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Robust growth in Fixed income ETFs

"ISHARES MANAGES ABOUT HALF OF THOSE ASSETS AND FIXED INCOME ETFS TODAY, WE'RE DEFINITELY THE LEADER IN THIS SPACE"

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What trends have we seen in Fixed income ETFs globally? And in Asia?

Fixed income ETFs have grown phenomenally. It's the fastest growing category within ETFs. We're just shy of a trillion dollars globally in fixed income ETF assets **(*)**. This year alone, 55% of the net new inflow into ETFs globally has come into fixed income. That's tremendous. The historical is somewhere between 15% to 20%, and now we're at 55%. So that gives you some context.

It reflects the structural trend that we see of money moving into fixed income ETFs. And the second is obviously the market and the context where we came out of a really dire December in terms of equity market performance and everybody moved into yields. So the hunt for yield really came on, and expectations obviously were for higher yields earlier this year and now we've seen them come down again.

Fixed income ETFs allow you to define yield, to diversify your fixed income book, and to build multi-asset portfolios that includes fixed income exposures that you may not have in-house. It also allows you to move on the credit spectrum, all the way from high yield emerging market bonds to safer US investment grade for instance. It also allows you to move on the duration spectrum.

It's that flexibility, the ability to diversify, get access at low cost that really is driving fixed income ETFs to this trillion-dollar mark, and we think in the next five years we'll go to two trillion globally in assets. iShares manages about half of those assets and fixed income ETFs today, we're definitely the leader in this space.

***Note:** The interview was conducted on May 30, 2019. Global bond ETF AUM surpassed USD 1 trillion on June 4, 2019.*

One thing I want to highlight is, especially for fixed income, our UCITS platform which is our European domicile ETFs - still global exposures with the fund based in Europe - have a real benefit when it comes to fixed income because investors typically find them more tax-efficient here in Asia. You keep more of that yield in your portfolio, which helps you get better returns.

Why would a client not just buy a physical bond or a bond fund?

ETFs are bond funds, they just happen to trade on an exchange, which makes it easier for you to implement, in many cases faster and it also adds liquidity. But the choice of fixed income ETFs is typically greater than what you can see in the traditional bond mutual fund space. Anything from very specific exposure to the very, very broad-based exposure.

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Typically, if you buy a bond there might be a minimum size, but ETFs have no minimum size. Individual bonds aren't particularly diversified, so you really have to like that company bond. If you buy a corporate bond, you have really got to love that company because chances are, you're going to sit in that till maturity. The ETF allows you to buy and sell as the markets move, and the markets are moving currently where expectations for interest rates go from hikes to cuts in the space of six months. Something that investors need to take into account when they invest is that flexibility you get with ETFs, in a very cost-efficient and transparent way. Mutual funds may also have higher trading costs to go in and out of than what you find for ETFs.

There's a lot of benefits, and if you look at the Greenwich Associates survey that we did very recently on ETFs, 40% of institutional investors say they're now looking to increase fixed income ETF investments this year. And nobody said that they would reduce.

How does the fixed income ETF structurally effect the capital market?

After the global financial crisis, you've had a situation where pre-crisis, banks would hold large inventories of fixed income bonds which allowed you to get liquidity in a very easy way. Those inventories have dropped by around 80%. At the same time the

number of fixed income issuance has gone up two times, so you've seen a doubling of bonds and an 80% reduction in inventories at the banks.

What ETFs do is bring these markets onto an exchange. From an OTC market where you just face the bank, to an exchange market like STOXX, where you can trade with all market participants. That increases transparency, it increases liquidity, it helps reduce cost, and it standardises fixed income.

If you think about it, some companies have 50,000 bonds outstanding. How do you navigate that? There's only 500 securities in the S&P 500, 500 companies, but imagine each of those companies have thousands of bonds outstanding. It's a very hard space to navigate. ETFs make that easy. Really easy.

We get a lot of questions on how are ETFs put together? The reality is ETFs buy the underlying bonds, when we talk about fixed income ETFs, and BlackRock manages that quite efficiently due to our scale in these markets and our ability to get access to these bonds.

The other thing you have to think about when you look at ETFs in the context of capital markets is that, ETFs are close to a trillion dollars in assets currently, but that compares to a fixed income market globally that is 90 trillion, so there's still a lot of room to grow for fixed income ETFs. ■