



## Under the Hood: What's in Your Index?

(An Ongoing Series - February 2016)

*Robo-Adviser, Part II, or What's in Your Asset Allocation Program?*

The iShares Core Builder<sup>1</sup> creates an asset allocation policy for one's portfolio based on the answers to five multiple-choice questions. Recently, I took this robo-test with hypothetical responses—in fact, I took it twice with different responses to see what the difference in the proposed asset mix and costs would be. The questions are all multiple choice.

Q: What do you consider your investment style to be?

A: My answer: conservative.

Q: If the market sees a downward swing, how would you react?

A: Do nothing.

Q: If the market sees an upward swing, how would you react?

A: Do nothing.

Q: How long do you plan to keep your assets invested for?

A: 11-20 years.

Q: How much would your initial investment be?

A: \$1 million.

My results generated an asset mix of four ETFs that would carry a weighted-average management fee of eight basis points. To be clear, that is 8 hundredths of 1%. From that 8 basis points, BlackRock, the owner of iShares, must pay administration and distribution fees, so perhaps there are 5 or 6 basis points left. After application of taxes, maybe 3 or 4 basis points. What if this robo-test was so successful that it helped to gather \$100 billion of new assets into each of the four ETFs? Each of them would then be tied for the 2<sup>nd</sup> largest ETF in the world; the largest is presently \$164 billion and the 2<sup>nd</sup> largest is \$64 billion. So the four together would represent \$400 billion of new assets – a sterling and singular success in the world of asset management. At 3 ½ basis points, this would produce \$140 million of incremental earnings for BlackRock, a company that earns \$3.3 billion; it would move the earnings needle by 4%.

This proposed portfolio, based on my first set of hypothetical answers, would be weighted 68% in stocks, 32% in bonds. Table 1 shows the proposed holdings:

Table 1: Conservative Asset Allocation

<u>Symbol</u>	<u>ETF</u>	<u>Weight</u>
ITOT	iShares Core S&P Total Market	51%
IXUS	iShares Core MSCI Total International Stock	17%
IUSB	iShares Core Total USD Bond Market	22%
IAGG	iShares Core International Aggregate Bond	10%

*Source: iShares Core Builder*

Now, iShares says it can accomplish my return objectives by either buying the four ETFs shown in Table 1, or it can simplify the solution with one allocation: 100% invested in the iShares Growth Allocation ETF (AOR) for a fee of 24 basis points.

I then decided that I was too conservative in these responses, so I changed my answers, seeking a more aggressive allocation. I answered, therefore, in the following way:

Q: What do you consider your investment style to be?

A: Aggressive

Q: If the market sees a big downward swing, how would you react?

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<sup>1</sup> <https://www.blackrock.com/wte/core-builder/us?refType=fi>



A: Invest more.

Q: If the market sees a big upward swing, how would you react?

A: Sell some investments.

Q: How long do you plan to keep your assets invested for?

A: 11-20 years.

Q: How much would your initial investment be?

A: \$1 million.

These responses drew a weighted-average management fee of 11 basis points and an asset allocation of 75% stocks, 25% bonds versus 68% and 32% respectively in the conservative asset mix. Table 2 shows the proposed portfolio selections:

Note that the first three allocations—iShares Core S&P 500 (IVV), iShares Core S&P Mid-Cap (IJH), and iShares Core S&P Small-Cap (IJR)—add up to 51%, the same allocation proposed for the iShares Total Market in the conservative portfolio. That might be coincidence, however. To simplify, the proposed alternative was to put 100% of my money into iShares Core Growth Allocation ETF for 24 basis points, the same as for the conservative portfolio.

The rate of return of the Growth Allocation ETF since its November 2008 inception is 8.1%. The fund is 40% weighted in bonds. Yet in neither of the proposed multiple-ETF portfolios was I anywhere near the 40% bond allocation that I would get if I purchased AOR.

Table 2: Aggressive Asset Allocation

<u>Symbol</u>	<u>ETF</u>	<u>Weight</u>
IVV	iShares Core S&P 500	27%
IJH	iShares Core S&P Mid Cap	15%
IJR	iShares Core S&P Small Cap	9%
IXUS	iShares Core MSCI Total International Stock	15%
IEUR	iShares Core MSCI Europe	9%
IUSB	iShares Core Total USD Bond Market	9%
CRED	iShares Core US Credit Bond	8%
IAGG	iShares Core International Aggregate Bond	8%

Source: iShares Core Builder

So, the question arises: How is a 100% allocation in the iShares Core Growth Allocation ETF with a 40% weight in bonds equivalent: 1) to both the aggressive strategy, as well as the conservative strategy together and, 2) to either of them alone when its bond allocation is far higher? This should provide the reader with a sense of how extreme the fee compression (or perhaps the impact of extreme fee compression upon asset allocation) has become.



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