INTERVIEW

Differentiation through innovation, disruption and distribution

FTSE RUSSELL CONVENES

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President, Pacer ETFs

Interviewed by

Jamie McDonald, ex-portfolio manager, Point 72

Jamie: Sean, thank you very much for joining us today. It's great to have you here.

Sean: It's nice to be here. Thanks for doing this, Jamie.

Jamie: So Sean, these are tricky times for investors, interesting times, so let's talk about that. How do the smaller, let's say niche players like Pacer Financial, how do they compete with the Big Three? Or how do competitors try and catch up with the Big Three?

Sean: Well, you can't go toe-to-toe with them on stuff that's cheap, if you will, right?

Jamie: Do they just have too much scale?

Sean: They just do. It's just impossible to compete with, you know, an iShares who can issue product at five basis points and make money at it, you know?

Jamie: Or even less.

Sean: Or less… So we try to find places where we can build products that are either innovative, disruptive, or unique where we think there's a problem that an investor's facing and we might have a unique solution to that. And then that there's a decent or a sizable addressable market so that if you're successful in building that kind of a product you can get to scale. And so we focus on the end user of the product, at the end of the day, the client or the investor, or the FA in most cases as well, and try to solve problems for them or build things that they might find useful in portfolio construction. But we also pay attention to size and scale, like you know, I don't want to have the best $20 million ETF in the history of mankind. It's of no use to anybody really. So there has to be, above and beyond, a need for the investor or a tool that the FA can use in their client's portfolio. There has to be the ability to get it to a billion, or 2 billion, or 3 billion, or 4 billion, or $10 billion in AUM because that will ultimately sustain our organisation as a smaller issuer over time, as we have to be able to get to a certain level of scale to be able to continue to go forward. We've already achieved that at Pacer.

Sean: It took us a long time. The other thing that's , a differentiator is distribution.

Jamie: You're just through FA's are you?

Sean: Yes, we just focus on the FA for now, but we have a very, very big sales force relative to the size of our assets. We have almost 80 external wholesalers in the field, and we've got 40 or so internals. And so we focus on that distribution as a way to gather assets. It's very expensive to start that way, but if you're good at it….

Jamie: Very sticky though, I imagine.

Sean: If you're good at it, it provides that ramp to AUM growth because you know that those people are out there every day working with FA's and they're going to accumulate some level of sales. And so that's our approach and that's what makes us different, that I think holds some of the other smaller ETF issuers back because it is very expensive.

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Jamie: So if I asked, this side of your ledger, you're still pretty bullish on it or you kind of pairing back?

Sean: I'm a little worried about valuations, to be honest with you. I'm always worried about valuations. I'm sort of an old fashioned guy. You know, the stock market should work on fundamentals, right? Like, you should be able to figure out like, do I make money and how much money do I make for how much capital I'm committing to the stock? So I'm a sort of a traditionalist in that sense, so I look at the overall market and like I said when we began with our discussion today, is like if you're going to go through a cycle where you're going to overpay a little bit for stocks, you want to feel good about the environment, right? That's when you should be thinking like that. And it doesn't feel like that right now, I think there's too many potential negatives that could come to keep the stock market at a level that it is right now, so I'm a little cautious.

Jamie: Let's talk credit if we could for a little bit. Finally, we're getting rates that give us a real yield. What kind of products do you have in the fixed income side of things, and is that something you're looking to roll out more of?

Sean: We're a little light on fixed income. I think it's great. I mean, the biggest, the person who got hurt the most here in the United States the last decade is the retiree because we had rates at zero and, you know, they need fixed income in their portfolio to live. It's nice to see rates are back up and I think that helps the American retiree a little bit. So it's good to see, and it's, I think it's a healthy thing. We have essentially two ETFs that focus on fixed income. We have others that focus on income but not in fixed income. We have a, like a four times dividend product on the S&P 500, for example, that's got a very attractive yield. But in fixed income we have a floating rate fund, which is, you know, basically 90 day paper that rolls over. So the more rates go up, the better the yield is without that duration risk. And we have a strategy that rotates from high yield to treasuries based on a signal that we've built that sort of, we call a risk ratio. I think we need more fixed income when you look at the competitive landscape and, you know, I gotta pay attention to that kind of stuff. Like when you look at what people have sold that we're not selling, the biggest, most glaring hole in our lineup is probably fixed income.

Jamie: Sean, as you look out, we've talked about quite a few of the macro headwinds. We have an election next year, equity valuations seem very full, tensions between the US and China in terms of trade. How do you see the markets playing out?

Sean: I don't know. You know, there's narratives that have proven to be not true alright?

Jamie: That we're going to have a recession.

Sean: Well, the first one is that the Fed's going to stop raising rates. And that the second is that those, the speed at which they've raised rates is going to destroy the economy. And that hasn't happened yet either. Now it could, right? You could start to see some of this employment numbers roll over. I think.

Jamie: Sorry to interrupt, but why do you think that is, actually?

Sean: Because we don't want to believe that the Fed's going to do what they want to do 'cause we want the party back.

Jamie: So it's a credibility thing?

Sean: Well, the Fed doesn't have a lot of real credibility if you look at their track record.

Jamie: It seems to be less and less.

Sean: They tend to be like a bull in a china shop. They break a lot of stuff when they implement policy sometimes, and they're not, you know, their track record on that side's not very good. But I think, and by the way, they were late to the party, right? I mean, you know, the inflation was 8% before they actually said, "Okay, maybe this is a real problem". If the economy stays strong, and it so far looks like that, and employment, you know, we don't have, you know, 6, 7% unemployment, then I think it is possible that we could see a, you know, not a recession, or a very, very mild recession. What will be interesting to watch though, is what the interest rate changes and what inflation is doing to companies bottom lines, right? So we haven't seen the full effect of that. Because the Fed raised so fast, we don't have enough time to see what the impact of that was. And so the biggest potential risk perhaps, might not be recession, might not be that unemployment will go up. It might be that margins will come down because the companies across the, you know, the fruited plain, if you will, haven't fully digested that. Now some are starting to get ahead of it a little bit by announcing some layoffs, so that might fuel the unemployment thing, or trying to cut costs in other ways. But that'll be the interesting thing, is do we see a robust earnings growth or do we have a non-normal recession but an earnings recession as a result of what's going on here?

Jamie: Sean, you've given us so much to think about. This has been a great conversation and thanks for your time.

Sean: Thank you so much.

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