

and maintainability. They will not have been designed with knowledge of the other systems with which they must now interact. They will each require their own unique view of data that is commonly needed throughout the business, such as security definitions, portfolio structures and trades, which creates work in the form of multiple data entry and reconciliation.

It is also highly likely that many of them will exchange data with each other via custom-built interfaces, knowledge of which is supported by documentation of indifferent and uneven quality, or worse, lost in the heads of long-departed IT contractors.

So perhaps it should be no surprise that firms that have taken this route should experience considerable difficulty when they need to pull together data from across departments at short notice.

Of course, September 2008 was not the first time that IT departments had tried to deal with the problem of collecting data from an inflexible platform built up from a multitude of systems.

Various approaches have been tried to solve this problem, a common one being deployment of a data warehouse in which data from many systems may be periodically stored for later reporting purposes. This can be useful only if an accurate prediction has been made about the actual data required to be analysed at some future time. However, since data must still be aggregated and loaded into the data warehouse

on a predefined schedule, there are time-inherent delays in the approach and as a result a true current picture can never be seen.

However, the use of a seamless processing system can dramatically improve the situation. Such a system offers functionality to support each business activity, in the front, middle and back office, so to each it appears that they have their own system. But the whole operates around a single core database. Thus there is only one instance of any data in the system, so one definition for each security, portfolio, trade and so on.

All users use exactly the same physical data, rather than their own department's private version. Furthermore, all asset classes are handled in the same database and all reporting is driven from it too.

The result is that aggregation is no longer a significant issue, since data retained within the business does not need to be collected from multiple, disparate sources or converted into a consistent form. Instead, standard reporting tools may be used to query the database, which, if it is a modern, widely used platform, will have its structures clearly and openly defined for easy data extraction.

For people working in an investment management business where a fragmented systems architecture exists, a seamless processing approach may sound almost too good to be true. However, at the same time

as some investment organisations were taking days and weeks to establish a consolidated view of counterparty exposure when Lehman Brothers failed, seamless processing systems users were deriving the information in seconds where such reports were predefined, and in a few hours where new reports had to be created from scratch. And since all users access the exact same physical data, there are no time delays in data being updated so all reports are based on data as current as anyone anywhere in the business knows.

Use of a seamless processing system can be expected to improve visibility of many kinds of investment management business risk, such as market risk, credit risk, liquidity risk and counterparty exposure, right across the business. Furthermore, operational risks can be reduced dramatically, as complex processes are simplified or eliminated.

However, there is a caveat. Just as would be required to obtain a view of risk that goes beyond the departmental level, vision and drive above the senior management level is required in the highest echelons of the business.

*The 2009 Global Investment Management Risk Survey, undertaken by The Neilsen Company on behalf of SimCorp StrategyLab, is available at www.simcorpstrategylab.com

John Mayr is marketing and partner development director at SimCorp

Down but not out

Clients are adopting a hard-nosed approach in response to the recent bear market losses, argue **Amin Rajan** of CREATE-Research and **Willie Watt** of Martin Currie

For investors, the current credit crisis has proved deeper, darker and scarier than anything in living memory, according to a new survey carried out by CREATE-Research on behalf of Martin Currie.

Focusing on the credit crisis that started in 2007, the survey aimed to find out how it has affected investors in different segments so far, and how it will influence their investment choices over the next three years or so.

The surveyed respondents have reacted with a blend of profound disillusionment, cautious opportunism and disciplined introspection.

Disillusionment, because they were still repairing the damage caused by the 2000-03 equity bear market; opportunism, because many assets are now seemingly mispriced; introspection, because a number of activities have come under scrutiny.

Such activities have focused on enhancing capabilities in crucial areas like asset allocation, risk management and managerial reviews. Their central thrust is aimed at tactical opportunism and better governance.

While there is no overt evidence of a blame culture under which clients are pointing accusing fingers at their fund managers for the losses inflicted by the crisis, neither is there a tacit acceptance that "we are all in this together". Specific reservations about fund managers have come to the fore, as revealed by the survey quotes in the box (right).

Looking to the future, the key driver of investment choices over the next three years will be the global economic outlook, which has dual significance on this occasion – first, as a forward



Amin Rajan

indicator of the success of governments worldwide in tackling the current credit crunch, and second, as a motor of financial markets.

Faith in the inherent abilities of markets to deliver returns is not impaired. What is unclear is whether governmental actions so far can jumpstart the global economy.

Evidently, a line has been drawn under the current losses, with a desire to move on in search of better returns to plug the funding gaps.

This pragmatism supports the widely held view that the current bear market is but an extension of the last one: in between, the excessive use of leverage, derivatives and shorting to shore up the returns only helped the prime mover investors.

For the rest, diversification has cost dearly. ▶

"I think it's really a case of 'return to basics'. That means plain vanilla equity and bond strategies, at keen prices. We never really went for the structured or alternative products with low transparency that masked high fees. It will be a better world when these things, and the people who peddled them, are gone."

"Our process/philosophy has not changed. We simply seek to understand what portfolio managers are actually doing, and construct portfolios accordingly. Sometimes we're wrong – that's usual."

"We've mostly avoided disasters, and many of our favourite managers have done a decent job. This probably tells you something – the people who are really disappointed with their managers are those who had unrealistic expectations. Probably because they were sold products, rather than intelligently buying them."

"A lot of people in this industry - both on the buy and sell side - have no clothes. This has now become apparent for all to see."

"There is excessive focus on risk relative to benchmark as opposed to absolute volatility, often caused by commercial concerns on the part of the asset manager. There is also evidence that managers do not understand well enough the sources of risk and return in their portfolios."

◀ They entered the scene when peak returns were history. Now, it is no longer about avoiding placing all eggs in one basket, partly because of the high correlation between the previously uncorrelated asset classes in the down market, and partly because the risk-return features of all asset classes have become ever more volatile and unpredictable in this decade.

Accordingly, the low return environment is expected to prevail over the next five years with diminished risk appetite (see figure).

Less than 15% of the respondents expect their five- or 10-year target returns to go into double digits (north-west segment). These expectations are tempered by actual recent experiences.

Over a five-year horizon:

➔ 35% of respondents are targeting returns in the 5-7.5% band.

➔ A further 40% are targeting within the 7.6-10% band.

Over a 10-year period, a fractionally bigger proportion is looking at the latter band.

However, at the disaggregated level, pension funds don't appear to follow the general pattern (south east segment). Notably, none of them are targeting returns in excess of 10%, unlike other segments of respondents.

Pension funds have evidently learnt from past experience that high returns invariably involve trade-offs – high risks, high opacity, high volatility or low liquidity.

Given their diminished risk appetite in the current climate, their return targets are conditioned by what is possible rather than what is desirable. Furthermore, pension funds are increasingly keen to preserve and enhance the strength of covenant with their plan sponsors.

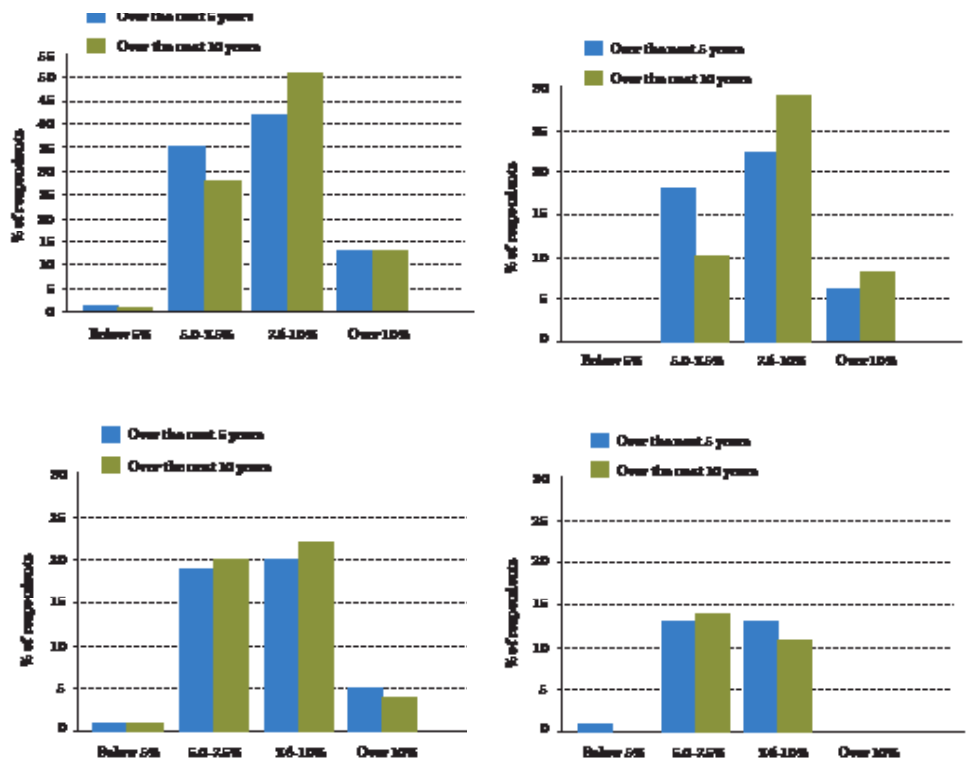
In the private sector, the new mark-to-market rules have played havoc with the sponsors' balance sheets, as the funding levels have dropped like a stone in the current crisis. Likewise in the public sector, the traditional aversion to risky asset classes has been reinforced. Either way, trustees are enjoined to buy what they understand and avoid fads as well as liquidity traps.

At the other end of the spectrum (north east segment), intermediaries are targeting relatively higher returns partly to compensate for an extra layer of fees; and partly to account for their clients' relatively shorter investment horizons.

Likewise, foundations, endowments, charities and family offices are also targeting marginally higher returns (south west segment) in pursuit of illiquidity premia, aided in part by the nature of their contractual obligations.

Returns expectations are consistent with a low real return environment

What is the annual return that you currently target on your asset portfolio?



Source: CREATE Research/Martin Currie survey 2009

These preferences are duly reflected in the investment choices that clients are likely to make over the next three years.

Bonds and equities occupy the top five slots out of a possible list of 22 asset classes, followed by alternatives, then by structured investments.

Back to basics is the new mantra. But, reports of the death of alternatives are exaggerated. They are still seen as ideal for taking advantage of the current volatility to deliver alpha in a low-return environment. However, some, like hedge funds and infrastructure, will need better liquidity and transparency before clients venture into them in numbers. Finally, complex structures – which may include derivatives – will be out of favour, unless they survive the stress tests based on extreme scenarios.

Against this background, the next generation

of mandates will go to fund managers who can deliver either consistent or uncorrelated absolute returns. Clients are chasing returns, not asset classes. They want better returns per unit of risk.

They also want their fund managers to become strategic partners who can understand, anticipate and articulate client needs; and who can offer solutions that also provide a better alignment of interest.

There is only limited appetite for performance-based fees, unless they come as a part of transparent strategies. But there is a huge appetite for a value-for-money fee structure, backed by a zero tolerance of mediocrity.

Amin Rajan is CEO of CREATE-Research and Willie Watts is CEO of Martin Currie

Identifying skill in fund management



Rick Di Mascio

Sound measurement can help trustees carry out informed monitoring and selection of managers, says **Rick Di Mascio** of Analytics

Two of the most important questions in fund management are one, whether skilful fund managers can be identified and two, if fund managers in general have skill. Here we cover some common sense measures of skill that go a long way to answering both.

Fund management, as with most things in life, is made up of a mixture of the good and the not so good; what is important is to understand the balance between them. To this end, we

describe three measurements of fund manager skill as the 'hit rate', the 'win-loss ratio' and the 'Analytics ratio'.

Firstly, let us focus on the hit rate, which represents the number of correct decisions as a percentage of the total number of decisions. Surprisingly, we have found that fund managers typically only get around 50% of their decisions right and that even 'good' managers only have hit rates of 51%.