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Pension Funds

LACERA CIO's methodical approach pays off

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Jonathan Grabel, CIO of the $77 billion Los Angeles County Employees Retirement Association, which just adopted a new asset allocation reflecting the higher interest rate environment, said pension fund officials there take a methodical approach, adjusting its targets rather than making sweeping changes.

But that doesn't mean that the Pasadena, Calif.-based pension fund is opposed to change.

In the seven years since Grabel joined LACERA from the $16.3 billion New Mexico Public Employees Retirement Association, Santa Fe, where he was CIO, the pension fund has ditched asset class buckets for a total fund approach, brought private equity co-investments in-house and launched a cash overlay program that has produced a total of about $500 million in gains so far.

In the pension fund's most recent performance report, it beat its benchmarks in the one-, three-, five- and 10-year time periods ended Feb. 29. LACERA earned 10% for the year (9.9% benchmark), 7% for the three years (4.1%), 8.4% for the five-year period (7%) and 7.5% for the 10 years (6.8%).

Grabel managed LACERA through changes while carefully nurturing its culture.

"The best aspect of LACERA is the team," Grabel said. "We constantly try to improve our culture."

"At LACERA, we want to create a learning environment where there is a focus on attracting, motivating and retaining people," he said. LACERA officials spent a lot of time identifying best practices for the investment office's internal committees. He said that part of attracting, motivating and retaining people is the intellectual stimulation.

Total fund approach

Having a cohesive team alongside him helped guide the board toward moving to the total fund approach six years ago.

The total fund approach is "why we moved to a function framework and why we focus on total fund diversification," Grabel said.

The functional framework, which LACERA implemented in 2018, is an asset allocation approach where LACERA officials group like strategies together, he said. The pension fund's largest asset category, for instance, is growth, which includes global equity, private equity and noncore real estate.

FLEXIBILITY: Jonathan Grabel's approach has LACERA beating benchmarks.

"We build diversification across the total fund rather than overly diversify each asset class," Grabel said. "For example, we do not need fixed income to be equity-like because we have a discrete allocation to equities."

At its April 10 meeting, the board made several changes to its target asset allocation, which Grabel said were "adjustments, not major changes."

The largest decrease was to the growth category, which the board lowered by 5 percentage points to a 48% target allocation. Most of the reduction was taken from global equity, which is now 29% from 32%. Noncore real estate dipped by 2 percentage points to a 2% target allocation and private equity stayed at 17%.

LACERA also cut by 2 percentage points its real assets and inflation hedges to 15%. That category groups together core real estate, natural resources and infrastructure. Core real estate and infrastructure were trimmed by 1 percentage point each to 5% and 4%, respectively.

"Our approach to asset allocation is to be methodical," Grabel said. "We are very deliberate and look at asset allocation through a variety of lenses including where the fund currently is, its capital market assumptions and the fund's liquidity needs. LACERA conducted its most recent asset allocation study over the past nine months."

The biggest boost was to LACERA's risk reduction and mitigation functional category, made up of investment-grade bonds, long-term government bonds, hedge funds and cash equivalents. That category increased 5 percentage points to 24% by increasing investment-grade bonds to 13% from 7% and boosting hedge funds to 8% from 6%, while decreasing long-term government bonds to 2% from 5% and keeping cash equivalents at 1%.

The credit category grew by 2 percentage points to 13%.

LACERA's modeling anticipates that the new asset allocation should maintains the plan's expected return at the current policy level of 7.5%, and with lower volatility, according to a report for the board's April 10 meeting. Since the changes were considered moderate, staff said the allocation can be implemented within a reasonable time frame of 12 to 24 months, the report said. LACERA's board is expected to update its investment policy statement in June to reflect the new asset allocation and implement the allocation between July and June of 2026.

The new asset allocation targets are "based on the notion that with higher interest rates than we had three years ago we have the opportunity to enhance returns or reduce risks in the portfolio," Grabel said.

In-house co-investments

One way LACERA is enhancing returns is its private equity co-investment program, which LACERA brought in-house in 2019. Grabel has experience in private equity. Before he launched his public pension plan investment career, he had been a general partner at a private equity firm focused on growth-stage investments in technology, networking industries, and digital communications.

"Since that time (2019), it has outreturned our PE (private equity) program as a whole," Grabel said. "It has been additive to returns and additive to returns for the growthiest portion of our portfolio."

At the same time, LACERA officials have been able to build a more intentional portfolio making co-investments in private equity that has also saved the plan tens of millions of dollars in fees, he said.

Another program that enhanced returns while reducing risk is its cash overlay program, which uses cash above the pension fund's three months of benefit payments target to rebalance the portfolio. The overlay is based on LACERA's asset allocation targets, he said.

"Since we put the program in place in 2019, we have generated about $500 million in gains for the fund from a program designed to mitigate total fund risk," Grabel said. ■