

The overemphasis on the Total Expense Ratio (TER) is a common pitfall in ETF selection. In fact, TER is only one component of the Total Cost of Ownership (TCO) – the true cost of ETF investing. This leaflet will look into the components of TCO and reveal how much ETF investors can save by trading Asia, in Asia.

WHAT IS THE TOTAL COST OF OWNERSHIP (TCO)?

The true cost of ETF investing can be broken down into both trading and holdings costs:

TOTAL COST OF OWNERSHIP (TCO) =	
TRADING COSTS	HOLDING COSTS
<ul style="list-style-type: none"> ✓ Bid/ask spread ✓ Broker commissions 	<ul style="list-style-type: none"> ✓ Tracking difference <ul style="list-style-type: none"> • Total expense ratio • Securities lending revenue • Investment taxation • Transaction costs • Other factors ✓ Fund and investor level taxation <ul style="list-style-type: none"> • Dividend and interest withholding tax (WHT). See further details below

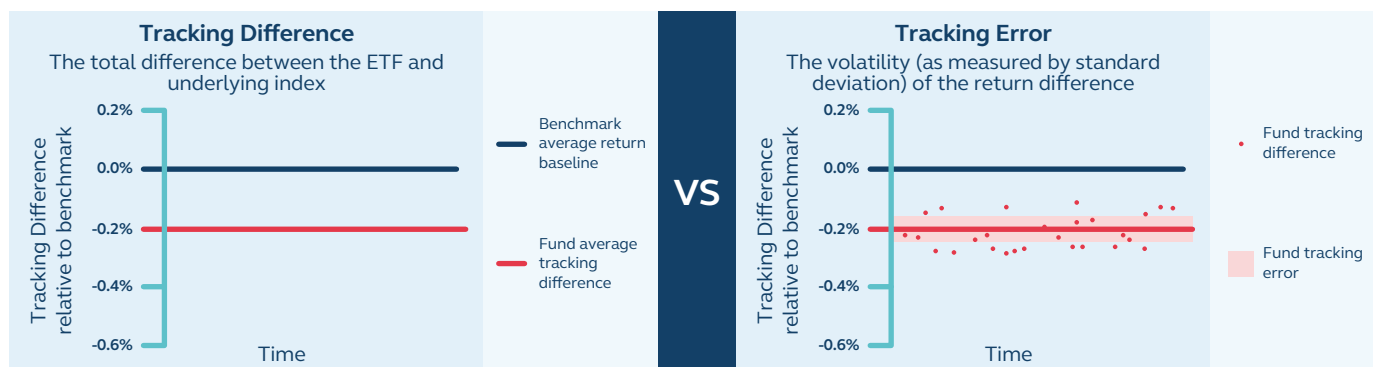
TAX SAVED IS ALPHA CREATED

ETF investors spend considerable time optimising their investment strategies, but few are aware that tax reduction can be a way to maximise return. Learn more about this significant yet overlooked source of alpha:

THREE TIER TAXATION	LOCATION MATTERS
<p>Investment Level</p> <p>Taxes incurred to an ETF for its underlying investments, including stamp duty and withholding tax (WHT) on interest, dividends received or capital gains incurred</p>	<p>Tax costs vary widely depending on domicile of the investor, domicile and type of ETF, and the jurisdiction of the underlying portfolio investments. With its tax treaty network and domestic tax rules, Hong Kong offers benefits for investors seeking to gain exposure to Asian markets.</p> <p>Source: EY report</p>
<p>Fund Level</p> <p>WHT on dividends, interests and other distributions paid by the ETF. Access to reduced or nil WHT dependent on domicile of the fund</p>	
<p>Investor Level</p> <p>Taxes on an individual investor’s income, capital gains, estate tax etc. dependent on the investor’s profile</p>	
<p>Example: By investing in China equities through a Hong Kong ETF, Japan investors would receive 62% after tax return for dividend versus 56% using a US ETF.</p>	

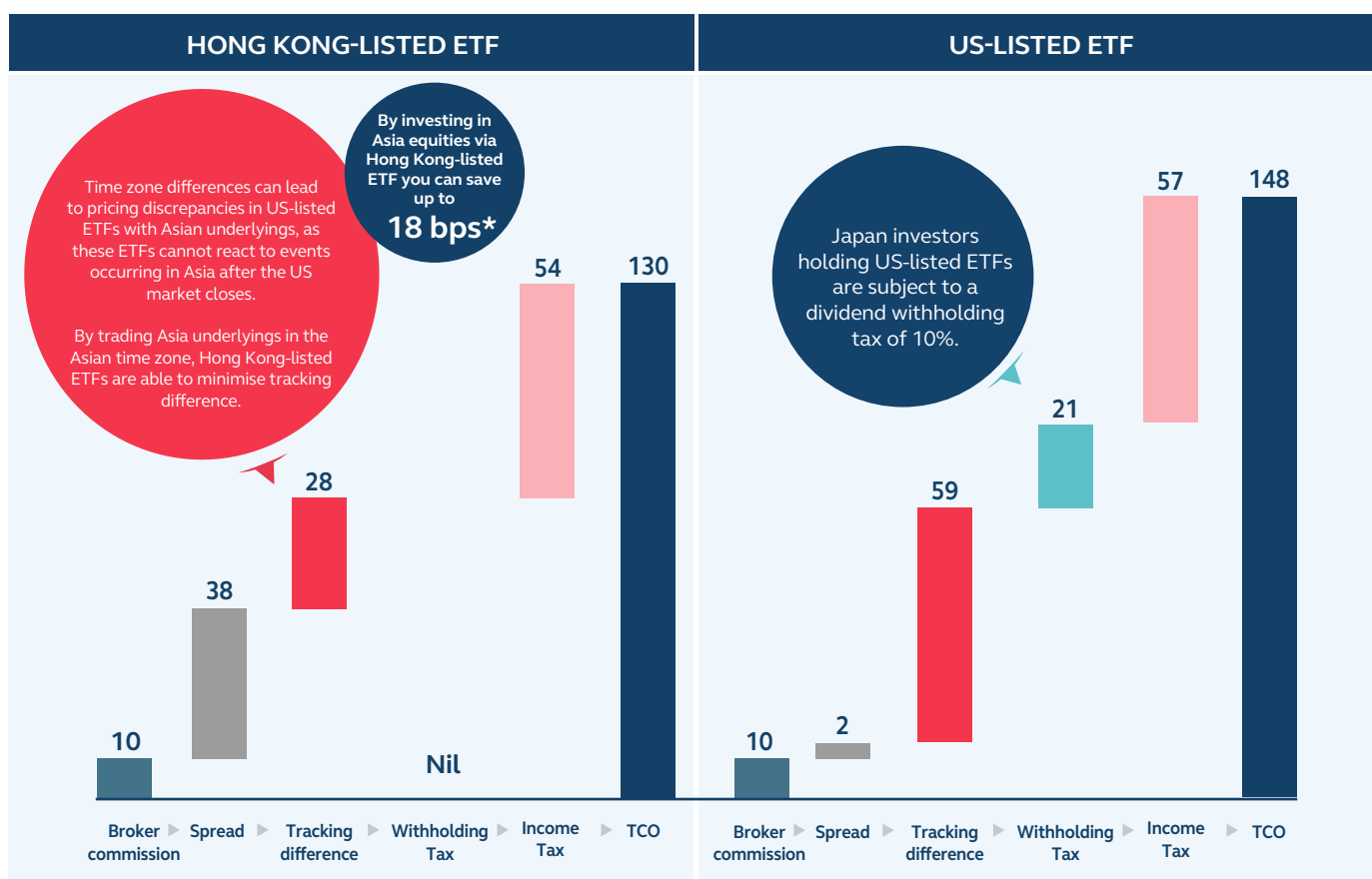
TRACKING DIFFERENCE VS. TRACKING ERROR

Tracking difference, an important component of TCO, is often confused with tracking error. In fact, tracking error is the standard deviation of tracking differences. In other words, it measures the volatility of tracking differences.



TCO CASE STUDY: HONG KONG ETF VS. US ETF

The following case study compares the Total Cost of Ownership (TCO) incurred by gaining exposure to Asia equities through ETFs listed in Hong Kong and the US. All figures are expressed in basis points.



*The case study and all figures are provided for demonstrating the calculation of TCO and are for reference only. They do not constitute investment advice.

Assumptions:

- Hong Kong ETF: iShares Core MSCI AC Asia ex Japan Index ETF (3010 HK); US ETF: iShares MSCI All Country Asia ex Japan ETF (AAXJ US)
- Tracking difference is measured over a period of 12 months as of 30 June 2019. Data sourced from Blackrock.
- Spread represents a 30-day average as of 30 June 2019. Data sourced from Bloomberg.
- Dividend yield based on dividend payments in the 12 months up to 30 June 2019. Data sourced from Bloomberg.

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