GLOBAL EQUITY

Developing Manager Program	Inception Date	Original Commitment	Current Size (in millions as of 12/31/23)
Asset Class: Global Equity - U.S. Equity	5/1/2004	$600 Million	455.5

Developing Manager Program	Inception Date	Original Commitment	Current Size (in millions as of 12/31/23)
Asset Class: Global Equity - Non-U.S. Equity	11/1/2016	No Set Commitment	1,516.2

Background

The Global Equity Developing Manager program was established in 2004, by funding six fund-of-funds firms, to facilitate engagement with newer, smaller investment management firms. Each fund-of-funds firm was tasked with identifying high quality emerging managers and constructing a multi-manager portfolio that, in aggregate, outperform their assigned benchmarks. In 2016, as part of the transition of the Global Equity portfolio to global index weights, the Developing Manager program was restructured away from all U.S. equities to a combination of less efficient U.S. small cap equities and non-U.S. developed market equities and also resized to roughly 4% of the active Global Equity portfolio at that time. As of December 31, 2023, the Developing Manager program represented 7% of all externally managed active portfolios.

Performance

Time Weighted Net Return
As of December 31, 2023

	ITD Return	10 Year	5 Year	3 Year	1 Year
U.S. Equity Developing Managers	7.6	6.8	10.0	1.7	13.0
STRS U.S. Dev Mgr Index	8.2	8.4	10.0	2.1	16.9

Time Weighted Net Return
As of December 31, 2023

	ITD Return	10 Year	5 Year	3 Year	1 Year
Non U.S. Equity Developing Managers	7.2		8.3	2.9	18.9
STRS Non-U.S. Dev Mgr Index	7.1		8.5	4.4	18.1

Prior to the 2016 restructure, the Developing Manager portfolio had underperformed from the program's inception. A large contributor to the underperformance was the relatively high fees of the program due to the fund-of-funds structure. Fees ranged from 0.40% to 0.80% compared to fees of Global Equity core managers at 0.20% to 0.25%. Since the 2016 restructure, the program's results have been mixed. With the mandate's shift to small cap equity strategies, the U.S. Developing Manager portfolio's performance has stabilized, but the portfolio has underperformed its benchmark over most periods through the end of 2023. Inception to date, the non-U.S. Developing Manager portfolio has shown promise by outperforming its benchmark by 10 basis points.

Although the program has experienced an improvement in performance, it has not met its established excess return objectives, and it remains to be seen if it will add alpha going forward. The program goals are to focus on engagement with smaller and newer investment firms, which also tend to be more diverse in their workforce with differentiated investment views. However, it is harder to measure those results. Additionally, a few emerging managers have made it to the final evaluation phase in Global Equity manager searches, and one was selected for direct funding in the core equity portfolio.

Next Steps

Staff recommends maintaining the Developing Manager program and continuing to investigate current best practices. Additionally, staff will continue to consider developing managers when conducting manager searches. While direct investment would require additional staff oversight and resources, there would be a tradeoff with any potential cost savings via reduced management fees.

PRIVATE EQUITY

Proactive Investments	Inception Date	Original Commitment	Current Size (in millions as of 12/31/23)
Asset Class: Private Equity	3/1/2003	4% of overall Private Equity Portfolio	2,026.9

Background

In September 2018, Special Mandates Policy merged Private Equity's Underserved Urban & Rural California mandate with the New & Next Generation investments, renamed as the Proactive Program. The Urban and Rural (UR) portfolio is one of two private equity special mandates established in the early 2000's at the urging of Teachers' Retirement Board Member Treasurer Philip Angelides. The other special mandate established at that time was the New and Next Generation (NNG) portfolio. Combined, these two mandates (UR and NNG) have historically been referred to as the "Proactive Portfolio".

The UR portfolio focuses on investments related to economically underserved communities, populations and geographies. As the name implies, such underserved segments are often overlooked by mainstream financing sources. The UR portfolio seeks to deliver risk-adjusted private equity returns by exploiting the inherent market inefficiencies and biases in these segments, often (but not exclusively) in conjunction with minority- and women-owned managers and businesses.

Originally, the UR portfolio focused exclusively on economically disadvantaged areas *in California.* In addition to delivering appropriate economic returns, UR also sought to deliver an ancillary benefit of increased economic activity in disadvantaged areas of California. The performance of UR was particularly weak in its early stages, and therefore, among other changes, the geographical mandate was widened to include all of the U.S. Consequently, the hoped for ancillary benefit for this program evolved from spurring economic growth in underserved areas of California to increasing diversity within the private equity portfolio – similar to the NNG mandate but approaching it from a different angle.

Due to the highly specialized nature of this mandate, a fund-of-funds structure has been used to allocate *most* of the capital commitments. Such a structure has prevailed until now and is expected to prevail to the extent that this mandate continues.

Background on NNG

The New and Next Generation (NNG) special mandate is the second of two private equity special mandates established in the early 2000's at the urging of Teachers' Retirement Board Member Treasurer Philip Angelides.

The NNG portfolio focuses on newly formed private equity managers (generally, first-, second-, and third-time institutional fund managers). The NNG portfolio seeks to deliver risk-adjusted private equity returns by targeting a less efficient segment of the private equity market. In this market segment, promising entrepreneurs (usually with significant experience at mainstream firms) start their own firms and deploy capital into smaller investment deals where competition is generally less intense and information flow is generally less efficient.

Originally, the NNG portfolio focused on newly formed private equity managers, *primarily* in California. In addition to delivering appropriate economic returns, NNG also sought to deliver an ancillary benefit of increased economic activity in California as well as increased diversity in the CalSTRS portfolio and the investment ecosystem as a whole. The performance of NNG was particularly weak in its early stages and therefore, among other changes, the geographical mandate was widened to include all of the U.S. Consequently, the hoped for ancillary benefit for this program have become mostly focused on diversity (similar to the UR portfolio).

Due to the highly specialized nature of this mandate, a fund-of-funds structure has been used to allocate *most* of the capital commitments. Such a structure has prevailed until now and is expected to prevail to the extent that this mandate continues.

Performance

Time Weighted Net Return As of December 31, 2023					
	ITD Return	**10 Year**	**5 Year**	**3 Year**	**1 Year**
Private Equity - Proactive Program	5.74	12.23	13.67	19.79	0.44
Private Equity Custom Index	11.03	12.53	13.12	15.83	6.26

Early in the life of the program, it was challenging to find suitable, institutional-quality investment opportunities within the specified mandate. Performance was particularly poor, but over time has improved due to the following factors: (1) an enlarged geographical mandate that is now US-focused rather than California-focused; (2) a maturation of the segment which has significantly deepened the pool of suitable investment opportunities; and (3) the increased skill of our fund-of-funds manager learned over a decade plus of experience in the segment.

Next Steps

From both, a qualitative and quantitative perspective, staff believes this program has improved and continues to improve over time. Although it is difficult to measure precisely, it appears that the ancillary benefit of increasing manager diversity is being realized to a significant degree. It should be stressed that investments in this mandate is made, first and foremost, based on expected investment returns. However, given the nature of the subject mandate, the prevalence of diversity in the investment managers funded, and in the underlying investments targeted, diversity appears to be higher in this emerging manager mandate vis-à-vis our other private equity investments as a whole.

Given the observed improving performance, staff recommends that CalSTRS continue funding the Proactive program as a special mandate.

Clean Tech Investments	**Inception Date**	**Original Commitment**	**Current Size** (in millions as of 12/31/23)
Asset Class: Private Equity	5/1/2005	$100 Million - VC $400 Million - Energy	3.3

Background

The Clean Energy and Technology mandate was established in 2005, a year after the Investment Committee expressed interest in this sector. A study by Cambridge Energy Resource Advisors expressed the opinion that a targeted private equity investment program in this sector was viable. Also, a Clean Tech Advisory Board was established around the same time to advise CalSTRS in this endeavor. The Private Equity program advisors (Cambridge Associates and Pavilion) met with over 70 investment managers and CalSTRS staff met with approximately 40 of these teams. Ultimately, twelve investment products were chosen and $693 million was committed. Originally, it was envisioned that the mandate would be focused primarily on venture capital, but upon further due diligence and after screening the universe for potential opportunities, the mandate skewed heavily towards growth equity capital and buyouts. The program encompasses both fund investments as well as co-investments.

Performance

Time Weighted Net Return
As of December 31, 2023

	ITD Return	10 Year	5 Year	3 Year	1 Year
Private Equity - Clean Tech Investments	-17.76	-26.49	-43.40	-49.03	-80.66
Private Equity Custom Index	10.94	12.53	13.12	15.83	6.26

The performance of this mandate has been particularly poor. Staff attributes this poor performance to these primary factors:

1. Unfortunate Market Timing: The capital for this mandate was deployed in the years leading up to the global financial crisis. High prices were paid and then equity markets collapsed. In addition, natural gas prices fell dramatically, thereby undercutting the investment thesis of the underlying projects and companies. Energy prices were generally slower and less robust in recovering relative to equities. Also, in the wake of the global financial crisis, interest in subsidizing and mandating renewable energy and power sources waned considerably.

2. Mandated Deployment into an Immature Market: In retrospect, CalSTRS (along with many other investors) was perhaps complicit in setting off a boon of specialty managers trying to cater to this relatively narrow mandate which, while it was expected to grow rapidly, did not. To some degree, investment managers tailored their strategies and mandates to fit the organizational desires of institutional investors, such as CalSTRS, rather than organically reacting to and profiting from long term market price signals.

It should be noted that venture capital investments in this sector performed particularly poorly when compared to growth equity and buyout investments. This differential occurred across the industry, not just at CalSTRS. Fortunately, CalSTRS chose to focus on the latter rather than the former.

Next Steps

Much has changed in the clean energy and technology industry since the initiation of this mandate, and much has changed in the ways in which private equity interacts with this sector. In the industry itself for example, wind and solar have become much more mainstream as has the financing of these projects. With respect to private equity, investments in this sector have also become more mainstream. Also, private equity investments in this sector have shifted more to the realm of generalist private equity managers (as opposed to specialty managers) and more to the realm of private equity managers that focus on energy in general (as opposed to clean energy in particular).

Given the past performance of this special mandate and given the trend for such investments to be done more by generalist firms, CalSTRS private equity has partnered with Sustainable Investment & Stewardship Strategies staff to collaborate on Clean Tech and Clean investments more broadly given the ESG focus of their investment mandate. To date, the two groups have collaborated on several investments outside of special mandates in support of CalSTRS ESG initiatives.

The Clean Energy and Technology mandate was expected to perform on par with other private equity investments; however, it has been one of the lowest performing groups of investments in the Private Equity portfolio. Subsequently, existing investments were grandfathered in, and the program was discontinued as a special mandate as of July 2018. Staff recommend continuing to maintain the Clean Tech legacy investments as a special mandate.