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ETFs Trading Strategy for Australian Investors

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ETFs Trading Strategy

While ETFs are already highly popular in North America and Europe, it remains as a relatively new breed in Australia, but this is changing rapidly as more and more investors are finding them as a great alternative way in expanding their investment portfolio.

In the United States, one survey showed that ETFs had grown significantly since it was first introduced about 15 years ago, the growth was more than 10 folds, with over a trillion dollar now under management.

However, issues seen in ETFs in these markets can also happen in Australia, and these should be mentioned to investors that are new to ETFs.

But first, let us take a quick look on some of interesting ETFs traded in Australia in the recent months.

ETFS Physical Silver (AU) ETC ETPMAG was the best-performing Australian ETF in January 2012, up 23.85 percent for the month. This is another instrument that can be considered by investors that are interested in precious metals. Prior to these ETFs, it was hard for investors to find investment choices to invest either in gold or silver.

Precious metals ETFs performed strongly across the board during a period of easing monetary policies such as Europe's Long Term Refinancing Operation and the potential for further quantitative easing in the United States.

For example, ETFS Physical Platinum (AU) ETC ETPMPT was up 14.81 percent, ETFS Physical PM Basket (AU) ETC ETPMPM rose 13.33 percent, and BetaShares Gold Bullion ETF (A$ Hedged) QAU rose 11.77 percent.

In January, four of the five top-performing ETFs for the month were precious metals vehicles. (The other was Vanguard Australian Property Securities Index ETF VAP, which was up 21.54 percent.

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The Vanguard Australian Property Securities Index ETF is an interesting ETF. Such type of ETF is long overdue in Australia, and finally they are available to investors.

These ETFs are great for investors that are interested in investing Australia's listed REITs, or for those seeking consistent income as REITs generally pay dividends between 6% to 8% yield, typically on the quarterly basis or every 6 months. This is a good way to diversify your investments in the REIT sector.

ETFs also track the overall market, so for the month of January, some ETFs had declined such as the iShares S&P Global Telecommunications (AU) IXP, which fell 4.99 percent.

iShares Global Consumer Staples (AU) IXI was also weak, declining 4.55 percent; these were due to declines in some larger companies held in portfolios as well as due to many telecommunications and consumer products companies went ex-dividend in January.

Foreign Currency ETFs had gained popularity recently, these ETFs can perform or underperform due to currency fluctuations. Strength of $A was the major factor in some weakness seemed in some of these foreign currency ETFs.

Foreign currency ETFs such as BetaShares US Dollar ETF USD, BetaShares Euro ETF EEU and BetaShares British Pound ETF POU are interesting ETFs that can be considered by investors as a way to diversify their currency holdings.

I personally like these ETFs as I don't trade on forex markets as I do not like the high risk nature of Forex trading. Up until introduction of foreign currency ETFs, my primary currency strategy was to invest and hold cash deposits or simply through investing in US or European companies listed on the sharemarkets. By using foreign currency ETFs, they give me a "pure currency" investments just like how I use ETFs to invest in gold and silver.

ETF trading volumes in Australia were down in January to 14,587,395 completed trades, the second consecutive monthly decline. However, December and January are typically quiet trading months – ETF trading volume was 12,528,358 a year earlier, so the January 2012 figure represented a 16.44 percent year-on-year increase.

In terms of the volume, the three ETFs (SPDR S&P/ASX 200 STW, BetaShares US Dollar ETF USD, and iShares S&P/ASX

High Dividend IHD) accounted for approximately 60.0 percent of January trades.

Some new ETFs were launched recently including the Digga Australian Mining Fund.

DGA was listed on 30 January 2012. DGA tracks the Chimaera Australian Mining Index, which according to Chimaera includes approximately 70 of the largest publicly-traded minerals and exploration businesses that meet specific investability and liquidity requirements. Digga is the first new ETF provider in Australia since Russell in 2010.

The dominance in trading volume as described above shows ETFs do have trading and liquidity risks sometimes. The same risks are also evidenced in the US, where the top 30 ETFs dominate the market trading volume, making new ETFs hard to trade even if they have good performance.

For investors, it is important to consider this before they invest into some of the newly created ETFs.

Bid/Ask Spread

Some investors also ask about the Bid / Ask Spread, which is a financial terminology.

The Bid/Ask Spread is a trading cost that can have a significant impact on long-term returns.

The ASX calculates the bid/ask spread as the offer-bid/midpoint measured from 10.30am - 3.45pm.

The ASX avoids using data before 10.30am and after 3.45pm because the ETF market can be illiquid at these times, and bid/ask spreads can blow out.

For the same reason, it may also be wise to avoid trading in these windows, because of reduced liquidity.

The Cost Can Add Up

Bid/ask spreads can be even more punishing for frequent traders, as they will incur the cost each time they trade.

Investors with a long time horizon might prefer an ETF with a lower fee, but be willing to accept a higher bid/ask spread, as the latter cost will only be incurred while transacting, while the ongoing fee is an annual impost.

On the other and, frequent traders might be willing to accept a higher ongoing fee if the bid/ask spread is low.

The small- cap ETFs have significantly higher bid/ask spreads because of the reduced liquidity in the small-cap segment. But even within the segment, spreads vary from 0.37 to 0.53, which could make a significant difference to performance.

Typically, the larger the ETF and the more liquid the underlying assets, the smaller the bid/ask spread, although other factors can influence the spread.

Average Premium/Discount

An ETF's Net Asset Value (NAV) is the total value of the assets backing the ETF – whether these be gold, shares, or currency, or whatever assets the ETF holds.

However, the ETF can trade at a discount or premium to the value of these underlying assets. Any discount or premium is driven by supply and demand.

For example, if more investors want to get out of an ETF than buy in, it may trade at a discount to its net asset value.

Other things being equal, the greater the traded volume of an ETF, the narrower the discount or premium, because high trading volumes indicate a liquid market.

If an ETF is trading at a significant discount, arbitrageurs (professional investors and institutions) may buy in and capture the discount, pushing the price up towards the NAV.

An ETF which is managed and priced efficiently should trade with a very small premium or discount, so the onus is on the ETF provider and market-makers to ensure that this occurs.

Trading Volume

High traded volume is a good thing, because it represents liquidity, and technically speaking, these should also have smaller premium or discount to their Net Asst Value.

However, ETFs with low trading volumes may still have significant liquidity.

ETF providers and market-makers are often willing to create or redeem ETF shares to satisfy investor demand. This is called an off-market trade. Traded volume statistics only capture on-market trades.

CEO of

The average discount /premium and trading volume are 2 very good indicators whether the ETFs are well managed and maintained. You should not be greedy and jump into an ETF simply because it has a very large discount to its Net Asset Value, as it may become even harder to sell due to lack of buyers.

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