Link to Article on website

Hubbis Survey: Code CORONA - Custody & Execution in Times of Global Financial Market Stress

During this global economic and social hiatus, Hubbis decided to conduct an exclusive mini-survey on how the service providers - namely the custodian banks and online platforms - have either helped or hindered the client management for independent wealth management firms operating out of Singapore and Hong Kong for wealthy investors in these most challenging times amidst the extreme volatility of the COVID-19 crisis. We are pleased to report that 62 of the most senior decision-makers at such IAMs, EAMs and Family Offices offered their honest insights. The views proffered paint a reasonably, even somewhat surprisingly positive picture, but with some notable caveats, as the market specialists call for even more robust digital and online execution capabilities.

The world of custody and execution has been evolving apace, indeed quite dramatically. There is little doubt that during the time in which the only real viable options for custody and execution for independent wealth management firms in Asia were the Tier I private banks, these providers had become complacent, sometimes offering a sub-par service at an elevated price.

It was amidst those conditions that the digital online platforms surged in prominence and efficiency in the major financial markets, especially in the US and Europe. In more recent times, these platforms have shifted their attention to the wealth management markets of Asia Pacific, wanting to capture a sizeable slice of what had in the pre-COVID-19 world been the most robust region on the planet in terms of economic momentum and private wealth creation.

In recent times, there is little doubt - and this view is supported by the numerous deep relationships and continuous dialogue Hubbis enjoys with Asia's independent wealth management community - that these IAMs, EAMs and MFOs have become increasingly interested in and engaged with the digital online platform solutions available.

But at the same time, there is also little doubt that the Tier 1 banks, the traditional custody and execution providers in Asia, have been trying to fight back, building their digital capabilities, honing their internal structures, and re-focusing and sharpening their execution capabilities.

In short, there is a greater region-wide acceptance amongst the independent wealth community of the move to digital and to somewhat different operating models, especially those that also offer the range of transparent, cost-effective solutions that today's clients increasingly want, for example, not just efficient access, execution and custody but also real-time reporting and portfolio valuations, combined as well with face-to-face advisory capabilities. But the traditional players are also finding ways to upgrade their technologies, their talent and their approach.

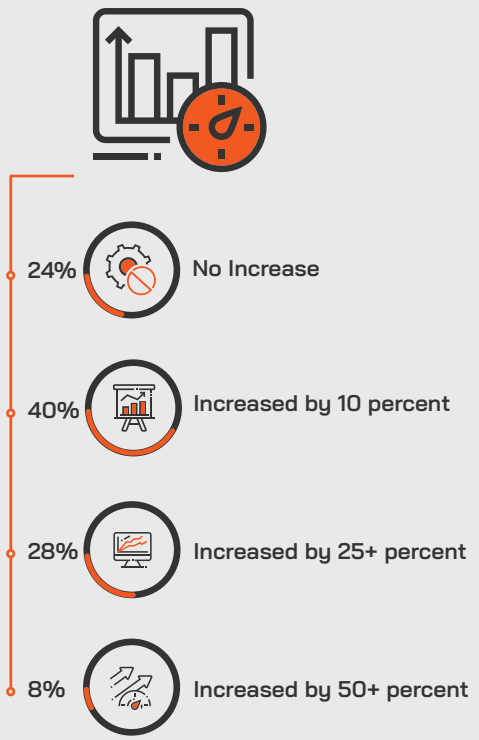
It is with this background that Hubbis decided to test the market sentiment amongst some of Asia's leading independent wealth firms, to gauge how their providers have been performing amidst what has been a perfect storm of economic, social and financial markets turmoil.

SETTING THE SCENE

We first asked respondents how their high-net-worth (HNW) and ultra-HNW (UHNW) clients had reacted to

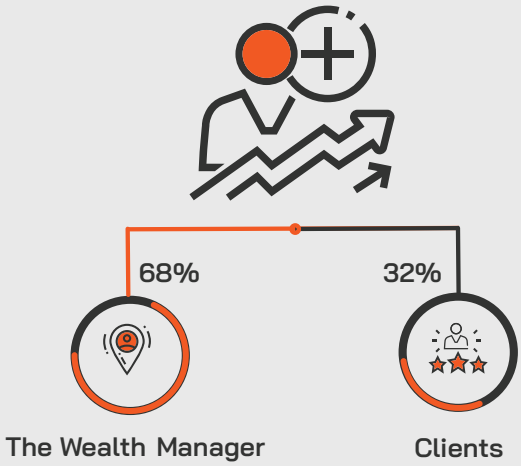
HAS YOUR TRADING VOLUME (IN RELATION TO MANAGING YOUR CLIENTS' PORTFOLIOS) INCREASED SIGNIFICANTLY?

Unsurprisingly, a resounding 28% reported that trading volumes for managing client portfolios had increased by more than 25% and 8% said volumes had surged by more than 50%. Meanwhile, 40% replied that volumes had risen by more than 10%, and 24% reported no change at all.



WAS THIS LED BY YOURSELVES AS PROFESSIONAL MANAGERS? OR WAS THIS INITIATED BY YOUR CLIENTS?

In reply to the question as to whether this increased trading activity was driven by the independent wealth firms as managers, or by their end-clients, an emphatic 68% stated that it was they themselves who had crystallised the greater trading activity, while 32% said their clients were the prime movers.



the crisis in terms of their investments, their portfolios and overall wealth planning activities, and what challenges and opportunities had arisen.

What we found is that the responses varied from extreme nervousness to relative calm, and pretty much every emotion in-between. One reply highlighted how the firm's wealthy clients had been mostly well-controlled, with very little panic about the financial markets and their portfolios, although with great concerns about the pandemic.

"Some have panicked," one said, "but others have not. The movement in the markets has been too fast for much reactive trading, [it has been] more on the margin. Some clients have been selling volatility structures, which is possibly a smart move."

"Not surprisingly, leveraged investors have been adversely affected while (some of) those sitting on cash or strategies with low market correlation are elated with the buying opportunity."

A key factor to emerge is that some of the more prescient clients had anticipated or perhaps more accurately expected some form of financial markets crisis, albeit not one wrought by this sinister virus.

"Our clients have been fully prepared for this crisis since last year," said one expert. "Valuations in the US were far too rich for comfort. Albeit too early, we have been holding cash since August last year. We have also resisted buying bonds and bond funds. This meltdown is creating great opportunities for our clients who are now positioned to short the market."

There are clearly some of the end-clients who had been more intricately caught up in the web of chaos in the markets, especially those who had been excessively optimistic and perhaps also leveraged. "Challenges remain on the margin call for those which have leverage," came a reply, "but as we [as a firm] were conservative at an early stage, our clients are safe. Actually, we have good opportunities to see our existing consolidated assets with our firm rise, as we are gaining new clients who are disappointed with the banks."

Another said: "Not surprisingly, leveraged investors have been adversely affected while [some of] those sitting on cash or strategies with low market correlation are elated with the buying opportunity." And one view indicated that they had for some time been 'training' their clients to keep an eye on volatility and see falls in the markets as opportunities. "All have asked us on the timing to buy more equities and sell our hedges," they remarked.

A similar thought came in another reply, which noted that their firm's clients have stayed calm as their portfolios are well diversified, and they reported they had won over several new clients seeking to

build their portfolios while markets are down. "Different clients have different reactions towards the market volatility, even those with similar exposures," came another view. "It depends on their risk tolerance level."

up well but the longer the out-of-office scenario continues, the more distance the RMs will be from the market insights of their colleagues and perhaps the weaker their advisory proposition, understandably of course. And

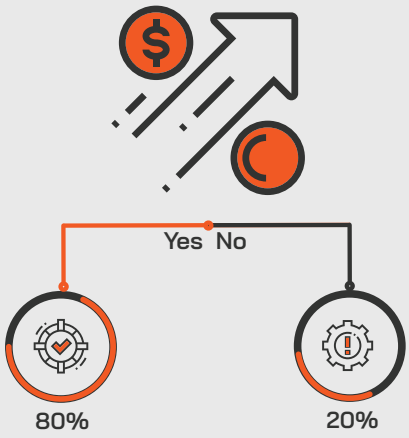
"Together we have lived through a number of 'interesting' market periods over the years. Importantly, their expectations are aligned with ours. Some clients have added to portfolios at the lower levels to take advantage of opportunities. No clients have sold positions."

The reality as gleaned from the market experts is that perhaps the majority of their HNW clients have not panicked, but instead they have sensibly been focusing more on their and their family's wellbeing. Custodians have generally held

in reality, the value of those online platforms that perform all functions remotely and extremely efficiently, and the value of discretionary mandates might well have been significantly boosted by the COVID-19 crisis.

HAVE YOU BEEN ABLE TO EXECUTE THE INCREASED VOLUME?

Even more resoundingly, some 80% of the IAMs who replied said that they had easily been able to execute their orders, while only 20% indicated they had struggled to do so.



CLOSER RELATIONSHIPS

And what emerged as an overriding theme of the replies from those we surveyed was that the crisis had, in fact, brought the IAMs closer to their clients.

As one expert commented: "The whole world has been on edge for the last few weeks, and this has brought us closer to our clients, as they have sought our guidance." Another respondent noted that there was daily communication, and suggestions are going back and forth regularly with clients.

As to the prime movers in the relationships, a respondent from one independent firm explained that generally, its clients had not initiated contact, but that, quite naturally, the firm had been proactive in reaching out to clients. Most of these clients are discretionary accounts, they noted, adding that they had been reassuring them that they must not panic and that it is important to stay the course, to follow the long-term strategy.

Another commented that most clients had been with the firm for a long time. "Together we have lived through a number of 'interesting' market periods over the years," they replied. "Importantly, their expectations are aligned with ours. Some clients have added to portfolios at the lower levels to take advantage of opportunities. No clients have sold positions."

This stoic approach was echoed by another respondent, who said that very few clients had been panic selling and that there were more buyers than sellers. Another said their clients were generally waiting for the right buying opportunity, while one reply noted that their more mature and

experienced clients mostly believe that this is the opportunity to buy in at a big discount.

BEST-CASE & WORST-CASE

We then asked the experts we surveyed to offer their 'back-of-the-envelope' views on the potential outcomes of the crisis in terms of their best-case and worst-case scenarios.

As to the length of the crisis, the consensus was that June might be the best the world can hope for the end of lockdowns, while the crisis could endure until June 2021.

Some respondents expressed concern over further falls in the US and Western markets while predicting that China had considerable upside at this juncture.

"Our worst scenario is that we hit another major setback in the markets, and then a long economic depression," came another view. "And our best scenario is if the virus burns out in the next few months, then we would see a great rebound in the markets."

Another indicated that markets would be down about 25% by year-end at worst, and perhaps 5% down at best. One reply indicated the best hope is for a vaccine, and the worst case would be a hard recession which will become a depression.

Another worst-case scenario was a major second wave of the virus, with many populous emerging economies hit harder this time, such as India, Indonesia, Brazil, Nigeria and others, overwhelming their more nascent healthcare systems.

Other rather despondent views were also expressed. "For us, there is no best possible scenario," said one respondent. "We expect this market to crash much further as we are extremely bearish after an extremely bullish 11-year run. This is only the beginning of the meltdown."

And everyone's worst fears were expressed by one doomsday view of a worst-case in which the virus runs amok when governments lose control, the world goes into lockdown, leading to social disorder and wars while emerging markets default en-masse.

Nevertheless, the same person held out hope of a best-case scenario of the markets having already effectively bottomed out after the recent tsunami of fiscal stimulus, and COVID-19 peaks out by the end of April, or perhaps May, leading to a recovery of up to 30% for the markets from the recent bottom.

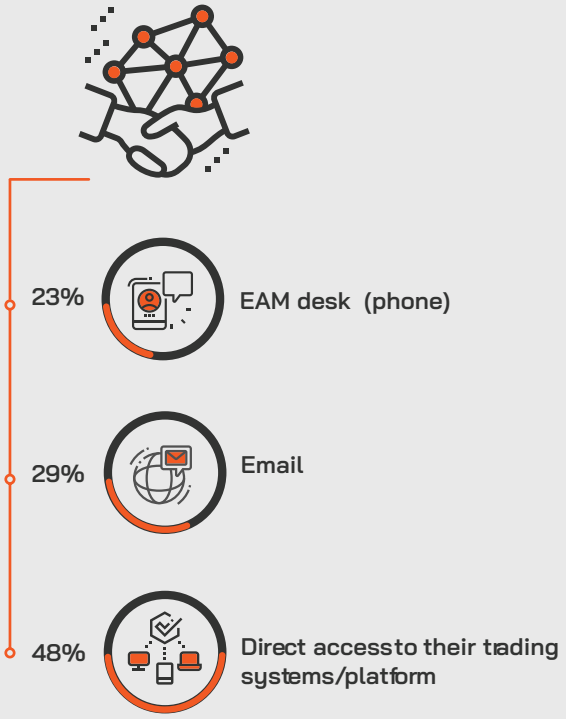
A well-articulated view was that a V-shaped recovery for capital markets shortly followed by a slow economic recovery and return of business and consumer confidence would be a good outcome, while new outbreaks during the coming winter in the southern hemisphere might similarly overwhelm healthcare systems and lead to massive societal dislocations that

HOW WOULD YOU RANK THE PERFORMANCE OF YOUR CUSTODY AND EXECUTION PARTNERS FROM 10 (EXCELLENT) TO 1 (VERY WEAK)?

Here the replies were fairly broadly dispersed across the spectrum, with slightly more than half of those replying with ratings of five and below, and just under half offering plaudits of six and above, with a significant number in the six and above segment rating their providers at eight and above.

BY WHICH AVENUES DID YOU HAVE TO ACCESS YOUR PARTNER TO EXECUTE TRADES?

When asked how the IAMs accessed their partners' execution capabilities and the medium through which they reached them amidst the chaos of the recent volatility, 23% replied that they contacted the dedicated EAM desks via telephone calls, 29% said it was via email, and 48% had direct access to their providers' trading systems/platforms.



could, in turn, kill off any nascent recovery elsewhere.

Amidst a host of other more hopeful and more pessimistic scenarios, the final word goes to a respondent whose best-case scenario is a reduction of GDP in the developed economies of 10%-12% with a 6-month recovery time from May in the financial markets and 12-24 months for economic activity. But their worst-case scenario is a 30% reduction in GDP with social distancing measures in place for two years and a decade needed for economic activity to return to normal.

LESSONS BEING LEARNED

In reality, it is early in this crisis, and the shape of the world is being re-calibrated daily, but Hubbis nevertheless felt that it was valid to ask our experts what lessons are already being learned for the future, focusing for our purposes on the world of investments. The replies ranged from expressions of concern that, yet again few lessons would be learned, to assertions that this could lead to a fairly radical change to the lifestyles and therefore economic and financial models we have been used to for many, many decades.

One respondent fairly observed that global supply chains and economic activity are far more vulnerable than had been believed and that major changes may be necessary in the long-term, particularly regarding flights coming in and out of countries with a poor track record on viral contamination and poor practices, especially in segregation, or lack of, between animals and humans.

"We average one to two warnings each year on H5N1 and H7N9 human transmission," they observed, "and in the future, such cases are likely to spark further market panics without drastic measures taken by the UN to limit international travel."

Rather cryptically, one reply stated that western countries which are developed countries do not appear so developed anymore, with medical and other infrastructure being tested to the limits.

A fairly studied perspective came in the form of a comment that as this 'enemy' is unprecedented, it is critical to be cautious and to ensure clients' leverage in their portfolio is not more than 30%." And another respondent reiterated the view to stay the course, as timing in the markets is nigh on impossible. A rather more cavalier view came from a respondent who said that soon after the crisis abates, whenever that might be, there will be a good opportunity to make money.

Another somewhat more balanced view stated that greed continues to be the danger. "Look at charts for guidance," they advised. "The writing was on the wall for a major crash. Unfortunately, it was the coronavirus that pricked the huge bubble."

Another view stated: "It is not so much what I have learned, but all about taking my experience in the last few economic cycles and applying it to this time. In particular, I am worried about the health and mental state of my friends, clients and colleagues."

"The lessons from 2008 went largely unheeded. Leverage in portfolios is the financial market equivalent of coronavirus. In the end, valuations based on conventional metrics will re-assert themselves."

A word of warning came in a reply that stated: "The lessons from 2008 went largely unheeded. Leverage in portfolios is the financial market equivalent of coronavirus. In the end, valuations based on conventional metrics will re-assert themselves."

A somewhat philosophical view emerged in the form of a comment that what is not sustainable will not sustain. "The trigger may be uncertain," they remarked, "but better to assume that bubbles will burst." Along similar lines, a respondent noted that "lessons from previous markets do work very well", while another said this is a stark reminder to always expect the unexpected while advising that discipline should always come before greed and other human emotions, whether at times when markets are rising, or falling.

Some words of wisdom came as one reply stated that recessions often come when least expected, and another replied that nothing is impossible, anything can happen, but health and freedom are the most valuable assets we have.

The final word on this particular aspect - lessons learned in a crisis - came as one reply stated: "We have to revisit our true operational requirements; some people can operate remotely, some services are better outsourced, and some of the infrastructural capacity is not so much needed. Business continuity will be now built on agility, resources utilisation and remote process management capacity."

HOW THE PROVIDERS HAVE PROVIDED

In the last section of our survey aimed to mine down into the independent wealth community's perception of the performance of their service providers – the custodian banks and online platforms – during these few weeks of the crisis thus far.

What we actually found was that these providers have in fact largely risen to the challenge, although there is still considerable room for improvement. The conclusion must, therefore, be that those surveyed are being met with a generally positive and accommodating response from their banks and other execution providers such as the online platforms, but that work still needs to be done to boost capabilities.

The indication evidently is that these independent firms are generally satisfied with their providers' availability, response times and execution during the period of supreme stress.

However, mining down further into the replies and also from further discussions Hubbis has had on this matter, it appears that considerably fewer, in reality, have direct access to the providers' trading systems/platforms, which from our past anecdotal experience of the market in more normalised times is perhaps nearer to the reality they face on a daily basis unless they are working through one of the most sophisticated digital platforms.

Moreover, those who offered their comments on the feedback that they would like to offer to their custody and execution partners on how to improve their offering, as a result of their direct experiences at a time like this, they were considerably more negative than the 'naked' results of the survey might have suggested.

While some of the comments were indeed positive, others offered observations such as the providers must provide better access to night desks, that they require greater investment in automation, and they must make sure login access is not compromised due to high traffic.

One reply expressed concerns that not all trades were executed, another advised them to significantly upgrade their digital capabilities and online trading systems.

One particularly robust view came from a leading firm that said they worked with an online digital platform that had been impressive

in its capabilities, noting that "their online trading is robust and reliable", and adding that "I am very glad we do not have to depend on an EAM desk during this period and we were able to take control of our client trading directly ourselves".

A well-balanced view said the banks must generally be more flexible in anticipating a spike in trading activity especially in times of significantly increased volatility, as well as offering more human capacity if and when digital systems and electronic trading availability is lacking or under duress.

CONCLUSION

There is already a darkening mood across the globe as the perniciousness and elusiveness of COVID-19 become more evident day by day.

When will science start to turn the tide in this battle? Or can it? When will we be able to stop relying on the types of largely pre-modern defences that ultimately stemmed the tsunami of the Spanish Flu, but after such cataclysmic loss of life? Will, as some hope, the virus suddenly - and sooner rather than later - decrease in both potency and lethality? When things settle down, will, for example, up to date health certificates be needed before people travel?

The only certainty right now is that there remains huge uncertainty. Whatever the situation, we can but express our solidarity with everyone out there, and our hope that business and society will soon return to some sort of normality, one that is not too distant from that we have known and enjoyed for so long.

In the greater scheme of things, introspection about the state of our industry is, admittedly, somewhat irrelevant. But we must all continue in the hope and expectation that life as we knew it will sooner or later resume, so we at Hubbis will continue to engage with our clients, with the industry at large, and we will endeavour to gauge the mood of the players and their plans for the future and to filter it for our readers.

It is in human nature to strive and to compete, and there is no doubt, assuming the world remains roughly spherical, that the world of custody and execution will continue to become more efficient and more transparent, re-shaped we expect both by a sharper vision of the future client and their needs, and a greater understanding of the shortcomings of the past. ■