

Money

ETFs prove popular with investors

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Exchange traded funds are some of the fastest growing investment products on the market thanks to their low cost and diversification benefits. ETFs are index funds that are listed on the Australian stock exchange. They trade like any other share but with an ETF, when you make one transaction, you're buying a broad, diversified portfolio.

In the Australian Securities Exchange's monthly update on listed managed investments, at the end of July 2010 there were 32 ETFs listed on the stockmarket – up 28 per cent on the same time last year. The market capitalisation of ETFs is \$3.7 billion – up 69.3 per cent on last year's figure of \$2.2 billion.

In June, research house Investment Trends released a report into ETFs that found the number of investors using them doubled in 2009 to 38,000 and adoption is higher among direct (non-advised) investors. The report also found that investors use ETFs for low-cost diversification.

“SPDRs [from State Street Global Advisors] and iShares [owned by Blackrock] lead in terms of market share but Vanguard is the most recognised brand,” it states.

Robyn Laidlaw Vanguard ETF product manager says ETFs have been experiencing strong growth for a number of reasons. “Typically the product is about indexing – gaining exposure to an index,” she says. “And ETFs offer all the benefits of indexing such as instant diversification.”

The second reason for the growth, she says, is ease of transacting. “Many investors are already set up to trade equities and that makes it simple to buy ETFs as you can trade them on the stock exchange just like any other share,” she says.

While the Investment Trends report states the adoption of ETFs is higher among direct investors, Laidlaw says she has seen a lot of interest lately coming from advisers.

“Often early adopters of products are more sophisticated retail investors who buy direct,” she says. “But we have seen a lot more interest coming from advisers who see the diversification benefits ETFs offer and how they could assist their clients.”

ETFs are also typically lower in cost than managed funds. “If they are being used in a buy and hold strategy they can also potentially be more tax efficient than managed funds,” Laidlaw says. “This is because the stocks are not being turned over as frequently which can happen with managed funds, with the resulting capital gains tax consequences.”

Vanguard has been offering ETFs for just over a year – since May 2009 – and Laidlaw says there is now \$220 million under management. Its Australian ETF is its most popular product and she says Vanguard will be introducing more ETFs over the next year following the interest from advisers.

The Investment Trends report states diversification and liquidity, combined with low cost, have been the main drivers fuelling growth in the ETF market. It states 71 per cent of current ETF investors say they used the product to diversify their portfolio, 55 per cent cited low cost, and 53 per cent say they had chosen ETFs because they were easy to sell.

“It is worth noting that liquidity is seen as less important than cost,” the report states. “This has changed since November 2008 when 60 per cent of investors cited liquidity and 52 per cent cited low cost as reasons for investing in ETFs.”

Meanwhile, Tom Keenan director of Blackrock iShares says the early adopters of ETFs tended to be superannuation funds. “SMSF investors are used to investing in direct equities rather than managed funds and understand how ETFs provide more diversification very simply,” he says. “Awareness about ETFs is growing as investors become more educated about how they work and the benefits they bring with low-cost, liquid diversification.”

Keenan says demand is coming via financial advisers as well as from direct investors. “Advisers are realising that ETFs offer a more liquid way to invest for their clients but also the non-advised segment can see that it is an easy way to gain exposure to a large number of stocks.”

iShares has 19 ETFs listed on the ASX offering a range of exposures to countries. Keenan says the two most popular iShares are the MSCI Emerging Markets and the S&P 500 iShares. “Another popular one is the FTSE/Xinhua China 25 which is used a lot by the self-directed segment,” he says.