

2020 Global ETF Investor Survey

ETFs Continue to Chart a New Path

In partnership with



Foreword

In our seventh year providing insight into the investor uses of exchange-traded funds (ETFs), BBH, in partnership with ETF.com, captured responses from institutional investors, financial advisors, and fund managers from around the world to identify key trends in ETF selection, demand for certain asset classes and investment strategies, and how investors may access these products. Our findings this year suggest global ETF investors are finding creative ways to use ETFs in driving outcomes for their own clients.

ETFs have had a historic year. The market now represents a \$6.3 trillion industry and is showing no signs of slowing, growing at an annual rate of 32%. The US represents approximately 70% of the ETF market, reaching more than \$4.4 trillion in assets under management (AUM) as of December 2019. The European market is also growing rapidly, surpassing \$1 trillion this year. Meanwhile, the Greater China market is poised for accelerated growth, capturing 4% of the market, or \$177 billion in AUM.¹

Beyond strong global ETF flows, we also saw significant efforts in product development in 2019. In the US, the SEC approval of active non-transparent ETFs stands to bring new managers—and products—to the ETF market. The reason these products may be compelling for some active managers is simple: they no longer have to reveal their ‘secret sauce’ on a daily basis. But, will investors embrace the products? There are encouraging signs captured in this year’s survey—62% of surveyed US investors plan to increase their allocation to active ETFs in the next 12 months. And active was the top strategy US investors wanted to see more of in the market. As we continue to see large, established asset gatherers expand to these new innovative structures the belief is that these products will allow them to port successful active strategies into ETF wrappers offering investors compelling new product choices.

Fixed income ETFs have also come of age in the past year. In Europe, fixed income ETFs gathered more assets than equity ETFs for the first time in three years.²

Likewise, in the US, for the first time ever, fixed income ETFs attracted more new money than US equity ETFs.³ Despite the strong finish in 2019, it appears some investors are bracing for a turbulent year ahead. In the US and EU, fixed income was the top choice for combating market volatility, underscoring the versatility of the ETF wrapper in adverse market conditions. Respondents were also most likely to choose fixed income as the asset class they would most like to see in an active vehicle, which suggests continued growth in the expanding segment of actively managed ETFs.

We also continue to see strong demand for environmental, social, and governance (ESG) products among our respondent pool, especially in Europe. The stated enthusiasm for ESG strategies, however, is somewhat at odds with what we see in the market. ESG ETFs have captured just a fraction of total global ETF AUM, representing \$52 billion through November 2019.⁴ But as the adage goes: past performance is no guarantee of future results. 54% of global surveyed investors said they plan to increase allocations to ESG ETFs in 2020.

We’ve highlighted here only some of the key findings, but there is more pertinent detail for ETF sponsors in the report that follows. Sponsors should consider the findings in terms of their product development plans, marketing, and distribution strategies, as well as on-going client service and education. While global markets in 2019 closed on a positive note, uncertainty is the only certainty in 2020. One thing remains steady: our respondents have shown a willingness to keep ETFs at the center of their portfolio in good times and bad.

¹ETFGI, December 2019

²Bloomberg Intelligence, January 2020

³ETF.com, 2019’s \$326B ETF inflows 2nd Largest Ever, January 2, 2020

⁴ETFGI, November 2019



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Key Findings

ETF adoption continues rapid ascent.

69% of global ETF investors plan to increase their ETF allocation in the next 12 months, an increase of 8 percentage points from our 2019 survey.

Active ETFs may reach new heights.

US investors ranked active as the number one strategy (tied with low volatility ETFs) they would like to see more of in the market, and 62% of US investors plan to increase their exposure to actively-managed ETFs, an increase of 10 percentage points from 2019.

ESG ETFs are poised for growth.

While ESG ETFs have struggled to attract flows, the prospect for growth is encouraging. In five years, 30% of global ETF investors expect to have between 11% and 20% of their portfolio in ESG ETFs. ESG ETFs also earned the top ranking among global ETF investors as the strategy they want to see more of in the market.

Buying a new ETF requires a solid AUM foundation.

When evaluating new ETFs, only 12% of investors would buy a new ETF that has less than \$25 million AUM.

Amid turbulent markets, investors are using ETFs for diversified fixed income exposure.

The prospect of volatile global markets in 2020 has generated outsized interest in fixed income ETFs. For the second year in a row, investors ranked fixed income ETFs as their go-to product type in periods of heightened volatility.

Low volatility ETFs find an audience.

Investors in the US and Greater China both ranked managed risk/low volatility as the top ETF strategy (tied with active in the US) they would like to see more of in the market.

Smart beta ETFs are emerging as core portfolio staples.

40% of global investors have 11-20% of their portfolio in smart beta, an increase of 7 percentage points from 2019.

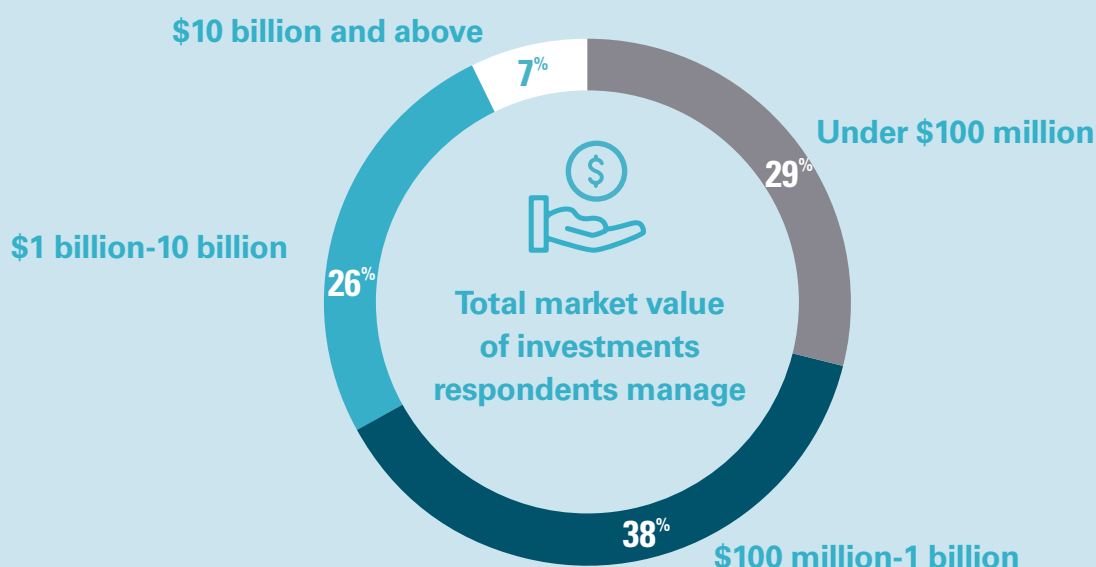
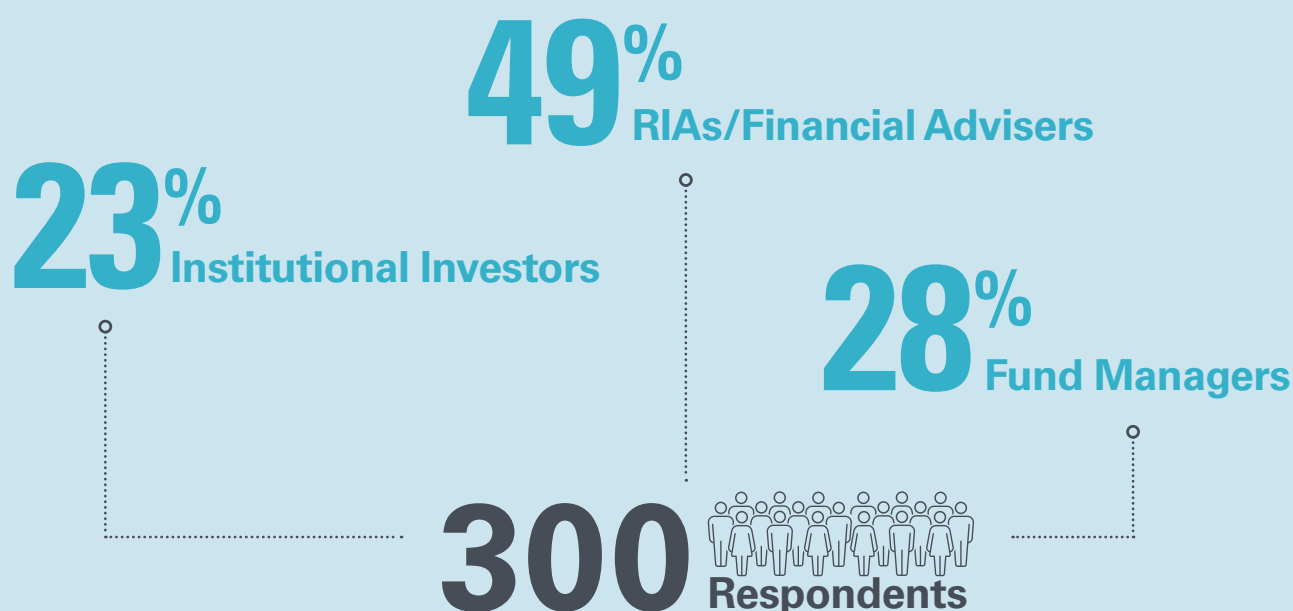


Demographics

Brown Brothers Harriman (BBH), in partnership with ETF.com, recently surveyed 300 institutional investors, financial advisers, and fund managers from around the world (100 in the US, 100 in Europe, and 100 in Greater China – including Mainland China, Hong Kong, and Taiwan). The sample was composed of 23% institutional investors, 49% registered investment advisers (RIAs), and 28% fund managers. All respondents invest in ETFs and are aware of their institution's overall investment strategy.

Unless otherwise indicated, data sources for all results are BBH proprietary surveys and all numbers are in US dollars.

Respondent Primary Business Activity

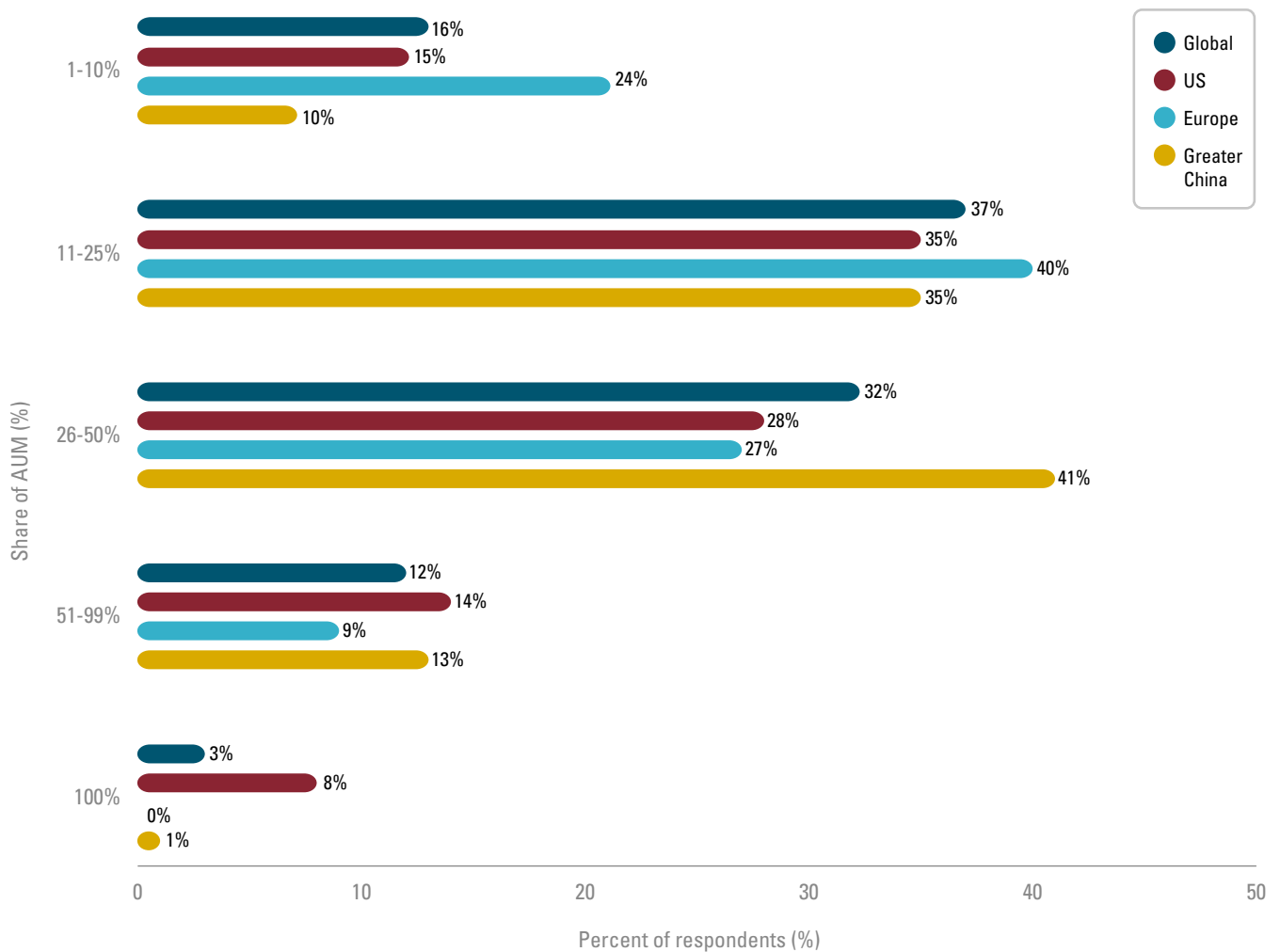


The Global ETF Market in Context

ETFs represent a sizeable portion of investors' portfolios

Globally, the majority of respondents (69%) hold 11-50% of their portfolios in ETFs. Broken out by region, 63% of investors in the US hold 11-50% in ETFs. That number is 67% in Europe, and 76% in Greater China. On the upper end of the AUM spectrum, 22% of US investors, 9% of European investors, and 14% of Greater China investors said their portfolios were comprised of 50% or more ETFs.

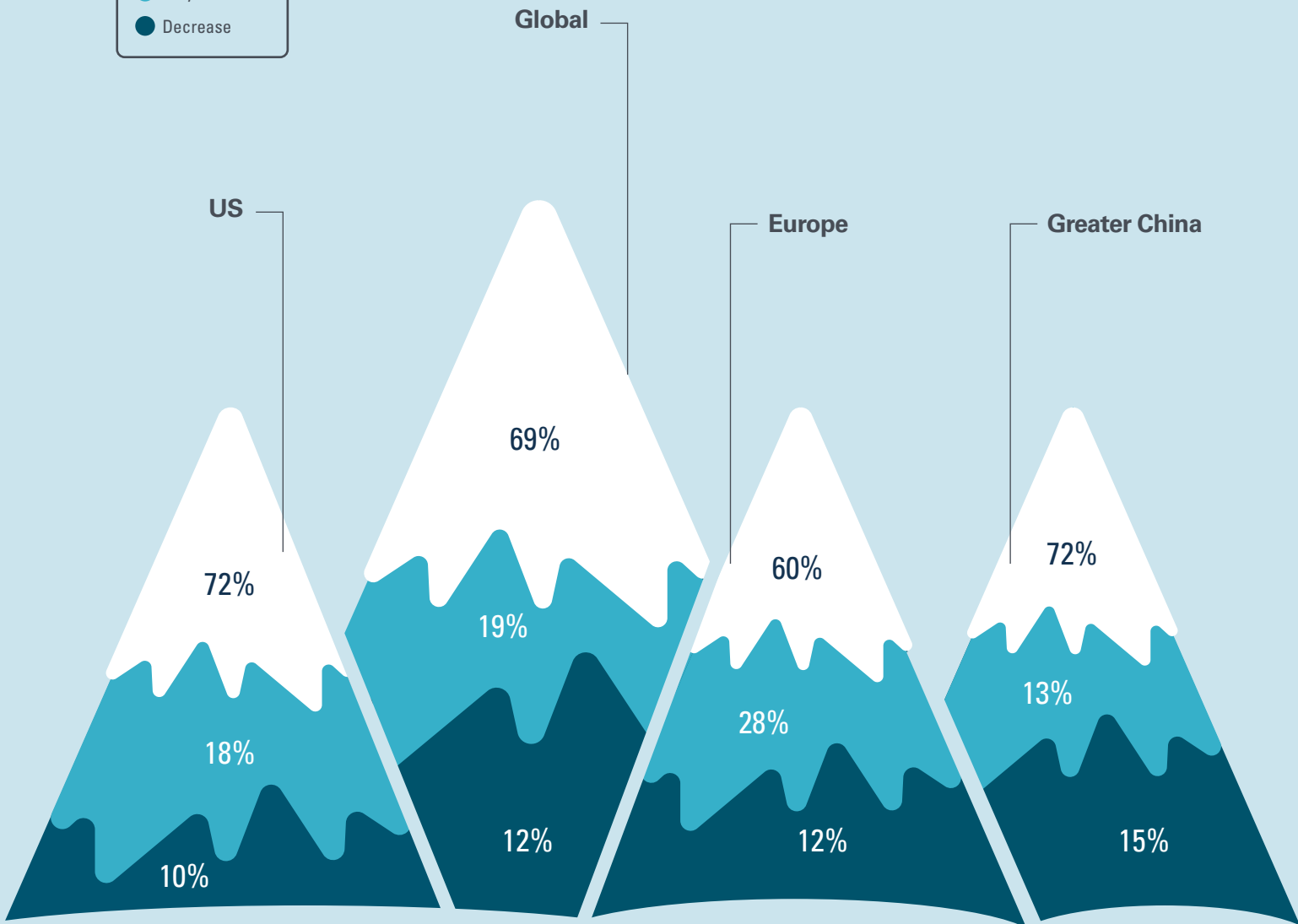
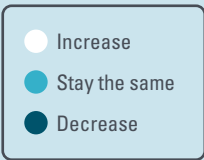
 Please indicate the percentage of your AUM invested in ETFs/ETNs:



ETF adoption continues rapid ascent

In a sign that the ETF market will grow, 69% of global ETF investors plan to increase their ETF allocation within their portfolios in the next 12 months, an increase of 8 percentage points from 2019. Broken out by region, 72% of investors in the US plan to increase their use of ETFs, up from 59% in 2019. In Europe, 60% plan to increase their use of ETFs this year, flat from 2019. In Greater China, 72% plan to increase their use of ETFs, up from 63% in 2019.

Do you expect your use of ETFs to increase, stay the same, or decrease over the next 12 months?

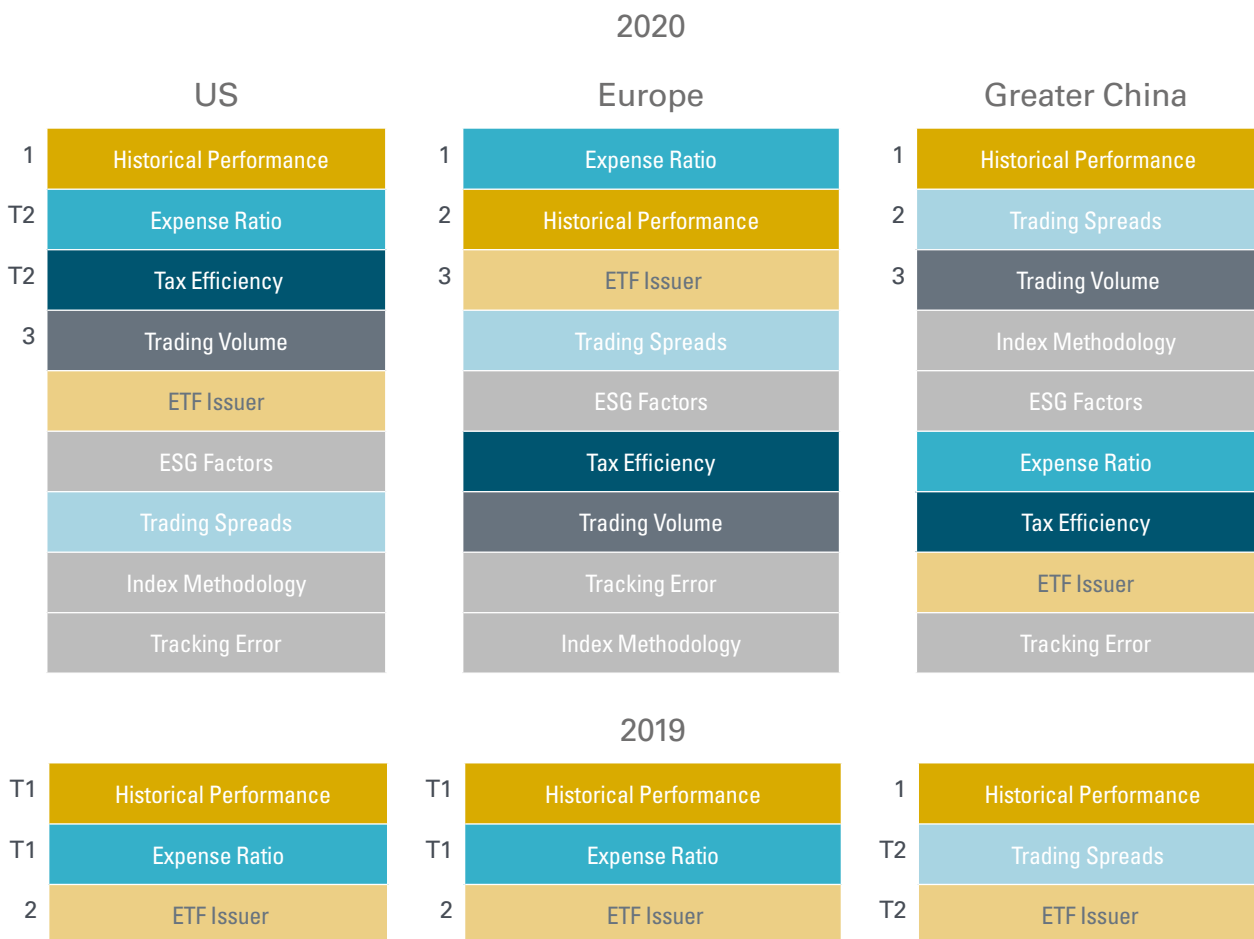


ETF Selection

Returns are a unifying theme across regions

For the second year in a row, historical performance edged expense ratio as the most important consideration for ETF investors in two out of three regions. Also of note is the regional distinction between trading volumes and spreads. Volume is of greater importance to US and Greater China investors, while trading spreads ranked higher in Europe. Regardless, it's clear that ETF liquidity (volume) and the cost of that liquidity (spreads) continue to be top of mind for investors.

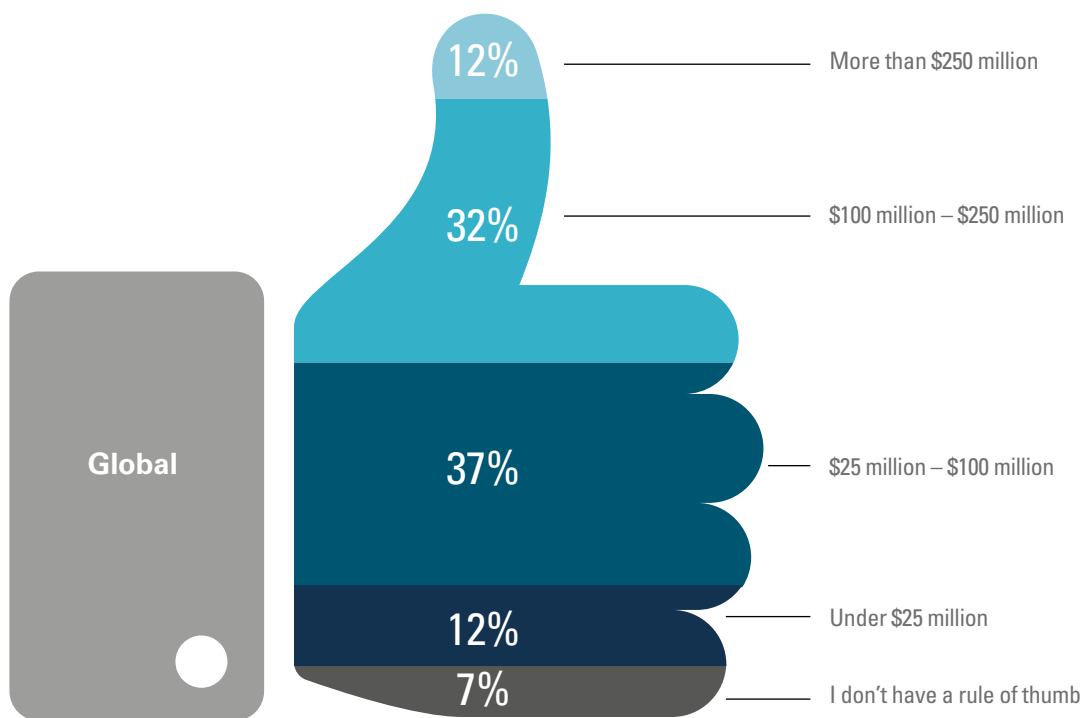
When selecting ETFs, please select and rank your top three of the following in terms of importance.



Buying a new ETF requires a solid AUM foundation

It's taken a few years, but it appears investors are moving up in market value in terms of the AUM minimums they want in new ETFs. Globally, 37% of investors are looking for \$25 million - \$100 million before investing in a new ETF. Some larger managers have already taken note by 'bringing their own cash' to their products as part of their launch strategy, while intermediary platforms are increasingly seeking AUM minimums before adding new ETFs.

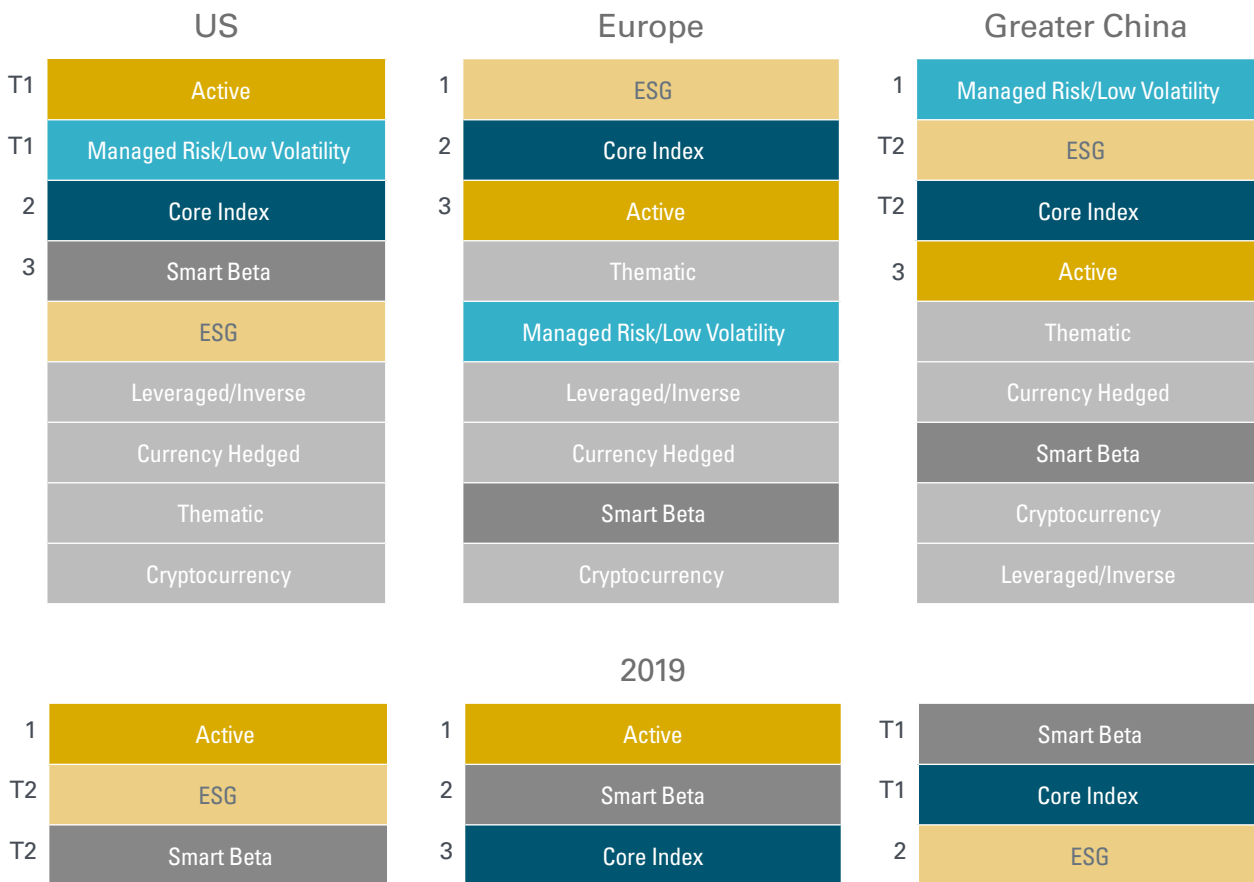
What is your "rule of thumb" for minimum AUM for a new ETF before you'll invest?



Low volatility and active ETFs gain favor in US and Greater China

Investors in the US and Greater China both ranked managed risk/low volatility as the top ETF strategy they would like to see more of in the market. In the US, active ETFs tied for the first ranking, consistent with last year. In Europe, interest in ESG surged to the top ranking. The results suggest an increased comfort level for more nuanced investment strategies, particularly those that may help hedge a portfolio, or reflect the investors own values.

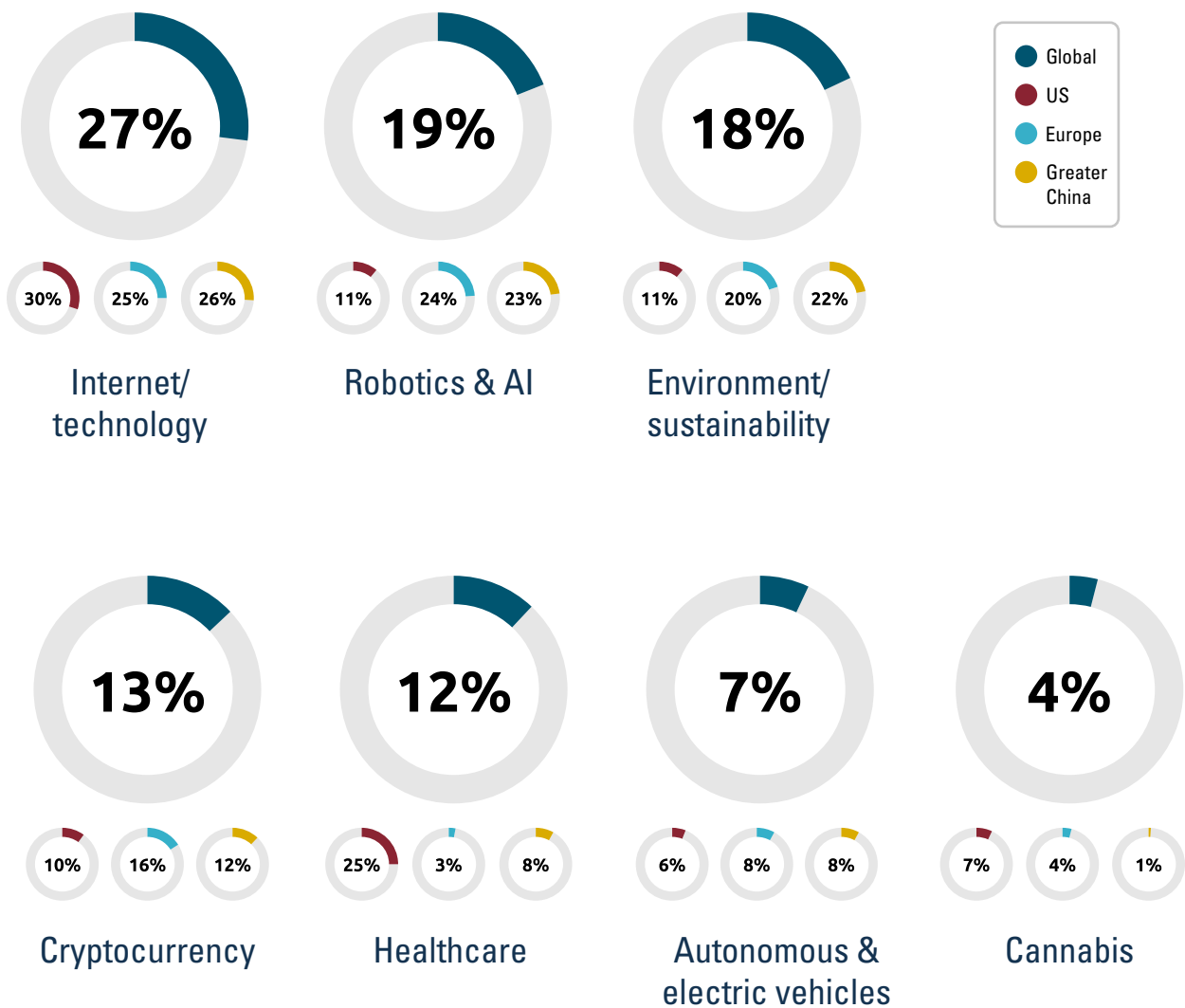
 **In which of the following areas would you like more ETFs to be available in your local market?**



Technology leads thematic ETF interest

Technology has caught the eye of ETF investors: globally, 27% of ETF investors chose technology as the thematic ETFs they are most interested in.

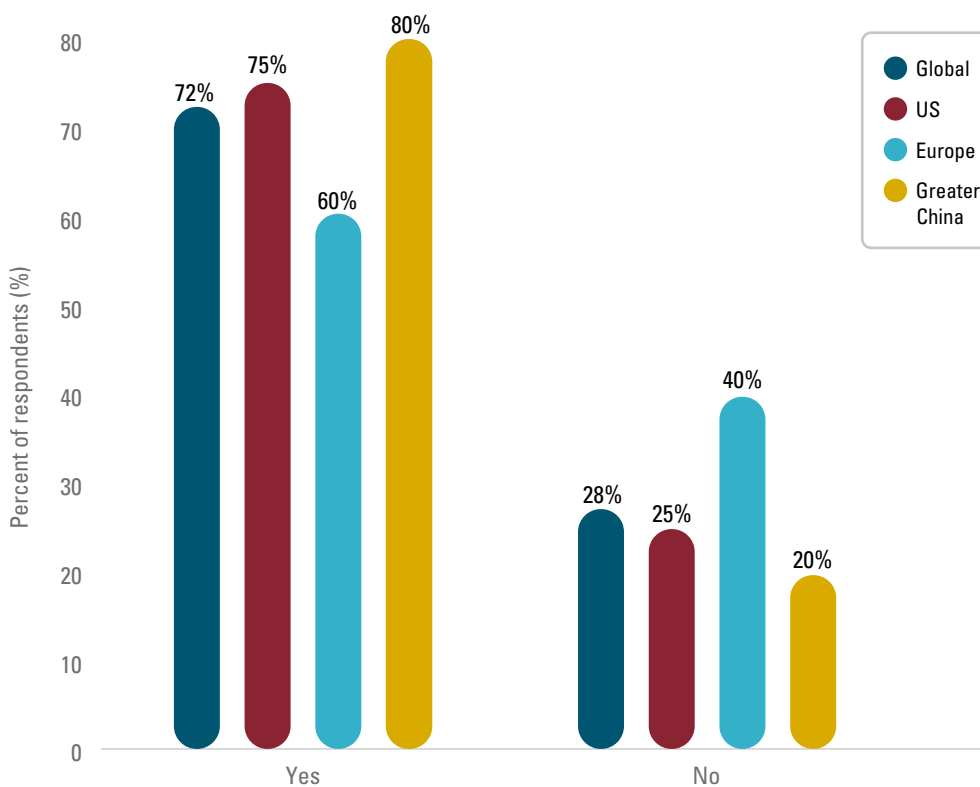
What type of thematic ETFs are you most interested in?



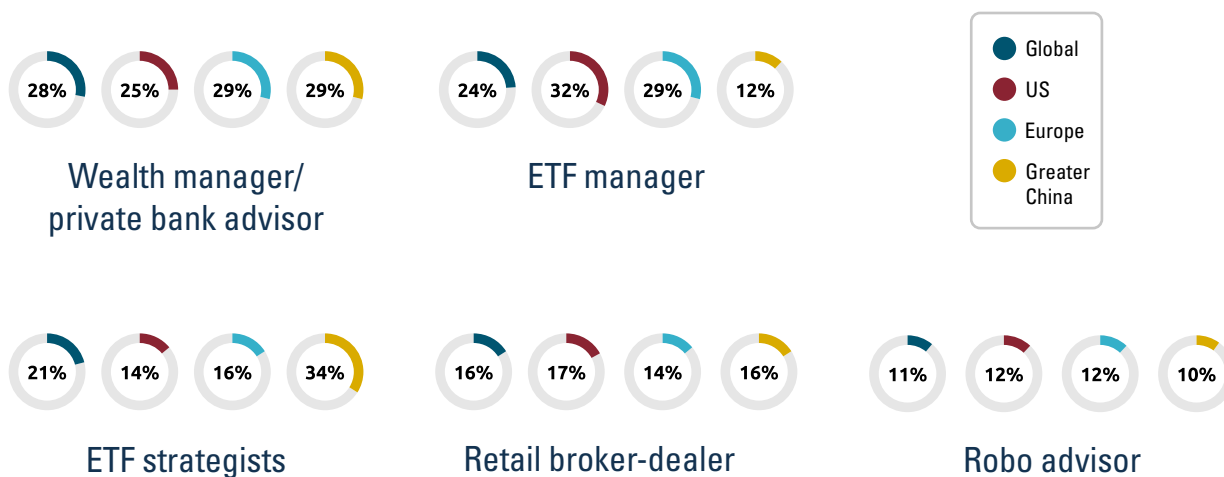
Ready-made ETF model solutions are in demand

More than 70% of global ETF investors have used a model with ETFs in the past year suggesting opportunities for ETF managers who can offer pre-packaged solutions for investors.

Do you use model portfolios that hold ETFs?



What third-party channel do you use to access ETF model portfolios?





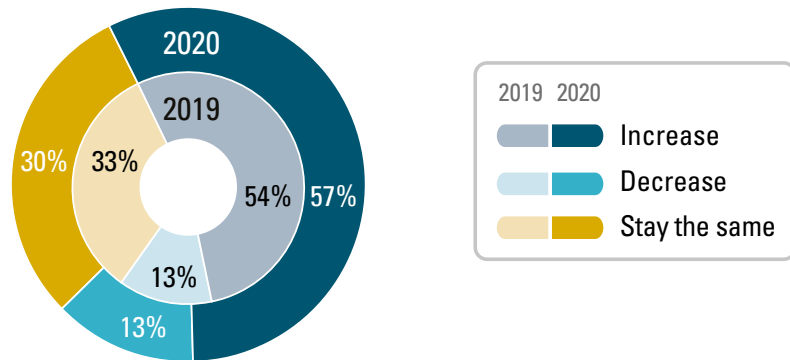
Active and Smart Beta ETFs

Outlook is bright for active ETFs

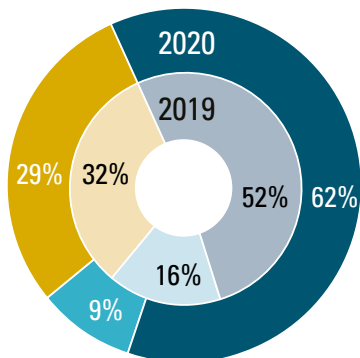
In the US, long-awaited action by the SEC to approve semi-transparent and non-transparent ETFs may spur greater interest in active ETFs. US investors ranked active as the number one strategy (tied with low volatility ETFs) they would like to see more of in the market, and 62% of US investors plan to increase their exposure to actively-managed ETFs, an increase of 10 percentage points from 2019. As previously mentioned, active ETFs were the top strategy investors wanted to see more of in the market. In Europe, interest in active products decreased 10 percentage points this year. With limited regulatory action, European investors may be in 'wait and see' mode until further developments occur.

Do you expect your exposure to actively-managed ETFs to increase, decrease, or stay the same over the next 12 months?

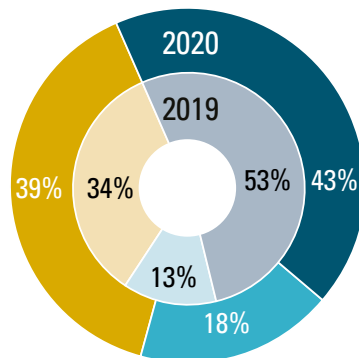
Global



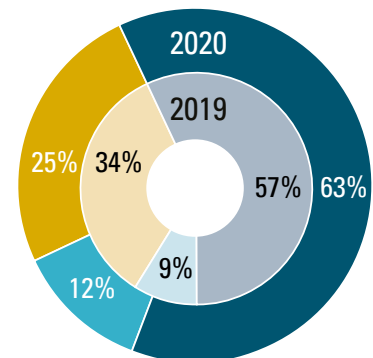
US



Europe



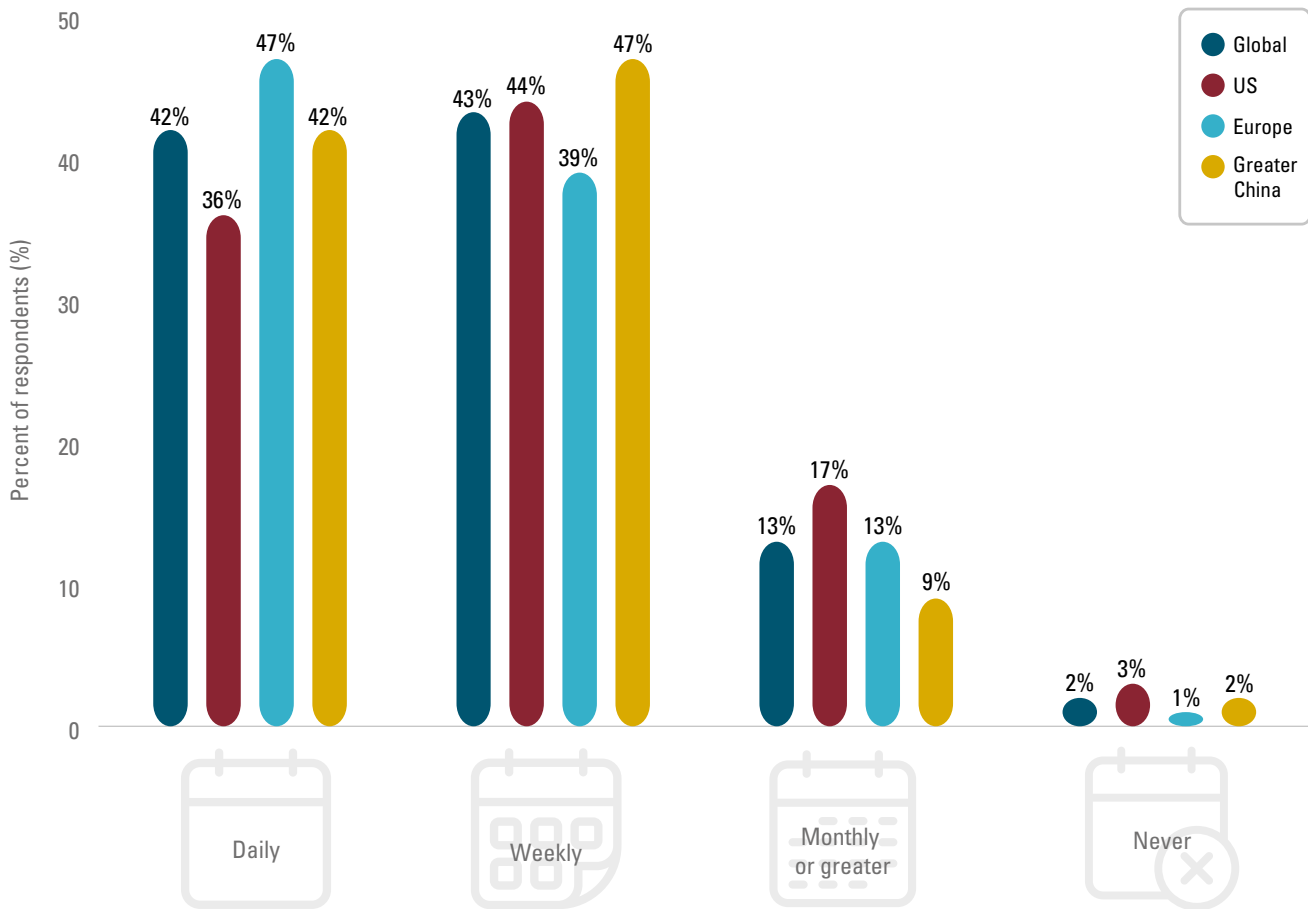
Greater China



Transparency of ETFs is still important

The T in ETF may also mean transparency. Visibility into an ETF's holdings is still important as investors were split between wanting their ETF to disclose its holding daily (41%) and weekly (43%).

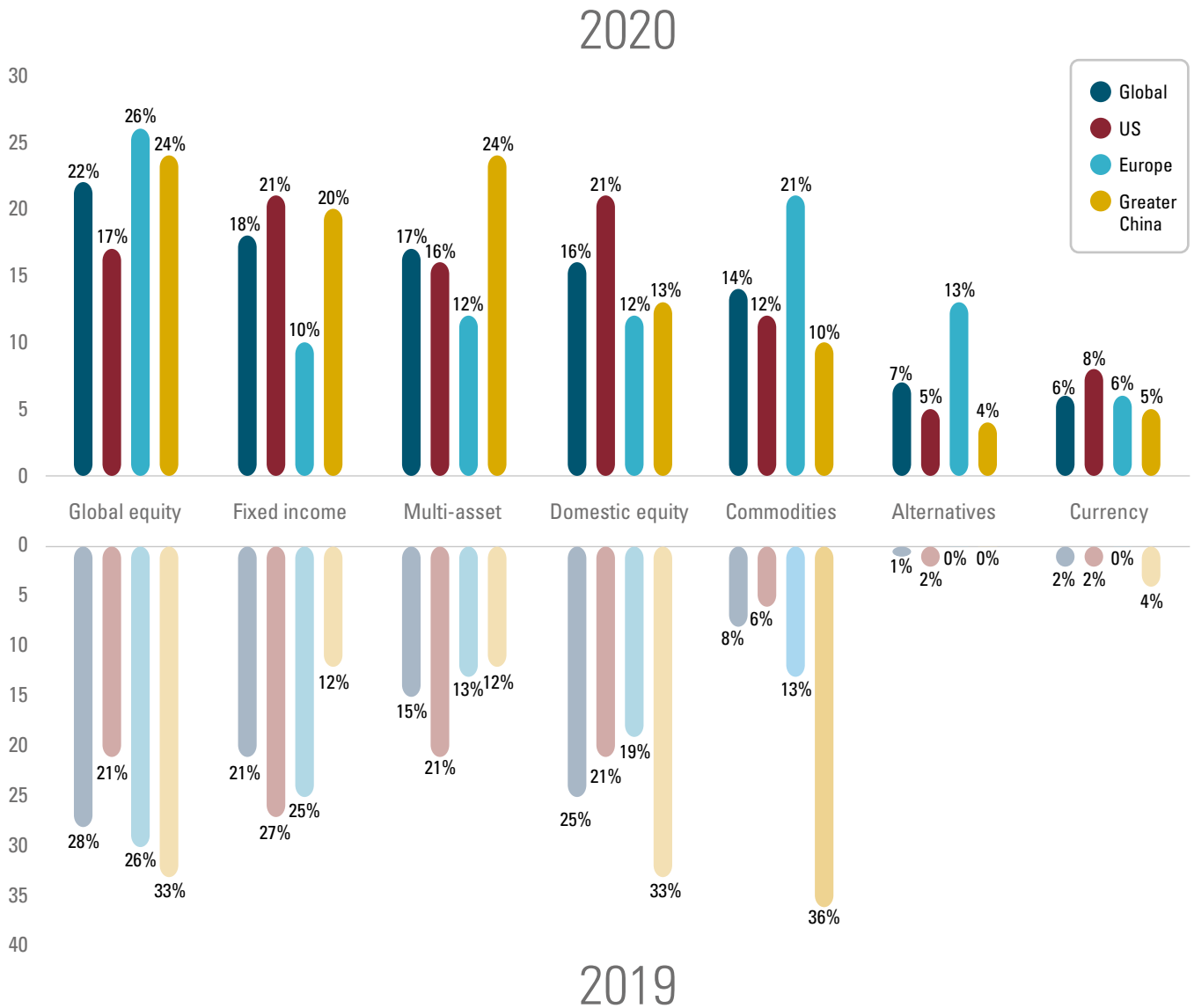
How frequently would you want your ETF to disclose its holdings?



Investors would look for active ETFs in a variety of asset classes

Global equity is the asset class investors are most likely to look for an active product. Investors would also look for active ETFs in fixed income, multi-asset, and domestic equity asset classes.

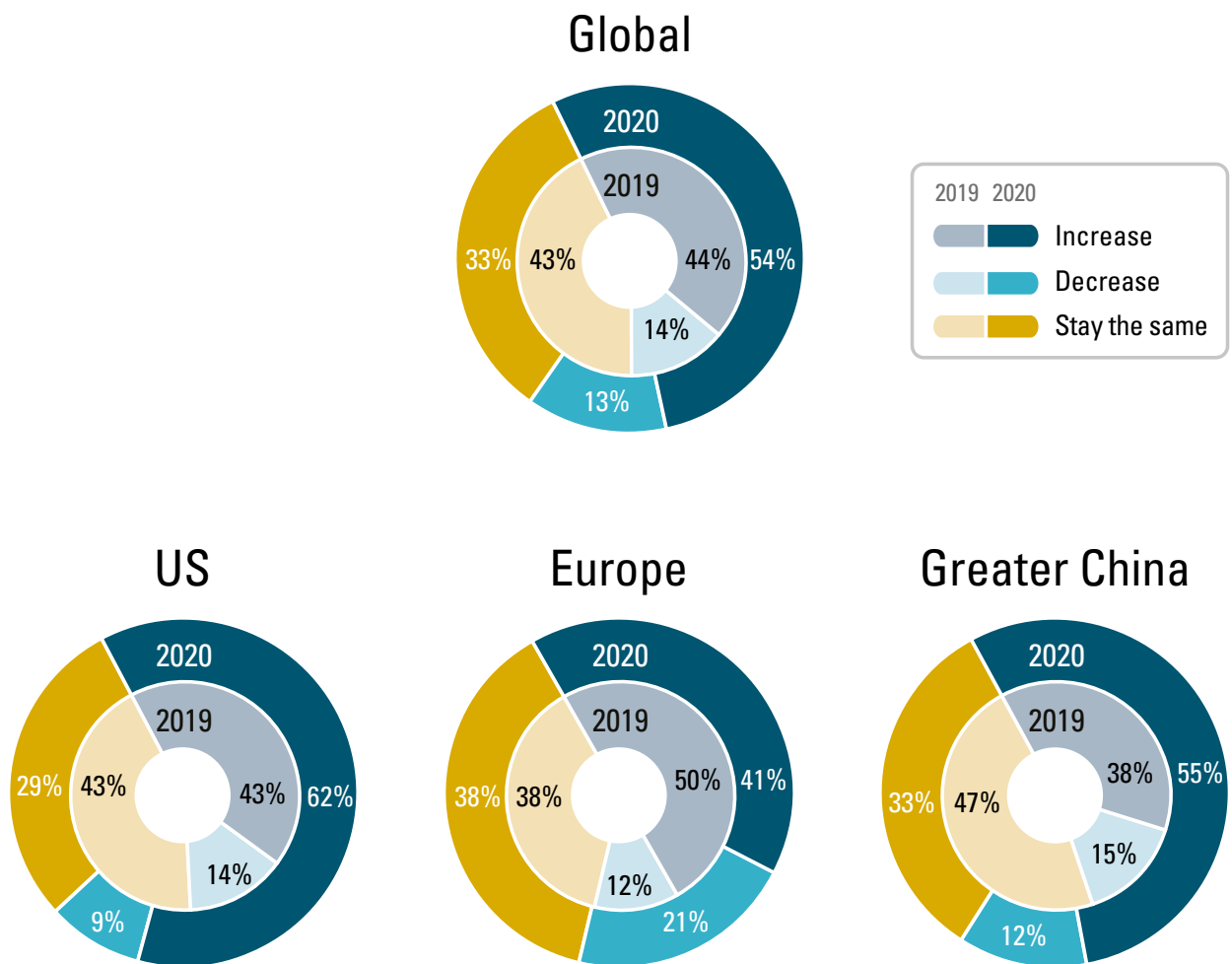
In what asset class would you be most likely to look for an actively-managed ETF?



Smart beta usage continues to rise

Smart beta ETF reached a record of \$835 billion in assets in 2019 and it appears there's room for growth.⁵ 54% of global investors plan to increase their exposure to smart beta ETFs over the next 12 months, 10 percentage points higher than 2019. In the US, enthusiasm for smart beta is especially pronounced, rising nearly 20 percentage points from 2019. Likewise, 55% of investors in Greater China plan to increase their smart beta exposure, 17 percentage points higher than 2019. In Europe, interest in smart beta has steadily declined, with 41% planning to increase their allocation, 9 percentage points lower than last year.

Do you expect your exposure to smart beta ETFs to increase, decrease, or stay the same over the next 12 months?

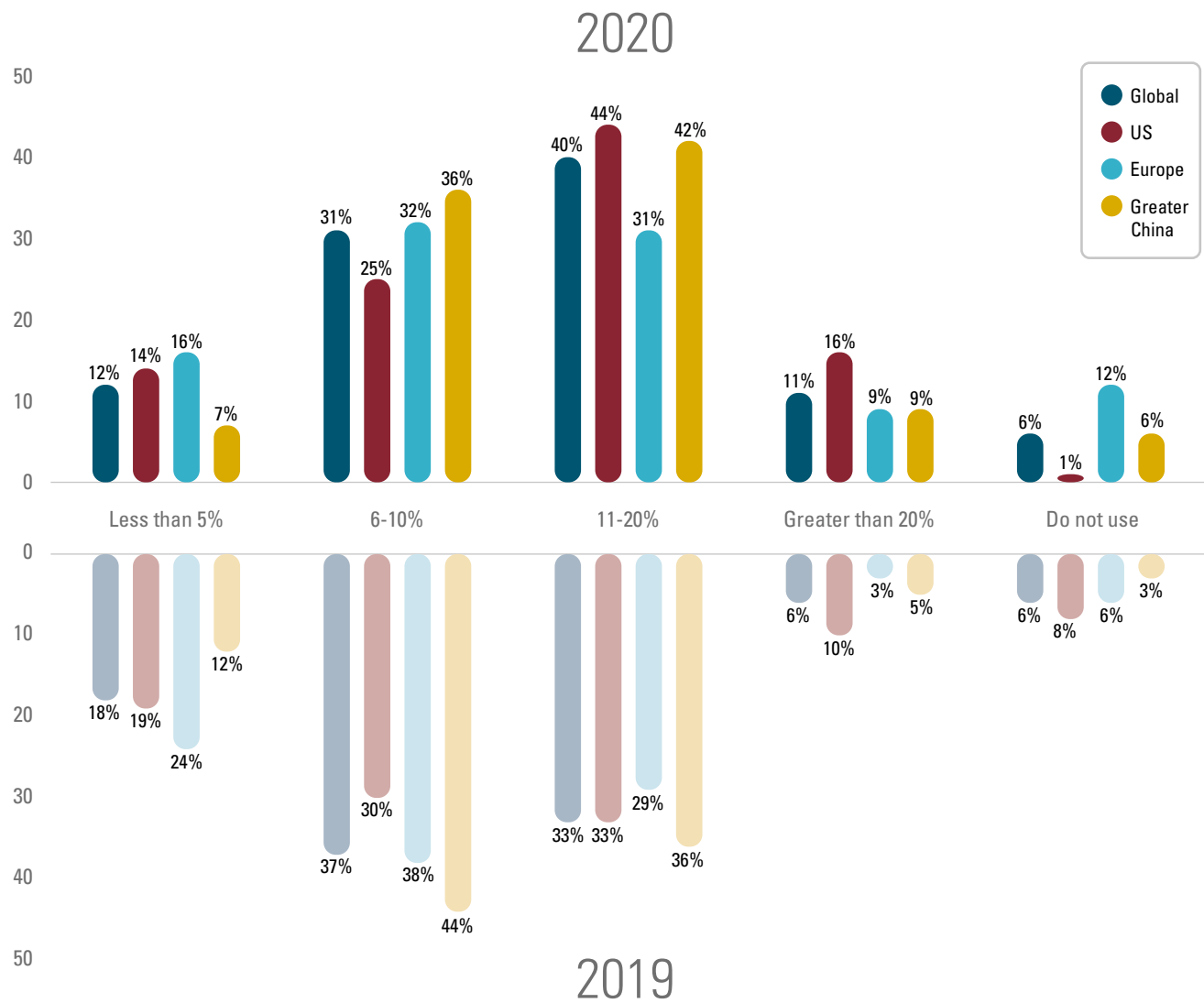


⁵ETFGI, November 2019

Investors are putting more of their portfolio into smart beta

This year we saw significant increases in investor portfolio allocations to smart beta, with 40% of global investors now allocating 11-20% to these strategies. This highlights the idea that investors are using smart beta strategies beyond satellite opportunities, and that more nuanced, factor-based strategies — like smart beta — may now become a pillar of their ‘core’ holdings.

What share of smart-beta products currently make up your AUM?

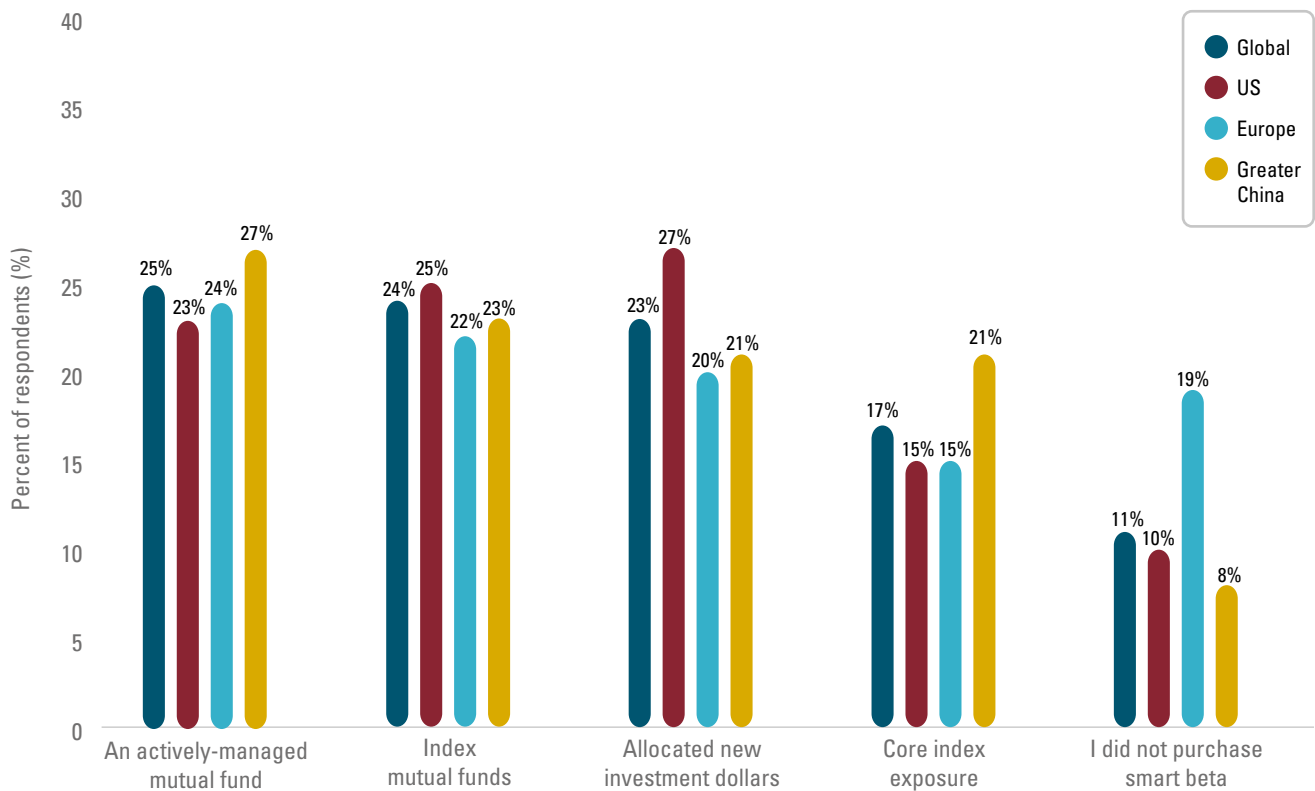


Smart beta ETFs are still catching asset from mutual funds

This year we see a continuation of a trend where investors are re-allocating assets from both active and passive products to smart-beta ETFs, underscoring that many investors view versatility as one of the greatest attributes of the ETF wrapper.

Globally, 25% of investors purchased a smart beta ETF to replace an actively-managed mutual fund. In Greater China, that number jumps to 27%. In Mainland China, a market dominated by active mutual funds, the ongoing regulatory reform focusing on deleveraging the financial markets and reallocating investment from wealth management products into more transparent collective investment vehicles should be a tailwind increasing use of ETFs.

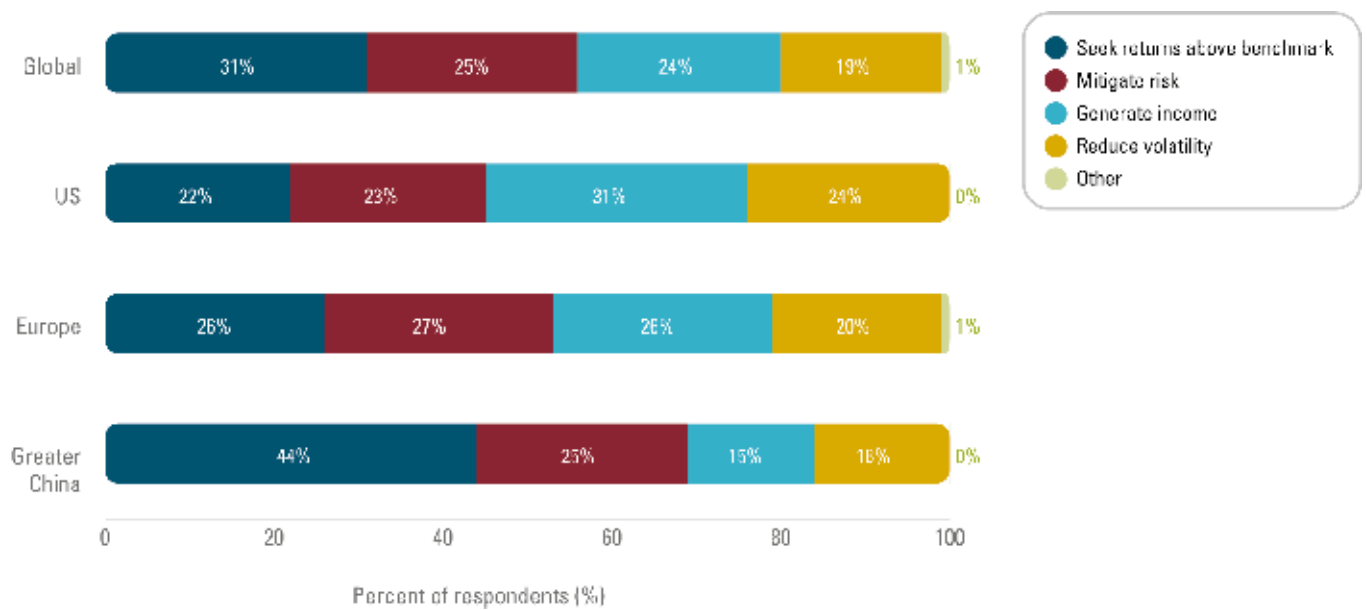
If you purchased a smart beta ETF in the last 12 months, what did it replace in your portfolio?



Investors still view smart beta as a multi-tool

While alpha generation leads the global responses (something active ETF managers should note), other outcomes like risk mitigation and income generation are critical reasons for investors adding smart-beta into their portfolios.

What is the top reason why you are using/considering using smart beta?

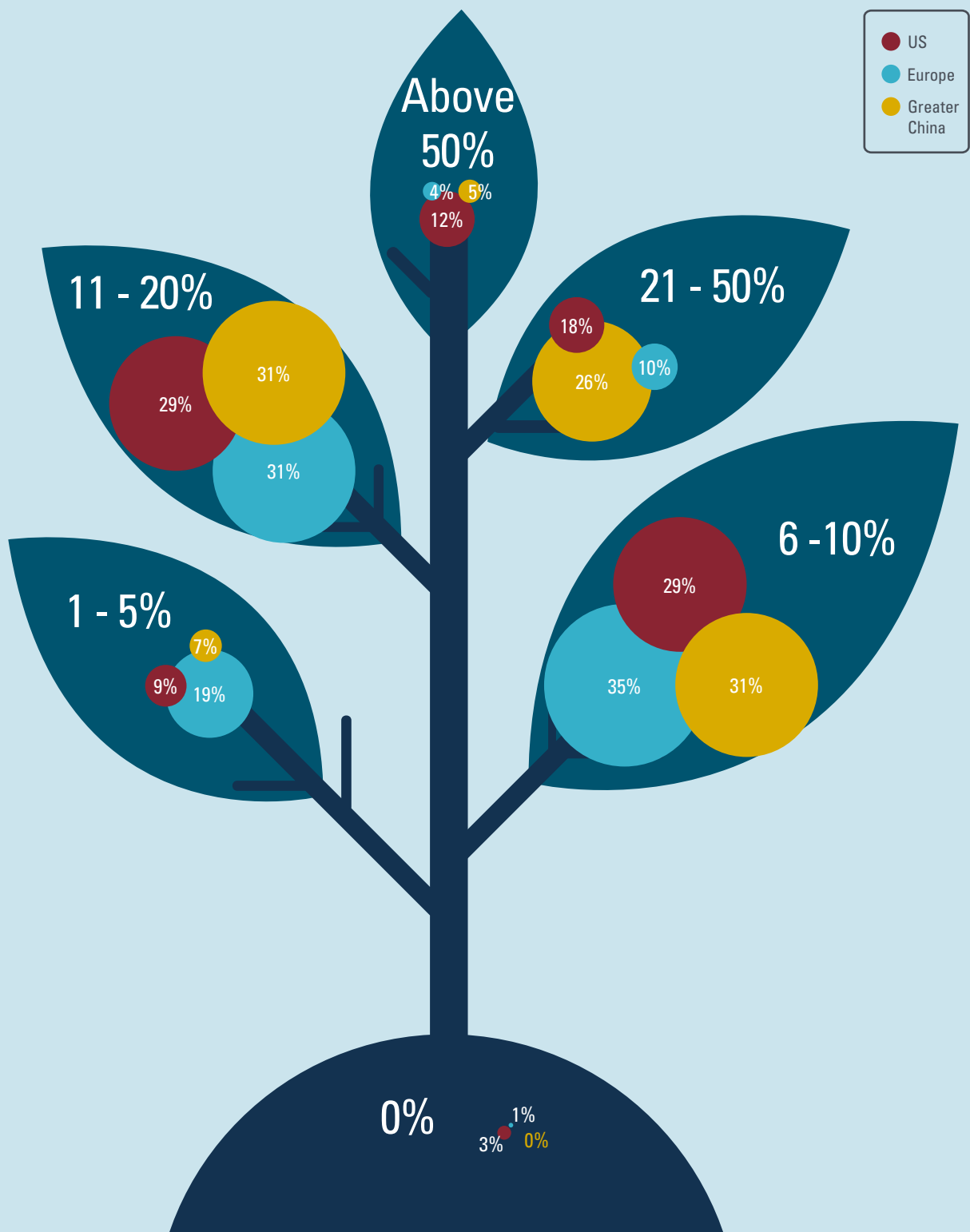


ESG Investing

ESG doesn't appear to be a passing fad

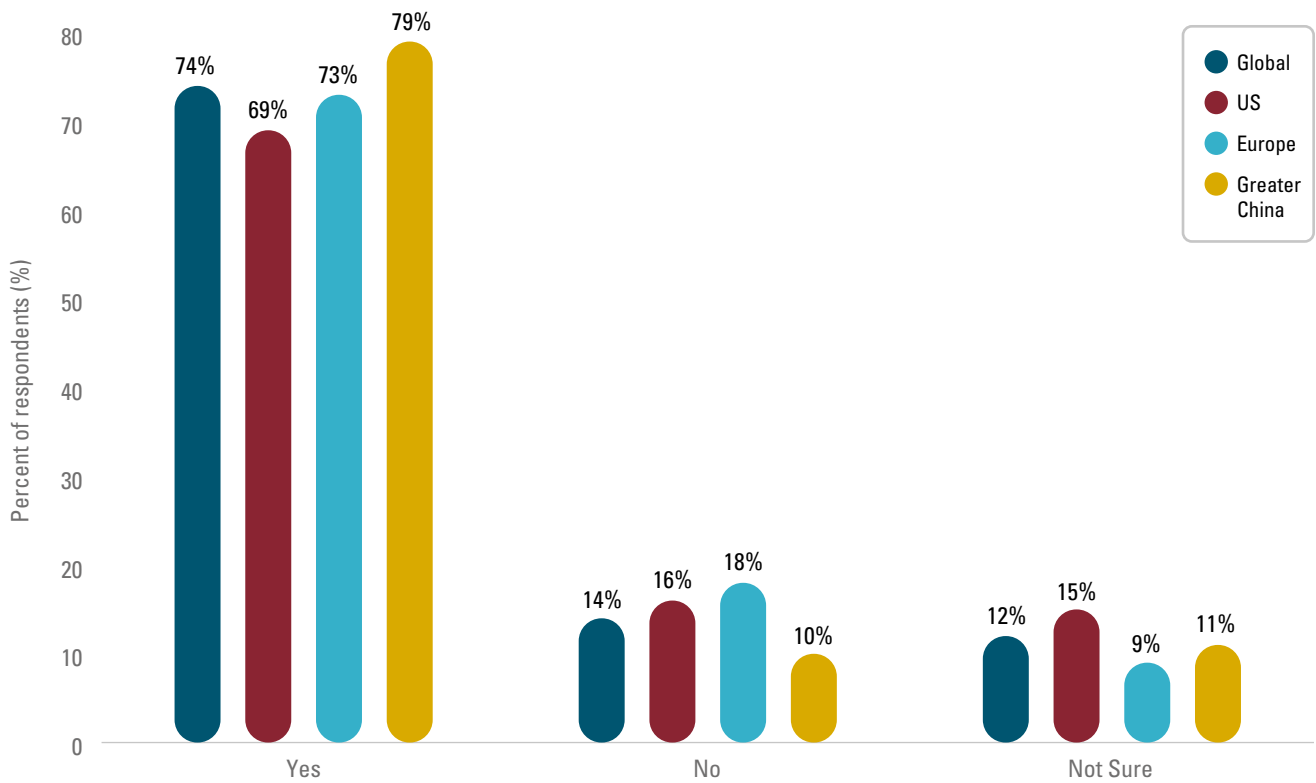
It should come as no surprise that ESG investing has captured the attention of the financial industry. What is surprising is the discrepancy between this growing interest – which is highlighted in this year's responses – and the actual flows to these products. According to recent ETFGI data, ESG ETFs globally represent \$52 billion of the \$6 trillion in ETF AUM in 2019. Yet, nearly 74% of global investors say they plan to increase their allocation to ESG ETFs over the next year. And in five years, many survey respondents believe they will have significant allocations to ESG ETFs – 19% said between 21-50% of their portfolio will be in ESG ETFs. In Europe, we continue to see ETF sponsors and index providers focus on developing investment strategies that include ESG factors.

In five years, what percentage of your portfolio will be ESG ETFs?



Most global investors say they will increase their allocation to ESG

Do you plan to increase your allocation to ESG investments (not limited to ESG ETFs) over the next year?

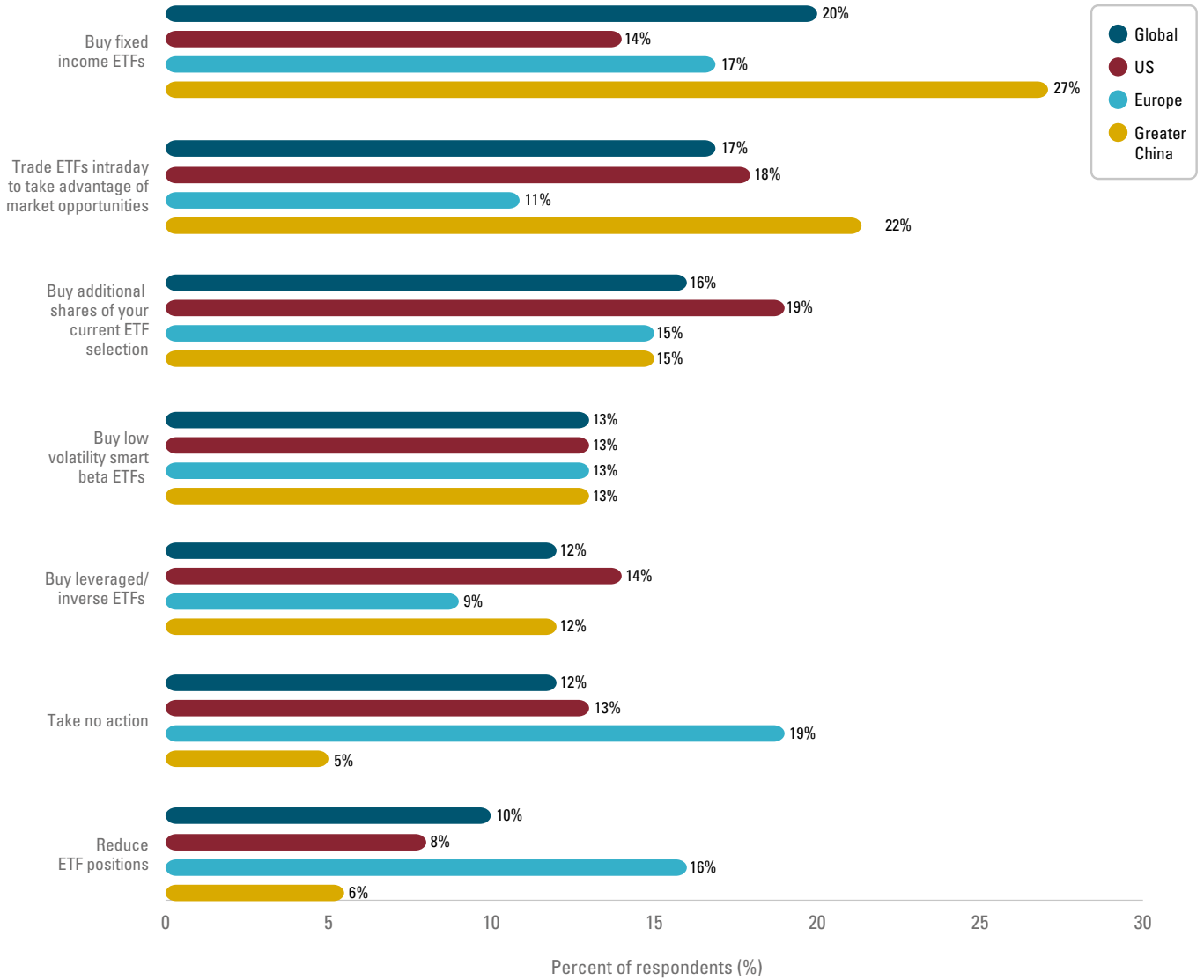


Fixed income ETFs

Fixed income ETF is the top choice for combating market volatility

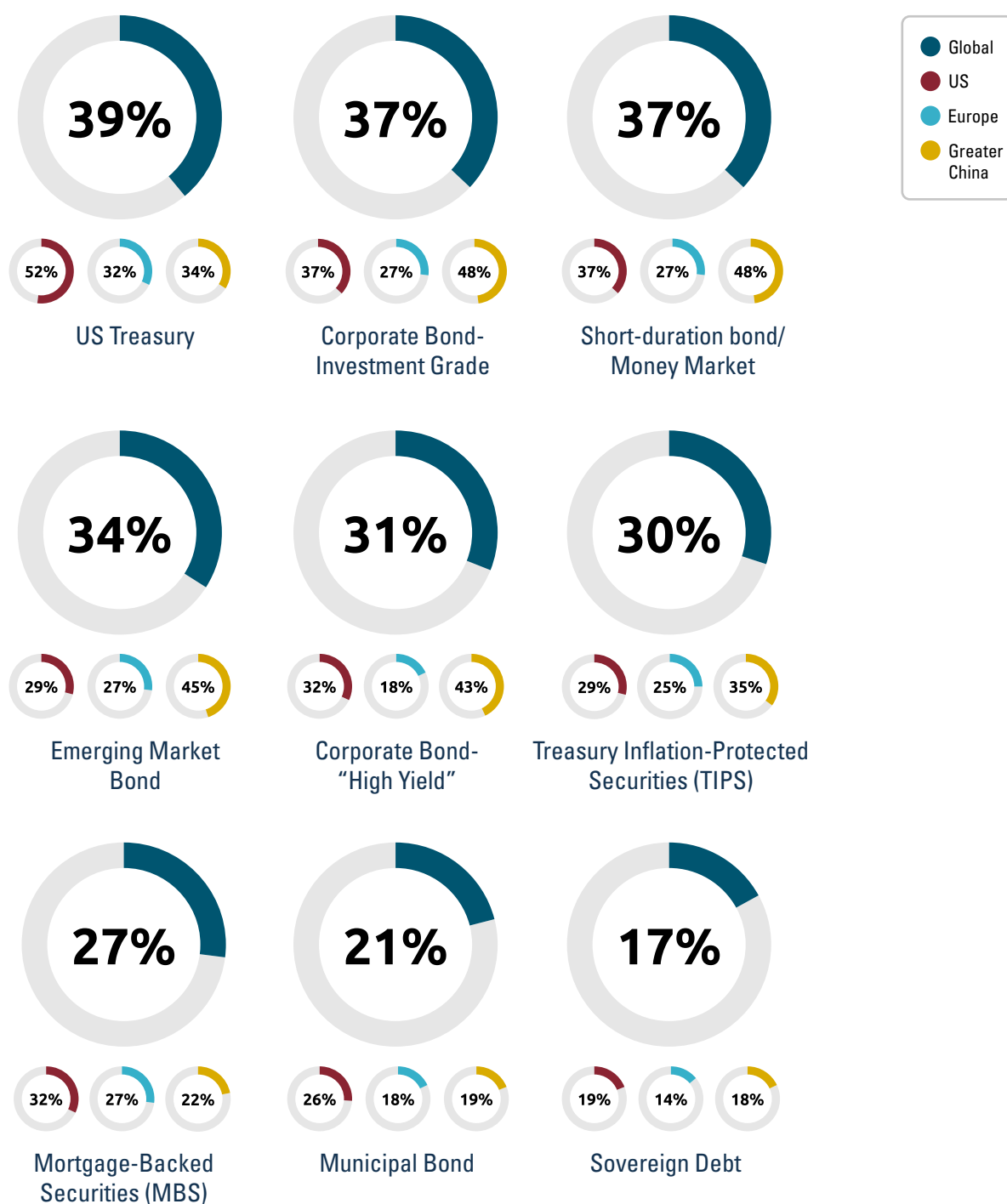
During periods of heightened market volatility, investors across the three regions are most attracted to fixed income ETFs (20%), followed by active ETF trading to capitalize on opportunities (17%).

How will you use ETFs in your portfolio during a period of heightened market volatility?



Investors are attracted to a variety of fixed income ETF types

What types of fixed income ETFs do you plan to add to your portfolio? (Select all that apply)

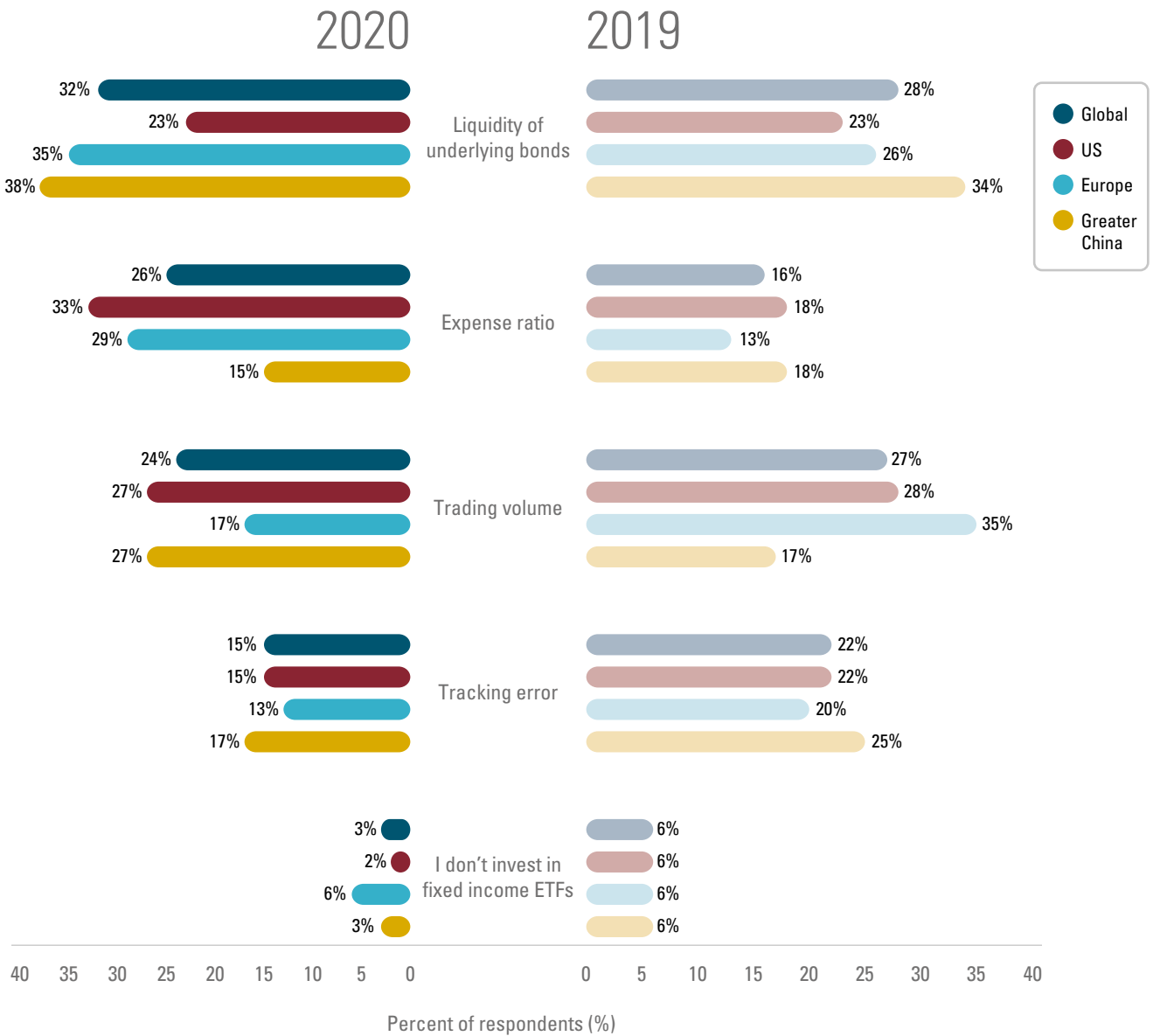


Potential Headwinds for ETFs

Liquidity remains the top fixed income concern

Regarding fixed income ETFs, the main concerns are liquidity of the underlying bonds, expense ratio, and trading volume.

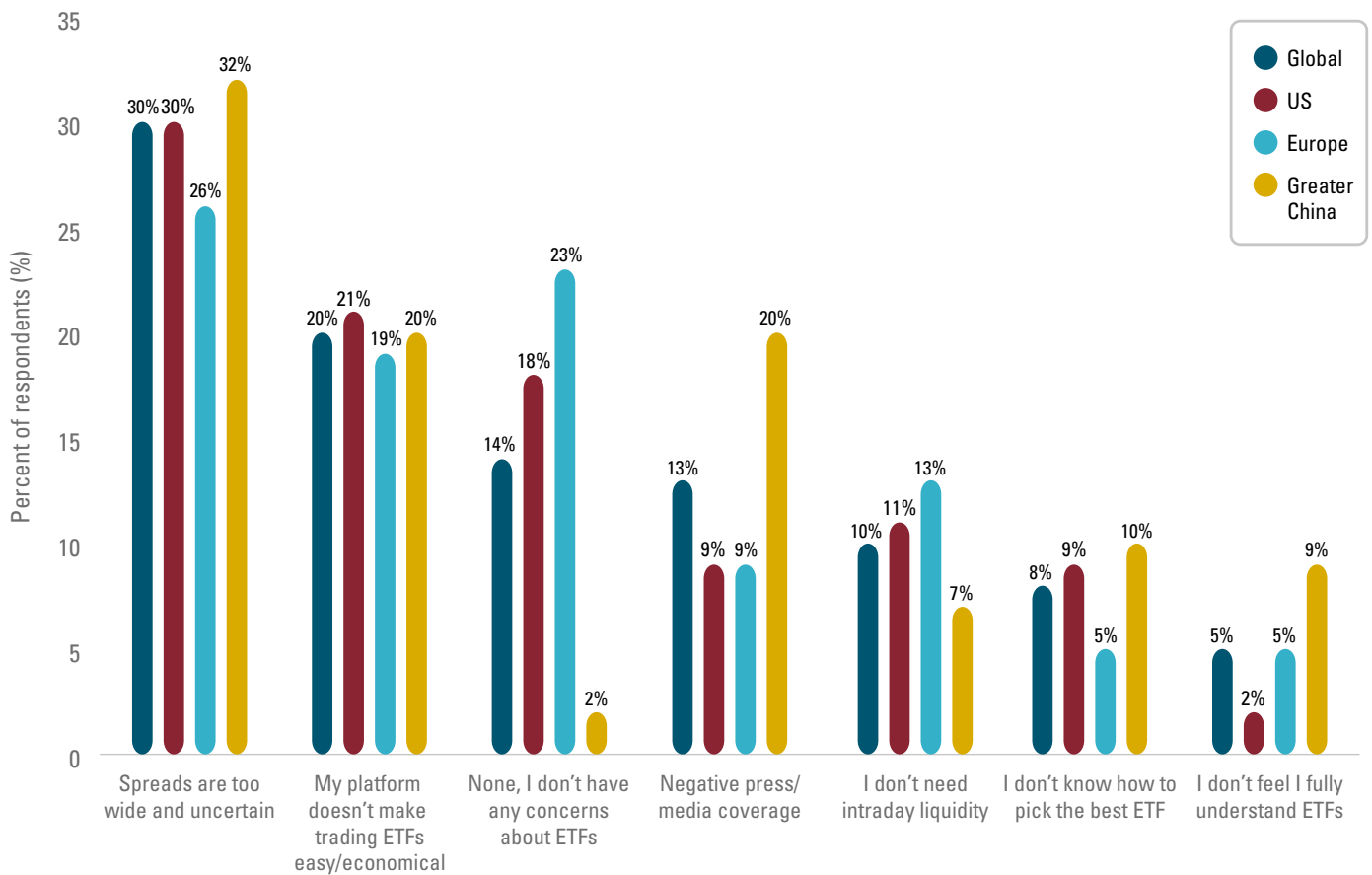
What concerns you most when investing in fixed income ETFs?



Uncertainty around spreads is the chief ETF concern

30% of global respondents stated that ETF spreads are the biggest headwind to further product adoption. This may present an area of continued education from the issuers, as they seek to help investors better understand the impact of spreads in their ETF trading strategy.

What are the concerns about ETFs that keep you from increasing your exposure more than you have already?



Looking Ahead

US

In prior years, our survey found that investors continue to adopt ETFs and are using them in dynamic ways. This year is no different: 72% of US respondents plan to increase portfolio allocations to ETFs and a third already allocate 25-50% of their portfolio to ETFs.

Investor demand for active and fixed income strategies continues to shine. The SEC's recent approval of a number of new types of active ETF structures that do not require daily disclosures of the fund holdings could be a new tailwind for the active segment. The industry will be watching to see how quickly these products are adopted by advisors and institutional investors, but they could add a new crop of managers to the ETF arena. On the bond side, investor demand for income solutions, further institutional adoption, and the potential flight to 'safe harbors' in uncertain market conditions should continue to favor fixed income ETF growth in 2020.

ETF distribution, however, is only becoming more complex for managers. Product closures were off their record pace in 2018, but only slightly: the US market still saw over 100 ETFs shuttered in 2019.⁶ We expect existing ETF issuers will continue to trim under-performing ETFs to manage costs, while new managers coming to market will need to work closely with their intermediary partners to differentiate in a crowded playing field.

Europe

ETFs continue to enjoy phenomenal success in Europe. 2019 saw growth in excess of 20% and in December AUM breached the key milestone of \$1 trillion.⁷ In April 2020 the European ETF industry will enjoy its 20th birthday and some commentators are predicting growth in excess of \$2 trillion by 2024.

Ireland and Luxembourg, where the majority of European ETFs are domiciled, continue to support ETF product innovation including thematic, active, and smart beta ETFs launches across all asset classes. Recent policy changes by the Central Bank of Ireland to permit the co-mingling of listed and unlisted share classes has the potential to spur a new range of products. These products stand to open new distribution channels, creating greater access to new investors, which may help boost ETF growth in the region.

As with last year's survey, European investors are sending a clear message: ESG is immensely important to their portfolio construction. 73% of European investors plan to increase their allocation to ESG investments and ESG is the top asset class they want to see more of in the market. Regulators in Europe are also paying considerable attention to sustainable investing by establishing the "Green Deal," which seeks to define a universal ESG methodology. These factors, combined with the cultural view of ESG investing in Europe, are all key to the future growth of ESG investing in Europe.

Greater China

Momentum for ETF adoption continues throughout Asia Pacific as regulators and exchanges are implementing changes to fortify the foundation in support of the next wave of growth. This includes enhancing liquidity, reducing cost, and aligning with international best practices. Education efforts are gaining traction around the benefits ETFs play in asset allocation for retail investors. Asia Pacific based institutions continue to be active participants, trading ETFs from around the world.

Looking back to the 2019 survey, 63% of Greater China investors had plans to increase their allocation to ETFs, which slightly exceeded the global response of 61%. Investors followed through and added \$68 billion in assets to locally listed products in Greater China over the last year. This represented a 63% increase in assets in Greater China ETFs. Greater China accounted for over 73% of all ETF flows last year in Asia Pacific (excluding Japan).⁸ In this year's survey, 72% of respondents in Greater China confirmed they were planning to increase their ETF investments this year. Flows are expected to remain robust in the region as the regulatory reform agenda in Mainland China could push further ETF adoption in 2020.

ETF issuers continue to evaluate their product line-ups and look for opportunities to bring new innovative product to the market. As highlighted in the survey, thematic ETFs are generating interest with respondents most interested in internet/technology, robotics, and ESG. In Hong Kong, the Securities and Futures Commission (SFC) recently announced streamlined eligibility requirements for ETFs by adopting a master-feeder structure. In addition, the first actively-managed ETF was launched in Hong Kong in 2019. We expect other asset managers to leverage the ETF wrapper in 2020 for their active investment strategies and to try to capitalize on the outsized demand for active investment in the region.

⁶ETF.com, November 2019

⁷ETFGI, December 2019

⁸ETFGI, December 2019

If you would like to discuss the survey or learn more about ETFs, please let us know. We look forward to collaborating with you. www.bbh.com/etf



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