
Tom Lydon

ETF TRENDSETTER

Educating clients and advisors about ETF strategies sets Global Trends apart. ■ MICHAEL S. FISCHER

Global Trends Investments' entrepreneurial investment approach appeals to business owners who make up the bulk of its high-net-worth client base, according to the firm's founder and president Tom Lydon. "We tend to attract people who worked hard for their money and want to keep it, but also look for opportunities to make it grow over time," says Lydon. The Newport Beach, California investment advisory firm, which he started in 1996, has some $75 million under management.

In 2001–2002, Global Trends Investments transitioned from using mainly mutual funds in its investment process to using mostly exchange-traded funds because many of the best-performing mutual funds had either put in place redemption fees or closed to new investors. ETFs, says Lydon, were transparent, cost effective, tax efficient and easy to use, and they traded throughout the day, which was an advantage to his clients. "As the ETF evolution continued, we got more and more choices, more and more ways to diversify for our clients, and more opportunity to take advantage of trends as they developed in the marketplace."

But by 2005, Lydon and his colleagues were feeling frustrated by the lack of information about ETFs. They decided to create a Web site that would fill the information gap and at the same time educate their firm's clients about the benefits of these products. They started by posting a new story every day on the site, ETF Trends, and offering basic information about the funds—"ETF 101," says Lydon.

That an information vacuum had existed quickly became apparent as search engines began to pick up ETF Trends, he says. "All of a sudden, as we got into 2006 and 2007, we were finding that with the growing popularity of ETFs we were getting more and more not only advisors coming to us and sharing information, questions and ideas, but also self-directed investors." Of course, the site also served as a very effective marketing tool for the advisory business, albeit an indirect one. "As you create this community, and more and more people learn about ETFs and you help them, a level of trust is created. Our site is purely educational; there's nothing on the site that says anything about money management."

In 2007, ETF Trends began offering advertising, and today the advertising funds the site, according to Lydon, who devotes about half his time to maintaining it. Visitors now find eight new stories a day. "As far as we know, we are the most trafficked ETF-only content site on the Net," he says.

Lydon recently explained his firm's investment process during a telephone interview and in an email exchange. He also discussed performance in 2008, and spoke optimistically about ETFs' prospects going forward.

Would you describe your investment plan?

We are not a traditional strategic asset allocation buy-and-hold shop; we have a tactical nature to our investment style. Quite simply, if the market is above its 200-day average, we tend to be more fully invested; if the market's below its 200-day average, or the individual holdings we own, we'll sell them and go to cash or other areas that happen to be trending in the right direction. That's the nature of our investment plan.

It generates trading, and it generates capital gains. But the good things that it provides are less risk than the market, flexibility and opportunities to take advantage of markets as different ones move at different times.

We look at all asset classes—domestic, global, sectors, commodities, currencies and alternatives. And we are only invested in ETFs that are above their trend line. Again, we're not going to have a conventional asset allocation strategy. For example, right now we're 100% in cash, and because most markets, pretty much across the board, were below their 200-day average in 2008, we were 100% in cash for the vast majority of the year.

We've got a very structured discipline, and our company is based on that discipline; we don't override the discipline. Even though we'll do the fundamental research, the bottom line is if we don't sell when we go below that 200-day average, then all our integrity goes right out the door. That's what people are paying us for because they understand what we're doing.

What does your research entail?

On our site, we have an ETF analyzer that will show which ETFs are above their 200-day average; and it also shows the assets. We'll look into the underlying holdings that we get directly from ETF providers; we'll look at daily volumes and confirm the assets in the portfolio. On top of that, if it's getting close to a technical buy because it's getting above its 200-day average, we also do some fundamental research to find out, for example, if we're about to have a rebound, that we're seeing that small-cap stocks are moving faster than large-cap stocks.

We want to understand not only from a technical standpoint, but also from a fundamental standpoint that it makes sense to invest. That's true whether we're buying a sector or we're getting into a global region. It's important for us to feel secure right across the board. Which isn't to say that from time to time we don't get whipsawed, meaning we go above the trend line and it rolls over and goes down, and we get out with a loss. That's just part of the discipline, and clients understand that.

What operational changes did you have to make in the shift between mutual funds and ETFs?

When you buy an allocation for your clients in mutual funds, you determine how much you're going to put in for your clients. You get that night's closing price, the closing NAV, plain and simple.

With ETFs, because they're traded on exchanges during the day, there's a bid-and-ask price that fluctuates during the course of the day. If we're going to buy, say, $5 million of an ETF, there are some things that need to be done first. You have to understand the underlying volume and underlying holdings of the portfolio from a liquidity standpoint to validate that it makes sense. Even though from a technical standpoint it looks right on the chart and the fundamental research backs it up, the liquidity needs to be there. In most cases, we won't buy an ETF that's under $100 million in assets. We also want to make sure the spread is in line and we watch the indicative value of the ETF so that we're not paying a price that's out of line.

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With most of the custodians out there—we use Schwab—we're able to get real-time quotes, real-time bid-and-ask spreads, and get the current indicative value of that ETF. Then we go in and put limit orders. It may be 5,000 shares at a time because you don't want to buy $5 million all at once; it takes a little bit of time to get the order processed. Or you can work through a broker to work with the market-makers on the exchange to create units or shares at a current determined price you agree on. It's very efficient; you have to understand the process. And for many advisors who have utilized mutual funds in the past, this is something new. And once your trade is done, all brokers have the ability to provide average pricing so that way every client buys in at the same price.

In addition, a transaction fee is charged because you're buying a security. So it was very important to us to work with a custodian that gives reasonable pricing. Schwab is very reasonable from a price standpoint; in fact, in the past year or so, they gave commission structure breaks if you agreed to get confirmation statements and monthly statements via the Internet.

We actually worked with all of our clients to sign them up for that, gave them all passwords so they could look at their accounts online. Any time there's a trade, they get an email with a confirmation directly from Schwab. That makes it great for us from a communication standpoint.

How did you perform in 2008?

We were down 10.5% last year versus the S&P 500 being down 38.5%. There were very few periods that were above their trend line for any period of time, and those that were, were above only for short periods. From a relative standpoint that went very well, but there were a few whipsaws. At one point in time, the market will turn. If you look at our performance in 2003, we drastically outperformed the market when we finally had a rebound.

And the ETF sector?

Despite a severely depressed economy in 2008, ETFs still saw net inflows, attracting $178.4 billion. For the year, $320 billion were pulled out of mutual funds. ETFs did lose assets—about 13% for the year—but it could have been a lot worse, considering the kind of year it was for the markets.

Most of the top ETFs in 2008 were short and leveraged funds—a real sign that the markets were stressed and investors were looking for a solution. Investors also flocked to safe havens, such as Treasuries.

How is the market for new ETF products looking?

ETFs are here to stay. We're seeing more interest in ETFs among advisors, who want to learn how to use them.

Three or four years ago, there was a land grab. Those providers who decided to make a commitment to ETFs were going out and trying to have representation in most of the big asset classes, then it moved to the global areas and then to the sectors, and then thinly sliced sectors. Most of the conventional asset classes have representation right now, in competition, which is good. In coming months, we're going to see a number of new types of funds that are targeting new sectors—there's an airline ETF in registration, an Islamic fund and more socially responsible types of funds.

New players are also going to be entering the marketplace. We'll see more mutual funds venture into ETF territory. PIMCO is one of the most recent ones to register with the SEC. We should also be seeing more actively managed ETFs entering the market space.

There has been an increased interest in 401(k) plans and incorporating ETFs into them. We're going to see more of a call for this, and ETFs are ready to make a serious run at this market.

President Obama's stimulus package has made certain sectors more appealing to investors. So we'll see lots of eyes on infrastructure, green ETFs and potentially healthcare.

There's so much momentum right now, and with all the trillions of dollars on the sidelines, once people become comfortable in the marketplace again and it does turn, ETFs are going to get more than their fair share of attention.

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