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Active ETFs
The next step in Asia's ETF innovation

The exchange-traded fund (ETF) space has long been dominated by passively managed funds, but active ETFs are gaining popularity among investors and issuers. Although active ETFs are not yet a mainstream investment instrument, their growing investor interest is already prompting regulatory changes in Asia. Hong Kong Exchanges and Clearing (HKEX) explores more

Active ETFs on the rise

Active exchange-traded funds (ETFs) are gaining momentum. According to independent research firm ETFGI, ETFs account for around $5 trillion in assets globally, out of which a record $109.4 billion was invested in actively managed ETFs as of the end of November 2018, with 773 actively managed ETFs listings from 127 providers in 20 exchanges around the world.[1]

Investors are increasingly looking to active ETFs as a way to combine the higher returns potential of active investing with the convenience of ETFs. Although the aggregate size of active ETFs is still small relative to their passively managed counterparts, growth is rapid with record inflows of $24.92 billion in 2017 and $35.1 billion in 2018. The active ETF market could grow to $217 billion by 2020, accounting firm EY predicts, especially as the advent of new technologies such as artificial intelligence are gradually transforming the way active ETFs grow and manage assets.

Going active in Asia

Asia has been playing a key role in the growth of active ETFs, according to EY. This trend is set to persist as regulators in Asia introduce more accommodative policies towards active ETFs. For example, in Hong Kong, on 2 January 2019 the stock exchange began accepting applications for the listing of active ETFs. This represents a welcome development for Hong Kong investors, as 30% of them would like to have active ETFs options in their local market, according to a 2018 survey by Brown Brothers Harriman.[2]

"Asset managers around the world are looking for ways to tap China's potential; I believe more ETF issuers will draw on active ETFs as a preferred channel to enter China," says Deborah Fuhr, managing partner and founder of ETFGI. "Being able to launch products domiciled in Hong Kong, with the idea that they can expand their footprints in China's market, is a compelling proposition for many large asset managers."

An efficient wrapper for active strategies

In terms of asset class, bond funds account for the largest share (70%) of all actively managed ETF assets, and the proportion is set to increase further with $24.4 billion of capital flowing into active bond ETFs in 2018, up from $16 billion the year before. The increasing popularity is mainly attributable to their easy-to-trade feature, which enables investors to gain tactical fixed income exposures at a lower cost than traditional mutual funds. The flexibility to adjust duration and credit risks also bodes well for the growth of active bond ETFs in a rising rate environment.

Deborah Fuhr, ETFGI

Environmental, social and governance (ESG) investing is another area seeing increasing adoption of the ETF wrapper. An executive for an actively managed ESG ETF explains: "By adopting an active approach to ESG investing, the ETF manager can proactively engage the senior management of companies about their ESG policies and advocate for ESG improvements, which is a flexibility that passive funds lack." This is of particular importance to investors in the Greater China area, where 58% of respondents consider ESG factors "very important" to their investment decisions, according to the Brown Brothers Harriman survey.

Opportunities for asset managers

Active ETFs are not only a boon to investors, but they also create new distribution channels for asset managers to grow assets. Currently, Asia's fund distribution model requires asset managers to partner with intermediaries, such as banks and independent financial advisers, to distribute mutual funds to individual investors. With ETFs, asset managers are able to gather assets through stock exchanges, thus opening up their active solutions to a broader investor base, including individual investors with limited initial capital.

Higher pricing certainty also makes ETFs a preferred choice. The net asset values of mutual funds are calculated daily after the market closes, which means mutual funds can only be traded once a day. ETFs, however, are priced in real time and can be traded any time during trading hours, which makes them an agile tool for asset allocation. Fuhr adds: "Active mutual funds are a popular product among Asian investors, so it will be encouraging to see more active strategies being offered in the convenient, lower-cost ETF wrapper in the region."

[1] *D Fuhr, Nasdaq,* Assets invested in actively managed ETFs/ETPs globally reach high of $109 billion by Nov. '18, *December 2018, https://bit.ly/2RtHiQb*

[2] *Brown Brothers Harriman,* Ready to grow: ETF opportunities in Greater China, *https://bit.ly/2RYozkM*