

Actively Managed Exchange-Traded Funds: *Competitive Threat or Passing Fad?*

An exploration of the future of actively managed ETFs.

In early 2008, the first Exchange-Traded Funds (ETFs) possessing the "active" label began to emerge, leading the asset management industry to begin assessing the impact this unique structure could have on the marketplace. Since 2000, FRC has closely monitored the ETF market, recognizing that this product had the capacity to change industry dynamics going forward. In its latest study on the ETF market, FRC teams with ETF expert Gus Fleites to explore the future of actively managed ETFs, the next frontier in the continuing evolution of ETFs.

In this study, titled *Actively Managed ETFs: Competitive Threat or Passing Fad?*, Financial Research Corporation:

- Track the evolution of the ETF structure, from the launch of SPDR in 1993 to the introduction of the first active ETFs in 2008, highlighting specific milestones in the product's development.
- Evaluate the competitive advantages of the ETF structure over open-end mutual funds and other investment products in the delivery of active management strategies.
- Identify the roadblocks ETFs still face in their evolution toward true active management, including the need for transparency, regulatory delays, and the ability to attract market makers.
- Discuss the factors that firms considering the build out of an actively managed ETF business must address, including regulatory, operational, and trading considerations, as well as potential distribution opportunities.

For more information on this report, contact FRC today at (866) 532-8009 or e-mail frcinfo@frcnet.com.

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METHODOLOGY

The launch of the first actively managed ETF products in 2008 represented the “first stake in the ground” for this evolving product concept. Recognizing that interest in these emerging vehicles was growing both inside and outside of the ETF marketplace, FRC partnered with Gus Fleites, an ETF industry veteran, to explore how actively managed ETFs would continue to evolve, as well as how they could impact other actively managed investment vehicles.

The study begins by providing a brief history of the growth of ETFs and the unique structure and processes behind ETFs. After laying this foundation, we address how the ETF structure can be applied to active management, as well as the roadblocks active ETFs will continue to face in their pursuit of widespread marketplace acceptance. Finally, we look at key questions firms exploring entrance into the active ETF business must consider, including product development issues and distribution opportunities.

The research used to complete this study came from four sources:

- Knowledge and inside understanding of the ETF business of Gus Fleites, who was responsible for the development and introduction of more than 40 ETFs across the globe while working for SSgA and ProShares
- FRC’s proprietary database of ETF sales and assets
- Survey of 15 asset management firms regarding their opinions on active ETFs and the impact they will have on the mutual fund industry
- Secondary sources, including news articles and websites related to ETFs

This study on the ETF marketplace—FRC’s third since 2000—is designed to serve as a tool for asset management firms exploring the opportunities in active ETFs, as well as those seeking to understand the level of competition these emerging vehicles will present to actively managed mutual funds in the years ahead.

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STUDY AUTHOR

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Ri-Ta Advisors is focused on developing innovative financial tools to serve the needs of sophisticated investors. Prior to forming Ri-Ta Advisors Gus was Chief Investment Officer for ProFund Advisors where he was responsible for over 100 registered investment company portfolios and led the launch of the ProShares family of exchange-traded-funds (ETFs), the first levered and inverse index ETFs listed in the U.S.

Before joining ProFunds Gus was President of SSgA Funds Management Inc. where he was responsible for the company's ETF, mutual fund, and separately managed account businesses with assets exceeding \$115 billion. His group was responsible for the distribution and management of 45 funds including the SPDR, the industry's largest and among the most actively traded ETFs; the Select Sector SPDRs, the industry's largest and most actively traded sector based ETF family; and the DOW DIAMONDS, one of the earliest ETFs launched to track the venerable Dow Jones Industrial Average. Earlier responsibilities at SSgA included creating the firm's asset allocation group; establishing the firm's first Asia-Pacific investment management operations out of Sydney, Australia; and managing international, quantitatively driven equity investment portfolios.

Gus is a proven leader in the field of ETFs. While leading two of the most successful ETF businesses, SSgA and ProShares, Gus was responsible for the development and introduction of over 40 ETFs across the globe, including many of the most innovative and successful products trading today. In addition to the first levered and inverse index ETFs at ProShares, at SSgA Gus's team worked closely with the World Gold Council to launch the Gold Shares Trust (GLD), the first U.S. listed commodity based ETF. Gus also led State Street's efforts to launch the Hong Kong TraHK Fund, the first ETF to be launched through an initial public offering.

Gus is an active contributor at industry conferences in the fields of index management, ETFs, and asset allocation. He has also provided consulting services to organizations evaluating opportunities relating to exchange-traded funds. He holds a Bachelor's degree in Finance and Multinational Management from the Wharton School of the University of Pennsylvania and a Master of Business Administration degree in Finance from Babson College. He is also a Chartered Financial Analyst.