

# Pension Trust

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San Luis Obispo, CA 93408  
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www.SLOPensionTrust.org

San Luis Obispo County  
Pension Trust  
*SLOCPT*

## AGENDA

**Monday, September 28, 2020 9:30 AM**

### **PENSION TRUST BOARD OF TRUSTEES**

\* Online only

#### MEETING MATERIALS

Materials for the meeting may be found at

<http://www.slocounty.ca.gov/Departments/Pension-Trust/Board-of-Trustees>

Any supporting documentation that relates to an agenda item for open session of any regular meeting that is distributed after the agenda is posted and prior to the meeting will also be available at this location.

#### AMERICANS WITH DISABILITIES ACT (Government Code §54953.2)

Disabled individuals who need special assistance to listen to and/or participate in any meeting of the Board of Trustees may request assistance by calling 805/781-5465, or sending an email to [SLOCPT@co.slo.ca.us](mailto:SLOCPT@co.slo.ca.us). Every effort will be made to reasonably accommodate individuals with disabilities by making meeting materials and access available in alternative formats. Requests for assistance should be made at least two days in advance of a meeting whenever possible.

#### **\* TELE-CONFERENCE / VIDEO-CONFERENCE**

**Due to the current pandemic Board of Trustees meetings are closed to the public attending in person until further notice.**

This meeting of the Board of Trustees will be held via teleconference and/or videoconference pursuant to Executive Order N-25-20, issued by Governor Newsom on March 12, 2020, Executive Order N-29-20, issued by Governor Newsom on March 17, 2020, and Executive Order N-35-20, issued by Governor Newsom on March 21, 2020. Items of business will be limited to the matters shown on the agenda.

If you wish to view the videoconference of the meeting please access

<https://zoom.us/j/91982523756?pwd=ejJEUXp2K2NjRS91cWhwdmh6UjVtQT09>

If you wish to listen to the teleconference meeting, please dial 669/900-6833. (Meeting ID 919-8252-3756). If you have any questions or require additional service, please contact SLOCPT at 805/781-5465.

**A) PUBLIC COMMENT**

1. Public Comment: Members of the public wishing to address the Board on matters other than scheduled items may do so when recognized by the Chair. Presentations are limited to three minutes per individual.

**B) CONSENT**

2. Minutes of the Regular Meeting of August 24, 2020 (Approve Without Correction).
3. Reports of Deposits and Contributions for the month of August 2020 (Receive and File).
4. Reports of Service Retirements, Disability Retirements and DROP Participants for the month of August 2020 (Receive, Approve and File).

**C) ORGANIZATIONAL**

None

**D) CLOSED SESSION**

5. PUBLIC EMPLOYEE EVALUATION. The Board will convene in closed session pursuant to Gov. Code section 54957(b)(1) to conduct the annual employee evaluation of the Executive Director.

*Closed session to be held in a separate Zoom videoconference for Trustees only*

**E) APPLICATIONS FOR DISABILITY RETIREMENT**

None

**F) OLD BUSINESS**

None

**G) NEW BUSINESS**

- 6. Fiduciary Refresher Briefing – General Counsel (Review, Discuss).

***Break – 10 minutes***

**H) INVESTMENTS**

- 7. Monthly Investment Report for August 2020 (Receive and File).
- 8. Asset Allocation Policy – Amended Investment Policy Statement (Recommend Approval).
- 9. Alternative Investments Fee Disclosure – CA Code 7514.7 - (Receive and File).
- 10. Asset Allocation - (Review, Discuss, and Direct Staff as necessary)

***Break – 30 minutes***

**I) STRATEGIC PLANNING SESSION**

- 11. Funding Policy and Projections Update - (Review, Discuss, and Direct Staff as necessary).
- 12. Staffing Continuity - (Review, Discuss, and Direct Staff as necessary).
- 13. Investment Consultant – Future Needs - (Review, Discuss, and Direct Staff as necessary).

**J) OPERATIONS**

- 14. Staff Reports
- 15. General Counsel Reports
- 16. Committee Reports:
  - i. Audit Committee                      No Report
  - ii. Personnel Committee              Report

17. Upcoming Board Topics (subject to change)
  - i. October 26, 2020 (planned as a non-meeting month)
  - ii. November 23, 2020
    - a. Appointment of Replacement Elected Trustee
    - b. Interest Crediting Rates and PEPRAs Compensation Limit
    - c. Actuarial Services RFP responses and Selection
    - d. Quarterly Investment Report
    - e. Investment Strategy – Liquidity Investments
    - f. Investment Strategy – Growth Asset Classes
  - iii. December 21, 2020 (planned as a non-meeting month)
  - iv. January 25, 2021
    - a. Election of Officers
    - b. Committee Appointments
    - c. Annual Policies Review
  - v. February 22, 2021
    - a. Retiree COLA – effective 4/1/21
    - b. Quarterly Investment Report
    - c. Capital Market Assumptions
    - d. Asset Allocation Policy Investment Strategy – Diversifying Asset Classes
    - e. Investment Strategy – Growth Asset Classes
18. Trustee Comments

## **K) ADJOURNMENT**

**PENSION TRUST  
BOARD OF TRUSTEES**

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**MINUTES**

**PENSION TRUST  
BOARD OF TRUSTEES**

**Monday, August 24, 2020 \***  
Regular Meeting of the Pension Trust  
Board of Trustees

*\* Note – all attendees participated via videoconference as noticed on the agenda for the meeting. Public access was available via videoconference or an audio-only phone-in line.*

- Board Members Present:**    Guy Savage                      President  
   Gere Sibbach                      Vice President  
   Taylor Dacus  
   Jim Hamilton  
   Jeff Hamm  
   Matt Janssen  
   Michelle Shoresman
- Board Members Absent:**    -
- Pension Trust Staff:**        Carl Nelson                      Executive Director  
   Amy Burke                      Deputy Director  
   Jennifer Alderete              Accountant
- General Counsel:**         Chris Waddell
- Consultants:**                Scott Whalen                      Verus
- Others:**                        Natalie Fixler                      SLO County Human Resources  
   Anna Bastidos, Josh Lopez, Ros Harding  
   SLOCPT staff  
   Larry Batchelder                SLOCREA  
   Andrea Paley                      Retiree  
   Mike Brown  
   3 others via unidentified teleconference numbers

**Call to Order:** 9:35 AM by President Savage, presiding over the meeting.

## **A) PUBLIC COMMENT**

None

## **B) CONSENT**

2. Minutes of the Regular Meeting of June 22, 2020 (Approve Without Correction)
3. Reports of Deposits and Contributions for the months of June and July 2020 (Receive and File)
4. Reports of Service Retirements, Disability Retirements and DROP Participants for the months of June and July 2020 (Receive, Approve and File)
5. Monthly Investment Report for June 2020 (Receive and File)
6. Stipulation for the Division of Pension Benefits – Option Four Pension Benefit Election (Recommend Approval)

Motion: Approve the Consent items.

Public Comment: none

Discussion: none

Motion Made: Mr. Hamm                      Motion Seconded: Mr. Janssen

Carried: Unanimous (roll call vote)

## **C) ORGANIZATIONAL**

7. Resolution Honoring Trustee Matt Janssen - Resolution 2020-04 (Recommend Approval)

Public Comment: none

Discussion: All Trustees commented on Trustee Janssen's positive qualities as a long-serving member of the Board of Trustees. Trustee Hamm noted that it was an honor to serve with Matt. Trustee Sibbach noted how Matt was a great benefit to the Board, did his reading, asked thoughtful questions and the County was fortunate to have had him throughout his career. Trustee Savage commented on Matt's independent thought and useful questioning. Trustee Hamilton also appreciated Matt's thoughtful questions over the years. Investment consultant Whalen commented on how positive it was to work with Matt.

Trustee Janssen spoke of the tumultuous events since he joined the Board of Trustees in 2007. He expressed his feeling that it was an honor to serve the Pension Trust and its members. Matt thanked former Trustees Dana O'Brien and Caryn Maddalena for initially appointing him to the Board of Trustees.

Motion: Approve Resolution 2020-04.

Motion Made: Mr. Savage                      Motion Seconded: Ms. Shoresman

Carried: Unanimous (roll call vote)

8. Committees – appointment of members by President.
  - i. Audit Committee (standing committee)
  - ii. Personnel Committee (standing committee)

Board President Savage, after discussion with the Trustees, announced that Matt Janssen would remain on the Personnel Committee through the planned meeting on September 17<sup>th</sup> which is prior to his final day on the Board of September 25<sup>th</sup>. Mr. Savage noted that he planned on making readjusted Committee assignments at the November Board meeting.

## **D) APPLICATIONS FOR DISABILITY RETIREMENT**

None

## **E) OLD BUSINESS**

None

## **F) NEW BUSINESS**

9. June 30, 2020 Mid-Year Financial Statements and Fiscal Year 2019-2020 Administrative Budget Status (Receive and File)

Discussion: Presentation by Amy Burke, Deputy Director

Motion: Receive and File

Public Comment: None

Motion Made: Mr. Janssen                      Motion Seconded: Mr. Hamm

Carried: Unanimous (roll call vote)

10. Actuarial Services Request for Proposal – Process and RFP Draft (Recommend Approval)

Discussion: After commentary from Carl Nelson, Executive Director, Trustees inquired about the evaluation process for Actuarial Services RFP responses.

Board President Savage appointed an ad hoc Actuarial Services Committee of Trustees Hamilton, Sibbach and Hamm to meet with Staff to evaluate Actuary responses to this RFP and make a recommendation to the Board of Trustees at the November 23, 2020 meeting.

Motion: Approval of Actuarial Services RFP

Public Comment: None

Motion Made: Mr. Janssen                      Motion Seconded: Mr. Savage

Carried: Unanimous (roll call vote)

*10:12 AM – Board President Savage called for a break*

*10:20 AM – back in session*

## **G) INVESTMENTS**

11. Quarterly Investment Report for the 2nd Quarter of 2020 – Presentation by Scott Whalen, Verus (Receive and File)

Discussion: Scott Whalen of Verus presented extensively on the quarterly investment report. Trustees asked numerous questions.

Motion: Receive and File

Public Comment: None

Motion Made: Mr. Savage                      Motion Seconded: Mr. Hamm

Carried: Unanimous (roll call vote)

12. Monthly Investment Report for July 2020 (Receive and File)

Discussion: Brief discussion by Carl Nelson, Executive Director

Motion: Receive and File

Public Comment: None

Motion Made: Mr. Hamm                      Motion Seconded: Mr. Sibbach

Carried: Unanimous (roll call vote)

13. Asset Allocation Policy – Amended Investment Policy Statement (Review, Discuss, and Direct Staff as necessary)

Discussion: An extensive discussion of the proposed revisions to the Investment Policy Statement with Mr. Whalen and Mr. Nelson. It was noted that the Strategic Asset Allocation asset mix in the draft policy was illustrative and that a final recommendation would be part of the September 28<sup>th</sup> adoption.

While discussing the estimate levels of investment risk and return inherent in setting an asset allocation policy the Trustees' consensus was that a level of investment risk similar to the current policy with an annual standard deviation of returns of approximately 11% was their preference.

Motion: No action necessary

Public Comment: None

14. Private Markets – Program Review (Review, Discuss, and Direct Staff as necessary)

Discussion: Mr. Whalen delivered an extensive presentation on private market investing. Mr. Whalen commented that if the Board of Trustees approved the amended Investment Policy proposed that includes a large increase in the allocation to private equity and private credit, that the economies of scale suggest the possibility of a direct program of investments instead of the current fund-of-funds strategy may be reasonable. Trustees engaged in active discussion on this topic. Because Verus also provides private market advisory services, Mr. Whalen declined to comment further on the use of consultants for private market direct investments.

Motion: No action necessary

Public Comment: None

15. Asset Allocation – (Review, Discuss, and Direct Staff as necessary)

Discussion: Staff reviewed routine administrative asset allocation transfers related to liquidity and portfolio rebalancing to asset allocation policy targets.

Motion: No action necessary

Public Comment: None

**H) OPERATIONS**

16. Staff Reports

- i. Elected Trustee replacement at the discretion of Trustees Shoresman and Dacus.
- ii. Fiduciary Insurance and cyber liability insurance renewals complete retaining current \$15m level of fiduciary insurance coverage.
- iii. Board of Trustees 2021 meeting schedule.
- iv. Business Continuity Services service with LRS was successfully tested on July 28<sup>th</sup>.
- v. Member Direct enrollments status.

17. General Counsel Reports

- i. Mr. Waddell summarized the ruling by the California Supreme Court in the Almeda case. He noted that no changes to SLOCPT practices or the Retirement Plan were necessary as a result of the ruling.

18. Committee Reports:

- i. Audit Committee                      No Report
- ii. Personnel Committee              No Report

19. Upcoming Board Topics – published on meeting agenda

20. Trustee Comments

- i. Trustee Janssen thanked the Board for the opportunity to serve as a Trustee and bid the Board farewell.

**I) CLOSED SESSION**

None

**J) ADJOURNMENT –**

There being no further business, the meeting was adjourned at 12:39 PM. The next Regular Meeting was set for September 28, 2020, at 9:30 AM, to be a virtual online meeting.

Respectfully submitted,

Carl Nelson  
Executive Director

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**REPORT OF DEPOSITS AND CONTRIBUTIONS FOR THE MONTH OF  
AUGUST 2020**

PP 17 8/14/2020	Pensionable Salary	Employer Contributions	Employer Rate	Employee Contributions	Employer for		Employee Rate	Combined Rate	Additional Contributions	Buy Backs	TOTAL Contributions
					Employee Contributions	Employee Rate					
<b>By Employer and Tier:</b>											
County Tier 1	3,241,301.53	880,038.50	27.15%	427,106.67	275,467.99	21.68%	48.83%	1,212.50	1,692.05		<b>1,585,517.71</b>
County Tier 2	1,008,418.89	285,962.69	28.36%	61,884.45	84,960.88	14.56%	42.92%	-	332.54		<b>433,140.56</b>
County Tier 3	3,428,912.98	910,166.02	26.54%	464,514.85	-	13.55%	40.09%	-	1,564.83		<b>1,376,245.70</b>
Superior Court Tier 1	248,248.56	69,100.36	27.84%	46,083.31	-	18.56%	46.40%	-	-		<b>115,183.67</b>
Superior Court Tier 3	106,691.42	26,577.46	24.91%	13,373.19	-	12.53%	37.45%	-	-		<b>39,950.65</b>
APCD Tier 1	56,689.22	14,027.23	24.74%	8,181.97	4,200.30	21.84%	46.59%	-	-		<b>26,409.50</b>
APCD Tier 3	21,216.82	5,065.53	23.88%	2,954.99	-	13.93%	37.80%	-	-		<b>8,020.52</b>
SLOCPT Tier 1	7,715.87	1,969.86	25.53%	1,135.78	716.80	24.01%	49.54%	-	-		<b>3,822.44</b>
SLOCPT Tier 2	9,171.20	2,341.40	25.53%	475.98	852.01	14.48%	40.01%	-	-		<b>3,669.39</b>
SLOCPT Tier 3	11,733.96	2,938.19	25.04%	1,689.33	-	14.40%	39.44%	250.00	-		<b>4,877.52</b>
LAFCO Tier 1	4,314.84	1,326.81	30.75%	343.46	400.85	17.25%	48.00%	-	-		<b>2,071.12</b>
LAFCO Tier 3	1,835.20	534.04	29.10%	196.92	-	10.73%	39.83%	-	-		<b>730.96</b>
RTA Tier 2	25,866.65	6,590.81	25.48%	541.62	3,362.66	15.09%	40.57%	-	-		<b>10,495.09</b>
RTA Tier 3	15,836.80	4,439.28	28.03%	1,759.20	-	11.11%	39.14%	-	-		<b>6,198.48</b>
	<b>8,187,953.94</b>	<b>2,211,078.18</b>	<b>27.00%</b>	<b>1,030,241.72</b>	<b>369,961.49</b>	<b>17.10%</b>	<b>44.10%</b>	<b>1,462.50</b>	<b>3,589.42</b>		<b>\$ 3,616,333.31</b>

PP 18 8/28/2020	Pensionable Salary	Employer Contributions	Employer Rate	Employee Contributions	Employer for		Employee Rate	Combined Rate	Additional Contributions	Buy Backs	TOTAL Contributions
					Employee Contributions	Employee Rate					
<b>By Employer and Tier:</b>											
County Tier 1	3,232,959.64	877,909.05	27.15%	426,106.39	274,702.91	21.68%	48.83%	1,212.50	1,692.05		<b>1,581,622.90</b>
County Tier 2	1,011,152.13	286,723.23	28.36%	59,649.57	86,402.79	14.44%	42.80%	-	332.54		<b>433,108.13</b>
County Tier 3	3,421,705.12	908,236.05	26.54%	463,266.45	-	13.54%	40.08%	-	868.38		<b>1,372,370.88</b>
Superior Court Tier 1	246,228.88	68,486.08	27.81%	45,730.33	-	18.57%	46.39%	-	-		<b>114,216.41</b>
Superior Court Tier 3	106,800.07	28,083.80	26.30%	14,052.26	-	13.16%	39.45%	-	-		<b>42,136.06</b>
APCD Tier 1	57,105.22	14,127.61	24.74%	8,246.19	4,224.22	21.84%	46.58%	-	-		<b>26,598.02</b>
APCD Tier 3	21,872.81	5,220.60	23.87%	3,037.74	-	13.89%	37.76%	-	-		<b>8,258.34</b>
SLOCPT Tier 1	7,715.87	1,969.86	25.53%	1,135.78	716.80	24.01%	49.54%	-	-		<b>3,822.44</b>
SLOCPT Tier 2	9,171.20	2,341.40	25.53%	475.98	852.01	14.48%	40.01%	-	-		<b>3,669.39</b>
SLOCPT Tier 3	11,733.97	2,938.19	25.04%	1,689.33	-	14.40%	39.44%	250.00	-		<b>4,877.52</b>
LAFCO Tier 1	4,314.83	1,326.81	30.75%	343.46	400.85	17.25%	48.00%	-	-		<b>2,071.12</b>
LAFCO Tier 3	1,835.20	534.04	29.10%	196.92	-	10.73%	39.83%	-	-		<b>730.96</b>
RTA Tier 2	25,866.65	6,590.81	25.48%	541.62	3,362.66	15.09%	40.57%	-	-		<b>10,495.09</b>
RTA Tier 3	15,836.80	4,439.28	28.03%	1,759.20	-	11.11%	39.14%	-	-		<b>6,198.48</b>
	<b>8,174,298.39</b>	<b>2,208,926.81</b>	<b>27.02%</b>	<b>1,026,231.22</b>	<b>370,662.24</b>	<b>17.09%</b>	<b>44.11%</b>	<b>1,462.50</b>	<b>2,892.97</b>		<b>\$ 3,610,175.74</b>

<b>TOTAL FOR THE MONTH</b>	<b>16,362,252.33</b>	<b>4,420,004.99</b>	<b>27.01%</b>	<b>2,056,472.94</b>	<b>740,623.73</b>	<b>17.09%</b>	<b>44.11%</b>	<b>2,925.00</b>	<b>6,482.39</b>		<b>\$ 7,226,509.05</b>
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<b>TOTAL YEAR TO DATE</b>	<b>145,725,296.91</b>	<b>37,763,923.03</b>	<b>25.91%</b>	<b>17,123,739.63</b>	<b>6,710,130.46</b>	<b>16.36%</b>	<b>42.27%</b>	<b>23,285.50</b>	<b>285,457.71</b>		<b>61,906,536.33</b>
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**REPORT OF RETIREMENTS****August 2020**

<b>RETIREE NAME</b>	<b>DEPARTMENT</b>	<b>BENEFIT TYPE *</b>	<b>EFFECTIVE DATE</b>	<b>MONTHLY BENEFIT</b>	<b>SS TEMP ANNUITY**</b>
Arnell, Marianne R	Department of Social Services	Service Retirement	05/01/2020	1,072.19	False
Beaumont, Pamela	Public Health Department	Service Retirement	08/08/2020	3,417.27	False
Bryant, David P	Planning Department	Service Retirement	07/31/2020	253.48	False
Caruso, Cheryl Ann	Public Health Department	Service Retirement	07/01/2020	55.90	False
Church, David	LAFCO	Service Retirement	07/25/2020	10,392.28	False
Conway, Sharon L	Sheriff-Coroner	Service Retirement	08/19/2020	4,889.88	False
Gehre, Dennis Alan	Facilities Management	Service Retirement	07/25/2020	733.46	False
Wilkerson, David G	Golf Courses	DROP	08/01/2020	4,341.26	False

*\* Additional Annuity Benefits are calculated based on the Additional Contribution and associated Interest balance of the Retiree at the point of retirement (per Sections 5.07, 27.12, 28.12, 29.12, 30.12, and 31.12 of the Plan)*

*\*\* If "True" Retiree has elected an optional Social Security Coordinated Temporary Annuity (per Section 13.06 of the Plan), actual monthly allowance will be increased until age 62 and then actuarially reduced going forward*

## Board of Trustees

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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director  
Chris Waddell – General Counsel

### **Agenda Item 6 Fiduciary Responsibilities Refresher Briefing**

Chris Waddell, General Counsel, will present a Board educational session on Fiduciary Responsibilities. This is an annual refresher briefing on fiduciary issues.

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# **Making Sound Decisions– Understanding Fiduciary Duty and Other Complexities**

San Luis Obispo County Pension Trust

September 28, 2020

Chris Waddell  
General Counsel  
Olson Remcho, LLP

# *Today's Agenda*

- “Fiduciary Duty in a Nutshell”
- Board Member Topics of Interest:
  - Asset Allocation and Investing (2 votes)
  - Actuarial Process (2 votes)
  - Financial Controls (2 votes)
  - Compliance
  - Disability Process (2 votes)
  - Benefit Administration
  - DROP (2 votes)

## *Applicable Fiduciary Duties*

- **Duty of Loyalty** *Cal. Const. Art. 26, §17(b)*
- **Duty of Care** *Cal. Const. Art. 26, §17(c)*
- **Did I Mention There are a Few More?**
  - Duty to administer the system in a manner that will assure prompt delivery of benefits and related services to the participants and their beneficiaries *Cal. Const. Art. 26, §17(a)*
  - Duty to diversify investments *Cal. Const. Art. 26, §17(d)*
  - Duty to provide for actuarial services in order to assure the competency of the assets of the public pension or retirement system *Cal. Const. Art. 26, §17(e)*

# *Duty of Loyalty*

- “Most fundamental” fiduciary duty
  - “...the punctilio of an honor the most sensitive...” (Justice Cardozo)
  - **“A retirement board’s duty to its participants and beneficiaries shall take precedence over any other duty”** (California Constitution)
- Board member must place the interests of system participants above all other interests
  - Not harm the interests of system members and beneficiaries by doing any of the following:
    - Acting in the fiduciary’s own interests ( no self-dealing)
    - Acting in the interests of the plan sponsor or a third party (avoid prohibited transactions)
    - Favoring the interests of one group of members/beneficiaries over those of another group (Duty of impartiality)

## *Duty of Care*

- Must act “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.”
  - Focus on conduct of fiduciary and extent of his/her investigation and performance of acts consistent with the specific purpose and circumstances of the plan (“procedural prudence”)

## *Duty to Diversify*

- “The members of the retirement board of a public pension or retirement system shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.”
  - Generally viewed as being a part of the duty of care.

## *Sound Board Decisions Consistent with Applicable Fiduciary Duties*

- Common denominator = Casting the vote
- One approach:
  - What should a trustee ask his/her self in order to be confident that they are complying with their fiduciary duties before casting a vote?
  - CalPERS asked itself this question a few years ago, and the resulting 8 questions tie directly to the underlying fiduciary duties we've discussed and tell us a lot about the need for sound governance practices.

## *CalPERS “Eight Questions”*

1. Do the agenda materials and presentation/discussion at the meeting provide all of the information necessary for a proper understanding of the issue so that we can make a sound, informed decision?
2. Have all of the potential benefits and risks resulting from this decision been appropriately identified and analyzed?
3. Have all viable alternatives to this proposal been appropriately identified and analyzed?

## *CalPERS “Eight Questions”—Cont’d*

4. Are staff and the outside expert (where applicable) in agreement on the recommended course of action?
  - If not, are the bases for disagreement adequately explained?
  - Are both recommendations reasonable (so that I can reasonably choose/decide between them), or do we need to seek another opinion?
5. Were any questions that we had before and during the discussion of the item sufficiently addressed?

## *CalPERS “Eight Questions”—Cont’d*

6. Do I have any actual or potential conflicts of interest that prevent me from participating in this decision or make it advisable for me not to do so?
7. Does my intended vote reflect what I feel to be in the best interests of the System’s members, beneficiaries and retirees as a whole, without regard to the interests of any constituency or appointing power responsible for my position as a Board member?
8. Will the results of the Board’s decision favor the interests of one group of the System’s members, beneficiaries or retirees over those of another group?

# *Board Member Topics of Interest*

- **Asset Allocation and Investments**
  - Good timing– strategic planning session this afternoon
- **Actuarial Process**
  - See above
- **Financial Controls**
  - Good area for future education/discussion
- **Compliance**
  - See above

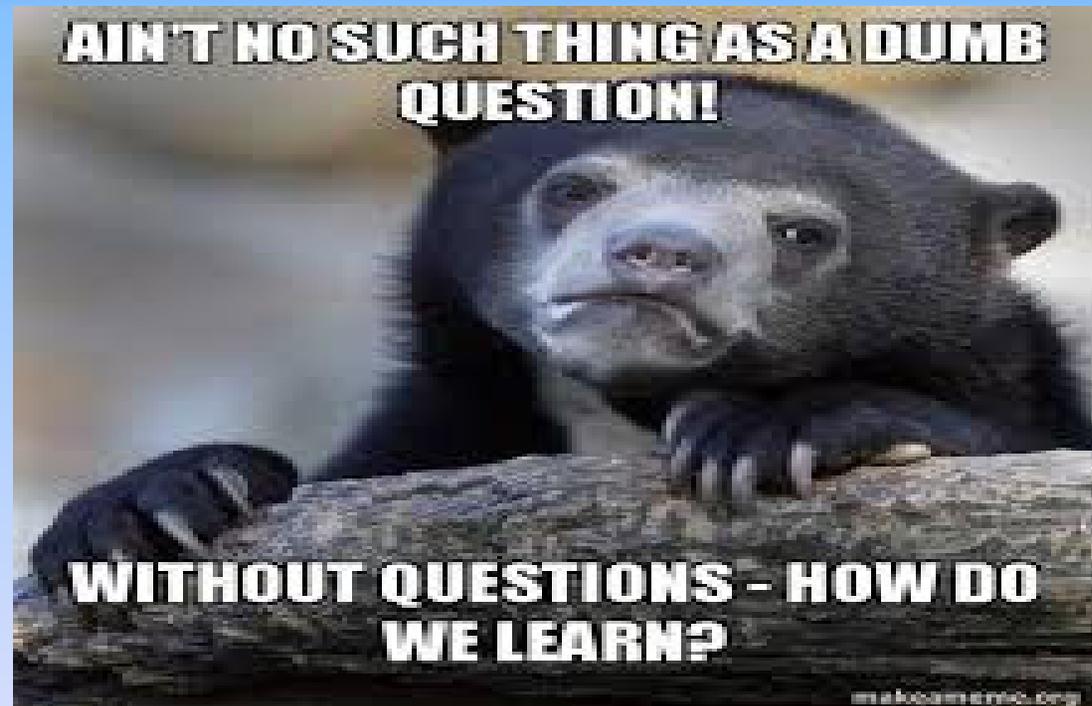
## *Board Member Topics of Interest—Cont'd*

- **Disability Process**
  - Board will be revisiting the hearing process in the near future
  - Regarding level of discretion in evaluating disability applications, Board retains final authority; must consider medical and other evidence presented but has duty to follow prudent process and ask appropriate questions before taking action.
- **Benefit Administration**
  - Good area for future education/discussion

## *Board Member Topics of Interest—Cont'd*

- DROP
- Tier 1 Members only (certain BU's excluded)
  - Intended to be “cost-neutral) to Pension Trust
  - Requires irrevocable commitment to retire
  - Monthly Pension Benefit paid into separate investment account while still working
    - Member chooses investments just like Deferred Comp Plan
    - No access to funds until official retirement
  - Payroll pension contributions cease upon entry
  - Once retired, must withdraw lump sum or elect monthly annuity lasting now less than 10 years.

# Questions?



Chris Waddell  
Olson Remcho, LLP

## Board of Trustees

1000 Mill Street  
San Luis Obispo, CA 93408  
Phone: (805) 781-5465  
Fax: (805) 781-5697  
www.SLOPensionTrust.org



Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Item 7: Monthly Investment Report for August 2020**

	August	Year to Date 2020	2019	2018	2017	2016	2015
Total Trust Investments (\$ millions)	\$1,474		\$1,446 year end	\$1,285 year end	\$1,351 year end	\$1,196 year end	\$1,148 year end
<b>Total Fund Return</b>	2.2% Gross	1.0% Gross	16.3 % Gross	-3.2 % Gross	15.5 % Gross	6.6 % Gross	-0.8% Gross
Policy Index Return (r)	2.7%	3.5%	16.4 %	-3.2 %	13.4 %	7.7 %	-0.5 %

(r) Policy index as of April 1, 2020 revision to Strategic Asset Allocation Policy: 21% domestic equity, 21% international equity, 15% core bonds, 6% bank loans, 5% global bonds, 5% emerging market debt, 17% real estate, 0% commodities, 5% private equity, 5% private credit.

### **SLOCPT Investment Returns:**

The attached report from Verus covers the preliminary investment returns of the SLOCPT portfolio and general market conditions through the end of August. The attached market commentary from Verus details market conditions in August, but subsequent activity in August is not yet factored into these numbers.

The dramatic path of total fund returns in 2020 is shown in the following table. The Total Fund Return has recovered all of its losses from the at the low point in March. However, as of September 25<sup>th</sup>, the September pullback in equities brings the total fund return near a -3% number for the month.

## **The Economy and Capital Markets:**

### ➤ **Covid-19 Pandemic Impact -**

- The global pandemic and its U.S. infection rate had declined in July-August. However, the start of a resurgence is apparent in mid-September data. The total of U.S. Covid-19 deaths passed 200,000.

### ➤ **Policy Responses**

#### ▪ **Monetary Policy –**

- The Fed at its annual Jackson Hole Symposium considered its dual mandates for low unemployment and stable inflation rates. Fed Chair Powell's remarks after the meeting on August 27th clarified the Fed intention to focus on employment growth primarily for now and to be less concerned over inflation. This reflects the long-running issue for the Fed of inflation being too low – below the Fed target of 2% - and that a more robust economy takes precedence during current times.
  - Markets rallied on the Fed Chair's comments in the expectation of Fed interest rate policy staying with a "lower for longer" policy. The yield curve steepened with long Treasury rates rising while the short end stayed suppressed. This is a positive indication that the credit markets expect stronger long-term economic conditions.
- On September 16<sup>th</sup> the Federal Open Market Committee wrapped up its last meeting prior to the November elections. The Fed reiterated its expectation of aggressive monetary policy support for the U.S. economy as it recovers from the Covid-19 / economic lockdown induced recession. The Fed publicly commented on the possibility that interest rates would not increase until at least 2023. These actions are supportive of the economy but, increase concerns over a moderate resurgence of price inflation.

#### ▪ **Fiscal Policy –**

- The Federal government failed to pass some version of renewed economic stimulus to follow the July 31<sup>st</sup> expiration of the supplemental unemployment benefits that were a particularly effective component of the CARES Act. Presidential executive order based partial increases are of limited impact. The House and the Senate remained far apart in their negotiating positions, so no added fiscal stimulus is expected until after the election. This raises concerns over a pullback in consumer spending as unemployment benefits drop sharply.

### ➤ **Employment and Wages –**

- The August DOL report from the BLS on nonfarm employment showed a gain of 1.4 million jobs despite surging Covid-19 infections. Unemployment fell from 10.2% in July to 8.4% in August (February low was 3.5%).

➤ **Equity Markets –**

- The U.S. equity markets continue to advance in August with a pullback in September as shown below.

February 15 <sup>th</sup>	3,386	high point
March 23 <sup>rd</sup>	2,237	-33% off the Feb. 15 <sup>th</sup> high
August 31st	3,500	+56% from the Mar. 23 <sup>rd</sup> low
September 2 <sup>nd</sup>	3,581	+60% from the Mar. 23 <sup>rd</sup> low
September 25 <sup>th</sup>	3,298	-8% from the Sep. 2 <sup>nd</sup> high

Respectfully Submitted,

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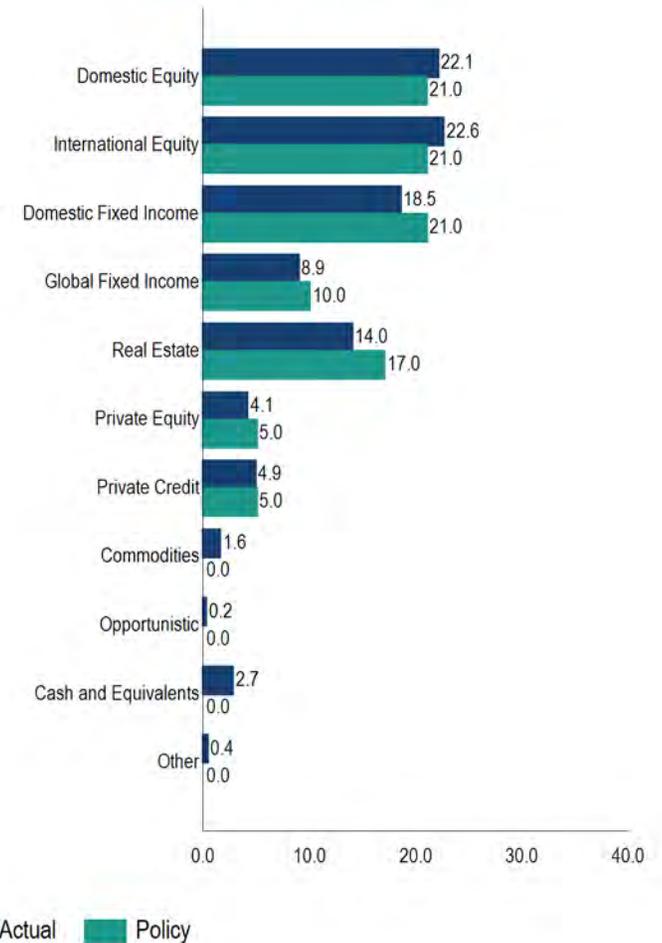
# San Luis Obispo County Pension Trust

## Executive Summary - Preliminary (Gross of Fees)

Period Ending: August 31, 2020

	Market Value	% of Portfolio	1 Mo	YTD
<b>Total Fund</b>	<b>1,473,956,891</b>	<b>100.0</b>	<b>2.3</b>	<b>1.0</b>
<i>Policy Index</i>			2.7	3.5
<b>Total Domestic Equity</b>	<b>325,380,495</b>	<b>22.1</b>	<b>6.2</b>	<b>2.1</b>
<i>Russell 3000</i>			7.2	9.4
PIMCO RAE US	71,798,748	4.9	5.4	-8.2
<i>S&amp;P 500</i>			7.2	9.7
Loomis Sayles Large Cap Growth	105,602,597	7.2	10.2	27.7
<i>Russell 1000 Growth</i>			10.3	30.5
Boston Partners Large Cap Value	86,249,702	5.9	3.0	-11.2
<i>Russell 1000 Value</i>			4.1	-9.3
Atlanta Capital Mgmt	61,729,449	4.2	4.8	-3.5
<i>Russell 2500</i>			4.5	-3.3
<b>Total International Equity</b>	<b>332,686,748</b>	<b>22.6</b>	<b>4.3</b>	<b>2.0</b>
<i>MSCI ACWI ex USA Gross</i>			4.3	-2.7
Dodge & Cox Intl Stock	143,253,840	9.7	4.7	-13.0
<i>MSCI ACWI ex USA Value Gross</i>			4.5	-13.7
WCM International Growth	189,432,908	12.9	4.1	15.5
<i>MSCI ACWI ex USA Growth Gross</i>			4.1	8.5
<b>Total Domestic Fixed Income</b>	<b>273,255,690</b>	<b>18.5</b>	<b>-0.1</b>	<b>5.8</b>
<i>BBgBarc US Aggregate TR</i>			-0.8	6.9
BlackRock Core Bond	98,645,473	6.7	-0.7	8.1
<i>BBgBarc US Aggregate TR</i>			-0.8	6.9
Dodge & Cox Income Fund	101,878,759	6.9	-0.2	7.4
<i>BBgBarc US Aggregate TR</i>			-0.8	6.9
Pacific Asset Corporate Loan	72,731,458	4.9	1.1	-0.3
<i>S&amp;P/LSTA Leveraged Loan Index</i>			1.5	-1.3
<b>Total Global Fixed</b>	<b>131,785,878</b>	<b>8.9</b>	<b>0.2</b>	<b>-1.0</b>
<i>FTSE World Govt Bond Index</i>			-0.5	7.4
Brandywine Global Fixed Income	62,014,095	4.2	-0.5	-
<i>FTSE WGBI TR</i>			-0.5	-
Ashmore EM Blended Debt Fund	69,771,783	4.7	0.9	-4.3
<i>50% JPM EMBI GD/25% JPM GBI EM GD/25% JPM ELM+</i>			0.3	-1.1

Actual vs Target Allocation (%)



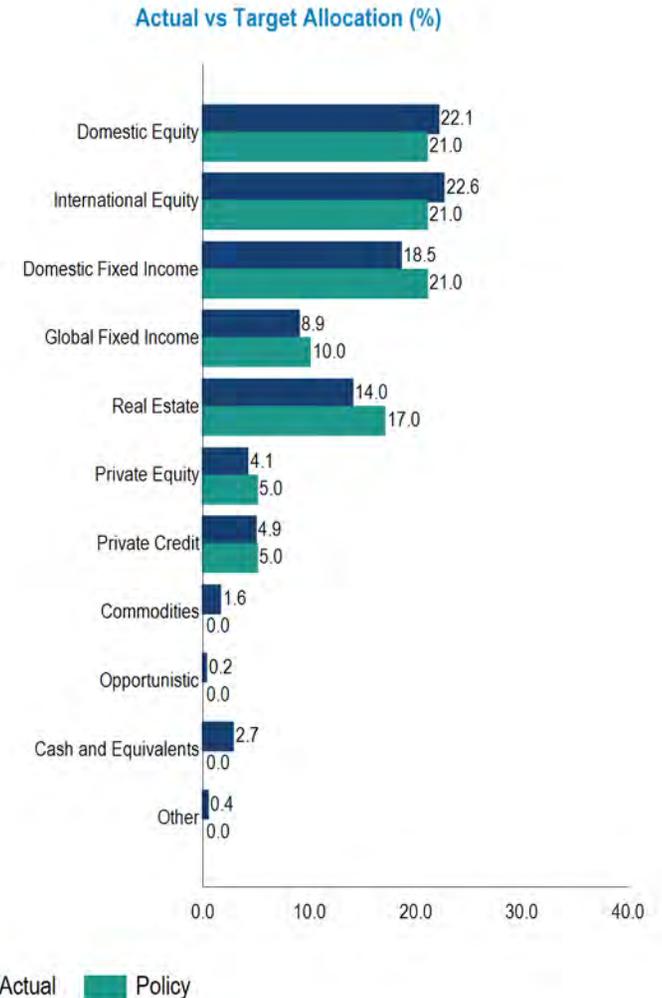
\*Other balance represents Clifton Group.

Policy Index (4/1/2020): 21% Russell 3000, 21% MSCI ACWI ex. US, 31% BBgBarc Aggregate, 17% NCREIF Property, 5% Russell 3000 + 300 bp lagged, 5% BBgBarc High Yield + 200 bp lagged. Effective 1/01/2017, only traditional asset class (public equity, public fixed income, REITs) investment management fees will be included in the gross of fee return calculation. Stone Harbor liquidated 3/22/2019. Ashmore EM Blended Debt funded 3/31/2019. Direct RE liquidated 5/3/2019. Pathway 10 funded 3/25/2020. Sixth Street Partners TAO funded 4/16/2020. Brandywine transitioned from International FI to Global FI on 6/24/2020. PIMCO Distressed Credit liquidated 6/25/2020. Most recently reported market values for private equity/credit, opportunistic, and illiquid real estate funds adjusted for calls and distributions through the report end date. All data is preliminary.

San Luis Obispo County Pension Trust  
 Executive Summary - Preliminary (Gross of Fees)

Period Ending: August 31, 2020

	Market Value	% of Portfolio	1 Mo	YTD
<b>Total Real Estate</b>	<b>206,108,231</b>	<b>14.0</b>	<b>-0.1</b>	<b>-0.2</b>
NCREIF Property Index			0.0	-0.3
JP Morgan Core Real Estate	167,366,224	11.4	-0.1	-0.9
NCREIF-ODCE			0.0	-0.6
NCREIF Property Index			0.0	-0.3
ARA American Strategic Value Realty	38,742,007	2.6	0.0	3.2
NCREIF-ODCE			0.0	-0.6
NCREIF Property Index			0.0	-0.3
<b>Total Commodities</b>	<b>22,956,108</b>	<b>1.6</b>	<b>5.6</b>	<b>-9.0</b>
Bloomberg Commodity Index TR USD			6.8	-9.0
Gresham MTAP Commodity Builder	22,956,108	1.6	5.6	-9.0
Bloomberg Commodity Index TR USD			6.8	-9.0
<b>Total Private Equity</b>	<b>60,695,760</b>	<b>4.1</b>		
Harbourvest Partners IX Buyout Fund L.P.	14,950,808	1.0		
Pathway Private Equity Fund Investors 9 L.P.	36,832,440	2.5		
Harbourvest 2018 Global Fund L.P.	7,944,302	0.5		
Pathway Private Equity Fund Investors 10 L.P.	968,210	0.1		
<b>Total Private Credit</b>	<b>63,349,290</b>	<b>4.3</b>		
Sixth Street Partners DCP	63,349,290	4.3		
<b>Total Cash</b>	<b>40,427,392</b>	<b>2.7</b>	<b>0.0</b>	<b>1.4</b>
91 Day T-Bills			0.0	0.4
Cash Account	40,427,392	2.7	0.0	1.4
91 Day T-Bills			0.0	0.4
<b>Total Opportunistic</b>	<b>11,703,101</b>	<b>0.8</b>		
Kohlberg Kravis Roberts & Co. Mezzanine Partners I	3,448,434	0.2		
Sixth Street Partners TAO	8,254,667	0.6		



\*Other balance represents Clifton Group.

Policy Index (4/1/2020): 21% Russell 3000, 21% MSCI ACWI ex. US, 31% BBgBarc Aggregate, 17% NCREIF Property, 5% Russell 3000 + 300 bp lagged, 5% BBgBarc High Yield + 200 bp lagged. Effective 1/01/2017, only traditional asset class (public equity, public fixed income, REITs) investment management fees will be included in the gross of fee return calculation. Stone Harbor liquidated 3/22/2019. Ashmore EM Blended Debt funded 3/31/2019. Direct RE liquidated 5/3/2019. Pathway 10 funded 3/25/2020. Sixth Street Partners TAO funded 4/16/2020. Brandywine transitioned from International FI to Global FI on 6/24/2020. PIMCO Distressed Credit liquidated 6/25/2020. Most recently reported market values for private equity/credit, opportunistic, and illiquid real estate funds adjusted for calls and distributions through the report end date. All data is preliminary.



**PERSPECTIVES  
THAT DRIVE  
ENTERPRISE  
SUCCESS**

AUGUST 2020  
Capital Markets Update

# Market commentary

## U.S. ECONOMICS

- According to the Mortgage Bankers Association's National Delinquency Survey the delinquency rate for mortgage loans on one-to-four-unit residential properties rose to its highest level in nine years. The delinquency rate jumped from 4.4% in the first quarter to 8.2% in the second quarter.
- The University of Michigan's Consumer Sentiment indicator came in at 74.1 in August, up 1.6 points from the July reading. The index reading was +0.4 points above the April to July average. Increases in the index are likely to lead to stronger levels of consumer spending.
- Non-farm payrolls grew by about 1.4 million in August, less than in the previous month when about 1.7 million jobs were added. If on average 1.6 million jobs are added per month it will take just under a year to recover the 22 million jobs lost in March and April.

## U.S. EQUITIES

- The S&P 500 Index finished the month of August up +7.2% and has more than recovered from the pandemic-driven sell-off that began in late February. The index saw a -33.9% decline from its February peak to March lows. The index closed the month up +56.5% from the March lows.
- The S&P 500 Index finished the month with a trailing price-to-earnings ratio of 27.3, well above the five-year average price-to-earnings of 20.3. Stock prices today are much higher relative to earnings than they have been on average the last five years.
- Analysts have increased earnings estimates for Q3 2020 by +2.6% since June 30th, indicating analysts are trending in a more optimistic direction around the outlook for corporate earnings in Q3.

## U.S. FIXED INCOME

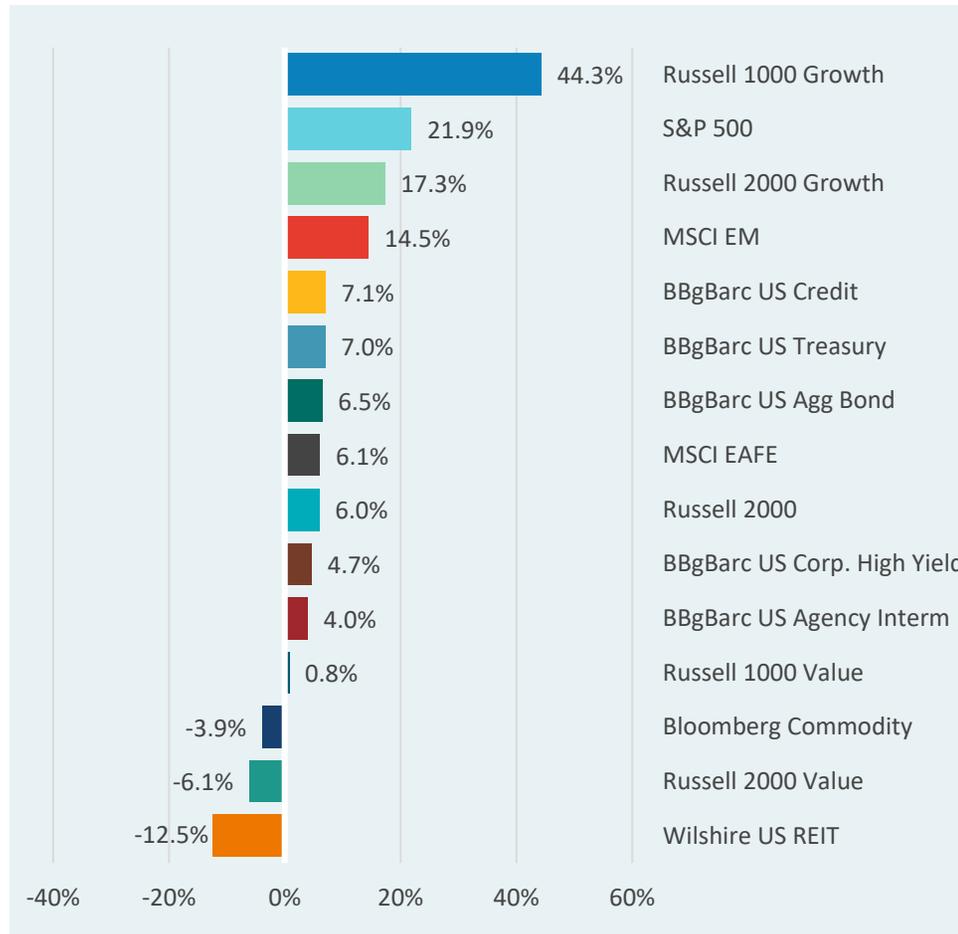
- Federal Reserve Chair Powell unveiled the FOMC's new approach for setting monetary policy. The Fed will now allow inflation to run above its target level of 2% for some time after periods of low prices, raising the probability that rates will remain low for years.
- The U.S. government now holds \$26.6 trillion in debt and has added \$3 trillion during the pandemic. Congress was not able to agree on another stimulus bill before the summer recess. Debate persists around the size and scope of the next support package.
- The Federal Open Market Committee's July meeting minutes indicated a pessimistic outlook. Members of the committee agreed that the pandemic will weigh heavily on economic activity, employment, and inflation in the near-to-medium term, underscoring the need for continued easy policy from the Fed.

## INTERNATIONAL MARKETS

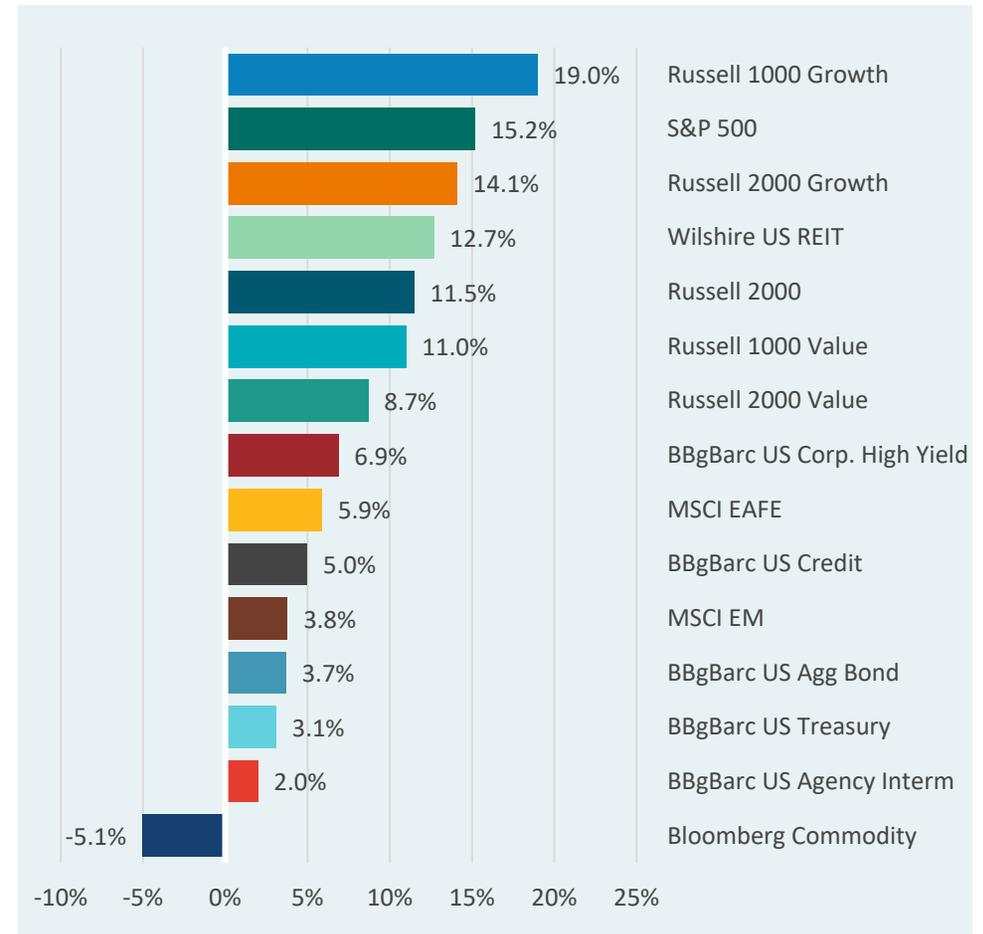
- Chinese and U.S. officials are ironing out standards on Chinese state-owned enterprises being audited by U.S. regulators. The China Securities Regulatory Commission sent a proposal that would allow U.S. regulators to inspect Chinese companies listed on U.S. exchanges, albeit with some redactions.
- The Eurozone Manufacturing PMI fell from 51.8 in July to 51.7 in August and the Services PMI fell from 54.7 to 50.1, both missing expectations. In the U.K., the Manufacturing PMI rose from 53.3 to 55.3 in August, while the Services PMI grew from 56.5 to 60.1.
- Germany earmarked €10 billion (\$11.8 billion) to extend a subsidy program through 2021 that aims to keep millions of people from losing their jobs.

# Major asset class returns

ONE YEAR ENDING AUGUST



TEN YEARS ENDING AUGUST



\*Only publicly traded asset performance is shown here. Performance of private assets is typically released with a 3- to 6-month delay.

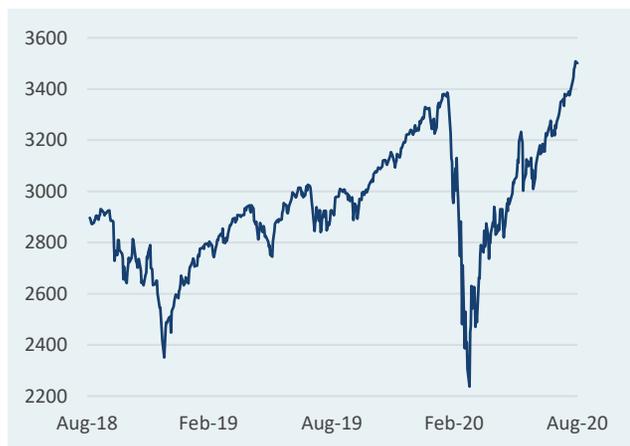
Source: Morningstar, as of 8/31/20

Source: Morningstar, as of 8/31/20

# U.S. large cap equities

- The S&P 500 Index gained +7.2% over the month, and closed August 31<sup>st</sup> just a few points off the all-time-high level of 3508. The losses incurred between the February 19<sup>th</sup> peak and the March 23<sup>rd</sup> low have been completely recovered.
- The breadth of the rebound in the stock market remains a concern for some analysts. The rebound in the S&P 500 was focused to the five largest weighted companies in the index; these tech stocks make up roughly 20% of the index. The S&P Equal Weighted Index was still -6.0% below its peak pre-pandemic.
- A steady flow of progress on COVID-19 vaccines and a shift in focus away from U.S.-Chinese tensions has likely bolstered risk assets. Nine of the eleven major sectors contributed positively to returns. The Information Technology sector (+12.0%) pushed the index higher, and the Consumer Discretionary sector (+9.5%) made the second largest contribution to the advance of the overall index.
- The CBOE VIX Index of implied volatility on the S&P 500 Index ticked higher in August. Between July 31<sup>st</sup> and August 31<sup>st</sup> the index rose from 24.5 to 26.4.

**S&P 500 PRICE INDEX**



Source: Bloomberg, as of 8/31/20

**IMPLIED VOLATILITY (VIX INDEX)**



Source: CBOE, as of 8/31/20

**S&P 500 VALUATION SNAPSHOT**

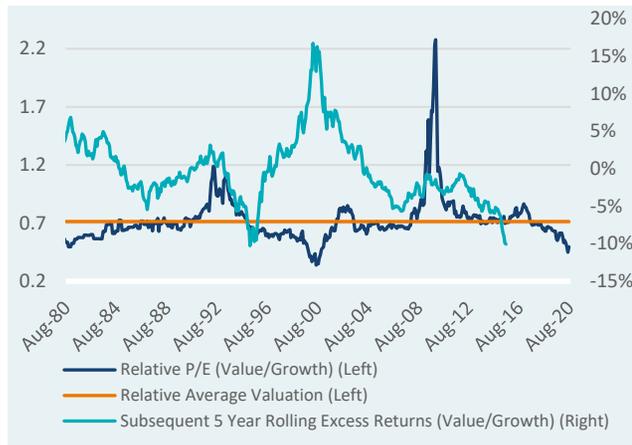


Source: Bloomberg, as of 8/31/20

# Domestic equity size and style

- Growth stocks continued to outperform value stocks. The Russell 3000 Growth Index (+10.1%) handily outpaced the Russell 3000 Value Index (+4.2%). The Information and technology sectors propelled the growth index forward while value-oriented sectors such as utilities declined during the month.
- Economic-data-sensitive cyclical sectors, such as energy, outperformed the less-sensitive defensive sectors again this month. The MSCI USA Cyclical - Defensives Total Return Spread Index returned +7.2%.
- Large-caps (Russell 1000 Index +7.3%) outperformed small-cap equities (Russell 2000 Index +5.6%) during the month. Large-cap stock outperformance over small-cap stocks was perhaps buoyed by several tech company stock splits that may have broadened access for retail investors.
- Momentum factor investing—a strategy of buying stocks that have performed well and selling underperformers—continued to outpace the broader market. The S&P 500 Momentum Index outperformed the S&P 500 Index by +1.0% in August.

**VALUE VS. GROWTH RELATIVE VALUATIONS**



Source: Russell, Bloomberg, as of 8/31/20

**VALUE VS. GROWTH 1-YR ROLLING RELATIVE PERFORMANCE**



Source: FTSE, Bloomberg, as of 8/31/20

**SMALL VS. LARGE 1-YR ROLLING RELATIVE PERFORMANCE**

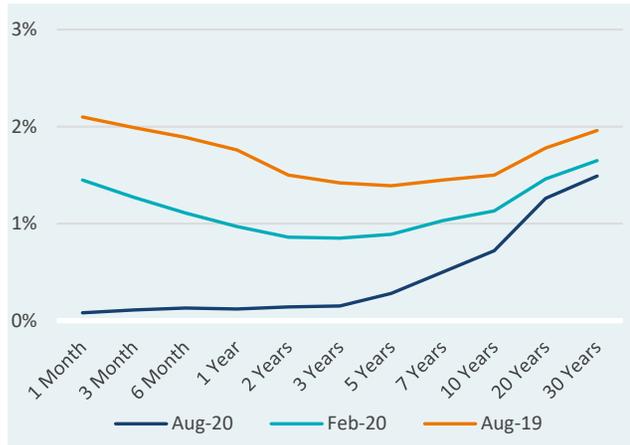


Source: FTSE, Bloomberg, as of 8/31/20

# Fixed income

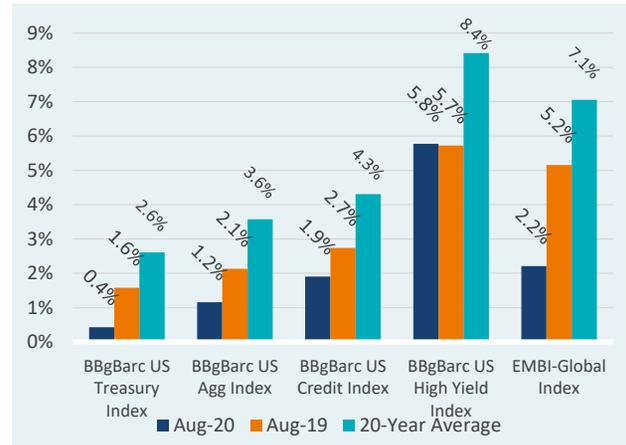
- Within the U.S. fixed income market, Treasury Inflation-Protected Securities (BBgBarc US TIPS +1.1%) were the top-performing assets as the Fed Chair hinted at letting inflation run above its 2% target for some time. High yield fixed income (BBgBarc US Corp. High Yield +1.0%) also posted solid performance.
- The ten-year breakeven inflation rate, increased in August to 1.8%, a post-pandemic high. Nominal yields rose more than enough to offset the rise in breakevens, leading to a small increase in real yields. Ten-year real yields increased from -1.08% to -1.03%.
- The euro (+1.1%), the pound (+2.0%), and a basket of emerging market currencies (Credit Suisse EMCI TR +0.7%) all gained on the dollar. The Bloomberg Dollar Spot Index continued to slide; the index was down -1.5% in August.
- Global credit outperformed most U.S. fixed income indices. Hard-currency denominated emerging market debt (JPM EMBI Global Diversified Index) returned +0.5% and outperformed local-currency denominated emerging market debt (J.P. Morgan GBI-EM -0.3%).

**U.S. TREASURY YIELD CURVE**



Source: Bloomberg, as of 8/31/20

**NOMINAL YIELDS**



Source: Morningstar, as of 8/31/20

**BREAKEVEN INFLATION RATES**

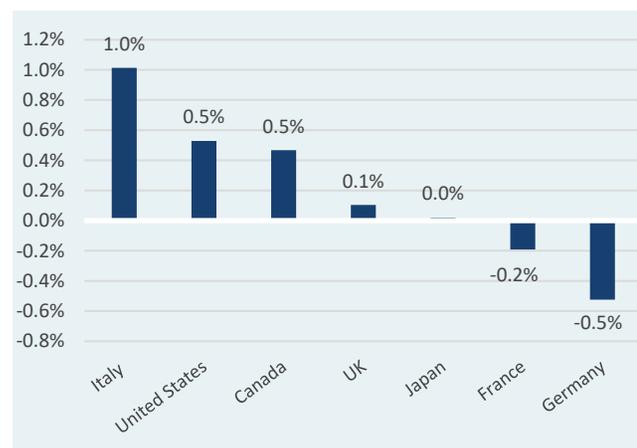


Source: Bloomberg, as of 8/31/20

# Global markets

- The pound rallied another +2.0% against the U.S. dollar in August, resulting in currency tailwinds for unhedged U.S. investors in U.K. equities. The MSCI United Kingdom Index returned +3.5% while the index hedged to U.S. dollars, returned +1.5%.
- International developed equities (MSCI EAFE +5.1%) outperformed emerging market equities (MSCI EM +2.2%) as weakness in Latin America (-6.2%) weighed on the index. Within the MSCI EAFE Index, Japanese companies (MSCI Japan +7.6%) outperformed European companies (MSCI Euro +4.5%) in U.S. dollar terms.
- China is poised to purchase a record amount of soybeans from the U.S. in Q4 to attempt to meet the target value implied in the phase one trade deal. China's purchase of agricultural goods until July were just 27% of the target, though talks between U.S. and Chinese officials remain relatively conciliatory.
- Italy, France and Spain decided to not impose new lockdown measures even as the daily cases grew as a result of the reopening of intra-European travel. News that 38 COVID-19 vaccines are in clinical trails on humans, and at least 92 preclinical vaccines are in animal trials has likely been supportive for equities.

**GLOBAL SOVEREIGN 10-YEAR YIELDS**



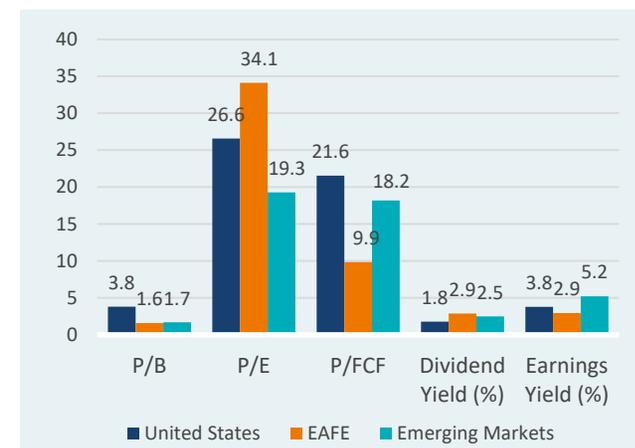
Source: Bloomberg, as of 8/31/20

**U.S. DOLLAR MAJOR CURRENCY INDEX**



Source: Federal Reserve, as of 8/31/20

**MSCI VALUATION METRICS (3-MONTH AVG)**



Source: Bloomberg, as of 8/31/20

# Commodities

- The Bloomberg Commodity Index rose for the fourth consecutive month in August, returning +6.8%. All the major sub-indexes within the Bloomberg Commodity Index advanced over the month, but the energy, industrial metals and grains sectors were the top contributors to top-line performance.
- Energy (+13.1%) helped the overall index higher. In August, Natural gas returned +25.2% and oil gained +3.9%. The rally in natural gas was driven in part by fears that tropical storms in the Gulf of Mexico may develop into hurricanes which might threaten U.S. oil refining capacity.

- Industrial Metals (+6.9%) continued to post strong performance in August, and both zinc (+24.1%) and nickel (+21.9%) delivered positive double-digit returns. Copper, the most highly-weighted industrial metal (7%) in the Bloomberg Commodity Index, returned +2.7% in August.
- Grains returned +6.3% in the month of August. Front-month corn and soybeans futures contracts due for delivery in September advanced +9.3% and +6.4% respectively. The expectation for substantial Chinese purchases through year-end, as well as some idiosyncratic supply-side concerns have supported performance.

## INDEX AND SECTOR PERFORMANCE

	Month	QTD	YTD	1 Year	3 Year	5 Year	10 Year
Bloomberg Commodity	6.8	15.4	(9.0)	(3.9)	(3.1)	(3.1)	(5.1)
Bloomberg Agriculture	5.5	10.1	(7.2)	3.5	(6.2)	(5.2)	(4.7)
Bloomberg Energy	13.1	18.0	(38.0)	(33.7)	(12.0)	(14.1)	(13.8)
Bloomberg Grains	6.3	5.8	(8.1)	0.1	(6.1)	(7.4)	(5.4)
Bloomberg Industrial Metals	6.9	22.2	4.8	5.0	(1.3)	4.8	(2.5)
Bloomberg Livestock	0.4	(3.0)	(30.4)	(25.1)	(11.7)	(9.8)	(5.9)
Bloomberg Petroleum	3.4	16.5	(46.6)	(38.7)	(10.8)	(12.6)	(10.3)
Bloomberg Precious Metals	3.6	19.3	32.8	31.7	13.5	11.1	3.7
Bloomberg Softs	3.4	20.1	(5.3)	12.5	(7.9)	(3.1)	(6.4)

Source: Morningstar, as of 8/31/20

## COMMODITY PERFORMANCE



Source: Bloomberg, as of 8/31/20

# Appendix

# Periodic table of returns

BEST ↑

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	YTD	5-Year	10-Year
Large Cap Growth	38.7	66.4	31.8	14.0	25.9	56.3	26.0	34.5	32.6	39.8	5.2	79.0	29.1	14.3	18.6	43.3	13.5	13.3	31.7	37.3	6.7	36.4	30.5	20.7	19.0
Large Cap Equity	27.0	43.1	22.8	8.4	10.3	48.5	22.2	21.4	26.9	16.2	1.4	37.2	26.9	7.8	18.1	38.8	13.2	5.7	21.3	30.2	1.9	31.4	10.4	14.3	15.2
US Bonds	20.3	33.2	12.2	7.3	6.7	47.3	20.7	20.1	23.5	15.8	-6.5	34.5	24.5	2.6	17.9	34.5	13.0	0.9	17.3	25.0	0.0	28.5	6.9	10.5	14.1
Small Cap Growth	19.3	27.3	11.6	3.3	1.6	46.0	18.3	14.0	22.2	11.8	-21.4	32.5	19.2	1.5	17.5	33.5	11.8	0.6	12.1	22.2	-1.5	26.5	6.2	8.7	11.5
60/40 Global Portfolio	16.2	26.5	7.0	2.8	1.0	39.2	16.5	7.5	18.4	11.6	-25.9	28.4	16.8	0.4	16.4	33.1	6.0	0.0	11.8	21.7	-3.5	25.5	5.8	8.0	11.0
Hedge Funds of Funds	8.7	21.3	4.1	-2.4	-6.0	29.9	14.3	6.3	15.5	10.3	-33.8	23.3	16.1	-2.1	15.3	23.3	4.9	-0.8	11.2	14.6	-6.0	22.4	5.5	7.7	9.7
Emerging Markets Equity	15.6	24.3	6.0	2.5	-5.9	30.0	14.5	7.1	16.6	10.9	-28.9	27.2	16.7	0.1	16.3	32.5	5.6	-0.4	11.3	17.1	-4.8	22.0	0.4	7.5	8.7
Cash	4.9	20.9	-3.0	-5.6	-11.4	29.7	12.9	5.3	15.1	7.0	-35.6	20.6	15.5	-2.9	14.6	12.1	4.2	-1.4	8.0	13.7	-8.3	18.6	0.4	6.8	7.2
Real Estate	1.2	13.2	-7.3	-9.1	-15.5	25.2	11.4	4.7	13.3	7.0	-36.8	19.7	13.1	-4.2	11.5	11.0	3.4	-2.5	7.1	7.8	-9.3	18.4	-0.3	4.7	5.9
International Equity	-2.5	11.4	-7.8	-9.2	-15.7	23.9	9.1	4.6	10.4	5.8	-37.6	18.9	10.2	-5.5	10.5	9.0	2.8	-3.8	5.7	7.7	-11.0	8.7	-4.6	4.4	3.8
Small Cap Equity	-5.1	7.3	-14.0	-12.4	-20.5	11.6	6.9	4.6	9.1	4.4	-38.4	11.5	8.2	-5.7	4.8	0.1	0.0	-4.4	2.6	7.0	-11.2	7.8	-5.5	4.3	3.7
Commodities	-6.5	4.8	-22.4	-19.5	-21.7	9.0	6.3	4.2	4.8	-0.2	-38.5	5.9	6.5	-11.7	4.2	-2.0	-1.8	-7.5	1.0	3.5	-12.9	7.7	-9.0	3.3	3.1
Large Cap Value	-25.3	-0.8	-22.4	-20.4	-27.9	4.1	4.3	3.2	4.3	-1.6	-43.1	0.2	5.7	-13.3	0.1	-2.3	-4.5	-14.9	0.5	1.7	-13.8	6.4	-9.3	1.1	0.6
Small Cap Value	-27.0	-1.5	-30.6	-21.2	-30.3	1.0	1.4	2.4	2.1	-9.8	-53.2	-16.9	0.1	-18.2	-1.1	-9.5	-17.0	-24.7	0.3	0.9	-14.6	2.1	-17.7	-3.1	-5.1

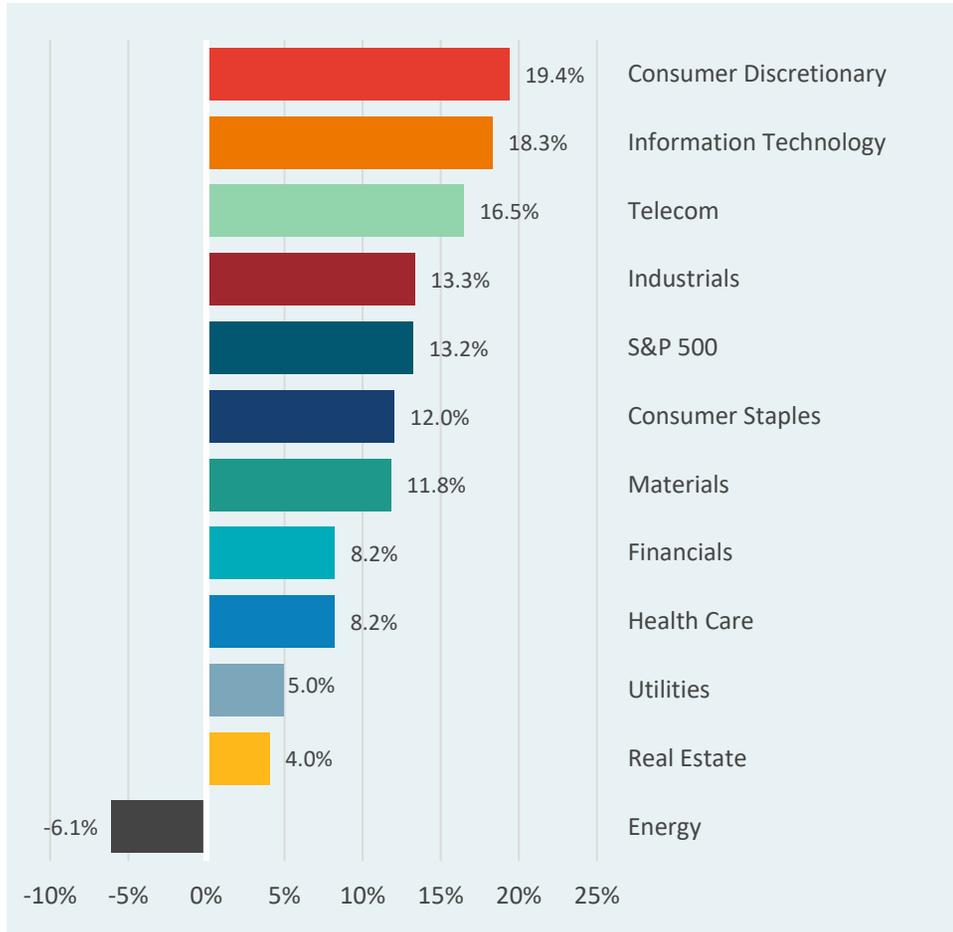
↓ WORST



Source Data: Morningstar, Inc., Hedge Fund Research, Inc. (HFR), National Council of Real Estate Investment Fiduciaries (NCREIF). Indices used: Russell 1000, Russell 1000 Value, Russell 1000 Growth, Russell 2000, Russell 2000 Value, Russell 2000 Growth, MSCI EAFE, MSCI EM, BBgBarc US Aggregate, T-Bill 90 Day, Bloomberg Commodity, NCREIF Property, HFRI FOF, MSCI ACWI, BBgBarc Global Bond. NCREIF Property Index performance data as of 6/30/20.

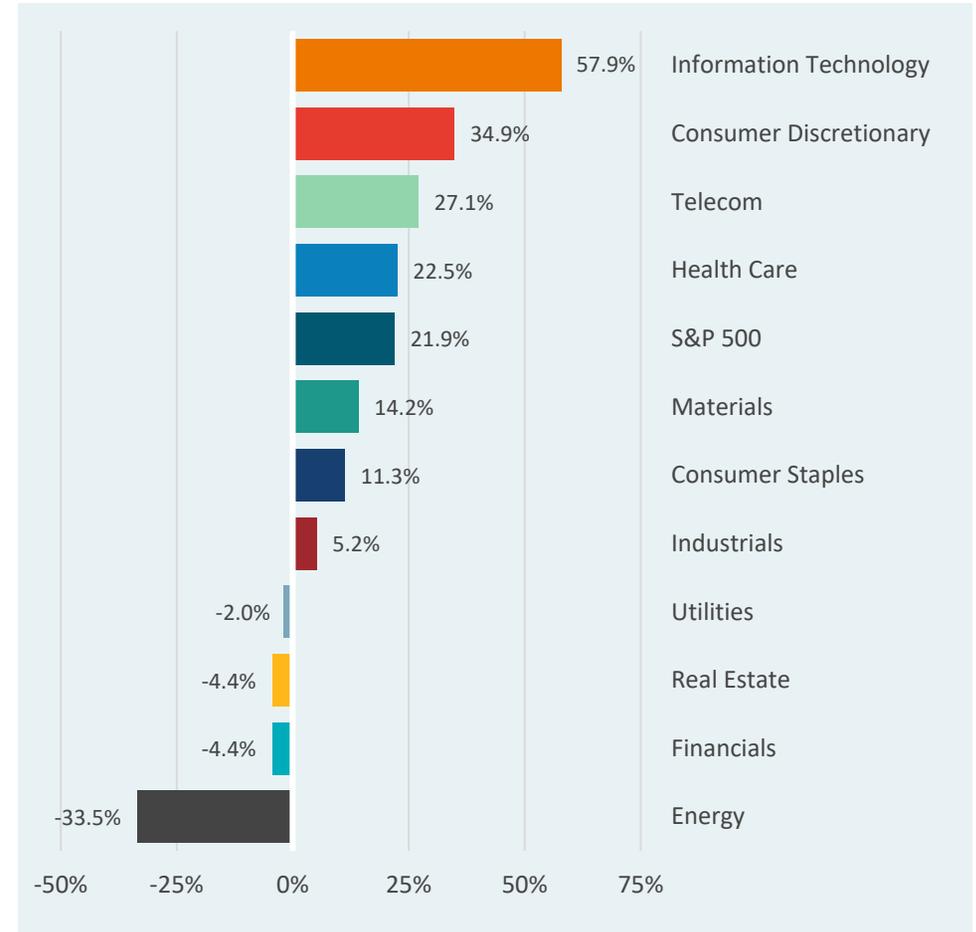
# S&P 500 sector returns

QTD



Source: Morningstar, as of 8/31/20

ONE YEAR ENDING AUGUST



Source: Morningstar, as of 8/31/20

# Detailed index returns

## DOMESTIC EQUITY

	Month	QTD	YTD	1 Year	3 Year	5 Year	10 Year
<b>Core Index</b>							
S&P 500	7.2	13.2	9.7	21.9	14.5	14.5	15.2
S&P 500 Equal Weighted	4.5	9.5	(2.3)	8.4	8.4	10.1	13.4
DJ Industrial Average	7.9	10.6	1.3	10.3	11.6	14.2	13.8
Russell Top 200	8.6	15.0	14.4	27.7	16.7	16.0	15.9
Russell 1000	7.3	13.6	10.4	22.5	14.6	14.3	15.2
Russell 2000	5.6	8.6	(5.5)	6.0	5.0	7.7	11.5
Russell 3000	7.2	13.3	9.4	21.4	13.9	13.9	14.9
Russell Mid Cap	3.5	9.6	(0.4)	8.7	8.8	9.8	13.1
<b>Style Index</b>							
Russell 1000 Growth	10.3	18.8	30.5	44.3	24.2	20.7	19.0
Russell 1000 Value	4.1	8.3	(9.3)	0.8	4.5	7.5	11.0
Russell 2000 Growth	5.9	9.5	6.2	17.3	10.9	10.5	14.1
Russell 2000 Value	5.4	7.6	(17.7)	(6.1)	(1.4)	4.4	8.7

## INTERNATIONAL EQUITY

<b>Broad Index</b>							
MSCI ACWI	6.1	11.7	4.7	16.5	9.0	10.2	9.9
MSCI ACWI ex US	4.3	8.9	(3.1)	8.3	2.6	5.8	5.3
MSCI EAFE	5.1	7.6	(4.6)	6.1	2.3	4.7	5.9
MSCI EM	2.2	11.3	0.4	14.5	2.8	8.7	3.8
MSCI EAFE Small Cap	7.5	11.1	(3.5)	10.7	2.6	6.8	8.6
<b>Style Index</b>							
MSCI EAFE Growth	4.5	9.1	5.3	15.5	8.0	8.5	8.2
MSCI EAFE Value	5.9	6.1	(14.4)	(3.2)	(3.4)	0.8	3.5
<b>Regional Index</b>							
MSCI UK	3.5	5.0	(19.4)	(7.7)	(2.9)	(0.3)	3.4
MSCI Japan	7.6	5.9	(1.6)	10.2	4.3	5.8	6.6
MSCI Euro	4.5	8.4	(5.4)	4.9	0.5	4.1	5.2
MSCI EM Asia	3.2	13.2	9.2	25.3	6.1	11.2	6.7
MSCI EM Latin American	(6.2)	4.1	(32.6)	(23.6)	(9.8)	1.5	(4.3)

## FIXED INCOME

	Month	QTD	YTD	1 Year	3 Year	5 Year	10 Year
<b>Broad Index</b>							
BBgBarc US TIPS	1.1	3.4	9.6	9.0	5.7	4.6	3.7
BBgBarc US Treasury Bills	0.0	0.0	0.7	1.3	1.7	1.2	0.7
BBgBarc US Agg Bond	(0.8)	0.7	6.9	6.5	5.1	4.3	3.7
<b>Duration</b>							
BBgBarc US Treasury 1-3 Yr	(0.0)	0.1	3.1	3.5	2.6	1.9	1.3
BBgBarc US Treasury Long	(4.3)	(0.3)	20.9	13.0	10.9	8.5	7.0
BBgBarc US Treasury	(1.1)	0.0	8.8	7.0	5.2	3.9	3.1
<b>Issuer</b>							
BBgBarc US MBS	0.0	0.2	3.7	4.5	3.6	3.1	3.0
BBgBarc US Corp. High Yield	1.0	5.7	1.7	4.7	4.9	6.5	6.9
BBgBarc US Agency Interm	(0.0)	0.2	3.9	4.0	3.1	2.4	2.0
BBgBarc US Credit	(1.3)	1.8	6.7	7.1	6.2	5.9	5.0

## OTHER

<b>Index</b>							
Bloomberg Commodity	6.8	12.9	(9.0)	(3.9)	(3.1)	(3.1)	(5.1)
Wilshire US REIT	0.4	4.8	(13.8)	(12.5)	1.6	5.7	12.7
CS Leveraged Loans	1.5	3.4	(1.5)	0.6	3.1	4.6	5.0
Alerian MLP	0.5	(40.2)	(42.5)	(17.8)	(12.7)	(10.1)	(2.0)
<b>Regional Index</b>							
JPM EMBI Global Div	0.5	4.2	1.4	2.7	4.1	6.3	5.8
JPM GBI-EM Global Div	(0.3)	2.7	(4.4)	1.5	0.7	4.6	1.3
<b>Hedge Funds</b>							
HFRI Composite	2.7	2.0	5.5	3.5	4.1	4.0	4.1
HFRI FOF Composite	2.1	2.8	5.5	3.1	2.8	3.3	3.1
<b>Currency (Spot)</b>							
Euro	1.1	7.5	6.5	8.6	0.2	1.3	(0.6)
Pound	2.0	8.3	1.1	9.9	1.3	(2.7)	(1.4)
Yen	(0.3)	1.6	2.5	0.1	1.3	2.7	(2.3)

Source: Morningstar, as of 8/31/20

# Detailed private market returns

## Comparison to public market index returns

Private Equity Pooled IRRs	1 Year	3 Year	5 Year	10 Year
Global Private Equity FoFs & Secondary Funds	4.9	10.8	9.3	11.6
Global Private Equity Direct Funds *	3.6	12.2	11.4	13.5
U.S. Private Equity Direct Funds *	4.7	12.7	11.5	14.7
Europe Private Equity Direct Funds *	3.6	14.9	14.8	12.1
Asia Private Equity Direct Funds *	2.3	9.7	9.5	12.0

Public Index Time-weighted Returns	1 Year	3 Year	5 Year	10 Year
MSCI World	(10.4)	1.9	3.2	6.6
S&P 500	(7.0)	5.1	6.7	10.5
MSCI Europe	(15.5)	(2.3)	(1.3)	2.5
MSCI AC Asia Pacific	(12.1)	0.1	1.1	3.4

Private Real Estate Pooled IRRs	1 Year	3 Year	5 Year	10 Year
U.S. All Private Real Estate	0.1	6.7	8.6	12.6

Public Index Time-weighted Returns	1 Year	3 Year	5 Year	10 Year
FTSE NAREIT Equity REIT	(21.3)	(3.1)	(0.3)	7.4

Private Credit Pooled IRRs	1 Year	3 Year	5 Year	10 Year
U.S. All Private Debt **	(5.9)	4.0	5.5	9.4

Public Index Time-weighted Returns	1 Year	3 Year	5 Year	10 Year
S&P / LSTA U.S. Leveraged Loan 100 Index	(5.1)	0.5	1.6	3.2

Private Real Assets Pooled IRRs	1 Year	3 Year	5 Year	10 Year
Global Nature Resources ***	(28.3)	(8.7)	(5.2)	(0.1)
Global Infrastructure	2.4	8.7	10.6	9.3

Public Index Time-weighted Returns	1 Year	3 Year	5 Year	10 Year
S&P Global Natural Resources	(30.0)	(6.4)	(2.7)	(2.2)
S&P Global Infrastructure	(21.1)	(3.2)	(0.4)	4.2

Source: Pooled IRRs are from Thompson Reuters C/A and Time-weighted Returns are from Investment Metrics, as of March 31<sup>st</sup>, 2020. All returns in U.S. dollars.

\* Includes Buyout, Growth Equity and Venture Capital.

\*\* Includes Control-Oriented Distressed, Credit Opportunities, Senior Debt and Subordinated Capital.

\*\*\* Includes Private Equity Energy, Timber and Upstream Energy & Royalties.

# Notices & disclosures

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## Board of Trustees

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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director  
Scott Whalen - Verus

### **Item 8: Investment Policy Revisions – Approval**

#### **Recommendation:**

That the Board of Trustees approve the attached -

1. **Investment Policy Statement (IPS)** based on a Functionally Focused Portfolio asset allocation methodology. It includes a recommended Strategic Asset Allocation (SAA) exhibit as **Addendum A**.
2. **Investment Procedures** – a policy document supplement to the IPS that addresses administrative and investment governance related matters. Both the IPS and the Investment Procedures documents are edits from the prior IPS. They are presented here split into two documents for logical ease and readability.

#### **Discussion:**

Staff and Verus have discussed the concept of a Functionally Focused Portfolio (FFP) asset allocation methodology with the Board over several prior meetings. At the August 24<sup>th</sup> Board of Trustees meeting draft Investment Policy and Investment Procedures documents were presented for Board consideration.

The Investment Policy Statement (IPS) and the Investment Procedures document are both derived from the present IPS. The investment policy sections and the procedural/governance sections of the existing IPS have been separated into two documents for improved focus and clarity of presentation. All sections of the existing IPS are included in one or the other of these two documents. Changes from the original IPS are shown in redline form.

The advantages of an FFP based methodology include –

- Based on functional goals and conceptually simple.
- Portfolio efficiency (return per unit of risk) is increased
- Based on providing a structured and explicit level of liquidity.
- Allows Growth assets to focus on higher risk-adjusted returns with lessened need for liquid assets (e.g., more Private Equity and less Public Market Equity).

### **Proposed FFP based asset allocation:**

Staff and Verus recommend the adoption of a Strategic Asset Allocation (SAA) based on the asset mix in the accompanying Verus materials identified as “FFP Mix 3” which is based on a 10% allocation to a Liquidity sub-portfolio.

A Functionally Focused Portfolio based asset allocation policy sets the Strategic Asset Allocation (SAA) policy into three elements –

- **Liquidity** Sub-portfolio – designed to **provide** for the payment of retirement benefits with a meaningful allocation to very liquid, short term investments – e.g., 10% to 20% of the total fund.
  - **Recommended:**
    - **Liquidity allocation of 10%** of the total portfolio. This is equal to approximately 1.3 years of forecasted gross pension benefits and over 6 years of net pension benefits (pension benefits less incoming pension contributions). The sizing of the Liquidity allocation considers balancing risk and liquidity needs. It also takes into consideration the strong underlying credit quality of San Luis Obispo County as the Plan Sponsor.
    - Short term investment (existing cash equivalents funds) of 4%
    - Short Duration Government/Investment Grade Credit of 6% with selection of specific investment manager scheduled for November 2020 or February 2021 meetings.
- **Growth** Sub-portfolio – designed to **produce** long term investment gains to fund the Plan with lessened constraints on risk and liquidity (which are accomplished with the other two sub-portfolios) with a majority allocation to diverse, long term investments – e.g., 70% to 80% of the total fund.
  - **Recommended:**
    - **Growth allocation of 75%** - with specific allocations to public and private markets investments as detailed on the attached SAA Policy exhibits.

- **Risk-Diversifying** Sub-portfolio – designed to **protect** by reducing the volatility inherent in the Growth sub-portfolio – particularly in times of market dislocations with an “anchor to windward” allocation to diversifying assets – e.g., 10% to 20% of the total fund.
  - **Recommended:**
    - **Risk Diversifying allocation of 15%** - with specific allocations to Long Term Treasury bonds and Treasury Inflation Protected (TIPS) bonds as detailed on the attached SAA Policy exhibits.

**Risk and Return:**

The development of investment policy prudently starts with the level of investment risk that is appropriate. The Pension Trust’s risk tolerance has developed over a number of years with extensive actuarial projections, investment consultant asset/liability modeling and policy development. Risk is typically specified as the expected volatility in rates of return as quantified in the total portfolio standard deviation of returns.

The existing investment policy has been developed such that its current level of expected volatility is approximately a standard deviation of 11%. At the August 24<sup>th</sup> meeting the Board of Trustees indicated to Verus and Staff that an SAA policy that kept an approximately similar risk level with improved expected return (and therefore an improved Sharpe Ratio) was preferred.

The recommended SAA policy contained in the attached Addendum A to the IPS, using the latest estimates from Verus for Capital Market Assumptions (CMAs) results in the following expected risk and return metrics.

	<u>Existing SAA</u>	<u>Proposed SAA</u>
Forecast 10 year Return	6.2%	6.9%
Standard Deviation	11.1%	11.4%
Sharpe Ratio	0.44	0.49

**Transition to Revised SAA:**

As shown on the attached Verus presentation slide on Implementation, transitioning to a Functionally Focused Portfolio with an increased private markets allocation will take several years. To illustrate the shift in asset mix, the following graph illustrates the change. It is an illustrative exhibit that assumes –

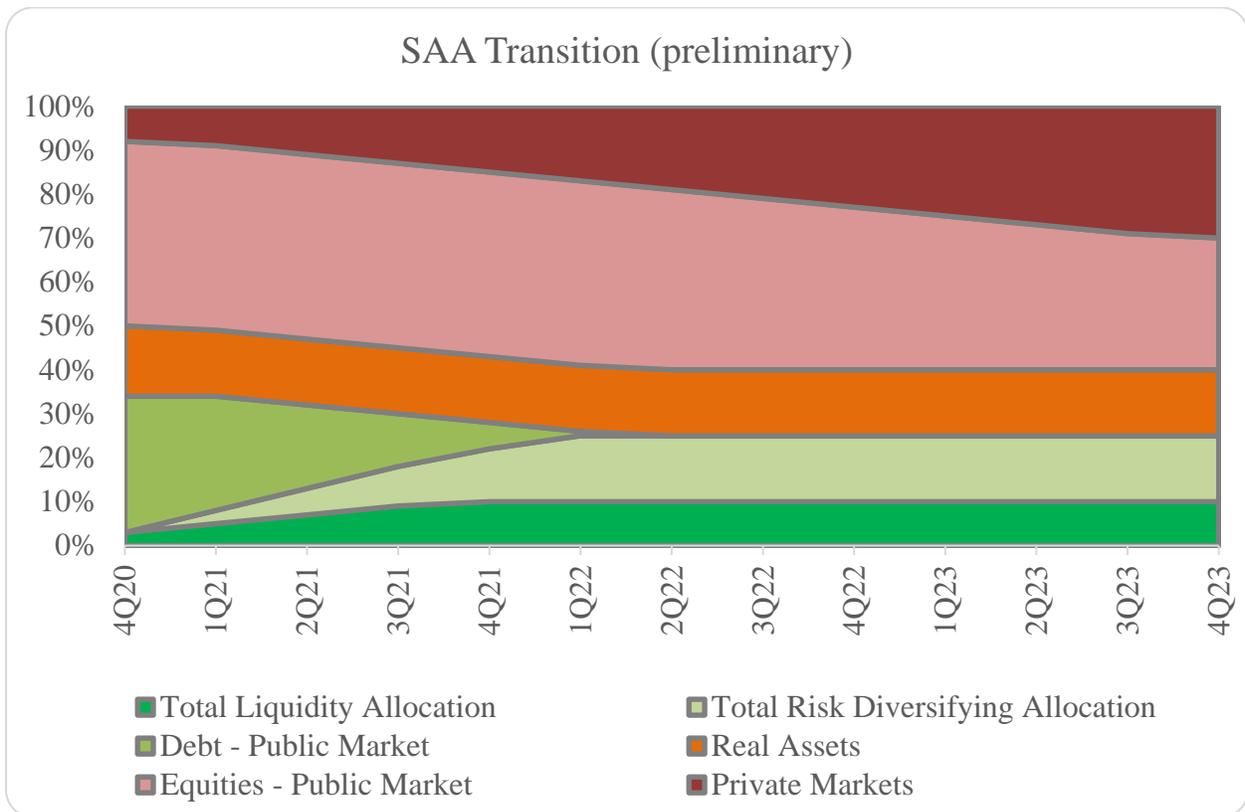
1. Liquidity –
  - a. Investment manager selection for a Short Duration Government/Investment Grade Credit completed by 1Q21.
  - b. Liquidity portfolio funded to 10% allocation across all of 2021 with drawdowns of public market debt primarily.

2. Diversifying –

- a. Investment manager selection for Long-Term Treasuries and TIPS portfolios completed by 2Q21.
- b. Diversifying portfolio funded to 15% allocation through at least 1Q22 with drawdowns of public market debt primarily.

3. Growth –

- a. Full design of the Growth portfolio asset mix considered in 4Q20 and 1Q21 Board meetings.
- b. Private Markets strategy based on the current diversified Fund-of-Funds strategy or an Advisor-managed Direct private market program selected by 2Q21.
- c. Gradual funding of private markets over 2021 to 2023.
- d. Real Assets allocation rearranged gradually as Core Real Estate is drawn down in favor of Value-Add Real Estate and Infrastructure.



**Exhibits –**

1. SAA policy Addendum A exhibit comparing the existing SAA policy to recommended, FFP based allocation.
2. Verus presentation materials.
3. Draft Investment Policy Statement – the included Addendum A on SAA policy is the policy recommended by Verus and Staff.
4. Draft Investment Procedures document.

Respectfully Submitted,

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**San Luis Obispo County Pension Trust  
Strategic Asset Allocation (SAA) Policy**

Strategic Asset Allocation Policy <b>Recommended Changes</b>	Present SAA	Limits		FFP TARGET	Limits		Chg. Target
		Min.	Max.		Min.	Max.	
<b>LIQUIDITY</b>							
<b>Total Liquidity Allocation</b>	<b>0%</b>	0%	5%	<b>10%</b>	5%	20%	10%
Cash Equivalents	0%	0%	5%	4%	1%	15%	
Short Duration Govt/ IG Credit				6%	0%	15%	
<b>GROWTH</b>							
<b>Total Growth Allocation</b>	<b>100%</b>	45%	100%	<b>75%</b>	30%	90%	-25%
<b>Equities - Public Market</b>	42%	15%	31%	30%	15%	75%	-12%
US Large Cap Growth/Value	17%	12%	22%				
US Small/Mid Cap Growth/Value	4%	2%	9%				
Intl. Developed Market	14%	9%	19%				
Intl. Emerging Market	7%	0%	12%				
Global				30%	15%	70%	
<b>Debt - Public Market</b>	31%	25%	46%	0%	0%	30%	-31%
US Core Bonds - Govt. / IG Credit	15%	10%	20%				
Intl. Sovereign / IG Credit	5%	0%	10%				
Global Aggregate							
HY below IG Credit							
Bank Loans	6%	0%	10%				
Emerging market Debt (hard currency)	5%	0%	10%				
Emerging market Debt (local currency)							
<b>Real Assets</b>	17%	5%	22%	15%	10%	30%	-2%
Real Estate - Core	11%	6%	16%	5%	5%	15%	
Real Estate Value Add	6%	1%	11%	5%	0%	15%	
Real Estate - Global							
Commodities	0%						
Infrastructure - Global				5%	0%	15%	

**San Luis Obispo County Pension Trust  
Strategic Asset Allocation (SAA) Policy**

Strategic Asset Allocation Policy <b>Recommended Changes</b>	Present SAA	Limits Min. Max.		FFP TARGET	Limits Min. Max.		Chg. Target
<b>Private Markets</b>  <b>Private Equity</b> Diversified PE strategies (d) Specific PE funds Equity related alternatives  <b>Private Credit</b> Diversified PC strategies (d) Specific PC funds Debt related alternatives	10%	0%	10%	30%	5%	45%	20%
<b>Other Growth Strategies</b> Opportunistic	Varies	0%	10%	Varies	0%	10%	0%
<b>RISK DIVERSIFYING</b>							
<b>Total Risk Diversifying Allocation</b>				15%	5%	30%	15%
US Treasury - Long Duration				8%	4%	15%	
US Treasury - Inflation Protected - TIPS				7%	3%	15%	
<b>TOTAL</b>	<b>100%</b>			<b>100%</b>			
<p>(a) Liquidity target ~ 1.3 yrs gross pension benefits - currently ~\$140m ~10%</p> <p>(b) Growth - long-term investments with some illiquidity. Periodic drawdowns to replenish Liquidity as needed.</p> <p>(c) IG = Investment Grade Credit HY = High Yield - below IG Credit</p> <p>(d) Diversified Private Markets may be Fund-of-Funds or Direct LP program</p>							



**PERSPECTIVES  
THAT DRIVE  
ENTERPRISE  
SUCCESS**



SEPTEMBER 28, 2020

Asset Allocation Policy

**San Luis Obispo County Pension Trust**

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Session objectives **SLIDE 3**

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FFP review **SLIDE 4**

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Liquidity assessment **SLIDE 11**

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Strategic asset allocation **SLIDE 13**  
assessment

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Next steps **SLIDE 16**

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# Session objectives

# Session objectives

1. Determine appropriate size for liquidity pool within FFP framework
2. Finalize high-level FFP policy allocation

# FFP review

# FFP vs. traditional portfolio

Relative to a traditional approach, the Functionally Focused Portfolio puts liquidity at the center of the process and builds in growth and diversification once that core function has been satisfied

The portfolio is segmented to meet three primary functional purposes:

**Provide** – designed to meet monthly net outflows and a meaningful liquidity cushion

**Produce** – designed for sufficient growth to satisfy the perpetual nature of the Plan

**Protect** – designed to reduce the volatility inherent in the growth portfolio and provide liquidity to take advantage of market dislocations

# Transitioning to an FFP allocation

Current Allocation /  
Traditional Buckets

Asset Class	Allocation
Domestic Equity	20
International Equity	20
<b>Total Public Equity</b>	<b>40</b>
Core+ Fixed Income	15
Bank Loans	5
Global Bonds	5
Emerging Market Debt	5
<b>Total Fixed Income</b>	<b>30</b>
Commodities	5
Core Real Estate	10
Value-Added Real Estate	5
<b>Total Real Assets</b>	<b>20</b>
Private Equity	5
Private Credit	5
<b>Total Illiquid Assets</b>	<b>10</b>
<b>Total Assets</b>	<b>100</b>



FFP Allocation/  
Traditional Buckets

Asset Class	Allocation
Domestic Equity	14
International Equity	11
<b>Total Public Equity</b>	<b>25</b>
Cash	5
Short-Term Gov/Credit	10
US Treasury Bonds	10
<b>Total Fixed Income</b>	<b>25</b>
Core Real Estate	10
Value-Added Real Estate	5
<b>Total Real Assets</b>	<b>15</b>
Private Equity	15
Private Credit	10
<b>Total Illiquid Assets</b>	<b>25</b>
<b>Other Diversifying Assets</b>	<b>10</b>
<b>Total Assets</b>	<b>100</b>



FFP Allocation /  
Functional Buckets

Functional Bucket	Allocation
Public Markets Equity	25
Private Equity	10
Private Credit	15
Real Estate	15
<b>Total Growth Assets</b>	<b>65</b>
Cash	5
Short-Term Gov/Credit	10
<b>Total Liquid Assets</b>	<b>15</b>
Treasuries	10
Other Diversifiers	10
<b>Total Diversifying Assets</b>	<b>20</b>
<b>Total Assets</b>	<b>100</b>

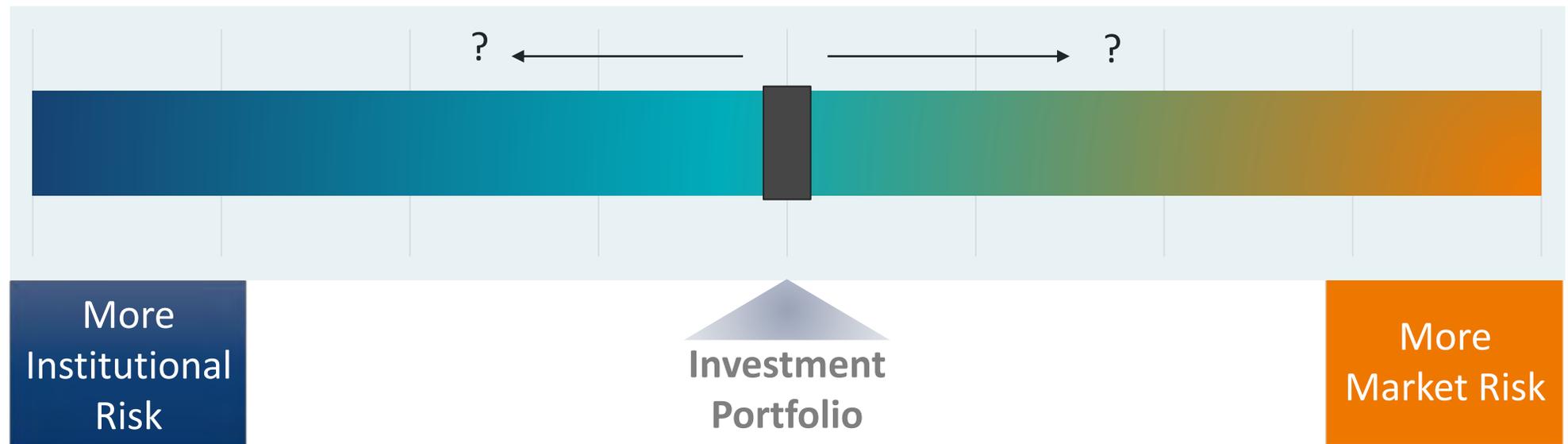
Note: The FFP asset allocation is preliminary, and adjustments may be made throughout the implementation process.



# Liquidity assessment

# Spectrum of Pension Risk Management

Every pension finds a unique balance between Market and Institutional risk; there is no one size fits all



- Low Discount Rate
- High Contributions
- Low Volatility
- High Liquidity

- High Discount Rate
- Low Contributions
- High Volatility
- Low Liquidity

Source: Verus

# Determining an appropriate margin of safety

- There are various choices available to a plan sponsor which change the risk characteristics of the liquidity reserve
  - Years of benefits to lock-in
  - Assumed contributions, from gross (0% of expected) to net (100% of expected)
  - Credit quality, from true cash to low quality bonds
  - Rebalancing rules / tactical positioning
- Today, we are focused on identifying the desired level of liquid reserves (“Lock-in Years”) to include in the FFP framework

SLOCPT EXPECTED NET CASHFLOWS



Source: Verus. Based on data provided by SLOCPT, using an expected 7.0% asset return.

# Determining an appropriate margin of safety

- The below left table provides an overview of the assets necessary to maintain an appropriate liquidity reserve, based on the number of years locked in and the portion of projected contributions expected to be paid.
- In general, as year lock-in increases and contributions decrease the size of the CDI bucket in the portfolio increase.
- A large CDI bucket may have negative return implications for the broader portfolio, requiring increased illiquidity.
- The below right table provides an overview of proposed mixes and its relation to the maximum amount of liquid reserves affordable for that portfolio.

**% OF TOTAL ASSETS IN LIQUIDITY BUCKET**

Assumed Contribution		Gross				Net
		0%	25%	50%	75%	100%
# of Years Secured	1	8%	6%	5%	3%	1%
	2	16%	13%	9%	6%	2%
	3	25%	20%	15%	9%	4%
	4	34%	27%	20%	13%	6%
	5	44%	35%	26%	17%	8%
	6	54%	43%	32%	21%	10%
	7	64%	51%	38%	25%	12%
	8	75%	60%	45%	30%	15%
	9	86%	69%	52%	35%	18%
	10	97%	78%	59%	41%	22%

**COMPARISON OF MIXES AND LOCK-IN AMOUNTS**

Mix	Expected 10 Year Return	% Cash-Like Assets	% in Illiquid Assets	Lock-in Years (Gross)	Lock-in Years (Net)
Current Policy	6.2%	0.0%	27.0%	0	0
FFP Mix 1	7.3%	5.0%	50.0%	<1	3
FFP Mix 2	7.1%	8.0%	45.0%	1	5
FFP Mix 3	6.9%	10.0%	40.0%	1	6
FFP Mix 4	6.5%	15.0%	35.0%	2	8

Source: Verus, MPI. Allocation targets based on a 7.0% expected return. Cash-like assets expected to earn 1% annually.

# Asset allocation assessment

# Mean Variance Analysis

2020 CMA's (10 Yr)

	Current Policy	FFP Mix 1	FFP Mix 2	FFP Mix 3	FFP Mix 4	Return (g)	Return (a)	Standard Deviation	Sharpe Ratio (a)
Cash	0.0	2.0	3.0	4.0	5.0	1.9	1.9	1.2	-
Short-Term Gov't/Credit	0.0	3.0	5.0	6.0	10.0	1.7	1.8	3.6	-0.03
<b>Liquidity Bucket (Provide)</b>	<b>0</b>	<b>5</b>	<b>8</b>	<b>10</b>	<b>15</b>				
Core Plus Fixed Income	15.0	0.0	0.0	0.0	0.0	2.7	3.0	8.3	0.14
Bank Loans	6.0	0.0	0.0	0.0	0.0	5.3	5.8	10.0	0.39
Global Aggregate	5.0	0.0	0.0	0.0	0.0	1.2	1.4	6.2	-0.08
Emerging Market Debt (Hard)	2.5	0.0	0.0	0.0	0.0	5.0	5.7	12.4	0.31
Emerging Market Debt (Local)	2.5	0.0	0.0	0.0	0.0	5.7	6.4	12.0	0.37
US Treasury	0.0	8.0	8.0	8.0	8.0	1.7	1.9	6.7	0.00
US TIPS	0.0	7.0	7.0	7.0	7.0	2.1	2.2	5.4	0.06
<b>Diversifying Bucket (Protect)</b>	<b>31</b>	<b>15</b>	<b>15</b>	<b>15</b>	<b>15</b>				
Public Markets Equity	42.0	25.0	27.0	30.0	30.0	6.4	7.7	16.8	0.34
Private Equity (FoF)	5.0	0.0	0.0	0.0	0.0	7.5	10.3	25.3	0.33
Private Equity (Direct)	0.0	23.0	20.0	18.0	15.0	9.5	12.3	25.3	0.41
Private Credit	5.0	17.0	15.0	12.0	10.0	7.0	7.5	10.0	0.56
Core Real Estate	11.0	0.0	0.0	0.0	0.0	6.6	7.3	12.4	0.44
Value Add Real Estate	6.0	5.0	5.0	5.0	5.0	8.6	10.0	17.7	0.46
Opportunistic Real Estate	0.0	5.0	5.0	5.0	5.0	10.6	12.9	23.0	0.48
Infrastructure	0.0	5.0	5.0	5.0	5.0	7.2	8.6	17.8	0.38
<b>Growth Bucket (Produce)</b>	<b>69</b>	<b>80</b>	<b>77</b>	<b>75</b>	<b>70</b>				
<b>Total Allocation</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>				

Increased liquidity

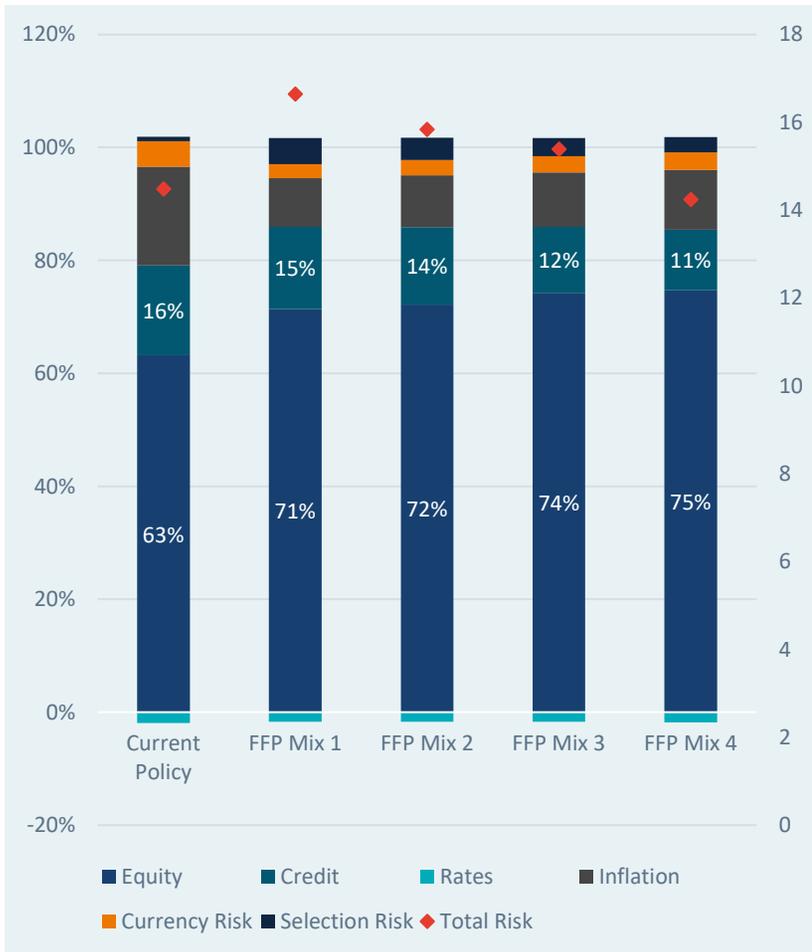
Shift to Treasuries (also highly liquid)

Lower public market equities in favor of illiquid, private markets investments

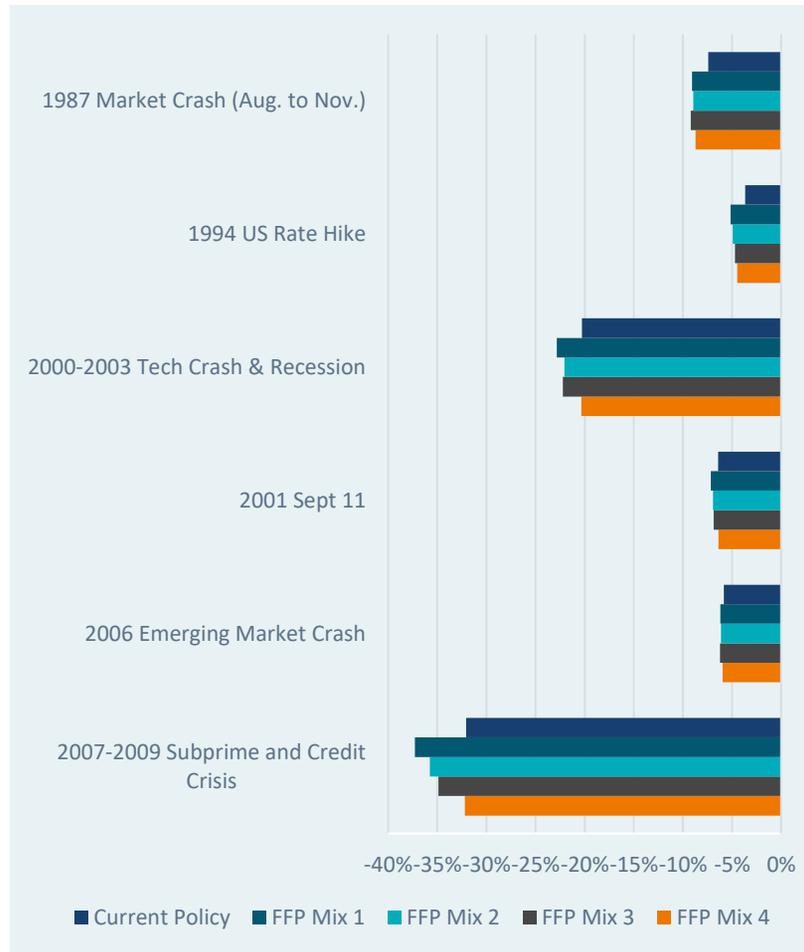
	Current Policy	FFP Mix 1	FFP Mix 2	FFP Mix 3	FFP Mix 4
<b>Mean Variance Analysis</b>					
<b>Forecast 10 Year Return</b>	<b>6.2</b>	<b>7.3</b>	<b>7.1</b>	<b>6.9</b>	<b>6.5</b>
Standard Deviation	11.1	12.0	11.5	11.4	10.6
Return/Std. Deviation	0.6	0.6	0.6	0.6	0.6
1st percentile ret. 1 year	-16.6	-17.1	-16.5	-16.4	-15.3
Sharpe Ratio	0.44	0.50	0.50	0.49	0.48

# Proposed Mix Risk Characteristics

## RISK DECOMPOSITION



## SCENARIO ANALYSIS



Source: MSCI BarraOne

# Next steps

# Next steps

- Determine preferred private markets structure and identify next steps, as appropriate
- Develop and execute transition plan

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**SAN LUIS OBISPO COUNTY  
PENSION TRUST**

**BOARD OF TRUSTEES**

**INVESTMENT POLICY STATEMENT**

**September 28, 2020**

**Replaces prior Investment Policy  
Dated Nov. 23, 2015 and  
Last amended March 23, 2020**

# I. Investment Policy Purpose and Authority

The San Luis Obispo County Pension Trust Board of Trustees, pursuant to applicable County, State and Federal laws and regulations and in keeping with its fiduciary responsibilities, has established this Investment Policy to govern the investment of the assets of the Pension Trust.

The purpose of this Investment Policy is to provide policy guidance and documentation of the authority, role and governance practices of the Pension Trust relative to the investment of the Trust's assets.

In formulating this Investment Policy, the Board of Trustees has followed the provisions of Article XVI, Section 17 of the California State Constitution which are set forth in pertinent part below:

1. Notwithstanding any other provision of law or of the California Constitution to the contrary, the Board of Trustees shall have plenary authority and fiduciary responsibility for investment of moneys and administration of the Pension Trust.
2. The Board of Trustees shall have the sole and exclusive fiduciary responsibility over the assets of the Pension Trust.
3. The Board of Trustees shall have the sole and exclusive responsibility to administer the Pension Trust in a manner that will assure the prompt delivery of benefits and related services to members, participants, and their beneficiaries.
4. The assets of the Pension Trust are trust funds and shall be held for the exclusive purpose of providing benefits to members, participants and their beneficiaries and defraying the reasonable expenses of administering the Pension Trust.
5. That each member of the Board of Trustees shall discharge his or her duty with respect to the Pension Trust solely in the interest of, and for the exclusive purposes of:
  - a. providing benefits to members, retired participants and their beneficiaries
  - b. minimizing contributions to the Pension Trust
  - c. defraying the reasonable expenses of administering the Pension Trust.
6. The Board of Trustees' duty to its members, participants and beneficiaries shall take precedence over any other duty.
7. Each member of the Board of Trustees shall discharge his or her duty with respect to the Pension Trust with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
8. The Board shall diversify the investments of the Pension Trust so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so.

## II. Investment Objectives

1. The overall objective is to invest the assets of the Pension Trust solely for the benefit of plan members, participants and their beneficiaries while attempting to minimize contributions, investment costs and administration costs.
2. The long-term performance objective for the Pension Trust is to meet or exceed the actuarially assumed rate of return net of fees and expenses, over a complete economic cycle and relevant longer periods.

## III. Investment Philosophy

1. Time Horizon - The Pension Trust will periodically review the portfolio's alignment with the Retirement Plan's liabilities. The investment policy and guidelines are based on a time horizon of greater than five years. The Pension Trust will consider both intermediate-term and longer-term investment return horizons in formulating expected returns and assessing portfolio risk parameters. The Pension Trust's strategic asset allocation is based on this longer-term perspective. Fluctuations of investment results in the interim should be viewed with an appropriate perspective
2. Risk Tolerance - Investment opportunities in various asset classes have differing risk and return expectations. In general, investments with higher expected returns involve a higher level of risk. The Pension Trust recognizes that some level of risk must be assumed to achieve the long-term investment objectives. The Pension Trust will attempt to achieve its investment return objective with an appropriate level of risk using an efficient combination of investable assets.
3. Drawdown Risk – The Pension Trust is a retirement system in a negative cashflow status (benefits paid exceed contributions received annually), As a result, the Pension Trust's funded level and required contributions are increasingly sensitive to periods when investment returns are negative even with the expectation that investment markets will recover after such events. As part of its consideration of risk tolerance and asset allocation the Pension Trust will attempt to manage short-term drawdown risk when developing its long-term asset allocation policy and when shifting or rebalancing the portfolio.
4. Liquidity Needs - Sufficient liquidity must be maintained to pay benefits and expenses. Investment income and contributions may or may not exceed projected benefit payments and expenses on an annual basis. Within the constraints of maintaining adequate liquidity for the payment of benefits and expenses, a reasonable portion of the portfolio may be invested in illiquid investments. The liquidity requirements shall be reviewed at least annually.
5. Asset Allocation as Primary Control Over Risk and Return - It is impossible to accurately and consistently predict the future; therefore, the Plan is required to be prudently diversified across

and within asset classes in anticipation of various economic conditions. In a well-diversified portfolio, the overall volatility of investment returns is principally driven by the asset allocation and secondarily driven by the individual investment strategies. As such, asset allocation is the primary tool by which the Board can manage the expected risk/return profile of the Plan.

5.6. Performance Objectives - The expected and actual investment returns of the total fund will depend on the asset allocation targets, the mix of investment styles within asset classes, and individual manager performance. Therefore, performance objectives have been set at three levels: total fund, asset class, and individual portfolios.

a. Total Fund

- i. Meet or exceed the actuarial ~~rate of interest~~discount rate which has taken into account expected composite portfolio returns. Annualized investment returns (net of fees) should exceed the actuarial ~~discount rate~~interest rate over most five-year periods and over complete economic cycles.
- ii. Meet or exceed the policy benchmark. Annualized investment returns (net of fees) to exceed the policy benchmark over five-year periods. The policy benchmark is a composite of the benchmarks of the asset classes in the asset allocation policy. Composition of the policy benchmark is detailed in Addendum A.

b. Asset Class

- i. Annualized returns (net of fees) for the asset classes should exceed their respective benchmarks over a five-year period. The asset class benchmarks will be broad market indices that are representative of the investment structure for that asset class. Current benchmarks for the asset classes are shown in Addendum A.

c. Individual Portfolios

- i. Performance objectives for manager portfolios are stated in the respective investment-manager-agreements. Returns (net of fees) are expected to exceed the respective benchmarks over three to five-year periods. Manager benchmarks will be determined based upon the investment style of the portfolio for which the manager is hired.

6.7. Compliance – The Board believes that investment policies, in aggregate, are the most important determinants of investment success. Compliance with investment policies should, therefore, be monitored diligently.

## IV. Asset Classes

The asset classes that may be utilized by the Pension Trust include, but are not limited to, the listing shown below. Not all asset classes listed below may be approved for use at any given time. **The asset classes approved by the Board of Trustees at any given time are specified in the Strategic Asset Allocation (SAA) policy contained in Addendum A to this Investment Policy.**

The purpose of utilizing multiple asset classes for the investment of Pension Trust assets is to diversify across different assets that respond to economic and capital market conditions differently. The expected returns, volatility of returns, cross-asset-class-correlations, liquidity and cashflow of different asset classes are to be considered in the setting of the Strategic Asset Allocation specified in **Addendum A**.

### Possible Asset Classes:

1. Domestic Equities
2. International / Global Equities
3. International – Developed Market Equities
4. International – Emerging Market Equities
5. Domestic Fixed Income / Bonds
6. International / Global Fixed Income
7. International – Developed Market Fixed Income
8. International – Emerging Market Fixed Income
9. Short Term Cash Equivalents
10. Domestic Real Estate
11. International / Global Real Estate
12. Infrastructure
13. Timber
14. Commodities
15. Private Equity
16. Private Credit
17. Other Alternative Strategies (e.g., Risk Parity, Alternative Risk Premia, Momentum, Volatility Capture, Currency Beta)

## V. Asset Allocation

**The current Strategic Asset Allocation – approved asset classes, target allocations and ranges are detailed in Addendum A as approved by the Board of Trustees of the Pension Trust.**

The Board of Trustees of the Pension Trust has adopted a strategic asset allocation plan based upon the fund's projected actuarial liabilities and liquidity needs, the Pension Trust's risk tolerances and the risk/return expectations for various asset classes. This asset allocation plan seeks to optimize long-term returns for the level of risk that the Pension Trust considers appropriate. Since projected liability and risk/return expectations will change over time, the Pension Trust will conduct a periodic review of the asset allocation plan, at least triennially, to maintain an optimal allocation, and may also revise the asset allocation in response to significantly changing market conditions that have affected valuations and forward-looking expected returns of asset classes. The Pension Trust will review capital market expectations at least annually.

### Functionally Focused Sub-Portfolios

The asset allocation methodology used in this Strategic Asset Allocation (SAA) policy is based on the Functionally Focused Portfolios model. Three primary sub-portfolios are employed – Liquidity, Growth, and Risk-Diversifying. Specific investment strategies and investment managers fit within these three Functional sub-Portfolios. The sub-portfolios are described below.

#### LIQUIDITY

- Purpose - to ensure adequate assets are available to pay benefits over an extended period, thereby allowing the Growth sub-portfolio to invest for the long term with lessened constraints on liquidity.
- Liquidity Allocation – to be established in the setting of the SAA policy specified in Addendum A to this Investment Policy as a certain number of months of gross benefit payments set within an allowable range.
- Replenishment – to be replenished through contribution payments and periodic-transfers from the Growth or Risk-Diversifying -sub-portfolios as part of routine rebalancing transactions.
- Investments - highly liquid, low volatility securities expected to generate modest levels of return while preserving capital throughout a market cycle. This portfolio will contain assets such as cash, short-term bonds, laddered government bonds, derivatives, and other investments that provide fixed, contractual cash flows with an acceptable –level of credit risk.
- Secondary Purpose - a portion of the Liquidity sub-portfolio may be allocated to the Growth sub-portfolio on an opportunistic basis during broad market corrections so long as at least 50% of the SAA Policy target for the Liquidity sub-portfolio is maintained.

- The success of the Liquidity sub-portfolio will be measured by its ability to directly fund benefit payments through low-risk, cash flowing investments, as well as providing a stable offset to the rest of the portfolio during periods of severe market stress.

## **GROWTH**

- Purpose - to grow invested assets over the long term to pay future benefits. Assets from the Growth sub-portfolio may be sold over time and transferred to the Liquidity sub-portfolio as needed.
- Time Horizon, risk and return - -The Growth sub-portfolio has a long investment horizon and can, therefore, accept a higher level of risk. Assets in this portfolio may be volatile, have reduced liquidity, and derive the bulk of their return from capital appreciation. These assets include public and private equity, corporate and other debt with credit risk premiums, private real estate and other private assets.
- The success of this portfolio will be measured primarily by compounded annual growth rates in conjunction with the annualized standard deviation of returns as the primary measure of risk. Performance evaluation will, therefore, focus on the long-term total risk-adjusted return of the portfolio.

## **RISK DIVERSIFYING**

- Purpose - to offset the investment risk of the Growth sub-portfolio.
- Time Horizon, risk and return - investment strategies in the Risk Diversifying sub-portfolio are expected to have return profiles that have a low correlation to those in the Growth sub-portfolio. This low correlation of returns is expected to effectively dampen the market volatility across the entire portfolio.
- Secondary Purpose - the investment strategies in the Risk Diversifying sub-portfolio will offer additional sources of return to those in the Liquidity and Growth sub-portfolios. Assets in the Diversifying sub-portfolio may be sold during times of market stress or when the assets in the Growth Sub-portfolio are impaired -to fund the Liquidity sub-portfolio.
- The success of the Risk Diversifying sub-portfolio will be measured by its ability to offset declines in value in the Growth sub-portfolio, as well as its ability to provide liquidity during times of market stress.

## **ADMINISTRATION OF THE FUNCTIONAL SUB-PORTFOLIOS**

- The allocations to the Liquidity, Growth, and Risk Diversifying sub-portfolios will vary over time.

- The Liquidity sub-portfolio will operate as a drawdown vehicle to pay benefits and expenses.
- The Growth and Risk Diversifying sub-portfolios will be subject to the volatility of the markets in which each functional sub-portfolio invests.
- In order to reallocate between the functional sub-portfolios, the SAA Policy as shown in Addendum A to this Investment Policy will guide periodic rebalancing transactions.
- The SAA Policy as shown in Addendum A to this Investment Policy will be reviewed annually by the Board of Trustees based on the advice of the Executive Director / CIO and the Investment Consultant(s).

DRAFT

## VI. Investment Managers

### Internal vs. External Investment Management:

The Board of Trustees may from time to time authorize the Pension Trust staff to provide investment management services directly, on an internally managed basis. Any such internal management must consider the professional qualifications and resources of Pension Trust staff. Any such internal management must be fully specified with a stated investment style and goals equivalent to those applied to external investment managers. **In general, the Pension Trust has a strong bias towards utilizing external investment managers.**

### Investment Manager Diversification:

In general, the Pension Trust will employ multiple investment managers across asset classes with diversified investment styles. Examples of investment manager diversification may include, but are not limited to the list shown below.

1. Domestic Equities – diversified by -
  - a. Market capitalization (e.g., small cap, mid cap, large cap)
  - b. Industry and across individual companies
  - c. Investment style (e.g., “growth” and “value”)
  - d. Active investment management and index/ passive/ semi-passive strategies.
2. International / Global Equities – diversified by -
  - a. Developed markets
  - b. Emerging markets
  - c. Global markets (including both domestic U.S. and international)
  - d. Individual countries
  - e. Currency exposure and management
  - f. Market capitalization (e.g., small cap, mid cap, large cap)
  - g. Industry and across individual companies
  - h. Investment style (e.g., “growth” and “value”)
  - i. Active investment management and index/ passive/ semi-passive strategies.
3. Domestic Fixed Income / Bonds – diversified by –
  - a. Governmental or corporate issuer
  - b. Credit quality
  - c. Industry
  - d. Collateral (e.g., mortgage backed)
  - e. Maturity and Duration
  - f. Yield
  - g. Active or passive management
  - h. Investment Style
4. International / Global Fixed Income – diversified by –
  - a. Developed markets

- b. Emerging markets
  - c. Governmental or corporate issuer
  - d. Country
  - e. Currency exposure and management
  - f. Credit quality
  - g. Industry
  - h. Collateral (e.g., mortgage backed)
  - i. Maturity and Duration
  - j. Yield
  - k. Active or passive management
  - l. Investment Style
5. Domestic / International / Global Real Estate Income – diversified by –
- a. Geographic area
  - b. Property type
  - c. Leverage
  - d. Investment style – e.g., “core”, “value added”
  - e. Open end commingled fund or closed end fund (e.g., a limited partnership)
6. Commodities– diversified by –
- a. Active or passive management
  - b. Derivatives used
7. Private Equity, ~~and~~ Private Credit, and other private market illiquid funds – diversified by –
- a. Type of investment (e.g., venture capital, buyout, debt, secondary market interests, co-investments)
  - b. General Partner
  - c. Vintage year of limited partnership
  - d. Investment Style

### **Active Investment Management:**

The Pension Trust may from time to time utilize active investment managers to the extent that it holds the expectation that active investment management can generate risk adjusted returns greater than relevant, investable benchmarks over an entire market cycle. The use of passive or index-based investment management will be preferred by the Pension Trust in the absence of expectations of active management outperformance. The Pension Trust will regularly evaluate all active investment managers relative to lower cost alternatives of passive or index-based management.

## **Environmental / Social / Governance:**

The Pension Trust recognizes that the economic value of its investments may be impacted by Environmental / Social / Governance issues. In its capacity as fiduciaries, the Board of Trustees in the interests of prudent diversification may evaluate potential Environmental / Social / Governance issues at the investment manager level as being a reasonable factor when other expected investment alternatives are estimated to be equal in merit (i.e., all else being equal). The Pension Trust delegates consideration of the merits of any such Environmental / Social / Governance issues at the individual investment level to investment managers employed by the Pension Trust. Investment managers employed by the Pension Trust may consider Environmental / Social / Governance factors (e.g., environmentally sustainable business practices, responsible corporate governance and transparency) in the context of their positive impacts on expected investment returns. The Pension Trust expects its investment managers to be aware of Environmental / Social / Governance issues and consider their impact on diversification and risk in their portfolios.

## **Role of Derivatives, Cash Securities, Long/Short Positions, Leverage:**

In general Pension Trust investments will be in long positions in cash securities markets. Some asset strategies may employ both long and short positions in derivative securities or which may be acceptable depending on the type of investment manager and/or strategy applicable. Some asset strategies may employ leverage which may be acceptable depending on the type of investment manager and/or strategy applicable.

Some investment exposures may be more efficiently achieved with derivative instruments which are acceptable depending on the type of investment manager and/or strategy applicable. Investment managers may be permitted under the terms of individual investment guidelines to use derivative instruments to implement market decisions and security positions and to control portfolio risk. Derivatives are contracts or securities whose returns are derived from the returns of other securities, indices or instruments including, but not limited to, futures, forwards, options, swaps and options on futures. Examples of appropriate applications of derivative strategies include hedging interest rate and currency risk, rebalancing portfolio exposures, securitizing fund level and manager cash, maintaining exposure to a desired asset class while effecting asset allocation changes, adjusting portfolio duration for fixed income and gaining exposure to commodities. Portfolio liabilities associated with investments (i.e. mortgage forward bond purchases, futures, in-the-money short puts, reverse repurchase agreements, etc.) shall be backed by cash equivalents or deliverable securities. No derivatives positions can be established that create portfolio characteristics outside of portfolio guidelines. Managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

## VII. Investment Policy Statement and Investment Procedures – Review and Revision

The Board of Trustees reserves the right to amend ~~the~~<sup>is</sup> Investment Policy Statement and ~~these~~ Investment Procedures at any time they deem such amendment to be necessary, or to comply with changes in federal law as these changes affect the investment of Fund assets.

This Investment Policy Statement and ~~these~~ Investment Procedures shall be reviewed, at a minimum, every three years or as directed by the Board of Trustees. Such reviews will focus on the continuing feasibility of achieving the investment objectives and the continued appropriateness of the investment policy relative to the Pension Trust's circumstances.

It is not expected that the investment policy will change frequently; in particular, short-term changes in the financial markets generally should not require an adjustment in the investment policy. However, specific policy issues may be visited whenever the Board of Trustees deems necessary. Specific occurrences which might suggest to the Board an earlier review include, but are not limited to, a change in the Fund's circumstances and / or a material change in the capital market environment.

San Luis Obispo County Pension Trust  
 Strategic Asset Allocation (SAA) Policy

ADDENDUM A

Strategic Asset Allocation Policy Recommended Policy Sep. 28, 2020		TARGET	Limits		Performance Benchmark
			Min.	Max.	
<b>LIQUIDITY</b>					
<b>Total Liquidity Allocation</b>	(a)	<b>10%</b>	<b>5%</b>	<b>20%</b>	Policy mix composite
Cash Equivalents		4%	1%	15%	90 day T-Bills
Short Duration Govt/ IG Credit	(c)	6%	0%	15%	TBD
<b>GROWTH</b>					
<b>Total Growth Allocation</b>	(b)	<b>75%</b>	<b>25%</b>	<b>95%</b>	Policy mix composite
<b>Equities - Public Market</b>		30%	15%	85%	Russell 3000
US Large Cap Growth/Value	TBD				S&P 500
US Small/Mid Cap Growth/Value					Russell 2500
Intl. Developed Market Growth/Value					MSCI EAFE
Intl. Emerging Market					
Global		30%	15%	70%	MSCI ACWI
<b>Debt - Public Market</b>		0%	0%	30%	
US Core Bonds - Govt. / IG Credit	(c)				BC Aggregate Bond
Intl. Sovereign / IG Credit					Citi World Govt. Bond
Global Aggregate					
HY below IG Credit					
Bank Loans					
Emerging market Debt (hard currency)					
Emerging market Debt (local currency)					
<b>Real Assets</b>		15%	10%	30%	Policy mix composite
Real Estate - Core		5%	5%	15%	NCREIF
Real Estate Value Add		5%	0%	15%	NCREIF
Real Estate - Global					
Commodities					
Infrastructure - Global		5%	0%	15%	TBD

Strategic Asset Allocation Policy Recommended Policy Sep. 28, 2020	TARGET	Limits Min. Max.		Performance Benchmark
<b>Private Markets</b> <b>Private Equity</b> Diversified PE strategies (d) Specific PE funds Equity related alternatives <b>Private Credit</b> Diversified PC strategies (d) Specific PC funds Debt related alternatives	30%  18%  12%	5% 45%  5% 30%  5% 25%	Russell 3000 + 3%	
<b>Other Growth Strategies</b> Opportunistic	Varies	0% 10%		
<b>RISK DIVERSIFYING</b>				
<b>Total Risk Diversifying Allocation</b>	<b>15%</b>	<b>5% 30%</b>		
US Treasury - Long Duration	8%	4% 15%	TBD	
US Treasury - Inflation Protected - TIPS	7%	3% 15%	TBD	
<b>TOTAL</b>	<b>100%</b>		<b>Total Fund Policy mix</b>	
<p>(a) Liquidity target ~ 1.3 yrs gross pension benefits - currently ~\$140m ~10%</p> <p>(b) Growth - long-term investments with some illiquidity. Periodic drawdowns to replenish Liquidity as needed.</p> <p>(c) IG = Investment Grade Credit HY = High Yield - below IG Credit</p> <p>(d) Diversified Private Markets may be Fund-of-Funds or Direct LP program</p>				

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**SAN LUIS OBISPO COUNTY  
PENSION TRUST**

**BOARD OF TRUSTEES**

**INVESTMENT PROCEDURES**

**Supplement to Investment Policy Statement**

**September 28, 2020**

# I. Investment Procedures Purpose and Authority

The San Luis Obispo County Pension Trust (SLOCPT) Board of Trustees establishes the Investment Policy governing the investment of Pension Trust assets. The Investment Policy Statement (IPS) approved and periodically amended by the Board of Trustees is the guiding document for investments.

This document on Investment Procedures addresses the various procedures that support the implementation of the IPS and thus is supplementary to the Investment Policy Statement. The Investment Procedures are presented herein as a separate document from the IPS for the sake of clarity and a concise focus in the IPS.

The primary responsibility for administering, monitoring, and reporting to the Board of Trustees on the Pension Trust Investment Policy lies with the Executive Director / Chief Investment Officer (CIO).

## II. Investment Managers

### Investment Manager Guidelines:

All investment managers engaged by the Pension Trust must:

1. Be registered investment advisors with the Securities and Exchange Commission, trust companies that are regulated by State and Federal Banking authorities, or mutual fund companies.
2. Accept fiduciary responsibility and contractually agree to notify the President of the Board of Trustees and the Executive ~~Director~~Secretary in writing if they are unable to continue acting in the capacity of a fiduciary or investment advisor.
3. Maintain insurance coverage, including errors & omissions, surety bond, fiduciary liability, ERISA bond, etc. consistent with normal practices for investment management firms managing retirement plan assets.

Each investment manager hired by the Pension Trust shall be governed by ~~the~~is Investment Policy Statement and these Investment Procedures. Moreover, each investment manager shall be hired by the Board of Trustees pursuant to a written agreement which shall incorporate this Investment Policy Statement and these Investment Procedures~~Investment Policy~~ and which shall provide that the agreement is terminable at any time, with or without cause, at the discretion of the Board of Trustees.

Investment Managers shall agree to:

1. Maintain the investment approach that the manager was hired to implement under any

and all capital market environments.

2. Immediately report in writing to the Board any changes in firm structure, firm management, portfolio management personnel, or the manager's investment decision making process.
3. Fully educate the Pension Trust as to the specifics of the manager's investment process.
4. Exclusive of specific Pension Trust investment guidelines, maintain a portfolio that generally conforms to other portfolios managed by the investment manager for other clients using similar mandates.
5. Otherwise, treat the portfolio managed for the Pension Trust in a manner consistent with similar to other comparable portfolios managed for other clients in portfolio construction, trading, and all other aspects.

Members of the investment manager's research and portfolio management teams will comply with the CFA Institute Professional Standards and Code of Ethics. Any industry or regulatory disciplinary action taken against members of the investment manager's investment staff must be immediately reported in writing to the Board.

If the Board delegates proxy voting responsibilities to its investment managers, the investment manager agrees to vote all proxy ballots according to the best economic interest of the Pension Trust and in a manner consistent with any specified Board approved proxy policies.

### **Investment Manager Due Diligence – Retention and Termination:**

The Board of Trustees delegates to Staff, with assistance from its Consultant(s), the process of identifying and recommending investment managers for retention or termination. Staff, working with Consultant(s), will conduct comprehensive due diligence to provide the Board of Trustees with necessary and sufficient information in support of recommendations to retain or terminate external investment managers. The specific elements of due diligence will vary based on the asset class and the characteristics of the individual manager(s) and/or strategies under consideration. The due diligence with respect to underlying investment managers shall include, but is not limited to, an assessment of the merits of investment process and philosophy, resources and talent available to the organization, the likelihood that key resources will remain, risk management processes, internal control and compliance processes and procedures, and other organizational considerations.

### **Prohibited Transactions, Transactions and Brokerage:**

The following transactions will be prohibited: selling on margin; "prohibited transactions" as defined under ERISA; transactions that involve a broker acting as a "principal" where such broker is also the investment manager who is making the transaction; and any or all investment activities forbidden by Securities and Exchange Commission or other applicable governing bodies. The Pension Trust hereby instructs its investment managers to seek best execution when conducting all trades. Managers are instructed to seek to minimize commission and market impact costs when trading securities. Also, either internally or through an externally provided transaction cost evaluation service, investment managers are expected to measure the costs associated with their

investment trades. When trading securities, best execution is the paramount consideration and this objective is expected to provide for and protect the best economic interest of the Pension Trust.

### **Placement Agents:**

The Pension Trust will not use the services of investment managers secured through the use of external Placement Agents as that term is defined in Section 7513.8(d) of the California Government Code.

## **III. Investment Custody**

### **Master Custodian:**

~~The Pension Trust will hold its investments to the extent possible through the custody of a qualified trust bank.~~

The Custodian Bank, selected by the Board to act as the principal custodian of assets of the Trust, is delegated the responsibility of holding the assets and evidence of interests owned by the Pension Trust in investment vehicles and cash (and equivalents). The Board may authorize the Custodian Bank to invest in temporary short-term fixed income investments both for the investment strategies and as a part of the cash portion of the Pension Trust assets. Such investments will be managed in general accordance with short-term fixed income investment guidelines as detailed in the Custodial Agreement. Cash managed for investment strategies shall be considered to be sub-portions of the assets managed by the directing Investment Managers.

The Custodian Bank shall be authorized to conduct a securities lending program within liquidity and risk constraints if established by the Board.

### **Separate Account vs. Commingled Funds:**

The Pension Trust may hold its investments in separate accounts managed by investment managers and custodied by a master custodian. The Pension Trust may also hold its investments in pooled, commingled accounts, mutual funds, collective trusts, limited partnership interests or similar arrangements. In general, the Pension Trust has a bias in favor of commingled funds where available.

## IV. Investment Consultants

The Board of Trustees of the Pension Trust recognizes that the employment of highly qualified investment consultants is necessary to the discharge of its fiduciary duties. Accordingly, it is the policy of the Pension Trust to consistently employ a general investment consultant. From time to time the Pension Trust may employ more specialized investment consultants as deemed necessary for particular asset classes (e.g., real estate, private equity, other alternatives).

## V. Investment Administration

### Liquidity Management:

**Cashflow Analysis** - Annually the Executive ~~Secretary-Director/CIO~~ shall cause to be prepared a Cashflow Analysis of the Pension Trust addressing contributions, benefit payments, investment cashflows, administrative expenses and the net liquidity needs of the Pension Trust and submit such report to the Board of Trustees.

**Cash Management** – The Executive ~~Director/CIO Secretary~~ will manage the cash transactions of the Pension Trust such that benefit payments are made in a timely manner. A reserve of liquid funds shall be maintained equal to at least three months of expected benefit payments. ~~Such liquidity reserve should not exceed six months of expected benefit payments except to fund upcoming investment cashflows (e.g., capital calls).~~

### Portfolio Rebalancing:

The Pension Trust recognizes the importance of regular and disciplined rebalancing of its asset allocation to match the target allocations and remain within the approved asset mix ranges as specified in Addendum A to the Investment Policy Statement. Accordingly, the Executive ~~Secretary-Director/CIO and/or Chief Investment Officer~~ is authorized by this policy to evaluate the need for rebalancing at least quarterly and effect regular rebalancing of the asset mix as needed, but no less than annually if needed.

Portfolio rebalancing necessary to maintain the targeted level of the Liquidity Pool under the adopted Investment Policy Statement shall be performed monthly by the Executive Director / CIO.

## Proxy Voting:

The Pension Trust acknowledges that the ownership of equities requires proxies to be voted and commits to managing its proxy voting rights with the same care, skill, diligence, and prudence as is exercised in managing its other assets. As a responsible fiduciary, the Pension Trust will exercise its proxy voting rights in the sole interest of the Plan's members, participants, and their beneficiaries in accordance with all applicable statutes. Consequently, all proxies shall be voted by the Pension Trust's equity investment managers consistent with their respective policies on proxy voting and in the best interest of the shareholders. The investment managers will provide a copy of their proxy voting guidelines to the Pension Trust when first hired and whenever there are changes thereafter. The Executive ~~Secretary-Director~~/-CIO will monitor the voting of proxies by external investment managers managing separate accounts to ensure that all proxies are being voted and to identify any potential policy concerns with such votes. The Executive ~~Secretary-Director~~/CIO will report to the Board of Trustees as necessary with respect to proxy voting.

## Reporting:

1. Monthly reports on the estimated investment performance and status of the Pension Trust shall be made to the Board of Trustees.
- ~~2.~~ Quarterly reports on investment performance shall be made to the Board of Trustees and shall include a review of the Pension Trust's adherence to investment style and discipline as set forth by the Investment Policy Statement and these Investment Procedures~~this policy~~, a review of current strategy, and recent investment performance. Investment performance is to be evaluated on a total return basis. Quarterly reports will include a report on asset allocation policy compliance.
- ~~3.2.~~ ~~An annual report on asset allocation policy compliance shall be made to the Board of Trustees~~
- ~~4.3.~~ An annual report on expected capital market returns and recommendations for potential modifications to asset allocation policy shall be made to the Board of Trustees.

## Policy Compliance Monitoring:

The Executive ~~Secretary-Director~~ and/or the Chief Investment Officer shall monitor the compliance of the Pension Trust's Investment Managers with the requirements of the Investment Policy Statement and these Investment Procedures~~this policy~~ and their respective investment management agreements, and report any instances of non-compliance to the investment consultant and to the Board of Trustees.

## Funds Transfers:

1. Funds transfers, including wire transfers, outside of the accounts of the Master Custodian may be necessary for purposes that include –
  - a. Benefit payments
  - b. Administrative expenses
  - c. Transfers to or from commingled investment accounts, mutual funds or limited partnerships.
  
2. All Wire Transfer Instructions shall –
  - a. Be in writing or submitted via a secure online portal to the Custodian Bank.
  - b. Require the signatures or electronic validation through a secure online portal to the Custodian Bank -of at least two officers of the Pension Trust as may be designated by ~~from~~ time to time by Board of Trustees action.
  - c. Wire Transfer Instructions for amounts in excess of \$5,000,000 shall always require the signature or electronic validation through a secure online portal to the Custodian Bank of the Executive ~~Secretary~~ Director or the Deputy ~~Executive Secretary~~ Director .
  - d. Wire Transfers shall be verified by the Bank via telephone with one of the Pension Trust employees authorized as officers with signing authority over the account consistent with the Bank's policy on wire transfers, or verified via electronic validation through a secure online portal to the Custodian Bank.

# VI. Responsibilities and Delegation of Authority

## Responsibilities of the Board of Trustees:

In keeping with the provisions of California State Constitution, the Board of Trustees shall have the following responsibilities under this policy:

1. Establish Policy and Policy Guidelines.
2. Delegation of Specific Authority to Qualified Investment Personnel or Providers
3. Designate the Executive ~~Secretary~~ Director of the Pension Trust to act as the Chief Investment Officer (CIO) or designate other staff or service providers/consultants to act as the CIO under the supervision of the Executive Director ~~Secretary~~.
4. Establish the Strategic Asset Allocation (SAA) Policy.
5. Monitor Compliance and Adherence to This Policy.
6. Retaining and terminating investment managers based on recommendations of the Executive Director ~~Secretary~~, CIO, and ~~the~~ Investment Consultant(s).
7. Retaining and terminating key professionals including General Counsel, Investment Counsel, -and Investment Consultants.

## Responsibilities of the Executive Director ~~Secretary~~:

The Executive Director ~~Secretary~~ shall have the following responsibilities under this policy:

1. Management and Supervision of the investment activities of the Pension Trust
2. Adherence to and implementation of ~~theis~~ Investment Policy Statement and these Investment Procedures ~~Policy including periodic rebalancing transactions~~.
3. Management and Supervision of the Chief Investment Officer and other investment staff if applicable
4. Respond to Information Requests from the Board of Trustees
5. Maintenance of Due Diligence of Custodian Banks, Consultants and External Managers
6. Ensure Policy Compliance, Identify Areas for Review and Revision
7. Implement Asset Allocation Decisions of the Board of Trustees

8. Manage internally managed investment portfolios if directed by the Board of Trustees and execute investment trades as necessary
9. Manage the cashflow of the Pension Trust to ensure the timely payment of benefits;

## VII. Investment Policy Statement and Investment Procedures – Review and Revision

The Board of Trustees reserves the right to amend the Investment Policy Statement and these Investment Procedures at any time they deem such amendment to be necessary, or to comply with changes in federal law as these changes affect the investment of Fund-Plan assets.

This Investment Policy Statement and these Investment Procedures shall be reviewed, at a minimum, every three years or as directed by the Board of Trustees. Such reviews will focus on the continuing feasibility of achieving the investment objectives and the continued appropriateness of the investment policy relative to the Pension Trust's circumstances.

It is not expected that the investment policy will change frequently; in particular, short-term changes in the financial markets generally should not require an adjustment in the investment policy. However, specific policy issues may be visited whenever the Board of Trustees deems necessary. Specific occurrences which might suggest to the Board an earlier review include, but are not limited to, a change in the Fund's circumstances and/or a material change in the capital market environment.

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## Board of Trustees

1000 Mill Street  
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Fax: (805) 781-5697  
www.SLOPensionTrust.org



Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Agenda Item 9: Alternative Investments Fee Disclosure – CA Code 7514.7**

This item will be delivered under separate cover pending the reconciling of the data received for this reporting requirement.

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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Agenda Item 10: Asset Allocation - September 2020**

This item on the agenda provides a properly noticed opportunity for the Board of Trustees to discuss and take action, if necessary, regarding asset allocation and related investment matters.

Rebalancing transactions for 4Q20 and into 1Q21 are to be determined after possible changes to the asset allocation policy of the Pension Trust being considered at today's meeting.

Respectfully submitted

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## Board of Trustees

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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Agenda Item 11: Funding Policy and Projections Update**

Staff will present updated data and graphs on actuarial projections based on the 2020 Actuarial Valuation under various investment return scenarios for Board discussion.

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San Luis Obispo County  
Pension Trust  

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*SLOOPT*

**Funding Policy  
Projections Update**

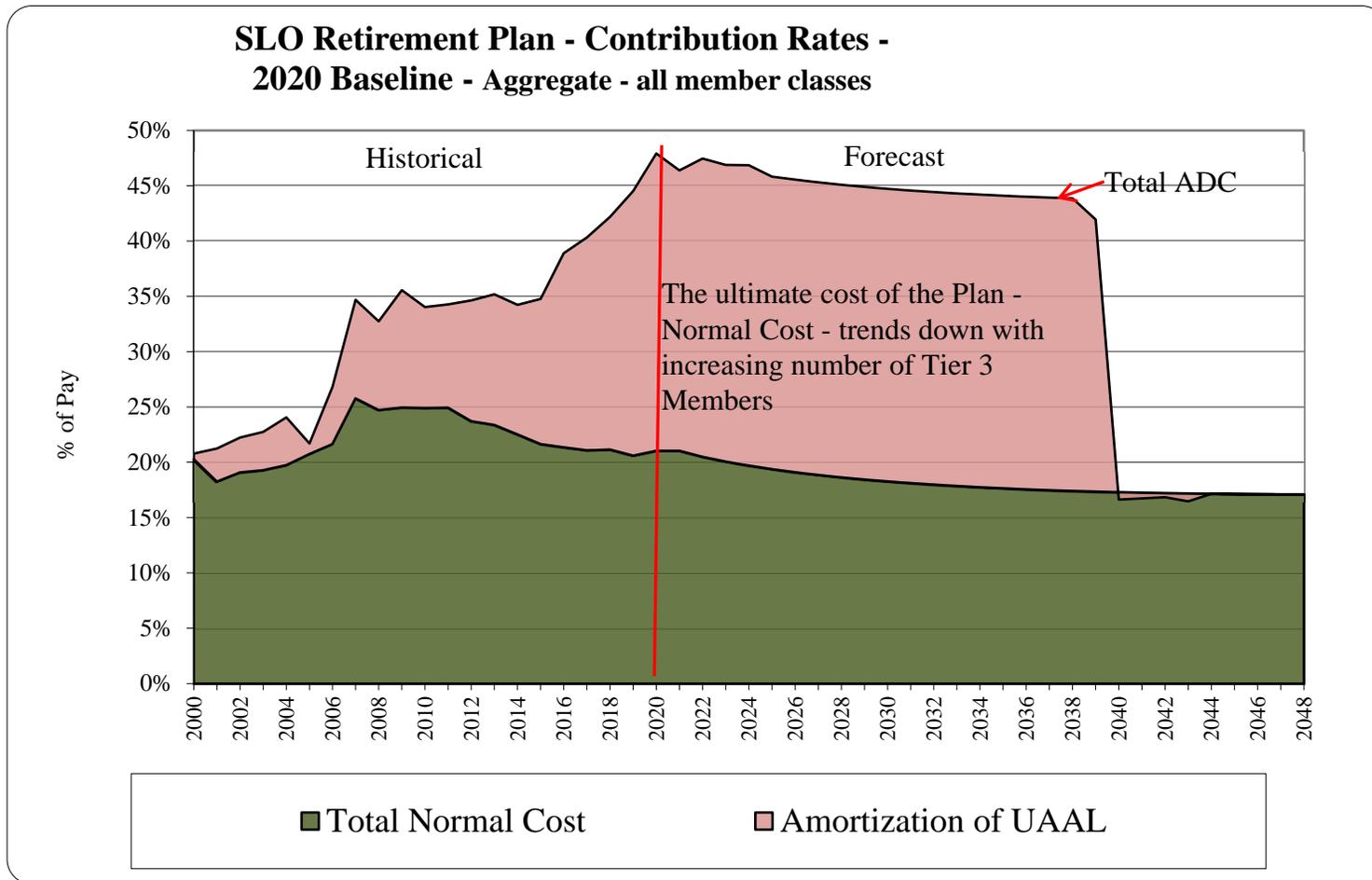
Board of Trustees – September 28, 2020

# Funding Policy Projections

- **Based on 2020 Actuarial Valuations**
- **Projections from Gabriel Roeder Smith's "Foresight" projection model**
- **Data**
  - **Discount Rates**
  - **Investment Return Scenarios**
  - **Investment Returns – different SAA policy**
- **Metrics**
  - **Pension Contribution Rates**
  - **Funded Ratio and UAAL**

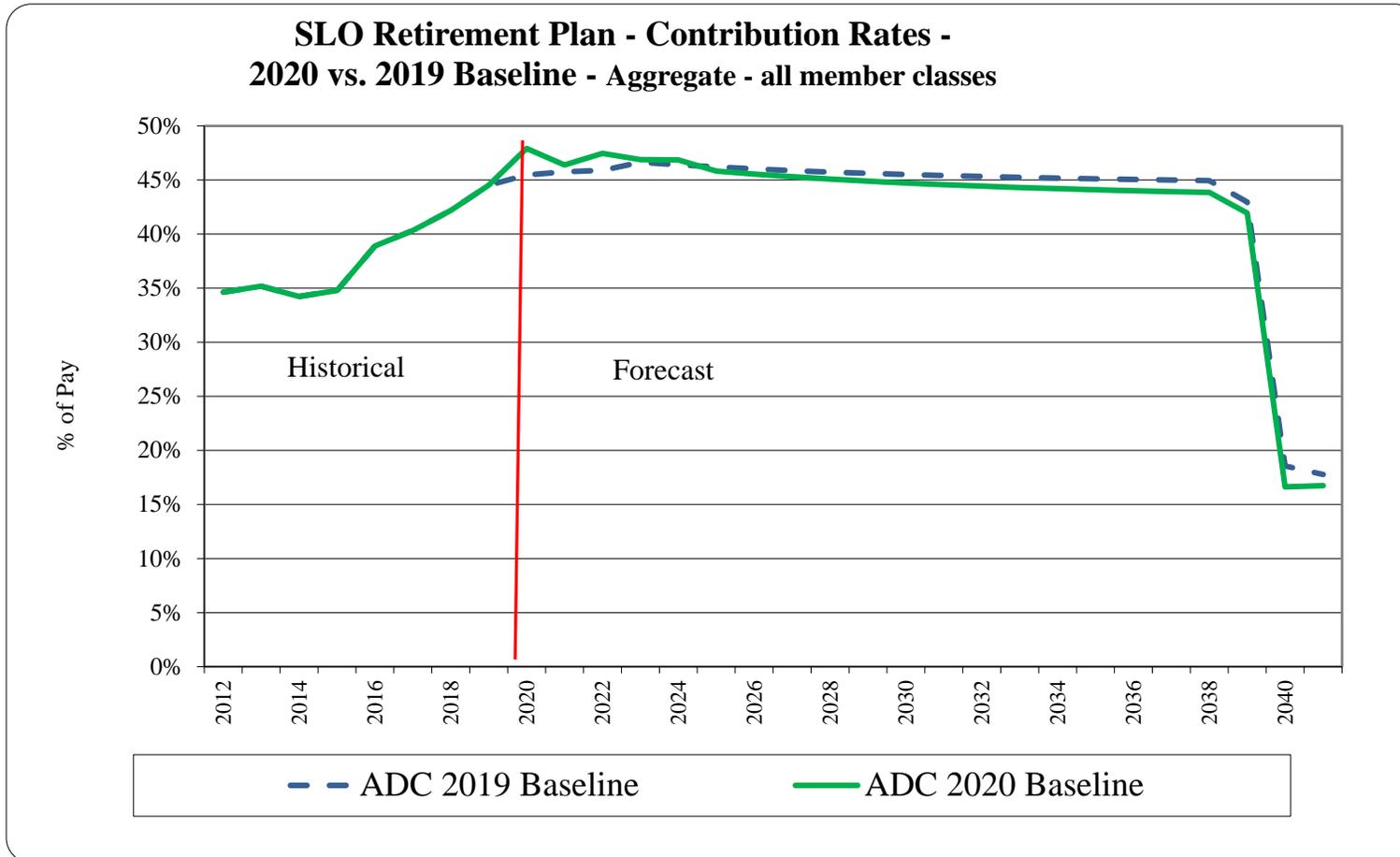
# Funding Policy Projections

## Baseline Projections – Contribution Rates



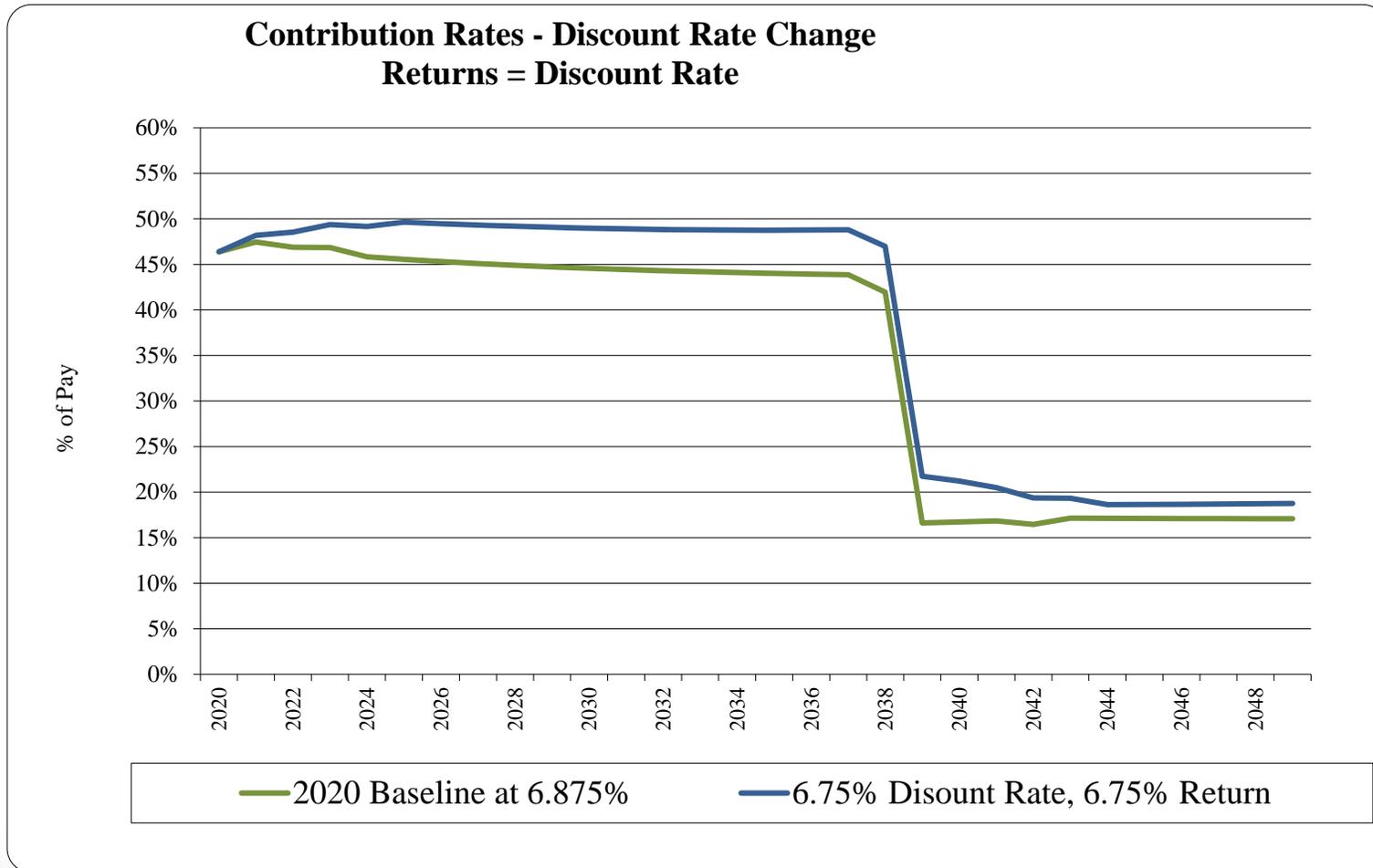
# Funding Policy Projections

## Baseline Projections – Contribution Rates



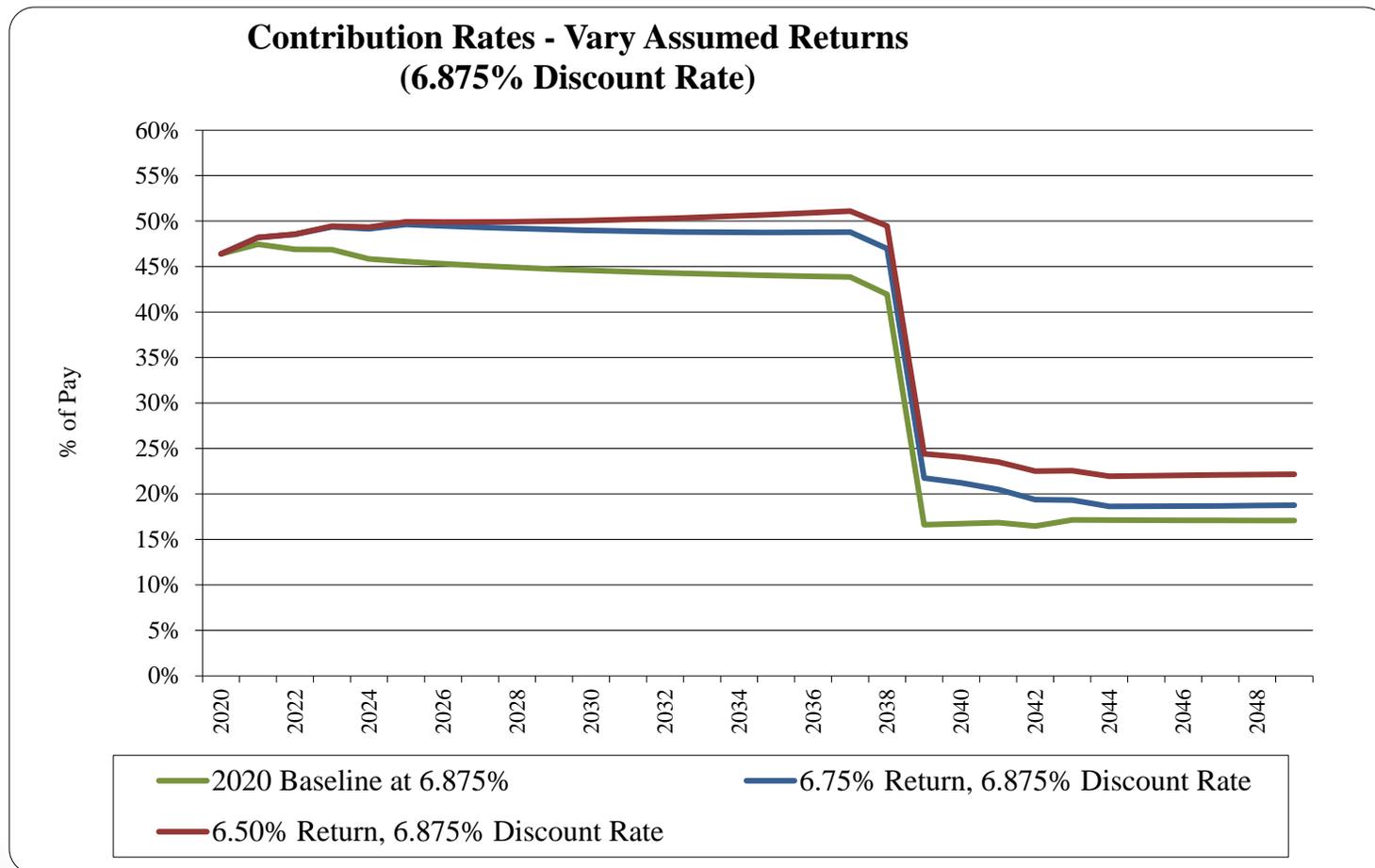
# Discount Rate Change

## Baseline Projections – Contribution Rates



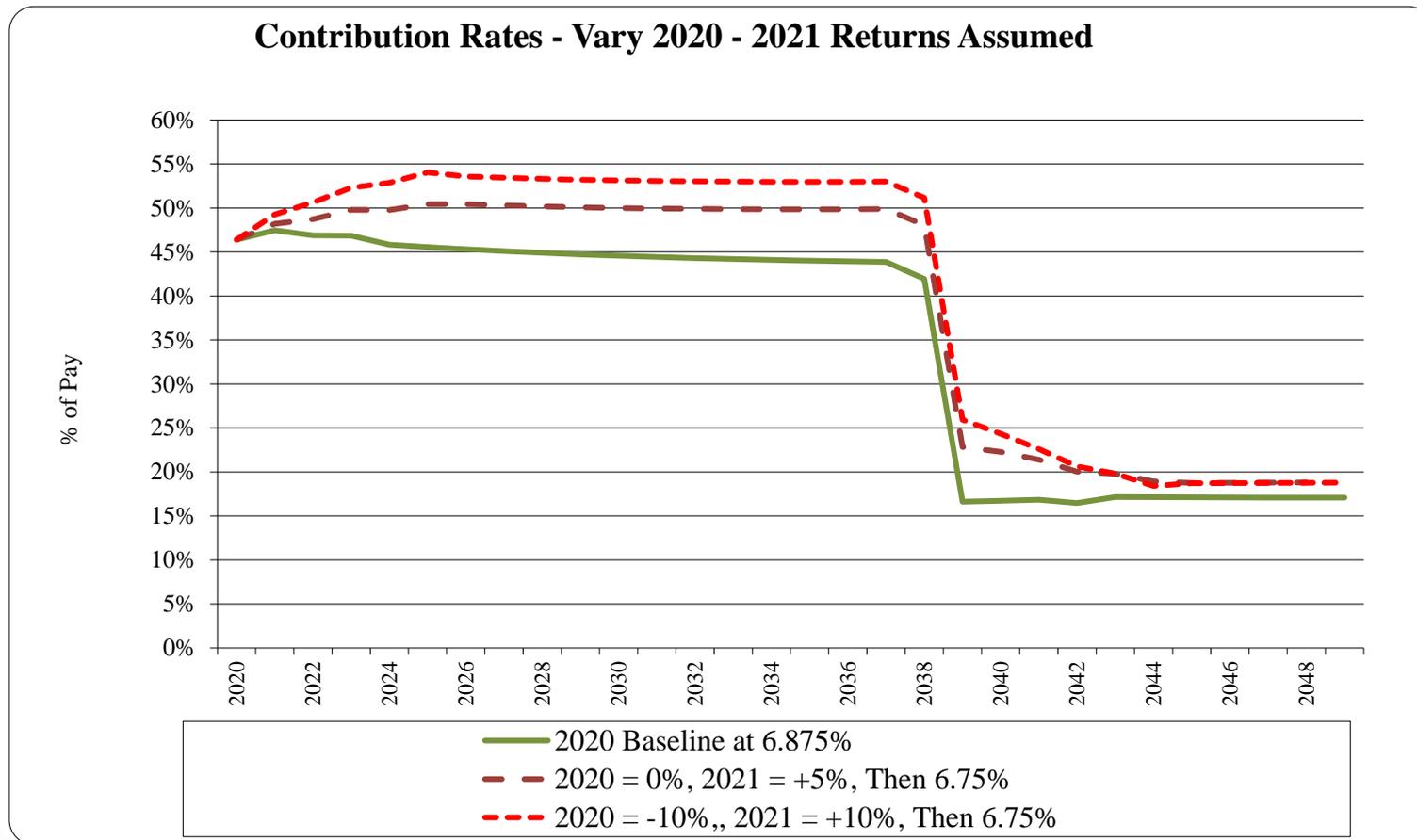
# Effect of Investment Return

## Baseline Projections – Contribution Rates



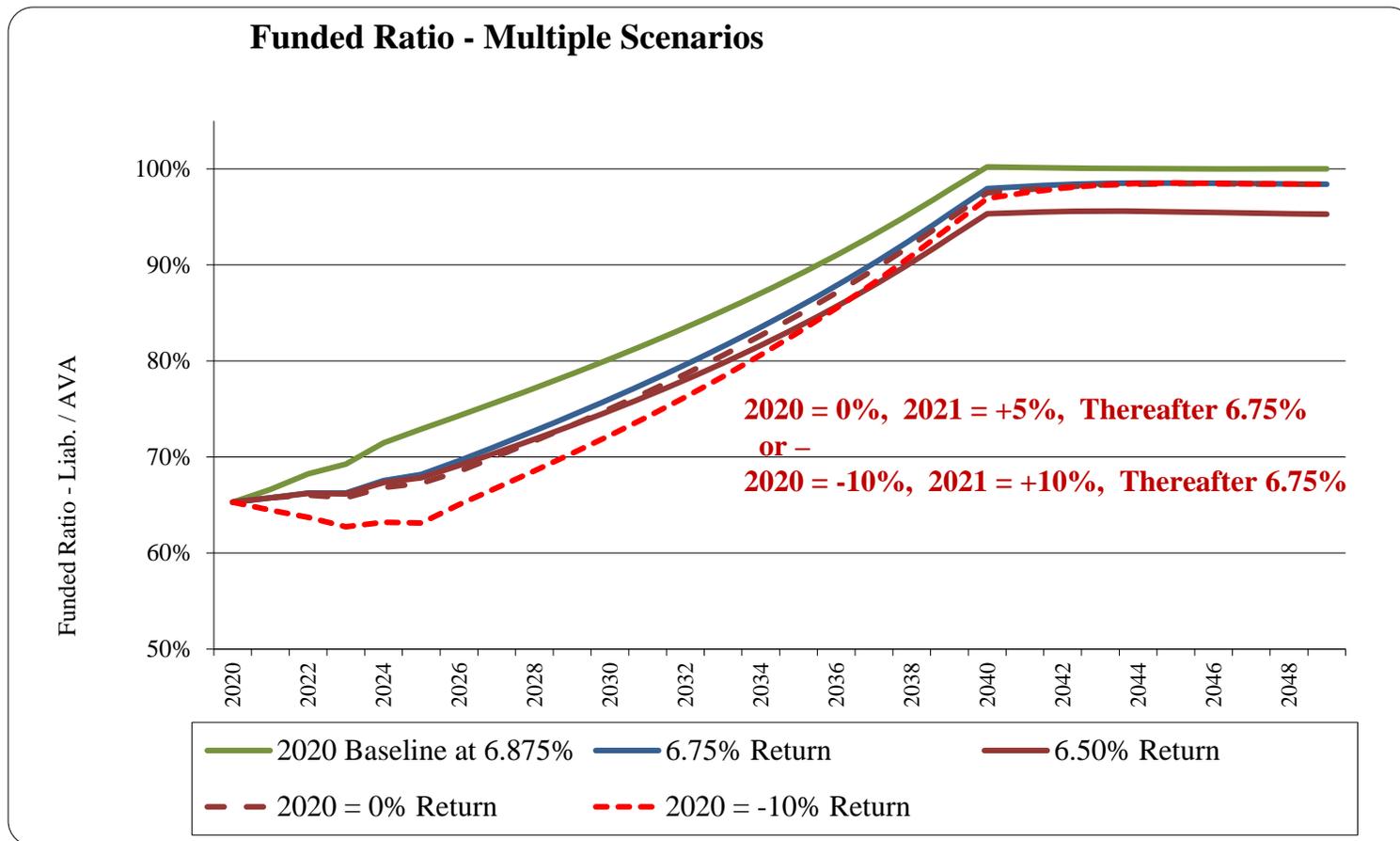
# Effect of 2020 – 2021 Returns

## Scenario Based – Contribution Rates



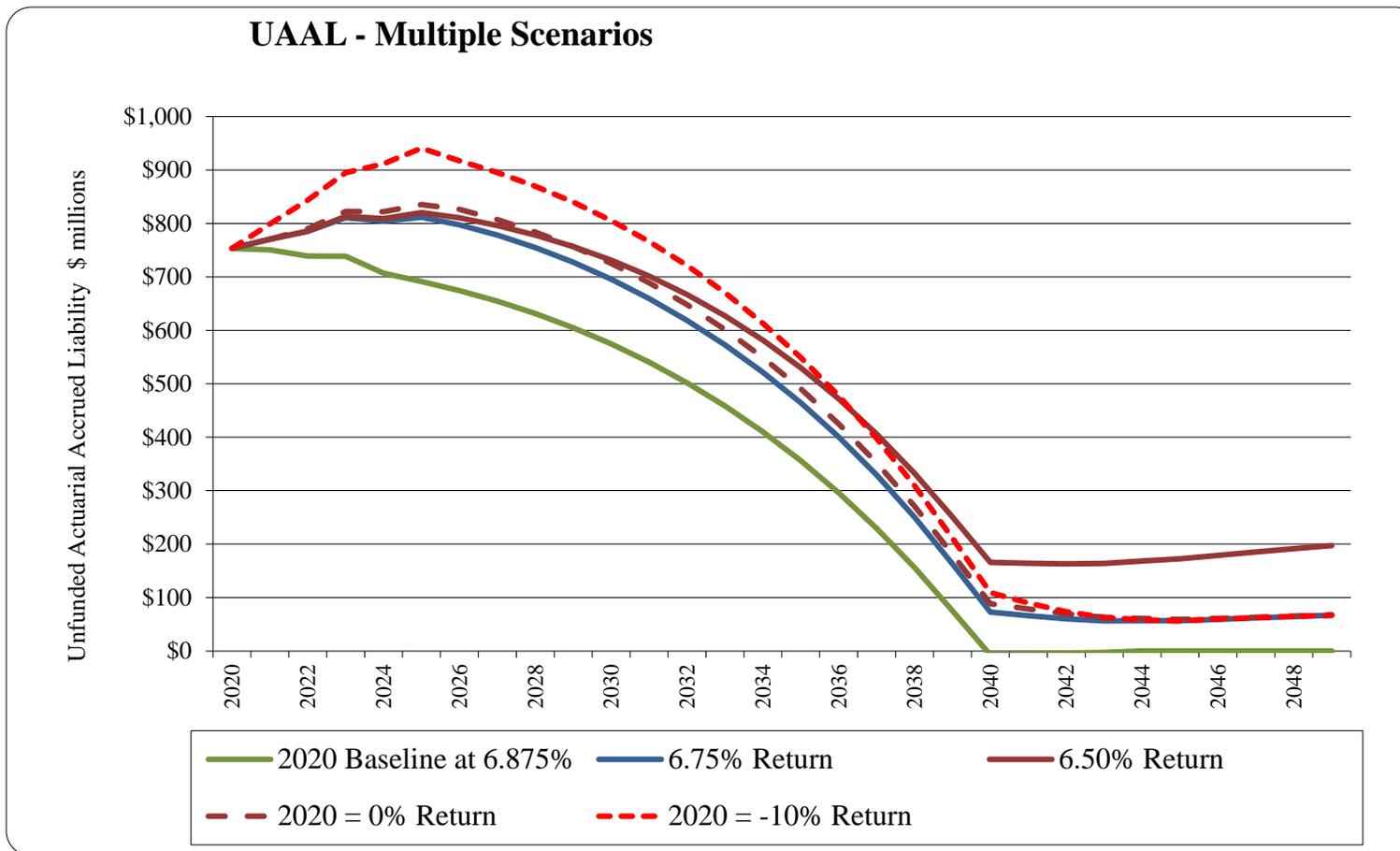
# Effect of 2020 – 2021 Returns

## Funded Ratio



# Effect of 2020 – 2021 Returns

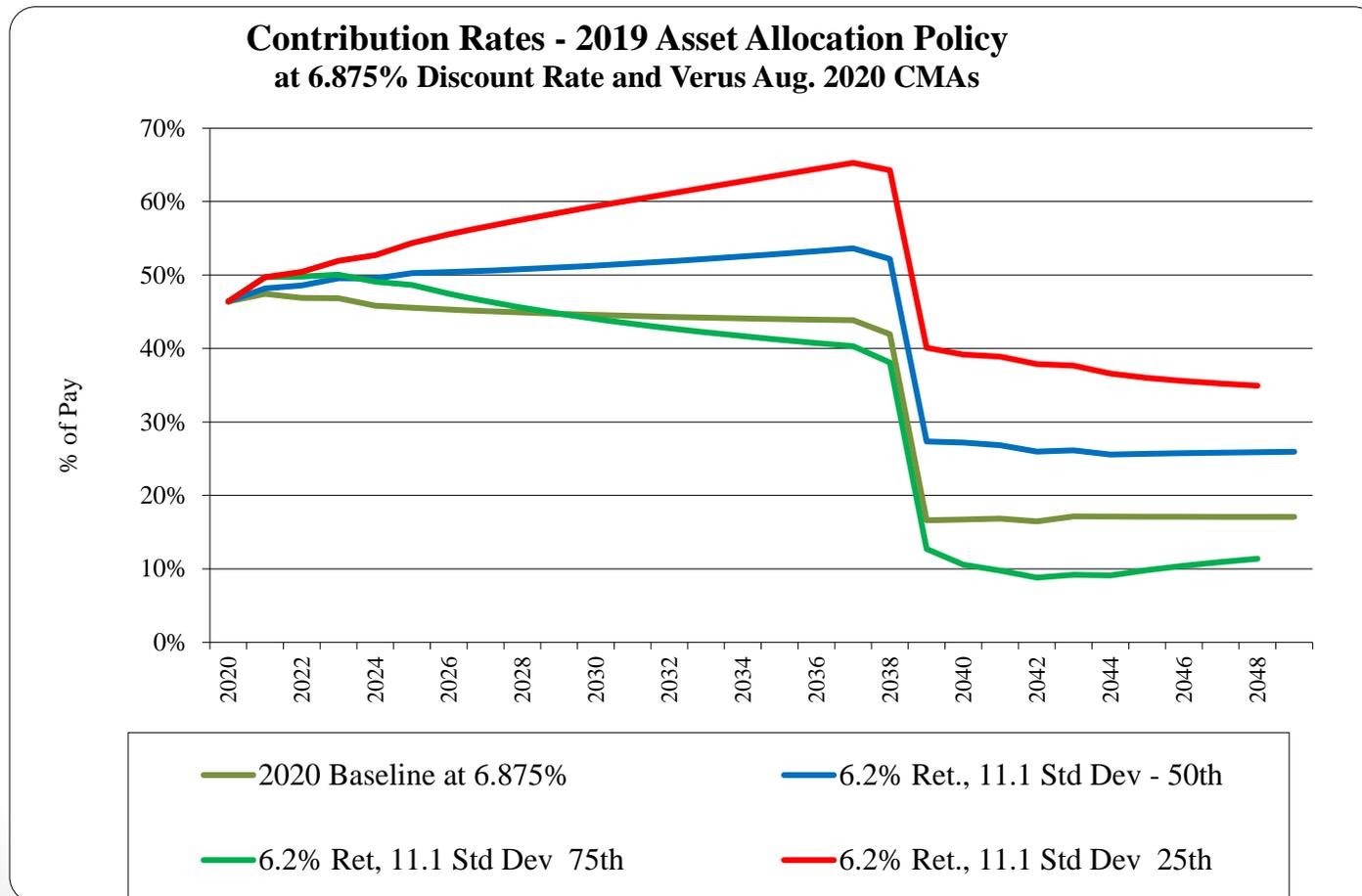
## Unfunded Accrued Actiuarial Liability



# Investment Policy Effects

Contribution Rates – 25<sup>th</sup>, 50<sup>th</sup>, 75<sup>th</sup> percentiles

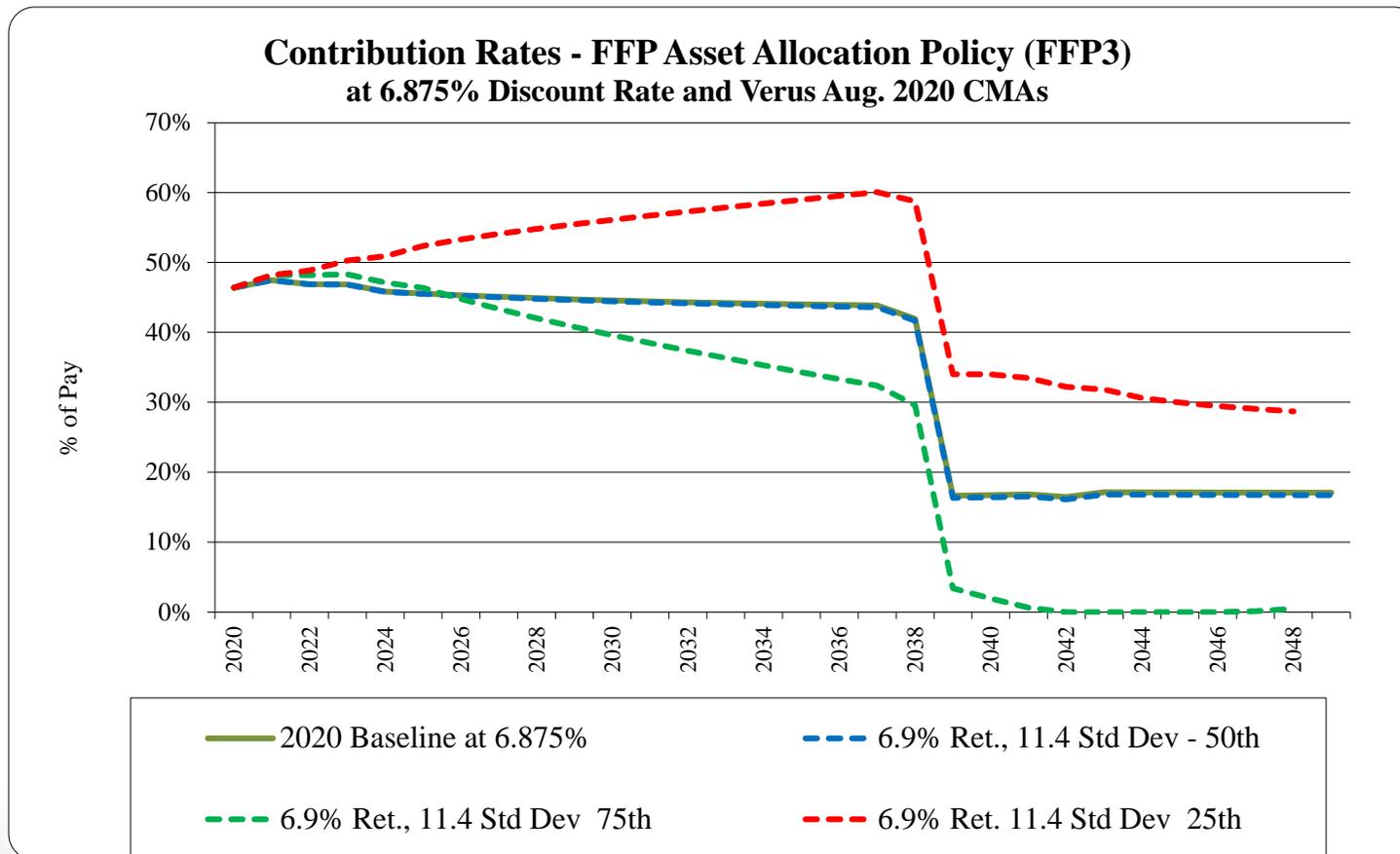
SAA Policy – 2019



# Investment Policy Effects

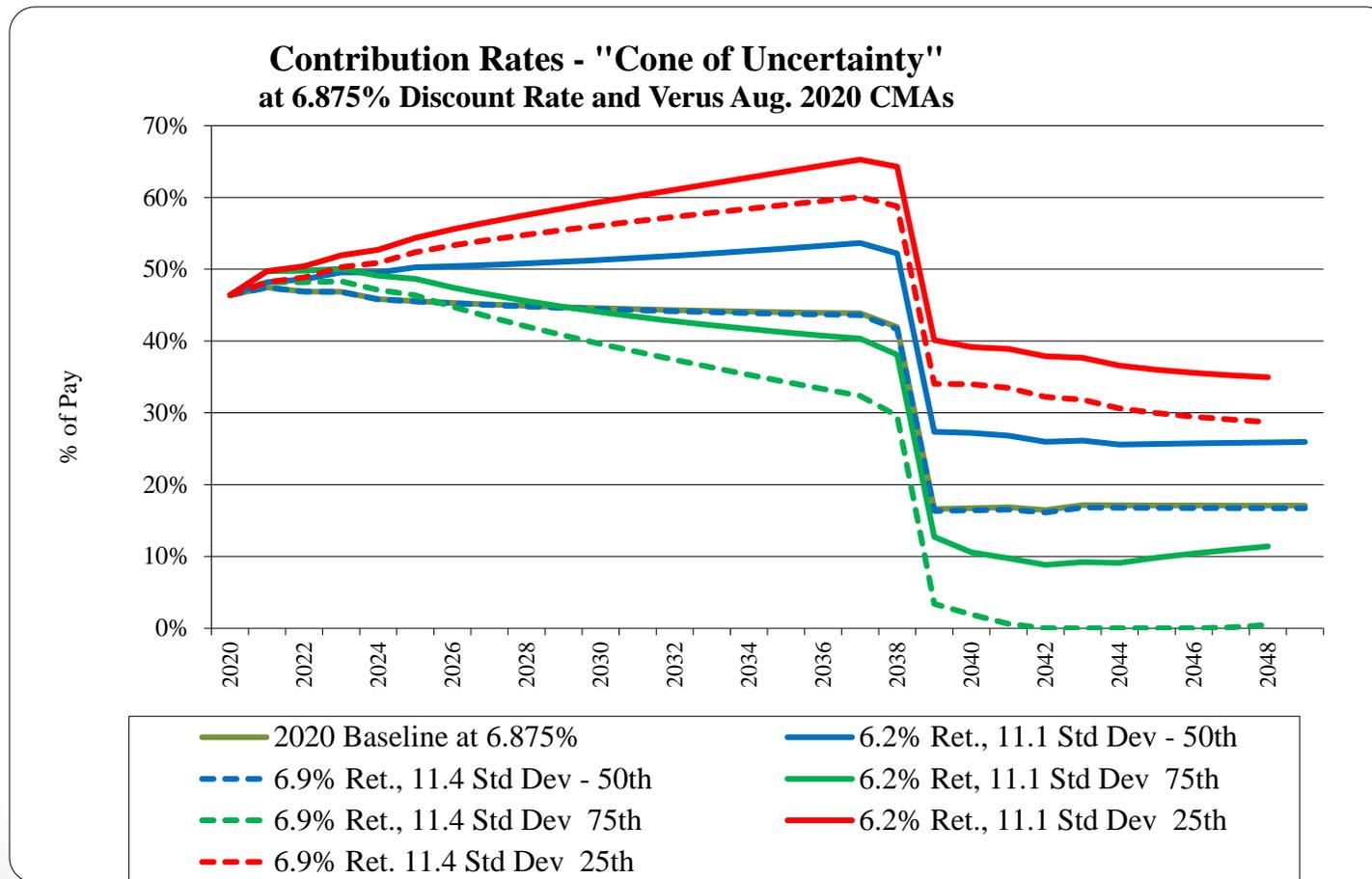
Contribution Rates – 25<sup>th</sup>, 50<sup>th</sup>, 75<sup>th</sup> percentiles

FFP Based Policy – 2020



# Investment Policy Effects

## Prior Strategic Asset Allocation Policy and Functionally Focused Policy ("FFP3) 10% Liquidity



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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Agenda Item 12: Staffing Continuity**

#### **Recommendation:**

1. Review, discuss and provide guidance to Staff as necessary.

#### **Background:**

SLOCPT – as a small organization with long-term fiduciary obligations to its members – needs to provide for continuity of operations. The key components of operational continuity that have been previously discussed with the Board include:

- **Data Security and Records Integrity** – addressed through cloud-based PensionGold architecture, security measures and transition to electronic document management.
- **System Security and Continuity** – addressed through cloud-based PensionGold system with regular disaster recovery testing.
- **Business Continuity Plan** – addressed through the drafting and presentation to the Board of Trustees in September 2019 of a broad-in-scope written BCP document.
- **Business Continuity Services** – addressed through a Business Continuity Services contract with LRS, Inc. that has been tested to allow LRS to perform crucial functions (transmittal of contributions and payment of retirement benefits) if the SLOCPT is inoperable.

Another source of risk for a small organization is **Staff Continuity**.

**Staffing Continuity Status:**

Staffing continuity includes plans to address coverage for crucial functions. The following tables describe staff coverage and back up for crucial functions.

Abbreviations:

RPS	Retirement Program Specialist (retirement counselors)
RT	Retirement Technician
AA	Administrative Assistant
Acct	Accountant
Deputy	Deputy Director
Exec.	Executive Director
CIO	Chief Investment Officer (currently the Executive Director)
LRS	LRS, Inc. (current PAS vendor)
BCS	Business Continuity Services provider – (currently LRS)
Consultant	Investment Consultant (currently Verus)
IM	Investment Managers
Custodian	Asset custodial bank (currently JP Morgan)
Counsel	General Counsel
Actuary	Actuary retained for valuations and analysis (currently GRS)

<b>Function</b>	<b>Primary</b>	<b>Backup</b>	<b>Written Procedures</b>	<b>Consultant / Outside Provider</b>
Retiree Payroll	RTx2	Deputy	extensive	BCS
Contributions Transmittal	RTx2	Deputy	extensive	BCS
Retirement Counseling and Onboarding	RPSx2	Deputy	yes – as applicable	N/A
Retiree administration	RTx2 AA	RPSx2 Deputy	yes – as applicable	N/A
Active Member administration	RTx2 AA	RPSx2 Deputy	yes – as applicable	N/A
Member & Retiree legal topics relative to Plan (e.g., divorce)	RPSx2 Deputy Exec. Counsel	Deputy Exec. Counsel	Plan document	Counsel

<b>Function</b>	<b>Primary</b>	<b>Backup</b>	<b>Written Procedures</b>	<b>Consultant / Outside Provider</b>
Audit	Acct	Deputy	yes – as applicable	N/A
System accounting and internal records	Acct	Deputy	System based	N/A
PAS Coordination and LRS liaison	Deputy	RPS Acct. Exec.	System based	LRS
Plan Administration and Legal	Deputy Exec.	Deputy Exec.	Plan document	Counsel Actuary
Plan Sponsor Liaison	Exec. Deputy	Exec. Deputy	Plan document	Counsel
Actuarial	Exec. Deputy	Exec. Deputy	Plan document & Valuations	Actuary
Financial Accounting	Acct	Deputy	System based	Consult audit firm
Business Operations (e.g., payroll, insurance)	Acct	Deputy Exec.	variable	N/A
Cash Management	Acct. Deputy Exec.	Deputy Exec.	Banking based systems	Custodian
Asset Custodial Bank	Exec. Deputy Acct.	Exec. Deputy Acct.	Bank system based	Custodian
Investment Policy & Strategy	Exec./CIO Consultant	Deputy	Policy documents	Consultant
Investment Management	IMs	N/A	IM document based	Consultant

<b>Function</b>	<b>Primary</b>	<b>Backup</b>	<b>Written Procedures</b>	<b>Consultant / Outside Provider</b>
Investment Administration	Exec. Deputy	Exec. Deputy	Policy documents	Consultant IMs Custodian
Deferred Compensation Plan Administration (on behalf of SLO County)	Exec. RPSx2	Deputy RPSx2 County HR	DC Plan provider	N/A

**Succession Planning:**

**Executive Director** turnover – The current Executive Director, Carl Nelson, serves at the pleasure of the Board of Trustees. He is age 62 and plans on retiring approximately in the range of age 65 to 68. Combine these factors and the need to replace Carl as the Executive Director can be anywhere from 30 days to 8 years or so. Succession planning factors can be summarized as –

1) **Internal Staff Development** –

- a) The current Deputy Director, Amy Burke is developing quite well as a possible future Executive Director
  - i) With SLOCPT since 2012 as both Financial Accountant and Deputy Director
  - ii) As Deputy Director manages all customer service, system coordination, and financial accounting functions
  - iii) Fully competent and qualified in -
    - (1) Plan management and benefits.
    - (2) Actuarial knowledge and the valuation process.
    - (3) PAS System Coordination – Amy is the lead maven on the implementation of the PensionGold system and is clearly qualified to the point that she could serve as a full consultant for LRS, the PensionGold vendor (although has no plans to do so).
    - (4) SLOCPT staff and process management.
    - (5) Human Resources.
    - (6) Plan sponsor liaison.
    - (7) Board of Trustees liaison and support.
  - iv) Actively progressing in knowledge of -
    - (1) Institutional Investing – strong fundamentals and knowledge with growth in the more complex topics (e.g., private markets) progressing appropriately.

- 2) **Successor Recruitment and Selection** – options for the Board of Trustees to consider in the future include –
  - a) **Internal Staff** – evaluation and direct promotion - assuming no turnover in the Deputy Director role.
  - b) **Recruitment** – Competitive search for qualified candidates (national recruitment needed), and including the current internal staff, with skills and experience in –
    - i) Defined Benefit pension administration – from other retirement systems.
    - ii) Pension investing combined with significant plan administration and benefits management experience.
    - i) Financial institution senior level experience combined with customer service management for complex functions in a financial services environment.
    - ii) Governmental finance or accounting senior level experience.
    - iii) IT systems management combined with customer service management for complex functions in a financial services environment.

**Chief Investment Officer role** – Retirement systems of various sizes and levels of sophistication staff the CIO role in several different ways such as -

- 1) **Part-time CIO / Executive Director** – currently what SLOCPT utilizes. **This arrangement appears to be the most cost-effective and is likely the appropriate model for the SLOCPT for the foreseeable future.** Underlying this CIO arrangement must be a strong general investment consultant relationship such as the one SLOCPT has currently with Verus. Other specialized consultants may also be retained (e.g., private markets, real estate). Examples of California public sector retirement systems that use the part-time CIO model include Tulare County and Imperial County.
  - a) **Investment staff** – under the part-time CIO model it is also possible to employ mid-level investment staff for research, investment administration and recommendations. Job titles for this role can be Investment Analyst or Investment Officer designations.
- 2) **CIO as full-time role** – Larger retirement systems typically have a full-time CIO to handle all of the investment functions. The CIO may report to the Executive Director or directly to the Board in a manner similar to how General Counsels typically report to the Board. This arrangement does not seem consistent with the size and complexity of SLOCPT for the foreseeable future.
  - a) **Investment staff** – Full-time CIO positions frequently have a small staff of Investment Officers or Investment Analysts supporting them. Very large systems may have a CIO over multiple Managing Directors over different asset classes.
- 3) **Outsourced Chief Investment Officer (OCIO) role** – An area of growth in the pension industry is the use of an OCIO role where a consultant manages the entire fund with discretion to allocate assets (within Board approved investment policy), hire/fire investment

managers, invest in private market partnerships, and perform investment administration / rebalancing / cashflow management.

a) **OCIO Pros** –

- i) Cost effective method when compared to full-CIO + staff alternative for small to medium sized funds.
- ii) Strong CIO skills brought to bear with more diverse intellectual approaches.

b) **OCIO Cons** –

- i) Fees for fully discretionary OCIO programs may run in the 20-50 basis point range.
- ii) Subject to OCIO bias if not fully understood by the Board. Early OCIO engagements failed not because of the underlying concept of an OCIO, but because the investment strategy followed by the OCIO. In the case of San Diego, the OCIO's strategy was aggressive, levered, and not fully understood by the Board. Other more conventional OCIO strategies are more successful, particularly for smaller funds.

**Deputy Director** turnover – candidates include –

1) **Internal staff** –

- b) Retirement Program Specialists if interested and qualified
- c) Accountant if interested and qualified

2) **Recruitment** – Competitive search for qualified candidates with skills and experience in some of these categories –

- a) Defined Benefit pension administration – possibly from other retirement systems.
- b) Financial institution mid-senior level experience.
- c) Governmental finance or accounting mid-senior level experience.
- d) IT systems management combined with customer service for complex functions, preferably in a financial services environment.

**Other Staff** succession planning includes:

- RPS turnover - RTs learn more complex functions and are possible candidates for RPS replacement. Outside hires of an RPS replacement is also possible from other retirement systems staff.
- RT turnover - Replacements for RTs include the incumbent AA, outside hires of candidates with financial, accounting, administrative experience.
- AA turnover - Outside hire of candidates with relevant experience.

- Accountant turnover - Outside hire of experienced accountant with Bachelor's degree and relevant experience. CPA optional.

SLOCPT staff are at-will employees. Outside hires can be from unrelated backgrounds/employment. Outside hires can include current SLO County employees, although they are equivalent to any other outside hire (i.e., no Civil Service status) with the exception of pension tier placement and contribution rate age.

Respectfully submitted,

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## Board of Trustees

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Date: September 28, 2020

To: Board of Trustees

From: Carl Nelson – Executive Director  
Amy Burke – Deputy Director

### **Agenda Item 13: Investment Consultant – Future Needs**

#### **Recommendation:**

1. Review, discuss and provide guidance to Staff as necessary.

#### **Background:**

The Pension Trust appropriately and prudently uses a general investment consultant for advice on all items related to the investing of the assets of the Trust. Verus (formerly named Wurts and Associates) has served in this role since 2007 and throughout that time Scott Whalen of Verus has been the primary consultant assigned to the Pension Trust.

Investment consultants operate in two broad modes –

- **Advisory** – the consultant has no authority to directly manage assets, allocate funds, rebalance funds, or to hire/fire investment managers. The consultant advises the client on investment policy, asset management and investment managers. The Chief Investment Officer (CIO) for the client actually implements investment actions following Board approved policy. The fees for Advisory consulting are typically fixed. Verus operates in an Advisory capacity to the Pension Trust and their current level of fees is \$300k per year amounting to about 3 basis points on the overall value of the Pension Trust assets.
- **Discretionary** – the consultant has discretionary authority to implement investment management actions. The Board approves the overall investment policy (probably recommended by the discretionary consultant). The discretionary consultant allocates assets, rebalances, manages cashflows hires/fires investment managers and direct private

market partnership investments. The fees for discretionary consultant services are usually asset based or may be a flat fee. Fees can be expected to be far higher than for advisory only consultant assignments.

The future needs of the Pension Trust for investment consulting services should be discussed by the Board in several areas.

### **General Investment Consultant:**

The practice of the Pension Trust regarding consultant RFPs is to issue them only when –

- The Board perceives a need to evaluate alternative consultants.
- A change in key personnel assigned to the consulting relationship.
- Evidence of a non-competitive level of fees.
- Dissatisfaction with performance as a consultant.

None of these factors are currently evident relative to Verus. The Board of Trustees should discuss and review their opinions on the general practice of issuing RFPs for consulting services.

### **Private Markets Advisor / Discretionary Consultant:**

The recommended change to Strategic Asset Allocation (SAA) policy includes a substantial increase in the allocation to private market investments. Private market investments are typically in the form of Limited Partnerships (LP) of a closed end nature. In that the LP secures commitments from investors, calls the capital over several years, invests in non-publicly traded equity or debt assets, and distributes the capital back to the investors. The life of a private markets LP may be from 5 to 15 years. Such LPs are legally complex with extensive documents to review. They also are administratively a bit more complex with the managing of cashflows for capital calls and distributions.

The Pension Trust currently manages its Private Equity and Private Credit investments using Fund-of-Funds arrangements (see below). With an expanded private markets strategy, Verus has suggested that it may be advantageous from a fee-level and a performance point of view to consider direct investment in various LPs. Verus also suggests that such a direct private market strategy would need a separate consulting relationship to prudently manages. A point that Staff concurs with.

However, Verus cannot advise the Pension Trust any further on this topic due to conflict of interest considerations. There are a number of capable investment consulting firms that could serve as a private markets consultant – Verus among them. Hence the conflict of interest barrier on Verus providing more advice on this topic.

**Fund-of-Funds** – these structures can be summarized as –

- The managing LP is an investment manager that invests in other LPs – hence the Fund-of-Funds name. The managing LP can invest in other LPs, purchase secondary market interests in other LPs, invest alongside LPs in their portfolio investments as a co-investment.
- The underlying LPs charge their normal fees made up of a management fee on committed capital and a percentage of realized profits above some hurdle rate of return. A typical way to describe such fee arrangements is as a “2 and 20” structure where the management fee is 2% and the LP shares in 20% of the returns above an X% hurdle rate of return.
- The Fund-of-Funds LP also charges a management fee on top of the fees of the underlying LPs. The Private Equity fund used currently by the Pension Trust (Pathway and Harbourvest) average approximately 70 basis points in fees.
- The Fund-of-Funds LPs are also closed end in lifespan. As result, a typical approach is to invest in new editions of the funds each year or so to layer in the Private Equity exposure and achieve diversification across various vintage years of LPs.

Advantages of Fund-of-Funds LPs include –

- Broad diversification across private markets – especially for a smaller pension fund that may not be able to manage \$10-\$100 million investments for each LP.
- Professional management - Fund-of-Funds LP managers are deep organizations with highly competent staffs to select and manager hundreds of LP investments across multiple years of various funds.
- Access to better performing LPs – Private Markets are expected to have higher risk adjusted returns than public markets, albeit with significant illiquidity. History suggests that truly competitive returns come from about the top-quartile of private equity LPs. The better performing LPs are typically over-subscribed and the managing General Partners (GPs) allow investors that they deem large enough and sophisticated enough to be easy to deal with. A smaller pension fund pursuing a direct private markets program is less likely than a larger fund to get access to top-quartile GPs.

Disadvantages of Fund-of-Funds LPs include –

- Higher fees
- Some evidence of well-run Direct Private Market strategies performing somewhat better than Fund-of-Funds. See the attached excerpt from the Verus 2Q20 Quarterly Investment Report.

### **Direct Programs – Advisory Consultant –**

In this structure the pension fund and its CIO implement direct investment in various Private Equity or Private Credit LPs with the advice of a consultant retained specifically for this asset class. This approach is not recommended by Staff for a fund the size of the Pension Trust. Such an approach would require not only the fees for the Private Markets Consultant, but the cost of additional internal investment officers or analysts.

### **Direct Programs – Discretionary Consultant -**

In this structure a Private Market consultant is hired and given discretionary authority to manage the direct program.

Advantages of Direct Program Discretionary Private Market strategies include –

- Similar advantages to those listed above for Fund-of-Funds in terms of diversification and professional management.
- Lower fees than Fund-of-Funds structures. Competitive fees for these discretionary structures are not known precisely at this time but, as a rough estimate are expected to be under 50 basis points.
- Potentially better returns than Fund-of-Funds, but this is highly subjective and would require further research to actually come to this conclusion. See the attached excerpt from the Verus 2Q20 Quarterly Investment Report.

Disadvantages of Direct Program Discretionary Private Market strategies include –

- Somewhat less diversification across Private Market assets when compared to larger Fund-of-Funds LPs. Depending on the size of the commitment to Private Markets this may or may not be material.
- Complexity of the Direct Program Discretionary Private Market strategies is somewhat higher than Fund-of-Funds structures.
- Selection of a consultant for a Direct Program Discretionary Private Market strategy requires it to be done without the advice of Verus as the Pension Trust's general investment consultant due to conflict of interest factors. Whether there are project-based consultants to assist with such searches or other consultants is unknown at this time. At present Staff assumes that selecting a Direct Program Discretionary Private Market strategy consultant would be based on Staff research and evaluation for a recommendation to the Board of Trustees.

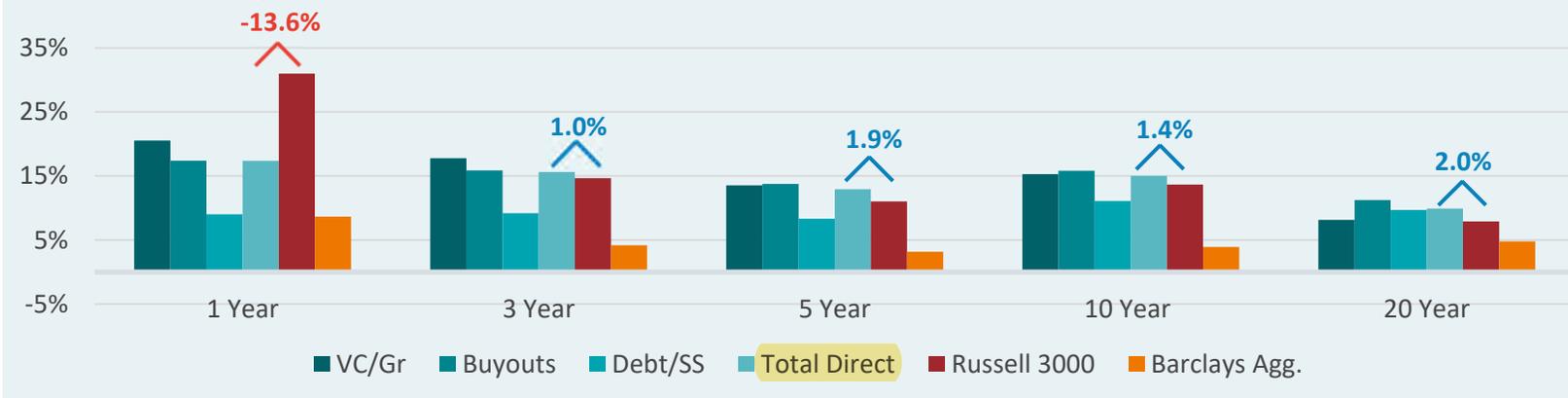
The Board should discuss and consider what is known at this point about the various strategies to approach an expanded Private Markets allocation.

Respectfully submitted,

# Private equity vs. public performance

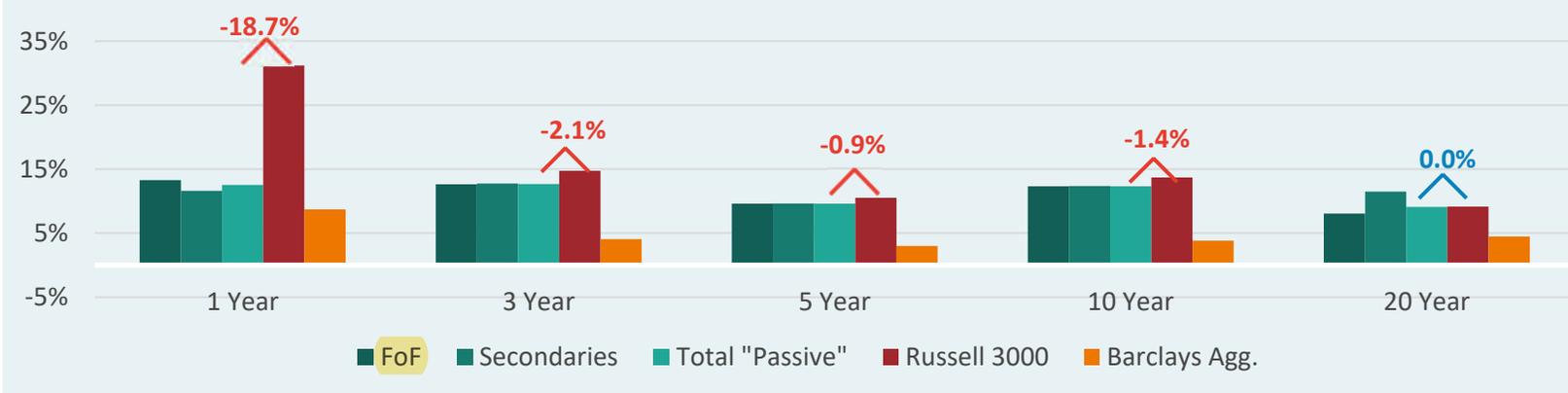
As of 12/31/2019

## DIRECT PRIVATE EQUITY FUND INVESTMENTS



Direct P.E Fund Investments outperformed comparable public equities across all time periods, except on a 1-year basis

## "PASSIVE" STRATEGIES



"Passive" strategies underperformed comparable public equities across all time periods, except on a 20-year basis

Sources: Thomson Reuters Cambridge Universe's PME Module: U.S. Private Equity Funds sub asset classes as of December 31, 2019. Public Market Equivalent returns resulted from "Total Passive" and Total Direct's identical cash flows invested into and distributed from respective traditional asset comparable.

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