Tuesday, February 2, 2016

Reprint

New-to-Market - This blog series highlights ETFs that have recently gone public and reflect those strategies currently most in demand by investors. While ETFs are not eligible for ETFG Risk Ratings until traded for 3 months and ETFG Reward Ratings for 12 months, our goal is to highlight the most cutting-edge investment strategies that have recently embraced the ETF structure – we hope you enjoy this special series of posts.

For the latest edition of the ETFG New-to-Market series, we're exploring the first actively managed utility ETF to hit the market, the Reaves Utilities ETF (UTES), built around the promise of pure sector exposure with all the liquidity and tax advantages of an ETF but with the promises of active management so far only found with mutual funds. So stick around as we pull a 180 from our usual fare of smart beta strategies and turn our sights to UTES.

In our last review, we joked that thanks to the rise of smart beta funds you could generally learn all you needed to know about a new ETF just by studying its name, which is why we normally start by focusing on underlying benchmarks and how they're constructed but that approach makes deconstructing UTES challenging because it doesn't actually have one! Sub-advised by Reaves Asset Management, a boutique research firm that was founded in the golden era of equity research (1961 to be precise) and focusing on energy and utility stocks, the firm employs a bottoms-up approach with no reference benchmark or trade schedule. Instead, they outline an investment philosophy that would be easily recognizable to any disciple of Benjamin Graham or Warren Buffet with a focus on searching out opportunities among well-capitalized names with strong balance sheets and a history of stable and growing earnings along with rising dividends. And how do they find these opportunities? While they employ a variety of quantitative processes, ultimately it involves doing their own leg work through management meetings and field research which to many of our readers who focus on data mining and machine learning may sound unique.

And while you think you know what constitutes a "utility", Reaves goes the extra mile to define their universe as companies either designated as utilities or those that derive at least 50% of their revenue, gross income or profits from the generation/distribution of gas, electricity or water which excludes the telecom and energy names that make up a large percentage of the average "utility fund." Why should that be important to you? Because the statistics for the average utility fund show that typically, around 74% of its allocation is actually in utility stocks with another 11% in telecoms and 10% in energy names. Now 74% is way more utility exposure than you'll find in any index fund and while sound in theory, telecoms and utilities have had a relatively low correlation to each other in the last decade with the net result being actively managed mutual funds underperforming "less diversified" passive utility index funds thanks to persistently weak telecom stocks.

As the only actively managed utility ETF, it might be fairer to compare UTES with its mutual fund brethren (and we'll get to that later) but advisers willing to consider investing in the strategy should know how it stacks up against the rest of space, especially the ubiquitous Utilities Select Sector SPDR (XLU.) And to be fair, those harried advisers who only have time to compare the two might wonder what exactly the hubbub is all about, especially with an almost 80 bps difference in fees. The 30,000 foot overview shows that both funds are highly concentrated and 100% invested in pure U.S. utilities although the management team at UTES retains the right to invest in ADRs or even to temporarily hold large amounts of cash (up to 100% of the fund) if they feel conditions warrant a defensive posture. In fact, a quick glance might seem to indicate that the only noticeable difference being a slightly lower average market cap for UTES that also helps generate a portfolio with less of the deep value feel that either XLU or the S&P 1500 Utilities index exudes. But once you get beyond the summary and start comparing the names, you'll find UTES to be a remarkably different portfolio that so far has held its own in 2016.

The first question any advisor will ask is just how different can the portfolio of UTES be from any index fund in such a small sector? The problems of concentrated portfolios with overlapping names are going to be difficult to avoid in any regulated market; the S&P 500 Utilities Index has a mere 29 stocks that make up just 3% of the index while the much broader S&P 1500 Utilities Index has just 59 for a whopping 3.3% of that much broader index. So how much overlap are we talking about? 16 of the 21 names that currently make up UTES are also included in XLU and in terms of percentage of the assets those 15 common holdings make up slightly more than 82% of UTES. But active management doesn't mean you can't hold the same names as your indexed competitors, you just have to be smart in how you use them and so far, the managers of UTES have lived up to the challenge. There are significant weighting differences between the two funds with only 2 of those 16 common holdings at UTES having an allocation within 100 bps of the index with significant underweights to major names like Southern Holdings while Duke Energy is completely missing from UTES. So what kind of performance differential can you expect with only 21 stocks and 16 of those in common with the much larger XLU? More than you would expect in such a short period.

While we're just one month into 2016, UTES has managed to hold its own against XLU with a 5% return for the month compared to 4.94% for XLU and more anemic 1.75% for the average utility mutual fund with among the biggest returners in that pool of common holdings being NiSource Energy, up 7.69% and which carries a nearly three times greater allocation at UTES than XLU. Cautious investors will note that NiSource is a distinctly midcap name although the management team at UTES also overweighted several large-cap names that are common holdings in the utilities space like Dominion Resources and NextEra Energy. So then why is UTES just holding its own with XLU? It certainly isn't due to poor security selection in the portion of the portfolio invested in names not held by XLU where Friday's surge made sure that none closed the month in the red. UTES also managed to avoid holding some of the worst performers in XLU's portfolio like Centerpoint Energy and the now notorious NRG Energy, whose 8.26% loss in January eroded nearly 20% of the gain from XLU's strongest single name not held by UTES, Consolidated Edison, even though NRG is just a .58% position!

In fact, when we started our comparison of the two funds at the start of last week, UTES was solidly outperforming XLU and it's only been in the last few days that the larger index fund has caught up with its new rival largely thanks to those weak performers like Centerpoint and NRG. Saying that the utilities sector has been gaining momentum against the broader equity market in 2016 is an understatement; from January 4th to the 19th XLU gained over 1.8% while the S&P 500 lost almost 8%. That sort of extreme outperformance wasn't likely to last, so of course from the 20th through the 26th the market managed to recover 1.19% while XLU lost ground (.75% to be exact), but it was during that time that UTES and its management team really managed to shine, losing only a mere .1%. But as volatility waned and investors returned to the markets in the second half of the week, they've been seeking out indexed products like XLU with a vengeance and that's helped some of the sector's worst performers like NRG and Centerpoint recover almost half of their losses in January. Putting it another way, a focus on higher quality names with strong earnings growth has been what has held UTES back.

We agree that one month does not a year make, not to mention that comparing an active and passive fund during a period of high volatility might make for an unfair comparison, so consider the performance of UTES and that of the largest active (and top-ranked) mutual fund in the Utilities category, Franklin Utilities (FKUTX). Franklin Utilities is managed by John Kohil whose fund carries four stars and a "Gold" ranking by absolutely dominating the space over the last decade with performance in the top decile in the three, five and ten year periods and often with significantly lower volatility than other funds in the space. So far the story in 2016 has stayed the same with a 4.02% return compared to the category's 1.75% gain and the secret of Franklin's success is that they have avoided most of the telecom and energy names that have held back other funds in that space with FKUTX currently holding 93% of its portfolio in U.S. utility names with just over 5.6% in energy stocks including Williams Companies. Compare that with the performance of MFS Utilities (MMUFX) with just 64% in utilities stocks and nearly 15% in energy stocks! In fact, only 68% of the overall portfolio is in domestic names, all of which helps explain why the fund is down 1.24% in 2016 and over 15.9% in the last year compared to a loss of 9.95% for the category.

So if that kind of performance spread between active mutual fund managers makes you queasy, or you just prefer to daily liquidity and tax advantages of an ETF, then the careful advisor is only left with one major decision; to benchmark or not to benchmark and for many the question will be decided over fee's. At 16 bps, XLU is one of the lowest priced ETF choices available and as a well-established fund has much greater liquidity than UTES, which has only been trading since last September and at 95 bps is the most expensive exchange traded option for clients. In a world of lowered expected returns, 79 bps isn't an inconsequential number but perhaps the better question for advisors to ask themselves is what kind of defensive equity exposure their clients were seeking. If they're trend followers and comfortable chasing momentum (and timing their entry and exit points) then XLU might be the choice but for those looking for a "buy-it and forget-it fund" to offer the right amount of upside potential and downside protection, it might be worth adding UTES to your portfolio.

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Fund Risks

Equity Securities: The market price of equity securities may be adversely affected by financial market, industry, or issuer-specific events. Focus on a particular style or on small or medium-sized companies may enhance that risk.

Energy Sector Concentration: The fund's investments are concentrated in the energy sector and may present more risks than if the fund were broadly diversified over numerous sectors of the economy.

Industry/Sector Concentration: A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund.

Closing Price: The Closing Price is the price of the last reported trade on the fund's primary exchange. If there has been no reported trade for a particular date, the Closing Price represents the 4PM Bid/Offer Midpoint.

4PM Bid/Offer Midpoint: The midpoint between the highest bid and the lowest offer on the listing exchange, as of the time that the Fund's NAV is calculated (usually 4:00pm Eastern Time).

Premium/Discount: The amount the Fund is trading above or below the reported NAV (based on 4PM Bid/Offer Midpoint).

The Fund is an actively managed exchange-traded fund ("ETF") and does not seek to replicate the performance of a specified index. The Fund may have a higher portfolio turnover than funds that seek to replicate the performance of an index.

The "net asset value" (NAV) of the Fund is determined at the close of each business day, and represents the dollar value of one share of the Fund; it is calculated by taking the total assets of the Fund, subtracting total liabilities, and dividing by the total number of shares outstanding. The NAV of the Fund is not necessarily the same as its intraday trading value. Fund investors should not expect to buy or sell shares at NAV because shares of ETFs such as the Fund are bought and sold at market price (not NAV) and are not individually redeemed from the Fund. Thus, shares may trade at a premium or discount to their NAV in the secondary market. Brokerage commissions will reduce returns.

Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. NAV returns are calculated using the Fund's daily 4:00 p.m. NAV, and include the reinvestment of all dividends and other distributions (reinvested at the Fund's NAV on distribution ex-date). Market price returns are calculated using the 4:00 pm midpoint between the bid and offer, and include the reinvestment of all dividends

and other distributions (reinvested at the 4:00pm bid/offer midpoint on distribution ex-date). Market price returns do not represent the return you would receive if you traded at other times.

SEC Yield is an annualized yield that is calculated by dividing the investment income earned by the Fund less expenses over the most recent 30 day period by the current NAV at the end of the 30 day period. The Subsidized Yield reflects fee waivers and/or expense reimbursements recorded by the Fund during the period. Without waivers and/or reimbursements, yields would be reduced. The Unsubsidized Yield does not adjust for any fee waivers and/ or expense reimbursements in effect. If the Fund does not incur any fee waivers and/or expense reimbursements during the period, the Subsidized Yield and Unsubsidized Yield will be identical.

Distribution Yield is the annual yield that an investor would receive if the most recent distribution remained the same going forward. The yield represents a single distribution from the Fund and does not represent total return of the Fund. The distribution yield is calculated by annualizing the most recent distribution and dividing it by the most recent NAV.

Returns for periods of less than one year are cumulative total returns.

Please consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. The prospectus contains this and other information about the Fund. Contact us at 888-383-0553 or visit www.reavesetfs.com **for a copy of the Fund's prospectus. Read the prospectus carefully before you invest or send money.**