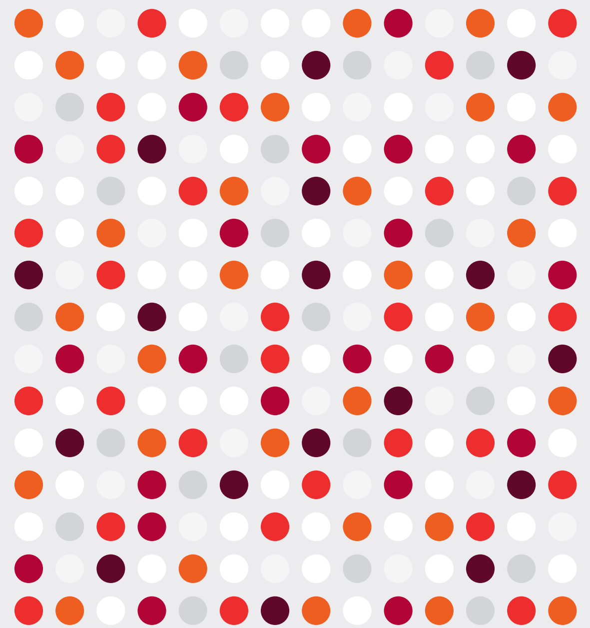
Vanguard®

Vanguard ETF quarterly report

June quarter 2020



In this edition:

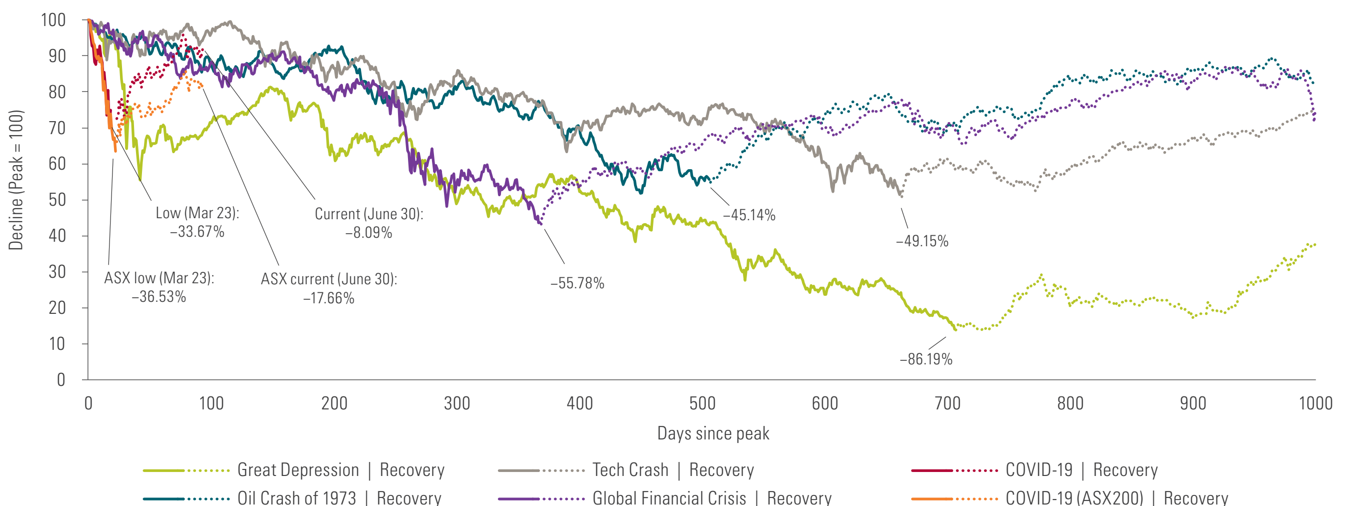
- The Australian ETF market recorded strong flows in Q2 2020 attracting $4.4 billion, pushing the total ETF market cash flow in 2020 to $8.2b
- In Q2, investors favoured Australian equities (45.5%) over international equities (25.2%) a continuing theme resulting from market volatility in March and April.
- Vanguard attracted 27% of the total ETF cash flow in Q2 and is 1st for cash flow year-to-date with $2.66b.

Quarter in review

Following the sharp fall in markets at the start of the year, Q2 saw strong rallies across global equity markets as investors shed their bear skins for bull horns. Despite the continual spread of COVID–19 across the globe, the backdrop of ultra-loose policy and expectations that economic lockdowns could soon ease restored some positive sentiment in markets, fostering conditions for a "V-shaped" recovery in risk assets. (**Figure 1**). However, there is validity in questioning the speed and magnitude of the rebound given much of the real economy is only slowly emerging from hibernation. Indeed, towards the latter part of Q2, markets started showing signs of "slight fatigue" after retracing much of their losses in April and May. We interpret this as a suggestion that investors have begun incorporating some caution into their outlooks, especially when assessing the loss of output, profits and employment that can be recouped in 2020.

Figure 1. From bear to bull: "Lightning speed" in markets

S&P 500 performance in five bad bear markets



Source: Vanguard, using data from Factset.

A closer look at Q2's macro data highlights the uncertainty that lies ahead. In the labour market for instance, the impact of the lockdowns on unemployment has remained substantial, even considering the huge fiscal interventions designed to mitigate the impact on the real economy. Vanguard estimates the global economy lost over 300 million full-time jobs in Q2 alone, with official measures of unemployment rates rising by historically unprecedented amounts in a short time. In fact, our calculations suggest that the 'true' unemployment picture is even worse once furloughed workers are taken into account, that is, people who have been given a temporary leave of absence from work. The 'true' levels of unemployment paint a much bleaker picture, with the US unemployment rate exceeding 15%, while a rate higher than 30% is observed in Europe.

In Australia, the unemployment situation is not as gloomy given the role of expensive fiscal programs assisting businesses to retain workers. But those programs will eventually be wound down, casting doubt on the shape of the recovery in jobs and spending towards the second half of this year.

Economic outlook

As developed markets begin easing lockdown measures, many have begun focussing their attention on the shape of the recovery. Will the recovery be a more aggressive "V-shape", as priced in by the equity markets, or will it be a more conservative "U-shape" as reflected in the bond market? Vanguard expects it will be a little of both. The sharp downward-slope experienced in a V-shaped recovery is so severe that it is unlikely to continue for extended periods of time. In technical terms, a recession is over once GDP rebounds from pandemic-induced lows and unemployment starts to decline. Vanguard expects both these trend have already begun as reflected in our high frequency indicators (**Figure 2**).

Figure 2. High frequency indicators show a quick rebound from the trough, though certain face-to-face intensive sectors remain lacklustre

Source: Vanguard, based on data from OpenTable, CityMapper, Apple, Google, Box Office Mojo, OAG and Westpac.

But initial signs of positivity doesn't mean the road to recovery will be easy going. Getting business activity back to pre-COVID levels could take more than a year in a scenario more closely resembling a U-shaped recovery. This is owing to shocks to both supply (stemming from containment measures) and demand (stemming from consumers' likely reluctance to resume face-to-face activities such as dining out, traveling, or attending large events). The confluence of these two shocks leads us to expect a "two-phased" path to recovery. Phase one would likely exhibit stronger growth rates as restrictions on the ability to transact and produce are eased, such as when factories can begin operations and restaurants can receive customers once again. However, the second phase will take a longer time to unfold. Once the initial bottlenecks on growth ease, industries that have a higher direct exposure to consumer demand will likely be the most vulnerable in this stage, given their dependence on face-to-face activities.

On the fiscal front, while most unemployment benefits are slated to end by Q3, we expect governments around the world to recognise the fragility of the recovery and continue to provide targeted and tapered support, particularly to those industries less able to restart fully.

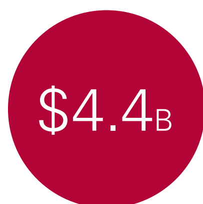
The sense in staying the course

Recent rallies in equity markets pushed valuations upward over the quarter, but they still fall within fair value range. The disciplined investor who opted to stay the course, held fast and rebalanced during the March downturn, would have enjoyed much higher returns with the market rebound. Vanguard advocates for the power of sticking with an investment discipline even amidst unprecedented market events such as these.

Australian ETF Update

The Australian ETF market recorded strong flows in Q2 2020 attracting $4.4 billion. The Q2 flows followed on strong flows in Q1 ($3.8b) and pushed the total ETF market cash flow in 2020 to $8.2b. In Q2, investors favoured Australian equities (45.5%) over international equities (25.2%) a continuing theme resulting from market volatility in March and April. Fixed income ETF flows remain subdued throughout Q2 following on from Q1.

Vanguard attracted 27% of the total ETF cash flow in Q2 and is 1st for cash flow year-to-date with $2.66b. The Vanguard Australian Shares ETF (VAS) has attracted the most cash flow of any product listed on the market in 2020 with $1.4b in the first half of the year surpassing total flow in 2019 ($939m).



Total ETF cash flows for Q2 2020

Assets under management (AUM)

The Australian ETF market AUM grew to $65.8b as at 30th June. Inflows in of $1.1b in Q2 helped Vanguard ETF AUM grow to $20.6b from $19.5b as at 31st Dec 2019. Nine Vanguard ETFs have achieved an AUM of greater than a billion dollars and the Vanguard Australian Shares ETF (VAS) remains the largest ETF in the market with $5.6b in AUM.

Performance

A total of 28 of 29 Vanguard ETFs returned positive returns over the quarter. The best performing ETF of Q2 is the Vanguard Australian Small Companies ETF (VSO) returning +30.74%, followed closely by Vanguard Australian Property ETF (VAP) returning +20.32%.

The best performing ETFs over the past 12 months are the Vanguard Ethically Conscious International Shares Index ETF (VESG +9.8%), Vanguard Total US Stock Market ETF (VTS +8.5%), followed closely by Vanguard MSCI International Shares (VGS +5.24%).

The best performing fixed income ETFs over Q2 was the Vanguard International Credit Securities (AU Hedged) ETF returning +5.87%. The best performing fixed income ETF of the past 12 months is the Vanguard International Fixed Interest Index (AU hedged) ETF (VIF, +5.14%), followed by the Vanguard Global Aggregate Bond Index ETF (AUD hedged) (VBND, +5.11%).

Industry cash flow by asset class

	Quarter		YTD	
Asset class	($m)	%	($m)	%
Australian Equity	2,000	45.5	3,897	47.6
Global Equity	1,108	25.2	2,134	26.0
Infrastructure	79	1.8	203	2.5
Australian Fixed Income	220	5.0	202	2.5
Global Fixed Income	–69	–1.6	74	0.9
Cash	364	8.3	174	2.1
Australian Property	132	3.0	250	3.1
Global Property	18	0.4	48	0.6
Commodity	436	9.9	929	11.3
Currency	-7	–0.2	47	0.6
Mixed	112	2.5	237	2.9
Total	**4,393**	**100%**	**8,193**	**100%**

Source: ASX Monthly Report and Vanguard.

Industry cash flow by issuer

Issuer	Cash flow $m	Cash flow %	AUM $m
AMP/BetaShares	–1.2	0.0%	59.7
Beta Shares	1,437.2	32.7%	10,970.2
ETFS	249.6	5.7%	2,648.7
Fidante	29.8	0.7%	199.5
Fidelity	3.5	0.1%	84.5
InvestSMART	–0.7	0.0%	44.4
iShares	513.8	11.7%	15,344.2
K2	–5.3	–0.1%	7.4
Legg Mason/BetaShares	11.7	0.3%	206.3
Magellan	169.6	3.9%	2,566.8
Montgomery	29.1	0.7%	114.7
Morningstar	80.6	1.8%	92.2
Perennial	–2.0	0.0%	9.8
Pinnacle	0.6	0.0%	23.5
Antipodes	0.2	0.0%	22.8
Russell	15.6	0.4%	830.0
Schroders	–6.2	–0.1%	38.8
State Street	270.1	6.1%	6,079.0
Switzer	11.6	0.3%	196.1
The Perth Mint	80.7	1.8%	529.9
Platinum	–10.9	–0.2%	452.3
UBS	–30.6	–0.7%	230.2
VanEck	391.1	8.9%	4,501.1
Vanguard	1,154.7	26.3%	20,585.0
Total	**4,393**	**100%**	**65,837.1**

Source: ASX Monthly Report and Vanguard.

Vanguard product summary

Asset Class	ASX Ticker	Last Price#	MER (%)	Quarter Return (%)	1 Year Return (%)	3 Year Return (% p.a.)	Quarterly Cash Flow (m)	FUM (m)
Australian Equity ETFs								
Broad Market	VAS	$75.11	0.10	16.93%	–7.51%	5.19%	$678.9	$5,558.0
Property	VAP	$69.37	0.23	20.32%	–20.72%	2.23%	$111.0	$1,534.8
High Yield	VHY	$51.79	0.25	16.43%	–12.44%	0.87%	$78.9	$1,344.4
Large Companies	VLC	$60.33	0.20	13.19%	–9.28%	4.72%	$12.9	$105.7
Small Companies	VSO	$56.43	0.30	30.74%	–1.40%	7.01%	$10.8	$366.9
International Equity ETFs								
Developed Markets	VGS	$76.87	0.18	5.94%	5.24%	10.84%	–$25.0	$2,118.6
Developed (AUD hedged)	VGAD	$69.36	0.21	17.86%	1.40%	6.34%	$114.7	$1,027.2
All world Ex US	VEU	$69.30	0.08	4.43%	–1.99%	5.06%	$25.4	$1,543.5
Total US Market	VTS	$224.37	0.03	8.53%	8.48%	14.07%	$2.9	$1,816.9
Developed Europe	VEQ	$52.82	0.35	3.90%	–4.81%	2.97%	–$59.4	$174.3
Asia ex Japan	VAE	$66.97	0.40	4.16%	3.05%	6.71%	$5.5	$184.5
Emerging Markets	VGE	$64.95	0.48	5.23%	–2.88%	4.70%	$2.7	$346.5
Global Infrastructure	VBLD	$54.06	0.47	–3.71%	–2.67%	—	$6.6	$91.6
International Small Companies	VISM	$48.03	0.32	10.04%	–3.65%	—	$3.7	$36.0
ESG	VESG	$55.60	0.18	6.84%	9.80%	—	$15.9	$122.9
Minimum Volatility – Active	VMIN	$53.44	0.28	9.75%	–3.96%	—	$0.8	$12.3
Global Value – Active	VVLU	$38.55	0.28	8.16%	–17.46%	—	$5.6	$26.4
Multi Factor – Active	VGMF	$54.33	0.33	5.81%	–8.69%	—	$1.0	$16.3
Fixed Income ETFs								
Australian Composite	VAF	$52.82	0.20	0.41%	3.97%	5.39%	$5.4	$1,402.4
Australian Government	VGB	$54.00	0.20	0.17%	4.18%	5.64%	$24.8	$513.2
Australian Corporate	VACF	$53.42	0.26	1.39%	3.26%	4.90%	$8.2	$337.7
International Treasury (AUD hedged)	VIF	$52.09	0.20	0.77%	5.14%	4.73%	$33.1	$510.0
International Credit (AUD hedged)	VCF	$50.95	0.30	5.87%	4.81%	4.64%	-$30.4	$179.1
Global Aggregate (AUD hedged)	VBND	$54.50	0.20	2.56%	5.11%	—	$0.1	$152.7
ESG	VEFI	$55.00	0.26	2.39%	5.41%	—	$1.7	$18.4
Diversified ETFs								
Conservative	VDCO	$55.16	0.27	4.95%	2.84%	—	$4.2	$111.1
Balanced	VDBA	$55.03	0.27	7.21%	1.94%	—	$15.2	$257.7
Growth	VDGR	$53.73	0.27	9.36%	0.65%	—	$22.5	$255.0
High Growth	VDHG	$52.77	0.27	11.48%	–0.75%	—	$77.5	$421.2
TOTAL							1,155	20,585

Returns assume that an investor purchased shares at Net Asset Value and does not reflect transaction costs imposed on the creation and redemption of ETF units, the brokerage or the bid ask spread that investors pay to buy and sell ETF securities on the Australian Securities Exchange. Total returns are after management costs.
Source: Vanguard and Bloomberg.

Vanilla vs Exotic ETFs

Robin Bowerman
Head of Corporate Affairs, Vanguard Australia

Advertising for exotic foreign destinations were among the first things to disappear from our screens when the COVID-19 virus struck.

The notion of flying off to some far-flung destination to experience something new, exciting and possibly on the risky side seems a distant concept in the midst of a pandemic lock down.

Our risk appetite—apart from the physical limitations—have certainly changed on the travel front at least for the foreseeable future.

So how about on the investment front? How has COVID-19 and the market volatility we have experienced in the first half of 2020 changed your appetite for the exotic versus the plain vanilla?

In the world of ETFs you have an increasing choice of "flavours" from the plain vanilla to outright exotic.

In the investment world as the name suggests, vanilla is just another way of saying "standard" or "straight-forward". Exotic, on the other hand, refers to when the vanilla financial instrument has been engineered in some way that usually results in more complexity and potentially higher risk.

Vanilla ETFs are generally ETFs that track a broad underlying index, such as the ASX 300 or S&P 500. But the ETF world is a competitive market and as it continues to expand and evolve, we are seeing new, exotic products focused on niche sectors developing.

Examples of exotic ETFs include those that have been constructed around a very specific theme, such as cryptocurrency ETFs, robotics ETFs and physical gold ETFs. While these ETFs may still track an underlying index, they are likely to provide less diversification benefits than a mainstream ETF as it is focused on a very niche part of the market.

Additionally, exotic ETFs may not provide the same liquidity or transparency as mainstream ETFs that have been tried and tested in bouts of extreme market volatility during different market cycles. Our recent article on the resilience of vanilla ETFs during COVID-19 discussed their robust nature and ability to provide investors liquidity even during severe market corrections.

Conversely, exotic ETFs by their nature track more specialised indexes wherein the companies that make up the index may have smaller market capitalisation and are traded with less frequency than companies included in vanilla ETFs. While they may offer more targeted control over your investment preferences or access to niche markets, it is important to understand the greater risks that may be lurking beneath the surface.

The critical message to interested investors is be sure you fully understand them before buying. That rule applies to all investing not just exotic ETFs.

Past performance may not be a reliable guide to what future returns may be delivered but an investment product's track record is a valuable indicator of whether it will stand the test of time. ETFs with a particularly narrow market focus or those that enjoy the novelty factor (i.e. cannabis ETFs, millennial ETFs) may not prove as resilient when hype dies down and market cycles turn.

How to choose ETFs

Deciding on which ETFs to invest in is ultimately a personal decision and needs to be factored into your overall portfolio construction, long-term investment goals and risk appetite. Some specialised ETFs or investment products may well fit into your personal financial plan because of the specialist exposure it gives you.

One of the many benefits of a mainstream ETF is its ability to provide investors with broad diversification. Mainstream ETFs typically invest in companies from a broad range of industries or asset classes. It goes back to the old argument that rather than try and find the needle in the haystack better to buy the haystack.

Although they are not going to win any literary prizes we also always recommend reading the ETF's product disclosure statement (PDS) before investing. This is where you will find the index composition and/or sector allocation and a discussion of the risks. From this you can get a sense of whether or not the underlying investments are going to help you achieve your investment goals. Or whether or not there is too much concentration or liquidity risk.

Lastly, costs can also become a big drag on returns if they're not carefully considered and factored into your investment plan. Exotic ETFs usually have higher fees, whether that be due to lack of economies of scale and/or less industry competition or the higher costs of investing.

While exotic ETFs may sound exciting and prove useful in the portfolios of more sophisticated investors be aware that they generally come with greater risk and may be designed more as short-term trading tools.

At times the plain vanilla—even dull—can be the smarter strategy for the long term.

For more information

Personal investors can transact in Vanguard ETFs through their financial adviser or stockbroker.
Our telephone service is available from 8am to 5pm, Monday-Friday AET.

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