Seven Ways Fixed-Income Investors Will Benefit from the Digital Revolution

September 20, 2018

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At long last, fixed-income investing is entering the digital age—and investors should pay close attention to what their asset managers are doing to keep up. From better pricing to better solution design, the digital revolution that's transforming the fixed-income management landscape can lead to a host of benefits.

To grasp the performance gap between managers who upgrade their technology and managers who don't, it's important to understand just how behind the times many fixed-income teams still are. Roughly 80% of the notional value of US corporate bond trades comes from transactions executed over the phone. The biggest innovation in credit research until very recently? Microsoft Excel, which came on the scene in 1985.

The investment process is just as analog. Portfolio managers in many shops spend a lot of time going back and forth with different analyst teams to vet an interesting idea, then pinging it to traders, who in turn spend lots of time going back and forth with brokerages to see whether the idea is executable at a price that's worth bothering with. And if it doesn't work out, the whole tedious process begins again.

There is a better alternative. In fact, technology is already helping progressive fixed-income managers get to market and execute their ideas faster by allowing humans and machines to do what they do best. Computers crunch mountains of data at breakneck speeds and instantly tease out patterns from a swirl of numbers. Humans do the abstract thinking and high-level strategy planning that's still very hard to code.

The end result: Machines make it easier for humans to instantly collect information from disparate trading pools so they can compare prices and availability, consider analysts' views within a consistent framework, and even find new ideas by integrating the data that traders, analysts and portfolio managers rely on.

Here are seven ways investors stand to benefit from these changes:

1) Better, faster bond selection. The first step in integrating technology is to centralize and digitize the data, making it easily accessible to all members of the investment team—including increasingly capable artificial intelligence. By integrating the collective insights of teams of expert credit-research analysts in a central location, and by evaluating bonds within a consistent framework that puts everything on a level playing field with explicit numerical comparisons, bond managers will be vastly more effective at selecting which bonds to buy and sell.

2) Capturing more buy/sell opportunities. In the post-crisis era, liquidity is scarce, and even relatively small events can freeze bond markets. Even under normal conditions, a bond that seems to be available can disappear moments later, and the appetite for a particular security can fade just as fast. Having a centralized feed of market liquidity information and a combination of machine and human intelligence to monitor that feed gives investment professionals an edge when it's time to grab a coveted bond or unload one that no longer serves the portfolio. That ability will be especially critical during a liquidity crunch, when the first to transact often wins.

3) Best prices. Under scarce liquidity conditions, tools that can survey the entire bond market won't just find the bonds investors need. They'll also help investment professionals ensure that they're getting the best pricing without having to spend precious hours calling multiple brokers for quotes.

4) More time to find differentiated insights. If one of the biggest benefits of a more efficient investment process is that it gives talented humans more time to do the things machines cannot, the logical next question is: what exactly are those things?

Technology can help human investment managers find new data, proprietary or not, and ask it interesting questions—questions that competitors haven't thought of yet. Machines are great at spotting patterns and teasing predictions from mind-bogglingly huge data sets, but the output is only as good as the input. It's up to humans to consider more sources, try out more hypotheses and run more models to answer their own most vexing queries.

5) More time for human-to-human intelligence gathering. Not all data comes in binary code, of course. A more efficient investment process that gives analysts and portfolio managers more time to meet with, say, the officials who run municipalities or foreign Treasuries, or with company management teams, may also lead them to differentiated insights. All of this improves the odds of creating alpha.

6) More time for investment professionals to interact with clients. Investment teams have many priorities, but client interaction should always be one of the most important. Investors' priorities are always shifting, and it's up to investment managers to ensure not only that they understand these shifts, but that investors are comfortable with the strategies their managers are pursuing. That means answering questions at all hours about portfolio performance, how market events affect positioning, and a portfolio's exposure to the megatrends that are shaping the world economy.

But this isn't a one-way street. Clients and investment managers often work closely together to design and develop new investment solutions. Devoting more time to these creative partnerships can pay real dividends.

7) Lower overall trading costs. A less cumbersome investment process will ultimately result in savings for investors. While asset growth typically leads to higher trading costs and the need for additional personnel, technology pushes costs in the other direction.

For investors, all these benefits boil down to one inescapable conclusion: investment managers who integrate the right kinds of technology into their investment processes now stand to significantly outperform those managers that dither. Think of it this way: would you rather stand outside in the rain trying in vain to hail a cab, or push a few buttons on your smartphone to hail a ride-sharing service?

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