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### **Vanguard Adding Active ETFs?**

On Friday, March 7, Vanguard filed for "exemptive relief" with the Securities and Exchange Commission (SEC), asking for permission to offer exchange-traded fund (ETF) share classes of the firm's actively-managed open-end mutual funds. If the SEC approves, it would clear the way for Vanguard to enter the growing active ETF market. Whether or not the firm does so any time soon is a question mark.

While active ETFs remain a very small piece of the \$1.3 trillion ETF industry, their numbers and assets have grown since their advent in 2008 to include 80-plus funds and about \$15.1 billion under management (just over 1% of the overall ETF market), according to Morningstar. Most popular in the fixed-income space, there are also equity and alternative active ETFs, as well as a handful that focus on asset allocation, commodities, currencies and real estate.

The path to active ETFs for a number of fund firms has some obstacles. Perhaps the biggest stumbling block might be the level of disclosure. As SEC rules stand, active ETFs are required to reveal their holdings on a daily basis.

In the index arena, this is not a big deal, as the holdings of indexes are known to the marketplace—ETFs that track the same benchmark will perform very similarly (with the differences generally coming down to what expenses each charges), because they own the same stocks in the same proportions.

But (ideally) active management isn't about closely tracking an index and owning everything it does. A manager is pulling the strings, making investment decisions based on research, methodology and professional experience. Having those choices disclosed on a daily basis means that anyone who wants to can go to the ETF's website and duplicate the portfolio—using a manager's expertise without paying her fee. (Note that due to the nature of how fixed-income securities are traded, this is less of an issue for active bond ETFs, part of the reason they account for nearly 40% of all active ETFs.) You can see why this has been a disincentive for managers and fund firms to date.

Vanguard has stated as much. In a March 7 comment to *Barron's*, a spokesperson said that the firm has no plans to introduce active ETFs so long as fund managers feel that revealing fund holdings on a daily basis could impact performance or how they run the fund.

Our feeling is that Vanguard won't rush into the active ETF market. The firm just wants to open the door, but won't step through until ready—or when the desire for market share forces its hand. Fidelity and T. Rowe Price, among other mutual fund firms, have also filed for active ETFs. (For our past coverage of Fidelity's planned active ETFs, please [click here](#) or [here](#).) Meanwhile, bond giant PIMCO's offerings have gathered \$7.9 billion in assets since 2009 (not a large sum when it comes to the overall ETF or mutual fund markets, but it represents more than half of the active ETF markets' assets).

While active ETFs may play a bigger role in the future of the mutual fund industry one day, for now they are bit players, and Vanguard is content to wait off stage.

### **Vanguard Fires Manager**

With very little fanfare, Vanguard fired sub-adviser Armstrong Shaw from its Windsor II fund and handed the 4% of assets the firm handled to co-managers Hotchkis & Wiley. While Vanguard spun the move as being about placing more trust in Hotchkis & Wiley, which now runs about 11% of the fund, it seems like the motivation behind the change had more to do with Armstrong Shaw not performing up to expectations than anything else. The change reduces Windsor II's sub-adviser count from six to five, but in our view, that's still too many cooks in the kitchen.

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