

Cogent: ETF Use Growing In Risky Markets

By Alex Ulam and Olivier Ludwig | November 16, 2011

(Updated with information from Cogent executive.)

Investors are growing increasingly concerned about market volatility, and their advisors are turning more and more to ETFs to manage portfolio risks, according to a new study from Boston-based consultancy Cogent Research.

The study, commissioned by the money management firm Invesco, found that 59 percent of independent registered investment advisors (RIAs) say market volatility has made their clients more risk averse in the past 12 months. Indeed, many investors are shelving hopes for making alpha bets and are hunkering down getting defensive and trying to preserve capital—increasingly with ETFs, the study found.

In crafting portfolios tailor-made for minimizing risk, RIAs are increasingly blending active and passive investments. Specifically, the study found that RIAs indicated that ETFs will represent 22 percent of their client portfolios in the next year, and 30 percent by 2014—a 36 percent increase in ETF investments, Invesco said in a press release. Invesco is behind the Invesco PowerShares family of ETFs, but has no direct relation to Cogent.

"This new investment environment and the resulting change in investors' risk tolerance is prompting advisors to re-evaluate how they manage client assets and which methods are most effective in mitigating risk," said Andrew Scherer, a managing director at Invesco's RIA division.

The money management industry is clearly adopting ETFs more and more, attracted by their lower fees, tax advantages and, if Cogent's study is any indication, for their risk management attributes as well. [More than \\$100 billion in fresh assets had flowed into U.S.-listed ETFs through October](#), and total assets including market movements are up about 7 percent year-to-date to almost \$1.083 trillion.

The attractiveness of ETFs as risk-management tools turns to a great extent on how liquid they are compared to mutual funds.

For advisors looking at risk-management with a tactical rather than long-term strategic view, it's easier to quickly shift an asset-allocation scheme using ETFs, Tony Ferreira, a managing director at Cogent who had a hand in the risk-management research, told IndexUniverse.

ETF Blind Spot

That said, the study also found many still do not have a good understanding of the industry.

“Our research shows that our industry has a long way to go to educate RIAs on the pros and cons of ETFs in general,” Scherer said.

“Thirty-nine percent of RIAs say they don't have an above-average understanding of ETFs, and 53 percent say they don't have a high knowledge level of existing ETF products,” he added.

Part of the challenge is the ongoing proliferation of new ETF options. Indeed, hardly a week goes by when new funds aren't put into registration or brought to market.

To better educate RIAs, Invesco is designing a Risk University that will teach them about risk management, portfolio construction and managing client expectations. The new university will also be available online, and information about the program can be found at www.invesco.com/us.

Unsettling Markets

Invesco said Cogent found that 70 percent of RIAs cited market volatility as the top concern of their clients, with 99 percent of RIAs citing it among their clients' top three concerns.

By comparison, only 6 percent of RIAs said wealth accumulation was their clients' top concern.

Given their clients' current mindset, 45 percent of RIAs say managing risk is now their top priority in terms of portfolio construction, ahead of wealth preservation, at 24 percent; exceeding a performance benchmark, at 12 percent; and delivering absolute return, at 10 percent.

Cogent's Ferreira acknowledged that risk management and capital preservation might seem to be quite similar, but stressed that the difference between the two is that risk management is more tactical in nature, and implies quick portfolio changes based on some unexpected event that increases market volatility.

The Cogent study was based on a survey of 206 RIAs with an average of \$488 million in investable assets.