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Rising Rates Playbook

Arden Rodgers, CFA, founded Arbus Capital Management in 2008

A Different

View on Alpha

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By Hung Tran

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Rodgers, a former executive in the high-tech industry, opened his doors in 2008 because he saw a need for independent, unbiased advice and wanted to match his newfound financial acumen with ETFs for his clients.

The former tech executive turned fee-based advisor, who currently manages $36 million in institutional and retail assets, recently spoke to ETF Report's staff writer Hung Tran about his take on alpha and why he thinks the Pimco Enhanced Maturity Strategy Fund (MINT) is a "funny investment."

Advisor Quick View	
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FOUNDED	2008
LOCATION	New York
AUM	$36 Million
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THERE SHOULD BE MORE TRANSPARENCY IN THE INVESTMENT MANAGEMENT INDUSTRY

What was the basis for forming your own advisory practice?

I believe there should be more transparency in the investment management industry. Clients should understand what fees they're being charged both by the advisor and by the investment product. They should also understand how their investment products work. ETFs, for the most part, provide the needed transparency in terms of fees and underlying investments, so they work well in my practice.

I find investors are often in investments that are not transparent and may or may not be appropriate for them. Many times I've asked prospective clients why they're in a certain investment, and they would respond that their broker thought it was a good idea, but that they don't quite understand it themselves.

There was a case where a client was in a complex managed futures fund and there was no particular reason why. It wasn't a great fit for the sophistication of the client or their overall portfolio. I'm working on moving them into an alternative investment that will also act as a diversifier, but will be simpler and cheaper, such as a commodity fund.

Also, a lot of times I see annuities in a client's portfolio and there isn't a compelling reason why they should have them, either from a life-insurance or a tax perspective. So depending on surrender charges and the client's goals and objectives, I may move them into ETF investments to save them investment fees.

Describe your history with ETFs and some of the products you've used since 2008 based on market conditions.

I purchased the SPDR S&P 500 ETF (SPY | A-98) for my own account back in 2000, so I've been an ETF investor for a long time. I use ETFs for most of my clients' investments, and right now I have about 67 percent of my clients' assets in ETFs. I'm a strategic, long-term investor and build broadly diversified portfolios. The thing I'm looking for in an ETF is to fill the right role in a client's portfolio, whether it be income, growth, diversification or hedging. I'm not a tactical or day trader, so I don't change my investment strategy based on yesterday's news.

For clients, 2008 was difficult because of the markets bottoming out. Back then, it was about sticking to the investment course and rebalancing as needed. In the current environment, I'm concerned about tapering and rising interest rates like most advisors, so I'm looking at shortening duration on my fixed-income investments.

Since 2008, some of the products I've used haven't changed, such as the Vanguard Total Stock Market ETF (VTI | A-100) and SPY. Other funds have come on line since 2008, such as the Vanguard Total International Bond ETF (BNDX). I'm constantly looking at new issues to see if there are any improvements over current products. I also have the same type of investments for myself as for my clients, but every client is different, so their portfolios are customized based on their needs.

How are you looking to shorten your duration in fixed income?

I primarily use index-based, passive ETFs; however, I do invest in the Pimco Enhanced Maturity Strategy Fund (MINT | A), which is an actively managed fund. I use it as a cross between a short-term bond fund and a money market fund. It's a funny investment for me because typically, when you think of actively managed funds, you're trying to exploit inefficiencies in smaller or less liquid markets. Yet the short-term bond market is very liquid, and Pimco does a good job of balancing liquidity, risk and yield.

ONE OF THE THINGS I'VE BEEN LOOKING AT IS CURRENCY-HEDGED BOND AND EQUITY FUNDS

Your take on generating outsize market returns is different from other advisors'. Can you talk us through how you view alpha?

I don't try to beat the market by generating investment alpha. Rather, I believe in two other kinds of alpha: tax alpha and rebalancing alpha.

One reason I like ETFs is because of their tax efficiency. Back during the 2008 crash, you had mutual funds that went down in value, but investors were still getting hit with capital gains distributions because of the way the redemption mechanism works in mutual funds. ETFs, for the most part, avoid unwanted capital gains distributions.

I try to be very tax efficient in my investing. One client I was advising had a very concentrated position in a handful of stocks. Some of them were up quite a bit and some of them were down. We were able to liquidate that position without a tax hit by carefully netting the gains and losses. When moving to ETFs, I review a client's overall portfolio and try to not incur capital gains taxes unless there's a good reason to do so.

Rebalancing forces you to sell your winners and buy your losers, which over time adds to your total return. I use market rallies as an opportunity to rebalance and take some profits off the table. Retail clients typically want to stay with their winners for an overly long time and don't want to buy into losers.

What advice are you giving your clients in a higher-interest-rate environment?

A few years ago, investors were more concerned about the dollar weakening. Now, investors are more concerned about rising interest rates and a stronger dollar. One of the things I've been looking at is currency-hedged bond and equity funds such as the WisdomTree Japan Hedged Equity ETF (DXJ | B-45).

I'm seeing that the Federal Reserve is pushing investors out on the risk curve. Investors who used to be able to generate income from their savings accounts, CDs and bonds are now looking at junk bonds, senior loans and MLPs. I've expressed to clients to not take on risks that they don't understand, especially if they're not prepared to deal with the downside consequences.

I try to play the counterweight to my clients because they're starting to get excited about the market rally we've had this year. When the Dow hit 16,000, my clients became much more interested in their portfolios' performance than they were a year ago. They're confident things will continue, but research studies out there show that, in general, retail investors are always late to the party. So a lot of retail investors may have missed the big run-up in the last year.

What's your take on gold?

Gold is down about 25 percent year-to-date, but I still think it has a role as a diversifier. It's got some head winds because of the strengthening dollar, but it's a good diversifier and, compared to the record market, it's currently cheap. I'm not selling out of gold by any means because I think it still has a role in investors' portfolios. I'm currently in the iShares Gold Trust (IAU | A-99) because I don't trade a lot, so you save little bit on the expense ratio compared to the SPDR Gold Trust (GLD | A-100). ●

Photo by Irene Park