

# Equities Research in Investment Banking

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# Equities within Capital Markets

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## What are we here for?

- ◆ Financial Markets are an essential aspect of international trade
  - efficient trade in raw materials & commodities
  - managing cash flows
  
- ◆ Companies use Capital Markets to raise money for investment in their businesses and managing their balance sheets
  - debt - credit risk
  - equity - capital risk
  - derivatives (off balance sheet)
  
- ◆ Brokers act as intermediaries between buyers and sellers
  - companies issuing shares (equity) or bonds (debt)
  - investors managing portfolios
  
- ◆ Corporate Finance intermediates changes in structure
  - mergers and acquisitions
  - changes balance sheet structure



# Equities Stockbroking

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## The business perspective

- ◆ Corporate Finance and Equities are mutually dependent but distinct businesses in that each requires the presence of the other to thrive best
  - They can exist independently yet have clear business synergies, each supporting the other
  - They have to remain operationally isolated to prevent conflicts of interest that would damage both
- ◆ Equities Division are primarily directed towards exploiting the economies of scale through providing services to investors beyond just execution
- ◆ Make money through commission and trading by providing investment research, products and services to institutional investors
  - Research
  - Sales (distribution)
  - Transaction Execution
  - Ancillary Services (e.g. Prime Brokerage)
- ◆ The key to success: Active Client Management
  - operate as a focussed team with defined objectives



# Adding Value to Investors - 1

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## Research and Distribution – Nectar to attract bees

### ◆ Research

- Assist investors in selecting stocks by providing recommendations based on detailed company analysis
- Assist in asset allocation by providing macro economic and strategy forecasts and scenario analysis
- Assist in portfolio construction and investment decisions with analytic tools, data and research into investment process

### ◆ Sales

- Act as filters on research information providing personalised regular contact
- Arrange meetings with analysts and customized services from within the Research pool
- Intermediate with Execution to convert goodwill into commission
- Manage the relationships with clients including prioritisation and distribution controls



# Adding Value to Investors - 2

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## Execution, enhancing yield and managing risk

### ◆ Execution

- Vanilla Service in its most basic form – low revenues but provides flow pool (liquidity) on which positions can be made at low cost (Edge)
- Large trades or Portfolio Trades or trades in illiquid stocks offer opportunities for extra services managing the execution to minimise market impact
- Some clients will pay extra for the bank to take on some of the execution risk – guaranteeing prices
- Risk management products such as exchange-traded derivatives or structured products can increase or reduce risk exposure

### ◆ Ancillary Services

- Global Custody – administrative management of portfolios (registration, dividends, etc)
- Prime Brokerage – stock lending to investors wanting to go short
- Hedge Fund Services – assist in the startup of hedge funds, introducing them to potential investors and covering startup costs in return for PB business later



# Research

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## A consistent, unified view of the world

- ◆ Where Fixed Income research is about credit quality (default risk), Equities research is about forecasting earnings growth
- ◆ This is a disciplined process requiring analysts to forecast whole balance sheets for at least five years into the future, to establish trends and identify key variables
- ◆ Target prices (from which recommendations are derived) are based on the sum of present value of future earnings based on a discount rate incorporating an equity risk premium
- ◆ This process produce comparable results - based on common assumptions and using consistent methods - for this to be useful to investors
- ◆ The key to successful research is teamwork, discipline and structure - plus curiosity and insight



# Distribution (Sales)

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## Marketing and Distribution Management

- ◆ The role of sales is to manage the relationships with clients, using research as the main product
- ◆ General Sales - manage clusters of clients and act as a single contact point communicating whatever research is most relevant in a daily call or email
- ◆ Specialist Sales (Global Sector Marketers) - cover all clients for a limited range of research products – acting as business managers for Research teams
- ◆ Clients pay through overall commission - allocation to individual products / teams / people through broker votes rather than individual trades
- ◆ Clients are targeted based on size (funds under management) and ability to pay - key contacts (who can influence commission allocation) are then identified and targeted to maximise impact
- ◆ Active control over access to research to maximise revenue impact and emphasise that it is a value added product and not a freebie
- ◆ Equity Client Relationship Directors (ECRD) manage the process



# Research 1 – Individual Companies

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## “Lies, damn lies and statistics” – Benjamin Disraeli

- ◆ The most obvious economy of scale – to publish what we have to know anyway
- ◆ Investors want help deciding which companies to invest in – forecasting future price performance
- ◆ The nature of Company Statement of Accounts is to present each company to investors in the best possible light within the rules – e.g. Enron
- ◆ Equity Research can help interpret this to make things more transparent so that forecasts can be made on a more consistent basis (note potential conflict of interest with Corporate Finance)
- ◆ To value a company we must forecast cash flows and asset value changes into the future, based on growth rate assumptions, and then discount these back to the present based on the return investors would pay for (risk-free rate plus equity risk premium)



## Research 2 – Macro – Economics and Strategy

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### The Big Picture

- ◆ Growth rate drivers of companies may be
  - company-specific (e.g. investment in new infrastructure, superior marketing team, leading research) or
  - common to many companies – either industry or country effects – company research should be consistent in use of macro assumptions
- ◆ Similarly investor appetite for risk (equity risk premium) is mostly not company-specific – combination of industry and country factors
- ◆ Forecasting these is a task for Strategy Research and Economic Research (Strategy Research is focussed on equity markets)
- ◆ Strategy Research also has the task of deriving market forecasts (country or industry) to assist investors making asset allocation decisions – which should be consistent with aggregated company forecasts



# Research 3 - Analytics - Quantitative Research

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## Meet the Geeks

- ◆ Systematic investment processes require high quality data
  - construction of databases is a specialist task
- ◆ Portfolios can have unexpected risks
  - risk measurement and decomposition is not straightforward
- ◆ Asset Allocation and Portfolio construction require discipline
  - optimisers can assist in processing information in a consistent way
- ◆ Investment processes have to be clear
  - identification of meaningful styles of investment
- ◆ Quantitative disciplines require specialist statistical knowledge
  - brokers can add value to the investment decision processes of clients



# Marketing Quants – not just Salesmanship

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## Translating pointy-head into human?

- ◆ UBS has the best quant research group in the world
  - how do we convert this into revenue & votes?
- ◆ Clear marketing message - Value Added Process Enhancement
- ◆ Systematic marketing
  - regular global marketing tours – maintaining relationships
  - variation of analyst / message / product
- ◆ Disciplined client / contact records
  - know who our contacts are / what we have done for them
  - 2,500 people at 500 institutions
- ◆ Thorough follow-through - value added comes through service
- ◆ Targeted research distribution
  - make sure each publication is going to the right people

# The Result

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## Revenge of the Nerds

- ◆ Since 2000 client activity with quant department increased 500%
- ◆ UBS has the best quant research group in the world
  - Ranked top 3 in Institutional Investor Surveys for Global, Europe, Asia & Japan
  - Ranked 1st in Extel Europe Survey for last three years
    - one third of the individual nominations
    - 3rd highest team vote across all UBS Equities products
    - 11th highest team vote across all broking houses
  - This year David Jessop won overall Best Rising Star Analyst
- ◆ Quantitative Research is one of UBS's most popular products
- ◆ Accounts for about 5% of commission revenues overall
  - But for some major clients as high as 25% or more



# Summary

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## Teamwork, Structure, Discipline, Focus

- ◆ Equities is a business, not a process
  - think outside the box
  
- ◆ High quality, consistent product
  - focus on added value
  - discipline & structure
  - open and transparent
  
- ◆ Targeted sales - maximise revenue potential
  - active client management
  - systematic, teamwork coverage
  
- ◆ Distinctive culture helps
  - flat hierarchy, involved accessible management
  - collaborative, consensus decisions, team approach
  - willingness to embrace radical solutions
  - high staff retention
  - emphasis on efficient work and balanced life

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