‘Don’t overlook us,’ a boutique ETF issuer tells advisers

By Editorial Staff *Thu, Jan 9, 2020*

The three largest ETF sponsors have 82% of ETF assets; market share jumps to 90% when expanded to the top five, according to Cerulli Associates. A smaller ETF issuer calls that suboptimal.

Advisers are now more than twice as likely to say they’re seeking safety than seeking “alpha” for their clients, according to a new **white paper** from Cerulli Associates and Rafferty Asset Management, LLC, the adviser to Direxion ETFs.

But that sense of caution, inspired by an over-valued stock market, low bond yields, and liquidity concerns, can cause advisers to over-rely on the biggest exchange-traded funds (ETFs) providers and overlook boutique ETF issuers (like Direxion), the white paper said.

“The uncertain regulatory environment coupled with tightened internal compliance have made advisors refrain from bold tactical shifts in favor of strategic allocation,” a Cerulli release said. “Two-thirds of advisors use strategic allocations when building portfolios and seek downside protection and portfolio diversification (57% and 55%, respectively) over alpha generation (22%).”

As advisers try to build portfolios to withstand volatility, “they could be building portfolios that are too conservative to meet their clients’ objectives,” said Ed Louis, Cerulli senior analyst, in the release. “Issuers need to explain how their product is a strategic fit for advisors’ client bases instead of pure alpha generation.”

Many advisors are using multifactor ETF products to gain exposure to strategic asset allocations or making small factor tilts as recommended by asset managers they know and trust, the release said.

“Within the strategic asset allocation component, advisors are expressing their views by adding and subtracting sector exposure risk, selecting asset classes to overweight, or choosing to use passive products. At the earliest stages of portfolio construction, selecting and implementing a strategic asset allocation consists of active decisions,” according to Daniil Shapiro, associate director at Cerulli.

These factors, along with the search for lower expenses, are good for the ETF industry overall. In the first half of 2019, ETFs gathered 50% more flows than their mutual fund counterparts. But, to the chagrin of asset managers like Rafferty, the major ETF issuers are receiving all but a trickle of the flows.

The top-three largest ETF sponsors have 82% of ETF assets; market share jumps to 90% when expanded to the top five, according to Cerulli. Advisers evidently gravitate toward well-known brands, and tend to evaluate them on the basis of performance, liquidity of underlying holdings, and expense ratio.

But the assumption that brands are "proxies for quality and liquidity" and reliance on the top providers "can result in use of products that are not optimized to these advisors' specific needs," Shapiro said. Offerings from other providers may allow them to express specific views in a more targeted manner.