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Unless you've been hiding under a rock lately, you will have heard the buzz around exchange-traded funds (ETFs). Coupled with a growing enthusiasm for direct equities, are we seeing a new mode for financial planning – one based on lower costs and higher transparency? JANINE MACE reports.

"We believe it is the new wave in financial planning."

Although it might sound like a big call, that is how Henderson Maxwell managing director and senior financial adviser, Sam Henderson, describes the way his firm uses a combination of exchange-traded funds (ETFs), direct equities and term deposits to create client portfolios.

"ETFs and direct shares are a better and cheaper way to do it," he explained. "This is the New Age way to do financial planning."

Factors ranging from distrust of the investment industry through to a desire for greater control and reduced costs are creating an environment where ETFs and direct equities are flourishing.

"People are talking about them more and

more," explained Australian Money Planners director and representative, Michael Houlihan. "We see a number of distinct advantages in going direct as you can build a portfolio for a client that is very cost-effective."

While much of the interest in ETFs and direct equities has been driven by planners, Henderson believes client attitudes are also important.

"Clients are now more sensitive about fees on platforms and they want more transparency. High net worth clients in particular are cynical about managed funds and are looking for transparency and simplicity. This is a very strong trend at the moment, especially among SMSF clients," he said.

A significant story

Mark Johnston, director of research firm Investment Trends, agrees direct equities and ETFs are very much in favour.

"The growth area for advisers has been in direct equities and we have seen a big spike in direct equities use," he said.

While trading levels fluctuate month to month, the underlying numbers are higher than ever, Johnston notes.

Houlihan agrees: "Most of our SMSF clients have a relatively high allocation to direct shares. It is a great love affair for many clients to own them directly."

Some of the growth in direct equities is coming at the expense of managed funds, which now represent only 50 per cent of new inflows into unlisted funds, according to the 2010 Investment Trends Planner Direct Equities Report.

ETFs, on the other hand, are enjoying strong growth, with the July 2010 ASX market capitalisation of these products standing at $3.7 billion – up almost 70 per cent on the previous year.

The figures show planners are also slowly getting on board the ETF train, with Investment Trends research indicating 30 per cent were planning to use these products with clients.

"Advisers are still taking baby steps at the moment in their use of ETFs," Johnston said.

Why the interest?

The popularity of direct equities and ETFs is being fuelled by investor disillusionment with managed funds and fees in the wake of the global financial crisis (GFC), according to Simon Robinson, a senior adviser at Wilson HTM Private Asset Management.

"We are seeing a trend towards direct investment in terms of focusing on accountability in the investment process," he said.

With complex structures inextricably linked with the GFC in the minds of many investors, simple vehicles are far more popular, coupled with the need for a sense of control.

"The past 12-18 months has brought the focus back on keeping things simple," Robinson said.

Houlihan agrees simplicity and cost are key issues. "Transparency is a big thing – clients want to see it both in terms of fees and products. They want to know what they are paying for."

In flat or declining markets, fees become a major issue for many clients, according to Henderson. "It is directly related to performance, as people question fees more when performance is largely sideways, as it has been in the past year or two."

BlackRock iShares Australia director, Tom Keenan, believes these factors have had a significant impact.

"The growth in Australia's ETF market has been largely driven by investor preference for transparency, liquidity and low-cost diversification. Self-managed super fund investors,

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Sam Henderson

both do-it-yourself and advised, continue to embrace these benefits after emerging as the early adopters," he said.

"The benefits of ETFs – transparency, cost-effective diversification, and the fact that they can trade them on the ASX – really speak to the SMSF market."

Shifting regulatory landscape

Changes in the financial planning business model are also making direct equities and ETFs more appealing, with the shift to asset-based remuneration in particular helping to fuel the trend, according to Johnston.


Stuart Sayers

"Financial planners are evolving how they do business due to a mix of issues, including regulatory and client demand. The industry is going through a very rapid transition period at the moment," he said.

Morningstar Australasia co-head of fund research, Tim Murphy, agrees: "The shift from commission to fee-for-service advice businesses in Australia will make ETFs a more attractive proposition for advisers to recommend to their clients."

Reworking the traditional remuneration model and greater usage of ETFs and direct equities can even prove financially beneficial for both clients and planners. As Henderson said: "The client's total fee has gone down, while our fees have gone up. We are cheaper and more active in what we do for clients."

Another attraction for planners is that ETFs and direct equities make the process of building a client portfolio quick and efficient.

"One of the advantages of [ETFs] is you can build a cost-effective portfolio for a client and commence portfolio construction quickly and easily. ETFs are liquid and easily tradeable," Houlihan said.

Increasing strategic sophistication

According to E*Trade managing director Stuart Sayers, the use of direct equities and ETFs also makes it easier to implement sophisticated portfolio construction strategies.

"Investors are using ETFs for both buy and hold as a passive investment strategy and for active trading," he said.

"Increasingly, we are seeing people replicating a core plus satellites strategy themselves as it is easy to do it yourself online."

Henderson's firm utilises ETFs for this purpose, using Vanguard products for the core Australian equities exposure and iShares global ETFs for the international component.

"With ETFs you can get wholesale exposure for the core and use direct shares for the satellites," he said. This is then complemented with fixed interest exposure via term deposits and hybrid fixed interest securities.

Houlihan also uses ETFs in this way. "We get the asset allocation determined and then buy the index, as you are able to buy the market at a low cost."

Sayers believes retail use of what was once an investment strategy only available to institutional investors highlights how things are changing.

Planners intending to use ETFs will find the legwork a little easier with the launch of Morningstar's qualitative analyst research on Australian-offered ETFs. This independent research will help investors and planners "better evaluate the relative strengths and weaknesses of ETFs and how they should be used most effectively in portfolios," Murphy said.

Administration tools are also improving, with online trading platforms enhancing their reporting services to make life easier for clients and their planners. For example, earlier this year E*Trade released an upgraded


Michael Houlihan

version of its free Tax Tools Standard service. It can be used to prepare in-depth tax reports, complete 'what if' scenarios on share parcels with different tax treatments and manage investment income distributions.

E*Trade's Premium Service also offers tools which can be used much like a complete – and much cheaper – administration service. "You can add in different asset classes such as art, wine or property and use it like a wrap platform," Sayers explained.

Even traditional financial planning software is getting in on the act, to make the administration of direct equities and ETFs easier.

"We use Praemium as an administration and reporting tool as this simplifies the process," Houlihan explained. "However, most of the larger financial planning tools allow direct shares to be managed on them alone. Praemium was the first one, but the other software tools are catching up." ❖