

**iShares**<sup>®</sup>

by BlackRock

# **BEING ACTIVE BY USING PASSIVE**

**Head of BeLux iShares&Wealth**

**Charles Symons**

**Passive investing starts with active decisions**

**FOR PROFESSIONAL CLIENTS ONLY**

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# The investment landscape

Where do ETPs sit?

**Alpha**  
**Actively managed vehicles**

Seek to outperform a particular benchmark

**Active funds**

**Beta**  
**Index vehicles**

Seek to match the performance of the index, like for like

**Basket of securities**

**Index Mutual Funds**

**ETFs**

**Segregated Mandates**

**Futures**

**Swaps**

**Certificates**

Source: BlackRock, as of 30/06/2020. For illustrative purposes only.

# Defining active and passive investing

## Active Management

Aims to achieve a higher risk-adjusted return than its benchmark index

$$\alpha > 0$$

## Passive Management

Aims to track the performance of its benchmark as closely as possible

$$\beta = 1$$

### Mutual Fund

- Not traded on stock exchanges
- Aims to beat the performance of its benchmark
- Higher TER
- One NAV per day

### Index Fund

- Not traded on stock exchanges
- Aims to track the performance of its benchmark as closely as possible
- Low TER
- One NAV per day

### ETF

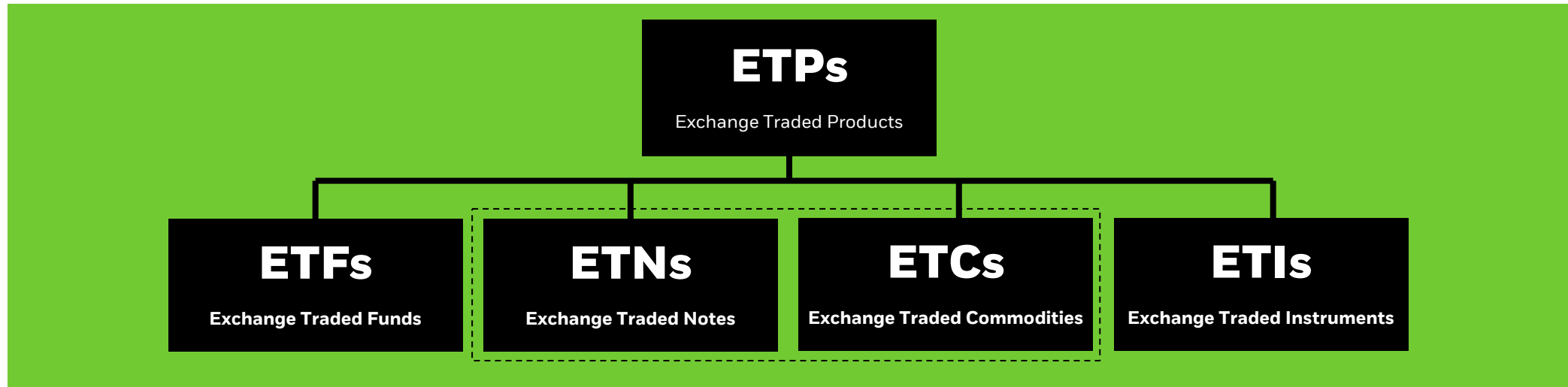
- Traded on stock exchanges
- Aims to track the performance of its benchmark as close as possible
- Low TER
- Traded in intraday

**Capital at risk.** The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

**TER: Total Expense Ratio.** The figures shown on this page are fictional examples to explain the types of investments you may consider.

# What is an ETP?

## Know what you own: advancing ETP classification



- Open-Ended fund
- Registered
- Unit linked

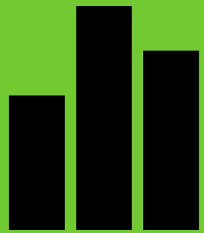
- Debt security
- Issued by a corporate issuer
- May or may not be collateralised

- Pooled investment vehicle with a share that trade on exchange
- Debt linked security
- Physically backed

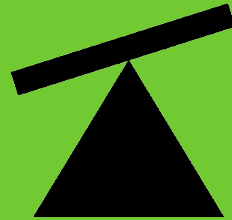
- Debt or physically backed
- May or may not be collateralised
- Can be leveraged or inverse

Source: BlackRock, as of 30/06/2020. For illustrative purposes only.

# Investors are **changing** how they construct portfolios.



**Portfolio  
outcomes**



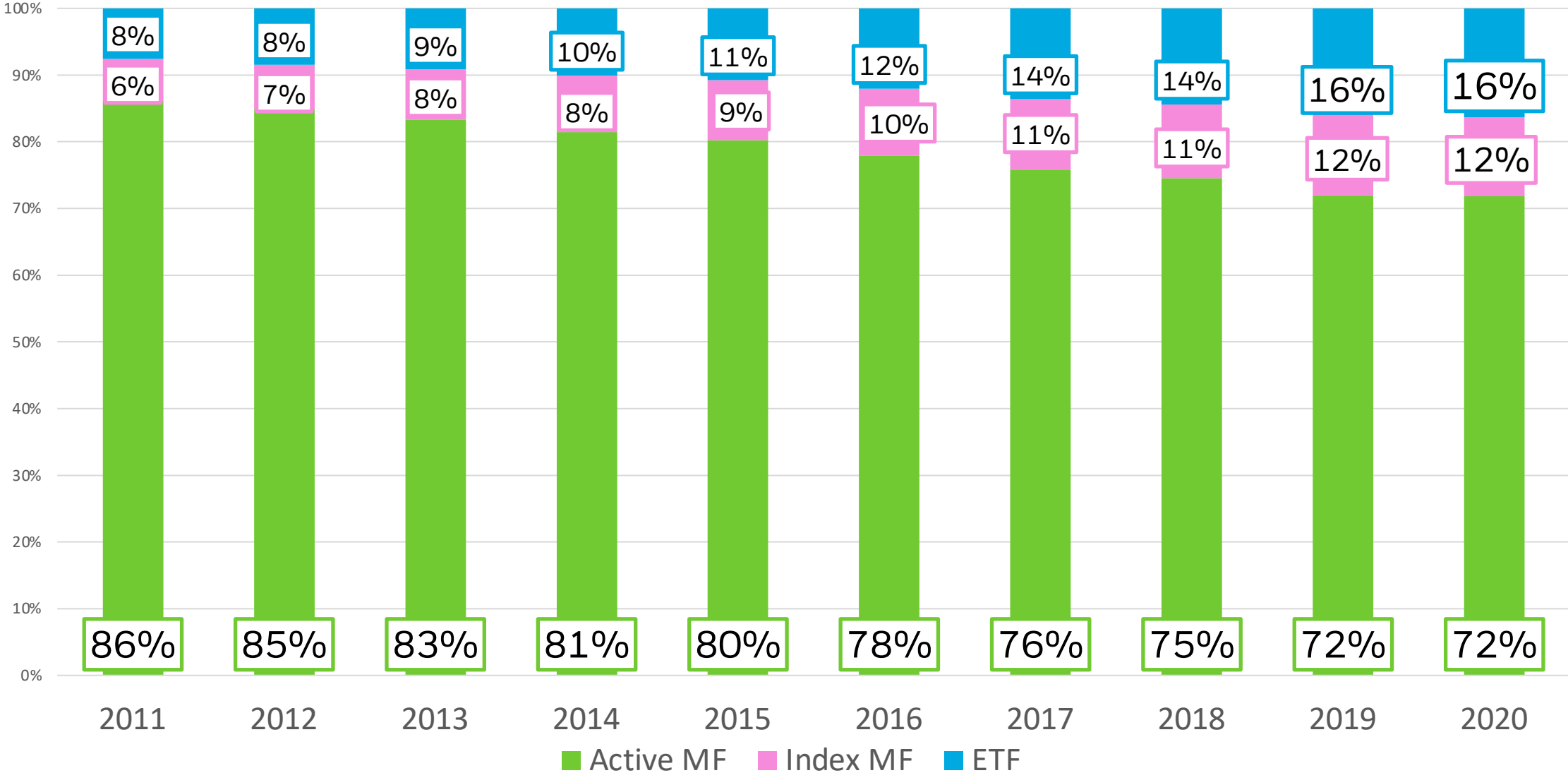
**Barbell  
approach**



**Value  
for money**

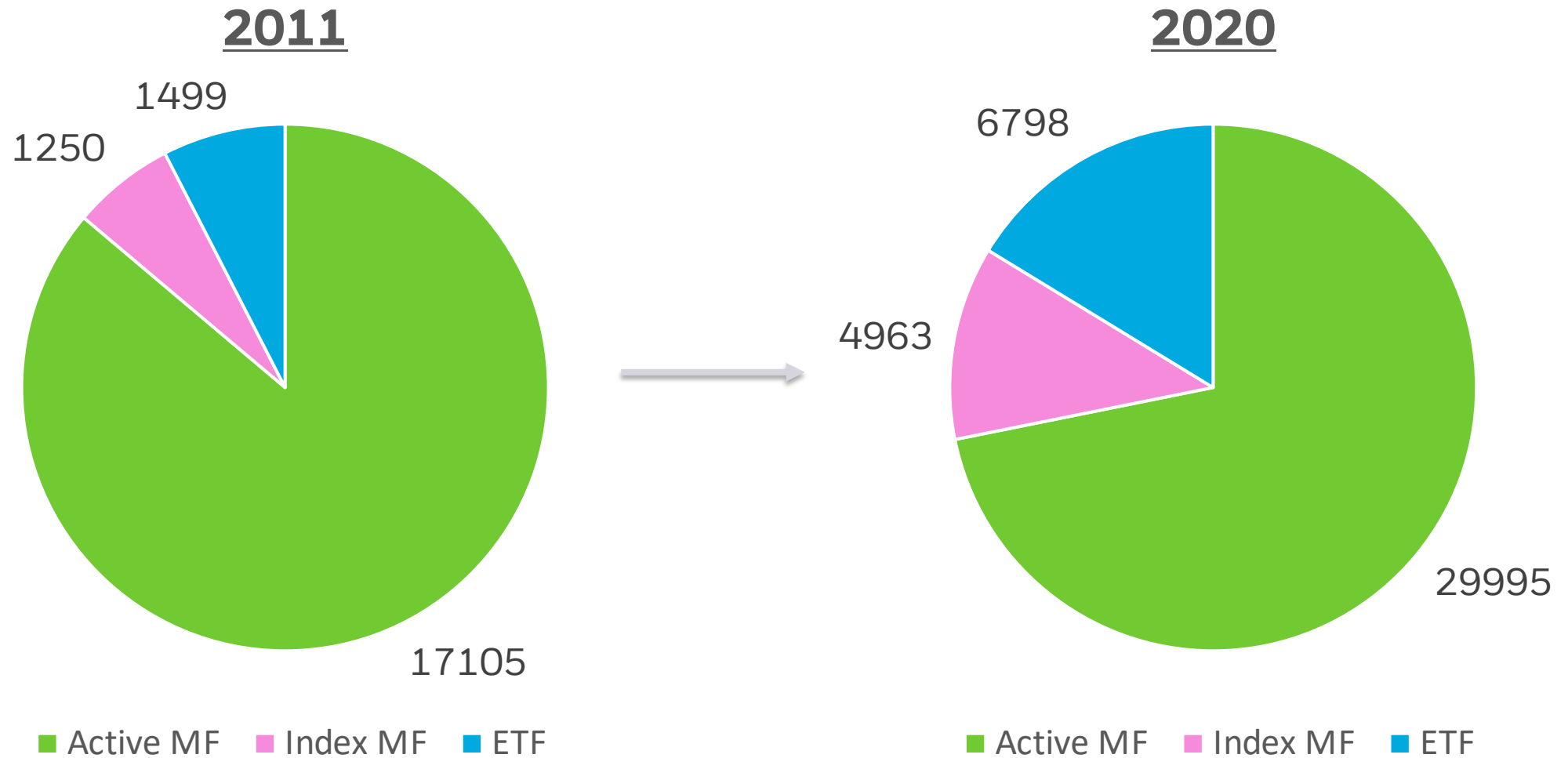
Source: BlackRock (17/08/2020)

# Fund landscape evolution



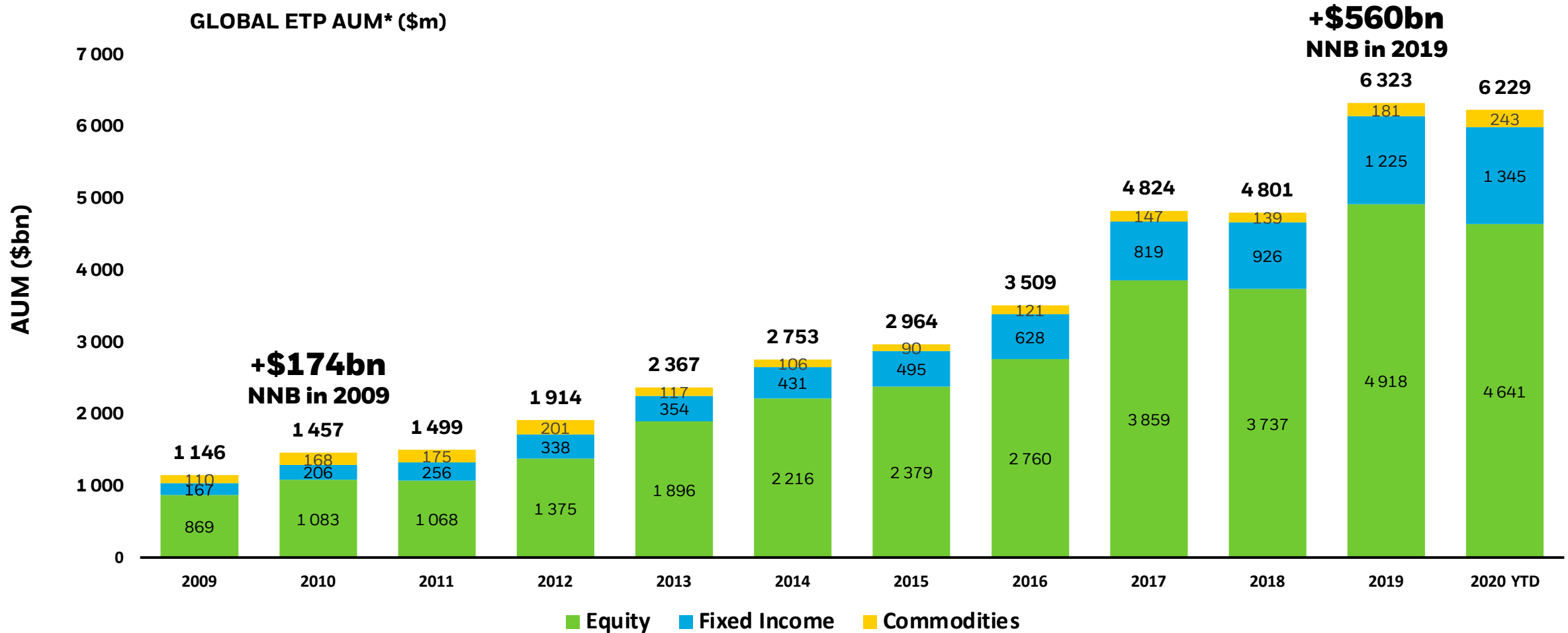
Source: Simfund for US market; Broadridge FundFile for Non US market and GBI iShares for Global ETFs. FoFs and Closed End funds excluded throughout. Data as of September 2020 for Simfund and Global ETFs and August 2020 for Broadridge.

# Fund landscape evolution



Source: Simfund for US market; Broadridge FundFile for Non US market and GBI iShares for Global ETFs. FoFs and Closed End funds excluded throughout. Data as of September 2020 for Simfund and Global ETFs and August 2020 for Broadridge.

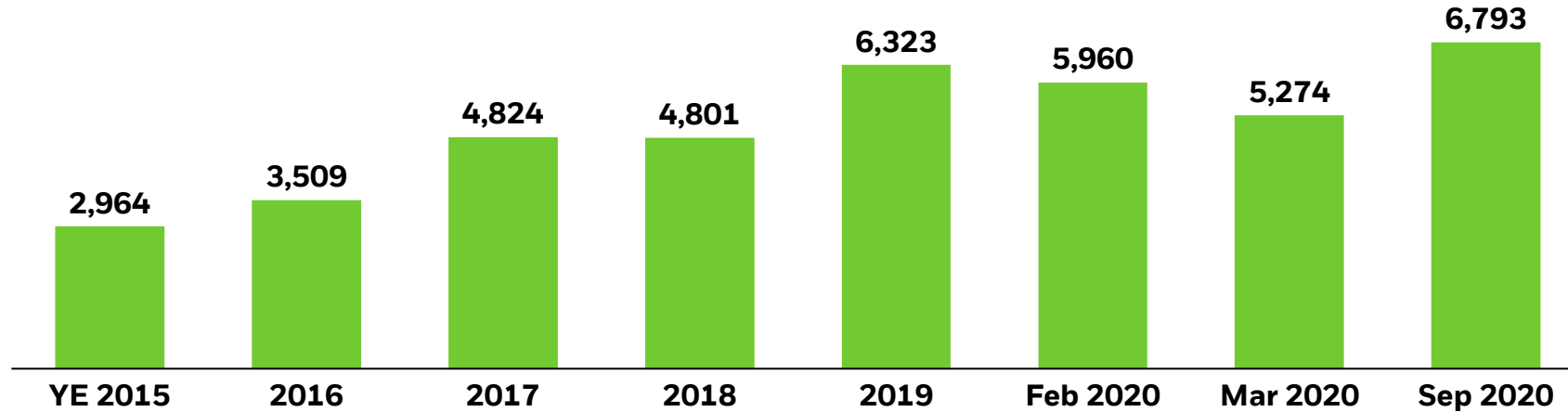
# WHERE WE ARE



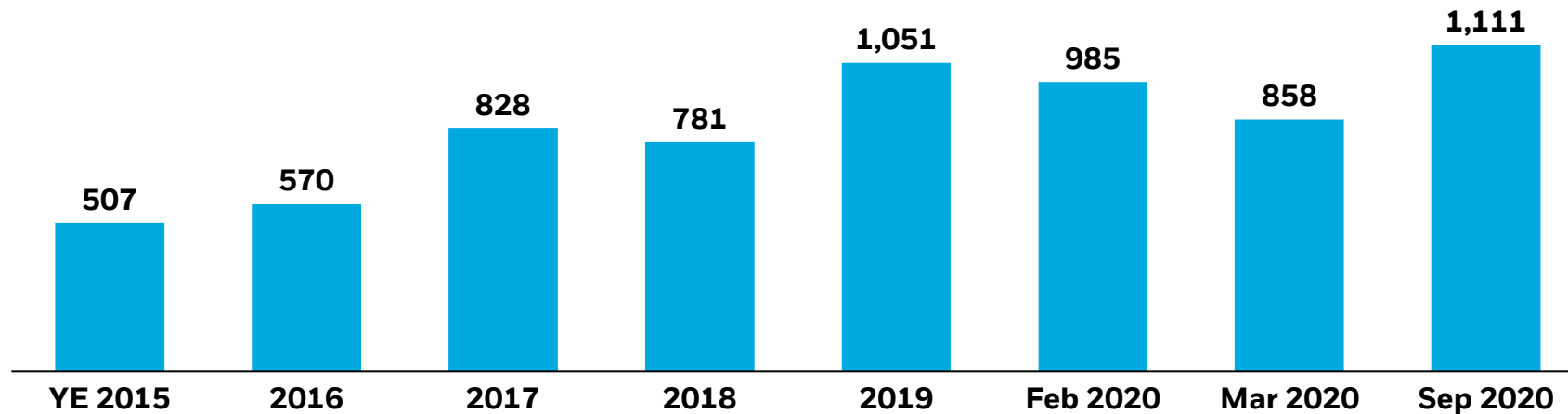
Source: BlackRock Global Business Intelligence, 30 June 2020. All amounts given in USD. \* AUM = Assets Under Management

# ETP AUM evolution

Global ETP Market (AUM, \$bn)

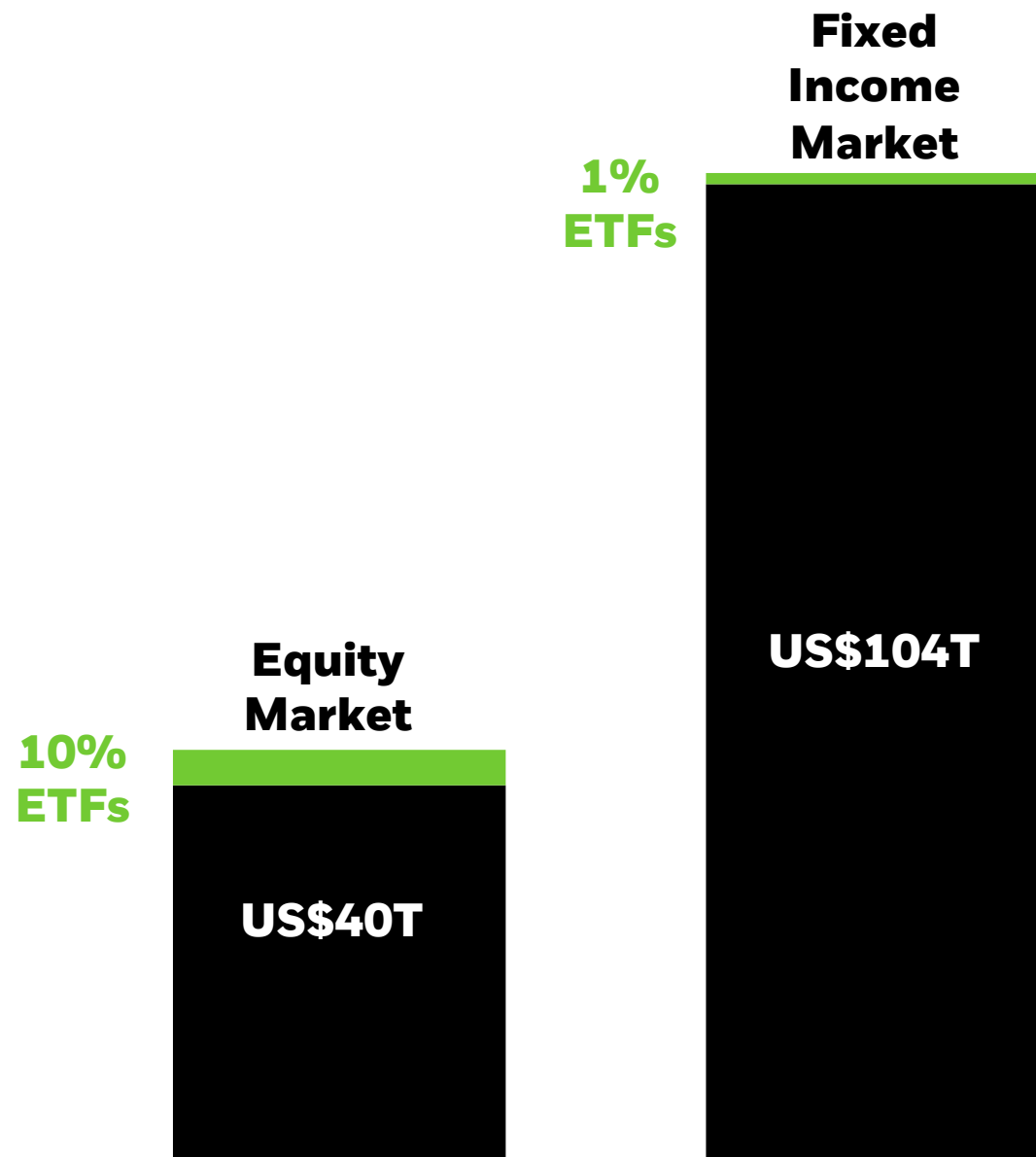


European ETP Market (AUM, \$bn)



Source: BlackRock Global Business Intelligence, data as at 09 October 20

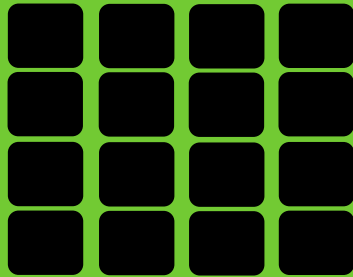
**ETF assets indicate we are at the early stage of the adoption cycle**



Source: Blackrock, Markit, Bank for International Settlements, 30 March 2020.

# Replication Methodologies

## Physical Replication Full



- ✓ **All securities** within an index are purchased according to their weightings
- ✓ Most common and preferred method
- ✓ **Full transparency** and **low tracking error**
- ✓ Typically used for concentrated indices with **liquid constituents**

## Physical Replication Optimised/Sampled



- ✓ A **limited number** of securities within an index are considered.
- ✓ For iShares Equity ETFs and IMFs optimisation is applied: **model driven approach** that is based on a risk model with factors (iShares uses the Aladdin risk modelling)
- ✓ For iShares FI ETFs and IMFs **stratified sampling** is applied: portfolio manager thoughtfully selects a subset of bonds that they believe will deliver the index performance while maintaining liquidity and minimising transaction costs.
- ✓ Practical for indices with **lots of constituents**
- ✓ May track index less accurately than full replication

## Synthetic / Derivative

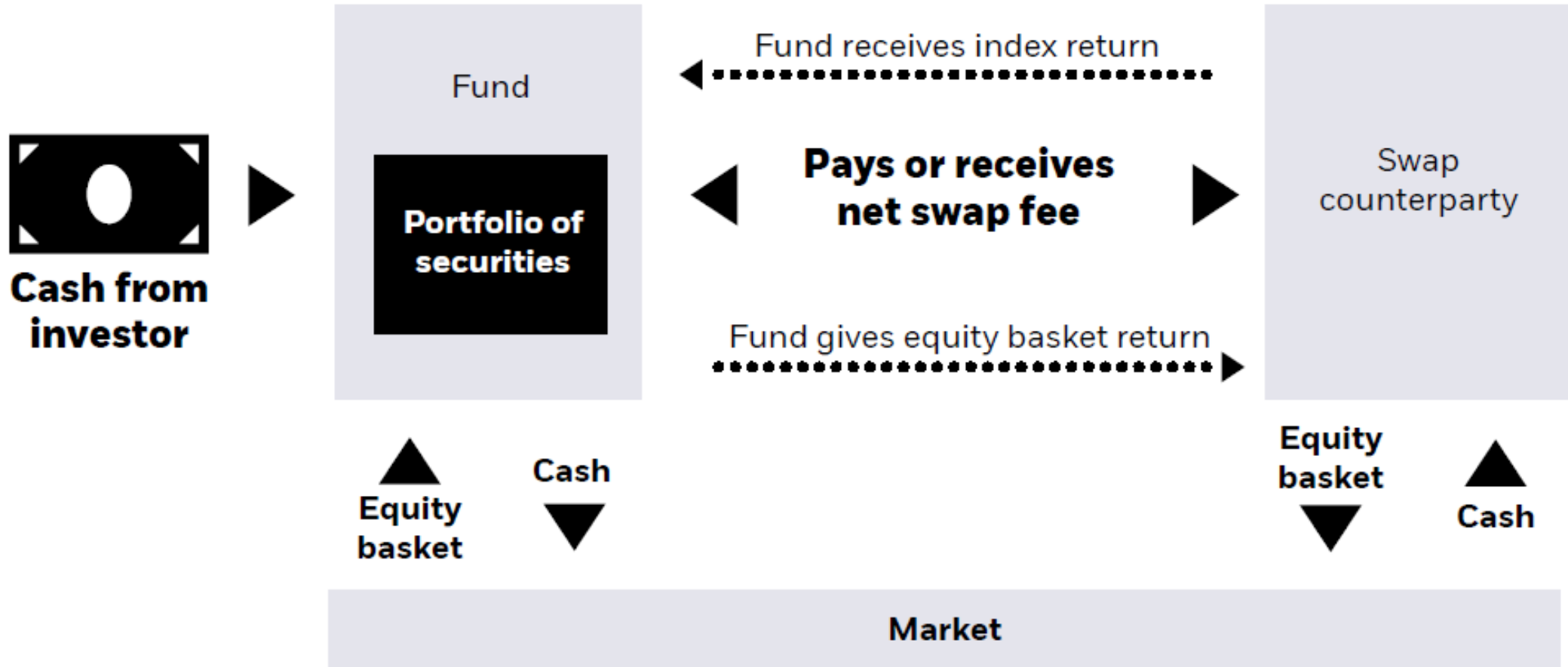


- ✓ Synthetic products can use futures or swaps to deliver index return
- ✓ Swaps can be funded or un-funded
- ✓ There may be tax efficiencies that can be achieved with synthetic replication
- ✓ **There can additional risks associated with synthetic products, particularly counterparty, and require further due diligence**

Source: BlackRock, as of 30/06/2020. For illustrative purposes only.

# Synthetic replication

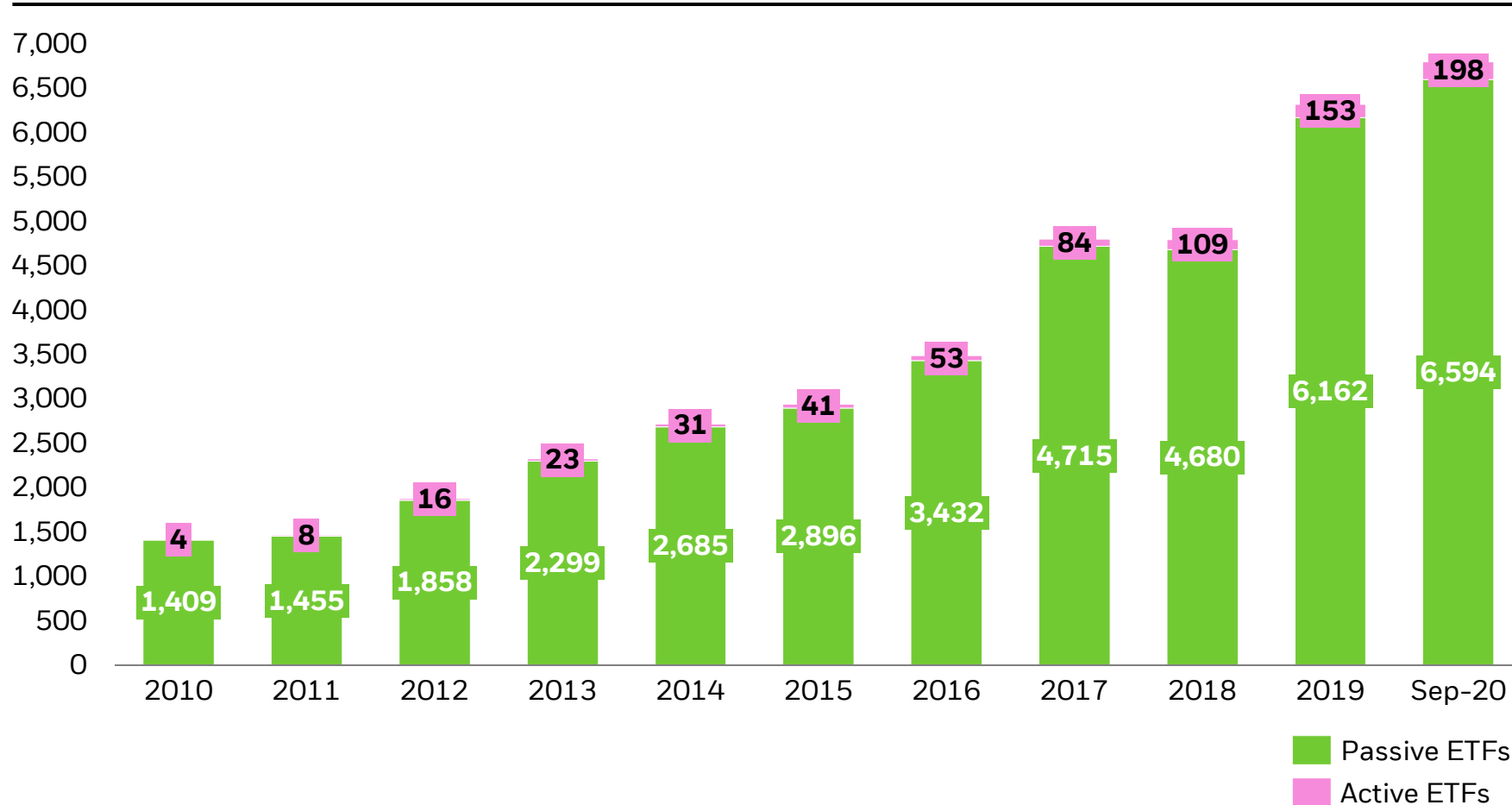
Visual representation of synthetic replication



Source: BlackRock, as of 30/06/2020. For illustrative purposes only.

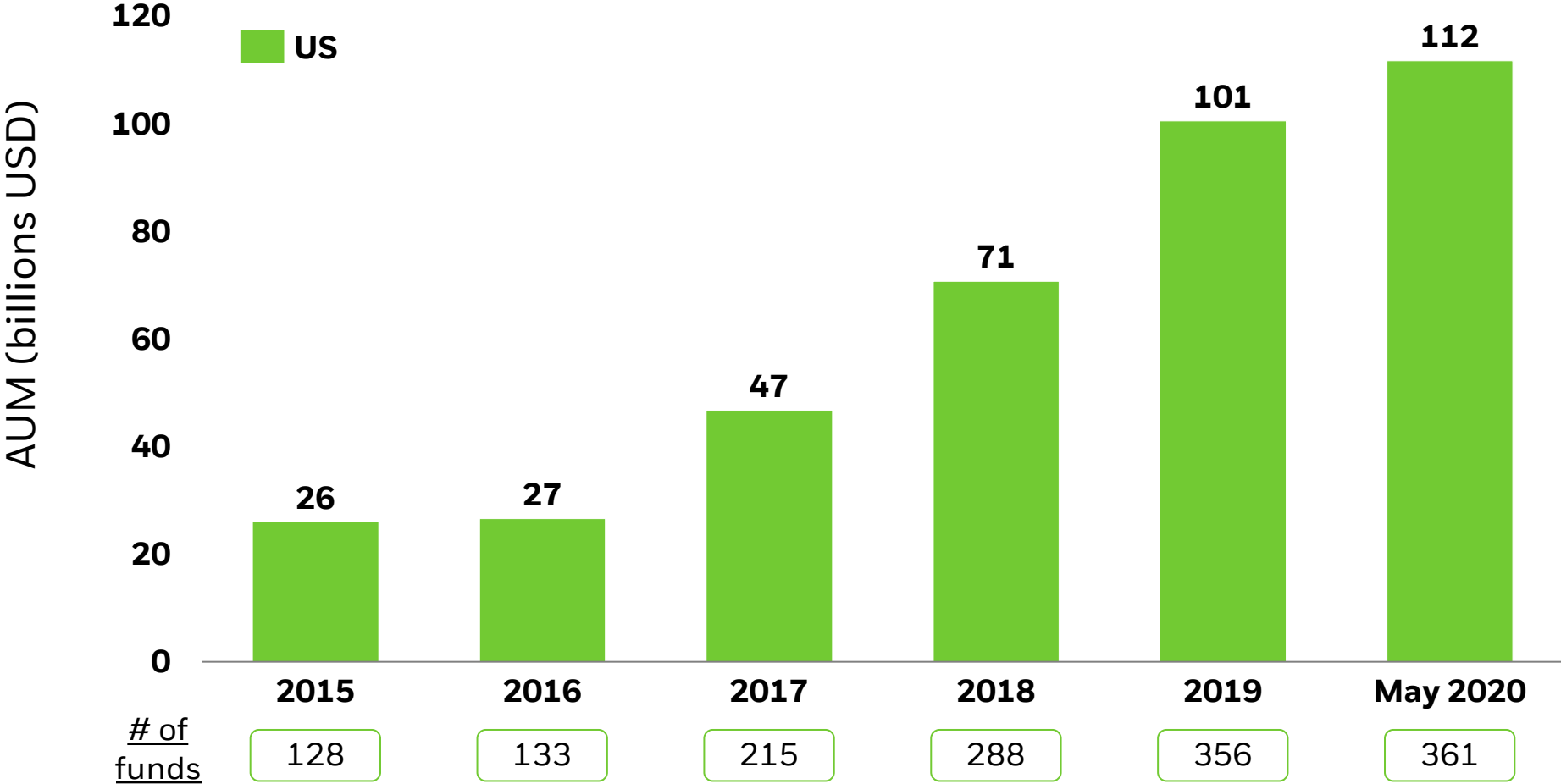
# Active ETFs are slowly growing over time, with over half falling under the fixed income asset class in 2020

Global AUM evolution of passive and active ETFs (\$bn)



Source: BlackRock Global Business Intelligence, data as at 30 Sept 20

# US active ETF evolution – AUM (\$bn)



The EMEA active ETF market is at an earlier stage with classification yet to be decided

Source: BlackRock Global Business Intelligence, data as at 09 October 20

# Problem With Inverse/Leveraged ETFs

## Daily resets can erode returns

	Day 1	Day 2 (+20%)	Day 3 (-15%)
Standard ETF	100	120 (+20%)	102 (+2%)
Double leveraged ETF (x=2)	100	140 (+40%)	98 (-2%)
Inverse ETF (x= -1)	100	80 (-20%)	92 (-8%)

## Real-life examples

- Between December 1, 2008 and April 30, 2009, a particular index gained 2%. However, a leveraged ETF seeking to deliver twice that index's daily return (2x) fell by 6%--and a leveraged inverse ETF seeking to deliver twice the inverse of the index's daily return (-2x) fell by 26%. An investor unaware that these funds only try to achieve their stated performance objectives on a daily basis may have expected the 2x fund to deliver a 4% return and the -2x fund to return a flat 0% during this period.
- During that same period, an ETF seeking to deliver three times the daily return of a different index (3x) fell 53% while the underlying index actually gained about 8%. An ETF seeking to deliver three times the inverse of that index's daily return (-3x) declined by 90% over the same period

Source: "Leveraged and Inverse ETFs: Specialised Products with Extra Risks for Buy-and-Hold Investors". Securities and Exchange Commission. [www.sec.gov](http://www.sec.gov). August 18, 2009.

# Anything but passive



### Portfolio construction

Managing portfolio replication leveraging Blackrock's proprietary tools

### Local presence

BlackRock's global footprint of over 50 equity traders and over 80 fixed income traders span across 4 trading hubs

### Benchmark change

Evaluate thousands of index events and corporate actions each year

### Performance

Daily portfolio review and portfolio-specific oversight

Source: BlackRock, as of 30/06/2020. For illustrative purposes only. **Risk:** While proprietary technology platforms may help manage risk, risk cannot be eliminated.



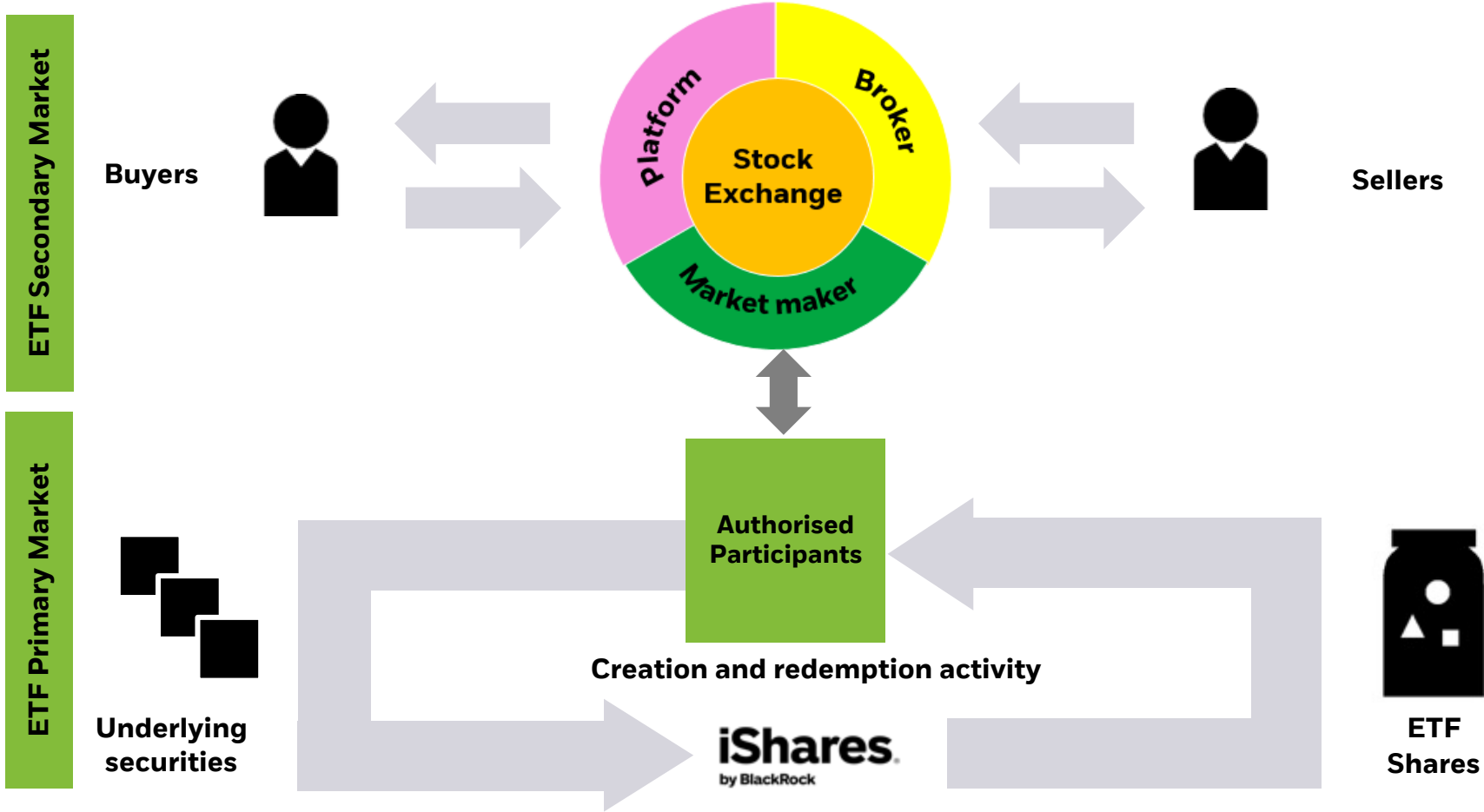
## MANAGING RISK

From portfolio management and trading to compliance, operations and risk oversight, **Aladdin** brings together people, processes and systems to support a seamless investment process.



# ETFs: Behind the scenes

Market participants help facilitate liquidity in the ETF market by accessing the underlying securities to maintain the equilibrium of supply and demand



Source: BlackRock, as of 30/06/2020. For illustrative purposes only.

# ETF secondary market provides an additional layer of liquidity

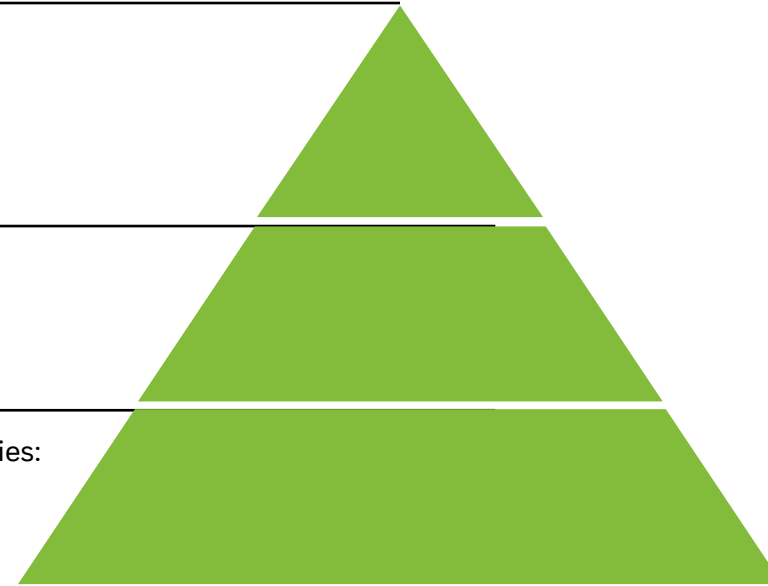
## ETF secondary market

Display ETF liquidity visible on screen and available to trade

Hidden ETF liquidity sitting on broker dealer inventory

## ETF primary market

Liquidity of the underlying securities: ETF creation/redemption



### For example

A well-known ETF trades \$405mn each day in the secondary market, while its underlying securities (ETF primary market) trade in excess of \$225B per day.

\$450m

\$225B

Risk: There can be no guarantee that the investment strategy can be successful and the value of investments may go down as well as up.

Underlying securities refer to the stocks or bonds held within the ETF. Source: Bloomberg, TRACE, as at 30 June 2020. All amounts given is USD. For illustrative purposes only.



# 2020 Volatility

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# As bond market liquidity deteriorated, fixed income ETF trading surged

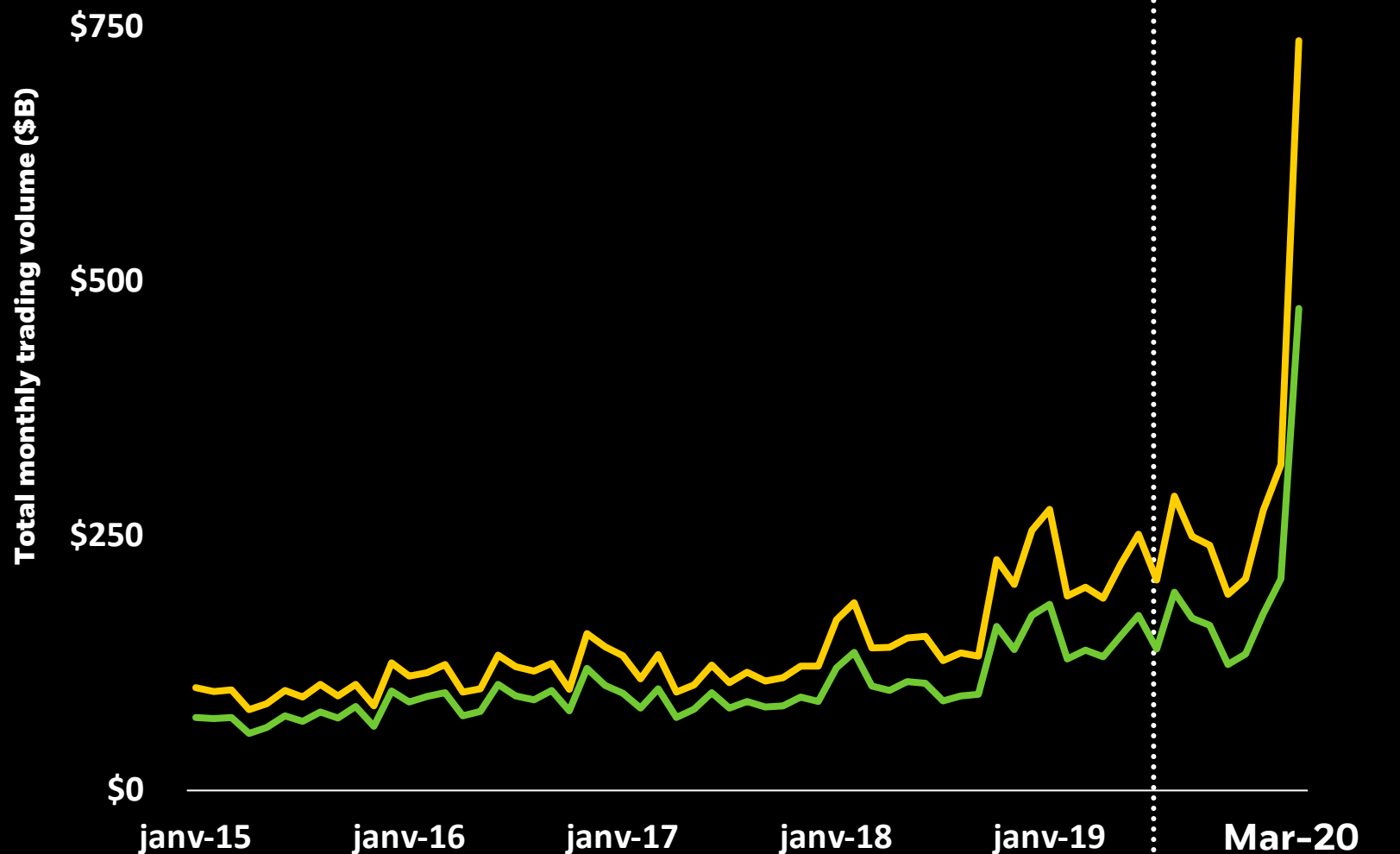
— Total FI ETF Industry

— iShares FI ETFs

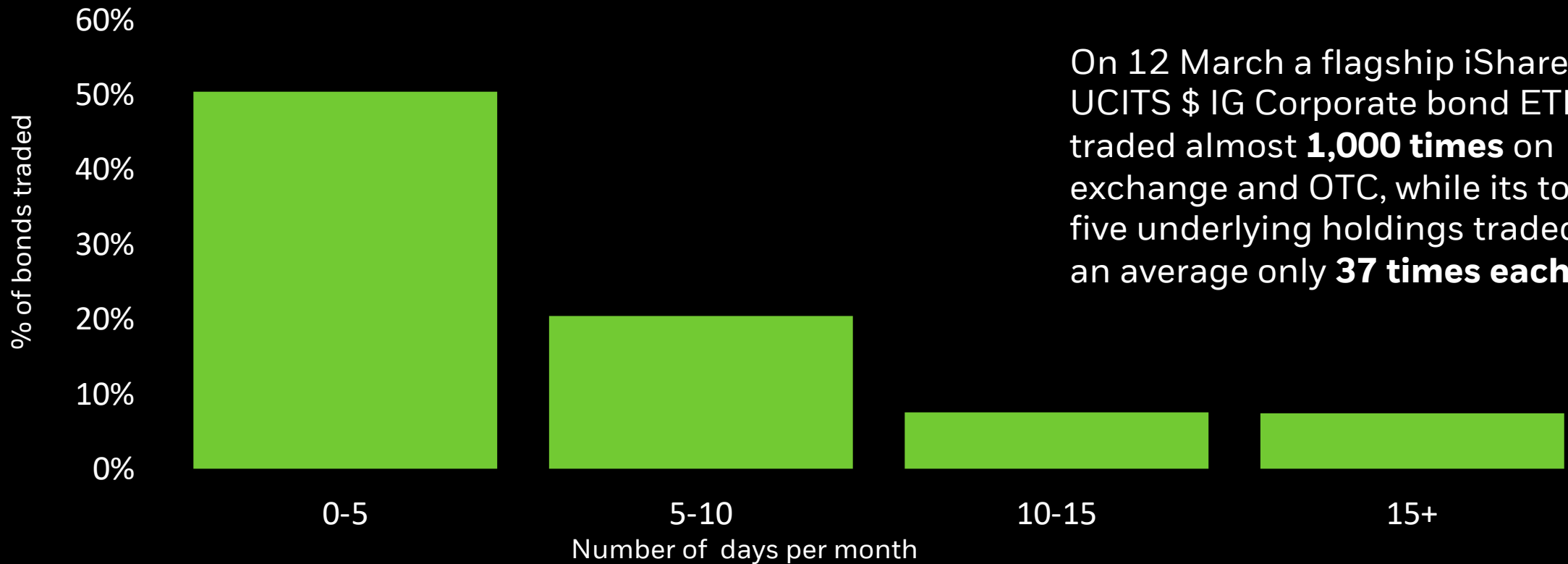
For illustrative purposes only.

Source: FINRA TRACE, BlackRock from 2/3/2020 -20/3/2020. Includes only end investor buys and sells – not dealer-to-dealer trades.

### Total monthly trading volume (\$B)



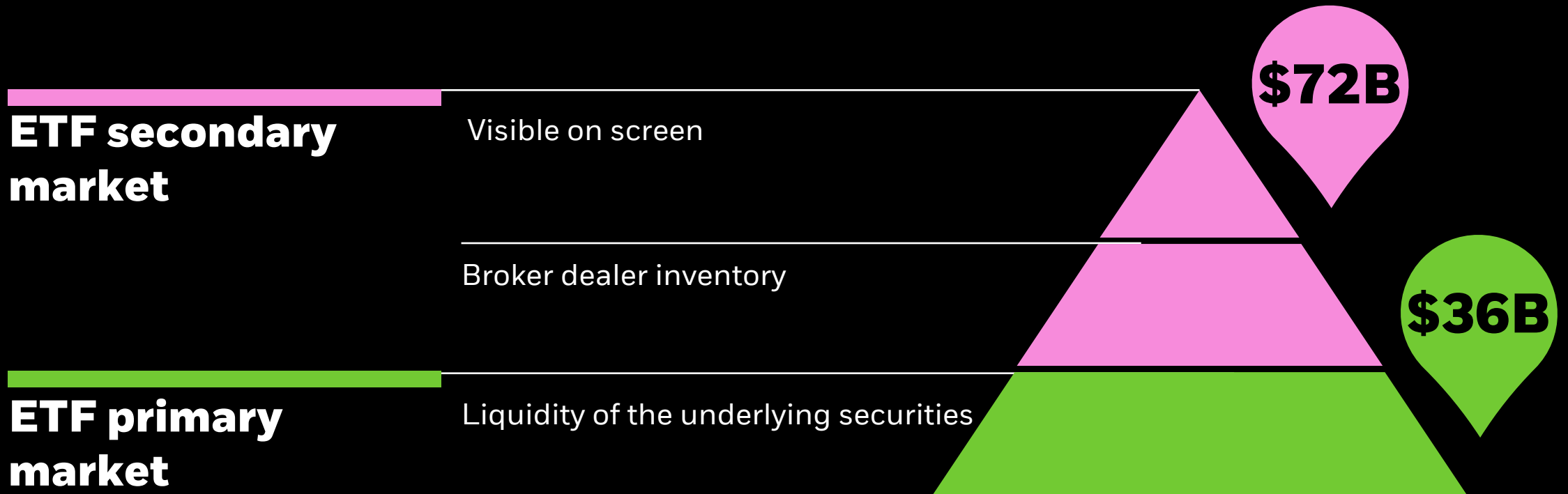
# Fixed income ETFs traded more than underlying bonds, offering price discovery



On 12 March a flagship iShares UCITS \$ IG Corporate bond ETF traded almost **1,000 times** on exchange and OTC, while its top five underlying holdings traded an average only **37 times each**

Source: FINRA TRACE, BlackRock from 2 March 2020 to 20 March 2020. Includes only end investor buys and sells – not dealer-to-dealer trades. LQDE offers liquidity when underlying cash bond market liquidity is difficult to source.

# ETFs add an extra layer of liquidity



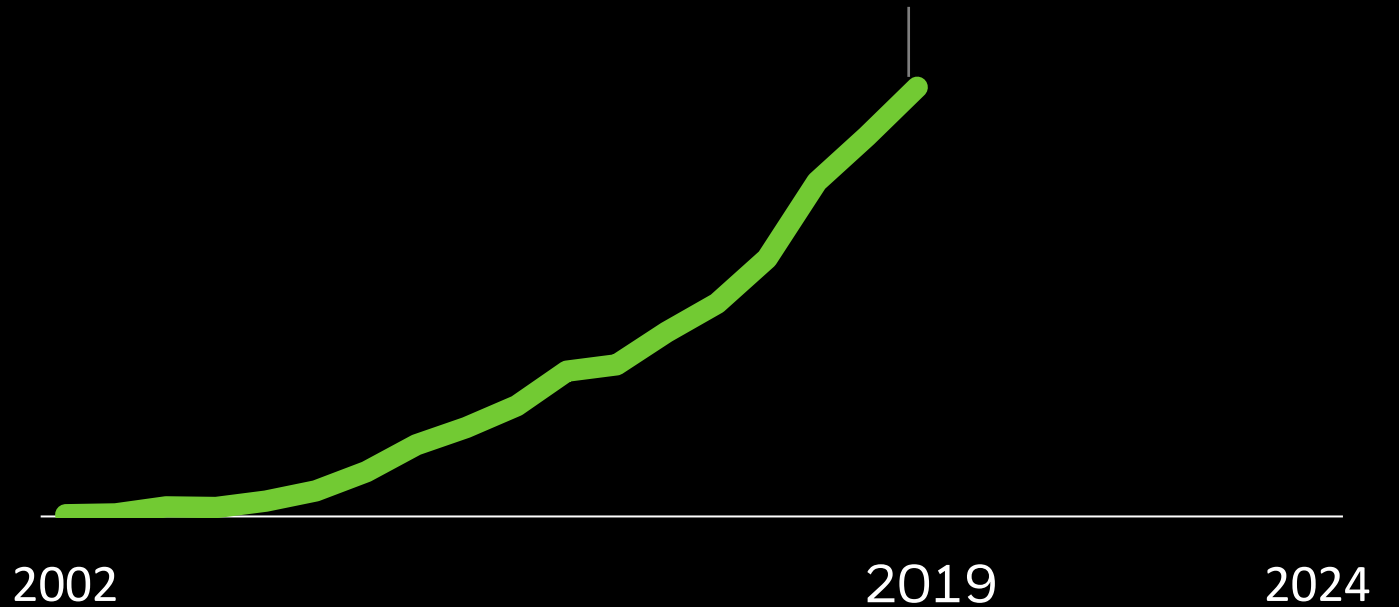
Sources: BlackRock, as of 30 June 2020. All amounts given is USD. For illustrative purposes only.

Underlying securities refer to the stocks

# Fixed income ETFs assets will...

**\$1T**  
surpassed

— Global Bond ETF AUM



Source: BlackRock, Bloomberg, Morningstar, as of 31/1/19.

All currency figures in USD.

For illustrative purposes.

# Fixed income ETFs assets will **double** to **\$2 trillion** by 2024.

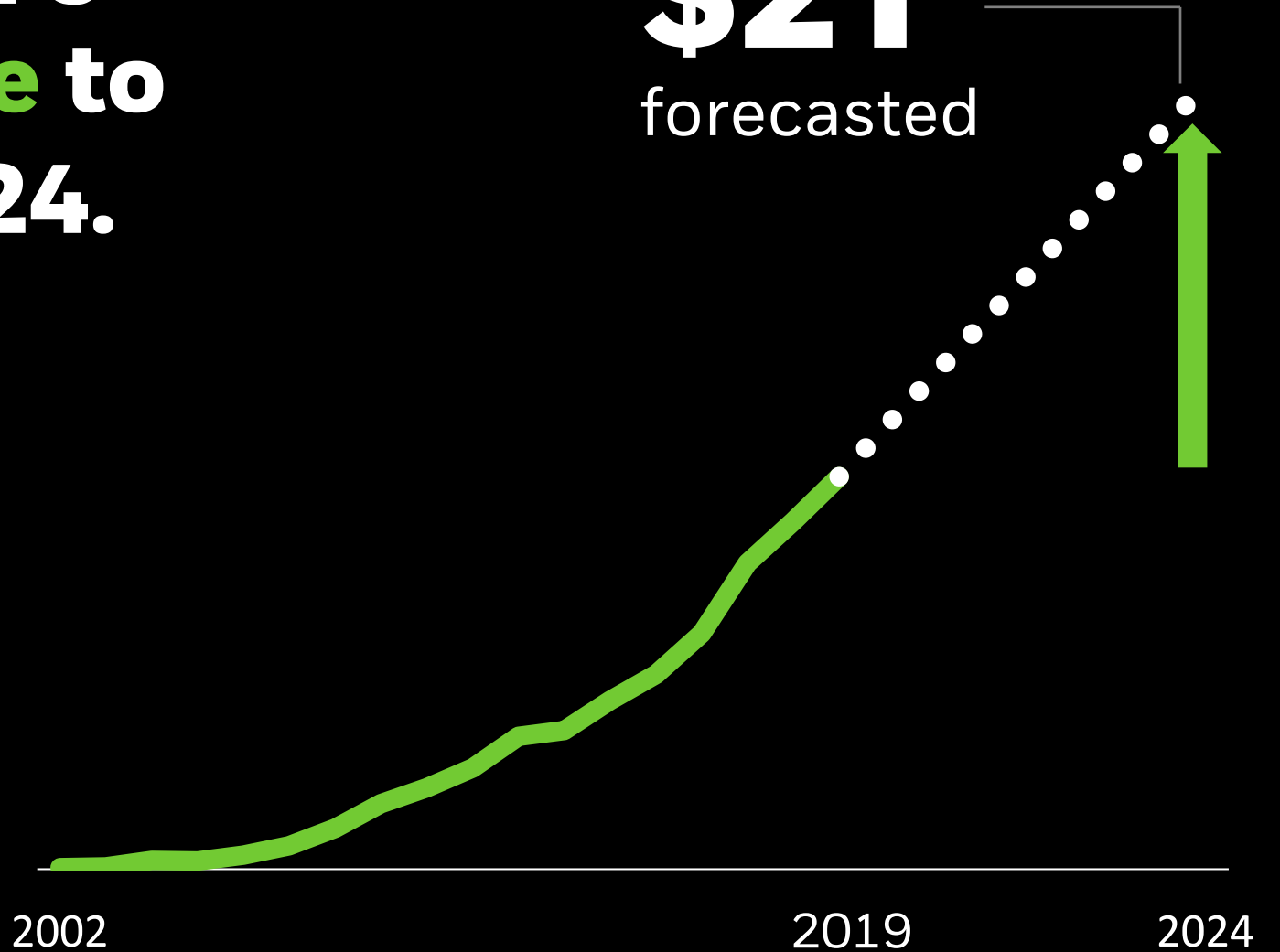
**\$2T**  
forecasted

— Global Bond ETF AUM  
••••• AUM Forecast

Source: BlackRock, Bloomberg (as of 30 June 2020). For illustrative purposes

BlackRock, "Primed for Growth: Bond ETFs and the Path to \$2 Trillion," June 2019; global bond ETF assets were US\$1.322 trillion (as of 30 June 2020).

**Risk:** There is no guarantee that any forecasts made will come to pass.



# Risk Warnings

**Capital at risk.** The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

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