Leveraging ASTRO to Better Transition Clients to Your Target Strategy

Introduction to Transition Management

While you may recognize the term ‘Transition Management’ in succession planning, it is also known as a strategy to optimize portfolios. Specifically, in the RIA world, transition management refers to the transitioning of a client’s portfolio from the current allocation to an allocation that the advisor believes is more suitable.

Most institutional custodians offer transition management services for their large institutional client base. Typically, an asset owner fires an outside manager and looks for a service to transition that part of the portfolio to the new manager’s positions in the most effective way.

Transition management, however, is not unique to the institutional space. In fact, this service is probably more desirable in the RIA channel, as incorrectly transitioning a portfolio likely has a larger effect on a client than a large asset owner. Since there are more variables to consider when working with clients—such as taxes, exposures, and costs—generally more is at stake.

The truth is, financial professionals have historically lacked advanced tools to accomplish transition management in a scalable, cost-effective manner. Most firms do this in a very manual process—using a combination of trade restrictions, spreadsheets, and one-off notes. Many RIAs transition clients over four quarters in order to spread out the capital gains hit over two tax years. With this strategy, these advisors sell 25 percent of the portfolio and invest the proceeds into a model allocation each quarter. While this allows firms to scale the process to an extent, the strategy ultimately treats all clients the same, ignoring their current allocations and tax sensitivities.

Transition Management: ASTRO in Motion

Orion's ASTRO empowers advisors to implement transition management—while optimizing for risk factors, tax considerations, and more. At its core, ASTRO is a portfolio optimizer that uses a risk model to decompose portfolios into a series of factor exposures. One of the unique attributes of ASTRO is that it allows advisors to enter unique client-specific constraints that persist throughout the life of the account until they change it.

For example, a new client has an existing portfolio of 200 individual stocks, two of which have very low-cost basis. The client is overweight in the technology sector and does not have any exposure to fixed income. Additionally, the client does not want to realize more than $50,000 in capital gains this year and $100,000 in capital gains next year.

After reviewing the client's comprehensive plan—including goals tied to risk tolerance—you've determined the client should be in a more moderate diversified strategy consisting of domestic and international equity exposure, along with a 40% allocation to fixed income. The model that fits this description contains a suite of ETFs.

Through the optimization process, ASTRO deconstructs both the client's current holdings and the ETF model portfolio into a series of factor exposures. Next, it calculates each security's unique risk contribution relative to your model portfolio. Essentially, ASTRO determines which trades have the highest impact in order to move the client closer to your model. Given the example, ASTRO would most likely recommend selling positions in the technology sector and add positions in the Fixed Income ETFs.

As part of this contribution calculation, ASTRO takes into account whether the securities have unrealized gains or losses. It favors selling losses first in order to harvest those losses. ASTRO iterates over suggested trades until it hits the client's capital gain budget—which can be inputted into the system and broken out by quarterly capital gains realization targets (e.g. realize 40% of annual capital gains budget in Q1). You can then reoptimize the client next quarter when the capital gains budget increases—or when there is an opportunity to harvest more losses in order to offset gains while staying within the client's budget.

Conclusion

While the above example paints a clear picture of how to optimize a single account, ASTRO really thrives in batch client optimization. Once you set your clients' unique constraints—like legacy 'do not trade' positions, tax brackets, and security-specific allocation percentages—ASTRO enables you to batch multiple clients together and optimize that group in a single workflow.

To learn more about how ASTRO can help you better transition clients to your target strategy, sign up for one of our upcoming ASTRO demos.

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