New Index Derivatives Target Growth, Value Managers

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So you like the idea of indexed investing — but consider yourself a growth-oriented manager?

No problem.

New exchange-traded stock-index derivatives launched earlier this month are offering U.S. money managers novel ways to fine-tune their portfolios. While stock-index futures and options have emerged as speedy, cheap and easy ways for institutional investors to implement investment decisions, the Standard & Poor's 500-Stock Index is too broad a tool for many growth and value managers.

Enter S&P's newest tradable index products: growth and value index futures, traded on the Chicago Mercantile Exchange, and options, traded on the Chicago Board Options Exchange. The products, which made their debut earlier this month, were developed jointly with **Barra** Inc., a Berkeley, Calif., consulting firm, and divide the S&P 500 index into two groups of stocks, based on the ratio of stock price to book value.

"Growth and value is how a lot of pension funds and money managers increasingly look at the world," says Ron Peyton, president of Callan Associates Inc., a San Francisco investment-advisory firm. The new futures and options "enable someone to put together a portfolio that has many of the tailor-made characteristics of an actively managed fund without the costs that usually accompany active management."

The S&P/Barra indexes aren't the only growth and value benchmarks around: Money managers can track the performance of their own portfolios against the Russell 1000 value and growth indexes, and similar products based on the Wilshire 750. But until now, the only way for managers to use derivatives as part of their growth and value investment strategies was to turn to the less-transparent, more-costly world of privately negotiated, over-the-counter derivative products. The advent of the new S&P products, says Joanne Hill, vice president of equity derivatives research at Goldman, Sachs & Co. in New York, means that instead of having to hire a new manager or be willing to venture into the OTC markets, pension-plan sponsors can simply execute a futures or options trade.

"I think there's a very big difference between the acceptability of exchange-traded instruments" and OTC products, says Paul Samuelson, chief investment officer of Boston-based PanAgora Asset Management, an investment management firm. "When there's a new futures instrument like this that allows you to create exposure to a particular segment of the market to which people want to create exposure, its future looks very promising."

Investors can use the new products in a number of ways. A manager seeking to increase the weighting of growth stocks in his portfolio can implement that decision quickly by buying futures on the value index. That gives him instant exposure to value stocks in general, as well as time to ponder what specific companies might fit well in the rebalanced portfolio. Similarly, managers who have received a large influx of new investment dollars can use futures to deploy those assets quickly. Both value and growth managers can use the futures and options to insulate their portfolios from any sudden, adverse market moves.

Some money managers have already ventured into the new products. **Vanguard** Group, the Valley Forge, Pa., mutual-fund company, launched index funds tracking the S&P/Barra products nearly three years ago that together have nearly $700 million in assets. "We're quite eager for the new futures to succeed," says Gus Sauter, vice president of Vanguard, whose quantitative equities group runs the funds. "They give us tremendous trading benefits, by enabling us to remain fully invested and cutting our transaction costs."

Investment dealers hope that the existence of new derivatives vehicles will spark more interest in similar OTC instruments. So far, despite increasingly active marketing efforts, these products have met only moderate success.

"People are more willing to do OTC

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