

Going Modular

Why Outsourced Trading Is No
Longer an All-or-Nothing Option



STATE STREET®

Damian Hoult from State Street Global Markets LLC's Outsourced Trading Distribution and Product Development team explains how outsourced trading solutions are gaining traction among fund managers across all asset classes.

Outsourcing trading execution used to be a binary decision. Fund managers either concentrated entirely on asset allocation and strategy and handed over all trading to a third party, or they built an in-house trading desk to handle all their liquidity requirements and potentially create an extra avenue for alpha.

But asset owners and managers are becoming more receptive to a modular approach as technology advances expand execution capability and regulatory burdens increase execution costs. **In Bloomberg's 2022 US Institutional Equity Trading Study**, 20 percent of participants said they have plans to implement some form of outsource trading in the next two years.

Here, State Street's Damian Hoult tells us why this shift is happening.



DAMIAN HOULT

State Street Global Markets

What are the main benefits of an outsourced trading solution over in-house execution?

Outsourced trading should not be seen as an alternative, but as a partner offering a broad spectrum of products and services for fund managers to choose from. A fund manager considering outsourcing should first assess the needs of their portfolio and whether they can carry out cost-effective execution.

If there are areas where that is lacking, outsourcing to a global third-party platform can fill those gaps and create the optimal trading model. The Bloomberg survey showed, for instance, that traders are more willing to outsource specific markets, asset classes and account types—rather than the whole trading desk. And that quantitative asset managers and hedge funds are more open to this than more traditional fundamental funds.

In practice, we're seeing different parts of the industry embrace outsourcing for a variety of reasons. There are the funds that are just launching and may not have the scale to justify building an internal trading desk; managers

that are expanding into new areas and lack the necessary expertise; smaller-sized firms with one-off events such as managing an unusually large cash flow; and hedge fund managers that want to take advantage of a short-term opportunity in a new market, where setting up internally would take too long.

These scenarios often involve complying with constantly changing regulatory environments across the globe, and this requires a significant investment in both people and technology. In some markets, the risk of breaching regulations can be catastrophic, so being able to outsource this risk alone can be invaluable. And using an outsourced trading desk provides the benefit of instant access to global teams that have local regulatory and compliance expertise.

“We're seeing different parts of the industry embrace outsourcing for a variety of reasons. There are the funds that are just launching and may not have the scale to justify building an internal trading desk.”

Fund managers always need to be on top of costs that can eat into their performance. How does outsourcing help?

For many hedge fund managers, the cost of building desks to access global markets from a single hub or moving into other asset classes can be prohibitive.

Some of the bigger outsourced trading desks can offer multi-asset class trading, which enables fund managers to tap into trading expertise within a specific asset class without needing to build their own trading capability.

And for the more opportunistic hedge funds, outsourcing also provides the economy of a variable — rather than fixed — cost structure, which can be scaled up or down depending on

level of utilization. A trading solution is available whenever you need it, but unlike building an internal capability there is no cost when you don't use it.

On the regulatory side, where compliance costs are steadily rising, transaction cost analysis (TCA) has become an integral part of the investment process for asset managers and owners. Some outsourced trading businesses have invested heavily in market-leading bespoke analytics products to measure and identify trading costs. Outsourced trading desks with an unconflicted agency model will always direct flow where liquidity is available, which gives clients “best execution” outcomes.

What has Covid-19 taught fund managers about their trading set-up?

Through the Covid-19 pandemic firms learned that not all traders need to work in the same location as their team members. Once you accept the idea of not needing all your asset managers and traders to be in one place, outsourcing some of your trading to a better-suited location is a much smaller step.

Another discovery was the flexibility in almost everyone's business contingency plans (BCPs). BCPs were based on the premise of providing

a separate workspace if the primary location is not functional or available, but they never accounted for the possibility that personnel may need to be in various separate locations.

So, in the same way that cloud technology has made computer access portable, outsourcing ensures trading continuity when access to internal capabilities is restricted.

How should fund managers be thinking about the optimal model for their business?

As with most issues, it usually comes down to money. Fund managers need to constantly invest substantial sums in technology in order to keep up to date with the evolving market structure and global regulatory requirements and to optimize their trading outcomes.

Some larger outsourced trading firms are able to invest significantly in technology to stay ahead of the curve, which is only possible thanks to their global footprints and scale. This is reflected in the Bloomberg survey and explains why small- and medium-sized firms are more open to outsourcing: it gives them access to markets and resources that would not otherwise be available. Having already made that investment, large asset managers tend to prefer to stick with their in-house desks.

It is important to distinguish between different outsourced trading desks. Some are experienced in managing cross-asset class trades, derivatives, overlays and FX, while others may only offer a more vanilla service. Outsourced trading is not a binary offering or one-size-fits-all solution, and not all outsourced trading desks are created equal.

For more information, contact:
statestreet.com/portfoliosolutions

Disclaimers and Important Risk Information

State Street Global Markets® is the business name and a registered trademark of State Street Corporation® used for its financial markets businesses and that of its affiliates. This document is for marketing and/or informational purposes only, it does not take into account any investor's particular investment objectives, strategies or tax and legal status, it does not purport to be comprehensive nor is it intended to replace the exercise of an investor's own careful independent judgement regarding any corresponding investment decision. This document and the information herein does not constitute investment, legal, or tax advice and is not a solicitation to buy or sell securities or other investments, to participate in any trading strategy, and does not constitute investment research. It is not intended to constitute any binding contractual arrangement or commitment by State Street Bank and Trust company or any of its affiliates to provide any products or services.

You should make your own assessment and evaluation of the communication in the light of your needs and circumstances. Past performance is no guarantee of future results. There are risks trading foreign exchange, equities, fixed income or derivative instruments or in investments in non-liquid or emerging markets. Derivatives generally involve leverage and are therefore more volatile than their underlying cash investments.

Any information provided has been obtained from sources believed to be reliable at the time of publication, nonetheless, we cannot guarantee nor do we make any representation or warranty as to their accuracy and you should not place any reliance on such information. State Street Global Markets hereby disclaims all liability, whether arising in contract, tort or otherwise, for any losses, liabilities, damages, expenses or costs arising, either direct or consequential, from or in connection with the use of or any reliance placed upon the information herein.

The communication and information or any portion thereof may not be reprinted, sold or redistributed without the prior written consent of State Street Global Markets. This communication is not intended for retail clients, nor for distribution to, and may not be relied upon by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to applicable law or regulation.

United States. This communication is being distributed in the United States by State Street Bank and Trust Company, authorized and regulated by the Federal Reserve Board and / or State Street Global Markets, LLC, which is regulated by the SEC and a member of FINRA, the NYSE, NFA, MSRB and SIPC. Transition Management Services are offered through State Street Bank and Trust Company; securities products and services are offered through SSGM, LLC.

Canada. This communication, when made available in certain provinces and territories of Canada, is made available by State Street Global Markets Canada, Inc. a member of the Investment Industry Regulatory Organization of Canada.

APAC

Singapore. This communication is being disseminated by State Street Bank and Trust Company, Singapore Branch ("SSBTS"), which holds a wholesale bank license by the Monetary Authority of Singapore. In Singapore, this communication is only distributed to accredited, institutional investors as defined in the Singapore Financial Advisers Act ("FAA"). Note that SSBTS is exempt from Sections 27 and 36 of the FAA. When this communication is distributed to overseas investors as defined in the FAA, note that SSBTS is exempt from Sections 26, 27, 29 and 36 of the FAA. This advertisement has not been reviewed by the Monetary Authority of Singapore.

South Korea / Taiwan. The activities that are being discussed are carried out from off-shore; State Street is not licensed to carry on this business within South Korea / Taiwan. Any of the services discussed in these materials are undertaken by State Street Bank and Trust Company in an offshore capacity and are not provided within South Korea / Taiwan.

Japan. This communication is being distributed in Japan by State Street Trust and Banking Co., Ltd. ("SSTB"). SSTB is regulated by the Financial Services Agency of Japan ("FSA"). SSTB is licensed under Article 4 of Banking Act and is registered as Registered Financial Institution with the FSA as Kanto Zaimu-kyokucho (Tokin) No. 648 under Article 33-2 of Financial Instruments and Exchange Act, and also is a member firm of Japan Securities Dealers Association and Japan Investment Advisers Association.

Peoples Republic of China ("PRC"). State Street Bank and Trust Company is not licensed or carrying on business in the PRC in respect of any activities described herein and any such activities it does carry out are conducted outside of the PRC. These written materials do not constitute, and should not be construed as constituting: 1) an offer or invitation to subscribe for or purchase securities or futures in PRC or the making available of securities

or futures for purchase or subscription in PRC; 2) the provision of investment advice concerning securities or futures; or 3) an undertaking by State Street Bank and Trust Company to manage the portfolio of securities or futures contracts on behalf of other persons.

Australia. This communication is made available in Australia by State Street Bank and Trust Company ABN 70 062 819 630, AFSL 239679 and is intended only for wholesale clients, as defined in the Corporations Act 2001.

SSGM LLC has an exemption from the requirement to hold an Australian financial services licence under the Corporations Act 2001 (Cth) in respect of the financial services it provides to wholesale clients in Australia. SSGM LLC is regulated by the Securities and Exchange Commission of the United States under US laws and regulations, which differ from those in Australia.

Please contact your State Street representative for further information. PS TMBR NA A 2022-01

To learn how State Street looks after your personal data, visit: <https://www.statestreet.com/utility/privacy-notice.html>.

STATE STREET[®]

State Street Corporation
One Lincoln Street, Boston, MA 02111

www.statestreet.com

© 2022 State Street Corporation and/or
its applicable third party licensor. All rights reserved.

Expiration date: 06/06/2023,

4754638.1.2.GBL.