

## The role of ETFs in portfolio construction

Nick Good of BlackRock discusses the issues in relation to incorporating ETFs in investment portfolios, and explains why a fee-based advisory model is critical for the greater take-up of ETFs in general in Asia.



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### Interview

#### Nick Good

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**Nick Good**

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- >> The ability for investors in Asia to construct entire portfolios of ETFs is relatively limited because the building blocks aren't there, so ETFs should be seen as tools to supplement other asset classes
- >> Within other asset classes than equities, such as fixed income or commodities, the number of ETFs vehicles available is more limited but growing
- >> The rise of advisory- and fee-based models will be a primary driver of the growth of ETFs
- >> Another key thing to help the rise of ETFs in Asia will be a move by investors towards the view that there are long-term returns available in the market via such steady and liquid vehicles

In Europe and the US, it is not uncommon for ETFs to make up 100% of an investor's portfolio. In Asia, however, the range of ETFs available is nowhere near the same scale, said Nick Good in an interview.

While there are around 1,000 ETFs available in Europe, and roughly 900 in the US, only about 250 ETFs exist in Asia, he explained. And in individual markets, he added, that number might drop to 30 to 50.

As a result, the ability to construct an entire portfolio of ETFs is relatively limited because the building blocks aren't there, said Good.

He advised investors in Asia to therefore look to use ETFs as tools to supplement other asset classes in the portfolio.

#### Decision-making factors

According to Good, ETFs have become very popular recently because of the fact that they are transparent, liquid, diversified and low cost.

Given that it is important for investors to view ETFs essentially as building blocks for a portfolio within their overall asset allocation, when they are making a decision on whether to buy an ETF, they need to think about how it fits into their total portfolio, their investment horizon and their risk tolerance, to ensure it is really meeting their needs, said Good.

In addition, he said they need to understand the structure of the ETF and the nature of the fund, to balance out across all their investments to meet their objectives.

#### Growing diversity of underlyings

When looking at the variety of underlyings accessible via ETFs, for investors in the US as an example, Good said the range of ETFs within the equities space is staggering.

Within other asset classes, such as fixed income or commodities, the number of vehicles available is more limited. At the same time, however, he said that a few years ago it wasn't possible for most retail investors to buy a lot of these products in a simple and liquid way.

And during 2008 and 2009, Good pointed to the large inflows into fixed income ETFs, explaining that investors found during these times that these ETFs continued to trade even when many of the underlying securities were not.

#### Spurring the growth of ETFs in Asia

Since ETFs trade on an exchange, there are no commissions or fees paid to advisers for putting clients into these products. While this is good for end-clients, explained Good, it isn't as good for advisers in Asia, many of whom are incentivised through commission-led remuneration structures.

Until this changes, and unless unique product categories are developed or there is true end-client demand, Good predicted that it will be very difficult for an adviser to recommend ETFs as they don't get paid for doing so. Subsequently, he said he thinks it will take a long time before ETFs become mainstream in Asia as they are in other parts of the world.

So the rise of advisory- and fee-based models will be a primary driver of the growth of ETFs, said Good.

In addition, another hurdle to the growth of ETFs in Asia is the fact that for most of the direct investing public, securities are still not generally thought of as long-term investments. Instead, said Good, investors keep a large amount of bank deposits for the long term.

One of the key things to help the rise of ETFs in Asia, therefore, will be a general move by investors towards the view that there are long-term returns available in the market via steady vehicles which still give investors access to their money relatively easily, said Good.

That will happen as a result of increasing understanding, awareness and education as the ETF market in Asia matures and gets deeper, he explained.

Do you have any comments?  
Contact the editor:

T 852 2563 8683  
E [editor@hubbis.com](mailto:editor@hubbis.com)  
W [www.hubbis.com](http://www.hubbis.com)



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