Managing diverse assets in the new world

Roger Woolman of SS&C Advent analyses the effects now and into the future of the coronavirus pandemic

Now we know. Commentators have long speculated on whether the central bank-sustained equity bull market had entered bubble territory and what might burst it. The pin turned out to be Covid-19.

Record index highs in February were followed by record bear market plunges as the coronavirus pandemic spread across the world. The first quarter saw the Dow Jones Industrial Average plummet 23%, while the FTSE 100 shed 25%, their biggest quarterly drops since 1987. The S&P 500 slumped 20% – its worst quarter since 2008.

The second half of March was particularly challenging for many investment strategies, with widespread de-risking adding to downward price pressure, exacerbated by heightened illiquidity and wide bid/ask spreads, according to bfinance research[1]. "This was particularly evident in fixed income and currency markets, where spreads in usually highly liquid instruments widened by many multiples." Absolute return multi-asset strategies offering diversification and more all-weather return profiles fared best during the turmoil, with certain strategies delivering 'impressive' capital preservation.

Stock markets may have rallied since amid the unprecedented government and central bank responses, and hopes of a quick economic rebound. Yet downside risks remain pervasive. The International Monetary Fund predicts the global economy will shrink -3% this year, with a prolonged U- or L-shaped recovery threatening further equity market routs and bond market dislocations in the months ahead. That will throw up investment opportunities, but also bring high levels of volatility and risk of losses.

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So what are the lessons?

"Overall, once results are digested, we believe that the performance during the first phase of the Covid-19 crisis will support ongoing investor demand for multi-asset strategies – particularly the absolute return contingent," argues Chris Stevens, director, diversifying strategies with bfinance[2].

And with the prospect of future pandemics and climate change impacts threatening further shocks and extreme volatility, the attraction of a multi-asset class approach – especially one that draws on a range of traditional and alternative assets to provide resiliency in times of strife, and steadier, non-correlated, risk-adjusted returns over the long term – has never been more compelling.

The operational ask

Yet while the investment rationale may be strong, the operational and technology intricacies involved in processing and reporting on multiple, especially alternative, assets shouldn't be underestimated.

Automating the workflows for various forms of derivatives and alternative assets such as private equity, real estate and private debt pose particular challenges. Rather than simply holding a position and recording a price gain, the cash and P&L that flow from the products have to be carefully managed.

Swaps, for instance, feature complex financing calculations. Resets generate P&L and/or cashflows, and can be different for each swap type. Within private equity, the terms of each particular credit/debt fund structure need to be supported. Waterfall calculations, expense allocations, hurdles, tiered incentive and management fees, liquidity terms, potential conflicts of interest and valuation processes all have to be monitored and managed.

Common problems

Different asset types, investment strategies and fund structures bring specific processing demands, but common operational pain points include:

- Data sources
  Investment managers need to access and integrate a range of data sources and counterparty information as they expand their asset class mix. These data sources differ from one asset class to another, with the information often delivered in varying formats. Private capital markets-related data in particular seldom come from standardised data feeds. Notices may be sent as a PDF or fax, and image-type data may be used to notify investors of a capital call or distribution.

- Accounting treatment
  Modern hybrid and private equity funds need to combine their

investment accounting and investor accounting records if they are to furnish investors with detailed look-throughs to the underlying assets – and so provide transparency into their portfolio constituents and XIRR by investor and investment. Generating accurate fee calculations also depends on detailed look-throughs from investor to the investments. Meanwhile, calculating and allocating the different tiers in a fund's distribution schedule can be a real headache without a sophisticated waterfall calculator.

Monitoring and managing derivative instrument underliers are another challenge. Traditional, non-derivatives systems are configured to report on a position, not what underlies it. As a result, they struggle to provide comprehensive reports on the true exposure and risk to specific regions, countries, industries, companies or assets that managers need, and investors and regulators increasingly demand.

- Data migration
  Adding new assets to a portfolio management system typically requires a point-in-time conversion of whatever positions the fund holds at that moment. However, certain asset types require migration of the complete back history, to accurately track all the capital commitments and drawdowns, allocate management fees and generate waterfall calculations. Any errors or oversights will result in inaccurate or missing data.

- Scalability
  Expanding into new derivative types or alternative asset classes may offer diversification and return benefits, but without the right systems firms often become dependent on manual workarounds. A scalable investment and operational support infrastructure is vital if institutions are to handle volume throughput efficiently, provide the transparency regulators demand, and ensure operational controls are in place to manage risks and service clients correctly.

- Data governance matters
  Accessing different data sources and intelligently applying relevant data is critical to successful asset class diversification. The data's real-world value though ultimately rests on its usability. Systems and activities – from portfolio modelling and risk management to accounting, reporting and compliance – rely on accurate, complete and timely information. Without data accuracy and integrity, key investment management functions will be fatally flawed.

Yet data governance – how organisations manage the full data lifecycle to create a golden source of business-critical data backed by superior quality assurance and control – often remains haphazard and beset by inefficient, error-prone manual processes. The sub-standard data that results poses huge operational risks, and acts as a significant drag on efficiency, especially where it is employed by multiple users and for different use cases.

A sophisticated data governance tool can transform the way data is managed and employed. Rather than a mishmash of processes – with business lines or operating silos working off their own spreadsheets and following distinct procedures – a centralised, automated, workflow-based process for data examination, repair and resolution delivers true data quality and consistency across the enterprise. Operational and key person risks, and the associated financial and reputational risks, are minimised. And efficiency gains reduce data management costs, improve oversight and control, and enhance employee productivity.

Effective data governance allows errors to be identified and corrections made earlier in the lifecycle. More accurate data means it can be employed with confidence sooner, in some cases without needing to be reconciled. Risk management and investment decision making are a case in point. Any overexposures to specific counterparties, asset classes or securities can be readily identified, allowing a proactive rebalancing of positions to ensure compliance with any regulatory or investor limits. Monitoring cash positions can also help firms avoid the twin costs of either going overdrawn or having idle cash sitting on the sidelines.

And by surfacing errors and exceptions in the data, an automated data governance tool can limit the number and seriousness of breaks that emerge during the reconciliations process and reduce the time and trouble involved in fixing them, offering further big wins.

Intelligent data governance in a multi-asset environment

Bad data can spread and mutate quickly through an organisation, with painful and often costly consequences. Data governance therefore needs to be an enterprise-wide effort to be effective.

That is why at SS&C Advent we have integrated our intelligent data governance tool with the industry-leading Geneva platform, which was named Best Fund Accounting and Reporting Software at this year's HFM European Services Awards.

Geneva is a true multicurrency, multi-asset solution. Designed to meet investor demand for diversified fund allocations, the system's capabilities span front-office decision support and portfolio management through trade capture and reconciliation to accounting and reporting. Integrating data governance into this framework enables data to flow seamlessly end-to-end, optimising its integrity and allowing user firms to diversify their portfolios while mitigating risk.

With margins under pressure, and regulators and clients less tolerant of errors and delays, efficient data governance and extensive multi-asset class capabilities are a powerful combination that can give investment managers a real competitive edge in both good times and bad. HFM

[1] Research team update: Liquid alternatives, by Dr. Toby Goodworth, Chris Stevens and Pravir Sharma, bfinance, 21 April 2020, https://www.bfinance.co.uk/insights/research-team-update-liquid-alternatives/

[2] Are Multi Asset Strategies Delivering for Investors? by Chris Stevens, bfinance, April 2020, https://www.bfinance.co.uk/insights/are-multi-asset-strategies-delivering-for-investors/