IPO ETF 'Catch and Release' Strategy

BI ETFs, Global Dashboard


Eric Balchunas
Team: Strategy
BI Senior ETF Analyst


Morgan Tarrant
Team: Retail
BI Associate Analyst

`Catch-and-Release' ETF Hooks More IPO Winners Than Losers

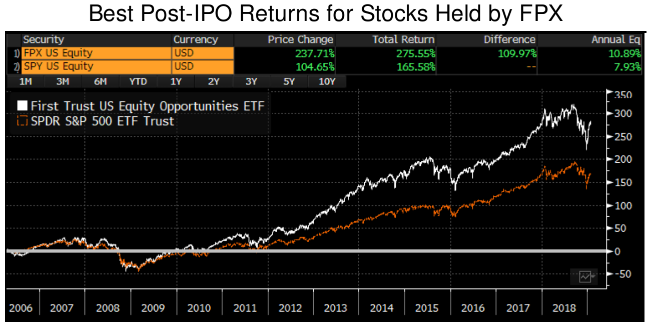
(Bloomberg Intelligence) -- IPO exchange-traded funds capture the early returns of public stocks before they qualify for stricter mainstream indexes, a strategy that's helped the oldest ETF in the category beat the market by more than 100 percentage points since launching in 2006. Despite the outperformance, IPO ETFs as a whole only have $1.2 billion in assets. (02/04/19)

1. S&P 500 Beaten by Overlooked IPO ETF

A catch-and-release strategy for IPOs and spinoffs has backed a 275% return for the First Trust US Equity Opportunities ETF (FPX) in the 13 years since it launched -- 110 percentage points better than the S&P 500 Index. FPX buys newly listed securities with market capitalizations of least $50 million and reasonable liquidity, with an equity float greater than 15%. In 2018, 142 of the 204 domestically listed IPOs made the cut. The ETF seeks to earn excess return on the structural time gap from IPO to when a security can be added to major indexes, typically 2-3 years after listing. Holding the shares for four years aims to minimize turnover and helps diversification.

Despite its performance, FPX has gathered only about $990 million. IPOs may be perceived as risky to own. (02/04/19)

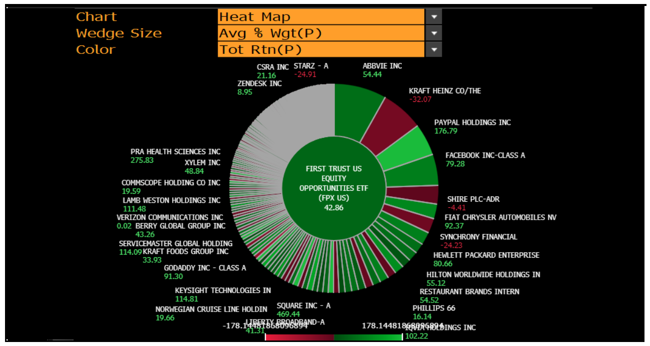
Best Post-IPO Returns for Stocks Held by FPX



2. Abbvie, PayPal Drive Returns for IPO ETF

Abbvie and PayPal are the top contributors to positive returns for the First Trust US Equity Opportunities ETF (FPX) over the past four years. Not every IPO lives up to its hype in the initial years, as with Fitbit and DropBox. As an ETF following a rules-based index, FPX holds both breakouts and duds -- such as flagging Kraft Heinz -- for four years, though the former have more than made up for the latter. The fund has about $990 million in assets and charges 60 bps a year in fees. (02/04/19)

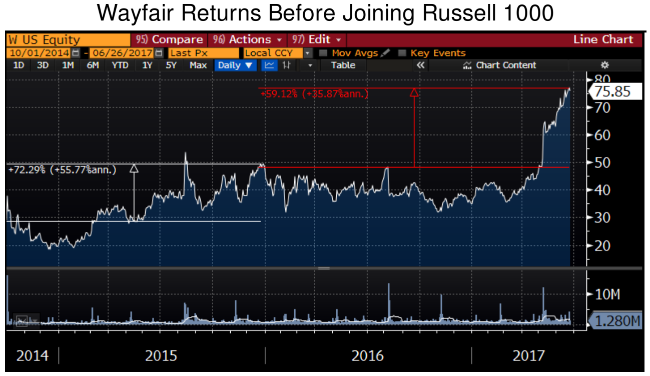
IPO ETF Beats S&P 500 by 110 Points



3. Structural Advantages Support Index Gains

FPX gets a chance at newly issued equities' returns before major indexes, which tend to have strict criteria for inclusion, typically meaning years can pass before a company is taken in. First Trust's US Equity Opportunity Index added Wayfair in mid-December, 2015, after its IPO in October 2014. The stock returned 59% before being added to the Russell 1000 Index a year and a half later. Square was added by FPX in mid-March 2016, four months after its IPO, and gained 89% before joining the Russell 1000 at the end of May 2017. While Fiserv's acquisition of First Data may take aim at some of Square's mobile-payment market, FPX also holds FirstData, which went public in October 2015. (02/04/19)

Wayfair Returns Before Joining Russell 1000

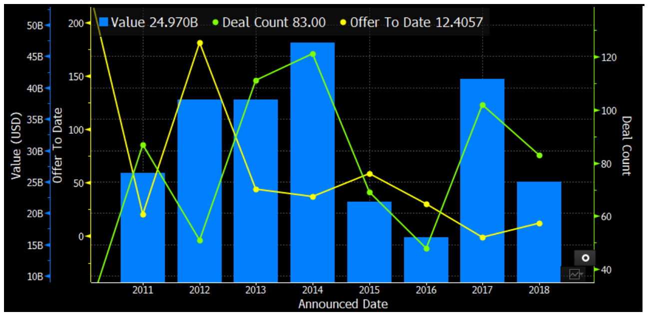


4. IPO Decline Could Affect ETFs in Future

A potential challenge for IPO ETFs is a narrower pool of issues. The number of domestically listed IPOs above $50 million declined 18% in the past four years vs. 2011-14, and listed values were 30% smaller overall. Research shows more closely held companies are choosing to be acquired rather than hold IPOs, giving founders and management a bigger say in a buyout than potential shareholders. Heightened demand can buoy shares above the listing price in the first days of trading. FPX adds new issues to its index on rebalancing dates, avoiding early volatility, but also ceding any initial price jump.

An IPO boom -- perhaps sparked by inflation -- could spell trouble for FPX if there's a subsequent crash, as in the late 1990s. (02/04/19)

IPO ETFs Face Narrower Issue Pool

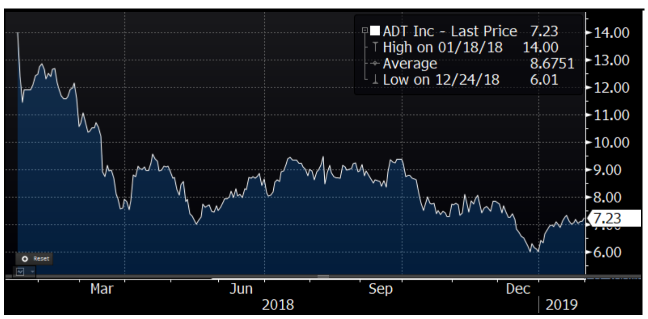


5. Rules-Based ETFs Can Cut Both Ways

A rule-following IPO ETF forces investors to purchase future winners that they may not connect with intially, but FPX is also susceptible to buying overvalued new listings. ADT's early-2018 IPO, less than two years after being taken private, was considered by analysts to carry a lofty valuation amid heightened competition in home security. The shares have since fallen to half of the initial listing price -- a drag on FPX to-date. Yet the security will remain in the fund for three more years and consensus is bullish.

Counterpoint: Rules-based fund management withstands turbulence and share declines that an otherwise disciplined manager may not be able to. (02/04/19)

ADT Share Price Since 2018 IPO



6. Renaissance ETF Releases IPOs Earlier

A handful of IPO ETFs do roughly the same thing as FPX, but with variations. The Renaissance IPO ETF (IPO), which is run by a research shop tracking its own index, releases IPOs and spinoffs after two years, instead of four, and has a mechanism to take in bigger offerings after the fifth trading day, rather than the next quarterly rebalance. The Renaissance ETF also draws more of its returns from overseas companies listing in the U.S., such as Spotify, with almost 20% of its holdings in such companies vs. FPX's 10%.

IPO has underperformed FPX by 31 percentage points over the past five years. (02/04/19)

New Issue ETFs, Tale of the Tape

	FPX	CSD	FPXI	IPO	IPOS	FPXE
Name	First Trust US Equity Opp.	Invesco S&P Spin-Off	First Trust Intnl. Equity Opp.	Renaissance IPO	Renaissance Intnl. IPO	First Trust Europe Equity Opp.
Fee	60 bps	65 bps	70 bps	60 bps	80 bps	70 bps
AUM ($MM)	993	148	20	16	2	2
Geo-Focus	U.S.	U.S.	ex-US	U.S. Listed, 20% Intnl.	ex-US	Europe
New Listing 'Capture' Period	4 years	2 years	4 years	2 years	2 years	4 years

Source: Bloomberg Intelligence

To contact the analyst for this research:
Eric Balchunas at ebalchunas@bloomberg.net