

Co-sourcing

Making Buy-Side Fixed Income
Portfolio Management More Efficient



Solution Whitepaper

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While the ultimate goal of a portfolio manager is to outperform the index or benchmark, one has to constantly ensure the portfolio is resilient to economic, political, and financial volatilities and uncertainties.

Hybrid co-sourced models can help.

Buy-side fixed income firms are increasingly considering offshore relationships as an extension to their trading desks and in-house research teams. While outsourcing is not new to buy-side engagements, this practice is gaining more traction with portfolio managers who are under intense pressure to screen and propose effective investment ideas constantly.

Read on to know how co-sourcing can make buy-side fixed income firms far more efficient.

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Why is a Proprietary Research Platform Critical for Buy-Side Fixed Income Portfolio Managers?

Here's a typical range of questions that a global fixed income research manager has to generally consider in the present economic situation.

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- What would be the position of South African gold mining companies' bond yields and spreads if prices fall below the critical support level of USD1,200/oz?
 - What is our view on the ratings of our energy credits, if oil remains below the level of USD 40/bbl? Should we downsize our energy portfolio or restructure it to add more IG papers?
 - Can we work out our portfolio's exposure and sensitivity to domestic currency depreciation and ascertain various hedging strategies?
 - Are we appropriately balanced to mitigate the risks associated with the political situation in Ukrainian markets further worsening? Should we decrease the duration by selling long-term instruments and adding short-term ones?
 - Can we ascertain if the yield compression in the EM debt space is driven by a change in Treasuries or a declining risk premium is reflected in tighter spreads?
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The challenge is not only to find the right answers to such questions, but also to proactively anticipate such queries.

It is, therefore, extremely important for the supporting research team to predict the potential research backup for portfolio managers.

While the ultimate goal of a portfolio manager is to outperform the index or benchmark, one has to constantly ensure the portfolio is resilient to economic, political, and financial volatilities and uncertainties. This requires constant monitoring of various factors to which the portfolio is exposed.

For example, if we assume a scenario of volatile crude oil prices, a portfolio manager investing in EM debt could have several persistent issues or potential research tasks, including:

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- Understanding the impact of falling crude oil prices on those countries being tracked by the portfolio manager, keeping track of their currency, sovereign budgets, as well as positions of fiscal and international reserves.
 - Taking a call on actions by sovereign governments and central banks where growth and trade are driven mainly by oil.
 - Understanding cues from announcements made and meetings held by the OPEC or other economic agencies, and taking a call on the sovereigns that would be impacted relatively more.
 - Identifying companies under coverage whose performance directly correlates to oil prices, revising in-house estimates to reflect new oil price assumptions.
 - Analyzing the impact on key credit metrics, valuation multiples, and rating triggers in order to identify risky companies and reduce exposure, subject to the current spread levels or portfolio positioning.
 - Seeking sovereigns, sectors, and companies positively impacted by a decline in crude oil prices, identifying attractive additions to the fixed income portfolio.
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Taking the dynamic global economic environment into account, critical issues need prompt and priority resolution to enable quicker investment decisions.

Your challenge here is to ask the right questions and find the right answers.

We believe this needs a like-minded and experienced research team.

How Does Offshoring Help Buy-Side Firms Expand Their Coverage Universe Within Defined Budgets?

Fixed income markets across the globe underwent a radical change lately.

While macro issues in developed markets kept interest rates in the lower or negative trajectory, supply-side constraints led to limited primary opportunities in fixed income markets. That's why global portfolios managers have begun actively exploring opportunities in the EM debt market, despite several issues such as currency volatility and data transparency. Considering the dynamic global markets, a robust proprietary research platform for buy-side clients is imperative. However, the challenge lies in the scale of the universe in the fixed income space, considering the small size of onshore research teams. Hence, to increase the span of coverage and identify relatively greater mispricing opportunities, the buy-side fixed income firms have started exploring offshoring to boost their research platforms.

Admittedly, offshoring may not be an easy option for pure buy-side engagement where time is critical and research deliverables and output are interrelated and time-sensitive. Here, the primary question to ask is whether an offshore research team is decision-oriented and equipped to deliver timely output that needs minimal rework.

We believe the offshoring paradigm—especially for buy-side engagements—has evolved significantly.

In our view, cost-savings is not the only reason to opt offshoring. It is also to better manage research tasks, and enable the result-oriented generation of trade ideas. In fact, buy-side fixed income firms are increasingly considering offshore relationships as an extension to their trading desks and in-house research teams. While outsourcing is not new to buy-side engagements, this practice is gaining more traction with the portfolio managers who are under intense pressure to screen and propose effective investment ideas constantly.

How to Address the Inherent Challenges Faced by Buy-Side Fixed Income Firms?

Portfolio managers are predominantly concerned with issues such as:

1. Continuously screening the bond universe, watching out for opportunities in secondary markets.
2. Timely access to in-depth research.
3. Resource bandwidth to conduct and communicate detailed research.
4. Regularly monitoring investments in order to create balanced churn.
5. Scaling capabilities.

Outsourcing can help address some of the issues and offer effective solutions to enable buy-side fixed income firms to take better strategic business decisions.



Are we appropriately staffed to continuously screen the global bond universe and not miss out on available opportunities in secondary markets?

Screening of the global bond universe to regularly identify mispricing is a continuous process. Portfolio managers and asset management firms deploy a variety of techniques to screen trade ideas based on size of the portfolio and team structure in place. The extent of automation in the idea generation platform would depend on the size of the fund, scale of the organization, and working style of portfolio managers. Idea generation is a critical stage and requires consistent efforts by trading teams and the research division.

The fixed income research platforms in small and mid-sized firms include a few senior analysts tracking various markets and directly interacting with traders in their respective markets. Firms with cost constraints or startup funds may not have research teams and rely only on sell-side research, traders' views, and opinions of market participants. However, as these firms scale up, they start investing in proprietary research to address regulatory requirements and manage a larger coverage universe. Initially, the firms may hire senior credit research analysts to track key markets and then consider closely integrating the research division with trading desks.

Considering the high cost involved in setting up a full-fledged research team, most small firms use a combination of sell-side research and a small-sized research team to assist in customized research solutions. While there are specific advantages like cost benefits and regulatory compliance associated with this structure, it most often does not serve the sole purpose of providing in-depth research through collaborative proprietary research models.

Collaborating research through small in-house research teams is different. The research process is customized to the requirements of traders and is simply a "trader-driven research engagement," which documents the necessary research for compliance reasons.

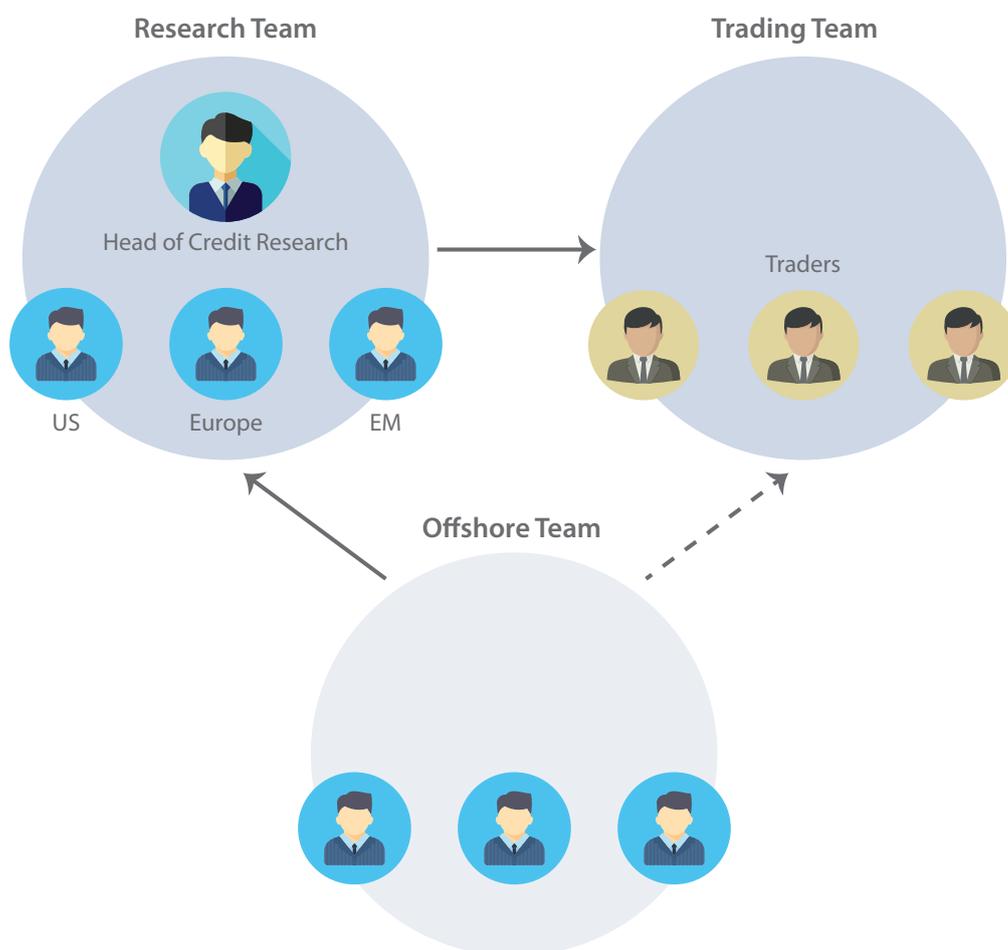
Considering the dynamic global environment and need to continuously track the research coverage universe, 'trader-driven engagements' are not as successful as the 'pure research support model'. The pure research support model works effectively to deliver screened and thoroughly researched fixed income research ideas, rather than just working on an idea shared by in-house traders.

Parameters	Trader-Driven Research Engagements	Pure Research Support Model
Idea Generation	Usually Initiated by Traders and Their Supporting Teams	Collaborative Effort Between Traders and the Research Team
Research Coverage	Limited and Driven by Trade Ideas Generated by Traders	Exhaustive and In-Depth Research Offering Detailed Commentary and Facilitating Generation of Trade Ideas
Research Team Size	Small	Medium to Large

Fix the Staffing Issues in Buy-Side Research Division Setup

Lately, buy-side fixed income firms found an effective outsourcing solution to expand their research coverage universe without exceeding the research budget. Fixed income portfolio management firms have started creating an extension of their research platforms through a dedicated offshore team equipped with similar skill sets and capabilities to produce in-depth and thoroughly screened research ideas.

Here's an illustration of a typical structure in a credit research buy-side engagement. Obviously, the structure varies across firms based on various factors, including the internal organizational structure and AUM.



We believe that co-sourcing solutions customised to the needs of the onshore team can help fixed income portfolio managers overcome issues such as limited research budgets or insufficient in-house research staff.

Are we investing appropriately in a research platform that's getting us access to timely, in-depth research? Do we have sufficient resource bandwidth to conduct detailed research and communicate it effectively?



Buy-side fixed income research firms generally face two fundamental issues:

1. *Access to high volume of sell-side research and market data, and limited time to digest and convert the information into trading strategies*
2. *Absence or limited presence of in-house research teams to generate customized and thoroughly researched and analyzed trading strategies*

Small and mid-scale buy-side engagements largely face these issues, with most of them applying an unstructured approach. Some of the firms just rely on sell-side research and subscription to the basic database. Others work with a small in-house research team on a 'trader-driven research model'. We believe the co-sourcing solution is strategically suitable in such cases, as outsourced analysts range from junior credit analysts to senior credit experts, who are skilled to even generate RV trading ideas on clients' behalf.

Co-sourced buy-side solutions enable offshore analysts to track a coverage portfolio based on sector, region, or directly mapped to the coverage universe of the trader. While traders focus on market dynamics and sentiment, offshore analysts provide critical research output in an easy to consume pre-defined format. The close interaction of traders, in-house research teams, and offshore research teams enables detailed research coverage of the portfolio universe such that the investment calls do not go wrong. The range of research tasks offshored is varied and depends on the structure of the onshore team.

Let's discuss the range of outsourced tasks by analyzing the daily schedule of a typical fixed income portfolio manager.

Case Study

Working As An Extension Arm of Client's Fixed Income Trading Desk

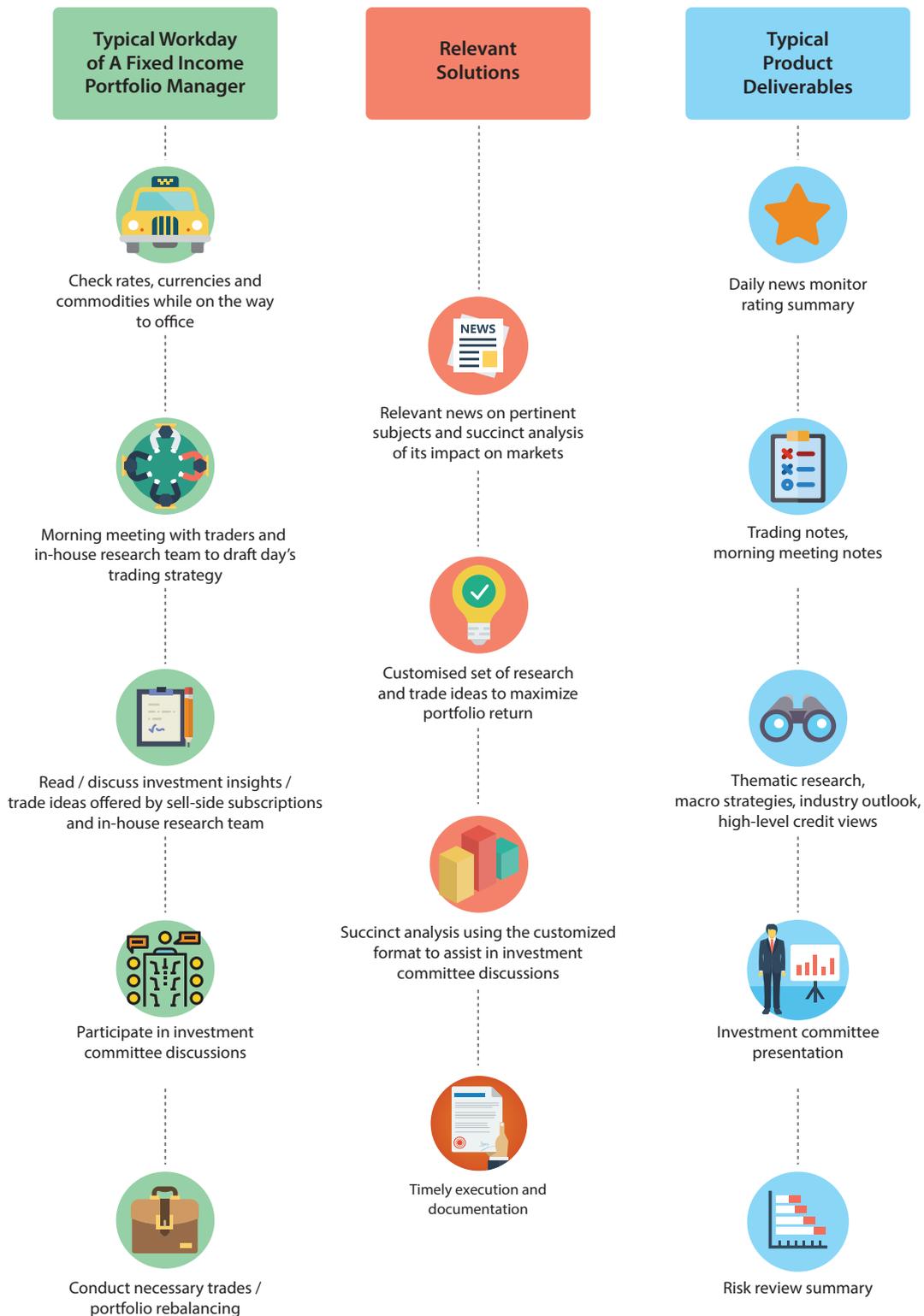
Client – Proprietary Investment Management Firm

An investment management firm managing certain fixed income fund needed fixed income research advisory support to enable portfolio managers to generate higher alpha.

PROBLEM AREAS AND OUTSOURCED SOLUTIONS

Problem Areas	Co-sourced Solutions
<ul style="list-style-type: none"> • Expanding the coverage area to generate higher alpha for the portfolio • Lack of skilled resources to provide time-sensitive opinion on the pricing of new issuances • Monitoring the coverage universe to accurately time the entry and exit of investments 	<ul style="list-style-type: none"> • Dedicated analysts to assume independent responsibility for maintaining research coverage on assigned names • Monitoring the portfolio universe to analyze and timely communicate the impact on investments/portfolio • High-level credit analysis on new issuances with succinct opinion on expected pricing and peer valuations • Generating active trade ideas for EMEA and APAC portfolio managers

Typical Workday of a Fixed Income Portfolio Manager – How a Co-sourced Solution Can Help



Are the portfolio and investments being monitored regularly to generate adequate breadth and create a balanced churn? How can we scale our capabilities and create a structured approach to managing our portfolio effectively?



Fixed income investing entails far more than a straightforward buy and hold process. With fixed income markets highly dependent on monetary policy frameworks and economic cycles, monitoring a fixed income investment is more critical than ever before. For example, if a major move such as a rate hike by the central bank is forecast, the credit portfolio is analyzed to understand the duration risk. Based on this, a fixed income trader might consider decreasing the portfolio duration to mitigate the impact of widening yields.

The approach based on economic cycles is now common and a leading indicator for portfolio managers, in addition to corporate credit risk. In other words, if a bond clears all the filters for a portfolio on the basis of credit quality, it might not be invested in, as the economic cycle does not favor the inclusion of the bond in the portfolio.

Therefore, economic perspective and risk management clarity are becoming increasingly important for fixed income portfolio managers. Issues pertaining to portfolio management and the risk side of the portfolio are discussed at regular intervals with the investment committee, with close involvement of the Head of Risk. Although not many tasks pertaining to risk management are outsourced, a couple of buy-side fixed income firms have started exploring the data management tasks pertaining to portfolio risk and compliance as well. 

Aranca's Fixed Income & Credit Research Solution Portfolio

Solutions for Buy-Side Fixed Income Clients

Aranca has an extensive fixed income and credit research team, offering a variety of customized solutions to a wide spectrum of client segments. At Aranca, we ensure fixed income buy-side firms get qualitative investment recommendations and portfolio management strategies on time to reap maximum benefits. We offer innovative and customized solutions to our clients based on their internal business structure and requirements.

Our service offerings include:

Daily News Monitor

A daily news monitor, customized to client requirements, is shared with the client at the pre-determined time.

Our analysts carefully understand client needs to deliver the right set of news on relevant subjects and succinct analysis of its impact on markets.

Trade Ideas

We understand traders have to digest extensive information in a short span of time. Our experienced buy-side focused credit analysts share the right set of research and trade ideas with our clients for them to maximize returns.

Peer RV Analysis/Sector Research

Our fixed income research analysts have in-depth experience of working on credit research assignments, thematic sector pieces, macro strategies, industry outlooks, and high-level credit views. All or any of these can be made relevant and customized as per client/trader requirements.

Investment Committee Presentations

We have extensive experience in preparing investment committee presentations for in-house research teams, delivered within deadlines. In fact, most of the clients outsource about 70% of the presentation content, with only the "executive summary" retained at their end to enable last-minute changes.

Covenant Quality Analysis

Our experts offer in-depth covenant screening and benchmarking to identify potential gaps in covenants for distressed cases.

Recovery Analysis

We share insightful recovery analyses for various classes of debt with realistic assumptions on exit multiples, for our clients.

Our On-demand Product Offerings for Buy-Side Fixed Income Research Clients

Through our experience with numerous clients and a wide range of requirements over the years, we've developed several out-of-the-box solutions that fit the needs of buy-side fixed income firms.

Some of our product offerings include:



Customized Investment Screeners

Designed in collaboration with our business automation team to handpick certain credits/fixed income instruments, based on various filters/criteria such as fundamental and technical metrics.



Credit Rating Trackers

Sophisticated trackers designed to identify the breach of triggers and potential credits due for upgrade or downgrade.



Structured RV Template

Graphical illustrations through scatter charts and RV templates to detect mispricing and arbitrage opportunities in the fixed income market.



Peer Sheets

In-depth fundamental analysis on peers and exploring credit diversities across sectors and asset classes.



High-Level Model with Robust User Interface

A built-in scenario analysis user interface to capture the effect of changed assumptions on projected outcomes.



Customized Credit Research Reports

Succinct and opinionated credit research reports with clear investment recommendations, explained in context to the risk and return profile of the portfolio.



Automated Earning Calendars

Interlinked and automated earning calendars to enable clients to be on top of the upcoming events and schedules.

How We Engage With Clients

Aranca devises strong integration with our client teams to reduce impediments while working together and ensure rigorous and timely investment support.

We achieve these results through various initiatives, some of which are:

- Detailed and accurate scoping of work
- Collaborative white boarding sessions and one-on-one meetings
- Clearly defined SOWs and clear and concise service level agreements
- Continuous monitoring by project managers and seamless governance by engagement managers
- Regular feedback and sharing of dashboards to enable clients to understand the offshore interface
- Eliminating time zone differences (such as ensuring macro and portfolio updates reach them on time before the market opens)
- Building strong communication channels to eliminate distance barriers
- Being on top of the coverage universe 24x7 (a critical update pertaining to the coverage universe is sent to the client over the weekend before the market opens on the first weekday)
- Initiating and maintaining strict shadow coverage to ensure consistent research support
- Maintaining strong relationships with investor relations, rating agencies, sell-side analysts, brokers, and internal risk management teams
- Offering innovative solutions and implementing automation in research processes to ensure quick dissemination of information

Our analysts are proactive and astute in understanding the significance of events on a case-to-case basis and taking appropriate and proactive actions.

Two things are extremely pivotal to a buy-side environment – time is money and effective communication is mission-critical. Evidently, co-sourcing models do make buy-side fixed income portfolio management much more efficient.

Outsourcing, especially offshoring, helps portfolio managers and their buy-side fixed income firms resolve most of the critical issues on top priority to enable quicker investment decisions by asking right questions to find right answers. Offshoring enables buy-side firms to expand their coverage universe despite limited budgets. We believe that cost-savings are not the only reason for buy-side firms to opt for offshoring, but to manage research and enable result-oriented generation of trade ideas. In fact, offshore relationships are being considered more as an extension to firms' trading desks and in-house research teams.

As we stated earlier, while the ultimate goal of a portfolio manager is to outperform the index or benchmark, one has to constantly ensure the portfolio is resilient to economic, political, and financial volatilities and uncertainties. Trust hybrid outsourcing models to help you do exactly that.

At Aranca, we strongly believe an open-ended approach and a flexible and dynamic attitude are needed to promptly serve buy-side clients. Our disciplined and flexible approach has helped us win clients' faith and trust and driven mutually beneficial engagements for both the parties.

We believe our fixed income buy-side research support is more than just a relationship, and we take care and pride in nurturing these relationships through the highest standards of service and dedication.

For more details on our fixed income and credit research offerings, please visit www.aranca.com

OUR SERVICES



BUSINESS RESEARCH & ADVISORY



INVESTMENT RESEARCH & ANALYTICS



FIXED INCOME RESEARCH & ANALYTICS



VALUATION ADVISORY



TECHNOLOGY INTELLIGENCE & IP RESEARCH



PROCUREMENT & SUPPLY CHAIN INTELLIGENCE



TRANSACTION ADVISORY SERVICES



QUANTITATIVE RESEARCH SERVICES