Lombard Odier's CIO on DPM Aligned with Advisory as a Best of Both Worlds Approach

The quest to win clients over to more DPM mandates in Asia is of increasing importance for many of the private banks and independent wealth firms plying their trade in the Asia region. A banker who believes that they have some of the vital keys to unlock this particular treasure trove of recurring business is Jean-Louis Nakamura, Chief Investment Officer, Asia, and head of the Hong Kong office at Swiss private bank Lombard Odier. He has a world of experience in wealth management, as well as deep insights into the key trends that will likely emerge in the years ahead. He has been working hard to help his Asian clients refocus their portfolios in the aftermath of the pandemic, and Jean-Louis has consistently reported in recent years how the bank is focusing more of its energies on encouraging private clients to adopt DPM mandates for some elements of their AUM with Lombard Odier, and how Lombard Odier has been making some significant headway. He was on our panel of experts at the October 13 Hubbis Digital Dialogue event that focused on the future of DPM in the region, and analysed why and where it should succeed and what the impediments might be to a more rapid rollout amongst private clients in Asia, and how those hurdles can be overcome.

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The background for

Lombard Odier is that the bank has really concentrated a significant amount of effort on DPM and advisory in the past five-plus years, and since early 2020 has more accurately refined and articulated what the bank offers on the DPM side and on the advisory side, forging both into a holistic portfolio approach. This centres on strategic thinking around a total portfolio approach, which aims to combine the best of the institutional-type, systematic investment process aligned with more judgmental, emotionally driven market direction, thereby bringing the best of both worlds together for clients.

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Refining the DPM proposition

Jean-Louis has been working diligently on expanding the annuity type DPM business at the bank for the past six years roughly, evolving the offering and the way it is communicated to clients.

"We have been evolving the DPM offering constantly," he told delegates. "A few years back, we did something very different from the competition because we wanted to propose and promote something that, by definition, individual investors would not do by themselves. We take a highly systematic, very agnostic, and very quantitative process, and this approach has been successful in differentiating ourselves and attracting clients who have been looking for something that was not so readily available in the market."

Helping clients make the leap of faith

He explained that having successfully grown the DPM client base and AUM, the bank then realised they needed to help more clients make that major leap from highly-emotional, individually-managed portfolios to completely agnostic and systematic portfolios by "nudging" the DPM offering towards what he calls a second layer.

"This is much more judgemental, more forward-looking," he explains. "Accordingly, we now have two layers, one completely non-emotional, very systematic and agnostic and then the more judgmental approach as the second layer. We believe in a way that we can try to manage the two paths that we believe are very important when you wish to be exposed over the longer term to the financial markets. That approach has really been one of the biggest innovations at the bank, but we have further innovation to come, such as a net zero mandate compliant with our own methodology in terms of net zero emissions, and sustainability."

Multi-asset, but with limits

Jean-Louis offered delegates some further insights into the asset mix on the core portfolios, noting that the bank steers well clear of structured products and cryptocurrencies or other digital assets in all their DPM portfolios. "Liquidity is currently very important," he reported, "although more of the DPM mandates do indeed have 'real' assets, but the core focus is on liquid, multi-asset DPM portfolios that we rebalance regularly. We mainly invest through funds, either passive, smart beta, ETFs covering all kinds of liquid asset classes, and also active funds. We tend to lean more to the judgemental part I was mentioning before, and are much more granular in terms of geographic style and factor markets than we are in the more systematic and diversified part of the portfolio."

As to current investment conditions, Jean-Louis observed that it had indeed been easy to make money in equities since the markets recovered following the worst early weeks of the pandemic.

Diversification and risk management

"But I think one of the core value-added elements of DPM is to propose something a little different to some clients," he remarked, "and accordingly, a significant part of our portfolio is

JEAN-LOUIS NAKAMURA
Lombard Odier

made of very diversified assets, aiming to diversify away from the traditional extreme risk. For example, we have already seen a lot of disruptions in the economies that have translated into disruptions in markets this year, and we can expect this to continue, or possibly get worse. We anticipate growth maturing, or slowing, policy support normalising, some tightening, and this means a tricky period to absorb for financial markets. And this is precisely the kind of period during which a solid and robust portfolio construction should make a significant difference."

Returning to the DPM proposition itself, Jean-Louis explained that the bank does not see DPM and advisory as substitutes but as complementary to the other.

Combining cultures and appetite

"The ideal structure of a portfolio for clients should include some DPM and some advisory," he said. "DPM allows clients to have a portfolio managed without emotions involved and through an external team with focus and expertise, while the advisory will be more the result of dialogue between the investment advisor and the client, taking into account, of course, all the preferences and some of the emotional facets of the client. We believe it is very important for us not to try to oppose these two dimensions, but to integrate them together."

He explained that it is a typical avenue to encourage clients to test out DPM with modest allocations first, alongside advisory, and then analyse the performance and the differences in approach, so the client becomes more confident in the different approaches. The client can either then increase the size of the DPM allocation, or perhaps conclude that maybe this is not for them, and they prefer more of the advisory protocol.

Road-testing DPM and gaining confidence

"We encourage clients to test this all out," he said. "With DPM and advisory working for them at the same time, they have a better guide to their preferences as we progress with them."

Jean-Louis said he also agreed with a fellow panellist who had remarked that DPM is a service, not a product, and therefore requires great attention to communication to ensure clients are fully aware of the behaviour of the portfolio; that they have access to the portfolio management team, something that the digital platforms really cannot afford to do, by definition. "This is certainly still a value-added service provided on a more personal level by private bankers or independent asset managers," he commented.

Nurturing and communicating

He explained that when you are selling DPM, you are selling that service through a process; you are promoting a certain vision of how to approach financial markets; and you are taking a long-term perspective of the various economic and financial cycles.

"Remember, DPM is extremely systematic and agnostic and very quantitative, and non-emotional. But we aim to incorporate a second leg into the approach, which is more judgemental, taking into account the more 'emotional' characteristics of the client, and incorporating their biases, perhaps in terms of business sectors or countries they know best and so forth."

"When you convince your client to share this vision with you, the great positive is that client normally should stick with you, as long as you communicate consistently over the full cycle. The outcome for the bank or wealth firm is recurring revenues, and consistency and the avoidance of the trading mentality for the client. For the relationship managers, it is important to get them supporting DPM fully by reminding them of

the value they create for all parties including themselves through DPM, rather than continually being exposed to volatility and reacting all the time with trading activity."

Tailoring the DPM allocations

As to the process of devising the approach to each portfolio, Jean-Louis explained that the first step is an open conversation with the clients in order to define what the bank calls a risk budget, which is the maximum loss they are ready to suffer.

"We spend quite a lot of time to calculate with them their true level of discomfort, which is sometimes a little not completely obvious to define, but it is an important step. Then we can layer in innovations we have introduced in the last two years such as goal-based investments, which aims to determine cashflows to match upcoming liabilities and commitments of the clients in the coming months and years. And then we can target the surpluses we want to achieve beyond those thresholds and consider this also a buffer for difficult personal or financial times ahead. Armed with all that, we can then set about building the right portfolio that will maximise the probability to achieve his or her goals."

The 'Best of Both Worlds' approach

His final comment was that for the more emotional, hands-on type of inclination of many clients in Asia, the bank aims to satisfy and cater to their needs through its advisory proposition. "Remember, DPM is extremely systematic and agnostic and very quantitative, and non-emotional," he said. "But we aim to incorporate a second leg into the approach, which is more judgemental, taking into account the more 'emotional' characteristics of the client, and incorporating their biases, perhaps in terms of business sectors or countries they know best and so forth. Over time, they can quite clearly see the relative value of the full cycle of the DPM approach compared with advisory and adjust their allocations accordingly."

Jean-Louis clearly believes this approach has many merits. "In particular," he told Hubbis in an interview recently, "when performance tends either to concentrate or to disperse, in places or in markets that were not expected to perform well, the outcomes will tend to be better than the traditional approach to managing money. On the other hand, when markets tend to concentrate performance on segments, where everyone is constructing their own bets, for example, a concentration on tech names some two or so years ago, or cyclical names some six months ago, then the more traditional approach tends to outperform. Hence our best of both worlds approach." ■