

HUB 24



PLATFORM ALPHA SERIES: MEASURING THE COST OF DELAY

SEPTEMBER 2021

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CONTENTS

2

Executive
summary

3

Reliance and
limitation

4

Introduction
by HUB24

5

The cost of delayed asset
allocation changes

6

The cost of delayed
portfolio rebalances

10

Summary

EXECUTIVE SUMMARY

Managed portfolios are at the forefront of delivering client value, enabling advisers to tailor portfolios to client and market circumstances to create better client outcomes. Although no two platforms are the same, the innovative functionality available from managed portfolio solutions empower financial advisers with greater flexibility and capabilities to adapt portfolios and add value for their clients.

Platform Alpha refers to the value that can be unlocked for clients by the enhanced technology available on HUB24. The platform alpha or value these enhanced capabilities could deliver were quantified last year in HUB24's Platform Alpha whitepaper.¹ This paper builds on this notion to illustrate how platform capabilities can be used to unlock implementation efficiencies, which can have a significant impact on a client's portfolio value over time.

¹ Delivering Platform Alpha paper, 2020 – <https://www.hub24.com.au/2020/11/12/delivering-platform-alpha-new-milliman-whitepaper/>

RELIANCE AND LIMITATION

- This report is not a recommendation for the use of one particular platform over other platforms.
- Milliman worked with HUB24 in connection with the preparation of this paper and in relation to the verification of HUB24's analysis.
- The strategies reflected in the scenarios and examples may not be suitable for all platform clients, portfolio managers or advisers. Readers of this report should consider clients' unique circumstances before deciding to use an equivalent strategy.
- Examples and scenarios in this report are provided purely for illustrative purposes. They are not exhaustive, and a person's actual experience may differ from that shown in the example or scenario, as individual circumstances differ. Past performance is not an indicator of future performance.
- These results are dependent on underlying assumptions, in particular, portfolio composition, transaction timing and tax rates. Different assumptions would result in different results.
- As with all investments, there are risks as well as benefits associated with managed portfolios. You should carefully examine the investment strategy, asset allocation and relevant disclosure documents before making an investment decision or implementing any of the strategies outlined in this report.
- Milliman is a firm of consultants which employs mainly actuaries and experts in capital markets, information technology and risk management. We do not employ accountants or solicitors for consulting purposes. Formal professional opinions of an accounting or legal nature (e.g. regulatory or tax matters) are outside the scope of our work, although analysis of the financial implications of these items is something we do.

INTRODUCTION BY HUB24

Financial advisers who manage their client's investment portfolios are facing crunch time as the ability to do this becomes increasingly challenging. In the post-FOFA and Best Interests Duty operating environment, advice practices must find a scalable way to meet their client's demand for greater portfolio customisation and better investment outcomes while delivering a valued customer experience.

A fundamental element of financial planning is to provide solutions tailored to individual client circumstances. In our previous Platform Alpha whitepaper, we discussed the way innovative managed portfolio solutions like those found on HUB24 can enable advisers to take individual client taxation circumstances into account, drive greater transparency and flexibility, and add value to client portfolios.

In this paper, HUB24 has again partnered with Milliman to explore the challenges advisers face in running portfolios for their clients inhouse. These include the cost of time constraints associated with making portfolio changes to individual portfolios inhouse versus the benefits of automatic implementation which can be achieved through accessing investment expertise through managed portfolios.

Intuitively, the benefits derived from automatic implementation of investment changes to client portfolios adds up— advisers can design appropriate strategies to meet their clients' individual needs and be confident their client's investment portfolios are automatically updated at scale in line with the portfolio manager's strategy.

Financial advisers are responding to the benefits of managed portfolios, with the latest Investment Trends February 2021 Managed Accounts Report finding 44% of advisers have used and intend to continue using managed accounts, up from 40% in 2020 and 35% in 2019. Further, planners' allocation of new client inflows into managed accounts has accelerated, now at 17% up on average from 12% in 2020².

The increased traction of managed portfolios reflects the innovative functionality available through managed portfolio solutions from providers such as HUB24, which provide financial advisers with greater flexibility and capability to adapt portfolios to add value and create better outcomes for their clients.

The Investment Trends February 2020 Managed Accounts Report survey of 799 financial planners found advisers saved an average of 13 hours a week using managed accounts - time that could be used with clients, focusing on their specific goals, needs and strategies.

This time saving comes from the automatic implementation of portfolio changes and rebalance instructions, which ensures client portfolios are kept up to date, without the need for additional paperwork, ROAs or client signatures, saving time and the chance of unnecessary costly delays.

In comparison, although traditional model portfolios may provide the diversified managed investment structure advisers and their clients are looking for, they lack the implementation efficiencies that can be gained through managed portfolios.

2 Investment Trends 2021 Managed Accounts Report

THE COST OF DELAYED ASSET ALLOCATION CHANGES

SCENARIO

This scenario was modelled using actual live portfolio performance of a diversified managed portfolio on the HUB24 platform. While asset allocation changes in the live managed portfolio were implemented instantly, this scenario compares and simulates the potential cost of delaying asset allocation changes by 1, 2, 4 or 6 weeks, to demonstrate the real-world experience of many advisers who administer portfolios manually on a client-by-client basis outside of a managed portfolio structure.

On 25 March 2020, Client A held an investment of \$500,000 in a diversified growth managed portfolio (**Managed Portfolio X**). In light of the fluctuating market conditions, The portfolio manager implemented an asset

allocation change to Managed Portfolio X, resulting in a reallocation of 5.5% (\$27,500) of the portfolio from a growth futures managed fund (**Managed Growth Fund X**) to a defensive asset Australian income securities managed fund (**Managed Defensive Fund Y**).

The performance of both managed funds X and Y were tracked for just over 6 months after the change was implemented on 25 March 2020. By the end of September 2020, Managed Growth Fund X (the previously held fund) had performed at -15.46%, while Managed Defensive Fund Y (the receiving fund) performed at 23.29% over the same period. We then calculated the cost of delaying the implementation of the asset allocation change for a range of time periods (1 week, 2 weeks, 4 weeks, and 6 weeks) and the total portfolio performance impact to 30 September 2020.

FIGURE 1: ASSET ALLOCATION

Time delay	Benefit of asset allocation change (\$)	Cost of delaying asset allocation change (\$)	Cost of delaying asset allocation change (%)	Impact of asset allocation change on overall portfolio performance
No delay	\$ 10,630	NA	NA	2.13%
1 week	\$ 6,170	(\$4,460)	(42.30%)	1.23%
2 weeks	\$ 5,810	(\$4,810)	(45.50%)	1.16%
4 weeks	\$ 5,700	(\$4,920)	(46.50%)	1.14%
6 weeks	\$ 4,250	(\$6,380)	(60.10%)	0.85%

Notes:

- All returns are calculated to include transaction costs and fees for the reallocated investments assumed to be 11 bps for both investments.
- Tax is not taken into consideration in these examples.
- The magnitude and direction of the results above are specific to the given set of market movements. Other sets of market circumstances and parameters will yield different results.

OUTCOME

Analysis of this scenario shows that implementing an asset allocation change of \$27,500 from Managed Fund X (which performed at -15.46%) into Managed Fund Y (which performed at 23.29%) led to a switching advantage of \$10,630 (or 2.13% of initial portfolio balance of \$500,000) when compared to not making the change.

However, delays in implementing the asset allocation change by one week reduced the switch advantage to \$6,170. In other words, 42.3% of the gain (or \$4,460) was lost through an implementation delay of one week. Further, Delays to the implementation of the asset allocation change

by six weeks reduced the switch advantage to \$4,250. In other words, 60.1% of the gain (or \$6,380) was lost through an implementation delay of six weeks.

As illustrated in the given set of scenarios implementing asset allocation changes without delay meant that Client A was able to achieve a better investment performance outcome compared to scenarios where implementation was delayed (assuming the decision made a positive benefit to the portfolio performance). This illustrates the importance of timely and efficient implementation of asset allocation changes in maximising potential investment outcomes resulting from fully capturing portfolio management decisions and expertise.

THE COST OF DELAYED PORTFOLIO REBALANCES

Outsourcing investment decisions to professional portfolio managers means portfolio rebalances are implemented as and when they are required, rather than during client portfolio reviews, which are typically at set times twice a year. Although the underlying benefit of automatic implementation of portfolio changes is understood in practice, proving the benefits through quantitative analysis can be challenging.

Manager decisions are often driven by a mix of qualitative factors (e.g. experience, instinct) and quantitative factors (e.g. allocation thresholds, market movements), and with an inability to accurately model qualitative factors, assumptions need to be applied.

To explore the benefit of automatic implementation, we've used a rules based 'dynamic, tolerance-based' approach to portfolio rebalancing as a proxy for manager expertise and decision making, and compared it to a 'static, point-in-time' approach (akin to biannual client reviews outside of a managed portfolio structure). Using these approaches, we can model outcomes across a range of time periods and measure the underlying benefit of automatic implementation of rebalances.

The benefit of automatic implementation of portfolio changes seems obvious in times of market volatility. 2020 was a difficult year for advisers as the pandemic hit and markets reacted with uncertainty creating volatility in markets domestically and around the world, particularly in the early part of the year.

THE COST OF DELAYED PORTFOLIO REBALANCES – SCENARIO

The scenario contained data over three selected time periods between 1 January 2016 to 31 December 2020 (incorporating the heightened period of COVID-19 market volatility in 2020). We define 'rebalancing' as the act of resetting asset allocation weightings of a portfolio back to the initial Strategic Asset Allocation (**SAA**) weightings.

This scenario compares the following rebalance approaches:

- Dynamic, tolerance-based asset allocation rebalancing (**dynamic rebalancing**) where rebalances are implemented whenever the asset allocation weightings move 2% outside the initial SAA range.
- Static, point-in-time asset allocation rebalancing (**static rebalancing**) where rebalances are implemented twice a year on 28 February and 31 August (typically when client reviews and rebalances occur) to bring the portfolio back to the initial SAA target.

\$500,000 is invested in a 70/30 growth-based portfolio (**Portfolio Y**) with a SAA based on the following asset class weighting and underlying index benchmarks:

- 35% Australian Equities (S&P/ASX 100 index)
- 35% Global Equities (MSCI world ex Australia index), and
- 30% Australian Cash (Bloomberg Bank Bill (0+Yr Maturity index)

Results from the two rebalancing methods (dynamic and static) were then compared over 1, 3 and 5-year periods.

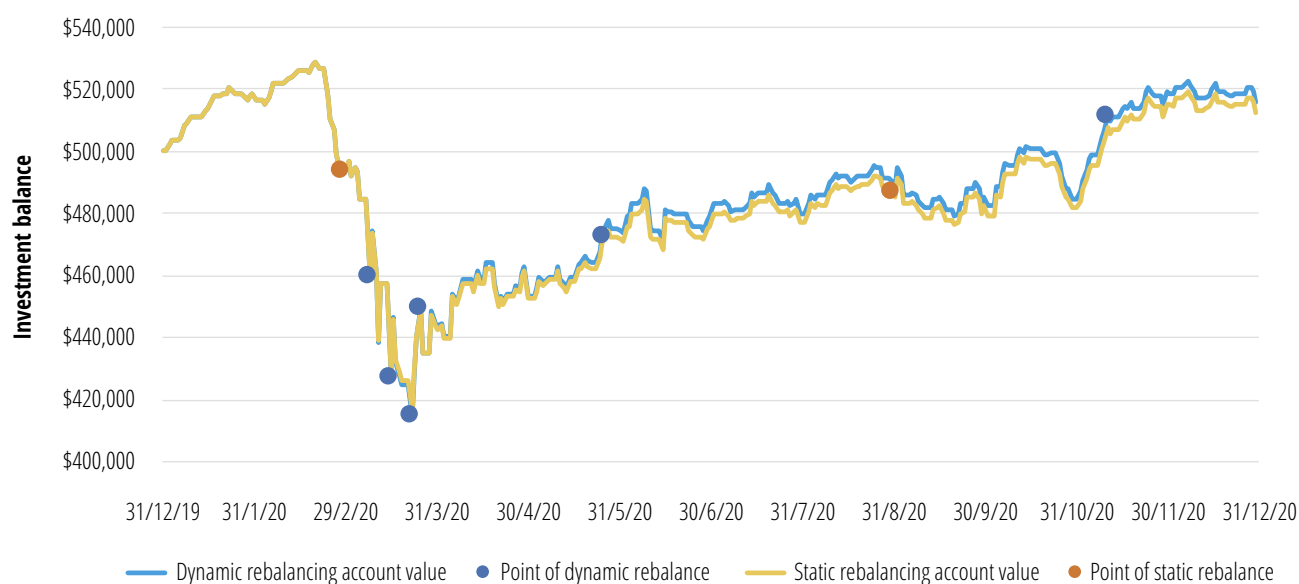
FIGURE 2: 1 YEAR RETURN RESULTS OF PORTFOLIO REBALANCING

Time	Period	Total Return	Scenario 1: Dynamic rebalances		Scenario 2: Static rebalances		Advantage derived from dynamic rebalancing	Advantage derived from dynamic rebalancing (as a % of initial balance)
			Profit/loss	Number of rebalances	Profit/loss	Number of rebalances		
1 year	1.1.20–31.12.20	3.19%	\$15,951	6	\$12,420	2	\$3,531	0.71%

Notes:

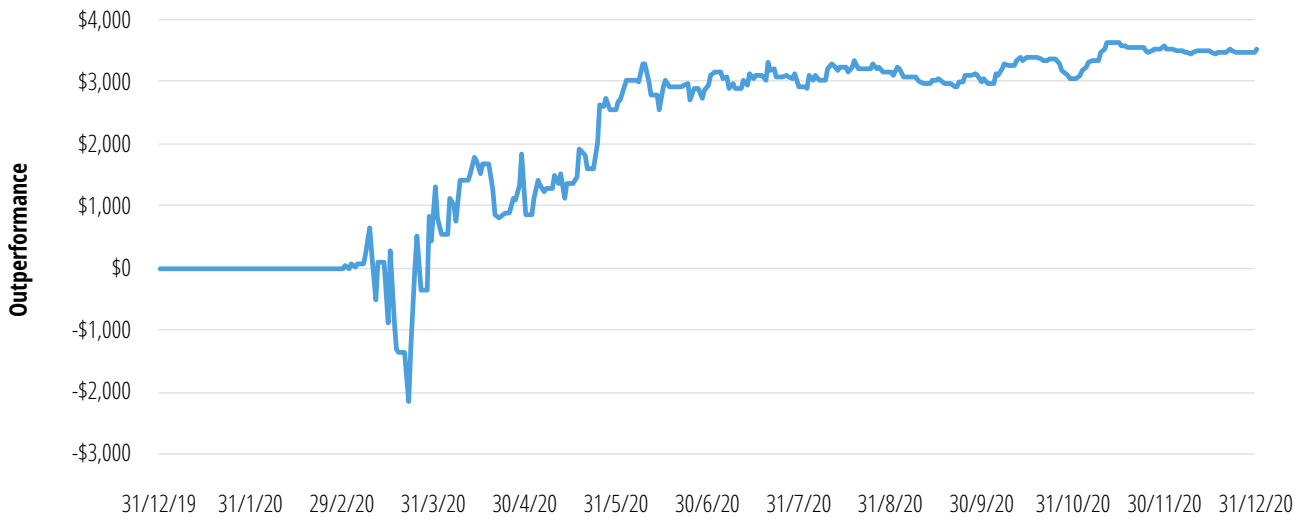
- All returns are calculated to include transaction costs and fees for rebalancing (11 bps for Australian equities and 22 bps for International equities, 0 bp for cash).
- Tax is not taken into consideration in these examples.
- The magnitude and direction of the results above are specific to the given set of market movements, tolerances selected and static rebalancing frequency and timing (dates used). Other sets of market circumstances and parameters will yield different results.
- This figure has been prepared for illustrative purposes only and is not intended to reflect any particular person's circumstances. Past performance is not indicative of future performance.

FIGURE 3: 1 YEAR OUTPERFORMANCE OF DYNAMIC REBALANCING OVER STATIC REBALANCING

**Notes:**

- This graph illustrates the performance of both rebalancing approaches and highlights each time a rebalance occurs.
- Tax is not taken into consideration in these examples.
- The magnitude and direction of the results above are specific to the given set of market movements, tolerances selected and static rebalancing frequency and timing (dates used). Other sets of market circumstances and parameters will yield different results.
- This figure has been prepared for illustrative purposes only and is not intended to reflect any particular person's circumstances. Past performance is not indicative of future performance.

FIGURE 4: 1 YEAR OUTPERFORMANCE OF DYNAMIC REBALANCING OVER STATIC REBALANCING



Notes:

1. The blue line represents the difference between the dynamic rebalancing approach and the static rebalancing approach.
2. Tax is not taken into consideration in these examples.
3. The magnitude and direction of the results above are specific to the given set of market movements, tolerances selected and static rebalancing frequency and timing (dates used). Other sets of market circumstances and parameters will yield different results.
4. This figure has been prepared for illustrative purposes only and is not intended to reflect any particular person's circumstances. Past performance is not indicative of future performance.

OUTCOME – 1 YEAR ANALYSIS

This scenario demonstrates that dynamic portfolio changes resulted in a \$3,531 performance advantage for Portfolio Y through 2020, rebalancing six times through the year (in comparison to rebalancing twice during the year). The benefit was highlighted between February and April where dynamic rebalancing enabled four rebalances, compared to one rebalance under static rebalancing.

As we've used dynamic portfolio rebalancing as a proxy to model the ability for managers to implement changes

with greater flexibility, we can see that empowering managers to make changes to client accounts at the point it's required may lead to a better outcome for clients compared to simply reviewing the portfolio twice a year.

Note: Market volatility enhanced the performance outcome of the portfolio where rebalances were implemented dynamically. Importantly, dynamically rebalancing at the dates shown in Figure 3 would have challenged the very best resourced advice practices and would have been near on impossible to replicate inhouse. While managers may not have been able to replicate these results, we feel that providing them with the flexibility to implement changes automatically should result in a positive outcome for clients (as modelled using the dynamic rebalancing approach).

FIGURE 5: 1, 3 AND 5 YEAR CUMULATIVE RETURN RESULTS

Time	Period	Total Return	Scenario 1: Dynamic rebalances		Scenario 2: Static rebalances		Advantage derived from dynamic rebalancing	Advantage derived from dynamic rebalancing (as a % of initial balance)
			Profit/loss	Number of rebalances	Profit/loss	Number of rebalances		
1 year	1.1.20–31.12.20	3.19%	\$15,951	6	\$12,420	2	\$3,531	0.71%
3 years	1.1.18–31.12.20	22.80%	\$114,001	11	\$107,857	6	\$6,144	1.23%
5 years	1.1.16–31.12.20	44.35%	\$221,771	15	\$213,435	10	\$8,335	1.67%

Notes:

1. All returns are calculated to include transaction costs and fees for rebalancing (11 bps for Australian equities and 22 bps for International equities, 0 bp for cash)
2. Tax is not taken into consideration in these examples.
3. The magnitude and direction of the results above are specific to the given set of market movements, tolerances selected and static rebalancing frequency and timing (dates used). Other sets of market circumstances and parameters will yield different results.
4. This figure has been prepared for illustrative purposes only and is not intended to reflect any particular person's circumstances. Past performance is not indicative of future performance.

OUTCOME – 3 & 5 YEAR ANALYSIS

Over three years, between 2018 and 2021, our analysis shows the portfolio which used the dynamic rebalancing did so 11 times compared to six times under static rebalancing, and lead to a \$6,144 investment performance benefit for dynamic Portfolio Y, representing an additional total return of 1.23% of the initial portfolio balance.

Over five years, our analysis shows that the portfolio which used the dynamic rebalancing resulted in it being enhanced by \$8,335 when compared to the portfolio that used static rebalancing, representing an additional return of 1.67% on the initial portfolio of \$500,000.

Further to this five year analysis, we tested outcomes based on 20 one-year timeframes (2001 to 2020) to observe that the dynamic approach (based on the same parameters) achieved more favourable results 70% of the time (representing 14 of the 20 one-year timeframes).

SUMMARY

This paper provides two scenarios that illustrate the potential benefits advisers can generate for their clients by leveraging managed portfolio capabilities on the HUB24 Platform to minimise delays in implementing portfolio changes. Further, Advisers can unlock efficiencies in their business by accessing professional investment expertise at scale, and tailor portfolios to meet individual client needs to add value for clients.

TWO WAYS MANAGED PORTFOLIOS CAN ENHANCE VALUE

TIMELY ASSET ALLOCATION CHANGES

The scenarios in this paper highlights that by using managed portfolios from managers who made the right call, implementing asset allocation changes without delay may achieve a better investment outcome compared to when portfolios are managed outside a managed portfolio environment, where portfolio changes are often delayed.

The paper demonstrates the importance of timely and efficient allocation changes in maximizing potential client investment outcomes resulting from portfolio management expertise and decisions.

Both scenarios illustrate how a managed portfolio structure can reduce the cost of delaying the implementation of investment decisions, potentially resulting in significant benefits for clients. They highlight how enhanced technology available on the HUB24 Platform can support advisers by unlocking value for clients in the form of 'platform alpha',

AUTOMATIC IMPLEMENTATION OF PORTFOLIO REBALANCES

This scenario shows that there may be benefits derived when portfolio changes are implemented when needed, rather than merely at set fixed points in the year. Using managed portfolios, advisers can outsource investment decisions to managers, giving them the confidence that their client portfolios are kept up to date, reducing the administration burden of traditional portfolio management processes. Portfolio managers can control rebalancing frequency as and when needed with the knowledge that implementation is automatic, allowing investors to capture the maximum potential benefits of investment decisions.

challenging the perception that all platforms are the same and emphasising the need to evaluate platform capability when considering client outcomes. As the scenarios are for illustrative purposes only, it remains important for advisers to consider the particular circumstances of your client, as outcomes may differ depending on market circumstances at the time.



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