FINANCIAL NEWS

Tuesday, 30 October 2012

Investors search for access to all areas via ETFs

Peter Davy

29 Oct 2012

Exchange-traded funds are gaining favour as a cheap and cheery way to access emerging markets, this year's Financial News ETF Snapshot Survey has found.

Access all areas

Asked why they invest in ETFs, market participants said exposure to markets that would otherwise be difficult to access was second most important. It scored 2.16 points out of a possible three, behind cost-effectiveness (2.31).

This access is particularly important for investors who don't have enormous scale, according to Irene Bauer, partner at Twenty20 Investments, which builds portfolios of ETFs. She said: "ETFs are still the easiest way for any asset manager that isn't huge to get the exposure to many asset classes."

However, she pointed out that an important consideration was whether that access can be gained while meeting investors' desires for low costs, liquidity and narrow spreads.

Respondents were also asked which markets they were most interested in accessing through ETFs, and again, emerging markets came top of the list, with a score of 2.22, followed by US equities (2.13) and European equities (2).

Dan Draper, global head of ETFs at Credit Suisse, is not surprised by their appeal as an access tool. He said if ETFs are appreciated for their cheap, easy market access, they're likely to be most appreciated for markets that are expensive and harder to access. He said: "It gives a high-net-worth individual sitting in Newcastle the ability to invest in a broad-based emerging market equities product or something as specific as China equities," he said.

And there is room for much more growth. According to Draper, most institutional investors' allocations to emerging markets in their portfolios are still underweight compared with the size of those markets in the world economy.

Moreover, the possibilities are expanding. Deutsche Bank offers more emerging and frontier market ETFs than any other provider in Europe. Some of them, such as its products tracking equity markets in Pakistan and Bangladesh launched earlier this year, wouldn't have been possible even a few years ago, according to Manooj Mistry, UK head of Deutsche Bank's ETFs business db X-trackers.

He said: "As the stockmarkets in these countries develop, index providers are increasingly able to construct indices based on the most liquid and investible components."

Nevertheless, just as with the more difficult parts of the fixed-income markets, there are challenges with ensuring adequate liquidity. Mistry said Deutsche Bank has had to work closely with index providers to ensure the construction takes adequate account of the tradability of the component shares.

Bauer at Twenty20 agrees that liquidity is always an issue, as is tracking error. She said: "You have to take trading costs into account."

Laurent Kssis, a partner at Bluefin Trading, a marketmaker specialising in ETFs, believes the industry needs to work hard to provide education on emerging market ETFs.

He said: "I think people often don't understand what they are buying when presented with emerging markets products. We deal with people every day who don't even read the prospectus." And he believes that is often the case even with institutional investors.

For that reason, while he expects emerging market ETFs to continue to grow, Kssis reckons many investors in the short term would be better off sticking with less exotic options. He said: "Safe, liquid ETFs is where people should start. Let's not run before we can walk."

Bradley departs JP Morgan amid fears of 'Christmas bloodbath'

Top Canadian investment bank rankings

It is finally time to start weaning ourselves off excessive pessimism

UBS to cut 400 investment banking jobs

[?]