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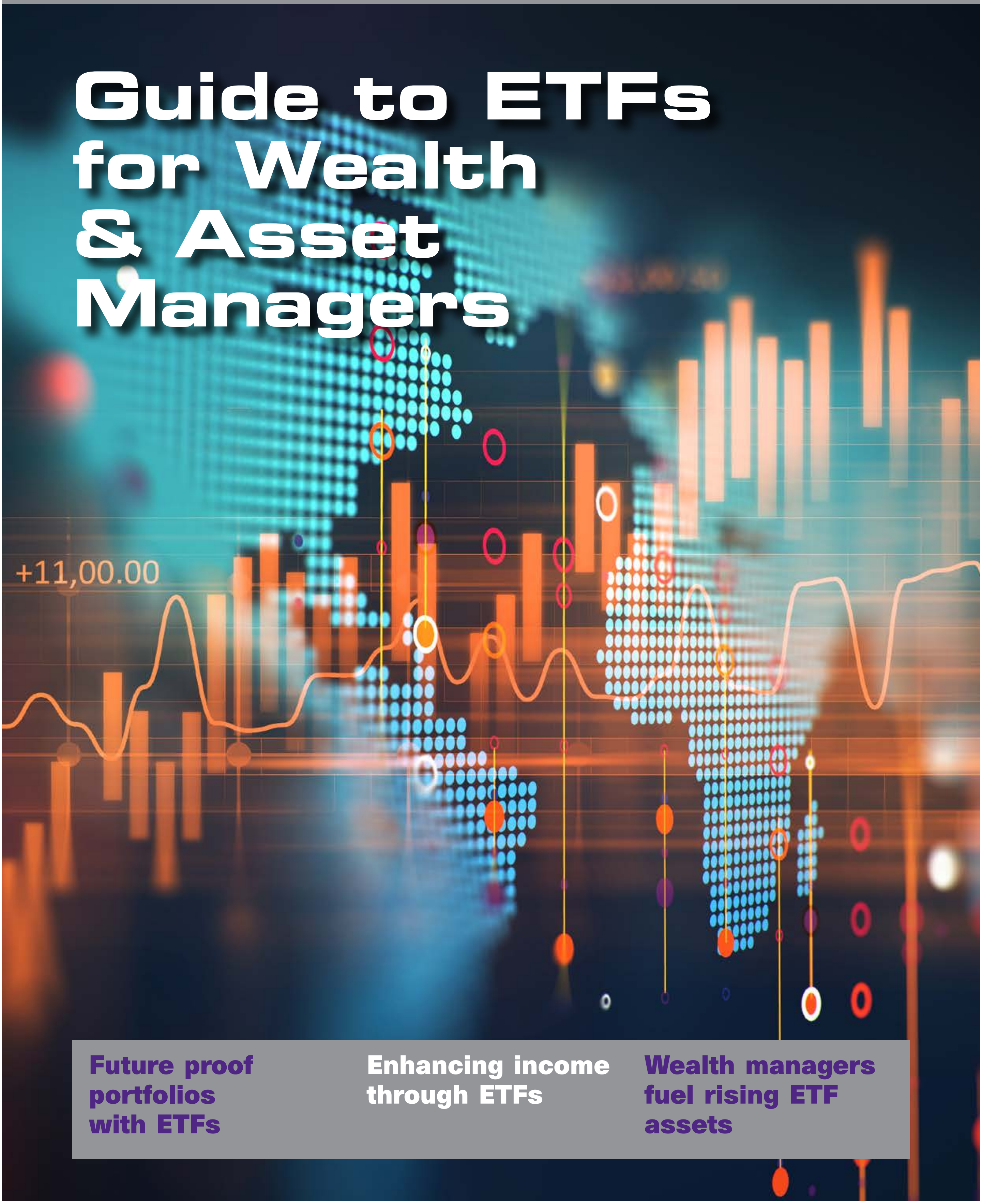
Guide to ETFs for Wealth & Asset Managers



Future proof portfolios with ETFs

Enhancing income through ETFs

Wealth managers fuel rising ETF assets

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Continued wealth management support fuels rising ETF assets

By Beverly Chandler

The ETF industry has enjoyed another extraordinary year of asset gathering. At the end of June 2017, there were 1,830 US exchange traded funds with assets of USD2,886 billion according to the latest monthly overview of the US ETF market by Ultumus. Assets in the iShares Core products MSCI EAFE ETF, S&P 500 ETF and US Agg Bond ETF all experienced strong inflows during the month of June, attracting in excess of USD2 billion each along with the SPDR Fin Sel Sector ETF.

Assets in US fixed income ETFs saw gains of over USD4 billion for the month, while the iShares ETF range was the largest winner, increasing more than USD12 billion.

Meanwhile in Europe, ETF data provider ETFGI reported that assets invested in ETFs/ETPs listed in Europe reached a new record high of USD682 billion at the end May 2017 surpassing the prior record of USD658 billion set at the end of April 2017.

At the end of May 2017, the European ETF/ETP industry had 2,276 ETFs/ETPs, with 7,157 listings, assets of USD682 billion, from 59 providers listed on 27 exchanges.

ETFs and ETPs listed in Europe gathered net inflows of USD12.65 billion in May marking the 33rd month of positive net inflows. Year to date, net inflows stand at USD53.21 billion. At this point last year there were net inflows of USD17.60 billion.

Part of the increased assets in ETFs lies that the door of the rise of the robo-adviser and its associated technology which has encouraged wealth advisers of all types to turn to ETFs for constructing efficient, liquid and economical pooled portfolios for clients.

A survey published earlier this year from BBH found that some 54 per cent of respondents believed that robo-advice presents an opportunity for their business as opposed to a threat.

And in terms of sectors and strategies within ETFs, 2017 is also set to be a growth year for smart beta ETFs. That BBH survey found that some 70 per cent of investors plan to increase smart beta allocation over the next 12 months. This comes from a relatively low base of some 5 to 10 per cent of people's portfolios as advisers try out the concept, testing the waters to see if smart beta ETFs do what they say will.

The results are proving to be good and the potential of using a smart beta ETF as an alternative to an active fund is slowly being realised. This type of ETF is surely set to grow in popularity.

ESG, SRI or Impact investing is another strong theme in ETFs this year, with an increasing number of ETF providers issuing ETFs using ESG rules to create their ETFs and an increasing number of wealth advisers finding that their clients want those types of products. The BBH survey found that 50 per cent of respondents indicated that ESG factors lie behind their investment decisions and a number of firms have developed ESG data to aid issuers in their production of ESG based ETFs.

Meanwhile, looking at sectors, ETF selection platform TrackInsight has commented that despite some pronounced outflows in June, the Technology Stocks segment saw the biggest sector inflows overall in the first six months of the year, attracting more than EUR4 billion.

ETFs linked to Materials Stocks experienced the biggest outflows with nearly EUR400 million leaving the segment. The Biotechnology Stocks segment was the best performer, with the ETFs in this segment delivering an average performance of 11.23 per cent, closely followed by Leisure Stocks with 10.87 per cent and Internet Stocks with 10.71 per cent.

The worst performing segment by some way was Gas Stocks which saw performance decline -22.68 per cent over the period, followed by the wider Energy Stocks segment with -16.87 per cent.

The firm writes that as a proportion of January AUM, the Chemicals Stocks segment saw the biggest change, with inflows of EUR122.7 million representing an increase of 90 per cent in the first half of the year (this doesn't reflect the contribution of performance to June 30th AUM), and Transportation Stocks saw the biggest proportional negative shift in investor sentiment, with outflows of EUR276.5 million representing a decrease of 21 per cent on AUM at the start of the year.

Detlef Glow, head of EMEA research at Thomson Reuters

Detlef Glow, head of EMEA research at Thomson Reuters, conducted a recent study into the potential of a period of consolidation in the fast-growing ETF industry.

He wrote that net new sales figures are the fuel for new product offerings and also for the launch of new ETF promoters, since active asset managers want to capture their share of this growing market.

However, the flows are intensely concentrated in the European ETF industry, he found with some new firms able to gather assets very quickly for a new launch, while others struggle.

"Since profitability is a key measure for companies, it is fair from my point of view to assume that ETF promoters want to run ETFs that are profitable for them," Glow writes and examined ETFs with EUR100 million in them, on the grounds that this is likely break- even amount.

Glow writes that by the end of May 2017 there were 2,183 instruments (primary funds and convenience-share classes) listed as ETFs in Europe, according to the Thomson Reuters Lipper database, and some 404 ETFs in European have not had assets over EUR100 million at any point in the last three years.

"This meant that 18.5 per cent of the ETFs registered for sales in Europe were at risk of being closed by the ETF promoters," Glow writes. "If all these funds were to be closed within a short time horizon, one could speak of a consolidation; it would mean the number of products available to investors was shrinking. The impact of closing these ETFs could not be neglected, since these 404 ETFs hold a combined approximately EUR11.2 billion in assets under management."

Next, Glow analysed the ETFs registered for sales in Europe by implementing a EUR50 million threshold filter which brought the totals down to 249 ETFs with assets of EUR3.8 billion, while down to EUR10 million, revealed just 40 ETFs.

Glow writes: "The closure of these 40 ETFs would in my opinion still not mark a consolidation, since the ETF promoters may launch a similar number of products over the same or a slightly extended timeframe."

Glow concludes: "I would see such a clean-up of product ranges as a sign of the maturity of the ETF industry and not a consolidation." ■


Precision engineering
with BMO Enhanced Income Equity ETFs

Enhanced Income Equity ETFs – a first for BMO

Interview with Christine Cantrell

The new BMO Enhanced Equity Income ETFs range is a first for passive investors says Christine Cantrell, sales director, ETFs, at BMO Global Asset Management. The strategy brings an institutional approach to investing, available in an ETF format, with broad equity benchmarks at its core and an option overlay for additional yield.

"I am excited because these are so unique," Cantrell says. "They haven't been done before in the UCITS ETF structure but it is a tried and tested approach because we are already leaders in a similar strategy in Canada."

Canadian headquartered BMO has GBP23.5 billion assets under management across its Systematic and ETF strategies as at 31 May 2017. BMO Global Asset Management has GBP183 billion assets under management as at 30 April 2017.

BMO has been running eight options-based ETFs in Canada for six years and has accumulated USD3.4 billion under management in those ETFs as at 30 June 2017.

"We are replicating the equity indices that a lot of our clients benchmark against while also trying to enhance the income," Cantrell explains. "We are increasing the distribution yield from this product to be above the typical dividend yield.

"For a portion of the portfolio we are writing call options which allows us to take advantage of the volatility risk premium. We get paid for writing the options through a premium estimated at between 2-4 per cent which goes on top of the typical dividend yield. This results in an attractive yield on an estimated net basis of 4.6 per cent in the US, 6 per cent on European equities and 6.8 per cent in the UK."

Cantrell reports that a lot of the firm's asset and wealth manager clients are trying to find income. "Private wealth managers are constantly trying to think of ways to construct a higher income portfolio for clients who are retired and need an income stream but don't want to sell down parts of their portfolios," she says.

Christine Cantrell, sales director, ETFs, at BMO Global Asset Management

"Wealth managers construct risk profiled portfolios for different clients but may have to create another portfolio just dedicated to an increased amount of income. We have a lot of demand from those types of clients for something paying at least 5 per cent. Typically these clients would have to increase their risk to achieve that level of yield but we are allowing them to reduce their equity risk while increasing their income."

BMO Global Asset Management's experience in Canada has shown that the Enhanced Income Equity ETFs achieve 90 per cent of the volatility of their respective equity benchmarks.

Costs on the new funds have an ongoing charge of 30 basis points. "In the past, you would have had to use a 75 basis points to 1 per cent active fund and exposed yourself to idiosyncratic stock picking risk," Cantrell says. ■

Source: BMO Global Asset Management. For professional investors only. The value of investments and income derived from them can go down as well as up as a result of market or currency movements and investors may not get back the original amount invested. Investing in ETFs involves risk, including risks associated with market volatility, currency rate fluctuations, replication strategies, and changes in composition of the underlying index and assets. *BMO Global Asset Management is a trading name of F&C Management Limited, which is authorised and regulated by the Financial Conduct Authority. CM13674 UK*

Future proof your portfolio

Interview with Howie Li

Howie Li, CEO, Canvas, ETF Securities

Against the backdrop of the current macroeconomic environment, Howie Li, CEO, Canvas, ETF Securities, is encouraging investors to think deeply about future proofing their portfolios.

"The unconventional policy steps which central banks took from 2008 onwards has had knock-on effects to the valuation of assets and this continues to create big challenges for investors. At the beginning of the year, investors were concerned about inflation, how much longer the equity markets could continue to perform strongly and about Brexit as well as geopolitical risk generally. Not much has changed over the year but these remain drivers for uncertainty at a macro level," Li says. "Accordingly, investors seem particularly focused on uncorrelated returns and risk mitigation through diversification."

Li says that the strong equity market performance and relatively low volatility has created a risk-on atmosphere. Nevertheless, he says investors are increasingly aware they must prepare for this equity rally to slow down, particularly as central banks try to withdraw from asset purchases.

"Interest in broad commodity exposure has increased this year as investors factor in an asset class that has a low correlation to equities and bonds," he says. "If 10 per cent of your portfolio is in broad commodities against 60 per cent in equities and 40 per cent in bonds, that has historically reduced volatility and the size of drawdowns in a portfolio."

Li also believes that, in the current environment, 'future-proofing' also involves looking carefully at emerging long-term trends. "The risk on appetite also means people are diversifying their portfolio to include thematic investing, where returns can be captured through exposure to assets linked to long-term structural trends. We've seen a surge in appetite for cyber security and robotics and automation products, which have seen strong inflows and performance this year."

"Those portfolios are predominantly in small to mid-cap companies which provide a high-growth exposure. Of particular interest to investors though is the underlying growth trend of increasing automation in our daily lives and cybersecurity against data theft as the world becomes more connected. The growth of these are often driven by forces unconnected with the financial markets."

Li says that, in five years' time, automation will undoubtedly be a larger part of everyone's life. "And cyber security will be more important because data are the building blocks of the modern world. These are the long term megatrends investors are attaching themselves to, with opportunities to track a precise theme executed through precise investments."

With ongoing geopolitical uncertainty, some wealth managers have also kept a steady allocation to gold, which his firm believes is currently fairly priced. "Gold is perhaps the original hedge against market uncertainty and is often used by investors as a safe haven."

"As it relates to ongoing inflation concerns, especially where it's unexpected, investors are again examining broad commodities and precious metals for their inflation-hedging qualities. In addition, currencies such as the Japanese yen and the Swiss franc are often considered for their haven status as well."

Finally, the search for yield continues apace, Li says. "Emerging market local currency bonds are looking increasingly attractive as the US dollar loses steam.

"On a fundamental basis, these countries are faring rather well and, on a currency basis, there is a relative undervaluation against the dollar. The continued search for yield has forced investors to take on wider considerations as to what will be included in their portfolio and we're seeing more risk added to maintain desired yield levels." ■

Providing RIA clients with the best of both worlds

Interview with Mike Castino

"If the investment manager has the ability to form their own regulated investment company and trust to launch an ETF, then as an organisation and service provider we can offer the necessary guidance, support and required services in tandem with their existing infrastructure and capabilities," says Mike Castino, senior vice president with U.S. Bancorp Fund Services.

"If they don't have experience with the nuances of launching an ETF, we are prepared to provide full support, from creation of an investment strategy or index to the launch of the fund and beyond. If a manger is looking for a simpler structure, they can also join our series trust solution. This includes services such as fund administration, fund accounting, tax and legal administration services such as exemptive relief and fund filings, along with the compliance and distribution services included in a much less complex and cost effective solution. We can fully customise our services depending on what the client needs to run their ETF."

"We generally see two types of clients come from the RIA space," Castino says. "Those who say 'I have a better index methodology and can compete with existing sponsors in an asset class or strategy', so they launch an ETF with the aim of capturing assets from existing products for example. "

"Then there are other RIAs who are running separately managed accounts who want to put those assets into a more efficient wrapper for the benefit of their clients. They have captive assets under management that they can bring to an ETF when it is launched."

Castino explains that the scale can vary with a client on one side of the spectrum managing USD75 to USD100 million in a single strategy. While on the other side, a client can have multiple strategies, such as domestic U.S. equity, international equity and a bond fund with combined assets of over USD1 billion.

Mike Castino, senior vice president at U.S. Bancorp Fund Services

About U.S. Bancorp Fund Services – Mike Castino serves as business development officer for the exchange-traded products division and has over 20 years of ETF experience. He is also the chairman and trustee of ETF Series Solutions (ESS). U.S. Bancorp Fund Services administers over $59 billion in 10 multiple series trusts, of which the ETF series trust (ESS) administers over $2 billion. Additionally, U.S. Bancorp Fund Services provides administration to 26 ETF clients with over $17 billion in assets under administration.

"Given the regulatory environment and everyone looking at the DOL rules and fiduciary standards, it is expected there will be new areas of regulatory focus that will require close analysis," Castino says. "So RIAs are, or should be, preparing. If you create an index ETF there is transparency in its methodology, which can make the due diligence very simple for your current and future clients.

"ETFs are known for being low cost and tax efficient, which combines nicely with their transparency. Who doesn't love to not receive a capital gains tax bill at the end of the year?"

Many index providers are currently helping RIAs create their own indexes. Indexing is not exclusive only to big ETF providers, Castino explains. "Anyone can have a custom index. Once we tell that story to an RIA who thinks the only route is to be an active manager they realise they can do this, get the benefits and the clients will love it."

Crucial to launching an ETF is a good pedigree in terms of performance for managed accounts, but Castino explains that they don't limit themselves and exclude smaller RIAs. "What a lot of them are finding is that outside of a separately managed account, an ETF can open new channels of gathering assets which they didn't have before."

Castino concludes, "everyone is going to believe in their own strategy but if you want to make it in the ETF space and fight for market share prepare for a minimum of two years of time, resources and effort for your ETF to catch on. If you do have internal assets to dedicate to your ETF at launch (from an SMA for example), that definitely makes things easier." ■