

Transcript

The Ideas Exchange

Episode 42: ETFs: building blocks for a diversified portfolio

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Jacinta King (00:01):

Welcome to the Ideas Exchange by ASX, connecting you with investment experts, market updates and ideas. I am Jacinta King, business development manager, investment products at ASX, and this is our regular podcast covering everything from investment trends through to different ways to invest using a variety of products.

Disclaimer (00:20):

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Jacinta King (00:48):

Welcome to the Ideas Exchange. I'm your host, Jacinta King from ASX, and today I welcome two guests to our programs. And for those of you who listen regularly, you'll be familiar with our guests who have joined us previously, but it's been a while, so we're really pleased to welcome back Gemma Dale, who is director SMSF and investor behaviour at nabtrade. Welcome, Gemma.

Gemma Dale (01:09):

Thank you for having me.

Jacinta King (01:10):

It's an absolute pleasure. And we also have Tamara Haban-Beer Stats who's director ETF and index investment specialist at BlackRock. Welcome, Tamara.

Tamara Haban-Beer Stats (01:21):

Thank you, Jacinta. Nice to be here.

Jacinta King (01:23):

Look, before we start our discussion, I want to provide some background on nabtrade and BlackRock. Many listeners would be familiar with these companies, but for those who are new to investing, iShares by BlackRock has been a leader in the ETF marketplace for more than two decades, and their products are engineered by investment professionals with discipline and

deep risk management expertise. Tamara is a regular speaker and presenter for iShares and BlackRock.

(01:49):

Now, nabtrade is a broker that provides investors access to over 10,000 securities across instruments such as shares, bonds, and managed funds. Nabtrade also provides access to global markets in the US, UK, Hong Kong and Germany. Gemma is also a regular speaker and presenter and she hosts the Your Wealth Podcast, one of nabtrade's signature education programs. So ladies, we have a great discussion plan today and we're going to unpack core ETFs and how ETFs can help and investor diversify their portfolio.

(02:23):

So this spawned out of some ideas. I think each of us have been discussing this together and separately and putting our heads together and at ASX, our investor research and monthly ETF report has shown a very real uptick in investor interest in the usage of ETFs over the past few years. And for context, the stats tell us that in Australia since 2019, there has been an increase of 1.2 million investors and ETFs are more likely to be the first investment made rather than holding shares directly. And specifically 20% of investors now hold ETFs versus around 15% in 2019.

(03:02):

Now, we have more than 300 investment products listed on the ASX and they are across all asset classes. So an investor can now put together an entire portfolio using ETFs if they choose, and some of the ETFs will be a core part of their portfolio and some will be satellite. So to start with, Gemma, what do you think is driving some of this interest in ETF?

Gemma Dale (03:23):

Yeah, it's such an interesting one. We talk about ETFs all the time now and it's easy to forget that they were an innovation at one point and quite a marginal product. They felt a little complex for people and they didn't quite understand what they were. Once the word got out, and I used to get this question all the time is how much real exposure is there. Are ETFs taking over direct equity ownership? That was always the question. Are people going to stop buying shares and just buy ETFs? This is sort of pre-COVID and at that point ETFs were about 4% of our turnover, about 4% of our holdings. So really, really marginal at that point. It was pretty tiny. Now they're well over 10% and it's very clear that the vast majority of investors know what ETFs are. They know what they do.

(04:10):

To my mind, the primary reason that investors, particularly new to market investors and looking at the data you just mentioned, great example, is that it removes the biggest, most difficult question for people before they start investing. And the biggest question people have is, "What do I buy? I want to

invest. I really love this idea of being invested in growth assets, seeing my money work harder over time, building wealth in a portfolio." That's what they're looking to achieve, but it's terrifying to go out and try to determine which stocks you think are going to outperform the market or which ones are going to meet your needs in your portfolio.

(04:51):

For most people, that's the most intimidating aspect of starting investing. And ETFs, remove that problem for you. It's amazing. You go, "I can just buy the ASX 200. Just buy the top 200 companies. Or I can buy the S&P 500. That's the top 500 companies in the US. That's amazing." You've completely removed The biggest challenge for me, and I no longer have to feel like it's this dark complex world of me against the market, having to do deep analysis that I don't really feel equipped to do. I'm afraid of making a mistake."

(05:26):

To my mind, the greatest asset or the most greatest benefit of ETFs is they remove that question. What do I invest in? That's out of the way now and it's just how much and how often? That's much easier.

Jacinta King (05:39):

Most definitely. I was reading through this and thinking about it, and yes, my time starting off in this industry, it was a lot harder. It felt a lot harder back then because there wasn't as much guidance and information, I think that is readily available and there definitely wasn't ETFs in the market then. So that's giving away my age a bit. But yeah, I find it fascinating the rapid changes that we've experienced. Tamara, can I bring you in here because I'm sure-

Tamara Haban-Beer Stats (06:03):

Sure.

Jacinta King (06:04):

... iShares are watching these trends and noticing similar things.

Tamara Haban-Beer Stats (06:07):

No, absolutely. I mean, we completely agree. ETFs and the evolution of ETFs as a vehicle and a way for investors, particularly new investors as Gemma mentioned to actually access the market are really what we see as a democratizing force in the investment market. So it's no longer something that's only reserved for professionals. This is really a way for everyday Australians to access investment markets. And we think that is a good thing, particularly as people become more attuned to saving for retirement, investing for retirement and the like.

(06:45):

I think the main benefit that we see with ETFs is they've also opened up a range of different asset classes. Now, by asset classes, what we mean are it's

not just equities or stocks which are shares of a particular company, but you can also invest in what's called fixed income markets or bonds traditionally are harder to access asset class for everyday investors. There are also ETFs available that allow you to track the price of precious metals such as gold.

(07:15):

Again, historically maybe not an easy to access asset class. So ETFs are a simple, very transparent and typically low cost way for all investors to access these asset classes, which has been terrific.

Jacinta King (07:32):

So what's happening then in overseas markets regarding the use of ETFs and with BlackRock's global reach? You'd see some trends in the US I imagine? So how are they developing there versus where we are in Australia?

Tamara Haban-Beer Stats (07:44):

Yeah. We think there's actually a huge runway to go globally, but no doubt about it. The US and Europe for that matter are quite far ahead in terms of take up of ETFs amongst the investing audience. So in the US, around 14% of the equity market is made up of ETFs. So people [inaudible 00:08:06] 14% of the equity market trades are done through the ETF market. In Australia that's only around 7%,. So there's still a gap there. We're also a developed market. Europe has similar numbers up there in the low double digits, and that number is actually far lower when you consider something like fixed income as an asset class. So indeed, I think, there's definitely a long runway for us to go, a big gap for Australia to catch up to those developed markets as well.

Jacinta King (08:35):

So I'll turn now to Core ETFs specifically, and Tamara, I'll stay with you because let's first explain what we mean by a core ETF, because Gemma also touched on this at the beginning. So if you could just give a bit of an explanation there for us.

Tamara Haban-Beer Stats (08:48):

Sure. We refer to Core ETFs in the context of an overall portfolio. So Core is something that you could, as the name suggests, you could think of as long-term buy and hold essentially whereas you could also have more tactical or satellite trades that are invested into depending on the market and conditions at the time. So core ETFs are those broad, we think broad-based, low-cost, long-term exposures that investors could keep in their portfolio for a relatively long time.

Jacinta King (09:24):

And then by comparison, when we mention satellite, what are we meaning there specifically?

Tamara Haban-Beer Stats (09:29):

So satellite exposures would be something a little less core, so maybe not as broad-based. They might be more specific to geography or a theme, or it might be a particular part of the fixed income market such as credit or a particular country's bonds. So those types of investments might be more appropriate in different market environments.

Jacinta King (09:51):

Gemma, what are your insights here given nabtrade and what are you seeing investors and how are they using their ETFs and their portfolios?

Gemma Dale (09:58):

Yeah. So it's such a good question. It sounds really simple, but there's a massive bifurcation in our investor base between those who already had a portfolio. And you talk about when you started investing and I had the same experience. You've had to pick stocks because it was very difficult to access a portfolio. The only options available to you were LICs or perhaps a managed fund, but it wasn't listed.

(10:23):

So this was long time ago and you were forced to cobble together a portfolio of your own choosing. And for the vast majority of us, to be honest, we were guessing. I'd like to use it more sophisticated term. But we were doing our best with the information-

Jacinta King (10:38):

I can relate.

Gemma Dale (10:38):

... available at the time. Didn't have huge amounts of research available to us. The research tools available on nabtrade now are vastly better than I had even sort of working in an allied industry at the time. So people put together portfolios of their choosing and they tend to hold those. If you bought CBA in the 90s, you're not going to sell it now and buy an ETF. You're going to crystallize massive capital gains. So you've got an existing portfolio. You're probably pretty happy with it.

(11:04):

Those people are using ETFs to build exposure in things they don't have. So they are buying international equities using ETFs. They're considering things like credit. They're considering things like bonds and so on. So they are using ETFs to diversify outside of their current holdings, but they tend to continue holding their existing equities for very good reasons in many cases. New investors are very, very different. If you are coming to invest for the first time, and this is true of those who've joined us over the last, it's not quite five years, so four years since COVID really.

(11:40):

We have seen a doubling of the number of investors we have since COVID because it was just this extraordinary influx of people realizing particularly that COVID though was an extraordinary opportunity to buy shares. They came in and an extraordinary proportion of that group bought ETFs as a way to get exposure to the market and they bought Core. Exactly as Tamara said, they bought the ASX 200. They bought the S&P 500. They bought massive equity portfolios, and then they've just added to those over time.

(12:13):

They haven't felt the need to diversify. A lot of them are younger, much, much younger than those who've been holding for 15 years. And so they are just looking to build growth into their portfolio. They're not worried about fixing income at this point, right? They're not worried about defensive assets. What they want is growth assets and they want an equity portfolio, so they buy their ETFs and they keep adding to them when they have some extra money. So it's really interesting to see the difference between the two groups and they are using ETFs to build out the portfolio that they're really looking for.

Tamara Haban-Beer Stats (12:48):

And sorry, if I can just add to what Gemma said. I mean by definition, those investors that actually just want to get started and get exposure to the market by going for Core as your first port of call, again, by definition, the ASX 200, that's 200 stocks in your portfolio in the Australian equity market, and they're the largest. It's a market capitalized weighted index. The S&P 500 or IVV is the ETF that we have, which tracks that particular index. That's 500 stocks.

(13:18):

Again, by definition, by those two ETFs alone, that's over 700 stocks across 10 or 11 GIC sectors that you are immediately getting exposure to. And these are large international companies. We've got a global 100 ETF as well, which tracks the largest 100 global companies. Again, it's a fantastic way for first time investors or just investors who want to get a broad range of exposures across international markets as well as Australian markets to do in very short order.

Jacinta King (13:54):

It's cost-effective, time-effective, I think. I don't know about you, but when you learn by doing, and this is what I've always talked to people about, whether it's investing or anything else. And so as soon as you dip your toe in the water, so to speak and pick up some units in ETF, then you suddenly you'll have a bit more laser focus on the individual stocks and learning about how that all fits together in the different asset classes and the sectors. I think that it garners interests over the longer term.

Gemma Dale (14:26):

Funnily enough, I would suggest a lot of people are actually not looking to do that.

Jacinta King (14:29):

Oh, really?

Gemma Dale (14:30):

They are happy to-

Jacinta King (14:33):

Just me, the nerd.

Gemma Dale (14:34):

You chose to work at the ASX, so there's a solid chance that you are actively interested in the market. Most investors we find who are just building an ETF portfolio, and that is more than a quarter of our new investors. That's what they're building. They just want to sit and forget. I think that's a wonderful thing. We often talk about it as being investing as an activity that you have to be very engaged with and you have to give it a lot of thought and you should review your portfolio and all that stuff.

(15:00):

A lot of people just don't want to. They want to invest. They want to feel confident that they're putting their money to work. They're not just leaving it in a time deposit. They're not seeing it eroded by inflation and taxes. They want to feel they're investing, but they don't want to stress about it. And this for them is an amazing solution. So the democratization word is one. I love the idea that people have a simple low cost, very low effort way of investing and building wealth.

(15:31):

I think that is a fabulous opportunity for so many people who would, if they had to be more active and had to second guess their choices and had to do more analysis and put more work into something with very uncertain outcomes because if you know you build your own portfolio, some things might be amazing and some things might be garbage, right? And it's sometimes bad luck and it's sometimes poor choices on your part. Who knows? Some people don't want that stress and here's a lovely alternative for them.

Jacinta King (15:58):

You make a really good point actually. I love it. So look, that leads me to, because you've been talking and mentioning about indexes. So index providers play an important role in investments, and I was thinking we could spend the last part of our discussion just focused on this a little bit. We'll use S&P Dow Jones Index as the example. And for transparency at ASX, we do

work with the S&P. They provide a variety of indexes to track the performance of a market, market segments, investment strategies or asset classes. So Gemma, why are indexes useful?

Gemma Dale (16:31):

So think for anyone who's not given this a great deal of thought, the industry has done a wonderful job of simplifying one index does and why it exists. It will tell you the effective value of the top 200 or 500 companies, as Tamara has already alluded to. So this is the proportion of the index. It makes up. You are not getting, if you buy the top 200 companies. Each of them weighted at 0.5 of a percent. That's not happening. They're weighted according to size, and that's quite important.

(17:04):

BHP is a lot, lot bigger than some of the companies in the ASX 200. And so it takes up a much bigger weighting. And that then gives you a good view effectively of what the largest and most valuable companies on the ASX are. Then we look at the performance of those and you get an aggregate value. Basically, at the end of the year, they go, that went up 9%. Those companies weighted by size went up 9%, plus you got a dividend yield as well, which in Australia we know is terribly important. Our investors cared.

(17:33):

It is as an investor, a benchmark. So we use the term benchmark sometimes in place of the word index, but it's a benchmark. It gives you a guide. This is roughly what everything is doing. This is the performance of the market. It isn't the whole market. There's a whole lot of other stuff in, and it depends on what you hold. That's your performance. But the benchmark is this, and that gives you an idea. If you hold those top 200 companies weighted by size, this is kind of the performance you can expect.

(18:01):

That's very, very handy to know, particularly for investors who do choose to pick their own stocks. It's a way of going, am I doing relatively well at this, or would I be better off actually outsourcing completely to an ETF provider and just letting them run with it and going the easy option. And because the cost of that's relatively low now, that might not be a bad idea.

Jacinta King (18:24):

And to your point earlier that many are happy to sit and forget because we have busy lives. [inaudible 00:18:30]

Gemma Dale (18:30):

Large number of people love the idea of sitting, forgetting.

Jacinta King (18:32):

Managing jobs, family commitments, all of that. So Tamara, how are these indexes built?

Tamara Haban-Beer Stats (18:39):

Well, I will get into that, but first of all, I was going to add more than just a benchmark indexes or indices, depending on your school of grammar, they're mainstream. If you watch the news, if you turn on the news, you'll hear about it in kind of financial parlance. So it's a really... People talk about what did the Australian market do today? The ASX 300 went up 1%, down half a percent. That's what they're referring to. So it makes it nice and easy if you've got investments that are tracking that same index.

(19:14):

Now, how are they built? Well, essentially what happens is the index providers create an index, which includes constituents or stocks, or securities based on rules. So in the case of the ASX 300 or the S&P 500, excuse me, they're by size. So the proportion that particular company makes up in the overall market, that's what we mean by market capitalized indices.

(19:44):

So they're weighted by the relative size of that company in the context of the overall market. Or indeed, sometimes indices, deselect securities for whatever reason. It might be a rule on how much free float there is of that company, for example. And then of course, you can get more niche as we move away from the broad-based market cap indices. And again, it's a rules-based, transparent. There's a methodology. And so really I would say one of the great things about just thinking about indices more broadly is the hard work is done for you.

(20:20):

So the index provider, as Gemma mentioned, is doing all of that work. So if you are invested in an index tracking ETF, the index provider is always making sure that you are invested in the top 200 companies or the largest 500 companies, or the largest 100 global companies in the case of our Global 100 ETF. So I think that's actually a really important part of investing in index tracking products.

(20:49):

Not to say there aren't active tracking products out there that are certainly worth investors considering, but when we're talking about indices, I think the hard work is largely done by the index provider, which certainly can't be understated in my opinion.

Jacinta King (21:02):

Jess, just to round it up here, how does it that inform the ETFs that iShares develop? And we're just talking generally here. We're not giving advice on the

particular funds, but you've mentioned in our conversation, iShares do provide an ETF for the ASX 200, IOZ, and then also the S&P 500 AUD, IVV, and then also the global 100 AED, which is under ticker IOO.

Tamara Haban-Beer Stats (21:26):

Yes, exactly. So they're three of our largest or flagship ETFs. And again, they do track these indices, which are again governed by methodology set by the index provider in this case, S&P. And essentially the ETF is a nice easy way to get exposure to all of the companies that index provider says. Essentially what these ETFs do is give investors the ability to be invested in the top 200 companies as defined by the index provider.

Jacinta King (22:00):

Fantastic. So Gemma, before we close, what are some insights perhaps on the sectors that are within the S&P 200 and the S&P 500?

Gemma Dale (22:09):

It's a really interesting question. I think one thing that investors need to be cognizant of is that, yes, you will get the performance of the market in inverted commerce, so of the index. When you look at different industries globally, they can be very different in their underlying composition because of just how those countries operate and what companies and sectors tend to dominate. So Australia is really well understood to be heavily overweight financials, by which we mean banks and heavily overweight materials being mining companies. Bit of oil and gas.

(22:47):

That's what we specialize in, and that is well over 50% of the index. So if you are an investor who is either uncomfortable with those two sectors for one reason or another, or you don't think they're going to perform particularly well, then that's something you want to think about when you are investing. Is that really the kind of performance you're looking for and so on?

(23:08):

Because there's always this little bit of criticism like, "Why is Australia so rubbish in terms of performance relative to the US?" The reason the US has shot the lights out is because they're heavily, heavily dominated by tech. And that's obviously a development over the last couple of decades. At the moment, the US, in terms of the S&P particularly the NASDAQ is at one of the most concentrated levels in history, by which I mean it's got a small handful of companies that are much, much, much bigger than their predecessors have been at any point.

(23:39):

So NVIDIA give or take the largest company in the world because it kind of bobs up and down. It's risen so quickly. And then a bad day, we'll drop it back down to number two. You've got Microsoft. You've got Apple. These

companies have grown so dramatically that when you buy the S&P 500, you think you're getting this amazingly well-diversified portfolio.

(23:59):

And to an extent you are, except that you have an awful lot of your money in a small handful of companies because they are so massive. So there are some interesting developments in how markets grow and contract and the companies within them, how they grow and contract they can end up with some really interesting things in your portfolio. And sometimes it's a little bit fun to have a look at that. You might love it, right? You might want a ton of exposure to NVIDIA and AI because you do think it's the next big thing, or you might feel it's massively overvalued and that's not for you, and you want to be thinking about that thing when you're putting together a portfolio of different ETFs because you can't control what size those things are within those portfolios.

Jacinta King (24:42):

Thank you. Some really good thoughts and takeaways, I think there. So to summarize really, there are a broad range of ETFs available across all asset classes. Core ETFs are the base building blocks of a portfolio, and understanding indices is an important part of investor education. So really thank you both for your insights. Are there any closing comments you wanted to add there?

Gemma Dale (25:03):

Having watched our investors build ETFs into the core of their portfolio, particularly new investors over the last few years, and seeing more mature investors start to integrate them into their portfolio as a way of getting more diversified exposure, either in new asset classes or just as simply things that they didn't hold before, it's been quite fabulous. I think it's a really positive development to see people getting more access to investments and more access to markets, particularly those people who might've otherwise been a little intimidated and held off. I think it's a great outcome.

Jacinta King (25:38):

Fantastic.

Tamara Haban-Beer Stats (25:39):

I would add, I mean, if you are looking to start your investing journey, or indeed, if you're an experienced investor, ETFs are a high quality institutional grade vehicles for investing. And the transparency that you can... Again, we talked about index providers a little bit today, Jacinta, you're able to see what goes in and out of the ETF based on the index methodology.

(26:08):

It's also published on issuers websites. So it's a nice, transparent, low-cost accessible way to access investment markets, again, across asset classes,

geographies. The diversifying benefits that you can get from investing in core ETFs to access some of the largest markets in the world really can't be understated. And I think it's a really positive development in financial markets globally and we're really starting to see that take hold here in Australia as well. But the runway certainly continues to be long.

Jacinta King (26:39):

If you'd like to learn more, please head to the websites of nabtrade, iShares, S&P, and ASX. There's a wealth of information for investors to be found there. Gemma and Tamara, thank you so much for joining us today. Appreciate it.

Gemma Dale (26:51):

Thank you.

Tamara Haban-Beer Stats (26:53):

Thanks, Jacinta.

Jacinta King (26:53):

And thank you to all of our listeners. As always, please tune in next month to The Ideas Exchange.

Check out our blog: (27:00):

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