

BROWN 
BROTHERS
HARRIMAN



SHINING THROUGH:

Global Investors Appear Confident in Multi-Faceted Use of ETFs

2019 Global ETF
Investor Survey Results



Contents

Foreword	2
Key Findings	4
Demographics	6
The Global ETF Market in Context . . .	7
ETF Selection	9
Active and Smart Beta ETFs	14
ETF and Market Exposure	18
Potential Headwinds for ETFs	20
Looking Ahead	23

Key Findings

For the first time, investors are giving historic returns equal consideration to cost.

Past performance and expense ratio (cost) were cited as the two most important factors for ETF selection. It appears investors are willing to pay a premium for products that can either mitigate risk or generate outsized returns – particularly during periods of heightened volatility.

Investors are playing defense.

Volatile global markets may have produced more interest in fixed income ETFs, non-correlated sectors like commodities, and smart beta/active products. This is in contrast to previous years, where reduced volatility spurred greater interest (in some regions) in core index equity ETFs.

Smart beta ETFs are catching assets from mutual funds.

Nearly 30% of respondents said they purchased a smart beta ETF to replace an actively-managed mutual fund. This is consistent with prior years' findings that investors view smart beta and active ETFs as tools with multiple uses in portfolio construction and often lower costs than active funds.

Many investors are using smart beta to weather potential storms.

In past years, survey results indicate smart beta and active ETFs were deployed primarily to generate alpha. Not the case this year: Most (70%) of smart beta ETF users are searching for risk mitigation or volatility control, suggesting some may be positioning portfolios for a turbulent year in 2019.

Global holdings in ETFs are set to rise.

61% of global respondents plan to increase their ETF allocation within their portfolios in the next 12 months.

When investing in ESG, investors want a pure play.

Environmental, social, and governance (ESG) factors ranked last in importance for global investors when selecting ETFs. Yet, ESG was selected as a top three response (across all regions) for strategies they want to see more of. This suggests that when seeking ESG exposure, investors go directly to ESG funds, instead of looking for ESG exposure in non-ESG ETFs.

Investors are comfortable buying ETFs with low AUM.

40% of respondents are comfortable buying a new ETF with AUM under \$24 million, suggesting there is still a willingness in the market to engage with newer products.

All signs point to a maturing global ETF market.

Across all regions, respondents have increased their allocation to ETFs: 80% of investors surveyed in Greater China have more than 10% of their AUM in ETFs, compared to 73% in Europe and 79% in the US.



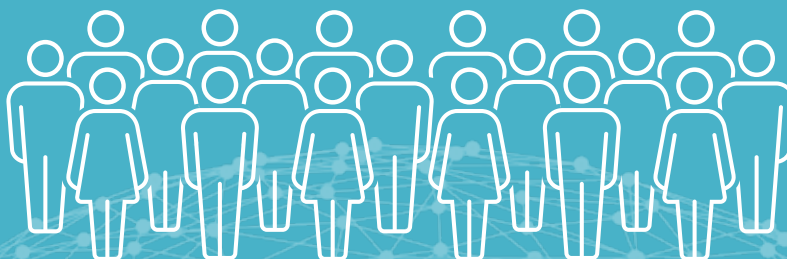
Demographics

Brown Brothers Harriman (BBH), in partnership with ETF.com, recently surveyed 300 institutional investors, financial advisers, and fund managers from around the world (100 in the US, 100 in Europe, and 100 in Greater China – including Mainland China, Hong Kong, and Taiwan). The sample was composed of 89 institutional investors, 151 RIAs / financial advisers, and 60 fund managers. All respondents invest in ETFs and are aware of their institution's overall investment strategy.

Unless otherwise indicated, data sources for all results are BBH surveys and all numbers are in US dollars.

.....

Respondent Primary Business Activity

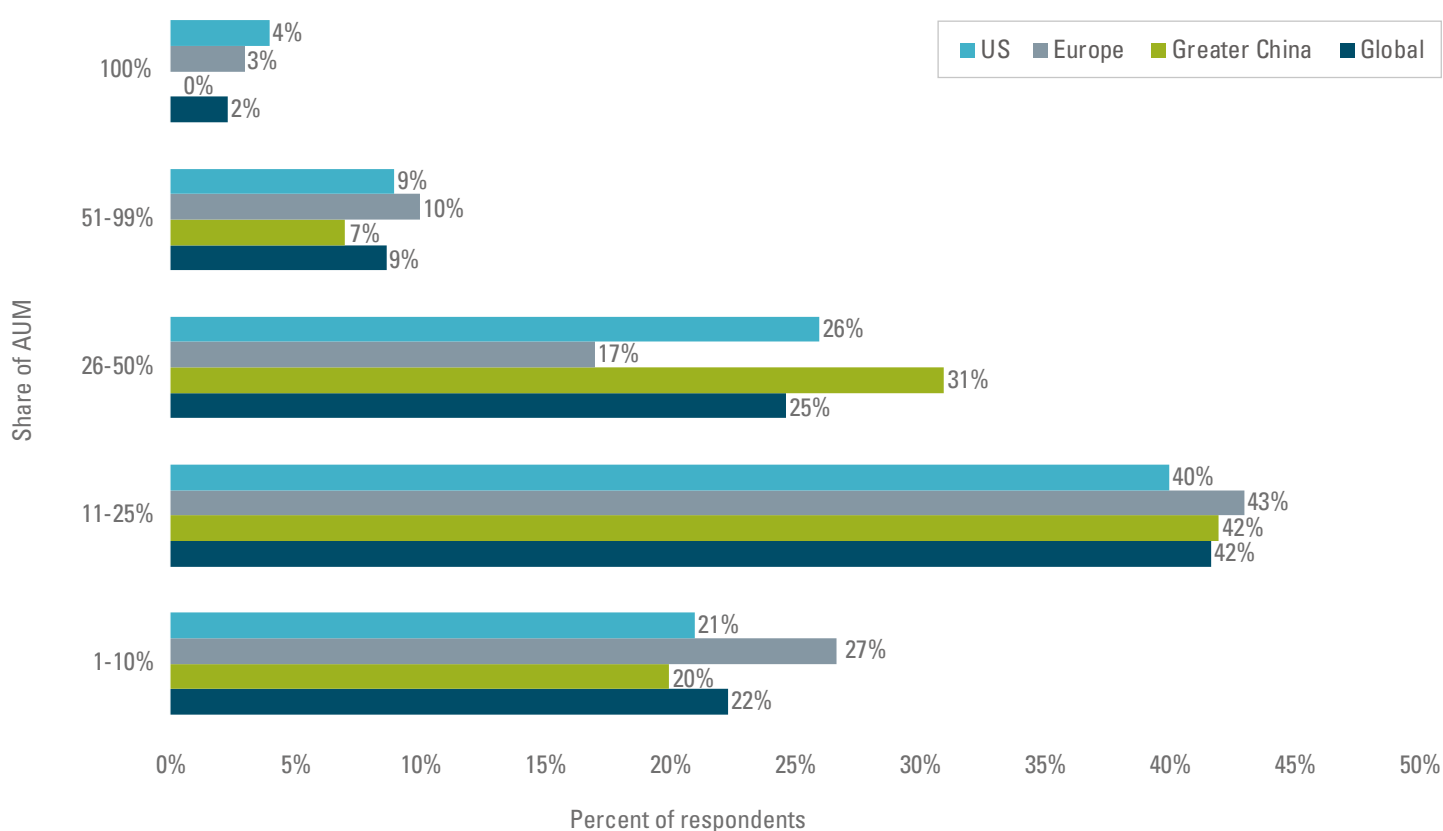


The Global ETF Market in Context

Usage of ETFs is relatively consistent across regions

Comparing ETF investment across regions reveals a maturing global ETF market. Globally, the majority of respondents (67%) hold 11-50% of their portfolios in ETFs. Broken out by region, 66% of investors in the US hold 11-50% in ETFs. That number is 60% in Europe, and 73% in Greater China. On the upper end of the AUM spectrum, 13% of both US and European investors said their portfolios were comprised of 50% or more ETFs. This compares with just 7% in Greater China. While this is a testament to the size and liquidity levels in the US and European markets, it's also an indicator of the room for growth in Greater China, where 38% of investors surveyed have at least 26% of their AUM in ETFs, an increase of 7 percentage points from the 2018 BBH Greater China Survey.

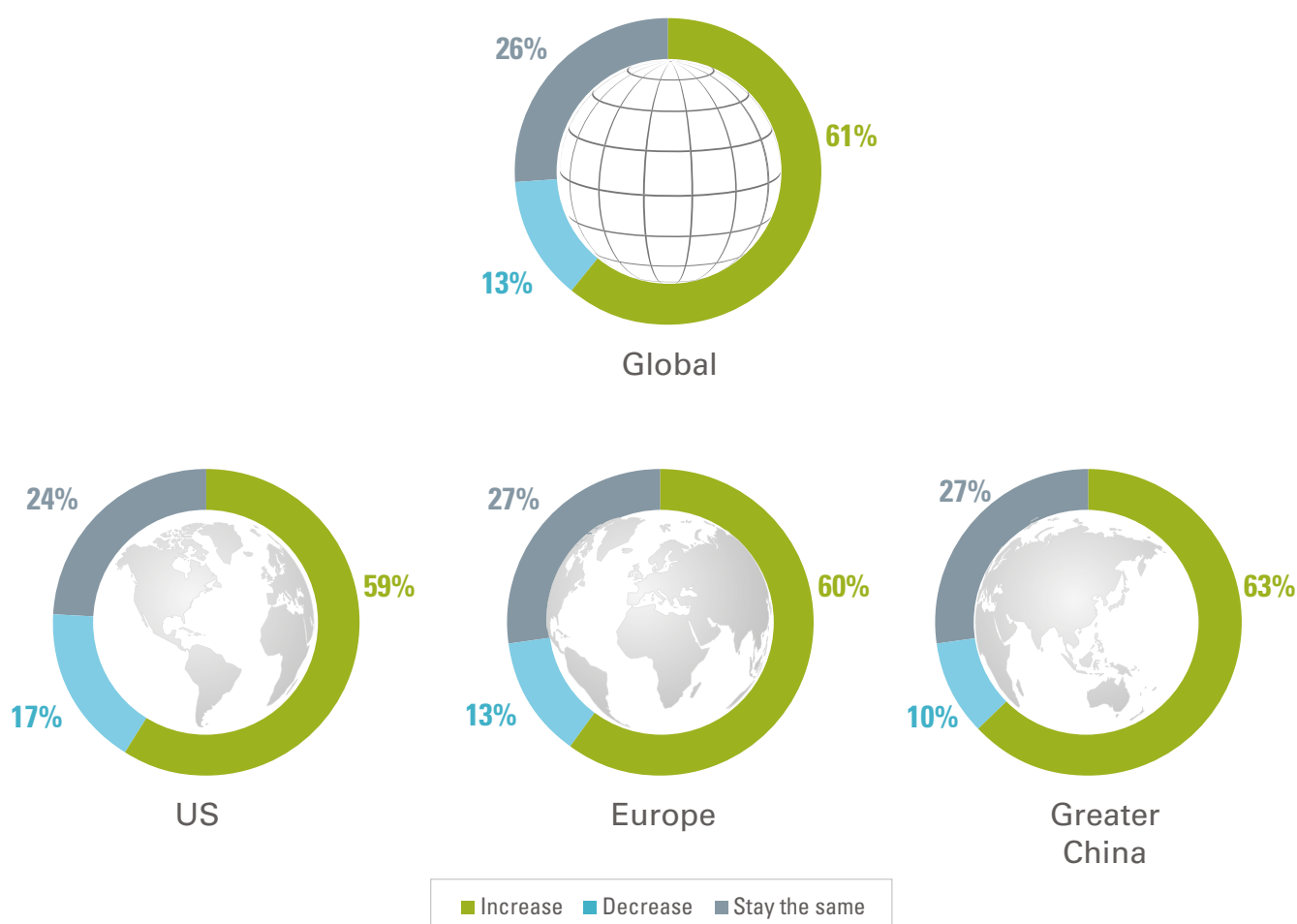
Please indicate the percentage of your AUM invested in ETFs/ETNs:



Global holdings in ETFs set to rise

In a sign that the ETF market will continue to grow, the majority of respondents (61%) plan to increase their ETF investments in the next 12 months, while 26% plan to keep their ETF usage the same. Comparing ETF investment in Greater China with global markets may present the greatest opportunity for growth, with 63% of investors expecting to increase their ETF allocations over the next year, up from 56% last year. In addition, given the volatility experienced in global markets in 2018, it is a positive sign that shareholders may view ETFs as viable tools to position portfolios for market fluctuations.

Do you expect your use of ETFs to increase, decrease, or stay the same over the next 12 months?



ETF Selection

Investors are giving historic returns equal consideration to cost

When selecting ETFs, investors' top three criteria are historical performance, expense ratio, and ETF issuer. Last year in the US, expense ratio sat alone at the top, with index methodology and historical performance rounding out the top three. In Europe, again, expense ratio ranked first, followed by index methodology, and a tie between tracking error and trading spreads. In Greater China, index methodology ranked first, followed by historical performance and a tie between trading spreads and trading volume.

The emergence of historical performance may come as a surprise to those who subscribe to the conventional wisdom that cost is the single most important criteria for ETF selection. Expense ratio continues to rank high, but it is only one among a handful of key factors for investors selecting ETFs.

In Greater China, results suggest expense ratio is less important to investors compared with the US and Europe. As ETF adoption by retail investors in Greater China is still at a nascent stage, perhaps investor sensitivity to fees is less acute than in other regions. When compared with regional mutual funds, ETFs on the higher end of the expense ratio – such as active or smart beta ETFs – still present a significant cost value.

When selecting ETFs, rank your top three in terms of importance:

US			Europe			Greater China		
T1	Historical Performance		T1	Historical Performance		1	Historical Performance	
T1	Expense Ratio		T1	Expense Ratio		T2	ETF Issuer	
2	ETF Issuer		2	ETF Issuer		T2	Trading Spreads	
3	Index Methodology		T3	Index Methodology		3	Index Methodology	
	Tracking Error		T3	Trading Spreads			Expense Ratio	
	Trading Volume			Tracking Error			Tracking Error	
	Trading Spreads			Tax Efficiency			Trading Volume	
	Tax Efficiency			Trading Volume			Tax Efficiency	
	ESG Factors			ESG Factors			ESG Factors	

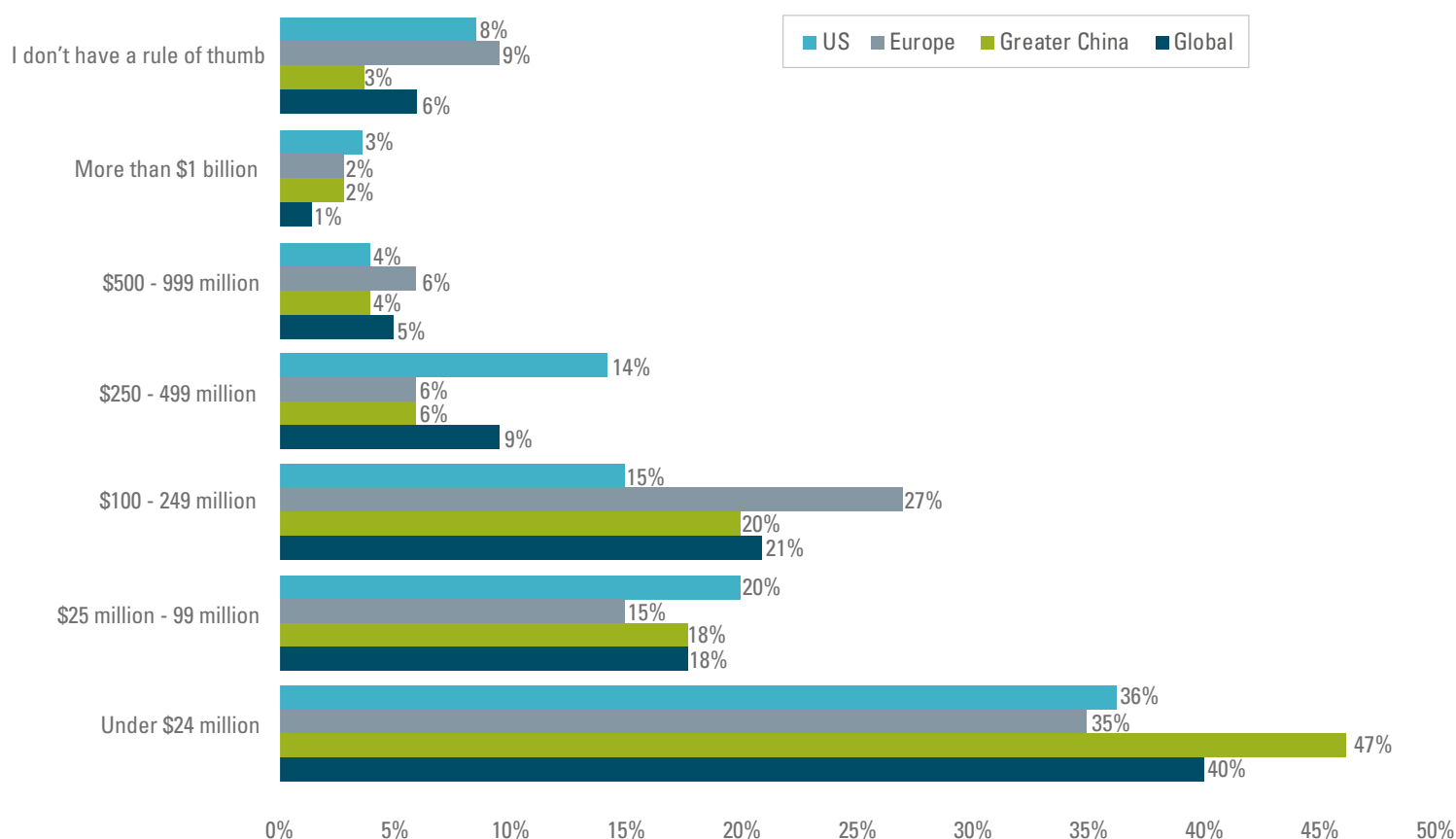
2017/2018								
1	Expense Ratio		1	Expense Ratio		1	Index Methodology	
2	Index Methodology		2	Index Methodology		2	Historical Performance	
3	Historical Performance		T3	Trading Spreads		T3	Trading Spreads	
			T3	Tracking Error		T3	Trading Volume	

Investors are comfortable buying ETFs with low AUM

Nearly all investors have a “rule of thumb” for a new ETF before investing, however, 40% globally stated they are willing to buy a new ETF with less than \$24 million AUM. Given the nuances with ETF seeding and recent trends of larger managers self-seeding new ETFs (thereby underscoring commitment to their product set), and the ability to trade intra-day, perhaps investors are more willing to take on the risk of a newly launched ETF with lower AUM.

In Greater China, nearly half of respondents would invest in a new ETF that has \$24 million or less AUM. Given this region is the more nascent of the three markets, there may be a higher comfort level with smaller products, as many investors are accustomed to investing in new listings.

What is your “rule of thumb” for minimum AUM for a new ETF before you’ll invest?





Investors are looking for more active and smart beta ETFs

The top ETF strategies respondents most wanted to see listed in their local market are active, smart beta, core index, and ESG. In Greater China, smart beta and core index are the most important, while active is the most important in Europe and the US.

For the US and Europe, the survey suggests that the debate between active and passive isn't necessarily a binary choice. Results indicate ETF investors still want active management; they just want to see it in a low cost wrapper. In Greater China, the results suggest that core building blocks are still in demand, with a heightened focus on accessing equity markets outside of their home market. Active ETFs are also new to the region: the vehicles were just approved in Hong Kong earlier this year but are currently not available in Taiwan or Mainland China.

Generally, when looking across the regions, the more mature the market, the lower respondents ranked core index as a strategy they're looking for. This is not surprising given passive core index offerings are already available by the largest ETF issuers.

In which of the following areas would you like more ETFs to be available in your local market?

US		Europe		Greater China	
1	Active	1	Active	T1	Smart Beta
T2	ESG	2	Smart Beta	T1	Core Index
T2	Smart Beta	3	Core Index	2	ESG
3	Leverage/Inverse		Leverage/Inverse	3	Active
	Managed Risk/Low Volatility		Thematic		Leverage/Inverse
	Core Index		ESG		Currency Hedged
	Currency Hedged		Currency Hedged		Managed Risk/Low Volatility
	Thematic		Managed Risk/Low Volatility		Thematic

Investors also want to see more fixed income ETFs

The top asset classes that investors across the three regions think could use more ETFs are fixed income, US equity, and commodities (including gold, oil, metals, energy, food, etc.) These selections might be attributed to investors seeking a flight to more stable and less correlated asset classes given the market volatility experienced in late 2018, and which some expect will continue through 2019.

Which asset classes do you think could use more ETFs in your local market?

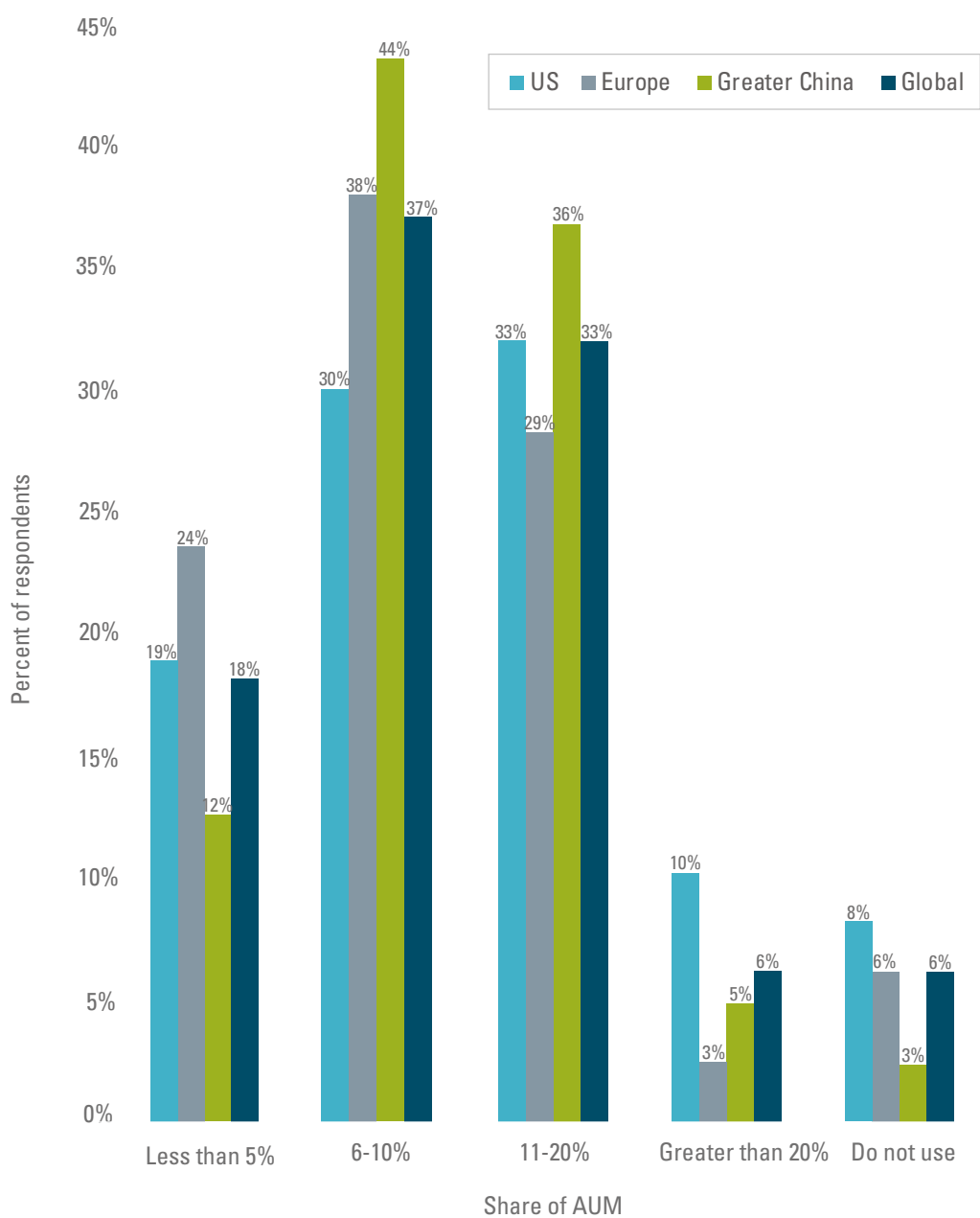
	US		Europe		Greater China
T1	Fixed Income	1	Fixed Income	T1	Fixed Income
T1	US Equity	2	Commodities	T1	US Equity
T2	Commodities	3	US Equity	T2	Commodities
3	Alternatives		European Equity	T2	Alternatives
	European Equity		Alternatives	3	Greater China Equity
	Greater China Equity		Greater China Equity		European Equity

Active and Smart Beta ETFs

Smart beta settles in

While smart beta and active ETFs represent just 17%² of the broader global ETF market, their relevance has increased significantly in recent years. Broken out by region, 92% of respondents in the US have at least one smart beta ETF in their portfolio. That number is 94% in Europe and 97% in Greater China. This represents a pronounced increase in usage in the US and European markets from a year ago: In last year's survey, just 67% of US investors and 61% of European investors held smart beta, while Greater China remained at a similar level.

What share of smart beta products currently make up your AUM?



²Morningstar

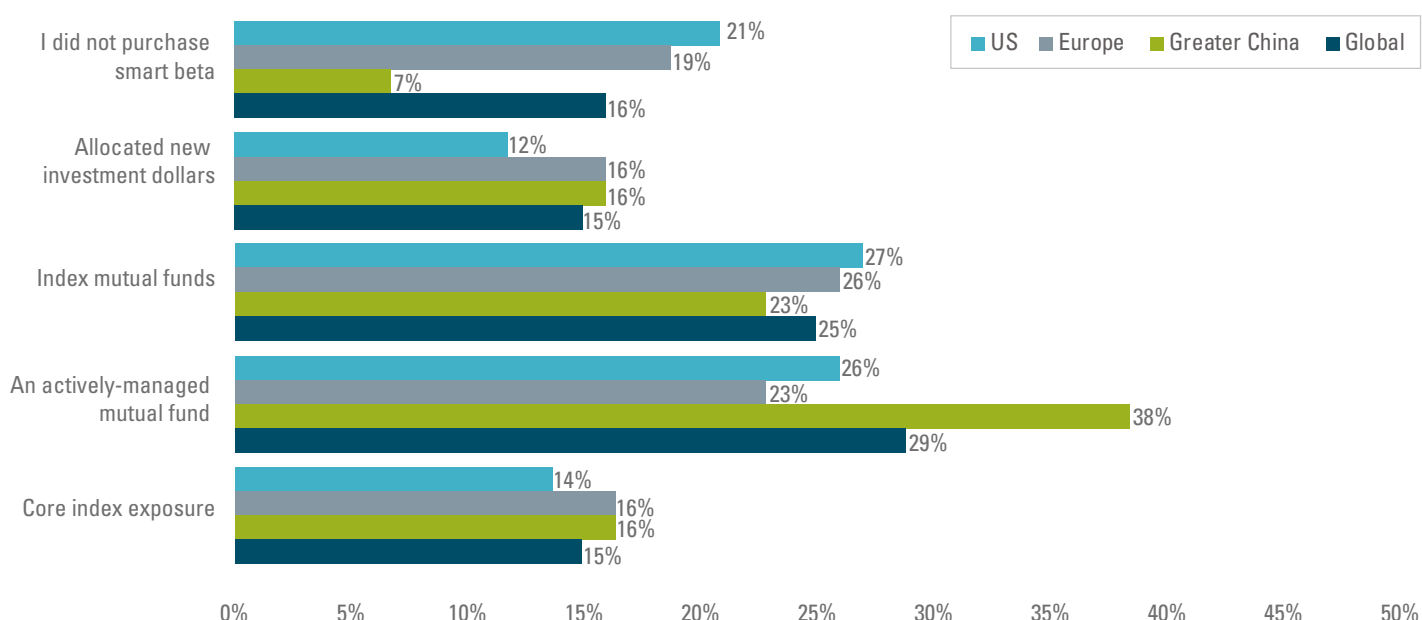
Smart beta ETFs are catching assets from mutual funds

Smart beta is often cited as the middle ground in the active-to-passive spectrum. It appears that investors view smart beta ETFs as vehicles that may offer some benefits of traditional active management when compared with passive core index ETFs, at a lower cost. These results are consistent with previous years and underscore that many investors view versatility as one of the greatest attributes of the ETF wrapper.

In fact, 29% of global respondents purchased a smart beta ETF in the last 12 months to replace an actively-managed mutual fund.

In Greater China, that number jumps to 38%. In Mainland China, a market dominated by active mutual funds, the ongoing regulatory reform focusing on deleveraging the financial markets and reallocating investment from wealth management products into more transparent collective investment vehicles should be a tailwind increasing use of ETFs.

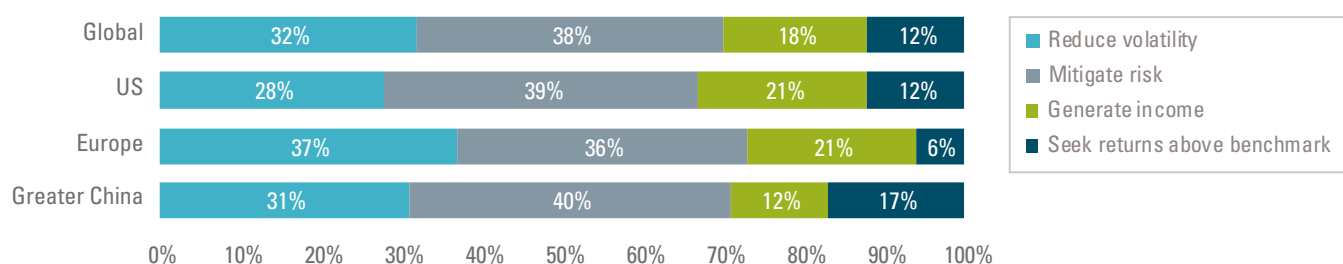
If you purchased a smart beta ETF in the last 12 months, what did it replace in your portfolio?



Many investors are using smart beta to weather potential storms

Most (70%) of smart beta ETF users are searching for risk mitigation or volatility control, suggesting some may be positioning portfolios for a turbulent year in 2019.

What is the top reason why you are using/considering using smart beta?



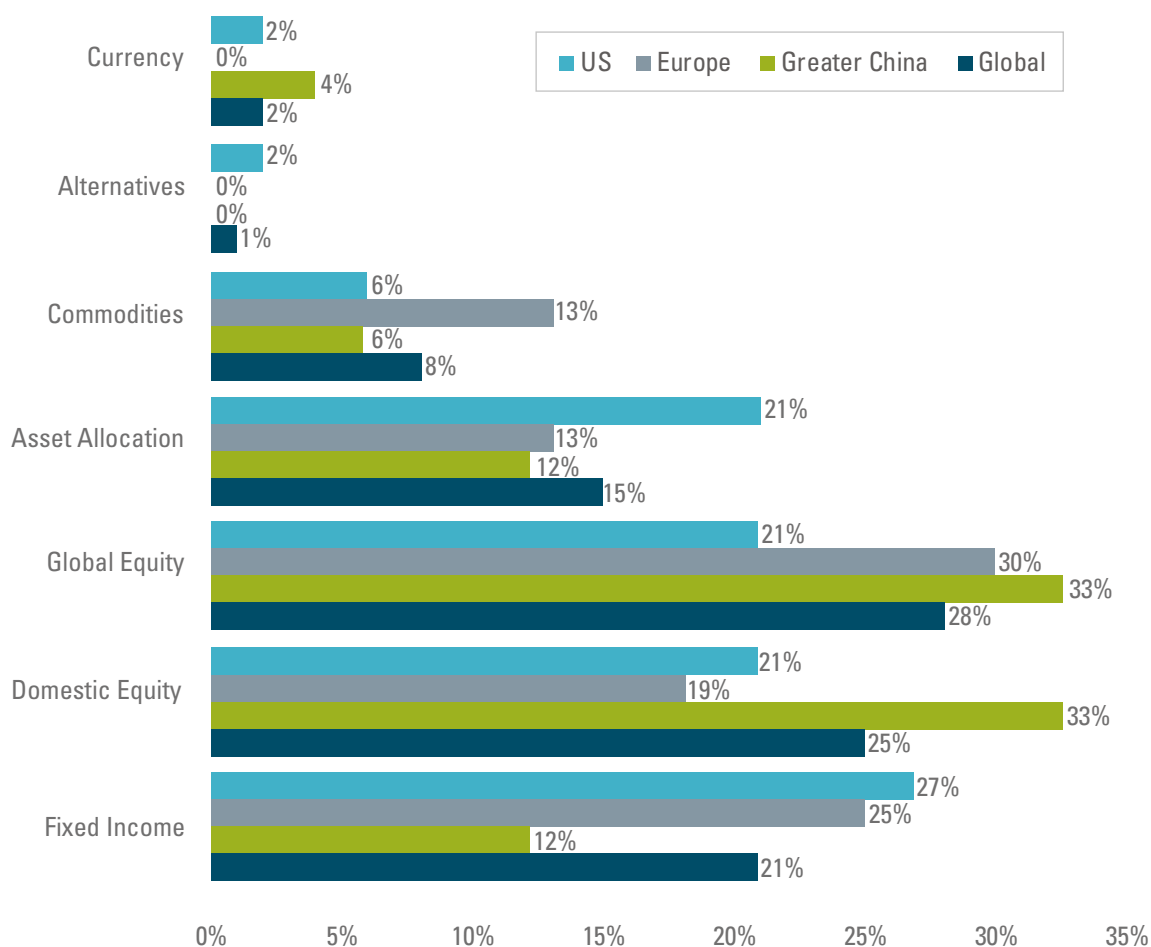
Global equity still reigns supreme when it comes to active ETFs

More than 50% of global respondents would look for an actively-managed ETF in equity asset classes. The survey also highlights a difference between the US and Europe – fixed income ranked highest for US respondents, while European respondents had a preference for global equities.

The results below echo what we see in the market. When investors are looking at active ETFs, they are looking for asset classes where inefficiencies may be turned into alpha opportunities. Areas such as domestic equity may be better served by passive products because there are fewer arbitrage opportunities.

Strong demand for active fixed income, which has been a success story in the smaller actively managed ETF market, is still an opportunity for asset managers. We expect respondents are showing demand for domestic and global equity in order to chase returns in a volatile market.

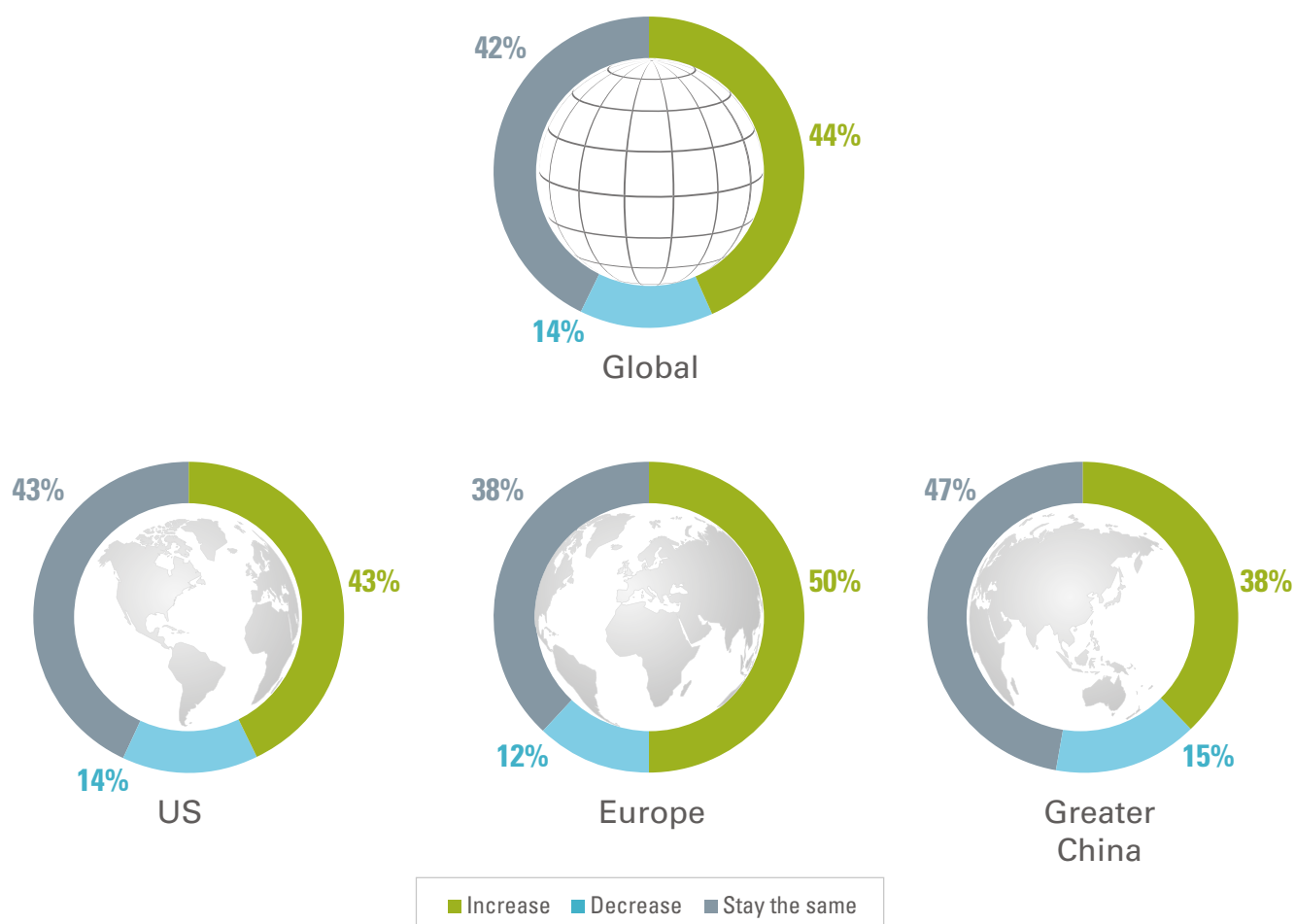
In what asset class would you be most likely to look for an actively-managed ETF?



Smart beta demand is set to accelerate

44% of surveyed investors will increase their allocation to smart beta in the next 12 months, suggesting a potential area of focus for product development.

Do you expect your exposure to smart beta ETFs to increase, decrease, or stay the same over the next 12 months?



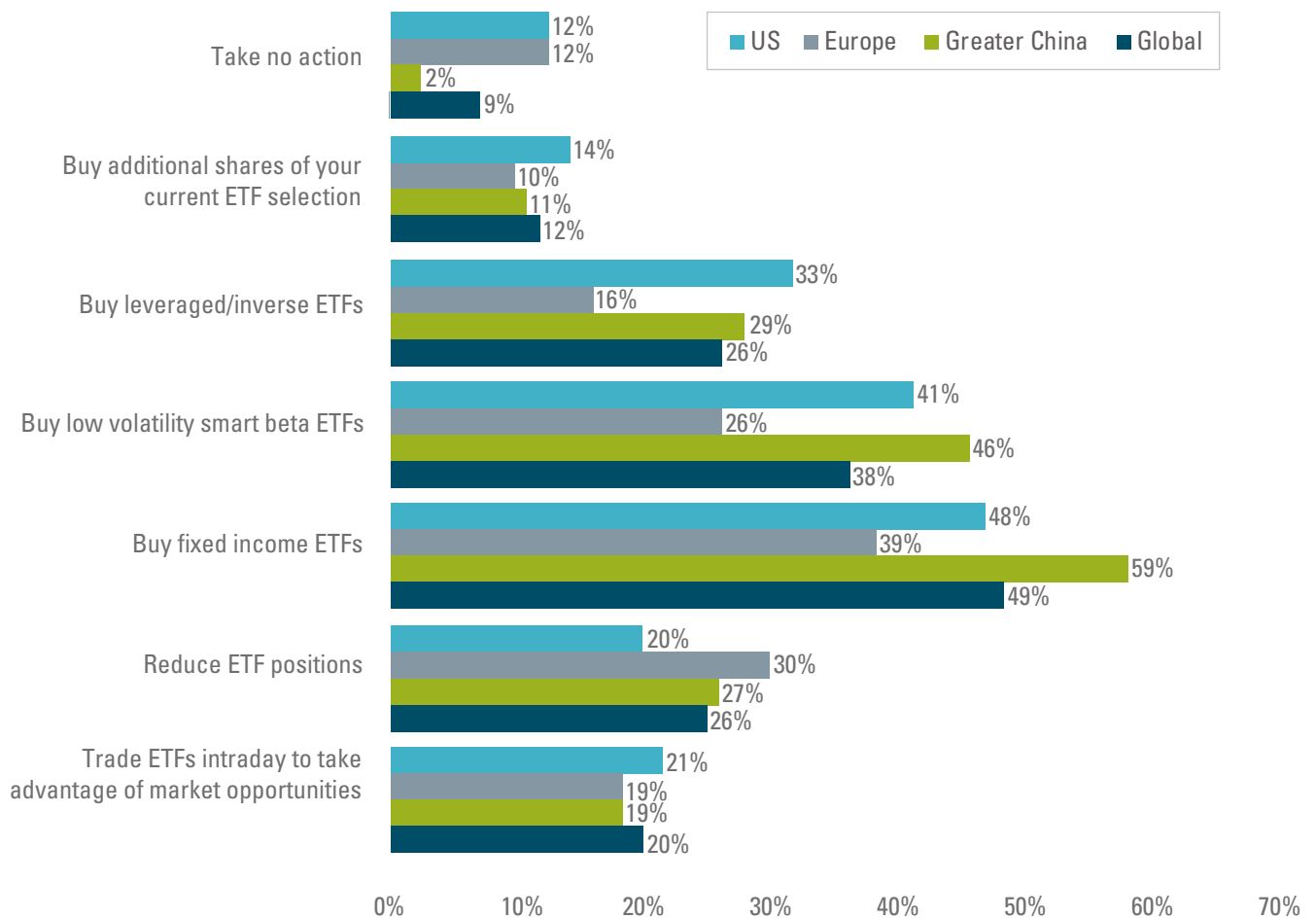
ETFs and Market Exposure

Investors seek fixed income ETFs in volatile markets

During periods of heightened market volatility, investors across the three regions tend to buy fixed income ETFs (49%) and low volatility smart beta ETFs (38%).

The chart below shows that although intraday liquidity is often a selling point for ETFs, it's not the main reason investors are buying them. It appears access – especially to asset classes like fixed income or nuanced strategies like low volatility – is compelling many to use ETFs opportunistically.

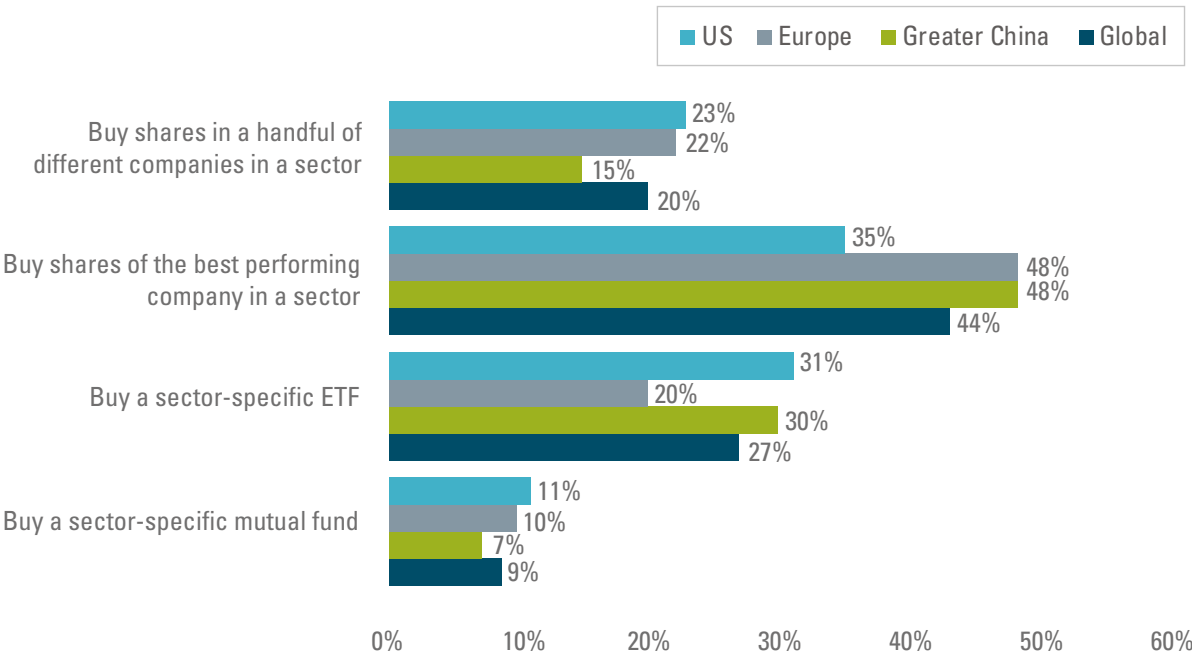
How will you use ETFs in your portfolio during a period of heightened market volatility? (select all that apply)



Investors prefer stocks over ETFs for sector exposure

Sector exposure is often seen as a smaller segment of portfolio construction, one that appears many investors prefer to achieve through individual stocks. However, 27% of investors (the second most) achieve sector exposure through ETFs, showing investors may value the versatility of ETFs for exposure.

Which is your preferred method for achieving exposure to a specific sector for your portfolio?

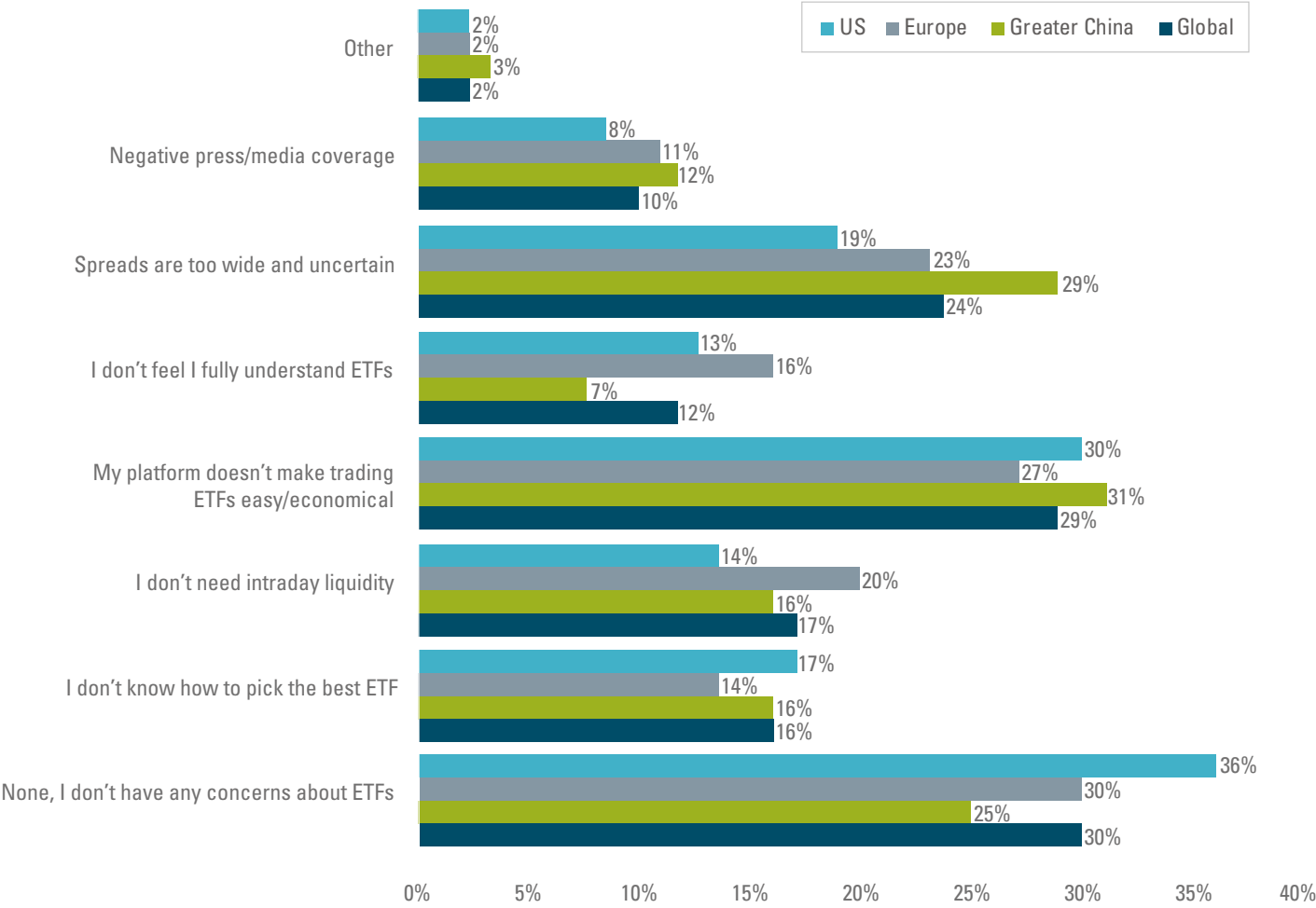


Potential Headwinds for ETFs

ETF platforms leave room for improvement

29% of global respondents stated that the platforms they use make ETF trading difficult or expensive. While platform issues could be a potential headwind in further ETF adoption, the results highlight how much opportunity exists for global intermediaries to continue to improve the user experience and make trading ETFs more cost effective.

What are the concerns about ETFs that keep you from increasing your exposure more than you have already? (select all that apply)

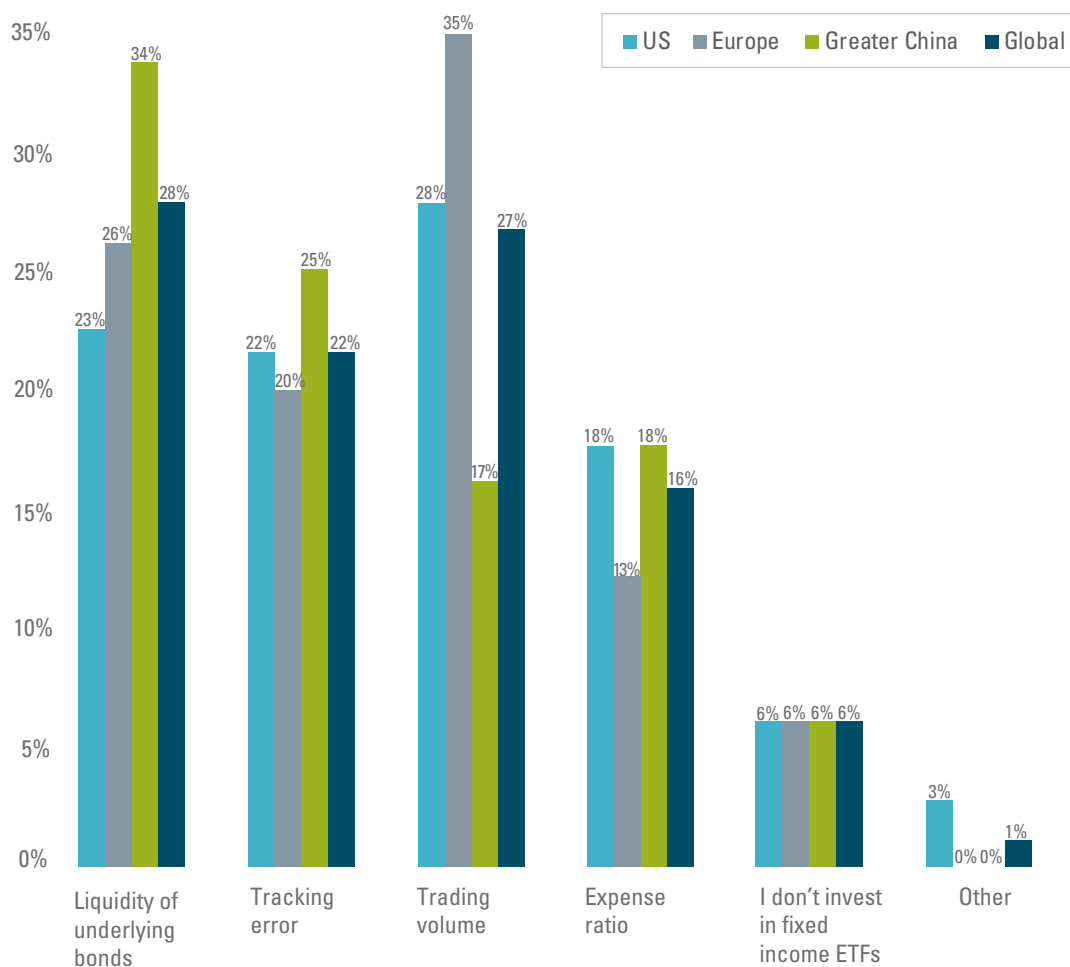




Fixed income trading volume is also a concern

Regarding fixed income ETFs, the main concerns are trading volume, followed by liquidity of underlying bonds in Europe and US; In Greater China, liquidity of underlying bonds and tracker error are the main concerns.

What concerns you most when investing in fixed income ETFs?



ETF education efforts are paying off

In Europe and Greater China, the number of respondents who selected “I don’t feel I fully understand ETFs” and “I don’t know how to pick the best ETF” dropped sharply from last year. Whether through asset managers, the media, or the broader ecosystem, it appears investors are more knowledgeable and comfortable with ETFs, demonstrating the global ETF market is maturing.

	Europe		Greater China		US	
	I don't feel I fully understand ETFs	I don't know how to pick the best ETF	I don't feel I fully understand ETFs	I don't know how to pick the best ETF	I don't feel I fully understand ETFs	I don't know how to pick the best ETF
2018	24%	26%	11%	30%	N/A	N/A
2019	↓ 16%	↓ 14%	↓ 7%	↓ 16%	13%	17%

Looking Ahead

US

Many signs point to a US ETF marketplace that has evolved significantly over the six years we've surveyed investors. US respondents are using more nuanced products, deploying ETFs beyond purely passive strategies, and using the versatility of ETFs to actively pursue opportunities. All of this underscores the maturity of the US ETF market and how asset allocators may be positioning their portfolios in what some expect to be a turbulent year ahead.

The survey also suggests investors are weighing factors beyond expense ratio when selecting ETFs. An ETF's track record and the ETF issuer both emerged as near equal considerations with cost. This perhaps shows increasing importance of an issuer's brand, highlighting the need for C-suite commitment to their ETF business line.

On the regulatory front, promising steps taken in 2018 by the SEC to normalize the regulatory process for ETFs are anticipated to gain acceptance this year, which would further cement ETFs in the investment landscape. At the same time, domestic distribution channels are becoming more accepting of these products, which could spur wider ETF adoption as investors of all stripes come to understand the benefit of ETFs. However, selling US ETFs to non-US investors is becoming more difficult given changes by global regulators (e.g. PRIIPs) resulting in US managers launching local ETFs in Europe and Asia.

One area of focus is whether markets continue their volatile close to 2018. If volatility continues, the versatility and intra-day liquidity of the ETF wrapper and proliferation of factor-based strategies may be put to another test by investors. Either way, we expect to continue to see new entrants in the US ETF market, while existing issuers advance their product innovation.

Europe

87% of survey respondents in Europe confirmed that they will increase or maintain their investments in ETFs this year. European regulations should play a role in this adoption as MIFID II, implemented at the beginning of 2018, brings additional clarity to European ETF trading activity and commissions charged by financial advisers. The latter is key as respondents selected expense ratio as the second most important factor when selecting an ETF. This is why transparency around fees may naturally direct investors towards ETFs.

ETFs in Europe are regulated UCITS products. European local regulations continue to evolve (in line with the US SEC's normalization) to bring additional flexibility, protection, and confidence to the product. As a result, we are seeing that European ETFs attract not only European investors but also Asian and Latin American investors who find the UCITS features around disclosure and protection attractive. Europe is gaining momentum and we believe 2019 may bring more volume, as well as more confidence, transparency, and innovation to ETFs in Europe.

Greater China

Passporting between Mainland China and Hong Kong continues to be a focal point as global asset managers look to capitalize on Chinese investor demand for offshore investments. ETF inclusion in the Stock Connect program has yet to launch due to the challenges of normalizing the settlement processes between the respective exchanges. As a result, regulators are pursuing a new option to cross-list ETFs between Mainland China and Hong Kong through the Mutual Recognition of Funds (MRF) program. ETF sponsors are eagerly awaiting further clarity on the cross-listing program as well as understanding if all existing MRF requirements (track record, minimum size, 50/50 asset raising, etc.) would be applicable for ETFs. Further clarity on this program is expected in the first half of 2019.

If you would like to discuss the survey or learn more about ETFs, please let us know.
We look forward to collaborating with you. www.bbh.com/etf



GLOBAL

Shawn McNinch

+1.617.772.1376

shawn.mcninch@bbh.com



US

Ryan Sullivan

+1.617.772.6905

ryan.sullivan@bbh.com



EUROPE

Antonette Kleiser

+353.1.603.6465

antonette.kleiser@bbh.com



ASIA

Chris Pigott

+852.3756.1749

chris.pigott@bbh.com



EUROPE

Andrew Craswell

+44.207.614.3992

andrew.craswell@bbh.com

BROWN 
BROTHERS
HARRIMAN

NEW YORK BEIJING BOSTON CHARLOTTE CHICAGO DENVER DUBLIN GRAND CAYMAN HONG KONG JERSEY CITY
KRAKÓW LONDON LUXEMBOURG NASHVILLE PHILADELPHIA TOKYO WILMINGTON ZÜRICH WWW.BBH.COM

This publication is provided by Brown Brothers Harriman & Co. and its subsidiaries ("BBH") to recipients, who are classified as Professional Clients or Eligible Counterparties if in the European Economic Area ("EEA"), solely for informational purposes. This does not constitute legal, tax or investment advice and is not intended as an offer to sell or a solicitation to buy securities or investment products. Any reference to tax matters is not intended to be used, and may not be used, for purposes of avoiding penalties under the U.S. Internal Revenue Code or for promotion, marketing or recommendation to third parties. This information has been obtained from sources believed to be reliable that are available upon request. This material does not comprise an offer of services. Any opinions expressed are subject to change without notice. Unauthorized use or distribution without the prior written permission of BBH is prohibited. This publication is approved for distribution in member states of the EEA by Brown Brothers Harriman Investor Services Limited, authorized and regulated by the Financial Conduct Authority (FCA). BBH is a service mark of Brown Brothers Harriman & Co., registered in the United States and other countries.
© Brown Brothers Harriman & Co. 2019. All rights reserved. February 2019. IS-04716-2019-02-01 0032_19