



## ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments



August 28, 2015

### **Vanguard Launches Two New Funds**

It took a while, but Vanguard finally pulled off the launch of two new funds this week. While the Alternative Strategies fund will be out of the reach of most individual investors, the oft-delayed Tax-Exempt Bond Index may be of interest to those looking for a low-cost index or ETF covering the national municipal bond market.

### **Vanguard Tax-Exempt Bond Fund Finally Debuts**

On August 25, Vanguard officially introduced Tax-Exempt Bond Index fund, its first municipal bond index fund, after a half-dozen false starts. Here's a final rundown of Tax-Exempt Bond Index's countdown to launch.

In June 2010, Vanguard filed to launch three muni bond index funds and ETFs before withdrawing the application six months later and going mum on the topic.

Then, as we've [covered extensively](#), Vanguard announced plans in January 2015 to launch a single municipal bond index fund on April 7 before pushing its opening back six times.

Now that it's finally available to investors, we thought we'd take a look under the hood and share what we know about the new fund. It comes in three share classes: Investor (ticker symbol: VTEBX), Admiral (VTEAX) and ETF (VTEB).

The Investor class shares require a \$3,000 minimum investment, and charges 0.20% in operating expenses along with a 0.25% front-end load. Investors with deeper pockets can invest in the Admiral shares, which carry a reduced 0.12% expense ratio (along with the same 25-basis-point front-end load), by meeting the \$10,000 minimum.

Our expectation is that the ETF shares—which also charge a 0.12% expense ratio, but have no investment minimum or purchase fee—will end up with the most assets of the three share classes.

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Tax-Exempt Bond Index's objective is to track the performance of the S&P National AMT-Free Municipal Bond index, which has an average maturity of about 14 years and a portfolio of more than 10,000 bonds across the investment-grade, muni-bond spectrum.

As befitting Vanguard's low-cost reputation, the new fund undercuts the industry average by a significant margin. The average expense ratio of municipal bond funds in Lipper's General and Insured Municipal Debt Funds category was 0.95% as of Dec. 31, 2014. Similar ETFs carried average fees of 0.28%.

The iShares National AMT-Free Muni Bond ETF—which tracks the same index and has more than \$5 billion in assets—is Tax-Exempt Bond Index's most immediate competition. The iShares product launched in 2007, a nice early edge, but that's nothing new with Vanguard and the ETF space, where it has regularly entered late and won market share through lower costs. With an expense ratio less than half of the 0.25% charged by the iShares ETF, Vanguard Tax-Exempt Bond ETF enters the market with a decided cost advantage.

### **Vanguard Alternative Strategies Fund Now Available**

As we reported earlier this summer, Vanguard's Alternative Strategies fund was approved for launch in late May, but just started trading on August 11—and only for a select, institutional audience, which includes Vanguard itself.

As a refresher, the fund is an unusual one in the Vanguard universe, which is typically known for its low-cost, straightforward stock, bond and money market options. Alternative Strategies, managed by Michael Roach from Vanguard's in-house Quantitative Equity Group, looks to deliver positive returns in all market environments by employing "alternative" investment strategies involving long and short positions in stocks, bonds, commodities and currencies. The ultimate aim is gains with low correlation to stock and bond markets with less volatility than stocks.

Given Vanguard's decades-long stance against relatively exotic investment strategies, Alternative Strategies stands out as an anomaly, but most retail investors will be locked out of the fund (which carries a \$250,000 minimum and charges 1.10% in expenses) because Vanguard is solely offering it through its institutions-only advisory service at first. Vanguard has said the fund will eventually assume an approximately 10% position in the Managed Payout fund-of-funds, and we expect it will replace two former sleeves: Commodities, once owned by an internal fund but recently accessed via the PowerShares DB Commodity Index Tracking fund; and long-short strategies represented by Vanguard's Market Neutral fund.

We're not convinced that limiting the fund to institutional investors is the right call here. Vanguard says that adding the alternative fund to Managed Payout will "provide further diversification and reduce portfolio volatility." (We'd note here that they don't mention improving returns.) There are certainly outside advisers and individual investors who would like the opportunity to add those benefits to their portfolios. For now, they'll have to wait for a low-cost, accessible alternative fund.

Maybe the wait is a good thing. Whether Vanguard can provide an alternative fund worth investing in is a question only time will answer.

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Adviser Investments 85 Wells Avenue Newton, MA 02459 USA