Nordic ETF Trends 2017

Supplement | Distributed with Nordic Fund Selection Journal #05, 2017

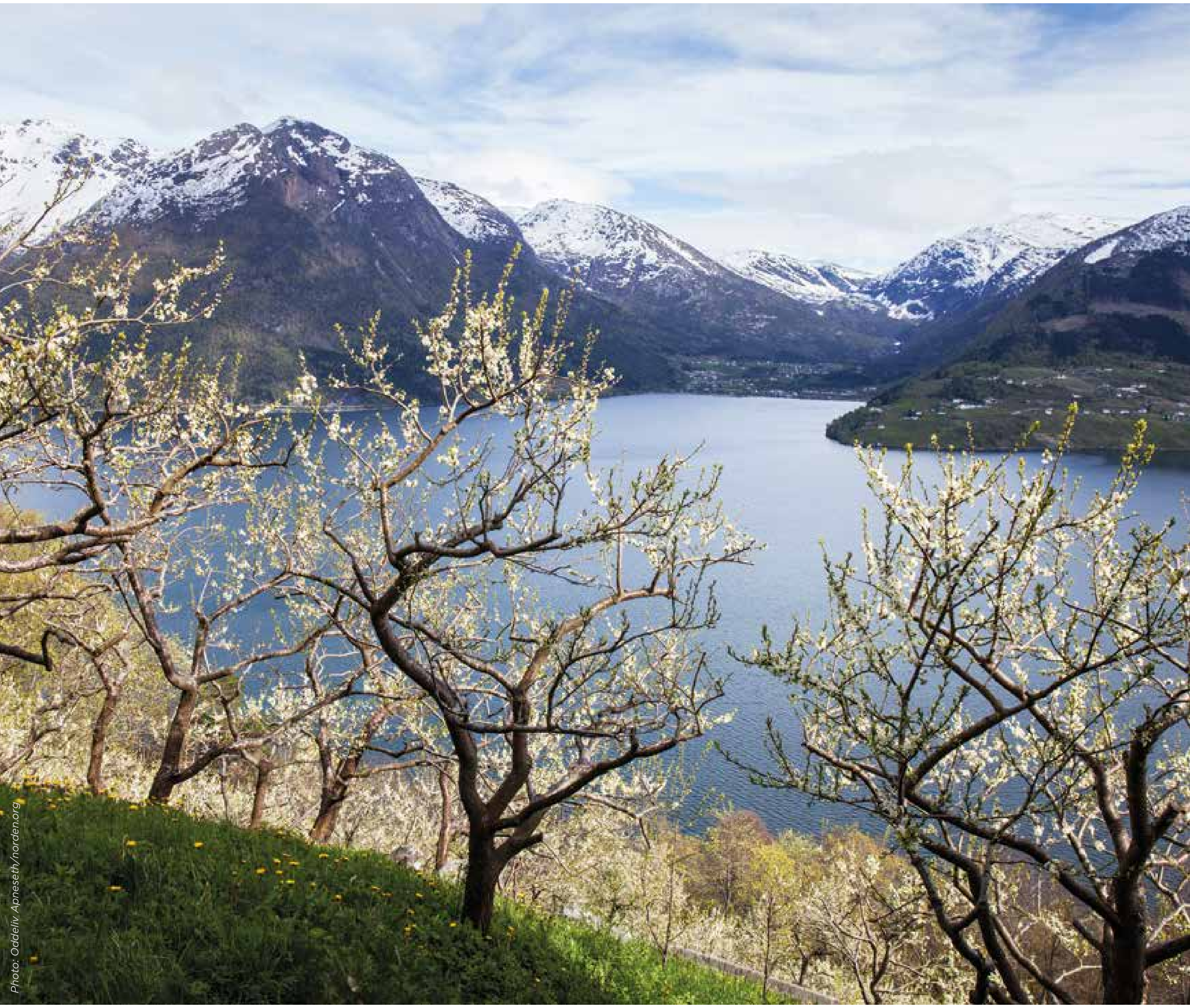


Photo: Oddeliv Apneseth/norden.org

tell MEDIA GROUP

WAITING FOR THE RETAIL INVESTOR...

Welcome to the second annual Nordic ETF Trends supplement. Just as last year, we have strived to gain insight from investors as well as product providers. For the latter we travelled to London to host a roundtable discussion with some of the biggest names in the industry. Representatives from BlackRock/iShares, Deutsche Asset Management, Lyxor ETF and Vanguard debated, among other things, established and emerging trends, the growth of robo-advisors and how to handle ESG aspects. A summary of the roundtable discussion starts on page 10.

ETFs are still very much an institutional product in the Nordic region and how the product is used continues to develop. The trends identified last year, which focused around factor investing and fixed income, are still very much in focus. The development of the ETF industry is, however, not only about new products. Last year we reported that some institutional investors had expanded their use of ETFs – using them also for strategic positioning. The product is however still very much seen as a tactical tool. More insight on how different investors in the Nordic region use ETFs on pages 20–22.

While ETFs at the moment mainly are used by institutional investors, the introduction of Mifid II early next year is expected to be a wake-up call for the industry and is also expected to kick-start the growth of ETFs in the retail space. An early sign is the growth of so-called robo-advisors in the Nordic region – a topic covered on pages 6–7.

Niklas Tell
Tell Media Group

CONTENT

Nordic ETF Trends 2017

Supplement | Distributed with Nordic Fund Selection Journal #05, 2017

Sponsors:

iShares by BlackRock

Deutsche Asset Management Xtrackers ETFs

LYXOR etf SOCIETE GENERALE GROUP

Vanguard

NEWS

ETFs, robo-advisors and the currency of trust

ETFs are still very much an institutional product in the Nordic region. The upcoming introduction of Mifid II, the growth of robo-advisors and a new definition of trust could change that.

Text: **Niklas Tell**

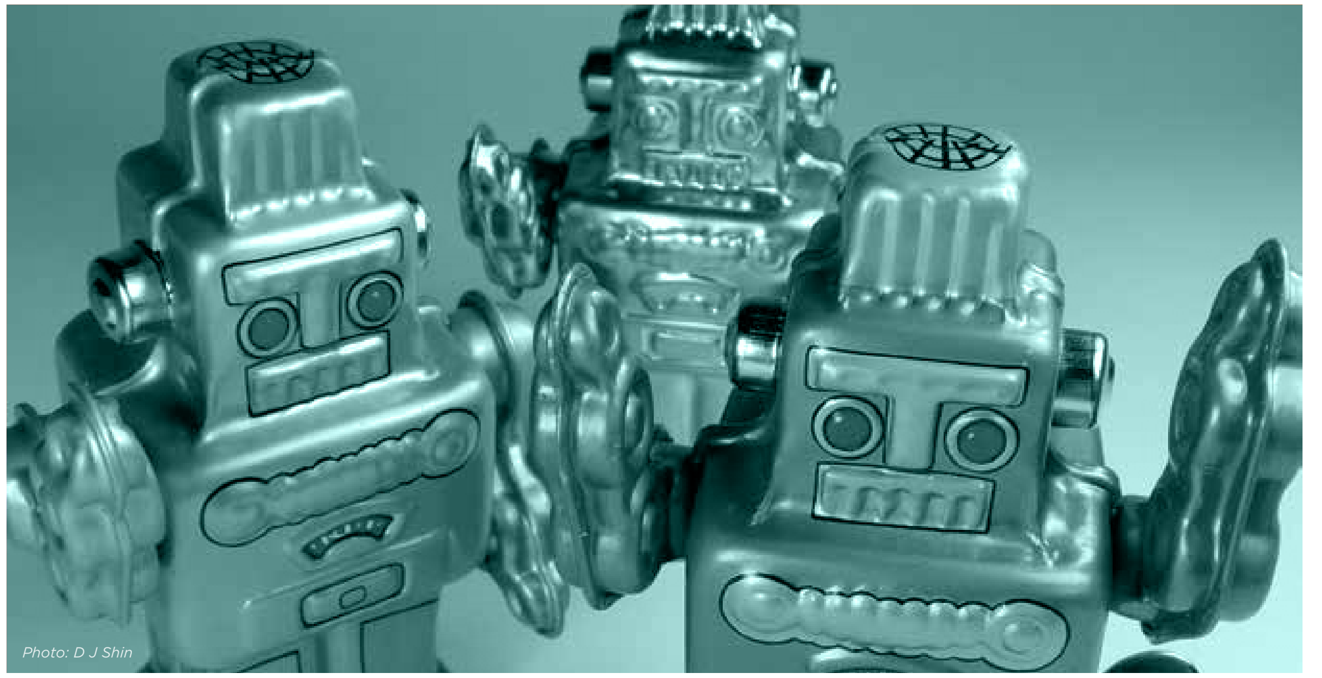


Photo: D J Shin

In July, Swedish investment firm Kinnevik announced it had made an additional investment of USD 65 million into the robo- advisor Betterment. Following the investment, Kinnevik will own a 16 per cent stake in the company, which is the largest independent automated investing service (or robo-advisor) in the US, managing nearly USD 10 billion of assets for more than 270 000 customers. Jon Stein, CEO and founder of Betterment said in a comment: "We are uniquely positioned to help our customers get better advice and the returns they deserve, and the additional funding will fortify our ability to build personalised financial services around the customer to allow them to optimise their financial life."

With the success of companies such as Betterment and Wealthfront in the US as well as Nutmeg in the UK, it was only a matter of time before similar services started to be launched in the Nordic region. Apart from international inspiration, the introduction of Mifid II is also likely to drive the development in the Nordics, not least due to the increased transparency around fees that will come with the new regulation.

"Mifid II will be a game changer. Historically, distribution in the Nordic region has been a fairly closed environment and it has been difficult for ETF providers to gain a foothold. The transparency factor alone will make a big difference, even if distributors opt not to be independent as a way of keeping retrocessions, which we expect is what will happen," Matti Tammi, head of the ETF and index investments business in the Nordic and Baltic region at iShares, said in our roundtable discussion.

Nordnet, founded in 1996 as one of the first online brokers in the Nordics, announced at the end of August its launch of a robo-advisor service called Robosave, offering automatic advice with investments in ETFs. At the launch, Nordnet's CEO Peter Dahlgren said that the launch of a robo-advisor signals the biggest shift in the company's business model since the launch some 20 years ago. He added: "Robosave doesn't look for hot stocks or the perfect market timing. The service will help build long-term savings by investing systematically in ETFs with high quality and low cost."

Avanza, its closest competitor, launched Avanza Auto at the end of September as a way to help clients "manage their money in a smart and cheap way". Nordnet and Avanza are, of course, not alone in pursuing digital and automated financial services. Established banks across the Nordics have launched or are working on launching similar services. One example is Danske Bank, which earlier this year launched June, a digitalised investment platform. In the announcement Danske Bank said: "On the basis of some simple questions, June provides the user with an individual recommendation to invest in one of June's five investment funds, composed to match various investment profiles that take into account the risk profile, time horizon, assets, and other characteristics of the individual investor." The bank also highlights that the funds will invest in a broad selection of both shares and bonds via ETFs and that it will be optimised on an ongoing basis by Danske Bank's investment experts.

There are also smaller start-ups who are targeting the same market. In Sweden, Opti and Lysa have been able to attract a lot of media interest and a similar service in Denmark is provided by Nord Investments.

As services like these charges for the ongoing management of the portfolio, it makes sense for them to search for cheap underlying products such as ETFs to keep the overall fee on a decent level. Ease of trading is another feature that benefits the use of ETFs in these portfolios.

"ETFs are still building blocks and the man on the street will need some guidance. That's what the robo-advisors do really well. There's no rule that says that robo-advisors must use ETFs but it just makes sense," Adam Laird, head of ETF strategy for Northern Europe at Lyxor ETF, said in our roundtable discussion on the topic of robo-advisors.

The question is, of course, who the winners will be in the digitalisation of the financial advisory market. Will it be established names or new fintech disruptors?

Andreas Zingg, head of ETF distribution at Vanguard Asset Management, said in our roundtable discussion that he thought it would be the established names. "Established banks and asset managers will win the battle. They will use technology and it could be that today's robo-advisors become software or platform providers for established names," he said. His views were echoed by Matti Tammi, who added: "Many fintech firms might have a great platform but they may not have the brand, nor the distribution or client base. What they can do is use that technology in a b2b scenario but the winners in the b2c space will most likely be the established players."

It might, however, be wrong to dismiss start-ups just because they don't have an established and trusted brand yet. New start-ups might actually be in a better position compared to established names - at least from a trust perspective – according to Rachel Botsman, the award-winning author, speaker, university lecturer and leading authority on trust.

Her upcoming book, "Who Can You Trust?" is promoted as being set to revolutionise our perception of trust and will transform traditional ideas, for example around banking. In a popular Ted talk, she talks about the currency of trust and how technology is creating new mechanisms that are enabling us to trust unknown people, companies and ideas while our trust in institutions is fading. She says that we are witnessing a shift away from 'institutional trust' towards a model defined as 'distributed trust'. That shift might be the reason for why Danske Bank launched its automated investment advice as June rather than including it under the Danske Bank brand.

// THE GROWTH OF ETFS IN EUROPE

According to ETFGI, a research and consultancy firm focusing on the ETF industry, assets invested in ETFs (Exchange Traded Funds) and ETPs (Exchange Traded Products) listed in Europe have increased 28.3 per cent in 2017 to reach a new record of USD 734 billion at the end of August.

ETFS IN NUMBERS:

Number of ETFs/ETPs in Europe: 2 285
Number of listings: 7 215
Total assets: USD 734 billion
Number of providers: 60

So far this year (to August), iShares gathered the largest net ETF/ETP inflows with USD 26.62 billion, followed by UBS ETFs with USD 9.61 billion and Lyxor AM with USD 8.78 billion in net inflows.

ETFs for the long term

Andreas Zingg, Head of ETF distribution, Vanguard Europe

ETFS ARE GROWING IN POPULARITY as more investors use them for long-term investment strategies, not just for tactical investing. Let me highlight some of the most popular strategic uses of ETFs.

Implementing strategic asset allocation
The range of ETFs available to European investors makes them ideal building blocks for portfolios. Investors can chose single market ETFs that track the S&P 500 or FTSE 100 for example, or regional exposure like the EuroStoxx 50 or the broader FTSE Developed Europe. Bond indices are also well represented by ETFs with country, regional and global exposure available.

Investors can create well-diversified portfolios with just a few trades in broad-based ETFs. This partly explains the increasing demand for bond ETFs. The availability of some individual bonds has deteriorated as investors reconcile the risk-dampening characteristics of bonds with the search for higher-yielding assets. But with just one trade in a global bond ETF, an investor can gain exposure to thousands of individual bonds. And as many ETFs tend to have lower expense ratios than actively managed funds, they are a cost-effective way to build portfolios too.

Combining active and passive
ETFs are most often associated with passive investing. Typically, they reflect the risk and return characteristics of a particular market or asset class. Active investing, on the other hand, offers the opportunity to outperform. But it does bring greater relative risk and unpredictability.

Combining lower-cost active funds with index-based ETFs can achieve a balance between the two approaches. One way to do this is with a core-satellite strategy that uses indexing at the core of the portfolio and actively managed funds as the satellites. An indexed core provides a risk-controlled, low-cost way to capture market returns (beta) over the long term, while actively managed satellites provide an opportunity for market outperformance (alpha).

Addressing liquidity concerns
Since the financial crisis, liquidity has become a source of concern for many investors. One way to deal with liquidity concerns is simply to hold cash. Of course, that could result in a significant, and most likely undesirable, change to a portfolio's risk and return attributes.

An alternative option is overlay management. Instead of reducing exposure and allocating to cash, investors can invest in an ETF that matches the asset class in which they have liquidity concerns.

Arguably, this ETF use is tactical if liquidity concerns are short term. If they persist, overlay management may be a strategic tool for the long-term investor. Moreover, if these worries are broad-based, investors could use a selection of ETFs that mirror the portfolio's strategic asset allocation. This ensures the portfolio is fully invested but with liquidity options from the ease and accessibility of trading ETFs.

Long-term thinking
ETFs are best known as a short-term investment tool, used for investing short-term cash flows, rebalancing, tactical adjustments or transition management. But their versatility in offering investors flexible, low-cost access to a wide range of asset classes is just as applicable across long-term investing. At Vanguard, we expect ETF demand to grow as more investors adopt ETFs for long-term positions.

Mifid II and fee transparency will drive retail growth

On September 7, **Tell Media Group** invited representatives from **Blackrock/iShares**, **Deutsche Asset Management**, **Lyxor ETF** and **Vanguard** to a roundtable to discuss current trends in the ETF space. Nordic Fund Selection Journal editor Caroline Liinanki and Tell Media Group founder Niklas Tell moderated the discussion.

Text: **Niklas Tell** Photo: **Christer Salling**

The discussion, which was held at Grange St. Paul's Hotel in London, started with Niklas Tell asking about the most important product development trends over the last year. At last year's discussion, it was all about factor investing and fixed income but do these remain the big topics or has it moved on to something new?

MATTI TAMMI: Those are still areas that we focus a lot on. There's obviously product development and innovation going on in the industry but if we look at trends over the past 12 months, it's not just about new products. It's also about how investors are using ETFs and we see that investors are clearly expanding the usage of ETFs. So we have both new users as well as a new usage of ETFs. In the Nordic region it's very much an institutional business when it comes to ETFs, even though we expect more growth in the wealth management segment and the institutional segment has been showing new ways of using ETFs. We're to a larger degree seeing institutions using ETFs for strategic positioning rather than just as a tactical tool.

CAROLINE LIINANKI: IS THE STRATEGIC USE OF ETFS A BIG SHIFT FROM HOW INSTITUTIONAL INVESTORS USED ETFS BEFORE?

ADAM LAIRD: I think the ability to do short-term trading has always been one of the appealing factors but that has never been the biggest driver. I think people do use these products more for their longer-term asset allocation goals but the fact that they can trade short term has been one of the things that have made investors comfortable with the product.

AMANDA REBELLO: We see investors using fixed income ETFs more for their strategic allocation. One of the reasons for that might be that there are now more exposures available on the fixed income side in the ETF space. They also provide more granular exposures compared to index funds on the fixed income side.

ANDREAS ZINGG: Matti, you said before it's not about new products but rather how investors use existing products. I looked up how many new products that have been launched. We have seen 115 new ETFs coming out this year and when you go through that list of new products, there are not that many ETFs that the world has been waiting for. However, what we see is that there is more competition on the fixed income side, which is positive. But there are some 2300 ETFs in Europe out of which some two-thirds are below EUR 100 million in AUM, which is typically the critical mass for an ETF to be profitable. That's a big concern. We believe that there are too many products, too many small products that are not liquid enough and all these new products add to the list of the very small products. Many of the new products are also very niche and providers must ask if there really is a big enough market for the product they are launching.

AMANDA REBELLO: If you look at the big providers, we have all gone through clearing-up exercises. We've given some products time to attract assets but if they haven't been as successful as we thought they would be, we have closed or repurposed the funds. The good thing about that is that the end investor is benefitting. At Deutsche, we celebrated the ten-year anniversary of our ETF platform this year and as part of our clearing-up exercise, we were able to pass on reduced fees to investors as we lowered our own costs from stop running these less popular exposures.

CAROLINE LIINANKI: WHY HAVE THERE BEEN SO MANY PRODUCT LAUNCHES IN THE FIRST PLACE? HAVE THE ETF PROVIDERS BEEN TOO OPTIMISTIC?

ANDREAS ZINGG: It's difficult being a new provider, so you must stand out from the crowd. A lot of the new providers go to very niche products that don't make sense – especially if you believe that retail investors will be the driving force of the industry in five years' time. Retail investors don't need these niche products.

NIKLAS TELL: IS THERE A RISK FOR THE ETF MARKET AS A WHOLE WHEN YOU HAVE GIMMICKY PRODUCTS BEING LAUNCHED?

ANDREAS ZINGG: Absolutely.

ADAM LAIRD: I think you're on the wrong path here. I think that you're right in saying that everyone needs core building blocks but ETFs have opened up markets and areas that haven't been available before. Also, for the institutional market it makes sense to provide exposure to very specific areas of the market. There needs to be niches available for those big investors that have very specific requirements. Yes, there are some nonsense products out there and I think everyone would agree with that but I don't think product diversity is a bad thing.

ADAM LAIRD – LYXOR ETF, AMANDA REBELLO – DEUTSCHE ASSET MANAGEMENT, NIKLAS TELL – TELL MEDIA GROUP, CAROLINE LIINANKI – TELL MEDIA GROUP, MATTI TAMMI – ISHARES BY BLACKROCK, ANDREAS ZINGG – VANGUARD ASSET MANAGEMENT.

> "We believe that there are too many products, too many small products that are not liquid enough and all these new products add to the list of the very small products"
>
> *– Andreas Zingg, Vanguard*

AMANDA REBELLO: But this is also where your readers have a role to play, in doing their due diligence on products for their own investors.

ANDREAS ZINGG: I actually think a key innovation in the market was a silent one and that was when Luxembourg allowed multi-share classes so we can combine ETFs with non-listed share classes in the same sub-fund. That's really a great innovation and it's the same set-up that we have in the US where we're able to combine ETFs and funds in the same

ADAM LAIRD
Lyxor ETF
Head of ETF strategy for Northern Europe at Lyxor ETF. He joined from Hargreaves Lansdown where he was in charge of the passive and ETF fund business, investment research and selection.

AMANDA REBELLO
Deutsche Asset Management
Head of passive distribution for the UK, Ireland and Channel Islands at Deutsche Asset Management. She joined the company in 2015 having previously worked at iShares for three years.

> "As ETF providers, or providers of passive products in general, I think we need to think about downside protection or defensive plays"
>
> *– Amanda Rebello, Deutsche AM*

structure. That provides massive scale benefit for investors. I therefore hope that all regulators in Europe will allow this structure going forward.

MATTI TAMMI: I would like to come back to strategic asset allocation and why that is growing. ETFs are getting bigger and cheaper and investors are at the same time willing to pay a small premium relative to an index mandate as they get the liquidity and are able to trade.

CAROLINE LIINANKI: BUT ISN'T THE LIQUIDITY STILL GOOD IN AN INDEX FUND?

MATTI TAMMI: Yes, but you have another level of flexibility in an ETF of getting in and out of a position.

CAROLINE LIINANKI: IS THIS ALSO DRIVEN BY THE FACT THAT INVESTORS ARE GETTING INCREASINGLY NERVOUS ABOUT VALUATIONS IN THE MARKET?

MATTI TAMMI: Absolutely. Some pockets of the Nordic region are taking that into consideration.

ANDREAS ZINGG: I think it's important to remember that when the underlying market is closed, an index fund is closed and an active fund is also closed. An ETF is traded, which means you can get out of a position even if the underlying market is closed. It's like a free option and even if a pension fund is very long-term, you never know when you need to get out of a position.

MATTI TAMMI: We also see an increased use of ETFs at the expense of futures among institutional investors as ETFs are getting bigger, more liquid and cheaper.

NIKLAS TELL: THIS WAS MENTIONED ALREADY LAST YEAR AS A TREND THAT WAS STARTING TO EMERGE, SO I GUESS IT HAS TAKEN OFF.

MATTI TAMMI: Yes, especially for larger indexes such as the S&P 500 and also European exposures.

NIKLAS TELL: IS THIS MAINLY BECAUSE DERIVATIVE EXPOSURES HAVE BECOME MORE EXPENSIVE?

AMANDA REBELLO: Yes, or a combination of both maybe: ETFs are getting cheaper and derivative exposures more expensive. Plus, in the case of funded derivatives positions, yields are still low.

ANDREAS ZINGG: On the other hand, you have some derivative positions, such as total return swaps, where it's hard for us as ETF providers to make a case as it's not traded on an exchange so we don't really know what we're up against.

AMANDA REBELLO: I think ETFs are also becoming the preferred choice from an operational point of view and with the introduction of MiFID II, we will see more UCITS ETFs traded on exchanges where currently some 70 per cent of trades are OTC.

CAROLINE LIINANKI: EVERYTHING YOU HAVE MENTIONED SO FAR IS VERY POSITIVE FOR ETFS. WHAT ARE SOME OF THE CHALLENGES FOR THE INDUSTRY?

ANDREAS ZINGG: One challenge is too many products. But one specific area where I think we need to work together is in taking the debate with active managers. The ETF industry is growing and it's growing at the expense of someone – mainly active managers. That means we are confronted with a lot of stories in the press about the danger of ETFs. We need to stand up to that. What I like about ETFs is that you have one instrument and everyone pays the same price – both the retail investor and a very big institutional investor. They also share the liquidity so the institutional investor benefits from the liquidity that thousands of retail investors provide and the retail investor benefits from the low cost. You also don't depend on distributors – you put it on the exchange and everyone can buy it.

NIKLAS TELL: WHAT ARE THE MAIN MISCONCEPTIONS OR THE CONCERNS THAT YOU NEED TO STAND UP TO?

AMANDA REBELLO: If I were to play the devil's advocate here, as we are moving into 2018 and in light of where we are in the market cycle with investors worrying that valuations are stretched, investors might rotate out of passive and into active. Not because they're looking for outperformance but as a way to improve risk management. As ETF providers, or providers of passive products in general, I think we need to think about downside protection or defensive plays. We can do this with defensive asset classes or potentially interesting smart beta plays.

ADAM LAIRD: Liquidity is the one concern that always comes up. There's a fear relating to the ability of ETFs continuing to trade in an adverse market. Yes, it's a concern and people need to be aware of that but having said that, we have never had an issue with ETF liquidity in Europe.

CAROLINE LIINANKI: WILL ANOTHER FINANCIAL CRISIS BE THE REAL TEST OF THAT?

MATTI TAMMI: You do have the extra layer of liquidity in an ETF in the secondary market but ultimately the liquidity is what the market liquidity is. We also need to understand and recognise where we're coming from. ETFs are still a very small part of a very big pie.

ANDREAS ZINGG: Some 5 per cent of the European fund market is in ETFs. I think it's hard to argue that ETFs are responsible for creating asset bubbles when you have central banks pumping liquidity into the market.

NIKLAS TELL: IF WE GO BACK TO LIQUIDITY. IF INVESTORS SHOULD BE CONCERNED AT ALL, IS IT PRIMARILY ON THE FIXED INCOME SIDE OR THE EQUITY SIDE?

MATTI TAMMI: It's the fixed income that's mentioned but fixed income ETFs actually do very well when there's a crisis as investors move into these instruments to gain liquidity.

MATTI TAMMI
iShares by Blackrock
Head of the ETF and index investments business in the Nordic and Baltic region. He joined Blackrock in 2011 from London-based hedge fund and independent research boutique Blue Oak Capital.

ANDREAS ZINGG
Vanguard
Head of ETF distribution at Vanguard Asset Management. He joined from iShares where he was head of sales for Middle East & Africa as well as for the German-speaking parts of Switzerland.

ADAM LAIRD: The genuine liquidity concern is, of course, in the unlisted part of the market, such as real estate funds or hedge funds buying small unlisted assets. ETFs should not be the big concern.

NIKLAS TELL: ROBO-ADVISORS ARE A FAIRLY NEW TOPIC IN THE NORDIC REGION. WHAT IS YOUR TAKE ON THE DEVELOPMENT?

MATTI TAMMI: We have seen a lot of newcomers also in the Nordic region – disruptors that are able to present a nice solution but not everyone has the complete package if you look underneath the bonnet.

AMANDA REBELLO: We also see more established players moving in this direction, such as Nordnet.

MATTI TAMMI: With the upcoming introduction of Mifid II, all tier one distributors are looking into this. Digitalisation will be important in the post-Mifid II world in order to serve the mass-affluent segment.

NIKLAS TELL: SO WILL THIS BE HOW RETAIL INVESTORS WILL ACCESS ETFS GOING FORWARD?

ADAM LAIRD: Yes, I think so. ETFs are still building blocks and the man on the street will need some guidance. That's what the robo-advisors do really well. There's no rule that says that robo-advisors must use ETFs but it just makes sense.

ANDREAS ZINGG: I think it will be the established names that are the robo-advisors of the future. We're one of the biggest in the US – mainly because we have an established and trusted brand. I think we will see the same in Europe and in the Nordics. Established banks and asset managers will win the battle. They will use technology and it could be that today's robo-advisors become software or platform providers for established names.

MATTI TAMMI: I agree. Many fintech firms might have a great platform but they may not have the brand, nor the distribution or client base. What they can do is use that technology in a b2b scenario but the winners in the b2c space will most likely be the established players.

AMANDA REBELLO: This trend is already happening. In the UK, Blackrock has bought a stake in Scalable and Schroders have a stake in Nutmeg. Also, when you think about robo-advisors, they all started from scratch. They have no legacy and no funds or fund groups they are tied to. They asked themselves, what's the optimal portfolio allocation and how do we best populate that portfolio. They have done due diligence with no bias so if investors look at these portfolios, I think they can learn a lot.

CAROLINE LIINANKI: WHEN THE ROBO-ADVISORS SELECT ETFS, DO THEY USUALLY LOOK AT THE WHOLE UNIVERSE OR ARE SOME TEAMING UP WITH SPECIFIC PLAYERS?

AMANDA REBELLO: They do tend to focus more on the larger providers, as size really matters. In terms of the due diligence, they focus on replication - if it's physical or synthetic. Most tend to focus on the main exposures from each of the providers as these are the most important building blocks in the asset allocation. Then clients tend to look at things such as TER and tracking error and here size really matters as well. Internally, we have 30 categories of performance attribution so you can be really geeky when looking at this.

NIKLAS TELL: WHEN YOU LOOK AT THE ACTIVE SIDE OF THE INDUSTRY, THERE'S A LOT OF TALK ABOUT MORE PARTNERSHIPS RATHER THAN OPEN ARCHITECTURE AS YOU CAN'T KEEP RELATIONS WITH EVERYONE IN A POST-MIFID II WORLD. DO YOU HAVE THOSE DISCUSSIONS WHEN IT COMES TO ETFS?

MATTI TAMMI: I think on the robo-side of the business, it's like Amanda said before. They do their due diligence and filter out which products to use and typically end up with products from a range of providers.

NIKLAS TELL: SO FROM YOUR POINT OF VIEW – IS THERE ANYTHING YOU CAN DO? IS IT JUST ABOUT THE PRODUCT OR ARE THERE OTHER FACTORS THAT COME INTO PLAY SUCH AS CLIENT SERVICING ETC?

ANDREAS ZINGG: We can do a lot. We can help them build asset allocation products and so on.

MATTI TAMMI: Yes, there are many ways in which you can help in a more consultative role.

NIKLAS TELL: APART FROM THE GROWTH OF NEW PLAYERS, SUCH AS ROBO-ADVISORS, WHERE DO YOU SEE THE MARKET GOING? IS IT STILL AN INSTITUTIONAL PLAY OR ARE THERE OTHER POCKETS OF GROWTH AND OPPORTUNITIES?

ADAM LAIRD: I would say wealth managers and traditional private banking.

ANDREAS ZINGG: The main buyers of ETFs are still asset managers and banks. In the wealth management business, it's more on the discretionary side rather than the advisors, which of course depends on the market and regulation. The future opportunity is wealth management but in the advisory channel. Also, with Mifid II when advisors must become more open about costs, there could be more pressure from clients as well. They might start asking why there are not more passive investments in their portfolio as a way of pushing down the overall fee. It will, however, take time and education.

MATTI TAMMI: I agree. Mifid II will be a game changer. Historically, distribution in the Nordic region has been a fairly closed environment and it has been difficult for ETF providers to gain a foothold. The transparency factor alone will make a big difference, even if distributors opt not to be independent as a way of keeping retrocessions, which we expect is what will happen.

ADAM LAIRD: I agree, the disclosure of costs that comes as part of Mifid II will make a big difference.

MATTI TAMMI: As we said, it's still very much an institutional market in the Nordic region. If we look five or ten

ROUNDTABLE – LONDON

> "If we look five or ten years ahead I believe the wealth segment will play a much bigger role in the Nordic ETF market"
>
> – Matti Tammi, iShares by Blackrock

years ahead I believe the wealth segment will play a much bigger role in the Nordic ETF market.

NIKLAS TELL: WOULD YOU SAY THE SPLIT IS AROUND 80/20?

ANDREAS ZINGG: Yes, that's probably a fair estimate if you with institutional include insurance companies, pension funds, asset managers and so on.

MATTI TAMMI: We've seen that asset managers and especially teams working with multi-asset solution have really increased their use of ETFs over the last couple of years. We must also remember the structure we're working with. The big banks will still dominate distribution in the Nordic region, even in a post-Mifid II world. That's why it's important that we're there to educate them and to explain how ETFs makes sense for the solutions they build. They have, of course, the resources to build a lot of the solutions in-house and they could also decide to go very active. These are scenarios we must be aware of.

NIKLAS TELL: I ASSUME YOU'RE ALL TALKING TO THE BIG BANKS IN THE NORDIC REGION. WHAT INDICATIONS ARE YOU GETTING?

MATTI TAMMI: Very mixed signals. Some are really looking at independence to go full fee based, while others want to be a little of both – what we call a hybrid model. Others are focused on the in-house capabilities. It's still early stages.

ANDREAS ZINGG: Mifid II comes into play in January but that does not mean that everything will change at that date. Transparency will come in January but changed client demand will play out over time.

MATTI TAMMI: The alarm clock will go off in January and some will try to snooze for a while but the ones that are ahead of the curve will be the winners.

AMANDA REBELLO: What we saw in the UK, following the introduction of RDR, was a growth of outsourcing when advisors had to choose if they were going to be independent or not. Being truly independent is difficult and many advisors opted to have the portfolio management done by an external firm and many of these use ETFs to address pricing competition amongst themselves. We've also seen a lot of consolidation among wealth managers in the UK and I suspect we will see a similar trend in the Nordic region.

ANDREAS ZINGG: Following the retrocession ban in the UK, we've seen distributors adding new layers of fees and I therefore think that Mifid II will be much more powerful as it will introduce a new level of transparency. We might not even need a ban on retrocessions when clients see the actual cost.

MATTI TAMMI: This is also what we saw in Switzerland. They didn't introduce a ban on retrocessions but because distributors and advisors had to disclose everything, they chose to adopt a fee-based model. Also, another benefit from Mifid II is more around market structure as the trading will move to exchanges. This will be important to institutional investors, which are more comfortable when they see the trading and the liquidity.

NIKLAS TELL: THAT BRINGS ME TO THE QUESTION OF LOCAL LISTINGS OR NOT. IS IT IMPORTANT TO HAVE ETFS LISTED LOCALLY?

ANDREAS ZINGG: Not yet as it's still an institutional market and institutions can trade wherever. But it will become important going forward. When targeting retail investors, I do think it will be important to have ETFs locally, not least in the Nordic region with four different currencies. Then you need to have ETFs listed locally in the local currency.

AMANDA REBELLO: We actually already have some 25 ETFs listed locally in the local currency.

MATTI TAMMI: Local listings will be important but in some countries, such as Denmark, it's also important to have local settlement. For trades that are not traded and settled in the local Danish market, custodians charge a much higher fee.

ADAM LAIRD: More broadly though it's not only about having products listed locally. I also think it's important to have people in place locally in order to help investors.

NIKLAS TELL: ESG AND SUSTAINABLE INVESTING IS A BIG AND GROWING TREND AMONG INVESTORS IN THE NORDIC REGION. HOW DOES ETFS FIT INTO THAT?

ADAM LAIRD: I think ESG is an area where ETFs can make more of a difference going forward and it goes hand in hand with the growth of big data. Five or ten years ago, it was difficult to gain access to ESG data. Today it's all there and it can be made into an index. I think it's a big opportunity for ETFs.

ANDREAS ZINGG: ESG is still very much an institutional consideration and most still work with exclusion lists. The problem is that they're all different and it's therefore not perfectly suited for funds or ETFs. Today less than 1 per cent of total ETF assets are invested in ESG-type products. As it becomes more of a retail concept, ETFs will be very well positioned.

MATTI TAMMI: At Blackrock this is a strategic initiative but we are wrapper agnostic when we try to find the best way to approach this. Maybe it's an active solution or maybe a bespoke passive solution. From the client side, it's still very much about exclusions but this is changing.

CAROLINE LIINANKI: DO YOU THINK WE WILL SEE A SIMILAR DEVELOPMENT WITH ESG AS WE HAVE SEEN WITH FACTOR INVESTING, WHICH HAS BEEN A BIG DRIVER FOR THE ETF INDUSTRY? LOW CARBON STRATEGIES, FOR EXAMPLE?

ADAM LAIRD: We launched a green bond ETF earlier this year.

MATTI TAMMI: We've also launched green bond index funds and we have low carbon strategies as well. When you look at ESG-screened indices, it's important, however, to realise that we're moving away substantially from the traditional benchmark indices. The MSCI EM SRI Index is a good example, which differs a lot from MSCI emerging markets standard index. It doesn't include China, which in turn has implications for stock selection, sector weightings and diversification. That's a challenge for some investors.

> "I think ESG is an area where ETFs can make more of a difference going forward and it goes hand in hand with the growth of big data"
>
> – Adam Laird, Lyxor ETF

AMANDA REBELLO: I think we're moving away from exclusions and more towards tilting of portfolios up or down based on ESG scores. I therefore think what you said Caroline is interesting as we think that ESG should be considered an investment factor. Ultimately, the justification of including a company comes down to fundamentals and with ESG input we just have another lens through which we can view companies. There's an investment case here and it's not just something fluffy for charities.

MATTI TAMMI: There's no doubt we're moving in that direction. The question for us in the ETF industry is how we go about it.

AMANDA REBELLO: The good thing is that there are already good indices available. The content is there but this is where we need input from investors. They need to communicate what it is they want and then we can look to build it. ●

The different flavours of the Euro corporate bond market

2017 was yet again another year of large inflows into Fixed Income ETFs in Europe. The largest category for inflows was EUR-denominated corporate bonds. Ultra-low government bond yields and the ECB's decision to include certain corporate bonds into their asset purchase program have driven investments.

With the increased demand also came an increased offering, with Xtrackers now managing **five physical ETFs on EUR corporate bonds**. Here are the 'different flavours' of it:

1. Plain Vanilla: The no-frills, standard version of Euro corporates is typically understood to be a broadly diversified EUR investment grade bond ETF. With an index like the Bloomberg Barclays Euro Aggregate Corporate Bond Index that includes just over 2000 bonds.

2. Mario's Favourite: EUR Corporate Ex-Financials indices. The name speaks for itself, and it's the strategy with the largest overlap to the ECB's CSPP program. The yield is typically slightly below that of a broad EUR corporate index.

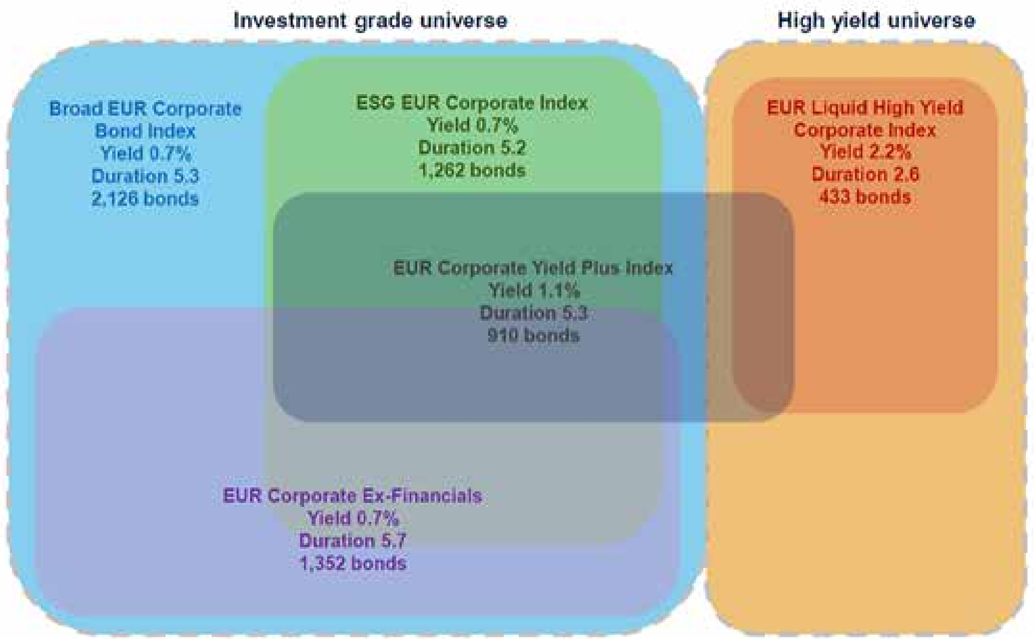
3. Fair Trade Vanilla: The idea behind environmental, social and governance (ESG) themed EUR corporates – also often called 'sustainability' – is to start with the broad EUR corporate universe and screen out bonds from companies that don't adhere to certain defined ESG criteria. Interestingly, the average yield and duration of an ESG EUR corporate index can be in line with a broad EUR corporate universe as is the case with the Bloomberg Barclays MSCI Euro Corporate Sustainable and SRI Index.

4. Added Cream: A EUR corporate 'Yield Plus' index targets the higher yielding part of the investment grade universe. It may also include downgraded bonds (so called 'fallen angels') as long as the bonds remain BB rated and the total position doesn't exceed 20%. The yield on such an index is currently significantly above a broad EUR corporate index with a similar duration, due to the increased credit risk exposure.

5. Spicy: Last but not least, high yield rated corporate bonds provide a significant credit spread increase versus investment grade bonds. The Markit iBoxx EUR Liquid High Yield Index aims to strike a good balance between the liquidity of the underlying bonds and diversification and currently includes around 430 bonds.

To sample these flavours via ETFs please contact your Deutsche AM sales representative or go to **https://etf.deutscheam.com/**.

The EUR corporate bond universe – Illustrative examples only



Yield shown is yield to worst unless otherwise indicated. Duration shown is duration to worst

Source: *Bloomberg Barclays, Markit iBoxx, as of 31/08/2017. Indices shown are the ones tracked by Xtrackers: Bloomberg Barclays Euro Corporate Bond Index, Bloomberg Barclays Euro Corporate Ex-Financials Index, Bloomberg Barclays MSCI Euro Corporate Sustainable and SRI Index, Markit iBoxx EUR Corporate Yield Plus Index, Markit iBoxx EUR Liquid High Yield Index.*

Deutsche Asset Management
Xtrackers ETFs

INVESTOR INSIGHT

Finnish ETF investors on the record

Nordic Fund Selection Journal asks three Finnish investors about how they use and view ETFs.

Text: **Janina Sibelius**

TIMO SALLINEN
Head of listed securities at Varma

HOW MUCH DO YOU CURRENTLY INVEST IN ETFS?
ETFs are commonly used instruments at Varma.

HOW ARE YOU CURRENTLY USING ETFS AND HAS THIS CHANGED OVER TIME?
We use ETFs mainly for tactical purposes. Their use has increased simultaneously with the internationalisation of our portfolio.

WHAT HAVE BEEN THE MOST IMPORTANT/SIGNIFICANT PRODUCT DEVELOPMENT TRENDS OVER THE LAST YEAR WHEN IT COMES TO ETFS?
The supply of different ETFs is increasing constantly. This can be seen, for instance, in the increase of many new sector ETFs.

ESG INTEGRATION IS GROWING IN IMPORTANCE AMONG INSTITUTIONAL INVESTORS IN THE NORDIC REGION. HOW ARE ETFS MAKING OPTIONS AVAILABLE FOR RESPONSIBLE INVESTING?
Our ESG investments are linked to our so-called core-investments, which comprise mainly of direct equity investments or index funds. There are still very few ETFs with an ESG bias that we could actually invest in due to liquidity constraints. They're just too small for us. Also, institutions define ESG in different ways so creating ETFs is very challenging. I believe there will be more suitable and diverse products over time.

THE GENERAL USE OF ETFS IS GROWING BUT WHAT DOES THE FUTURE HOLD? DO YOU SEE ANY EMERGING TRENDS?
We believe that the supply of ETFs will keep on increasing. However, in order for the vehicle to really take off among investors, the total expense ratio will need to become lower in relation to index funds. This is because ETFs are more flexible to use than index funds and adjusting equity allocation is easy and fast using them.

WHAT ARE THE MAIN CHALLENGES FOR INVESTORS IN FINLAND LOOKING TO INVEST IN ETFS?
The amount of ETFs currently available for investors needs to grow and the cost needs to come down in order for them to become mainstream. Especially investment costs on more illiquid markets are still too high. In addition, many ETF products are still too illiquid. There needs to be more transparency in the trade actions so the investor can get a clearer picture on what the final price contains.

JUHA VENÄLÄINEN
Head of equity allocation and funds at Ilmarinen

HOW MUCH DO YOU CURRENTLY INVEST IN ETFS?
Over EUR 3 billion, mainly in equities but also some fixed income.

HOW ARE YOU CURRENTLY USING ETFS AND HAS THIS CHANGED OVER TIME?
We're using ETFs for tactical allocation, in order not to trade active funds.

WHAT HAVE BEEN THE MOST IMPORTANT/SIGNIFICANT PRODUCT DEVELOPMENT TRENDS OVER THE LAST YEAR WHEN IT COMES TO ETFS?
The fee level decreases show intensifying competition among ETF providers.

ESG INTEGRATION IS GROWING IN IMPORTANCE AMONG INSTITUTIONAL INVESTORS IN THE NORDIC REGION. HOW ARE ETFS MAKING OPTIONS AVAILABLE FOR RESPONSIBLE INVESTING?
There are a growing number of ETFs tailored to specific indices that have ESG bias.

THE GENERAL USE OF ETFS IS GROWING BUT WHAT DOES THE FUTURE HOLD? DO YOU SEE ANY EMERGING TRENDS?
The growing amount of money allocated to passive products will eventually provide more opportunities for active managers. Passive products don't differentiate between equity valuations. Active managers can take advantage of these differences. At some point the differences between these valuations are bound to stabilise.

WHAT ARE THE MAIN CHALLENGES FOR INVESTORS IN FINLAND LOOKING TO INVEST IN ETFS?
Volatile tax treatment, poor liquidity and trading costs outside OECD.

> "There are a growing number of ETFs tailored to specific indices that have ESG bias"
>
> *– Juha Venäläinen, Imarinen*

NIINA BERGRING
Chief investment officer at Veritas

HOW MUCH DO YOU CURRENTLY INVEST IN ETFS?
We only use ETFs occasionally in limited capacity.

HOW ARE YOU CURRENTLY USING ETFS AND HAS THIS CHANGED OVER TIME?
Like I mentioned before, our use of ETFs is fairly limited but when we do use them it's limited to tactical allocation while we search for a suitable active manager.

ESG INTEGRATION IS GROWING IN IMPORTANCE AMONG INSTITUTIONAL INVESTORS IN THE NORDIC REGION. HOW ARE ETFS MAKING OPTIONS AVAILABLE FOR RESPONSIBLE INVESTING?
Our philosophy is that "passive is irresponsible". We're an active investor, which means that the integration of ESG fits naturally to all our investment decisions.

For Danish Tryg, it's a time horizon decision

Kenneth Winther, head of investment portfolio at Danish **Tryg**, explains to Nordic Fund Selection Journal how and when he prefers to use ETFs.

Text: Caroline Liinanki

HOW DO ETFS FIT INTO YOUR PORTFOLIO AT TRYG?

We're not huge fans of ETFs but we use them occasionally. In our equity portfolio, we have passive market cap, active market cap, smart beta and "smart alpha" strategies. It's a dynamic exercise around being active or passive and within that, we're dynamic as well in what kind of vehicles we're using to implement the portfolio. We never want to have all eggs in one strategy basket. For the passive market cap exposure, we focus a lot on whether we want to have a linear exposure, which you can get from futures, ETFs or a cash manager, or a non-linear exposure, which you can get from the options market. For more binary events, like North Korea, you would want to have a non-linear exposure. Most of our exposure is, however, linear. Sometimes ETFs are cheaper than futures and sometime it's the other way around. On top of that, it's not possible to capture different sub-sectors in the US market through futures, so for the sector overlay there you have to use ETFs.

HOW COME YOU'RE USING FUTURES AND ETFS RATHER THAN INDEX FUNDS?

For us, it's a time horizon decision. Over the longer term, we usually have the ambition of finding an active manager so we use passive instruments more for when we have a shorter time horizon. If that time horizon is very short, we usually want futures but if you need to roll them a lot, the cost of that means that you should go to ETFs. And if you have a time horizon for more than a year, you should probably go to index funds but since we want to use active managers for that instead, we don't use index funds. That's our cost perspective and conclusions.

TO WHAT EXTENT ARE YOU DETERRED BY THE COSTS OF USING ETFS?

Because of the costs, ETFs are only a smaller part of our exposure but the costs have really come down. One thing

KENNETH WINTHER, TRYG

that some of the ETF providers are doing quite well is stock lending. They have a very good opportunity there because an ETF has the exact market exposure. Each time the market pricing changes, the ETF has exactly the market exposure after that market change. Having that makes a huge difference in stock lending so they're earning a lot through that, much more than we see active managers are doing.

HOW ARE THOSE EARNINGS REFLECTED FOR THE END INVESTOR?

Most of the ETF providers use it as a fee reduction. That actually means that these passive ETFs sometimes beat the indices because their costs are lower than what they're earning through stock lending - so they're actually beating the market.

Factors at Full Tilt

Andrew Ang, PhD
BlackRock's Head of Factor Investing Strategies

In this article Andrew Ang, PhD, discusses the concept of factor tilting.

In my many conversations with investors and industry peers about factor investing, one topic seems to always come up: factor timing. I've had recent discussions on this topic with a central bank whose managers explicitly wants to use timing to generate incremental returns.

Factors, which are broad, persistent drivers of return, are inherently cyclical: Because each factor is driven by different phenomena, they tend to outperform at different times. How can investors take advantage of this cyclicality of factor premiums?

Our view: Market timing is difficult to accomplish, and with factors, it is no different. Rushing in and out of a factor can cause harm to long-term returns and erode a portfolio's diversification. That said, factors do demonstrate some cyclicality, which offers opportunity to improve the prospects of a diversified factor portfolio.

We believe there is a better way. To effectively use factors in your investing strategy, start with a portfolio that is well diversified across key factors. Most investors can rebalance to those strategic factor weights.

Some investors might go further and implement modest tilts around that strategic factor allocation. Factor tilting can balance opportunities to improve returns without fundamentally disrupting the long-term benefits of a well-diversified factor portfolio.

How we tilt

Our research indicates that it's possible to tilt to various factors to add incremental return to a multifactor portfolio by over- and underweighting select factors relative to others, while maintaining long-term exposure to all factors.

Here's how. We consider four indicators to determine whether to tilt towards or away from the factor.

1. **Macroeconomic conditions** – to determine if the factor is helped or hindered by the current environment. For example, during the expansion phase of the business cycle, when growth is accelerating, the momentum factor tends to perform well.
2. **Valuations** – to see whether the factor is expensive or cheap relative to its own history.
3. **Relative strength** – to measure whether the factor has had strong recent performance.
4. **Dispersion** – measures how much opportunity a factor has to outperform in the current environment. More dispersion creates more opportunity.

While each of the four indicators is valuable on its own, we think it is more effective to combine these four insights into a composite indicator. This tells us whether to under-, over- or neutral-weight the factor relative to the other factors, while still maintaining diversified exposure to all the factors over time–i.e. tilting, not timing.

How to implement

Investors may choose to incorporate tilting views in several ways: by explicitly allocating to a factor-rotation strategy within the equity allocation, by layering tilting insights over existing investments or by letting tilting views influence manager selection and rebalancing. The availability of a wide range of factor ETFs makes implementation straightforward and transparent.

iShares
by BlackRock®

TELL MEDIA GROUP

MALIN TELL
Managing Director
Mobile: +46 70 679 12 75
malin.tell@tellmediagroup.se

CAROLINE LIINANKI
Editor, Nordic Fund Selection Journal
Mobile: +46 70 304 64 65
caroline.liinanki@tellmediagroup.se
Based in London

JENNIE NYSTRÖM
Event Manager
+46 70 304 30 77
jennie.nystrom@tellmediagroup.se

NIKLAS TELL
Chief Content Officer
Mobile: +46 70 304 35 20
niklas.tell@tellmediagroup.se

JANINA SIBELIUS
Editor, FBNW
Mobile: +46 70 679 04 47
janina.sibelius@tellmediagroup.se
Based in London

CHRISTER SALLING
Graphic Designer
+46 18 69 22 22
christer.salling@tellmediagroup.se

Publishing schedule 2018 – **Nordic Fund Selection Journal**

Issue	Ad due date	Print date	Publishing date
01	January 19	February 2	February 16
02	March 30	April 13	April 27
03	May 18	June 8	June 22
04	August 10	August 24	September 7
05	September 28	October 12	October 26
06	November 23	December 7	December 21

Tell Media Group AB
Västra Ågatan 16
753 09 Uppsala, Sweden
www.tellmediagroup.se
+46 18 69 22 22