

AFTER HOURS QUARTERLY

TRANSITION MANAGEMENT RE-DEFINED

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Almost all consultants, plan sponsors and active investment managers are familiar with transition management. The service has been around for 20+ years and has become an integral part of the investment process for many firms.

That said, many investment professionals, including many who use transition managers, still look at transitions as infrequent events that are defined by large changes taking place in the asset allocation or manager lineup. In reality the opportunities to incorporate a transition manager are often much more frequent than the “big” events.

Seeking the counsel of a Transition Manager could be beneficial with many other aspects of running a fund. Some examples, that most fund managers deal with frequently, include:

- Large cashflows including monthly payment requirements
- Fund and/or manager rebalances
- Capital calls for private equity investments
- Benchmark changes

By regularly incorporating transition management into these events, the opportunity to control the costs and risks can be managed as they are in a more traditional sense. Think of it as separating the investment decision from the implementation of that decision.

Where a manager will likely charge full commission to liquidate the assets required for funding, a transition manager may charge significantly less. Over time, this lower commission will provide improved performance to the fund. Additionally, not enough focus is placed on the following more significant components to overall costs:

- **Implicit Costs** - If a manager is only focusing on their portfolio, rather than all the moving parts involved, who is maintaining overall market exposure during this time? In today's highly volatile market, exposures outside of plan goals, for even short periods of time, can have a significant effect on returns.
- **Timing** - In the situation of capital calls for private equity investments, in many cases, the variability of how much is needed, and the timeframe involved, leads to subpar executions and risk management.
- **Market Exposure** - A transition manager focused on maintaining your overall plan exposure and executing ALL activity in a cost efficient manner is crucial.

Too often, we see situations where events are not considered “Transition Events” and, therefore, do not receive the same level of research and scrutiny. Over time, the costs of this approach add up when they would not with the involvement of an experienced Transition Manager.

For additional information please contact transitions@penserra.com.

THE FUTURE OF ACTIVE ETFs

As we have explored in this column in the past, ETFs are one of the hottest areas of growth in financial services and now account for just shy of \$2 trillion in AUM in the US and over 25% of the daily trading volume on US exchanges. Most ETFs are passively managed in terms of the number of funds as well as the AUM tied to them. But most of the talk these days is around actively managed ETFs. So what is the future of active ETFs?

Regulatory Issues

Launching an ETF requires an exemptive order from the SEC, giving exemption from certain provisions of the securities laws to make a mutual fund work as an ETF. To date there are two separate tracks for getting relief whether you are an actively managed or passively managed ETFs. Further, active ETFs require daily disclosure of portfolio holdings, which is a big concern for many active managers who are not too keen on sharing their portfolio on a daily basis. There are currently a number of applications under review by the SEC that contemplate non-transparent active ETFs. In each of these models, a manager would still be held to the disclosure requirements of traditional mutual funds (quarterly), but nothing more onerous than that. While I believe that some of the models are better than others, it is likely that the SEC will approve several at once and let the marketplace decide which is best. According to several industry insiders who are in regular communication with the SEC, that could happen by year-end 2014. I believe the transparency issue has hindered the growth of active ETFs and that, once resolved, you will see a significant increase in product filings.

Shifting Competitive Landscape

The common thinking among traditional mutual fund shops was that ETFs were direct competition and, because the fees were lower, they were all afraid that having ETFs would cannibalize their revenue. That has changed significantly over time and now most mutual fund companies look at ETFs as an extension of their distribution reach and something that could be accretive to revenue. At the end of the day, an ETF is just a vehicle to deliver an investment program in the same manner as a mutual fund, hedge fund or collective trust fund are vehicles. Over time people have realized that the main reason ETFs appear cheaper is because they are index funds; and index funds are naturally going to be cheaper than actively managed funds. If you look at the actual infrastructure costs between ETFs and mutual funds, they are about the same, which isn't too surprising since ETFs are just a specialized version of mutual funds. We are now seeing where active managers are being able to charge the same management fees regardless of the vehicle that delivers the investment program.

The Future

While I believe that index ETFs will continue to dominate the ETF AUM chart in terms of dollar values and growth, I also believe that, once non-transparent active ETFs are approved, you will see a flood of new product launches focused on active ETFs. Several of the largest ETF sponsors, including BlackRock and State Street, have filed for non-transparent active ETFs and over the summer you saw Capital Group make a filing, which is especially significant because you are talking one of the largest traditional mutual fund companies. Of course, performance will still be the biggest driver of success and a distribution strategy will still be critical for any active ETF to get assets. As I have said before, ETFs don't invent investment strategies, they are simply a vehicle to deliver an investment program.

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THE US LABOR SITUATION

As the Fed moves closer to the next inevitable tightening phase, market participants are trying to fine tune their guesses on the timing and the extent of the rate increases.

Several weeks ago, consensus, on the beginning of rate hikes, seems to have been focused on the mid 2015 time frame. The market knee jerked to higher rates September 8th when the Federal Reserve Board of San Francisco released its Economic Newsletter. The crux of the newsletter states: "Evidence based on survey, market expectations and model estimates show that the public seems to expect a more accommodative policy than the Federal Open Market committee participants".

The treasury market reacted quickly to the FRBSF release with an increase of 4-5 basis points. The labor situation is key to the Fed's decision regarding the timing of rate increases. The Labor Day Weekend Wall Street Journal edition featured an article entitled "Less Inflation pressure lets the Fed focus on Jobs", witnessing their emphasis on the labor situation. The Fed has taken pains to point out that it is not just targeting the unemployment rate and growth of non-farms payrolls, but also the underutilization of labor resources. "This matters because well before the Fed moves toward raising short-term rates, officials will make a determination that the market is no longer burdened by 'significant underutilization of resources'".

The "U-6" underutilization rate has attracted more attention as an indicator of the above underutilization. "This measure of unemployment includes the total unemployed, plus all persons marginally attached to the labor force, plus total employed part-time for economic reasons, as percent of the labor force plus all persons marginally attached to the labor force (persons marginally attached to the labor force are those who currently are neither working nor looking for work, but indicated that they want and are available for work)".

The FOMC meeting ended on September 17th. Fed watchers were focusing on whether or not the phrase on accommodation would remain for "considerable time". The phrase "considerable time" did remain in the FOMC comments, though it was somewhat hedged by Chairperson Yellen's statement that "considerable time" was not a "firm promise". The Federal Reserve did reiterate its intention to end Quantitative Easing with the October 2014 FOMC meeting. Most interest rate observers noticed no real changes in the Fed's commentary.

On the final day of the September meeting, the Fed did, however, release its "Dot Plot" which evidences the Fed Governors sentiments on where it feels their benchmark rate will be over time. Interest rate markets quickly picked up on the revised Dot Plot showing an increase of the Fed Funds rate target by year end 2015 from an average of 1.20% to 1.27%. Janet Yellen did downplay the upward revision as "modest" and attributable to a downshift in unemployment rate forecasts. We will see, but the markets' concern is how we will get from the current 0.25% fed funds target at the beginning of the tightening (widely thought to be mid 2015) to 1.27% by year end 2015.

For additional information please contact Paul Gilbert at bondtrading@penserra.com.

PENSERRA EQUITY RESEARCH: ANSWERS TO FAQs

Many have asked, “How can I best utilize Penserra’s Equity Research product?” To help answer that question, we have provided the following responses to several frequently asked questions:

1. If Penserra forecasts that a company is going to BEAT (or MISS) consensus revenue estimates, does that mean we have a positive (or negative) bias on the stock?
No. Penserra Research does not offer investment ratings or opinions. Penserra presents statistical data without interpreting it. The goal of Penserra Equity Research is to provide data useful to form or confirm an opinion.
2. What message is Penserra delivering when it says a company will BEAT/MISS consensus quarterly revenue estimates?
Penserra is making a quarterly revenue forecast based on, but not limited to, the following factors embedded in our proprietary model:
 - **The number of published revenue estimates for a specific company.**
 - **The historical accuracy of published revenue estimates for a specific company.**
3. If Penserra forecasts a quarterly revenue MISS for a particular stock, while at the same time a competing brokerage firm upgrades the stock or has positive comments, should one firm be considered “right” and the other “wrong?”
No. Three points to consider:
 - **Penserra Research does not offer investment ratings or opinions. Therefore, under this scenario, Penserra can’t be considered “right” or “wrong” because we don’t provide an investment opinion.**
 - **Penserra Research only provides revenue forecasts. We do not construct earnings models.**
 - **There are numerous reasons why a competing brokerage firm may provide commentary about a specific stock, such as valuation, earnings projections or discussions with senior management. Penserra Research does not offer such commentary.**
4. If Penserra forecasts quarterly revenues for a specific company to BEAT by 4.8%, and the company beats by only 0.1%, does that mean Penserra is “wrong?”
No. Penserra is considered “right” regardless of the “size” of the BEAT/MISS. Two points to consider:
 - **In order to measure the effectiveness of its revenue forecasting model, Penserra essentially “draws a line in the sand” to judge its miss/beat performance.**
 - **The “size” of an expected miss/beat is frequently determined by the number of analysts covering a specific stock. For example, if a stock is covered by only two analysts, their revenue forecasts could vary widely, resulting in a consensus number that varies widely from both estimates. Conversely, a stock followed by twenty analysts will result in a much more defined consensus number. As mentioned in Question #2, two of the most important factors used to create a Penserra revenue forecast are the number of revenue estimates of a specific company and the historical accuracy of those estimates.**
5. If Penserra forecasts quarterly revenues to BEAT for a specific company, and the company beats revenues but its stock drops 10% the next day, was Penserra “wrong?”
No. Numerous factors surrounding a company’s quarterly earnings announcement can move its stock, including but not limited to:

- *Forward guidance regarding earnings and revenue*
 - *Management changes*
 - *Financial engineering (buybacks, dividends, etc.)*
 - *The recent trading action of a company's stock*
6. Can survey comments published by Penserra be considered positive or negative indicators by the recipients of the report?
- Yes. Two points to consider:**
- *Penserra gathers market intelligence using innovative crowdsourcing techniques. Survey comments can reference pricing, volume, and market share. It is up to the individual analyst or portfolio manager to interpret these comments.*
 - *The comments are best utilized when compared to prior quarterly research reports published by Penserra.*
7. Do Penserra Research's crowdsourcing techniques involve an "expert network?"
- No. Our surveyors call upon low level employees and industry contacts in a FINRA compliant manner to statistically gauge a company's business trends.**
8. How can an institutional customer best utilize Penserra Research?
- *Customized Research Reports- Utilizing our crowdsourcing resources, Penserra Research can tailor research reports for a customer's specific needs. Strictly speaking, this is Penserra's version of corporate access.*
 - *Value- Instead of paying a traditional brokerage firm \$500,000 a year for a blanket research product, a customer can pay Penserra a fraction of that cost for tailored research reports, revenue forecasting, and crowdsourcing market intelligence.*
 - *Accretive- Penserra Research provides a statistical edge allowing a customer to enhance their proprietary models.*

For a copy of any reports or to be added to our research list please contact research@penserra.com

WHAT'S NEW AT PENSERRA

In August, the firm welcomed three new employees including: Calvin Lee, Sam Patel, and Jane Rudneva. Calvin and Sam join Penserra from Mellon Capital Management, where they were both in its Transition Management unit. They will provide integral leadership to the continued expansion of the firm's growing transition management business. Both Calvin and Sam were also previously at BlackRock/Barclays Global Investors on various teams, including portfolio management and transition management. Jane Rudneva joins Penserra as an accountant/financial analyst. Jane was previously with the Academy of Art University and is working on her M.S. in Accounting from St. Mary's College. Join me in welcoming Calvin, Sam, and Jane.

In September, Penserra hosted an Open House Celebration for family, friends, and customers. We had phenomenal catered street tacos and margaritas. Thank you to everyone who came by to say hello and checkout our new office in Orinda. The event was such a success that we will host one again for Cinco de Mayo.

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ADDITIONAL PENSERRA REPORTS AVAILABLE

- Thematic Views of Asia – Monthly report highlighting views from Brokers, Buy-Side Firms, and Industry groups
- Updated IPO and Secondary Calendar for Asia and Japan – Bi-monthly
- The Marginal Prophet – a topical thought-provoking piece that humanizes the crazy industry we work in

To receive an individual report, or to be added to our distribution list, please contact: research@penserra.com

ABOUT PENSERRA

Founded in 2007, Penserra Securities is a full service broker/dealer servicing institutional clients with offices located in the New York, Chicago, and San Francisco areas. Through state of the art technology, Penserra 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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