

US versus European ETFs: Myths and Reality

Exchange Traded Products Day - SIX Swiss Exchange



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The Myths...

- US ETFs are much larger funds
 - Guaranteeing a better tracking...
 - and higher liquidity
- US ETFs are less expensive
 - Lower TERs
- US ETFs offer higher liquidity
 - Larger Average Daily Volumes (ADV) of trading...
 - and tighter spreads
- Overall US ETFs are more efficient than European ETFs

The Fund Size argument

- On average ETFs' size in the US is US \$ 841 Mn⁽¹⁾ vs. US \$ 243 Mn⁽¹⁾ on average in Europe
- 10 largest ETFs in the US have more than US\$ 10 Bn under management: SPDR S&P 500 (US\$ 67Bn), iShares MSCI Emerging Markets (US\$ 35Bn), iShares MSCI EAFE (US\$ 34Bn), iShares S&P 500 (US\$ 21), iShares Barclays TIPS Bond (US\$ 20)⁽¹⁾
- But European flagship ETFs are not small funds

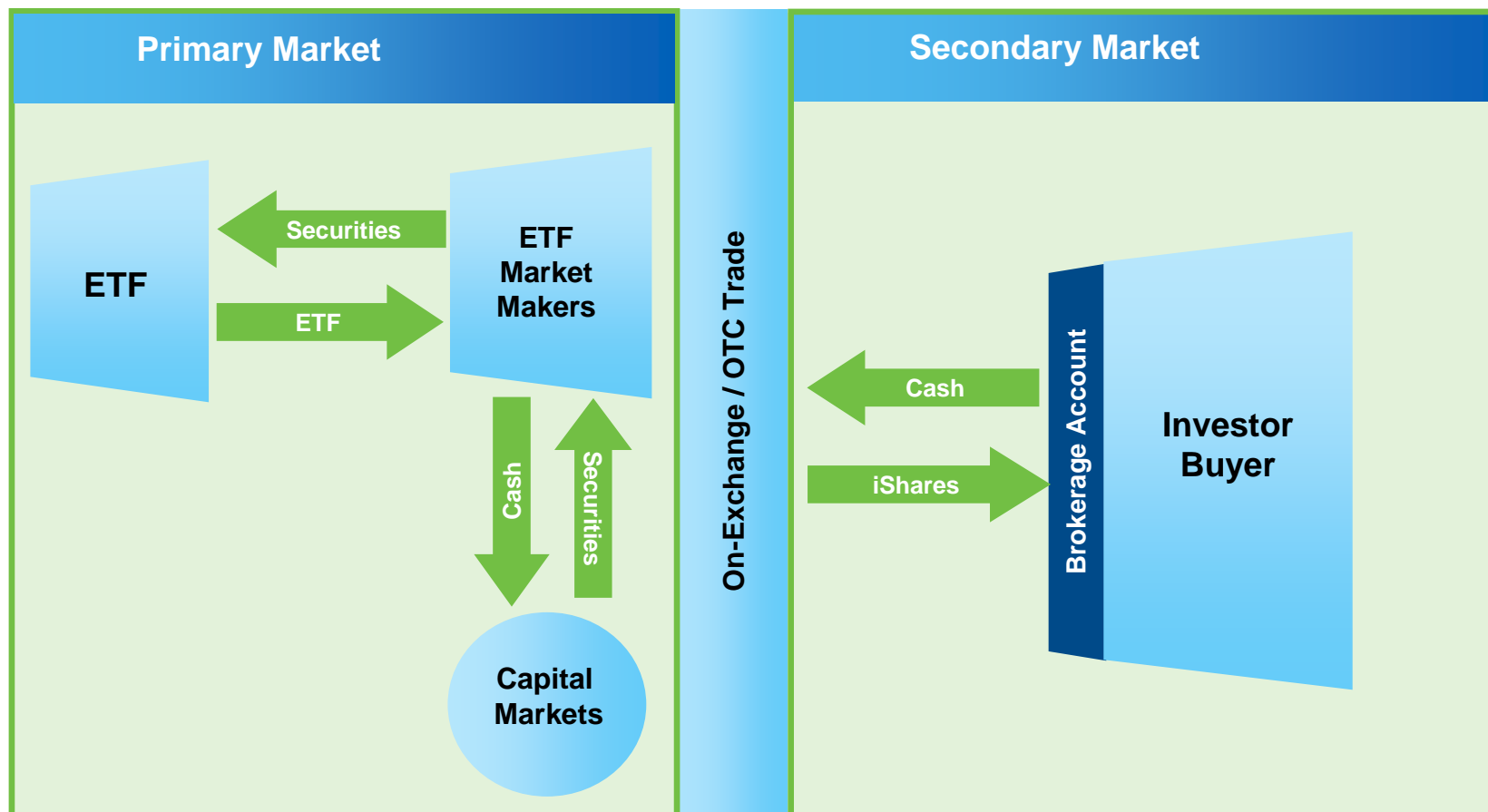
ETF	Ticker	AUM (US\$ Mn) ⁽¹⁾
Lyxor DJ Euro Stoxx 50	MSE FP	\$ 6,684
iShares S&P 500	IUSA LN	\$ 6,581
iShares DJ Euro Stoxx 50 (DE)	SX5EEX GY	\$ 5,646
iShares DJ Euro Stoxx 50	EUN2 GY	\$ 5,574
iShares FTSE 100	ISF LN	\$ 5,391
ZKB Gold ETF (CHF)	ZGLD SW	\$ 5,061
iShares € Corporate Bond	IBCS GY	\$ 4,513
Lyxor CAC 40	CAC FP	\$ 4,093
iShares DAX (DE)	DAXEX GY	\$ 3,683
Xmtch (CH) on SMI	XMSMI SW	\$ 3,606

- Large size does not mean better tracking
 - Size can impact tracking difference at fund launch...
 - or for small optimised funds

(1) Source: ETF Research and Implementation Strategy Team, BlackRock, Bloomberg. As at end January 2010

The Fund Size argument

- Size of ETF is not an indicator of liquidity
- Liquidity of ETF depends on liquidity of underlying market
- ETFs' Creation/Redemption process



The Cost argument

- Differences at individual levels...
- but on average European ETFs are not significantly more expensive than US ETFs in terms of TER

ETFs Exposure	Average TER (bps) ⁽¹⁾	
	Average TER in the US	Average TER in Europe
Equity ETFs	32	37
Fixed Income ETFs	25	16
Total	31	31

- TER is just an element of the Total Cost of an ETF

$$\text{TOTAL COST} = \text{TER} + \text{Trading Costs} + \text{Tax} + \text{Index Tracking Costs} \\ (- \text{Revenues})$$

- Investment horizon matters in Total Cost evaluation

(1) Source: ETF Research and Implementation Strategy Team, BlackRock, Bloomberg. As at end February 2009

The Liquidity argument

- The 2 most actively exchange traded US securities are ETFs⁽¹⁾
- 5 of the 10 most actively traded US equities were ETFs in 2009⁽¹⁾

- ETFs represented approximately 30% of total US equity trading volumes in 2009⁽¹⁾
- iShares ETFs represented approximately 7% of total US equity volumes in 2009⁽¹⁾
- 10 most traded US ETFs had ADVs higher than US\$ 1 Bn in January 2010: ex. US\$ 22 Bn for SPDR S&P 500, US\$ 4 Bn for iShares Russell 2000 or US\$ 3 Bn for iShares MSCI Emerging Markets⁽²⁾

- US ETF market is more mature...
- but European ETF market is catching up quickly
- ETFs accounted for approximately 12% of European equity trading volume in 2009

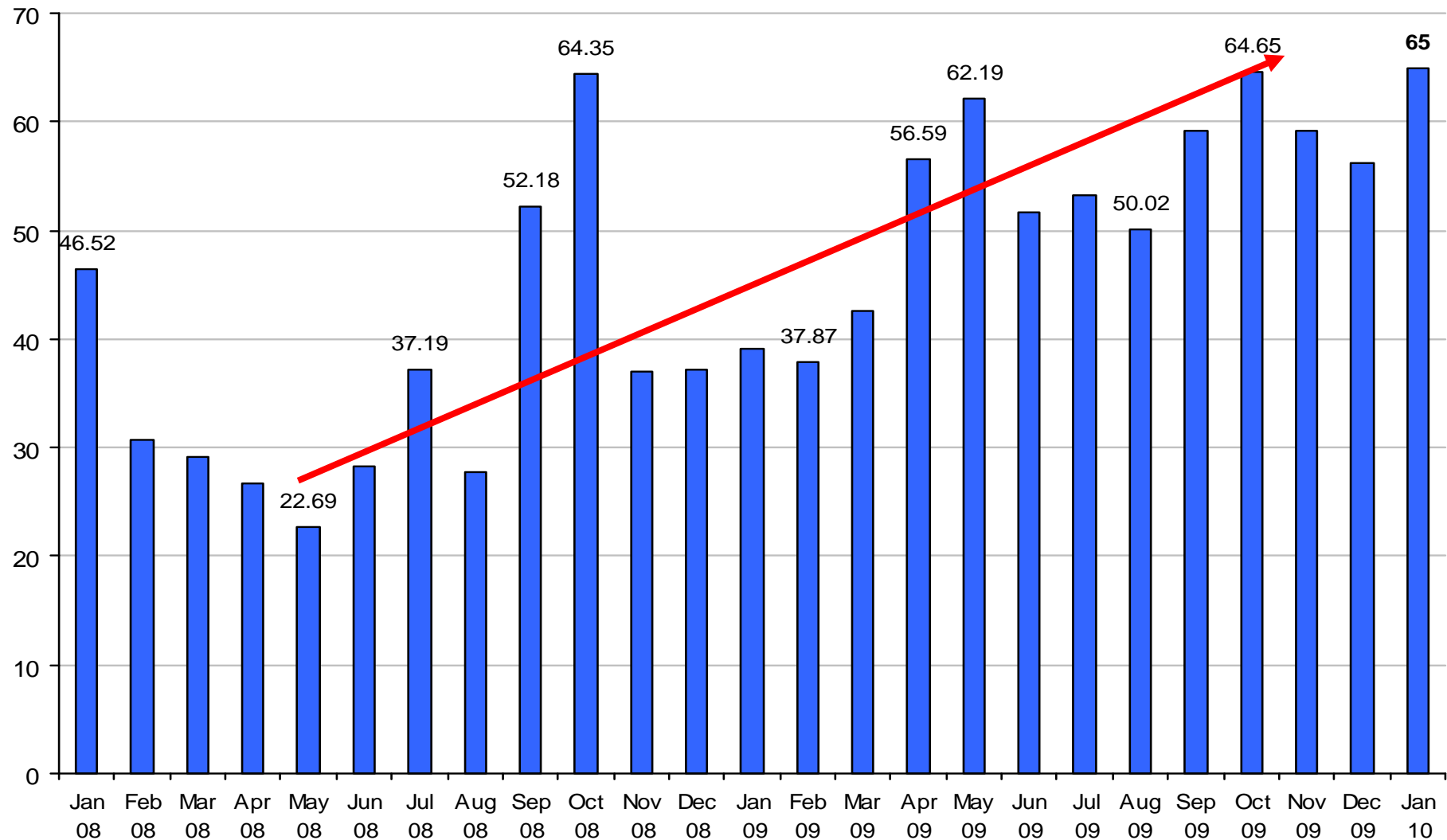
- All trades in the US are done on-exchange
- In Europe, ETFs are listed on 18 exchanges...
- and most trades occur OTC

(1) Source: NYSEArca, Bloomberg

(2) Source: ETF Research and Implementation Strategy Team, BlackRock, Bloomberg. As at end January 2010

The Liquidity argument

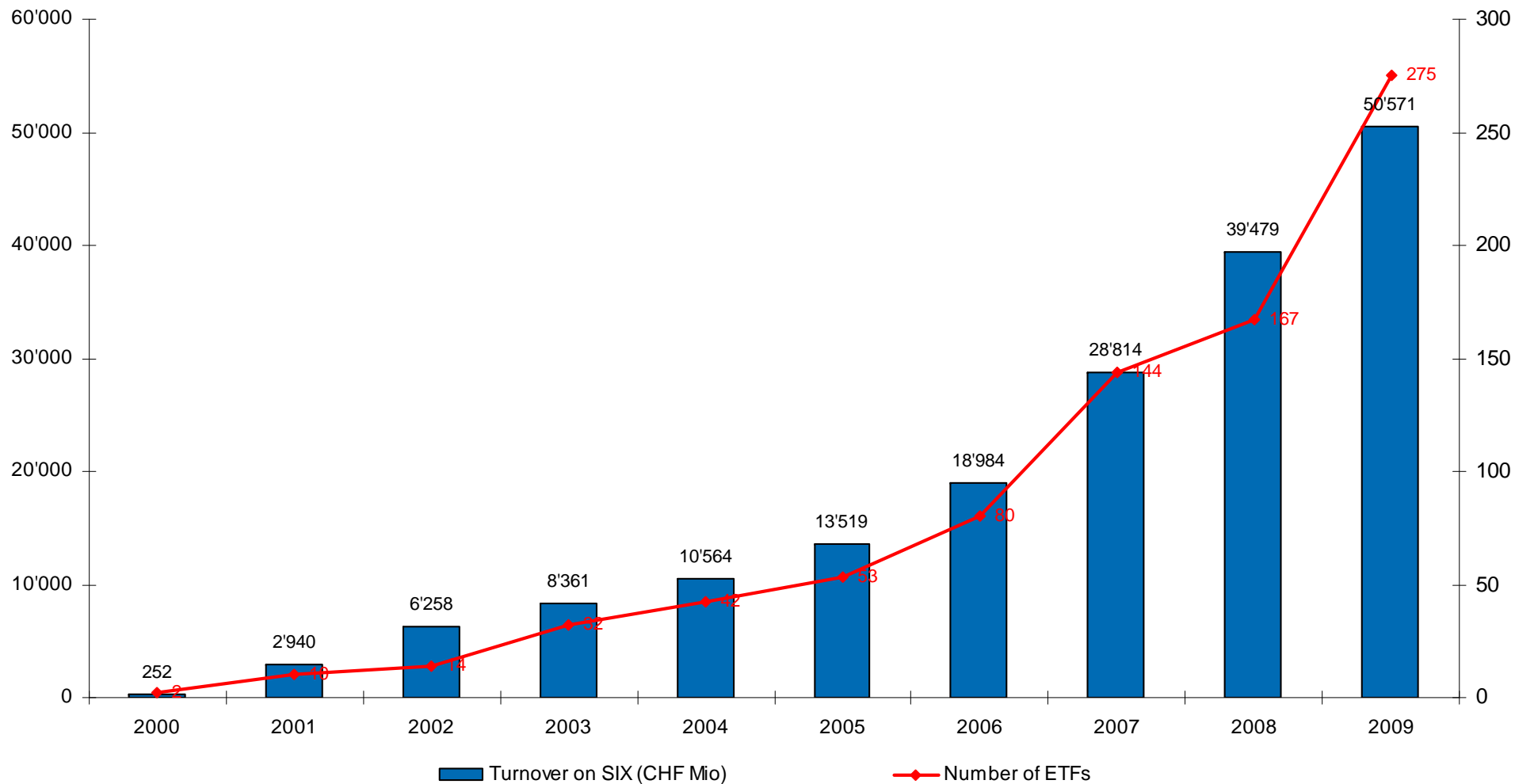
European Turnover: On-Exchange & Reported OTC (in € Bn)



Source: Bloomberg, BlackRock

The Liquidity argument

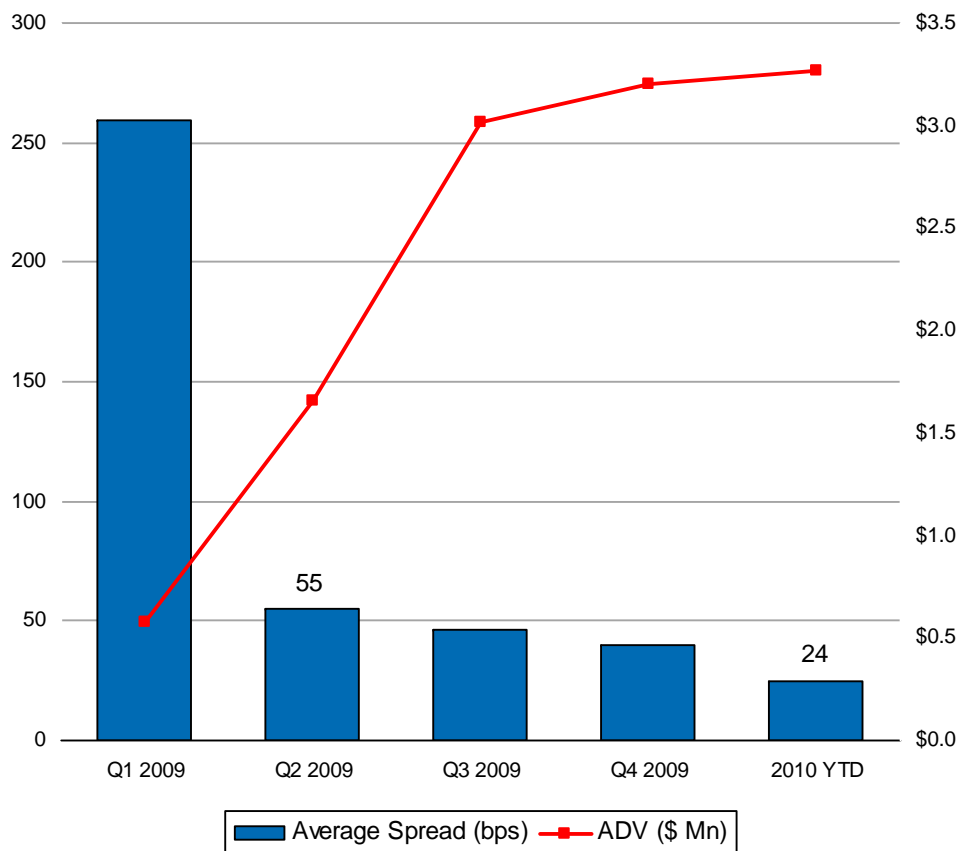
Turnover on SIX (in CHF Mn)



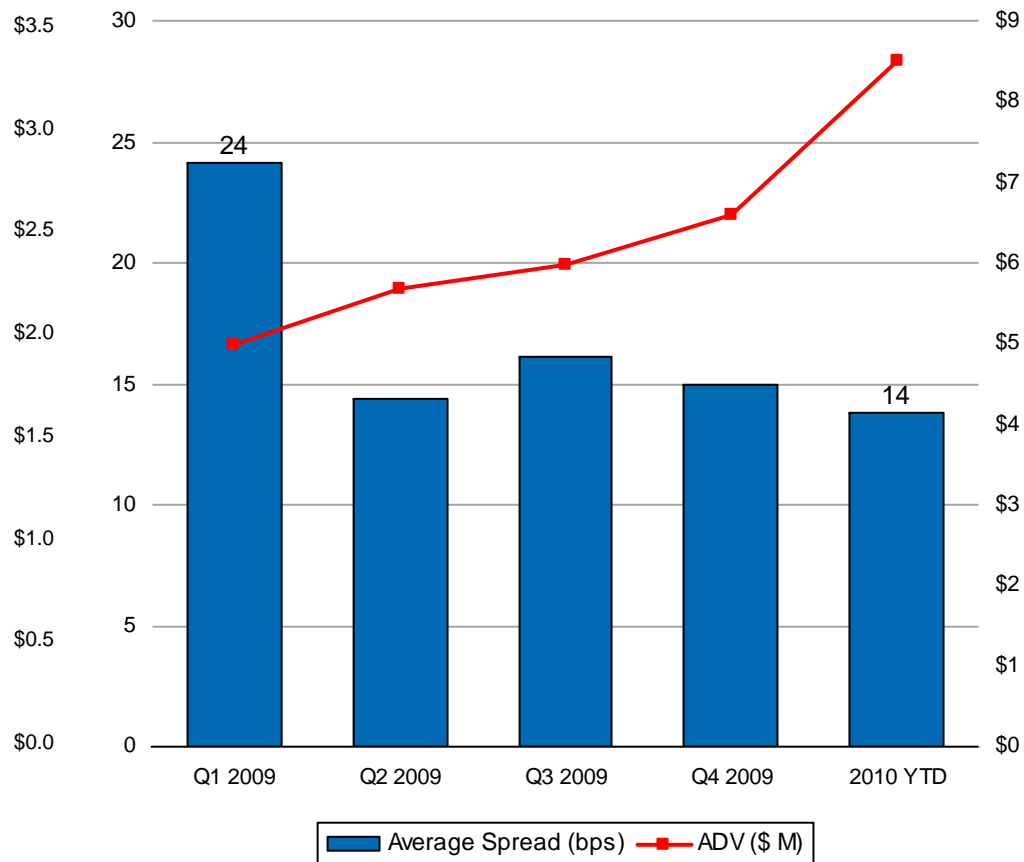
The Liquidity argument

ETFs' Spreads tightening on SIX

iShares MSCI Emerging Markets trading on SIX



iShares S&P 500 trading on SIX



The Tax question

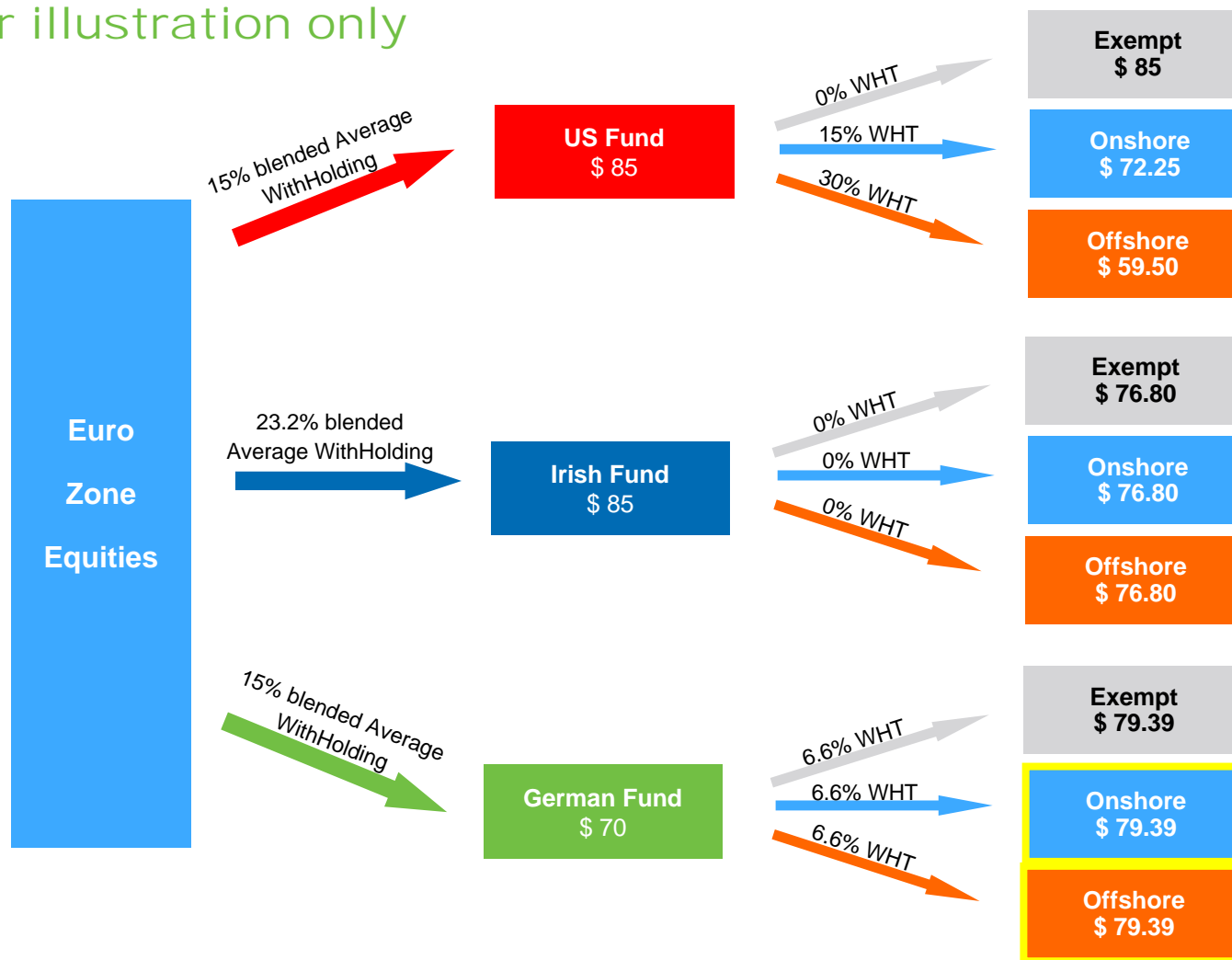
Investing in an ETF on US Equities For illustration only



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The Tax question

Investing in an ETF on Eurozone Equities⁽¹⁾ For illustration only

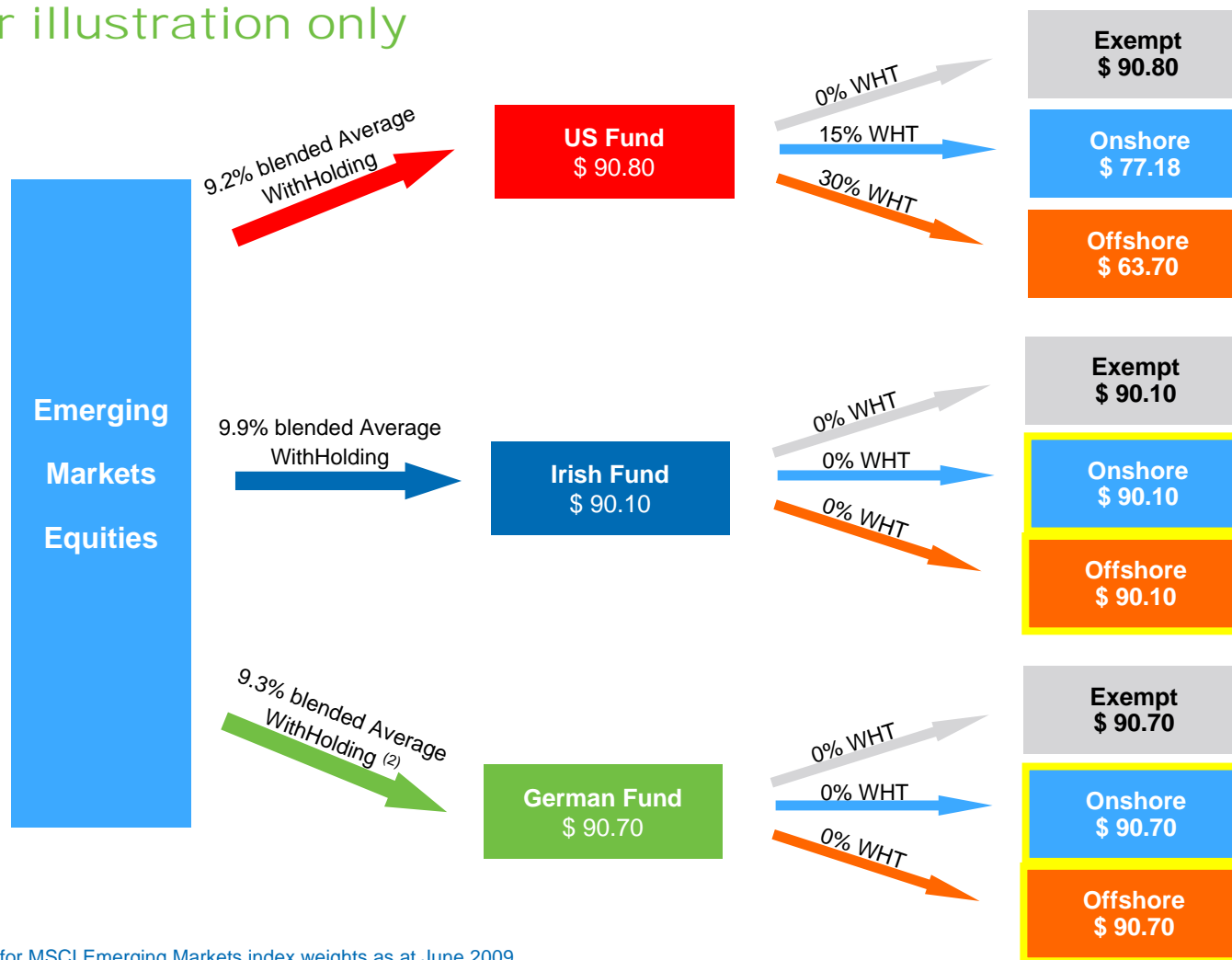


(1) Example for DJ EuroStoxx 50 index weights as at March 2009

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The Tax question

Investing in an ETF on Emerging Markets Equities⁽¹⁾ For illustration only



(1) Example for MSCI Emerging Markets index weights as at June 2009

(2) For most EMs, iShares do not in practice have experience of the treaty rate applied in reality on a payment to German funds

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Conclusion

$$\text{TOTAL COST} = \text{TER} + \text{Trading Costs} + \text{Tax} + \text{Index Tracking Costs} \\ (- \text{Revenues})$$

- TERs of European ETFs are on average as competitive as US ETFs
- On-exchange ETF volumes are much higher in the US, but the European market is catching up and most trades in Europe are done OTC
- US ETFs spreads are generally tighter...
- but this advantage can be largely eroded by differences in Tax treatment
- Quality of tracking depends on funds and way they are managed

- Questions remain about investing into US funds/securities

- Investment horizon enters in the equation

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