

# S&P Dow Jones Indices

An **S&P Global** Division

## FA Talks

### Innovation: The Engine of Business Growth

with Roger Scheffel and Dave Abrams



**Roger Scheffel**

Principal and Portfolio  
Manager WST Capital  
Management



**Dave Abrams**

Director of Quantitative  
Strategies WST Capital  
Management

*FA Talks is an interview series where industry thinkers share their thoughts and perspectives on a variety of market trends and themes impacting indexing.*

Shaun Wurzbach, Global Head of Financial Advisor Channel Management, S&P Dow Jones Indices (S&P DJI), chatted with Roger Scheffel and David Abrams of WST Capital Management about how innovation in the application of indices and exchange-traded funds (ETFs) led to a new and growing business division for Wilbanks, Smith & Thomas Asset Management.

**S&P DJI: Wilbanks, Smith and Thomas Asset Management (WSTAM) is a Registered Investment Advisor (RIA) and long-time collaborator with S&P Dow Jones Indices—your firm was the first RIA to work with us to design a custom index. What was your inspiration for that? And what is WST Capital Management?**

Roger: WST Capital Management is a division of WSTAM, a decades-old wealth management firm based here in Norfolk, Virginia. WSTCM, which has evolved into its own investment boutique within WSTAM, grew out of a research effort to identify a rules-based, quantitative core asset class solution for our wealth management clients.

Dave: We began developing custom indices for more robust benchmarking and analytical purposes, working in partnership with S&P Dow Jones Indices—the very first RIA/S&P DJI custom index collaboration—to validate the work behind our proprietary quantitative science. We felt that inviting an external firm “under the hood” of our strategies would add credibility to our high conviction and would add rigor to the research and analysis processes. The whole experiment essentially had us raising the bar for ourselves as asset allocators and researchers.

Roger: Embracing index creation made it easier to see the path forward. Kicking the tires of our first custom index approach, by working with S&P DJI, made it clear that the investment science backing our approach was replicable and likely to be viable across various asset classes. Building out an integrated suite seemed to be the natural next step. WSTCM is the structure built around that investment science; we now have, in addition to our long-standing research team, support resources working to enhance business development and grow our footprint in the marketplace.

**S&P DJI: Who are WSTCM's clients and how do your clients' needs and objectives inform the investment outcomes you try to deliver?**

Roger: WSTCM's clients range from our own wealth management clients, to those who have invested at the direction or recommendation of their own advisors, to brokers who found us on national brokerage platforms, to institutional market participants. Most market participants are interested in efficient, liquid, and transparent risk-managed growth that is adaptable to today's market realities; WSTCM exists because our approaches have, so far, helped address that appetite in some measure. Every solution we bring to market is designed with the client in mind.

**S&P DJI: You use what you describe as an "investment science" in constructing investment strategies. Describe that science and explain how indexing and ETFs have fit into or enabled execution of your approach.**

Dave: Portfolio construction is facilitated by a quantitative model that seeks to identify and align exposures with sustainable sources of alpha, which we call Persistent Market Effects™ (PMEs). We classify a market observation or force as a PME if it is persistent across time periods, pervasive across different markets and asset types, and if it is robust and not random within the data; these criteria are what differentiate PMEs from regular factors and narrow market premia, and they are what empower them over the long-term as potential sources of alpha (positive or negative). These effects—which capture the underlying tendencies of the market, such as momentum areas at certain stages in an economic cycle—are moving targets across asset classes and sectors. Finally, we will invest in a PME if it is cost effective to capture in a diversified portfolio. We believe that, where there exists an ETF option suited to the exposure we are targeting, ETFs offer the quickest, most efficient, cost effective, and transparent path to timely exposure to these effects.

**S&P DJI: So, you are using ETFs, which are passive, but you consider yourself an active manager. Can you qualify that description? How does your platform fit into the commonplace "active versus passive" question?**

Dave: We're aiming to be an answer to that question, really. In our view, we are leveraging the best of both disciplines. We execute through an objective rules set that aims to eliminate the sometimes-emotional guesswork of traditional active management, while preserving the crucial, risk-minded aspects of that value proposition. We can't eliminate risk, but we work to mitigate one source or driver of it (i.e., asset selection) through a quantitative, rules-based framework and multi-layered risk management. Risk management is a function of structure and ongoing execution. All of our approaches systematically weight

what the model identifies as the best growth opportunities in the market but our structurally risk-managed strategies also maintain a defensive allocation. Risk management is also a matter of execution seen through daily and monthly adjustments that support our effort to address systematic and sector or asset class risk. As for passive: by using ETFs, we still benefit from every aspect of the "passive" argument: liquidity, cost efficiency, and transparency.

**S&P DJI: We see many asset managers using S&P 500® cap-weighted sectors to express their tactical strategy. You went down a different path and designed tactical strategies using ETFs that track the S&P 500 Equally Weighted sectors and the S&P Global 1200 sectors. How would you describe the value of using these less-well-known tactical tools?**

Dave: Equal-weighted sector ETFs, as opposed to market-cap-weighted, can potentially correct for the common issue of heavy concentrations in the largest cap (often highest-priced) stocks. Relative to cap-weighted, equal-weighted ETFs also create a natural tilt towards value and small-cap stocks. Overall, the impact stands to promote diversification of market cap and style exposure and thus diffusion of cap and style risk within the sector, but it also seeks to support improved capture of the factor we're pursuing when we overweight that sector. In our Focused International Equity strategy and the corresponding custom index, we use ETFs that track the S&P Global 1200 sectors, helping us tailor our exposure to a factor profile in the tactical opportunities we're looking to access. The use of ETFs that track more focused indexing schemes is, in our view, a fairly unique structural point that supports our effort to capture PMEs. And we believe that thoughtful portfolio design is a big part of what differentiates us from providers of simple smart beta.

**S&P DJI: In U.S. and global equity exposures you have the ability to combine a tactical, sectors-based strategy with a more diversified core. What inspired you to combine the two approaches and how has that combined approach performed?**

Dave: Our risk-managed structure, which anchors tactical sector rotation with a defensive segment, is part of a multi-tiered solution to risk management. This effort involves shifting allocations between lower- and higher-risk sectors and shifting to defensive instruments, such as short-term bonds and treasury securities, as needed. Market volatility, economic patterns, market risk appetite, and interest rate cycles are factors we evaluate in managing systemic, asset class, and sector risks. While we prefer to evaluate long-term results over full market cycles, we believe our strategy track records evidence some measure of success in the effort to diminish downside participation while capturing the majority of market upside.

**S&P DJI: You've since come back to us to design and launch more custom indices. What are the sources of your inspiration and innovation and how are these custom indices being used to help your business grow?**

Dave: Our increased use of custom indexing really reflects, simply, that we have come to see custom indexing as a critical accountability transparency, and validation control for the strategies we manage.

Roger: As for business growth: in short, we benefit from the visibility of a brand like S&P DJI, and our clients see that our work is validated by an organization of that stature. Ultimately, we believe our approach is well-suited for implementation across all public asset classes, and our goal is eventually to offer satellite options for all components of a strategic asset allocation. So there are few limits to scope of this practice, and S&P DJI figures prominently into our plan to execute this rollout as diligently and thoughtfully as possible.

**S&P DJI: Let's go back to the topic of outcomes. Year after year, the DALBAR studies paint a grim picture of and provide a behavioral explanation for why many market participants achieve less than market-based returns. You have branded your Risk-Managed suite as "The Bridge Between Protection and Growth®." How do you relate market participant outcomes to your value proposition?**

Dave: For us, the DALBAR study is instructive mainly in that it confirms the widespread, continued need for risk-managed investment solutions in an era that is really sending market participants back to the strategic drawing board. The global economic landscape has taken shape such that market confidence is, ironically, often most fragile when it's sending stocks to new highs; DALBAR studies have always indicated steep consequences for emotional, behavioral-driven investment decisions, but the price is particularly high in an environment such as this one. Equity markets are subject to large pullbacks at surprising frequency, and today more than ever, sources of "safety" or income are hard to find. Through a combination of risk asset volatility and rates that are globally bottomed out or negative, market participants are learning, bitterly, that we can no longer rely on one side of the traditional 60%/40% equation to work at all times. All in all, preservation of capital and growth of capital often feel like mutually exclusive outcomes in recent years, but it's hard to see a path back to the old normal.

Roger: Thus, this Bridge Between Protection and Growth idea aims to connect those two outcomes in this new era, where we see low return, low yield, and fewer growth opportunities, all at higher risk. We believe in the potential of risk-managed growth to help navigate the "new normal" by shifting dynamically between those two objectives, mitigating the give-and-take experience that frustrates so many market participants and seems to be a fact of participating in this new market environment. In the context of that goal, our value proposition rests in the unique science and portfolio design backing our risk-managed product.

**S&P DJI: When you started custom index collaboration with us, you represented Wilbanks Smith & Thomas Asset Management. Was the formation of WSTCM as a separate division a structural change to enable business growth?**

Roger: We would say the structural change was more a response to growth; it is as much about ensuring the integrity of our existing business as it is about sustaining WSTCM's momentum. WSTCM has its roots in the research-related experimentation we undertook, basically, to benefit our clients, but it has evolved tremendously in scope. Thus, we felt our existing clients and business were best served if we formally articulated the mission of WSTCM versus the wealth management side. The goals are complementary and aligned, of course, and there are exceptionally compelling business synergies. WSTCM benefits from the infrastructure of an established firm, and WSTAM, as a wealth manager, has unique access to high quality, in-house research. Those synergies are even more clear thanks to this structural change.

**S&P DJI: Give us your thoughts on how firms such as WSTCM can offer more to market participants, advisors, and institutions.**

Roger: Naturally, we are delighted by the opportunity to grow and diversify our business through WSTCM, and we are humbled by the traction we're seeing in the advisory and institutional space. But we take pride in the fact that WSTCM grew out of the effort to better serve our clients, and we consider it a good, "horse-before-the-cart" story of business growth. So our advice is simple; aim for the intersection of what you're good at and what solves a critical challenge. Plan for the long term, and execute with your clients' needs and goals in mind.

## NOTES & DISCLOSURES:

Endeavoring to offer the Bridge Between Protection and Growth through risk-managed strategies, WSTCM has cut an innovative path in the pursuit of next-generation investment science for today's market participants. By embracing the science of investing, we believe we can advance our firm's mission: to provide market participants a balance of protection and growth, encouraging confident participation over the long term. WST Capital Management is a division of Wilbanks, Smith & Thomas Asset Management, LLC.

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