TW Advisors

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Spotlight on the "Low Volatility Factor"

Every now and then the financial industry produces innovative, useful new products. Factor ETFs (exchange traded funds) fit that mold and TW Advisors have been increasing our use of these investments in our portfolios**. Factors align well with our roles as portfolio managers and through our newsletters we will highlight some of the factors we use and favor.** This month we highlight the Low Volatility Factor.

The primary purpose of active management is to improve performance and/or reduce volatility. The investment industry is supported by decades long research that demonstrates certain portfolio **factors like Value, Momentum, Quality, Size and Low Volatility offer superior results.** Traditional asset management is all about trying to tap into the inherit benefits of these respected research factors. However, the profession has a poor track record in delivering these benefits. In our opinion the lack of success comes down to the prevalence of concentrated portfolios that are not well diversified. The most consistent way to obtain the benefits of factors is by owning a large basket of stocks that track the factor which is exactly how the Factor ETFs that we own are structured.

Factor ETFs are active strategies, so it is important to diversify and understand the conditions where factors are expected to outperform. In this newsletter we highlight the Low Volatility Factor.

N**ot surprisingly the Low Volatility factor tends to outperform during volatile and down markets.** Over a complete market cycle Low Volatility has generally matched the performance of the market but with much less drama. Leading into and during the fourth quarter 2018 market decline we increased exposure to this factor by adding to iShares MSCI USA Min Vol (ticker symbol, USMV).

We have owned USMV for our clients since May 2015. Over the five years ending April 2019 it has returned 12.72% versus 11.63% for the S&P 500. This year USMV had lagged the market by about 3% through April but has made up all the lost ground during the sloppiness in May. According to BlackRock from November 2011 to March 2018, USMV performed its job well capturing 82% of the market's upside but only 56% of the downside while delivering market-like returns.

We have studied and like the construction and management of this ETF. USMV screens for low volatility stocks, considers the correlations among them, and then generates an optimized portfolio with guardrails in place to limit sector and country concentrations. Importantly it owns the entire basket of stocks currently 213 stocks and only costs 0.15%

Last year the stock market suffered two abrupt and violent shocks. These are signs that liquidity has deteriorated across markets. Since volatility has historically clustered more should be expected making Low Volatility ETFs a valuable tool in the portfolios.