



MarketMingle: Bringing Together the Front Office & Capital Markets Community.

Navigating the Challenges Ahead

The investment industry is evolving, with a number of key trends and complexities impacting the global pensions and asset management landscape. As a result, systemic shifts are occurring in asset allocation and performance decision-making, as well as in securities finance, trading and liquidity. In an increasingly challenging environment, asset owners and asset managers are leveraging new technologies and insights to help them achieve their goals.



**NORTHERN
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Navigating the challenges ahead

In March 2023, Northern Trust was delighted to host our inaugural MarketMingle events in Amsterdam and Stockholm, bringing together the front office from across the local asset owner and asset manager communities, with Northern Trust's senior leadership and front office coverage team.

Discussions focused on a myriad of key typical issues that impact strategy and direction, and the following themes emerged as particularly pertinent today:

Focus on Performance

MAJOR CHALLENGES



We are living in a world of increasing uncertainty and volatility, and generating alpha has become a key concern for both asset owners and asset managers. Last year was the worst year on record for balanced funds since The Great Depression in the 1930s, but the issues around performance go deeper, according to Gary Paulin, head of Global Strategic Solutions at Northern Trust. "I think we are about to enter a future where inflation volatility is the standard. The tools and techniques that may have worked well in the past may not work as well in the future," he suggested.

It means re-thinking asset allocation models, which tend to assume that stocks go up over time, irrespective of time frames. Consider that an investor who bought stocks in 1929 would have had to wait 35 years to recoup their investment. If the same investor bought a stock in 1968, it would have taken them 20 years to get their money back, and in 2000, the wait would have been 15 years in real terms. Paulin compared today's financial climate to the 1970s, when the investment industry went through a painful period of readjustment in a difficult market environment. Some stocks did well, but markets started and finished a decade at more or less the same price.

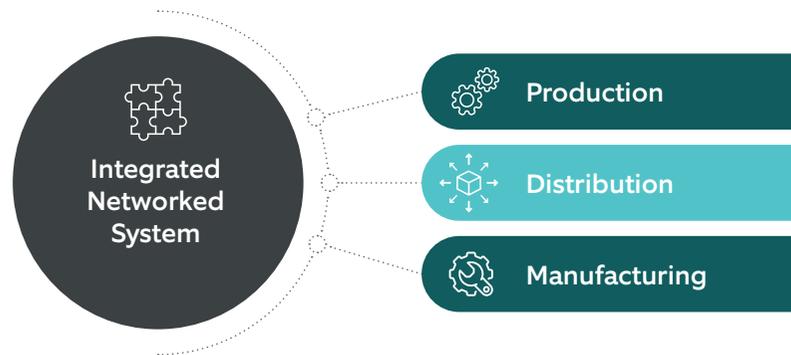
Northern Trust's role as an asset servicer to asset owners and asset managers around the world provides us with a global lens of the investment industry. Through this we gain a view of market trends impacting our clients, as well as the potential opportunities open to them and key challenges that they and their investors face.

Today, the industry is navigating similar challenges, which has implications for asset allocation decision-making. If stocks underperform, passive indices may underperform as well, meaning it could be time for investors to make more active bets. It may also be time for them to reassess their diversification approaches, according to Paulin. In the 1970s, supply constrained real assets such as gold, commodities, forestry, farmland and even fine art added value, and today, new emerging asset classes are likely to play a similar role. Investors are also more likely to use derivatives to manage tail risk and for interest rate hedging, and income generation. Balance sheet optimisation will also be a key consideration to navigate future performance.

Capital Lite Models

Another important trend will be the shift to 'capital lite' operating models. Asset owners and asset managers are grappling with different cost complexities which are making them reassess their existing operating models. Fixed costs in particular are a challenge in times of underperforming markets. Adopting a capital lite variable cost model will be one way for asset allocators to navigate the current market environment. By renting fixed cost infrastructure from a consolidated hyperscale asset services provider, many capital intensive workflows can be outsourced.

According to Paulin, investment managers are transitioning to something more akin to what is being provided by the software industry, focused on producing decision-making, while outsourcing non-core processes. As a result, they are building margin resilience, scalability, and business agility in the face of disruption.



In this landscape, asset servicers take on a role similar to that of a technology provider, allowing investment firms to outsource all their production, distribution, and manufacturing needs into one integrated networked system.

The Rise of Behavioural Science

There's a lot of hype around data at the moment, but current data models still struggle to be forward looking. There is also the challenge of decreasing signal value, as more people use the same data to generate insights. Asset owners and asset managers have unique datasets however – data generated by their own activities. “The one data set that you have that nobody else has is data about your own decision-making,” said Clare Flynn Levy, Founder and CEO of Essentia Analytics, the behavioural analytics firm that works in strategic partnership with Northern Trust. By adopting behavioural analytics and scrutinising their own performance in a myriad of different ways, investment managers can think about enhancing their performance in different market conditions.

Flynn Levy highlighted the ways in which identifying manager skill can make a key difference, whether it is around measuring investment entry timings, exit timings, sizing, adds, trimming, or other behavioural biases. There are more than 50 different analysis points of decision-types, she said. “It's just like in sports... tiny little incremental improvements can add up to gold medals and league wins and the rest. The same goes for fund managers. It doesn't have to be some radical change that takes place. Just the will to get a little bit better every single day is enough.”



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Clare Flynn Levy

Founder and CEO, Essentia Analytics



The technological ability to connect with behavioural biases with investment patterns is rapidly evolving. Younger fund managers have grown up with data analytics and feedback loops, and managers who are implementing what they learn from the data have a competitive advantage.

Generating Trade Data Analytics

Data analytics are advancing trade execution quality to strengthen performance as well as improving transparency and oversight. “There is a lot more importance now on performance gains, because performance gains are actual tangible costs savings in the grand scheme of things,” said Victoria Bryan, Senior Capital Markets Data Analyst at Northern Trust. By using the key analysis that is generated, traders can gain a better understanding on the strength of the execution, and on if the benchmark they are focusing on is right for the goals of the portfolio.

Moreover, when it comes to areas such as data analytics in foreign exchange, there should be a focus on costs tangential to execution quality, such as: market exposure risk in conjunction with netting benefits, operational and execution risk, access to cash, and fees relating to the service, according to Rowan Gillespie, Business Development manager, Foreign Exchange at Northern Trust. Gillespie also highlighted the role of performance attribution when making hedging decisions. “...Once you have those attributor metrics, you can then use those as a feedback loop to optimise your hedge parameters, which allows you to run a better performing hedge, which then has a knock-on effect on performance in a positive way,” he said.



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Victoria Bryan

Senior Capital Markets Data Analyst, Northern Trust

SOLUTIONS IN ACTION: FOREIGN EXCHANGE VALUE STUDY

Client Challenges	Northern Trust Solutions	Results
<ul style="list-style-type: none"> • Disparate and fragmented existing FX programme with five or six different FX providers • Increased risk exposures • Inconsistent execution quality • Lack of transparency and varied execution methods • Increased costs 	<ul style="list-style-type: none"> • To execute foreign exchange transactions in an efficient, precise, and transparent manner and achieve enhanced execution quality • Greater flexibility and sophistication in placing orders to increase operational efficiency and control • Leading technology solutions with experienced global foreign exchange client service team 	<ul style="list-style-type: none"> • Up to a potential 65% savings through pure consolidation, organic netting benefits and level of execution quality as estimated by Northern Trust’s cost analysis • Homogenised and transparent reporting • Homogenised and efficient operational processes put in place

SOLUTIONS IN ACTION: TRANSACTION COST ANALYSIS VALUE STUDY

Client Challenges	Northern Trust Solutions	Results
<ul style="list-style-type: none">• Needed to improve trade execution efficiencies and manage costs• Was grappling with performance analysis• Outsourced dealing to Northern Trust as a result	<ul style="list-style-type: none">• After six months of trade data was available, Northern Trust ran a detailed analysis including looking at behavioural analytics• The analysis revealed inefficiencies on the timing orders were sent• It also revealed an underperformance due to orders being reloaded• Northern Trust worked with the client to create an execution plan going forwards	<ul style="list-style-type: none">• 73 basis points of potential savings from more efficient trade timing, if the orders were sent just one day prior• An additional 80 basis points of performance gains from better execution of reloads which was 14.5% of this client's order flow* <p>* Independent Analysis from Abel Noser</p>



Portfolio Restructuring in a Shifting Operational World

Portfolio solutions have always been a key priority for the asset owner community, but they are becoming much more important to asset managers as well, as both groups look to review their operational efficiencies and models. A number of trends and themes are shifting operational and fund structuring requirements. Data analytics, regulation, consolidation, the evolution of ESG and a focus on costs are all having an impact.

Asset managers are looking to simplify their operational costs, according to David McPhillips, business development manager, Capital Markets at Northern Trust. “We will routinely get a call from an asset manager who will be running multiple fund structures in multiple jurisdictions. They’ll have a Luxembourg fund, they’ll have an Irish fund, there will be a UK fund, and they’re looking at their cost base and saying, ‘Well, does it make sense? Do we need all these different types of vehicles, these different types of structures?’ And, candidly, in most cases they don’t,” he said. There are numerous considerations for asset owners and asset managers who are looking to consolidate their structures, from regulatory environments to pension reform, beneficial ownership, legal requirements, tax, and costs. “It is the job of asset servicers to help clients identify these challenges and complexities around restructuring, and provide solutions that meet their clients’ needs,” said McPhillips.

One key issue is liquidity, though when it comes to liquidity risk, no one size fits all. Asset managers, for example, need to understand both their fund structures and their investment base when making decisions about portfolio positioning. They need to adopt new liquidity reporting solutions that will allow them to understand the impact of redemptions on their overall fund, the tracking error of their benchmarks, trading costs, different market exposures, and more.



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David McPhillips

Business Development Manager, Capital Markets, Northern Trust

SOLUTIONS IN ACTION: PORTFOLIO SOLUTIONS VALUE STUDY

Client Challenges	Northern Trust Solutions	Results
<ul style="list-style-type: none"> Client had previously run a platform with a range of subadvisors and needed a more cost efficient solution Determination to manage its new commodity-based fund itself 	<ul style="list-style-type: none"> Northern Trust implemented a rules-based methodology to match the weights and holdings as provided by the asset manager. Worked with stakeholders including transfer agent and fund administrator so that daily flows coming into the fund came directly to Northern Trust for rebalancing and portfolio restructuring purposes 	<ul style="list-style-type: none"> Client was able to launch and manage the fund with clear understanding of costs and robust reporting, transparency and data analysis Northern Trust was able to provide a flexible operating model to meet their requirements

For more information

To find out more about our MarketMingle network and capital market solutions that can support your organisation, please contact your local Northern Trust business development teams, or:



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