Magoon’s New ETF Firm Offers Income Focus

By Cinthia Murphy | May 03, 2013

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Christian Magoon, well known in ETF circles from his tenure at Claymore and, more recently, as a consultant to ETF providers, is starting a new ETF firm, YieldShares, that will focus exclusively on the development and marketing of income-oriented funds, a niche of the market he says is underserved.

His very first ETF, already in registration under Exchange Traded Concepts’ “ETF-In-A-Box” platform, is the YieldShares High Income ETF (NYSEArca: YYY), a fund that will invest in about 30 closed-end funds (CEFs) with a heavy focus on equities CEFs.

The strategy, which is in many ways akin to what Invesco PowerShares sets out to do with the PowerShares CEF Income Composite Portfolio (NYSEArca: PCEF), looks to screen for CEFs that show high discounts to NAV, high distribution rates and high liquidity. It’s a much smaller portfolio—about a fifth the size of PCEF’s, which should provide for a more focused access to high-income-generating names, Magoon said. PCEF is currently yielding about 7.25 percent.

The index from the International Securities Exchange that’s underpinning the strategy is currently showing an average 5 percent discount to NAV, meaning investors would be buying $1 worth of assets for 95 cents—that discount feature for what’s considered an income-producing asset is not uncommon for CEFs, he said.

Still, carving a niche in an ETF market that, while it continues to grow, is heavily dominated by a handful of sponsors, is no easy task. Many have tried and failed to find a foothold in a space where some 90 percent of the assets lie in the hands of 10 providers or so.

Magoon is betting on keeping a very clear focus and a very specific investment objective as his way to break through the crowd and stand out as the provider of income strategies.

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“It’s important to have a line of products that’s easily understood and designed for a very specific purpose,” he said. “There’s an opportunity here being missed in the income ETF space. YYY will not be for everyone, but hopefully YieldShares becomes synonymous with income investing.”

YYY will comprise about 60 percent equities CEFs and 30 percent bond CEFs—roughly the inverse of the split PCEF offers. That higher focus on equities, Magoon says, could land YYY among the top yield-producing ETFs in the market as it captures more of the source of distributions, namely equities.

YYY can invest in a variety of funds that own securities including equities, taxable investment-grade bonds, high-yield debt, municipal securities, preferred stock, convertible bonds, commodities and REITs, among others.

Eligible holdings, picked from the entire universe of U.S.-listed closed-end funds, must have at least $500 million in market capitalization and meet minimum trading volume requirements.

The funds are then ranked based on factors thusly: in descending order by fund yield; in ascending order by fund share price premium/discount to NAV on the index rebalancing date; and in descending order by fund average daily value of shares traded over the six-month period prior to the index rebalancing date.

Once ranked, the top 30 underlying funds are included in the index, and are weighted based on what the company calls a “modified linear weighted methodology.”

That essentially means the weighting scheme begins by assigning the top-ranked security the greatest weighting in the portfolio that equates to the multiple of the smallest weighting—in a portfolio of 30 names, the top-weighted holding’s weight will be 30 times that of the smallest.

YieldShares will be sharing a home office ZIP code with First Trust in Wheaton, Ill., meaning it’s not too far from PowerShares’ and Guggenheim’s headquarters either.

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