Talking Transitions *with* Penserra

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Using Futures during a Transition

Futures can be effective tools to manage exposure risk during a transition event.

▶ Regional exposure mismatches and timing

A transition involving global portfolios introduces risk management challenges, as global exchanges do not always have overlapping trading hours. This makes it difficult if not impossible to closely match buys with sells. When trading any transition event, managing asset class exposure is one of the essential processes to control risk and minimize cost.

An essential element of managing exposure is timing the sell of legacy securities to match the purchase of target securities. For example, a transition out of U.S. equity into an EAFE benchmarked portfolio provides challenges when trying to buy target securities in Asia Pacific while selling legacy U.S. securities. Exchanges in Asia Pacific are not open at the same time as U.S. equity exchanges. Buying equities in Asia before being able to sell securities in the U.S. creates intra-day leverage; selling in the U.S. prior to being able to buy in Asia creates intra-day cash or underexposure. In this case, using S&P500 futures can help to manage exposure and reduce risk.

A useful strategy in this example might be to sell S&P 500 futures exposure during Asia Pacific trading hours matching each dollar invested in Asia. As trading is completed in Asia, the transition account will have purchased the desired target securities in Asia Pacific markets while having sold and equal dollar value in S&P 500 futures. When U.S. markets open, the strategy would be to buy back the S&P 500 futures while concurrently selling a corresponding dollar value of U.S. equities. The end result is a tool to manage equity exposure using futures which significantly lowers opportunity risk.

▶ Beta Management

Clients seeking to maintain asset class exposure over pools of cash may consider a derivatives-based interim solution. These pools of cash are generally established for operational efficiency (regular outgoing payouts) or derived from trade timing constraints resulting from an asset re-allocation.

Based on a number of factors including the interim benchmark, timing requirements, and client preferences, Penserra can create a derivatives overlay. These are structured as an optimized basket using primarily futures and ETFs. The goal is to match benchmark exposures. Some examples of potential derivative overlay solutions include:

- Client liquidates an equity portfolio intending to re-invest proceeds in a U.S. Treasury fixed income portfolio.
- Client with benefit payments due to be paid out on a specific monthly schedule going forward. The operational concerns about repeatedly going back to asset managers requesting cash to fund those benefit payments should be evaluated versus the impact on investment returns of maintaining a larger than necessary pool of cash. A potential solution addressing both operational and investment concerns is to liquidate a fixed month's worth of benefits payments and overlay that cash with a futures basket that is constructed to replicate the benchmark exposure. As benefits payments are made, an equivalent portion of the futures overlay is sold. The cost and operational considerations can make a liquidity pool futures overlay attractive.

Clients seeking to create synthetic asset class exposure for pools of cash may consider a derivatives-based interim solution.

- There are also scenarios where a client may want exposure to a specific benchmark for a period of time as part of an overall plan asset allocation or re-allocation. Here, creating an optimized basket of futures and currencies to closely replicate most actively traded benchmarks would be practical.

In all instances, the use of futures would require additional paperwork with a futures commission merchant in order to set up an account to trade. Penserra assists clients with both the operational and investment aspects of establishing, maintaining and managing these synthetic beta solutions.

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