

MEMORANDUM

TO: Investment Committee, CalSTRS
FROM: Stephen McCourt, Allan Emkin, Mika Malone, Stephanie Sorg, Meketa Investment Group
CC: Chris Ailman
DATE: March 6, 2024
RE: Opinion Memo – Collaborative Strategies Portfolio Policy

Summary and Recommendation

In January 2024, Staff provided draft language for the first reading of the proposed policy for the newly established Collaborate Strategies Portfolio. This policy, if approved, will decommission/replace the current Innovative Strategies policy, with the purpose of adding flexibility/discretion for the investment team to pursue new and compelling strategies and address some of the existing constraints faced when investing within the traditional asset class structure (e.g., benchmarking, structure, scale). This policy will maintain CalSTRS’ current portfolio structure by holding and tracking existing investment strategies within the Innovative Strategies (“IS”) and Sustainable Investment and Stewardship Strategies (“SISS”) Portfolios in one “Innovation” sleeve, while also introducing a new “Opportunities” sleeve that will invest in unique opportunities that do not fit cleanly into existing portfolios. **After independently evaluating the proposed policy, Meketa Investment Group supports Staff’s recommendation to establish the Collaborative Strategies Portfolio Policy and decommission the Innovative Strategies Policy.**

Discussion

Innovative Strategies was originally formed in 2009 with the intent of testing out strategic initiatives that could eventually be added to the CalSTRS portfolio. If successful, and if the strategy was worthwhile to pursue at greater scale, the CIO would transfer the strategy and investments to the appropriate asset class or take it to the Investment Committee during an Asset Allocation Study for approval of a new asset class with a permanent allocation. This has been demonstrated several times since 2009, including the incubation of Trend Following and Global Marco in 2012, Inflation Sensitive in 2015, Public Equity Low Volatility strategies in 2014, and Private Credit in 2017.

In aggregation, the portfolio has executed on its mandate and generated strong absolute and relative trailing period performance, as well as on a risk-adjusted basis (as measured by the Sharpe Ratio).

As of December 31, 2023	Trailing Period Performance (%)				Trailing Period Sharpe Ratios			
	10 Year	5 Year	3 Year	1 Year	10 Year	5 Year	3 Year	1 Year
Innovative Strategies	6.8	9.7	12.5	15.1	1.12	1.46	2.48	2.08
<i>Policy Benchmark</i>	<i>3.8</i>	<i>4.3</i>	<i>3.2</i>	<i>9.1</i>	<i>0.68</i>	<i>0.66</i>	<i>0.43</i>	<i>1.09</i>



Currently, the Innovative Strategies portfolio consists of diversifying private credit investments that do not fit neatly into CalSTRS current asset classes but are under consideration for future growth, and Sustainable Investment and Stewardship Strategies (SISS) which is accelerating CalSTRS investments in climate-related solutions across a broad risk/return spectrum. If approved, the new Collaborative Strategies Portfolio will group these assets together to make up the “Innovation” sleeve.

Using the current Innovative Strategies policy as a template, Staff is proposing the following changes to create the new Collaborative Strategies Portfolio policy:

- 0 – 5% Allocation Range (currently 0 – 2.5%) with a 0% target
- 1% limit (of Total Fund AUM) for any single investment strategy (currently 0.5%)
- Two sleeves: Opportunities and Innovation
- No set allocation for Opportunities and Innovation sleeves
- No change to the benchmarks: weighted average of underlying strategy benchmarks + long-term (ten years) meet or exceed 7%

The expansion of the allocation range and single investment strategy limit stem from the introduction of the “Opportunities” sleeve that is projected to grow up to approximately 2% of the total fund over the next three years, assuming that compelling transactions are identified. Through this sleeve, Staff will strive to invest in unique opportunities that Staff believe make sense at the total portfolio level, but do not fit cleanly into the existing asset class structure, or otherwise provide CalSTRS an avenue to pursue investments that exceed asset class diversification goals or have risk/return profiles that are not in-line with existing asset class benchmarks and risk parameters. The sleeve encourages collaboration across various asset class teams.

In regard to portfolio governance, Chief Investment Officer (“CIO”) or designee will have the authority to manage the Collaborative Strategies Portfolio up to 5% of the CalSTRS Total Portfolio net asset value. Staff is recommending limiting any single investment allocation within the Portfolio to 1% of the CalSTRS Total Portfolio. Staff reviewed the delegation of authority within the individual asset class policies and this 1% limitation falls within a range of other asset class policy delegation limits.

Based upon current asset values¹, the Innovation sleeve is approximately \$5.1 billion, which would represent a total fund allocation of 1.5%, or 30% of the Collaborative Strategies Portfolio’s 5% maximum allocation range. Through three-year pacing projections conducted by Staff, it is anticipated that the split between the sleeves would be 60% Innovation (40% Innovative Strategies / 20% SISS) and 40% Opportunities (keeping in mind that there are no set allocation limits for the investment categories).

¹ As of December 31, 2023.



From a process standpoint, the reporting and monitoring will align with current practices employed for Innovative Strategies and SISS. Current oversight includes Meketa’s quarterly Enhanced Monitoring of the Private SISS portfolio, Meketa’s semi-annual asset class reviews, performance reporting (conducted with the custodian), and Staff’s substantive activities report.

Meketa has independently reviewed the proposed first reading of the Collaborative Strategies Portfolio policy and supports Staff’s recommendations for adoption.

If you have any questions, please feel free to contact us at (760) 795-3450.

SBS/SPM/MLM/jls