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Portfolios

## Interview series: Investment Factors that drive ETF performance

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Title: Factor: The Emerging Market Consumer

Robert Holderith, President and Founder of EGShares is the President and Founder of EG Shares which as a firm was launched in 2008 under the premise that investors needed a different approach to investing in the emerging markets than the traditional market weighted strategies. The focus of this interview is on the consumer factor and demographics.

*Dan Weiskopf: As an innovator in the ETF industry you were very early to focus on factor based investing. When you launched your firm What did you see as the flaw in the main drivers leading the performance in the broad based market weighted ETFs in the emerging markets.*

Robert Holderith: Overall, traditional, broad-based market-weighted benchmarks are not designed to be portfolios or address basic portfolio tenets. Traditional benchmarks are based on historical factors that have driven market capitalization and the degree of diversification across country or sectors is usually a consequence, not an intended outcome. Usually these benchmarks are composed of a large number of constituents and position sizes can be outsized as a result of market-weighting. The performance of these broad-based market-weighted indexes is a result of this historical view and may not reflect the investments that could drive future growth. Therefore, in emerging markets, there is an opportunity for smart beta indices to be more relevant to investors.

*Dan Weiskopf: What factors drive the performance of EGShares' ECON fund? What factors should tactical investors be looking at to monitor whether the index investment process will work in a specific environment? Should ECON be viewed as a defensive emerging market strategy?*

Robert Holderith: We do not use a standard set of rules or factors for our product suite. Instead, we prefer to implement specific factors for each set of investment objectives. In the case of the EGShares Emerging Markets Consumer ETF (ECON), the fund is designed to focus on the growth potential of the consumer sectors in emerging markets. These sectors may stand to benefit from the transition for many emerging markets from an export-led growth model to one focused on domestic spending. Favorable demographics underlie this opportunity, as the labor force in EM is expected to grow by over 10% through 2020 (vs. 3.8% in developed markets)<sup>1</sup> and consumption growth in EM is expected to grow by 150% through 2025 (vs. 30% for developed markets), to over \$30 trillion<sup>2</sup>. ECON tracks the Dow Jones Emerging Markets Consumer Titans 30 Index, which includes factors of market capitalization, revenue and profitability to determine the 30 companies in the consumer goods and consumer services industries that we believe will most benefit from this opportunity.

We find that most of the investors in our funds (including ECON) have a long-term focus, so it does not make sense for us to comment on tactical investor interests. We believe that ECON is a strategy for growth-oriented and diversification-



minded investors who believe that higher wages in the emerging markets should lead to greater consumption at the local level in the emerging markets.

In addition to ECON, EGA's India Consumer ETF (INCO) has done quite well as it appears India will go through a period of reforms that will likely help grow their economy. GDP growth is an important factor that we would expect would lead to higher wages and more consumption.

*Dan Weiskopf: How frequently do you review these factors and potentially re-allocate or tweak the portfolio?*

Robert Holderith: Our portfolios generally undergo quarterly rebalancing and then annual reconstitutions, where the factors/rules for that specific strategy are "re-run" and the portfolio constituents change as determined by the factors/rules. Because our factors are selected from an investment thesis, we usually do not revisit our factors. Should our investment thesis change, we may then consider redefining the factors used. This has not occurred in ECON.

Dan Weiskopf: Thank you Bob for your innovative thinking and being a pioneer back in 2008 when others may have been hiding under the desk.

#### **Footnotes**

<sup>1</sup>UNCTAD data as of October 2014.

<sup>2</sup>McKinsey & Company, "Winning the \$30 trillion decathlon", August 2012.

#### **Disclosures**

Dan Weiskopf is a portfolio manager of Access ETF Solutions LLC, whose third-party ETF strategies are offered through IPI Wealth Management, Inc. (IPI). IPI is an SEC-registered investment adviser, with its principal office located at 226 W. Eldorado St., Decatur, IL 62522, 217-425-6340. Access ETF Solutions LLC was established in 2013 with a focus that structure matters in selecting ETFs. Access ETF Solutions LLC is not affiliated with IPI.

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