Adam:	**00:01:44**	Hello, and welcome to the GestaltU Podcast. We have today with us our guests, Jason Josephiac and my co-host, Rodrigo Gordillo. And Jason is from Meketa Consulting, and we're going to talk about optimal ways to construct institutional portfolios, specifically, touching on alternatives, and what Meketa and Jason call *risk mitigation strategies*. So, yeah, I'm excited. We should, we should definitely get started. So, Jason, maybe to start us off, give us a little bit about your background and how you landed at Meketa, and then what you're doing in your current role?

Backgrounder

Jason:	**00:02:24**	Yeah. First of all, guys, thanks for having me on, really appreciate it. I mean, I'm a voracious podcast listener, so it's kind of odd to be doing one, but I look forward to it and looking forward to having fun. But yeah, so I'm at Meketa Investment Group. I joined Meketa in May of 2021. So, I've been there for a little bit over a year now. Prior to that, I was at a corporate pension plan, managing their portable alpha hedge fund allocation. And I know portable alpha has some negative connotations associated with it, so, we'll get into that later on. And then prior to that, I was at a global asset management firm that was a subsidiary of BNY Mellon. And that firm was focused mostly on long only active equities with some hedge funds. So, I've gone from being on the dark side of asset management, on more kind of sales and client service to hopping over to the other side of being an allocator for a big institutional pool of capital. And now I'm sort of toeing the line in between of helping institutional allocators build their portfolios, as well as doing a bit on the kind of consulting side, on the non-discretionary as well as discretionary. So, it's kind of the best of both worlds with allocating as well as sort of an asset management type of spin to it with the discretionary side of our business too.

Portable Alpha, Defined

Adam:	**00:03:44**	Great. Well, I think actually, a really interesting place to start is what is portable alpha and why does it have a negative connotation? I didn't realize that, so fill us in.
Jason:	**00:03:56**	Yeah. So, portable alpha, it's not what most people think it is, or at least it shouldn't be. From my understanding of portable alpha, one of the original practitioners, at least in the corporate pension space, was Warehouser, or their pension plan back in the late 70s, or early 80s or so. There's a gentleman there by the name of Robert Ferguson, actually, and he's still around. He heads up a fund to funds on the West Coast. And then his boss, I believe, was Jack Coates, who was the CIO of Warehouser at the time, and so they've really brought this notion of separating alpha and beta and hiring arbitrage, hedge fund-like

strategies, marrying that with futures across the equity space, fixed income space, whatever it might be, and getting more bang for your buck. So, instead of putting 100 bucks in a long only active strategy where you only allocate to so much active risk, get that via financial leverage, via futures, and then put the rest of that capital into hedge funds.

Then, I think over time as the hedge fund universe grew, you started to have these more long/short equity types of funds. And then you had other forms of sort of notions of alpha/beta separation that were saying, okay, well, our beta is equities. And anything outside of equities is alpha. And then so you had sort of this advent of these short duration credit strategies. And I think we all know what happened during the crisis there with, you're putting a short duration credit on top of an equity beta. And that's just beta on top of beta. And when correlations increase, you get blown out on both sides of that trade. And then you had other allocators, right, putting together a quote-unquote, hedge fund program. And anything underneath the sun, that is long/short equity, is apparently 100% alpha.

But of course, they run with pretty high net exposure. Because if you want to get paid on incentive fee, and you want to put up a decent return, then you need some embedded beta there to juice up that return to get paid on your incentive fee. So, once you had folks mish-mashing together a bunch of long-short strategies, I had embedded beta with a credit spread or equities, and you put a beta one on equities with that, then you're just levered beta. And then again, when stuff hits the fan, you get blown out on both sides of the trade. So, I mean, I'll pause there if you guys want to ask any questions.

Rodrigo: **00:06:16** Yeah. No, that makes sense to me. Certainly the alpha overlay has changed and evolved through time, and we're going to get to what our ideal alpha stacks that you can put on top of beta. But let's discuss a little bit what beta has meant to the world of institutions throughout the last 30 years, and what it is today. Like, what is an asset class? How do the institutions feel -- felt, how did they feel about it 20 years ago, and how are we thinking about it today?

Jason: **00:06:50** Yeah, I mean, from my perspective, it really hasn't changed that much over the past 20 years, except we've introduced new labels such as alternatives, and private equity and private debt, private credit. There's only a few asset classes out there. There's equities, there's credit, there's rates, there's commodities, there's FX, and maybe you could throw vol in there, although you could argue, you could implement all of those asset classes in a long vol or short vol type of manner. And then you cut those asset classes across public markets and private markets. But again, over time, things have just been sort of -- you have had more label proliferation than actually any new things to invest in.

So, investors have gone from typical kind of public equity, public debt 60/40 portfolios to private equity, private debt portfolios, where you still have some public equity and public bond allocation, but you've introduced those alternatives, right? And to me alternatives is just a really lazy way of kind of pulling the veil in front of people and making it sound like it's something that it's really not. And it gets back again, to all those kinds of basic asset classes that are there. You're just extending your duration, you're locking up capital and you could argue there's a risk premium there for illiquidity. But at the end of the day, equity is equity, credit spread is credit spread, interest rates are rates, commodities are commodities. They're just repackaged differently.

Defining "Alternatives"

Adam: **00:08:29** So, how does the typical institution define alternatives or the alternative sleeve now? I mean, I remember it used to be that alternatives encapsulated all of the things that you mentioned, right? Publicly traded real estate, commodities, gold, long-short funds, market, neutral, CTAs, etc., was kind of in alternatives. I thought that there had been at least a transition from not classifying private securities as alternatives over the -- at least the last three to five years, right. Many institutions have kind of made that shift, thankfully. So, what's the current state of affairs in terms of how institutions think about alternatives?

Jason: **00:09:13** I think it really depends on where you go and the sophistication level of the boards and the investment teams. I mean, I don't really see explicit alternative buckets out there anymore. So, people have, I think, labelled things in an appropriate manner now. However, sometimes, you will still see hedge fund allocations, right, or absolute return allocations. And then you kind of live in this no man's land of really, what is the purpose of that? And sometimes you find the purpose of that is to kind of jam things in there that don't fit nicely anywhere else, but you like it enough that you want to invest in it.

However, where that goes wrong over time is when those strategies don't keep up with beta one over the last 10 or 12 years, you're like, well, why are we invested in these higher fee types of products, where I can go and get the S&P for whatever basis point, few basis points. So, you've started to see those things go away too, because folks rather get the risk premium in equities, and then get a higher risk premium if you go into private equity, or on the other end go into private credit/private debt versus say, the Barclays Agg or investment grade bonds or high yield bonds.

Adam: **00:10:36** It's just like structure arbitrage, though, Jason. It feels like the advantage of allocating to privates has nothing to do with diversification, and everything to do with the constraints on n many institutional portfolios. Like, you can buy a private equity fund, and you get embedded leverage of whatever it is, around 60%. So, you get a little extra juice there. You also don't get daily marks, which is attractive for many institutions. They don't need to report losses to their boards when markets go down, right? But in reality, it's just cloaking right? There's nothing really novel about private securities. You're buying equities or you're buying credit. And what you're buying really is just access to leverage, because you can't directly take on leverage at the fund level and that smoothing of returns.

Jason: **00:11:28** Yeah. And I think it really depends on your perspective, it depends on where you sit, right? So, I obviously have a bias because I've spent a lot of my career in the hedge fund world. However, I think there's a role for every type of investing out there. When I say every type of investing, I'm talking about private equity, private credit. There's definitely a role there, but you still have to pick and choose your spots, just like you had to pick and choose your spots in the hedge fund world. And I even hate using the term hedge fund because it's like what is that? Saying hedge fund is like saying sports. Saying we invest in hedge funds is saying like, we invest in ETFs or we invest in mutual funds. Yeah, yeah. So, at the end of the day, it all really comes down to the strategy that you're investing in, and those people that you're investing in, because this is really a people oriented business.

And with the advent of big data and access to data and information and flow, data has been democratized. And I think investors have been too keen on using quantitative tools to optimize previous sort of historical outcomes. And of course, you want to use those tools to get an understanding of what has been possible or what has been realized in the past. But then you have to use a bit more of your imagination and more of the art and qualitative side of our brains and of the approach of investing, to assess the risks that aren't in the back tests that aren't in the historical data set, even if they might rhyme, but they could be realized in a much different type of manner.

Defining the Alternative Sleeve

Rodrigo: **00:13:07** So, when you think about these categories of -- what are we calling it then? So, we have the alternatives are no longer alternatives. So, these are now asset classes, like real estate and gold and all that are just betas. Is that what we're calling them? Okay. So, now we have X amount allowed in the alternative sleeve? Is that what we're calling it?

Jason: **00:13:28** Yeah, I mean, the way that we slice and dice the hedge fund world at Meketa, is we think about the world in terms of return seeking strategies, and risk mitigating strategies. Now return seeking is your typical directional long/short equity fund, event driven funds, directional, your directional credit funds, and then risk mitigating is more in a beta neutral world, as well as trend following as well as long volatility. And I mean, the way that we try to help our clients better understand kind of how to think about that is in this framework of RMS, *risk mitigating strategies*.

And we break it down into three components: first responders, which are your long-vol types of oriented managers. And that can, again, be sliced and diced a lot of different ways. Like, is it tail-risk hedging, where you're spending some sort of risk budget and buying deep out of the money puts on some sort of index, most likely the S&P. Or is it more of an actively oriented long vol manager that's looking at rates, credit, equities, FX, commodity, and they're just trying to source and find cheap vol across the world regardless of where it is or what asset class it might be in.

And then you can perhaps argue that strips or long duration treasuries could be in that bucket of first responders. However, rates, treasuries have a temporal negative correlation to equities. So, what has worked so well for quite some time now, that is definitely coming into question right now. And you don't even have to really -- what has happened over the past six to 12 months here, that's not the reason to really question whether rates will be a good hedge going forward. You have to look back over more than 20 years and realize, hey, over the whole course of history, rates and equities have been more positively correlated than negatively correlated, and especially when you're in a more inflationary type of environment.

Rodrigo: **00:15:34** Particularly when the problem is we haven't seen periods of high inflation, and then deflation, high inflation and deflation. We were riddled with that from 1900 to 1980. And we've been largely absent of that in the last 40 years. So, that's why it's been put in the category of non-correlated savior. But it's interesting to see how that's kind of changing. And like you said, we just have to look at the past.

Jason: **00:16:04** Exactly, exactly. So, that's first responders, long duration treasuries, long vol, tail risk hedging. Second responders are trend following. And I'll just say that broadly, because there's lots of different ways you can implement that. And then diversifiers is our third component. And that's really more beta, neutral market neutral types of hedge fund strategies. And that can cut across various different asset classes. And then we can put some things in there that might be very uncorrelated to kind of capital markets, perhaps ILS. Think about appraisal rights, think about litigation finance, those are areas you can maybe play in that aren't explicitly tied to capital markets, financial flows and whatnot.

Rodrigo: **00:16:46** So, the risk seeking one that you mentioned before, it will take beta, and what you're trying to do with this -- return seeking.

Jason: **00:16:54** Return seeking, yeah.

Rodrigo: **00:16:55** What you're trying to do with this third category within the risk mitigation strategy is just provide non-beta alpha. But I saw -- when we discussed this in the past, you have things like global macro, and long/short multi-strat. Like, those tend to have conditional correlations. It seems to me, it's not a guaranteed market neutral approach. How do you think about that?

Jason: **00:17:16** No, I mean, even market neutral is never a guaranteed market neutral approach, right? Because when you get into a delivering event, when folks take down their risk, the shorts are going to rip higher, the longs are going to rip lower, and you're going to lose a bit there. So, then you really have to pick and choose how much leverage do you want in those types of strategies? And what do you believe could be the distribution of outcomes on the left side there in an adverse event? So, we really think about that book as how much pain are we willing to tolerate for max drawdown at any one given strategy there.

And that might vary by strategy, depending on kind of what they're doing. And leverage is not created equal across all these strategies, right? If you're a fixed income relative value fund, of course, you're going to be using many more terms of leverage than a sector focused equity market mutual fund. So, the goal there is you're going to lose money in those big down events, but our goal is to lose five to 10% in that diversifiers bucket, not 15 plus. And then …

Rodrigo: **00:18:20** Right. And the flip side, is you use that third bucket to carry the first and second responders in the decade, like we've experienced the last 10 years.

Jason: **00:18:30** Exactly, exactly. And depending on what a client is looking for, they can pick and choose the mix between first responders, second responders, and diversifiers, based on their goals and objectives. I mean, when we think about it, we sort of take a naive approach, a third of a risk in diversifiers, a third in trend following, a third in, you know, long vol or treasuries. But again, I mean, it really depends on the goals of the organization, and where their gaps might be across their portfolio and what their own kind of biases might be and philosophy on investing.

Portable Alpha

Rodrigo: **00:19:04** Now, I can't imagine that is an easy strategy to stick to long-term in a roaring equity bull market. Are you tempted to provide that as a stack, like as an overlay?

Jason: **00:19:16** Yeah, so this is where not many investors do it. But the investors that tend to do the best over time, and tend to kind of be recognized in the industry are ones that are implementing this in some sort of portable alpha type of fashion. Now, typically, in portable alpha programs, I don't see too much in the long vol or trend following space. I think there's an opportunity there for investors to help dampen the downside risk of that negative skew embedded in market neutral types of strategies. So, whether the split is a third, a third, a third across first responder, second responder and diversifiers or whether it's hey, I want 60% in diversifiers, I want 20% in long vol and 20% in trend following. I think it depends, again, on their total asset allocation and what their goals are. What type of return are they trying to meet and what type of risk are they willing to take?

Adam: 00:20:10

Where do you think about allocating to long/short equity and long/short credit? Seems to me that people think about those alternatives, but they typically have sort of an average beta to the underlying of between kind of 0.6 and 0.8. So, I've always thought that long/short equity should be lumped in with equity and long/short credit should be lumped in with credit. But a lot of institutions don't do that, is my understanding. Is that right?

Jason: 00:20:35

Yeah. That's where kind of long/short equity, long-/short credit, it lives in no man's land, because investors are never happy because that doesn't keep up with beta one, right? And then, on the downside, they lose more than what they would want them to lose, because they think it's an absolute return or it's a hedge fund. Hey, you shouldn't lose money when the market goes down. And if you look at the HFRI index since its inception back in like, what Jan 90 or so, you take it through in March of 2022, the beta of that index, the S&P is about 0.35. But the downside beta, when S&P goes down, is slightly higher than 0.35, and the upside beta when the S&P is up, is slightly lower than 0.35. So, they're getting more of the downs and less of the ups there.

Adam: 00:21:20

For sure. So, that's definitely one of the challenges. But the other challenge is that the beta has increased over time, right? Because it's just been harder and harder to generate alpha. And so as you mentioned earlier, when it's harder to generate alpha, then you allow your beta to creep higher. So, you continue to print your performance fees, right. Whereas long/short equity may have been a little bit more accretive from a diversification standpoint, a decade or two ago, it now is kind of a much more of an equity proxy than an alpha proxy, at least if you look at the numbers over the last decade or so. And then credit's kind of the same. Long/short credit's a little bit of a newer asset class, right, or asset category, but has similar kind of characteristics.

Jason: 00:22:09

And I think in the long short equity side, there's certainly managers out there that can put up alpha in that space. However, we don't want our clients paying for that embedded beta. And unfortunately, the industry really hasn't come far enough yet to say, hey, to admit, hey, yes, we do have embedded beta here, versus this benchmark. And the benchmark should be representative of what they're actually, you know, the universe that they're hunting in. And then we'll pay you an incentive fee, over that benchmark, not over some sort of risk free rate, not over some sort of zero hurdle.

Rodrigo: **00:22:46** But that's such a difficult thing sometimes when -- So, there's obviously mandates that can be very specific, right, where we're going to say, listen, I'm a market neutral fund, and my goal is to provide zero beta for you. So, you just get my pure alpha from a spread perspective, right, certain longs, certain shorts, and you're done. But there's always the possible added value of those managers in the long/short space that can market time; that they will be in beta when it's appropriate to be in beta and then kind of cut those losses, start shorting some more.

How do you think about that? Because do you penalize them based on how much beta exposure they have, contemporaneously? Or do you just -- you look at their back test or their track record and say, on average you've been point three, and therefore we're not going to pay you for that? Or we don't want your … like, how do you deal with that type of manager, which I'm sure exists on the long-short side?

Jason: **00:23:39** To be quite honest, we deal with those types of managers by straying away from those types of managers. I mean, they may have embedded kind of idiosyncratic alpha, but it's just too difficult to know how much of they're swinging around their net. And if we want to have a strategy that's going to capitalize on where betas are going, we'd much rather do that in the global macro space, where that's what they live and breathe, as opposed to the long/short equity space, and they're focused on individual companies. Same thing in long-short credit side, individual bonds. So, that's why we tend to stay away from the long/short equity directional side, long/short credit directional side, and rather find macro managers that can probably do that in a better manner because that's all they do.

Adam: **00:24:33** It's just funny, because my experience, at least with advisors and smaller institutions is that long/short equity is actually by far the most preferred alt vehicle, right? And I think it's just because they're able to tell the stories. They're in an asset class that everybody feels comfortable with. But the reality is, it's the hardest way to make money. Just purely market timing a single market is actually extremely hard, right? The reason that CTA's and macro funds have a chance is because they are timing dozens of markets in a wide variety of different areas, right, in commodities and currencies and equities and rates and bonds and credit, etc., right?

And the hit rate is really small, but because you're so diversified, and you're taking bets so frequently, at least you've got a shot, right? But trying to time a single equity index based on fundamental exposures or some other, is just a really hard problem. I also think that it's not that you can't kind of disaggregate. You can quantitatively or qualitatively disaggregate market beta from stock picking ability, right? You know, you can do it using simple regressions by progressing on squared returns, and residuals, etc. There's things to do to disaggregate them. It's just that people don't do them. They're hard. What is the frequency at which you run the regressions? If they're trading daily versus rebalancing weekly or monthly or whatever idiosyncratically, it just gets complicated, right?

So, I like that you as a general rule, as a firm kind of de-emphasize the long/shorts and sort of prioritize. The market neutral at least adheres to that alpha-beta separation framework that I think we're all trying to get closer to. Right.

Jason: **00:26:21** Yeah, and even market neutral. I mean, it's tough, because if you're, like emerging markets, market neutral, right, there's some countries where you can't short, so you need to take on some sort of basis risks there on the short side. Or you may find yourself saying, hey, there's this massive valuation spread between S&P and EM. I rather just use kind of like a dirty hedge on being short S&P. And then you know, how has that worked out up until kind of this point here, and that's tough too. So, I mean, to do market neutral, really well, and to reduce that basis risk, you need to have a deep and liquid market across the long side and the short side, so you can match up all those different factor risks. Because otherwise, you're taking on basis, and sometimes it works in your favor, sometimes not. When it doesn't, investors have a tough time sticking around.

Adam: **00:27:15** You mean it's not simple and commoditize-able? Wow, that's inconvenient.

Failure or Success?

Rodrigo: **00:27:21** I mean, look at the only market neutral funds that I see actually do a decent job of being beta neutral are systematic types, beta neutral. And that, if you do it, well, you are going to be very different as we've seen over the last five years for a lot of these guys. But the vast majority of kind of fundamental based market neutral managers, when I've measured their beta, they're always running hot, right? They're always running between 0.1 to 0.3 correlation to the S&P or Canada, the S&P/TSX 60, which is problematic, right? Because again, they're getting their fee. That's what they have to do in order to survive. And when you see something, for example, like AQR doing the correct implementation that they were paid for, to have to be beta neutral and go through the drawdown that they've gone through, is that a failure or is that a success from the perspective of proper execution of a market neutral strategy, right? They certainly are non-correlated.

Jason: **00:28:19** Yeah, yeah. I mean, everyone likes to say, non-correlated, and I want a negative correlation. But you need to go through some long periods of pain, right, for it to eventually pay off. And I mean, I think if folks stuck around with Cliff in AQR, they're very happy this year. I think if folks have stuck with trend following, and even kind of beta one commodities, or long-vol in some sort of fashion, they were very happy in 2020. You know, this year, they're fairly happy as well. Not so much in the long- vol space this year, since the implied markets really haven't moved as much as you would think based on where we are today in terms of the negative prints in the market. However, you can't time this stuff and that's why you need to set your strategic allocation across those three components, first responder, second responders, diversifiers, and just rebalance as those things pay off.

Rodrigo: **00:29:16** Just slap on a 200-day moving average on that pure alpha, man. Problem solved. Right?

Adam: **00:29:23** Not advice.

Jason: **00:29:26** Well, you know, the pushback on the long-vol side is. it's negative bleed. And it's like well, yeah, if you hold it in perpetuity, it's a negative bleed, but once it pays off, if you've rebalanced it by beta one, or if you rebalance, say into trend following or diversifiers, then you're going to do you know, pretty decent there, I think.

Rodrigo: **00:29:48** The beautiful rebalancing premium that nobody talks about, right? In isolation, it's a problem but once you include it in a multi-strat, it adds tremendous value. Just last question with regards because I want to finish up on market neutral. The idea of hedge funds, alternatives, whatever you want to call them has always been -- there's another monitor here, which is the *absolute return label*, right? And so the belief here is that if you're an absolute return fund, you better be providing returns in every single year in good and bad markets. This is the Ed -- was it Ed Thorpe, that came up with the first hedge fund and that was what he was trying to do. And I believe he accomplished that for most of his career.

Now we're looking at market neutral funds like these where we do not expect a positive turn every single year. We expect it to meander and provide a positive expectancy over long periods of time, but no guarantee of positive returns in a given year. Are there absolute return managers out there that can accomplish that? Or are we now in the realm of it's just another risk factor that we're allocating to with drawdowns and bull markets?

Jason: **00:31:00** Yeah, I mean, it's strategy by strategy, and you're not going to invest in one quote-unquote absolute return manager. And again, that's not even like a term that I would use to classify within like asset allocation. You know, it's that are you -- What is your correlation profile and obviously, that can be conditional right to what the market is doing. But I mean, absolute return stand alone, it gets back to what I said before, if it doesn't keep up with beta one, over a long time bull market, and then when you do get those draw downs, if it picks up that correlation, then people are just not happy. They're not happy. And that's, if you want to be able to use the right types of hedge funds in your asset allocation, they've really -- it's tough for them to stand alone.

You need to package it up, I think, with some sort of beta, such as equities or rates, to use that as a complement to your traditional types of asset allocation buckets, such as global equities, or US equities, or your Barclays Agg, your investment grade credit book. Because again, otherwise, you go to the board every single quarter, and market's up, markets up, oh, why is this thing only up 3% annualized over the past five years. Like, well, you know, it has a beta zero, the correlation is really low. If we married it with some sort of equity futures or interest rate futures, then it would shoot the lights out relative to active long-only equities, or some sort of Barclays Agg or active long only fixed income. So, I think if you really want to have a program that's going to withstand the test of time, that's really not the only way to do it. But the path that can keep you in the game.

Adam: **00:32:55** Okay. Well, let's *blue sky* this, Jason, because we've sort of been orbiting, the more normative discussion, what are plans and funds currently doing? And I think it's fun to sort of blue sky what they could do if they decided to liberate themselves from sort of the tyranny of peer evaluations and or sort of benchmarking, and focus exclusively on trying to meet, plan or fund objectives with the lowest -- with the highest probability of success, right? So, just unburden themselves from peer comparisons, allow tracking error to whatever extent is required in order to maximize the chances of hitting fund objectives. So, if we allow ourselves to kind of blue sky, what does that look like for you, do you think in the modern, given all of the available modern options?

Jason: **00:33:55** Yeah, I mean, this industry in general, people are massively focused on benchmarks, on what others to the left and to the right are doing, as opposed to maybe sitting down and having a pure focus on your own institution, on your own beliefs, and what you believe you need to do to accomplish your goals. Instead of worrying about what your peers are doing, where you show up in the league tables, or anything along those lines. I mean, I have a bias or my philosophy on investing is it's an absolute return, absolute risk game. It's not relative return relative risk. But everyone likes to compare themselves to others. It's just kind of human nature, and am I doing better or am I doing worse and what do I need to do in order to do better. But again, better is in the context of the goals and objectives of what you need to achieve for your own idiosyncratic, specific kind of institution. It shouldn't be based on what someone else is doing.

So, I mean, I sort of saw this within the confines or in the context of corporate pensions where the thinking there is, you want to eventually get rid of this liability that you have to your pensioners. And to do that you need to get to at least 100% funded status. And then as you get closer and closer to that 100%, or go north of that, to immunize your assets against your liability, you buy the things that make up -- that are used to measure your liability. So, in the corporate pension world, those are AA investment grade corporate bonds.

However, it wasn't always that way. It wasn't until I believe, like the early 2000s, where they shifted, I believe, the discount rate and corporate pensions from using 30-year treasuries to using a corporate bond index, a corporate bond universe. And that's because the Treasury stopped issuing 30-year treasuries for, I think, it was something like four or five years that they stopped issuing those. So, then it got shifted to this corporate bond discount rate. So, now when I think about, okay, eventually, I'm just going to load my whole portfolio into investment grade corporate bonds or a mix of investment grade corporate bonds and treasuries. I just look at that simply and say, well, what's my risk of that asset portfolio now? It's like I reduced my tracking error, or volatility or funded status volatility, relative to my accounting liability. But those dollars that I owe my pensioners, those are absolute dollars. I owe them regardless of where credit spreads go and where interest rates go, it does not matter where spreads and interest rates go based on what I've already promised to Mr. and Mrs. Joe and Jane Smith pensioner from X, Y, Z Corporation.

So, you look at that portfolio, and you're taking massive credit spread risk. And what is credit spread risk, credit spread risk is … equity risk. So, you're still taking some form of equity risk, and you're concentrated on pretty much one risk, and that's credit spreads. So, then when credit spreads blow out, right, your discount rate is going to decrease. Because if you have a downgrade or a default in one of those corporate bonds, then that bond gets kicked out of your universe for the way that your liability is measured. And then your discount rate goes down, and your liability goes up. Meanwhile, you hold this bond in your asset portfolio that you're taking a hit on whether a mark to market hit, which I think a lot of folks would argue well, these things have a mark to market hit, but they never go to zero. Just like oh, that's been true for, you know, since the GFC.

Now, however, these companies do go to zero. And it only really probably takes one of those companies to go to zero or have a low recovery value for those portfolios to take a huge, massive hit. And then so on the financial statements, it looks like your hedged relative to your accounting liability, but then on the economic liability, you're taking the pain in those bonds. And then before you know it, you don't have the dollars that you thought you had to send out the door to your pensioners.

Adam: **00:38:21** Well, yeah, I mean, all of the legislation that's come down the pipe in the last two decades has been oriented to benefiting the planned sponsor, not the beneficiaries. Right? I mean, clearly, this is clearly a policy that they introduced to make the -- to lower the value of the accounting liability for the plan sponsor, but that does not in any way benefit the beneficiaries of the plan, right?

Rodrigo: **00:38:49** It meets the accounting standards, but does not meet the ultimate goal of what this whole process has been created for. Right? This is the problem.

Jason: **00:38:59** And we're also fiduciaries, right? We're supposed to be fiduciaries. And when I think about being a fiduciary, I think about absolute risk. What is my -- how am I going to lose absolute dollars, not relative dollars? Because like they say, you can't eat Sharpe ratio. You can't eat … to satisfy volatility either. Right? And ultimately, you want to be able to make sure you have those dollars to send to your pensioners, because these are the families, right? The families that we're serving.

Up the Complexity Scale

Rodrigo: **00:39:25** How could this happen? Well, look at my statements. They're pristine. Yeah, but I'm not getting my money. Like, what's going on here? Like, this is what they can hide behind, right? So, I guess the question is, that used to be very easy when you were doing it with treasuries now, you're doing it with corporate bonds. We're going -- we're having to go up the complexity scale, right? And so how are you -- I imagine what you were getting to is like, there's a better way, right? And the better way is a lot of the stuff that we've been talking about. How has that been going?

Jason: **00:40:02** It's tough because, you know, inertia, pure risk, career risk is obviously a real thing. And you rather do a little bit better than your peers on the downside than do much better kind of over a longer period of time. I guess you never get fired for doing a conventional thing, right? It's the bane of my existence in this industry, because there's just so much groupthink and so much herding mentality, it's really tough to, again, it's not fighting against that, but you need to use education, right, to help folks think about it from a different perspective.

However, most of the industry is centered around benchmarks and tracking error and pure risk and career risk, as opposed to absolute risk, and really having that true fiduciary mindset. And a lot of firms will slice and dice the world up into, like, our public pension practice, our endowment foundation practice, our corporate pension practice, but everyone at the end of the day is trying to do the same thing. Everyone's like, pretty much trying to put up a 6 to 8% return with as little risk as possible.

Now again, that comes down to labels and then throwing out these more optics types of things like … volatility, like, and I'm not sure exactly what it'd be in the EMF space. But I guess if I break down the different areas of institutional investors, public plans, politics are involved a lot there. Corporate plans, financial statements are involved a lot. High net worth kind of individual, individual investors, behavioral biases, and psychological biases. And then on the EMF side, I think social issues and things of that nature are big kind of hurdles.

So, I think every institution caters to sort of their own constituent base, and what drives their incentives. And then if we were to kind of strip away all of that and look to the true end investor, the true beneficiary, I think we naturally kind of come to this spot of, hey, how do I just do this in the best absolute return absolute risk type of manner? And strip away all these other kinds of biases and these external types of factors.

Adam: **00:42:27** I think we've got to let many of the largest institutions off the hook a little bit too, because I mean, the fact is, once you get up into the multi-10s of billions, or multi-hundreds of billions of dollars, then you just don't have -- you've got too much capital to be able to deploy to the vast majority of diversifiers. You're kind of stuck with betas, to equities and duration and their derivatives, right? Like, credit, for example. So, what's always confused me, though, is how the small plans and the small institutions who actually have the flexibility to pursue more of an absolute return policy, and are not so large that they'll consume all of the available bandwidth than some of these true diversifiers, still failed to take advantage of this type of mandate flexibility, right? Why do you think that is? Do you think they're sort of sucked into the gravity of trying to emulate their larger peers?

Jason: **00:43:37** Well, I wouldn't say it's -- on the larger side, you have these staffs that are very sophisticated, right? So, they can go into these most sophisticated types of strategies and eat up all the capacity. And at the same time, they command kind of better terms and fees. When you're the small fish in the pond, and you're going in there, and you can write an X dollar amount of check, as opposed to whatever, 10X, it's tough for you to get that kind of, I would just call a pure alpha off the bat, by having a lower fee load. So, then they're starting from a position automatically on the front end, that whatever, whatever that might be, 50 to 100 basis points. They need to make that up by finding managers that also put up good alpha, and that don't want to grow to the moon. But what happens, the good managers, they see capital, capital comes in, and then larger checks come in, larger checks come in, and the fees go down. And the only way for those investors to get lower fees is to write those bigger checks. And so the smaller the smaller investors can't necessarily do that, at least on the front end.

Now, are there opportunities that are out there, arbitrage opportunities and different strategies where it's worth the higher fees, I think so. At the same time, when you're dealing with small managers that have limited capacity, you need to find lots of those small managers that have limited capacity. And if you're managing some sort of larger pool of institutional capital, then pretty soon you have a lot of capital that needs to be put to work again, right? So, you kind of back -- your back into -- you can consolidate a bunch of smaller plans, but then it becomes a larger pool of capital. And then before you know it, you can't capitalize on those smaller types of niche opportunities. However, you can still now drive down fees for funds that started off with great alpha opportunities. And over time, as they grow, that alpha tends to get degraded, and then you kind of need to move on to the next thing or further diversify. But how much can you diversify until you just end up looking like the index, or you really don't really have enough active risk?

Rodrigo: 00:46:02 Well, that's it. I mean, that's the issue with these very large pension funds. You just described the evolution of what ends up happening as billions and billions of dollars and money that needs to get deployed ends up having very little alpha or very little of that absolute bucket. And they have to just go to plain betas, right? Private credit, private equity, even on the idea of risk parity, right, that you have some equities, you have some fixed income and you have some inflation assets. Those inflation assets become much more complicated to use commodities because of the CFTC limits that you have on assets. So, you end up tilting towards TIPS, which is a way of protecting against a type of inflation, but not all types of inflation, right?

So, as you get bigger, you're just limited to betas, and you're even limited to being able to implement a robust risk parity portfolio, that'll get you there. But I mean, that's closer, right? And so it doesn't matter that you have purchasing power, it doesn't matter that you can get lower fees, you're just not going to get that big slice of 33% risk mitigation strategies. There is a sweet spot there, of managers that have enough purchasing power, they can negotiate fees, and have those big slices of alternative sleeves of the RMI, and so on. And yet we're not seeing that sweet spot in AUM take advantage of those sleeves. Right? So, I mean, this is I guess, as you consult with people, you're trying to push this agenda, I imagine, trying to get them to open their eyes to this, right?

Jason: 00:47:37 Well, yeah, and also think about the smaller institutions, right. The alpha opportunities might be more abundant for them, but they're smaller, and they don't have large staffs that can really uncover all these opportunities.

Adam: 00:47:48 It's a search problem for them.

Jason: 00:47:49 Yeah, yeah. So, hence, they might hire an OCIO, or some sort of consultant to do that. But then that also depends on how big that consultant ends up getting. And then what the uptake is, of all those underlying strategies that consultant or OCIO, might cover. Where, if you're operating in a discretionary manner, you can act on these things relatively quickly. But if you're acting on a non-discretionary manner, it takes a bit longer to kind of implement a whole total portfolio strategy. Because some of these institutions are set up where they meet quarterly, and they need to approve every single investment that goes into the book, right? And it's very tough to get 10 line items all approved at once. That would probably take for some, for some setups a year or more than a year.

Whereas if that was shifted more to a discretionary type of implementation, that could maybe be implemented right away. But then again, you're paying higher fees for that type of implementation. So, the end investor needs to weigh, hey, am I getting the execution and a portfolio that's up and running much quicker, that's going to put me in a better position where I can outsource that decision making process and all like the legal process, the operations, the investment due diligence, and I get good bang for my buck? Or am I better off sort of maintaining this strategic asset allocation and moving things on the fringe every now and then, hiring this manager or hiring that manager? I mean, only those institutions can decide. Of course, we would have our own biases, because this is what we do.

And there's some areas where that might be more appropriate than others, maybe on long-only equities, long- only fixed income, it doesn't really make sense to outsource that to some sort of discretionary manager, but perhaps on the hedge fund side, risk mitigating strategies, private investments, perhaps that makes more sense because the complexity there is so much higher, all the operational things you need to do there, all the legal things you need to do there, perhaps that's worth it. And then some people might think none of it is worth it. Others might think everything is worth it.

Adam: **00:50:05** It's a real catch 22. I hear what you're saying totally, right. You've got a small institution that has the mandate flexibility and portfolio agility to be able to pursue a wide variety of different options, but they don't have the same level of resources or in-house technical expertise, to be able to vet all of the different opportunity set, right. So, then what do you do? Well, you pursue economies of scale, and you consolidate up to an OCIO, or consultant. But then now you're choosing from a limited list of funds that have been already vetted by the consultant and are also getting allocations from all of the other different clients that have similar objectives and are pursuing similar types of strategies.

And so you quickly run up against the capacity constraints, right? And you've got these ultra large institutions, which it seems like, it's just absurd, if you've got 50, 60 or $100 billion for you to allocate a couple billion dollars to diversifiers. These are like almost glamor allocations, right? You're sort of justifying, an alts team without actually having and making any difference to the risk budget or risk profile of the overall plan or institution. So, it's a real quagmire, I absolutely see the problem. It does seem like there's an opportunity in the small to medium size plan space to pursue very different objectives in sort of a non-scaled OCIO context that allows them to pursue these types of opportunities without consuming all the bandwidth and sort of pricing themselves out of the market that they're going to -- that's going to be most acretive. So, that's very interesting.

Jason: **00:51:45** Yeah, definitely. And we pride ourselves on, we don't run sort of any products here, right? Every single client that we have on the OCIO side is 100% bespoke. At the same time, and I always go back to what Tony Deaton said on Grant William's podcast, because it was just so brilliant, so simple, but so eloquent and brilliant. Do you want to be an investment practice? Or do you want to be an investment business? Now one isn't necessarily better than the other. But in the investment business, you give the clients what they want. In the investment practice, you give the clients what they need. And I always think in my head, if I were a client, and I'm hiring someone, OCIO, consultant, whatever it might be, I'm hiring them because I need their help. I need their advice, I need their guidance. I can't do this all on my own. I might have my own biases, my own thoughts and opinions.

Now, however, if I really could do it on my own, then I would do it on my own. So, then when you go somewhere being an OCIO or a consultant, do you only want to implement what your client says they want? And then if you're doing that, then why are they even coming to you for advice if you're not going to give them your kind of true, unvarnished opinion, or you give them what they need, because you believe that's in their best interest to meet their goals and objectives. And again, one versus the other isn't necessarily better than the other, you just need to decide who you are. And an investment business, to me, is more of a scale game, right, and quantity. An investment practice, to me, is more of a quality type of setup.

Adam: **00:53:37** But you know, you're just moving the same challenges upstream one, one notch or one level, right? So, if you're a manager of a small to medium sized plan, then or institution, endowment foundation, etc. Well, you've either got some experience in the business, which means that you bring your own biases to the table. And so you're going to go out and choose; the criteria that you're going to use to choose an OCIO is going to be aligned with your own basic set of beliefs and biases. In which case, you're just going to hire an OCIO that is going to express your own internal views anyway, right?

And if you don't have any expertise or experience in the business, what criteria or qualifications do you have in order to choose an effective OCIO in the first place, right? So, it doesn't solve the problem, right? The problem is agency effects and lack of criteria to be able to make good choices all the way along. It's kind of turtles all the way through, right, and doesn't. So, we've sort of -- let's put a pin in that as kind of a very hard problem that's kind of unsolved, maybe move back a little bit more into the practical side.

Risk Parity and the Alts Bucket?

One thing that I always am curious about, and I've talked about this question with other people in similar roles to yourself, who advise on institutional plans is, but who you also understand the idea of diversification the way that we all espouse it, they all hold -- they have risk parity, global risk parity mandates, somehow in the alts bucket. And yet, to me, that is kind of the foundational core to any portfolio. Like if you espouse the idea of diversification as pursuing diversity and pursuing balance, that's kind of where you start, right?

And then as you add elements to the portfolio, you're continuing to just add new diversifiers and continue to add them in a way that preserves maximum portfolio balance. Right? So, walk me through why many consulting arms and many institutions think about risk parity as an alt, and then how we can begin to change people's minds and bring them more on track?

Jason: **00:56:01** Yeah. I mean, at least within our group, at Meketa, we don't think of risk parity as a line item, right? It is a strategic asset allocation, it's a framework to invest your strategic asset allocation. Now, I've definitely seen risk parity strategies as sort of line items broken out separately across asset allocations. Now, I mean, I think that just comes down to -- it's just so different than the conventional way of thinking about how to do your strategic asset allocation. And it gets back to like, what is the risk neutral position of where you sit, at least from an optics standpoint. Again, I go back to the kind of corporate pension plan example. Your risk neutral position is to be 100% investment grade corporate bonds, so you can minimize that … as volatility and lower that tracking error.

Adam: **00:56:53** Yeah. No, you're right. And we've got to sort of separate that out. Because of course, you're going to have people that view the liability in a very different way. Right. So, from an actuarial standpoint, I totally get that. But if you're thinking about kind of a foundation, or an endowment, or maybe even a public plan, where you're not really held to liabilities, but rather, you're held to a kind of an expected target return, how did these guys think about it? And why haven't they been able to kind of get closer to risk parity as the core?

Jason: **00:57:23** Yeah, I think within E and F, their risk neutral position, right, is their spending plus inflation. So, there, you probably have more latitude to be a bit more intellectually curious about your strategic asset allocation. On the public plan side, their discount rate is pretty much using whatever their asset allocation is. Right? So. I mean …

Adam:	**00:57:45**	Yeah, but I mean, you can meet a target discount rate with a risk parity portfolio too, with an appropriate level of leverage. So, I don't think that's …
Jason:	**00:57:53**	It's leverage, right? You just said it, it's leverage, right? People are adverse to the type of leverage that is used in risk parity, even though they're exposed to similar types of leverage …
Rodrigo:	**00:58:07**	Levered bonds, you're buying levered bonds. Why would we lever into bonds right now, right? That idea is what's really got, I think, it's the ultimate -- Yeah.
Jason:	**00:58:15**	Well, risk parity is just equities combined with levered bonds, right?
Rodrigo:	**00:58:18**	That's right.
Adam:	**00:58:10**	Yeah, you just got Rodrigo triggered.
Rodrigo:	**00:58:23**	I can't even…
Jason:	**00:58:25**	I don't even know where that came from. Because ever since I learned about risk parity, I always thought about it in terms of rates, credit, equity, commodities …
Rodrigo:	**00:58:35**	You know where I think it came from, I was thinking about this, okay. Remember that paper that Cliff out of all people wrote, or maybe it wasn't Cliff, but it was AQR that talked about 60/40 portfolio or equities, and they levered the 60/40 in order to match the volatility of equities and showed how it performed. It outperformed equities with lower drawdowns, right. And that one was a simple enough paper that I think went viral. And then he also had his risk parity funds. And I just, I think it just got conflated. I think it was just -- …
Adam:	**00:59:06**	I think most people articulate risk parity, they sort of go from a 60/40 portfolio, if you use risk goggles as 95% equity risk and 5% rates risk or duration risk, right. And so that's -- you communicate it this way, right, because it's a really simple way to articulate the concept. And then I think people just don't move on to the fact that besides the fact that you want to hold everything in proper balance, so that their unique personalities can show through, you also want to hold diverse investments. And that includes commodities and break-evens. And it's factor exposures, etc. Right? So, they just kind of stopped too early in the presentation or in the talk or in the paper.
Rodrigo:	**00:59:52**	And we're all guilty of that, by the way, right? It's this problem. I mean, like, how do we keep it as simple as possible, right? Well, you get these two asset classes or you have -- what was the example I used to use, a scale, right? You have two fit spheres that you put on a scale and you think they're going to weigh the same thing, but because they look the same, but in reality, ones made out of metal ones made out of wood, right? That's equities. This is bonds. You can't do a scale

analogy with a third scale. That becomes that -- now you break minds. So, maybe, yeah. I mean, it's a combination of all those things, right.

Jason: 01:00:24 And it could be too, commodities are maybe a bit tougher for investors to grasp since it's in the, you know, not in the kind of physical -- it's in the futures market, right? And people get scared when you start talking about futures.

Rodrigo: 01:00:39 And they, I think, commodities rightfully so when they look at any single commodity, it doesn't seem to have a positive risk premia, right? So, there's this, okay, you're getting paid on bonds, you're getting paid dividends on equities, right? What are you getting in commodities? And this is, again, where we -- I think we talked a lot about our paper, the optimal commodities paper, where Adam went through the different sectors and securities and how you weight them appropriately and then rebalance to actually manufacture a positive risk premia in the commodity space. Right? Which was -- ended up being something like 4%, Adam? I can't remember what the actual number was. But it rivaled the equity risk premium, not by any sort of carry strategy, but simply from rebalancing.

Adam: 01:01:28 It rivaled the global equity risk premium. Yeah. Not the US one, which is an outlier, but the global

Rodrigo: 01:01:32 Which is impossible to beat. So, I think that one is also a problematic thing, right? There's no value. Who would own commodities, right? So, it requires much more education, I guess, to them to not only introduce that third leg of the stool, but then explain all of these other layers as to why it's important to own them and why there's a positive risk premium long-term and so on.

Jason: 01:01:54 And it gets back to, you know, I think, the bane of our existence, right, the old tracking error benchmark risk thing, right? Because they think, well, if I'm doing risk parity, what's my benchmark?

Rodrigo: 01:02:05 Well, yeah, or like …

Adam: 01:02:06 The economic value of your liabilities, that's your benchmark, right?

Jason: 01:02:12 Yeah. I mean, that's what I argue. Like, what is the absolute return that you need to achieve in order to meet your objective? And how can you do that in the least risky fashion?

Rodrigo: 01:02:25 Well, it's so funny. There's another pension plan that we're talking to that is literally just levered equities. And they've been levered equities for a decade or more, right? And a few of them have woken up to like, whoa, this is a lot of risk. Maybe we should start thinking about this risk parity approach. And they're starting to add it as a sleeve, right, as a slice, a 5% sleeve. Their issue is we are incentivized by performance and beating our benchmark, right? You show me the incentives, and I'll show you the outcome.

Adam: **01:03:00** Well, that's a governance challenge.

Rodrigo: **01:03:01** But then what I say to them is, listen, just lever it up to -- You're obviously willing to take 25% vol. Right? Why don't you leave a risk parity 25%? Well, no, that's too risky. No, it's not. It's less risky than what you're actually taking, right? It's actually less. You seem to be comfortable with leverage. Yes, this is going to have to be more leveraged because we're more diversified. But the volatility is going to be the same by definition, due to the diversification. You're going to have less tail events, so on and so forth. They can't process that, right? It is -- you show me the outcome you want, you show me the return, the risk profile you're willing to take, you can do that here.

Jason: **01:03:40** I think you almost have to blind investors to what the actual outcomes have been. Like, I did this exercise a while back, and I created my own risk parity portfolio using the indices. And then I compared over what percentage of rolling one, three, five, seven, 10 year periods does a risk parity portfolio lever to the same vol as a global 60/40? How often does that outperform a global 60/40? And once you know, even over a one year periods or above 50%, then once you get up to three, five, seven, 10, when you get up to like 10 year periods, it's close to 100% where you're outperforming a 60/40 portfolio. However, the path is very different. Right?

So, it gets back to that herding mentality and that you're looking left, you're looking right, you're looking at the lead tables, you're looking at where you stack up against your peers. And if you're not keeping up in up the markets, then you're just like, oh, I can't withstand that. Like, how do I justify that to my boss, when my boss's boss is telling them how great their portfolio is doing, and we're and we're not keeping up? Because these big events, they happen more often than I think people give them credit for. But when these big events happen, folks tend to forget them really quickly. And that could go dovetailing a whole nother conversation in regards to kind of the macro and central banks and policy and all that stuff.

Now, is the gig up there? I don't know. Maybe, maybe not. To be quite honest, I don't really think it matters. Because even if you brought this, like a risk parity portfolio back in time, like I just said, you're still doing, you're still outperforming a plain vanilla global 60/40 portfolio.

Rodrigo: **01:05:26** Yeah. Okay, let's take it back to the -- I come -- I'm a small foundation, I only care about my absolute requirements. And so you're going to put together the ideal portfolio for me, what does that look like? Is it risk parity with alpha overlay? Like, what --

Jason: **01:05:43**

Yeah. I mean, if we strip away sort of all biases and investor or someone's coming in, or if I had a blank sheet of paper, what I think about the world in terms of beta, alpha, long-vol, and then sort of like, niche, right? So, what's your best beta, some form of risk parity? Alpha/ beta-neutral market-neutral types of managers, long-vol, components of trend following outright long-vol. And then niche is kind of like things that are just episodic, really different, it doesn't really fit into anywhere, probably illiquid. But you say what is your return objective? How much do I have to lever a risk parity portfolio to meet that return objective? And then do you want some sort of alpha on top of that? And so it's really risk parity, plus the RMS portfolio that I described before; first responders, second responders and diversifiers.

And I think you always need some sort of component of that long-vol and trend following, because it really bails you out during the Q1s of 2020, during the Q4s of 2018, during, you know, fall of 2011, the GFC. So you can't time these things. You need to set your strategic asset allocation on your beta side and some form of risk parity. And then you need to set your sort of wonky kind of alpha-oriented downside type of protection stuff with that, a third, first responders, a third second responders, a third diversifiers. And that would be my going in kind of framework. And then on the fringe, you can tweak that based on different sort of needs and circumstances.

Rodrigo: **01:07:24**

Right. So, that's certainly the way we think about it here as well, right? The risk parity and then return stack up to diversifiers. Because I think when you think about what the two major blind spots that I see from risk parity, and you see it over and over again, is it does a pretty good job during most economic regimes. But there is an illiquidity. There should be, you know how we've seen that like high inflation, low inflation axes, and then high growth, low growth axes, and you split into quadrants, I think there's a third level there, which is abundant liquidity and liquidity shocks, right? When there's abundant liquidity, it turns out that everything goes up together, right? So, you're getting this excess return than you should. It's not three pistons going in different directions, it's all of a sudden, everything's going up. Right? And the same is true in those moments, like the last week of March 2020, where, in fact, the first week of the correction, risk parity is doing really well. It was positive, markets had gone down 15%. Treasuries were up double digits, gold was up single digits, and everything else was down.

But then there was that moment of like, oh, my God, everybody prefers cash, you have that liquidity shock. So, that's where the long volatility side, those big convexity trades come in, to fill that gap. Okay. So, I see how important that is to filling the risk parity gap. The other risk that I think is kind of the unknown diversifiable risk that you get paid for, in order to get a positive return is that central policy risk, that central governor, the Fed Governor's black box in his head, that wetware, where from one day to the next they say something wrong, something stupid, or just raise rates verbally more than what people expected. And it's just, we haven't found a strong way of reliably mitigating against that risk. How have you thought about that problem?

Jason: **01:09:20** Yeah, I mean, it's -- I think that long-vol piece is kind of exactly what you said. That's where you …

Rodrigo: **01:09:29** Yeah. But the long-vol piece isn't doing liquidity events. The long-vol didn't help you in August of 2018.

Adam: **01:09:33** But we should also differentiate, right? Like, I think …

Rodrigo: **01:09:37** Didn't help you in the 94 massacre. Anyway, sorry, Adam.

Building Sleeves

Adam: **01:09:41** It's key to sort of say inflation and growth are true risks, their diversifiable risks. So, if you assemble a portfolio thoughtfully, you can mostly eliminate or dramatically reduce the amount of variance in the portfolio that is due to changes in expectations around both those axes. There's the liquidity risk premium sentiment kind of risk, right, which is non diversifiable, right, as you say, that is a risk that you're rewarded -- that's why you earn a premium on the risk parity portfolio or one of the reasons you earn a premium on the risk parity portfolio because there's no costless way to hedge that risk, okay, costless, being critical. In other words, you need to pay a little bit in theory to hedge that risk.

And then there's the Fed policy risk, which I like to frame as a shift in expectations about future cash rates, right. So, if future cash rates are shocked higher, then investors have a higher incentive to move out of risky assets into cash, all things equal, right. So, you need to lower the price of risky assets to the point where the expected premium that investors are going to earn on that is high enough to continue to entice investors out of cash, when cash investments become more attractive, because the Fed says we're going to raise rates, right? So, those latter two things are risks that cannot be diversified away.

And accepting those risks is why you earn a premium, a long-term premium on the global risk parity portfolio, right? And you can hedge those risks, but we shouldn't be able to, we shouldn't expect to be able to hedge those risks costlessly. For free, right? So, this is where I think it's really -- I'm curious to explore right? So, you've got this kind of first responder portfolio that is kind of meant to hedge against both that sentiment slash liquidity risk, right, which is kind of that basically, long-vol, strategic long-vol exposure, right? And then more of a sustained series of shocks to expected future cash rates, which is where you get these longer drawn out kind of bear market type environments like we're currently experiencing. You've got this Trend sleeve, and then you've got more of this Absolute Return sleeve, right. So, let's dig into how you think about constructing the most efficient first responder's sleeve?

Jason: **01:12:28** Yeah, I think efficiency there, again, is when you think about what you're trying to hedge, and then what type of scenario are you trying to hedge for. Like, are you trying to hedge for just downside equity risk? Or are you just trying to get long-vol exposure across the board? I think we would err more on the side of, again, depending on the client, but say someone came in and said, hey, we have no biases. We want long-vol exposure, multi-asset class, because we just don't know where the event will come from. However, normally these events have cascading effects on various asset classes. Now, we haven't really seen it in the FX markets for quite some time up until this point, right. But would you say maybe 5-10 years ago, would you want FX vol exposure? Probably not. But now, would you? Absolutely.

Would you want rate exposure in the past, like 10 years, on the long-vol side? Probably hasn't done too much for you. But this year it is especially on the trend side. So, I mean, within that long-vol, side, you can structure in a way to more hedge for that immediate, quick and deep drawdown. Or you can implement those strategies for more longer drawn out periods and buy options that are two years out as opposed to one month out or one week out. So, there's lots of different ways to implement that. Again, what is the expiration of those options? And then what markets are you playing in? And we would diversify across kind of time, as well as the velocity of that event. And I think you do something similar in the Trend following space. Are you more shorter term Trend, medium term or longer term? And then how are you expressing the different asset classes that Trend is investing in? Are you kind of equity heavy because equities tend to be the -- well, not tend to be, are the most deep and liquid markets, and they've done quite well, for quite some time.

You know, maybe you have some Trend following managers that have gravitated more toward equities and equities have been a big part of their book. But if you rolled it to this year with that type of exposure you're not doing as well as the guys that have sort of taken a more true kind of equal risk allocation across the board. So, it gets back to again, it's client dependent on what they're trying to hedge for relative to whatever else is in their plan. And then how much should they think about investing in terms of absolute return, absolute risk versus relative return, you know, relative risk. Like if …

Rodrigo: **01:15:02** Right. Because you have to hedge different risks.

Jason: **01:15:04** Exactly, yeah. I mean on the -- again, going back to the pension plan example, you could hedge against some sort of major credit event, right? But you're going to realize that event in the equity markets as well. Like, these things have cascading effects. So, why not try to eke out as much return or eke out as much diversification as you can, across all those all those different types of risks, because you just don't know where they're going to come from.

Rodrigo: **01:15:33** Yeah. Well, it's interesting because when we talk about that tail protection or that first responder's part, it's a very different amount of first responders that you need when you're dealing with the risk parity portfolio, which tends to have more of a normal distribution, much thinner left tails, people think about tail protection when they're dealing with a 60/40, 80/20. And when you're having that conversation, you're saying, yes. So, this is how big your tail protection is, you say, how much protection do you want, right? You want to mitigate against half of your 50% loss in 2008 scenario? Okay. Well, this is how big your first responder allocation needs to be. And that means that there's going to be a massive amount of drag sometimes, that requires you to truly understand and have a stick-to-it-iveness. Right. And this is, again, why I like the risk parity set because for risk parity -- for anything that's diversified and approximate a Gaussian distribution, you're going to have a much easier time allocating a small sliver to the first responder's portfolio, right?

Jason: **01:16:31** And it frees you up intellectually, where if you're going in, strategic asset allocation is a risk parity type portfolio. You're not automatically thinking about downside equity risk and first responders. You're think about multi-asset- class vol, right?

Adam: **01:16:47** Well, I was thinking about hedging against growth risk and hedging against inflation risk, right. And like major inflation shocks or major growth shocks that are mispriced by the market. And also policy risk, right? Like, maybe you're hedging in the Eurodollar market, right. So, I think growth risk, you can effectively hedge exclusively with equities. Because if you're going to have a financial crisis, that's going to dramatically hit growth, you're also going to get -- you're going to get a downward spiral in commodities, right? So, I just think that you can sort of apply the risk parity framework of growth and inflation, liquidity risk and policy risk in the same way to your first responder's basket, maybe, as a place to start.

Jason: **01:17:41** And in the case that nothing works out, right, end of days type of scenario where we're still kind of all in the metaverse here talking to one another, and the world hasn't blown up. But institutions really don't carry that much cash. I mean, Adam, that's probably the answer there is to carry enough cash to get you through whatever event that you need to get through. Now, are you going to carry more than one year's worth of cash based on your outflows that you have? Probably not. But what is that cash number? Is it three months' worth of your liability? Is it six months'? Is it one year? Does it change based on where you think we might be in some sort of cycle?

Rodrigo:	**01:18:29**	Market evaluation.
Jason:	**01:18:30**	Yeah, yeah. I don't know. But I think the answer is it's not zero, or it's not like 50 basis points. Perhaps cash allocations. If you're gaining so much efficiency from risk parity, and from thinking about the alpha component, or maybe what you guys would call the stacking component of RMS and first responders, second responders, diversifiers. If you're getting that much more bang for your buck, than why not carry a little bit more cash on your balance sheet for that scenario, where nothing's working.
Adam:	**01:19:02**	I'm not averse to that. I mean, again, just all of these, in theory, these all have costs, right? There's a cost to carrying more cash, right? It's an opportunity cost. There's a cost in theory to being long-vol, right? Like, in the end, if you hedge out all the risks, you effectively should be earning the risk free rate, right? So, it's a bit of a tricky kind of situation. I actually would be curious how you sort of think about this. But the more I've thought about kind of standard trend following, just moving into trend following for a minute. The shorter the trends that you're looking to capture, the more the strategy should resemble the profile or character of a diversified long straddle portfolio, right? You're capturing almost none of the drift of the underlying assets. And you're effectively just buying long straddles and hoping that those long straddles are mispriced, because there's more outliers in the distribution than are priced by the straddles, is kind of what you're buying when you buy sort of more shorter term Trend strategies, right? And when you're buying longer term Trend strategies, you're buying, maybe more strangles and you're also benefiting to some extent from the drift in markets that have a long-term drift, right. So, if you look at kind of the long-term beta of a long-term Trend strategy, typically, it'll have kind of a 0.2 to 0.3 beta to equities to 0.3 to 0.4 equity to beta duration. Because you're on average, because these markets do have drift, they're going to be in an upward trend more often than they're in a downward trend. And you're going to get that sort of long-term average.
Rodrigo:	**01:21:05**	It has a high correlation to risk parity.
Adam:	**01:21:07**	Yeah, the longer the trend strategy -- …
Rodrigo:	**01:21:09**	The longer the Trend the more it looks like a risk parity portfolio, yeah.
Jason:	**01:21:13**	Exactly. Exactly. Yeah. I mean, and in that Trend following, we tend to like, once we blend together, the strategies that we have, we end up being a medium, call it like six month type of look back there. Because within first responders, we have those -- And we're diversified there again, across time, right? But those are more meant to kick in during the Q1s of 2020s, during those short, steep draw

		downs. Or the gap risk, that's an easier way to say it, during the gap risk. And then the Trend is meant for, hey, it's just going to persist?
Rodrigo:	**01:21:53**	You know, what was interesting -- I was just the next sleeve is that -- what's your third sleeve again, your diversifiers. You know, we run a systematic global macro strategy that is multi-faceted, right. And I wanted to take a look at this concept of how trend is the savior, it's the one that's going to be there. And I was looking at the Carry sleeve, for example, that counter intuitively, did significantly better than trend in March 2020. Right? And it often does it. It has done a pretty good job this year as well. So I wonder how much of that third sleeve ends up becoming the second responder as well. Right? Kind of focusing on the systematic global macro and the like. Like, I kind of almost feel like trend and systematic global macro are in the same realm there and this idea that Trend is the only thing that is …
Jason:	**01:22:54**	That's the way we think about it. Like macro, especially systematic global macro, it kind of like hugs the line between second responders and diversifiers. That's definitely the way that we think about it.
Adam:	**01:23:05**	That's a good point actually. I'm so glad I want to hug you, Rodrigo, for bringing up Carry. Because I feel like this is the redheaded stepchild of alts, right, where it gets no love, it gets no play, everybody continues to think about Carry strategies as being like a Currency Carry, which is …
Rodrigo:	**01:23:22**	That's right. Everybody sees it as currency.
Adam:	**01:23:25**	It's procyclical and just sort of dovetailing off Koijen's seminal paper on *global carry*, I mean, it is remarkable. Just looking at his analysis, clearly, even time series carry does not have that procyclical component that has historically been attributed to carry as a sort of global quality. And we obviously have -- we've done a huge amount of work in Carry, we just don't see that procyclicality that everybody is so concerned about. And in fact, it seems to me like global Carry is the ultimate kind of diversified global risk premium strategy. And it has the long-term kind of Sharpe ratio to prove it. Like it really is a remarkably under loved and attractive potential for …
Rodrigo:	**01:24:15**	And it should be. It should be loved because Trend is actually more complicated than just yield, which is all Carry is, right? People love yield. Maybe we're calling it the wrong thing. This is our fault. How about that yield strategy? Diversified Futures Yield Strategy -- … of distribution. We're off to the races. Just created the next ReSolve product, Adam.
Adam:	**01:24:40**	I hear you, buddy. I hear you.

Jason:	**01:24:42**	I would ask you to throw a few examples of how you're thinking about you know, Carry.
Adam:	**01:24:46**	Yeah. So, for example, Carry being in bonds, is the yield curve upward sloping at the duration of the bond that you're looking at, right? If it's upward sloping, you should be long. If it's downward sloping it means you're getting paid more to be short the bond, right? You're actually having -- you're earning a negative return relative to cash. If equities are earning -- if equity sort of, dividends are less than the cash rate, should you be long or short equities, right. And in commodities, obviously, well, if markets are in contango, you should be short, because the further the deferred futures contract is going to, all things equal be drawn towards the gravity of spot which is lower than the contract. If it's in backwardation, it's going to have the gravity of rising too, right. So Global Carry is a diversified global long-short strategy that basically says, you should be long assets that have a yield, either roll yield, or dividend yield or coupon that is higher than the cash rate. And short markets that where, if you're short it, you're earning a premium that is higher than the cash rate, right. And if you do that, then over the very long-term, and net of all fees and costs, it just has a remarkably stable long-term profile.
Rodrigo:	**01:26:08**	And the misconception comes again, from mislabeling what Carry is, which is what -- when you say Carry, people think I'm going to buy Mexican pesos. I'm going to grab my US dollars, I'm going to convert them to Mexican pesos, I'm going to get the spread between that Mexican peso yield and US dollar, assuming that the, the FX rate doesn't change for a year. And yeah, that'll blow up on you. That is counter cyclical, right? That's not -- so procyclical. It's not going to be great. And that's the only thing people know. Risk Parity is just a levered 60/40 portfolio. Again, naming conventions, and maybe it's again, doing a better job of communicating the value of different approaches and that we shouldn't be naming it Carry at all.

Geopolitical Risk

Jason:	**01:26:49**	Now, I'd be curious, your thoughts on, obviously, the markets have been driven so much by flows, and macro policy for so long versus fundamentals. Everyone talks about this, right? But now, do fundamentals matter more? I don't know, like, whatever. But how are you thinking about geopolitical risk? Because in this age of globalization, that has mattered less up until whatever, 2020. You know, how being a quant investors, systematic investors? How do you incorporate the scenarios that have not yet come to fruition? Even though there might be an analog to some sort of historical type of event?
Adam:	**01:27:45**	Well, there's two types of geopolitical events. One is the kind of geopolitical event that happens slowly and then all at once, but that the market participants

and agents are observing. And there's information diffusion, and there's all the normal market based dynamics at play, that allow normal type of systematic, consolidated information analysis to drive portfolios to migrate in different directions based on different expected risk and return characteristics, right? But then there's that unknown-unknown risk, or the even -- I don't know, I guess it's a known unknown risk, but like, the risk of nuclear war, right? Like, that's kind of like, that's event risk.

You know, I use, like, massive California earthquake. And half of California slides off into the Pacific, what happens to markets? Right? I don't know, right. And it's not the kind of risk that you can hedge because it's purely idiosyncratic. Now, I do think that there's kind of a society disintegration type of risk, which I think is sort of the global nuclear war type risk or global catastrophe type risk. That, for example, for my own family, I own catastrophe insurance, which is very far out of the money, long-term calls on gold. You know, but that's, like a kind of almost an individual type of question, right? Like, I think, a diversified ensemble of systematic global macro is actually very well-suited to navigate normal types of geopolitical risks that evolve over time. You know, there's some uncertainty, but markets are kind of aggregating with bets in one direction or another in a wide variety of markets. The other type of risk that sort of event, singular event risk, you know.

Rodrigo: **01:29:43**

So, let me touch upon that, because I think we talked about this with Chris Schindler on our previous podcast, Adam. How do you mitigate against that policy risk that like overnight risk that policymakers have or the earthquake in California? And what's the best solution and the answer was, well, your best solution is still something that can get luckier, because certainly your long-only portfolio, it has one thing that's going to happen to it, it's going to go down. In a long-short systematic global macro, you might be net long position and be just as bad as your risk parity portfolio. Or you might be 50/50, or you might be net short. And so you have the opportunity in this single event risk horizon to get lucky in a way that you have no opportunity in a long-only portfolio, right.

So, I guess my answer to that as a systematic global macro investor is exactly what Adam said, but with the ability to get slightly luckier in those other risks, right. And I've got a chance, exactly. But just even like, when we think about the period prior to 1981 and you look at the volatility of inflation, I think, MAN Group came out with, I'm going to get the numbers wrong. But prior to 1981, from 1926 to 1981, it was around 4.6%, standard deviation, volatility. And after 1981, it's 1.2, or something like that, right? Okay. So, that was a harder time, and there was a lot more conflict, there were wars, but the drivers of asset classes, right, the reasons why inflation went up and what was affected when inflation went up and then what was affected when inflation went down, what was affected when there were wars, what was affected when there were recessions are the same drivers that exists today, just more magnified, right?

So, the reality is that when you look at alpha, when you look at alpha, alpha requires dispersion. When there's blood on the streets, alpha managers are going to win. And I don't just mean long-short managers, I mean equity selection managers, sector rotation managers. But they have more opportunities. There's more things moving away from each other in unique ways. And when you look at the returns from LTCM crisis in 98 all the way to the peak of the commodity bull cycle in February 2011, active management crushed it in every category. And then you go through a period of benign inflation, persistent growth, where everything's hunky dory, everybody's cooperating, while all of a sudden, it's just a single asset class that dominates, because it's easy. Everybody knows.

Elon Musk did an interview recently that I loved his analogy. He said, in a period of benign inflation, it rains money on idiots, right? It just rains money on fools and resource allocation goes the wrong way. And so I think that if we go through a period of global economic problems and issues and wars, alpha, and that overlay is going to do better than it ever has. We've just forgotten. And this idea that Vanguard funds that three basis points are the way of the future is a miss reading of history.

Jason: 01:32:52

Yeah, that's my next kind of natural question is how much of this is driven by the macro versus the structural orientation and financial markets today, with ETFs, with a ton of passive. And in order for that kind of, I just do these intellectual thought exercises all the time. What if everyone was investing in passive, right? And then you have that next one investor or incremental dollar, say, hey, that doesn't make sense. So, then you kind of walk that back, right? And then you do it in the inverse way. Does something need to massively break there before, like, we get -- we're getting dispersion this year, definitely. We're getting sector rotation this year. But then how does that look for the longer term?

Rodrigo: 01:33:34

What's the saying about inflation? *Nothing is better at fixing inflation than inflation itself,* right? So, in the same way, like you have this situation where indeed, yes, there are market distortions now. There's this like pile of money doing these lifecycle funds that are coming in at the same time, the same way. And retirees are plowing money into it. There's more retiree funds that are coming out globally that are doing the same thing. And the way to do it is to do it through simple Vanguard funds in a market cap weighted approach. Okay. So, that's what's happened and it's gotten more and more amplified. Right?

What's the solution to that? Well, the solution to that is when things start to break, all of a sudden, that's going to transition out. Some funds and we're seeing it already. I'm like, well, we're not going to do the passive stuff. We're going to do an active version of a lifecycle fund, right? Or discussions online. I've been saying it for 10 years, why not a lifecycle fund that does a risk parity approach and starts with a massive amount of leverage, and just reduces the leverage, keep the same expected Sharpe ratio, right? So, all of a sudden, these other ideas are going to start coming in because a decade's worth of flat returns through 60/40 will solve that problem.

And that reflexivity that maximum reflexivity that we see now where you see massive increases and then massive instant collapses and a V recovery because of that. It's going to slowly end and by the end of this decade, nobody is going to want passive and we're going to be way -- We're going to have way too much bad money chasing these active managers that are not as good. And we're going to repeat the cycle over and over. That's one way …

Jason: **01:35:11** I think going forward, especially in private markets, it's what you don't do going forward, is what makes a difference, as opposed to what you do do. And I mean, we get, maybe not the question explicitly, but I hear a lot of folks still talking about China and onshore China investing, whether it's private equity or VC, whatever it might be. And perhaps that's something that if you don't do that, that's going to make a huge difference relative to the other things that you do do.

Adam: **01:35:45** Right. The things that you avoid and they end up making the big difference, rather than how you do the things that you do do. Right. Yeah, that's a fair point. I just had a 45 or 50 minute conversation on this passive flows topic with Drew Dixon and Dave Nadig and Wes Gray and Cory Hoffstein. We spent like 45 or 50 minutes on this just last week. And we kind of agreed there's two different things, right. One is, I mean, obviously, passive flows are having an impact. But it's impossible to disaggregate the impact of the passive flows against other factors just like a consistently declining discount rate over the last three decades, or increasing liquidity of global markets and/or markets taking on a different utility for investors.

Where now by making them the default for retirement plans, the moneyness of markets has increased, and they're now a policy utility. So, the Fed and the government can't let markets go down or find some kind of equilibrium, because now, the real economy is so reliant on those asset prices. Like, there's so many different competing dynamics. So, there's that whole thing where you can't really disaggregate the different effects. And then there's the other thing is, if not, making cap-weighted passive the default, what is the default? Right? From a macro efficiency standpoint, you kind of can't make global risk parity the default, or at the limit, global risk parity becomes the global-cap-weighted portfolio, just from a macro efficient standpoint, right? So, it's kind of a turtle's argument.

Rodrigo: **01:37:32** No, but its excess is the issue. It's when one thing becomes too much of the pie.

Adam: **01:37:39** No, I agree.

Rodrigo: **01:37:39** And then you go back, like there's no -- we could talk about it *reductio ad absurdum* and talk about 100% this and 100% that. But the reality is, there is a level by which everybody starts talking about it and realizes that this is not good. And we're seeing and you move back to something more reasonable.

Adam: **01:37:53** But you can't measure it like the uncertainty …

Rodrigo: **01:37:55** No, you certainly can't, yeah.

Adam: **01:37:56** This is true, you can't measure it because of all the conflating factors. And if you could measure it, how would you change it? You know, these are two, I think, critical questions that Dave Nadig keeps asking.

Rodrigo: **01:38:06** I can't describe it, but I know it when I see it, is the best we could do, right?

Adam: **01:38:10** Yeah, yeah, kind of. I know it's bad, I know it ends poorly, but I don't know how to measure it and I don't know what to do about it.

Jason: **01:38:16** Well, because we're trying to optimize for the average person, right? We're trying to protect the average person. And then at what point of protecting people, it ends up taking on its own kind of massive kind of gap risk.

Adam: **01:38:31** Systemic risk.

Jason: **01:38:32** Yeah, yeah, yeah.

The Specialist Tradeoff

Adam: **01:38:36** I wanted to talk about just in the context of diversification, kind of just moving on a little bit, the diversifiers sleeve. And it doesn't need to be the diversifier sleeves across all the alts, right? I think a typical institution and you correct me, my observations could be a wrong sample. But it seems to me that investors typically like to find -- to identify diversifying strategies that they want in their portfolio and then find specialists in each of those categories to allocate to. So, that's an area. And I guess there's some theoretical advantages there. In theory, the specialist in each of those areas is going to have the greatest chance of identifying all of the different potential alpha opportunities and know the area the best and know the pitfalls, etc. So, that's fine.

But that direction does not have zero cost, either. Because, imagine you've got five funds all expressing different types of strategies, right? And in theory, they're all uncorrelated, and they all trade similar securities, right? But they trade them from different perspectives using different approaches. All the time, you're going to have one fund that's buying the same market or security that another fund is going to be selling. And you're going to have, you know, this can be happening across all five funds. Or if you're going to use seven or 10 funds, it's going to be happening across all 10 funds. All of these trades are unproductive trades in isolation. In aggregate, in theory, they're productive, because each of them has an edge and the hedges are uncorrelated.

But it seems to me there's a very substantial advantage to owning a multi-strat fund that is able to net out all of these unproductive trades that would otherwise be happening in the individual funds all trying to capitalize on their individual edges. How do you think about this trade off?

Jason: **01:40:49** Yeah, I mean, for me, it's not necessarily binary, whether you build your own kind of multi-strat sector specialist by sector specialists. It really comes down to, again, the people and the culture, and the sustainability of that type of alpha stream versus the alternative. So, if you were to build your own multi-strat with a bunch, say, let's call it five sector specialists, all operating different sectors, you're going to be taking on the netting risk as the investor, right. Whereas if all those five sector specialists were wrapped up in a multi-strat and it wasn't passed through, then the multi-strat is taking on a netting risk. So, I mean, in that regard, the multi-strat makes more sense. Now, however, is the talent at that multi-strat just as good as the talent of any one of those sector specialists on their own? And that's where the art comes in, really more than the science there. Because if you have someone that's like super, super passionate about energy investing and that's all they want to do. And they don't want to be constrained by some sort of top level risk management and a multi-strat, then they might go set up their own shop.

Now that's very, very hard to do. But I'm probably more willing to bet on that type of person than the energy kind of PM or team at a multi-strat in isolation. But again, it's not -- there are benefits of that multi-strat because then you have all these other teams across the multi-strat. And then you have the idiosyncratic risk of that one manager, energy manager on his or her own not doing well, right, or failing. However, that's our job to make sure that those types of firms aren't going to fail, or if they -- What is failure, right? Like, failure to me, is it going to go to zero? I mean, I would hope not, I think competent human beings, investment due diligence professionals, can pick strategies in certain areas that aren't going to be …

Adam: **01:43:06** No. I mean, failure is sort of what is the delta between your outcome and the ex-post optimum outcome?

Jason: **01:43:13** Exactly. And it's unknowable, right? So, manager selection is definitely important. But portfolio construction is just as important as manager selection. We're never going to find the best energy market neutral or TMT market neutral manager in this space for any one single given year. But can we find ones that are top third, top quartile over a longer time period? No, I think so. Are those top quartile, top third managers going to be better than a multi-strat of a bunch of sector specialists? I think you're sort of comparing apples and oranges there. Right? Because the idiosyncratic risk that you're taking in the sector specialist, single strategy is very different than a multi-strat.

At the same time, these things need to be adjusted from a leverage perspective, right? Because a multi-strategists, you aggregate all these strategies together, they're putting on, yeah, they're putting on leverage there. So, it's really hard to compare one team in a multi-strat versus a different team and operating in the same area, not on a multi-strat, unless you really have true visibility to those books in isolation. But multi-strats, they tend not to share those things, especially the big ones who might have 10 different kinds of TMT types of pods there that are managing those things. So, it's almost unknowable and impossible to do that.

It comes down, to me, again, I try not to have a bias toward a multi-strat versus a sector specialist. I think you just have to pick and choose your spots with partners that you trust, that you can vet, and that you believe are going to be good long-term partners and put up a decent risk adjusted return. Because otherwise you're going to be churning your book, churning your book, churning your book, and you're going to be resetting your high watermarks, and it's going to be a losing proposition over time.

Adam: **01:45:26** Yeah, I mean, there's just, I hear where you're coming from, because really, if you've got idiosyncratic managers that are trading the same markets, but maybe they're trading at different frequencies, or you know, you've got two different energy specialist traders, one is an energy specialist primarily in natural gas, the other is primarily in the crude complex, or whatever. Then I can certainly see there being very little advantage to consolidating them. And in a -- I'm more thinking about -- there's sort of high capacity, scalable diversifiers, right, you sort of think about market neutral, Value or Carry or Trend or low risks.

You know, kind of the Antti Ilmanen type of diversifier universe which are which are fairly well-specified, uncorrelated generally from one another, relatively higher frequency turnover, and your cross trading a bunch of the same markets, right? It seems to me that you're better off in that instance, to allocate to a multi-strat manager that's going to allocate and trade net across all five different sleeves, all trading the same type of securities, but with five different styles than you are to allocate to a Momentum manager, a Carry manager, a Trend manager, etc. Right? You can get them all on the same.

But even for idiosyncratic managers, like I would be vastly more inclined to invest in Millennium, for example, knowing that he's going to have hundreds of thousands of idiosyncratic managers at his disposal and he's able to trade net, that managers that are trading the same instruments than trying to choose five or 10, or 15, different kinds of idiosyncratic or specialist managers. Anyways, and there's a whole leveraged -- …

Jason: **01:47:23** Yeah, the leverage thing is really where it comes in, right, because am I getting a 5% alpha with 2X leverage, versus a 7% alpha with 7X leverage, which one there is better after your leverage adjust those? The 5% alpha.

Adam: **01:47:46** Well, it depends. Like if you're going to …

Jason: **01:47:48** With 2X leverage it would be. But then when you take on that leverage factor, right, when things go wrong, it's really going to go wrong, it's going to go wrong quickly. And that's where leverage can just kill you. Again, that's not to comment on any sort of single manager because they do a fantastic job. It just ends up being you need to know, there's always a risk that you're taking on once you start kind of using … all the betas, right, and leverage is a beta. You need to factor adjust or leverage adjust those returns to really get a true apples to apples comparison. Because at what point does capital become not as abundant, or leverage become not as easily to come by, in the future? Who knows again, but that's a risk. Right? So, maybe you want those guys, those types of strategies, as well as the idiosyncratic that aren't using as much leverage?

The Framework

Adam: **01:48:44** Yep, yep. Okay. So, I mean, just to sort of if I can maybe try to sum up your -- the framework that I think you're espousing here, diversify your core beta exposures to the greatest extent possible, and then layer on those three levels of alternative diversifiers, right. So, what are they again, maybe walk through them, just to reinforce them?

Jason: **01:49:11** So, first responders, which would be long-vol, tail risk hedging, and in some instances, long duration treasuries. Second responders, more kind of … trend following CTAs, diversifiers, beta neutral, market neutral types of managers. You could maybe sprinkle in some event oriented managers that are really good at hedging that actually do you hedge, versus the ones that are taking on a bit more directional risk. You see that a lot in the kind of the distressed credit space, where like, we're buying these assets for pennies on the dollar, and it's an EMP company. We don't have to hedge out the embedded kind of oil risk there because it's so idiosyncratic as to what's going to happen. But, I mean, I've seen that go wrong.

And again, it doesn't have to be a one for one hedge, but what type of embedded beta do you have to the oil markets for those securities that you're trading that you might be having, you know, buying on a deep discount with a hefty margin of safety. But when things go the other way, they just go the other way, and you just can't predict it. So, hedge out the risk that you're not compensated for, even though that's where the inherent conflict is, right? Because you're compensated on incentive fees. And you want to get a high enough return as you can to take away as much income as you can. But we don't want to pay for beta, we don't want to pay for beta. We don't want to pay incentive fees for beta.

Adam:	**01:50:33**	Just generally, that's a really good takeaway for people is to sort of, you know, this alpha beta separation, and knowing what you should be paying for is really important and not paying for things that you can get for free, like just general exposure to equities and duration and broad credit. Jason, where can people learn more about this framework that you're describing and your practice in general?
Jason:	**01:50:59**	You can go to our website, I believe it's Meketa.com. If not, just go to your local search engine, whether that's Google or DuckDuckGo, or whatever people use nowadays. And you can find us there. And we have white papers out there. We have webinars. I don't really traffic in social media that often. I kind of just listen to podcasts a lot and kind of be the fly on the wall for a lot of these conversations. And as I said, this is new to me, but more than happy to have a conversation with anyone that wants to reach out. Probably the best way to find me is on LinkedIn. And other than that, guys, this has been a lot of fun. And I look forward to hearing more of your interviews because I always get so much knowledge and insights. And I'm trying to maximize the signal to noise ratio, because there's a lot more noise out there, especially in legacy kind of financial rags versus signal.
Rodrigo:	**01:51:49**	Jason, it's been a pleasure having you. This has been a great conversation, man.
Adam:	**01:51:52**	Yeah, thank you so much for being with us.
Rodrigo:	**01:51:53**	I'm sure we'll have you back.
Jason:	**01:51:55**	Thanks, guys. Appreciate it.