

THE TRUTH ABOUT SETTLING FOR ETFs

(2017)

On Aug. 31, 1976, John Bogle launched the first index fund. Originally called the First Index Investment Trust, it was later renamed the Vanguard S&P Index (VFINX). Today, there are 971 index funds holding just over one trillion dollars.

This led to Exchange-Traded Funds. As of this moment, there are 2,178 ETFs ~~managing~~ holding \$3.5 trillion. The catalyst for this soaring growth was the constant drone from the likes of John Bogle and writer Jonathan Clements that actively managed mutual funds just do not beat their category index.

When it comes to beating the index, we are asking how many funds beat the average of the category, right? Mathematically, what percent will beat *average*? I assume your answer is 45% to 50%.

Too many advisors leap to the conclusion that “if you cannot beat ‘em, buy ‘em!”

Let us consider this question a bit differently.

1. What percent of investors need a financial advisor to purchase ETFs for them? The financial media is happy to help them every step of the way!
2. How are you separating yourself from other advisors if you too promote ETFs?
3. Lastly, let us take a look at the competitive results between ETFs and actively-managed funds. Over the last three years (2015-2017), 33% of actively-managed funds outpaced the return of the largest ETFs of these equity categories:

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CATEGORY	LARGEST ETFs	FUNDS	BEAT ETF	PCT
China Stock	PowerShares Golden Dragon China ETF	81	1	1%
Emerging Mkts	Vanguard FTSE Emerging Markets ETF	669	439	66%
Equity Energy	Energy Select Sector SPDR® ETF	86	11	13%
Europe Stock	Vanguard FTSE Europe ETF	106	32	30%
Financial	Financial Select Sector SPDR® ETF	99	25	25%
Foreign Large Blend	iShares MSCI EAFE ETF	607	330	54%
Foreign Large Growth	iShares MSCI EAFE Growth ETF	340	229	67%
Foreign Large Value	iShares MSCI EAFE Value ETF	265	178	67%
Health	Health Care Select Sector SPDR® ETF	129	31	24%
Japan Stock	iShares MSCI Japan ETF	33	22	67%
Large-Cap Blend	SPDR® S&P 500 ETF	1209	138	11%
Large-Cap Growth	PowerShares QQQ ETF	1218	23	2%
Large-Cap Value	iShares Russell 1000 Value ETF	1091	534	49%
Mid-Cap Blend	iShares Core S&P Mid-Cap ETF	356	44	12%
Mid-Cap Growth	SPDR® S&P 400 Mid Cap Growth ETF	549	170	31%
Mid-Cap Value	iShares Select Dividend ETF	361	14	4%
Real Estate	Vanguard Real Estate ETF	228	111	49%
Small-Cap Blend	iShares Russell 2000 ETF	627	175	28%
Small-Cap Growth	iShares Russell 2000 Growth ETF	595	288	48%
Small-Cap Value	Vanguard Small-Cap Value ETF	348	109	31%
Technology	Technology Select Sector SPDR® ETF	179	104	58%

That is over 3,000 actively-managed funds from which you can choose!

Now, here is another factor for you to consider. Look at the cumulative return difference between the category's biggest selling ETF and the top managed fund of the category.

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CATEGORY	ETF	CUM RETURN	TOP FUND	CUM RETURN
China Stock	PowerShares Golden Dragon China	61.93	Matthews China Small Companies	63.30
Emerging Mkts	Vanguard FTSE Emerging Markets	24.30	JOHCM Emerg Mkts Sm Mid Cp Eq	51.37
Equity Energy	Energy Select Sector SPDR®	-4.84	Fidelity® Select Energy	-2.26
Europe Stock	Vanguard FTSE Europe	17.76	DFA Continental Small Company I	50.15
Financial	Financial Select Sector SPDR®	48.82	RMB Mendon Financial Services A	78.12
Foreign Large Blend	iShares MSCI EAFE	17.19	Goldman Sachs Intl Eq Insghts Instl	33.86
Foreign Large Blend	iShares MSCI EAFE Value	12.75	Hartford International Value I	35.84
Foreign Large Growth	iShares MSCI EAFE Growth	20.22	Morgan Stanley International Opp	65.64
Health	Health Care Select Sector SPDR	16.99	Fidelity Select Medical Tech & Devcs	40.23
Japan Stock	iShares MSCI Japan	25.03	Hennessy Japan Small Cap Investor	77.60
Large-Cap Blend	SPDR® S&P 500	35.55	Pin Oak Equity	43.75
Large-Cap Growth	PowerShares QQQ	56.33	Morgan Stanley Inst Growth IS	63.51
Large-Cap Value	iShares Russell 1000 Value	24.92	HCM Dividend Sector Plus A	51.69
Mid-Cap Blend	iShares Core S&P Mid-Cap	29.11	Thrivent Mid Cap Stock S	48.62
Mid-Cap Growth	SPDR® S&P 400 Mid Cap Growth	31.87	PRIMECAP Odyssey Aggr Growth	64.34
Mid-Cap Value	iShares Select Dividend	34.63	AllianzGI NFJ Mid-Cap Value Instl	38.28
Real Estate	Vanguard Real Estate	2.30	Altegris/AACA Opport Real Est I	25.69
Small-Cap Blend	iShares Russell 2000	27.48	Federated MDT Small Cap Core	45.87
Small-Cap Growth	iShares Russell 2000 Growth	29.11	Virtus KAR Small-Cap Growth I	80.07
Small-Cap Value	Vanguard Small-Cap Value	25.87	Aegis Value	62.72
Technology	Technology Select Sector SPDR	65.98	Putnam Global Technology Y	95.17

That is an ETF cumulative return of 29% compared to 53% for the best actively managed fund average. While I understand I am comparing the ETFs to the BEST fund return, do you think it is reasonable to use deliberative quality fund research to find actively managed mutual funds to outpace these ETF? I sure do!

Please consider this before joining the herd of ETF converts.

P.S. I did not mention that when it comes to beating the S&P 500, I have presented researched proof over the years that (a) not all funds were meant to beat the S&P 500, and (b) that those funds which are meant to beat the S&P 500 — beta of 1.00 or more — do indeed beat it in significant numbers. I am currently in the midst of updating those statistics. Stay tuned.