



Investment Committee

Item Number 4 – Open Session

Subject: Collaborative Strategies Portfolio Policy – First Reading

Presenter(s): Scott Chan, Mike DiRe, Glen Blacet, Kirsty Jenkinson

Item Type: Information

Date & Time: March 6, 2024 – 20 minutes

Attachment(s): Attachment 1 – Meketa Opinion Memo

Attachment 2 – Collaborative Strategies Portfolio Policy

Attachment 3 – Innovative Strategies Policy

PowerPoint(s): PowerPoint – Collaborative Strategies Portfolio

Video Link – [Collaborative Strategies Portfolio](#)

Item Purpose

The purpose of this item is to build on the [education item](#) provided to the Board in May 2022 and present a policy for the newly-named Collaborative Strategies Portfolio. This policy advances, expands and clarifies the objectives of the current Innovative Strategies policy and portfolio to allow staff across asset classes to invest in attractive opportunities, including those supporting CalSTRS Collaborative Model and net zero-related strategic priorities.

The Collaborative Strategies Portfolio will add flexibility for the investment team to pursue new and/or compelling strategies that align with CalSTRS existing investment goals. Specifically, it will allow CalSTRS to capture opportunities that may extend beyond the specific frameworks or capacity of existing asset classes, as well as opportunities that fall in between asset classes, across asset classes, and/or traverse private markets to public markets.

Markets are, and will continue to be volatile, and, at a very minimum, they are cyclical with “boom” and “bust” cycles. In addition, global market and economic shifts can create significant dislocations in asset prices, which can play out in both short-term and long-term investment opportunities. The Collaborative Strategies Portfolio will provide more flexibility, outside of existing asset classes, to continue to capture these opportunities at scale. Current feedback across

asset classes indicates that there are existing opportunities that may be a good fit for this portfolio.

This item is an Information item and staff intends to bring a subsequent Action item relating to the policy at the May Investment Committee meeting. Staff however supports the Committee in approving this first reading, if so desired.

Recommendation

In accordance with the CalSTRS [Investment Policy Statement \(IPS\)](#), staff is recommending the Board establish a Collaborative Strategies policy and portfolio as a replacement to the existing Innovative Strategies policy and portfolio. Meketa Investment Group, the Board's consultant, supports the policy language recommended as shown in Attachment 1. If this new policy is approved by the Investment Committee, the Innovative Strategies policy will be decommissioned (Attachment 3), and the appropriate investment policies will be updated administratively to reflect the impacts of the Collaborative Strategies Portfolio Policy.

Executive Summary

Portfolio Governance, Oversight and Reporting

The 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.

The Collaborative Strategies Portfolio will be managed within existing guidelines and policies and all investments will be subject to appropriate due diligence (as defined in the Collaborative Strategies Portfolio supporting guidelines and procedures). Investments will only be approved following an affirmative recommendation from the Investment Senior Management Team (DCIO, Senior Investment Directors) and, if required, an Independent Fiduciary with final approval by the CIO or his/her designee.

Staff will provide the Investment Committee with regular reporting, in line with other asset class norms, and as detailed in the Collaborative Strategies Policy. The following reports will be prepared and presented to the Board:

- Semi-Annual Review with Meketa – prepared by staff,
- Performance Report – prepared by master custodian/consultant (semi-annually),
- Substantive Activities Report – prepared by staff.

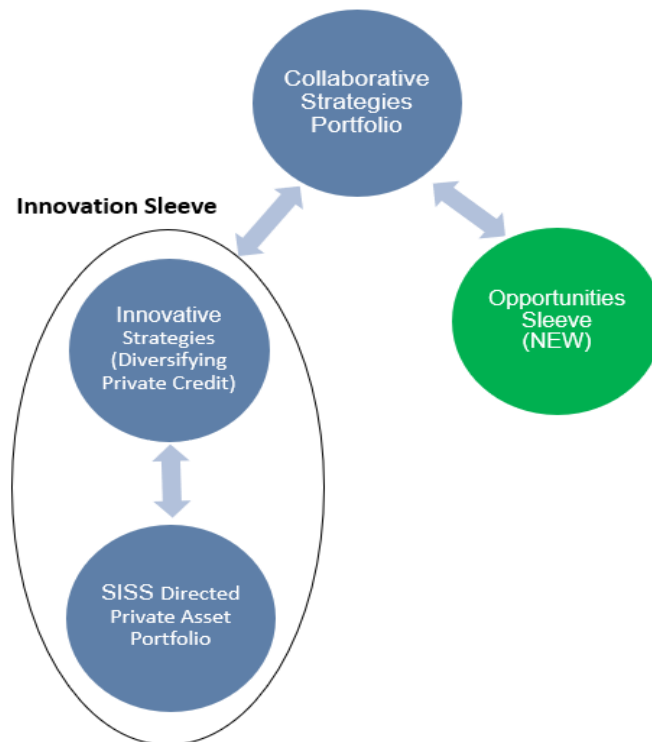
Any deviations to the Policy will be reported by the CIO to the Board Chair and Vice Chair when they occur. Any deviations from investment policies are also reported to the Board by the Director of Investment Services through the Semi-Annual Investment Compliance report.

Portfolio Rationale

Staff believes asset owners that are able to invest and capture an expanded set of investment opportunities, while also managing the risks, will continue to have significant competitive advantages versus peers. The Collaborative Strategies Portfolio builds on CalSTRS existing experience and expertise in effectively allocating capital to the best investment opportunities. However, it will create additional flexibility and scale for staff to invest in and create value-added investments aligned with the Collaborative Model, often with increased control and lower fees.

Portfolio Structure

The Collaborative Strategies Portfolio will have two ‘sleeves’ that serve two distinct, but related purposes: (1) an Innovation sleeve and, (2) an Opportunities sleeve, as illustrated below:



Innovation sleeve: this part of the Collaborative Strategies Portfolio provides CalSTRS with flexibility to identify, research and incubate new and compelling strategies that may fall beyond existing asset classes because of their structure, their benchmark or their thematic focus. The existing Innovative Strategies Portfolio already ‘houses’ two existing sub-portfolios that currently serve this goal: (1) Innovative Strategies’ diversifying Private Credit investments and

(2) the Sustainable Investment and Stewardship Strategies (SISS) Directed Private Portfolio which is accelerating CalSTRS investments in climate-related solutions across a broad risk/return spectrum.

Staff in the respective Innovative Strategies and SISS teams would continue to manage these sub-portfolios under the new Collaborative Strategies Policy (Innovation sleeve) and, after a three-year holding period, would decide if a strategy should be (i) graduated to a traditional asset class, (ii) dedicated to a new asset class, (iii) remain in the Collaborative Strategies Portfolio with the same or additional allocation, or (iv) be terminated and liquidated over time.

Opportunities sleeve: this part of the Collaborative Strategies Portfolio would be new and would allow all asset classes (public and private) to invest in unique opportunities that do not fit cleanly into their respective portfolios. Examples of such opportunities include: (1) investments whose scale may exceed asset class diversification goals (but would not exceed Total Fund diversification goals), and (2) compelling investments whose risk/return expectations may not be in line with specific asset class benchmarks, but which nevertheless have attractive return expectations from a Total Fund perspective.

Policy Changes Summary

The current Innovative Strategies Policy was used to create the enhanced Collaborative Strategies Portfolio Policy with the following notable changes:

- Allocation range: 0-5% of CalSTRS Total Portfolio net asset value with zero percent target; versus 0-2.5%.
- Single investment strategy limit: 1% of Total Portfolio; versus 0.5%.
- Structure: two sleeves – an Innovation sleeve (including current Innovative Strategies Private Credit and SISS Private Portfolio) plus a new Opportunities sleeve (which does not currently exist).

The Collaborative Strategies Policy will utilize the same benchmark structure as the current Innovative Strategies Policy: a weighted average of underlying strategy benchmarks and a long-term (ten years) goal to meet or exceed CalSTRS actuarial rate of return, currently 7%.

Background

The Innovative Strategies team was formed in 2009 with the goal of testing strategies that would be beneficial to the CalSTRS Total Portfolio. The Innovative Strategies Portfolio was given an allocation of 0-2.5% to invest in strategies and monitor their performance. If a strategy was considered worthwhile to pursue and at a greater scale, the CIO had the authority to transfer the strategy and investments to the most appropriate asset class, or request approval for the creation of a new asset class, with a permanent allocation, from the Investment Committee during an Asset Allocation Study. Highlights include:

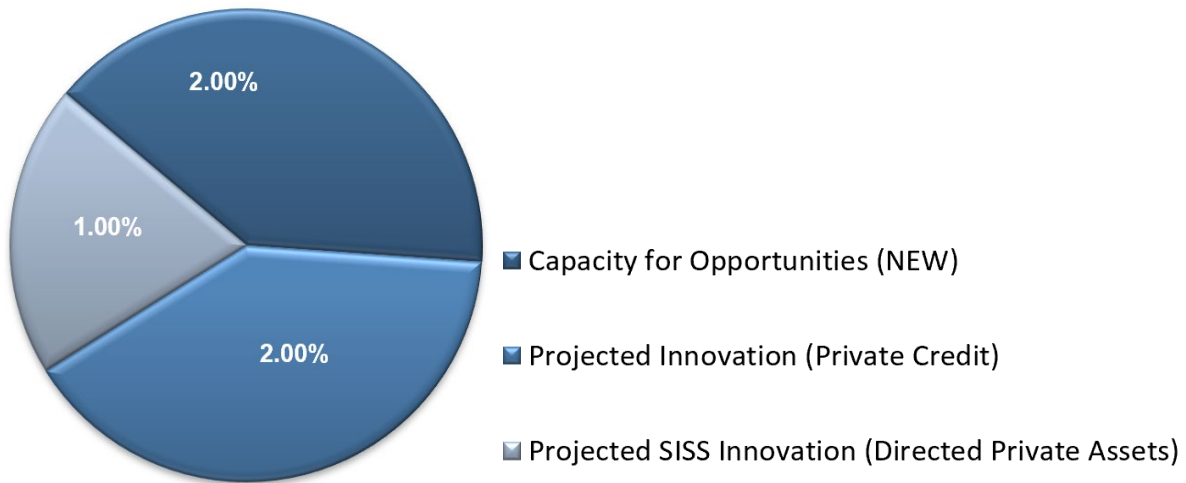
- Trend Following and Global Macro strategies were incubated in 2012 and approved as the new Risk Mitigating Strategies (RMS) asset class, with an initial allocation of 9%, during the 2015 Asset Allocation Study.
- Inflation Sensitive originated as an asset class in 2015 and the Board adopted a new policy that expanded the investable universe to include two sub-asset classes being researched by the Innovative Strategies team: Agriculture and Timber. The Innovation team transitioned their research to Inflation Sensitive and facilitated introductions to managers and consultants.
- Public Equity Low Volatility strategies were incubated in 2014 and, following a successful evaluation period, transferred to Global Equities in 2019.
- Private Credit began as an incubation in 2017. In 2023, following the Asset Allocation Study, the Board approved the Direct Lending portion of this strategy in Fixed Income.

Current Innovative Strategies, that will continue to be part of the Collaborative Strategies (Innovation sleeve) are:

- Innovative Strategies Private Credit: An existing portfolio of diversifying private credit investments, beyond Direct Lending, that do not fit neatly into CalSTRS current asset classes but are under consideration for future growth. These strategies currently represent approximately \$4.4bn in asset value.
- SISS Directed Private Portfolio: In 2019, the Investment Committee approved the expansion of the SISS Portfolio into private asset classes with a particular focus on climate solutions. These strategies currently represent over \$2bn in underwritten commitments and the portfolio is expected to grow over time, seeking to take advantage of unique alpha opportunities where advantaged economics may exist for CalSTRS.

Staff recognizes that having two growing innovation strategies could eventually exceed the current 2.5% Innovative Strategies policy limit. As shown in the following pie chart, it is anticipated that at current investment pacing, the Innovation sleeve, which includes both the Innovative Strategies Private Credit and the SISS Directed Private Portfolio, will double to approximately 3% of the Total CalSTRS Portfolio over the next 3 years. The Opportunities (NEW) sleeve would therefore have the capacity to grow over the next three years to approximately 2%, assuming compelling transactions are identified across asset classes.

There are no set allocation limits for the Innovation and Opportunities sleeves. The pie chart represents a hypothetical mix based on current pipelines and 3-year pacing for both the Innovative Strategies Private Credit and the SISS Private Portfolio. Currently, there is no active pipeline for the Opportunities sleeve. The flexibility provided in this policy will allow staff to allocate to any or none of these strategies as market opportunities change.



Strategic Plan Linkage: [Trusted Stewards](#)

Board Policy Linkage: [Investment Policy Statement](#)

Optional Reference Material:

May 5, 2022 Investment Committee: initial briefing on the [Collaborative Model 2.0-Opportunities Portfolio](#)