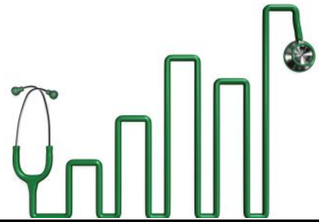
How health systems can enhance returns through effective implementation



Ideas to help you pursue some of the easiest and most reliable sources of investment return

Without effective implementation, a great strategy can yield mediocre outcomes—or worse! Effective implementation means being able to execute your strategy quickly, cost-effectively, and with minimal risk. However, in order to succeed in an environment characterized by greater investment complexity, you have to leverage the latest innovations in portfolio management.

In this article, we outline several scenarios where a greater focus on implementation can help preserve or enhance your overall portfolio returns, by focusing on reducing unnecessary costs and unrewarded risks.

Implementation matters

In an environment where implementation matters, managing every aspect of your implementation is potentially one of the easiest and most reliable sources of return. However, this task is getting harder because in the current market environment:

- Investor strategies are becoming more complex in their pursuit of higher returns
- There is greater scrutiny of costs and every basis point counts
- Stakeholders are more sensitive to the impact of unexpected risks

Investors need to reduce unnecessary costs and manage risks in more areas to ensure that the good work they have undertaken in setting strategy is not lost through small gaps in implementation. There is an array of implementation tools available which can help investors manage costs and risks more effectively, while keeping operational burden to a minimum. These tools help investors ensure that value from their investment strategy is maximized.

Reliable sources of cost savings

In our experience managing multi-asset solutions for over 40 years, we find that the aspects of implementation which offer the easiest and most reliable sources of investment return opportunities relate to the following three areas:

1. **Managing changes effectively.**

   You make many changes to your investment portfolios—for example, changing managers, switching between asset classes, and investing or dis-investing cash. This can involve changes to a variety of investment allocations, ranging from physical securities and currencies, to more complex strategies such as derivative exposures. In many cases, there are more cost-effective solutions available to investors relative to the methods that they currently employ to manage changes.

> *“Prior to 2000, 80% of portfolio returns came from intelligent asset allocation and 20% from implementation. Since then, the ratios have changed dramatically. In today’s world, where effective implementation has become much more important, intelligent asset allocation accounts for only 50% of returns.” -Sally Bridgeland and Professor Amin Rajan*[1]

2. **Reducing deviation from target asset allocation.**

   You spend a lot of time setting your strategic asset allocation (SAA). However, without the proper exposures. When the portfolio weights drift as a result of market movements and are not an intentional decision, there is a chance that these will detract value relative to your portfolio's strategic benchmark. This risk can be easily managed by holding exposures in line with your target more efficiently, or only moving exposures deliberately.

3. **Attaining ongoing best execution.**

   It's not always easy to have visibility into transaction costs within all parts of a portfolio. However, visible or not, these costs exist, and managing them helps to ensure that more assets stay in the portfolio rather than being eroded away. This helps preserve performance. An example of such transaction costs frequently mentioned in the press over recent years is foreign exchange (FX) costs.

> *Through a greater focus on implementation, one of our large healthcare clients saved 90 basis points in transaction costs and reduced portfolio tracking error by 65%.*

Material savings from specialist techniques, such as Transition Management

Often, a greater focus on implementation can help you identify, measure, and explicitly manage costs and risks that are hidden. For example, consider a $5 billion long-term pool. If you can save 25 basis points through better implementation, that's an additional $12 million in excess revenue over expenses that the system would have available. And this is not a one-off gain; the savings would compound year after year to add up significantly over time.[2]

Transition managers achieve this result by adopting a number of specific techniques designed to help reduce unnecessary transition costs and risks. Examples of such techniques include redeeming from, or subscribing to, commingled funds using a portfolio of securities in lieu of cash (known as "in-specie" transfers), maximizing retentions (also known as "in-kinds"), and crossing (reducing the amount that needs to be traded in the open market).[3]

The greater benefits from aggregating implementation tools

Aggregated across multiple areas, cost savings can quickly add up. For example, we helped a large health system increase its implementation focus across a number of areas on a centralized platform of specialist implementation services. Through this greater focus on implementation, our client saved a total of 90 basis points in transaction costs over a ten-year period, and reduced portfolio tracking error by 65%.[4]

Clients can save additional costs by utilizing other specialist implementation disciplines, such as:

- **A passive currency overlay** to manage the volatility—caused by the fluctuation of foreign currencies—of the portfolio's international assets.
- **A rebalancing overlay** to maintain the portfolio's asset allocation. The overlay manager monitors the difference between the portfolio's actual and strategic allocations and uses exchange-traded futures to rebalance the portfolio's assets to strategic targets.
- **Short-term cash management** to fund margin requirements for the overlays but with the additional objective of improved investment performance.
- **Transition management services** to restructure the portfolios in a smart and cost-effective way.
- **Execution services,** which are increasingly being used to prudently liquidate distributions of stocks from private equity investments.
- **FX transaction assistance** in which the portfolio's international private equity and global equity managers deliver FX orders to a central currency desk. A central desk nets the orders and efficiently trades them to reduce transaction costs, minimize liquidity, and enhance reporting.[5]
- **Responsible investing solutions** to remove unwanted exposures, capture specific environmental, social, and governance (ESG) outcomes, or manage ESG risks using tailored solutions and proprietary investment strategies.

> *An implementation partner can help you strengthen your current governance structure and extend your implementation reach—today, and in the future.*

Conclusion

Today, implementation has a much greater impact on the total return of your portfolio than it had in the past. Further, the breadth and depth of areas in which investors need to apply this focus has increased significantly as investment strategies have become more complex and greater scrutiny on governance has led to a brighter spotlight on costs and risk.

There is, however, some good news. One of the easiest and most reliable ways designed to enhance return is focusing more on implementation. With finite resources, you can work with a specialist implementation partner to help you extend your implementation capabilities. This will enable you to manage costs and risks in more areas, implement decisions more swiftly, and adopt more ambitious investment strategies. An implementation partner can help you strengthen your current governance structure and extend your implementation reach—today, and in the future.

[1] Bridgeland, S., and Rajan, A., "Governance practices: Bridging the gap between rhetoric and reality," (2016). *The 300 Club.*

[2] Bagley, Travis. "The importance of implementation efficiency." Russell Investments blog Available at: https://russellinvestments.com/us/blog/importance-implementation-efficiency

[3] For a full overview of transition management, see "Transition Management Explained" (2014, September). *Russell Investments*.

[4] As of December 31, 2020.

[5] For example, if investment manager A is buying 1 million euros and manager B is selling 600,000 euros, the central currency manager matches the orders and trades the net 400,000 euros.

We would love to explore how a platform of specialist implementation services can help you manage risk and pursue significant additional returns easily and reliably—extending your implementation potential and adding value to your portfolio.

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