MONEY management executive

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August 2019 | Volume 27 • Number 8 | mmexecutive.com

SPECIAL REPORT

OPERATIONS: Meeting new distribution demands

By Rebecca Stropoli

As clients demand more from funds, asset managers are embracing new distribution technology, big data and alternative investment strategies.

"Data science is a holistic part of the fiduciary responsibility we adhere to on behalf of our clients," says Tiffani Potesta, head of distribution strategy, North America, for Schroders.

Tiffani Potesta, head of distribution strategy, Schroders

Dan O'Lear, president, Franklin Templeton Distributors

"Customization that aligns with client goals is becoming essential," says Dan O'Lear, president of Franklin Templeton Distributors. "Tax optimization and value-aligned options such as impact, ESG and SRI strategies are a few examples."

For more on what Potesta, O'Lear and four other execs told *Money Management Executive,* read our special report.

SPECIAL REPORT on page 6

PRODUCTS: How factors are reshaping asset allocation strategies

By Joseph Lisanti

For years, active fund managers have been tasked with helping their clients target factors, including value, low volatility, capitalization size, momentum, dividend yield and quality to obtain higher returns.

These days, however, with more than 370 U.S. equity smart beta ETFs that feature one or more factors available, clients like financial advisors have the tools to supercharge their own asset allocation strategies.

The extent to which they do so depends on the advisor — whose attitude toward factor investing can run the gamut from gung-ho to proceed with caution.

"When they first came out, I was probably a little skeptical about factors as just as a marketing play," says Eric Uchida Henderson, CIO of East Horizon Investments, a planning firm in Cambridge, Massachusetts.

Today, Henderson uses factor-based investments in one-quarter to a one-third of his clients' domestic

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STRATEGY: Vanguard's ambitions create a 5-year spiral for ETF advisors

By Vildana Hajric

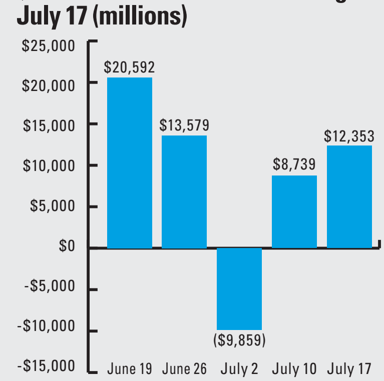
With the flick of his wrist, Richard Michaud flashes his Apple Watch and presses on its sleek black screen. In a few taps, green and red squiggles appear, revealing how the market performed that day. But this isn't a benchmark like the S&P 500 or the Russell 2000. Instead, Michaud's screen reflects the trajectory of his firm's own strategies, using an index he started earlier this year.

"You can check it on your phone in real time," says Michaud in an interview. "There's no index like this in the world. These are all totally new."

The proprietary gauge is one of several that Michaud, who runs Boston-based New Frontier Advisors

VANGUARD, on page 10

Estimated value of ETF shares issued exceeded redemptions by $12.4 billion for the week ending July 17 (millions)



Source: Investment Company Institute

INDUSTRY HIGHLIGHTS

VANGUARD PROPOSES INTERNATIONAL STOCK FUND

Vanguard filed a preliminary registration with the SEC for a new stock fund, specializing in developed and emerging markets outside the U.S., the company announced.

The International Core Stock Fund will be actively managed by Wellington Management and is expected to be available by the fourth quarter of 2019, according to the firm. The fund will hold anywhere from 60 to 100 equities across sectors and will have no position holding more than 5%.

Vanguard has been expanding its roster of actively managed funds over the past two years.

CMFG VENTURES, FILENE RESEARCH TO LAUNCH FINTECH INCUBATOR

CUNA Mutual subsidiary CMFG Ventures and Filene Research Institute announced the launch the FinTech Catalyst Incubator, a new platform aimed at testing fintech products and services.

The platform, designed to test new fintech products and services, will run through a group of up to 12 credit unions of varying asset sizes, location and consumer demographics for a span of six months, according to the firm. Participating credit unions will offer their members the new fintech product or service while receiving tools and support from Filene Research Institute to test a unique hypothesis.

"We have a long and successful track record of executing incubators that test and scale solutions in the marketplace," said Ryan Foss, senior director, Filene Research Institute. "Over the last five years with Filene, more than 100 credit unions have been involved in the creation, launch, testing and adoption of more than 15 products and service innovations across the U.S. and Canada. We're excited to help position credit unions as drivers of innovation in the financial services industry."

RESEARCH

ASSET OWNERS INTEGRATE RESPONSIBLE INVESTMENTS IN HEDGE FUNDS

As much as 21% of asset owners reported that integrating responsible investing practices into hedge funds is of great importance, a joint survey from Cerulli Associates and Principles for Responsible Investment found.

Increasing demand from asset owners for improved ESG reporting standards and increased commitment to ESG integration and engagement is driving hedge fund managers to define their position — they want greater transparency and expect managers to provide detailed explanations of how they integrate ESG considerations into their investment decisions.

"In time, the value of a business will be its impact on societal issues; asset owners recognize this, and hedge fund managers have a role to play in helping them make good choices," says associate director of European institutional research at Cerulli, Justina Deveikyte. "Companies must be part of the solution to challenges such as climate change and inequality. Hedge funds can help individual

ETF estimated net issuance ($ millions)

	7/24/2019	7/17/2019	7/10/2019	7/2/2019	6/26/2019
Equity	-7,736	-10,555	-6,776	-16,794	-15,576
Domestic	-6,170	-8,325	-5,465	-12,619	-10,795
World	-1,566	-2,230	-1,311	-4,176	-4,781
Hybrid	-965	-284	-147	-620	-2,060
Bond	7,570	8,934	9,583	7,538	5,514
Taxable	5,175	6,723	7,681	6,082	3,299
Municipal	2,396	2,211	1,903	1,456	2,215
Total	-1,130	-1,905	2,661	-9,877	-12,123

Source: Investment Company Institute

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and institutional investors secure legacies that incorporate financial, climate, and social considerations — asset owners do not want to choose between these criteria, and hedge funds can make sure they do not have to."

PRODUCTS

INTERACTIVE ADVISORS TO OFFER ETF MODEL PORTFOLIOS FROM GLOBAL X

Interactive Advisors, an online investing platform, will offer two new ETF model portfolios from Global X, the ETF provider announced.

The portfolios will be allocated across several ETFs, mostly from Global X. The China Sector ETF model consists only of Global X ETFs and exposes investors to China and consumer-led sectors. The other ETF model portfolio, Equity Thematic Disruptors, uses both Global X and third-party ETFs. The model targets ETFs that have the potential to disrupt sectors in the marketplace. The minimum to use Interactive Advisors starts at $5,000 with a management fee of 10 basis points.

JPMORGAN CHASE LAUNCHES AUTOMATED INVESTMENT PORTFOLIOS

JPMorgan Chase announced a new portfolio platform called You Invest Portfolios, which uses a client's risk tolerance assessment to allocate assets into the bank's proprietary index ETFs, according to the firm. The product is available on the website and mobile app, according to the firm.

The portfolio builder is an extension of the You Invest brand which launched last year as a digital brokerage product and offered investors 100 free stock and ETF trades for their first year.

You Invest attracted new and younger customers for JPMorgan, as 90% of its users were first time customers and 56% were under the age of 40. The platform has an account minimum of $2,500 with a fee of 35 basis points and is designed for customers who want help investing.

AMPLIFY ANNOUNCES ACTIVELY MANAGED CANNABIS ETF

Amplify ETFs released Amplify Seymour Cannabis ETF (CNBS), an actively managed fund with a 0.75% expense ratio, according to the company. It will expose investors to businesses that operate in the marijuana industry, specifically ones that support cultivation and retail, provide services to the broader market, and specialize in the cannabis or hemp plant.

The ETF will contain at least 80% of companies that receive over half of their revenues from the cannabis and hemp industry.

GLOBAL X ADDS FUNDS TO SCHWAB'S COMMISSION-FREE PLATFORM

Charles Schwab's ETF OneSource will add three ETFs from Global X, according to the firm. With the additions, there will now be 25 total funds available from the New-York based provider on Schwab's platform.

The ETFs come from Global X's Thematic Growth and International Access fund suites, the firm said. They include Global X Cloud Computing ETF (CLOU), the MSCI China Financials (CHIX) and the MSCI Argentina ETF (ARGT). The funds are commission-free and available to Schwab clients. Schwab is not affiliated with Global X.

CAPITAL SQUARE ROLLS OUT FIRST OPPORTUNITY ZONE FUND

Leading sponsor of tax-advantaged real estate investments Capital Square is set to launch its first opportunity fund aimed at promoting economic growth in Richmond, Virginia, the firm announced.

The CRSA Opportunity Zone Fund I's focus is to develop Scott's Collection I, a multifamily property in the Scott's Addition designated opportunity zone in Richmond.

ARRIVALS

EAGLE ASSET MANAGEMENT PROMOTES NEW PORTFOLIO MANAGER

Brad Erwin, a financial advisor at Eagle Asset Management, has been promoted to portfolio co-manager on the team managing Eagle's equity income, value, all-cap equity and strategic income portfolio SMAs, as well as the Carillon Eagle Growth & Income Fund, according to the firm.

SOFI APPOINTS CHIEF RISK OFFICER

SoFi will add Aaron Webster as its chief risk officer, according to the firm. He will run the company's risk, fraud and credit management frameworks. He will also lead credit risk and underwriting activities.

Webster comes from Citigroup. He was the CRO for their U.S. retail bank and mortgage business and also worked at Toyota Financial Services for a decade in senior risk management roles.

FRANKLIN TEMPLETON EXPANDS DEFINED CONTRIBUTIONS TEAM

Matt Foster, former director of retirement national accounts at Invesco, has joined Franklin Templeton as its national retirement consultant, according to the firm. The position is a hybrid role with responsibilities that include national coverage of home office relationships of D.C. advisory and consulting firms, outsourced fiduciaries and D.C. record-keepers, according to the firm.

Matt Foster

In this newly created position, Foster is responsible for the sales and retention of Franklin Templeton defined contribution and workplace investment solutions through third-party retirement plan providers, mid-market retirement advisors and consultants with various distribution partners in the domestic defined-contribution space.

AMERICAN CENTURY RECRUITS PORTFOLIO MANAGER FROM ABERDEEN STANDARD

American Century Investments hired Aberdeen Standard's Jason Greenblath as vice president, senior portfolio manager and director of corporate credit research within the firm's Global Fixed Income division, according to American Century.

Greenblath will focus on fixed-income strategies and investment outlook. Before joining American Century, Greenblath worked at Aberdeen Standard for 11 years as a senior portfolio manager and head of U.S. Investment Grade Credit Research. He also worked at RBS Greenwich Capital as a high-yield and distressed credit analyst. MME

News Scan by Bernadette Berdychowski and Paola Peralta

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Tiffani Potesta, head of distribution strategy, North America, Schroders

Is data pointless or priceless?

Asset management firms make frequent headlines by investing in big data, but they often miss how to fully articulate its true value.

Data for data's sake is pointless, but the ability to interpret countless data points of information is priceless.

Data science is a holistic part of the fiduciary responsibility we adhere to on behalf of our clients, and we integrate this in two important ways.

We launched our data insights unit in 2014 to better inform our investors. This team is composed of experts from diverse fields such as physics and sports, who provide unique insights to specific questions that can only be obtained through the analysis of billions of data points.

For example, as ESG becomes a greater imperative to our institutional clients, we can outline the value of data analytics by citing the partnership between our data insights unit and the sustainable investment team on a project to assess the true cost of climate change risk on companies.

This is sort of like data going on a date with investments resulting in the marriage of unique insights and an investment thesis that improves client outcomes.

Another institutional trend we've seen is pension plan derisking from equities.

In order to more directly apply data expertise to our work with clients, we formed a client data analytics team within our U.S. strategy division.

The data team analyzes allocations in the context of client goals, then works in partnership with our solutions team to devise outside-the-box ways to achieve desired outcomes.

In a highly competitive environment, if our industry isn't finding credible ways to harness the power of information to drive better client outcomes, we simply aren't doing our jobs.

Kip Meadows, CEO, Nottingham

A distribution success story

In today's crowded marketplace, mutual fund and ETF issuers must place a heavy emphasis on distribution to both attract and retain assets.

Most funds limit their expense ratio for competitive and performance reasons. Assuming a 1% expense ratio, for example, an ETF needs to raise $18 million to $20 million just to cover its expenses. At that level, the portfolio manager still is not receiving a fee.

In theory, a skilled portfolio manager with a great investment idea should be able to easily raise assets, but unfortunately this is not always the case.

For one, every portfolio manager thinks his or her idea and methodology is singularly superior, which the law of statistics proves cannot be the case.

Secondly, impressive performance does not necessarily translate into assets pouring into a fund.

Mutual funds and ETFs are sold, not bought. A wealth manager or retail broker advisor will typically default to a known quantity. Before putting client assets into a new ETF, that advisor will need to be educated on the costs, benefits and risks, as well as the story of why.

The most successful launches of both mutual funds and ETFs during our 31-year history have been from RIAs with a significant existing book of separately managed accounts.

The RIA is typically trying to solve the issue of efficiency, reduce administrative necessities and open new markets.

RIAs that have reached the threshold of $300 million or more have been more successful than the smaller RIA, and have usually grown to that level as a result of strong relationships with the wealth management and retail investment professionals. Those sources of referrals are the best way to grow a new mutual fund or ETF.

Casey Dylan, director of investment product strategy and communications, Symmetry Partners

Delivering on demand

Both retail and institutional investors have become more focused on the methodology of delivering outcomes, ranging from an adoption of more nuanced or complex solutions like ESG factors, to a heightened cost-consciousness, to an expectation of extreme personalization.

Historically, the asset management industry's approach to distribution has been akin to brute force. To grow sales, simply add more bodies to the sales and marketing effort.

According to a recent study by Casey Quirk, between 2012 and 2017 the industry added 50% more sales and marketing-related headcount.

However, over that same time frame, per employee revenue and profit dropped by more than half.

The demands of retail and institutional investors have evolved dramatically, and the old distribution paradigm no longer holds. Future distribution success will depend on delivering the outcomes retail and institutional investors have demanded.

In order to deliver the customer experience necessary for distribution growth, firms will have to quickly and dramatically increase their deployment of the next generation of integrated distribution technology (data repository, client analytics engines, AI, client experience apps). Over the three years ending in 2017, asset managers who ranked in the top third of their peers based on distribution technology spend grew twice as fast as the industry overall.

Leveraging the benefits of new distribution technology will require that asset managers evolve the composition and talent of their sales teams.

The efficiencies of technology suggest fewer, but more sophisticated and tech savvy, team players will be required to deliver the curated client experience of more personalized and complex solutions.

Many firms have already successfully taken steps down this path.

However, those that have yet to make it a key business imperative risk the looming Scylla and Charybdis of ever-increasing fee and margin compression on dwindling assets under management.

Joe Anthony, president of financial services, Gregory FCA

3 truths of distribution

Asset management firms face immense pressure to move the needle with distribution, as competition forces them to up their game. Marketing and public relations teams supporting these efforts need an edge.

Brands need to be broadcasters, not just publishers. It seems that just as financial brands were getting into the swing of things with content publishing, the video beast splashed into the picture and made much of that content feel diminished in relevance. Creating thoughtful video doesn't have to be costly or time-consuming. Nor does it have to sacrifice quality. Video content has to meet audiences where they are.

One-offs can be impactful. What matters more than the efficacy of an ongoing campaign are the individual merits of each piece of content your team produces in support of its products and services. If communicators and marketers fall victim to the "more is more" approach, without concern for quality, the impact of their efforts will diminish.

Third-party credibility is key. Getting content in the hands of the right audience is crucial. Visibility and credibility remain essential for the success of promoting products and services. Consistent media coverage can breed familiarity for buyers and centers of influence. Most important, strong press recognition lends credibility with buying audiences that place a premium on trust.

The media landscape has shifted, but the change hasn't undercut the influence media can have on how your company is perceived.

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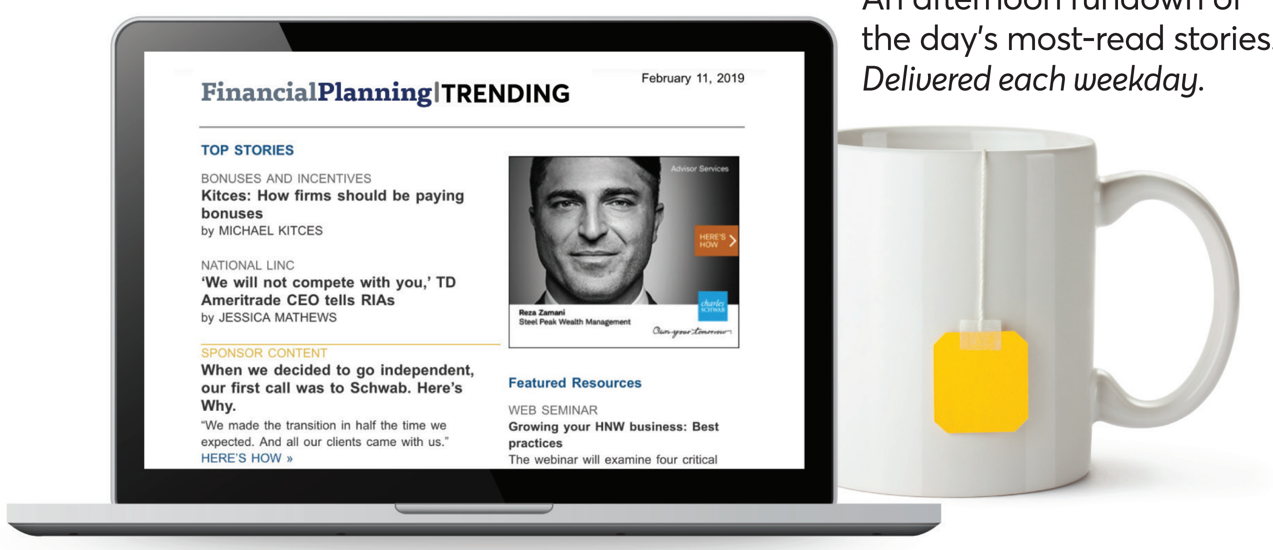

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Dan O'Lear, president, Franklin Templeton Distributors

Focusing on better outcomes

Advisors are keenly focused on delivering enhanced value to their clients. We see several key trends where asset managers can help advisors customize, access specialized investment strategies and provide a better overall client experience.

Outcome-oriented solutions. Customization that aligns with client goals is becoming essential. Tax optimization and value-aligned options such as impact, ESG and SRI strategies are a few examples.

Solutions designed to achieve a specific outcome — or even an individual goal — are areas where leading advisors are looking for partners. We see a huge opportunity to leverage the power of machine learning alongside our award-winning goals-based investing research to help advisors deliver truly personalized solutions that are purpose-built for unique goals.

A number of shifts are required in the ecosystem across the entire value chain of wealth management, technology infrastructure and asset management.

Enhanced alpha. Active managers have always helped advisors deliver the potential for enhanced alpha and risk management to their clients.

With increased scrutiny of fees, demonstrating value is even more critical. To that end, we're implementing new ways to enable exposure to investment options historically available only to institutional investors.

Providing access to alternative asset classes such as private equity, private credit and real assets is a key focus area for us, as is delivering sophisticated quantitative strategies across investment vehicles.

Superior client experience. The quest to provide a better client experience has advisors looking to us for value far beyond product. Thought leadership that helps advisors stay abreast of market shifts and trends, portfolio construction and risk management services to assess and improve the solutions they're providing, and practice management support and technology to enhance efficiency and effectiveness, are all areas distributors should be committed to elevating.

Steven L. Skancke, chief economic advisor, Keel Point

The new portfolio construction

The 121-month economic expansion, record stock market highs, increased concentration of private wealth, growth of RIAs, advancing retirements of baby boomers and increased investment activity of millennials all converge to impact the way asset managers market, sell and view redemptions of their products.

The equities bull market has allowed institutional and private investors to fund distribution requirements with a portion of their gains.

An economic slowdown and equities slump will have a direct impact on how institutional and retirement distributions are funded.

Such funding will increasingly tap into principal when earnings in equity and fixed-income investments are insufficient to cover spending needs.

Portfolio construction anticipates liquidating investment principal when markets are drawn down in order to avoid selling assets whose value is temporarily impaired.

My firm seeks to change the way RIAs interact with asset managers.

Our focus is on the construction of all-weather portfolios, and we look toward how an asset manager's solution provides a needed component to such a portfolio.

We expect asset managers to contribute to our risk-based analytical process and not just concentrate on selling a an "interesting product."

Asset manager distribution success will depend on adapting to the new method of portfolio construction. MME

VANGUARD
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with his son, Robert, created to stand out from the crowd. His peers are starting podcasts, ramping up their social media footprint and even creating video content. But all this creativity is aimed at fending off an existential threat.

'NO BARRIER TO ENTRY'

These companies are holdouts in a previously vigorous slice of the ETF industry: Independent advisors that craft investment strategies almost exclusively with ETFs. Once the dominant game in town, smaller players are devising new ways to stay competitive as multi-trillion-dollar companies like BlackRock, Vanguard and State Street muscle in on their turf.

"It's becoming such a competitive field that the term 'ETF strategist' will fall away," says Scott Smith, a director at Cerulli Associates. "There was no barrier to entry before, but now you're coming up against every asset manager in the world who wants to do this," he says, adding, "I don't know how many can survive."

Close to 80% of strategists cited competition from the mega-managers as their most significant challenge last year, up from about 30% in 2016, according to research from Cerulli.

ETF strategists — including BlackRock, Vanguard and State Street — managed $127 billion as of the second quarter of 2018, according to the latest available data from Morningstar, up from $80 billion for the same period of 2015. Those three big issuers together account for about a quarter of assets, up from 2%.

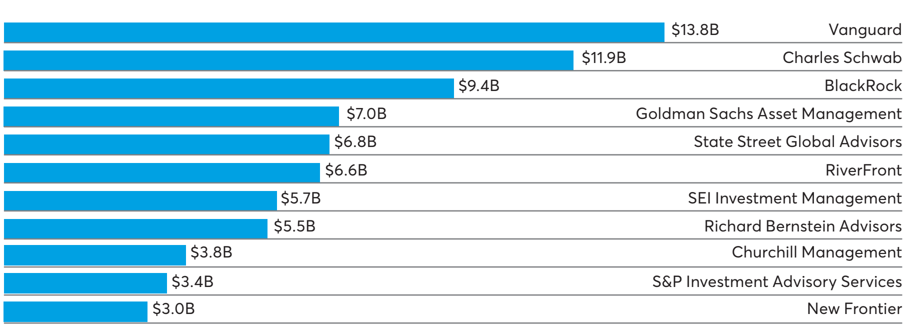
"The ETF strategist space before, it was just really all boutiques, and we kind of had the whole pie to ourselves," says Rusty Vanneman, chief investment officer at CLS Investments, which oversees about $9 billion, some of which is in ETF strategies. Now, "growth is dominated by the Big Three," he says.

A crisis for ETF strategists five years ago gave the big boys their entry point. Massachusetts-based F-Squared Investments filed for bankruptcy after regulators found it defrauded investors, and 13 other firms were later penalized for repeating F-Squared's false claims about the performance of one of its strategies.

That created an avenue for large asset managers to enter the market, and create packages of their own funds to compete with strategists. These ready-to-go collections, now known as model portfolios, usually ensure that investors stay within their provider's chosen ETFs — an appealing prospect for issuers.

"They decided, 'You know? Let's go in a different direction. In fact, let's go right at them,'" says Bob Smith, the Austin, Texas-based president and chief investment officer of Sage Advisory Services, who's been using ETFs for two decades. "They basically telegraphed to the world that the strategy part is meaningless. What's really important is what's inside and so, in a word, I think they cut us off at the knees."

Only the top 5 strategists sell their own ETFs



Data as of 2018
Sources: Bloomberg, Morningstar

A COMPETETIVE EDGE?

Companies such as Vanguard, which offers ETF models on its website, have built their portfolios on some of the same ideas espoused by strategists. But Rich Powers, Vanguard's head of ETF product management, believes there's still room for the older pioneers and that they have a good relationship with these strategists.

"I don't look at us as competing for the same type of clientele," he says. "They have tilts in their portfolios, they omit certain parts of the market, they'll actively reallocate capital as they see opportunities or risks. That's a big departure from what our ETF models are attempting to do."

A spokeswoman for BlackRock declined to comment.

State Street's Sue Thompson, head of Americas distribution for the firm's ETF business, described strategists as "a very important client base," and said the firm charges similar fees on its portfolios to try to even the playing field.

Still, many ETF strategists are adopting novel methods to protect their businesses from the growth of the Big Three.

Some firms are expanding their social media presence. Others are launching their own ETFs, while shops including 3D Asset Management offer podcasts. RiverFront Investment, one of the largest boutique strategists, produces weekly video commentaries.

Omaha, Nebraska-based CLS Investments started its podcast in 2015, and found it helped the firm reach new investors. "It has built a little fan base," says Vanneman. "People have listened to it that we haven't even contacted before and they've become clients."

New Frontier's assets have also grown, more than doubling in the past five years. Its indexes, which highlight the performance of its investment approach, attract extra attention.

"I would not be surprised if other ETF strategists realize these advantages and follow," says Robert Michaud, New Frontier's chief investment officer. "We're not just doing the standard practices of asset management. We're innovative." — *Bloomberg News* MME

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equity portfolios.

He favors single-factor products targeting "dividends, low volatility and quality."

Phil Huber, CIO of Chicago-based Huber Financial Advisors, uses both single-factor and multifactor products "depending on the situation."

Huber notes that a pure momentum and a pure value factor product could cancel each other out.

But a well-run multifactor fund might choose stocks that rank B or B+ in both categories that would fit together better.

"We tend to gravitate more to multifactor funds," says Aldo Vultaggio, director of investments at Capstone Financial Advisors in Downers Grove, Illinois.

The firm uses them to hedge the risk that any one factor might underperform for an extended period of time.

The use of multifactor funds also avoids overloading the portfolio with a multitude of single-factor products, Vultaggio says.

Even though value stocks have long been in the doghouse, "you have to believe that buying cheap works," says Steven Sivak, managing partner at Pittsburgh-based Innovate Wealth. Sivak focuses client portfolios on value and momentum factors. "You want something that's very pure. I try to go for that," he adds.

John Diak, principal at Oatley & Diak in Parker, Colorado, is restrained when it comes to the use of factors. "We're pretty vanilla when it comes to asset allocation," he says.

Diak mainly uses low-volatility factor ETFs for up to 25% of the large-cap domestic equity allocation of conservative clients "to try to mitigate some risk."

A pure momentum and a pure value factor product could cancel each other out. But a well-run multifactor fund might choose stocks that rank B or B+ in both categories that would fit together better.

Paul Winter has been "interested in factor investing since the '90s." Although the president of Five Seasons Financial Planning in Salt Lake City initially looked at value, size and momentum, he now mainly employs value and quality factors in client portfolios.

While Winter says "quality" has many definitions, he defers to providers who have done the research. "I don't really impose my own views with respect to what is valid in terms of how to define quality," he adds.

What does 'quality' mean for selected providers?

Provider	Quality inputs
FTSE Russell	Return on assets and change in asset turnover
	Accruals
	Operating cash flow to total debt
MSCI	Return on equity
	Debt to equity
	Earnings variability
Northern Trust FlexShares	Management efficiency
	Profitability
	Cash flow
S&P Dow Jones Indices	Return on equity
	Accruals ratio
	Financial leverage ratio
WisdomTree	Long-term estimated earnings growth
	Historical three-year average return on equity
	Historical three-year average return on assets

Note: FTSE Russell, MSCI and S&P Dow Jones Indices license their indexes to numerous funds and ETFs. Northern Trust and WisdomTree use proprietary indexes for their own products.
Sources: Company websites.

FIXED-INCOME FACTORS

Most of the activity in factors has been on the equity side, but some planners have begun to use factors in allocating fixed-income assets.

Robert Anderson, principal at Voyager Capital Management in Lake Geneva, Wisconsin, modified his approach to debt assets after the 2008 financial crisis.

As duration of the aggregate bond index began to increase, Anderson moved client assets to a combination of a short-term bond fund, a low-duration, high-yield product and an international bond fund.

"We recently did a background analysis on credit. That led us to add a new position to our portfolio recently," he says — a fund that uses credit quality as a factor. MME

Joe Lisanti is a former editor-in-chief of Standard & Poor's weekly investment advisory newsletter, The Outlook.

COMMENTARY

Fund adoption: A potential growth strategy

By Dan Sondhelm

Many boutique asset managers start mutual funds with the "Field of Dreams" mentality: If we offer them, investors will come. What they quickly discover is, without a long-term track record, an extensive distribution network and a well-planned marketing strategy, efforts to get in front of clients and draw in AUM largely fall flat.

With flows to passively managed funds outpacing actively managed funds, and the fee stampede squeezing profit margins for all but the most popular fund families, asset managers that don't have household names in their lineups may be looking for ways to exit the fund business. For many, executing fund adoption agreements with larger firms may offer the best way to focus on their core strength: managing investments for institutional or high-net-worth clients.

SHED THE PRODUCTS, KEEP THE EXPERTISE

What is a fund adoption? It's a euphemism asset managers use when they sell their funds to a larger fund company and stick around to manage them as subadvisors. In many cases, this can be a win-win situation for both sides.

Adopters get to own funds that may be outside their area of expertise. The sudden influx of new AUM helps move them up the ranking of largest asset manager. The enhanced combination of depth and size gives them a better story to pitch to the gatekeepers and research teams. And since adopters generally have greater bench strength in their sales and marketing departments and a broader network of advisors and consultants to reach out to, they have a better chance of generating inflows for the newly added funds.

The adoptee sheds the costs and operational, regulatory and distribution headaches of managing mutual funds, freeing them to focus solely on generating alpha from the funds they're subadvising.

Fund adoption can also serve as a viable exit strategy for founders and partners who haven't established succession plans.

GREATER SELLER-SIDE RISK

While fund adoption carries risks for both sides of a sale or merger, adoptees have more to lose if a deal goes south. Once the adoptee exchanges ownership and control of its funds for a subadvisory relationship, it's essentially shedding its independence and autonomy. Adoptees have to play by the rules of their new parents. And since they're sharing management fees, they depend on the goodwill of the adopter's business development team to increase AUM to make up revenue shortfalls.

This can be a problem if the adopter's network of investors and intermediaries are not interested in the newly acquired funds. Or if support for the adoptee's new subadvisory role among senior executives doesn't percolate down to the distribution personnel who are now tasked with the job of marketing and selling their former funds.

"If you're considering a fund adoption, it's critical to conduct due diligence on any potential adopter."

EVALUATING ADOPTIONS

You've worked hard to develop your funds and establish your reputation. That's why, if you're considering a fund adoption, it's critical to conduct due diligence on any potential adopter. In addition to looking at the numbers, you need to get the answers to qualitative questions that could indicate whether the transaction is your lifeline to future profitability or points to a rocky road ahead. Consider the following questions:

- Is the adopter committed to growing assets in your funds, or are they buying them purely to gain AUM and to create the impression of being a more diversified?
- Does the company have the sales and marketing resources to grow AUM in the funds you're sub-advising? Are there opportunities beyond the funds such as annuities or institutional accounts to manage?
- Does your firm and the adopter share the same corporate values? Is there potential for clashes that could drive away your investment experts?
- Have they added AUM for an adopted manager before?
- Does the manager already have competing funds?
- How do you make sure the funds you're selling are valued properly? What characteristics can raise or lower your valuation?
- How will you be paid?
- How much time will your managers need to devote to sales and marketing? Will they need to participate in sales pitches? Will conference appearances be required? Will they need to produce thought leadership?

One manager had his $60 million fund adopted by a large global asset management firm. Between the growth of the fund and other accounts he was given, he managed close to $1 billion AUM. Sure, he had to do more marketing than he was used to. But as he said, "It was worth it. Half the fee of a billion is much better than the whole fee of $60 million." And managing $1 billion made it easier for him to qualify for institutional accounts that came to him directly. MME

Dan Sondhelm is CEO of investment management industry marketing firm Sondhelm Partners.

Which bond funds had the biggest inflows over 3 years?

By Andrew Shilling

Popularity in the fixed-income universe, similar to nearly all other corners of the fund industry, comes at a price; and the lower that is, the better. For those monitoring the trend to passive, it should be expected that low-cost products most suited to navigate volatile markets and minimize interest rate risk over the past three years dominated the list.

The 20 fixed income funds, ranked by their largest inflows over three years, hold just over $1 trillion in AUM. Those funds brought in a combined $431 billion over the period. Many of these products, according to Bankrate senior analyst Greg McBride, have benefited from investors aiming to shed risk and navigate choppy markets.

"Investor preference for short-term bonds is very clear by looking at the largest inflows over the past three years," McBride says. "This is entirely appropriate, as shorter-duration bonds minimized the interest rate risk of the rising rate environment from 2016 to 2018."

Annualized returns, when compared with all other bond funds, show another reason why these products have maintained popularity. With an average three-year gain of 2.50%, the funds bested the Bloomberg Barclays U.S. Aggregate Bond Index's 2.21%, as measured by the iShares Core US Aggregate Bond ETF (AGG), over the same period, according to data.

"While U.S. Treasurys are free from default risk, they are susceptible to interest rate risk — when rates rise, prices fall," McBride says. "Even though rates are currently falling, boosting bond fund returns, investors must be mindful that a swift reversal can erase recent gains."

McBride added that a highly anticipated short-term rate cut by the Fed would ultimately "generate less interest income over time as newer, lower-yielding bonds come into the funds, and older, higher-yielding bonds mature, or are refinanced." MME

	Ticker	Net 3-Yr. Share Class Flows (millions)	3-Yr. % Annualized Returns	Expense Ratio	Net Assets (millions)
Vanguard Total Bond Market II Idx Inv	VTBIX	$68,477.68	2.10	0.09%	$181,700.13
Vanguard Total Intl Bd Idx Admiral	VTABX	$65,926.28	3.46	0.11%	$18,853.58
Vanguard Total Bond Market Index Adm	VBTLX	$49,407.08	2.17	0.05%	$229,332.82
PGIM Total Return Bond Z	PDBZX	$27,613.29	3.66	0.49%	$44,572.35
iShares Core US Aggregate Bond ETF	AGG	$25,129.69	2.21	0.05%	$64,053.31
Fidelity US Bond Index	FXNAX	$22,513.98	2.15	0.03%	$31,740.70
iShares Short Treasury Bond ETF	SHV	$21,092.24	1.32	0.15%	$24,566.22
Morgan Stanley Instl Ultr-Shrt Inc A	MUAIX	$15,980.50	1.54	0.50%	$17,304.24
Vanguard Interm-Term Corp Bd ETF	VCIT	$14,662.17	3.58	0.07%	$25,726.84
Vanguard Short-Term Corporate Bond ETF	VCSH	$14,009.77	2.51	0.07%	$29,835.89
Bridge Builder Core Plus Bond	BBCPX	$13,064.88	3.07	0.19%	$18,031.55
Vanguard Interm-Term Tx-Ex Adm	VWIUX	$12,410.40	2.60	0.09%	$68,299.54
Putnam Ultra Short Duration Income A	PSDTX	$12,211.50	1.75	0.40%	$15,885.00
Lord Abbett Short Duration Income F	LDLFX	$11,853.95	2.83	0.49%	$50,490.30
American Funds Bond Fund of Amer A	ABNDX	$10,933.67	2.13	0.60%	$45,284.74
Fidelity Series Long-Term Trs Bd Idx	FTLTX	$9,578.91	0.81	0.00%	$10,793.09
iShares US Treasury Bond ETF	GOVT	$9,356.91	1.20	0.15%	$12,049.05
Strategic Advisers Core Income	FPCIX	$9,258.35	3.13	0.47%	$41,337.61
iShares JP Morgan USD Em Mkts Bd ETF	EMB	$8,681.57	4.34	0.39%	$15,143.79
Dodge & Cox Income	DODIX	$8,563.96	3.48	0.42%	$59,621.18

Note: Funds with less than $500 million in AUM, institutional, leveraged and investment minimums over $100,000 are excluded. Daily returns as of 7/19/19.
Source: Morningstar Direct

SCORECARD

Mutual fund flows

($ millions)

		Equity									
		Domestic							World		
Date	Total long-term	Total equity	Total domestic	Large-cap	Mid-cap	Small-cap	Multi-cap	Other	Total world	Developed markets	Emerging markets
Estimated weekly net new cash flow											
7/24/2019	-1,130	-7,736	-6,170	-2,121	-521	-167	-2,544	-816	-1,566	-1,538	-28
7/17/2019	-1,905	-10,555	-8,325	-3,368	-642	-1,047	-2,402	-865	-2,230	-1,837	-393
7/10/2019	2,661	-6,776	-5,465	-2,753	-408	-491	-1,411	-403	-1,311	-1,106	-205
7/2/2019	-9,877	-16,794	-12,619	-3,311	-1,394	-1,331	-5,798	-784	-4,176	-3,821	-355
6/26/2019	-12,123	-15,576	-10,795	-5,123	-1,272	-848	-2,755	-797	-4,781	-4,123	-658
6/19/2019	-2,300	-6,736	-5,244	-2,168	-658	-360	-1,405	-654	-1,492	-1,341	-151
6/12/2019	-2,846	-4,857	-3,931	-1,789	-498	-249	-973	-422	-926	-996	70
6/5/2019	-6,240	-697	-1,539	1,392	-855	-454	-472	-1,149	842	831	11
Monthly net new cash flow											
5/31/2019	1,216	-8,875	-12,309	420	-3,186	-1,537	-5,227	-2,779	3,434	3,020	414
4/30/2019	-13,767	-42,409	-26,802	-13,898	-2,731	-2,424	-4,766	-2,983	-15,607	-16,643	1,036
3/31/2019	-1,845	-24,656	-19,427	-6,910	-3,069	-3,305	-5,090	-1,053	-5,229	-5,907	678
2/28/2019	20,676	-12,582	-10,858	-4,801	-1,369	-520	-3,910	-258	-1,724	-2,595	871
1/31/2019	22,907	9,474	3,641	3,332	-438	950	12	-215	5,834	3,222	2,611
12/31/2018	-183,174	-89,352	-43,893	-1,046	-9,466	-8,793	-15,229	-9,360	-45,458	-39,174	-6,285
11/30/2018	-64,308	-25,772	-17,990	-3,252	-3,082	-3,194	-5,057	-3,405	-7,782	-7,970	189
10/31/2018	-57,456	-15,148	-12,740	642	-3,689	-3,064	-4,048	-2,581	-2,408	-2,313	-95
9/30/2018	-22,650	-27,929	-25,452	-12,283	-1,978	-995	-8,061	-2,136	-2,476	-2,615	139
8/31/2018	-17,783	-24,453	-23,108	-12,975	-2,019	1,179	-8,006	-1,288	-1,345	-1,469	124
7/31/2018	-9,801	-20,874	-18,876	-9,658	-2,173	1,572	-6,727	-1,890	-1,998	-2,231	233
6/30/2018	-16,209	-19,894	-24,292	-15,216	-2,714	1,453	-6,517	-1,298	4,397	4,810	-413
5/31/2018	-5,521	-8,733	-15,722	-5,623	-4,423	544	-5,152	-1,068	6,989	5,795	1,194
4/30/2018	-6,622	-9,293	-12,669	-702	-1,128	-104	-3,965	-6,771	3,376	1,620	1,756
3/31/2018	9,865	264	-12,013	368	-2,823	-1,600	-6,599	-1,358	12,277	11,229	1,047
2/28/2018	-11,902	-8,369	-19,562	-1,655	-2,858	-2,634	-9,412	-3,003	11,194	9,455	1,739
1/31/2018	39,992	-7,078	-24,539	-6,895	-5,288	-2,117	-9,952	-286	17,461	13,260	4,201
12/31/2017	-28,528	-38,329	-43,086	-18,741	-4,770	-3,202	-12,395	-3,979	4,757	4,294	463
11/30/2017	-4,725	-16,441	-24,059	-5,891	-3,756	-3,439	-7,094	-3,879	7,619	6,295	1,324
10/31/2017	11,607	-15,971	-22,091	-7,338	-2,411	-2,109	-8,386	-1,847	6,120	4,952	1,169
9/30/2017	892	-21,998	-22,610	-7,535	-2,720	-2,046	-9,340	-968	612	1,365	-754
8/31/2017	-86	-16,493	-24,559	-7,221	-3,513	-2,555	-8,213	-3,057	8,066	6,641	1,425

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute

ETF flows

($ millions)

Date	Total equity	Domestic equity	World equity	Hybrid	Total bond	Taxable bond	Municipal bond	Commodity	Total LT MF and ETF flows
Estimated weekly net new cash flow									
07/24/2019	-10,060	-9,045	-1,015	-776	10,407	7,696	2,711	1,196	767
07/17/2019	-719	1,113	-1,831	-170	11,100	8,567	2,533	237	10,448
07/10/2019	1,377	2,382	-1,005	-46	9,858	7,694	2,164	208	11,397
07/02/2019	-28,756	-25,153	-3,603	-560	10,437	8,811	1,626	143	-18,735
06/26/2019	-8,827	-5,417	-3,410	-1,947	10,528	8,011	2,517	1,703	1,456
06/19/2019	10,128	11,676	-1,548	-156	7,932	6,342	1,590	389	18,292
06/12/2019	5,043	6,195	-1,152	-1,282	11,934	10,653	1,281	317	16,012
06/05/2019	-9,636	-8,210	-1,427	-1,017	4,614	3,154	1,460	681	-5,359
Monthly net new cash flow									
05/31/2019	-9,997	-26,017	-24,684	-1,334	-3,829	21,015	12,473	8,542	-1,166
04/30/2019	18,065	-15,614	-5,326	-10,288	-4,963	40,472	33,194	7,279	-1,829
03/31/2019	24,674	-7,613	-3,658	-3,955	-5,723	38,363	29,268	9,094	-353
02/28/2019	43,405	2,227	3,604	-1,377	-2,423	45,094	34,155	10,939	-1,493
01/31/2019	19,357	-11,223	-21,198	9,975	-886	29,298	21,723	7,575	2,169
12/31/2018	-133,847	-57,436	-28,953	-28,483	-28,169	-49,415	-49,512	98	1,173
11/30/2018	-16,560	6,964	2,780	4,183	-12,380	-11,261	-7,459	-3,803	117
10/31/2018	-49,539	-6,659	-9,659	3,000	-11,251	-31,965	-27,700	-4,264	336
09/30/2018	10,899	-1,052	880	-1,932	-6,086	18,072	18,526	-454	-36
08/31/2018	7,083	-3,953	-6,658	2,705	-6,187	19,545	17,219	2,326	-2,322
07/31/2018	19,005	-305	984	-1,289	-6,007	25,916	22,495	3,421	-599
06/30/2018	-16,463	-26,524	-20,980	-5,544	-7,085	19,595	16,995	2,601	-2,450
05/31/2018	23,007	13,744	10,061	3,683	-3,630	13,026	11,749	1,277	-133
04/30/2018	20,935	-27	-7,411	7,384	-3,752	22,405	24,176	-1,771	2,310
03/31/2018	7,979	-6,742	-22,166	15,424	-1,712	15,880	14,148	1,732	554
02/28/2018	-20,221	-19,502	-41,442	21,940	-3,439	1,694	2,706	-1,012	1,026
01/31/2018	113,025	54,200	10,785	43,416	356	56,744	46,287	10,457	1,724
12/31/2017	24,237	8,940	-9,047	17,987	-3,334	19,158	19,491	-333	-528
11/30/2017	31,712	13,723	-4,421	18,145	-3,164	21,597	19,788	1,809	-444
10/31/2017	60,068	23,928	3,162	20,766	-1,818	38,705	36,110	2,595	-747
09/30/2017	36,715	653	-9,775	10,428	-2,099	36,427	33,440	2,987	1,733
08/31/2017	22,091	-6,149	-22,766	16,616	-3,685	29,532	25,078	4,454	2,393
07/31/2017	33,572	7,402	-12,520	19,922	-2,001	31,702	29,139	2,564	-3,532
06/30/2017	53,542	21,927	-7,950	29,878	-2,546	32,632	29,372	3,260	1,528
05/31/2017	57,736	23,363	-10,750	34,113	-1,549	36,372	33,070	3,302	-449
04/30/2017	36,905	12,335	-8,264	20,599	-1,563	25,185	22,064	3,120	948
03/31/2017	59,904	24,562	9,421	15,141	-1,924	37,797	36,562	1,235	-531
02/28/2017	73,081	35,179	17,610	17,569	44	35,990	33,991	1,999	1,867
01/31/2017	53,584	20,678	5,093	15,585	-1,976	35,519	31,037	4,482	-637

Note: Weekly cash flows are estimates are based on reporting covering 98% of industry assets.

Source: Investment Company Institute