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Is ETF innovation out of control?

Not according to a panel that discussed the topic during the recent CFA Society Calgary Wealth Management Conference.

By: Jacqueline Louie | October 28, 2013 | 00:00

Are there too many ETFs? Are they evolving too quickly?

Not according to a panel that discussed those topics during the recent CFA Society Calgary Wealth Management Conference.

Since the financial crisis, the term innovation has had a negative connotation. But "ETFs are clean, transparent instruments that […] have all the same controls and protections that traditional mutual fund products do," says panel member Neil Marsh, vice president of iShares Institutional Business at BlackRock.

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According to Marsh, ETFs are now undergoing responsible innovation, with the development of new products to meet investor needs and demands.

For example, "minimum- and low-volatility ETFs have evolved in response to client concerns about the level of volatility in the marketplace," he says.

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He adds, "ETFs allow the democratization of investing to all investor types, because they allow access to segments of the market that have not traditionally been available to financial advisors and end investors."

One of the largest growth areas has been in the fixed-income segment. “Fixed-income investments are typically traded over the counter in a very opaque market. ETFs allow for greater transparency and liquidity, by bringing some of this activity into the public market on stock exchanges,” he says.

Such activity includes local dollar emerging market fixed income, international fixed income, and U.S. high-yield credit.

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And in response to concerns around rising interest rates, “particularly in the U.S. and Canada, we’ve seen client demand for fixed-income ETFs with shorter maturities, but more robust yield.”

Panellist Craig Lazzara, global head of index investment strategy for S&P Dow Jones Indices, says even unpopular market segments and countries are prime candidates for passive management. “Small cap managers are just as likely to underperform as are large cap managers.”

He suggests that investors think about patterns of return, and how to obtain them passively. If you need a particular pattern of return that is different from what a cap weighted index will give you, there are very often passive means of obtaining that pattern of return.

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For example, investors using a low-volatility ETF can expect to be protected from a down market, and to participate in an up market. “Particularly for an individual investor who has finite time horizons, that is a very congenial way to obtain equity exposure,” Lazzara says.

And for very aggressive investors who think the market will go up, high-beta ETFs can serve that purpose. They’re designed to go up more when the market rises; they accentuate the movement of the market, in both directions.

“High beta indices are very likely to outperform in a strong market. They’re good tools if you have a bullish tilt,” he says.