ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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Fidelity Gets Serious about ETFs

Earlier this month, Fidelity filed with the SEC for permission to introduce an actively managed fixed-income exchange-traded fund, which would represent only its second ETF product and the first to come to market since 2003. Around the same time, the fund giant hired former iShares and Russell ETF product chief Greg Friedman to its growing exchange-traded fund team.

The new ETF will likely be named Fidelity Corporate Bond ETF, and it should be similar to Fidelity's Corporate Bond fund, which launched in May 2010 and offers targeted exposure to the corporate fixed-income universe. We'd speculate that the corporate bond sector was chosen as the vehicle for Fidelity's first foray back into the ETF market in a decade due to the firm's confidence in its bond group's fundamental, research-driven security selection. It will also put Fidelity in competition with PIMCO in the active ETF market, which, with $11.6 billion in assets, is just a tiny slice of the overall $1.4 trillion, index-dominated ETF universe.

The recent moves have made it a question of when, not if, we'll see more Fidelity-brand ETFs appear. By all indications, the firm is intent on considerably expanding its business, and has been recruiting industry veterans like Friedman for its team.

Fidelity is very late to the ETF game and the firm will have its work cut out for it if it wants to compete with more established ETF providers like BlackRock and Vanguard. However, the fact that Fidelity is launching its second effort with an active offering may help it distinguish itself from competitors and gain some market share. We'll keep you posted on any notable developments.

Vanguard to Add Emerging Markets Bond Fund

In our last update, we covered Vanguard's plan to finally introduce an international bond fund (and ETF): Total International Bond Index. That fund was originally announced back in 2011, along with a planned emerging markets bond index offering—both were delayed by well over a year, and the emerging markets fund seemed forgotten. But this week, Vanguard revealed that it was going forward with plans to bring Emerging Markets Government Bond Index to market in both open end fund and ETF shares sometime in the second quarter of 2013 (read our initial coverage by clicking here).

The fund will track the Barclays USD Emerging Markets Government RIC Capped Index, which attempts to remove currency risk by investing only in issues denominated in the U.S. dollar. Like its Total International Bond Index cousin, it will also limit the size of individual securities to meet regulated investment company (RIC) diversification standards.

Vanguard is planning to offer Investor, Admiral, Institutional and ETF shares of Emerging Markets Government Bond Index. The non-ETF share classes will be subject to a front-end load (or purchase fee) of 0.75% and the two lower-minimum share classes will have operating expenses of 0.50% (Investor class, which has a $3,000 minimum) and 0.35% (Admiral, $10,000 minimum). The ETF shares, which will be exempt from the front-end load and have no minimum cost of entry other than the share price, will also charge 0.35% in expenses, likely making it the most popular means of access for most investors.

Emerging-market bonds have gained prominence over the last few years, as compelling total returns and higher yields relative to domestic offerings have proven attractive to fixed-income investors searching for alternatives to the low yields found on more traditional domestic fixed-income options. Of course, this boost in yield and potential return comes with added risks, and not all fixed-income investors will have the tolerance for an investment in this area.

That said, this is one of the more interesting funds Vanguard has cooked up in recent years, and we plan to track it carefully when it opens to investors.

Fidelity Closing Small Cap Value Fund

Similar to the move it made in closing its Small Cap Discovery fund at the end of January (read more about it by clicking here), Fidelity recently announced plans to close the Small Cap Value fund on March 1.

Small Cap Value shares more than just a small-cap focus with Small Cap Discovery—Chuck Myers is a manager on both funds. As with the earlier closing, the story here is about limiting cash in-flows and the fund's overall size ($3.7 billion at the end of February) to allow Myers and his co-manager Derek Janssen to stay competitive in the small-cap value space.

Myers oversees nearly $9 billion between the two funds (including Small Cap Value's multiple share classes), and over the last three years, total assets have swelled by $6.5 billion (with nearly half of that growth taking place in since the beginning of 2012), a more than 260% increase. To remain nimble in the small-cap space, where market capitalization is limited and size can become a constraint on a given stock's impact on a portfolio, fund assets need to be kept far more in check than in the mid-cap or large-cap arena, hence Fidelity's preventative closing of the two funds.

While the move may be disappointing for investors locked out of Small Cap Value, it's the right one on Fidelity's part to protect the interests of current shareholders (who are the only ones who will be able to purchase new shares after the deadline).