

ETF Selection

November 5, 2013

The universe of investable ETFs has experienced tremendous growth over the over the last 20 years since the launch of the first ETF to over 1,000 investable products. The vast expansion of choices raises the question: How to choose among so many options? To vet new ETFs and reconsider ETFs that are currently included in our portfolios, the New Frontier investment committee analyzes a few important questions:

- Does the underlying asset class of the ETF offer a risk premium or diversification benefit not currently in the portfolios?
- What is the underlying index methodology and asset class history?
- What are the costs, tracking error relative to benchmark, and liquidity of the ETF?

Risk Premium/Diversification

New Frontier seeks ETFs that represent asset classes that offer strategic risk premiums and diversification benefits that do not currently exist in the portfolios. For example, recently we added Senior Bank Loans to our investable universe of some of New Frontier portfolios. A main reason for the addition is because we believe that a fixed income asset with no duration risk but credit risk would allow the optimization process to work on the pure exposure to the credit risk premium without duration risk. New Frontier seeks to use ETFs to isolate risk premium to allow for a better optimization process and ultimately more properly diversified portfolios.

Index Methodology

In line with long term strategic goals, New Frontier favors indices from reputable providers that have an investable history, clear methodology, and accurately represent the asset class that offer a strategic risk premium. New Frontier is conservative in seeking ETFs that represent asset classes with long investable histories when possible. We believe that the risk of jumping into an untested asset class offers secondary risks. Also, going in and then out of products will incur additional trading costs down the road.

For our strategic portfolios, New Frontier favors market capitalization based indices. The market place offers many alternative weighting methodologies: low volatility, factor indices, smart beta, and many more alternatives to capitalization

weighting. The advantages to market capitalization weighted indices are that they are well diversified products with longer and more reliable investable history and clear methodology that accommodate strategic investing initiatives. New Frontiers patented optimization process is able to capture the risk premiums available in alternative indices by properly weighting the market capitalization indices while also being able to accommodate the proper target level of risk. With regard to our Multi-Asset Income products New Frontier prefers income oriented indices because the MAI portfolios meet the needs of investors with an income preference.

Asset Class History

Though New Frontier does not believe past index performance predicts future performance, we do believe that historical data has information about how an asset class has behaved in relation to other asset classes. For this reason, we prefer ETFs that reflect asset classes with longer investable histories. New Frontier's estimation process relies on using advanced statistics to synthesize historical data with financial principles and current information.

Sponsor Cost/Liquidity/Provider History

The sponsor of the ETF is important because they are ultimately responsible for creations and redemptions as well as maintaining the cost of the ETF. Thus New Frontier prefers established sponsors in the industry all other things the same. The expense ratio is an important consideration with regard to choosing ETFs, but it is important to note that the cost of an ETF also is the trading costs and the ETFs ability to properly track the underlying index. New Frontier seeks liquid ETFs that have low bid/ask spread.

Conclusion

Doing due diligence on the sponsors and underlying index providers is a crucial aspect to choosing an ETF. Ultimately these ETFs go through a rigorous estimation and optimization process that allows us to determine the significance and proper allocation of the fund in the portfolios. New Frontiers vetting process allows us to create well diversified Michaud Optimized portfolios with the most appropriate funds available for meeting the objectives of the portfolios.

This note was posted as an entry on New Frontier's investment blog on November 5, 2013. Read this entry and other posts at: newfrontieradvisors.com/blog.