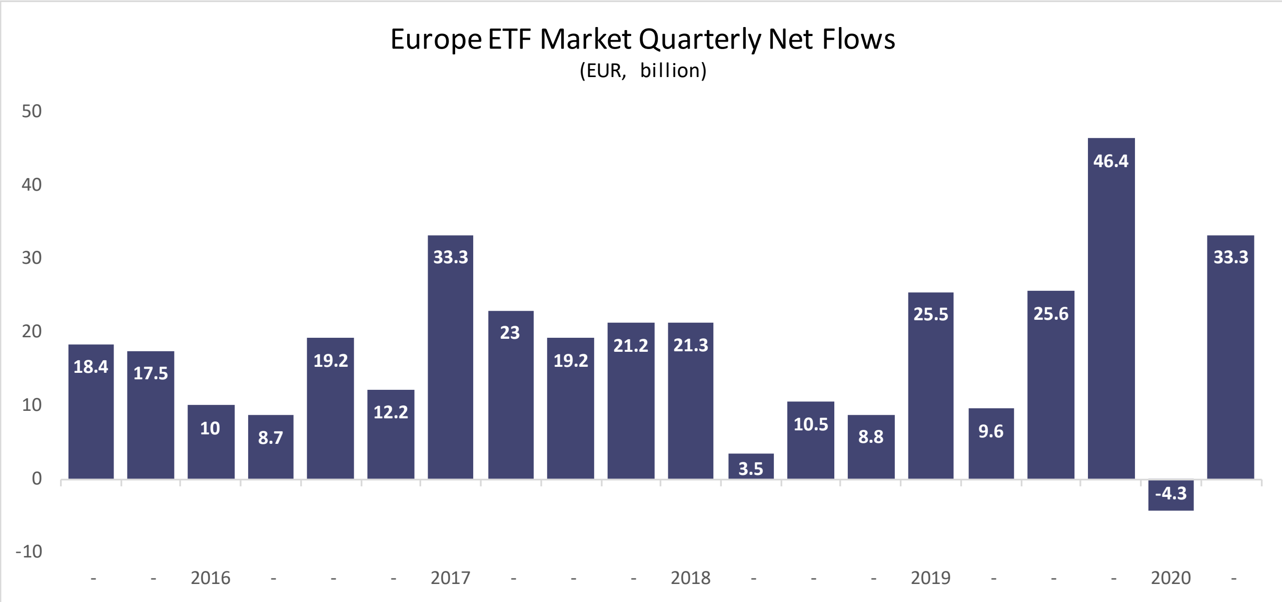
ETFs return to favour post-Covid crisis

European exchange traded funds (ETFs) have made a remarkable comeback in the last few months after a massive sell-off at the start of the coronavirus crisis. We take a closer look at what is driving this, and which types of ETFs are doing best.

When the coronavirus began to spread around the world in March and markets crashed, panicked investors pulled money out of ETFs by the billions. This brought an ETF rally that had run throughout 2019 to an abrupt end, and some commentators suggested it could be a long road back for such funds. But markets have since turned around, and with them ETF fortunes.

Investors put more than EUR 33 billion into ETFs in the second quarter of the year, according to research from global fund ratings and research agency Morningstar.

Meanwhile, total exchange traded fund assets are on course to reach EUR 1 trillion in 2020, the group says, reaching EUR 903 billion at the end of the quarter.



Source: Morningstar Direct. Data as of 30/06/2020.

The news of the inflows may not at first seem a complete surprise given that many equity markets delivered stellar performance in the second quarter of the year.

The S&P 500 index was up more than 20% for the quarter, and major benchmarks in Europe and Asia also posted double digit gains.

But 70% of the inflows in the period – EUR 23 billion – went into bond ETFs, Morningstar data showed.

The group says this was driven by the stimulus packages unleashed by central banks around the world.

Morningstar analyst Jose Garcia-Zarate, said: “The second quarter was a period of solid flows for bond ETFs, with investment-grade credit at the forefront of investors’ preferences.”

Figures from Bloomberg show that investments into exchange-traded funds tracking corporate bonds grew at a record rate in June. Inflows into broad credit ETFs in the month stood at USD 18 billion – the highest on record.

Meanwhile the USD 9.8 billion inflows into aggregate bond funds was also the highest ever, as was the USD 3 billion into ETFs investing in inflation-protected securities and USD 2.4 billion into municipal-bond products, according to the financial news and research group.

The inflows for bond ETFs vastly outstripped inflows for equity ETFs, which only recovered in June after finishing the first two months of the second quarter with outflows overall.

However, data on ETF inflows confirmed a wider trend that has been seen during the coronavirus crisis: ESG – or environmental, social and governance – ETFs, drew in EUR 6.7 billion. Equity ESG investments fared much better than their mainstream peers, according to Morningstar.

As we wrote in View From The Dome May 2020, ESG funds weathered the worst of the pandemic-induced market crash better than conventional peers, outperforming them considerably in some cases, for reasons both specific to the crisis and rooted in the long-term philosophies behind sustainable investing.

Anaelle Ubaldino, a quantitative financial adviser at Koris International, a French investment advisory firm, told the Financial Times in July, “In the coronavirus crisis a lot of businesses might suffer from the stop in the global economy. ESG is not just about the environment, it’s social and governance with respect to cash flows. It might be that those ESG funds are going to see a lot more traction.”

Meanwhile, Morningstar’s research also showed that interest was greatest in three equity sectors: technology, healthcare, and industrial materials.

Tech shares have led the post-Covid market recovery and the tech-heavy Nasdaq index was one of the few major benchmarks to be in positive territory for the first half of the year. Experts say they have benefitted from trends in lockdown, including working from home, teaching over the internet, a sharp rise in online shopping, and greater demand for online entertainment services.

Healthcare stocks have also become more interesting for investors as companies look to develop coronavirus treatments and vaccines.

Morningstar’s Garcia-Zarate explained that the group’s findings highlighted how investors are viewing the economic future as the crisis continues.

“This signals that investors made very pointed investment decisions to fit the expectations of how the economy might respond and evolve to the unfolding Covid-19 crisis,” he said.

The data has also underlined where investors remain reluctant to put their money with emerging markets being largely shunned.

Emerging market stocks saw steep outflows at the start of the crisis as investors worried about the effects of Covid-19 on less developed healthcare systems and economies.

Outflows from emerging market funds totalled more than USD 83 billion in March, according to data from the International Institute of Finance (IIF).

They have since recovered to an extent and in June gained 9%, as measured by the MSCI Emerging Markets Index.

“Stabilising financial conditions in major emerging markets reflect a swift and well-orchestrated response from global policymakers to suppress systemic market turmoil from the pandemic,” Rahul Ghosh, Senior Vice President of Emerging Markets Research at Moody’s, told Gulf News.

“In global emerging markets (EM), capital flows, equity markets, bond spreads and – to a lesser degree – economic sentiment have begun to calm,” Ghosh added.

However, experts warn that developing markets will remain vulnerable to ongoing negative pandemic developments even as their economies re-open, as they continue to come to terms with lost economic output and subsequent higher government debt burdens.

"The coronavirus outbreak and its aftermath may accelerate the trend toward a more splintered and protectionist global economy, weighing on EM trade prospects well after lockdowns ease," Ghosh explained.

But while emerging market ETFs may not be drawing in investors, the ETF industry appears set to continue growing.

According to a report in the Financial Times in July, there were record listings of new ETFs in the second quarter of the year. While there were 435 ETFs and exchange traded products launched worldwide in the first six months of 2020 – roughly the same as in the same period in the previous two years – listings hit 113 in June, well above the previous June record of 86 set in 2016.

As the FT put it: "It seems not even the pandemic of the century can stop the juggernaut of the ETF industry in its tracks." ■

What is an ETF?

An exchange traded fund (ETF) is an investment fund made up of a group of companies. When you invest in an ETF you are not buying shares in one company but in a whole lot of companies. For example, you can own a piece of every one of the 100 companies listed on the London Stock Exchange by investing in an ETF that tracks the FTSE 100.

ETFs can be made up of different types of investments such as equities, bonds or commodities. As mentioned above, ETFs often track a specific index, such as the FTSE or S&P 500.

An ETF is called an 'exchange traded' fund because they are traded on an exchange just like stocks, meaning the price of an ETF may change throughout the day. This is different to mutual funds which typically trade once a day after markets have closed.

What are the benefits?

Diversification – investing in an ETF allows you to own a piece of a range of assets, instead of investing in just one company. This way you avoid 'putting all your eggs in one basket'.

Accessibility – ETFs open up the share market to a wider audience by allowing investors with lower amounts of money to access the same investments as wealthy private portfolio clients. For example – to buy a single share in Amazon today costs more than USD 3,000 but for USD 300 you can own a piece of every tech company that sits on the Nasdaq.

Lower fees – ETFs tend to have lower fees than other types of investments simply because they are tracker funds and don't require analysts and researchers to determine where the fund's money should be invested.

Liquidity – ETFs are traded on an exchange so can be sold whenever there are interested buyers.

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