INVESTSMART

Australian Exchange Traded Fund Report

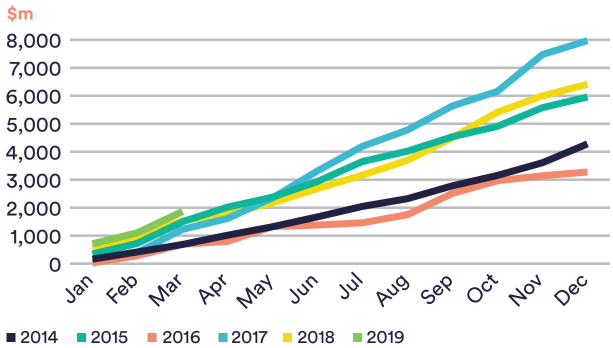
March Quarter 2019

ETFs: Smashing Records

The Australian Exchange Traded Funds (ETFs) market's unprecedented growth has broken another record. The first quarter of 2019 is officially the best start to a calendar year on record. In Q1 2019, we saw over A$1.86 billion in cumulative inflows into Exchange Traded Products (ETPs), beating the previous best start to a year, 2018, by A$300 million.

Flows are clearly chasing the current global 'melt-up' in equity markets. The Q1 data illustrated that over 37% of all flows entering the Australian ETF market were into global shares ETFs (Source: Vanguard Australia 2019). The ease of use and cost-effective nature of ETFs provide a perfect vehicle for both retail and institutional clients to enter into international investments.

Cumulative Flows – Market

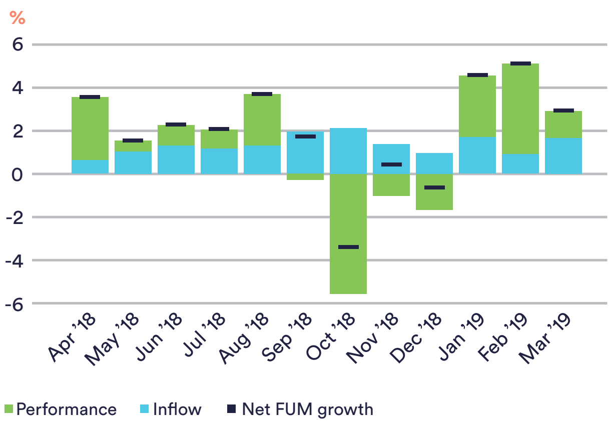


Source: ASX, InvestSMART

However, as we saw in 2018, which was the most volatile year of the past six and among the worst returning years of the past seven, cumulative flows continued to surge independently of these market issues. If markets continue their current trajectory through 2019, this will not only beat last year, but also overtake 2017 as the best cumulative year on record.

The impact on Funds Under Management (FUM) growth was plain to see. February's performance was the best month in the past year, and January the third best. Inflows across the first three months were steady, increasing by approximately 6%, which is above the monthly average to see a new record FUM for the Australian ETF market at A$45.61 billion.

% of FUM growth: Inflow vs Performance

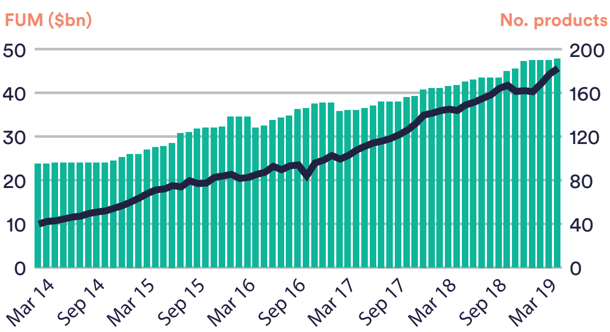


Source: ASX, InvestSMART

What is also noteworthy, although there was a new record reached in Q1 of 2019 in both FUM and products on offer (ETPs in Australia now stands at 191), the growth of products is beginning to flatline.

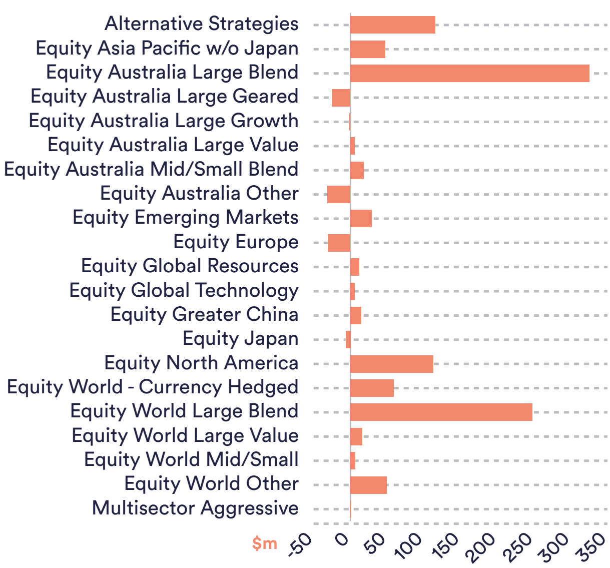
Only one additional product was added in the quarter. Compare this to the average quarterly growth over the past 5 years of 4 new ETPs. Have we reached product saturation? If markets do ease over the coming months, one would expect those products with low FUM or cost issues as likely to close.

Market Growth



Looking to product specifics, the biggest product flows continue toward large cap blended funds. Australian large caps again topped the list with over A$325 million of flows closely followed by world large blended products with A$247.8 million. This trend was developing in the final quarter of 2018 as these large passive investments allow the investor an ability ride out volatility and achieve investment 'scale' with small(er) capital.

Flows – Equities ($m)



Source: ASX, Morningstar, InvestSMART

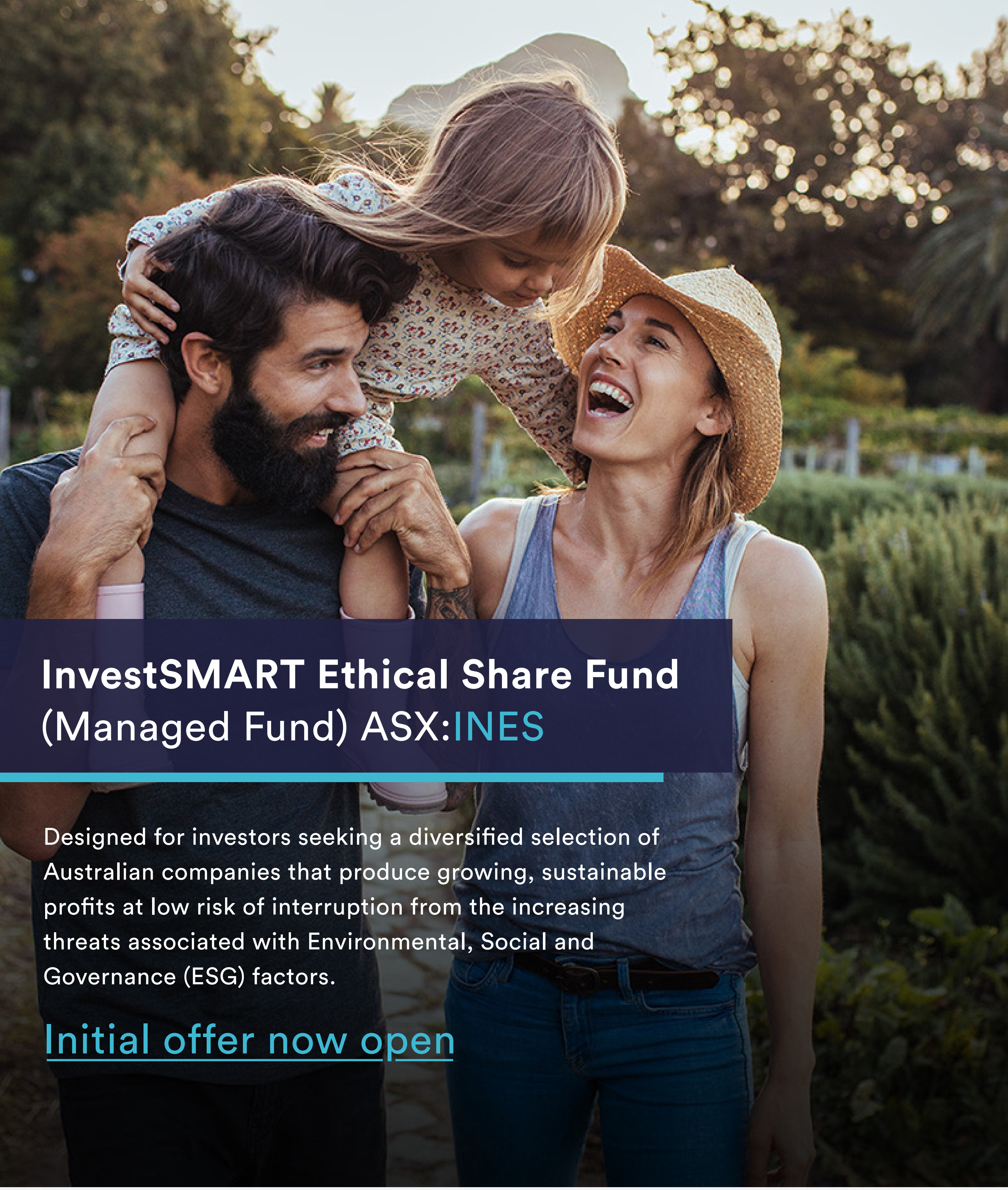
However, our data also highlights ETF operational risks. Although both net inflows and market performance read positively, there were several classes (sector-focused etc.) and design-based (market directional, geared etc.) ETFs that experienced net outflows.

Interestingly, one of the types that suffered were 'geared' ETFs. In upward trending markets, geared products traditionally see high levels of investment as investors look to take full toll of the upswing while leveraging further to the upside.

> **"WITH 2019 STARTING IN SUCH A POSITIVE MANNER, FUM AND CUMULATIVE FLOWS ARE LIKELY TO REMAIN HIGH. WHAT'S MORE, IF PERFORMANCE FALTERS IN THE BACK HALF OF THE YEAR, ETFS ARE STILL LIKELY TO SEE INFLOWS.**

However, Q1 shows this wasn't the case. The most likely conclusion as to why this is occurring is that over the past five years there has been a large increase in 'short' geared ETFs (a product that offers you the ability to invest in a falling market). With the S&P up over 17% year-to-date, and the ASX up over 13% over the same period, these short ETF products will be heavily in the red and investors are likely to have dumped out.

With 2019 starting in such a positive manner, FUM and cumulative flows are likely to remain high. What's more, if performance falters in the back half of the year, ETFs are still likely to see inflows. As we saw in 2018, investor make the most of their diversification and low cost as a way to ride out downturns.



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