

IAPF SEMINAR

13 JULY 2023

Managing Portfolio Change: Understanding the benefits of a transition manager



WELCOME



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Managing portfolio change

Understanding the benefits of a transition manager

The role of a transition manager

Transition Management is not just about manager change



THE CHALLENGE

- Strategic Asset Allocation changes.
- Incorporating ESG filters/tilts.
- Manager change – poor performance.
- Manager change – manager lift out.
- Fund / portfolio mergers
- Periodic cash flows – benefit payments, cash calls for real assets.

THE IMPACT

DELAY to implement physical changes.

DELAY due to manager selection, due diligence, contracting.

COST of active fees.

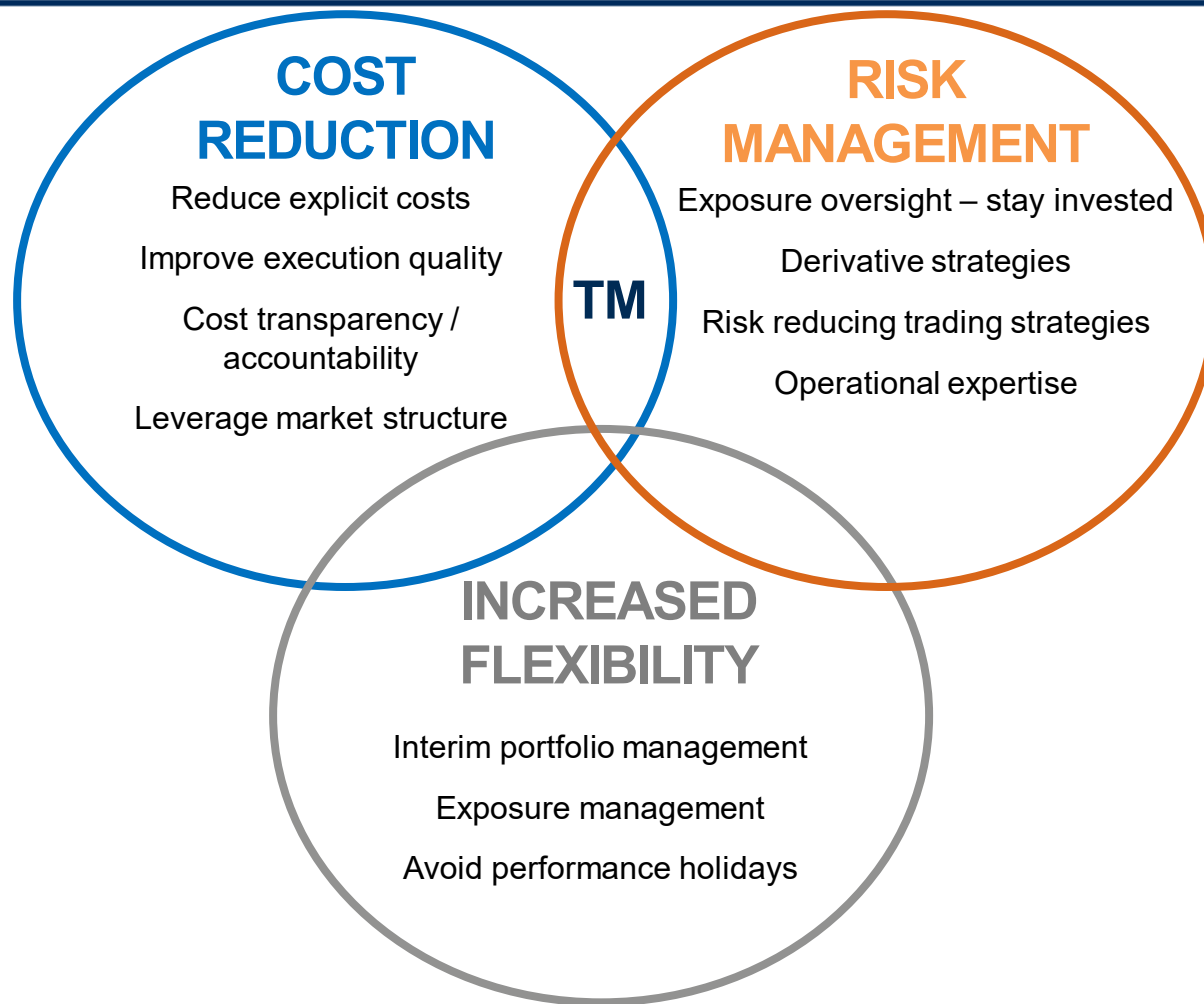
DELAY =

- Unrewarded risk
- Increased costs
- Loss of control

Market volatility exacerbates the risk/cost of implementing these tasks efficiently

Why use a transition manager

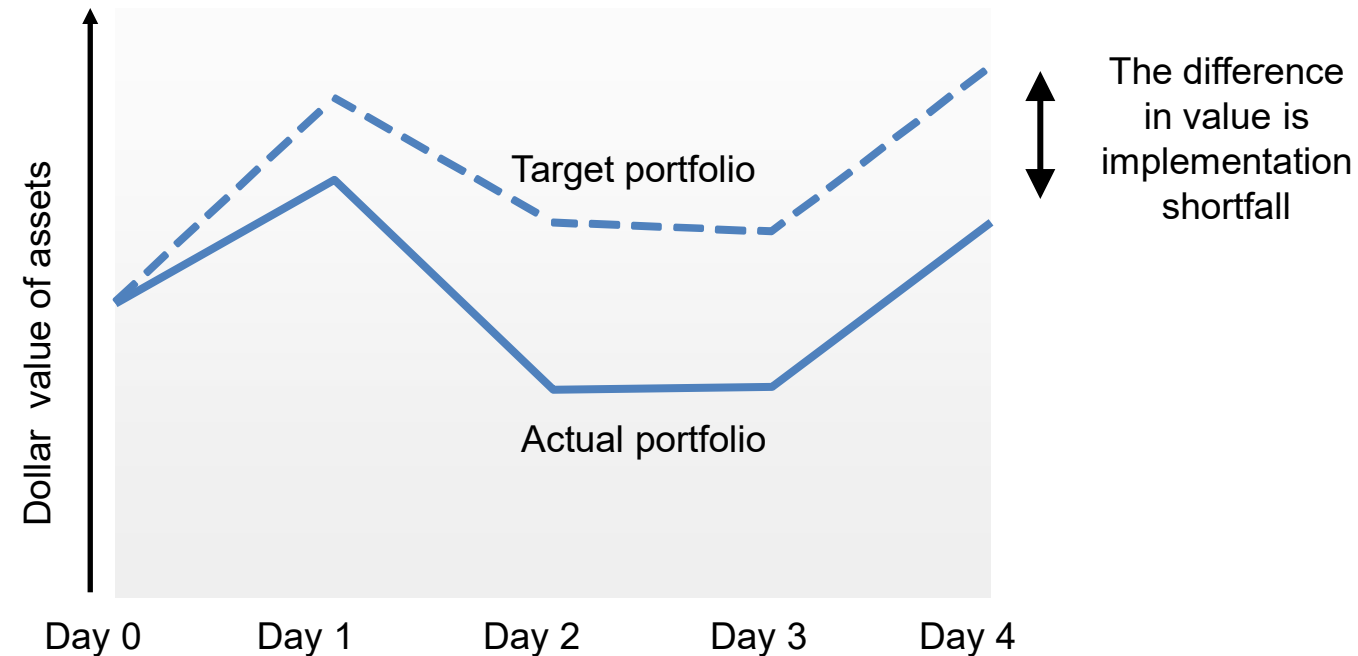
Minimise cost and mitigate unrewarded risk



Why use a transition manager

Defining “cost”

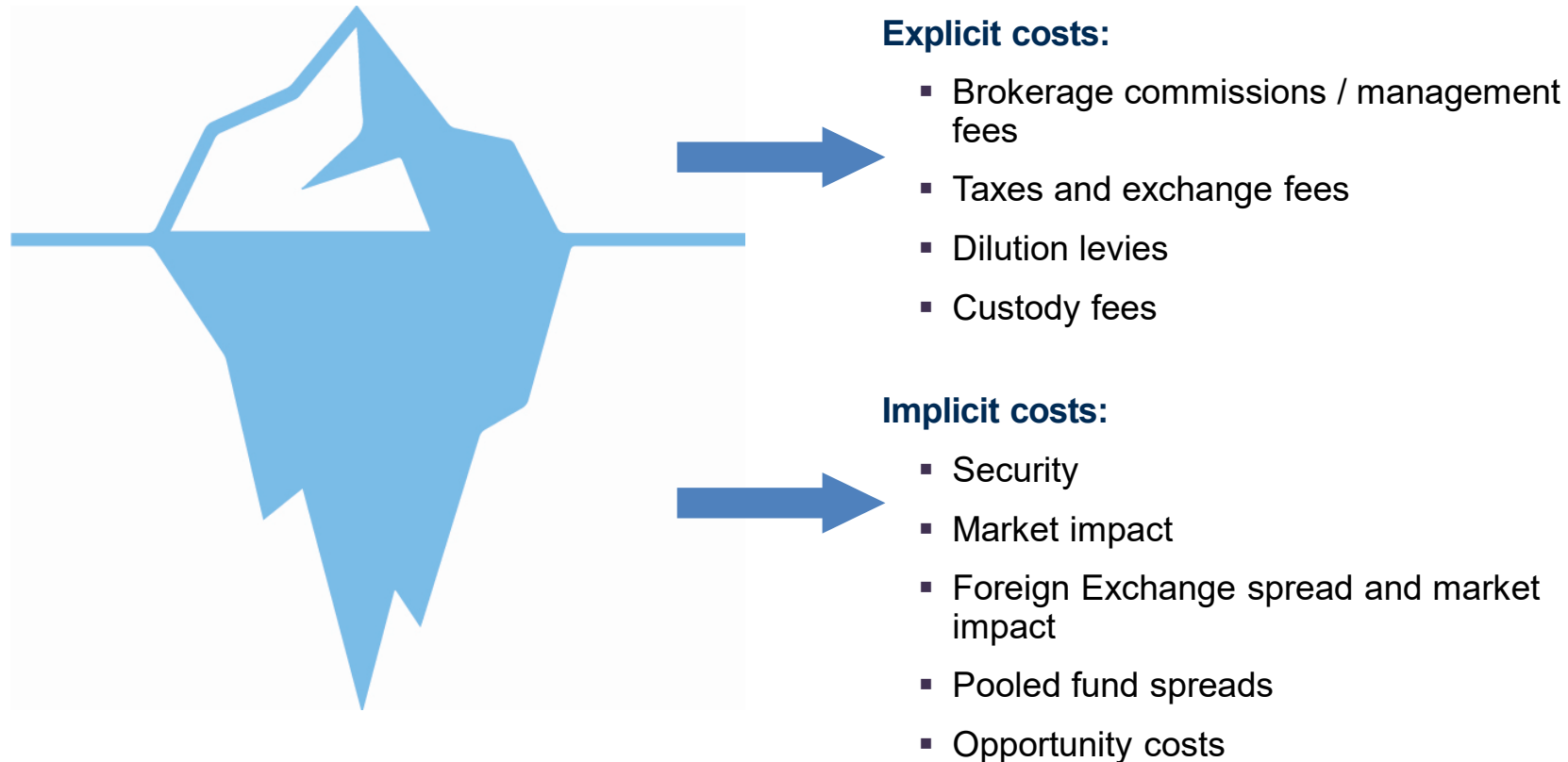
Cost = Performance = T Standard Implementation Shortfall (IS)



Implementation Shortfall (IS) includes commissions, taxes and fees, bid/ask spread, market impact and opportunity costs – back to the reference date.

Why use a transition manager

Explicit costs are the tip of the iceberg



Explicit costs typically account for less than 15% of total transition costs

Why use a transition manager

Minimising costs

TOOLS

- Maximise “retentions”
- Cost / benefit analysis: in-specie vs cash
- Any tax exemptions?
- Re-use custody account?
- Access to liquidity
- Use of Market on Close (MOC)
- Internal versus external crossing
- Internalisation versus multi dealer/venue
- Multiple staged transitions

In depth Pre-Transition cost analysis.

Regular updates – no surprises

Transparency – comparison in Post Transition report

To manage cost you first have to accurately identify all costs

Why use a transition manager

Mitigating unrewarded risks

TOOLS

- Defining “risk”
- Macro analysis of risk
- Strategies to manage – use of derivatives
- Micro analysis of risk – identify those securities with highest contribution to marginal risk
- Clear and workable trading strategy. MOC?
- Coordination
- Multiple staged transitions

In depth Pre-Transition cost analysis.

Dynamic risk management

Transparency – show how risk is being mitigated

Clearly identify all risks and a strategy for managing them

Why use a transition manager

The potential cost of unmanaged risk

Unmanaged intraday exposures on a cash flow of \$500mm USD:

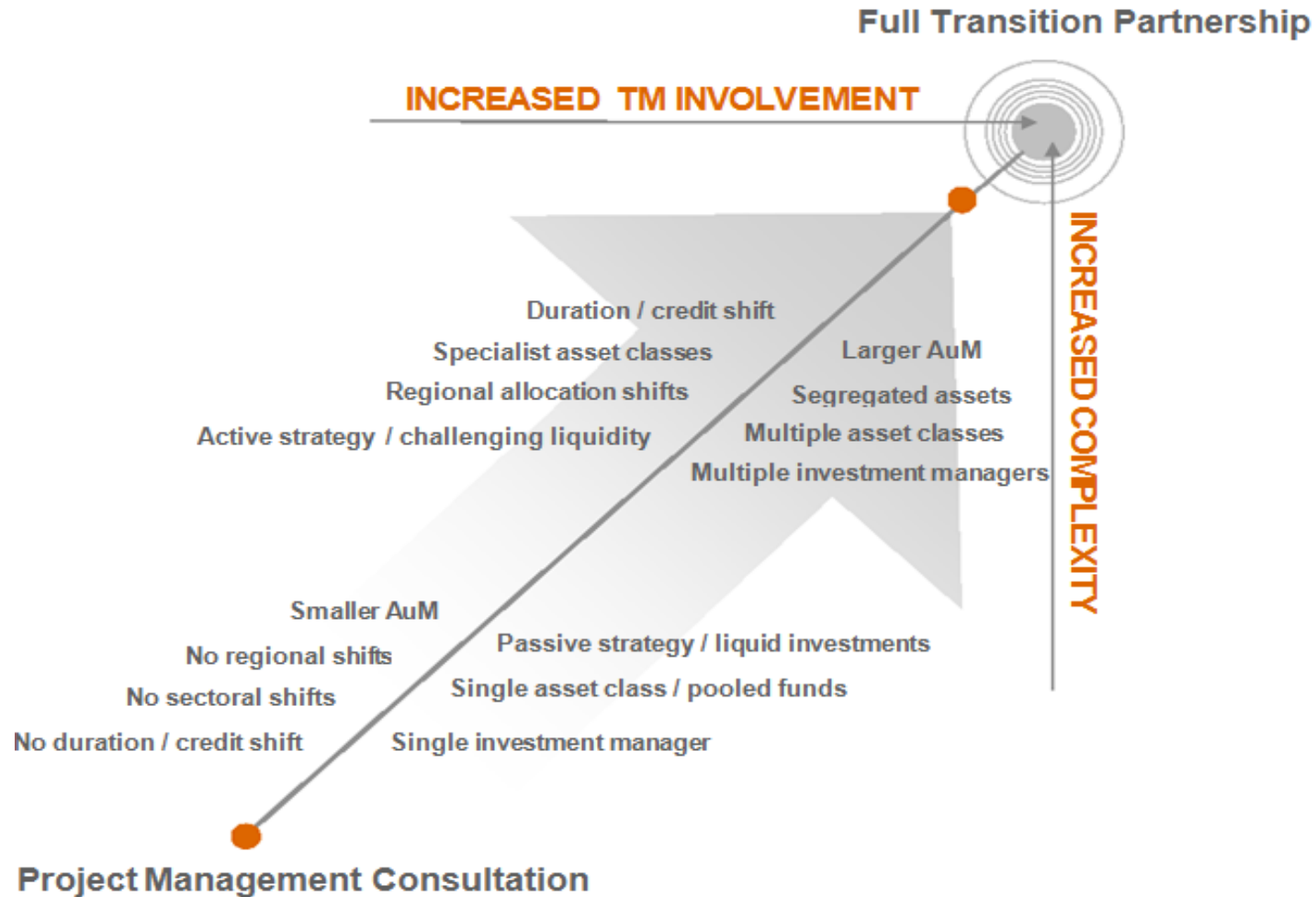
- › Market volatility of 1.1% introduces benchmark risk of \$5.5mm USD.
- › *Active implementation strategies can minimise this risk.*



A robust risk and exposure management strategy is critical in volatile, liquidity constrained markets

When to use a transition manager

The more complex, potentially the more value add



When to use a transition manager

The cost of an equity transition versus fixed income

Mandate	Benchmark	Tracking Error	Target annual gross excess performance *	5-year average estimated transition costs **	Transition cost as % of target alpha
Global Equities	Russell Investments Global Developed Equity	350 bps	200 bps	35 bps	17.5%
Global fixed income	Barclays Global Aggregate Bond Index	175 bps	100 bps	23 bps	23.0%

If a fixed income transition is managed incorrectly or not at all, the erosion of alpha can be significantly worse than the results shown above.

The value of your investments may fluctuate. Past performance does not predict future returns. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies, and/or current market conditions and are not an exact indicator. What you will get will vary depending on how the market performs and how long you keep the investment/product.

* Estimated based on alpha expectations of Russell Investments Funds.

** Average estimated TM Implementation Shortfall (IS) costs from Russell Investments. performance database, three years to 31 December 2021. For illustrative purposes only. It is not representative of a projection of the stock market, or of any specific investment.

When to use a transition manager

Isn't it easier just to use the new manager?

TRANSITION MANAGEMENT REQUIREMENTS	RUSSELL INVESTMENTS PURE AGENCY TRANSITION MANAGER	INCOMING MANAGER
Alignment of interest with client	✓	✓
Contracted as investment adviser	✓	✓
Accountable for performance	✓	<i>Performance holiday?</i>
Duration/cash exposure management	✓	?
Strategy coordination with other fund activity	✓	?
Event confidentiality	✓	?
Ability to transact all security types	✓	?
Multi-venue execution/price discovery	✓	✓?
Liquidity sources for small quantities	✓	?
Pre/post transition reporting (t standard is)	✓	X
Reconciliation with custodian	✓	✓
Management of operational issues	✓	✓

Summary

Preservation of performance and transparency

- Transition Management is an important tool to preserve the performance of your investments, as strategy changes occur.
- Increasing the efficiency of portfolio changes, helps reduce cost and risk in clients' funds.
- Important to focus on the “outcome”, **not** just the explicit costs. They do not represent an additional layer of cost.
- Typically, it is more cost effective (with increased transparency of costs) for a scheme to use a transition manager than asking the outgoing or incoming manager to trade the portfolio.
- A Transition Manager will not charge for a pre-trade analysis. So, you can engage them in a discussion about the most cost-effective approach, without worrying about a bill.
- Transition managers add value not just for manager change.
- Suggested reading: Russell Investments: “*TM Explained*”



Case studies: Transition management

iapf 
representing pension savers

TM Case Study 1

Large and Illiquid Global Real Estate Equity

OVERVIEW

Highly Illiquid Real Estate Equity Transition

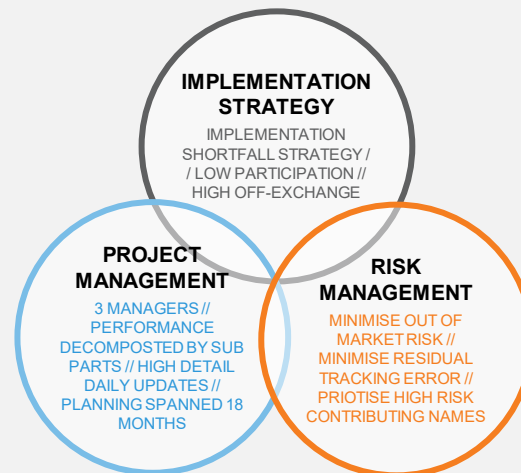
Execute two tranches of legacy portfolio into three target portfolios totalling ~€11bn of executions. Planning for the two events spanned 18 months, due to Covid19.

Due to the illiquid nature of the transition each tranche time horizon was within 1 to 2 months.

~Pace of transition was to be largely driven by less liquid sells which were >210% of average daily volume.

SOLUTION

Transition management mandate / Illiquid Equity



Execution

110+
UNIQUE VENUES USED

16,433
TRADES
Value €11bn +

>54%
OFF EXCHANGE (ON AVG.)

IMPACT

>€23m spread saving

Actual spread and impact cost of 34.8 bps on tranche I (vs. 55.6bps estimate) and 32.4 bps on tranche II (vs. 58.8 bps estimate)

- ✓ **Timing:** Transition was completed ahead of estimate by two weeks in both scenarios (tranche I and II).
- ✓ **Passive trading approach** with exchange participation <10%. Minimised signalling with largest cost contribution from trades <10% ADV
- ✓ **Controllable costs were below estimate.** Achieved through significant off-exchange transactions
- ✓

TM Case Study 2

Global Equity

OVERVIEW

Large Global Equity Transition

Large active global equity event. 1 legacy and 3 target managers, fund accounting and consultant involved.

Concentrated portfolios, only 153 names, T/E of **over 11%**. Large “style” risk.

Increase in volatility due to Covid19 – trading July 2020.

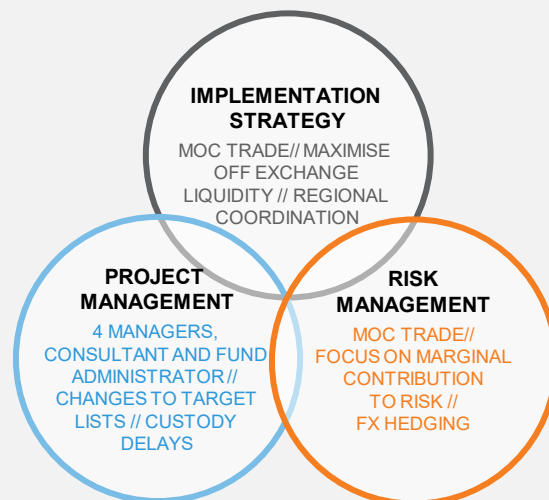
MOC trade of ~£850m.

Over £5 bn to trade.

Trade horizon of ~ 2 wks. for 95% completion.

SOLUTION

Transition management mandate / Global Equity



Execution

86
DIFFERENT TRADING VENUES USED

997
TRADES
Value £4.96bn
(inc. £846m MOC trade)

84
FX TRADES INCLUDING HEDGES

IMPACT

~£11.6m savings

~£ 3.3m spread and impact savings from MOC trade.

Savings of ~£8.3m from increased off-exchange trading.

✓ **Timing:**
Transition was 90% complete in 6 days in line with estimate.
Target manager list changes implemented.

✓ **MOC trade:**
£846m on T-1 reduced est. costs by 11.5 bps or ~£3.3m and risk by over 300 bps.

✓ **Costs were lower than estimated:**
Actual costs 63.8 bps versus 115.5 with a range of +/- 117.6 bps.
Opportunity gain of 23bps due to target performance.

✓ **Multi venue trading:**
86 different venues used and ~56% traded off exchange led to savings on spread and market impact of ~£8.3m.
FX costs of only ~3 bps.

Appendix



Interim asset management

Improved efficiency over portfolio changes

Interim asset management is the process whereby Russell Investments acts as a short-term asset manager to implement decisions that can take many months to finalise:

THE CHALLENGE

- Strategic Asset Allocation changes.
- Incorporating ESG filters/tilts.
- Manager change – poor performance.
- Manager change – manager lift out.
- Fund / portfolio mergers

THE IMPACT

DELAY to implement physical changes.

DELAY due to manager selection, due diligence, contracting.

COST of active fees.

THE SOLUTION - INTERIM

Strategic changes made with little delay.

Risk and cost reduced while finalising decisions.

Accountability and reporting retained.

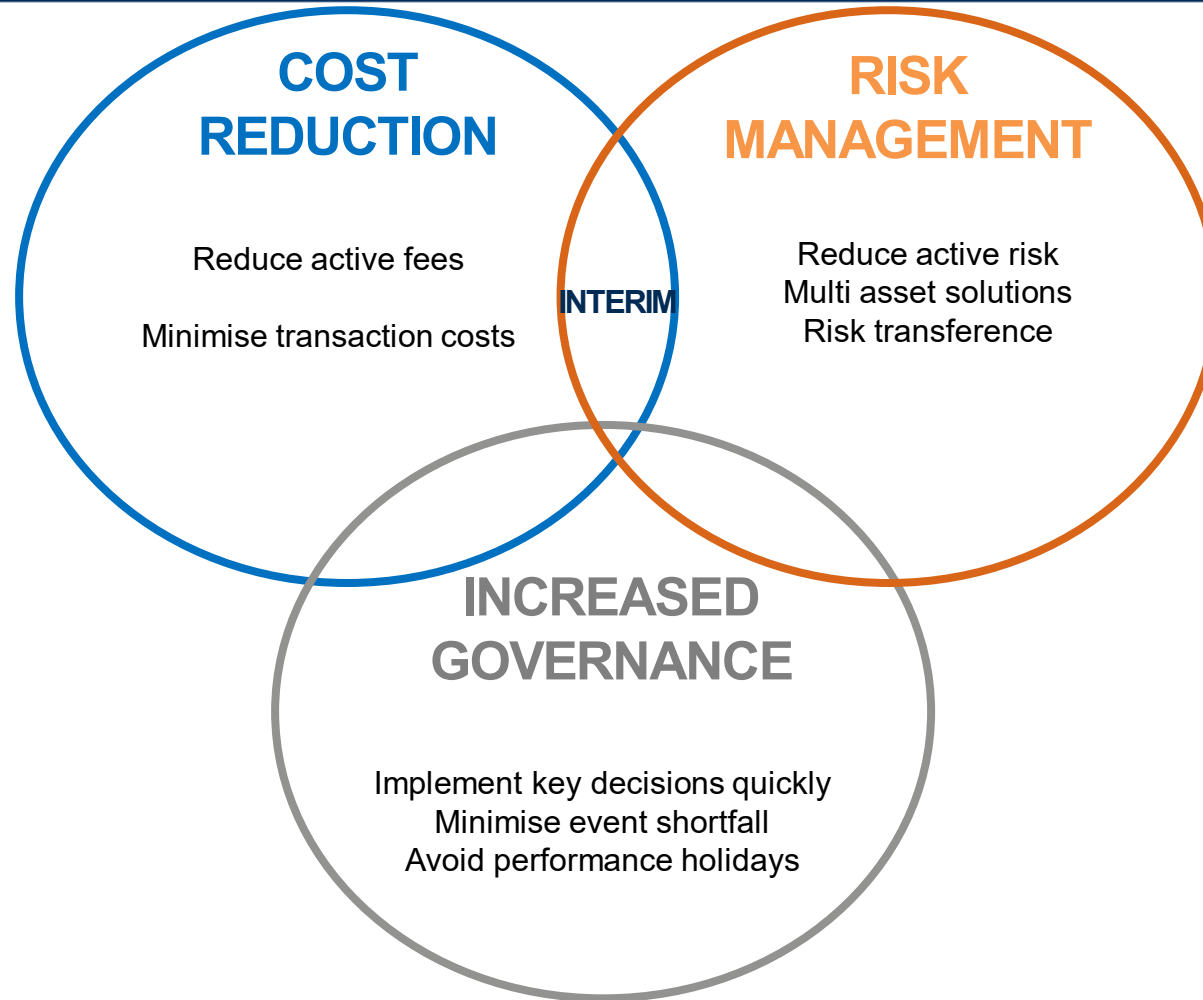
Passive fees during interim.

DELAY =

- Unrewarded risk
- Increased costs
- Loss of control

Interim asset management summary

Take control from the time the decision to change is made



Important information

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Q&A



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THANK YOU



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UPCOMING IAPF EVENTS

Webinar - 14 September 2023

50th Anniversary Lunch – 21 September 2023

Trustee Training Online 1 & 2 – 22 & 29 September 2023

Seminar – 28 September 2023

Autumn Conference – 5 October 2023

*CPD details on IAPF website when available –
see Past Events*