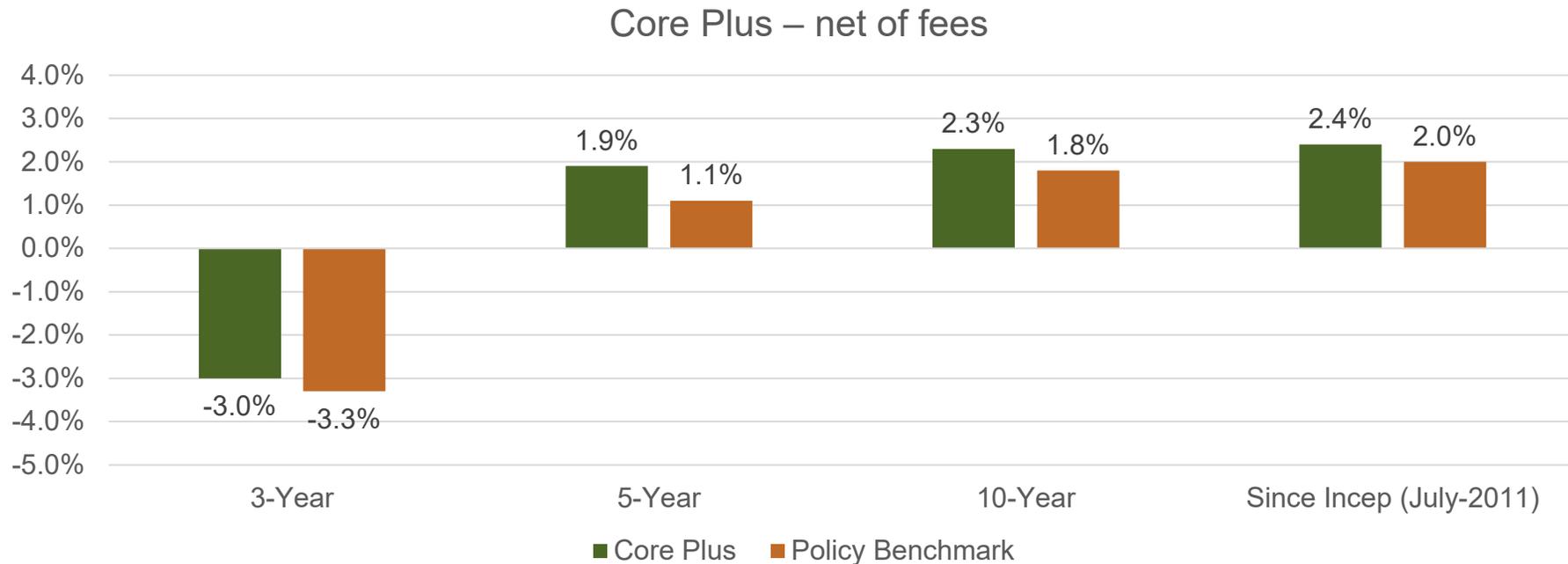
- Enhanced return objective - since inception return of 4.4%
 - Has underperformed 2013 forecast of 5.3%, but has outperformed core plus which was the funding source
- Greater volatility reflects placement in Growth asset category
- Sole manager (Brigade) has performed in line with benchmark (50% ML High Yield Index + 50% Credit Suisse Leveraged Loan Index) over time

Fixed Income Performance – Diversifying Asset Category



- Primary role is diversification, income, and liquidity; secondary is return enhancement
- Returns have been muted – impacted by recent interest rate hikes
 - Anchor-to-safety link broke during recent inflationary years
 - Treasury addition in 2018 helped during COVID selloff
- Benchmark: 75% Bloomberg U.S. Aggregate Index / 25% Bloomberg U.S. Treasury Index

Core Plus Performance



- Core plus represents SCERS' active Fixed Income exposure
- Excess return expectations are moderate
- Moderate outperformance generated by active core plus mandates
- Benchmark: Bloomberg U.S. Aggregate Index

Investment Manager Performance

Above Expectations

- PGIM (\$344 m) – core plus (Aug-14)
- TCW (\$345 m) – core plus (Jan-02)
- Reams (\$352 m) – core plus (Jun-22)

In Line with Expectations

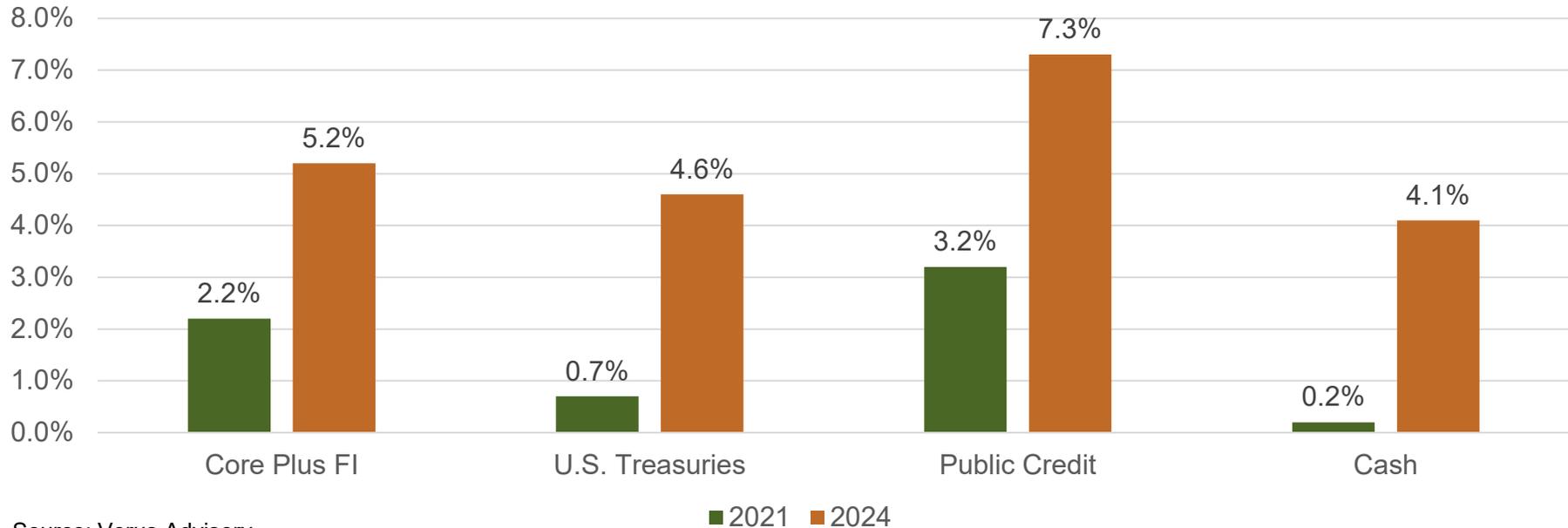
- Brandywine (\$337 m) – core plus (Jun-22)
- Brigade (\$224 m) – public credit (Dec-13)

Below Expectations

- None

Asset Class Trends and Considerations

Capital Market Assumptions – Expected Returns as of 01/01/24



Source: Verus Advisory

- Higher interest rates – increased return expectations for fixed income, and downside protection too
- Public credit portfolio structure
- Cash implementation in a rate cutting environment

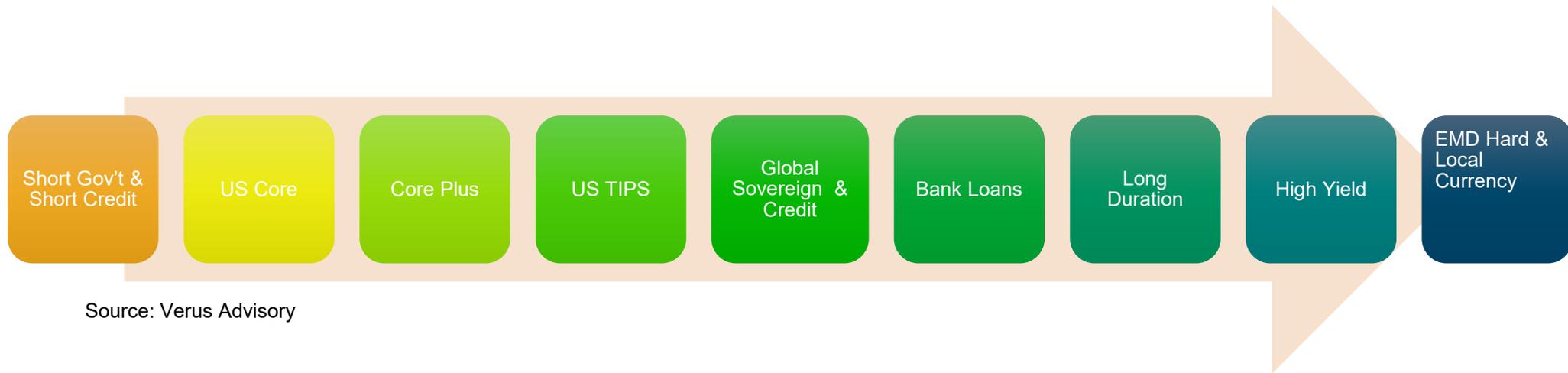


Appendix – Fixed Income Concepts and Terminology

What is Fixed Income?

- Fixed income is a class of assets and securities that pay out a set level of cash flows to investors, typically in the form of fixed interest or dividends.
- Government and corporate bonds are the most common types of fixed-income products.
- They are known as fixed-income because they pay a fixed interest rate credited to investors.
- At maturity for many fixed income securities, investors are repaid the principal amount they had invested in addition to the interest they have received.
- In the event of a company's bankruptcy, fixed-income investors are often paid before common stockholders.

Spectrum of Fixed Income Opportunities



Source: Verus Advisory

Role of fixed income asset classes

ASSET CLASSES	LEVERS					DIVERSIFICATION & VOLATILITY		FACTORS Elements of Return for Asset Class
	CAPITAL PRESERVATION	INCOME	CREDIT PREMIUM	TENOR PREMIUM	LIQUIDITY	ABSOLUTE VOLATILITY	CORRELATION TO EQUITIES	
SHORT GOV'T/ CREDIT								Short-end exposure; less sensitive to moves in rates.
US CORE								Diversified exposure to Treasuries agencies, MBS, CMBS, corporates.
CORE PLUS								Increased exposure to spread sectors adds credit exposure.
US TIPS								Diversify nominal bonds, hedge against inflation.
GLOBAL SOVEREIGN & CREDIT								Unhedged portfolios add currency beta: expands bond opportunity set.
BANK LOANS								Below-investment grade, floating rate, LIBOR floor, very low duration.
LONG DURATION (GOV'T CREDIT)								Long duration, higher credit exposure.
HIGH YIELD								Below-investment grade, high credit and default risks, high YTM.
EMD HARD & LOCAL CURRENCY								Local currency adds currency beta: increased geopolitical, credit and default risk.

Source: Verus Advisory



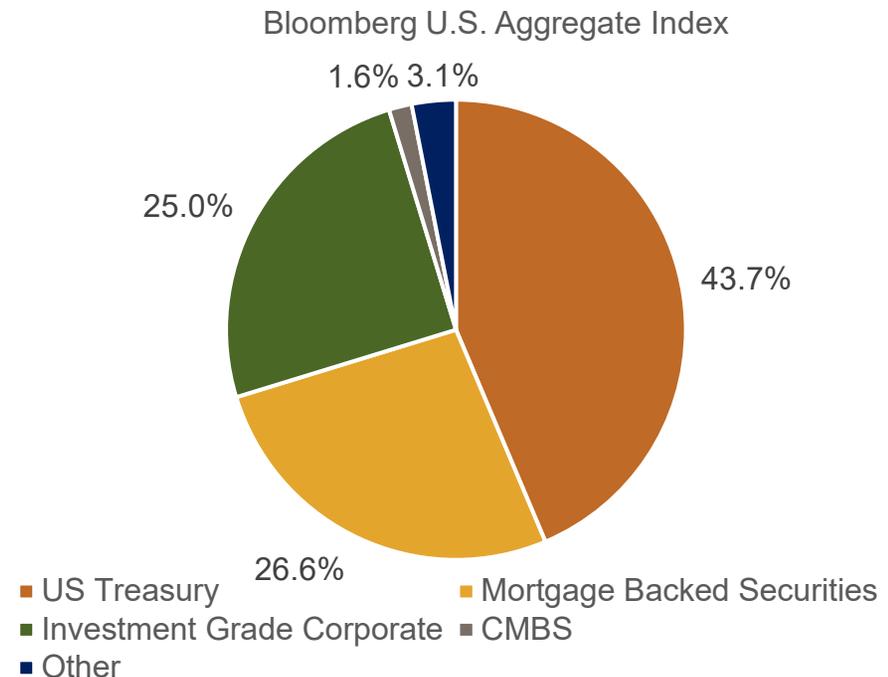
Core Fixed Income

Characteristics:

- Core fixed income strategies typically invest primarily in a diversified mix of U.S.-dollar denominated investment-grade fixed income securities, particularly U.S. government, corporate and securitized assets
- Active fixed income managers seek to add value by managing various risk exposures, including duration, yield curve, sector allocation, and security selection
- Strategies are often benchmarked versus the Bloomberg Aggregate Bond Index

Benefits:

- Core fixed income strategies are considered more conservative than other fixed income strategies (EMD, high yield, bank loans)
- Bonds provide income, act as a diversifier and can reduce overall portfolio volatility



Core Plus Fixed Income

Characteristics:

- Core plus strategies add investments to core investment-grade portfolios that have greater risk and return potential. “Plus” sectors include high yield, bank loans, non-U.S. dollar bonds, emerging markets, etc.
- Managers often add value through sector allocation and issuer selection

Benefits:

- Core plus strategies can offer investors broad market exposure
- Convenient way to access “plus” sectors for smaller clients who do not have dedicated exposures
- Yield advantage over core strategies

High Yield Fixed Income

Characteristics:

- High yield fixed income strategies consist primarily of corporate bonds rated below BBB- or Baa3 due to higher risk of default
 - To compensate for this risk, these bonds pay a higher yield than investment grade bonds

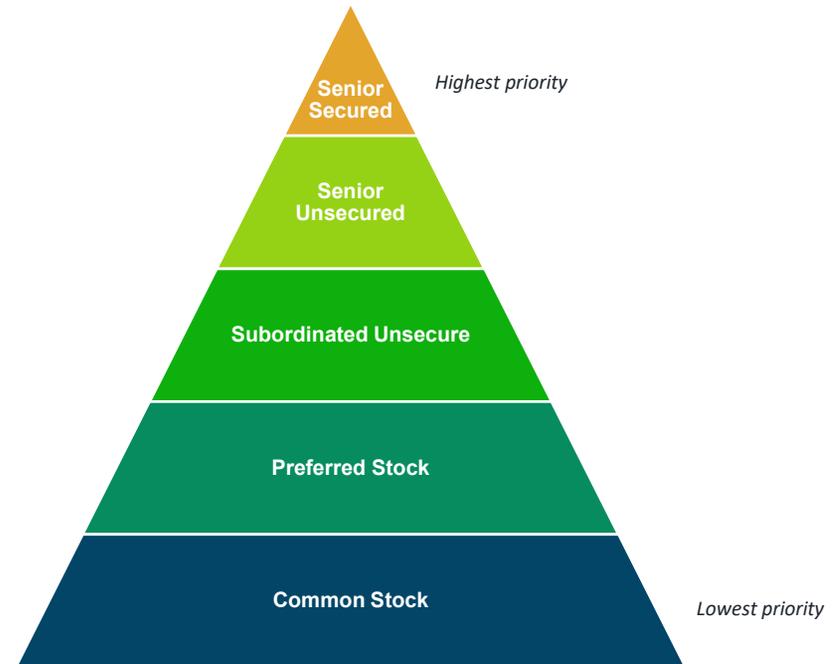
Benefits:

- Investors in high yield earn a credit risk premium in the form of higher coupon payments
- Generally low correlation to other sectors of the fixed income market although high yield can exhibit return patterns similar to equities

Bank Loans

Characteristics:

- Bank loans or “floating-rate” loans are debt obligations issued by banks and other financial institutions that consist of loans made to companies
- Loans are most often senior and secured, sitting atop the capital structure
- Bank loans have the highest priority in case of a default, above senior unsecured debt, subordinated unsecured debt, preferred stock and common stock



Source: Verus Advisory

Benefits:

- Exposure to floating-rate securities can generate consistent risk-adjusted return across interest rate regimes.
- Bank loans reduce the duration risk but offset the yield loss with increased credit exposure.
- Senior loans have diversification benefits to fixed income or equity portfolios (historically low correlation to investment-grade bonds and Treasuries).



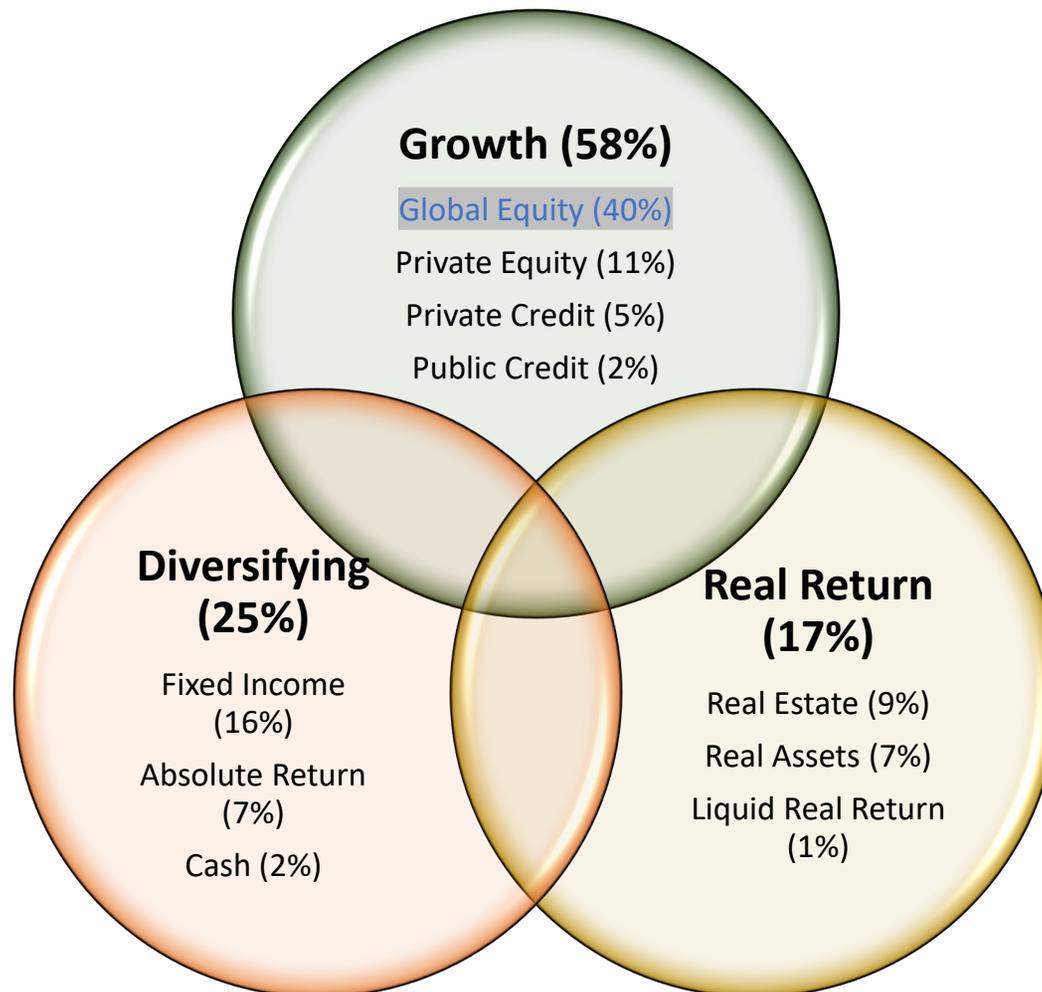
Education – Global Equity Overview

February 21, 2024

Introduction

- Portfolio Fit
- Roles and Objectives of Global Public Equity
- Public Equity Timeline
- Portfolio Construction
- Performance – Total Returns and Relative to Benchmark
- Asset Class Trends and Considerations

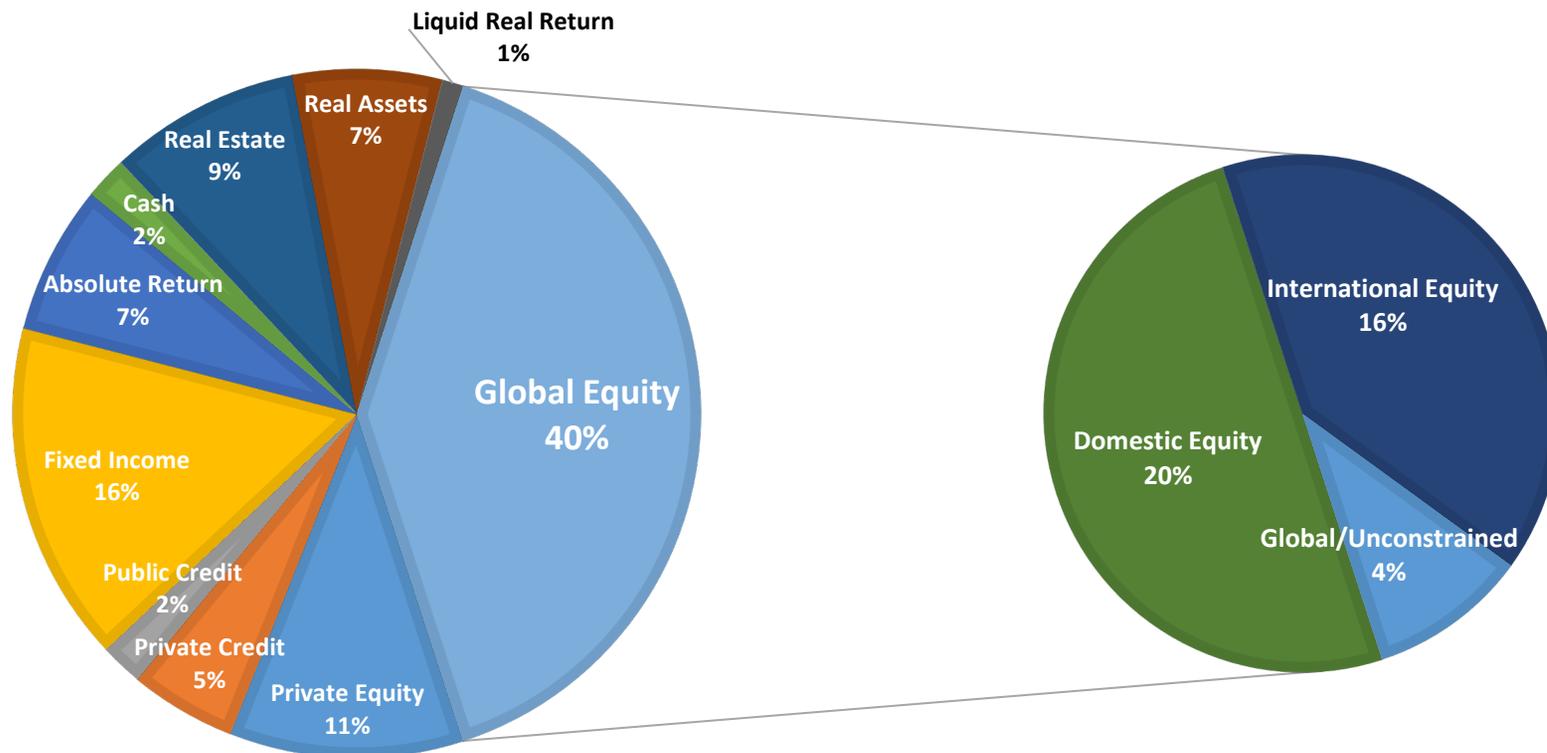
Portfolio Fit



- Global Equity resides in the Growth Asset Category

Portfolio Fit

SCERS ASSET ALLOCATION ASSET CLASS DETAIL



- Global Equity is the largest individual asset class allocation
- Dedicated Sub-asset class allocations

Roles and Objectives

Enhance total fund performance

Generate returns in excess of equity benchmarks

Invest in a diversified portfolio of public equity securities (geography, market capitalization, investment style, etc.)

Maintain reasonable levels of aggregate risk

Governance

- Traditional assets/public markets protocol
- Includes Public Equities; Fixed Income; Public Credit; Liquid Real Return
 - Delegates the most time-intensive elements of the process to Staff and consultant, including screening and evaluation leading to the recommendation to engage or terminate a particular investment manager
 - Board provides oversight of these segments and makes final decision regarding engagement or termination of investment managers

Public Equity Timeline

2005

- 58% Public Equity Target
- 35% Domestic, 20% Int'l
- 3% Real Estate Public Equity (included in Real Estate asset class)

2017

- 41% Target
- 21% Domestic, 20% Int'l
- Core Approach in Large Cap Domestic Equity
- Eliminated dedicated REIT exposure
- Reduced Domestic Small Cap from 15% to 10%
- 2019 Reduced Allocation by 1% for Dedicated Cash Allocation

2012

- 45% Target
- 22.5% Domestic, 22.5% Int'l
- Real Estate (REITs) moved to sub-allocations within Domestic and Int'l
- Passive Exposure increased to 54% of Domestic Equity

2021

- 40% Global Equity Target (updated benchmark to ACWI IMI)
- Added Global/Unconstrained
- 20% Domestic, 16% Int'l, 4% Global
- Restructured Int'l Equity sub-asset class
- Passive Exposure 50% of Domestic Equity

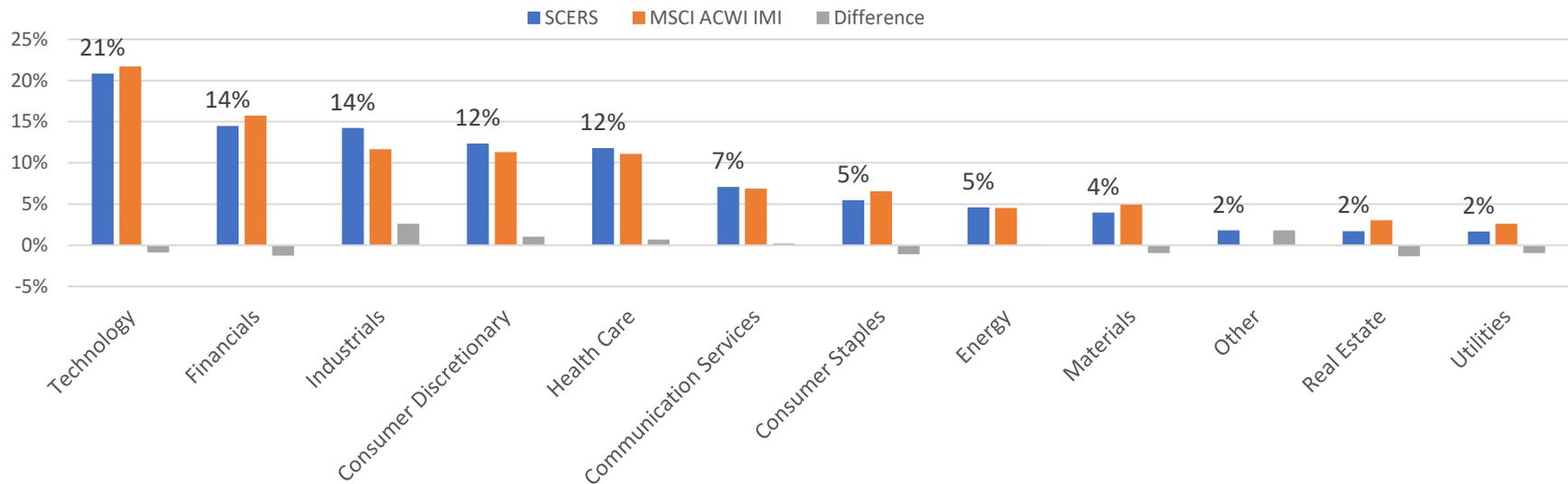
Portfolio Construction

Asset Class/Segment	Minimum	Target	Maximum	Allocation 12/31/23
Total Global Equity Portfolio	36%	40%	44%	40.6%
Domestic Equity	18%	20%	22%	20.7%
International Equity	14%	16%	20%	16.9%
Global/Unconstrained	1%	4%	6%	3.0%

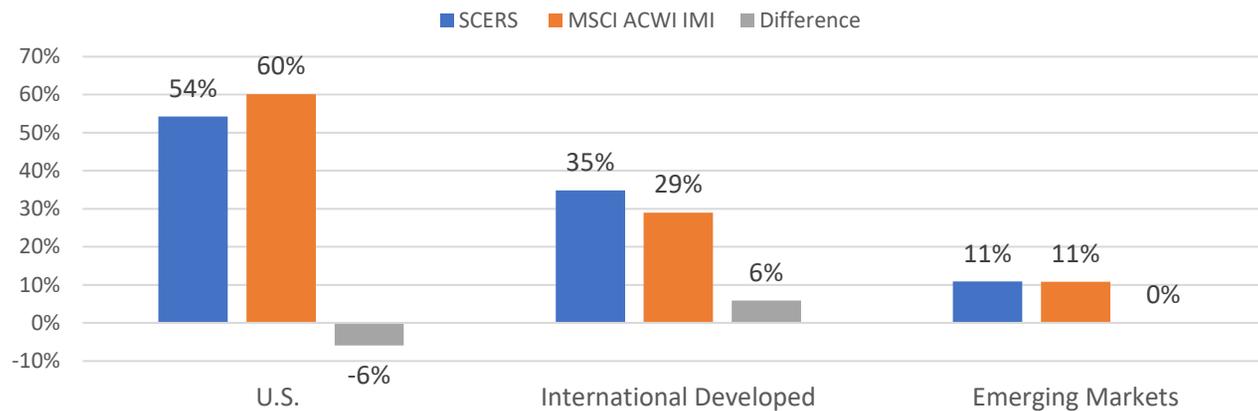
- Global Equity benchmarked to the MSCI ACWI IMI Index
- Total allocation near target of 40% following strong returns in 2023
 - Slightly above target for Domestic and International
 - Below target for Global/Unconstrained
 - Added to asset allocation in 2021

Global Equity Portfolio Exposures

SCERS Global Equity Sector Exposure vs MSCI ACWI Benchmark

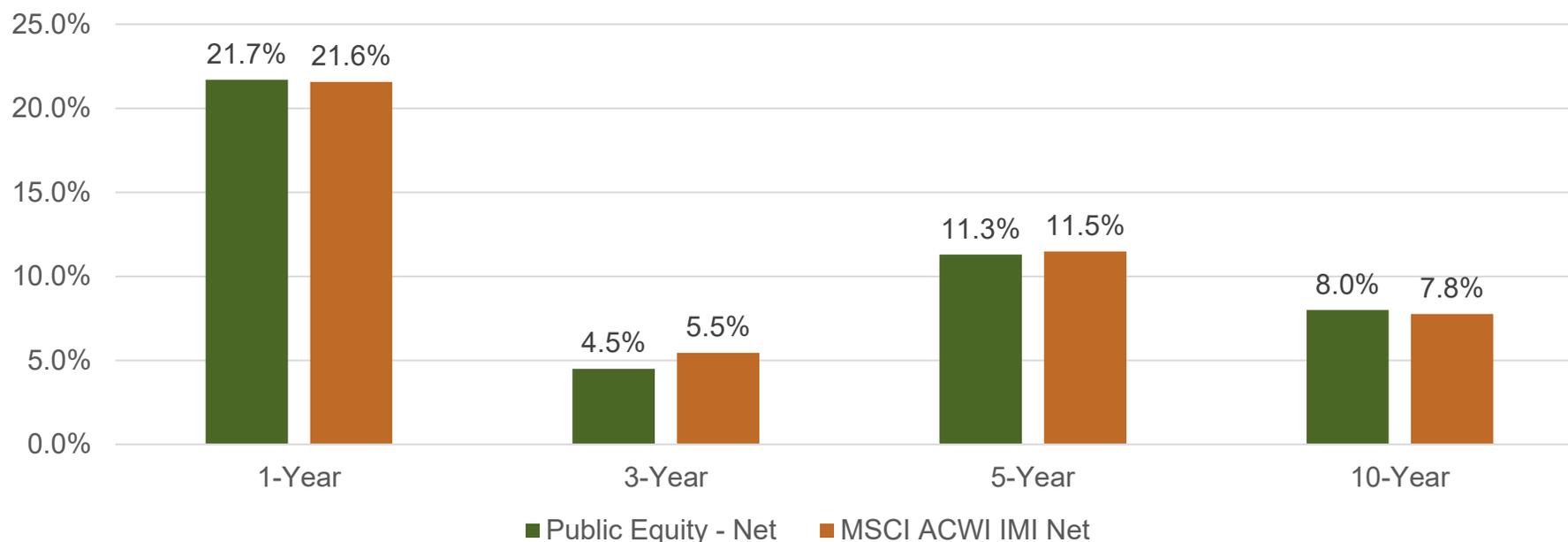


SCERS Global Equity Regional Exposure vs MSCI ACWI Benchmark



Global Public Equity Performance

Public Equity – net of fees as of 12/31/23



- Enhanced return objective – 10-Year return of 8.0% versus 7.8% CMA forecast, 5-Year return of 11.3% versus 6.7% CMA forecast
- Moved to Global Equity benchmark (MSCI ACWI IMI) following 2021 ALM Study
- Returns have underperformed asset class benchmark
 - Underweight U.S. Equity relative to benchmark weight

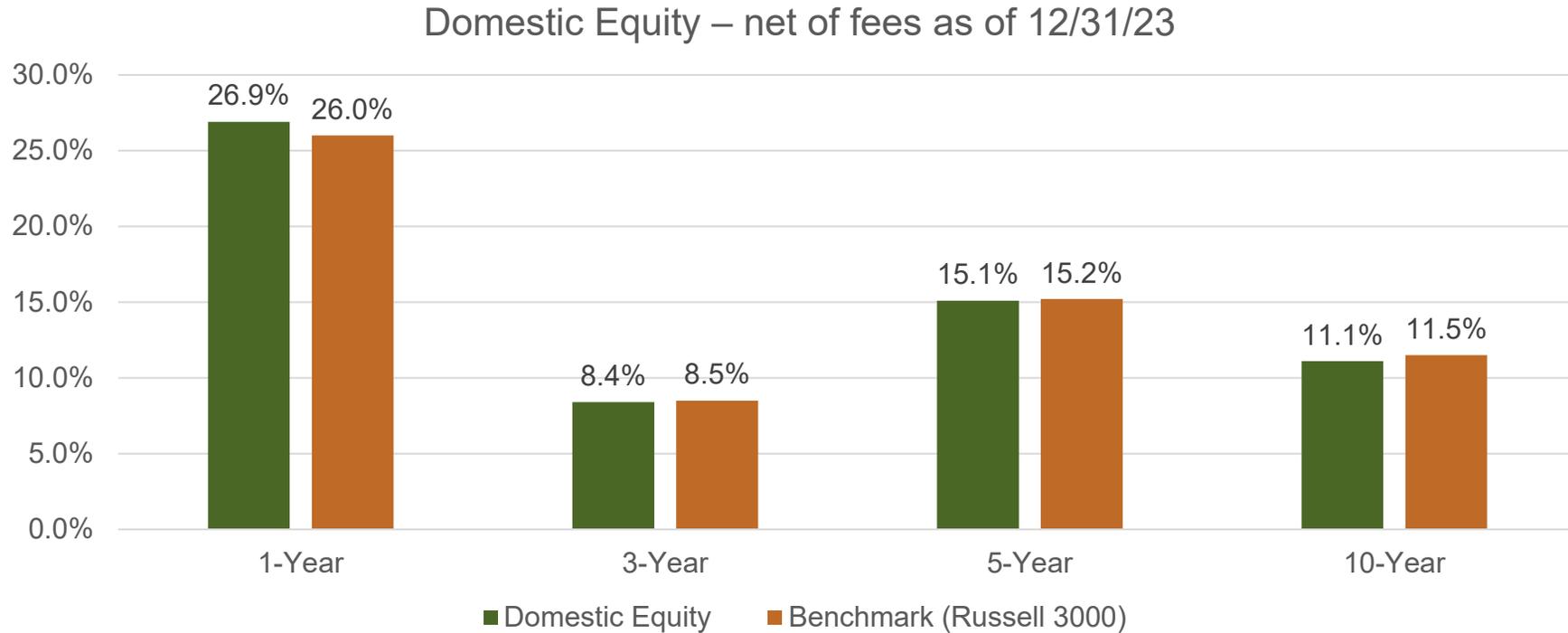
Domestic Equity Structure and Exposure

Domestic Equity Structure				
Sub-Asset Class	Minimum	Target	Maximum	Allocation 12/31/23
Domestic Equity	12%	16%	20%	20.7%

Sub-Asset Class Segment	Target	Allocation 12/31/23
Domestic Equity Large Cap	90%	91.4%
Large Cap Passive	50%	49.9%
Large Cap Active	40%	41.4%
Domestic Equity Small Cap		
Small Cap Active	10%	8.6%

- Large Cap has outperformed Small Cap in recent years
- Small Cap underweight relative to target, but still above benchmark weight
 - Small cap 5.4% weight within Russell 3000 Index
- Restructured in 2017 and moved to Core approach in Large Cap active segment
 - Reduced management fees, eliminated Growth/Value, decreased Small Cap

Domestic Equity Performance



- Large Cap has outperformed Small Cap in recent years
- Small Cap managers generating greater excess returns versus benchmarks

Domestic Equity Manager Performance

Above Expectations

- J.P. Morgan 130/30 (\$196m) – large cap active (Aug-08)
- Alger/Weatherbie (\$101m) – small cap growth (Jan-03)

In Line with Expectations

- Eagle (\$369m) – large cap active (Mar-12)
- AQR (\$374m) – large cap active (Aug-18)
- Snyder (\$128m) – small cap value (Feb-21)

Below Expectations

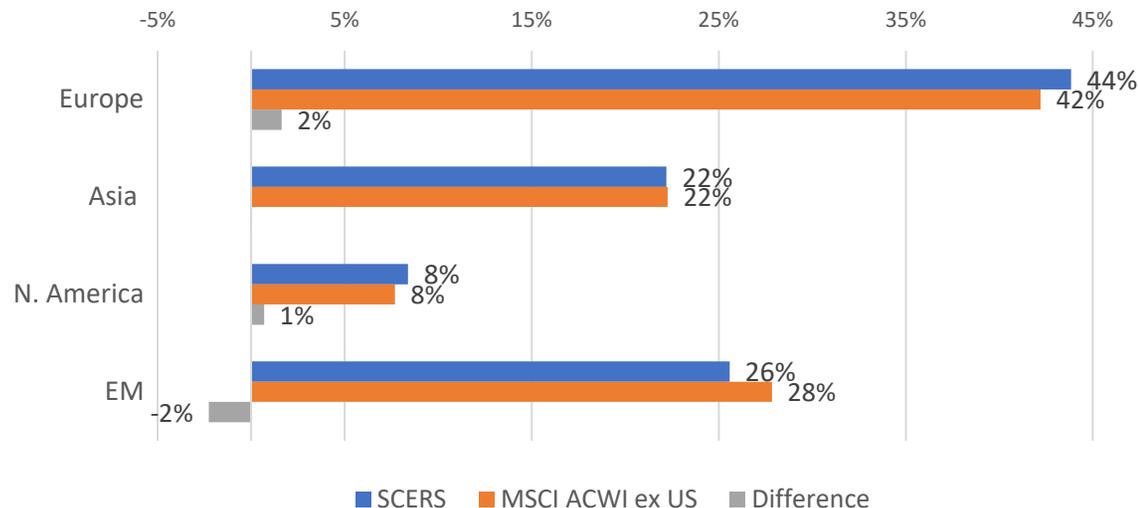
- D.E. Shaw 130/30 (\$171m) – large cap active (Feb-19)

International Equity Structure and Exposure

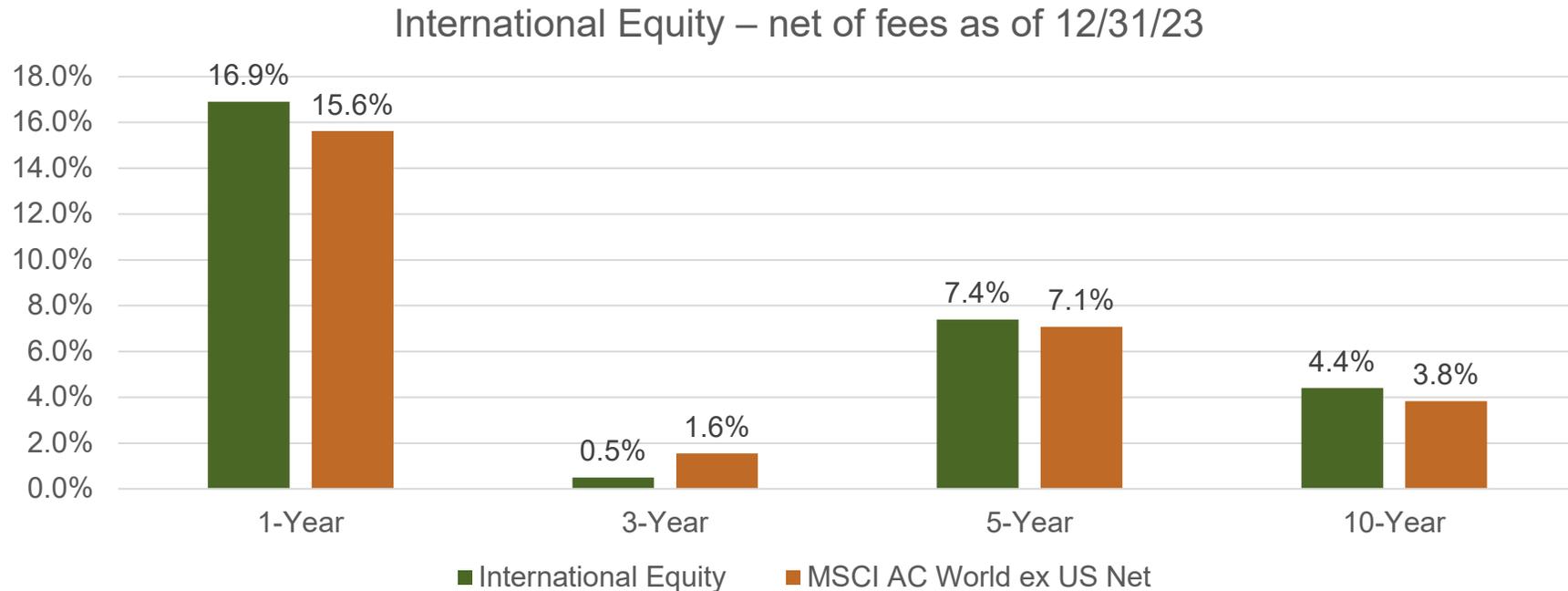
International Equity Structure				
Sub-Asset Class	Minimum	Target	Maximum	Allocation 12/31/23
International Equity	14%	16%	20%	16.9%

Sub-Asset Class Segment	Target	Allocation 12/31/23
International Equity Large Cap	60%	63.1%
International Equity Small Cap	10%	9.7%
Emerging Markets	30%	27.2%

SCERS Int'l Equity - Regional Exposure



International Equity Performance



- Reduced Int'l Equity target to 16% (from 20%) and restructured portfolio in 2021
 - Increased EM exposure and restructured EM manager line-up
 - Restructured Large Cap Core mandate with Lazard
 - Replaced Int'l Small Cap Value manager in 2022

International Equity Manager Performance

Above Expectations

- Baillie Gifford (\$213m) – EM growth (Apr-16)
- ARGA (\$200m) – EM value (Feb-23)
- Walter Scott (\$515m) – developed large cap growth (Apr-17)

In Line with Expectations

- LSV (\$525m) – developed large cap value (Jan-05)
- Lazard (\$342m) – developed large cap core (Jul-12)
- Acadian (\$108m) – developed small cap value (Apr-23)
- Oaktree (\$183 m) – EM core (Feb-23)

Below Expectations

- William Blair (\$104 million) – developed small cap growth (Oct-08)

Global/Unconstrained

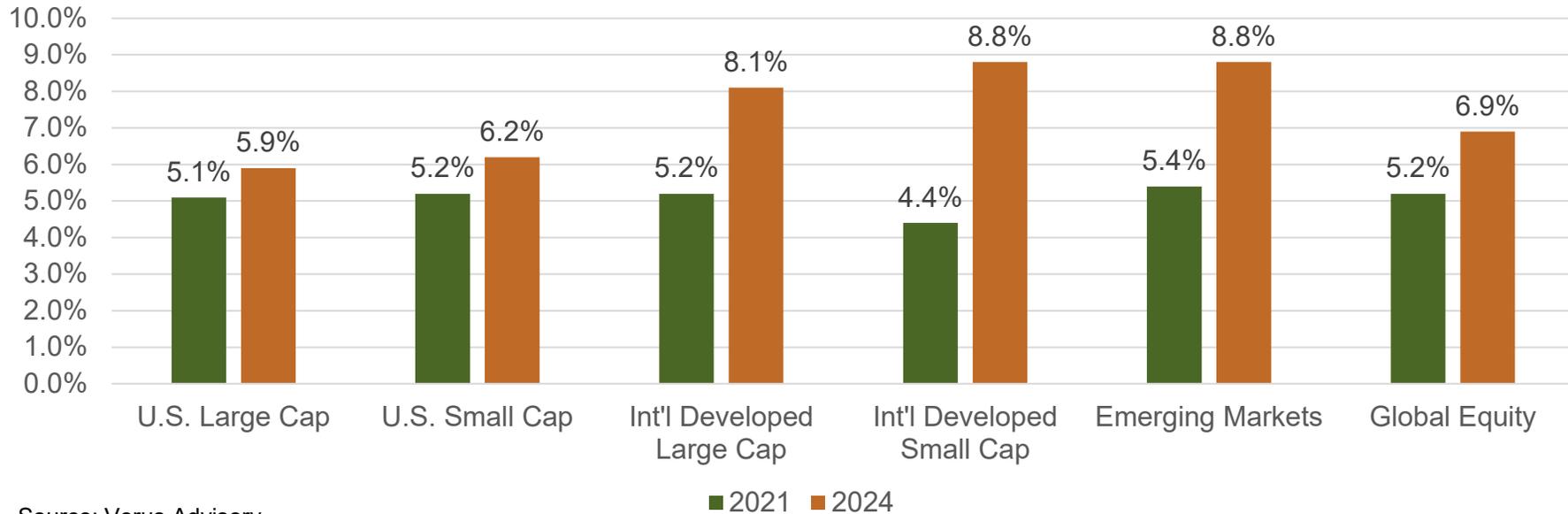
Global/Unconstrained Equity Structure				
Sub-Asset Class	Minimum	Target	Maximum	Allocation 12/31/23
Global/Unconstrained Equity	1%	4%	6%	3.0%
Sub-Asset Class Segment		Target	Allocation 12/31/23	
Global Equity		>/= 50%	68.9%	
Non Beta 1 (Long/Short)		</= 25%	9.1%	
Other Unconstrained		</= 25%	22.0%	

Note: Includes Third Point Partners (Unconstrained – Non Beta 1), which is being fully liquidated

- Added to SCERS' Global Equity asset allocation in 2021
 - First additions to portfolio in 2022
 - Long-only global mandates with Artisan and Nikko (September 2022)
- Expanded opportunity set for public equity mandates
- Marginally increased exposure to U.S. equity
 - Decreased International Equity exposure by 4%
 - Global mandates benchmarked to MSCI ACWI benchmark (60% U.S.)
- Initial Performance from Nikko and Artisan have been below expectations

Asset Class Trends and Considerations

Capital Market Assumptions – 2024 10-Year Expected Returns



- Higher overall return expectations for Public Equity, particularly in International and Emerging Markets (versus U.S.)
- Active versus Passive Management – emphasis on management fees and net returns
- Evaluation of benchmarks and SCERS' Total Global Equity exposure
 - Geographic and Market Cap Exposure relative to benchmark

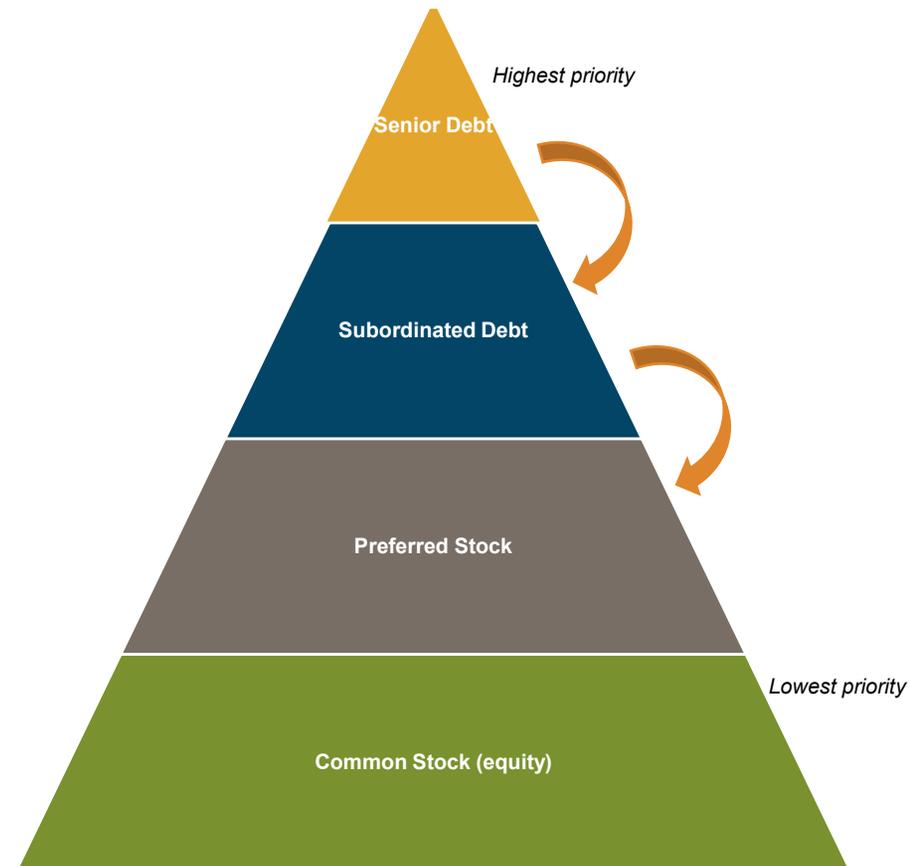


Appendix – Public Equity Concepts and Terminology

What is a stock?

- Equity is an ownership interest in a company or asset.
Think of a home, homeowners that have a mortgage are the “equity” and the mortgage holder (bank) is the debt.
- Common Stocks are the equity position in a publicly-traded company. They represent a fractional ownership in a company.
- Since common stocks are the lowest priority position in a capitalization table, they get paid last on company cash flows.
- Going back to the homeowner analogy, if he/she sells their home, the mortgage holder gets paid first, anything left over goes to the homeowner.
- Same with stocks, companies that generate cash flows must pay the debt and any securities ahead of common stock first, the remainder goes to stockholders.

Capitalization Table



Source: Verus Advisory

Types of Stocks

Large Cap

- Bigger companies, “household names”
- Represented by Russell 1000 Index
- \$666 billion weighted average market cap

Small Cap Stocks

- Smaller companies
- Represented by Russell 2000 Index
- \$3.3 billion weighted average market cap

“Value” Portfolios

- Are “cheaper” than the market and as such thought to represent “a good value”

“Growth” Portfolios

- Aren’t “cheap” but are believed to have high potential for earning growth and price appreciation

“Core” Portfolios

- Contain a mix of value and growth companies

Characteristic	Russell 1000	Russell 1000 Growth	Russell 1000 Value	Russell 2000
Weighted Avg. Mkt. Cap (\$ billions)	\$666.04	\$1,114.75	\$139.54	\$3.27
Price-to-Earnings (P/E)	25.4	35.7	19.0	34.4
P/E Ex-Neg Earnings	22.9	34.5	16.2	15.8
Price-to-Book (P/B)	4.3	5.6	2.43	
Dividend Yield (%)	1.44	0.74	2.27	

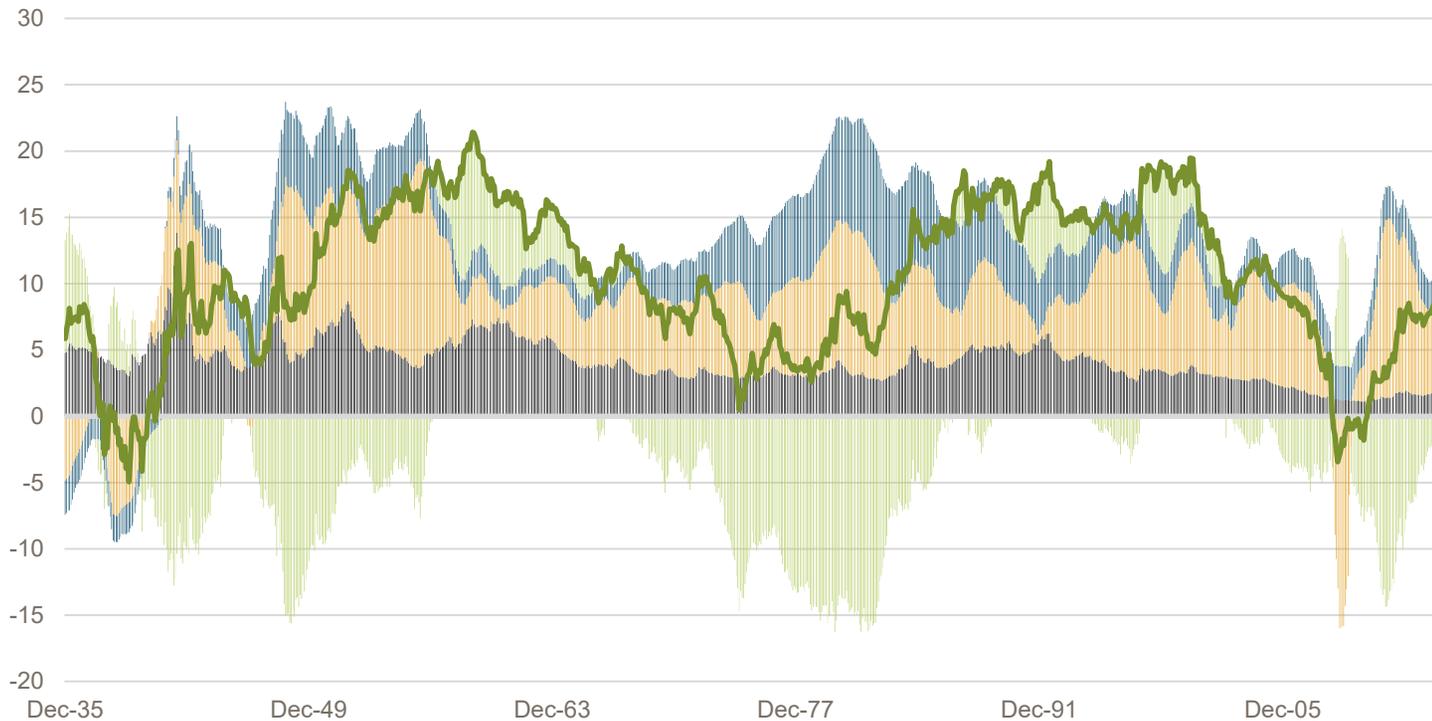
Source: SCERS, FTSE Russell, as of 12/31/23



*EM = Emerging Markets Source: SCERS, Caissa, FTSE Russell, as of 12/31/23

The bar chart shows the breakdown of large vs. small as well as the weighting of domestic, international developed and emerging markets.

Composition of S&P 500 Index return



The performance (return) of the stock market is comprised of various factors, including dividend yield, earnings growth, impact of inflation, and market repricing

■ Dividend Yield ■ Real Earnings Growth ■ Inflation Growth
■ Repricing Return — 10 Yr. Rolling Return

Note: Figures shown in chart are rolling 10-year returns for the Standard & Poor's 500 Index.

Source: Verus Advisory

The role of asset classes

- Why do we invest in various asset classes?
- What is it we practically expect them to contribute to the portfolio over time?
- What will determine whether or not they serve the desired role?

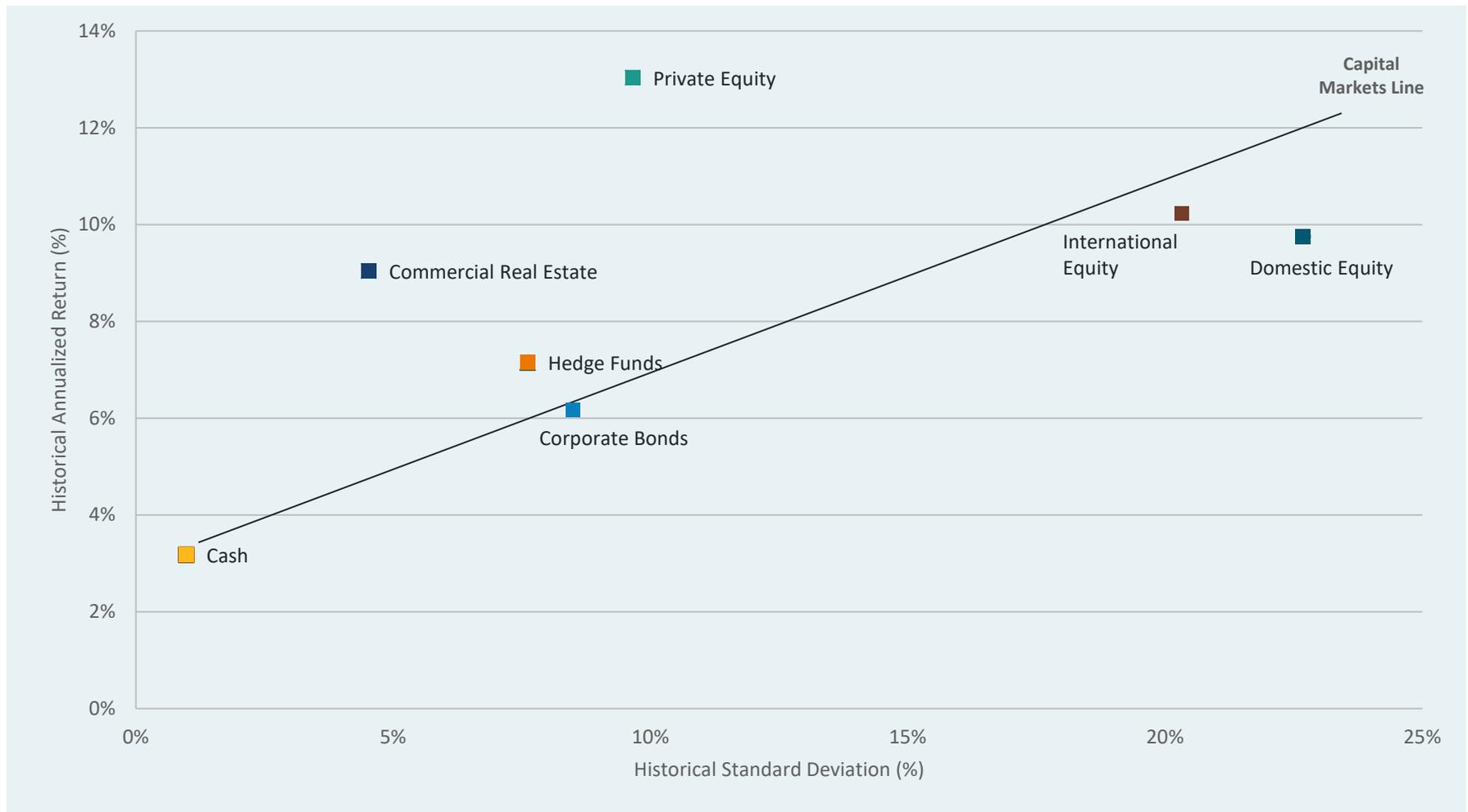
	RETURN ROLES				DIVERSIFICATION & VOLATILITY ROLES			HOW MACRO OUTLOOK/GDP AFFECTS ROLE	
	Benefit from GDP Growth	Earn Risk Premium	Produce Stable Income	Hedge Against Inflation	Low Absolute Volatility	Low Corr. To Other Assets	Reduce Portfolio Volatility	Elements of Return for Asset Class	Sensitivity to GDP
Public Equities	●	◐	◐	◑	○	○	○	PEs, Dividends, Earnings Growth	●
Private Equities	●	●	○	◑	○	◐	○	PEs (exits), Financing, Opportunity Set	●
Fixed (Treasury)	○	○	●	◐	●	●	●	Direct Link to Yields	◑
Fixed (Credit)	◑	◑	●	◐	◐	◑	◐	Direct Link to Yields, Credit Spreads	◐
Real Estate	●	◑	◐	●	◐	◑	◑	Unemployment, Vacancies, Cap Rates	●

MAGNITUDE	●	◐	◑	◒	○
	High	Med-High	Medium	Low	None

Source: Verus Advisory

Asset class risk vs. return

Different asset classes have very different risk and return profiles



Source: Verus Advisory