Softer tone ahead of Budget 2018 – 48

Spurring ETFs' trading growth

- **Overcoming** lack of appeal which stunted growth
- **A task** force has been set up to boost competitiveness of ETF market

by **Cheah Chor Sooi**

THE true potential of exchange-traded funds (ETFs) can probably be best "unearthed" with the participation of big-time institutional investors.

Currently, the level of understanding regarding ETFs among retail investors remains low while at the institutional level, most assets managers do not include ETFs in their portfolios.

An ETF is essentially an open-ended fund – much like a unit trust – but is listed on the stock exchange. However, it does not impose sales charge and has lower management fees (less than 1% compared to managed funds).

Moreover, fund managers – unlike those in more developed markets – generally prefer an active stock-picking approach rather than utilising a core or satellite strategy using ETFs, according to i-VCAP Management Sdn Bhd acting CEO Zulkifli Ishak.

In developed ETF markets, institutional fund managers create a sizeable core portfolio using ETFs as a base while seeking alpha from the balance of the portfolio by actively selecting individual stocks.

"There is also a missing link for product wrappers from the asset management and insurance/takaful [Islamic insurance] industries in terms of utilising ETFs as a tool to access foreign markets," he tells *FocusM*.

Malaysian fund managers generally prefer an active stock-picking approach rather than utilising a core strategy using ETFs, says Zulkifli

Lack of appeal to investors has persistently stunted the growth of ETFs in Malaysia, says Goh

Malaysia currently has only three ETF issuers managing eight funds (a stark contrast from 637 unit trust funds as of end-June), namely AmFunds Management Bhd, i-VCAP Management Sdn Bhd and CIMB-Principal Asset Management Bhd. As of end-December, trading value stood at RM1.51 bil while trading volume amounted to 1.38 billion units.

Total returns from ETFs between June 1, 2016 and July 31 range from 4.06% to 39%.

In Japan, ETF trading volume grew rapidly when the Bank of Japan (BoJ) started buying into ETFs as part of its monetary easing measures. As of end-2015, BoJ had about ¥7 tril (RM263 bil) out of ¥16 tril of total ETF assets under management (AUM) in Japan.

In the case of Taiwan, the Financial Supervisory Commission, the country's top financial regulator, has eased rules governing risk-based capital ratios to allow local insurance companies to have more disposable funds to invest in stocks as well as ETFs.

"We certainly have much room to grow, as AUM in the ETF market was less than RM2 bil as of end-June compared to RM409 bil for Malaysia's unit trust industry," suggests Zulkifli who is also i-VCAP Management's head of business development. "The initiative from the Employees Provident Fund (EPF) to allow investment from its savings has actually helped to enhance the unit trust AUM in a significant way."

Poor retail investor appeal

AmInvest acting CEO Goh Wee Peng says that the lack of awareness and low product comprehension factors partially contribute to the low rate of participation in Malaysian ETFs.

"However, it is the ETFs' lack of appeal to investors that has persistently stunted the growth of ETFs in Malaysia," she says. "ETFs should be used by investors to build a diversified portfolio for the long term."

Unfortunately, many local investors tend to be short-term trading oriented with preference on stock specific ideas. Hence, there appears to be a basic mismatch between what retail investors expect and what ETFs are able to offer.

"One way of addressing this matter would be to develop short or leverage ETFs/vehicles to encourage shorter/intraday trading," Goh points out. "Another proposition would be to make ETFs easily available and eligible under retirement savings schemes and pension plans for longer term investments."

Moreover, the existing ETFs do not appeal to local retail investors given they are spoilt for choice if compared to actively managed unit trusts which are generally still able to deliver the alpha or excess returns compared to the market.

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List of exchange-traded funds (as of end-August)

FUNDS UNDER MANAGEMENT	DATE OF INCEPTION	FUND MANAGER	FUND MANAGER
ABF Malaysia Bond Index Fund	July 13, 2005	HSBC (Malaysia) Trustee Bhd	AmFunds Management Bhd
FTSE Bursa Malaysia KLCI etf	July 19, 2007	HSBC (Malaysia) Trustee Bhd	AmFunds Management Bhd
MyETF Dow Jones Islamic Market Malaysia Titans 25*	July 31, 2008	Deutsche Trustees Malaysia Bhd	i-VCAP Management Sdn Bhd
CIMB FTSE China 50	July 9, 2010	Deutsche Trustees Malaysia Bhd	CIMB-Principal Asset Management Bhd
CIMB FTSE ASEAN 40 Malaysia	July 9, 2010	Deutsche Trustees Malaysia Bhd	CIMB-Principal Asset Management Bhd
MyETF MSCI Malaysia Islamic Dividend*	March 21, 2014	Deutsche Trustees Malaysia Bhd	i-VCAP Management Sdn Bhd
MyETF MSCI SEA Islamic Dividend*	May 7, 2015	Deutsche Trustees Malaysia Bhd	i-VCAP Management Sdn Bhd
MyETF Thomson Reuters Asia Pacific exJapan Islamic Agribusiness*	Nov 12, 2015	Deutsche Trustees Malaysia Bhd	i-VCAP Management Sdn Bhd

*Syariah funds | Source: Securities Commission

Pushing ETFs to greater heights

REGARDLESS of its slow growth rate, market regulators Bursa Malaysia and the Securities Commission (SC) have been supportive to grow the fund size, depth and breadth of exchange-traded funds (ETFs) listed.

In May, an ETF task force chaired by the SC and comprising Bursa Malaysia, fund managers, market makers and institutional investors was set up to attract greater investor participation and incentivising issuances by ETF managers in the market.

Some of the key recommendations are:

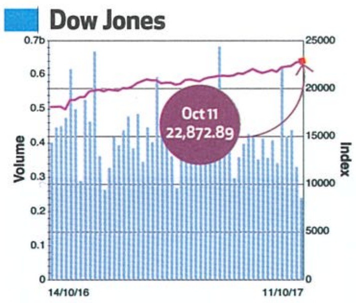
- Reducing the minimum capital requirement for ETF issuers from RM10 mil to RM2 mil to encourage the issuance of more new ETFs.
- Broadening of the ETF distribution channels by permitting financial institutions, online platforms and financial planners to offer ETFs to clients via stockbroking companies. The use of such alternative distribution channels will provide investors greater access to a more diverse range of products at a lower entry cost.
- Facilitating the introduction of new types of ETFs, including those which are futures-based and conventional commodity-based. This will provide affordable entry points to retailers in traditionally difficult-to-access investments such as physical gold and foreign futures market.

Adding further impetus to the task force's recommendations, Bursa Malaysia is providing a 100% clearing fee rebate, as well as a full waiver of transfer and securities, borrowing and lending fees to ETF market makers to provide trading liquidity to ETFs.

Elsewhere, the local bourse has also increased the number of investor education programmes to raise investors' awareness and understanding of ETFs. As of end-August, the exchange has organised 64 investor education activities nationwide on the benefits of investing in ETFs.

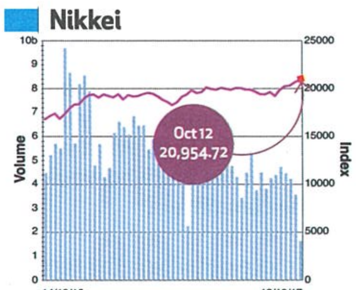
Another 38 are expected to be conducted by the end of this year, a 67% increase of ETF-specific education and marketing initiatives planned for this year compared to only 61 such initiatives last year.

Dow Jones

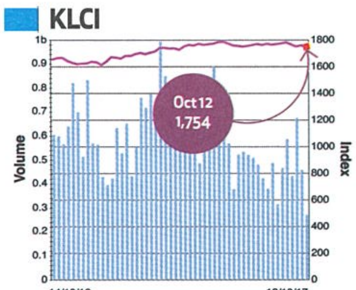


Hang Seng

Nikkei



KLCI



Asian markets close higher

MOST major Asian markets ended higher on Oct 12 with Japan's Nikkei 225 continuing its fine run after closing at a 21-year high the previous day. The benchmark Japanese index firmed a further 73.45 points to 20,954.72.

US stock benchmarks also closed at records during the Oct 11 overnight trading with the Dow Jones Industrial Average gaining 0.18% or 42.21 points to 22,872.89 while the S&P 500 rose 0.18% or 4.6 points to 2,555.24.

Elsewhere, Hong Kong's Hang Seng index inched up 0.24% or 69.46 points to 28,459.03 while China's Shanghai Composite Index ended flattish at 3,386.1 (down 2.18 points). South Korea's Kospi index advanced 16.6 points to 2,474.76 while Australia's S&P/ASX 200 added 22.32 points to 5,794.47.

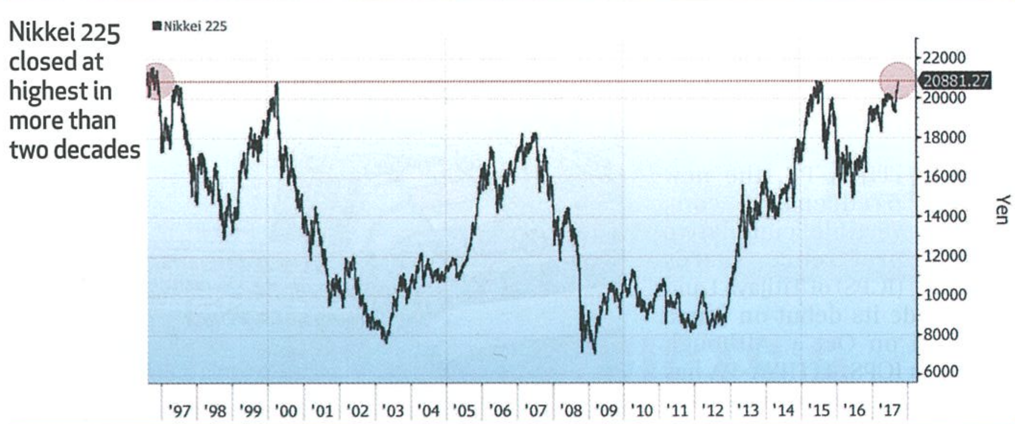
Brent crude was hovering around the US$56.70 (RM239.84) per barrel level during Asian trading hours – down about 0.4% – following a report showing an increase in US crude stockpiles the week before.

At Bursa Malaysia, selling interest in heavyweights prompted the FBM KLCI to retreat 0.18% or 3.21 points to 1,754. FocusM

Japan stocks hitting new highs

- **Nikkei** 225 Stock Average rose to highest since 1996
- **Earnings** forecast boosts and elections keeping market buoyant

Back to 1996



Source: Naikei, TSE I Bloomberg

CORPORATE scandals may be tainting Japan's once-revered business reputation but at least one market isn't perturbed: equities.

The Nikkei 225 Stock Average shot to a level unseen since December 1996 on Oct 11 even as investors licked wounds after Kobe Steel Ltd lost 36% over a record two-day slide on its false product data debacle.

A day earlier, the nation's benchmark Topix index climbed to a 10-year high.

The buoyant market is reflecting investors' expectation that Japan Inc will boost annual profit targets during the upcoming earnings season as well as an anticipated victory for the (Japanese prime minister Shinzo) Abe administration in the upcoming election.

A global rally that has added more than US$20 tril (RM84.6 tril) to worldwide share values hasn't hurt.

"For the Nikkei 225 to head for levels like 21,000 and 22,000, Abe will have to win big, without which foreign investors won't be convinced," says Yoshihiro Ito, chief strategist at Okasan Online Securities Co in Tokyo. "Of course, one thing that has to back all this up is the economy, and whether corporate earnings will show bigger growth."

Even as the Nikkei 225 marked a milestone, the scandal engulfing Kobe Steel deepened as the company said it falsified data on several products, wiping out US$1.6 bil of its market value. Leading customers from Shinsho Corp to Mitsubishi Corp have been sucked into Kobe's false product data debacle, triggering outsized moves in debt, credit and equity securities associated with Japan's third-largest steelmaker by output and sales.

Foreign investors poured ¥201.8 bil (RM7.58 bil) into Japanese stocks during the last week of last month and became net buyers for the first time since July amid expectations for robust earnings growth as the reporting season kicks off in late this month.

"We have a pretty positive Japanese equity story, we actually have an overweight in Japanese equities," says Ben Luk, global macro strategist with State Street Global Markets, at a press event in Hong Kong.

"Japan has the highest earnings growth potential because earnings momentum is also highest right now. Earnings are there, valuation is a great support and now you're seeing a political backdrop which is still supportive of growth."

The Nikkei 225 has surpassed a key 38.2% Fibonacci-retracement level. The next common retracement of 50% stood at 22,981.49 as of Oct 11 as the gauge closed up 0.3% to 20,881.27.

Investors may still be cautious going forward. In the same time it took the Nikkei 225 to just get back to its late 1996 levels, the S&P 500 Index has soared 243%. Among major markets, only Italian stocks have done worse than those in Tokyo.

Further weakness in the yen will be crucial for a sustained rally in Japanese stocks, says Okasan's Ito.

"We're now in the 'high's zone,'" he says. "We've seen these highs in 1996 and in 2000 and so forth, but stocks have always pulled back from these levels without being able to stage a breakthrough." **– Bloomberg**

ETFs' management fee slightly higher

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"In comparison, our present ETFs are index-tracking, hence their returns would generally be giving the market or index returns," she observes. "This is a phenomenon that occurs in emerging and still-developing markets."

ETFs' assets under management in the US passed the US$3 tril (RM12.69 tril) mark this year, having grown by 20% between 2015 and last year. This was sparked by the availability of registered investment advisers who are incentivised to introduce low-cost products to their clients.

In the UK, the spur of ETF growth came from the fact that financial advisers can no longer take remuneration as a percentage. They have to get used to fee-based services rather than trailer commission.

For much of Asia – Malaysia included – the mutual fund industry pays commission to intermediaries such as banks, brokerages or financial advisers that might recommend them.

Unfortunately, ETFs are disadvantaged because they are traded openly at stock exchanges and not structured to pay commission. In a way, a vibrant ETF market does hinge on the evolution of fee-based advisory model and networks.

In Japan, the regulators are encouraging fee-based sales with a new fiduciary code for this objective. Drawing lessons from the Japanese experience, Australia has introduced reforms to increase the transparency around fund pricing, thus encouraging the growth in ETFs.

According to i-VCAP's Zulkifli, the Malaysian ETF market is experiencing low trading volume and wide bid-offer spreads which leads to less competitive pricing. Feedback from market makers indicate that the opportunity cost for them to hold ETFs for the purpose of market-making is high.

"Investors tend to shy away when faced with the wide spread which compounds the low trading volume issue further," he reckons. "Ideally, market makers are supposed to provide liquidity for retail investors on the exchange."

On the other hand, institutional clients and high net-worth individuals can always bypass the secondary market and focus solely on the primary market by leveraging a principal dealer or opt for in-kind or cash creation and redemption.

Moreover, the management fee of ETFs are slightly higher compared to regional ETFs. Currently, ETFs with equities as their underlying assets – plain vanilla ETFs – charge between 0.4% and 0.75% while regional ETFs charge more competitive fees, eg between 0.18% and 0.35% in Hong Kong.

"Fees are even cheaper when you look at the US where they are less than 0.1%," asserts Zulkifli. "If we can bring the cost of buying into ETFs down, we may be able to attract more institutional investors who have previously only been looking at regional ETFs."

AmInvest's Goh views that challenges relating to costs, regulations and the resulting lack of trading activity still persists although the ETF market in Asia has generally indicated growth (ie in Taiwan, South Korea and Japan).

"ETFs are liquid as long as the market makers are there quoting bid and offer prices at the exchange," she rationalises. "When the market could see that money could be made as a market maker, there will be more players in the market. It boils down to demand for ETFs." FocusM