February 2021

Generating Alpha: ETF Appeal Grows for Asia-focused Investors

Asia ETF Forum 2020 concluded with stimulating discussions among participants from the Exchange Traded Fund (ETF) industry. In this article, Hong Kong Exchanges and Clearing Limited (HKEX) summarises the topics covered in the Forum, including considerations in ETF selection and trading, and strategies to maximise returns for investors keen on being a part of Asia's growth story.

The investment market entered 2021 having learned some important lessons. Key among those are ways to cope with black swan events such as Covid-19, which continues to cast a long shadow over financial markets and world affairs. Still, there is reason for hope and optimism.

Progress has been made on vaccines that have the potential to end the pandemic, and our collective fiscal health may also soon be on the mend. China and other Asian markets, through their effective handling of the virus, are bouncing back to reopen their economies and begin the recovery process. In doing so, they not only serve as role models for post-pandemic growth but also create opportunities for investors searching for alpha amid unprecedented macroeconomic and geopolitical challenges.

ETFs came into their own in the wake of the global financial crisis of 2007–08 and continue to demonstrate their ability to generate reasonable returns at relatively low cost and risk. As Brian Roberts, Head of Exchange Traded Products, HKEX, noted: "2020 has stress-tested us all in many different ways. In the financial markets, we have experienced extreme downward and upward movements but, through all this volatility, ETFs have remained resilient."

What does this mean for investors and where should they look for future growth opportunities? Experts from across Asia gathered in Asia ETF Forum to seek answers.

China: Leading by example

After successfully flattening the Covid-19 infection curve in the first half of 2020, Mainland China has bounced back strongly and is expected to do better than many major economies, while its capital markets are outperforming their counterparts in the US and Europe.

"We'd argue that things are progressing pretty well in China in terms of the recovery," said Kinger Lau, Chief China Equity Strategist, Macro Research at Goldman Sachs, which expects China's 2021 GDP to expand at a healthy clip of 7.5%.

According to Lau, the three areas on which investors should focus on are Mainland China's fast-growing digital economy, its push for greater self-sufficiency in core technologies such as semi-conductors, and growing demand from the country's expanding, and increasingly sophisticated consumer class.

Another area with potential is big data, which Haibin Zhu, Managing Director, Chief China Economist and Head of Greater China Economic Research, J.P. Morgan, predicted will be the next hot sector. Meanwhile, the government's forward-looking policies are expected to create new growth opportunities.

A prime example of this is China's bid to become carbon neutral by 2060,[1] according to David Lai, Partner and Co-Chief Investment Officer, Premia Partners. "China is one of the largest energy users in the world. Transitioning from that to carbon neutrality, within a few decades, would take a lot of effort and accelerated investment in alternative energy sources," he pointed out, identifying solar power as one of the most promising sectors.

[1] https://edition.cnn.com/2020/09/22/china/xi-jinping-carbon-neutral-2060-intl-hnk/index.html

Stephen Chung, Global X ETFs Sales Vice President, Mirae Asset Global Investments, concurred: “These are structural growth opportunities where investors will find alpha.”

ETFs, which are growing in popularity across Mainland China, are seen as helping investors capitalise on this growth. Traditional ETFs have helped bring long-term flows into the country from foreign investors while thematic ETFs have encouraged them to look beyond the usual mega and large cap companies, and gain exposure to niche areas in Mainland China’s old and new economic sectors, the panellists concurred.

"There are a wide range of products. And the key structural benefits of ETFs – their cost-effectiveness and efficient access – are important to investors,” pointed out Chris Pigott, Senior Vice President, Investor Services, Brown Brothers Harriman.

Asia: Near-term challenges, long-term growth

Asia has been buffeted by the same challenges as China and the rest of the world, ranging from global trade tensions to uncertainties stemming from the US presidential election year and, of course, the pandemic.

Painting a picture of how these crises have affected the region, Kiyong Seong, Director, Asia Rates Strategist, Société Générale, noted that North Asian markets, such as South Korea and Taiwan, have successfully controlled the coronavirus while South and Southeast Asian countries have struggled to do so, with near-term growth implications.

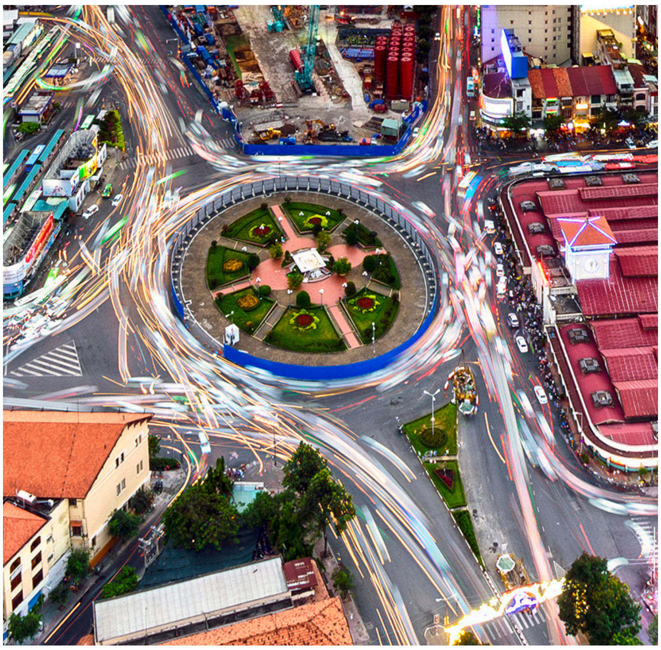
However, a combination of favourable demographics and proactive fiscal policies in regional giants such as India and Indonesia, and emerging markets in ASEAN, provides cause for hope in 2021 and beyond, the panellists agreed. Vietnam’s prospects, with its prominent role in the ‘China Plus One’ model favoured by companies to diversify their global supply chain network, are seen as especially upbeat.

Notwithstanding Asia’s mixed pandemic response record, the region has fared better than developed markets, Seong pointed out: “We are looking at Asia as a better place for a stable portfolio or mitigating portfolio risks going forward.”

ETFs, which have found traction over the past few years across retail, private wealth and institutional channels in Asia after a sluggish start compared with other markets, are an effective tool for investors looking to build strategic, long-term exposure to the region.

ETFs are expected to become even more popular across Asia as investors become more cost conscious and the shift away from commissions and brokerages fees for investments towards a flat-fee model for advice grows, according to Georgina Mitchell, Vice President, iShares, Asia ex-Japan Wealth Distribution, BlackRock.

“Fixed income ETFs are really the fastest growing part of the market,” she added. “The growth is absolutely phenomenal. And we're really seeing that growth play out in Asia.”



ETFs: Resilient, transformational, and misunderstood

In October 2020, ETFs reached USD6.81 trillion in assets under management and recorded net inflows of more than USD540 billion,[2] in a sign of their growing popularity as a cost-effective means to generate alpha, especially during times of market stress. ETFs have also transformed the way investors access financial markets, and investment strategies, and, ultimately, how we construct investment portfolios.

The popularity of ETFs will continue to grow across Asia helped by network effects, according to Jackie Chien, Vice President, Asia ex-Japan iShares Distribution at BlackRock, who also highlighted the growing popularity of fixed income ETFs and green ETFs as ESG principles and sustainable investing gain traction across all investor classes in the region.

"It's definitely something Asia is going to see more of," Mitchell at BlackRock agreed, especially when it comes to the technology megatrend, driven by development in healthtech, robotics and cybersecurity – a point echoed by Mirae Asset Global Investments' Chung, who noted the proliferation of thematic ETFs focused on China's fast-growing electric vehicles sector.

Yet, even as ETFs grow in popularity, misconceptions surrounding costs and liquidity are limiting their growth.

"The total expense ratio (TER) is probably the most marketed cost associated with an ETF so much so that ETF issuers have engaged in fee wars," noted HKEX's Roberts, adding: "We need to step back from just looking at the TER, or even just looking at one or a couple of components of cost. We need to take a holistic approach to assessing the cost of ownership of an ETF. Your total cost of ownership is really derived from two components of an ETF – your trading cost and holding cost."

Total cost of ownership =

Trading costs + **Holding costs**

Trading costs
- **Bid/ask spread**
- **Broker commissions**

Holding costs

Tracking difference
- TER
- Securities lending revenue
- Investment/ Fund taxation
- Transaction costs
- Other factors

Fund and investor level taxation
- Dividend and interest withholding tax

Addressing the liquidity issue, Sebastian Born, Institutional Trader at Flow Traders, stressed that an ETF is as liquid as its underlying assets. "The on-exchange volume is really just the tip of the iceberg. If you want to determine how liquid an ETF really is, it's very important to understand that it's more than just the on-exchange volume. There's a lot of liquidity underneath that...The fundamental and the crucial part for ETFs is the underlying liquidity."

Ultimately, the popularity of ETFs will only grow as investors further enhance their understanding of the product and its myriad benefits. ETFs will remain particularly well suited for investors who want to capitalise on the multitude of growth opportunities offered by China and other markets across Asia and beyond.

[2] https://etfgi.com/news/press-releases/2020/11/etfgi-reports-etfs-and-etps-listed-globally-have-gathered-record

Hong Kong Exchanges and Clearing Limited
8/F, Two Exchange Square, 8 Connaught Place, Central, Hong Kong
info@hkex.com.hk (t) +852 2522 1122 I (f) +852 2295 3106 hkexgroup.com I hkex.com.hk