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New Mexico PERA CIO Expanding Alpha, Beta Strategies at Plan Level

Porting his Wisconsin experience, CIO Garcia plans to expand portable alpha portfolio with hedge funds.

New Mexico PERA's Dominic Garcia

Reorganizing a pension fund is no small feat. Fortunately for Dominic Garcia, CIO at Public Employees Retirement Association (PERA) of New Mexico since August 2017, he's been through this before. Prior to returning to his native New Mexico, Garcia was a senior funds alpha manager at the State of Wisconsin Investment Board (SWIB), where he successfully oversaw its $5 billion hedge fund program.

During his nine-year tenure in the investment committee at Wisconsin, Garcia's role was to manage all public market external managers. As a senior funds alpha manager, he worked with long-only managers as well as with alpha-overlay hedge funds.

So now that he's at the helm of a $16 billion pension system, Garcia has set in motion a process that he hopes will learn from Wisconsin's success, but will make its own mark.

"Now, coming to New Mexico, the big thing that we're trying to do is take that ethos of separating alpha and beta at the total plan level," said Garcia. "That ethos leads us to two things: on the beta portfolio we're looking to be more risk balanced across different economic regimes; and on the alpha portfolio we're looking for active management to produce an extra 1%, uncorrelated return at the total plan level." The latter would be

split across private illiquid as well as liquid assets.

Currently, the hedge fund allocation is small at PERA. Over time, Garcia plans to extend the alpha overlay from around $500 million currently to include a more diversified mix of hedge fund managers, similar to the strategy he undertook in Wisconsin.

On a practical level, in the time Garcia has been at PERA, he's successfully embedded the philosophy or ethos of separating alpha and beta. In addition, PERA has enhanced its governance, resulting in more clearly defined roles and responsibilities amongst board and staff.

"Staff now has delegated focus for manager selection and implementation–that's been a big deal," he said. "Two, we've implemented a risk budget that separates out returns and risk coming from passive beta and returns coming from our active management."

The team has built out exactly what the active management plan needs to be. "The risk budget was a huge thing and the team did a wonderful job. It really sets up a plan and a goal in a forward framework of how we're going to manage the portfolio."

Next, the New Mexico team is starting an education and implementation program for risk balancing in the passive beta

portfolio. The team's first goal is to streamline the beta portion of the fund in 2018. In 2019, the team will tackle in more detail the portable alpha side.

From his past experience in Wisconsin, Garcia says he's learned a few things regarding implementing portable alpha strategies. One: "I think hedge funds are probably the most efficient active managers–period. But I think what's important for investors is that you have to treat them as alpha, you have to port them, you can't put them into your policy portfolio. They're not a total return strategy."

He emphasizes that investors first need to build the total return portion of the portfolio before adding the portable alpha element to it. "I think a lot of investors probably miss the role of hedge funds in their portfolio or they're misaligned with objectives." He stresses that it's paramount that hedge funds are playing the right role in the portfolio, and "that to me is pure alpha."

A second thing he learned is to have a very diversified synthetic beta program in place. "I think a lot of folks focus on just porting [derivatives] over equities. Equities are volatile, so I think you want to port it over your total plan, not just equities, in a synthetic way [using derivatives and futures]," he explained.

Third, it's important to get exposure to "pretty much all

strategies of hedge funds. You want to build a collection of that in a market-neutral fashion."

Fourth, Garcia says to ensure fees are aligned, meaning that 60% to 70% of the gross is kept in alpha. Lowering management fees in favor of performance comes into play in that context.

And finally, he says that it's important to have conviction in your managers. "It's important to not have 50 [managers], but rather a collection that you can have conviction in, so that you minimize the netting risk of the portfolio, meaning that you want to make sure your managers aren't canceling each other out in alpha space."

By Marie Beerens