

# WIDENING THE SCOPE OF ETFS IN MALAYSIA

i-Vcap Management Sdn. Bhd. Continues To Take Concerted Steps To Encourage More Investor Participation In ETFS

in December 2008. In the US, ETFs are a popular investment and trading tool for both investors and fund managers to participate in the equity market. The SPDR S&P 500 ETF, which tracks the S&P500 Index, is one of the most actively traded securities on the New York Stock Exchange Arca.

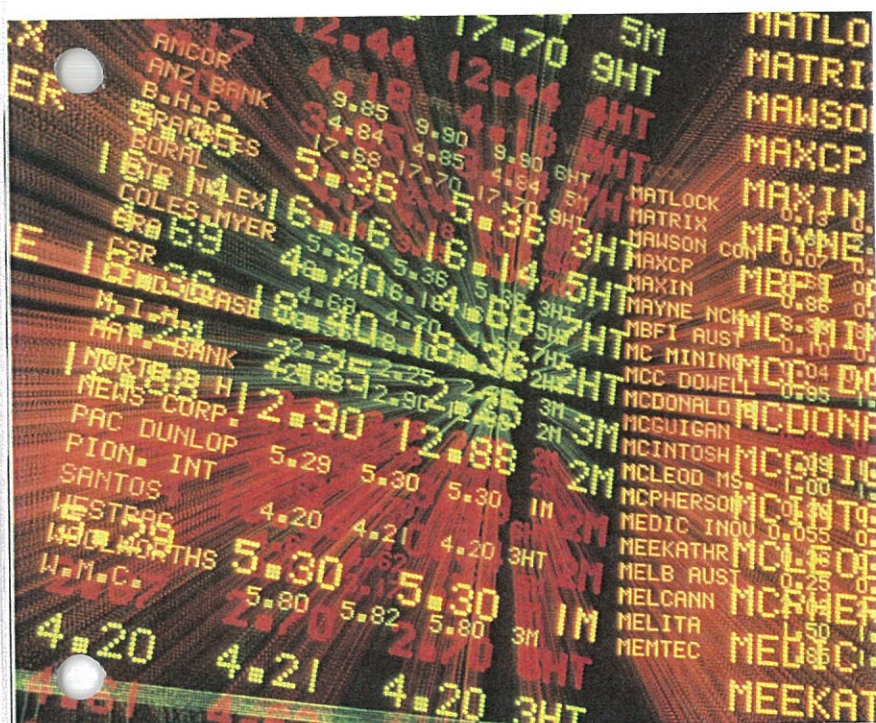
In Malaysia, there are three ETFs listed on Bursa Securities with combined NAV of RM1.18bn or US\$0.34bn as at the end of December 2009. "However, the volume of ETF trading has not been high as some investors may be less familiar with ETFs while some others prefer to invest directly in stocks", says Zainal Izlan Zainal Abidin, CEO of i-VCAP Management Sdn. Bhd., the manager of MyETF Dow Jones Islamic Market Malaysia Titans 25, one of the three Bursa-listed ETFs.

What is an ETF? An ETF is a unit trust fund that is listed and traded on a stock exchange. The fund invests in underlying securities of a benchmark index with the objective of tracking the performance of that index. On Bursa Securities, investors transact in units of an ETF in board lot of 100 units via any of the stock broking companies.

"Investors who buy into an ETF effectively gain exposure to a diversified portfolio of securities via a single transaction", explains Zainal Izlan. Investors also enjoy transparency as an ETF's underlying securities are usually known to the investors before they invest in the fund, given that ETF is an index-tracker. In addition, the ETF units are readily tradable during exchange trading hours with low transaction costs similar to trading of stocks i.e., brokerage commission, stamp duty and clearing fee. Furthermore, there are no sales charges or exit fees when trading ETF units and, being a passively-managed fund, the annual management fees charged to an ETF are generally lower than those for actively managed unit trust funds.

At the same time, investing in an ETF entails similar risks as investing in the ETF's underlying securities. For instance, an equity-based ETF carries stock market volatility and liquidity risks. In addition, a risk specific to an ETF is that of Tracking Error, which represents how closely the ETF tracks the benchmark index by measuring the correlation between the change in the ETF's NAV and the change in the performance of its benchmark index.

A Shariah ETF has similar features to a conventional ETF. "The main difference is that a Shariah ETF tracks a benchmark index comprised wholly of component securities which



**T**he global Exchange Traded Fund ("ETF") industry's net asset value ("NAV") as at end of December 2009 stood at US\$1,035.7billion, an increase of 45.7% from US\$711billion in December 2008, according to Blackrock's "ETF Landscape: Industry Review - Year End 2009" report. The report also indicated that the average daily trading volume (in US dollars) in 2009 decreased by 37.6% to US\$50.3billion, which nevertheless remained sizeable.

The NAV of the largest ETF market - the US - stood at US\$706billion as at the end of December 2009, an increase of 41.9% from US\$497billion



are Shariah-compliant whereas a conventional ETF may track any benchmark index regardless of the Shariah status of its component securities", adds Zainal Izlan.

MyETF Dow Jones Islamic Market Malaysia Titans 25 ("MyETF-DJIM25") is Malaysia's first and currently the only Shariah ETF listed on Bursa Securities. MyETF-DJIM25, launched in January 2008, is also the first Shariah ETF listed in Asia and the largest Shariah ETF in the world to-date (NAV: RM657million / US\$192million as at 31 December 2009).

MyETF-DJIM25 tracks the Dow Jones Islamic Market Malaysia Titans 25 ("DJIM25") Index, which consists of 25 leading Shariah-compliant stocks listed on Bursa Securities. The sector with the highest weighting in the DJIM25 Index currently is plantation, followed by telecommunication, transportation, infrastructure and oil & gas.

MyETF-DJIM25 is managed by i-VCAP Management Sdn. Bhd. ("i-VCAP"), a fund management company that provides solely Shariah-compliant investment management services. i-VCAP is wholly owned by Valuecap Sdn. Bhd. which in turn is equally owned by Khazanah Nasional Berhad, Permodalan Nasional Berhad & Kumpulan Wang Persaraan (Diperbadankan).

In addition to the Shariah stock screening process which differentiates a Shariah ETF from its conventional counterpart, i-VCAP undertakes an income purification process for MyETF-DJIM25 which involves segregating the non-Shariah-compliant income from the income (mainly dividends) received from the component stocks, and distributing it to charities and/or utilising it for educational programmes for the public.

While investor education is recognised by ETF industry players as one of the main drivers to encourage stronger growth of ETFs in Malaysia, Zainal Izlan believes that further development of supporting infrastructure for ETF trading also plays a pivotal role. On this note, he commented that the trading liquidity of MyETF-DJIM25 on Bursa Securities has improved significantly since the reduction of tick size that was implemented by Bursa Securities on 1 August 2009.

The average daily traded volume of MyETF-DJIM25 for the five-month period between 3 August and 31 December 2009 increased to 257,417 units, compared to 88,448 units for the five-month period prior to implementation of the reduced tick size.

"We believe the almost three-fold increase in traded volume can be attributed largely to the smaller tick size which allows investors to participate in the fund at a price that more accurately reflects its underlying NAV at any point of time", says Zainal Izlan.

In order to further enhance the trading liquidity of MyETF-DJIM25, i-VCAP announced effective 28 December 2009 the reduction in the creation/redemption unit block of MyETF-DJIM25 from 1,000,000 units to 500,000 units.

Zainal Izlan explains that the halving of the unit block size would spur greater participation by investors in the primary market for MyETF-DJIM25 and therefore enhance its trading liquidity on Bursa Securities.

The primary market is where investors via the Participating Dealers create new units and redeem existing units of MyETF-DJIM25, mainly to cater for larger transaction sizes. The Participating Dealers for MyETF-DJIM25 are CIMB Investment Bank Berhad and OSK Investment Bank Berhad.

Looking ahead, greater awareness and acceptance of the applications and usage for ETFs will spur the demand for ETFs in Malaysia. Investors may use ETFs to facilitate their portfolios' tactical asset allocation strategy by gaining immediate positions in various asset classes such as equities, money market and commodities. Investors may also invest in ETFs to gain exposure to markets or asset classes that are relatively difficult to access directly, or to specific investment styles. Furthermore, ETFs can form part of a 'fund of funds' strategy.

"In Malaysia, when more ETFs are introduced and listed on Bursa Securities to provide a broader range of ETFs tracking different asset classes and geographical regions, then they will become a widely-accepted investment tool", concludes Zainal Izlan. **SI**



Zainal Izlan Zainal Abidin