MUTUAL FUNDS AND ETFS

Why Frontier Utilizes Mutual Funds & ETFs

Frontier has a long history of managing global allocation portfolios, and has provided clients with consistent added value attributable to the use of mutual funds in our portfolios.

Mutual Funds, ETFs, separate accounts, wrap accounts, and partnerships are all vehicles to gain access to portfolios of securities. There are no inherent performance advantages to any of these vehicles, other than differences in fees, trading costs and liquidity.

The following points highlight why, for clients with assets under $20 million, Frontier implements investment strategies using mutual funds and ETFs.

Access to the Best Managers

We know that some investment managers are better than others and better than indexes, and sometimes this performance advantage is significant. When we build portfolios, we simply want access to the very best managers that we can find. Some of the managers that we determine to be superior only manage mutual funds. Others manage mutual funds and institutional separate accounts, but often they do not manage lower minimum SMAs (Separately Managed Accounts). ETFs provide highly efficient access to indexes, but for now this is an extremely limited universe when it comes to available active managers.

Choice

The mutual fund universe is comprised of over 7,000 distinct mutual funds, representing almost any investment strategy available. Neither the ETF universe nor the separate account universe offers this variety of strategies.

Minimum Investments

Mutual funds and ETFs offer investors access to portfolio management with a low minimum investment. There are also over 3,000 institutional mutual funds with minimum investments over $1 million. Oftentimes we have access to these funds as well for our clients. The separate account vehicles of the managers that we select often have $5 million minimum investments and some have minimums over $50 million per account.

Liquidity

Mutual funds and ETFs are highly liquid, allowing us to purchase and sell entire portfolios of securities in one trade. When investing in separate accounts, the client owns the individual securities and it often involves over 50 trades to buy or sell a portfolio, which takes time and incurs transaction costs. Furthermore, to adjust a portfolio of multiple separate accounts (for example, if a client deposited or withdrew assets, needed to rebalance, or wanted to change allocations) could require hundreds of trades.

Clarity of Track Record

Not all track records are created the same. Mutual fund and ETF track records are the true track records of the portfolio. Frontier utilizes highly quantitative processes which require transparent, clean and representative track records as a data input in the selection of managers and in managing portfolios.

Expenses

There are over 6,000 mutual funds available with expense ratios below 0.70%. If expenses were the only consideration, this is a significant number of actively managed and index funds to choose from. Of course, ETFs are indexes and are inexpensive as well. However, there is often no inherent expense advantage when comparing equivalent portfolios or indexes of mutual funds and ETFs. For example, the Vanguard 500 Index Admiral mutual fund's expense ratio is 5 bps and the Vanguard 500 Index ETF is also 5 bps in expenses. Similarly for active managers, PIMCO offers both an ETF and mutual fund vehicle of their Total Return strategy and both have an expense ratio of approximately 50bps. It is important to compare like investments when evaluating expenses.

Taxes

Mutual funds and ETFs are great vehicles for tax managed portfolios. Due to the liquidity and wide variety of mutual funds available, tax loss harvesting is simple and effective. By trading one mutual fund position in a portfolio at a loss and replacing it with a similar fund, a client can harvest a significant loss. With a separate account portfolio tax trading usually occurs one security at a time, often resulting in little tax benefit to the overall portfolio. Furthermore, many separate accounts require the client or advisor to initiate the tax trading, which is frequently not actually done.

Mutual fund managers know how to manage taxes and often consider taxes in the management of their portfolios. Mutual funds that are growing assets can actually be more tax efficient than ETFs, as asset inflows spread gains across a wider base of clients. Furthermore, after poor markets mutual funds can have embedded losses, which can enable a fund to grow without paying capital gains. ETFs, on the other hand, have an additional tax benefit because they seldom pay out capital gains distributions.

Priority

Portfolio managers are teams of people executing processes to select and manage portfolios of securities. These management teams may offer mutual fund and separate account vehicles for their portfolios. Often the mutual fund is the largest portfolio for a management team and may receive the most attention.

Conclusion

We maintain a vehicle neutral perspective; we simply use the vehicle that works best for our clients. Through our innovative process and professional experience, we find that mutual funds and ETFs have great advantages as vehicles to better achieve the investment goals of our clients.

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