ETF Trends 2021

The Australian ETF market is finally hitting its stride. Investors flocked to ETFs in 2020, pushing assets under management to AU$94.44 billion, nearly triple its value three years ago[1]. The investment winners in the year of the pandemic were technology companies, particularly FAANG and WAAAX stocks, along with commodities, like gold and silver.

Economic drivers for the ETF landscape

The year has commenced with cautious optimism as the world anticipates an end to COVID-19. It will continue to influence activity in 2021, presenting three key market drivers:

Global economic recovery from COVID-19

We now have approved vaccines being rolled out in the US and UK, along with planned pipelines for the rest of the globe, but investors shouldn't assume an instant return to normal. It takes time to vaccine a population and many countries are still battling severe outbreaks.

The UK reported 54,940 new cases on 10 January 2021, while the US reported 248,089 according to the World Health Organisation[2]. Within Australia, the NSW outbreak starting on Sydney's Northern Beaches triggered lockdowns and border closures creating continued uncertainty for individuals and businesses.

Investors can expect to see continued outbreaks of COVID-19, even as the world works to vaccinate. Depending on the size of the outbreaks, this may continue to trigger some market volatility with certain industries witnessing a variation in recovery pending specialities. For example, when looking at the travel and tourism sector, domestic providers may be swifter to see returns compared to their international counterparts as much depends on the opening of borders.

Governments globally have announced generous stimulus packages to revive business activity. On the domestic front, the Australian government has announced it would provide AU$200 billion in fiscal stimulus, with state governments employing a variety of activities from small business packages to entertainment and dining vouchers. Populations tired of lockdown and social isolation are likely to respond swiftly to such programs. Consumer confidence should continue to grow across the year, supporting momentum generated by stimulus packages.

Internationally, the European Union approved a coronavirus stimulus package to raise 750 billion euros[3] after being hard-hit by the pandemic, particularly Italy and Spain in the earlier stages but countries like the Czech Republic struggling in later waves[4]. The US, continuing to struggle to contain infections, have proposed a US$1.9 trillion stimulus package covering payments to families along with health and vaccination programs[5].

Beyond this, many countries are considering or resuming broadscale projects to further economic growth, with infrastructure one option for this. For example, India, initially subject to the world's toughest lockdowns to manage COVID-19, has forged ahead with its existing US$1.4 trillion infrastructure program[6] while domestically, the Federal Government announced a further AU$1.5 billion commitment to accelerate priority infrastructure projects[7].

Products in focus

Investors are likely to already hold broad Australian and US exposure but may also consider other regions such as Europe through an ETF like ETFS EURO STOXX 50® ETF (ASX Code: ESTX) which is well positioned with stimulus plans for recovery. Or country-specific exposure through an ETF like ETFS Reliance India Nifty 50 ETF (ASX Code: NDIA) to capitalise on India's infrastructure program.

Low interest rates globally

Sluggish growth and inflation were a concern globally before the COVID-19 pandemic hit, leading many central banks to revisit monetary policy in 2019. Interest rates declined further in 2020 to support global economies dealing with the pandemic. The Australian official cash rate dropped to 0.1%, while the US Federal Funds Rate lower bound fell to zero. It is likely cash rates will remain low through most of 2021 to support recovery with the potential of increases late in the year.

Low interest rates are typically supportive of business development and growth activities; however, they have also placed pressure on yield-focused investors. Many have been forced to consider asset classes outside of fixed income to support their needs and this trend is likely to continue across the year. Some will take a 'riskier' approach to their yield investments and look for dividend-bearing assets, including equities.

Investments in "safe-haven" commodities, including gold and silver, have a low opportunity cost and offer stability so are likely to continue to be popular across the year. Precious metals also typically perform well during periods of low interest rates, with investors using these, particularly gold, rather than cash as a store of value and to protect against inflation[8].

Products in focus

Investors may consider tailored ETF market exposures which are oriented towards high dividend-paying shares such as domestic option ETFS S&P/ASX 300 High Yield Plus ETF (ASX Code: ZYAU) or US option ETFS S&P 500 High Yield Low Volatility ETF (ASX Code: ZYUS).

Those interested in incorporating commodities like gold or silver could consider ETFS Physical Gold (ASX Code: GOLD) or ETFS Physical Silver (ASX Code: ETPMAG).

Changing global political dynamics

This year marks the official completion of 'Brexit' and a change of US government with the inauguration of President Joe Biden. Also significant is the shifting relationships between China and the world which were heightened by COVID-19, global concerns over activities in Hong Kong, activity in the South China Sea and trade clashes globally.

Brexit

Completion of Brexit and agreement to a trade deal should remove some uncertainty from European markets, though there will be some challenges in the early months as individuals and businesses adjust to agreed trade and travel conditions[9].

The US Presidency

The government transition in the US is expected to see a return to more traditional and less divisive global diplomacy, particularly with regards to relationships with China. While it is unlikely that the Biden administration will abandon all the goals of the Trump administration in terms of trade with China, the approach is anticipated to be different and other countries may also expect a more international and collaborative approach in trade dealings[10]. This may be supportive for businesses with global operations, and certainly, countries like Australia may hope to benefit economically from more open trade partnerships.

Within the US, the Biden administration is expected to offer more predictability and stability compared to the Trump administration, which should assist in greater certainty for business activity and in turn, investment markets. However, this should be viewed with caution. There is also the potential of tax increases under the new administration for businesses as well as wealthy individuals[11] which could influence some corporate activity and consumer spending[12].

Activity in the US typically dominates global investment markets as well as global policy, so indications of a Biden administration focus on infrastructure, clean energy and health spending has bolstered share markets, while dampening fixed income[13]. It has also spurred several countries to announce their own programs, particularly on the clean energy front, in recent months.

Tension between China and the world

The past year has seen tensions rise between China and the rest of the world, surpassing the previous US-China trade war.

In recent years, there have been increasing concerns about the potential for Chinese government interference and espionage in the affairs of other countries. This has meant many countries have debated the extent they allow Chinese businesses to purchase assets within their countries, as well as to build key infrastructure, such as the 5G mobile network. Australia was one of the first to take a particular stance on this by banning Huawei Technologies from building its 5G network on the basis of national security and was followed by New Zealand, Japan, Taiwan and the US, with the UK banning specific components[14].

China's response to the COVID-19 pandemic heightened tensions in 2020 with many countries, including Australia, pushing for investigations into the origins of COVID-19.

In the wake of this, China has placed tariffs and bans on a range of Australian goods from beef to coal[15]. It has also taken action against other countries with a similar stance, for example, halting agricultural imports from Canada.

Some nations, like the UK, have expressed concern over China's activities in Hong Kong and the US has made indirect statements about incidents in the South China Sea by sending naval forces and carrying out combat exercises in the region[16].

Also disturbing was the clash between Indian and Chinese forces in Galwan Valley in June 2020, with both nations maintaining armed forces along the Line of Actual Control[17].

China has significant economic power, which it has demonstrated it is comfortable to deploy in diplomatic and trade activity. The next significant driver of uncertainty in markets may relate to global trade wars with China unless diplomacy is able to manage this.

Products in focus

Investors interested in the US economy could consider an ETF like ETFS S&P 500 High Yield Low Volatility ETF (ASX Code: ZYUS) while those anticipating more certainty for the eurozone with Brexit complete, could look at an investment like ETFS EURO STOXX 50® ETF (ASX Code: ESTX).

Investors concerned about potential volatility should tensions with China persist or even rise, could consider assets like gold which tend to offer stability and a store of value through an ETF like ETFS Physical Gold (ASX Code: GOLD)

Three trends for 2021

In keeping with economic drivers, there are three investment themes likely to dominate in 2021.

Movement to value

As news of vaccines hit markets in late 2020, investors started to shift their approach away from a pure growth focus and towards value investments such as banks and industrials.

James Gerrish, Senior Investment Adviser for Shaw and Partners and author of investment newsletter, Market Matters, says, “in Australia, we had the value index up around 17% in the month of November. The growth index in Australia was up around 5%. There's a huge rotation out of growth, into value in a relative standpoint.”

This trend is likely to continue in 2021 as investors anticipate a return to ‘normal’ and start to view growth stocks, particularly in the technology sector, as overpriced.

Jon Reilly, Chief Investment Officer for Implemented Portfolios, agrees and says, “We do expect to see a continued rotation to this year’s out of favour sectors such as financials, and away from the high-fliers of 2020 including the technology sector. With a return at least some way back to pre-virus normal life over the course of 2021 likely, paying more than 35x earnings for some of the big tech names will at some point provide a disappointing portfolio outcome. By contrast, the restoration of bank dividends, both here and overseas, should sustain interest and deliver performance in the much cheaper financials sector.”

Products in focus

The Australian sharemarket is strongly skewed towards financials and resources which include companies typically falling into value investments. Investors could consider an ETF like ETFS S&P/ASX 300 High Yield Plus ETF (ASX Code: ZYAU) for exposure.

Thematic investing with climate and biotechnology

Investors are increasingly interested in tailored investments accessing the growth themes of the future, as well as being able to invest according to their views and values. ETFs targeting specific themes should continue to be prominent in the coming year as investors become more aware of how to use these as part of their porfolios.

While themes like virtual connectivity will continue to be popular, dynamics in the coming year should mean climate change and biotechnology will be focus points for investors.

Biotechnology

The COVID-19 pandemic has put a spotlight on healthcare biotechnology and the rollout of vaccines will ensure it remains front-of-mind. This industry was already tipped for growth in coming years. It is predicted to be valued at more than US$833.34 billion by 2027, compared to US$447.92 billion at the end of 2019[18], and will continue to grow, driven by the growing global population and the need for affordable, effective treatments and vaccines.

Climate investing

Concern over climate change has continued to rise in recent years. While 2020 may have been quieter for climate news from a media perspective compared to 2019, it remained present for investors. In the late parts of 2020, the push to take action on climate change returned to the fore with the election of Joe Biden, who has been vocal about recommitting the US to the Paris Agreement. Already, a number of nations and companies have announced specific projects to move towards renewable energy, such as battery storage projects from the Victorian state government or Origin Energy[19].

Products in focus

Investors considering thematic investing may wish to look at ETF Securities’ Future Present Range of ETFs. Those specifically interested in biotechnology may consider ETFS S&P Biotech ETF (ASX Code: CURE). While investors focused on renewable energy may consider battery technology - a key supporter for the viability of renewable energy. ETFS Battery Tech & Lithium ETF (ASX Code: ACDC) is the only Australian-listed ETF to offer exposure to the global battery technology supply chain.

Short and leveraged investments

Across the volatility of 2020, many self-directed sophisticated investors took a short-term approach to trading and embraced short & leveraged funds. There are currently seven leveraged exchange-traded hedge funds listed on the ASX covering Australia, US markets and the technology sector which generated significant activity in 2020.

As the world continues to recover from COVID-19 and manages the ongoing tension in global relationships, use of short and leveraged instruments is likely to continue along with continued bouts of volatility. This is also within keeping with global trends and sophisticated investors and institutions may anticipate the exchange-traded hedge fund range in Australia to continue to expand to meet demand.

As part of this, some sophisticated investors may anticipate changes in growth sectors like technology as the world opens again and choose short-term investments reflecting their views.

Products in focus

Sophisticated investors with high conviction on technology companies may consider exchange-traded hedge funds like ETFS Ultra Long Nasdaq 100 Hedge Fund (ASX Code: LNAS) and ETFS Ultra Short Nasdaq 100 Hedge Fund (ASX Code: SNAS).

Moving forward in 2021

The last year was unexpected but has shifted global investment behaviour and dynamics. The Australian ETF market will continue to grow and evolve to meet the needs of investors and if the past year is any indication, investors are looking for opportunities and increasingly using ETFs for their market exposure.

For more information on accessing these trends, please speak to ETF Securities.

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