# Active ETFs
# The ETF buyers' guide

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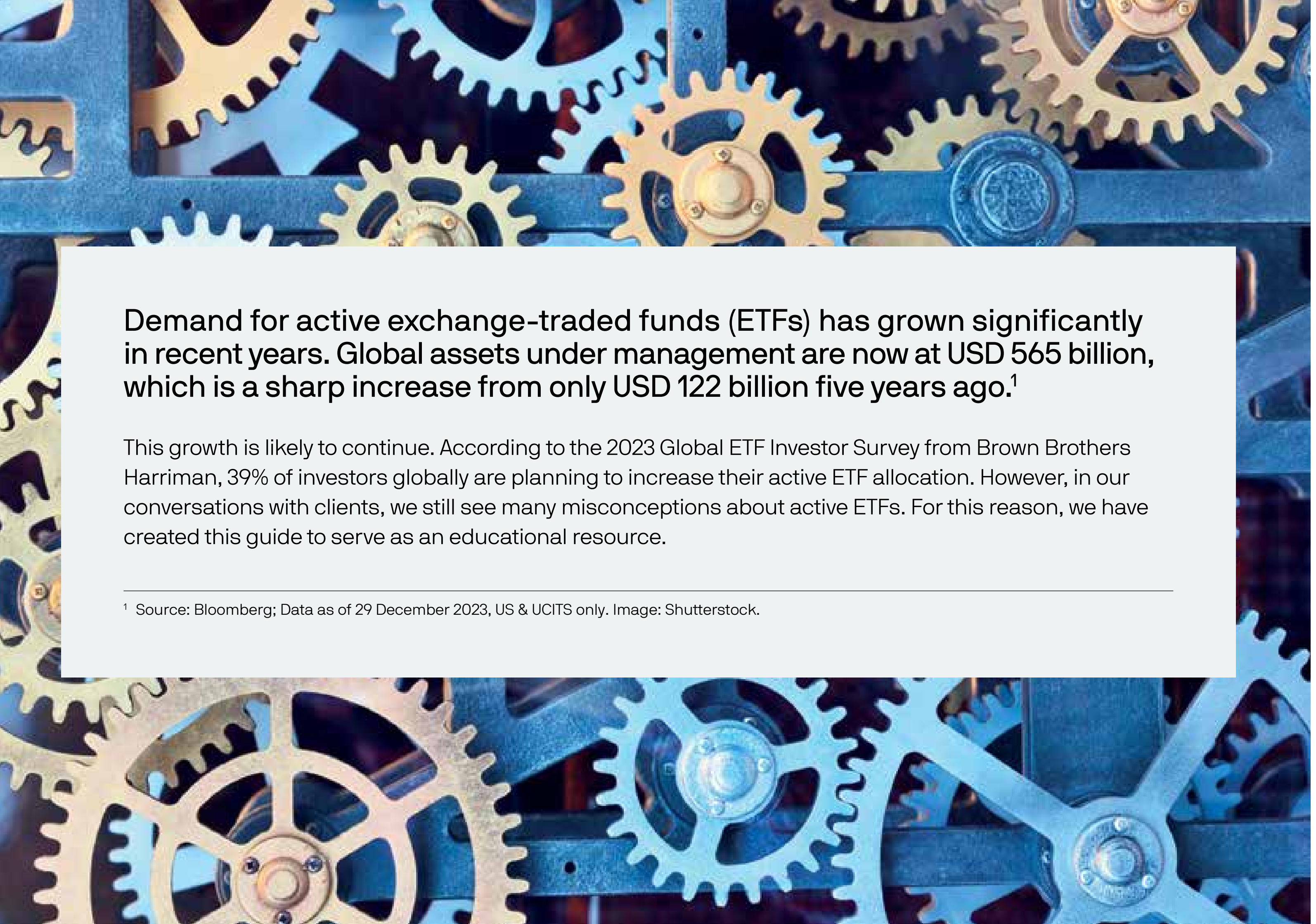
J.P.Morgan
ASSET MANAGEMENT



Demand for active exchange-traded funds (ETFs) has grown significantly in recent years. Global assets under management are now at USD 565 billion, which is a sharp increase from only USD 122 billion five years ago.[1]

This growth is likely to continue. According to the 2023 Global ETF Investor Survey from Brown Brothers Harriman, 39% of investors globally are planning to increase their active ETF allocation. However, in our conversations with clients, we still see many misconceptions about active ETFs. For this reason, we have created this guide to serve as an educational resource.

[1] Source: Bloomberg; Data as of 29 December 2023, US & UCITS only. Image: Shutterstock.

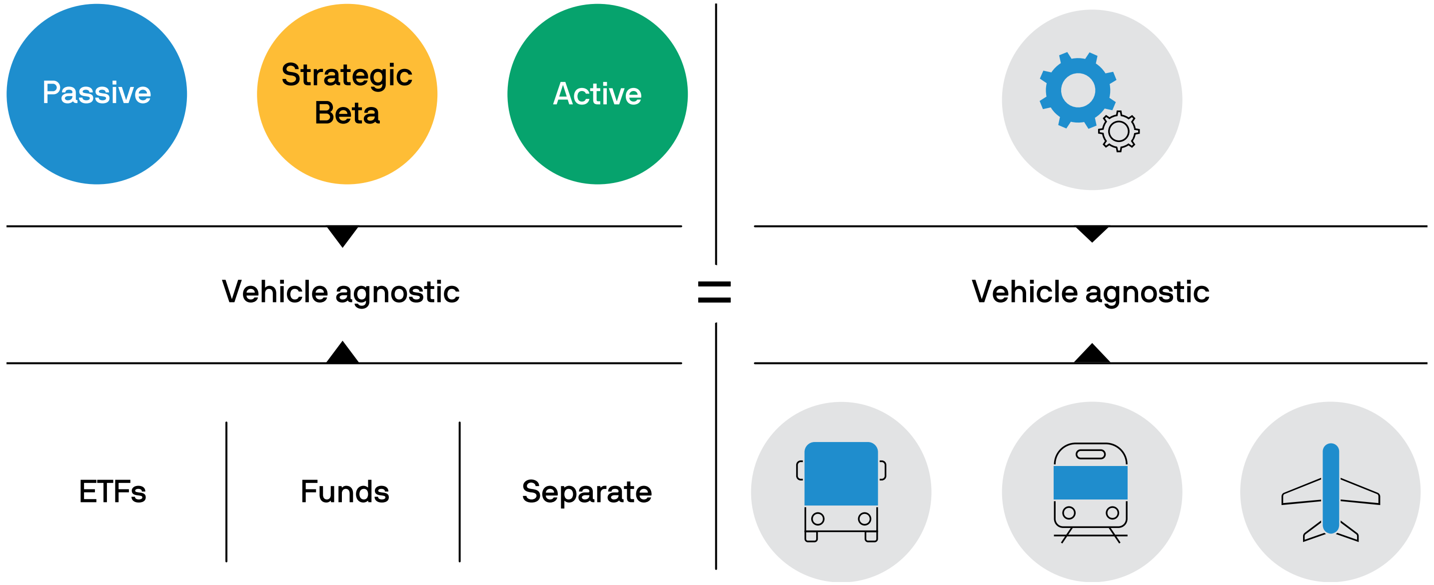
## Contents

## What is an active ETF?

- When looking at active ETFs, it is first important to note that terms such as "ETF", "passive" and "index" are not synonymous. ETF simply means Exchange Traded Fund, which means an ETF is traded at an exchange regardless of the investment strategy used.
- A variety of "engines" or strategies can therefore be placed in the ETF structure to leverage its benefits.
- "Active" refers to specific investment decisions, which are designed to achieve specific outcomes, such as outperforming an index (Alpha), generating income, or achieving control in terms of duration, yield or credit quality.
- An active ETF provides access to these specific outcomes, all while maintaining the attributes of the ETF structure.



**The ETF is just a wrapper and the content itself is independent of the vehicle**




Source: J.P. Morgan Asset Management. For illustration purposes only. The ETF aims to replicate the performance of an index however its market price can be different from its net asset value and from the net asset value of the index.

## Demand for active ETFs

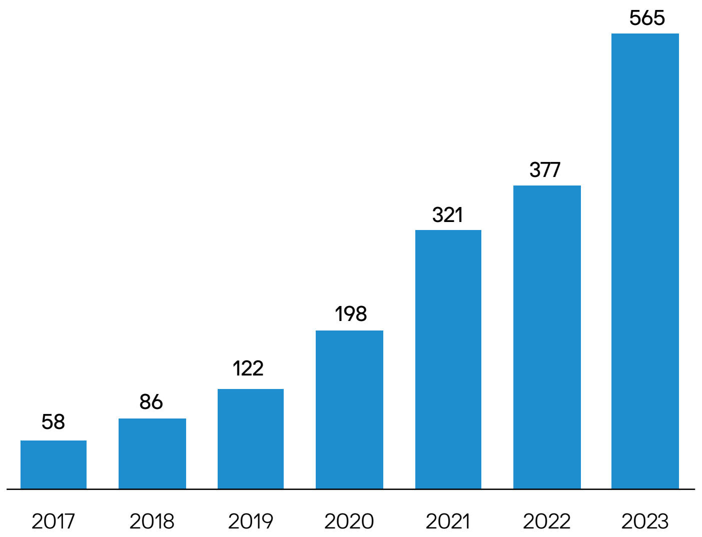
- Active ETF assets have grown sharply in recent years. At the end of 2017 the global assets under management were only at 58bn US dollar, growing to 565bn US dollar end of 2023.[2]
- The share of active ETFs in investors' portfolios has risen steadily over the past five years. According to the Trackinsight Global ETF Survey 2024, which has insights from over 500 ETF buyers globally, over 80% of these investors now use active ETFs in their portfolios.
- So far, active ETFs make up only 2% of the UCITS ETF market[2], but this share is likely to rise if growth follows the same trajectory as we are witnessing in the US today.
- While passive strategies continue to dominate European ETF inflows, investors are increasingly realising that the ETF wrapper is also an ideal home for actively managed strategies: 39% of European investors recently said that they expect their exposure to active ETFs to increase over the next 12 months.[3]
- Active management in an ETF wrapper is one of the factors that will drive further ETF growth, as active ETFs provide investors with the opportunity to earn alpha on their investments and retain all the benefits that they expect from the ETF structure.

[2] Bloomberg; Data as of 29 December 2023, US & UCITS only.
[3] Brown Brothers Harriman, Global ETF survey 2023.

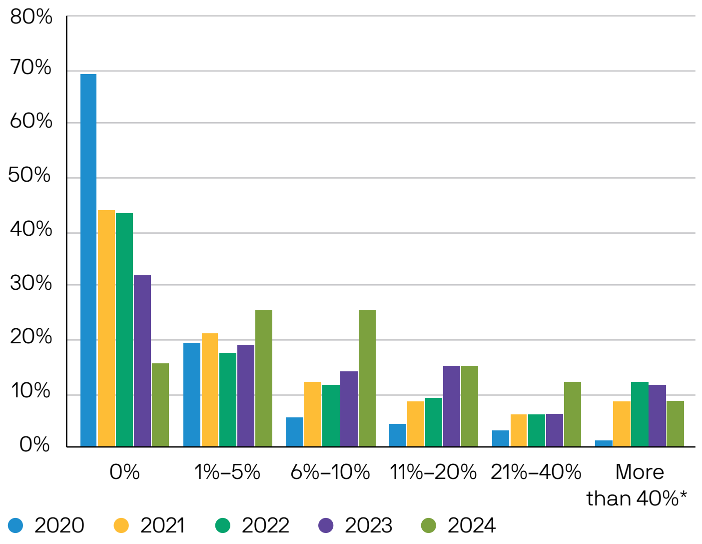


### Demand for active ETFs is growing

Global active ETFs assets by year ($bn)




Percentage of portfolio invested in actively managed ETFs




Source: (left) Bloomberg; Data as of 29 December 2023, US & UCITS only. (right) TrackInsight Global ETF Survey 2024.

# Types of active ETFs

- The first active ETF was launched in 2008. Since then, a lot of innovation has happened in the active ETF market.
- There are now 19 ETF issuers offering active ETFs – a number that has tripled over the last five years.
- In 2023 equities overtook fixed income as the largest asset class for active ETF allocations, with 56% of UCITS active ETF assets aligned to equity strategies.[4]
- The active ETF market is already as diverse as the active mutual fund market, ranging from index-like active research enhanced indexing strategies, to higher tracking error unconstrained or even thematic strategies.

[4] Source: Bloomberg as of 29 December 2023.



## Active UCITS ETF: a market overview

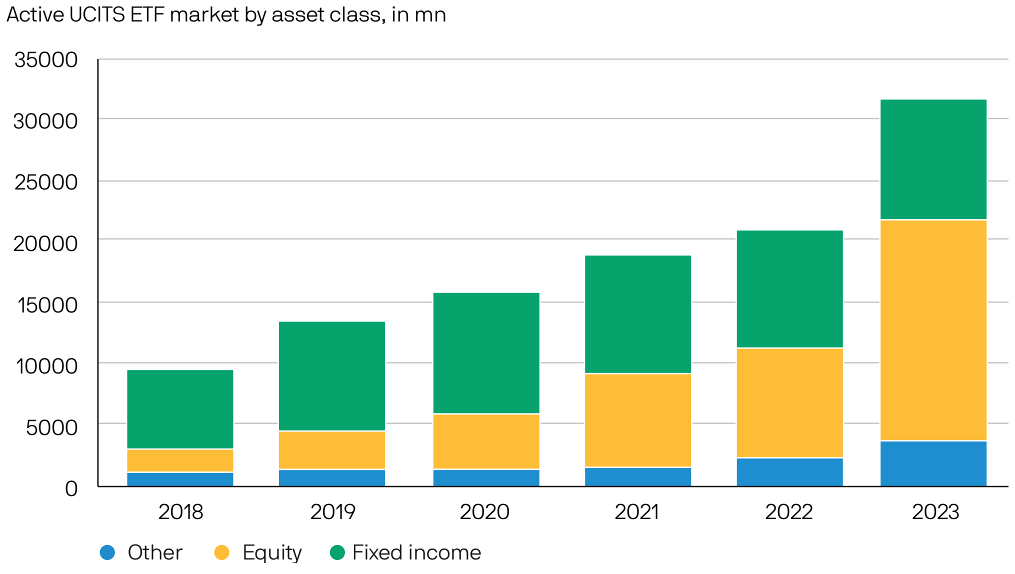
19 ETF providers offering actively managed ETFs

Assets under Management 32bn USD

94 active UCITS ETFs

55 Article 8 SFDR ETFs

13 Article 9 SFDR ETFs

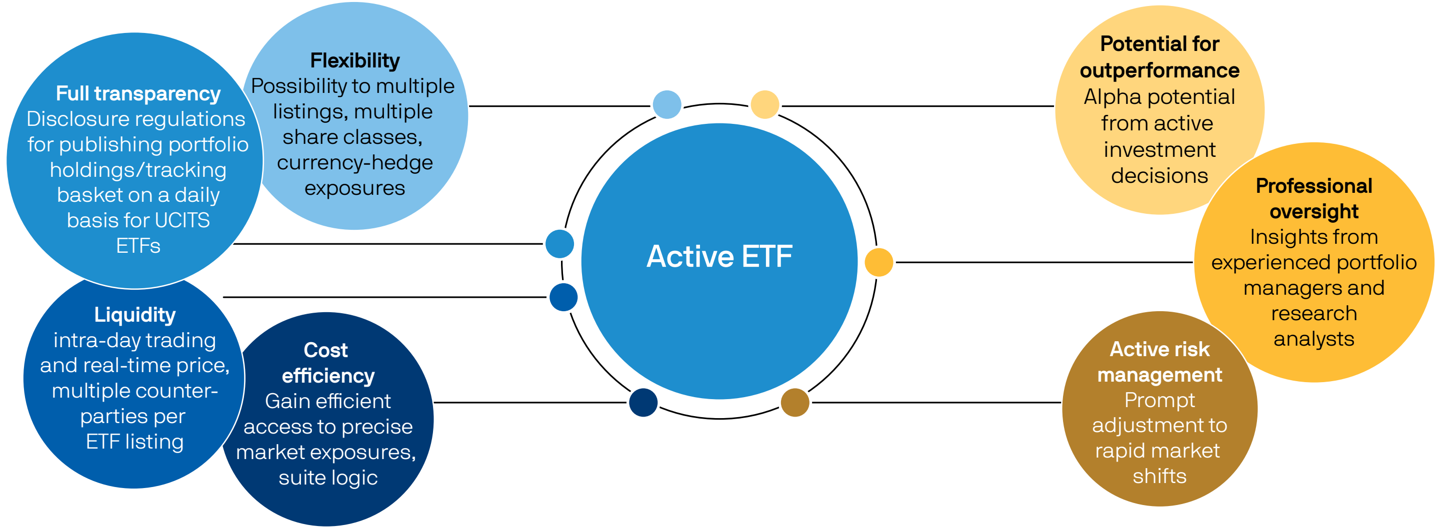



Source: Bloomberg as of 29 December 2023.

## Why invest in active ETFs?

- Active ETFs offer the same benefits of the ETF wrapper as passive ETFs. Active ETFs are cost effective, offer daily holdings transparency, can be traded throughout the day at a known price and offer access to virtually every market worldwide.
- Additionally, active ETFs bring expert research and security selection to ETF investors. Active security selection can identify dislocations in the market and focus on alpha generation.
- Adding active ETFs to an ETF allocation also brings diversification benefits – in terms of the ETF providers themselves and with regards to the sources of return within a portfolio.
- Traditionally it has been more expensive to access active research capabilities and strategies in the mutual fund wrapper. The ETF wrapper now gives more cost-efficient access to these active capabilities.

### Actively managed ETFs in focus




The value of investments may go down as well as up in response to the performance of individual companies and general market conditions. Active risk management process includes an effort to monitor and manage risk, but does not imply low risk.

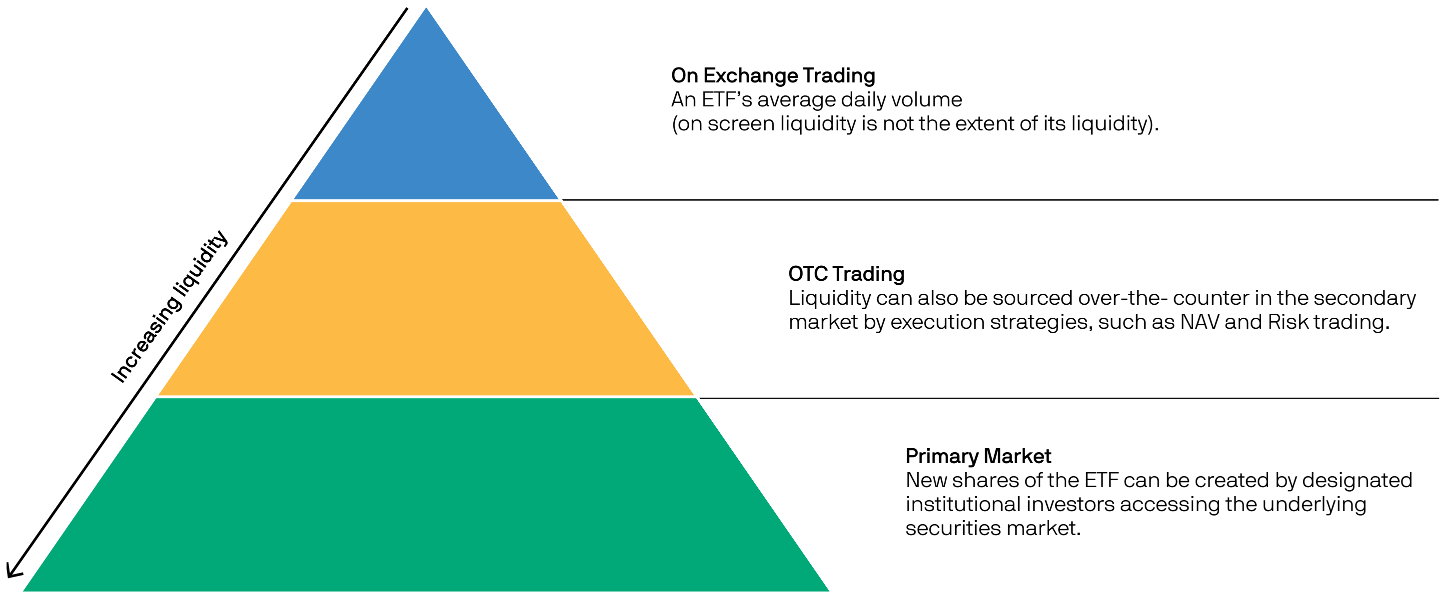
# Trading active ETFs

**Trading active ETFs is the same as trading passive ETFs. There are three methods: NAV trading; risk trading; and agency trading.**

- **NAV trading** is where the dealer and client agree to trade the ETF at a price that is tied to its future net asset value per share. The price is usually quoted as NAV plus or minus basis points (bps).
- **Risk trading** is a common alternative to NAV trading. It involves the client requesting an intraday price from one or more brokers that it can act upon immediately. Investors can get price quotes any time during the trading day. Quotes have two parts: bid and ask. The bid is the highest price a buyer is willing to pay for ETF units. The ask is the lowest price a seller is willing to accept to sell units. The difference between the two is called the bid-ask spread. This method of trading may be advantageous to clients looking to execute orders quickly at one price.
- **Agency trading** is where the client employs a broker to act on their behalf in order to trade the ETF in the secondary market (via the stock exchange or over the counter). This method is similar in execution to risk trading. The client, rather than the broker, bears the market risk.



### Ways to trade active ETFs



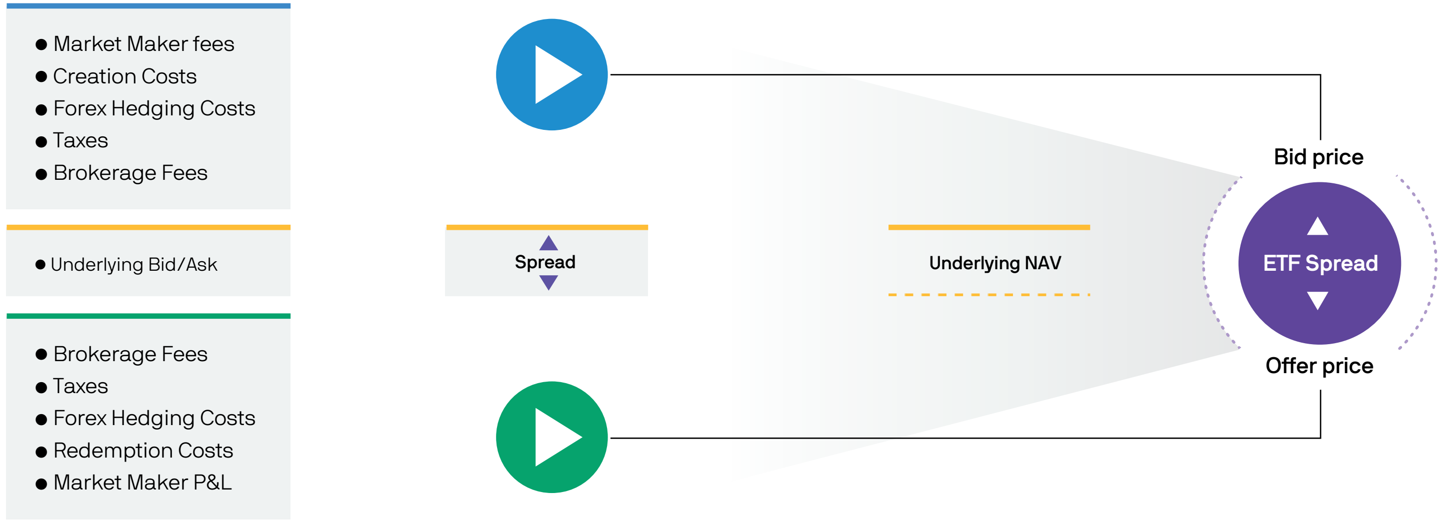

Source: J.P. Morgan Asset Management.

## Liquidity of active ETFs

- Fundamentally, the liquidity profile of any ETF is driven by its underlying securities. In other words, the primary market costs of similar active and passive market exposures should be the same, as they incur very similar commissions, taxes, and other charges.
- The components of the bid-offer spread are the same for both active and passive strategies – for example, they have the same brokerage fees, taxes, currency/hedging costs and creation/redemption costs.
- The tightening of ETF spreads within the primary market creation/redemption cost is a factor of volume, velocity and diversity of the client base.
- Commonly, the oldest and largest passive ETFs have tighter spreads. For active ETFs, we expect spreads to evolve over time as the adoption of active ETFs increases. Similar developments can already be noticed for relatively new ESG/Sustainable ETF strategies, as more clients adopt these products.
- In general, a tighter bid-ask spread means the ETF is more liquid, which means the cost of buying and selling the ETF is lower.
- In the US, where active ETF adoption is higher and more trading takes place on exchange, there are several examples where active ETF spreads are on a par with passive ETFs.



**What goes into an ETF price?**




Source: J.P. Morgan Asset Management.

## ESG: The active advantage

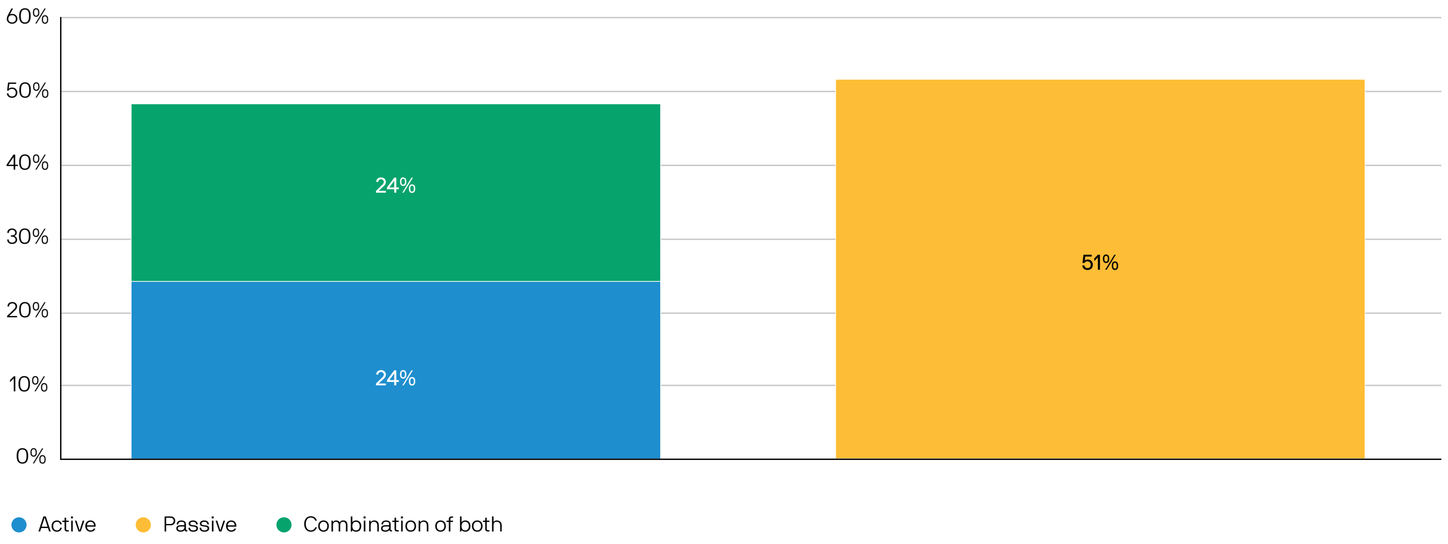
- Over USD 38 billion flowed into ESG ETFs in 2023 equating to 23% of overall ETF flows.[5] We expect ESG funds to continue growing through 2024, and well beyond.
- The UCITS ESG ETF market has reached USD 307 billion in assets.[5]
- When it comes to ESG ETFs, combining the benefits of ETFs with active management can be particularly advantageous.
- Passive ESG ETFs typically apply exclusions or, if a sharper ESG focus is required, they track ESG indices such as socially responsible investment (SRI) or Paris-aligned benchmarks. As a result, investors are fully reliant on the ESG analysis of these index providers.
- Unlike passive index investing, an active approach allows for a more in-depth assessment of ESG characteristics. While some index trackers use exclusions alone to reflect investors' sustainability preferences, exclusionary strategies will only help investors mitigate ESG risks by avoiding companies with the worst ESG attributes. As a result, investors who are looking to invest in companies with strong ESG practices, or to capitalise on sustainable opportunities, will need to look beyond exclusions alone.
- According to the 2024 Trackinsight Global ETF Survey, many investors have already realised the benefits of combining ETFs and active management for ESG, with 48% using active investment approaches for ESG investing - either as purely active or in combination with passive ETFs.

ESG determinations may not be conclusive and securities of companies/issuers may be purchased and retained, without limit, by the Asset Manager regardless of potential ESG impact. The impact of ESG integration on a Fund's performance is not specifically measurable as investment decisions are discretionary regardless of ESG considerations.

[5] Source: Bloomberg, as of 31 December 2023.

**48% of ETF buyers use active strategies for ESG investing**

What is your preferred investment approach for investing in ESG ETFs?



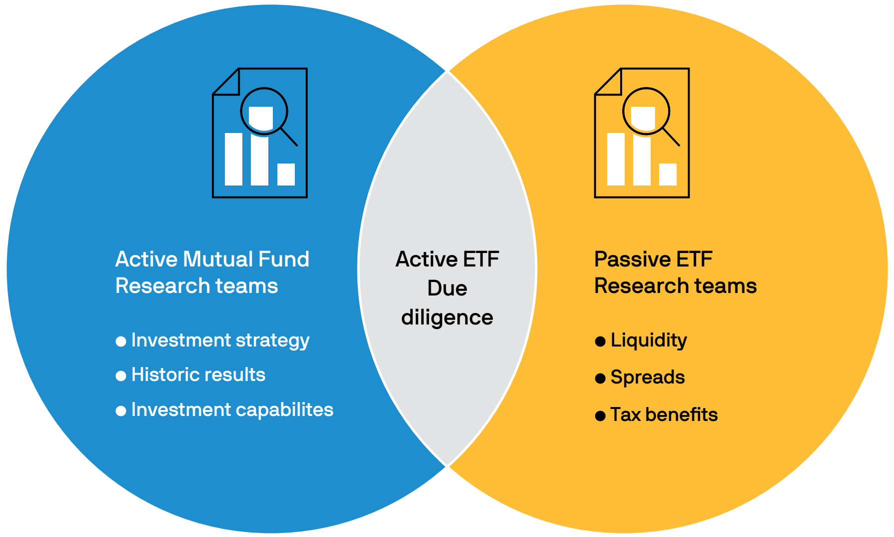

Source: 2024 Trackinsight Global ETF Survey.

## Due diligence for active ETFs

- Active ETF strategies are still relatively new in Europe, so not every investor has experience of the active ETF due diligence process.
- Clients tend to approach the active ETF due diligence process in two ways, either from the perspective of a passive ETF research team, or from the perspective of an active mutual fund research team. Both approaches make sense, but due to the background of these research teams there are a few crucial factors specific to active ETFs that will need to be focused on.
- If passive ETF research teams have not previously reviewed active strategies, it might make sense to partner with their active research counterparts for mutual funds and benefit from their experience in the active space.
- If active mutual fund research teams oversee the due diligence, it makes sense to pay attention to specific ETF-related topics, such as spreads, liquidity or potential tax benefits.
- As one of the largest active ETF providers globally, our experience suggests that the due diligence process is usually most effective if it's driven by an active research team with broad input from passive ETF specialists.



### Active ETF due diligence: a team effort



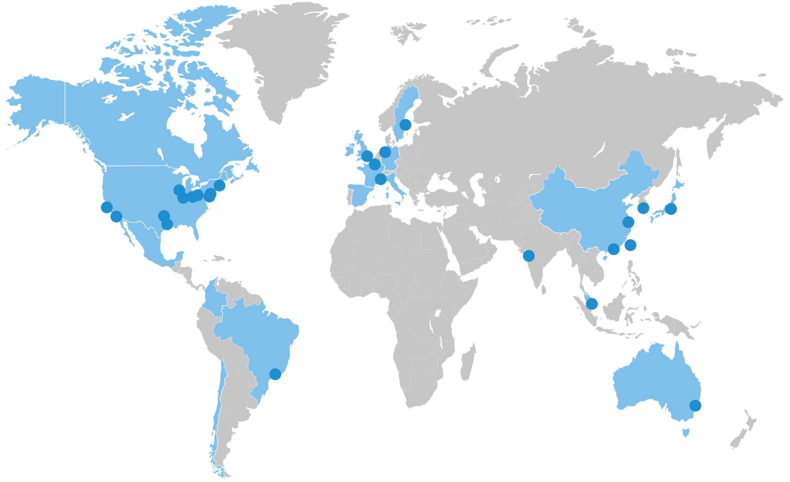

Source: J.P. Morgan Asset Management.

## Finding the right active ETF provider

- When selecting an active ETF provider, it is of course important to look closely at the strategy itself. However, the capabilities and resources of the ETF provider are also crucial.
- The most relevant aspect to check is the resources of the ETF provider. Research insights are crucial for active ETFs; therefore, an active ETF provider should have a global network of analysts and portfolio managers.
- As an example, if you are considering active emerging market ETFs, it is paramount that the ETF provider has local resources on the ground with local language skills who do their own research and do not purely rely on sell-side analysis.
- Finally, the ETF provider should have a well-resourced capital markets team, backed by a strong technology platform and solid relationships with a diversified set of authorised participants (“APs”). The ETF provider must be able to demonstrate that it can provide APs with all the information they need to deliver efficient pricing of the ETF at all times, while using both primary and secondary markets to boost liquidity.



### J.P. Morgan Asset Management’s global investment capabilities



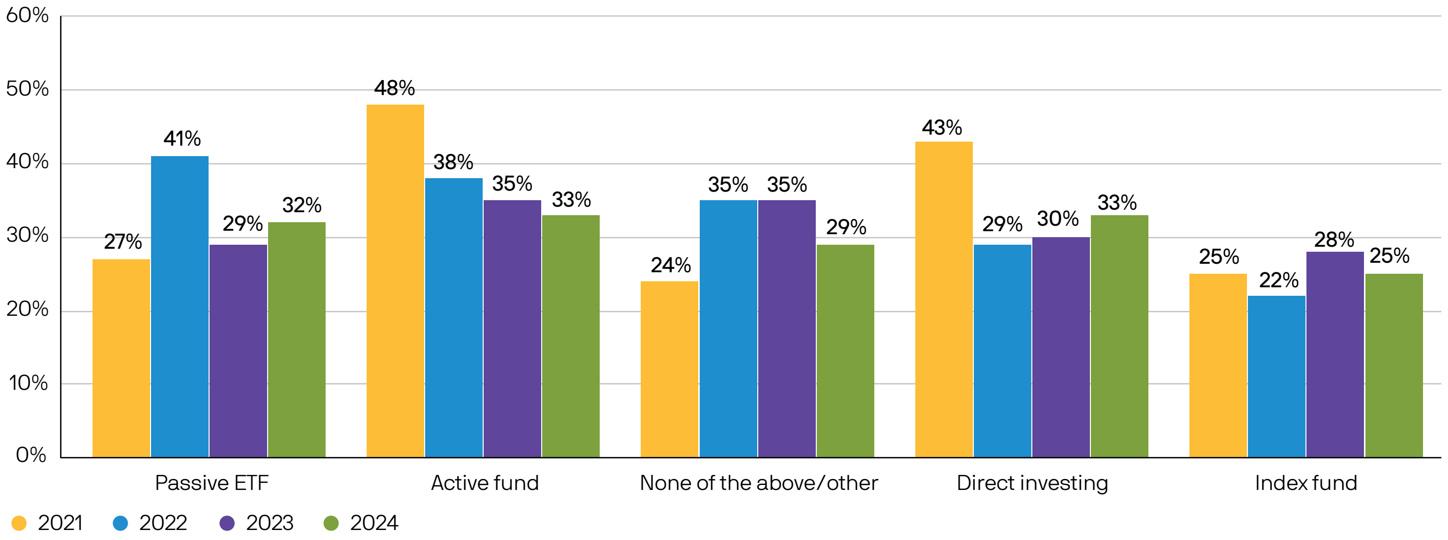
| Americas | EMEA | APAC |
|---|---|---|
| Boston<br>Chicago<br>Columbus<br>Dallas<br>Houston<br>Indianapolos<br>Jersey City<br>Los Angeles<br>New York<br>Pittsburgh<br>San Francisco<br>Sao Paulo | London<br>Paris<br>Geneva<br>Stockholm<br>Frankfurt | Hong Kong<br>Mumbai<br>Seoul<br>Shanghai<br>Singapore<br>Sydney<br>Taipei City<br>Tokyo |
| **1,300+**<br>Portfolio managers, investment specialists, traders and research analysts* | **600+**<br>Strategies managed on our Spectrum platform[6] | **2,500+**<br>Annual onsite company visits[6] |

Source: J.P. Morgan Asset Management; as of 31 December 2022.
*JPMAM employee in location. [6] Data is updated annually; as of 30 December 2022.

## The role of active ETFs in asset allocation

- Passive and active ETFs can complement each other by providing an attractive balance between risk and return.
- Passive as well as active ETFs share similar risks in terms of performance, since both investments might go down as well as up in response to the performance of individual companies or general market conditions.
- Active ETFs introduce higher tracking error risk, but they can help investors generate alpha for a portfolio alongside core passive holdings. Active ETFs can also be used for tactical allocations at different times through the market cycle.
- Looking at the Trackinsight Global ETF Survey 2024, it is clear that investors are increasingly using active ETFs to replace or complement passive allocations, and also as a substitute for active mutual funds or direct investing.

**Have you ever used an actively managed ETF to replace...?**




Source: TrackInsight Global ETF Survey 2024.

## J.P. Morgan Asset Management: Advancing the potential of ETFs

- J.P. Morgan ETFs are rigorously designed to push the boundaries of ETF investing so that investors can build diversified, competitively priced portfolios.
- J.P. Morgan Asset Management launched its first UCITS ETF in November 2017. Since then, we have brought many innovations to the ETF market – from our successful Research Enhanced Index Equity strategies which now consists of ten ETFs, to the launch of the industry's first active China equity and UK equity ETF, as well as a UCITS global equity version of the world's largest ETF. Our active ETF solutions tap directly into our global investment capabilities and the expertise of our specialist investment teams.
- J.P. Morgan Asset Management is the number 1 provider for active ETFs in the UCITS space and one of the largest globally.[7] We have also been named "Best Active ETF Provider (USD 500 million +)" by ETF Express and got awarded "Best Active ETF" at the 2023 ETF Stream Awards.

**Past performance is not a reliable indicator of current and future results.**

[7] Source: Bloomberg as of 31 December 2023.



### The J.P. Morgan ETF platform

**170bn+ USD** global Assets under Management and more than **80 ETFs** globally

**#1 active UCITS ETF provider**

**25bn+ USD** Assets under Management in UCITS ETFs

**30+ UCITS ETFs** with over 70 share classes across 5 currencies

**Largest active** UCITS ETF range

Active ETF of the Year (JREU)
ETF Stream Awards 2023

Best Active ETF Provider 2024
ETF Express European Awards

**Past performance is not a reliable indicator of current and future results.**

Source: J.P. Morgan Asset Management, Bloomberg as of 27 March 2024, ETF Express.

## Notes

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