JUNE 30, 2015

PENSERRA

AFTER HOURS QUARTERLY

INSIDE THIS ISSUE:

So You Want to Launch an ETF?

So you want to launch an ETF? A lot of people are surprised that there is no one way to do it. There are as many different operating models as there are ETF sponsors—you can outsource or take in house just about any function.

ETFs at the core are open-ended mutual funds, and there are more similarities than differences between them. But the differences are significant enough that you often see the ETF management business broken out as a separate and dedicated division within the larger financial organization, or you at least find ETF specific personnel located within the various functional units. Providers of fund services including custody, fund administration, distributor, listing exchange, index provider and other services also tend to have personnel if not whole business units dedicated to ETFs.

"Who will buy my ETF and why?" is probably the most important question you can ask yourself. This is certainly the issue that we see most of our clients get hung up on. One observation we can share is that if you think people will buy it simply because it is listed for trading on a national exchange and available to trade through any broker, you'll probably be disappointed. Typically the key issues here are identifying who your target market is, the most effective way to reach that market and where your pricing needs to be.

But having the idea isn't enough. Here are some key issues to address on the road to your own ETF launch.

<u>Managing Supply and Demand for Liquidity</u>

Often times, asset management organizations that have existing sales channels struggle with the best way to integrate ETF sales. Do you use the same sales people or hire new ones? If you are a small startup without any existing sales resources, what do you do?

One of the unique aspects of ETFs is that they trade like stocks in the secondary market. Closed end funds also trade this way, but the revolutionary thing about the ETF is that it gets special exemptive relief from the SEC to allow for large institutional investors called authorized participants (APs) to create and redeem new shares directly with the fund in exchange for baskets of the underlying portfolio securities. This primary market activity allows for an arbitrage mechanism to force secondary market pricing to be in line with the fund's NAV. A standard knock on closed end funds is that there is

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market pricing to be in line with the fund's NAV. A standard knock on closed end funds is that there is no arbitrage so you can experience large premiums and discounts in market pricing relative to the fund's NAV. ETFs address this concern with the creation/redemption mechanism.

Why is this important for you, the nascent ETF sponsor? Because the sponsors who succeed incorporate this part of the business into their distribution strategy and have resources dedicated to APs, market makers and listing exchanges. Think of selling to the end investor as creating demand for liquidity and selling to the capital markets crowd as creating supply for that liquidity.

Cutting Through The Red Tape

So you have a product idea and a distribution strategy. What else do you need?

Much of the corporate governance structure looks the same for ETFs as it does for mutual funds. You will need a Trust, an Advisor and a board of directors. The board will likely hire a number of service providers, such as custody, fund administration, transfer agency, distributor, audit and more. Just a few years ago, this meant you either used a trust and board you already had for mutual funds or you created a new one. If you consider this the "build" option you now have to consider the "buy" or "rent" options as well. With a large number of small sponsors as well as a number of sponsors who have started the regulatory process, there are frequently shops that are explicitly for sale or would entertain a discussion. There are also some shops who are offering an ETF platform model where you use their Trust, Advisor and board for a fee and they will help put together the other pieces.

If you decide to do it on your own, you will need to file for exemptive relief with the SEC's division of Investment Management. You will ask the SEC for exemption from certain provisions of the securities laws that will allow your mutual fund to operate as an ETF. Unfortunately this process has never been streamlined and is looked at on a case-by-case basis. If you want to operate index based ETFs, that is one application with the SEC. Active ETFs require a separate application as well as a product specific filing with the SEC division of trading and markets that can take just as long as the exemptive application.

All in, you are probably looking at anywhere from 3 months on the short end to several years on the long end to complete the regulatory hurdles with a 3-6 month window common for most new products.

Keeping The Trains Running

You will also need to establish what the day-to-day operations of the funds will look like. The key thing for ETFs is the daily construction and maintenance of the creation/redemption baskets. The best sponsors have integrated their investment process with the basket process and provide support and service to the capital markets. This work can be completely outsourced to a sub-advisor and fund administrator or the majority of the work can be done in house, though typically the fund administrator plays the role of liaising with the NSCC to disseminate the daily basket files to APs, market makers and

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other capital markets participants. There are a number of operational issues that will need to be addressed that are unique to ETFs across various areas including custody, fund accounting, tax, risk and compliance.

If you are going to launch an index based ETF, you will need to select an index or work with an index vendor to create a new one. Even if you have your own index methodology, you will probably still need to work with an index vendor to calculate and disseminate the index and it's data. You will need to select an exchange to list your ETF for trading, as well as line up APs and market makers to help provide liquidity. You will also need to select an indicative intraday NAV (IIV) agent, a requirement of the exemptive orders to provide updated pricing estimates for the fund's NAV at least every 15 seconds throughout the trading day.

Another requirement of the exemptive orders is a publicly available website with certain key information about the ETF. You will also need to source seed money to get the fund launched, something that has become increasingly difficult as ETF trading has gone electronic, economic incentives have changed and newer ETFs have been slower to attract the type of trading volume that has historically been attractive to market makers.

The number of people you will need, the amount of money it will cost and amount of time it will take to launch your ETF can vary widely based on the type of ETF you are looking to launch, the nature of your organization and what your metrics for success are. Generally speaking you will need someone to oversee the day-to-day operations of the funds—including service providers, APs and market makers on the capital markets side, as well as investor inquiries that can't be addressed by other service providers. You will also need some form of sales support, either dedicated sales professionals or ETF specialists who can support your sales professionals and your marketing effort. A startup organization may have just one of each type, while a large asset manager new to the ETF space may have specialists who focus on different areas of operations, capital markets, sales, marketing, legal, compliance, etc. A number of costs are fixed regardless of the number of funds while others are specific to each fund.

Final Tally

So what's the butcher's bill? Initial startup plus first year expenses will be at least $300k for a single ETF just to get a fund out. You will still need to spend money on a sales and marketing effort, which is typically the largest expense as well as the one with the most variability. As for timing, the biggest factor is typically the SEC and the review process. Outside of that, 4-6 months is generally enough time to hire service providers, establish daily process flows and finalize a distribution strategy.

Is it a lot of work? You bet. But the end result is your very own, publicly traded exchange-traded fund.

For additional information please contact Dustin Lewellyn at ETF@penserra.com.

MULTI-CLASS SECURITIES: THE NEW NORM

S&P 500 is considering adding most dual listed securities. Even though there will be 500 companies in the index, there is the potential to have 509 different tickers. Much thanks to Google, this trend started last year by the company splitting into voting and non-voting shares. Historically companies tried to eradicate this complex structure by collapsing the spread into one security. Things are changing.

Why do they exist?

There are various reasons why these structures exist but most typically it is the result of either a company spinning off a holding or a company looking to raise capital but not dilute the voting control.

McDonalds spin off of Chipotle is a great example of how a dual listed company is born. In 1998 McDonalds took a minority stake in Chipotle in which they held about 88% of the voting shares. In 2006 Chipotle went public issuing non-voting shares. McDonalds then decided to divest their entire holding in Chipotle. McDonalds held voting shares, so when they distributed these shares Chipotle now was trading both the voting and non-voting shares. Sounds simple enough but during that time period the spread between the voting and non-voting shares was as wide at 30%. Two years later the board decided to collapse the shares into the class we now see today.

Lennar Corporation is an example of a super voting structure. The more liquid line LEN has 1 vote per share while LEN/b has 10 votes per share. So in essence you can control the same amount of voting power for 10x less capital.

More often than not, the only difference between the shares are the voting rights. Fundamentally each class are entitled equally to all company profits - but that's where it stops. Given the shares are rarely fungible, the spread between each class can vary dramatically based on liquidity, buybacks and share issuance.

Why is this important?

Indexes typically would track the more liquid line and adjust the weights to reflect total shares outstanding. When the spread is minimal this works great but the concept falls short when the prices between each class widens. Russell already took the first steps to minimize this shortfall by adding all liquid share classes during their last reconstitution. S&P 500 is slated to adjust this September. This is going to create two things- First, companies now will be fairly represented in the index. Secondly, liquidity should increase and the liquidity discount applied to many names should collapse. It's a win/win for both the index and companies that have the structures.

Penserra Securities Special Situation Research provides analysis on these type of events. For more information or to speak to our analyst please email Kevin.mclaverty@penserra.com

Transition Management for Asset Managers

Advances in transition management have been driven by increases in computing capacity that have opened the door for tools that more accurately measure transaction costs and real time residual risk. Historically, and for obvious reasons, it has been primarily the owners of assets that have cared most about trading costs and exposure risk when moving assets. Having a process in place to address asset owner's cost and risk concerns can give asset managers a new approach and potential competitive advantage when competing to win business from pension plans, public funds, foundations or endowments.

Background

Asset managers are often not called upon to manage exposure risk as assets are added to their portfolios. For many, the 'performance clock' does not start until new funds are fully invested in the target portfolio. While clean from a reporting perspective, this approach fails to completely align the interests of the asset manager with those of a client looking to minimize the costs of re-structuring their holdings. Buy side trading desks can also be more regularly focused on trade strategies designed for NAV or MOC related benchmarks and risk management tools like dollar neutral and residual risk optimized trading strategies are less a part of their daily process. If asset managers with transition management tools can be brought into the discussions regarding how and when legacy assets are traded as part of a transition event, there is room for both asset owners and asset managers to benefit.

Advantage of Utilizing a Transition Manager

Penserra can offer asset managers' solutions that promise an ability to address significant concerns for key clients. To build lasting relationships with those potential clients, asset managers can and should improve their competitive advantage by working together with asset owners to control costs, manage risk, and demonstrate good governance not just from the point where money comes in the door, but from the moment a client commits to a business relationship.

By working with Penserra, an asset manager can offer the ability to evaluate a potential client's current holdings; provide a timeline to identify all steps required by the client and their custodian to move assets; a project plan that provides detail to the timeline including contacts, key deliverables, and responsible parties; an identification of any securities already held by the client that the asset manager would like to continue to hold; estimates of the cost to sell the residual securities; estimates of the cost to purchase the asset manager's target portfolio; an evaluation of the active market risk between what the client currently holds and what the asset manager would like to hold instead; full transparency as to the explicit and implicit costs of transitioning assets; and an overall strategy to move from current holdings to target holdings in an effective and cost efficient manner.

This service can often be provided with no incremental fee beyond the commission rates the asset

Transition Management for Asset Managers (cont.)

owner would normally pay. A comprehensive on-boarding process can position asset managers as more of a partner to their asset owner clients, expanding the scope of interaction and in turn, providing a business development competitive advantage.

For additional information on our Transition Management Services please contact transitions@Penserra.com

WHAT'S NEW AT PENSERRA?

At the beginning of the quarter Penserra was pleased to complete a transition management event that involved approximately $2 billion of trading. This transition event went smoothly and had a strong outcome for our pension plan client. The number of transition events is growing as is the average size of these events. In addition, as of the end of June our assets under management continued to grow. We were fortunate to reach $1.5 billion across our various ETF strategies where we act as sub-adviser. We will be launching four more strategies in July and and additional four-six by the end of September. I

Also, please join me in welcoming two new employees to Penserra. Keith Wilson joined the firm as Head of Transition Management in our Orinda office. He was most recently Head of Global Portfolio Management and Trading at BNY Mellon Beta & Transition Management for almost nine years. Previous to BNY Mellon he worked for Deutsche Bank, JP Morgan, and Merrill Lynch. We also hired Ashley Handel as our new Human Resource Specialist and Office Manager. She is a graduate of St. Mary's College with degree in Psychology and is currently studying for her Master's Degree in Counseling.

HACK (Purefunds ISE Cyber Security ETF sub-advised by Penserra Capital) rang NYSE opening bell on July 9, 2015

Source: NYSE

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Penserra Research Universe

Ticker	Full Company Name
AAP	Advance Auto Parts Inc
ACAT	Arctic Cat Inc
BGFV	Big 5 Sporting Goods Corp
BIG	Big Lots Inc
BJRI	BJ's Restaurants Inc
BONT	Bon-Ton Stores Inc/The
SAM	Boston Beer Co Inc/The
BWS	Brown Shoe Co Inc
CAB	Cabela's Inc
CRI	Carter's Inc
CASY	Casey's General Stores Inc
PLCE	Children's Place Inc/The
CNK	Cinemark Holdings Inc
CONN	Conn's Inc
TCS	Container Store Group Inc/The
PLAY	Dave & Buster's Entertainment Inc
DKS	Dick's Sporting Goods Inc
DDS	Dillard's Inc
DLTR	Dollar Tree Inc
DSW	DSW Inc
RDEN	Elizabeth Arden Inc
ETH	Ethan Allen Interiors Inc
FINL	Finish Line Inc/The
FRAN	Francesca's Holdings Corp
FRED	Fred's Inc
TFM	Fresh Market Inc/The
HOG	Harley-Davidson Inc
HGG	hhgregg Inc
HIBB	Hibbett Sports Inc
IRBT	iRobot Corp
JACK	Jack in the Box Inc
JMBA	Jamba Inc
KATE	Kate Spade & Co
LF	LeapFrog Enterprises Inc

Ticker	Full Company Name
LTM	Life Time Fitness Inc
MW	Men's Wearhouse Inc/The
ORLY	O'Reilly Automotive Inc
PTRY	Pantry Inc/The
PIR	Pier 1 Imports Inc
RCII	Rent-A-Center Inc/TX
SBH	Sally Beauty Holdings Inc
SKX	Skechers U.S.A. Inc
SODA	SodaStream International Ltd
SFM	Sprouts Farmers Market Inc
SSI	Stage Stores Inc
SHOO	Steven Madden Ltd
TXRH	Texas Roadhouse Inc
TUES	Tuesday Morning Corp
TUMI	Tumi Holdings Inc
ULTA	Ulta Salon Cosmetics & Fragrance Inc
VRA	Vera Bradley Inc
WEN	Wendy's Co/The
WGO	Winnebago Industries Inc

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ABOUT PENSERRA

Founded in 2007, Penserra is an institutional financial services firm with offices located in the New York, Chicago, and San Francisco areas. Through state of the art technology, Penserra Securities LLC delivers products and services in equity, fixed income, interest rates, and credit markets. Our networks deliver global connectivity to customers seeking unparalleled liquidity and flow in orderly marketplaces. Penserra Capital Management LLC is a Registered Investment Advisor and affiliate of Penserra Securities LLC. Advisory and fiduciary services including transition management and ETF sub-advising offered through Penserra Capital Management LLC, a Registered Investment Advisor and affiliate of Penserra Securities LLC.

Penserra Securities is a certified Minority-Owned Business Enterprise (MBE).

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