StepStone Atlantic Fund, L.P.

Private Equity and Infrastructure Investment Plan
Proposed: November 2020

Report Prepared For:

SDCERS
San Diego City Employees' Retirement System
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All data is as of June 30, 2020 unless otherwise noted.

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EXECUTIVE SUMMARY

This Investment Plan ("Plan") provides an overview of the investment approach and philosophy that StepStone Group LP ("StepStone") will utilize in building a Private Markets Portfolio (Private Equity and Infrastructure Portfolio) for San Diego City Employees' Retirement System ("SDCERS") (the "Portfolio").

This version of the investment plan, formulated in October 2020, is forward looking and will be updated as necessary.

There are three primary components to this Plan:

- Investment Strategy
- Portfolio Pacing
- Risk Management

Investment Strategy:

StepStone anticipates that the primary driver of portfolio outperformance will be selecting the highest quality private market managers for the portfolio. In addition, StepStone will utilize its extensive proprietary research to target funds that operate in areas of the private markets that are positioned to outperform. The following is an overview of the areas of the private equity market that will be targeted:

- **Strategies:** A broad range of private markets sectors will be targeted including Buyouts, Growth Equity, Venture Capital, Secondaries and Infrastructure. Infrastructure sub-sectors includes Energy and Power, Renewables, Transportation, Real Assets, Telecommunication, and Credit/Special Situations. StepStone will overweight the opportunistic approach with Secondaries, Co-Investments, and Seasoned Primaries.

- **J-Curve Mitigating Strategies:** StepStone continues to target strategies which can lower the risk profile of the Fund and offer earlier distributions. This includes secondaries and other special situation strategies.

- **Fund Size:** The Fund will continue to favor Small and Middle Market funds, which StepStone expects to outperform the larger end of the market. The Fund will also focus on emerging growth General Partners with an emphasis on growth equity investments.

- **Geographies:** The Portfolio will invest globally, primarily targeting opportunities in the US, Western Europe and Developed Asia. Developed markets are generally more mature private markets that involve lower risk than Emerging Markets. In addition, StepStone expects to selectively invest a small allocation in Emerging Markets, including China, Southeast Asia, Latin America, and Eastern Europe.

Portfolio Pacing:

- **Commitment Plan:** StepStone will target aggregate annual commitments ranging from $60 million to $180 million. The Portfolio will have the flexibility to invest greater or lesser amounts in any given year. Actual amount invested will be determined by changing market conditions, changes in valuation of SDCERS’ overall portfolio and the quality of funds in the market in any given year. An updated Portfolio Pacing Analysis will be provided to the SDCERS Board at least once per year in the Annual Review memorandum.

- **Cash Flow Projections:** In the early years of the investment program, StepStone overweighted investments that generated relatively early cash flow (such as Secondaries and Seasoned Primaries). This served to reduce the typical J-curve that is experienced by young private equity portfolios.

- **Allocation by Fund and Year:** StepStone will seek to make larger commitments to blind pool primaries with a limited pool of fund managers in which we have the highest conviction. Primaries will range from $10 million to $30 million. However, StepStone will emphasize an Opportunistic Portfolio, which selectively invests in Secondaries, Co-
investments, and Seasoned Primaries. The Opportunistic investments typically are smaller in size, due to available allocation and risk management considerations. Secondaries will range from $1 million to $30 million per investment. Co-investments will range between $1 million and $15 million. Seasoned Primaries will range between $5 million and $30 million.

Risk Management:

StepStone will manage risk in the private markets program through a combination of (i) in-depth due diligence and (ii) portfolio construction techniques and active portfolio monitoring.

- **Due Diligence**: StepStone will utilize a number of proprietary due diligence techniques designed to identify investments that involve inappropriate levels of investment risk or insufficient institutional controls. An emphasis will be placed on investments that offer superior transparency and limited (or appropriately managed) conflicts of interest.

- **Diversification**: Portfolio risk will be reduced through appropriate diversification by sector, strategy and geography. StepStone will seek to balance the need to target the best individual investment opportunities with the need to maintain an appropriate level of portfolio diversification. Investments will be paced in a systematic way over multiple years to avoid inappropriate concentration of investments in any single year. Specific diversification guidelines that StepStone will follow to manage portfolio risk will include:
  
  - **Industry Concentration**: Over a five-year investing period no more than 40% of the Portfolio will be concentrated in any one industry.

  - **Fund Concentration**: No single fund commitment will be greater than 30% of the Fund.

  - **Vintage Year Concentration**: A maximum of 40% will be committed in any single vintage year.

- **Monitoring and Reporting**: StepStone will utilize its monitoring and reporting techniques to review portfolio risks on an ongoing basis. This will include monitoring for unexpected portfolio concentrations or manager performance issues. Quarterly portfolio reports will be provided to the staff and board of SDCERS, providing an additional level of ongoing oversight.
INVESTMENT STRATEGY

StepStone Investment Strategy

StepStone will continue to build a private equity and infrastructure portfolio through a combination of primary fund purchases, seasoned primaries, secondary purchases, and co-investments.

- **Primary funds**: Blind pool funds with no existing assets when the investment by the limited partner is made. Investing through primary fund commitments will establish long-term, lower-risk growth potential. StepStone’s analysis of return drivers will be fundamental to manager selection and risk management. In particular, StepStone will investigate whether potential fund managers can generate additional value in infrastructure projects through developing and upgrading operations, using project leverage, and establishing scalable business models that will encourage growth and be attractive to strategic players interested in the sector at the time of exit.

- **Seasoned primaries**: Funds which currently have assets in the ground but are still fundraising to reach a final close on commitments. Investing through seasoned primary deals will mitigate risks associated with blind-pool primary investments by giving StepStone and SDCERS the ability to look through to the underlying assets in the fund before committing to the investment. Most seasoned primaries can be expected to have anywhere from 5% to 50% of their committed capital already invested by the time SDCERS enters the Fund. StepStone will investigate potential seasoned primary fund managers the same way as primary investment fund managers. StepStone will investigate whether the managers will be able to generate additional value in infrastructure projects through developing and upgrading operations, using project leverage, and establishing scalable business models that will encourage growth and be attractive to strategic players interested in the sector at the time of exit.

- **Secondary purchases**: Investments in limited partner interests in private equity partnerships (funds which are purchased from prior LPs, typically at a discount to current Net Asset Value). Acquiring secondary positions will mitigate much of the risk inherent in primary fund investments. Investing in a seasoned portfolio affords the opportunity to vet the portfolio’s leverage level, regulatory compliance, and structural robustness. Purchasing quality assets at a discount will also minimize the J-Curve effect and increase the overall return profile by a meaningful margin to drive Portfolio returns. In addition, attractive discounts achieved in purchasing secondary positions in existing funds will reduce the fee burden.

- **Co-Investments**: Deals directly into individual company with an equity sponsor (StepStone does independent diligence on co-investment deals alongside the equity sponsor). StepStone will seek to target high quality assets with value creation potential through a co-investment strategy alongside proven managers. This approach can generate incremental returns in the Portfolio that would be otherwise difficult to achieve through a traditional infrastructure fund investment program. Co-investments involve low or non-existent fees, enabling a meaningful reduction in the fee burden. Furthermore, StepStone can perform careful due diligence on individual assets before committing capital in order to understand value creation and key milestones.

StepStone will seek to generate attractive private equity returns through a combination of (i) identifying the highest quality investment managers and (ii) emphasizing areas of the private equity market that, based on current market conditions, StepStone believes are positioned to outperform. For infrastructure investments, StepStone will (i) target sectors in which managers with a strong track record of infrastructure investment can add value to infrastructure businesses and services; (ii) focus on high-growth economies where governments will rely on Private Equity investors to establish or improve infrastructure; and (iii) utilize primary fund commitments, seasoned primary commitments, secondary investments, co-investments, and mezzanine investments to improve risk-adjusted returns, shorten the J-curve effect typical of Private Equity portfolios, and tailor portfolio construction to SDCERS’ investment goals and policies.
StepStone will place a primary emphasis on building a portfolio of investment managers that are exceptionally high quality. Private equity is an asset class where superior returns are driven by capturing alpha, and this is primarily done by selecting managers that StepStone believes will substantially outperform the index. Despite the doubling of allocation to private equity, StepStone will seek to increase commitment size to select managers rather than increase the number of commitments to different managers. This strategy will not be applicable to secondaries as StepStone will continue to take advantage of secondaries representing all sizes of commitment.

Exceptional managers will be identified through a systematic comparison of a large universe of potential investment managers. StepStone would expect to review over 550 managers per year and select less than 1% of these managers for investment. StepStone will utilize a proprietary due diligence process to identify the best managers among those reviewed each year. These due diligence techniques will include:

- An on-site due diligence meeting at the fund’s investment offices to develop a first-hand view of how the fund operates, how the team interacts and the firm’s investment philosophy and culture;
- Review of the investment team, and their background and expertise. In addition to references provided by the manager, extensive off list reference checks will be utilized to assess the quality, experience, reputation and integrity of the investment team;
- Assessment of the fund’s investment strategy and the expected fit of this strategy with the current market environment;
- Detailed analysis of the fund’s investment track record, with a particular emphasis on how returns have been generated historically (earnings growth, increase in multiple of earnings, leverage, etc.) and the risk the fund has taken to generate its returns; and
- Review of the structure of the fund, its management company and compensation approach with an emphasis on confirming alignment of interest between limited partners and the general partner and among the fund’s investment team members.

Additionally, StepStone will focus its due diligence on the sub-sectors of infrastructure in which selected managers can add the most value. These sub-sectors, listed below, will also serve to balance the levels of risk and return according to SDCERS’ investment goals

- **Energy and Power**: Has generally outperformed other infrastructure sub-sectors historically and will be a key area of focus.
- **Renewables**: Have matured as a sector and increasingly represent a compelling opportunity in StepStone’s view.
- **Transportation**: Generally involves lower returns than other areas of infrastructure. As such StepStone will focus on the US lower middle market and emerging markets, and also seek to provide exposure through secondaries where possible.
- **Real Assets**: Strategies such as agriculture, timber and water can be compelling diversifiers for the infrastructure portfolio.
- **Telecommunications**: Infrastructure is being driven by the rise of cloud computing and the coming deployment of 5G wireless.
- **Credit and Special Situations**: Exposure can enhance the portfolio by improving cash yield, broadening sector diversification and reducing correlation.

As a secondary driver of returns, StepStone will emphasize areas of the private equity market that are positioned to outperform based on the current market environment. Long-term trends are emphasized due to the long-term structure of private equity commitments. StepStone conducts extensive proprietary research on the investing environment in different geographies and for different strategies. Factors that are considered when assessing the relative attractiveness of different areas of the private equity market include projected economic growth, capital available for investment relative to expected amount of investments available and condition of capital markets.

StepStone’s investment process seeks to combine these two areas of analysis to identify funds that are of exceptional quality operating in areas of the private equity market that are positioned to outperform.
**Investment Plan**

StepStone will seek to make larger commitments to blind pool primaries with a limited pool of fund managers in which we have the highest conviction. StepStone also built an Opportunistic Portfolio, which selectively invests in Secondaries, Co-investments, and Seasoned Primaries. The Opportunistic investments typically are smaller in size, due to available allocation and risk management considerations. Secondaries will range from $1 million to $30 million per deal, seasoned primaries will range from $5 to $30 million per deal, and co-investments will range from $1 million and $15 million per deal.

StepStone will continue to favor Opportunistic investments, which consists of Secondaries, Co-Investments and Seasoned Primaries. Opportunistic investments are used in selectively building desired exposures by project stage, industry sector, fund strategy and they are inherently opportunistic. Part of the Opportunistic Portfolio will consist of small secondaries. Due to changes in the secondary market, StepStone expects the best opportunities to come from these smaller bite-sized deals. StepStone will also look to selectively add Co-Investments to the portfolio. Co-Investments offer limited partners the ability to make investments directly into companies which can help to build targeted exposure to geography.

StepStone continues to target strategies which can lower the risk profile of the Fund and offer earlier distributions to mitigate the effects of a typical J-Curve. The J-Curve effect is when an investment is made, an initial loss is accrued as management fees and organizational expenses are paid. To help mitigate the J-Curve effect, the Fund has focused on secondaries and other special situation strategies. StepStone currently believes that the Fund has a healthy distribution yield and is lowering the priority of cash-yielding strategies, such as mezzanine and distressed debt, while continuing to focus on secondaries.

The Fund will continue to favor Small and Middle Market funds, which StepStone expects to outperform the larger end of the market. The Fund will also focus on emerging growth General Partners with an emphasis on growth equity investments. StepStone believes that current market conditions lend themselves well to these strategies.

The Portfolio will be appropriately diversified across the various strategies within private equity, including but not limited to Buyouts, Growth Equity, Venture Capital, and Secondaries. The Portfolio will invest globally, primarily targeting opportunities in the U.S., Western Europe and Developed Asia. Developed markets are generally more mature private equity markets that involve lower risk than Emerging Markets. In addition, StepStone expects to selectively invest a small allocation in Emerging Markets, including China, Southeast Asia, Latin America, and Eastern Europe. Within this diversified framework StepStone will use its extensive market research to overweight areas of the private equity market that are positioned to outperform. As an example, based on market conditions at the time, StepStone overweighted Secondaries in 2009 through 2011.
**Portfolio Pacing**

The Portfolio’s commitment pace has been determined based on the cash flow pacing analysis conducted by StepStone using our proprietary cash flow model. The model provides a target series of annual commitment amounts that allow a portfolio to reach its target allocation percentage. The charts below provide the commitment plan (the bars represent annual commitments) for the Portfolio based on the following assumptions:

- Total size of overall SDCERS Portfolio: estimated $8.3 billion as of June 2020.
- Assumed growth rate of overall SDCERS Portfolio: 6.5%
- Target allocation of Private Markets: 6.5%

Forward estimates of SSAF as a percentage of SDCERS based upon June 2020 SDCERS AUM with an assumed growth rate of 6.5% and a base-case annualized return projection for SSAF of 13.0%.

There can be no assurance that actual cash flows will be similar to the model set forth on this slide or that the investment will achieve its investment objectives or avoid substantial losses. Cash flow patterns will vary depending on the activities of the underlying investment. This is a simplified example, and may not represent the actual performance the investment. Please let us know if you want to see a cash flow analysis based on assumptions other than those we have used for this analysis.
Risk Management

Consideration of the risk/return trade-off is critical to move to efficient risk allocation. The chart below considers these factors giving a schematic view of the Private Equity sector. StepStone’s philosophy is that in building a private equity portfolio, risk should be managed by assembling an appropriate mix of exposure between risk and targeted returns (IRR).

Definitions and examples of select risk factors relevant to the Portfolio are captured in the table below:

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<tr>
<th>Risk Factors</th>
<th>Definition</th>
<th>Examples</th>
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| Market risk factors           | Widely accepted non-idiiosyncratic risk factors, that are associated with offering a long term premium (and this is supported by evidence). They may be replicable in the market. | • Equity risk  
• Credit risk  
• Duration risk  
• Commodity risk  
• Insurance risk |
| Thematic risk factors         | Non-idiiosyncratic risks associated with long term thematic change, for which we expect a risk premium. It is not clear at this stage as to whether the expected premium is paid in realized returns. | • Climate change  
• Demographics  
• Technology |
| Manager/Asset Specific Risks - Other risks | Other non-idiiosyncratic risk factors that represent key exposures for which we expect a margin of performance. It is not clear at this stage as to whether the expected premium is paid in realized returns. | • Liquidity  
• Regulatory  
• Political, geopolitical |
| Manager/Asset Specific Risks - Idiosyncratic risks | Also called unsystematic risk. Risks associated with the unique circumstances of a specific security, as opposed to the overall market. This risk can be virtually eliminated from a portfolio through diversification. | • Management risk  
• Valuation risk  
• Implementation risk |

Target returns are hypothetical and are neither guarantees nor predictions or projections of future performance. Future performance indications and financial market scenarios are no guarantee of current or future performance. There can be no assurance that such target IRRs will be achieved or that the investment will be able to implement its investment strategy, achieve its investment objectives or avoid substantial losses.
StepStone’s risk management approach optimizes exposure to the specific risks in the private equity asset class through the portfolio construction process, as well as the due diligence process.

**Portfolio Construction**

StepStone’s portfolio construction process utilizes a risk management framework that insures appropriate diversification across private equity managers and investment years (vintage years).

Regardless of the quality of due diligence regarding manager quality there still exists a risk that a specific manager can encounter unexpected difficulties in its investment activities or firm stability. For this reason, StepStone monitors its managed portfolios to confirm that an inappropriate level of manager concentration does not develop.

In addition, StepStone avoids excessive concentration of investments in any single year. This is an important risk mitigator because private market pricing multiples run in cycles related to equity risk. In order to control for this, StepStone spreads portfolio exposure across multiple vintage years, which will provide exposure to a variety of pricing environments. This is similar to the public market strategy of “dollar cost averaging.” Secondary purchases can be an effective tool in this respect, as they can provide vintage year diversification that would otherwise take 4 to 5 years to achieve.

Specifically, StepStone will implement the following concentration limits to ensure the portfolio has appropriate diversification to manage risk:

- **Industry Concentration**: Over a five-year investing period no more than 40% of the Portfolio will be concentrated in any one industry.
- **Fund Concentration**: No single fund commitment will be greater than 30% of the Fund.
- **Vintage Year Concentration**: A maximum of 40% will be committed in any single vintage year.

**Manager Due Diligence**

StepStone’s due diligence and manager selection process are designed to reduce exposure to downside risk factors. This process also allows StepStone to develop a detailed understanding of the potential idiosyncratic risk factors to which the Portfolio may be exposed.

StepStone will focus on managers who are best positioned to avoid idiosyncratic risk factors to produce alpha. It is likely that these funds will have more specialized strategies that are able to mitigate risk factors such as execution risk, regulatory risk, management risk, etc. Managers with operating expertise tend to be best positioned to mitigate these potential risk factors.

StepStone’s due diligence process utilizes additional processes to control undesired idiosyncratic risk. An example is the design of the limited partnership, ensuring that general partners and limited partners have interests that are highly aligned. Legal documents also contain numerous controls and governance provisions that give limited partners rights that help to minimize potential idiosyncratic risks associated with the general partner, which generally do not contribute to alpha generation.

The due diligence process also focuses on ensuring that the Portfolio is not exposed to undue financial risk. StepStone looks at leverage ratios employed by managers and favors strategies that are able to deliver returns without excess financial risk. Optimizing the capital structure can be an important tool for private equity managers, but the benefits of leverage are quickly outweighed by the increased risk when leverage rises beyond a certain “optimal” point.

While StepStone conducts numerous types of analyses to better understand the risk factors involved in a manager’s strategy, the most basic is an analysis of the sources of value in the firm’s track record. The chart below shows an example of such an analysis. Increases in value from EBITDA growth (Earnings Before Interest Taxes Depreciation and Amortization) generally
reflect the benefits from better execution, or from the benefits of exposure to upside thematic risk factors. Multiple Expansion can come from buying companies well (e.g., with upside risk factors not priced in, or downside risk-factors overly discounted), or from a general rise in multiples in the market (e.g., systematic risk factors). Changes in value attributed to Debt Paydown generally reflect the impact of financial engineering, although improved operating performance will enhance a firm’s ability to pay-down debt. Increases in debt may reflect a tendency to drive returns through dividend recaps, or through acquisitions that result in increased leverage and, as a result, increased financial risk.

**Monitoring and Reporting**

On an ongoing basis, StepStone monitors the development of the Portfolio to identify unplanned risk exposures, such as changes to Thematic risks. Private equity involves blind pools, which may lead to industry or geography exposures that are sub-optimal. These imbalances can be addressed in two ways. First, through an updated portfolio plan, changing targeted exposures to specific geographies, strategies or managers. Second, Secondary transactions, co-investments, and seasoned primaries can provide for a reduction in exposure, or can augment underexposures, since the underlying assets are generally known.

StepStone will review and confirm that all capital requests of the fund manager are consistent with the terms of partnership agreement and will review Amendment requests from managers to assess whether they are in the best interest of SDCERS.

StepStone’s monitoring and reporting function is managed by StepStone team of investment professionals who are experts in the area where the fund operates and who typically conducted the initial due diligence on the fund. This monitoring function allows StepStone to identify funds that are encountering performance issues or an increased risk of firm instability. In the rare instances where a restructuring is required, StepStone becomes actively involved in negotiating adjustments to the fund structure and management to ensure appropriate stewardship of existing investments and optimal managed of future investment activities.

Finally, StepStone will provide the quarterly reports to the SDCERS investment Staff and Board regarding the status and performance of the Portfolio, as outlined in the Private Equity Program Policies document. These reports will include:

- An annual review of the Investment Plan. This will consist of a comprehensive analysis of what happened in the past year, and any revisions to the Plan moving forward.
- Quarterly monitoring reports. These are meant to alert Staff to possible adverse developments as well as provide timely updates on the performance and analysis of investments. Quarterly reports will include, but not be limited to, the following:
  - The general investment environment and perceived opportunities coming to the private markets;
- Allocations made across different industries and subclasses of private equity;
- An assessment of future outcomes of the investments held;
- Summary of investment portfolio performance, along with an update on overall market performance;
- New commitments made since the last report; and
- Summary of draw-downs and distributions.

StepStone has a ranking system designed for those funds that we actively monitor. There are four primary categories: Outperform, Perform, Underperform, and Too Early to Tell. For each category, the ranking is determined based on quartile performance (based on IRR), as defined by Venture Economics Cumulative Vintage Year Performance report. The following outlines the four categories and how they are determined:

1. Outperform – Top Quartile
2. Perform – Second Quartile
3. Underperform - Third and Fourth Quartile
4. Too Early to Tell – Primary Investment less than 2 years old

In addition, qualitatively, if StepStone believes that a General Partner is having operating issues, then we will add “Watch” to the Funds ranking. This simply means that StepStone will put the fund through an additional level of scrutiny in our monitoring process. For example, a Fund that is a top quartile performer but has recently had a key man depart from the Firm, would be classified as “Outperform (Watch)”.

StepStone’s reporting will also include the following:

- Investments in the Portfolio shall be valued on a quarterly basis according to the standards of the Financial Accounting Standards Board; and
- The Portfolio shall be audited annually by an independent, third party.
As discussed in detail above, StepStone will use a combination of its investment strategy, proprietary portfolio pacing and risk management tools to continue to develop a private equity portfolio for SDCERS that has attractive risk-adjusted returns characteristics.