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Active ETFs, Small ETFs and Other Trends to Watch in 2020

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As we kick off the new year, market prognosticators are busy making their 2020 predictions. David Mann, our Head of Capital Markets, Global Exchange-Traded Funds (ETFs), offers some thoughts on trends and milestones within the ETF industry he thinks could come to fruition in 2020.

Is this really the fourth version of my New Year "predictions" posts? (Here are my 2019, 2018 and 2017 posts, if you'd like to revisit them.)

As in previous versions, you are not going to get my call on where the S&P 500 Index will be a year from now—which is probably a good thing! However, it is also impossible not to note that many of the major US stock market indexes were up more than 30% last year, which should impact the ETF flows for 2020.[1]

Furthermore, last year we saw some major regulatory-related announcements impacting ETFs, including the adoption of the ETF Rule and approval of non-transparent, active ETFs. So, we probably need to incorporate the impact of those developments into my predictions for this year.

Here are my predictions for 2020.

Active Fixed Income ETF Assets Will Reach $110 Billion

Some recent trends worth highlighting that impact my prediction above:

- Most active ETF assets (roughly 80%) are in fixed income funds.
- Fixed income ETFs in general are becoming more and more popular; in 2019, fixed income ETFs accounted for almost half of the $334 billion of ETF inflows.[2]
- The ETF Rule was finally passed. It states that operationally, there are essentially no differences between active and index funds, and it also evens the playing field regarding the usage of custom baskets for all fixed income ETFs.

These are trends we have seen in our own active fixed income lineup, which stands at $1.8 billion AUM (as of January 2, 2020), with $1.5 billion of that coming in 2019. Fixed income is an asset class where we think active management can really shine.

So, how do I get to a figure of $110 billion in my prediction? Currently, active fixed income ETF assets under management (AUM) sits at $77 billion. Flows basically doubled in 2017 and again in 2018 before plateauing last year at $21 billion, matching the year prior. If we simply match again and there is no market appreciation in that asset class, they are already at $100 billion. I think we should likely exceed that easily, hence the extra $10 billion in my prediction. That gets us to $110 billion of active fixed income ETF assets.

We Will See More Smaller Funds Make the Leap

Last year, the prediction regarding smaller funds was focused on large trades at multiples of the average volume, a topic that we have discussed repeatedly in these pages. I think investors have become more comfortable with the best practices when trading newer funds and understand that trading multiples of the average daily volume is now commonplace.

However, often the trading question will not even enter the conversation until a fund reaches a certain AUM. This actually has nothing to do with liquidity, a topic I talked about in the first year of this blog, or how people choose a restaurant, which I talked about more recently (you will have to click the hyperlink to understand that one). The conundrum is that people do not want to invest until the fund is large, but the fund will never get large unless people invest—quite the puzzle.

In 2019, there were 1,320 ETFs that started the year with under $200 million.[3] Does anyone out there want to guess how many of those funds made it to $500 million? Only 10! Not even 1% of the funds made it from the $200 million milestone to the $500 million milestone, and that was during a positive market cycle with some real asset appreciation giving some AUM tailwinds.

This year we are starting with 1,491 ETFs that are under $200 million out of the almost 2,400 ETFs listed in the United States.[4] I think this year investors will take the plunge and give more of these newer funds a chance. From there, size begets size.

By the end of 2020, I predict 25 of these funds will brag about reaching the $500 million milestone.

We Will See a Non-transparent ETF Reach $500 Million

As discussed earlier in this post, we have spent a fair amount of time discussing ETF-related regulations. The first big one of last year was the passage of the ETF Rule. The second was the approval for all sorts of non-transparent ETF flavors.

You can click on those prior posts to get a sense of some of the headwinds these funds might face. In 2020, this will no longer be a theoretical exercise as there will live funds where we can watch the spreads, the trading and the investor interest. I have always been more of a “glass is half full” kind of guy, so I am pulling for these to work as envisioned.

Assuming that is the case, then I do not think it is that much of a leap for one of them to take off to the tune of $500 million of AUM.

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1. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or guarantee of future results. There is no assurance that any estimate, forecast or projection will be realized.

2. Source: Bloomberg, as of 1/2/20.

3. Ibid.

4. Ibid.