

Why New Frontier Traded Vanguard's Revised ETFs

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July 17, 2015

On June 2nd, Vanguard announced they were redefining the indices tracked by four of their ETFs.¹ These are: Vanguard Emerging Markets ETF (VWO), Vanguard Developed Markets ETF (VEA), Vanguard European Stock ETF (VGK), and Vanguard Pacific Stock ETF (VPL). The transition will result in each ETF including small cap stocks. In addition, VEA will add Canadian equities and VWO will add China A-shares. Each of these ETFs was held in some measure in New Frontier's global strategic portfolios.

Vanguard's reconstituted ETFs represent an expanded level of one-stop diversification for investors. However, the upshot is that they will homogenize important global risk premiums, limiting the benefit of sophisticated global ETF asset management. Other concerns include the difficulty of controlling risk during the transition period as well as possible front-running by various market entities.

The integrity of New Frontier's asset management process depends critically on each fund's holistic representativeness for optimal diversification. Each ETF is required to reflect an identifiable global risk premium. Unfortunately, the redefined funds may often duplicate exposures held elsewhere in our portfolios. In addition, continued exposure to funds during the transition would require guesswork which is unwelcome in our risk management process.

To address these issues we have decided to replace the Vanguard ETFs with iShares Core MSCI Europe ETF (IEUR), iShares Core MSCI Pacific ETF (IPAC), and iShares Core MSCI Emerging Markets ETF (IEMG). These are institutional quality ETFs with known exposures to known indexes with stable histories and differentiated risk premiums. Our patented rebalance test, which signals when portfolios are meaningfully different from optimal, provided rigorous quantitative justification for the trades. Market impact from trading was carefully considered before executing these sizable trades, including extensive discussions with institutional secondary market traders. We have been pleased with the effectiveness of our trading partners. Rebalancing also provided an opportunity to make minor adjustments to various risk characteristics of the portfolio with particular attention to proposed contemporary interest rate policies.

¹ Vanguard. (June 2, 2015). Four Vanguard international equity index funds to broaden diversification with all-cap exposure [Press Release]. Retrieved from https://pressroom.vanguard.com/content/press_release/Four_Vanguard_Funds_to_Broaden_Diversification_6.2.15.html

New Frontier is proud to be at the forefront of institutional quality strategic global ETF portfolio management. We have more than a ten year continuous track record of high-performing, reliable risk-managed funds. Our portfolios are optimized and managed with uniquely effective multi-patented investment technology. We continuously monitor all aspects of the ETF universe. As always, our overriding focus is to provide short- and long-term investors with uniquely effective risk-diversified investment strategies well-positioned for addressing future global market opportunities.

This note was posted as an entry on New Frontier's investment blog on July 17, 2015. Read this entry and other posts at: newfrontieradvisors.com/blog