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Global ETF Trends to Watch in 2020

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Investors' appetite across the globe for exchange-traded funds (ETFs) was strong in 2019 and shows little sign of slowing, according to Jason Xavier, our Head of EMEA ETF Capital Markets. He shares some of the themes and trends he sees ahead in 2020.

The tailwind for exchange-traded funds (ETFs) going into not only a new year but a new decade couldn't be stronger. Last year, global ETF assets under management (AUM) surpassed US$6 trillion, and in Europe we broke US$1 trillion in AUM.[1] I've identified some themes that could continue/materialise in 2020 for ETFs globally.

Three predictions that stand out for me centre around: fixed income, environmental, social and governance (ESG) factors and volatility.

Let's discuss.

Fixed income: Active fixed income ETFs in Europe will surpass US$15 billion in AUM.

My first prediction centres around the growth of this asset class. Last year fixed income ETFs gathered over US$250 billion in inflows globally, thus pushing AUM in this category to almost $1.2 trillion globally, representing an annual growth rate of approximately 30%.[2] European fixed income ETFs grew at a higher rate of almost 54% last year to end the year at approximately US$260 billion in AUM[3] outpacing equity ETF growth for the region.

Investors continue to embrace the ETF wrapper for fixed income allocation across all client segments for the transparency, liquidity and price discovery that typically make the ETF wrapper a true value-add.

As I've mentioned in an earlier blog , the democratisation of price discovery that ETFs have brought to the fixed income investing landscape continues to be very well received by clients. We see more and more of them adopting the use of fixed income ETFs in their portfolio construction.

Fundamentally, global economic growth is still an issue, and Europe remains fragile. Headwinds persist around the process for Brexit, slow German manufacturing numbers amid the US/China trade tensions, and a lack of a clear favourite to succeed German Chancellor Angela Merkel as she prepares to depart next year.

Hence, we believe the continued low-yield environment globally and negative environment in Europe points to the need for a more active management approach to successfully navigate these waters. A focus on earning some return on cash in Europe will likely continue to dominate actively managed fixed income ETFs as investors position for shorter durations,[4] and continue to utilise the intra-day liquidity benefits of the ETF wrapper for fulfilment.

Outside of Europe, credit markets have been the main beneficiary of recent periods of equity market weakness. We believe this type of rotation is likely to continue to take place into 2020 amid bouts of equity volatility. We see interest likely to rise in the US investment-grade corporate sector, which remains supportive for those investors searching for yield outside the eurozone.

Indeed, we've been seeing these trends in our own active fixed income line-up, which now stands at US$2.4 billion globally with US$1.6 billion of inflows in 2019. Fixed income is an asset class where we really think active management can shine.

ESG-focused strategies will be the fastest-growing segment and dominate European ETF issuance in 2020.

While fixed income ETFs gathered the most AUM in 2019, ESG-focused ETFs dominated the growth rate in Europe. Last year ESG-focused ETF AUM grew by US$16 billion in Europe, a 150% increase, to take European ESG AUM to US$33 billion from approximately US$12 billion at the end of 2018.[5]

Many factors continue to support the growth for sustainable finance. European Union (EU) regulation continues to push for a sustainable finance action plan, and governments and central banks are paying more attention to climate change as a systemic risk. Advancing big data and artificial intelligence technology are filling the gaps in capturing the explicit risks for proprietary Investment use.

In addition, global demographic shifts are taking place that have investment implications. A sizeable wealth transfer to a new generation will occur, one born into a digital environment.

Both Millennials and Generation Z that follows have grown up with and are dependent on technology, and hence an active audience for investing in and tracking ETFs via mobile devices. I strongly believe there's likely to be solid support for increased ESG-focused ETF issuance, particularly because various studies have cited values-based investing as a priority among Millennial investors.

One potential factor that certainly stands out within this discussion is the "Lagarde effect." Having taken over the reins at the European Central Bank (ECB) at the tail end of last year, it's clear that climate change is a priority for ECB President Christine Lagarde and will likely feature heavily in the ECB policy going forward.

With limited room for conventional monetary policy, should the eurozone economy falter we could see a potential extension to quantitative easing, could Lagarde also extend asset purchasing to ETFs and those that support her climate-change policy?

We believe many investors have already positioned for this possibility.

Factor investing and factor ETF strategies are here to stay.

As mentioned above, European ETF AUM surpassed US$1 trillion last year, representing an annualised growth rate of 25% over the last 10 years.[6] While ESG-focused and fixed income ETFs have featured heavily in recent years, factor-based or smart beta ETFs have still dominated passive ETF annualised growth rates over the last 10 years.

Smart beta ETFs grew over 145% last year, having slowed in 2018.[7] Over the last 10 years, the sub-sector has grown at a compound annual growth rate of 34%, illustrating the wider adoption by investors seeking more diverse fundamental drivers to help shape their investment allocations.

While the ongoing low-yielding global economic backdrop has clearly been very supportive of market-capitalisation-based strategies, more and more investors are embracing strategies to protect themselves against an economic downturn. Within the smart beta landscape, strategies that incorporate a multi-factor approach tilted to quality or risk-control strategies dominated flows last year.

As previously outlined, global growth remains an investor concern in early 2020, and the eurozone is facing some challenges. And while the US economy is still in the midst of its longest expansion in history, many observers are questioning its sustainability. Consumer spending and a strong labour market continue to point to an upward trajectory. However, it's clear more and more investors are embracing non-traditional ETF strategies to help them participate in potential upside while aiming to minimise any drawdowns.

We saw this to be the case last year with our US multi-factor strategy. Inflows took this product to an AUM of over US$1.5 billion as investors embraced the benefits of transparency, liquidity and low cost with a tactical allocation via the ETF wrapper.

Will my predictions come to pass? Stay tuned! It looks like an exciting year already.

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1. Sources: Franklin Templeton, Morningstar.

2. Ibid.

3. Ibid.

4. Duration is a measure of sensitivity of a bond or a fund to changes in interest rates. It is typically expressed in years.

5. Source: Morningstar.

6. Source: Ibid.

7. Source: Ibid.