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5796 Armada Drive
Suite 110
Carlsbad, CA 92008

760.795.3450
Meketa.com

MEMORANDUM

TO: Investment Committee, CalSTRS
FROM: Stephen McCourt, Allan Emkin, Mika Malone, Eric White, Stephanie Sorg, Meketa Investment Group
CC: Christopher Ailman
DATE: May 4, 2023
RE: Opinion Memo – Global Equity Investment Policy Revisions

Summary & Recommendation

In March 2023, Staff asked that Meketa review two proposed changes to the Global Equity Investment Policy. The first revision is to modify the Global Equity policy benchmark to include a component based on the MSCI ACWI Low Carbon Target Index ("LCTI"). It is noted that the recommended change is a compensation-specific benchmark. The second proposed revision is to add an active risk budget for the Total Public Equity Portfolio of 10 to 60 basis points. ***After independently evaluating Staff's proposed changes, Meketa concurs with Staff's recommendation to add an active risk budget of 10-60 basis points to the Total Public Equity Portfolio, but continues to review Staff's proposed benchmark changes in the context of the Board's broader benchmarking work stream.***

Discussion

At the September 2021 Investment Committee meeting, CalSTRS adopted a pledge to achieve a net zero investment portfolio by 2050 or sooner. Subsequently, at the August 2022 Investment Committee meeting, the Committee approved an interim reduction goal of 50% less emissions by 2030 for the Total CalSTRS Fund. Additionally, the Board approved allocating 20% of Public Equity to the MSCI Low Carbon Target Index ("LCTI"), to assist in achieving this goal. Staff has developed an implementation plan and is proposing 1.) to modify the Global Equity benchmark to include a component based on the LCTI and 2.) to add a risk budget of 10-60 basis points for the CalSTRS Total Public Equity composite. The Total Public Equity composite is the aggregate of the public equity holdings across the CalSTRS portfolio. Currently, public equity holdings are exclusively held within the Global Equity and SISS portfolios.

Staff determined that the LCTI can be implemented within the Global Equity portfolio, with the LCTI portfolio managed as a separate sleeve. The existing Global Equity portfolio would consist of a "core" sleeve managed against the MSCI ACWI IMI Custom benchmark, while the LCTI would be managed separately against a MSCI ACWI Custom Low Carbon Target benchmark. Staff noted that the modified policy benchmark would allow them to focus on alpha generation and maintain desired factor exposures in the core sleeve of the portfolio while allocations to the LCTI increase over time.

As part of the recommended LCTI implementation, Sustainable Investments and Stewardship Strategies ("SISS") will no longer have a stand-alone risk budget but will instead be governed along with Global Equity by a Total Public Equity Risk Budget. Staff analyzed the Total Public Equity risk budget, ran various scenario analyses to confirm that the active risk profile changes against the MSCI

ACWI IMI Custom benchmark, and recommends establishing an active risk budget range of 10 to 60 basis points for the overall Total Public Equity portfolio versus the Total Public Equity benchmark. The Global Equity portfolio (which excludes the SISS public equity investments) will continue to be managed within an annualized forecast active risk range of 10 to 50 basis points.

In summary, Meketa reviewed Staff's proposal and respective justifications for the changes, conferred with our internal team, and concurs with Staff's recommendation to add a risk budget of 10-60 basis points to the Total Public Equity portfolio, but continues to review Staff's proposed benchmark change in the context of the Board's broader benchmarking work stream.

If you have any questions, please feel free to contact us at (760) 795-3450.

SBS/SPM/EDW/jls