COVID-19 Has Woken Asset Managers and Owners Up to the Possibilities of Outsourced Trading

By: Michele Hardeman, head of State Street Global Markets, Asia Pacific

May 2020

COVID-19 has been a black swan event in the truest sense of the phrase. The sudden emergence of the virus in early 2020 has slammed the brakes on huge swathes of the global economy and resulted in violent market swings that have effectively and unexpectedly ended the world's longest bull run.

It is in times like this that asset management is needed more than ever and yet, like much of the economy, the industry has also been brought to a halt. The forced closure of offices and imposition of work-from-home arrangements have significantly constrained the operations and capabilities of asset owners and managers. With Asia now overcoming the worst of the coronavirus outbreak and entering the second phase of this crisis, asset owners and managers are now reviewing the resilience of their operations to sudden shocks and forced closures, and revising their business continuity plans to better handle future crises.

A part of the conversation has been the outsourcing of trading, which allows asset owners/managers that may not have a sufficient business continuity plan or work-from-home technology to continue making important investment decisions and trade, even when crucial staff, systems and locations have become suddenly unavailable. The dramatic impact that coronavirus has had on markets has served as a wakeup call that a fully functioning back-up platform is needed when crisis hits. This means that asset managers and owners in the region will be looking to include this option in any robust future business continuity plan.

The onset of COVID-19 feeds into, and gives new relevance to, what has already been a growing trend of outsourcing trading activities. In the last decade, asset managers around the world have been facing existential fee pressures from increased competition and the structural shift into index investing. The current low-yield environment and the costs associated with growing regulations adds more cost pressures to asset managers as well as asset owners. This has created a need to be laser-focused on the areas where they can truly add value for clients as well as where it makes sense to cut costs. Outsourced trading has enabled them to reduce costs, focus on their core portfolio construction mission, and get access to the scale and diverse sources of liquidity of a larger trading operation. They are the architects who design what they want and their engineers, i.e. outsourced trading partners, execute on it as an extension of their teams.

In Asia Pacific, the issue facing asset owners is twofold. First has been the rapid growth in their scale, which is allowing them to increasingly take investment management in house. Yet many of them do not have adequate investment management infrastructure or experience with that infrastructure. Outsourced trading has thus allowed them to focus on investment strategies rather than execution.

Second, after years of being predominately focused on domestic markets, asset owners in the region – particularly those in Korea and Japan – are looking to allocate more assets internationally. However, this presents the dilemma of where to locate execution staff – do they locate them purely in the region or have additional desks outside of Asia? Both come with significant costs and logistical challenges. The 24/7 trading operations would be highly expensive, not to mention the expense of keeping up with highly complex regulations and technological advances. All these have made them think more seriously about outsourcing their trading infrastructure to global providers with state-of-the-art technology and experience. Asset managers in the region – particularly start-up and domestic managers – also face the same issue. They are expanding into new geographies or new asset classes to generate additional return. They need to adopt some form of outsourced or co-sourced trading to have a complete trading desk.

Against this backdrop, there will be increased urgency once the dust settles for owners and managers to be even more focused on their workflow and cost structure. Outsourcing implementation functions that are non-core to investment management, such as trading, will be an important part of a robust business continuity plan and ensuring long-term viability. This will, however, likely need to extend beyond simple front-office execution of trades to cover the whole lifecycle of a trade, including post-trade settlement and a full suite of reporting and trade analysis. The ability to integrate the front-, middle and back-office operations is critical as it provides not only a single source of data but also real-time views on investable cash, unpledged collateral and securities available for lending. It will help the front office to make investment decisions more confidently and quickly, and ultimately generate more alpha.

COVID-19 has accelerated the process of outsourcing for investors of all sizes. As the industry emerges from this crisis, the question of outsourcing certain components of the investment management process will become more acute as firms look to strengthen their business resiliency and reduce costs incurred during the forced lockdown. This will likely open the eyes of asset owners and managers to the wider benefits of focusing on the more strategic aspects of investment management.

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State Street Corporation
One Lincoln Street, Boston, MA 02111

3095564.1.1.GBL.RTL
Expiration Date: 4/30/2021