JPM sees upside in blurring lines between QIS and SMAs

Hedge funds are combining their strategies with bank indexes to create new products

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JP Morgan is looking to capitalise on a growing convergence between its proprietary index and separately managed account (SMA) businesses.

The US bank has $40 billion in client assets **on its SMA platform**, Nexus. Of this, $25 billion sits in Nexus Prime, where institutional investors can gain leveraged exposure to hedge fund strategies in synthetic format.

JP Morgan has also amassed $100 billion notional in its Strategic Index (SI) business, which spans quantitative investment strategies (QIS), alternative risk premia and thematic benchmarks.

These previously distinct worlds are now colliding. An early example of crossover was clients creating their own portfolios of JP Morgan indexes with adjusted weightings and gaining exposure through Nexus. The bank then decided to give investors discretion to adjust parameters within some of its index strategies – for example, systematic dispersion, where clients can alter the universe of names and tweak the weights of index and single-stock legs.

The SI and SMA businesses are now leaning heavily into this convergence. "That's where we see new trends emerging," says Benjamin Rostein, head of Nexus. "The synergies are massive."

The trend accelerated as JP Morgan expanded the suite of Nexus instruments. While over-the-counter options have been available on Nexus for more than seven years, the first listed equity derivatives were only added around two years ago. The range of asset classes and instruments accessible on the platform now includes exchange-traded funds and options on ETFs and commodities and single-stock options.

The way we combined SI and Nexus is a massive growth opportunity

Arnaud Jobert, JP Morgan

This has led buy-side quant teams to work more closely with JP Morgan's QIS desk to develop their own intellectual property on more complex strategies, which can then be accessed via Nexus. Rostein calls this 'SMA 2.0'.

"These new types of clients do have their own models and do have their own research, but they come to use because they need some of our existing tooling, which is being developed by our QIS team, particularly delta hedging for vol strategies," says Rostein.

Portfolio managers at some multi-strategy hedge funds began using this crossover approach earlier this year to trade volatility strategies on equities and commodities, where variance swaps may be less liquid, with delta hedging provided by JP Morgan's QIS desk.

"The novelty here is it's not just a portfolio of options, but a portfolio of options combined with delta hedge execution, which is one of the business-as-usual building blocks of a QIS strategy," says Arnaud Jobert, global head of equities structuring and co-head of global strategic indices at JP Morgan. "The IP can be from very sophisticated vol pods and we're here to deliver pure execution outsourcing as a single TRS, which combines the option exposure and delta execution in one go."

JP Morgan says around $15 billion of its Nexus prime balances represent exotic exposures.

Another crossover use case saw an asset owner decarbonise exposure to an MSCI benchmark using optimisation tools developed by the QIS team, with the custom index delivered through Nexus.

"The combination of a client willing to have customised exposure, optimisation through a QIS tool and delivery through a Nexus strategy is another illustration of how clients are building on their own IP through the tools being developed by our QIS teams," Rostein says.

Some financial institution clients have used a similar approach to build their own in-house quant strategies using JPM data sets. These include the bank's macro-quantamental dataset, JPMaQs, which includes unrevised, point-in-time reference data for more than 10,000 macro indicators.

For the most sophisticated hedge funds, JPM recently launched Nexus Prime Almea, which allows clients to execute with other dealers using a Cayman-based segregated portfolio company (SPC).

"If a manager doesn't need to talk to the Street to execute, we have the existing Nexus Prime. For those who would like to trade away from JP Morgan, we have opened up the platform to provide multi-broker execution, which means a manager can trade with their existing counterparties," says Rostein. "They can trade in blocks and allocate post-trade to Nexus Prime Almea on a *pro rata* basis with other funds they manage."

While give-ups were already possible for swap transactions and some equities executed via Nexus, US-listed stocks can only be opened to other dealers via the SPC structure.

The SPC structure was used for the first time at the end of 2023 by a hedge fund client that wanted to open its flagship strategy to a broader pool of investors. JP Morgan says it is working on six additional mandates, with "dozens" of discussions for further onboarding.

While hedge funds have been **piling into banks' pure QIS strategies** over the past two years – largely in options format – Jobert sees the convergence between QIS and Nexus as the bigger opportunity for his business.

"The way we combined SI and Nexus is a massive growth opportunity for us. With hedge fund inflows, we see more growth in this business than hedge funds doing options on QIS," says Jobert.

"A lot of the IP we are doing on the QIS side, particularly on the vol side, is mostly pure execution and giving better access, so the lines between innovation and execution are getting very blurry."

Editing by Kris Devasabai