ETF Exchange Podcast

Episode 29 Rough Transcript

Announcer: Hello and welcome to the Fidelity ETF Exchange, powered by Fidelity Connects, a Fidelity Investments Canada podcast, connecting you to the world of investing and helping you stay ahead.

On today's episode, host Etienne Joncas-Bouchard is excited to welcome his special guest Eric Balchunas, senior ETF analyst for Bloomberg Intelligence, for a deep dive into some of the most notable trends in the ETF Industry, Canada and U.S. alike.

As a Bloomberg analyst, podcaster and author, Eric shares a bit about what his typical day and week is like. Etienne and Eric also have an engaging discussion on the markets and the ETF industry, getting into new products, flows, how the traditional 60/40 portfolio has changed, bond markets, crypto, and more.

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Étienne Joncas Bouchard: Hello everyone and welcome to the Fidelity ETF Exchange. I'm your host, Étienne Joncas Bouchard, a.k.a. EJB. I am extremely excited about today's episode as we are joined by a very special guest. And for those of you that are into FinTwit like myself, you probably know this individual quite well for some of you might be a little bit newer. We'll have the chance to get to know the guest a lot better, hear his thoughts on various topics in the ETF industry, but before we proceed with introductions and formal introductions, I just want to remind everyone that previous episodes are available at www.fidelity.ca. or on your favorite podcast app, Apple, Spotify or whatever it may be.

Just a quick recap of our last episode, to maybe pique interest for a few people. We did an industry recap for the first quarter of 2022, myself and my colleague Himesh Patel, who's also our co-host for the podcast. We talked about subjects such as flows, various factor performances, ongoing difficulties for the fixed income space, as well as some key trends to look out for on a go-forward basis. And you know, a few of those were the growth in Multi-asset ETFs as well as thematic/industry-focused ETFs.

Without further ado, I'd like to welcome our guests, one of the ETF industry's most respected and knowledgeable individuals, Eric Balchunas. Eric is a senior ETF analyst for Bloomberg Intelligence. In this role, he writes research articles and feature stories about ETFs for Bloomberg. He also appears in a weekly on-air segment for Bloomberg TV called Exchange-Traded Friday. Furthermore, Eric is the author of two books, The Institutional ETF Toolbox and the freshly printed book, The Bogle Effect, which I just received my very own copy, which I'll probably be digging into as I head on vacation for the weekend.

Eric, welcome to the show. Thank you so much for taking the time to be with us today. We're very glad to have you.

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Eric Balchunas: Thank you for having me. And thank you for that kind introduction. It's funny that that bio there's one little thing that is new, is that instead of the weekly segment called Exchange -Traded Friday it's now a show, it's a half an hour long called ETF IQ, which is good. It shows ETFs moving up in the world from a segment to a show.

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Étienne Joncas Bouchard: That's awesome. That's great stuff.

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Eric Balchunas: Only a half an hour a week, but we'll take what we can get.

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Étienne Joncas Bouchard: Hey, that's a lot better than a lot of other 3 minutes places. Yeah, that's amazing. Eric the idea today: explore some of the key topics and themes that are important to you are top of mind for you, I should say, as much as we can and say this limited 30-minute capsule type podcast. But before we get started, maybe for people who are a bit less familiar with yourself, what does a day in the life of Eric Balchunas look like as a senior ETF analyst for Bloomberg?

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Eric Balchunas: Yeah. I guess a typical day if I'm in research mode would be to wake up. I usually work from home, especially since the pandemic, sometimes I find I have the best creative energy in the morning and then in the afternoon I sort of maybe do more busy work. So I'll look at flows. I'll just tool around the terminal looking for what's going on. I might tweet a couple of things out, see if there's any reaction, look for inspiration where I can find it. If I don't have anything planned, I'm sort of like just looking around and feeling out for what I need to give my take on for that day or the next day. If I have something planned, I just bang it out. I end up writing five notes. I get the charts prepared. That might take like 2 hours, 3 hours. And then I'll enter in some client, like, notes where like we talk to clients and we sort of enter a note in or I have a client meeting or I do a media like this. I'll do a podcast now and then, and I think, and then also try to promote my stuff in various ways. And, that's basically it.

Now that said, every Monday I'm in New York City for a TV show and a podcast and a bunch of media stuff. So I think my week is almost a better way to look at it. I sponge in the data like a sponge and I accumulate some research and some hot takes. And on Monday, I just squeeze the sponge out. Basically tell the world everything I'm thinking. And then I go back into the research cave and then, I don't know, once or twice a month I travel. So that's essentially my job because what I'm graded on as a performer at Bloomberg is how many bits do I produce, how much readership do I get, and how am I branding? And so those are the three things I try to divide my week into, and that's pretty much it. So, I just look at myself as somebody who's doing those things and trying to be seen as a voice or an expert on this topic.

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Étienne Joncas Bouchard: That's great. And you know, another thing that I think anyways, that I that I've noticed is, is the participation of interacting with important people in the ETF industry in general and whether that be like you said going out and meeting clients or at conferences, podcast, whatever it may be, you've had the opportunity to interview some of the more not say senior but say impactful voices in the ETF industry.

Is there anything recent that you've done that's stuck out to you, whether that's ... I think you were part of the Miami ETF exchange. Is there anything that's that stuck out recently where you said like, "Wow, that was an interesting bit?"

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Eric Balchunas: That's a good one. Sometimes it all just blends together. I've been doing this so long. I will say, like every now and then, we just have somebody on that's at the right time or ahead of the curve. Like, I for some reason, I'm going further back in history. But as you mentioned, I have this book out, so I've been talking about it recently, and it's a book on Jack Bogle, Vanguard founder, who had a obviously a huge influence on portfolios and the industry. We had an ETF IQ episode with him and Cathie Wood. This is like four years ago and that is like so cool, right? Those are like two ships passing in the night, obviously polar opposite in how they view things. But that's what I love about the ETF industry is the big-tent-ness of it. Even though I love covering Vanguard and I think that's interesting, exciting in its own way, I like covering this sort of more fun stuff in the high-octane stuff, and the leverage stuff. So that stands out.

Another one that stands out is, I don't know if you guys remember XIV. That was the inverse volatility ETP that kind of blew up. We had the maker of that on two weeks before it blew up, and I remember on that show, I have to give 90 seconds on the ETF before ... it's called the Drill Down. And I went back and I watched it and I was so happy that I had actually given really fair warning that this thing can go down in a hurry. And so that one sticks out, too.

But I think more recently we've done some stuff on crypto. We've had Reggie Brown on, who's an amazing market maker, to talk about how the sausage is made, the ETF world. So, those older ones always stick out my memory. It's been a little bit of a blur this year, to be honest, because I've been doing so many things. I'm not sure if that's a satisfying...

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Étienne Joncas Bouchard: No, but that is a perfect answer. And I think, like you mentioned with Jack Bogle and Cathie Wood, like that is completely two different trains of thought, almost, of the way to approach markets. Like, of course, having the same people in the same room and talking to them, that must have been quite fun.

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Eric Balchunas: What's funny. but what I didn't realize at the time and I have realized over time and the conclusion I come to in the book and in our research notes, is that Cathie Wood and the staying power of Ark is ironically a byproduct of what Bogle and Vanguard in Indexing did. Because the more indexing is used in the core of the portfolio, cheap beta, the more people search for something completely different to decorate on top of it.

And this really, I think, helped Cathie and I think it's helped thematic investing and I think it's helped crypto because people now want lottery ticket type active because they've already got the bread and butter stocks covered, they already got it covered. So whether it's Apple or Amazon earnings, I don't think it's as important to them. I think we have a whole theme coming out that we're trying to distill it down to that active share is the new alpha. So Alpha used to be the Holy Grail. You wanted an active manager who could deliver Alpha. And like at Fidelity, you have some great managers that do that and they're still used, I think, especially among institutional investors.

But I have found that among advisors in retail, I think if they have a low-cost index fund in the core, that isn't as appealing because then you're doubling up on some stocks you already own. What they are looking for is some of those things like a Cathie Wood. And that's why I think the flows are more sticky than people think. They have much more stomach for volatility because it's just a small slice of the portfolio. So over time, I kind of realized that those two are interlocked in a way.

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Étienne Joncas Bouchard: That's really interesting. Okay, so there's a lot to unpack in that comment there because from a growth perspective in terms of just number of launches that we've seen say over the past two years in the ETF space. There's just only so much that's been new index type strategies, like a lot of it is coming from these more focused, active, high-active share products, very niche, product-centric. That's a function of what you're describing in reality is that there is demand for these kind of like satellite positions that are very, very different from those core exposures. And I feel like at first it was kind of like those sector, industry-type. Now you're getting even more focused stuff, right?

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Eric Balchunas: Yeah. And a lot of it is narrative driven and tries to capture the imagination of investors and we call all of it the shiny object lane. These are ETFs built to shine. When their number comes up, they usually pop and they double or triple the market, whereas back in the day used to be the big fund manager, they can give me 2, 3% over the S&P, some excess return. Yet at the same time delivering me largely beta. So what happens is that kind of got replaced with beta for three basis points and now they're looking to get that active speculative return with these funds. And that's why if you look at the last three years or so, active equity mutual funds have seen something like, I want to say almost 2 trillion in outflows, but a lot of that goes to passive.

But the thematic ETFs have taken in 100 billion in that time. That's a pretty good chunk of change considering that ... I would open for smart beta it was more of a big thing back like ten years ago but smart beta still does pretty well, like value ETFs have taken in 100 billion over the last year and a half. So smart beta and thematic and ESG, all of this is what we call new active. This is the way that active has evolved over the years. And in my book, I point out that I think the rise of indexing, mainly driven by Vanguard and Bogle, has forced active to evolve. And I think there's many ways that it's doing it. I also think direct indexing is sort of another really interesting way that that active is evolving. But it's okay.

I mean, I think as Matt Hogan said in a panel we did on this topic, an exchange which was in Miami like two weeks ago, passive is making active better. It's making it be more active, serve up more interesting things. And I think that's it's pretty good. And then the overall cost of your portfolio is still much lower than it was. So I think investors are sort of like trying to have their cake and eat it, too. The only thing I will say is that active share does not equal alpha and risk does not equal return. And so that's been bothering, I think, some of the legacy CFA studied people out there with Cathie, they're like, how on earth is this what people want? This isn't how I was taught. This isn't what Alpha is about. I'm trying to explain to them that I'm not saying it's right, right or wrong. I'm just saying this is what's happening and it kind of makes sense.

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Étienne Joncas Bouchard: Yeah, this is where the demand is coming. At the end of the day, whether you are you're in agreeance with the way that that impacts portfolio management is irrelevant to a certain extent from an industry standpoint.

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Eric Balchunas: Yes. Because there's just a practical use case for really high active share, even fund investments. And I actually think there's an actual behavioral purpose for this as well. I'm not sure people use it for this reason, but if you have, say, 80, 90% in a cheap core, 60/40 -type portfolio, then the way to maximize that return is to wait a long time and let it compound. And I think that takes a lot of patience. It's boring.

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Étienne Joncas Bouchard: Nobody wants to wait a long time.

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Eric Balchunas: Yeah, but if you can distract yourself with some of the fund stuff and the stuff that could give you 10x return, maybe like lottery ticket style, that may be a way to follow the market. Maybe you do some options or some single stock picking. I think that's actually a pretty decent behavioral purpose because if that stops you from touching the 60/40 that takes 30 years to grow, well then maybe there's a real use case on that, because we've all learned over the years that even if you get low cost, even if you get your costs down in your funds, if you can't behave well, it doesn't matter. Behavior will destroy everything. So there's a decent argument for that behavioral hack. But it's interesting. You know, Fidelity has evolved very well. You guys have a metaverse ETF now. You have the sectors. I think you launched a … you have a fund that's ARK-ish, I think, in terms of being high growth tech

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Étienne Joncas Bouchard: This is a fund managed by … I think the one you're referring to is managed by Mark Schmehl, who has been one of our … anyways here in Canada, it's called the Global Innovators Fund. It's a manager that likes to go on the tails, as he says. So, he rotated from that say COVID 19, what worked like the high-growth, stay at home-type stuff into now was looking at like where earnings growth is and the cyclicals and lots of commodity plays in the portfolio. So, it's very interesting strategy. That is one fund that has garnered a lot of flows because if you look at, say, discretionary advisor who has a core, that's something they can't do. And that's kind of the idea also with a lot of these like you said say shiny object ETFs. Well, you can't replicate what some of these managers do. So, I agree. There are some mandates, whether that's on the ETF or the fund side that tend to correlate a bit more or be more beta. But there are definitely active managers as much on the fund side as the ETF side, where you're seeing this very high turnover, very high conviction and get that active share. And those have been some of our more successful strategies over the past couple of years. So, to your point is basically that applies to the fund space as well.

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Eric Balchunas: Yeah, we say you cannot index Cathie [indechiperable/ and this looks like you can't index this manager]. So because we have a lot of professional investors as clients, so we sometimes try to point them out, like think about going where the indexes are because even like the value, like the Russell 1000 value, which is a value trade, the price of that has been whittled down to five basis points too. So I think that's what Cathie found the lane that wasn't really taken by anything indexed and she was early there. And that I think helps explain the growth. I think this is what probably will benefit private equity down the road, too. I think people are really going to search for private equity for some of that 10%, 15% as well, although that's not quite been democratized the way other things have. But I think that's coming.

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Étienne Joncas Bouchard: And that's an interesting point. It actually brings me to another topic that I wanted to discuss, because in my conversations anyways with advisors over the past couple of years, there's been this appetite for fixed-income alternatives, knowing that eventually we're going to get this rising-rate environment and that those long-duration aggregate indices would come under fire. There's like no, no way around it. There's no security selection sector, sector allocation changes. Pretty much every sector in the fixed-income space is down this year. And I think from a tweet of yours, like 98% of or above, let's say above 90% of fixed-income ETFs are negative to start the year. Well, a lot of advisors have been looking towards alternative investments as a way to hedge out some of that duration, if you will. How do you see that space evolving? That seems like there's one place where active management has done quite well. Like beating that benchmark, say, over the past 24 months, say the U.S. AG hasn't been too hard. Right. How do you see that space?

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Eric Balchunas: Yeah. So it's complicated. First of all, all the bond ETFs are down and why wouldn't they be? The Fed is serious about raising rates finally, because they care more about inflation. Well, I got used to them folding like a lawn chair every time the market had a stomach ache. They were like, all right, all right, we're not going to do this. And the market would then rip again. And so they had this pattern of like just backing off and but they haven't this time because they think inflation is a bigger boogeyman than the market going down now. Anyway.

So obviously, if rates go up, all the bonds held by these funds are worthless because you could get better bonds at the new rate. So it's just logical that there would be this sort of creative destruction period in bonds. And it's really bad. I mean, everything's down. And the problem for active fixed income and I'm looking at like a PIMCO fund, which seems to be outperforming the AG a little. It's down 6.4% versus 8%. I'm sure there's Fidelity funds in the same boat. The problem, though, is just that they're down. We found that even if you beat the AG, but you're down, the outflows start to come. I think people just get bugged out. There's a lot of older, maybe boomer types in fixed-income mutual funds and they're like, Look, I can't risk this. I got to pull out. So I think the money in these bond mutual funds is probably pretty vulnerable.

Now, the managers are really smart. They might be able to navigate this, but it is a tricky.. it's almost is it Homer's The Odyssey where they're in between the rocks in the waterfall or something. But it's almost like try to navigate between some really treacherous terrain. And I don't know if they can pull off a positive return by the end of the year, it will be an active management feat. I'm a little skeptical only because if you have constant outflows from fixed-income mutual funds … and they're not they're not seriously bad, but they're steady … basically every week about 10 billion comes out that these funds have to sell the bonds, which then just has a suppression, suppressing the byproduct, and the bonds go down and their return then isn't able to get positive. So more people pull out, which creates more suppression.

And it's a slow-moving downward spiral and I'm not sure how it reverses, but that's something we're watching for sure. We think this is potentially a big deal. And bond managers have largely escaped the move to passive bond. Active bond funds have done very well with flows, whereas the stock pickers have been pretty beat up and have been bleeding a lot in the past ten years. So, it will be interesting to see how bond managers get through this year. It doesn't look good right now, but who knows? You know, we'll see.

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Étienne Joncas Bouchard: No, absolutely.

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Eric Balchunas: But alternatives, to your point on alternatives, if 60 and 40 is consistently down, it will spark a, I think, a renaissance in alternative 60 things.

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Étienne Joncas Bouchard: 60/30/10 is new 60/40 or something like that.

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Eric Balchunas: Things that use derivatives. They're more liberal here in the U.S., especially if you can sculpt outcomes with options, maybe some hedge fund strategies, anything that can sort of provide some diversification benefit to the 60/40 going down, I think could start to get some looks. I still think it's just a little early. People are so used to the dip, to the market coming back. I think it could take like eight or nine months, even a year before the alt space starts to get real looks

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Étienne Joncas Bouchard: Interesting. Interesting. And what's also I think quite fascinating is that a lot of the negative returns so far this year, just on the rate side, like spreads haven't widened really, right? And if we go back to like March 2020, one of the big issues with fixed income in general is that there was no bid for a lot of the corporate bonds. And re-ratings happened a little bit, but not too much. And if you look at, say, for example, the U.S. investment grade corporate index, more than 50% is in Triple Bs. Like, is that also something that you're seeing you're looking at active management.

You can try to mitigate a bit of that. Once again, if you're holding that index, is that something that could come under pressure? At the end of the day, there's not too much you can really do about it. It's a function of what's being issued in the market. I know we saw this morning that just GDP undershoot in the U.S. Is that's going to spark a little bit of spread in some bonds? Is there going to be a little bit less bids? The rate side is kind of the clear picture, I think, whereas like you said, a more hawkish Fed. But what about the credit side?

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Eric Balchunas: Oddly enough, HYG is a little positive today. It's you know, it's up two basis points, but it's not down. You know, tough to say. Bonds are a very complex asset class and I don't pretend to know a ton about them. I generally understand that duration and credit risk are the two biggies, and you have to navigate those, which is why I also think advisors still I guess prefer active is because I feel like they view bonds as chess, whereas stocks are like checkers. Like yeah, checkers are no problem, nobody knows that much over there. But the bond space, there's this extra dimension of time and you got the Fed and convexity and all this stuff and they're like, You know what?

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Étienne Joncas Bouchard: And trading, it's just not as easy as trading.

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Eric Balchunas: That's true. And there's more of them. There's like there's so many bonds, I think there's like a million or something in the markets. Well, I'm don't know it's bigger any more, but at one point, it was bigger in the stock market. I bet they're both around 50, 60 trillion, but bond market's massive. And so, I think I get it. But yeah, this is something where looks like it's really about rates. That's the big fear, is that if this starts to hit the economy, that's when the credit risk probably becomes a concern. But the GDP number could add to that. And this is where things could get scary and this is where the Fed is going to be like probably would have to pull back system on this hard-core mission they're on.

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Étienne Joncas Bouchard: I was going to say you were mentioning the Fed and saying how every time there was a little bit of a scare, they back off. Right. Like, is this going to happen again?

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Eric Balchunas: The problem with this, the reason that they have a spine all of a sudden is because of politics, in my opinion, because inflation is a bigger deal to people than even their 401k plans now, because inflation, everybody deals with it, especially the mass of people who aren't really wealthy. And so the Biden administration and the midterms are coming up. I'm sure they're like crapping their pants because inflation. You will lose an election because of that, because the gas prices and all this historically known. So that is going to trump whether your PIMCO fund or your Fidelity fund is down a little bit. I think there is a point where it might not. And it just depends on how much the Fed's fighting of inflation

hurts the economy and that that point where that tradeoff happens, I would leave that to a smarter economist than me. But I just think that's where the spine ... because they never had this kind of like endurance. The markets would spaz out and they would completely alleviate the situation by saying some word or two that just sounded dovish and it was like, All right, cool, party's back on.

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Étienne Joncas Bouchard: We're/bets off the table.

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Eric Balchunas: Almost like we're the cops come to the house and it's like, we're good. And then they close the door, you're like, we're still good. Yeah, no, but they're serious this time. And I think this is what people have to deal with and why the bond market is a mess.

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Étienne Joncas Bouchard: Interesting. Interesting. Good stuff. Earlier you mentioned when you were talking about some of those satellite kind of complementary positions. You mentioned crypto and one of the kind of ongoing situations, I don't know how you characterize it, but the fact that Canada has spot crypto and a lot of other geography, pretty much every other geography I think in the world other than the U.S. has gone forward with the approbation of having spot crypto ETFs. Why hasn't the U.S. moved that route yet and only been on futures based?

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Eric Balchunas: Yeah, it's complicated. But the basic thing is that Gary Gensler is the SEC head and the SEC in general I think it's just been a little bugged out about crypto exchanges and manipulation and hacking and all this. They see it as the Wild West. They're afraid of a headline that says how could the SEC have allowed investors into this crazy asset class by approving an ETF, which essentially is saying, like, it's ready for mainstream America? So, they're worried about that potential awful public relations.

But more lately, I think we've seen other countries launch them and they're fine. And I think crypto has been more adopted. So it's now morphed. I think it's just really Gary Gensler's brain and motivations and I think ... this is my opinion, again, I'm an analyst ... I believe he wants to show his superiors, meaning the president, that he was able to get crypto into a regulatory framework as SEC chair. Checking a nice box potentially for promotion or just because he likes to do a good job. And that's what he thinks the superiors want. And the only way to do that is to hold the ETF hostage for a while.

So, there's a proposal they put out, which we think is how they're going to do this. The proposal wants to expand the definition of the word "exchange". And so if it does that, I won't go to the details, it basically means the SEC would all of a sudden, just like that, have oversight of crypto exchanges. Once that happens and they feel like it's within Gary's arena and world, then a spot ETF would be inevitable because that's why Gary was fine approving the futures ETF because it was under the CFTC and SEC regulatory arena. It was inside that arena. The exchanges were out of that wall. But if you expand the walls to include the exchanges, then the spot ETF then exist within that wall. And I think that's what will need to happen. We think that will take 14, 15 months though, because the government moves slow. But that's our view right now. But it is up for shifting if we get new information.

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Étienne Joncas Bouchard: Hey, I mean, I don't think many Canadian asset managers are complaining right now.

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Eric Balchunas: I know it works fine.

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Étienne Joncas Bouchard: It's helping to attract a bit of foreign flows, so... but I thought it was just an interesting one because I feel like there's demand for that from as much the retail as the advisor channel, right?

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Eric Balchunas: Of course, the advisors have $26 trillion here and they don't want to go to the exchanges. They don't like separately managed accounts. They just want to buy the ETF and they don't like the futures one, because the real costs are by 10 to 15% a year, which is a lot. And GBTC trades at a constant discount and you don't know where the price is not near the NAB. And it's they don't want that either. But some actually hold their nose and buy BITO or GBTC just to do something or they pay a lot of money for an SMA.

But the spot ETF would be perfect, fits into their brains, their plumbing. They're used to it, they're comfortable with it. So we think it would basically unleash a ton of money. And there'd be like, I don't know, probably 500 billion that would come in over the course of the first couple of years. Just because there's 26 trillion of advisors would start to allocate a small percentage, not all of them, but a lot of them. But all you need is a couple percentage of 26 trillion to be a lot of money.

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Étienne Joncas Bouchard: Point-two-five of a percent and like one, the equivalent of a rate hike of a percent.

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Eric Balchunas: Yeah. And I also think the trading crowd would like a spot ETF. I think there's a lot of retail investors who may choose to trade the spot ETF over using exchange because the commissions on the exchange are really high. The spot ETF would trade at one basis point, that would beat all of them easily. So spot ETF is the probably ... it's a lock for being a huge hit and I rarely say that sometimes I always say you never know which ETFs are good. That's the lock.

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Étienne Joncas Bouchard: That's a lock.

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Eric Balchunas: That's a lock.

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Étienne Joncas Bouchard: That's good. I like that.

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Eric Balchunas: So that's why all the insurers are filing all the time and just testing the wind a little bit with where the SEC is. Sometimes they file one and they get rejected. They file this one because if you're out first, it's a good sign. If ProShares was out with BITO only six, seven days before the second one, it has like 9% of the assets in volume. You guys in Canada had I think it was Purpose was out first.

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Étienne Joncas Bouchard: Yeah, I believe there was Purpose and then C.I. and we came into play a little bit later because we were ... So, Fidelity Clearing Canada is now a licensed custodian of Bitcoin and we're the only one in Canada. So we were making sure to launch it where we were kind of doing the back end and not really relying on a third party as being custodian. So yeah, we were a bit later but first mover advantage, we saw it here too, right?

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Eric Balchunas: Although over time it got better. Purpose might not even be the biggest one anymore, but it's like there's three of them sharing like 70% of the assets. Now it's a little more even than it was, although Purpose had a huge head start. If I'm wrong, I believe it was Purpose who was out in front. It was a while ago. But anyway, they had a good head start. But the good news about crypto is I think there's enough for everybody. I think whoever gets out first has a huge advantage. I think you guys are in good shape. I saw you launch an ETF in Europe that spots for 75 basis points. That's a compelling deal. And over the next decade, those fees are going to get compressed as bigger issuers come out.

So, we keep telling people in five years you're going to have a great offering of single crypto and a crypto basket spot for 30, 40 bips. It's going to trade at one penny spread, and it's going to be a beautiful thing and it's going to be a monster category. And so, we've just got to sort of wait till ... it's like instead of Waiting for Godot, it's waiting for Gensler.

[00:34:46]

Étienne Joncas Bouchard: One of the one of the key things I think maybe not hindering. It's already been a huge growth category. Let's not kid ourselves, but one thing that's maybe holding things back is from an advisor perspective: it's not that easy to incorporate to bring into that 60/40 fold. Like you, like we said earlier, as much from a regulatory standpoint, as much from a psychological standpoint where we mentioned earlier, let's say you have your core, it's passive or whatever it may be, it's more beta. And then you add in an asset class like this, it becomes the focal point of 90% of client conversations. Right? Because if it's up 60%, I want more. If it's down 60%, I want you to get rid of it. And that's something that we've observed. Then I think maybe as we move forward and I don't know if you agree with this, is that maybe like multi-crypto type portfolios are combining different stable coins together instead of single line item. Is that a potential growth space or is that just ... we're not even there yet?.

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Eric Balchunas: Yeah, well, a lot of companies have separately managed accounts that are essentially index funds of crypto. And that's how I would invest. Because I don't know which one's going to do better or worse. I'm not an expert. I would apply the indexing concept to crypto buy a basket and just own all of them. It's possible there could actually be a nice little renaissance for active here because if you're good at crypto picking, the outperformance could be incredible given how volatile that is. So I think we could see like an ARK, maybe not ARK but somebody like them being like the ARK of crypto picking, that could be a whole thing.

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Étienne Joncas Bouchard: Or the first to do active crypto and I'm sure that would, like you mentioned, create quite a bit of interest.

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Eric Balchunas: Yeah, because that's, again, it's a vanguard free zone. Indexes, it would take them a long time to get there and the volatility is ripe for major outperformance, which again is what people are looking for these days more than a little outperformance. So I think active … I've been telling our internal people here we really need to get on top of crypto even more because as stock picking active becomes a little more, I don't know what the word is, like it's getting replaced by index funds. Not completely, but to a degree. You know, NFTs, crypto, these other things, private equity are where active I think could serve a purpose because it's there's less information known. There's 50 analysts that cover Amazon. There's not that many crypto analysts, you know what I mean? So I think information out there is less … it's not as covered and there's more opportunity. And so, I think if you're serving active managers, having coverage of these areas makes a lot of sense. But certainly a crypto basket ETF trading at like at 25 basis points if they can get it down that low. And having a penny spread is the dream. That's the dream. That's the Holy Grail.

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Étienne Joncas Bouchard: Everybody has dreams.

[00:38:02]

Eric Balchunas: It's going to take a while, though, if you are somebody out there looking at ETFs and shopping for ETFs. You know, we have this thing called the intensity score. And I just think that whether it's ESG or smart beta, you need to know how intense it goes after what it says it's going to do. And anyway, I really think this is something investors just need to think about, because there's 150 value ETFs. Some are hard core and some are watered down.

It's like some have the alcohol percent content of like a German beer and some are like O'Douls and there are some in the middle like IPAs. And so, this is an important thing for ETF investing and I know you had expressed some interest in that. But I would just say that think about how intense an ETF is before you buy it. Look at the holdings, the number of holdings. Some people want the hot sauce and some people want the exact opposite. But this is something that's very important for people so they don't have a bad experience buying ETFs.

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Étienne Joncas Bouchard: To me, that intensity scores, what you're describing is super important because in our lineup that we have here in Canada, at Fidelity, is heavily tilted towards smart beta. And when we come across either competitive products or just other stuff out there, we have some tools internally that we can create this intensity score, this factor exposure or tilt. But a lot of products out there don't do their names justice, right? Like you can be called a value ETF, but not really have a big value tilt. It's kind of like knowing what you own, but also like a more quant nature, almost. Right? Is that kind of what you're …

[00:39:58]

Eric Balchunas: Yeah. And we don't judge. There are advisors out there that I guess they know their clients well that yes the client wants value or ESG. But I know them well enough that they don't like tracking error. So I'll buy the watered down one for like and usually the watered-down ones are cheaper, so at least you're getting beta fees for them. But

like the Russell 1000 value, it's not going to give you that much value. But there's ones that are more factor-oriented type managers who go hardcore, and those are the ones that have more value loading, but they're more volatile and they usually charge a little more. So you have to weigh all this. And I think it's just that also exists in ESG. It's a hot topic there, too, because there's this whole greenwashing concern that ESG ETFs own a bunch of stuff that like, what are you really even getting with ESG? So, these this idea of thinking of the intensity of an ETF and themes, some thematic ETFs like they come out so soon, they don't actually hold a lot of stocks that get a lot of the money from that theme. So you want to also know how much of a theme they're capturing. But these are some of the tools we're trying to build that if anybody's listening is interested, I'm happy to share you like a screenshot or if you've a ticker that interested in, we're happy to ... especially if you happen to have a terminal, well clearly I'll train you. I'll sit there for a half an hour and go over all this with you. But also happy to give away some for free if people are interested to learn more about our intensity scores.

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Étienne Joncas Bouchard: I'm sure you'll have a few takers on that offer, Eric. Actually, I might take up your offer for the full course on my terminal.

[00:41:35]

Eric Balchunas: Sure, if you have a terminal, looks as you get it, terminals aren't cheap and so you get whatever you want. If your client calls me and says, I want a half an hour training, I'll do it.

[00:41:44]

Étienne Joncas Bouchard: All right. I'm going to have to take you up on that offer. All right. Eric, thank you so much for doing this. Very appreciated. Hopefully we can do this again sometime in the future. And I'm sure we'll have a bunch of other subjects that are that new top-of-mind topics. So once again, just thank you for taking the time.

[00:42:04]

Eric Balchunas: Thank you for having me. It was a pleasure.

Speaker 1 [00:42:08]

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