

SBCERS

Santa Barbara County Employees' Retirement System

DATE: March 20, 2024

TO: SBCERS BOARD OF RETIREMENT

FROM: SBCERS Investment Staff

RE: **Board Education - Introduction to Derivatives Overlay**

Recommendation

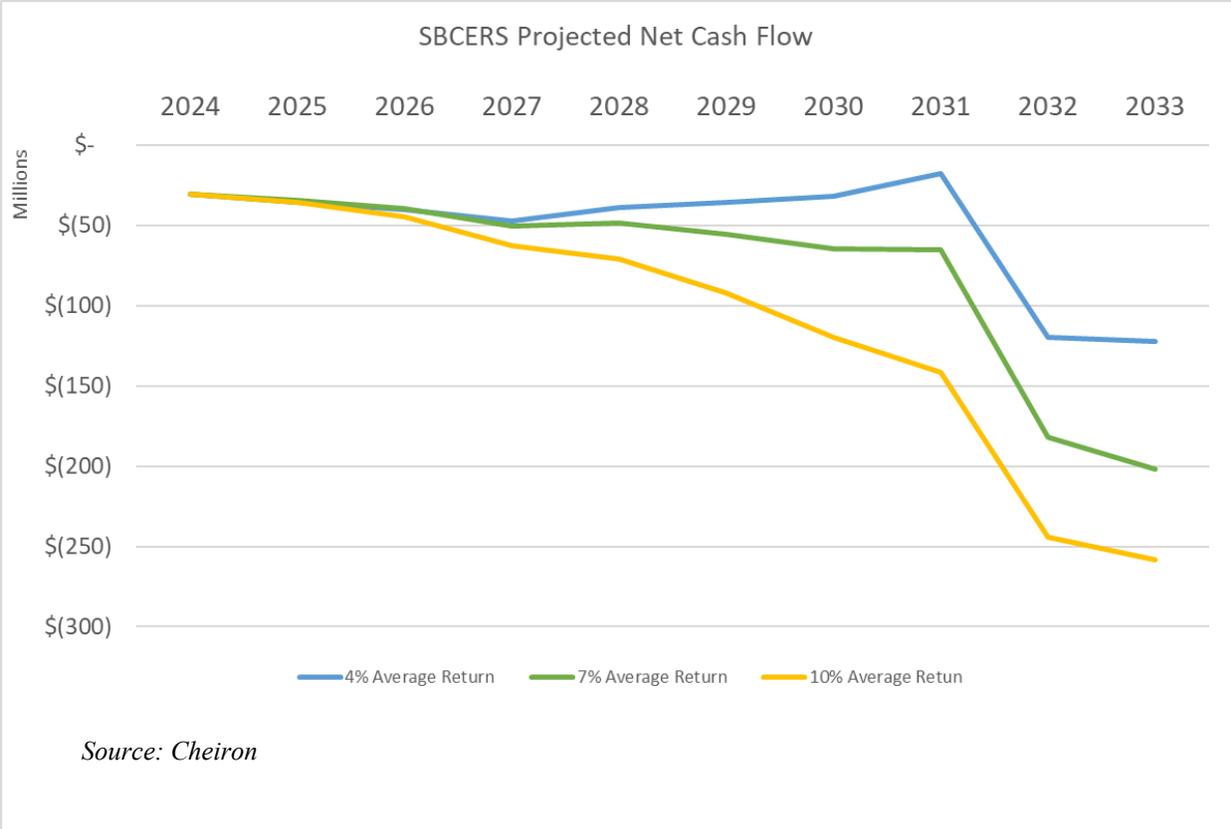
That the Board of Retirement receive and file the Introduction to Derivatives Overlay presentation by Parametric Director of Institutional Relationships Jesse Cauble and Executive Director of Investment Strategy Sylvia Horstmann, CFA.

Summary

Derivatives are financial instruments whose value is dependent on an underlying asset. The term “Derivative” encompasses Forwards, Futures, Swaps and Options among others. Derivatives have many functions in portfolio construction including adjusting risk or market exposure. Futures can be incorporated into a portfolio for use in a Cash Overlay, Transition Overlay or Rebalancing Overlay. The focus of this presentation will be using futures to implement a Cash Overlay strategy. A Cash Overlay uses excess cash in the portfolio to purchase futures in order to create equity-like returns. This prevents “cash drag”, which is the lost return, or opportunity cost, of holding cash in a long-term investment portfolio.

Currently, SBCERS has the benefit of being a relatively cash neutral organization, the net contributions of the system are approximately that of the net distributions. As shown in the chart below, this will continue until approximately 2028, when the amortized losses from the Great Financial Crisis in 2008 will cease to continue as part of the net contributions into the System. At that time, it is expected the net distributions will exceed the net contributions of the System. In preparation for this shift in cash flows, SBCERS Investment Staff is beginning to introduce to the Board investment tools that would be prudent for implementation prior 2028 this includes Cash Overlay which would allow SBCERS to hold a greater sum of cash on hand and have enhanced flexibility about how to redeem investments, while reducing the opportunity cost of having a more liquid portfolio.

This presentation is intended to set a foundation for understanding derivatives. This foundation is fundamental to future dialogues and proposals that impact the System’s handling of the change in cash flows.



Attachments

- INV - Parametric - SBCERS - Overlay Derivatives Intro- Update for Board Meeting_V3