
DISCUSSING GLOBAL ETF PORTFOLIO BUILDING AND INSTITUTIONAL RESEARCH

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On last week's show, we had the pleasure of speaking to John Davi, founder and CIO of Astoria Portfolio Advisors, a new ETF model manager, and Pankaj Patel, head of quantitative research at Cirrus Research, who focuses on, among other things, how ETFs and fund flows impact the market.

Building Global Portfolios

Davi has been in the ETF and investment industry for many years—most recently at Morgan Stanley on the institutional ETF desk as well as the equity derivatives research team at Merrill Lynch. He left his institutional strategy role at Morgan Stanley to launch a firm that builds low-cost wealth management solutions focused on ETFs. Davi believes his institutional background gives him a unique tool set in constructing portfolios.

- On the show, we talked about how Davi utilizes [macroeconomic](#) models and cross-asset risk indicators with the goal of providing better risk-adjusted returns across varying economic cycles. Davi's goal is to find the cheap asset classes where the market will come to realize the asset's potential.
- Davi tries to blend [active](#) and [passive](#) characteristics and is not just buying the lowest-cost ETF. He brought up the example of the [S&P SmallCap 600 Index](#) compared to the [Russell 2000 Index](#) and how the simple quality screen employed by S&P—companies must be profitable for a year before they enter the Index—has led to significant outperformance versus the Russell 2000 over the last two decades.
- Davi believes 2017 embodies a cyclical recovery that will continue: The shift to global ex-U.S. leadership is intact, and his portfolio has been positioned toward emerging markets all year in both equities and currencies. He sees the Federal Reserve remaining very accommodative, and there will still be support from global central banks.
 - Specifically, Davi thinks India looks attractive in the emerging markets. There is also Japan, which he sees as a broader play on global economic growth, but that comes with a market selling at a 20% discount to the U.S. on a [forward price-to-earnings](#) basis, while earnings growth looks robust with the Bank of Japan still supportive.
- Davi sees news around President Trump as noise and the bigger story being the change in leadership to move toward foreign companies and small-cap foreign companies.
- Davi discussed using game theory for positioning/sentiment. He believes one key differentiator for his approach is the utilization of positioning and sentiment indicators to determine whether there's a mispricing in the market compared to what we think will happen.

- In this regard, Davi cites concern about [secular stagnation](#) in the post-credit crisis period. People piled into bond [yield](#) trades given that growth was perceived to be low. But what we had after the credit crisis was one of the greatest equity [bull markets](#) ever, and people were largely absent from it. There has been nearly \$1.5 trillion in inflows into bonds since 2007 versus negative \$75 million into U.S. equities. The flows, even in 2017, are dominated by [fixed income](#), which makes Davi think gains can continue for longer.

Institutional Research

In our conversation with Patel, we talked about the quantitative research his firm produces. Cirrus Research focuses on equity research for institutions—producing unique style and sector models that supplement the research of firms across the [large-](#), [mid-](#) and [small-capitalization](#) universes. Cirrus tries to make calls on sectors, looking for under- and overvalued markets across the globe.

- Patel has a risk-appetite model looking for market opportunities and a polarization index that looks for valuations. Patel's model does not say [valuations](#) are as high as the previous market bubble.
- We had an interesting conversation around ETF flows and what they indicate. John Davi broke into that conversation by saying that during times of distress, the [high-yield](#) bond market ETF trading volume picked up as market participants preferred to execute trades—the counter to the prevailing narrative that the high-yield ETF could be a source of risk in next big high-yield crisis.
- Patel talked about how ETFs are starting to own large percentages of individual stocks in the range of 20% of shares for large-cap stocks and sometimes more. The positive side of this says stocks might have more [liquidity](#), but on the negative side, the stocks may become more volatile. Patel also thinks ETFs are driving up valuations on stocks due to the one-way nature of flows into passive ETFs.
- We talked about [dividend](#) investing and the Cirrus Research model for high yield, combined with [payout ratios](#) and dividend growth. We also talked about the trend toward [buybacks](#) and why companies are trying to manage to given payout ratios.
- Patel talked about hedged strategies and when shorting strategies work. When market participants are focusing on valuations, [short positions](#) can work. But right now the market environment is less concerned with valuations in the market, so short positions are hard to work today.

It was a fairly interesting conversation with Davi and Patel, and you can listen to the full discussion [here](#).

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DEFINITIONS

Macro : Focused on issues impacting the overall economic landscape as opposed to those only impacting individual companies.

Active : Funds that attempt to outperform the market by selecting securities a portfolio manager believe to be the best.

Passive : Indexes that take a rules-based approach with regular rebalancing schedules that are not changed due to market conditions.

S&P SmallCap 600 Index : Market capitalization-weighted measure of the performance of small cap equities within the United States, with constituents required to demonstrate profitability prior to gaining initial inclusion.

Russell 2000 Index : Measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

Forward P/E ratio : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

Secular stagnation : A long term and sustained slow-down in economic growth.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

Bullish : a position that benefits when asset prices rise.

Fixed income : An investment security that provides a return in the form of fixed periodic payments and the eventual return of principal at maturity.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Mid-Cap : Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Small caps : new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securities.

Liquidity : The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets.

Dividend : A portion of corporate profits paid out to shareholders.

Payout ratio : The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Short (or Short Position) : The sale of a borrowed security, commodity or currency with the expectation that the asset will fall in value, the opposite of Long (or Long Position).