Hello, and welcome back to the Mullooly Asset video and podcast this week. We're joined by Tom. Tom, thanks for hopping on with me. We're going to talk about one of our favorite writers here in the office, Jason Zweig. He wrote a piece in the Wall Street Journal, and he asked the question, what's left to be ETF'ed?

It's a good question.

It is a good question. So just to refresh when we say ETF, we're talking about exchange traded funds. And these ETFs track indices. This is where the term index fund comes from.

So these indices have rules for what companies to include and exclude based on what the, their investment objective is, and rebalances happen, they usually happen on set dates a couple of times throughout the year. Usually quarterly, you know, each fund does things differently, but when these rebalances happen, companies go in and companies go out.

And like I said, every ETF has a different set of rules. So just as an example, the S and P 500, the most common index in the world, the most common ETF in the world, SPY, recently did a rebalance; Dell computers came in to the S& P 500 while American Airlines and Etsy went out.

These are not buy and sell recommendations, just wanted to, um, highlight. Some of the different companies coming in and out of these indices as an example.

The question that I have for you Tom is, you know, there seems to be, an ETF and an index for everything nowadays.

Do investors need to worry about the companies coming out of the indices -- out of the indices and the ETF's? Or is it more about more about sticking with the rules based strategies of these funds -- not jumping into and out of different funds depending on what exposure they get

I think if you're going to be a long term investor, uh, an exchange traded fund may be appropriate for you because all of the changes in an underlying index are happening below the surface, so you don't even have to get involved in something like that.

If you've owned the S& P 500 for the last 10 years, 15, 20 years, there have been a lot of companies that have been added.

And an equal number that have been dropped over the years. You don't even see it.

And that actually works out really well because people don't point to certain points in history and say, this is when this company wasn't in the S and P 500. All they're looking at is the yardstick itself.

What the S and P 500 do. And how did my investments measure up -- against that yardstick?

Along those lines, it doesn't really matter if you're talking about the S and P 500, uh, or you're talking about the Dow Jones industrial average, the Russell 1000, the Russell 2000, there's a lot of indices out there that you can measure against.

In fact, when ETFs were first started about 30 years ago in 1993 - 1994, they were all passive baskets of stocks.

And so, you needed an index underneath it, to track it.

Once they created, once Wall Street created baskets that followed the S and P 500 or the Dow Jones Industrial Average, or any of these indices, they had to go out and create more indices so they could create more products, more ETFs.

Yes, the ETF business is booming! And that's something that Jason writes about, what will be the next ETF.

I'm gonna pull up a chart here that just shows the different funds and how many funds there are compared to just 10 years ago.

In 2014 there was about 1,300 different ETF's. And now there is just about 3,500 different ETFs 10 years later.
So an explosion.

And it's big business for these different fund companies. They're trying to slice the investment universe every which way into the next ETF.

I mean, the, the main driver of Jason's article was talking about how there's now an ETF for companies that have been removed from indices. The theory behind this one is that these companies actually tend to, while they might underperform in the short term, they're actually a pretty good long term buys. They're undervalued.

And now that a lot of these rebalances are public and people know the rules, people are trying to front-run these trades and buy or sell these companies - based on whether they're coming into or out of an index.

Just to represent the number, the dollar total of US ETFs, again, a similar looking chart: up and to the right.

In 2015, just under $2 trillion in US ETFs and now we're approaching $10 trillion. So these fund companies know what they're doing. They want to entice investors with these more active styles of funds, the next ETF, instead of the passive funds that you were talking about, Tom.

Another question I have for you here is with all these different styles of funds, all these different types of funds, "how do investors know how many funds is an appropriate amount to have in their investment account?"

A typical mistake or misconception that we see a lot -- and this is more with 401k plans - and these are mutual funds, but I think it's still the same thing where, you'll have a menu of 30 funds in a 401k.

And someone will be, someone will want to be diversified. So they'll sprinkle a little money around in all of these 30 funds. And, uh, (I think we both know the answer here), but what should folks be doing instead?

How many funds is an appropriate amount to have in an overall portfolio?

Well, in our industry, I think a lot of folks who ask us questions like this... they just want an answer.

They just want to know. "Okay, I should have 5 funds I should have 8 funds?

There is no hard and fast answer! One of the things we do when someone comes in and they want us to take a look at their investment positions, we'll go in and see "where's the overlap?" Or where are the problems with the allocations?

And we've seen some folks bring in statements -- whether it's their 401k or their individual investments -- they'll own these, target date funds.

Now a target date fund is a "fund of funds." It is basically your own allocation.
And so you wind up getting folks that have money in the 2030? fund.
That means basically you're looking to retire around 2030.

But they'll also have money in the 2035 fund, and the 2040 fund.

You'll also find more funds and the next ETF further and further out the spectrum.

On the flip side, you'll also find folks that say, "well, I want to have a lot of money in growth."
And so they will own, uh, a couple of different growth funds.

When you go beneath the surface, you may find a lot of times, these exchange traded funds or mutual funds will have many of the same positions.

And so mistakenly, or, not done on purpose, you're going to find that some folks wind up having an unusually large position in one stock, like... pick one.

But you're also going, you're... they own seven different U S large cap? ?

Right. Yeah. And they, these (funds might) all own the same names.

Exactly. So I think it's like you said, you have to look at what the funds are doing. And, this is not the fault of the end 401K user.

Sometimes it's difficult to, to determine what the fund is investing in and, uh, you kind of have to know what to look out for there.

The other problem that comes with that is - like a school of fish, when they,...
...have you ever seen a school of fish change directions?

They all go at the same time. And so if you own, you know, large cap growth -- and that falls out of favor. Uh, and that is the majority of how your money is invested in your portfolio...

Uh, you could be taking a lot more risk than you ever realized.
That is something that we try to drive home.

So I think it's important to have allocations across the spectrum. Meaning, you want to have some large cap, mid cap, small cap. You also want to have growth. You want to have value. You want to have some things for income. But overloading in one area, one side of the market or one corner of the investment spectrum...

Not a good idea.

Right. You're not diversified just because you own nine different funds. You could own nine different large cap US funds, and they're all doing the same thing, like you said. So the idea with diversification is you're exposing yourself to different areas of the market, not the same, not overloading in the same area of the market.

Okay.

Just wanted to share my screen one more time and talk about, I know I asked before, you know, should we be jumping from fund to fund here. Or just kind of maintain an asset allocation that's broadly diversified?

So we're going to pop up some stats from the Morningstar "Mind the Gap" study.
I love looking at this information whenever it comes out!

This shows the different types of funds going back 10 years.

And just to spell it out for our listeners and viewers here: we have the investor return, which you can see here, these are the blue bars.

And then the total return, which is indicated by the black marks here on the chart.

And moral of the story is that investors tend to underperform the funds they own.

This was something I want to drill home. It's pronounced in different types of funds So in non-traditional equity funds the gap is 2.3%. Which is much higher than the average 1. 1%.

Sector funds 2.6%, much higher again.

But in allocation funds, it's 0.4% - which is under the average.

So allocation funds are those broadly diversified Funds; whereas the non-traditional equity, or the sector equity funds are used more as trading vehicles.

My point by showing that data is to illustrate that while you, while these may be exciting to invest in (the next ETF), new funds that are coming out. You have to worry about, like you said before, the timing of buying and selling these funds.
And taking that all into account when you're building out an investment philosophy.

So, a lot to consider.

A lot to consider there. We'll see what's left to be ETF'd. I'm sure the investing industry and all these fund companies will develop more strategies along the way that will leave us chuckling! And give us some more fuel for the fire here on the videos and podcasts.

So, thanks again for joining me and we'll be back with you on the next video podcast.
Sounds good. See you then.

Website: https://mullooly.net

Phone: 732-223-9000

Address:
Mullooly Asset Management, Inc.
1971 State Route 34, Suite 102
Wall Township, NJ 07719

Please note:

This content is provided for informational purposes only and does not constitute personalized investment, tax, legal, or accounting advice, and should not be relied upon as such. Mullooly Asset Management, Inc. is not endorsing practices, products, or services that may be mentioned, and highly recommend consulting with a licensed financial professional about your own specific goals and circumstances prior to engaging in any financial decisions.

Investing involves the risk of loss. Employees of Mullooly Asset Management, Inc. may maintain positions in securities discussed, however absolutely none of this is a solicitation or recommendation to buy or sell. Charts and graphs provided within are for informational purposes solely and should not be relied upon when making any investment decisions. Past performance is not indicative of future results. This content speaks only as of the date indicated.

Any projections, estimates, forecasts, targets, prospects, and/or opinions expressed in these materials are subject to change without notice.