Ryan Kirlin - Alpha Architect - Transcript

Tim Mullooly: Welcome back to Living With Money. This is Tim Mullooly. On today's episode, I'm joined in the office by Ryan Kirlin. Ryan is the head of capital markets for Alpha Architect. Thanks for stopping by the office today, Ryan.

Ryan Kirlin: Yeah. Thanks for having me.

Tim Mullooly: So before we dive into ETFs and that whole universe, do you want to take us back to the beginning of your career, how you got started in the industry and what you were doing when you got started?

Ryan Kirlin: Yeah. I guess I went to college and didn't really know what I wanted to do with my career. I thought maybe I wanted to be a political science major, just purely because I liked writing. My Dad at the time, I called him, I was like, "Yeah, I want to be a political science major." He was like "Well, what are you going to do with that?" No offense to political science majors out there.

Tim Mullooly: It's a fair question.

Ryan Kirlin: Yeah. But I was like, "I don't know." So then, yeah, I just basically studied economics, because I was like, Well, that seems to be more sense, a business major." I don't know. I went to school in New York City, so that led me to the New York Stock Exchange. There I worked in the exchange-traded funds group, where basically our job was to convince ETF issuers, so ETF companies, iShares, Vanguard, all the way down, to list on the New York Stock Exchange. And it was pretty easy to do at the time because the New York Stock Exchange was the only real player in the game at the time for ETF listings, so we had 99% market share, so that was good.

Tim Mullooly: Definitely makes it easier.

Ryan Kirlin: But it was just a great training ground. My whole time in the ETF industry, everybody's always thought of the ninth inning, the ninth inning. So at that time people kind of thought it was late, but obviously in hindsight we know that it wasn't late. There was still a lot of growth to go.

Tim Mullooly: Yeah.

Ryan Kirlin: It was just a great training ground because you kind of get to meet everybody in the industry, working with all the ETF issuers.

Tim Mullooly: Right. Definitely get your feet wet, build relationships with everyone at different companies. Definitely a good place to start.

Ryan Kirlin: Yeah.

Tim Mullooly: Before we go any further, for the listeners out there, I feel like we should start at square one and just explain what an exchange-traded fund or an ETF is. Probably a term for some individuals that they've heard, but might not know exactly what it is.

Ryan Kirlin: Yeah. Exchange-traded fund, simplest sense, I guess you would just say, I would think of it as a mutual fund. Most clients are familiar with the mutual funds. What's a mutual fund? Well it's a pooled investment vehicle, meaning you're combining all of these different investors together in one structure so that you own one small slice of that pool.

Tim Mullooly: Right.

Ryan Kirlin: Okay. So mutual fund, we can have a lot of investors own a piece of the larger. ETF same thing, you have a lot of investors own a piece of the larger. But then there's some differences with an ETF, such as the most noticeable one I would say is that ETFs trade like a stock. They don't trade the exact same as a stock, but they trade like a stock in the sense that you can trade them all day long on an exchange. You can wake up at 9:30, and buy some shares, and then you can turn around at 10:00 and decide, I'm sick of this, I'm out, whatever, as opposed to a mutual fund, you can only buy or sell once a day at the end of the day.

Tim Mullooly: Right. Yeah.

Ryan Kirlin: That's probably the biggest, most noticeable difference, I would say, but that's generally what an ETF. It's just a pooled investment vehicle that is because it's listed on the exchange, can trade similar to a stock.

Tim Mullooly: Right. Got it. Okay, while you were working on the stock exchange, you said you were helping getting ETFs listed and on the exchange. What's that process like getting an ETF launched, and what needs to be done before an ETF can start trading on the exchange?

Ryan Kirlin: It all depends how exotic or non-exotic that ETFs investment strategy is, but generally speaking most ETFs can be fast tracked were SEC has created a set of rules where they're like, this is just a plain vanilla thing, which 95 plus percent of ETFs that get listed and end up trading are. It owns U.S. stocks, it owns a hundred of them, or two hundred of them, or whatever. That's just considered clean, and easy, and simple, and safe relatively for investors. That kind of stuff can just get fast tracked. Once a ETF issuer submits to list with the exchange, then it's the same process as doing an initial public offering for a stock.

Tim Mullooly: Right.

Ryan Kirlin: Where the ETF becomes then just listed on the exchange, and there's a first day of trading. Difference is, with a stock they're using that to raise capital in an IPO. They're like, "Hey, we're going to sell these 200 million dollars’ worth of our company. So investors are now going to own 50% of company for 200 million dollars." With an ETF, there is no ... An ETF could trade zero shares on day one. You're just listing it on the exchange, again because the ETF is giving you the rights to own whatever is in the underlying fund. The process is pretty straightforward. Go to the exchange, the exchange gives you the thumbs up to list, and then you're up and running. It takes about three months all in.

Tim Mullooly: Depending on ... And if it's, like you said more exotic, it takes a little bit longer?

Ryan Kirlin: Yeah, there's always some wacky stuff. People are always trying to push the limits. There was one, people had an idea to launch a diamond ETF. So there's a gold ETF, and this thing is a smashing success. To this day, the gold ETF, GLD, was the most successful launch of all time. It hit over a billion dollars in three days, in assets under management because it just made sense. It was really though in a lot of ways, the GLD ETF was a great example of how ETFs are democratizing asset management because before that ETF, if you wanted to own gold it was a very complicated process. There was no clean way for a regular retail person. You could go buy physical gold and store it in your house, but that's not a great solution.

There were complicated vehicles to have exposure to gold, but GLD you could just go on, with $25 buy one share of GLD, and now you have $25 worth of gold that you technically own. GLD, the ETF investment vehicle handles the actual holding of the gold. For more exotic stuff like that, it sometimes can take longer.

Tim Mullooly: I also read that you helped build indexes at the stock exchange as well. Do you want to talk a little first about, on a basic level, what an index is, and the process of building an index. And how these different ETFs that we've been talking about use and incorporate some of the strategies that the index uses?

Ryan Kirlin: Yeah. So with ETFs ... ETFs will track an index. So, what's that mean? Well, basically the index is just an Excel spreadsheet that tells the fund, which is the physical investments what to buy and sell. But because the index is just an Excel spreadsheet ... So let's say it's a simple thing. You own Ford, General Motors, and Toyota. So you have Ford, General Motors, Toyota, we own those three, that's our index. Then the fund, the ETF itself, owns then Ford, General Motors, Toyota. Good thing about the index is, it's not real so it doesn't have to deal with trading consequences. It cost you some kind of money to go out and buy Ford, you have to pay a brokerage fee or whatever. The ETF simply tracks what the index tells it to do, but the fund is the real world thing that's actually happening.

So now, something I had learned when I was at the NYC, there's a reason you'll never see a bad back test. When we say back test, that means the index. Whenever you create an ETF, you're basically creating an index, and you're saying, "Hey, this strategy would have performed really well in the past. Here's why."

Then here's our index test, where again that's just basically some Excel numbers, we bought this here, we sold this here. You'll never see a bad one. Why is that? That's just human nature. If you've reached ... If you were studying some investment strategy, and it came out bad, you're like, "Well, that's not going to work."

Tim Mullooly: Right, yeah.

Ryan Kirlin: But if it comes out good, you're like, "Hey, maybe we're on to something here."

Tim Mullooly: Right, let's use it.

Ryan Kirlin: Let's use it. But the key is though there's a lot of things that can look good, that have no sense in the real world. I forget the exact example, but it was from 1970 through the year 2000 or something, the number one correlated predictor of how the S&P 500 was going to do was like soybean sales in Bangladesh, meaning if you looked at soybean sales in Bangladesh, that would be the best predictor of how the S&P 500 was going to do.

Tim Mullooly: Right.

Ryan Kirlin: Now, there is no economic tie between soybean sales in Bangladesh, or whatever it is I forget the exact example, and the S&P 500. It was just random chance that those two things moved together for that extended time period, but I guarantee you going forward for the next ten years that that won't be the case.

Tim Mullooly: Right, you don't want to hang your hat on that moving forward. It was just a weird coincidence most likely.

Ryan Kirlin: So with any investment strategy that's like all these things look good. Another one that I know people tested, had you gone long stocks that started with the letter U, and shorted stocks with the letter T. You would have had a positive return in 2008, the worst year ever for investing since The Great Depression, and you would have outperformed the market by 20% annualized every year. So it's like ... But again, that doesn't mean anything.

Tim Mullooly: Yeah, it's not real life applicable stuff. No one's actually going to do that.

Ryan Kirlin: Right.

Tim Mullooly: Or if they did, they're just the luckiest person ever. It's just so random.

Ryan Kirlin: It's just random.

Tim Mullooly: Yeah.

Ryan Kirlin: Yeah, that's just random noise. So that was something I learned with building indexes. You can always torture the data to make it work, to make it look good, but there needs to be economic rational. Why do we think this will work in the future? The simplest economic rational, if you're buying ... To give an example of that, if you're buying the S&P 500, we as investors expect to get a return. And everybody understands that maybe next year it'll go down, but we expect as investors, over a 20 year time horizon, to get something like the historical return of equities, four, five, six, seven percent annualized. But why do we get that return? What's the economic rational? The economic rational, just for the equity risk premium, why do stocks ... Equity risk premium, that's just a fancy word for why do stocks give you a return.

Tim Mullooly: Right.

Ryan Kirlin: The economic rationale for that is it's risky. You get compensated for risk.

Tim Mullooly: Taking that risk.

Ryan Kirlin: And that's why you earn a return. If something was risky, and didn't earn you a return, well then nobody would do it.

Tim Mullooly: Okay, so now that's what you were working on with the stock exchange. Mentioned earlier, you're now with Alpha Architect. Do you want to talk about your role with them, and what a day looks like for you with them now.

Ryan Kirlin: Yeah, so Alpha Architect, it's just a bunch of 50 pound brains, sitting in a garage.

Tim Mullooly: Super smart dudes.

Ryan Kirlin: Yeah, and I think my role sometimes there is to attempt to translate it from quant Ph.D. speak, to a more English-

Tim Mullooly: Every day, understandable terminology.

Ryan Kirlin: Yeah, however you want to think about that. Maybe I'm the dumb guy.

Tim Mullooly: Or maybe you're the smartest guy because you can talk about it to everyone.

Ryan Kirlin: Yeah, that's what they say, always try to be the dumbest guy in the room. I am definitely the dumbest guy in the room, so that's good. So, super smart guys all sitting around me, and for the most part I'm the first person that clients end up talking to. We don't have a traditional sales force, like a lot of exchange-traded fund, or mutual fund providers have. For the most part, we believe in transparency. Everything we do, all the research we have, everything we're thinking, we're always pushing out on our blog, or through Twitter. Just letting the result speak for itself, or not, either way. We want to show everything, again we can, all the research, and then people reach out to us.

Tim Mullooly: So when people reach out, your job is pretty much to just dumb down all the super heady stuff. The math and everything that goes behind the different ETFs, kind of lay it out for them in terms that they can fully understand.

Ryan Kirlin: Yeah. It just runs the gambit, like I'm sure it does for you guys in that some people want to go so far into the weeds, and that's awesome. We love geeking out on that kind of stuff, but then some people are like, "What's value investing? Can you explain that? What is momentum investing?" It's like oh, okay.

So the conversations run, and we're just like ... The other mission we have is just a mission to educate, so we just want to educate everybody. We're happy to talk to people.

Tim Mullooly: We've talked pretty much extensively about ETFs. You've worked, obviously a lot, in the ETF universe. For people who are very new to ETFs, which might be a lot of people listening right now, what would you say are some of the biggest pros and cons to using ETFs as opposed to other investment vehicles.

Ryan Kirlin: Yeah, the pros ... The three biggest pros for ETFs are transparency, cost, and tax efficiency. So transparency, ETF companies post, almost all, post their daily holding of their funds every day on their website. That seems kind of straight forward, but mutual funds don't have to do that. They publish on a quarterly lagged basis, so you may not know what's in your mutual fund quarter to quarter. Think much more opaque, like hedge funds or private equity or things like that. You don't know what you own.

Tim Mullooly: You're not getting that info.

Ryan Kirlin: With ETFs ... A key though, the ETF industry ... It was just really interesting because it was a reset on the asset management industry. Because of the ETF vehicle, there were all these brand new pure ETF companies that were able to spring up, and because they were brand new and able to compete with the behemoths of the asset management world, they were able to rethink how asset management should be done. What is the best way to run an asset management company?

One of the things that led to too, is for the most part ... So I said, first thing transparency, ETF issuers ... Well, take a step back. ETF issuers aren't required though. There's not requirement that they have to post their daily holdings. It's just the culture of the ETF industry is to be transparent, so they-

Tim Mullooly: I feel like that's a good thing for the investors.

Ryan Kirlin: It's great for investors.

Tim Mullooly: Yeah.

Ryan Kirlin: So they post their holdings daily, so it's just a cultural thing. It's great. Getting back to where is said ETFs could rethink how asset management was done, because they just didn't have the baggage. That's just no different from anytime ... It's like Uber got to rethink how the taxi industry should be done because they didn't have the baggage of having to spend ... In New York it was like, at its peak, it would cost you two million dollars to buy a taxi medallion, something like that. It's outrageous. If you're trying to disrupt that purely by being a better taxi company, you're never going to win.

Tim Mullooly: Yeah, you needed something completely new.

Ryan Kirlin: You needed something like a paradigm shift, which is like a totally overused word, but that's what you needed. ETFs were different enough, and enough of an advantage that they could actually win against this established industry, mutual funds, hedge funds, private equity, and win. One of the big reasons they were able to win over those industries were costs. Without going into the weeds, it just costs less to run a ETF company than it does a mutual fund company.

There's a lot things that mutual funds have to do, that us ETF companies in terms of an operational basis, don't have to do. That's awesome, that's why we work out of a garage at Alpha Architect.

In general then, what's that lead to. Well, net and net ETFs are cheaper than mutual funds on average. On average, the ETF is like half the price, and the average mutual fund is one and a half, something like that. That doesn't mean that every ETF is cheaper than-

Tim Mullooly: Yeah, there are expensive ETFs out there, but-

Ryan Kirlin: But the operating cost of running an ETF is less, so that's good at the end of the day. That's a more efficient economy.

Tim Mullooly: Yeah.

Ryan Kirlin: Then the third thing is tax efficient. ETFs are generally more tax efficient. Again, without going too far into the weeds, but there was a study by Rob Arnott, who makes money off the ETF industry. We'll throw that out there for full transparency, so always do your own research. His study showed that on average, the average mutual fund costs you zero in short term and long term capital gains, whereas the average mutual fund cost you .8% per year in taxes, capital gains.

Tim Mullooly: Right.

Ryan Kirlin: So ETFs, there not some magical thing that makes taxes disappear forever, but they're similar to a 401K or an IRA in that they can help you defer your taxes, which from a personal financial planning standpoint, I think you'd agree, what's probably the first thing you'd tell people to do with their money? 401K, IRA, that's step one.

Tim Mullooly: Right, you want to take advantage of those tax deferred vehicles. Everyone always wants to figure out a way to defer taxes as long as possible.

Ryan Kirlin: So ETFs can help with that, to the tune of about .8% a year, on average. That's the pros, transparent, tax efficient, cost. And then, the downsides ... The hard thing with 401K's versus pensions and a lot of things, is ETFs have put a lot of the power back in the hands of the individual investors, but a lot of the individual investors probably are better off not having the power back in their hands. The great thing about the pensions versus 401K is turn 60, turn 70, and then you were getting this check until the day you died. You never had to go in, figure out what it was going to be invested in, what it was going to be. So,

Tim Mullooly: You didn't have to worry about all that.

Ryan Kirlin: Yeah. From a trading perspective, mutual funds versus ETFs are the same thing. For ETFs they trade on an exchange, so you have to go out and physically buy shares of that ETF, which can be scary and intimidating for someone who's never done it before. Again, you're buying and selling like an individual stock.

Tim Mullooly: Yeah.

Ryan Kirlin: Whereas a mutual fund, the mutual fund company is handling the purchase of that. They're giving you a guaranteed net asset value, so that's the downside.

Tim Mullooly: It could be an advantage, but it's also a disadvantage if you abuse the ability to trade it. If you're just wheeling and dealing ETFs every single day, it's probably not good for you.

Ryan Kirlin: Power's in your hands, good and bad with ETFs.

Tim Mullooly: For the individual investor, we might have already touched on it, but what would you say would be the biggest advantage of using an ETF instead of individual stocks and bonds? We've talked about the differences between mutual funds. What would you say is the biggest thing that ETFs have over just an individual stock or bond?

Ryan Kirlin: Yeah, for the most part is just the blow up risk. Around 20 to 30 stocks is when you get most of the benefits of diversification from avoiding a systematic risk, we call it. That's just basically ... Twenty to 30 stocks will basically prevent you from having a permanent loss capital. You're fully diversified across. If you're trying to buy one stock-

Tim Mullooly: That could go completely to zero.

Ryan Kirlin: Yeah, so buying a pooled investment vehicle you're increasing your diversification. That's the biggest advantage. And again, with ETFs, there is a tax advantage to buying the ETF. If you were running a strategy on your own, on using single stocks, and you're buying and selling every year, or every month, or whatever it may be, and then you ran that same exact strategy in an ETF, when you were selling those individual stocks each year, you'd be hitting yourself. So say you made 100%, then you have to pay taxes on that 100% you made-

Tim Mullooly: For each stock.

Ryan Kirlin: Each stock you sell.

Tim Mullooly: Right.

Ryan Kirlin: So that sucks.

Tim Mullooly: Same thing with just trading costs too.

Ryan Kirlin: Trading costs.

Tim Mullooly: Commissions. Now it's like four, five, up to seven bucks for a trade.

Ryan Kirlin: Yeah, so that's it with ETFs. ETFs are able to get around that tax issue, and able to turn over the portfolio strategy within it to get around the issue that you would have with individual stocks. In theory, a professional money manager who's managing the fund, whatever that's worth.

Tim Mullooly: Yeah, there that too. We talked about how ETFs intruded on the mutual funds space, and I'm sure that you've encountered a lot of people who aren't the biggest fans of ETFs, whether they're in the mutual fund industry or not. There's always push back on these new products. What would you say are some the most common myths about ETFs that you've heard? Feel free to set the record straight on any of those naysayers out there that have bad or incorrect things to say about ETFs.

Ryan Kirlin: Well, fortunately I think most myths about the ETFs have been dispelled. It was like any new technology, at first it's just so misunderstood because it's brand new. There literally aren't that many people that when a new technology it created, that understand it till you explain it.

Tim Mullooly: Right, yeah.

Ryan Kirlin: So it takes time to make it's way. The knowledge takes time to work it's way through the economy. I remember when the iPhone first came out. Everybody loved Blackberry. Blackberry were it, and the iPhone came out, and everybody was like, "It doesn't even have a keyboard. This is so stupid."

Tim Mullooly: Where's the buttons?

Ryan Kirlin: Yeah, where's the buttons, screw this. And now, I have an iPhone, or if you use a Samsung Galaxy, or whatever you use, nothing has keyboards. We've firmly established now that-

Tim Mullooly: The iPhone even got rid of the one button they had. They don't even have the home button anymore.

Ryan Kirlin: They don't even have one button. So it's clearly that's a better way, but it was really misunderstood at the time. Even I, at the time, was like, "That doesn't make sense. That's going to be so hard."

Tim Mullooly: It was like why do I need this too. It felt like too much.

Ryan Kirlin: There was so much of that push back in the early goings. ETFs have now been around 26 years, so SPY launched in 1993, so there's been this long time coming for people to understand. There's definitely scare stories out there, I think that are persisted by misunderstanding. Or to be blunt, the mutual fund industry or the hedge fund industry, they have reason to push back because that's their lively hood. If you've got a competitor, you're going to do everything you can to create scare stories, I guess. So there is some of that, but that's dwindling every day. There will always be people who resist new technology, new change, so that's going to be no different. Really, I think we're most of the way there. The trading thing is probably the last big boogeyman that people have.

Tim Mullooly: The fact that people can trade themselves into the ground with ETFs, so to speak I guess.

Ryan Kirlin: Yeah, well there's always scare stories, like ETFs can collapse or ETFs da-da-da, which isn't true. Again, ETFs are the same as a mutual fund in the sense that they're just a pooled investment vehicle. So as long as the underlying stocks in an ETF, just like in a mutual fund, aren't collapsing, then the ETF won't collapse.

Tim Mullooly: It can't go to zero.

Ryan Kirlin: No.

Tim Mullooly: There's no ... Unless every single stock in the ETF simultaneously went to zero, I guess.

Ryan Kirlin: Yeah, if-

Tim Mullooly: The odds of that are-

Ryan Kirlin: Well, that's the point of diversification.

Tim Mullooly: Exactly, right.

Ryan Kirlin: That goes back to that owning 30 stocks or more to get that benefit to remove that risk of going to zero. I mean, it can happen. General Motors, 2008, they went to zero, or maybe 2009 when exactly they went to zero, but they had billions in revenues and they disappeared overnight. But if you own the S&P 500, that's one out of 499, and it was in the grand scheme of things it didn't really effect you.

Tim Mullooly: You don't really feel it that much. So like you just said, ETFs have been around now for my whole life. I'm 26, so I'm as old as the ETF. Just in your career so far, things are always changing, but how have you seen the world of ETFs change over the span of your career?

Ryan Kirlin: Yeah, ETFs ... It's now a mature industry. It manages around ... ETFs in general manage 3.3 trillion dollars. Contrast that with the mutual fund industry. We've been talking ETFs ... Maybe I'm being negative on mutual funds, I don't know, but the mutual fund industry manages something like 17 trillion I think, 16 trillion, somewhere around there. I know it's ... The mutual fund industry is four times the size still of ETFs.

Tim Mullooly: You hear ETFs are taking over the whole industry, but then like you said-

Ryan Kirlin: On a relative basis.

Tim Mullooly: It's like they started at zero, so they have grown a lot, but it's still a long way to go before taking over the majority share.

Ryan Kirlin: You can look at glass ... Depending on which side of the fence you're sitting on, it's glass half full, glass half empty. If you're on ETF side, you're like, "Man, what an opportunity for ETFs to continue to grow and grab assets." On the flip side, if you're in the mutual fund industry you're like, "No. See ETFs aren't really affecting us. We're still on top."

Tim Mullooly: Right.

Ryan Kirlin: So you can view that however you want. I'm on the side of ... I think the mutual fund industry, it shrank in the U.S. by 7% last year, whereas the ETF industry only shrank by 1% last year. What do I mean shrank? Why did it shrink? Well, because the fourth quarter socked it. Assets across the U.S. went down.

Tim Mullooly: Just across the board.

Ryan Kirlin: But mutual funds got hit a lot harder. They shrunk 7%. For what's the next step in the evolution of ETFs, well right now again because it's a mature industry it's pretty ... It's in a phase where it's all consolidating, so you don't want to really be in the middle for an ETF [inaudible 00:29:13]. Vanguard, iShare, State Street, and then sort of Invesco power shares are battling it out at the top for the scale play. It's hard living in the middle, and then you're going to have all these boutiques towards the bottom.

Tim Mullooly: So the bigger guys will just continue to grow. Obviously, Vanguard is going to continue to bring in their assets. And then do you think more and more smaller, like you said, boutique style shops are going to continue to open up, or is it going to reach a breaking point at some point?

Ryan Kirlin: Yeah, the rapid iteration, the rapid improvement that the ETF industry brought, I think has happened. Like any industry, there's always going to be a new company is popping up, a new company is forming, but it's just not going to be as rapid as it was for the next 25 years versus the last 25 years.

Tim Mullooly: With everyone jumping on.

Ryan Kirlin: Yeah. That was cool. A lot of ETF companies have a similar story to what we have, except they're 20 times the size of us now. But they started in 2005, or 2008, or whatever it may be. They started out of a garage, and they grew to manage multi, multi, multi-billions of dollars.

Tim Mullooly: Right, yeah.

Ryan Kirlin: So that path isn't going to be I think as ... Again, you could think of just like the computer industry. It was ... Those all started out of garage. There's all the famous Bill Gates photos, and Steve Jobs, literally building computers in their garages. Now, if you try to start a computer business, you'd probably just get

Tim Mullooly: Yeah, you're not going to get anywhere close to the scale of those companies.

Ryan Kirlin: Microsoft.

Tim Mullooly: Yeah.

Ryan Kirlin: So the only way you would have that innovation again is with a new platform, something to replace the computer.

Tim Mullooly: Like what the ETF did to the mutual fund industry.

Ryan Kirlin: That can happen-

Tim Mullooly: Whatever the next iteration of it is.

Ryan Kirlin: Mutual funds had the reign for 40 years, or 45 years, and ETFs are now having their day.

Tim Mullooly: I want to touch on a couple articles that you've written recently, over the past year or so. This past fall you wrote an article that I liked a lot. It was about smart beta. Do you want to talk about that article and the term smart beta? How terms like that have been effecting the ETF industry?

Ryan Kirlin: Yeah, so with smart beta ... The point is, I'm like what's smart beta even mean? And if you're a regular investor, it doesn't mean anything to you.

Tim Mullooly: But it sounds cool.

Ryan Kirlin: But it sounds cool, exactly.

Tim Mullooly: I want to smart investor.

Ryan Kirlin: Depending who's telling you that, if an expert quote-un-quote is telling you that ... You're a regular investor and somebody who the outside world has deemed an expert, and they're like, "Hey this is smart beta, it's smarter. This is good." You're just kind of like, "Okay, I guess. I don't really know what that means." I'll tell you a story of ... I used to lifeguard at the Jersey Shore when I was growing up, and one summer I had a lady come up to me, and she was like, "Hey, excuse me. When do the dolphins go by?", and I was like, "Ma'am, they're wild animals."

Tim Mullooly: Yeah, they don't adhere to a schedule.

Ryan Kirlin: Yeah, exactly. They don't adhere to a schedule. I don't really control them. She's like, "Oh, okay.", and she walks away. So my stand partner, all day we were laughing about it. We were like, "I can't believe she said that." We're joking. The next summer, swear to God, someone else comes up to me, and he's like, "Hey, excuse me sir, when do the dolphins go by?" And this time is was ready for the question. I was like, "Oh, this is hilarious.", so I was like, "Oh, well pod A is going to come by at 1:00, shortly followed by pods B at 2 and 2:30." They were like, "Oh, thank you." So 1:00 comes along, persons up against the edge of the water with their whole family like

Tim Mullooly: Pod A coming in hot.

Ryan Kirlin: Yeah. They were looking at me like, "Where are they?" And I'm like, "I don't know they must be late today."

Tim Mullooly: I don't know, they're wild animals.

Ryan Kirlin: Why did they believe me? Because I was in an authority position. I was an expert. So my problem with smart beta is you have all these quote-un-quote experts, pitching this now meaningless term that most of them don't even know the history on, don't even know what it means. It's just confusing to investors. In my head, I don't think its nefarious. I think most people are good people, but I think it's wrong in the sense that they're trying to use it to just attach to help their business. But really what you should do is be transparent, and just say at this point what are you doing. Okay, you have an ETF, you said it's smart beta. Well, don't tell me it's smart beta, you have an ETF, what's it do?

Tim Mullooly: Right.

Ryan Kirlin: Oh, it's a value ETF. Well, what's value?

Tim Mullooly: What's the actual strategy.

Ryan Kirlin: It buys cheap stocks. They're stocks that are undervalued relative to other stocks. Even if you have a little bit more bells and whistles on it, whatever, the average investor like that makes sense. Everybody gets that. When you're buying a car, you want to get one that's one sale rather than the full price one because in theory we think cheaper is not always, we understand that. Sometimes you buy slightly undervalued thing, and you're not getting a deal. But in the long run, typically when stuff goes on sale that's a better time to buy than when it's not on sale.

Tim Mullooly: Right.

Ryan Kirlin: So with a value, you're like, "I have an ETF, it's a value strategy, buys undervalued stuff." That makes sense, got it. I have an ETF, it's smart beta. That's it.

Tim Mullooly: It's like okay, well what does that mean.

Ryan Kirlin: What's that mean, right.

Tim Mullooly: So it's pretty much just a marketing terminology with buzz words that people with think mean something. It is kind of, I don't want to say predatory, on people who don't know any better, but that kind of is what it's doing.

Ryan Kirlin: There's like ... It's like something form Wall Street forever. There's always a new marketing going on.

Tim Mullooly: And you can charge more for it because there's some proprietary underlying strategy that they can't, or they don't, explain.

Ryan Kirlin: Yeah, the black box. I have a whole blog post on it, if anybody wants to read the history of smart beta. There was value to the term originally. People can go read that at Alpha Architect blog, but to not get into that basically going forward, I believe just say what you do. That's my problem with smart beta.

Tim Mullooly: Especially with the ETF. Like you said, one of the biggest pros is transparency, so to have a non-transparent ETF is counterintuitive to the product itself.

Ryan Kirlin: You're exactly right. The culture ... I'm a bit of an evangelist I guess at some point for the ETFs 'cause I've grown up ... My whole career has been ETFs, and the fact that the ETF industry was able to start fresh and not have this baggage that these other asset management industries had. There's great cultural things about the ETF industry as a whole, and I think it's important to keep that. If we start doing black boxy da-da-da, and get away from transparency being a core part of the culture, then that's not good in the long run for anybody.

Tim Mullooly: Yeah, and it's no better than the products it was trying to disrupt.

Ryan Kirlin: Yes, correct.

Tim Mullooly: So about this time last year, you wrote another article about ETF firms and how they compete with each other. Normally, you would think they just want to get to the lowest price possible because that's what people want, less expensive stuff. So how have ETF firms been competing? Is it things different than just price?

Ryan Kirlin: Yeah, no great. It's just something that the media in the ETF industry, or the asset management industry, everybody is so hyper-focused on who has the most amount of flows, what's the biggest things. And that stuff matters, I talk about it too, so I'm not necessarily knocking. I'm just saying there's other story lines out there. In any industry, there's three things ... So whether you're a lawyer, whether you're a doctor, farmer, Walmart, whatever you are, there's three things you can do to win. This is something ... I didn't go to business school, but people tell me they teach in business school.
Three things you can do to win. You can either be the low-cost leader, you can be the product leader, or you can be the service leader.

Tim Mullooly: Right.

Ryan Kirlin: If you're the low-cost leader ... Well, I guess step back. Most companies that win, focus on one thing, and do a second thing pretty good, but you can't, you literally can't do all three.

Tim Mullooly: All three.

Ryan Kirlin: Yeah. So Walmart is the low-cost leader.

Tim Mullooly: Right.

Ryan Kirlin: They have to have good enough stores that you want to return and actually shop there. Be clean, reasonably nice people that work there.

Tim Mullooly: But you know when you go to Walmart it's going to be low-cost, but it's not the highest end quality products out there.

Ryan Kirlin: Yep. It's not going to be Tiffany's, like the service people.

Tim Mullooly: Right, exactly.

Ryan Kirlin: You go buy a diamond ring at Tiffany's, they're going to bring you out a glass of champagne.

Tim Mullooly: Getting wined and dined, you know.

Ryan Kirlin: Yeah.

Tim Mullooly: The whole nine.

Ryan Kirlin: You're sipping champagne, it's great. So whatever, but Tiffany's is playing a different game. They're not going to be the low-cost leader, they don't want to be the low-cost leader. My point was there's interesting things with ETFs. You're not necessarily winning by just pouring in assets 'cause you can't ... Some firms, I believe are trying to do it all, and trying to be the low-cost leader, the service leader, and the product leader. I think, in any industry again, if you try to do it all in the long run, that's going to smoke you. You want to do what your core competencies are.

Tim Mullooly: Find your strengths and play to that.

Ryan Kirlin: Yeah. It seems like everybody in the ETF industry, every big company, is in this race to zero, and just chasing assets-

Tim Mullooly: So eventually that advantage is just going to not exist because everyone's going to get to zero in terms of cost, so they're going to have to find a different way to win.

Ryan Kirlin: Yeah, you're still a business.

Tim Mullooly: Right, yeah. You still have to make money.

Ryan Kirlin: Yeah, and that's good for investors too. You want asset management companies to make a decent living. You want your doctor to get paid for what he does because then he actually comes to work the next day, does the work.

Tim Mullooly: There's motivation to do good work.

Ryan Kirlin: Yeah, so don't ... For some of the ETF companies in this race to zero, I'm like, "I don't know if that's going to work out for you in the long run."

Tim Mullooly: Yeah, definitely. I feel like for some firms it could be sustainable, but for others-

Ryan Kirlin: For Vanguard, it is.

Tim Mullooly: Yeah, exactly.

Ryan Kirlin: Vanguard's a non-profit. I don't want to go head-to-head with a non-profit in a profit business.

Tim Mullooly: Right, so for other ETF providers out there, you're racing to zero, but Vanguard is essentially there and they're killing it, so you should probably find a different way to-

Tim Mullooly: Get your business ... Yeah.

Ryan Kirlin: Sounds good.

Tim Mullooly: So I like to ask this at the end of interviews for pretty much all the guests. Whether it's a personal or a professional things, what's one piece of advice that you've gotten over the span of your lifetime thus far that's always stuck with you?

Ryan Kirlin: Go get a hard scale, I think is the best thing you can do if you're in college or if you're in high school. But then also, once you have that always, always, always, always be seeking growth. So seek a growing industry, and the faster that industry is growing the better because if you're in a booming industry, and you're totally mediocre, you move up. It's just rising tides with small boats.

Tim Mullooly: You just grow with the industry.

Ryan Kirlin: So even if you're relatively staying flat, it's like company went from 100 people to 1,000 people. You were number 100, now there's 900 people beneath you. You're now doing well. Same thing, you can be the freaking smartest person in the world, if you're in a shrinking industry, it's just a bloodbath. You can be so smart, but just the aggregate trends are moving against you, so stay away from shrinking things. That's personal level too, just always be growing whether it's ... Any way you can, learning, reading, writing, do that. Grow personally, go to growing industries. That'll more often than not, work out for you in the long run.

Tim Mullooly: Yeah, and definitely spans personal and professional as well. It's both of those. Bonus last question for you. You're a big Philly sports guy.

Ryan Kirlin: Yeah.

Tim Mullooly: What's your take on the Wentz and Foles debate. If there is a debate, if you think there is one.

Ryan Kirlin: I think it's heartbreaking. We had a guy win us a Super bowl, and now he can't be our quarterback. It's like we're just put in this impossible situation. We had a guy who was basically the MVP of the season until he got hurt, and Carson Wentz. And then another guy won us the Super Bowl, and now we got to pick one. There's no good answer, so ...

Tim Mullooly: Yeah, I agree. Gun to your head, if you had to pick, are you a Foles gut or a Wentz guy?

Ryan Kirlin: Honestly, if my goal was to win a Super Bowl next year, I think I would pick Foles because he won us a Super Bowl.

Tim Mullooly: And he played well this past year too. Wentz has an injury history too, so how reliable is that?

Ryan Kirlin: And I think that's it, but if my goal is to win a Super Bowl for the next ... The most amount of Super Bowls in the next 15 years, then I guess you go with Wentz. So it's like-

Tim Mullooly: Baseball, what's taken the Philly's so long to sign Bryce Harper or Manny Machado?

Ryan Kirlin: I think there's not a market for them, besides the Philly's.

Tim Mullooly: Yeah.

Ryan Kirlin: The Philly's ... There's only really like four, five, six teams in baseball that really can spend. That's Yankees, Red Sox, Philly's, Dodgers. Yankees, Red Sox, Dodgers, aren't spending this year. They're all like, "Hey, we're good. We got our team. We've got our massive free agents. We're not going to load up with another 300 million dollar dude." So there's literally no other major market bidding on Machado and Harper. So they're just hanging out there begging somebody else to get ... I bet you the Philly's gave them a relatively low-ball offer. They gave them 230 million, 210 million instead of 300.

Tim Mullooly: Right. It's not what they wanted, but it's probably what the market thinks they deserve.

Ryan Kirlin: This year. Timing matters.

Tim Mullooly: Exactly, totally. If they do or don't get either of them, how good do you think the Philly's are going to be this year? Are you optimistic?

Ryan Kirlin: I think they could win a ... They could get to the world series. I'm not totally sure if they could win, but fluky stuff happens. Again, once you get in the playoffs ... Philly's had the best team they've ever had, whatever year that was, a little bit after they won the World Series. It was 2012 or something, 2011. Roy Halladay and ... Won 102, 103 games, and they lost in the second round of the playoffs. That was heartbreaking. That was Roy Halladay's last real game ever, and they were the best team and they lost.

Tim Mullooly: Right.

Ryan Kirlin: It's just Philly's ... This will make them good enough to get in the playoffs, and ...

Tim Mullooly: That's all you got to do. You got to get in and hope for the best. Hope the cards fall your way.

Ryan Kirlin: Bats get hot.

Tim Mullooly: Yeah. All right, so last one. You said you're a big 76er's guy.

Ryan Kirlin: Yes.

Tim Mullooly: I'm not really a close follower of the NBA, so fill me in on what you think the 6ers can do this year 'cause they're pretty good, right?

Ryan Kirlin: Yeah. You just got to ... At the end of the day, sports is all about entertainment. That's what we care about. 6er's are probably the most entertaining team in basketball right now because they're young, and they're going all in. There was this ... For those Philadelphia non-fans it's what we call trust the process, where the 6er's blew everything up, totally started from scratch, were horrible forever to try to build for the future. Now, this is the culmination of the process, where they're just all in, and I love it. At the end of the day, it's entertainment, but also you want to win a championship and that's all that matters. So let's go actually give it everything we got to win a championship when we can, rather than ... I don't want to be the third best team for eight years. I don't care about being-

Tim Mullooly: Right, exactly.

Ryan Kirlin: I want to go-

Tim Mullooly: The point is to win.

Ryan Kirlin: Go win one year, and that's so much better than being pretty good for 15 years.

Tim Mullooly: Yeah, I totally agree as a Mets and Jets guy. I just want one.

Ryan Kirlin: Just one.

Tim Mullooly: I've said if the Mets were to get in on a guy like Machado or Harper, and that means that they win the World Series once in the next two years, and then the rest of the contract is garbage, I don't care because we got our one championship. I just want one.

Ryan Kirlin: Nobody in Philly complained, which is unheard of, when the Eagles lost in the playoffs this year. Everybody was still-

Tim Mullooly: You already got your one.

Ryan Kirlin: Everybody was still riding that Super Bowl high. Nobody cares. We were like, "This is great." So, just go win.

Tim Mullooly: Yeah, awesome. Well Ryan, that's all the questions I had for you today. Thanks for coming on the podcast.

Ryan Kirlin: Yeah, thanks for having me.

Tim Mullooly: For the listeners out there, we'll link in the show notes to Alpha Architect's website, and the couple of blog posts that we mentioned here as well. Thanks for listening to this episode, and we will catch you on the next one.