Explore The Upsides Of Exchange-Traded Funds

The current economic climate is certainly not the most favourable, with some market watchers anticipating a global recession. How have the markets performed in the past four months? Can investing in Exchange-Traded Funds (ETFs), many of which are uniquely structured, help investors to navigate the financial headwinds? DBS regional equity strategist, Joanne Goh, shares her views on ETF investments.

What are ETFs, and the benefits and risks of investing in it?
ETF is one of the most crucial innovations and are traded like stocks, but their values are pegged to an underlying index such as stock, bond or commodity index. This means investors can enjoy the benefits of instant diversification, and the flexibility that goes with investing in entire markets, sectors, regions or asset types. It is easy to trade, and additionally, compared to mutual funds or unit trusts, investing in ETFs is more cost efficient in terms of fees and expenses.

Take note of the trading spreads, premiums/discounts, tracking errors and regulatory requirements. As more complex products are being introduced, it is important to fully research and understand the unique risks that come with each product, as they impact gains and losses differently.

How has the global investment environment been since 2016?
The month of January was one of the worst for the global financial markets. The broad-based sell-off was triggered by a confluence of factors, which left investors worried that we may be heading for a global recession.

The months of February and March fared better. Spurred by rising commodity prices, and hot on the heels of dovish central bank policy moves, markets rebounded.

While investors continue to focus on economic issues, such as the US's recovery, as well as Japan and Europe coming out of recession, new worries have since surfaced in 2016. Uncertainties surrounding the EU, including the possible UK's withdrawal (Brexit), China's debt concerns, deepening profits recession and geopolitical risks may shake the global economic order.

As we enter the second quarter, all eyes are on the first quarter reporting season. It remains to be seen how the strong USD, weak oil price and negative interest rates in Japan and Europe are impacting corporate earnings. There are also concerns about the creeping inflation in the US and how it will impact US Fed's stance to keep rate hikes on hold.

Given the global financial headwinds and volatility, how can investing in ETFs help investors to manage these risks?
Investors should continue with strategies that minimise risks, and look for solutions that offer varied income sources. Global ETFs provide investors exposure to different asset classes. Based on the top ETF inflows in March, we have noted a few trends:

Dealing with higher volatility and aversion to risk - Investors should prepare their portfolios to cope with higher volatility, against the backdrop of geopolitical risks, possible rising US inflation and China's uncertain economic health. One can consider gold ETFs and US Treasury Inflation Protected Securities. Some examples of such ETFs are SPDR Gold Trust ETF (GLD) and iShares TIPS Bond ETF (TIP).

Yield and fixed income ETFs - ETFs have become increasingly popular as the current low inflation environment has preserved the value of fixed-income assets and boosted real yields. Government bonds such as iShares 7-10 year Treasury Bond ETF (IEF) and iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD) are worth considering. The declining U.S. Treasury yields have also put the spotlight on dividend ETFs.

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> *DBS Regional Equity Strategist*

Capitalise on crude oil price movements - It is unclear how long OPEC is willing to tolerate low prices, while surplus continues to stockpile from the lack of demand. Investors who are interested in going long on crude oil have the option of United States Oil Fund LP (USO).

Foreign diversification - Flow data indicates a shift towards emerging markets, fuelled by low US inflation and delayed rate hikes by the Fed. On average, diversified emerging markets ETFs yield 2.62 per cent as compared to SPDR S&P 500 ETF of 2.17 per cent.

Demand for minimum volatility strategy and utility funds – This type of ETFs are defensive in nature, favoured by risk averse investors who are wary of volatility and would like to generate risk adjusted returns. Examples of such ETFs include iShares MSCI USA Minimum Volatility (USMV), and First Trust Utilities (FXU).