



# Report From the Investment Department

Oct. 19, 2023

- **Matters requiring board action:**
  - None
- **Educational or scheduled updates and reviews requiring no action today:**
  - Summary of Investment Activity Report, September 2023
  - Initial review of the Statement of Investment Objectives and Policy and Statement of Fund Governance
  - Alternative investment review
  - Callan comments
  - Review of September investment transactions
- **Summary of requests**

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# Summary of Investment Activity Report



- **Highlights**
- **September returns and activity**

# September Returns and Activity



- **The preliminary total fund net return for September was -2.29%**
- **The preliminary fiscal year to date net total fund return is -1.72%**
  - Major asset classes negative returns; liquidity reserves positive
- **Investors continue to evaluate monetary policy and economic growth**
- **Rebalancing activity**
  - Allocated \$550 million to domestic equities
  - Reduced fixed income by \$500 million
- **Total investment assets ended September at \$87.5 billion**
  - Lower by \$2.6 billion during the first quarter

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# Initial Review of the Statement of Investment Objectives and Policy and Statement of Fund Governance



- **Initial review; final adoption at December 2023 meeting**
- **Board recently approved changes December 2022**
- **Most changes proposed are updates and fiduciary audit recommendations**

# Updated Capital Market Assumptions

**Exhibit 2: Asset Mix Policy and Return Expectations for STRS Ohio Total Fund**

Asset Class	Target Allocation <sup>5</sup> (%)	Rebalancing Range (%)	Expected 10-Year Policy Returns <sup>1</sup> (%)	Expected Management Net Returns <sup>2</sup> (%)	Expected Total Return (%)
Equity					
Domestic	26	21-31	<u>7.37</u> <del>6.60</del>	0.25	<u>7.62</u> <del>6.85</del>
International	22	17-27	<u>7.45</u> <del>6.80</del>	1.00	<u>8.45</u> <del>7.80</del>
Alternatives	19 <sup>4</sup>	0-5	<u>8.19</u> <del>7.38</del>		<u>8.19</u> <del>7.38</del>
-Private Equity	9 <sup>4</sup>		<u>8.53</u> <del>8.00</del>		<u>8.53</u> <del>8.00</del>
-Opportunistic/Div	10 <sup>4</sup>		<u>6.78</u> <del>5.73</del>		<u>6.78</u> <del>5.73</del>
Fixed Income	22	13-29	<u>4.23</u> <del>1.75</del>	0.35	<u>4.58</u> <del>2.10</del>
-Core	17	13-22			
-Liquid Treasury	5	0-7			
Real Estate	10	6-13	5.75	1.00	6.75
Liquidity Reserve	1		<u>2.77</u> <del>1.00</del>		<u>2.77</u> <del>1.00</del>
<b>Total Fund</b>	<b>100</b>		<u>7.17</u> <del>6.03</del>	0.40	<u>7.57</u> <del>6.43</del> <sup>3</sup>



- 4.5 From the 2022 Asset Liability Study, the 6.03% expected asset mix 10-year policy return was developed with reference to the observed long-term relationships among major asset classes. The Board believes this return expectation is reasonable but recognizes that the actual ten-year asset mix policy return can deviate significantly from this expectation – both positively and negatively. The volatility level associated with this asset mix is approximately 12.90%. **The Board's investment consultant updates capital market assumptions on an annual basis. The most recent updated capital market assumption results in a 7.17% expected asset mix 10-year policy return and associated volatility level for the asset mix of approximately 12.78%.**

**Revised/Approved Dates (current and past five years):**

**December 14, 2023**

**December 15, 2022**

**May 19, 2022**

**March 18, 2021**

**December 19, 2019**

**December 13, 2018**

## 4.0 Investment Decisions Delegated to Investment Staff

4.1 The Board, through the Executive Director, has delegated to qualified STRS Ohio investment staff the following investment management and implementation decisions:

- (a) Buying, selling, managing, and monitoring individual securities, real assets, and/or other investment transactions to achieve the total fund and asset class investment objectives approved by the Board;

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**(e) Investment staff will determine the most suitable fund management approach, internal or external, by assessing internal capabilities, comparing costs and benefits, and considering potential external collaborations.**

ESTABLISHED PARAMETERS AND RISK LEVELS, AND,

- (d) Preparing, negotiating, and executing external investment manager mandates, guidelines and fee agreements.

**(e) Investment staff will determine the most suitable fund management approach, internal or external, by assessing internal capabilities, comparing costs and benefits, and considering potential external collaborations.**

4.2 In making these decisions, STRS Ohio investment staff seeks the advice, guidance, and recommendations of Board-retained investment consultants, external investment managers and other experts and sources as considered prudent by STRS Ohio staff.

## 5.0 Board Oversight

- 5.1 The Board requires investment staff to prepare and deliver an Annual Investment Plan that explains how STRS Ohio assets will be managed in order to achieve the Board-established investment objectives. This provides the Board a focused opportunity to:
- (a) Question and comment on staff's investment management plans;
  - (b) Request additional information and support about staff's investment intentions; and
  - (c) Express its confidence in the Annual Investment Plan.

### **5.4 External management fees are reviewed annually by the board. To facilitate this review staff and consultants prepare and deliver an annual review.**

Investment decisions are based on total fund, asset class, and manager level performance. Performance is monitored and evaluated with respect to risk and return objectives established by the Board.

- (a) Investment risks are monitored and evaluated quarterly by comparing total fund and asset class risk characteristics relative to suitable *benchmarks*.
- (b) Investment returns are monitored monthly and evaluated quarterly by comparing total fund and asset class returns relative to suitable benchmarks.

### **5.4 External management fees are reviewed annually by the board. To facilitate this review staff and consultants prepare and deliver an annual review.**

- 5.54 Before approving or amending the criteria for monitoring and evaluating investment decisions, the Board seeks advice, guidance, and recommendations from STRS Ohio investment staff, Board-retained investment consultants, and other experts and sources as considered prudent by the Board.

October 19, 2023

Mr. Dale Price, Chair  
State Teachers Retirement Board of Ohio  
275 East Broad Street  
Columbus, OH 43215-3771

Dear Mr. Price,

The purpose of this letter is to share Callan's comments regarding proposed modifications to the STRS Ohio Statement of Investment Objectives and Policy and Statement of Fund Governance recently prepared by STRS Ohio Staff.

The Statement of Investment Objectives and Policy (SIOP) covers elements of investment strategy such as long-term investment goals, asset allocation strategy, asset class risk budgets, rebalancing, and benchmarking. Modifications included in the latest version of this document include changes that reflect Callan's 2023 capital market assumptions. As we discussed with the Board in March, Callan's 10-year forecast of asset returns increased meaningfully from our 2022 forecasts due to the significant change in macroeconomic conditions experienced in 2022. The SIOP currently covers all invested assets overseen by STRS Ohio but future versions will be created with distinct policies planned for each separate asset pool: Defined Benefit, Health Care, and Defined Contribution. This planned future change is based on explicit recommendations from Funston Advisory Services (Funston) to establish distinct policies covering each asset pool.

The Statement of Fund Governance (SFG) is evaluated in tandem with the SIOP. This document establishes critical governance functions at STRS Ohio, including delegation by the Board to the Investment Staff and crucial Board oversight activities. Two changes are included in the proposed draft and both relate to recommendations made by Funston. The first proposed addition to the SFG clarifies the Investment staff's role in evaluating whether internal or external investment management will be relied upon for certain investment strategies. The second proposed addition to the SFG clarifies that external investment management fees will be evaluated by the Board at least annually.

The SIOP and SFG are of critical importance in overseeing the investment function and understanding the many reports received by the Board on a periodic basis. Callan has reviewed the proposed changes to the Statements and discussed the proposed changes with STRS Ohio Staff. In addition to being comfortable with the proposed changes, Callan continues to feel the SIOP and SFG appropriately reflect

the high-level investment strategies set by the Board and provides for suitable oversight and monitoring of those investment decisions delegated to STRS Ohio Staff.

Callan recommends the Board approve the Statement of Investment Objectives and Policy and Statement of Fund Governance prepared by STRS Ohio Staff.

Regards,



Brady O'Connell, CFA, CAIA  
Senior Vice President

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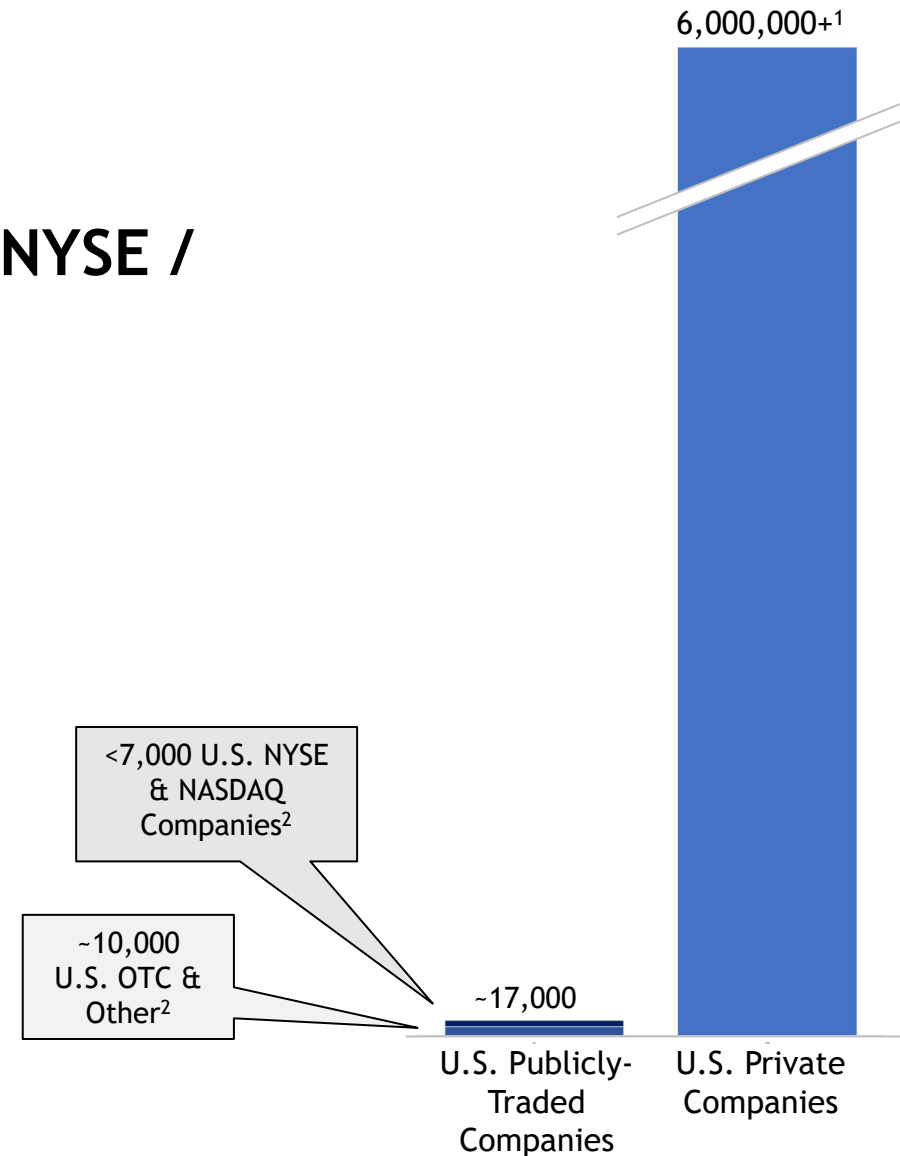
# Asset Class Presentation – Alternative Investments

Aaron DiCenzo

Oct. 19, 2023

# What is an 'Alternative' Asset?

- 6,000,000+ U.S. private companies
- <7,000 U.S. public companies listed on NYSE / NASDAQ exchanges
  - Down from peak of 8,000+ in 1990s





# What is an 'Alternative' Investment?

## Publicly-Traded Financial Assets

- **Stocks**
- **Bonds**



## Alternative Investments

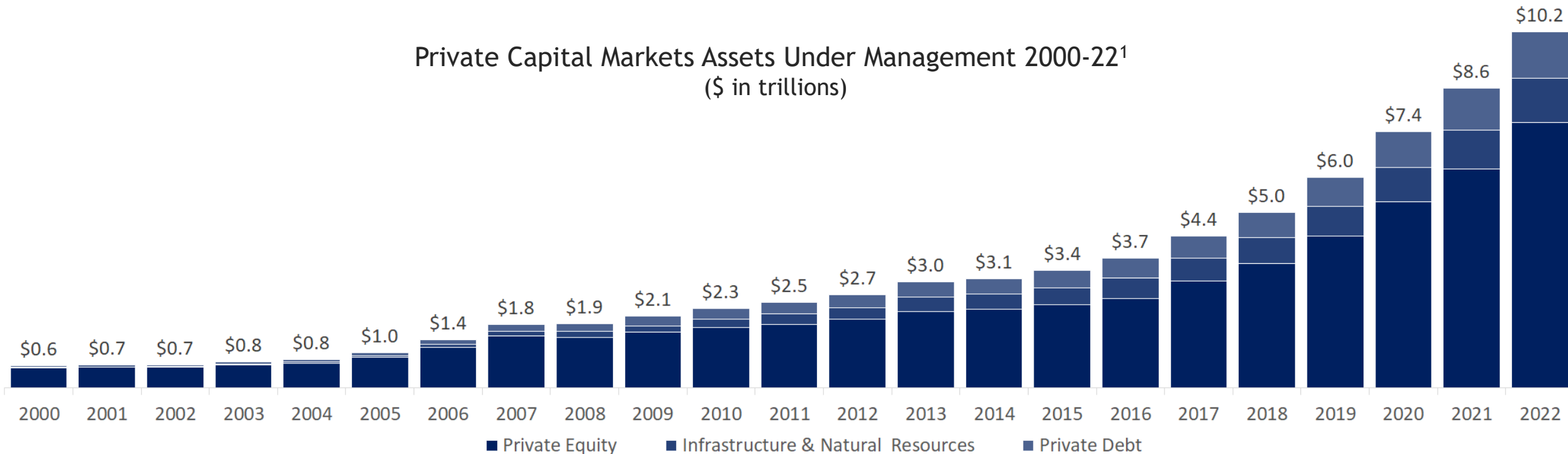
- **Private company stock**
- **Private lending**

# Alternative Investments Market Continues to Expand



- Estimated \$10.2 trillion addressable market in 2022<sup>1</sup>
- Broadly diversified by strategy, asset class and investor type

Private Capital Markets Assets Under Management 2000-22<sup>1</sup>  
(\$ in trillions)



<sup>1</sup> As of 6/30/2022; excludes real estate; Source: McKinsey & Company; Prequin

# Alternative Investments' Purpose within Total Fund



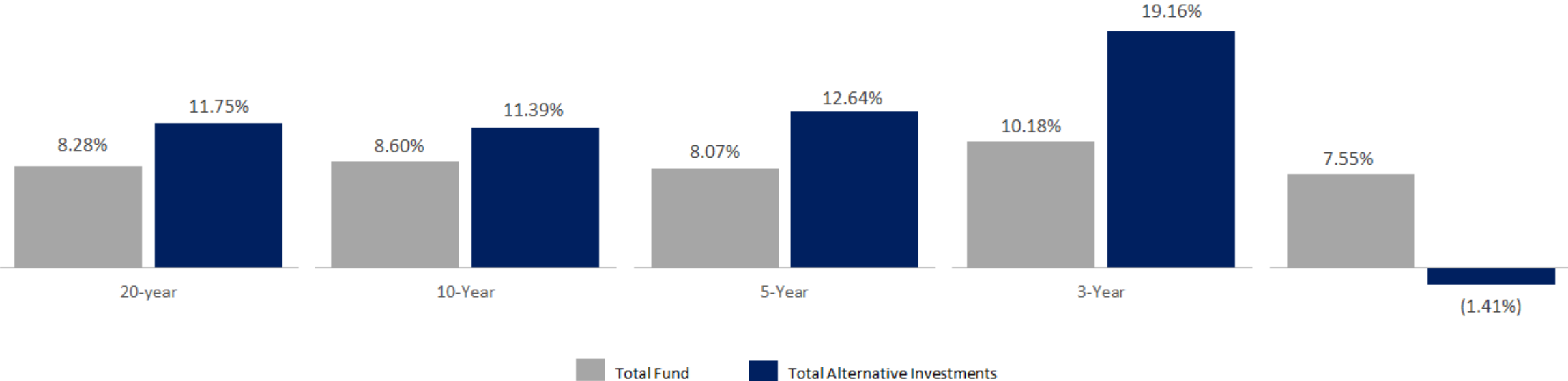
- **Growth**
- **Income**
- **Diversification**

# Alternative Investments' Purpose within Total Fund



- Alternative Investments increases Total Fund returns

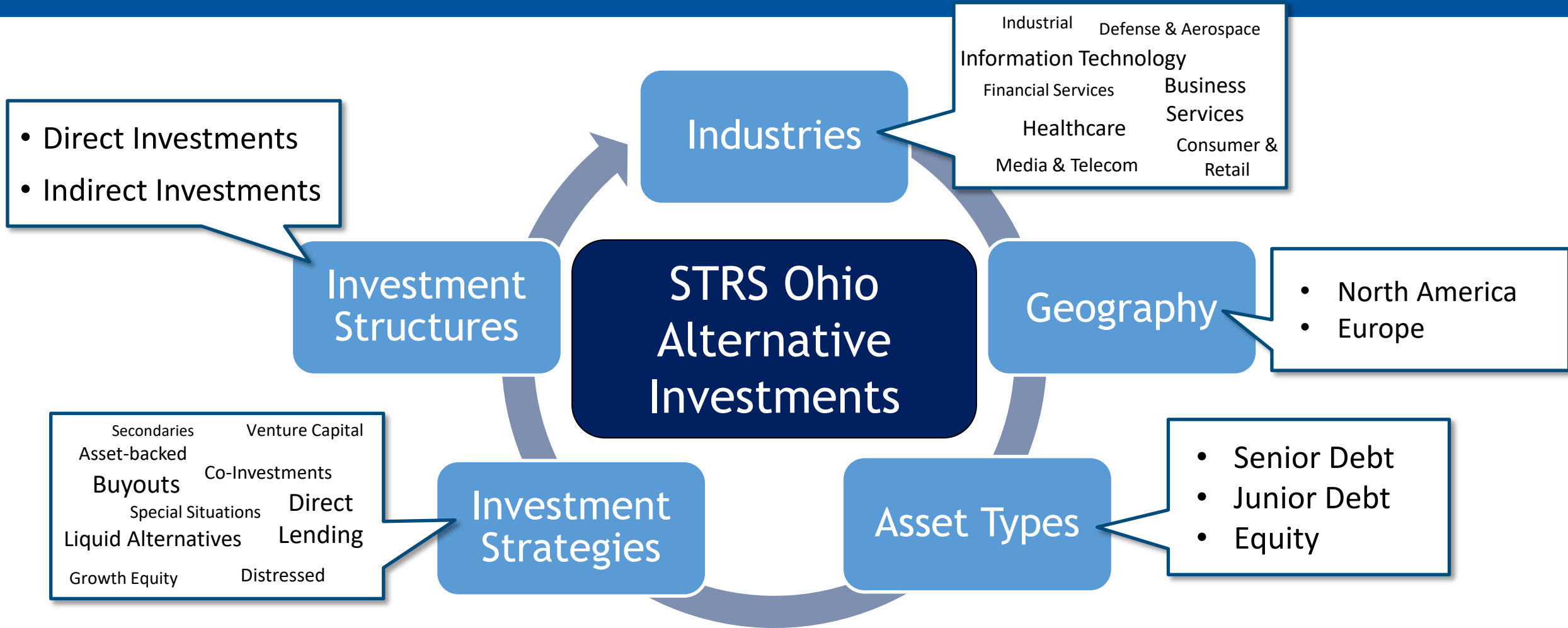
Comparative Historical 20-, 10-, 5-, 3- and 1-Year Total Fund Returns, net<sup>1</sup> vs Alternative Investments Returns<sup>2</sup> (as of June 30, 2023)



<sup>1</sup> STRS Ohio Total Fund, net returns are net of all internal and external investment management fees and costs, including carried interest and other fund expenses.

<sup>2</sup> STRS Ohio alternative investments returns are net of all external investment management fees and costs, including carried interest and other fund expenses.

# Alternative Investments' Purpose within Total Fund



*Highly diversified portfolio of 100+ managers, 400+ investments, 5,000+ companies*

# Alternative Investments Business Model

## The Ohio Model

- Funds**
- Private equity
  - Venture capital

**Generalist Teams**

- Asset allocation
- Diversification
- Manager selection
- Sourcing by relationships

**Specialty Funds**

- Opportunistic
- Thematic
- Sector

**Generalist Teams**

- Asset allocation
- Diversification
- Distinct themes
- Manager selection
- Sourcing by relationships

**Direct Investment Capabilities**

- Private equity
- Private credit
- Liquid alternatives

**Generalist-Specialist Teams**

- Asset allocation
- Diversification / Distinct themes
- Direct investment discretion
- Lower-cost
- External sourcing based on reputation and relationships

**Dedicated Administrative Resources**

- Dedicated internal counsel
- Third party fee validation
- Third party administration

**Lead Private Capital Investors**

- Majority-owners of private companies
- Lead private lenders
- Active private capital markets participation

**Specialist Teams**

- Asset allocation established
- Diversification established
- Specialist teams aligned with distinct themes
- Distinct investments
- Internal sourcing preferred

**Enhanced Administrative Capabilities**

- Operations
- Dedicated internal legal staff
- Third party fee validation
- Externally-facing administrative capabilities

Investors that are active at each level:

LPs, SWF, InsuranceCo, Endowments/Foundations

LPs, SWF, InsuranceCo, Endowments/Foundations

LPs, SWF, InsuranceCo, Money Managers

Lead Private Capital Investors, Money Managers

**Experience & intuition:** Total cost declines; governance and transparency improves; competition for deals and investment talent increases; number of investment staff and compensation increases; dedicated non-investment staff increases

## Board strategic initiative

- Investment objectives
  - Generate good risk-adjusted returns
  - Build a diversified portfolio
  - Lower investment costs by paying lower or no fees
- Operating objectives
  - Build and maintain skilled investment staff
  - Expand capabilities

# Investing at a Significantly Lower Cost

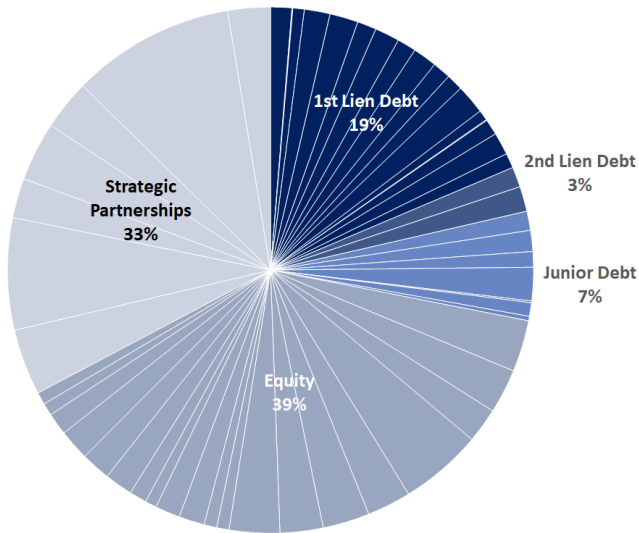


- Significant Direct & Co-Investment theme cost savings by investing directly in transactions
- 0.02%-0.05% estimated internally-managed Direct & Co-Investment cost
- Compared to private capital managers:
  - Typically ~1.00%-2.00% managements fees, plus
  - Additional costs associated with fund investments
  - Carried interest typically 10%-20% of excess profits

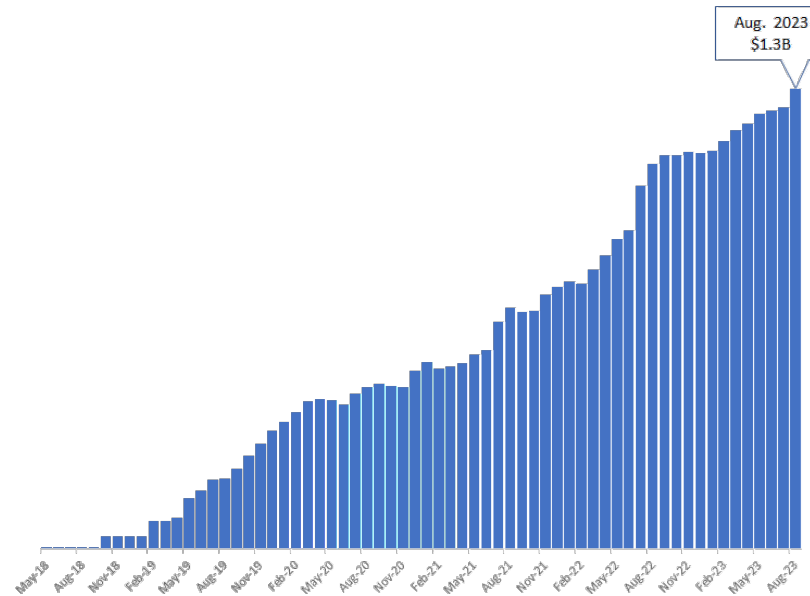


# Direct & Co-Investments Update

Direct & Co-Investments  
by Security Type



Illustrative Direct & Co-Investments  
Net Asset Value 2018-23



- **\$1.3 billion in current net asset value**
  - Over \$1.4 billion invested
  - Over \$500 million returned
- **12%+ inception-to-date return**

*Diversified portfolio, demonstrated asset growth & 12%+ inception-to-date returns*

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- STRS Ohio Board receives regular reporting and has access to significant information to devise policy and exercise oversight

## Data Available for Investment and Management

- Detailed due diligence / access to market research
- All governing documentation
- Portfolio company-level reporting
- Fund financial & investment reporting
- Direct access to investment managers and company / asset owners
- Recently-added resources:
  - Albourne - fee validation services provider
  - Hamilton Lane - third party administrator

## AI-Related Board Resources & Reporting

- Board independent investment consultant
- Board independent Alternative Investments consultant
- Third party assurance providers
- Board Reporting & Analysis
  - Monthly investment reporting
  - Quarterly performance reporting
  - Quarterly Alternative Investment (“Stoplight”) Report
  - Ad hoc board requests
- Investment Strategy
  - Annual Investment Plan
  - Asset class board presentations

# SEC Private Fund Adviser Rule Summary Overview



Topic	Private Fund Adviser Compliance Date
Quarterly Reporting	18 months
Audited Financial Statements	18 months
Adviser-Led Secondaries	>\$1.5b AUM - 12 months <\$1.5b AUM - 18 months
Disclosures and Consents	>\$1.5b AUM - 12 months <\$1.5b AUM - 18 months
Preferential Treatment	>\$1.5b AUM - 12 months <\$1.5b AUM - 18 months

*New SEC rules increase transparency to and fairness among private fund investors*



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