# ETF Buyers Club

**The ETF Buyers Club is a community for investors active in the world of ETFs and is the first peer-related group of its kind. Each month, a member of *ETF Stream*'s ETF Buyers Club will analyse some of the most important issues facing ETF investors**

# How and why we use ETFs in portfolios

Active-passive debate similar to Messi-Ronaldo GOAT arguments

**By Julien Serbit**

ETFs have marked a turning point in the asset management industry over the last 30 years. Investing money is a clearly different art since the emergence of ETFs and more widely this has introduced a new way of considering financial markets.

Let us avoid the never-ending debate between passive and active investment. It can be compared to the obsession of nominating the greatest player of all time (GOAT) in a sport like football.

We can easily find common characteristics between portfolio construction – especially multi-asset ones – and team sports. Therefore, as Messi has different features than Ronaldo, active and passive products should not be opposed in a portfolio construction process but associated.

That is clearly the way most independent wealth managers construct portfolios for private clients. Mixing both active and passive products in the implementation of an investment strategy is allowing portfolio managers to justify their fees with, in the same time, not taking the risk on relying exclusively on a selection of external active managers.

Taking the client's point of view is a good way to understand this process: accessing financial markets is something easy in 2023 and tons of financial information is available for free. Therefore, giving a discretionary mandate to a bank or to an independent wealth manager is more and more justified to benefit from tactical asset allocation through the different phases of the economic cycles.

## Nimble and low-cost

From this standpoint, ETFs are a perfect tool to get exposure to bonds and equities, with the certainty to deliver the market's performance at low fees. On the other side, active managers have the ability to outperform markets and, at the end of the day, that is the main goal of the vast majority of private clients.

That is why I am convinced that ETFs are key in the portfolio construction process and must be used as a flexible tool to implement tactical asset allocation. Especially on the equity side, the very large range of ETFs available allows portfolio managers to play almost every market, sector and theme they want. The offer is quite comparable on fixed income where the available universe of bond ETFs is providing portfolio managers with all the duration, rating, country or bond type they want.

**"After an exceptional growth phase over the last 30 years, the future still looks bright for the ETF industry and passive investing in general"**

All in all, we can say the ETF industry has reached a point where every portfolio manager has the opportunity to implement a part of their investment strategy passively without suffering from any kind of constraints in terms of product's availability or fees.

However, all ETFs are not made equal and as we do for active managers, due diligence is required when it comes to selecting a passive vehicle. I would say that the same criteria that apply to active funds are relevant such as asset under management (AUM), tracking difference, fees and a complete understanding of the underlying strategy – especially the replication method used by the ETF in question.

After an exceptional growth phase over the last 30 years, the future still looks bright for the ETF industry and passive investing in general.

The initial belief of a complete shift towards a full passive investment era seems behind us and many money managers and private clients are


aware of the use case for combining active and passive products in a diversified portfolio. The growing importance of the tactical asset allocation, especially since 2020, is highlighting the strength of ETFs in terms of nimbleness at low cost.

## What is next for the ETF industry?

However, many new ideas and opportunities are yet to be explored. The first to come in mind – and the most debated over the recent years – lie in the field of cryptocurrencies.

The saga concerning the potential launch of the first spot bitcoin ETF is far from over and I would not bet against some credible passive investment products tracking the largest cryptocurrency's performance appearing in the coming years.

Another potential future development for the industry could be on specific vehicles that allow investors to take directional exposure with a leverage. We can also mention the recent launch of the long and short Jim Cramer ETFs which are to be taken with a pinch of salt but reflect the idea that the universe of passive products is only limited by the provider's creativity.

Last but not least, the ongoing technological evolution in digitalisation or artificial intelligence will continue to fuel innovation and to enlarge the scope of possibilities for ETF in terms of replication or new index creation.

After years of very accommodative monetary policy across the globe and unprecedented liquidity injections, the assets pooled in passive vehicles have reached levels that would not have been conceivable a decade ago.

Some giant players have emerged with a significant impact on the whole financial markets. As of today, and compared to banks or active managers, the ETF industry managed to avoid large failure or scandals. This is certainly a point to highlight as investors' confidence is central to financial markets. However, it is wise to keep in mind that ETFs are not magical instruments immune to any type of default or technical problems.

Diversification is also recommended in the type of financial products invested in a portfolio and that is why passive and active products should be combined both in terms of portfolio construction and risk control.

In other words, the creativity and innovation deployed on financial instruments must not push good old investment principles into the background. ETFs are not an exception to the common sense required by portfolio management.

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