San Joaquin County Employees
Retirement Association

A G E N D A

BOARD MEETING
SAN JOAQUIN COUNTY EMPLOYEES RETIREMENT ASSOCIATION
BOARD OF RETIREMENT
FRIDAY, AUGUST 11, 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/83421685465 and following the prompts to enter your name and email, or (2) calling (669) 219-2599 or (669) 900-9128 and entering Meeting ID 83421685465#.

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 the Board Meeting of July 14, 2023 — 05

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 (3) 10

5.02 Board to consider and take possible action

6.0 INVESTMENT CONSULTANT REPORTS

6.01 Presented by David Sancewich of Meketa Investment Group

01 Monthly Investment Performance Updates

a Manager Performance Flash Report - June 2023 11

b Economic and Market Update - June 2023 16

02 Board to receive and file reports

7.0 2023 ANNUAL INVESTMENT ROUNDTABLE

7.01 Draft Investment Roundtable agenda 34

7.02 Board to review, discuss and give direction to staff and consultant as appropriate

8.0 PRIVATE EQUITY PORTFOLIO REVIEW

8.01 Presented by Judy Chambers of Meketa Investment Group

01 Private Equity Program 4th Quarter 2022 36

02 2023 Private Equity Investment Plan 55

8.02 Board to receive and file report, discuss and give direction to staff and consultant as appropriate

9.0 STAFF REPORTS

9.01 Trustee and Executive Staff Travel

01 Conferences and Events Schedule 2023 66

02 Summary of Pending Trustee and Executive Staff Travel 67

03 Summary of Completed Trustee and Executive Staff Travel 68

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

9.03 General Counsel Services 69

01 Board to consider and take possible action

9.04 Legislative Report 72

9.05 CEO Report 75

9.06 Board to receive and file reports

10.0 CORRESPONDENCE

10.01 Letters Received (0)

10.02 Letters Sent (0)

10.03 Market Commentary/Newsletters/Articles

01 PIMCO
Secular Outlook: The Aftershock Economy
June 2023 84

02 NCPERS
Monitor
July 2023 — 96

03 NCPERS
PERsist
Summer 2023 — 111

04 Research Affiliates
Inflation: Don't Pop the Champagne (Yet)
August 2023 — 156

05 Wall Street Journal
Rising Rates Raise Questions for Pension Funds
July 25, 2023 — 164

06 NCPERS
The ESG Debate: How Recent Legislation is Impacting Retirement Fund Best Practices
July 7, 2023 — 166

07 Meketa
Lag Effect in Private Equity
July 2023 — 169

08 Meketa
Deglobalization
July 2023 — 173

09 NCPERS
Monitor
August 2023 — 189

11.0 COMMENTS

11.01 Comments from the Board of Retirement

12.0 CLOSED SESSION

12.01 Personnel Matters
California Government Code Section 54957
Employee Disability Retirement Application(s) (1)

13.0 REPORT OUT OF CLOSED SESSION

13.01 On May 5, 2023, the Board voted unanimously to approve Resolution 2023-08-01 titled "Ares Pathfinder Fund II" and to authorize the CEO to sign the necessary documents to invest $62.5 million in the fund.

13.02 SJCERA has dismissed its action entitled *San Joaquin County Employees' Retirement Association v. Travelers Casualty and Surety Company of America,* San Joaquin County Superior Court, Case No. STK-CV-UIC-2018-7607 (Coverage Action), as provided in the Settlement Agreement that the parties fully executed on July 13, 2023. In exchange for dismissal of the Coverage Action, SJCERA received total payment from Travelers of $952,101.74.

14.0 BOARD OF RETIREMENT COMMITTEE ASSIGNMENTS

14.01 Chair to review committee assignments and make changes as necessary

01 Trustee committee assignments August 2022 - July 2023 — 201

15.0 CALENDAR

15.01 Special Meeting September 1, 2023 9:00 a.m.

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

15.03 Board Meeting October 11, 2023 at 9:00 a.m.

15.04 Special Meeting October 12, 2023 at 8:00 a.m.

16.0 ADJOURNMENT

San Joaquin County Employees
Retirement Association

M I N U T E S

BOARD MEETING
SAN JOAQUIN COUNTY EMPLOYEES RETIREMENT ASSOCIATION
BOARD OF RETIREMENT
FRIDAY, JULY 14, 2023
AT 9:00 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, Jennifer Goodman, JC Weydert, Steve Ding, Chanda Bassett, Michael Duffy, Steve Moore Raymond McCray (out at 10:53 a.m.) 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, Department Information Systems Manager Adnan Khan, Information Systems Analyst II Lolo Garza, Administrative Secretary Elaina Petersen, Accounting Technician II Marissa Smith

OTHERS PRESENT: Counsel Yuliya Oryol of Nossaman, David Sancewich, Ryan Lobdale (via Zoom) and Eric White of Meketa, Graham Schmidt of Cheiron

2.0 PLEDGE OF ALLEGIANCE

2.01 Led by Ray McCray

3.0 MEETING MINUTES

3.01 Minutes for the Board Meeting of June 2, 2023

3.02 Minutes for the Administrative Committee Meeting of June 22, 2023

3.03 The Board voted unanimously (9-0) to approve the Minutes of the Board Meeting of June 2, 2023 and the Administrative Committee Meeting of June 22, 2023 (Motion: Duffy; Second: Bassett)

4.0 PUBLIC COMMENT

4.01 There was no public comment

5.0 CONSENT ITEMS

5.01 Service Retirements (4)

5.02 Mid-Year Administrative Budget Update

5.03 Board Policies and Charters Not Requiring Amendments

01 CEO Performance Review Charter

02 CEO Performance Review Policy

5.04 Board Policies Requiring Amendments

01 Cash Management and Liquidity Policy

a Cash Management and Liquidity Policy - Mark-up

- b Cash Management and Liquidity Policy - Clean

02 Declining Employer Payroll Policy

- a Declining Employer Payroll Policy - Mark-up
- b Declining Employer Payroll Policy - Clean

03 Disability Retirement and Active Member Death Policy and Procedure

- a Disability Retirement and Active Member Death Policy and Procedure - Mark-up
- b Disability Retirement and Active Member Death Policy and Procedure - Clean

04 Investment Manager Monitoring and Communications Policy

- a Investment Manager Monitoring and Communications Policy - Mark-up
- b Investment Manager Monitoring and Communications Policy - Clean

05 Investment Roles and Responsibilities Policy

- a Investment Roles and Responsibilities Policy - Mark-up
- b Investment Roles and Responsibilities Policy - Clean

06 Placement Agent Information Disclosure Policy

- a Placement Agent Information Disclosure Policy - Mark-up
- b Placement Agent Information Disclosure Policy - Clean

07 Proxy Voting Policy

- a Proxy Voting Policy - Mark-up
- b Proxy Voting Policy - Clean

5.05 Resolution 2023-07-01 titled “Board Policy Amendments”

5.06 The Board voted unanimously (9-0) to approve the consent items and adopt Resolution 2023-07-01 (Motion: Keokham; Second: Goodman)

NOTE: Items number 14.0, 7.0, 8.0, 9.0 and 10.0 were taken next out of order.

6.0 ACTUARIAL REPORT AND 2024 RETIREMENT CONTRIBUTION RATES

6.01 Annual Actuarial Valuation Report as of January 1, 2023 prepared by Cheiron

6.02 The Board received and filed report

6.03 Resolution 2023-07-02 titled “Actuarial Report and 2024 Retirement Contribution Rates”

6.04 The Board voted unanimously (8-0) to accept the actuarial report, approve the retirement contribution rates for 2024 and adopt Resolution 2023-07-02 (Motion: Goodman; Second: Duffy)

7.0 REAL ESTATE MANAGER PRESENTATION

7.01 Presentation by Matt Novac and Erin Byrne Watson, of Berkeley Partners Fund VI

8.0 CLOSED SESSION

The Chair convened Closed Session at 9:57 a.m. and adjourned Closed Session and reconvened Open Session at 11:36 a.m.

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

8.02 Personnel Matters
California Government Code Section 54957
Employee Disability Retirement Application(s) (1)

01 Thomas Wheelhouse
Accountant I
Behavioral Health Admin

The Board voted unanimously (9-0) to approve non-service disability claim for the applicant (Motion: Duffy: Second: Keokham) pending the outcome of a separate administrative hearing related to his service-connected disability retirement application.

8.03 Conference with Legal Counsel - Potential Initiation of Litigation
California Government Code Section 54956.9(d)(1)
1 Case

8.04 Threat to Public Services or Facilities
California Government Code Section 54957
Consultation with: Information Systems Manager Adnan Khan

8.05 Public Employee Performance Evaluation
California Government Code Section 54957
Title: Retirement Administrator/Chief Executive Officer

8.06 Counsel noted that, other than what is reported under 8.02 above, there was nothing further to report out of Closed Session.

9.0 INVESTMENT CONSULTANT REPORTS

9.01 Presented by David Sancewich of Meketa Investment Group

01 Monthly Investment Performance Updates

a Manager Performance Flash Report - May 2023

b Economic and Market Update - May 2023

02 Investment Fee Transparency Report

9.02 CRO search finalists memo

9.03 The Board received and filed reports, and indicated their support of Meketa's recommendation to interview three CRO managers sometime after the October meetings.

10.0 2023 ANNUAL INVESTMENT ROUNDTABLE

10.01 The Board listened to suggestions on format, topics and speakers and will discuss further when the draft agenda is presented at the August meeting.

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

a Travel requiring approval (2)

03 Summary of Completed Trustee and Executive Staff Travel

11.02 The Board voted unanimously (8-0) to approve an exception to the $2,500 annual travel cap for Trustee Duffy and approved ACEO Brian McKelvey to attend the top 1000funds Fiduciary Investors Symposium September 19-21, 2023. (Motion: Weydert; Second: Nicholas)

11.03 Quarterly Operations Reports

01 Pending Member Accounts Receivable - Second Quarter 2023

02 Disability Quarterly Report - Statistics

03 Pension Administration System Update

11.04 Legislative Summary Report

11.05 CEO Report

In addition to the written report, CEO Shick: 1) Congratulated Trustee Michael Restuccia and Trustee Raymond McCray on their reappointment to the Board of Retirement; 2) Recognized the Superior Court for their additional $1.5 million contribution (an additional payment of approximately 15% of their annual contribution amount); 3) Reminded the Board of the Special Board meeting on September 1, 2023 regarding ESG (location pending), and the Investment Roundtable dinner on Wednesday, October 11 at 5:00 p.m. at Wine and Roses, the night before the Investment Roundtable Special Board meeting.

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 PitchBook
Are "ESG Investors" Underperforming?
June 6, 2023

02 Pensions & Investments
North Carolina Passes bill blocking ESG Investments
June 14, 2023

03 Top 1000 Funds
Utah Retirement Systems: Why ESG is a waste of time
January 26, 2023

04 Capital Group
Commercial Real Estate: The next shoe to drop for the banking sector?
June 2023

05 Chief Investment Officer
Goldman: Look for EMs to Overtake US in Stock Valuation by 2030
June 27, 2023

06 MEKETA - Whitepaper
Liability Driven Investing
June 2023

07 CALAPRS
Update
Summer 2023

08 NCPERS
Monitor
June 2023

13.0 COMMENTS

13.01 Chairperson Restuccia was joined by the Board and staff in congratulating Trustee Raymond McCray and his wife on their Fiftieth Wedding Anniversary.
Trustee Keokham thanked the Board for moving the Roundtable meeting back one week so he would be able to attend each year.

14.0 ELECTION OF OFFICERS

14.01 Board to elect officers for 2023-2024

14.02 The Board voted unanimously (9-0) to re-elect Trustee Michael Restuccia as Chairperson, Trustee Michael Duffy as Vice Chairperson and Trustee Raymond McCray as Secretary. (Motion: Keokham; Second: Ding)

15.0 CALENDAR

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

15.02 Special Meeting September 1, 2023 at 9:00 a.m.

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

16.0 ADJOURNMENT

16.01 There being no further business the meeting was adjourned at 12:30 p.m.

Respectfully Submitted:

____
Michael Restuccia, Chair

Attest:

____
Raymond McCray, Secretary

San Joaquin County Employees Retirement Association

August 2023

5.01 Service Retirement — Consent

01 ROSALIND LUNA — Senior Office Assistant, Hosp Medical Records

Member Type: General
Years of Service: 27y 07m 13d
Retirement Date: 6/1/2023

02 ROGER D RIGGS — Sr Info & Assistance Spec, Aging - Community Services

Member Type: General
Years of Service: 08y 03m 27d
Retirement Date: 6/17/2023
Comments: Tier 2 member - eligible to retire with 5 years of service credit.

03 SORIN VEN — Probation Officer III, Prob-JPCF-Juv Detention

Member Type: Safety
Years of Service: 23y 10m 09d
Retirement Date: 6/9/2023

San Joaquin County Employees' Retirement Association (SJCERA)

Preliminary Monthly Flash Report (Net)[1] June 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]			$ 4,040,651,639	100.0%	100.0%	2.3	2.4	5.2	5.8	7.0	5.9	7.6	Apr-90
Policy Benchmark [4]						2.5	3.2	7.6	7.1	7.3	6.2	7.5	
Difference:						-0.2	-0.8	-2.4	-1.3	-0.3	-0.3	0.1	
75/25 Portfolio [5]						4.4	4.4	11.0	12.4	7.3	6.9	6.8	
Difference:			.			-2.1	-2.0	-5.8	-6.6	-0.3	-1.0	0.8	
Broad Growth			$ 3,096,599,443	76.6%	76.0%	3.1	2.8	6.3	8.0	9.1	6.9	8.2	Jan-95
Aggressive Growth Lag[2]			$ 386,358,905	9.6%	10.0%	0.2	0.2	0.2	6.3	18.9	14.7	-2.0	Feb-05
Aggressive Growth Blend [6]						-4.4	2.6	2.6	-4.4	9.3	9.7	0.0	
Difference:						4.6	-2.4	-2.4	10.7	9.6	5.0	-2.0	
BlackRock Global Energy&Power Lag[3]	*$50,000*	*Global Infrastructure*	$ 43,804,104	1.1%		-3.5	-3.5	-3.5	3.7	5.6	--	8.4	Jul-19
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	--	9.2	
Difference:						0.2	-13.9	-13.9	20.0	-1.0	--	-0.8	
Ocean Avenue II Lag[3]	*$40,000*	*PE Buyout FOF*	$ 36,572,535	0.9%		-4.5	-4.5	-4.5	12.0	39.2	26.6	18.2	May-13
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	8.0	-12.1	
Difference:						-0.8	-14.9	-14.9	28.3	32.6	18.6	30.3	
Lightspeed Venture Ptr Select V Lag[3]	*$40,000*	*Growth-Stage VC*	$ 9,606,757	0.2%		-1.3	-1.3	-1.3	--	--	--	--	Jun-22
MSCI ACWI +2% Lag						-3.7	10.4	10.4	--	--	--	--	
Difference:						2.4	-11.7	-11.7	--	--	--	--	
Long Arc Capital Fund Lag[3]	*$25,000*	*Growth-Stage VC*	$ 19,753,658	0.5%		--	--	--	--	--	--	--	Apr-23
MSCI ACWI +2% Lag						--	--	--	--	--	--	--	
Difference:						--	--	--	--	--	--	--	
Ocean Avenue III Lag[3]	*$50,000*	*PE Buyout FOF*	$ 52,236,036	1.3%		2.9	2.9	2.9	16.9	26.3	25.8	25.3	Apr-16
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	8.0	8.3	
Difference:						6.6	-7.5	-7.5	33.2	19.7	17.8	17.0	
Ocean Avenue IV Lag[3]	*$50,000*	*PE Buyout*	$ 56,728,463	1.4%		9.7	9.7	9.7	42.1	35.5	--	39.4	Dec-19
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	--	9.6	
Difference:						13.4	-0.7	-0.7	58.4	28.9	--	29.8	
Ocean Avenue V Lag[3]	*$30,000*	*PE Buyout*	$ 3,000,000	0.1%		--	--	--	--	--	--	--	Jun-23
MSCI ACWI +2% Lag						--	--	--	--	--	--	--	
Difference:						--	--	--	--	--	--	--	
Morgan Creek III Lag[3]	*$10,000*	*Multi-Strat FOF*	$ 3,589,696	0.1%		-9.0	-9.0	-9.0	-19.4	-12.8	-11.0	-5.8	Feb-15
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	8.0	8.4	
Difference:						3.7	-10.4	-10.4	4.4	-17.4	-18.1	-14.2	
Morgan Creek V Lag[3]	*$12,000*	*Multi-Strat FOF*	$ 7,744,302	0.2%		11.0	11.0	11.0	10.0	14.8	13.3	12.8	Jun-13
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	8.0	8.5	
Difference:						3.7	-10.4	-10.4	15.4	4.3	3.0	4.3	
Morgan Creek VI Lag[3]	*$20,000*	*Multi-Strat FOF*	$ 23,243,098	0.6%		-1.9	-1.9	-1.9	-11.7	17.1	15.7	9.6	Feb-15
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	6.6	8.0	8.4	
Difference:						3.7	-10.4	-10.4	6.3	11.2	8.2	1.6	
Ridgemont Equity Partners Lag[3]	*$50,000*	*Special Situations PE*	$ 3,879,531	0.1%		--	--	--	--	--	--	--	Apr-23
MSCI ACWI +2% Lag						--	--	--	--	--	--	--	
Difference:						--	--	--	--	--	--	--	
Stellex Capital Partners II Lag[3]	*$50,000*	*Special Situations PE*	$ 30,749,246	0.8%		-1.3	-1.3	-1.3	21.2	--	--	0.1	Jul-21
MSCI ACWI +2% Lag						-3.7	10.4	10.4	-16.3	--	--	-4.7	
Difference:						2.4	-11.7	-11.7	37.5	--	--	4.8	
Non-Core Private Real Assets Lag[3]	*$341,100*	*Private Real Estate*	$ 95,451,479	2.4%		-2.3	-2.3	-2.3	-9.5	8.8	6.6	-2.5	Nov-04
NCREIF ODCE + 1% Lag Blend						-5.1	-4.9	-4.9	7.6	10.0	8.8	8.8	
Difference:						2.8	2.6	2.6	-17.1	-1.2	-2.2	-11.3	

[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 3/31/23, and lagged 1 quarter.

[3] Manager returns are as of 3/31/23, 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] June 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			$ 27,383,483	0.5%									
Greenfield V[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 216,175	0.0%		-1.2	-1.2	-1.2	-2.0	-10.7	-7.5	-3.0	Jul-08
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*13.5*	
Difference:						3.0	3.0	3.0	-12.8	-24.0	-19.5	-16.5	
Greenfield VI[3]	*$20,000*	*Opportunistic Pvt. RE*	$ 23,599	0.0%		-20.3	-20.3	-20.3	-33.2	-36.0	-35.5	-15.2	Apr-12
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*14.3*	
Difference:						-16.1	-16.1	-16.1	-44.0	-49.3	-47.5	-29.5	
Greenfield VII[3]	*$19,100*	*Opportunistic Pvt. RE*	$ 2,314,538	0.1%		-11.1	-11.1	-11.1	-2.1	10.2	11.5	12.2	Oct-14
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*13.9*	
Difference:						-6.9	-6.9	-6.9	-12.9	-3.1	-0.5	-1.7	
Grandview[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 17,382,607	0.4%		4.8	4.8	4.8	-0.4	21.9	--	19.8	Apr-18
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*--*	*12.0*	
Difference:						9.0	9.0	9.0	-11.2	8.6	--	7.8	
Walton Street V[3]	*$30,000*	*Opportunistic Pvt. RE*	$ 1,047,788	0.0%		43.5	43.5	43.5	-28.1	-16.3	-17.0	-6.3	Nov-06
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*10.4*	
Difference:						47.7	47.7	47.7	-38.9	-29.6	-29.0	-16.7	
Walton Street VI[3]	*$15,000*	*Opportunistic Pvt. RE*	$ 6,398,776	0.2%		5.3	5.3	5.3	14.3	6.7	4.8	8.2	Jul-09
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*12.1*	
Difference:						9.5	9.5	9.5	3.5	-6.6	-7.2	-3.9	
Value-Added Private Real Estate			$ 72,334,149	1.8%									
AG Core Plus IV[3]	*$20,000*	*Value-Added Pvt. RE*	$ 9,907,015	0.2%		-10.6	-10.6	-10.6	-15.9	0.8	4.5	2.9	Sep-15
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*12.5*	
Difference:						-6.4	-6.4	-6.4	-26.7	-12.5	-7.5	-9.6	
Almanac Realty VI[3]	*$30,000*	*Value-Added Pvt. RE*	$ 4,090,987	0.1%		2.2	2.2	2.2	-1.2	-8.4	-5.5	19.5	Feb-13
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*12.0*	*13.5*	
Difference:						6.4	6.4	6.4	-12.0	-21.7	-17.5	6.0	
Berkeley Partners Fund V, LP	*$40,000*	*Value-Added Pvt. RE*	$ 29,895,103	0.7%		-4.5	-4.5	-4.5	4.6	--	--	21.4	Aug-20
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*--*	*--*	*16.9*	
Difference:						-0.3	-0.3	-0.3	-6.2	--	--	4.5	
Stockbridge RE III[3]	*$45,000*	*Value-Added Pvt. RE*	$ 28,441,044	0.7%		1.1	1.1	1.1	8.1	21.3	--	12.9	Jul-18
NCREIF ODCE + 1% Lag Blend						*-4.2*	*-4.2*	*-4.2*	*10.8*	*13.3*	*--*	*12.0*	
Difference:						5.3	5.3	5.3	-2.7	8.0	--	0.9	
Traditional Growth[2]			**$ 1,498,709,898**	**37.1%**	**33.0%**	**6.0**	**6.3**	**13.6**	**17.0**	**11.1**	**6.8**	**8.9**	**Jan-95**
MSCI ACWI IMI Net						*5.8*	*5.9*	*13.2*	*16.1*	*11.0*	*8.4*	*7.7*	
Difference:						0.2	0.4	0.4	0.9	0.1	-1.6	1.2	
Global Equity			$ 1,455,444,652	36.0%									
MSCI World IMI Net						*6.1*	*6.4*	*14.2*	*17.9*	*--*	*--*	*8.5*	
Difference:						0.0	0.1	0.2	0.4	--	--	0.4	
SJCERA Transition		*All Cap Global*	$ 3,131	0.0%		NM	NM	NM	NM	--	--	NM	Jul-20
Emerging Markets			$ 148,225,824										
GQG Active Emerging Markets		*Emerging Markets*	$ 63,993,158	1.6%		6.1	10.8	14.6	10.5	--	--	1.9	Aug-20
MSCI Emerging Markets Index Net						*3.8*	*0.9*	*4.9*	*1.7*	*--*	*--*	*-0.6*	
Difference:						2.3	9.9	9.7	8.8	--	--	2.5	
PIMCO RAE Fundamental Emerging Markets		*Emerging Markets*	$ 84,232,666	2.1%		5.1	6.4	10.9	19.1	14.8	4.8	4.9	Apr-07
MSCI Emerging Markets Index Net						*3.8*	*0.9*	*4.9*	*1.7*	*2.3*	*0.9*	*2.8*	
Difference:						1.3	5.5	6.0	17.4	12.5	3.9	2.1	
REITS			$ 43,265,245	1.1%									
Invesco All Equity REIT		*Core US REIT*	$ 43,265,245	1.1%		4.0	0.2	2.5	-5.3	4.8	3.7	7.6	Aug-04
FTSE NAREIT Equity Index						*5.2*	*2.6*	*5.4*	*-0.1*	*8.9*	*4.6*	*7.3*	
Difference:						-1.2	-2.4	-2.9	-5.2	-4.1	-0.9	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] MSCI ACWI IMI Net as of 4/1/2020, MSCI ACWI Gross prior.

[3] Manager returns are as of 3/31/22, 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] — June 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			$ 1,211,530,640	30.0%	33.0%	0.6	-0.4	0.1	0.4	4.3	4.9	3.7	Jan-05
Risk Parity			$ 369,648,270	9.1%		0.8	-2.5	3.2	-2.8	-0.7	1.6	3.1	
T-Bill +4%						*0.8*	*2.2*	*4.3*	*7.7*	*5.3*	*5.6*	*4.8*	
Difference:						0.0	-4.7	-1.1	-10.5	-6.0	-4.0	-1.7	
Bridgewater All Weather		*Risk Parity*	$ 190,206,645	4.7%		1.0	-2.4	4.4	0.1	0.8	2.0	3.3	Mar-12
T-Bill +4%						*0.8*	*2.2*	*4.3*	*7.7*	*5.3*	*5.6*	*4.9*	
Difference:						0.2	-4.6	0.1	-7.6	-4.5	-3.6	-1.6	
PanAgora Diversified Risk Multi-Asset		*Risk Parity*	$ 179,441,625	4.4%		0.7	-2.6	2.0	-5.6	-2.2	1.2	3.0	Apr-16
T-Bill +4%						*0.8*	*2.2*	*4.3*	*7.7*	*5.3*	*5.6*	*5.4*	
Difference:						-0.1	-4.8	-2.3	-13.3	-7.5	-4.4	-2.4	
Liquid Credit			$ 234,537,952	5.8%		1.8	2.2	4.3	8.8	3.0	2.5	2.0	
50% BB High Yield, 50% S&P/LSTA Leveraged Loans						*2.0*	*2.4*	*5.9*	*9.9*	*4.8*	*3.8*	*5.4*	
Difference:						-0.2	-0.2	-1.6	-1.1	-1.8	-1.3	-3.4	
Neuberger Berman		*Global Credit*	$ 100,035,487	2.5%		1.8	2.0	4.5	7.3	1.6	--	1.9	Feb-19
33% ICE BofA HY Constrained, 33% S&P/LSTA LL, 33% JPM EMBI Glbl Div.						*2.0*	*2.3*	*5.3*	*9.0*	*2.1*	*--*	*2.4*	
Difference:						-0.2	-0.3	-0.8	-1.7	-0.5	--	-0.5	
Stone Harbor Absolute Return		*Absolute Return*	$ 134,502,465	3.3%		1.8	2.4	4.2	10.0	4.0	3.1	2.8	Oct-06
3-Month Libor Total Return						*0.4*	*1.2*	*2.3*	*3.6*	*1.3*	*1.7*	*1.5*	
Difference:						1.4	1.2	1.9	6.4	2.7	1.4	1.3	
Private Credit Lag[2]			$ 369,250,291	9.1%		-2.1	-2.1	-2.1	0.0	4.2	3.6	3.5	
50% BB High Yield, 50% S&P/LSTA Leveraged Loans						*-0.1*	*3.4*	*3.4*	*-6.0*	*1.3*	*2.8*	*5.2*	
Difference:						-2.0	-5.5	-5.5	6.0	2.9	0.8	-1.7	
BlackRock Direct Lending Lag[3]	*$100,000*	*Direct Lending*	$ 88,584,831	2.2%		-4.2	-4.2	-4.2	-1.5	---	---	5.5	May-20
S&P/LSTA Leveraged Loans +3% Blend[5]						*0.7*	*3.4*	*3.4*	*2.2*	*---*	*---*	*11.1*	
Difference:						-4.9	-7.6	-7.6	-3.7	---	---	-5.6	
Mesa West RE Income IV Lag[3]	*$75,000*	*Comm. Mortgage*	$ 37,723,245	0.9%		-1.3	-1.3	-1.3	-1.9	4.6	6.0	6.0	Mar-17
S&P/LSTA Leveraged Loans +3% Blend[4]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	*7.7*	*7.9*	
Difference:						-2.0	-4.7	-4.7	-4.1	-3.0	-1.7	-1.9	
Crestline Opportunity II Lag[3]	*$45,000*	*Opportunistic*	$ 13,111,344	0.3%		-8.7	-8.7	-8.7	-15.9	-2.3	-1.9	2.8	Nov-13
S&P/LSTA Leveraged Loans +3% Blend[4]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	*7.7*	*8.3*	
Difference:						-9.4	-12.1	-12.1	-18.1	-9.9	-9.6	-5.5	
Davidson Kempner Distr Opp V Lag[3]	*$50,000*	*Opportunistic*	$ 48,696,516	0.0%		-0.3	-0.3	-0.3	-0.6	--	--	19.7	Oct-20
S&P/LSTA Leveraged Loans +3% Blend[4]						*0.7*	*3.4*	*3.4*	*2.2*	*--*	*--*	*7.8*	
Difference:						-1.0	-3.7	-3.7	-2.8	--	--	11.9	
Oaktree Lag[3]	*$50,000*	*Leveraged Direct*	$ 29,989,431	0.7%		-4.6	-4.6	-4.6	1.8	11.7	--	9.6	Mar-18
S&P/LSTA Leveraged Loans +3% Blend[6]						*0.7*	*3.4*	*3.4*	*2.2*	*6.7*	*--*	*7.9*	
Difference:						-5.3	-8.0	-8.0	-0.4	5.0	--	1.7	
HPS EU Asset Value II Lag[3]	*$50,000*	*Direct Lending*	$ 26,213,395	0.6%		2.6	2.6	2.6	9.8	--	--	4.4	Aug-20
S&P/LSTA Leveraged Loans +3% Blend[4]						*0.7*	*3.4*	*3.4*	*2.2*	*--*	*--*	*7.9*	
Difference:						1.9	-0.8	-0.8	7.6	--	--	-3.5	
Raven Opportunity III Lag[3]	*$50,000*	*Direct Lending*	$ 56,961,866	1.4%		-2.5	-2.5	-2.5	6.9	7.4	8.3	4.4	Nov-15
S&P/LSTA Leveraged Loans +3% Blend[4]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	*7.7*	*8.1*	
Difference:						-3.2	-5.9	-5.9	4.7	-0.2	0.6	-3.7	

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[2] Total class returns are as of 3/31/23, and lagged 1 quarter.

[3] Manager returns are as of 3/31/23, 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] — June 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	0.0	0.0	-7.0	-9.4	-2.1	Jul-12
S&P/LSTA Leveraged Loans +3% Blend [3]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	*7.7*	*8.4*	
Difference:						-0.7	-3.4	-3.4	-2.2	-14.6	-17.1	-10.5	
White Oak Summit Peer Fund Lag[2]	*$50,000*	*Direct Lending*	$ 24,547,529	0.6%		0.7	0.7	0.7	-10.2	-2.0	1.6	3.4	Mar-16
S&P/LSTA Leveraged Loans +3% Blend [3]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	*7.7*	*7.5*	
Difference:						0.0	-2.7	-2.7	-12.4	-9.6	-6.1	-4.1	
White Oak Yield Spectrum Master V Lag[2]	*$50,000*	*Direct Lending*	$ 39,043,350	1.0%		-3.7	-3.7	-3.7	-1.6	2.3	--	-0.3	Mar-20
S&P/LSTA Leveraged Loans +3% Blend [3]						*0.7*	*3.4*	*3.4*	*2.2*	*7.6*	--	*7.5*	
Difference:						-0.7	-3.4	-3.4	-0.1	-4.0	--	-6.6	
Core Private Real Estate Lag			$ 238,094,127	5.9%									
Principal US[2]	*$25,000*	*Core Pvt. RE*	$ 43,794,434	1.1%		-6.2	-6.2	-6.2	4.1	8.7	8.0	8.6	Jan-16
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*12.1*	
Difference:						-11.7	-11.7	-39.4	-29.1	-7.4	-5.9	-3.5	
Prologis Logistics[2]	*$50,500*	*Core Pvt. RE*	$ 131,265,133	3.2%		-5.1	-5.1	-5.1	12.4	22.4	20.1	13.0	Dec-07
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*9.7*	
Difference:						-10.6	-10.6	-38.3	-20.8	6.3	6.2	3.3	
RREEF America II[2]	*$45,000*	*Core Pvt. RE*	$ 63,457,827	1.6%		-3.7	-3.7	-3.7	7.6	10.6	9.1	9.1	Jul-16
NCREIF ODCE + 1% Lag Blend						*5.5*	*5.5*	*33.2*	*33.2*	*16.1*	*13.9*	*11.8*	
Difference:						-9.2	-9.2	-36.9	-25.6	-5.5	-4.8	-2.7	
Diversifying Strategies			$ 768,130,531	19.0%	24.0%	0.2	1.4	1.2	-1.7	0.8	2.8	6.1	Oct-90
Principal Protection			$ 292,667,064	7.2%	9.0%	0.1	-0.1	3.0	1.2	-1.2	0.9	5.8	Oct-90
BB Aggregate Bond Index						*-0.4*	*-0.8*	*2.1*	*-0.9*	*-4.0*	*0.8*	*5.3*	
Difference:						0.5	0.7	0.9	2.1	2.8	0.1	0.5	
Dodge & Cox		*Core Fixed Income*	$ 200,157,994	5.0%		0.3	0.1	3.1	2.1	-1.6	2.2	6.5	Oct-90
BB Aggregate Bond Index						*-0.4*	*-0.8*	*2.1*	*-0.9*	*-4.0*	*0.8*	*5.3*	
Difference:						0.7	0.9	1.0	3.0	2.4	1.4	1.2	
Loomis Sayles		*Core Fixed Income*	$ 92,509,070	2.3%		-0.3	-0.7	2.6	-0.6	--	--	-4.0	Mar-22
BB Aggregate Bond Index						*-0.4*	*-0.8*	*2.1*	*-0.9*	--	--	*-4.5*	
Difference:						0.1	0.1	0.5	0.3	--	--	0.5	

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[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] — June 2023

	Commitment ($000)	Sub-Segment	Market Value	Physical % of Total	Policy Target %	1-Mo	3-Mos	YTD	1-Yr	3-Yrs	5-Yrs	SI Return	SI Date
Crisis Risk Offset			**$ 475,463,467**	**11.8%**	**15.0%**	**0.3**	**2.4**	**0.2**	**-3.4**	**2.5**	**4.1**	**6.3**	**Jan-05**
CRO Custom Benchmark [2]						*0.6*	*0.9*	*2.2*	*-0.7*	*1.2*	*4.0*	*4.8*	
Difference:						-0.3	1.5	-2.0	-2.7	1.3	0.1	1.5	
Long Duration			$ 116,635,615	2.9%		-0.2	-2.4	4.3	-5.9	-11.4	-0.8	-0.8	
BB US Long Duration Treasuries						*0.0*	*-2.3*	*3.7*	*-6.8*	*-12.1*	*-0.9*	*-0.8*	
Difference:						-0.2	-0.1	0.6	0.9	0.7	0.1	0.0	
Dodge & Cox Long Duration		*Long Duration*	$ 116,635,615	2.9%		-0.2	-2.4	4.2	-6.0	-11.4	-0.8	-0.8	Feb-16
BB US Long Duration Treasuries						*0.0*	*-2.3*	*3.7*	*-6.8*	*-12.1*	*-0.9*	*-0.8*	
Difference:						-0.2	-0.1	0.5	0.8	0.7	0.1	0.0	
Systematic Trend Following			$ 238,198,009	5.9%		0.2	4.2	-1.2	-4.4	16.1	8.3	8.9	
BTOP50 Index						*1.5*	*3.7*	*-0.2*	*-1.5*	*10.9*	*6.9*	*5.0*	
Difference:						-1.3	0.5	-1.0	-2.9	5.2	1.4	3.9	
Mt. Lucas Managed Futures - Cash		*Systematic Trend Following*	$ 119,427,413	3.0%		-2.8	1.6	-2.6	-5.9	16.9	7.4	8.3	Jan-05
BTOP50 Index						*1.5*	*3.7*	*-0.2*	*-1.5*	*10.9*	*6.9*	*5.0*	
Difference:						-4.3	-2.1	-2.4	-4.4	6.0	0.5	3.3	
Graham Tactical Trend		*Systematic Trend Following*	$ 118,770,596	2.9%		3.4	7.0	0.1	-2.8	15.3	9.0	4.6	Apr-16
SG Trend Index						*2.0*	*8.0*	*0.1*	*-1.1*	*14.2*	*9.6*	*5.3*	
Difference:						1.4	-1.0	0.0	-1.7	1.1	-0.6	-0.7	
Alternative Risk Premia			$ 120,629,843	3.0%		1.2	3.8	-1.3	-1.1	-0.4	1.6	7.2	
5% Annual						*0.4*	*1.2*	*2.5*	*5.0*	*5.0*	*5.0*	*6.2*	
Difference:						0.8	2.6	-3.8	-6.1	-5.4	-3.4	1.0	
AQR Style Premia		*Alternative Risk Premia*	$ 57,874,282	1.4%		10.5	6.1	5.0	9.4	17.6	0.8	1.3	May-16
5% Annual						*0.4*	*1.2*	*2.5*	*5.0*	*5.0*	*5.0*	*5.0*	
Difference:						10.1	4.9	2.5	4.4	12.6	-4.2	-3.7	
PE Diversified Global Macro		*Alternative Risk Premia*	$ 62,755,561	1.6%		-6.1	1.8	-6.6	-6.0	-3.2	3.1	2.0	Jun-16
5% Annual						*0.4*	*1.2*	*2.5*	*5.0*	*5.0*	*5.0*	*5.0*	
Difference:						-6.5	0.6	-9.1	-11.0	-8.2	-1.9	-3.0	
Cash[3]			**$ 147,425,440**	**3.6%**	**0.0%**	**0.3**	**0.9**	**1.7**	**3.1**	**1.1**	**1.2**	**2.3**	**Sep-94**
US T-Bills						*0.5*	*1.2*	*2.3*	*3.6*	*1.3*	*1.6*	*2.3*	
Difference:						-0.2	-0.3	-0.6	-0.5	-0.2	-0.4	0.0	
Northern Trust STIF		*Collective Govt. Short Term*	$ 116,605,813	2.9%		0.4	1.1	2.0	3.2	1.2	1.3	2.6	Jan-95
US T-Bills						0.5	1.2	2.3	3.6	1.3	1.6	*2.3*	
Difference:						-0.1	-0.1	-0.3	-0.4	-0.1	-0.3	0.3	
Parametric Overlay[4]		*Cash Overlay*	**$ 28,496,226**	**0.7%**		**0.0**	**0.0**	**0.0**	**0.0**	**--**	**--**	**0.0**	**Jan-20**

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[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 | YEARS

Economic and Market Update

June 2023 Report

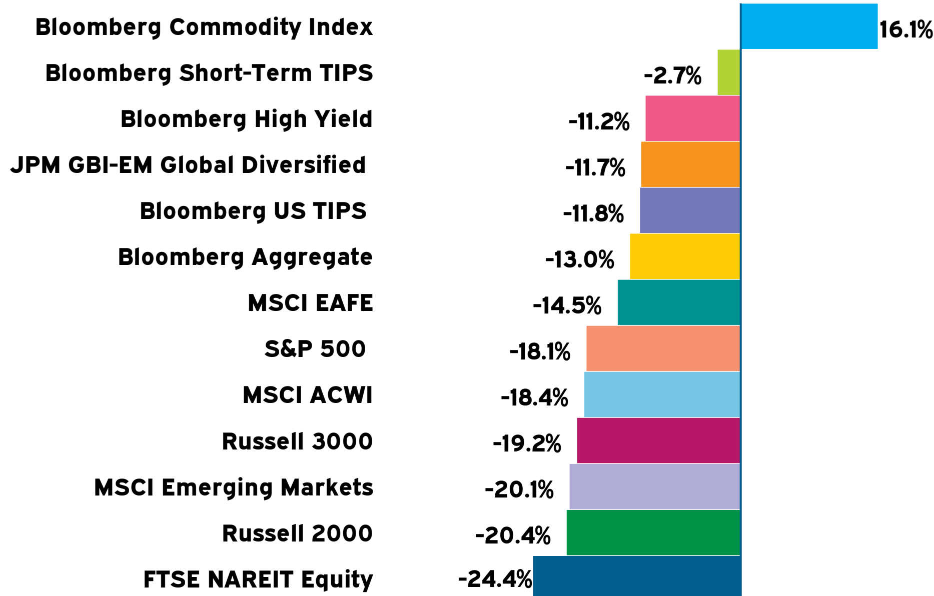
Commentary

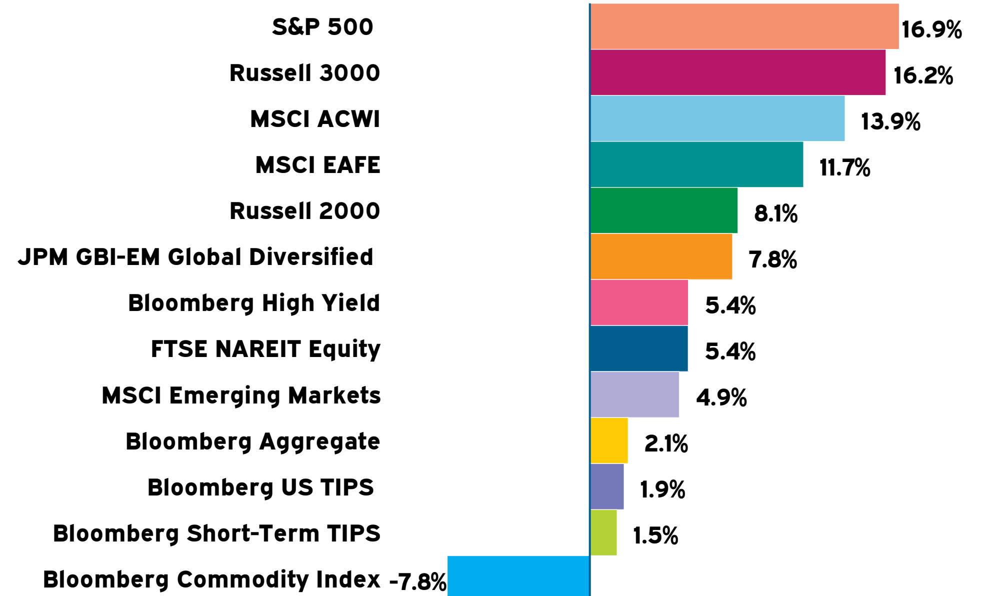
→ Asset returns were positive in June with US and Non-US equities posting gains, while most fixed income sectors sold-off on expectations for further interest rate hikes later this year. Except for commodities, most public market asset classes remain up for the year.

- Although the Fed skipped a rate-hike in June, Fed comments signaled further rate hikes in the 2H 2023; the US economy appears to be resilient supporting domestic demand and low unemployment.
- US equity markets (Russell 3000) rose in June (+6.8%) adding to YTD gains (+16.2%). Some of the largest technology names drove positive results. Growth stocks continued to outpace value stocks, particularly in the large cap space.
- Non-US developed equity markets rose in June (MSCI EAFE 4.6%) falling behind US equities in 2023 (+16.2% versus +11.7%). A strengthening US dollar weighed on returns.
- Emerging market equities rose in June (+3.8%) supported by positive returns in China (+4.0%). They significantly trail developed market equities YTD returning +4.9%, due partly to higher US-China tensions.
- Rates generally rose in June leading to bond markets declining, with the broad US bond market (Bloomberg Aggregate) falling 0.4% for the month. It remains positive (+2.1%) year-to-date, though, on declining inflation and expectations for the Fed to end their rate hikes soon.

→ This year, the paths of inflation and monetary policy, slowing global growth and the war in Ukraine will all be key.

Index Returns[1]





→ After a particularly difficult 2022, most public market assets are up thus far in 2023, building on gains from the fourth quarter of last year.

→ Risk sentiment has been supported by expectations that policy tightening could be ending soon, as inflation continues to fall, and growth has slowed.

[1] Source: Bloomberg and FactSet. Data is as of June 30, 2023.

Domestic Equity Returns[1]

Domestic Equity	June (%)	Q2 (%)	YTD (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)
S&P 500	6.6	8.7	16.9	19.6	14.6	12.3	12.8
Russell 3000	6.8	8.4	16.2	19.0	13.9	11.4	12.3
Russell 1000	6.8	8.6	16.7	19.4	14.1	11.9	12.6
Russell 1000 Growth	6.8	12.8	29.0	27.1	13.7	15.1	15.7
Russell 1000 Value	6.6	4.1	5.1	11.5	14.3	8.1	9.2
Russell MidCap	8.3	4.8	9.0	14.9	12.5	8.4	10.3
Russell MidCap Growth	7.7	6.2	15.9	23.1	7.6	9.7	11.5
Russell MidCap Value	8.7	3.9	5.2	10.5	15.0	6.8	9.0
Russell 2000	8.1	5.2	8.1	12.3	10.8	4.2	8.2
Russell 2000 Growth	8.3	7.1	13.6	18.5	6.1	4.2	8.8
Russell 2000 Value	7.9	3.2	2.5	6.0	15.4	3.5	7.3

US Equities: Russell 3000 Index rose 8.4% in the second quarter and 16.2% YTD.

→ US stocks rose sharply in the second quarter of 2023. Most of the gains came in the month of June when the Fed kept its target rate unchanged for the first time since early 2022. Investors are expressing optimism that the Fed can tame inflation without widespread disruptions to the equity markets.

→ With the exception of energy and utilities, each sector of the Russell 3000 index appreciated during the second quarter. Technology led all sectors and was driven by enthusiasm for growth stocks, particularly those with exposure to artificial intelligence (e.g., NVIDIA).

→ Large cap stocks continue to outperform small cap stocks, driven by technology and the underperformance of small cap biotechnology stocks. Growth stocks continue to broadly outperform value stocks.

[1] Source: Bloomberg. Data is as of June 30, 2023.

Foreign Equity Returns[1]

Foreign Equity	June (%)	Q2 (%)	YTD (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)
MSCI ACWI ex. US	4.5	2.4	9.5	12.7	7.2	3.5	4.7
MSCI EAFE	4.6	3.0	11.7	18.8	8.9	4.4	5.4
MSCI EAFE (Local Currency)	3.6	4.3	12.1	17.5	11.7	6.4	7.7
MSCI EAFE Small Cap	2.9	0.6	5.5	10.2	5.7	1.3	6.2
MSCI Emerging Markets	3.8	0.9	4.9	1.8	2.3	0.9	2.9
MSCI Emerging Markets (Local Currency)	3.4	1.7	5.6	3.3	3.9	3.0	5.7
MSCI China	4.0	-9.7	-5.5	-16.8	-10.3	-5.3	3.0

Foreign Equity: Developed international equities (MSCI EAFE) rose 3.0% in the second quarter bringing the YTD results to +11.7%. Emerging market equities (MSCI EM) rose 0.9%. in the quarter, rising 4.9% YTD.

→ Eurozone and Japan markets continued their strength in June, wrapping up a strong second quarter. In Europe, financials and IT led returns whereas energy and communication services lagged. Enthusiasm for AI helped company fundamentals and prices for semiconductor stocks. Headline inflation was down in June, although core inflation was up slightly month over month. Energy and materials were the main drivers for falling UK equities, along with Bank of England rate hikes. Optimism continues to build for Japanese investors, while the Yen remains weak, and Bank of Japan remains dovish.

→ Emerging markets were laggards as China equities struggled from weak export demands and rising negative sentiments. Brazil, India, and Taiwan are bright spots in EM, the former due to good earnings and macro, the latter from AI and IT strength.

[1] Source: Bloomberg. Data is as of June 30, 2023.

Fixed Income Returns[1]

Fixed Income	June (%)	Q2 (%)	YTD (%)	1 YR (%)	3 YR (%)	5 YR (%)	10 YR (%)	Current Yield (%)	Duration (Years)
Bloomberg Universal	-0.2	-0.6	2.3	0.0	-3.4	1.0	1.8	5.2	6.3
Bloomberg Aggregate	-0.4	-0.8	2.1	-0.9	-4.0	0.8	1.5	4.8	6.5
Bloomberg US TIPS	-0.3	-1.4	1.9	-1.4	-0.1	2.5	2.1	4.6	6.8
Bloomberg Short-term TIPS	-0.2	-0.7	1.5	0.1	2.3	2.7	1.7	5.3	2.5
Bloomberg High Yield	1.7	1.7	5.4	9.1	3.1	3.4	4.4	8.5	4.1
JPM GBI-EM Global Diversified (USD)	3.3	2.5	7.8	11.4	-1.4	0.3	-0.6	6.6	5.0

Fixed Income: The Bloomberg Universal declined 0.6% in the second quarter as global sovereign debt yields generally rose. Bonds retained a positive start to the year (+2.3% YTD) though as inflation continues to decline.

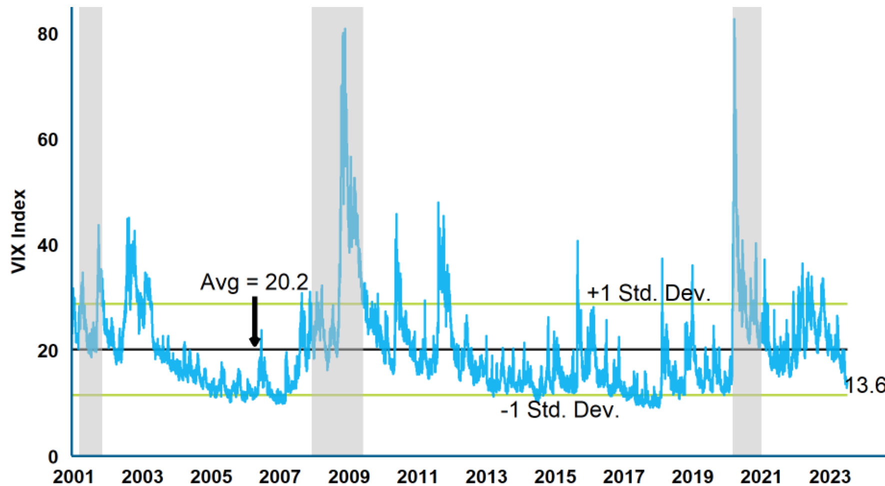
→ US Treasury yields generally rose over the month, with 1-year to 10-year maturity sector rising the most due to higher policy expectations.

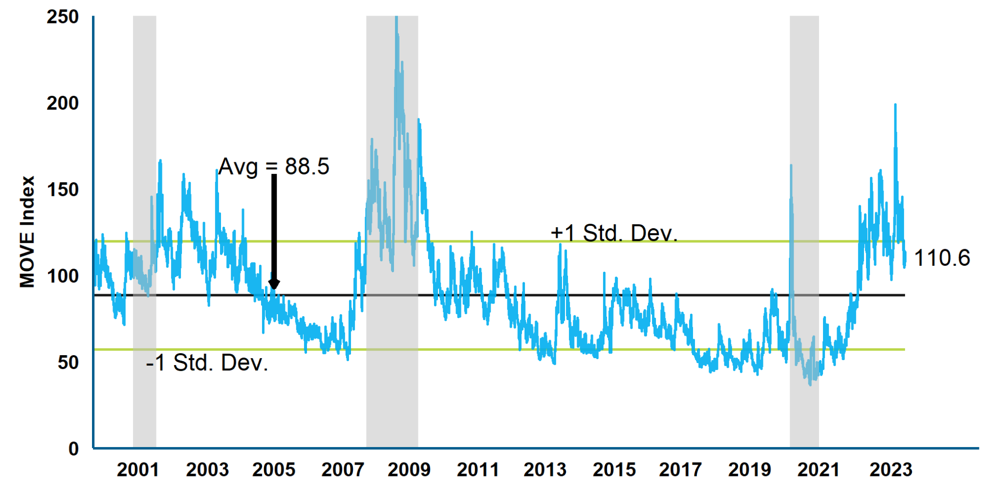
→ The TIPS index and the short-term TIPS index posted negative returns for the month as inflation concerns continued to ease.

→ Continued risk appetite drove high yield bond performance (1.7%) and outperformance versus the broad US bond market (Bloomberg Aggregate). Emerging market bonds (3.3%) also performed well on investor risk sentiment.

[1] Source: Bloomberg. JPM GBI-EM data is from InvestorForce. Data is as of June 30, 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]



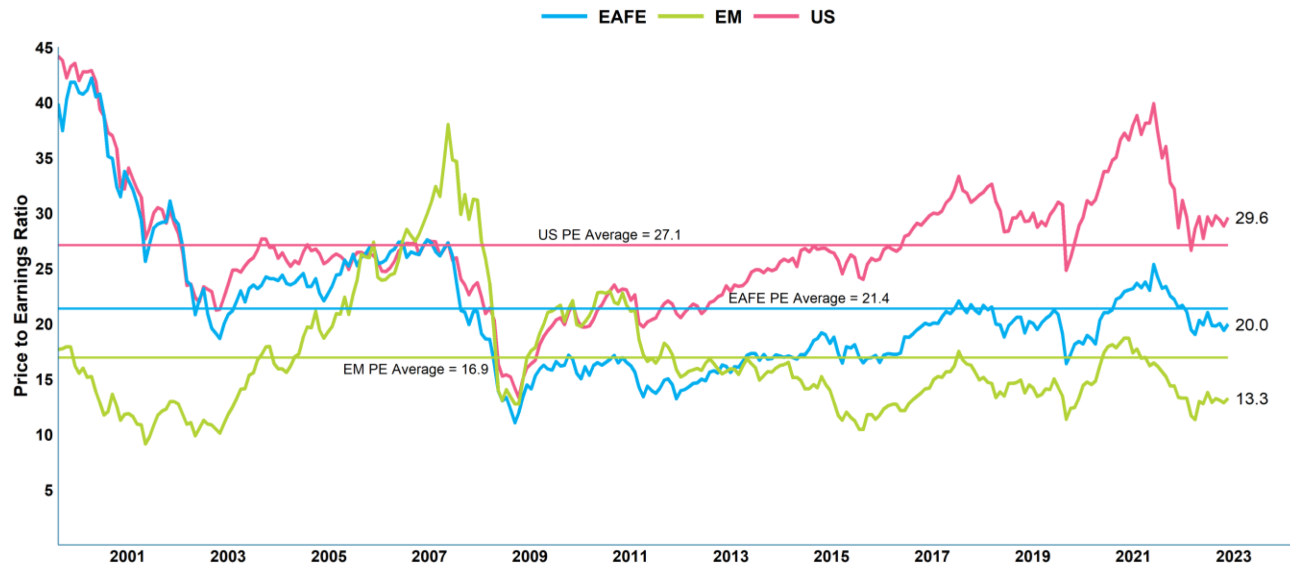


→ Volatility in equities (VIX) declined in June and remains low as investors continue to anticipate the end of the Fed's policy tightening.

→ In comparison, the bond market remains on edge after last year's historic losses and continued volatility in interest rates this year due to policy uncertainty and issues in the banking sector. The MOVE (fixed income volatility) remains well above (110.6) its long-run average (88.4), but off its recent peak during the heart of the banking crisis.

[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 June 2023. The average line indicated is the average of the VIX and MOVE values between January 2000 and June 2023.

Equity Cyclically Adjusted P/E Ratios[1]

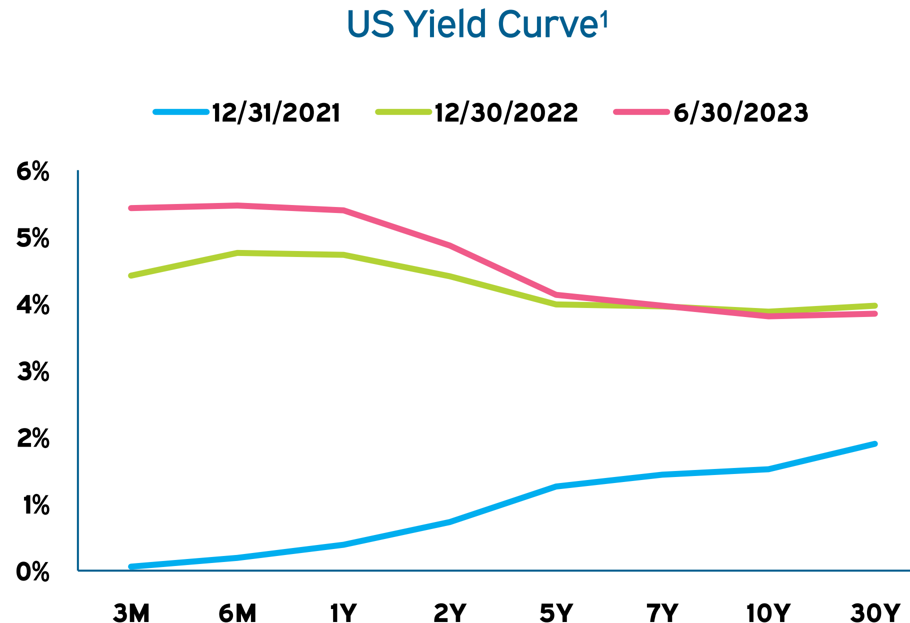


→ After its dramatic decline last year the US equity price-to-earnings ratio remains above its long-run (21st century) average.

→ International developed market valuations are 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 June 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]

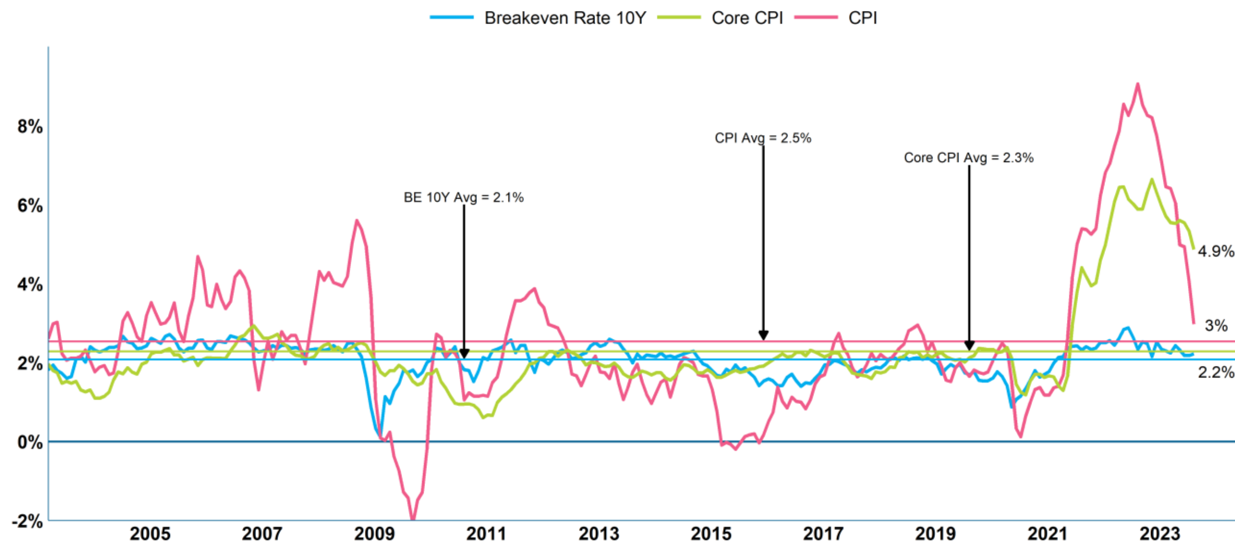


→ Interest rates have started rising again across the curve given policy maker guidance that policy rates are likely to rise further and potentially stay longer at the terminal rate than market participants expect. The rise in rates was particularly acute at the very front-end (< 1 year). Maturities from two years out also drifted higher as market participants considered the possibility of additional policy rate increases as economic data (mainly inflation and labor markets) remains strong.

→ The yield curve remains inverted with the spread between two-year and ten-year Treasuries finishing the month at -1.06%. The more closely watched measure (by the Fed) of the three-month and ten-year Treasuries spread also remained inverted at -1.62%. Inversions in the yield curve have often preceded recessions.

[1] Source: Bloomberg. Data is as of June 30, 2023.

Ten-Year Breakeven Inflation and CPI[1]



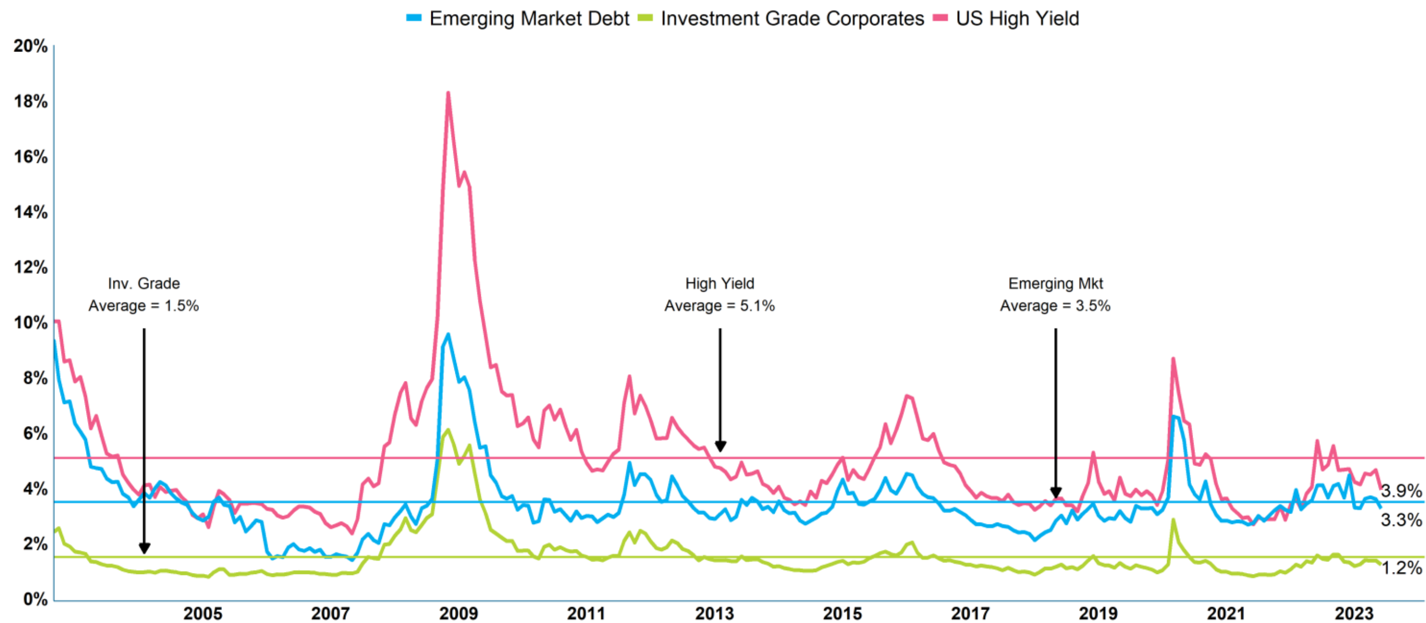
→ Headline inflation continued to decline in June, with the year-over-year reading falling from 4.0% to 3.0% and coming in slightly below estimates. The month-over-month rate of price increases rose slightly (0.2% versus 0.1%), with food prices ticking up slightly (0.1%) and energy prices rose (0.6%).

→ Core inflation – excluding food and energy - fell (5.3% to 4.9%), coming in slightly above forecasts. It remains stubbornly high driven by shelter costs.

→ Inflation expectations (breakevens) remain well below current inflation as investors continue to expect inflation to track back toward the Fed's 2% average target.

[1] Source: Bloomberg. Data is as June 30, 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.

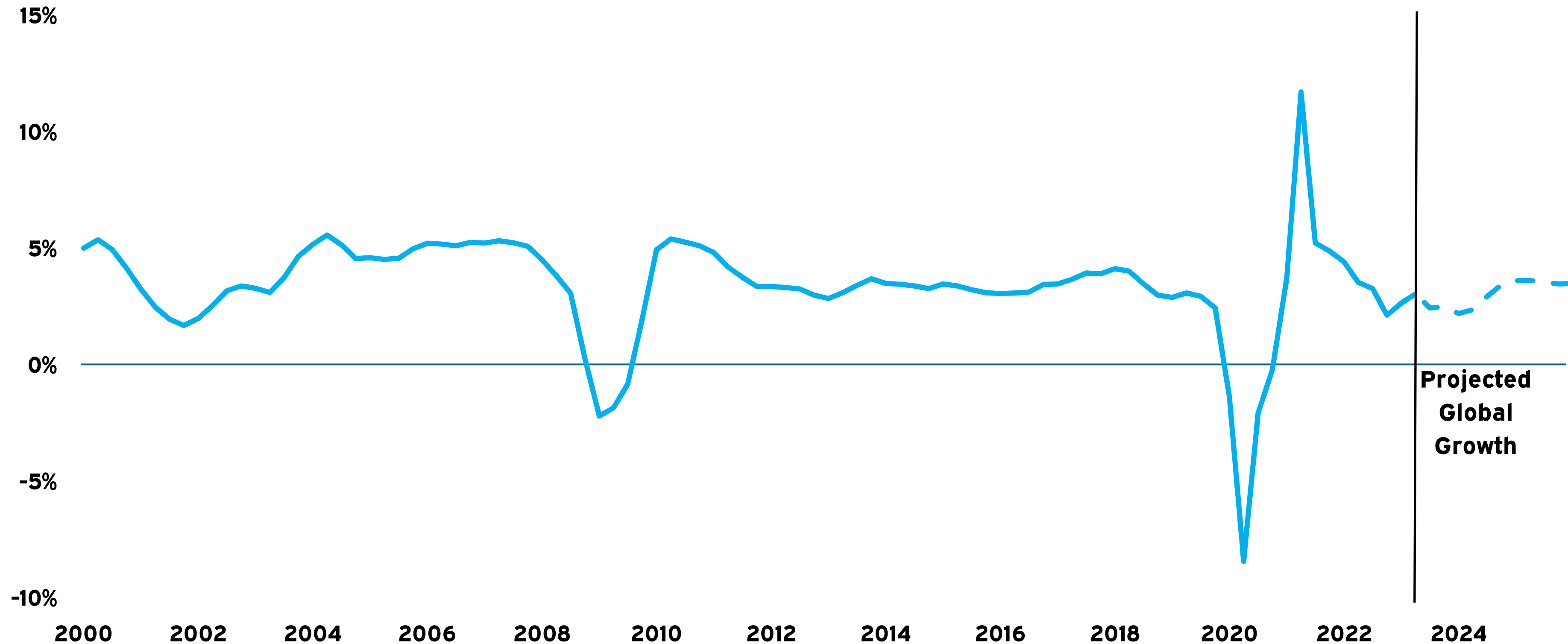
Credit Spreads vs. US Treasury Bonds[1]



→ Spreads (the added yield above a comparable maturity Treasury) declined in June as risk appetite remained robust for respective credit exposures.

→ High yield spreads remain below their long-term average. Investment grade spreads and emerging market spreads are narrower than high yield spreads and close to their respective long-term averages.

[1] Sources: Bloomberg. Data is as of June 30, 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.



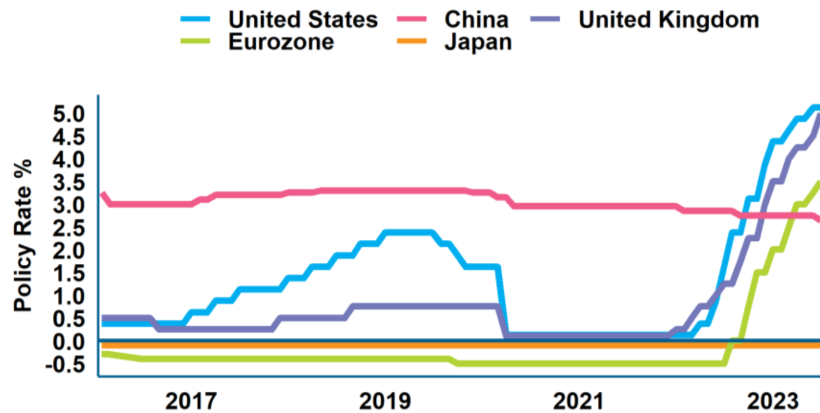
→ Global economies are expected to slow this year compared to 2022, with risks of recession as the impacts of policymakers' aggressive tightening to fight inflation flow through economies.

→ The delicate balancing act of central banks trying to reduce inflation without dramatically depressing growth will remain key.

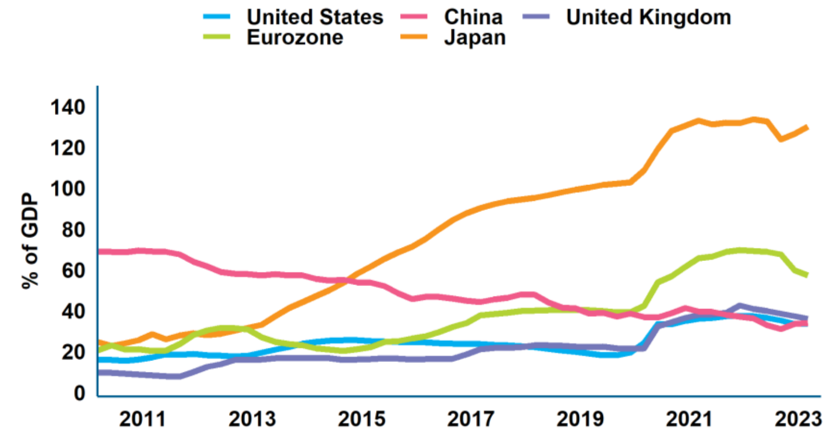
[1] Source: Oxford Economics (World GDP, US$ prices & PPP exchange rate, real, % change YoY). Updated June 2023.

Central Bank Response[1]

Policy Rates



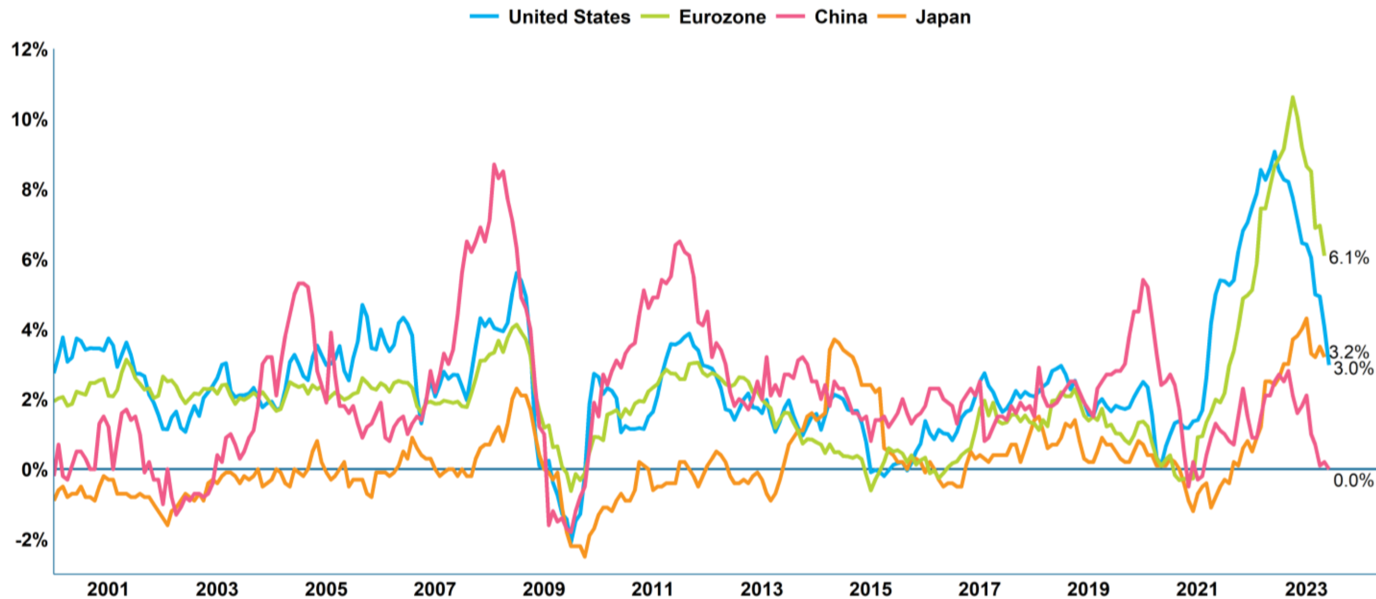
Balance Sheet as % of GDP



- → 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 growth have led to expectations for reductions in policy tightening going forward.
- → In May the Fed raised rates another 25 basis points to a range of 5.0% to 5.25%. After month-end, the FOMC paused its tightening campaign but hinted that one or two additional rate hikes could come later this year.
- → In China, the central bank has continued to cut interest rates and inject liquidity into the banking system, as weaker than expected economic data appears to indicate a widespread slowdown.
- → Looking ahead, risks remain for a policy error as central banks attempt to balance multiple goals, bringing down inflation, maintaining financial stability, and supporting growth.

[1] Source: Bloomberg. Policy rate data is as of June 30, 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 March 31, 2023.

Inflation (CPI Trailing Twelve Months)[1]



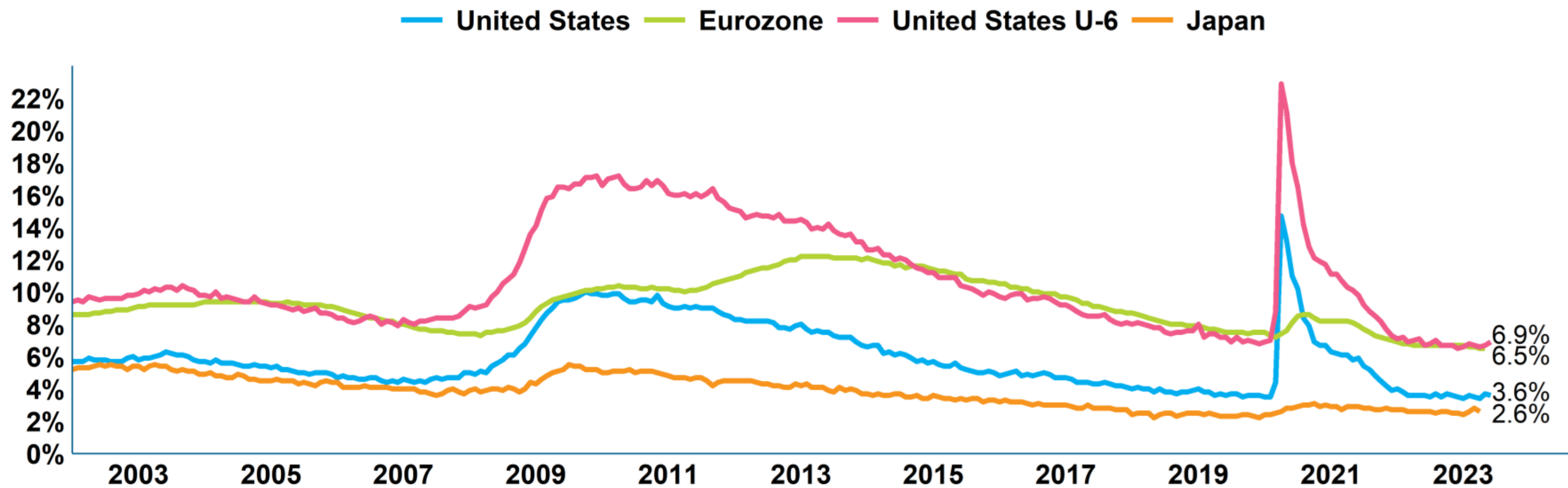
→ Inflation pressures continued to decline globally due to the easing of supply chain issues from the pandemic, declining energy prices, and tighter monetary policy.

→ In the US, inflation fell to 3.0% at month-end, while eurozone inflation also fell (6.1% from 7.0%) a level well off its peak. Despite 2023's significant declines in the US and Europe, inflation levels remain elevated compared to central bank targets.

→ Inflation remains lower in China and Japan. In China, inflation levels were only slightly above 0% at month-end as the reopening of their economy has led to an uneven economic recovery.

[1] Source: Bloomberg. Data is as June 30, 2023. The most recent Japanese inflation data is as of May 2023.

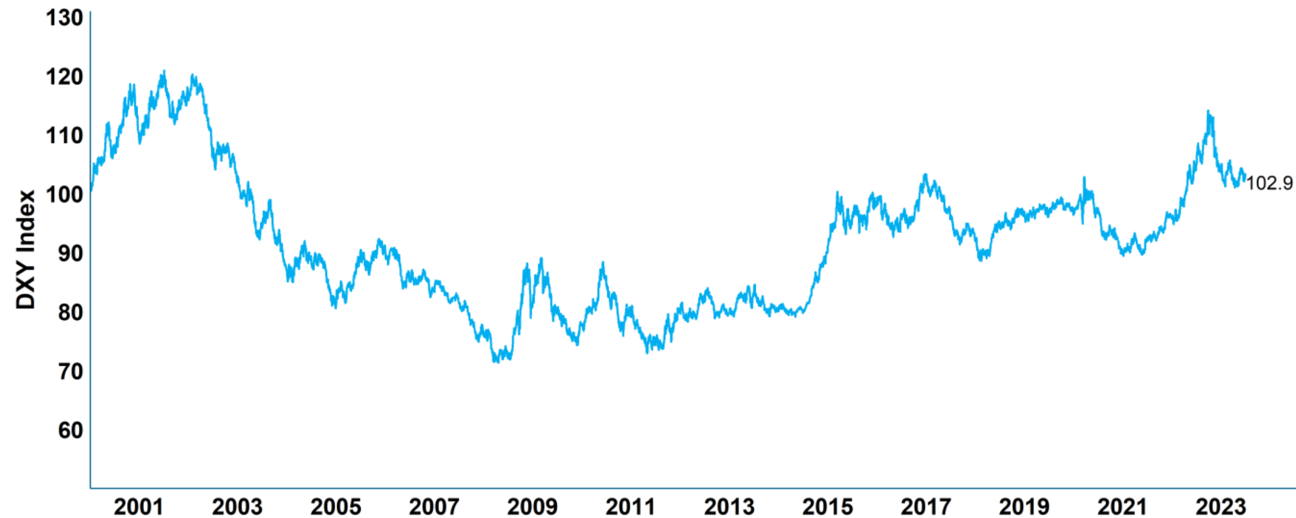
Unemployment[1]



- → Despite slowing growth and high inflation, the US labor market still shows signs of resiliency. Unemployment in the US, which experienced the steepest rise, recently returned to pre-pandemic levels. Broader measures of unemployment (U-6) remain higher at 6.9% but 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, leading to higher unemployment.
- → Unemployment in Europe has also declined but remains higher than the US, while levels in Japan have been flat through the pandemic given less layoffs.

[1] Source: Bloomberg. Data is as June 30, 2023, for the US. The most recent data for Eurozone and Japanese unemployment is as of May 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 this year, the dollar declined, as weaker economic data and lower inflation led to investors anticipating the end of Fed tightening. In June, we did see a slight decline in the dollar though.
- → This year, the track of inflation across economies and the corresponding monetary policies will be key drivers of currency moves.

[1] Source: Bloomberg. Data as of June 30, 2023.

Summary

Key Trends:

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

→ Recent issues related to the banking sector seem to have subsided for now but are a reminder that there is a delicate balance for central banks to continue to fight inflation but also to try to maintain financial stability.

→ Global monetary policies could diverge in 2023. The risk of policy errors remains elevated as central banks try to reduce persistent inflation while not tipping their economies into recession.

→ 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, consumers could feel pressure as certain components of inflation remain high (e.g., shelter), borrowing cost are elevated, and the job market may weaken.

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

→ Equity valuations remain lower in both emerging and developed markets, but risks remain, including potential continued strength in the US dollar, higher inflation weighing particularly on Europe, and China's sluggish economic reopening and on-going weakness in the real estate sector.

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SIGNIFICANT EVENTS MAY OCCUR (OR HAVE OCCURRED) AFTER THE DATE OF THIS REPORT AND THAT IT IS NOT OUR FUNCTION OR RESPONSIBILITY TO UPDATE THIS REPORT. ANY OPINIONS OR RECOMMENDATIONS PRESENTED HEREIN REPRESENT OUR GOOD FAITH VIEWS AS OF THE DATE OF THIS REPORT AND ARE SUBJECT TO CHANGE AT ANY TIME. ALL INVESTMENTS INVOLVE RISK. THERE CAN BE NO GUARANTEE THAT THE STRATEGIES, TACTICS, AND METHODS DISCUSSED HERE WILL BE SUCCESSFUL.

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CERTAIN INFORMATION CONTAINED IN THIS REPORT MAY CONSTITUTE “FORWARD - LOOKING STATEMENTS,” WHICH CAN BE IDENTIFIED BY THE USE OF TERMINOLOGY SUCH AS “MAY,” “WILL,” “SHOULD,” “EXPECT,” “AIM”, “ANTICIPATE,” “TARGET,” “PROJECT,” “ESTIMATE,” “INTEND,” “CONTINUE” OR “BELIEVE,” OR THE NEGATIVES THEREOF OR OTHER VARIATIONS THEREON OR COMPARABLE TERMINOLOGY. ANY FORWARD-LOOKING STATEMENTS, FORECASTS, PROJECTIONS, VALUATIONS, OR RESULTS IN THIS PRESENTATION ARE BASED UPON CURRENT ASSUMPTIONS. CHANGES TO ANY ASSUMPTIONS MAY HAVE A MATERIAL IMPACT ON FORWARD - LOOKING STATEMENTS, FORECASTS, PROJECTIONS, VALUATIONS, OR RESULTS. ACTUAL RESULTS MAY THEREFORE BE MATERIALLY DIFFERENT FROM ANY FORECASTS, PROJECTIONS, VALUATIONS, OR RESULTS IN THIS PRESENTATION.

PERFORMANCE DATA CONTAINED HEREIN REPRESENT PAST PERFORMANCE. PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.

2023 Annual SJCERA Investment Roundtable

October 12, 2023

7:15 a.m. – 5:00 p.m.

Wine & Roses
2505 Turner Road
Lodi, CA 95242
(209)334-6988

AGENDA - DRAFT

Thursday, October 12, 2023			Duration (Minutes)
I.	7:15 a.m.	Roundtable Registration & Continental Breakfast	:45
II.	8:00 a.m.	Roll Call Pledge of Allegiance Welcome and Introduction of Participants	:15
III.	8:15 a.m.	Overview of SJCERA – Asset Allocation, return/risk, goals, and objectives. (Meketa)	:30
IV.	8:45 a.m.	Keynote Speaker – The state of the world in 2023 and beyond (TBD)	1h:00
V.	9:45 a.m.	Break	:30
VI.	10:15 a.m.	Private Markets Investing (Private Equity, Private Credit, Infrastructure) – What's next and where are the markets today. (TBD)	1h:00
VII.	11:15 a.m.	Inflation –The Global economy has been faced with historically high inflation due to several different reasons. Will we see normalized inflation in the next three years? (TBD)	:45
VIII.	12:00 p.m.	Lunch	1h:15

IX.	1:15 p.m.	Manager Debate: In a classic debate format; watch teams of managers debate various topics. (TBD)	:45
X.	2:00 p.m.	International Markets –The U.S. equity markets have dominated investment returns since the GFC. Are we going to see a reversal? Are international markets more attractive over the next ten years? Where do the Chinese markets fit within this structure? (TBD)	1h:00
XI.	3:00 p.m.	Break	:30
XII.	3:30 p.m.	Real Estate –What lies ahead in Real Estate and where are the opportunities? (TBD)	:45
XIII.	4:15 p.m.	Open Discussion and Re-Cap (Meketa) Comments from the Board Comments from the Public	:45
XIV.	5:00 p.m.	Adjournment	

San Joaquin County Employees' Retirement Association

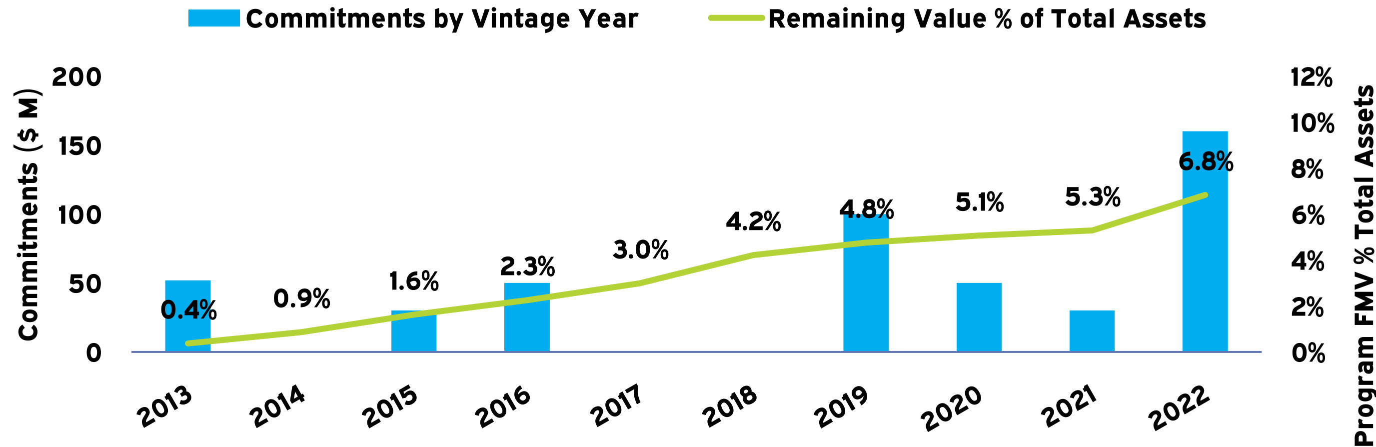
Fourth Quarter 2022

Private Equity Program

Introduction

→ SJCERA has been an investor in private equity since 2013, and the program is a part of the Aggressive Growth portfolio which has an 8% target allocation. Initial investments focused on fund of fund strategies.

→ Since 2019, a more consistent deployment of capital into commingled funds has supported the buildout of the portfolio.



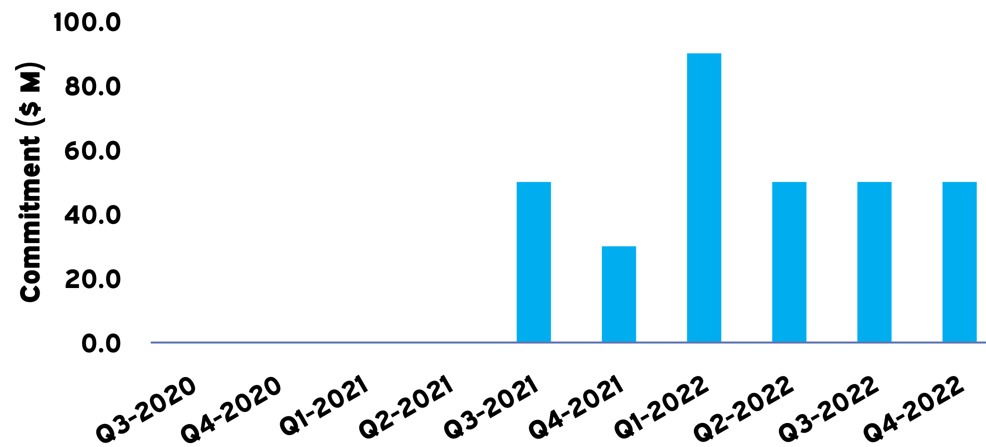
Program Status

No. of Investments	16
Committed ($ M)	552.0
Contributed ($ M)	242.7
Distributed ($ M)	174.6
Remaining Value ($ M)	259.5

Performance Since Inception

	Program
DPI	0.72x
TVPI	1.79x
IRR	18.8%

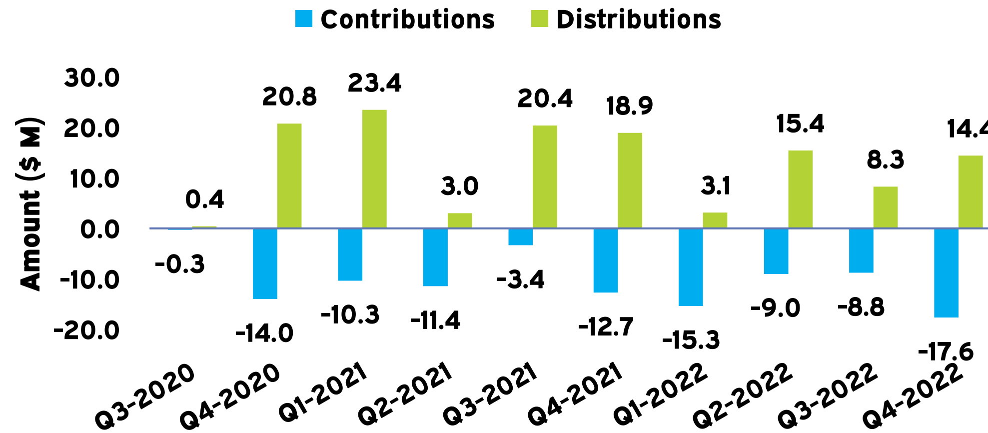
Commitments



Commitments This Quarter

Fund	Strategy	Region	Amount (M)
Oaktree SSF III	Special Situations	North America	25.00
Long Arc I	Growth Equity	Global: Developed	25.00

Cash Flows



Largest Contributions This Quarter

Fund	Vintage	Strategy	Region	Amount ($M)
Stellex II	2020	Special Situations	Global: Developed	14.04
Ocean Ave IV	2019	Buyout	North America	2.00
Lightspeed Select V	2022	Venture Capital	North America	1.60

Largest Distributions This Quarter

Fund	Vintage	Strategy	Region	Amount ($M)
Ocean Ave IV	2019	Buyout	North America	8.50
Stellex II	2020	Special Situations	Global: Developed	1.88
Ocean Avenue III	2016	Buyout	North America	1.73

Significant Events

→ In Q4 2022, Stellex Capital Partners II completed $330.4 million of new investments in three companies: (i) Stellex Stucki Holdings LP, a supplier of engineered parts and services for the railroad sector, (ii) LFG Data Services Holdings LP, a platform focused on providing mission-critical risk, fraud mitigation, and regulatory compliance services to its customers in the financial and digital commerce sectors, and (iii) Stellex W&B Holdings, LLC, a supplier and servicer of semi-trailers and refrigerated equipment with exclusive OEM relationships with Carrier Transicold and Hyundai. Fund II also distributed $73.2 million in proceeds from its sale of PLH Group, a provider of construction and maintenance services to the electric power delivery and pipeline industries, to Primoris Services Corporation (NASDAQ: PRIM).

→ Ocean Avenue III distributed $8.1 million in Q4 2022. Investments in Consulting Solutions (IT staffing company), Marketron (revenue management and audience engagement solutions for the media industry), ServicePower (mobile workforce management software), and Voyager Global Mobility (provider of short-term, fully insured, taxi and limousine commission-licensed automobiles to on-demand drivers in the New York City area) were all marked up from Q3 2022. Two investments were permanently written off as of 12/31/22: Burrana (producer of cabin electronics systems for commercial aircraft) and Fore Aero (aerospace and defense manufacturing company).

→ During Q4 2022, Ocean Avenue IV called $14.0 million and distributed $59.5 million. Fund IV made one investment in Q4 2022, investing alongside Acacia Group in Isos Technology, a partner in the Atlassian software ecosystem delivering a suite of services enabling customers to adopt, maintain, and optimize their Atlassian toolsets. Hero Cosmetics, a functional skincare brand focused on acne breakouts, was sold for 7.1x cost in less than two years.

→ As of December 31, 2022, Lightspeed Select V is 24% called and invested into 17 total investments across the US, Europe, India, and Canada, all of which remain unrealized with a total carrying value of $393 million (versus a cost of $412 million). In Q4 2022, the Fund completed $38.4 million of new investments in three companies: (i) Enable Global, a cloud-based rebate management solution provider helping distributors, manufacturers, and retailers manage rebates, (ii) zkSync, a generalized layer-2 protocol that aims to increase blockchain scalability without compromising security for Ethereum, and (iii) Gnosis, a secure digital asset management platform for Ethereum.

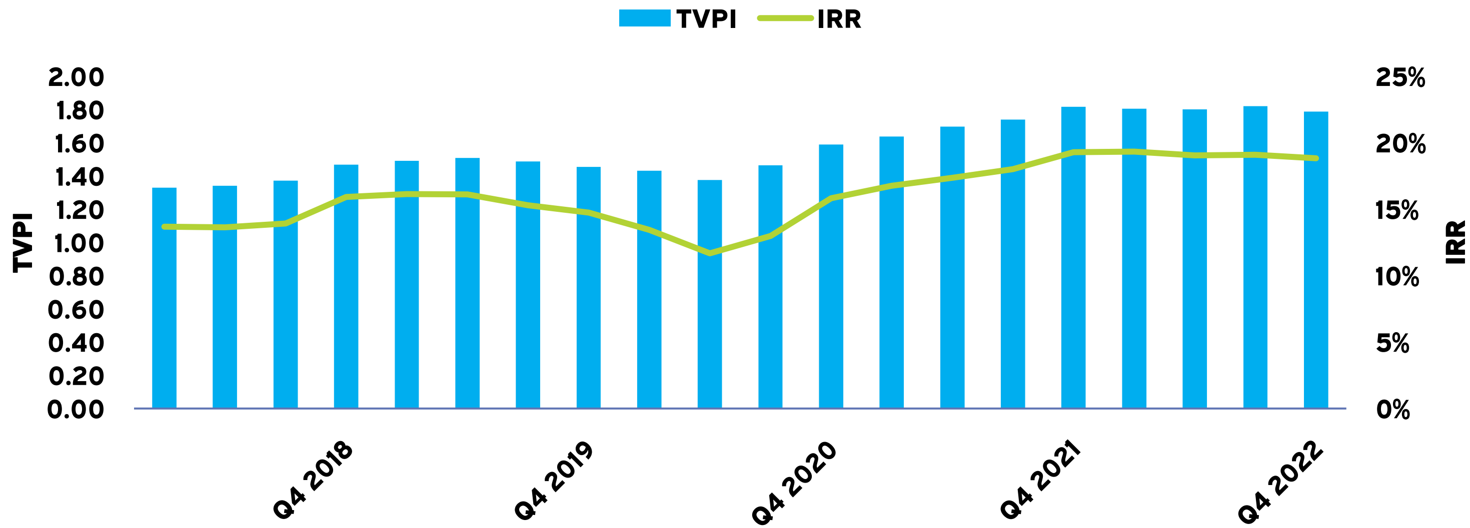
By Strategy

Group	Number	Committed ($ M)	Contributed ($ M)	Unfunded ($ M)	Distributed ($ M)	Remaining Value ($ M)	Exposure ($ M)	DPI (X)	TVPI (X)	IRR (%)
Buyout	6	210.0	99.9	110.1	80.0	115.2	225.3	0.80	1.95	22.8
Fund of Funds	3	72.0	65.8	6.3	85.3	67.6	73.9	1.30	2.32	17.2
Growth Equity	1	25.0	0.0	25.0	0.0	0.0	25.0	0.00	NM	NM
Infrastructure	2	100.0	36.5	66.4	7.4	37.5	103.9	0.20	1.23	13.6
Special Situations	2	75.0	30.9	44.6	1.9	30.7	75.4	0.06	1.06	NM
Venture Capital	2	70.0	9.6	60.4	0.0	8.4	68.8	0.00	0.88	NM
Total	**16**	**552.0**	**242.7**	**312.8**	**174.6**	**259.5**	**572.3**	**0.72**	**1.79**	**18.8**

By Vintage

Group	Number	Committed ($ M)	Contributed ($ M)	Unfunded ($ M)	Distributed ($ M)	Remaining Value ($ M)	Exposure ($ M)	DPI (X)	TVPI (X)	IRR (%)
2013	2	52.0	47.6	4.5	71.2	44.4	48.8	1.50	2.43	18.2
2015	2	30.0	28.1	1.9	17.1	27.4	29.3	0.61	1.58	8.3
2016	1	50.0	46.0	4.0	54.3	52.2	56.2	1.18	2.31	26.5
2019	2	100.0	80.5	22.4	30.2	96.3	118.7	0.38	1.57	31.3
2020	1	50.0	30.9	19.6	1.9	30.7	50.4	0.06	1.06	NM
2021	1	30.0	0.0	30.0	0.0	0.0	30.0	0.00	NM	NM
2022	4	160.0	9.6	150.4	0.0	8.4	158.8	0.00	0.88	NM
2023	3	80.0	0.0	80.0	0.0	0.0	80.0	0.00	NM	NM
Total	**16**	**552.0**	**242.7**	**312.8**	**174.6**	**259.5**	**572.3**	**0.72**	**1.79**	**18.8**

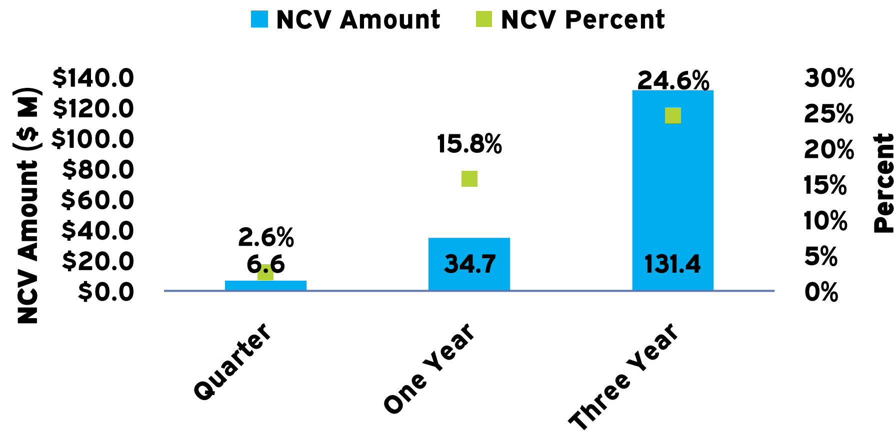
Since Inception Performance Over Time



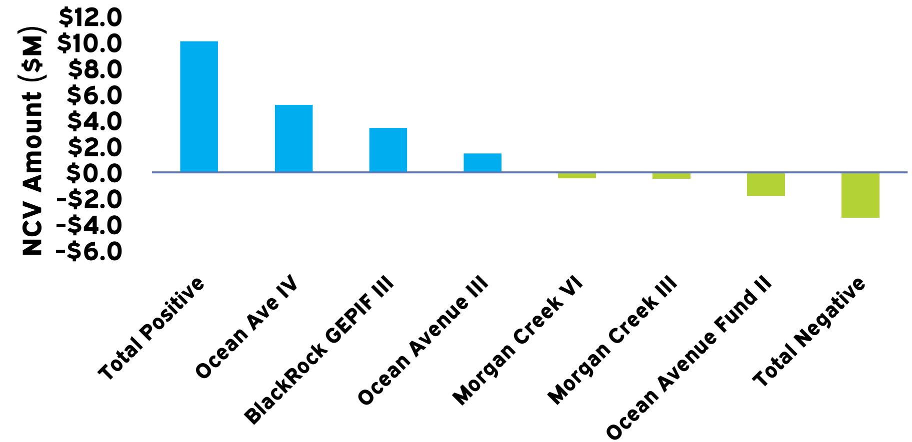
Horizon IRRs

	1 Year (%)	3 Year (%)	5 Year (%)	10 Year (%)	Since Inception (%)
Aggregate Portfolio	15.7	24.9	28.0	NM	18.8

Periodic NCV



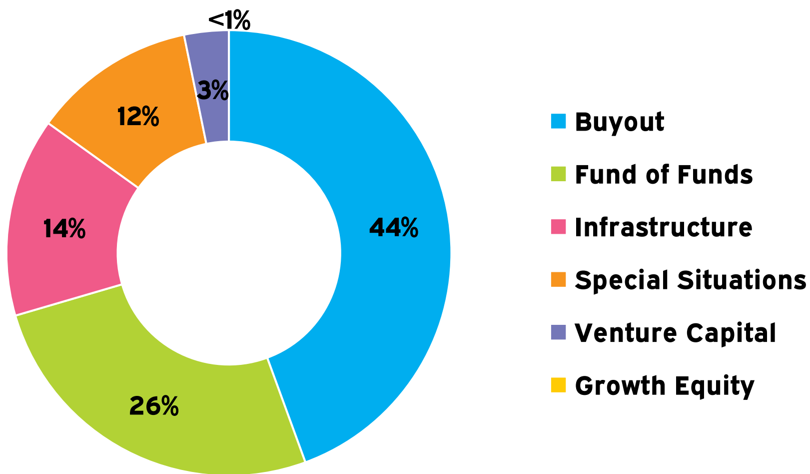
1 Quarter Drivers Of NCV

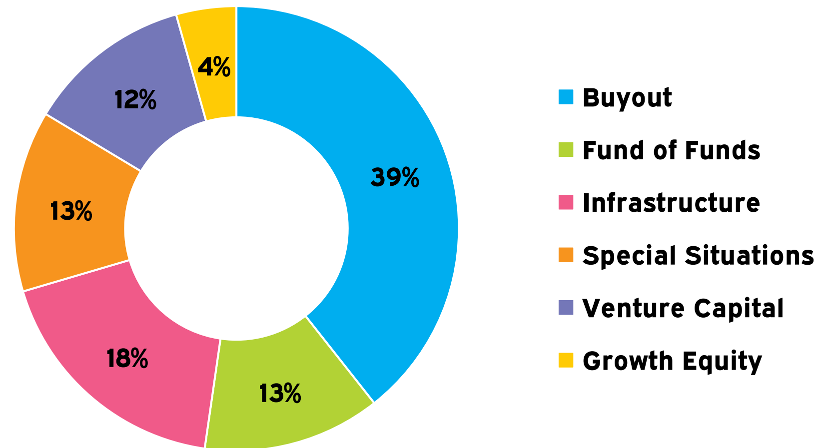


Fund Performance: Sorted By Vintage And Strategy

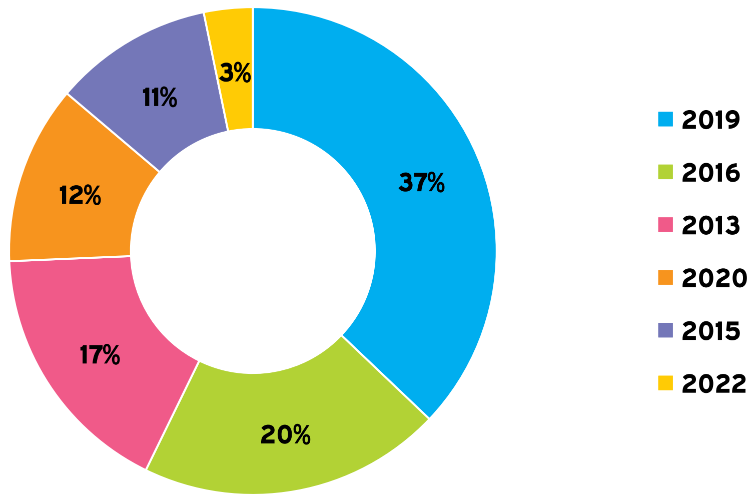
By Investment	Vintage	Strategy	Committed ($ M)	Contributed ($ M)	Unfunded ($ M)	Distributed ($ M)	Remaining Value ($ M)	TVPI (X)	Peer TVPI (X)	IRR (%)	Peer IRR (%)
Morgan Creek V	2013	Fund of Funds	12.0	11.6	0.5	14.4	6.7	1.81	1.79	12.3	14.3
Ocean Avenue II	2013	Fund of Funds	40.0	36.0	4.0	56.8	37.7	2.63	1.79	19.9	14.3
Morgan Creek III	2015	Buyout	10.0	9.9	0.1	3.0	4.2	0.73	1.96	-5.0	19.1
Morgan Creek VI	2015	Fund of Funds	20.0	18.2	1.8	14.0	23.2	2.05	1.96	14.0	19.1
Ocean Avenue III	2016	Buyout	50.0	46.0	4.0	54.3	52.2	2.31	1.98	26.5	20.6
Ocean Ave IV	2019	Buyout	50.0	44.0	6.0	22.8	58.8	1.85	1.42	45.0	21.9
BlackRock GEPIF III	2019	Infrastructure	50.0	36.5	16.4	7.4	37.5	1.23	1.42	13.6	21.9
Stellex II	2020	Special Situations	50.0	30.9	19.6	1.9	30.7	1.06	1.22	NM	17.8
Ocean Avenue V	2021	Buyout	30.0	0.0	30.0	0.0	0.0	NM	1.07	NM	NM
Bessemer Forge	2022	Buyout	20.0	0.0	20.0	0.0	0.0	NM	1.00	NM	NM
Ridgemont IV	2022	Buyout	50.0	0.0	50.0	0.0	0.0	NM	1.00	NM	NM
Blackrock Infra IV	2022	Infrastructure	50.0	0.0	50.0	0.0	0.0	NM	1.00	NM	NM
Lightspeed Select V	2022	Venture Capital	40.0	9.6	30.4	0.0	8.4	0.88	1.00	NM	NM
Long Arc I	2023	Growth Equity	25.0	0.0	25.0	0.0	0.0	NM	NM	NM	NM
Oaktree SSF III	2023	Special Situations	25.0	0.0	25.0	0.0	0.0	NM	NM	NM	NM
BVP XII	2023	Venture Capital	30.0	0.0	30.0	0.0	0.0	NM	NM	NM	NM
Total			**552.0**	**242.7**	**312.8**	**174.6**	**259.5**	**1.79**	-	**18.8**	-

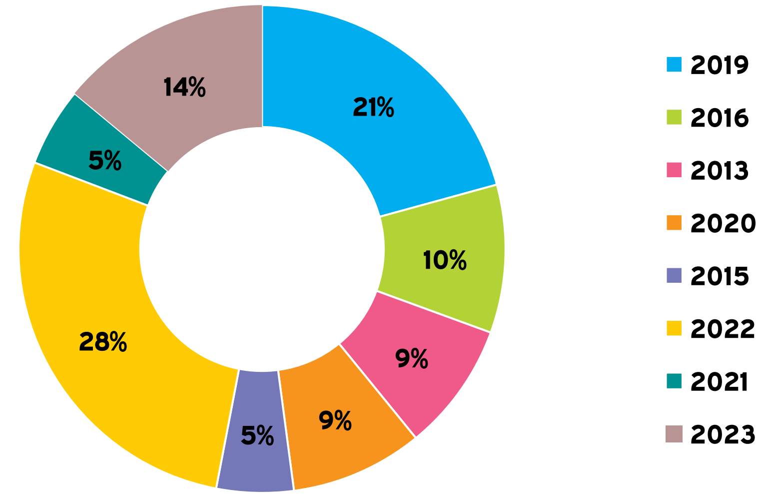
By Strategy





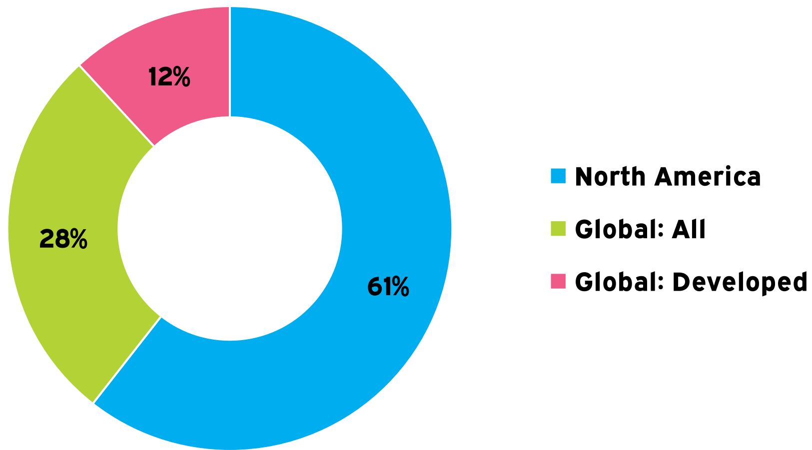
By Vintage



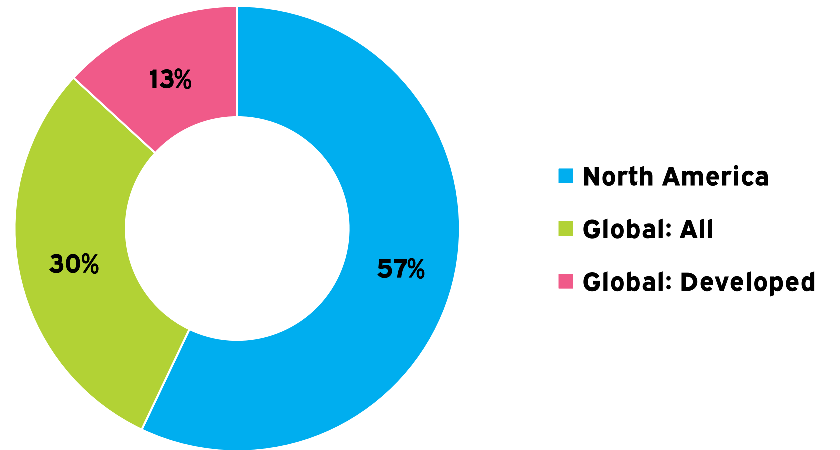


By Geographic Focus

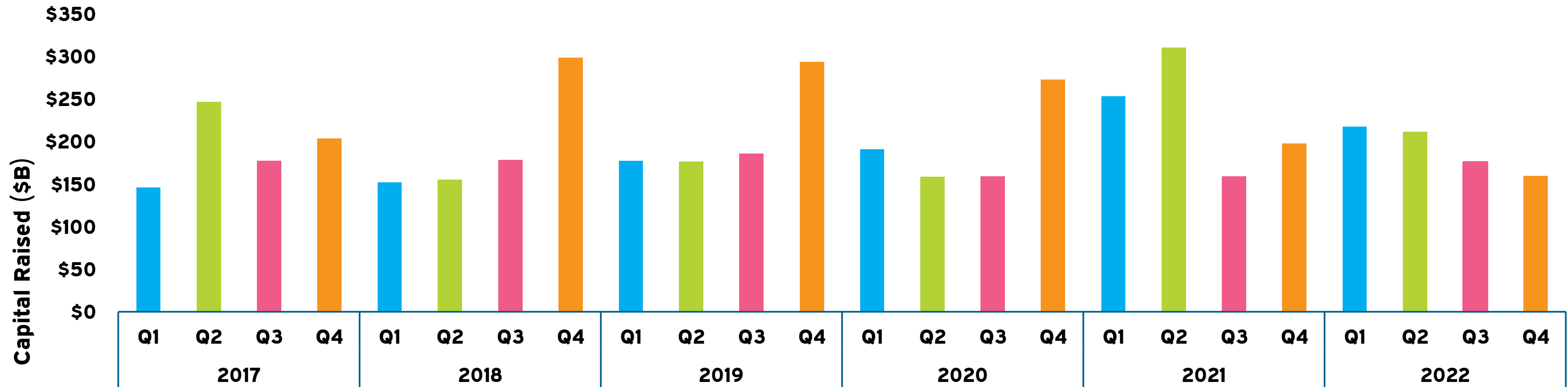
Percent of FMV



Percent of Exposure



Private Equity Global Fundraising[1]



Fundraising activity for private equity funds in the fourth quarter of 2022 decreased by 9% compared to the previous quarter, with $159.2 billion raised, and represents the lowest amount of capital raised for the fourth quarter over the last six years. While 2021 was an exceptional year for private equity markets, there have been signs of moderation of activity throughout 2022, especially in the second half of the year. On an annual basis, fundraising was down 17% in 2022 compared to 2021, with $764.0 billion raised. The post-COVID boost in fundraising activity has diminished, and evidence is growing of a sustained slowdown on the back of macroeconomic and geopolitical concerns resulting from the war in Ukraine, inflationary pressures, and rising interest rates. Additionally, the denominator effect on investors' portfolios is among the factors expected to continue driving softer fundraising in coming quarters. As public equity and fixed income markets declined in 2022, private equity allocations are proportionately higher as a percentage of investors' overall portfolios, given the delay in private equity valuations reflecting those of public markets. Therefore, some investors have found themselves relatively closer to long-term target allocations, which could curb their appetite for fresh allocations. That said, the fourth quarter saw some optimism return, as public markets managed a gentle rebound from the year's lows, making it the only up quarter of the year. Per Preqin, despite overall concerns with public markets, most investors still plan to continue committing capital to private equity in 2023 even as the aggregate amount of fundraising is expected to remain weak. According to Preqin data, there were 9,080 funds raising in the market as of year-end, with aggregate capital targeted of over $1.7 trillion. Both metrics are pushing record highs and therefore paint a picture of highly competitive fundraising. As a result, funds have been spending more time on the road than ever, with 57% of private equity funds (and 45% of venture capital funds) closed having been in market for more than 18 months compared to an average of 30% (and 31% for venture capital) from 2017-2021.

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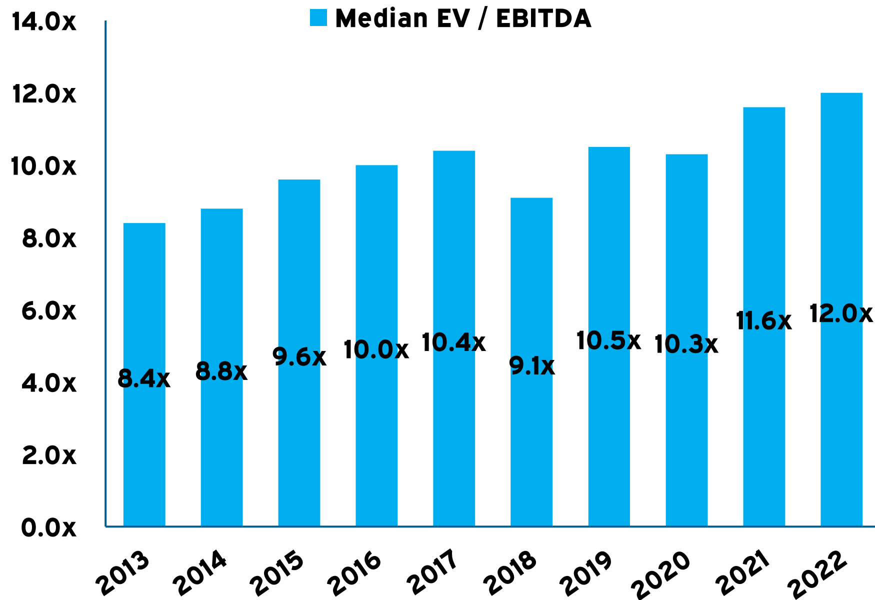
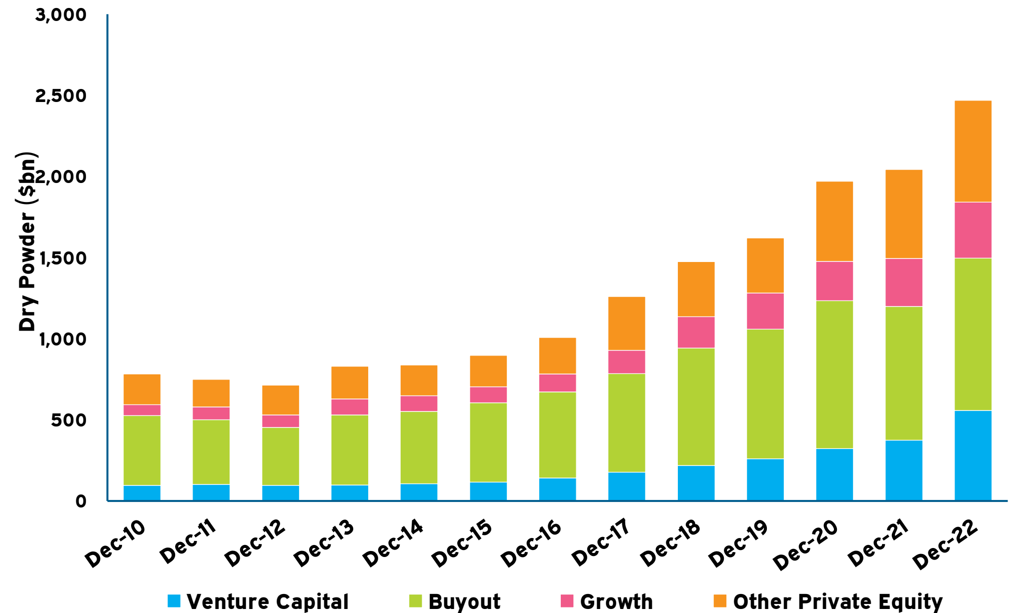
[1] Preqin

Purchase Price Breakdown, All LBOs[1]



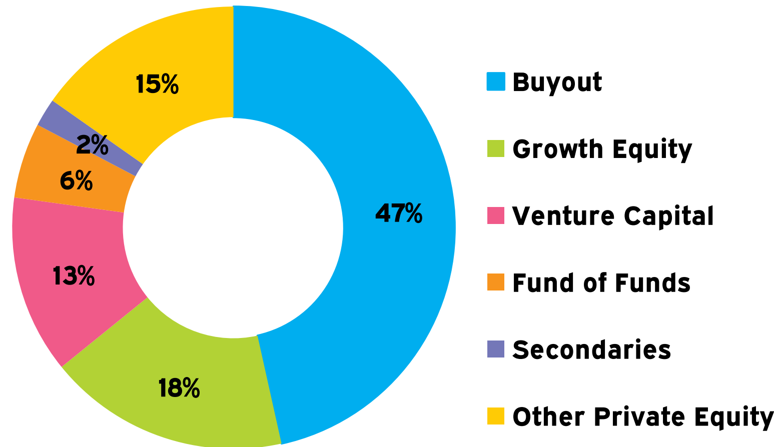
Dry Powder by Fund Type[2]



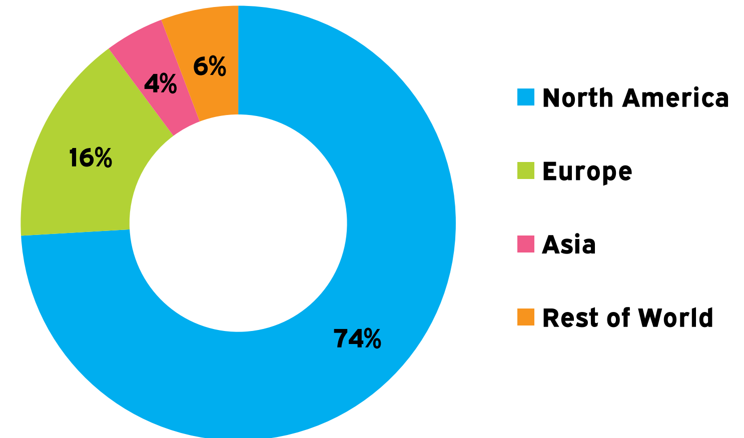
Relative to 2021, the median private equity purchase price multiple has increased from 11.6x EBITDA to 12.0x EBITDA in 2022. This represents a 3% increase from 2021 relative to the 13% increase observed in 2021 from 2020. Despite the continued rise of purchase price multiples on the year, there appear to be signs of downward pressure on private equity valuations as deal activity slowed in the second half of 2022 as a result of rising interest rates, the decrease in public market valuations, and an imbalance between expectations of buyers and sellers. Dry powder levels have increased by approximately 21% from Q4 2021 and remain at all-time highs. Dry powder will remain high as long as more capital is being raised than is being deployed, and in the near-term, investors may expect to continue to see high purchase prices as a result of the high levels of capital competing for deals. That said, private equity deal valuation multiples have also experienced downward pressure and started to lower with depressed valuations in the public markets as well as higher interest rates, which have increased borrowing costs.

[1] Preqin. Data pulled on April 7, 2023.
[2] Preqin. Data pulled on April 7, 2023.

Capital Raised by Strategy[1]



Capital Raised by Geography[2]



Buyout (47% of all private equity capital raised) and Growth Equity (18%) funds represented the most popular private equity sub-strategies during the fourth quarter of 2022. Buyout funds increased from 43% of capital raised in Q3 2022 to 47% in the fourth quarter of 2022, and Growth Equity increased from 15% to 18% of capital raised. Venture Capital strategies, as a percentage of total capital raised, decreased by 14% from Q3 2022. Fund of Funds, Secondaries, and Other Private Equity, which includes co-investment and hybrid vehicles, increased from 15% to 23%, collectively, through the fourth quarter compared to the previous quarter.

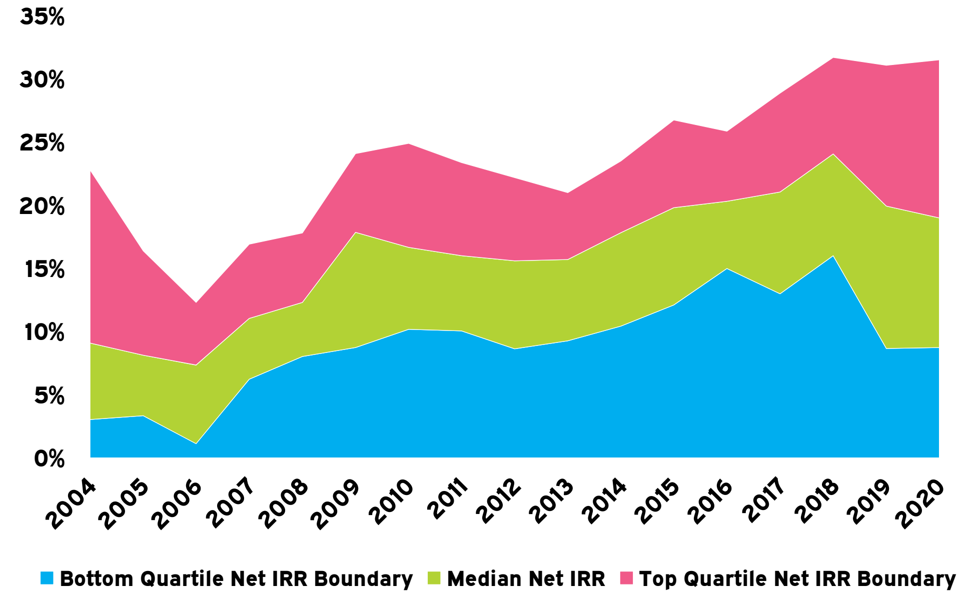
North America-focused vehicles continued to represent the majority of funds raised during the fourth quarter, representing 74% of total capital. This represents an increase from 66% in the prior quarter. Alternatively, as a percentage of total capital raised, commitments to Europe and Asia decreased by 2% and 10%, respectively, during the fourth quarter. As China-focused funds have made up the lion's share of funds raised in the region in recent years, the decrease in capital raised by Asia-focused funds highlights investors' risk aversion toward China in the wake of China's zero-COVID-19 policy, among other geopolitical and economic challenges. Overall, private equity investors continued to favor commitments to North America-focused funds, and investor appetite for Rest of World increased slightly over the quarter while commitments to Europe- and Asia-focused vehicles decreased.

[1] Preqin
[2] Preqin

Private Equity Performance by Horizon[1]

Horizon	Private Equity	Buyout	Venture Capital	Growth Equity
1 Year to 9/2022	3.5%	5.1%	(4.7)%	(5.5)%
3 Years to 9/2022	20.5	20.8	19.0	19.4
5 Years to 9/2022	18.2	18.2	17.0	18.6
10 Years to 9/2022	16.5	17.1	14.7	17.2

Private Equity Performance by Vintage Year[2]



As of September 30, 2022, private equity returns weakened significantly, generating a 3.5% IRR over the trailing 12 months through Q3 2022. This represents an ~11% drop from the trailing one-year returns as of Q2 2022, which shows that private equity returns are starting to reflect the decline of valuations observed in the public markets throughout 2022 and the dampening effects of inflationary pressures, rising interest rates, and geopolitical concerns on performance. One-year returns have decreased significantly across each private equity strategy with Growth funds experiencing the largest drop of 10.4% from 4.9% one-year returns as of Q2 2022 to (5.5)% as of Q3 2022. In general, however, performance has been strong in each vintage year since the Global Financial Crisis. Buyout, Venture, and Growth funds have all generally performed well over the various horizons on an absolute basis, with Buyout and Growth funds slightly outperforming Venture funds across longer time periods as of Q3 2022. Lastly, the spread between first and third quartile performance in private equity has grown consistently since the Global Financial Crisis; 2007 vintage funds reported an 10.7% spread while 2020 vintage funds reported a 22.8% spread.

[1] Preqin Horizon IRRs as of 9/30/2022. Data as of 12/31/2022 not yet available.
[2] Preqin, Private Equity – All, Quartile Returns as of 12/31/2022. Data pulled on April 7, 2023.

Below are details on specific terminology and calculation methodologies used throughout this report:

Term	Definition
Committed	The original commitment amount made to a given fund. Some funds may be denominated in non-USD currencies, and such commitment amounts represent the sum of fund contributions translated to USD at their daily conversion rates plus the unfunded balance translated at the rate as of the date of this report.
Contributed	The amount of capital called by a fund manager against the commitment amount. Contributions may be used for new or follow-on investments, fees, and expenses, as outlined in each fund's limited partnership agreement. Some capital distributions from funds may reduce contributed capital balances. Some funds may be denominated in non-USD currencies, and such aggregate contributions represent the sum of each fund contribution translated to USD at its daily conversion rate.
Distributed	The amount of capital returned from a fund manager for returns of invested capital, profits, interest, and other investment related income. Some distributions may be subject to re-investment, as outlined in each fund's limited partnership agreement. Some funds may be denominated in non-USD currencies, and such aggregate distributions represent the sum of each fund distribution translated to USD at its daily conversion rate.
DPI	Acronym for "Distributed-to-Paid-In", which is a performance measurement for Private Market investments. The performance calculation equals Distributed divided by Contributed. DPIs for funds and groupings of funds are net of all fund fees and expenses as reported to by fund managers to Meketa.
Exposure	Represents the sum of the investor's Unfunded and Remaining Value.
IRR	Acronym for "Internal Rate of Return", which is a performance measurement for Private Market investments. IRRs are calculated by Meketa based on daily cash flows and Remaining Values as of the date of this report. IRRs for funds and groupings of funds are net of all fund fees and expenses as reported by fund managers to Meketa.
NCV	Acronym for "Net Change in Value", which is a performance measurement for Private Market investments. The performance calculation equals the appreciation or depreciation over a time period neutralized for the impact of cash flows that occurred during the time period.
NM	Acronym for "Not Meaningful", which indicates that a performance calculation is based on data over too short a timeframe to yet be meaningful or not yet possible due to inadequate data. Meketa begins reporting IRR calculations for investments once they have reached more than two years since first capital call. NM is also used within this report in uncommon cases where the manager has reported a negative Remaining Value for an investment.

Peer Universe	The performance for a set of comparable private market funds. The peer returns used in this report are provided by Preqin, based on data as of the date of this report. Fund-level peer performance represents the median return for a set of funds of the same vintage and the program's set of corresponding strategies across all regions globally. Data sets that include less than five funds display performance as "NM". Meketa utilizes the following Preqin strategies for peer universes: Private Equity: Private Equity Private Debt: Private Debt
Public Market Equivalent ("PME")	A calculation methodology that seeks to compare the performance of a portfolio of private market investments with public market indices. The figures presented in this report are based on the PME+ framework, which represents a net IRR value based on the actual timing and size of the private market program's daily cash flows and the daily appreciation or depreciation of an equivalent public market index. Meketa utilizes the following indices for private market program PME+ calculations: Infrastructure: Dow Jones Brookfield Global Infrastructure Index Natural Resources: S&P Global Natural Resources Index Private Debt: Meryl Lynch High Yield Master II Bond Index Private Equity: MSCI ACWI Investable Market Index Real Assets (excluding Real Estate): Equal blend of Dow Jones Brookfield Global Infrastructure Index and S&P Global Natural Resources Index Real Assets (including Real Estate): Equal blend of Dow Jones Brookfield Global Infrastructure Index, S&P Global Natural Resources Index, and Dow Jones U.S. Select Real Estate Securities Index Real Estate: Dow Jones U.S. Select Real Estate Securities Index
Remaining Value	The investor's value as reported by a fund manager on the investor's capital account statement. All investor values in this report are as of the date of this report, unless otherwise noted. Some funds may be denominated in non-USD currencies, and such remaining values represent the fund's local currency value translated to USD at the rate as of the date of this report.
TVPI	Acronym for "Total Value-to-Paid-In", which is a performance measurement for Private Market investments. The performance calculations represents Distributed plus Remaining Value, then divided by Contributed. TVPIs for funds and groupings of funds are net of all fund fees and expenses as reported to by fund managers to Meketa.
Unfunded	The remaining balance of capital that a fund manager has yet to call against a commitment amount. Meketa updates unfunded balances for funds to reflect all information provided by fund managers provided in their cash flow notices. Some funds may be denominated in non-USD currencies, and such unfunded balances represent the fund's local currency unfunded balance translated to USD at the rate as of the date of this report.

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Meketa Investment Group has prepared this report on the basis of sources believed to be reliable. The data are based on matters as they are known as of the date of preparation of the report, and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available.

If we manage your assets on a discretionary basis, please contact us if there are any changes in your financial situation or investment objectives, or if you want to impose any reasonable restrictions on our management of your account or reasonably modify existing restrictions.

In general, the valuation numbers presented in this report are prepared by the custodian bank for listed securities, and by the fund manager or appropriate General Partner in the case of unlisted securities. The data used in the market comparison sections of this report are sourced from various databases. These data are continuously updated and are subject to change.

This report does not contain all the information necessary to fully evaluate the potential risks of any of the investments described herein. Because of inherent uncertainties involved in the valuations of investments that are not publicly traded, any estimated fair values shown in this report may differ significantly from the values that would have been used had a ready market for the underlying securities existed, and the differences could be material.

This document may contain certain forward-looking statements, forecasts, estimates, projections, and opinions ("Forward Statements"). No representation is made or will be made that any Forward Statements will be achieved or will prove to be correct. A number of factors, in addition to any risk factors stated in this material, could cause actual future results to vary materially from the Forward Statements. No representation is given that the assumptions disclosed in this document upon which Forward Statements may be based are reasonable. There can be no assurance that the investment strategy or objective of any fund or investment will be achieved, or that the client will receive a return of the amount invested.

In some cases Meketa Investment Group assists the client in handling capital calls or asset transfers among investment managers. In these cases we do not make any representations as to the managers' use of the funds, but do confirm that the capital called or transferred is within the amounts authorized by the client.

Because there is no readily accessible market for private markets assets (companies and partnerships), the values placed on private markets assets are calculated by General Partners using conservative and industry standard pricing procedures. Annually, an independent auditor reviews the pricing procedures employed by the General Partner of each partnership.

The values of companies and partnerships are audited at year-end, and are not audited at other quarter-end periods. While financial information may be audited, there is some discretion as to the method employed to price private companies and, therefore, private markets partnerships. At all times, Meketa Investment Group expects General Partners to utilize conservative and industry standard pricing procedures, and requires the General Partners to disclose those procedures in their reports. However, because of the inherent uncertainty of valuation, these estimated values may differ from the values that would be used if a ready market for the investments existed, and the differences could be significant.

San Joaquin County Employees' Retirement Association ("SJCERA")

2023 Private Equity Investment Plan

Table of Contents

1. Program Review and Investment Plan
2. Summary and Recommendation

Section 1: Program Review and Investment Plan

SJCERA PROGRAM OVERVIEW

→ Since inception, $552 million has been committed across 16 partnerships (as of December 31, 2022)

- Initial commitment began in 2013
  - Funds are a combination of Fund-of-Funds, Buyout, Venture, Special Situations, Co-Investment and Infrastructure Funds.

→ Six new partnerships approved in 2022

- Totaling $200 million of commitments

→ Private equity targeted to be 8% of the total portfolio as part of the Aggressive Growth allocation

- Current actual allocation at approximately 6.6%
- Market value of $259.5 million as of December 31, 2022

→ The Program has approved commitments across nine firms

- Ocean Avenue has the largest commitments with a total of $170 million across four funds and is approximately 57% of the market value.

SJCERA COMMITMENT LIST

Since Inception Partnership Commitments (as of December 31, 2022)

Partnership	Vintage Year	Commitment	Strategy
Ocean Avenue Fund II	2013	$40 million	Primary Market Fund of Funds; diversified
Morgan Creek Partners Fund V	2013	$12 million	Primary Market Fund of Funds; diversified
Morgan Creek Partners Fund VI	2015	$20 million	Primary Market Fund of Funds; diversified
Morgan Creek Co-Investment Fund III	2015	$10 million	Co-Investment
Ocean Avenue Fund III	2016	$50 million	Co-Investment
BlackRock Global Energy and Power Infrastructure Fund III	2019	$50 million	Infrastructure
Ocean Avenue Fund IV	2019	$50 million	Co-Investment
Stellex Capital Partners II	2020	$50 million	Special Situations
Lightspeed Select Fund V	2021	$40 million	Venture Capital
Ocean Avenue Fund V	2021	$30 million	Co-Investment
Ridgemont Equity Partners IV	2022	$50 million	Buyout
Bessemer Forge Fund	2022	$20 million	Buyout
Bessemer Venture Partners XII	2022	$30 million	Venture Capital
BlackRock Global Infrastructure Fund IV	2022	$50 million	Infrastructure
Long Arc Capital Fund I	2022	$25 million	Buyout
Oaktree Special Situations Fund III	2022	$25 million	Special Situations
Total Program	---	**$552 million**	---

FUTURE GROWTH

→ The current portfolio allocation to private equity is impacted by the denominator effect related to the decrease in the public equity values due to volatility and macroeconomic elements.

→ While the portfolio target may be met in the near term, additional investment activity is required to achieve diversification and to position the portfolio for attractive performance over the long term.

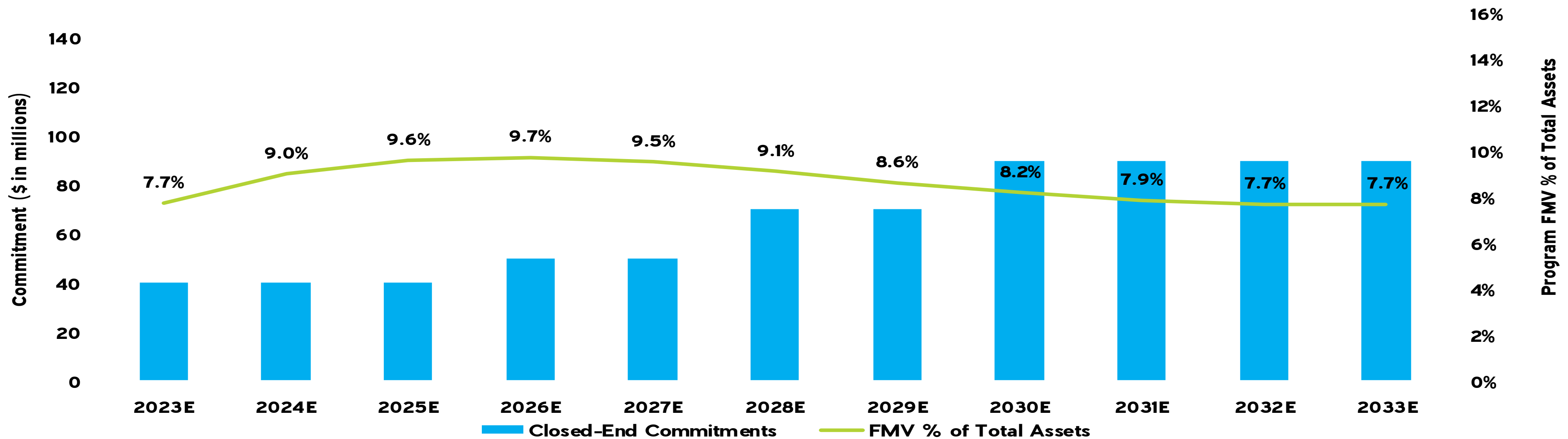
- A consistent deployment of capital is a key element for consistent performance
- Further diversification needed – vintage years, geography and sector

→ Growth of a private equity program is a function of several factors – commitment pace, rate of investment by underlying managers, investment growth, investment liquidations/distributions

→ Percentage allocation to private equity impacted by Total Portfolio growth

- Slower Total Portfolio growth = larger private equity allocation
- Faster Total Portfolio growth = smaller private equity allocation

SJCERA PROJECTED ALLOCATION



→ Modeling above assumes a commitment pace of $40 to $90 million per year

- Reflecting 5% growth scenarios for the Total Portfolio
- Achieving the target allocation in the 2024-time frame

→ Consistent pacing needed to achieve the target allocation over several years

- Maintains vintage year diversification
- Revisit pacing annually to reflect existing portfolio conditions

SJCERA PROJECTED ALLOCATION & FMV BY STRATEGY

	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E
Buyout	30	30	30	30	30	40	40	50	50	50	50
Venture Capital	0	0	0	10	10	15	15	20	20	20	20
Special Situations	10	10	10	10	10	15	15	20	20	20	20
Infrastructure	0	0	0	0	0	0	0	0	0	0	0
Closed-End Total	**40**	**40**	**40**	**50**	**50**	**70**	**70**	**90**	**90**	**90**	**90**

	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E
Buyout	44%	45%	46%	47%	47%	48%	49%	49%	50%	51%	51%
Venture Capital	7%	12%	14%	16%	18%	20%	23%	24%	26%	26%	27%
Special Situations	14%	16%	16%	17%	17%	17%	17%	17%	18%	18%	19%
Infrastructure	16%	16%	16%	16%	14%	13%	11%	8%	6%	4%	3%
Fund of Funds	18%	12%	8%	5%	3%	2%	2%	1%	1%	0%	0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Section 2: Summary and Recommendation

SJCERA COMMITMENT PACING

2023 Investment Plan

	Projections
Commitment Target: (commitment range)	$40 million per year ($40 - $90 million)

→ Recommend targeting $40 million in commitments annually

- May scale up or down depending upon opportunity set

→ Continue to update pacing targets on an annual basis

- Update actual private equity cash flows and market values
- Incorporates volatility of the public markets and Total Portfolio growth
- Discuss legacy investments and possible secondary sales

RECOMMENDATIONS

Adopt the proposed 2023 commitment pacing plan and search criteria for the SJCERA private equity program. Specifically, SJCERA should commit $40 million per year to private equity partnerships.

2023 CONFERENCES AND EVENTS SCHEDULE

2023 EVENT DATES		EVENT TITLE	EVENT SPONSOR	LOCATION	REG. FEE	WEBLINK FOR MORE INFO	EST. BOARD EDUCATION HOURS
Aug 20	Aug 22	2023 Public Pension Funding Forum	NCPERS	Chicago, IL	$1500	ncpers.org	10
Aug 28	Aug 31	Principles of Pension Governance for Trustees	CALAPRS	Malibu, CA	$3000	calaprs.org	*9
Sep 6	Sep 7	ALTSSV2023 Forum	Markets Group	Mountain View	$0	marketsgroup.org	3.5
Sep 8	Sep 8	Virtual Attorneys Roundtable	CALAPRS	Online webinar	$50	calaprs.org	4
Sep 12	Sep 14	IREI Editorial Advisory Board Meeting	IREI	Santa Monica, CA	$0	irei.com	TBD
Sep 19	Sep 21	Fiduciary Investors Symposium	Top 1000 Funds	Stanford	$1900	top1000funds.com	11.4
Sep 27	Sep 29	Administrators' Institutue 2023	CALAPRS	Carmel-by-the-Sea	$2500	calaprs.org	8.15
Oct 3	Oct 4	6th Annual Private Equity SF Forum	Markets Group	San Francisco, CA	$5000	marketsgroup.org	TBD
Oct 5	Oct 5	2023 Pensions, Benefits & Investments Fiduciaries' Forum	Nossaman's	San Francisco, CA	$95	nossaman.com	TBD
Oct 21	Oct 22	NCPERS Accedited Fiduciary (NAF) Program	NCPERS	Las Vegas, NV	$855	ncpers.org	12
Oct 22	Oct 25	NCPERS Fall Conference	NCPERS	Las Vegas, NV	$750	ncpers.org	TBD
Oct 27	Oct 27	Trustee Roundtable	CALAPRS	Online webinar	$50	calaprs.org	4
Oct 30	Oct 30	2023 Pensions, Benefits & Investments Fiduciaries' Forum	Nossaman's	Los Angeles, CA	$95	nossaman.com	TBD
Nov 7	Nov 10	SACRS Fall Conference	SACRS	Rancho Mirage, CA	$120	sacrs.org	*11
Dec 3	Dec 5	Alternative Investing Sumimit 2023	Opal Group	Dana Point, CA	$0	opalgroup.net	TBD
Dec 5	Dec 6	10th Annual California Institutional Forum	Markets Group	Napa, CA	$0	marketsgroup.org	TBD

** 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
Sep 12-14	IREI Editorial Advisory Board Meeting	Santa Monica	JC Weydert	$2,725.89	5/5/23
Sep 19-21	Fiduciary Investors Symposium	Stanford	Paris Ba, Michael Duffy, Brian McKelvey	$6,500	6/2/23 6/2/23 7/14/2023
Sep 27-29	CALAPRS Administrators Institute 2023	Carmel	Johanna Shick Brian Mckelvey	$5,000	N/A

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	$1,849.74	6/2/2023 5/5/2023
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	$12,260	N/A
Jul 16-19	SACRS/UC Berkeley Progam	Berkeley, CA	Brian McKelvey JC Weydert Emily Nicholas Michael Duffy	$20,000	TBD	N/A

Board Member	Travel (not including SACRS & CALAPRS)	Dates	Amount used of $2500:	Balance of $2500	
RESTUCCIA	IREI	1/2023	$1,736.00	$764	
BASSETT					
DING					
DUFFY	Fiduciary Investors Symposium	9/2023			(increase approved 7/14/23)
GOODMAN					
KEOKHAM					
MCCRAY	Pension Bridge Annual Conference	4/2023	$798.77	$1,701.23	
NICHOLAS					
WEYDERT	IREI	9/2023			
MOORE					

Agenda Item 9.03

August 11, 2023

SUBJECT: General Counsel Services: Classification of Position

SUBMITTED FOR: ___ CONSENT _X_ ACTION ___ INFORMATION

RECOMMENDATION

Approve the staff recommendation to establish the Chief Counsel position as an at-will position, exempt from the San Joaquin County Civil Service system, in the Senior Management Unit.

PURPOSE

To clarify and communicate the Board's expectations related to the Chief Counsel position.

DISCUSSION

At its June 2, 2023, meeting, the Board of Retirement voted to establish an internal Chief Counsel position to provide general counsel services for SJCERA and its Board. The Board further authorized the CEO to work with the County Division of Human Resources to establish the position and salary range, and then recruit and fill the position.

To assist Human Resources in properly assessing the Chief Counsel Position, staff seeks clarification from the Board as to its intent regarding (1) whether this position should be exempt from the San Joaquin County Civil Service system and (2) the bargaining unit into which this position should be placed.

Chief Counsel Position: At Will vs. Civil Service
If SJCERA is to move forward with hiring an internal Chief Counsel, it is imperative that the position is exempt from Civil Service. The reasons for this recommendation follow.

1. **SJCERA's Chief Counsel position is similar to County Counsel, which is at-will.** SJCERA's Chief Counsel position is to the Board of Retirement, what County Counsel is to the Board of Supervisors: it is the ultimate legal authority for the Board and administrative staff. Similar to the County Counsel position, the SJCERA Chief Counsel would have no supervising attorney to review or guide their legal analysis, the appointing authority (the Board) is wholly dependent on their work product, and the consequence of error can easily run in the millions (or more). The County Counsel position is exempt from Civil Service; SJCERA's Chief Counsel position should also be exempt.

2. **Retirement systems' internal counsel positions are typically at-will.** The vast majority (75%) of County retirement systems operating under a Civil Service system that have internal counsel positions, have classified their internal counsel as at-will positions. Clearly there is precedent for exempting these positions from Civil Service. In fact, to create the position as covered by civil service would make SJCERA an outlier.

3. **The County Employees Retirement Law supports establishing internal counsel as at-will**

a. Government Code (GC) Section 31522.3 permits the appointment of more than one "assistant administrator," in its use of the plural term "assistant administrators". While SJCERA will not use the title "assistant administrator – legal" for its Chief Counsel position, that individual will report directly to both the CEO and the Board, and it thus has the same management function as the Assistant CEO (ACEO) and Investment Officer (IO) under the law, and the Chief Counsel position should therefore be deemed subject to the rules set forth in Section 31522.3 that are applicable to assistant administrators, which specifically state, these positions "shall not be subject to…civil service or merit system rules … [and] shall serve at the pleasure of, and may be dismissed at the will of, the appointing board or boards. Specific charges, a statement of reasons, or good cause shall not be required as a basis for dismissal…."

b. GC Sec. 31522.1 says that "administrative, technical, and clerical staff" are the only retirement system positions subject to county civil service or merit system rules. As a "Chief" position, the Chief Counsel position clearly does not fall into the category of administrative, technical, or clerical. This is an executive level position and as explained above, should be deemed subject to the same rules applicable to assistant administrators with regards to being at-will.

c. GC Sec. 31529.9 provides the Board of Retirement with direct appointment authority over the decision to "employ staff attorneys for legal services (which may be delegated to the CEO, with Board oversight as provided by the SJCERA Board of Retirement in its bylaws). That context also anticipates such an appointee will be managed in a manner analogous to the CEO and ACEO positions, that is, at-will.

4. **Making Chief Counsel at-will aligns with SJCERA's classification of other positions.** The CEO, ACEO, and Investment Officer (IO) are at-will positions. The Chief Counsel position requires more education, and has greater influence, autonomy and authority with less oversight and greater consequence of error than either the ACEO or IO positions. Since the ACEO and IO positions are at-will (exempt from civil service), the Chief Counsel position should also be at-will.

5. **Delays in termination would put SJCERA and members at risk.** Civil Service employees are entitled to certain employment rights including a prescribed progressive discipline process. In contrast, positions exempt from Civil Service, such as SJCERA's CEO, ACEO and IO, do not have the same grievance and job protection rights as Civil Service employees. Instead, these at-will positions serve at the pleasure of the Board and may be dismissed at will (as described above in 3.a, above).

   As noted previously, the consequence of error for the Chief Counsel position is significant. If counsel's guidance is wrong, the cost of defense, damages, and plaintiff's legal fees, can be well into the millions of dollars. There is also a risk to potentially thousands of members whose benefits could be adversely affected by bad legal guidance. SJCERA, our members and our employers, simply cannot afford to have our primary attorney on a performance improvement plan. Much like the CEO position, if the Chief Counsel's judgement or guidance is inappropriate or off-base, for the sake of the organization (and to fulfill their legal fiduciary obligations) the Board must be able to efficiently replace the person in that position.

6. **Making Chief Counsel at-will most closely aligns with SJCERA's historical practice.** Since 1947, SJCERA has used County Counsel staff (most recently a Deputy County Counsel IV position) to provide General Counsel services. Although Deputy County Counsel positions are covered by civil service, SJCERA has contracted with County Counsel for those services—

the Deputy County Counsels who have provided services have not been SJCERA employees. This arrangement is analogous to either contracting with external counsel or an at-will situation, where SJCERA and its Board can efficiently replace the person providing legal services. Establishing the Chief Counsel position as at-will maintains a long-standing, proven approach to handling the provision of legal services.

Chief Counsel Position: Bargaining Unit

SJCERA's CEO position is in the Executive Management Unit, whereas the ACEO and IO positions are in the Senior Management Unit. While the types of benefits offered to both units are similar, the quantity of those benefit types differ, with the Senior Management Unit receiving somewhat fewer hours (or dollars) of various benefits. A summary of the differences follows.

	Executive Management	Senior Management
Moving Expenses	$8,000	$5,000
Vacation Accrual	○ Based on total years of public service. ○ Maximum accrual rate 184 hours/year ○ Max accumulated hours: 448 hours.	○ Same ○ Same ○ Max accumulated hours: 368 hours.
Vacation Hours "Purchase"	Up to 120 hours per year	Up to 64 hours per year
Sick Leave	Up to 160 hour credit based on last agency's balance	Same
Cafeteria Plan (County Contribution)	$923.96 bi-weekly	Same
Additional Life Insurance	100% of employee's annual salary, up to $75,000	Same
Vehicle Allowance	$585/mo	N/A
County Contribution to Deferred Compensation	5%	2%
Administrative Leave	10 days	Same

CONCLUSION

Staff recommends the Board determine that the position of Chief Counsel should be established as an at-will position, exempt from the San Joaquin County Civil Service system, and be placed in the Senior Management Unit. Staff will communicate the Board's expectations to the Division of Human Resources.

JOHANNA SHICK
Chief Executive Officer

2023 LEGISLATION

Last Updated: 7/31/2023

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 if still in effect from January 1, 2024 to indefinitely and make additional non-substantive changes to the Ralph M. Brown Act.	06/29/23	Senate JUD. Comm. Ordered to third reading	
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 (PTSD), skin cancer, lower back impairments, Lyme disease, tuberculosis and meningitis. **This bill would, contingent upon passing of SB 623 (workers' compensation bill on PTSD), repeal the provisions related to PTSD on January 1, 2032.**	07/12/23	Senate L., P.E. & R Comm. Ordered to third reading.	

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 accessible 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, 2029, would require a local agency's website and emails to utilize a ".gov" top-level domain or a "ca.gov" second level domain.	07/10/23	Senate APPR. Comm. Placed on suspense file	
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.	07/12/23	Assembly APPR. Comm. Placed on suspense file	
SB 885	Senate Comm. P.E. and R.	This bill would clarify the definition of final compensation for specified members, members who are subject to PEPRA, and members whose services are on a tenure that is temporary, seasonal, intermittent, or part time in the CERL. The bill would revise the age at which the retirement system is required to either start payment of an unmodified retirement allowance or make a one-time distribution of accumulated contributions and interest to the age specified by federal law. The bill would change the age threshold from April 1 of the calendar year in which the member attains 72 years of age to the age specified by federal law with regard to requirements that apply when members cannot be located and with reference to when distributions are to be made to members who are participating in a Deferred Retirement Option Program. This bill would correct several erroneous references and also make other technical, nonsubstantive changes to these provisions.	07/03/23	Senate Concurrence in Assembly amendments pending	SACRS

BILL NO.	AUTHOR	DESCRIPTION	LAST ACTION DATE	LOC	SPONSOR
Other Bills of Interest:					
AB 1246	Nguyen	This bill would, commencing January 1, 2025, permit a PERL member who elected to receive a specified optional settlement at retirement, if the member's former spouse was named beneficiary and a legal judgment awards only a portion of the interest in the retirement system to the retired member, to elect to add their new spouse as the beneficiary of the member's interest, subject to conditions.	07/03/23	Senate APPR. Comm. Suspense file	
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.	06/02/23	**Chaptered**	
Federal Legislation:					
None to report.					

2023 TENTATIVE State Legislative Calendar	
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

August 4, 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
SJCERA's assets under management exceeded the $4 billion mark again. SJCERA is a calendar year plan, which means we mark our investment returns as of December 31 each year. However, because most retirement systems in the state are fiscal year plans, which use June 30 as their measuring date, it can be interesting to see how our fiscal year returns compare. SJCERA's June 30 one-year net return of 5.8% equals CalPERS' preliminary fiscal year net return and is close to CalSTRS' return of 6.3%.

Review and confirm or refresh asset allocation

- *Initiate implementation of new asset allocation policy*
  Pacing plans set the course for implementing different segments of the asset allocation policy. At the August 11, 2023 Board meeting, Judy Chambers, of Maketa Investment Group, will review SJCERA's private equity program and recommend a commitment pacing plan. Specifically, we expect Meketa to recommend SJCERA target committing $40 million a year (and perhaps more depending on the opportunities).

Determine the future vision for the investment program operating model

- *Define and document SJCERA's views on environmental, social, and governance (ESG) matters for the organization and the investment portfolio*
  The Board will meet on September 1 from 9:00 a.m. to 1:00 p.m. at the San Joaquin County Agricultural Center to receive ESG education and participate in a facilitated discussion to define the Board's view on ESG. Investment Consultant David Sancewich will provide education on ESG from an investment perspective; Fiduciary Counsel Ashley Dunning will provide training on ESG from a fiduciary perspective and facilitate the discussion. A draft of the Board's view will be presented for final approval at a subsequent regularly scheduled Board meeting.

- *Define and document SJCERA's approach to proxy voting*
  In July, SJCERA updated the *Proxy Voting* policy to include the Custodian Bank's role. Documenting SJCERA's views on ESG (see above), will help inform Board's determination on whether SJCERA wishes to use its proxy votes as a lever to advocate certain positions (e.g., corporate disclosures on certain topics, corporate governance, etc.).

Optimize the investment manager lineup

- *Evaluate the portfolio for investment efficiency (e.g., fees, risk, return, consolidation)*
  Investment Officer Paris Ba attended the Annual Investor Meetings for Walton Street Fund V and VI virtually. Walton Street is one of SJCERA's Opportunistic Private Real Estate managers.
  - Walton Street Fund V. SJCERA made a $30 million commitment to Walton Street Fund V in 2006, and the current market value of our investment is approximately $1 million. The fund has realized or substantially realized 51 of 52 investments, with only one major asset remaining. The remaining

investment is an apartment building in India, which is projected to be liquidated by the end of 2024. Currently there is no management fee payable to the General Partner.

- Walton Street Fund VI. SJCERA made a $15 million commitment to Walton Street Fund VI in 2009, and the current market value of our investment is approximately $6 million. The fund is in disposition phase with 64 of the 69 investments realized or substantially realized to date. The most significant progress that Walton Street has made over the past 12 months is the IPO of the Shriram Entity in India. The Walton Street Fund VI term expired on March 31, 2021, and General Partner management was reduced effective April 1, 2021.

Modernize the operations infrastructure

Implement Pension Administration System (PAS)

- *Program/test planned processes in PAS*

  In August, staff begins user acceptance testing on “PRIME”, SJCERA’s new Pension Administration System, being developed by Tegrit. This will be staff’s first experience with the new system, and Tegrit and Linea staff will be on-site to support the effort.

  Tegrit uses an “agile” approach to software delivery. Agile project management is an iterative approach to delivering a project throughout its lifecycle, which provides staff multiple opportunities to test, learn, and use the system in parallel well before we “go-live. Agile project management generally provides staff the long-term benefit of becoming familiar with the software over time and improving feedback between staff and developers at each stage of the project. As such, August’s user acceptance testing is just the first in a series of testing that staff will perform to verify the requirements and system functionality.

- *Linea’s Owners Acquire Data Conversion Vendor*

  The owners of Linea Solutions, the firm providing project management services for SJCERA’s PAS project, recently acquired Icon Integration and Design, a data conversion vendor. Icon was one of the three data conversion vendors that responded to SJCERA’s 2022 data conversion vendor request for proposal (RFP). Ultimately, SJCERA selected MBS to provide data conversion services. The acquisition should not affect SJCERA’s PAS project. The Linea staff supporting SJCERA’s PAS project will remain unchanged, and they are committed to maintaining good working relationships with all data conversion managers on the various projects upon which they consult. Linea’s goal remains the same: successful implementation of their clients’ projects. Linea will also reach out to MBS and other data conversion vendors with which they work to inform them of the acquisition

Enhance the member experience

- *Improve content and organization of website*

  Communications Officer Kendra Fenner revised the Active Member pages of the website, is working with Rolling Orange to reconfigure the Active Member page menu and anticipates implementing the revised Active Member pages by September 1. Additionally, Kendra is working with Rolling Orange on website analytics. Analytics identified, among other things, that SJCERA’s benefit calculator, videos, and beneficiary designation form are among the top 5 most frequented areas of the website.

- *Develop and implement online member education videos on prioritized topics*

  Our Forms and Publications page is now our Forms, Publications & Videos page! Kendra Fenner completed the *How Retirement Benefits are Calculated* video and posted to the website. This video and all future videos will be available both on the Forms, Publications & Videos page, and linked to from the website page that discusses related content. This provides access to videos both from a centrally located area (the Forms, Publications & Videos page) and in context (for example, if we had a video about Reciprocity, the link to the video would be provided on the Reciprocity page as well). Kendra is already hard at work on more videos—so stay tuned! Kudos to Kendra for identifying,

obtaining, and learning the software for producing cost-effective videos efficiently and for making SJCERA's goal a reality! IMPRESSIVE work!

Improve technology for business operations

- *Adopt industry standard business processes wherever possible*
  - *Plan transition from Mac to Windows*

    Information Systems Specialist II, Lolo Garza continues to migrate SJCERA to Windows servers. Of the four Mac servers eligible to be migrated, the data on the second server will be migrated the weekend of August 5. The two remaining Mac servers (which house our Optics and Core-37 data) are scheduled for migration in the future. In addition, as part of the migration, Lolo has built 10 Windows servers
- *Adopt contemporary risk management, disaster recovery and business continuity practices*
  - *Implement Phase 1 of Enterprise-Wide Risk Management (EWRM) plan*

    After the Leadership Team (Johanna Shick, Brian McKelvey, Paris Ba, Adnan Khan, Carmen Murillo, Melinda DeOliveira and Greg Frank) met on May 4 to initiate Phase 1 of the EWRM plan, the following actions to further mitigate identified risks were initiated.

    Cybersecurity – IT staff implemented the following mitigations to enhance SJCERA's cybersecurity. Additional cyber-attack action items are in the process of being implemented and will be reported out in upcoming CEO reports.

    1) Implemented an automated threat detection and response solution
    2) Updated the firewall and initiated periodic meetings with cybersecurity solution providers to assess and implement best practices
    3) Continued conducting ongoing cybersecurity training and awareness
    4) Continued conducting periodic meetings with the County Security Information Officer to stay abreast of the County's cybersecurity efforts
    5) Continued leveraging cybersecurity vendor resources.

    Check Fraud Prevention – Staff implemented the following mitigations to better manage the risk of theft or misdirection of mailed checks

    1) Contacted all retiree payroll vendors receiving payment via check (30 in total). About 77% (23 out of 30) agreed to convert from check to direct deposit vendor; those changes have been implemented. The remaining seven retiree payroll vendors still receiving checks, will be mailed those payments directly from Northern Trust, rather checks first coming to SJCERA.
    2) Implemented additional mail controls to ensure overnight mailing of any checks being sent to SJCERA.
    3) Implemented additional check verification controls to decrease the ability to alter check information and deposit into a fraudulent account.
    4) Updated the internal control process for mailed checks.

    Federal and State Law Compliance – At the June 2 meeting, the Board approved the recommendation to establish and fill an internal Chief Counsel position. A portion of their duties will include compliance related services such as reviewing member and employer communications for legal compliance, overseeing implementation of new legislation, reviewing of and reporting on compliance with policies, Bylaws, and contracts, and overseeing contract administration. I am currently working with the County Human Resources Division to establish the position and salary range, which are precursors to the recruitment process.

Implement Phase 2 recommendation from 2021 cyber-security and disaster recovery plan assessments, including annual security assessment

Information Systems Manager, Adnan Khan and ACEO, Brian McKelvey met with Linea Secure to begin scoping the remaining tasks to complete all Phase 2 recommendations. Additionally, they are working with Linea Secure to begin our Third-Party Risk Assessment in September.

Improve employer experience

- *Increase outreach and education to payroll/personnel staff at employers and/or County departments*
  This month SJCERA sent employers four emails to provide education and/or assist them with proper administration of the plan. Communications Officer Kendra Fenner wrote and coordinated the distribution of two emails to all members and employers. The first email encouraged members to enroll in the Understanding your Retirement seminar; the second educated readers about the ACFR and PAFR and advised where to find more information. Additionally, I reached out to each County Supervisor and followed up with an email to advise them that members would soon be receiving the PAFR and prepare them for any questions they might receive. Copies of these emails are attached to this report for your reference. In addition, Finance Officer distributed the 2024 employer contribution rates to employers and payroll coordinators on August 1.

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*
  - Mandatory Training: All staff completed their required FEMA training, IS-100 "Introduction to Incident Command System" by Friday, July 28 (ahead of the July 31 deadline). To recognize everyone's efforts to complete it early, I treated staff to pizza and ice cream bars for lunch. We are awaiting further instructions from the Division of Human Resources regarding any additionally required Disaster Service Worker related training.
  - Financial Officer Carmen Murillo completed and graduated from the CALAPRS Management Academy. Congratulations Carmen.
  - Communications Officer Kendra Fenner completed the following webinars "The Launch of Vyond Go: Creating Videos in Seconds", and "Using AI to Design More Human-Centered Learning Experiences."
  - ACEO Brian McKelvey attended the UC Berkeley SACRS Investment Management Program, which covered topics including Investment Basics, Actuarial Considerations, Asset Allocation Decision, Fiduciary Responsibilities, Behavioral Finance, and Active vs. Passive investing. Speakers included public pension industry investment professional such as Ian Toner, Chief Investment Officer of Verus, Graham Schmidt from Cheiron, and Christopher Ailman, Chief Investment Officer of CalSTRS.

Create a foundation of performance metrics and measurements

- *Identify and establish best use of existing performance measures*
  ACEO Brian McKelvey met with the unit managers in Benefits, IT, and Finance to document existing performance measures, and identify performance metrics needed both now and with the implementation of the new PAS ("PRIME").

Employee of the Month

Congratulations and job well done to our pair of Employee(s) of the Month recipients, Communications Officer Kendra Fenner and Information Systems Specialist II Jordan Regevig. Kendra and Jordan accomplished what many thought couldn't be done: they mailed Member Statements in June! In past years, we mailed them as late as September, but thanks to their planning, process improvements, and drive, they set a record for timeliness of statement delivery. OUTSTANDING!! Great work Jordan and Kendra, you are appreciated for many reasons including your amazing work.

Maintain Business Operations

Interest Posting

In compliance with Government Code Section 31591, SJCERA credits interest semiannually on June 30 and December 31 to all contributions in the retirement fund that have been on deposit for six months immediately prior to such date. SJCERA's *Reserve* policy requires semiannual interest be credited to the

Member Reserve before any other reserve using the rate which, when compounded, produces the annual actuarial assumed rate of investment return (regardless of the fund's actual investment gains or losses). The current assumed rate of return is 6.75%, and the semiannual rate is 3.32%. SJCERA completed the June 30 interest posting on July 7. This is compared to July 13, 2022, July 12, 2021, August 12, 2020, August 28, 2019, and October 19, 2018. Thanks to Investment Accountant Eve Cavendar, Finance Officer Carmen Murillo, Accounting Technician II Marissa Smith, Information Systems Specialist II Jordan Regevig, and Information Systems Manager Adnan Khan, for ensuring the timely posting of interest, and to Communications Officer Kendra Fenner for updating the website.

Financial Reporting

Staff mailed the Popular Annual Financial Report (PAFR) to all Active and Deferred members in July. Retired Members will receive the PAFR with their August 1 earnings statement. Additionally, as noted in the Employer Experience section above, I reached out to each County Supervisor's Office to let them know of the PAFR distribution date and provide them with highlights if they get questions from members.

Financial Auditing Services Request for Proposal (RFP)

SJCERA received six proposals, including the incumbent, in response to the Financial Auditing Services RFP. The Evaluation Team (Financial Officer Carmen Murillo, Greg Frank, and myself) will meet on August 21 to determine a finalist(s), which will then go to the Audit Committee for approval. Thanks to Management Analyst III Greg Frank for managing the RFP process, including writing the RFP, issuing it to prospective vendors, answering bidders questions, and coordinating the review and selection process. His experience in this realm is evident: the process runs like clockwork!

Provide Excellent Customer Service

A few quotes from our members:

"Andrea [Bonilla] has been exceptionally helpful with my questions and the processing of my retirement paperwork since about September 2022. She responds the same day that I have had questions and she has provided me with additional information to help me process my retirement application."

"Kathleen [Goodwin] was extremely helpful…going above and beyond what I was requesting…asking if I wanted to use banked sick leave hours towards my payments. YES!"

"Bethany [Vavzincak] was very informative and efficient."

Conclusion

During the summer, I find myself grateful for the Delta Breeze, swimming pools, ceiling fans, insultation, and air conditioning! No matter the weather, though, SJCERA, the Board, our members and employers can count on our super-hero staff to get the job done…and do some more besides. Staff is making excellent progress on our goals, the pension administration system project, facilities projects, keeping up with their regular work, and everything else they are asked to tackle. Impressively, they keep their cool while juggling it all! I couldn't be prouder of our team and their efforts.

"Ahhhh."

Subject: Understanding Your Retirement Webinar
Date: Wednesday, July 5, 2023 at 11:23:25 AM Pacific Daylight Time
From: ISD Service Desk [ISD] <isdservicedesk@sjgov.org>
To: ISD Service Desk [ISD] <isdservicedesk@sjgov.org>
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!
AUGUST 3, 2023 – 9:00 AM
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,

ISD Service Desk
Information Systems Division
San Joaquin County
209-953-HELP (4357)

Subject: SJCERA Financial Report to members this week

Date: Wednesday, July 26, 2023 at 11:35:49 AM Pacific Daylight Time

From: Shick, Johanna [SJCERA] <johannas@sjcera.org>

To: Rickman, Robert [BOS] <rrickman@sjgov.org>, Villapudua, Miguel [BOS] <mvillapudua@sjgov.org>, Canepa, Paul [BOS] <pcanepa@sjgov.org>, Patti, Tom [BOS] <tpatti@sjgov.org>, Ding, Steven [BOS] <sding@sjgov.org>, Tyrrell, Scott [BOS] <styrrell@sjgov.org>, Rouppet, Chris [BOS] <crouppet@sjgov.org>, Calder, Gina [BOS] <gcalder@sjgov.org>, Anderson, Michael [BOS] <mdanderson@sjgov.org>, Goehring, Nicole [BOS] <ngoehring@sjgov.org>

CC: Wilverding, Jay [CAO] <jwilverding@sjgov.org>, Regalo, Sandra [CAO] <sregalo@sjgov.org>, Hopkins, Brandi [CAO] <bhopkins@sjgov.org>, Kiely, Brenda [CAO] <bkiely@sjgov.org>

Attachments: image001.jpg

Dear County Supervisors and Chiefs of Staff,
This email follows up on my phone calls to your offices this week. To recap: SJCERA's summarized annual financial report, the "Popular Annual Financial Report" (PAFR) will be distributed to members on Thursday or Friday this week. Both the PAFR and the longer Annual Comprehensive Financial Report (ACFR) from which it is derived, are available for your viewing on our website now using the hyperlink provided in this email.

Occasionally, members have called supervisors' offices with questions after having received the PAFR. Although you are always welcome to refer those call to SJCERA (209.468.2163), I have also provided you a summary of the highlights of our financial reports to assist you in addressing any phone calls you might receive. These highlights will sound familiar: they are the same as those we shared with you about the comprehensive report, in preparation for the June 20 Board of Supervisors meeting, because PAFR is simply a 4-page summary of that comprehensive report.

Highlights of SJCERA's financial reports.

- 2022 was a difficult year in the investment markets; SJCERA's diversified portfolio, with its downside protection, successfully minimized losses.
- SJCERA's investment performance ranked 13th best nationwide of all public pensions over $1 billion
  - The S&P 500 was down 18.1% last year
  - Most public pension plans had double-digit losses (average return was negative 11.1%); in comparison SJCERA's gross-of-fee return was negative 6.75% (more than 4% better than the average public pension fund).
- SJCERA's investment strategy protects the fund during challenging investment market conditions and helps ensure the safety and security of members' benefits.
- Members can rest assured that their benefits are secure.

Again, feel free to refer any calls you might receive to SJCERA. Additionally, if you have any questions, you are always welcome to contact me directly.

Best regards,
Johanna

Johanna Shick
Chief Executive Officer
6 South El Dorado Street, Suite 400 | Stockton, CA 95202
Office 209.468.2163 | Fax 209.468.0480 | www.SJCERA.org

San Joaquin County Employees' Retirement Association: 75 Years as Your Trusted Financial Steward

Subject: SJCERA's 2022 Financial Update
Date: Wednesday, July 26, 2023 at 2:10:04 PM 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)

Retirement benefits are funded through member and employer contributions along with long-term investment earnings. For the year ended December 31, 2022, the total fund generated a gross-of-fees return of -6.7%. Although this is below SJCERA's 6.75% assumed rate of return (our target), the portfolio's performance during this time ranks 13th best nationwide of public pension plans greater than $1 billion. SJCERA's diversified portfolio, with its downside protection, protects the fund during challenging investment market conditions and helps ensure the safety and security of members' benefits.

Read more in the 2022 Popular Annual Financial Report (PAFR) or the more detailed Annual Comprehensive Financial Report (ACFR).

Thank you,

ISD Service Desk
Information Systems Division
San Joaquin County
209-953-HELP (4357)

PIMCO

SECULAR OUTLOOK

JUNE 2023

The Aftershock Economy

Markets will likely face more volatility as the global economy exits a period of massive fiscal and monetary support. In this post-policy era, attractive yields on high quality bonds encourage a more resilient approach to investing.

A company of Allianz

KEY TAKEAWAYS

WRITTEN BY:

Richard Clarida
Global Economic Advisor

Andrew Balls
Chief Investment Officer
Global Fixed Income

Dan Ivascyn
Group Chief Investment Officer

The first few years of the 2020s have seen a number of acute economic, financial, and geopolitical disruptions on a worldwide scale, and it will take time for the ultimate consequences of these shocks to be fully felt. At PIMCO's latest Secular Forum, we discussed how recent short-term cyclical dynamics are likely to have longer-lasting secular consequences.

The global economy is exiting a period of massive fiscal and monetary policy interventions that are unlikely to be repeated over our secular horizon. After the post-pandemic surge in global inflation, central bankers are starting to recognize that unconventional monetary policies bear costs as well as deliver benefits, while surging sovereign debt levels will likely limit fiscal capacity to address future downturns.

With the era of volatility-suppressing policies possibly over, markets are likely in for a period of heightened volatility, with an unusually large array of potential aftershocks. We believe the risks to global growth are skewed to the downside over our five-year secular horizon, and that returns across asset classes are likely to be more differentiated in this new era.

We expect central banks to maintain their existing inflation targets and to prioritize keeping longer-term inflation expectations anchored at those target levels. We believe that neutral long-run real policy rates in advanced economies will remain anchored in a range of 0% to 1%. With rising government debt and the possible return of an inflation risk premium, we expect the yield curve to steepen as investors demand more compensation on longer-term bonds over the secular horizon.

Our expectations of low neutral rates and a return to near-target inflation reinforce a positive outlook for core and high quality fixed income. After rising sharply last year, starting yield levels – historically strongly correlated with future returns – for high quality bonds are close to longer-term averages for equity returns, potentially with significantly less volatility and more downside protection than equities. This may help investors to construct prudent, resilient portfolios without relinquishing upside potential. We have a bias toward high quality, more liquid investments and remain cautious about more economically sensitive areas. We expect increasingly attractive opportunities across private markets over time, particularly in light of the changing banking landscape.

A new era of geopolitical tension between an established superpower and a rising rival will likely create global economic implications. We continue to believe that the U.S. dollar will retain its status as the dominant global currency, despite a widening U.S. fiscal gap and growing indebtedness, but that there are investment opportunities to be found elsewhere.

Secular theme: The aftershock economy

Ongoing disruption – to the global economic and financial order, to the geopolitical balance, and to the scale and scope of government policy interventions – has defined the first three years of this decade and will, we believe, remain a new reality that investors need to recognize over the next five years. This has been a trend we've noted in recent PIMCO *Secular Outlooks* and one we revisited at our latest annual Secular Forum in May.

Our Secular thesis last year, "Reaching for Resilience," argued that in a more fractured world, governments and businesses would increasingly prioritize safety over short-term economic efficiency. We flagged potential inflationary pressures as companies friend-shore supply chains and as governments boost spending on energy initiatives and national defense.

While that thesis broadly continues to hold, our outlook for the next five years must incorporate and assess a number of major developments since our May 2022 forum, including

- Hawkish monetary policy pivots in response to the largest sustained surge in global inflation in 40 years
- A debate over the destination for neutral monetary policy rates once (or if) central banks return inflation to target levels
- Three of the largest bank failures in U.S. history and the collapse of Credit Suisse in Europe
- The passage of an ambitious U.S. fiscal trifecta – the Infrastructure Investment and Jobs Act, the Inflation Reduction Act, and the CHIPS and Science Act – in support of a newly assertive American industrial policy push, which will serve as a cyclical and secular tailwind as funds are released into the economy
- Conflicting signals on the economic and geopolitical direction of China amid President Xi Jinping's "third act"

Our secular views also build upon our latest *Cyclical Outlook*, "Fractured Markets, Strong Bonds," which anticipated modest recessions across developed markets, with tighter credit conditions raising downside risks. We said major central banks are near the end of their rate-hiking cycles, although not yet close to normalizing or easing policy, while future fiscal responses may be constrained due to high debt levels and the role of post-pandemic stimulus in fueling inflation.

In this environment of ongoing and multiple disruptions, short-term cyclical dynamics are having more long-lasting secular consequences, ushering in what we're calling "the aftershock economy." Here we share some key economic and investment implications we took away from our 2023 Secular Forum.

2023 Secular Forum guest speakers

Tim Adams
President and CEO, Institute of International Finance

Alejandro Díaz de León
Former Governor, Bank of Mexico

Elizabeth Economy
Senior Fellow, Hoover Institution, Stanford University; on leave to serve as Senior Advisor for China, U.S. Department of Commerce

Niall Ferguson
Author; Milbank Family Senior Fellow, Hoover Institution, Stanford University; Senior Faculty Fellow, Belfer Center for Science and International Affairs, Harvard University

Kathryn Judge
Harvey J. Goldschmid Professor of Law, Columbia Law School

Adi Kumar
Senior Partner leading global work in Reinvesting in Economies, McKinsey & Company

Nancy Lazar
Chief Global Economist, Piper Sandler

Michael Pettis
Professor of Finance, Guanghua School of Management, Peking University; Senior Fellow, Carnegie Endowment for International Peace

Hélène Rey
Lord Bagri Professor of Economics, London Business School

PIMCO's Global Advisory Board
World-renowned experts on economic and political issues

Macroeconomic volatility and geopolitical tension likely to persist

It's worth remembering how unusual the first three years of this decade have been in comparison with the 2010s.

The world faced a once-in-a-century pandemic, which authorities countered by locking and shutting down big chunks of the global economy and providing massive monetary and fiscal stimulus. In time, that stimulus, along with the cost of reopening the global economy and restoring supply chains, fueled the sharpest sustained surge in global inflation in 40 years. Central banks eventually responded with the most aggressive global rate-hike cycle in decades, with consequences that included a financial market rout in 2022, a banking crisis, tighter credit conditions, and widespread forecasts of a recession this year or next (see Figure 1).

These events will likely reverberate for years to come. We expect more frequent and more volatile business cycles, with less scope for governments to deploy countercyclical fiscal policy, and with central banks less willing to double down on administering unlimited doses of quantitative easing (QE).

We anticipate an era in which constraints on supply – not just shortfalls of demand – as well as enduring post-pandemic labor market shifts become significant sources of economic fluctuations, and continue to put upward pressure on global price levels.

Figure 1: As of last year's Secular Forum (May 2022), several things we hadn't seen in a long time

In May 2022, if you had been watching markets for...	Then you had never seen...
13 years	The MOVE Index of bond market volatility at 180
15 years	A federal funds rate north of 5%
34 years	Double-digit average inflation across OECD countries
42 years	475 bps of Fed hikes in 12 months

Source: ICE BAML, U.S. Federal Reserve, OECD as of May 2022

While we broadly share the prevailing view that global growth on average over our secular horizon will disappoint compared with the pre-pandemic experience, we also believe that the risks to growth are skewed decidedly to the downside. The reasons include the risk of sharper and more persistent tightening of global financial conditions due to recent banking system turbulence and the policy response to it, sharper contractionary effects from synchronous central bank rate hikes, possible escalation of war in Ukraine, a potential faltering of China's economic recovery, and rising risk of a U.S.–China confrontation over Taiwan.

Our forum included presentations on the potential trajectories for real and nominal neutral interest rates and the destination for central bank inflation targets over the next five years. We believe that neutral long-run real policy rates in advanced economies will remain anchored over the secular horizon in the New Neutral range of 0% to 1% by powerful long-term forces of aging demographics and sluggish productivity growth.

The U.S.–China relationship is expected to continue to dominate geopolitical dynamics, and we may have already entered "Cold War II," as historian Niall Ferguson – one of the forum guest speakers – suggested, with implications for countries worldwide as alliances and trade relationships realign. That said, we expect that trends in global trade and investment patterns will be driven much more by "de-risking" than they are by "decoupling." Supply chains are not being fundamentally decoupled; they are for the most part in the process of being globally recoupled in the direction of "friend-shoring," a trend that at least in the U.S. is already underway.

Policymakers face constraints and fatigue

Notwithstanding the post-pandemic surge in global inflation, we believe central banks will do what it takes to keep longer-term inflation expectations anchored at their existing inflation targets. We don't expect developed market central banks to formally change their targets, but do expect those targeting 2% to be willing to tolerate "2-point-something" inflation as part of an "opportunistic disinflation" strategy, in which they expect a shortfall in aggregate demand during a future recession to return inflation to target from above. Relative to our baseline, we think that the risks to inflation are skewed to the upside.

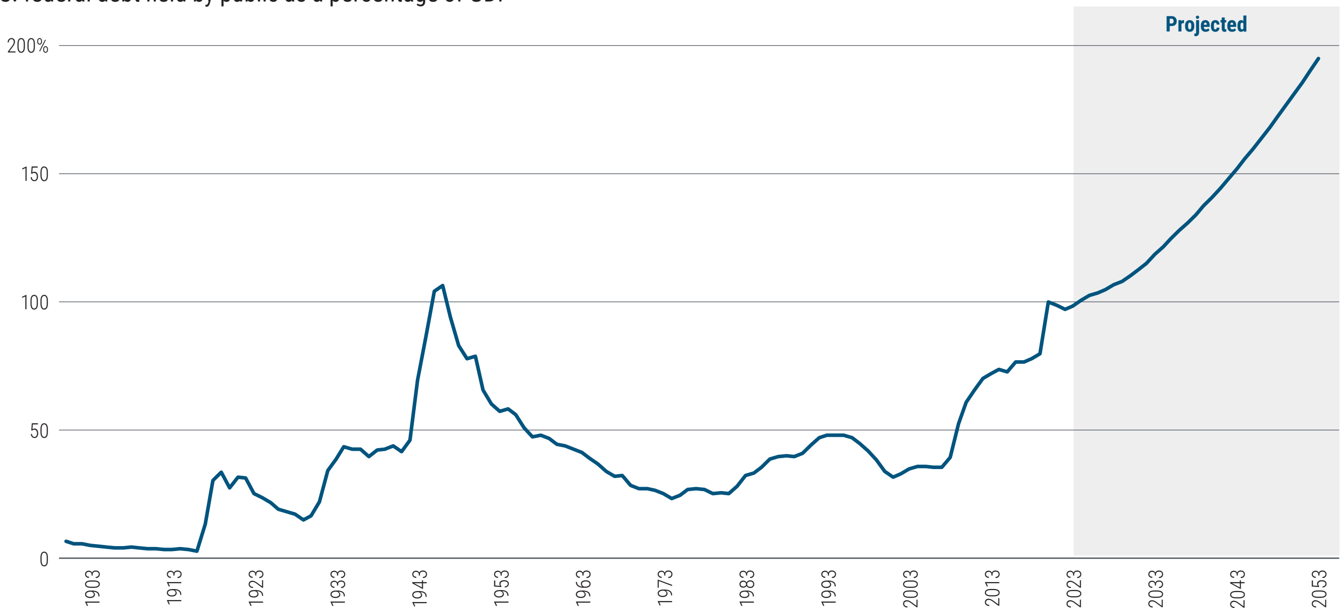
Turning to the policy toolkit, we believe over the next five years that, given the current astronomical levels of sovereign debt relative to GDP (see Figure 2), fiscal space will be more limited than in the past – either by politics or financial markets – and will constrain the ability of fiscal policy to soften future economic downturns.

We also anticipate the possibility that global central bankers will begin to suffer from "QE fatigue." For the first time in decades, elevated and stubborn inflation is highlighting the fact that, as with any economic decision, QE and fiscal largesse can have costs as well as benefits.

This may have ramifications for future policy, as playbooks that worked over the past 15 years may become less relevant. And in a world of QE fatigue and constrained fiscal capabilities, a cyclical disruption could become more secular.

With less scope to deploy traditional fiscal policy, governments may turn over time more to regulatory interventions. That will create winners and losers across affected sectors, while presenting opportunities for active asset managers.

Figure 2: Ratio of U.S. debt to GDP projected to rise substantially over the long term



Source: U.S. Congressional Budget Office (CBO) data and projections as of February 2023

In light of the collapse of Credit Suisse, as well as the failures and the cumbersome resolutions of Silicon Valley Bank, Signature Bank, and First Republic Bank, we believe that renewed calls to rethink and redesign the financial architecture within which banks operate will finally gain traction.

This will imply, at least in the U.S., tighter regulation that requires banks to have more capital and hold more liquidity. Banks' liquidity-intermediation capacity will likely shrink further, and some traditional activities will likely go into private markets and nonbank lending. We see a window to step in as a senior lender in areas once occupied by regional banks, such as consumer lending, mortgage credit, and various forms of asset-based finance.

Potential disruptions and aftershocks abound

Our forum discussions informed our broad baseline outlook described above, but they also highlighted the remarkable array of aftershocks that could emerge over our secular horizon.

Outcomes of the 2024 elections for the White House and control of Congress could have significant implications for U.S. fiscal and monetary policy, as well as foreign policy. The political tenor means that there will likely be even more pressure to be "tough on China," regardless of who is in the White House in 2025.

Similarly, the January 2024 presidential election in Taiwan could prove pivotal for U.S.–China relations, as those nations shift toward a structural rivalry and as China increasingly asserts itself across Asia. If the Kuomintang (KMT) defeats the more pro-independence incumbent Democratic Progressive Party (DPP), it may decrease the secular risk of confrontation over Taiwan.

Even absent a deepening military conflict, there is potential for a significant escalation of the U.S.–China rivalry on other fronts. The economic implications could include demand surges and supply shocks; further shifts in the global trade landscape amid nearshoring, friend-shoring, and duplication of supply chains; and even China potentially reconsidering its holdings of U.S. Treasury bonds. Meanwhile, an anticipated U.S. executive order on capital outflows is likely a beginning, not an end, over the secular period of a ratcheting up of restrictions on capital flows in addition to what has already been seen on export controls.

There are risks around the outlook for inflation, both in the U.S. and globally. While not our base case, there is the possibility that U.S. inflation remains stickier than anticipated and does not drop below 4% in the intermediate term, or remains closer to 3% over our secular horizon.

There are uncertainties about how responses to inflationary pressures will play out across emerging markets (EM) versus developed markets (DM). There is also uncertainty about the longer-term effects of high realized inflation on inflation expectations, given the persistent rise in inflation to levels previously not experienced in decades.

Central banks could continue to confront the challenges of balancing the conflicting policy objectives of maintaining growth, reducing inflation, and minimizing financial instability, while demonstrating that they've learned policy lessons from the "roaring inflation" 2020s. The potential for widespread adoption of central bank digital currencies (CBDC) or privately provided stablecoins also looms as a possible disruptor for the global financial order and – although not likely over our secular horizon – a possible challenge to the dominant global status of the U.S. dollar.

Since Russia's invasion of Ukraine, Europe in particular has faced shocks to energy supply and demand that made energy security and independence paramount objectives. That may force certain countries to further invest in energy sources and hasten the green transition, potentially contributing to inflationary pressures.

> The wide adoption of large language models of AI is a legitimate "wild card."

The accelerated adoption of large language models (LLM) of artificial intelligence (AI) is a legitimate "wild-card" factor. Over our secular horizon, it could have a material positive influence on productivity growth, which could put downward pressure on inflation and upward pressure on real interest rates. That influence could be seen in areas such as autonomous driving, reduced switching costs for consumers, and improved information flow. AI could also increase human longevity, for example by speeding medical breakthroughs such as immunotherapy cancer treatment using nanotechnology.

There are also significant risks associated with the recent swift advances in AI, including increased spread of disinformation via social media and risk of cyberattacks. Moreover, AI has the potential, even over our secular horizon, to worsen trends in income inequality and contribute to further political polarization and populism.

Investment implications: It pays to be resilient

Given that the era of QE, near-zero rates, and volatility suppression by central banks appears to be over, we have a bias toward high quality, more liquid investments over our secular horizon and remain cautious about more economically sensitive areas. We believe returns across assets are likely to be more differentiated in this new aftershock economy era.

FIXED INCOME

Based on today's starting yield levels – which historically have a strong correlation with future returns – high quality bonds may offer long-term, equity-like return potential with significantly less volatility and more downside protection than equities. We believe fixed income markets are pricing in expected volatility in ways that equity markets are not. Further, our expectation that central banks will maintain their credibility when it comes to price stability supports our view of bonds as a hedge against equity risk in a diversified portfolio.

With U.S. government debt rising above 100% of GDP, and with the possible return of an inflation risk premium, the term premium on U.S. Treasury bonds will likely increase and may be a secular force that steepens the yield curve (see Figure 3). That curve is inverted today, but we expect investors to eventually demand more yield for intermediate and longer-term bonds given higher inflation uncertainty. That would further increase the allure of bonds.

The U.K. liability-driven investment (LDI) crisis last year was a reminder that concerns over fiscal stability can bite in major DM countries with their own currencies as well as in the eurozone and EM. Market pricing does not suggest high levels of concern over long-term fiscal stability, but the U.K. could be a canary in the coal mine on long-term fiscal issues.

Meanwhile, the eurozone has come through a set of disruptions and stress tests relatively successfully, when judged in terms of the stability of its sovereign debt markets compared with the rolling crises of a decade ago. In part, this reflects the role of the European Central Bank and a more coherent set of fiscal tools for dealing with macroeconomic shocks.

Figure 3: Term premium on the 10-year U.S. Treasury remains elevated and will likely increase

Source: New York Federal Reserve survey of primary dealers as of March 2023. Term premium is defined as the compensation that investors require for bearing the risk that interest rates may change over the life of the bond.

But an ongoing focus on determining winners and losers will be important amid ongoing banking-sector uncertainty. We have an up-in-quality bias in financials, both in terms of individual names and within capital structures. The euro area banking system has coped fairly well with spillover from the U.S. regional banking turbulence and the aftershocks from Credit Suisse. But the euro area still looks ill-equipped for a full-blown banking crisis, given existing framework deficiencies on the resolution and deposit insurance side.

PUBLIC AND PRIVATE MARKETS

We would caution against any complacency stemming from the low levels of volatility exhibited by many private credit assets relative to public markets in recent years. With the repricing in public markets occurring at a more rapid pace, we expect better compensation for risk in high quality bonds relative to various forms of economically sensitive private credit.

With that said, private credit stands to benefit from the recent seismic shifts in the banking industry. We expect a target-rich environment over the secular horizon for both performing private lending strategies as well as more opportunistic investment styles.

Coming out of the 2008–2009 global financial crisis, a long period of low rates led to a search for yield. Private credit experienced aggressive growth and a relaxation of underwriting standards. One of the aftershocks will likely be higher credit losses in the sector, which will tend to create challenges across existing assets while also creating longer-term opportunities.

Much of the growth in private credit has come in the form of private corporate lending. We draw two key conclusions from this. First, we believe the existing stock of private corporate credit is likely to disappoint investors in a more challenging economic environment. Second, we believe investors may benefit from diversifying their private credit portfolios to include various forms of performing private credit, including real estate and specialty-finance-related credit.

The challenges facing corporate credit and commercial real estate markets will likely create investment opportunities for flexible private capital that can invest across the capital structure. While patience is required, we expect to see compelling long-term opportunities amid a shift from robust capital formation and complacency to more challenged capital availability and weakening fundamentals.

CURRENCIES AND EM

We continue to believe that the U.S. dollar will retain its status as the dominant global currency, despite a widening U.S. fiscal gap and growing indebtedness, but there are investment opportunities to be found elsewhere. The dollar could see its use in international trade continue to erode, albeit slowly, as the world trading system fragments further into competing regional blocs. This could signal a decline in American exceptionalism, and potentially a sustained period when non-U.S. investments outperform.

> We believe the U.S. dollar will remain the dominant global currency, but we also see investment opportunities elsewhere.

One of the obligations of being the global reserve currency is that when the world is in crisis, people want to buy the dollar, which can cause it to become overvalued. The dollar will continue to be buffeted by cyclical capital flows, and over time it may weaken against certain EM currencies, particularly those poised to benefit from onshoring and friend-shoring trends.

The EM share of the global economy is expected to accelerate over the next five years amid a more multipolar backdrop. The key drivers are already underway and include the globalization of services; nearshoring and friend-shoring; a race for key commodities such as lithium, cobalt, and rare earth minerals; and the green transition. This will create a more diverse EM universe that can serve as a risk diversifier in global portfolios.

Amid this expected secular period of ongoing disruption and adjustment, PIMCO's global capabilities help us as we seek to strike a balance between resilient, more liquid holdings and timely private investments, and to find value across EM and DM alike. We aim to identify opportunities for diversification, relative value, and risk-adjusted returns across the broadest possible investment universe without relying on outsize concentrations in riskier areas.

About our forums

PIMCO is a global leader in active fixed income with deep expertise across public and private markets. Our investment process is anchored by our Secular and Cyclical Economic Forums. Four times a year, our investment professionals from around the world gather to discuss and debate the state of the global markets and economy and identify the trends that we believe will have important investment implications. In these wide-reaching discussions, we apply behavioral science practices in an effort to maximize the interchange of ideas, challenge our assumptions, counter cognitive biases, and generate inclusive insights.

At the Secular Forum, held annually, we focus on the outlook for the next five years, allowing us to position portfolios to benefit from structural changes and trends in the global economy. Because we believe diverse ideas produce better investment results, we invite distinguished guest speakers – Nobel laureate economists, policymakers, investors, and historians – who bring valuable, multidimensional perspectives to our discussions. We also welcome the active participation of the PIMCO Global Advisory Board, a team of world-renowned experts on economic and political issues.

At the Cyclical Forum, held three times a year, we focus on the outlook for the next six to 12 months, analyzing business cycle dynamics across major developed and emerging market economies with an eye toward identifying potential changes in monetary and fiscal policies, market risk premiums, and relative valuations that drive portfolio positioning.

Past performance is not a guarantee or a reliable indicator of future results.

All investments contain risk and may lose value. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Investing in **foreign-denominated and/or -domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Currency rates** may fluctuate significantly over short periods of time and may reduce the returns of a portfolio. **Private credit** involves an investment in non-publically traded securities which may be subject to illiquidity risk. Portfolios that invest in private credit may be leveraged and may engage in speculative investment practices that increase the risk of investment loss. The **value of real estate** and portfolios that invest in real estate may fluctuate due to: losses from casualty or condemnation, changes in local and general economic conditions, supply and demand, interest rates, property tax rates, regulatory limitations on rents, zoning laws, and operating expenses. **Management risk** is the risk that the investment techniques and risk analyses applied by an investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to the manager in connection with managing the strategy. The **credit quality** of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. **Diversification** does not ensure against loss.

Forecasts, estimates and certain information contained herein are based upon proprietary research and should not be interpreted as investment advice, as an offer or solicitation, nor as the purchase or sale of any financial instrument. Forecasts and estimates have certain inherent limitations, and unlike an actual performance record, do not reflect actual trading, liquidity constraints, fees, and/or other costs. In addition, references to future results should not be construed as an estimate or promise of results that a client portfolio may achieve.

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THE NCPERS MONITOR
The Latest in Legislative News July 2023

NCPERS Executive Director's Corner

Introducing NCPERS Securities Fraud Recovery Services

By Hank Kim, Executive Director and Counsel, NCPERS

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Securities losses due to fraud are assets of public plans, and it is the duty of plan fiduciaries to recover those assets. However, the field of securities litigation is complex and even the largest and most sophisticated public plans seek help to evaluate whether to pursue legal action and in what manner.

To help our smaller public plan members get a similar kind of objective advice, we have partnered with DIVIDEX Management, LLC to create a new member benefit: NCPERS Securities Fraud Recovery Services.

Designed after months of conversations and evaluations with a focus group composed of five target public pensions, NCPERS Securities Fraud Recovery Services was created to help our pension fund members make more informed decisions as to when and how to take action regarding opportunities to recover securities fraud losses with minimal in-house staff time spent doing so.

"We are honored to be working with NCPERS to provide public pension funds this first-of-its-kind set of securities fraud recovery consulting services," said Irwin Schwartz, president and managing member of DIVIDEX Management, LLC. "We look forward to helping pilot project participants improve their abilities to find, track and manage their securities fraud recoveries," he added.

About NCPERS Securities Fraud Recovery Services

The year-long pilot program begins July 1, 2023 and is open to the first 25 public pension funds members that enroll at no cost. In order to be eligible, the fund must 1) be a pension fund in good standing with NCPERS and 2) have $30 billion AUM or less; or have annual average securities litigation recoveries of less than $2.5 million. The base level of services is available to enrolled members at no cost, with optional services available for nominal fees. Sign up here to enroll.

Participating pension funds will receive:

- Up to three free consultations where, upon request, DIVIDEX Management will help your fund evaluate whether it makes financial sense to pursue a domestic or foreign securities fraud recovery opportunity. Such an evaluation may include a loss analysis and prudence of serving as lead plaintiff or opting-out of domestic class action cases, or joining in foreign cases. Additional evaluation services are available for a fee of $500 per consultation case.
- Free monthly reports including information on foreign securities fraud recovery opportunities; claims filing deadlines for select class action settlements; and payouts from select large class action settlements.
- Reconciliation services to analyze the efficacy of their securities class action settlement claims filings and recoveries on selected cases. For this service, participating funds will provide DIVIDEX Management with the subject securities transactions and holdings data. In the event a fund elects to receive a Settlement Recovery Evaluation, the cost will be $100 per case, payable directly to DIVIDEX Management.

Participating members may also elect to have DIVIDEX Management provide Foreign Assistance Services—negotiating retention, joinder and litigation funding agreements on behalf of the pension fund—at a cost per filed case of $5,000.

To enroll in the pilot program, please complete this form. You can learn more and find answers to frequently asked questions here.

NCPERS Securities Fraud Recovery Services is another example of how we're seeking to provide value to our member mid- and small-market plans that may not have the resources to address the operational and fiduciary challenges they face each day. As the largest trade association for public pensions, NCPERS continues to expand and evolve its member benefits to help bridge those gaps and meet the growing needs of public pensions and industry stakeholders.

If you have any questions or comments about this new program, please don't hesitate to reach out to membership@ncpers.org. ◆

Pension Industry Careers: Job Listings, Hiring, and Retirement Announcements

Brought to you by NCPERS

How to Assess the Health of Public Pensions

By: Lizzy Lees, Director of Communications, NCPERS

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Funding ratios—the conventional metrics used to assess the health of public pensions—lean heavily on multiple unpredictable variables, in effect guessing at the direction that important factors such as interest rates, stock market performance, fiscal policy, and other variables will move over the course of decades. In addition, much analysis takes funding levels out of context by comparing a pension fund's long-term financial needs to the funds it has available in a single year. As a result, the magnitude of unfunded liabilities is distorted. It stands to reason that failing to factor in revenues and funding that will be collected over the long periods during which benefits are paid would warp the math.

Not surprisingly, these faulty approaches produce flawed analysis and recommendations. Yet policymakers routinely rely on such distorted assessments of public pension health as the basis for devising sweeping reforms. Doing so has long-lasting implications for public-sector workers and their beneficiaries. Over many years, policymakers have reduced public pension benefits, hiked employee contributions, and even closed plans to new hires on the basis of flawed and distorted analysis.

NCPERS recently published a Research Series paper that proposes five ways, including a few innovative ones, to assess the health of public pensions. During the 2023 Public Pension Funding Forum, researchers will further explore these methods and discuss emerging funding solutions and strategies to improve the health of public pensions.

As noted in the paper, studies by NASRA and the Reason Foundation have found that low funding ratios are frequently an impetus for reforms. Further, many opponents of public pensions often use inaccurate and out-of-context comparisons of unfunded liabilities to push through harmful pension reforms.

We believe there are better, less damaging ways to evaluate the health and sustainability of public pension plans. Below, we've outlined five ways to assess the health of public pensions beyond funding levels. To learn more, read the full NCPERS Research Series paper.

Five ways to assess the health of public pensions

1. Compare unfunded and total liabilities that are amortized over 30 years with the total economic capacity of the plan sponsor over the same period.

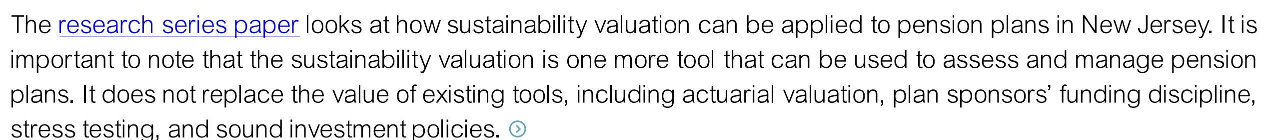
Too often, policymakers view unfunded and total liabilities of public pensions in isolation. Yet focusing simply on the trends in liabilities provides an incomplete picture, and that can lead to misguided decision making. If liabilities are rising rapidly, it's easy to jump to the conclusion that their rise cannot be sustained. Therefore, the focus shifts to strategies such as cutting benefits, increasing employee contributions, or closing the pension plan to new hires. However, this is a one-sided view that overlooks other important facts. For example, while liabilities are growing, it's very often the case that the economic capacity of the plan sponsors is also increasing. Liabilities must be considered in the context of the economic capacity of the plan sponsors. In the research series paper, we look at Kentucky as an example to see how this can play out with real data.

2. Assess the fiscal sustainability of the pension plan in terms of trends in the ratio between unfunded liabilities and the economic capacity of the plan sponsor.

Fiscal sustainability is a well-established concept in economics. It means that the ratio of debt to economic capacity is stable or declining over time. It's a simple concept that applies to individuals and public pensions. If unfunded pension liabilities continue to rise faster than the economic capacity of the plan sponsor, liabilities are likely to become unsustainable. However, if they are rising more slowly or in concert with the economic capacity of the plan sponsor, the pension plan is sustainable. Monitoring the ratio of unfunded liabilities to the plan sponsor's economic capacity against a benchmark – such as the historical average or another benchmark – can be a powerful tool in assessing and managing the health of a pension plan.

The NCPERS study *Enhancing Sustainability of Public Pensions* applies the concept of fiscal sustainability to state and local pension plans in each state.[1] The study refers to the application of the concept of fiscal sustainability to public pensions as the "sustainability valuation." An analysis of the 50 states in the NCPERS study shows that using the sustainability valuation – stabilizing the ratio of unfunded liabilities to the plan sponsor's economic capacity – has several benefits:

- The sustainability valuation shifts the focus from cutting benefits and closing plans to stabilizing unfunded liabilities in relation to economic capacity.
- As unfunded liabilities stabilize, funding levels are likely to improve.
- At the same time, contribution rates, measured as a percentage of revenues, are likely to decline.
- The sustainability valuation gives plan sponsors and policymakers important information that they can use to prevent a well-funded plan from becoming unsustainable due to changes in the sponsor's economic circumstances.



The research series paper looks at how sustainability valuation can be applied to pension plans in New Jersey. It is important to note that the sustainability valuation is one more tool that can be used to assess and manage pension plans. It does not replace the value of existing tools, including actuarial valuation, plan sponsors' funding discipline, stress testing, and sound investment policies.

[1] Michael Kahn, *Enhancing Sustainability of Public Pensions* (Washington, DC: NCPERS, 2022), https://www.ncpers.org/files/ncpers-enhancing-sustainability-of-public-pensions-2022.pdf.

3. Monitor the net amortization of the plan.

Net amortization is a way of measuring whether the annual contribution rate reduces or increases unfunded liabilities, presuming all other assumptions are met. The contribution rate may result in negative or positive amortization. If the annual contribution rate decreases liabilities, its impact is referred to as positive amortization. If, in contrast, liabilities increase despite contributions, the result is negative amortization.

If amortization continues to be negative, there are solutions that can be considered. A 2022 NCPERS publication authored by Tom Sgouros of Brown University proposes that an effort should be made to stabilize unfunded liability through unfunded actuarial liability (UAL) stabilization payments, or USPs.[2] The USP is the payment necessary to leave a plan in the same condition at the end of a year as it was at the beginning, presuming all other assumptions are met. Details on how to calculate the USP are shown in the report, *Measuring Public Pension Health: New Metrics and New Approaches*. This approach can have a significant impact on the health of a pension plan. The research series illustrates this using the example of Oklahoma Public Employees' Retirement System.

4. Monitor employers' funding discipline.

If employers skip a contribution or pay less than the actuarially determined contribution (ADC), it throws everything off balance. It's hard to make up the loss created by skipping the contribution or paying less than is required because the asset base that grows through a compound rate of return on investments continues to be smaller. Pension plan managers should monitor contributions closely and press for employers to pay 100 percent of their ADC.

A study by the Center for Retirement Research at Boston College shows that pension plans in which plan sponsors skipped or underpaid their required pension contributions had relatively low funding ratios.[3] Conversely, a study by the National Institute on Retirement Security found that pension plans in which plan sponsors made the full required contribution were well funded and remained well funded through the 2001 and 2007–2008 recessions.[4]

In short, it is important to assess funding discipline – that is, the habit of always making the full required contribution – in the past as well as going forward. As various studies show, funding discipline has a profound impact on the health of a pension plan.

5. Monitor trends in the fund-exhaustion period.

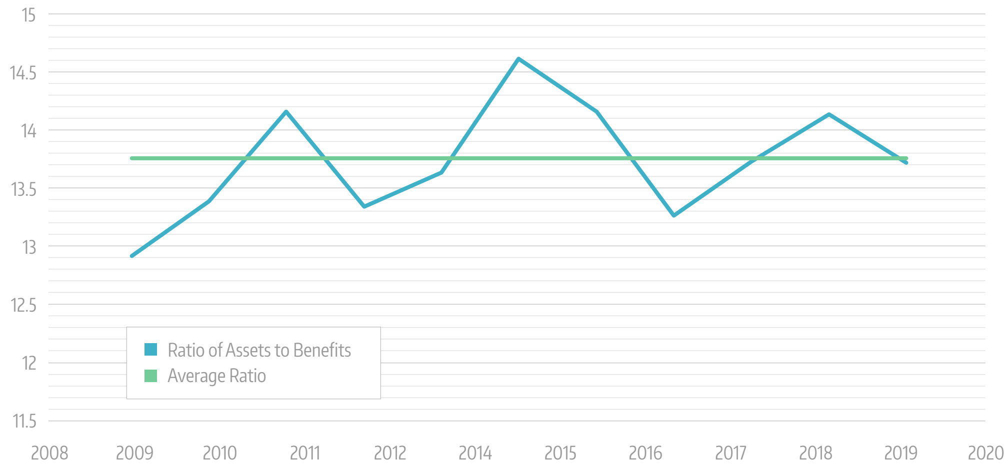
In actuarial terms, the fund-exhaustion period is the point in time at which a pension fund would no longer be able to pay benefits if assets were frozen at current levels. A rough way to look at the fund-exhaustion date is by simply considering the ratio of current assets to annual benefit payments. Figure 5 from the research update shows how the ratio of assets to benefit payments fluctuated during the decade in relation to the average ratio. It also shows that there was an improvement in the financial health of state and local pension plans from 2009 to 2019. For example, in 2009 state and local pension plans had enough assets to pay benefits for about 12.8 years. The figure for 2019 was 13.8 years, meaning that if everything were frozen, state and local pension plans could pay benefits for the next 13.8 years.

[2] Tom Sgouros, *Measuring Public Pension Health: New Metrics and New Approaches* (Washington, DC: NCPERS, 2022), https://www.ncpers.org/files/NCPERS-Pension-Metrics.pdf.

[3] Alicia H. Munnell, Jean-Pierre Aubry, and Laura Quinby, "The Impact of Public Pensions on State and Local Budgets," *Issue in Brief* 13 (Chestnut Hill, MA: Center for Retirement Research at Boston College, 2010), https://crr.bc.edu/wp-content/uploads/2010/10/slp_13-508.pdf.

[4] Jun Peng and Ilana Boivie, *Lessons from Well-Funded Public Pensions: An Analysis of Six Plans that Weathered the Financial Storm* (Washington, DC: National Institute on Retirement Security, 2011), https://www.nirsonline.org/wp-content/uploads/2011/06/final_june_29_report_lessonsfromwellfundedpublicpensions1.pdf.

Figure 5. Trends in Ratio of Assets to Benefit Payments, U.S., 2009–2019



There are more sophisticated methods to estimate the fund-exhaustion period, which involve projections of assets, contributions, and benefit payments. But the simple calculation is something that trustees can do on the back of an envelope and get a sense of the direction in which the financial health of the plan is moving. Using the fund-exhaustion period to assess the health of a pension plan is especially important for plans that are projected to run out of money in a few years.

Read the full research paper, and find additional research from NCPERS here. ◆

NCPERS 2023 Public Retirement Systems Study:

Trends in Fiscal, Operational, and Business Practices

READ THE REPORT

Federal Legislative Update

By: Tony Roda, Partner, Williams & Jensen

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Congress is careening toward the end of the fiscal year, September 30, with little or no plan on how to resolve the growing disparity between the House Republicans, on one hand, and the Senate Democrats and the President, on the other, with regard to funding levels for federal programs.

Soon after enactment of legislation to suspend the debt ceiling and set new spending caps for the next two upcoming fiscal years, conservative House Republicans balked at those levels and are demanding an additional reduction of $120 billion in fiscal year 2024. House appropriators are approving bills at the reduced levels, which will set up contentious floor consideration later this summer.

As we've seen for decades now, a short-term Continuing Resolution will be necessary to fund the federal government after September 30. However, hardline House Republicans may force a government shutdown in order to force negotiations on additional spending cuts. Questions already are being raised on whether the fiscal turmoil will lead to a massive end-of-year agreement that includes further spending and changes to the tax code. As state and local governmental retirement plans are qualified under federal tax law, any changes to the tax code need to be watched closely.

Meanwhile, the House Financial Services Committee (FSC) is spending considerable time on matters related to environmental, social, and governance (ESG) investing. Earlier this year the FSC created an ESG Working Group on which only Republicans serve. The Working Group recently released an interim report with the following priorities:

- Reform the proxy voting system to safeguard the interests of retail investors.
- Promote transparency, accountability, and accuracy in the proxy advisory system.
- Enhance accountability in shareholder voting by aligning voting decisions with economic interests of shareholders.

- Increase transparency and oversight of large asset managers to ensure their practices reflect the pecuniary interest of retail investors.
- Improve ESG rating agency accountability and transparency to safeguard retail shareholders.
- Strengthen oversight and conduct through investigations into federal regulatory efforts that would contort our financial system into a vehicle to implement climate policy.
- Demand transparency, responsibility, and adherence to statutory limits from financial and consumer regulatory agencies.
- Protect U.S. companies from burdensome EU regulations, safeguarding American interests in global markets.

In addition, a senior member of the FSC, Rep. Andy Barr (R-KY), recently introduced H.R. 4237 which, in part, would require a study of state and local governmental plans. Specifically, the U.S. Comptroller General, who is the head of the Government Accountability Office (GAO), would conduct a study on the potential impact on the federal government of underfunded state and local pension plans. The study would include the following:

(1) the extent to which such pension plans subordinate the pecuniary interests of participants and beneficiaries to ESG or other objectives; and

(2) legislative and administrative actions that, if implemented at the federal level, would prevent such pension plans from subordinating the interests of participants and beneficiaries to ESG objectives.

Finally, another senior member of the FSC, Rep. Bill Huizenga (R-MI), has introduced H.R. 4168, which is designed to block the Securities and Exchange Commission's (SEC) proposed regulation to require public companies to make certain disclosures on greenhouse gas emissions. Specifically, the legislation would amend both the Securities Act of 1933 and the Securities Exchange Act of 1934 by amending them to state that an "issuer is only required to disclose information in response to a disclosure obligation adopted by the Commission to the extent the issuer has determined that such information is important with respect to a voting or investment decision regarding such issuer."

Spending disputes and anti-ESG legislation are expected to fill the House legislative calendar this summer and early fall. Please be assured that NCPERS will closely monitor these issue areas for their impact on state and local governmental plans. ◆

__Tony Roda__ is a partner at the Washington, D.C. law and lobbying firm __Williams & Jensen__, where he specializes in legislative, regulatory, and fiduciary matters affecting state and local pension plans. He represents the National Conference on Public Employee Retirement Systems and state-wide, 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 the Catholic University of America, and LL.M (tax law) from the Georgetown University Law Center.

The ESG Debate: How Recent Legislation Is Impacting Retirement Fund Best Practices

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

Photo Illustration © 2023, istock.com

Utilizing an environmental, social, and governance (ESG) framework to invest is nothing new, but it has been rapidly growing in popularity, with global ESG fund assets reaching approximately $2.5 trillion at the end of 2022. However, one new and concerning trend has been the recent ESG backlash led by lawmakers.

Recent research shows that, in fact, ESG and non-ESG investing strategies result in similar returns. When weighted by market capitalization, portfolios with ESG preferences did not fare significantly better or worse than non-ESG investments.

Despite this, with the growing politicization of ESG, lawmakers across the country are proposing or adopting legislation to regulate how and what public pension funds invest in. In blue states, the focus has primarily been on divestment from fossil fuels. Most recently, a California bill was introduced that would prevent CalPERS and CalSTRS from making new investments in fossil fuels and would require them to divest by 2030. The CalPERS board voted to oppose the bill, citing the staggering transaction costs and the lack of evidence that divestment would impact the demand for fossil fuel.

On the other end of the spectrum, red and purple states have been rapidly adopting anti-ESG legislation modeled after ALEC's 'boycott bill,' which was designed primarily to protect oil companies and gunmakers from 'boycotts' by investors and businesses. This politicization of ESG is dangerous and ultimately will likely have a negative impact on public pension funds' investment performance.

Oftentimes, these anti-ESG bills are rooted in political beliefs rather than operating as an apolitical fiduciary. They come with exorbitant costs with both direct and indirect impacts on public retirement funds' performance. Lawmakers also may not fully comprehend the long-term impact of these bills. Restricting how a fund invests can impact diversification and long-term returns by reducing the universe of investments. There are hidden costs as well. For instance, a fund may need to hire additional staff to help manage the mandates or protect the system from lawsuits. Or, due to decreased returns, the fund may ultimately require increased employee and employer contributions.

Already, we're seeing these negative impacts across the country. Below is a sampling of the impact of recent legislative proposals on retirement systems:

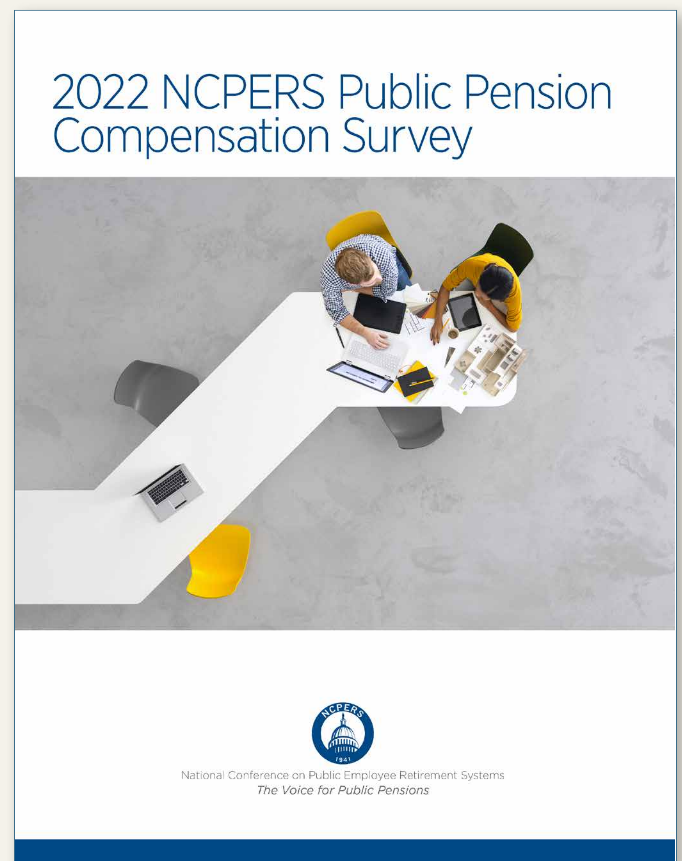
- Texas County District Retirement System will lose an estimated $6 billion over the next 10 years due to investment restrictions included in SB 1446.
- Due to investment restrictions included in HB 1469, North Dakota anticipates additional overhead costs of $10.2 million biennially.
- As a result of decreased competition in the municipal bond market, Florida "now pays 43 basis points more in yield (or $4.3 million for every $1 billion of bonds sold) than California with an inferior credit rating, or 0.35% more than it did prior to 2022," according to a Bloomberg analysis.

These legislation proposals—being replicated throughout the country—will likely lead to reduced investment returns, increased overhead costs, and ultimately increases in employee and employer contributions. This could have broad impacts on not only the retirement plan and its beneficiaries, but also businesses, local economies, and ultimately taxpayers.

NCPERS believes that, in order to execute their fiduciary duty, funds should be able to decide what to invest in. If you are interested in learning more about the impact of these legislation proposals, or if you would like to obtain advocacy-related resources from NCPERS, please contact me at bridget@ncpers.org. ◆

Order your copy of NCPERS 2022 Public Pension Compensation Survey today.

Access in-depth compensation and benefits data from more than 150 public pension funds representing more than 9 million active and retired individuals.



LEARN MORE

Recognizing the 2023 Trusty Trustee Award Winners

By: Lizzy Lees, Director of Communications, NCPERS

Last month, nearly 100 public pension trustees and staff attended the Trustee Educational Seminar (TEDS). Held in conjunction with NCPERS Annual Conference & Exhibition, this two-day program is designed to meet the educational needs of new and novice trustees, or as a refresher for experienced hands. The curriculum focuses on investing principles, understanding actuarial science, board policies, and other fundamental concepts that every fiduciary should know.

Each year, the program puts attendees' investment knowledge to the test with the interactive Asset Allocation Game. During this exercise—led by Bob Parise, managing director, public funds & Taft-Hartley Plans at Northern Trust Asset Management—attendees first learn about strategic and tactical approaches to asset allocation. The educational portion also covers risk models and frameworks for successful investing.

Parise then changes gears to host the gameshow-style exercise, "The Risk is Right." During this interactive asset allocation game, attendees form teams and respond to various scenarios, applying the lessons learned during the educational portion of the session in real time.

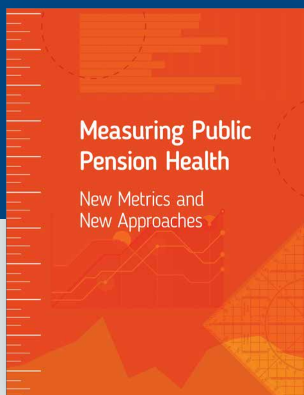
Members of the top-scoring team are then awarded the 'Trusty Trustee Award.' Congratulations to the 2023 winners for demonstrating your mastery of asset allocation and investing principles:

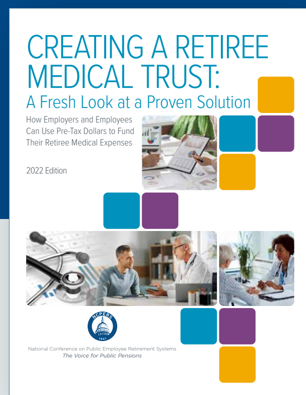
- Victoria Lee, Trustee, Teachers Retirement System of NYC
- William Canning, Trustee, Municipal Employees' Annuity Benefit Fund of Chicago
- Mike Goetz, Trustee, Illinois Teachers' Retirement System
- Jesse Evans, Jr., Director, City of New Orleans Employees' Retirement System

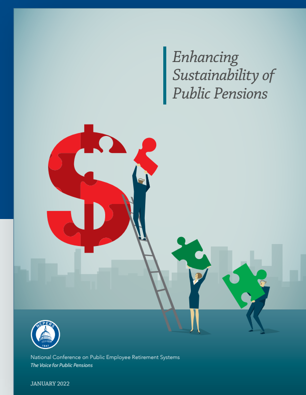
Save the date for next year's TEDS, held May 18-19 in Seattle, Washington. Sign up here to be notified when registration opens. NCPERS offers ongoing education for trustees, administrators, and industry stakeholders of all experience levels throughout the year.

View the event calendar to see your next opportunity to learn about important advances in public pension funding, financial services, legislation and regulation, and other significant issues related to public sector pension plans. ◆

Don't miss the latest research from NCPERS.







Find new metrics and approaches for measuring public pension health, research on how employers and employees can use pre-tax dollars to fund retiree medical expenses, and more.

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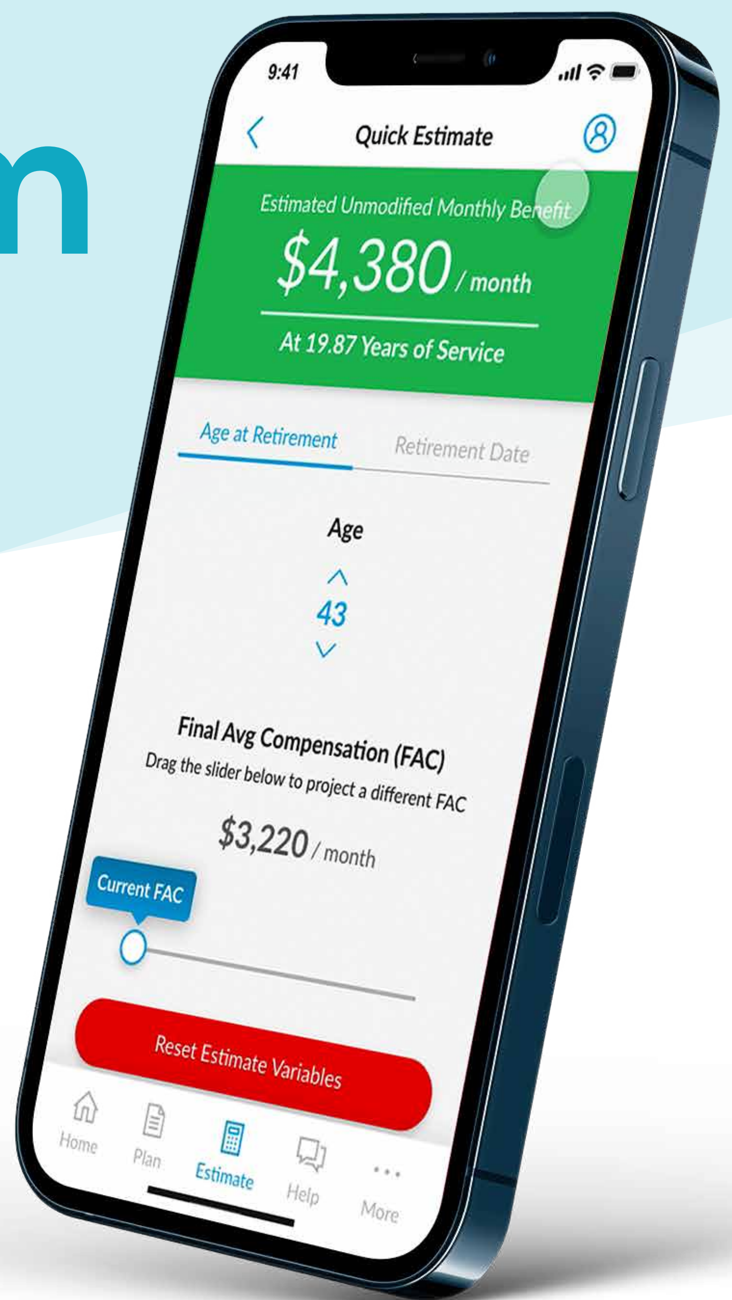
NCPERS PensionX Digital Platform



NCPERS has partnered with Digital Deployment to offer its members a **10% DISCOUNT** on PensionX, the premier digital platform that securely enables pensions to engage with active and retired participants via a mobile self-service app and portal.

pensionX

Learn more about this new NCPERS member benefit at ncpers.org/pensionx

Nebraska Legislators, In a Rare Move, Reject Hiring By a State Agency

In a rare move, state lawmakers voted Wednesday to reconsider, and then reject, a state agency appointment — the hiring of Jason Hayes as the new director of the Nebraska Public Employees Retirement Systems (NPERS).

READ MORE *Source: Nebraska Examiner*

Most Companies on Oklahoma's Blacklist Aren't Actually Subject to a State Law Banning 'Woke' Investing; State Treasurer Added Them Anyway

The Frontier found the Oklahoma State Treasurer's office applied criteria for blacklisting companies inconsistently, leaving some firms claiming they have been arbitrarily and wrongly banned from doing business with the state. The blacklist could have far-reaching effects on everything from financing for public works projects to how state payroll checks are processed.

READ MORE *Source: The Frontier*

Missouri Pension Bills Include Benefits for Lawmakers, Officials While in Office

Inside pension bills with provisions to encourage retired teachers to return to the classroom and protect the finances of the Missouri Sheriffs Retirement System are provisions that could boost the incomes of Gov. Mike Parson, Lt. Gov. Mike Kehoe and at least three legislators.

READ MORE *Source: Missouri Independent*

Nevada, Vermont to Offer State Auto-IRA Programs

More states are following the trend of offering state-sponsored retirement savings plans to private sector workers who would otherwise not have any job-related retirement savings, as Nevada and Vermont are the latest to approve such programs, and another could potentially pass in Pennsylvania.

READ MORE *Source: PlanSponsor*

CalPERS Laser-Focused on Killing State Fossil Fuel Divestment Bill

CalPERS is executing a full-court press with staff and trustees and other stakeholders to stop a California bill that would require it and CalSTRS to divest from and halt further investment in fossil fuel companies.

READ MORE *Source: Pensions & Investments*

New York Common Signs Political Disclosure Agreements With 7 Firms

New York State Comptroller Thomas DiNapoli, trustee of the $242 billion New York State Common Retirement Fund, announced the fund has struck deals with seven portfolio companies to get them to be more transparent about their spending on political issues.

READ MORE *Source: Chief Investment Officer*

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Calendar of Events 2023

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.

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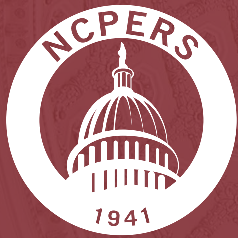

PERSist

The Voice for Public Pensions Summer 2023 | Volume 36 | Number 3

NCPERS Message

Understanding the Latest Developments in Pension Funding

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Funding ratios—a simplistic metrics used to assess the health of public pensions—is heavily favored in our summarize-on-a- bumper-sticker mentality, short attention span society. However, and precisely because it is simple, funding ratios only conveys a one-dimensional, a single point in time measurement and do not provide trends and other important context.

Relatedly, too many policymakers and the media take funding levels out of context by comparing a pension fund's underfunded amount – which is an aggregation of 30 years of projected shortfall – to a single year's revenue of its plan sponsor. As a result, the magnitude of unfunded liabilities is distorted. It stands to reason that failing to factor in revenues and funding that will be collected over the long periods during which benefits are paid would warp the math.

Not surprisingly, these faulty approaches produce flawed analysis and recommendations. Yet policymakers routinely rely on such distorted assessments of public pension health as the basis for devising sweeping reforms. Doing so has long-lasting implications for public-sector workers and their families. Over many years, policymakers have reduced public pension benefits, hiked employee contributions, and even closed plans to new hires on the basis of flawed and distorted analysis.

NCPERS recently published a Research Series paper that proposes five ways, including a few innovative ones, to assess the health of public pensions. During the 2023 Public Pension Funding Forum, researchers will further explore these methods and discuss emerging funding solutions and strategies to improve the health of public pensions.

The forum, held Aug. 20-22 in Chicago, provides attendees with practical insights into the latest pension research, including case studies that showcase emerging funding solutions. Attendees learn which pension reform initiatives have and haven't worked, while examining the short- and long-term effects that tweaking public pension benefits and formulas can have on public employees, stakeholders, communities, and the broader economy. Download the event brochure to learn more.

The Public Pension Funding Forum will kick off with a session on understanding crypto followed by a networking reception. The next morning, panelists will explore what drives pension reforms (and the politics that often surround them). Attendees will then hear from the Treasurer of North Carolina, Dale Folwell, and NYSTRS' executive director and CIO, Thomas Lee, about the factors that keep funding levels high in their respective systems. Later that day, Andy Blough and Seth Stock of the Indiana Public Retirement System will draw from their experiences to discuss how stabilizing funding contributes to improved fiscal health of pensions.

The next day, attendees will get the actuarial perspective on enhancing the health of public pension plans and hear about Fairfax County Retirement Systems' experience with applying the concept of Sustainability Valuation to the system. Following up on last month's webinar preview, leaders from BlackRock will then share insights from their annual Peer Risk Study. The program will conclude with an update from the Federal Reserve Bank of Atlanta's David Altig on the current economic outlook.

The event also features plenty of networking opportunities to promote building connections and sharing ideas. Early-bird pricing ends July 28, so don't wait to register for the Public Pension Funding Forum. If you have any questions, please email conferences@ncpers.org. ◆

PUBLIC PENSION FUNDING FORUM August 20 – 22 Chicago, IL

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Navigating retirement can be overwhelming® for members and organizations. There are many important items members must consider that will affect how well they retire, with healthcare being primary. For organizations, providing support, education, and great coverage at retirement for their members while saving on costs for both groups and members is a balancing act.

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Page 11 **Direct Listing Dilemma for Pension Funds: Understanding the Impact of *Slack Technologies v. Pirani* on Liability under Section 11**
Pension funds that have invested in direct non-registered initial offerings should understand that when initial offering shares are not issued pursuant to a registration statement, investors lack the same legal protections for shares that were purchased pursuant or traceable to a registration statement. Consequently, the recent Supreme Court decision in Slack Technologies v. Pirani *poses a challenge in pleading and proving claims under Section 11 of the Securities Act for shares acquired through non-registered direct listings.*

Page 13 **Today's Public Pensions Cannot Be Considered Government Agencies**
To remain sustainable and address existing funding gaps, today's pension systems need to become competitive asset management organizations and no longer operate as government agencies.

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This article analyzes how well public pension plans keep up with inflation by comparing the cost-of-living adjustments (COLAs) they offer in comparison to those offered by Social Security in both periods of low inflation and high inflation. The analysis includes a comparison of Social Security participation of private plans compared to public plans and how that differs by state as well as how it affects benefit levels over time.

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The latest revision to Actuarial Standard of Practice (ASOP) No. 4 is upon us. Andy Hunt and Jonathan Hobbs, from Allspring Global Investments' Pension Solutions team, review the implications for how public pension plans need think about and invest their fixed income portfolios.

Page 21 **Modernized Pension Administration: Five Critical Automation Advantages for Public Sector Entities**
While the administration of public pension plans has evolved through the years, many public sector entities aren't fully optimizing the advantages of automation, with some still relying on manual processes and spreadsheets. When evaluating the capabilities of a modernized Pension Administration System (PAS), here are five critical automation advantages to consider.

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Pension funds are fundamentally exposed to risk because of their business processes. Understanding the nuances of how your fund operates is crucial to recognizing the cyber risks related to your services offered.

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The piece explores how China's large and growing weight within emerging markets equity indices is crowding out attractive investment opportunities in other emerging market countries and why asset owners might want to consider an emerging markets ex-China framework to broaden the exposure to these attractive developing countries.

Page 29 **General Partner (GP)–Led Secondaries**
Private market investment strategies continue to expand while providing differentiated risk/return profiles. Capital investments into private market management companies, known as "GP stakes", are an example of this expansion. GP stakes provide a differentiated way to participate in the potentially attractive economics of private market firms ("GPs" or "managers").

Page 32 **Beyond Retirement Benefits: Equipping Members with Just-In-Time Financial Information**
Plan members would benefit from financial education and guidance, in different forms and with varying degrees of personalization, corresponding to their current financial situations.

Page 35 **Private Credit: Decision Drivers for Today's Markets**
For a look behind the scenes in navigating private capital investments, Churchill's teams share what is top of mind today from an underwriting perspective.

Page 38 **The Cyber Threats for Pension Funds**
The combination of large amounts of personal information, money and small staffs make public employee pension funds especially vulnerable to cyberattacks. These funds, especially those with fewer IT-savvy employees, must protect themselves.

Page 40 **Worlds Apart: The Case for Separating Emerging Markets from your International Allocation**
While emerging markets may only represent 29% of the allocation of the international index, it deserves a far larger percentage of a manager's attention. Their diversity and inefficiency offer active managers an excellent opportunity for alpha generation, however, the magnitude and complexity of underlying markets require dedicated resources to extract this alpha.

What’s Shaping India? Five Emerging Trends

By: Jeremy Murden, William Blair Investment Management

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While COVID-19 impacted near-term developments in India, key sectors are standing out, offering compelling investment opportunities. Here are five emerging trends to watch.

Expanding Digital Infrastructure with the India Stack

Over the past decade, the Indian government has pushed the creation of the “India Stack,” a series of free public digital goods that enable a digital economy for those who have historically been outside the formal economy. The net impact of the India Stack is that street vendors are now more likely to be inside the formal economy, accepting digital payments for goods, and can now use those sales as a verification of income for credit access. The expansion of digital infrastructure, combined with the pandemic (which increased remote work globally), also led to more outsourcing to India. India essentially became the office of the world as corporations became more comfortable with work being performed outside of the office.

From Biscuits and Toothbrushes to Luxury Goods: A Tale of Two Indias

While overall income levels in India have risen, there is still a large disparity between the highest earners and the average Indian. By income, the top 10% of Indian people earn more than 50% of the country’s total GDP. Much of the population is still low-income by global standards, and most incremental consumption goes toward products lower on the pyramid. We see fewer opportunities in branded sneakers and more opportunities in basic consumables. That’s why our biggest overweights in India’s consumer sector are consumer staples companies.

While overall income levels in India have risen, there is still a large disparity between the highest earners and the average Indian.

Is Solar the Future?

India is a sun-rich country, and as solar energy continues to become more competitive, it can help reduce India's need to import oil and natural gas. Beneficiaries of India's renewable power investment range from large Indian businesses using their scale to expand into domestic polysilicon mining, solar panel manufacturing, and energy storage to a global leader in industrial automation geared toward electrification products such as solar inverters and switching.

Modernizing India's Urban Infrastructure

India is investing heavily to modernize and expand its infrastructure. My colleagues on our industrials team believe these investments, along with other schemes by the government (such as production-linked incentives), will go a long way in driving private capital investment and economic growth and supporting manufacturing growth. Structural steel tubing manufacturers, as well as an explosives manufacturer used in the extraction of minerals and India's leading manufacturer of cables and wiring, could potentially benefit from urban infrastructure investments.

Growth Opportunities in Rural Areas

As in urban areas, rural infrastructure in India continues to be a challenge. But my industrials team colleagues also believe this presents an opportunity for companies that can address India's infrastructure challenges. The growth rate in industries, ranging from waterproofing adhesives and coatings to piping and concrete, continues to be greater than India's gross domestic product (GDP). In addition, rural farming remains a primary source of income in India and improving agricultural efficiency is another strong growth trend. Investable examples include innovative agricultural chemical manufacturers and distributors.

In addition, rural farming remains a primary source of income in India and improving agricultural efficiency is another strong growth trend.

The Case for India

As bottom-up asset managers, we are excited about India's economic potential and remain focused on seeking out quality companies that create sustainable value. ◆

This article is excerpted from our blog, which you can read in full here.

Jeremy Murden, CAIA, *is a portfolio specialist for William Blair's global equity strategies. In this role, Jeremy conducts portfolio analysis, participates in the team's decisionmaking meetings, and communicates portfolio structure and outlook to clients, consultants, and prospects. Before joining William Blair as a portfolio specialist, Jeremy was a portfolio strategist at Matthews Asia, where he provided macro thought leadership and individual portfolio insights focused on the firm's China and Asia equity strategies. Before joining Matthews Asia, Jeremy spent 10 years as a senior investment manager analyst for William Blair Select, leading external equity manager coverage for the team that was responsible for the selection and ongoing evaluation of thirdparty investment managers. He started his career in distribution as a product specialist at Claymore Securities, now Guggenheim Funds. Jeremy received a B.Sc. in finance honors from DePaul University and an M.B.A. from the University of Chicago Booth School of Business.*

Navigating Retiree Healthcare: The Advantages of Medicare Advantage

By: Merrilee Logue, National Labor Office at the Blue Cross Blue Shield Association (BCBSA)

For organizations who have employees edging towards retirement, the Medicare landscape can be daunting, and the options can seem endless and confusing. Medicare, which is the federal health insurance for anyone aged 65 or older, is comprised of multiple parts: There is Part A, which is the Hospital Insurance, Part B covers doctor and other health care providers' services, and Part D is Prescription Drug coverage. All Parts cover different healthcare components and come at different costs, each of which may be administered separately. The government offers partial coverage for Medicare including Part A and B, but at the end of the day, to keep their existing doctors and health services, some members might find that they need to purchase Medigap to avoid gaps in their coverage.

Medicare Advantage (MA), also known as Part C, is a private insurance alternative to the government-provided Medicare that can provide supplemental benefits and help streamline this process. Rather than worrying about the logistics of administering multiple plans, MA combines Part A and B into one and most often includes Part D. This means that healthcare services can be managed together, making it easier to oversee and track.

Additionally, MA can offer extra services that traditional Medicare does not. For example, some plans might include fitness programs, like gym memberships or discounts, and some vision, hearing, and dental services, like routine checkups and cleanings (vision, hearing, and preventative dental are among the most popular select benefits[1]). Some MA plans might even cover services like transportation to doctor visits or over-the-counter drugs that Part D doesn't cover.

Medicare Advantage (MA), also known as Part C, is a private insurance alternative to the government-provided Medicare that can provide supplemental benefits and help streamline this process.

Medicare Advantage plans may have lower out-of-pocket costs than Original Medicare. With MA, members will need to pay their Part B insurance premium plus a monthly premium. Nationally, the average monthly premium for MA is $16[1]. However, many plans offer options for low or zero-dollar monthly premiums and reduced Part B costs. Ninety-nine percent of eligible enrollees have access to a no premium plan[2], with 74% of those people enrolling in no premium plans[1]. With Medicare Advantage, there also is no need to pay for any type of gap in coverage through Medigap, further lowering the cost.

Just like group health insurance, there are multiple types of plans available as a group, including Health Maintenance Organizations (HMOs), Preferred Provider Organizations (PPOs), and Private Fee-For-Service (PFFS). Sixty-one percent of MA members enroll in an HMO, with 38% choosing PPOs and 1% PFFs[3].

Medicare Advantage plans may be a valuable alternative to original Medicare, both for the organization and the member. MA helps streamline the administration process and provides additional coverage that may make it easier for members to continue getting the care they need. It may be beneficial to explore options to determine if a Medicare Advantage plan is right for your organization. ◆

Merrilee Logue *is Executive Director of the National Labor Office at the Blue Cross Blue Shield Association (BCBSA), a national federation of 34 independent, community-based and locally operated Blue Cross and Blue Shield companies. Merrilee leads the National Labor Office which is the liaison for unions to ensure that Blue Cross and Blue Shield products meet the labor community's bargaining objectives. In addition, she oversees the NLO Board of Directors which represents 90% of the union members covered by Blue Cross and Blue Shield. Merrilee has spent over 30 years in healthcare concentrating on innovation and strategy to improve the member experience. She earned a bachelor's degree in Secondary Education and a Master's degree in Education Administration from Villanova University.*

Endnotes:

[1] Centers for Medicare and Medicaid Services (CMS) Landscape File, 2023
[2] Centers for Medicare and Medicaid Services (CMS) Enrollment by Plan, 2023
[3] Centers for Medicare and Medicaid Services (CMS) MA Penetration File, 2023

Pension Industry Careers: Job Listings, Hiring, and Retirement Announcements

Brought to you by NCPERS

Three Reasons Why the Fixed Income Environment May Be Better Than You Think

By: Martin Horne, Barings

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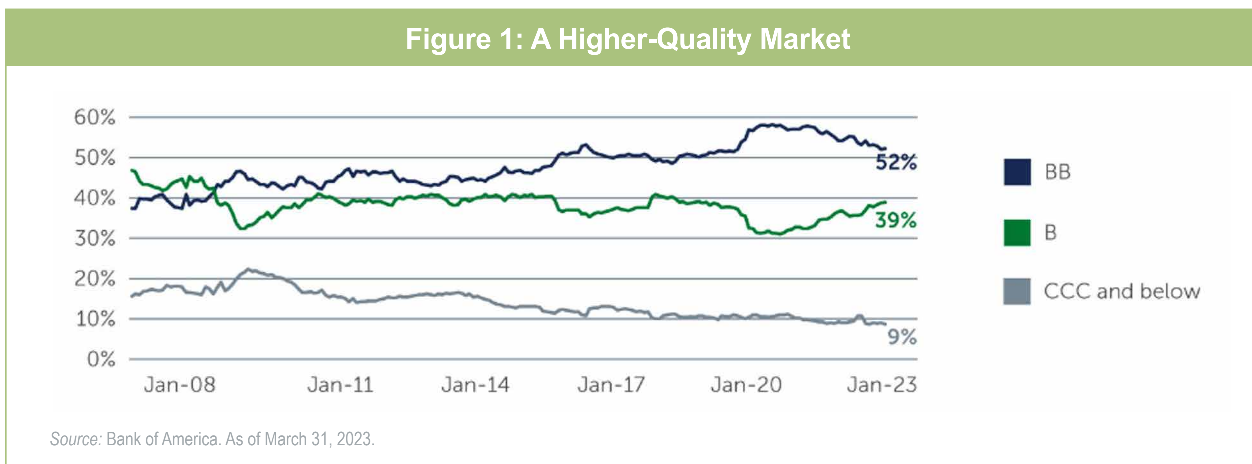
For fixed income investors worried about wider credit spreads and an imminent wave of defaults, assessing the overall level of risk-reward on offer may help allay concerns. Despite the prevailing negativity, fixed income currently offers a range of compelling opportunities. Here are three reasons why:

1. The Long-Anticipated Downturn

While certain countries such as Germany have technically already entered a recession, other major economies such as the U.S. may not follow until later in 2023 or early 2024—arguably making it one of the most widely anticipated downturns in recent history. That has given companies considerable time to prepare. Corporate management has been managing costs closely and keeping inventory levels low. Many companies have also reduced leverage levels and proactively increased the maturity profile of their debt. As a result, any earnings decline that occurs as growth slows is likely to be orderly, while default rates could be lower than in previous downturns. Indeed, high yield issuers are in a stronger financial position to ride out challenges than they were pre-pandemic. The credit quality of the global high yield bond market has also improved considerably since the global financial crisis.

Figure 1: A Higher-Quality Market



Source: Bank of America. As of March 31, 2023.

2. Dislocations Create Opportunities

While recent banking problems are more a result of declining market values for high-quality bank assets than of lax lending standards, banks are now more cautious. But fears among public fixed income investors that tighter and more expensive bank credit could trigger liquidity problems for borrowers in public markets may be overblown. Perhaps counterintuitively, bank tightening could benefit investors in credit markets—both public and private. Opportunities to finance healthy companies that would otherwise have tapped banks are likely to increase and with supply/demand dynamics moving in favor of lenders, investors can expect to earn not only attractive yields but do so with added structural protections. In essence, providing capital when capital is scarce can be an attractive source of returns for investors willing to take smart credit risk—even into a downturn.

While recent banking problems are more a result of declining market values for high-quality bank assets than of lax lending standards, banks are now more cautious.

3. Yields Offer a Considerable "Margin of Safety"

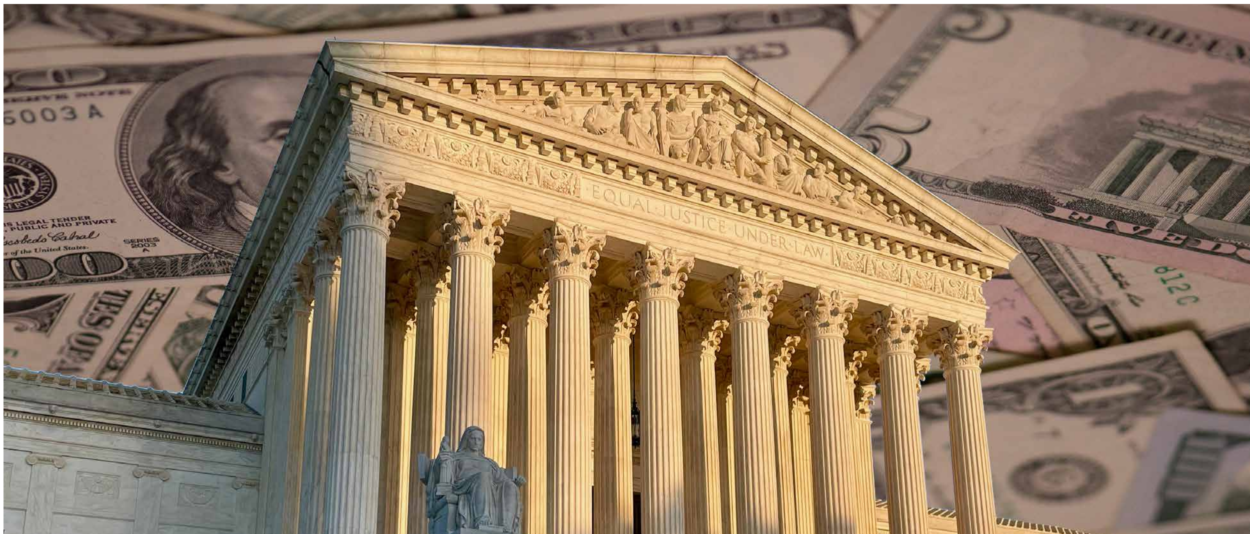
With current prices reflecting much of the uncertainty and volatility, yields across most fixed income assets are at levels not seen since the global financial crisis (aside from the depths of the pandemic). This offers the potential for higher and more dependable absolute returns than many other asset classes.

At Barings, we advocate for patient investing and diversification in helping our clients solve for challenges ranging from income generation to liability matching. Fortunately, there are more choices today than ever before to help achieve this—from corporate and sovereign bonds (both high yield and investment grade) across developed and emerging markets, to floating-rate loans, collateralized loan obligations and various flavors of asset-backed securities. In our view, for investors who keep a level head, environments like today's can offer some of the best long-term opportunities for total returns. ◆

Martin Horne *is Barings' Global Head of Public Assets, which incorporates the global high yield, investment grade, structured credit, equities, emerging markets corporate debt and global sovereign investment teams. Martin is also Chairman of the European High Yield Investment Committee and Chairman of the Global High Yield Allocation Committee. He is also an Executive Sponsor of the Barings Black Talent Network employee resource group, as well as the Charter for Black Talent in Finance and the Professions in the U.K. Martin has worked in the industry since 1993 and his experience has encompassed the mid cap, structured credit, investment grade and leveraged finance markets. His roles at Barings also incorporated roles as senior portfolio manager in cornerstone strategies, and head of research for the European High Yield Group. Martin previously served on the board of directors of the Loan Market Association and holds a B.A. in Economics from Reading University.*

Direct Listing Dilemma for Pension Funds: Understanding the Impact of *Slack Technologies v. Pirani* on Liability under Section 11

By: Robert C. Finkel, Wolf Popper LLP



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On June 1, 2023, the United States Supreme Court issued a unanimous decision in *Slack Technologies v. Pirani.*[1] Slack held that Section 11 of the Securities Act of 1933 requires all plaintiffs asserting a claim under the statute to plead and prove the shares they purchased through a direct listing are traceable to an allegedly defective registration statement.[2] However, in a direct listing, unregistered shares are sold into the market, and even if accompanying registered shares are sold at the same time, it is challenging to trace whether the shares purchased by a particular plaintiff are subject to the registration statement, unless those shares were purchased directly from an underwriter.

In 2019, Slack went public on the New York Stock Exchange through a hybrid direct offering, rather than a traditional IPO.[3] 118 million of the total shares offered by Slack were registered pursuant to a Registration Statement and 165 million shares were unregistered.[4] The Plaintiff Fiyyaz Pirani purchased shares on the NYSE the day the company went public.[5] After the price dropped, he filed a class action lawsuit under Sections 11 and 12 of the 1933 Securities Act alleging that the registration statement filed was "materially misleading."[6]

The Supreme Court vacated the Ninth Circuit's decision denying the Defendant's motion to dismiss and remanded the case for the court to decide whether the pleadings satisfy Section 11 in light of the Supreme Court's construction of the statute.[7] The Court's analysis focused on the ambiguous language in Section 11(a) which "authorizes an individual to sue for a material misstatement or omission in the registration statement when [they] acquire[] 'such security.'"[8] The issue for the Court was to decipher the meaning of "such security" and whether Congress intended liability under the statute to extend to unregistered shares acquired in a direct listing.[9] Through various "contextual clues," the Court concluded that "such security" refers to a "security registered under the particular registration statement that allegedly contains a falsehood or misleading omission."[10]

As a result of the *Slack* decision, it will be difficult for plaintiffs to prove a Section 11 claim for shares purchased on the open market as a consequence of a direct listing. In the future, companies may prefer direct listings over IPOs due to the advantage of avoiding strict liability under Section 11. Correspondingly, pension funds in direct offerings should understand that they may not be able to hold the issuers of the IPO shares to the same standard of liability as in a traditional offering. However, direct listing claims for misleading registration statements can still be brought under Section 10(b), though proof of scienter and loss causation must be shown and plaintiffs must meet a higher pleading standard of pleading fraud with specificity. In a footnote, the Court discussed Section 12 of the 1933 Act, which allows an individual to sue for a security acquired based on false or misleading statements communicated by the company orally or in a prospectus.[11] The Court chose not to rule on the proper interpretation of Section 12(a), but recommended the Ninth Circuit vacate its judgment and reconsider its holding sustaining the complaint under Section 12(a) based on the Supreme Court's Section 11 holding.[12] ◆

As a result of the Slack *decision, it will be difficult for plaintiffs to prove a Section 11 claim for shares purchased on the open market as a consequence of a direct listing.*

Robert C. Finkel *is a senior partner and member of the executive committee at Wolf Popper LLP. Robert is a graduate of the Columbia Law School, Class of 1981 (where he was a Harlan Fiske Stone Scholar), and the University of Pennsylvania, Class of 1978, where he obtained a B.S. in accounting from the Wharton School of Business and a B.A. in history from the College of Arts and Sciences. Robert began his employment in the 1980s with two large New York City defense firms. Robert became a partner at Wolf Popper LLP effective January 1, 1992. He has been repeatedly designated a Super Lawyer in Securities Litigation.*

Robert has written for The New York Law Journal on subjects including shareholder voting rights and ERISA class actions. He can be reached at rfinkel@wolfpopper.com or (212) 451-9620.

Endnotes:

1 *Slack Techs., LLC v. Pirani*, No. 22-200, 2023 U.S. LEXIS 2301 (U.S. June 1, 2023).
2 *Id.* at 18.
3 *Id.* at 1.
4 *Id.*
5 *Id.* at 2.
6 *Id.*
7 *Id.* at 18.
8 *Id.* at 12.
9 *Id.*
10 *Id.* at 4.
11 *Id.* at 18-19.
12 *Id.*

Today's Public Pensions Cannot Be Considered Government Agencies

By: Brad Kelly & Peter Landers, Global Governance Advisors LLC

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Passive oversight and management of pension systems is clearly not working. Today, pension systems need to navigate the complex and dynamic nature of financial markets, while maintaining fiduciary responsibility to pension plan beneficiaries. To do this and address existing funding gaps, pensions need to focus on modernizing their investment strategies and capabilities; benchmark against their peers; enhance their accountability and transparency; and maintain a strategic focus on maximizing investment returns for their members while continuing to provide timely and accurate pension benefits to members.

Historically, public pensions were extensions of government entities. Hiring people with similar project management and program oversight skills, under similar human resources policies, and compensating them within similar pay ranges worked well until the 1990s. By the mid 90s and 2000s, governments started to take notice and the public grew concerned about growing unfunded pension liabilities. Pension systems that are well funded today realized years ago that to ensure their long-term sustainability, they needed to operate more like competitive asset management organizations to optimize their investment strategies, enhance investment returns and better manage operating costs.

Public pensions have an inherent responsibility to deliver stable and secure returns. By attracting and retaining investment talent and adopting a competitive asset management mindset, pensions become equipped and able to actively seek out investment opportunities that generate optimal returns. The asset management community is highly competitive and the ability to recruit and retain skilled professionals is crucial for success. By positioning themselves more as asset managers, public pensions must put in place more competitive compensation packages, implement performance-based incentives, and establish a culture of innovation and excellence. It is important to realize that this does not mean pension systems need to pay Wall Street pay levels. Pensions can leverage the mission of the organization, the sole focus on deal making (not fundraising) and other benefits of working at a pension system to help attract the professional talent they need. However, it does mean some of the pay gap does need to be narrowed and that unadjusted public sector wages will not help pension systems meet this goal. With the right talent in place, pensions can leverage the knowledge and experience of high-performing investment professionals, improve their decision-making, and deliver superior investment performance.

Furthermore, adopting a competitive mindset allows pensions to pursue diverse investment opportunities that are not readily available to traditional public agencies. Asset management organizations operate in a global and interconnected financial landscape where new investment instruments, markets, and strategies constantly emerge. Considering themselves as competitive asset management organizations allows public pensions to benchmark their activities against peers, foster healthy competition, as well as modernize investment strategies, risk management practices, and operational efficiencies. This helps improve ongoing performance and can mitigate the impact of market downturns, thus protect long-term financial health.

Viewing public pensions as competitive asset management organizations increases their focus on transparency and accountability. By subjecting themselves to industry best practices, regular reporting and rigorous oversight, pension funds build higher levels of trust and credibility with their stakeholders, including members, taxpayers, and plan sponsors.

By adopting a competitive asset management organization approach, pension systems will be able to better navigate the complexities of financial markets, deliver superior investment performance, and fulfill their fiduciary duty to plan beneficiaries. The competitive asset management model enables public pensions to position themselves at the forefront of industry best practices, leveraging innovation and technology to generate sustainable returns and secure the financial future for generations of retirees to come. ◆

Brad Kelly and Peter Landers *are Partners at Global Governance Advisors (GGA) and the principal NCPERS Accredited Fiduciary (NAF) program developers and lecturers. They specialize in the strategic evaluation of corporate governance and compensation programs including board effectiveness evaluations, charter and policy development, board education, compensation philosophy executive pay alignment, performance management and incentive design. Global Governance Advisors (GGA) is a human capital consulting firm providing governance and human capital advisory services to boards of directors and senior management. The value we offer our clients stems from our unique combination of independence, experience, rigor, and integrity. This means clients receive advice that is strategic, objective and conflict-free. We bring a strategic, innovative, and practical approach to maximizing board and executive performance.*

NCPERS Accredited Fiduciary (NAF) Program

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How do Public Pension Plans Measure up to Social Security on Inflation Protection?

By: Daniel J. Siblik, ASA, MAAA, FCA, EA, Segal

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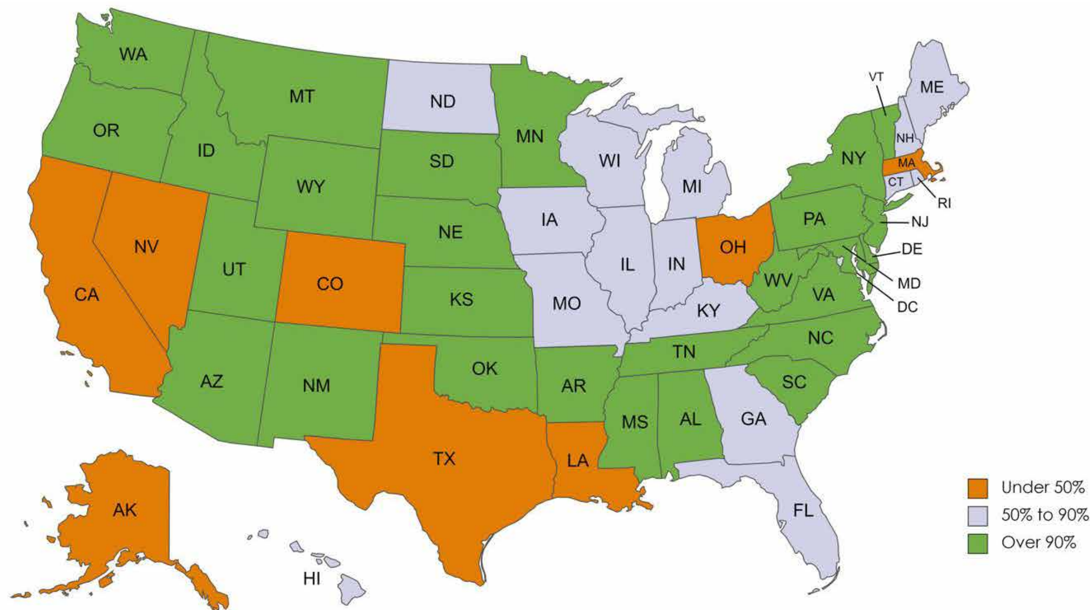
Despite concerns about how well Social Security is funded, the program has provided full annual cost-of-living adjustments (COLAs) to benefits based on the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W), a measure of inflation, since 1975. This is basically a “one-for-one” adjustment. For example, the CPI-W showed an 8.7% inflationary increase for 2022 and Social Security benefits increased 8.7%. In years with negative CPI-W values, the COLA is 0.0%.

These COLAs are good news for private sector employees, 94% of whom are covered to some degree by Social Security. A smaller percentage of the 23 million public sector employees are covered by Social Security: 72%.[1] Even that percentage is not uniform across states.

While public employees' participation in Social Security is over 90% in more than half of states, in some large states the participation rate is much lower. For example, Texas and California are only at 46% and 45%, respectively.[2] Of the 6.5 million public employees who are not covered by Social Security, 2.4 million reside in those two states.

> *Participation in Social Security varies not only by state but also by industry.*

Social Security Participation Rate of Public Employees, by State



Source: Segal Map created using CRS Report: Social Security Coverage of State and Local Government Employees, November 2021

Participation in Social Security varies not only by state but also by industry. At least 12 states exclude teachers from Social Security participation.[3] Public safety employees also often do not participate in Social Security.

Inflation's Impact on Benefits

Many public pension plans have COLAs, but they typically offer lower annual increases than Social Security. Other public plans offer no scheduled COLAs. Consequently, even short periods of high inflation can negatively affect public plan retirees' ways of life. The impact is more acute when there are sustained increases in inflation.

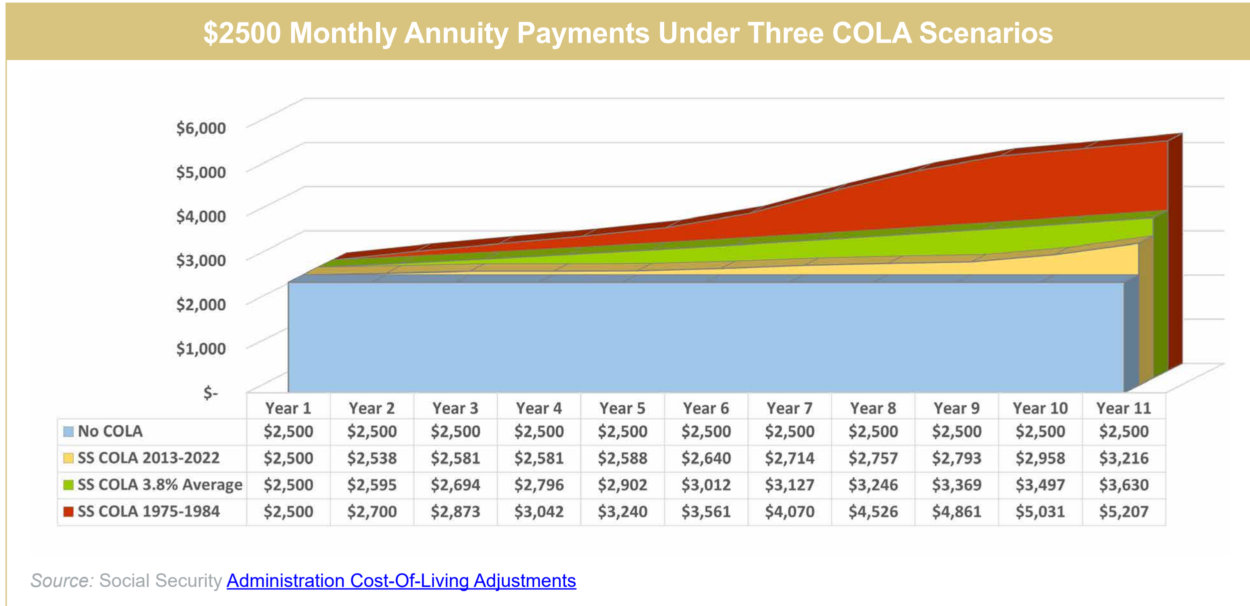
Social Security COLAs and Cumulative Increase for Two 10-Year Periods

Most Recent 10-Year Period				High-Inflationary Period from 1975–1984		
	Social Security COLA	Cumulative Increase			Social Security COLA	Cumulative Increase
2022	8.7%	128.6%		1984	3.5%	208.3%
2021	5.9%	118.3%		1983	3.5%	201.2%
2020	1.3%	111.7%		1982	7.4%	194.4%
2019	1.6%	110.3%		1981	11.2%	181.0%
2018	2.8%	108.6%		1980	14.3%	162.8%
2017	2.0%	105.6%		1979	9.9%	142.4%
2016	0.3%	103.5%		1978	6.5%	129.6%
2015	0.0%	103.2%		1977	5.9%	121.7%
2014	1.7%	103.2%		1976	6.4%	114.9%
2013	1.5%	101.5%		1975	8.0%	108.0%

Source: Social Security Administration Cost-Of-Living Adjustments

The average Social Security COLA increase from 2013 through 2022 was 2.6%. The average annual increase over all Social Security COLA years (1975–2022) was 3.8%. The first 10 years of COLAs averaged 7.7% (1975–1984). So, as with many things, timing is critical. The following graph illustrates this timing dependence for a starting monthly payment of $2500.

$2500 Monthly Annuity Payments Under Three COLA Scenarios

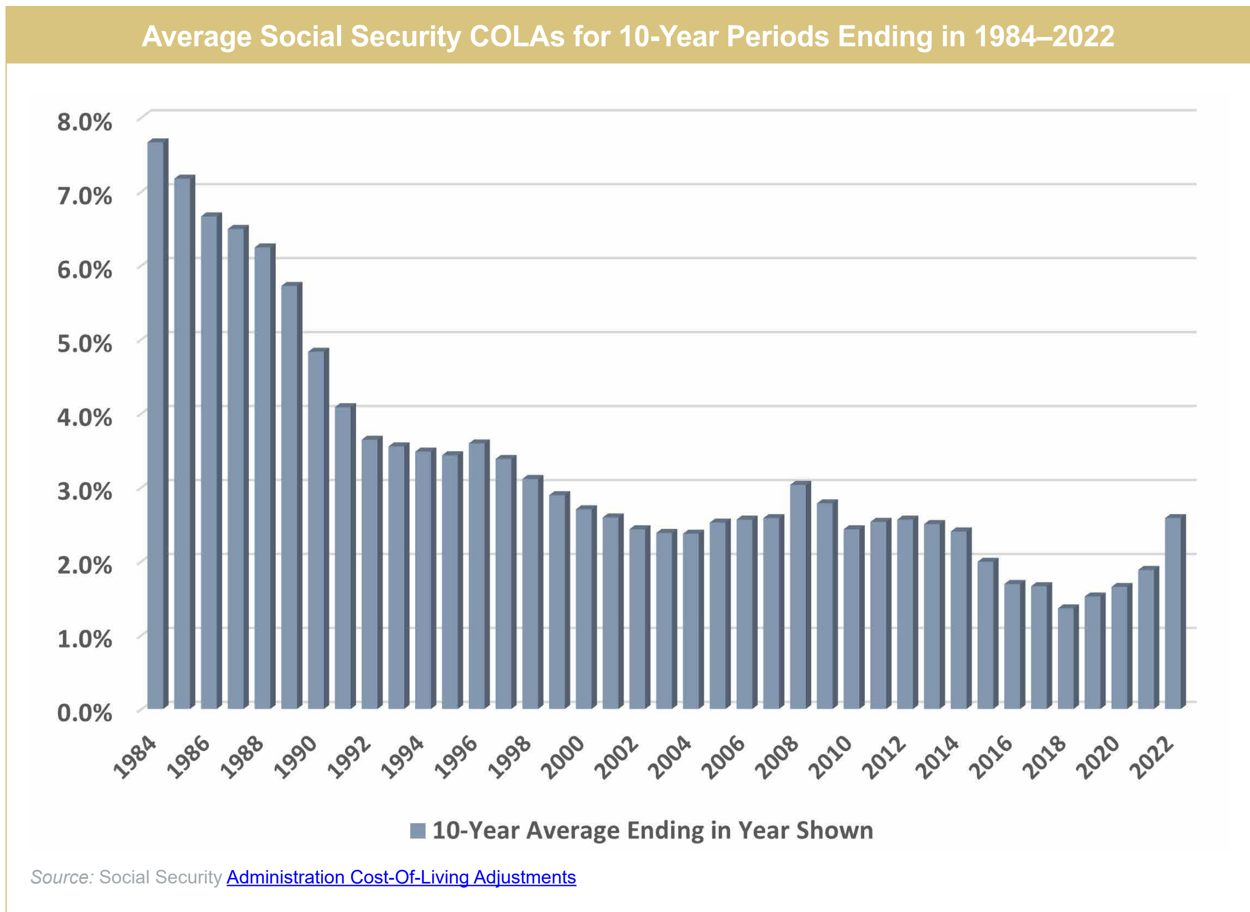


	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
No COLA	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500	$2,500
SS COLA 2013-2022	$2,500	$2,538	$2,581	$2,581	$2,588	$2,640	$2,714	$2,757	$2,793	$2,958	$3,216
SS COLA 3.8% Average	$2,500	$2,595	$2,694	$2,796	$2,902	$3,012	$3,127	$3,246	$3,369	$3,497	$3,630
SS COLA 1975-1984	$2,500	$2,700	$2,873	$3,042	$3,240	$3,561	$4,070	$4,526	$4,861	$5,031	$5,207

Source: Social Security Administration Cost-Of-Living Adjustments

We are emerging from one of the lowest inflationary periods in recent history during which Social Security COLA increases averaged under 2.0% for multiple 10-year periods. That is now trending upward.

Average Social Security COLAs for 10-Year Periods Ending in 1984–2022



Source: Social Security Administration Cost-Of-Living Adjustments

Conclusion: How Do Public Plans Fare Against Inflation?

On average, public retirement plans whose members are ineligible for Social Security offer higher COLAs (2.5%) than plans that allow members to participate in Social Security (1.8%).[4] In both cases, these averages only sustain purchasing power for members in low inflationary environments. Yet, as already noted, some funds offer no scheduled COLAs. As inflation increases, members not participating in Social Security who receive a typical COLA or no COLA will lose net purchasing power and likely fall behind public sector employees who participate in Social Security. These plans may find retirees struggling to keep up with rising costs, especially during years of high inflation like we've seen recently. COLA concerns may vary state to state as well as across different industries.

Your actuarial consultant can help you learn more about your plan's COLA situation, including potential gaps and possible mitigations relative to inflation. ◆

Endnotes:

1 CRS Report: Social Security Coverage of State and Local Government Employees, November 2021

2 Ibid

3 Social Security Intelligence, "Teacher's Retirement and Social Security" by Devin Carroll https://www.socialsecurityintelligence.com/teachers-retire-ment-and-social-security/ (accessed June 25, 2023.)

4 NCPERS 2023 Public Retirement Systems Study: Trends in Fiscal, Operational, and Business Practices

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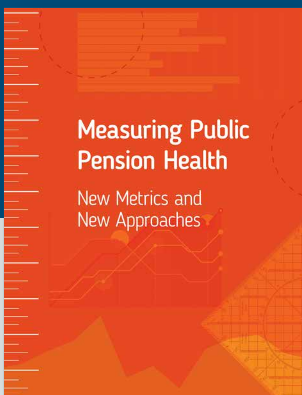

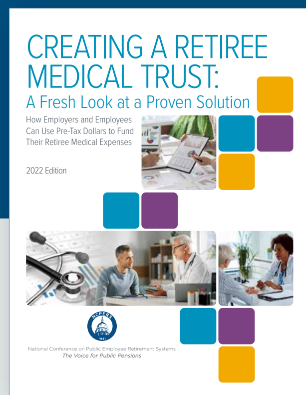

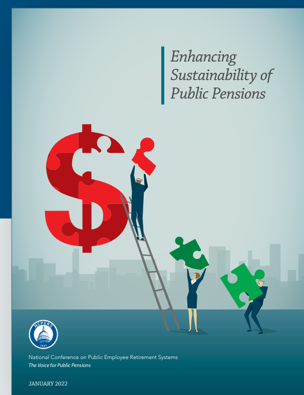

Find new metrics and approaches for measuring public pension health, research on how employers and employees can use pre-tax dollars to fund retiree medical expenses, and more.

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Embracing LDROM

By: Andy Hunt, CFA, FIA & Jonathan Hobbs, CFA, FSA, Allspring Global Investments

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The latest revision to Actuarial Standard of Practice (ASOP) No. 4 is upon us, and we believe it will have implications for how public pension plans think about and invest their fixed income portfolios.

Why it matters

ASOP 4, "Measuring Pension Obligations and Determining Pension Plan Costs or Contributions," has just been updated. The headline is that all pension plans' actuarial reports are now required to disclose an additional liability value known as the Low-Default-Risk Obligation Measure, or **LDROM**.

State and local pension plans have used—*and will continue to use*—the so-called accrued actuarial liability value. This liability value discounts projected benefit payments based on the expected return of the asset portfolio. However, public plans will now also disclose the market value of the liability (LDROM) using a discount rate tied to high-quality bond yields. This LDROM liability value will introduce mark-to-market volatility as the LDROM will go up and down as bond yields change (and vice versa).

What it could mean to investment portfolios

For municipal bond investors, it's too early to tell how this might affect the perceived risk/return of a given investment. Pension deficits and funding can have a large impact on the creditworthiness of state and local bond issuers, and investment analysts keep a keen eye on pension obligations. Since the LDROM is not a change to accounting and funding rules—it's merely an additional disclosure—we expect no immediate effects on the municipal bond market. However, as ratings agencies and investors digest LDROM disclosures, they may begin to prefer those pension plans with investments that better track the liability.

For public plans, this presents an opportunity to tweak their bond portfolio. Broad-based portfolios will likely give way to more tailored bond portfolios that help meet specific outcomes.

For example, public plans have very long investment horizons because their plans are typically open to new members. They use this to their advantage by investing in assets with higher expected returns, which are typically more volatile (such as public equities) or less liquid (such as private markets). At the same time, the pension plan still has short-term obligations in the form of benefit payments to members and capital calls from their private market asset managers. A bond portfolio could be devised to meet both short- and long-term needs:

A) A portion could be allocated to ensure short-term liquidity needs are met, thereby allowing riskier assets time to ride out downturns and harvest risk premia.

B) The remaining fixed income allocation could be allocated to longer-dated bonds. This has three benefits:

- Longer bonds have higher yields than shorter bonds when the yield curve is upward sloping. This could be an added source of return.
- Longer bonds are a better match to the LDROM, thus helping the portfolio move a bit more like the LDROM valuation over time.
- Longer bonds offer greater duration. In times of economic downturns, risky assets like equities and credit tend to fall while rate-sensitive assets tend to rally. More duration provides more macroeconomic diversification.

Putting these two ideas together, the bond portfolio could be reconfigured to a barbell strategy of short-term and long-term bonds. The message for pension plan sponsors? Don't call it LDI. Call it better bonds. ◆

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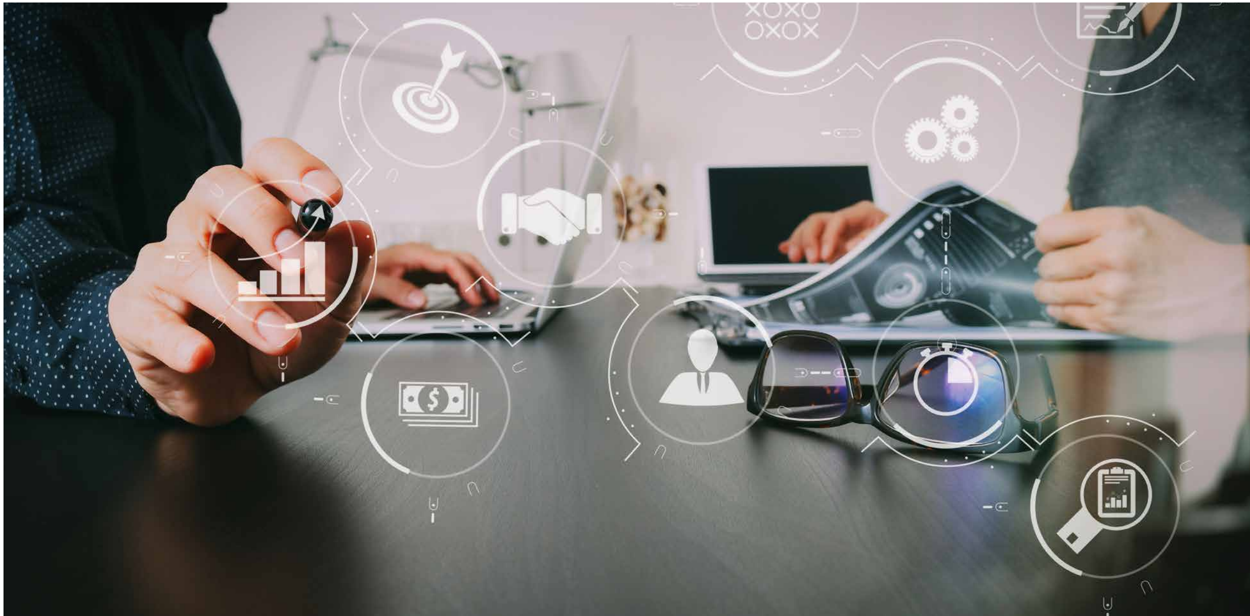
Jonathan Hobbs *is the head of U.S. solutions for the Systematic Edge Investment Solutions team at Allspring Global Investments. In this capacity, he designs and implements outcome-oriented investment portfolios. Prior to this, he served as head of client solutions, San Francisco, and co-head of LDI North America for BlackRock. He began his investment industry career in 2003. Jonathan earned a bachelor's degree in actuarial science/ finance from Drake University.*

Modernized Pension Administration: Five Critical Automation Advantages for Public Sector Entities

By: Todd Flessner, CBIZ



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Traditional pension plans remain the norm in the public sector industry. Today, there are more than 5,000 public sector pension plans in the U.S.

While the administration of these plans has evolved through the years, many public sector entities aren't fully optimizing the advantages of automation, with some still relying on manual processes and spreadsheets. When evaluating the capabilities of a modernized Pension Administration System (PAS), here are five critical automatic advantages to consider.

1. Increased Accuracy and Efficiency

The automation of administrative tasks and processes can significantly improve accuracy and efficiency. Modern PAS platforms bring all the plan's data together in a centralized pension database. Along with the benefits of the initial data clean-up, a PAS can also provide user-friendly tools that streamline ongoing data imports.

PAS platforms automate pension calculations based on each plan's unique and often complex rules. Automation of calculations increases accuracy and reduces administrative time dedicated to calculations and verifications. Through automated administrative processes, the system is able to initiate, calculate and process monthly pension payments, and then automatically complete payment reconciliation between the PAS and the payments made.

To optimize current PAS capabilities, your system should also provide user-friendly case management/workflow that helps to streamline:

- Day-to-day management and tracking of participant requests and transactions
- Electronic storage of correspondence and historical documents
- Customizable workflows that trigger based on data updates, status changes or upcoming milestones

2. Reduction of Risk

The enhancements in accuracy and efficiency reduce the inherent risks associated with pension plan administration. Having an automated process helps to ensure plan provisions are consistently applied, data updates are timely and calculations are correct. This reduces the opportunity for data inconsistencies and overpayments. Today's PAS platforms provide the ability to produce on-demand calculations using real-time participant data and the flexibility to make adjustments as plan rules change.

The streamlined processing also creates increased transparency through detailed data audit trails, showing when changes were made, who made them and the resulting new values. The increased transparency ensures issues can be quickly identified, addressed and minimized. The detailed information also assists with internal and external audits.

3. Enhanced Data Security

Pension administration involves extensive private information that must be protected. Your PAS should provide end-to-end data security that's compliant with the Department of Labor's cybersecurity guidance. System security should enable different user access levels based on roles. Data access and actions can be defined for each level, helping to protect sensitive data. All access to the system by administrators or participants should always require multi-factor authentication at login.

When evaluating PAS platforms and plan providers, do a deep dive into their cybersecurity practices, procedures and track record. Ensure that contracts include ongoing compliance plans to keep pace with changes in security standards and detailed action plans in the event a data breach occurs.

4. Comprehensive Reporting

Modern PAS platforms do more than centralize pension data and administration. Today's systems include powerful, robust reporting tools through simple, intuitive reporting dashboards and report generation interfaces. Users can quickly and easily produce standard reports, create customized reports based on plan needs or perform ad-hoc queries. The single source of plan data ensures accurate, real-time reporting and enables reports to be generated automatically for ongoing monitoring.

PAS automation also streamlines the annual data extract required by plan actuaries to calculate pension liability. Built-in validations and verifications save time for both actuaries and plan administrators by minimizing questions and separate data requests.

5. Convenient User Access

Modern PAS platforms also provide valuable participant-facing capabilities that make information easily accessible and user-friendly. Today, participants expect secure, online portal access to instantly access information about their pension. Pension portal experiences include access to plan information and pre-filled forms, real-time calculation of current or future payments, and secure self-service options. These robust capabilities enable participants to complete tasks like making online retirement elections, updating beneficiary information or maintaining tax/banking information.

Fully automated systems also enhance participant experiences by giving plan administrators the ability to automatically trigger personalized communications to members as the system recognizes defined changes in employment status or upcoming age milestones. ◆

Todd Flessner, CBIZ *is a vice president of pension administration with the Retirement & Investment Solutions practice of CBIZ, Inc. He provides management and support for pension administration and is responsible for the implementation of new client accounts, complex pension calculations, special projects and new business development. Since 1994, Todd has experience managing teams that provide pension and benefits administration services for clients of all sizes.*

2023: The Year of the Pension Hedging Revolution

By: Shauna Hewitt, LGIM America

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With ever-present uncertainty around interest rates, inflation, recession, geopolitics and more, we believe 2023 will see many plan sponsors move to preserve their funded status gains and narrow the range of future outcomes through hedging strategies.

Capitalizing on the inverted yield curve opportunity

Many pension plans have used long-dated STRIPS as a "blunt tool" to add interest rate duration to hedge the liabilities. We say it is blunt because STRIPS do not hedge as well when the yield curve steepens. Fortunately, for those who held STRIPS, the yield curve flattened substantially, and even inverted in 2022 — meaning the strategy has done quite well. And historically speaking, the yield curve tends to steepen dramatically after a Fed rate hiking cycle. In other words, now may be an opportune time for plan sponsors holding STRIPS to move to an LDI completion framework and hedge against a potential steepening yield curve scenario.

Monetizing your glidepath

Implementing glidepath frameworks have been popular investment strategies for over a decade, and we have seen many plans de-risk over the past year due to hitting specified funded ratios and/or interest rate levels. For plans that have not yet reached the end state of their glidepath, we may recommend looking into monetizing the future glidepath triggers by selling payer swaptions.

In this case, the plan would sell payer swaptions, which are options on interest rates, which the buyer could exercise if interest rates rise to a specified level. If rates fall, or stay below the strike price through expiry, the plan keeps the premium paid by the buyer at inception. If rates rise above the strike at expiry, the option will be exercised and the plan enters into a receive fixed/pay floating swap — an action that effectively buys duration, increasing the interest rate hedge, which is in line with the plan's glidepath. This strategy is designed to allow the plan to receive an upfront premium while committing to a decision that was already established via their glidepath. Of course, it's not guaranteed that the plan's funded status will be better when rates rise, as credit spreads and return-seeking asset performance may offset the gains due to rising rates. It is critical that the plan sponsor explore the strategy in greater detail prior to implementing.

While we believe this strategy makes sense for those on a glidepath in most market environments, periods with higher interest rate volatility may result in a higher premium for selling swaptions (and consequently may also mean there is a higher chance of the swaption being exercised).

One of the main themes of 2023 is the debate over the timing and severity of the upcoming recession that most market participants seem to be forecasting.

Reducing equity risk

One of the main themes of 2023 is the debate over the timing and severity of the upcoming recession that most market participants seem to be forecasting. Historically, one popular way to protect against equity downside without paying an upfront premium has been to implement a put-spread collar. This allows the plan sponsor to protect against downside equity returns up to a point, while capping the upside. In 2023, plans may want to consider a standard collar structure, one that provides unbounded downside protection. In the past, market pricing of standard collars limited upside substantially, but due to increases in interest rates and flattening implied volatility skew, this is not currently the case. Today, it may be possible to have a symmetrical collar, providing protection below a specified percentage and allowing gains up to that same specified percentage for the next 12 months, while potentially collecting a small premium. Employing this strategy can narrow potential equity return outcomes for pension plans even as uncertain economic conditions loom. ◆

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Shauna Hewitt *is a Senior Investment Director at LGIM America. In her role, she focuses on Consultant Relations and Institutional Sales efforts in the Midwest Region. She covers Corporate Defined Benefit and Defined Contribution clients, Public Plans, Taft-Hartley as well as Endowments and Foundations.*

She has over 25 years of investment industry experience. Prior to joining LGIM America in 2018, she served as Managing Director at Pavilion Global Markets. Shauna founded Lambright Financial Solutions which was later acquired by Knight Capital Americas. She has also held senior roles at Loop, BNY Brokerage and CRA RogersCasey. Shauna began her career with Donaldson, Lufkin & Jenrette.

Shauna serves on various committees of community outreach services in Chicago in addition to being a former board member of Women Investment Professionals (WIP), current WIP Professional Development committee member and member of National Association of Securities Professionals. She is also the past chair of LGIM America's Women's Collective.

Navigating Inherent Risk: A Guide to Cyber Risk Management for Pension Funds

By: Peter Dewar & Joe Potischman, Linea Solutions

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Pension funds are fundamentally exposed to risk because of their business processes. This unavoidable exposure – or "inherent risk" – applies to all funds regardless of size. Understanding the nuances of how your fund operates is crucial to recognizing the cyber risks related to your services offered.

For instance, financial transactions and the handling of personally identifiable information constitute significant aspects of many organizations, and both bring with them inherent risks. If we examine a pension fund for example that provides services to active contributors and retired individuals, a broad spectrum of risk is dispersed across the entity.

Pension funds are usually recommended or required to conduct an annual actuarial assessment. This exercise involves meticulous scrutiny of various components like contributions, membership composition, and investment returns to determine funding levels. As pension funds supply this information to the actuary, they also inherit the third-party risk based on the actuary's risk mitigation capabilities.

Similarly, pension funds that deal with investment managers are exposed to third-party cyber risk. If these investment managers lack strong cyber controls, assets could inadvertently end up in the hands of threat actors (as we have written about in detail here). Likewise, providing member self-services, such as allowing members and annuitants to access information electronically, apply for loans, or update beneficiaries, could also expose organizations to cyber threats. .

> *Pension funds are usually recommended or required to conduct an annual actuarial assessment.*

So, how can pension funds effectively manage this risk?

Watching the news and worrying or reacting to the latest security breach is not a preventative risk management strategy. Instead, developing a comprehensive risk management and mitigation approach is a more proactive solution. This process begins with a detailed risk assessment to determine the current likelihood of threats based on an organization's policies and operational activities

Next, pension funds should evaluate potential mitigation strategies. These could include implementing risk management controls that are aligned with recognized risk management standards, transferring risk to other organizations either through insurance or another means, or avoiding certain risks altogether. For example, opting not to offer a service such as refunds through a member self-service portal that exposes the organization to risk, unless a mitigation strategy is in place such as strong identity management capabilities.

After risk assessment and mitigation, the following critical step is continuous risk management. This ongoing process involves regularly reviewing and updating risk management strategies and practices, reflecting evolving threats and organizational changes.

Understanding your fund's inherent risk and cyber threats associated with its operations is vital. However, merely understanding isn't enough. Implementing a holistic risk management approach, which includes risk assessment, risk mitigation, and continuous cybersecurity governance, is essential to navigating the terrain of inherent risk. Remember, the goal is not to eliminate all risk – an impossible task – but to manage it effectively, maintaining a balance between security and operational effectiveness. ◆

Peter Dewar *has over 25 years of experience in cybersecurity and leads the cybersecurity practice for the Linea group of companies that provide services across the United States and Canada. Under his leadership Linea has developed a Pension Cyber Security Framework (PCSF) to complement the generalized standards for protecting information systems. The PCSF focuses on the business process employed, services provided, and technology utilized by pension and benefits organizations, and devises controls to minimize and mitigate the inherent cybersecurity risk experienced by the industry.*

Peter has a Master's degree in Information Systems from the George Washington University, a Bachelor's degree in Information Systems from the University of the District of Columbia, is a Certified Information Systems Security Professional (CISSP), Certified Data Privacy Security Engineer (CDPSE), and has received certificates of achievements from the Harvard Kennedy School of Government, Gartner CIO Academy, and International Foundation of Employee Benefit Plans.

Joe Potischman *is the marketing specialist for Linea Secure with over 5 years of experience in the professional services industry. With his work, Linea has been able to present at over 15 separate engagements and has been published by multiple pension and benefit associations.*

Joe has a Master's degree in Communication, Culture & Technology from Georgetown University. He has also received a Certificate of Achievement in Public Plan Policy from the International Foundation of Employee Benefit Plans (IFEBP). Prior to working for Linea, he managed, CommLawBlog, an award-winning blog on Communications Law & Policy.

Emerging Markets ex-China? Looking Beyond China for Opportunities within Emerging Markets

By: Navin Hingorani, CFA, Eastspring Investments

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China's increasing dominance within the emerging markets investable universe has numerous implications for strategic asset allocation and for allocators seeking to diversify sources of alpha across return-seeking assets. Despite heightened geopolitical risks and volatility, China plays a critical role within global portfolios and within emerging market (EM) equity allocations. The decision of whether asset owners want to invest in China and how to go about doing so is a complex and subjective topic but deserving of serious consideration.

As a specialist manager in Asia, with a long history of investing and operating in China, Eastspring believes that for many allocators the longer-term financial case for adding exposure to China is quite compelling. While this comes with headline risks given deteriorating relations with the West, the tremendous alpha opportunity is hard to ignore. As China's influence and size within EM indices grows, we believe it may be more efficient to gain exposure through a dedicated China allocation while at the same time, creating a separate and less correlated EM ex-China allocation. While still early days, there've been increased discussions among large public and sovereign wealth funds about making the shift and numerous managers have launched ex-China strategies to meet anticipated demand. In some cases, the decision to exclude China all together is based on opposing views of risks or given ESG concerns, in which case an ex-China allocation is also an effective solution.

China plays a critical role within global portfolios and within emerging market (EM) equity allocations.

While strategic asset allocation decisions have implications for China's domestic markets, they also create "spill-over" effects on peripheral EM countries outside China, which stand to benefit from shifting allocations within an ex-China framework. Coupled with positive foreign direct investments (FDI) into peripheral EM countries resulting from diversification of global supply chains, the "China +1 effect" is creating substantive positive tailwinds for ex-China beneficiaries. With China comprising 30% of the MSCI EM index and continuing to grow, it's arguable that it's still under-represented within global portfolios, justifying larger, discrete allocations. China represented 5% of the MSCI EM Index 20 years ago, and at year end 2022, it stood at 32% and is forecast to hit 44% with 100% inclusion of onshore China A shares. As China's index weighting continues to rise, attractive alpha opportunities in other emerging markets will continue to be crowded out as they have disproportionately smaller index weights. Asset owners cannot afford to miss out on idiosyncratic opportunities across EMs ex-China and shouldn't have their opportunity set limited by the benchmark.

As China's index weighting continues to rise, attractive alpha opportunities in other emerging markets will continue to be crowded out as they have disproportionately smaller index weights.

As historically seen with ACWI ex U.S. and Asia Pacific ex Japan, when a single country dominates a global or regional index, sophisticated investors typically transition to discrete allocations to that dominant market to better optimize active risks and in turn often hire specialized asset managers within that region to generate alpha. This transformation to EM ex-China plus dedicated China is gaining traction and we believe it's the beginning of a sustained, longer-term shift in strategic asset allocations. ◆

Disclosures:

Source: MSCI, RIMES, Morgan Stanley Research as of 28 February 2023

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Navin Hingorani *is a Portfolio Manager within Eastspring Investment's Global Emerging Markets Focus Value Team, based in Singapore. He joined the firm in January 2011. Navin is the lead Portfolio Manager for the Global Emerging Markets ex China Dynamic Strategy as well as Co-Portfolio Manager for the Global Emerging Markets Fundamental Value strategy.*

Prior to joining Eastspring, Navin worked as an Equity Research Analyst at Bear Stearns in London. In 2003, Navin joined RMB Asset Management, focusing on US equities. In 2006, Navin joined the Emerging Markets team at JP Morgan Asset Management in London, focusing on the EMEA region, and was subsequently promoted to Portfolio Manager, responsible for covering strategies focused on the EMEA region. Navin has 23 years of investment experience.

Navin is a CFA charterholder and holds a Bachelor of Science (Hons) from University College London in Economics and a Masters of Science in European Politics & Policy from London School of Economics.

General Partner (GP)–Led Secondaries

By: Steven Hartt, CAIA & Balaj Singh, CFA, CAIA, Meketa Investment Group

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General Partner (GP)-led transactions are initiated by the GP, often to restructure the ownership of one or more assets within their funds while providing a liquidity option to existing Limited Partners (LPs). While the bespoke nature of GP-led transactions has produced a variety of structures, the vast majority involve creating a new vehicle, called a "continuation fund," that purchases one or more companies from the GP's existing fund(s). The continuation fund is managed by the same GP and backed by new investors plus any existing LPs that wish to retain exposure to the asset(s).

Increase in GP–Led Secondary Volume

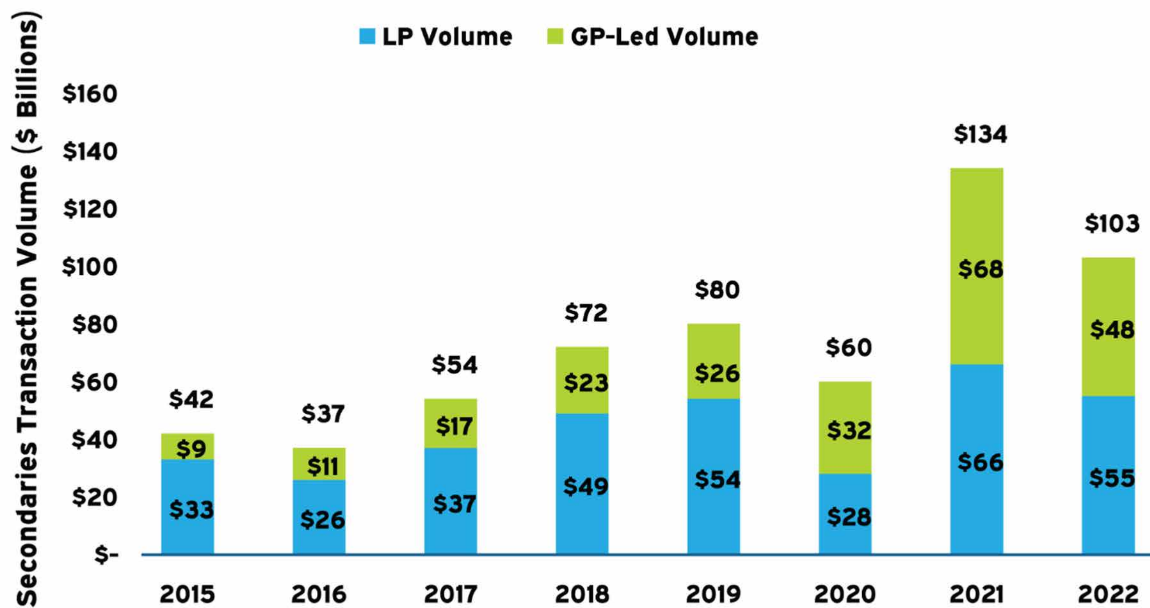
The secondaries market has grown substantially in recent years. Over $132 billion in secondary transactions took place in 2021. The secondary transaction boom has been accompanied by strong growth in GP-led secondary transactions. As shown in Figure 1, over 50% of secondary transactions in 2020 and 2021 were GP-led deals. Further, GP-led secondary transactions grew from $9 billion in 2015 to $68 billion at its peak in 2021.

The secondary transaction boom has been accompanied by strong growth in GP-led secondary transactions.

The mechanics of these transactions

In the GP-led secondary process, the GP decides they would like to continue to maintain ownership of one or more assets in a fund that is nearing the end of its term. The GP causes their fund to enter into an agreement with a continuation fund (also controlled by the GP) to purchase a significant portion of one or more of the assets. As part of this transaction, the GP negotiates with an unaffiliated third party to provide capital to, among other things, offer liquidity to those LPs that wish to exit their investment.

FIGURE 1: Secondary Market Annual Transaction Volume



Source: Evercore, 2022 Secondary Market Synopsis.

In connection with the transaction, the GP typically offers the existing LPs of the fund the option:

a) to sell their interest and receive the pro rata portion of the cash purchase price,
b) to "roll" their pro rata share of the Limited Partnership interests in the fund into the continuation fund established to purchase the asset(s),
c) to increase their participation above their pro rata share of the new interest, or
d) in some cases, to receive a combination of options (A) and (B).

Challenges and considerations

GP-led secondary transactions require significant attention from LPs, but the timing and process is often difficult to predict. This can be disruptive for an LP that is reviewing multiple deals at the same time.

The structure of each GP-led secondary transaction is typically unique, making evaluating the impact of an election to buy, sell, or hold complex. Due diligence for GP-led secondaries can often be labor and resource intensive. These transactions require a distinct skill set to respond in a "real-time," transaction-oriented timeframe to evaluate factors including transaction pricing and valuation, vehicle structure, and economic terms.

Given that the particular asset has likely been "de-risked" (e.g., more diversified revenue base, increased operational efficiency, higher profit margins, lower debt ratio, etc.) under the GP's ownership, the next leg of value development may offer less upside than the first phase. The investor should understand the value creation strategy as well as the scope of the GP's resources to assist the company in its next phase of growth.

The structure of each GP-led secondary transaction is typically unique, making evaluating the impact of an election to buy, sell, or hold complex.

GP-led secondary transactions can also present conflicts of interest, as the transaction can introduce different alignments of interest among the parties, including, for instance, payment of carried interest to the GP. The GP has a duty to act in the best interest of the LPs in the current fund while also trying to broker a deal with a buyer which the GP itself controls, thereby giving the GP a financial interest on both sides of the transaction. To address the conflict of interest related to valuations, GPs should consider engaging an independent valuation firm and also consider obtaining Limited Partner Advisory Committee ("LPAC") or investor approval of the transaction terms, especially the sale price.

Conclusions

For experienced LPs with capital to deploy, there is currently a significant supply of GP-led secondary transactions in which to potentially invest. We expect that there will continue to be a substantial number of GP-led secondary transactions to consider, particularly in today's more challenging market conditions and slower transaction volume. However, not all deals are created equal, and GP-led transactions tend to have different structures and considerations for investors to consider – so due diligence experience is essential. ◆

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Steven Hartt, CAIA *joined Meketa in 2010 and has been in the financial services industry for 36 years. He works in the Private Markets Group where he leads the firm's private equity manager research efforts, as well as our private equity coinvestment and secondary transaction sourcing, execution, and research. In addition to his research efforts, Mr. Hartt works directly with clients on their private markets programs.*

Prior to joining Meketa, Mr. Hartt was a Senior Vice President at Amalgamated Bank where he was in charge of alternative investments. While at Amalgamated Bank, he managed the discretionary portfolios of private equity, debt, and infrastructure funds, in addition to the development, marketing and management of a private equity fund of funds.

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Prior to joining Meketa, he was a research Analyst at West Capital Management, a family office RIA with $1 billion in AUM. Mr. Singh was responsible for investment due diligence on managers, portfolio construction, and performance reporting. Previously, he was a Senior Stock Operations Associate at Broadridge Financial Solutions, Inc. and a Client Service Analyst at Hamilton Lane Advisors.

Mr. Singh graduated from Rutgers University with a Bachelor of Science in Finance and Accounting with a Minor in Economics and he is currently enrolled in a Master of Science in Finance at Georgetown University.

Beyond Retirement Benefits: Equipping Members with Just-In-Time Financial Information

By: Thomas Anichini CFA, CFP, GuidedChoice/3Nickels

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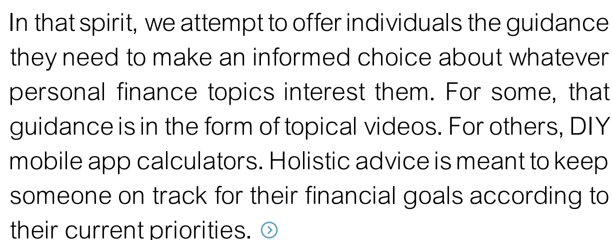
Retirement security is a goal all plans seek to provide. Beyond retirement security, members' financial situations vary from one to another and across their working lives. At different times, members may face decisions about buying a home, paying off debt, or saving for college. They would benefit from having access to financial guidance on demand.

Researchers Fernandes, Lynch, and Netemeyer have shown the best way to equip people to make financial decisions is with "just in time" financial education.[1] Since acquired knowledge is a "use it or lose it" tool, attempts at financial literacy often make little difference because their concepts have been forgotten by the time they are needed. The authors found that a brief financial education intervention just prior to a decision may guide a person to a better choice.



In that spirit, we attempt to offer individuals the guidance they need to make an informed choice about whatever personal finance topics interest them. For some, that guidance is in the form of topical videos. For others, DIY mobile app calculators. Holistic advice is meant to keep someone on track for their financial goals according to their current priorities.

Holistic advice is meant to keep someone on track for their financial goals according to their current priorities.

Source of guidance	Topics	Benefits
Educational program	Money Debt Spending Investing Giving	Learn from topical videos and track progress with occasional quizzes
Mobile app calculators	Budget Rent or buy Pay off debt Finance a car Save for college Buy or sell a home	Access only the help needed at the time it is needed
Holistic financial advice	How to allocate discretionary income	Define your current financial goals Prioritize your goals Learn how to allocate your paycheck according to your priorities Revise as time passes and your goals change

Consider the prospect of paying down debt. People who are not financial professionals might not realize just how much money they could save by paying more than their minimum payments. Imagine a person who holds three debts totaling $54,000.

Measure	Debt 1	Debt 2	Debt 3	Total
Minimum payment	$267	$458	$691	$1,416
APR	12%	18%	24%	19.33%
Balance	$12,000	$18,000	$24,000	$54,000

With access to the relevant mobile calculator, the person can calculate the actual time and dollar savings available from paying more than the minimum. The calculator would require details about the debts – balance, rate, minimum payment – and how much extra the person could pay. (For this example, assume $200/month). The results show how long it will take and how much interest it will cost to pay off the debt by paying only the minimum and compares that to two different early payoff strategies, "Avalanche" and "Snowball." "Avalanche" pays the extra to the highest interest rate debt; "Snowball" to the smallest balance.

The output reveals the time and money savings from paying more than the minimum according to both strategies.

Payment Plan	Months until payoff	Total Interest Paid
Minimum payment *Pay only the minimum payment each month*	60	$30,801
Snowball *Pay extra $200 each month on smallest balance*	50	$26,106
Avalanche *Pay extra $200 each month on highest interest rate*	48	$23,061

Source: Author's calculations based on 3Nickels mobile app

Instead of simply learning that paying more than the minimum can be advantageous, having access to a calculator where they may enter their own information and see their savings in terms of time and dollars of interest might spur the member to pursue one of the early payoff strategies.

Debt payoff is merely one topic among many. While some members might benefit merely from having access to on-demand education and single-topic calculators, others may prefer holistic financial advice: advice on prioritizing their entire discretionary spending. Members' financial situations are complex and constantly evolving. They likely have different values with respect to debt, saving, owning property, and personal and charitable giving. Holistic financial advice first asks them about their priorities and then guides them in deciding how best to allocate their paycheck according to their values. ◆

Endnotes:

[1] Daniel Fernandes, John G. Lynch Jr, and Richard G. Netemeyer, "Financial literacy, financial education, and downstream financial behaviors," Management Science 60, no. 8 (2014): 1861-1883.

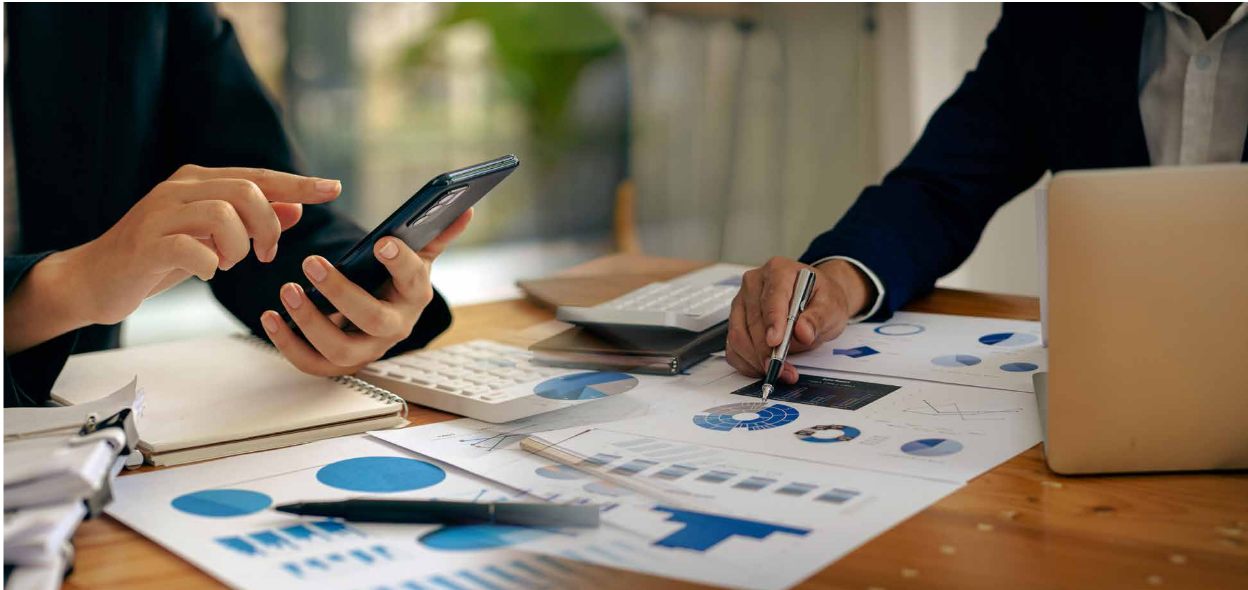
Thomas Anichini, CFA, CFP, *is Chief Investment Strategist with GuidedChoice / 3Nickels, with over 30 years of actuarial and investment experience.*

Tom is a member of GuidedChoice's Investment Committee. He refines GuidedChoice's capital market assumptions and proprietary return model, and also contributes to GuidedChoice's retirement advice engine and 3Nickels financial advice engine. Tom communicates about the firm's philosophy and advice, and represents the investment team when facing clients and consultants.

Prior to joining the firm, Tom gained experience in various actuarial, investment consulting, and portfolio management positions, including for EnnisKnupp & Associates, Mercer, Westpeak Global Advisors, and Freeman Investment Management.

Private Credit: Decision Drivers for Today's Markets

By: Randy Schwimmer, Churchill Asset Management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The private capital industry has seen a surge in popularity among investors seeking stability in the face of public market volatility, recession fears and banking sector turmoil. Private capital not only provides the potential for attractive income and returns but also serves as a less correlated portfolio diversifier, generally with lower mark-to-market volatility than the public markets. In today's economic climate, many investors are prioritizing scaled, conservative managers with proven track records and all-weather portfolios to help them meet their investment objectives. The confluence of higher interest rates and overall economic uncertainty can lead to attractive private capital investment opportunities; however, it is critical to align with experienced managers that remain vigilant, selective, and diversified.

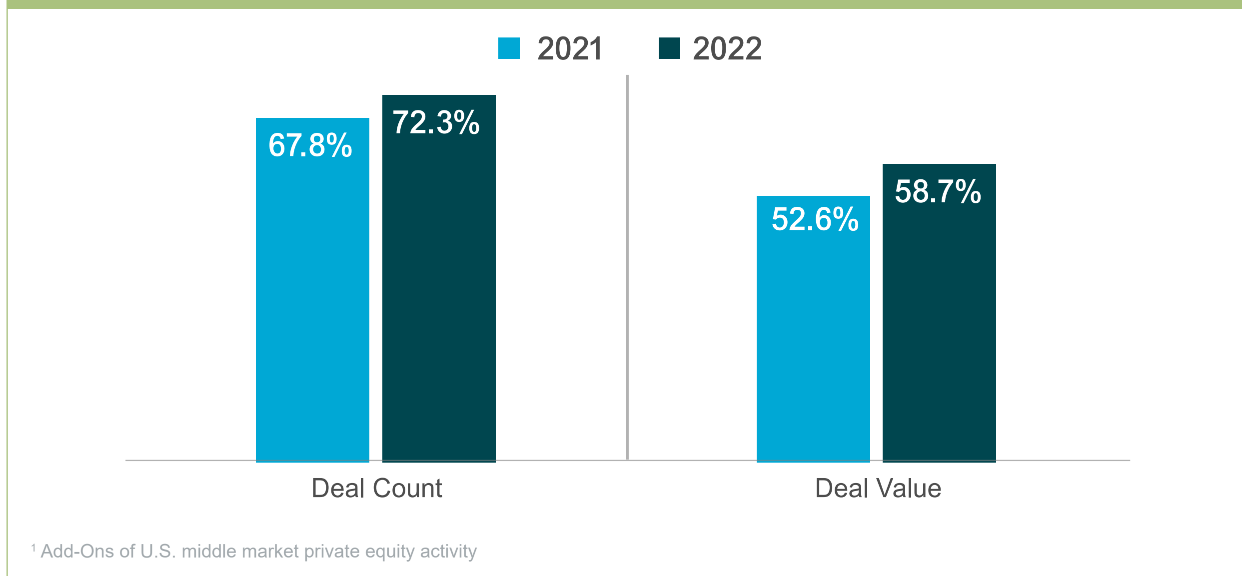
Churchill's investment teams share what is top of mind today from an underwriting perspective and why we are completing deals in this environment.

Top three reasons we're completing deals today

1. Already in our portfolio

In a volatile market, the best and healthiest companies often play offense and seek to grow through M&A. Private capital managers with large existing portfolios and flexible mandates are well positioned to benefit from this trend. Through Q1 2023, financing add-ons within Churchill's existing portfolio have seen a meaningful uptick, representing 60% of senior lending volume and accounting for 20% of the capital deployed by its equity co-investment strategy. We expect to see tailwinds for add-on activity to continue well into 2023 from 2022, where add-on transactions represented over 70% of all U.S. middle market private equity deal count.[1]

Private capital not only provides the potential for attractive income and returns but also serves as a less correlated portfolio diversifier...



2. Top sponsor relationships

Investors must adjust to a new paradigm after 10+ years of strong market conditions. In today's environment, partnering with top-tier private equity firms is more important than ever. Those with strong investment teams, proven value creation strategies and differentiated networks of operating partners and potential executives have the ability to perform irrespective of broader economic conditions. Furthermore, working with many top-tier sponsors can give investors a wide perspective on deal flow, driving increased selectivity. The ability to both identify and access private equity firms with which to partner is predicated upon years of relationship building, cemented by scale and a longstanding presence in the market.

3. Less cycle sensitive

Many investors have been positioning their portfolios in anticipation of a downturn for several years, seeking to back non-cyclical assets. Yet, what does it mean to be "non-cyclical" in today's world? The last five years have shown that performance during negative GDP growth is not the only factor to consider when evaluating the durability of businesses. Pandemics, inflation, and rising interest rates all have the potential to wreak havoc on profitability and growth. Investors should focus on partnering with companies that succeed in any macroeconomic environment. Churchill seeks to identify businesses whose products and services are a) non-discretionary, b) purchased on a recurring basis, and c) comprised of a small percentage of customers' overall cost structure but command a high cost of failure. In our experience, companies that demonstrate a combination of these three factors are most likely to provide downside risk mitigation protection in a variety of market conditions. ◆

Endnotes:

1 Pitchbook 2022 Annual U.S. PE Middle Market Report. 2 Reflects committed capital as of 01 Jan 2023. The amount of 'private capital invested' shown above includes private credit and private equity investments made, originated or committed to by Churchill Asset Management LLC and its affiliates, including TIAA, since 2011 (in respect of its Private Equity and Junior Capital platform) and since 2015 (in respect of its Senior Lending platform). Investments include committed investments that ultimately may not have been fully drawn or funded.

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__Randy Schwimmer__ is co-head of senior lending and oversees senior lending origination and capital markets for Churchill Asset Management, an investment specialist of Nuveen.

Randy has broad experience in middle market finance and is widely credited with developing loan syndications for middle market companies. Prior to joining the firm, Randy served as a senior managing director and head of capital markets and indirect origination at Churchill Financial. In those positions, he took responsibility for all loan capital markets activities and for managing the firm's indirect origination platform. Before that, he worked as managing director and head of leveraged finance syndication for BNP Paribas. He spent 15 years at JP Morgan Chase in corporate banking and loan syndications, where he originated, structured and syndicated leveraged loans.

Randy graduated with a B.A., cum laude, from Trinity College and an M.A. from the University of Chicago.

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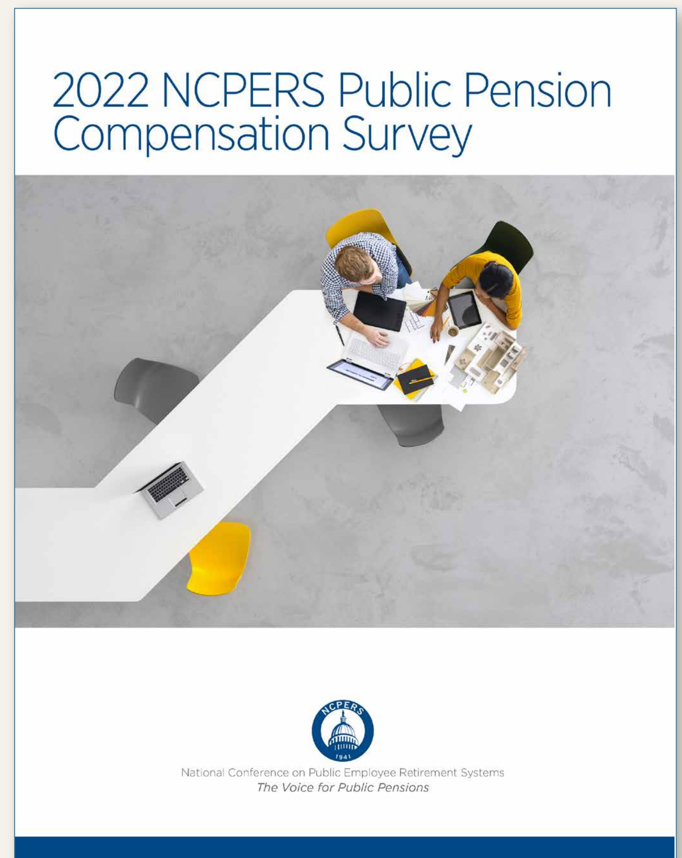

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The Cyber Threats for Pension Funds

By: Steve Ross, Board Smart LLC

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Public employee pension funds are prime targets for cyberattacks. Very few other enterprises have the combination of large amounts of personally identifiable information (PII), lots of money and relatively small staffs. Most financial institutions with assets the size of a typical pension fund have many more employees, particularly in Information Security. Hedge funds and private equity firms also have plentiful assets, but very little personal information, while companies with databases rich in PII rarely have as much money as pension funds do.

The recent cyberattack on a servicer to CalPERS and CalSTRS, America's two largest public employee pension funds, has exposed the PII of more than a million members and the reality of the threat to pension funds. And this was not an isolated incident. Attacks have been reported on systems in Oklahoma, Massachusetts, and Missouri, among other jurisdictions.

Public employee pension funds, especially those with fewer IT-savvy employees, must protect themselves. The first thing is to accept the potential danger and to train employees as to what they can do – and not do – to make their systems safer. Equally, boards should be educated as to the magnitude of the threat in their systems so that they can allocate adequate resources to prevent and detect cyberattacks and to build resilience should an attack occur.

Public employee pension funds, especially those with fewer IT-savvy employees, must protect themselves.

Every fund that runs its own systems, whether on their premises or in the cloud, should implement at least a baseline cybersecurity program. The Employee Benefits Security Administration (EBSA) Cybersecurity Program Best Practices lists twelve measures that range from the general ("Have a formal, well-documented cybersecurity program.") to the rather specific ("Encrypt sensitive data, stored and in transit.") Every pension fund should be aware of this guidance, even if they feel they cannot afford to adhere to all its requirements. Those funds that outsource benefits administration, investments or both should ensure that their service providers follow EBSA's practices.

In terms of information security technology, every pension fund's systems should be equipped, at a minimum, with up-to-date firewalls (also known as next generation firewalls), intrusion detection and prevention software and, of course, encryption. Equally important is to have round-the-clock monitoring of information systems applications and infrastructure to detect attempted attacks, or worse, successful ones. There needs to be an incident response capability so that malware can be removed before it causes too much damage. Finally, every pension fund should have a plan for how they will continue to serve members and annuitants if a cyberattack does bring down their critical systems.

All of these technical and organizational measures require people to implement, administer and maintain them.

All of these technical and organizational measures require people to implement, administer and maintain them. Often, this is the limiting factor for adoption of best practices, especially for smaller funds. There are outsourced services known as Managed Security Service Providers (MSSP) that can fill the gap. They can bring the expertise, resources and technology that these funds either lack or cannot afford.

However, if a public employee pension fund chooses to address the issue of cybersecurity, it must accept the reality that this is not a one-time investment. Each advance in information technology has been accompanied by bad guys (a technical term) who attempt to exploit the vulnerabilities that are introduced. This will go on for the foreseeable future. ◆

Steven Ross *is Senior Advisor at Funston Advisory Services and holds certification as a Certified Information Systems Security Professional (CISSP) as well as a Master Business Continuity Professional (MBCP), a Certified Information Systems Auditor (CISA) and a Certified Data Privacy Solutions Engineer (CDPSE). Mr. Ross is a specialist in the field of information systems security and control, specializing in Information Security, Business Continuity Management, Data Privacy and IT Disaster Recovery Planning services. He has implemented Information Security programs for numerous pension funds, banks, government agencies and industrial corporations. Prior to joining Funston Advisory Services, Mr. Ross was a Director and global practice leader with Deloitte.*

In consulting engagements, he specializes in planning, policy development, implementation, and standardization of Information Security processes. In recent years, his focus has been on reliability, prevention, detection and recovery from the technical and business impact of cyberattacks.

Worlds Apart: The Case for Separating Emerging Markets from your International Allocation

By: Natascha B. E. Willans, ABS Global Investments

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While emerging markets may only represent 29% of the allocation of the international index, it deserves a far larger percentage of a manager's attention. These markets are too large, diverse, and complex to be managed as an afterthought. Equally, the cost in terms of forgone alpha potential is too high.

An Impossibly Large International Universe

Forty-five countries, 2,237 stocks.[1] The international equity universe as defined by the MSCI AC World ex-US Index leaves investors with an impractically large universe. The natural question is whether it is possible for even an experienced investor to cover such a large universe in appropriate depth. Faced with this dilemma, allocators are encouraged to rethink the universe and split it into more manageable sub-segments: emerging and developed markets.

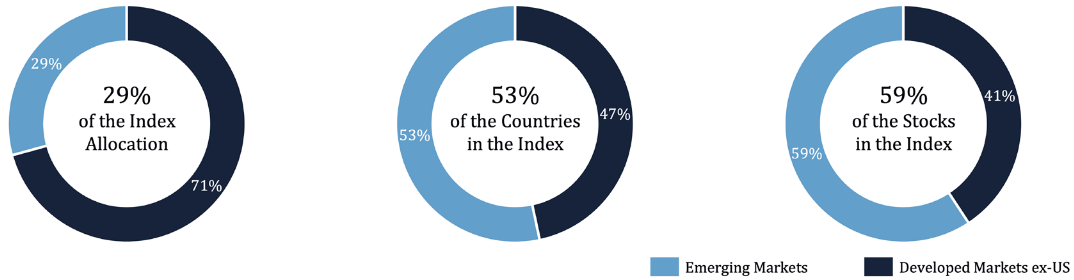
Emerging Markets: An Increasing Part of International Markets

The steady growth in the size and importance of emerging markets should not be overlooked. As recently as 2004 these markets represented only 10% of the international index. The allocation has grown almost three times since then.[2] Similarly, the number of stocks within these markets have multiplied over four times in the past 20 years.[3] While emerging markets today represent just under 30% allocation within the MSCI AC World ex-US index, they represent more than half of its countries and 59% of its stocks.

Each country has its own economic, political and market dynamics to be analyzed and each stock their own fundamentals to be dissected. So, while emerging markets have rapidly grown as a segment within international markets, managers trying to cover the full universe have generally struggled to expand their coverage at the pace of this evolution.

Each country has its own economic, political and market dynamics to be analyzed and each stock their own fundamentals to be dissected.

Emerging Markets as a Share of MSCI AC World ex-US Index

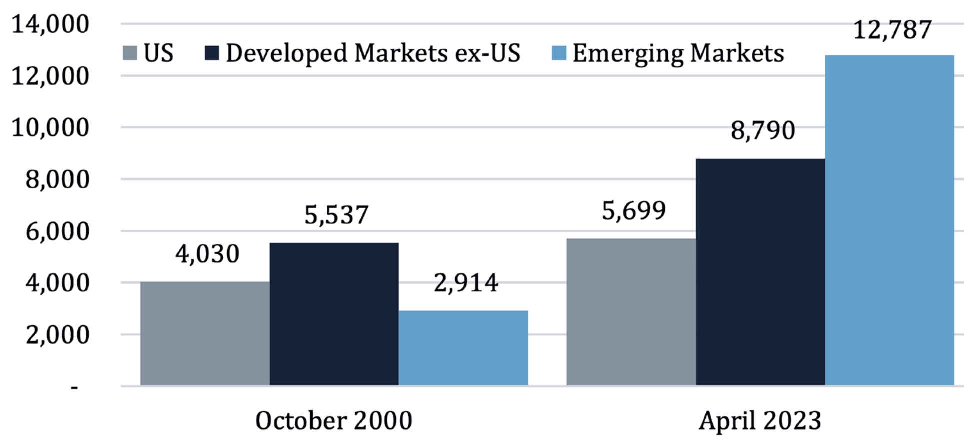


Source: MSCI and Bloomberg as of May 31, 2023.

Growth of Emerging Markets in the MSCI AC World ex-US Index

Source: MSCI and Bloomberg as of May 31, 2023.

Stock Universe with over $100M Market Cap: 2000 vs 2023



Source of October 2000 Data: MSCI, FactSet as of October 31, 2000. Includes all stocks by country with market caps over $100M. Source of April 2023 Data: MSCI, Bloomberg. Country weights as of April 30, 2023. Data based on Bloomberg EQS screen that includes all stocks by country with market caps over $100M as of April 30, 30, 2023. Developed and Emerging Market country definitions based on MSCI classifications.

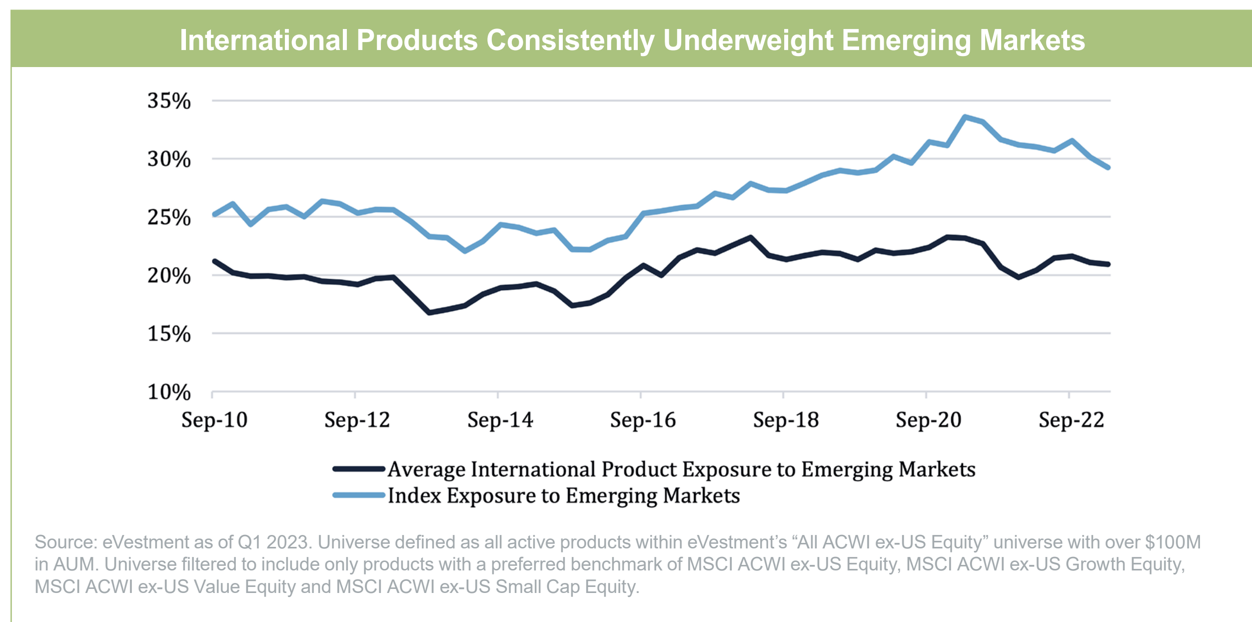
Emerging Markets Inefficiency & the Alpha Opportunity

It is generally accepted that emerging market equities are priced more inefficiently than developed market equities. Not only are information asymmetries more significant, but in many cases the large presence of retail investors creates further opportunities. This backdrop makes emerging markets fertile ground for skilled active managers to generate substantial alpha via stock selection. However, for this inefficiency to translate into value, investors must have the time, focus and mandate to scour this large and complex universe to find these opportunities.

Pitfalls of a Combined Allocation

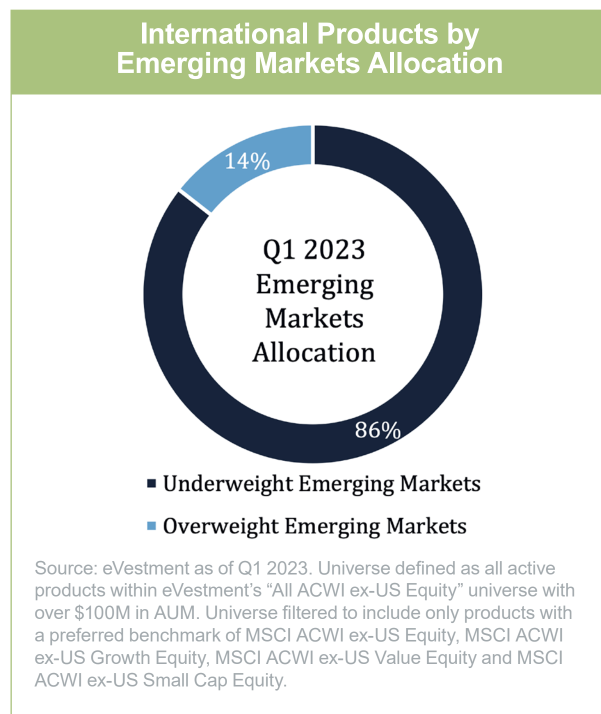
Without the bandwidth to perform appropriate diligence, many international strategies "make do". In the past, we found that approximately 80% of international products were underweight emerging markets.[4] Although all these strategies were benchmarked to an index that includes emerging markets, they were on average underweight the asset class by 28%.[5] Further, when these products were able to generate alpha within emerging markets, it tended to be driven by style, country and/or sector bets, rather than stock selection.

International Products Consistently Underweight Emerging Markets



Source: eVestment as of Q1 2023. Universe defined as all active products within eVestment's "All ACWI ex-US Equity" universe with over $100M in AUM. Universe filtered to include only products with a preferred benchmark of MSCI ACWI ex-US Equity, MSCI ACWI ex-US Growth Equity, MSCI ACWI ex-US Value Equity and MSCI ACWI ex-US Small Cap Equity.

International Products by Emerging Markets Allocation



Source: eVestment as of Q1 2023. Universe defined as all active products within eVestment's "All ACWI ex-US Equity" universe with over $100M in AUM. Universe filtered to include only products with a preferred benchmark of MSCI ACWI ex-US Equity, MSCI ACWI ex-US Growth Equity, MSCI ACWI ex-US Value Equity and MSCI ACWI ex-US Small Cap Equity.

Conclusion

Once an afterthought for most managers focused on international markets, emerging markets have grown to become a core part of the non-US equity universe. Their diversity and inefficiency offer active managers an excellent opportunity for alpha generation, however, the magnitude and complexity of underlying markets require dedicated resources to extract this alpha. Moreover, the rapid growth of these markets suggests that the challenges of covering the full suite of international countries in one mandate will continue to grow. We believe the best way to extract alpha from these markets is to separate developed and emerging countries and specialize. ◆

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Endnotes:

1 Number of countries and stocks within the MSCI AC World ex-US Index as of May 31, 2023.
2 Emerging Market countries as a percent of MSCI AC MSCI AC World ex-US Index as of May 31, 2023.
3 Refers to stocks within each stock market defined as an emerging market by MSCI, with at least $100M in market capitalization. As of April 30, 2023
4 Data based eVestment as of Q1 2023. Universe defined as all active products within eVestment's "All ACWI ex-US Equity" universe with over $100M in AUM. Universe filtered to include only products with a preferred benchmark of MSCI ACWI ex-US Equity, MSCI ACWI ex-US Growth Equity, MSCI ACWI ex-US Value Equity and MSCI ACWI ex-US Small Cap Equity. Considers data from Q1 2019 through Q1 2023.
5 IBID

Natascha B. E. Willans *is a Partner and Investment Analyst at ABS. She is responsible for sourcing and monitoring emerging markets equity strategies. Mrs. Willans has been active following and allocating resources to Emerging Markets Managers for over 16 years. Currently, ABS manages over $6.8 Billion, mostly on behalf of Pension Funds, Endowments and Foundations.*

Prior to joining ABS in November 2013, she was an Executive Director in Goldman Sachs' Global Portfolio Solutions group participating in the oversight of multi-asset class investment portfolios and manager research and selection. She holds a BS in Finance, Marketing and Italian Language Studies from Georgetown University.

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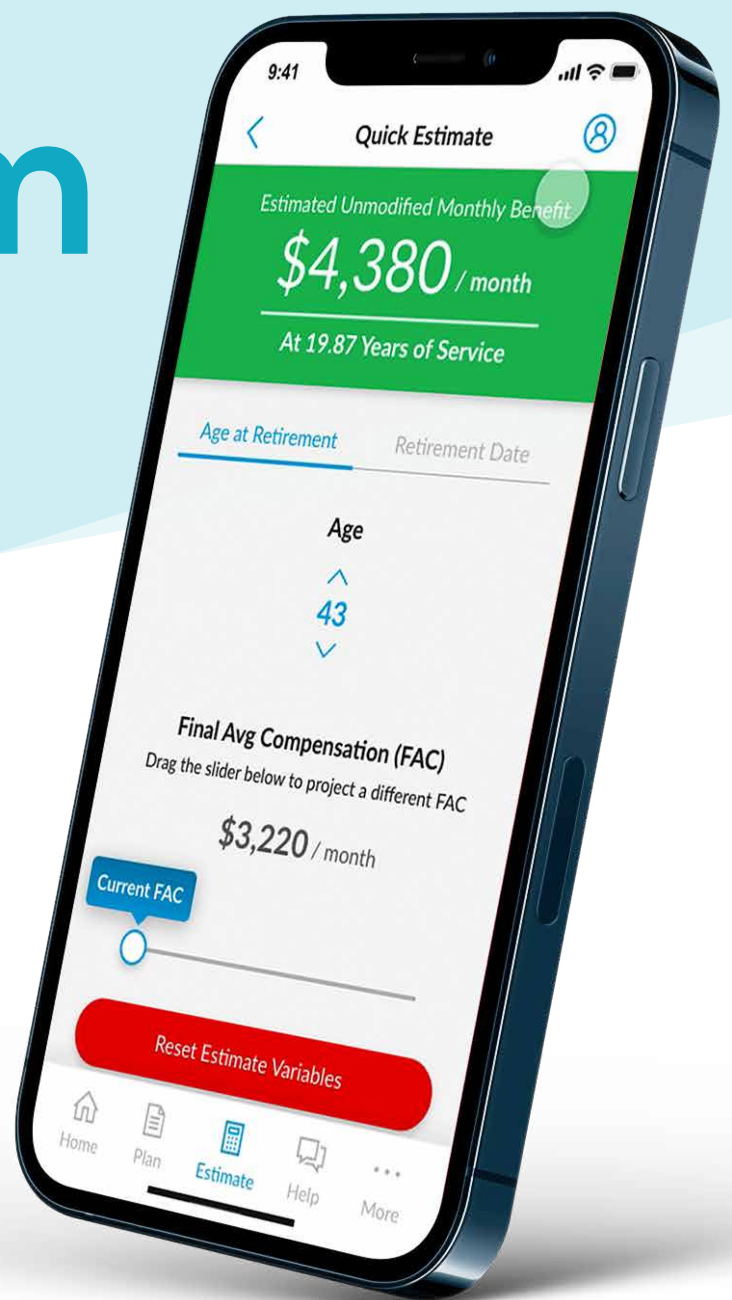

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ARTICLE

Inflation: Don't Pop the Champagne (Yet)

August 2023

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With inflation now running below 3%, many are breathing a sigh of relief, perhaps thinking, "I'm glad that's over!" But let's not be overly hasty in popping the champagne corks. Early this year, we predicted that inflation could recede below 3%, and rebound sharply, all in the same year.

Most observers are thrilled when they correctly forecast whether stocks, bonds, inflation, or GDP is likely to go up or down. We had the chutzpah to forecast that inflation would tumble *and* rebound. Because last year's 6.5% inflation happened almost entirely in the first half of the year, we told our investors that there would likely be an illusion of tumbling inflation in the first half of the year, perhaps even falling below 3% by midyear, then an illusion of soaring inflation in the second half of the year. Both the benign first half and the daunting second half are illusions, because they are based entirely on the months that we are replacing from 2022.

We cautioned our investors to not join the masses in celebrating, when inflation tumbled in the first half of the year. We predicted that there would be gleeful reports – whether investors, pundits, politicians, economists or reporters – that inflation is contained. That's exactly what we're seeing. We also cautioned our investors to recognize that a rebound in inflation during the second half of 2023 is likely, and is no basis for panic. Finally, we suggested that, if inflation rebounds in line with our expectations, we should expect countless observers to be surprised and deeply concerned. This remains a high-odds outcome.

We find it stunning that so few economists and investors look back at the months that we are replacing. Many companies invest substantial resources trying to gauge what the future months' inflation reports will look like, and then pay little or no attention to the months that they will replace. We never know with any precision what the new monthly inflation will be, and yet we have an exact fix on the month that it will replace.

Break out the Champagne??

Inflation is very simple, nothing more than a supply/demand imbalance. Worldwide, we paired a stimulus-induced surge in demand for goods and services (from helicopter drops of cash into consumers' bank accounts, and a mood to spend like there's no tomorrow!) with a lockdown-induced crash in supply of goods and services (from supply-chain disruptions, just-in-time production protocols, and millions of people either required or choosing not to work). As the causes of the supply-demand mismatch dissipate, so does the inflation.

Key Points

- Even though inflation fell below 3% in the first half of 2022, let's not celebrate too early as there is a possibility of inflation rebounding later in 2023.
- Inflation is not always transitory, it's just one of a wide range of outcomes (and historically has not been the norm).
- Investors are cautioned not to be overly optimistic about inflation and to be prepared for the possibility of higher inflation in the future.

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The “spaghetti graph” on the next page gives us reason to applaud the rapid slaying of the inflation demons of 2021 to 2023. Early this year, we published a paper examining the trajectory of inflation in fourteen developed economies around the world over the last half-century. We expanded on that paper in a more thorough article which appeared soon thereafter in the *Journal of Portfolio Management*. This graph is drawn (and updated) from that research. What does it show us?

- Inflation has crossed the 8% threshold 31 times in the 14 countries that we studied. After first exceeding 8%, it can dissipate quickly: it took only 15 months for New Zealand to see its early-1990 inflation of 8% to retreat to the 2% target that seems to be today’s central bankers’ target (ironically first proposed by the New Zealand central bank in the late 2000s). Or it can dissipate slowly: inflation crossed 8% in Spain in 1970 and did not fall below 2% until 1997, a full generation later.

- If we define “transitory inflation” based on reverting to 2% or less within two years, the current round of global inflation may produce three candidates, Canada, Spain, and the US. History, however, is less encouraging. If we look closer, the two past episodes of transitory inflation (New Zealand, 1990-91, and Japan, 1980-82) were nothing of the sort! These were both the tail end of multiple peaks, in which only the last surge beyond 8% inflation dissipated fast (finally). You can see the dashed green lines replicated on the right side of the graph. Here we can see that the 1980-82 inflation in Japan actually started in 1971. It only counts as a separate episode because it fell below 4% in the interim. Likewise, the New Zealand inflation of 1991-92 actually began in 1984. So, these inflationary bursts were part of a much longer-term inflation lasting 11 years and seven years, respectively.

- In nine of our 14 countries, inflation exceeded 8% in the aftermath of Covid lockdowns. In all nine of these countries, inflation is already well below its post-Covid peak. In the US and Spain, it’s already below 3% and tumbling fast.

In other words, while rapid dissipation of inflation was rare in the past, this time is different. So sayeth the narrative!

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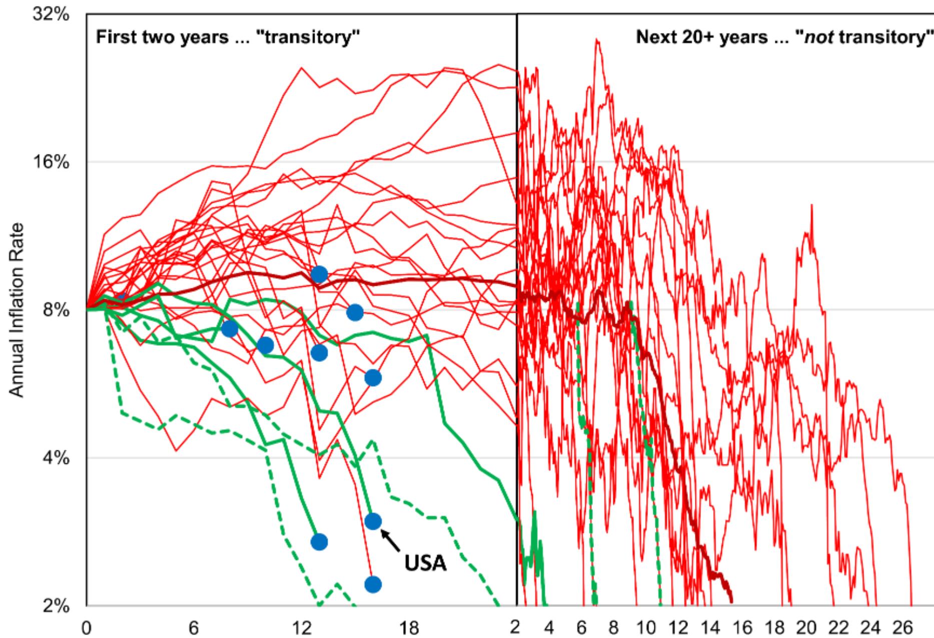
History suggests that when inflation crosses the 8% threshold, it takes years, not months, before it falls back below 2%.

All Episodes (N=31) that Exceeded 8% Inflation

Green lines are "cresting inflation," which never reach 10%. (N=3, plus 3 pending)
Red lines are "accelerating inflation," which rises to 10% and often far more. (N=25)
Solid bold red line is the average outcome for unique, resolved episodes.
Bold blue dots denote inflation that still persists to this day. (N=9)



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Hold the Applause

Some misconstrued our inflation articles as suggesting that transitory inflation (inflation that dissipates within a year or two) won't happen. More accurately, our work suggested that transitory inflation is entirely possible, but resides at benign end of a breathtakingly wide range of outcomes. Our counsel was that readers should not dismiss the possibility of benign or transitory inflation. *Nor should they anchor on that as their central expectation.*

The graph below shows the trajectory of rolling 12-month CPI inflation (seasonally unadjusted) in recent years and through calendar 2023.

- The solid dark blue line shows the actual result through year-end 2022.
- The dashed orange line shows our projection this past January, showing what would happen if every single month of 2023 were to deliver 46 basis points of monthly inflation (matching the average CPI inflation of the previous three years), with zero variability for the full year. The result is not a straight line, as the casual observer might expect. Instead, it is a pronounced "V", as a consequence of the fact that almost all of the 2022 inflation occurred in the first half of the year.

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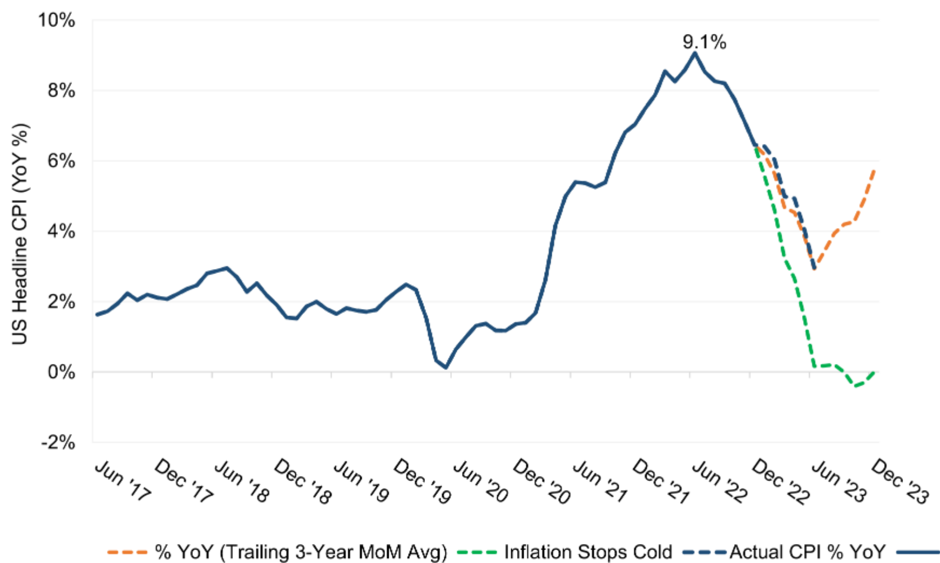
- The dashed green line shows our projection of what would happen if inflation were zero *every single month of 2023*. Again, we don't get a straight line. We get an "L". During the first half of the year, we are replacing monthly inflation of 1% with zero. During the second half of the year, we are replacing monthly inflation of near-zero with zero.

- The dashed blue line, like the solid blue line, also shows the actual inflation results, now extended through mid-year 2023. *In other words, the dashed orange line, our forecast at the beginning of the year, almost exactly matched the actual outcome, the dashed blue line*.

I harbor absolutely no illusions that this astonishingly tight fit is in any way normal. It was a remarkable stroke of luck that the monthly inflation reports were so steady from month-to-month, and so consistently matched the prior three-year average. The Cleveland Fed's "Inflation Nowcast" currently projects July inflation at a manageable 35 basis points.

Because that figure will replace zero inflation from last July, this would actually take inflation higher, very nearly in line with the orange dashed line.



Source: PIMCO and Research Affiliates, based on data from the U.S. Bureau of Labor Statistics, retrieved from FRED, Federal Reserve Bank of St. Louis.

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We are not as pessimistic for the second half of the year as the outlook implied by the orange dashed line. The orange line finishes the year at 5.7%, which is at the very high end of our own expected year-end range. Suppose, for example, that we see an average of 20-40 basis points of inflation each month through year-end. Then we should see the year-over-year inflation rise to somewhere between 4% and 5½% by year-end. *That's enough to be alarming to most observers, who are typically not paying attention to the low rates of inflation that we are replacing late 2022*.

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We find it a bit amusing that, if inflation finishes the year at half its peak levels of mid-2022, this will be an adverse shock to many (indeed, likely most) investors. If we finish the year at 4½% inflation, we will be pleased by this usually benign denouement following a dangerous inflationary surge, but most of the investment community, media, and political elite will likely be alarmed (fear sells!).

What Does the Future Have in Store?

The first graph in this paper shows that 8% inflation is rarely benign or transitory. It takes serious policy errors—in the case of 2021-23 inflation, bipartisan errors—to trigger inflation of this magnitude. Those policy errors are unlikely to be reversed until our central bankers and political leaders have lost much credibility, and the populace no longer accepts the "bad luck" that the policy elite typically wants to blame.

The table on the next page tells the story. If we choose to view the 8% threshold as our key measure for serious inflation, we can see that there are 21 "resolved" episodes, meaning that the inflation receded below the ubiquitous 2% inflation target. Of these, three episodes were "cresting," meaning that they never hit 10% inflation. Three more cresting episodes are still happening now and remain elevated; the US is one of these. There are three more "resolved" examples, in which inflation eventually returned to 2% or lower. Two of these involved "multiple peaks," meaning they receded below 4% and rebounded above 8% before they finally settled down below 2%.

More typically, 8% inflation moves to higher levels, which we call "accelerating inflation." Of the 21 resolved episodes of 8% or higher inflation, 18 went on to higher levels of 10% or more, four with multiple peaks (receding below 4% before rebounding above 8%). In the current inflationary surge, six of our fourteen countries went on to inflation levels above 10%, and have yet to settle down.

"Through year-end 2023, we would suggest that a rebound to 4% or more is more likely than a continuing near-term drop to 2% or less."

The more interesting information on this table is the median time span for getting inflation under control. When we cross 8% inflation, the median time to bring inflation to heel depends upon circumstances. If inflation crests, and does not proceed to 10% or more, the median outcome is that inflation remains elevated for 4.1 years before it is brought below 2%. If, on the other hand, inflation accelerates to the next level (10%) or higher, the median span required to contain inflation is 15.3 years.

It's very important to note that these are historical patterns. *They are not a forecast.* But they are a cautionary tale. If inflation is reined in, within 4 years or less, investors may be disappointed by the wait. But we would count that as a success, at the benign end of our very wide range.

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Historically, when inflation crests above 8%, the median outcome for dropping back below 2% is 4.1 years.

Number of Inflation Episodes Above Various Thresholds & Median Span (in Years) Before Inflation Recedes Below 2%

	Cresting Inflation			Accelerating Inflation			Total
Once Inflation Exceeds:	Still in Progress	Resolved	Multiple Peaks	Multiple Peaks	Resolved	Still in Progress	
4% Thresholds	2	24	4	3	20	13	66
Median Span		1.5			14.4		
6% Thresholds	3	6	1	3	15	10	38
Median Span		1.6			14.2		
8% Thresholds	3	1	2	4	14	7	31
Median Span		4.1			15.3		
10% Thresholds	3	3		4	11	4	25
Median Span		7.7			14.9		
12% Thresholds	2	1		6	11	3	23
Median Span		11.0			14.5		
14% Thresholds	1	5	1		7		14
Median Span		13.7			11.8		
16% Thresholds			1		7		8
Median Span		11.8			12.7		
18% Thresholds		2	1		5		8
Median Span		7.3			15.1		
20% Thresholds		1	1		4		6
Median Span		7.3			18.8		

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Conclusion

We do not reject the possibility that inflation may be benign in the not-too-distant future, with a rapid return to "normal" 2% inflation. As we've said repeatedly, this happy outcome is entirely possible. But it's also possible that we'll see a rebound in inflation. We strongly caution against viewing this benign outcome as our central expectation. Through year-end 2023, we would suggest that a rebound to 4% or more is more likely than a continuing near-term drop to 2% or less. We strongly doubt that inflation will recede below 2% in the coming year. Beyond that, anything could happen.

Our outlook is optimistic, when measured relative to historical norms, but we readily acknowledge that it's a pessimistic outlook relative to the current rosy consensus. We posit that too many observers have not studied the past, and that they and their outlook are ill-informed.

Regardless, this too shall pass. We just think it'll take longer than the consensus expectations.

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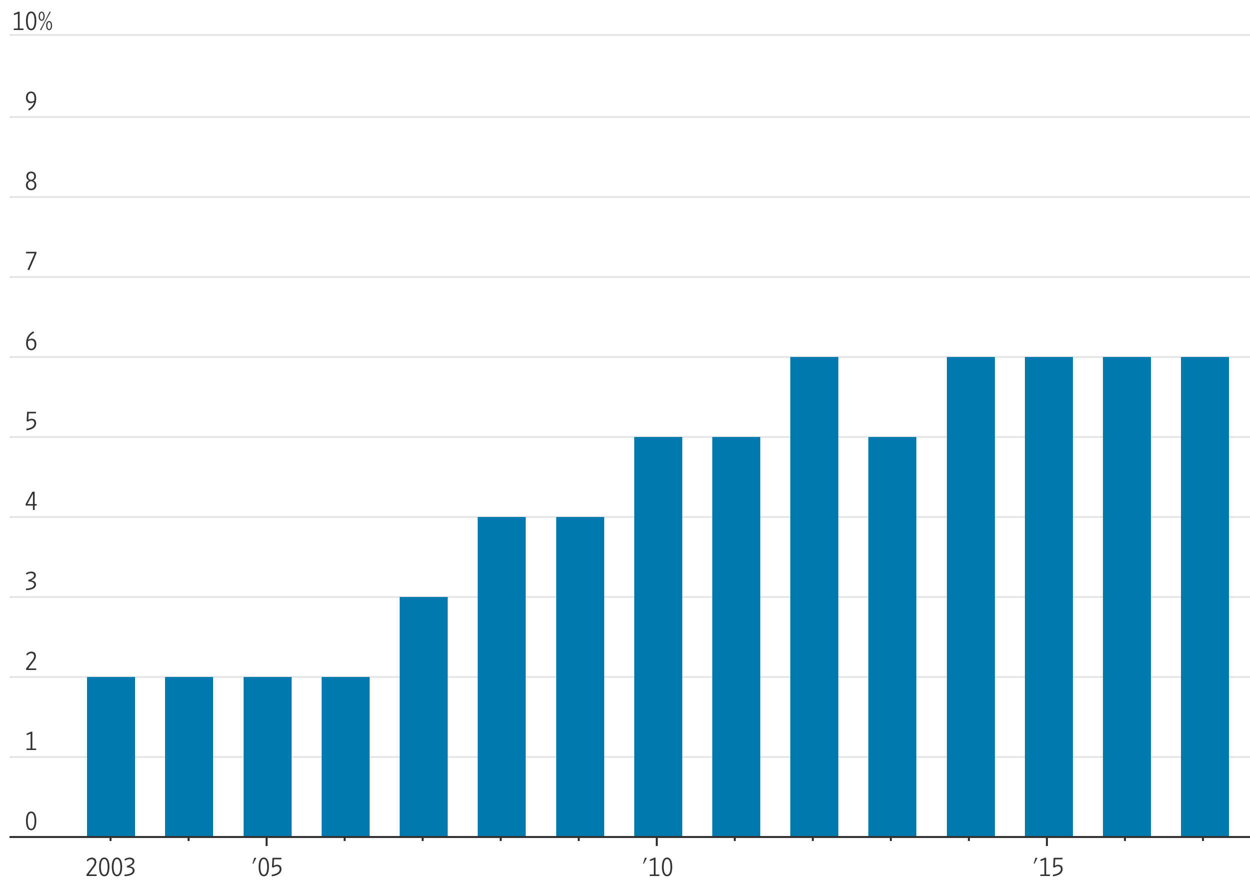
Last Updated: July 25, 2023 at 7:16 PM EDT

6 days ago

Rising Rates Raise Questions for Pension Funds

By Heather Gillers, Reporter

Average public pension allocation to private equity



Source: Boston College Center for Retirement Research

It's hard to find a part of the economy that won't feel some effect from the Federal Reserve's next moves on interest rates. Pension funds are no exception.

Public retirement funds are expected to report fiscal year losses on private equity investments after a decade-long winning streak that attracted hundreds of billions of public dollars to the asset class. Meanwhile, higher interest rates are motivating some pension managers to add lower-risk bonds and other debt investments.

That's a shift from a decade ago when pensions seemingly moved in lockstep to increase holdings in the high-risk high-return investment. When rates were near zero, public officials viewed private equity as key to hitting return targets and covering promised future benefits.

Investors generally believe that the central bank will raise interest rates by a quarter percentage point to 5.25% to 5.5% Wednesday but what the central bank will do after that is less clear. Falling rates could send pension funds back on the hunt for higher risk and higher yield.

"Will you need private equity? Well it depends where rates will stay," said Leandro Festino, a senior consultant with pension advisor Meketa Investment Group.

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The ESG Debate: How Recent Legislation Is Impacting Retirement Fund Best Practices

By: admin **On**: 07/05/2023 17:41:50 **In:** Pension Defense **Comments**: 0

NCPERS believes that, in order to execute their fiduciary duty, funds should be able to decide what to invest in.

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

This article was originally featured in the July 2023 issue of The Monitor.

Utilizing an environmental, social, and governance (ESG) framework to invest is nothing new, but it has been rapidly growing in popularity, with global ESG fund assets reaching approximately $2.5 trillion at the end of 2022. However, one new and concerning trend has been the recent ESG backlash led by lawmakers.

Recent research shows that, in fact, ESG and non-ESG investing strategies result in similar returns. When weighted by market capitalization, portfolios with ESG preferences did not fare significantly better or worse than non-ESG investments.

Despite this, with the growing politicization of ESG, lawmakers across the country are proposing or adopting legislation to regulate how and what public pension funds invest in. In blue states, the focus has primarily been on divestment from fossil fuels. Most recently, a California bill was introduced that would prevent CalPERS and CalSTRS from making new investments in fossil fuels and would require them to divest by 2030. The CalPERS board voted to oppose the bill, citing the staggering transaction costs and the lack of evidence that divestment would impact the demand for fossil fuel.

On the other end of the spectrum, red and purple states have been rapidly adopting anti-ESG legislation modeled after ALEC's 'boycott bill,' which was designed primarily to protect oil companies and gunmakers from 'boycotts' by investors and businesses. This politicization of ESG is dangerous and ultimately will likely have a negative impact on public pension funds' investment performance.

Oftentimes, these anti-ESG bills are rooted in political beliefs rather than operating as an apolitical fiduciary. They come with exorbitant costs with both direct and indirect impacts on public retirement funds' performance. Lawmakers also may not fully comprehend the long-term impact of these bills. Restricting how a fund invests can impact diversification and long-term returns by reducing the universe of investments. There are hidden costs as well. For instance, a fund may need to hire additional staff to help manage the mandates or protect the system from lawsuits. Or, due to decreased returns, the fund may ultimately require increased employee and employer contributions.

Already, we're seeing these negative impacts across the country. Below is a sampling of the impact of recent legislative proposals on retirement systems:

- Texas County District Retirement System will lose an estimated $6 billion over the next 10 years due to investment restrictions included in SB 1446.
- Due to investment restrictions included in HB 1469, North Dakota anticipates additional overhead costs of $10.2 million biennially.
- As a result of decreased competition in the municipal bond market, Florida "now pays 43 basis points

more in yield (or $4.3 million for every $1 billion of bonds sold) than California with an inferior credit rating, or 0.35% more than it did prior to 2022," according to a Bloomberg analysis.

These legislation proposals—being replicated throughout the country—will likely lead to reduced investment returns, increased overhead costs, and ultimately increases in employee and employer contributions. This could have broad impacts on not only the retirement plan and its beneficiaries, but also businesses, local economies, and ultimately taxpayers.

NCPERS believes that, in order to execute their fiduciary duty, funds should be able to decide what to invest in. If you are interested in learning more about the impact of these legislation proposals, or if you would like to obtain advocacy-related resources from NCPERS, please contact me at bridget@ncpers.org.

Comments

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Viewpoints

Lag effect in Private Equity, or "Where are my returns?"

JULY 2023

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Over long time periods, private equity has outperformed public equity. However, there have been periods, including the first half of 2023, where private equity appears to underperform public equity. This apparent private equity underperformance can happen when public equity markets are rising, while conversely, private equity can appear to outperform when public equity markets are falling. Over long periods of time, these differences balance out and private equity has shown to outperform public equity.

While in some ways, equity is equity, whether private or public, there are some important distinctions between public and private. The observed volatility for private equity appears to be less than public equity. Driving this is that unless there is a significant event, private equity portfolio company valuation models tend to result in much more stable values than those determined in daily priced public markets. Further, private company valuations can be lagged 3 months or more and are generally updated on a quarterly basis.

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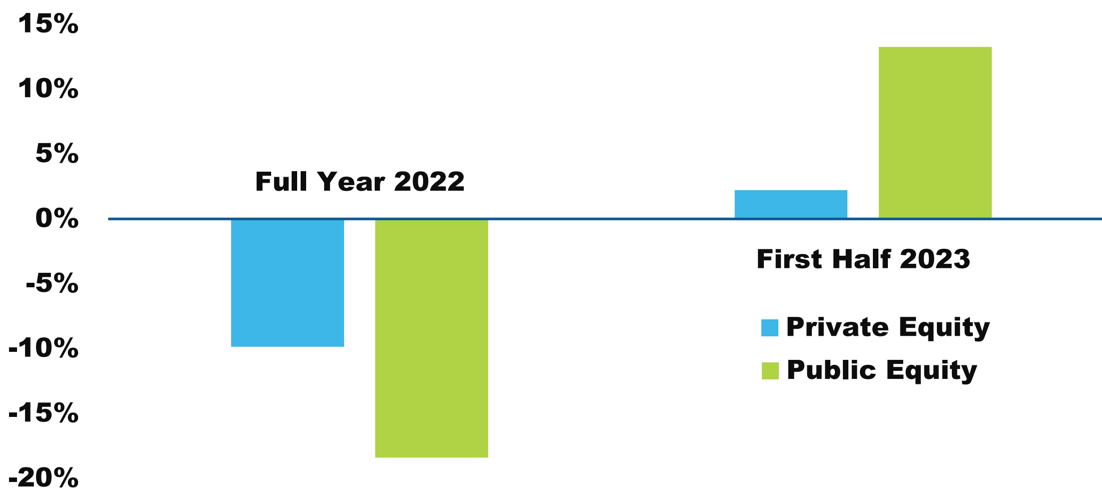

FIGURE 1

Recent Public Equity & Private Equity Performance

Source: Public Equity performance is MSCI ACWI for the calendar year 2022 and for the calendar first half of 2023 through June 30, 2023. The Private Equity performance is Cambridge Associates Global Private Equity & Venture Capital quarterly performance for the full year 2022, while First Half 2023 represents quarterly performance for Q4 2022 and Q1 2023 which are the most recently available as of July 2023.

An example of apparent private equity underperformance can be seen in the returns of public and private equity during the first half of 2023. As shown above, private equity had stronger performance than public equity for the full year 2022. However, private equity performance has appeared to lag public equity performance in the first half of 2023. This observed private equity underperformance is due, in part, to the valuation policy practices described above, as well as the lag in private equity reporting. For instance, Q2 2023 private equity performance data are likely not going to be available until late August, or perhaps September 2023. As such, private equity investors will not see how their investments performed in Q2 2023 until they receive their quarterly statements, while public equity investors can see their investment performance in real time.

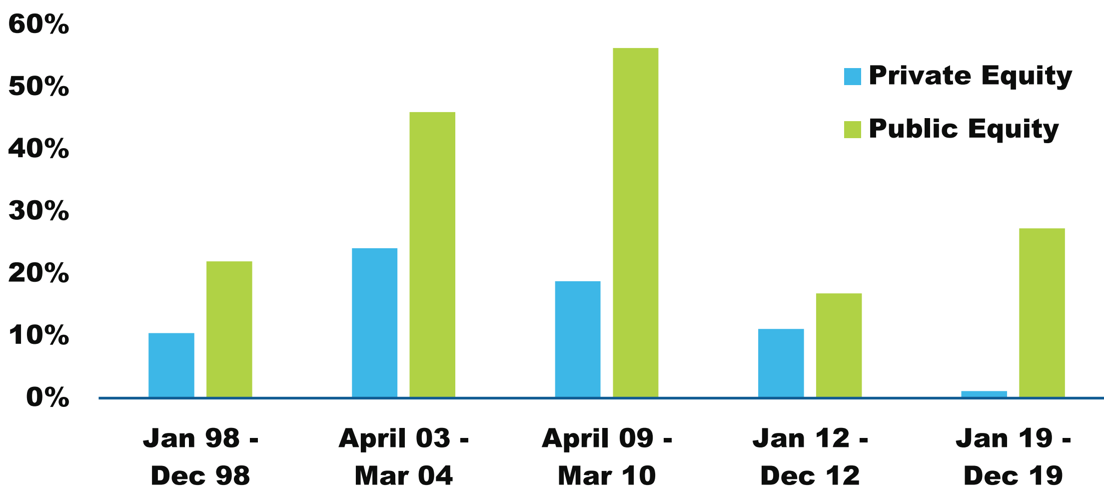

FIGURE 2

One Year Returns Public vs. Private Equity

Source: Annualized quarterly Pooled IRR as of December 31, 2021. Data sourced from Cambridge Associates via IHS Markit as of August 2022. Indices used: Cambridge PE Composite, MSCI ACWI Index.

We have seen other periods where private equity performance has appeared to underperform public equity, so this phenomenon is not new. As shown in the chart above, there have been other times where the 12-month performance of private equity has lagged the 12-month performance of public equity. Often this happens when public markets have very strong upturns, and thus private equity can appear to lag.

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Historical returns

Over the past 20 years, private equity has been the best performing major asset class. Historically, private equity investors have earned 2% to 5% per year more than investors in comparable common stocks, even net of fees.

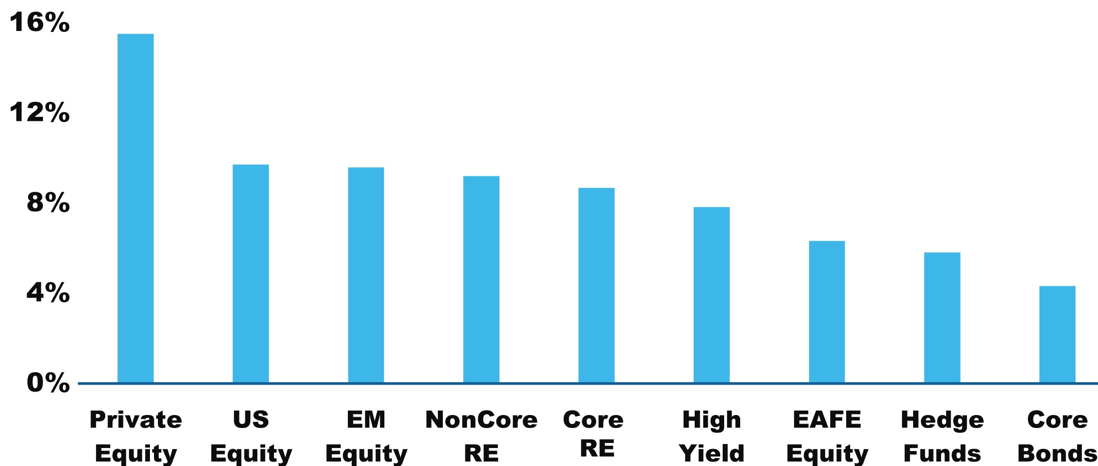

FIGURE 3

Trailing 20 Year Performance

Source: Annualized monthly returns as of December 31, 2021. Data sourced from Cambridge Associates via IHS Markit as of August 2022. Indices used: Cambridge PE Composite, Cambridge Non-Core RE, Bloomberg Barclays US Corporate High Yield Bond Index, MSCI EM, Russell 3000, NCREIF Property Index, Bloomberg Barclays US Aggregate Bond Index, HFRI Weighted Composite Index, MSCI EAFE. PE and Non-Core RE values are Pooled IRR. PE, Core RE, and Non-Core RE are annualized quarterly returns. Note that all historical performance presented throughout this document is net of fees.

Expected returns

Private equity has the highest long term expected return among all asset classes, based on a broad industry survey of firms that produce capital markets expectations. Investors generally assume they will earn more from their private equity portfolio than they will from public equities. This has been the case for the asset class historically, and it is expected by most to persist in the future.

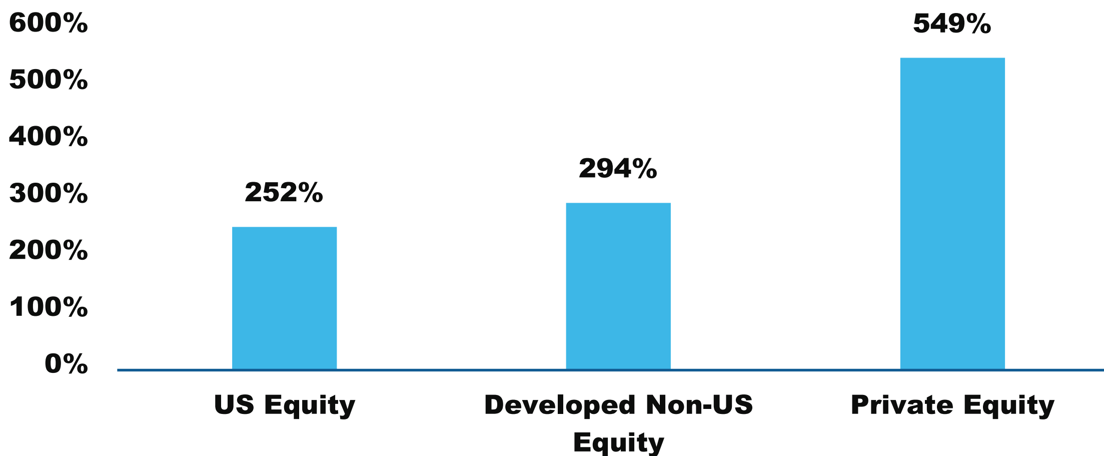

FIGURE 4

Expected 20-Year Cumulative Returns for Equity Asset Classes

Source: 2022 Horizon Actuarial Services survey.

The chart above shows the projected cumulative investment performance for US Equity, Developed Non-US Equity, and Private Equity asset classes over a 20-year period. These cumulative returns are based on average surveyed expected annual returns of 6.5%, 7.1%, and 9.8%, respectively.

Conclusion

In recent months, public equity markets have performed strongly while private equity valuations have lagged behind. Over time, the lag effect of private equity valuations should catch up, allowing private equity's long term performance advantages to become visible.

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Deglobalization

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COVID and the war in Ukraine have led to headlines about corporations wanting to secure their supply chains and countries wanting to secure their national interests, both by limiting and changing with whom they trade. Thus, there is reason to believe that we may be entering a period of deglobalization, that is, a halt or even an outright reversal of the globalization that drove global investment, boosted growth, and lowered the cost of manufactured goods for much of the last fifty years. This would have lasting consequences for the global economy and for investors.

In this paper, we examine the current evidence for deglobalization by analyzing the current environment and the historical effects of globalization, primarily during the post WWII era. We also examine the costs and benefits of globalization to identify potential impacts of its unraveling. Beyond the obvious diminishment of the peace dividend, we find that deglobalization may have ramifications for price stability, interest rates, economic growth, and lower returns on investment in the US and beyond.[1]

[1] In economics, the peace dividend represents a concept where a nation that is at peace will spend less money on military defense, allowing for more spending on social and other programs. See: IMF, "Transcript of April 2023 MD Kristalina Georgieva Press Briefing on Global Policy Agenda," April 14, 2023 where IMF head Kristalina Georgieva stated "the peace dividend is over". See also New York Times, P. Cohen et al. "The 'Peace Dividend' is Over in Europe. Now Come the Hard Tradeoffs," May 3, 2023.

Deglobalization: recent evidence

While the pace of globalization slowed considerably after the Global Financial Crisis (see Figure 2), it has been a combination of the COVID pandemic and geopolitics that have given rise to the notion that globalization might be on the retreat.

COVID and supply chain vulnerabilities

The COVID pandemic led many governments to close their borders and limit "non-essential" economic activity. This interrupted the production of goods and services, and thereby disrupted global supply chains (see Figure 1). The initial lockdowns caused a reduction in both supply (as manufacturers temporarily shuttered operations) and demand. Yet, there was a sharp rebound in demand, especially in the US, particularly for goods more so than services. The rebound in demand in the US pushed shipping capacity to its maximum so that the volume of imports in December 2020 was 30% higher than December of 2019.[2]

[2] Source: United States International Trade Commission, "The Impact of the COVID-19 Pandemic on Freight Transportation Services and US Merchandise Imports" as of June 23, 2023.

Supply was not able to rebound nearly as quickly in 2020 due to several factors related to the pandemic. The pandemic caused disruptions in global supply chains, as factories and transportation networks were shut down or slowed down in many parts of the world. This led to shortages of raw materials and finished goods, and reduced production capacity. Additionally, there were changes in consumer demand patterns. Many people started working from home, which led to increased demand

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for electronics and home office equipment, while demand for other products, such as clothing and travel-related goods, decreased. This shift in demand created imbalances in supply chains, further exacerbating supply shortages. Furthermore, social distancing measures and lockdowns imposed in many countries also caused labor shortages and reduced productivity, particularly in industries such as manufacturing, construction, and logistics. This made it difficult for businesses to maintain pre-pandemic levels of production, resulting in continued supply chain disruptions.

[3] Source: Ibid.

[4] Source: Pacific Basin Economic Council & KPMG as of March 2023. And McKinsey & Company, "Taking the Pulse of Shifting Supply Chains," August 26, 2022. A range of surveys reveal a range of reasons for diversification of supply chains. Companies cite political risks and rising tariffs as the main reasons for diversifying their productive capacity since 2019.

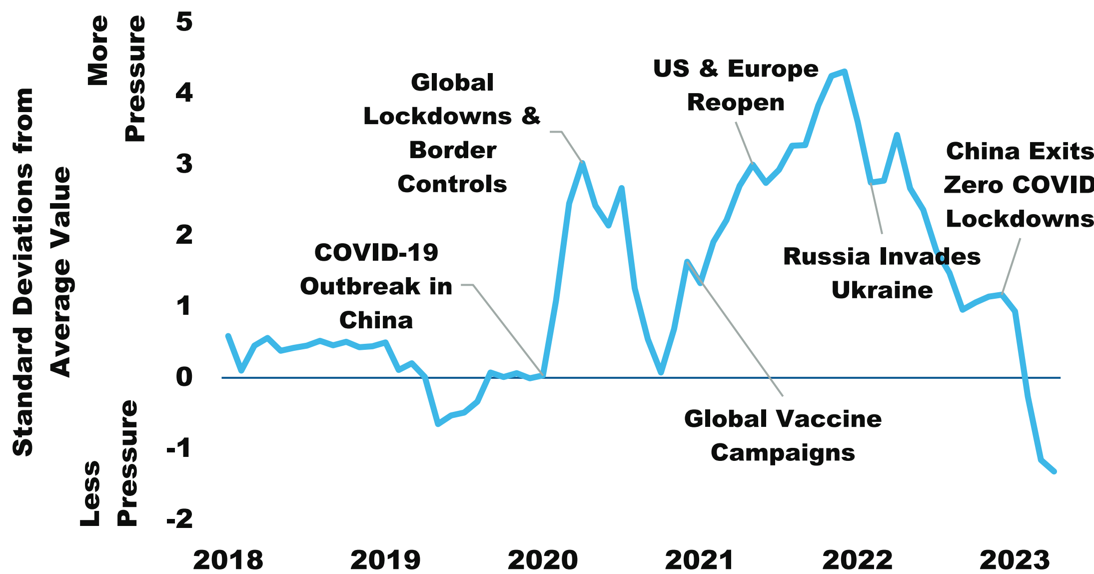

FIGURE 1

Global Supply Chain Pressure Index

Source: New York Federal Reserve as of March 2023. The Global Supply Chain Pressure Index ("GSCPI") also uses several supply chain-related components from Purchasing Managers' Index ("PMI") surveys, focusing on manufacturing firms across seven interconnected economies: China, the euro area, Japan, South Korea, Taiwan, the United Kingdom, and the United States.

The US Commerce Department and other governmental agencies have coordinated with allies and partners to develop supply chain principles and plans. Even the members of the World Trade Organization ("WTO") are on the record advocating for diversifying supply chains to ensure resiliency and reduce potential country specific or government disruptions.[3]

For private corporations,[4] the reorganization of supply chains is a bit more complicated. While there are numerous anecdotal headlines of major multinational companies diversifying their supply chains, the nuances regarding these changes is more challenging. For example, to take advantage of the US CHIPS Act's attractive tax breaks and loans, global chip makers have announced new investments in the US. But a majority of the world's existing chip foundry capacity remains in places like Taiwan.[5] In a recent survey of corporations doing business in the Asia Pacific Region, most of the companies plan to remain in the Asian Pacific Basin, even as tensions between the US and China are on the rise. "Much of the relocated distribution has remained in Asia (71%), with 55% centered in Southeast Asia. Vietnam receives the highest number of company inflows, but India shows the greatest potential for future sourcing patterns to emerge."[6] Such "Friend-shoring" and China +1, and China +2 strategies may diversify supply chains, but they may also incur additional costs.[7] Still, there is clear evidence that foreign direct investment ("FDI") has pivoted away from Asia since the outbreak of COVID, and this shift is even more pronounced for China (see Figure 2).

[5] Source: New York Times: J. Liu *et al.*, "Inside Taiwanese Chip Giant, A US Expansion Stokes Tensions," February 22, 2023. Taiwan Semiconductor Manufacturing Company ("TSMC") has announced plans to build new foundry capacity in Arizona in 2022. TSMC's announcement of $40 billion investment in the US raised tensions with China.

[6] Source: Pacific Basin Economic Council & KPMG as of March 2023. In this report, a sample of 132 companies were analyzed that are considering or have already altered their supply chain sourcing, covering 232 market relocations between 2018 and 2023. Vietnam tops the list with 70 companies that relocated or diverted production there, followed by Taiwan (24), Thailand (20), and India (18) Outside of Asia, Mexico is the biggest beneficiary outside of the US (19), given its proximity to the US market. The US also features as a sourcing relocation destination (19), but less than half of these are reshoring moves.

[7] There are many terms to describe the process of re-organizing supply chains such as friend-shoring, re-shoring, and de-risking China +1 and China +2 are sometimes used to describe a new supply chain strategy that incorporates new sources for goods in addition to an existing China based supply chain. For example, a China +1 supply chain strategy could mean a US company adds Vietnam based suppliers to their current supply chain that depends solely on Chinese suppliers.

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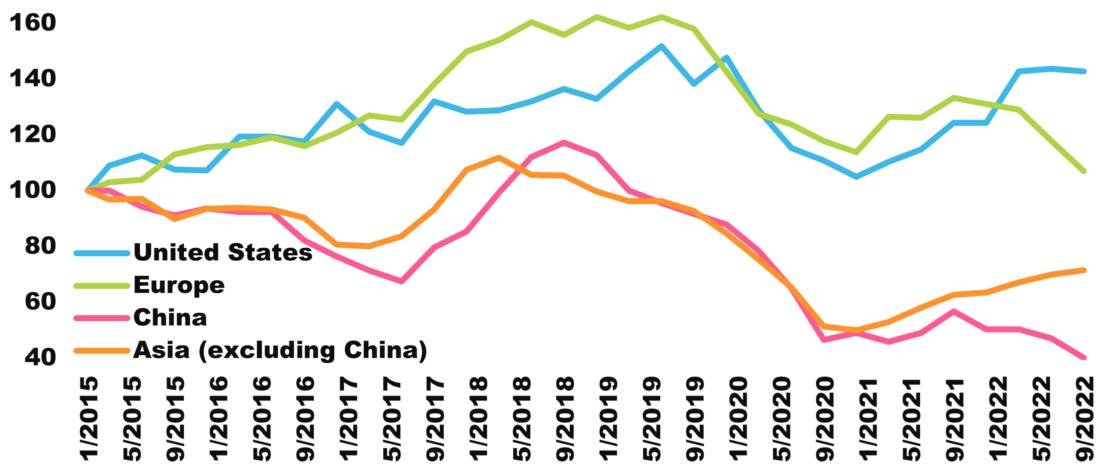

FIGURE 2
Number of Global Foreign Direct Investments By Region (2015 – 2022)

Source: IMF World Economic Outlook April 2023. Chapter 4. Geoeconomic Fragmentation and Foreign Direct Investment. Number of investments with four-quarter moving average.

Resource security

Even as the pandemic receded, Russia's invasion of Ukraine and the West's trade and financial sanctions of Russia made self-sufficiency and national security even more important. Global food and energy prices soared in response to the war in the Ukraine. Supply chain disruptions and lockdowns created food insecurity around the world, and poorer countries suffered the most.[8]

As a result, national governments became more focused on policies to support self-sufficiency. Europe and NATO allies have engaged in price controls on Russian natural gas and pursued infrastructure investments to diversify away from Russia. They built up reserves of natural gas prior to the winter and replaced imports of Russian gas and oil with those from other countries. The decoupling of Europe from Russian natural gas pipelines will force restructuring and investment around the world. Natural gas is a key transition fuel for advanced and developing economies as they move away from coal-fired power generation. The EU, Germany, and the UK have announced fiscal plans for energy infrastructure investments and energy subsidies.[9] In addition, multinational corporations (and their management consultants) now include security and resiliency when assessing the structure of their supply chains.

National security

The invasion of Ukraine reinvigorated interest and support for NATO as countries along Russia's border, such as Finland who reassessed their national security policy and joined NATO in 2023. Not only did NATO allies re-commit to their mutual defense in the face of Russia's invasion, but many of the same countries are also re-drawing trade relationships to prioritize shared security concerns. Multinational corporations – like national governments – are looking to diversify and secure their supply-chains to stay clear of future international tensions and possible sanctions.

Diplomatic and trade tensions primarily between the US and China have added to the waning enthusiasm for globalization. Over the past fifteen years, the US attitude to China's rise has shifted from engagement and cooperation to strategic decoupling. Antecedents for our present-day trade related tensions between the US and China reach back to the early 2000s when China was accused of currency manipulation and

[8] Source: National Institute for Health (NIH) as of July 2022. H. Kakaei et al., "Effect of COVID-19 on Food Security, Hunger, and Food Crisis."

[9] Source: Daniel Yergin, "The New Map", 2020.

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violations of its WTO commitment to avoid unfair trade policies.[10] Prior to 2008, most trade disputes simmered at the level of trade policy and sector specific challenges in the WTO and did not rise to the level of national security for the US. China was first named as a currency manipulator in 1994 where the Peoples Bank of China ("PBOC") actively suppressed the value of their currency to enhance the competitiveness of its exports. By the end of 2011, the process of artificially weakening the value of its currency against the US dollar had allowed China to attract massive investment from global companies anxious to take advantage of the competitive exchange rate and very cheap labor.[11]

After nearly two decades of waiting for China to open its economy and allow its currency to float like other G20 members, the US government began to take action. Following the Global Financial Crisis, US policy on trade with China began to shift and gain priority as an issue of national security.[12] China's use of economic and industrial espionage, systematic use of state support for exports, and currency manipulation reduced US appetite for diplomatic and economic engagement. In January 2018 the Trump administration began to actively defend US interests in key sectors that they perceived were being harmed by China's unfair trade practices. In particular, these sectors included steel, aluminum, and intellectual property rights for technology like semiconductors.[13] President Biden's administration has increasingly embraced new industrial policies (e.g., CHIPS Act and Inflation Reduction Act) along with targeted sanctions of Chinese companies with connections to the Chinese People's Liberation Army ("PLA").[14]

Declining political support domestically

Since 2012, more Americans have seen foreign trade as "an opportunity for economic growth" as opposed to a "threat to the economy." In 2020 the number of Americans with a negative view on foreign trade declined to a multi-decade low of 18%.[15] That trend reversed in 2021 and 2022, with support for foreign trade falling from 79% to 61%.[16] Still, this indicates that there is popular support for trade broadly. Despite voters having a positive view on foreign trade, the Biden administration has looked to national industrial policy and increased use of foreign sanctions.[17] This might be due to a harsher view on trade, specifically with China. A 2021 survey indicated that a "majority supports a more assertive stance on bilateral relations with China across a range of issues."[18]

In the Spring of 2022, US Treasury Secretary Janet Yellen gave a speech at the Atlantic Council recommending "friend-shoring," whereby multinational corporations seek supply chain security from friendly, like-minded allies.[19] In the US, the Inflation Reduction Act and the CHIPS Act of 2022 included passages designed to boost domestic production of green energy and semiconductors, respectively. Moreover, corporations have sufficient financial and political incentives to bring production closer to home markets. For example, the CHIPS Act established the Advanced Manufacturing Investment Credit ("CHIPS ITC"), which offers a 25% credit against a qualified company's investment in a facility with the primary purpose of manufacturing semiconductors or related equipment.[20] Moreover, recipients of these governmental incentives cannot transact or build facilities in "countries of concern" – a list which includes China - for a ten-year period. [21]

[10] Source: US Treasury and US Government Accountability Office ("GAO"). China was the first country to be named as a currency manipulator in 1994 by the US Treasury Department. While China is not the only country to have been named a currency manipulator, its outsized ability to accumulate foreign reserves in US dollars has been a long-standing subject of debate among economists. By the end of 2011, China had accumulated over $3 trillion US dollars through a process of sterilization where the central bank of China actively managed the inflow of foreign currency which kept the value of the local Chinese currency (RmB) very low. The process requires a closed capital account and pegging the value of its currency (RmB or CNY) to the value of the US dollar.

[11] Source: Peterson Institute for International Economics C. Fred Bergensen et al, "Currency Manipulation, the US Economy and the Global Economic Order," 2012. Analysis varies, but some estimate that currency manipulation has cost the US domestic economy hundreds of billions of dollars a year and millions of jobs. The US Commerce Department has estimated that $1 billion in US exports would add around 5,000 jobs. In 2012, the US Federal Reserve estimated that currency manipulators have cost the US between 3 and 5 million jobs.

[12] Source: Center for Strategic & International Studies ("CSIS"), M. Blesser, "The Drive to Decouple," January 24, 2023. See also, The Peterson Institute for International Economics "Trump Trade War Timeline" for detailed chronology of the US -China trade war and effected sectors and goods.

[13] Source: Ibid.

[14] Source: US Treasury 's Office of Foreign Asset Control ("OFAC") and US Commerce Department blacklist.

[15] Source: Gallup, "US Views of Foreign Trade Nearly Back to Pre-Trump Levels," March 10, 2022.

[16] Source: Ibid.

[17] Source: Whitehouse, US Department of Commerce, "Build Back Better", CHIPs Act, Inflation Reduction Act.

[18] Source: Pew Research Center, "Most Americans Support Tough Stance Toward China on Human Rights, Economic Issues", March 4, 2021.

[19] Source: Atlantic Council April 13, 2022. Treasury Secretary Janet Yellen's Speech "Next steps for Russia sanctions and 'friend-shoring' supply chains."

[20] Source: US Treasury Department Press Release, "Treasury Department Mobilized Semiconductor Supply Chain Investment Incentives with Key CHIPS Investment Tax Credit Guidance," March 21, 2023. The CHIPS ITC provision includes a 10-year claw back of the original credit which follows the sizing of facility investment.

[21] Source: National Institute of Standards and Technology ("NIST"), "Commerce Department Outlines Proposed National Security Guardrails for CHIPS for America Incentives Program," March 21, 2023.

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The historical impact of globalization

For much of the past three decades, globalization was considered an unmitigated positive. From an economic perspective, it increased growth and reduced inflation, leaving much of the world's population better off than it had been previously. From a corporate perspective, globalization increased specialization, decreased labor costs, and increased profitability.[22] However, a more nuanced picture emerges when this period is examined more closely.

[22] Source: Center for Economic Policy Research ("CEPR"), Y. Xu et al., "Globalisation, Specialisation, and the Division of Labour," August 7, 2021.

Trade and growth

Global trade grew from around twenty percent of global GDP in 1970 to over fifty percent of global GDP in 2008 (see Figure 3). This was happening as the world's gross domestic product grew from $2.9 trillion dollars in 1970 to $85.1 trillion dollars in 2020.[23]

[23] Source: World Bank and FRED. Annual data as of September 2022.

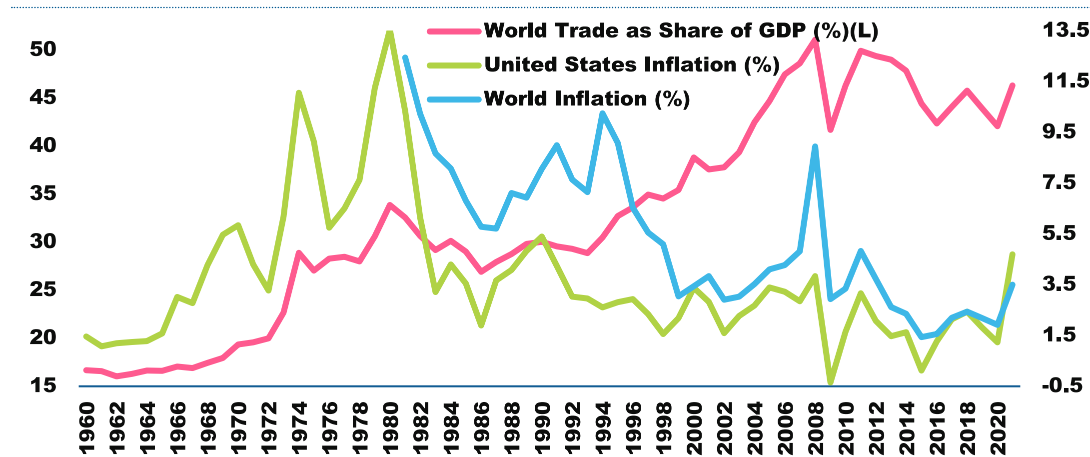

FIGURE 3

Global Trade and Global Inflation (1970 – 2021)

Sources: World Bank and United Nations Conference on Trade & Development Trade Analysis Information System ("UNCATD TRAINS") and FRED. US corporate profits after tax as a percentage of GDP. Inflation, consumer prices for the World. Annual data as of September 2022.

A major driver of these increases in trade and growth was that globalization expanded developing countries' access to global capital markets and investment. Classical economic theory argues that relative differences in productivity can lead to greater aggregate efficiency and growth.[24] When individuals and entities are free to pursue economic activities that they are best at, the result is the efficient allocation of capital. Trade of specialist goods and services is the most efficient use of labor and resources.[25] As countries adopted trade liberalization policies, access to new markets and trading partners offered new avenues for economic growth and investment. Multinational firms were quick to leverage and integrate competitive advantages across borders for sourcing of inputs and accessing markets. For developing nations, the expansion of trade allowed for countries to compete on the basis of comparative advantage.

[24] Source: Brookings, D. Bahar, "Diversification or specialization: What is the path to growth and development," November 16, 2016. David Ricardo.

[25] Source: Adam Smith, "The Wealth of Nations", 1776.

Specialization and efficiency have dominated corporate investment decisions since the 1990s. For example, just-in-time manufacturing and inventory systems connected specialist manufacturers from far-flung regions in the production of other goods. However, such levels of specialization also introduced fragility to the system, leaving these entities vulnerable to geopolitical risks, raw material or labor shortages, etc.

Inflation and global capital markets

In the 20th century, there were multiple periods of low and stable inflation in the US.[26] The period from 1982 to 2021 was by far the longest such period. And this trend

[26] Source: Brookings, J. Ha et al.,"Is High Inflation Here to Stay?" April 5, 2022.

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was not limited to the US. Global inflation averaged just 3.4% per annum from 2000 through 2020.[27]

Several factors contributed to the most recent period of low and stable inflation, including trade and financial openness, central bank independence, and inflation-targeting monetary policy.[28] Globalization increased global competition across borders, and openness to trade helped drive the price of goods and labor lower even as demand grew.[29] In the 1990s, many governments in emerging economies gradually adopted policies advocated by the IMF and the World Bank that included trade openness, flexible exchange rates, fiscal responsibility, and privatization of state assets. As developing countries adopted these policies, often as part of a multilateral aid package from the IMF and World Bank, trade expanded and economic instability and inflation started to fall.

[27] Source: FRED, Inflation, consumer prices for the World. Annual data as of September 2022.

[28] Source: World Bank, editors J. Ja et al., "Inflation in Emerging and Developing Economies."

[29] Source: Brookings, J. Ha et al.,"Is High Inflation Here to Stay?" April 5, 2022.

Economic stability attracted foreign investment. Global capital markets permitted investors access to new markets and investment opportunities based in other regions. Between 2000 and 2021, the MSCI All Country World Index – representing approximately 95% of global listed stocks - grew from 2,187 securities to 2,966 securities, despite the number of listed US companies shrinking.[30] The expansion of trade and access to capital helped to rein-in global inflation (see Figure 2). Inflation, which had averaged 7-10% in the 1980s, fell to around two percent for most of the 2010s.[31]

[30] Source: MSCI as of March 2023.

[31] Source: FRED. Inflation, consumer prices for the World. Annual data as of September 2022.

Economic growth

As developing countries benefited from foreign investment and higher wages, local financial markets also matured, allowing public investment and expansion of public services. The period of globalization from the early 1990s through 2020 saw living standards rise across the developing world. Since the 1980s, the percentage of the world's population living on less than two dollars a day fell from over forty-two percent to less than ten percent.[32] In particular, China experienced the most rapid decline in poverty on historical record, lifting between 400 and 500 million people out of extreme poverty between 1980 and 2013.[33]

[32] Source: World Bank UNCATD TRAINS as of March 2023. Annual data through 2019.

[33] Source: IMF, S. Jain-Chandra et al., "Inequality in China - Trends, Drivers, and Policy Remedies," June 2018. Between 1980 and 2015 the number of Chinese people in the lowest decile of income declined by 86%. However, income inequality remains high.

Trade of goods and services reflects a surplus that is available to trade outside of a nation's domestic economy. When countries are able to produce more than enough goods and services to meet their own needs, the ability to sell the surplus boosts the gross domestic product of a country.[34] In 2021, the World Bank estimates that 57% of global GDP came from international trade, which was down slightly from the 2008 peak of 61%.[35]

[34] Source: Gross Domestic Product ("GDP") = Private Consumption Spending + Investment + Government Spending + **Exports minus Imports.**

[35] Source: World Bank UNCATD TRAINS data as of April 23, 2023. The 2008 peak of global trade to GDP may have reflected slower domestic demand or decline in investments where trade remained at quite high levels. Since 2008, the ratio has not returned to its former highs. However in 2011 the ratio did reach 60%.

Profitability

Since the 2000s, multinational corporations have enjoyed generous profit margins as they pursued low-cost production strategies in relatively unregulated developing economies. These corporations built complex, multi-country supply chains connecting low-cost producers delivering cheaper goods to global consumers. US corporate profits as a share of US GDP rose from around five percent of GDP to around 10% of GDP (see figure 4).

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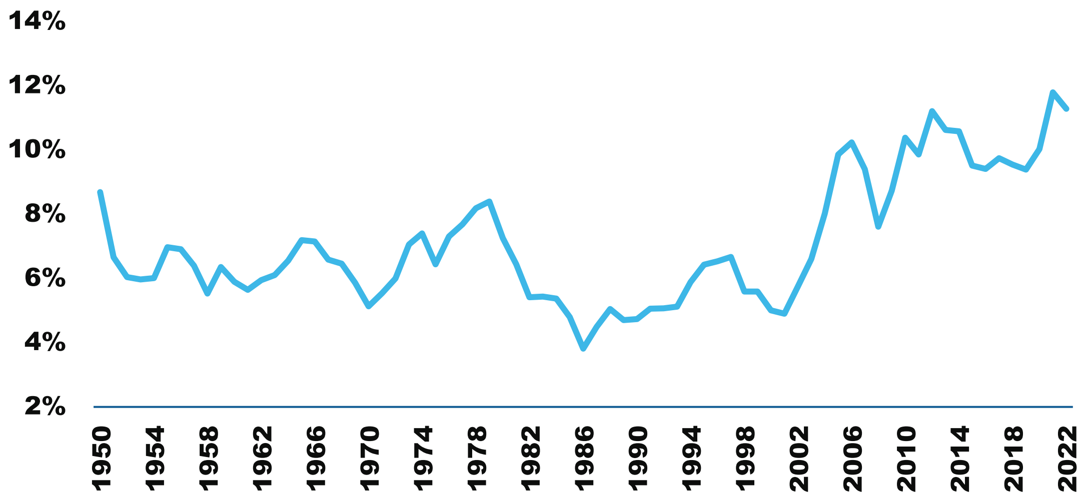

FIGURE 4

US Corporate Profits as a % of GDP

Source: Meketa analysis of data from FRED. Corporate Profits After Tax (without IVA and CCAdj), Seasonally Adjusted Annual Rate, and Gross Domestic Product, Seasonally Adjusted Annual Rate.

Employment and income

The net impact on employment of globalization has been positive, as a significant number of people in developing countries have entered the global labor force. According to the Organization for Economic Co-operation and Development ("OECD"), the poorest of the world's population saw their income increase by 20% between 1993 and 2008.[36] For decades, the shift from subsistence farming to manufacturing and urbanization provided global corporations a massive influx of inexpensive labor.[37] But globalization's substantive benefits obscured numerous pitfalls, such as stagnant wages in advanced economies, the loss of manufacturing jobs in Europe and the US, and expanding income inequality both within and across countries.

At the end of the 1970s, there were nearly twenty million manufacturing jobs in the US, which fell to less than twelve million jobs by 2010. There is some debate among economists regarding the extent of the impact of globalization on the loss of manufacturing jobs in the US. Some point to the role of automation and technology as having a larger impact in reducing the number of manufacturing jobs.[38] Manufacturing in the US has nearly doubled in value to $2.3 trillion dollars since China joined the WTO in 2001, but the number of workers in manufacturing fell from around 17 million workers to around 13 million in 2021 (see Figure 5).[39] Over that same period, the US share of GDP from manufacturing fell from 13% to around 10% as the value of the service sector expanded.[40] The apparent decline in manufacturing as share of GDP can be associated with efficiency and productivity in the manufacturing sector, along with greater accumulation of wealth that has been used to purchase consumer goods and services.[41]

When we look at labor compensation, we note that US workers' wages as a share of GDP declined over the same period. Wages started to fall as a share of GDP in the 1970s. There was a short-lived rebound that peaked in 2001, when China joined the WTO. It then fell for much of the next twenty years to around 60% of GDP (see Figure 5). It is unclear how much of this decline was due to the side effects of global trade versus other factors, such as disruptive technological advancements.[42]

[36] Source: OECD, "Why Open Markets Matter" as of April 2023.

[37] Source: Ibid.

[38] Source: Atlanta Federal Reserve, S. Alder *et al.*, "The Decline of the US Rust Belt: A Macro Economic Analysis," CQER Working Paper 14-05 August 2014.

[39] Source: FRED as of April 23, 2023.

[40] Source: FRED as of April 23, 2023. Deindustrialization in the US was evident in the 1960s and 1970s when consumption grew more important as a driver of GDP. In 1965 manufacturing accounted for approximately 28% of the US economy. See also, IMF R. Rowthorn et al., "De-industrialization – Its Causes and Conditions," 1997. Deindustrialization is considered to be a part of economic maturing.

[41] Source: IMF, R. Rowthorn *et al.*, De-industrialization – Its Causes and Conditions," 1997. Deindustrialization is considered to be a part of economic maturation.

[42] Over the past century, higher wages have prompted companies to invest in technologies to boost productivity without hiring more workers. On balance, when wages rise to a point where the alternative technology investment makes sense, new technology advances emerge. Disruptive technologies and novel shared-economy solutions have revolutionized transportation (Uber), accommodation (AirB&B), and retail investing (RobinHood). But rather than suppress incomes, investment in technology ultimately has shown to boost overall worker income over time. Over the past 200 years, technology advancements have increased wages ten-fold while productivity increased.

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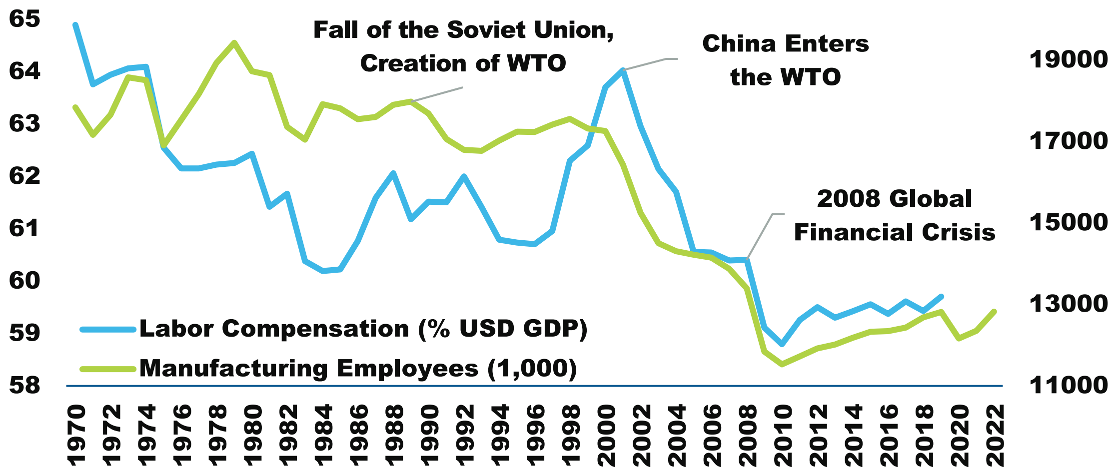

FIGURE 5

US Manufacturing Jobs (Millions of Employees) & US Labor Compensation (% GDP) 1970 -2022

Source: FRED as of May 2023.

Although global trade has helped lift living standards of the very poor, income inequality has risen inside countries and across countries since the founding of the WTO in 1990.[43] Rising inequality in major emerging market countries and in some developed markets has fueled criticism of globalization. When China joined the WTO, its income inequality was modest with a ratio of 29, but this measure has risen quickly to around 47 by 2020 (see Figure 6). An often-cited result of income inequality is an increase in political divisions.

[43] Source: IMF, F. Jaumotte *et al*, "Rising Income Inequality: Technology, or Trade and Financial Globalization?" 2008. Trade is associated with reducing inequality while global capital market expansion is indicated as increasing income inequality.

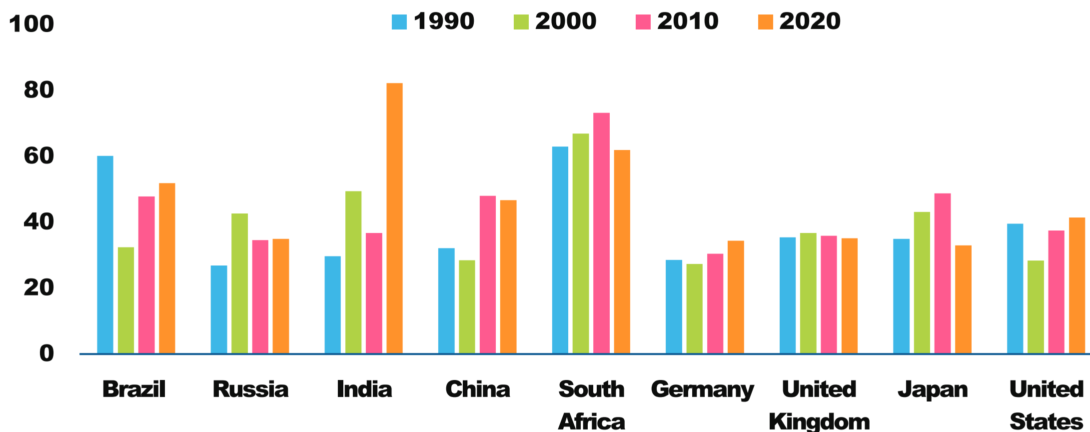

FIGURE 6

Income Inequality by Decade (1990 – 2020)

Source: WIID Income Inequality annual income inequality as of May 2023. The World Income Inequality Index (WIID) annual income inequality data reflects independent and consistent income inequality measurement. Official multilateral and national estimates may vary and reflect different official calculation methods and statistics.

Peace dividend

The fall of the Soviet Union and the end of the Cold War left the West's post-WWII multilateral organization without a diplomatic and economic foe. The IMF, NATO, the World Bank and other Western institutions expanded their membership and reach. Former economic and political rivals became trade partners. Communist China joined the WTO in 2001. The Eurozone monetary union was signed into existence in early 1992, establishing common structures and rules for the creation of a single currency.[44] Within a decade, the European Union agreed to terms to put former Soviet nations of eastern Europe on the path to membership.[45] For nearly three decades, the expansion of trade and financial relationships appeared to reduce military and diplomatic tensions, the so-called 'peace dividend' of globalization and multilateralism.

[44] Source: European Central Bank, "Economic and Monitory Union" as of April 2023.

[45] Source: Ibid.

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Political backlash

Since the Global Financial Crisis ("GFC") in 2008, the rate of trade growth and globalization slowed as political appetite for liberalizing reforms waned. Global trade quickly rebounded to its pre-GFC levels, but the annual growth rate of trade slowed notably. Although global trade continued, its general growth trend slowed (see Figure 7). Falling energy and commodity prices cannot entirely explain the slowing of trade growth as the same pattern is evident in manufactured goods over the same period.[46] The slowing growth rate of global trade in the years after the pandemic were accompanied by a pullback in global foreign direct investment and cross-border bank lending.[47]

[46] Source: World Trade Organization ("WTO") annual trade data as of March 2023.

[47] Source: Bank for International Settlements, S. Avdjier *et al.*, "The Shifting Drivers of International Capital Flows," 2016.

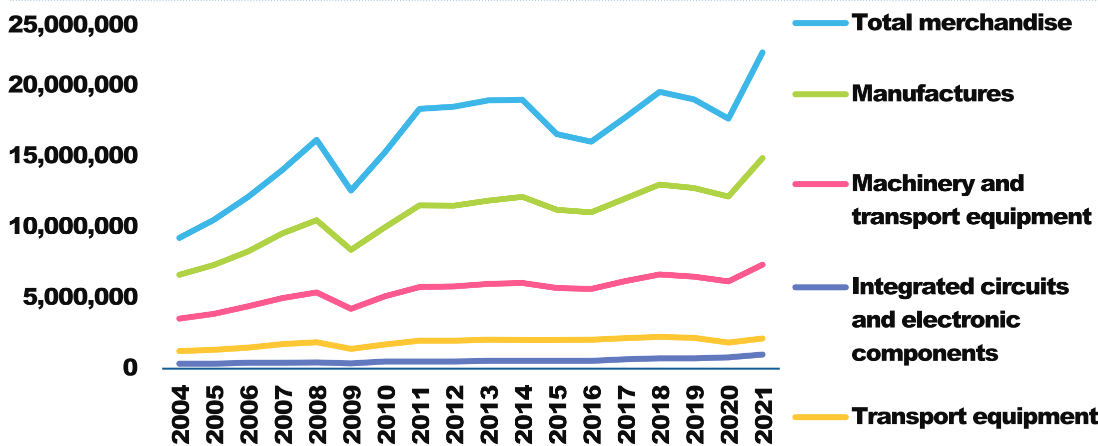

FIGURE 7
Annual World Trade Data 2004 – 2021 ($M)

Source: World Trade Organization (WTO) annual trade data as of March 2023.

Likewise, since 2010, foreign investment has increasingly been directed to "friendly" countries, as defined by those nations that are geopolitically close to each other (see Figure 8). This is a reversal of the trend toward more geographically and geopolitically diverse FDI levels prior to the GFC.

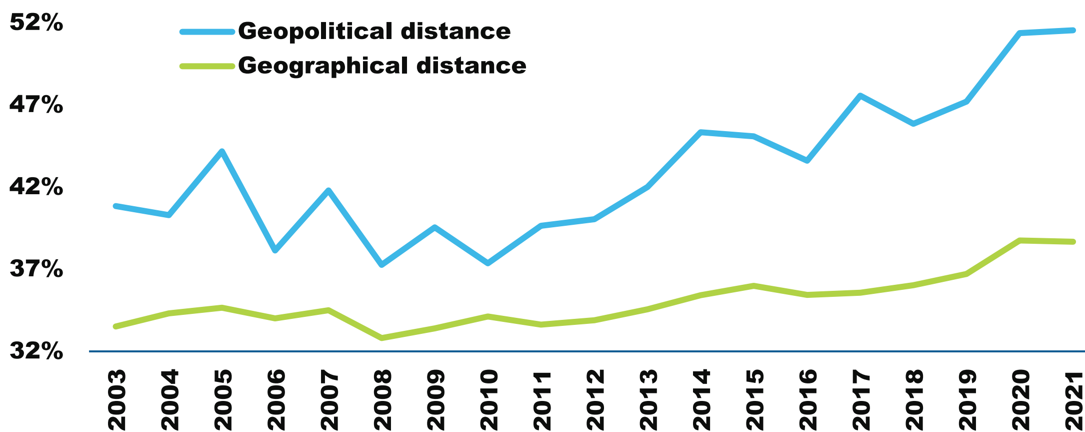

FIGURE 8
Foreign Direct Investment Between Geographically and Geopolitically Close Countries

Source: IMF World Economic Outlook April 2023. Chapter 4. "Importance of geopolitical distance for FDI has increased. Figure shows the annual share of total foreign direct investments between country pairs that are similarly distant (that is in the same quintile of distance distribution), geopolitically and geographically, from the United States.

The backlash against unbridled globalism and multilateralism has been connected to the rise of populist and nationalist domestic policies in the advanced and developing world. Some people feel that their cultural identities and economic interests are being threatened by global forces, such as international trade and immigration. This has led to a backlash against globalization in many parts of the world and has fueled

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the growth of nationalist and anti-globalization movements. In some cases, this has led to increased polarization and divisiveness in politics.

In addition, the benefits and costs of globalization have not been distributed evenly across countries and within societies. Some people have benefited greatly from globalization, while others have been left behind or even harmed by it. This has contributed to political polarization, as different groups have competing visions of how to address the challenges and opportunities of globalization.

Deglobalization's economic ramifications

Slower global growth

Some analysis suggests that reshoring of supply chains may be detrimental to growth as costs will rise.[48] Countries and corporations that pursue self-sufficiency policies may experience lower rates of growth and higher prices for goods, services and labor.[49] For some sectors of global trade, the costs for reshoring may outweigh perceived policy benefits. But for strategic industries like high tech goods and materials (e.g., semiconductors and pharmaceuticals), reshoring some of the supply chain could be beneficial.[50]

After decades pursuing lowest-cost production, the building out of diversified supply chains may result in lower return on investment for corporations. Companies seeking to diversify their supply-chains may be forced to deploy capital on duplicative capacity rather than to optimize and streamline current productive capacity. Building new production facilities (i.e., green field investment) may have a lower rate of return than upgrading current machinery or facilities. Likewise, many developing countries will require infrastructure investment designed to facilitate trade, such as roads, ports, and airports. From the perspective of the global economy, multiple smaller infrastructure projects may have less economic return than a few very large projects, such as ports that can accommodate super-tankers and large intermodal facilities. Taken together, invested public and private capital may experience lower rates of returns and increase the costs of goods for consumers.[51]

[48] Source: CSIS, C. Savoy et al., "Diversifying Supply Chains: The Role of Development Assistance and Other Official Finance," June 2022.

[49] Source: CSIS, D. Runde et al., "Recovery with Resilience: Diversifying Supply Chains to Reduce Risk in the Global Economy," September 2020.

[50] Source: CSIS C. Savoy et al., "Diversifying Supply Chains: The Role of Development Assistance and Other Official Finance," June 2022.

[51] Source: Project Syndicate, K. Rogoff, "Deglobalization Will Hurt Growth Everywhere, June 3, 2020.

High inflation

As globalization and interdependency helped to reduce global inflation pressures, if the process goes into reverse, inflation pressures could rise. The disinflationary drivers of globalization and expansion of supply chains may be waning. The demographic dividends of a rapidly growing young global workforce are now dissipating. Higher labor costs could force companies to reconsider their supply chain. For example, the average monthly wage in Mexico is $480 a month compared to the average wage in China of $840.[52] Multinational companies are investing in Mexico with its younger, cheaper work force and access to the NAFTA free trade zone. But there are limits to new areas of cheap labor and reshoring, as reconfiguring supply chains can be costly.

[52] Source: Baker Institute, D. Gantz, "Will New Chinese Investment in Mexico Benefit North America?" March 2023. See also New York Times, P. Goodman, "Why Chinese Companies Are Investing Billions in Mexico" February 3, 2023.

Lower profitability and investment returns

The higher cost of capital and higher wages could negatively impact corporate earnings, especially if corporations are not able to completely pass these costs on to their customers. The inflation of 2021 was expected to have a major hit on profitability,

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but instead, most businesses were able to pass through their new, higher costs. However, this may have been an anomaly, as demand was fueled by pandemic fiscal stimulus. More broadly, US corporate profits have been a larger share of GDP over the past two decades than they were historically (see Figure 8). If this trend was partly fueled by globalization, it is reasonable to expect that a reversal of globalization will hurt corporate profitability.

Higher wages can also mean higher levels of unemployment where less skilled workers or new entrants into the labor force find it increasingly difficult to find work. During the 1970s, when inflation surged with the oil crises, wages were high but so was unemployment.[53] The net impact was slower economic growth and market volatility. Higher interest rates and inflation combined with lower growth may impact corporate profitability. High labor and manufacturing costs are more easily passed along to consumers when the economy is growing than when it is stagnant.

[53] Source: https://meketa.com/leadership/stagflation/

The combination of the lower growth and higher inflation poses challenges both for central banks and the private sector. Deglobalization may result in a toxic mix of inflation and low growth otherwise known as stagflation. The traditional central bank toolkit is ill-equipped to deal with such an environment.

Where could we be wrong?

The combination of a pandemic and geopolitical turmoil has wreaked havoc on the global economy and brought about many changes. However, it is as yet unclear which of these changes may be temporary versus permanent. For example, the work-from-home response to pandemic lockdowns could be temporary, as people have gradually been returning to work in physical offices.[54] Or it could be a permanent feature of economic activity going forward, with implications for urban real estate and businesses everywhere. The pandemic and the War in Ukraine have refocused governmental policy and focus on domestic security. But it remains to be seen if these impulses will be long-lived.

[54] Source: Wall Street Journal, G. Guilford, "Work from Home Era Ends for Millions of Americans," March 25, 2023.

Many of the potentially inflationary forces we noted could be cyclical instead of secular headwinds. The global pandemic unleashed a series of sudden stops, shutdowns, and stimulus-fueled reopening demand booms around the world. The effects on labor markets and supply chains drove inflation to multidecade highs. The momentum of inflation pressures, labor shortages, and demand for housing and goods has forced central banks to aggressively raise interest rates. The Russian invasion of Ukraine added fuel to the fire where energy and food prices rose rapidly in 2022. But many of these trends have reversed. Food and fuel prices have fallen from their peaks, though they remain elevated relative to the previous decade.

The reshoring of critical sectors and technology could help reduce diplomatic and security concerns. Some diversification away from China was to be expected as wages rose far above their neighbors in Southeast Asia.[55] Outside of Singapore, China has the

[55] Source: The Economist, "The Future of Factory Asia: A Tightening Grip – Rising Wages Will Only Strengthen Asia's Hold on Manufacturing," March 2015.

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highest wages in the Asian region, and as the Association of Southeast Asian Nations Economic Community trade bloc matures, manufacturing is expected to move out of China.[56] The bottom line is that, despite many headlines about deglobalization, it is not (yet) evident in global trade metrics. The value of global trade reached a historic high in 2022, topping $32 trillion dollars.[57]

[56] Source: Ministry of Trade for New Zealand Government, "The China-ASEAN Dynamic, February 2016. The ASEAN Economic Community is a trade block founded in December 2015.

[57] Source: World Bank UNCTAD data as of December 2022.

How will deglobalization risks impact investment returns?

The pace and degree of deglobalization is unknowable as the evidence for outright deglobalization remains mixed. As with most investment decisions, there are trade-offs where risks and potential returns help guide asset allocation and portfolio discussions. With this in mind, we designed a scenario analysis with a focus on a range of potential outcomes.

In our analysis we considered four potential deglobalization scenarios. The premise of our most optimistic scenario is that governments will rediscover their pro-trade multilateralism, which could reboot globalization. Our next scenario resembles the current situation, extending the current drift of regionalism and rerouting of global trade and capital flows within trade blocs. Our third scenario considers what might happen if outright deglobalization becomes prevalent. Our final scenario is the most bearish, as it ponders the consequences of a military blockade and embargoes related to a military conflict over Taiwan.

Should globalization resume its long-term trend, our model estimates that investor returns will benefit. However, slower globalization or regionalism will likely weigh on portfolio returns due to the negative impact on economic growth. A well-diversified institutional portfolio might experience a decline in expected returns of between -0.5% and -1.5% per annum in all but the worst-case scenarios.[58]

[58] We describe our scenario analysis and the outcomes in greater deal in the appendix.

Conclusion

Deglobalization could have significant impacts on global growth, inflation, and politics. One potential impact of deglobalization is a reduction in global growth. Economic integration has helped to increase productivity and efficiency, and it has allowed countries to specialize in the production of goods and services in which they have a comparative advantage. Reduced economic integration could lead to a decline in trade, investment, and innovation, which could ultimately lead to slower economic growth.

Deglobalization could also have an impact on inflation. Globalization has contributed to lower prices for goods and services, as countries have been able to take advantage of lower labor and production costs in other countries. Reduced economic integration could lead to higher prices, as companies face higher production costs and trade barriers.

In terms of politics, deglobalization could lead to a rise in nationalism and protectionism, as countries seek to protect their domestic industries and reduce their dependence

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on foreign trade and investment. This could lead to increased tensions between countries and a breakdown in international cooperation. However, it is important to note that the impact of deglobalization on global growth, inflation, and politics is complex and uncertain, and will depend on the specific policies and circumstances involved.

Institutional investors can take a variety of steps to respond to deglobalization. First is to construct portfolios that are geographically diversified. Specifically, equity portfolios should provide exposure to a range of regions and economies. This could mean that portfolios include companies that have diversified operations across multiple countries or regions.

Investors should also monitor political developments. The trend of deglobalization is closely tied to political developments, and investors should monitor political risks and changes in policy. This could include paying attention to election outcomes, trade negotiations, and other policy changes that could affect global markets.

Finally, investors should consider the long-term perspective. While the trend of deglobalization could lead to short-term volatility and uncertainty, it is important to consider the long-term prospects of the global economy. Over the long term, economic growth and innovation are likely to continue, even as the global economic landscape evolves. Investors should focus on building well-diversified portfolios that can weather short-term volatility and continue to benefit from long-term growth opportunities.

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Appendix: scenario analysis description and output

We modeled four Monte Carlo deglobalization simulation scenarios: Rising Globalization, Stalled Globalization, Moderate Globalization, and Chinese Assets Embargoed. Rising Globalization is defined as a return to long-run globalization trends after 2 years, combined with an increase in US onshore production and increases Chinese demand for goods. Stalled Globalization is defined as a broad slowdown of in growth of the global economy and Chinese trade growth slowing to 2%-5% per year. Moderate Globalization is defined as an increase in established trade blocks reducing global trade and GDP growth by 25%, and Chinese trade growth declines by 50%. The Chinese Assets Embargoed scenario is defined by an immediate 50% decline in global trade and GDP, while Chinese assets receive the same treatment as Russian assets did during the early half of 2022.

Our model uses Monte Carlo scenario analysis incorporates machine learning to identify the probabilities and paths of returns for each scenario. Each scenario includes 10,000 trials and forty-seven economic variables to determine probabilistic paths of portfolio returns. We used our Large Public Plan universe[59] as our sample portfolio which included US and non-US equities, global fixed income, hedge funds, real estate and private equity.

[59] Meketa annually compiles a peer universe average for large public plans that is based on the asset allocation of the ~50 largest US public pension plans as published in their most recent (e.g., 2022) Annual Comprehensive Financial Report and/or quarterly reports.

Meketa's asset allocation modeling tools allow us to conduct scenario analyses on a wide variety of long-term capital market risks. Meketa uses a top-down, statistical approach to give asset allocators a "big picture" estimate of potential impacts to returns and risks that they might face in fundamentally uncertain situations where the magnitude, direction, and timing of economic shocks and investment risks can vary substantially from historic experience during typical economic cycles.

Each of our simulation models iteratively generate monthly return data for 47 different economic, financial, and climate factors by using available historical data to estimate relationships among these variables. The process assumes a randomized movement of each factor consistent with its historical behavior. The impact of all other relevant factors is added to derive a forecasted monthly return for each asset class. We repeat this process for each month in the forecast period to generate a simulated return stream stretching across the entire period (a "simulation"). We then repeat this process to create multiple simulations. The relationships of 104 asset classes to these factors are estimated based on historical data and then applied to the simulated pathways, generating asset class returns for each simulation.

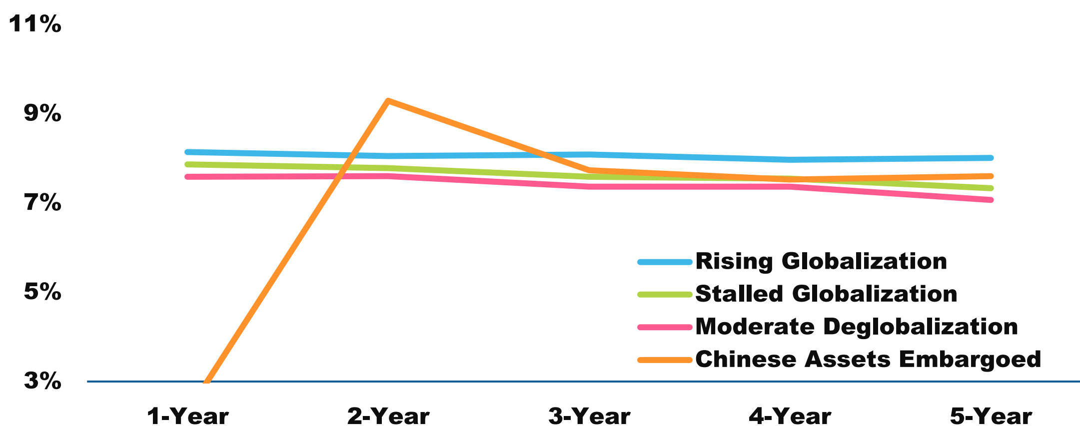

FIGURE 9
Four Globalization Scenarios Average Annual Return (50th Percentile Estimates)

Source: Meketa's Deglobalization Scenario Analysis as of May 2023.

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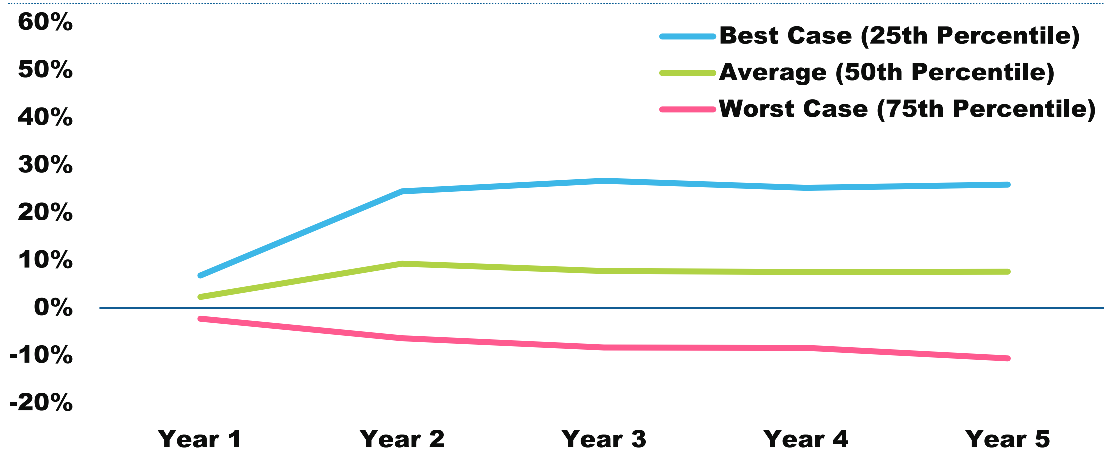

FIGURE 10
Portfolio Annualized Return Probabilities for the Chinese Assets Embargoed Scenario

Source: Meketa's Deglobalization Scenario Analysis as of May 2023.

FIGURE 11
Model Asset Allocation Expected Returns (%)

Source: Meketa's Deglobalization Scenario Analysis as of May 2023.

	Large Plan Asset Weight (%)	Meketa 10-Year Expected Returns (%)	10-Year China Assets Embargoed Scenario Expected Returns (%)	Year 1 (%)	Year 2 (%)	Year 3 (%)	Year 4 (%)	Year 5 (%)
Cash Equivalents	2.0	3.10	3.86	5	4	3	3	3
Investment Grade Bonds	9.1	4.80	7.41	12	7	6	5	6
Long term Government Bonds	3.2	4.30	6.05	10	7	3	4	6
TIPS	0.7	4.30	7.69	13	7	6	5	7
High Yield Bonds	1.9	8.00	9.34	8	9	9	10	11
Bank Loans	1.3	7.60	9.39	8	8	9	10	12
Private Debt	4.6	9.40	7.62	2	11	9	8	8
Foreign Bonds	0.6	3.80	2.79	1	4	3	3	3
Emerging Market Bonds	0.8	6.40	5.09	2	6	6	6	6
US Equity	25.0	7.80	6.94	2	10	8	8	7
Developed non-US Equity	11.8	10.10	8.40	-3	13	11	11	10
Emerging Market Equity	4.4	10.30	5.85	-8	11	9	9	9
Private Equity	14.7	9.70	8.01	2	9	10	10	9
Real Estate	10.3	5.90	4.41	1	7	5	5	5
Natural Resources	1.0	8.60	7.26	-2	11	9	9	9
Commodities	1.0	6.30	9.00	13	8	7	9	8
Infrastructure	2.0	6.90	5.44	1	8	6	6	6
Hedge Funds	3.4	5.40	4.46	1	7	5	5	5
RMS Aggregate	0.8	4.00	2.91	1	4	3	3	3
Risk Parity (10% vol)	0.5	7.80	7.23	2	11	8	8	8
Tactical Asset Allocation	0.9	5.60	5.14	1	8	6	6	6

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THE NCPERS MONITOR
The Latest in Legislative News
August 2023

NCPERS Executive Director's Corner

Why Total Compensation (and Protecting Pensions) is Key to Addressing the Teacher Shortage

By Hank Kim, Executive Director and Counsel, NCPERS

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As teachers across the country are savoring their last few weeks of summer break before preparing to return to the classroom, schools continue to struggle with attracting and retaining educators.

According to a recent report, 86 percent of school districts are experiencing difficulty hiring new teachers. Some districts have resorted to fast-tracking certifications or reducing the requirements for hiring, but these are not sustainable solutions.

Teachers rightfully complain they are not compensated enough, with the same report finding that 78 percent of educators think that low pay is a serious issue. While some might think teachers have to choose between higher pay and pensions, we believe there is a path forward where teachers are both fairly compensated and have access to the long-term retirement security that defined benefit pension plans afford them.

Pensions continue to be a driving force in retaining teachers and other public servants across the country. While there is ample research on the positive effects on worker retention that occur when employers offer a pension, studies looking specifically at teachers have found they were more likely to leave the profession sooner if their benefits are reduced.

In order to solve the long-term challenges of attracting and retaining quality educators, looking at the total compensation offered will be key. Critics of public pensions, however, will argue that pensions are not sustainable and that teachers need to choose between salary increases and retirement security. We analyzed a recent article authored by Andrew Biggs, senior fellow at conservative think tank American Enterprise Institute, that makes this case to illustrate the flaws in these ideological arguments.

Biggs asserts that many teacher pension plans are significantly underfunded, reducing resources for teacher pay and benefits. But recent research from NCPERS found that during the past quarter century, the average pension expenditures were 3.6 percent of state and local own-source revenues. The same figure for education expenditures was 33.8 percent. The fact is that pension benefits are mostly funded through state appropriations, and not usually part of education finance foundation formulae from which salaries are paid.

The author attributes the funding shortfalls that teacher pensions face to an “overreliance on the stock market” and the “funding rules these plans follow.” With this oversimplification, he blatantly overlooks other important determinants of funding ratios that must be examined. For example, employer funding discipline. There is ample evidence that skipping and/or making less than the full actuarially determined contribution is the key reason for underfunding. Biggs also fails to mention that almost all plans in the public sector have revised their return assumptions downward.

He concludes with a less than subtle push for 401(k)-style retirement plans, arguing that teachers could benefit by transitioning away from traditional pensions to a “more sustainable and affordable model that frees up resources for improved teacher salaries.” This approach has proven to be more costly for school systems while simultaneously providing less benefits to educators.

Since Alaska transitioned from a defined benefit plan to the “more sustainable” 401(k)-style retirement plan in 2005, it has faced growing challenges with recruitment and retention—in addition to increased costs. In comparing termination rates between the two plans, women in their prime working years have turnover rates 138 percent higher in the 401(k)-style plans; men have turnover rates 189 percent higher. Another study found that pensions provide better retirement income compared to a 401(k) for 80 percent of teachers. As a result, Alaska is losing $20 million each year due to these retention challenges.

Pensions have been proven to be a key factor in retaining top talent, but misinformed and biased attacks continue to argue that they are not sustainable. While true unfunded liabilities may be rising due to many reasons beyond pension managers’ control (e.g., economic downturns, demographic changes, etc.), so is the economic capacity of plan sponsors. As long as the ratio between unfunded liabilities and total economic output of state and local governments over the amortization period (usually 30 years) is stable or declining, the pension plans are sustainable. As Brookings and NCPERS studies show, state and local pension plans (teachers and others) are sustainable with moderate fiscal adjustments.

Addressing the teacher recruitment and retention crisis—by looking at the total compensation packages—must take precedence. Governments face competing priorities, but they can afford both pensions and increases in education budgets (where raises typically come from). To do so, however, state and local governments must bring their revenue systems into harmony with the economy. ◆

A Simple Solution to the Looming Retirement Security Crisis: Pensions

By Hank Kim, Executive Director and Counsel, NCPERS

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As Gen Xers begin to enter their retirement years, we are starting to see the consequences of the late 20th century shift from defined benefit (DB) pensions to 401(k)-style retirement plans. Americans' insufficient retirement savings will result in a combined $1.3 trillion burden for state and federal governments over the next 20 years, according to The Pew Charitable Trusts. With record levels of inflation, rising health care costs, and Social Security benefits that can't keep up, we are truly facing a retirement security crisis.

According to a study recently released by the Transamerica Center for Retirement Studies and Transamerica Institute, only 17 percent of Gen Xers feel very confident they will retire with a comfortable lifestyle.

Gen X entered the workforce as defined contribution (DC) plans were quickly becoming the norm, and they are the first generation to stare down their golden years without having had broad access to a DB pension plan. A new report from the National Institute on Retirement Security (NIRS) estimates the typical Gen X household has only $40,000 in retirement savings, and only 14 percent of Gen Xers are covered by a DB pension plan.

The outlook is grim as a comfortable retirement seems further and further out of reach for most Americans. And at the same time, employers are struggling with employee retention in a particularly tight labor market.

While the solution to these massive challenges will ultimately require a multifaceted approach, the long-term answer may be simple: Make pensions mainstream again.

Some might assume this solution would automatically be more costly for employers, but research shows otherwise. Defined benefit pensions provide more than twice as much benefit as 401(k)s at the same cost to the employer. For example, NCPERS' analysis of data shows that from 1975 to 2018, the average assets per participant in a private-sector DB plan grew from $5,634 to $184,432. During the same period, average assets per participant in DC individual accounts only grew from $6,432 to $59,186.

According to the Investment Management Institute, administrative and investment costs for DC schemes can also be more than four times higher than for DB plans. Further, DB plans reduce the overall cost of providing lifetime retirement benefits by pooling mortality and risk over a relatively large number of participants.

A 2023 report from JP Morgan Asset Management echoes these sentiments, and also highlights how a well-funded DB pension can actually enhance corporate finance. “A well-funded DB offers the most cost-efficient mechanism to finance retirement benefits for employees. Running a low risk, well-funded plan can be accretive to earnings while also reducing corporate leverage,” its authors note.

Defined benefit pensions can also support the recruitment and retention of workers, reducing cost for employers associated with high levels of turnover. Research shows that 84 percent of millennials in state and local governments said their pension benefit was the reason they’re staying in the public sector, with 85 percent indicating they would stay in their public sector jobs until they retire.

Considering that voluntary employee turnover costs U.S. businesses approximately $1 trillion each year, it’s hard to imagine why more businesses are not offering a pension to help attract and retain quality employees.

While some might think pensions are a relic of the past, they may be key to solving the retirement crisis that our country is facing. Research suggests this would also be popular across party lines, with a national survey indicating that 77 percent of Americans agree that all workers should have a pension.

Addressing Americans’ lack of retirement security will be a critical issue in the coming years. Pensions and annuities offer a lifetime stream of income while providing added benefits such as lower costs for employers and increased employee retention.

So, why not make pensions mainstream again? ◆

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Roth Method Catch Up Contributions

By: Tony Roda, Partner, Williams & Jensen

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During consideration of the 2017 tax legislation by the Senate Finance Committee, then-Chairman Orrin Hatch (R-UT) released a list of potential amendments to the bill that members of the Committee were interested in offering at the upcoming markup. One amendment listed by the Chairman himself would have subjected all catch up contributions to the Roth method, i.e., after-tax contributions and tax-free distributions.

The amendment was never offered. By the time the markup took place there was a distinct loss of appetite on imposing the Roth method. Months earlier, the House Ways and Means Committee was close to mandating the Roth method on most contributions to defined contribution plans, but then-President Trump upended the effort by publicly declaring his opposition to it.

However, legislative proposals never really die in Washington. They just get put on the shelf for a future, more opportune time to be taken down, dusted off, and reintroduced. Such is the case with the Roth method and its application to catch up contributions. Last year, Congress approved, and President Biden signed into law the SECURE Act 2.0. As enacted, the Act requires individuals who made more than $145,000 in the previous calendar year to use the Roth method for all catch up contributions to 401(a) qualified plans, 457(b) governmental plans, and 403(b) plans. The provision is effective for years beginning after December 31, 2023.

This abrupt effective date does not provide a reasonable amount of time for retirement plans to make the change. Some public and private sector plans do not have a Roth option and now must create this feature. Public sector plans have the additional burden of having to amend their plans, which are often found in state statutes, by new law approved by their legislature and signed by the governor. In recognition of this burden, previous legislative and regulatory changes have provided additional time for governmental plans to come into compliance. Unfortunately, the SECURE Act 2.0 with its over 90 separate tax law changes, each of which with its own unique effective date, does not provide a universal extended effective date for governmental plans.

NCPERS has joined its public and private sector allies in writing several letters to the U.S. Treasury Department and the Internal Revenue Service requesting a delay in the effective date. Moreover, a recent comment letter by the New York City Bar Association's Committee on Employee Benefits and Executive Compensation outlined numerous detailed questions on the implementation of the Roth catch up requirement.

While no official government response has been made, we remain hopeful that Treasury-IRS will provide a delay in the enforcement of the Roth catch up changes. NCPERS will be certain to keep its members up to date on any developments in this area. ◆

__Tony Roda__ is a partner at the Washington, D.C. law and lobbying firm __Williams & Jensen__, where he specializes in legislative, regulatory, and fiduciary matters affecting state and local pension plans. He represents the National Conference on Public Employee Retirement Systems and state-wide, 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 the Catholic University of America, and LL.M (tax law) from the Georgetown University Law Center.

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Recognizing the June 2023 Class of Accredited Fiduciaries

By: Lizzy Lees, Director of Communications, NCPERS

NCPERS Accredited Fiduciary (NAF) Program was created nearly a decade ago to help educate public pension trustees and administrators about best practices for plan governance, oversight, and administration. Attendees can earn their Accredited Fiduciary designation, recognized nationally as a prestigious symbol of governance excellence.

The next NAF Program will take place October 21-22 in Las Vegas, immediately preceding NCPERS Financial, Actuarial, Legislative & Legal (FALL) Conference.

In order to earn the Accredited Fiduciary designation, trustees and staff must complete four training modules that cover governance and the board's role; investment and finance; legal, risk management, and communication; and human capital. Upon completion of all four modules, candidates must demonstrate mastery of the content through an exam held in June and December each year.

We would like to recognize the public pension trustees and staff who most recently earned their Accredited Fiduciary designation, demonstrating their commitment to and knowledge of pension plan governance:

- Deborah Cherney, San Bernardino County Employees' Retirement Association
- Pattie Featherston, Austin Police Retirement System
- Andrew Felder, City of Monroe Employees`Retirement System
- William Fowler, Austin Fire Fighters Relief & Retirement Fund
- Oscar Garcia, Fresno County Employees Retirement Association

- David Harer, Retirement Systems of Alabama
- Timothy Heling, Employees' Retirement System of Milwaukee
- Molly King, Employees' Retirement System of Milwaukee
- Brandon Krsak, Firefighters Pension and Relief Fund for the City of New Orleans
- RomanNelson, Firefighters Pension and Relief Fund for the City of New Orleans
- John Perryman, Austin Fire Fighters Relief & Retirement Fund
- Stephen Roy, Firefighters Pension and Relief Fund for the City of New Orleans

Learn more about the NAF Program and enroll in the fall class to start earning your Accredited Fiduciary designation. ◆

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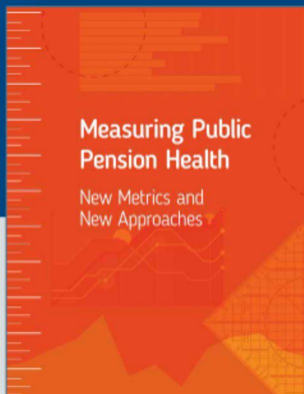

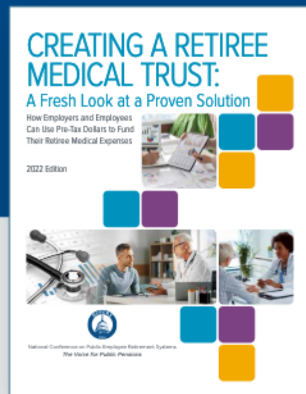

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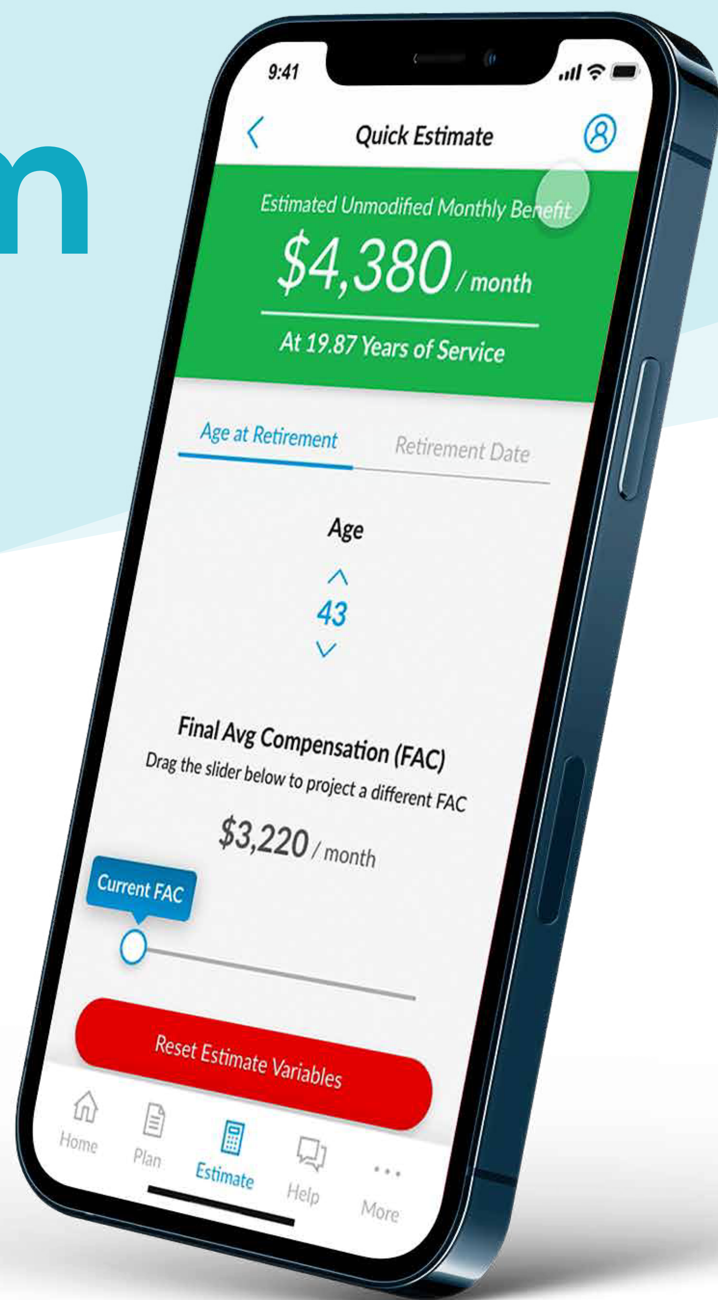
NCPERS PensionX Digital Platform



NCPERS has partnered with Digital Deployment to offer its members a **10% DISCOUNT** on PensionX, the premier digital platform that securely enables pensions to engage with active and retired participants via a mobile self-service app and portal.

pensionX

Learn more about this new NCPERS member benefit at ncpers.org/pensionx

These Arizona Cities are Saving Big Money By Paying Down Pension Debt

Chandler this week became the largest city in Arizona to pay off its public safety pension debt, saving $8-10 million per year in the city's budget and ensuring its police and fire employees receive their promised pensions.

READ MORE *Source: Axios Phoenix*

Missouri Will Exempt Social Security and Public Pension Payments From State Income Taxes

The bipartisan bill, exempting Social Security benefits and public pension payments from income tax, would reduce state general revenue by an estimated $309 million annually.

READ MORE *Source: NPR in Kansas City*

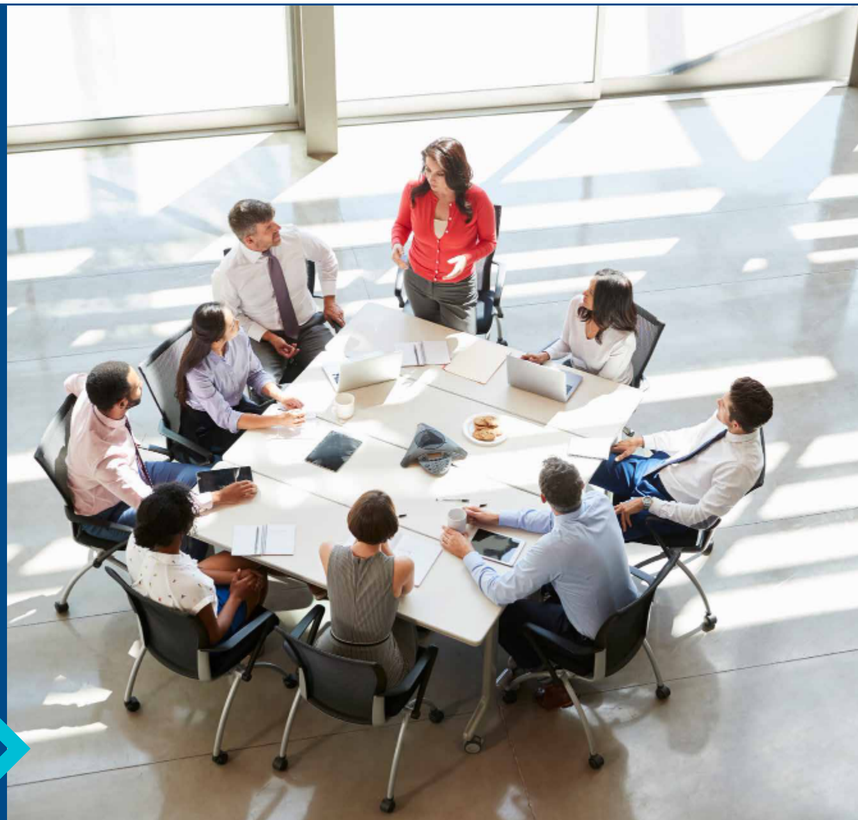
New Jersey Fully Funds Pension System for Third Straight Fiscal Year

New Jersey Gov. Phil Murphy has signed a fiscal year 2024 budget that includes a $7.1 billion contribution to the state pension system, the third consecutive fiscal year in which the state has made the full actuarially determined contribution.

READ MORE *Source: Pensions & Investments*

NCPERS
2023 Public Retirement Systems Study:
Trends in Fiscal, Operational, and Business Practices

READ THE REPORT



California Quietly Shelves $15 Billion Pension Divestment Bill

The California State Assembly has shelved legislation that would have forced the country's two largest pension funds to divest an estimated $15 billion from oil and gas companies, a major blow to environmental advocates who hoped the funds could be a national model for the divestment movement.

READ MORE *Source: Bloomberg*

Florida Sweetens Pension Pot, Hoping to Retain Public Employees

The expansion of the Deferred Retirement Option Program could prove lucrative for career government workers and educators, who will be able to draw pensions while continuing to work for eight to 10 years instead of the current limit of five years.

READ MORE *Source: The Orlando Sentinel*

New York City Clamps Down on Fossil Fuels Via ESG in Defiance of National GOP Blowback

Proponents of ESG investing, such as New York City Comptroller Brad Lander, who oversees the city's pension plans, see ESG investment strategies, for example, moving away from investments in the fossil fuel industry, as compatible with fiduciary duty, as they contend divestments help safeguard plan beneficiaries from the longer-term financial risks associated with disruption from climate change.

READ MORE *Source: Washington Examiner*

Pension Industry Careers: Job Listings, Hiring, and Retirement Announcements

Brought to you by NCPERS

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Calendar of Events 2023

August

Public Pension Funding Forum

ugust 20-22
Chicago, IL

October

NCPERS Accredited Fiduciary (NAF) Program

October 21-22
Las Vegas, NV

Program for Advanced Trustee Studies (PATS)

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.

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The Voice for Public Pensions

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Board of Retirement Meeting

San Joaquin County Employees' Retirement Association

Agenda Item 14.0

August 11, 2023

SUBJECT: Board Committee Assignments

SUBMITTED FOR: ___ CONSENT ___ ACTION _X_ INFORMATION

PURPOSE

To establish the membership of the Board of Retirement's standing committees for the period of August 2023 through July 2024.

DISCUSSION

SJCERA's bylaws require the Board elect its Chairperson, Vice Chairperson and Secretary annually at the July Board meeting.

The bylaws go on to define the role of each officer. Regarding the Chairperson, the bylaws state "The Chairperson shall appoint Board members to standing and ad hoc committees of the Board, which shall consist of now fewer than three and no more than four Board members." The Chairperson makes the standing committee appointments at the August meeting each year.

The Board of Retirement has three standing committees: Administrative, Audit, and CEO Performance Review. Attached to this memo is a document showing the membership requirements of each committee, the members of each committee since 2019, and Chairperson Restuccia's recommended committee appointments for August 2023 through July 2024.

ATTACHMENT

SJCERA Board of Retirement Standing Committees

JOHANNA SHICK
Chief Executive Officer

SJCERA BOARD OF RETIREMENT

STANDING COMMITTEES

	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024 (Appt @ 8/2023 Mtg.)	Membership Requirements
ADMINISTRATIVE COMMITTEE	Bassett, Chair Duffy Goodman McCray	Bassett, Chair Keokham, Goodman, McCray	Goodman, Chair Bassett Keokham McCray	Goodman, Chair Bassett Keokham Nicholas	Duffy, Chair Goodman Keokham Restuccia	Charter: √ At least 1 elected by membership √ Charter does not require any specific experience. √ Note from staff: Committee's duties are budget, Executive HR planning, and policy administration so experience in those areas would be helpful (not required)
AUDIT COMMITTEE	Duffy, Chair McCray Restuccia Van Houten	Duffy, Chair McCray Restuccia Van Houten	Duffy, Chair Keokham McCray Restuccia	Duffy, Chair Keokham McCray Restuccia	Duffy, Chair Keokham McCray Restuccia	Charter: √ 3 to 4 members √ Expertise in accounting, auditing, financial reporting & internal control preferred
CEO PERFORMANCE REVIEW COMMITTEE	Goodman, Chair Keokham Restuccia Van Houten	Goodman, Chair Bassett Restuccia Van Houten	Bassett, Chair Nicholas Restuccia Weydert	Bassett, Chair Restuccia Keokham ~~Rickman~~ (Vacant)	Bassett, Co-Chair Keokham, Co-Chair Duffy Weydert	Charter: √ Retain no more than 50% of members √ Mix of elected & appointed members √ Include a trustee w/ knowledge of County HR practices √ Note from staff: The Board Chair has historically served on this committee, which has been helpful; however, it's not required by the Charter

02/13/2023

SAN JOAQUIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
BOARD OF RETIREMENT

STANDING COMMITTEES

ADMINISTRATIVE COMMITTEE

Jennifer Goodman, Chair
Chanda Bassett
Phonxay Keokham
Emily Nicholas

AUDIT COMMITTEE

Michael Duffy, Chair
Phonxay Keokham
Raymond McCray
Michael Restuccia

CEO PERFORMANCE REVIEW COMMITTEE

Chanda Bassett, Chair
Michael Restuccia
Phonxay Keokham

AD HOC COMMITTEES

FACILITIES AD-HOC COMMITTEE

Michael Restuccia, Chair
Michael Duffy
Jennifer Goodman

INVESTMENT CONTRACT AD-HOC COMMITTEE

Michael Restuccia
Phanxay Keokham
Raymond McCray