

Transition Management:

More than restructuring

By Nell Axelrod



A sophisticated offering that emphasizes minimizing the overall financial impact to client portfolios.

The investment industry has witnessed the transition management service change from one focused on project management and crossing to a sophisticated offering that emphasizes minimizing the overall financial impact to client portfolios. This approach to managing risks is now the norm, as outlined in the T-Charter¹, and one that all transition management providers are expected to follow.

In recent years however, transition management has undergone a second, quieter evolution where some providers have leveraged their risk management and trade execution skills to offer additional services beyond single transactional portfolio restructures. We now see a divergence among transition managers, with some providing the core portfolio restructure services, and others providing a more complete range of related services. We've outlined below a number of these enhanced transition management services.

Risk measurement and management services

Significant investment decisions are made on a regular basis through formalized asset liability studies and manager reviews. These rigorous studies can often result in the major portfolio restructures that transition managers are asked to undertake. A subset of transition managers now offer interim risk management services that help bridge the gap between these studies. When an asset manager is terminated, transition managers can neutralize an active portfolio so passive exposure is provided with minimal market trading. On a macro level, by using futures, ETFs and other instruments to realign portfolios, clients can reduce policy drift and more closely align portfolios to their investment objectives and strategic asset allocation.

These services generally all follow the same process. The transition manager reviews the client's portfolio through their multi asset class platform, which captures overall risk and exposure. The transition manager

can then evaluate this exposure versus the intended exposure within the client's policy statement and the manager implements the appropriate measures to realign the portfolio. Rebalance frequency, data sources, permissible securities and duration of the service are all determined in advance.

Specific examples of this service include:

Cash securitization

Cash securitization can be implemented over a single portfolio, providing passive benchmark exposure for a proscribed period of time. This is useful when an institution has decided to make an asset allocation shift but is not yet ready to appoint portfolio managers for the new investment. A portion of the securities can be transitioned to the strategic allocation with the use of futures, swaps or exchange traded products.

and securitize this value in accordance with the client's investment policy statement and asset allocation policy, using listed Index Futures and/or ETFs. Armed with holistic portfolio information, decisions can also be made to hedge specific exposures.

Asset allocation adjustment

The investment policy statement and asset allocation model prescribe the optimal asset mix, and are widely held as the single largest determinant of long term portfolio return. However, market movements skew actual allocations away from policy and create risk. Therefore, overlay services have been developed, which utilize listed index futures and ETFs to create marginal long and short exposures, bringing actual exposures back to policy weightings.

Style management

Passive securities can be used to influence portfolio style in the same way they are used to adjust asset allocation. Portfolios are evaluated versus value and or growth indices, and adjustments can be made, in line with predetermined rules, to achieve the desired style exposure.

The overlay services essentially utilize the same multi asset class global platform for risk management and execution to deploy a continual "transition like" service that sits atop the client's assets. Beyond simply managing deviations from strategic targets, there is an incidental and incremental benefit to the client as well. In order to manage this risk, there must be a process in place to regularly measure the exposure drift, thus allowing for the possibility of more timely recognition of these exposures. This monitoring process also allows asset owners to make tactical decisions should markets or specific asset classes move sharply or potentially dislocate from standard norms. It is this process of regular measurement and management that allows clients to protect their assets on a strategic basis or take tactical measures.

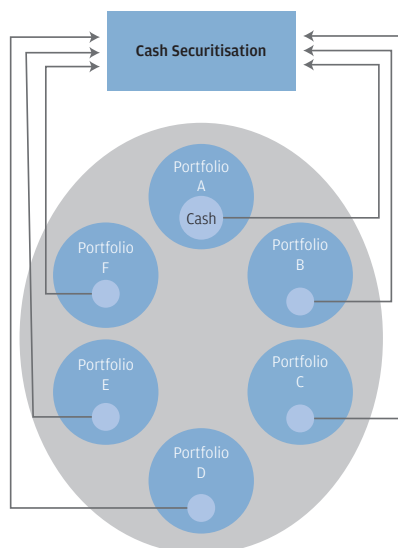


Diagram 1

This example addresses individual portfolio changes, however cash positions across multiple portfolios within a single client can also be securitized. These balances, while small in any single portfolio, on aggregate create a drag on investment performance. As illustrated in diagram 1, transition managers combine the balances of applicable portfolios

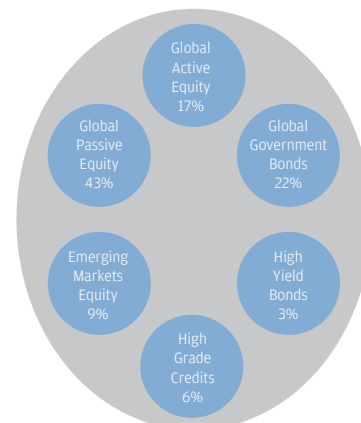
Execution services

Transition management delivers pre- and post trade analysis along side an optimized execution strategy – a service that is desirable to block traders and to institutions implementing significant portfolio changes alike. To this end, some asset managers have started to outsource a portion of their trading requirements to transition managers. The level of required service ranges from specific portfolio restructures, similar to traditional transitions, to the outsourcing of an entire dealing desk. Examples of specific restructures include regular fund manager changes to multi manager funds, onboarding of new clients as in-specie subscription, and fund mergers and consolidations.

On a grander scale, some smaller asset managers have started to shift their dealing requirements, with transition managers handling all of the manager's execution requirements. Fund managers send the required trades to the transition manager, normally electronically via the FIX protocol, and they receive filled orders in the same way. The transition manager designs and implements an optimized trading strategy and handles all post trade middle office and settlement functions. The fund managers benefit by accessing a robust transition management platform, trade strategy design and execution capabilities, while receiving comprehensive reporting detailing trade performance. This extension of the transition services also provides asset managers with the transparency and accountability they require.

Client's Investment Policy Statement			
Asset Class	Current		
	Allocation	Exposure	Deviation
Global Passive Equity	40%	43%	3%
Global Active Equity	15%	17%	2%
Emerging Market Equity	5%	9%	4%
Total Equity	60%	69%	9%
Global Government Bonds	25%	22%	-3%
High Grade Credits	10%	6%	-4%
High Yield Bonds	5%	3%	-2%
Total Fixed Income	40%	31%	-9%

Diagram 2



Summary

Transition management started life as a client's trusted partner delivering a basic transactional service. Over time, the industry has expanded, building on that close relationship, and making available additional analytic and execution services required by clients. Today, we remain trusted partners, although we see a divergence of transition management providers; some focus on the core transactional service, while others, with the infrastructure and skills, offer the basic service as well as the enhanced tailor-made services for both asset owners and asset managers.

¹ The T Charter is a voluntary code of best practise for transition managers, meant to encourage disclosure and transparency. Firms stating they comply with the T-Charter must comply with it in its entirety.

Nell Axelrod, J.P. Morgan Transition Management Team

To find out more about our transition management solutions, visit: jpmorgan.com/transitionmanagement or contact your J.P. Morgan representative.