informed investor

evolutionroad
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Welcome to our latest edition of the Informed Investor newsletter.

As always, should you have any questions or would like some further information, please get in touch and we'll be happy to help.

Investing in ETFs

An ETF is an investment fund that holds a basket of securities – such as shares or bonds that tracks a specified index – and is itself a listed share, traded on a stock exchange.

ETFs are low-cost, simple vehicles that can offer exposure to a wide range of Australian and global asset classes, indices and sectors, currencies and commodities, as well as a variety of investment strategies.

Investors can gain cost-effective, fast exposure to different markets that were once only accessible to institutional investors, including asset classes and strategies through a single investment by buying an ETF. As ETFs are listed, the investment is liquid, and therefore tradable at any time, however like shares, liquidity is dependent on market volumes and during time of significant market stress, liquidity (the ability to buy and sell) could decrease.

The appeal of ETFs

Typically, ETFs tend to be much cheaper in their annual management costs compared to traditional managed funds. They have no entry or exit fees – investors pay normal brokerage when buying or selling in the same way an investor trades shares.

The attraction of ETFs is that they are very flexible investment tools, which allow investors to easily improve their portfolio's diversification; or to easily implement an investment view; or to use investment strategies that were once too complicated or expensive for them to consider. An investor can use ETFs for their entire asset allocation, or they can act as a low-cost complement, or alternative, to existing investments with active fund managers.

Understanding the risks

Investments carry risk, and ETFs are no exception to this rule. While there is the obvious risk of gain or loss of value depending on market activity, there are other risks to appreciate.

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These range from risks specific to the assets the ETF is invested in, to the liquidity of the underlying investments, currency changes should some of the assets be international or even counterparty risk that is the risk the issuer of the ETF will be unable to fulfil the duties of managing the ETF.

Using ETFs in investments

The simplest way in which investors use ETFs is to establish – or diversify – an investment portfolio. For example, an investor who does not own any shares can simply buy an Australian share ETF, giving them a holding in hundreds of Australian shares, in a vehicle that aims to replicate the annual performance of the Australian share market index (give or take some differences in returns due to challenges of copying the index exactly). Adding a global shares ETF to your portfolio can widen this exposure to an international shares allocation; this might add thousands of shares to the portfolio depending on the particular ETF, picking up the world's top companies (and brands), and tapping into the global revenue streams these generate.

This same investor can then very simply extend the diversification of their portfolio into other asset classes.

ETFs can also be used to gain exposure to a specific investment 'theme', as part of a tactical asset allocation process. For example, an investor who believes that the resources sector is poised to out-perform the rest of the Australian share market can tilt their portfolio toward over-weighting the resources industry by buying a relevant ETF. This tilt can be short-term or long-term. Alternatively, an investor who believes that the European economy will grow more strongly than the other developed-world economies could 'play' that view by buying a broad European share ETF.

Similarly, an investor who believes that the emerging markets will outperform the developed-world markets could bring an emerging markets ETF into their portfolio, and hold it as long as they believe this outperformance will prevail. Alternatively, this strategy could involve a view on a particular industry: an investor who believes that global spending on healthcare will increase as populations in many countries age – both in the developed and developing worlds – can tap into this theme by buying a global healthcare ETF.

To find out more about ETFs, please contact us.

Source: BT Financial Group, 2018

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