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MONEY management executive

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TD Ameritrade bolts ahead in ETF fee war

OPERATIONS

By Kenneth Corbin

TD AMERITRADE IS STAKING A BOLD claim in the low-cost ETF space, announcing it will begin offering a dramatically expanded menu of commission-free funds from many of the leading asset managers.

The custodian plans to offer advisors and retail investors access to 296 commission-free ETFs, nearly tripling its current roster of 100 funds and challenging rivals Schwab and Fidelity.

TD boasts of its long roots in the ETF space, but amid explosive growth in that sector, the firm's lineup had gotten "fairly stale," according to Kostya Etus, a portfolio manager with CLS Investments, an ETF strategist based in Omaha, Nebraska.

"Clients asked us for greater choice and a wider variety of high-quality, commission-free ETFs," said Jim Dario, managing director of product management for TD Ameritrade Institutional.

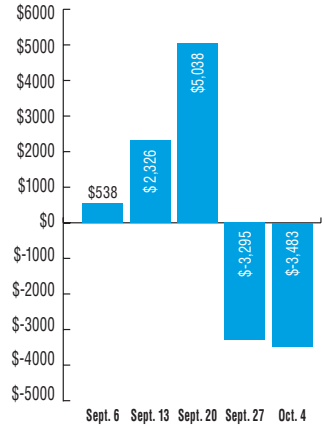
He expects the new fund lineup to have a ripple effect throughout the industry. "I think it's going to be a huge realization … that this is something that everybody needs to be doing. These lineups need to be revamped," Etus says. "Now that they've done it, I think they've really raised the bar for everyone else."

TD's move comes as the latest salvo in the ongoing fee wars in the ETF space, what Etus calls a "race to zero," as asset managers and custodians look to undercut each other by slashing commissions and basis points.

TD's lineup will feature a new suite of 15 ultra low-cost ETFs from State Street Global Advisors. State Street's SPDR Portfolio ETFs

FEE, *on page 6*

Outflows from mutual funds reached $3.48B for the week ending Oct. 4 (millions)



Source: Investment Company Institute

Asset managers are losing hidden ETF war

STRATEGY

By Rachel Evans and Annie Massa

A HIDDEN WAR IS TAKING PLACE WITHIN the ETF landscape, and some of the biggest names on Wall Street are losing out. Banks like Goldman Sachs have surrendered a once-lucrative type of market making amid an onslaught of regulation that's wiped out profit margins. Nimbler high-frequency traders have picked up the slack.

These speedsters have harnessed technology to gain an edge over banks as the U.S. ETF market surpasses $3 trillion in assets and trading explodes. That shift, though barely perceptible

ETFs, *on page 5*

Can 3 bond funds outperform 1?

OPINION

By Craig Israelsen

OVER THE PAST FEW MONTHS, I HAVE GONE on a journey to examine the strengths — and limits — of total-market funds. My quest was to answer these questions: Can a single fund that invests in U.S. stocks outperform a carefully selected collection of three index funds chosen to cover the corresponding asset group? Is the same true when we examine a single fund of non-U.S. stocks? With that, I have set my sights on bonds.

Can a single U.S. "total" bond fund outperform a trio of bond funds that collectively cover the

BONDS, *on page 8*

INDUSTRY HIGHLIGHTS

Vanguard partners with Wellington to oversee 2 new balanced funds

Vanguard has launched two new actively managed global balanced funds and has appointed its long-time investment advisory partner Wellington Management to manage them.

The two funds are Global Wellington Fund and Global Wellesley Income Fund. Wellington manages $1 trillion worldwide and currently oversees $351 billion across 23 Vanguard mandates.

Global Wellington Fund Investor shares have an estimated expense ratio of 0.45% and Admiral shares an estimated expense ratio of 0.35%.

Global Wellesley Income Fund has an estimated expense ratio of 0.42% for Investor shares and 0.32% for Admiral shares.

RESEARCH

Most U.S. investors are worried about their financial future

If the Sunday scaries have people feeling anxious before the start of a new work week, than the "someday scaries" probably have people feeling downright terrified at the thought of an uncertain financial future.

According to a survey of 2,000 U.S. adults by Ally Invest, 60% of American adults know that someday they will need to be more financially secure, but also that they aren't sure how to make that happen. This figure jumps to 70% for adults between the ages of 18 and 39.

Additionally, 61% of those surveyed say they find investing in the stock market "scary or intimidating," and data show that millennials feel more intimidated than Gen Xers or baby boomers.

"The paradox this survey data underscores is that people are scared about not being prepared for the future, so they put off thinking about it, but history has proven again and again that the key to achieving financial security is to start saving and investing early," Rich Hagen, president of Ally Invest, said. "What people need most is to face the 'someday scaries' head on and get started, taking one small step at a time."

PRODUCTS

First ever ETF with exposure to political events from EventShares

EventShares has launched the first family of actively managed ETFs that are designed to expose investors to major multi-factor political, economic and policy-driven events and themes.

There are two flagship ETFs — the EventShares Republican Policies Fund (GOP) and the EventShares Democratic Policies Fund (DEMS) — both of which have expense ratios of 0.75%. Each fund looks to construct portfolios expected to be positively impacted by the respective party's policies.

EventShares has also launched a tac-

ETF estimated net issuance

($ millions)

	10/11/2017	10/4/2017	9/27/2017	9/20/2017	9/13/2017
Equity	6,271	7,212	335	4,891	7,515
Domestic	3,143	3,861	-2,261	2,396	5,297
World	3,128	3,351	2,596	2,495	2,218
Hybrid	46	60	46	29	17
Bond	2,180	3,795	1,736	3,033	3,780
Taxable	2,062	3,652	1,636	2,999	3,607
Municipal	118	143	100	34	172
Commodity	265	-357	861	-134	125
Total	**8,761**	**10,710**	**2,978**	**7,819**	**11,437**

Source: Investment Company Institute

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tical tax policy ETF. The EventShares U.S. Tax Reform Fund, with an 0.85% expense ratio, provides exposure to companies set up to see the greatest benefit from the implementation of significant tax reform.

OppenheimerFunds launches Wealth Market joint venture

OppenheimerFunds and the Carlyle Group have formed a joint venture focusing on the global private credit opportunities for high-net-worth investors and advisors.

The venture will begin operating in 2018 and looks to deliver long-term income solutions that aren't usually available to accredited investors. The venture will be led by co-heads Kamal Bhatia, head of investment solutions for OppenheimerFunds, and Mark Jenkins, head of global credit for the Carlyle Group.

State Street adds suite of 15 ultra low-cost ETFs

State Street Global Advisors is launching SPDR Portfolio ETFs, a suite of 15 ultra-low-cost ETFs providing access to a variety of equity and fixed-income asset classes. The funds will carry expense ratios of between 0.03% and 0.11%.

The launch of the SPDR Portfolio ETFs coincides with the launch of TD Ameritrade's newly expanded ETF Market Center. The 15 SPDR portfolio will be available for purchase commission-free on TD Ameritrade's ETF Market Center. SSGA is the asset management business of State Street.

Change Finance introduces its first ETF

Earlier this month, Change Finance, a majority women-run asset manager, announced the launch of its first ETF: the Change Finance Diversified Impact U.S. Large Cap Fossil Fuel Free ETF (CHGX).

The fund, which has an expense ratio of 0.75%, is the only ETF using diversified impact screens to look beyond excluding fossil fuels, the firm said.

"Our investors want alignment with what they care about, without sacrificing performance," Change Finance CEO Donna Morton said.

"Fossil fuel-free is essential, but CHGX then goes further, divesting not only from companies who dig up, refine, burn and service fossil fuels, but also from companies that are serious polluters, that have significant human or labor rights violations, and that fail to meet a variety of other social and environmental standards," she added.

Stadion Money Management takes on traditional target-date funds

Earlier this month Stadion Money Management debuted TargetFit, a target-date solution designed to mitigate the "one-size-fits-all Achilles heel of traditional target-date funds."

The launch follows the introduction of Station's StoryLine, which was built with SPDR ETFs, a retirement planning solution made specifically for 401(k) participants in advisor-sold plans.

"StoryLine brought a new managed account solution offering personalized 401(k) investment options in the small and micro market space for retirement plan participants, sponsors and the advisors who serve those audiences," Jud Doherty, President and CEO of Stadion Money Management, stated.

ARRIVALS

Northern Trust appoints President Michael O'Grady to CEO

Frederick Waddell, the current chairman and CEO of Northern Trust, is stepping down and will be replaced by the firm's current president, Michael O'Grady, according to the firm. The change goes into effect on Jan. 1.

Waddell, CEO since January 2008, will remain in his position as chairman of the board, a spot he has held since November 2009. O'Grady has been serving as the wealth management provider's president since January of this year.

"I am honored and look forward to assuming the role of chief executive officer and leading our talented employees worldwide to continue to build upon the strong foundation Rick has established," O'Grady said.

Voya Financial's former pricing VP will lead all product

Voya Financial named Bill Bainbridge, the former vice president of pricing for the firm's annuities and individual life businesses, to senior vice president and leader of the unit's product development and in-force management.

Bainbridge will oversee a team of more than 40 professionals and report to Carolyn Johnson, chief executive officer, Annuities and Individual Life.


Bill Bainbridge

"We have a talented product team developing valuable solutions that enable our distribution partners to help Americans get ready to retire better, and I'm looking forward to working even closer with Bill to continue this work," Johnson said.

W.E. Donoghue names new managing director

W.E. Donoghue has appointed Jeffery Hudson as managing director to lead the firm's development and acceleration of the company's focus on institutional markets. Prior to W.E. Donoghue, Hudson was a partner with Cedar Ridge Partners and member of its portfolio management team and investment committee.

"Actively managing risk in a portfolio is amazingly important for all investors. It's a narrative we've been able to grow within the broker-dealer and RIA advisory space, and we believe Jeff will help us define that benefit with institutional clients," Jeffrey R. Thompson, president and CEO of W.E. Donoghue, said. MME

News Scan by Amanda Schiavo

ETFs
from page 1

to the outside world, has made it easier and cheaper for everyone from mom and pop to the world's biggest pension funds to buy and sell these increasingly popular products. But it's also placed a market that's 60% retail into the hands of less-regulated firms.

"Recent regulatory changes have caused many banks to re-evaluate their various lines of business, one of which was the trading and market making in ETFs," said David Mann, head of global ETF capital markets at Franklin Templeton. "This allowed smaller firms who focus solely on providing liquidity in ETFs to gain market share."

Over the last few years, high-speed traders have moved from quietly trading ETFs in the shadows, to overseeing much of the market. On NYSE Arca, which hosts the majority of U.S. ETFs, 83% of funds have appointed an electronic firm such as Virtu Financial or Susquehanna International Group to the key role of lead market maker, instead of a bank or conventional broker-dealer.

Amsterdam-based IMC, for example, was the lead market maker for 125 ETFs on NYSE Arca as of Oct. 4, up from just one 17 months earlier. Other growers include Jane Street Group, Flow Traders and Latour Trading. Citadel Securities is considering getting into the business.

Goldman has meanwhile backed away from this job over the last year and a half, resigning its lead role on more than 300 of the 359 NYSE-listed funds it used to assist, data from the exchange shows. Among the funds Goldman relinquished was the nearly $14 billion Guggenheim S&P 500 Equal Weight ETF, which went to IMC.

Goldman Sachs had been looking to exit the business for a while as the rewards didn't offset the obligations, a person familiar with the matter said, asking not to be identified because the details are private. Tiffany Galvin-Cohen, a spokeswoman for Goldman Sachs, said "we remain committed to serving our clients as an active market maker in the ETF space." Resigning as a lead does not stop a firm doing other types of market making.

GREATER CONSTRAINTS

Lead market makers are a fund's linchpin, setting the price that investors pay to trade an ETF over an exchange. LMMs are required to post the "national best bid-offer" — the most attractive price at which an investor can buy or sell that fund — for most of the day, and receive a rebate from the ETF's home exchange in return.

Banks used to benefit from this model as much as other firms, but the financial crisis changed all of that. New rules designed to ensure lenders have a buffer to weather tough times and boosted the amount of capital allocated to cover these trades and constrained trading desks.

Not so for the new guard. Protected from the capital burdens that plague the banks, these firms leverage lightning-fast technology and complex algorithms to do millions of trades a day. Each transaction earns firms mere cents, but do enough and it starts to pay off.

"You're really dependent on increasing your trading volume to help manage and secure those fractions of a penny," said Ryan Sullivan, vice president of Brown Brothers Harriman's global ETF services. "That's resulting in some of the shift that we're seeing."

GETTING HARDER

But that shift — the rise of electronic traders at the expense of banks and conventional brokers — may be set to slow. Lead market makers are usually expected to invest about $5 million of startup capital in the ETFs they support, and as the number of funds tops 2,000 in the U.S., that's less and less sustainable.

"The concentration of firms that are providing lead market-maker services is the biggest systemic risk in the market," said Phil Bak, chief executive of ACSI Funds and Exponential ETFs. "There are plenty of firms that could step in, but the incentives aren't there. That's the risk people should be looking at."

From June 2018, the SEC will gather information about which firms are "creating" or "redeeming" ETFs by switching an agreed-upon bunch of securities for shares in a fund. While this role is distinct from making markets, many firms operate in both the primary and secondary markets, and the data gathered could inform future policy, according to the SEC.

"You're really dependent on increasing your trading volume to help manage and secure those fractions of a penny. That's resulting in some of the shift that we're seeing."

Ryan Sullivan, vice president of global ETF services, Brown Brothers Harriman

That could give banks a second chance. Credit Suisse has, for example, already boosted the number of ETFs it works for over the last 18 months to "assist our strategic partners," according to Robert Bernstone, a managing director in equities at the bank. RBC Capital Markets also ramped up its business.

If market making becomes more of a relationship business, banks may find they have a place alongside the high-speed firms. But for now, their fast electronic counterparts have the upper hand.

"We are still growing and evolving our client offering in the ETF space, which includes evaluating whether we want to take a more active role in the LMM business," said Cory Laing, head of ETF and one-delta institutional sales at Citadel Securities. "We're working with a lot of sponsors to understand their needs and where they see a role for us to play in the rapidly evolving ecosystem." — *Bloomberg News* MME

ETF
from page 1

will carry expense ratios of between 0.03% and 0.11%, a move Etus expects will send Schwab scrambling to respond.

"The most likely scenario going forward is that Schwab is going to have to reduce their fees to be lower than State Street," Etus says. "All of this has really created … this huge push to lower costs and [offer] better options for all investors."

The news follows closely on the heels of Charles Schwab's announcement earlier this month that it's rolling out the Schwab 1000 Index ETF, offering exposure to the nation's largest firms at a cost of five basis points and undercutting fees of comparable funds offered by other firms, at least until the announcement from State Street.

Schwab spokeswoman Kaitlyn Downing writes in an email: "We won't speak to competitor programs, but we will say that investors continue to embrace Schwab ETF OneSource and we're immensely proud of the success that the program has achieved in just four years."

Asked about State Street's ultra low-fee ETFs, Downing says: "The fact that prices are coming down on index products across the industry is great news for investors. For our part, Schwab has been an important catalyst in bringing those costs down."

Bloomberg News

TD's lineup will include offerings from AGFiQ, First Trust, BlackRock, JPMorgan, Invesco and WisdomTree.

CALLS FOR GREATER CHOICE

TD Ameritrade bills its new lineup as the industry leader in non-proprietary, no-commission ETFs, explaining the expansion came in response to calls from its advisors and retail investors.

"Clients asked us for greater choice and a wider variety of high-quality, commission-free ETFs," Jim Dario, managing director of product management for TD Ameritrade Institutional, said in a statement. "The new platform will feature some of the biggest names in the ETF industry, with ETFs selected to cover a range of investment strategies, and enable investors and advisors to create tailored, diversified portfolios."

The U.S. ETF sector topped $2.5 trillion with more than 1,700 individual funds last year, up from $608 billion invested in 620 funds in 2007, according to data from the Investment Company Institute.

In addition to the State Street funds, TD's new ETF lineup will include commission-free offerings from AGFiQ Asset Management's QuantShares, First Trust Portfolios, BlackRock's iShares, JPMorgan Asset Management, Invesco's PowerShares, ProShares and WisdomTree.

Schwab's Downing says her firm offers 244 commission-free ETFs through OneSource; Fidelity says it offers 91. By expanding its menu to nearly 300 funds, TD Ameritrade could become a more appealing custodian for advisors.

"For RIAs this is, once again, a huge benefit. You've got a much wider opportunity set to create investment opportunities for your clients," Etus says. "It's definitely a selling point. They've lined themselves up with the growing ETF market."

He also argues retail investors stand to gain from any industry shift that brings fees down, and calls TD's move a "home run" in the face of the looming Department of Labor rule governing commissions and other compensation arrangements for retirement investments.

While the fate of that regulation remains uncertain, the specter of more government oversight and the competitive pressure of cheap ETFs are likely to further squeeze higher-cost mutual funds.

"The most likely scenario going forward is that Schwab is going to have to reduce their fees to be lower than State Street."

Kostya Etus, portfolio manager, CLS Investments

"As more regulation comes out, I think there's going to be more and more of a push to start using ETFs for client portfolios," Etus says. "Anyone investing in mutual funds that are particularly higher-expense-ratio funds is really going to feel the pain here."

In addition to the competitive pressure TD's revamped ETF lineup could put on rival custodians and higher-cost funds, Etus expects asset managers might take a hard look at their own funds with an eye toward even deeper fee cuts.

"I think that competition is kind of heating up," Etus says. "Maybe that race to zero took the summer off and it's starting to ramp up into the holiday season." MME

MONEY management executive

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BONDS
from page 1

same bond categories?

Here's why it matters: Domestic bond funds face an uphill battle as interest rates will likely rise in the coming years. Thus, anything you can do to enhance the performance of the bond portion of your client's portfolio is worth investigating.

Our first stop is at Vanguard. To cover the broad U.S. bond market, the firm has a one-stop offering for investors wishing to simplify their exposure to the U.S. bond market. Its fund, the Vanguard Total Bond Market Index (VBMFX), currently has a 40% allocation to U.S. government bonds, a 25% allocation to government mortgage-backed securities (GNMA) and a 35% allocation to U.S. corporate bonds. This type of fund is certainly convenient, but is it the best approach?

A THREE-FUND APPROACH

Another approach would be to invest in separate bond funds from each distinct bond segment: a government bond fund, a Ginnie Mae fund and corporate bond fund. For our exploration, we'll use Vanguard Intermediate-Term Treasury (VFITX), Vanguard GNMA (VFIIX) and Vanguard Intermediate-Term Investment-Grade (VFICX).

When combined, these three funds seek to accomplish (at least in theory) what the Vanguard Total Bond Market Index tries to achieve. This study compares the performance of one single mega index bond fund against the combined performance of three separate bond funds, which are rebalanced annually. The time frame for this study was the 18-year period from Jan. 1, 1999, to Dec. 31, 2016.

Over the full course of the study, each individual bond fund had better performance than the VBMFX, but in some cases this advantage was very slight.

The largest gap was 83 basis points between VFICX, the corporate bond fund, and VBMFX. Over 18 years, this resulted in an ending balance that was larger by almost $3,500, assuming an initial investment of $10,000.

The performance of each fund in 2008 is highlighted in yellow. VFITX was the clear winner, with a one-year return of 13.32%; VFIIX was a distant second at 7.22%. VBMFX generated a positive return of 5.05%, whereas VFICX lost 6.16% in 2008.

When using three separate funds, there are more so-called "buckets" from which to withdraw money. Of course, we try to avoid withdrawing money from a fund if it has had a negative year.

If using a total-index fund, there is only one bucket — even though the bucket contains several different bond exposures. Nevertheless, if the overall return is negative (as in 1999 and 2013) and the investor had to withdraw money that year, the loss would be exacerbated. If, however, there were more buckets to withdraw money from, the investor could pull the money out of whichever fund had the best return. In 1999, that would have been the Ginnie Mae fund (VFIIX).

I refer to this phenomenon as distrib-

Threesome vs. stand-alone

Annual performance from 1999 through 2016

18 Years of Annual Returns	Vanguard Intermediate-Term Treasury (VFITX)	Vanguard GNMA (VFIIX)	Vanguard Intermediate-Term Investment Grade (VFICX)	Vanguard Total Bond Market Index (VBMFX)
1999	–3.52	0.78	–1.53	–0.76
2000	14.03	11.22	10.70	11.39
2001	7.55	7.94	9.42	8.43
2002	14.15	9.68	10.28	8.26
2003	2.37	2.49	6.29	3.97
2004	3.40	4.13	4.75	4.24
2005	2.31	3.33	1.97	2.40
2006	3.14	4.33	4.43	4.27
2007	9.98	7.01	6.14	6.92
2008	13.32	7.22	–6.16	5.05
2009	–1.69	5.29	17.73	5.93
2010	7.35	6.94	10.46	6.42
2011	9.79	7.68	7.51	7.56
2012	2.67	2.35	9.13	4.05
2013	–3.09	–2.23	–1.37	–2.26
2014	4.32	6.65	5.80	5.76
2015	1.50	1.33	1.53	0.30
2016	1.19	1.85	3.83	2.50
18-Yr. Annualized Return	**4.79**	**4.83**	**5.47**	**4.64**
18-Yr. Std. Dev. of Return	**5.58**	**3.45**	**5.55**	**3.42**
Growth of $10,000	**23,225**	**23,392**	**26,071**	**22,613**
Expense Ratio	**0.2**	**0.21**	**0.2**	**0.15**
Correlation to VBMFX	**0.81**	**0.96**	**0.64**	**--**
Beta with VBMFX	**1.32**	**0.96**	**1.04**	**--**

Source: Steele Systems Mutual Fund software, calculations by author

uted performance versus concentrated performance. A one-fund total-market solution is subject to concentrated performance and is therefore more vulnerable to the timing of withdrawals during market downturns. A combination of funds produces separate returns and is likely to be less vulnerable to portfolio withdrawals during a bond market downturn.

The important comparison, however, is the mix of the three funds against the total bond market fund. The three-fund mixtures both produced better 18-year performance than the total bond market index. But this advantage over Vanguard Total Bond Market Index was modest.

Moreover, the threesomes have high correlation with VBMFX and a slightly higher overall expense ratio (20 basis points) than the total bond index, whose expense ratio was only 15 bps.

In addition, the beta coefficient for the Vanguard-weighted three-fund approach was 1.13, which indicates it is 13% more volatile than VBMFX. When the three bond funds are equally weighted, the beta coefficient dropped slightly to 1.11 — still 11% more volatile than VBMFX.

WHICH APPROACH?

However, in both cases, the modest amount of added volatility when using three bond funds instead of one mega index had a payoff — 45 bps of higher performance when using Vanguard weighting and 43 bps when holding each bond fund in an equal allocation of 33.33% (and rebalancing each year in both cases).

Despite slightly lower performance, when it comes to a fixed-income portfolio, the convenience of using a single total bond market index fund is compelling.

But the tipping point in deciding an approach to use may be the issue of distributed versus concentrated performance.

When using three or more separate bond funds, there are more buckets from which to withdraw. That is a beneficial option when it comes to preserving the value of a portfolio in turbulent markets.

If all bond funds had similar performance, there would be no need to use several of them. But, as clearly shown in "Threesome Versus Stand-Alone," there was often substantial performance variation among the three bond funds.

When considering the wide variety of bond funds beyond the three that are illustrated in the table, we can safely conclude that distributed performance is a prudent approach when dealing with bond funds.

Thus, if the slight performance advantage of using three separate bond funds doesn't sway you, the advantage of having distributed performance in the fixed income portfolio of your client's portfolio just may. MME

Seeking an ideal mix

Three approaches to gain exposure to the entire bond market

18 Years of Performance Annual Returns	VFITX 40% allocation VFIIX 25% allocation VFICX 35% allocation	VFITX 33.33% allocation VFIIX 33.33% allocation VFICX 33.33% allocation	Vanguard Total Bond Market Index (VBMFX)
	Vanguard Weighting 40% Government Bonds 25% GNMA 35% Corporate Bonds	Equal-Weighting	
1999	-1.75	-1.42	-0.76
2000	12.16	11.98	11.39
2001	8.30	8.30	8.43
2002	11.68	11.37	8.26
2003	3.77	3.72	3.97
2004	4.06	4.09	4.24
2005	2.45	2.54	2.40
2006	3.89	3.97	4.27
2007	7.89	7.71	6.92
2008	4.98	4.79	5.05
2009	6.85	7.11	5.93
2010	8.34	8.25	6.42
2011	8.46	8.33	7.56
2012	4.85	4.72	4.05
2013	-2.27	-2.23	-2.26
2014	5.42	5.59	5.76
2015	1.47	1.45	0.30
2016	2.28	2.29	2.50
18-Yr. Annualized Return	**5.09**	**5.07**	**4.64**
18-Yr. Std. Dev. of Return	**3.98**	**3.89**	**3.42**
Growth of $10,000	**24,421**	**24,373**	**22,613**
Expense Ratio	**0.2**	**0.2**	**0.15**
Correlation to VBMFX	**0.97**	**0.98**	**--**
Beta with VBMFX	**1.13**	**1.11**	**--**

Source: Steele Systems Mutual Fund software, calculations by author

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Are You Exploring New Product Structures?

Launching innovative strategies with interval funds

By Lisa Mougin and Chris Shaw

With investors demanding more sophisticated investment choices and access to higher yielding securities, advisors are taking a more strategic approach to investment management. So it's no surprise that investment in real estate, hedge fund strategies and alternative asset classes have become more prevalent among advisors — even among advisors who focus on the mass affluent.

Chris Shaw

Lisa Mougin

But while open-end liquid alternatives, listed REITs and other highly liquid investment structures are suitable for certain strategies, they are not a panacea for all investment categories. The ability to deliver innovative products with differentiated risk/returns requires some limitation on liquidity and redemptions.

The closed-end fund structures known as interval funds provide intermittent liquidity while offering a more suitable fund structure for some of these alternative strategies. Interval funds, which invest in both private and public assets, offer shareholders regular periodic repurchase offers without subjecting investors to the trading discounts to NAV pricing that are commonplace among closed-end funds.

Considered a niche product, interval funds are gaining popularity. Five years ago AUM were less than $8 billion, today AUM is almost $30 billion. The number of new interval or tender offer fund launches has picked up over the last few years as advisors search for investment strategies that offer low correlation investment benefits or differentiated risk/return benefits.

The interval fund structure can be appealing to institutional managers who are looking to expand their distribution into the retail market. The interval fund structure allows them to maintain the basic profile (risk/return) of their strategy by enabling greater exposure to less-liquid holdings and greater flexibility to use leverage. And as regulators continue to push for more liquidity and oversight of derivative usage in '40 Act mutual funds and ETFs, the continuously offered closed-end fund structure can also be more appealing to alternative strategy investment managers.

The benefits of interval funds are in the eye of the beholder. Nonetheless, the selection of the optimal structure needs to be carefully weighed against the management of the investment strategy, the distribution of the product and the needs of shareholders.

For firms considering an interval fund structure, here are some recommendations:

- **Strategy Brand Considerations:** A primarily mutual fund-focused organization will need to consider how the product fits and how its distribution staff is trained and incentivized to sell the new product. These products need to be a focus for the firm, otherwise they can get lost in the shuffle of the broader product line.
- **Optimizing Share Class and Pricing:** Firms need to evaluate their targeted distribution channel and any associated fee sensitivities. When evaluating fees, master-feeder options and loads, it's critical to work with legal counsel who has extensive experience in supporting the launch and management of these structures. Working with a platform that has extensive experience in servicing these structures and offering full shareholder record-keeper and distribution support capabilities is imperative.
- **Transparency and Straightforward Communications:** Closed-end fund sponsors (tender offer and interval) need to be explicitly clear on all features, fees, and the liquidity of the product. Being transparent on these details assists in the education process and ensures there are no surprises among advisors later on. To ensure full disclosure and a thorough understanding among potential investors, firms should place an explanation of the structure and the underlying investment strategy on the product page of the website.
- **Identifying a Targeted Audience:** Not all firms and advisors will be receptive to investing in an interval fund. Identifying the right audience and focusing marketing and distribution to those advisors is highly recommended. This will ensure that marketing and distribution costs and resources are optimally deployed to those most willing to invest.
- **Support Sales Through Client Journey Personalization:** Understanding the decision-making process of advisors and how they engage with asset managers is a critical element in the placement and sale of any financial product. Sponsors of interval funds need to ensure their national account, sales, marketing and product teams are working symbiotically to educate and engage advisors.
- **Working with Distributor Platforms:** Sponsors of closed-end fund structures need to work closely with the firms responsible for the oversight of the managed account program to evaluate how the product can plug into these platforms. This can assist in attracting a wider potential audience, as it doesn't force them to change how they manage investments in their client portfolios.

Certainly, a wide range of institutional alternative money managers have found success in the mutual fund or ETF market over the past several years. But for those asset managers looking to develop new alternatives that appeal to investors and also assists in managing liquidity, interval funds should be considered.

Download the whitepaper at **www.dst-systems.com/insights/launching-innovative-strategies**.

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Top 50 fund groups

September 2017

		Assets ($ in billions)			Asset growth		Market share	
Rank	Group	Sept. '17	Dec. '16	Sept. '16	YTD	1 Year	Sept. '17	Sept. '16
1	Vanguard	4,328.1	3,635.5	3,531.4	19.1%	22.6%	20.0%	18.4%
2	Fidelity Investments	2,017.0	1,825.3	1,813.0	10.5%	11.3%	9.3%	9.4%
3	BlackRock	1,790.1	1,465.7	1,425.3	22.1%	25.6%	8.3%	7.4%
4	American Funds	1,607.2	1,393.0	1,396.4	15.4%	15.1%	7.4%	7.3%
5	State Street Global Advisors	654.6	595.1	531.5	10.0%	23.2%	3.0%	2.8%
6	T. Rowe Price	592.6	520.4	523.3	13.9%	13.2%	2.7%	2.7%
7	JPMorgan	545.5	529.2	520.3	3.1%	4.8%	2.5%	2.7%
8	TIAA	455.9	409.9	412.6	11.2%	10.5%	2.1%	2.1%
9	Franklin Templeton Investments	436.5	422.5	428.6	3.3%	1.8%	2.0%	2.2%
10	Dimensional Fund Advisors	393.5	327.0	313.0	20.3%	25.7%	1.8%	1.6%
11	Invesco PowerShares	375.3	334.0	327.9	12.4%	14.5%	1.7%	1.7%
12	PIMCO Funds	358.7	318.5	327.7	12.6%	9.5%	1.7%	1.7%
13	Schwab/Laudus	321.7	286.8	276.5	12.2%	16.3%	1.5%	1.4%
14	John Hancock Investments	280.0	264.0	266.3	6.1%	5.2%	1.3%	1.4%
15	Goldman Sachs	265.2	286.7	275.0	-7.5%	-3.6%	1.2%	1.4%
16	Columbia Threadneedle	255.6	244.1	249.7	4.7%	2.3%	1.2%	1.3%
17	Dreyfus	245.3	211.1	217.3	16.2%	12.9%	1.1%	1.1%
18	Federated	242.3	242.0	248.4	0.1%	-2.5%	1.1%	1.3%
19	MFS	237.6	209.5	212.5	13.4%	11.8%	1.1%	1.1%
20	OppenheimerFunds	218.7	195.1	200.3	12.1%	9.2%	1.0%	1.0%
21	Dodge & Cox	211.6	185.0	179.2	14.4%	18.1%	1.0%	0.9%
22	Wells Fargo	200.7	201.2	225.9	-0.2%	-11.2%	0.9%	1.2%
23	Northern Funds	170.0	151.3	151.3	12.4%	12.4%	0.8%	0.8%
24	Natixis Distributors	166.2	142.2	142.5	16.9%	16.7%	0.8%	0.7%
25	Jackson National	164.5	146.1	142.9	12.6%	15.1%	0.8%	0.7%
26	Morgan Stanley	151.0	136.7	134.2	10.4%	12.5%	0.7%	0.7%
27	Principal Funds	142.8	128.9	130.0	10.8%	9.9%	0.7%	0.7%
28	Advanced Series Trust	142.3	133.4	134.8	6.6%	5.5%	0.7%	0.7%
29	Legg Mason/Western	136.6	134.5	135.4	1.5%	0.9%	0.6%	0.7%
30	Janus Henderson	132.6	118.0	119.8	12.3%	10.7%	0.6%	0.6%
31	Lord Abbett	126.5	112.5	111.4	12.4%	13.6%	0.6%	0.6%
32	American Century Investments	123.2	116.0	116.8	6.2%	5.5%	0.6%	0.6%
33	PGIM	122.9	109.7	109.4	12.0%	12.4%	0.6%	0.6%
34	Hartford Funds	112.7	98.6	98.6	14.2%	14.3%	0.5%	0.5%
35	SEI	111.4	102.7	103.5	8.5%	7.6%	0.5%	0.5%
36	AXA Equitable	108.3	102.1	101.4	6.1%	6.8%	0.5%	0.5%
37	TCW	105.9	104.5	108.9	1.4%	-2.7%	0.5%	0.6%
38	Voya	94.0	90.4	92.2	4.0%	2.0%	0.4%	0.5%
39	AllianceBernstein	90.7	79.2	81.6	14.5%	11.1%	0.4%	0.4%
40	Lincoln National	88.4	82.0	82.1	7.8%	7.6%	0.4%	0.4%
41	First Eagle	82.5	73.0	74.1	13.0%	11.3%	0.4%	0.4%
42	Transamerica	80.9	72.6	73.4	11.4%	10.1%	0.4%	0.4%
43	Deutsche Asset Management	79.4	77.8	79.7	2.2%	-0.4%	0.4%	0.4%
44	DoubleLine	77.7	71.9	76.7	8.1%	1.3%	0.4%	0.4%
45	Eaton Vance	76.6	70.0	69.1	9.5%	10.9%	0.4%	0.4%
46	MainStay	76.0	74.6	77.5	1.8%	-2.0%	0.4%	0.4%
47	USAA	75.1	69.1	69.8	8.7%	7.6%	0.3%	0.4%
48	Putnam	74.7	69.8	70.0	7.1%	6.6%	0.3%	0.4%
49	Waddell & Reed	74.1	70.4	74.0	5.3%	0.1%	0.3%	0.4%
50	Harbor	70.3	67.2	73.2	4.7%	-3.9%	0.3%	0.4%
	Top 50	**19,090.7**	**16,906.9**	**16,736.3**	**12.9%**	**14.1%**	**88.1%**	**87.2%**
	Industry Total	**21,658.0**	**19,346.1**	**19,203.6**	**11.9%**	**12.8%**	**100.0%**	**100.0%**

Source: FUSE Research