

# *Calpers Prepares for the Long Haul*

By investing in private equity and credit, we expect to be able to achieve 7% returns.

By *Ben Meng*

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Market turmoil has thrown a spotlight on the challenges that public pension funds face in delivering retirement security to public employees. The debate about how to meet obligations is important for policy makers, who worry that securing the benefits pensioners depend on will burden state and local governments—and future generations.

As the largest defined-benefit public pension fund in the U.S., the California Public Employees' Retirement System has been anticipating these questions. We're now ready to announce our strategy for dealing with them.

Over the past year, we have reviewed our investment approaches. We improved our liquidity position and redeployed \$64 billion to reduce active risks in public markets. These decisions, along with asset allocation changes over the past couple of years, helped Calpers reduce by about \$11 billion the impacts of the market downturn caused by Covid-19. We also scaled back our use of external asset managers, saving \$115 million in fees annually.

Yet even before the pandemic, we knew that our goal of achieving a risk-adjusted return of 7% would require addressing the market's triple threat of low interest rates, high asset valuation and low economic growth. In late 2019 we mapped out an investment strategy to deliver sustainable results.

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The solution is based on “better assets” and “more assets” and will capitalize on Calpers’s advantages: a long-term investment horizon and access to private asset classes.

Calpers must diversify and increase exposure to private assets, such as private equity and private credit. We refer to these as “better assets” because they have the potential for higher returns and lower expected volatility when compared with publicly traded assets.

“More assets” refers to a plan to use leverage, or borrowing, to increase the base of the assets generating returns in the portfolio. Leverage allows Calpers to take advantage of low interest rates by borrowing and using those funds to acquire assets with potentially higher returns.

This approach is not without risk. Private debt can reduce liquidity. Leverage can exacerbate some short-term volatility. But prudent use of leverage can reduce risk over time by allowing Calpers to keep more exposure in diversifying assets such as Treasury bonds, while pursuing higher returns in other parts of the portfolio.

We have factored in these realities carefully and have implemented a comprehensive, forward-looking plan for mitigating risk. Over the past several months, we have meticulously planned a measured shift toward this strategy, improving liquidity management, installing proper controls and a centralized management framework.

There is no panacea in the current market. Yet we think this new strategy will increase the probability of achieving a risk-adjusted return of 7% within the next 10 years. This will require sticking to the path regardless of short-term outcomes.

This is only the beginning. Calpers is positioning itself to deliver sustainable returns to our two million members for decades to come.

*Mr. Meng is chief investment officer of Calpers.*