



# The Outlook

## The analysis of global ETF industry and its development trend

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### 1. Foreword

Major global financial events in 2009 were:

- ◆ Dubai World declared debt restructuring of USD26 billion, where some creditors faced a loss of up to 50% in capital. Dubai's investment company, Istithmar World, became the first sovereign fund to be liquidated. Dubai's real estate market that used to be top in the world, crashed and its status as the financial center in the region has been taken over by Abu Dhabi.
- ◆ Moody's warned that both America and United Kingdom should reduce its deficits or lose their "Aaa" credit rating status.
- ◆ Both ECB and Fed plan to withdraw their quantitative easing policy in the first quarter, and rescind a major portion of the non-traditional measures for market liquidity during the financial crisis.

Few of the major events show that the financial market has recovered from the challenges of 2008 in 2009 as the global market bottomed-out by the first quarter. However, the aftershocks of the financial crisis continue within a market that has not fully recovered and stabilized. This kind of market gave the liquid and high transparency ETFs the opportunity to become the most popular and fastest growing product in 2009. According to statistics from BLACKROCK, a total of USD13.3 billion was subscribed in global mutual funds in 2009, and in the same period, ETF had a net subscription of USD93.8 billion,

showing the market's preference for ETFs. This document will briefly describe the development of global ETF industry and take a deeper look at the future development trend of the ETF market.

### 2. Current global ETF industry status

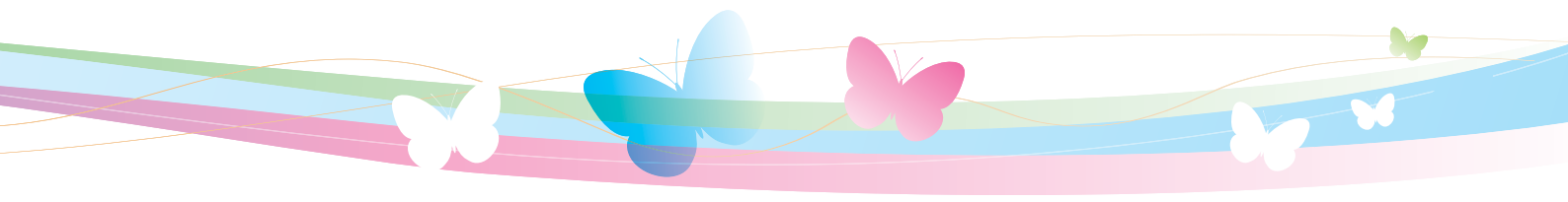
According to statistics from BLACKROCK, up to October 2009, a total of 1,859 ETFs was issued worldwide and 3,327 listed (including 1,468 cross listing), managed by 97 fund management institutions and listed on 40 exchanges. Total asset size reached USD941.85 billion, with a growth of 32.5% since the beginning of 2009 with 805 more ETFs planned for issuance.

Besides its appeal to investors, the exchanges have also placed high emphasis on ETFs. From beginning of the year till the end of November 2009, there were a total of 29 IPOs on NYSE Euronext, and at the same time, 51 new ETFs were issued. In Europe and Asia, ETF were cross-listed, and up to October 2009, the number of European listed ETFs and asset size increased by 44.2% and 43.2% respectively. ETFs in Hong Kong and Singapore doubled in listings and asset size. ETFs on the TWSE have increased from 3 to 14 with an increased asset size of 92.95%, to USD2.48 billion (NTD78 billion).

### 3. ETF industry development trend

#### a. Increase in cross-listing ETF trading

The cross-listing ETFs reduced some of the common skepticism by the general public about offshore funds such as super-



vision effectiveness, transparency, the lack of liquidity, and high investment costs. For investors,ETFs are the perfect investment object in global asset allocation and risk diversification since an ETF can be listed on multiple exchanges, meaning that it satisfies regulation of multiple authorities and exchanges, or be backed by high-profile, large-asset-size companies with long investment history. Therefore, after the financial crisis, the demand for cross-listing ETFs on the market has been phenomenal.

Apart from market demand, many major exchanges around the world are enthusiastically developing cross-listing ETFs. Cross-listing ETFs constituted 27% of the total market share in 2006, and at the end of October 2009, the figure has grown to 44% from the enthusiastic development in Europe and Asia. Europe possesses development advantage from its consistent “Undertakings for Collective Investment in Transferable Securities (UCITS)” regulation between European Union member countries and the single-currency in the Euro-zone. In Asia, major exchanges and regulatory agencies in Hong Kong, Singapore and Malaysia are vastly amending regulations to introduce various offshore ETFs. Tokyo Securities Exchange has set a target of listing a hundred ETFs in 2010 in expressing their ambitions to develop the ETF market.

### **b.Amalgamation of the ETF industry and fund issuers’ entry into the ETF market**

After the financial crisis, the high-leverage, structured products and complicated hedge funds were discredited by the market and resulted in large redemptions in the fund market. The redeemed capital ultimately sought refuge in ETFs. Recently, the fund institutions are entering into the ETF industry, such as BLACKROCK, PIMCO, Charles Schwab Corp and T.Rowe Price Group Inc. These large fund management institutions have filed applications to issue ETFs to recoup their losses incurred during the crisis from the fund market.

When more and more large fund institutions enter into the ETF market, it implies that the competition will greatly increase, gradually taking the ETF industry on a path to amalgamation. For example, the recent large merger by BLACKROCK with one of the leaders in ETFs – Barclays Global Investors in June 2009. BLACKROCK, who originally only operated active investment management, through its merger, directly included the passive management market of indexed investment into its portfolio and became the largest asset management company in the world.

### **c.Toward a diversified product structure**

Comparative to the traditional stock index, the diversified components or strategic investment ETF products that are able to utilize difference trading strategies and investment objects have gained popularity in



Europe and America. According to BLACK-ROCK's survey, ETFs that track emerging market, bonds, commodities, currency and structured products on alternative investments have had an average of more than 60% growth in asset size since the beginning of 2009 till the end of October in the same year. Recently, Europe and America have introduced hedge fund ETFs and private offering ETFs that signifies investors' acceptance of the diversified and non-traditional ETF products and popularizing trend.

In the future, when more fund management institutions enter the market, it could provide flexible trading and become slightly more complex in operation. Therefore, the higher operating complexity, the higher the cost of trading and difficulty in information disclosure. It would be a challenge to fund management institutions to strike a balance between the two issues in the future, however for investors it means a wider variety of ETF products.

#### 4. Conclusion

Looking ahead in 2010, international mergers, fast capital movement, resource reallocation will be prevalent. However, the general expectation is that the market will recover with slight instability, bigger fluctua-

tion and extended period. Under such market conditions, the financial product with the biggest development potential is the ETF, owing to its transparency, liquidity, flexibility in structure, ease in cross-trading, and approval granted by regulators. In the future, more flexibility would be increased through the amendments made by most authorities that allow more financial institutions to enter the market, thus making more ETF products available. Cross-trading and cross-listing would become a conspicuous trend, and extend the prosperity of the ETF market in 2009 with strong growth.



## The global ETF development and trends

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### Development of American ETF products

For global investors, 2009 was a year of turbulence. In the beginning of the year the market was still battered by the financial crisis and left with weak foundation. Then hope always presents itself in despair, in a couple of months, the global stock market bottomed out and rebounded. Major global markets climbed over 50% and by the end of October 2009, America, the biggest ETF market in the world, had increased its number of ETFs to 796 with asset size of USD707.4 billion, which is 43.5% increase compared to 2008 in the same period. In a year, a total of USD72.2 billion were invested in American ETFs.

As the ETF products increase in popularity all over the world, the American financial institutions began issuing ETF products recently. For example, Charles Schwab, Jefferies etc. Although 42 ETFs were delisted in America by the end of October 2009, we believe in the foreseeable future, ETF products will gain more investor recognition and continue to prosper.

The year of 2009 was an unpredictable year for the American economy and affected the American investors' preference for ETF products. More specifically, fix-income ETFs, commodity ETFs, and global equity ETFs attracted huge amounts of capital. Compared to the development of the above-mentioned ETF products, traditional American equity ETFs resulted in USD30.1 billion

capital outflow. This is evident of asset allocation by American investors to diversify their risk exposure.

Furthermore, the uncertainties in the economic environment also gave way for the development of inverse ETFs. According to statistics, in 2009, American investors reduced investment in leveraged ETFs by USD5.7 billion, and the inverse ETF investment increased by USD19.9 billion, representing a significant difference in growth between the two.

The innovation of American ETF products has continued. To stand above the rest, in 2009, various ETF issuers issued new ETF products such as single-country ETFs, frontier markets ETF, emerging country small cap ETFs, and Islamic ETFs.

In 2009, the number of ETFs significantly increased, and each ETF faced intense competition. Many of late ETF issuers began to provide cheaper management fee and front-end load to obtain bigger market share. For example, Vanguard MSCI Emerging Markets Fund had a capital inflow of USD6.4 billion due to its cheaper management fee, considerably higher than the leader in Emerging Marketing ETF – iShares MSCI Emerging Markets Fund with a capital inflow of USD3.6 billion.



Regulation also created pressure for some American ETF products. As an example, regulations forced many commodity ETFs to suspend trading, and ultimately caused Powershares DB Crude Oil Double Long Oil ETN to shut down.

### Development of European ETF products

Although the European ETF market is smaller than America, but the European ETF products are still in a strong growing position. By the end of October 2009, Europe had 783 ETF products, with an asset size reaching record-high of USD204.2 billion. Comparing to 2008 in the same period, it grew 43% with over 170 ETFs issued in 2009, and trading volume increased by 76% compared to 2008 in the same period.

In Europe, there are also more and more financial institutions are competing in the ETF market. Since 2009, besides mergers like iShares and BlackRock, others like Source, HSBC, Deutsche Bank, and Credit Suisse are formidable competitors entering into the market, intensifying the competition. Currently in Europe, most of the ETF investors are still institutional investors, compared to the limited number of independent financial consultants incorporating ETFs in individual investors' portfolios. Therefore major ETF issuers are doing their best to gain investors' recognition through various channels.

### Development of Asia-Pacific ETF products

Compared to America and Europe, the ETF market in Asia-Pacific region is smaller. By the end of September 2009, the whole Asia-Pacific region only had 12 countries that issued ETF products, with total asset size of only USD65.1 billion.

Although the Asia-Pacific region seems to lag behind America and Europe, but the growth potential of the region cannot be underestimated. Recently, under the efforts of Japan, Singapore, and Hong Kong, the Asia-Pacific region is developing similar trends as Europe, anticipating high-growth.

Japan is the leader in Asia-Pacific ETF market with 40% market share, however its growth declined in 2009. Its total ETF product investment declined to USD4.6 billion, and asset size decreased by 3%.

Comparatively speaking, the Asia-Pacific, non-Japan countries had impressive ETF development. According to JP Morgan, non-Japan listed ETF products grew 49.7%, moreover, the average trading volume increased by 91.1% since 2009. Among them, Singapore and Hong Kong possess the best growth potential. But, as the relaxing of ETF cross-listing, it is possible that Taiwan may become another star in the Asia-Pacific ETF market.