Discussion of Alternatives Cap

Joint Committee on Pensions, Investments and Benefits

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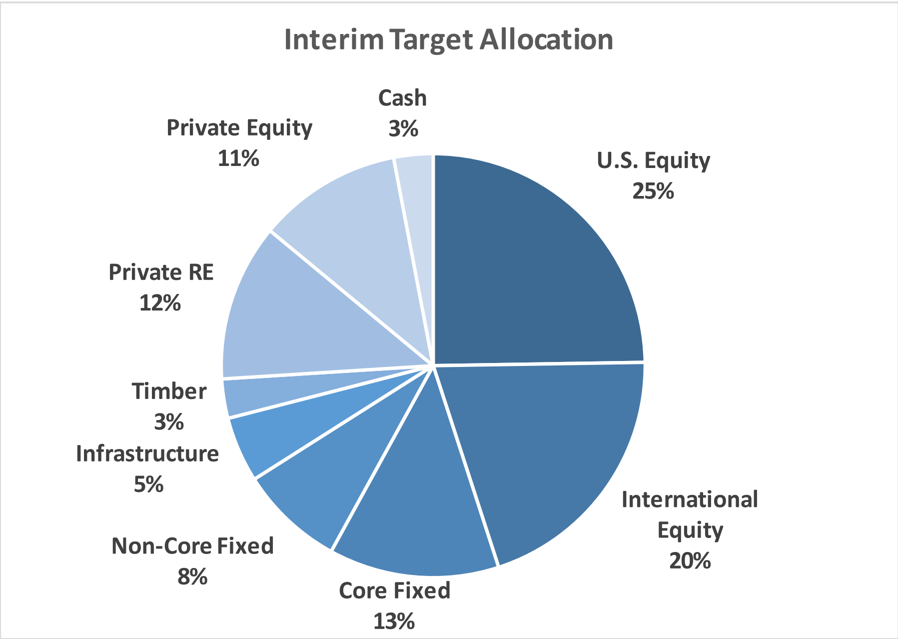
Introduction

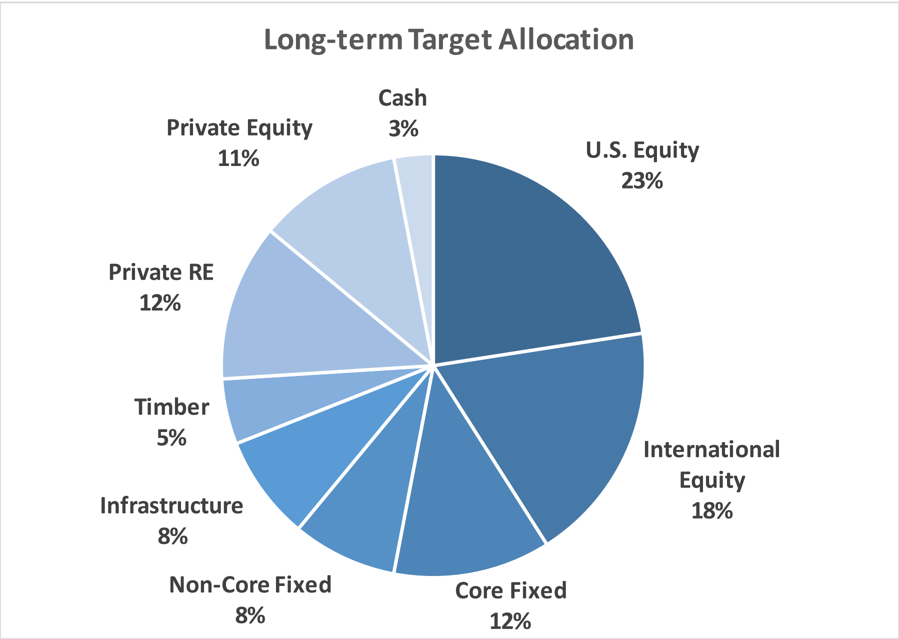
- The cap on alternative investments was increased from 15% to 25% at the close of the 2024 legislative session.
- Following this increase, the System deemed it prudent to revisit the 2023 Asset/Liability Study results.
  - An Asset/Liability Study is conducted by Meketa, the System's general consultant, and Investment staff every three to four years.
  - The Study uses data provided by the System's actuary coupled with Meketa's investment risk/return expectations to model and evaluate asset allocation strategies designed to achieve the System's 7.0% actuarial assumed rate of return assumption while mitigating contribution, funding and other risks to the System.
- The 2023 Asset/Liability Study was concluded In May 2023, under the 15% alternatives cap.
- The System's statutorily defined exposure to alternatives was ~13% during the 2023 Asset/Liability Study.
  - The latitude to consider additional alternatives strategies in the System's portfolio was limited.
- With the increase in the alternatives cap to 25%, Investment staff and Meketa deemed it prudent to revisit the outcomes from the 2023 Asset/Liability Project given the latitude afforded under the new statutory limit on alternatives.
- The 2024 Asset Allocation Review Project commenced in May 2024.

2024 Asset Allocation Review Project

- The 2024 Asset Allocation Review project was conducted under the following guidelines:
    - Maintain the expected rate of return on the allocation adopted in the 2023 Asset/Liability Study.
    - Use the additional latitude under the 25% alternatives cap to reduce risk at the total fund level.
- Expectations for the Project were:
    - The 2023 asset allocation strategy would remain fundamentally intact with adjustments, if any, at the margin.
    - Changes, if any, will be incremental and implemented in a risk-controlled manner.
    - The System would not move to fully utilize the 25% alternatives exposure in the near or intermediate term.
- The goal of the Project was to evaluate asset allocation strategies, now available with the 25% cap, that might serve to better diversify the System's portfolio.
- In September 2024, the Board approved new Interim and long-term allocation targets for the System (detailed on the next slide) which we believe achieved this goal.

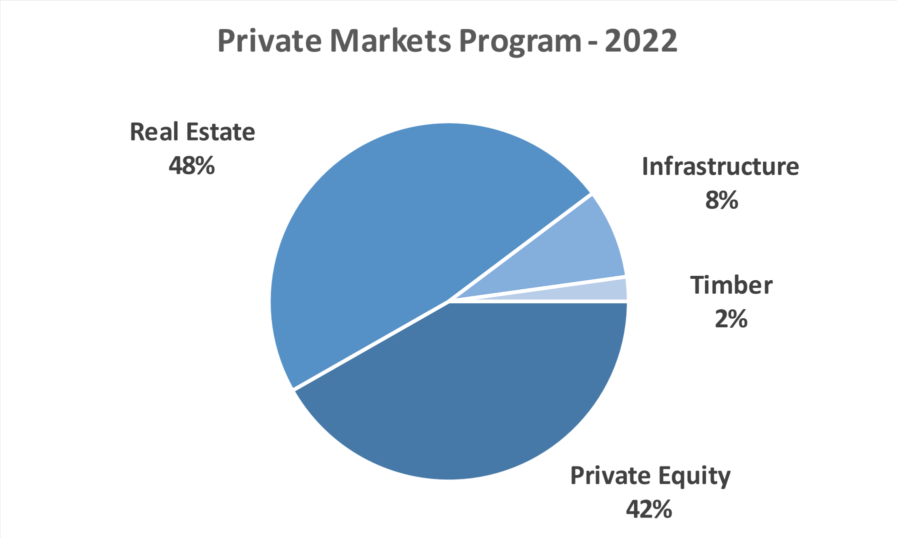
2024 Interim and Long-term Targets

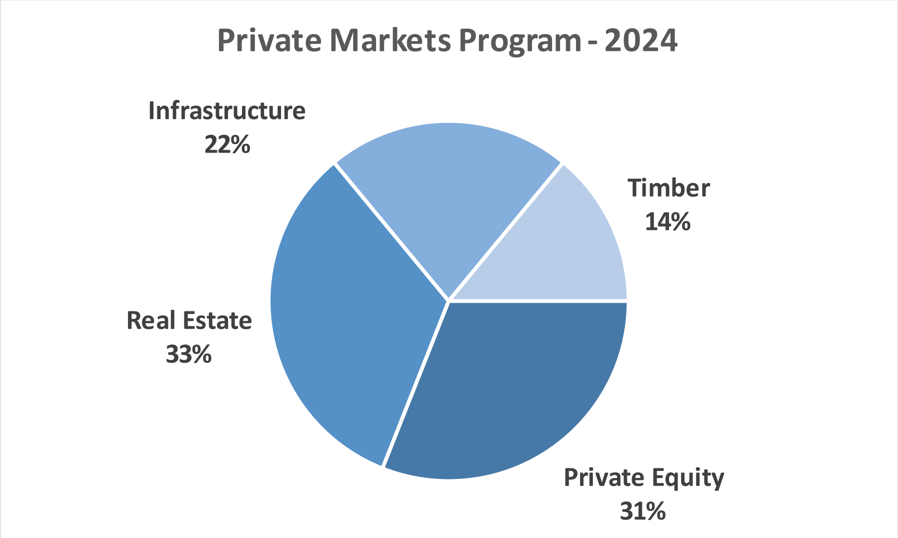




- Interim Targets will be achieved over the next three years.
- Expectations are for Long-term Targets to be reached in five-plus years.
- Long-term targets set a direction for the portfolio and may not end up to be the destination.
- As is the System's practice, a new Asset/Liability Study will be conducted in 2027 or 2028 with necessary adjustments made to Long-term Targets.

Alternatives Cap Update: Diversification

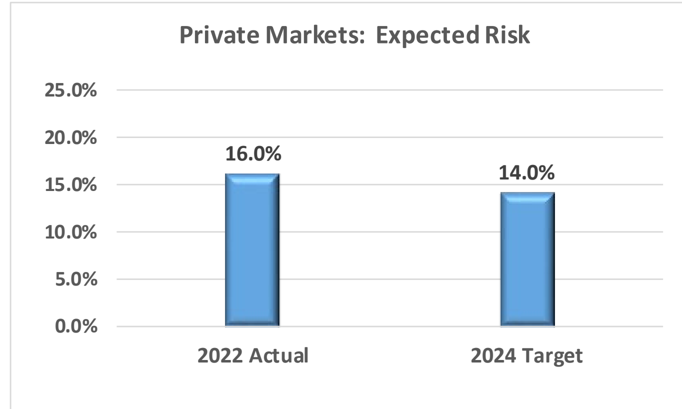


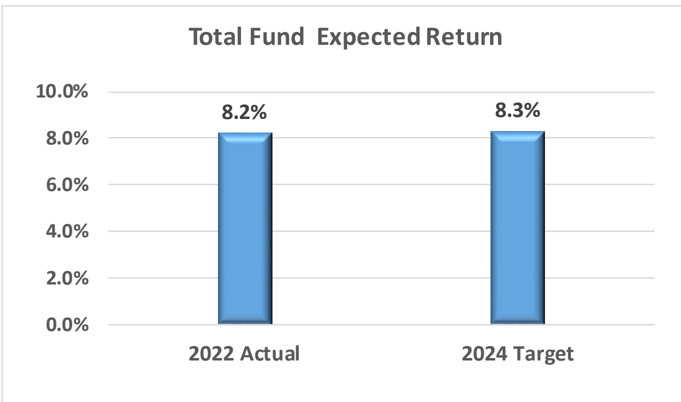


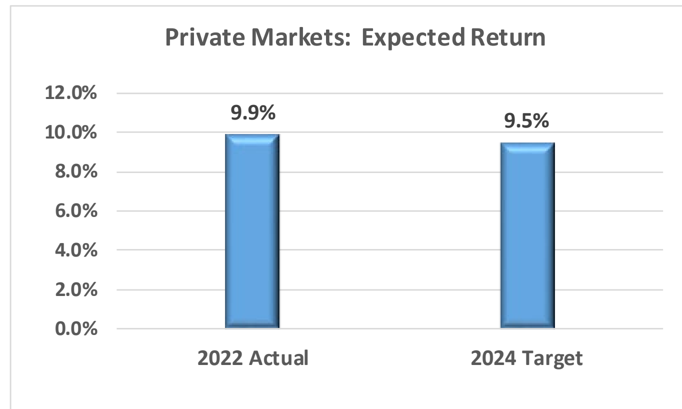
The increase to a 25% cap on alternative investments allowed the System to set long-term allocation targets which better diversify the Private Markets Program.

2022: Based on actual allocation at 12/31/22.
2024: Represents the long-term allocation targets reported as a percent of the Private Markets Program.
Expected Risk and Return based on Meketa's 2024 Capital Market Expectations.

Alternatives Cap Update: Risk/Return







The additional latitude provided under the 25% alternatives cap allowed the System to reduce risk while maintaining target returns.

2022 Actual: Based on actual allocation at 12/31/22.
Expected Risk and Return based on Meketa's 2024 Capital Market Expectations.

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Summary

- The System's Board of Trustees has undertaken a methodical process to identify prudent uses for the latitude afforded by the new 25% cap on alternatives.
- Risk at the total fund level has been reduced while expected return has modestly improved.
- Increased diversification has allowed the System to materially reduce expected risk of its private markets portfolio.
- Only a portion of the increased alternatives cap has been utilized, i.e., 19% at the long-term allocation target versus the 25% cap.
    - Providing "denominator effect" protection, i.e. the risk that a decline in public markets could increase alternatives exposure above the cap, requiring the System to suspend its alternative investment program.
- Passage of the bill to increase the alternatives cap to 25% allowed the System to structure a more efficient portfolio, reducing expected risk while maintaining/improving return, to the long-term benefit of the System.
- The System will implement the 2024 Interim and Long-term Asset Allocation targets in a prudent manner over coming years.