

# Investing in Asia with ETFs

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# What Are ETFs?

- An exchange traded fund is generally a diversified portfolio of securities that track a specific index.
- Top 10 US-listed ETFs by size:

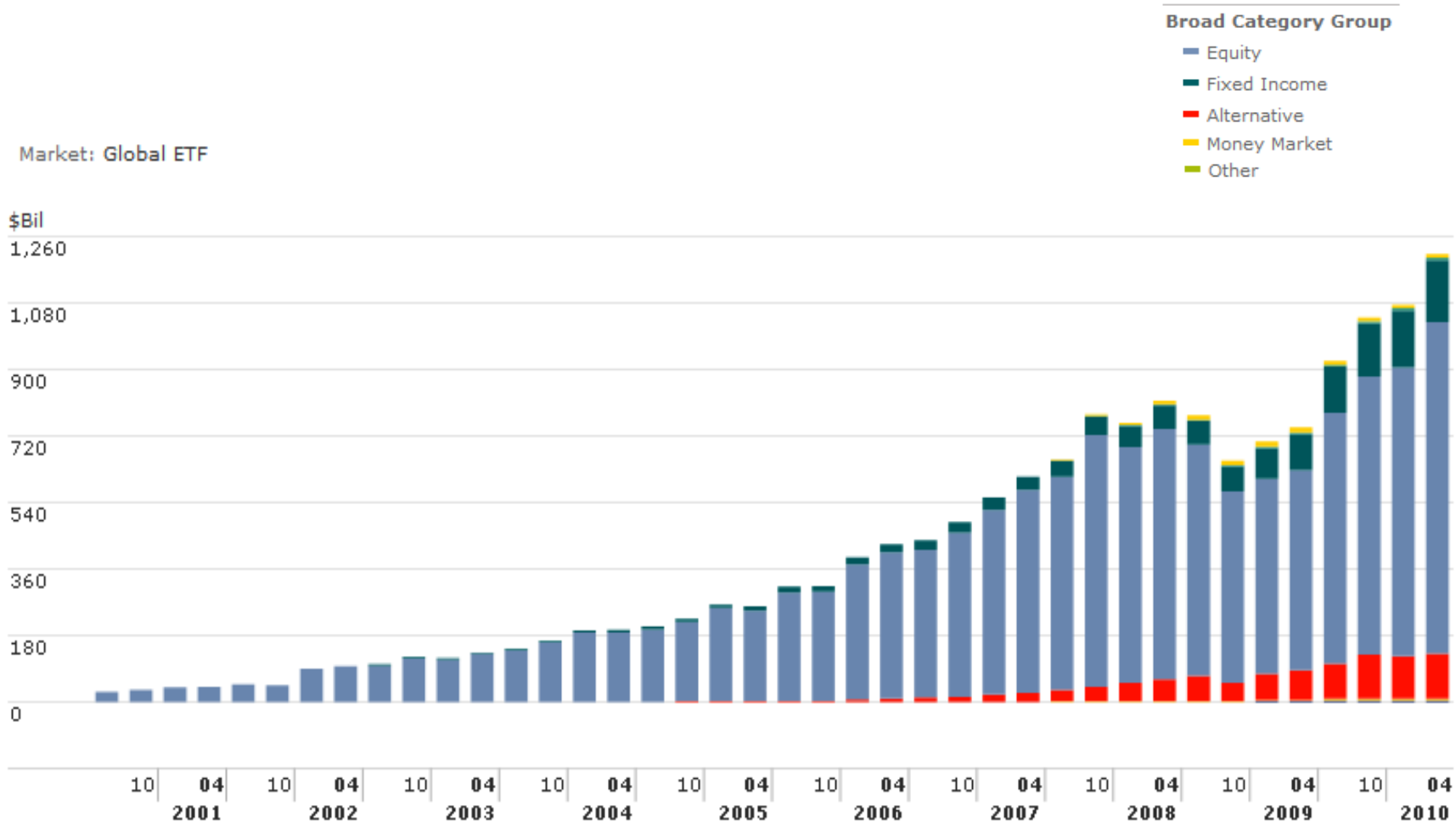
SPDR S&P 500	SPY	iShares S&P 500	IVV
SPDR Gold Shares	GLD	iShares Barclays TIPS Bond	TIP
iShares MSCI Emg Mkts	EEM	PowerShares QQQ	QQQQ
iShares MSCI EAFE	EFA	Vanguard Total Stock Mkt	VTI
Vanguard MSCI Emg Mkts	VWO	iShares Russell 2000	IWM

- Like stocks, they can be bought and sold (long or short) throughout the trading day.
- Many ETFs also have liquid options.

# What Are The Advantages of ETFs?

- Tax efficient
  - creation and redemption process
- Low cost
- Diversified
- Intraday liquidity
- Immediate market execution
- Provides access to a variety of asset classes
  - commodities, VIX index, precious metals, MLPs, hedge fund strategies

# Global ETFs Total Net Assets, Quarterly



Source: Morningstar Direct

## Potential Drawbacks of ETFs

- May's Flash Crash
- Transaction fees
  - However, some providers have waived transaction fees for certain funds traded on their platform—Schwab, Vanguard, Fidelity.
- Complicated fund structures
  - E.g.: leveraged and inverse funds, international bond ETFs, futures-based commodity ETFs
- Tax issues
  - In general, ETFs are tax-efficient, but they are only as tax efficient as their underlying holdings
- Trading costs

## The Case for Investing Internationally

- Improved risk-adjusted returns
  - 5-year Sharpe Ratios through 2Q10:
    - Vanguard Emerging Markets ETF (VWO): 0.44
    - iShares FTSE/Xinhua China 25 Index Fund (FXI): 0.59
    - SPDR S&P 500 ETF (SPY): -0.12
- Lower correlations to the S&P 500 compared with domestic small- and mid-cap stocks
- Hedge against a falling U.S. dollar

## ETFs are Attractive Vehicles for Investing Internationally

- ETFs are easy to use, liquid, transparent, tax efficient, and are generally cheaper than comparable international mutual funds
- ETFs provide a breadth of choice, which allow investors to customize their international holdings according to their investment objectives. ETFs are available:
  - by geography (global, regional, and single country)
  - by market-cap
  - by investment style
  - by sector
  - by investment themes (EGS Brazil and China Infrastructure)

# How To Select The Appropriate ETF

- What is your investment thesis?
  - Diversified exposure to emerging markets?
  - Targeted exposure to China's growth?
  - Indirect exposure via Australia (commodities) or Korea (consumer products)?
- What is the fund's or index's construction?
  - Some single-country funds can have very heavy weightings in certain sectors or individual stocks
  - China funds can purchase H-shares, red chips, and ADRs



# How To Select The Appropriate ETF

- Understand your risk tolerance and the volatility of international markets
  - Funds invested in countries such as China, Brazil, and smaller emerging markets can have double the volatility of the S&P 500
  - In 2008, iShares MSCI Brazil Index Fund (EWZ) fell 56%, and in 2009 rose 123%
  - Foreign currency effects can cut both ways
- Portfolio impact
  - Check correlations

## Popular Asia ETFs

Name	Ticker	AUM, \$m	3Mo Trading Vol, K	Exp Ratio	YTD ret, 2Q10-end
Vanguard Emerging Markets	VWO	27,252.6	18,338.6	0.27%	-6.8%
iShares MSCI All Country Asia ex Jpn Idx	AAXJ	1,761.5	640.5	0.72%	-5.4%
SPDR S&P Emerging Asia Pacific	GMF	598.7	75.7	0.59%	-3.7%
iShares MSCI South Korea Index	EWY	3,284.5	4,714.5	0.65%	-4.3%
iShares MSCI Australia Index	EWA	2,257.6	6,712.5	0.55%	-15.7%
iShares MSCI Singapore Index	EWS	1,569.6	4,318.9	0.55%	-1.1%

Source: Morningstar Direct

## Popular Greater China ETFs

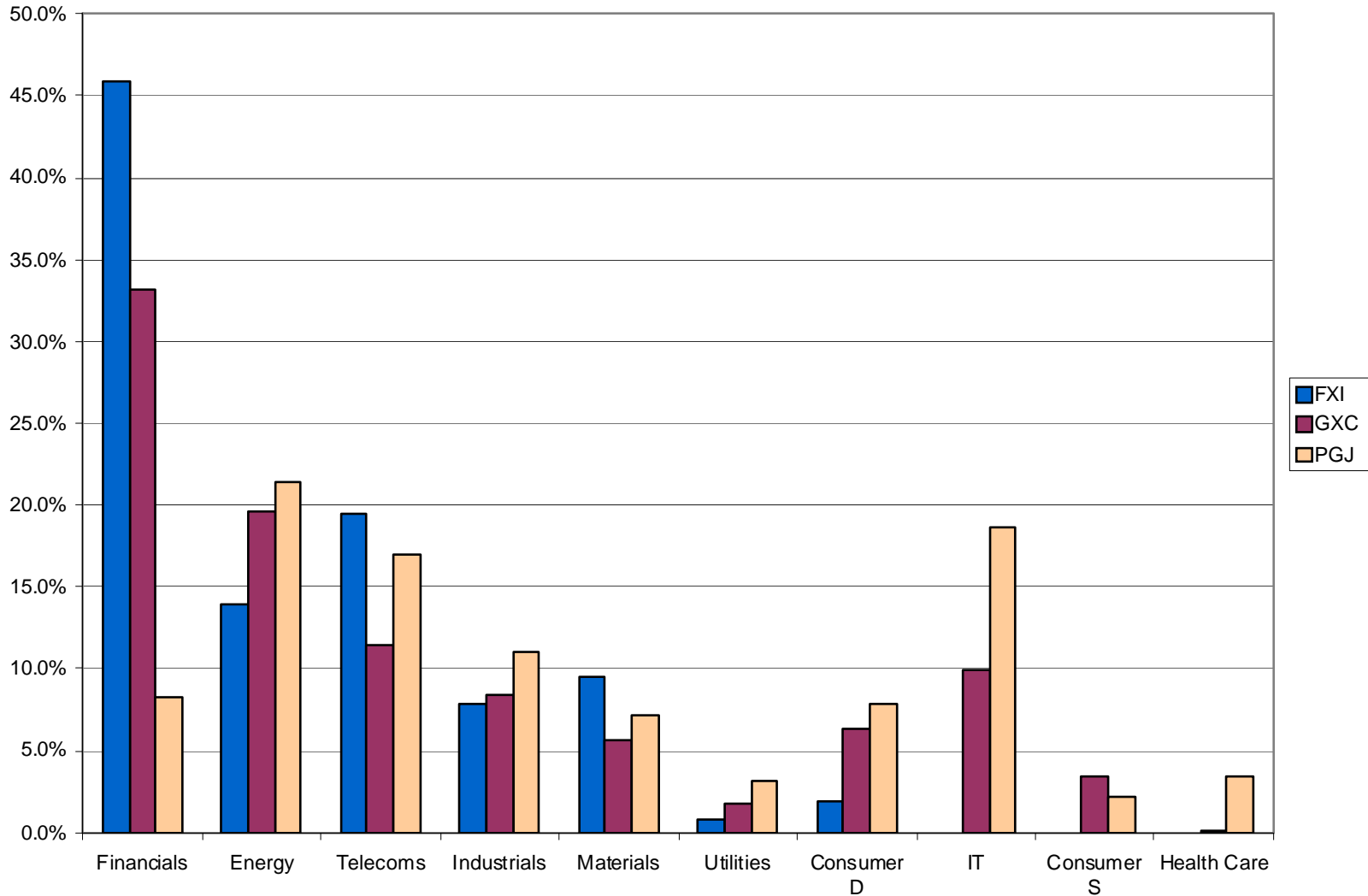
Name	Ticker	AUM, \$m	3Mo Trading Vol, K	Exp Ratio	YTD ret, 2Q10-end
iShares FTSE/Xinhua China 25 Index	FXI	7,943.5	32,900.5	0.73%	-5.7%
SPDR S&P China	GXC	542.2	103.0	0.59%	-5.6%
PowerShares Gldn Dragon Halter China	PGJ	395.7	111.3	0.60%	-6.2%
Claymore/AlphaShares China Small Cap	HAO	282.0	265.5	0.70%	-8.0%
iShares MSCI Taiwan Index	EWT	2,846.7	14,559.2	0.82%	-13.0%
iShares MSCI Hong Kong Index	EWK	1,472.3	6,790.5	0.55%	-3.8%

Source: Morningstar Direct

## Comparing the Three Largest China ETFs

- iShares FTSE/Xinhua China 25 Index FXI
  - Holds 25 of the largest and most liquid public Chinese companies available to international investors. Most of these companies are state-owned enterprises.
  - Includes Hong Kong-listed red chips and H-shares.
- SPDR S&P China GXC
  - Provides broad exposure to China-domiciled companies available to international investors.
  - Includes US- and Hong Kong-listed companies.
- PowerShares Golden Dragon Halter USX China PGJ
  - Provides exposure to companies that derive a majority of their revenue from China.
  - Only includes US-listed securities and ADRs.

# FXI's, GXC's and PGJ's Sector Weightings

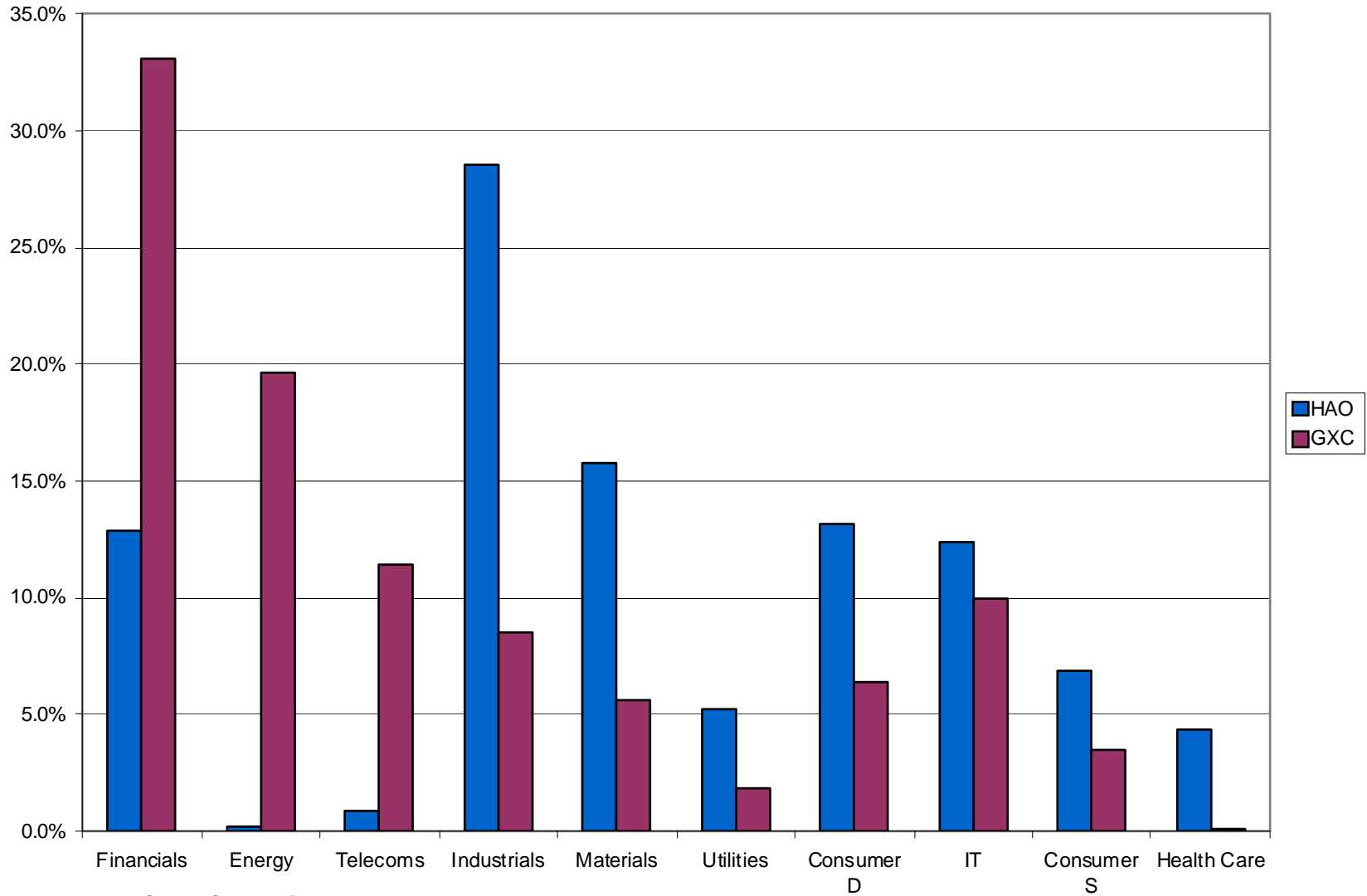


Source: Company Reports





# Comparing All Cap (GXC) vs Small Cap (HAO)

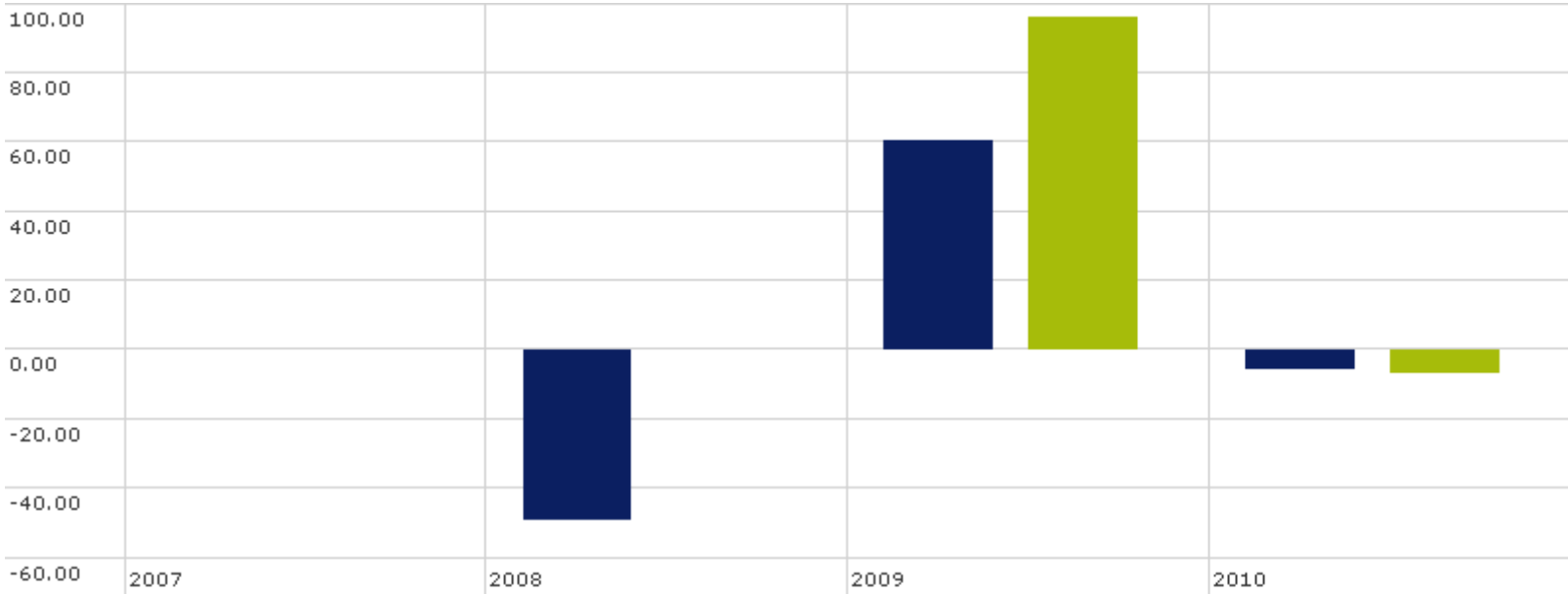


Source: Company Reports





# GXC's and HAO's Annual Returns



Investment Name
<span style="color: #002060;">■</span> SPDR S&P China <span style="color: #70ad47;">■</span> Claymore/AlphaShares China Small Cap
<i>Source: Morningstar Direct</i>

# Volatility

<b>Name</b>	<b>Ticker</b>	<b>3Yr Std Dev</b>	<b>5Yr Std Dev</b>	<b>3Yr Max Drawdown</b>
SPDR S&P 500	SPY	20.6	16.7	-50.8%
Vanguard Emerging Markets Stock ETF	VWO	33.9	28.6	-62.7%
iShares MSCI South Korea Index	EWY	40.8	34.1	-68.7%
iShares MSCI Taiwan Index	EWT	33.4	28.2	-58.1%
iShares MSCI Australia Index	EWA	32.7	26.9	-62.9%
iShares MSCI Singapore Index	EWS	33.7	27.6	-59.1%
iShares MSCI Hong Kong Index	EWH	30.3	24.4	-55.2%
iShares FTSE/Xinhua China 25 Index	FXI	39.1	33.6	-63.8%
SPDR S&P China	GXC	39.0	na	-63.8%
PowerShares Gldn Dragon Halter USX China	PGJ	38.7	32.4	-67.0%

*Source: Morningstar Direct*

# The Importance of Correlations

- ▶ Some Asia region ETFs are fairly correlated to the widely held Vanguard Emerging Markets VWO (or the iShares version).
  - ▶ Asian companies accounts for over 50% of VWO's portfolio

Correlation Matrix		1/05 - 12/07			7/07 - 6/10			Overlap w/ VWO
		1	2	3	1	2	3	
MSCI Emerging Markets Index	VWO							
MSCI AC Asia ex Japan	AAXJ	0.87			0.96			20.3%
S&P Asia Pac Emg BMI	GML	0.83	0.98		0.94	0.99		24.2%
FTSE/Xinhua China 25	FXI	0.80	0.83	0.84	0.87	0.89	0.91	8.4%

*Source: Morningstar Direct*

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