January 2024

ETF Spotlight

# Active ETFs: A game changer in the investment world

# Contents



# Hong Kong ETP market: 2023 in review

# Hong Kong ETP market: 2023 in review

**HK$14.0b**
Average daily turnover (ADT)
up 16.9% YoY

**HK$383.6b**
Market capitalisation
ETFs: HK$360.1b
L&I products: HK$23.5b

**174**
ETPs
149 ETFs and
25 L&I products

**HK$57.1b**
Net fund inflow
up 25.5% YoY

### New ETP listings

**16**
new ETP listings

**HK$15.2m**
ADT of newly listed ETPs

### New listing highlights

**First Saudi Arabia ETF in Asia Pacific**

- CSOP Saudi Arabia ETF (2830/82830) listed on 29 November 2023
- Largest Saudi Arabia ETF in the world with over HK$8 billion in AUM

**4 money market ETFs listed in 2023, taking the total number of money market ETFs listed on HKEX to 10**

**2 new ESG ETFs listed in 2023, taking the total number of SFC-authorised ESG ETFs to 11**

**First bond ETF in Hong Kong which seeks to offer investors steady monthly distributions**

- Global X Asia USD Investment Grade Bond ETF (3075/9075) listed on 12 October 2023
- Providing exposure to investment grade bonds from Asian markets

### ETP initiatives

**ETF Connect**

- 3 new ETFs included into ETF Connect in 2023, taking the number of Southbound Stock Connect eligible ETFs to 8
  - Hang Seng TECH Index ETF (3032)
  - Global X Hang Seng TECH ETF (2837)
  - ChinaAMC Hang Seng TECH Index ETF (3088)
- ETF Connect 1st anniversary on 4 July 2023
- Southbound ETF ADT reached HK$2.7 billion in 2023, up 196.5% from 2022 and representing 8.6% of total Southbound turnover

**New development**

- Enhancement to ETF quotation rules effective on 20 March 2023
- The SFC has authorised the listing of spot virtual asset ETFs from 22 December 2023

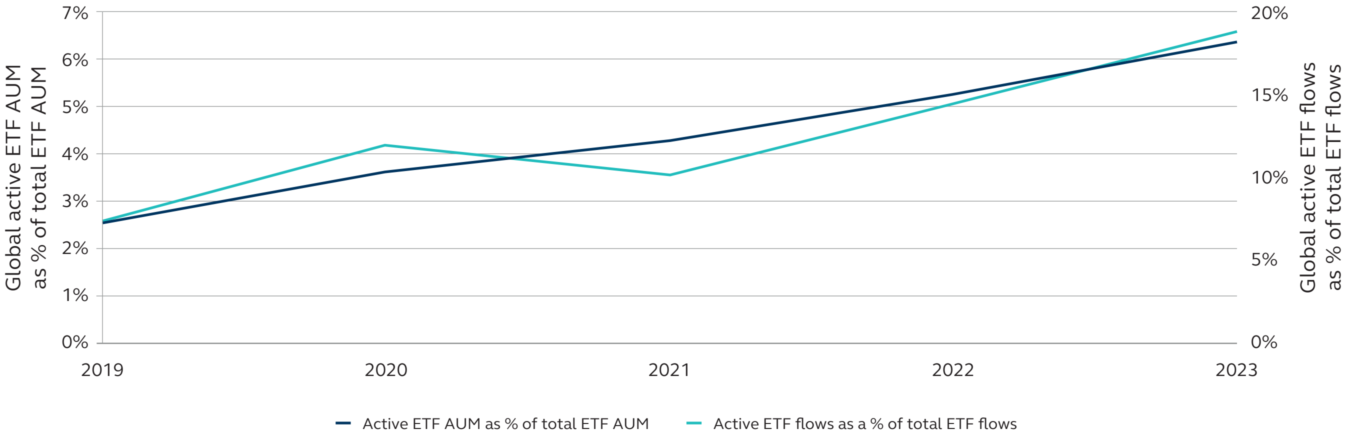
Source: HKEX, data as of 29 December 2023

# Active ETFs on the rise

# Surging popularity of active ETFs

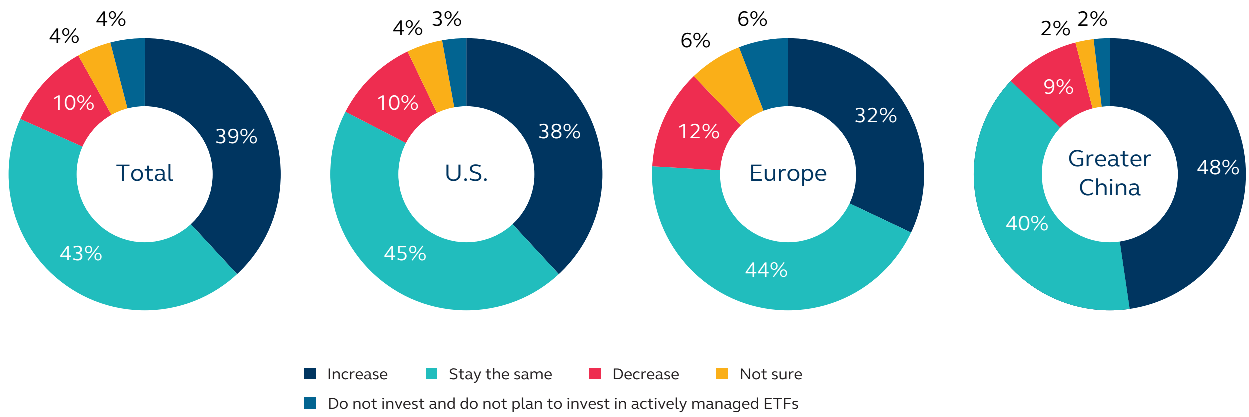
The global investment landscape has witnessed a remarkable surge in the popularity of active exchange-traded funds (ETFs) in recent years. Investors are increasingly drawn to the advantages of active ETFs, leveraging the low-cost benefits of the ETF structure to capitalise on the potential for higher returns and diversification. According to ETFGI, assets invested in actively managed ETFs surged from US$161 billion in 2019 to US$740 billion in 2023. Concurrently, global flows into active ETFs have experienced substantial growth, surpassing US$180 billion in 2023, setting a new record for active ETF flows relative to total ETF flows (see figure 1 below)[1].

**Figure 1. Active ETFs gaining ground in global ETF market**




In Asia Pacific, the concept of active ETFs is relatively nascent: South Korea introduced its first active fixed-income ETF in 2017[2], while Hong Kong welcomed the first active ETF listing in June 2019. Mainland China approved the launch of its first active ETFs in 2020, and Japan joined the fray by listing its first active ETFs in September 2023.[3] However, the region is poised for significant growth. Notably, Asia Pacific has witnessed a remarkable influx of net inflows into active ETFs, reaching almost US$9.2 billion[4] in 2023, marking a 220% year-on-year increase. Moreover, the growth rate of AUM in actively managed ETFs in Asia Pacific reached 82% in 2023 compared to the previous year, albeit from a smaller base, making it the fastest-growing region for active ETFs.[5]

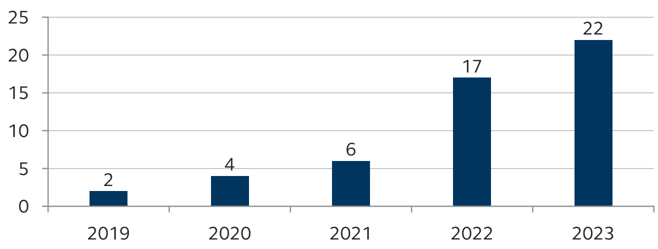
**Figure 2. Percentage of respondents who planned to increase allocation to active ETFs in 2023[6]**




1 Source: ETFGI, data as at 29 December 2023
2 Source: State Street, "The unlimited potential of actively managed ETFs", June 2023
3 Source: Nomura Asset Management, "Nomura Lists Japan's First Actively Managed ETFs on TSE", 7 September 2023
4 Source: Bloomberg, data as at 29 December 2023
5 Source: ETFGI, data as at 29 December 2023
6 Source: Brown Brothers Harriman, "2023 Global ETF Investor Survey" Respondents could choose multiple responses

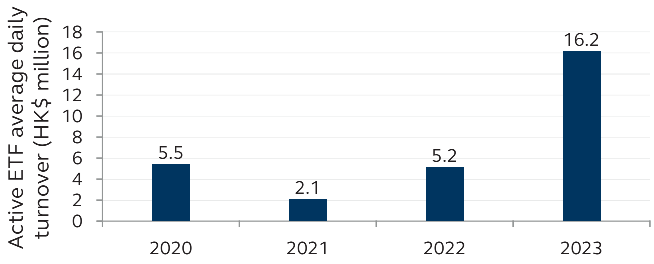
Hong Kong's ETF market has long been at the forefront of product innovation. In the active ETF space, the city's first active ETF was listed in June 2019 and by the end of 2023, there were 24 active ETFs being traded on HKEX with a combined market capitalisation of HK$8.6 billion. These active ETFs cover a diverse range of sectors, such as money markets, virtual assets, technology, and ESG investments. In 2023, active ETFs contributed HK$16.2 million to the average daily turnover of Hong Kong's ETF market, up 214% from 2022.[7]

**Figure 3. Number of active ETF listings in Hong Kong**




Note: The management approach for CSOP Hong Kong Dollar Money Market ETF and CSOP RMB Money Market ETF was changed from passive to active in 2021 and 2022, respectively. Figure 3 does not include these ETFs.

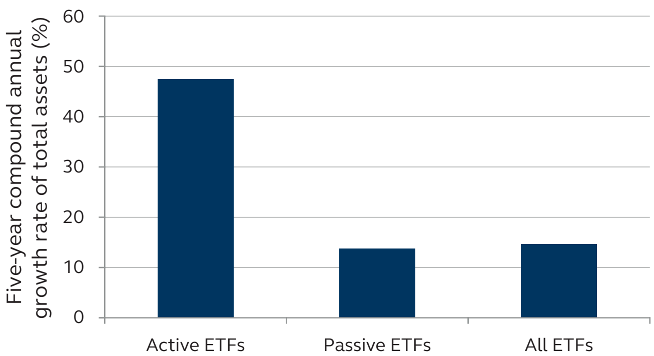
**Figure 4. Liquidity growth of Hong Kong-listed active ETFs**




## Active ETFs: fastest-growing ETFs

Active ETFs have emerged as the dominant force in the growth race among ETFs. Although they currently constitute only approximately 6% of the global ETF market's asset base[8], their growth has surpassed that of passive ETFs. Over the past five years, the compound annual growth rate (CAGR) of active ETFs stood at around 48%, more than three times the rate of passive ETFs and the overall industry (see figure 3).[9]

**Figure 5. Active ETFs outpace overall industry growth[10]**



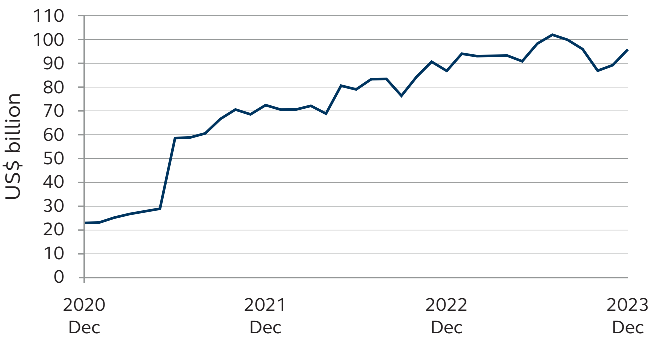

One of the primary drivers behind the robust growth of active ETFs has been the shift of capital from mutual funds to active ETFs. In 2022, ETFs recorded substantial inflows of US$779.4 billion, in stark contrast to the outflows of US$1.4 trillion from mutual funds during the same period.[11] Furthermore, the 2023 Global ETF Investor Survey conducted by Brown Brothers Harriman (BBH) revealed that 46% of investors had allocated from index mutual funds to active ETFs in the past year, while 42% had made allocations from active mutual funds, a notable increase compared to around 19% for both in 2022.[12]

7 Source: HKEX, data as of 29 December 2023
8 Source: ETFGI, data as at 29 December 2023
9 Source: State Street, "Why Invest in Actively Managed ETFs", 14 July 2023
10 Source: Morningstar, as of 31 May 2023. Calculations by SPDR Americas Research
11 Source: PWC, "ETFs 2027: a world of new possibilities"
12 Source: Brown Brothers Harriman, "The 10th Annual Global ETF Investor Survey", 3 April 2023

This trend can be attributed, in part, to increased market volatility stemming from the Fed's recent rate hike cycle, which had an adverse impact on index-tracking funds. This has prompted investors to shift towards active strategies to seek out returns that surpass benchmark performance.

Furthermore, the growing trend of converting existing mutual funds into ETFs among asset managers has been providing an additional impetus to the inflows of active ETFs. According to Bloomberg Intelligence, more than 70 mutual funds have undergone conversion, bringing in an inflow of US$96 billion in assets.[13] Mutual fund conversion presents an attractive avenue for asset managers to expand their investor base while retaining the existing investor base and track record.

**Figure 6. Mutual-fund-to-ETF conversion (AUM)**



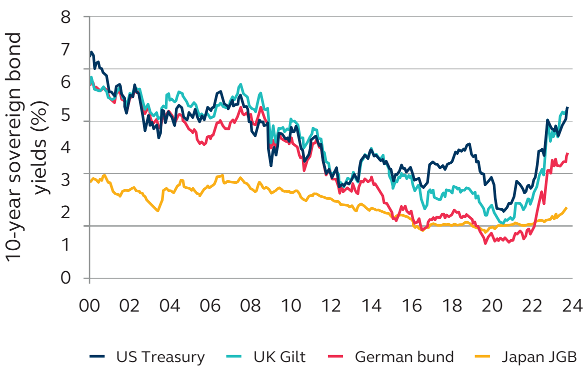

## A diverse selection of opportunities

Active ETFs combine the benefits of traditional ETFs with the potential for active management. In the following section, we will delve into the different types of active ETFs and explore their unique benefits.

### Active fixed income ETFs

While equity ETFs continue to dominate the global ETF landscape, fixed income ETFs have been making waves in recent years, capturing approximately 21% of total ETF AUM globally.[14] In addition to the advantages they offer over holding individual bonds, such as greater liquidity, enhanced transparency, and lower transaction costs, the appeal of attractive yields is another pull factor enticing investors to embrace bond ETFs.

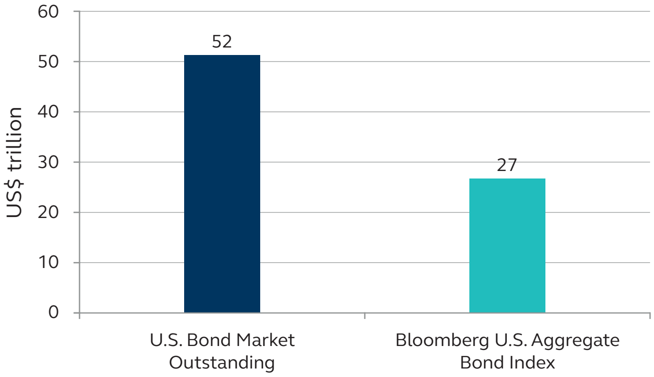
**Figure 7. Bond yields rise to highest level since 2007[15]**




The growth of bond ETFs isn't limited to the passive realm. The active ETF market has also caught the attention of investors who seek to combine the expertise of active management and fixed income exposure. Unlike their passive counterparts, active bond ETFs have the flexibility to select securities beyond traditional benchmarks, unlocking potential for higher returns by identifying undervalued or overlooked issuers. Active managers can also assert their convictions and capitalise on market inefficiencies that often arise due to the size and complexity of the bond market.

13 Source: Bloomberg Intelligence, as of 29 December 2023
14 Source: Financial Times, "Inside the $10tn ETF industry", 3 July 2023
15 Source: LSEG Datastream, Schroders Economic Units, 9 Oct 2023

**Figure 8. Actively managed portfolio may have a much larger opportunity set their passively managed counterparts[16]**




Within the fixed income ETF space, money market ETFs have recently taken center stage. With the rise of cash as a vital asset amid rising interest rates, these ETFs have emerged as a preferred choice for investors navigating volatile periods while preserving capital. Notably, the Hong Kong market has witnessed a surge in listings of active money market ETFs as issuers strive to meet the growing appetite of yield-seeking investors. Among the five active ETFs listed in Hong Kong in 2023, four of them are money market ETFs. Collectively, active money market ETFs contributed HK$6.3 million to the average daily turnover of ETFs in Hong Kong.[17]

### Active thematic ETFs

From disruptive technologies like artificial intelligence and blockchain to emerging sectors such as the metaverse, active thematic ETFs allow investors to position themselves at the forefront of transformative trends. Active management in thematic ETFs enables portfolio managers to select companies within these themes, capitalising on the dynamic nature of the industries.

One of the distinct advantages of actively managed thematic ETFs is the expertise and research provided by the portfolio managers, which enable them to adapt to market trends and navigate the complexities of rapidly evolving sectors. Moreover, active thematic ETFs can offer investors the potential for risk mitigation, as the active approach allows the fund manager to quickly divest from securities that are no longer aligned with the investment objective, without being constrained by the benchmark.

Active managers benefit from a wider investment universe, giving them access to a broader range of opportunities within a specific theme. JP Morgan Asset Management pointed out that given the increasing number of thematic ETFs and the relatively limited number of pure-play stocks, thematic benchmarks can result in numerous funds pursuing the same stocks and investing in highly crowded positions.[18]

**Figure 9. Timeline of the first listings**

**16 June 2020**
**First metaverse active ETF**
NikkoAM Metaverse Theme Active ETF (3091 | 9091)

**21 Mar 2022**
**First EV active ETF**
Global X Electric Vehicle and Battery Active ETF (3139)

**23 Jun 2022**
**First blockchain active ETF**
Samsung Blockchain Technologies ETF (3171)

**26 Sep 2022**
**First ESG active ETF**
Harvest China Sustainable Lifestyle Tech Active ETF (3155)

**16 Dec 2022**
**First virtual asset ETF**
CSOP Bitcoin Futures ETF (3066)

16 Data as of December 2021. Source: SIFMA, Bloomberg, as cited in Fidelity Investments, "Why Bond Investors May Benefit from Actively Managed Mutual Funds and ETFs
17 Source: HKEX, average daily turnover of 10 active money market ETFs listed on the HKEX in 2023.
18 Source: J.P. Morgan Asset Management, "Thematic ETFs – the active advantage"

**Portfolio-shielding active ETFs**

The majority of active ETFs are transparent, meaning they disclose their complete portfolio holdings on a daily basis. However, there are also semi-transparent and non-transparent active ETFs that operate differently. These types of ETFs are not obligated to publicly reveal their entire portfolio composition on a daily basis.

| Transparent active ETFs | Semi-transparent and non-transparent active ETFs |
| --- | --- |
| Transparent active ETFs disclose their holdings daily. This transparency allows investors to monitor the fund's portfolio and make informed investment decisions. | These types of ETFs maintain some level of opacity regarding their holdings. This allows fund managers to protect their proprietary research and strategies. By disclosing holdings less frequently, these types of ETFs can potentially reduce market impact costs associated with large-scale trading. |

While semi-transparent ETFs do not disclose portfolio holdings daily, some of them are required to disclose a proxy portfolio on a daily basis. The proxy portfolio consists of specific securities that closely mirror the daily performance of the actual portfolio holdings. The disclosed portfolio characteristics may include the percentage overlap between the weight of proxy portfolio holdings and actual portfolio holdings, the daily tracking error between them, and more.[19] Such disclosures offer investors a glimpse into the fund's underlying portfolio.

Despite generating significant market attention upon their introduction in the US in 2020, semi-transparent ETFs still represent a small portion of the overall active ETF market. All active ETFs listed in Hong Kong are fully transparent.

## Active ETFs vs. passive ETFs vs. mutual funds[20]

| | Active ETFs | Active mutual funds | Passive ETFs |
| --- | --- | --- | --- |
| Seeks alpha | ✓ | ✓ | x |
| Tax-efficient structure | ✓ | x | ✓ |
| Intraday trading | ✓ | x | ✓ |
| Can be sold short | ✓ | x | ✓ |
| Relative cost (typical) | Moderate | Highest | Lowest |
| Minimum investment amounts | Lower | Higher | Lower |
| Charge sales loads | x | ✓ | x |

Note: The above table is a general overview of the investment strategies and should not be interpreted as representative of all products in each investment strategy.

19 Source: Charles Schwab Asset Management, "An introduction to active semi-transparent ETFs", 10 November 2022
20 With reference to the article "Active ETF vs Mutual Fund: Similarities and Differences" published on wealthtender.com

# Applications of active ETFs

From alpha generation to tax efficiency, tactical allocation and ESG investing, active ETFs provide a versatile platform for achieving investment goals.

### Alpha generation

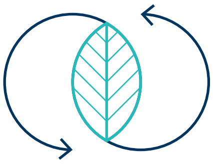
Active ETFs offer investors the potential to generate excess returns above a benchmark index. With their active approach, these ETFs enable the identification of mispriced securities, market inefficiencies, and emerging trends, thereby potentially leading to superior performance. By investing in active ETFs, investors can access the expertise of skilled portfolio managers, especially considering the ongoing trend of mutual fund to ETF conversion.

### Tactical allocation

Active ETFs can be an ideal vehicle for tactical allocation, which involves adjusting portfolio allocations in response to changing market conditions or macroeconomic events. For example, managers of active bond ETFs can employ sector and security selection to attain a desired duration and credit exposure over time. Investors can leverage these ETFs to effectively position themselves along the yield curve and fine-tune their sensitivity to credit spreads to adapt to changing market conditions.[21]

### Competitive total cost of ownership

The total cost of ownership (TCO) for ETFs includes trading costs (e.g. bid-ask spread and broker commissions) and holding costs (e.g. investor-level taxation and management fees). For trading costs, the Hong Kong SAR Government has waived stamp duty for all ETFs since February 2015. As for holding costs, for which taxation is a key component, a taxation report by HKEX found that Hong Kong-listed ETFs are among the most tax efficient ETFs in major markets when investing in Chinese equities.[22]



### ESG investing

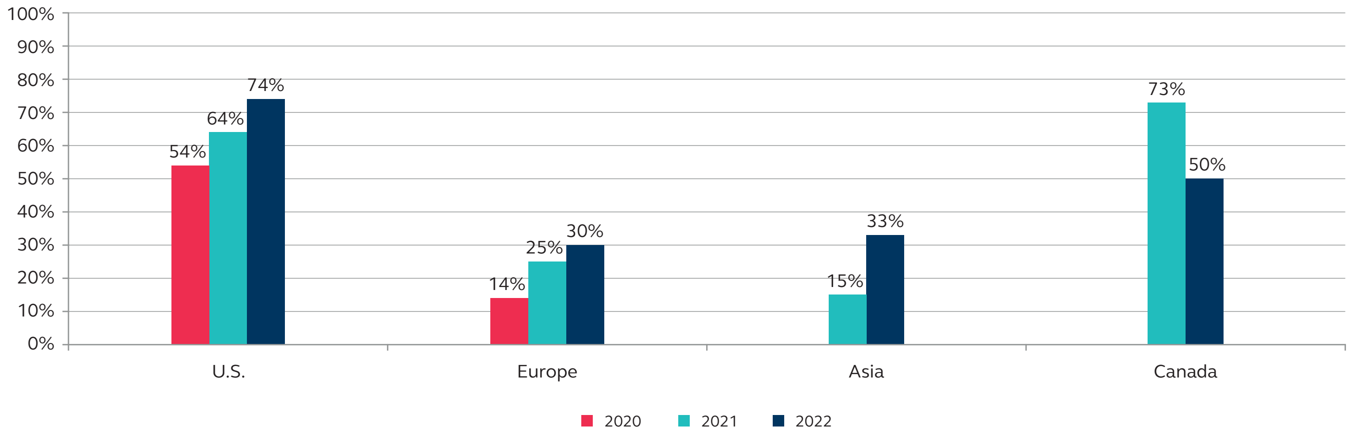
Active ETFs have become a favoured platform for integrating ESG factors into investment decisions, as a survey conducted by J.P. Morgan Asset Management showed that nearly a third of respondents use active strategies to meet their ESG goals, surpassing the 16% who reply on passive ETFs.[23] The active approach may allow for more effective corporate engagement between asset managers and investee companies, enabling them to work together to create value and mitigate ESG risks.

21 Source: J.P. Morgan Asset Management, “The use of active ETFs in ESG investing”
22 Source: HKEX, ‘ETF taxation report for investors (Hong Kong)’, August 2023
23 Source: J.P. Morgan Asset Management, “The use of active ETFs in ESG investing”

# Opportunities for issuers

The active ETF market is poised for significant growth as investor demand continues to surge, presenting a wealth of opportunities for ETF issuers to explore and expand into.

**Figure 10. Percentage of ETF issuers who expected significant demand for active ETFs over the next two to three years[24]**




Investors are increasingly seeking investment vehicles that offer the potential for alpha generation and active management. One of the significant opportunities in the active ETF market lies in product innovation. ETF issuers can explore less crowded product categories and asset classes to differentiate themselves and capture market share. By venturing into niche sectors, such as thematic investing, emerging markets, or alternative assets, issuers can attract investors seeking unique investment opportunities.

In addition, by listing active ETFs, fund managers can save on commissions that they would otherwise pay to external fund distributors. It enables direct distribution to investors, eliminating the need for intermediaries and allowing investors to access the fund's strategy without incurring additional fees from financial advisors.

24 Source: PWC, "ETFs 2027: a world of new possibilities"

# Product List

# Active ETFs

| Stock code | Currency | Product name |
|---|---|---|
| 3152 | HKD | Bosera HKD Money Market ETF |
| 3192 \| 83192 | HKD \| RMB | Bosera RMB Money Market ETF |
| 3196 \| 83196 \| 9196 | HKD \| RMB \| USD | Bosera USD Money Market ETF |
| 3161 \| 83161 | HKD \| RMB | ChinaAMC RMB Money Market ETF |
| 3071 | HKD | CICC HKD Money Market ETF |
| 3066 | HKD | CSOP Bitcoin Futures ETF |
| 3068 | HKD | CSOP Ether Futures ETF |
| 3053 \| 83053 | HKD \| RMB | CSOP Hong Kong Dollar Money Market ETF |
| 3122 \| 83122 | HKD \| RMB | CSOP RMB Money Market ETF |
| 3096 \| 9096 | HKD \| USD | CSOP US Dollar Money Market ETF |
| 3051 | HKD | Global X Asia Innovator Active ETF |
| 3058 | HKD | Global X China Innovator Active ETF |
| 3139 | HKD | Global X Electric Vehicle and Battery Active ETF |
| 3006 | HKD | Global X Metaverse Theme Active ETF |
| 3137 | HKD | Global X USD Money Market ETF |
| 3155 | HKD | Harvest China Sustainable Lifestyle Tech Active ETF |
| 3011 \| 9011 | HKD \| USD | ICBC CICC USD Money Market ETF |
| 3091 \| 9091 | HKD \| USD | NikkoAM Metaverse Theme Active ETF |
| 3112 | HKD | Pando Blockchain ETF |
| 3056 | HKD | Pando Innovation ETF |
| 3172 | HKD | Samsung Asia Pacific ex NZ Metaverse Theme ETF |
| 3135 | HKD | Samsung Bitcoin Futures Active ETF |
| 3171 | HKD | Samsung Blockchain Technologies ETF |

For the full list of Hong Kong-listed ETFs, visit

# FAQs

# Trade Asia. In Asia.

**What are the benefits of trading Hong Kong-listed ETFs?**

There are a number of advantages to trading ETFs listed in Hong Kong, including the opportunity to diversify portfolios with exposure to a range of geographies and asset classes, including but not limited to, commodities, fixed income, sector-based, thematic (e.g. ESG, technology and digital asset) and smart beta funds.

In addition, Hong Kong-listed ETFs trade in the Asian time zone, enabling investors to trade Asian underlying within a much narrower band of premiums and discounts compared to US-listed ETFs. This means that they do not deviate from their fair values as much, making them an ideal choice for trading in the secondary market.

Further, investors opting for a Hong Kong-listed ETF benefit from the city's simple and low tax regime, where the tax rate on ETFs is up to 30% lower than that of their US-listed counterparts.

# The cost advantage

**How has Hong Kong's ETF market been affected by the government's decision to reduce stamp duty on stock transactions from 0.13% to 0.1%?**

The stamp duty for trading ETFs in the secondary market in Hong Kong has been waived since 2015, which is still effective after reduction in stamp duty on stock transactions. In other words, when trading Hong Kong-listed ETFs in the secondary market, investors do not incur stamp duty.

Additionally, in the primary market, since August 2020, ETF market makers have been enjoying zero stamp duty on stock transactions when they create and redeem ETF units in Hong Kong, resulting in lower creation and redemption costs for market makers.

As a whole, all stamp duty waivers reduce transaction costs for trading ETFs.

# Inclusion of ETFs in Stock Connect

**What does the inclusion of ETFs in Stock Connect mean for HKEX?**

The inclusion of ETFs in Stock Connect is the latest milestone in HKEX's landmark mutual market access programme with Mainland exchanges. It broadens the Connect product ecosystem and opens up opportunities for investors. In addition, it helps support Mainland Chinese investors' diversification to offshore assets and strengthens our position as the global base for China-bound investments.

The expansion of Stock Connect to include ETFs also provides issuers with an additional channel to access Mainland Chinese investors, thus encouraging more active ETF issuance and trading in Hong Kong. This, in turn, will further expand HKEX's ETF product diversity and enhance liquidity.

**What are the benefits of the inclusion for Hong Kong and international investors?**

Investors are now able to access new pools of established liquidity across the border, and capture new investment opportunities that are uniquely available in the Mainland China market.

## Why were ETFs included in 2022?

The inclusion of ETFs in Stock Connect followed a strong year for ETFs in Hong Kong and:

- Growing investor demand for A-share products;
- Increasing diversification needs among Mainland Chinese investors;
- Continuing RMB internationalisation; and
- Increasing use of ETFs as an investment tool by investors

We expect these factors to drive wider adoption of China-focused ETFs and broaden the investor base.

# Contact us

For more information please visit www.hkex.com.hk/etf or contact ETFs@hkex.com.hk

Hong Kong Exchanges
and Clearing Limited

8/F, Two Exchange Square,
8 Connaught Place,
Central, Hong Kong

**hkexgroup.com** | **hkex.com.hk**

info@hkex.com.hk
**T** +852 2522 1122
**F** +852 2295 3106