

San Jose Police and Fire Department Retirement Plan

Private Markets Program Update

December 10, 2024

Private Markets Asset Classes

Buyout



- Large Buyout
- Small-/Mid- Buyout
- Special Situations
- Other

Equity investments in growing, established, and mature companies, with enterprise values generally ranging from \$20mm to \$20bn.

Venture



- Early Stage
- Mid Stage
- Late Stage
- Diversified

Primarily equity investments in start-ups and high growth companies.

Debt



- Par Credit
- Securitized
- Stress/Distress
- Other

Debt investments include credit expected to pay back original principal and interest (par credit), loans and bonds that have been packaged into special purpose vehicles (securitized), securities where the obligor is in a stressed or distressed financial situation (stress/distress), and unique strategies that have some or all the characteristics of debt investments.

Real Estate



- Value-Added
- Opportunistic
- Real Estate Debt
- Other

Equity and debt investments in operating companies and physical properties where the economic value is derived primarily through real estate-related activities. Value-added and opportunistic are distinguished by the level of risk associated with an investment.

Real Assets



- Infrastructure
- Energy
- Natural Resources
- Other

Investments in operating companies and physical assets where the economic value is derived primarily from the development, production, transport, or processing of natural resources, and the facilities supporting their downstream progress.

Objectives

Economic objectives leading to inclusion of private markets within the asset allocation

The purpose of Private Markets is to get exposure to investment strategies that are not available in public markets, thereby capturing an illiquidity premium. The factor exposures will be comparable to those of public markets – primarily growth, supplemented by credit and inflation. The sub-asset classes are Buyout, Venture Capital, Private Debt, Growth Real Estate, and Private Real Assets.

Quantified “absolute” objectives as a result of the asset allocation

- Be near target Net Asset Value for Private Markets and individual private asset classes.
- Achieve performance consistent with asset allocation assumptions:

<i>Measurement Group</i>	<i>Net Return</i>	<i>Time Horizon and Methodology</i>
Private Markets Program	10%	20Y, Meketa geometric expected return
Buyout	11%	
Venture	12%	
Debt	9%	
Real Estate	10%	
Real Assets	9%	

Quantified “relative” objectives as a result of asset class characteristics

- Achieve performance that justifies use of private markets versus public markets.
- Achieve performance that demonstrates a level of staff skill.

<i>Measurement Group</i>	<i>Net Return</i>	<i>Time Horizon and Methodology</i>
Private Markets Program	Global Equity + 100 bps	20Y, Meketa geometric expected return
Individual investments	1 st & 2 nd Quartile	Investments’ peer groups, by vintage year

Key Elements of Private Markets Strategy

1. **Ensure beta exposure above all else.**

Failure to execute the pacing plan guarantees not meeting objectives envisioned within the asset allocation.

Implication is that consistent commitments and vintage diversification matter more than anything else, including manager selection.

2. **Alpha is an outcome of process.**

Sources of alpha can be picking: better sub-sectors (beta timing), managers who are better at choosing the right investments (security selection), manager who operate more effectively (value creation), capital structure optimization (risk decomposition).

Consistently harvesting alpha from those sources requires a competitive advantage relative to all sources of private capital, which must be deliberately developed and maintained.

3. **Alignment of interests can overwhelm most other investment factors.**

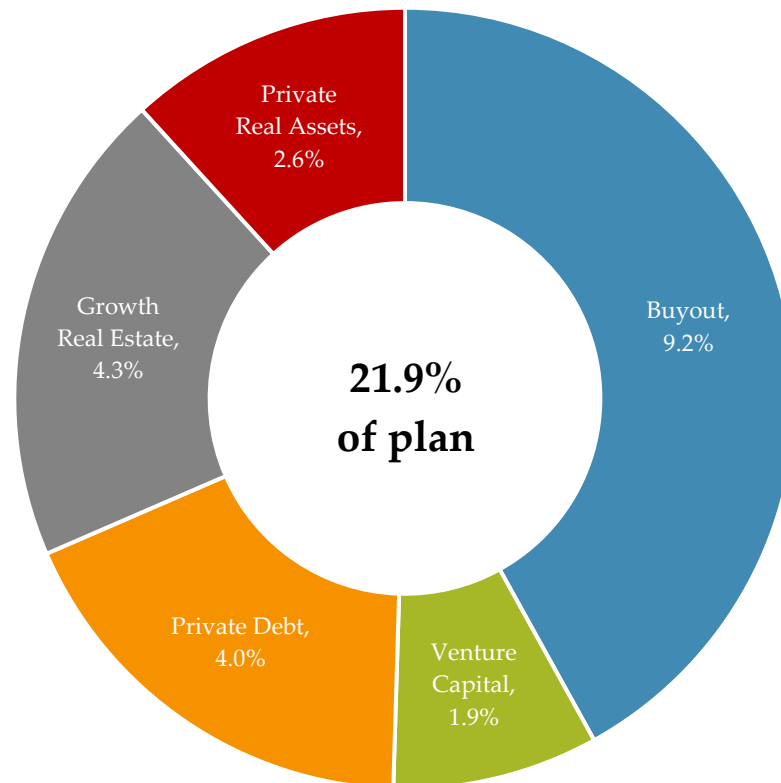
Long-term illiquid commitments require careful due diligence and selection of partners.

Agency conflicts increase with (a) distance from the asset and (b) dispersion of ownership.

Fees are the result of a buy-versus-build decision and market forces.

Private Markets Allocation Snapshot

	% of Plan	Target	Difference
Buyout	9.2%	10%	-0.8%
Venture Capital	1.9%	4.5%	-2.6%
Private Debt	4.0%	5%	-1.0%
Growth Real Estate	4.3%	4%	0.3%
Private Real Assets	2.6%	4%	-1.4%
Total Private Markets	21.9%	27.5%	-5.6%

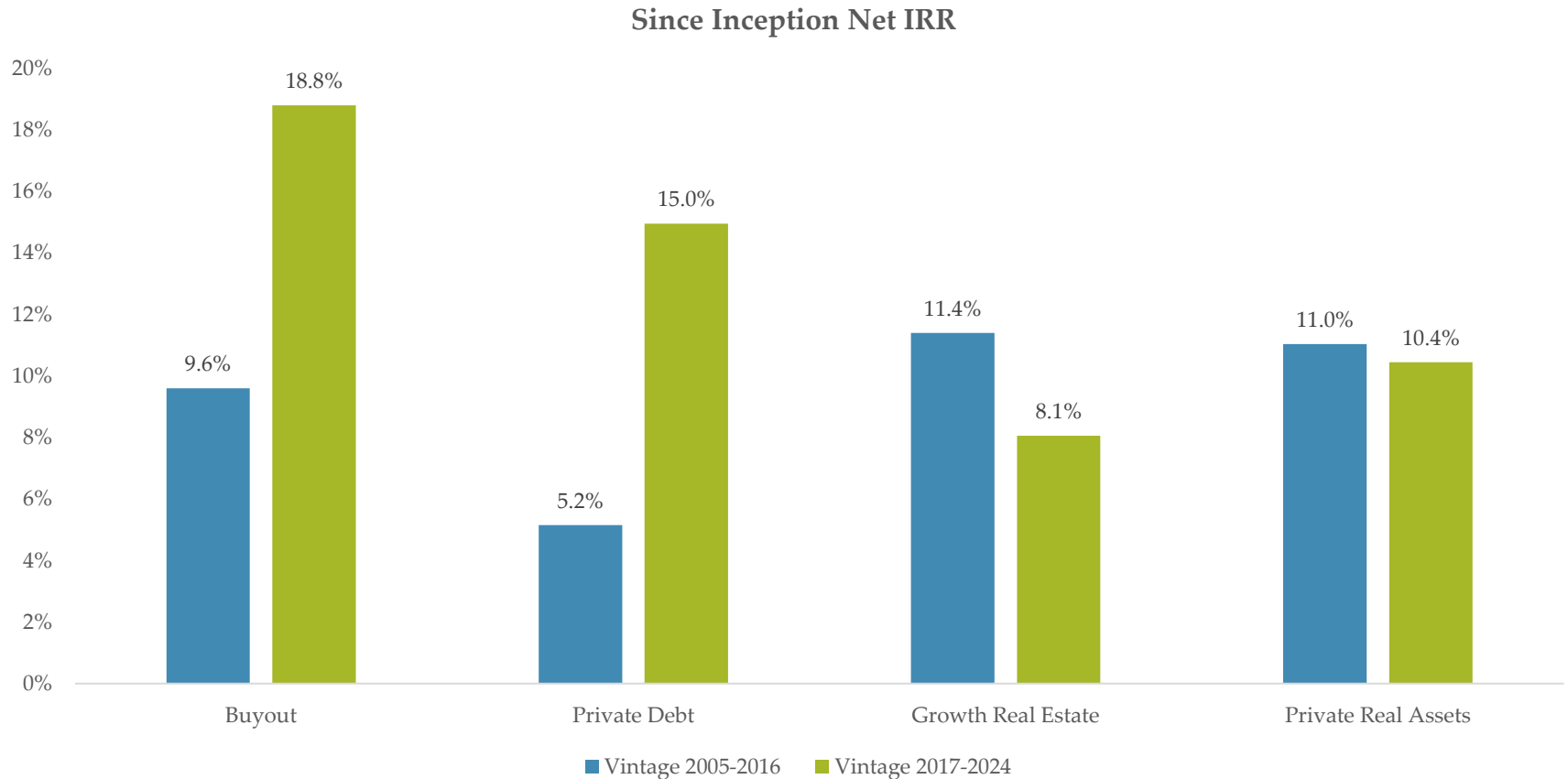


Pro Forma as of November 15, 2024

Post-2017 Commitments Generally Outperforming

Commitments in vintage years 2017-2024 are outperforming legacy commitments in vintage years 2005-2016 for Buyout and Private Debt.

A formal private markets investment strategy, team, and enhanced resources were put in place in 2017.



As of June 30, 2024

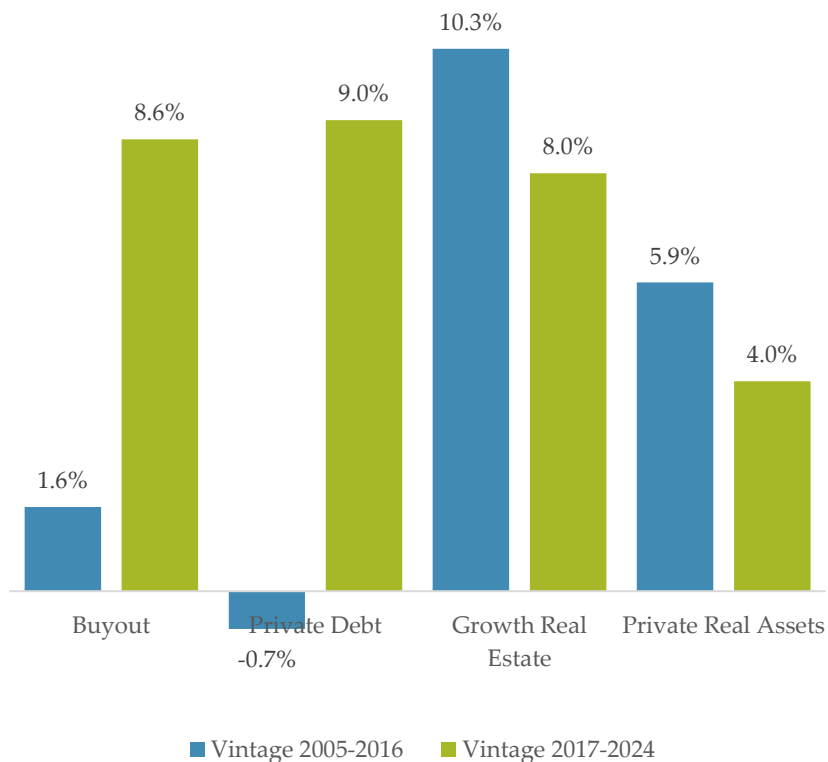
Source: Meketa, Neuberger Berman

Private Returns Relative to Public Markets

Commitments in vintage years 2017-2024 are outperforming legacy commitments in vintage years 2005-2016 except for Growth Real Estate and Private Real Assets.

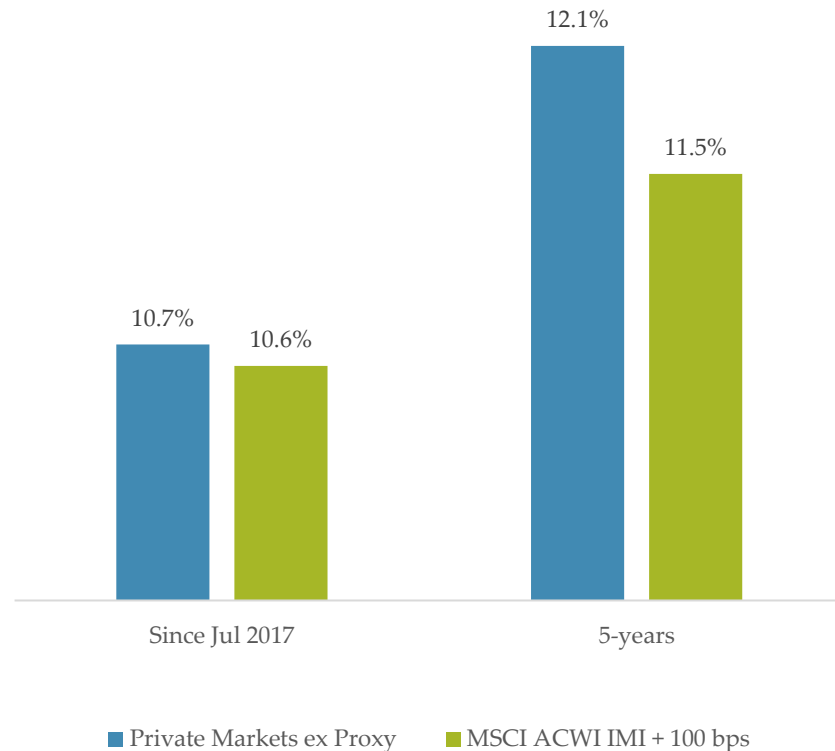
The Private Markets portfolio is also exceeding the return of the MSCI ACWI IMI + 100 bps by 10 bps per year since July 2017.

Excess Return to PME by Vintage Year



As of June 30, 2024
Source: Meketa, Neuberger Berman

Time-Weighted Net Returns



As of June 30, 2024
Source: Meketa, BNY Mellon

Pacing Plan Execution

84% of FY 2024-25 pacing plan committed (including closed and pending closes).

	Style	Date	Executed (\$mm)	Target (\$mm)	% of Target
Buyout			150	/ 150	100%
PE Strategic Partnership SJPF	Fund-of-one	7/1/2024	150		
Venture Capital			26	/ 35	74%
Tiger Iron SJPF	Fund-of-one	7/1/2024	10		
<i>Expected to close soon</i>	<i>Early Stage</i>	<i>TBD</i>	1		
<i>Expected to close soon</i>	<i>Early Stage</i>	<i>TBD</i>	5		
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<i>Expected to close soon</i>	<i>Early Stage</i>	<i>TBD</i>	5		
Private Debt			84	/ 80	105%
Silver Point Specialty Credit Fund III	Par Credit	11/15/2024	28		
<i>Expected to close soon</i>	<i>Stress</i>	<i>TBD</i>	28		
<i>Expected to close soon</i>	<i>Stress</i>	<i>TBD</i>	28		
Growth Real Estate			24	/ 70	34%
<i>Expected to close soon</i>	<i>Value Added</i>	<i>TBD</i>	24		
Private Real Assets			48	/ 60	80%
Primary Wave Music IP Fund 4	Infra	9/27/2024	18		
Pelican Energy Partners Base Zero	Energy	10/25/2024	18		
Lime Rock New Energy II	Infra	12/3/2024	12		
Total Private Markets			332	/ 395	84%

AI

AI – What is it?

A brief history of Artificial Intelligence

From cybernetics to AI
The idea that humans and machines are essentially the same gives rise to a project where scientists began to seriously consider what it would take to develop machines with human-like intelligence.

The "birth of AI" in the wake of the cybernetics movement
Bringing together the functioning of machines and organic beings.

1940's 1950's 1960's 1970's 1980's 1990's 2000's 2010's 2020's

1940's

- 1941: "Cybernetics" - the study of control and communication in the animal and the machine. Created by Norbert Wiener.
- 1942: Accelerated code breaking. Alan Turing and his British machine to decide messages encrypted using the Enigma machine at an accelerated pace during WWII.
- 1943: Machines and behavior: "Behavior, Purpose, and Teleology" by Rosenbuth, Wiener, & Bigelow.
- 1943: "Artificial Neurons" - A Logical Calculus of the Ideas Immanent in Nervous Activity by McCulloch & Pitts.
- 1944: "The Manchester Baby" runs its first program.
- 1946: "The birth of neural networks" - The construction of computer programs that engage in tasks that are currently more satisfactorily performed by human beings because they require high-level mental processes such as perceptual learning, memory organization and critical reasoning. - Marvin Minsky.

1950's

- 1950: The Imitation Game: Computing Machinery and Intelligence by Alan Turing.
- 1955: First AI Workshop Proposed to be held at Dartmouth in 1956. McCarthy, Minsky, Rochester, Shannon.
- 1956: THELIX - First, more-liking mouse for card "remember" in path. Claude Shannon, Bel Labs.
- 1956: LISP (List Processing) First Programming Language. Created by John McCarthy.

1960's

- 1960: SHAKY - First robot to perceive its surroundings, navigate, plan a route, hold a broom, and improve its skills using English language communication. Stanford Research Institute.
- 1961: "Artificial Intelligence" - Introduced into the nomenclature by John McCarthy.
- 1962: Program that can play Checkers is developed by Arthur Samuel.
- 1964: Facial Recognition - Used "templating" techniques to identify facial features. Created by Robert Mahoney.
- 1965: GENERAL - Expert System. Hypothesis formation and science. Intelligent & Logical Conclusions. Feigenbaum & Lederberg.
- 1966: "Machine Learning" - Introduced into the nomenclature by Arthur Samuel of IBM.
- 1967: General Problem Solver Means-End Problem Solving. Newell, Simon, & Shaw.
- 1968: "1st AI Winter" - Natural language processing program that converted a book word using English language reductions created by Terry Winograd.

1970's

- 1970: "From three to eight years we will have a machine with the general intelligence of an average human being" - Marvin Minsky.
- 1970: Physical Symbol System Hypothesis "Computer science as empirical physics" by Newell & Simon.
- 1971: MARRION - Autonomous Drawing Program creates the first "AI Art" - pairs a "turtle" Designed by Harold Cohen.
- 1972: WAKAT - The first "android" Waikak, communicated in Japanese and gripped objects. Waseda University.
- 1973: Reduced funding for AI due to lack of promised progress in Britain.
- 1974-1980: "1st AI Winter" - Natural language processing program that converted a book word using English language reductions created by Terry Winograd.
- 1975: SAM - Program meant to "understand" stories from a script. Created by Roger Schank.
- 1976: "2nd AI Winter" - Natural language processing program that converted a book word using English language reductions created by Terry Winograd.
- 1977: Macroscope invented by Ted Hoff. ushering in the "Golden Age" of Expert Systems. Hoff revealed the microprocessor technology in November 2018.
- 1978: "AI Boom" - machine learning shifts from knowledge driven approaches to data-driven approaches.
- 1979: Commanded bots champion of back-gammon. Created by Hans Berliner.
- 1979: The Stanford Cart successfully navigates a room without human assistance.
- 1979: "Writers at Writing" - Schank & Minsky.
- 1980: XCON - First expert system on the commercial market. Used to configure customer orders and reduce shipping times.
- 1980: "2nd AI Winter" - Natural language processing program that converted a book word using English language reductions created by Terry Winograd.
- 1981: "The Stanford Cart" first autonomous vehicle created by James Adams.
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- 1983: The problem of "holologic scalability" acknowledged as a barrier to AI progress.
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- 1986: Back-propagation for networks of neuron-like units. "Learning representations by back-propagating errors" by Rumelhart, Hinton, & Williams.
- 1987: Market for specialized LISP-based hardware collapses. Low consumer, public, and private interest in AI.

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- 1981: 5th Generation Computer Project. Japan spends \$850 million to create computers that could translate and use human language + express human-level reasoning.
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Information collected and poster designed by Danielle J. Williams, PhD | Washington University in St. Louis
daniellejwilliams.com

AI – What is it and why should we care?

- AI is a concept that has been around since the 1940s
 - Any technology that allows a machine to simulate human cognition
- Sum of technological improvements and advancements in AI has created this immense investment opportunity today
 - *Cheap and powerful compute*
 - *Efficient networks*
 - *Accessibility through mobile*
 - *Proliferation of data online*
- Software is able to do things that was not possible before
 - *Create content (multimodal....text, video, music)*
 - *Reason*
 - *Interact in a human capacity*
- Allows software to address markets that were previously inaccessible






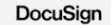



































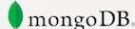















Enterprise AI Opportunity



Source: Gartner Market Databook 3Q24

AI – What does this opportunity look like?

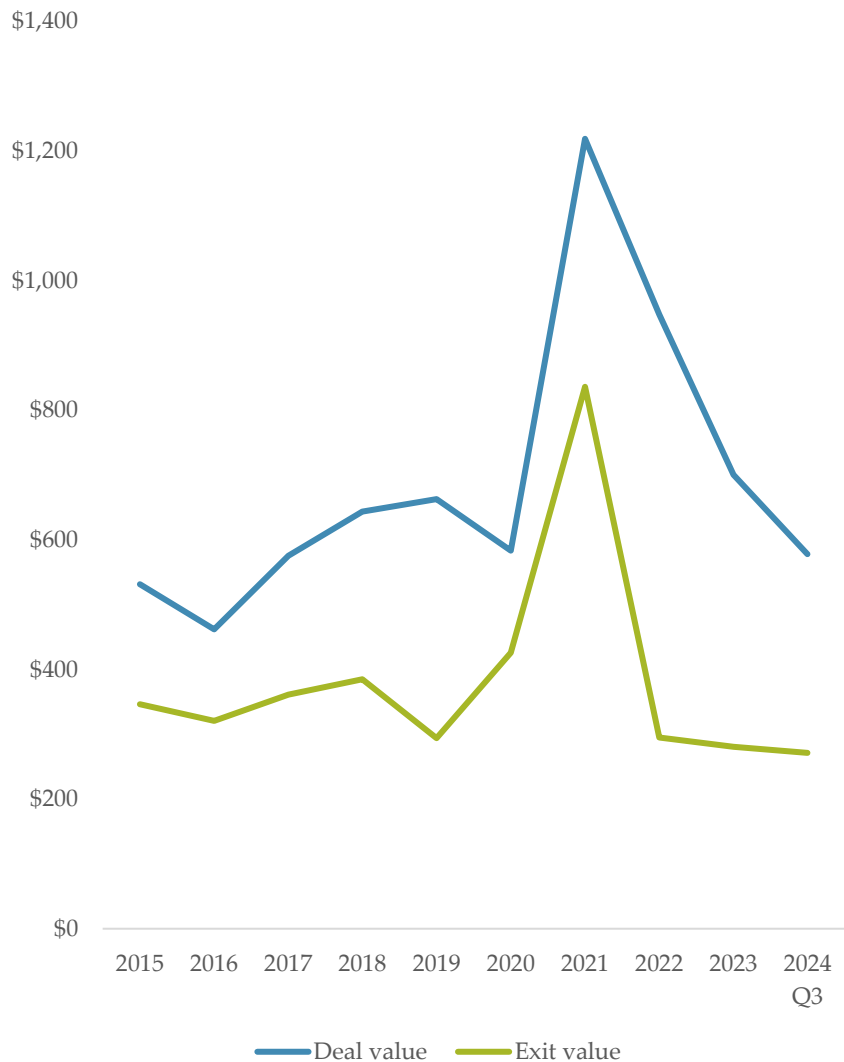
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	CLOUD	MOBILE	AI
APPS	                 	              	 <p>ChatGPT</p>
DEVELOPER	 	 	
DATA	    		
SECURITY	    		
INFRA	  		   

Buyout

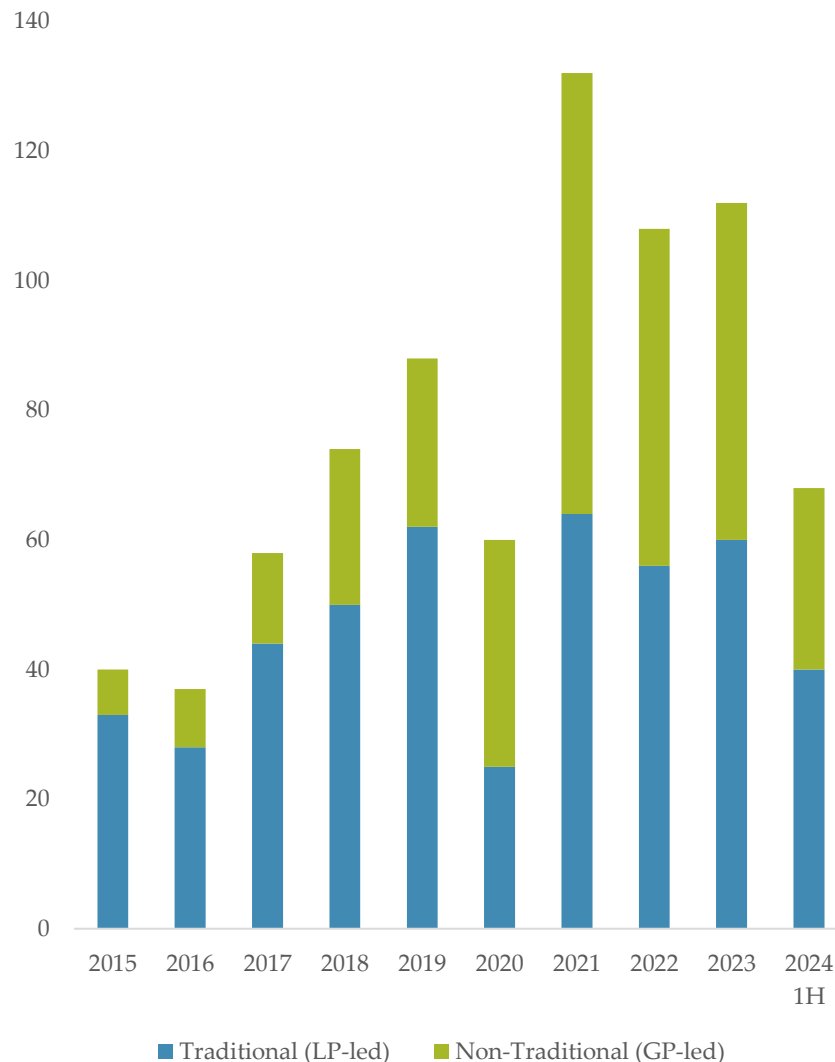
Deal activity remains slow

U.S. Private Equity Deal Activity (\$ billions)



Source: Pitchbook, as of September 30, 2024

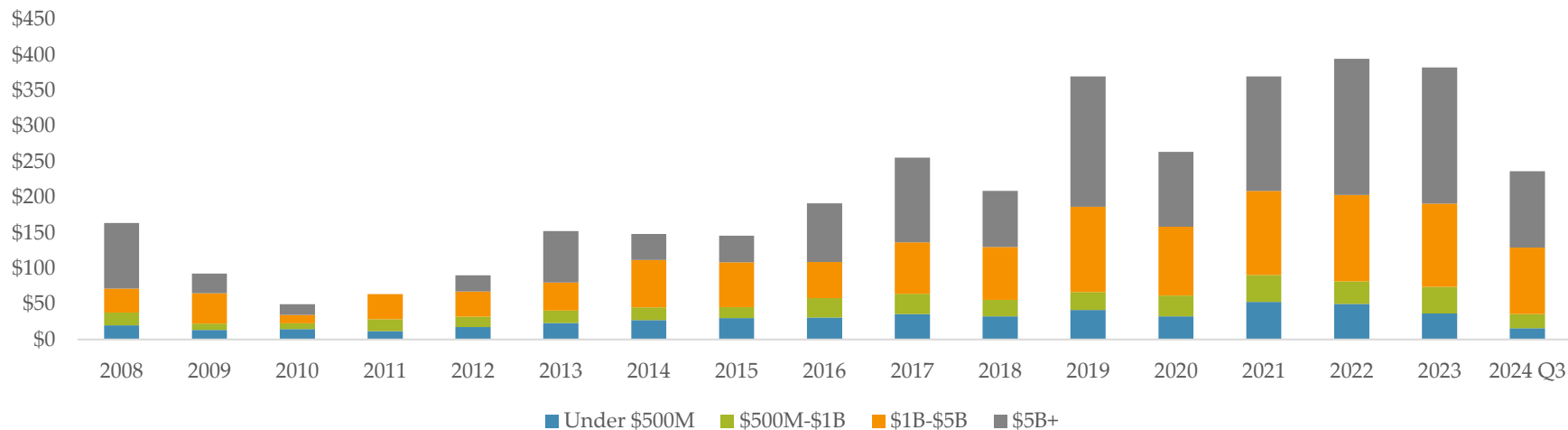
Secondary Transaction Volume (\$ billions)



Source: Jefferies Global Secondary Market Review, as of June 30, 2024

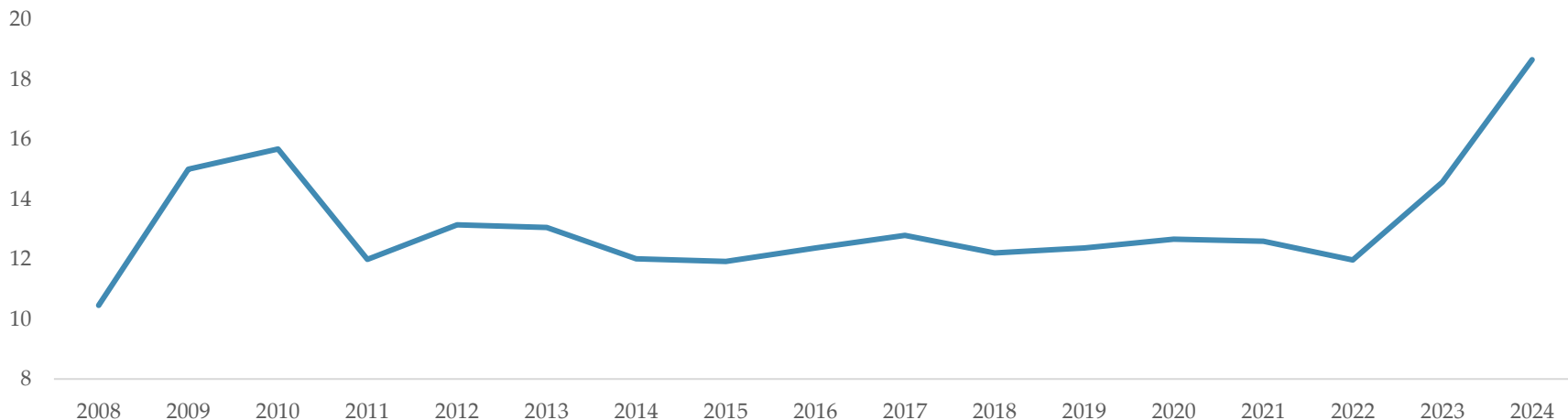
Larger funds raising more capital and fundraising taking longer

U.S. Private Equity Capital Raised by Fund Size (\$ billions)



Source: Pitchbook, as of September 30, 2024

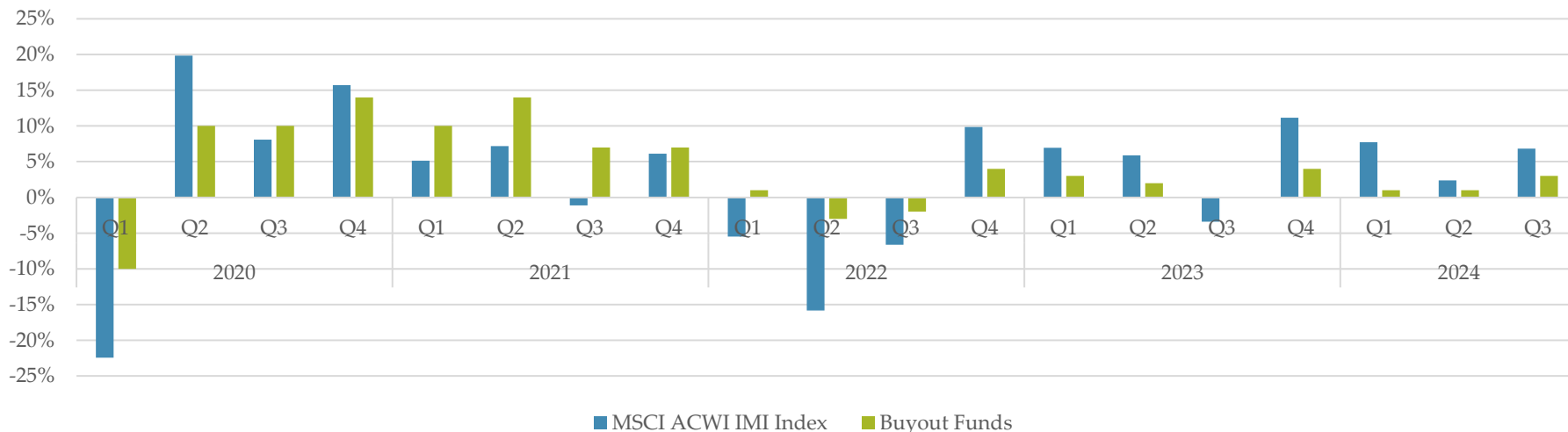
Median Number of Months to Close Private Capital Funds



Source: Pitchbook, as of September 30, 2024

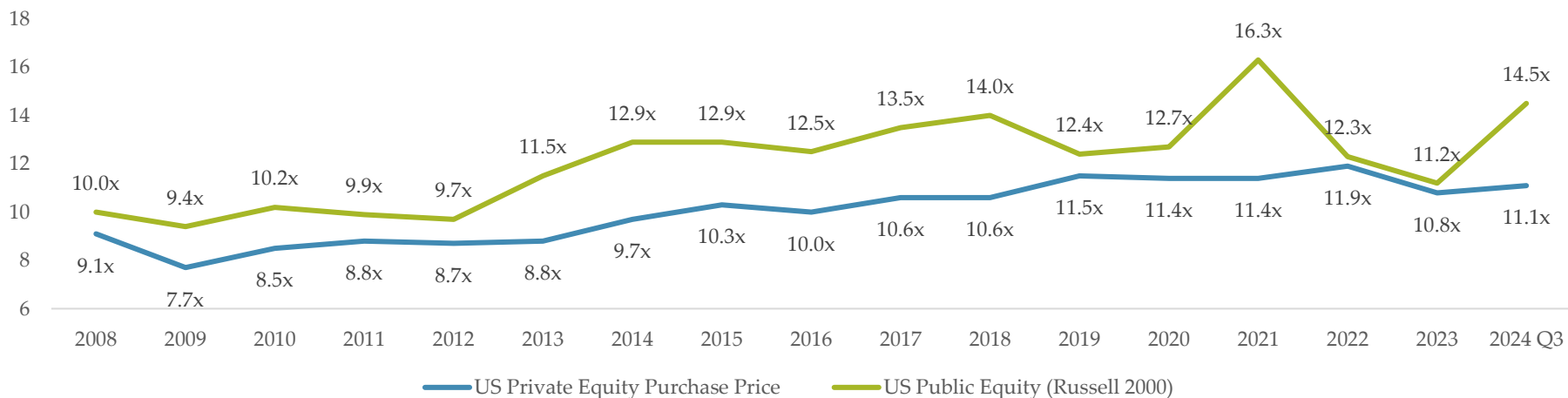
Private valuations lagging public markets

MSCI ACWI IMI Index and Buyout Funds Quarterly Returns



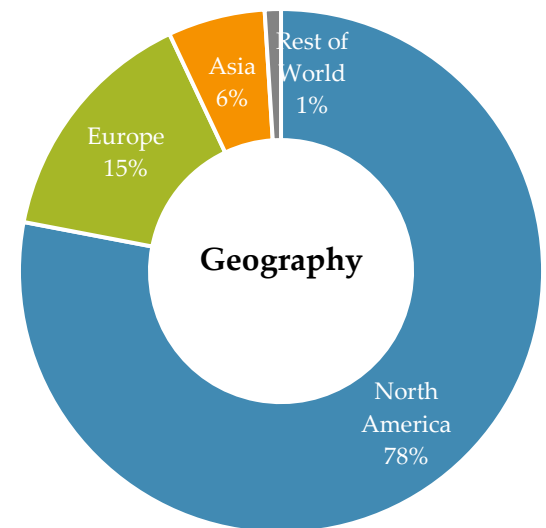
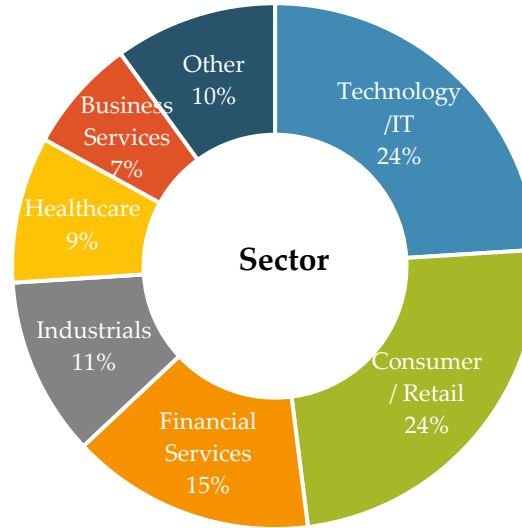
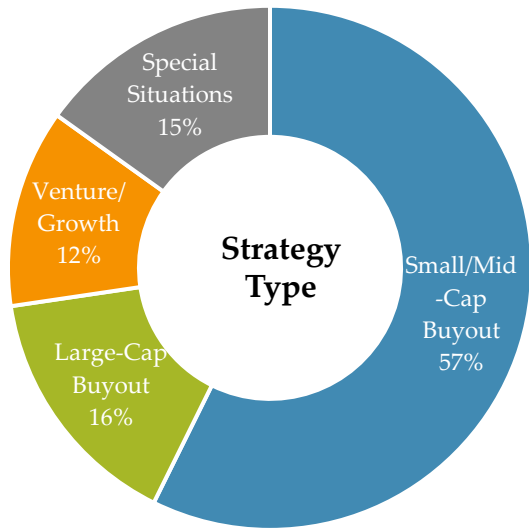
Source: Bloomberg (MSCI ACWI IMI Index), Neuberger Berman (Buyout Funds), as of September 30, 2024

EV / EBITDA Multiple



Source: Pitchbook LCD and S&P Capital IQ, as of September 30, 2024

Buyout Portfolio Update



Source: Neuberger Berman
As of June 30, 2024, values based on NAVs
Only includes PE Strategic Partnership

Buyout Portfolio Update

Primary Fund Commitments	Status	Region	Strategy Type	\$ mm
Redacted Fund A	Committed	North America	Small/Mid-Cap Buyout	14.6
Redacted Fund B	Committed	Europe	Small/Mid-Cap Buyout	21.4
Redacted Fund C	Committed	North America	Small/Mid-Cap Buyout	24.9
<i>Redacted Fund D</i>	<i>Model</i>	<i>North America</i>	<i>Small/Mid-Cap Buyout</i>	<i>24.9</i>
Total – Primary Fund Commitments				85.7
Co-Investments / Secondaries	Status	Region	Strategy Type	\$ mm
Redacted Co-Investment A	Committed	North America	Small/Mid-Cap Buyout	2.3
Redacted Co-Investment B	Committed	Asia	Small/Mid-Cap Buyout	5.1
Redacted Co-Investment C	Committed	Europe	Small/Mid-Cap Buyout	5.9
Redacted Co-Investment D	Committed	North America	Small/Mid-Cap Buyout	3.3
Redacted Co-Investment E	Committed	North America	Large-Cap Buyout	4.3
Redacted Co-Investment F	Committed	North America	Small/Mid-Cap Buyout	1.5
Redacted Secondary G	Committed	North America	Small/Mid-Cap Buyout	6.8
<i>Unallocated Co-Investments / Secondaries</i>	<i>Model</i>	<i>n/a</i>	<i>n/a</i>	<i>42.9</i>
Total – Co-Investments / Secondaries				72.1
Total				157.8

Source: Neuberger Berman, as of November 30, 2024

Private Debt

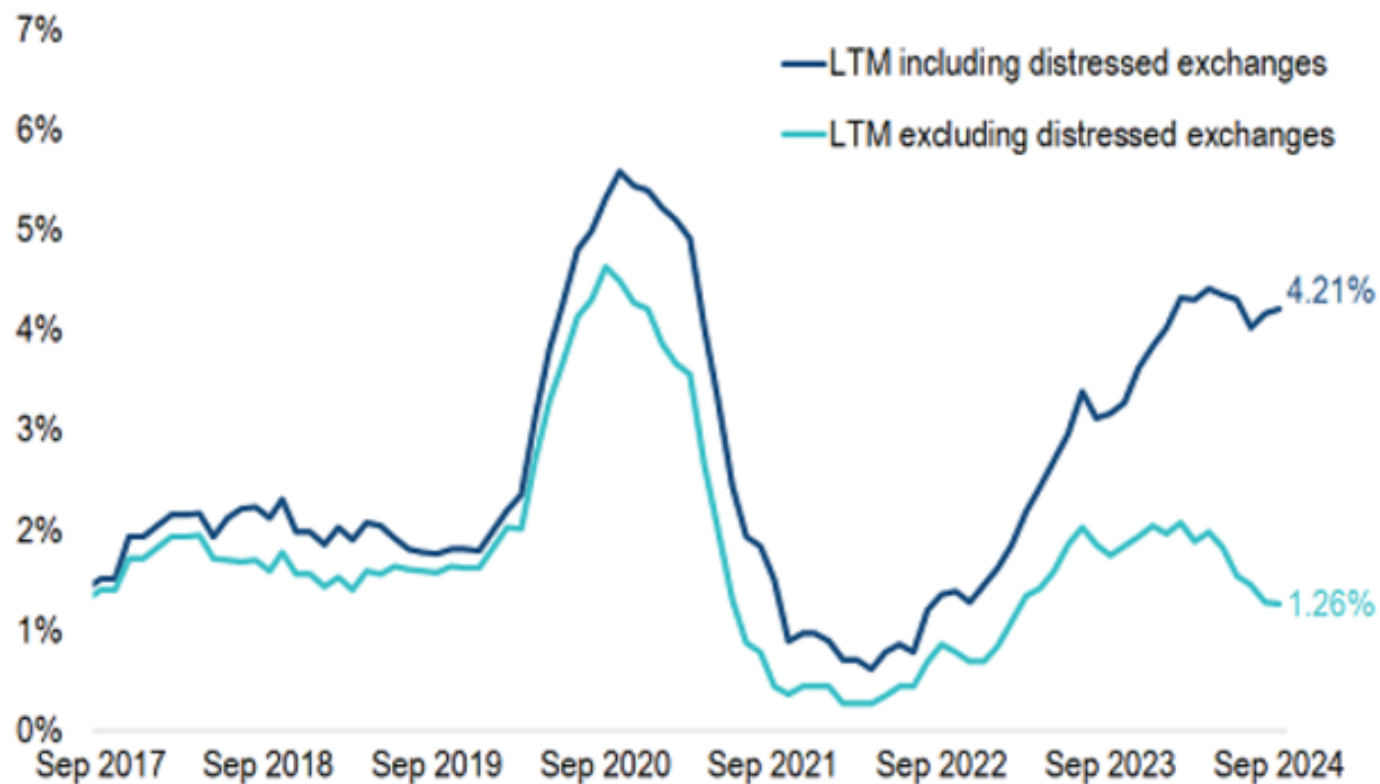
Yields remain elevated despite credit spreads tightening



Source: Bloomberg, as of October 31, 2024

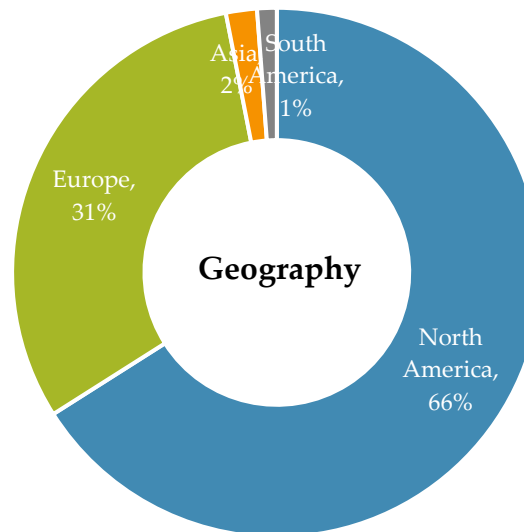
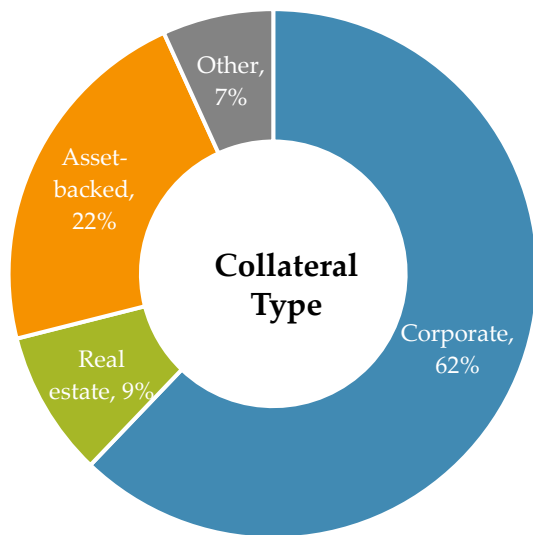
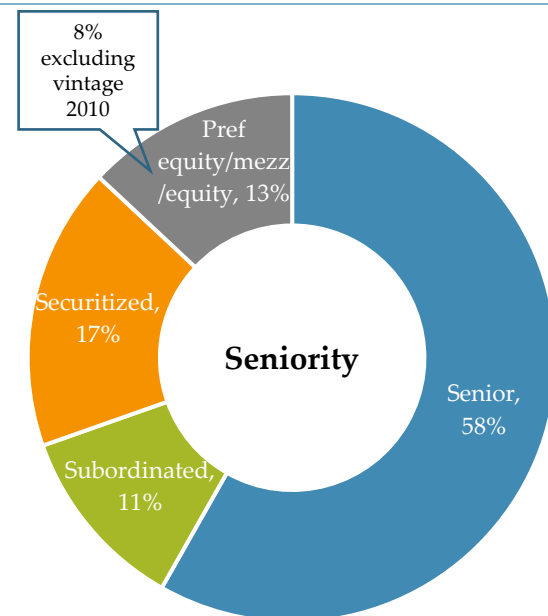
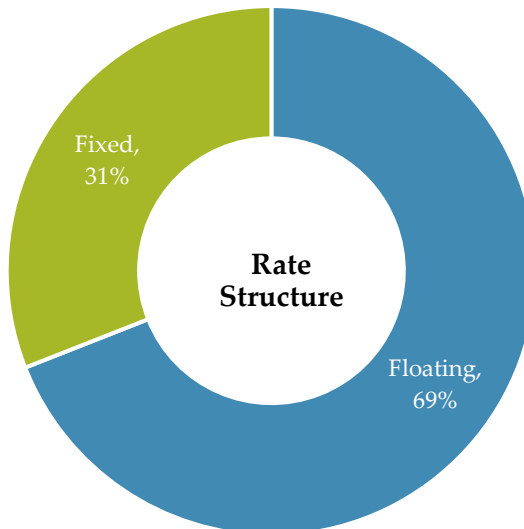
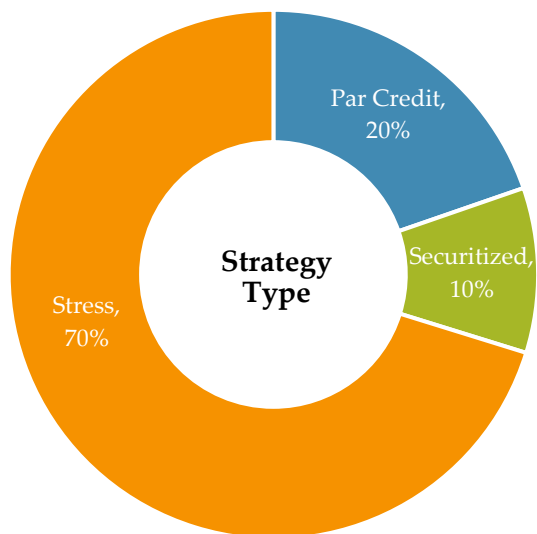
Defaults down, but distressed exchanges rise

Dual-track US loan default rate: issuer count



Sources: PitchBook | LCD; Morningstar LSTA US Leveraged Loan Index • Data through Sept. 30, 2024

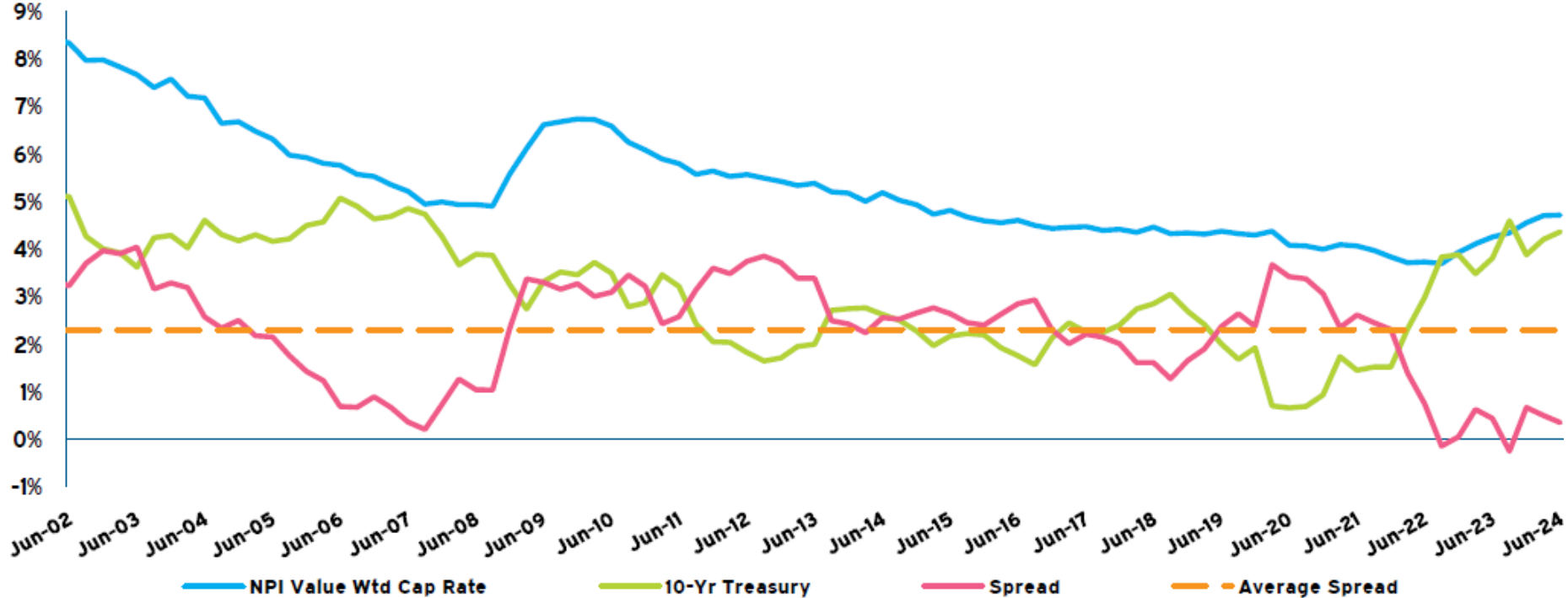
Private Debt Portfolio Update



Source: San Jose Staff, as of June 30, 2024
 Values based on NAVs plus unfunded commitments

Growth Real Estate

Cap rate spread to 10-Year Treasury remains flat

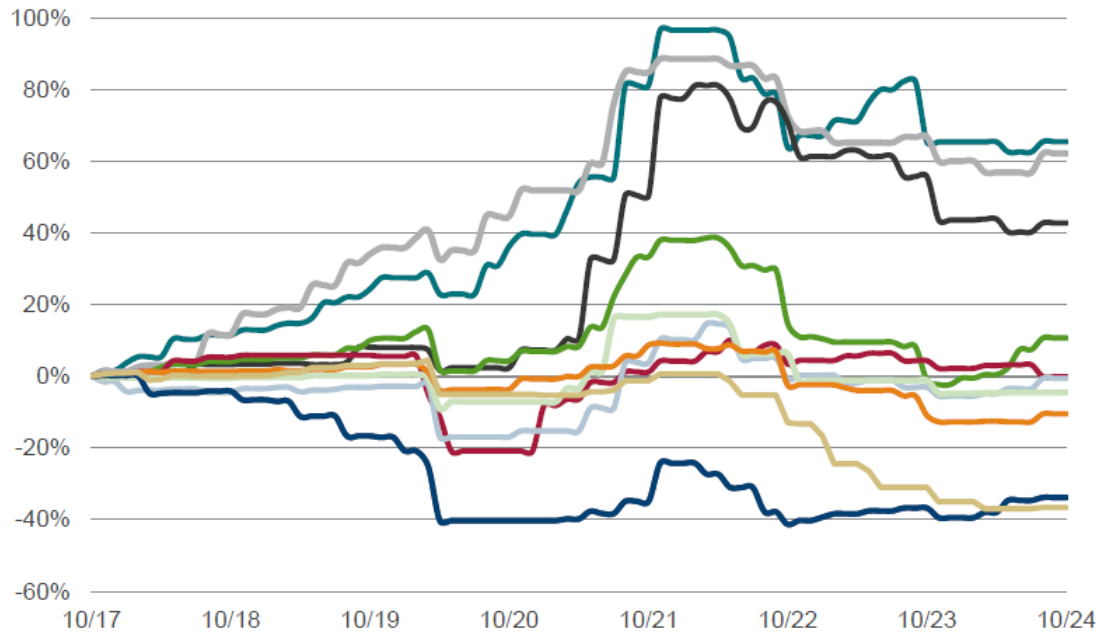


Source: Meketa, NCREIF, US Department of Treasury

Valuations rising for transactions going into contract

Green Street's Commercial Property Price Index® is a time series of unleveraged U.S. commercial property values that captures the prices at which commercial real estate transactions are currently being negotiated and contracted.

Cumulative Change in CPPI®: Past Seven Years



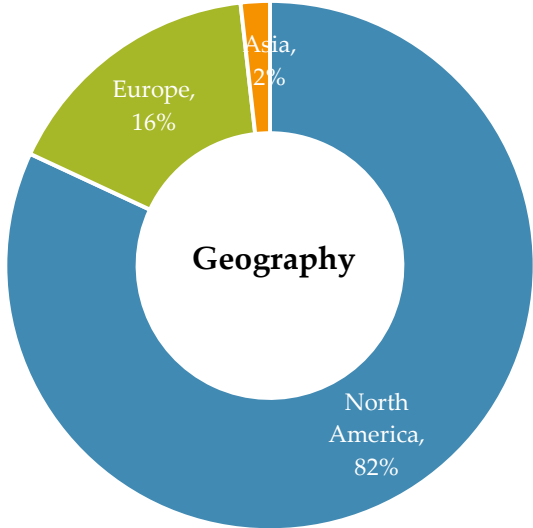
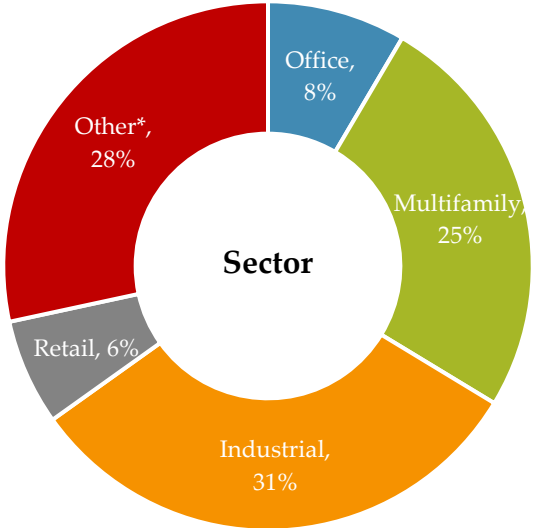
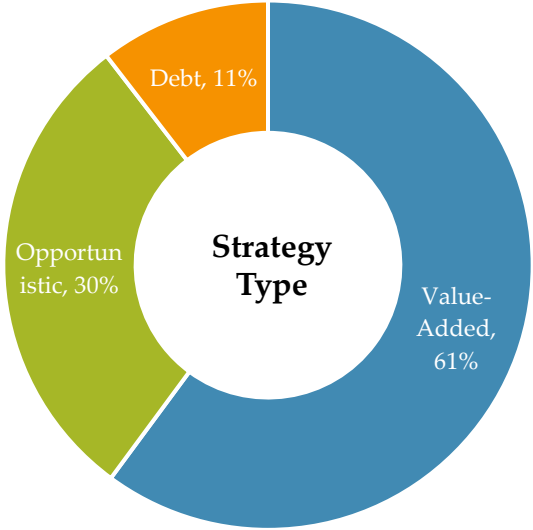
- Indust
- Man Home
- Self-Storage
- Apartment
- Lodging
- Strip Retail
- Net Lease
- Health Care
- Mall
- Office

	TTM	From Peak
Industrial	0%	-16%
Man Home	-3%	-14%
Self-Storage	-8%	-21%
Apartment	12%	-20%
Lodging	-4%	-9%
Strip Retail	3%	-13%
Net Lease	-3%	-19%
Health Care	0%	-18%
Mall	5%	-13%
Office	-8%	-37%

Source: Green Street Commercial Property Price Index®, as of November 6, 2024

TTM: Trailing twelve months

Growth Real Estate Portfolio Update



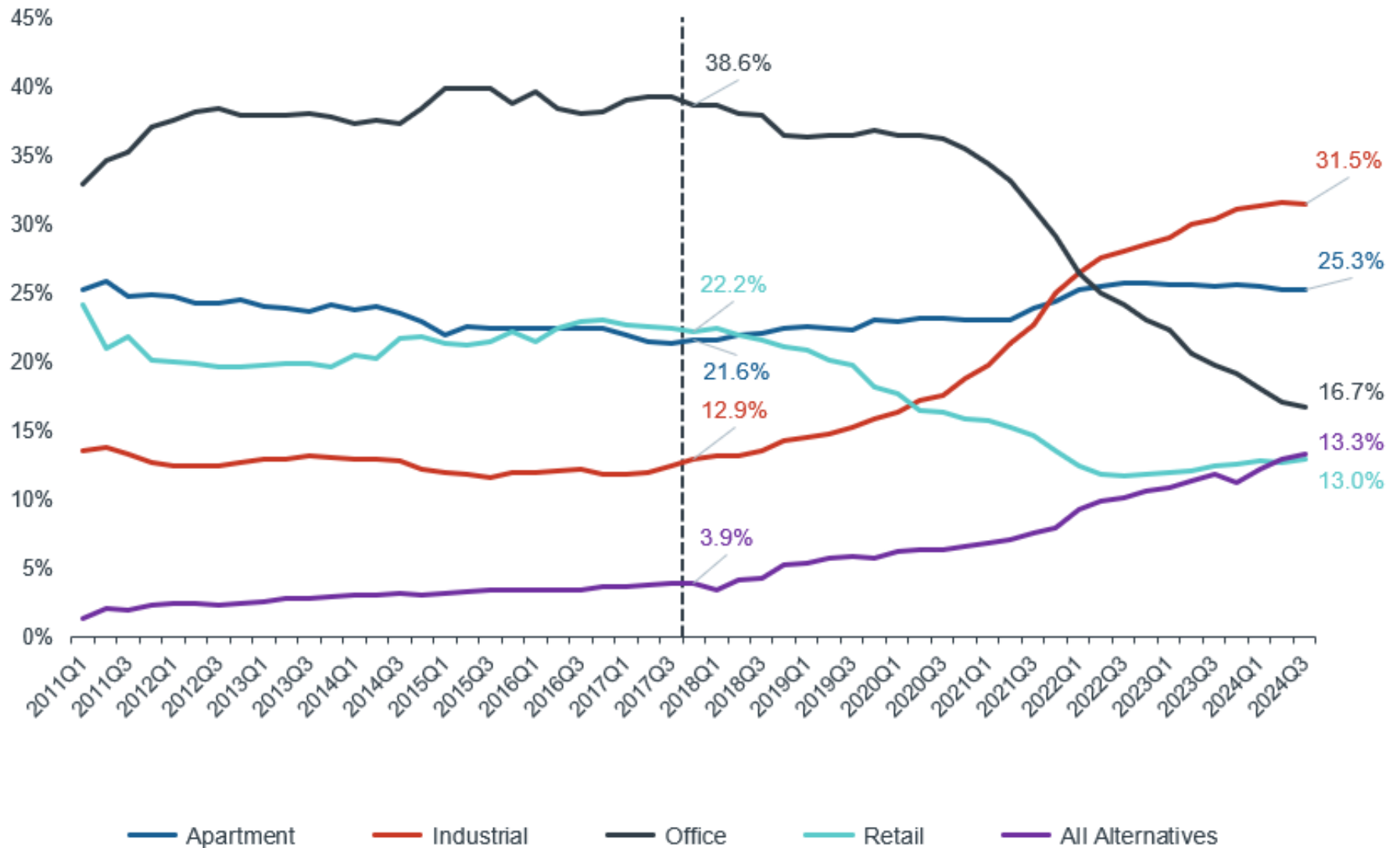
Source: San Jose Staff, as of June 30, 2024

Values based on NAVs plus unfunded commitments

* Other Sector category includes 11% hospitality, 8% data centers, 5% self-storage, 2% each in single-family rentals, lab office, student housing

Core Real Estate

NCREIF ODCE Index Sector Allocations Shifting



Source: NCREIF, Clarion Partners Investment Research

Core Real Estate Portfolio Update


Both the Pension and Health Care Trust are below the Core Real Estate policy targets, but are expected to rebalance to target following a new fund commitment that is expected to close by year-end.

The Pension and Health Care Trust closed their second secondary purchase of LP interests in TA Realty Core Property Fund on October 31, 2024.

Core Real Estate Allocation

	% of Plan	Target	Difference
Police & Fire Pension	4.7%	5%	-0.3%
Police & Fire Health Care Trust	10.8%	12%	-1.2%

Over \$21 million of alpha over 6 years



Core Real Estate Alpha (\$ millions)

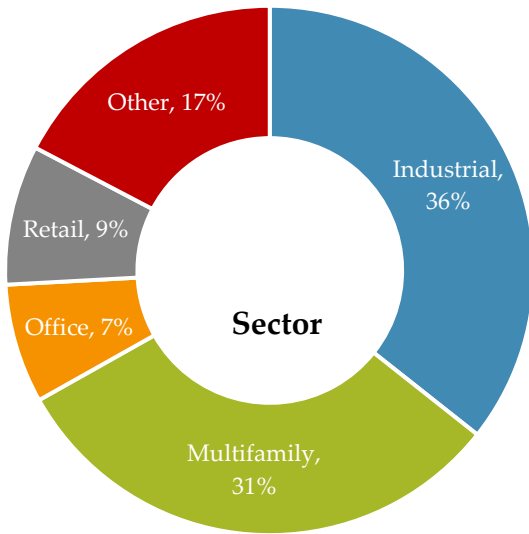
	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	6-years
Police & Fire Pension	\$2.2	\$3.8	\$2.3	\$2.3	\$9.9	\$0.1	\$20.7
Police & Fire Health Care Trust	n/a	n/a	n/a	n/a	n/a	n/a	\$1.1

The Core Real Estate asset class manager lineup was restructured in 2019 and has generated meaningful alpha over the asset class benchmark (NCREIF ODCE Index).

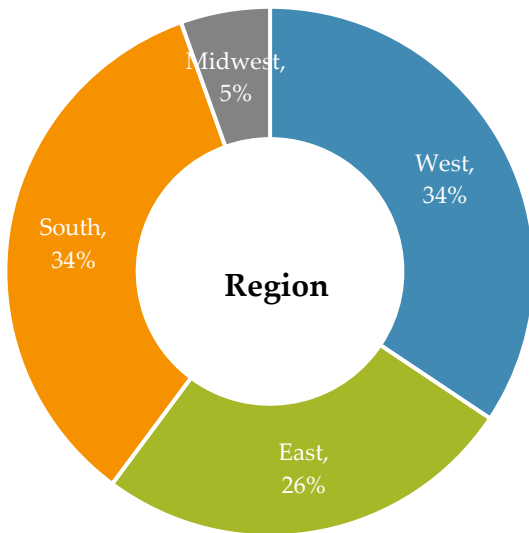
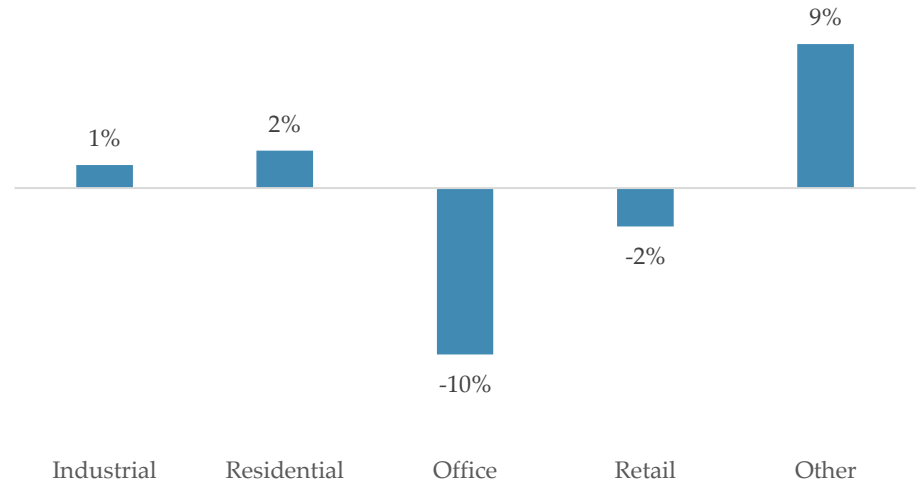
Source: Meketa, BNY Mellon

% of Plan is Pro Forma as of November 15, 2024

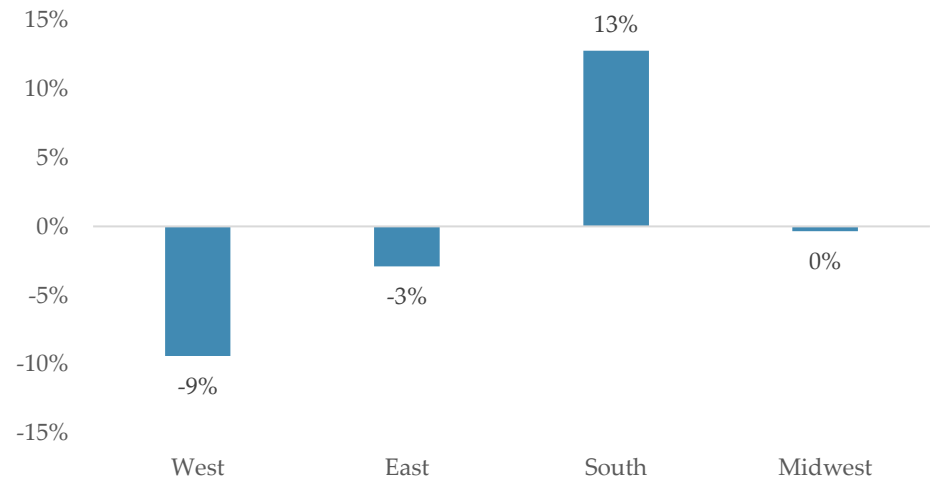
Core Real Estate Portfolio Update



Active Sector Weights



Active Regional Weights

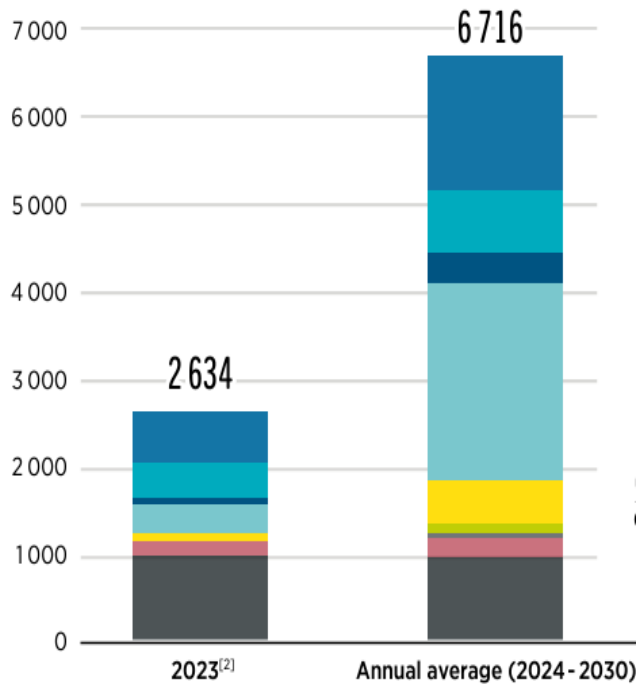


Pro Forma as of October 2024 including expected capital activity

Private Real Assets

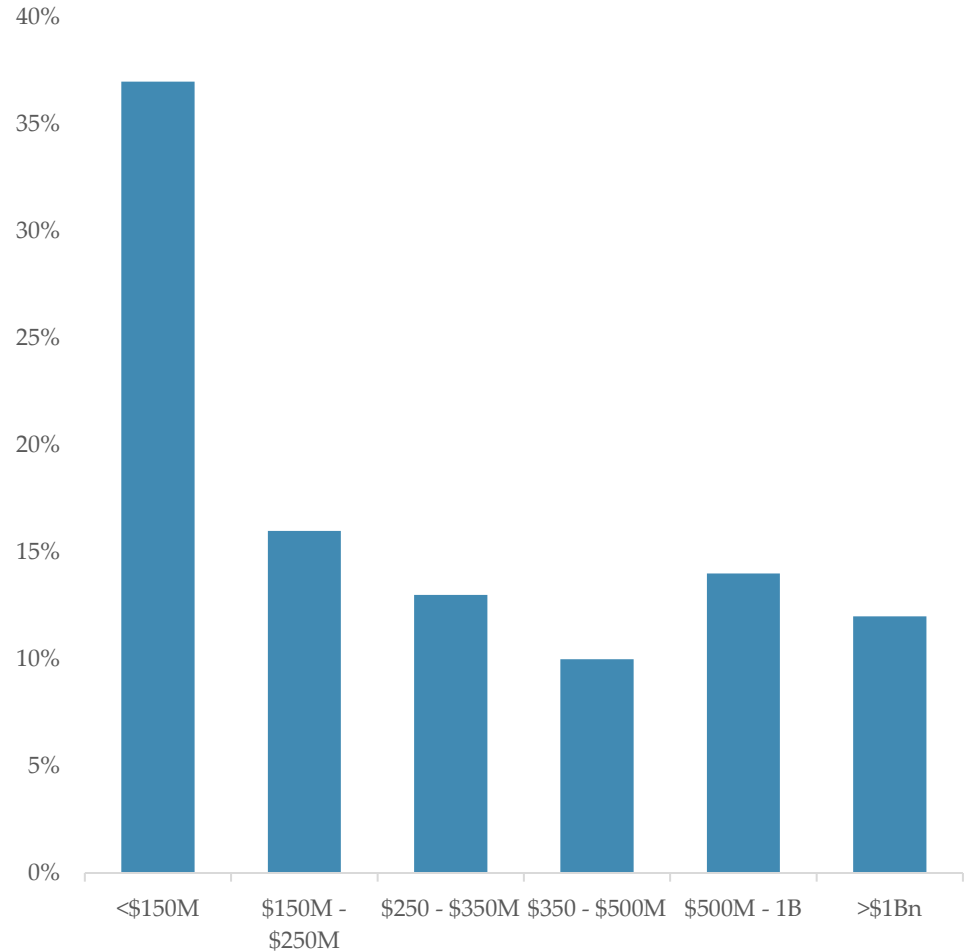
More Real Assets Spending Needed

Global investment (USD billion, 2023)^[1]



Source: IRENA World Energy Transitions Outlook

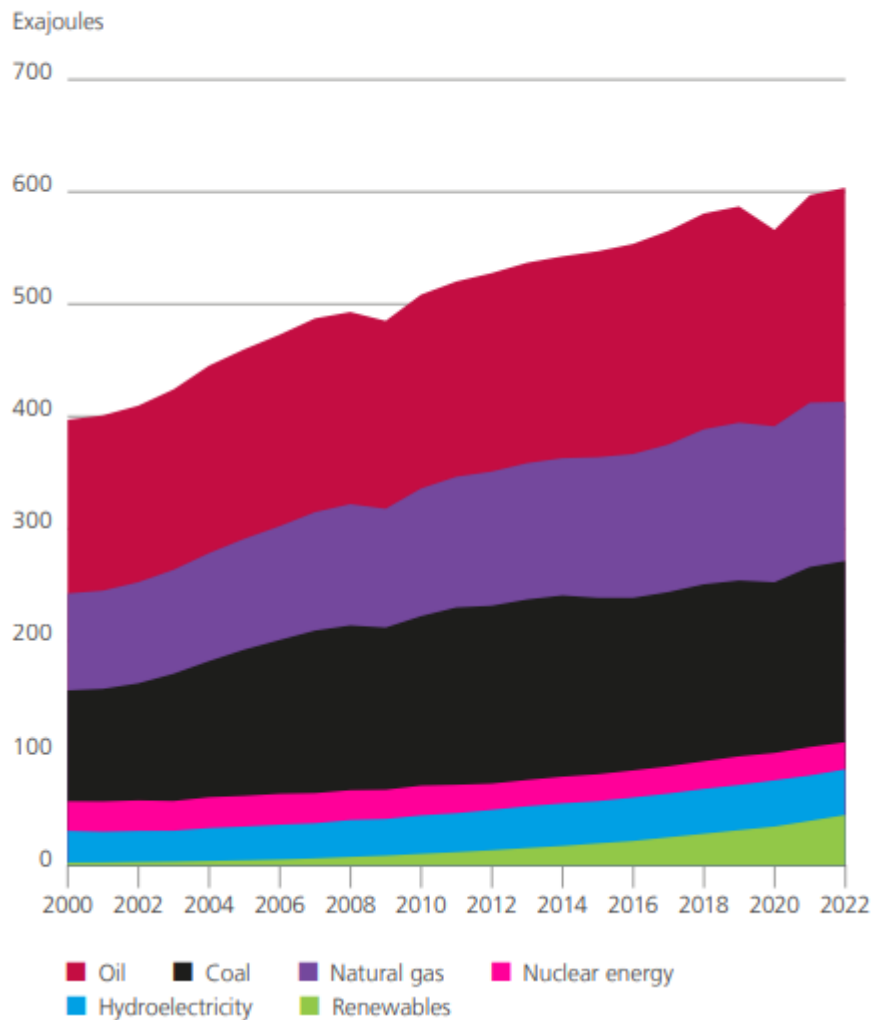
North American Infrastructure Equity Transactions by Size



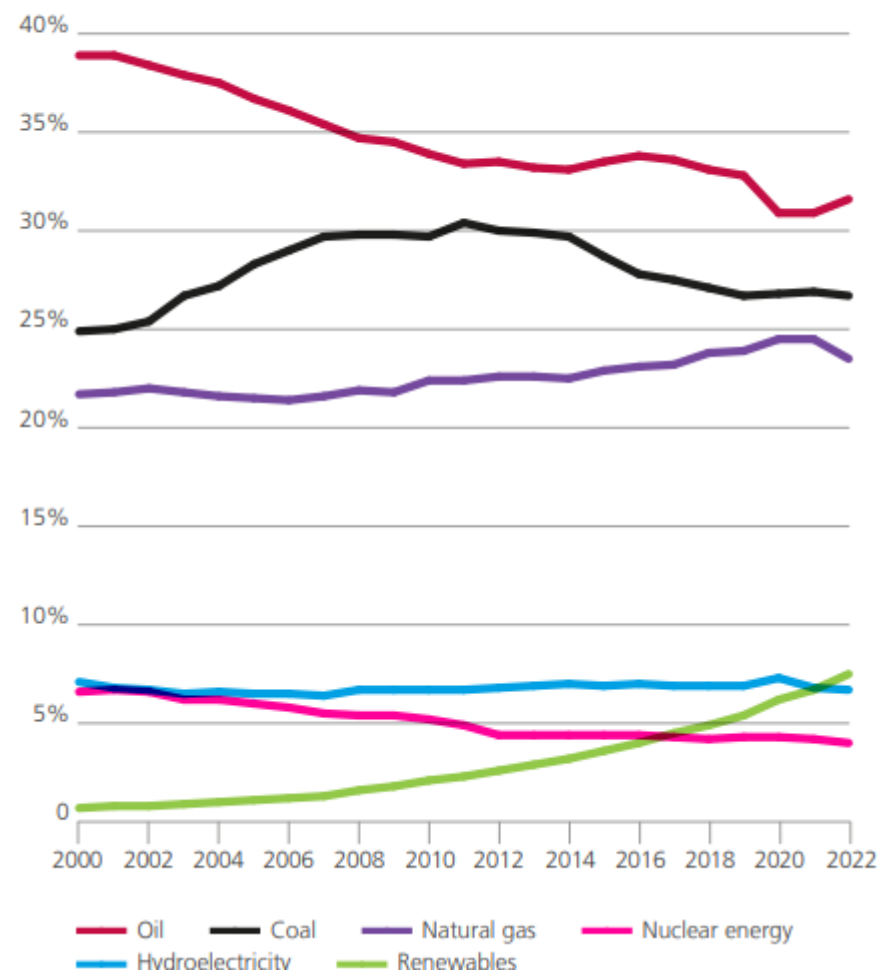
Source: Inframation, Ridgewood Infrastructure

Hydrocarbons still account for over 80% of world energy consumption

World consumption

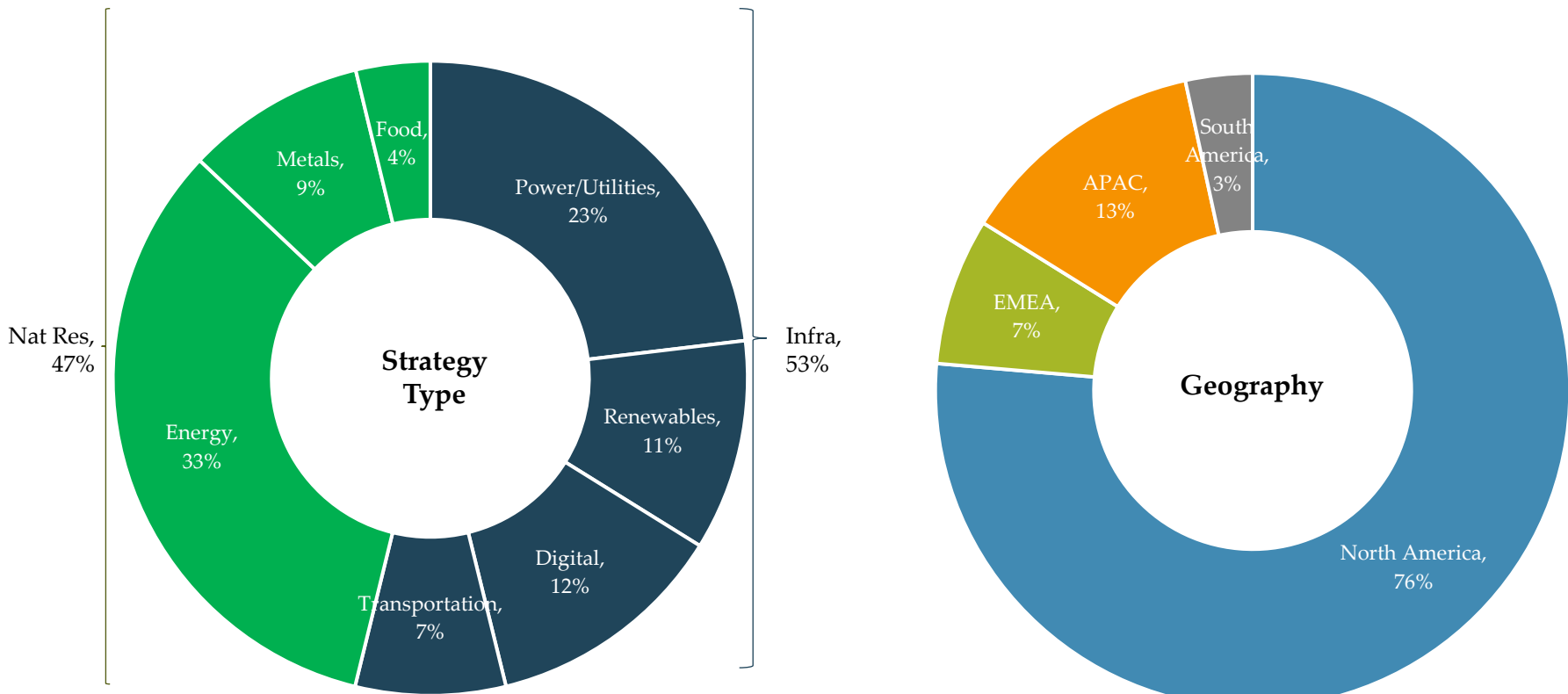


Share of global primary energy



Source: Energy Institute Statistical Review of World Energy, June 2023

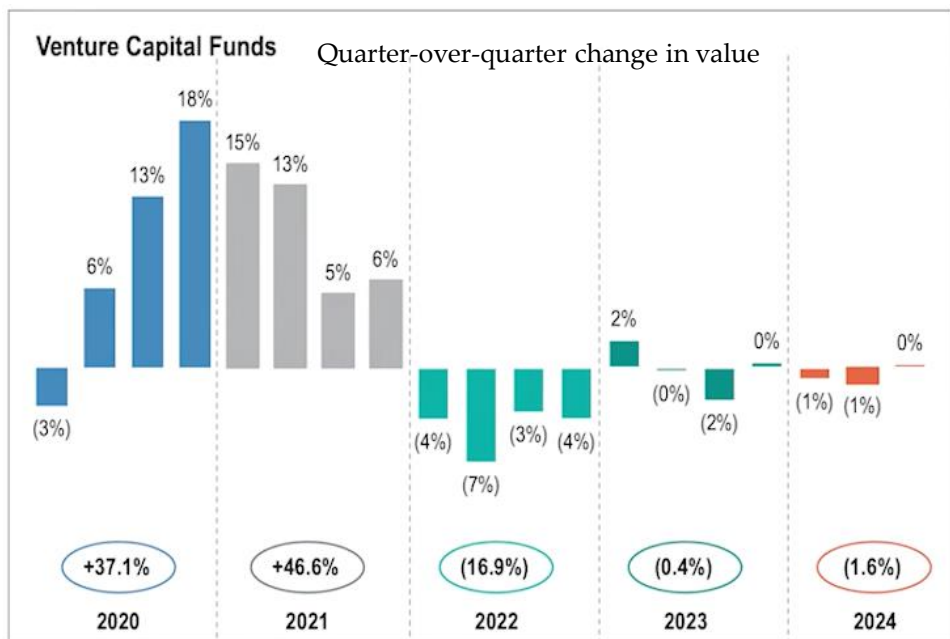
Private Real Assets Portfolio Update



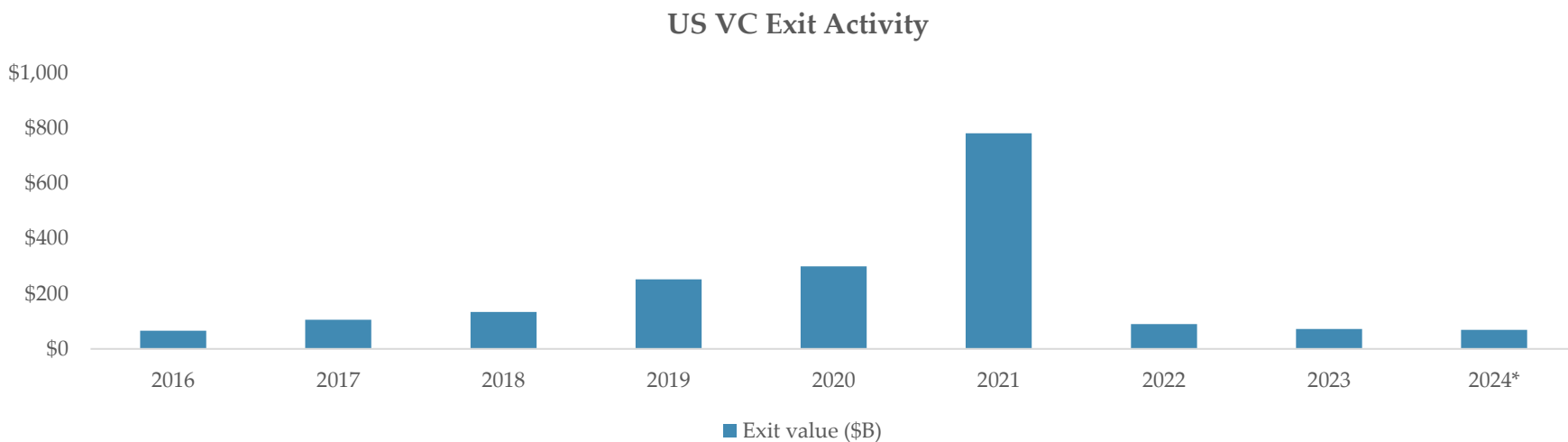
Source: San Jose Staff, as of June 30, 2024
Values based on NAVs plus unfunded commitments

Venture Capital

Challenging period for VC – Poor returns coupled with a challenging exit environment



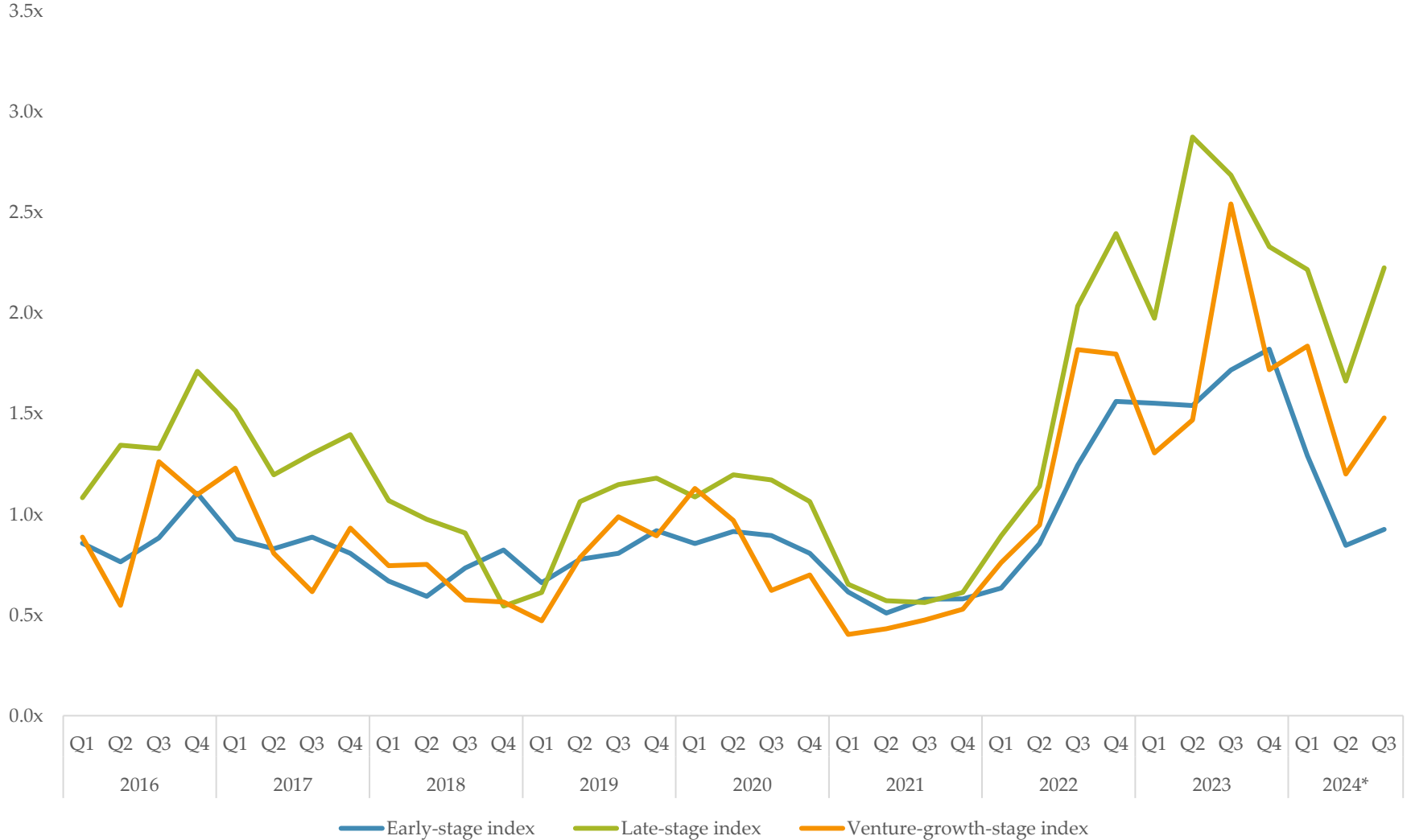
Source: Neuberger Berman Q3 2024 Valuation Summary



Source: Pitchbook, as of September 30, 2024

AI Optimism Driving Early Stage Investment Interest

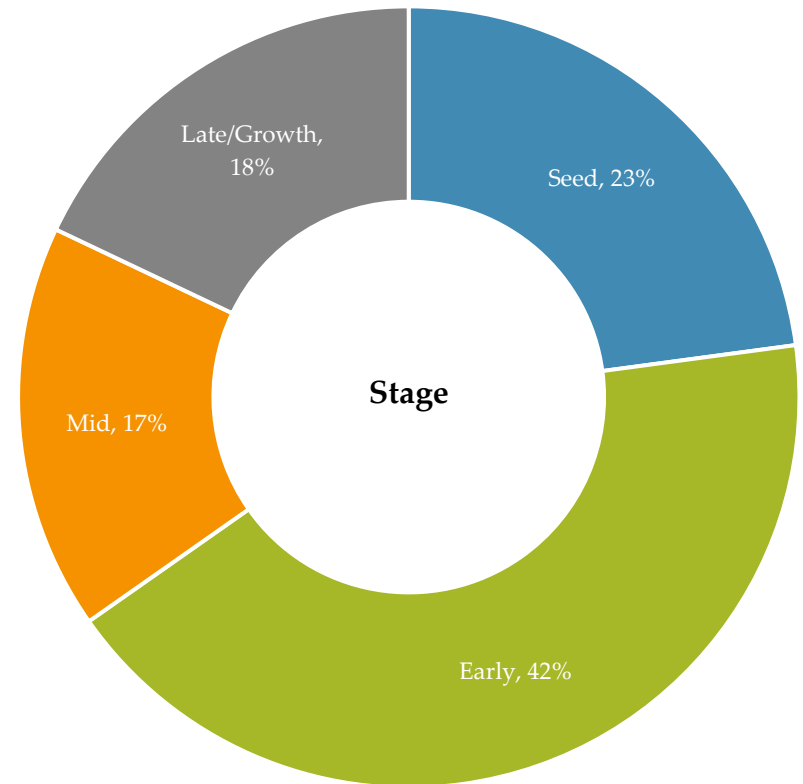
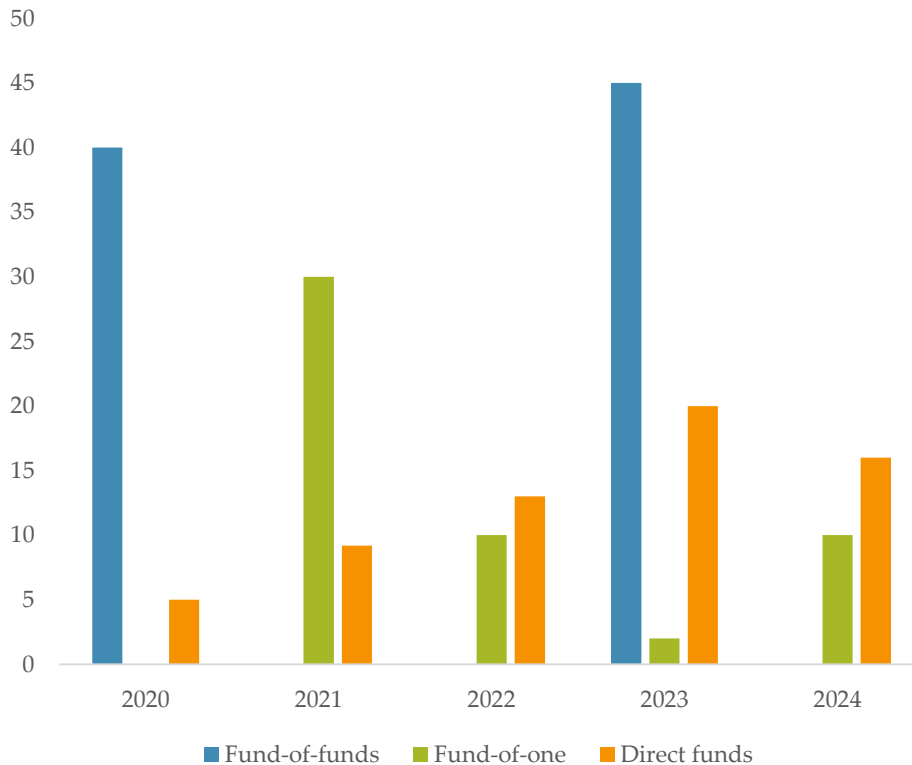
Capital Demand/Supply Ratio



Source: Pitchbook, as of September 30, 2024

Venture Capital Portfolio Update

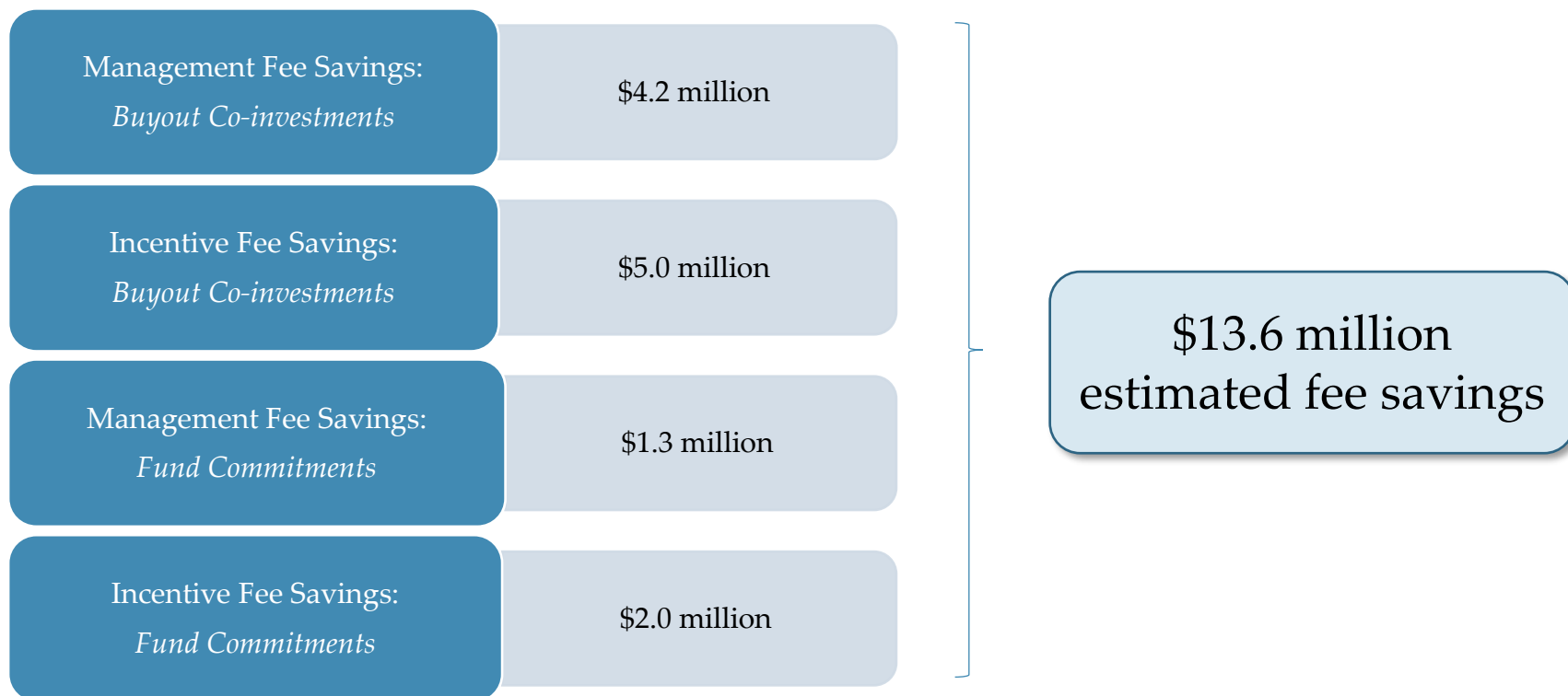
Commitments (\$ mm) by Vintage and Fund Type



Source: San Jose Staff, as of June 30, 2024
Values based on committed capital

\$13.6mm estimated fee savings for CY 2023 investments

- Estimated fee savings from commitments made in calendar year 2023 over the projected life of the investments for both San Jose Police and Fire and Federated plans:



- Fund Commitments fee savings from Staff negotiations, early closing discounts, and volume discounts.
- Additional fee savings not modeled: fee structures of fund-of-ones compared to fund-of-funds alternative, upside performance of investments with incentive fee discounts, commitments to funds with standard fees below asset class averages, and fee savings from investments made prior to January 2023.