

TEACHERS' RETIREMENT BOARD

INVESTMENT COMMITTEE

SUBJECT: 2009 Asset Allocation Study, Final Step –
Adopt New Asset Targets and Implementation Plan

ITEM NUMBER: 4

CONSENT: _____

ATTACHMENT(S): 0

ACTION: X

DATE OF MEETING: August 13, 2009 / 20 mins.

INFORMATION: _____

PRESENTER(S): Christopher J. Ailman
Allan Emkin, Pension Consulting Alliance

POLICY

This item is the core part of the Investment Policy & Management Plan.

BOARD STRATEGIC PLAN GOAL

Goal 5: Ensure a financially sound retirement system through adequate contributions and optimal investment returns.
➤ Objective A: Explore different alternatives to portfolio management.
➤ Objective B: Consider a risk budgeting approach to the portfolio structure.
➤ Objective D: Develop and implement a full funding plan.

HISTORY OF THE ITEM

This is the third step in the 2009 Asset / Liability study. The outline for the 2009 study is displayed below:

Agenda for 2009 Asset-Liability Project

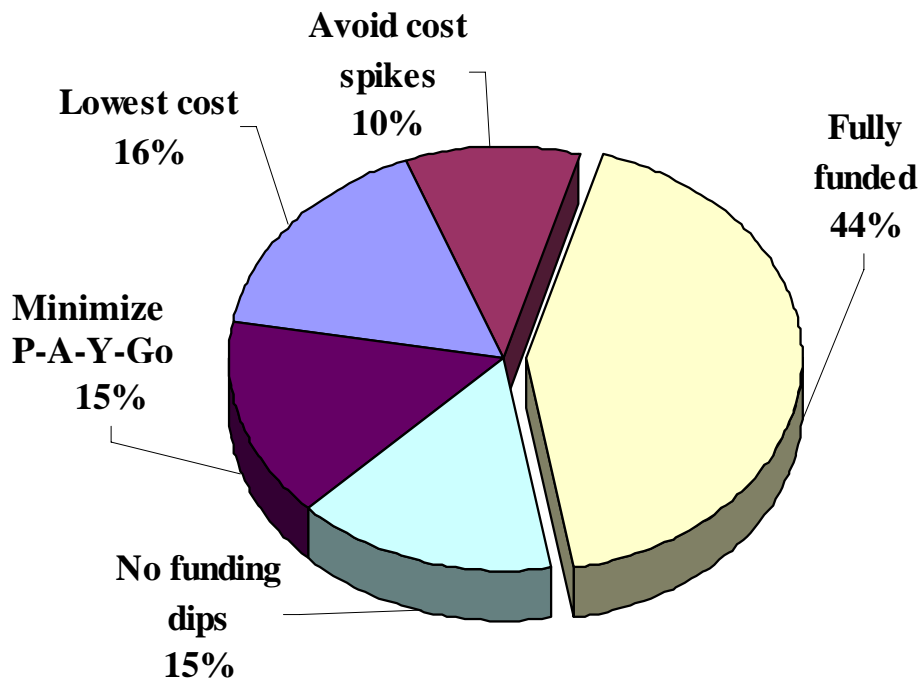
February	Discuss strategic asset class assumptions, constraints, and methodology Introduction/Review "Decision Factor" concepts
March	Approve strategic asset class assumptions, constraints, and methodology and addition of a new Asset Class.
April	Presentation of CalSTRS A/L Model Discuss and approve custom set of Decision Factors
June	Interactive sensitivity analysis of Decision Factors Approve Decision Factor weightings and select policy portfolio
July-August	Formally adopt the strategic asset class targets into the Investment Policy & Management Plan

BACKGROUND

This draws to a conclusion the 2009 Asset Liability Study. The six month process utilized the CASSY® Asset Liability Model developed by EFI Associates. This model develops the optimum asset allocation based upon the priority and weight the Investment Committee gives to key financial goals for the CalSTRS Defined Benefit Plan. At the June 4, 2009 meeting, the Investment Committee focused much more on the long-term financial success of the Portfolio, rather than on short term stability. The trade-off between stability and strong investment results is the basic trade-off of risk versus return. As Trustees for a defined benefit plan with very long-term liabilities, the Investment Committee reinforced that the Investment Portfolio should accept short term risk to gain long-term financial success.

The final voting established the following weighting of the priorities:

1	Strive to achieve the lowest average actuarial cost.	16%
2	Attempt to avoid actuarial employer cost over 35%.	10%
3	Seek to achieve highest actuarial funding ratio.	44%
4	Attempt to avoid actuarial funding ratio below 57%.	15%
5	Attempt to minimize the likelihood of Pay-As-You-Go.	15%



NEW ASSET ALLOCATION

Based on these priorities and the CalSTRS Capital Market Assumptions and Constraints, the model selected the following asset mix as the best fit:

Global Equity	47%
Private Equity	12%
Real Estate	15%
Absolute Return	5%
Fixed Income	20%
Liquidity	1%
Expected Avg. Return	8.5%
Expected Risk (SD)	12.2%

The table below shows the current asset mix versus both the prior long-term asset mix established in the Investment Policy & Management Plan and the new asset targets.

Asset Class	Current Allocation	Prior Long-term targets	New Long-term Targets
Global Equity	52.1%	60%	47%
Private Equity	12.1%	9%	12%
Real Estate	13.5%	11%	15%
Absolute Return	0%	0%	5%
Fixed Income	21.2%	20%	20%
Liquidity	1.1%	0%	1%

The most significant shift from the current allocation is the five percent allocated to the new Absolute Return asset class. As discussed during the asset allocation study, this asset class can include a variety of investments; the common factor will be a higher correlation to inflation and a lower correlation to global equities. On average, across the asset class, we are looking for nominal returns of 6.5 percent with a volatility or standard deviation of 6.1 percent. The initial asset types approved for this asset class are inflation protected or linked bonds and infrastructure.

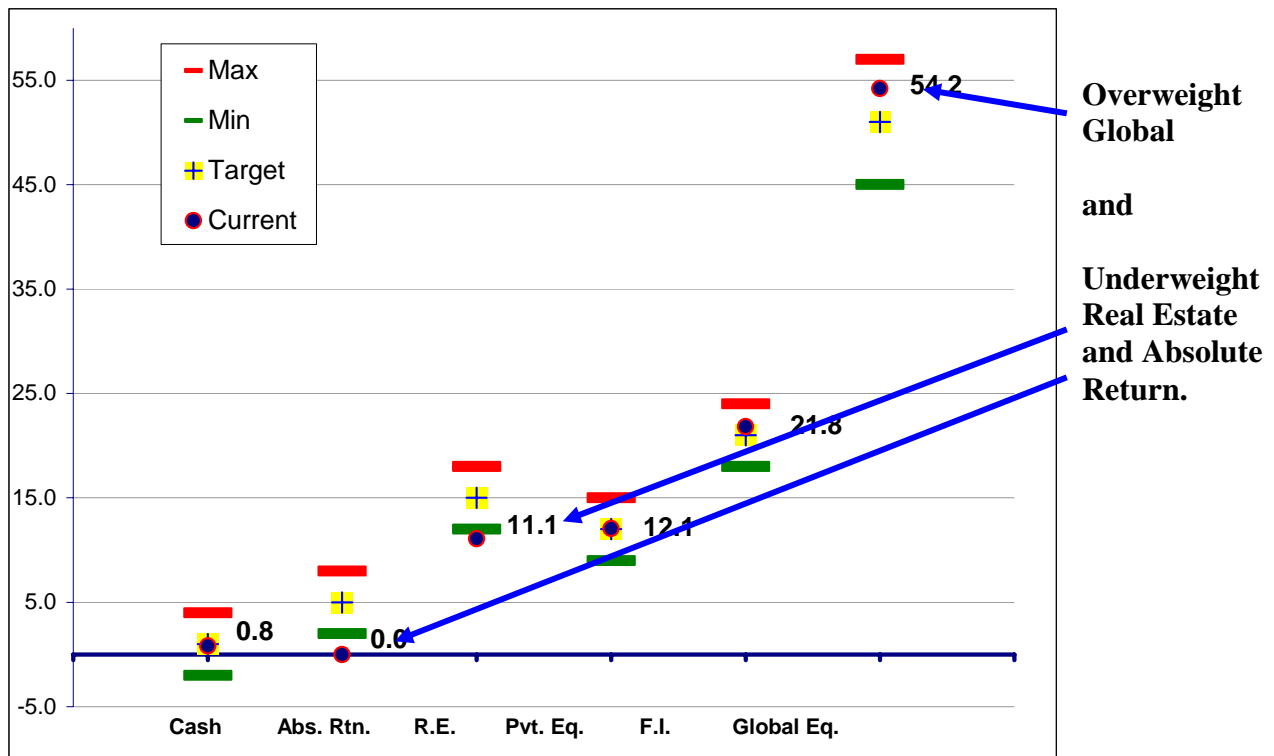
Inflation linked bonds, which are offered by the U.S. government and other major developed nations, are fairly liquid and can be purchased reasonably quickly. Infrastructure, on the other hand, will take three to five years to build up a multi-billion dollar portfolio. Therefore, staff and PCA recommend the Investment Committee adopt a multi-step plan to implement the new asset allocation.

IMPLEMENTATION PLAN

Since we can build a portfolio of Inflation linked bonds, we can ramp up the new asset class right away. We will not shift 100% into inflation linked because a prudent portfolio would be time diversified as well as inflation link diversified. In addition, it will take three to five years to

build the infrastructure segment. In the past, CalSTRS and other funds have often adopted a year-by-year implementation plan; however, CalSTRS has found that investment opportunities do not follow a rigid calendar and we need to respect the need to be flexible. Therefore, PCA and staff recommend a step-by-step rather than a year-by-year approach.

As noted below, the significant deviation from the new target is primarily isolated to Global Equity, Real Estate, and the new Absolute Return asset class.



Therefore the implementation plan will focus on shifting out of Global Equity and into Absolute Return and slowly ramping up real estate. The proposed multi-step implementation is as follows:

Asset Class	Policy starting July 1, '09	Step 1	Step 2	Step 3	New Long-term Targets
Global Equity	54%	52%	50%	48%	47%
Private Equity	12%	12%	12%	12%	12%
Real Estate	12%	13%	14%	15%	15%
Absolute Return	0%	2%	3%	4%	5%
Fixed Income	21%	20%	20%	20%	20%
Liquidity	1%	1%	1%	1%	1%

Our initial goal would be to adopt Step 1 in December of this year for an effective date of January 1, 2010, if the investment opportunities present themselves. Since the Policy asset

allocation serves as the Benchmark for performance measurement in public reports and in the incentive program, the incremental steps and timing of the changes are important.

Adjustments from one Step to another will be considered in June and December of each year. If the investment opportunities present themselves, the steps may be jumped or shifted in six month intervals. If the investment opportunities are not available, the steps could be in place for years before shifting.

CONCLUSION

Allan Emkin of PCA and staff recommend the Investment Committee adopt the new CalSTRS Asset Allocation Targets and the multi-step implementation plan.

Recommended by:



Christopher J. Ailman
Chief Investment Officer

