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Revamping Retirement Episode 89

Intro: Covering the ever evolving retirement plan landscape to help identify the biggest opportunities for plan sponsors, CAPTRUST presents Revamping Retirement.

Jennifer Doss: Hello, everyone, and welcome to another episode of Revamping Retirement. I'm Jennifer Doss, and I'm joined by Pete Ruffel today. Pete, welcome back. You just got back from having, your second child.

Pete Ruffel: Yeah, thanks, Jennifer. Still trying to figure out what I do around here, so hopefully this'll help remind me what I do.

Jennifer Doss: I'll make a list for you, yes. absolutely. Pete and I are joined by Austin Guy today. Austin is a vice president and senior client portfolio manager within the global institutional client group at Northern Trust. I know that's a lot of words, but we're gonna have him explain his role here, in more layman's terms.

he is responsible for developing global solutions and insights for our institutional investors, dealing with custom indexing, quantitative, active, sustainable, factor-based investing, all- those fun things we're gonna be talking about index, composition and how that gets created, how they're different, and how mega IPOs, which have been coming up a lot, are interacting and intersecting with index, methodology.

So Austin, welcome. Welcome to the podcast.

Austin Guy: Pete, Jennifer, thanks for having me. Excited to be here, and honored to join the podcast. And Pete, of course, congrats on the family addition.

Pete Ruffel: Thanks, Austin.

Jennifer Doss: Austin, I guess start by, telling us a little bit more about your role at Northern Trust, and how Northern is involved in indexing.

Austin Guy: Sure. So let's start with Northern Trust Asset Management. We manage over a trillion dollars in global index assets spanning equities and fixed income. We're privileged to manage assets for some of the largest institutions in the world, and we've been doing so for more than five decades. In my role, I sit at the intersection of portfolio management, our clients, consultants, product design.

I spend a lot of time translating index mechanics into practical implications for our investors. And so I help clients out with their beta solutions.

Pete Ruffel: there's gonna be some jargon, I'm sure, that'll just find its way into this conversation, Austin. So if you don't mind me stopping you at time to time. Beta is probably something we'll get back to a little bit later into the conversation for sure, 'cause, we're fortunate to have a spectrum of an audience, from plan sponsors to retirement advisors and other industry stakeholders.

So as that kind of weaves in, we'll maybe ask a question and try to simplify it for the layman. but I think what's probably most important for our audience, and Jennifer teased this a little bit, is everyone has read headlines, and certainly now we're two months in arrears of the IPO for SpaceX.

And for a long time, IPOs had stalled out a little bit. There wasn't really anything that was so mainstream, small companies here and there. But I think a lot of what people understood were that private companies were staying private much longer. And now all of a sudden this year, there's a few name brands that are gonna have a potentially big impact, not only to markets, but potentially the investments that Americans are investing in for their retirement.

So with all that lead in, can you give us a little bit of background, maybe 101 on the SpaceX IPO and how that's impacted index providers and asset managers this year?

Austin Guy: Yes. So June 12th, 2026, for those of us in index land, it's probably as close as we're gonna get to the "you remember where you were" type of moment.

Every single client, and I'm not exaggerating, every single client conversation from the beginning of the year through the IPO started or ended with, "And what's happening with these mega cap IPOs?" Because they wanted to know what their exposures were because of the headline valuation. And I'll take us back to 2020 for a moment because Tesla is a really useful reminder that these index rules and timing, they matter for investors.

So Tesla was added to the Russell 1000 Index in September of 2010. It wasn't added to the S&P 500 index until December 1st of 2020. Now, the performance difference wasn't all that big. In 2020, Tesla returned nearly 750% for the year. The S&P 500, underperformed the Russell 1000 by about two and a half percent that year.

One and a half percent of that was just driven by the fact that Tesla was not added to that index, or not part of that index. So if you're a plan sponsor on a billion-dollar allocation within your 401plan, that one and a half percent is $15 million of differences in wealth. So these are not predictable outcomes, but it's a good reminder of why the benchmark construction index eligibility rules, all these things, Pete, that you were talking about, can be real dollars.

And we think about mega cap IPOs, technology companies, SpaceX, we think of disruption, and this was disruption of another kind to the index providers, as you alluded to. And one of the things that's not well known is on IPO day, it's not when the company gets added to the benchmark. So I'll give you a few examples of how these disrupted the index providers.

So take the NASDAQ 100 index, for example. Well-known tech-heavy index. Generally, IPOs needed to trade for about three months until they were considered eligible to be added to that index. NASDAQ went out, they consulted with the marketplace, and they came back and said, "Okay, now if you're in the top 40 by full valuation, we'll announce after five days, and we'll add you after 15 days."

FTSE Russell also went from quarterly inclusion reviews to now a addition, so it was added within the Russell reconstitution at the end of June. MSCI, they've always had a 10th business day rule, so they preserved that. The one big one that I haven't mentioned yet, which everyone was watching, was what is S&P gonna do with the S&P 500?

They had a consultation come out to the marketplace thinking about going from 12-month seasoning period down to six months. Although, I think in a bit of a surprise, they preserved that 12-month rule and the earnings requirement. So if you own the S&P 500, you may not have exposure to SpaceX for at least a year relative to other companies, and I think that surprised a lot of folks

Jennifer Doss: it did, and I think it created, to your point, a lot of confusion with investors.

I think a lot of people thought SpaceX, oh man, they're thinking trillion-dollar company.

This is gonna be massive. How much is it gonna be in the index when it does get added? But can you help our listeners understand why maybe a trillion-dollar company is not necessarily as big of an impact on... I mean, certainly it can, but not quite one-to-one impact on an index,maybe using SpaceX as an example.

Austin Guy: Yes, and this absolutely threw a lot of folks. If you look at the IPO date, at the full valuation, we'll call it about $1.75 trillion. It would've been, and it is technically, the seventh or eighth largest publicly traded company in the US. However, from index investors' perspective, size is not just about that total market value of the company.

It's actually about the investable market value. index jargon, we use the term float or free float. That is the portion of a company's shares that are readily available for trading. So it excludes those held by insiders or government bodies, founders, restricted employee pools, et cetera. So let's compare a couple companies.

Microsoft, Apple, NVIDIA, their float levels in the index are 95 to 100%. So their weight within the Russell 1, the S&P 500, is representative of their full market cap, the full valuation of the company. SpaceX has a 7% float, so you're discounting 93% of that value using only 7% of it to calculate its representative weight within these indexes.

So that's how a nearly $2 trillion company can come into an index at .13%, and as of August 11th, . 1% of the index, despite that headline valuation

Pete Ruffel: the other thing certainly that matters is obviously share price to that valuation. that's a big influencer along with that float like you mentioned, and I think a lot of people have certainly paid attention to what that stock price has done.

Bit of a rollercoaster ride so far, for sure. but the other element that you mentioned, that investable market cap, that float-adjusted market cap for SpaceX, we knew that there was gonna be some lockup periods expiring through the course of the year which would adjust that float, which would bring it from that 5 to 7% that you said can you give us a sense of, what that, roadmap looks like, where that might get closer to 50% float and therefore make more of a mark relative to its total valuation of that company?

Austin Guy: So let's just keep peeling back the onion. Let's keep going. The next layer of complexity, Pete, you're right, it's that lockup expiration.

And this can actually be for indexes more of an event than the IPO itself. So 7% to start, earnings on August 4th, they triggered a staged insider unlock that began August 6th. That freed up about 20% of the additional shares, about 911 million shares. So again, potential for sale. I think actually the stock traded up that day, so don't equate that with necessarily downward price pressure, but grab your pencils because there's lockup on day 70, 90, 105, 120, 135, and an additional 28% will be eligible after Q3 earnings.

So that kind of gives you a sense of the step-ups that are out there. There's some quirkiness within this IPO specifically for SpaceX. There was about 460 million shares that were due to be unlocked back in August 6th, had the stock price been 30% or greater than the IPO price. That clearly did not happen, so that'll get kicked to early December.

But this is absolutely something that index providers, managers, investors are watching because to your point, price action aside, this is how these companies can become larger percentages of these indexes.

Pete Ruffel: Just one little pivot here that I found interesting as someone who's obviously in this industry and following certain investments, there was plenty of actively managed large cap funds that were insiders, in quotes, owning the private stock of SpaceX and have owned it for years in a rear.

So they had potentially bought it at a much lower price than what it IPO'd at. And now they're benefiting from the growth of stock. Stock's public, but they're not able to sell it, to trim that position, till some of these lockup periods. So we've seen, and we've done some calculation back of the hand math of how a position that might have been less than 3% in one of these big large cap growth funds ballooned up to 10% over the course of these past two months.

So super interesting stuff, even outside of the indexing world as, active managers have been trying to, get some action of this as well.

Jennifer Doss: All right, last question on the mega cap IPOs, and then I think we're gonna take some of what we've just talked about and widen out the scope and bring it back to what does that mean for just, index methodology and comparison and plan sponsors.

But I'm gonna ask you in your crystal ball, what do you think's gonna happen? We have some other mega, cap IPOs, on the docket at least. Should we expect the same type of reaction as the SpaceX IPO, or should we really think about each situation being unique?

Austin Guy: I think the SpaceX buzz was due to so many factors, the Elon Musk factor, the valuation factor, the index treatment factor. It's hard to imagine that the next several companies are gonna gather that same type of hype. Largely because, again, we've now gone through this.

We know what the expectations are in terms of understanding the floats and the impacts to investors, but this was unprecedented. the largest IPO prior to SpaceX was Saudi Aramco, and they raised less than half the amount, about $30 billion relative to the $75 billion. And Alibaba in 2014 was valued at a minuscule only $168 billion.

So never say never. These companies are gonna continue to get bigger. I think the really fascinating part, back to your question as well, is the knock-on effects of these types of IPOs, and Pete, you mentioned at the onset, is these private companies are staying private for longer. They're becoming larger.

There's impacts on small cap indexes as well that used to be where clients would go to get these types of exposures. So it's a bit of turtles all the way down when you start to think about it, but the implications are pretty far and wide.

Pete Ruffel: Austin, you talked a little bit about obviously your role in intersecting from the product design to what questions clients have, from the pension side to the retirement side.

in your experience throughout your career, what do you hear from plan sponsors about what they think passive investing is or isn't? Do you generally feel there's an oversimplification there or an understanding that this is a foundational element of a pension plan and we gotta have S&P 500?

or do you feel like a lot of the questions you've been getting is indicative of a deeper understanding of how passive fits in a retirement plan?

Austin Guy: I think the last five or six years, what we've seen in the marketplace, the growth of passive, the challenges and the uneven performance of active, have absolutely made a lot of plan sponsors, investors re-underwrite their index funds and want to re-understand and do more due diligence and make sure.

we never really thought about this that much. We thought that these were substitutes. We understand active management- What's there to know more about passive? And that conversation has absolutely evolved. Clients are asking us all things that's relate to indexing, the daily management, the benchmark differences, securities lending, how to think about passive versus active.

What's the area in the middle of these things as they continue to evolve? So while the objective of passive is relatively straightforward, the implementation is anything that's automatic. I know we're gonna dive into some areas to really flush that out.

Jennifer Doss: what are some of those biggest active decisions that happen within a passively managed option? You just rattled off a few, but I what are the biggest ones that have the biggest impact in your mind?

Austin Guy: So when I typically get this question, I like to at least start with, let's just conceptualize the idea that index funds could be treated as active managers.

So if you're on a committee and you are responsible for manager due diligence, and you had two US large CAP managers come to you, and the first one says, "We tend to own about 500 largest companies within the US equity market. We prefer those that are higher quality, higher profitability. We have discretion around sector composition.

We're not really tied to any specific rules about when or how companies are added or deleted from the portfolio." The second one comes to you and says, "We prefer to broaden out the portfolio. We tend to hold up to 1,000 companies. We don't take a view on fundamentals. We use more of a market cap ranking rule selection.

Relative to the other manager, we have 2% less weight in information technology, and that's driven a bit of performance difference." Obviously, the first one's the S&P 500, the second one is the Russell 1000. And you can play this game through small caps, global. The point here is that when you start to look at index funds this way, it opens up to a better understanding of them and how they can be used.

The biggest differences are things like market cap spectrum. So the S&P 500 generally covers 80 to 87 and a half percent of the US investable market, whereas the Russell 1000 covers up to 93 to 94% of that, and the MSA US large cap is 70%. Talk about IPO additions, some are reconstituted quarterly, semiannually.

The NASDAQ 100 is annually. How you handle BDCs, SPACs, DATcos? All these different things are really sometimes surprising to committees because even indexes that have similar labels, now with the theme we're talking about again and again, they can produce very different results.

Pete Ruffel: we've gotten similar questions, and we're fortunate enough to, lean on experts like yourself, Austin, to give some of that depth.

Because as a product manager who doesn't necessarily subscribe to one individual index provider, Northern Trust does a great job of offering clients whatever index they're looking to match. You have a sense of the comings and goings and the management of all that and fitting the bill of all those methodologies.

So you probably have some own personal bias as far as which indexes you like. We're not gonna touch that one today. But I know when I've looked through those methodologies myself, I'm always surprised by things like, for example, an index let's take Russell 1000, for an example.

The growth version of that and the value version of that,I think I always oversimplified it that a company like Apple or Microsoft is either value or growth. It finds itself in one or the other. But in reality, Russell tends to kind of split it. they do have absolutes depending on the characteristics of the company, but I found that very surprising.

giving depth to what index funds are outside of just beta, which again, is just that idea of tracking the market. Beta is all about, if the S&P 500 is going up, I want that same exposure to the S&P 500. So what's been interesting to you? What's stood out?

Austin Guy: Yeah, I wish my friends, my wife would sit around with me and talk about these types of things. it's not really the case. But I'm gonna borrow from what you said, Pete, because I think the US Style Index methodologies are so fascinating. You read them, they read like academic research papers. And let's use some examples.

So 2022, market down 20%, communication services down 40%, energy up 60%. S&P considers price momentum within their growth factor. So roll the clock forward to 2023, and a lot of clients were calling us saying, " Hold on a second, I'm in your S&P 500 index fund. Why do I own Exxon and Chevron and Pfizer and all these classical non-growth companies?"

It's because that little wrinkle in the methodology actually had a big impact. And as that trade unwound, Russell 1000 Growth Index in 2023 outperformed the S&P 500 Growth Index by 13%. If you can find an active manager to compound more than 1% alpha in a year, by all means, they win. and we're seeing this same thing now.

The Russell recon in June, now we're getting questions around the Russell 1000 Value Index. The top 10 in that value index went from 19% to 28%. Amazon is now the largest holding at 6%. Tech exposure went from 12% and my favorite is the Mag 7 went from 6% to 16% of the Russell 1000 Value Index. So Russell's gonna say, "Look, value is fundamentally driven.

It's not a sector decision." But back to what we said earlier, treat these like they were active funds. Raise questions that you would. It probably pays to know these methodologies and understand, look under the hood.

Jennifer Doss: Yeah, I think it's interesting because somebody listening to this that doesn't know a lot about, indexing or passive management and then came into this conversation thinking they were the same and now is finding out that there's all these differences and things, I could see them thinking, "Oh,

They should be all the same, right? That's a mistake. They should be more similar to each other. Or guess I wanna make sure our, audience understands. These are not differences that are mistakes. These are differences on purpose,

These are conscious decisions Like you said, if we treat them like active managers, this is their view of value, and this is their view of value, And you can subscribe to whichever philosophy you want, and that's why we have so many index providers,and methodologies and things like that.

So that is actually by design to give people choice and an opportunity to express their philosophy.

all right, so let's bring it back to the plan sponsors and these retirement plan committees that are sitting around. They've listened to this, and now they're thinking, what should I ask when I'm evaluating passive investment options?"

Or, "What should I be asking my investment consultant?" like a CAPTRUST coming in and making a recommendation.

So I've been privileged. I've presented these research remarks, podcasts, panels, webinars, conferences, you name it, and almost every time someone will stand up or they'll grab me at the end and say, " All right, this is all great and interesting, but just tell me, what are the indexes I should be using?

Austin Guy: Just cut to the chase." And I say, "Okay, write this down. It depends." And then I run for the door, and I'm sure it was a glowing r-review in their mind, and my presentation just falls down to a one star. But I have a framework, I promise you, and the two things I think about is, think about how the passive benchmarks play with each other, and then how do the passive options play with the active ones within your plan lineup.

Because the goal is to ensure that participants have a coherent global equity option and exposures, not just a menu of individual funds that, in isolation, look reasonable. let's actually put this into practice. US large caps, for example. We keep talking about the S&P 500, the Russell 1. The Russell 1 includes mid caps, whereas the S&P 500 doesn't.

So if you're preferential to the S&P 500 index, it makes sense to have a mid cap index option is there as well. If you like all the S&P indexes, so the large cap, the mid cap, the small cap, you're missing out on a lot of the smaller companies that are found in the Russell 2000 index. So maybe it makes sense to make sure you have an active manager who is a small or micro-cap biased manager.

Emerging markets I think is one of the most dynamic areas to think about when you're a plan sponsor. A lot of the active managers have rotated out of Latin American commodities-based EM into financials, APAC, technology, semiconductors. So if you have only active managers, you're likely providing your participants with that level of exposure, not broad emerging markets.

So we've seen a lot of index plus some active, maybe they roll together into a white label multi-manager solution as well. So again, think about how the passive gaps are filled to make sure the lineup is complete, and then where are the active managers drawing active risk? What is their niche and their specialty, and does that have any influence or gaps or duplications if you're gonna have participants using both passive and active?

And that's the framework that I would use.

Pete Ruffel: it's a great one and certainly one that we've preached, which is trying to create a menu that's simple, simplified, gives broad market exposure, reduces overlap, reduces duplication, and I think exactly how you stated it, which is just identifying characteristics that complement each other.

And in indexes, you can be a little bit more exacting with that because The methodologies are more defined, and it's rare that they're going to, fully change. Active managers obviously have a little bit more tactical ability, so trying tofigure out what their sweet spot is and complement it, I mean, that is the crux of designing a healthy, defined contribution menu for plan participants.

So we're seeing some indexes change. you talked about this, Austin, like a lot of these index providers went to the marketplace, did a consult, and tried to reestablish some rules for the future based off these mega cap IPOs that are coming.

what else? How does indexing look different, or is it thought about differently in the future than it is today?

Austin Guy: I think it's gonna be quite different, and I think indexing or indexation is not a product category as much as it is a technology. We've seen such rapid change in the last decade. the classical definitions of passive and active are likely going to continue to evolve.

Passive absolutely has. And think about the fact that we have more ETFs than we have stock tickers right now. Indexing has played a large role in that, thematic indexes, single stocks- ... synthetic indexes. So how you get that data or your broad market exposure in your portfolio, it's absolutely going to continue to change.

A lot of these products are going to mature in these trends, but it's gonna be offset by the rise of artificial intelligence, because we're just gonna see continued new product development enabled through this technology, and we're already seeing it. A lot of our clients are asking us about, how do you build a product that can include some alpha signals or some sustainable integrations and quantitative inputs in portfolio construction but deliver it in an index?

Active thoughts, index. So the convergence is gonna be there. I do think if we look five, 10 years in the future, passive versus active is gonna be a very different spectrum than the way we describe it today.

Pete Ruffel: I guess there will always be contrarian views. I believe I saw recently an ETF that came out that was an index exposure without AI companies involved.

So there will be something for someone everywhere, so Austin, we always like to round out our podcast by asking our guest a very, personal question, and I'm hoping this is closer to you than probably it is, even though we're similar ages, so it's far off.

But what does retirement look like for you, Austin?

Austin Guy: Well, to your point, I probably need some binoculars to really bring it into focus and see it clearly. Although, if the market just keeps compounding at 15%, I think it's gonna compress the timeline for everyone. I think time is our most valuable asset, and I think about the balance I want to have in retirement.

I have a really hard time envisioning myself being easily able to just jam on the brakes and throw the car in park and walk away, as much as I'd like to think I'll do that. So I'd love to maybe teach, get involved in a not-for-profit board, but do it at the minimal amount of hours it takes to be productive so that I can do all the things that I want to do, spend time with my family, travel, all the things that you would expect me to say here.

So let's hope I'm just wise enough to get there sooner rather than later.

Pete Ruffel: Well, you're in the Chicago area, so I expect you'll be a professor at Booth soon enough, right?

Austin Guy: that's the one path in which is the most easy, I think, yes. For some. I don't know about me. We'll find out maybe.

Pete Ruffel: we appreciate your time today, Austin.

It's super informative. it's a topic that is near and dear to a lot of people as they're reading the headlines, so hopefully we made some sense of it for a lot of our audience members out there today. Just a reminder to those that are listening in, please go ahead and like and subscribe.

We wanna continue to give you updates around the retirement industry. And again, appreciate your time and look forward to having you for the next episode. Thanks.

Jennifer Doss:

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