Portfolio Management in the Era of Transparency

Compliance with clients' objectives: "Do what you said you would do."

Mention "compliance" to most asset managers and they immediately think "regulatory," meaning making sure their operations are sufficiently buttoned up should they get a knock on the door from the regulator. Broadly defined, however, compliance encompasses more than regulation. It also means adherence to your firm's stated investment policies and to your clients' directives and objectives. And in the post-2008 investment environment, that is becoming more of a challenge.

For the most part, the Dodd-Frank legislation of 2010 does not call for major operational adjustments on the part of traditional asset managers. The most significant reforms deal mainly with market structure, systemic risk, reining in derivatives, regulating hedge funds, and strengthening regulatory enforcement. Many asset managers can confidently say they already have the processes and controls in place to withstand regulatory scrutiny in today's more tightly regulated environment.

The more profound change and bigger challenge for asset managers is the increase in investor scrutiny. While the markets may have recovered from the 2008 crisis, some degree of volatility globally is a fact of life. Institutional investors are more risk averse. They are demanding greater transparency from investment managers. They seek greater assurance that managers are living up to their fiduciary responsibilities.

Goal-driven investors want to minimize the impact of market movements on their long-term investment objectives. They are asking more questions about operations, systems and risk management. And they want to see that the firms managing their money have controls in place to ensure adherence to agreed upon investment objectives.

In the face of more rigorous investor due diligence, there is a growing need for portfolio managers to have sophisticated systems and tools to assist in managing and monitoring asset allocation. In a fast-moving market, where the values of holdings can change dramatically in a moment, it is no longer adequate to go through each account manually at monthly or quarterly intervals to determine whether rebalancing is necessary. Without a system that can monitor and adjust asset allocation for all of a firm's accounts simultaneously throughout the trading day, managers run the risk of missing market events that can cause significant deviation from investment objectives.

Solutions for Portfolio Modeling and Asset Allocation

Fortunately, the technology exists to give the portfolio manager more control over asset allocations and to protect the portfolio against market movements that can alter its composition. The newest versions of Advent's Moxy® order management system incorporate the Moxy Portfolio Manager, a module that brings a high level of automation to the processes

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of portfolio modeling, asset allocation, drift analysis and rebalancing.

Portfolio Manager enables you to create models with complex asset allocation structures customized to your clients' investment objectives. You can set targets in these models at both the security level and at classification levels (for example, asset classes or sectors). You can then set up client portfolios to follow the models that match their objectives, creating trades that will bring each portfolio in line with its model's asset allocation targets. If a change is made to the target in the model, it is automatically reflected in all portfolios associated with that model.

Analyzing and Minimizing Portfolio Drift

Portfolio drift occurs when changes in the market values of holdings cause the securities, sectors or other classifications to move away from their asset allocation target percentages. It becomes a problem when the composition of the portfolio changes to such a degree that it no longer meets the stated objectives for the portfolio, and must be remedied through rebalancing.

With the Moxy drift analysis tool, once you have associated a portfolio with a model, the system will automatically compare the two and alert you if the portfolio drifts from the model's targets. When creating models, you establish tolerances or percentage thresholds indicating how far you are willing to allow sector weightings or individual securities to deviate from their targets before generating alerts. The tolerances can be absolute (percentage added or subtracted) or relative to target (percentage multiplied). For example, if your target for a certain security is 10% of an equity portfolio, and you set an absolute tolerance of plus or minus 5%, the security may drift between 5% and 15% of total portfolio value before triggering an alert. If you have set a relative tolerance of 5%, the window is much narrower—9.5% to 10.5%.

You can set up drift analysis to run across all portfolios on a batch basis overnight, and have the results waiting for you on a dashboard when you arrive each morning. You can also perform drift analysis on any portfolio on demand.

Daily drift analysis is an aide to decision making for the portfolio manager. There may be an explanation for the drift. It may be caused by temporary market volatility. The client may have a restriction on selling the securities that caused the drift. It is the portfolio manager's call whether to take action and rebalance the portfolio. While frequent rebalancing may mitigate a portfolio's downside risk, it also entails transaction costs that need to be taken into account. If rebalancing is called for, it can be initiated directly from the drift analysis tool.

Five Key Benefits

The use of technology for portfolio modeling, asset allocation and drift analysis has five key operational advantages:

1. Risk reduction
Proactive, automatic drift monitoring reduces the risk of missing significant drift, compared to checking each individual account manually.

2. Increased efficiency
Drift analysis helps to reduce the amount of time and data needed to evaluate portfolios and groups for deviations from targets, and to identify exactly which portfolios or groups require rebalancing.

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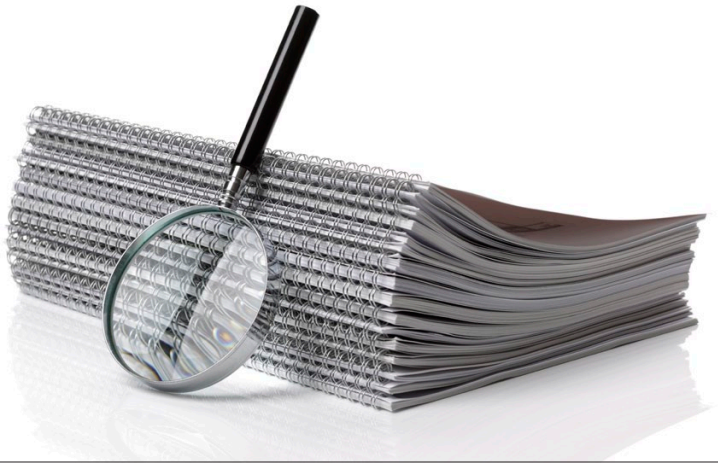

3. Consistent risk/return profile
Asset allocation is the primary determinant of a portfolio's risk and return characteristics. When a portfolio drifts from asset allocation targets, its risk/return profile changes from that of the model. Daily drift monitoring enables portfolio managers to bring portfolios back into line as quickly as possible, minimizing the inconsistency.

4. Scalability
A single manager can monitor multiple accounts at once rather than having to check each one individually, enabling the firm to manage more assets without more managers.

5. Management by exception
Portfolio managers can focus their attention on just those portfolios identified as experiencing drift. All others can be safely assumed to be in line with objectives and targets.

Gaining Client Confidence

The greater strategic advantage, however, is that smart portfolio management tools help assure both you and your clients that you are fulfilling your mission and keeping your promises—allocating assets precisely in accordance with the agreed upon objectives and strategies, and managing portfolios in a way that minimizes deviation from those objectives.

Institutional investors are asking more questions about process these days. Being able to demonstrate a consistent process for asset allocation and drift monitoring, supported by proven technology, is likely to increase client confidence and satisfy due diligence requirements.

Ultimately, the real challenge for asset managers in today's environment is gaining, growing and retaining assets. Investors vote with their money, and they are not shy about moving it if they lack confidence in the manager's processes and controls. Technology that promotes transparency across the entire investment process, from portfolio construction through trade execution, can be a powerful competitive advantage. A system that shows clients you are consistently looking out for their interests and fulfilling your commitments—the primary tenets of compliance—can go a long way toward strengthen and deepening relationships.

About Advent Moxy® Order Management System

Moxy® is the most widely used third-party system for portfolio construction and trade order management on the market. Combined with Advent's portfolio accounting solutions and expertise, the integrated Advent suite of products delivers the enhanced functionality needed to streamline the entire investment process.

Who We Are

Over the last 30 years of industry change, our core mission to help our clients focus on their unique strategies and deliver exceptional investor service has never wavered. With unparalleled precision and ahead-of-the-curve solutions, we've helped over 4,500 firms in over 60 countries—from established global institutions to small start-up practices—to grow their business and thrive. Advent technology helps firms minimize risk, work together seamlessly, and discover new opportunities in a constantly evolving world. Together with our clients, we are shaping the future of investment management. For more information on Advent products visit www.advent.com.

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