ASSET MANAGMENT

November 2018

Institutional Usage of North America ETFs

Ready for Next

Sizing the North American institutional ETF market

Methodology: data derived from Broadridge's proprietary data. Segmentation of data is categorized based on an account tagging process which identifies the type of institutional investor. Only North American (US & Canadian) listed and registered ETFs are included in this paper. North American institutional ETF assets totaled $1.04 trillion at end of H1 2018.

All referenced data in the paper are sourced via Broadridge except where otherwise indicated for periods 2014 through H1 2018.

KEY TAKEAWAYS

NORTH AMERICAN INSTITUTIONAL ETFS: A TRILLION DOLLAR OPPORTUNITY AND GROWING

Institutional investors are embracing ETFs as major benefits such as ease of use and access to liquidity attract an increasingly larger pool of institutions to this investment vehicle. Assets have grown at an average annual rate of 17% since 2014 to reach more than $1 trillion, easily outpacing the growth rates of most other investment vehicles. This asset pool is forecast to grow even faster as institutions adopt ETFs to replace higher fee products in an increasingly volatile market environment.

EQUITY LEADS IN ASSETS BUT FIXED INCOME GROWING FASTEST

Equities enjoyed the first wave of product innovation and amassed the dominant share of assets. Institutional equity ETF assets reached $840 billion at the end of H1 2018, representing more than 80% of overall institutional ETFs. Large cap equity is by far the largest category representing ~56% of the total ETF equity offering or 45% of overall ETFs used by institutions.

However, fixed income ETFs have experienced the fastest growth in recent years, advancing 21% annually since 2014 and surpassing an equity ETF growth rate of 14%. More institutional users have warmed to their ease of use, low trading costs and the broadening of offerings in more sophisticated strategies.

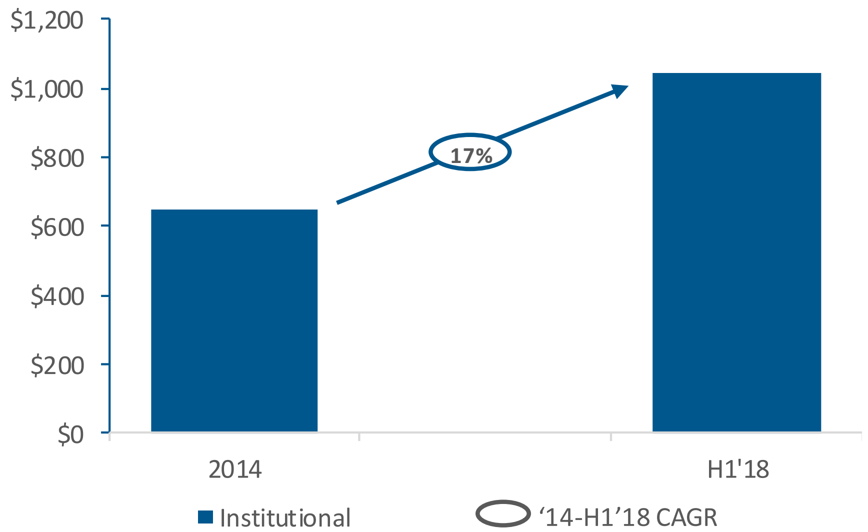
US INSTITUTIONS ARE CORE BUYERS BUT CANADA SEES ENCOURAGING GROWTH

As of H1 2018, almost three-quarters of North American ETFs were bought by US investors, 6% by Canadians a further 6% by Latin Americans and the remainder by APAC and EMEA investors. While US investor usage saw an increase from 70% in 2014, all other regions experienced a contraction in the use of ETFs with the sole exception of Canada, where buyers favor ETFs for core allocation, international diversification and tactical adjustments – the top-3 reason cited for employing ETFs.

Since the launch of the first North America ETF in 1993, ETFs have enjoyed exponential growth, reaching milestones no other investment vehicle has come close to matching. These include achieving average organic growth rates of 20% between 2001 to 2017, surpassing index mutual fund assets in 2009, and posting triple digit net flows in the last seven years. The demand for ETFs can be attributed to ongoing fee pressure, the use of ETFs as the main building blocks for model portfolios by a fast-growing robo-advisory segment and increased appetite among institutional investors – the focus of this paper.

Institutional investors are adopting ETFs to meet their strategic and tactical needs, largely because of their ease of use, low cost and liquidity. Institutional ETF assets have grown at around 17% annually over the last three and half years, with assets surpassing $1 trillion in 2017. An eye popping growth rate of 35% in 2017 was driven by the market environment including the need for better liquidity, diversification and cost efficiency to enhance returns. Though growth slowed in the first half of 2018 as result of market volatility, global trade tensions and rising rates, ETF assets are projected to more than double in the next five years.

NORTH AMERICAN (NA) ETF ASSET GROWTH BY INSITUTIONAL USERS
$BN



EQUITY LEADS IN ASSETS

The first wave of ETFs focused on equities, an asset class that will continue to remain a dominant force in ETF innovation. Institutional equity ETF assets have grown to $837 billion at the end of H1 2018, representing more than 80% of overall institutional ETFs.

US large cap equity is by far the dominant equity ETF category, holding $271 billion in assets or 32% of the overall equity ETF pool. Global large cap is in second place with assets of $86 billion, but it has grown at more than 3x the rate of US large cap equity over the last three and half years, which represents an annual growth rate of 34%. Emerging markets equity rounded out the top-three with approximately $60 billion in assets and an annual growth rate of 9%.

The top-10 equity ETF categories represented 80% of assets, with US equity categories accounting for five of the top-10.

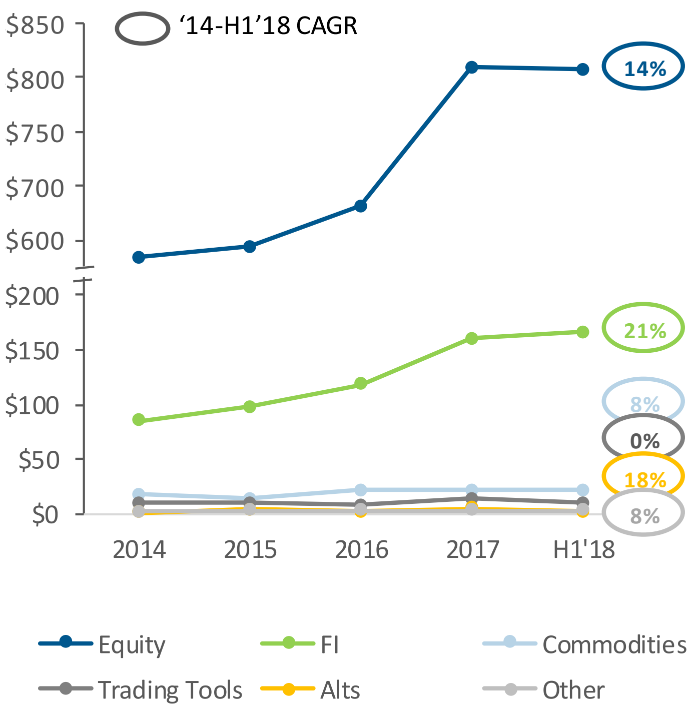
FIXED INCOME GROWING FASTEST

However, growth in fixed income ETFs has spiked in recent years, advancing 21% annually since 2014 and surpassing an equity ETF growth rate of 14%. More institutional users have warmed to their ease of use, low trading costs and the broadening of offerings in more sophisticated strategies. In a global ETF study, Ernst & Young projected fixed income ETFs will grow north of 25% annually in the next several years, more than doubling assets as there is "*huge untapped appeal to medium-sized institutions that might otherwise struggle to access corporate, high-yield or emerging market debt*".

Overall, the majority of fixed income ETF categories have enjoyed double digit growth since 2014, with eight of the top-10 categories growing at between 14% and 48%. The current market environment may continue to provide a tailwind, boosting asset growth as market volatility and the need for liquidity increases higher ETF usage rates by institutions.

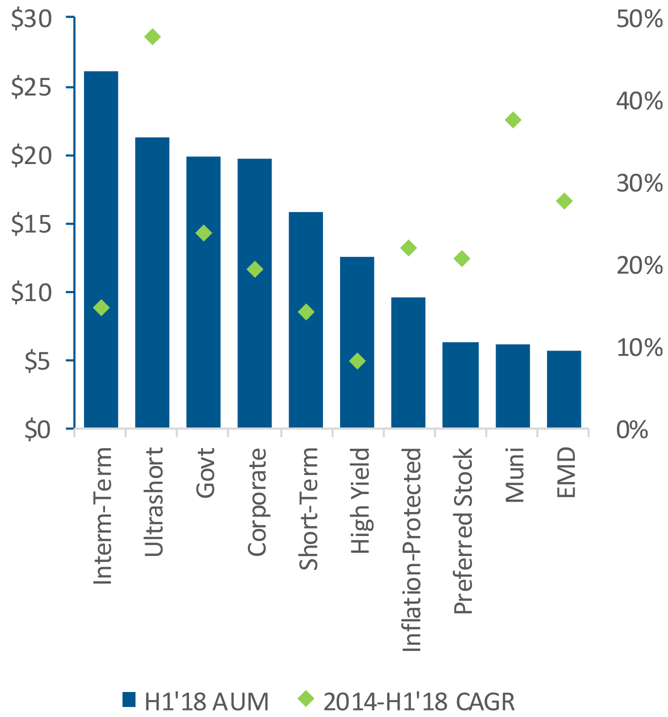
GROWTH OF NA INSTITUTIONAL ETFS BY ASSET CLASS

%



INSTITUTIONAL FIXED INCOME ETFS BY TOP-10 CATEGORY

AUM in $BN; CAGR in %

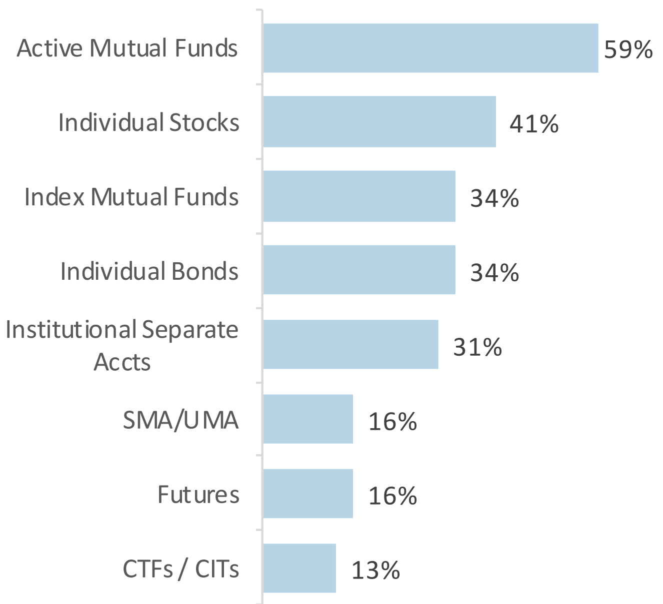


US INSTITUTIONS ARE CORE BUYERS ...

As of H1 2018, almost three-quarters of North American ETFs were bought by US investors, 6% by Canada, a further 6% by Latin American users and the remainder by APAC and EMEA investors.

ETFs are becoming more popular than ever as institutions employ them to replace higher fee vehicles and other less liquid investment alternatives. A recent Greenwich US ETF study found that 30% of study participants are using ETFs to replace other vehicles in their portfolios, with active mutual funds having the highest replacement rate at 59%, followed by individual stocks and index mutual funds at 41% and 34%, respectively. These replacement rates will likely climb as institutional investors become more adept in using ETFs. Additionally, consultants are recommending that clients use ETFs in place of other passive and active strategies which is contributing to the upward trend.

PRODUCTS OR INVESTMENT VEHICLES BEING REPLACED BY ETFs



Greenwich Associates US ETF Study, Q2 2018

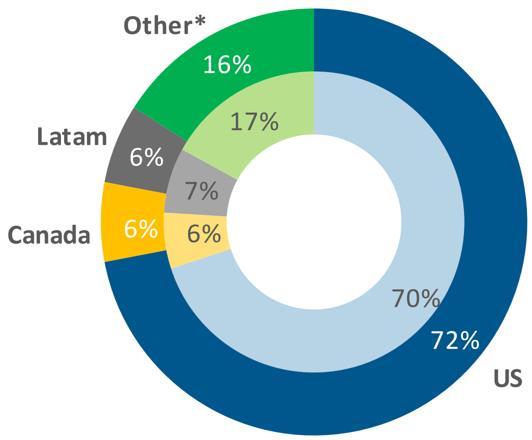
...AND THEIR SHARE CONTINUES TO RISE

Broadridge data also showed that North American ETFs held by institutions domiciled in North America increased from 70% in 2014 to 72% in H1 2018, as the growing emphasis on fees, ease of use and expanding options, such of smart beta, fixed income and active ETFs, chimed with a broader audience. Approximately 6% of North American ETFs were utilized by pension plans in Latin America, and 16% held by institutions outside of the Americas.

Similar to fixed income ETFs, smart beta ETFs employed by institutional investors have been growing faster than equity ETFs, at an annual rate of 16% since 2014. Assets of fixed income and smart beta ETFs combined are expected to double in the next few years with fixed income ETFs growing the fastest, boosted by institutional investors' increased adoption as a replacement and liquidity tool.

SHARE OF NA INSTITUTIONAL ETFS BY INVESTOR COUNTRY/REGION

H1'18 = Outer ring (darker color); 2014 = inner ring (lighter color)



- US investors are the largest and fastest growing ETF users in North America, largely due to fee pressure
- US investors are tapping into Canadian ETFs for active strategies which are still nascent in the US

** Includes APAC and EMEA (for more information on APAC usage, please refer to the Q1 2018 APAC Trend Report.*

CANADA SEES ENCOURAGING GROWTH

Although the first Canadian ETF was launched in 1990 (vs. 1993 for the first US ETF), Canadian investors were slower to adopt but they are warming to the product, thanks in part to its ease of use and diversification benefits.

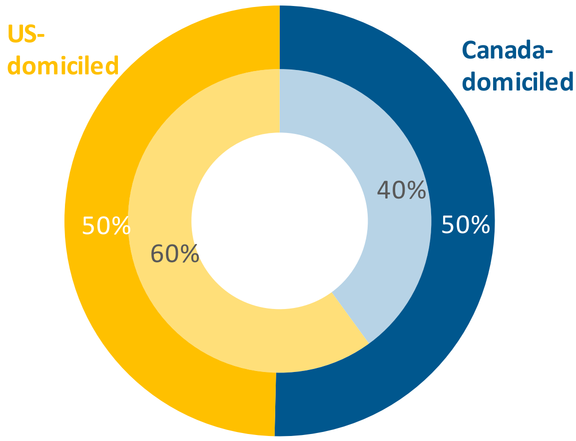
Among users of North American domiciled ETFs, only Canada was able retain market share in institutional usage (see chart from previous page), while shares in EMEA, Latin America and APAC contracted. Canadian investors are also seeing steady growth from a dollar basis as ETFs are more frequently used for 1) core allocation, 2) international diversification and 3) tactical adjustments - the top-three reasons cited by the Greenwich study.

It is also notable that Canadian investors are becoming less dependent on US-domiciled ETFs, as domestically launched products are better aligned to their needs. Our MIDS data shows that Canadian investors' use of US-domiciled ETFs decreased from 60% in 2014 to 40% in H1'18, while Canada-domiciled ETFs increased 10% percentage points in the same period. Over this time frame, Canadian-domiciled ETFs employed by institutional investors grew 19% annually vs. 5% for US-domiciled ETFs. Equity ETFs enjoyed an annual growth rate of 17%, but fixed income ETFs grew faster, albeit from a small asset base, at 23% over the same period.

The faster adoption rate also coincides with the Greenwich survey, which cites an increasing number of Canadian institutional investors embracing ETFs, allocating an average of 19% of total portfolio assets to these products. This is the highest allocation rate among the regions covered. It's also interesting to note that while cost is an important consideration, it is not among the top-3 reasons why both US and Canadian institutional investors turn to ETFs. Just like their US peers, Canadian investors are attracted to ETFs for their ease of use, diversification characteristics, accessibility and liquidity benefits.

CANADIAN INSTITUTIONAL USAGE OF NA ETFS BY DOMICILE

H1'18 = Outer ring (darker color); 2014 = inner ring (lighter color)



Case Study: iShares - ETFs providing access to "illiquid" markets and low trading costs

Glovista Investments LLC, a $900 million investment advisory firm and global macro manager, believed that Frontier Markets would provide a higher beta return and wanted to make a short-term bet of $10 million in these markets. Glovista purchased iShares MSCI Frontier 100 ETF which has exposure to 100 of the most liquid stocks in the Frontier Markets by executing a block trade through their broker with minimum impact on the spread.

"When institutions typically think of Emerging Markets or Frontier Markets, they wonder if, how and at what cost they can efficiently access these markets. We inform our clients that ETFs provide us an efficient vehicle to access exposure to specific EM/FM. The transaction costs and bid-ask spreads of ETFs are much more cost-effective than trading the underlying securities or ADRs."

Darshan Bhatt, CFA, co-founder and co-portfolio manager of Glovista Investments

Case study showcased by iShares published on Business Wire

BOTH US AND CANADIAN INVESTORS HAVE SIMILAR NEEDS

US and Canadian investors alike are using ETFs to access strategies for diversification and liquidity. Of the largest asset classes by AUM, similar themes - such as domestic and global equity, domestic and global fixed income and emerging market fixed income - topped the leaderboards for both US and Canadian investors. These strategies have enjoyed remarkable growth in excess of 20%.

INSTITUTIONAL USAGE OF NA ETFS BY TOP ASSET CATEGORY

AUM in $BN; CAGR in %

Categories with 20%+ growth: DOMESTIC GLOBAL EMERGING MARKETS OTHER

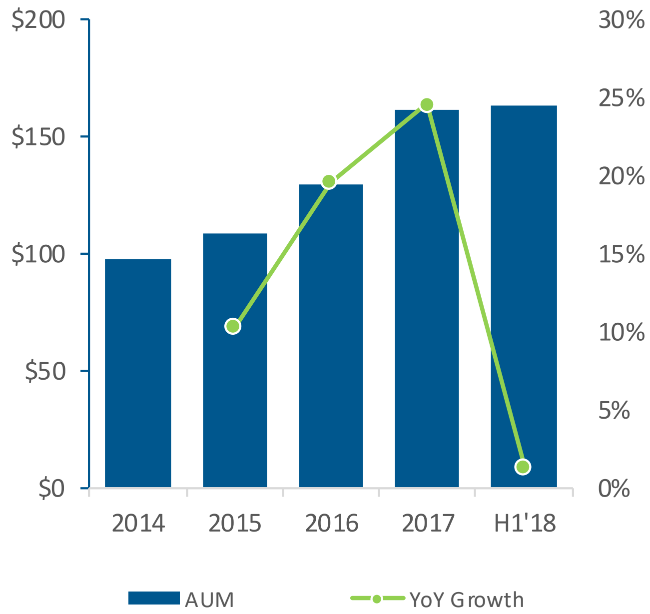
		CATEGORY	2016 AUM	H1'18 AUM	'16-H1'18 CAGR
	EQUITY	US Equity Large Cap Blend	$143.7	$191.5	21%
	EQUITY	Global Equity Large Cap	46.3	77.8	41%
	EQUITY	US Equity Small Cap	31.9	44.3	24%
	EQUITY	US Equity Mid Cap	33.5	43.1	18%
	EQUITY	US Equity Large Cap Growth	26.8	42.5	36%
	EQUITY	US Equity Large Cap Value	34.9	41.9	13%
	EQUITY	Emerging Markets Equity	30.6	41.3	22%
	EQUITY	Real Estate Sector Equity	11.6	13.2	9%
	EQUITY	Technology Sector Equity	7.6	13.2	44%
	EQUITY	Energy Sector Equity	12.6	11.9	-4%
	EQUITY	Financials Sector Equity	9.4	11.8	16%
	EQUITY	Europe Equity Large Cap	6.9	10.6	34%
	EQUITY	Healthcare Sector Equity	7.4	9.1	15%
	EQUITY	Global Equity	5.7	8.2	28%
	EQUITY	Consumer Goods & Services	7.2	6.5	-7%
	EQUITY	Japan Equity	6.3	5.5	-9%
	EQUITY	Global Equity Mid/Small Cap	2.6	4.5	45%
	FIXED INCOME	US Fixed Income	61.5	82.5	22%
	FIXED INCOME	High Yield Fixed Income	9.3	9.9	5%
	FIXED INCOME	Inflation Linked	5.4	8.0	31%
	FIXED INCOME	US Municipal Fixed Income	4.9	6.0	14%
	FIXED INCOME	Emerging Markets Fixed Inc	3.4	4.7	25%
	FIXED INCOME	Global Fixed Income	2.3	3.4	32%
	EQUITY	US Equity Large Cap Blend	$14.3	$15.7	6%
	EQUITY	Canadian Equity Large Cap	8.0	8.1	1%
	EQUITY	Global Equity	1.4	2.8	61%
	EQUITY	Emerging Markets Equity	1.8	2.4	20%
	EQUITY	Global Equity Large Cap	1.9	2.1	7%
	EQUITY	Financials Sector Equity	1.0	1.8	53%
	EQUITY	Real Estate Sector Equity	1.1	1.4	21%
	EQUITY	US Equity Small Cap	0.9	1.3	31%
	EQUITY	Europe Equity Large Cap	0.7	1.2	45%
	EQUITY	Precious Metals Sector Eq	0.3	1.1	125%
	EQUITY	US Equity Large Cap Growth	0.4	0.9	63%
	EQUITY	US Equity Large Cap Value	0.9	0.9	-1%
	EQUITY	Other Equity	0.4	0.6	37%
	EQUITY	US Equity Mid Cap	0.6	0.5	-4%
	EQUITY	Technology Sector Equity	0.3	0.5	31%
	FIXED INCOME	Canada Fixed Income	5.6	7.6	23%
	FIXED INCOME	US Fixed Income	1.5	2.3	36%
	FIXED INCOME	High Yield Fixed Income	1.0	1.1	8%
	FIXED INCOME	Global Fixed Income	0.4	0.9	82%
	FIXED INCOME	Emerging Markets Fixed Inc	0.3	0.5	40%

SMART BETA ETFS ARE GROWING AT A HEALTHY PACE

Smart beta ETFs averaged annual growth of 16% since 2014 and grew even faster in 2016 and 2017 at 20% and 25% respectively, thanks to faster adoption by institutional investors. The top-three categories – Value, Growth and Dividend weighted – comprised 69% of smart beta AUM, but Min Vol, Quality and Momentum grew faster in the last three and half years.

NORTH AMERICA INSTITUTIONAL SMART BETA ETF ASSETS

$BN, YoY Growth %



TOP-10 CATEGORIES

Smart Beta Category	H1 2018 AUM	'14-H1'18 CAGR	Average TER (BPS)
Value	$40	17%	23
Growth	39	19%	24
Dividend Screened/Weighted	33	3%	45
Low/Min Volatility/Variance	14	39%	27
Equal Weighted	11	15%	42
Quality	5	44%	45
Momentum	4	54%	47
Fundamentals Weighted	3	11%	37
Multi-Factor	3	4%	70
Non-Traditional Commodity	2	-1%	37
Other	8	26%	41
Total	**$163**	**16%**	**40**

- Min. Vol's popularity driven by increased volatility concerns
- Momentum continued growing after a spectacular 2017
- Multi-Factor attracted much attention, but growth still relatively slow – though according to surveys by E&Y and Greenwich, investors point to higher usage in 2019

TOP-15 SMART BETA MANAGERS BY ASSET

$BN

Top -1 | Top -2 | Top -3

			Top-5 Factor Segment by AUM											
			Dividend Wtd		Equal Weighted		Growth		Low/Min Vol		Value		Other	
Manager	H1'18 AUM	2016-H1'18 CAGR	AUM	Avg. TER	AUM	Avg. TER	AUM	Avg. TER	AUM	Avg. TER	AUM	Avg. TER	AUM	Avg. TER
iShares (A)	$67.7	15%	$7.0	0.39	$0.4	0.39	$23.9	0.24	$8.8	0.21	$21.8	0.24	$5.8	0.23
Vanguard	38.9	22%	10.2	0.08			12.2	0.10			16.6	0.09	0.0	
Invesco (A)	13.8	39%	0.4	0.49	4.3	0.39	0.8	0.40	2.4	0.26	0.5	0.41	5.5	0.61
WisdomTree	10.6	-3%	8.6	0.52									2.0	0.46
State Street (A)	9.7	12%	3.5	0.36	3.9	0.35	0.9	0.15	0.4	0.25	0.5	0.15	0.5	-
First Trust	4.8	21%	1.0	0.59	0.7	0.47			0.2	0.61			3.0	0.68
Schwab ETFs (B)	3.7	40%	0.9	0.07			1.0	0.05			0.7	0.05	1.1	0.30
Goldman Sachs	2.0	69%			0.0				1.8	0.26			0.2	-
BMO AM	1.1	28%	0.0		1.0								0.1	-
JPMorgan (C)	1.0	103%	0.0	-					0.0	-	0.0	-	0.9	0.35
ProShares	0.8	13%	0.8	0.40									0.0	-
First Asset IM	0.7	61%			0.1						0.0		0.6	-
PowerShares	0.7	15%	0.1						0.3				0.3	-
OppenheimerFds	0.4	38%	0.0	-					0.0	-	0.0	-	0.4	0.38
ALPS	0.4	20%	0.4	0.45	0.0	0.47							0.0	-

A iShares, Invesco and State Street are the only top managers with strategies across the top-5 smart beta segments
B Schwab has the lower price point on Dividend-weighted strategies
C JPM has the largest growth likely boosted by internal transfers of private client assets

Broadridge

Broadridge, a global fintech leader with over $9 billion* in market capitalization, provides communications, technology, data and analytics solutions. We help drive business transformation for our clients with solutions for enriching client engagement, navigating risk, optimizing efficiency and generating revenue growth.

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