RPEA PROTESTS CALPERS BOARD DECISIONS

by Al Darby

Nobody likes being a messenger of bad news but bad results for CalPERS members resulted from the September 2024 CalPERS Board and committee meetings.

Those bad results involve the following:

- A 10% premium rate hike in 2025 for the Long Term Care program with another 10% increase in 2026;
- Huge increase in CalPERS CEO compensation from $778,000 in 2023, to $1,200,000 in 2024;

Continued private equity (PE) focus and expansion by CalPERS, despite numerous reports about financial shortcomings of PE causing investors to seek discounted cash-out options. Also, resistance from general partners suggests that unloading these assets at a profit is becoming problematic.

While PE impressively outperformed public equity some ten years ago, current conditions in PE are much different and returns on investment (ROI) have declined significantly. CalPERS new Chief Investment Officer Stephen Gilmore appears committed to the current CalPERS PE program, one that reflects a belief that PE remains a strong investment category. As a result, CalPERS will continue its current PE program.

Gilmore mentioned that the private loan program will continue to increase from the current 3% allocation to 8%. This is a risky category and like any other PE investment, it is illiquid and selling off the loans and defaults can be problematic.

Public equities (stocks) markets have been 'bullish' since late in 2022 and appear to be stimulated now by Federal reserve rate cuts, that began in September 2023 and are expected to continue if inflation remains close to 2%

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annually. Intended cuts to public equities allocation by CalPERS from 50% to 45% to provide additional funding for PE, now appear even more misguided. Usually during the period before 2008, the public equities allocations were in the high 50% range, and there were times when the CalPERS pension fund (PERF) was frequently more than 100% funded. The current PERF funded status stands at about 77%.

I made the following public comments at the September 18, 2024, CalPERS Board meeting on behalf of RPEA, that were related to the investment component of the CalPERS CEO evaluation used to determine the CEO pay and bonus:

"RPEA opposes a compensation increase for the CEO due to the following reasons:

- The 10-year average growth rate of 6.2% for the PERF is an underperformance of 80 basis points when compared to the average 7% return on investment of all U S public pension funds in the same period. The PERF growth would be about $40B greater at the 7% average and funded status would be about 85% (see table on page 3).
- CalSTRS produced 8.4% ROI (return of investment) for the same period – it is 60% of the size of CalPERS, but it disproportionately outperforms CalPERS on a consistent basis.

- The Canada Pension Plan, which is about the same value of the PERF, produced 9.1% ROI over the same 10-year period.
- New York combined pension fund returns for the same period is 7% - these funds combined are about the same value of CalSTRS.
- Texas Teachers ROI was 7% in this period.
- Four, top, manager positions had ill-fated outcomes mostly due to poor vetting practices.

"Investment policies that diminished public-equity performance were partly responsible for that underperformance. This resulted from cutting the public equities allocation from 50% to 45% to accommodate private-equity investment that underperformed. It was also determined that U,S. stock holdings were underweight as were non U.S. stocks for several years, thereby reducing ROI in the bull market periods."

I believe the outsized pay package awarded to the CalPERS CEO was partly due to the large pay package received by the CalSTRS CEO which was almost $1,000,000. Investment performance at CalSTRS far exceeded that of CalPERS in the 10-year period ending June 30, 2024.

RPEA seriously questions the $400,000 increase CalPERS bestowed on its CEO Marcie Frost – this is more than 50% above the 2023 compensation for her. With interest rates falling, we should look for strong stock markets gains in the near term along with better PE results and the overall economy improving.

Maybe, we are at the outset of a period of growth that will move the PERF closer to 100% funded – something we haven't seen for almost 20 years, but possible if all allocations and the US economy meet expectations. The CalPERS investment team may want to take a closer look at CalSTRS and the Canada Pension system and learn their secret to success over the past ten years.

	Asset Value ($Billion)	Quarter	1 Year	3 Year	5 Year	10 Year
CALPERS PERF	$ 502.9	1.4%	9.3%	2.8%	6.6%	6.2%
CalPERS PERF Policy Benchmark		1.8%	10.3%	2.7%	6.6%	6.3%
Actuarial Rate		1.7%	6.8%	6.8%	6.9%	7.2%
PUBLIC EQUITY*	$ 210.6	2.2%	17.5%	5.2%	9.8%	8.2%
Public Equity Policy Benchmark		2.0%	17.1%	5.1%	9.6%	8.2%
PRIVATE EQUITY	$ 78.2	3.5%	10.9%	9.5%	12.4%	11.0%
Private Equity Policy Benchmark		8.5%	25.4%	8.5%	12.9%	11.6%
INCOME*	$ 148.9	-0.1%	3.7%	-3.9%	-0.1%	2.0%
Income Blended Benchmark		-0.2%	3.6%	-3.9%	-0.2%	1.6%
REAL ASSETS	$ 66.4	-0.8%	-7.1%	3.7%	3.7%	5.6%
Real Assets Policy Benchmark		-2.5%	-11.9%	2.5%	2.5%	5.5%
PRIVATE DEBT	$ 13.9	5.2%	17.0%	-.-%	-.-%	-.-%
Private Debt Policy Benchmark		2.3%	13.5%	-.-%	-.-%	-.-%
OTHER TRUST LEVEL	$ 11.9					
TOTAL FUND FINANCING	$ (27.0)					
TERMINATED AGENCY POOL	$ 0.2	-0.2%	-0.8%	-5.5%	-0.1%	1.8%
CalPERS PERF PLUS TAP	$ 503.1	1.4%	9.3%	2.8%	6.6%	6.2%

* The CalPERS PERF asset values shown include derivative exposure.