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Blue Tractor Allows Shielded Alpha ETFs to Adjust Transparency

The firm had a 'eureka moment' last month when it realized its semitransparent ETF technology allows managers to scale back transparency as needed, its cofounder says.

By Brian Ponte | November 30, 2022

Blue Tractor Group has started promoting a capability that will allow managers using the firm's Shielded Alpha wrapper to adjust their product's transparency as needed.

Dubbed "Flexible Transparency," the capability within the firm's semitransparent ETF wrapper allows managers to adjust the transparency of their portfolios without filing for new exemptive relief, said Terry Norman, Blue Tractor's co-founder.

The capability is available for managers who license Blue Tractor's portfolio-shielding platform, Norman said.

"You can enjoy all the benefits of a fully transparent ETF when you want, but there will be times when you want to reduce that level of transparency, and you can't do that in a fully transparent framework," Norman said. "Even if the creation unit doesn't contain all the security names, you still have to reveal the portfolio on your website."

There are instances, however, when managers may wish to reduce an ETF's transparency, he noted.

"For instance, if you're building up or unwinding a position, you're signaling to the market that you believe this is a buy or a sell," Norman said. "You might find lots of other people take note of what you're doing and wish to sell as well, but with the Shielded Alpha structure, you can sell without signaling that to the market."

Managers that use Flexible Transparency can opt to make their products fully transparent, Norman noted.

While Shielded Alpha products have always technically been able to use this feature, Blue Tractor did not "conceive of it" until a month ago, said co-founder Simon Goulet.

“We kind of had this epiphany watching Cathie Wood and Ark struggle in the marketplace being fully transparent and [we thought], ‘Wouldn't it be nice if she could turn it on when she wants to be a little bit opaque, perhaps when she wants to rebalance or buy or sell, but then go back to being fully transparent?’” Goulet said. “And that's when we kind of had this eureka moment that we can do that with the cloud solution.”

Wood's activity has been highly scrutinized, with websites like CathiesArk.com documenting all of the trades conducted by Ark's six ETFs.

The firm's flagship ETF, the \$7.7 billion Ark Innovation ETF, has also been imitated by ETFs such as the \$333 million AXS Short Innovation Daily ETF. The AXS ETF “seeks to provide investment results that are approximately the inverse (or opposite), before fees and expenses, of the daily price and yield performance of the Ark Innovation ETF,” its prospectus shows.

Blue Tractor's structure differs from its rivals like Precidian Investments because those structures are fully nontransparent and do not require funds to publish baskets, meaning they can “never show any names,” Goulet said. And proxy structures, like those offered by Fidelity and T. Rowe Price, must disclose to the marketplace how much transparency has been given, he added.

Blue Tractor's model, meanwhile, only requires funds to disclose at least 90% of the holdings and weightings of a fund's portfolio, Goulet said. It does not require managers to disclose how much transparency they're giving.

Managers can run a fully transparent product every day and “the market would have no clue, unless you want to let the market know,” he added.

Shops including Capital Group, Harbor and Neuberger Berman have entered the ETF market this year with primarily large-cap-focused, active equity ETFs that are fully transparent, said Todd Rosenbluth, head of research at VettaFi.

There are, however, other firms “on the sidelines” that might want to offer core strategies with added protections against front-running, as well as existing ETF providers that seek to offer smaller-cap strategies that would “benefit from delayed disclosure,” he added.

Blue Tractor hopes that offering a choice to managers who wish to embrace transparency will mean some will opt for “flexibility as opposed to rigidity,” Norman said. “The bigger challenge for us is making managers aware that a new option exists for them,” he added.

Portfolio-shielding ETFs have had a rocky start since the first two debuted in 2020, due in part to distribution-related hurdles. In addition, some of the “biggest holdouts” among active managers have recently launched fully transparent products, said Bryan Armour, director of passive strategies research for North America at Morningstar. Blue Tractor's

flexible transparency could attract new sponsors, but investors largely do not prefer less transparency, he added.

The Shielded Alpha wrapper is currently used by two ETFs, Norman said: the \$45 million Stance Equity ESG Large Cap Core ETF and the \$18 million Alps Active REIT ETF.

In April, Summit Global Investments disclosed plans to use the Blue Tractor technology for its forthcoming SGI Dynamic Tactical ETF.

Investors piled \$9 million into the Stance Equity ESG Large Cap Core ETF and pulled \$3 million from the Alps Active REIT ETF during the year ended Nov. 29, according to data from FactSet.