MONEY management executive

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SPECIAL REPORT

OPERATIONS: Adapting to Change

By Rebecca Stropoli

Rapid developments in financial technology are top-of-mind for asset managers pondering the industry's top operational challenges.

Money Management Executive reached out to various executives for their takes on how to adapt.

Kris Chester, chief operating officer, Kestra Financial

Ron Redell, president, DoubleLine Funds

Kestra Financial COO Kris Chester says firms that only provide proprietary technology solutions will find it difficult "to quickly build new and innovative solutions" in a fast-evolving environment, suggesting open-architecture platforms as a solution.

DoubleLine Funds President Ron Redell predicts the strongest managers "will forge ever-closer linkages with the growing array of systematic investment products, open-architecture vehicles and new technologies such as artificial intelligence and predictive analytics."

PNC exec Alex Overstrom says firms must "be careful to avoid a focus on innovation simply for its own sake."

For more on what Chester, Redell, Overstrom and other executives foresee in new technology, regulatory changes, resource allocation and more, read the rest of our special report.

ADAPTING, on page 6

ANALYSIS: Big opportunities in regtech

By Mark Evans

Some things are truly rare, like blue moons, Triple Crown winners and Major League Baseball players who have .400 batting averages.

There are rarities in finance, too. When infrequent happenings occur, they tend to create unique opportunities for us to look beyond the mundane problems, stretch our imaginations and take on — and solve — much larger challenges in more strategic ways. It's a nifty place to be.

We're seeing this happen with the future of regulatory technology in the asset management space.

Various forces driving these changes are shifting and aligning in new ways.

This unique alignment is creating tremendous opportunities to reinvent the old, unglamorous back-office processes we've had in

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COMMENTARY: Vanguard's not the only threat to active

By Eric Balchunas

Truly passive index funds and ETFs are winning over many financial professionals. There are some holdouts who look after perhaps as much as $25 trillion. They are not rushing to move into cheap beta-style ETFs for fear of seeing their value diminished. But at the same time, money managers may want to move away from out-of-favor and expensive active mutual funds.

Enter Goldman Sachs, which has built the ETF equivalent of the T-1000 Terminator, a killer cyborg fund sent from the future perfectly calibrated to eliminate human managers by exploiting the growing world of fee-based advisors. The firm's Goldman Sachs ActiveBeta U.S. Large Cap Equity ETF (GSLC) is a multifactor fund loaded with all the bells and whistles a fee-

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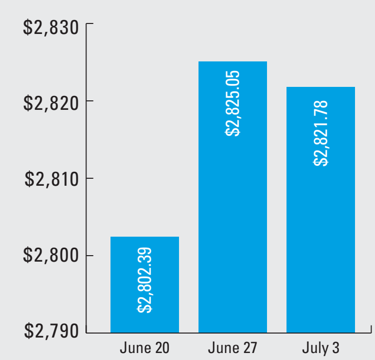
Money market fund assets dropped by $3.27B for six-day period ending July 3 (billions)



Source: Investment Company Institute

INDUSTRY HIGHLIGHTS

SEC POISED TO ADVANCE RULE THAT STREAMLINES ETF APPROVAL PROCESS

The SEC is considering a proposal that will make it easier for mutual funds to introduce new ETFs into the market.

The proposal would lay out formal steps for setting up less-complicated funds and eliminate many of the issuers from having to seek a special order from the SEC to operate.

"The main goal, as we understand it, is to streamline the process for straightforward ETFs to come to market and possibly level the regulatory field," Michael Mundt, a partner at Stradley Ronon, said of the SEC's proposal.

This is the second recommendation to be considered by the SEC after years of complaints that the ETF application process is too expensive, and takes too long. The first, which attempted to get rid of unnecessary regulations, was dropped in 2008.

VANGUARD TO CUT ONLINE ETF FEES FROM NEARLY ALL ETFs

Vanguard plans to eliminate online commissions for a majority of its ETFs, as well as from various competitors' products.

The firm said it will expand its access to low-cost ETFs to 1,800 from, offering them at no cost. The program excludes speculative and complex ETFs, but will include funds from BlackRock, Schwab and SSgA.

"We believe giving investors access to a broad choice of low-cost, broadly diversified, commission-free investments is good for investors and good for the asset management industry," said Karin Risi, managing director of Vanguard's retail investor group.

Vanguard expects the changes to take effect in August.

RESEARCH

COMPETITION TO INTENSIFY AMID SHRINKING FEE POOL: CERULLI

Fund fees are dropping as asset allocation advice is becoming increasingly important, according to a study.

Since there is more advice available, managers are competing for a shrinking fee pool, said Cerulli Associates Director Bing Waldert. In some cases, fees are dropping close to zero, according to the report from Cerulli. One of the reasons for this has to do with greater regulation formalizing the buying process and creating demand for low-cost passive products. Cerulli also expects automation to continue to drive down fees.

"Under the influence of professional buyers, eliminating the highest-priced products is often the first screen, creating a race to the bottom as managers try to avoid having above-average fees," Waldert said.

PRODUCTS

J.P. MORGAN LAUNCHES DIGITAL PORTFOLIO TOOL

J.P. Morgan announced a new digital tool from Portfolio Insights that will help financial advisors build stronger portfolios and improve client communication.

The tool will provide on-demand diag-

Estimated fund flows ($ millions)

	7/3/2018	6/27/2018	6/20/2018	6/13/2018	6/6/2018
Equity	-10,614	-17,948	-5,172	6,773	-3,651
Domestic	-11,376	-12,535	-3,879	7,815	-4,532
World	762	-5,413	-1,293	-1,042	881
Hybrid	-2,552	-1,214	-857	-1,975	-1,118
Bond	4,587	2,980	4,548	5,564	1,376
Taxable	4,231	2,454	3,806	5,238	727
Municipal	356	525	742	326	648
Commodity	-1,027	-612	-264	-416	-761
Total	-9,606	-16,794	-1,744	9,946	-4,155

Source: Investment Company Institute

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nostics, observations and content, according to J.P. Morgan. Advisors will be able to upload a portfolio and tailor their analysis to address specific risks and concerns, evaluate new asset classes and products, or simply perform a portfolio checkup against a benchmark they choose.

VANGUARD FILES FOR TWO ESG ETFs

Vanguard is in the preliminary stage of introducing a Stock ETF and Vanguard ESG International Stock ETF that should begin trading in September, the firm says.

The fund will seek to track the FTSE US All Cap Choice Index, a market-cap weighted benchmark that is made up of stocks that are screened to avoid companies involved in certain industries, such as adult entertainment, tobacco and weapons sales.

The methodology also screens stocks of companies that don't meet criteria set by the U.N. global compact principles, such as diversity and environmental standards.

"The adoption of ESG investing has accelerated in recent years, and more investors are looking for opportunities to align their investment choices with their values," said Jon Cleborne, head of Vanguard's portfolio review group.

FRANKLIN SEEKS APPROVAL FOR SAUDI ARABIA ETF

Franklin Templeton Investments is seeking approval with the SEC for a Saudi Arabia ETF, Bloomberg reports.

Investors are starting to pull billions from broad emerging market funds to invest in single-country ETFs, and Saudi Arabia is having the most success.

There is only one other fund like the ETF Franklin Templeton is now launching. This fund, the iShares MSCI Saudi Arabia ETF (KSA), has ballooned by as much as 1,700% this year, surpassing all other single-country funds.

E FUND, STATE STREET DEVELOP CHINA ESG STRATEGY

E Fund Management and State Street Global Advisors are co-developing the State Street – E Fund Environmental Driven China A Strategy, a strategy that will integrate environmental thinking into Chinese equity portfolios.

The strategy will have a bottom-up construction approach that combines sustainability metrics with a focus on companies that are more carbon-efficient, have better environmental policies and generate higher green revenues.

AMPLIFY ETFs PLANS FOR NEW BATTERY METALS ETF

Amplify ETFs will launch the Amplify Advanced Battery Metals and Materials ETF (BATT), says the firm. It will invest in companies doing business related to Lithium, Cobalt, Manganese and Graphite.

BATT, which has an expense ratio of 0.72%, will invest in companies that either have at least 10% market share of any advanced battery metal or derive 50% or more of their revenue from an advanced battery metal. BATT will be co-managed by its sub-advisers Toroso Investments and Exponential ETFs.

OCEAN CAPITAL, ETF MANAGERS LAUNCH GLOBAL ETF

Ocean Capital Advisors is partnering with ETF Managers Group to launch the Rogers AI Global Macro ETF (BIKR), a fund aimed at providing investors optimally weighted global portfolios.

BIKR has an expense ratio of 1.18% and will primarily hold single-country ETFs, according to the firm. The ETF will also use artificial intelligence and Jim Rogers' insight to find, track and project leading economic indicators.

The fund will primarily invest in global equity markets and attempt to achieve long-term capital gain by trying to outperform global large and mid-cap equity indexes.

"Artificial intelligence is constantly evolving and changing the asset management space, and a product like BIKR satisfies growing investor needs," said Sam Masucci, Founder and CEO of ETF Managers Group, in a statement.

FIDELITY BEGINS TRADING 2 FACTOR ETFS

Fidelity started trading two new commission-free ETFs: the Fidelity Low Duration Bond Factor ETF and the Fidelity High Yield Factor ETF on the firm's online brokerage platform.

The Fidelity High Yield Factor ETF will invest 80% of its assets in debt securities that are rated below investment grade. It will use the ICE BofAML BB-B US High Yield Constrained Index (FRED) as a guide in structuring the fund and selecting its investments according to credit quality and risk characteristics.

The Fidelity Low Duration Bond Factor ETF will try to follow the performance of the Fidelity Low Duration Investment Grade Factor Index. The fund will invest at least 80% of its assets in securities that are included in the index.

ARRIVALS

KENNEDY LEWIS HIRES NEW CHAIRMAN

Kennedy Lewis Investment Management announced that former CarVal Investors President John Brice will be joining the firm as chairman.

Brice will work on strategic initiatives with the firm's executive committee and co-founders David Chene and Darren Richman.

John Brice

"John's client-first philosophy and strong track record of success make him a valuable addition to the team as we continue to pursue new and innovative market opportunities across a broad range of sectors," said Chene in a statement.

FRANKLIN TEMPLETON INVESTMENTS NAMES NEW SENIOR VICE PRESIDENT

Franklin Templeton Investments hired former Voya Portfolio Manager May Tong as senior vice president for Franklin Templeton Multi-Asset Solutions.

Tong will report to Tom Nelson, senior vice president and director of portfolio management.

"We anticipate adding her as a portfolio manager to certain US products over the coming months," Nelson said. MME

News Scan by Jessica Mathews

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Polen Capital Information Technology Director Andrew Powers

Shifting to the cloud

The benefits of virtualization and subsequent proliferation of cloud-hosting capabilities have been transformative.

Businesses of all sizes can obtain availability and access controls that were previously only available to enterprises.

The subsequent reallocation of resources to value-added activities in support of firm goals has been a follow-on benefit.

The challenge that arises, versus on-premise hosting of critical business applications, centers around data governance and integrated reporting.

When the firm's data assets are local, control and access to the data is taken for granted.

When this data is remote, and often only accessible through limited interfaces, it can become a challenge to manage and use the data properly.

To address this challenge requires a reassessment of the firm's approach to data management.

On-premise systems allow data requirements to be partially fulfilled by direct connections to source systems.

Databases or data warehouses will need to be redesigned to store source data that is now remotely accessible.

In the best-case scenario, the firm can leverage offerings from the cloud/outsourcing provider, such as data marts and APIs, to automatically feed these new data stores.

In terms of data governance, the cloud shift allows firms to redesign or affirm the ownership/stewardship of the data, and achieve consensus on taxonomy.

The result can be applied consistently and be used to construct meaningful validation and reconciliation routines.

Automation is important in this phase, to insure accuracy in the result.

The ultimate payoff is in the implementation of modern reporting tools against the new or redesigned database.

These business intelligence platforms can significantly increase reporting agility, allowing mass customization of relevant visualizations.

The effort also lays the groundwork to implement modern algorithms to support AI and machine learning.

Kestra Financial Chief Operating Officer Kris Chester

Embracing open platforms

There's currently a disparity of technology adoption between baby boomer advisors and Gen X and Gen Y advisors.

Boomer advisors, while highly successful and independent, are generally more hesitant to adopt integrated and advanced technological solutions that help streamline their business operations and enhance their client experience.

Conversely, Gen X and Gen Y advisors are more apt to implement new technologies.

A digitized client experience will not only simplify and streamline client interactions, but will also offer back-office efficiencies that will give advisors and their staff more time to focus on building client relationships.

However, the speed at which technology continues to evolve presents a real operational challenge to firms that provide only proprietary technology solutions.

This is because it can be difficult to quickly build new and innovative solutions in a closed environment.

An open architecture platform allows providers to quickly incorporate new technologies into their platform.

It's easier to partner with premier software applications and then integrate them into the platform, taking advantage of innovation before it becomes stale or even obsolete.

When firms can create a technology platform that is consistently giving advisors the tools to increase the value they are delivering to their clients, advisors may be less resistant to the change needed to evolve their business model.

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Northern Trust Relationship Manager Ryan Burns

Allocating your resources

Fund operations professionals face hard choices on a daily basis.

There is not just one major challenge facing the industry, but rather the coalescing of a few trends that is applying the pressure.

For one, regulatory change requires funds to make more data available in new formats. At the same time, fees are shrinking and aging systems are starting to reach their limits.

The search for new revenue leads to different strategies and new distribution channels across the globe, which then puts further pressure on infrastructure.

And in this constrained revenue environment, operations managers need to ensure they are spending their personnel dollars on the right type of people with the right skill set.

The squeezing of the discretionary dollar is forcing those in the industry to take fresh looks into what is truly needed when it comes to people, technology, and new distribution channels and products.

Certainly, just because a particular initiative or function has been funded in the past does not mean it should get the same level of support in the future. It can be challenging to discard strategies that worked before, but that's all part of managing growth strategies.

It can come down to a build-or-buy decision: Do you continue to invest internally, or move to a more nimble technology structure that may allow you to respond more quickly to regulatory change, go to market faster with new strategies or respond more effectively to client or investor needs?

Successful firms will be able to use their scarce resources to prepare for the months, years and even decades ahead through investments that will shore up the long-term viability of their business.

Of course, they just need to make the right choices today.

Leaseum Partners CEO Steve Sillam

Blockchain boosts efficiency

Blockchain has the potential to bring the security, speed and ease of digital goods transfer, such as Bitcoin, to real-world assets.

Tokenized securities may replace stocks, bonds, REITs and other securities through the blockchain, improving efficiency, liquidity and transparency.

A security token is a digital asset subject to securities regulations.

Therefore, these tokens must be fully compliant from issuance to secondary trading on exchanges. Even though tokenized securities will exist on a blockchain in a digitized form, they must still rely on the ethics and restraints of the real world, which includes securities regulations and compliance with the institutions that enforce them.

Until now, the typical investment in private securities has been locked up for long periods of time, pending a liquidity event. This has traditionally made sense, as many of these investment classes are illiquid in nature and fulfilling redemptions would be extremely costly. However, if tokenized securities are undertaken, these historically illiquid assets would become more liquid, generating a massive improvement in market efficiency.

Recent technology developments have created token compliance protocols and regulated security token trading platforms, thereby allowing investors to trade while meeting regulatory standards.

Regulations implemented within tokens can enforce US RegD 506c rules that relate to holding periods, accreditations or maximum number of shareholders at any time, easing issuers' and regulators' potential concerns.

Additionally, dividend payments can be automated and the mechanisms can deliver automated compliance permissions, which are improving the speed of transactions while introducing liquidity to real-world assets.

Furthermore, the buyer and issuer do not need to bear the additional regulatory risk they would in a traditional private security investment, as all trades are subject to know your customer and anti-money laundering rules.

Finally, security tokens won't be vulnerable to the hacks that have crippled Bitcoin and other cryptocurrencies, due to investors' ability to prove ownership with KYC.

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Alex Overstrom, PNC EVP and COO, Asset Mgmt./Corp. & Inst. Banking

Don't innovate just to innovate

Technology has, of course, always played a crucial role in the asset and wealth management industry.

The pace of change over the past five or so years, however, has fundamentally altered both our understanding of what technology and data can do and what our clients expect from us.

From data-driven investing and intuitive, real-time client portals to the ability to automate vast swaths of back-office processes, the scope and opportunity for change is unprecedented.

That being said, as an industry, we need to remember what hasn't changed — that is, our obligation as stewards of our clients' capital.

While firms should continue to invest in technology and data to take advantage of the many real opportunities that innovation has unlocked, we also must be careful to avoid a focus on innovation simply for its own sake.

Financial and technical engineering can create transparency and enhance resilience, but they can also lead to unneeded complexity and risk.

Firms must strike the right balance between investing in value-added innovation that truly delivers for clients and avoiding the temptation to constantly keep up with ever-evolving technological developments, especially considering the high costs this can incur.

A focused business model and clear understanding of client needs are essential. Having a long-term perspective is also critical.

Strategically, how firms deploy resources across the growing range of technological opportunities may ultimately be what differentiates the winners from the losers over the next cycle.

Clients will be more likely to reward those firms that have invested with the aim of delivering strong and resilient outcomes on their behalf.

DoubleLine Funds President Ron Redell

Adapting business models

Conventional thinking about asset management and financial advice often reflects false dichotomies.

For example, either the future of asset management belongs to active investing or passive. Or the future of financial advice belongs to robo-advisors or human advisors. Or the future of delivery vehicles must belong to mutual funds or ETFs.

To be sure, active asset managers and advisors face relentless fee compression and ever-keener competition from new technologies and index products.

Those that fail to adapt business models and deliver outperformance are headed for decline, if not extinction.

Adaptation of business models, I would add, means more than improving cost efficiencies. For example, successful firms also must be agnostic with respect to delivery vehicles, giving clients a variety of choices.

The good news is the emergence not of category killers but of hybrid models. I believe the best traditional practitioners in our two industries will forge ever-closer linkages with the growing array of systematic investment products, open-architecture vehicles and new technologies such as artificial intelligence and predictive analytics.

This process is underway. DoubleLine, to cite my firm as an example, has built the majority of its business as an active bond manager, most of that within mutual funds. Smart-beta solutions have extended DoubleLine into equities and commodities.

Meanwhile, strategic partnerships have diversified our distribution into variable annuity, multi-manager funds, active ETFs and international vehicles.

In the advisory world, robo-advisors already guide hundreds of billions of dollars. Much of that, however, has been in the digital-advice units of brokerage firms.

At a recent fintech conference, a representative of a large brokerage service organization described that business "as a tech firm that happens to be in financial services." MME

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based financial advisor goes nuts for, which should scare the daylights out of an active fund manager.

GSLC has taken in cash in all but two months of its three or so years in the market, accumulating $3.5 billion in assets even though it has underperformed, an unheard of feat for a smart-beta ETF. GSLC's success is spawning a new generation of similar multi-factor ETFs from the likes of JPMorgan Chase and Fidelity Investments. Even ETFs from BlackRock and Vanguard that are priced for next to nothing and could end up stealing a large portion of the (remaining) assets from active mutual fund managers.

So what exactly makes GSLC a force to be reckoned with? There are five main components:

Cost: GSLC charges an absurdly low fee of 0.09%, which is 10 times cheaper than the average active mutual fund and five times cheaper than the average ETF.

The fee "opened up a lot of doors for us," Michael Crinieri, the global head of ETFs at Goldman Sachs Asset Management, said in an interview on ETF IQ on Bloomberg TV.

The dirt-cheap cost is hyper-appealing to advisors who have moved to fee-based models, as opposed to the fading commission model. They know cost is a key variable in predicting performance and it allows them to better protect their own fees.

Let's stop for a minute and just take note of that last sentence because it is the single-biggest driving force all fund flows for the past 10 years — and likely the next 20 years.

LOW COST, CHECK

Quant: Factor investing is hot, winning over the clients of traditional discretionary active managers. Factor investing looks for characteristics of stocks that academic studies have shown to explain outperformance over time. Factor investing is typically rules based, meaning it effectively removes emotion from the equation. The most popular — and respected — factors are value, momentum, quality and low volatility.

The problem for many advisors is trying to figure out which factors to use and when. GSLC attempts to solve this by combining four factors into one fund using separate sub-indexes with their own calculations, as seen below.

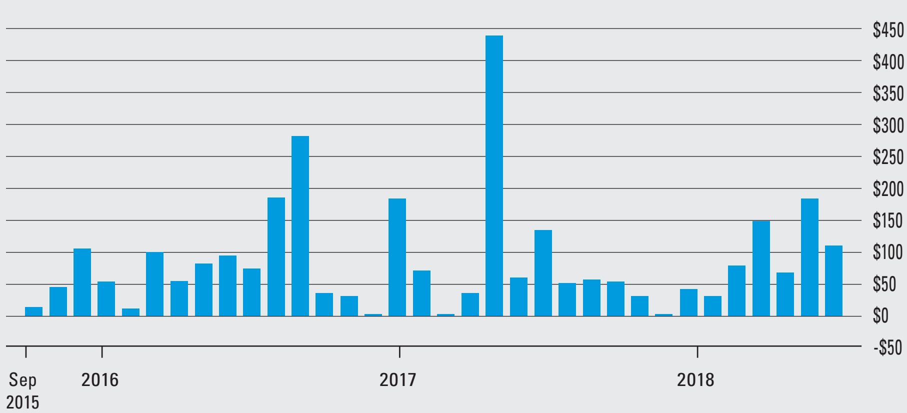
CONVENIENCE, CHECK

Brand: ETF investors favor products with some brand recognition, if not rock-star sizzle. Goldman is a top-shelf brand. If a smaller or less-established firm offered the same product, even for the same fee, it likely wouldn't as big a smash hit as GSLC.

Being able to offer clients a new quantitative strategy that was once reserved only for Goldman's institutional clients is appealing to any investor and part of the ongoing democratization of investing ushered in by ETFs.

Raking it in

Goldman Sachs' ActiveBeta U.S. Large Cap Equity ETF has had only two months of outflows. (millions)



Source: Bloomberg News

ROCK-STAR ELEMENT, CHECK

Safety: GSLC is very similar to the S&P 500 in that its top five holdings are the same: Apple, Microsoft, Amazon.com, Facebook and JPMorgan.

It has a 98.5% correlation to the stock market thanks to a 73% overlap with the index, which is almost double that of a typical active mutual fund at about 40% (which have long been criticized of "closet indexing").

It is arguably a bad strategy investment-wise to hug the S&P 500, but in terms of asset gathering it is a great strategy because it allows advisors to tell a "story" without the risk of significant underperformance. Most advisor clients do not have the stomach for a more pure, highly active style of factor investing.

That's what some daring, and unfortunately unloved, ETFs attempt to do.

These products are typically used in smaller portions to complement the core of a broader portfolio, whereas GSLC can be used to replace the core.

WON'T GET ADVISOR FIRED, CHECK

Taxes: The topic of taxes is boring, which is why you don't hear much about one of the big problems with the mutual fund structure: capital gain distributions.

Mutual fund investors have to endure getting taxed based on what the fund does and then again when they sell shares of the fund.

GSLC utilizes the ETF's brilliantly designed creation/redemption mechanism to eliminate any gains inside the fund. GSLC has made no distributions.

The taxes saved by an ETF can seriously compound over time, creating what some refer to as "tax alpha."Tax efficiency, check.

Add it all up and it doesn't really matter that GSLC will likely outperform by a small margin in some periods and underperform in others.

The product is so powerful and interesting because it is essentially an active strategy that isn't dependent on returns to rake in assets.

So, after Vanguard and BlackRock are done ravaging active mutual funds, human managers will have to do battle with a new breed of ETFs such as GSLC over what is left.

Good luck with that. — *Bloomberg News* MME

REGTECH
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place for years, even decades.

In their place, our industry is imagining more vibrant, more agile and more inclusive processes that deliver significantly greater strategic business results.

With regtech, we have a golden opportunity to take the things we've built to handle specific requirements like the European Union's Alternative Investment Fund Managers Directive and the SEC's Money Market Fund reporting, and challenge ourselves to zoom out to focus on solving larger, more holistic problems.

Instead of nixing or slow-rolling these initiatives, leaders in our industry are seeing their potential and green-lighting them.

WHY NOW?

Why are so many people in our industry seizing the opportunity to stop having a million processes that essentially do the same thing?

Why are they showing willingness to move away from little data islands and little information silos and taking the steps to really attack the larger problem?

Let's take a deeper look at this growing trend.

In my experience, I've seen three roadblocks that get in the way of progress. The first is when there's a problem with no viable solution available.

Second is when people build solutions for problems that either don't exist or are simply not important.

Third, and maybe the toughest, is inertia. That's when there's a real problem and available solution, but no action is taken due to the organization's narrow focus, limited budget or lack of appetite for change.

Happily, none of these roadblocks have plagued regtech. The challenges that regtech addresses are real, and there are viable solutions available.

However, the really interesting dynamic here is that many investors are gaining clarity in their vision, and seeing that as digitalization continues to increase, the old boundaries that separated different parts of their operations are fading away.

They are recognizing that more unified and automated processes can yield new operational intelligence.

Their imagination is being inspired by what regtech is doing.

BACK-OFFICE UPDATES

This last piece — the organizational "permission to reach further" — is paving the way for regtech to transform into a broader movement across fund servicing.

Firms are supercharging their regtech systems and applications so they can do more.

It's not hard to imagine insights from trade settlements, transaction accounting, compliance records and other back-office activities being used to inform and improve middle-office activities such as risk management.

Confluence CEO Mark Evans

This is the tipping point that's creating datatech, extending the value of structured data and technology innovation beyond regtech to the entire post-trade ecosystem.

Existing tools are being augmented in ways that unlock significant advances in automation and data management.

Those advances are informing breakthrough improvements across the full range of asset managers' back-office functions — and more and more middle-office processes as well.

It's one of those moments that we at Confluence love to see. We have both an opportunity and the permission to act upon it.

Everyone stands to win

'SPARK THE IMAGINATION'

With datatech, firms can tap into their data in new ways and automate the production of a range of financial, marketing and statutory reports.

These capabilities spark the imaginations of in-house people who then challenge their tech vendors to think differently along with them.

This tandem creates a virtuous circle that generates continuous innovation without requiring a new process or system at every turn.

Now, instead of focusing on producing pre-ordained deliverables like prospectuses and financial statements, back-office processes will be optimized for shared data.

The smart and creative people in our industry will now be able to take that data in whatever directions intrigue them.

With this new thinking and access, it's not hard to imagine insights from trade settlements, transaction accounting, compliance records and other back-office activities being used to inform and improve middle-office activities such as risk management, or even sales, marketing and other client-facing processes in the front office.

No one can argue that this evolution is overdue. Back-office data has been underutilized for decades.

The opportunity has arrived, and the shared data and digital infrastructures are now being put in place. We can take these advances as far as our imaginations allow.

There's a blue moon, a Triple Crown winner or a .400 hitter waiting to emerge from the shadows of your back-office operations. Don't fail to see it, and don't miss out on this rare opportunity.

As an industry, let's not squander this chance to reimagine the back office. Let's not allow old realities or today's requirements to inhibit tomorrow's possibilities. By embracing DataTech, we can avoid that trap.

Let's have some fun. MME

Mark Evans is founder and CEO of Confluence, a global investment data management company for regulatory, financial and investor reporting.

The Strategic Shift to Middle-Office Outsourcing

By George Martinez

Typically charged with an array of critical post-trade functions including position keeping, derivatives monitoring and more, increased demand for sophisticated investment strategies has made the middle office more vulnerable to fragmentation. By outsourcing these services to a specialist third party, buy side managers can relieve pressure on the middle office while also gaining access to a range of invaluable services such as custody, fund administration, oversight and safekeeping.

GREATER TRANSPARENCY

As in past years, outsourced demand has been fueled by factors like front-office synchronization, streamlined data processing, and, more recently, the need for advanced cybersecurity protections. With investment products growing in complexity and spanning a wider range of markets and asset classes, more than ever managers require greater transparency around asset valuation, process monitoring and other areas in order to satisfy both regulators and clients. Key to this effort is proper integration of the middle office with front- and back-office systems, using automation to create a more effective system of data gathering across multiple sources, thereby reducing the likelihood of siloed activity.

While funds with deeper pockets could conceivably acquire the tools necessary to achieve enhanced inter-operability, demands on personnel, along with the push towards fully independent accounting, reporting and risk-management protocols, makes seeking a qualified third-party an increasingly attractive option for traditional and alternative managers alike. Rather than devote copious amounts of investment capital to ensure data is effectively managed and kept secure, even Tier 1 managers are now considering handing off to a provider who is better equipped at handling these tasks.

Indeed, enhancing the middle office not only means having the right tools for the job, but also ensuring solutions are properly integrated with a firm's existing technologies, and are flexible enough to meet the needs of a perpetually changing marketplace.

George Martinez

Along with current mandates such as Dodd Frank, Form PF and FATCA, the issuance of newer regulatory rules has been front-and-center among firms seeking outsourced assistance. These include the recent transition to a two-day settlement cycle under T+2 in the US, as well as the ongoing phase-in of regulations around variation and initial margining of non-cleared derivatives products (the latter impacting in particular smaller buy side firms with minimal derivatives exposures that nonetheless must get up to speed in terms of regulatory compliance). Providers can help fund managers reduce their workload through solutions that can facilitate management oversight, thereby allowing companies to know where their exposures are and whether the data they're reporting is accurate.

CYBERSECURITY TO THE FORE

In the effort to build a faster and more efficient marketplace, the securities industry has in many ways made itself increasingly vulnerable to rogue cyber activity. While large-scale fund companies have yet to be directly impacted, the growing interconnectedness of the exchanges, clearinghouses, broker-dealers and asset managers is such that even minute breakdowns resulting from a hack attack could lead to major problems, potentially putting investors in harm's way.

Not surprisingly, the Securities and Exchange Commission (SEC) and other oversight agencies have underscored the need for market participants—asset managers included—to seek strategies for countering these risks as a precautionary measure. Accordingly, utilizing a provider's fully secure, streamlined systems can bring real peace of mind to management teams.

Today asset managers must be able to analyze and organize vast amounts of internal and external information in order to fully achieve control of their data. Lack of integration between front, middle and back offices, however, can hamper this effort, making breakdowns more likely. Data that requires constant recalculating due to insufficient or outdated technologies only worsens the problem, leading to potential redundancies that in turn sap funds of precious energy.

It would be one thing if the average middle office had the wherewithal to keep pace with the constantly changing investment and regulatory environment. However, today many operations still rely on yesterday's solutions, including outdated Excel spreadsheets and other manual processes. As fund information grows in complexity, maintaining inadequate or outdated systems only increases the chances for data siloes and other transmission errors.

While a global enterprise with more jurisdictions to monitor would appear to be the best candidate for middle-office outsourcing, in reality companies of all sizes can benefit from having an expert in the field, one that allows the fund to devote fully to their core competencies. Without having years of legacy systems to unwind, for instance, boutique and other micro fund managers may be able to get up and running with an outsourced solution that much faster.

Looking ahead, managers face steadily increasing regulatory and compliance costs, not to mention a challenging distribution landscape. Thus, for firms with only limited in-house resources, the ability to access a more efficient, secure and technologically advanced middle-office architecture on an outsourced basis will continue to win converts within the fund industry, particularly as concerns around beta and cybersecurity become more front-of-mind.

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Top-performing mutual funds and ETFs by year-to-date returns

The stock market, which encountered heavy volatility, has turned in a fairly muted performance year-to-date.

A pullback from much more significant gains has left the S&P 500 ahead 2.6% through much of the firs half.

But it's hardly a surprise that many funds have managed to hold on to substantial advances. In a review of the best-performing funds year-to-date, many funds are strongly in the black — indeed, the average return among the top 20 was 24%. The average expense ratio was slightly more than 1% and the best performers tended to be focused on small-cap, growth and the health care sectors. Highly leveraged funds, institutionals, those with less than $100 million in assets or investment minimums of more than $100,000 were excluded. MME

	Ticker	YTD % Returns	3-Yr. % Annualized Returns	Expense Ratio	Net Assets (millions)
iPath S&P 500 VIX ST Futures ETN	VXX	32.39	-48.96	0.89%	$859.75
ProShares VIX Short-Term Futures	VIXY	31.70	-49.11	0.87%	$129.93
Invesco S&P SmallCap Health Care ETF	PSCH	30.34	20.73	0.29%	$737.15
First Trust Dow Jones Internet ETF	FDN	25.26	26.03	0.53%	$8,789.37
Alger Small Cap Focus I	AOFIX	25.15	17.35	1.20%	$1,391.09
Amplify Online Retail ETF	IBUY	24.59	N/A	0.65%	$447.67
Invesco DWA Healthcare Momentum ETF	PTH	23.20	11.29	0.60%	$239.85
Wasatch Ultra Growth	WAMCX	23.01	17.31	1.35%	$180.33
Lord Abbett Developing Growth A	LAGWX	22.86	7.82	0.96%	$2,010.41
Driehaus Micro Cap Growth	DMCRX	22.78	14.38	1.45%	$434.10
Eventide Healthcare & Life Sciences I	ETIHX	22.74	11.24	1.35%	$695.49
Virtus KAR Small-Cap Growth I	PXSGX	22.67	25.39	1.21%	$4,252.49
SPDR S&P Health Care Equipment ETF	XHE	22.59	21.13	0.35%	$460.56
iShares MSCI Saudi Arabia ETF	KSA	22.28	N/A	0.74%	$268.81
ARK Innovation ETF	ARKK	22.19	28.78	0.75%	$1,070.68
ARK Genomic Revolution Multi-Sector ETF	ARKG	21.94	8.36	0.75%	$206.80
Virtus KAR Mid-Cap Growth A	PHSKX	21.85	16.02	1.40%	$155.78
Berkshire Focus	BFOCX	21.47	19.09	2.02%	$158.37
Ivy Micro Cap Growth I	IGWIX	21.15	7.62	1.27%	$177.83
Morgan Stanley Multi Cap Growth B	CPOBX	20.95	18.43	2.02%	$715.85

Data as of 6/25/18 Source: Morningstar Direct

Mutual fund flows

($ millions)

		Equity									
			Domestic						World		
Date	Total long-term	Total equity	Total domestic	Large-cap	Mid-cap	Small-cap	Multi-cap	Other	Total world	Developed markets	Emerging markets
Estimated weekly net new cash flow											
7/3/2018	-8,619	-8,798	-11,206	-4,641	-1,024	-1,017	-4,412	-113	2,409	2,214	195
6/27/2018	-11,465	-9,425	-8,896	-6,273	-1,100	94	-1,420	-196	-529	-631	102
6/20/2018	788	-1,583	-3,127	-1,604	-414	445	-1,274	-281	1,544	1,994	-450
6/13/2018	538	-771	-1,147	-709	-358	878	-749	-208	376	229	147
6/6/2018	-2,334	-2,594	-4,741	-1,871	-1,309	617	-1,416	-761	2,147	1,976	171
Monthly net new cash flow											
5/31/2018	-5,798	-8,733	-15,812	-5,722	-4,423	544	-5,145	-1,067	7,079	5,886	1,194
4/30/2018	-6,967	-9,293	-12,680	-727	-1,127	-104	-3,953	-6,769	3,387	1,631	1,756
3/31/2018	9,559	264	-12,020	353	-2,823	-1,600	-6,594	-1,356	12,284	11,236	1,047
2/28/2018	-12,109	-8,369	-19,568	-1,665	-2,858	-2,634	-9,410	-3,000	11,199	9,460	1,739
1/31/2018	39,002	-7,078	-24,546	-6,914	-5,288	-2,117	-9,942	-285	17,469	13,268	4,201
12/31/2017	-28,893	-38,329	-43,096	-18,763	-4,770	-3,202	-12,383	-3,978	4,767	4,304	463
11/30/2017	-4,894	-16,441	-24,067	-5,949	-3,756	-3,439	-7,045	-3,878	7,627	6,303	1,324
10/31/2017	11,021	-15,971	-22,101	-7,360	-2,411	-2,109	-8,375	-1,846	6,130	4,962	1,169
9/30/2017	438	-21,998	-22,617	-7,548	-2,720	-2,046	-9,336	-967	618	1,372	-754
8/31/2017	-517	-16,493	-24,569	-7,242	-3,511	-2,555	-8,205	-3,056	8,075	6,650	1,425
7/31/2017	3,778	-13,782	-25,545	-10,330	-4,487	-2,242	-7,298	-1,188	11,763	11,038	726
6/30/2017	7,558	-9,412	-18,492	-13,228	-3,146	-2,291	1,918	-1,746	9,081	7,504	1,576
5/31/2017	27,289	3,144	-9,243	2,766	-2,379	-2,169	-5,234	-2,227	12,387	8,827	3,561
4/30/2017	306	-12,498	-19,556	-5,057	-4,061	-2,006	-7,056	-1,375	7,058	5,197	1,861
3/31/2017	12,553	-14,101	-13,409	-1,715	-833	-827	-7,620	-2,415	-692	-571	-121
2/28/2017	27,047	3,995	-2,694	-1,235	524	712	-2,069	-626	6,690	5,784	906
1/31/2017	11,157	-7,754	-10,936	778	-792	998	-10,606	-1,314	3,182	2,124	1,058
12/31/2016	-56,070	-33,615	-26,974	-10,891	-977	-816	-12,204	-2,085	-6,642	-5,817	-825
11/30/2016	-52,080	-27,965	-25,929	-8,244	-1,709	-293	-11,058	-4,626	-2,035	-888	-1,147
10/31/2016	-32,791	-37,928	-31,452	-8,576	-5,287	-2,541	-12,213	-2,834	-6,477	-6,258	-219
9/30/2016	-9,028	-22,398	-15,377	-152	-1,750	-1,086	-10,123	-2,265	-7,021	-6,113	-908
8/31/2016	-9,807	-32,287	-24,782	-5,504	-3,355	-1,711	-12,753	-1,459	-7,505	-7,276	-229
7/31/2016	-15,129	-37,685	-31,253	-11,922	-5,015	-3,382	-9,045	-1,889	-6,432	-6,239	-192
6/30/2016	-14,369	-18,895	-14,871	1,099	-4,486	-1,576	-7,812	-2,095	-4,024	-4,027	2
5/31/2016	-5,588	-17,369	-17,342	-4,178	-3,363	-1,188	-7,098	-1,516	-27	-1,217	1,190
4/30/2016	-4,520	-23,767	-19,455	-5,800	-3,381	-2,405	-7,327	-542	-4,312	-3,413	-899
3/31/2016	14,661	-9,971	-9,814	-5,473	-1,428	87	-2,661	-338	-157	1,307	-1,464
2/29/2016	8,492	8,779	-2,332	2,072	-2,871	-351	-525	-657	11,111	10,509	602
01/31/2016	-20,729	-4,927	-15,549	5,587	-5,958	-2,887	-7,339	-4,952	10,622	10,862	-239

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute

ETF flows

($ millions)

Date	Total equity	Domestic equity	World equity	Hybrid	Total bond	Taxable bond	Municipal bond	Commodity	Total LT MF and ETF flows
Estimated weekly net new cash flow									
07/03/2018	-10,614	-11,376	762	-2,552	4,587	4,231	356	-1,027	-9,606
06/27/2018	-17,948	-12,535	-5,413	-1,214	2,980	2,454	525	-612	-16,794
06/20/2018	-5,172	-3,879	-1,293	-857	4,548	3,806	742	-264	-1,744
06/13/2018	6,773	7,815	-1,042	-1,975	5,564	5,238	326	-416	9,946
06/06/2018	-3,651	-4,532	881	-1,118	1,376	727	648	-761	-4,155
Monthly net new cash flow									
05/31/2018	13,744	9,970	3,774	-3,989	13,108	11,831	1,277	-133	22,730
04/30/2018	-27	-7,422	7,395	-4,127	22,435	24,206	-1,771	2,310	20,590
03/31/2018	-6,742	-22,173	15,431	-2,059	15,920	14,188	1,732	554	7,673
02/28/2018	-19,502	-41,447	21,946	-3,724	1,772	2,784	-1,012	1,026	-20,428
01/31/2018	54,200	10,777	43,423	-669	56,779	46,322	10,457	1,724	112,035
12/31/2017	8,940	-9,057	17,997	-3,698	19,158	19,491	-333	-528	23,872
11/30/2017	13,723	-4,429	18,152	-3,365	21,628	19,819	1,809	-444	31,543
10/31/2017	23,928	3,152	20,776	-2,458	38,759	36,163	2,595	-747	59,482
09/30/2017	653	-9,782	10,435	-2,589	36,463	33,476	2,987	1,733	36,261
08/31/2017	-6,149	-22,775	16,626	-4,162	29,578	25,124	4,454	2,393	21,659
07/31/2017	7,402	-12,528	19,930	-2,575	31,728	29,164	2,564	-3,532	33,023
06/30/2017	21,927	-7,958	29,886	-2,754	32,681	29,420	3,260	1,528	53,382
05/31/2017	23,363	-10,760	34,123	-2,040	36,430	33,128	3,302	-449	57,304
04/30/2017	12,335	-8,278	20,613	-2,078	25,236	22,116	3,120	948	36,441
03/31/2017	24,562	9,409	15,153	-2,424	37,867	36,632	1,235	-531	59,474
02/28/2017	34,769	17,600	17,170	-552	36,025	34,026	1,999	1,867	72,110
01/31/2017	20,678	5,081	15,597	-2,484	35,543	31,061	4,482	-637	53,100
12/31/2016	23,720	18,848	4,872	-12,210	-4,142	12,190	-16,331	-3,600	3,768
11/30/2016	21,953	23,151	-1,197	-7,538	-13,284	-2,142	-11,142	-3,572	-2,441
10/31/2016	-24,010	-23,111	-899	-4,885	13,896	12,297	1,599	-87	-15,086
09/30/2016	-13,030	-5,816	-7,214	-4,110	24,670	20,671	3,999	496	8,025
08/31/2016	-12,238	-9,930	-2,308	-461	30,859	23,565	7,295	-568	17,591
07/31/2016	-2,166	441	-2,607	-1,736	33,578	26,825	6,753	2,069	31,745
06/30/2016	-14,803	-15,722	919	-3,886	16,698	9,639	7,059	4,327	2,336
05/31/2016	-19,695	-14,044	-5,651	-1,516	16,925	8,955	7,970	3,466	-820
04/30/2016	-17,054	-12,677	-4,378	428	22,114	16,291	5,824	-674	4,814
03/31/2016	11,642	7,599	4,043	3,173	29,422	23,591	5,832	2,148	46,385
02/29/2016	-4,472	-9,066	4,594	-1,435	11,915	6,616	5,299	5,664	11,672
01/31/2016	-20,171	-27,292	7,121	-10,561	7,686	2,676	5,011	2,010	-21,035

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute

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