How PERA uses PME analysis in TopQ+ to align interests with fund managers

CASE STUDY

Public Employees Retirement Association of New Mexico ("PERA") is the $15 billion organization that manages the retirement plans for the state, municipal, and county employees of New Mexico. Like many public pension plans, PERA's portfolio is diversified across the public and private markets with target allocations set for the various asset classes within those markets. However, what makes PERA unique when compared to their peers is their approach to risk. eVestment Private Markets spoke with Isaac Beckel, CFA, CAIA, an Investment Associate at PERA to learn more about this approach and how it is supported by TopQ+.

An innovative approach to portfolio construction

When PERA thinks about portfolio construction, they do so in terms of risk budgeting and alpha & beta generation regardless of asset class. Central to this process is understanding how much of a fund's return stream is truly idiosyncratic (alpha), versus beta or alternative risk premia. PERA's view is that beta exposure can be gained easily and efficiently via liquid markets. Conversely, strategies that are meant to generate active return or alpha are more costly to access. What PERA seeks to avoid is paying active return type fees for beta exposure while gaining that alpha.

> *In the private space, we don't want to be paying for embedded beta within these managers. A fund manager may claim to have a proprietary or idiosyncratic strategy, but the reality is that to some extent, it could be they are just giving you levered beta, or exposures to some other common risk factor that can be more efficiently accessed elsewhere.*

To that end, a central component of their private markets fund due diligence process is assessing the extent to which managers are producing alpha and understanding how they are creating value in their portfolio companies.

Finding alpha in a sea of beta

To understand a manager's ability to generate alpha, PERA analyzes their track record with Public Market Equivalent ("PME") analysis. By comparing the performance again public benchmarks, they can determine if the returns are creating alpha or more generally "excess value". Before adopting TopQ+, constructing a PME analysis across several managers was an onerous process for PERA that lacked uniformity and depth.

> *There was no one-stop place where we could go and look to compare managers or evaluate the actual deals within each portfolio. We had no way of doing that prior to TopQ+.*

PERA
Public Employees Retirement Association of New Mexico

Client:
Public Employees Retirement Association of New Mexico

Locations:
Santa Fe & Albuquerque, New Mexico

Description:
$15 billion Pension Plan

Isaac Beckel, CFA, CAIA
Investment Associate

EVESTMENT Private Markets

CASE STUDY

How PERA enhances analysis and aligns interests with the help of TopQ+

Moving to TopQ+ gave PERA a centralized and consistent tool in their search for alpha. The platform is allowing their team to more efficiently conduct PME analysis across a range of managers and added the ability to dive into individual deals to better understand value creation.

> *We're a small team, so operational efficiencies go a long way. If we can just pull up TopQ+ and with a few clicks have this data in front of us, that's key.*

Identifying alpha to assess fees and align interests

As previously mentioned, PERA is keenly focused on not overpaying for beta exposure. This means that being able to identify the level of alpha generated by a fund manager is crucial to their assessment of whether a fund's fee structure is justified. TopQ+'s PME functionality is again a central to this analysis and enables PERA to easily compare a manager's track record to relevant public indices.

> *When we are evaluating a manager, one of our first questions is, "How are they doing relative to our benchmark or beta?" If they are not adding value over and above that beta, it leads to questions that help us better understand the manager. After further questions, maybe you identify a more realistic beta, or maybe you determine that the strategy is simply not that attractive within our portfolio. Either way, this analysis leads to good conversations.*

For PERA, discussing fees in terms of alpha creation helps align LP and GP interests. Rather than pay standard fee structures like a 2% management fee and 20% carried interest, PERA might suggest a structure that offers the fund manager more favorable fee terms that are based purely on alpha creation. Generating alpha is not easy, and as such PERA would offer more favorable terms to managers who are willing to stake their compensation on their investing acumen. How managers react to these discussions also offers insight according to Beckel.

> *Most managers will tell you that they generate alpha. This may be true, but when presented with the option of collecting a share of the alpha that would (in strong alpha or excess value terms) generate higher fees for the GP compared to the traditional carry model – If they balk at that option, that can be very telling. Either we did a poor job of explaining our proposal, or they actually lack confidence in their ability to produce alpha consistently. Once again, either way it leads to good conversations with the manager.*

A central hub to empower a data-driven team

In the institutional investing community, PERA and their unique approach to portfolio construction are at the forefront of the broader industry push for a more quantitative approach to fund manager due diligence. TopQ+'s centralized and intuitive platform empowers PERA's team with access to valuable data and analysis they need to make better decisions for their portfolio.

> *TopQ+ is a great tool to help break down the manager's return stream into actionable items. It allows us to see the drivers of return for portfolio companies, see the geographic, sector exposure, comparing data across funds, etc. It's all very intuitive for the user which is really important in a tool like this.*

Learn more about TopQ+