EXCHANGE TRADED FUNDS VS MANAGED FUNDS: THE KEY DIFFERENCES

BetaShares
Exchange Traded Funds

In the space of a few short years the ETF industry has grown exponentially, and now holds a significant place in the investment landscape.

Funds have continued to flow out of managed funds and into ETFs, and there is no sign of this changing, as a new generation of investors comes to understand the benefits ETFs offer.

However, there is still some confusion around exactly how ETFs differ from traditional, unlisted, actively-managed funds. Some of the key differences are set out below, followed by discussion of how these differences can affect investors.

Comparison of exchange traded funds to managed funds

	ETFS	MANAGED FUNDS
DIVERSIFICATION	Varies depending on the fund, but generally high, typically with exposure to an entire index	Varies depending on the fund
EXPENSES AND FEES	Brokerage costs, typically lower management fees, bid/offer spreads	Buy/sell spreads, typically higher management fees, performance fees may also be charged
PRICING	Real time, intra-day	Varies from end of day to weekly or even monthly
LIQUIDITY	Generally high, intra-day	Varies significantly from high (daily) to limited liquidity in closed end structures
ACCESSIBILITY	Buy or sell units like any share on a stock exchange such as the Australian Securities Exchange (ASX)	Usually need to apply through an adviser or the fund manager – higher administrative burden
TRANSPARENCY OF UNDERLYING PORTFOLIO	Portfolio constituents visible daily	Rarely available daily - can be opaque

The differences between ETFs and managed funds explained

Diversification

A key benefit of many ETFs is the diversification benefits they can provide.

Broad market or sector ETFs typically aim to track an index that serves as a benchmark for an entire sharemarket, or a market sector. For example, the BetaShares Australia 200 ETF (ASX Code: A200) provides exposure to the top 200 companies on the Australian sharemarket by market capitalisation, in a single trade. This diversification means that the risk when investing in an ETF is significantly lower than when investing in a single stock.

In the case of actively-managed funds, the fund manager selects which stocks to invest in. While the manager typically will invest in a portfolio of stocks, in many cases a managed fund will have more concentrated exposure compared to a broad market or sector ETF, potentially increasing the risk position from an investor's perspective.

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Expenses and fees

The cost differential between managed funds and ETFs is arguably one of the primary reasons for the growing popularity of ETFs.

Managed funds typically charge significantly higher fees than ETFs offering similar exposure. In addition, some managed funds charge investors 'performance fees' when their performance exceeds a specified benchmark. By comparison, most ETFs charge a simple management fee and no performance fees. The management fees for BetaShares' broad market Australian shares ETF (A200), for example, are only 0.07% p.a.[1] – whereas managed funds providing similar exposure to Australian shares can charge fees of between 1-2% p.a. The primary reason for this dramatic cost differential is that most ETFs are passive funds, aiming to track the performance of an index, and so do not incur the costs of active management.

The impact of fees on your returns can be significant.

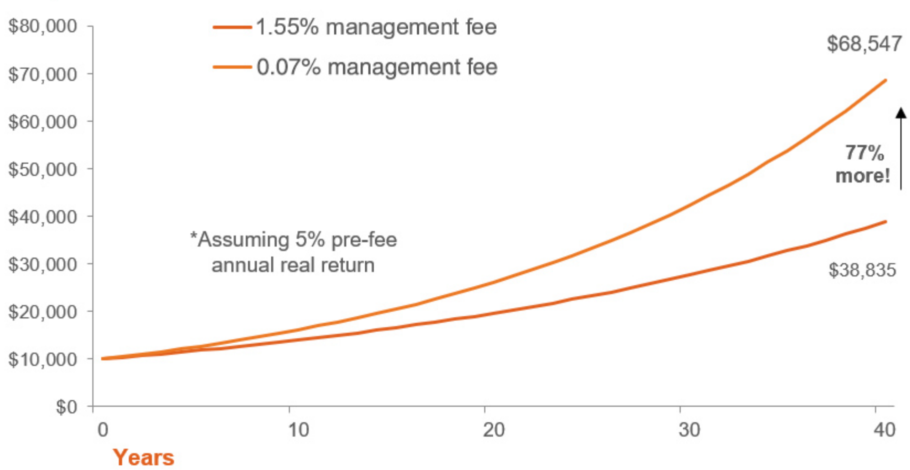
As an example, the chart over the page compares the investment return of a low-fee passive ETF (A200) with that of an actively managed fund with a similar investment strategy (Australian shares), assuming:

- pre-fee returns of 5% p.a.
- a starting balance of $10,000
- A200's management fee of 0.07% p.a.
- a typical active management fee of 1.55% p.a.[2]

Over a 40-year period, the lower-fee ETF investment would grow to be worth $68,547, compared to the higher-fee managed fund investment's closing value of $38,835. The low-fee option would be worth around $30,000, or 77%, more than the high-fee option at the end of this period.

Seemingly small differences in management fees may not. at face value. appear to matter all that much, but they can have a significant effect on after-fee returns over time.

Investment Portfolio Value Over Time



Example provided for illustrative purposes only. Assumed performance is not indicative of actual performance. Actual performance will differ and may vary between funds.

1. Additional fees and costs, such as transactional and operational costs, may apply. Refer to the PDS for more detail.
2. Source: Morningstar.

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Pricing

Another benefit of ETFs is their pricing transparency.

Because they are traded on the ASX, you can see the price of your investment at any time during each trading day. By comparison, pricing for managed funds is typically provided far less regularly, on a daily, weekly or even a monthly basis. Due to the intra-day pricing of ETFs, you should in most circumstances be able to readily determine your investment position. Also, because they trade like shares, there is no minimum investment size for ETFs (aside from any minimum your broker may require), unlike many managed funds that have minimum investment amounts that can be quite sizeable.

Liquidity

As ETFs are traded on a stock exchange, you can normally buy or sell at any time during the trading day at prevailing market prices. Also, ETFs are required to have at least one dedicated 'market maker', which seeks to ensure there will be sufficient liquidity to allow you to buy and sell your units, and also that the difference between the bid and offer is generally kept low. Most managed funds do not provide intra-day liquidity. Investors will usually only be able to dispose of their investment at the end of each day or less frequently.

Accessibility

ETFs are traded like shares, so you can buy units through your broker or financial adviser. Once you have a brokerage account, no additional paperwork is required to trade ETFs. In comparison, managed funds are typically purchased off-market. Application forms are usually required, which can be time-consuming and complicated to fill out.

Transparency

One of the most oft-cited benefits of ETFs is the transparency of their underlying portfolios. For example, the BetaShares website provides information on each of the portfolios held by BetaShares ETFs, updated on a daily basis, so you can check what each fund holds at any time. By comparison, many managed funds provide relatively little information about the holdings of the fund. Often you are given information only about the largest holdings, and even then on a relatively infrequent basis, making it harder to understand exactly what underlying assets you are investing into.

Performance

Investors are increasingly comparing the performance of actively managed funds against passive options, and are becoming increasingly aware of the impact on performance of the typically higher fees charged by active fund managers, relative to lower cost alternatives such as ETFs.

Active fund managers historically have not shown a great track record against their performance benchmarks. As the below table indicates, after fees were taken into account, fewer than 1 in 5 Australian equity fund managers surveyed who benchmark to the S&P/ASX 200 Accumulation Index actually beat their benchmark over the 3 and 5 years to 30 June 2019, while fewer than 1 in 10 beat their comparison benchmark in the 2018/19 financial year. By comparison, most ETFs simply aim to track the index return, at low cost. A200, for example, aims to track the performance of the largest 200 companies on the ASX by market capitalisation, at a management fee of 0.07% p.a.

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Percentage of active funds underperforming the comparison index - as at 30 June 2019

FUND CATEGORY	COMPARISON INDEX	ONE YEAR (%)	THREE YEARS (%)	FIVE YEARS (%)
AUSTRALIAN EQUITY GENERAL	S&P/ASX 200 Index	93.2%	83.3%	80.6%
AUSTRALIAN EQUITY MID- AND SMALL- CAP	S&P/ASX Mid-Small	60.5%	79.8%	75.2%
INTERNATIONAL EQUITY GENERAL	S&P Developed Ex-Australia	72.9%	74.0%	82.8%
AUSTRALIAN BONDS	S&P/ASX Australian Fixed Interest 0+ Index	84.6%	77.6%	90.6%

Source: SPIVA Australia Scorecard Mid-Year 2019 Report, Standard and Poor's. Past performance is not an indication of future performance.

ETFs are increasingly being used in place of, or as a complement to, managed funds. Furthermore, as more and more products are launched onto the Australian marketplace, you are able to diversify further into new investment strategies, new asset classes and new geographic regions – all as simply as buying a share.

About BetaShares

BetaShares is a specialist provider of fund products that are traded on the ASX. We offer the broadest range of ETFs and other funds on the ASX. Our objective is to provide intelligent investment solutions to help investors reach their financial goals. BetaShares is part of the Mirae Asset Global Investment Group, one of the largest asset managers in Asia.

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