EXCHANGE TRADED FUNDS V MANAGED FUNDS: THE KEY DIFFERENCES

BetaShares
Exchange Traded Funds

In this article, we describe the key differences between the managed funds and exchange traded funds, and highlight how these differences can affect investors.

The exhibit below describes the primary differences between Managed Funds and ETFs.

COMPARISON OF EXCHANGE TRADED FUNDS TO MANAGED FUNDS

	ETFS	MANAGED FUNDS
RISK DIVERSIFICATION	High – exposure to entire index	Varies depending on the fund
EXPENSES AND FEES	Brokerage costs; low management fees; bid/offer spreads	Buy/sell spreads, higher management fees, performance fees possible
PRICING	Real time, intra-day	Varies from end of day to weekly or even monthly
LIQUIDITY	High	Varies significantly from high to limited liquidity in closed end structures
MARKET PRICE V. NAV	Generally no significant and sustainable divergence	NAV subject to entry, exit and management charges
ACCESSIBILITY	Purchased like a share	Entry via manager or intermediary (platform or advisor) – generally high administration burden
TRANSPARENCY OF UNDERLYING PORTFOLIO	Portfolio constituents available at all time	On request, rarely daily. Can be opaque

The Differences between ETFs and Managed Funds Explained

Risk Diversification

Depending on the underlying exposure, ETFs can provide all the diversification benefits of traditional managed funds, in that they can provide an investor exposure to an entire index. For example, BetaShares Resources Sector ETF (ASX Code: QRE) gives an investor exposure to the performance of the largest Australian Resources companies via a single trade. This diversification means that the risk position for an investor in an ETF is significantly lower than investing in a single stock. In the case of managed funds, it is up to the discretion of the individual fund manager to invest in particular stocks – while typically they would also invest in a portfolio of stocks, there are several funds which have significantly concentrated exposure, increasing the risk position from an investor's perspective.

Expenses and Fees

It is arguable that the cost differences as between managed funds and ETFs are one of the primary reasons for ETFs global success. Managed funds typically charge significantly higher management fees than similar ETFs. In addition, several managed funds also charge investors "performance fees" when their performance exceeds a nominated benchmark. By comparison, ETFs charge a simple management fee and no performance fees. BetaShares Sector ETFs management fees, for example are only 0.39% per annum – whereas managed funds providing exposure to sectors would typically charge fees that are between 1.5%-2% per annum. The primary reason for this dramatic cost differential is that ETFs are not actively managed, and thus experience lower levels of turnover, shielding investors from the costs of buying and selling shares.

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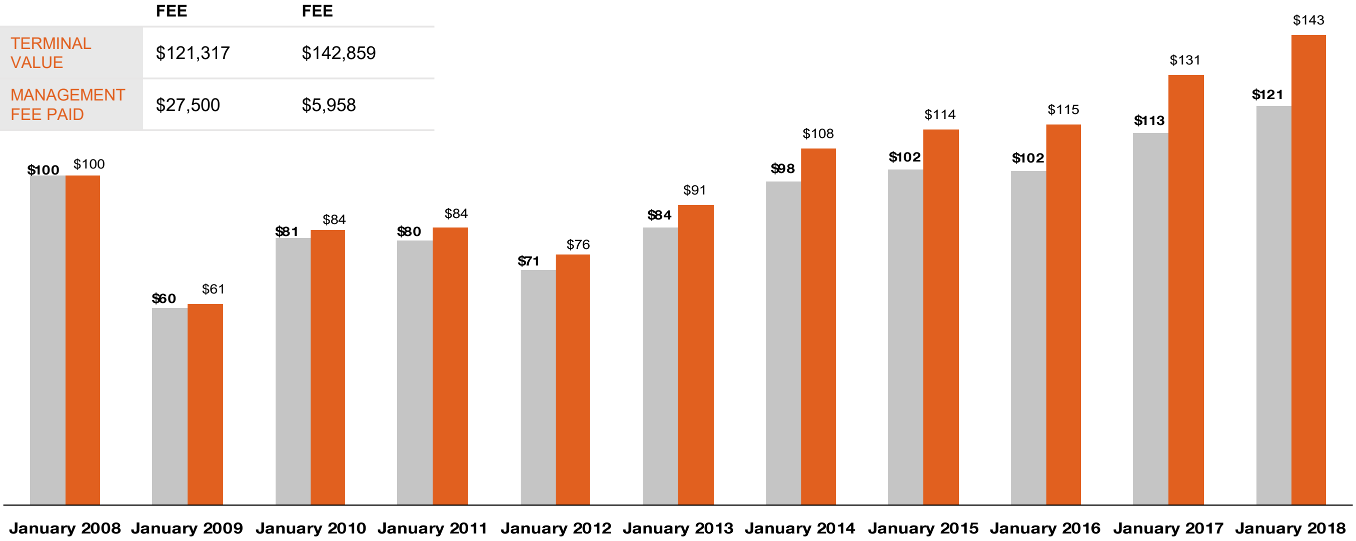
The impact of fees on investor returns can be significant. As an example, the below exhibit indicates the differences in an investor's returns assuming the performance of the S&P/ASX 200 Index, and assuming a fee of 0.40% vs. a fee of 2.00% per year. As you can see from the below, over 10 years, assuming an investment size of $100,000, the savings to an investor are over $20,000!

VALUE OF $100,000 INVESTED IN S&P/ASX 200 ACCUMULATION INDEX UNDER VARYING FEE ASSUMPTIONS

	2% MANAGEMENT FEE	0.40% MANAGEMENT FEE
TERMINAL VALUE	$121,317	$142,859
MANAGEMENT FEE PAID	$27,500	$5,958



SAVINGS TO INVESTOR OF ~$21,542

Source: Bloomberg. Illustrative only. Past performance is not an indication of future performance of the index or ETF. You cannot invest directly in an index.

Pricing

One of the best things about ETFs is their pricing transparency. Because they are traded on stock exchanges, like the ASX, an investor is always able to see the price and the value of their investment. By comparison, pricing for managed funds can often be provided far less regularly, sometimes on a daily, weekly or even a monthly basis! Due to the intraday pricing of ETFs, an investor will always know his or her investment position and therefore be able to take action accordingly. Also, because they trade like shares, there is no minimum investment size for ETFs, unlike many managed funds which include strict minimum investment sizes.

Liquidity

As ETFs are traded on a stock exchange, an investor can, at any time, choose to buy units or sell them. There are generally no restrictions on the ability of an investor to sell down their position, allowing them to be traded on a flexible manner and with no fuss. In most circumstances, so long as the market is open, ETFs can be bought or sold! Also, because all ETFs are required to have at least one dedicated market maker there is sufficient liquidity to permit investors to buy and sell the units, and also ensure that the difference between the bid and offer is kept low. Managed Funds, in the main, do not exhibit such flexible liquidity. Liquidity in managed funds can range from being very high to very low depending on the fund strategy.

Accessibility

ETFs are purchased like a share. This means that investors can utilise brokers or financial advisors to buy the product. Once an investor has a broker or advisor, no additional paperwork is required and ETFs can be bought and sold at any time that the stock market is open. 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 often cited benefits of ETFs is their transparency. Because they track specified indices or asset classes, an investor has information on the ETF portfolio. For example, for BetaShares ETFs, the BetaShares website provides information on the Fund portfolio at all times. By comparison, many managed funds provide relatively little information about the holdings of the fund. Often an investor is only given information about the largest holdings, and even then on a relatively irregular basis, making it harder for investors to understand exactly what is being held by the manager.

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Performance

Investors are increasingly scrutinising the performance of actively managed funds vs passive options. This is particularly so due to the fees charged by active fund managers, relative to lower cost alternatives, such as ETFs. The track record of active fund managers in outperforming their benchmark indices has been statistically poor. As the below table indicates, only 41% of Australian equity fund managers who benchmark to the S&P/ASX 200 Accumulation index actually beat this index in the year to December 29, 2017. By comparison, ETFs provide simply the index return, at low cost.

PERCENTAGE OF ACTIVE FUNDS OUTPERFORMING THE INDEX – AS AT DECEMBER 29, 2017

FUND CATEGORY	COMPARIOSN INDEX	ONE YEAR (%)	THREE YEAR (%)	FIVE YEAR (%)
Australian Equity General	S&P/ASX 200	41%	33.2%	37%
Australian Equity Mid- and Small-Cap	S&P/ASX Mid-Small	25.9%	25%	44.3%
International Equity General	S&P Developed Ex-Australia LargeMidCap	47.5%	19.1%	9.1%
Australian Bonds	S&P/ASX Australian Fixed Interest 0+ Index	31.4%	22.64	14.6%

Source: Standard and Poor's. Past performance is not an indication of future performance.

Exchange Traded Funds are increasingly being added to investment portfolios, either as a supplement to, or indeed, a substitute for managed funds. Furthermore, as more and more products are launched onto the Australian marketplace, investors will be able to access new investment strategies, asset classes and performances – all as simply as buying a share.

About BetaShares

BetaShares is a specialist provider of fund products that are traded on the Australian Securities Exchange. Our objective is to expand the universe of investment possibilities for investors in Australia.

BetaShares is part of the Mirae Asset Global Investment Group, one of the largest asset managers in Asia. Currently, Mirae manages in excess of US$120B.

www.betashares.com.au
T: 1300 487 577 (Australia)
T: + 61 2 9290 6888 (ex Australia)
info@betashares.com.au