



Getting comfortable with outsourced trading

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**When it comes to
outsourced trading,
one factor keeps coming
up in conversations.
Call it the comfort factor.**

As outsourcing evolves from back office to front, more institutional investors are considering outsourcing some or all of their trading activities. In that decision-making process, three key considerations often arise: cost, control and comfort.

While cost and control are tangible and can be addressed, comfort is something different entirely. It's a gut feeling and ultimately a leap of faith. And it is likely to vary from one person to the next.

In the past two years at State Street, we've conducted in-depth research about the industry's attitudes, experiences and plans around outsourced trading. Taken together with client conversations and engagement, we've uncovered what it takes to get over the line when it comes to outsourced trading.

[Our latest survey](#) of 300 institutional investors from around the world, for example, has been particularly helpful in this regard. We designed the survey with two groups in mind: current users of outsourced trading (241) and potential users (59), but excluded those who said they can't or won't employ outsourced trading. That approach has allowed us to understand the multitude of benefits of outsourced trading as well as the reasons holding back potential adopters. The survey, built on [our previous research](#), examined in detail how some asset managers were leveraging outsourced trading to meet their strategic goals.

Based on their comments, three enablers stand out:

1. Start small

Outsourced trading is not an all-or-nothing proposition. In fact, our survey shows that most users apply outsourced trading to one or two asset classes at the outset. Fixed income is the most widely outsourced asset class (47 percent of all respondents), followed by foreign equities (32 percent) and derivatives (24 percent).

But based on our results, adoption is poised to grow. Eighty-one percent of current users plan to increase their use of outsourced trading in the future, and not one expects to reduce it. This proportion is highest among current users based in Europe, the Middle East and Africa (EMEA) at 86 percent. And 73 percent of current users plan to adopt outsourced trading for foreign exchange.

This approach is consistent with what we've seen work well. "I think in general, our outsourced trading relationships start out as somewhat of a test," says Dan Morgan, State Street's Head of Portfolio Solutions. "Maybe it's a specific security type, for instance. And then we build on that, whether it be more activity within the asset class or potential expansion across regions or asset classes. It is a process to build trust. And to build trust you have to generate results."

2. Consider the benefits beyond the cost

When we asked potential adopters what was holding them back, a common response was a lack of understanding about the benefits of outsourced trading. That makes our findings around the benefits of outsourced trading reported by current users even more important. We found that current users report three major benefits: a multitude of efficiency gains, reduced costs and improved investment performance.

Look closer at investment performance (Exhibit 1). More than eighty percent, a clear majority of current users, said outsourced trading had improved their investment performance. That number increased to 94 percent of mid-sized firms (AUM between \$30 billion to \$50 billion) that are current users and 91 percent of asset owners that are current users.

But there are many other reported benefits as well, including enhanced regulatory compliance, market intelligence, access to trading talent, and expansion into new markets. (Exhibit 2).

Scott Chace, State Street's Head of Trading, Portfolio Solutions, has been offering outsourced trading services for more than two decades in EMEA. "I think there are two things that get funds comfortable with outsourced trading, and they're very important," he says.

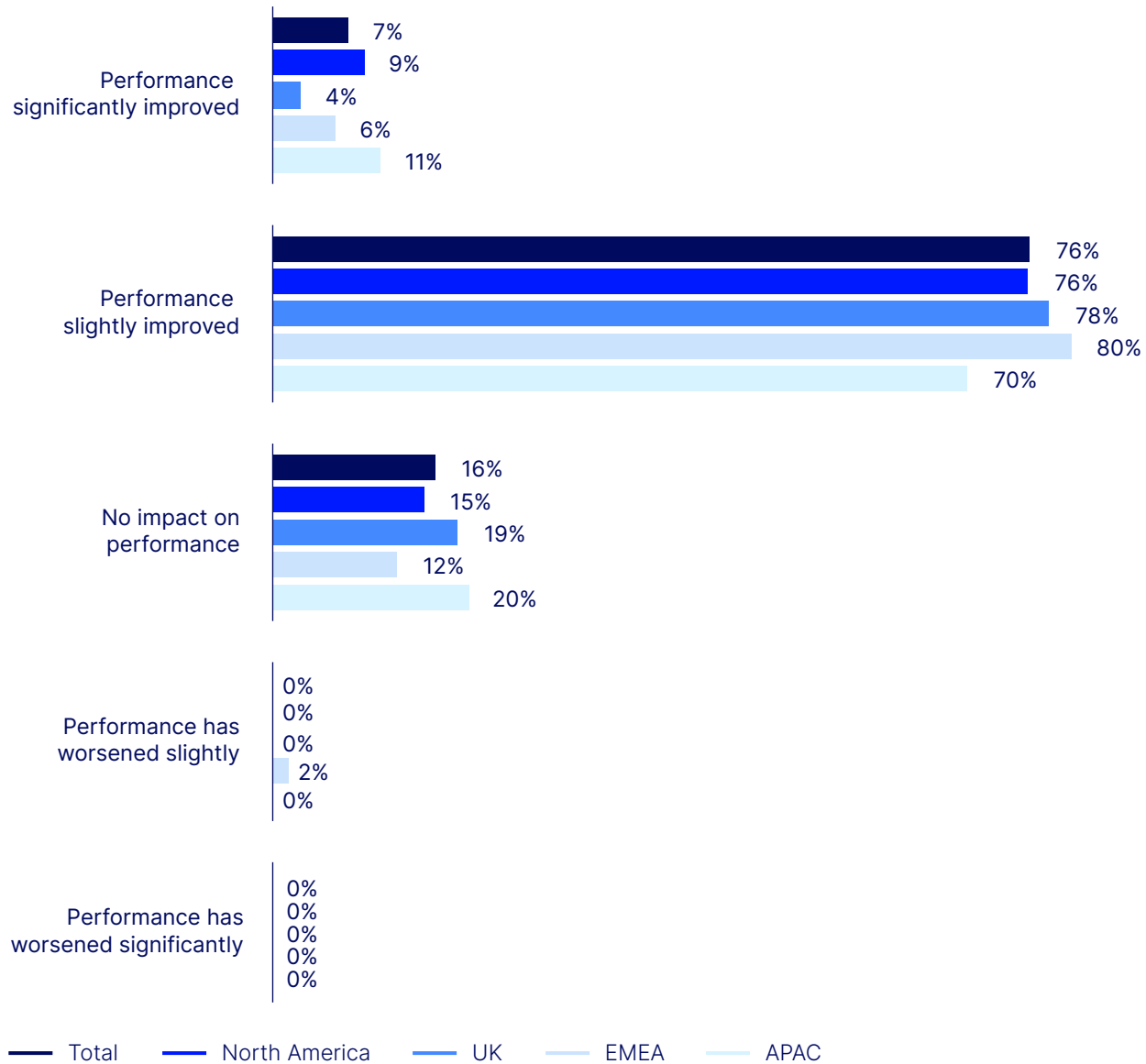
"One is our performance where we measure our trading performance. But also the operational and settlement aspect of the service, where you really have to make sure trades settle — and do that day in and day out, 24 hours a day, consistently."

94%

Outsourced trading performance increased to mid-sized firms (AUM between \$30 billion to \$50 billion) that are current users and 91 percent of asset owners that are current users.

Exhibit 1: More than 80 percent of current adopters report an improvement in investment performance

Q: How would you rate the impact of outsourced trading on your organization's investment performance?

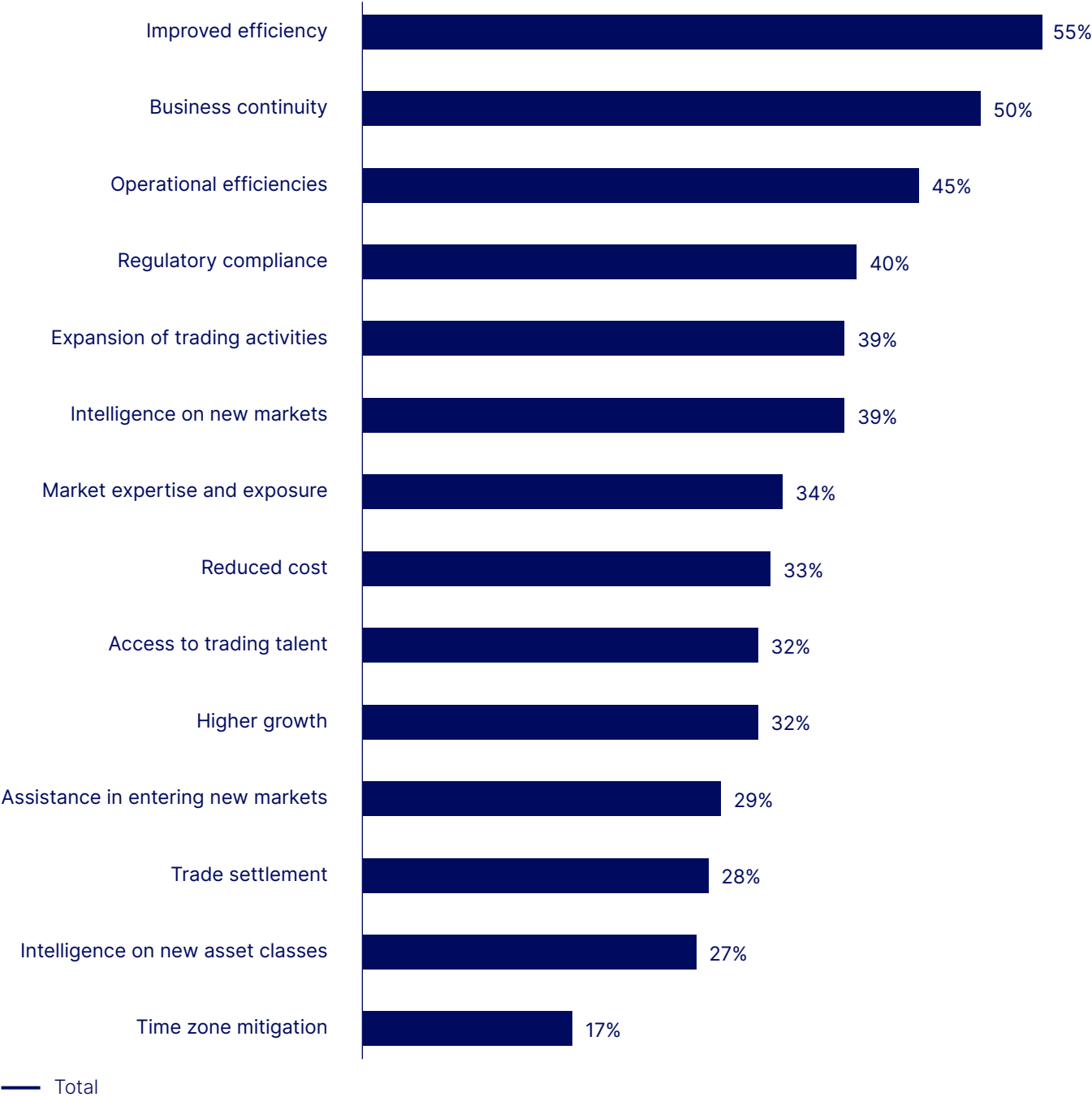


Source: **241** respondents who use outsourced trading

Note: The total number of respondents that said "performance has worsened slightly" was 1 out of 241 which is 0.41% of total respondents and was rounded down to 0%. That respondent was EMEA based so 1 out of 65 or 1.53% of EMEA respondents and this was rounded up to 2%.

Exhibit 2: Improved efficiency is the top benefit from outsourcing

Q: What benefits have you actually seen from using outsourced trading services? (rank up to 5)



Source: 241 respondents who use outsourced trading

3. Understand relationship dynamics

We asked both groups in our survey what they were looking for in an outsourced trading provider. And the most important attributes reported were: flexibility, ability to customize outsourcing needs and seamless technology integration.

From our ongoing research and client discussions it has become clear that a good relationship between organizations and outsourced trading providers relies on effective communication and understanding of the fund's investment strategy.

What's more, the model of outsourcing as purely transactional is outdated and being replaced with a new collaborative, partnership-based model.

"For business management, the most important things are incentives and in outsourced trading our incentives are aligned with those of our clients," explains Chace. "We're a client service team. We're just trying to get the best price for our clients every day. And I think that's sort of the essence of our success, ensuring our incentives are aligned."



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