Meeting Date
11/20/2024
Agenda Item
#9b.

Contra Costa County Employees' Retirement Association

Memorandum

Date: November 20, 2024

To: CCCERA Board of Retirement Trustees

From: Timothy Price, Chief Investment Officer

Subject: Investment Staff Report – Q3 2024

Overview

On a quarterly basis CCCERA's Board receives a report which details critical elements of CCCERA's Functionally Focused Portfolio's sub-portfolios. The purpose of the report is to highlight elements of the sub-portfolios which are good indicators to the Board of the program's efficient and effective operation.

Summary

CCCERA's Total Fund is largely performing as expected over a ten-year horizon, exhibiting returns above expectations for the amount of risk taken over the long term. This is measured by the Sharpe Ratio (risk-adjusted return), and a comparison to the Simple Target Index. The Simple Target Index is the most basic index which could replicate CCCERA's Total Fund, and is made up of 76% MSCI ACWI, 17% Bloomberg 1-3 Year Gov/Credit, and 7% 3-Month Treasury Bills (please see the Total Fund pages in the appendix for additional details). CCCERA's portfolio is much more complex, especially as it relates to allocations to private equity, private credit, and real estate.

Over shorter periods, there are aspects of the implementation that have fallen short of expectations, which are discussed in the Growth and Risk Diversifying sub-portfolio reviews. The Board adopted a new asset allocation in August 2024 and the new allocations have begun to be implemented. This is the last full quarter where the prior positions were in effect. Notably, the Board terminated risk parity allocation and implemented new mandates for Treasuries, multi-asset credit and real estate credit. These new allocations will be implemented over the next several quarters.

CCCERA has experienced lower risk and return levels than the Simple Target Index over trailing periods. This has led to underperformance vs the STI over more recent periods, but has exceeded the STI on a risk-adjusted basis over past ten years. Details on performance relative to this index are included in the appendix. It is worth noting that CCCERA's Total Fund return is an aggregate of the performance of the Liquidity, Growth, and Risk Diversifying sub-portfolios.

1) **Liquidity**
The purpose of the liquidity program is to match three years of benefit payments with high credit quality, low duration assets. The liquidity sub-portfolio is made up of three fixed income managers, all of whom pursue a high quality, low duration investment approach. In the second quarter of 2024, all managers held high quality (as measured by credit ratings), low duration portfolios. The average credit quality for the entire liquidity program is AA (AAA is the highest rating), and the duration is 1.7 years, which is considered short. Importantly, the current yield of all three portfolios remains near 5%.

2) **Growth**
The Growth portfolio is designed to take advantage of capital appreciation and income opportunities globally. To achieve this, the Growth portfolio includes a variety of assets, from stocks and growth-oriented bonds to private equity, real estate, and private credit.

For the trailing five-year period ending September 30, 2024, the Growth portfolio returned 8.7% relative to the index return of 12.2%, for a relative underperformance of -3.5%. Over this period, the Growth program produced a superior Sharpe ratio of 0.55 relative to the index's 0.51. During the third quarter of 2024, CCCERA's Growth sub-portfolio returned 4.8% relative to MSCI ACWI Index return of 6.6%. We expect underperformance relative to the public equity markets during sharp rallies such as we experienced in 2023 and 2024 due to the private market investments where valuations lag.

The past five years have been exceptionally strong for public equities, both on the basis of earnings growth and mostly benign monetary policy. This growth has been concentrated in the US tech sector and even more so in the "Magnificent 7" mega cap stocks. Given this environment, underperformance of a diversified portfolio relative to a single equity index should be expected.

3) **Risk Diversifying**
The Risk Diversifying mandate holds assets that are expected to diversify the growth portfolio's volatility while offering moderate growth. The mandate as a whole seeks to be highly liquid, have a low beta to the growth market, and produce positive real returns. In the third quarter, the Risk Diversifying mandate fulfilled two of these goals. The entire mandate can be liquidated within 90 days, meeting the requirement of high liquidity. The correlation of the mandate to growth markets is 0.8, an increase from 0.7 during Q2 2024. The trailing real (net of inflation) return over the past five years is -4.4%, improving slightly in the last quarter from -4.5%, but remaining below expectations.

CCCERA's Total Fund in aggregate is performing in line with expectations over the past ten years, having a similar or higher risk-adjusted return but a lower level of volatility compared to the Simple Target Index. Enclosed are additional details on CCCERA's Total Fund, sub-portfolios, and individual investment strategies.

CCCERA Portfolio Report Card

Below we have itemized those elements of each of CCCERA's sub-portfolios and Total Fund which we believe the Board should pay particular attention to. Additional details on each of the sub-portfolios are available in the appendix. All CCCERA performance is stated on a net of fees basis.

Liquidity

Objective	Measurement	Current Period Data	Status
High Quality	Credit Quality	AA	Meeting Expectations
Low Risk	Duration	1.7 years	Meeting Expectations
Appropriately Sized	Months of Benefit Payments Invested	34 Months	Meeting Expectations

Growth

Objective	Measurement	Current Period Data	Status
Growth of Plan Assets	Absolute Returns	Trailing 5 yr return: 8.7%	Meeting Expectations
	Benchmark Relative Returns	-3.5% relative to ACWI over trailing 5 years	Below Expectations
Efficient Capital Deployment	Sharpe Ratio	CCCERA: 0.55 MSCI ACWI: 0.51 over trailing 5 years	Meeting Expectations

Risk Diversifying

Objective	Measurement	Current Period Data	Status
Offset Volatility in Growth Portfolio	Correlation	0.8 over trailing 5 years	Below Expectations
Positive Real Returns	Returns	5 yr real return: -4.4% 5 yr nominal return: -0.25%	Below Expectations
High Liquidity	% of Portfolio that can be liquidated within 90 days	100%	Meeting Expectations

Total Fund

Objective	Component/Measurement	Status
Store 3 Years of Benefit Payments	Liquidity Sub-portfolio	Meeting Expectations
Participate in Growth Opportunities	Growth Sub-portfolio	Meeting Expectations
Provide an offset to Growth volatility	Risk Diversifying Sub-portfolio	Below Expectations
Produce superior risk adjusted returns	Total Fund Sharpe Ratio	Meeting Expectations

Appendix – Liquidity Sub-Portfolio

Manager Reviews

Organizational Stability

	Portfolio Management Assessment	1 Year Product Asset Growth	1 Year Firm Asset Growth	Regulatory Action in Last Year?
Insight	Good	16%	21%	N
Sit	Good	-11%	16%	N
DFA	Good	20%	29%	N

Performance

	Portfolio Average Credit Quality	Portfolio Average Duration	Portfolio Average Yield	1 Year Total Return
Insight	A+	1.4	4.3	7.3%
Sit	AAA	2.7	5.6	9.5%
DFA	A+	0.3	5.0	6.4%

Manager Notes:

Fixed income yields have fallen slightly on recent rate cuts even as a “higher for longer” expectation remains dominant in the market. The Federal Reserve has cut rates twice as of November 2024, but the outlook for further rate cuts remains clouded. As the yields on these portfolios fell, CCCERA’s mandates have experienced strong total returns over the past year.

Manager Theses:
The Liquidity Portfolio is a combination of three managers which work together to match three years of CCCERA’s liabilities. The portfolio is refreshed every year during the annual funding plan.

Insight: Insight plays a completion role in the liquidity program, matching out liabilities with short duration government and corporate fixed income securities.

DFA: Dimensional Fund Advisors runs a strategy that focuses on obtaining fixed income exposures via the most liquid securities available. DFA contributes to the Liquidity Program by selling securities at regular intervals to pay a portion of CCCERA’s monthly benefit payment.

Sit: Sit invests in high yielding government backed mortgages. The cash flow from these securities is harvested monthly to make up a portion of CCCERA’s monthly benefit payment.

Appendix – Growth Sub-Portfolio

Manager Reviews

	Organizational Stability			
	Portfolio Management Assessment	1 Year Product Asset Growth	1 Year Firm Asset Growth	Regulatory Action in Last Year?
Boston Partners	Good	27%	22%	N
BlackRock Index Fund	Good	22%	26%	N
Emerald Advisors	Good	20%	19%	N
Ceredex	Good	16%	-11%	N
Pyrford	Good	4%	-2%	N
William Blair	Good	15%	23%	N
First Eagle	Good	22%	16%	N
Artisan Global	Good	16%	23%	N
PIMCO/RAE EM	Good	47%	15%	N
TT EM	Good	-32%	-5%	N
Adelante	Good	30%	20%	N
Invesco REIT	Good	37%	21%	N
Voya	Good	13%	11%	N
AQR	Good	-1%	22%	N
PanAgora	Good	-33%	10%	N
Private Equity	Good	--	--	N
Private Credit	Good	--	--	N
Real Estate	Good	--	--	N

Performance

	Trailing 1-Yr Return	Trailing 5-yr Return	Trailing 10-yr Return	Performance in Line with Expectations?	Inception Date
MSCI ACWI-ND	32%	12%	9%		
Boston Partners	27%	13%	10%	Y	04/30/1995
BlackRock Index Fund	35%	16%	13%	Y	03/31/2017
Emerald Advisors	33%	11%	11%	Y	03/31/2003
Ceredex	23%	9%	9%	Y	09/30/2011
Total Domestic Equity	***32%***	***13%***	***12%***	***Y***	
Pyrford	23%	8%	5%	Y	03/31/2014
William Blair	25%	8%	6%	Y	09/30/2010
PIMCO/RAE EM	28%	11%	7%	Y	01/31/2017
TT EM	28%	4%	5%	N	06/30/2017
Total International Equity	***25%***	***8%***	***5%***	***Y***	
First Eagle	27%	10%	8%	Y	12/31/2010
Artisan Global	33%	12%	12%	Y	11/30/2012
Total Global Equity	***30%***	***11%***	***9%***	***Y***	
Adelante	33%	6%	8%	Y	07/31/2001
Invesco REIT	34%	N/A	N/A	Y	02/28/2022
Voya	14%	4%	4%	N	04/30/2000
AQR	15%	3%	3%	N	12/31/2018
PanAgora	16%	0%	4%	N	02/28/2019
Private Equity	1%	13%	11%	Y	
Private Credit	8%	8%	9%	Y	
Real Estate	-4%	-1%	4%	N	

For periods longer than inception date within CCCERA's Total Fund, the return is from a representative composite account.

Manager Notes:

As we have noted in prior quarters, Niall Paul, lead portfolio and architect of the TT International Global Emerging Market strategy, announced his planned retirement as of June 30, 2024. Rob James, who had been a co-PM on the strategy, will continue along with Diego Mauro, who joined the firm in 2020. We have conducted an on-site reviews with James and Mauro to vet the team's capacity to manage the strategy effectively on a go forward basis. We continue to closely monitor this strategy, but recent performance has been above benchmark.

Both risk parity managers, AQR and PanAgora, are being wound down after the Board eliminated the risk parity allocation in the asset allocation targets adopted in August.

Manager Theses:
The growth portfolio includes all managers in public and private equity, real estate, and private credit. These managers grow CCCERA's assets for future benefit payments (beyond the three years already covered by the Liquidity program).

Boston Partners: Large cap domestic equity which follows a value discipline. Boston Partners will buy out of favor companies and sell them when their intrinsic values are reflected in the market. Expected to outperform in flat to falling markets.

BlackRock Index Fund: Large cap domestic equity portfolio which should follow the Russell 1000 Index.

Emerald Advisors: Small cap growth equity seeking companies with high growth rates. Expected to produce strong returns in rising markets, and weak returns in falling markets.

Ceredex: Domestic equity small cap value portfolio of companies with dividend yields and low valuations. This portfolio should outperform flat markets.

Pyrford (Columbia): International equity value portfolio of non-US companies with low valuations at the country and stock level. This portfolio should outperform in flat markets.

William Blair: International equity growth portfolio of non-US companies with high growth rates constructed from the security level. This portfolio should outperform in rapidly rising markets.

First Eagle: Global equity portfolio that is benchmark agnostic comprised of companies with low valuations.

Artisan Global Opportunities: Global equity portfolio of companies that is benchmark agnostic with accelerating profit cycles and a focus on capital allocation.

PIMCO/RAE Emerging Markets: Quantitative equity with a value orientation. This portfolio follows the fundamental indexing approach (ranking companies by metrics other than market capitalization), resulting in a diversified, low turnover portfolio. This portfolio underperforms in momentum driven markets.

TT International Emerging Markets: Concentrated, growth-oriented manager which invests in small and mid-cap emerging market companies. TT employs both a top-down and a bottom-up research approach and seeks to outperform by identifying companies that have a catalyst to drive future growth.

Adelante: Diversified portfolio of U.S. REITs with a focus on the underlying real estate assets. Adelante is a public market proxy of the core real estate market.

INVESCO Fundamental Beta REIT: Invesco invests in US REITs following a sector neutral strategy that allocates to the securities that INVESCO believes have the strongest financial conditions.

Voya High Yield Fixed Income: Domestic high yield fixed income portfolio with a focus on security selection. Voya will focus on the higher quality segment of the high yield universe. Voya should provide a steady income stream and provide downside protection in falling markets.

Private Equity: CCCERA invests in private equity to generate returns above those available in the public equity markets.

Private Credit: CCCERA invests in private credit to generate cash flow streams above those available in the public debt markets.

Real Estate: CCCERA invests in value-add, distressed, and opportunistic real estate to generate returns from the capital appreciation and cash flow associated with commercial real estate investment.

Risk Parity: Multi-asset approach that strives for balanced contributions to total portfolio risk from multiple asset classes.

Appendix – Risk Diversifying Sub-Portfolio

Organizational Stability

	Portfolio Management Assessment	1 Year Product Asset Growth	1 Year Firm Asset Growth	Regulatory Action in Last Year?
AFL-CIO	Good	13%	13%	N
BH-DG	Good	26%	-2%	N
Sit LLCAR	Good	23%	16%	N

Performance

	Trailing 1 Year Correlation to Growth	Trailing 3 Year Correlation to Growth	1 Year Return	5 Year Return	% of Portfolio Liquid in 90 Days
AFL-CIO	0.6	0.8	12%	0%	100%
BH-DG	0.5	-0.6	-7%	8%	100%
Sit LLCAR	0.4	0.5	12%	N/A	100%

Notes: Acadian MAARS was liquidated in May 2024; BH-DG Systematic Trend was funded in April 2024.

Manager Notes:

None.

Manager Theses:
Managers in the risk diversifying allocation seek to have a low correlation with the growth portfolio, positive returns in flat and falling equity markets, and a high degree of liquidity. These managers work together to offset some of the risks in the growth portfolio.

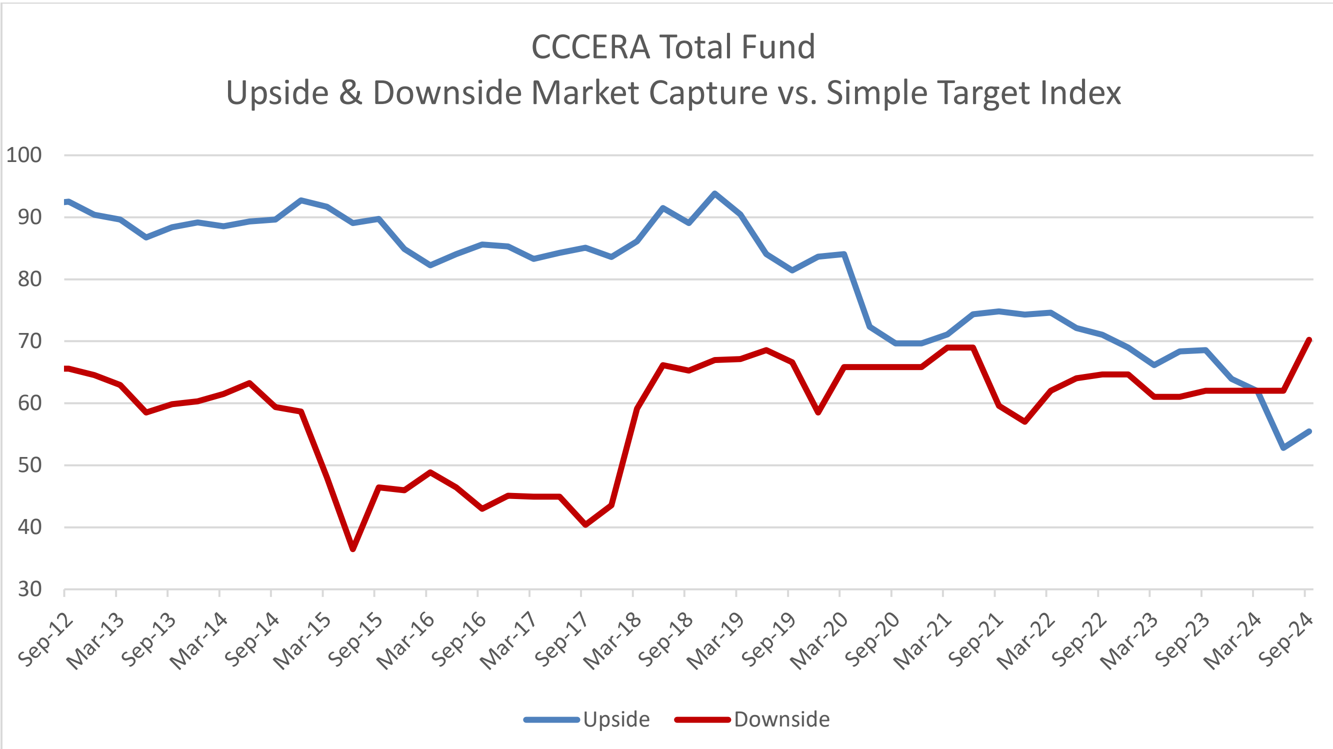
AFL-CIO: Portfolio of domestic, high quality fixed income securities which are backed by commercial and residential mortgages.

BH-DG: Quantitative multi-asset strategy that uses various models to capture both increasing and decreasing price trends across markets and timelines.

Sit LLCAR: Multiple fixed income strategies (closed end funds, mortgages, Treasuries) actively managed to target a modest positive return in most market environments.

Appendix Data – Total Fund

Rolling 3-Year Total Fund Upside/Downside Market Capture



*The composition of the Simple Target Index has mirrored changes in CCCERA's asset allocation over time: from 2008 to 2012 the benchmark was 73% MSCI ACWI, 23% Bloomberg 1-3 Year Gov/Credit, and 4% 3-Month Treasury Bills. From 2012 to 2016 the composition was 74% MSCI ACWI, 18% Bloomberg 1-3 Year Gov/Credit, and 9% 3-Month Treasury Bills. From 2016 to 2017 the composition was 63% MSCI ACWI, 25% Bloomberg 1-3 Year Gov/Credit, and 12% 3-Month Treasury Bills, from 2017 to June 2018 the composition was 61% MSCI ACWI, 27% Bloomberg 1-3 Year Gov/Credit, and 12% 3-Month Treasury Bills, from July 2018 to June 2019 the composition is 69% MSCI ACWI, 23% Bloomberg 1-3 Year Gov/Credit, and 8% 3-Month Treasury Bills, from July 2019 to June 2020 the composition is 68% MSCI ACWI, 24% Bloomberg 1-3 Year Gov/Credit, and 8% 3-Month Treasury Bills, from July 2020 to June 2021 the composition is 68.5% MSCI ACWI, 25% Bloomberg 1-3 Year Gov/Credit, and 6.5% 3-Month Treasury Bills; from July 2021 to June 2022 the composition is 75% MSCI ACWI, 18% Bloomberg 1-3 Year Gov/Credit, and 7% 3-Month Treasury Bills; from July 2022 to present the composition is 75.5% MSCI ACWI, 17% Bloomberg 1-3 Year Gov/Credit, and 7.5% 3-Month Treasury Bills; from July 2023 to present the composition is 76% MSCI ACWI, 17% Bloomberg 1-3 Year Gov/Credit, and 7% 3-Month Treasury Bills.

Total Fund Quarterly Attribution

	CCCERA Total Fund			Simple Target Index			Analysis		
	Allocation	Return	Return Contribution	Allocation	Return	Return Contribution	Allocation Difference	Return Difference	Total Effect
Liquidity	19.6%	2.7%	0.5%	17.0%	3.0%	0.5%	2.6%	-0.2%	0.0%
Growth	72.4%	4.8%	3.5%	76.0%	6.6%	5.0%	-3.6%	-1.8%	-1.6%
Risk Diversifyin	6.8%	2.1%	0.1%	7.0%	1.4%	0.1%	-0.2%	0.7%	0.0%
Overlay	1.2%	1.3%	0.0%	0%	0%	0%	1.2%	1.3%	0.0%
Total Fund	100%		4.2%	100%		5.6%	-0.1%		-1.5%

CCCERA Total Fund Performance vs. Simple Target Index

	One Year		Three Years		Five Years		Ten Years	
	CCCERA	STI	CCCERA	STI	CCCERA	STI	CCCERA	STI
Return	15.2	25.4	3.1	6.9	6.6	9.6	6.5	7.1
Volatility	3.5	5.4	8.1	12.8	9.4	14.1	7.5	11.2
Sharpe	**3.0**	**3.9**	**0.0**	**0.3**	**0.5**	**0.5**	**0.7**	**0.5**

The Simple Target Index is made up of 76% MSCI ACWI, 17% Bloomberg 1-3 Year Gov/Credit, and 7% 3-Month Treasury Bill. This purpose of this index is to examine whether CCCERA is being rewarded for pursuing a more nuanced portfolio versus a very simple representative portfolio.

CCCERA's Total Fund has produced good risk adjusted returns over all trailing time periods, but has lagged the absolute return of the Simple Target Index. This primarily reflects the exceptionally strong performance of the global equity markets in recent years relative to more modest private equity and credit returns and significant challenges in real estate.

The Sharpe ratio is a measure of risk adjusted returns which shows the amount of return a portfolio earns above the risk-free rate per unit of volatility. The Total Fund has matched or exceeded the Sharpe ratio relative to the Simple Target Index over the trailing five and ten-year over time.