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Tria Strategy Series - ETFs

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Agenda

Why ETFs are a large opportunity

How ETFs address some of the issues with managed funds and listed investment companies

Why an ETF business is different & some things to watch out for

Source:



Hi, I'm a managed fund

- I've been around a while and most people own one or more of me.
- I can meet the needs of most people, most of the time, reasonably well.
- I'm mainstream.
- I'll be around for a long time to come.



I'm an ETF

- I've been around a while and most people own one or more of me.
- I can meet the needs of most people, most of the time, reasonably well.
- I'm mainstream.
- I'll be around for a long time to come.



- I've been around a while, too, but I recently became cool and everyone is talking about me.
- I can fill the needs of some people, some of the time, and I do a great job.
- I'm niche, but I'm growing very quickly into a big niche.
- Like the iPad, a lot of people can't decide if I'm a passing fad or a lasting trend.

...and I'm a Listed Investment Company

- I'm not as young as I used to be.
- You should have seen me in my heyday – I was efficient and low cost. All the brokers were talking about me.
- But these days I can be difficult to predict...what with trading at a premium or discount to my NAV.
- I'm niche alright – always have been. And unfortunately I'm one of a dwindling number.



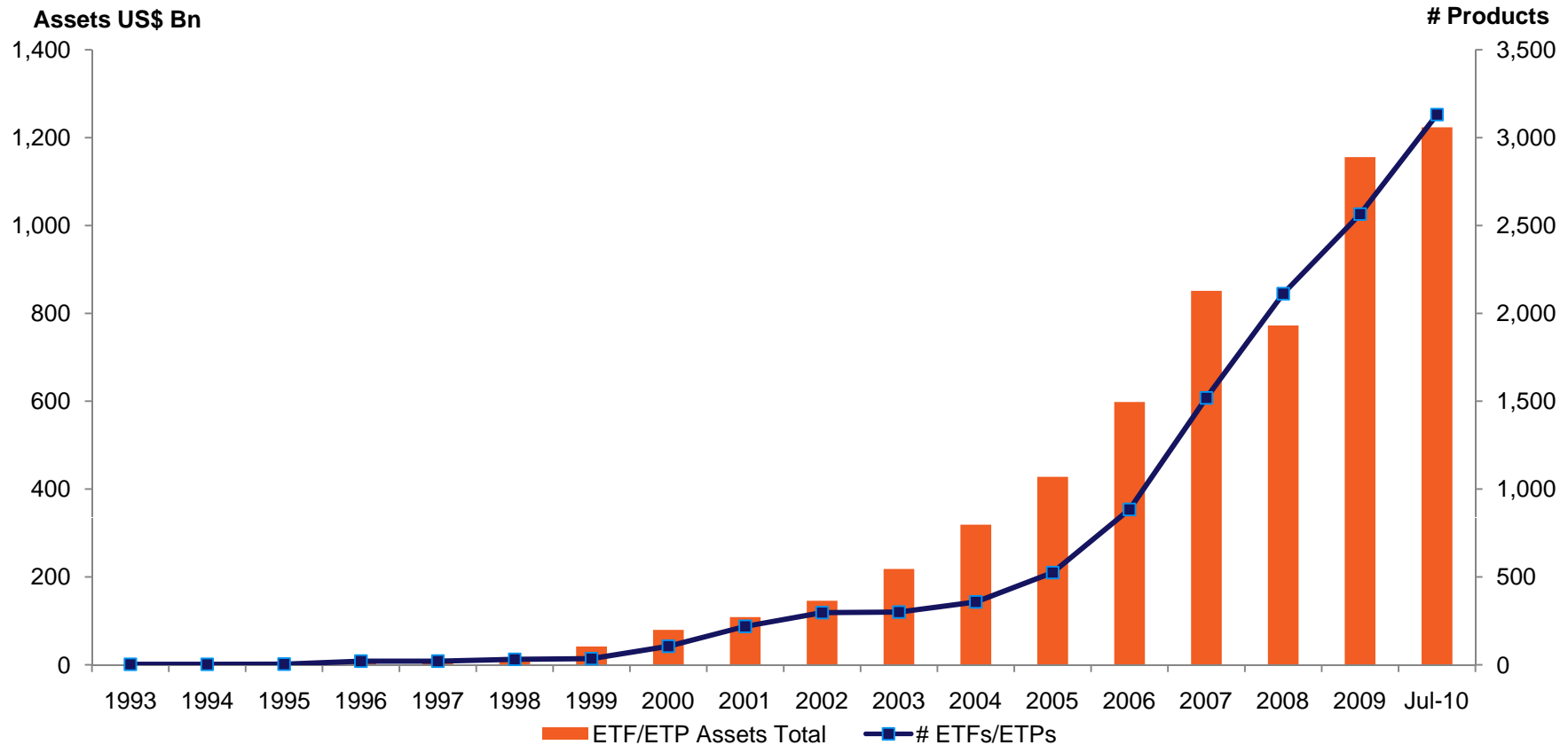
A more serious comparison

	Structure	Governance	Open / closed ended	Price v NAV	Intra day price / liquidity	Listed
Managed Funds	Unlisted unit trust	Responsible entity	Open	NAV	No	No
LICs	Listed investment company	Board	Closed	Premium / discount	Yes	Yes
ETFs	Listed unit trust	Responsible entity	Open	NAV	Yes	Yes

ETF market

Global ETF market – US\$1.2 trillion market

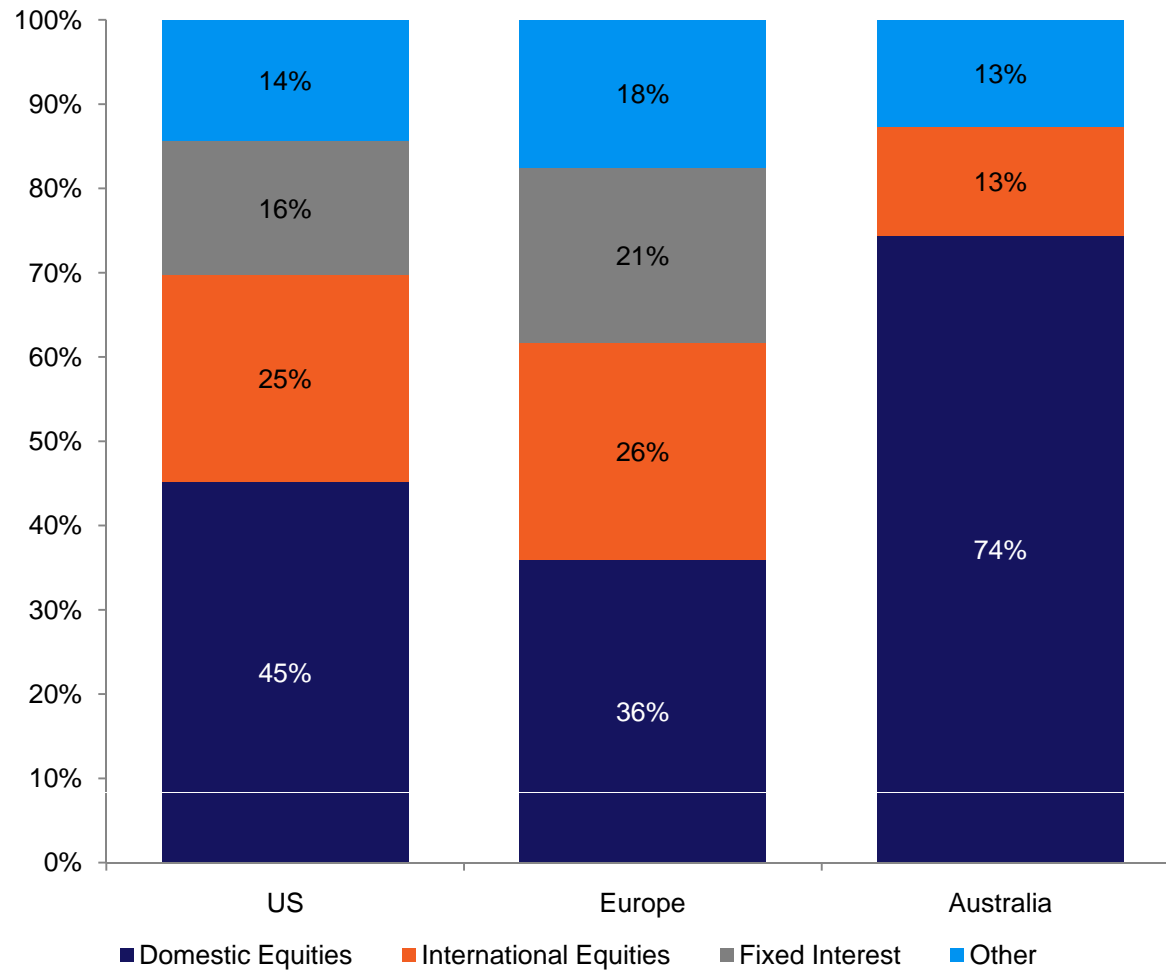
Typical S-curve



Source: ETF Landscape (BlackRock)



Where is the money?



How many ETFs can our (relatively thin) domestic equities market withstand?

Source: ETF Landscape (BlackRock)

The exotica

“Other” includes:

- Commodities: \$109bn
- Foreign currency: \$3bn
- Leveraged equities: \$13bn
- Inverse: \$6bn
- Leveraged inverse: \$11bn

A different type of client...

Section 2

ETF mechanics

Two ways to trade...

Share Quote as at 1:29 PM Sydney Time, Tuesday, 7 September 2010

▲ SPDR 200 FUND ETF UNITS ▲

CommSec Margin Lending LVR: 65% ^

Code	Bid	Offer	Last	Change*	% Change*	Open	High	Low	Volume	Trades	Value	News
STW	43.400	43.420	43.390	+0.040	.09	43.300	43.450	43.290	191,506	189	8,307,853	

[Buy](#) | [Sell](#) | [Add to Watchlist](#) | [Research](#) | [Chart](#) | [Course of Sales](#)

Trading Status: **Normal**

Market Depth

BUY				SELL			
Number	Quantity	Price	#	Price	Quantity	Number	
2	13,924	43.400	1	43.420	38,021	4	
4	41,857	43.390	2	43.430	41,907	4	
3	38,900	43.380	3	43.440	47,907	4	
4	42,278	43.370	4	43.450	41,966	4	
1	25,000	43.360	5	43.460	28,000	2	
			6				
			7				
			8				
			9				
			10				

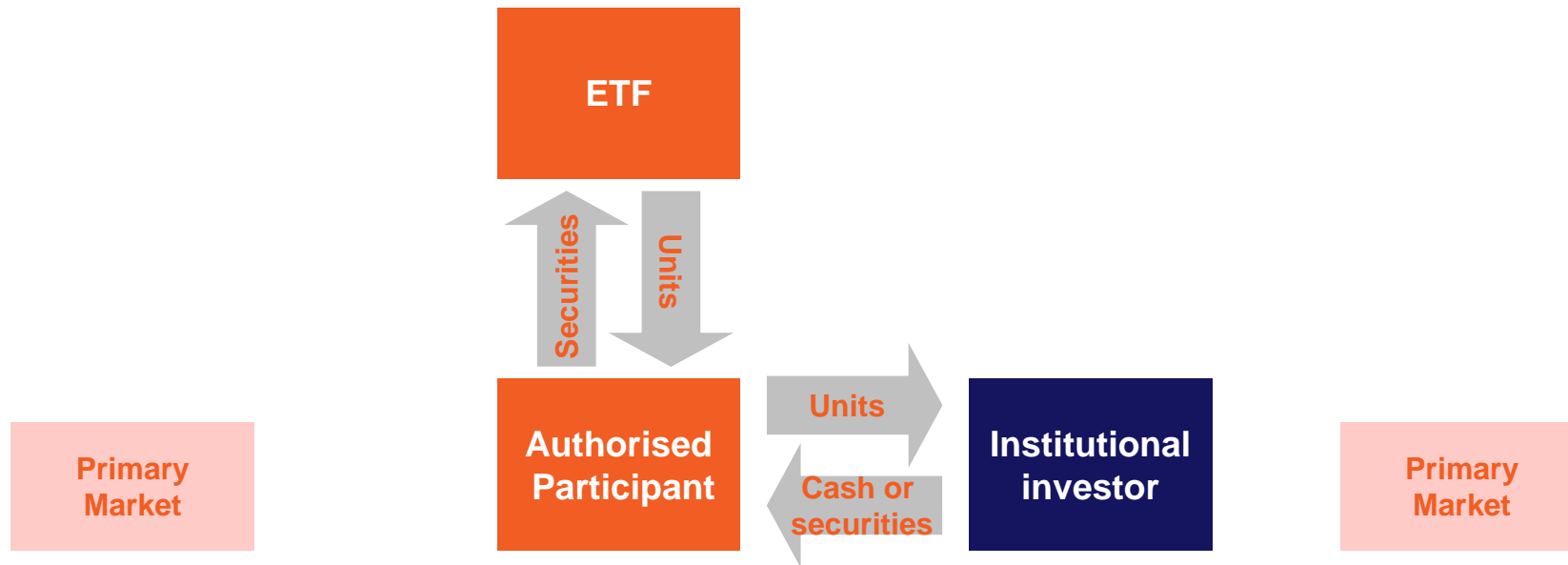
14 buyers for 161,959 units

18 sellers for 197,801 units

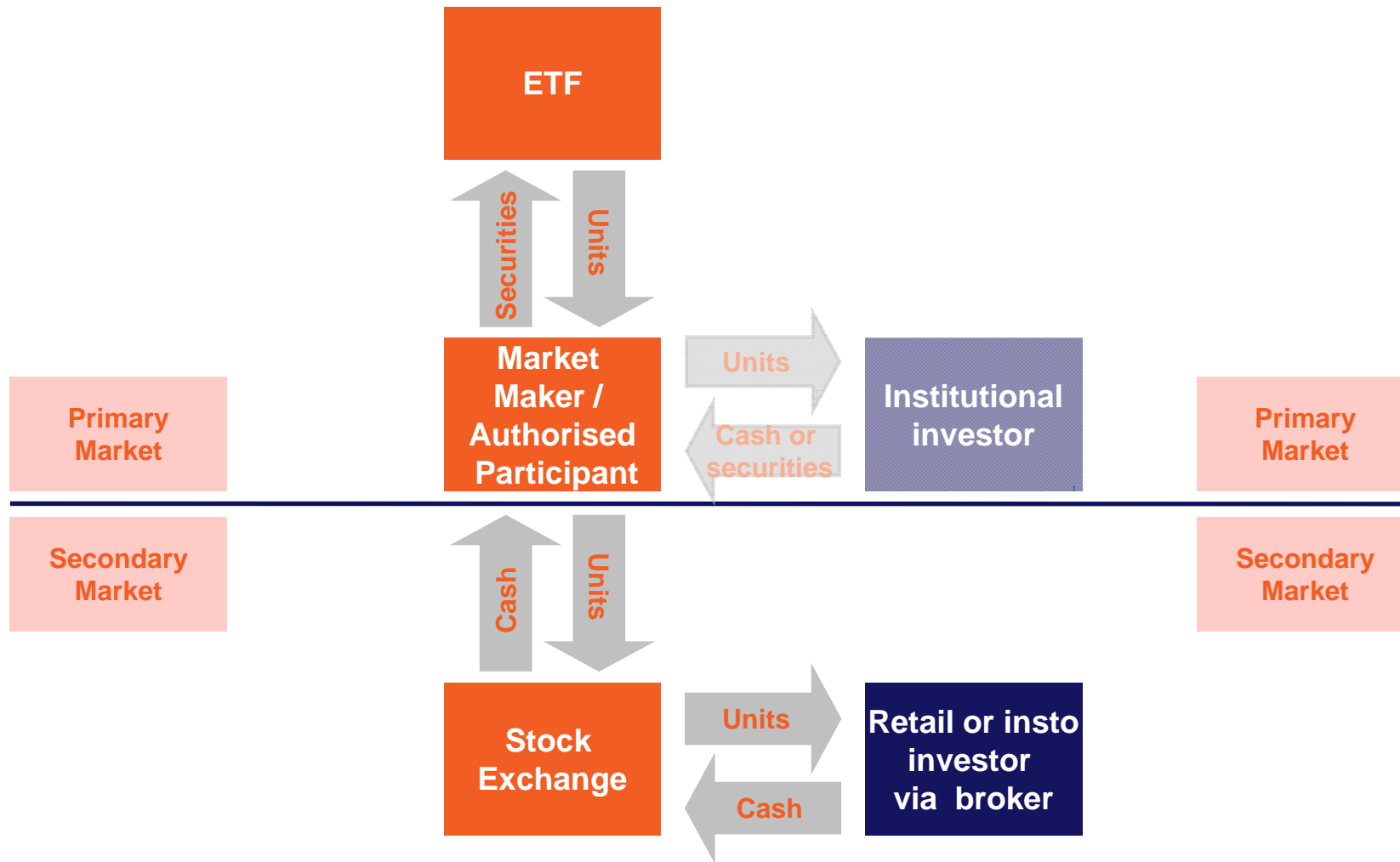
52 Week	
High	Low
47.630	39.220
Last traded time	
13:26:45	

Market Indices		
Index	Value	Change
ASX SPI 200	4,575.00	-17
All Ordinaries	4,620.40	4.7
Dow Jones	10,447.93	127.83
FTSE-100	5,439.19	11.04
Hang Seng	21,333.52	-22.25
NASDAQ	2,233.75	33.74
Nikkei 225	9,279.80	-21.52
S & P 500	1,104.51	14.41

The primary market...and why it matters



The secondary market – retail distribution



ETFs are efficient and predictable...it's all in the NAV

Closed-ended vehicles (including LICs) generally trade at a premium or discount

- Eg AFIC is trading at a 5% premium and Contango Microcap is trading at a 42% discount.

Why is this a problem?

- This presents an opportunity (eg if a discount closes), but also a risk (if a discount widens).
- Ultimately it makes them unpredictable.

ETFs trade at NAV

- Because of the direct access to assets in the primary market, ETFs trade very close to NAV.
- This makes ETFs predictable.

Hot topics – three questions we answer every month

Are swap-based ETFs too good to be true?

Funds that gain exposure to index via derivatives

Extremely popular in Europe

- Perfect index tracking.
- Low/no fee.

But on the nose post-GFC

- Counterparty risk is top of mind.
- Transparency is lost

Some local catches

- Swaps are generally held on revenue account, so can be disastrous for distributions and generally difficult to manage.
- The value of franking credits may not be passed into the trust.

Why wouldn't I turn my active product into an ETF?

White noise

- Active ETFs have generated a lot of coverage.
- There are just a handful of active ETFs in the US with less than \$1bn between them (mostly in a single enhanced index product).
- Main obstacle is portfolio publication.

Exception to the rule

- ETFs that follow a rules-based investment process.
- Rules must be substantial enough to create an index.
- Index must be published.
- Examples are tilted products (value, growth, dividend)

ETFs are not simply a distribution channel for your active business

Are ETFs really that tax efficient?

Passive

- Low turnover means realised gains are minimal.

In-specie creation and redemption

- Intelligent tax parcelling results in the pushing out of unrealised gains to redeeming parties.

Capital account

- Unit trusts are generally held on capital account, whilst most derivatives are held on revenue account.

Easy as E T F ?

Things to watch out for

There are many unique features of an ETF business that mean new processes, relationships and documents that take time to develop.

- Constitution
- PDS
- Creation/redemption process (admin, custody, unit registry)
- Regular in-specie transfers
- ASX approval
- ASIC approval
- Tax treatment
- APs/market makers

Takeouts

1. A growing niche, a big opportunity
2. ETFs address many of the shortcomings of managed funds and LICs
3. A very different business – not just a panacea for active funds management firms



The big picture

The big picture – what's in this for me?

1. Will ETFs really move into the Australian mainstream?
2. Should I get involved?
3. How should I get involved?

Successful ETF participant



And Tria client (of course)

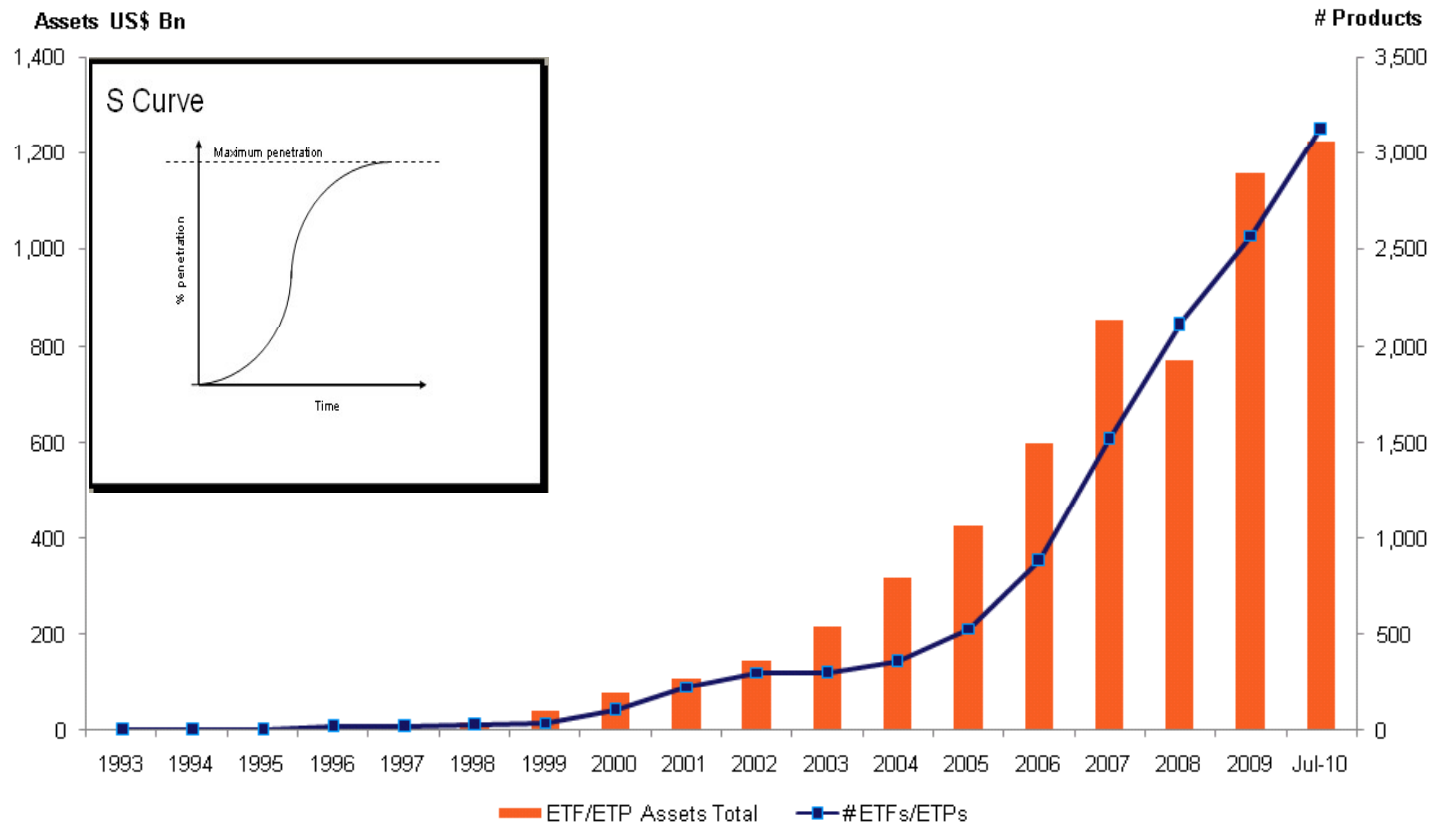
Unsuccessful ETF participants



Didn't consult with Tria

Market evolution

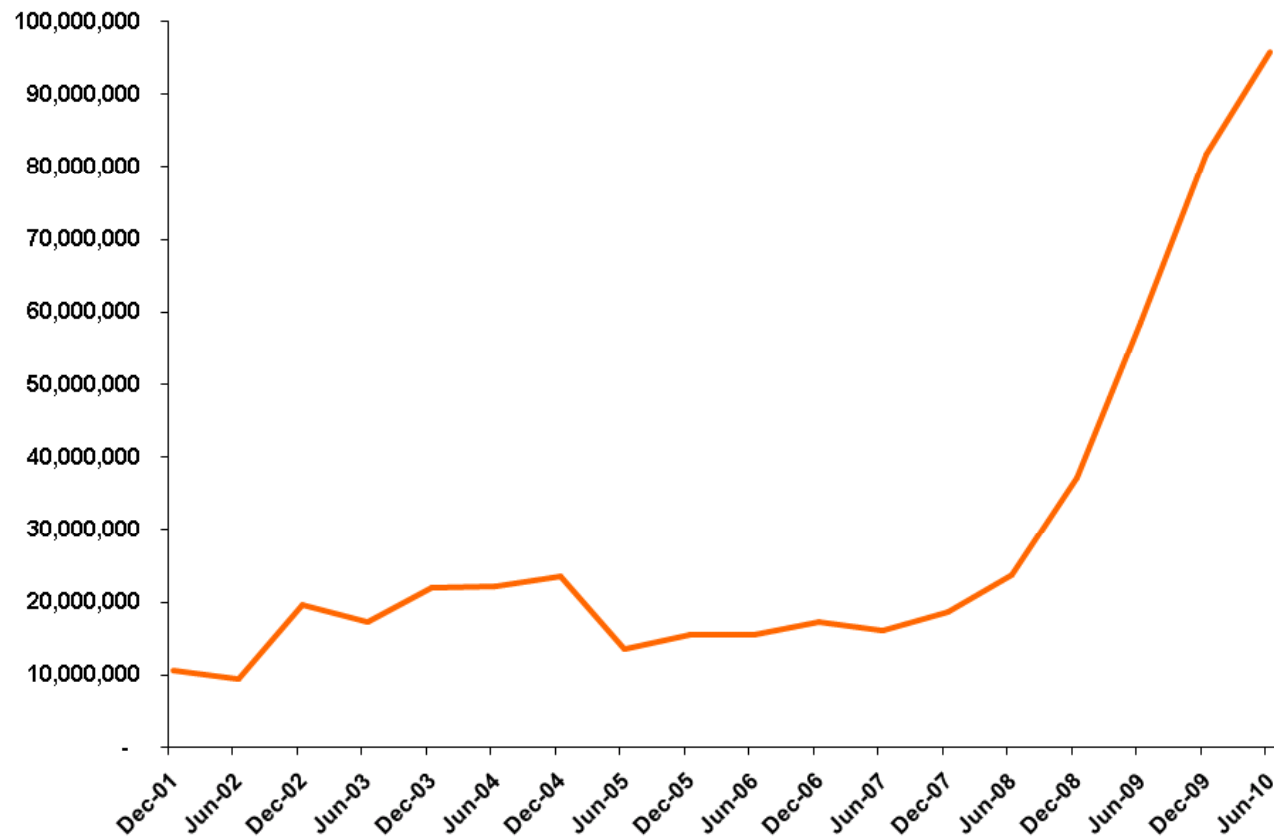
Global ETF market – a US\$1.2 tn market



Source: ETF Landscape (BlackRock)

Australia's ETF S-curve gets moving

Units on issue, ASX SPDRS

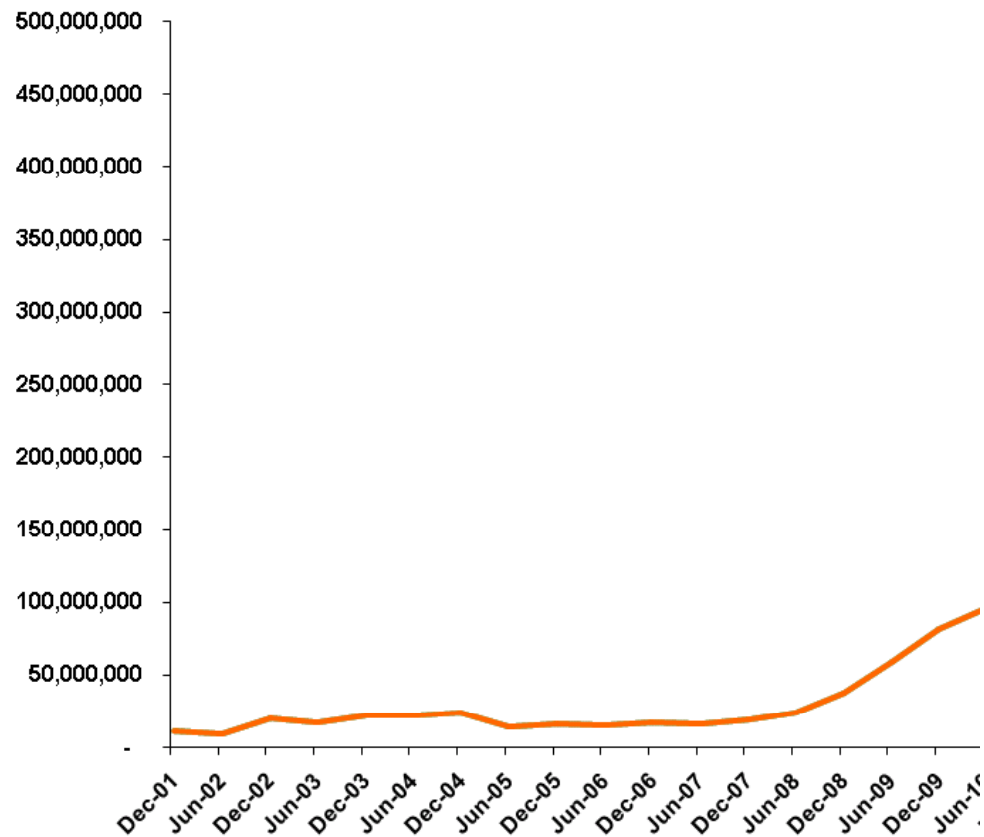


Source: Tria Dimensions

Or does it?

Units on issue, ASX SPDRS

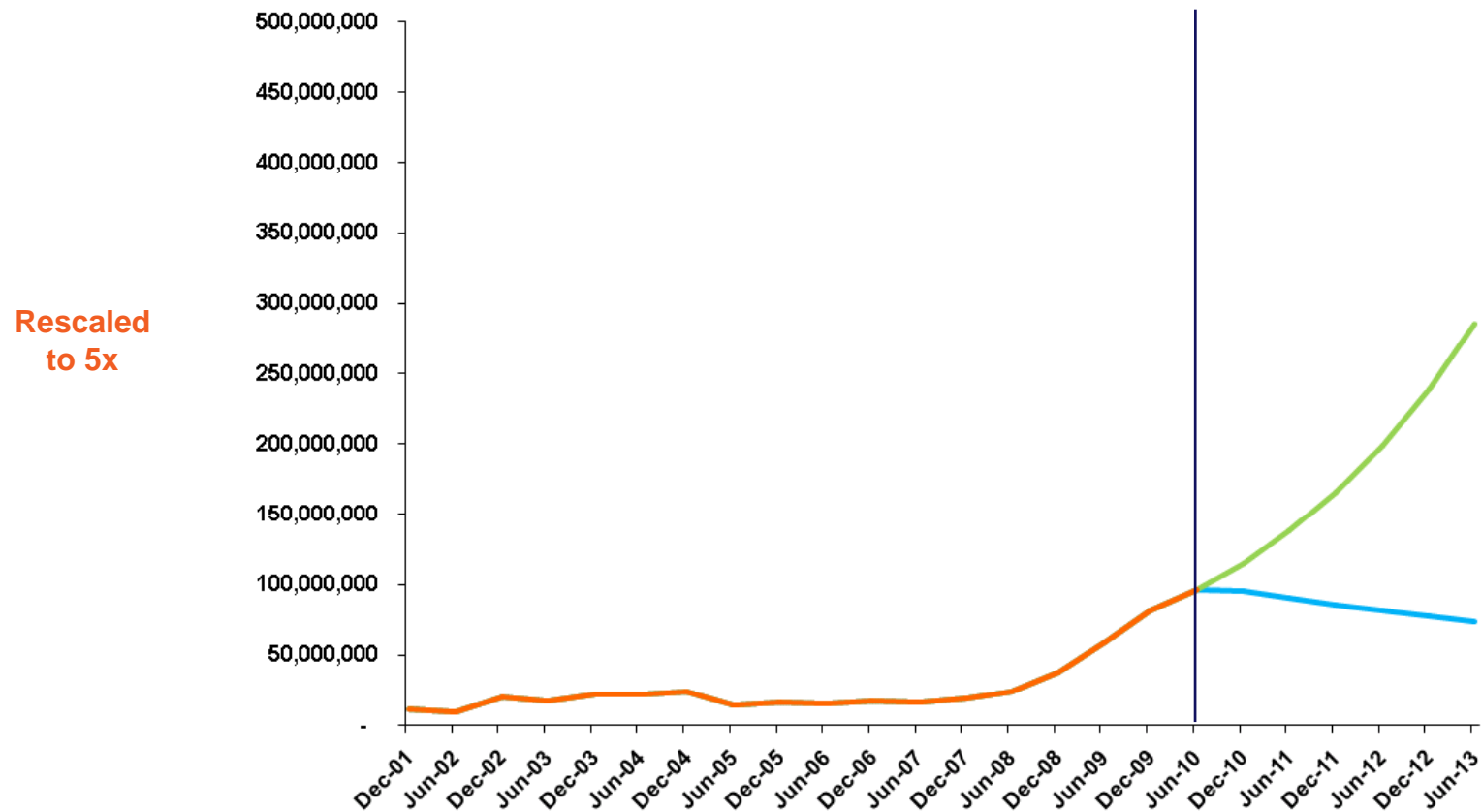
Rescaled
to 5x



Source: Tria Dimensions

Are we at the peak – or just the foothills?

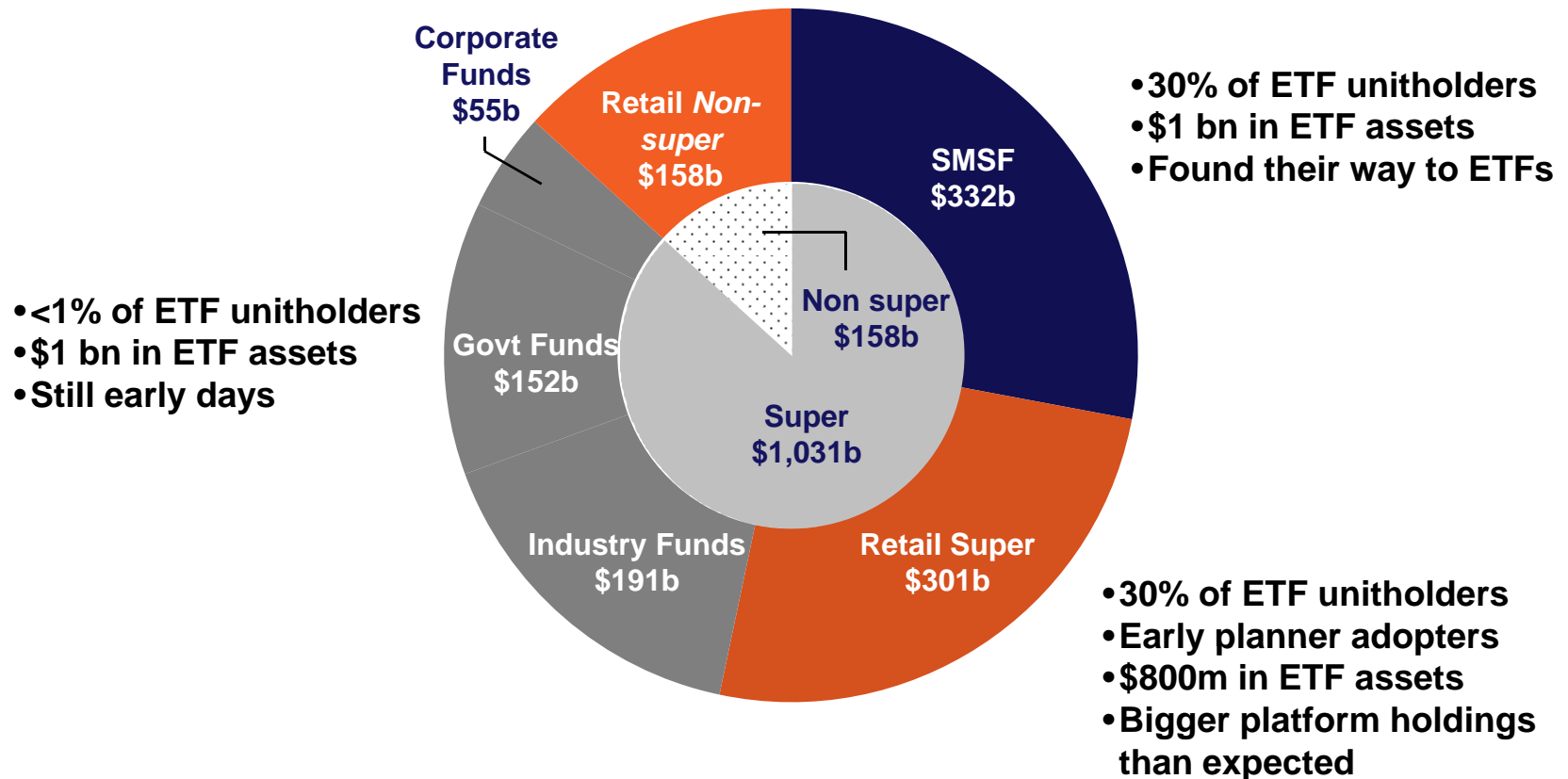
Units on issue, ASX SPDRS



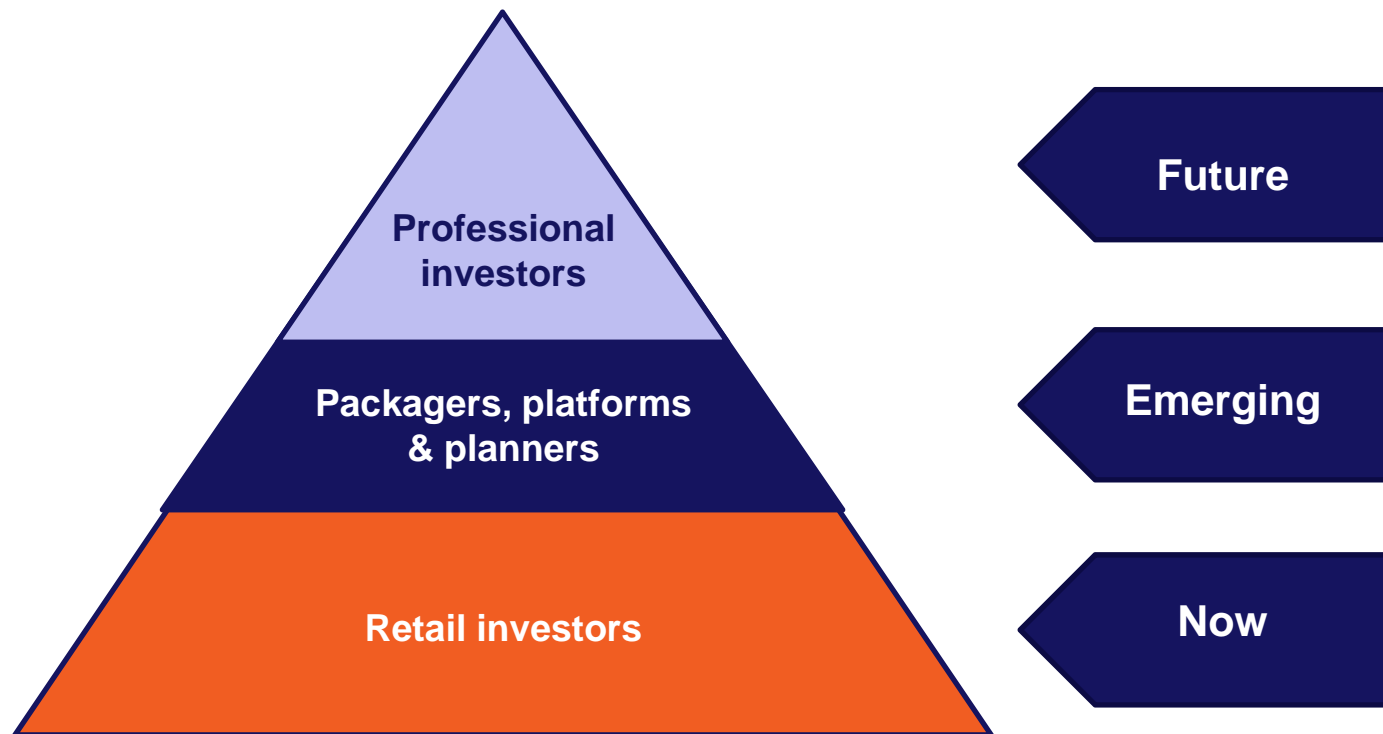
Source: Tria Dimensions

From niche to mainstream

Australian ETFs: appealing to multiple segments



Each segment has favourable ETF drivers



Now – retail investors

- **Low costs**
- **Transparent**
- **Control**
- **Easily bought or sold**
- **No embedded commissions**
- **Reaction to poor active outcomes**

Emerging – packagers, platforms and planners

Tax & regulatory change

- Unbundled pricing
- Lower cost structures
- Less concessional super
- Gearing in super rules
- MySuper



Australia's future tax system



Emerging - packagers, platforms and planners

Business model change:

Manufacturing

- Facilitates start-ups
- Building block
- Match with gearing

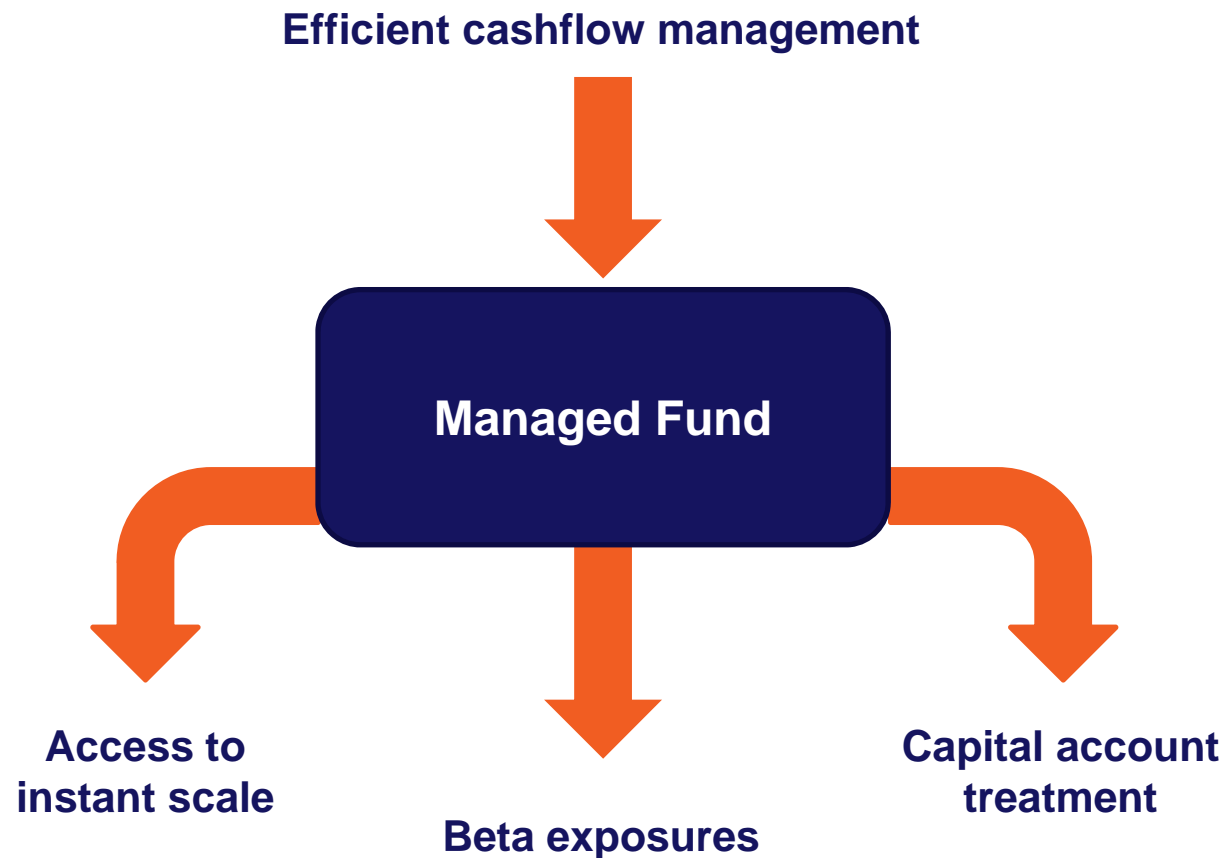
Platforms

- MySuper solution
- Platform equities programs
- Step between managed funds and SMAs

Planners

- Cut portfolio costs (or reallocate revenue!)
- ETF portfolios
- Bypass traditional platforms
- Private banks

Future – fund and product managers “ETF inside”



Future – institutions

- **Australian institutions and multi-managers**
- **Not significant supporters of ETFs at present**
- **Contrasts with US and Europe where institutions are 50-80% of ETF assets**
- **Trading capability is key**
- **Some local institutions will install trading desks as assets are internalised**

Bright future but issues remain

- **Investor experience in exotic ETFs**
- **Less liquid ETFs**
- **Uneasiness about the swap based structures**

Strategic impact and competitive choices

Winners and losers



Winners	Losers	Limited impact
Global index managers	LICs	Quality active managers
ETF entrants with distribution or product edge	Mediocre active managers	
Engaged platforms	Underprepared ETF entrants	
Bundlers	Non-engaged platforms	
Investors		

Warning bell 1: concentrated markets, profits hard to come by

Of US\$1.2 trillion in 3,000 products globally

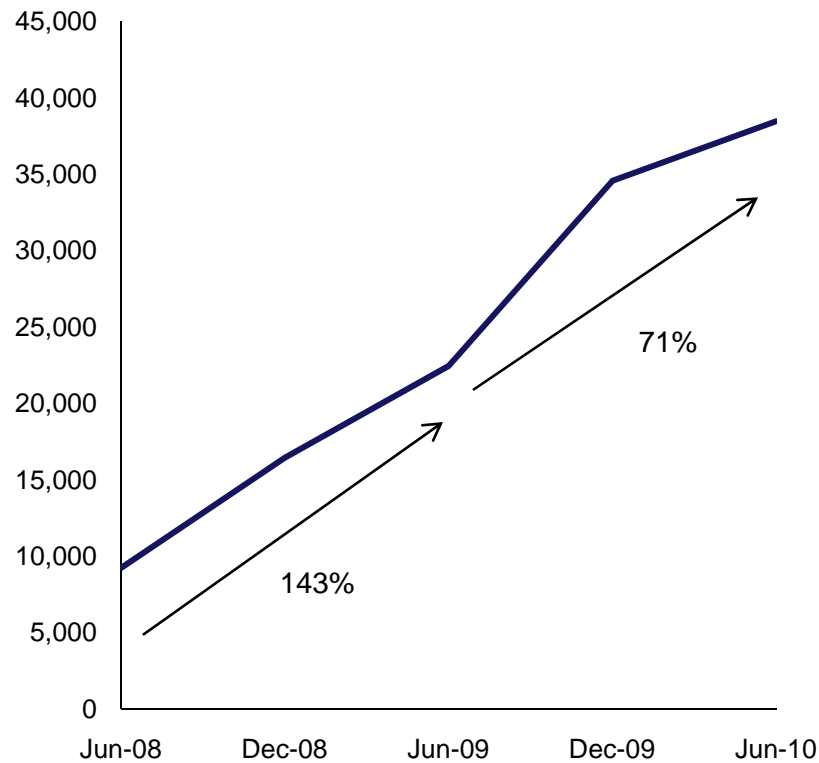
- 25% is in the top 200 products (average \$1.5bn each).
- 70% is managed by the top three (iShares, SSgA, Vanguard).
- The top three managers in most countries hold 70%

We estimate around 70% of ETF issuers globally are currently unprofitable

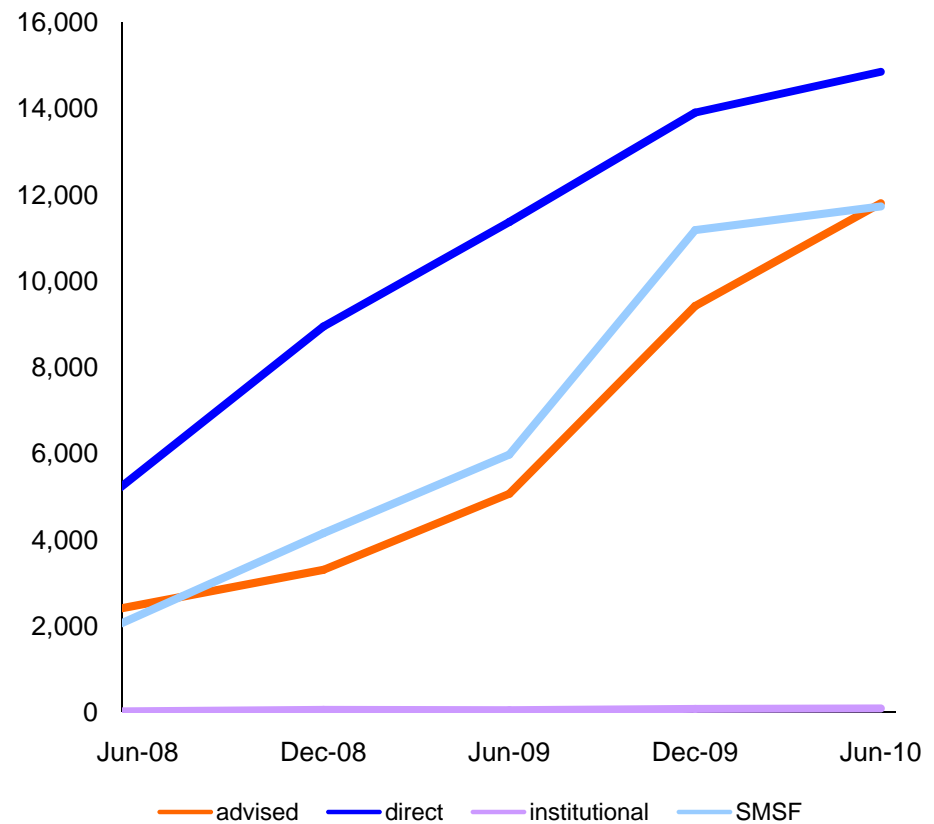
- And despite this, another 30 have indicated plans to launch ETFs.
- Many are gold-digging startups.

Warning bell 2: ETF investor numbers are rising rapidly...

Number of investors over time



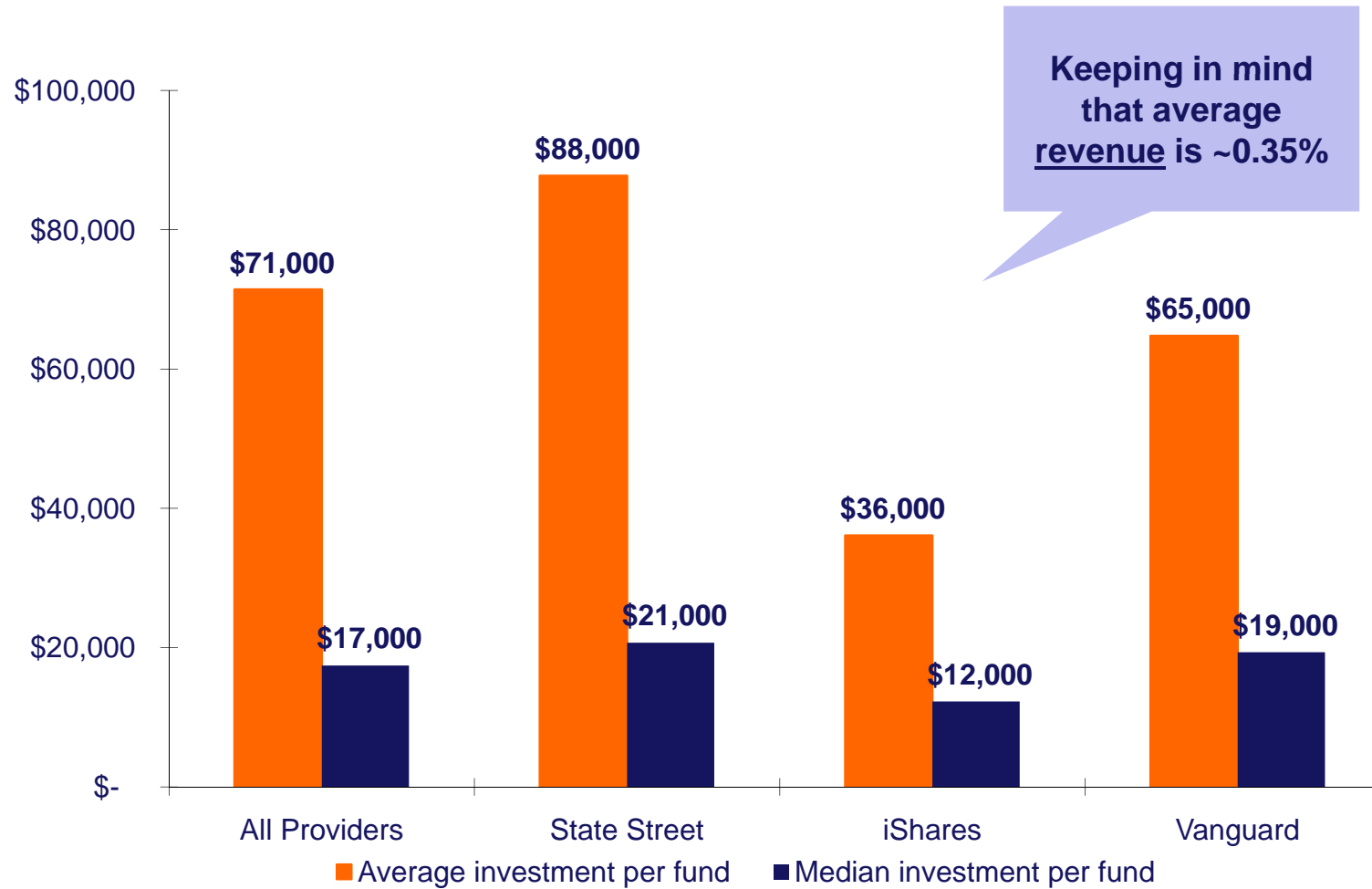
Number of investors over time by investor



Source: Tria analysis



...but there is a long tail of unprofitable clients



Source: Tria analysis. Data as at 30 June 2010



Show me the money!

Assumed ETF assets	\$30bn
Revenue pool @ 0.35%	\$105m
Profit pool @ 0.10%	\$30m
Indirect profit pool	?

- You want to be a market share leader – top 5
- You want serious scale
- You might make more money bundling ETFs than building them

Competitive choices

ETF strategy

Do nothing

Enter now for top 5 position

Enter now for niche position

Enter later and step over the bodies

Facilitate

Bundle / structure



Makes sense for

Good active managers

Major distributors

Innovators with genuine edge
Brave and the foolish

Cautious players who want a lower
risk bet

Platforms, lenders

Asset managers, investment banks,
SMA providers and more

Summary

- 1. The ETF S-curve will keep heading north**
- 2. Many different applications and room for innovation – lots of ways to play**
- 3. Potential is far reaching – you need an ETF strategy**



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