A Flurry of Activity in Active ETFs

The funds are still a rarity, but launches by high-profile managers could stimulate interest, says Chris Goolgasian of State Street Global Advisors

ETFs are widely known and appreciated as low-cost, passively managed index trackers, but there are signs that actively managed ETFs are about to emerge from the obscurity in which they have toiled for several years. While they remain a tiny niche, accounting for less than one percent of total ETF assets, according to Morningstar, the recent introduction of active ETFs by some big-name management companies could generate increased interest, says Chris Goolgasian, head of U.S. portfolio management for State Street Global Advisors’ investment solutions group. “There were some fits and starts in the past,” he concedes, but greater use of active management “is the natural evolution of where the space is going.”

Goolgasian says that in April, SSgA launched three new products in the space: SPDR State Street Global Advisors Income Allocation, SPDR State Street Global Advisors Multi-Asset Real Return and SPDR State Street Global Advisors Global Allocation. The following month Pimco brought two active ETFs to market. Goolgasian, who manages the three SSgA active ETF strategies, predicts that the Pimco Total Return ETF and the Pimco Global Advantage Inflation-Linked Bond Strategy Fund will “be a category changer for active ETFs, along, hopefully, with ours.”

Beyond his vote of confidence in actively managed ETFs demonstrated by these asset managers, Goolgasian expects investor interest to grow as a result of the same inherent advantages that passive ETFs have over mutual funds: lower operating costs and tax advantages. Another potential edge is that ETFs trade throughout the day, while mutual funds are only priced at the market close—although Goolgasian acknowledges that this benefits traders more than buy-and-hold investors.

A feature of active ETFs that could be particularly useful, he says, is the requirement that portfolio positions be disclosed daily. Because mutual funds need only report holdings quarterly, it can be difficult to know how concentrated a portfolio is in certain sectors or individual securities, he explains. That’s especially true, he says, because of what he calls “alpha cycles,” the tendency of fund managers to act in concert, albeit unintentionally. “Many managers tend to outperform and underperform at the same times,” he says. “Sometimes there’s a lot of overlap in securities, because managers have similar processes that make [the securities] come in and out of favor at the same time.”

Goolgasian further observes that despite the advance in the prices of stocks and other risk assets, one thing that has been out of favor for years on Wall Street is a sunny disposition. And from a contrarian standpoint, he thinks widely expressed doubts about the rally bode well for the long-term health of the markets. The three SSGA portfolios, which are managed with a combination of quantitative methods and fundamental analysis, have been overweight in high-grade bonds and overweight in equities and higher-yielding debt—a mix that that Goolgasian feels is in line with Federal Reserve policies. “The goal of central bankers is to push people out on the risk curve,” he says.

The goal of many nervous investors, meanwhile, is to stay safe. But Goolgasian questions just how safe they are in
havens like Treasury bonds. The 10-year bond yielded 1.74% on Oct. 9, figures from the Federal Reserve Bank of St. Louis show, well below the 2.7% annual increase in consumer prices over the past two years, according to the Bureau of Labor Statistics. Holding instruments that pay such miserly yields may give investors “a sense of mental satisfaction that they have less volatility in their accounts,” Goolgasian says, “but over time they’re losing real wealth.”

All the same, he is concerned that investors in stocks could lose some real wealth in the short term. Goolgasian says the extension of the run-up may indicate that many otherwise-skeptical investors have become true believers in the Fed’s ability to stimulate the economy. Prices can keep rising, he contends, but only if the test of faith is passed. “We have a gap between this strong policy rally and a [yet to be realized] pickup in economic data,” he says. “If we can get that gap bridged with an actual improvement in some of the data, then the rally could be sustainable.”

With the stock market looking a bit frothy, in his opinion, Goolgasian is not inclined to wait too long for economic data to live up to expectations. “It’s likely that we’ll get a bit more conservative given the rally we’ve had,” he says. His concerns, however, are only for the short haul. “People lost a lot of faith due to the credit crisis and some events since then,” he says. “That sentiment is bullish longer term.”
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Tracking No. 2012-PS-1454 11/2012

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