INTRODUCTION

SAFETY AT THE CORE TO ALLOW A FEW RISKS

As core satellite investing – which offsets a passive core with some more aggressive 'satellite' investments – makes headway in the mass affluent and high-net-worth space, Elisa Trovato reports on how new players entering the market are offering their own take on the concept

The core satellite approach, which includes a passively managed core, typically representing a large part of an investor's portfolio and a few actively managed, more aggressive, satellite investments, has traditionally been implemented in the institutional investment arena. For very large portfolios in particular, where trading actively big sums of money proves difficult, this approach is considered much more cost-effective, because of the low management fees of index investing.

This concept is being applied increasingly to the mass-affluent and high-net-worth segments, but it can assume different nuances in meaning.

At Italian bank BNL, Stefano Colasanti, head of the individuals segment, which bundles both the affluent and mass-market clients, explains the new core-satellite strategy currently being implemented by the firm. After its acquisition by BNP Paribas in 2006, BNL has started a deep process of rationalisation of its fund range, culminated with the 'restyling' of its old product array in 16 different funds in April. The firm has also taken this opportunity to devise a new type of approach to its investment product offering, splitting it into a core, satellite and 'marketing campaign' range.


Colasanti: client segmentation will be dynamic

The core will be made of actively managed target return funds, falling within the Italian category of 'fondi flessibili', having specific return objectives on different time horizons.

In Italy, during the first four months of the year, net inflows have been impressively negative (-€13bn). This could lead to think that managed savings are going through a strong crisis, says Mr Colasanti. However, he adds, €9bn of net inflows have gone, during the same period, in the category of target return type of funds.

Following the recent interest rate increase, retail investors have started investing more in government bonds and clients are increasingly orienting themselves towards types of products offering a capital guarantee, he says. This clear criticism towards asset managers can be taken as an opportunity. "You have to offer clients investment products which are able to beat the return offered by government bonds," says Mr Colasanti.

The Italian firm has already enjoyed a good success in the bank-insurance arena, recently launching two capital guaranteed unit linked products, which have gathered €600m in four weeks and €1.5bn in five weeks respectively, states Mr Colasanti. The plan is to replicate this success in the banking sector.

The new core funds, which are due to be launched during

Sindby: mass affluent clients have nothing but core-satellite

the summer, will be differentiated in terms of risk-return objectives, time horizons but will also be adapted to the needs of the different clusters of clients, which are now being created at the bank, as a consequence of a customer segmentation exercise.

NO BANK LOYALTY

Reviewing the classification segment of the individuals, who, at BNL, are traditionally defined as those having assets invested in the bank up to €500,000 and currently total 2.5m people, means evaluating a number of factors. These include not only the assets that the clients have with the bank, but also the client's profession, age, income, a whole series of parameters which can describe their potential, says Mr Colasanti. "The key development, compared to the past is that this client segmentation will be dynamic," adding that that investing €500,000 at one bank does not exclude the fact that the client might be effectively a private banking client, given that in Italy, the proportion of investors using the services of more than one bank is very high.

The satellite range for the individuals segment, on the other hand, will include active equity and fixed income asset classes having a specific benchmark. These are already present in the bank's product offering and cover different geographical areas.

"These are single bricks which are used by our distribution network to build, together with the customer, an asset allocation as tailored as possible to the client's expectations in terms of risk-return."

Finally, the 'marketing campaign' range will include products where development opportunities are identified, which will vary depending on market performance expectations. They will focus on particular active asset classes or specific geographical areas.

This new approach has somewhat determined a heavy reorganisation of BNL's distribution network. A strong recruitment campaign is now in progress at the bank, with the plan to hire 900 qualified professionals by 2009 and organise extensive technical and commercial training programs. "The idea is to guarantee a better service and more advisory time to the client," says Mr Colasanti.

Fredrik Nerbrand, head of global strategy, HSBC Private Bank UK states that the concept of a core-satellite approach is "a bit yesterday from a private client prospective".

The concept implies that you have a core and independent satellites, without taking into consideration the full risk and return dynamics of the overall portfolio. "The core satellite approach is fine as long as you are aware of the correlation between the different satellite investments as well as the core, he says. "Rather than calling it core-satellite, we tend to think of this concept as onion rings," says Mr Nerbrand. "So you have a core in the middle and then around that you have investments that hedge some of the risks that you have in your core portfolios or take some additional, idiosyncratic types of risk," he says. This terminology gives the correct idea of investments that, rather like an onion, are interconnected, he adds.

BESPOKE SOLUTIONS

Private clients are offered bespoke solutions, says Mr Nerbrand, but what tends to happen is that clients' portfolios tend to be split in two parts. "The discretionary part of clients portfolios tend to be the very risk-controlled central bit, the core," says Mr Nerbrand. This is represented by equity and bonds, which are managed by US manager of managers firm SEI, but can also include some hedge funds, which can have some type of correlation to the equity markets. "We use a true multi-manager approach so that we have a complete see-through into active managers and what they are doing on a real time basis," says Mr Nerbrand.

The satellites represent the advisory part of the portfolio, which can include exchange traded funds (ETFs), structured products, hedge funds or private equity for different thematic approaches. "We use ETFs extensively," says Mr Nerbrand, "but we tend to use them more on the tactical side then on the core side."

If you invest your equities into an ETF, you will never be able to beat the benchmark, it is very difficult to achieve that even by tactically trading them in and out, continues Mr Nerbrand, but by implementing a risk-controlled multi-manager approach you will have that possibility.

Asked what percentage of a private client portfolio is made by the core investments and what by the satellites, Mr Nerbrand says that it will be different from client to client and will also be different from time to time.

"Last December for example we highlighted that volatility was very low and we advised clients to come out of their normal equity allocation into capital protected solutions, providing a very cheap insurance to their portfolios because volatility was so low."

The ones who took this advice, he says, would have taken assets from their core and invested them into structured products or capital protected solutions. "In that case quite a lot of the assets would have gone into satellites," he says. "At other times you just want to have a long and steady allocation to your equity markets, without much active approach to it. That depends on where in the cycle you are."

Currently, what Mr Nerbrand recommends that his clients should have a very diversified core, take a very balanced approach and not to bet too much away from their long term asset allocation.

BLANKET APPROACH

At Danske Bank, the core-satellite approach has been employed for several years for all the bank's customers. Morten Kyhn Sindby, head of group wealth management at the Copenhagen-headquartered Danske Capital, the asset management arm of the bank, explains that the whole idea of the core-satellite approach is to give the customers a full asset allocation tool. "Most of the mass affluent clients, who are the clients of the branch network, will only have a fund solution, meaning that they will only have the core satellite set up and nothing else." The high- net-worth individual customers would receive the core satellite foundation and, then upon that, they will make individual investments, such as alternatives or structured products, he says.

"What we have seen in the past year or two is that the amount of customers who just want somebody to take care of their money and report to them every year, what we call the delegators, has increased dramatically," says Mr Sindby. And the basic idea behind core satellite is really that you inform the customers on the developments of the portfolio and tell them when it is time to buy or sell.

In order to meet customer needs, the Danish firm last year built a fund of funds type of solution, where the customers only see one product or one solution. The basic idea behind this is the same as in the core satellite approach, says Mr Sindby. Normally, Danske Capital will manage the core funds whereas either the Danish firm or other third-party providers, which are monitored by the fund rating and selection unit established three years ago, will manage the satellites.

Jeremy Beckwith, chief investment officer at private bank Kleinwort Benson, the UK-based private bank operating under the Allianz umbrella, states that if the traditional core satellite approach makes sense for a large institutional investor, being much more cost-effective, this approach will not save any money to the private client, who generally invests considerably less than an institutional client. This is true especially considering that in the UK the management fees for ETFs are still too high, being 30 or 40 basis points for private clients.

The UK private bank applies the concept of core satellite, in its broader definition within its alternatives offering, in hedge funds, private equity and some property funds.

For example, in the hedge fund arena, Kleiworth Benson offers a collection of hedge funds of funds. But for larger clients, for those who want to take a higher risk, the bank provides hedge funds specialised in a particular region of the world or in a particular strategy. "We have the core holdings and more specialist investments that we would classify as satellites, which involve a bit more of a bet on the volatility of the underlying portfolio," adds Mr Beckwith.

Remodelling the asset management side to fit core-satellite approach

Implementing a core-satellite approach often involves rethinking business models on the asset management side.

In France, over the past couple of years, Société Générale asset management (SGAM) re-shaped all its balanced assets in a core-satellite strategy, in order to better monitor and improve performance. The concept also resulted more efficient in terms of pricing, explains Michel Agou, director of business development at the French firm.

But embracing this approach brought with it a re-structuring of the organisation.

Last year, Alain Clot, chairman and chief investment officer at SGAM, decided to create a new investment strategy unit inside the company, called ADO, the French acronym for equities, balanced and private, bonds and money market, appointing Alain Pitous, head of balanced and private management, to run it.

The traditional asset classes, previously split into three separate units were re-organised in a one more performing entity. SGAM Paris is now a strategy-oriented organisation, designed towards meeting the needs of specific client types and demand for asset classes, explains Mr Agou, who is ADO's director of business development.

This is the result of the convergence process between alternatives and traditional asset classes, which has pushed SGAM Paris to overhaul its way of managing assets, placing it, in a way, more on the satellite side, says Mr Agou.

"Traditional active managers find it difficult to compete with the cheap products that tend to form the core part of the 'core-satellite' approach, simply because active asset management is more expensive than trackers or indexed funds," says Mr Agou.

"At SGAM ADO most of our investment bricks used inside our balanced funds for the core part are index funds and low tracking error actively-managed funds, whilst on the satellite side we include more aggressively managed funds," continues Mr Agou.

"So our low tracking error actively-managed products have been obliged to 'redesign' themselves either by increasing their alpha, so that their strategies become part of the satellite range, or by lowering their tracking error in order to fit as a core investment."