

ETF Insider

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The tyranny of ESG ETF choice

Fund selectors overwhelmed by vast array of products

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Opener



The problem of choice

Welcome to the Winter edition of *ETF Insider*, the first ETF magazine dedicated to professional investors across Europe. Each month, we produce analysis on a specific area of the market, be that fixed income, emerging markets or factors while also providing expert insights into the latest on asset allocation and portfolio construction, always through an ETF lens.

This issue focuses on the ESG ETF landscape in Europe, an area of the market that continues to attract inflows, albeit at a slower pace versus the last two years. According to data from Morningstar, ESG ETF inflows accounted for just 25.6% – €7.3bn – of all flows into European-listed ETFS in Q3, a far cry away from the 50+% inflows seen in 2021 and 2022. Despite the lower inflows, ETF issuers still view the area as a key way to differentiate from competitors. Sustainable ETFS have tripled over the past five years and now total 592, up from 187 at the start of 2018. How to navigate this landscape is one of the focuses of this issue (p.34) as fund selectors grapple with the myriad of options available – select, leaders, elite, Paris-aligned, climate transition, net zero and socially responsible, to name a few.

Understanding these labels is crucial for fund selectors if they want their portfolios to have the desired performance and impact (p.22). The performance dispersion across S&P 500 ESG UCITS ETFS this year has been 7.8%, as at 22 November, with the best ETF returning 23% versus 15.2% for the worst performing, according to data from Bloomberg Intelligence. While choice is always welcomed by fund selectors, extra due diligence is required when incorporating ESG ETFS in portfolios.

Elsewhere, keep an eye out for fantastic analysis on why diversification may not be the free lunch everyone thinks it is from Parala Capital's Reza Vishkai (p.44) and a deep dive into active ETFS and China from ETF Buyers Club members Edoardo Mezza (p.46) and Karin and Stefan Wiederkehr (p.48) as well as the usual 'Education Corner' (p.13), 'ETF of the month' (p.14) and 'Fund Fights', where *ETF Stream* compares the strengths and weaknesses of similar ETFS (p.15). Finally, I want to highlight our Expert Investors series where *ETF Stream* interviews fund selectors about their asset allocation and ETF usage (p.12).

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Tactical ETF investing in China

Why it is important to hold shorter to medium-term time horizons when investing in Asia's largest economy

By Karin Wiederkehr and Stefan Wiederkehr

Our enduring fascination with China spans many years. Throughout our experience as investors, we have focused our asset allocation approach around global megatrends. This entails our commitment as long-term investors, advocating a buy-and-hold strategy for our client portfolios. However, in the realm of developing Asian nations, this approach has proven to be challenging, predominantly influenced by behavioural finance.

Consequently, we have opted for a more agile and responsive asset allocation in China, focusing on market timing and flexibility. This strategy entails a proactive approach to trading, leveraging continuous analysis of shifting market trends, economic indicators and investor sentiment. The overarching goal is to achieve superior performance within shorter to medium-term trading horizons.

By closely monitoring these dynamic factors, we seek to capitalise on market movements and fluctuations, making informed decisions based on the evolving landscape of economic indicators and prevailing investor sentiment. This method aims to outperform benchmarks and generate higher returns within relatively brief timeframes by capitalising on timely opportunities as they arise.

We perceive the stock market in China as having significant potential, buoyed by multiple favourable factors within the economy. With a population of 1.4 billion people, China offers a vast consumer base across diverse markets. Despite recent moderation, China's economic growth has remained rapid, outpacing other global economies.

The nation is strategically shifting its focus from high-speed growth to a more sustainable, high-quality economic model. This transition involves a pivot from an export-driven approach to emphasising domestic consumption and fostering

innovation to drive its economy forward. The expanding middle class in China has experienced a surge in spending power, resulting in heightened consumption and a sustained demand for a wide array of goods and services.

The widespread internet population in China has cultivated a strong preference for eCommerce and various social media platforms. As a global pioneer in eCommerce, online shopping has become deeply ingrained in Chinese consumer culture.

Notably, China hosts the largest population of internet users globally, with a significant preference for mobile-centric internet consumption. Moreover, the country has made remarkable advancements in technology and innovation, establishing itself as a leader in these pivotal domains.

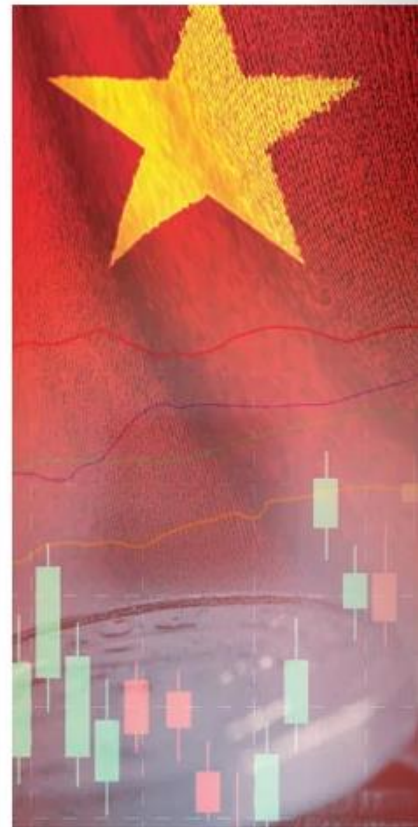
Thriving industries

To seize this investment opportunity, we have strategically identified two thriving industries: eCommerce and luxury goods. The recent resolution of the Chinese government's regulatory actions on online retail, data privacy and consumer protection within the technology sector signifies a newfound stability. This sector is now seen as aligned with the government's focus on domestic consumption, reflecting a vital element of the latest Five-Year Plan.

This plan emphasises boosting domestic consumption, fostering technological innovation, promoting self-reliance, while still maintaining global engagement and inviting foreign investments. Although the post-reopening demand surge has been relatively slow, there is an eager anticipation for a significant resurgence in consumption. Additionally, the ongoing dialogue between the US and China hints at the potential for a normalisation of relations between these influential global powers.

This scenario may present an opportune mo-

“Chinese consumers growing inclination towards unique and personalized products resonates well with the offerings provided by both the domestic and foreign luxury sector”



ment to invest in the eCommerce and luxury goods sectors deriving revenue from Chinese consumers. The regulatory clarity and alignment with government policies, coupled with anticipated consumption growth and the potential for improved US-China relations, suggest a favourable environment for investments in these segments. The projections from the Brookings Institute regarding the rapid expansion of China's middle-class hold immense significance for the global luxury market. By 2027, an estimated 1.2 billion Chinese individuals are anticipated to transition into the middle-class, constituting a quarter of the global total.

As their incomes rise, there is a discernible shift in consumer preferences towards high-quality products and heightened service experiences. Chinese consumers are already displaying increasingly sophisticated and refined tastes. Their growing inclination towards unique and personalized products resonates well with the offerings provided by both the domestic and foreign luxury sector.

With the continuous growth and evolution of the Chinese economy, the luxury market is expected to assume an even more prominent role in the global



luxury industry. Major luxury brands stand to benefit not just from increased local purchases within China, but also from the avenues of cross-border eCommerce, buying agents, and sales through travel retail. Luxury brands that cater to the changing preferences and expectations of the Chinese market are likely to gain a significant competitive edge in terms of market share and financial growth.

Investment strategy

In order to implement this investment strategy of the above-mentioned sectors, we have opted for the following approach by utilising the identified ETFs below:

KRANESHARES CSI CHINA INTERNET ETF (KWEB) is an ETF that focuses on providing exposure to Chinese internet companies. Its investment objective is to track the performance of the CSI Overseas China Internet index. The ETF typically invests in companies that are domiciled in China, have a significant part of their business operations in China, or are listed on an eligible stock exchange and are classified as Chinese internet companies.

DIREXION DAILY CSI CHINA INTERNET INDEX BULL 2X SHARES (CWEB) is a leveraged ETF designed to provide daily investment results, before fees and expenses, that correspond to two times (2x) the daily performance of the CSI Overseas China Internet index. This ETF is different from KWEB in that it aims to achieve twice the daily return, which can magnify gains but also amplify losses compared to the underlying index.

KRANESHARES GLOBAL LUXURY INDEX ETF (KLXY) is an ETF that focuses on providing exposure to leading developed markets companies from global luxury-related sectors weighted by market capitalisation. Its investment objective is to track the performance of the Solactive Global Luxury index. The fund typically invests in global companies that operate across industries, including leather goods, jewelry, accessories, skincare, cosmetics, beverages, travel and super-car businesses.

This strategy allows us to seize these opportunities by actively investing in a highly focused mix of ETFs in line with our investment process, striving to achieve optimal results for our clients. In this context, it is imperative to

acknowledge this tactical investment approach might not align with the preferences of all investor types. It demands a comprehensive understanding of the thematic trend, a tolerance of concentrated risk, an ability to weather price fluctuations, and a resolute approach during periods of market turbulence.

While we have strong conviction in China's market potential, we advocate for a short to medium-term investment approach aimed at strategically securing profits. The goal is to capitalise on the current opportunities within a relatively shorter to medium-term timeframe, allowing for the realisation of gains and mitigating potential risks effectively. This strategy aligns with our emphasis on seizing the present prospects in China's market while being mindful of the need to secure profits within a defined and practical investment horizon.



Karin Wlederkehr and **Stefan Wlederkehr** are co-founders of IMP AG, a discretionary asset manager based in Liechtenstein.