I'll Take The High Dividend; You Take The Low Volatility - Which ETF Road To Take? Part II

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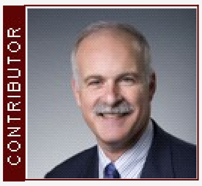

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Disclosure: I have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours. **(More...)**

Part I of this series summarized the performance of PowerShares S&P 500 Low Volatility Portfolio (SPLV) as one of the new class of "low volatility" ETFs against "high dividend" ETFs. The results were inconclusive over the past 12 months since risk-return results have been mostly comparable amongst the High Div peer group.

From Table 1 of Part I, the iShares Dow Jones Select Dividend Index Fund (DVY) underperformed the total return of SPLV over the 1-year horizon, but had a higher dividend yield and lower standard deviation. Vanguard High Dividend Yield ETF (VYM) beat SPLV with a higher total return and lower standard deviation with a comparable dividend yield. The First Trust Morningstar Dividend Leaders (FDL) beat SPLV on all counts.

Most interestingly, the volatility of SPLV at 14.25% (modeled) was actually a bit higher than the 12-13% range of its High Div counterparts, but lower than the S&P 500 of 15%.

Part II that follows will explore other comparable strategies to enhance risk-return within the booming ETF managed portfolio universe. Morningstar recently reported that this product sector has experienced rapid growth over the last year having increased by 48% since September 2011 (Morningstar ETF Managed Portfolios Report). These ETF managed portfolio products cover many different attributes and are primarily available through separately managed accounts (SMAs). We will focus on the "tactical asset allocation" attribute where a dynamic approach is employed to achieve risk reduction and enhanced total return compared to a buy-and-hold strategy.

Due to the newness of these strategies and the preponderant SMA structure, it is difficult to accumulate publicly available comparable risk-return statistics. Generally, though, all promote lower risk and higher return - an anomaly that is gaining traction in the academic world (iSharesBlog). This is the topic for another article, but for now let's look at three high profile "tactical asset allocators" and see if they are an alternative to either passive High Div or Low Vol ETF strategies.

As seen below in Table 1, the three listed popular tactical asset allocation investment advisory firms have accumulated large amounts of assets under management. In the case of Windhaven, an opportune acquisition by Charles Schwab in November 2010 added distribution and marketing clout to an organization that was already experiencing rapid growth with AUM more than doubling since the acquisition (RIABiz). Likewise, both F-Squared and Good Harbor has seen large AUM percentage increases in the past year.

Table 1.

Sample of Popular Tactical ETF Managed Portfolios

	1-Yr Return (June 2012)	3-yr SD	Firm AUM ($B)
Windhaven Investment Management			

Diversified Growth	3.70%	10.70%	$11.049
F-Squared Investments			
AlphaSector Premium Index	2.90%	10.60%	$7.542
Good Harbor Financial			
Tactical Core	12.87%	17.58% *	$2.319
SPDR S&P 500 (SPY)	1.68%	15.54%	
* long-term modeled SD at 13.03%			

As evidenced by their websites, none of these advisors promote their tactical equity growth strategies as income solutions. This seems mostly due to the total return objective function that these strategies are designed to optimize, as opposed to income return. On the other hand, in the summary table they are shown to produce evidence of lower volatility and higher total return performance.

Each of the advisors subscribes to a thesis comprised of combinations of economic, fundamental, technical, algorithmic, and statistical factors to drive the investment process and reduce volatility. They all have some binary triggers to go to risk-free assets when the models indicate a sell signal. One of the underlying tenets of these strategies is to reduce "drawdown" so that it is easier to recover lost value and enhance overall total return. They are all modeled to produce less volatility and more return than the S&P or custom benchmark (notwithstanding the Good Harbor 17% SD anomaly in the table that is not addressed on the Good Harbor web site).

It is clear then that, although High Div and Low Vol ETFs may be close cousins, the new generation of tactical asset allocation ETF managed portfolios seem to be "once removed". Don't buy them for income to replace High Div, but they currently compete favorably with Low Vol ETFs for an enhanced total risk-return profile.