WEALTH ADVISER

Funds Feast on High-Quality IPOs

By DAISY MAXEY

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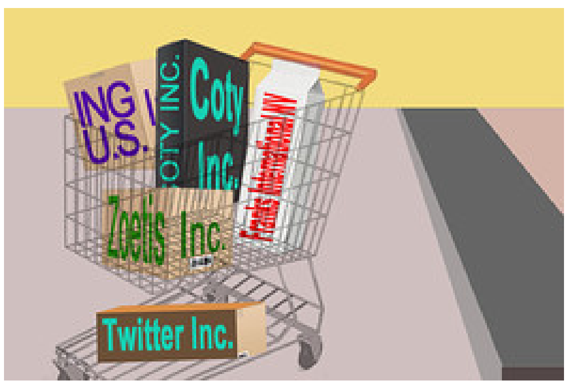
This year's unusual bounty of quality initial public offerings is buoying the few mutual funds and exchange-traded funds that invest in them.



Financial advisers who eschew potentially high-flying individual offerings for these diversified portfolios say they're thrilled with their performance this year, but appreciate the relative safety such funds can offer over the longer term.

Diversified funds "take the hype and emotion" out of IPO investing, says Prateek Mehrotra, chief investment officer at Endowment Wealth Management, who's been investing client assets in the First Trust US IPO Index ETF for about five years. "It offers a systematic way to capture that [IPO] exposure in a diversified portfolio," says Mr. Mehrotra, whose Appleton, Wis., firm manages $50 million.

Investing in one IPO--such as the much-discussed Twitter Inc., which begins trading Thursday--"is a crap shoot," he says, far too risky for his high-net-worth clients. "They may or may not work; the aftermarket reception might be good or bad."

It can take investors in a disappointing issue, such as Facebook Inc. 's (FB) rollout debacle, several months or more than a year to reach a break-even price, he says.

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Josef Schuster, founder of IPOX Schuster LLC in Chicago, which provides the underlying index to the First Trust US IPO Index fund, says there's been tremendous interest in the ETF this year. Launched in 2006, its assets have ballooned to $250.3 million from just $21 million at the beginning of this year.

The ETF has gained 39.3% this year through Nov. 5, while the S&P 500 index is up 25.8%, and its large-growth peers are up 29.1% on average, according to Morningstar.

"We've had a lot of interest from financial advisers, who look for a solution to how to invest in IPOs and spinoffs," Mr. Schuster says.

The ETF tracks the IPOX 100 U.S. index, which includes the 100 largest and typically best-performing and most liquid U.S. public offerings ranked quarterly in the IPOX Global Composite Index. The fund's smallest holding has a $1 billion market capitalization, and its average market cap is $6 billion.

"It's really tilted toward the largest IPOs out there and spinoffs launched in the last four years," Mr. Schuster says, while it seeks to rotate companies out of the index as they head into their fourth year on the exchange. The fund often tracks companies before they are included in the S&P 500.

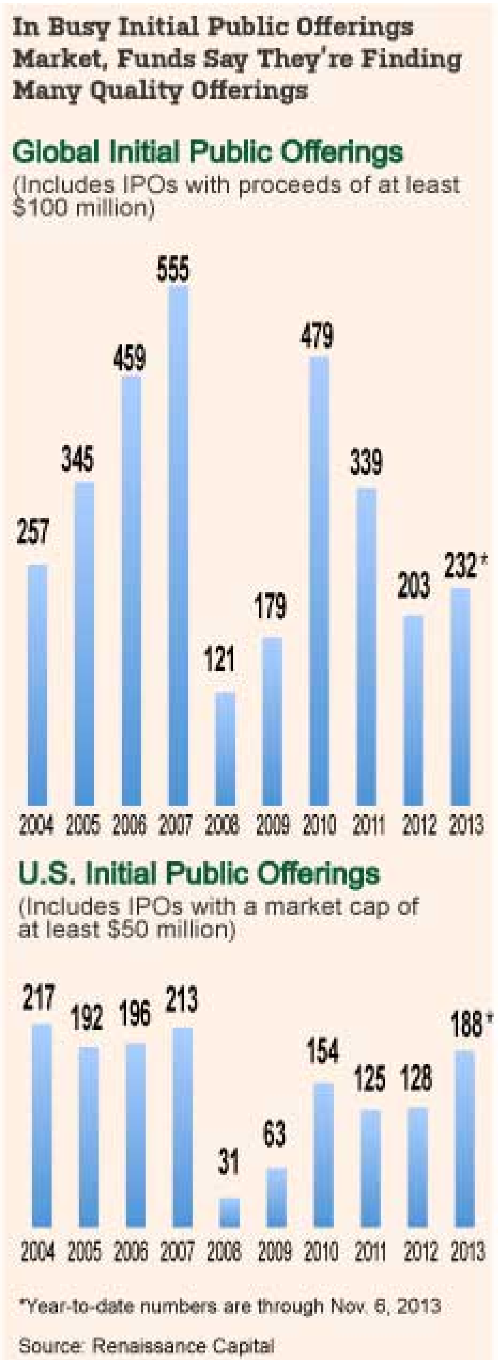
This year through Tuesday, there have been 188 initial offerings in the U.S., which have raised $44.4 billion in assets, according to Renaissance Capital. That is the most since 2007, it said. Globally, 232 issues have raised $105.4 billion, it says.

"There's been a lot of deal flow, and there's lots more to come," Mr. Schuster says. "But a lot of the performance hasn't come from the hot names, like the Facebooks ... of the world, but from the good old U.S. names."

Among the fund's top 10 holdings as of Nov. 5 were discount-retail chain Dollar General Corp, which it first purchased in 2009, and health-care service provider HCA Holdings Inc., which it purchased in 2011, according to Morningstar. Among the names it has purchased this year and still holds are luxury-home-furnishings company Restoration Hardware Holdings Inc., which went public for the second time about a year ago, and insurance group ING U.S. Inc., which was offered in May.

Mr. Schuster says he isn't sure yet whether the fund will buy shares of Twitter. "We have to see all the accounting data, and determine the number of shares outstanding," he says.

Jay Helvey, co-founder of Cassia Capital Partners LLC, began investing in the First Trust IPO Index ETF last summer. Mr. Helvey, who advises primarily high-net-worth individuals along with some trust accounts and small foundations, seeks to provide diversified low-volatility strategies.



Currently, the fund accounts for about 8% to 10% of clients' overall portfolio, depending on the individual, says Mr. Helvey, whose Winston Salem, N.C., firm manages $13 million.

"The ETF offers us a nice opportunity to layer in an exposure that has higher volatility but yet brings a nice, risk-adjusted return to the portfolio," he says. "Should the sector fall out of favor, and we need less risk, it's an easy way to reduce that exposure."

The Renaissance IPO Plus Aftermarket fund has also had a strong year. Its 42.8% gain this year through Nov. 5 has outpaced both the S&P 500 index and its mid-cap growth peers, which are up 28.8% on average, according to Morningstar.

"This has been the first sustained period in more than 10 years that the IPO market has had continued offerings and the quality is both strong and diverse," says Linda Killian, the fund's manager.

Though the Renaissance fund can hold new companies for up to 10 years, it typically focuses on companies that have been offered in the last year or two, she says. Among those purchased this year are animal-medicine maker Zoetis Inc., which had a very successful January offering and was the largest deal from a U.S. company since Facebook's; and oil-and-gas-services company Franks International NV, shares of which surged on its August debut.

Last month, Renaissance Capital of Greenwich, Conn., launched the Renaissance IPO ETF, which has an expense ratio of 60 basis points, the same as that of the First Trust IPO ETF, and substantially lower than the 2.5% ratio of the actively managed IPO Plus Aftermarket ETF.

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