Is there a future for ETFs?

Lacklustre performance probably due to lack of push from Bursa Malaysia and brokerage firms

by FARAH SAAD

SINCE 2007, Bursa Malaysia's Exchange Traded Funds (ETFs) have arguably been languishing in obscurity. The lack of visibility is possibly due to a lack of push from Bursa Malaysia and brokerage firms in promoting ETFs. This has caused a slow pickup on ETFs from investors, who may be missing out on an opportunity to capitalise on KLCI's growth trajectory.

Research houses contacted by ***FocusM*** reacted with amusement and surprise when asked for comments on ETFs. Their analysts say that they do not cover ETFs or do not know much about them and declined to comment further. Those who did speak to us wanted to do so only on condition of anonymity. Both ETF fund managers at CIMB Bhd and AmBank Bhd declined to comment.

"The awareness and education level has not been on the fast lane. We have been going around to brokers. We have worked with Bursa Malaysia and regulators to educate the investor, but there is a lot to be done. We're working on the issues collectively," a source from an Islamic investment fund house tells ***FocusM***.

In stark contrast, ETFs in Singapore Exchange (SGX) are thriving. The Straits Times Index has a PE multiple of 28.31, compared to FBM KLCI's 15.62 times. The SGX website is regularly updated with information on its monthly turnover for its 90-odd ETFs under 10 market makers. In February, SGX's turnover was S$331.08 mil (RM812.5 mil). Year-to-date, turnover is S$670.75 mil, with a trading volume of 68.3 mil units. Besides equities and fixed income, there are ETFs for commodities and the money market as well.

With Bursa Malaysia on an uptrend since 2008, shouldn't ETFs be attracting attention from investors? Going by the KLCI's statistics since 2008, an investor who had purchased ETFs then, would have likely doubled his investment by 2012.

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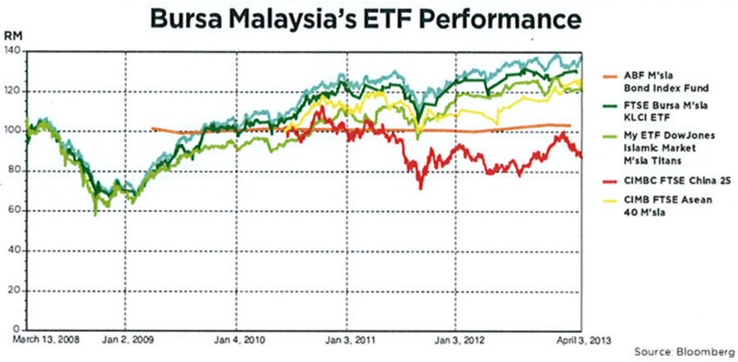

ETFs are a safe investment option

It appears that few understand the potential of ETFs listed on Bursa. Following the index of the exchange is a key positive for ETFs. "The very nature of ETF is it is safe, as it tracks the index and if it drops it doesn't drop very much," says the source.

There are currently five ETFs listed on the local stock exchange. These include the ABF Malaysia Bond Index Fund, FTSE Bursa Malaysia KLCI ETF, MyETF Dow Jones Islamic Market Malaysia Titans, CIMB FTSE China 25 and CIMB FTSE Asean 40 Malaysia.

The total asset size of the FBM KLCI ETF is a mere RM2.76 mil, focusing on large-cap growth companies in Malaysia, with 34.94% of its portfolio in the financial sector.

The small number of ETFs is not surprising, given the attention it is receiving. "The Malaysian market is very small, but we will see a few more ETFs being listed in the next few years. The market is growing slowly," says the source.

The FBM KLCI ETF is one of the more expensive funds, with an expense ratio of 1.11. As at April 3, its closing price was RM1.65, with almost no movement in the volume traded. Over the past five years it has provided an average dividend yield of 3.33%.

On the other end of the movement spectrum is the shariah-compliant MyETF, which tracks the Dow Jones Islamic Market Titans 25 index. The fund, formed in 2008, has a total asset size of RM278.33 mil. It focuses on Malaysian companies of all cap sizes, with 32.26% of its investments in the communications sector. It is cheaper at an expense ratio of 0.42, with a dividend yield of 3.66%. It closed trading on April 3 at RM1.06, down from RM1.08 the day before. On March 28, the fund saw 550,000 units changing hands, its highest trade volume so far this year.

The FTSE China Index is CIMB's FTSE China 25 ETF which was introduced into the market in 2010. The fund has a total asset size of RM29.63 mil. On April 3, the fund price was 90 sen.

For the risk-averse investor there is the ABF Malaysia Bond Index Fund, which tracks the iBoxx ABF Malaysia Bond Index, which invests primarily in government bonds (87.17% of a total asset size of RM650.06 mil). It has a small exposure of 3.7% to South Korea. Investors who take up this ETF are generally not in it for the price appreciation, but rather for the income from the bonds.

Unlike unit trusts, ETFs lack attention from EPF

ETFs have a cheaper management fee compared to unit trusts. Transaction costs and brokerage fee for ETFs can go up to 0.7% and clearing fee of up to 0.04%. On the other hand, fund managers of unit trusts may charge up to 1.5% per annum in management fee, compared to 0.5% for ETFs.

Despite the potential benefit of investing in ETFs, retail investors still tend to lean towards unit trusts, mainly because of the Employees Provident Fund (EPF) members investment scheme which allows members to withdraw up to 20% from their Account 1 for investment in unit trusts.

Industry players say a similar investment scheme for ETFs would significantly increase participation and benefit the industry. It is learnt that the EPF and regulators have been approached for a similar investment scheme, which can drive participation in ETFs. However, the EPF has been dragging its feet.

Will ETFs attract greater attention?

Attempts by fund managers to increase awareness through marketing campaigns have much room for improvement. Foreign investors, mostly from Asia, are said to be participating in Malaysian ETFs, says the source.

It is learnt that there is a possibility of local ETFs going for listing abroad once regulatory issues are overcome. The same goes for foreign ETFs listing in Malaysia, says the official. For now the growth in the number of ETFs will be solely from local providers.

"It is difficult for foreign ETFs to list here because the approval process is very rigorous and the regulators are protecting us as well, so we can understand that. We can expect growth soon, with more [local] ETFs joining the market. There has been a lot of effort to increase the number of ETFs, and we will be able to see growth," says the source.

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How ETFs work

ETFs are designed to mimic the performance of the underlying index, such as the KLCI, Dow Jones shariah-compliant index and Asean 40 index. ETFs give a wider exposure to investors wanting to spread their risks on the equity market, much like unit trusts.

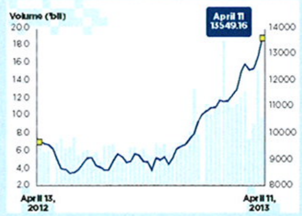
The ETF manager is tasked with keeping the fund's holdings in line with the underlying index through the trading of the stocks involved. Because they do not buy and sell securities according to client orders, unlike unit trust funds, this keeps costs low. A trustee is given the task of acting as custodian of the fund's assets, and actively monitors the administration of the fund by the manager.

ETFs are open-ended funds listed and traded on a stock exchange. Investors are able to enter and exit at any time, much like buying shares. The features are a combination of a stock and index fund, and the liquidity of the fund depends on the liquidity of the underlying basket of shares. Investors determine the level of exposure by looking at the underlying benchmark or assets held in the ETF.

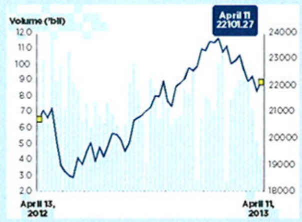
An ETF tracks the performance of an index through its basket of securities. The basket is grouped to reflect the movement of the market. The object of ETFs is to provide returns very close to the performance of their underlying index. They do not seek to outperform the index.

ETFs function much like a share of a company, except that they follow the performance of the stock market index. Also like stock trading, a brokerage commission, stamp duty, and clearing fees are applicable. ETFs are traded in minimum lots of 100 units, and transactions are settled not more than three days after the transaction date.

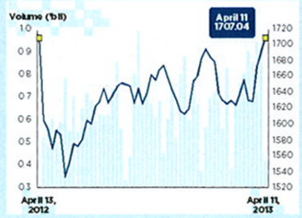
Dow Jones



Nikkei



Hang Seng



KLCI

Markets hit all-time highs

MARKETS in Asia as well as the Dow Jones Industrial Index hit all-time highs, boosted by positive news from the US.

The Dow Jones hit a record high of 14,802.24 points on April 10, a gain of 128.78 points, from the previous day. The index had climbed steadily over the week from 14,613.5 points on April 8.

Investors took comfort in the outcome of the US Federal Reserve's March meeting which showed a majority of policymakers in favour of continuing the central bank's bond purchases to help boost the economy, at least until mid-year.

The Bank of Japan's aggressive plan to inject US$1.4 tril (RM4.24 tril) into its economy has pushed the Nikkei to an all-time high of 13,549.16 on April 11, catching the market by surprise. The index has been rising steadily since a low of just 8,295.63 on June 4, 2012, and has been up 30% since the start of the year.

Hong Kong's Hang Seng advanced 66.71 points to close at 22,101.27 on April 11, returning to above the 22,000 mark, which it last saw in May last year. Investors were buoyed by activity in the US and easing worries about China's economy.

The FBM KLCI endured a roller-coaster year and breached the 1,700 mark to close at an all-time closing high of 1,707.04 on April 11. Investors had taken on a positive outlook following the confirmation of the date for the 13th general election, which has been slated for May 5. Trading was spurred by buying of telcos, plantations and Tenaga Nasional Bhd. However, local investors remained on the sidelines, preferring to wait until after the elections, leaving the activity to foreign buyers.

Ringgit strengthens, KLCI breaches 1,700 mark

But manufacturing sales value and IPI decline in February

by PRATHAB V

THE ringgit is making an impressive climb upwards, closing at 3.03 to the US dollar, climbing 2% against the greenback this month. Market observers note that this is partly due to the general election which will be held on May 5.

The steady climb of the ringgit surprised RAM Holdings Bhd group chief economist, Dr Yeah Kim Leng. "The ringgit's performance is a surprise as we were factoring in the impending general election. However, it bucked the trend," Yeah tells ***FocusM***, explaining that this may largely be attributed to foreign capital inflow.

"These are short-term capital due to quantitative easing [QE] policies in major industrialised countries such as US, Europe and even Japan. The QE implementation in these economies has caused capital inflow to emerging economies, in search of better yields," Yeah says.

The benchmark FBM KLCI also hit its all-time record high, erasing its previous intraday high the previous week. The index closed at a new psychological high of 1,707 points on April 11 with total trade worth over RM2 bil.

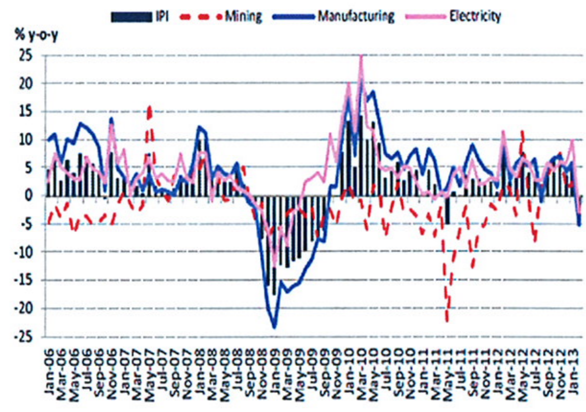
While the ringgit continues its upward trend, the Malaysian manufacturing sector and industrial production index (IPI) slipped last February.

February was a poor month for the country in terms of the manufacturing sector and industrial production.

According to the Department of Statistics (DOS), sales value of the manufacturing sector regressed by 6.9% (RM3.4 bil) to record RM46.2 bil from RM49.6 bil in the corresponding period last year. On a month-to-month basis, sales value decreased by 8.2% (RM4.1 bil) in February from January, whose figure has been revised upwards by 3.2% year-on-year (y-o-y) to hit RM50.3 bil.

The year-on-year depreciation in the sales value in February 2013 was attributed to the lower sales in 83 of 116 industries (71.6%) surveyed. Meanwhile, the sales value also declined month-on-month due to the decreases in 99 of 116 industries (85.3%)," says the DOS report on its website.

Malaysia Industrial Production Index



Source: DOS, Alliance Research

Similar to the manufacturing sector, the IPI, which tracks the overall industrial output, also showed a decline. February IPI declined by 4.5% compared with the same month the previous year. All key indices retreated. They include manufacturing (-5.2%), mining (-3%) and electricity (-3%). On seasonally adjusted terms, February's IPI retreated by 1.2% month-on-month (m-o-m).

According to Yeah, the decline was below expectations. "We had earlier been expecting a positive growth, but it turned out to be a decline. This is mainly due to the shorter working days in February as well as a result of the (Chinese New Year) festive season," he tells ***FocusM***.

Yeah also says that the drop in IPI and manufacturing sector's sales value will likely be a "one-off" incident, with the economy bouncing back in the coming months.

Alliance Research says the performance was worse than market expectation, below its in-house estimate of -1.9% and Bloomberg's poll of -2.5%.

"In particular, the decline in output in the manufacturing sector was due to lower output in key sub-sectors: petroleum, chemical, rubber and plastic products (-2.5%); electrical and electronics products (-6.5%); and non-metallic mineral products, basic metal and fabricated metal products (-10.1%).

"In the mining sector, output fell 3% in February 2013, attributed mainly to the decrease in crude oil index (-5.4%). In contrast, natural gas index was up 1.7%, which was not enough to pull the mining index higher," says Alliance Research.

While RAM remains optimistic that economic performance in the coming months may turn out positively, Alliance Research is concerned. "Volatility in the coming months may still be in play as witnessed by figures reported in purchasing managers' index (PMI)," says Alliance Research.

"While global manufacturing PMI rose from 50.9 in February 2013 to 51.2 in March on the back of a faster expansion seen in China, slower growth in the US and the EU remains a worry. Nonetheless, global chip sales for February 2013 were up by 1.4% y-o-y to US$23.25 bil [RM70.45 bil], while Semiconductor Equipment and Materials International (Semi) book-to-bill ratio was 1.10 times, down marginally from 1.11 times in January," says the report. Exports in February also contracted by 7.7%, on the back of lower exports of E&E products, crude petroleum and palm oil. FocusM

Calling for Gen-Y investors

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What can be done to improve market participation and attract a younger demographic to invest in ETFs? This particular demographic is more financially sophisticated and educated – but also less patient. Investors who take up ETFs, like investors in unit trusts, are in it for the long term.

"Most of the investors now are in the above 40s category, but we are working to get the younger demographic involved. It is all a question of mentality as most of the younger generation, the Gen-Ys, want something that is exciting, and they can make quick returns. They need to be aware that this is a tool that they can invest in for the long term and perhaps can contribute to their savings as well," says the official.

ETFs are really a neat way of diversifying investment portfolio via the exchange's performance. However, whether there is still a future for local ETFs is a question that is yet to find an answer. Perhaps the answer lies with Bursa, the Securities Commission and the EPF. FocusM