



**Date:** January 12, 2022

**To:** The Retirement Board

**Through:** Jay Huish  
Executive Director

Kurt Braitberg, CFA, CAIA  
Interim Chief Investment Officer

**From:** Han Pham  
Director, Public Equity

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**Subject:** DFA Emerging Markets Small Cap – Recommendation to Terminate

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### **Overview**

Investment Staff (“Staff”) is recommending the termination of the DFA (“the Firm”) Emerging Markets Small Cap (“the Strategy” or “EM Small Cap”). Through September 30, 2021, the Strategy has underperformed its benchmark (MSCI EM Small Cap) for 1, 3, and 5-year periods (see Appendix A for details). SFERS’ estimated investment in the Strategy is approximately \$120.2 million as of November 30, 2021. DFA EM Small Cap strategy has been “under review” due to performance issues since 4Q2020.

As detailed in the Public Equity Update presented at the April 2021 Retirement Board meeting, Staff shifted its focus several years ago to specialist strategies that can add meaningful alpha. Staff will continue to buildout a portfolio of concentrated high-active share, unconstrained fundamental strategies complemented with innovative diversified quantitative strategies. Staff favors smaller, more nimble firms that have specialty skills, a singular investment focus, and niche strategies. Staff believes that exceptional managers have a unique, significant, and sustainable edge, and a high degree of alignment with investors. DFA Emerging Markets Small Cap is not consistent with Staff’s current plan for the public equity portfolio.

### **Background**

**Firm** – DFA was founded in 1981 by David Booth, Rex Sinquefield, and Larry Klotz. Prior to founding DFA, Mr. Booth, Mr. Sinquefield, and Mr. Klotz had studied under Eugene Fama and Kenneth French, both renowned academics and pioneers in finance. As of September 30, 2021, the Firm managed \$653 billion in over 31 strategies.

**Assets** – The DFA EM Small Cap Strategy had approximately \$5.5 billion in assets as of September 30, 2021. The Strategy is currently open to existing clients and strategic relationships.

Investment Team – DFA employs a staff of over 1,400, including 308 investment professionals as of September 30, 2021.

Strategy – The Strategy’s universe focuses on the smallest 15% of stocks by market cap within Emerging Markets and consists of companies with market capitalizations down to \$50 million. Within small and micro-cap names, DFA quantitatively excludes stocks that exhibit low profitability and high relative prices. The portfolios’ objectives are to capture the returns of the EM asset class while outperforming the benchmark through portfolio design and minimizing trading costs in addition to a systematic style tilt towards the small cap and value premium. The Investment Team targets a broad coverage of eligible securities to achieve diversification across countries and sectors, which results in a very diversified portfolio of over 4500 names.

### **SFERS Investment in DFA**

SFERS invested \$80 million in the DFA Emerging Markets Small Cap strategy in October 2011. Since inception and ending November 30, 2021, there have been \$61 million of additional inflows to the Fund and \$125 million of outflows from the Fund. The Strategy peaked at approximately \$234 million in June 2021.

### **Performance**

The Strategy has outperformed its benchmark (MSCI EM Small Cap) by 89 basis points on an annualized basis since SFERS’ investment in 2011. More recent performance has been challenging with the Strategy underperforming the benchmark by 375 basis points in the first 3 quarters of 2021. Moreover, the Strategy has underperformed its benchmark (MSCI EM Small Cap) for the trailing 1, 3, and 5-year periods by -770, -130, and -50 basis points, respectively. Outperformance has been highly cyclical and more recently has been trending downwards. DFA’s value bias will underperform during periods of strong outperformance of growth, which has been the case for much of the last 10-plus years.

### **Role in SFERS Portfolio**

As noted earlier, the public equity portfolio is focused on producing alpha. The portfolio has shifted towards smaller, more nimble firms with a singular or specialty investment focus. Staff believes that DFA does not meet these criteria given their sizeable assets (\$653 billion) and the numerous strategies that they manage. Staff also believes that the best way to outperform the public equity market is to be different than the market rather than closely tracking a benchmark. The Strategy’s low tracking error (3.3%) since SFERS’ inception indicates that its return profile is quite similar to the benchmark.

### **Recommendation**

Staff is recommending a termination of SFERS’ investment in the DFA Emerging Markets Small Cap Strategy.

**Appendix A – Performance Analysis**

**Annual Returns**

	9 mos									
	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
DFA EM Small Cap	13.5	13.8	14.9	-17.6	35.3	10.9	-8.7	3.0	-1.4	24.5
MSCI EM Small Cap	17.2	19.3	11.5	-18.6	33.8	2.3	-6.8	1.0	1.1	22.2
MSCI ACWI	11.1	16.3	26.6	-9.4	24.0	7.9	-2.4	4.2	22.8	16.1
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
DFA EM Small Cap	-22.2	31.2	101.3	-54.2	39.1	38.4	27.0	30.2	74.7	1.0
MSCI EM Small Cap	-27.2	27.2	113.8	-58.2	42.3	32.4	29.2	24.7	60.4	-1.4
MSCI ACWI	-7.4	12.7	34.6	-42.2	11.7	21.0	10.8	15.2	34.0	-19.3

**Annualized Returns**

	1 Yr	3 Yr	5 Yr	7 Yr	10 Yr	15 Yr
DFA EM Small Cap	35.5	11.8	9.2	6.9	8.1	8.4
MSCI EM Small Cap	43.3	13.1	9.8	6.2	7.2	7.2
MSCI ACWI	27.5	12.6	13.2	10.0	11.9	7.2
Value Added vs MSCI EM SC	-7.7	-1.3	-0.5	0.7	0.9	1.2
Value Added vs MSCI ACWI	8.1	-0.8	-4.0	-3.1	-3.8	1.2

**Rolling 3-Year Value Added vs MSCI EM Small Cap (Since DFA Incept: Jan 2002 – Sep 2021)**



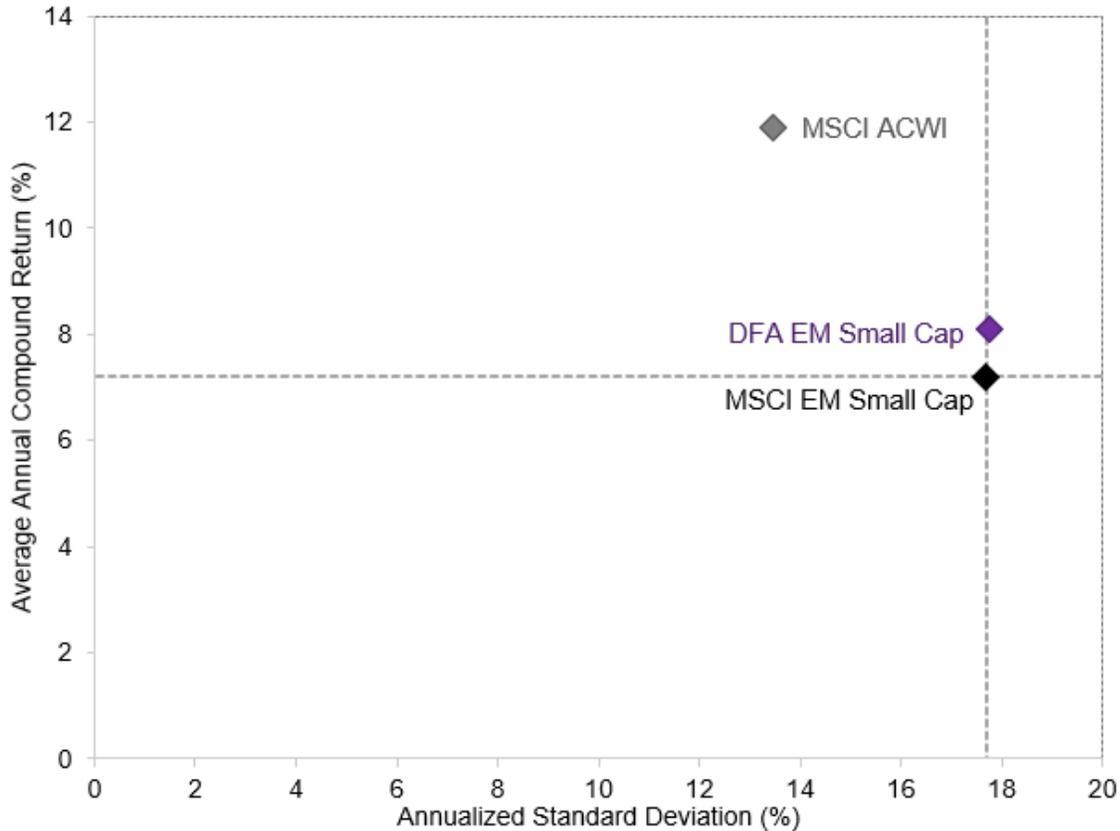
Notes: Prior to SFERS' investment, gross composite level returns are used. All other performance is net of fees.

DFA Emerging Markets Small Cap  
Recommendation to Terminate

**Cumulative Growth of \$100** (Since SFERS Investment in DFA ending September 2021)



**Risk-Return Tradeoff** (Since SFERS Investment in DFA ending September 2021)



Notes: Prior to SFERS' investment, gross composite level returns are used. All other performance is net of fees.