The hidden source 2020

Index funds play a thumbs-up game. Because fees are so low and funds often track identical or very similar benchmarks, winning funds often beat their colleagues by simple decimalplaces. This has never been more true than with funds traded on the stock exchange, with spending ratios now up to 0.03%. But there's another game that's played behind the scenes of those title fees. This is what ETF revenues produce by lending securities, which can generate additional returns for shareholders and hidden fees for managers. Such a loan is a huge business: more than $2.3 trillion of securities are lent on an average day. About $3 trillion of our assets that we consider lendable, which consist of iShares ETFs, mutual funds, collective trusts, and separate accounts, says Jason Strofs, BlackRock's securities lending chief executive. Through that $3 trillion, about 9% of these securities are on loan on any given day. Legally, mutual funds and stock exchange trades can lend up to 50% of their leveraged securities portfolios to borrowers who pay them interest. Short sellers who bet on stocks are typical borrowers, and the interest they pay on such loans can make ETF shareholders and money managers richer, but there are risks. Consider two ETFs that replicate the same benchmark: the $1.3 billion Vanguard Russell 2000 (ticker: VTWO) and the $41 billion Russell 2000 (IWM) iShares. Vanguard's expense ratio is 0.15%, and iShares' expense ratio is 0.2%, but over the past five years iShares has achieved an annualized return of 11.90%, compared to 11.89% for Vanguard. Meanwhile, the benchmark Russell 2000 underperformed both ETFs with a yield of 11.84%. The bond lending largely explains these performance differences. The iShares ETF had $4.8 billion of its securities on loan, according to its 2017 annual report, and average assets of $31.7 billion during that fiscal year. For this loan, the fund received $68 million in interest. This interest is equal to 0.21% of the ETF's assets, sufficient to cover the entire expense ratio. So, he outperformed the Russell benchmark. In contrast, the Vanguard ETF only had $25.1 million on loan during its 2017 tax, with an average assets of $1.4 billion. For his loans, he received $1.9 million in interest, which translates into an interest rate of 0.14%. So the higher return on the iShares ETF allowed it to overtake Vanguard's fund, despite having a higher expense ratio. However, in this case a fundamental distinction must be recognised. lent only 2% of its assets, compared to 15% of iShares. This added risks to the loan courts. With any loan, there is a possibility of the borrower defaulting. ETFs, however, have regulatory guarantees. Loans must be fully guaranteed by law; in fact, in standard practice, they are over-collateralized, which means that fund companies raise more money than the value of the lend : 102% of the value of US equities, slightly more for foreign equities, all adjusted daily for share price fluctuations. In addition, portfolio managers examine the credit quality of each borrower. However, lending 15% of assets is 2% riskier. In an August 2016 paper titled Securities Lending: Key Considerations, Vanguard outlined two common lending strategies: volume and value. Vanguard takes a value-based approach, where we are much more selective in the securities we lend, says Jim Rowley, head of active/passive portfolio research at Vanguard Investment Strategy Group. Such stocks on Wall Street are called trading specials, which means there is more demand to borrow them. So, the loan fee we collect on this is a premium to lending other shares. We have less on loan, but the income we generate on that lower amount is a higher percentage of their value. Another Vanguard 2016 document, of which Rowley is also a co-author, analyzed loan results for 50 mutual fund managers and exchange traded from 2007 to 2014. It found that when it adjusted results for the loan amount, Vanguard had the best return on its loans, followed by Charles Schwab (SCHW), while BlackRock (BLK) ranked 26th out of 50 fund managers. The funds had a weighted average of 0.027% of loan yields, but yields varied considerably. ETFs that invested in smaller, less liquid securities, which are harder to borrow, had higher loan yields. But why not lend more if it increases returns? Strofs argues that BlackRock lends more because it is better equipped to do so than its peers: It's fair to say that Vanguard is lending less. I would also say that we are lending what makes sense to our funds. I'd say it's more challenging and difficult to do what we're doing. It is easy to lend the required special titles. In fact, BlackRock has a history of proving that it can handle large loan volumes. Since the beginning of its lending programme in 1981, only three of its borrowers with borrowings have defaulted. In any case, BlackRock was able to use loan guarantees to avoid losses for its investors. However, loans invite conflicts of interest. Unlike Vanguard and Charles Schwab, which return all proceeds from loans to their ETF shareholders, BlackRock maintains a share of the ETF's borrowing income for itself, from 20% to 28.5% depending on the fund. In addition, most ETF managers invest loan guarantees in the affiliated money market, allowing companies to collect additional fees and creating another incentive to over-charge. Of the ETF's five largest players, only Schwab invests guarantees in non-affiliated money market funds. Such hidden conflicts could play a damaging role in the ongoing tax wars. For example, State Street (STT) made a big splash last October, when it announced that was reducing fees on 15 SPDR ETFs to undercut those of Vanguard and BlackRock. Less publicized was the fact that State Street had, five months earlier, increased the amount of bond loans that all its ETFs could make, to 40% of assets from 25%. State Street also returns the proceeds of its loan revenue to its ETFs, after 15% of it goes to its loan agent, State Street Bank. So while the drop in stock exchange-traded fund fees benefits investors, loan risks and State Street revenue may now increase, but most shareholders will no longer be wise. Correction: An earlier version of this story said that State Street maintains 15% of the revenue it earns from loan stocks. All proceeds are returned to the fund; that 15% goes to compensate his loan agent, State Street Bank. In addition, State Street increased the amount of securities its funds could lend five months before lowering prices on 15 of its SPDR ETFs. An earlier version of this story said it happened at the same time. Email: editors@barrons.com There's nothing wrong with walking the well-worn trail of tourist hotspots in any city, but it's the hidden gems that really add depth and excitement to a vacation. With that in mind, here are the underrated restaurants, museums, shops, and more to visit in several key locations. It's time to make the most of that plane ticket. Photo by Ryan SlackTokyoBig Love Records: Japan remains a place where tactile music has a huge fan base. The case is the colossal Tower Records in Shibuya that is always teeming with customers. But amid the series of independent hole-in-the-wall record stores, Harajuku's Big Love Records stands out. It's one of the best places to find dark B-Sides, the rarest rarity, and even limited-edition music by artists like David Lynch. Even if you don't leave with an album (or three), it's a great place to grab a bite, a beer, or one of its tote bags with Gothic letters made in collaboration with artist Cali Thornhill-Dewitt.Grandfather: The concept of a record-only bar is a kind of recurring theme in Shibuya hotspots, but grandfather's has a certain nostalgic charm that's worth it. Tucked away in the basement of a building, it was founded in 1971 by a group of audiophiles from Hitsotsubashi University. Glenplaid upholstery and tablecloths and dim atmosphere have made it a favorite of Japanese salaried men looking to relax after work - some will also buy bottles of whiskey specially to drink at the bar, with their names clearly labeled on each bottle. You'd almost be forgiven for thinking that this kind of place to Mad Men. Unlike nearby JBS, which plays a variety of records, Grandfather's is unique in that its musical selection stops in the 1970s. Requests are made one song at a time, via paper slips delivered to the bartender. Kaikaya by the Sea: Tokyo is not lacking bars specializing in Japanese pub food, but Kaikaya has become something of a cult restaurant for in-the-know jetsetters. Located in Shibuya, its mural exterior is covered in stickers from global streetwear brands, and inside both locations (a second restaurant open next to the original) are framed letters from California surfboard shaper godfather turned streetwear Shawn Stüssy. Sake cocktails like Lemon Sours are especially tasty here, and chef prix fixe's menu is an ideal way to immerse yourself in the restaurant's offerings. Appetizers such as fish carpaccio and the unusual but tasty sea bass pancakes of gorgonzola ricotta offer the place to more substantial offerings such as tuna ribs and sushi nigiri of kobe beef. Homemade cherry blossom ice cream is the perfect end of the meal. Millions of people turn to free and open source software for personal productivity and gaming. But is this the right move for you? There are many advantages to taking the open road, as well as some danger signs to be aware of first. Open source perks Don't ignore a good deal. Not only is the software free, there are no licensing fees to pay, making open source particularly attractive to low-cost businesses. At that price, testing the waters of open source is available to anyone. Join a community. Being part of the open source movement binds you to a legion of developers and users who share a common interest and enthusiasm to improve the performance of the program. Be safe, safe and see-through. Since there are so many people working on the program and bugs can be handled immediately, you can expect fixes and new versions faster than commercial applications. And because the source code is public, the security measures in the software can be easily verified and, if necessary, improved. Customize programs. If you know enough about programming, you can dive into the available source code and create your own software add-ons to make programs do exactly what you want. If playing with a program language makes you feel as comfortable as a medical intern dealing with a corpse for the first time, users with great ideas can offer suggestions to developers. ShortcomingsLess Open Source Selection. While there are thousands of open source programs available, commercial software still surpasses them by far. While there are representative programs for many common types of software, there is almost no wealth of availability that commercial programs have, especially when it comes to video games and productivity titles. Not ready for prime time. Many developers immature programs to leverage willing helpers in the open source community. Users can expect to run into some operational issues. People can fix the bugs themselves or refer to older, more stable versions that may not have newer changes, but have been extracted and tested can be difficult to use. In many cases, open source software is programmers for programmers and lacks the delicate learning curve or support that would be found with commercial titles. As open source programs progress and mature, however, they are becoming friendlier for beginners to enter and have better designed tutorials and help options. A price for freedom. Sure, the programs are free, but it could still cost a bit if you're having trouble running the programs. Open source licenses do not prevent companies from selling advanced packages of free software or doing a business without offering support. Sun, for example, sells a packaged version of OpenOffice called StarOffice for $79.95, which comes with manual and technical help. Guide.

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