Why outsource investment management?

There are many potential benefits from outsourcing your investment proposition. However, to determine whether it is the right decision for your business and clients, there are a number of fundamental questions that need to be thought through:

- What are the client benefits of outsourcing versus retaining all asset allocation and investment management decisions in-house?
- Will it increase business efficiency and/or lower costs?
- Will it shift risk away from the business?
- How will outsourcing fit into the client advice proposition?
- Can fees still be earned from clients if investment management is outsourced?
- How much of the investment management process should be outsourced in view of the resources, capacity, appetite and expertise available in-house?
- What does the outsourcing process entail?
- What does doing it in-house really entail?

Where does outsourcing fit into the client advice process?

At a basic level, the investment management process involves undertaking a client risk assessment (including assessing a client’s attitude to risk, capacity for loss and required return), undertaking an asset allocation process based on this assessment and then selecting investments against that asset allocation. Although risk assessment is essentially the preserve of the financial adviser (sometimes in collaboration with a discretionary manager) investment outsourcing can support the two latter stages.
The RDR has acted as a catalyst for the emergence of a variety of outsourcing options and, as a result, it has become an increasingly complex landscape for advisers to navigate. Understanding the investment outsourcing universe is therefore a crucial first step in the partnering process.

Outsourced investment solutions fall into two categories: Discretionary Fund Management and Multi-Asset Funds. Within each area, there are a broad range of solution types available.

Here we map out these two landscapes to help you understand how the options fit together.
We believe that there are four core building blocks which can contribute to the construction of Multi-Asset Funds: Investment Style, Investment Method, Asset Type and Management Approach. An adviser’s (and their clients’) preferences across these different levers will be fundamental to determining the appropriate fund type. Importantly, these aspects are not mutually exclusive.

**Investment Style**
- Return Focused aim for a certain level of return, either absolute or relative to a benchmark or peer group
- Risk Targeted aim for a particular amount of risk
- Risk Targeted always exist as a range/family, with the risk taken varying across the range

**Asset Type**
- ‘Traditional’ investments include equities, bonds, property and cash
- ‘Alternatives’ include commodities, hedge funds and private equity
- Alternative investments can increase return and diversification but also risk and cost

**Investment Method**
- Active used if portfolio manager believes they can find managers that can consistently outperform benchmark/peer group
- Passive used where the portfolio manager believes that markets are ‘efficient’, or to mitigate ‘manager risk’
- Fees are generally lower for passive underlying funds
- Both Active and Passive involve an active manager to decide on the asset allocation

**Management Approach**
- Multi-Manager uses a number of funds/managers as one manager is hardly ever the best across all asset classes; Single-Manager is usually cheaper, and often invests directly in underlying assets
- Fund of Funds involves investments in a number of discrete collective funds; Manager of Managers is where funds are segregated and given to be managed on a bespoke basis
- Fettered vs Unfettered – whether a portfolio is restricted or not to their own firm’s funds (a choice vs cost consideration)

**and how does it all fit together?**

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How do you select an appropriate solution(s)?

Once you’ve made the decision to outsource your investment management process and have decided which solution type(s) would meet your clients’ needs (as well as those of your business) the next step is to choose a suitable partner or partners.

We believe that there are a number of key aspects that need to be considered:

- The nature of the provider - including assets under management, resource, expertise, investment philosophy and processes
- The range of solutions offered and whether they meet the needs of the vast majority of your clients
- Charges and costs
- The performance of the solution in relation to its expectations
- Reputation and standing
- Service delivery to the client, including management information
- Service and support to you as the adviser

Importantly, beyond initial selection there needs to be an ongoing review process to ensure that the solutions remain fit for purpose. Review should occur at regular intervals and when key developments occur, including market, regulatory, legislative and client changes – as well as developments relating to the solution itself.

Contact us to discuss how our research software – Defaqto Engage – and consultancy services, including bespoke due diligence and partner audit services, can support your investment outsourcing activity.