Re-Thinking Buy-Side Portfolio Decision Support Solutions

A State Street Company

The leading web resource for financial technology

The growing diversity and complexity of actively managed investment products, intense competition from low fee passive strategies, and the increasing focus on risk throughout the investment process are forcing many institutional investment managers to re-examine their operating models and technology choices. This article examines the most significant drawbacks of traditional approaches, outlines improvements seen in the newest generation of decision support solutions, and provides an overview of key capabilities and differentiators to consider when evaluating commercially available offerings.

Traditionally, technology vendors have addressed portfolio and risk management in one of two ways. One approach offers standalone, asset-class specific portfolio management, risk, and performance measurement systems. This approach fails to provide a timely and enterprise wide view of risk due to fragmentation and reliance on overnight batch processes. From a buy-side perspective, these systems are difficult to integrate, resulting in manual workarounds and custom integrations. Accessing multiple systems, each with a different user interface, decreases portfolio manager productivity and delivers incomplete information. Redundant data feeds and improperly mapped or missing data are a common problem. Largely deployed on-site, they require dedicated support staff and are plagued by lengthy software upgrade cycles.

A second approach offers a black box, one-size-fits-all model. While providing integrated functionality, these systems lack scalability and API support for incorporating 3rd party optimization tools, risk models, data sources and analytics providers. Configurability is largely missing, resulting in the need for custom reports and spreadsheets to bridge the gap between system functionality and the needs of portfolio managers. The one-size-fits-all model also saddles firms with significant licensing costs, even for unused functionality.

An emerging class of SaaS-based portfolio decision support solutions seeks to address these shortcomings. In broad strokes, these offerings provide seamlessly integrated multi-asset risk management and scenario analysis, performance measurement and attribution, and portfolio analysis and construction capabilities on a single platform, with a comprehensive foundation of security and benchmark data, real-time positions, and analytics. These solutions are highly configurable and accommodate each manager's preferred views and workflows and the ability to incorporate 3rd party tools, bespoke data and specialty analytics.

A Compelling Value Proposition

These decision support solutions offer a compelling value proposition for the front and middle office:

- Increase Portfolio Manager and Analyst productivity - provides a complete set of capabilities, accessible from a central workspace, for streamlining the investment process
- More readily understand risks and counterparty exposures
- Help firms respond faster to market opportunities and make more informed allocation, targeting and hedging decisions
- Improve service to institutional clients - manage all investment mandates on a single platform
- Deliver performance and data quality – SaaS deployment provides scalability and ensures a highly performant infrastructure with the latest software capabilities and necessary data

Streamlining the Investment Process

A portfolio decision support solution increases productivity by streamlining investment processes for order construction, asset allocation and rebalancing, overlay strategies and exposure management. Extensive automation and exception-based workflows keep Portfolio Managers focused on value-added activities. For example, automated compliance checks inform managers when allocations are outside of compliance guidelines. Heat maps provide visibility into overweight/underweight exposure to benchmarks, alerting managers to rebalancing opportunities. These solutions also incorporate self-service data aggregation and visualization capabilities and a familiar spreadsheet-like interface directly in the portfolio management workspace. This supports auditability and data governance, eliminates spreadsheet risk, and improves front office productivity.

A Single and Consistent View of Risk and Performance

Heightened regulatory scrutiny and the increasing frequency and variety of risk events have driven demand for tools that clearly identify and quantify risk. A decision support solution provides Compliance Officers and Risk Managers with a consistent enterprise-wide view of portfolio, market, and sector risk, portfolio/strategy performance, and manager contribution. Users can look through pooled or indexed assets across any number of levels for complete visibility into exposures, which is difficult if not impossible with separate portfolio and risk systems. Risk and performance assessment are based on a single, consistent set of data and analytics, eliminating the potential for conflicting results.

Unlike standalone performance systems that rely on back office accounting systems for position data, a decision support solution maintains an internal, real time view of positions and cash. This ensures comprehensive return, contribution, attribution and ex-post risk data for each portfolio, and for a variety of timeframes and user-defined classification levels. Firms can satisfy regulatory requirements and client demands for greater visibility into risk-adjusted performance and the value added by their Portfolio Managers.

These solutions also provide real time, actionable views of portfolio holdings and risk exposures, expediting the construction of hedging strategies. Proposed trades are immediately reflected in the portfolio workspace and can then be routed to the trade desk. Risk metrics are also actionable. For example, a manager seeking to reduce a portfolio's Value-at-Risk (VaR) would sort by component VaR and then sell off the position that contributes most directly to risk exposure.

One Solution for Managing Multiple Mandates

Competition from low fee, passive investment products is forcing actively managed funds to explain their value proposition to investors more frequently and in greater detail. The increased use of derivatives and alternative asset classes also requires insight into how these instruments enhance portfolio returns or dampen risk.

When evaluating vendors, an important differentiator to consider is how broadly the solution supports multiple asset classes, investment styles and mandates. The ability to manage multiple investment mandates on a single platform helps firms eliminate disparate systems, offer more competitive management fees, and bring new products to market faster. Configurability is another key requirement. For example, while the investment processes for Rates desks and Credit desks may appear similar, each desk is concerned with different risk factors, implements strategies based on different instruments, and utilizes unique workflows.

Ensures Scalability and Performance

Scalability and performance are critical considerations for firms managing large portfolios and/or large numbers of portfolios, especially those that are multi-asset or derivative-heavy. The sophistication and mathematical complexity of today's risk and valuation models require a highly performant computational infrastructure that can process models and scenarios in near real-time. SaaS-based deployment reinforces seamless scalability and high performance, and also ensures that firms stay current with the latest risk and valuation models.

Also needed is a comprehensive foundation of managed security, benchmark and reference data, a real time view of positions and cash balances, and extensive global analytics coverage. Previous bobsquide articles discuss enterprise data management and position-level transparency in the context of Buy-Side decision support.

SaaS-based decision support solutions address the limitations of piecemeal and black-box approaches, and provide important benefits. By consolidating investment management best practices and institutional knowledge on a single solution, firms are ultimately more resilient to operational risks and regulatory changes and can better serve their institutional clients.