

WORKING WITH...  
APERIO GROUP, LLC



## THE NEXT GENERATION OF INDEXING: CUSTOMIZED PORTFOLIOS THAT MEET CLIENT NEEDS

Aperio is an investment management firm managing approximately USD 3 Billion in public equity portfolios for ultra-high-net-worth investors, foundations, and endowments through financial intermediaries such as independent advisors and family offices. The firm's major product lines include Active Tax Indexing, Thematic Beta and Socially Responsive Indexing. The firm's specialty is designing and managing "bespoke" portfolios that can track index benchmarks or deliver targeted risk, factor, geographic, or industry exposures customized to a client's specific tax situation, values, and/or desired economic exposure.

### Aperio's Customized Strategies: Supported by flexible Barra products

Patrick Geddes, Aperio's Chief Investment Officer, emphasizes that Aperio's differentiation comes from its willingness to customize solutions in collaboration with the intermediaries with whom they work. "Our quantitative processes, supported by Barra tools, enable us to deliver to our clients' customized exposure to equity markets by incorporating risk factor tilts, environmental, social and governance screening, and special tax requirements."

"A good analogy would be to compare us to a bespoke tailor, where the customer has total control over fabric, features and fit. Once the client has made his or her selection, our job is to use our tools and experience to make sure they understand how the components might combine in terms of aesthetics and function, and then we make the suit. In fact, we call our process 'hyper-customization.' Our ability to hyper-customize in an efficient and cost-effective fashion is possible because of the availability of the Barra tools we've integrated into our process. We have built an investment 'factory' that can very precisely and efficiently design and manage separately managed accounts (SMAs) to our clients' exact specifications. Our challenge, and our success, has been to deliver bespoke suits at the same price as off-the-rack suits."

For its taxable clients, Aperio uses Barra Aegis, Barra Equity Models and optimizer to sell securities trading at a loss and replace them with securities with a comparable factor profile while maintaining the desired risk/return profile and target tracking error. These losses can substantially improve the after-tax returns of the investor. Patrick said, "We started our business to track standard index benchmarks while adding value beyond plain-vanilla indexing. And because all of our portfolios are managed in SMAs we're able to offer a level of customization around taxes, values and risk factors that is impossible to achieve through mutual funds or ETFs. Historically we've used Barra Aegis to track index benchmarks, but increasingly we're using the Barra risk models to, at the request of our clients, replicate active strategies using various factors. The result is active management, but with the advantages more typically associated with indexing, such as transparency, low costs, and tax-efficiency. We like to call it the marriage of active management and indexing."

### Matching client values with socially responsible investing: Using Barra products & MSCI ESG Research data

The firm manages customized SRI portfolios designed to track standard US, foreign and

global equity index benchmarks. Clients can customize their portfolios along any combination of environmental, social and governance (ESG) screens, utilizing negative, positive and/or best-of-breed screens. According to Patrick, "Our optimization process is designed to maximize a portfolio's social score while minimizing its tracking error relative to its benchmark index by excluding the screened companies and more heavily weighting higher scoring companies. Using this approach, we are able to profile investors with different value systems while successfully tracking market indices globally.

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*"Barra's suite of products and ongoing research provides us with what we need to strengthen our offerings to clients and to push the boundaries traditionally imposed on investment managers."*

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**Patrick Geddes**  
Chief Investment Officer



Investors can achieve market returns while avoiding investments in companies and/or industries they view as socially irresponsible. A socially responsible proxy voting policy completes the program.”

“We work with investors that want to incorporate their values to show them the tracking error, tax impact, and how close they can get to their ideal values set. This type of quantitative analysis, using Barra tools, allows investors with their wealth advisors to make informed decisions about the trade-offs. Investors appreciate having their values included into the decision, and advisors like understanding the risk implications.”

“Years ago it would have been impossible to do this. Now the tools and research are available and it’s cost-effective. We use MSCI ESG Research data to help our clients understand what’s happening within companies. Combined with all the other factors that Barra covers,

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*“As a quantitative shop providing this service, we’re only as good as the model we’re using. We’re selling innovation. If we are wrong, then clients aren’t going to trust us. We put a lot of weight on the Barra research behind the models. We have Barra behind us, and it helps us gain even more credibility.”*

**Patrick Geddes**  
Chief Investment Officer

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we then can layer in custom factors to constrain the portfolio. For example, we get data from MSCI ESG Research on the Global Environmental Innovators. MSCI ESG Research scores most publicly traded companies on the percentage of revenue they generate from various environmental themes (for example, pollution prevention or sustainable water). We load that into Barra Aegis as a customized factor and optimize the portfolio to maximize the portfolio’s environmental revenue score subject to the tracking error constraint (relative, for example, to the MSCI World Index).”

Patrick said, “We had an intermediary call us and say, ‘we have a client that is very focused on low-fees, tax sensitive, etc. They have certain Catholic screens they want to incorporate as well as GMOs (Genetically Modified Organisms). They also want a global portfolio, including emerging markets, but not China. And can you make this a small cap value play?’ That’s a good example of hyper-customization. In Barra Aegis, we can convert the ESG screens and other factors that the client wants – GMO screens, geographical tilts, factor exposures – into constraints, and we are able to deliver their public equity objectives fully customized in one global portfolio.”

“Hyper-customization of client investment strategies. That’s what Barra products help us to do.”

#### Using proxy voting from ISS

Increasingly, clients are interested in using their power as shareholders to change corporate behavior. As a result, Aperio started to see more interest in the proxy voting process. ISS provided a solution, as Patrick noted, “As indexers we needed a cost-effective way to vote those proxies. We selected ISS to help us develop the guidelines, provide research on

the issues, and vote the shares on behalf of our clients. ISS allows us to further align investors’ shares with their values.”

#### The power of customized portfolios: Delivering what clients want

Aperio is seeing three primary trends with their wealth management clients: 1) A move towards global allocations; 2) An increased desire to align investment portfolios with investor values and/or institutional missions; and 3) A demand for risk-controlled, quantitatively managed factor exposure – often referred to as smart or customized beta. Patrick said, “Barra Aegis enables us to capitalize on these trends and help our wealth advisors better respond to their clients’ needs. Our abilities around thoughtfully replicating active strategies at a much lower cost, greater tax efficiency, and high level of customization are key components of our service.”

“A client recently commented to us: ‘I tell you guys whatever I want and you engineer it for me!’ This is an entirely different approach to portfolio management because we offer wealth advisors a new level of control. Wealth advisors and their clients are no longer limited to the products that the investment industry decides to mass-produce – they now can demand custom solutions to reflect the uniqueness of each client situation in a low-cost and efficient manner.”



**High quality research driving better decision making**

Over the past few years, Aperio has been focused on the research that has demonstrated that an even greater percentage of returns can be defined as beta – attributed to a larger pool of factors than previously understood – and a shrinking portion to security selection. Patrick commented, “Investors can now seek that factor exposure without the active fees. And since the fees are the only thing an investor can confidently control for, this is a huge step forward for the investor.”

Patrick said, “Barra has been a pioneer in documenting and defining those factors. For example, when a client wants a desired strategy like quality, we can evaluate the leverage, earnings yield, volatility and earnings variability of thousands of companies in seconds. Then using a Barra Equity Model, we select the securities that in combination provide the optimal factor exposures.”

As Aperio’s customized beta business grows, they were seeing increasing demand for back-testing to understand the performance of various factors, alone and in combination,

historically in different market environments. To meet this need, they recently integrated the Barra back-test module. Patrick believes: “With this tool, we can provide deeper analysis so that our clients can make more informed decisions.”

“The Barra suite of products and ongoing research provides us with what we need to strengthen our offerings to clients and to push the boundaries traditionally imposed on investment managers. We value Barra products as they help us in hyper-customizing solutions to sophisticated investors.”

**The strength of the Barra brand**

Patrick emphasized the prestige and strength of the Barra brand and how that resonates with their clients. Patrick said, “From the beginning, we needed a strong and credible foundation upon which to build our investment platform. As our business evolves and grows, Barra’s suite of tools has been able to support us along the way. We have expanded our suite of Barra products and services. Barra tools are critical components of the Aperio factory and have enabled us to meet our clients’ increasing complex needs for hyper-customized solutions.”

“As a quantitative shop providing this service, we’re only as good as the model we’re using. We’re selling innovation. If we are wrong, then clients aren’t going to trust us. We put a lot of weight on the Barra research behind the models. We have Barra behind us, and it helps us gain even more credibility.”



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