Sensible Investments

A resource for debunking the investments myths peddled by the financial press and Wall Street hype and presenting rational,sensible investing approaches based on sound research and academic findings. This blog is maintained by Lawrence Weinman MBA an independent Registered Investment Advisor www.lweinmanadvisor1.com

Monday, February 11, 2019

Passive Crushes Active...But HopeSprings Eternal

I have written before about the report by S+P which consistently shows the performance of actively managed funds to fail to beat their relevant indices.

A similar report is produced by Morningstar and shows similarly that performance of active funds is inferior to passive funds. The longer the time frame for evaluation with a sample that includes by definition only funds that survive shows particularly poor performance. Since the study includes all passive funds --many of which carry higher fees than the ETFs in the same categories --one would expect performance of the funds vs.ETFs would show even worse performance for the active funds.

This report compares passive funds to their actively managed peers in the same asset class.

Among the key findings:

In 2018 only 36% of active funds outperformed passive...down from 46% in 2017.
Over 10 years that number drops to only 24%,

Across all the equity sectors studied only two showed outperformance for active funds over 10 Years. Emerging markets (54.5%) and foreign small mid blend (70.6%). The latter category likely included a limited number of passive funds. Among domestic stock funds the "best" record was for US Small Cap Value at 33.3%. outperformance vs passive over 10 years/ US Large Cap Blend --the category where the most money is invested and the largest number of funds --showed only 10.9%.

In sum. the evidence shows that investors are far better off with passive rather than active funds particularly when measured against the most important benchmark-- long term performance.

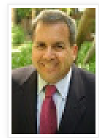
But hope for active funds springs eternal. The WSJ reports on the growth of actively managed ETFS
moving active management to a new wrapper.

Market Turbulence Spurs Demand for Fledgling Active ETFs

Passive funds still dominate industry, but a flurry of interest in active segment hints investors' perceptions are shifting

....ETF managers who handpick stocks and bonds drew a record $27.5 billion in new investor cash last year, while inflows into index-tracking ETFs slowed for the first time since 2013, according to Morningstar. So-called strategic beta funds, a hybrid between active and passive management, likewise had a banner year, garnering $74 billion.

About Me



Lawrence Weinman

Lawrence Weinman is an independent fee only investment advisor with over 20 years experience in the financial markets, (www.lweinmanadvisor.com). In his client practice he makes use solely of index instruments including those of Dimensional Fund Advisors. His portfolios incorporate the findings of Nobel Prize winning research. He definitley does not follow the Wall Street mantra of endlessly jumping from one "hot" stock or mutual fund to another. Mr. Weinman also specializes in investment advice for dual US/Israeli citizens and is available to meet with them in Israel. The statements and opinions expressed are solely those of Lawrence Weinman and not necessarily those of the Investment Advisor Alliance. This site, nor any information contained herein is to be considered investment advice or a solicitation of sales or services of Mr. Weinman or the Investment Advisor Alliance Any performance results are unaudited and PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. Please consider investments and their purposes carefully and you are encouraged to contact a financial professional prior to making investment decisions.

Favorite Investing Books

- The Quants
- Fault Lines
- Liar's Poker
- When Genius Failed
- The Economist Guide to Investment Strategy
- Irrational Exuberance
- The Misbehavior of Markets

These funds may have lower management fees than active funds but still higher than passive ETFS. They carry their own complications.Since they must disclose their holdings each day they run the risk of making public their strategies and holdings thus reducing what is seen as their comparative advantage. Funds run the risk of traders and others taking advantage of this information for short term profits.Additionally it is quite possible that these funds will run into the complication encountered with closed end mutual funds and to a lesser extent with passive ETFS; The fund and may trade at a premium or a discount to the actual holdings in the fund, It would be difficult for the market makers to consistently be able to deliver a portfolio matching fund holdings that unlike a passive fund would frequently, Several fund companies are petitioning the SEC to have active etfs without daily disclosure,

Judging by the record of actively managed mutual funds including last year's volatile markets it would be hard to give much credence to the claims expressed in the article :

But the rise of ETFs has also coincided with a decade long bull market that has left most stock pickers in the dust. Less than one quarter of U.S. active funds beat their index-tracking peers in the past decade, according to Morningstar. Investors fled.

Now the prospect of more turbulent markets has investors reconsidering their commitment to plain-vanilla indexing, Mr. Rosenbluth said. Active ETFs are especially appealing because, while more expensive than passive ETFs, they can be significantly cheaper than actively managed mutual funds, he added.

The logic here is puzzling 2017 markets (in which investors pulled money from equity ETFs was volatile and active funds performed poorly

In what can only be seen as a case of hope springs eternal the article notes:

Now the prospect of more turbulent markets has investors reconsidering their commitment to plain-vanilla indexing,

As can be seen by the Morningstar report particularly the long term data which include periods of low and high volatility it seems unlikely investors switching to active management in ETFs will fare any better than active mutual fund investors.

Posted by Lawrence Weinman at 2:13 PM 2 comments:

Thursday, February 7, 2019

A Cautionary Tale About Investing "Geniuses"

This wsj video report on Bil Gross who just announced his resignation from investment management gives a good brief summary of his career and a cautionary tale for investors looking to a "genius investor" to "go anywhere" particularly in the bond part of their allocation.

Well before his departure from PIMCO (which he cofounded) and his dismal final act at Janus Henderson I voiced hesitations with the use of Gross' Total Return Bond Fund as a core bond holding (which was how it was marketed, and the fund was often the only or one of only a few bond fund choices in 401k plans) despite its admirable performance for most of Gross' tenure.

Message *

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The reason was the lack of transparency in the fund. The mandate for the fund let Gross go anywhere in fixed income, making large bets on developments in the bond market across the globe frequently making use of options and futures and even delving into equity derivatives. Gross rode the huge bond market rally as interest rates reached historic lows (see below price moves inversely to yield) it no doubt gave him a tailwind to his returns . His track record faded just as the Federal Reserve was ending its era of zirp (zero interest rate policy).As assets in the fund left in response to poor performance Gross left Pimco in amidst a messy breakup.

At Janus Henderson he managed an Unconstrained bond fund which as the title suggests let him take big bets across markets including significant positions outside the stock market, The fund failed to deliver

> *His unconstrained fund lagged the aggregate bond index by 1.6 percentage points a year from October 2014 through January, despite that Gross took more risk relative to the broad bond market than he had as a total return manager (a standard deviation of 3.5 percent for the unconstrained fund compared with 2.8 percent for the index).*

One commentatorr had an interesting view on Gross's strategy in the last round of his career: that he had the right idea but just bad results...wrong for the right reasons" I couldn't disagree more.

Bill Gross Misfired at Janus. But He Had the Right Idea.

Active managers need to make risky wagers, even if they could go bust.

As I've said repeatedly about stock pickers, investors no longer need a bond manager to tinker around the edges of the bond market. There's a growing number of low-cost index funds that mimic total return bond funds by delivering modestly more credit risk than the broad market with similar average maturity. Many of those index funds are relative newcomers, so they don't yet have a long performance history. But there's no reason to believe they wouldn't perform at least as well as total return bond funds, particularly given their lower cost.

To the extent that investors need a bond manager, it's to make the kind of unconstrained calls that Gross made at Janus Henderson, knowing full well that those calls could be a bust just as easily as a boon. You can't get that from an index.

I would agree to a limited extent bond investors no longer need an active fund manager that strays little from the overall bond market. But they hardly need to allocate the bond portion of their portfolio _- which should be the most stable part of their portfolio- to a non transparent hedge fund type vehicle which could be anything from Treasury bonds to bets on the spread between Turkish and German Government bonds.

Investors are far better off allocating their bond investments across ETFs which are transparent as to the maturity, credit rating and geography of their bond investments. They don't need an active bond fund manager either with a conservative mandate of an "unconstrained" strategy.

Betting on manager skill in a hedge fund type vehicle is no more likely to be a road to investing success than in equities. As the headline implies he could go bust...not a pretty outcome...even more so for the part of an asset allocation which is to be the more stable: the bond side.

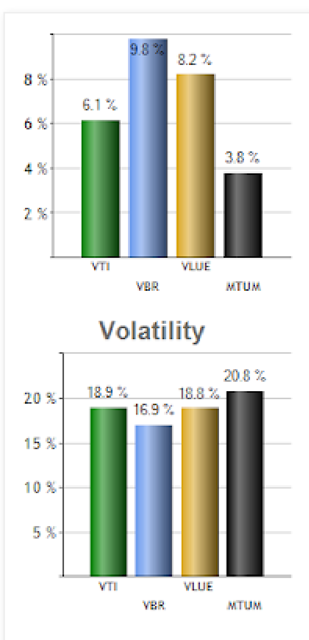
Posted by Lawrence Weinman at 7:48 AM 1 comment:

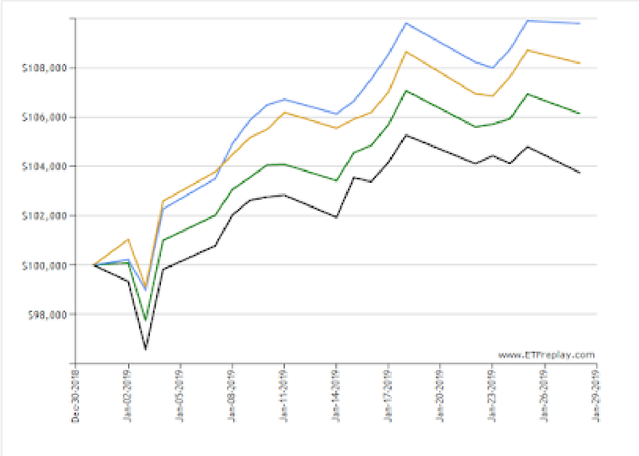
Tuesday, January 29, 2019

A Good Start to 2019 for Value Investors

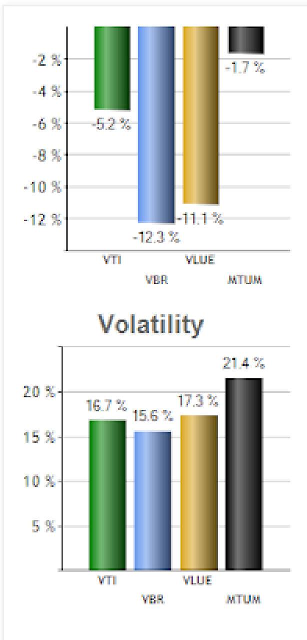
Value investors had a hard time in 2018 watching their holdings fall much more than the overall US market: Value and small value have strongly outperformed the overall US market and the momentum factor ETF thus far in 2019.

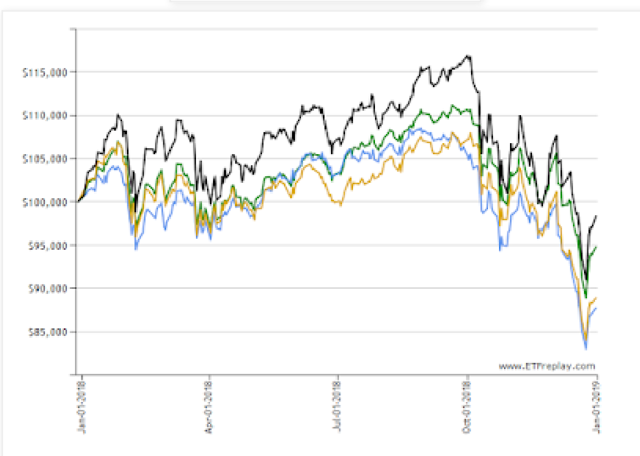
2019 ytd (Momentum in black,value in gold, small value in blue, total US market in green)
Performance top volatility bottom in bar chart.





This is in sharp contrast to 2018 where value stocks had larger losses than the total market or momenetum.





Posted by Lawrence Weinman at 4:46 AM 1 comment:

Tuesday, January 15, 2019

Update on High Yield Bonds

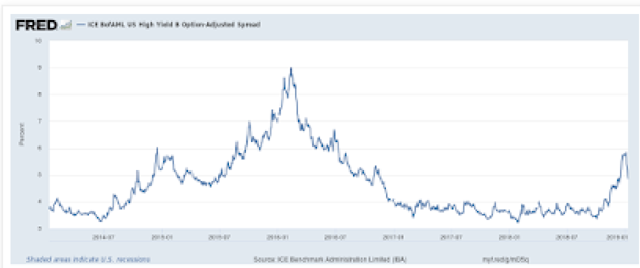
Along with the stock market the high yield bond market has had a strong rally since the turn of the year. The secondary market and ETFs had strong performance as did the market for new issues

as the wsj reported:

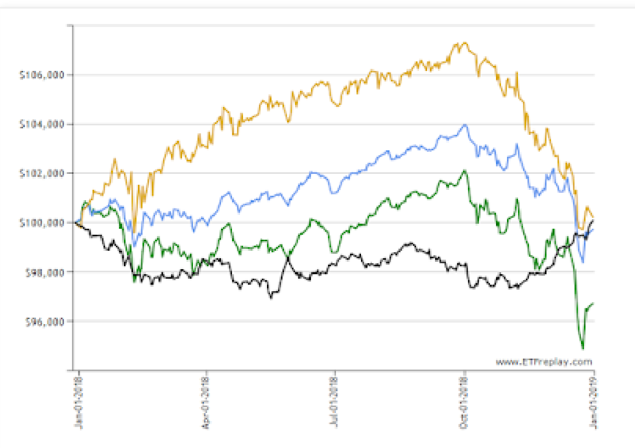
A long freeze in the junk bond market thawed Thursday as midstream energy company Targa Resources Partners LP became the first business to sell below-investment-grade bonds since November.

Targa, which has credit ratings at the upper end of the speculative-grade spectrum, sold $1.5 billion of eight and 10-year bonds, twice the amount initially expected. In another sign of a strengthening corporate debt market, investment-grade Anheuser-Busch InBev SAalso sold $15.5 billion of bonds Thursday, the largest since October, as the beer giant moved to repay existing debt.

The high yield spread over Treasuries has dropped sharply from 5.35 on Jan 2 to 4.83 jan 8



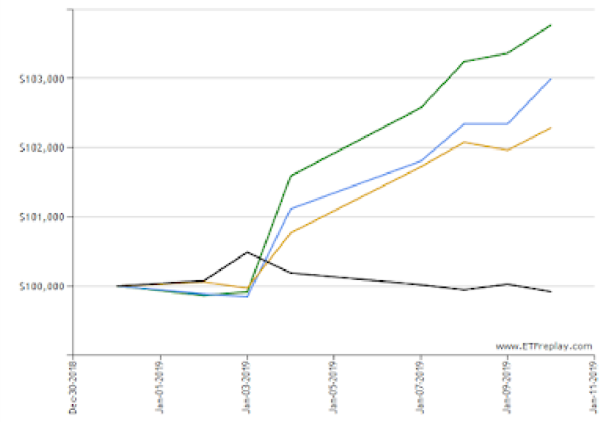
And after experiencing a terrible 2018, underperforming the aggregate bond market (AGG) in 2018...



High Yiekd ETFa 2018 JNK

2018 returns
JNK (intermediate term high yield) -3.3%
SJNK (short term high yield in blue) -.3%
HYLD(short term high yield in gold)+.2%
AGG (aggregate bond market in blue)+ .1%

...2019 has started out strongly for high yield bond ETFs



HIgh Yield Bonds YTD as of Jan 8
JNK +3.5%
SJNK+2.3%
HYLD+2.0%
AGG 0

Posted by Lawrence Weinman at 1:13 PM 1 comment:

Opportunity in Asian Emerging Markets ?

WSJ notes

Better Value Than U.S. Stocks: Asian Shares Hit Fire-Sale Valuations

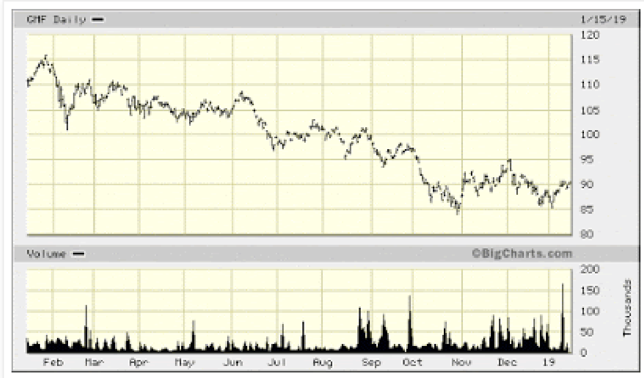
Regional stock valuations are at their lowest levels in years

Compared with forecast earnings, regional share valuations are at their lowest levels in about five years, according to a FactSet index covering thousands of Asia-Pacific stocks. They trade at about 12 times expected earnings for the next 12 months, while FactSet shows U.S. stocks trade at about 15.5 times, roughly in line with their 10-year average.

Set against free cash flow, the stocks look even better value. On that basis, Asian equities are at their cheapest levels in more than a decade, below even lows hit at the depths of the financial crisis.

Despite a dismal 2018 (GMF emerging markets ETF -14.2 vs-4.6 for SP 500) emerging market Asian stocks outperformed the US in the fourth quarter (-6.4% vs -13.8% for sp 500) and are up 2.0% ytd (3% sp 500).

GMF is very sensitive to short term news reports related to China's domestic economy and US Chinese trade relations. For long term investors these can be considered "noise" and declines in response to news may turn out to be excellent entry points for long term investors.

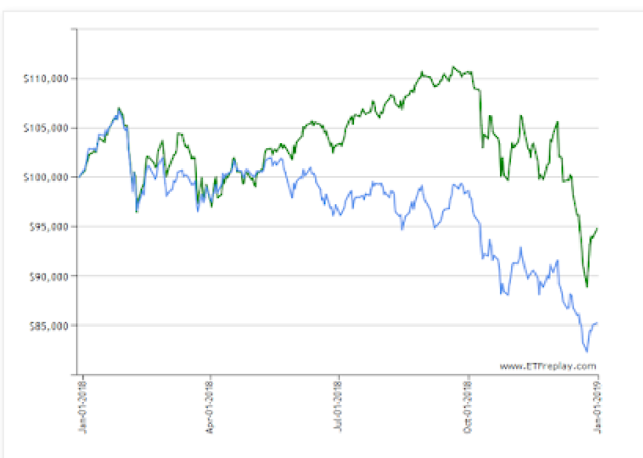


Posted by Lawrence Weinman at 1:12 PM 1 comment:

Tuesday, January 8, 2019

2018 Market Review

US stock markets ended the year with sharp declines and extreme intra and inter day volatility during the fourth quarter. The US market ended the year with its worst performance since 2008. Perspective is in order, however, the decline in 2008 was 36% for the total US stock market (total return) vs -5.2% for 2018. Although the US underperformed non US markets in the fourth quarter it far outperformed those markets for the entire year.
Below is total return for total US stock market ETF (VTI green) and world ex North America (VEA blue) for 2018:



The list of reasons for the decline includes the following:

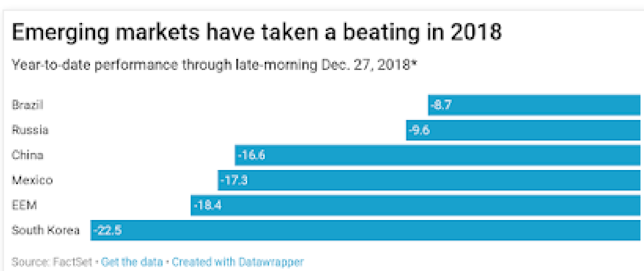
- Fears of a “trade war” between the US and China with negative impact for US exporters and the overall US economy and for that of China the worlds second largest economy. Economic data from China already show a significant slowing of economic activity.
- Slow growth from Europe due to the continued complications of Brexit and tensions related to Italy as well as fallout from protectionist US trade policy.
- Governance issues related to US domestic politics currently evidenced by the US government slowdown.

- Fears that the US is headed towards slower growth, if not a recession. while the Federal Reserve remains committed to continuing a tightening policy for the near term future.
- Regulatory and other issues related to the future earnings prospects of the stocks that dominated during the market rally (the "faang stocks of Facebook, Amazon, Apple, Netflix and Google)

US Stock Market
The US market fell 14.2% in the fourth quarter closing the year down (total return for the total US stock market index), Market movements were extremely volatile no doubt related to the large portion of each day's trading which is based on computer generated trades such as algorithmic trades or index instruments of varying types. The technology leaders took the hardest fall in the fourth quarter but their strong performance during the earlier part of the year meant that the tech heavy Nasdaq index lost only .1% for 2018 and XLK the technology ETF was +.1%,
Similarly, despite the sharp retreat of momentum stocks in the fourth quarter they still outperformed value stocks for the year (see table below) among smart beta factor ETFS. The minimum volatility ETF showed itself to live up to expectations and outperformed other factors in the volatile down market.
US Stocks

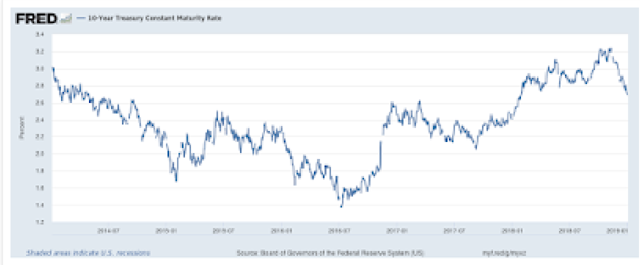
	Total Return (%)			
		4q	2018	3 yr
Vti	total us	-14.2	-5.2	27.4
Mtum	momentum	-15.4	-1.7	39.6
Usmv	minimum volatility	-7.6	1.4	31.3
Vlue	value	-16.8	-11.1	23.2
Qual	quality	-14.6	-5.7	23.8
Vbr	small value	-17.5	-12.3	20.6

Non US Stock Market
Emerging and Developed international markets had dismal performance throughout 2018 although they managed to outperform the US in the fourth quarter.
In the case of emerging markets there is evidence of an economic slowdown most notably in China due to the difficulties connected with implementing China's domestic growth strategy, overextension of credit and difficulties related to trade tensions with the US Other emerging markets were affected by the trade tensions as well.



Europe continued to be plagued by slow growth and was also affected by trade tensions with the US. Germany (etf ewg) was the worst performing market in Europe reflecting both the weakness in the local market and the weakness of the Euro. The lack of resolution of how Brexit will proceed weighed on the British pound and the UK stock market and its impact was felt in other European markets as well.

US Bond Market
The US market went through extreme volatility with the Federal Reserve continuing a policy of raising interest rates yet the bond market showing pessimism towards prospects for future economic growth. The Federal Reserve raised rates in December, the fourth increase for 2018 and indicated intention to continue rate hikes in 2019, The Fed policy is based on a positive outlook for the US economy and a desire to proactively move against any incipient inflation.
For bond market participants the "message of the market" is far more pessimistic with regards to the US economy. After starting the year with a 10 year bond yield of 2.48% taking the interest rate on the ten year treasury bond over 3.2% in October and November reflecting positive expectations for the US economy and therefore higher rates. The market reversed its outlook towards the end of the year. The ten year treasury bond ended the year at 2.69% , an extremely low rate in an environment of the Fed raising rates. .



Other indicators of the message of the bond market which show an outlook for slower US growth, low inflation, and low interest rates can be seen in the market for inflation protected treasury bonds ,the narrow spread between short term and long term interest rates, and futures contracts on the federal funds (overnight) interest rate. The fall in longer term yields (increase in prices) meant a recovery in the aggregate US bond index (AGG) which ended the year +.1% and the long term Treasury ETF (TLT) +.5%.
Another reflection of a pessimistic view for the US economy was the widening of spreads between high yield bonds and investment grade bonds during the fourth quarter with high yield bond prices declining along with the US stock market. The most widely traded high yield ETF HYG fell 4.4 % in the fourth quarter

Looking Forward
Looking at the list of factors that generated the market decline at the end of 2018 they all continue to hang over the market. Resolution of trade issues with China would give some support to the stock markets in both the US and abroad. The negative profit outlook now built into the US market may be overdone which would mean the now lower valuations for US stocks may leave room for price increases from current depressed levels. The current P/E for the S+P 500 is a bit under 19 vs. close to 25 at the beginning of 2018 Sentiment seems almost uniformly pessimistic: usually a buying opportunity for disciplined long term investors. Non US markets are very low valuation levels from a valuation perspective emerging markets are likely the most attractive current p/e is 10.5 vs 13.2 in January of 2018.
Federal Reserve policy will be a focus of the stock market participants. Currently the stock market sees Fed policy as a negative with the central bank in a tightening mode based on their optimistic view of the economy. The long period of near zero interest rates was a major factor giving a boost to the US stock market the end of that policy as well as the unwinding of the bond purchases in quantitative easing presents a negative towards the US market.
The Federal Reserve indicates that its policy is “data dependent” so that any indications of an economic slowdown will likely mean an end to the tightening policy and perhaps even interest rate cuts later in 2019. Should the Fed’s optimism on the economy prove correct rate hikes are likely to continue but it would mean that the stock markets view for the economy was overly pessimistic.
One thing that seems near certain is that volatility will be high in both the stock and bond markets as can be expected at market inflection points. Structural changes in the marketplace with activity dominated by algorithmic traders and index instruments exacerbate volatility. But the bottom line for investors is that market timing is impossible and the best strategy for long term equity investors is to stick with their long term plans, acknowledge that part of the price for higher long term returns for stocks vs.bonds and cash is higher volatility and periods with short term losses.

	Total Return (%)			
	US Stocks			
		4q	2018	3 yr
vti	total us	-14.2	-5.2	27.4
mtum	Momentum	-15.4	-1.7	39.6
usmv	minimum volatility	-7.6	1.4	31.3
vlue	Value	-16.8	-11.1	23.2
qual	Quality	-14.6	-5.7	23.8
vbr	small value	-17.5	-12.3	20.6
Non US Stocks				
veu	world ex us	-11.5	-14.2	12.6
gmf	emerging asia	-7.8	-14.2	25.8
fez	euro zone	-12.7	-15.8	3.1
ewg	Germany	-14.8	-21.4	0.5
US Bonds				
vgsh	short term us govt	1.4	1.6	2.8

vcsh	short term inv grade	0.7	0.9	6
bsv	short term blend	1.4	1.3	4
flot	floating rate	-0.4	1.5	4.8
tlt	long term us treas	4.6	-1.5	9.1
agg	aggregate us bond	1.9	0.1	6.4
hyld	short term high yield	-6.4	0.2	29.9
sjnk	short term high yield	-3.9	-0.3	19.9
hyg	high yield	-4.4	-2	18

Posted by Lawrence Weinman at 12:47 PM 1 comment: