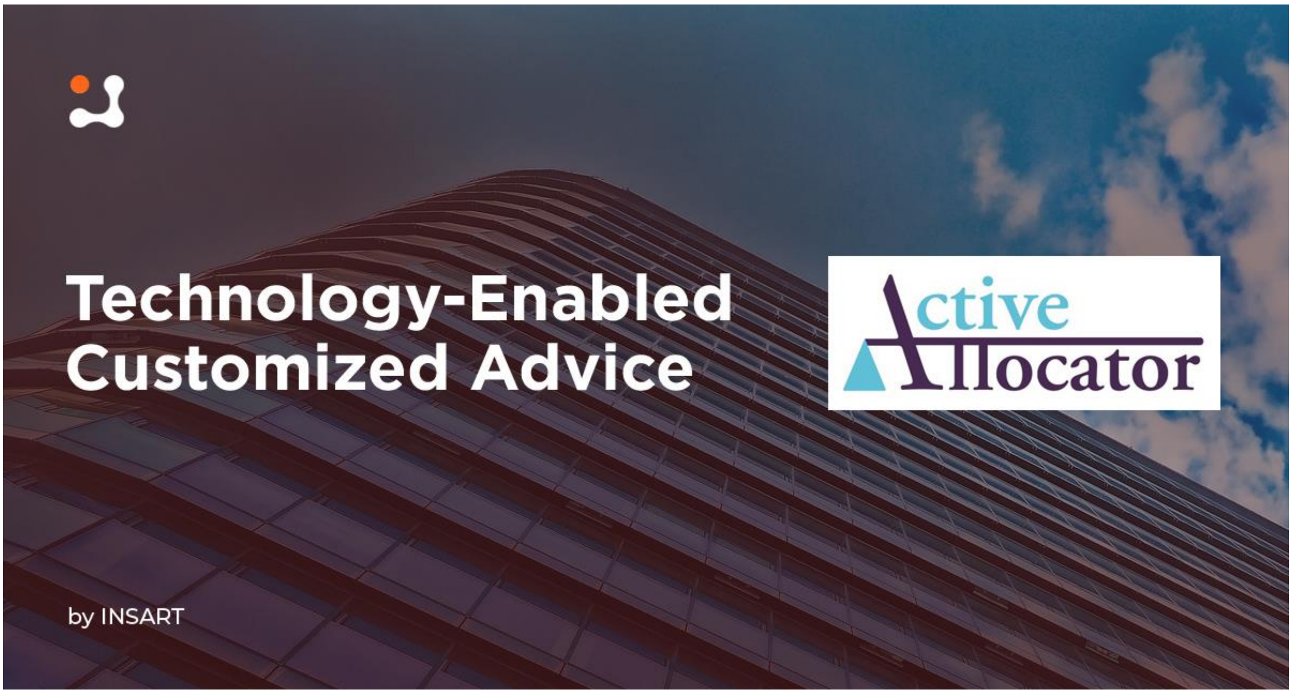
ActiveAllocator: Digital Asset Allocation Platform with Technology-Enabled Customized Advice



Website:	www.ActiveAllocator.com
Founded:	2015
Clients:	Private investors, wealth-management firms, insurance companies, registered investment advisors, and independent broker-dealers' financial advisors
Value proposition:	World's first portal that seamlessly integrates traditional, illiquid and alternative investments within portfolios. It helps investors analyze existing allocations, discover inefficiencies and create bespoke portfolios in minutes.
Top management:	Sameer Jain, Founder and CEO Brian Jones, Co-founder Manoj Shahi PhD., CFA, Partner Akl Noun PhD., Partner

ActiveAllocator is an early stage WealthTech company that helps individual investors, financial advisors, and asset managers analyze existing allocations, discover inefficiencies,

and create optimized bespoke portfolios - in 10 minutes, in 10 clicks and at 10 percent of the typical cost. It provides a platform where custom portfolios can be constructed for self-directed investors, or can be advisor-driven, or collaborative with advisor's discretion. The platform provides a wide range of services: accounts aggregation, existing portfolio analysis, preferences personalization, portfolio choices comparison, recommendations on new asset classes, proposal generation, bespoke portfolio construction, and trade execution.

I met with Sameer Jain, CEO of ActiveAllocator, in New York. He shared details about the company and gave me a demo.

Sameer immigrated to the United States from India. He graduated from MIT and Harvard, and has multiple degrees in engineering, management, public administration, and public policy. Before starting ActiveAllocator, Sameer worked on Wall Street where he was a managing director at American Realty Capital, headed investment content & strategy at UBS, and was a director of product development & research at Citi Alternative Investments.

Whilst working on Wall Street, Sameer realized that "*the real underbelly of capital formation in America is not Wall Street but the scattered 300,000 financial advisors aggregating millions of small checks across this country,*" and decided to create a portal to bring the best of Wall Street analytics and fact-based approach to decision making to "*every financial advisor and their client on the planet.*"

Conceived to reshape the whole industry

Sameer states that he intends to build ActiveAllocator to respond to industry trends. He highlights the following:

- **WealthTech disruption** from newer forms of digital advice and fulfillment platforms;
- **Regulation-driven changes** intended to eliminate conflicts of interest in financial advice;
- **Birth of technology-driven personalization** in financial advice;
- **Adoption of alternative investments** by affluent investors;
- **Financial advisor migration** to independence from wirehouses and captive channels;
- **Propensity to buy vs. build** in-house by mid-size financial firms; and
- **Major technology shifts**, including cloud-based services, usage of low cost and open source software development tools as well as partnering across the digital ecosystem through APIs.

"*I'm going to build ActiveAllocator to essentially reshape the whole wealth-management industry by re-setting advisor and investor expectations about where the best advice comes from, what it should cost, and how it is delivered.*"

Sameer points out that engaging a typical financial advisor leads to 20–30% deadweight loss on portfolio returns automatically every year. A typical advisor's fee is 1–1.5%, while a typical diversified portfolio return is 5–7%; the value destruction is both explicit in typical 1% or higher advisory fees charged and implicit in 0.5% or more asset allocation inefficiency. Moreover, these costs are in addition to other contracting frictions, product commissions and costs.

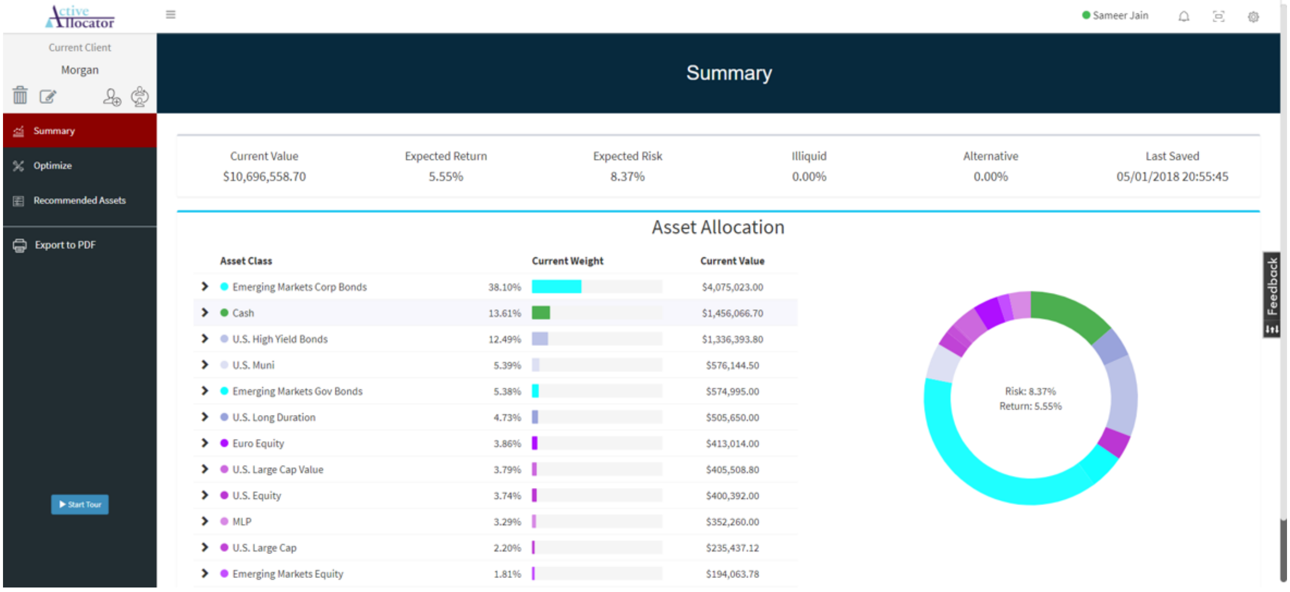
When creating ActiveAllocator, Sameer did not want it to become just another digital money or investment or digital financial advice provider and to differ from emerging robo-advisors that create simple, low-fee, diversified, automated ETF portfolios. His focus is on bringing greater investment centricity, improving returns and deep personalization.

Not scaling the business, but personalizing the portfolio

Sameer recognizes that most financial institutions and firms are more concerned with scaling their business than on investor returns and, therefore, offer simplistic asset allocation and portfolio construction. This has led to a proliferation of undifferentiated financial advisor and robo-advice.

Sameer believes that what ActiveAllocator does is extremely different. The company seamlessly integrates traditional illiquid and alternative investments within portfolios. Nobody else does this because "*there's a lot of complexity around private debt, illiquids, hedge funds, real estate, private equity and managed futures; moreover, each of these ha[ve] their different sub-strategies.*"

I observed in the demo that ActiveAllocator allows users to aggregate investment accounts and holdings across 15,000 financial institutions. The system can search, recognize and automatically map over four million financial products and securities to granular 50 asset sub-classes in seconds. It allows users to compare and validate their own market views with capital market assumptions from 10 Wall Street firms. The system also personalizes investing preferences across 10 dimensions to optimize and construct bespoke portfolios. Once this is done it seamlessly execute rebalancing trade orders across a choice of brokerages.



As a new client enters the system, the platform starts by aggregating inhouse and held away investment accounts to provide a holistic picture as a starting point. It maps financial products to asset sub-classes, analyzes them and calculates their expected risk and return as well as other forward-looking metrics that meet specified objectives.

ActiveAllocator promotes the idea that investors and their advisors need to have access to market analytics to be able to reach better investment decisions. Therefore, the company gleans capital market and other economic assumptions from Wall Street research and populates it to allow users to validate their own views with others.

In the next step, the platform personalizes each portfolio. Sameer names a few dimensions used to personalize portfolios, including:

- How much exposure does a client want to a certain asset class?
- Do they like illiquidity and, if so, how much?
- Do they like alternative investments and, if so, to what value?
- What level of turnover do they want?
- What is their target return and investment horizon?

"*And then the system calculates a new, enhanced frontier. You can be on any point and it tells you with numbers: what is your expected return risk, what is your probability of loss, how your VaR changes, everything, everything, everything dynamically and interactive.*"

A financial advisor using ActiveAllocator may, together with the client, see and change any input assumption, thereby bringing transparency and optimizing the portfolio on the fly. Sameer says that something as easy as this would not have been possible a few years ago, when the enormous power of cloud computing was not available:

"*We have multiple machines with multiple CPUs crunching this optimization dynamically, across risk-return-illiquidity-downside risk transcending typical archaic mean variance optimization and going far beyond Modern Portfolio Theory, which is 60 years old. We do constrained optimization considering over 10 dimensions of personalization, selecting from a universe of over 50 asset sub-classes versus the typical 10 to 15 that most people are constrained to choose from.*"

If an investor wants to execute on an ActiveAllocator constructed portfolio they can do so seamlessly since the platform is connected to many broker-dealers, including to Fidelity, E*Trade, OptionsHouse, Scottrade, TradeStation, Tradier Brokerage, Interactive Brokers, Ally Invest, Vanguard, DriveWealth etc.

Reaching the end customer

Active Allocator was featured as one of the top 30 emerging global disruptors in WealthTech by investment bank FT Partners. Unlike many other startups, the company has not admitted external funding. Sameer says only his own and Partner money has been put into building the platform, which took over two years before they released it at the end of 2017. The company did not set the goal of starting as soon as possible, but instead wanted to create a state of art product, which included alternative investments inclusion that would rival any Wall Street firms' proprietary system.

"*The reason they [end investors] still have a financial advisor is firstly they don't know investments any better [and] secondly they need psychological support. A lot of these are inherited relationships but sadly such engagement detracts over 30% [of] annual portfolio returns on their capital. We wanna change that.*"

This is why the platform was designed ground up to addresses shortcomings endemic to asset allocation tools and services, allowing advisors and individual investors to analyze existing allocations, discover inefficiencies and create bespoke portfolios in minutes. An open architecture encourages exploration and expression of advisor views, as well as express investor-specific preferences and constraints. I got the impression that

ActiveAllocator allows advisors not only to deliver real value to clients, but to own the advice they provide and to quantify the direct benefits of their services.

However, Sameer mentions a problem to reach end retail investors:

"*The acquisition cost is extremely high to aggregate small $30,000 checks—that is a dilemma for overcapitalized venture funded robo advisors burning money and going nowhere. Someone with $100,000 is probably not going to care about fact-based analytics to arrest unexpected outcomes. So, it [the Active Allocator platform] is really aimed at affluent investors— those with million dollar-plus investible assets who are reasonably sophisticated. As soon as we launched we hit the magic one billion dollars AUA [assets under administration] mark across 80, 90 high net-worth investors which validates our thesis.*"

In line with its name, the company provides active management of portfolios, which includes the following steps:

- Calculating active risk-adjusted returns;
- Recalculating an active manager's skill;
- Identifying and isolating the characteristics of that manager's skill: "*We look at the correlation amongst [the] alphas of different managers and calculate the effect of changes in the number of managers.*"; and
- Combining fund managers that provide high return[s] so that they complement each other, and generating relative allocations amongst managers.

The platform offers its customers exact numbers of how much should be put into active investment versus passive investment in order to make a portfolio robust and profitable.

	Alpha			Alpha Volatility			Information Ratio			
	Security Selection	Market Timing	Total	Security Selection	Market Timing	Total	Security Selection	Market Timing	Total	Market Timing Impact
Convertible Arbitrage	3.85%	-0.04%	3.81%	4.94%	2.30%	5.45%	0.78	-0.02	0.70	▼
Distressed Securities	3.79%	1.58%	5.37%	6.65%	3.38%	7.46%	0.57	0.47	0.72	▲
Merger Arbitrage	7.46%	0.18%	7.64%	3.44%	2.00%	3.98%	2.17	0.09	1.92	▼
Fixed Income Arbitrage	4.26%	-0.10%	4.16%	6.08%	1.26%	6.21%	0.70	-0.08	0.67	▼
Equity Market Neutral	3.49%	0.62%	4.11%	4.20%	1.01%	4.32%	0.83	0.61	0.95	▲
Statistical Arbitrage	2.80%	0.04%	2.84%	3.83%	0.09%	3.83%	0.73	0.45	0.74	-
Equity Long Short	7.61%	0.71%	8.32%	4.70%	2.88%	5.51%	1.62	0.25	1.51	▼

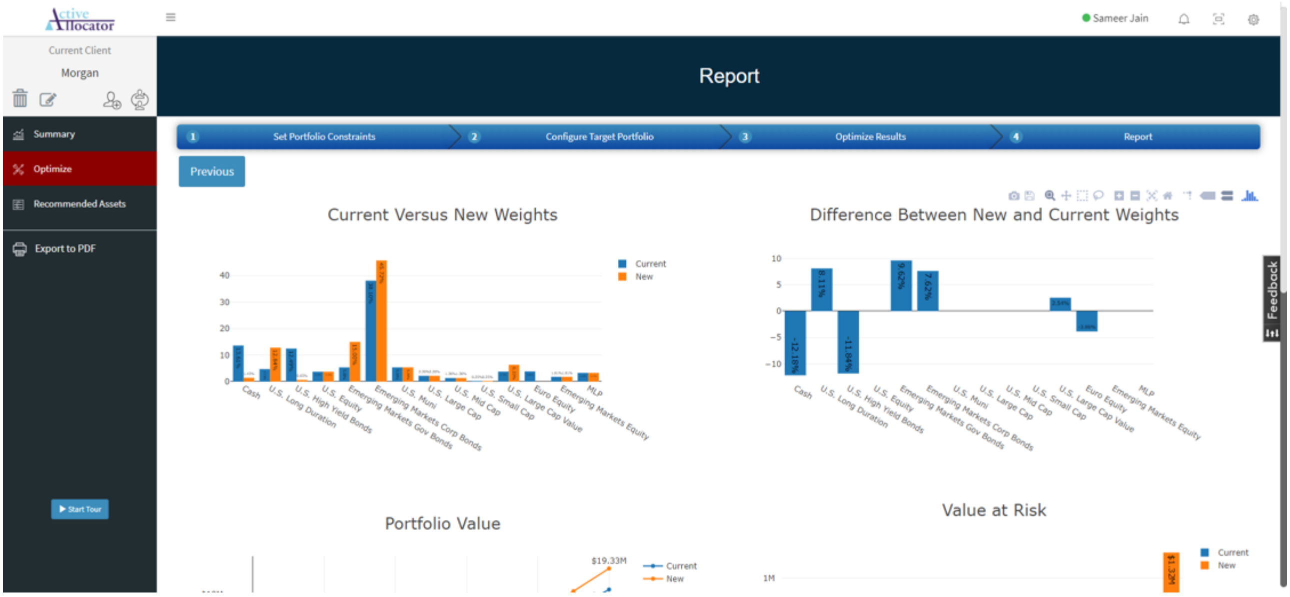
The company structure

As still in early phase of evolution, ActiveAllocator does not have a formal organization structure and, according to Sameer, is never going to become a conventional software and technology company.

My conversation revealed that his team has complementary Wall Street operating, investing, financial engineering, asset management, investment banking and software development experience. Their engineers and investment personnel bring academic credentials from Technion, MIT, Harvard, Fletcher School at Tufts etc. Collectively they have allocated billions of dollars in client capital, run large businesses, served both institutional and retail investors and have published extensively. The cofounders bring deep ensconced distribution relationships as well as a rich rolodex to call upon. They have written software and developed cutting edge algorithms that bring quality asset allocation and portfolio construction methods forth.

Sameer emphasized:

"*Many software firms, as they have morphed and grown have become all things to all people. Their offerings are most often geared to providing the applications and services advisors use to manage their practices. These include workstation-based deployment for data aggregation and analytics; financial planning; portfolio management, trading and rebalancing; multi-custodial aggregated performance reporting; portfolio accounting, rebalancing, client relationship management and billing calculation and administration. Within this category we also include traditional asset allocation software firms that provide software packages for conventional stocks and bonds allocation using archaic mean-variance optimization approaches. We do not want to be just another software company*."



On sales he went on to say:

"*Until we admit external capital we won't be able to invest in having a sales organization. It's my cofounder, Brian Jones, and me who [are] now focused on sales, because this selling is not like you go and sell to everyone. It's like conceptual selling; it's at a high level. In the international territory we have had Dr. Akl Noun join us in Dubai who has had a three-decade career within the financial services industry in executive management roles with top tier institutions. Prior to joining ActiveAllocator he spent 18 years with Invest AD - Abu Dhabi Investment Company where he served as the firm's Chief Information & Digital Officer. Akl recently helped us sign a partnering and distribution deal with Finastra, the world's third largest FinTech*."

Technologies under the hood

The platform is built using cutting edge technology making it fast, flexible and safe. The server provides RESTful API and is based on the **Django REST Framework**. The database is stored in **PostgreSQL**. The entire back-end code is written in **Python**. They use SSL encryption, modern authentication standards, object level permissions and more to protect their users. The web client is a single page application based on the **React** & **Redux** stack.

Sameer says:

"*Another very interesting thing we do, which nobody else does, we said that we are never going to have any client identifiable data. We took a decision—we do not want to know a client's name. Our system is developed using modern technologies that befit a digital disruptor. Our key decisions to arriving at choice of technology stack include: security, maturity, stability and ease of development to quickly add new features in the future*."

Further evolution

For about two-and-a-half years, a team of computer scientists, investment experts, and lawyers discussed what the platform would look like and its functionality, security, and algorithms. Today, Sameer is proud to say that the system is almost complete though will continuously evolve.

"*But in building a company, the product is just one piece to work. If you get customers, then you can attract external capital at higher valuations*. *We envision our business not as a standalone entity, but as part of an ecosystem of collaborating businesses sharing data and services. We can bring a level of integration with extended partners that would not have existed a few years ago. Once we are wired into ecosystems of value, we intend to quickly add new capabilities. As a digital business, we are setup to work easily with others; our usage of application programming interfaces (APIs) enables us to add capabilities from third parties quickly. Our use of consumer facing technologies delivers a substantially better customer experience.*"

Sameer now wants to be externally directed and acquire customers in international markets too. The company is now active in the Middle East and sees a huge opportunity in South Africa. Such success, if achieved, will raise valuations and create growth.

Final thoughts

ActiveAllocator seems to be an unusual WealthTech company with an innovative investment centric approach to investor–advisor relationships and attractive prospects. We look forward to seeing how the company will evolve and will track its success.