

Talking Actively-Managed ETFs With Tom Graves Of S&P

by [Eric Dutram](#) on July 18, 2011 | ETFs Mentioned: [ALD](#) • [ELD](#) • [MINT](#)

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Actively-managed ETFs have been all the rage so far this year as a number of issuers have thrown their hats into the increasingly competitive ring. One person who offered up some insight on this rapidly changing market was Tom Graves, CFA, who is an Equity Analyst at Standard & Poor's. Tom wrote a piece on actively-managed ETFs and how they have stormed the market in 2011, as well as what the future holds for this quickly growing slice of the market. In the interview, Tom discusses why some corners of the market have been more receptive to active management and why these funds have been so slow to catch on or even debut in other segments of the ETF world.

ETF Database (ETFdb): There has been great progress in the actively-managed ETF world in the last few months, what do you see as some of the big picture trends in this slice of the market?

Tom Graves (TG): By my count, as of late June, there were 39 actively-managed ETFs. As you probably know, there's been something of a flurry recently with new active funds from Guggenheim and AdvisorShares. Overall, I note the addition of about six actively-managed ETFs since early June. These include four introductions from AdvisorShares, and I see Guggenheim having transitioned a couple of indexed-based funds into actively managed ones. Also, it seems that Invesco Powershares is going to close a couple of the smaller actively-managed ETFs by the end of September.

Overall, I see active ETFs as a growing category, but still relatively small compared to the overall universe of ETFs and mutual funds. I totaled up around \$5.1 billion of assets under management as of late June, which I think would be around 5% of ETF assets in the U.S., so that is relatively small, but growing.

I see a couple of categories where there are bright spots, one of them being currency, where WisdomTree is clearly the leader in the actively managed area, with nine currency ETFs. The other category that seems to be a bright spot for actively managed is debt.

There are a number of ETF providers that have had some success in the actively-managed category. In the debt area, WisdomTree has had success with its [ELD](#) and [ALD](#) products, which focus on debt in emerging markets and Asia, respectively. Then you have the PIMCO [MINT](#) fund which has been pretty successful as an alternative for money markets [[Active ETFs: FAQs](#)].

ETFdb: Why do you think the fixed income and currency products have been so popular relative to the equity funds thus far?

TG: First of all, I think there are just so many alternatives for equity investors. Currency is an investment category that I think most investors do not believe that they have easy access to, so the development of currency-related ETFs gives them an entry into an asset class to help them diversify and potentially participate in developments in overseas markets. So I think that part of it is an access issue, where ETFs emerged as a good vehicle for an asset class that was otherwise less accessible than equity would be.

With debt-related ETFs, my view is that access is part of the story. In general, I don't think that debt investing is as familiar to individual investors as equity is.

Another aspect relating to debt that I think has contributed to the success of attracting assets to these ETFs is that debt is viewed sometimes as an asset class where there might be more inefficiency in the pricing of assets than what you would find in equity. A lot of the equity is pretty liquid and popular, and one of the things that people are looking for in active management is the ability of the manager to differentiate and spot assets that are perhaps

inefficiently priced and will perhaps go up in value in the future. I'm not saying that it couldn't happen with equity, also. Over time, I think actively-managed ETFs are likely to have higher fees than index-based funds, and in return for those higher fees, investors will be looking for higher returns.

There are many readily available alternatives for equity investors, and I believe that one of the reasons WisdomTree has had so much success with ELD and ALD is the opportunity they provide to access debt in overseas markets that don't seem readily accessible to people. I also think part of their overall success in gathering assets is that these ETFs may provide opportunities to benefit from the expertise of active managers to get decent returns.

So, I think the appeal of currency and debt-related actively managed ETFs reflects a combination of things. Meanwhile, equity ETFs are currently a very small part of the actively-managed ETF universe.

I totaled up how much of the \$5.1 billion of assets under management was in the different categories. As of late June, WisdomTree's currency ETFs had about \$1.9 billion of assets, or around 37% of all assets in actively-managed ETFs. The debt related ETFs, about 13 of them, totaled up to \$2.7 billion, or about 54% of the space. So you put debt and currency together, and they are taking up a huge majority of ETF assets.

Among ETF providers, I think the biggest success stories for actively managed ETFs come from WisdomTree and PIMCO, who together account for around \$4.6 billion of the total assets, or around 89% of all actively-managed ETF assets [[Complete List of Active ETFs](#)].

ETFdb: In your paper you wrote that you think actively managed ETFs are likely, over time, to have a cost structure that is more akin to actively managed mutual funds; can you explain what you meant by that?

TG: I see two reasons. One of them is trading costs. All else being equal, I would expect actively managed ETFs to have more trading involved than the passive or index funds. And second, the associated research costs that I would expect to have in actively managed ETFs. There are costs that go to supporting the analysts and managers who do the differentiation and make the active choices.

ETFdb: So are you anticipating higher fees or a more variable fee structure?

TG: I would expect, as a percent of assets, that fees would be higher on average for actively managed funds than for the passive or index funds.

ETFdb: The SEC has been very slow to approve active ETFs of late. Do you feel like this has impacted the market and possibly prevented some issuers from getting their hands in the space?

TG: I'm sure you have seen a lot of talk about the idea that a lot of people were going to get into actively-managed funds, but the actual introduction of funds has been relatively slow. Some of that could be SEC related, and some of it could be reluctance on the part of potential fund providers to get into it because of the transparency issue relating to ETFs, whereby people are expected to disclose what they own on a relatively current basis. I think the transparency expectation is probably slowing down the debut of actively managed funds because top managers, I assume, would be reluctant to be sharing their best ideas quickly with other parties because they want to build up positions and get out of positions in a quick and efficient manner.

I think we are seeing ETFs, in general, gain market share from traditional mutual funds. Over time, in part to protect their business and their assets, I expect that fund providers and asset managers, will be looking to introduce and manage more ETFs. For example, my sense is that if big fund managers don't get into ETFs themselves, they risk losing some of their assets and see the funds going to other money managers and funds.

Also, I think actively managed ETFs will be a growing category, but the early indications are that there are certain asset classes that are more attractive than others and that there are a couple of ETF providers who have established a leadership role.

I believe the growth of equity-based active ETFs will develop based, in part, on a track record to get people interested. Not that past performance will be duplicated in the future, but I think one of the things that gets people's attention is the ability of a manager's fund to significantly outperform a benchmark of the market at large. My sense is that as we get more history with actively managed ETFs, there will be increased thought about perhaps transforming existing mutual funds into ETFs or creating ETFs that largely mirror an existing mutual fund. I think things like that could help to grow the actively managed category as well. Additionally, I believe that the entry of high-profile companies will help spur a significant amount of attention into this space, as investors would be more interested to see how major managers or issuers handle the active ETF world [see more on this slice of the market in the [Active ETF Center](#)].

-All of Tom's reports, including his one on actively managed ETFs, can be read on the Standard & Poor's [MarketScope Advisor website](#). Access does require registration though.

Disclosure: No positions at time of writing.

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