San Joaquin County Employees Retirement Association

A G E N D A

BOARD MEETING
SAN JOAQUIN COUNTY EMPLOYEES RETIREMENT ASSOCIATION
BOARD OF RETIREMENT
FRIDAY, MAY 5, 2023
AT 9:00 AM
Location: SJCERA Board Room, 6 S. El Dorado Street, Suite 400, Stockton, California

The public may also attend the Board meeting live via Zoom by (1) clicking here https://us02web.zoom.us/j/81046763759 and following the prompts to enter your name and email, or (2) calling (669) 219-2599 or (669) 900-9128 and entering Meeting ID 81046763759#.

Persons who require disability-related accommodations should contact SJCERA at (209) 468-9950 or ElainaP@sjcera.org at least forty-eight (48) hours prior to the scheduled meeting time.

1.0 ROLL CALL

2.0 PLEDGE OF ALLEGIANCE

3.0 MEETING MINUTES

3.01 Minutes for Board Meeting of April 14, 2023 04

3.02 Board to consider and take possible action on minutes

4.0 PUBLIC COMMENT

4.01 The public is welcome to address the Board during this time on matters within the Board's jurisdiction, following the steps listed below. Speakers are limited to three minutes, and are expected to be civil and courteous. Public comment on items listed on the agenda may be heard at this time, or when the item is called, at the discretion of the Chair.

If joining via Zoom, Public Comment can be made in the following ways:

PC or Mac: select "Participants" in the toolbar at the bottom of your screen, then select the option to raise or lower your hand.

Mobile Device: select the "More" option in the toolbar at the bottom of your screen, then select the option to raise or lower your hand.

Tablet: select the icon labeled "Participants," typically located at the top right of your screen, then select the hand icon next to your device in the Participants column.

If dialing in from a phone for audio only, dial *9 to "raise your hand."

If attending in person, members of the public are encouraged to complete a Public Comment form, which can be found near the entry to the Board Room.

Except as otherwise permitted by the Ralph M. Brown Act (California Government Code Sections 54950 et seq.), no deliberation, discussion or action may be taken by the Board on items not listed on the agenda. Members of the Board may, but are not required to: (1) briefly respond to statements made or questions posed by persons addressing the Board; (2) ask a brief question for clarification; or (3) refer the matter to staff for further information.

5.0 CONSENT ITEMS

5.01 Service Retirements (22) 09

5.02 Board to consider and take possible action on consent items

6.0 INVESTMENT CONSULTANT REPORTS

6.01 Manager Performance Flash Report 12

6.02 Economic and Market Update 17

6.03 Board to receive and file reports

7.0 PRIVATE CREDIT MANAGER PRESENTATION

7.01 Presentation by Ankur Patel and Juliette Schainuck, of Ares Pathfinder Fund II 35

8.0 CLOSED SESSION

8.01 Purchase or Sale of Pension Fund Investments
California Government Code Section 54956.81

8.02 Personnel Matters
California Government Code Section 54957
Employee Disability Retirement Application(s) (2)

8.03 Conference with Real Property Negotiator - California Government Code Section 54956.8

01 Property: 6 S. El Dorado Street, Suite 400
Stockton, California 95202

Negotiating parties: Johanna Shick, Chief Executive Officer, SJCERA
Connie Hart, Assistant Director General Services, San Joaquin County

Under negotiation: Lease price and terms

9.0 STAFF REPORTS

9.01 Trustee and Executive Staff Travel

01 Conferences and Events Schedule 2023 56

02 Summary of Pending Trustee and Executive Staff Travel 57

a Travel requiring approval (1)

03 Summary of Completed Trustee and Executive Staff Travel 58

a Summary Pension Bridge Annual 2023 59

9.02 Board to consider and take possible action on any new travel request

9.03 Legislative Summary Report 63

9.04 CEO Report 66

9.05 Board to receive and file reports

10.0 SACRS VOTING PROXY 71

10.01 SACRS Voting Proxy - Current 72

10.02 SACRS Voting Proxy - Proposed 73

10.03 Board to consider and take possible action on SACRS Voting Proxy

11.0 CORRESPONDENCE

11.01 Letters Received (0)

11.02 Letters Sent (0)

11.03 Market Commentary/Newsletters/Articles

01	AQR Capital Management, LLC Re-Emerging Equities March 2023	74
02	Pensions & Investments Corporate DB Plans still hard to beat, JPMAM's Chief of Institutional Strategy says April 11, 2023	85
03	The NCPERS Monitor April 2023	87
04	Oaktree Capital Management Lessons from Silicon Valley Bank April 2023	99

12.0 COMMENTS

12.01 Comments from the Board of Retirement

13.0 CALENDAR

13.01 Audit Committee Meeting May 15, 2023 at 10:00 a.m.

13.02 Board Meeting June 2, 2023 at 9:00 a.m.

13.03 Administrative Committee Meeting June 22, 2023 at 10:00 a.m.

13.04 Board Meeting July 14, 2023 at 9:00 a.m.

13.05 Board Meeting August 11, 2023 at 9:00 a.m.

13.06 Board Meeting September 8, 2023 at 9:00 a.m.

14.0 ADJOURNMENT

MINUTES

BOARD MEETING
SAN JOAQUIN COUNTY EMPLOYEES RETIREMENT ASSOCIATION
BOARD OF RETIREMENT
FRIDAY, APRIL 14, 2023
AT 9:01 AM
Location: SJCERA Board Room, 6 S. El Dorado Street, Suite 400, Stockton, California

1.0 ROLL CALL

1.01 **MEMBERS PRESENT:** Phonxay Keokham, Emily Nicholas, Chanda Bassett, Jennifer Goodman, Steven Ding (out at 11:30 a.m.), JC Weydert, Steve Moore, Michael Duffy, Raymond McCray and Michael Restuccia presiding

MEMBERS ABSENT: None.

STAFF PRESENT: Chief Executive Officer Johanna Shick, Assistant Chief Executive Officer Brian McKelvey, Retirement Investment Officer Paris Ba, Management Analyst III Greg Frank, Information Systems Analyst II Lolo Garza, Information Systems Specialist II Jordan Regevig, Administrative Secretary Elaina Petersen, Retirement Services Associate Ron Banez, Retirement Services Associate Andrea Bonilla

OTHERS PRESENT: Deputy County Counsel Jason Morrish, Disability Attorney Vivian Shultz, David Sancewich of Meketa

2.0 PLEDGE OF ALLEGIANCE

2.01 Led by Phonxay Keokham

3.0 MEETING MINUTES

3.01 Minutes for Board Meeting of March 10, 2023

3.02 Minutes for Audit Committee Meeting of March 10, 2023

3.03 The Board voted unanimously (9-0) to approve the Minutes of the Board Meeting of March 10, 2023 (Motion: Duffy; Second: Weydert)

4.0 PUBLIC COMMENT

4.01 There was no public comment

5.0 CONSENT ITEMS

5.01 Service Retirements (14)

5.02 General (1)

01 Required Minimum Distribution Policy

a Required Minimum Distribution Policy - Mark-up

b Required Minimum Distribution Policy - Clean

5.03 The Board voted unanimously (9-0) to approved the Consent Items (Motion: Bassett; Second: Duffy)

6.0 DISABILITY RETIREMENT EDUCATION

6.01 Presentation by Disability Counsel Vivian Shultz

7.0 INVESTMENT CONSULTANT REPORTS

7.01 Presentation by David Sancewich of Meketa Investment Group

01 Manager Performance Flash Report

02 Economic and Market Update

7.02 The Board received and filed reports

7.03 Public Credit Review

7.04 After discussion, the Board supported the recommendation for staff and consultant to continue to assess the optimal structure of the liquid credit portfolio.

8.0 PORTFOLIO LIQUIDITY AND CASH ANALYSIS

8.01 Presentation by David Sancewich of Meketa Investment Group

8.02 Following discussion, the Board voted unanimously (9-0) to accept a modified recommendation from Meketa to eliminate the equity component of SJCERA's cash overlay strategy with Parametric, and to change the fixed income component of the cash overlay strategy to target treasury bonds with a maximum maturity of five (5) years with an average duration of two to three (2-3) years. (Motion: McCray; Second: Goodman)

9.0 DIVERSIFIER STRATEGY MANAGER SEARCH UPDATE

9.01 Presentation by David Sancewich of Meketa Investment Group

9.02 The Board received and filed report

10.0 SACRS BOARD OF DIRECTORS ELECTIONS

10.01 SACRS Board of Director Elections - 2023-2024 - Final Ballot

10.02 The Board votes unanimously (9-0) to support the SACRS Nominating Committees recommended slate for the 2023-2024 SACRS Board of Directors (Motion: Bassett; Second: Keokham)

11.0 STAFF REPORTS

11.01 Trustee and Executive Staff Travel

01 Conferences and Events Schedule 2023

02 Summary of Pending Trustee and Executive Staff Travel

03 Summary of Completed Trustee and Executive Staff Travel

11.02 The Board received and filed reports

11.03 Quarterly Operations Reports

01 Pending Member Accounts Receivable - First Quarter 2023

02 Disability Quarterly Report - Statistics

03 Pension Administration System Update

11.04 Legislative Summary Report

11.05 CEO Report

Prior to CEO Shick's report, Deputy County Counsel Jason Morrish announced he is leaving San Joaquin County to become General Counsel to Sacramento County Employees' Retirement System (SCERS). CEO Shick noted that Counsel Morrish has been an integral part of the SJCERA team and she has enjoyed working with him. She further noted that this change is an opportunity to assess how best to staff our General Counsel needs and Management Analyst III Greg Frank has started that analysis. In the interim Attorney Ashley Dunning of Nossaman will be available to serve as General Counsel.

In addition to the written report, CEO Shick reported: SJCERA will observe National Super Hero Day on Friday April 28 and will also join the County's 'Star Wars Day' on May the Fourth.

11.06 The Board received and filed reports

12.0 CORRESPONDENCE

12.01 Letters Received (0)

12.02 Letters Sent (0)

12.03 Market Commentary/Newsletters/Articles

01 Verus
The Investment World in 2023: Time for the New Simplicity?
March 2023

02 The NCPERS Monitor
March 2023

03 NCPERS
PERSist
Spring 2023

04 Meketa Investment Group
Whitepaper
Risk Mitigating Strategies (RMS) Framework
March 2023

05 Stone Harbor Investment Partners
Assessing and Tracking the Macro Fallout of Banking Stress
March 2023

06 BlackRock Alternatives
2023 Private Markets Outlook
A new era for investors
2023

13.0 COMMENTS

13.01 Trustee Weydert commented that he thought the Verus report on simplicity in investing was very good. Trustee Weydert requested staff place his attendance at the September IREI meeting on the May agenda for approval.
Trustee Moore thanked RIO Paris Ba for her prompt response to investment question about exposure over the recent banking issues and the possible agriculture exposure. Trustee Moore also asked about business cards for Trustees that want them. Board discussion was held and it was agreed if a trustee requests business cards, SJCERA would order and pay for them, using the organizations existing business card layout.
Trustee Duffy noted he was sad to see Counsel Morrish leave noting he has contributed so much to SJCERA.

14.0 CLOSED SESSION

The Chair convened Closed Session at 11:40 a.m. and adjourned Closed Session and reconvened Open Session at 11:52 a.m.

14.01 Personnel Matters
California Government Code Section 54957
Employee Disability Retirement Application(s) (5)

01 Consent Items

a Kara C. Barclay
Office Assistant Specialist
Non-Service Connected Disability

b Otilio G. Bautista
Deputy Sheriff II
Service Connected Disability

c Cherie A. Flores
Employment Training Specialist II
Service Connected Disability

d Joshua D. Thomas
Correctional Sergeant
Service Connected Disability

e Yiselle Zavala
Correctional Officer
Service Connected Disability

02 The Board voted unanimously (8-0) to grant the applications for disability retirement (Motion: Duffy: Second: Keokham)

14.02 Conference with Real Property Negotiator - California Government Code Section 54956.8

01 Property: 6 S. El Dorado Street, Suite 400
Stockton, California 95202

Negotiating parties: Johanna Shick, Chief Executive Officer, SJCERA
Connie Hart, Assistant Director General Services,
San Joaquin County

Under negotiation: Lease price and terms

14.03 Counsel noted that, other than item 15.0 on the agenda and those reported under 14.01 above, there was nothing further to report out of closed session.

15.0 REPORT OUT OF CLOSED SESSION

15.01 On December 9, 2022, the Board voted unanimously to approve Resolution 2023-04-01 titled “Silver Rock Tactical Allocation Strategy Vintage 2022 Fund” and to authorize the CEO to sign the necessary documents to invest $62.5 million in the fund.

16.0 CALENDAR

16.01 Board Meeting May 5, 2023 at 9:00 a.m.

16.02 Audit Committee Meeting May 15, 2023 at 10:00 a.m.

16.03 Board Meeting June 2, 2023 at 9:00 a.m.

16.04 Administrative Committee Meeting June 22, 2023 at 10:00 a.m.

16.05 Board Meeting July 14, 2023 at 9:00 a.m.

16.06 Board Meeting August 11, 2023 at 9:00 a.m.

17.0 ADJOURNMENT

17.01 There being no further business the meeting was adjourned at 11:53 a.m.

Respectfully Submitted:

____

Michael Restuccia, Chair

Attest:

____

Raymond McCray, Secretary

San Joaquin County Employees Retirement Association

May 2023

5.01 Service Retirement — Consent

01 REENE AVENTI
Information Systems Analyst IV
Information Systems Div - ISF

Member Type: General
Years of Service: 24y 01m 29d
Retirement Date: 3/25/2023

02 LINDA J BUTLER
Community Social ServicesAsst
Aging - Community Services

Member Type: General
Years of Service: 23y 01m 16d
Retirement Date: 3/24/2023

03 LAURA J CAPORUSSO
Senior Office Assistant
California Childrens Services

Member Type: General
Years of Service: 28y 11m 29d
Retirement Date: 3/18/2023

04 DAVID K CULBERSON
Hospital Chief Exec Officer
Hosp Administration

Member Type: General
Years of Service: 11y 01m 29d
Retirement Date: 7/16/2022

05 ELLEN J DUNN
Deferred Member
N/A

Member Type: General
Years of Service: 04y 03m 22d
Retirement Date: 3/18/2023
Comments: Deferred member since December 2017. Outgoing reciprocity and concurrent retirement with ACERA.

06 RON FASANO
Correctional Officer
Sheriff-Custody-Regular Staff

Member Type: Safety
Years of Service: 24y 10m 24d
Retirement Date: 3/7/2023

07 JILLENE J FINCH
Accounting Technician I
HSA - Admin Support

Member Type: General
Years of Service: 36y 04m 16d
Retirement Date: 3/25/2023

08 JOSEPHINE H FREEMAN
Position Control Coordinator
Human Resources

Member Type: General
Years of Service: 20y 03m 28d
Retirement Date: 3/24/2023

09 GLORIA R GAMEZ
Executive Secretary
Employment - Economic Developm

Member Type: General
Years of Service: 16y 03m 11d
Retirement Date: 2/13/2023

10 **VICKI J HOGE** Staff NurseV-AsstNDptMg-Inpat
Hosp Intensive Care Nursery

Member Type: General
Years of Service: 24y 01m 28d
Retirement Date: 3/26/2023

11 **SHERRILL D HOUSE** Office Secretary
San Joaquin Health Centers

Member Type: General
Years of Service: 07y 01m 29d
Retirement Date: 3/2/2023
Comments: Redeposit of prior county service brought member to the 10 years of membership required to retire.

12 **SHERRILL D HOUSE** Office Secretary
San Joaquin Health Centers

Member Type: Safety
Years of Service: 00y 04m 24d
Retirement Date: 3/2/2023
Comments: Redeposit of prior county service brought member to the 10 years of membership required to retire.

13 **BRUCE A JONES** Social Worker Supervisor I
Probation-Juv-CrossroadsCAPS

Member Type: General
Years of Service: 09y 04m 05d
Retirement Date: 3/25/2023
Comments: Tier 2 member - eligible to retire with 5 years of service credit.

14 **LAURA L LYMAN** Social Worker V
HSA - Services Staff

Member Type: General
Years of Service: 35y 01m 21d
Retirement Date: 3/23/2023

15 **ARLENE S MILLER** Social Worker Supervisor II
HSA - Services Staff

Member Type: General
Years of Service: 27y 08m 06d
Retirement Date: 3/1/2023

16 **SHELBY A OLIVER** Asst Sheriff-Coroner-PublicAdm
Sheriff-Admin-Support Services

Member Type: General
Years of Service: 01y 09m 12d
Retirement Date: 3/25/2023

17 **SHELBY A OLIVER** Asst Sheriff-Coroner-PublicAdm
Sheriff-Admin-Support Services

Member Type: Safety
Years of Service: 21y 00m 05d
Retirement Date: 3/25/2023

18 **MARCIA M OLMOS** Probation Unit Supervisor
Pretrial Services

Member Type: Safety
Years of Service: 27y 03m 16d
Retirement Date: 3/25/2023

19 **SUSAN M ONEIL** Deferred Member
N/A

Member Type: General
Years of Service: 03y 06m 25d
Retirement Date: 3/25/2023
Comments: Deferred from SJCERA since July 1993. Outgoing reciprocity and concurrent retirement with SCERS.

20 **NATHANIEL R RAFANAN** Deferred Member
N/A

Member Type: General
Years of Service: 07y 10m 06d
Retirement Date: 2/6/2023
Comments: Deferred from SJCERA since July 2017.

21 **JULIE A ROSE** Staff NurseV-AsstNDptMg-Inpat
Hosp Intensive Care Nursery

Member Type: General
Years of Service: 26y 01m 06d
Retirement Date: 3/26/2023

22 **ENRIQUE SILVA** Engineering Assistant II
Public Works-Engnr-Design

Member Type: General
Years of Service: 23y 09m 11d
Retirement Date: 3/24/2023

23 **TILLY SILVA** Administrative Assistant I
Community Infra-Engineer Svs

Member Type: General
Years of Service: 33y 10m 26d
Retirement Date: 3/24/2023

24 **VICKIE SPEEGLE** Senior Office Assistant
Recorder - County Clerk

Member Type: General
Years of Service: 30y 00m 26d
Retirement Date: 3/1/2023

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] March 2023

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
TOTAL PLAN[1]			$ 3,937,270,561	100.0%	100.0%	1.0	3.1	3.1	-3.4	8.5	5.5	7.6	Apr-90
Policy Benchmark[4]						*0.5*	*4.2*	*4.2*	*-3.5*	*8.2*	*5.6*	*7.4*	
Difference:						0.5	-1.1	-1.1	0.1	0.3	-0.1	0.2	
75/25 Portfolio[5]						*3.2*	*6.3*	*6.3*	*-7.1*	*10.9*	*5.8*	*7.1*	
Difference:			.			-2.2	-3.2	-3.2	3.7	-2.4	-0.3	0.5	
Broad Growth			$ 2,986,969,675	75.9%	76.0%	1.8	4.1	4.1	-3.6	11.7	6.6	8.2	Jan-95
Aggressive Growth Lag[2]			$ 333,730,398	8.5%	10.0%	2.0	2.0	18.3	28.1	20.3	17.5	-2.1	Feb-05
Aggressive Growth Blend[6]						*-1.8*	*-5.4*	*3.1*	*6.4*	*13.0*	*10.7*	*0.0*	
Difference:						3.8	7.4	15.2	21.7	7.3	6.8	-2.1	
BlackRock Global Energy&Power Lag[3]	*$50,000*	*Global Infrastructure*	$ 35,846,152	0.9%		4.7	4.7	10.6	10.6	7.0	--	10.1	Jul-19
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*--*	*6.8*	
Difference:						14.1	10.9	29.3	29.3	0.7	--	3.3	
Ocean Avenue II Lag[3]	*$40,000*	*PE Buyout FOF*	$ 38,708,381	1.0%		8.0	8.0	37.2	37.2	41.4	32.1	19.3	May-13
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*6.4*	*-20.4*	
Difference:						17.4	14.2	55.9	55.9	35.1	25.7	39.7	
Lightspeed Venture Ptr Select V Lag[3]	*$40,000*	*Growth-Stage VC*	$ 8,519,385	0.2%		-8.2	-8.2	--	--	--	--	--	Jun-22
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*--*	*--*	*--*	*--*	*--*	
Difference:						1.2	-2.0	--	--	--	--	--	
Ocean Avenue III Lag[3]	*$50,000*	*PE Buyout FOF*	$ 50,778,556	1.3%		-1.8	-1.8	28.7	28.7	26.8	33.4	25.8	Apr-16
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*6.4*	*7.0*	
Difference:						7.6	4.4	47.4	47.4	20.5	27.0	18.8	
Ocean Avenue IV Lag[3]	*$50,000*	*PE Buyout*	$ 49,621,478	1.3%		18.0	18.0	52.3	52.3	40.2	--	38.9	Dec-19
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*--*	*6.9*	
Difference:						27.4	24.2	71.0	71.0	33.9	--	32.0	
Morgan Creek III Lag[3]	*$10,000*	*Multi-Strat FOF*	$ 4,660,219	0.1%		5.4	5.4	-22.4	-22.4	-15.8	-8.3	-6.0	Feb-15
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*6.4*	*7.3*	
Difference:						14.8	11.6	-3.7	-3.7	-22.1	-14.7	-13.3	
Morgan Creek V Lag[3]	*$12,000*	*Multi-Strat FOF*	$ 6,974,665	0.2%		-1.7	-1.7	5.6	5.6	11.8	12.9	13.2	Jun-13
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*6.4*	*7.6*	
Difference:						7.7	4.5	24.3	24.3	5.5	6.5	5.6	
Morgan Creek VI Lag[3]	*$20,000*	*Multi-Strat FOF*	$ 23,692,977	0.6%		-4.4	-4.4	4.8	4.8	18.3	18.5	10.4	Feb-15
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*6.3*	*6.4*	*7.3*	
Difference:						5.0	1.8	23.5	23.5	12.0	12.1	3.1	
Stellex Capital Partners II Lag[3]	*$50,000*	*Special Situations PE*	$ 14,978,338	0.4%		0.3	0.3	19.9	19.9	--	--	1.1	Jul-21
MSCI ACWI +2% Lag						*-9.4*	*-6.2*	*-18.7*	*-18.7*	*--*	*--*	*-11.8*	
Difference:						9.7	6.5	38.6	38.6	--	--	12.9	
Non-Core Private Real Assets Lag[3]	*$341,100*	*Private Real Estate*	$ 99,950,247	2.5%		-11.1	-11.1	1.6	1.6	11.0	7.2	-2.4	Nov-04
NCREIF ODCE + 1% Lag Blend						*0.4*	*0.6*	*22.1*	*22.1*	*12.5*	*10.3*	*9.2*	
Difference:						-11.5	-11.7	-20.5	-20.5	-1.5	-3.1	-11.6	
Opportunistic Private Real Estate			$ 28,307,473	0.5%									
Greenfield V[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 218,903	0.0%		-0.1	-0.1	-2.1	-2.1	-10.3	-4.6	-3.0	Jul-08
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*10.0*	
Difference:						-1.4	-1.4	-27.7	-27.7	-26.1	-18.2	-13.0	
Greenfield VI[3]	*$20,000*	*Opportunistic Pvt. RE*	$ 29,613	0.0%		-2.7	-2.7	-22.3	-22.3	-39.0	-34.2	-14.4	Apr-12
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*14.3*	
Difference:						-4.0	-4.0	-47.9	-47.9	-54.8	-47.8	-28.7	
Greenfield VII[3]	*$19,100*	*Opportunistic Pvt. RE*	$ 2,688,969	0.1%		6.1	6.1	22.0	22.0	17.2	15.7	14.2	Oct-14
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*13.9*	
Difference:						4.8	4.8	-3.6	-3.6	1.4	2.1	0.3	

[1] Returns are preliminary and are finalized during each quarterly reporting cycle. Monthly returns since previous quarter are provided by the managers. Market values are provided by Northern Trust.

[2] Total class returns are as of 12/31/22, and lagged 1 quarter.

[3] Manager returns are as of 12/31/22, and lagged 1 quarter. Since Inception date reflects one quarter lag.

[4] 8/1/22 to present benchmark is 33% MSCI ACWI IMI, 9% BB Aggregate Bond Index, **16%** *50%* BB High Yield/*50%* S&P Leveraged Loans, 7% NCREIF ODCE +1% lag; **10%** T-Bill +4%, **10%** MSCI ACWI +2% Lag, **15%** CRO Custom Benchmark. Prior to 8/1/22 benchmark is legacy policy benchmark.

[5] 4/1/20 to present **75%** MSCI ACWI, **25%** BB Global Aggregate. Prior to 4/1/20 60% MSCI ACWI, 40% BB Global Aggregate.

[6] 1/1/2021 to present **50%** MSCI ACWI +2%,**50%** NCREIF ODCE +1%

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] March 2023

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
Opportunistic Private Real Estate (continued)													
Grandview[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 18,392,744	0.5%		-0.5	-0.5	19.7	19.7	26.7	--	24.6	Apr-18
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*13.7*	
Difference:						-1.8	-1.8	-5.9	-5.9	10.9	--	10.9	
Miller Global Fund VI[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 107,955	0.0%		-6.8	-6.8	36.7	36.7	0.6	4.4	2.3	May-08
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*10.0*	
Difference:						-8.1	-8.1	11.1	11.1	-15.2	-9.2	-7.7	
Miller Global Fund VII[3]	*$15,000*	*Opportunistic Pvt. RE*	$ 59,626	0.0%		-9.9	-9.9	239.2	239.2	-23.5	-19.9	8.3	Dec-12
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*14.0*	
Difference:						-11.2	-11.2	213.6	213.6	-39.3	-33.5	-5.7	
Walton Street V[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 730,244	0.0%		-45.3	-45.3	-55.7	-55.7	-28.0	-22.4	9.7	Nov-06
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*10.0*	
Difference:						-46.6	-46.6	-81.3	-81.3	-43.8	-36.0	-0.3	
Walton Street VI[3]	*$15,000*	*Opportunistic Pvt. RE*	$ 6,079,419	0.2%		2.7	2.7	17.7	17.7	4.9	4.1	7.9	Jul-09
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*12.7*	
Difference:						1.4	1.4	-7.9	-7.9	-10.9	-9.5	-4.8	
Value-Added Private Real Estate			$ 68,010,326	1.7%									
AG Core Plus IV[3]	*$20,000*	*Value-Added Pvt. RE*	$ 11,082,534	0.3%		-5.7	-5.7	-2.8	-2.8	5.5	7.0	4.6	Sep-15
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*13.6*	
Difference:						-7.0	-7.0	-28.4	-28.4	-10.3	-6.6	-9.0	
Almanac Realty VI[3]	*$30,000*	*Value-Added Pvt. RE*	$ 4,004,118	0.1%		-0.1	-0.1	-0.2	-0.2	-9.3	-6.3	19.8	Feb-13
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*14.3*	
Difference:						-1.4	-1.4	-25.8	-25.8	-25.1	-19.9	5.5	
Berkeley Partners Fund V, LP	*$40,000*	*Value-Added Pvt. RE*	$ 25,893,627	0.7%		-2.9	-2.9	14.1	14.1	--	--	27.2	Aug-20
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*21.8*	
Difference:						-4.2	-4.2	-11.5	-11.5	--	--	5.4	
Stockbridge RE III[3]	*$45,000*	*Value-Added Pvt. RE*	$ 27,030,047	0.7%		0.9	0.9	16.2	16.2	20.9	--	13.4	Jul-18
NCREIF ODCE + 1% Lag Blend						*1.3*	*1.3*	*25.6*	*25.6*	*15.8*	*13.6*	*13.8*	
Difference:						-0.4	-0.4	-9.4	-9.4	5.1	--	-0.4	
Traditional Growth[2]			$ 1,407,857,631	35.8%	33.0%	2.6	6.9	6.9	-6.9	15.3	5.7	8.8	Jan-95
MSCI ACWI IMI Net						*2.5*	*6.9*	*6.9*	*-7.7*	*15.6*	*7.3*	*7.6*	
Difference:						0.1	0.0	0.0	0.8	-0.3	-1.6	1.2	
Global Equity			$ 1,364,669,118	34.7%									
Northern Trust MSCI World IMI		*All Cap Global*	$ 1,227,697,446	31.2%		2.6	7.4	7.4	-6.5	--	--	7.2	Sep-20
MSCI World IMI Net						*2.4*	*7.3*	*7.3*	*-7.3*	*--*	*--*	*6.7*	
Difference:						0.2	0.1	0.1	0.8	--	--	0.5	
SJCERA Transition		*All Cap Global*	$ 3,118	0.0%		NM	NM	NM	NM	--	--	NM	Jul-20
Emerging Markets			$ 136,968,554										
GQG Active Emerging Markets		*Emerging Markets*	$ 57,769,292	1.5%		2.6	3.5	3.5	-11.4	--	--	-1.8	Aug-20
MSCI Emerging Markets Index Net						*3.0*	*4.0*	*4.0*	*-10.7*	*--*	*--*	*-1.0*	
Difference:						-0.4	-0.5	-0.5	-0.7	--	--	-0.8	
PIMCO RAE Fundamental Emerging Markets		*Emerging Markets*	$ 79,199,262	2.0%		3.7	4.2	4.2	-2.7	18.4	1.3	4.6	Apr-07
MSCI Emerging Markets Index Net						*3.0*	*4.0*	*4.0*	*-10.7*	*7.8*	*-0.9*	*2.8*	
Difference:						0.7	0.2	0.2	8.0	10.6	2.2	1.8	
REITS			$ 43,188,513	1.1%									
Invesco All Equity REIT		*Core US REIT*	$ 43,188,513	1.1%		-1.1	2.4	2.4	-17.5	9.3	5.0	7.9	Aug-04
FTSE NAREIT Equity Index						*-2.5*	*2.7*	*2.7*	*-19.2*	*12.1*	*6.0*	*7.7*	
Difference:						1.4	-0.3	-0.3	1.7	-2.8	-1.0	0.2	

[1] Returns are preliminary and are finalized during each quarterly reporting cycle. Monthly returns since previous quarter are provided by the managers. Market values are provided by Northern Trust.

[2] MSCI ACWI IMI Net as of 4/1/2020, MSCI ACWI Gross prior.

[3] Manager returns are as of 12/31/22, and lagged 1 quarter. Since Inception date reflects one quarter lag.

NM = Returns not meaningful

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] — **March 2023**

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
Stabilized Growth			$ 1,245,381,646	31.6%	33.0%	1.3	2.1	2.1	-2.3	6.5	5.5	3.9	Jan-05
Risk Parity			$ 379,187,859	9.6%		4.5	5.9	5.9	-15.6	3.0	2.3	3.3	
T-Bill +4%						*0.8*	*2.1*	*2.1*	*6.6*	*4.9*	*5.5*	*4.7*	
Difference:						3.7	3.8	3.8	-22.2	-1.9	-3.2	-1.4	
Bridgewater All Weather		*Risk Parity*	$ 194,896,842	5.0%		5.3	7.0	7.0	-13.2	4.3	2.8	3.6	Mar-12
T-Bill +4%						*0.8*	*2.1*	*2.1*	*6.6*	*4.9*	*5.5*	*5.5*	
Difference:						4.5	4.9	4.9	-19.8	-0.6	-2.7	-1.9	
PanAgora Diversified Risk Multi-Asset		*Risk Parity*	$ 184,291,017	4.7%		3.8	4.8	4.8	-18.0	1.7	1.7	3.5	Apr-16
T-Bill +4%						*0.8*	*2.1*	*2.1*	*6.6*	*4.9*	*5.5*	*5.3*	
Difference:						3.0	2.7	2.7	-24.6	-3.2	-3.8	-1.8	
Liquid Credit			$ 229,408,414	5.8%		-0.2	2.0	2.0	-0.4	5.6	2.0	1.9	
50% BB High Yield, 50% S&P/LSTA Leveraged Loans						*0.5*	*3.4*	*3.4*	*-0.3*	*7.3*	*3.5*	*5.3*	
Difference:						-0.7	-1.4	-1.4	-0.1	-1.7	-1.5	-3.4	
Neuberger Berman		*Global Credit*	$ 98,057,798	2.5%		0.3	2.4	2.4	-3.4	4.8	--	1.5	Feb-19
33% ICE BofA HY Constrained, 33% S&P/LSTA LL, 33% JPM EMBI Glbl Div.						*0.7*	*2.9*	*2.9*	*-2.5*	*4.8*	*--*	*2.0*	
Difference:						-0.4	-0.5	-0.5	-0.9	0.0	--	-0.5	
Stone Harbor Absolute Return		*Absolute Return*	$ 131,350,616	3.3%		-0.5	1.7	1.7	2.0	6.4	2.3	2.7	Oct-06
3-Month Libor Total Return						*0.4*	*1.1*	*1.1*	*2.4*	*1.0*	*1.6*	*1.4*	
Difference:						-0.9	0.6	0.6	-0.4	5.4	0.7	1.3	
Private Credit Lag[2]			$ 385,771,448	9.8%		0.4	0.4	6.4	6.4	4.8	3.5	3.7	
50% BB High Yield, 50% S&P/LSTA Leveraged Loans						*-3.1*	*0.4*	*-8.4*	*-8.4*	*0.9*	*2.3*	*5.1*	
Difference:						3.5	0.0	14.8	14.8	3.9	1.2	-1.4	
BlackRock Direct Lending Lag[3]	*$100,000*	*Direct Lending*	$ 89,801,555	2.3%		2.2	2.2	2.2	5.2	---	---	8.0	May-20
S&P/LSTA Leveraged Loans +3% Blend [5]						*-2.0*	*2.1*	*2.1*	*2.0*	*---*	*---*	*10.8*	
Difference:						4.2	0.1	0.1	3.2	---	---	-2.8	
Mesa West RE Income IV Lag[3]	*$75,000*	*Comm. Mortgage*	$ 38,111,162	1.0%		1.0	1.0	2.0	2.0	5.8	6.9	6.6	Mar-17
S&P/LSTA Leveraged Loans +3% Blend [4]						*-2.0*	*2.1*	*2.0*	*2.0*	*7.0*	*7.5*	*7.6*	
Difference:						3.0	-1.1	0.0	0.0	-1.2	-0.6	-1.0	
Crestline Opportunity II Lag[3]	*$45,000*	*Opportunistic*	$ 14,363,056	0.4%		-5.6	-5.6	-5.7	-5.7	0.2	0.1	3.9	Nov-13
S&P/LSTA Leveraged Loans +3% Blend [4]						*-2.0*	*2.1*	*2.0*	*2.0*	*7.0*	*7.5*	*8.2*	
Difference:						-3.6	-7.7	-7.7	-7.7	-6.8	-7.4	-4.3	
Davidson Kempner Distr Opp V Lag[3]	*$50,000*	*Opportunistic*	$ 47,540,041	0.0%		-0.8	-0.8	3.5	3.5	--	--	22.3	Oct-20
S&P/LSTA Leveraged Loans +3% Blend [4]						*-2.0*	*2.1*	*2.0*	*2.0*	*--*	*--*	*7.1*	
Difference:						1.2	-2.9	1.5	1.5	--	--	15.2	
Oaktree Lag[3]	*$50,000*	*Leveraged Direct*	$ 32,358,478	0.8%		0.0	0.0	13.0	13.0	15.4	--	11.3	Mar-18
S&P/LSTA Leveraged Loans +3% Blend [6]						*-2.0*	*2.1*	*2.0*	*2.0*	*8.9*	*--*	*7.6*	
Difference:						2.0	-2.1	11.0	11.0	6.5	--	3.7	
HPS EU Asset Value II Lag[3]	*$50,000*	*Direct Lending*	$ 36,246,712	0.9%		1.9	1.9	8.4	8.4	--	--	3.7	Aug-20
S&P/LSTA Leveraged Loans +3% Blend [4]						*-2.0*	*2.1*	*2.0*	*2.0*	*--*	*--*	*7.3*	
Difference:						3.9	-0.2	6.4	6.4	--	--	-3.6	
Raven Opportunity III Lag[3]	*$50,000*	*Direct Lending*	$ 58,435,316	1.5%		1.8	1.8	16.4	16.4	9.7	10.1	4.9	Nov-15
S&P/LSTA Leveraged Loans +3% Blend [4]						*-2.0*	*2.1*	*2.0*	*2.0*	*7.0*	*7.5*	*7.9*	
Difference:						3.8	-0.3	14.4	14.4	2.7	2.6	-3.0	

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[2] Total class returns are as of 12/31/22, and lagged 1 quarter.

[3] Manager returns are as of 12/31/22, and lagged 1 quarter. Since Inception date reflects one quarter lag.

[4] 9% Annual until 6/30/2018; CPI +6% Annual 7/1/2018 - 3/31/2022; S&P/LSTA Leveraged Loans +3% thereafter.

[5] 50% Bloomberg High Yield/50% S&P Leveraged Loan until 12/31/20 then CPI +6% Annual thereafter. Benchmark lagged one quarter.

[6] MSCI ACWI + 2% until 12/31/20 then CPI +6% Annual thereafter. Benchmark lagged one quarter

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] March 2023

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
Private Credit Lag (continued)													
Medley Opportunity II Lag[2]	*$50,000*	*Direct Lending*	$ 4,378,784	0.1%		0.0	0.0	-9.9	-9.9	-7.9	-10.1	-2.2	Jul-12
S&P/LSTA Leveraged Loans +3% Blend[3]						*-2.0*	*2.1*	*2.0*	*2.0*	*7.0*	*7.5*	*8.3*	
Difference:						2.0	-2.1	-11.9	-11.9	-14.9	-17.6	-10.5	
White Oak Summit Peer Fund Lag[2]	*$50,000*	*Direct Lending*	$ 24,841,538	0.6%		-3.8	-3.8	-8.3	-8.3	-1.5	1.9	3.4	Mar-16
S&P/LSTA Leveraged Loans +3% Blend[3]						*-2.0*	*2.1*	*2.0*	*2.0*	*7.0*	*7.5*	*7.0*	
Difference:						-1.8	-5.9	-10.3	-10.3	-8.5	-5.6	-3.6	
White Oak Yield Spectrum Master V Lag[2]	*$50,000*	*Direct Lending*	$ 39,694,806	1.0%		0.4	0.4	2.9	2.9	---	--	1.0	Mar-20
S&P/LSTA Leveraged Loans +3% Blend[3]						*-2.0*	*2.1*	*2.0*	*2.0*	*---*	*--*	*7.0*	
Difference:						2.4	-1.7	0.9	0.9	---	--	-6.0	
Core Private Real Estate Lag			$ 251,013,925	6.4%									
Principal US[2]	*$25,000*	*Core Pvt. RE*	$ 46,708,336	1.2%		0.4	0.4	22.1	22.1	11.5	9.8	10.0	Jan-16
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*13.2*	
Difference:						-5.1	-5.1	-11.1	-11.1	-4.6	-4.1	-3.2	
Prologis Logistics[2]	*$35,000*	*Core Pvt. RE*	$ 138,386,621	3.5%		0.2	0.2	34.4	34.4	26.4	22.4	13.6	Dec-07
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*10.2*	
Difference:						-5.3	-5.3	1.2	1.2	10.3	8.5	3.4	
RREEF America II[2]	*$45,000*	*Core Pvt. RE*	$ 66,337,801	1.7%		-0.8	-0.8	23.6	23.6	12.6	10.4	10.1	Jul-16
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*13.1*	
Difference:						-6.3	-6.3	-9.6	-9.6	-3.5	-3.5	-3.0	
Diversifying Strategies			$ 757,267,469	19.2%	24.0%	-1.5	-0.2	-0.2	-1.8	-0.6	2.4	6.1	Oct-90
Principal Protection			$ 293,110,614	7.4%	9.0%	2.1	3.1	3.1	-2.5	-1.0	1.0	5.8	Oct-90
BB Aggregate Bond Index						*2.5*	*3.0*	*3.0*	*-4.8*	*-2.8*	*0.9*	*5.4*	
Difference:						-0.4	0.1	0.1	2.3	1.8	0.1	0.4	
Dodge & Cox		*Core Fixed Income*	$ 199,944,563	5.1%		1.9	3.0	3.0	-2.8	0.3	2.1	6.6	Oct-90
BB Aggregate Bond Index						*2.5*	*3.0*	*3.0*	*-4.8*	*-2.8*	*0.9*	*5.4*	
Difference:						-0.6	0.0	0.0	2.0	3.1	1.2	1.2	
Loomis Sayles		*Core Fixed Income*	$ 93,159,923	2.4%		2.5	3.3	-4.4	--	--	--	-6.5	Mar-22
BB Aggregate Bond Index						*2.5*	*3.0*	*-4.7*	*--*	*--*	*--*	*-6.9*	
Difference:						0.0	0.3	0.3	--	--	--	0.4	
DoubleLine Capital		*MBS*	$ 6,128	0.0%		NM	NM	NM	NM	NM	NM	NM	Feb-12

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[2] Manager returns are as of 12/31/22, and lagged 1 quarter. Since Inception date reflects one quarter lag.

[3] 9% Annual until 6/30/2018; CPI +6% Annual 7/1/2018 - 3/31/2022; S&P/LSTA Leveraged Loans +3% thereafter.

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] — March 2023

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
Crisis Risk Offset			$ 464,156,855	11.8%	15.0%	-3.6	-2.2	-2.2	-0.8	0.0	3.6	6.2	Jan-05
CRO Custom Benchmark [2]						0.1	1.3	1.3	-3.0	1.0	3.8	4.9	
Difference:						-3.7	-3.5	-3.5	2.2	-1.0	-0.2	1.3	
Long Duration			$ 119,413,368	3.0%		4.8	6.8	6.8	-14.6	-10.8	-0.2	-0.5	
BB US Long Duration Treasuries						4.7	6.2	6.2	-16.0	-11.3	-0.4	-0.1	
Difference:						0.1	0.6	0.6	1.4	0.5	0.2	-0.4	
Dodge & Cox Long Duration		*Long Duration*	$ 119,413,368	3.0%		4.8	6.8	6.8	-14.6	-10.8	-0.2	-0.5	Feb-16
BB US Long Duration Treasuries						4.7	6.2	6.2	-16.0	-11.3	-0.4	-0.1	
Difference:						0.1	0.6	0.6	1.4	0.5	0.2	-0.4	
Systematic Trend Following			$ 228,531,735	5.8%		-5.5	-5.3	-5.3	0.9	12.4	7.1	8.7	
BTOP50 Index						-4.9	-3.7	-3.7	1.4	9.4	5.9	4.9	
Difference:						-0.6	-1.6	-1.6	-0.5	3.0	1.2	3.8	
Mt. Lucas Managed Futures - Cash		*Systematic Trend Following*	$ 117,535,341	3.0%		-1.2	-4.1	-4.1	0.8	12.8	7.0	8.3	Jan-05
BTOP50 Index						-4.9	-3.7	-3.7	1.4	9.4	5.9	4.9	
Difference:						3.7	-0.4	-0.4	-0.6	3.4	1.1	3.4	
Graham Tactical Trend		*Systematic Trend Following*	$ 110,996,394	2.8%		-9.7	-6.4	-6.4	1.0	12.0	7.0	3.6	Apr-16
SG Trend Index						-7.7	-7.3	-7.3	0.3	10.2	7.7	3.7	
Difference:						-2.0	0.9	0.9	0.7	1.8	-0.7	-0.1	
Alternative Risk Premia			$ 116,211,752	3.0%		-7.4	-4.9	-4.9	8.9	-4.6	0.8	7.1	
5% Annual						0.4	1.2	1.2	5.0	5.0	5.0	6.2	
Difference:						-7.8	-6.1	-6.1	3.9	-9.6	-4.2	0.9	
AQR Style Premia		*Alternative Risk Premia*	$ 54,545,728	1.4%		-8.3	-1.1	-1.1	15.9	8.6	-2.2	0.4	May-16
5% Annual						0.4	1.2	1.2	5.0	5.0	5.0	5.0	
Difference:						-8.7	-2.3	-2.3	10.9	3.6	-7.2	-4.6	
PE Diversified Global Macro		*Alternative Risk Premia*	$ 61,666,024	1.6%		-6.7	-8.2	-8.2	21.1	-10.4	3.6	1.8	Jun-16
5% Annual						0.4	1.2	1.2	5.0	5.0	5.0	5.0	
Difference:						-7.1	-9.4	-9.4	16.1	-15.4	-1.4	-3.2	
Cash[3]			$ 166,709,695	4.2%	0.0%	0.3	0.7	0.7	2.1	0.8	1.1	2.3	Sep-94
US T-Bills						0.4	1.1	1.1	2.5	0.9	1.4	2.3	
Difference:						-0.1	-0.4	-0.4	-0.4	-0.1	-0.3	0.0	
Northern Trust STIF		*Collective Govt. Short Term*	$ 142,060,902	3.6%		0.4	0.9	0.9	2.2	0.8	1.1	2.5	Jan-95
US T-Bills						0.4	1.1	1.1	2.5	0.9	1.4	2.3	
Difference:						0.0	-0.2	-0.2	-0.3	-0.1	-0.3	0.2	
Parametric Overlay[4]		*Cash Overlay*	$ 26,323,722	0.7%		0.0	0.0	0.0	0.0	--	--	0.0	Jan-20

[1] Returns are preliminary and are finalized during each quarterly reporting cycle. Monthly returns since previous quarter are provided by the managers. Market values are provided by Northern Trust.
[2] Benchmark is (1/3) BB Long Duration Treasuries, (1/3) BTOP50 Index, (1/3) 5% Annual.
[3] Includes lagged cash.
[4] Given daily cash movement returns may vary from those shown above.

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CELEBRATING A MILESTONE

Economic and Market Update

March 2023 Report

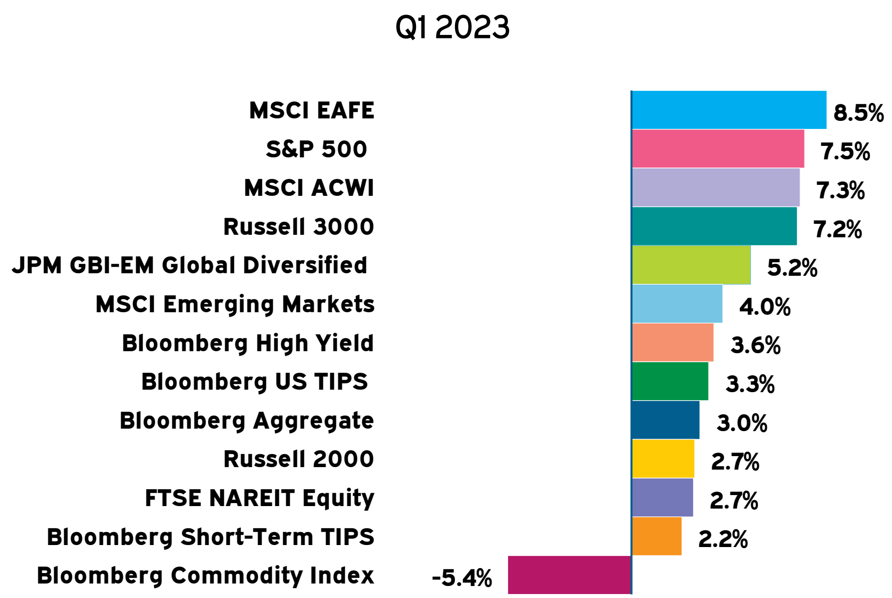
Commentary

→ It was a volatile quarter for most asset classes driven by evolving monetary policy expectations and high-profile bank failures. Ultimately, investors remained focused on slowing inflation and potentially peaking rate hikes leading to positive results across most asset classes for the quarter.

- The Fed's, and others', quick responses to pressures in the banking sector brought confidence back to the markets in March with the crisis driving the terminal policy rate expectations lower.
- US equity markets (Russell 3000) rallied in March (+2.7%) finishing the first quarter in strongly positive territory (+7.2%). Growth significantly outperformed value for the quarter, driven by the technology sector.
- Non-US developed equity markets (MSCI EAFE +2.5%) also posted positive returns in March. They returned 8.5% for the quarter, finishing ahead of US equities.
- Emerging market equities had positive returns for the month (+3.0%) supported by Chinese equities (+4.5%) and a weaker US dollar. They trailed developed market equities for the quarter partly due to higher US-China tensions.
- On expectations for lower inflation and concerns over the banking sector, bonds rallied in March, with the broad US bond market (Bloomberg Aggregate) rising 2.5%. For the quarter, the broad US bond market was up 3.0%.

→ This year, the path of inflation and monetary policy, slowing global growth, and the war in Ukraine, as well as recent pressures in small- and medium-sized regional banks in the US, will all be key.

Index Returns[1]



→ Despite volatility during the quarter, public markets, except commodities, finished the first quarter of 2023 in positive territory adding to the strong gains from the fourth quarter of last year.

[1] Source: Bloomberg and FactSet. Data is as of March 31, 2023.

Domestic Equity Returns[1]

Domestic Equity	March (%)	Q1 (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)
S&P 500	3.7	7.5	-7.7	18.6	11.2	12.2
Russell 3000	2.7	7.2	-8.6	18.5	10.4	11.7
Russell 1000	3.2	7.5	-8.4	18.6	10.9	12.0
Russell 1000 Growth	6.8	14.4	-10.9	18.6	13.6	14.6
Russell 1000 Value	-0.5	1.0	-5.9	17.9	7.5	9.1
Russell MidCap	-1.5	4.1	-8.8	19.2	8.0	10.0
Russell MidCap Growth	1.4	9.1	-8.5	15.2	9.1	11.2
Russell MidCap Value	-3.1	1.3	-9.2	20.7	6.5	8.8
Russell 2000	-4.8	2.7	-11.6	17.5	4.7	8.0
Russell 2000 Growth	-2.5	6.1	-10.6	13.4	4.3	8.5
Russell 2000 Value	-7.2	-0.7	-13.0	21.0	4.5	7.2

US Equities: Russell 3000 Index rose 2.7% in March and 7.2% in Q1.

→ US stocks rose in aggregate for the month and quarter as investors were optimistic that the Federal Reserve may end its policy tightening earlier than expected. However, turmoil in the regional banking industry weighed on segments of the market.

→ The small cap and value indices were more exposed to the banking turmoil and underperformed their broad market indices by significant margins.

→ Large cap stocks were driven higher by the continued strength of the technology and communication services sectors. This same dynamic contributed to the continued outperformance of growth stocks against their value counterparts across the capitalization spectrum.

[1] Source: Bloomberg. Data is as of March 31, 2023.

Foreign Equity Returns[1]

Foreign Equity	March (%)	Q1 (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)
MSCI ACWI ex. US	2.4	6.9	-5.1	11.8	2.5	4.2
MSCI EAFE	2.5	8.5	-1.4	13.0	3.6	5.0
MSCI EAFE (Local Currency)	0.5	7.5	3.8	14.6	6.3	7.3
MSCI EAFE Small Cap	-0.2	4.9	-9.8	12.1	0.9	5.8
MSCI Emerging Markets	3.0	4.0	-10.7	7.8	-0.9	2.0
MSCI Emerging Markets (Local Currency)	2.2	3.8	-6.6	8.8	1.9	5.0
MSCI China	4.5	4.7	-4.7	-2.6	-4.0	3.4

Foreign Equity: Developed international equities (MSCI EAFE) rose 2.5% in March and 8.5% for the quarter. Emerging market equities (MSCI EM) rose 3.0%. for the month and 4.0% in the first quarter.

→ Non-US equities also recovered in March with developed markets (MSCI EAFE) outpacing US equities (8.5% versus 7.2%) for the quarter and emerging markets (MSCI Emerging Markets) trailing (4.0% versus 7.2%).

→ Developed market equities also benefited from expectations that monetary policy may be peaking on declining inflation. The continued weakness in the US dollar also added to the quarterly results (+1%) for US investors.

→ Emerging market equities started the year with optimism over the reopening of China's economy, but the escalation of US-China tensions and the broader banking crisis led to weaker relative results compared to developed markets.

[1] Source: Bloomberg. Data is as of March 31, 2023.

Fixed Income Returns[1]

Fixed Income	March (%)	Q1 (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)	Current Yield (%)	Duration (Years)
Bloomberg Barclays Universal	2.3	2.9	-4.6	-2.0	1.0	1.6	4.8	6.3
Bloomberg Barclays Aggregate	2.5	3.0	-4.8	-2.8	0.9	1.4	4.4	6.5
Bloomberg Barclays US TIPS	2.9	3.3	-6.1	1.8	2.9	1.5	4.1	7.0
Bloomberg Short-term TIPS	1.9	2.2	-0.3	3.5	3.0	1.5	4.6	2.5
Bloomberg Barclays High Yield	1.1	3.6	-3.3	5.9	3.2	4.1	8.5	4.2
JPM GBI-EM Global Diversified (USD)	4.1	5.2	-0.7	0.9	-2.4	-1.5	7.1	5.1

Fixed Income: The Bloomberg Universal rose 2.3% in March and 2.9% in Q1 as global sovereign debt yields fell on monetary policy expectations.

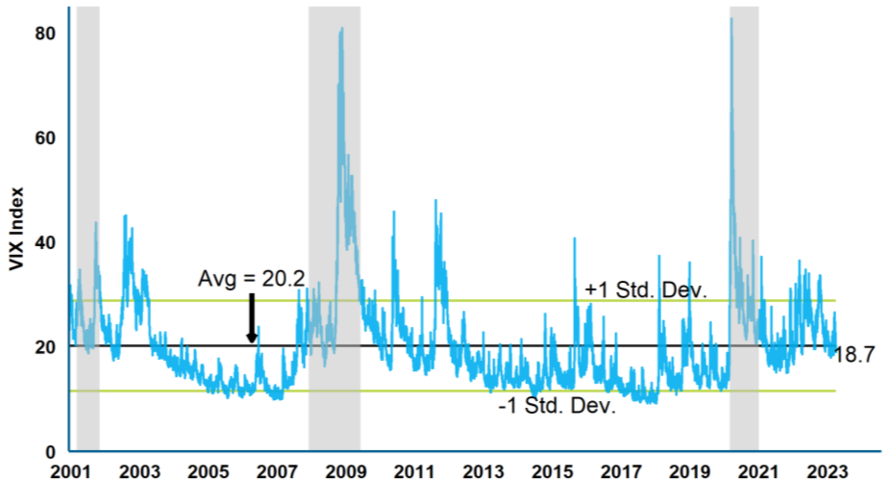
→ Anecdotal reports suggest bouts of flight-to-quality flows during the peak of interest rate volatility connected to the banking sector pushed sovereign debt yields lower. These concerns largely outweighed continued inflation concerns and caused investors to adjust their policy expectations.

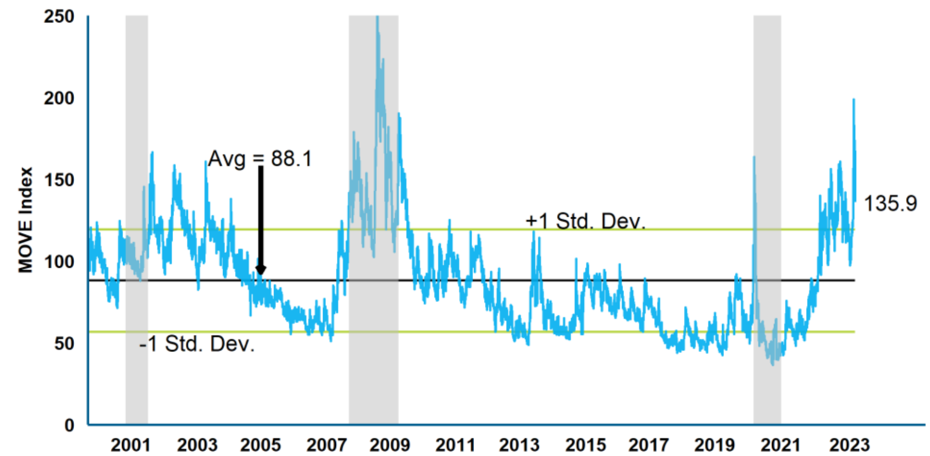
→ The broad TIPS index outperformed the broad US bond market (Bloomberg Aggregate) in March and for the quarter.

→ High yield bonds had the weakest results in March driven by banking sector weakness but outperformed the broad US bond market for the quarter.

[1] Source: Bloomberg. JPM GBI-EM data is from InvestorForce. Data is as of March 31, 2023. The yield and duration data from Bloomberg is defined as the index's yield to worst and modified duration respectively.

Equity and Fixed Income Volatility[1]



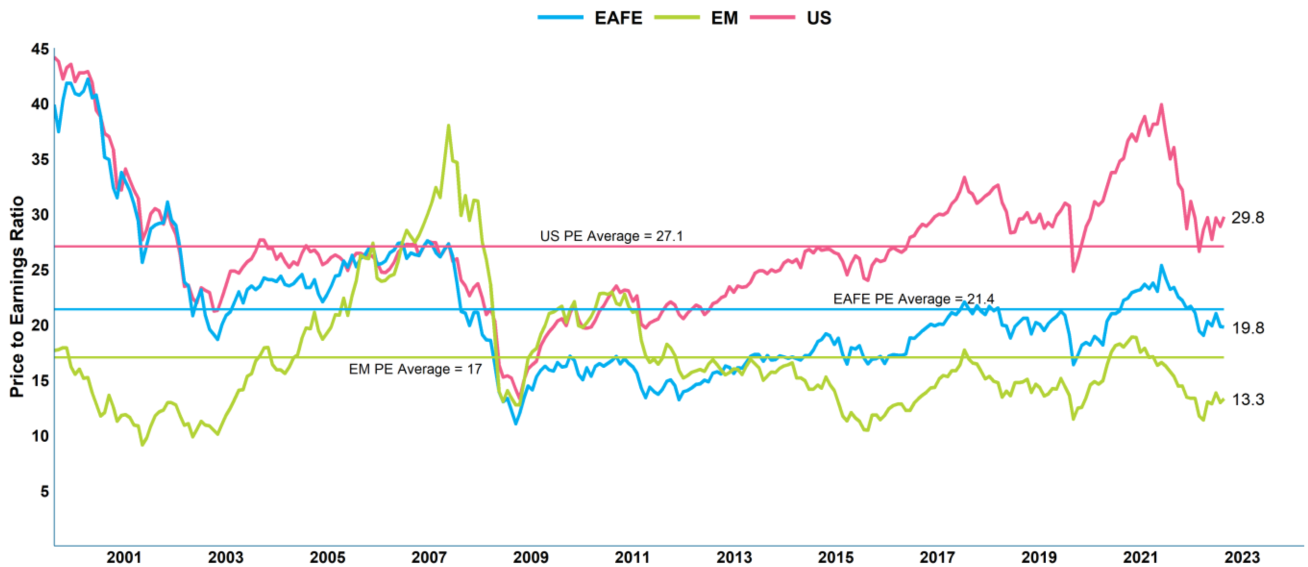


→ Volatility in equities (VIX) remained subdued through the end of March as investors continued to anticipate the end of the Fed's policy tightening.

→ In comparison, the bond market remains on edge with the more policy sensitive MOVE (fixed income volatility) remaining well above its long-run average. During the quarter it hit the highest level since the Global Financial Crisis as the banking sector issues created uncertainty over how the Fed would balance fighting inflation and maintaining financial stability.

[1] Equity and Fixed Income Volatility – Source: Bloomberg. Implied volatility as measured using VIX Index for equity markets and the MOVE Index to measure interest rate volatility for fixed income markets. Data is as of March 2023. The average line indicated is the average of the VIX and MOVE values between January 2000 and March 2023.

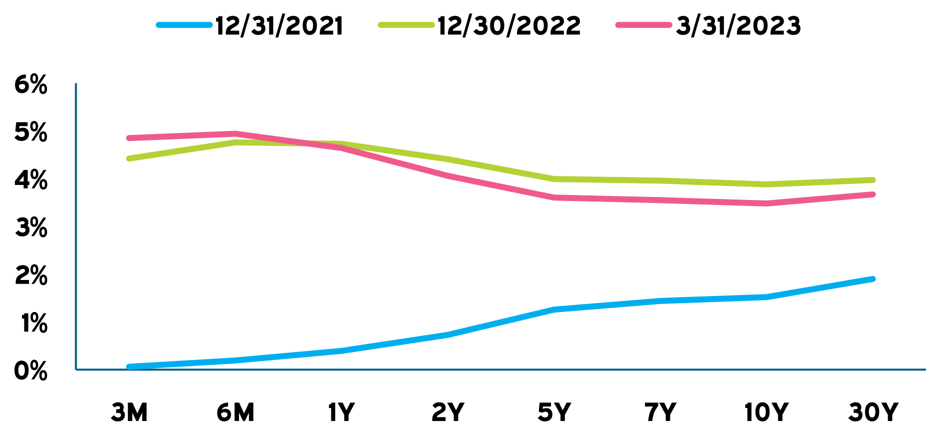
Equity Cyclically Adjusted P/E Ratios[1]



- → After its dramatic decline last year the US equity price-to-earnings ratio remains above its long-run (21st century) average.
- → International developed market valuations are slightly below their own long-term average, with those for emerging markets the lowest and well under the long-term average.

[1] US Equity Cyclically Adjusted P/E on S&P 500 Index. Source: Robert Shiller, Yale University, and Meketa Investment Group. Developed and Emerging Market Equity (MSCI EAFE and EM Index) Cyclically Adjusted P/E – Source: MSCI and Bloomberg. Earnings figures represent the average of monthly "as reported" earnings over the previous ten years. Data is as of March 2023. The average line is the long-term average of the US, EM, and EAFE PE values from December 1999 to the recent month-end respectively.

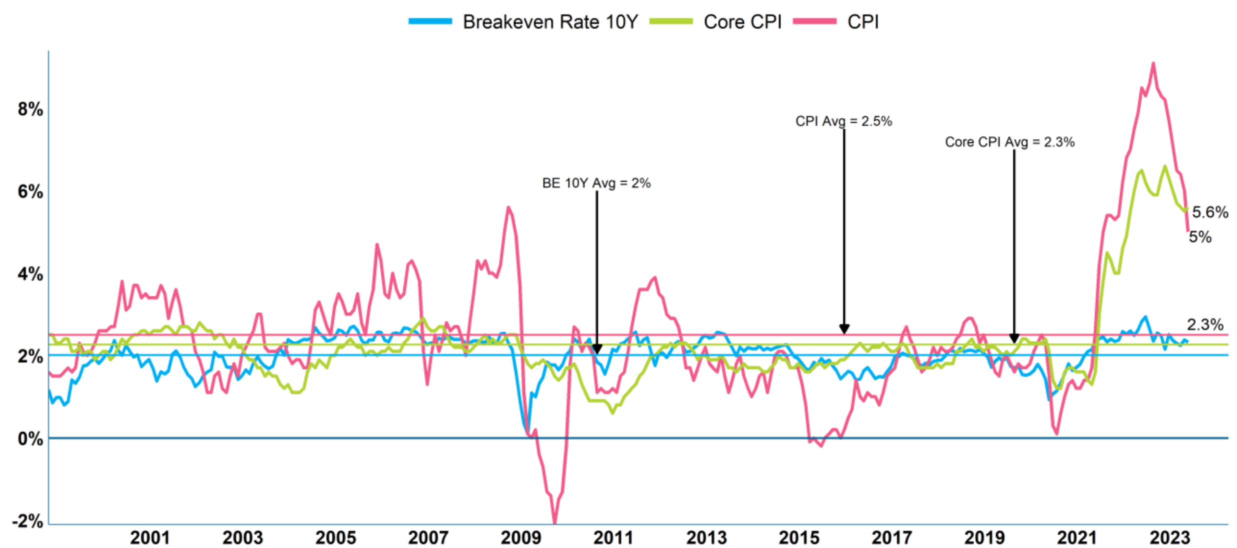
US Yield Curve[1]



- → It was a volatile quarter for interest rates, particularly shorter-dated maturities. Except for the shortest maturities, rates largely declined across the yield curve in the first quarter on expectations of peaking policy.
- → After hitting -1.07% in early March, the yield spread between two-year and ten-year Treasuries finished the quarter at -0.55% as policy-sensitive rates at the front-end of the curve declined faster than longer maturities. The more closely watched measure by the Fed of three-month and ten-year Treasuries also remained inverted. Inversions in the yield curve have often preceded recessions.
- → The Fed remained committed to fighting inflation, despite pressures in the banking sector, raising rates another 25 basis points to a range of 4.75% to 5.0% at its March meeting.

[1] Source: Bloomberg. Data is as of March 31, 2023.

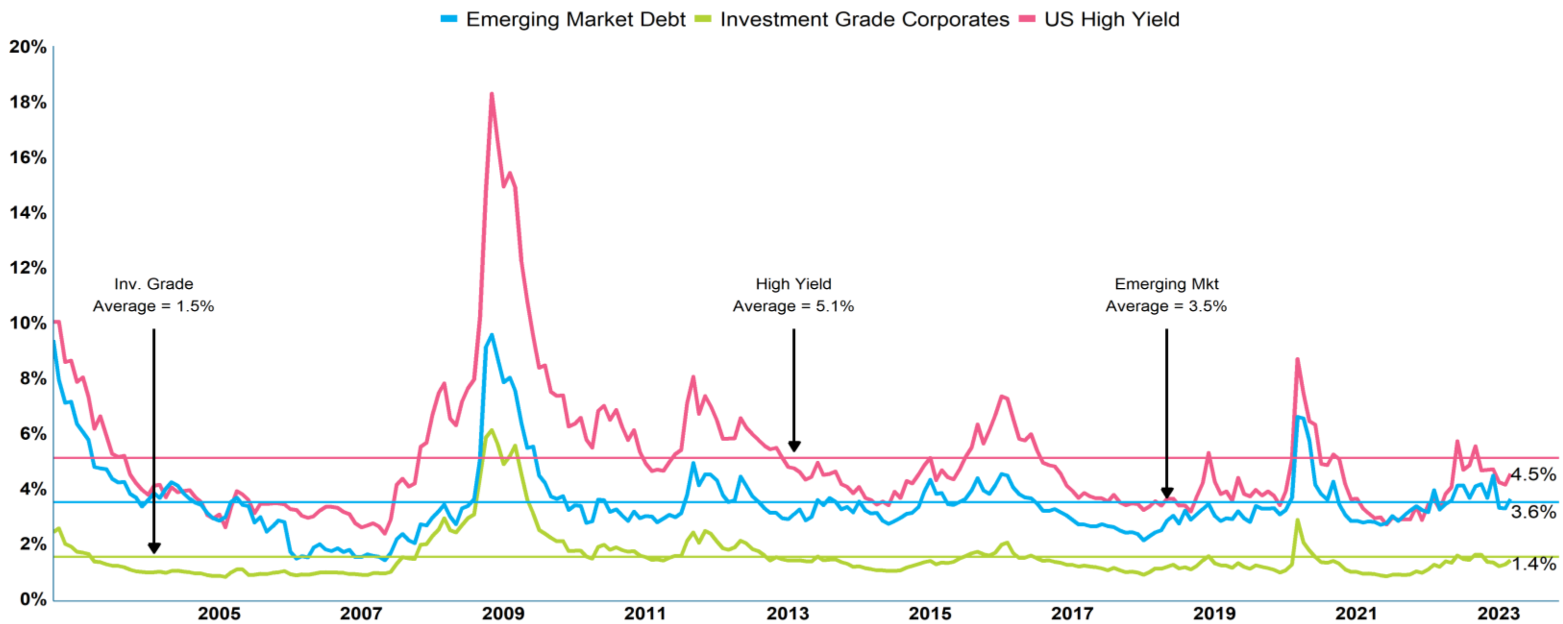
Ten-Year Breakeven Inflation and CPI[1]



- → Inflation continued to decline in March with the year-over-year reading falling from 6.0% to 5.0% and coming in slightly below the 5.1% expectations. The rate of price increases also slowed on a month-over-month basis (0.1% versus 0.4%), with food prices only slightly higher and energy prices declining.
- → Core inflation – excluding food and energy - rose (5.6% versus 5.5%) mostly driven by transportation and housing.
- → Inflation expectations (breakevens) were volatile over the month and declined on net, but nonetheless ended the month at 2.3% (roughly where it started the quarter).

[1] Source: Bloomberg. Data is as of March 31, 2023. The CPI and 10 Year Breakeven average lines denote the average values from August 1998 to the present month-end, respectively. Breakeven values represent month-end values for comparative purposes.

Credit Spreads vs. US Treasury Bonds[1]

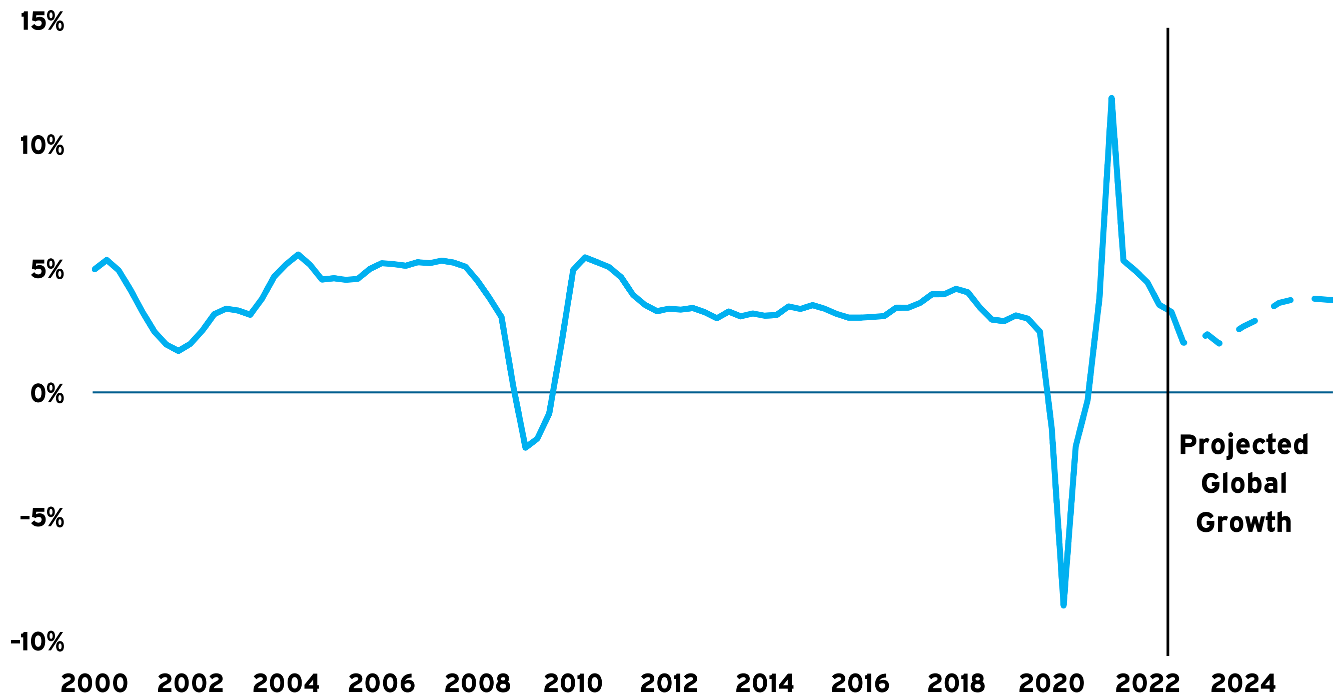


→ Spreads (the added yield above a comparable maturity Treasury) experienced a significant spike in March during the banking crisis but subsequently declined as the Fed and others stepped in to provide support.

→ High yield spreads rose from 4.1% to a peak of 5.2% in March before finishing the quarter at 4.5% (lower than the start of the quarter by 0.2%). Investment grade spreads also spiked in March (1.2% to 1.6%) but also fell from their peak to 1.4%. Emerging market spreads finished the quarter at 3.6% experiencing the largest decline (-0.9%).

[1] Sources: Bloomberg. Data is as of March 31, 2023. Average lines denote the average of the investment grade, high yield, and emerging market spread values from August 2000 to the recent month-end, respectively.

Global Real Gross Domestic Product (GDP) Growth[1]

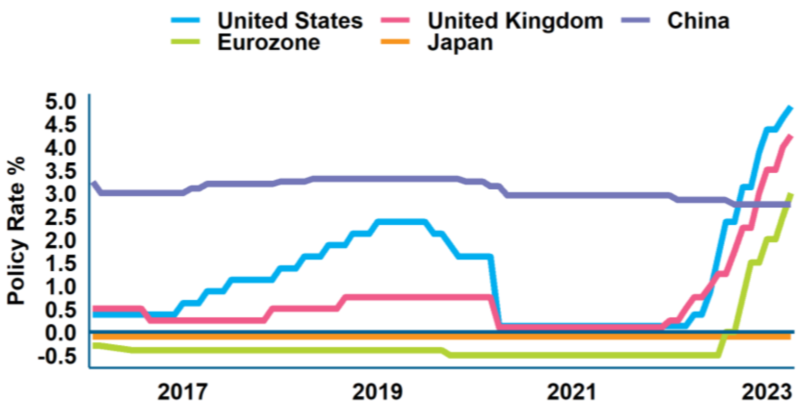


- → Global economies are expected to slow in 2023 compared to 2022, with risks of recession increasing given persistently high inflation and related tighter monetary policy.
- → The delicate balancing act of central banks trying to reduce inflation without dramatically impacting growth will remain key.

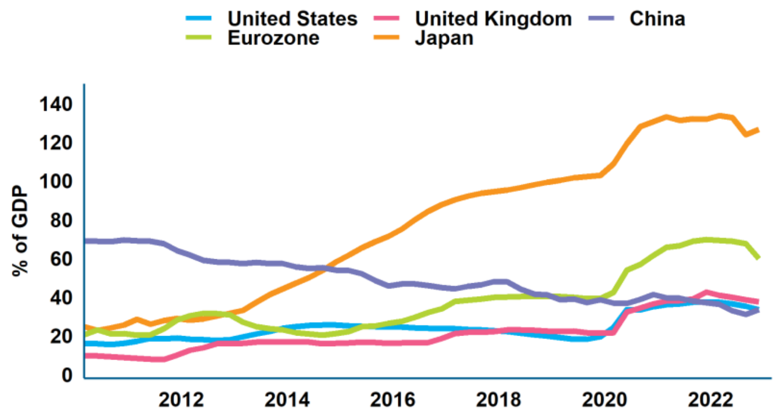
[1] Source: Oxford Economics (World GDP, US$ prices & PPP exchange rate, real, % change YoY). Updated March 2023.

Central Bank Response[1]

Policy Rates



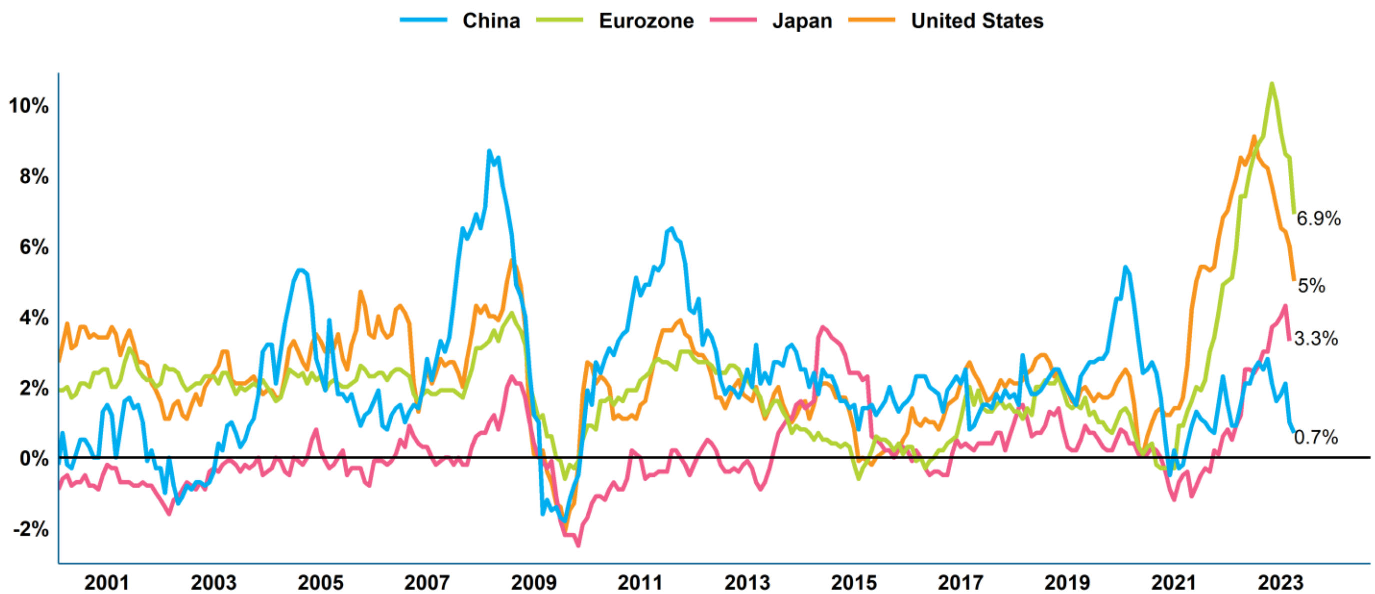
Balance Sheet as % of GDP



- → In 2022, many central banks aggressively reduced pandemic-era policy support in the face of high inflation with the US taking the most aggressive approach. Slowing inflation and recent signs of instability in the banking sector have led to expectations for the slowing of policy tightening going forward.
- → In March, the Fed, FDIC, and Treasury provided deposit guarantees after high profile bank failures revealed bank capital losses on US Treasurys related to higher interest rates and lax risk management.
- → China's central bank is one notable exception. They are expected to maintain an accommodative monetary stance to support the economy. They cut bank reserves requirements to improve bank liquidity and banks have also securitized over $390 billion in non-performing loans to improve loan quality ratios.
- → Looking ahead the risk remains for a policy error as central banks attempt to balance bringing down inflation, maintaining financial stability, and growth.

[1] Source: Bloomberg. Policy rate data is as of March 31, 2023. China policy rate is defined as the medium-term lending facility 1 year interest rate. Balance sheet as % of GDP is based on quarterly data and is as of December 31, 2022.

Inflation (CPI Trailing Twelve Months)[1]



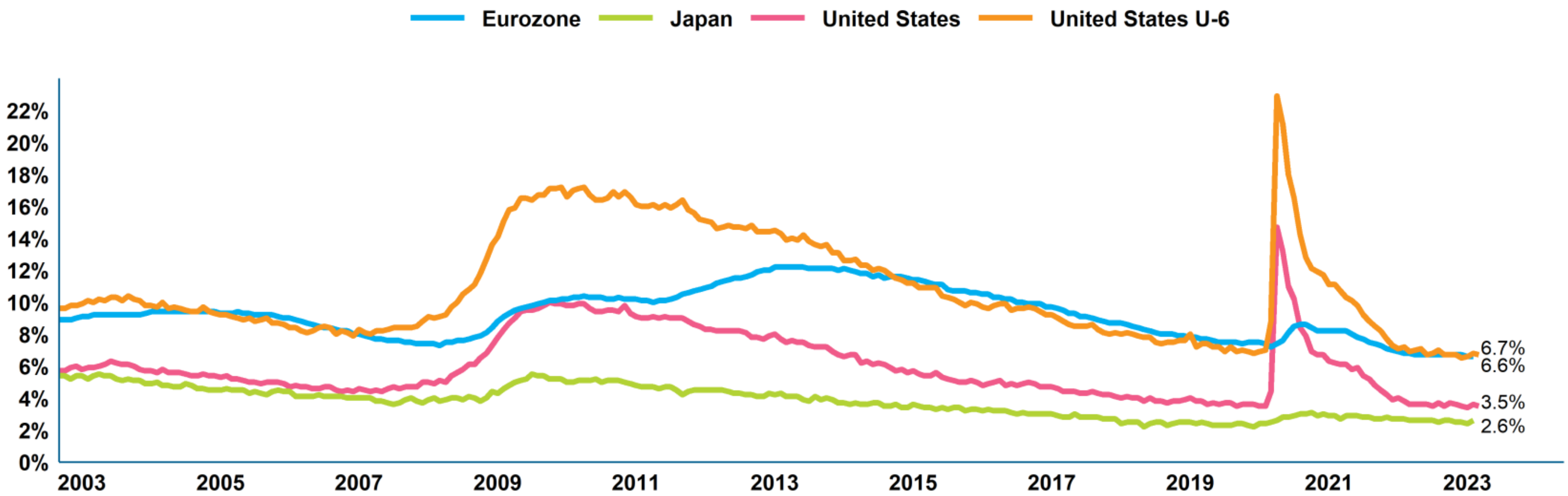
→ Inflation increased dramatically from the lows of the pandemic, particularly in the US and Eurozone where it reached levels not seen in many decades.

→ Inflation pressures are slowly declining in the US as supply issues ease, but they remain elevated, while in Europe they have also started to fall as energy prices have eased.

→ Lingering supply issues related to the pandemic, record monetary and fiscal stimulus, strict COVID-19 restrictions in China, and higher commodity prices driven by the war in Ukraine have been key global drivers of inflation.

[1] Source: Bloomberg. Data is as March 31, 2023. The most recent Japanese inflation data is as of February 2023.

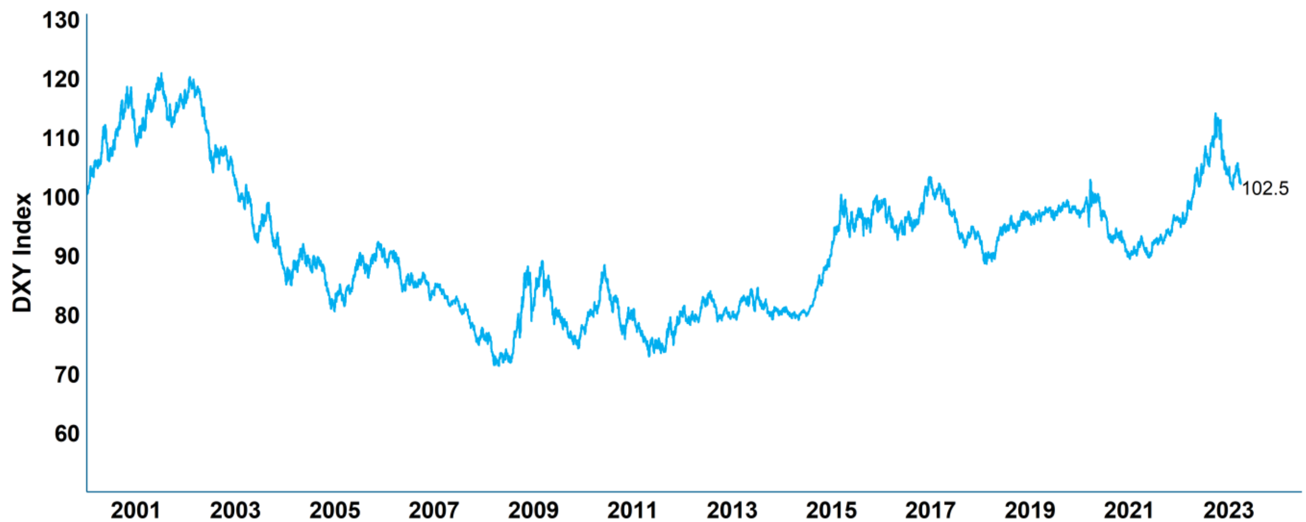
Unemployment[1]



- → Labor markets have significantly improved from the pandemic as economies have largely reopened.
- → Despite slowing growth and high inflation, the US labor market remains a particular bright spot. Unemployment in the US, which experienced the steepest rise, recently has returned to pre-pandemic levels. Broader measures of unemployment (U-6) remain higher at 6.7% but have also declined dramatically from their peak.
- → The strong labor market and higher wages, although beneficial for workers, motivates the Fed's efforts to fight inflation, likely leading to higher unemployment.

[1] Source: Bloomberg. Data is as March 31, 2023, for the US. The most recent data for Eurozone and Japanese unemployment is as of February 2023.

US Dollar versus Broad Currencies[1]



- → The dollar finished 2022 much higher than it started, due to the increased pace of policy tightening, stronger relative growth, and safe-haven flows. Late last year and into early this year, the dollar experienced some weakness though as investors anticipated the end of Fed tightening.
- → Overall, the US dollar depreciated in March and finished the quarter slightly lower than where it started as weaker economic data and bank turmoil drove interest rates lower in the US.
- → This year, the track of inflation across economies and the corresponding monetary policies will likely be key drivers of currency moves.

[1] Source: Bloomberg. Data as of March 31, 2023.

Summary

Key Trends:

→ The impacts of record high inflation will remain key, with market volatility likely to stay high.

→ Recent issues related to the banking sector have created a delicate balance for central banks to continue to fight inflation but also try to maintain financial stability.

→ Global monetary policies could diverge in 2023 with the Fed pausing and others continuing to tighten. The risk of policy errors remains elevated given persistent inflation pressures and a strong US labor market.

→ Growth is expected to slow globally this year, with many economies forecast to tip into recession. Inflation, monetary policy, and the war will all be key.

→ In the US, the end of many fiscal programs is expected to put the burden of continued growth on consumers. Costs for shelter, medical care, and education could continue to rise, keeping 'sticky price' inflation at elevated levels.

→ The key for US equities going forward will be whether earnings can remain resilient if growth continues to slow.

→ Outside the US, equity valuations remain lower in both emerging and developed markets, but risks remain, including potential continued strength in the US dollar, higher inflation particularly weighing on Europe, and China's rushed exit from COVID-19 restrictions and on-going weakness in the real estate sector.

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Ares Pathfinder Fund II: Asset-Focused Investing

Presentation to San Joaquin County Employees' Retirement Association

May 5, 2023

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These materials also contain information about Ares and certain of its personnel and affiliates whose portfolios are managed by Ares or its affiliates. This information has been supplied by Ares to provide prospective investors with information as to its general portfolio management experience. Information of a particular fund or investment strategy is not and should not be interpreted as a guaranty of future performance. Moreover, no assurance can be given that unrealized, targeted or projected valuations or returns will be achieved. Future results are subject to any number of risks and factors, many of which are beyond the control of Ares. In addition, an investment in one Ares Fund will be discrete from an investment in any other Ares Fund and will not be an investment in Ares Corp. As such, neither the realized returns nor the unrealized values attributable to one Ares Fund are directly applicable to an investment in any other Ares Fund. An investment in an Ares Fund (other than in publicly traded securities) is illiquid and its value is volatile and can suffer from adverse or unexpected market moves or other adverse events. Funds may engage in speculative investment practices such as leverage, short-selling, arbitrage, hedging, derivatives, and other strategies that may increase investment loss. Investors may suffer the loss of their entire investment. In addition, in light of the various investment strategies of such other investment partnerships, funds and/or pools, it is noted that such other investment programs may have portfolio investments inconsistent with those of the strategy or investment vehicle proposed herein.

This may contain information obtained from third parties, including ratings from credit ratings agencies such as Standard & Poor’s. Reproduction and distribution of third party content in any form is prohibited except with the prior written permission of the related third party. Third party content providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the use of such content. THIRD PARTY CONTENT PROVIDERS GIVE NO EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. THIRD PARTY CONTENT PROVIDERS SHALL NOT BE LIABLE FOR ANY DIRECT, INDIRECT, INCIDENTAL, EXEMPLARY, COMPENSATORY, PUNITIVE, SPECIAL OR CONSEQUENTIAL DAMAGES, COSTS, EXPENSES, LEGAL FEES, OR LOSSES (INCLUDING LOST INCOME OR PROFITS AND OPPORTUNITY COSTS OR LOSSES CAUSED BY NEGLIGENCE) IN CONNECTION WITH ANY USE OF THEIR CONTENT, INCLUDING RATINGS. Credit ratings are statements of opinions and are not statements of fact or recommendations to purchase, hold or sell securities. They do not address the suitability of securities or the suitability of securities for investment purposes, and should not be relied on as investment advice.

REF: TCA-01260

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Today's Presenters

Ankur Patel, CFA
Partner, Alternative Credit Group
Based in Atlanta

Mr. Patel is a Partner in the Ares Credit Group, where he focuses on alternative credit investments. Additionally, he serves as a member of the Ares Credit Group's Pathfinder Core Investment Committee. Prior to joining Ares in 2019, Mr. Patel was a Director at Fortress Investment Group in the Credit Group, where he focused on making opportunistic investments in direct lending, structured equity, and structured finance across a broad range of industries including financial services, retail, real estate, media and entertainment and energy. Previously, Mr. Patel was a Vice President in SunTrust Robinson Humphrey's Financial Services Investment Banking Group, where he focused on mergers and acquisitions, leveraged finance and equity capital markets transactions in the specialty finance, insurance, asset management and banking sub-sectors. In addition, Mr. Patel was a Vice President in SunTrust Robinson Humphrey's Structured Products Group, where he structured and executed a broad range of traditional and esoteric asset backed security transactions. Mr. Patel held prior positions with MassMutual Life Insurance Company's Financial Products Division and Barings' Structured Credit Group. Mr. Patel holds a B.B.A. from the University of Pennsylvania, and an M.B.A. from the University of Virginia's Darden School of Business. He is a CFA® charterholder.

Juliette Schainuck, CFA
Principal, Relationship Management
Based in Los Angeles

Ms. Schainuck is a Principal in the Ares Global Client Solutions Group, where she focuses on institutional client management in North America. Prior to joining Ares in 2020, Ms. Schainuck was a Vice President and Investment Counselor at Citi Private Bank, where she advised clients on investment solutions across asset classes. Ms. Schainuck holds a B.S.B.A., magna cum laude, from the University of Denver in Finance. Ms. Schainuck is a CFA® charterholder.

ARES

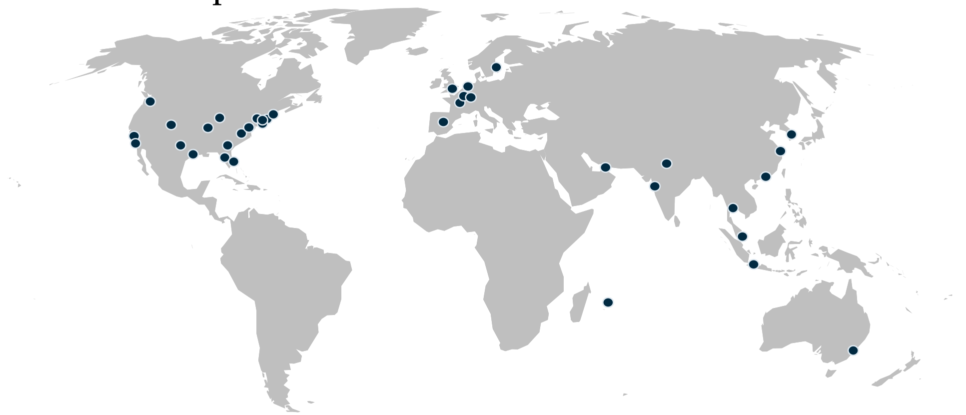
Ares Management

With approximately $352 billion in assets under management, Ares Management Corporation is a global alternative investment manager operating an integrated platform across five business groups

Profile

Founded	1997
AUM	$352bn
Employees	~2,565
Investment Professionals	~900
Global Offices	30+
Direct Institutional Relationships	~1,940
Listing: NYSE – Market Capitalization	$24.3bn[1]

Global Footprint[2]



The Ares Differentiators

Power of a broad and scaled platform enhancing investment capabilities

Deep management team with integrated and collaborative approach

20+ year track record of compelling risk adjusted returns through market cycles

Pioneer and a leader in leveraged finance, private credit and secondaries

	Credit	Private Equity	Real Assets	Secondaries	Strategic Initiatives
AUM	$214.2bn	$34.7bn	$66.1bn	$22.0bn	$15.0bn
Strategies	Direct Lending	Corporate Private Equity	Real Estate Equity	Private Equity Secondaries	Ares Asia
	Liquid Credit	Special Opportunities	Real Estate Debt	Credit Secondaries	Ares Insurance Solutions[3]
	Alternative Credit		Infrastructure Opportunities	Real Estate Secondaries	Ares Acquisition Corporation
			Infrastructure Debt	Infrastructure Secondaries	

Note: As of December 31, 2022. AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and registered investment adviser. Past performance is not indicative of future results.

1. As of March 30, 2023.
2. Jakarta and New Delhi offices are operated by third parties with whom Ares SSG maintains an ongoing relationship relating to the sourcing, acquisition and/or management of investments.
3. AUM managed by Ares Insurance Solutions excludes assets which are sub-advised by other Ares' investment groups or invested in Ares funds and investment vehicles.

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Pathfinder Strategy

- $5 billion target fund seeking to deliver 11-15%+ net returns with a 1.50-1.75x net MOIC including a 5% annual yield[1]
- Pathfinder II will seek to construct a diversified portfolio of ~30 to 50 investments (with significant underlying diversity), with ~2-3% average position sizes
- Investing with purpose: At least 10% of Pathfinder II's carried interest will be donated to support global health and education initiatives

What We Do

We target investments in **large, diversified portfolios of assets** that generate **contractual cash flows**. We invest in assets that have **historically demonstrated stable performance**.

Type of Assets

Loans / Leases | Receivables | Royalties / Fees

Format of Investments

Lending	Asset Acquisitions	Liquids
Lend against assets	Acquire asset pools	Buy Alt Credit Securities

For illustrative purposes only. Past performance is not indicative of future results. Diversification does not assure profit or protect against market losses.

1. Targeted returns are shown for illustrative purposes only and there can be no assurance that such targets can be achieved. Actual results may be materially different. No guarantee target fundraise can be achieved.

ARES

Why Alternative Credit?

1. **Resiliency through Cycles**
2. **Enhanced Yield**
3. **Relative Value Orientation**
4. **Diversification**
5. **Power of the Platform**

The Romans Figured This Out a Long Time Ago: Success is More Likely When Combat isn't One-on-One

Single-Name investment risk

Asset-Focused investment risk

We believe that investments in diversified asset portfolios can provide greater downside protection and greater visibility into outcomes than single-name risks whose outcomes can be more binary

For illustrative purposes only. Diversification does not assure profit or protect against market loss. References to "downside protection" or similar language are not guarantees against loss of investment capital or value.

ARES

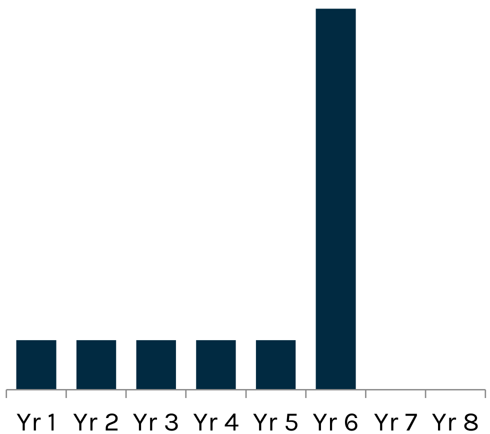
Comparing Investment Cash Flow Profiles

» The typical Alternative Credit investment has a cash flow profile that is very different

Private Equity

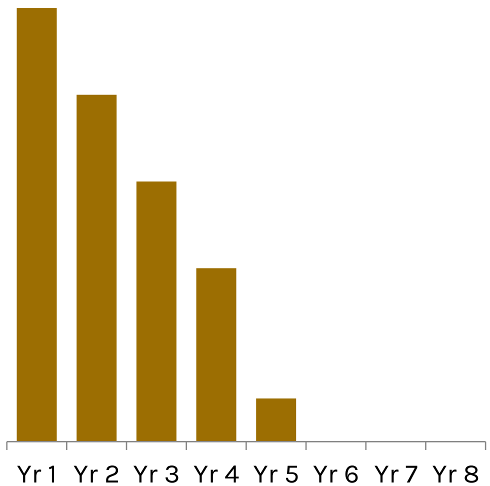
Typically receives little to no cash flow until a realization event (e.g., the sale or IPO of the company).

Corporate Debt



Typically receives only interest coupons until a realization event (e.g., the refinancing of the debt or sale of the company).

Alternative Credit



Typically sees a high volume of front-loaded cash flows from the underlying assets. It does not generally rely on a realization event.

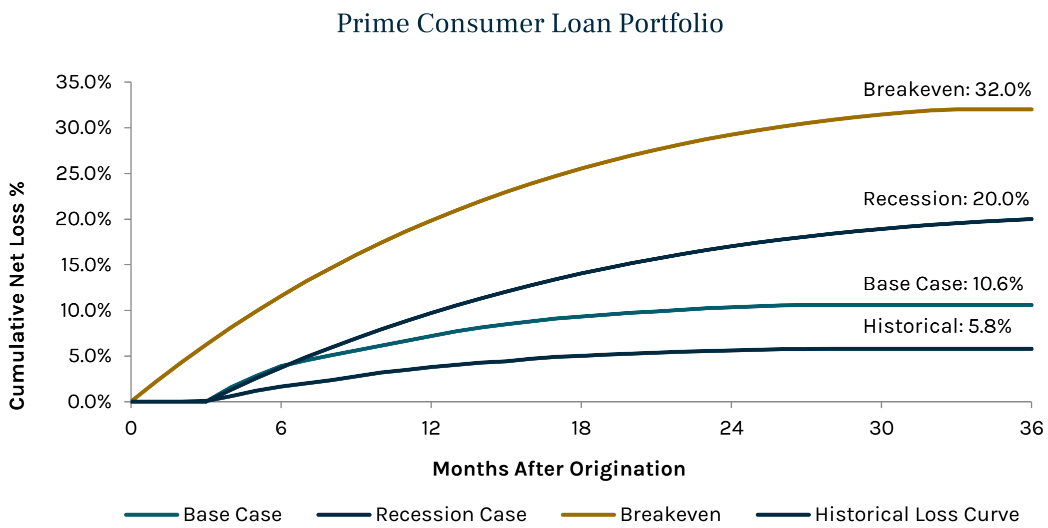
Typical cash flows are presented for illustrative purposes only. Actual cash flows may vary materially from those presented above.

We Design a "Margin of Safety" for Stressful Times

Focused on assets that generate resilient cash flows.

Designed to withstand an economic downturn.

Designed with structural features to ensure a full recovery.



Historical Loss Curve:
The historical level of losses in the underlying asset portfolio

Base Case:
Investment team's conservative estimate of future losses within the asset portfolio (typically based on the counterparty's worst vintage)

Recession Case:
Indicates the level of historic losses based on peak defaults during the last recession, which serves as a proxy for future recessionary environments

Breakeven Case:
The level of losses in the underlying asset portfolio that would be required to cause a $1 loss on our investment. Ares typically designs our investments of this type to withstand at least 200% of Base Case and at least 150%+ of Recessionary loss rates

For illustrative purposes only. There is no guarantee base case will be achieved. Results shown are not representative of Pathfinder's track record. Note: Great Financial Crisis is defined as the period just prior to and following the credit market dislocation of 2008. Modeled losses are exclusively for informational and discussion purposes only. Modeled results have inherent limitations, and actual results will differ significantly from the illustrative loss curves presented herein. In modeling the losses shown herein, Ares used publicly available data as well as assumptions that it believes are reasonable. Loss assumptions shown herein are meant to be purely illustrative and do not represent actual losses. The use of different assumptions could also produce materially different results. References to "downside protection" or similar language are not guarantees against loss of investment capital or value.

Ares Alternative Credit Capabilities

Ares is a leader in the Alternative Credit markets

60 investment professionals (one of the market's largest dedicated teams)[1]	**0.8bps** realized annualized loss rate across Alt Credit[3]
~21yrs of experience (on average) across the team's 31 senior investment professionals[1]	**~$22.8bn** in AUM across diverse Alt Credit mandates[4]
~$10.2bn deployed in last twelve months[2]	**~$31.0bn** deployed in Alt Credit since inception

Past performance is not indicative of future results.

1. As of April 2023.
2. As of December 31, 2022.
3. As of September 30, 2022. With respect to Ares' track record since inception in 2011, please review in conjunction with the Pro Forma Performance Notes.
4. As of December 31, 2022. AUM reflects USD amount. Includes ~$21.1bn invested across dedicated funds and ~$1.7bn invested across other strategies.

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Pathfinder Fund Portfolio Overview

~$3.9bn deployed to date[1]	~$3.4bn unrealized commitments to date[1]	~$1.2bn realized proceeds[2]

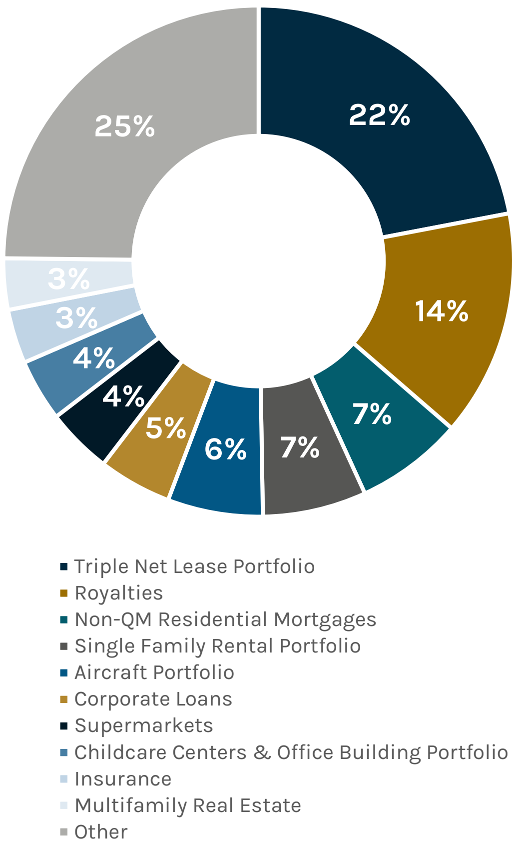
40 unrealized portfolio investments to date	43 total investments to date

As of December 2022 unless otherwise noted and subject to change at any time. Unaudited figures presented herein. Figures presented in USD. Past performance is not indicative of future results. EUR denominated assets converted using a 1.07 EUR/USD exchange rate. SEK denominated assets converted using a 0.10 SEK/USD exchange rate. GBP denominated assets converted using a 1.21 GBP/USD exchange rate. AUD denominated assets converted using a 0.68 AUD/USD exchange rate.

1. As of December 2022. Reflects capital committed to investments.
2. As of December 31, 2022. Includes realized and unrealized investments.

Look-through Diversification

» Each Pathfinder investment is collateralized by a highly granular, diversified asset pool representing tens of thousands of underlying obligors



Highlights from 15 Select Investments[1]

168,039 shipping containers
46,252 auto loans, 5,417 leases, 243 CRE mortgages and 2,603 agricultural loans[1]
38,419 recurring revenue home security contracts
14,225 stabilized single family rental homes and associated leases
4,272 distinct securities and loans backing 155,610 underlying policies
2,614 active small business receivables
2,103 Swedish rental apartments and 347 commercial spaces[2]
1,019 distinct corporate credit issuers via CLO Equity Sub-Portfolio[2]
545 childcare centers and three office building NNN leases
497 U.K. grocery stores
277 office, industrial and retail properties and related NNN leases to 34 primarily IG-rated tenants
253 retail automotive NNN leases
209 distinct corporate issuers via CBO Equity Sub-Portfolio[3]
105 cases across 4 categories of defendants[1]
55 related licenses and royalty streams associated with 11 consumer brands

As of December 31, 2022, unless otherwise noted. For illustrative purposes only. Unaudited, estimated figures presented herein.
Diversification does not assure profit or protect against market losses.

1. Reflects 9 unique CLO Equity investments and 4 CBO Equity investments as two investment line items.
2. As of September 30, 2022.

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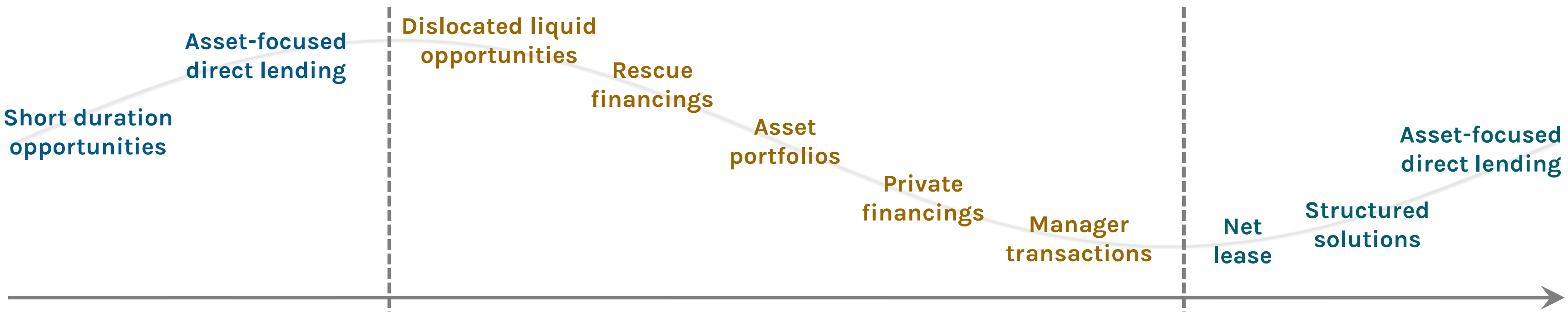
Tactical Approach with Respect to Markets, Relative Value with Respect to Assets

Investment Strategy Is Focused on Downside Protection…

- Performing assets that generate durable (e.g., contractual) cash flows
- Private opportunities where Ares can tailor risk and structure to drive performance
- Sectors that have historically demonstrated stable performance, including under stress
- Sectors where Ares can contribute proprietary insight and specialized resources (*"Power of the Platform"*)

… While Capturing Upside Optionality across Market Environments



End of Growth	Economic Cycle/Market Disruption		Start of Growth
Senior, Secured & Defensive	Liquid Markets	Dislocated Markets	Strategic Capital
Limited Correlation	Orphaned Assets	Tactical Playbook	Private Lending

Note: There is no guarantee that target results will be achieved. References to "downside protection" or similar language are not guarantees against loss of investment capital or value.

ARES

Pathfinder Sector Spotlight

	Market Opportunity	Scaled Capital Need	Recent Examples
FinCo Loans	• Dislocation/disruption of flow buyer capital and securitization markets • Credit tightening and improved underwriting criteria	• Flexible capital secured by loan portfolios or ABS residuals • Financing of non-core assets • Strategic capital for established finance companies	• $250mm strategic investment in finance company secured by consumer loan portfolio and ABS assets
Rescue Financing	• U.S. mortgage originators looking for alternative to repo/bank line • Financing or buying trapped assets (residuals)	• Flexible, scaled capital for balance sheet stabilization and offensive capital	• Rescue financing to a credit hedge fund with repo problems ($340mm) • Asset portfolio loan to a mortgage REIT to go on offense ($400mm)
Residential Mortgages	• Dislocation/disruption of securitization markets • New origination, high coupon, strong credit	• Continued purchase, financing and securitization of residential whole loans	• Purchase of non-QM whole loans from originators and banks • 730+ FICO, 72.9% LTV, 7.3%+ WAC
Asset Portfolios	• Drivers: liquidity and capital constraints of pension, insurance and banks	• Sale or financing of existing portfolios on balance sheets	• Quickly developing opportunities as market remains in price discovery mode

Based on the Ares Alternative Credit Team's market observations as of April 2023.

Summary of Key Terms

Investment Objective	The Fund will seek to generate current income and realize long-term capital appreciation through a flexible capital strategy in asset-focused investment opportunities. The Fund's strategy emphasizes downside protection[1] and capital preservation through a focus on predominantly directly originated opportunities spanning a broad spectrum of sectors that are often overlooked or misunderstood.
Target Fund Size[2]	$5 billion
Target Net Returns[3]	11 – 15%+, 1.50-1.75x MOIC
GP Commitment	Lesser of (a) 2.0% of aggregate commitments and (b) $100 million
Minimum Commitment	$10 million, subject to the GP's discretion
Investment Period[4]	Three years from the final closing date Each LP may elect to extend for additional successive two-year periods
Term[4]	Eight years from the first capital call subject to up to two consecutive one-year extensions, the first at the GP's discretion and thereafter with the approval of the advisory board or a majority of LP interest If an extension referred to above in Investment Period occurs, the Term will be extended to address investments acquired in the extended periods
Distributions[2]	Quarterly, targeting 5% per annum, at the GP's discretion
Management Fee	1.25% per annum on invested capital *(large ticket discounts available)*
Carried Interest[4,5]	20% subject to a 6% preferred return
GP / LP Catch Up	85% / 15%

The information presented herein is subject to change. The above briefly summarizes certain material indicative terms and conditions and does not contain all terms and conditions that will be included in any definitive documentation for the proposed transaction. The above summary does not constitute a commitment, a contract to provide a commitment, or an offer to make a commitment to Ares on these or any other terms. No legally binding terms shall be created until definitive documentation is executed and delivered.
1. References to "downside protection" or similar language are not guarantees against loss of investment capital or value.
2. No guarantee target fundraise or distributions will be achieved.
3. Adjusted for fees, expenses, and default expectations. There can be no assurance that the target return will be achieved. MOIC reflects the multiple of invested capital over the investment horizon.
4. The investment program may continue by creation of additional series of partnership interests. In general: each additional series will have a two-year investment period following the investment period of the prior series; each LP will have an initial option to participate in additional series; and electing LPs will have options related to each series following the initial additional series. Carried interest will be calculated separately for each series. Please refer to the PPM and definitive documentation for additional information.
5. Ares will not receive any carried interest until the limited partners have first received cumulative distributions equal to the aggregate amount of their capital contributions, plus a 6% return on these contributions.

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Ares Pathfinder Fund Team

🟡 Charity Working Group
🔵 ESG Steering Committee
🟢 ESG Champion

» 60 Alt Credit specialists in collaboration with ~900 investment professionals across Credit, Real Estate, Private Equity, Secondary Solutions and Strategic Initiatives

Investment Committee Members

Keith Ashton 🟡🔵 Partner, Co-Head of Alternative Credit *(24 years)*	**Joel Holsinger** 🟡🔵 Partner, Co-Head of Alternative Credit *(26 years)*	**Jeffrey Kramer** 🔵 Partner, Head of ABS *(36 years)*
Michael Arougheti Co-Founder, CEO, President of Ares *(30 years)*	**Kipp deVeer** Senior Partner Head of Ares Credit Group *(27 years)*	**Mitch Goldstein** Partner Co-Head of Credit *(28 years)*
Kevin Alexander Partner *(26 years)*	**Craig Cortright** Partner *(22 years)*	

Operations & Quantitative Analytics

Jason Cohen Partner, Chief Operating Officer *(22 years)*	**Dongning Luo** Vice President *(11 years)*	**Shashwat Singh** Vice President *(13 years)*
Hank Tai Vice President *(8 years)*	**Juna Iafelice** Senior Associate *(7 years)*	**Nate Kim** Senior Associate *(5 years)*
Julia Lin Senior Associate *(6 years)*	**Raghav Chawla** Associate *(4 years)*	

Product Management & Investor Relations

Sonya Lee 🟡🔵 Partner *(21 years)*	**Lauren Thomas** 🟡 Principal *(12 years)*	**Brenda Barnum** 🟢 Vice President *(8 years)*
David Walla 🟢 Vice President *(9 years)*	**Ejona Murataj** Senior Associate *(5 years)*	**Hunter Westerberg** Associate *(4 years)*
	Elley Song Analyst *(2 years)*	

Investment & Asset Management Team

Eli Appelbaum Partner *(17 years)*	**Charles Arduini** Partner *(22 years)*	**David Ells** Partner *(30 years)*	**Ankur Patel** 🟡🟢 Partner *(20 years)*	**Scott Rosen** Partner *(22 years)*
Vincent Salerno 🟢 Partner *(25 years)*	**Ian Smith** Partner, Trader *(21 years)*	**Michael Flynn** Managing Director *(26 years)*	**Benjamin Fox** Managing Director *(22 years)*	**Andie Goh** Managing Director *(11 years)*
Jeffrey Hughes Managing Director *(29 years)*	**Joshua Mason** Managing Director *(26 years)*	**Sara McGinty** Managing Director *(23 years)*	**Kristofer Pritchett** 🟡 Managing Director, Trader *(15 years)*	**Alex Smit** 🟢 Managing Director *(11 years)*
Joel Tomlinson Managing Director *(24 years)*	**Lisa Trolson** 🟢 Managing Director *(26 years)*	**Benjamin Tyszka** 🟢 Managing Director *(22 years)*	**Felix Zhang** Managing Director *(12 years)*	**Austin DeLana** Principal *(12 years)*
Stephen Gardner Principal *(13 years)*	**Peter Keane** Principal *(20 years)*	**Elizabeth Legunn** Principal *(9 years)*	**Cathy Lu** Principal *(10 years)*	**Greg Spilberg** Principal *(23 years)*
Cheng Zeng Principal *(16 years)*	**Bharat Chandrasekaran** Vice President *(12 years)*	**Linyi Chen** Vice President *(10 years)*	**Greg Eacho** Vice President *(9 years)*	**Ari Feldman** Vice President *(9 years)*
Zach Green Vice President *(7 years)*	**Ludo Hashemi** 🟢 Vice President *(8 years)*	**Haakim Nainar** 🟡 Vice President *(9 years)*	**Eric Tang** Vice President *(8 years)*	**Patrick Yu** 🟡🟢 Vice President *(7 years)*
Marta Aguiar Senior Associate *(9 years)*	**Aaron Chan** Senior Associate *(7 years)*	**Jacky Jiang** Senior Associate *(5 years)*	**Allen Lo** Senior Associate *(5 years)*	**Maksym Petrus** Senior Associate *(7 years)*
Carlos Rosario Senior Associate *(6 years)*	**Sameer Abbasi** Associate *(4 years)*	**Noah Gelman** Associate *(3 years)*	**Yanying Hao** Associate *(3 years)*	**Olivia Johnson** Associate *(3 years)*
Finian McAfee Associate *(5 years)*	**Jason Zhang** Associate *(4 years)*	**Payal Chowbey** Analyst *(1 year)*		

+ 370 Additional Strategy & Distribution professionals

+ 265 Direct Lending professionals	**+ 45** Liquid Credit professionals	**+ 95** Private Equity professionals	**+ 290** Real Assets professionals	**+ 65** Secondary Solutions professionals	**+ 70** Strategic Initiatives professionals

As of April 2023 unless otherwise noted. Please refer to Endnotes for additional important information. Years referenced represents number of years of relevant experience.

Appendix

Pathfinder's Relative Value Lens Today

Subject to change based on market conditions, relative value and investment opportunities

In Focus

- FinCo Loans
- Rescue Financing
- Asset Portfolios
- Residential Mortgages

Monitoring

- Auto Portfolios
- CLO Securities
- GP Financing Solutions
- Fund Finance (RE, PE)
- Insurance Related Assets
- Lease Portfolios
- Legal Assets
- Liquid FinCo Loans/Bonds
- Media/Sports Assets
- Real Estate Debt Securities
- Royalties
- Secondaries Portfolios
- Single Family Rental
- Triple Net Lease
- Consumer Lending
- REIT Financing

Not in Focus

- NPL/RPL
- Small Business Lending
- Renewables
- Timeshares
- Aviation (almost never)
- Venture Debt (almost never)
- Cryptocurrency (never)
- Life Settlements (never)
- Patent Litigation (never)
- Shipping (never)

For illustrative purposes only.
Based on the Ares Alternative Credit Team's market observations as of April 2023. There is no guarantee that assets will perform or opportunities will be identified as described.

ARES

Investing With Purpose

Since inception, our charitable pledge has accrued ~$9-10 million of donations based on performance to date[1]

OUR PURPOSE

- Ares is committed to investing in health and education to help save lives and drive equality
- Pathfinder's dual purpose:
  - Seek attractive risk-adjusted returns for our investors in a differentiated strategy
  - Drive real impact in health and education

OUR MOTIVATION

- Over 700 million people live in extreme poverty[2] and half of the world's population struggles to access essential health and education resources[3]
- Health charities have the tools to end senseless deaths and improve life for millions, but lack the resources

OUR ACTION

- **Ares, Pathfinder and Pathfinder Core's Portfolio Managers will together donate at least 10% and 5% of the fund's carried interest, respectively**
- Ares will partner with non-profit organizations that have a track record of delivering what we believe to be the most value per charitable dollar contributed

Charity Spotlights to Date[4]

As Ares explores potential charitable partners with a track record of delivering value per charitable dollar contributed, we have highlighted the following non-profit organizations in Ares events and/or our Alternative Credit Newsletter, *In the Gaps*

Pratham
amref health africa
GiveWell REAL CHANGE FOR YOUR DOLLAR
malaria consortium disease control, better health
PATH
Khan Academy
CHILDLIFE FOUNDATION
New Incentives
The Citizens Foundation

1. As of December 31, 2022. Projected donations may vary from the range included above and will be contingent on achieving investment returns exceeding stated performance hurdles and earning carried interest. Includes over $1 million of donations accrued from realized investments.
2. Source: World Bank – Poverty metrics as of 2015.
3. Source: World Health Organization, December 2017.
4. Note Ares is not endorsing the non-profit organization. Nor does this indicate whether Ares has donated to the highlighted charity at the time of this publication.

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Endnotes to Ares Pathfinder Fund II Team Slide

Additional professionals figures: As of December 31, 2022. Employee numbers are rounded down to the nearest 0/5. As such, numbers may not foot due to rounding. Additional Strategy & Distribution professionals figure is inclusive of Relationship Management, Strategy, Investor Relations, and Wealth Management Solutions.

Mssrs. Ashton, Holsinger and Kramer serve on Ares' Alternative Credit Executive Committee.

In addition to responsibilities on the Alternative Credit team, Mr. Rosen is a Partner focusing on U.S. Direct Lending.

In addition to responsibilities on the Alternative Credit team, Mr. Smith serves as a Portfolio Manager of U.S. Liquid Credit.

In addition to responsibilities on the Alternative Credit team, Mssrs, Fox, Tomlinson, and DeLana focus on net lease and related investments that also span the Ares Real Estate Group.

In addition to responsibilities on the Alternative Credit team, Mr. Hughes serves as a Portfolio Manager of U.S. Direct Lending.

Pro Forma Performance Notes to Alt Credit Track Record Slides

- **Past performance is not indicative of future results**. Please see the below performance disclosures for important information about the results shown herein. The investments reflected herein are intended to be illustrative, and are not intended to be used as an indication of current or future performance of any Ares strategy or investment. Further, reference to these particular investments is not necessarily indicative that any Ares fund or strategy will offer or hold any or all of the investments. The opportunity to invest in future Ares funds, strategies or investments on an ongoing basis is not guaranteed, and will be made by means of definitive offering memoranda, which will be furnished to qualified investors at their request.
- The Total Alternative Credit track record shown includes the following:
  - all CLO investments in commingled funds and separately managed accounts executed by investment professionals within Ares Credit Group for the period January 1, 2012 to September 30, 2022;
  - all FINCO debt investments in Ares Capital Corporation executed by investment professionals within Ares Credit Group for the period from January 1, 2012 to September 30, 2022;
  - all directly-originated Alternative Credit investments in commingled funds and separately managed accounts executed by investment professionals within Ares Credit Group;
  - all rated private ABS investments in commingled funds and separately managed accounts executed by investment professionals within Ares Credit Group;
  - all REDS investments in commingled funds and separately managed accounts executed by investment professionals within Ares Credit Group for the period January 1, 2018 to September 30, 2022; and
  - all K-Series investments in separately managed accounts executed by investment professionals within Ares Real Estate Group.
- The pro forma performance results shown have been compiled by Ares from actual realized and unrealized investments that were not collectively part of an actual portfolio. However, these results are based on a grouping of assets that are representative of the strategy that Pathfinder intends to follow. Pro forma results are hypothetical and have inherent limitations, and no representation is being made that any account will or is likely to achieve results similar to those shown. Had a fund focused on the assets represented by this performance actually existed, Ares may not have made the same investment decisions. Given Ares did not offer an investment vehicle that held all of the assets included in the pro forma track record, an investor was not able to invest in these assets as presented. There are factors related to the markets in general, or to the implementation of any specific portfolio strategy, which cannot be fully accounted for in the preparation of pro forma portfolio performance, all of which can adversely affect actual portfolio results. Returns of unrealized investments herein are based in part on unrealized valuations and the actual realized returns of such unrealized investments may differ materially from the returns indicated herein. The performance information summarized herein has not been audited. Past performance is not indicative of future results. No individual investor has received the investment performance indicated by the pro forma returns presented herein. Certain assumptions, not all of which are described herein, have been made to calculate pro forma returns and the use of different assumptions could produce materially different results. Assumptions are based upon what Ares believes represents a reasonable fee analysis. Fees and expenses for Ares Pathfinder Fund II may be materially different than the fee and expense assumptions provided herein.

  a. Represents total net losses on all realized investments divided by total invested capital.

ARES

ARES

2023 CONFERENCES AND EVENTS SCHEDULE

2023 EVENT DATES		EVENT TITLE	EVENT SPONSOR	LOCATION	REG. FEE	WEBLINK FOR MORE INFO	EST. BOARD EDUCATION HOURS
May 5	May 5	Trustee Roundtable	CALAPRS	Online webinar	$50	calaprs.org	4
May 9	May 12	SACRS Spring Conference	SACRS	San Diego, CA	$120	sacrs.org	10-12
May 21	May 24	Annual Conference & Exhibition	NCPERS	New Orleans	$900	ncpers.org	12
May 26	May 26	Attorneys Round Table	CALAPRS	Online webinar	$50	calaprs.org	4
Jun 19	Jun 20	Chief Offiers Summit	NCPERS	Denver, CO	$750	NCPERS.org	TBD
Jun 23	Jun 23	Administrators' Round Table	CALAPRS	Online webinar	$50	calaprs.org	4
Jul 16	Jul 19	SACRS/UC Berkeley Program	SACRS	Berkeley, CA	$2500	sacrs.org	24
Aug 28	Aug 31	Principles of Pension Governance for Trustees	CALAPRS	Malibu, CA	TBD	calaprs.org	*9
Sep 12	Sep 14	IREI Editorial Advisory Board Meeting	IREI	Santa Monica, CA	$0	IREI.com	TBD
Sep 27	Sep 29	Administrators' Institutue 2023	CALAPRS	Carmel-by-the-Sea	TBD	calaprs.org	*14.4
Oct 27	Oct 27	Trustee Roundtable	CALAPRS	Online webinar	$50	calaprs.org	4
Nov 7	Nov 10	SACRS Fall Conference	SACRS	Rancho Mirage, CA	$120	sacrs.org	*11

** Estimates based on prior agendas*

SAN JOAQUIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

SUMMARY OF PENDING TRUSTEE AND EXECUTIVE STAFF TRAVEL

2023 Event Dates	Sponsor / Event Description	Location	Traveler(s)	Estimated Cost	BOR Approval Date
May 9-12	SACRS Spring Conference	San Diego	JC Weydert, Phonxay Keokham, Jennifer Goodman, Chanda Bassett, Ray McCray, Johanna Shick, Paris Ba, Jason Morrish	$13,600	N/A
Jul 16-19	SACRS UC Berkeley Program	Berkeley, CA	Brian McKelvey, JC Weydert, Emily Nicholas	$12,600	N/A
Sep 12-14	IREI Editorial Advisory Board Meeting	Santa Monica	JC Weydert	$2,725.89	Pending

SAN JOAQUIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

SUMMARY OF COMPLETED TRUSTEE AND EXECUTIVE STAFF TRAVEL

Event Dates 2023	Sponsor / Event Description	Location	Traveler(s)	Estimated Cost	Actual Cost	Event Report Filed
Jan 17-20	IREI 2023 Visions, insights & Perspectives America	Rancho Palos Verdes, CA	Michael Restuccia	$1,250.00	$1,736.78	2/10/2023
Feb 7	2023 Employee Benefits Update	Webinar	Johanna Shick	$0	$0	N/A
Feb 11	CALAPRS Administrators' Round Table	Online	Johanna Shick	$50.00	$50.00	N/A
Mar 4-7	CALAPRS General Assembly	Monterey	Johanna Shick, JC Weydert	$2,857	$2,788.65	N/A
Mar 29-31	Advanced Principles of Pension Governance for Trustees	Los Angeles	Steve Moore	$4,150	$3,707.19	N/A
Apr 17-19	Pension Bridge Annual Conference	San Francisco	Ray McCray, Paris Ba	$2,360	Pending	Due 5/5/2023

Board Member	Travel (not including SACRS & CALAPRS)	Dates	Amount used of $2500:	Balance Left of $2500
RESTUCCIA	IREI	1/2023	$1,736.00	$764
BASSETT				
DING				
DUFFY				
GOODMAN				
KEOKHAM				
MCCRAY	Pension Bridge Annual Conference	4/2023		
NICHOLAS				
WEYDERT				
MOORE				

San Joaquin County Employees' Retirement Association

May 5th, 2023

TO: Board of Retirement

FROM: Paris Ba, Retirement Investment Officer

SUBJECT: Pension Bridge Annual Conference

Thank you for the opportunity to attend the Pension Bridge Annual Conference on April 17-19, 2023. The topics covered are summarized below.

Fireside chat with Virginia CIO
The Virginia Retirement System (~$110 billion AUM defined benefit plan) is cash flow negative by about 2% every year, so they are very careful with cash management. Currently they have a cash allocation of 2%. They are looking to add FI exposure given where rates are. They are also waiting for more dislocation in the private credit market before jumping in.

Asset Allocation: Is 50/50 (private assets/public assets) the smarter 60/40?
Panelists were more focused on income producing instruments than growth seeking assets at this moment, as they are not very sanguine on financial assets returns for the next five years. Private assets are a good place to be, as there are regular distributions from private equity managers. Cash is also becoming an attractive “asset class”.

Private Credit
Private Credit was definitely the hot topic of the year, as there were four sessions on private credit on the Pension Bridge agenda.
Private credit has over $250 billion dry powder waiting to be deployed, so their pricing power is likely to increase. Private credit’s loss ratios compare favorably to public markets - their loss ratio is either on par or better than high yield fixed income and leveraged loans due to better covenant structures. At the same time, private credit returns tends to be higher than public markets as well.
Blackrock thinks that macro risks skewed to the downside, so they are seeing a larger role for private assets. The US is in the fastest rate hiking cycle since the 1980s, and they don’t see near-term cuts likely, even though the market is pricing in some easing by the end of the year. A tight labor market is keeping services inflation elevated, which will force Fed’s hand in terms of rate cuts.

Going forward, corporations will have to refinance their debt at a higher rate, some companies will survive and some might not, which creates opportunities especially in the distressed markets.
Given the higher interest rate environment, first lien positions are likely to fare a bit better within the capital structure.
When things are going fine, managers can collect nice cash flows; however, when something bad happens, managers will need to have the experience to work out a new capital structure - whether it's restructuring the debt, or contributing more equity, or obtaining a waiver, etc. - that's where managers' experience makes a difference. The key is to have direct access to the lenders and keep the dialogue open.

Real Estate
In the real estate market, a lot of the “hot” areas in the US are already turning over (i.e., Southern California, Austin TX or Phoenix AZ etc.), given the higher mortgage rates. Supply is also down significantly, along with demand. Class A buildings are okay thus far, it is the Class B and Class C buildings that are experiencing difficulties, especially in office space. One panelist is seeing mezzanine debt to be the best asset within the Real Estate markets.

Emerging Markets (EM)
Emerging markets is becoming more complicated, not only because the Russian/ Ukrainian war, but also the trade war with China. However, given the current economic environment, EM has more experience dealing with high and sustained inflation, and many of them are in the later stage of rate hiking cycles (the Brazilian central bank could be the first central bank to cut rates among all the central banks). Panelists top pick in EM is Vietnam, given the supply chain shift away from China and to Vietnam. Over the last decade, China has been under-investing in human capital but over-investing in physical capital. China is a big part of EM, and panelists didn't see a lot of requests from clients to invest in EM ex. China though.

Energy Transition
In Europe, they are very serious about “Net Zero,” whereas it's not a big focus in the US yet. The Inflation Reduction Act (IRA) has been a positive catalyst for the energy sector - 25% of projects that had not been profitable before the IRA passed, are now being developed because of the subsidies.

Fixed Income
Meketa was the moderator for the Fixed Income discussion, and they are seeing clients starting to ask for allocations in the non-core fixed income segment, as well as moving to shorter duration instruments.

One panelist is actively investing in short term commercial papers where he gets to re-invest the cash flow on a weekly basis, so that strategy has done well given how much the Fed has raised rates.
Two other panelists prefer high yield fixed income, because high yield defaults have been low - only 1.5% default rates over the last five years. However, timing-wise, right now might not be the best time to go all in, as volatility is high, but fundamentals have been incredibly strong. Plus the liquidity of high yield fixed income has also improved significantly since the global financial crisis.

Hedge Funds

Hedge fund strategies tend to be more complex than other strategies, so they require more monitoring. San Francisco Employees Retirement System (~$33 billion AUM) has about 10% exposure to absolute return, where they see hedge fund as more of a strategy rather than an asset class.

Economy

2022 was a turning point. There are opportunities around, but investors need to focus on the long term and have a contrarian mind-set sometimes. High inflation is destroying consumers' purchasing power all over the world. The traditional 60/40 portfolio had the second-worst year over the last three decades. Valuation spreads are wider than any time in the last 90 years, representing long-term opportunities. One of the presenters, Orbis Investments, (they are active equity managers so take it with a grain of salt) claims that the past 10 years were great for markets but tough for stock pickers; the next 10 years may be tough for markets but great for stock pickers.

Private Equity

Companies that rely heavily on cheap financing are falling out of favor, given the higher rate environment. Growing and stable earnings are important for the next couple of years.

ESG

Investors have a fiduciary duty to provide investment returns, so ESG returns have always been a concern for investors. Panelists don't see ESG as a separate strategy, rather it permeates through all asset classes, from equity to fixed income to private equity. There is still a lot of debate and polarization among different states.

Risk-Mitigating Strategies

With the risk of a recession in 2023 continuing to loom over major economies, creating a risk mitigation portfolio continues to be a popular discussion. Risk mitigation strategies could be expensive when the market is doing well, but the payoff could be significant during a significant market drawdown. The ultimate goal is to stay liquid when a "black swan" event happens.

Equity Market

Technology and healthcare have been a big driver for returns for the last few years. Central banks' activities have also been a big force, but that might change for the next few years. Going forward, that's going to be a big change in paradigm in the macroeconomic environment, so you cannot just focus on the companies that you cover, you have to understand central bank activities. The equity market is also the place you see the most "home country bias" among different assets. (Home country bias refers to the tendency of equity investors to favor investing in domestic stocks over investing in the stock of foreign companies).

2023 LEGISLATION

Last Updated: 4/24/2022

BILL NO.	AUTHOR	DESCRIPTION	LAST ACTION DATE	LOC	SPONSOR
Legislation Impacting SJCERA:					
AB 557	Hart	This bill would extend the expiration date of the state of emergency provisions from January 1, 2024 to January 1, 2026 and make additional non-substantive changes to the Ralph M. Brown Act.	04/27/23	Assembly L. Gov. Comm.	
AB 739	Lackey	This bill would revise the conditions for suspending contributions to a public defined benefit plan from a threshold of more than 120 percent fund to more than 130 percent funded.	03/13/23	Assembly P.E. & R. Comm. Hearing canceled req. of author	
AB 817	Pacheco/ Wilson	This bill would authorize use of teleconferencing provisions similar to the emergency provisions indefinitely if the legislative body annually approves the provisions.	04/25/23	Assembly L. Gov. Comm. Hearing postponed by committee	
AB 1020	Grayson	This bill would expand the scope of Safety member heart presumption (which applies to members with five or more years of service) to include hernia and pneumonia. It also expands other Safety member presumptions to include post-traumatic stress disorder, tuberculosis and meningitis.	04/20/23	Senate Rls. Comm.	

BILL NO.	AUTHOR	DESCRIPTION	LAST ACTION DATE	LOC	SPONSOR
AB 1379	Papan	**This bill would (1) require a Board electing to use teleconferencing to post agendas at a singular designated location rather than at all teleconference locations; (2) allow a quorum to be established based on all participating trustees (whether remote or at the designated physical location), and remove the requirement that a quorum of the members participate from locations within the board's jurisdictional boundaries; (3)require the Board have at least two meetings per year in which the Board's members are in person at a singular designated location; (4) delete requirements to identify each teleconference location in the agenda and that each location be accessibe to the public; (5) delete restrictions limiting remote participation to a certain number, percentage of meetings or number of consecutive sessions per calendar year; (6)delete requirements to provide at least one of two specified means by which the public may remotely hear and visually observe the meeting; and (7) delete requirements that members participating remotely disclose whether individuals 18 years of age or older are present in the room with them and the general nature of their relationship; (8) expand the definition of just cause to include travel related to a member of a board's occupation; (9) make these provisions operative indefinitely.**	04/24/23	Assembly L. Gov. Comm. Hearing canceled request of author	
AB 1637	Irwin	This bill, no later than January 1, 202~~5~~**6**, would require a local agency's website and emails to utilize a ".gov" top-level domain or a "ca.gov" second level domain.	04/27/23	Assembly P. & C.P. Comm. Read second time and amended	
SB 411	Portantino/ Menjivar/ Luz Rivas	This bill would authorize a board to use alternate teleconferencing provisions similar to the emergency provisions indefinitely and without regard to a state of emergency.	04/26/23	Senate Jud. Comm. Hearing set for May 2	
SB 537	Becker	This bill would 1) authorize a board to use alternate teleconferencing provisions similar to the emergency provisions indefinitely and without regard to a state of emergency, 2) require Boards to provide attendance on the website within seven days after the teleconferencing meeting, and 3) expand circumstances of "just cause" to include having specified relatives who are immunocompromised.	04/26/23	Senate Jud. Comm. Hearing set for May 2	
SB 769	Gonzalez	Existing law imposes ethics training and sexual harassment prevention training and education to be two hours and requires each training every two years. This bill would add two hours of fiscal and financial training every two years **and exempt training requirements for the County Treasurer if they comply with existing continuing education requirements.**	04/25/23	Senate Appr. Comm. Hearing set for May 1	

BILL NO.	AUTHOR	DESCRIPTION	LAST ACTION DATE	LOC	SPONSOR
Other Bills of Interest:					
AB 1246	Nguyen	This bill would extend the ability of a PERL retiree who elected one of the specified optional benefit settlements to change their beneficiary to include naming a new spouse following the retiree's divorce and subsequent remarriage.	04/26/23	Assembly Appr. Comm. Hearing postponed by committee	
SJR 1	Cortese	This measure would request the U.S. Congress to enact, and the President to sign, legislation that would repeal the Government Pension Offset and the Windfall Elimination Provision from the Social Security Act.	04/26/23	Assembly P.E. & R. Comm. Third reading	
Federal Legislation:					
None to report.					

2023 TENTATIVE State Legislative Calendar

Mar 30 - Apr 9	Spring Recess begins upon adjournment
Jun 2	Last day for bills to be passed out of the house of origin
Jun 15	Budget Bill must be passed by midnight
Jul 14 - Aug 13	Summer Recess upon adjournment provided budget bill passed
Sep 8	Last day to amend bills on the floor
Sep 14	Last day for each house to pass bills; Interim Study Recess begins upon adjournment
Oct 14	**Last day for Governor to sign or veto bills.**

San Joaquin County Employees' Retirement Association

April 28, 2023

TO: Board of Retirement

FROM: Johanna Shick
Chief Executive Officer

SUBJECT: Chief Executive Officer Report

Strengthen the long-term financial health of the Retirement Plan

Review and confirm or refresh asset allocation

- *Initiate implementation of new asset allocation policy*
  In accordance with SJCERA's pacing plan for the Private Credit asset class, Ares Pathfinder, a Private Credit manager that focuses on asset-based direct lending, will present at the May Board meeting.

Determine the future vision for the investment program operating model

- *Evaluate SJCERA's policy on liquidity/cash, and refresh as appropriate*
  On April 27, Investment Officer Paris Ba and Parametric successfully implemented the Board's decision to change the Cash Overlay's allocation to 100% bonds with a duration target of three-years.

Optimize the investment manager lineup

- *Conduct Global Equity and Crisis Risk Offset asset class reviews, assessing managers'/mandates' alignment with our Strategic Asset Allocation policy and goals*
  - *Emerging Market Research/Education*: As part of the Global Equity asset class review goal, Investment Officer Paris Ba attended AQR's webinar, "Re-Emerging Equities" and included their white paper on the topic in your reading materials. AQR finds that the expected premium for investing in Emerging Market (EM) versus the Developed Market is on the upper end of its 25-year average. At the same time, many risks historically associated with EM have declined. Fundamentals have improved broadly in the EM: Over the last 20 years, per capita GDP in EM has roughly doubled as a share of developed markets. AQR argues investors who are underweight EM should get back to a more neutral weight. It appears that AQR is not the only one thinking about Emerging Market opportunities. You may have seen a recent media report that Alameda County Employees' Retirement Association (ACERA) plans to issue a request for proposal (RFP) for active emerging markets managers this quarter with the goal of completing their search by first quarter 2024.

Modernize the operations infrastructure

Implement Pension Administration System (PAS)

- *Deliver project milestones as scheduled on PAS project plan*
  The first two phases, Project Initiation, and Infrastructure and Hosting Setup were completed on-time. Phase 3, Implementation, began in early March, and the project team continues moving forward as scheduled with requirement confirmation meetings regarding Member Demographics, Employer Reporting and Benefit Calculator, and Service Purchase details.

- *Maintain functionality of legacy PAS until new PAS is implemented and stabilized*
  Retirement Services Officer Melinda DeOliveira, Communications Officer Kendra Fenner, and Information Systems Specialist II Jordan Regevig have been working on updating system-generated correspondence within our existing system CORE-37. The *Beneficiary Designation* form was most recently updated to include a section detailing the member's marital status.

Improve technology for business operations

- *Adopt industry standard business processes wherever possible*
  - *Plan transition from Mac to Windows*: As part of SJCERA's continuing adoption of Microsoft Windows and related technology, the IT Team rolled out Microsoft Teams on April 19. Microsoft Teams has numerous communication and collaboration functions for immediate communication, file sharing, and video conferencing.

Align resources and organizational capabilities

Enhance education and development across all levels of the organization

- *Offer training and development opportunities intended to strengthen staff's depth and breadth of knowledge and experience*
  - *Staff Education*: Investment Accountant Eve Cavender and Financial Officer Carmen Murillo attended the CALAPRS Accountant's Roundtable; Communications Officer Kendra Fenner attended the CALAPRS Communications Roundtable and the NCPERS Communications Roundtable; Retirement Investment Officer Paris Ba attended the NCPERS 2023 Proxy Voting Season: Key Proxy Votes for Pensions to Watch webinar; Information Systems Manager Adnan Khan attended the CALAPRS IT Roundtable.

Employee of the Month

Congratulations to SJCERA's two Employees of the Month: Information Systems Manager Adnan Khan and Retirement Technician Leonor Sonley. Adnan is recognized for finding and fixing the root cause of an issue with a member's 1099-R. Adnan traced the issue back to a system-related data integrity issue which allowed staff to delete previous payment records. Thanks to Adnan's thoroughness and attention to detail, the integrity of historical payment data is now secure and appropriate controls are in place. IMPRESSIVE work! Leonor is recognized for her willingness to go above and beyond in her duties. She recently took on the responsibility of generating estimates while a co-worker was out, that was great by itself; however, she exceeded expectations by thoroughly documenting the process complete with screen shots so the process will be easy to follow for those coming behind her. Leonor is laying the groundwork for SJCERA to have a robust library of well documented processes. EXTRAORDINARY work!

Maintain Business Operations

Monitor Portfolio: Blackrock Direct Lending Update. Investment Officer Paris Ba and Investment Consultant David Sancewich held an update call with Blackrock Direct Lending in April. SJCERA committed $100 million to Blackrock Direct Lending in 2020 as part of the Private Credit allocation. A 2019 vintage year fund, it is relatively fully invested right now, and currently yielding 11-12%. Their investment focus is on industries with light capital expenditure, minimizing the fixed cost components on the balance sheet. The fund is very well diversified, with average size position of 1-1.5% of the portfolio.

Cost of Living Adjustment (COLA)

Members who are retired on April 1 are eligible to receive the Board-approved Cost of Living Adjustment (COLA), if any. This year's 3% COLA was applied on schedule to the monthly benefit issued on May 1.

General Counsel Services

In consultation with Nossaman and Deputy County Counsel Jason Morrish, I added a supplement to the Nossaman Engagement Agreement for the provision of General Counsel services following Jason's departure. His last day in the office is expected to be May 19, at which point Nossaman will begin providing General Counsel services on an interim basis while SJCERA assesses how best to staff this legal function. I also notified Interim County Counsel Kimberly Johnson of SJCERA's plans. In brief, SJCERA will continue to use County Counsel for Domestic Relations Orders and Public Records Requests; all other General Counsel services will be directed to Nossaman during this interim period. Ashley Dunning, SJCERA's current Fiduciary Counsel, will be our primary contact, and Yuliya Oryol, one of SJCERA's Investment Counsel, will serve in that role if Ashley is unavailable.

Provide Excellent Customer Service

A few quotes from our members:

Retirement Services Associate Andrea Bonilla is “[a]lways professional and quick to respond”

Retirement Services Associate “Ron [Banez] has been awesome in handling my retirement application, and my buy back with Contra Costa County a few years back. He’s very knowledgeable which makes it easy to trust him.”

Recognizing Service:

On May 12, Information Systems Specialist II Jordan Regevig will mark her 15-year anniversary with SJCERA (and with the County) and on May 14, Information Systems Manager Adnan Khan will mark his five-year anniversary with SJCERA (17 years total County Service). Congratulations Jordan and Adnan!

Maintain a Positive Work Environment

On Wednesday, April 12, Staff celebrated “Grilled Cheese Day” a national favorite, and a new favorite of staff! The smell of tomato soup, toasted bread with butter, and cheese filled the office space for a fun and filling “holiday”. Thanks to Administrative Secretary Elaina Petersen, Communications Officer Kendra Fenner, and Retirement Services Associate Ron Banez for coordinating and executing this lactose-full (and scrumptious) event!

April 28 is National Superhero Day, a day on which we honor our real or fictional superheroes. When I think of all the ways that SJCERA’s staff goes the extra mile to help members, mentor each other, improve funding, improve efficiency, and help SJCERA make sound decisions, I’d say our organization is chock full of dedicated superheroes! Interestingly, May 1-5 is Public Service Appreciation week—maybe it’s not a coincidence that it is so close to Superhero Day! Other upcoming events include the County’s Star Wars Day on May 4 (“May the ‘fourth’ be with you), and a Cinco de Mayo potluck on May 5.

Conclusion

It’s been only two weeks since our last Board meeting, but even in that short span of time, there was plenty to report. So, in conclusion, here’s to the everyday superheroes among us—our members (including SJCERA staff) and our Trustees, who strive every day to serve the greater good and make life better for the residents of San Joaquin County every day. Many thanks to our staff and Trustees for your MARVEL-ous work making SJCERA a trusted partner in providing members a secure retirement benefit. Thank you: Trustees Mike Restuccia, Michael Duffy, Phonxay Keokham, Emily Nicholas, Jennifer Goodman, Steve Ding, Chanda Bassett, JC Weydert, Steve Moore, Ray McCray, and Staff Brian McKelvey, Paris Ba, Greg Frank, Kendra Fenner, Elaina Petersen, Melinda DeOliveira, Ron Banez, Andrea Bonilla, Bethany Vavzincak, Vickie Monegas, Leonor Sonley, Margarita Arce, Kathleen Goodwin, Carmen Murillo, Eve Cavender, Marissa Smith, Adnan Khan, Lolo Garza, and Jordan Regevig—You’re all heroes in my book!

Heroes are ordinary people who make themselves extraordinary. ~ Gerard Way

It’s not who I am underneath, but what I do that defines me. ~ Batman

Heroes are made by the path they choose, not the powers they are graced with. ~ Ironman

A hero is an ordinary individual who finds strength to persevere and endure in spite of overwhelming obstacles ~ Superman

You’re going to make a difference. A lot of times it won’t be huge, it won’t be visible even. But it will matter just the same. ~ James Gordon, Police Commissioner of Gotham City

A hero is someone who, in spite of weakness, doubt or not always knowing the answers goes ahead and overcomes anyway ~ Christopher Reeve

Act as if what you do makes a difference. It does. ~William James

Subject: Financial Literacy Month
Date: Monday, April 17, 2023 at 8:55:44 AM Pacific Daylight Time
From: ISD Service Desk [ISD]
To: ISD Service Desk [ISD]
Attachments: image001.png

Sent on behalf of Johanna Shick, Chief Executive Officer, SJCERA:
(Sent to all County Employees)

April is Financial Literacy Month, and a good time to get educated about your retirement savings.

Most employees of SJCERA's 10 participating employers contribute to the SJCERA pension plan and have access to employer-sponsored deferred compensation plans. This means that, for most of you, your retirement income derives from three sources: your SJCERA retirement benefit, Social Security, and the savings and investments you've made in your Deferred Compensation plan (such as the County's 457 plan, or any personal savings you might have.)

The average SJCERA monthly benefit is about $3,400, and the average monthly Social Security benefit is about $1,500. But what matters is how much will your benefits be? To boost your financial literacy, explore the following resources:

- Attend the Understanding your Retirement seminar on May 4 or read the Retirement Plan Summary fact sheet
- Estimate your SJCERA retirement benefit using the Benefit Calculator
- Check your eligibility for Social Security benefits
- Estimate your Social Security Benefit
- Use the Retirement Planning tools on the Nationwide website to estimate how much money you will need in retirement and how long your savings will last, or to determine if you can afford to contribute more. Nationwide is the County's administrator of the deferred compensation plan, visit their web site at sanjoaquindc.com.

Thank you,

Subject: Understanding Your Retirement - The time to plan for retirement is now!
Date: Tuesday, April 11, 2023 at 9:15:09 AM Pacific Daylight Time
From: ISD Service Desk [ISD]
To: ISD Service Desk [ISD]
Attachments: image001.png

Sent on behalf of Johanna Shick, Chief Executive Officer, SJCERA:
(Sent to all County Employees)
Understanding Your Retirement - The time to plan for retirement is now!
MAY 4, 2023 – 3:00 PM
Sign up for this 60-minute virtual seminar to learn more about your SJCERA retirement benefit. You are eligible to attend if you are a full-time civil service employee of one of SJCERA's participating employers. You will learn what it means to be vested, how your benefit is calculated, how to purchase service credit and much more.
Click here to register **Active Members - Seminars page**
You will receive the Zoom link via email immediately after you complete your registration. The seminar can be accessed via zoom on your computer or mobile device. Save the email with the Zoom link to access the seminar.

Thank you,

Board of Retirement Meeting
San Joaquin County Employees' Retirement Association

Agenda Item 10.0

May 5, 2023

SUBJECT: SACRS Voting Proxy Form

SUBMITTED FOR: ___ CONSENT __X_ ACTION ___ INFORMATION

RECOMMENDATION

Staff recommends the Board approve the attached amendments to the SJCERA's current list of SACRS Voting Delegates.

PURPOSE

To provide SACRS with a complete list of voting delegates who are authorized to vote on behalf of SJCERA.

DISCUSSION

SJCERA's list of voting delegates, as reflected on the attached SACRS Voting Proxy forms, remains in effect unless changed by the Board.

Due to variable attendance and availability, staff proposes including all Board members and executive staff on proxy form in order to improve efficiency and ensure at least one voting delegate is able to vote at the business meeting at each conference.

At the Friday, May 12, 2023, SACRS Business Meeting, Trustee Jennifer Goodman is available and willing to vote on SJCERA's behalf and Retirement Investment Officer Paris Ba, will serve as back-up. By including all trustees and executive staff, the proposed proxy form will allow them to vote.

The proposed voting proxy form is attached for the Board's consideration.

ATTACHMENT

SACRS Voting Proxy Form
Proposed SACRS Voting Proxy Form

J Shick
Johanna Shick
Chief Executive Officer

Elaina Petersen
Elaina Petersen
Administrative Secretary

SACRS VOTING PROXY FORM

The following are authorized by the San Joaquin County Retirement Board to vote on behalf of the County Retirement System at the upcoming SACRS Conference

(if you have more than one alternate, please attach the list of alternates in priority order):

Chair – Michael Restuccia	Voting Delegate
Vice Chair – Michael Duffy	Alternate Voting Delegate
Secretary – Raymond McCray	Second Alternate Voting Delegate
CEO – Johanna Shick	Third Alternate Voting Delegate
Ex-Officio – Phonxay Keokham	Fourth Alternate Voting Delegate.
Trustee – James Weydert	Fifth Alternate Voting Delegate
ACEO – Brian McKelvey	Sixth Alternate Voting Delegate

These delegates were approved by the Retirement Board on 05/06/2022.

This Voting Proxy supersedes that approved by the Retirement Board on 09/10/2021 and is to remain in effect until superseded or revoked.

The person authorized to fill out this form on behalf of the Retirement Board:

Signature: JShick

Print Name: Johanna Shick

Position: Clerk of the Board

Date: May 6, 2022

Please send your system's voting proxy by October 15, 2021 to Sulema H. Peterson, SACRS Administrator at Sulema@sacrs.org.

SACRS VOTING PROXY FORM

The following are authorized by the San Joaquin County Retirement Board to vote on behalf of the County Retirement System at the upcoming SACRS Conference
(if you have more than one alternate, please attach the list of alternates in priority order):

Chair – Michael Restuccia	Voting Delegate
Vice Chair – Michael Duffy	Alternate Voting Delegate
Secretary – Raymond McCray	Second Alternate Voting Delegate
CEO – Johanna Shick	Third Alternate Voting Delegate
Ex-Officio – Phonxay Keokham	Fourth Alternate Voting Delegate
Trustee – Emily Nicholas	Fifth Alternate Voting Delegate
Trustee – Jennifer Goodman	Sixth Alternate Voting Delegate
Trustee – Steve Ding	Seventh Alternate Voting Delegate
Trustee – Chanda Bassett	Eighth Alternate Voting Delegate
Trustee – James Weydert	Ninth Alternate Voting Delegate
Trustee – Steve Moore	Tenth Alternate Voting Delegate
ACEO – Brian McKelvey	Eleventh Alternate Voting Delegate
RIO – Paris Ba	Twelfth Alternate Voting Delegate

These delegates were approved by the Retirement Board on 05/05/2023.

This Voting Proxy supersedes that approved by the Retirement Board on 05/06/2022 and is to remain in effect until superseded or revoked.

The person authorized to fill out this form on behalf of the Retirement Board:

Signature: ______________________________

Print Name: Johanna Shick

Position: Clerk of the Board

Date: May 5, 2023

Please send your system's voting proxy by May 5, 2023 to Sulema H. Peterson, SACRS Administrator at Sulema@sacrs.org.

March 2023

Re-Emerging Equities

Executive Summary

- The expected premium for investing in emerging versus developed equity markets is on the upper end of its past 25-year range.
- At the same time, many of the risks historically associated with emerging markets have secularly declined.
- We believe there is a strong case for investors to “re-up” their emerging allocations to either a neutral or bullish positioning.

Michele Aghassi
Principal

Dan Villalon
Principal

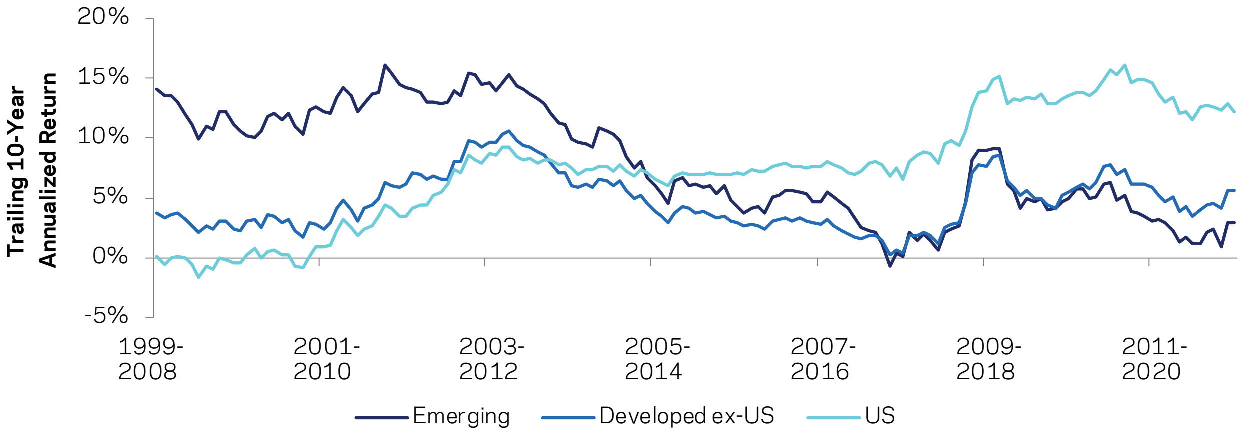
We would like to thank Ariel Altaras, Chris Doheny, Jonathan Fader, Charles Fattouche, Ron Gray, Pete Hecht, Kevin Infante, Greg Keenan, Mirella Lang, Joey Lee, Thom Maloney, Nikhil Reddy and Ekin Zorer for helpful comments.

Contents

Introduction

Investors *should* expect to receive a premium for investing in emerging versus developed markets. And indeed, there was one in the first decade of the 2000s, as emerging markets delivered meaningfully higher returns than their developed counterparts (see **Exhibit 1**). However, more recently the story has flipped, as developed markets have outperformed, with the US leading the pack.[1]

Exhibit 1: The US Hasn't Always Been the Outperformer
January 31, 1999 - December 31, 2022



Source: MSCI, AQR. "Emerging" is the MSCI Emerging Net Total Return USD Index, "Developed ex-US" is the MSCI Daily TR Net World Ex USA USD, and "US" is the MSCI USA Net Total Return USD Index.

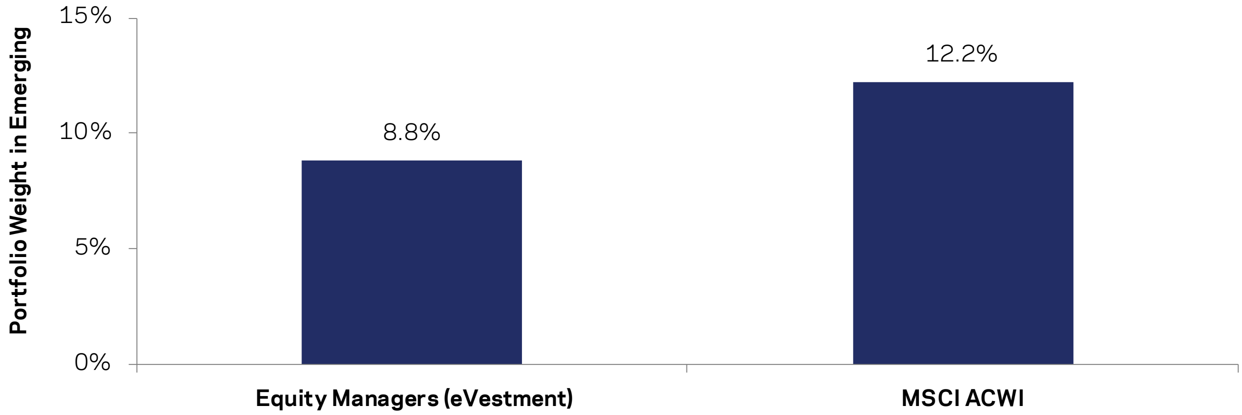
This has led to at least two outcomes for investor portfolios. The first is mechanical: as US markets have grown faster, they have also become a larger component of the global stock market, making global equity portfolios less diversified than they previously were. The second outcome is more discretionary: many investors, due to years of relative disappointment in emerging equities, have actively chosen to shift their equity allocations away from emerging markets and toward developed ones.

This second effect can be seen among active managers. For example, of all equity funds listed in the eVestment database, the aggregate allocation to emerging markets is 8.8% of total holdings—meaningfully lower than the market cap weight of 12.2% (**Exhibit 2**).[2]

1 Though for reasons that aren't as "fundamental" as commonly believed. Rather, US outperformance has largely been a repricing phenomenon (i.e., changes in valuations), and thus unlikely to be much of a guide for *expected* returns (if anything, we believe it suggests US returns are likely to be lower than Emerging over the next 5-10 years).

2 Asset allocators may also have de-allocated to emerging markets over the past decade indirectly via their shift from public equities to privates. Given many private investments tend to be US- or developed-focused, even investors who have shifted 1-1 from their global public equity allocation toward privates would likely have decreased their underlying emerging equities exposure.

Exhibit 2: Many Active Managers Are Underweight Emerging Markets
As of December 31, 2022



Source: MSCI, eVestment. As of September 30, 2022 due to data availability (though estimates as of December 31, 2022 are very similar). "Equity Managers (eVestment)" is the AUM-weighted average weight in emerging market securities of all equity managers in eVestment. "MSCI ACWI" is the MSCI All Country World Index. For illustrative purposes only.

In this paper, we argue that investors who are underweight emerging markets should get back to a more neutral weight—and that investors who are already near market-cap weights might well consider a modest increase to emerging markets.

A 5-10 Year Tailwind for Emerging Markets

Forecasting returns is a notoriously fraught exercise, but it's not futile. We find that yield-based methods have some ability to predict 5-10 year returns,[3] and such methods are currently pricing in an advantage for emerging markets on the upper end of the last 25 years' range.

Exhibit 3 shows this expected annualized "emerging premium" from the point of view of a currency-hedged investor, but we note this advantage is similar for unhedged, USD-denominated investors (which we expect many readers to be[4]).

3 See, for example, Ilmanen (2022).
4 These numbers from the perspective of unhedged investors with different base currencies are available upon request.

Exhibit 3: The Expected Premium for Emerging over Developed Is Generationally Wide

January 31, 1996 - December 31, 2022, latest observation is dashed

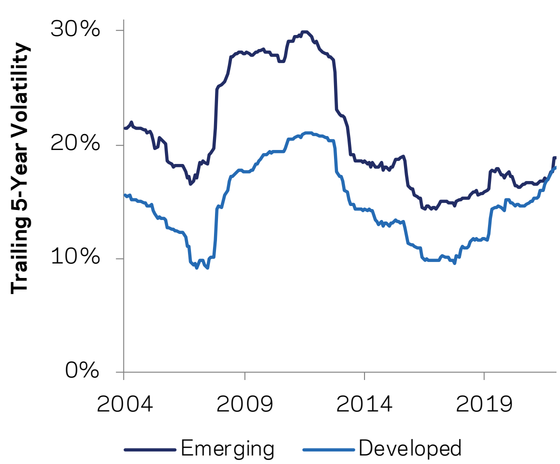
Source: AQR. See AQR's Capital Market Assumptions for full details. The chart above is from the perspective of a currency-hedged investor; the results are similar (in fact, slightly more attractive compared to history) for an unhedged USD investor (chart available upon request). "Expected" or "Target" returns or characteristics refer to expectations based on the application of mathematical principles to portfolio attributes and/or historical data, and do not represent a guarantee. These statements are based on certain assumptions and analyses made by AQR in light of its experience and perception of historical trends, current conditions, expected future developments and other factors it believes are appropriate in the circumstances, many of which are detailed herein. Changes in the assumptions may have a material impact on the information presented.

Of course, one reason investors would demand a premium for one investment over another is risk. Emerging markets historically have been riskier than developed markets, but that difference has come down over the past decade—both in terms of standalone index volatility (**Exhibit 4**, left side) and in terms of correlations (right side). This evolution suggests that from the standpoint of portfolio risk, the case for emerging markets potentially has even increased over the past decade compared to history.

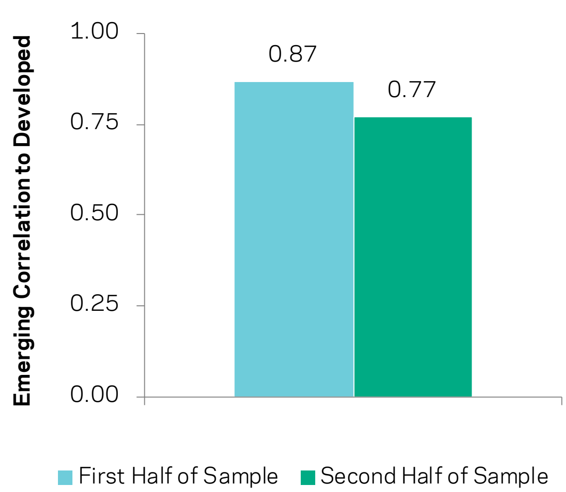
Exhibit 4: Emerging Risks Aren't What They Used to Be

January 1, 1999 - December 12, 2022

Volatility has come in line with Developed...



...And returns have become more diversifying



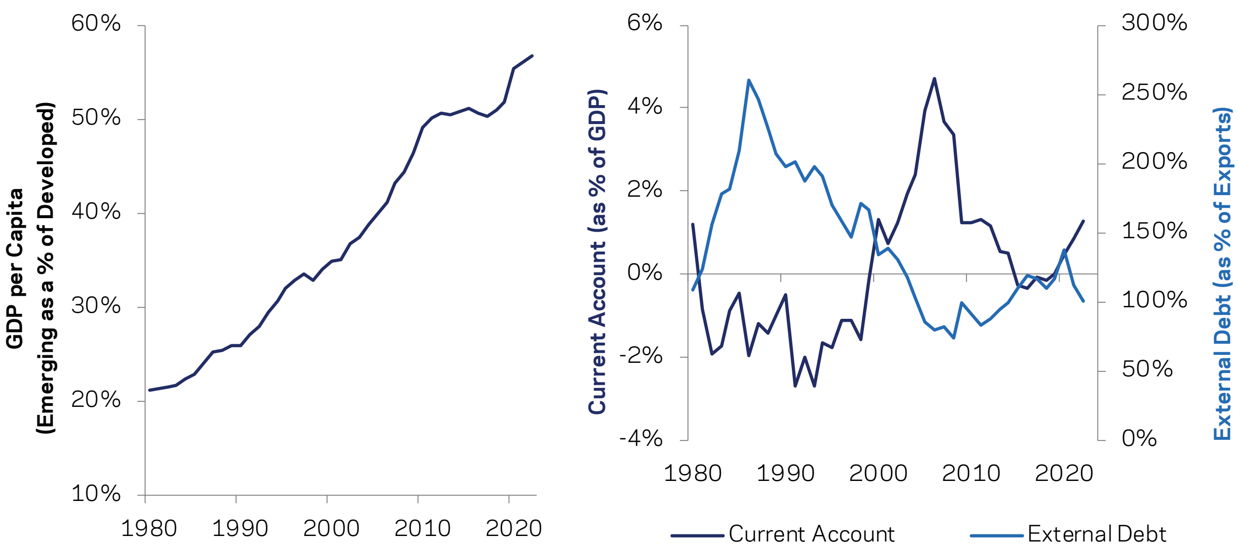
Source: MSCI, AQR. "Emerging" is the MSCI Emerging Net Total Return USD Index, "Developed" is the MSCI World USD Index. "First half of sample" is January 1, 1999 – January 31, 2011; "Second half of sample" is February 1, 2011 – December 31, 2022 (results are robust to other dates near the ones shown above.

China goes a long way in explaining both the drop in volatility and correlation, having become the single-largest component of emerging indices—it is now at roughly a 30% weight of the MSCI Emerging Index, up from under a 7% weight 20 years ago. Volatility of the Chinese market has fallen by nearly 50% since the Global Financial Crisis (GFC), and China has historically been more diversifying of developed markets than other major emerging markets (e.g., Korea, Taiwan, India), for a variety of reasons including government intervention.

However, lower risk in emerging markets isn't just a China story. Fundamentals have also improved more broadly. Over the past 20 years, per capita GDP in emerging markets has roughly doubled as a share of developed markets (**Exhibit 5**, left side). Measures of external vulnerabilities have also improved from their periods of peak fragility in the 1980s and 1990s. Current account balances in emerging markets are now positive in aggregate, and measures of external debt sustainability (e.g., external debt as a percentage of exports) look much healthier (**Exhibit 5**, right side).

Bottom line: there are many reasons to believe that the relatively attractive valuations found in emerging markets represent a 5-10 year opportunity. In other words, the current expected premium is likely due to these markets being relatively underpriced, as opposed to representing compensation for assuming meaningfully greater portfolio risk.

Exhibit 5: Fundamentals across Emerging Markets Are Broadly Improving



Sources: IMF, AQR, Bloomberg. Left chart is gross domestic product based on purchasing power parity. Emerging markets are represented as the average of China, Brazil, India, South Korea and Taiwan. Developed markets are the average of the US, Japan, France, Germany, and the UK. In the chart on the right, Current Account is shown as a percentage of GDP, and External Debt is shown as a percentage of exports.

Questions about China

China is the single largest market in the MSCI Emerging Index (by a factor of two), and as such has an outsized effect on performance, although far less than the United States' weight and effect on developed markets indices. Two of the biggest narratives surrounding the competitiveness of the Chinese market are fundamentals and market access.

1. **Fundamentals:** Chinese equities have been plagued by multiple fundamental concerns through 2022. The government's push to more heavily regulate certain Chinese companies that challenge Communist Party ideals and the government's attempt to dampen speculation and leverage in the real estate market have weighed on key segments of the Chinese equity market. However, these negative fundamental trends may already be priced in, with MSCI China close to 50% lower as of year-end 2022 than the highs of early 2021.[5] In addition, China's move away from "Covid Zero" may help ease some growth concerns that propelled Chinese stocks lower in 2022.

2. **Market access:** Both Chinese and US governments have taken action hindering access to some segments of the Chinese equity market. China has discouraged offshore listings by Chinese technology firms. The US has moved to tighten auditing standards for Chinese firms and has also restricted US investors from buying stocks with ties to the Chinese military. This action and rhetoric has softened somewhat since mid-2022.

Geopolitically, the potential for conflict with Taiwan is an issue, but one that we believe shouldn't discourage investors from allocating to emerging markets. The extreme scenario of an outright invasion of Taiwan (which we believe is quite unlikely) would be disruptive not just for the countries involved and their neighbors, but also for the broader global economy. Market pain would likely be fairly widespread, hurting the global semiconductor supply chain as well as prominent US companies with significant manufacturing in China. Additionally, from a risk management perspective, as was the case in Russia's invasion of Ukraine, there would likely be a noteworthy military buildup prior to any invasion, giving investors a chance to adapt to the increased risks. Absent an outright conflict, rising tensions could still catalyze trade restrictions. However, whether such developments prove real or rhetorical will determine the impact on markets.

Active or Passive?

Beyond the 5-10-year case for greater exposure to emerging equities, today presents a tactical opportunity for active management: the global growth bubble. Over the past five years, the growing dislocation between valuations of cheap and expensive stocks has been featured in many headlines, notably through FAANG stocks. Absent from headlines is the fact that this phenomenon isn't unique to a handful of large US-based technology companies. The gap between cheap and expensive companies has widened within myriad sectors and regions, and notably among companies in emerging markets.

Exhibit 6 quantifies this via the "value spread," which compares the valuations of expensive stocks versus cheap stocks (i.e., growth versus value stocks). When the line rises, growth stocks become more expensive compared to value stocks. Today this spread is near the largest reading ever seen, and one that we believe cannot be justified via fundamentals.[6] We believe this indicates a broad speculative

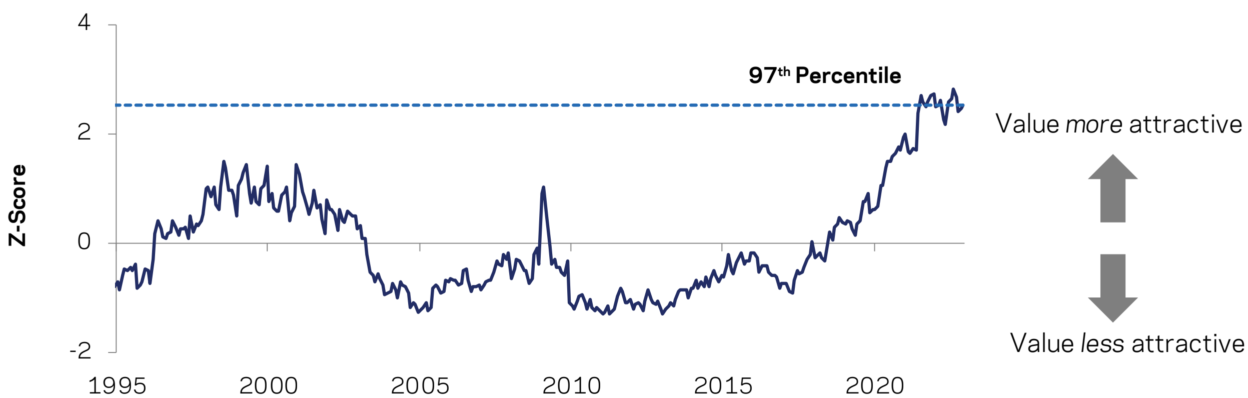
5 The high occurred February 2021. As a point of comparison, the MSCI Emerging Ex China Index has fallen close to 17% over the same period.

6 Two examples: 1) Implied growth rates cannot account for the differences (neither can analyst expectations). In fact, even taking the highest-ever realized growth rate for cheap versus expensive stocks (i.e., including the Tech Bubble) can't come close to justifying current spreads. 2) Interest rate sensitivities—which at least pointed in the right direction—also can't come close to explaining the magnitude of the differences either. For more, see 1Q2023 AQR Whitepaper "Value: Why Now? Capturing the Comeback in Its Early Innings".

bubble that is likely to burst, which is likely to reward value-oriented active management over the next few years.

Translating the value spread into an expected return is not simple, since implementation choices (e.g., which measures of value to use, whether to control for industry and country exposures, etc.) will lead to differences from manager to manager. That said, given the size of the dislocation between cheap and expensive companies in emerging markets today, we expect an allocation to value-based stock selection to earn a meaningfully higher excess return than usual in the coming years—e.g., we expect a 2% tracking error allocation to value-based stock selection to earn a 3-6% excess return over the next 2-3 years.[7]

Exhibit 6: Historic Opportunity for Value Investing in Emerging Markets
Value Spreads in Large Cap Emerging Equities, December 31, 1994 - December 31, 2022



Source: AQR. Spreads are constructed using the Hypothetical Value portfolio as described below, and are adjusted to be dollar-neutral, but not necessarily beta-neutral through time. Hypothetical value composite includes five value measures: book-to-price, earnings-to-price, forecast earnings-to-price, sales-to-enterprise value, and cash flow-to-enterprise value; spreads are measured based on ratios. To construct industry-neutrality, the value spreads are constructed by comparing the aforementioned value measures within each industry, which are then aggregated up to represent an entire portfolio. Hypothetical data has inherent limitations, some of which are disclosed in the Appendix. Please see the Hypothetical AQR Emerging Valuation Model Theme Description in the Appendix. For illustrative purposes only and not representative of an actual portfolio AQR currently manages. Please read the Appendix for important disclosures.

Closing Thoughts

Many investors are likely under-allocated to emerging markets—be it strategically, tactically or even via their investment managers. While these markets have generally underperformed developed ones since the GFC, valuations today suggest a premium to emerging that hasn't been seen in a long time, one that may be especially useful in today's low expected return environment. For investors seeking even more opportunity within emerging markets, "value spreads" suggest a historically attractive opportunity for investors with value-oriented portfolios.

7 Higher levels of value-oriented tracking error implies higher expected excess returns.

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MSCI All Country World Index is an index that captures large and mid cap representation across 23 Developed Markets and 24 Emerging Markets countries. With 2,882 constituents, the index covers approximately 85% of the global investable equity opportunity set.

MSCI World Index is a broad global equity index that represents large and mid-cap equity performance across 23 developed markets countries. It covers approximately 85% of the free float-adjusted market capitalization in each country and does not offer exposure to emerging markets.The MSCI All Country World Index is designed to measure the large and mid cap global equity market performance of 23 developed and 23 emerging countries.

MSCI World Ex USA Index is a market capitalization weighted index designed to provide a broad measure of stock performance throughout the world, with the exception of US- based companies.

MSCI USA Index is designed to measure the performance of the large and mid cap segments of the US market. With 625 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in the US.

MSCI Emerging Markets Index is designed to measure the performance of the large and mid-cap representation across 24 EM countries including Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates, covering about 85% of the free float-adjusted market capitalization in EM.

MSCI Emerging ex China Index is an index that captures large and mid cap representation across 23 of the 24 Emerging Markets (EM) countries excluding China.

MSCI China Index is an index that captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). With 717 constituents, the index covers about 85% of this China equity universe. Currently, the index includes Large Cap A and Mid Cap A shares represented at 20% of their free float adjusted market capitalization.

HYPOTHETICAL PERFORMANCE RESULTS HAVE MANY INHERENT LIMITATIONS, SOME OF WHICH ARE DESCRIBED HEREIN. NO REPRESENTATION IS BEING MADE THAT ANY FUND OR ACCOUNT WILL OR IS LIKELY TO ACHIEVE PROFITS OR LOSSES SIMILAR TO THOSE SHOWN HEREIN. IN FACT, THERE ARE FREQUENTLY SHARP DIFFERENCES BETWEEN HYPOTHETICAL PERFORMANCE RESULTS AND THE ACTUAL RESULTS SUBSEQUENTLY REALIZED BY ANY PARTICULAR TRADING PROGRAM. ONE OF THE LIMITATIONS OF HYPOTHETICAL PERFORMANCE RESULTS IS THAT THEY ARE GENERALLY PREPARED WITH THE BENEFIT OF HINDSIGHT. IN ADDITION, HYPOTHETICAL TRADING DOES NOT INVOLVE FINANCIAL RISK, AND NO HYPOTHETICAL TRADING RECORD CAN COMPLETELY ACCOUNT FOR THE IMPACT OF FINANCIAL RISK IN ACTUAL TRADING. FOR EXAMPLE, THE ABILITY TO WITHSTAND LOSSES OR TO ADHERE TO A PARTICULAR TRADING PROGRAM IN SPITE OF TRADING LOSSES ARE MATERIAL POINTS THAT CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS. THERE ARE NUMEROUS OTHER FACTORS RELATED TO THE MARKETS IN GENERAL OR TO THE IMPLEMENTATION OF ANY SPECIFIC TRADING PROGRAM, WHICH CANNOT BE FULLY ACCOUNTED FOR IN THE PREPARATION OF HYPOTHETICAL PERFORMANCE RESULTS, ALL OF WHICH CAN ADVERSELY AFFECT ACTUAL TRADING RESULTS. The hypothetical performance results contained herein represent the application of the quantitative models as currently in effect on the date first written above, and there can be no assurance that the models will remain the same in the future or that an application of the current models in the future will produce similar results because the relevant market and economic conditions that prevailed during the hypothetical performance period will not necessarily recur. Discounting factors may be applied to reduce suspected anomalies. This backtest's return, for this period, may vary depending on the date it is run. Hypothetical performance results are presented for illustrative purposes only. In addition, our transaction cost assumptions utilized in backtests, where noted, are based on AQR Capital Management LLC's, ("AQR's") historical realized transaction costs and market data. Certain of the assumptions have been made for modeling purposes and are unlikely to be realized. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented. Actual advisory fees for products offering this strategy may vary.

Hypothetical AQR Emerging Markets Valuation Theme Model Description:

The Hypothetical AQR Emerging Value Factor is the factor return of a hypothetical Value portfolio built upon 5 multiples: book-to-price (B/P), trailing-earnings-to-price (E/P), forward-earnings-to-price (FE/P), sales-to-enterprise-value (S/EV) and cash flow-to-enterprise value (CF/EV). Each factor is built to be industry neutral and dollar-neutral by using within-industry value scores. Factor returns are gross of advisory fees and transaction costs. The Valuation Theme is designed to capture the tendency for relatively cheap assets to outperform relatively expensive ones. Emerging data begins October 1994. The investment universe includes a broad subset of liquid tradeable large cap stocks within the emerging market universe (roughly MSCI Emerging Markets). The risk model used is the Barra Global Equity Risk Model (GEM3L_noCurr).

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Pensions&Investments

April 11, 2023

Corporate DB plans still hard to beat, JPMAM's chief of institutional strategy says

Rob Kozlowski

Jared Gross

You're a U.S. corporation, your frozen defined benefit plan is fully funded, and now it's time to get rid of it, right? One expert says perhaps not.

U.S. corporate defined benefit plans are healthier than they've been in decades, and companies should think about keeping them so they can take advantage of surplus assets, said Jared Gross, head of institutional portfolio strategy at J.P. Morgan Asset Management, in an interview on Monday.

The profile of corporate DB plans has diminished significantly over the past several decades, especially following a disastrous first decade of the 21st century that saw returns crash and funding ratios plummet following what Mr. Gross called the "tech wreck" of the early aughts. While the Pension Protection Act of 2006 was meant to remedy funding problems — especially among airline companies — the global financial crisis of 2008 brought funding levels crashing down and motivated companies to get out of the pension business.

Before companies started aggressively derisking their plans by closing and freezing them and oftentimes transferring assets and liabilities to insurance companies, Mr. Gross said pensions were seen "as a largely benign and relatively efficient mechanism."

But after 2008, pensions were seen "as a burden and a risk and a potential time bomb on the balance sheet." That potential was not just rumor and innuendo, he noted, but analysts soon punished companies for low pension funding ratios landing on their balance sheets and rating agencies started to hold microscopes to those funding ratios.

"It's occurred to us that many of the attitudes toward the DB plan were reflecting the 'scar tissue' of this period of extreme volatility," Mr. Gross said.

However, that volatility has ebbed. According to J.P. Morgan Asset Management's recent analysis, over half of the 100 largest corporate DB plans now have funding ratios of 100% or over.

"In that light, there is a very fair discussion that needs to happen around the future of defined benefit plans," he said. "They've gradually gotten back to full funding since the global financial crisis, since the lows of that era, and that's been on the basis of pretty good asset performance, as well as meaningful contributions."

One such discussion is how hibernation prevents a DB plan from improving its funding ratio.

"That narrative or that attitude pre-supposes that there is no value to the plan continuing to improve its funded status and achieving a surplus. In fact, that the next step to a plan's evolution is to terminate," Mr. Gross said. "I will just say that the path of derisk, hibernate, terminate is one possible path among many, and it is a path that ignores the massive value that a well-funded and well-managed defined benefit plan can provide to a sponsor if it is allowed to do what it was at the beginning."

"A lot of the negative attitudes are reflective of this kind of scar tissue from an era of volatility that no longer applies," Mr. Gross said, adding that there has long been the misconception that surplus assets of a pension fund are "trapped" assets that have no value and that "the money will be captured by the IRS through its excise tax."

Mr. Gross said there is tremendous value in having a pension surplus. It could provide capital to pay for retiree healthcare benefits, for establishing follow-on pension funds, and to provide capital for M&A activity, although not all possibilities apply for all companies.

"The idea that none of them apply across the board, and therefore pension surplus is without any value, I think, is preposterous," Mr. Gross said.

Re-embracing the DB plan makes sense, he said, especially in light of how defined contribution plans are trying to step into the shoes of a DB plan. Mr. Gross cited options such as target-date funds, retirement income portfolios and even some DC plans attempting to offer life annuities as an investment option in their DC plans.

Mr. Gross noted that particularly life annuities are the hardest part of a DB plan to replicate in a DC plan, which is why many sponsors haven't offered them. Meanwhile, actual defined benefit plans are now better funded and sponsors have figured out how to manage risk against liabilities, which means DB plans provide a benefit that is hard to replace and replicate, he said. "What it ultimately adds up to is a fairly strong case for sponsors to reconsider this decision to sort of end their defined benefit plans."

Mr. Gross said that embracing a pension surplus has made a lot of sense to the sponsors he has spoken to, and many are now revisiting the glidepaths of their liability-driven investing portfolios so they can continue to gain returns beyond a 100% funding level.

"There is at a minimum a very strong level of recognition that extending your plan's life into the future so you can accumulate a healthy level of surplus makes a tremendous amount of sense," Mr. Gross said.

THE NCPERS MONITOR
The Latest in Legislative News April 2023

ASOP 4: What Pensions Should Know About the Newly Required LDROM Disclosure

By Lizzy Lees, Director of Communications, NCPERS

Photo Illustration © 2023, istock.com

As part of the 2023 revisions to ASOP 4, the Actuarial Standards Board will require a new disclosure, Low-Default-Risk Obligation Measure (LDROM), that will affect future actuarial valuations. This liability measure assumes the pension plan is invested solely in high quality bonds.

It is highly unlikely that a public pension plan would adopt an all-bond investment strategy, and there is no indication that any plans intend to do so. For that reason, the new disclosure has limited practical application for public sector plans. However, understanding this new measure is critically important to ensure the new disclosure is not used to mischaracterize the financial health of a pension plan.

Last year, NASRA, NCPERS, NCTR, and NIRS formed a workgroup to develop the ASOP 4 Toolkit: Measuring Pension Obligations and LDROM to help pension funds communicate the new requirements of ASOP 4, avoid misunderstanding and misuse of the new disclosure, and communicate the benefits of a well-diversified investment portfolio. Over 30 public pension directors, senior staff, actuaries, and communications experts participated in the workgroup and their work shaped the ultimate outcome. The toolkit, which has been endorsed by GFOA, includes three products:

- The first product is a Fact Sheet that presents a clear and simple overview of LDROM—what it is and what it isn't—and provides appropriate context to frame the correct use of the disclosure for stakeholders of the pension plan, including policymakers, system participants and the general public.

- The second product is a set of suggested language for public pension actuarial valuations. Following these guidelines will ensure that valuations conform to ASOP 4 and provide context for the measure. Accurate and reliable valuations will maximize stakeholder understanding and the impact on taxpayers' contributions of various liability measures.

- The third product is a set of frequently asked questions on investment diversification and other important topics. These will help pension fund stakeholders with guidance on special considerations for Risk Sharing Plans.

Overall, the ASOP 4 Toolkit: Measuring Pension Obligations and LDROM is an essential resource for pension funds to educate policymakers and others on the best use of this new disclosure to help avoid misunderstandings concerning pension funding.

Later this month, NCPERS will host a webinar, ASOP 4: What Pensions Should Know About the Newly Required LDROM Disclosure, to provide members the opportunity to ask questions about the toolkit and learn more about LDROM. Panelists include Paul Angelo, Senior Vice President & Actuary, Segal; Emily Brock, Director, Federal Liaison Center, GFOA; Debby Cherney, CEO, SBCERA; Dan Doonan, Executive Director, NIRS; and Hank Kim, Executive Director & Counsel, NCPERS.

The webinar will be held on April 13 at 1:00pm ET. Register here to learn more about LDROM and to find out how to provide the appropriate context to frame the correct use of the disclosure. ◆

NCPERS **Executive Director's Corner**

The Importance of Ongoing Education

By Hank Kim, Executive Director and Counsel, NCPERS

The days are getting longer, the flowers are beginning to bloom, and—like many parents across the country—I've been anxiously awaiting news about my two children's college admissions (Genevieve got into University of Colorado and Cameron got into University of Vermont, if you were wondering).

After nearly 13 years in school, they're diligently preparing to continue the next steps in their education. But, after graduation, it can be hard to figure out where to learn new skills or how to stay on top of the latest developments in your field. Ongoing education, however, is so important for success—no matter your profession (even for professional hockey players, like my son aspires to be).

As the leader in providing education and training to public pension professionals, NCPERS aims to make ongoing education as easy as possible for our members. While each of our conferences is unique, attendees know they will find quality programming that will equip them to succeed. Our networking receptions and events are where long-term industry relationships are built. These are the contacts you can reach out to with questions, vendor recommendations, or just to grab lunch when you're in town. With so many repeat attendees, NCPERS post-pandemic networking receptions have sometimes felt like a family reunion!

Our Annual Conference & Exhibition (ACE) is our most comprehensive educational event, featuring fast-paced general sessions, highly focused breakout sessions, and networking opportunities. We take special care to welcome first-time attendees with a meet and greet on the first day to help facilitate networking. We've just released the agenda, which features a fantastic lineup of speakers.

The opening general session will cover responsible investment in private equity, as Jennifer O'Dell of LiUNA and Dan Pedrotty of NABTU discuss how funds can implement responsible contractor policies for investments in real estate and infrastructure.

Day two opens with a general session on the macro outlook for 2023 and ends with a breakout session on how to effectively engage with your actuary. During the breakout session, “Risk Management: A Key Reason for the Wisconsin Retirement System’s Success,” Brian Murphy of Gabriel, Roeder, Smith & Company and Matt Stohr of WRS will discuss how the retirement system has found success with stress testing every two years in collaboration with the State of Wisconsin Investment Board.

Day three features sessions on cybersecurity, ESG, legislative and regulatory updates, and more. Tom Vicente and Jim Ritchie of Bolton will explore the challenges that changing demographics pose to pension plans and their sponsors during their session, “The US Workforce is Changing – Evolving Pension Offerings to Serve the Future Membership.”

On the final day, attendees will learn about investing with diverse and emerging managers, what the new actuarial standards mean for your plan, and more. The program closes with a general session on crisis communications, where Michelle Holleman of the Chicago Teachers’ Pension Fund will discuss how to prepare your team for a crisis and share strategies for engaging with the media and stakeholders.

Less than a month after our Annual Conference, NCPERS will host public pension executives in Denver for the Chief Officers Summit. This event is designed to prepare pension CEOs and CIOs to drive their organizations forward in the face of constantly evolving opportunities and challenges. The agenda is created by an advisory faculty of c-suite pension leaders, covering vital skills such as risk management, governance, technology, and more.

Be sure to check our calendar to see all of our upcoming conferences and visit our Center for Online Learning to take advantage of the many opportunities NCPERS offers to continue your education and stay up to date on the latest developments in the public pension industry. ◆

Are Pensions the Answer to the Public-Sector Worker Shortage?

By Bridget Early, Director of Membership and Strategic Alliances, NCPERS

Photo Illustration © 2023, istock.com

It's widely known that state and local governments are struggling to recruit and retain workers. In Maryland, there are about 6,000 job postings available. And in Wayne County, Michigan, another approximately 1,000 jobs are available. These mounting vacancies can threaten the continuity of vital public services in public safety, education and transportation.

But as the number of layoff announcements in the private sector increase and a record number of Americans withdraw funds from their 401(k)s as a result of financial distress, the public sector may be uniquely positioned to reverse its worker shortage with a highly attractive benefit that gives it an edge over the private sector: a pension.

A 2021 brief from the Congressional Research Service shows how participation in defined benefit plans dropped from 30% in the late 1970s through the 1980s to just above 10% in 2020. As employers have shifted toward 401(k)-style plans, retirement security is much harder to attain for the average American. And it shows: a staggering 40% of Americans fear they won't be able to retire at all.

Pensions are Long-Term Solutions for Worker Retention

Recently, state and local governments have offered more incentives like sign-on bonuses and other benefits in the hiring phase to get more applicants in the door. But these are short-term fixes that may temporarily help with attracting applicants but not with retention. Given the high costs associated with employee turnover, a long-term solution is needed.

Research shows that defined benefit pensions already play an important role in worker retention in the public sector. That same study found that 84% of millennials working in state and local governments said their pension benefit was the reason they're staying in the public sector. That's despite the majority (80%) believing they could earn more in the private sector.

These robust retirement benefits are also leading to significant job loyalty: 85% of millennials said they plan to stay in their public sector jobs until they retire. However, 71% said that cutting their pension benefits would make them more likely to leave their state or local government job.

Pensions Can Help Attract Job Applications—If Positioned Correctly

While public-sector employers typically can't compete with the private sector on salary, they may have an edge when it comes to total compensation packages. It's clear that workers find their pension benefits to be extremely valuable, but it's crucial that the value of these benefits is demonstrated to applicants and new hires. Recent research from MissionSquare Research Institute suggests that by quantifying benefits—such as pensions, life insurance or paid leave—as part of a total compensation package, governments will have greater success in filling vacancies.

With the decline in participation of defined benefit plans in the private sector, many workers do not understand how pensions work or comprehend the value of reliable monthly checks during their retirement. Employers must clearly illustrate the total compensation packages being offered and incentivize retention through continued education on these benefits. Many public employee retirement systems are offering online portals or apps, retirement benefit calculators and educational events or webinars to help members easily understand their benefits.

Cutting Benefits Can Increase Costs in the Long Run

Given the widespread misunderstandings around pension funds, some lawmakers are considering legislation to eliminate these benefits, putting their workforce recruitment and retention efforts in jeopardy. Looking at municipalities that have closed their defined benefit plans, it's clear that eliminating pensions costs public employers both money and quality employees.

Since closing its defined benefit plans in 2005, Alaska has struggled to recruit and retain public employees. Without the incentive of vesting in the plan, "teacher tourism"—where educators gain experience and then move to another jurisdiction, mostly likely with a pension benefit—has become the norm. As a result, the state is spending $20 million per year trying to staff its education system. Recognizing the need to retain public servants, lawmakers are considering reopening the pension plan. On February 2, the Alaska House Committee on Community and Regional Affairs approved a bill that would create a state pension program for police.

Similarly, the Palm Beach Town Council voted in 2012 to close its pension for all employees, including public-safety professionals. Chronic turnover in public safety roles became common as individuals trained in Palm Beach but then accepted jobs in a neighboring district with a pension. Estimates put the cost of this high turnover at nearly $20 million. Lawmakers recognized the negative impacts of closing the town's pension on recruitment and retention, and the council reopened the plan in 2016.

As U.S. workers are increasingly anxious about retirement security and the private sector continues to experience layoffs, the public sector may become more attractive. Through deliberate messaging and ongoing education about total compensation and benefits packages, public sector employers can take advantage of their highly desirable pension benefits to help bring in applicants and retain their skilled employees. ◆

Developments on ESG

By Tony Roda, Partner, Williams & Jensen

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Saying it diplomatically, it's been a lively start to the year on the subject of Environmental, Social, and Governance (ESG) investing. Try as you might, you can't get away from the topic in the U.S. Congress, or in most state capitals, or at the winter conference of the National Association of Public Pension Attorneys, where ESG was the subject of many formal and informal discussions, or in two federal district courts, where the latest federal regulation is being legally challenged.

To recap, in late November 2022, the U.S. Department of Labor (DOL) released a final regulation entitled, *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*. The regulation is commonly referred to as the ESG rule.

It is important to note that the regulation was promulgated under the authority of the Employee Retirement Income Security Act (ERISA), which does not govern state and local governmental retirement plans. However, state and local officials, public pension boards, investment committees, and in-house and outside counsel often take DOL's regulatory pronouncements into consideration as they develop fiduciary standards and guidelines for investment-related decisions by public plan fiduciaries.

It's difficult to read any investment or financial media without seeing articles devoted to ESG investing. It has become a topic of heated debate. The bottom line, however, still remains that pension plan trustees and other fiduciaries must adhere to their basic fiduciary responsibilities of loyalty and prudence (including the duties of care, skill, and diligence) when making investment decisions.

The final regulation released by the Biden Administration makes clear at the outset that a fiduciary shall discharge their duties "...for the exclusive purpose of providing benefits to participants and their beneficiaries..." Furthermore, the regulation states that, "A fiduciary may not subordinate the interests of the participants and beneficiaries...and may not sacrifice investment return or take on additional investment risk to promote benefits or goals unrelated to interests of the participants and beneficiaries in their retirement income or financial benefits under the plans."

The final regulation also moves away from the standard included in the Biden Administration's proposed regulation, which was "(t)he projected return of the portfolio relative to the funding objectives of the plan…may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action." (Emphasis added.) While the proposed standard was still discretionary because of the use of the word "may," it would have taken us right to the brink of a regulatory requirement that in order to meet the fiduciary duty of prudence a fiduciary must consider ESG factors in all investment decisions.

Instead, the final regulation, in response to commenters who said the proposed language was a de facto mandate to analyze all investments through the ESG lens, replaced that standard with the following:

- Fiduciary's determination…must be based on factors…relevant to a risk and return analysis; risk and return factors may include the economic effects of climate change and other ESG factors; whether any particular consideration is a risk-return factor depends on individual facts and circumstances.

During the week of February 27, H.J. Res. 30 was approved by both houses of Congress. The resolution would overturn the Biden Administration's ESG rule. However, President Biden vetoed the resolution on March 20. Congress will not have two-thirds in either body to override the veto, so the Biden regulation will remain in place.

As we attempt to cut through the noise on this issue, we should recognize that there are substantive arguments being advanced. In general, Republicans are saying that then-President Trump's 2020 regulation (now superseded by President Biden's 2022 regulation) provided greater protection to plan participants. Specifically, a summary of their arguments follows:

- In the case of investments that fiduciaries are not able to distinguish based on pecuniary factors alone, the Trump rule allowed fiduciaries to use non-pecuniary factors as a tiebreaker, but only if accompanied by significant recordkeeping. Biden's regulation removed the recordkeeping requirement, arguing that it was onerous and would have a chilling effect on the use of non-pecuniary factors in a tiebreaker situation.

- The Trump rule disallowed the inclusion of any investment as a qualified default investment alternative (QDIA) if its objectives or goals or principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors. Biden removed this prohibition.

- Biden's regulation provides that fiduciaries of participant-directed individual accounts would not violate their duty of loyalty solely because they consider participants' preferences when assembling a menu of investment options, provided that fiduciaries conclude that accommodating these preferences will lead to greater participation and higher deferral rates.

Republicans obviously want to go back to the Trump rule. Legislative efforts will continue in Congress and the lawsuits will work their way through the federal court system and, possibly, find an audience before the U.S. Supreme Court. The issue will also remain a hot button throughout this presidential election cycle.

Plan trustees and other fiduciaries have to pay close attention to the regulatory framework in their specific states and localities surrounding the use of ESG factors in investment decisions. There already has been considerable activity in state capitals and it is likely to continue.

Please be assured that NCPERS will keep you apprised of significant developments in the area of ESG investing. ◆

__Tony Roda__ is a partner at the Washington, D.C. law and lobbying firm __Williams & Jensen__, where he specializes in federal legislative and regulatory issues affecting state and local governmental pension plans. He represents NCPERS and statewide, county, and municipal pension plans in California, Colorado, Georgia, Kentucky, Ohio, Tennessee, and Texas. He has an undergraduate degree in government and politics from the University of Maryland, J.D. from Catholic University of America, and LL.M (tax law) from Georgetown University.

How Organized Labor in Michigan is Driving Historic Change

Last month, Michigan Governor Gretchen Whitmer signed two key bills into law. One law will phase out the tax levied by the state on retirement income, and the second repeals the state's “right-to-work” law. Both bills originated at a time when working men and women, especially those in labor unions, were under constant attack by Lansing lawmakers.

READ MORE *Source: NCPERS*

Kansas Pension Says New Anti-ESG Bill Could Cost $3.6 Billion in Returns

The $25 billion Kansas Public Employees Retirement System has determined that complying with Republican state legislators’ latest anti-ESG bills would cost it $1.14 billion in forced divestitures and end up lowering returns by about $3.6 billion over the next decade. KPERS Executive Director Alan Conroy asked lawmakers to reject the bill as written.

READ MORE *Source: Institutional Investor*

Connecticut Municipal Pension Plan Debt Rises Dramatically, Putting Pressure on Towns

The Connecticut Municipal Employees’ Retirement System (CMERS), which was established as a state-run employee pension option for towns and cities, has long been overlooked when it comes to Connecticut’s pension debt. Aside from the working group of municipal and labor leaders, the Comptroller’s office is also pursuing a regulatory change to update how and when a retired CMERS employee can receive a pension while working for another CMERS municipality.

READ MORE *Source: Inside Investigator*

Generous Benefits Keep Oregon Government Worker Pay Competitive, Study Finds

The state of Oregon continues to pay its workers competitive compensation despite pandemic fluctuations in the labor market, thanks largely to highly subsidized health insurance and generous retirement benefits, a new analysis by the state’s human resources office has found.

READ MORE *Source: The Seattle Times*

DeSantis’ Targeting of ESG Could Cost Taxpayers, Pension Fund Millions of Dollars

One analyst, Econsult Solutions Inc., calculated that if Florida were to enact anti-ESG banking restrictions similar to what Texas approved in 2021, it would cost taxpayers as much as $361 million in higher interest rates for municipal bonds because of the limited options the state would have in choosing bond brokers. Financial analysts also said it could affect millions of retired state employees invested in the state’s $180 billion retirement fund because ESG issues do impact investment returns.

READ MORE *Source: Orlando Sentinel*

Illinois Bill Would Give Treasurer Proxy-Voting Power for State Public Pension Funds

If Senate Bill 2152 is passed by the Illinois legislature, the responsibility for proxy voting by the state's public pension funds will shift to Michael W. Frerichs, the state's treasurer. If passed, the bill would affect the Illinois Teachers Retirement System, the Illinois State Board of Investment, and the Illinois State Universities Retirement System.

READ MORE *Source: Pensions & Investments*

NCPERS Public Pension Profiles

NCPERS Public Pension Profiles series highlights the great work public pension staff are doing, showcases unique career paths, and gives visibility to NCPERS' member funds. Click the links below to read the most recent profiles. If you or a colleague is interested in being profiled, please contact communications@ncpers.org to schedule an interview.

El Paso Firemen and Policemen's Pension Fund Trustees

In honor of Women's History Month, NCPERS spoke with current trustees Lee Ellen Banks, Susanna Visconti, and Leila Melendez about why they serve the El Paso Firemen and Policemen's Pension Fund's members and the importance of diverse representation at the board level.

READ MORE

Educational Employees' Supplementary Retirement System (ERFC) Executive Director & CIO, Eli Martinez

"I was initially drawn to the public pension space because it gave me the ability to make a difference in my community while also doing something that I love," said Martinez.

READ MORE

Seattle City Employees' Retirement System (SCERS) CIO, Jason Malinowski

"From more of a macro perspective, we've thought a lot about how our liabilities should impact our investment strategy," said Malinowski.

READ MORE

Jacksonville Police and Fire Pension Fund (JPFPF) Executive Director, Timothy Johnson

"Pension administration technology is something to watch in 2023 and beyond," Johnson said.

READ MORE

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Calendar of Events 2023

May

NCPERS Accredited Fiduciary (NAF) Program

May 20–21
New Orleans, LA

Trustee Educational Seminar (TEDS)

May 20–21
New Orleans, LA

Annual Conference & Exhibition (ACE)

May 21–24
New Orleans, LA

June

Chief Officers Summit

June 19-21
Denver, CO

August

Public Pension Funding Forum

August 20-22
Chicago, IL

October

NCPERS Accredited Fiduciary (NAF) Program

October 21-22
Las Vegas, NV

Financial, Actuarial, Legislative, and Legal Conference (FALL)

October 22-25
Las Vegas, NV

View all upcoming NCPERS conferences at www.ncpers.org/future-conferences.

The Voice for Public Pensions

The Monitor is published by the National Conference on Public Employee Retirement Systems.
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Memo to: Oaktree Clients

From: Howard Marks

Re: Lessons from Silicon Valley Bank

This isn't going to be another history of the meltdown of Silicon Valley Bank. Dozens of those have appeared in my inbox over the past month, as I'm sure they have in yours. Thus, rather than merely recount the developments, I'm going to discuss their significance.

My sense is that the significance of the failure of SVB (and Signature Bank) is less that it portends additional bank failures and more that it may amplify preexisting wariness among investors and lenders, leading to further credit tightening and additional pain across a range of industries and sectors.

One-off or a Harbinger of Things to Come?

A number of things about SVB made it somewhat of a special case – which means it probably won't turn out to be the first of many:

- The bank's business was heavily concentrated in a single sector – venture capital-backed startups in tech and healthcare – and a single region – Northern California. Many regional banks' businesses are similarly concentrated, but not usually in sectors and regions that are both highly volatile.
- The boom in its sector and region caused SVB's business to grow very rapidly.
- In recent years, startups were a major destination for investors' cash, a good deal of which they deposited at SVB. This caused SVB's deposits to triple, from $62 billion at the end of 2019 to $189 billion at the end of 2021.
- For the same reason, many of SVB's clients had so much capital that they had little need to borrow. As deposits piled up at SVB, there wasn't offsetting demand for loans. Few other banks have customers with similar cash inflows and consequently so little need to borrow money.
- Because SVB had few traditional banking uses for the cash that piled up, it instead invested $91 billion in Treasury bonds and U.S. government agency mortgage-backed securities between 2020 and 2021. This brought SVB's investments to roughly half its total assets. (At the average bank, that figure is about one-quarter.)
- Presumably to maximize yield – and thus the bank's earnings – in what was a low-return environment, SVB bought securities with long-dated maturities. SVB designated these securities as "hold to maturity" (HTM) assets, meaning they wouldn't be marked to market on the bank's balance sheet since it had no intention of selling them.
- When the Federal Reserve embarked on its program of interest rate increases last year, bond prices fell rapidly, and, of course, the longer the tenor of the bonds, the greater the decline in value. In short order, the market value of SVB's bond holdings was down $21 billion.
- Word of the bank's losses caused depositors to start withdrawing their money. To meet the withdrawals, SVB had to sell bonds. Consequently, the bonds could no longer be considered HTM. Instead, they had to be categorized as "available for sale" (AFS), meaning (a) the bonds were marked down on SVB's financial statements and (b) actual sales caused the losses to be crystalized.

- The recognized losses helped hasten the spread of negative rumors throughout the tight-knit venture capital community, which led to further withdrawals. An unusually large percentage of SVB's deposits – 94% – exceeded $250,000 and thus weren't fully insured by the FDIC. This meant they were more "institutional" than "retail." Additionally, SVB's customers were highly interconnected: They had many backers in common, lived and worked near each other, and could exchange information almost instantaneously through social media.

The sum of the above rendered SVB particularly vulnerable to a bank run if adverse circumstances developed – and they did. However, many of the above factors were peculiar to SVB. Thus, I don't think SVB's failure suggests problems are widespread in the U.S. banking system.

<u>What Did SVB Have in Common with Other Banks?</u>

I talked above about some things that distinguished SVB from other banks. But it's as important to consider the elements they shared:

- <u>Asset/liability mismatch</u> – **Financial mismatches are dangerous, and banks are built on them.** Deposits are banks' primary source of funds, and while some have longer terms, most can be withdrawn on any day, without prior notice. On the other hand, making loans represents banks' main use of funds, and most loans have lives ranging from one year (commercial loans) up to 10-30 years (mortgages). So, while most depositors can demand their money back at any time, (a) no banks keep enough cash on hand to pay back all their depositors, (b) their main assets don't pay down in a short timeframe, and (c) if they need cash, it can take them a long time to sell loans – especially if they want a price close to par. Maintaining solvency requires bank managements to be aware of the riskiness of the assets they acquire, among other things. But liquidity is a more transient quality. **By definition, no bank can have enough liquidity to meet its needs if enough depositors ask for their money all at once.** Managing these issues is a serious task, since it's a bank's job to borrow short (from its depositors) and lend long.

  This mismatch, like most other mismatches, is encouraged by the upward slope of the typical yield curve. If you want to borrow, you'll find the lowest interest rates at the "short end" of the curve. Thus, you minimize your costs by borrowing for a day or a month . . . **but you expose yourself to the risk of rising interest expense, since you haven't fixed your rate for long.** Similarly, if you want to lend (or invest in bonds), you maximize your interest income by lending long . . . **but that subjects you to the risk of capital losses if interest rates rise**. If you follow the yield curve's dictates, you'll always borrow short and lend long, exposing you to the possibility of an SVB-type mismatch.

- <u>High leverage</u> – Banks operate with skinny returns on assets. They pay depositors (or the Fed) a low rate of interest to borrow the funds they need to operate, and they lend or invest those funds at slightly higher rates, earning a modest spread. But they literally make it up on volume. They employ heavy leverage, meaning they can do a lot of business based on little equity capital, thereby translating a low return on assets into a high return on equity. However, having a high ratio of total assets to equity capital means a modest decline in asset prices can wipe out a bank's equity, rendering it insolvent. **There's no source of meltdown – in any sector – as potentially toxic as the combination of high leverage and an asset/liability mismatch.** Banks have them both.

- Reliance on trust – Since depositors put money in banks in pursuit of safety and liquidity and, in exchange, accept a low return, faith in banks' ability to meet withdrawals is obviously paramount. Depositors ostensibly can get liquidity, safekeeping, and low interest from any bank – that is, one bank's offering is essentially undifferentiated from those of others. Thus, most depositors are perfectly willing to change banks if given the slightest reason, and there's no offsetting reason for them to leave their money on deposit if a bank's safety is questioned.

You may be familiar with one of my favorite sayings: "Never forget the six-foot-tall person who drowned crossing the stream that was five feet deep on average." **Surviving on average is a useless concept; you have to be able to survive all the time, including – no, especially – in bad times.** Borrowing short to invest long powerfully threatens that ability. Being highly levered is another reason why, metaphorically, tall people sometimes drown in streams that are shallow on average. And for financial institutions, customers' loss of confidence is a third.

The bottom line is that banks are, essentially, highly levered fixed income investors. Any long-term, fixed-rate loans or bonds they own (which for most banks aren't a large percentage of total assets) are subject to declines in economic value in a rising-interest-rate environment. Banks don't have to recognize price declines on assets they intend to hold to maturity, but any bank that is forced to sell those assets to meet withdrawals would have to show the declines on its financial statements.

Looked at this way, retaining depositors' trust is an absolutely essential ingredient in a bank's activities, and that means assets, liabilities, liquidity, and capital have to be skillfully managed. In SVB's case, its equity went up in smoke when rising interest rates reduced the value of a good part of its assets.

In that vein, I'm going to share a personal anecdote. When our son, Andrew, went off to college in 2005, Nancy and I concluded it would be great to live outside the United States for a while, something neither of us had ever done. We chose to live in the UK for four months of the year, during which I worked in Oaktree's London office. To generate income to cover our living expenses, we moved cash to a UK bank and asked that it be deposited in CDs at several building societies (what we in the U.S. call savings & loans). One of those was Northern Rock. In September 2007, as the financial crisis was brewing, Northern Rock had trouble securing the financing it needed in the wholesale funding market on which it traditionally had depended. That prompted depositors to queue up to close their accounts.

I called my banker on a Friday afternoon to ask whether I could move my funds elsewhere, and he told me there would be a 2% penalty for early withdrawal. It took me about one second to say, "please move those funds first thing Monday morning." A 2% penalty sounded like peanuts relative to risking my entire principal at Northern Rock. Now imagine the thinking of SVB depositors who could withdraw their money without any penalty. (As it happens, the UK government guaranteed Northern Rock's deposits over the weekend in question, eliminating the need to move the funds. But that was my closest brush with a bank failure.)

Another new trend that has added to banks' precariousness is the emergence of digital communications, including social media. Sixteen years ago, it took days for Northern Rock's depositors to become aware of its difficulties. And when they decided to move their money, they had to go to their branch during banking hours (what a quaint notion), queue up, and submit a withdrawal request. In SVB's case, word of the bond losses traveled quickly, through unusually interconnected depositors who had the ability to request withdrawals online. As a result, more than one-third of the bank's deposits departed in a single day. All banks have to contend with digital communication and online withdrawals these days, but SVB's depositors were particularly high flight risks, given the bank's region and the nature of its clientele.

About twenty years ago, my partner Sheldon Stone shared an interesting parable: Imagine you're on a boat crossing Lake Erie. The captain comes on the loudspeaker and says, "Everyone run to the left side of the boat." A minute later he says, "Everyone run to the right side." And a minute after that he says, "Run back to the left." It would make for an unusually rocky crossing. Today the internet and social media are the loudspeaker, which almost anyone can take over, disseminating any message they choose. This "digital herding," as Gillian Tett of *The Financial Times* has labeled it, can have a huge impact in many fields, particularly those that run on information and trust.

Was SVB's Collapse Inevitable?

To close the loop, I'm going to recap the interrelated factors that caused SVB to fail:

- If the bank had made more loans relative to the size of its deposit base, it wouldn't have bought as many potentially volatile bonds.
- If the bonds the bank bought hadn't had such long maturities, it wouldn't have been as exposed to price declines.
- If the Fed hadn't raised interest rates as much as it did, the bonds wouldn't have lost so much value.
- If the depositors hadn't exited en masse, the bank wouldn't have had to sell bonds and realize the losses.

You wouldn't think a portfolio consisting of bank loans and high-quality Treasury and mortgage-backed bonds could be vulnerable to a meltdown that would render a bank insolvent. But the scale of SVB's bond investments, the length of the maturities, and the extent of the Fed's interest rate hikes put SVB at risk, and the rapidity of the withdrawals caused the problem to run far ahead of the solutions.

When looking at SVB's demise, the decision-making behind its bond purchases stands out as particularly flawed and probably the primary cause of the bank's failure. According to public reports, SVB management "made a bet" that interest rates would hold steady or fall. While that expectation is implicit in its actions, I find it hard to believe it was a conscious, considered decision, as opposed to an example of mindlessly chasing yield, perhaps abetted by wishful thinking. The bond purchases took place in 2020 and 2021. In that two-year period, the yield on the 30-year Treasury ranged between 0.99% and 2.45%. How could anyone have thought rates that low were more likely to hold steady or fall than rise? Determining how to move forward is always challenging in economics and investing. However, when the Fed and Treasury flooded the economy with cash in 2020 and inflation began to rise in 2021, **the one thing that should have been obvious was that there was no good reason to hold long-dated bonds at pitifully low yields, which presented profound risk and miniscule potential for return.**

Comparisons to the GFC

SVB's failure – along with the collapse of Signature Bank, the rescue of First Republic Bank, and Credit Suisse's forced sale to UBS – roiled markets in March. This resulted from fear of bank failure contagion along the lines of what we saw during the Global Financial Crisis of 2007-08, when Bear Stearns, Merrill Lynch, Lehman Brothers, Wachovia Bank, Washington Mutual, and AIG either melted down or required rescues. There were times in that span, particularly in the last four months of 2008, when investors were forced to contemplate the possibility of an unstoppable series of failures that could have endangered the entire financial system. Nobody wants to face that again.

While I want to state clearly that I'm not an expert on banks or their regulation, I think the similarities between 2008 and 2023 are limited to the mere fact that, in both instances, problems existed at a few financial institutions. I find the common elements mostly superficial. What follows are the differences.

By far most importantly, the GFC occurred for the simple reason that investors and financial institutions experienced temporary insanity with respect to residential mortgages. They:

- accepted unquestioningly that mortgages' low-default history could be extrapolated;
- forced massive amounts of money into the mortgage market;
- loaned lots of it to subprime borrowers who couldn't or wouldn't document income or assets;
- built tranched and levered mortgage-backed securities using subprime mortgages; and
- in many cases, invested their own capital in the riskiest tranches of the RMBS to enable the formation process to be repeated.

These parties ignored the possibility that excessive faith in mortgages – and the resultant lowering of lending standards – could precipitate massive numbers of mortgage defaults. Further, they ignored the fragility of the structured securities built out of those mortgages. Investors, bankers, and rating agencies (which awarded AAA ratings to thousands of RMBS issues) naively trusted that people who were willing to pay extra interest to obtain mortgages without disclosing their financial condition would repay those mortgages, even if the prices of the homes they bought fell. This led them to conclude that mortgage defaults wouldn't be sufficient to jeopardize the mortgage-backed securities' viability. Subprime mortgages were totally lacking in substance, yet many of the world's leading financial institutions were happy to make those loans and invest in securities built out of them.

Looking at the current situation, I can't think of anything that's highly analogous to the subprime mortgages at the heart of the GFC. There are things here or there that have been over-hyped or are short on substance – some people will point to SPACs or cryptocurrencies – but they're not as massive in scale, perhaps not as lacking in substance, and certainly not held on the balance sheets of America's key financial institutions in amounts sufficient to endanger our financial system. **Indeed, I think it's safe to say the most glaring market excesses were corrected in 2022 and aren't hanging over us now. (However, for a caveat, please see this memo's last few paragraphs.)**

In addition, whereas the list of institutions that disappeared during the GFC included some that clearly were systemically important, I don't think that can be said of SVB. I doubt our financial system was highly reliant on promises made by SVB and thus subject to extensive counterparty risk. The GFC affected some truly large banks – household names – and most people believed it was on the way to jeopardizing even bigger ones before the government stepped in. There's no reason to think the failure of SVB poses the same risk.

Finally, it should be borne in mind that even though huge banks appeared to be endangered in 2008, **the Fed and other economic policymakers were able to come up with rescue plans** (for the institutions and for the economy), **and they worked!** In that vein, it's worth noting that the Fed's response to SVB's problems included (a) guaranteeing all SVB deposits, (b) making additional liquidity available to banks, (c) injecting extensive liquidity into the economy, and (d) letting its balance sheet grow, even though it's been in the process of winding it down from its post-pandemic high. Thus, I find it hard to believe that SVB or the like can set off a chain reaction sufficient to trigger an irreversible financial crisis.

On the subject of the problem's scale, I want to mention a new pet peeve of mine. Increasingly, we hear the media say things like, "this was the best month in the stock market since 2020" or "we saw more new daily lows today than on any day since October." The media like this kind of dramatic-sounding comparison, and the latest is that "SVB is the biggest bank to fail since the GFC." But these comparisons don't always mean much. In the case of SVB, it should be noted that, while this is the second-biggest bank failure in history, SVB was only two-thirds the size of Washington Mutual, the biggest. Further, since the financial sector has expanded meaningfully in the last 15 years, WaMu's $307 billion of assets in 2008 were much more significant than SVB's $209 billion today.

A Word on Regulation

In March 2011, in the aftermath of the GFC, I published a memo called *On Regulation*. Its basic thrust was that financial regulation is highly cyclical. Crashes, meltdowns, and widespread misbehavior bring on calls for increased regulation. They also make increased regulation palatable to most parties. But when the new regulations succeed – and thus appear to make the financial environment safer and better functioning – free marketeers and people with vested interests typically start to argue that such strong regulation is no longer necessary and that it restricts the financial system's effectiveness. For example, in response to the Great Crash of 1929, massive new regulations were enacted between 1930 and 1940 to constrain conduct in the wild, wild west of Wall Street. But by the 1990s, the pain of the Crash was long forgotten, and belief in the efficacy of the free market was riding high. As a result, multiple regulations were dismantled, enabling conduct that contributed to very painful experiences in the GFC.

The GFC, in turn, inspired another round of regulation. One of the governing principles was that financial institutions that are too big to fail – and thus will, by necessity, be bailed out if threatened – shouldn't be permitted to engage in risky activities, as this creates a situation where "heads, the shareholders and management win; tails, the taxpayers lose." That proposition seems reasonable on its face and was implemented via the Dodd-Frank Act and its Volcker Rule. In general, bank regulation was significantly tightened.

As time passed, the normal pushback against regulation emerged. The aspect that's most relevant here is the regulatory threshold. Following the GFC, all banks with assets above $50 billion were subject to the strictest standards. But in 2018, regulators were convinced to raise that figure to $250 billion (thanks in part to the lobbying of SVB's chief executive officer). As a result, SVB – with assets around $50 billion at the time the threshold was raised – faced a looser regulatory regime. This helped it expand massively – until it failed in a matter of days.

Nevertheless, thanks to the post-GFC rules, the major U.S. banks today are well capitalized and have significant liquidity and healthy balance sheets. This makes it less likely that we'll see a GFC-type round of bank failures. I've heard it argued that current regulations and the resultant financial condition of banks aren't robust enough, but I believe most banks – and especially the majors – are much stronger than they were before and during the GFC and typically much stronger than SVB.

Interestingly, Canada, Australia, and Britain function very well with far fewer banks than the U.S. Canada, for example, has $2 trillion of GDP and just 34 domestic banks (17 per $1 trillion of GDP), and it seems to get by. In contrast, in 2021, the U.S. had 4,236 FDIC-insured commercial banks for its $20 trillion of GDP, or 212 banks per $1 trillion. Could regulators do a better job if there were fewer banks to monitor? We'll see what happens to the number of U.S. banks if big ones absorb smaller ones and deposits become concentrated in the bigger ones. But given the role of private parties and their money in our system of government, I don't expect to see a major change.

Moral Hazard

One problem with government solutions of any kind – like the so-called "Greenspan put" – is the possibility that they'll generate moral hazard. That is, players will conclude that they'll be rescued if they make a mistake. This suggests they can freely engage in high-risk, high-return behavior; if it works, they'll get rich, but if it fails, they'll be bailed out. People sometimes refer to this as "privatizing profits and socializing losses."

On March 9, when SVB was hanging by a thread while experiencing massive withdrawals, people started talking about a possible government guarantee of all deposits. One of the arguments against such a bailout was that it would create moral hazard. If people know they'll be protected from losses, they'll have no reason to examine the solidity of a bank before depositing money, meaning the diligence function won't be performed. Consequently, poorly run, poorly capitalized banks will be permitted to stay in business and grow.

But we simply cannot expect depositors to perform that function. Since banks' operations are characterized by mismatched assets/liabilities and a dependence on depositors' trust, it's terribly hard to assess their financial health from the outside (maybe sometimes from the inside, too, since SVB succumbed to what in retrospect seem to have been obvious managerial mistakes). In the 28 years that Oaktree has been in business, we've invested in relatively few deposit-taking financial institutions. Other than in cases where we've become insiders, we've generally avoided investing in banks because their complex, often impenetrable financial disclosures and reliance on trust make them harder to evaluate than we like.

Few people are capable of studying banks' financial statements and determining whether they'll remain solvent and liquid. **Expecting depositors to do so could cause banking to grind to a halt.** That's why deposit insurance was introduced during the Great Depression. For the same reason, the government's decision to fully guarantee SVB's deposits was quite appropriate.

Notably, however, management and shareholders weren't bailed out; rather, in today's parlance, they were "bailed in," or left with their losses. We can hope their losses will encourage other investors and bank managers to apply greater prudence in their future decision-making.

AT1s

While not at all related, SVB's failure gives me a chance to discuss another topic involving financial institutions that's recently been in the news: Alternative Tier 1 bonds, or AT1s. On the heels of the GFC, European regulators required banks to raise new equity capital ("tier 1 capital") and delever. However, given the risks surrounding the banks, potential providers of capital demanded inducements. With AT1s, these came in the form of bond-like yields, a promise of repayment at maturity, and debtholder status. So far, so good.

In UBS's recent takeover/rescue of Credit Suisse, FINMA, the Swiss bank regulator, determined that (a) shareholders would receive modest compensation and (b) the holders of the $17 billion of AT1s would get nothing. There was an immediate outcry, along with threats of litigation.

Although AT1s are clothed as debt securities, it seems FINMA had the power to alter the AT1s' priority relative to the shareholders and even eliminate their value. In this case, they chose to put the AT1s behind the shareholders, wiping out investors who thought they were creditors. As *Bloomberg* noted on March 23, this shouldn't have come as a surprise:

> A prospectus for the Credit Suisse AT1s highlights from the very first page the possibility of a wipeout when there is what's known as a writedown event. In this scenario, interest on the notes would stop accruing and the full outstanding amount of the bonds would be automatically and permanently written down to zero. Finma has the power to decide that a type of writedown event known as a "viability event" has occurred if a bank's efforts to improve capital adequacy are "inadequate or unfeasible," or if there is "extraordinary public support" to avoid a bankruptcy, insolvency or halt to regular business.

Bloomberg's Matt Levine explained how this worked in Credit Suisse's case:

> If the bank's common equity tier 1 capital ratio – a measure of its regulatory capital – falls below 7%, then the AT1 is *written down to zero:* It never needs to be paid back; it just goes away completely. . . .
>
> **These securities are, basically, a trick.** To *investors*, they seem like bonds: They pay interest, get paid back in five years, feel pretty safe. To *regulators,* they seem like equity: If the bank runs into trouble, it can raise capital by zeroing the AT1s. **If investors think they are bonds and regulators think they are equity, somebody is wrong. The investors are wrong.**
>
> In particular, investors seem to think that AT1s are *senior* to equity, and that the common stock needs to go to zero before the AT1s suffer any losses. But this is not quite right. You can tell because **the whole point of the AT1s is that they go to zero if the common equity tier 1 capital ratio falls below 7%.** (*Bloomberg Opinion; Money Stuff*, March 20, 2023. Bolding added.)

Were the investors misled? To me, the answer is no. In this regard, let's consider the way the prospectus for one such Credit Suisse issuance – "a $2 billion US dollar 7.5% AT1 issued in 2018" – was labeled (per Matt Levine): "7.500 per cent. Perpetual Tier 1 Contingent Write-down Capital Notes." There shouldn't have been much doubt about their riskiness when "write-down capital notes" was in the title.

I once wrote of Bernie Madoff that you can say you did thorough due diligence or you can say he passed the test, but you can't say you did thorough due diligence and he passed the test. Likewise, in the case of Credit Suisse's AT1s, you can say you read and understood the prospectus, or you can say you thought they were like ordinary debt securities, but you can't say both.

Maybe there's a third path; maybe you could say "I knew the regulators had the power to zero me out, but I didn't think they ever would." **It seems to me that if people can take value from you legally, and especially if doing so isn't unambiguously immoral, you shouldn't be surprised if they do.** Holders of high yield bonds have for many years dealt with an analogous phenomenon called "event risk," which refers to actions undertaken by company management for the purpose of transferring value from bondholders to stockholders. In the case of Credit Suisse, the regulators likely gained the cooperation of shareholders by paying them a few francs per share while wiping out the AT1s. Under the circumstances, that shouldn't have come as a complete surprise. **It's all part of protecting banks, which – as noted above – are risky by nature.**

<u>Psychological Ramifications of the SVB Collapse</u>

As I previously mentioned, I don't view SVB, Signature Bank, First Republic, and Credit Suisse as having been connected other than by the fact that they were in the same general line of work. That did give them one thing in common: Since they're all financial institutions, events involving them can broadly impact depositors' and investors' confidence (or lack thereof). People seem to have trouble dealing with multiple problems at once, and the near-simultaneous challenges at four banks caused people to string them all together like beads, crafting a narrative that included a potential systemic meltdown.

While they don't seem to me to be connected in tangible ways, the four banks' recent crises certainly had the power to shake things up. And when participants in the economy or market are shaken up, the implications can be serious. As President Franklin D. Roosevelt said in his 1933 inaugural address during the Great Depression, **"the only thing we have to fear is fear itself."** Things don't have to be connected physically or even economically. In the markets, a series of scary events can have a very powerful impact.

The credit crises during which my partners and I have invested over the last 38 years generally have resulted from some combination of (a) negative economic developments, (b) excesses in the markets, (c) adverse exogenous events, and (d) rising fear among investors and finance industry professionals. The failures of SVB and the other banks likely aren't enough to bring on a credit crisis, but they could contribute to one. As a result, it seems inescapable that some financial institutions will reduce the amount of credit they make available, causing some borrowers to be left out. In particular, SVB's failure could mean the startup world will have a tougher time getting financing in the months ahead. Regional and community banks are likely to undergo increased scrutiny and experience deposit flight as cash flows to money market funds and larger banks perceived to be safer. Their importance as the main financers of real estate makes it likely that the going will get tougher for property owners and developers, just as office buildings, brick-and-mortar retail, and perhaps even multifamily are coming under pressure in many regions.

Combine developments like these with the reality that (a) interest rates are no longer declining or near zero; (b) the Fed can't be as accommodative as it was in the last few crises, because of today's elevated inflation; and (c) negative developments are popping up in portfolios, and I think the case made in my previous memo, *Sea Change* (December 2022), has been bolstered. The easy-money environment of the last few years has been blamed for – among other things – the difficulties at SVB and its peers. Their failure is likely to bring stricter scrutiny to banking, meaning things are unlikely to be as easy in the period ahead. And to paraphrase Warren Buffett, now that the tide has gone out a bit, we've caught a glimpse of some who were swimming naked near shore. The remaining questions are, how many more are out there, and will the tide go out far enough to expose them?

When investors think things are flawless, optimism rides high and good buys can be hard to find. But when psychology swings in the direction of hopelessness, it becomes reasonable to believe that bargain hunters and providers of capital will be holding the better cards and will have opportunities for better returns. We consider the meltdown of SVB an early step in that direction.

* * *

While I don't foresee widespread contagion – either psychological or financial – arising from the SVB failure alone, I can't end a memo on U.S. banks without mentioning one of the biggest worries they face today: the possibility of problems stemming from loans against commercial real estate ("CRE"), especially office buildings.

The following factors are influencing the CRE sector today:

- Interest rates are up substantially. While some borrowers benefit from having fixed interest rates, roughly 40% of all CRE mortgages will need to be refinanced by the end of 2025, and in the case of fixed-rate loans, presumably at higher rates.
- Higher interest rates call for higher demanded capitalization rates (the ratio of a property's net operating income to its price), which will cause most real estate prices to fall.
- The possibility of a recession bodes ill for rental rates and occupancy, and thus for landlords' income.
- Credit is likely to be generally less available in the coming year or so.
- The concept of people occupying desks in office buildings five days a week is in question, threatening landlords' underlying business model. While workers may spend more time in the office in the future, no one knows what occupancy levels lenders will assume in their refinancing calculations.

Total U.S. bank assets exceed $23 trillion. Banks collectively are the biggest real estate lenders, and while we only have rough ranges for the data, they're estimated to hold about 40% of the $4.5 trillion of CRE mortgages outstanding, or around $1.8 trillion at face value. Based on these estimates, CRE loans represent approximately 8-9% of the average bank's assets, a percentage that is significant but not overwhelming. (Total exposure to CRE may be higher, however, as any investments in commercial mortgage-backed securities have to be considered in addition to banks' holdings of direct CRE loans.)

However, CRE loans aren't spread evenly among banks: Some banks concentrate on parts of the country where real estate markets were "hotter" and thus could see bigger percentage declines; some loaned against lower-quality properties, which is where the biggest problems are likely to show up; some provided mortgages at higher loan-to-value ratios; and some have a higher percentage of their assets in CRE loans. To this latter point, a recent report from Bank of America indicates that average CRE loan exposure is just 4.5% of total assets at banks with more than $250 billion of assets, while it's 11.4% at banks with less than $250 billion of assets.

Since banks are so highly levered, with collective equity capital of just $2.2 trillion (roughly 9% of total assets), the estimated amount the average bank has in CRE loans is equal to approximately 100% of its capital. Thus, losses on CRE mortgages in the average loan book could wipe out an equivalent percentage of the average bank's capital, leaving the bank undercapitalized. As the BofA report notes, the average large bank has 50% of its risk-based capital in CRE loans, while for smaller banks that figure is 167%.

Notable defaults on office building mortgages and other CRE loans are highly likely to occur. Some already have. But that doesn't necessarily mean the banks involved will suffer losses. If loans were made at reasonable LTV ratios, there could be enough owners' equity beneath each mortgage to absorb losses before the banks' loans are jeopardized. Further, mortgage defaults generally don't signal the end of the story, but rather the beginning of negotiations between lenders and landlords. In many cases, the result is likely to be extension of the loan on restructured terms.

No one knows whether banks will suffer losses on their commercial real estate loans, or what the magnitude will be. But we're very likely to see mortgage defaults in the headlines, and at a minimum, this may spook lenders, throw sand into the gears of the financing and refinancing processes, and further contribute to a sense of heightened risk. Developments along these lines certainly have the potential to add to whatever additional distress materializes in the months ahead.

April 17, 2023

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