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ETFs: A simple and low-cost way to build diversified portfolios

Whether you're building portfolios from scratch or looking to deliver better value for an existing one, ETFs offer a simple and low-cost solution.

When it comes to your clients, there is certainly no "one size fits all" investment strategy. But there are at least two fundamental principles to keep in mind when it comes to achieving your clients' investment goals - diversification and cost. By having capital divided across a number of investments, the performance of one can offset a fall in another to ensure the portfolios value grows steadily over time. In the past, the cost associated with this diversification has been relatively high. But a low-cost solution in the form of Exchange Traded Funds (ETFs) is becoming a popular choice for advisers seeking a simple, more cost-competitive way to deliver diversified exposure, with the potential to deliver long-term, risk-adjusted portfolio performance.

Understanding the value of ETFs

Since launching on the Australian Securities Exchange (ASX) in 2001, the value of assets held in Australian ETFs has grown from $48 million to $21.8 billion. ETFs offer exposure to diverse assets in a product that's simple, flexible, highly liquid and cost-competitive. By buying one ETF traded on the ASX, investors instantly gain exposure to a wide range of asset classes.

With so many ETFs available, advisers have even greater opportunities to seek returns. For example, the iShares Core range of six ETFs offers exposure to 3905 stocks, 5548 bonds, 60 countries and 11 market sectors[1]. For advisers seeking a simple way to build portfolios, it represents a whole new world of diversified, cost-effective options to work with.

While diversification is certainly a key benefit, it's not the only advantage of ETFs. They're transparent, offering investors a clear exposure and returns profile, and are flexible and liquid. They can also be bought and sold on the ASX for a standard brokerage fee. But perhaps the greatest appeal of ETFs is that they are low-cost, which plays a critical role in overall investment returns in the long term.

The importance of cost over time

When it comes to investing, cost is the only known outcome which is why it's so important to consider and minimise where possible. The long-term effect on investment returns of paying lower fees is just as impressive as that of compound returns. What might seem like a small difference in percentage points can put a significant dent in returns over time, as can be seen in Figure 1.

In the ETF universe, annual management fees average 0.49% compared with 1.4% for managed funds.[2] iShares Core ETFs are among the most cost-competitive available with fees between 0.07% to 0.26% and are designed to help meet the needs of long term investors. iShares Core provides the principle of diversification, the power of asset allocation and the benefit of compounding returns.

Sticking to an ETF-only approach for a portfolio can keep total costs to a minimum when cost is an important factor. For a portfolio with a more nuanced or complex risk and return profile, using a "core" composed of ETFs can free up investing costs which can then be applied to other "satellite" investments that seek to enhance risk-adjusted performance.

Expanding investing horizons

By taking a blended approach to portfolio building with ETFs, diversification can be refined over time to maintain the right risk/return profile for each portfolio. The iShares Core range provides broad market exposure across Australian shares, international shares (hedged and unhedged), Australian fixed income and international fixed income (hedged) and cash. By selecting suitable funds from this range, advisers can give the right weight to a number of different exposures that best suit each clients' goals.

When investors limit their exposure to Australian equities only, they can be missing out on a whole world of opportunities to mitigate risk and harness growth in their portfolio. Australian equities represent just 3% of the international equities market and are heavily weighted to the finance and resources sectors. So a purely Australian portfolio creates sector concentration risk as well as limiting exposure to growth industries like technology and healthcare.

The easy way to build portfolios with ETFs

iShares Core ETFs provide advisers with a cost-effective, and simple way to acheive broad market exposure to help build a diversified portfolio. iShares delivers all the advantages of institutional grade ETFs- researched, developed and managed by BlackRock, and are backed by industry-leading portfolio management expertise and risk management platforms.

To trial iShares Core ETFs as part of your clients portfolio, use the **Core Builder Tool** to build portfolios with different performance and cost options using products from the iShares Core range. *Go to www.blackrock.com/tools/core-builder/au.* **FS**

Exchange traded funds were once considered a blunt instrument, but no more. Today, a financial adviser can use a handful of ETFs to finetune the risk and return profile of their client portfolios.

More than that, ETFs can easily address an issue that is always top of mind: fees. While many managed funds still charge annual management fees around the 1% mark, ETFs charge as low as 0.4%.

In plainspeak, an investor can access a $10,000 ETF portfolio for the price of a cup of coffee.

In this edition, we interview Alex Zaika, head of wealth at iShares Australia on how low fees impact long-term investment results and how investors can strike the right balance. Read this article to find out more from one of the most successful providers of ETFs in Australia, BlackRock.

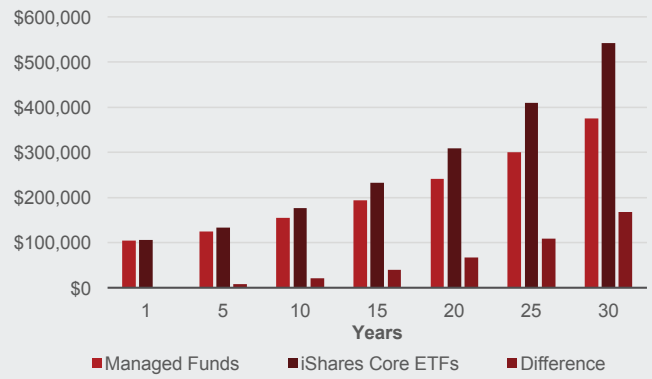
Michelle Baltazar
Director of Media & Publishing

The quote

ETFs can free up investing costs which can then be applied to other satellite investments.

Watch the video on www.fsitv.com

Figure 1. Impact of fees magnifies over time



Source: This example is for illustrative purposes only and does not account for any sales or trading commissions which would have reduced the returns. Assumes lump sum investment of $100,000 with a 6% annual rate of return invested over 30 years. Management fees assumed are the average management fee (or indirect cost ratio) of the iShares Core ETF range (0.19%) and the average indirect cost ratio of the Morningstar Australian Investment Trust universe (1.42%) as described in 1 above. Quoted management fees subject to change. For illustrative purposes only. This is not a recommendation to invest in any particular financial product. No analysis of their suitability was conducted and no statement of opinion in relation to their suitability is provided. Past performance is not a reliable indicator of future performance.

[1]Source: BlackRock, MSCI, Bloomberg, Barclays, as at 31 August 2017. [2] Source: ASX, 24 May 2018.