

Beverly Chandler

Hello, my name is Beverly Chandler and I welcome you to this outing of Off the Record, the podcast about all things ETF brought to you by ETF Express in partnership with asset managers and ETF issuers Harbor Capital Advisors. All views expressed in this podcast are the speakers own and we hope suitably controversial. In this outing for the ETF Express podcast, Off the Record, we're going to talk with Don Allen from Harbor Capital Advisors and Marcus Bellander from C WorldWide Asset Management. Don, if you'd like to take a minute now to introduce yourself first and then we'll go to Marcus.

Don Allen

Absolutely, Beverly. Thank you so much for having me. As you shared, my name is Don Allen. I'm with Harbor Capital Advisors, which is headquartered in Chicago. I am based out of Philadelphia, Pennsylvania and my responsibility at Harbor, I've been with the firm for a little over a year now, is managing relationships and representing Harbor's boutique partners like C WorldWide to wealth advisor clients in the Mid-Atlantic area.

Beverly Chandler

OK, Marcus, would you like to take a moment to introduce yourself?

Marcus Bellander

Yeah, sure, my pleasure. So I'm Marcus, I'm an analyst at C WorldWide. I've been with the firm for about two years, but I have been in equity research for almost 20 years, and my job here at the firm is to do fundamental analysis on stocks that we invest in and support our portfolio managers in the decisions they make.

Beverly Chandler

OK, we're going to advance to our first question. So Don, tell me more about the Harbor International Compounders ETF OSEA.

Don Allen

OSEA cleverly named O-S-E-A or the ticker OSEA for overseas investing. And before I get into, Harbor International Compounders and the ETF itself, I think it's important to just talk about Harbor and our firm and what we do. So our mission at Harbor is curating innovative active strategies from around the globe to inspire and empower people to invest better. And so, if you think about our firm, we have a 50 plus year history of manager research and due diligence to go out and find these really talented investment firms, from around the globe, C WorldWide being one of them. And, having spent a lot of time prior to joining Harbor at one of the largest asset management firms in the world, what I find really

compelling about Harbor's story is we kind of challenge the assumption that the best investment minds and strategies live inside of the walls of the largest US asset management firms, that tend to have a majority ownership of US wealth assets in this country. And so we think we're really good at finding these firms from around the globe, and we found one in C WorldWide, and Marcus knows this story better than I do, but a roughly \$20 billion equity boutique based out of Copenhagen. And what was really compelling to Harbor as a firm in forming a partnership with C WorldWide dates back to their founding in 1986 running high conviction equity portfolios and a high conviction non-US equity portfolio identifying those franchises that live outside of the US. And we have effectively taken that international equity strategy, and wrapped it in an ETF, OSEA, an active transparent ETF priced at 55 basis points, to make that strategy and C WorldWide's expertise available to wealth advisory clients in the United States.

Beverly Chandler

Thank you for that summary, Don. And then Marcus, perhaps you could tell me what does the Harbor International Compounders ETF invest in?

Marcus Bellander

Like Don suggested, it invests in stocks, and stocks only, and at no time does it have more than 30 holdings in it. We normally also don't have fewer than 28 or 29. We're basically always fully invested, so no cash sloshing around. The companies we invest in are typically large caps. We don't have any cut off or any threshold in terms of market capitalization, but as a point of reference, the smallest company or the company with the lowest market capitalization that we own is about 25 billion US dollars, so fairly large companies. And then as Don also alluded to, there are no US companies in this portfolio, but that is pretty much the only geographical restriction.

Beverly Chandler

And can you tell me a little bit about your firm C WorldWide Asset Management?

Marcus Bellander

Absolutely. We do equities and equities only. We've been around since 1986. We manage about 20 billion US dollars and we have 130 employees with an average tenure of 11 years. Our investment teams so the key decision makers, the portfolio managers and the analysts is about 25 persons and in fact the fun fact maybe the most senior employee of our firm, who is also a key decision maker for the ETF has been with the firm since 1989, so for about 35 years. So I guess in short you could say that we're stock nerds, and people tend to stick around here.

Beverly Chandler

And tell me, what do the stock nerds apply in this context of a ETF? Is it any different from anything else you do? How do you invest?

Marcus Bellander

How do we invest, yes. We have a soft spot for quality companies with the good growth prospects. And when I say quality companies, I mean companies with business models that can weather economic downturns can stand geopolitical swings and keep up with the technological revolutions or evolution. When it comes to the growth aspect, we do prefer companies that can grow for a long time, over companies that may grow very fast right here, right now. We like companies that benefit from the long-term secular trends. We're more about the sustainability of growth, than the magnitude of growth, perhaps. But in short, we're looking for companies that can compound earnings over a long time.

Beverly Chandler

And why do you have this largely ex-US focus?

Marcus Bellander

Well that's for a historical reason actually. The very first investor in our international strategy, which was The Nobel Foundation, they were well covered when it came to the US and they needed a vehicle that helped them diversify. And I think there's still a need for that today, I mean, given how well the US stock market has been doing and especially the US tech companies, I think that many investors, American or not, maybe have a bit of a US bias in their portfolios.

Beverly Chandler

Diversifying away from Nvidia, which seems to dominate all. So, given that you are thematic investors are there any sectors that you prefer over others?

Marcus Bellander

We don't think that much in terms of sectors. Of course we try to have a balanced portfolio, a reasonably broad exposure, but we think more in terms of themes or trends than sectors, and one of the trends or themes that we're thinking a lot about right now is the electrification of the world. Not only electric vehicles, all of that is maybe the most obvious application, but also, for example, how governments around the world and maybe especially in Europe are trying to decarbonize the heating of buildings and houses. So one thing that we have invested in are companies that make heat pumps and the bet there is that people will replace their old gas and oil boilers with heat pumps that run on electricity.

Another such theme that we think a lot about is the automation of factories. As we all know, job markets have been tight. And at the same time, robots have been getting better. So, we have invested in some of the makers of equipment for automated factories, companies that make the machines themselves, perhaps, but also sensors that help with machine vision and the like.

Beverly Chandler

It's such a concentrated portfolio, just 30 stocks, I think you said, how do you manage risk?

Marcus Bellander

Well, actually, if you look at the academic research, 30 stocks is enough to get about 90 or 95% of the diversification benefits that you get with a much, much broader portfolio. So already at 30 stocks, you are reasonably well diversified. But in practice we also, for example, we tend to invest in stocks with less debt on their balance sheet. I would perhaps argue that with 30 stocks, you can actually keep track of what's going on in every single company at a pretty detailed level, whereas if you invest in hundreds or a thousand companies, there is a much bigger risk that you miss something important in one of them.

Beverly Chandler

And that would bring me actually to how do you do your research? Are you proper pull your boots on in fundamental researchers or is it all data?

Marcus Bellander

We're very much about fundamental bottom up analysis. I mean both analysts and portfolio managers here at the firm travel a lot to meet with companies either at conferences or at the companies' headquarters or, or in their factories. We obviously also read research reports on companies and talked to the analysts that write them. We talked to former employees or other experts that have specific knowledge about a certain company or a certain industry. Naturally, we read company filings and we crunch numbers ourselves, that is a big part of the specialty analysts job. So yeah, it is really a boots on the ground, hands on approach.

Beverly Chandler

Thank you for that, Marcus. Don, I'm going to turn to you, active ETF for exactly where it's at, at the moment. Everyone's saying that's what this year is all about the active ETF. Can you explain for our audience, does that mean it's not based on an index?

Don Allen

Beverly, it's a great point you bring up. I share this data often with my clients. First ETF in the US was launched in 1993, so it took about 30 years for ETFs to hit about 10 trillion in assets¹. The expectation that number is going to double in a much shorter period of time. And so there's this exponential growth of ETF assets and interest in the US but just within the past couple of years. And really since 2019, when legislation allowed for active management inside an ETF wrapper, you've seen this explosive growth of the number of tickers that are out in the market, the number of strategies, but importantly the growth in assets in actively managed ETF's and their percentage of flows on a year over year basis, that continues to grow. So the trend is very much there, and to answer the question that you asked me, this is not an index based strategy. As Marcus alluded to C WorldWide is well known in their 30 plus year track record of fundamental deep research on the stocks that they own in their portfolios. I did some quick research ahead of this call. So just to put some context behind this and I'll share why I think this is important in a second. There are 4 ETFs in the US today from some of the larger asset management firms in the world, that collectively have over a quarter trillion dollars, invested in one of two indices and we can describe those indices as broad, non-US developed, so think about kind of MSCI EAFE index or ACWI ex US, so kind of the entire world ex the United States¹. Over 1/4 of a trillion dollars in four ETF's. If you look at the average holdings across those four ETF there's about 3700 companies on average across those four strategies.² And so I'll share a stat with you that always gets a lot of interest in my meetings with my clients. If you were to look out over the past 10 years and just look at the top 50 performing stocks across the entire world, 80% of those top 50 performers come from outside of the United States.³

Beverly Chandler

That's not what you would expect to hear at all. That's really interesting.

Don Allen

Absolutely not! It's, it's fun asking that question because oftentimes the answers I get are sub 10%. And it's to no surprise, right? Because the advisors and clients that we are talking to, they are US based investors. I think the acronym FANG, FANG stocks was dubbed a little over 10 years ago. Then it turned into FAANG, now we're talking about the Magnificent Seven. There's always going to be an acronym for top performing stocks in the US and there's no question that top performing stocks in the US are part of those top 50 cohort that I talked about globally, but not all indexing is created equal. If you look within the United States and let's just take the S&P 500 as an example, you have 500 stocks. And you have something on the order today of about 1/3 of the S&P 500 tied up in the 10 largest names in the index. So you are indeed getting concentrated exposure to the top performing stocks in the United States. If you go overseas and you look at the EAFE index or you look at

the ACWI ex US Index right? Thousands and thousands of securities, you're never getting the requisite level of exposure to that 80% of the stocks that are outside of the US that happen to be top performers like you do in the US and so that idea gets a bit watered down for clients. I would argue that you've seen this explosive growth not only of ETF, but of indexing over the past 10 years, partly due to just the really compelling returns that you've seen in US indices like the S&P 500 and that's carried through to how investors look at their non-US equities. But again, we think that there are some challenges in indexing non-US equities for just the sheer size of the indexes, the number of equities you hold from a composition and sector standpoint, you tend to have more exposure to sectors that don't deliver compelling returns relative to the broad market. And that's just based on the composition of the markets that you're invested in. So the idea of a high conviction portfolio that is actively managed with deep fundamental research to identify these franchises and the way I think about it is the 80% of those fifty stocks globally that are really good performers that nobody gets enough exposure to through an index, that's what C WorldWide is seeking to gain exposure to on behalf of our clients that invest in that ETF. That was a long winded answer, I apologise, but I hope it was helpful.

Beverly Chandler

No, it was a really good answer. I think it also encompassed what I was going to ask you next, is what this brings to the US investors portfolio. But I think you've summarised that it's diversification outside of the country. Is there anything else you'd like to add?

Don Allen

I think US investors are probably painting broad strokes here, but they look at non-US equities as some ways a necessary evil, right? It's a means of diversification outside of the US equities. But inherently clients are behaviorally more confident in owning the US equities they live here, they earn their money here. And what's interesting is if you look at kind of the global equity benchmark, right, just look at the All Country World Index, it's a little less than 50/50 split between US and non-US. It's hard to find client portfolios that have anywhere near the level of international equity exposure as that global equity benchmark indicates. And so there's definitely a means or a need for diversification outside the US you mentioned Nvidia, you know the Magnificent Seven, just the concentration that you've seen in returns in the US there's need for diversification beyond those names and I also think there's some recency bias to how folks invest. I mean, the US has been the place to invest for really the past 10 plus years, really going back almost to the global financial crisis. But if you look at the first decade of this century, it was the opposite. And so we constantly remind our clients of that and especially at a time when you're seeing this level of concentration in US equity markets that you really haven't seen

since 2000 was the last time you saw this level of concentration. So it adds a level of diversification, but gives you exposure to again those franchises that exist outside the walls of the US that I would argue US clients would own if those companies were domiciled here. They just happen not to be.

Beverly Chandler

Maybe Marcus, you'd like to comment to add to that with your ex-US view.

Marcus Bellander

I mean, I agree completely. I think there are many very interesting companies to analyse and invest in outside of the US and like Don said, there are many of them probably have similar traits, or properties, or exposure as certain US names. So why not look abroad? A little bit at least.

Beverly Chandler

Thank you for that. And then finally, we might just go back to you Don, about the actively managed ETF sector. Do you want to give us a little summary. What, what would you say to your clients explaining how an ETF that's not based on an index works?

Don Allen

Absolutely. I think clients in the US have largely been accustomed to ETFs that are, for lack of better term, wrapping up an index like the S&P 500, right? So you're gaining exposure to the S&P 500 and how it's constructed through a very cost and very tax efficient structure. The growth of the ETF has been predicated on those two latter ideas, cost and tax efficiency. And I think in some ways the baby got thrown out with the bath water, and what I mean by that is that really high quality, active management was almost a casualty of a less effective wrapper, which was the 40 Act Mutual Fund. And that's not to say that mutual funds don't have relevance moving forward in the wealth management industry, they do, but increasingly we see advisors recognising the benefit of the ETF, the cost and the tax efficiency, the level of transparency that you have to the underlying holdings, you now have the ability to gain exposure to again what we describe as exceptional active management through that more efficient, what I would consider to be wrapper of the future, which is the ETF. And so there is some education that needs to happen around that not new structure but different approach to investing within that ETF wrapper, right? If you look at, I mentioned those four ETFs that are more than 1/4 trillion dollars in assets, a lot of the questions that we answer for advisors and kind of address any concerns is size of active ETFs today they are inherently smaller because this is a new trend and so talking about trading and liquidity dynamics, a lot of the conversations that probably happened in the

early days of index ETFs, we're now having again in the, in the active ETF wrapper. But there's no question that the trend is there and just speaking to the United States alone, the preference is increasingly for that ETF wrapper. You now have the ability to access really compelling active management underneath of it. And it's something that's gaining a ton of interest in the US, and the approach at Harbor is the ability to identify and provide exposure to these really compelling boutique firms like C WorldWide is really resonating with US retail clients and advisors.

Beverly Chandler

Thank you, Don, thanks for summarising that so clearly and thank you to you both. I'm going to thank you both as my guests today and thank you to you for listening. Remember to subscribe and leave a review and feel free to contact us at podcast@chandlerpublishing.com. This has been an Off the Record podcast from ETF Express brought to you in partnership with Harbor Capital Advisors.

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^{1,2} Harbor Investments, June 2024

³ FactSet Research, March 2024

Recorded on 20 June 2024

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