The World of ETFs and their Expanding Role in Asia's Wealth Market Portfolios

Rebecca Sin, Head of ETF Sales Trading Asia at Commerzbank. She told delegates at the Hubbis Investment Solutions Forum why Asia's wealthy investors should consider ETFs as passive investments, or as part of broader active portfolios.

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SIN HAD ONLY 10 MINUTES to convey the attributes of ETFs. The ETF, she said, is used to secure market access to a variety of underlying products and the market's dramatic growth has provided investors with access to numerous different assets, different sectors, markets, indexes, commodities, countries, and regions. "Aside from the obvious mainstream financial assets and markets that ETFs represent," Sin noted, "there is now an ETF focused on almost everything an investor might want, from ESG investing to factor investing to smart beta."

ETFs act like a mutual fund and a stock combined. "An ETF can be traded at any time," Sin explained, "whereas a mutual fund has only one price at the end of the day,

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meaning there is more liquidity and greater transparency in ETFs. You can trade an ETF intraday any time during the day and ETFs are ultimately as liquid as the underlying, so for most ETFs, they are very, very liquid."

Sometimes, however, Sin noted that there is sometimes little on-screen liquidity via the major trading screens. However, through the very active market-makers such as Commerzbank, there is plenty of additional underlying liquidity. "Through Commerzbank's proprietary state-of-the-art electronic trading platform, we offer constant markets in more than 4,000 ETFs globally across all asset classes. Investors in Asia do not need to wait for the US to open to trade US-listed ETFs, they can trade US/European ETFs during Asian hours."

Expressing your preferences

ETFs can be used as building blocks in the construction of a portfolio. "Oftentimes," Sin reported, "we see investors use ETF in a combination of active and passive investments," Sin explained, "as ETFs can play a role in an active portfolio as well."

There are many different ways to use an ETF in a portfolio. Sin explained that an investor might have a global portfolio and wants to express an exposure into, Spain for example, but does not have the time or the inclination to look for all the single stocks, so can buy into an ETF like MSCI Spain, for instance.

Another approach is tactical, to express a view of a particular asset class but perhaps only for one day or one week, as ETFs allow investors to quickly access the market. ETFs, Sin explained, can act as building blocks in portfolios. "You can have active products," Sin observed, "you can have passive, you can have both. ETFs can be used as building blocks in a portfolio for diversification, quick market access, tactical asset allocation, and cash equalisation."

For example, on the last point, Sin explained that if there is cash in a portfolio waiting to be deployed, that cash can be 'parked' temporarily in ETFs until an active strategy is found. "Investors," she elucidated, "might for instance anticipate an event leading to a market change, perhaps that Italy would bounce back after a spate of bad news, but instead of the more complex research into individual stocks, an 'Italy' ETF can be used instead as a proxy to express views on the country as a short-term play."

Or this short-term parking of funds might simply be waiting for a strategy and can be facilitated by buying into one or more of the many fixed income ETFs available to obtain running yield.

Sin also remarked that ETFs are passive products and therefore, by definition, cannot beat the benchmarks. However, they are cost-efficient. She noted, for example, that an investor can select a US-listed ETF to effectively buy into the S&P 500 at just four basis points. "ETFs," she commented, "can be cheaper than other active products, they are also diverse, liquid, and tax efficient."

Strategies for choosing ETFs

Selection of an ETF is more complex. "Many people make the mistake of selecting the ETF based on the largest assets under management and the cheapest fee, all of which seems to make sense," she explained. "But there are strategies that can help wealth advisers and their clients more accurately and logically select ETFs."

Sin first highlighted exposure, explaining that there are physical or synthetic ETFs. "Physical replication is the most popular," she reported. "For example, if you buy an S&P 500 ETF, the ETF will physically own all 500 names of the index. On the other hand, a synthetic ETF will utilise derivatives such as futures and swaps, for example, to gain exposure to the oil markets. It is worth noting that for synthetic ETFs, there will be some inherent counterparty risk derived from the swaps."

Also, on the matter of exposure, Sin noted that there are variations on each theme. "If you want to select a Japan-focused ETF," she explained, "there are many different exposures you can invest into; for example, the MSCI Japan, Nikkei, Topix, and ultimately they will all perform somewhat differently around the major themes of Japan."

Sin then addressed structure. "What type of ETF are you buying? Is the ETF smart beta, leveraged/inverse, currency or commodities? There are many different structures to invest into, so make sure you pick the right structure for the exposure you want."

Performance components

"Many people simply look at the management fee and AUM, but they do not factor for example, in how much it costs them to trade in and out of the ETF. So, when you think of an ETF, you have to look at various components to determine if the ETF is suitable for your portfolio."

Sin closed her talk by remarking that Asia is a region of immense opportunity for ETFs, having lagged in the worldwide ETF explosion. The US still mainly dominates the worldwide landscape with a market share of more than 70%, while Europe represents almost 16% of the market. Asia meanwhile represents less than 10% of global ETF valuations and that presents Asian investors and leading proponents of ETFs such as Commerzbank with an opportunity. ■