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Semi-active ETFs more viable than active ETFs

New ASX platform offers distribution options

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It is unlikely many active exchange-traded funds (ETFs) will be listed on the Australian Securities Exchange (ASX) due to managers' concerns over portfolio disclosure.

Instead, fund managers could be attracted to ASX's new AQUA II platform, which allows the listing of units of managed trusts and can be used as a new distribution channel.

But we could see more semi-active ETFs, including rules-based, quantitative and other customised ETFs, being listed on the ASX, according to Tria Investment Partners.

"The impending arrival of AQUA II is causing active asset managers to think about the ASX as a distribution channel rather than a competitor," Tria senior consultant Oliver Hesketh said.

"The next logical step for active managers is to start asking about active ETFs."

Less than 1 per cent of ETFs worldwide are truly active, in that they are based on portfolios managed by asset management teams that make daily fundamental investment decisions.

"The biggest traditional problem with active ETFs is that fund managers must disclose their holdings on a daily basis to the market or at least the members of the fund," Hesketh said.

"Most active managers aren't comfortable with that."

The exception is fixed income, where it is more difficult to replicate a manager's holdings since the assets are not listed on an exchange, but instead are traded over the counter.

In between active and passive ETFs are about $100 billion in products that track a rules-based or custom index, but which aim to outperform an index more commonly associated with the asset class.

High-yield equity indices are one example of such ETFs in Australia.

"While these aren't necessarily trying to outperform the total return of the broader benchmarks, they are providing targeted outcomes classically offered by active managers," Hesketh said.

"We like the prospects for these semi-active ETFs.

"Products with a good chance of success include investment strategies that are difficult to replicate and those which address core needs of significant investor constituencies."

These could be covered call strategies, quant strategies and geared equity strategies.

"It is in these types of products that we expect to see the hype around active ETFs approach the reality," Hesketh said.
