Nordic ETF Trends 2020

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2020 A TURNING POINT FOR ETFS

Last year was special and not only due to the ongoing pandemic. It was also a year of ETF anniversaries. Not only did we host our fifth annual ETF roundtable but the global ETF industry celebrated its 30th anniversary in March 2020. Furthermore, April 2020 marked the 20th anniversary for the European ETF industry. You can read more about this on page 22.

Having postponed our annual ETF roundtable discussion from the spring to the end of the year in the hope of being able to gather people in person, we eventually ended up in front of our screens for a digital version. Our roundtable discussion was, as always, a great forum to receive an update about the development of the Nordic ETF market – this time with representatives from DWS, HSBC Asset Management, Invesco, JPMorgan Asset Management, State Street SPDR ETFs and UBS Asset Management. This year's discussion covered a broad range of topics but with some deeper dives, especially into ESG and fixed income. With regards to fixed income, one of the participants said that "we can probably state that 2020 marks a turning point in the acceptance of fixed income ETFs as an instrument by investors". A summary of the roundtable discussion starts on page 12.

Enjoy and please stay in touch. We look forward to hosting this year's roundtable in Stockholm (or digitally...) on September 23.

Niklas Tell
Tell Media Group

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Sponsors:

The new generation of Sustainable ETFs

from the World's Best Bank for Sustainable Finance[1]

As the topic of sustainability becomes more and more mainstream, the demand for investment solutions that have positive impact are rapidly growing. Long-term equity returns are becoming driven by companies that look after the environment, care about people and are properly governed. The companies best positioned to deliver sustainable solutions stand to benefit, making it logical for investors to pursue an investment strategy that prioritises sustainability among other factors, without sacrificing returns.

That is the driving force behind the **HSBC Sustainable Equity ETFs**, designed to take a step beyond traditional sustainable ETFs into a new generation.

Innovation through collaboration

Companies are consistently looking to transform their operations and adopt new business models to become more sustainable, more efficient and more conscious of the impact in society. HSBC has been, and remains, at the forefront of this transition, partnering with businesses and government authorities to provide sustainable solutions that accelerate change.

We have collaborated with FTSE Russell; a world leader in the creation and management of index solutions and founding member of the PRI (Principles on Responsible Investment), to develop indices with an innovative 3-tilt approach which goes beyond the typical market offering to build a new range of sustainable solutions.

Traditional ESG index-based strategies are generally focused on one or two factors, meaning that investors have faced a trade-off between generating the sustainable uplift they desire, whilst maintaining low tracking error and minimising sector divergence.

The FTSE Russell ESG Low Carbon Select Indices, which use FTSE Russell's Target Exposure methodology, have broken this boundary, introducing a new offering with three tilts through a clear and robust methodology.

20%

ESG improvement tilt

The ESG ratings and data model, sourced by FTSE Russell, allows investors to understand a company's exposure to, and management of, ESG issues in multiple dimensions.

50%

Carbon Intensity reduction tilt

The indices include carbon intensity as an independent tilt to ensure the impact of CO_2 emissions is explicitly captured in addition to the ESG rating. FTSE Russell sources this data from TruCost, a renowned and experienced third-party provider of data, tools and insights.

50%

Fossil Fuel Reserve Intensity reduction tilt

Due to the evolution of the energy industry, we chose an index that tilts towards stocks with lower reserves intensity, including alternative energy companies.

1. Source: Euromoney 2020 "World's Best Bank for Sustainable Finance".

Any forecast, projection or target where provided is indicative only and is not guaranteed in any way. HSBC Global Asset Management accepts no liability for any failure to meet such forecast, projection or target. Representative overview of the investment process, which may differ by product, client mandate or market conditions. The views expressed above were held at the time of preparation and are subject to change without notice.

"This innovative triple tilting process – developed together with FTSE Russell – allows us to target a 20% improvement of the various ESG strategies compared to their reference universes. This approach, combined with our focus on minimising tracking error, enables us to target performance returns while simultaneously meeting clients' ESG and financial requirements."

Xavier Desmadryl, Global Head of ESG Research

In addition to overweighting and underweighting stocks according to these factors, the indices take into consideration country neutrality and, within set bands, sector neutrality, vis a vis the parent market cap indices, and incorporates a custom exclusion list based on UN Global Compact Principles and other sustainability factors.

We are stewards of our clients' money

Passive investing does not mean being a passive investor. One natural concern among the investors community when it comes to sustainable investing is shareholder engagement. HSBC Global Asset Management is an active steward of the assets managed on behalf of clients. As an early signatory of the PRI in 2006, we are committed to responsible investing and do so by driving positive behaviour and promoting high standards.

HSBC Sustainable ETFs – sustainable by design and approach

Combining our responsible investment and ETF expertise was a natural step in the right direction for us. Our range of new sustainable ETFs provides investors with exposure to developed and emerging equity markets at global, regional and country levels. The funds aim to replicate the performance of the underlying indices while aiming to minimise the tracking difference between the fund and the index. This is achieved through our consistent implementation approach focused on both risk and costs that leverages our 30+ years' experience and leading proprietary technology.

Combining our ESG experience with our financial capabilities is in our DNA

We are a leading partner in the transition to a low-carbon world and we are committed to supporting responsible economic growth and enabling the low-carbon transition using our deep experience of sustainable finance.

HSBC Asset Management

Together we thrive

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Diverging Nordic investor opinions on ETFs

Nordic asset owners share their thoughts on ETFs and how the investment vehicle fits or doesn't fit into their investment strategies.

By: **Janina Sibelius**

ETFs have been around since the 1990s but have only recently started gaining popularity among Nordic investors. In Finland, the country's two largest pension companies Ilmarinen and Varma, with EUR 50.3 billion and EUR 46.8 billion in assets under management respectively, have dived straight into the deep end and partnered up with ETF providers to develop their own bespoke vehicles. However, interest has stayed lukewarm among institutional investors elsewhere in the region.

Gustav Karner, CEO of the SEK 12.4 billion (EUR 1.2 billion) Apotekets Pensionsstiftelse, says that mutual index funds and futures have so far worked well for the pension fund. "Mutual index funds and futures work fine for me as you know what you get," he notes, pointing out that in addition, mutual index funds often also have lower fees. However, he does admit that ETFs might give an edge to an investor wanting to execute tactical trades. "Maybe if you do tactical asset allocation (TAA) and make a lot of changes but I don't believe in TAA," he comments.

Where smaller investors often opt for mutual funds, the larger investors have more resources to experiment. Henrik Olejasz Larsen, chief investment officer of Sampension in Denmark, says the pension company uses futures for general short-term tactical changes in risk. "[They] are flexible, often more liquid and bind less cash," he explains. However, he says that in some instances when the aim is to express a tactical sector view, Sampension uses specialised ETFs. "We've also used specialised ETFs as a liquid buffer in our allocation to alternatives," he explains.

However, Henrik Olejasz Larsen notes that the core of the pension company's holdings is allocated in its own negotiated mandates in listed equity in the form of units kept under Sampension Invest. He says this setup allows the investment team to implement its own ESG exclusions and to vote and engage with companies, as well as being cost and tax efficient. "In some of the mandates, for instance in emerging markets, we also pursue active strategies that are not available in ETFs," he explains. He adds that ETFs are used for shorter term adjustments to the exposure, including both tactical views and rebalancing in the portfolio.

Juha Venäläinen, senior portfolio manager for cross asset allocation at Ilmarinen, says the pension fund uses derivatives and mutual index funds in combination with ETFs depending on what the investment team wants to achieve. However, when it comes to ESG, Ilmarinen has taken the initiative to address the lack of suitable products on the market by teaming up with asset managers to develop ETFs that suit its needs and enables it to address ESG according to its own requirements. "The benefit of using ESG ETFs instead of index funds is the greater impact we get on ESG awareness," he notes. Ilmarinen has created ETFs with an ESG tilt together with Lyxor, DWS Group, Blackrock and Amundi and currently holds a sizeable EUR 5 billion ESG ETF allocation, which accounts for approximately 90 per cent of the pension company's total ETF holdings.

Others, however, still prefer to use mutual index funds. Gustav Karner says he does not think that adding an ETF wrapper is a better way to include ESG aspects in the index than just using a regular fund structure. "There are plenty of mutual ESG index funds, even for emerging markets," he says.

Juha Venäläinen says there are other factors as well that influence Ilmarinen's decision to use ETFs. One is their flexibility. "In smaller trade sizes, you benefit from the ease of trading," he says. He observes, however, that the pension company uses derivatives in tactical trades as they are more cost efficient. "ETFs tie capital. This benefits the long-term investor in a negative rate environment," he notes.

Timo Sallinen, head of listed securities at Varma, agrees.

"ETFs are a transparent and flexible way to adjust the equity risk and the equity allocation in the portfolio," he says. He notes that the more liberal redemption process of ETFs gives investors more flexibility when it comes to making decisions regarding their investment. "If you need to redeem your assets from a mutual fund, it takes time, even days. There are no such delays with ETFs," he explains.

Gustav Karner also agrees that ETFs are easier to trade if liquidity is needed "in seconds". However, he says that for Apotekets Pensionsstiftelse, mutual index funds and futures are cheaper and efficient enough to use. He adds: "In some cases, you can also 'trade' mutual index funds at net asset value the same day you place the order, so you don't have days without exposure."

Timo Sallinen notes, however, that executing investment decision is one of the clear benefits of ETFs. "In mutual funds, the process of subscription or redemption is too slow for institutional investors' active part of the investments," Timo Sallinen explains. He says that although Varma has gained many benefits from using ETFs, he is by no means dismissing the use of traditional index funds, which still have their place in the pension company's investment strategy.

"Of course, it's easier to just select from existing funds the ones that suit our needs. You save a lot of time and effort in not getting involved in the actual creation work of a financial instrument. However, going through this development work and really getting to know ETFs as an investment vehicle has given us valuable insight into how ETFs work, especially in the ESG world and how they can be shaped to fit our specific needs," says Timo Sallinen. He adds that developing its own ETFs has also made the investment team more sophisticated and given it an edge when it comes to using ETFs to adjust equity risk.

Most importantly, by developing ETFs, the Finns say they have managed to address ESG issues in a way they haven't been able to do when investing in a mutual fund. Juha Venäläinen says that the ETF wrapper also increases ESG awareness in the market. "ETFs provide cost-efficient diversification. The traditional disadvantage has been the exposure to unwanted companies. However, that problem has diminished by using ESG or other filtered indices," he says.

Timo Sallinen adds that developing a bespoke ESG ETF product is easier than setting up a mutual fund. "We're a pension fund and therefore a single ETF product is much easier to develop than a fund. We can create an investment instrument that totally suits our needs," he says. As Varma has become more familiar with the pros and cons of the process of building an ETF from scratch, he says the pension company is more inclined to use the vehicle in the future as well.

Invesco

Invest responsibly without having to compromise

You need only to glance at fund flows over the past two years to see clear evidence of the growing popularity of ESG (environmental, social and governance) investments. In fact, over the first 11 months of 2020, more than 70% of the net new assets going into equity ETFs listed in Europe were captured by funds with an ESG approach. The increased demand is being driven by multiple factors, including the impact of tighter regulation, a brighter public spotlight on several key global issues and a growing belief that ESG strategies can actually be positive for financial outcomes.

Yes, that's right, ESG investing could be beneficial not only for the world around us, but for us as investors. The latter development attacks the decades-long perception that ESG funds were doomed to underperform non-restricted alternatives, which limited their appeal to a broader set of investors, including those whose fiduciary duty meant interpreting 'responsible investing' from a performance perspective. The regulators are now forcing asset managers and owners to start looking differently at ESG, and recent performance suggests investment returns may not need to be sacrificed to do so.

Before we get ahead of ourselves, let's be reminded that ESG is a very broad category comprising many different strategies with different objectives and risk-return profiles. Indices applying the "lightest touch" simply exclude companies in the most controversial business areas, while others apply an even stricter list of exclusions. However, indices launched more recently go beyond just exclusions by also either tilting whereby greater weight is given to companies with higher ESG scores (and lower weights to those with low scores) or adopting a "best in class" approach whereby only companies with the highest ESG scores in each sector make it into the final index.

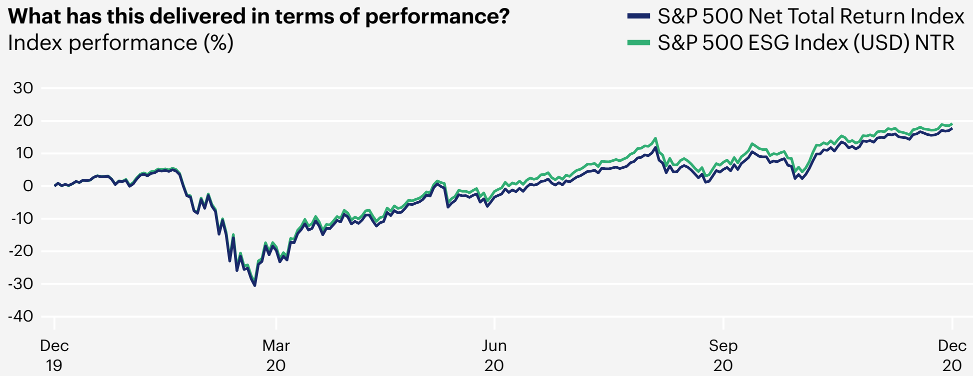
The potential downside to an index that reduces the number of constituents is that performance is likely to deviate from the starting, or parent, index. Typically, the greater the exclusions, the greater the tracking error, with some best-in-class indices (and in turn the ETFs designed to follow them) excluding up to 75% of the index.

Benchmark-like performance but with an improved ESG profile

But what if you're like the growing band of investors who need an ESG investment that performs similarly to the parent index? Many investors are beginning to use ESG ETFs as direct replacements for existing (non-ESG) core holdings and, as such, are looking for similar exposure as they currently have but with improved ESG characteristics.

Take for example the S&P 500 ESG index (the reference benchmark for the Invesco S&P 500 ESG UCITS ETF). The index starts with the existing 500 names, filters out any that are involved in controversial business practices, such as tobacco, thermal coal and controversial weapons, and those with ESG scores that place them in the bottom 25% of their industry. The resulting index avoids the main offenders but is broadly sector-neutral compared to the parent index, plus offers significantly lower carbon intensity and higher aggregate ESG scores.

What has this delivered in terms of performance?
Index performance (%)



Securities (%)	Dec 19 – Dec 20	Dec 18 – Dec 19	Dec 17 – Dec 18	Dec 16 – Dec 17	Dec 15 – Dec 16	Dec 19 – Dec 20	Dec 17 – Dec 20
S&P 500 ESG Index (USD) NTR	19.13	32.54	-4.54	20.48	11.75	19.13	50.73
S&P 500 Net Total Return Index	17.75	30.70	-4.94	21.10	11.23	17.75	46.29

Data: Bloomberg, net total return index returns in USD, as at 30 September 2020.
Past performance is not a reliable indicator of future returns.

Concluding thoughts

With many diversified portfolios now being constructed entirely of ESG ETFs, it's also interesting to consider ways to use them most effectively. That could be related to risk allocation, whereby some core holdings have relatively low tracking error to the broader benchmark, such as the S&P 500 ESG for large cap US equity exposure. And with an annual management fee of just 0.09% per annum, an allocation to the Invesco S&P 500 ESG UCITS ETF could leave you with more of your risk budget to spend on other areas of your portfolio as well as potentially saving you in overall costs. After all, we believe you should be able to invest responsibly without compromising on performance or cost.

ESG - important driver for ETF flows in 2020

In December, **Tell Media Group** gathered **DWS**, **HSBC Asset Management**, **Invesco**, **JPMorgan Asset Management**, **State Street SPDR ETFs** and **UBS Asset Management** to discuss trends within the ETF industry. Tell Media Group founder Niklas Tell moderated the discussion.

By: **Niklas Tell**

This year's ETF roundtable kicked off with Niklas Tell asking the participants to look back at and share their thoughts on some of the key developments over the past 12 months.

FLORIAN CISANA: "I assume that everyone has seen similar trends in the market due to the significant impact of Covid in Q1 and the following months. We saw large outflows, especially from market-cap ETFs, in the first quarter, which hasn't really recovered since. We have, on the other hand, seen inflows into fixed income ETFs, especially after the Fed made its announcement that it's buying ETFs on US corporates and that continued in the second quarter. In the second quarter, we also saw investors starting to focus on their ESG-related project again, something that was halted earlier in the year due to the market turbulence, basically analysing how they want to integrate this change in their portfolios. This resulted in increased inflows into equity and fixed income ESG ETFs from the second to the fourth quarter. By end of the year, we've seen that ESG ETFs have attracted more net inflows than traditional ETFs. Another trend that picked up in the second half of the year was some big factor rotations and also increased focus on certain thematic ETFs."

PETER LIDBLOM: "I know that we're going to discuss ESG separately but I think it's worth picking up on what Florian said on investors taking a pause in the second quarter. I think what we actually saw was more of a shift. When investors started buying equities again, they moved away from the traditional benchmark and into our ESG versions instead. Also, when it comes to fixed income I think the Covid situation, although terrible in every way, put the spotlight on fixed income ETFs and how they function. There were a lot of misunderstandings in the market about what was happening with fixed income ETFs in the spring. They were trading at a discount to the NAV and that provided us with a lot of opportunities to speak to clients and explain that this was a good thing: that the ETF is actually the price discovery tool that fixed income investors need."

CHRISTOPHER MELLOR: "Obviously, ESG was a big topic this year and we can clearly see that on flow statistics. Another key area where we saw a lot of interest this year was thematics, especially after the sell-off in March and the concerns about cyclical growth. That really focused investors' minds on the areas where they potentially could get secular long-term growth stories. So we saw significant flows into things like biotech and blockchain related ETF products and also into things like the Nasdaq 100, which provides exposure to the big tech names that should be well positioned for the Covid working environment. The final thing I would like to add is the increased interest in synthetic replication. This was a big subject in 2019 and we saw massive inflows into synthetic products on certain key US benchmarks such as S&P 500 and MSCI USA."

ANTOINE LESNÉ: "Obviously, we all work with the same transparent data, which is a nice feature of ETFs versus other vehicles, so I very much agree with what has been said about ESG and fixed income. With regards to fixed income, it seems as if 2020 will be the second best year in terms of inflows in Europe and we can probably state that 2020 marks a turning point in the acceptance of fixed income ETFs as an instrument by investors. Another important area of flows has been gold, both in Europe and in the US. It's a tool that has been used by investors to hedge against the potential consequences of the monetary policy, which could lead to inflation, as well as a defensive play."

OLGA DE TAPIA: "I just wanted to add some data on the ESG growth we're all talking about. In March and April, we saw outflows from market cap ETFs of about USD 7.7 billion but at the same time inflows into sustainable ETFs of some USD 13 billion. In the third quarter, the European sustainable market grew by some 10 per cent, according to data from Morningstar. We now have almost USD 900 billion of assets under management in sustainable ETFs, which is a spectacular growth. Also, it's not only institutional assets but retail clients as well. We've launched a sustainable range of funds targeting retail clients. At first, we didn't see much interest but after the pandemic hit in March, the flows have been fantastic."

TOBIAS NILSSON: "We spoke about ESG and fixed income last year and 2020 has essentially been the year when that really materialised. ESG ETFs saw more inflows that non-ESG ETFs and this spring was the first real stress test for fixed income ETFs. To Peter's point, I think the price discovery mechanism provided by ETFs is more recognised today and if anything, it shines a light on other vehicles. Investors also voted with their feet. When clients needed to exit in March, they did so in record volumes via fixed income ETFs and when the markets turned around, we again saw huge inflows."

NIKLAS TELL: IS THE CONCLUSION THAT ETFS WORKED AS THEY SHOULD DURING THE TURBULENCE IN THE SPRING?

OLGA DE TAPIA: "Peter mentioned earlier about fixed income ETFs working as price discovery tools and I agree. Clients saw that it was an instrument they could trade and it provided liquidity, so ETFs proved again that it was the perfect instrument in a crisis."

PETER LIDBLOM: "What happened last spring was very interesting. The fact that there was such a tiny proportion that had to go to the primary market shows the resilience and that extra level of liquidity that ETFs provides. So again, it was a phenomenal stress test and most ETFs passed with flying colours."

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OLGA DE TAPIA
HSBC Asset Management
Global head of ETF sales. Before joining HSBC Asset Management in 2018, she spent more than 11 years at BlackRock as senior emerging market debt product strategist and also as iShares business development manager for Iberia.

ANTOINE LESNÉ: "I agree. For example, trading in high yield ETFs normally account for some 20 per cent of the total volume and that increased to 30 per cent in March when people needed liquidity. That ability to help investors transact into the exposure they desire clearly captures the value of ETFs and it's something that has been proven again and again."

NIKLAS TELL: ARE YOU STILL TALKING TO CLIENTS ABOUT THE WRAPPER ITSELF OR HAVE WE MOVED PAST THAT? OR DID THE EVENTS IN MARCH ACTUALLY BRING THIS BACK TO LIFE?

ANTOINE LESNÉ: "We've done a lot of work over the past 10 years in terms of explaining the wrapper and how it's different from funds. However, we must still explain to the ones that are more sceptical, like some institutional investors – the ones managing the bigger pools of assets."

PETER LIDBLOM: "I think we need to make a distinction here between the different regions within the Nordics because there are regional nuances. We all know that Finnish investors know a lot about ETFs, both equity and fixed income. Similarly, Denmark is also advanced on the institutional side. But the market in Sweden is still a bit fragmented and I still think there's an awful lot that we as an ETF community can do to raise the awareness of ETFs. There are, of course, advanced users in Sweden as well and we all know who they are but the general adoption of ETFs is not as big in Sweden as in the other Nordic countries. I would be interested to hear from the other participants about your experience."

CHRISTOPHER MELLOR: "I can't think of the last time I had to explain what ETF stood for. So that's a clear sign of progress compared to some five years ago when most conversations started with explaining the basics of how it works. I think the conversation has moved on and it's now much more nuanced around what's happening inside the ETF. The events we saw in March brings that very clearly into focus with questions such as why a fixed income ETFs would trade at a premium or discount. In recent years, I've also talked a lot about the details of the underlying replication methodology – whether you're doing full physical application, physical sampling or whether you're using synthetic replication and what the advantages and disadvantages are. Synthetic replication is a trend that we've seen in certain markets and understanding the minutia of how a synthetic ETF works, how to structure it, how the counterparties work, how to monitor and control risk and all of those details have been hugely important, in particular for institutional investors that are digging into this area. So it's a much more nuanced conversation than it used to be."

FLORIAN CISANA: "To add to some of the points raised by my colleagues previously, starting with Christopher who mentioned synthetic replication. We've seen a similar trend, particularly when it comes to US and China equities. Synthetical replicated ETFs managed to outperform physically replicated ETFs due to the pricing of the swaps for those markets. Then, coming back to what Peter said on fixed income ETFs, I've found that we were able to have a lot of very good discussions with fixed income ETF investing portfolio managers in order to help them understanding that what they were observing in this volatile market was correct - meaning fixed income ETFs have become a great instrument for price discovery. Many of our clients felt comfortable to trade bonds but not necessarily bond ETFs, particular in difficult market situations like we have seen in the initial phase of COVID. I felt that was a nice experience. The industry had a lot of headwind from regulators and from the active side saying that ETFs are bad, so it's nice when clients start to understand that there are significant advantages in ETFs. Then commenting on Peter's question on different Nordic countries, I agree that there's a wide range of ETF knowledge among Nordic investors. When I started to work in the Nordics two years ago, I assumed the penetration of ETFs in client portfolios would be much higher. In fact, now 2 years later, I think it's on average much lower than in other European countries. I think one of the reasons is an overall lower allocation to passive and another reason that within the passive pocket, index trackers are often the preferred solution. ETFs have so far typically been used for tactical reasons or for niche products where no index trackers exist."

OLGA DE TAPIA: "I agree that we're having less of these more basic discussions in Europe but we still have them in Asia and in Latin America. In the Nordics, investors are much more open and agnostic when it comes to index providers or how to achieve the preferred ESG exposure. That's very different from Belgium, the Netherlands or France, for example, where it's much more about labelling and regulation."

ANTOINE LESNÉ: "In terms of the adoption and penetration of ETFs in different countries in the Nordics, I wholeheartedly agree with Finland and Denmark. Those markets are also euro markets – or pegged to the euro in the instance of Denmark – and therefore have more products to invest into. I think that's one explanation, especially when it comes to fixed income. This also applies to Switzerland to some extent, which also is a small country with its own currency. That domestic exposure is not as well supplied in terms of products by bigger ETF providers."

TOBIAS NILSSON: "Just coming back to your question on the wrapper itself. For us as an active house and an ETF provider, the lines are becoming increasingly blurred as we can have a strategy available as an active ETF, in an active mutual fund or as a segregated mandate. I definitely see an increasing trend of clients being more agnostic to the vehicle and that the strategy itself is the focus. But having said that, it's then usually up to us in the ETF world to demonstrate how we compete on the cost of trading etc and to quantify the different routes. And more often than not, we come out on top, which is great."

> "I think we need to make a distinction here between the different regions within the Nordics because there are regional nuances"
>
> *– Peter Lidblom, DWS, Xtrackers*

PETER LIDBLOM: "Coming back to different countries I must say that it's only in Sweden where we have conversations to explain the benefits of ETFs versus index funds and need to educate clients on how ETFs are more transparent and the liquidity that you get with an ETF compared to an index fund."

FLORIAN CISANA: "I think there's huge potential in Sweden to shift from index funds to ETFs but I'm still at the beginning of understanding the pockets of index trackers in Swedish clients' portfolios, in particularly those by banks. I agree with Peter and we're also working on educating clients about the benefits of ETFs."

NIKLAS TELL: WHERE WOULD YOU SAY THAT WE ARE TODAY IN TERMS OF HOW INVESTORS ARE USING ETFS? IS IT STILL VERY MUCH A LIQUIDITY TOOL, ESPECIALLY AFTER THE EXPERIENCE IN THE SPRING, OR IS IT ALSO BECOMING MORE OF A CORE HOLDING IN PORTFOLIOS?

PETER LIDBLOM: "ETFs are clearly not only a set of liquidity instruments or tactical instruments today but clients are rather seeing this as more strategic building blocks. I've talked about the regional differences before but what you saw in Finland many years ago was the birth of all these smaller asset managers that were adopting ETFs as a tool for asset allocation and building multi-asset portfolios. We're beginning to see that shift in the other countries as well. Clients are, of course, still using ETFs for tactical purposes but I think it's very encouraging to see that more and more investors are using our ETFs to build strategic allocations."

CHRISTOPHER MELLOR: "I agree. We see that the use of ETFs have increased significantly and the reasons for using ETFs have increased significantly but there are some distinct differences depending on the client type. In the institutional segment, ETFs have primarily been used as derivative replacements and performance has been part of that discussion. ETFs have also been used for portfolio completion in areas where investors perhaps don't have

ETF ROUNDTABLE 2020

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Invesco
Head of EMEA ETF equity & commodity product management. He joined Invesco in 2017 from Source ETF. He has previously also worked as an equity strategist at Sunrise Brokers and at State Street.

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Head of ETF distribution, Nordic region. Before taking on his current role in 2018, he was previously director of Nordic distribution at WisdomTree and an investment strategist for SPDR ETF.

the experience or the access and they have also been used for tactical asset allocation. However, we're also seeing that more institutional investors are looking to use ETFs as a low cost and efficient way of getting exposure to the plain vanilla benchmarks. In terms of the wealth management side and the private banking side, they typically use them as core building blocks within portfolios and that's a continuing trend. We're also starting to see some early signs of investors using the liquidity offered by ETFs in the alternative space, so people using the ETF as a liquidity sleeve to manage liquidity and exposures. It's clear that the usage is changing and evolving."

FLORIAN CISANA: "We have talked about the development with fixed income ETFs in Q1. Investors bought what was available rather than only the best-in-class ETF. For me, that was more tactical and we've seen some of these investors already selling that position again. I agree, however, that in general the use of ETFs for strategic allocations has increased. I think one of the reasons is the continued reduction in fees, which is closing the pricing gap to other passive solutions. Another reason why ETFs are used more often for strategic allocations is the wide offering on ESG indices to an extent that we probably can't see in other ESG solutions. A lot of ESG ETF product ranges are build-up systematically, meaning that ETF issuers provide certain ESG approaches for various countries and regional ETFs. Sometimes the same ESG methodology is even available across asset classes."

ANTOINE LESNÉ: "I think what happened last spring was that the Fed and the ECB provided investors with more comfort and that's why we saw a huge inflow into fixed income ETFs. At the time, equities didn't look great and credit looked amazing from an asset allocation standpoint, so we may see some repositioning from investors who move to higher risk exposure - that's perfectly fine. That's what ETFs are meant to be providing, i.e. flexibility, alongside being building blocks for core allocations."

NIKLAS TELL: FLORIAN, YOU MENTIONED THAT ESG ETFS HAVE DONE VERY WELL COMPARED TO ACTIVE ESG FUNDS. COULD YOU EXPAND ON THAT? NOT LEAST AS A LOT OF THE DISCUSSION FOCUSES ON THE NEED TO BE ACTIVE TO DO ESG PROPERLY.

FLORIAN CISANA: "First, let me say that I don't like the discussion of active versus passive as in my view, both solutions are required and used by investors. Nevertheless, I do see that some on active houses are pushing the agenda that ESG needs to be active. However, in the US ESG ETFs accounted for 60 per cent of the total flows into ESG funds during 2020. I think that speaks for itself. There are investors that need to move towards ESG portfolios, for example driven by regulation. One of the benefits of ESG ETFs and ETFs in general is that ETFs are replicating indices that are rule based, transparent and clearly defined. This makes it easy for investors to understand their exposure, which is of course very important, not least if there's regulation to follow. The ETF industry has also been active in providing a broad range of different 'shades of green', which provides choice to investors. I would also like to highlight that there's a lot of services we have to build around ESG ETFs. We have to allocate resources to analyse regulatory developments with regards to ESG but also towards ESG reporting requirements. The sales effort has become more complex and it's not uncommon that it takes one or two years of conversations with clients before an investor buys into an ESG ETF. That's very different to a plain vanilla ETF where clients might buy an ETF without any prior contact with the ETF provider."

PETER LIDBLOM: "This is obviously a very big topic and we could probably spend the rest of the afternoon talking about this. I would just like to say that it used to be the perception that you couldn't be an active owner with passive products but of course you can. It's obviously important for investors to distinguish between their passive providers and how the firm as a whole engage with the companies they invest in. At DWS, we have a very well-developed engagement policy and I believe it makes a difference that we act with one voice."

OLGA DE TAPIA: "I agree that investors are different, have different needs and that's why it's very important for us to educate them. Not least when it comes to ESG because there are so many different indices and so many different methodologies out there. We have, for example, launched new bespoke indices together with FTSE and if an investor is benchmarking to MSCI, they need to understand how to compare what they have in their portfolios with other different scoring methodologies. They need to understand how including our product would influence their targets when it comes to ESG. And coming back to what Peter said, I agree very much on active ownership. These bespoke indices we have launched take a different approach. We're not just excluding names, which is the very popular 'best-in-class' approach, but tilting the weight of these name according to their ESG scoring. This allows us to have more companies in our portfolios, which means we can engage with more companies and contribute to change. I think that's very important, especially when it comes to equities. Fixed income is different because when you exclude companies in fixed income, it sends a stronger signal. It's more of a punishment in fixed income because exclusions would contribute to higher costs for that company. If you exclude companies in fixed income, you simply say no to future revenues but you don't really influence the company."

CHRISTOPHER MELLOR: "I guess you can follow the growth in ESG ETFs along with the growth in ESG investing in general. Looking back, there were no ESG ETFs and the main reason was the heterogeneity of the ESG universe. Each country, each region and each group of clients had slightly different views on ESG. And ESG was a minority area of the market and that minority had some very clear and explicit views on what they did and didn't want in an ESG product. That's why a segregated mandate was typically the approach that most investors ended up taking. What you've seen since then is that ESG has become much more mainstream. We have more and more investors today coming to us saying that they need ESG solutions. We're now seeing more and more ESG ETF products and increasing flows. One reason is that the client group interested in ESG has changed and the needs of those clients have changed. Once you have a large enough group of investors that agree on a particular view on ESG, you can have a pooled investment vehicle that works well. I would also like to echo Olga's point on proxy voting and the power of staying invested rather than excluding a too large of a part of the universe. We're a large asset manager and a large asset base gives you a lot of clout when you're talking to company management and trying to get them to move in the right direction for your clients."

ANTOINE LESNÉ: "I fundamentally agree that by staying invested, you at least get a seat at the table and that's important for an active owner. What we've done at State Street is to collect data from different ESG providers and then re-scored them to create our own responsibility factor and we use that factor when we engage with companies. We've also launched strategies that incorporate this factor in the index and it lets us follow how individual companies transform over time. In fixed income, we follow the exposure from a duration and spread standpoint, as well as the ESG overall score improvement."

NIKLAS TELL: WHEN YOU TALK TO CLIENTS, WOULD YOU SAY THAT THE DISCUSSION IS MOSTLY ABOUT THE CONSTRUCTION OF THE INDEX OR IS IT MORE ABOUT HOW ACTIVE YOU ARE AS AN OWNER OF THE COMPANIES IN THAT INDEX?

FLORIAN CISANA: "The trend is to move away from off-the-shelf indices. More and more ETF providers are actively engaging in the index construction. This is a trend we see since around 2011, first on equity ESG indices and shortly later on fixed income ESG indices. What we do with clients is basically to explain the different ESG indices in the market and what they deliver. We also provide portfolio analysis, meaning we provide a report on how an ESG ETF impact a client portfolio from an ESG score perspective. Once the client has decided which ESG ETF works best for them, the due diligence starts. As part of this process, we do explain in detail what we do in terms of stewardship, meaning engagement and proxy voting. The underlying motivation behind why we do engagement for active capabilities and why for do it for passive capabilities might be different but the process is the same."

OLGA DE TAPIA: "We really believe that index selection is very important and we need to keep on innovating and put more and new factors on the table. One reason why we introduced our bespoke indices was that after listening to clients, a lot of them thought that traditional ESG indices were too restrictive. One example is MSCI Japan where the traditional index consists of some 321 stocks and the SRI version of the index only includes 59 stocks. That's a very concentrated portfolio and it would lead to some investors at least selecting an active approach instead of an ETF. That's one reason why we wanted to provide something different and something that would allow us to engage with as many companies as possible. It allows us to vote and it allows us to write to companies asking them to change."

ANTOINE LESNÉ: "I agree. It's important that we as an industry and as large asset management houses engage with companies. At State Street, 'Fearless Girl' is one of the most prominent ways that we engage for women at the board level but there are many other actions we are taking. However, I wanted to come back to Niklas' question, which was about if investors select the strategy no matter what the asset manager is doing or if they select the asset manager first. I would say that investors would

ANTOINE LESNÉ
State Street SPDR ETFs
Head of ETF strategy & research for EMEA. Before taking on the job in 2014, he was a senior fixed income portfolio strategist in EMEA, covering Europe and global fixed income beta strategies as well as smart beta credit for State Street Global Advisors.

FLORIAN CISANA
UBS Asset Management
Head of passive & ETF specialist sales strategic markets EMEA. Before taking on the role in 2018, he was responsible for ETF sales in the UK and Ireland.

tend to focus first on the ESG strategy of the firm. The second step is the part about explaining why a specific strategy might be better than that provided by others or why this strategy fits the investor's specific needs the best."

PETER LIDBLOM: "I agree but at the same time we need to bear in mind that clients will have a hard and fast exclusion list themselves that they work towards and then they're trying to find the exposures that matches that the best. Then it becomes a question of which provider they feel comfortable doing this. I therefore think it's important to see what people actually are doing when it comes to voting. If we take the climate resolution, which a lot of investors focus on, investors will see that different asset managers behave differently, to put it mildly. I also think the recent trend has shown that investors are increasingly looking at 'darker green' products with more tangible ESG impact."

CHRISTOPHER MELLOR: "I agree. It's not enough to have the right index if you're terrible on voting. But it is also a broader question. We're getting more and more questions around the ESG characteristics of non-ESG products, because there's a need for clients to actually understand what the whole portfolio looks like. So much more demand for reporting and more questions around ESG characteristics on things that you wouldn't normally think of from an ESG perspective. We have, for example, seen a huge demand for gold and we've had flows of about USD 5 billion into our product and we're increasingly getting question on the sustainability exposures of that. For example, how we ensure that we're not exposed to the use of child labour or that we're not contributing to conflict in the countries where these things are being developed or mined. I think this reflects how important ESG is becoming for our clients. They need to know more than just the ESG benchmark."

TOBIAS NILSSON: "I would say that ESG has been a way for the industry to really step up our understanding of what we invest in and ultimately what our clients invest in. That added level of transparency is positive. The efforts at JPMorgan has been going from understanding securities from a financial perspective to an ESG perspective as well. Clients also need us to communicate what we have done to influence companies, voted for on ESG issues, or which companies we avoided altogether in a given risk-bucket. Both that engagement and integration piece has been an important step forward. The entire ETF industry has stepped up in transparency".

PETER LIDBLOM: "As I mentioned, I don't think we can have this discussion about ETF development without actually almost synonymously talking about ESG because that's definitely going to be the way forward. And I think that's also going to be the way forward with the regulation that is coming into play in 2021. It's going to be even more important for investors and clients to actually know and understand what they're investing in because I think there will be potential for an awful lot of greenwashing when products need to be categorised. So investors need to be cognisant of what they're actually investing in. Luckily, when we show the performance aspect of an ESG investment versus a non-ESG investment, you can see the performance enhancement that you get from having an ESG approach. And I wouldn't be surprised if we five years from now won't talk about ESG or non-ESG indices. We will just be talking about indices and they would all integrate ESG and I think that's probably a very good thing."

ANTOINE LESNÉ: "I agree. Regulation generates new products and exposures to meet investors' needs to comply with it. I also agree that the thematic trend is very interesting. What we can do as an ETF industry is to provide the wrapper that will host these strategies. We provide the transparency and I think this is really something that's very much behind the success of the industry. We're accountable and transparent. These features are extremely important when we're talking about ESG, regardless if it's pushed by regulation or by a thematic trend."

> "It's encouraging to see what ESG has done for the ETF industry and vice-versa"
>
> *– Tobias Nilsson, JPMorgan Asset Management*

CHRISTOPHER MELLOR: "I think one of the biggest shocks that's going to hit investors in the next few years is when the ESG investment that they put in their portfolio this year underperforms the broader market and they suddenly realise that actually, ESG is not a panacea. I know Peter, that's not what you're saying but the truth is we've been through a pretty extraordinary period. There's some good data out there that suggests the ESG can enhance returns and one explanation is that you avoid the worst offenders – avoiding BP blowing up in the Gulf of Mexico and similar events. But the reality is that by taking your portfolio and adjusting it from the standard market, you're taking off-benchmark bets and they will or won't outperform. We've also seen a lot of interest and demand in thematic ESG with clients looking at things like solar, clean energy and clean water. So clients will have their ESG beta portfolio as a core holding, just as they would a standard S&P 500 in the old days and then they're using a satellite approach with thematic ESG based on their ESG needs and also partly on return expectations."

OLGA DE TAPIA: "I agree that we cannot predict the future. However, what's clear is that sustainable products have provided higher risk-adjusted returns and that's something we see also going forward."

PETER LIDBLOM: "We've studied this many, many times and we've done the well-known meta study together with the University of Hamburg on over 2000 academic studies going back to the 1970s. And there's an extremely strong correlation between having an ESG policy and corporate financial performance. So having an ESG hat on will actually enhance your performance. It's not an indication of the future but so far I think it looks good."

CHRISTOPHER MELLOR: "I agree entirely and over the long term, I think ESG will outperform but in the short term, like any factor, there will be periods where ESG underperforms and I think that will be the thing that scares a lot of people."

TOBIAS NILSSON: "If we're having this discussion next year, do we think this trend will have gone away? Personally, I can't see that. It's too important and there are still a lot of non-ESG assets out there – in the US and within retail. That speaks to continued inflows, which in turn should speak to ESG performance."

NIKLAS TELL: TO WRAP UP I HAVE A FAIRLY BIG QUESTION BUT I JUST WANT SHORT ANSWERS. WITH THE UPCOMING EU TAXONOMY, DO YOU THINK THAT THE REGULATION WILL BENEFIT ETFS, DUE TO THE TRANSPARENCY, COMPARED TO OTHER PRODUCTS?

FLORIAN CISANA: "Yes."

PETER LIDBLOM: "Yes."

ANTOINE LESNÉ: "In short, yes."

CHRISTOPHER MELLOR: "I would like to say yes but I also think there are elements of it that are almost designed for an actively managed approach. It's very hard to imagine that you could design an index-based passive ETF that will achieve all the requirements needed. The rules and the regulations have been designed by people that are running active green bond funds and things like that. It's a very specific requirement. However, there are areas in the regulation that focus on clarity on what you're doing and greenwashing is a potentially huge issue. I think the regulation that's coming through will be effective in preventing that because you have to be very clear about what you're doing. You've got to do that in the legal docs so from that perspective, it's great news. I also think ETFs are going to benefit because of the clarity and the simplicity of understanding exactly what we're doing but it's not going to be universally positive."

TOBIAS NILSSON: "It's encouraging to see what ESG has done for the ETF industry and vice-versa. Judging by the level of innovation and how ETFs have participated in ESG inflows so far, I think we're well positioned to benefit from the EU taxonomy."

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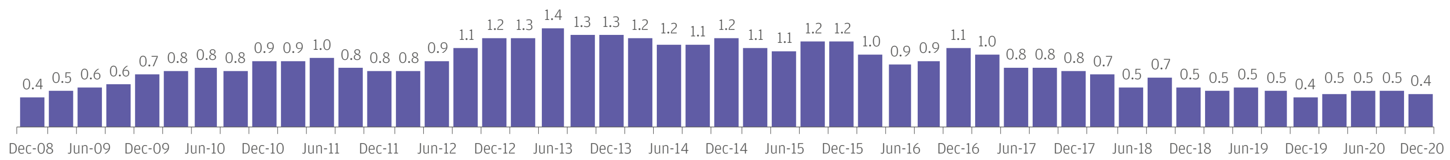
Ticker	JREG	JREU	JREE	JREM
Benchmarks	MSCI World	S&P 500	MSCI Europe	MSCI EM
Active Risk	1.00-1.25%	0.50-1.50%	0.75-1.25%	0.75-1.25%
TER	0.25%	0.20%	0.25%	0.30%

Track-record in other vehicles: J.P. Morgan Global REI Strategy – Rolling 5 years quarterly periods ending 31 December 2020

EXCESS RETURNS OVER THE BENCHMARK



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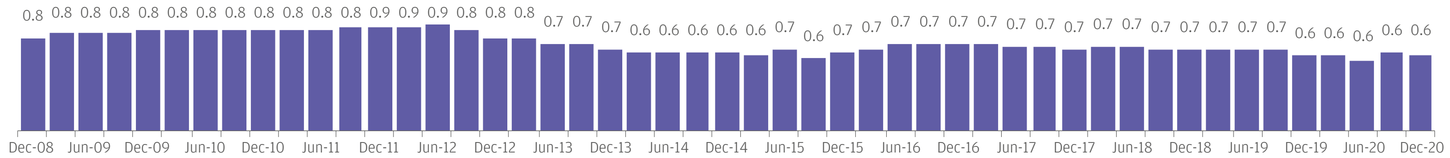

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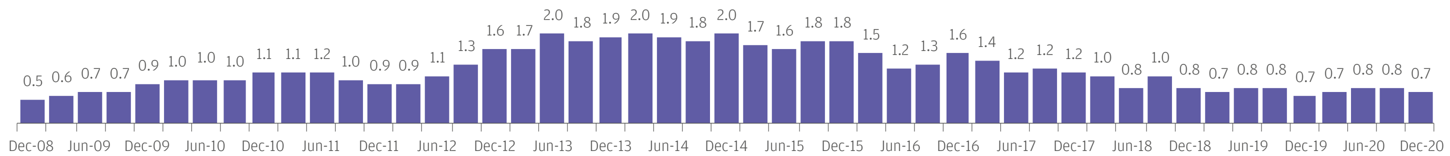
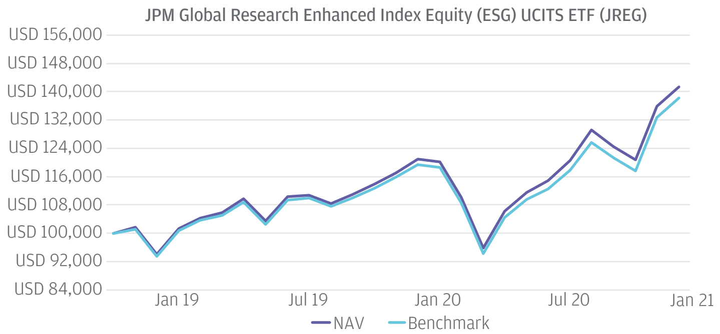
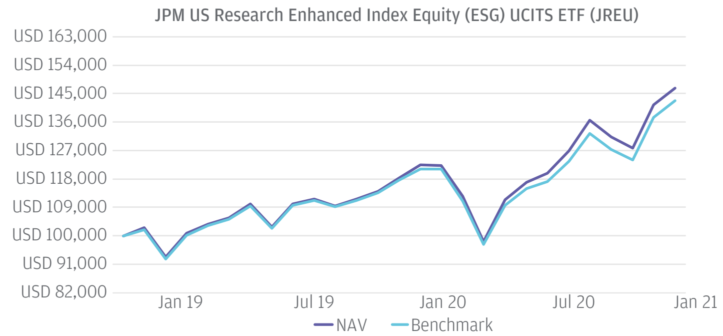
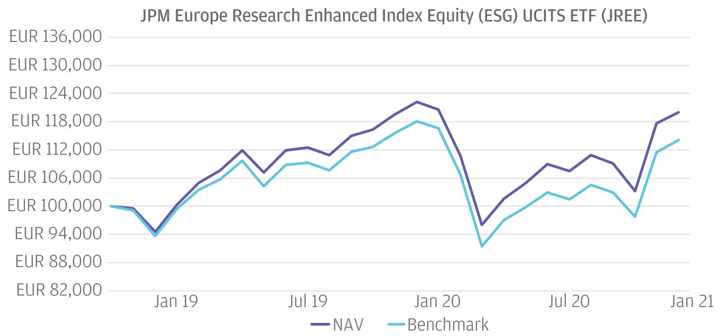


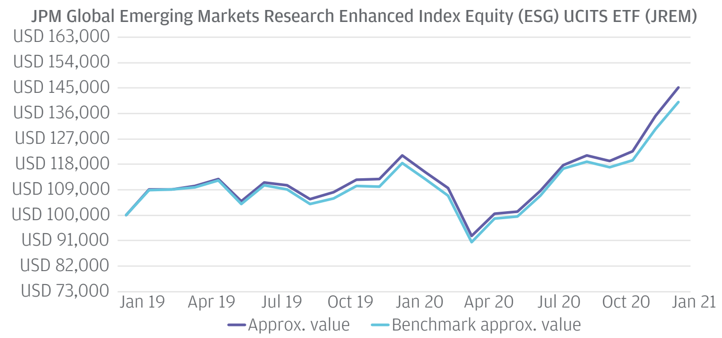
Past performance is not a reliable indicator of current and future results.
Source: J.P. Morgan Asset Management. Benchmark changed from MSCI World to MSCI ACWI on 31 May 2010. Strategy performance is calculated in compliance with GIPS® standards, where segregated mandate portfolios and/or pooled funds, as relevant, managed in accordance with the strategy are grouped into a 'composite'. Returns for periods less than one year are not annualized. Total return assumes the reinvestment of income. Excess returns are calculated on a geometric basis. The performance results are time-weighted rates of return net of commissions, transaction costs and non-reclaimable withholding taxes, where applicable. Gross returns do not reflect the deduction of management fees or any other expenses that may be incurred in the management of the account. Actual performance will vary depending on security selection and the applicable fee schedule. *Tracking Error here represents the standard deviation of the above chart's excess returns, presented here on a rolling five year basis.

Performance of the Research Enhanced Index Equity (ESG) UCITS ETFs









Past performance is not a reliable indicator of current and future results.

LET'S SOLVE IT®

ETFs by J.P.Morgan Asset Management

Focus on European statistics

2 308	77	29
Number of ETFs/ ETPs in Europe	Number of providers	Number of exchanges

Source: ETFGI, an independent research and consultancy firm, covering trends in the global ETF/ETP ecosystem. Compared to the end of 2019, the number of ETFs has decreased from 2 351, while the number of providers has increased from 68. ETFGI has also reported that assets invested in ETFs and ETPs listed in Europe reached a new milestone of USD 1.28 trillion at the end of 2020, an increase by 24.5 per cent in 2020.

2020 – a year of ETF anniversaries

On March 9 last year, Deborah Fuhr, managing partner and founder of the ETF research and consulting firm ETFGI, wrote on Linkedin about the 30th anniversary of the global ETF industry. She stated: "On March 9, 1990 – 30 years ago the first successful ETF was listed – the Toronto Stock Exchange listed the Toronto 35 Index Participation Fund, known as TIPs." Providing additional insight, she wrote that the ETF still exists today and is now known as the iShares S&P/TSX 60 index ETF XUI and owned by Blackrock. She also highlighted the first ETF launch in the US as the SPDR S&P 500 ETF Trust ticker SPY on January 22, 1993 by State Street Global Advisors. That is currently the world's largest ETF.

2020 also marked the 20th anniversary of the first ETFs to be listed in Europe. The LDRS DJ STOXX 50 and LDRS DJ EUROSTOXX 50 sponsored by Merrill Lynch were listed on the Deutsche Borse on 11 April 2000. This listing was followed by iShares FTSE 100 ETF on the London Stock Exchange on April 28, 2000.

Record flows into tech and ESG in 2020

According to the "Global ETP flows 2020 in review" report from Blackrock, sector ETPs (exchange traded products) had a fantastic year with record flows across many sectors. Healthcare ETPs gained a record USD 17.1 billion of inflows last year but it was technology that really stood out, where inflows hit a record USD 45.8 billion last year. That was more than the total flows into the sector from 2015 to 2019, according to the Blackrock report. The report also highlights 2020 as "the landmark year for sustainable ETP flows". US and EMEA listed products gathered a total of USD 85 billion last year, compared to USD 28 billion in 2019.

Credit Suisse Asset Management re-entered the ETF space

In February last year, Credit Suisse Asset Management announced that it was adding ETFs to its range of investment fund products. At the time, the asset manager said that the new ETFs will supplement the firm's existing index funds business and that it will be selectively adding ETFs "in areas where they exhibit efficiency advantages over index funds".

Michel Degen, head of Credit Suisse Asset Management Switzerland and EMEA, said: "We continually analyse the market, new trends and client needs to provide appropriate solutions for our customers. The strategic importance of ETFs will further increase in the future as digital sales platforms gain greater significance."

An interesting historical fact is that Credit Suisse sold its former ETF business to Blackrock in 2013. The firm stated at the time that the sale was "an important strategic step in an industry that requires significant scale and allows Credit Suisse to realize value in a business successfully built over many years". Martin Keller, at the time head of distribution for core investments, said: "In Blackrock we have found a buyer who is a leading ETF player with a successful track record and well-established products."

NEWS IN SHORT

Launching new products, reaching more investors and improving distribution networks

"Having passed the Covid-19 test with flying colours, the industry is now challenged to digitalize distribution, develop new products, and navigate greater regulatory scrutiny," EY writes in a report released at the end of last year.

In the report, called "Can ETFs scale new heights in an unfamiliar environment?", the consultancy argues that the performance of ETFs during market stress is not the only factor that speaks in favour of continued AUM growth into the 2020s but also that the industry's historic growth drivers, such as the move to passive and declining fees, remain in place. "Our forecasts anticipate a cumulative average growth rate in AUM of 10 per cent for European ETFs over the next five years," said Lisa Kealy, EY EMEIA ETF Leader.

Commenting on expected growth, the consultancy says that experience suggests that flagship index-tracking funds will capture a large slice of inflows but that wafer-thin margins mean that this is not a sustainable growth strategy for new entrants. It will also not help most of the ETF providers. Separate EY research shows that individual ETF promoters expect the key drivers of growth to be the launch of new products, to reach more investors and to improve distribution networks.

Equity style ETFs from Morningstar and iShares

At the end of last year, Morningstar announced that would launch a new index family (the Morningstar Broad Style Indexes) designed to represent the size and style dimensions of the US equity market and to be consistent with the Morningstar Style Box. As part of this initiative, the nine funds in the iShares Morningstar U.S. Equity Style Box ETF suite will begin tracking the new Morningstar Broad Style Indexes.

"Style investing is the bedrock of many investor's portfolios. Inspired by more than 30 years of independent research and analysis, the new Morningstar Broad Style Indexes aim to empower investors through a more flexible and intuitive framework for building US equity portfolios," said Ron Bundy, president, Morningstar Indexes.

Launching the first fixed income ETF aligned to the Paris Agreement

Michael John Lytle, CEO of **Tabula Investment Management**, and **Abdallah Muhammad**, responsible for Nordic client coverage, talk about the newly launched ETF and where they see the industry heading in the future.

By: **Janina Sibelius**

London-based ETF provider Tabula Investment Management has launched a fixed income ETF aligned to the Paris Agreement. The launch comes on the back of increased demand from investors that have been complaining about the lack of well-designed ESG products in the ETF space. Some Nordic funds, such as the Finnish pension companies Ilmarinen and Varma, have taken an even more proactive role in spearheading the development of products that match their demand.

"Nordic investors are really at the forefront driving this change," says Abdallah Muhammad, responsible for Nordic client coverage at Tabula. Michael John Lytle, Tabula's CEO, agrees. "We're going through a transition where more capital is needed to drive through long-term positive change. We need to be developing more innovative products that allocate capital to companies that drive and are a part of that positive change," he comments.

The new ETF, Tabula EUR IG Bond Paris-aligned Climate UCITS ETF, is the first passive vehicle on the fixed income side, which offers exposure to Euro investment grade bonds from companies with 50 per cent lower greenhouse gas emissions compared to the broad market and an annual decarbonisation of at least 7 per cent. The ETF was developed in co-operation with Solactive and ISS ESG that helped Tabula to construct the new Solactive ISS Paris Aligned Select Euro Corporate IG Index, which is a liquidity-focused Paris-aligned benchmark for Euro investment grade bonds. The ESG screen excludes companies that have violated social contracts, such as human rights or labour laws, as well as companies selling controversial weapons and tobacco, or those destroying the environment.

Michael John Lytle reveals that all lead investors in the new ETF are Nordic. "There's this reverse inquiry with Nordic investors where they identify and approach managers they would like to partner with. I think this is great. There has to be a dialogue because we're forging a new industry," he says.

For Tabula, this has meant adopting an approach that is more consultative than sales-based, says Abdallah Muhammad, who joined the firm in October last year. "In order to be relevant and to be able to offer products that are client led, it's important to have clients involved from the early stage of product development," he notes. Michael John Lytle agrees. With a long career of working with fixed income, including an 18 year stretch at Morgan Stanley, he is passionate about what can be achieved in the fixed income space. "We don't want to offer something for everybody," he says. "We want to create fixed income products that are unique and fill gaps in the investor toolkit. The ETF is just a wrapper. We don't do this because we think ETFs are interesting. We do this because we think fixed income and what you can do with it is interesting."

Michael John Lytle says he sees a change underway that will see investors demand a transition from screened products to those that aim to create an impact. "It will become a question of what outcome you're trying to achieve," he says. With a growing number of investors looking for ESG products on the fixed income side as well, Michael John Lytle says 2020 was a watershed moment for the industry. "Last year was definitely a tipping point for ESG. It went from 'nice to have' to 'must have'," he says. This trend is visible among the new ETFs launched in 2020 when almost half had an ESG label attached to them. Michael John Lytle says it has been a sharp rise in a short period of time but he believes that ESG will become a major part of the ETF world. "I think eventually every fund will have some sort of ESG filter built into it," he says.

Rize ETF surpasses USD 100 million in first year of trading

Rize ETF was founded in 2019 by Rahul Bhushan, Stuart Forbes, Anthony Martin and Jason Kennard, having previously built and managed a UCITS ETF platform, Canvas, at ETF Securities. This was subsequently sold to Legal & General Investment Management in 2018. The first Rize ETFs were launched in February last year and assets have now reached USD 100 million.

"The inflows we've seen since the launch of Rize ETF in February [2020] are testament to the value investors are seeing in thematically-built portfolios. More than ever, conviction in traditional investing frameworks is dwindling, as technology redistributes value from the old to the new economy at an unprecedented pace. We're talking about technology in food, in education, in health, in the way we work — no areas of our lives will remain untouched. And as this technological disruption permeates, we have the ability, through thematic investing, to back the companies we believe are building the type of future we want to live in," said Rahul Bhushan, co-founder of Rize ETF.

The company offers investment strategies that it sees as benefitting from megatrends, such as the sustainable food revolution, medicinal cannabis adoption and the increased need for cyber security.

Doing well while doing good

20 Years of UBS ETF –
10 Years of Sustainable UBS ETF

2020 represented a turning point for passive sustainable investing. Assets invested in sustainable ETFs (UCITS) have more than doubled over the past year alone, reaching USD 100bn by December 2020. As shown in Figure 1, UBS started its journey in the sustainability ETF space in 2011, a journey that led us to become the second largest sustainable ETF provider in Europe, with USD 22bn AuM (22% market share, ETFGI, data as of 31.12.2020). During these 10 years we have witnessed sustainable investing grow from being a niche investment to becoming a core component of many investors´ portfolios. During this time we have had the unique opportunity to engage with our clients, exchanging feedback and ideas which then constituted the basis for our product development phase. This has helped us to constantly remain at the forefront of innovation and being the first to bring innovative sustainable solutions to the market. For example, UBS ETF was the first provider to have launched ESG variants of the flagship S&P 500 and Euro STOXX 50 in 2019, launching thematic exposures like Sustainable Bank Bonds or Gender Equality, as well as starting with Fixed Income sustainable ETFs already in 2015.

Our sustainable value proposition

The product range today consists of 13 ESG ETFs covering equities and 7 ESG ETFs in fixed income, all offered in different currency-hedged versions in order to enable investors to build global sustainable portfolios. Our shelf is built in order to offer "different shades of green": some funds use a light-green screening that excludes only few controversial activities and ESG laggards, while other products have a dark-green approach that selects only highly rated companies and excludes a broader list of controversial activities. The cornerstone of UBS´ ETF offering is our 'dark green' line of products, which track MSCI SRI indices and select only the top 25% of the highest ESG-rated companies from respective universes. As shown in Figure 1, this set of products has been live since 2011 and UBS currently offers the widest selection of ETFs tracking MSCI SRI indices, spanning over 9 different geographies and multiple currency-hedged share classes. During this decades´ worth of experience with SRI solutions we've witnessed a constant evolution of sustainable investing, with certain themes like climate change rising to the top of investors' agendas. Recently many of our clients have expressed a desire for a 'dark-green' approach with an additional focus on climate change elements. For this reason we have worked closely with MSCI to create a unique customized solution that maintains the SRI best-in-class characteristics of our ETFs, which further improves the climate risk profile while limiting exposure to stranded asset risk. This new approach will ensure SRI investors can address their climate change concerns in a very focused way while also addressing the various metrics across the ESG framework.

The enhancements in a nutshell

As of December 2020, our UBS SRI ETFs changed benchmarks to the new MSCI SRI Low Carbon Select 5% Capped indices. As you can see in Figure 2, these indices are constructed in four distinct steps, with the best-in-class SRI selection remaining the cornerstone of the methodology. Starting from a core exposure, we first exclude the "highest carbon emitters", which are identified as the worst 10% securities (by number) in terms of carbon intensity and potential emissions. In a second step, we perform values-based exclusions which are in line with the standard MSCI SRI approach by removing companies deriving revenues from activities such as Controversial Weapons, Tobacco, Alcohol and others. Subsequently, companies that fail to meet our new "Climate change based exclusions" criteria (listed in Figure 3) are removed as well. As depicted in the table, MSCI also performed changes to its standard SRI methodology, but we went one step further by adding additional activities and lowering the revenue thresholds to the minimum possible. The final step remains the best-in-class SRI selection which aims to screen out of the portfolio companies that are involved in controversies or are ESG laggards, and in addition selects only the top 25% ESG rated companies per GICS sector.

Figure 1: UBS ETF – pioneer in sustainable investments

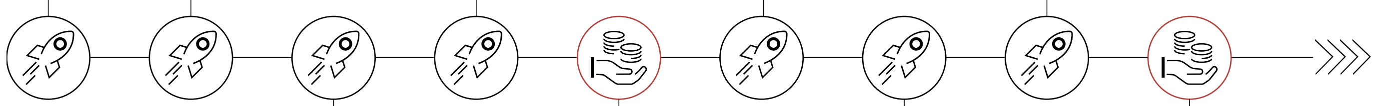
2001
Launch of our first ETF (EURO STOXX 50)

2011
Launch of four MSCI SRI equity ETFs:
- EMU
- Pacific
- USA
- World

2015
Launch of the first ESG Fixed Income ETF (on US Corp.)
UBS becomes market leader for sustainable investment ETFs in Europe

2017
Launch of:
- MSCI ACWI SRI and ACWI ESG Universal
- Global Gender Equality ETF
- Fixed Income Euro Area Liquid Corp. Sustainable

2019
Launch of:
- S&P500 ESG ETF
- EuroStoxx50 ESG ETF
- MSCI China ESG ETF
- EMD IG ESG ETF
- Global Government ESG



2014
Launch of MSCI Emerging market SRI ETF

2016
UBS sustainable investment ETFs surpassed USD 1bn of AuM

2018
Launch of Multilateral Development Bank (MDB) ETF

2020
UBS sustainable investment ETFs surpasses USD 22bn of AuM (89 ETFs, 22% market share in Europe).
MSCI ACWI, USA and EMU SRI ETFs passed USD 1bn in AuM and MSCI World SRI reached over USD 2bn in assets.

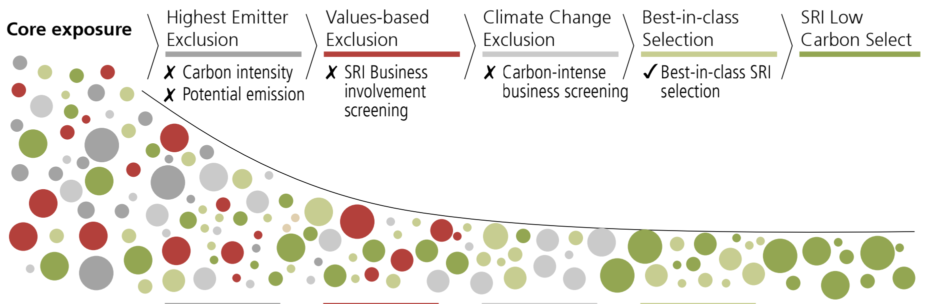
15% **European ETFs CAGR** Dec 2012–Dec 2020

24% **UBS ETFs CAGR** Dec 2012–Dec 2020

102% **UBS SI ETFs CAGR** Dec 2012–Dec 2020

Source: UBS Asset Management, ETFGI, Morningstar. Data as of December 2020.

Figure 2: Methodology overview



	Highest Emitter Exclusion	Values-based Exclusion	Climate Change Exclusion	Best-in-class Selection	SRI Low Carbon Select
Excluded mkt cap	~8%	~5%	~3%	~60%	~77%
Cumulative excl	~8%	~14%	~16%	~77%	

Source: MSCI, UBS Asset Management. Exclusion criteria as per November 2020 index rebalance. Weights from MSCI World as 1 December

Figure 3: Climate Change Exclusions

Climate Change Based Exclusions	MSCI SRI Market Consultation	MSCI SRI Low Carbon Select UBS New
Thermal Coal Mining	0%	0%
Thermal Coal Power Generation	5%	0%
Unconventional Oil & Gas (Oil Sands, Shale Oil & Gas, Artic Drilling, etc.)	0%	0%
Conventional Oil & Gas	N/A	0%
Oil & Gas Power Generation	N/A	0%
Fossil-Fuel Reserves Exclusions	✓	✓
Carbon Emission Exclusion Criteria	N/A	10% Heaviest Emitters

Source: MSCI, UBS Asset Management. Data as of December 2020. For illustrative purposes only.

Figure 4: A step further in climate-change

	MSCI World	MSCI World SRI 5% Capped	MSCI World SRI Low Carbon Select 5% Capped
Returns p.a.	12.18%	13.52%	14.04%
Volatility p.a.	16.08%	15.72%	15.34%
Sharpe Ratio (Rf=0)	0.76	0.86	0.92
Tracking error vs MSCI World	0.00%	2.06%	2.72%
Weighted Average ESG Score	6.1	7.8	7.9
Weighted Average Carbon Intensity tons CO_2e/USDm sales	140	81	35

Source: Bloomberg, MSCI, UBS Asset Management. Data from end-December 2014 to end-December 2020.
Includes backtested data. Past performance is not a reliable indicator of future results.

Doing well while doing good

From a performance perspective and using MSCI World as an example, we can see in Figure 4 that our new approach (World SRI Low Carbon Select 5% Caped) has shown a historically better performance when compared to both the parent benchmark and our previous SRI benchmark (World SRI 5% Issuer Capped). As shown in Figure 4, you notice how this excess return also combines with a lower volatility, which results in an overall improved risk-return profile for the new benchmark. When looking at the tracking error versus the parent benchmark, the figure is slightly higher for the new solution. This is however expected, as the additional exclusions are moving our portfolio further away from the parent benchmark. Nevertheless, this tracking error translated to higher performance. Along with these risk-return metrics, you can also notice how the additional exclusions translated into a substantial improvement from an ESG rating and a carbon footprint perspective for the new benchmark. More specifically, the weighted average carbon intensity of the MSCI World SRI Low Carbon Select is reduced by two thirds when compared to the SRI, and by three quarters when compared to the parent MSCI World.

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04	August 6	August 20	September 3
05	October 1	October 15	October 29
06	November 22	December 6	December 20

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