Workflow Magazine

INDUSTRY INSIGHT AND VIEWS FROM THE STATPRO BLOG AND CONTENT LIBRARY

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CONTENTS

Industry insight and views from the StatPro blog and content library

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INTRODUCTION

Changing landscape

Throughout the industry there is a feeling of increasing pressure as asset managers and asset service providers are faced with the ever-growing reporting, analysis, and compliance demands from clients and stakeholders.

This presents both asset managers and service providers with a number of opportunities, but also a few challenges. The only way to remain competitive is by updating operational processes to enhance service levels and in turn enhance operational efficiency – and in most cases, technology is the strategy.

With increasing regulations, such as the U.S. SEC's newly mandated set of rules aimed at quantifying liquidity risk in most mutual fund and ETF portfolios, asset managers need easy and efficient ways to assess the true liquidity of their portfolios if they are to comply with the new rules.

As volatility has returned to the markets this year it adds further emphasis on the ability to maintain timeliness and accuracy of performance and risk data, for an ever-growing list of stakeholders.

Self-service platforms from other industries, such as Netflix, are a good example of how asset managers and service providers should be adopting a similar strategy where all stakeholders can help themselves to portfolio analysis content that is designed specifically for them.

Utilizing this same self-service method for risk forecasting is a further opportunity that risk managers should be taking advantage of. When correctly implemented, the ability for managers to offer risk forecasts to their clients can be a powerful differentiator.

Neil Smyth
Marketing & Technology Director, StatPro

We hope you enjoy this edition of Workflow magazine.

ASSET SERVICE PROVIDERS

Opportunities and challenges

As reporting and analysis demands grow in both volume and complexity, what are some of the key challeges and opportunities that asset service providers are faced with in today's climate?

What are asset managers looking for from their ASPs when it comes to outsourced middle office functions?
Ultimately, what asset managers are looking for from their ASPs is to reduce their operational cost. The reason they are doing that is because the asset managers are under pressure through passive investing.

What opportunities do you think ASPs have today when it comes to the middle office?
When it comes to outsourcing the middle office, the growth opportunity for ASPs today is by offering enhanced data management services.

What are the biggest challenges you hear when speaking to ASPs?

When we speak to asset service providers, we hear that their biggest challenge is centered around data management. Asset service providers have a huge amount of data-- they have the accounting data, the trading data, they have market data, such as benchmarks, pricing, corporate actions.

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FANG stocks in volatility

The impact the FANG stocks can have on our portfolio is real - even in a globally diversified asset manager.

What are FANG stocks?

The term "FANG" was coined in 2013 by CNBC host Jim Cramer as an acronym for the four highest performing, high volume, technology growth stocks: Facebook (FB), Amazon (AMZN), Netflix (NFLX) and Google Alphabet (GOOG). Facebook's user growth has slowed recently, but their advertising-based business model can however reach over two billion daily users. Amazon has seen success expanding into business areas where they can see short-term profitability, for example Amazon Web Services, Twitch.tv, and Whole Foods. Netflix has capitalized on the cord-cutting trend in television, becoming the market leader in subscription-based content. They have added users quickly and expanded original programming, with both approaches spurring growth. Google, similar to Facebook, capitalizes on advertisement via their leading search platform. Combined they have enjoyed a tremendous run in the recent bull market, up 44% in 2017, which outpaces the S&P 500's otherwise unbelievable performance of 21.7% over the same period. The four FANG stocks contributed about 2.7% of the S&P 500's total performance in 2017.

How do FANG stocks affect our portfolio?

The four FANG stocks have had a significant impact on the US equity market when looked at as a whole. Together, they account for nearly 8% of the S&P 500, and that number will rise if the market cap of these giants continues to increase. So what happens when the hottest trade starts to unwind?

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The impact the FANG stocks can have on our portfolio is real - even in a globally diversified asset manager

2017 RETURNS	
FB	55.25%
AMZN	57.76%
NFLX	57.71%
GOOG	35.47%

Fig. 1: 2017 returns for the four original FANG stocks

2018 YTD RETURNS	
FB	-9.91%
AMZN	26.88%
NFLX	63.14%
GOOG	-0.96%

Fig. 2: 2018 YTD returns highlighting Facebook drawdown

THE ULTIMATE SELF-SERVICE PLATFORM

What can asset managers learn from Netflix?

The popularity of Netflix has exploded over the last two years with over 125 million subscribers now paying for the service.

They, along with the likes of Amazon and Apple have transformed the way we consume TV and movie entertainment. The ability to self-serve content on your own terms from almost any device, with no advertising and no restrictive schedules is so much more attractive than existing media channels. Their success is yielding huge growth in revenues which allows for large investments in content, which in turn adds more paying subscribers for the service.

What can asset managers learn from the way Netflix transformed content distribution? How can we move on from producing and blindly distributing large volumes of static reports, to creating tailored content for a specific audience and distributing the content using intelligent online self-service platforms?

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DIVERSIFICATION

Truly a free lunch

Most rules have an exception, and the rule that there is no such thing as a free lunch is no exception to this.

Investment portfolios seek to benefit from the free lunch that is diversification, one of the benefits of collective investment vehicles for end investors. Whilst books and courses on portfolio theory tend to concentrate on equities, diversification is just as important in fixed income and multi-asset investing.

Portfolio managers and risk controllers must understand and control the level of diversification (or concentration) of exposures to issuers as well as to sectors and regions. This requires knowledge and modeling of how credit spreads move at the issuer level, which in turn requires granular issuer level spread curves for calibration.

Without these, any estimate of diversification is guesswork, and a concentrated portfolio is indistinguishable from a diversified one. Without detailed issuer information and cross-asset connections, and a granular credit model, investment managers and asset owners cannot tell whether their fixed income and multi-asset portfolios are enjoying the free lunch of diversification or missing out with excessive concentration.

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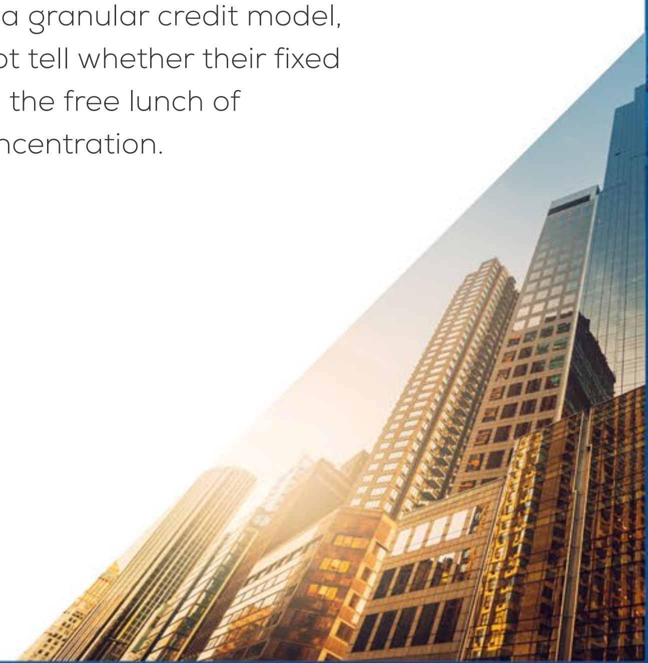

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PERSONALIZED AND CONFIGURABLE REPORTING

Creating risk forecasts for clients

It’s common for asset managers to communicate their expected return forecasts to clients, but less so their expected risk forecasts.

We believe a key reason for this is that the language of risk and return are different. Return is well-defined by PnL, whereas risk needs to be viewed as an analytical toolbox, with each analytic having a specific use in the risk forecasting problem. Understanding the differences between forecasting return and risk will allow managers to deliver a more comprehensive investment value proposition to their clients.

In a ***recent blog*** we proposed risk analytics as a means by which investment managers can drive conversations with their investors in order to better understand their investment preferences and risk tolerances. This allows investment managers to differentiate themselves in an increasingly competitive landscape.

Risk is all about using analytics to make forecasts. Managers should take advantage of this and we believe that when correctly implemented, the ability for managers to offer risk forecasts to their clients can be a powerful differentiator.

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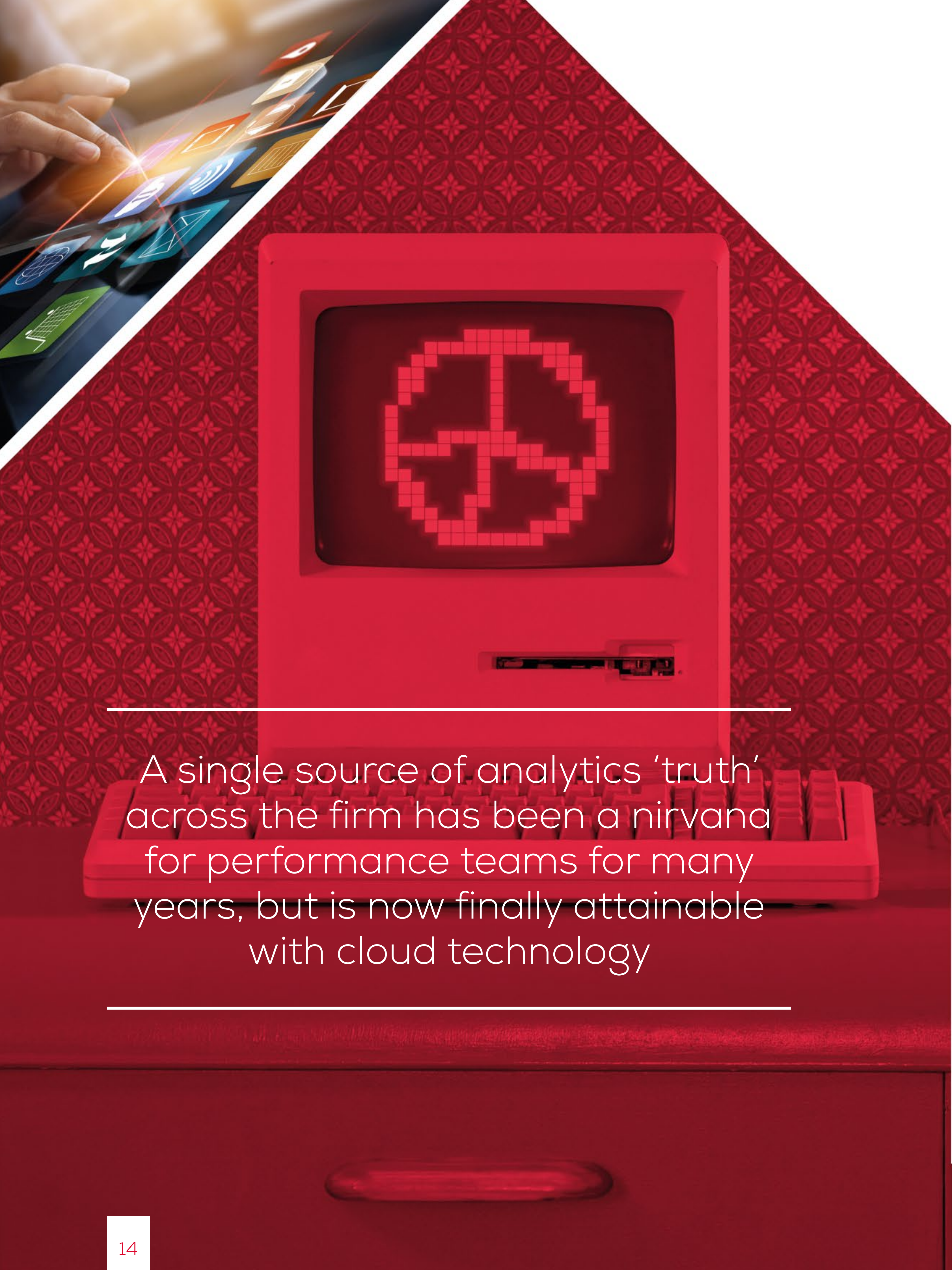
Understanding the differences between forecasting return and risk will allow managers to deliver a more comprehensive investment value proposition to their clients



A single source of analytics 'truth' across the firm has been a nirvana for performance teams for many years, but is now finally attainable with cloud technology

PERFORMANCE SYSTEM EVOLUTION

A short history of performance systems

Over the years, performance measurement has evolved from simple calculations of portfolio returns on a quarterly basis, to segment-level calculation on a monthly basis, to daily calculation of security (or even strategy) level returns.

A similar evolution has taken place in the standards applied for performance, from an initial insistence on external performance measurement, to the development of the AIMR PPS standards and then the Global Investment Performance Standards (GIPS®) in 2000 and in the later version of 'Gold' GIPS® 2010 and forthcoming GIPS® 20/20.

The scope of the role of the performance team has also broadened from measurement to attribution analysis (for equity and balanced portfolios to fixed income, multi-currency and multi-strategy / multi-asset analysis) and to provide not just ex-post risk statistics, but also ex-ante risk monitoring and in some cases risk management.

Parallel with this growth, numerous systems have been developed over the years, taking advantage of new technological developments and advances in IT to provide the necessary functionality and scalability to support the expanding requirements for performance measurement and analysis. Such are the significant differences in approach over the years that we can view these as successive new 'generations' of performance systems.

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ASSESSING THE TRUE LIQUIDITY OF A PORTFOLIO

Using technology to manage liquidity risk

If the financial crisis of a decade ago taught us anything, it's that the liquidity of traded financial instruments is unpredictable and can fluctuate wildly in a matter of seconds.

During the crisis, the eventual loss of liquidity, combined with the highly interconnected nature of modern directives, ultimately led to a rapid cycle of collapsing prices.

In the years since the crisis, regulators have responded by exploring new rules and statutes aimed at requiring fund managers to report and maintain a plethora of data about the liquidity of their portfolios, including the time it might take to sell them. In the U.S., for example, all eyes are on the new set of rules mandated by the SEC aimed at quantifying liquidity risk in most mutual fund and ETF portfolios. Directed towards the risk that a fund could not meet redemption requests without significant impact on remaining investors in the fund, the new rules require a fund to classify positions around four main parameters.

Like most new regulatory measures, we think the SEC's new rules will take some time to really be applied properly. It will also initially be subjective; what's relevant for one portfolio manager may be just market noise for others. The bottom line is that the ability to liquidate any asset depends on three things – how much of it you have to sell, how quickly you must sell it, and the price you are willing (or required) to take – and then systematically tracking such exposure. To us, the goal of the regulation is to measure the likelihood a fund will get caught – as Warren Buffett once said – swimming without a bathing suit when the tide goes out.

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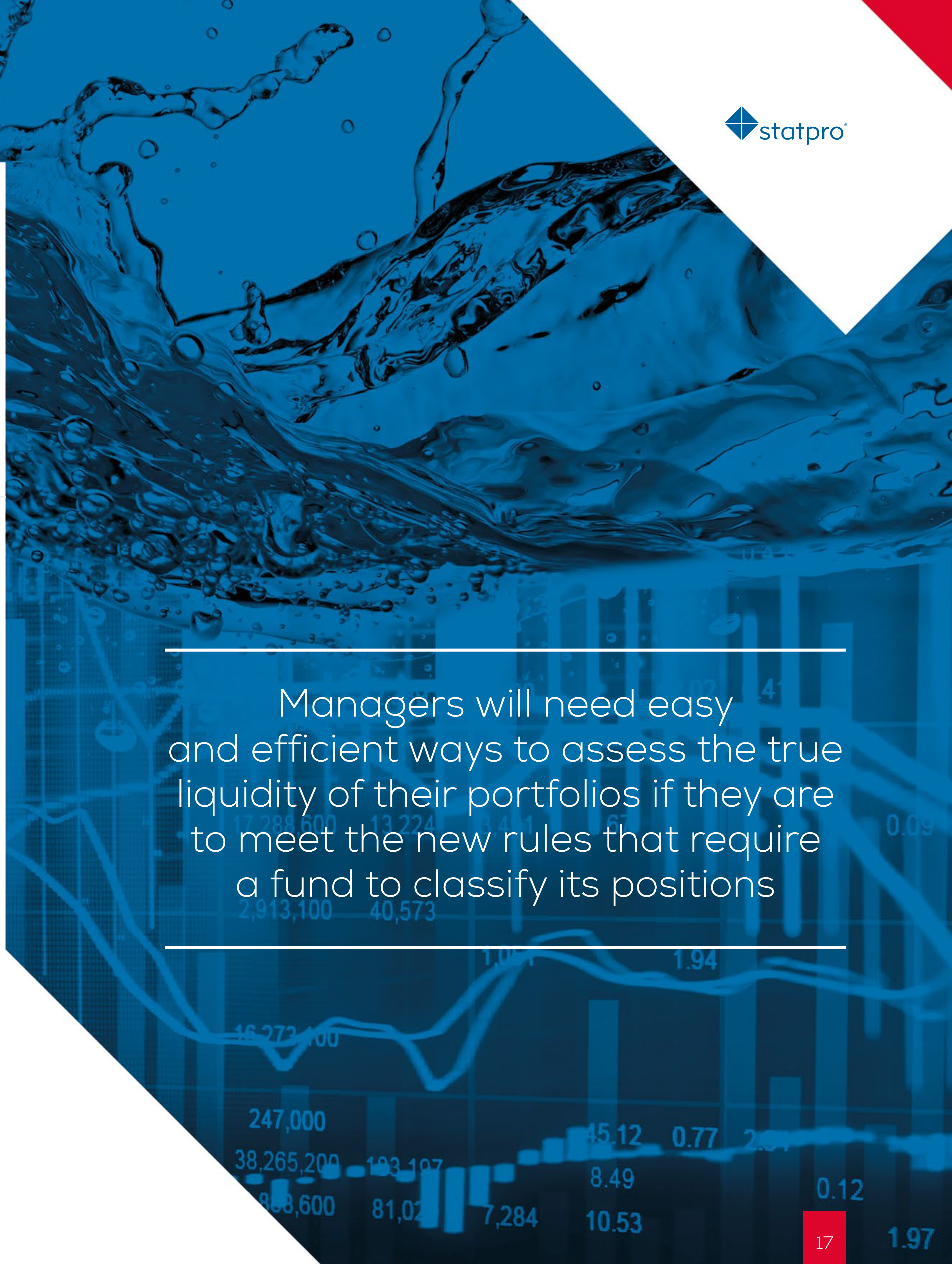

Managers will need easy and efficient ways to assess the true liquidity of their portfolios if they are to meet the new rules that require a fund to classify its positions

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