HUB24

THE FUTURE OF MANAGED PORTFOLIOS

How technology is changing the way advisers deliver investment solutions - now and in the future

Adviser use only

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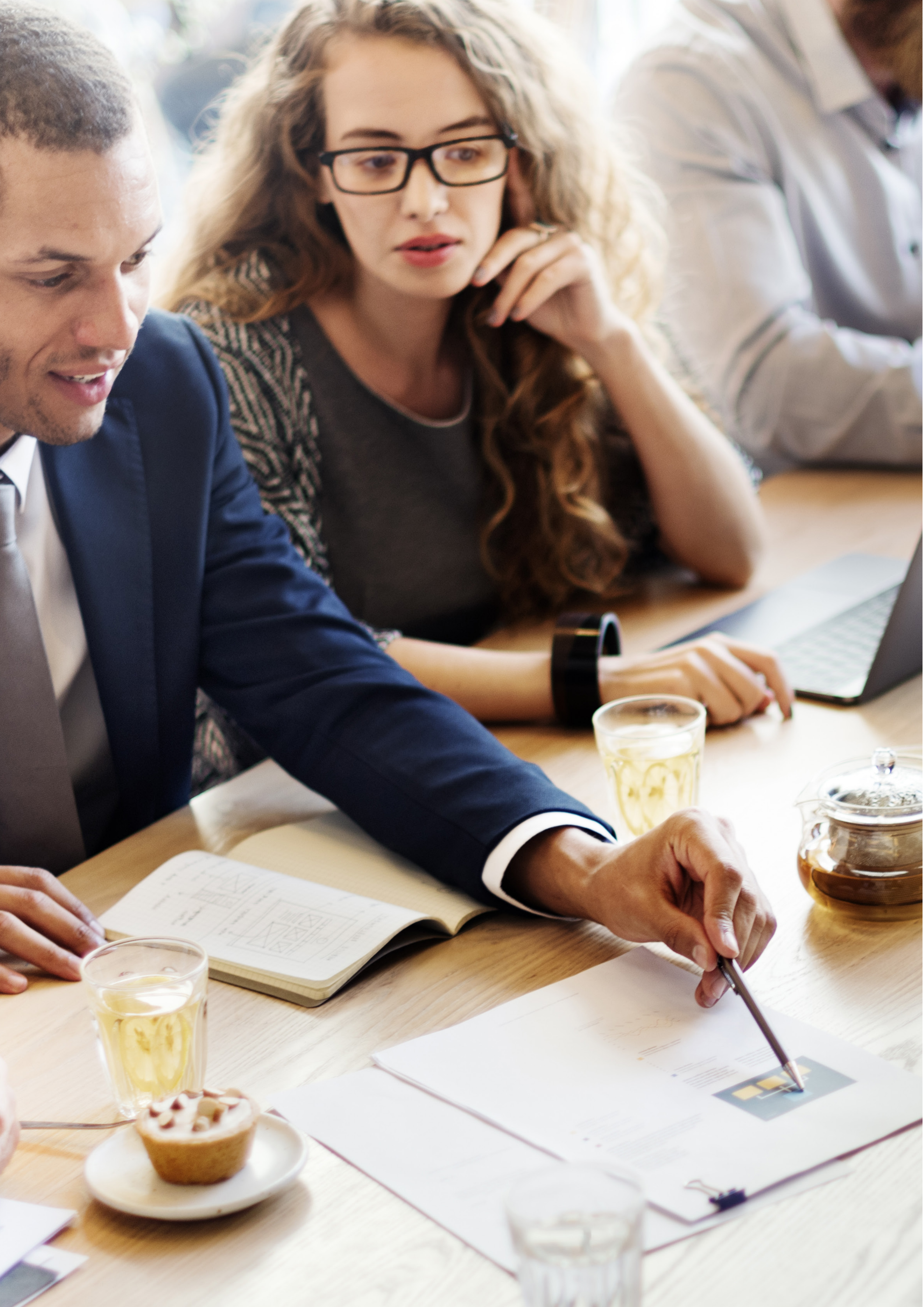


KEY POINTS

Keeping up to date with the latest developments in technology is a fulltime job in itself; it's important advisers understand the underlying technology when selecting a managed portfolio partner – technology that enables them to be adaptive and responsive to clients' needs.

Technology has already moved on considerably from the first iterations of managed portfolios. Now, providers allow a much higher degree of automated portfolio management, and new solutions and new services are being added consistently. Innovation is constant, and it won't stop.

The effectiveness of a managed portfolio today should be assessed not on the basic provision of investment choice or on transacting and reporting, but on a range of other factors and features provide better outcomes for clients and improve advisers' businesses.

The functionality and technology underpinning the platform is becoming interlinked with the skills and insights of the underlying investment managers, who are working increasingly closely with managed portfolio providers to collaborate and deliver technology that embeds asset management capabilities in the platform.

Technology will increasingly become a point of differentiation between managed portfolio providers. Providing a range of new opportunities for clients and advisers – including, but not only, opening up broader opportunity sets to investors, including offshore ETFs and currencies and the creation of multi-asset portfolios, and challenging the traditional models of offshore investing through ETFs and managed funds.

The market-leaders in the managed portfolio space already allow group and individual tilts (including stock exclusions) at the individual client level. These changes will allow for further customisation of portfolios without additional complexity, and more client-focused outcomes for investors and greater efficiencies for advisers in dealing with unique client requirements.

Managed portfolio providers will increasingly become big data partners to advice firms to drive and support client engagement, harnessing emerging AI and machine learning technologies to provide opportunities for clients.

Please note the terms 'managed portfolios' and 'managed accounts' are used interchangeably in this whitepaper.

INTRODUCTION

The significant benefits managed portfolios bring to the clients and advice businesses are well understood by financial planners. Managed portfolios have established themselves in less than a decade as vital weapons in the financial planner's armoury for delivering superior investment solutions to clients, and for improving business efficiency. This is just the beginning.

Today we stand on the cusp of a nothing less than a revolution in managed portfolio design and functionality, as technology develops to support the delivery of even more sophisticated and tailored solutions through mass-customisation and expanding opportunity sets, while at the same time continuing to deliver significant cost benefits and revenue opportunities for advice practices.

The Institute of Managed Accounts Professionals (IMAP) estimates that about $60 billion is invested via managed accounts but acknowledges this may understate the true figure. Even so, IMAP estimates that growth will run at about 40 per cent a year for at least the next two years, suggesting the managed account industry will grow to more than $115 billion by 2020.

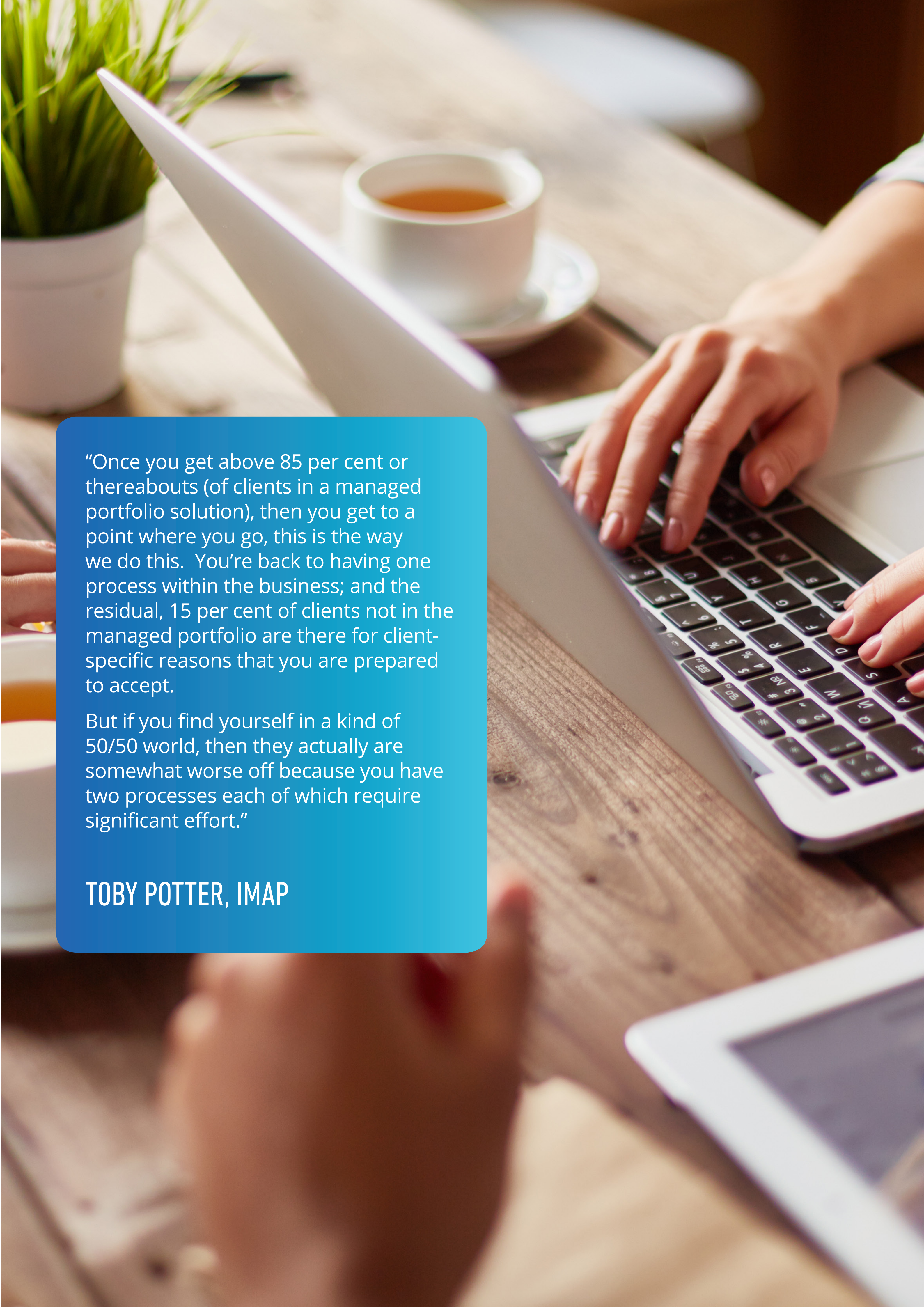
Managed portfolio providers are moving quickly to meet demand, refining offerings and allowing flexibility in design and construction previously available to only the very largest investors.

But while the efficiency benefits of managed portfolios for clients and advice businesses are now accepted, it remains a challenge to understand how technology will evolve to shape the offerings of the future.

Financial planners face some complex choices, but at the core of any decision to implement a managed portfolio solution is an understanding of how technology is being applied today, and how it may be applied in future, to support advisers and investment managers in delivering even more tailored, efficient services to clients.

This whitepaper is not concerned with the efficiency or implementation aspects of managed accounts; instead it examines how technology is revolutionising the way advisers can design and implement investment solutions for clients, and what they need to be considering as technology continues to advance rapidly.

Making the mistake of thinking all managed portfolio solutions are equal could see advisers backing the wrong horse in the technology race – could have significant implications for an advice business and its clients further down the track. The prevailing view that platforms are commodity is now being challenged by innovation.



"Once you get above 85 per cent or thereabouts (of clients in a managed portfolio solution), then you get to a point where you go, this is the way we do this. You're back to having one process within the business; and the residual, 15 per cent of clients not in the managed portfolio are there for client-specific reasons that you are prepared to accept.

But if you find yourself in a kind of 50/50 world, then they actually are somewhat worse off because you have two processes each of which require significant effort."

TOBY POTTER, IMAP

1. KEEPING UP WITH TECHNOLOGY: LOOKING FOR THE RIGHT SOLUTION

Keeping up to date with the latest developments in technology is a fulltime job in itself, its important advisers understand the underlying technology when selecting a managed portfolio partner – technology that enables them to be adaptive and responsive to clients' needs.

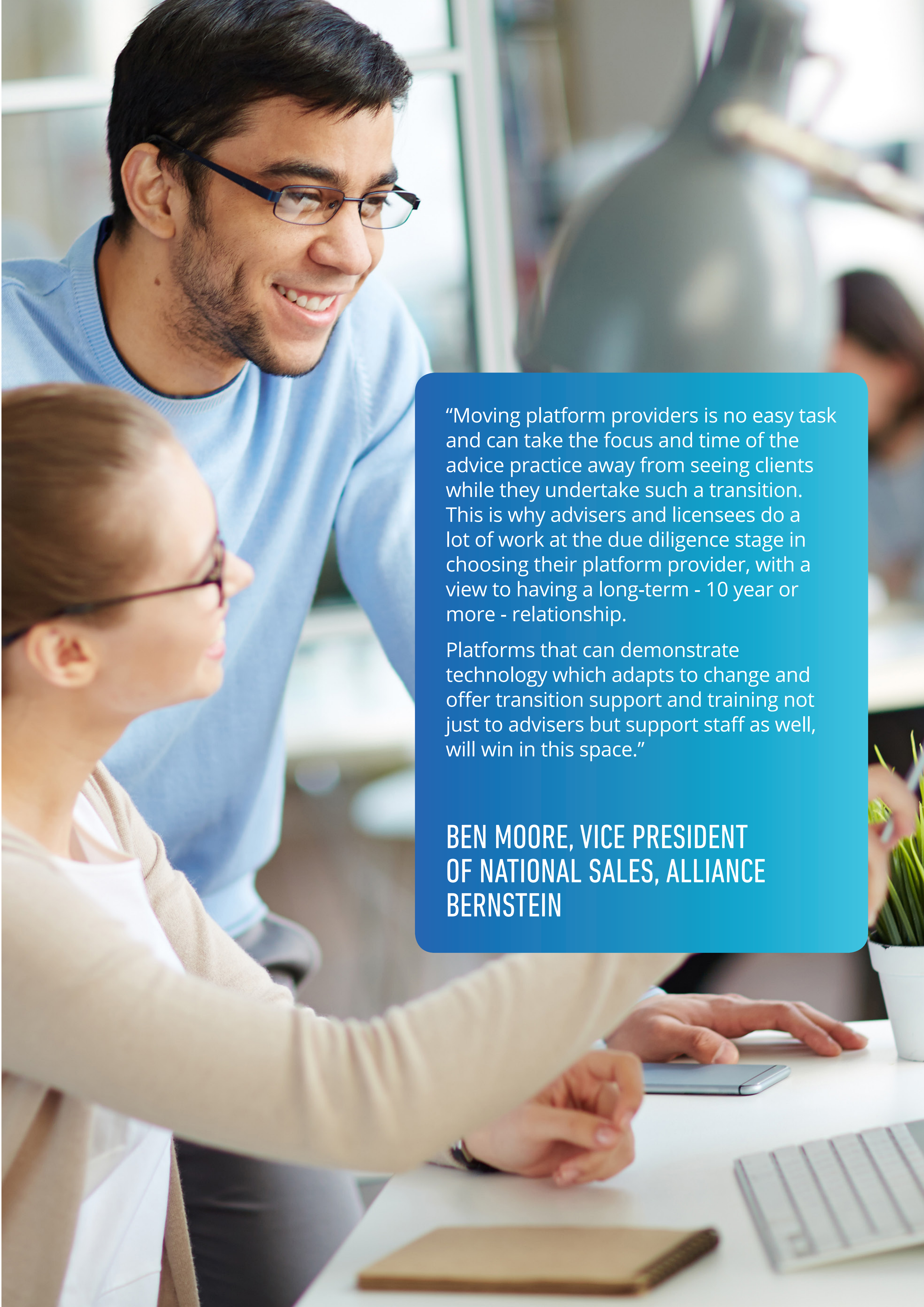
The establishment of specialised managed portfolio providers during the past decade has spurred competition and been a primary driver of improved user experience across the sector.

The adoption of adaptable technology has underpinned this increased competition to produce better outcomes for clients and advisers alike. But technology is advancing rapidly, and a solution designed and implemented today can quickly go out of date, becoming an impediment to achieving a client's long-term objectives.

Advisers need to have confidence the managed portfolio provider they partner with is committed to investing for the long term. An adviser's relationship with a client may conceivably last several decades, and advisers need to know a managed portfolio provider is committed to investing in the systems and technologies needed to ensure their offering remains efficient and constantly focused on improving client outcomes.

Whilst the choice of provider depends on satisfying specific client best interests, all things being equal the risks of choosing a provider that does not have a broad offer and enhanced functionality can result in an advice business having to move clients, reducing business efficiency and delivering substandard outcomes for some, not to mention and the disruption caused if forced to move clients from one platform to another, and the possible CGT consequences for those clients.

While the number of players in the managed portfolios space may proliferate in coming years, not all will be created equal, and many offers have only the basic functionality available. Those that prosper, and support advisers and their clients best will be those with a proven technology track record, a proven ability to remain responsive to clients' and advisers' needs, and a constant drive to deliver new features and solutions.



"Moving platform providers is no easy task and can take the focus and time of the advice practice away from seeing clients while they undertake such a transition. This is why advisers and licensees do a lot of work at the due diligence stage in choosing their platform provider, with a view to having a long-term - 10 year or more - relationship.

Platforms that can demonstrate technology which adapts to change and offer transition support and training not just to advisers but support staff as well, will win in this space."

BEN MOORE, VICE PRESIDENT OF NATIONAL SALES, ALLIANCE BERNSTEIN

2. LEAPS AND BOUNDS: PUTTING YESTERDAY'S SOLUTIONS IN THE SHADE

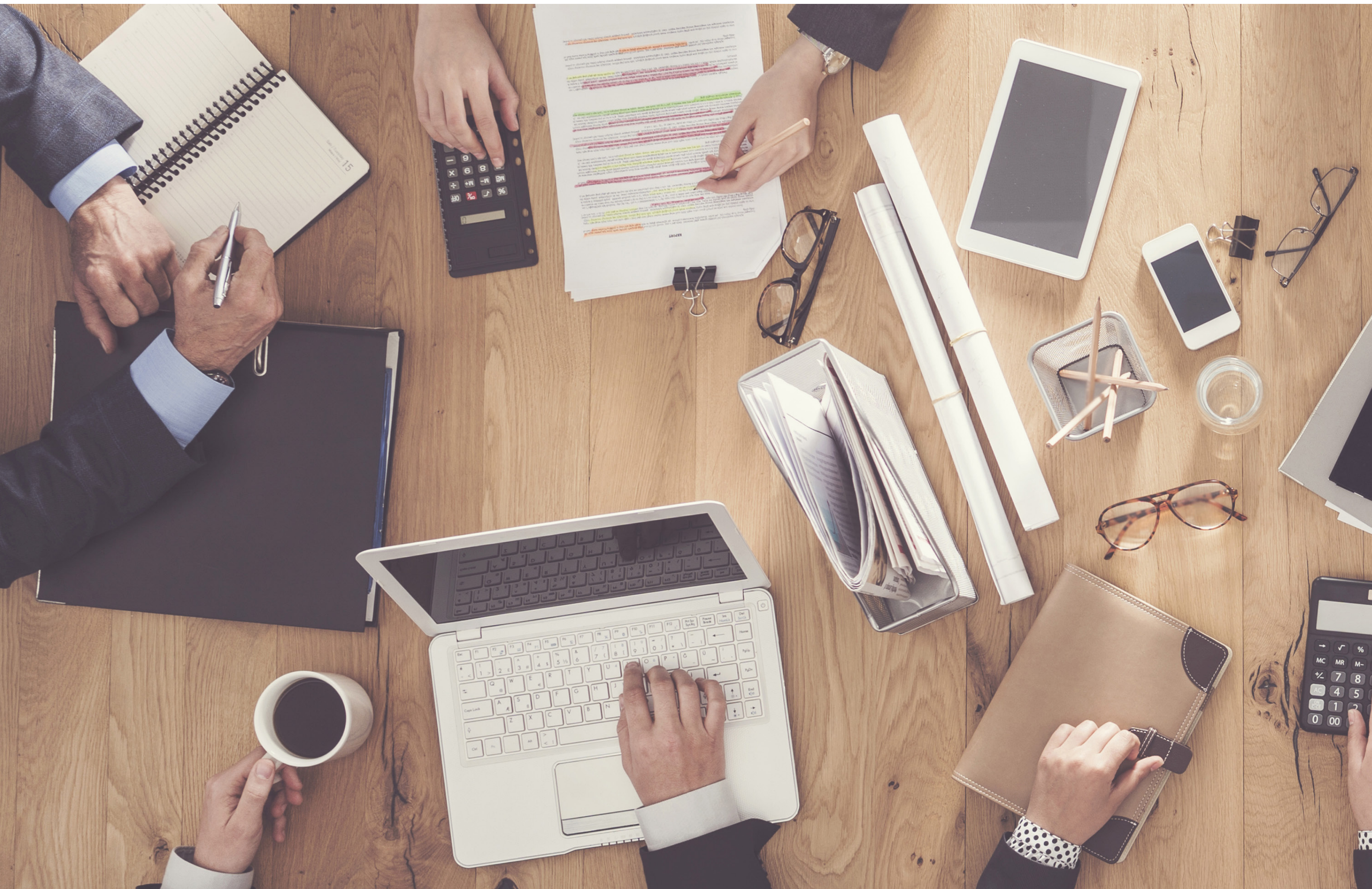
Technology has already moved on considerably from the first iterations of managed portfolios. Now, providers allow a much higher degree of automated portfolio management, and new solutions and new services are being added consistently. Innovation is constant, and it won't stop.

The early iterations of master trusts and wraps delivered solutions to advisers and clients unlike any seen before. But the pace of change and improvement in technology means those initial offerings have often struggled to remain relevant and to match the efficiency of newcomers to the market – and just keeping up to date has often involved the investment of tens or hundreds of millions of dollars.

In some respects, the solutions offered by the first wave of platforms now look quite quaint, but ongoing and relentless improvements mean that managed portfolios have unquestionably become a core part of an adviser's tool set.

The technology underpinning the current crop of managed portfolio offerings is industrialising the provision of robust, flexible, and tailored investment solutions by advisers to clients, whilst leveraging beneficial ownership to achieve tax benefits and simultaneously reducing costs. Innovation in features and services is only increasing as platforms become more technically capable.

Improvements in platform technology create some additional issues for advisers: if solutions exist that enable them to customise portfolios and deliver highly personalised investment solutions to clients, with the ultimate aim of delivering better investment outcomes, then those benefits must



not be stymied through related investment issues such as implementation leakage, and by other advice practice inefficiencies.

Fortunately, the latest thinking by the market-leaders in managed portfolio implementation is addressing these issues, offering solutions to enable advisers to execute transactions and rebalance portfolios efficiently, and to harness the insights and big-data analytical potential of platform providers to engage more efficiently and constructively with clients.

> 'You want to be partnering with a provider that is committed to continuing to invest in technology that will provide better outcomes for clients.
>
> Putting a shingle up and saying "we've got managed accounts" is not enough, there's a lot more you need to look at behind that, including the actual functionality and plans for its future'
>
> **JASON ENTWISTLE, DIRECTOR STRATEGIC DEVELOPMENT, HUB24**

3. REASSESSING MANAGED PORTFOLIO OFFERINGS

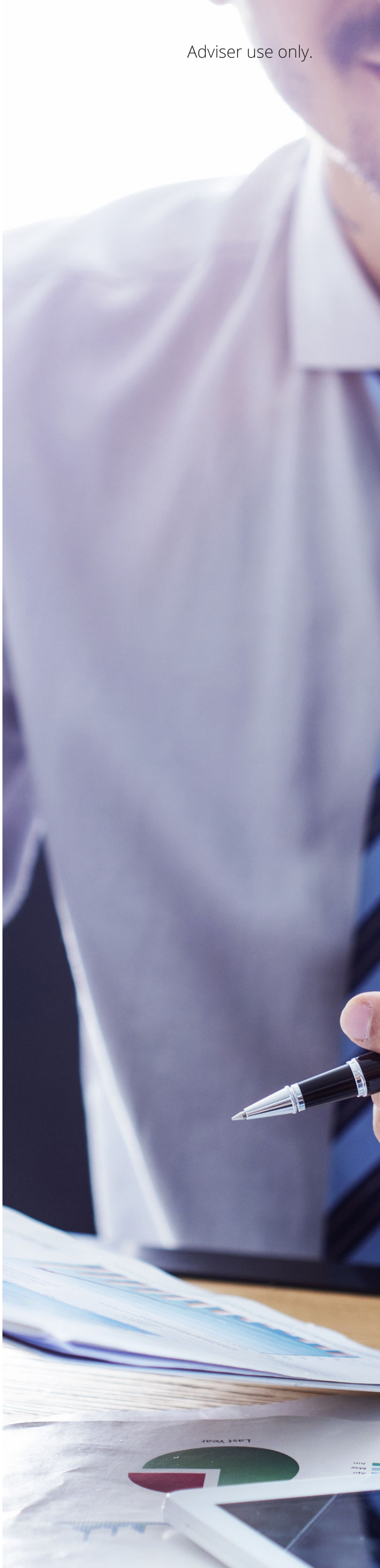
The effectiveness of a managed portfolio today should be assessed not on the basic provision of investment choice or on transacting and reporting, but on a range of other factors and features provide better outcomes for clients and improve advisers' businesses.

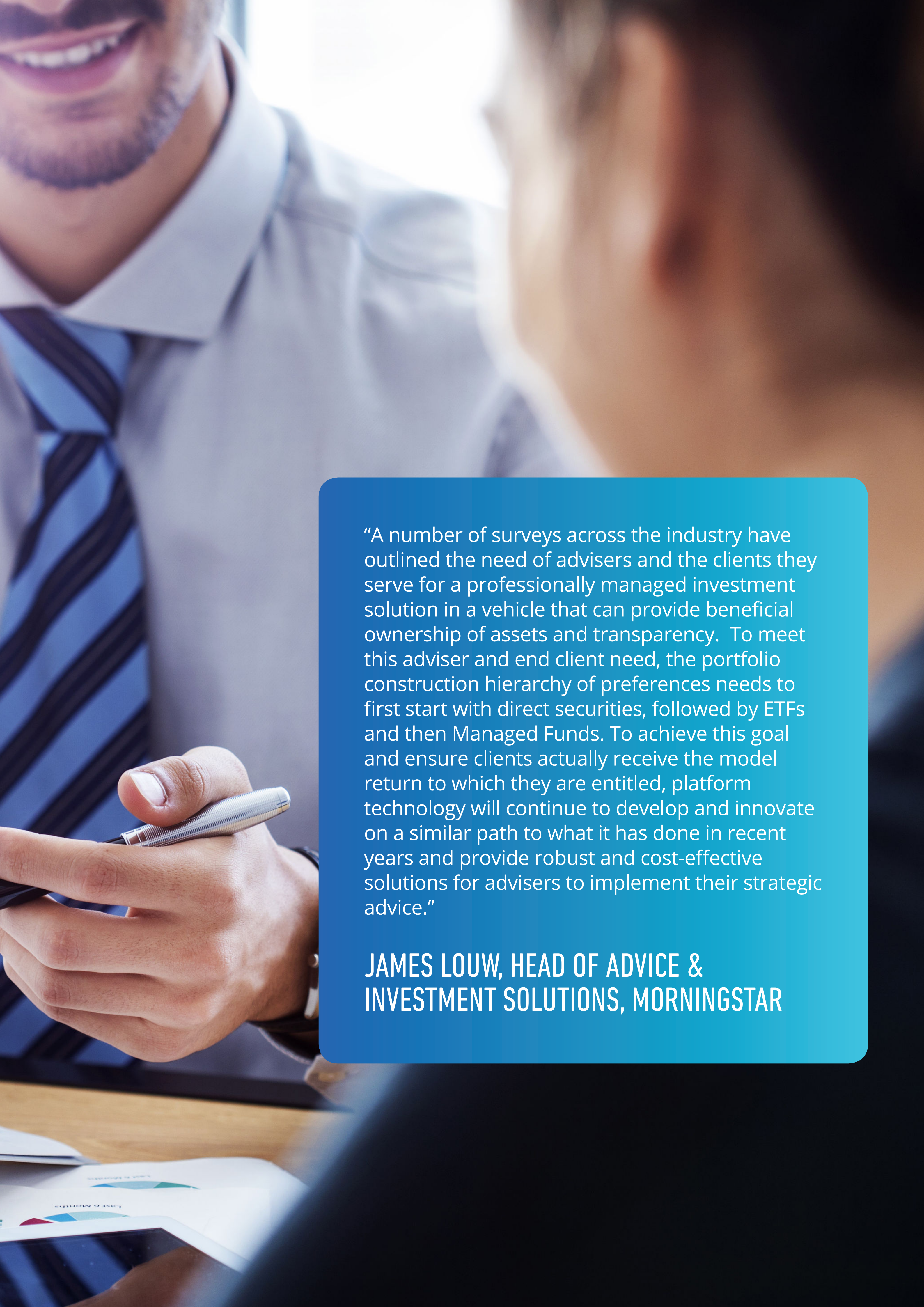
The traditional value proposition of a platform provider has been more choice, efficiency and lower cost. But it's sometimes easy to confuse choice with customisation. Choice is a necessary but insufficient factor; true customisation is only possible when technology enables a bespoke approach to portfolio construction.

Making an individual client's portfolio "tax-aware" is one possibility enabled by technology. In this scenario, for example, a decision by a portfolio manager to buy or sell a particular security will be executed or not on a case-by-case basis, according to whether the transaction will leave an individual client better off or worse off from an after-tax perspective.

The possible long-term benefits to a client of managing investments tax-effectively can outweigh the benefits of a few basis points of extra investment performance from constantly chasing better investment returns from the multitude of investment choices available (and also mitigates the risk of choosing the wrong ones). It may support client best interests to select a provider based on value which comes from the underlying functionality rather than just price.

The basic factors of ease of transacting and timely and accurate reporting are no less important to the implementation of efficient investment solutions than they were a decade ago, but advances in technology mean managed account offerings need today to be assessed on a wider range of factors, including customer service.





"A number of surveys across the industry have outlined the need of advisers and the clients they serve for a professionally managed investment solution in a vehicle that can provide beneficial ownership of assets and transparency. To meet this adviser and end client need, the portfolio construction hierarchy of preferences needs to first start with direct securities, followed by ETFs and then Managed Funds. To achieve this goal and ensure clients actually receive the model return to which they are entitled, platform technology will continue to develop and innovate on a similar path to what it has done in recent years and provide robust and cost-effective solutions for advisers to implement their strategic advice."

JAMES LOUW, HEAD OF ADVICE & INVESTMENT SOLUTIONS, MORNINGSTAR

4. COLLABORATING WITH INVESTMENT MANAGERS

The functionality and technology underpinning the platform is becoming interlinked with the skills and insights of the underlying investment managers, who are working increasingly closely with managed portfolio providers to collaborate and deliver technology that embeds asset management capabilities in the platform.

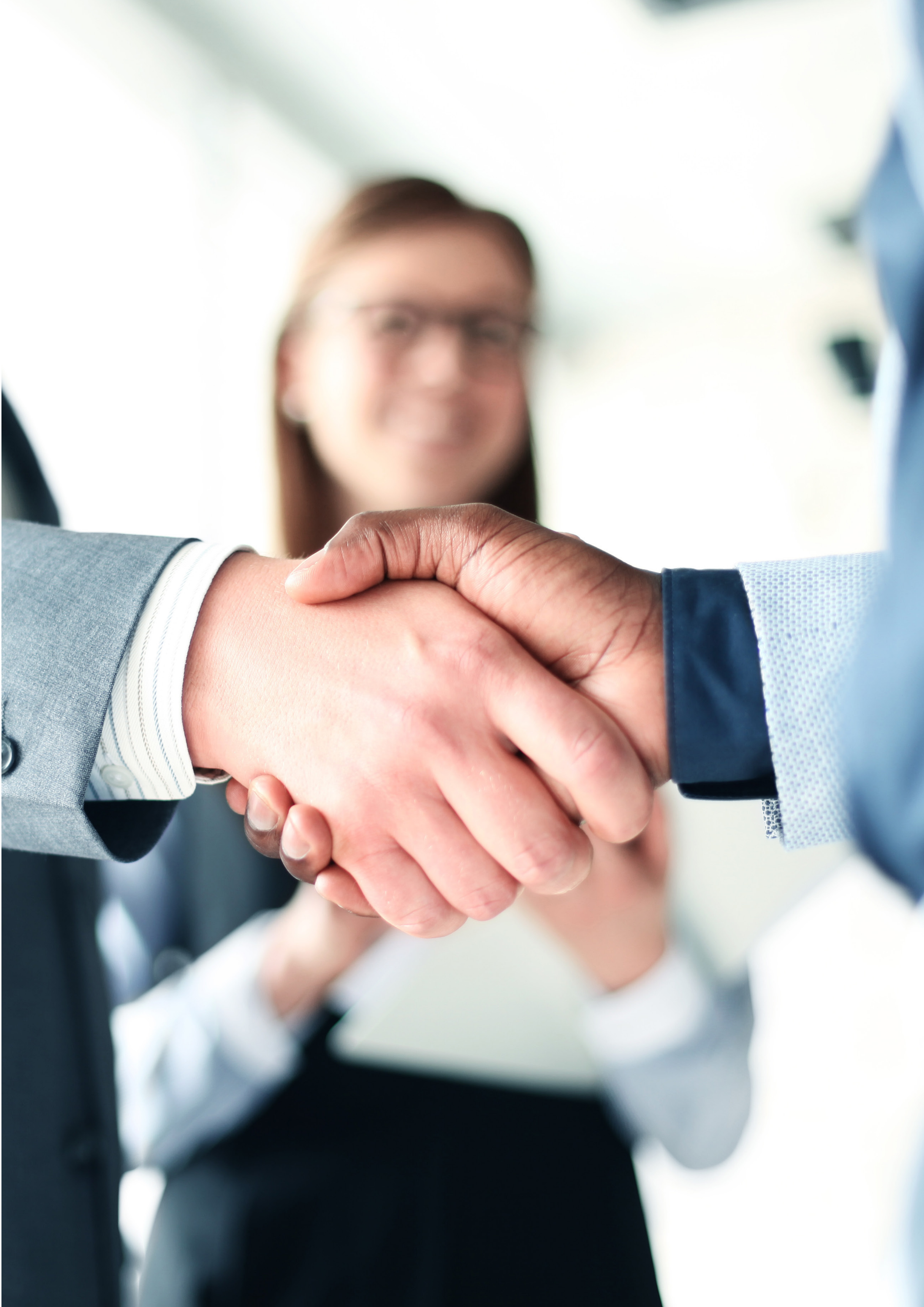
Australia is exceptionally well-serviced by many of the largest, most sophisticated and innovative asset management firms in the world. The rise of managed portfolios as a vehicle for delivering investment solutions to clients is enabling advisers to tap into those managers' expertise and capacity to innovate.

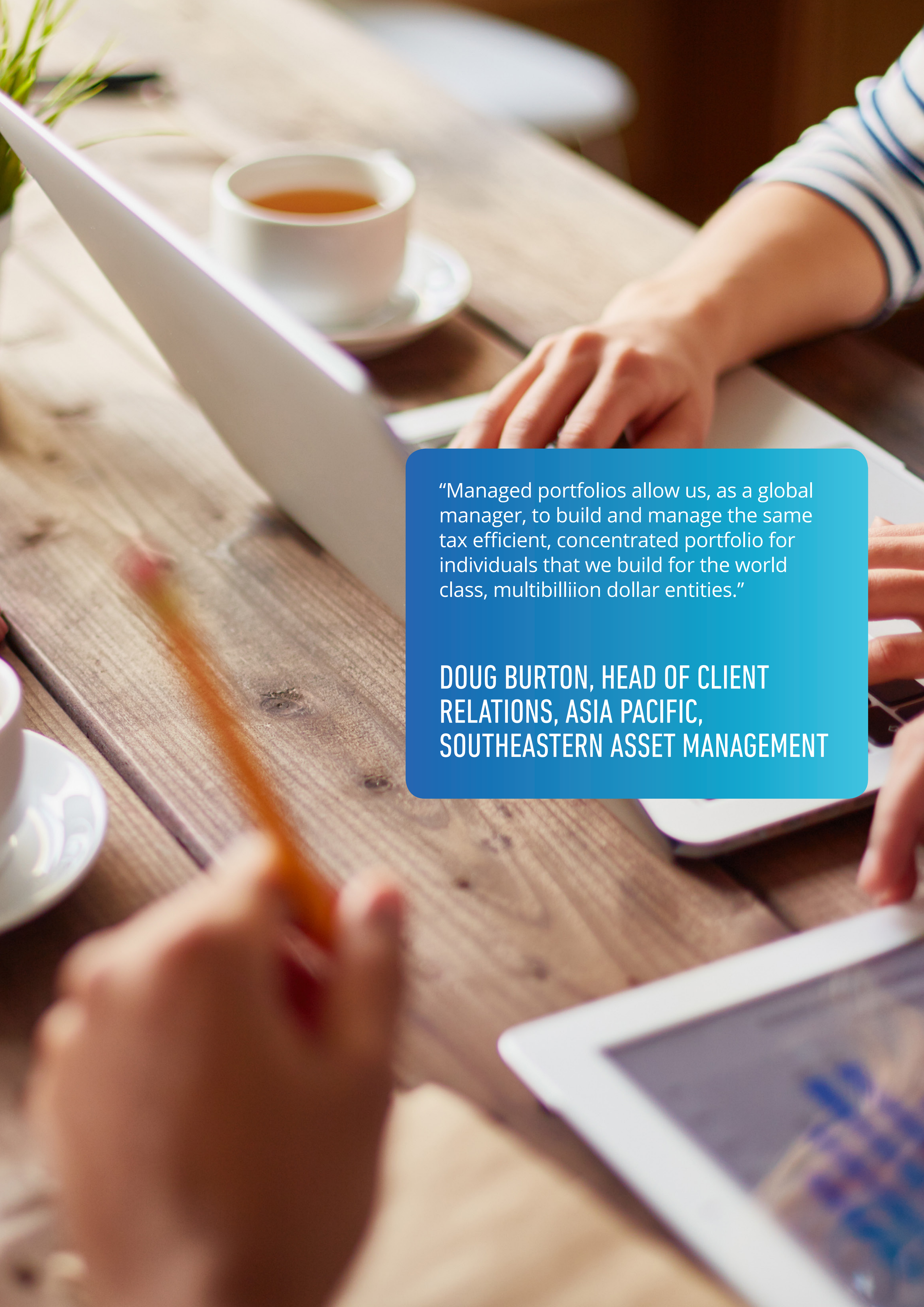
An adviser who chooses to take on the responsibility for creating investment solutions for clients, will therefore required to take on more and more of the characteristics of professional portfolio manager – or to hire-in that expertise in the guise of asset consultants, or from fund managers directly.

If the ultimate aim of investing a client's money is to achieve the best return for a given level of investment risk, then it stands to reason that sophisticated analysis of the risk inherent in a client's portfolio is integral to achieving that outcome. A growing number of fund management firms are offering portfolio analysis services through managed portfolio providers to help advisers create the best risk-adjusted portfolios for clients that they can.

These are the kinds of services that are only possible where technology is brought to bear successfully to allow complete transparency of portfolio holdings, appreciation of the client's current tax position, and the ability to fine-tune and adjust a portfolio to achieve an optimal outcome. Advisers creating their own portfolios combining several investment managers also benefit from the underlying platform technology when implementing their investment strategy.

In markets such as the US and Europe, large asset management firms are routinely providing risk-return optimisation services to advice firms to implement in portfolio construction for clients - and those services are coming to the Australian market as managed portfolio solutions continue to gain traction.





"Managed portfolios allow us, as a global manager, to build and manage the same tax efficient, concentrated portfolio for individuals that we build for the world class, multibilliion dollar entities."

DOUG BURTON, HEAD OF CLIENT RELATIONS, ASIA PACIFIC, SOUTHEASTERN ASSET MANAGEMENT

5. BROADENING THE OPPORTUNITY SET

Technology will increasingly become a point of differentiation between managed portfolio providers. Providing a range of new opportunities for clients and advisers – including, but not only, opening up broader opportunity sets to investors, including offshore ETFs and currencies and the creation of multi-asset portfolios, and challenging the traditional models of offshore investing through ETFs and managed funds.

The range and depth of investments available to clients through managed portfolios will increase as technology is developed to enable timely and efficient trading in offshore securities and in foreign currencies. It will also enable advisers to create deeper and more efficient portfolios spanning multiple asset classes and countries, and a wider range of securities, including derivatives.

The advantages of accessing foreign markets are significant: exchange-traded funds (ETFs), for example, are available at a fraction of the cost of similar products in the Australian market, and tracking indexes simply not available locally.

But as technology enables even finer control of a client's assets, the more advanced managed portfolio providers will introduce innovations like "unbundled" ETFs, in much the same way that they have already "unbundled" managed funds by allowing investors to have direct beneficial ownership in the same underlying securities – with all the recognised tax benefits that arise from the direct-ownership structure compared to a pooled portfolio approach

As an innovation based on technology, an "unbundled ETF" tracks the same market indexes as standard ETFs but mitigates some of the perceived liquidity risk. An investor holds a basket of the same stocks as the ETF, but avoids the issues faced by investors in a listed ETF if the ETF price drops for liquidity reasons rather than because of a fall in the value of the fund's underlying securities. There is a risk when purchasing ETFs that in a severe market correct an investor may not be able to sell quickly and hence leave themselves exposed, by replicating an ETF as a managed portfolio with individual stocks this risk is somewhat mitigated.

Developments in managed portfolio functionality has evolved the types of portfolios that can be implemented as managed accounts. The most notable trend has been the growth in multi-asset portfolios. This has been coupled wit the expansion of the underlying investment vehicles model managers can use to construct portfolios, which has resulted in many managed portfolios incorporating a mix of assets including ETFs, SMAs, LICs and managed funds.

6. CUSTOMISATION OF CLIENT PORTFOLIOS

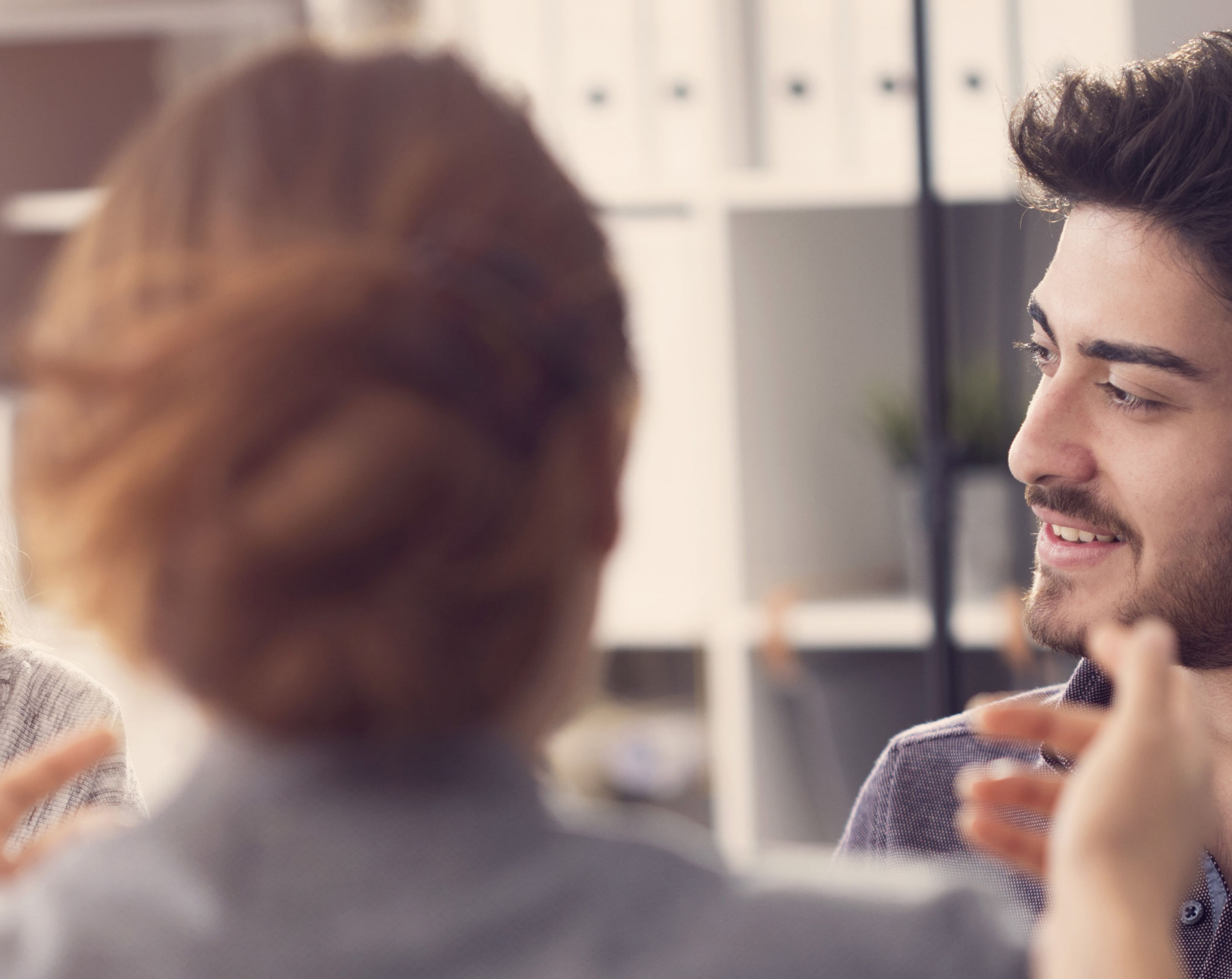
The market-leaders in the managed portfolio space already allow group and individual tilts (including stock exclusions) at the individual client level. These changes will allow for further customisation of portfolios without additional complexity, and more client-focused outcomes for investors and greater efficiencies for advisers in dealing with unique client requirements.

Not all clients are the same and not all of them view investing the same way. The technology underpinning contemporary managed accounts will allow far greater flexibility and tailoring of portfolios to an individual investors' preference. Mass customisation is one of the next big technology-enabled developments in managed portfolios, with advisers able to customise portfolios to exclude specific market sectors, or even specific stocks, according to clients' instructions, whilst getting the benefit of the investment managers' intellectual property.

Technology advances will provide far greater flexibility, and therefore superior client outcomes, in model portfolio implementation. For example, instead of a client buying into a fully valued security in a model portfolio, the managed account will facilitate a deviation from the model to allow the client to buy an alternative security. Then, if the valuation, timing and tax factors are right at a later date, the client can transition to the model portfolio holding. Or, if those factors cannot be satisfied, the client can continue to hold a slightly modified version of the model portfolio.

A "one-size-fits-all" approach – even in model portfolios – will be a thing of the past, and the client's ultimate investment outcome won't necessarily be compromised by quirks of timing and buying fully-valued securities.

At the same time, the further customisation of portfolios and bespoke implementation mayu support advisers in satisfying their best interests' duty. In fact, technology may challenge the best interests' paradigm so that product choice moves beyond simple factors such as price and manager selection.



"Technology has been transforming and democratising financial services globally. Too often, retail investors get left behind when it comes to accessing the most cutting edge technologies and investment strategies. Technology is changing that by providing managers with the supervisory capabilities to navigate an evolving regulatory environment, and empowering advisors with institutional quality risk analytics and modelling tools to better meet client needs. Digital advice is not just a millennial phenomenon - good technology finds its way into the hands of all different generations."

KATHRYN BARNES, HEAD OF DIGITAL STRATEGY, BLACKROCK AUSTRALIA

7. MAKING SENSE OF THE DATA

Artificial intelligence and machine learning will increasingly inform the decision-making processes of fund managers and financial advisers alike, ultimately improving investment outcomes for clients. Managed portfolio providers will be a vital conduit in the analysis of data.

The application of artificial intelligence (AI) and machine learning capabilities are already revolutionising industries across the globe. Managed portfolios are ideally positioned in the intersection between clients, advisers, fund managers and capital markets to deploy AI and machine learning to capture and analyse data to improve client investment outcomes, and, just as significantly, to enhance engagement between advisers and clients.

The application of AI is in its infancy in the managed portfolio sector, but its potential is immense. However, employing AI effectively will require an explicit commitment by providers to invest the time and money to make it work effectively. Not all providers will be willing or able to make the commitment.

In a 2017 report[1] IBM estimated that every day 2.5 quintillion bytes of data is produced, and that 90 per cent of the data in the world had been created in the previous two years alone. AI and machine learning are helping to find meaning and insights in that vast pool of data and turn it into useful actions.

For example, it helps fund managers to monitor the rate of new construction in China, or to analyse foot traffic through a retailer's doors, or to monitor the tone and use of language in chatrooms and in online reviews to identify trends in consumer sentiment[2].

They are already integrating machine learning and natural language processing to make better investment decisions and improve investment performance[3].

While the potential is immense, the application of AI is in the early stages will lead to gradual gains and efficiencies, rather than quantum improvements. But new technology promises to be the catalyst for a whole new technological revolution in how advisers, fund managers and managed account providers work together in future.

It will see the relationship shift from being one based on investment implementation and efficiency, to a more broadly encompassing relationship, in which a managed account provider becomes a genuine partner with advisers in supporting business efficiency and identifying potential areas of improving client outcomes.

1. Source: https://public.dhe.ibm.com/common/ssi/ecm/wr/en/wrl12345usen/watson-customer-engagement-watson-marketing-wr-other-papers-and-reports-wrl12345usen-20170719.pdf

2. Source: https://www.blackrockblog.com/2018/03/08/artificial-intelligence-blackrock/?cid=synd:SA:artificial_intelligence_BlackRock

3. Source: https://www.blackrock.com/au/individual/insights/artificial-intelligence-an-evolution-or-a-revolution

"Platforms hold vast amounts of data which can be used to help advisers deliver better, more targeted services. We see ourselves as custodians of this data and want to create tools to help advisers to deliver better outcomes for themselves and their clients."

JASON ENTWISTLE, DIRECTOR STRATEGIC DEVELOPMENT, HUB24

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The content of this white paper is derived from a series of in-depth interviews, each lasting between 35 and 50 minutes, with a range of key players in the Australian investment management and managed portfolio industries. This paper has been written by CoreData including feedback from HUB24. Portfolio managers interviewed manage portfolios on HUB24.

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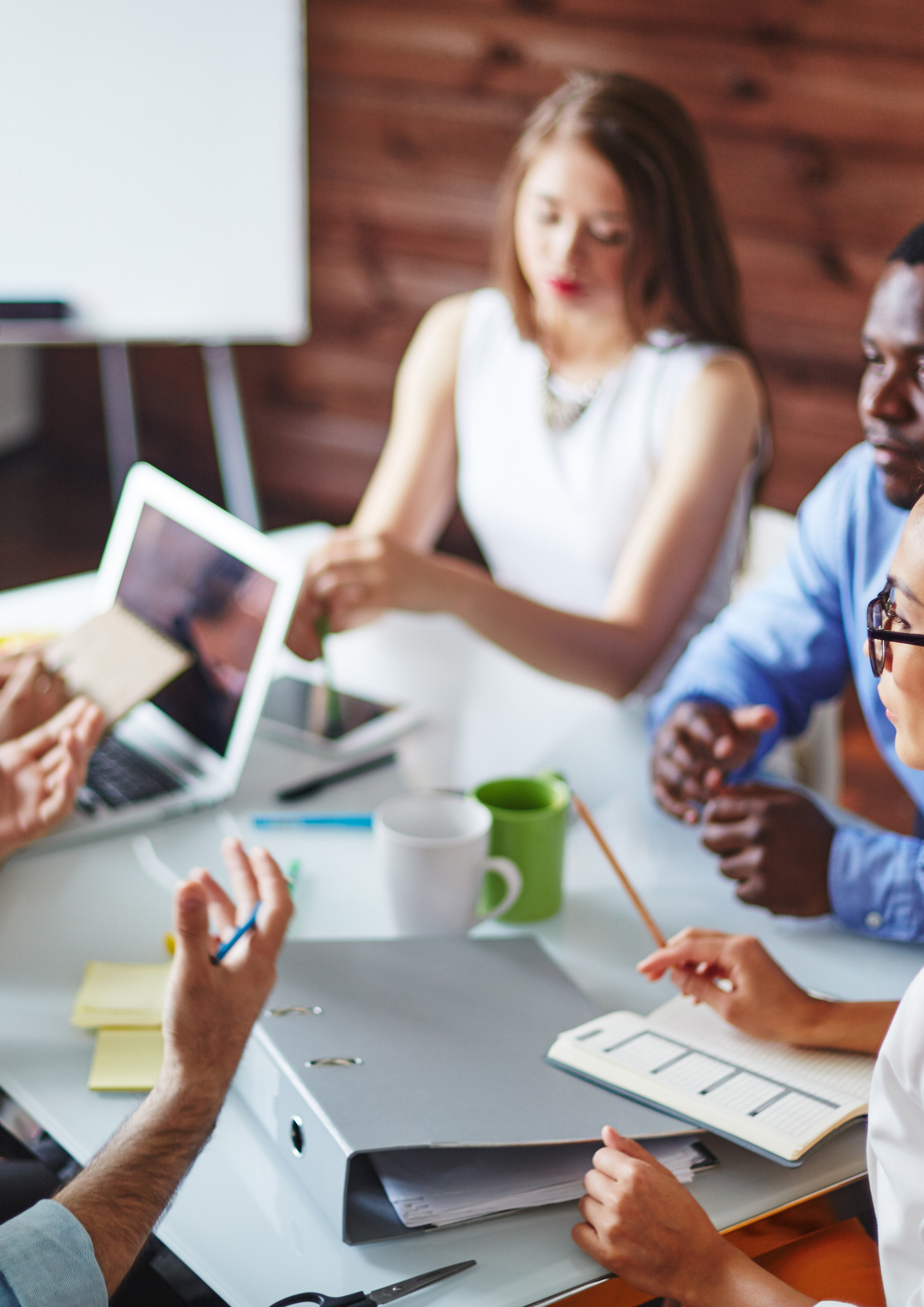

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