



# Board of Retirement Regular Meeting

## Sacramento County Employees' Retirement System

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### Agenda Item 16

**MEETING DATE:** June 15, 2022

**SUBJECT:** Global Equity Manger Search - Emerging Markets

**SUBMITTED FOR:**  Consent  **Deliberation** and Action  **Receive** and File

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### **RECOMMENDATION**

Staff and Verus recommend the Board authorize initiating a manager search for the Emerging Markets segment of the International Equity sub-asset class within the Global Equity asset class.

### **PURPOSE**

This item complies with SCERS' Growth asset category Investment Policy Statement (IPS) implementation protocols for Public Equities, to have Staff and Consultant present to the Board a report outlining the basis for changes necessary to the manager structure to obtain optimal performance and how the changes under consideration would fit within the allocation model for the asset class approved by the Board.

### **BACKGROUND**

This search is being recommended to reach the Emerging Market Equity target allocation, which was increased to 30% (from 20%) of the International Equity allocation under the revised asset class structure for Global Equity, as approved at the December 2021 Board meeting. In conjunction with the search process for new potential managers, Staff and Verus will also evaluate SCERS' existing emerging market managers. The search will be conducted to potentially add a new emerging market manager, and/or replace one of the existing emerging market managers, and to determine the appropriate allocation for meeting the target 30% allocation.

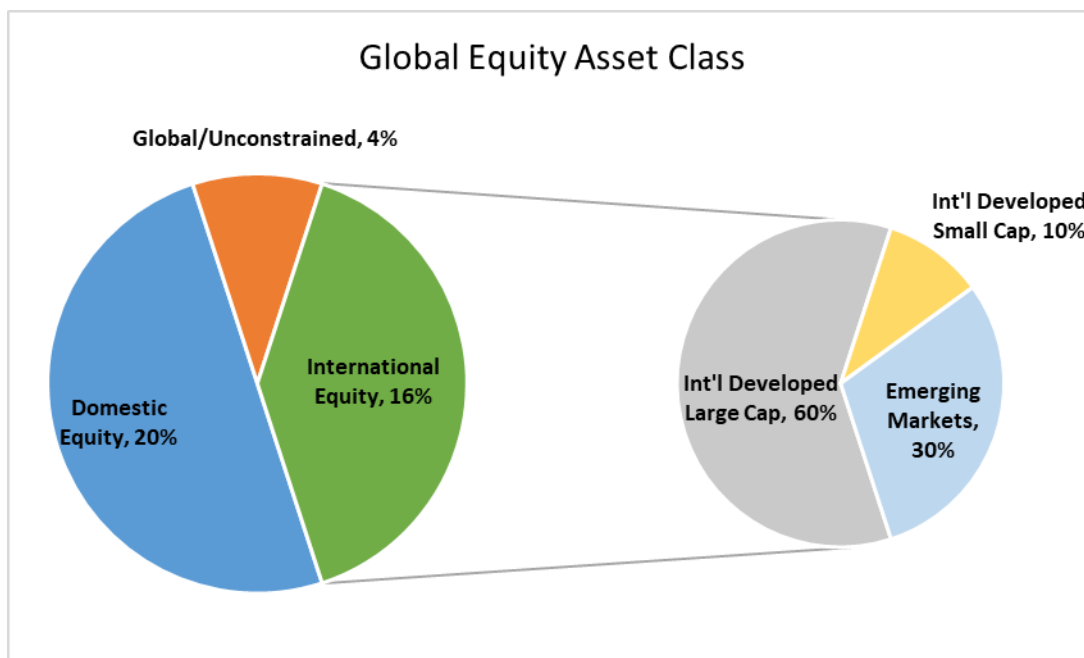
The investment objectives of the Global Equity asset class, which resides within the Growth asset category, include the following:

- Enhance total fund performance
- Invest in a diversified portfolio of domestic and international equity securities, across investment styles and market capitalizations, through externally managed strategies.
- Earn net returns in excess of equity index benchmarks, primarily from the selection of investment managers

- Maintain reasonable levels of aggregate risk, as measured through standard deviation and tracking error.

At the December 2021 Board meeting, the Board approved a 40% target allocation to the revised Global Equity asset class within the Growth asset category, which includes a 16% target allocation to the International Equity sub-asset class. Within the International Equity segment, 30% is targeted for emerging market strategies, with the other 70% allocated to developed market strategies. As of March 31, 2022, the allocation to Global Equity was below the 40% target allocation at approximately 36.7%.

Asset Class	Target %	Range
Global Equity	40%	36% - 44%
Sub-Asset Class	Target %	Range
Domestic Equity	20%	18% - 22%
International Equity	16%	14% - 20%
Global/Unconstrained Equity	4%	1% - 6%



Within International Equity, the target allocation to Emerging Markets was increased to 30% from 20% in the prior strategic allocation. The increased allocation to Emerging Markets was put in place to bring SCERS' international equity portfolio structure closer to the allocation targets for SCERS' international equity benchmark, the MSCI ACWI ex USA Index, which had an approximate 30% allocation to emerging markets countries. Emerging markets also have higher capital market return assumptions versus developed markets, increasing the forward return expectations for the international equity portfolio. Additionally, the approved structure for international equity included a change to an ACWI ex USA mandate, which was modified to a developed large cap core portfolio, and resulted in the elimination of approximately \$100 million

in emerging markets exposure from the mandate. This implemented change reduced SCERS' existing emerging markets exposure and delineated the developed and emerging markets exposure within SCERS' international equity portfolio.

## **DISCUSSION**

SCERS' Emerging Markets segment is allocated to two active managers, Baillie Gifford and Mondrian. The allocation is split between Growth (Baillie Gifford) and Value (Mondrian) oriented strategies. Both Baillie Gifford and Mondrian have flexibility to invest across the market capitalization spectrum, but have an emphasis on large cap securities. Mondrian and Baillie Gifford have been managing emerging markets portfolios for SCERS for six years, with both managers hired and having an inception start date as of March 2016. The performance of SCERS' Emerging Markets portfolio has been mixed, with the portfolio slightly underperforming the benchmark over the trailing five-year period ending March 2022 (see details below). Over that time period, Growth has typically outperformed Value; however, over the past year, Value has significantly outperformed Growth, minimizing the longer term performance disparity between the two investment styles. As a reminder, Mondrian is on SCERS' Watch List due to performance-related concerns. The following tables show the current allocation and trailing performance of SCERS' emerging market managers and total portfolio.

	<b>AUM</b>	<b>% of SCERS</b>	<b>% of SCERS</b>
<b>SCERS EM Portfolio</b>	<b>(\$ millions)</b>	<b>Int'l Equity</b>	<b>Total Portfolio</b>
Baillie Gifford	\$219.5	9.8%	1.7%
Mondrian	\$192.7	8.6%	1.5%
Total Emerging Markets	\$412.2	18.4%	3.2%
<b>SCERS Performance</b>	<b>1-Year</b>	<b>3-Year</b>	<b>5-Year</b>
Baillie Gifford	-21.9%	4.6%	8.0%
Mondrian	-12.8%	4.4%	4.6%
Total Emerging Markets	-17.9%	4.5%	6.2%
<b>Index Performance</b>	<b>1-Year</b>	<b>3-Year</b>	<b>5-Year</b>
MSCI Emerging Markets Growth	-18.1%	6.7%	7.8%
MSCI Emerging Markets Value	-3.1%	3.7%	4.8%
MSCI Emerging Markets	-11.1%	5.3%	6.4%

*As of March 31, 2022*

As shown above, the allocation to emerging markets strategies is below the 30% target allocation, as a percentage of SCERS' total International Equity exposure, at approximately 18.4%. Based on market values at the end of the first quarter, SCERS would need to invest an additional \$200 million to reach the target 30% allocation. The potential \$200 million additional allocation is roughly in line with the average investment with SCERS' existing emerging market managers. The funding of the allocation would come from the prior restructuring of the ACWI ex USA mandate (referenced above) and potential rebalancing of overweight allocations to other International Equity mandates.

With the potential \$200 million additional allocation to emerging markets, Staff and Verus are requesting authorization to conduct a search for an emerging market manager (or managers) to fill the allocation. Depending on the results of the search, the emerging markets investment could be made through an allocation to a new manager, adding capital to an existing manager, and/or to a replacement of an existing manager. In conjunction with the search, Staff and Verus will evaluate SCERS' existing emerging markets managers, to determine the appropriate allocation to these strategies going forward. As detailed in the Growth asset category IPS, SCERS' investment in emerging markets will address risk considerations by maintaining diversification across investment styles, geography, sector and industry, and by manager.

With Board approval, Staff and Verus will initiate a manager search for potential emerging market manager candidates. Staff and Verus will also evaluate SCERS' existing emerging market managers, Mondrian and Baillie Gifford, relative to the broader universe of emerging market managers. Staff will follow the implementation protocol for Public Equities, as detailed in the Growth asset category IPS. Staff and Verus anticipate a recommendation to occur in the second half of 2022.

### **ATTACHMENTS**

- Board Order
- Verus Memo
- Presentation

Prepared by:

/S/

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Brian Miller  
Senior Investment Officer

Reviewed by:

/S/

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Steve Davis  
Chief Investment Officer

/S/

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Eric Stern  
Chief Executive Officer



# Retirement Board Order

## Sacramento County Employees' Retirement System

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Before the Board of Retirement  
June 15, 2022

AGENDA ITEM:

### Global Equity Manager Search – Emerging Markets

THE BOARD OF RETIREMENT hereby accepts the recommendation of staff and Verus to initiate a manager search for the Emerging Markets segment of the International Equity sub-asset class within the Global Equity asset class.

I HEREBY CERTIFY that the above order was passed and adopted on June 15, 2022 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES (Present but not voting):

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Richard B. Fowler II  
Board President

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Eric Stern  
Chief Executive Officer and  
Board Secretary

# Memorandum

**To:** Sacramento County Employees' Retirement System (SCERS) Board

**From:** John Nicolini, Senior Consultant  
 Brian Kwan, Senior Consultant  
 Garrett Dinsmore, Associate Director

**Date:** June 15<sup>th</sup>, 2022

**RE:** Emerging Markets Search Recommendation

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## Verus Summary and Recommendation

In December 2021, the SCERS Board approved a new Global Equity allocation that would bring SCERS' public equity allocation more in line with that of the policy benchmark (MSCI ACWI IMI Index). Prior to the new global equity allocation, SCERS' Non-US equity portfolio had a target allocation of 80% International Developed and 20% International Emerging Markets. The MSCI ACWI IMI Index, on the other hand, has an allocation closer to 70% International Developed and 30% International Emerging Markets. With the higher allocation to emerging markets approved, Staff and Verus plan to evaluate the two current emerging market managers (Baillie Gifford and Mondrian) to ensure they are still the best options in their respective universes, as well as determine if additional emerging market managers are appropriate. Since the reallocation results in \$200M addition to the International Emerging Markets Portfolio, we believe a re-evaluation of the entire International Emerging Markets Portfolio is appropriate.

Asset Class	Target Allocation	Sub-Asset Class Target Allocation
<b>International Developed</b>	<b>70%</b>	
Developed Markets Large Active		60%
Developed Markets Small Active		10%
<b>International Emerging Markets</b>	<b>30%</b>	
Emerging Markets All Cap Active		30%



# Emerging Market Manager Search Recommendation

June 15, 2022

# Introduction

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- Authorize search for Emerging Market equity manager
- Fill increased target allocation for Emerging Markets to 30% of International Equity
- In conjunction with manager search, evaluate SCERS' existing emerging market managers

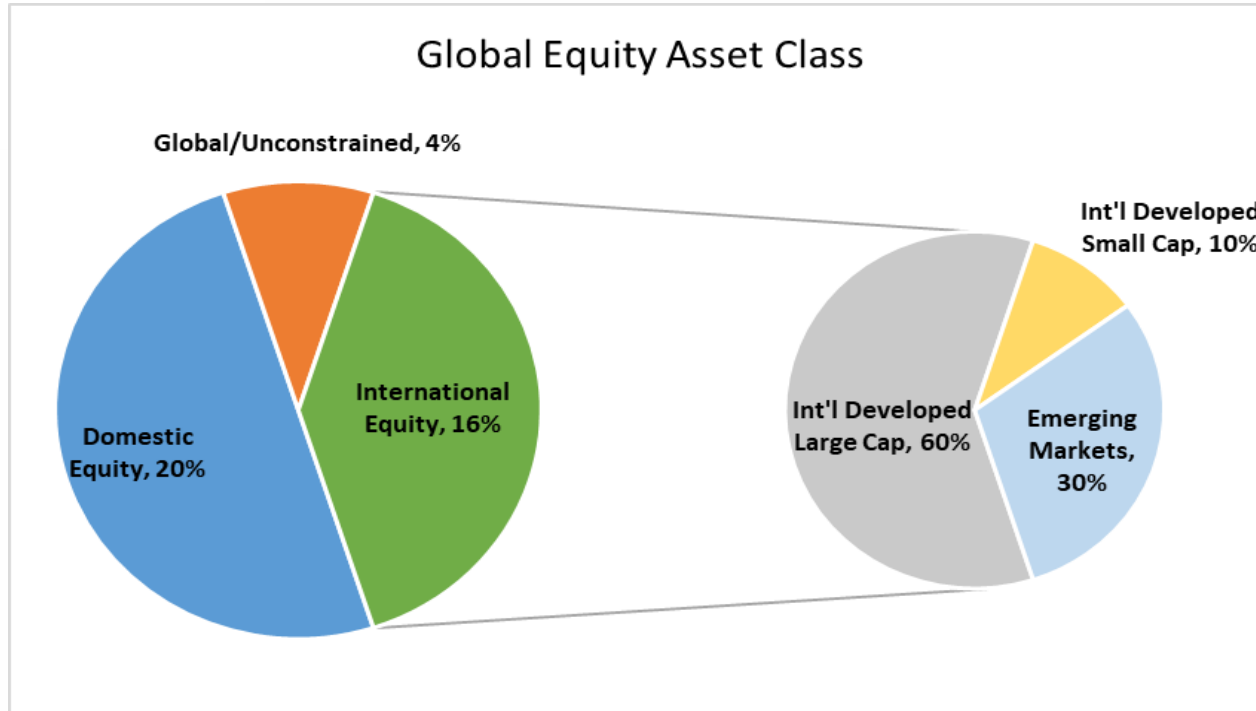


# Global Equity Structure

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- Reduced International Equity to 16% target
- Increased Emerging Markets to 30% of International Equity
  - EM allocation increased to align with International Equity Benchmark
- Mandates within International Equity focus on either Developed or Emerging Markets
  - Restructured existing mandate resulting in reduced EM exposure

# International Equity Allocation



Asset Class	Target Allocation	Current Allocation
<b>International Equity</b>	<b>16%</b>	<b>16.3%</b>
Int'l Developed Large Cap	60%	71.2%
Int'l Developed Small Cap	10%	10.0%
Emerging Markets	30%	18.8%

# Emerging Markets Search

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- SCERS' will need to invest an additional \$200 million to reach Emerging Market target allocation
- Emerging Market portfolio is currently allocated to Growth and Value oriented strategies
- Staff and Verus will evaluate existing managers in conjunction with search for potential new managers
- Evaluation and search process could result in:
  - adding a new manager
  - increased allocation to existing manager(s)
  - replacement of existing manager(s)

# Recommendations

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- Authorize Staff and Verus to initiate search of Emerging Market manager universe for potential new managers and/or replacement of existing managers
- Funding of the new mandates will come from previous restructuring of international equity mandates and future rebalancing of overweight international equity mandates
- Result of search and recommendations expected in the second half of 2022