SPRING 2025

# SACRS

STATE ASSOCIATION *of* COUNTY RETIREMENT SYSTEMS

## DON'T LEAVE MONEY ON THE TABLE

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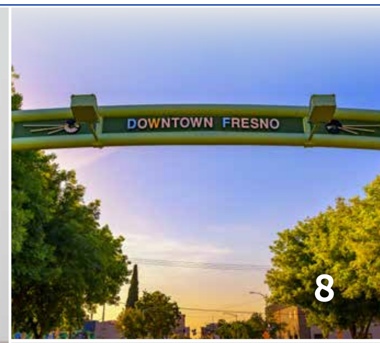









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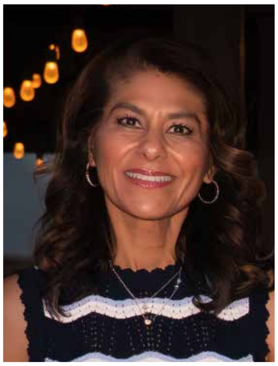

*"Our Affiliate members are vital to our mission and contribute in a variety of ways."*

# THANK YOU AFFILIATE MEMBERS!

I am happy to report that the Spring Conference was a huge success! We had a great (and productive!) time in Rancho Mirage. Thanks to everyone that came, to everyone that contributed to our local SACRS Community Hero Awardee, the Coachella Valley Rescue Mission, and a special thank you to our Affiliate Members.

Our Affiliate members are vital to our mission and contribute in a variety of ways. This magazine is a direct example of their sharing their vast knowledge with our system members. We encourage the Affiliates to contribute to each edition. To help offset conference expenses, Affiliates are offered sponsorship opportunities. Please look at the inside cover of this edition to see the various Affiliates that helped make Spring Conference 2025 possible. At the last few conferences, the Affiliates breakout sessions have been dedicated to educating System Members in incredibly fun and creative ways with the Shark Tank and Family Feud – SACRS Edition. The Affiliate Committee has worked hard to make these breakouts engaging and interesting. If you are an Affiliate member and want to become more involved, just reach out to me! There are lots of opportunities available for SACRS Fall Conference 2025 and this summer's UC Berkeley program.

Speaking of UC Berkeley – the SACRS Public Pension Investment Management Program is coming up July 13 – 16, 2025. Feedback about this immersive four-day intensive program is always highly ranked and recommended. Registration is open now. Just go to sacrs.org/Events/SACRS-UC-Berkeley-Program to learn more or to register.

I hope you find this issue of SACRS Magazine educational. We always appreciate feedback, so drop an email to sulema@sacrs.org and let us know what you think!

*Sulema H. Peterson*

***Sulema H. Peterson**, SACRS Executive Director, State Association of County Retirement Systems*

# HELLO, MY SACRS FAMILY!

> *"Whatever part you play in the pension system process – be proud of the work that you do."*

I hope you all are doing well.

We have a lot to be thankful for, especially during these unsettling times. Having our public pensions in place for our members provides them with a degree of financial stability and hope going forward. A myriad of life changes may occur, but our pensions are steadfast. This is a critical concept in regarding the work we do on behalf of our retirement systems.

The 20 counties of the CERL '37 Act serve over 500,000 members and have over 110 billion dollars in assets under management. Both numbers continue to grow, and we must think far into the future. Most systems have 30-to-40-year horizons as part of their planning calculus. If there are stabilizing factors in our society, then our public pension programs are definitely a part of them. We just completed our SACRS' 70th anniversary last year, but we are still in the relatively early stages of building our foundation of long-term success.

Defined benefit programs are very cost efficient and valuable forms of compensation for county employees as provided by the counties. Most of this compensation (over 60%) is funded by investment returns, 28% is covered by the plan sponsors (the counties) and 12% covered by the employees themselves. Pensions are critical in aiding the counties in recruiting and retaining vital public service employee talent.

On top of that, pension dollars received by retirees spill over into the local communities where the retirees reside. Take Contra Costa County for example. CCCERA pays out approximately $53 million per month to about 11,000 payees. Of that amount, about $30 million is paid to CCCERA recipients who live in Contra Costa County, Alameda County and Solano County. The impact of pension recipients on local economies is substantial.

Whatever part you play in the pension system process – be proud of the work that you do. This is all inclusive – retirement counselors, accountants, trustees, administrators, tech support, legal, fund managers, investment teams and consultants, compliance officers, auditors, actuaries, etc. – you all are part of the success of our mission. Our members rely on you and benefit from your efforts. Your work is incredibly meaningful. You impact people's lives. And you impact their communities.

I hope you attended SACRS Spring Conference 2025 in Rancho Mirage at the Omni Hotel. It was an outstanding program focused on education, understanding the world around us, and provided wonderful opportunities for networking and social gathering. If you didn't get a chance to go, make plans now to attend SACRS Fall Conference 2025 in Huntington Beach November 11-14. I guarantee it will be worth it!

Keep up the good work,

*David MacDonald*

***David MacDonald**, SACRS President & Contra Costa CERA Trustee*

*Adele Lopez Tagaloa,* *Orange County Employees' Retirement System*

# SACRS Elects New Board of Directors

***Newly elected Directors assume duties immediately.***

SACRAMENTO, CA – State Association of County Retirement Systems (SACRS) recently announced its new Board of Directors for the 2025-26 term, elected at the conclusion of its 2025 Annual Spring Conference held May 13-16 in Rancho Mirage, Calif.

SACRS welcomes Adele Lopez Tagaloa, Orange County Employees' Retirement System, as president of the Board of Directors. Other newly elected officers include Jordan Kaufman, Kern County Employees' Retirement Assn., as Vice President; Rhonda Biesemeier, Stanislaus County Employees' Retirement Assn., Secretary; and Zandra Cholmondeley, Santa Barbara County Employees' Retirement System, Treasurer.

Newly elected regular members of the board are Chris Giboney, Sacramento County Employees' Retirement System and Riley Talford, Fresno County Employees' Retirement Assn. David MacDonald of Contra Costa County Employees' Retirement Assn. will stay on the Board as SACRS Immediate Past President. Continuing in his role as an advisor to the Board in an educational, non-legislative, capacity is SACRS Affiliate Committee Chair Sean Gannon of Manulife Investment Management.

By working together, SACRS member systems provide better retirement security for California's public workers and their families. The activities and affairs of SACRS are conducted and all corporate powers are exercised by or under the direction of SACRS Board of Directors.


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# CHALLENGING MISCONCEPTIONS:

## Research Makes Compelling Case for Investing in Smaller Markets


> *"The findings uncovered surprising results on the vibrancy of local economies, outperformance in key real estate market fundamentals, and greater stability across the past 20 years."*

Cities such as Bakersfield, Orem, or Loveland aren't typically top-of-mind for institutional investors. But groups that once bypassed such secondary and tertiary markets in favor of major metros are now putting these smaller markets on their radar.

Institutions have traditionally viewed commercial real estate investment through a fairly narrow geographic scope with their sights firmly set on acquiring assets in primary markets. Even as competition and a search for better risk-adjusted yields pushed investors to expand their focus beyond the top 10 metros, they have typically moved cautiously and targeted large, fast-growing secondary markets.

That investment thesis is now changing, thanks in large part to greater transparency and historical data that presents a solid business case for strong performance of assets in smaller secondary and tertiary markets. Graceada Partners recently conducted an in-depth analysis of economic metrics and real estate fundamentals in workforce housing and industrial sectors in secondary and tertiary markets versus primary markets in the Western U.S. The findings uncovered surprising results on the vibrancy of local economies, outperformance in key real estate market fundamentals, and greater stability across the past 20 years.

When an institutional investor hears the term "secondary and tertiary markets," several concerns automatically come to mind, including lack of liquidity, less economic diversity and overall slower growth, particularly during economic downturns. Data-driven research is debunking many of those long-held market misperceptions.

> *"Secondary and tertiary markets in the West are economically more robust, and importantly, less volatile than primary markets."*

## VIBRANT LOCAL ECONOMIES

Secondary and tertiary markets in the West are economically more robust, and importantly, less volatile than primary markets. Analysis of data from Oxford Economics and the U.S. Bureau of Economic Analysis of 12 secondary and tertiary markets found that the sample set exhibited stronger GDP growth, income growth and job growth compared to bigger primaries, such as San Francisco and Los Angeles, over the 20-year period from 2002 to 2022. Key highlights include:

**Economic Growth:** GDP growth averaged 5.05% in secondary and tertiary markets– 36 bps higher compared to primary markets. During the Great Financial Crisis, GDP growth in secondary and tertiary markets was 300 bps better than in primary markets, and GDP growth also outperformed primary markets during the COVID pandemic.

**Job Growth:** Employment was consistently better in secondary and tertiary markets, even during the GFC and during the pandemic. Annual average job growth at 1.76% over the 20-year period is almost double the 0.92% in primary markets. Secondary and tertiary markets also posted consistently lower unemployment, with an average of 6.04% that is 35 bps below primary markets.

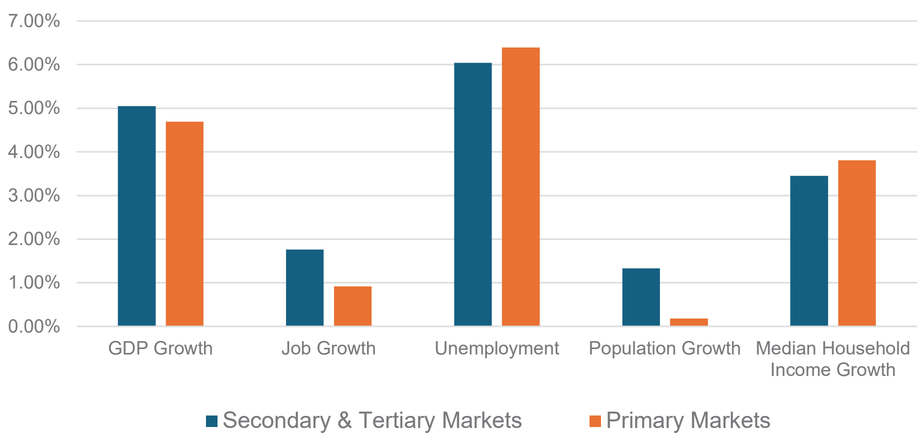
**Income Growth:** Household income growth in secondary and tertiary markets is on par with primary markets. However, growth in the smaller markets tends to be more stable, with fewer peaks and valleys as compared to primary markets. During the GFC, primary markets had more severe income declines, and during the pandemic secondary and tertiary markets posted continued positive income growth whereas primary markets had negative income growth.

## PEOPLE, DIVERSE ECONOMIES FUEL GROWTH

The perception that smaller metros are more likely to be so-called "one-mill" towns that are more prone to boom-and-bust cycles doesn't hold up in the West. Two key reasons why secondary and tertiary markets are outperforming are their diverse economies and population growth, including net in-migration.

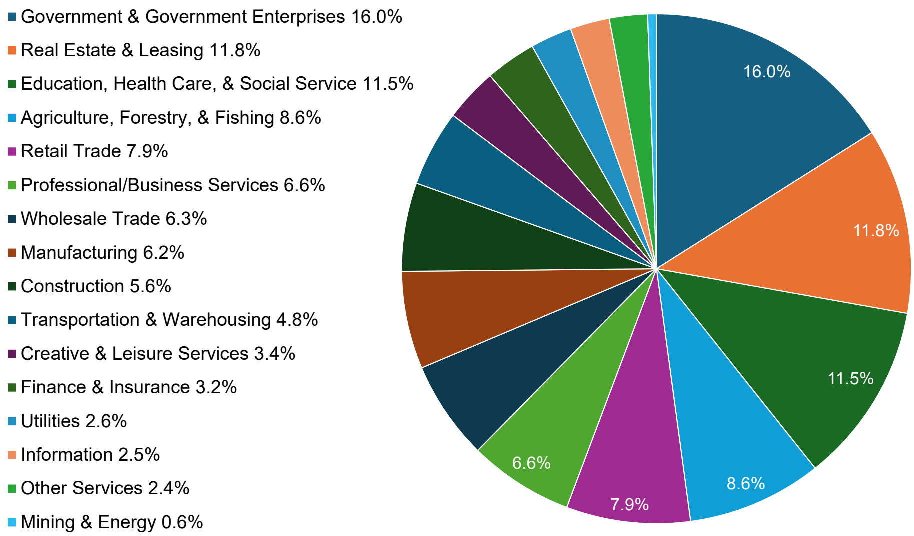
Among the dozen Western cities Graceada analyzed in California, Utah, Nevada and Colorado, all had broadly diversified economies with most having no single sector greater than 17% of GDP. The two exceptions are Sacramento and Colorado Springs, where the government represented 22% and 24%, respectively. In comparison, more than 50% of GDP in the San Francisco Bay Area is dependent on technology.

**Western US Economic Metrics -20 Years Average**




**Source:** U.S. Bureau of Economic Analysis, Oxford Economics
**Note:** Most recent 20 years of data as available

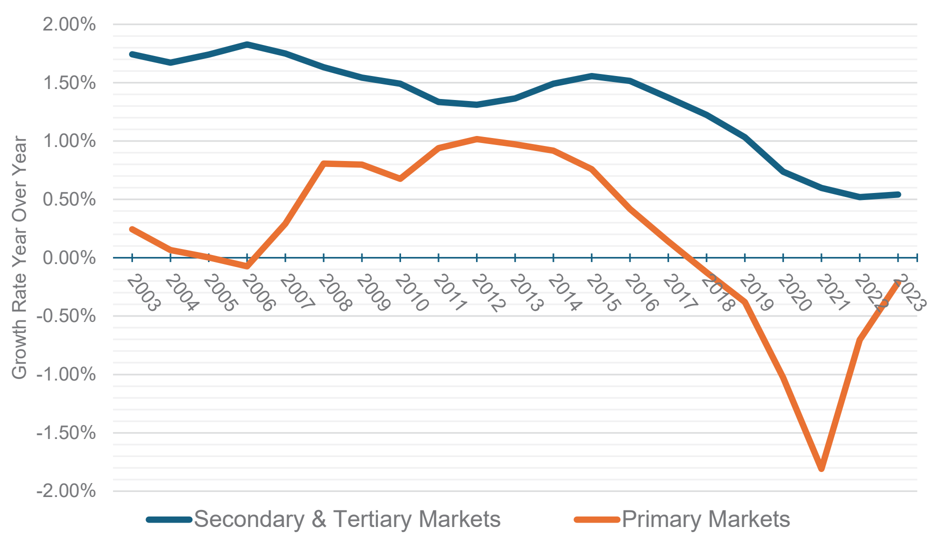
## Fresno GDP Diversity by Industry




**Source:** Bureau of Labor Statistics

> *"That strong economic base, and growth – in people, jobs, and incomes – drives demand for commercial real estate."*

## Western US Population Growth Rate




**Source:** CoStar

Fresno, for example, has a broad cross-section of industries ranging from manufacturing, transportation and agriculture to business & professional services and real estate. Among the top employers in Fresno County are major firms such as Cargill, Foster Farms, Pelco, Kaiser Permanente, and Amazon, among others.

Population growth is one of the biggest drivers of demand for real estate, and secondary and tertiary markets produce consistently higher net population growth with an annual average of 1.3% versus nearly flat growth in primaries at 0.2%. Primary market population growth exhibits almost twice the volatility of secondary and tertiary markets and registered declined in seven of the 20 years analyzed.

Another important point to highlight is that while the pandemic may have accelerated population growth out of primary markets and into smaller metros, data shows a consistent and positive trendline for Western U.S. secondary and tertiary markets over the last 20 years with no pandemic-induced spike. That suggests that these are long-term expansion markets that are receiving in-migration from other parts of the U.S. and not just from neighboring primary markets such as San Francisco or Los Angeles.

### SOLID FOUNDATION FOR REAL ESTATE

That strong economic base, and growth – in people, jobs, and incomes – drives demand for commercial real estate. The other side of the equation is supply. Another common misperception for secondary and tertiary markets is that there is abundant land and fewer barriers to entry for developers, which creates greater risk of oversupply.

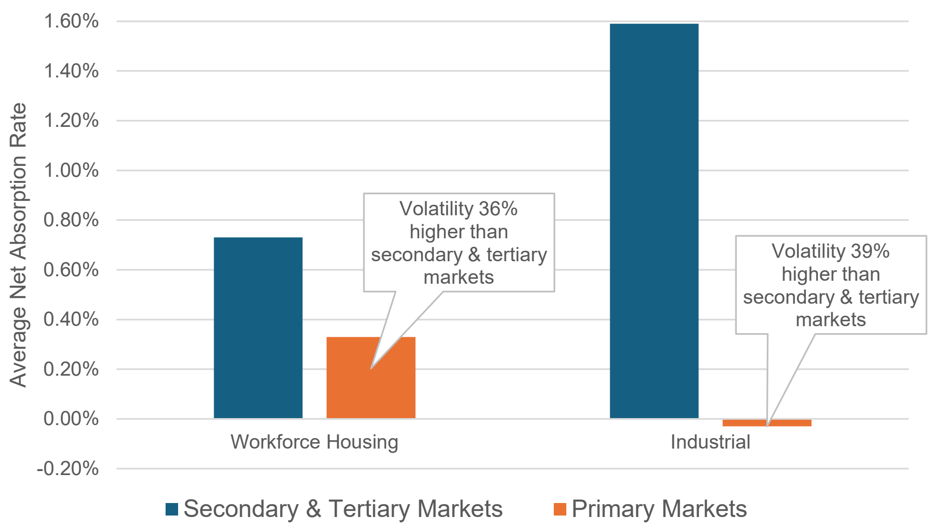
Analysis of CoStar data clearly shows greater volatility in supply and demand in primary markets when looking at net absorption. The likely reason for that is that there is more availability of capital for development in primary markets, whereas in secondary and tertiary markets, development tends to be limited

to private capital. The relatively good balance between supply and demand dynamics is another factor contributing to outperformance in market fundamentals.

## WORKFORCE HOUSING HIGHLIGHTS

- Rent growth: Secondary and tertiary markets average annual asking rent growth at 3.02% is roughly 40 basis points higher than primary markets.
- Net absorption: Secondary and tertiary markets have consistently better net absorption, with an annual average of 0.73%, more than double that of primary markets.
- Vacancy: While primary markets tend to have lower vacancy (4.75% on average versus 5.79%), data shows that vacancies have been converging.
- Cap rates: On average, cap rates are still higher in secondary and tertiary markets by about 45+ bps. In addition, the gap in cap rates between primary and secondary and tertiary markets has been narrowing since 2008, which underscores the broader acceptance of multifamily investment in these markets.

**Western US Net Absorption -20 Year Average**




**Source:** CoStar
**Note:** Most recent 20 years of data as available

## INDUSTRIAL MARKET HIGHLIGHTS

- Rent growth: Overall, primary markets lead in average annual rent growth at a rate of 4.31% versus 3.81%. However, secondary and tertiary markets outperformed during the GFC, and have posted stronger rent growth since 2017.
- Net absorption: Secondary and tertiary markets have consistently outperformed with annual net absorption of 1.59% versus -0.03% for primary markets, which likely underscores the greater risk of boom/bust development cycles in primary markets.

> “A snapshot of current market research shows that secondary and tertiary markets are continuing to follow historical trend lines.”

- Vacancy rate: Although vacancies trend higher in secondary and tertiary markets at 6.40% versus 4.91%, data shows that vacancies have been converging, especially over the past several years.
- Cap rates: Secondary and tertiary markets average cap rates that are 160 bps higher than primary markets. However, there is no convergence between cap rates (unlike in workforce multifamily), which potentially creates an opportunity for convergence in the future.

A snapshot of current market research shows that secondary and tertiary markets are continuing to follow historical trend lines. For example, a Q3 2024 research report on Sacramento’s multifamily markets published by Colliers showed a strong recovery in 2024. Demand outpaced supply by 1,000 units during the first three quarters, with vacancies at 5% and effective rents growing at an annual rate of 1.4%, pushing average rental rates past $2,000 for the first time ever.

Despite softening in many national industrial markets, vacancies in Colorado Springs dipped lower to 4.6% during the third quarter with newer class A space in particular that is in short supply. Asking rents grew at a modest 1.2%, while cap rates averaged between 6.5 and 7%, according to NAI Highland.

## EXPANDING INVESTMENT BOX

Targeting secondary and tertiary markets fits into what has been an ongoing trend in strategy for many institutional investors. Over time, institutions have been expanding their traditional view of what is considered to be the accepted “investable universe” and are continuing to move into new property types and sub-types, as well as new geographies.


A number of factors are opening pathways into new markets. The markets themselves are maturing and there is more data and transparency. Institutions also have developed their own processes for overcoming misperceptions, identifying opportunities, underwriting investment assets, and building the infrastructure and expertise to successfully execute investments in new areas.

A clear example of that expansion is the move beyond the traditional core property types and heavy concentrations in office into a variety of alternatives, such as self-storage, manufactured housing and single-family rentals, among others. In the early days for each of these new sub-sectors, there was a litany of reasons (and misconceptions) why such strategies or focus areas were “non-institutional” or not investable. Each time, those objections were ultimately overcome and the first investors into the space benefited from lack of institutional competition. That same trend is now underway in secondary and tertiary markets, and institutions have the potential to capture similar first-mover advantages.

***Ryan Swehla** is Co-CEO and Co-Founder at Graceada Partners, a value-add real estate investor focused on institutionalizing secondary & tertiary markets of the Western U.S. with a combination of entrenched market knowledge and institutional expertise. Ryan provides strategic direction for the firm and serves on Graceada Partners’ investment committee. His insights on the real estate investing climate have been cited in Institutional Real Estate Americas, The New York Times, Forbes, Barron’s, and REIT Magazine.*

# DON'T LEAVE MONEY ON THE TABLE:

## Strengthening Pension Board Policies to Monitor and Litigate Corporate Governance Actions Arising from Mergers and Acquisitions

*“Since the enactment of the PSLRA, pension funds and other institutional investors have played a vital role in federal securities class actions, and the data is well established that their leadership leads to larger recoveries and better outcomes for all class members.”*

Public pension boards are fiduciaries responsible for investing billions of dollars to fund retirement benefits for their members. Their fiduciary obligations extend to actively monitoring, evaluating, and, where necessary, leading litigation involving their securities investments. Traditional federal securities class action litigation is well-trodden ground and addressed by most public funds in formal board policies. But pension funds may be less familiar with the opportunities for both financial recoveries and governance improvements presented by corporate governance litigation, particularly in the context of mergers and acquisitions ("M&A"). This article explores the strategies and model policies pension funds can adopt to ensure they are recovering the full value of their stock in M&A deals and holding corporate insiders accountable for breaches of their fiduciary duties to shareholders.

## Updating Traditional Securities Litigation Policies to Clearly Address Corporate Governance Litigation

Securities monitoring and litigation is essential to carry out fiduciary oversight of trust fund investments. Securities litigation policies are therefore a well-established component of many pension boards' policies. These policies frequently focus on federal securities class actions governed by the Private Securities Litigation Reform Act of 1995 ("PSLRA") and, since 2010, securities litigation outside of the United States. Since the enactment of the PSLRA, pension funds and other institutional investors have played a vital role in federal securities class actions, and the data is well established that their leadership leads to larger recoveries and better outcomes for all class members. See James D. Cox, Randall S. Thomas & Lynn Bai, *There Are Plaintiffs and ... There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 Vand. L. Rev. 355, 379 (2008) (finding that "[t]he largest settlements arise in cases with institutional investor lead plaintiffs" and that "[p]ublic pension funds have by far the largest mean recoveries"). Since the U.S. Supreme Court's decision in *Morrison v. National Australia Bank*, 561 U.S. 247 (2010), which held that investors cannot bring or participate in U.S. securities class actions if their claims are based on securities purchased outside of the United States, many pension boards have updated their policies to include monitoring and evaluation of global actions.

Despite the strength of securities litigation policies in addressing public pension funds' vital role in traditional federal securities class actions and prudent monitoring of global securities actions, many public pension boards have not yet updated their policies to proactively monitor and provide clear guidance for their fiduciary decisions regarding corporate governance litigation, including M&A litigation involving their equity investments in U.S. public companies. As a result, real money is being left on the table.

*"In contrast, because many corporations are incorporated in Delaware—including over two-thirds of the Fortune 500—corporate governance litigation is typically governed by Delaware law and litigated in Delaware's specialized Court of Chancery."*

## An Overview of Corporate Governance Litigation

Corporate governance litigation is distinct from federal securities litigation. Securities class actions (and the right to opt out of a class and file an independent action) are governed by federal statutes, including the Securities Act of 1933 and the Securities Exchange Act of 1934, and litigated in federal courts throughout the United States. In contrast, because many corporations are incorporated in Delaware—including over two-thirds of the Fortune 500—corporate governance litigation is typically governed by Delaware law and litigated in Delaware's specialized Court of Chancery.[1] And even when a governance action is litigated in another state, many states follow Delaware law.

Broadly speaking, corporate governance litigation seeks accountability when corporate directors and officers breach their fiduciary duties to shareholders. Those fiduciary duties include their duties of loyalty and care, which prevent corporate directors and officers from putting their own interests ahead of the interests of shareholders. Pension boards, as fiduciaries themselves, are uniquely positioned to understand the importance of these duties, and to evaluate and lead legal actions to hold corporate fiduciaries accountable when their actions fall short.

There are two general categories of corporate governance litigation: (1) "derivative" actions and (2) "direct" or class actions, including breach of fiduciary duty and appraisal claims. The nature of and the different remedies available through each type of action are important for pension boards to understand.

### *Derivative Actions: Improve Governance and Long-Term Value for Company*

Derivative actions may be the most familiar to pension funds and the most likely to be covered—at least minimally—in current policies. These are actions in which shareholders seek redress for harm done to the *company* through directors' and officers' breaches of duty, which in turn harm shareholders "derivatively." In a derivative action, a shareholder commences litigation on behalf of the company, stepping into the shoes of the corporate directors. Typical scenarios giving rise to a derivative action including failures of board oversight that harm the company.

*"Indeed, derivative actions led by public pension funds in Delaware have resulted in significant improvements to corporate practices on issues like public corruption and bribery, public health and the opioid epidemic, and responsible labor practices."*

Derivative actions help improve company value over the long term by returning money to the company and driving positive governance changes. Indeed, derivative actions led by public pension funds in Delaware have resulted in significant improvements to corporate practices on issues like public corruption and bribery, public health and the opioid epidemic, and responsible labor practices. Thus, derivative actions led by public pension funds can be a powerful legal tool to further stewardship on governance issues that are important to many institutional investors. Because derivative actions are brought on behalf of the company seeking to redress harm to the company, any monetary remedy belongs to the company and no money typically is paid directly to shareholders.

### *M&A Actions: Directly Recover Fair Monetary Value for Shareholders*

"Direct" or class corporate governance actions typically arise from corporate transactions. Common scenarios involve (1) M&A transactions that raise concerns about self-dealing and conflicts of interest by corporate officers and directors, or (2) "controller squeeze outs," when a controlling shareholder takes a company private and buys out the minority shareholders. The concern in those cases is often whether corporate fiduciaries—i.e., directors, officers, or controlling shareholders—suffered disabling conflicts, received unique benefits from the deal, or prioritized personal interests over their duty of loyalty and as a result failed to maximize the deal's value for the corporation's public shareholders.

> *"In direct actions, the litigant receives the full merger consideration at closing and seeks additional damages over the deal price to redress harm by corporate fiduciaries."*

Shareholders like public pension funds can assert direct actions for breach of fiduciary duty, appraisal actions, or both, to protect their interests in these M&A scenarios. Appraisal actions are special statutory actions brought to protect an individual shareholder's right to a judicial determination of "fair value" of their shares in connection with certain deals. Direct actions for breach of fiduciary duty are actions in which shareholders (frequently as a class) seek redress for direct harm to shareholders caused by corporate fiduciary misconduct. Direct actions are based on Delaware common law; shareholders may seek monetary damages in the form of a premium paid per share, in addition to the deal price.

In most cases, direct actions are the more prudent approach for public pension funds. In direct actions, the litigant receives the full merger consideration at closing and seeks additional damages over the deal price to redress harm by corporate fiduciaries. As discussed in the case studies below, this additional recovery—in the form of a damages award or a settlement—can be meaningful, depending on the number of shares owned on the closing date. Conversely, appraisal actions require the petitioning shareholder to tie up the underlying funds beyond the closing date of the M&A deal (although the respondent in an appraisal may prepay interest).

Unlike in derivative actions, the recovery for direct breach of fiduciary duty actions is paid directly to shareholders who were harmed by the underlying misconduct. Shareholders are awarded monetary consideration in addition to the closing price. Direct actions also serve a broader purpose. In addition to holding corporate insiders accountable for breaches of their fiduciary duties, direct actions can create legal precedent that sets the bar higher for other corporate directors and officers going forward, an additional positive impact for equity investors like public pension funds.

## Key Procedural Considerations for Corporate Governance Litigation

### *First Conduct a Confidential Investigation to Determine How Best to Proceed*

Pension board policies should make clear that they will file public legal action only in strong, meritorious corporate governance cases. Importantly, when an announced M&A transaction, a rumor of a conflicted M&A transaction, or a public report regarding other potential corporate misconduct raises fiduciary concerns, expert legal counsel can be retained early to assist pension funds to conduct a confidential investigation under Delaware General Corporation Law Section 220 (or the equivalent statute in another jurisdiction). This investigation allows shareholders, with a proper purpose, to demand corporate books and records relating to the matter to determine whether legal action may be warranted. If the investigation uncovers corporate misconduct, counsel can advise how best to protect the pension fund's interests based on the findings, including taking no action or preparing and filing a direct or derivative action.

***Legal Claims and Property Interests Travel with the Shares***

As discussed above, in "direct" M&A litigation in Delaware, shareholders are harmed directly by corporate misconduct and may recover for that harm directly as well. Importantly, in these cases, the legal claims and right to share in the recovery "travels with the shares." That means that if the litigation achieves an increase in the share price above the deal value—either in the form of a settlement or a damages award—that value goes to the shareholders who own the shares when the deal closes. For that reason, it is important for pension boards to have strong policies and procedures in place to decide when to maintain holdings of a company's stock through the closing of a transaction to maximize the recovery when there is a potential corporate governance action that may result in an additional monetary payment if the litigation is successful. Additionally, Delaware courts will consider the size of a plaintiff's stock holdings when determining who to appoint as lead plaintiff for a class of shareholders in a direct action, raising strategic considerations for pension boards that want to lead the litigation.

## Last Words

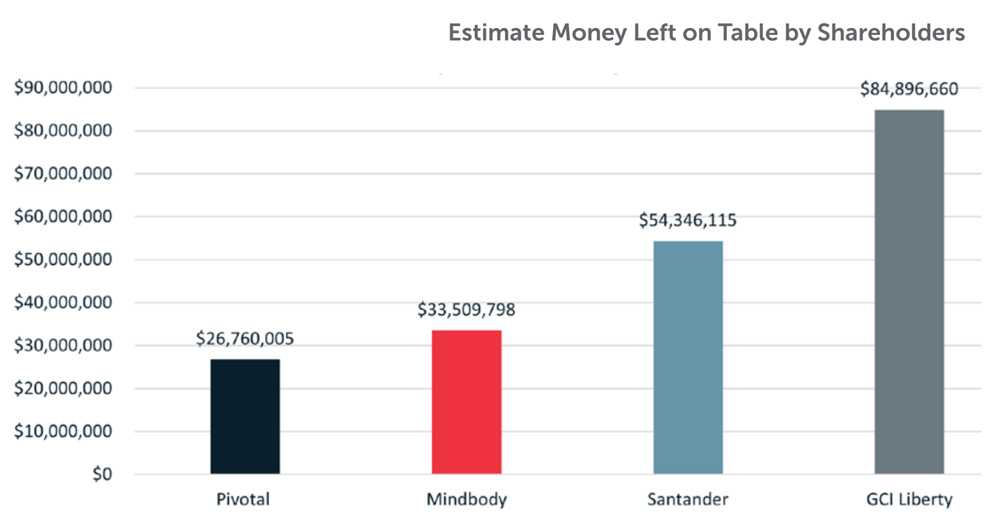
For pension funds, now is the time to update traditional securities litigation policies to strengthen policy language regarding corporate governance litigation, including both derivative actions and direct actions arising from M&A transactions. From a fiduciary standpoint, ensuring the full value of stock sales in M&A transactions and addressing corporate insider breaches of fiduciary duties is not merely about supporting good governance or the integrity of equities markets; it's about actively protecting the value of the fund's equity investments and ensuring that the fund—and ultimately its members—are receiving fair value for their shares in M&A deals. By building best-in-class policies regarding monitoring, evaluating, and litigating corporate governance actions, pension funds can recover financial benefits and reinforce their commitment to fiduciary excellence.

## CASE STUDIES: MONEY LEFT ON THE TABLE BY PUBLIC PENSION FUNDS IN M&A LITIGATION

Many pension funds currently do not have a strong policy to guide decision-making on M&A litigation and may not have access to expert legal advisors to provide timely guidance on strategic options. Without those proactive resources in place, it is challenging for pension funds to make timely and informed decisions whether to lead litigation or participate as a class member, and they therefore may miss out on any monetary recovery achieved through litigation because they did not hold shares at the time of the case's resolution. As demonstrated in the graph below,[2] that lost monetary recovery can be significant, depending on the number of shares held.

Recent cases, such as those illustrated in the bar graphs below, illustrate the fiduciary and financial stakes involved for pension funds in corporate governance litigation. Specifically, these cases demonstrate the importance of developing clear policies for M&A litigation that reflect the legal rule that, in those cases, the legal claims and property interest travel with the shares. In these cases, shareholders, including pension funds, missed out on millions of dollars in successful recoveries achieved through corporate governance litigation because of the shares they sold between the announcement and closing of the M&A transaction.[3] Decisions to hold shares should always be informed by independent fiduciary advice from qualified investment advisors. However, without a policy-driven approach to actively monitoring and engaging in corporate governance cases, pension funds risk missing out on substantial financial gains.

*"However, without a policy-driven approach to actively monitoring and engaging in corporate governance cases, pension funds risk missing out on substantial financial gains."*



## STEPS TO BUILDING STRONG POLICIES

*Strengthening Policies to Monitor M&A Transactions and Guide Fiduciary Decisions Regarding Corporate Governance Litigation*

Given these stakes, pension funds should develop and refine policies to monitor M&A transactions involving companies in which they are shareholders and to guide their decisions in corporate governance litigation, including direct and derivative actions. Strengthening these policies will empower pension funds to ensure they are protecting the financial value of their equity investments and support boards to better fulfill their fiduciary duties. Additionally, when serving as lead plaintiff in corporate governance class actions, having a clear policy with defined criteria for decision-making enhances the credibility of the fund and provides a strong foundation for any testimony required.

Strong policies should include the following key elements.

1. ***Establish Monitoring Mechanisms:*** Establish procedures for the ongoing monitoring of M&A transactions involving the pension fund's equity portfolio companies.
2. ***Engage Trusted Counsel:*** Retain experienced legal counsel who can provide timely expert guidance on the merits of potential claims and strategic options for the fund.
3. ***Conduct Confidential Investigations:*** With the assistance of expert legal counsel along with internal counsel, utilize tools such as books and records requests under Delaware law to confidentially investigate potential fiduciary breaches and determine whether legal action is warranted.
4. ***Articulate Clear Factors for Fiduciary Decisions:*** Ensure policies clearly state the qualitative and quantitative criteria for leading corporate governance cases. Clear policy factors strengthen fiduciary decisions and protect the fund's position in litigation.
5. ***Ensure Litigation Readiness:*** Define the decision-making process and roles and responsibilities of staff and outside experts for making and effectuating timely and informed decisions to file or join corporate governance litigation, ensuring readiness to act to protect the fund's interests when warranted.
6. ***Develop Guidelines and Investment Manager Communications Regarding Shareholding:*** Develop investment guidelines within the policy or cross-reference to the relevant investment policy section to address holding shares through the closing of M&A deals that raise governance concerns in order to maximize potential monetary recoveries for the fund in addition to the closing price. Such decisions should be based on independent fiduciary advice from the fund's investment advisors in addition to guidance from expert legal counsel and internal counsel.
7. ***Clearly Document Decisions.*** Ensure that the pension fund's decision to initiate an investigation or litigation is reflected clearly in board policies, board minutes, and other contemporaneous written materials. If the pension board has delegated such decisions to counsel or an executive, that delegation should be clearly stated in the board's policy. If the pension board makes decisions regarding active litigation directly in closed session, maintain attorney-client privileged records regarding the board's decision and vote to be kept confidential unless and until they are required to be publicly reported by the relevant open-meeting laws.

### RESOURCES

1 *See Delaware Division of Corporations, available at https://corp.delaware.gov/aboutagency/ (last visited Feb. 6, 2025).*

2 *The cases referenced in the bar graphs include In re: Pivotal Software, Inc. Stockholders Litigation, C.A. No. 2020-0440-KSJM (Del. Ch.); In re Mindbody, Inc. Stockholder Litigation, C.A. No. 2019-0442-KSJM (Del. Ch.); In re Santander Consumer USA Holdings Inc. Stockholders Litigation, C.A. 2022-0689-LWW (Del. Ch.); Hollywood Firefighters' Pension Fund, et. al. v. Malone, et. al., C.A. No. 2020-0880-SG (Del. Ch.).*

3 *The estimates in the graph are calculated by comparing the holdings of institutional investors at the time of the relevant deal announcement and the deal closing and multiplying the delta between the value of those shares by the per-share net monetary recovery achieved through the M&A litigation, after deducting court-approved attorneys' fees. The holding information used for these calculations is from investors' Form 13F reports, which are public reports certain institutional investors must file on a quarterly basis with the Securities and Exchange Commission.*

***Anya Freedman*** *is a trusted advisor to institutional investors on fiduciary law and governance matters. A partner in the Los Angeles office of Bernstein Litowitz Berger & Grossmann LLP, Anya helps pension leaders develop strong policies and make sound decisions in securities and corporate governance litigation so they can protect the value of their trust fund investments. Anya serves on the Council of Institutional Investors' Markets Advisory Council and has served on the National Association of Public Pension Attorneys (NAPPA) Fiduciary and Plan Governance Committee since 2019.*

***Christopher Orrico****, a partner in Bernstein Litowitz Berger & Grossmann LLP corporate governance practice, represents shareholders in breach of fiduciary duty litigation against boards and senior executives. Christopher has recovered hundreds of millions of dollars for investors, improved corporate governance practices at companies, and vindicated fundamental shareholder voting and franchise rights.*

*“While most private asset strategies thrived in the low-interest rate environment that was left in the wake of the late-2000s financial crisis, it was challenging for many hedged strategies.”*

# FUNDS-OF-ONE & MANAGED ACCOUNTS

## AMID NEW CAPITAL RAISING CLIMATES

Faced with a new macroeconomic, regulatory and political environment and an uncertain outlook for fund-raising, now is a vital time for investment managers and large institutional allocators to consider their fund structuring options.

> *"Funds-of-One are an outstanding fund-raising tool for asset managers and can enhance their alignment and engagement with investors."*

## THE INVESTMENT CLIMATE FOR PRIVATE ASSETS

Private asset funds, especially those run by new managers, are having a much harder time raising new capital. Several factors have converged to create these headwinds on the private markets:

- **Private Asset Targets:** After years of increasing exposure to private assets, many institutional investors now have a significant amount of their portfolios in private assets and are at or near those target allocation thresholds.
- **Private Asset Cash Flows:** Managers had been making larger-than-normal commitments to private assets because of rapid returns of capital that were occurring as the market offered a strong IPO exit environment for private companies. The end of a vibrant IPO market and the increased allocations of recent years are both contributing to allocation levels ballooning beyond targets.
- **Fundraising:** 43% of respondents to a survey published in November 2024 of 100 senior private equity executives in Asia, Europe and the U.S. cited geopolitical concerns as a potential hurdle to capital raising.
- **Exits and Liquidity Events:** Respondents to the same poll see unfavourable conditions for liquidity events over the next 12 months; however there has been an uptick in such activity as 2024 ends.

## A RETURN TO HEDGED STRATEGIES

While most private asset strategies thrived in the low-interest rate environment that was left in the wake of the late-2000s financial crisis, it was challenging for many hedged strategies. The broad market indices began a prolonged path of narrowing and concentrated price appreciation within a small group of stocks first represented by FAANG (Facebook, Apple, Amazon, Netflix, and Google) and later by the Magnificent Seven (the original FAANG stocks, with Netflix replaced by Microsoft, Nvidia and Tesla). This narrowing market environment presented an obstacle to hedge fund managers who did not hold an overweight in the dominant few stocks to compete with broad market indices.

On top of these conditions, as the markets were in recovery following COVID-related shocks after the COVID lockdown, meme stocks such as GameStop led to market dislocations after retail investors united on social media to exact damage on managers holding short positions in their beloved meme stocks.

While some hedged strategies, such as those focused on various forms of arbitrage, navigated these market conditions, many institutional investors reduced their hedge fund exposures to focus on long-only opportunities in the public and private markets.

### Separately Managed Accounts

Historically, large institutional investors have worked with investment managers to create separately managed accounts ("SMAs") to create buffers for their portfolio holdings and enhance their liquidity profile while exercising greater control.

SMAs helped create a solution that avoided the liquidity and transparency constraints and fee terms of some fund structures. They allowed investors to enjoy the liquidity of their own holdings, enabled them to take advantage of market dislocations without their capital being used to meet other investors redemptions, improved portfolio transparency, and often enhanced communication and fee terms with the manager. SMAs can be easy to establish. In addition to the contracting process, typically they only require creating an additional account with the allocator's existing custodian.

SMA structures can work well with strategies that are investing on a long-only basis in publicly traded liquid securities. They may, however, expose an investor to significant fee and agency risk in illiquid private assets. If held in the same name as the institutional investor, SMAs may even potentially expose the investor to liability risk beyond the value of the account. While these structures can be useful tools in some circumstances, better solutions are available to investment managers and large institutional investors who are seeking to improve transparency, pricing, liquidity, and control and may provide reduced risk and operational complexity and increased governance for alternative investment asset classes.

### Funds-of-One

Funds-of-One are an outstanding fund-raising tool for asset managers and can enhance their alignment and engagement with investors. They allow investment managers to create segregated vehicles for their allocator clients. The structure can accommodate, for example, an investment portfolio in private assets or a hedged strategy managed exclusively for the investor's benefit that also provides a comprehensive governance structure. These vehicles benefit from full third-party fund administration and accounting while using the asset manager's existing slate of service providers.

In addition, the Funds-of-One structure allows for easy tracking of investments across multiple vehicles. The fund administrator working on the structure can provide detailed, aggregated reporting solutions as well as middle office support and regulatory policy monitoring and compliance. While private asset vehicles are a bit simpler to launch via Funds-of-One, the structure also allows for managers to utilize their existing prime brokerage relationships. This makes the Fund-of-One an optimal tool for the delivery of an array of complex hedged strategies to large allocators that are looking for a fully segregated vehicle that adheres to their policies and objectives.

## Funds-of-One / Managed Account Platforms

For very large institutional investors, the creation of a proprietary platform may provide an ideal structuring solution. While the creation of a managed account or Funds-of-One platform may require a large allocator to hire service providers to implement the construction and operation of such a platform, it is a similar process that is followed by asset managers when launching a fund. It requires legal support from a fund attorney who can assist with the legal structuring, a third-party administrator who can provide the accounting and book of record for the fund vehicles and should include an auditor. The creation of this type of fund infrastructure is a common process, even with small managers launching new funds. For large allocators who want to also onboard hedge funds onto their platforms, there would be an additional requirement of establishing prime brokerage relationships for some strategies.

Key benefits of a managed account platform include:

- **Costs:** Large allocators may benefit from scale pricing that is better than that of their managers. Some large allocators have considerably more assets under management than the managers with whom they are investing. With a platform, such allocators could drive better pricing on many of these costs. Allocators could get scale pricing for administrative and audit-type services across multiple funds on the platform.

- **Reporting:** Transparency from reporting can be enhanced with a managed account platform. A service provider may create platform-level reports., in addition to fund-level reports. These platform-level reports can aggregate information such as asset class and entity exposures across the entire platform, as well as provide detailed information on fees and expenses. Risk reporting can be expanded to include correlation analysis of various platform components and scenario analysis, based on actual holdings.

- **SRAs:** In addition, allocators could streamline contracting processes with investment managers on their platforms through Strategic Relationship Agreements ("SRAs"). SRAs could enhance the ability to take advantage of market dislocations and enable portfolio teams to spend more time on investments rather than contracting. These agreements also enhance alignment of interest and potentially can improve investment performance while lowering contracting costs.

- **Liquidity:** Investor liquidity is generally driven by a particular fund's legal structure and redemption requirements. Managers usually try to match a fund's liquidity terms with the liquidity of the underlying investments and the strategy that is being implemented. This liquidity match may be disrupted, however, during periods of dislocation when other investors' need for capital forces managers to implement fund-gating provisions to protect fund holdings and investors. Under such market conditions, an investor who may be interested in buying into the dislocation may see muted results when trying to enter a fund as other investors are trying to exit. When allocators have their own platform, they can fully take advantage of dislocations without impact from other investors or reduce their exposures when they are not being well compensated for risk.

- **Performance:** The investment performance of allocators who own their own fund platform infrastructure may benefit from enhanced performance driven by improved cost structures, better portfolio information and risk management, as well as harnessing the structure's full capabilities to take advantage of market dynamics and their own portfolios' liquidity.

*As Head of Institutional Investor Solutions, **James Perry** is responsible for shaping the Maples Group's offerings and enhancing its service delivery to institutional investors including pensions, endowments, foundations, OCIOs and family offices. He brings more than 20 years of investment management experience, with 10 years serving in senior investment roles overseeing portfolios of public assets in California and Texas.*

***Nicholas Watson**, Regional Head of Fund Services, Montreal, manages the operations team for the Maples Group's fund services business in Montreal, which provides accounting and administration services to a wide range of investment funds including hedge funds, private equity funds, multi-manager funds, emerging market funds and unit trusts. He has significant experience in business process improvement, managing operational risk and developing client relationships.*

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AS WE SEE IT

**Jeffrey Palma**
Cohen & Steers

**Vince Childers**
Cohen & Steers

# FOMO, Reversals of Fortune and the Opportunity In Real Assets

*“In short, don’t let FOMO lead to poor portfolio construction.”*

As markets reach an inflection point, real assets stand out for their potential to diversify, protect against inflation and provide solid returns.

> *Meanwhile, stock and bond returns have become increasingly correlated, which means that stock-bond portfolios offer less diversification than investors have come to expect.*

## AVOID THE HINDSIGHT TRAP IN PORTFOLIO ALLOCATIONS

We, at Cohen & Steers, have fielded many questions about the role of real assets in portfolios and have often heard narratives about a preference for broad equities and private assets, driven in part by recent experience. We believe such thinking could have a material adverse impact on portfolio returns in the years ahead. Research shows that asset allocation is a dominant driver of returns. As such, investors need to carefully evaluate the market and macro landscape to consider how the future could play out. In short, don'tlet FOMO lead to poor portfolio construction.

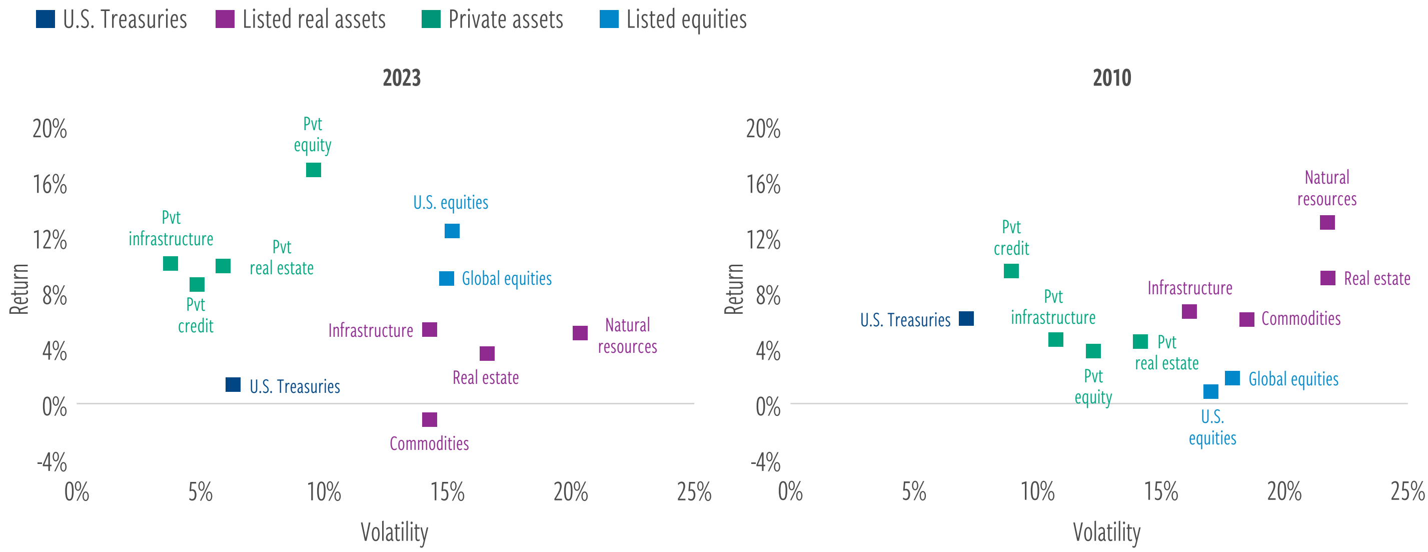
What is driving this thinking? To begin, consider the last decade, as shown in Exhibit 1. In the 10 years through 2023, global equities delivered a total return in excess of 8% per annum; U.S. equities were even more impressive, with a stunning annualized return of more than 12%. The performance of private assets was likewise remarkable, with double-digit returns in most categories amid extremely low (reported) volatility—more on this later.

Meanwhile, real asset returns were substantially lower. Excluding dividends, listed real estate returns would have barely been positive, while commodities had negative returns for the decade. Notably, U.S. Treasury returns were also paltry, driven by the starting point of interest rates post the global financial crisis (GFC) and the sharp rise in rates in 2022.

These recent returns stand in stark contrast to the 10 years that ended in 2010, which extend into the recovery following GFC lows. During that decade, equities were, by far, the worst-performing asset class (barely positive even with dividends). U.S. Treasuries returns, meanwhile, were strong, driven by falling interest rates and accommodative monetary policy. Private markets were also substantially weaker—and registered higher volatility during that period. Conversely, real assets were standout performers, led by natural resources.

In short, assets that performed well from 2001 through 2010 fared worse in the last decade, and vice versa. It should come as no surprise that returns are often unstable and mean-reverting, with starting valuations being key to future performance. While it is easy to become enamored with what has worked best recently, it's common to see reversals of fortune. Chasing leaders and succumbing to FOMO after 2010 would have been a recipe for poor returns. The current backdrop suggests that another inflection point may be upon us.

**EXHIBIT 1 | Asset class performance often changes over time**
**10-year annualized volatility/return (ending in 2023 and 2010)**



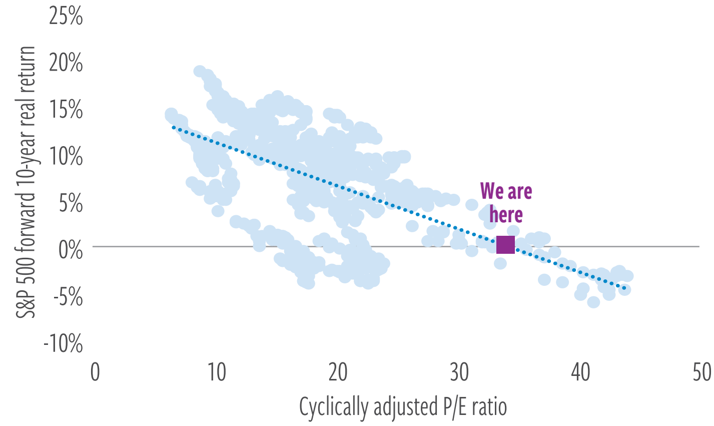

**At December 31, 2023. Source:** Burgiss, Barclays, Bloomberg, Dow Jones, FTSE, S&P, LSEG Datastream, Cohen & Steers.

**Past performance is no guarantee of future results.** The information presented above does not represent the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance listed above. Standard deviation, which represents historical volatility, is a measure of the dispersion of a set of data from its mean and is used by investors as a gauge of the amount of expected volatility. See endnotes for index associations, definitions and additional disclosures.

**EXHIBIT 2 | Current U.S. equity valuations pose headwinds to future returns**

Historical S&P 500 cyclically adjusted P/E (CAPE) ratio


CAPE ratio versus S&P 500 forward 10-year return




At September 30, 2024. **Source:** Research by Robert J. Shiller.

**Past performance is no guarantee of future results.** The information presented above does not represent the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance listed above. The cyclically adjusted price-to-earnings (CAPE) ratio is measured as the price of the S&P 500 Index divided by its 10-year moving average of earnings, adjusted for inflation.

## Little juice left to squeeze from equities

One key headwind for equities over the next decade is the starting point for valuations. Consider the Shiller cyclically adjusted price-to-earnings (CAPE) ratio. This measure of valuation is near an all-time high. While extreme valuations neither guarantee disastrous outcomes nor serve as catalysts for corrections, history suggests that 10-year forward returns tend to be challenged when the starting point for valuations is this elevated (Exhibit 2).

Looking ahead, we believe U.S. equity returns are likely to come (at best) solely from earnings growth and dividends rather than multiple expansion. More challenging outcomes are, of course, possible if multiples compress, as has been seen in previous episodes that began at these levels of valuation.

## Private asset classes also face headwinds

There are also reasons to believe private markets will struggle to repeat the extraordinary returns and (likely mischaracterized) low volatility of the past decade. Regarding volatility, it is worth noting that the true risks within these asset classes are higher than the statement volatility suggests due to appraisal valuations and other features of illiquidity. The lags of returns witnessed in private versus public real estate in this most recent cycle, and in previous cycles, underscore this reality. While this may be an attractive feature to some investors, there are implicit costs. For example, illiquidity impacts the ability to rebalance portfolios and to take advantage of market dislocations to sell at peaks or buy at

troughs. (This has been apparent in recent years.) Moreover, in asset classes such as core private real estate, there is no evidence that an illiquidity risk premium exists for investors.

One factor that has impacted both returns and volatility across private markets—the multi-decade decline in interest rates—is likely behind us. We believe yields of 4.0% to 4.5%, levels well above those that prevailed for most of the last decade, represent fair value in U.S. Treasuries. Consequently, the opportunity for private assets to lever investments at ultra-low and stable interest rates has largely vanished.

Private equity markets also rely on the ability to exit investments and return capital to investors. As it stands today, deal volume in IPO markets is near its all-time low. If broad equity valuations and overall returns falter, exits could remain challenging.

***Stock and bond returns have become increasingly correlated, providing traditional portfolios with less diversification than investors may expect.***

Private credit faces several challenges as well. Private credit benefited from major credit cycles when spreads blew out during the post–tech bubble and GFC periods. Now, in addition to higher interest rates, there is the issue of very tight spreads. As with stocks, the starting point of valuations matters. The rapid growth of assets and competition in the private credit market also pose a challenge. Private credit is now a $2 trillion asset class, 10 times larger than it was in 2009, according to Preqin. Given the increased competition in this market, there is a strong likelihood that returns will converge towards the broad corporate bond market.

## Diversification challenges: Concentration and correlation

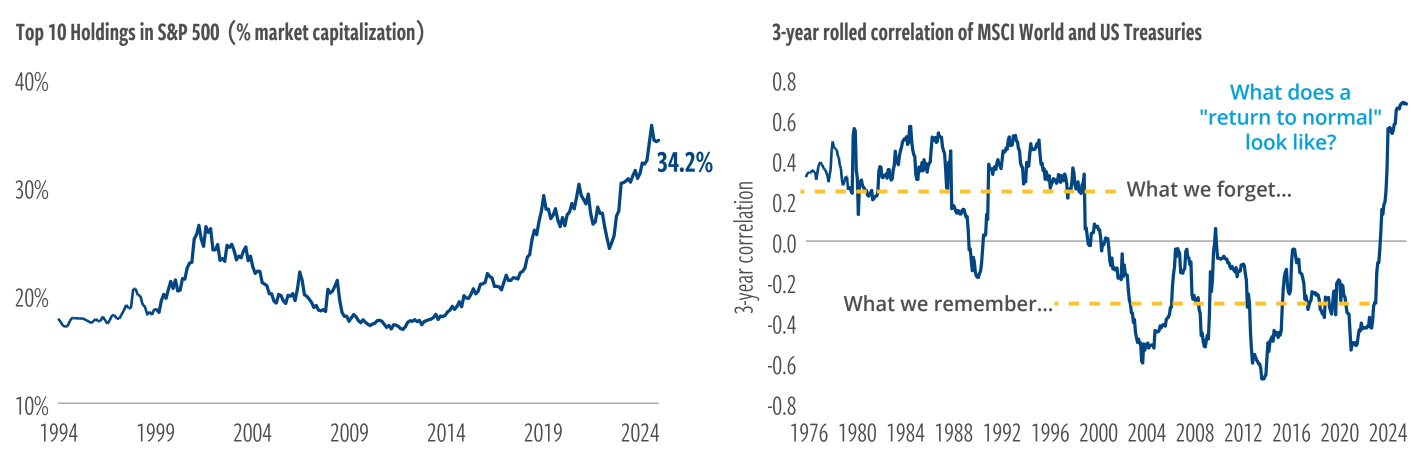
Diversification is another key aspect to portfolio construction and strategic asset allocation. In addition to the return challenges investors may face in equities, courtesy of elevated valuations, another issue of concern that may not be on investors' radar is the high degree of concentration in market capitalization-weighted stock indexes.

Equity market concentration has more than doubled in the past decade (Exhibit 3, below left chart). Strikingly, markets haven't seen this degree of concentration since the so-called "Nifty Fifty" era, which ultimately endured a spectacular collapse during the stagflationary bear market of the early 1970s. Just a handful of stocks now represent a large share of the market's overall capitalization and, therefore, risk and return outcomes. In effect, this results in a significant loss of diversification potential from equities.

Meanwhile, stock and bond returns have become increasingly correlated, which means that stock-bond portfolios offer less diversification than investors have come to expect (Exhibit 3, below right chart). When inflation was low and falling, the correlation turned negative. Bonds served as a cushion, protecting portfolios when equities struggled. But as inflation moved higher and interest rates normalized, the correlation changed. Correlation between stocks and bonds has turned positive, a condition that predates many investors' experience. In 2022, this danger was there for all to see as both stocks and bonds declined, resulting in one of the worst years ever for the typical 60/40 portfolio.

Higher interest rates suggest better return prospects in fixed income markets and, therefore, a greater appeal than in the prior decade. However, increasing one's allocation to fixed income comes with an array of added risks. For one, portfolios become more sensitive to inflation and duration risk.

**EXHIBIT 3 | The 60/40 portfolio offers increasingly less diversification than in the past**




**At September 30, 2024.** Source: Strategas Securities, LSEG Datastream, Bloomberg, Morningstar, Cohen & Steers.

**Past performance is no guarantee of future results.** There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin.

> *"Natural resource equities and real estate are best positioned for the new regime, with expected annual returns in excess of 8% on tap—nearly double their prior-decade performance."*

Following Republican presidential and congressional wins in the U.S. election, we see the potential for economic impacts in several areas, including trade policy, immigration and fiscal policy. All three can arguably be expected to deliver an inflationary impulse, stemming from higher tariffs, lower immigration, and lower taxes.

Furthermore, if today's higher correlation between stocks and bonds persists, total portfolio volatility and risk may remain elevated due to lower overall portfolio diversification.

## ASSET ALLOCATORS ARE FACING A HISTORICAL INFLECTION POINT

Our analysis indicates that we are entering a period consistent with an inflection point in the economic cycle and market backdrop. As we laid out in our 2024 Capital Markets Assumptions report, we believe the coming decade will be characterized by slower economic growth and higher, more volatile inflation (averaging around 3%, compared with the 1.8% rate of the previous decade). The bars in Exhibit 4 show the difference in returns we expect over the next decade as compared with the last 10 years. Point estimates of returns are also shown in the lower table. In short, as we see it, a reversal of fortunes is more likely than not.

Given their stretched valuations, we believe U.S. equities are set for more subdued annualized returns of around 7%, well below their returns in the last 10 years. Non-U.S. equities may produce similar returns, as a more attractive valuation starting point is offset by lower levels of profitability and slower earnings growth. Higher rates have made fixed income assets increasingly attractive. Though U.S. Treasuries should see an improvement over the previous decade, the expected annual return of 3.9% over the next 10 years is nevertheless relatively modest, and inflation surprises could threaten real returns.

In contrast, all core real assets categories are either neutrally or attractively valued and, we believe, positioned for meaningfully more substantial returns—compared with both the prior 10 years and relative to other asset classes. We see companies in the space as poised for higher profitability levels, driven by factors such as commodity undersupply (following years of underinvestment) and a move away from globalization toward onshoring. Other persistent inflationary pressures, as well as greater geopolitical uncertainty, also support real assets.

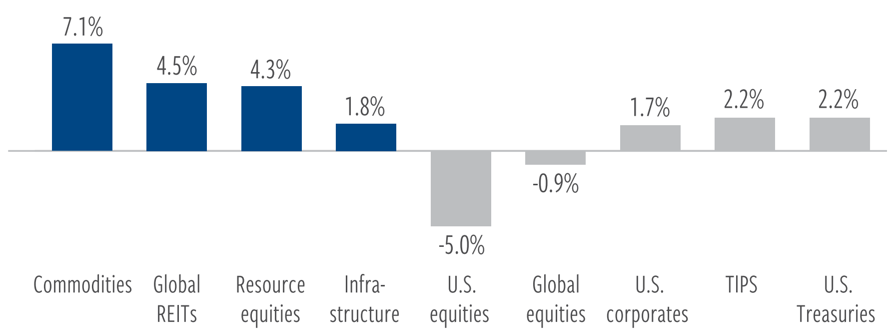
Natural resource equities and real estate are best positioned for the new regime, with expected annual returns in excess of 8% on tap—nearly double their prior-decade performance. Expected total returns for global listed infrastructure also appear attractive at 7.8%. Commodities, we believe, will see the most substantial improvement in returns amid undersupply and higher production costs.

## REAL ASSETS OFFER INVESTORS DISTINCTIVE PORTFOLIO BENEFITS

Beyond our favorable return outlook for real assets over the next decade, and in addition to their history of strong full-cycle returns, real assets offer valuable diversification potential. While metrics such as correlation and beta are often used to highlight this, these summary statistics can lack intuitive clarity. A breakdown of a market cycle may better illustrate how real assets diversify stock and bond exposures (Exhibit 5 on page 26).

**EXHIBIT 4 | Changes in return expectations favor real assets**

Cohen & Steers' capital market expectations for annualized returns vs. prior decade (%)




**Expected total return 2024–2033**

| Real assets | | | | Broad equities/Fixed income | | | | |
|---|---|---|---|---|---|---|---|---|
| **6.0%** | **8.1%** | **8.8%** | **7.8%** | 7.0% | 7.0% | 4.7% | 4.6% | 3.9% |

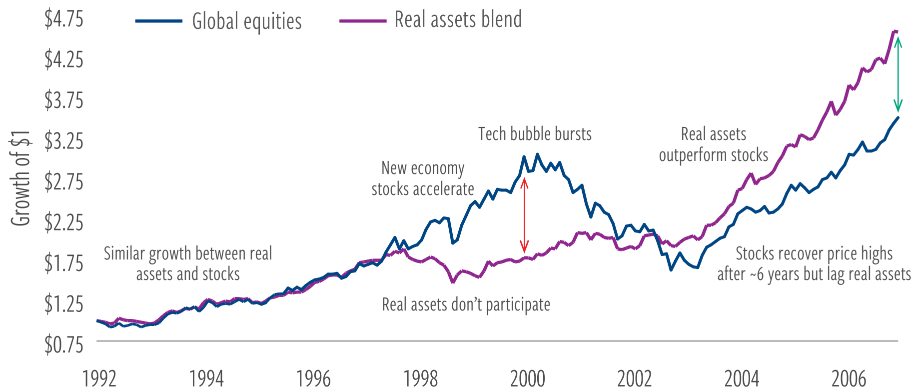
At June 30, 2024. Source: LSEG Datastream, Bloomberg, Cohen & Steers.

IMPORTANT: The capital market assumptions regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. The expectations and other information are for educational and illustrative purposes only. Hypothetical performance has inherent risks and limitations, and prospective investors should not place undue reliance on any such information. Because of Cohen & Steers' investment focus on real assets, Cohen & Steers will benefit from increased interest in the real asset classes and you should keep this conflict in mind when evaluating the capital market assumptions. Other investments may have characteristics similar or superior to real assets. Additionally, Cohen & Steers may make investment decisions that are inconsistent with the capital markets assumptions or any views expressed herein. Cohen & Steers may also develop and publish material that is independent of, and different than, the capital market assumptions or any views expressed herein.

**The intent of the capital markets assumptions is not to predict or project future returns of any investment, asset class or portfolio. Instead, the purpose of the capital markets assumptions is to express Cohen & Steers' view of expected general asset class returns of the period shown, which may be incorrect, potentially materially so, and are subject to change without notice. See endnotes for the Criteria and Methodology.**

**EXHIBIT 5 | Diversification goes beyond correlation statistics**
Historical returns before, through and after the tech bubble

> *"When the bubble burst, real assets outperformed as stocks plunged nearly 50%."*




| Annualized total returns | 1992–1996 | 1997–1999 | 2000–2006 | 1992–2006 | Max drawdown (1992–2006) |
|---|---|---|---|---|---|
| **Real assets blend** | **11.5%** | **1.0%** | **14.4%** | **10.6%** | **-22.4%** |
| **Global equities** | **10.8%** | **21.6%** | **2.2%** | **8.7%** | **-46.8%** |
| U.S. equities | 15.2% | 27.6% | 1.1% | 10.6% | -44.7% |
| Real estate | 14.5% | -2.5% | 19.9% | 13.3% | -35.5% |
| Commodities | 11.2% | -4.3% | 12.2% | 8.4% | -36.2% |
| Natural resources | 10.4% | 8.6% | 14.4% | 11.8% | -22.8% |
| Infrastructure | 12.5% | 6.3% | 12.1% | 11.1% | -39.2% |

**At September 30, 2024. Source:** Bloomberg, Cohen & Steers.

**Past performance is no guarantee of future results.** The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee investors will experience the type of performance reflected above. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend might begin. See endnotes for index associations, definitions and additional disclosures.

Here, we examine the 15-year market cycle from 1992 through 2006—a period marked by a historic market boom, bust and recovery—to gain insight into the value of a diversified real assets allocation. Arguably, there are echoes of this same dynamic in today's market. Stock valuations are once again in the 90th+ percentile, driven by investor interest in technology stocks and the handful of companies that dominate the market.

After initially tracking equities, real assets largely sat out the 1997–1999 tech bubble rally, lagging as "new economy" narratives took hold. When the bubble burst, real assets outperformed as stocks plunged nearly 50%. They continued to excel through the recovery, driven by their unique risk/return dynamics. Notably, while individual core real asset categories at times faced steep drawdowns themselves, a diversified blend of real assets saw only half the maximum drawdown of equities. In effect, core real assets also efficiently diversified each other across the full cycle period.

Zooming out and looking at market history through a different lens—one that considers economic conditions as well as initial conditions of sentiment and valuation—may help investors understand the distinctive diversification benefits of real assets. We believe today's historically stretched broad market valuation and related concentration risks underscore the need for effective portfolio diversifiers.

## Inflation sensitivity sets real assets apart

Real assets have historically shown resilience in a variety of economic and market environments, with payoffs that are often unsynchronized from the broad global equity market. And while real assets offer the potential for attractive full-cycle returns, their most distinguishing feature is their inflation sensitivity, which can help to buffer the adverse effect that inflation tends to have on equity and fixed income returns.

As Exhibit 6 demonstrates, inflation tends to be most damaging to a portfolio of stocks and bonds when the market does not see it coming, whether that "surprise" is proxied by year-over-year changes in the inflation rate itself (left-hand chart) or compares realized inflation to consensus expectations 12 months earlier (right-hand chart). Over the last 50 years, unexpected inflation has occurred roughly half of the time—and such upside surprises have tended to negatively pressure both stock and bond returns. Real assets' ability to counter inflation shocks offers potential benefits to portfolios in the short term, if prices unexpectedly climb, and in the longer term, should inflation rates more persistently surprise to the upside.

The post-Covid spike in inflation offers further, "real-time" proof of concept for the inflation sensitivity of real assets. Investors were blindsided by the inflation shock brought on by the confluence of lingering supply shortages and pent-up consumer demand. By the end of the second quarter of 2022, U.S. consumer inflation peaked around 9%—its highest level in more than 40 years, significantly above prior-year expectations.

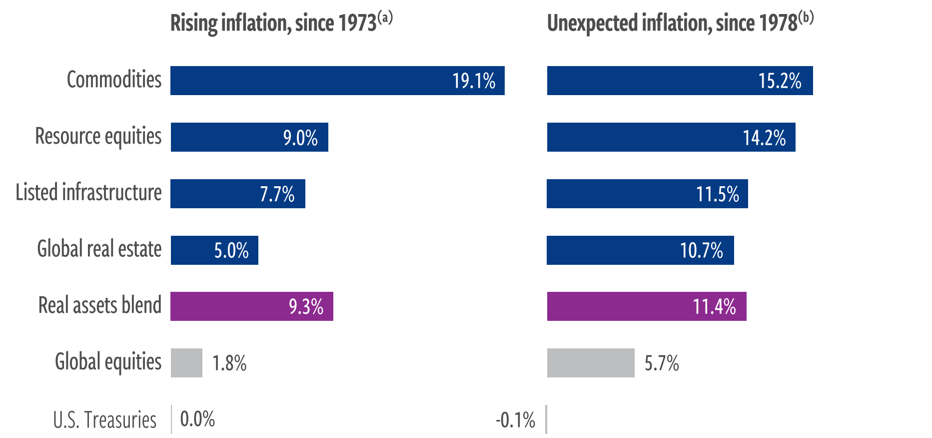
Exhibit 7 compares the relative performance of diversified real assets versus global equities during this unexpected surge in inflation. The blue bars compare realized inflation to 12-month prior survey expectations, and we see that the shock peaked in the first half of 2022. Relative returns for real assets, as compared with global equities, similarly accelerated during this period. At the relative performance peak in April 2022 (purple line), real assets were up more than 16% year over year, while the MSCI World Index was down 3.5%, reflecting outperformance of nearly 20 percentage points. Unsurprisingly (given the magnitude of the inflation surge), bond returns were likewise challenged during this period, declining more than 10% by the time inflation peaked in June 2022.

Bottom line: In accordance with the deep historical data, as the shock of unexpected inflation unfolded, stock and bond returns suffered while real assets "worked", delivering significant outperformance.

> *"In the final analysis, as we see it, the beneficial attributes of real assets warrant a strategic allocation in every investor's portfolio."*

**EXHIBIT 6 | Real assets have historically outperformed in inflationary environments**

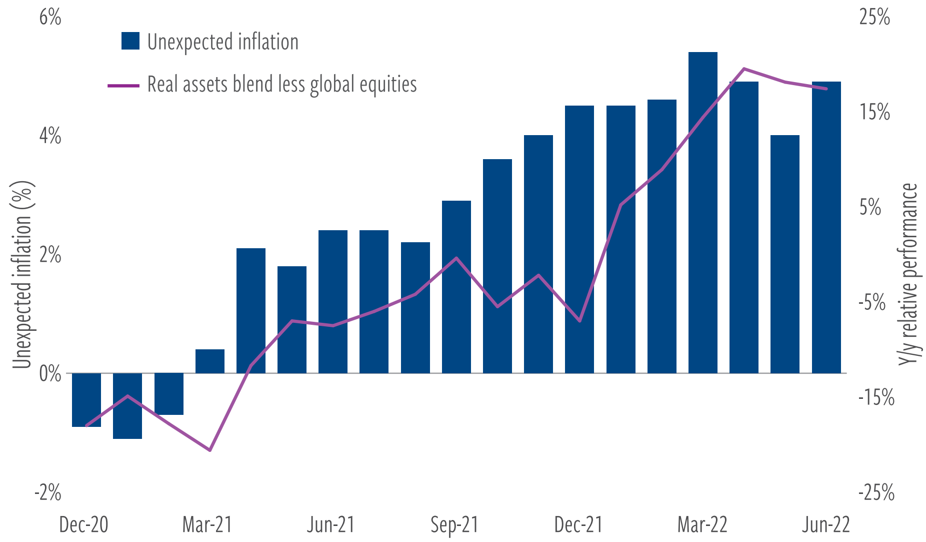
**Average annualized real returns in periods of...**




**At September 30, 2024. Source:** Barclays, Bloomberg, Dow Jones, FTSE, S&P, LSEG Datastream, Cohen & Steers.

**Past performance is no guarantee of future results.** (a) Represents the common period of available asset class returns. Rising inflation measured as a positive difference between the year-over-year realized inflation rate and the lagged 1-year inflation rate. (b) Unexpected inflation data begins in 1978. Inflation measured as the year-over-year change in the Consumer Price Index for All Urban Consumers, published by the U.S. Bureau of Labor Statistics. Unexpected inflation measured as a positive difference between the year-over-year realized inflation rate and lagged 1-year-ahead expected inflation, as measured by the University of Michigan survey of 1-year-ahead inflation expectations. The diversified blend of real assets shown above is composed of 27.5% real estate, 27.5% commodities, 15% natural resource equities, 15% infrastructure, 10% short-duration fixed income and 5% gold. The real assets blend is not representative of an actual portfolio and is for illustrative purposes only. **Commodities' performance includes back-tested returns**. The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. See endnotes for index associations, definitions and additional disclosures.

**EXHIBIT 7 | Preserving purchasing power Real assets' recent relative performance amid unexpected inflation**




**At September 30, 2024. Source:** Barclays, Bloomberg, Dow Jones, FTSE, S&P, LSEG Datastream, Cohen & Steers.

**Past performance is no guarantee of future results.** Inflation measured as the year-over-year change in the Consumer Price Index for All Urban Consumers, published by the U.S. Bureau of Labor Statistics. Unexpected inflation measured as a positive difference between the year-over-year realized inflation rate and lagged 1-year-ahead expected inflation, as measured by the University of Michigan survey of 1-year-ahead inflation expectations. The diversified blend of real assets shown above is composed of 27.5% real estate, 27.5% commodities, 15% natural resource equities, 15% infrastructure, 10% short-duration fixed income and 5% gold. The real assets blend is not representative of an actual portfolio and is for illustrative purposes only. Commodities' performance includes back-tested returns. The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. See endnotes for index associations, definitions and additional disclosures.

## A sensible permanent portfolio allocation

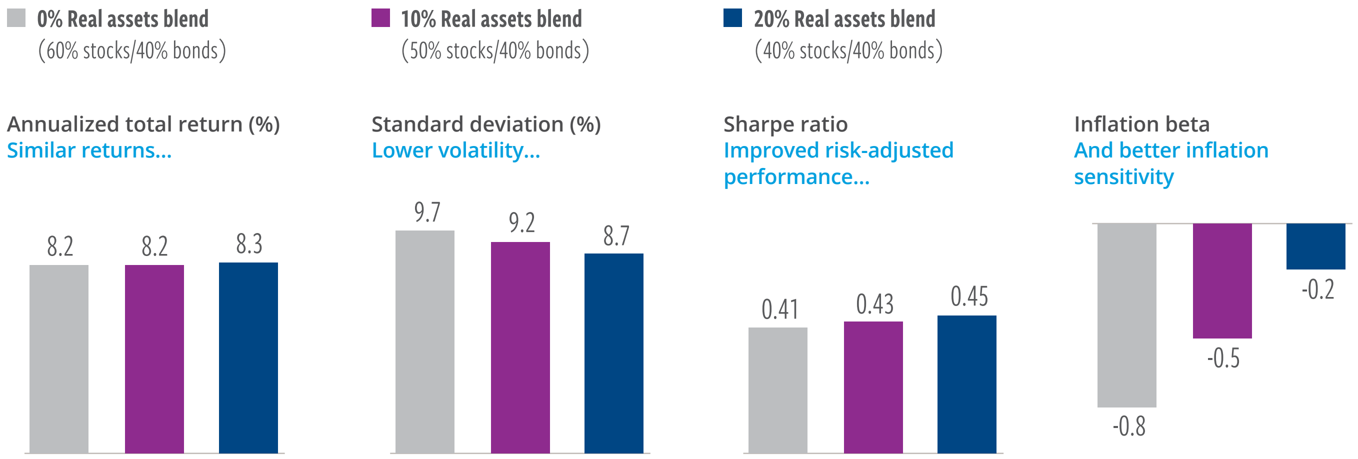
In the final analysis, as we see it, the beneficial attributes of real assets warrant a strategic allocation in every investor's portfolio.

Historical analysis spanning multiple market cycles and economic regimes shows that including a blend of real assets in a representative portfolio of stocks and bonds offers the potential to preserve returns, reduce risk through greater diversification and improve portfolio efficiency—while also helping to defend against inflation (Exhibit 8).

We attribute these results to the distinct return drivers of the underlying assets and their individual sensitivities to the business cycle. Keep in mind that historically, no single real asset category has excelled across each of the criteria of total returns, diversification potential and inflation sensitivity. Some real assets have historically performed better on certain dimensions than others, requiring investors to consider various strengths and tradeoffs according to the specific role of real assets in their portfolios.

But thoughtful diversification across real assets is likely to deliver improved risk/reward outcomes, while also allowing investors to modulate the inherent negative inflation sensitivity of core stock and bond allocations toward something closer to neutral over the long haul.

**EXHIBIT 8 | Real assets can improve risk-adjusted returns**
Effects of adding real assets to a stock/bond portfolio (1973–2024)




**At September 30, 2024. Source:** Barclays, Bloomberg, Dow Jones, FTSE, S&P, LSEG Datastream, Cohen & Steers.

**Past performance is no guarantee of future results.** The information presented above does not reflect the performance of any fund or other account managed or serviced by Cohen & Steers, and there is no guarantee that investors will experience the type of performance reflected above. An investor cannot invest directly in an index, and index performance does not reflect the deduction of any fees, expenses or taxes. Index comparisons have limitations, as volatility and other characteristics may differ from a particular investment. Return reflects compound annualized return. Risk reflects annualized standard deviation of monthly returns. There is no guarantee that any historical trend illustrated above will be repeated in the future, and there is no way to predict precisely when such a trend will begin. Inflation beta determined by calculating the multivariate regression beta of 1-year real returns to the difference between the yearover- year realized inflation rate and lagged 1-year-ahead expected inflation, including the level of the lagged expected inflation rate. Inflation is measured using the Consumer Price Index for All Urban Consumers, published by the United States Department of Labor's Bureau of Labor Statistics. Expected inflation, as measured, reflects the median inflation expectation from the University of Michigan's survey of 1-year-ahead inflation expectations. A real rate of return is the annual percentage return realized on an investment, which is adjusted for changes in prices due to inflation. See endnotes for index associations, definitions and additional disclosures.

*__Jeffrey Palma__, Senior Vice President Cohen & Steers, is Head of Multi-Asset Solutions responsible for leading the firm's asset allocation strategy and macroeconomic research. Prior to joining the firm in 2021, Jeff was a managing director at State Street Global Advisors, where he led a team of 20 individuals responsible for investment strategy and strategic asset allocation, as well as portfolio construction and implementation.*

*__Vince Childers__, CFA, Senior Vice President, is Head of Real Assets Multi- Strategy and a portfolio manager for Cohen & Steers' real assets strategy. Prior to joining the firm in 2013, Vince was a portfolio manager for real assets strategies at AllianceBernstein, where he co-managed a research team overseeing $2.3 billion in assets.*

## KEY TAKEAWAYS

### Avoid the hindsight trap in portfolio allocations

FOMO (fear of missing out) all too often plays an element in portfolio construction. But focusing on what worked well in the past can be a recipe for disappointment. We anticipate material headwinds for the winners of the recent past.

### Asset allocators are facing a historical inflection point

Equity markets increasingly depend on the fates of a handful of stocks, valuations are unappealing, and inflation risks could leave stock/bond correlations near 50-year highs. By contrast, return expectations in the new regime favor real assets.

### Real assets offer investors distinctive portfolio benefits

Both history and recent experience attest to the distinctive diversification potential and inflation sensitivity of real assets. We believe the beneficial attributes of real assets warrant a strategic allocation in every portfolio.


# BUDGETING

*“Different examples of risk include investment risks such as drawdown, inflation, liquidity, and active as well as organizational risks such as behavioral and shortfall.”*

While risks can be anticipated, they cannot be predicted. As investors we make investments today using our insights from historical data, our understanding of the present, and our expectations for the future; however, risk exists because the future is unknown.

Given the uncertainty of risk, it is important that investors understand their risk tolerance levels. In this article, the first in a series, we address how to measure risk, with the goal of helping investors better understand how much risk they are willing to take to achieve their investment goals. In future installments of this series, we address the topic of risk budgeting – what it is, why it matters, and how to do it.

## Risk Lenses

Risk is multi-faceted and can be viewed across a risk spectrum. Investors must consider how different risks may influence performance, and the board must decide what guardrails are necessary to manage these risks. This work is often done in conjunction with staff and the consultant and is codified in the governing documents such as the Investment Policy Statement. Different examples of risk include investment risks such as drawdown, inflation, liquidity, and active as well as organizational risks such as behavioral and shortfall. Wilshire's multi-dimensional view of risk is shown below.

- **Shortfall:** Support distributions and long-term growth
- **Behavioral:** Instill strong governance
- **Drawdown:** Limit portfolio losses
- **Inflation:** Preserve long-term purchasing power
- **Liquidity:** Balance near-term needs, long-term opportunities
- **Active:** Ensure unique exposures
- **Emerging and Long-Term:** Environmental, Social & Governance (ESG) risks, such as externalities, intangibles and reputation may be linked to various risk lenses


*For illustrative purposes only.*

Risk budgeting, the topic of future installments of this series is primarily related to active risk. We discuss active risk further in the following section.

> *When assessing risk, it is important to consider total fund tracking error which is the aggregate active risk of all investments versus the strategic policy.*

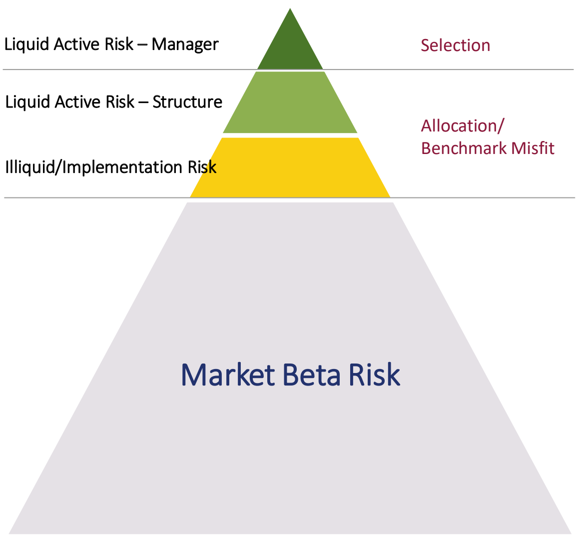
## Tracking Error

Tracking error is equal to either the realized or expected volatility of the excess returns. A plan should only accept tracking error in two circumstances: 1) if they expect to get compensated for that risk by generating additional return, or 2) if that risk is unavoidable in order to access the underlying beta, as is the case for many private market investments.

Many strategic policy portfolios cannot be implemented passively for a combination of reasons. First, rebalancing is costly, and transition costs should always be considered. Second, private markets are not directly investable in a passive vehicle and benchmarking remains a challenge. The result of this implementation hurdle is that portfolio returns can deviate from policy returns – be it to the upside or downside.

While tracking error is often associated exclusively with how much risk an active manager takes relative to its benchmark, active manager risk is not the only source of tracking error for asset owners. When assessing risk, it is important to consider total fund tracking error which is the aggregate active risk of all investments versus the strategic policy. The total fund tracking error can, and should, be split up among the various stakeholders (e.g., decisions made by staff/the board and decisions made by active managers).

**TYPES OF RISK**




*For illustrative purposes only.*

Market beta risk is the risk inherent within investing, beta representing the policy benchmark. This risk is a passive risk, rather than an active one.

Allocation/benchmark mismatch is an active risk and stems from differences in style in the portfolio versus the policy benchmark. The key stakeholder/responsible party for this risk is staff and/or the board. This type of misfit risk can be from structural differences (e.g., intentional tilts within a portfolio such as an overweight to U.S. equity relative to policy) or from risks associated with the implementation of the strategic asset allocation, such as decisions on which active managers to hire within a given portfolio. Another example of misfit risk is illiquid implementation risk. For instance, an emerging market debt fund may run into this actionable risk when executing the portfolio allocation. Due to the sporadic trading of a specific sovereign bond (e.g., Ghanaian government bond), an emerging market debt manager may lack the ability to easily replicate the benchmark, potentially leading to the bond's exclusion from the index and the fund taking on actionable tracking error risk.

In contrast, Manager Risk is also an active risk but is associated with how alpha generative asset managers are relative to their respective benchmarks.

> *"To help manage risk, the board must determine which risks and how much risk it is willing to endure over a market cycle."*

## Standard Deviation

For a board seeking to understand its risk tolerance level, it should consider the range of outcomes inherent in adding additional risk to the portfolio. To help manage risk, the board must determine which risks and how much risk it is willing to endure over a market cycle. While there are many ways to measure risk, standard deviation is often used as a proxy for risk. Standard deviation measures variation or dispersion around a central point. In this case, the central point is expected return. The example assumes an expected rate of return of 6.5% and a standard deviation of 12.5%. The graphic shows that, statistically, 68% of the time the return is expected to be within +/- 1 standard deviation of 6.5%, or between -6.0% and 19.0%.

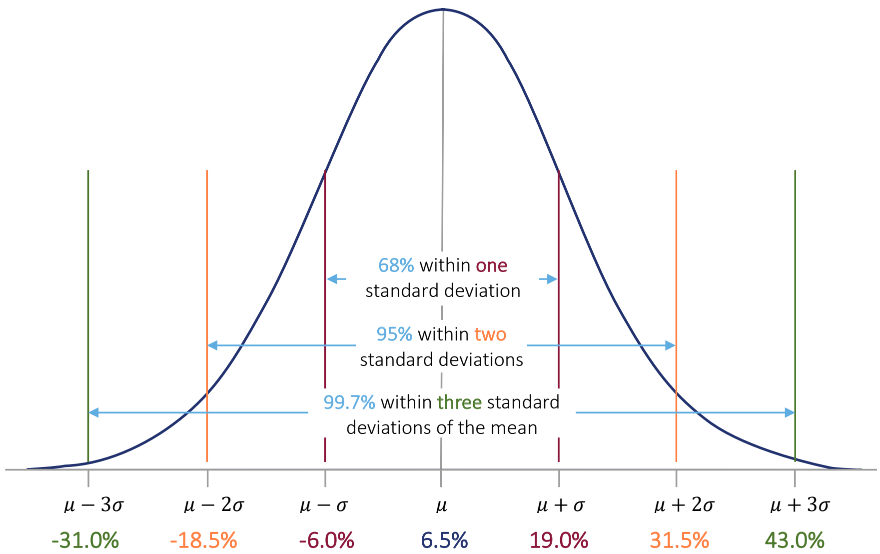
Ninety-five percent of the time, the return should be within +/- 2 standard deviations of 6.5%, or between -18.5% and 31.5%. If the standard deviation decreases, these ranges of outcomes will also decrease. The inverse is also true.

Notably, there are several ways, with no single way being perfect, to measure standard deviation. Within investing, we typically consider two forms of measurements: ex-post and ex-ante. Ex-post measures risk using historical realized returns, or "after the fact" returns. Using this method investors should keep in mind that the look back period is very impactful on the results. For instance, a 5-year look back period from 2009 – 2014 will look much different from a 5-year look back period beginning in 2007. The inclusion of the Global Financial Crisis will significantly impact the results. Additionally, ex-post measurements fail to address the underlying drivers of risk. In contrast, the ex-ante measurement, or "before the fact" returns, forecasts future risk using holdings and risk models. The ex-ante method allows the investor to decompose the underlying drivers of risk in the portfolio using factors that can then be managed.

## Value at Risk

While a common proxy, standard deviation is not the only way to quantify risk. Other methods for measuring risk include value at risk (VaR) and conditional value at risk (CVaR). These methods are more complex than standard deviation and seek to link the underlying risk factors to the portfolio's performance. The CFA Institute defines VaR as the minimum loss in either currency units or as a percentage of portfolio value that would be expected to be incurred a certain percentage of the time over a certain period of time given assumed market conditions. Similarly, CVaR is a variation of VaR that is the average loss conditional on exceeding the VaR cutoff. Both VaR and CvaR require the decomposition of portfolio performance into risk factors. There are different ways to estimate these metrics, each with advantages and disadvantages. Investors may also use stress testing and scenario analysis to assess risk under different market conditions. Future installments of this series dive deeper into stress testing and scenario analysis.

**STANDARD DEVIATION ILLUSTRATION**




*For illustrative purposes only.*

> *Investors should seek to avoid a phenomenon known as DINO, Diversification in Name Only.*

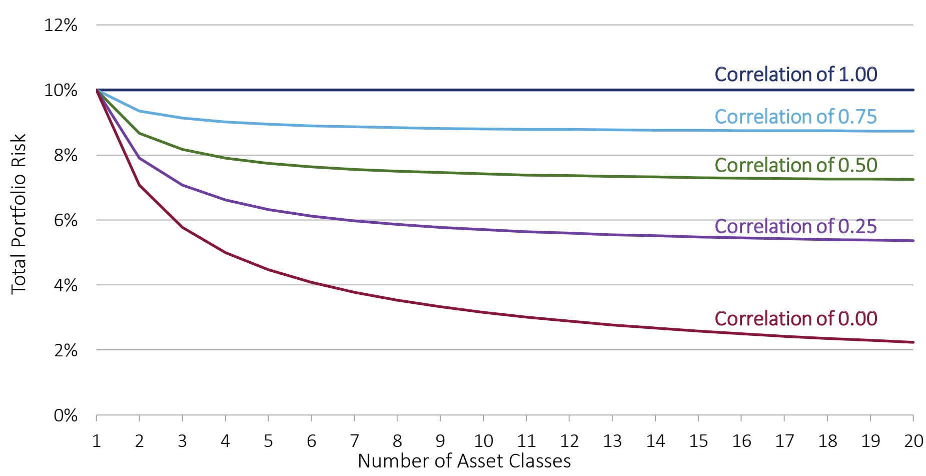
## Diversification of Asset Classes

Noble Prize recipient, Harry Markowitz, once stated that "diversification is the only free lunch in finance." The importance of diversification stems from the fact that asset classes have different correlations. Correlation measures the movement of asset class returns in relation to one another. As the chart below shows, increasing the number of asset classes across a portfolio can reduce the total portfolio risk. However, investors must take a thoughtful approach to diversification.

Investors should seek to avoid a phenomenon known as DINO, Diversification in Name Only. DINO occurs when adding an additional asset class offers diversification of the number of assets yet provides little to no benefit to the portfolio in terms of minimizing risk or enhancing returns. Said another way, investors should be wary of the diminishing marginal benefit of simply adding asset classes. This can play out, even with uncorrelated assets.

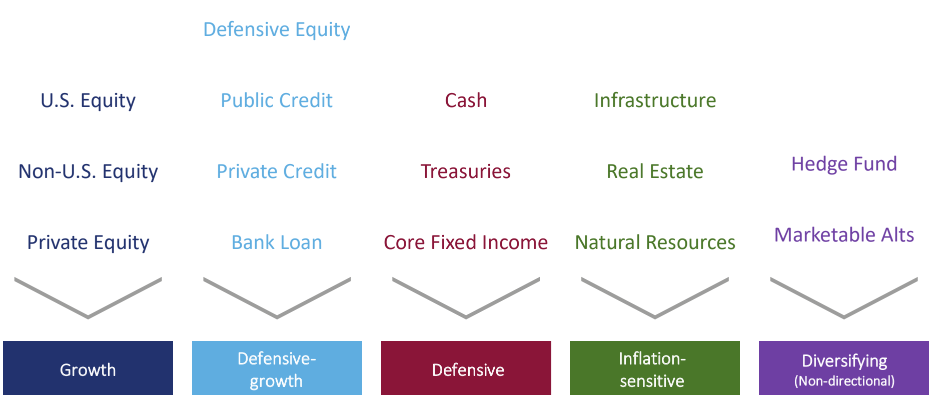
A way to address this concern is by using a "bucketing" approach to asset allocation. Wilshire buckets assets across five broad categories: Growth, Defensive-Growth, Defensive, Inflation-Sensitive, and Diversifying (Non-Directional). Ensuring that asset classes from across the various buckets are incorporated into the asset allocation helps investors capture the benefits of diversification and avoid DINO. To learn more about Wilshire's asset allocation research process, please refer to the Wilshire 2025 Asset Allocation Return & Risk Assumption report.

**IMPACT OF CORRELATION ON RISK REDUCTION**




**Source:** Wilshire Advisors. For illustrative purposes only.

**WILSHIRE ASSET CLASS CATEGORIZATION**




*For illustrative purposes only.*

## Conclusion

While often thought of as something to avoid, risk is an essential part of investing faced by all investors. Today we discussed ways to measure risk. Moreover, we laid the foundation necessary to help address how to achieve optimal risk-adjusted returns through risk budgeting. The next installment in this series will answer questions such as "What is risk budgeting?" and "Why is risk budgeting important?". In the subsequent installment of the series, we will provide a step-by-step guide to building a risk budget.

*__Lauren Gellhaus__, CAIA, is a Vice President at Wilshire serving on the client solutions team, focusing on pension plans and sustainability. Prior to joining Wilshire in 2022, Lauren was the head of environmental, social and governance (ESG) investing at the Teacher Retirement System of Texas where she developed the ESG strategic vision and roadmap for the investment management division's initiatives. She received her bachelor's degree in corporate finance from the University of Texas at Austin and is a CAIA Charterholder. Lauren has a certification in ESG investing from the CFA Institute. She also earned the Foundations in Responsible Investment certificate from the Principles for Responsible Investment (PRI).*


# State Association of County Retirement Systems

# LEGISLATIVE REPORT

The Legislature is rapidly approaching its first policy committee deadline, with committees working furiously to process more than a thousand bills ahead of the May 2nd deadline for fiscal bills and May 9th for non-fiscal bills. Following this milestone, attention will shift to the fiscal deadline, where a significant number of bills are expected to be held in the appropriations committees due to the state's challenging budget environment. Last year, an average of 32% of bills in each house were held at this stage.

Despite current budget constraints, the state's revenues are outperforming projections. According to the Department of Finance and the Franchise Tax Board, revenues at the end of March were approximately $4–5 billion above the January estimates. Nevertheless, broader economic uncertainty—driven by ongoing federal issues including trade policy and the rollback of key safety net programs—continues to cloud the overall fiscal outlook. Greater clarity is expected when the Governor releases the May Revision in mid-May.

On the legislative front, common policy themes continue to emerge with bipartisan interest, namely housing and permit reform. Legislators remain focused on addressing California's severe housing shortage, efforts largely hindered by the complex requirements of the California Environmental Quality Act (CEQA). The law has long been a source of friction between pro-development advocates and environmental stakeholders, without any lasting resolution.

That may soon change. Assembly Bill 609, introduced by Assemblymember Buffy Wicks (D-Oakland), proposes to exempt most urban housing developments from CEQA— a sweeping reform with significant implications. If passed, the bill would eliminate environmental litigation over multifamily housing proposals, reduce legislative wrangling over project-specific exemptions, and limit the use of CEQA as a tool for negotiating project concessions.

In addition, the Legislature has been focused on the need to lower the cost of living for working Californians, including lowering utility bills for rate payers. In the local government sphere, bills seeking to amend, extend or augment the Open Meetings Laws continue to move through the legislative process.

## SACRS IS TRACKING THE FOLLOWING BILLS:

**ACA 2 (Jackson)** - seeks to reinstate retirement for State Legislators. ACA 2 would establish a retirement system specifically for legislators elected or serving from November 1, 2010 onward. To qualify, legislators would be required to serve at least 10 years. If their service is less than 10 years, legislators could transfer their accumulated service credits to another public pension or retirement system they are a part of.

**Status:** This bill has not yet been referred to a policy committee.

**AB 259 (Rubio)** - was amended to extend the 2026 sunset on existing laws governing teleconferencing procedures for public meetings to 2030. This bill is sponsored the CA Special District's Association (CSDA).

**Status:** This bill passed out of the Assembly Local Government Committee and is on the Assembly Floor awaiting action.

**AB 288 (McKinnor)** - deletes a reference in government code 3558 to a date in which the section is operative. The section is related to the ability of an exclusive representative to file a charge of an unfair labor practice with the Public Employment Relations Board alleging a violation related to notice requirements.

**Status:** This bill passed out of the Assembly Committee on Public Employment & Retirement (PERS) and is on the Assembly Floor awaiting action.

**AB 339 (Ortega)** - would require the governing body of a public agency to give a recognized employee organization no less than 120 days' written notice before issuing a request for proposals, request for quotes, or renewing or extending an existing contract to perform services that are within the scope of work of the job classifications represented by the recognized employee organization.

**Status:** This bill passed out of Assembly PERS Committee and is in the Assembly Appropriations Committee.

**AB 340 (Ahrens)** - would prohibit a public agency employer from questioning any employee or employee representative regarding communications made in confidence between an employee and an employee representative in connection with representation relating to any matter within the scope of the recognized employee organization's representation.

**Status:** This bill passed out of the Assembly PERS Committee and is in the Assembly Appropriations Committee.

**AB 409 (Arambula)** - was amended to extend the 2026 sunset on existing laws governing teleconferencing procedures for California Community College student body associations and student-run community college organizations to 2030.

**Status:** This bill passed out of the Local Government and Higher Educations Committees and is awaiting action on the Assembly Floor.

**AB 467 (Fong)** - was amended to extend the sunset date from 2026 to 2030 (as opposed to 2031) for teleconferencing procedures for neighborhood councils, defined as an advisory body with the purpose to promote more citizen participation in government and make government more responsive to local needs that is established pursuant to the charter of a city with a population of more than 3,000,000 people that is subject to the Brown Act.

**Status:** This bill passed out of the Assembly Local Government Committee and is awaiting action on the Assembly Floor.

**AB 569 (Stefani)** - was amended to maintain the proposed authorization to negotiate contributions to supplemental Defined Benefit plans but also maintain consistency with the existing PEPRA prohibitions and limitations.

**Status:** This bill passed out of the Assembly PERS Committee and is awaiting action on the Assembly Floor.

**AB 1323 (Chen)** – would increase the compensation rate for certain members of the Orange County Board of Retirement to not more than $320 per meeting.

**Status:** This bill was set for hearing on 4/22 in the Assembly PERS Committee, but that hearing was cancelled by the request of the author.

**AB 1383 (McKinnor)** - This bill would establish new retirement formulas, for employees first hired on or after January 1, 2026, as 2.5% at age 55, 2.7% at age 55, or 3% at age 55. For new members hired on or after January 1, 2013, who are safety members, the bill would require employers to adjust the formulas for service performed on or after January 1, 2026, to offer one of the 3 formulas for safety members that is closest to the formula the employer provided pursuant to existing law. The bill would authorize a public employer and a recognized employee organization to negotiate a prospective increase to the retirement benefit formulas for members and new members, consistent with the formulas permitted under the act. This bill would authorize an employer and its employees to agree in a memorandum of understanding to be subject to a higher safety plan or a lower safety plan, subject to certain requirements, including that the memorandum of understanding is collectively bargained in accordance with applicable laws.

**Status:** This bill passed out of the Assembly PERS Committee and is in the Assembly Appropriations Committee.

**AB 1439 (Garcia)** - would prohibit the board of a public pension or retirement system from making any additional or new investments of public employee pension or retirement funds in development projects in California or providing financing for those projects with public employee pension or retirement funds unless those projects include labor standards protections.

**Status:** This bill was not heard in Committee and was made a two-year bill.

**SB 239 (Arreguín)** - allows flexibility for remote meetings of local advisory bodies ("subsidiary bodies" in the language of the bill). Specifically, this bill would allow the subsidiary body of a local agency to teleconference their meetings without having to make all locations publicly available, but amendments would now require the subsidiary body to post the agenda at each physical meeting location. The bill also sunsets these provisions in 2030.

**Status:** The bill passed out of the Senate Local Government and will be heard in the Judiciary Committee on May 6th.

**SB 301 (Grayson)** - would beginning on or after January 1, 2026, prohibit a city or district that contracts with a retirement system under the CERL from amending their contract with the system in a manner that provides for the exclusion of some, but not all, employees.

**Status:** This bill passed out of the Senate PERS Committee and is awaiting action on the Senate Floor.

**SB 470 (Laird)** - was amended to would delete the 2026 sunset on existing laws governing teleconferencing procedures for state agencies relative to the Bagley-Keene Open Meeting Act and extend the sunset provision to 2030.

**Status:** This bill passed out of the Senate Governmental Organization and is awaiting action on the Senate Floor.

**SB 707 (Durazo)** - would add additional teleconferencing meeting options for local governments until 2030 to allow members of the public to attend a public meeting via a two-way teleconferencing option or two-way audio-visual platform. The bill would also require additional alternative language noticing requirements.

**Status:** The bill passed out of the Senate Judiciary Committee with amendments on 4/22 (not yet in print). This bill is now in the Senate Appropriations Committee.

*As a former Capitol staffer and an advocate, **Laurie Johnson** has almost 30 years of legislative experience. Laurie spent five years working in the state Capitol as Legislative Director for several members of legislative leadership where she focused on local government, water, and utilities. For the past eleven years, she has been a contract lobbyist and in 2022, she started her own firm LJ Consulting & Advocacy, specializing in local government and environmental policy and partnered with many of her former clients, including, but not limited to, five local agencies, housing developers, a large Northern California tribe, as well as a County.*

*President and Founder of Public House Consulting, **Cara Martinson**, is a seasoned government affairs professional with two decades of lobbying and consulting experience in the private, public and non-profit sectors of government. Prior to founding Public House Consulting in 2022, Cara served as the Senior Director of Regulatory and Political Affairs for a Fortune 200 national renewable energy company where she managed the legislative and regulatory portfolio for ten western states. Cara also spent 13 years leading local government interests at the California State Capitol, representing counties at the California State Association of Counties (CSAC) on a myriad of local government issues.*


# Quality as the Path to Growth in Emerging Markets

> *Higher U.S. interest rates and a stronger dollar may challenge EM currencies and investor sentiment in 2025.*

William Blair believes emerging markets (EMs) present a landscape of opportunity amid increasing macroeconomic headwinds, as these markets remain an efficient gateway to powerful secular themes, from technology-driven transformations to consumer growth stories across many regions.

However, the recent U.S. election has introduced a new layer of uncertainty for EMs. Ultimately, though the U.S. election may shape the near-term backdrop, we believe diverse secular growth drivers and competitive valuations in EMs offer a compelling case for investing in quality, growth-oriented companies.

Higher U.S. interest rates and a stronger dollar may challenge EM currencies and investor sentiment in 2025. EM investors should be prepared for uneven outcomes across regions, with some markets likely to face near-term pressures while others could continue to thrive on solid growth trajectories.

In an environment marked by political shifts and uncertain economic policy, we believe a focus on high-quality companies (healthy balance sheets, strong management teams, and sustainable competitive advantages) is paramount for EM investors.

In sum, while obstacles exist, we believe the underlying case for EMs remains strong, especially for those who are selective about where they invest—and in this section, we will explore three key themes that highlight the breadth of opportunity in the asset class.

First is China. Although stimulus and relatively low valuations could offer near-term opportunities, China's long-term growth prospects remain tempered by structural economic challenges and policy uncertainties.

Second is India. Often compared to China's early-1990s growth phase, India stands out as a compelling long-term investment, supported by strong demographics, rising consumer spending, and pro-business policies—though its high valuations may warrant a selective approach.

Lastly, we will explore the AI boom. EMs play a pivotal role in the global artificial intelligence (AI) buildout, supplying critical components and infrastructure for AI advancements, while also addressing the energy demands that accompany this technological growth.

## PERFORMANCE HIGHLIGHTS FROM 2024

In 2024, emerging equity markets showed resilience, though returns were mixed across regions. As of November 30, 2024, EM equities (as represented by the MSCI EM IMI) posted a year-to-date (YTD) return of 7.38%, trailing developed markets, which returned 21.10% (as represented by the MSCI World IMI).

- ***China:*** China emerged as a strong performer in the EM universe, with a YTD return of 15.57%.[1] The rally was driven by government stimulus aimed at delivering GDP growth targets and supporting the property market. Despite lingering structural issues, this somewhat more aggressive stimulus seems encouraging, and the market has responded positively to policy measures and attractive valuations.
- ***India:*** India continued its impressive growth story, delivering a 16.48% YTD return. This performance was supported by strong economic fundamentals, favorable demographics, and a rising middle class. India's pro-growth policies and a burgeoning capex cycle helped the market remain an attractive destination for global investors.
- ***Taiwan and South Korea:*** The two markets showed contrasting outcomes. Taiwan, a key player in the global technology supply chain, gained 24.21% YTD, benefiting from the AI-driven semiconductor demand. South Korea, however, returned -16.52% YTD, as weaker demand for consumer electronics weighed on performance.
- ***South Africa:*** South Africa surprised on the upside, with a YTD return of 15.64%. Improving political sentiment and early signs of economic recovery contributed to investor optimism, while the start of an interest-rate-cutting cycle provided additional support.
- ***Brazil:*** Brazil struggled in 2024, recording a -23.94% YTD return. Fiscal and monetary concerns, along with economic challenges, overshadowed any potential for recovery.
- ***Mexico:*** Despite its role as a beneficiary of nearshoring trends, Mexico posted a discouraging -25.11% YTD return. Political uncertainties following recent elections have raised concerns about institutional stability and tempered investor enthusiasm.

*"In November, Beijing introduced a substantial 10 trillion renminbi ($1.4 trillion) fiscal package aimed at stabilizing the economy by bailing out local governments and restructuring their debts."*

**China: A Fragile Rebound Powered by Fiscal Intervention**

China's economy continues to face significant structural issues, particularly in its heavily indebted local government sector and struggling property market.

In November, Beijing introduced a substantial 10 trillion renminbi ($1.4 trillion) fiscal package aimed at stabilizing the economy by bailing out local governments and restructuring their debts. While investor response to these measures has been mixed, recent efforts reflect a more forceful and coordinated approach, with both monetary and fiscal measures working in tandem.

In addition, authorities are displaying a more constructive stance on the real estate sector, recognizing it as a critical component of Chinese consumers' net worth and overall sentiment.

**MSCI China Index Forward P/E Ratio**

Chinese equities' forward price-to-earnings ratio has been steadily trending downward.


Source: FactSet, MSCI, Goldman Sachs Global Incestment Research, and William Blair, as of November 2024. Based on latest constituents; showws z-score over the past 10 years (monthly). S.D. refers to standard deviation.

### Positives

China has shown signs of easing regulatory pressure and a refocusing on growth, with initiatives aimed at fostering self-reliance in high-end manufacturing sectors, such as semiconductors and automation.

Beijing has also increased monetary support, including reductions in the reserve requirement ratio and policy rates.

The property market has also received targeted support, with measures such as mortgage rate cuts, reduced downpayment requirements, and eased purchase restrictions to encourage housing demand.

Furthermore, large and growing household savings, alongside attractive market valuations, present a potential foundation for renewed consumer activity if confidence improves.

### Negatives

Consumer confidence remains weak, with excess household savings accumulating but not translating into spending.

The property sector continues to struggle, with declining new property starts, primary market sales, and overall investment. China's housing starts have outpaced urbanization rates, contributing to a surplus in residential real estate that weighs on the broader market.

In addition, the employment and income outlook remain subdued, further constraining consumer demand. Geopolitical tensions, especially with the United States, add an external risk layer that could impact trade and investment flows.

China's fiscal response—especially if expanded to include potential bank recapitalization and support for the housing sector—could present a near-term opportunity for investors, as has been the case historically.

### Key Takeaways

President Xi Jinping appears committed to maintaining economic stability, and we anticipate the series of incremental positive measures will support China's 5% gross domestic product (GDP) target for 2024 and the growth trajectory for 2025. With valuations still relatively low and company fundamentals improving in certain areas, stimulus efforts could fuel short-term boosts to the equity market as Beijing focuses on stabilizing key economic sectors.

But the sustainability of such rallies remains uncertain given the persistent structural challenges China faces. The country's long-term outlook is still clouded by high debt levels, demographic pressures, and slowing growth.

Stimulus efforts could fuel short-term boosts to the Chinese equity market as Beijing focuses on stabilizing key economic sectors.

### India: A Growth Powerhouse, but at a Premium

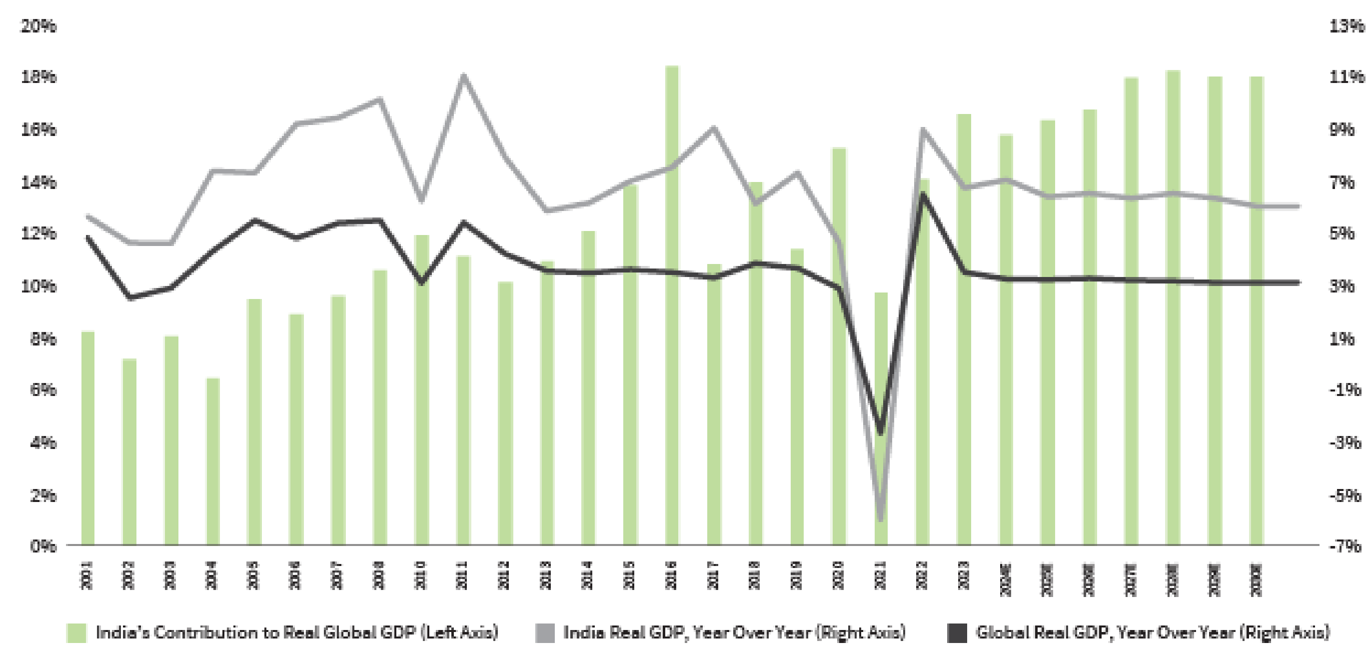
India's growth story is one of the most compelling among EMs, in our view, driven by favorable demographics, a burgeoning middle class, and strong economic policies.

Now the fourth-largest equity market globally in terms of market capitalization, India has risen to become the second-largest market in the MSCI EMI IMI as of November 30, 2024, with its weight roughly doubling over the past five years to approximately 20%. India's share of global GDP growth now exceeds 15% and is expected to trend higher.

The country's young and well-educated population supports a growing consumer base with increasing disposable income. Low household debt—at only 19% of GDP compared with 65% in China—signals potential for sustained consumer demand. Low penetration rates for durable goods, such as air conditioners, refrigerators, and cars, indicate a potentially large runway for consumption growth.

**India's Share of Global Growth**

India's contribution to global GDP is projected to rise significantly over the next decade.




**Source:** IMF, Morgan Stanley Research, and William Blair, as of September 2024. E refers to estimated.


**Positives**

India's pro-business policies have introduced structural reforms that should bolster economic growth and support secular trends across key sectors, particularly in financials and manufacturing. Initiatives like the Make in India and Production Linked Incentive (PLI) schemes have catalyzed a robust capital expenditures (capex) cycle, with public capex projected to reach $20.6 trillion rupees in 2024, up from $6.4 trillion rupees in 2014. This focus on domestic manufacturing and infrastructure is strengthening India's self-reliance and enhancing its appeal to global investors.

Key sectors such as real estate, personal financial services, healthcare, and travel services are seeing strong demand as consumer spending shifts from staples to experiences and services. In addition, India's aerospace and defense industry is moving up the value chain, while the domestic manufacturing sector is benefiting from the China +1 supply chain diversification trend.

We believe India's recent inclusion in global bond indices reinforce its attractiveness as an investment destination.

**Negatives**

Certain challenges in the country warrant caution. India is a net commodity importer, making it vulnerable to fluctuations in global commodity prices and external imbalances. The country's current account deficit reflects this dependency, and any sharp rise in commodity prices could impact economic stability. In addition, India's strong recent equity market performance has led to elevated valuations which, while justified (in our view) by high growth potential, may limit near-term upside. Relative to other EMs, India's higher valuations suggest that investors may need to take a selective approach.

**Key Takeaways**

Overall, we believe India remains one of the most attractive long-term growth stories in EMs. The current valuation premium, however, should encourage investors to take a cautious, quality-focused approach in the current environment. As the country continues its growth trajectory, it holds the potential to echo China's rapid economic ascent since the early 1990s, albeit with a more balanced and sustainable growth model.

**The AI Boom: EMs at the Core of the Supply Chain**

AI technology has become a central focus for global tech investment, and EMs are integral to the sector's development. Markets such as Taiwan and South Korea, for example, are critical to the AI supply chain, as they house leading manufacturers and suppliers who produce the hardware essential for AI applications, from high-performance semiconductors to data centers to autonomous vehicles. Taiwan, in particular, is at the forefront as a "picks and shovels" supplier of advanced components used in semiconductors and data centers, further strengthening its role in the AI buildout.

The growth of AI places unprecedented demands on energy infrastructure. Data centers, which are essential for AI-driven computations, are highly energy-intensive and create a need for reliable power sources and sophisticated grid infrastructure.

In addition to AI data center demand, there are several other big drivers of power infrastructure needs, such as the EV transition, government renewable targets, and power infrastructure and replacement demand from aging grid in Europe and the United States. We believe many EM companies could benefit from providing equipment to meet these high levels of transmission and distribution demands.

China is an energy importer, and by heavily investing in renewable energy, is trying to become more self-sufficient. Solar energy requires energy storage solutions given the limitations of daylight hours. Furthermore, much of the renewable power is generated in the west of China and needs to be transported through ultra-high-voltage lines to the east, where the majority of demand is.

Indian power investment is driven by historical underinvestment, with future strong economic growth requiring prolonged high levels of capacity expansion. India is earlier in its journey than China, but also investing heavily in renewable forms of energy.

**Key Takeaways**

EMs are positioned as pivotal players in the global AI supply chain and the development of next-generation energy infrastructure. For EM investors, this intersection of AI growth and energy expansion is compelling.

## TARGETED GROWTH: OPPORTUNITIES AND RISKS ACROSS KEY EMS

Select EMs stand out for their unique growth narratives paired with country-specific risk factors, and we believe active management within these nuanced opportunities can help investors participate in targeted growth opportunities while managing localized risks.

### *South Africa: Signs of Political Improvement*

In South Africa, we believe political developments have created a cautiously optimistic outlook for investors.

The African National Congress (ANC), South Africa's ruling party since the end of Apartheid in 1994, recently lost its parliamentary majority for the first time, leading it to form a coalition with more conservative, pro-business parties. This shift has raised hopes for economic reforms and improved governance, as the coalition's influence may drive policies more favorable to business and investment.

We think early signs of economic recovery, alongside lower inflation and potential rate cuts, make South Africa a more compelling opportunity than it was a year ago.

### *Mexico: Growth Potential Amid Political Uncertainty*

Mexico has become a key player in the global reshoring trend, attracting companies seeking proximity to the United States to reduce supply chain vulnerabilities. The country's competitive labor costs and established manufacturing base position it as an appealing location for production hubs.

But the recent election results, which granted the ruling Morena party a supermajority, have introduced uncertainty. Investors are concerned about the constitutional changes impacting the independence of the judiciary and other institutions, raising questions around Mexico's long-term stability. Given these political risks, a more cautious approach may be prudent.

### *Saudi Arabia: Structural Reforms and Vision 2030*

Saudi Arabia's ambitious Vision 2030 program has driven significant economic reforms, aiming to reduce the country's dependence on oil by fostering growth in sectors like finance, tourism, and technology. The Saudi government's fiscal largesse has spurred investment across these industries, creating opportunities for companies that align with the country's diversification efforts.

Despite these positives, geopolitical risks and the volatility of oil prices pose ongoing concerns for investors. In addition, while the market has grown in size and influence within EM indices, it remains relatively under-owned, suggesting potential for increased foreign investment as reforms continue to unfold.

## RESOURCES

1 *All country performance is based on MSCI IMI indices.*

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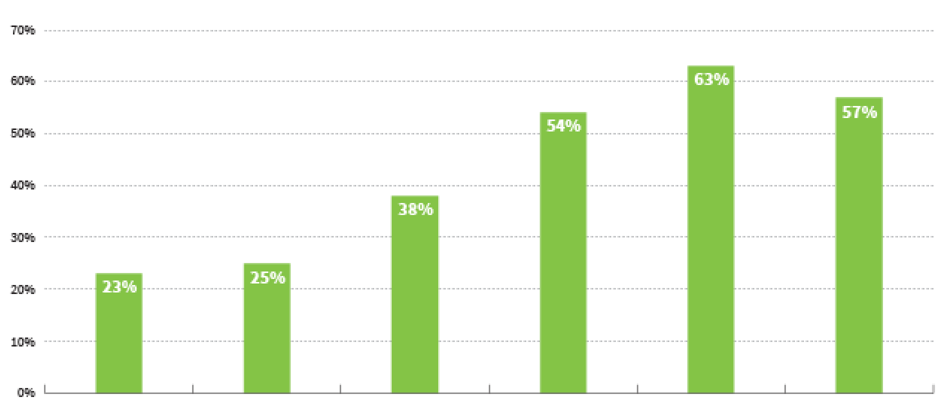
**Global EM Funds That Own Saudi Stocks**

Global EM fund ownership of Saudi stocks has been steadily increasing, though they remain relatively under-owned compared to other EMs.




**Source:** MSCI, Goldman Sachs, and William Blair, as of September 2024.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