

DIVERSITY IN THE MANAGEMENT OF INVESTMENTS 2016 ANNUAL PROGRESS REPORT



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2016 Annual Progress Report

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MISSION Securing the financial future and sustaining the trust of California’s educators.

VISION Your Reward – A Secure Retirement
Our Reward – Getting You There

CORE VALUES The CalSTRS core values are a set of attitudes, beliefs, and behaviors that define CalSTRS and its employees.

Customer Service – We never compromise on quality as we strive to meet or exceed the expectations of our customers.

Accountability – We operate with transparency and accept responsibility for our actions.

Leadership – We model best practices in our industry and innovate to achieve higher standards.

Strength – We ensure the strength of our system by embracing a diversity of ideas and people.

Trust – We conduct ourselves with integrity, acting ethically in every endeavor.

Respect – We respect the needs of our members, co-workers, and others, treating everyone with fairness, honesty, and courtesy.

Stewardship – We recognize our fiduciary responsibility as the foundation for all decision-making.

INVESTMENTS' CORE VALUES

The CalSTRS Investments Branch core values are a set of attitudes, beliefs, and behaviors that define CalSTRS and its employees.

Respect – We strive to not only treat others as we would like to be treated, but to go the extra mile and treat others as they would like to be treated.

Personal Development – We support an individual's career and personal goals.

Balance – We encourage employees to balance a strong work ethic with interests outside of the office.

Worth – We strive to recognize everyone's efforts and contributions to the organization.

Challenge – We are honored to accept the challenges placed upon us and strive to create an innovative work environment.

Purpose – We work toward a common goal, thereby making a difference for others and ourselves.

Honesty – We are truthful to ourselves, to peers, to supervisors, the board, and to the organization; our word is our bond.

Introduction

The Diversity in the Management of Investments report is hereby submitted as requested by the California State Teachers' Retirement System's Investment Committee. In addition, Senate Bill 294 (Chapter 701, Statutes of 2011), by Senator Curren D. Price, Jr., requires the Teachers' Retirement Board to define the term emerging investment manager, provide a five-year strategic plan for emerging investment manager participation across all asset classes and submit an annual report regarding the progress of the strategic plan to the Legislature. The mandated report must present CalSTRS' progress toward achieving the goals of the plan. In February 2011, the board approved a five-year strategic plan. This year's report provides an update on the progress CalSTRS made in 2015 related to the Diversity in the Management of Investments.

Since 2015 marks the culmination of our five-year plan, the CalSTRS diversity team, consisting of executive staff and staff representatives from each asset class, will work on a new long-term strategic plan that will evaluate past experiences and select impactful initiatives and goals to advance diversity throughout the investment management industry in the coming years.

This year's report includes, for the first time, a description of the Inflation Sensitive asset class, which currently consists of the Global Inflation Linked Securities Portfolio and the Infrastructure Portfolio (est. 2008). In September 2015, the CalSTRS Investment Committee adopted a policy for the asset

class that established its primary objective—investing in strategies that provide further diversification to the overall CalSTRS Investment Portfolio. The secondary policy objective is to invest in strategies that provide protection against inflation and generate long-term returns that exceed inflation and the performance benchmark, while taking reasonable and prudent risk. The policy also allows the Inflation Sensitive asset class to expand beyond infrastructure and global inflation linked securities to pursue a broad range of inflation-linked securities and security types. Therefore, it is expected that the Inflation Sensitive team will be working closely with the Innovation and Risk teams over the next year to further evaluate the correlation, volatility, potential risk, and return of various inflation-linked strategies that are in incubation or under review for inclusion in the Inflation Sensitive Portfolio.

In addition to efforts in the Inflation Sensitive Portfolio, CalSTRS consistently maintained committed capital to emerging managers in all portfolios. Internal investment staff continued to reflect a diverse population, both in gender and ethnicity throughout 2015. Additionally, staff continued to support diversity in the investment management industry by directly engaging with portfolio companies and attending and speaking at conferences and events throughout the year.

The CalSTRS Diversity in the Management of Investments team, representing every asset class and program, worked together preparing this report to capture the efforts and results of all Investments Branch programs in 2015.

Consistency of Philosophy and Action

CalSTRS seeks to honor the philosophy of inclusion, long practiced by California educators, while maintaining a financially sound retirement system. Diversity in the Management of Investments is interwoven throughout the investment business goals and is consistent with the objective to invest in strategies that enhance returns at a prudent level of risk. And, it is in accordance with CalSTRS' investment policies, the California Constitution and the California Education Code.

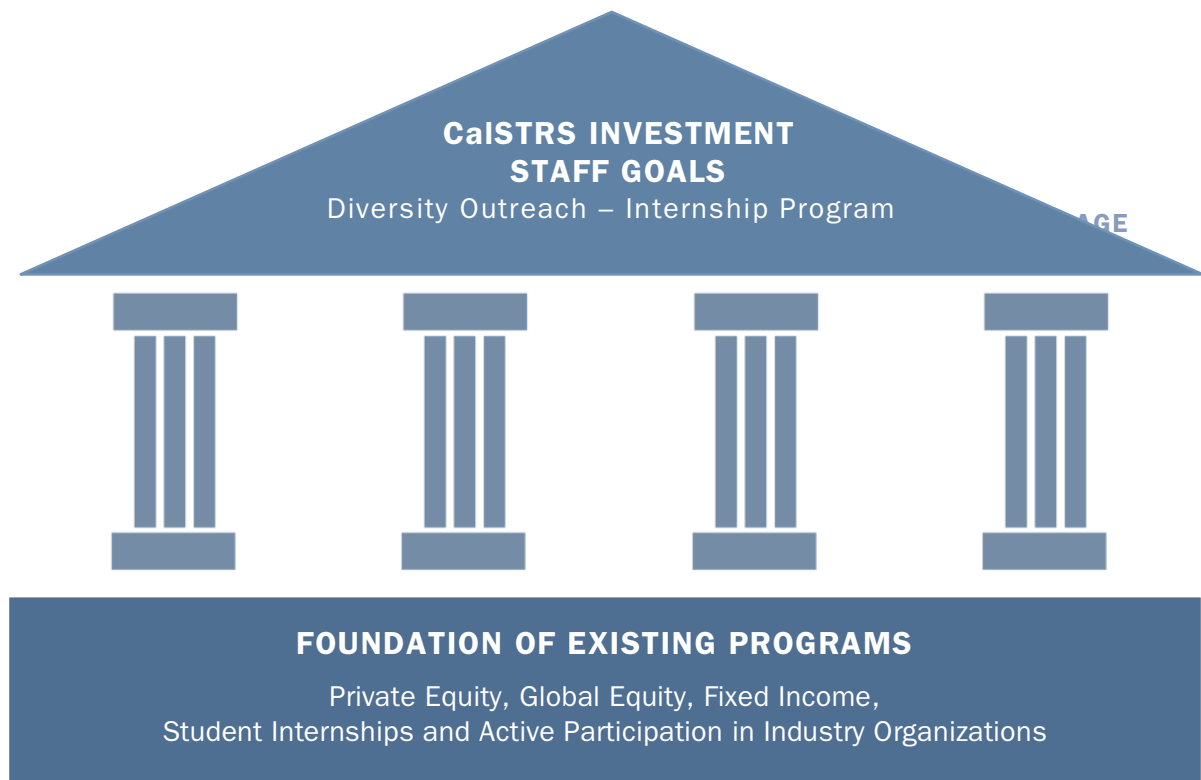
To ensure Diversity in the Management of Investments, CalSTRS must obtain exposure to a wide spectrum of investment opportunities and talent. Appropriate exposure must be accessed in a comprehensive, strategic manner, under the leadership of the chief investment officer, and consistent with the direction given by the Teachers' Retirement Board based on its core values. Specifically, Diversity in the Management of Investments operates under the CalSTRS core value of:

Strength – We ensure the strength of our system by embracing a diversity of ideas and people.

DMI is accomplished with an investment staff of 127 people who are multi-ethnic, multi-cultural, and possess myriad worldviews and investment perspectives. Part of this strategy includes our involvement in communities of color through strategic partners. The accomplishments of the Investments Branch in this area reflect a teamwork approach and the support of the entire investment staff.

INVESTMENTS STRATEGIC GOALS

The Teachers' Retirement Board approved a strategic plan for implementing the five-year business plan for Diversity in the Management of Investments in February 2011. DMI efforts over the ensuing five years are detailed in the following infographic.



Our strategic goals are in three segments:

- A. CaSTRS Investments Branch staff.
- B. The challenges depicted in the pillars.
- C. Our foundation of existing programs.

A. Investment Staff

We have two goals with respect to investment staff.

Goal 1:

Increase the diversity of internal investment staff.

Initiatives

1. Develop a recruitment strategy to attract a diversified workforce reflective of California's growing population.
2. Develop a training process in all asset classes to provide a system to hire recent graduates from California universities.
3. Develop training and development programs to retain current staff and attract civil servants from other disciplines.
4. Develop an internship program with local universities.

2016 Progress Report

CalSTRS values diversity, so much so that it is the number one goal of the Strategic Plan for Diversity in the Management of Investments.

Initiatives designed to meet this goal involve strategies to attract and retain a work force that reflects CalSTRS' educator membership.

Educators are predominantly female, and far more ethnically diverse than the institutional investment industry within which CalSTRS might traditionally recruit. In order to maximize resources toward this effort, investment staff continues to collaborate closely with the CalSTRS Human Resources Branch diversity coordinator. Current efforts are underway to redefine diversity in the context of CalSTRS core value, *Strength*.

Exhibits 1, 2, and 3 feature the diverse characteristics of internal investment staff. As of December 31, 2015, there were 127 individuals in the CalSTRS Investments Branch, an increase of 14 over the previous year. Gender diversity

decreased slightly from 50 percent male and 50 percent female to 52 percent male and 48 percent female as shown in Exhibit 2.

CalSTRS' continued commitment to ethnic diversity is evidenced in Exhibit 3 –47 percent of staff are ethnically diverse. These figures compare favorably to CalSTRS' membership profile.

CalSTRS Investments: A California State Civil Service

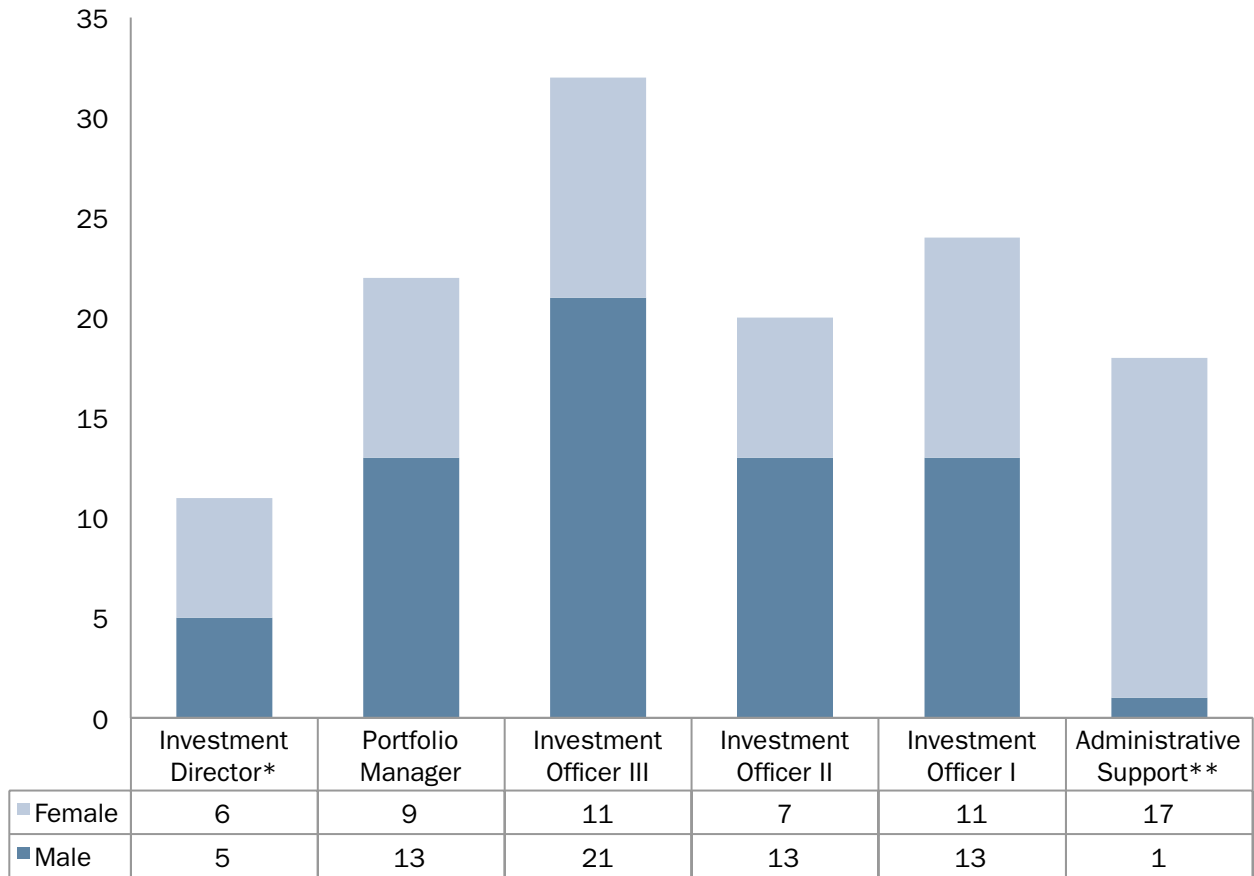
Exhibit 1 Workforce

Class Title	Schematic Code	Class Code	Number of Staff
Chief Investment Officer, CalSTRS	JV57	4693	1
Deputy Chief Investment Officer, CalSTRS	JV70	1014	1
Investment Director, CalSTRS	JV58	4694	8
Portfolio Manager, CalSTRS	JV59	4697	22
Investment Operations Director, CalSTRS	JV16	4699	1
Investment Officer III, CalSTRS	JV17	7684	32
Investment Officer II, CalSTRS	JV31	7339	20
Investment Officer I, CalSTRS	JV36	7338	24
Staff Services Manager I	JY15	4800	1
Associate Governmental Program Analyst	JY35	5393	1
Staff Services Analyst	JY20	5157	7
Administrative Assistant II	KG30	5358	1
Administrative Assistant I	KG40	5361	5
Executive Assistant	CD40	1728	2
Office Technician	CA46	1139	1
Total Investment Staff			127

Source: CalSTRS personnel data as of December 31, 2015

CalSTRS Investments: A Gender Diverse California
State Civil Service Workforce

Exhibit 2



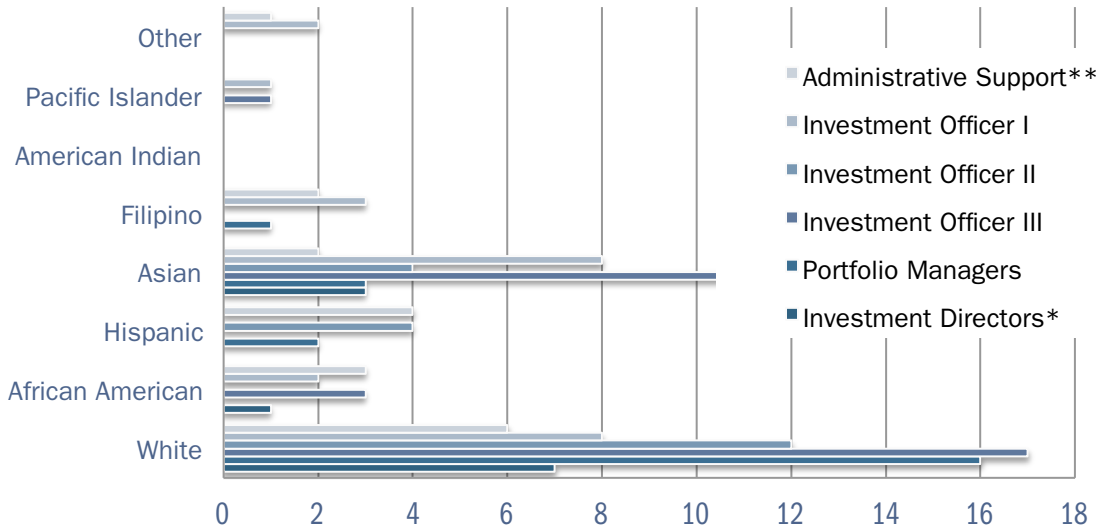
Source: CalSTRS personnel data as of December 31, 2015

* Investment director consists of the following California State Teachers' Retirement System classifications: Chief Investment Officer, Deputy Chief Investment Officer, Chief Operating Investment Officer, Investment Director and Investment Operations Director.

** Administrative support consists of the following classifications: Staff Services Manager I, Associate Governmental Program Analyst, Staff Services Analyst, Administrative Assistant II, Administrative Assistant I, Executive Assistant, and Office Technician.

CalSTRS Investments: An Ethnically Diverse
California State Civil Service Workforce

Exhibit 3



	White	African American	Hispanic	Asian	Filipino	American Indian	Pacific Islander	Other
Administrative Support**	6	3	4	2	2	0	0	1
Investment Officer I	8	2	0	8	3	0	1	2
Investment Officer II	12	0	4	4	0	0	0	0
Investment Officer III	17	3	0	11	0	0	1	0
Portfolio Managers	16	0	2	3	1	0	0	0
Investment Directors*	7	1	0	3	0	0	0	0

Source: CalSTRS personnel data as of December 31, 2015

* Investment director consists of the following California State Teachers' Retirement System classifications: Chief Investment Officer, Deputy Chief Investment Officer, Chief Operating Investment Officer, Investment Director and Investment Operations Director.

** Administrative support consists of the following classifications: Staff Services Manager I, Associate Governmental Program Analyst, Staff Services Analyst, Administrative Assistant II, Administrative Assistant I, Executive Assistant, and Office Technician.

Goal 2:

Increase the awareness of a career in investments at California’s high schools and community colleges.

Initiatives

1. Develop an outreach program with professional organizations aimed to attract diversity to the financial space, such as Robert Toigo Foundation, Sponsors for Educational Opportunity, National Association of Security Professionals, Association of Asian American Investment Managers, National Association of Investment Companies and New America Alliance.
2. Provide the resource of professional investment staff at the highest levels to speak at events that include professional organizations aimed to attract diversity to the financial space, such as Robert Toigo Foundation, SEO, NAIC, NASP, AAAIM and NAA.

2016 Progress Report

One of CalSTRS’ proudest accomplishments lies with the success of its internship

programs. Since 2004, the CalSTRS Investments Branch has made a comprehensive effort to mentor students from all walks of life, paying particular attention to ensuring the inclusiveness of ethnic and gender diverse students. The branch continues to reach out to these students via a student intern program in place with local colleges and universities at all levels of higher education—postgraduate, undergraduate and community college. The majority of the students involved in the program are from groups underrepresented on Wall Street. In 2015, two local college students took part in the CalSTRS Investments Branch internship program and these students were ethnic and gender diverse. In addition to the traditional long-term student intern program, the branch offers the Senator Nell Soto Internship Program. The CIO selects an ethnically diverse student from a non-investment major to work with the CIO over the summer. This year, a community college student, Kalihya Hayes, was the CIO’s “shadow”. The Senator Nell Soto Internship Program started in 2011 and will continue each year as the California budget allows.

The 2015 efforts with respect to Initiative 2 are included in the following relationships:

Leaders On Fast Track – CalSTRS is a partner with the Hispanic Heritage Foundation’s LOFT Finance Track. The main objective of the Finance Track is to ensure that every young Latino interested in working in the financial services industry has at least one Latino to speak to about their relevant area of interest. In addition, LOFT hosts finance boot camps, leadership trainings, and facilitates internships and jobs in the industry for interested Latinos. LOFT also has an online community where its most active members can connect. (<http://loftnetwork.org>).

In June 2015, CalSTRS was well represented at the 2015 LOFT Investors Forum. California State Treasurer and Teachers’ Retirement Board member John Chiang delivered a keynote speech. CalSTRS board delegate Eraina Ortega, CalSTRS Director of Global Equity June Kim, CalSTRS Private Equity Portfolio Manager Solange Fernandez Brooks, and CalSTRS Corporate Governance Investment Officer Travis Antoniono moderated or participated on various panels.

Plan Sponsor & Minority Manager

Consortium– The Consortium, initiated in 2004, is an annual event sponsored by the California, woman-owned firm of RG + Associates. Each year the event draws more than 300 top institutional investors and emerging managers. Considered the meeting place for exploring investment opportunities and building relationships, RG + Associates conceived of and launched the event in partnership with key business collaborators, including CalSTRS, CalPERS, and New York Common, among many others. Many CalSTRS staff have been members of the advisory committee and/or have been speakers at the Consortium event over the years.

At the ConsortiumEAST 2015 event, nearly 140 emerging or diverse managers were in attendance. CalSTRS Real Estate Portfolio Manager Greg Nyland was a panelist.

B. The Four Pillars

The four pillars represent some of the toughest challenges in incorporating DMI throughout the CalSTRS portfolio.

Goal 1:

Increase the diversity of external real estate managers who manage CalSTRS funds.

Initiatives

1. Conduct a study and survey the industry with the help of external advisors to establish the location, depth and capacity of diverse real estate managers.
2. Design a program based on the results of the study that encompass best practices to include DMI in the CalSTRS Real Estate asset class.
3. Implement and measure results of the new program to increase diverse real estate managers.

2016 Progress Report

The *Emerging Manager in Real Estate Report*, presented to the CalSTRS Investment

Committee in April 2013, highlighted the efforts of CalSTRS and the challenges of participating in that space.

Additionally, staff presented its *Real Estate Emerging Manager Implementation Plan* report to the CalSTRS Investment Committee on November 8, 2013. This plan calls for staff to evaluate new investment opportunities using a three-pronged approach: seek out direct joint venture relationships with emerging managers, access managers through manager-of-manager ventures, and access managers through fund-of-funds.

In 2015, CalSTRS made progress on the plan by beginning to implement a program to increase exposure to diverse real estate managers. While staff continued to grow and nurture existing emerging manager relationships, considerable progress has been made on identifying potential funds that specialize in emerging manager investing. Staff is currently undergoing final due diligence on a new relationship and in preliminary due diligence on several vehicles

which would provide a complement to its seasoned joint venture portfolio.

Goal 2:

Increase the diversity of corporate boards.

Initiatives

1. Implement and market the 3D, Diverse Director Database, and engage with CalSTRS portfolio companies to promote the nomination of diverse directors to corporate boards.
2. Assess the diversity of corporate boards by conducting a survey of current women and people of color with the top corporations where CalSTRS has investments.

2016 Progress Report

CalSTRS and CalPERS partnered to create 3D, the first director candidate database where candidates can self-nominate at no cost. This reduces the anecdotal nature of board appointments and broadens the pool of qualified candidates that gets presented to boards when vacancies do occur. It also helps to reduce the homogeneity bias and works against “group think” which was so detrimental to investors in the last financial crash. 3D has been

fully operational since September 2012 and to date has 813 qualified diverse candidates.

Thirty-eight percent of the candidates have prior public or private company board experience, so they are proven, quality candidates.

Staff has assessed the addition of new directors added to the companies in the S&P 500 Index and Russell 3000 Index against the percentage of new directors who are women as the measure of diversity in the top corporations in the CalSTRS portfolio. Women are generally considered a proxy for diversity as it is difficult to reliably assess individuals’ ethnicity and race.

Institutional Shareholder Services, a noted Corporate Governance vendor, concluded that the 2014 proxy year led to the highest percentage of new women directors. In 2014, 29 percent of new directors in the S&P 500 Index were women and 22 percent of new directors in the Russell 3000 Index were women. This dramatic change is especially noteworthy when compared to 2009. In 2009, new directors who were women represented just 14 percent of new directors in the S&P 500 Index and only 11 percent of new directors in the Russell 3000 Index. CalSTRS plans for the

future include continual assessment of the diversity of corporate boards relative to new directors within the CalSTRS portfolio.

- » CalSTRS began a joint effort with CalPERS in 2014 to engage with the 131 California companies identified in the 2012–13 UC Davis study of California Women Business Leaders, A Census of Women Directors and Highest-Paid Executives, as not having any women on their boards of directors. CalSTRS' total equity holdings of this subset of companies was approximately \$660 million. The engagement was very successful. CalSTRS and CalPERS met with or received responses from 39 of the companies. In addition, 27 of the companies added at least one woman to their boards of directors within one year of the initial engagement. Companies that appointed women to their board included LeapFrog Enterprises, Inc., Nanometrics Incorporated, ServiceNow, Inc., Tesla Motors Incorporated, and Thoratec Corporation.

- » The CalSTRS Corporate Governance team has made further progress in increasing diversity of corporate boards by inspiring other institutions to join the initiative. CalSTRS Director of Corporate Governance Anne Sheehan and CalSTRS Corporate Governance Investment Officer Travis Antoniono have been proactive and inspirational by advocating for diversity of corporate boards as speakers at numerous events, including Women in the Corporate Boardroom: A Business Imperative for American Companies; Harvard Law School Women's Alliance of New York: A Shareholder Activism Program; the Sixth SAIS Global Conference on Women in the Boardroom, and the 4th Annual Insurance Diversity Summit. During these speaking engagements, CalSTRS staff shared the organization's own successful initiatives and challenged other institutional investors to develop their own initiatives in order to reach

the common goal of increasing diversity of corporate boards.

- » CalSTRS is a member of the Thirty Percent Coalition, a unique groundbreaking national organization of more than 80 members committed to the goal of women holding 30 percent of board seats across public companies. CalSTRS led the Thirty Percent Coalition's latest initiative calling for companies to seek and place women on their boards of directors. Institutional investors representing more than \$3 trillion in assets under management, along with some of the nation's leading women's organizations, sent letters to 100 companies in the Russell 1000 Index that lack women on their boards, urging them to embrace gender diversity.
- » The initial Thirty Percent Coalition letter was sent out in fall 2014 and was followed up with a second letter in early 2015. CalSTRS took the lead in tracking the engagements and

interactions of the 100 companies with the Thirty Percent Coalition's institutional investor members. The results have been very encouraging. To date, 45 of the 100 companies have responded and 33 have added at least one woman to their board. A third letter is currently being prepared to send out to the 41 remaining companies that have neither responded to the first two letters nor have placed a woman on their board. An additional goal this fiscal year is to recruit at least one other institutional investor to become a member of the Thirty Percent Coalition.

- » CalSTRS intends to expand its portfolio engagement to include a greater number of public companies and those in the private asset classes. In the long run, long-term investors who own all classes of assets can benefit from taking a universal approach to systemic value-enhancing issues such as diversity on corporate boards.
- » CalSTRS intends to increase its

partnership experience, which is already substantial in this area, as a way of accelerating the pace of increasing diversity on corporate boards. CalSTRS has actively partnered with a number of organizations, including the National Association of Securities Professionals and New America Alliance.

- » CalSTRS will co-host Beyond Talk: Taking Action to Achieve Gender Balance in the Financial World, a diversity event with State Street Global Advisors.
- » CalSTRS will work with CalPERS as co-host of the 2016 Diversity Forum.
- » CalSTRS, in collaboration with Stanford University, will develop a diversity event for next spring focused on the technology industry.

CalSTRS has been, and continues to be, a leader on the issue of corporate board diversity, especially as it relates to the enhancement of shareholder value. Going forward, we will build on our success by educating our general partners in the private asset classes about the benefits of diversity on both boards of directors

and management teams in companies before they enter the public market.

Goal 3:

Develop a direct relationship program whereby developing equity managers in the CalSTRS managers-of-managers structure can be hired from the Developing Manager Program to the Core Portfolio.

Initiatives

1. Develop direct relationship program options for consideration.
2. Review options in consideration of state procurement process.
3. With input from managers-of-managers, select most viable option.
4. Implement and measure results of direct relationships with emerging managers and report findings.

2016 Progress Report

CalSTRS invests with developing managers to capture alpha potential, to provide more opportunities for newer and smaller firms, and to access new talent and future manager capacity. However, along with success and the

concomitant growth of assets under management, developing managers run the risk of no longer qualifying as developing managers, thus being eliminated from the Developing Manager Program. In addition to incorporating developing managers into its Global Equity Portfolio, CalSTRS ultimate goal is to allow managers who have performed well in terms of investment performance and overall business operations to move to direct relationships with CalSTRS when there is a need for a specific sub-asset class or investment style in the portfolio. Throughout the implementation of the DMI Strategic Plan, staff gathered input from current managers-of-managers and other stakeholders and developed several direct relationship program options for consideration. With ongoing input from various constituencies, including managers-of-managers, and respecting the state procurement process, staff selected a *Fast-Track* Alternative Solicitation Process. Both the required documentation and a process are in place to transition successful developing global equity managers into the Global Equity Portfolio. The new process was tested with a recent U.S. manager search. The result is that a prior developing manager is now

in the Global Equity manager pool and another is a finalist for funding.

Goal 4:

Global Equity/Fixed Income: Increase the diversity of firms providing brokerage services to CalSTRS.

Initiatives

1. Commission a study of best practices in brokerage trading and how to best increase utilization of women- and minority-owned brokerage services.
2. Adjust our practices based on the results of the study and monitor and measure results.

2016 Progress Report

Staff did not commission a study of best practices in brokerage trading. However, staff did have conversations with leading experts in the emerging manager space. Also, Investment Guidelines for the public asset classes, Fixed Income and Global Equity, were established in the fourth quarter 2015.

C. The Foundation

The foundation for the CalSTRS DMI strategy was constructed with existing programs, including the Private Equity Proactive Portfolio, the Global Equity Developing Manager Program, Fixed Income's direct relationships with diverse managers, outreach to local community colleges for internships and active participation in industry organizations.

Goal 1:

Continue DMI efforts in Private Equity Proactive Portfolio and achieve an absolute return of 7.5 percent and/or outperform the private equity benchmark.

Initiatives

- » Manage, monitor and evaluate side-by-side investments.

- » Manage, monitor and evaluate the fund-of-funds structure.

2016 Progress Report

The Private Equity Proactive Portfolio was incorporated into the Core Private Equity Portfolio, thus consolidating into one private equity asset class team for CalSTRS. This structure allows for the entire Private Equity team to have visibility, knowledge and direct contact with the emerging manager space. Direct Private Equity Proactive Portfolio relationships, including funds of funds, were distributed among the team to manage. This move expands the awareness and expertise in this area to all CalSTRS Private Equity team members. Further, it eliminates the emerging manager program from being a side program to the mainstream private equity world. Staff believes that CalSTRS is the first institutional investor to make this bold transition that in effect graduates not only one manager, but the entire portfolio into the core portfolio.

Goal 2:

Continue DMI efforts in the Global Equity Developing Manager Program and exceed the assigned benchmark for the manager.

Initiatives

Manage, monitor, and evaluate the manager-of-manager structure.

2016 Progress Report

Within the CalSTRS Global Public Equity Portfolio, diversification is a key consideration, not only in terms of achieving returns and mitigating risk, but also in terms of benefits that different backgrounds, experiences and ideas bring to the overall performance of the portfolio. The initiatives designed to help CalSTRS meet its goal consist of finding and incorporating developing managers into the Global Public Equity Portfolio. To complement internal resources and get the most out of staff's efforts to meet CalSTRS' investment goals, CalSTRS investment staff works with six managers-of-managers that design manager portfolios to fulfill various mandates within the

overall portfolio. These managers-of-managers were instrumental in the development of a process to establish direct relationships with developing managers who may qualify for mandates outside the Developing Manager Program. CalSTRS continued to work with these managers-of-managers to implement its strategy in 2016.

Over the past three years, the program has detracted 2.06 percent from the Global Equity Portfolio. However, some managers who have been in the program for more than five years added value relative to their respective benchmarks on a net of fee basis as of December 31, 2015.

Goal 3:

Continue active participation in industry organizations.

Initiatives

Attend and participate in the efforts of organizations that focus on Diversity in the Management of Investments, including, but not limited to:

- » The Robert Toigo Foundation
- » The National Association of Securities Professionals
- » New American Alliance
- » The Association of Asian American Investment Managers
- » Pacific Pension & Investment Institute

Anne Sheehan, Travis Antoniono and Ly Van; from Fixed Income, Glenn Hosokawa and Cathy DiSalvo; from Real Estate Mike DiRe; from Innovation & Risk, Carrie Lo; from Inflation Sensitive, Michael Warmerdam; from Global Equity, Candace Ronan; and from Investment Operations and Administration, Stephanie Ledesma, Michael Lawrence, and Alex Kinanahan.

2016 Progress Report

In 2015, CalSTRS staff attended and participated in the efforts of several organizations that focus on Diversity in the Management of Investments.

Some specific highlights include:

- » **2015 CalPERS Diversity Forum:**
CalSTRS was well represented at this annual event, which was held on September 10, 2015. Members from almost every asset class attended and CalSTRS Chief Investment Officer Christopher J. Ailman was a noted speaker. Other CalSTRS staff attendees included: from Corporate Governance,

- » **National Association of Securities Professionals:** NASP is a professional organization whose mission is to serve as a resource for the minority community at large to share information about the securities and investments industry by providing opportunities to share information about the securities markets, including functioning as a repository for information regarding current trends, facilitating fundamental education seminars and creating networking opportunities. In 2015, California State Controller and CalSTRS Board Member

Betty Yee was a speaker at the NASP Southern California Chapter Day of Education in Private Equity.

- » **The Association of Asian American Investment Managers:** AAAIM is dedicated to elevating and increasing the visibility of Asian American investment professionals to institutional funds. In May 2015, Global Equity Director June Kim, Fixed Income Director Glen Hosokawa, and Innovation and Risk Director Steven Tong attended the 2015 AAAIM Conference. The first day was devoted to young professionals and focused on developing and mentoring these young professionals.
- » **Robert Toigo Foundation:** Toigo Foundation, whose mission is to foster the career advancement and increased leadership of underrepresented talent by creating mechanisms for greater inclusion from the classroom to the boardroom, hosted its annual *Women in Leadership: Groundbreakers, a Toigo Institute Summit*. Groundbreakers

provides a unique opportunity for professional women across industries to network, learn from each other's experiences and blaze a path forward. It is the only event in the investments industry that provides such a unique forum for tomorrow's female leaders. Engagement Portfolio Manager, Geraldine Jimenez, and Private Equity Investment Officer, Jean Kushida Uda, attended the 2015 event on behalf of CalSTRS.

- » CalSTRS CIO Christopher J. Ailman continued to be part of the advisory board.
- » CalSTRS has been associated with the Toigo Foundation for many years – dating back to its beginning.
- » **New America Alliance:** NAA is dedicated to advancing economic development of the American Latino Community. The Alliance is organized on the principle that American Latino business leaders have a special responsibility to lead the process of

building the forms of capital most crucial to Latino progress – economic capital, political capital, human capital and the practice of philanthropy.

On an annual basis, CalSTRS CEO, CIO and investment staff host a meeting with the NAA CEO Maria del Pilar Avila and a group of NAA members to discuss the state of both organizations, projects for the year and ways in which the two can help each other. The 2015 meeting was held on May 21. Additionally, CalSTRS Private Equity Portfolio Manager Solange Brooks represented CalSTRS on a panel at the New America Alliance 15th Wall Street Summit event on October 27, 2015.

» **Pacific Pension & Investment**

Institute: PPI is a global organization centered on a common interest in helping asset owners and managers understand, learn and gain perspective from each other on geopolitical, economic and financial matters that affect the investment environment and opportunities for its members. In 2015,

PPI held its annual Asia Roundtable in Tokyo, Japan. CalSTRS Global Equity Portfolio Manager Candace Ronan represented CalSTRS at the roundtable.

Other Initiatives

In addition to the aforementioned goals and accomplishments, staff developed a more streamlined and relevant process to hire asset managers and other investment-related services to help meet our investment performance objectives. During the year, staff met with external stakeholder groups and held numerous discussions internally about CalSTRS' current manager hiring process. The meetings and discussions led to draft legislation, which if passed, will rationalize the investment-related hiring process. AB 1052 (Cooley) was last amended in August 2015. It is a two-year bill that will be taken up by the Senate in 2016.

2016 Asset Class Updates

Global Equity

ASSETS UNDER
MANAGEMENT
\$99.3 Billion Market Value

PERCENT OF OVERALL
PORTFOLIO (Equities/Total
Fund):
53.5 percent

DEVELOPING MANAGER
PROGRAM
\$2.3 Billion Market Value

Represents approximately
12.4 percent of the total
\$19 Billion Active U.S.
Equity Portfolio

The Developing Manager Program was established in 2004 to take advantage of a new source of alpha that smaller and newer firms could potentially generate for the portfolio. CalSTRS currently has direct contractual relationships with six managers-of-managers firms, five of which are minority and/or women-owned firms. These six managers-of-managers firms have underlying relationships with approximately 48 developing managers: 25 percent, or 12, of which are minority-owned firms; and 21 percent, or 10, are women-owned firms.

Investment Opportunity Review Process

- » After identifying a business need for a specific type of product in the portfolio, CalSTRS posts an advertisement of a solicitation on CalSTRS.com.
- » Potential managers are given approximately two weeks to enter or update information in a specified database.
- » Staff then screens for qualified managers in the defined database universe based on qualifications specified in the solicitation advertisement. The initial screen is finalized by selecting the top candidates based on criteria defined by CalSTRS.

Source: My State Street
as of December 31, 2015

- » Those managers who are identified at this stage are invited to submit due diligence questionnaires to CalSTRS. Staff reviews the submitted questionnaires and verifies the accuracy of the information.
- » Staff then scores all of the submitted proposals, and finalists are selected and invited for an interview at CalSTRS. The top scoring managers after the finalist interviews are subject to due diligence on-site inspections and negotiation of contract terms. Managers who are not selected for an initial funding are placed in the pool and may be funded at a future date based on portfolio needs.

FIXED INCOME

ASSETS UNDER
MANAGEMENT

\$30.3 Billion Market Value

PERCENT OF OVERALL
PORTFOLIO (Fixed

Income/Total Fund):
16.2 percent

EMERGING MANAGERS

Assets Under Management:

\$521 Million Market Value

Represents approximately
10% percent of the total
externally managed Fixed
Income Portfolio

Over 80 percent of CalSTRS' Fixed Income assets are managed internally. With respect to diversity, CalSTRS has a long-standing "open door" policy using a diverse group of broker/dealers to execute trades, and as a result, currently does business with approximately 15 emerging firms. All trades are done in a competitive environment. Since the financial crisis in 2008, the trading environment has gone through many changes. With the added risks and increased regulations, broker/dealers in general are not making markets like they did. Liquidity is harder to find as broker/dealers have moved from principal trading to agency trading. This change has impacted smaller firms by making it harder to compete. One area of success has been in primary market/new issuance where deals are released at a set price. Last year, the liquidity portfolio traded \$3.8 billion or 7 percent of trades with emerging broker/dealers.

The CalSTRS Fixed Income External Manager Program is comprised of five managers and one emerging manager, for a total of six managers. Fixed Income does not have a dedicated emerging manager program; however, the selection process has evolved over time to facilitate the consideration of a broad universe of managers regardless of assets under management, based on quantitative

AUM from Blackrock®
as of November 30, 2015.

Percentage of portfolio
represents NAV from
My State Street
as of November 30, 2015.

and qualitative factors that are indicative of a successful asset management business partner. In general, active investment management is challenging. The emerging managers have generated mixed results over time. An emerging manager was lost after the financial crisis when its assets under management dropped and they couldn't support the business. Another aspect of diversity is gender—the Fixed Income team is comprised of 47 percent females and 53 percent males. Among these employees, 47 percent are also classified as ethnic minorities.

Investment Opportunity Review Process

- » Based on the CalSTRS belief that investment opportunities can appear in large, small, and start-up firms, Fixed Income has established a process and a team of investment professionals to review all new investment opportunities. Each opportunity is reviewed for strategic fit, risk and alpha opportunity. All opportunities, incorporating several different strategies, are reviewed and logged into the Opportunities database. Since inception, this database has grown to capture over 368 investment opportunities. This process was designed not only to facilitate manager access to CalSTRS, but also to serve as a way for CalSTRS to assess opportunities and market conditions.

PRIVATE EQUITY

ASSETS UNDER MANAGEMENT

\$17.8 Billion Market Value

PERCENT OF OVERALL PORTFOLIO

(Private Equity/Total Fund):
9.2 percent

EMERGING MANAGERS

Assets Under Management:

\$1.0 Billion Market Value

Represents approximately 6 percent of the total Private Equity Portfolio's assets under management

The CalSTRS Private Equity Portfolio's current components include limited partnership commitments, side-by-side co-investments and secondary transactions. It is a global portfolio with approximately 81 percent of the portfolio in U.S.-based funds. The portfolio is concentrated with 117 active manager relationships. Selection is biased toward partnerships with experienced and stable management teams, strong track records, appropriately sized funds and high levels of side-by-side general partner commitments. Strong alignment of interests and utmost integrity are requisite.

Part of the Private Equity Portfolio's strategy focuses on investing with new and emerging managers, investing in underserved markets, and investing in niche or specialty emerging managers. For first, second or third time institutional private equity funds, CalSTRS developed a feeder program in cooperation with INVESCO Private Capital. For private equity funds specializing in reaching inner U.S. cities or other underserved markets, CalSTRS developed a feeder program in cooperation with Bank of America Merrill Lynch. CalSTRS also partnered with Muller and Monroe Asset Management, LLC, investing in its comingled fund that focuses on emerging investment management firms that are niche managers, and where women and minority-owned funds are actively considered.

Market Value and AUM figures from PrivateEdge® as of November 30, 2015.

Percentage of portfolio represents NAV from My State Street as of December 31, 2015.

Investment Opportunity Review Process

CalSTRS requires that two independent due diligence tracks and approvals be reached before a direct commitment is made to any fund. One track is by the advisor and the other is by CalSTRS staff. Both have to agree or the deal does not get done. Thus, we highly encourage funds to begin with our advisors first—the process is fashioned to be effective and efficient, targeting and making the best use of time. The following is a list of all the advisors to CalSTRS Private Equity:

- » U.S. underserved space mandate – Bank of America Merrill Lynch Capital Access Funds. You may send your private placement memorandum to Edward Powers at edward.powers@baml.com.
- » U.S. new and next generation managers (first, second or third time funds) – Invesco Private Capital. You may send your PPM to Amit Tiwari at amit_tiwari@invesco.com.
- » U.S., Latin American and/or Asian Offering – Cambridge Associates, LLC. You may direct your PPM to CalSTRSteam@cambridgeassociates.com.
- » European and Middle Eastern Offerings – Altius Associates. You may direct your PPM to jh@altius-associates.co.uk.

CalSTRS is also an investor in one of Muller and Monroe's commingled fund-of-funds vehicle, which invests in both emerging managers and niche or specialty private equity

managers nationally. Please contact and/or forward your PPM to Rendel Solomon at rendel.solomon@m2am.com for further information about this vehicle.

REAL ESTATE

ASSETS UNDER
MANAGEMENT
\$25.3 Billion Market Value

PERCENT OF OVERALL
PORTFOLIO (Real
Estate/Total Fund):
13.9 percent

U.S. EMERGING MANAGERS
Assets Under Management:
\$8.1 Billion Market Value
Represents approximately
36.9 percent of the total
\$21.9 Billion U.S.-only Real
Estate Portfolio

AUM from PrivateEdge®
as of September 30, 2015.

Percentage of portfolio represents
NAV from
My State Street as of December
31, 2015.

CalSTRS has been investing with emerging real estate managers since 2001. Approximately 36.9 percent of the current U.S.-only Real Estate Portfolio is invested with emerging managers. Believing there is no single correct method for investing with emerging managers, CalSTRS invests via joint ventures, funds of funds and managers of managers to provide the widest exposure. CalSTRS continues to review and reassess how it invests with emerging real estate managers.

Investment Opportunity Review Process

- » Upon determination that an opportunity may be suitable for CalSTRS' investment objectives, staff will decide whether it is appropriate to pursue a direct commitment to the opportunity, or to refer the opportunity to an existing partner funded with CalSTRS equity.
- » If an emerging manager has a successful track record and a strong prior background of investing institutional capital, CalSTRS staff may consider a direct investment with that manager. If, however, the emerging manager has yet to garner significant institutional investment experience, staff may refer the firm to one or more of several existing CalSTRS partners, with the aim of funding the emerging manager through the existing partner until sufficient institutional experience is acquired to merit a direct relationship with CalSTRS.

- » CalSTRS Real Estate investment staff has also invested in certain funds of funds and managers-of-managers that specifically seek to direct CalSTRS capital to emerging managers. Staff will continue to seek out such managers going forward.
- » It is expected that emerging managers selected by CalSTRS Real Estate investment staff and their partners will reflect the rich diversity found within the United States as such diversity should bring not only varied skills and investment approaches but also broader perspectives into the investment process.
- » The goal of the Real Estate Portfolio is to invest in and with emerging managers that need capital and infrastructure to grow their businesses to an institutional level. CalSTRS intends to provide a link between institutional capital and local, emerging managers, including minority and woman-owned firms to create a diversified, risk-controlled, multi-manager investment portfolio.

Inflation Sensitive

MARKET VALUE
\$1.7 Billion

PERCENT OF OVERALL
PORTFOLIO
(Inflation Sensitive/Total Fund):
1 percent

Global Inflation Linked Securities

MARKET VALUE
\$534 Million

Infrastructure

MARKET VALUE
\$1.129 Billion

EMERGING MANAGERS
TOTAL MARKET VALUE
\$181 Million

Represents approximately 11
percent of the Inflation Sensitive
Portfolio.

Market Value represents NAV from My
State Street as of December 31, 2015

The Inflation Sensitive asset class currently consists of the Global Inflation Linked Securities Portfolio and the Infrastructure Portfolio. The asset class provides improved diversification to the overall CalSTRS Investment Portfolio and invests in strategies that provide protection against inflation while taking reasonable and prudent risk. The CalSTRS team managing the asset class is 22 percent female and 33 percent ethnic minorities.

Among the notable team member accomplishments in 2015, Charles Fitzpatrick earned the Chartered Financial Analyst designation. A CFA designation requires passing three levels of exams that cover topics such as ethics, quantitative analysis, economics, security analysis, and portfolio management.

The Global Inflation Linked Securities Portfolio has been 100 percent internally managed since its inception in 2010. The portfolio uses a risk-controlled strategy with minimal tracking error. This strategy represents a relatively efficient, cost-effective way to provide market-like returns over time. The performance objective for the portfolio is to exceed the benchmark over a full market cycle, generally lasting three to five years.

Infrastructure investment policy was established by the board in 2008, a dedicated team was put in place in 2010, and the first investment in the portfolio was made in 2011. The Infrastructure Portfolio consists of investments that generally include a relatively stable

return stream, have a higher correlation to inflation than equity or fixed income investments, and provide a hedge against long-term liabilities and inflation. Approximately \$800 million in new infrastructure commitments were made during 2015 and an emerging manager definition was developed.

Investment Opportunity Review Process

The CalSTRS Infrastructure Portfolio seeks to employ and retain experienced investment managers that possess superior selection and management ability with respect to the targeted investment category. Investment managers are evaluated for selection based on criteria which include the following:

- » The suitability of the organization's investment strategy with respect to CalSTRS' Infrastructure policy, investment guidelines and objectives, and portfolio needs.
- » The quality, stability, integrity, and experience of the management team.
- » The ability and willingness of the firm to dedicate sufficient resources and personnel to optimally manage CalSTRS' investments.
- » The reasonableness of investment terms and conditions, including provisions to align interests of management and CalSTRS.

- » The appropriateness of management controls and reporting systems.
- » The manager's commitment to responsible contracting policies and workplace diversity, as well as their consideration of environmental, social, and governance issues.
- » The financial strength of the investment manager.
- » The scope and quality of services provided.

The need for investments in infrastructure is a global phenomenon and draws investment managers on a world-wide scale. Infrastructure investment demand from private capital sources remains strong, and as the Infrastructure Portfolio expands, it is expected that it will attract and include exceptional managers with diverse teams.

The Infrastructure team is open to meeting with managers of infrastructure assets and reviewing potential opportunities that are suitable and meet the needs of the portfolio. Investment managers specializing in infrastructure assets can request a meeting and submit proposals to Infra-Investments@CalSTRS.com.

Innovation and Risk

ASSETS UNDER MANAGEMENT
\$3.09 Billion Market Value

PERCENT OF OVERALL
PORTFOLIO (Innovation and
Risk/Total Fund):
1.66 percent

The Innovation and Risk team was established in 2009 with two primary objectives: (1) The Innovation team researches and incubates strategies that are new to CalSTRS and expected to improve the long-term risk-adjusted return of the total fund; (2) The Risk team monitors and manages the total fund risk across asset classes. The information gathered by the two teams provides both a view to manage the overall fund's exposures and contributes to discussions on how best to allocate funds going forward.

Up to 2.5 percent of the total fund may be invested in Innovation strategies and each strategy may account for up to 0.5 percent of the total fund. To date, approximately \$3 billion has been invested in 15 funds encompassing discretionary global macro, commodity trading advisors, low volatility equities, covered calls and risk-based allocation mandates. Strategies are evaluated based on a number of qualitative and quantitative factors, including performance during equity or fixed income drawdowns and volatile periods, correlations to traditional market indices, and liquidity. ESG concerns are also taken into account. Once a strategy is determined to be potentially beneficial, it is incubated for up to three years with a small allocation of capital and a few managers. After the three-year period, staff and the Investment Committee discuss whether a strategy should become a larger part of the portfolio, studied further or discontinued.

Due to its small allocations, potentially brief investment

Market Value represents NAV from My State Street as of December 31, 2015

period and early stage of the portfolio, the Innovation Portfolio does not have a dedicated emerging manager program. However, staff consistently seeks to identify the most competitive and experienced partners to achieve the portfolio's goals. The four pillars of manager search criteria are: People, Process, Philosophy and Performance. The Innovation team uses the four Ps alongside a transparent and competitive process to select institutional quality managers most likely to fulfill the strategy objectives.

In 2015, the Innovation and Risk team once again garnered accolades for its cutting-edge research and continuing education efforts. For her work on the Innovation Portfolio, Portfolio Manager Carrie Lo was featured in *aiCIO* magazine's *40 under 40*, which recognizes excellence among up-and-coming professionals employed by large asset owners. Another member of the Innovation team, Matt Lisonbee, earned the Chartered Financial Analyst designation.

Investment Operations

Investment Operations' overall goal is to provide middle office support to all asset classes and investment strategies for the successful implementation of the CalSTRS Investment Policy and Management Plan. The team's core services include cash forecasting and cash movement, trade processing and cash-security settlement, position, cash and trade reconciliation, collateral management, corporate action processing, operational risk management and compliance, market openings, responding to various investment and SEC surveys, and portfolio hierarchy and total fund reporting. Most of these processes have been identified as mission critical in the Investment Business Continuity Plan.

Investment Operations provides critical cash flow information to investment management to ensure sufficient cash balances are available to pay benefits to our members. Additionally, Investment Operations manages strategic business partners such as the global master custodian. Staff works in collaboration with the custodian to protect investment assets enabling investment management to concentrate on generating alpha.

Investment Operations is an integral part of the Investments branch. Similar to the rest of the branch, the source of our strength stems from many different ideas and people—a wide range of professionals with diverse backgrounds. To expand its knowledge of

diversity issues, Investment Operations participates in diversity research and reporting throughout the year.

Appendix 1 CalSTRS Portfolio Performance Benchmarks¹

Total Public Global Equity

(67 percent) Russell 3000 Custom Index + (33percent) MSCI ACWI , All Country World Index, ex-U.S. Custom Index

U.S. Equity – Russell 3000 Custom Index

Non-U.S. Equity – MSCI ACWI ex-U.S. Custom Index

Total Public Debt

(95 percent) Barclays Capital U.S. Aggregate ex-Tobacco ex-Firearms + (5 percent) U.S. High Yield Cash Pay (2 percent) Issuer Constrained Index ex-Tobacco ex-Firearms

U.S. Core – Barclays Capital U.S. Aggregate Index ex-Tobacco ex-Firearms

U.S. Core Plus Debt– Barclays Capital U.S. Universal Index ex-Tobacco ex-Firearms

High Yield Debt

Barclays Capital U.S. High Yield. Cash Pay ex-Tobacco ex-Firearms (2 percent) Issuer Constrained Index

Inflation Sensitive

Weighted blend of Global Inflation Protected Linked Securities and CPI+4 percent (quarterly lagged)

Real Estate

Real Estate NCREIF ODCE Value Weighted index Net of fees (quarterly lagged)

Private Equity

SSPEI , State Street Private Equity Index (quarterly lagged)

Absolute Return

90-day Treasury Bills plus 100 basis points, but the overall objective is not as important as each portfolio and sub component respective benchmark.

Blended indices are weighted based upon CalSTRS' target allocations to each respective index. Each investment manager for U.S. and non-U.S. equity, fixed income, and currency hedging has an individualized benchmark designed to measure their performance relative to the objective identified in each manager's respective investment guidelines.

Source: CalSTRS Investment Policy and Management Plan, November 2014

Appendix 2 CalSTRS Emerging Manager Definitions

Asset Class	Emerging Definition	Minimum Qualifications
Global Equity Investment Managers	Firm must have \$2 billion or less in assets under management at initial funding.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a Registered Investment Advisor or must qualify for exemption from registration.
Private Equity Funds	Firm must be a 1st, 2nd, or 3rd time private equity institutional fund, and raising a fund under \$1 billion. Firm must have a maximum of 55 percent nonemployee ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must have a private placement memorandum in place.
Fund of Private Equity Funds	Firm must have \$3 billion or less in assets under management. In addition, the firm must: a) Have a maximum of 55 percent nonemployee ownership, or b) Be a fund that is specifically focused on emerging private equity funds.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must have a private placement memorandum in place or a similar proposal, in the event of a separate account relationship.

Asset Class	Emerging Definition	Minimum Qualifications
Real Estate Partnerships	Firm must have \$1 billion or less in AUM. Firm must have a maximum of 67 percent non-employee ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must have a private placement memorandum in place, or have a similar proposal in the event of a separate account relationship.
REITs	Firm must have \$500 million or less in AUM. Firm must have a maximum of 55 percent non-employee ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a RIA or must qualify for exemption from registration.
Infrastructure	Firm must have no more than \$3 billion in total AUM and be raising a 1st, 2nd, or 3rd time vehicle which is no larger than \$1.5 billion. Non-employee ownership of the firm cannot exceed 55 percent.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be headquartered in the U.S. and have a private placement memorandum in place for the investment vehicle being raised. Firm partners must have a demonstrable track record with managing investments on behalf of institutional investors.

Asset Class	Emerging Definition	Minimum Qualifications
Hedge Funds	Firm must have \$1 billion or less in AUM or have up to one existing institutional investor. Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number.
Investment Management Consultant	Firm must have \$10 billion or less in assets under consulting/advisement. Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a RIA or must qualify for exemption from registration.
Investment Research Firms	Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a RIA or must qualify for exemption from registration.
Emerging Manager Program Managers	Firm must have \$8 billion or less in AUM. Firm must have a maximum of 55 percent non-employee-owned ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a RIA or must qualify for exemption from registration.

Broker-Dealers	Firm must have \$25 million or less in annual commissions. Firm must have \$50MM or less in Net Equity Capital as defined by the NASD. Firm must have a maximum of 55 percent non-employee ownership.	Firm must be a legally structured entity with a Corporate Tax Identification Number. Firm must be a NASD registered firm.
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Source: CalSTRS staff as of December 31, 2015

CalSTRS Resources



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