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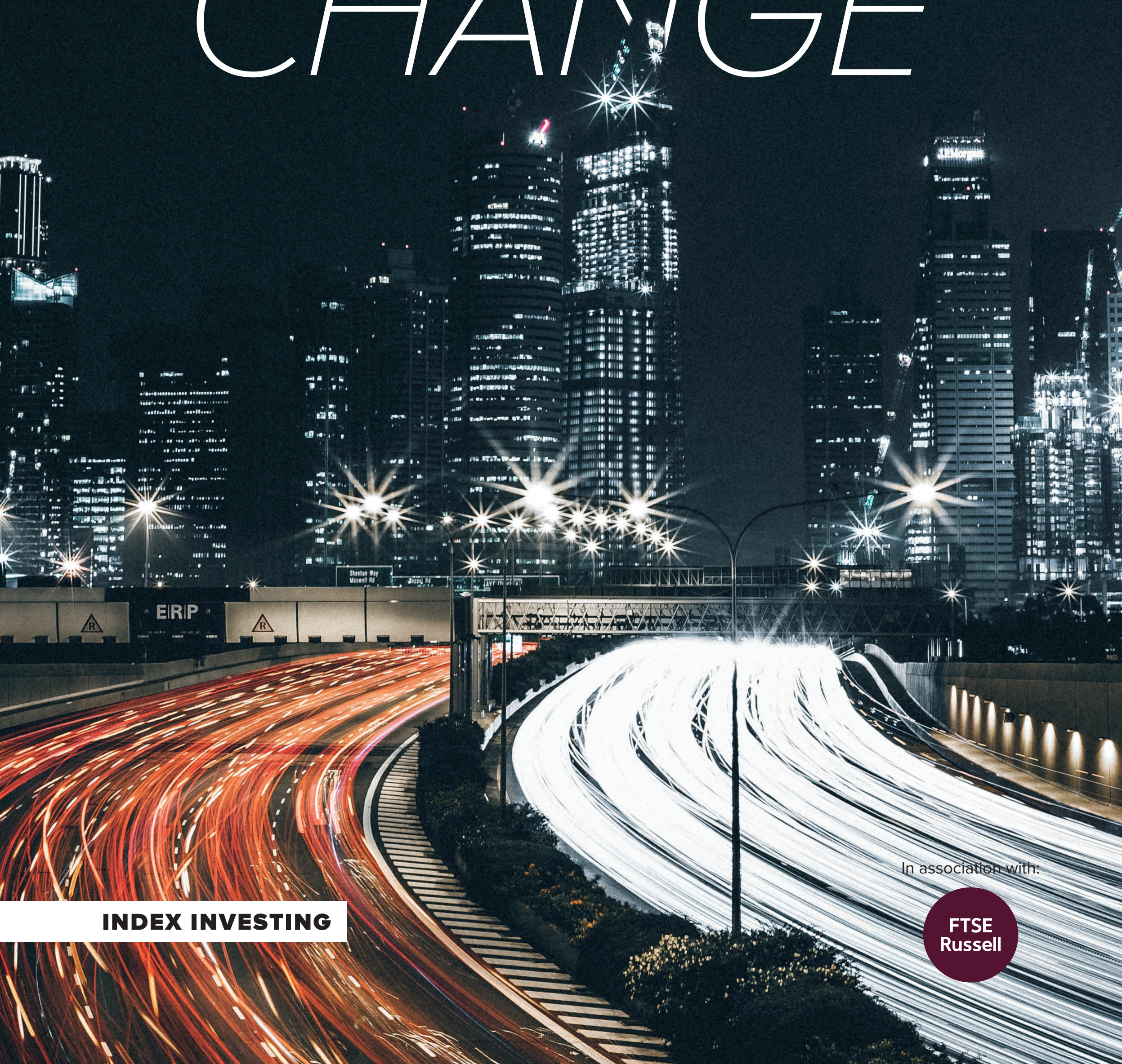
ROUNDTABLE

DRIVING CHANGE



INDEX INVESTING

In association with:

FTSE Russell

SHIFTING UP

The ETF industry is in constant flux. Since the debut of the first US ETF in 1993, these products have revolutionized and democratized the way people invest.

However, as ETFs evolve and new products get launched every day, investors need to be armed with the right tools to make better decisions for their portfolios.

This is especially true as new areas such as smart beta and thematic investing go mainstream, suggesting that there is still room for innovation. Competition among fund management players is heating up too, leaving many products behind or forcing them to close.

Given that this is such an important time for the index investing industry, FTSE Russell recently hosted a roundtable debate in New York, with ETF heavyweights sharing their views on how the market is developing.

From looking at the factors that investors should take into account when performing due diligence, to the emergence of costless ETFs and gauging the merits of ESG investing across indices, this supplement explores some of the most important trends in index investing and provides key insights into how the market is set for the future.

DELEGATES

ROLF AGATHER

Rolf Agather is managing director of North America research for global index provider FTSE Russell, part of the London Stock Exchange Group (LSEG). He joined the group in 2014 when it acquired Russell Investments. In his current role, Agather is responsible for leading the team that creates new index concepts and publishes compelling research on capital markets, indexation and investment management. He was previously the managing director of research and innovation for the Russell Indexes division of Russell Investments. He was instrumental in the creation of the Russell Global Indexes in 2007 and he continues to lead research and innovation in the field of index investing.

PETER BRAUDE

As a senior research and due diligence analyst in the traditional investments group at US Bank Wealth Management, Peter Braude provides investment manager due diligence, supports the enhancement of the research platform and selects products for new wealth management offerings. His specific areas of responsibility include serving as an asset class specialist on domestic growth equity products and the ETFs platform. He has more than 10 years of experience in the financial services industry, providing manager research, asset allocation and client services. Prior to joining US Bank, he was an investment analyst for a family office and a large banking institution.

MARIANA BUSH

Mariana Bush is a research director for Global Manager Research (GMR), a division of the Wells Fargo Investment Institute. The GMR team selects and oversees the third-party money managers used throughout Wells Fargo's brokerage, private banking, family wealth and retirement businesses. Bush began her career at Furman Selz in New York as an associate analyst following technology companies long before the internet became a fixture in everyone's lives. She joined the firm in 1991 as an analyst in investment strategy and has remained steady through five legacy firms following mergers and acquisitions over almost three decades. Bush first took on coverage of exchange-traded products in the late 1990s.

ED McREDMOND

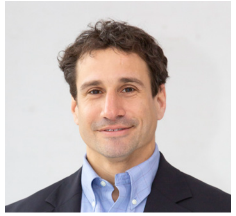
Ed McRedmond is the founder and managing principal of etfEd Advisory and has more than 20 years of experience in the ETF industry. His firm provides consulting services to existing ETF providers and others looking to enter the ETF space, with a focus on sales and distribution strategy. He previously spent 11 years at Invesco PowerShares as senior vice president of ETF Institutional & Portfolio Strategies. Prior to that, he was a senior analyst at AG Edwards & Sons (now Wells Fargo Advisors), covering ETPs and serving as a member of the allocation advisors investment committee overseeing the CAAP ETF portfolios. McRedmond was named an 'ETP Icon' at the Annual Global ETF Awards.

KRISTEN MIERZWA

Kristen Mierzwa joined FTSE Russell in March 2008 to work with asset managers that offer ETPs. Her role involves partnering with clients to design various alternative and cap-weighted indices for ETPs. Mierzwa has more than 20 years of experience in the financial industry, having started her career at Barclays Global Investors (now BlackRock). Since joining FTSE Russell, she has been involved in the development and design of various indices, such as the JP Morgan Diversified Factor Index Series, the FTSE Global Factor Index Series and the FTSE OFI Dynamic Factor Index Series. Most recently, she has developed the FTSE Index-Level Composite Index Series, which includes the new suite of 150/50 indices.

TOM PSAROFAGIS

Tom Psarofagis is an ETF analyst at Bloomberg Intelligence. Prior to joining Bloomberg, he held roles in the ETF groups at both OppenheimerFunds and IndexIQ. He previously worked in product development at Nasdaq, where he helped to create innovative indices for ETF sponsors. He attended the University of Connecticut, where he earned his bachelor's degree in finance. He is a Chartered Market Technician and a member of the Market Technicians Association.

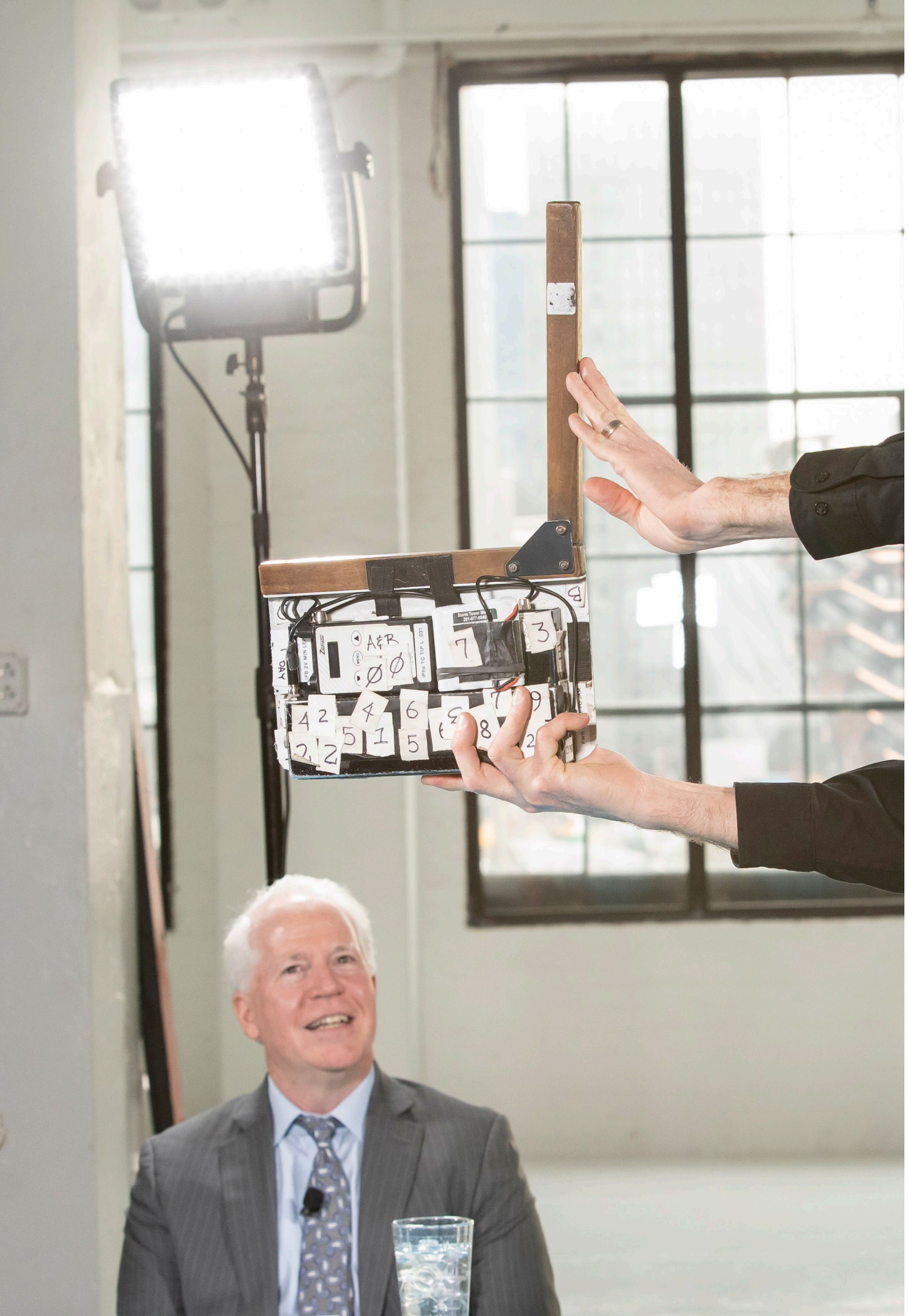


EVAN RATNOW

Evan Ratnow, director and head of third-party fixed income strategy at Citi Private Bank, is responsible for traditional investment manager research and due diligence. The global team sources third-party investment managers for the various advisory and non-advisory programs available to Citi Private Bank clients. Ratnow joined Citi in 2010 as an investment manager research analyst, primarily responsible for research coverage of US-based domestic and international fixed income managers. Prior to joining Citi, Ratnow was a portfolio officer at Lockwood Advisors, responsible for the investment oversight of Lockwood's Advisorflex™ mutual fund/ETF wrap portfolio series. He is a CFA charterholder.

VICKY GE HUANG

Vicky Ge Huang is a reporter at Citywire USA. She writes for Citywire's US biweekly *Professional Buyer* magazine aimed at investment gatekeepers. She joined Citywire in 2017.



GETTING UP TO SPEED WITH ETF SELECTION

A lot has changed since the first ETF was launched in 1993. Despite starting with little traction among investors and not picking up until after the recession, ETFs and index funds have transformed the investment landscape and have become the number-one disruptor affecting active managers.

And the numbers speak for themselves. By 2008, US investors had put $531 billion into ETFs. That figure hit $1 trillion in 2010 and has jumped to more than $3.4 trillion today. As the number of products continues to grow and diversify across asset classes and sectors, fund pickers and gatekeepers may soon be spending almost as much time analyzing ETFs as they do examining traditional mutual funds, if not more.

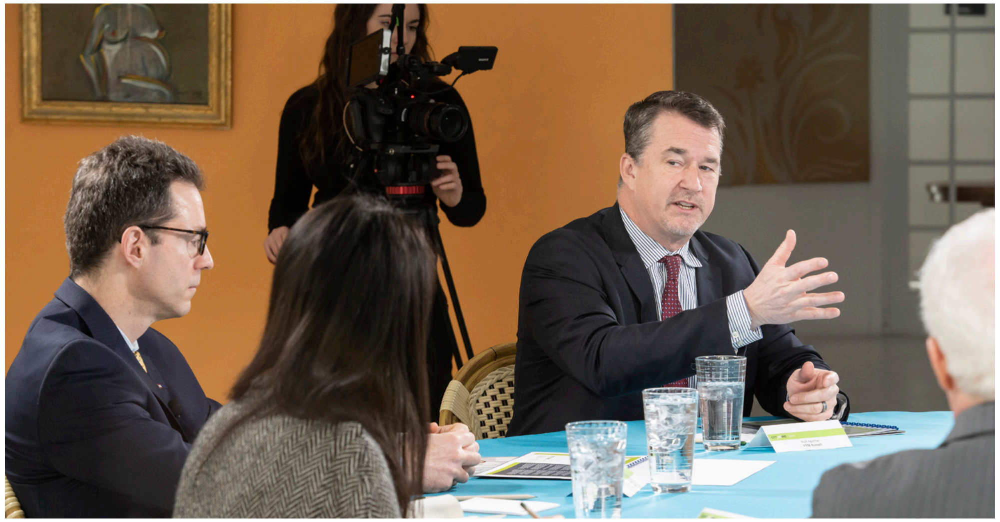
With the number of new ETF launches per year now regularly exceeding 200, FTSE Russell recently gathered a number of industry experts for a roundtable discussion in New York to consider which factors they take into account when selecting ETFs, and how to make the most of the available data in their research.

FINDING WHAT COUNTS

Analysts can use a range of different metrics to weigh up ETFs. After assessing why a certain exposure is needed in a portfolio, ETF peer group comparison tends to follow as the first port of call.

One advocate of this approach is seasoned ETF expert Mariana Bush, research director for the Global Manager Research team at the Wells Fargo Investment Institute. She argued that it is important to dissect ETFs' underlying holdings.

'Often, you have two or more ETFs that are apparently similar,' she said. 'Usually, one is not necessarily better than the other, but the critical question is, "What are the characteristics in



this particular ETF that are most desired by that specific client?"

'Taking a closer look at the underlying index and its exposures is critical. Small differences in exposure may result in larger divergences in performance.'

Fees and an ETF's tracking error against its benchmark index are also high on most analysts' checklists. 'Something that should be taken into consideration is the index, and the ETF should match whatever index the investor is seeking to replicate,' said Evan Ratnow, director and third-party fixed income strategy head at Citi Private Bank.

'So, for example, if we look at an asset allocation model that calls for a certain large-cap index, I would probably seek that same index in an ETF format. In my opinion, investors should want to try to avoid tracking error between a policy benchmark and an ETF.'

Peter Braude, the vice president of the traditional investments group at US Bank, agreed, adding that the track record and credibility of the index provider are also important parts of his decision-making process.

SHOW ME THE MONEY!

Does size matter when it comes to backing an ETF? Many investors tend to think that a passive fund should have at least $25 million in assets under management to be economically viable, as that sort of scale would enable an ETF to meet any redemption requests quickly, while simultaneously reducing costs and enabling it to trade at higher volumes.

But Tom Psarofagis, an ETF analyst at Bloomberg Intelligence, said that those who filter ETFs by size risk missing out on some good opportunities. 'When you just use a simple AUM screen or volume screen, I think as an investor, you're doing yourself a pretty big disservice because a lot of the ETFs are not going to meet that screen.

'If let's say 85% of ETFs don't meet that screen, you're screening out a big universe. There could be a lot of interesting products in that 85% that are all getting screened out. So I don't like when someone says the ETF is not big enough or it doesn't trade enough.'

That said, cutting out the smaller ETFs can help to avoid some unsuccessful products. 'Screening for asset size, which is a very simple metric, helps you to stay away from the "throw spaghetti on the wall" ideas that may sound very unique and interesting, but that actually have no legs,' Bush argued.

EDUCATION EMERGENCY

In the ETF industry, consistency of information is often called into question when it comes to indices and fund comparisons. Issues have also been raised around the lack of data for products' underlying exposures, and gatekeepers have called for more education in the sector.

The first source of these transparency problems is a product's marketing material. 'Some of the ETF factsheets may have a sector breakdown, but they don't necessarily state which index provider that is according to,' Bush said.

'When I was looking at the sector breakdown for an ETF recently, according to one index provider it was all in financials, but according to another index provider it was all real estate. I wouldn't necessarily say that one way was better than the other, or that one was right and the other was wrong, but let's make it easier for investors to understand these differences.'

Another way to improve the due diligence process would be to make data available spanning multiple market cycles rather than just a few years.

Ed McRedmond, founder and managing principal of etfEd Advisory said: 'I've run into it with a lot of strategists, where they need that data to do their modeling. I can think of one who was an equity strategist doing a sector rotation model. He said to me, "I use one particular sector ETF product, just because it has all the historical data. With less established indices, you're going to get five, maybe 10 years of data, and it's useless – I can't do any in depth modeling with that."

Even when data abounds, the panelists lamented the lack of guidance on how to use it or read it effectively.

This is particularly true for products such as smart beta ETFs, where, for example, there is little indication of performance projections for the factors that the fund targets, Ratnow noted. 'There's a ton of products and some good research, but I think there is something of a disconnect when it comes to how we should use it. I think that gets in the way a lot.'

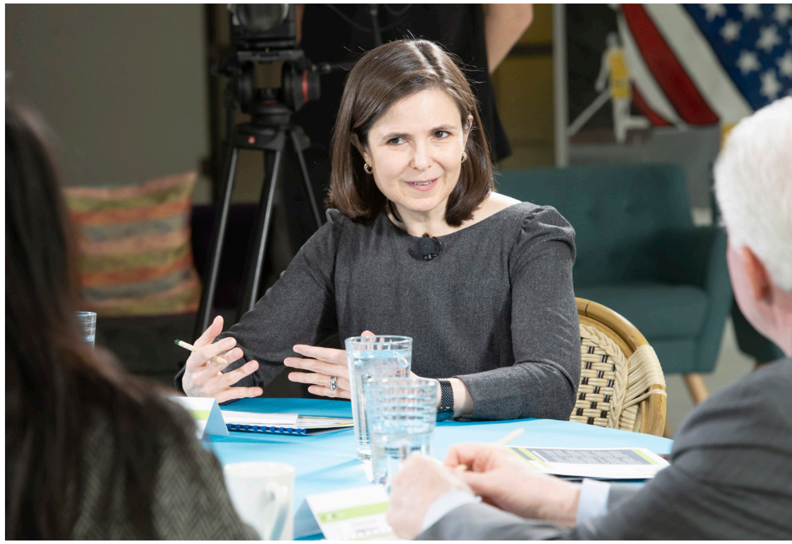
So where do index providers stand on this need for more education? While scale can affect the creation and distribution of informational content for an index provider, FTSE Russell strives to provide the full range of data on its funds to help clients make informed decisions.

'Transparency is really important,' said Kristen Mierzwa, managing director of ETP strategy and business development at FTSE Russell. 'We do sit on a lot of data, and we want to share that with everyone.

'We can share that data with the ETF issuer and with the end client so they can evaluate it better, along the lines of, "Does this make sense for the objective that I have in front of me?" A lot of data is out there that people don't know about.'

Rolf Agather, managing director for North American research at the index provider, added that FTSE Russell has been simplifying its research to make it more accessible, as well as engaging consistently with clients.

'I actually work in the research team and I would say that we have two key functions. One is obviously to build the products. That's a big part of what we do. The research team is really doing a lot of the work to create these indices and the methodologies, but another big part is the education process,' he said. 'We're always looking for ways that we can take the content that we are creating and the education that we do produce and find ways to get that out into the investment community.'



WHAT TO WATCH OUT FOR

With more than 2,000 ETFs on offer in the US alone, doing research on them has never been more overwhelming. From deciding whether a certain ETF is the right product for a client, to understanding the underlying exposures, there are many elements that need to be taken into account in the due diligence process. Here's a checklist of some of the factors to consider when performing ETF due diligence.

INDICES AND ETFs

- How long has the index or ETF existed?
- What are its objectives?
- Which sectors, companies and countries is it exposed to?
- How often does it report its holdings?

ETF STRUCTURE

- What is the investment approach?
- What are the top holdings?
- What index methodology does the ETF follow: market capitalization, fundamentally weighted, price weighted or equal weighted?
- What are the ETF's assets under management?
- Does the ETF lend securities?
- How is that risk managed?

COST

- What is the expense ratio?
- What are the trading commission and average bid-ask spread?
- What is the tracking error?
- How are all the costs managed?
- What is the total cost of ownership?

FUND PROVIDER

- How much experience does the firm have in ETFs?
- How much is the company involved in investor education?
- Does it support advisors?
- How good is the firm's relationship with index providers?
- How does the firm manage risks?
- What are the firm's total assets under management and ETF AUM?

LIQUIDITY

- What is the ETF's average daily volume?
- How does the ETF maintain liquidity?
- How does the fund's liquidity react in times of market volatility?
- Does trading activity cause big price swings?

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ROLF AGATHER
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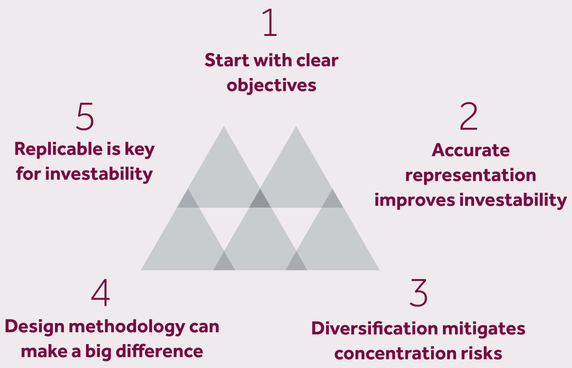
THE KEY TO AN ETF'S POWER? AN "INVESTABLE" INDEX

It is imperative that ETF product developers as well as fund selectors and analysts in the wealth space grasp how index selection can impact an investment product's ability to meet its objectives.

What makes an index investable?
Before embarking on any journey for an exchange-traded product, providers must consider core index construction tenets that serve as a strong foundation for investability.

1: Start with clear objectives
From the outset, ETF providers must define a clear vision of their goals, such as enhancing return, lowering volatility, or achieving targeted factor exposure(s). Then product providers and index engineers work together to map all the requirements and characteristics of an underlying index. Best practice is to design that index with a long view toward investability, ensuring the original objectives can be maintained over time.

Example: The Russell 1000 Index has the objective of tracking the top 1,000 US equities by market cap.



2: Accurate representation improves investability
It is important to assess indexes from multiple angles—not just market performance. An index that effectively represents a market does so by delivering an unbiased, complete view of the market or market segment it is designed to measure. This is only accomplished through the application of objective, transparent construction methodology. Arbitrarily excluding opportunities available to market participants can impact the weights of index members. Differences in weights and returns can impact index performance.

The introduction of constraints can be a useful safeguard against any unwanted extreme positions. In other words, an investable index must be "true-to-label."

Example: The Russell 3000 Index represents the top 3,000 investable stocks in the US stock market.

3: Diversification mitigates concentration risks
To achieve the original objectives, any index runs the risk of becoming overly concentrated. Naturally, its design can get biased toward a style resembling active management relative to the market capitalization of the benchmark. Ensuring appropriate levels of diversification within an index can mitigate potential sector, country, or stock-specific concentration risks.

Example: FTSE Global RIC Capped Indexes were built to help investors meet concentration and diversification requirements.

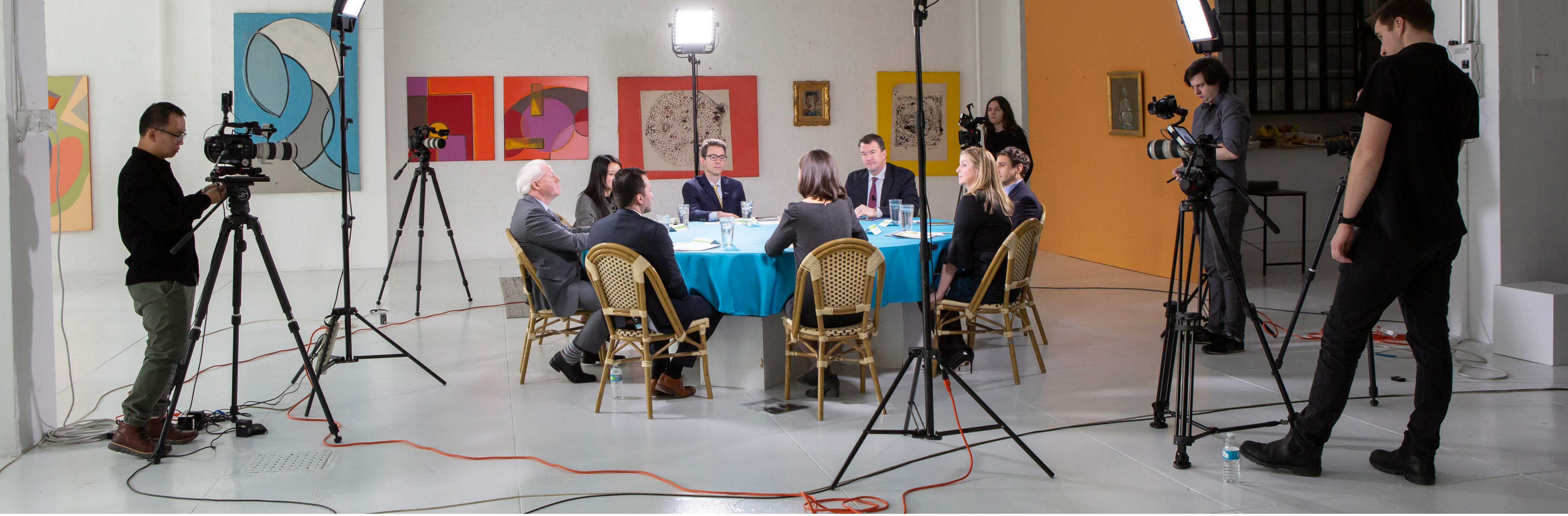
4: Design methodology can make a big difference
Index providers differ in their build methodologies. Each brand brings their own toolkit to design for particular objectives. In the process, trade-offs are made along the way: targeted factor exposure vs diversification, simplicity vs complexity, etc.

Investability relies on the most efficient methodology that most closely meets the stated objectives.

Example: FTSE Fixed Income Indexes are designed to appeal to a broad range of market participants and are widely followed by the investment community

5: Replicability is key for investability
A popular criticism of the latest generation of indexes (e.g. smart beta) is they rely on theoretical academic analysis and on back-tested data to simulate attractive performance outcomes. Investability relies on practical, real-world implementation issues; i.e., an investment product replicating the index can be traded in the market efficiently, and at a high capacity. Index design addresses many questions, such as: Can the fund manager trade the number of stocks? Is that market segment liquid enough? What's the turnover and likely trading costs? The most investable indexes are tempered by reality.

Example: The Russell 2000 Index aims to accurately measure the performance of the small cap segment of the US equity market



THE ROAD TO ZERO

In the midst of the financial crisis, South Africa-based Old Mutual Global Index Trackers launched the first 'zero cost' ETF in the US market. The fund tracked emerging markets and was seeded with $60 million. It only survived a year before being forced to close by 'market volatility' and a lack of sufficient market share.

Fast forward almost 10 years though, and the picture is very different. Over the course of 2018, the zero-fee fund war rapidly headed toward a tipping point. Fidelity is currently in pole position, having launched two index funds with no management fees, attracting around $1 billion into the two portfolios a month on from the announcement.

In a similar move, low-cost fund giant Vanguard removed trading costs from its direct platform across 1,800 of its ETFs to win more business. Other fund houses such as JP Morgan and BlackRock followed suit by cutting costs on their already cheap passive funds.

In February, riding the trend of the past few years, lending startup Social Finance – an unexpected rival to giants such as Vanguard – announced the launch of two no-fee ETFs, together with other products. The move may suggest that the shift to fee-free ETFs is not just a publicity stunt by the bigger players, but a genuine change.

NO FREE LAUNCH

However, the participants at the recent FTSE Russell roundtable viewed Social Finance's move with some skepticism. For example, Tom Psarofagis, an ETF analyst at Bloomberg Intelligence, said that it is important to look closely at the prospectus of any ETF claiming to be zero-cost to make sure consumers understand other costs that may be involved and whether the firm is engaged in securities lending.

When an ETF is marketed as free of charge, the product might in fact be lending out its securities to other parties, usually hedge funds, to get a collateral return in stock or cash. In effect, this approach stands to generate extra revenue, which can help fund managers to reduce the ETF's costs and improve returns.

'Free sounds great, but I'm a little bit wary sometimes when I hear "free" because they have to be making money somehow,' Psarofagis said. 'It can't just be free – it can't be a free lunch.'

Ed McRedmond, founder and managing principal of etfEd Advisory, argued that costless ETFs are mainly intended as marketing tools for firms such as Social Finance.

'I remember at one stage Harvard's endowment owned a couple of ETFs – one for emerging markets equity and one for India. It also owned a more expensive one, and you ask them, "Why do you own this one? It's twice as expensive." They said, "Because we can offset the entire expense ratio and make a few basis points by security lending the ETF."'

Whatever the source of extra revenue, Peter Braude, vice president of the traditional investments group at US Bank, said that it is 'reasonable' for wealth managers and asset managers to continue to reduce fund fees going forward.

However, on marketing a free fund, he said: 'To me it's similar to an old-school grocery store that offers coupons for laundry detergent or paper towels. It gets you in the store and then hopefully, you will buy some of the higher-margin products. To me, that's the direction.'

Despite the level of skepticism regarding free ETFs, fund buyers will still look favorably upon these cheap vehicles when it comes to allocating for clients.

'As long as it checks all the other screens that we would require it to, great. But we wouldn't say we're willing to sacrifice A, B and C because it's

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free,' Braude said.

'It would maybe just be embedded as part of all the other screens that we handle, but I would say lower fees are generally preferable to higher fees. Clients generally appreciate that.'

MRI, X-RAY AND CT SCAN

But how important is cost when it comes to assessing an ETF? If a couple of ETFs are tracking the same index, it makes sense to concentrate on cost as the next step, the panelists said.

However, priorities change when ETFs have different exposures to themes or sectors. Elements such as spread and tracking error need to be taken into account alongside the cost of owning the product.

'There is a lot of value add to analyzing the index and the exposure,' McRedmond explained. 'So if you're just buying something because it's giving you a zero expense ratio or free trading, you might be doing yourself a disservice, unless you're choosing among literally identical products.'

Cost can indeed derail analysts' judgment, noted Mariana Bush, director of global manager research at the Wells Fargo Investment Institute. For example, on one small-cap dividend-focused ETF which sounded 'plain vanilla,' Bush found that there was in fact a substantial exposure to real estate investment trusts, which she wouldn't have noticed at first glance.

'I'm not necessarily saying that it's good or bad, but you need to be aware of these exposures which might not be obvious at first,' she said. 'It's much more important, figuratively speaking, to do an MRI, an X-ray and a CT scan on the index to find out the exposure and understand what you are holding.'

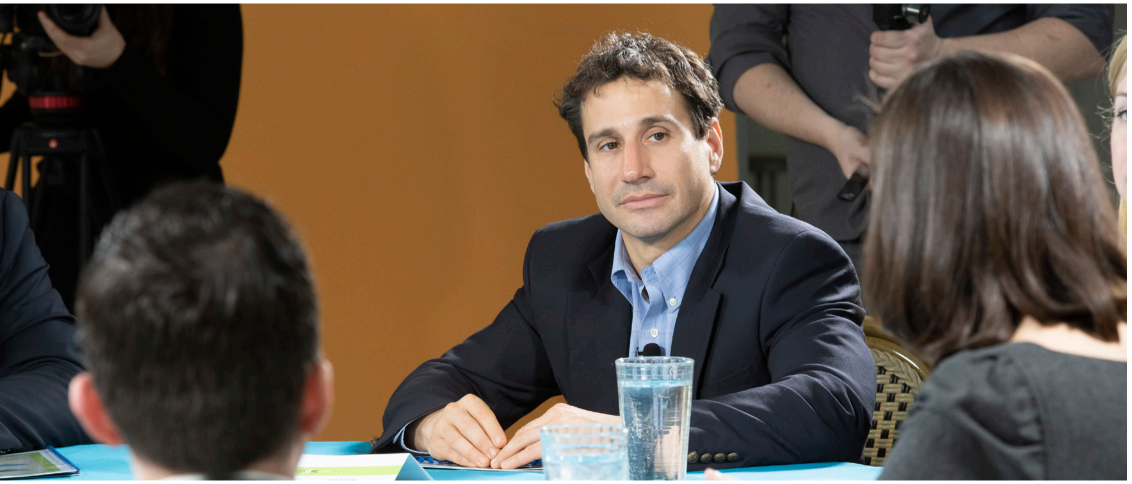
Rolf Agather, managing director for North American research at FTSE Russell, argued that it is paramount for the firm to focus on transparency for both the principles and the governance of the indices any time they are rebalanced.

'Transparency is one way that we can help give people some comfort as more and more assets go to passive. That's why it is important to know if there are other index methodologies that are less transparent.'

Fee compression also risks working against the industry. For example, managers may need to use currency hedging on some products, which will inflate prices and therefore make a product less attractive, especially if it's usually much cheaper than others.

Kristen Mierzwa, managing director of ETP strategy and business development at FTSE Russell, said: 'We don't have a lot of emerging market, market cap-weighted hedged products, and that's because people say it's too hard to hedge the emerging currency. I'd have to throw that into the expense ratio and then no one would buy it because it looks too expensive.

'All this fee compression forces us not to have the choice and the options that we could have out there. Ultimately, we'll pay for it.'



THE ETF JOURNEY

ETFs have transformed the investment landscape and made investing accessible to everyone. As demand increases, so does innovation. New products are being created every day. Here we look at how the ETF industry has evolved over time and what the market looks like for investors today.

1993 – First ETF in the US
ETFs were originally used by institutional investors to cover more sophisticated trading strategies. Just a few years later, ETFs started to become mainstream among advisors and individual clients. The first ETF, the SPDR S&P 500 ETF, is now the largest investment fund in the world, with $100 billion in assets.

2002 – First bond ETF
As bonds were mainly available over-the counter (OTC) for sophisticated investors, the first bond ETF was an important milestone for the industry. Regulators and index providers needed to adapt to the standardization of ETFs and find a way to trade bonds on stock exchanges. Exchange trading meant that bond ETFs were more liquid than OTC bonds.

2003 – First smart beta ETF
'Smart beta' refers to the use of an alternatively weighted methodology instead of the traditional market cap, which is based on the size of the companies in the index. Smart beta indices are also different than traditional ones as they have a series of rules-based screens – or factors – for selecting which companies make the cut. Companies are weighted based upon these factors, such as volatility or momentum.

2004 – First gold ETF in the US
At a time when ETFs were still a new story, the first gold ETF was launched in the US. The SPDR Gold Trust, a physically-backed gold fund, was the first ETF to allow allocation to the precious metal.

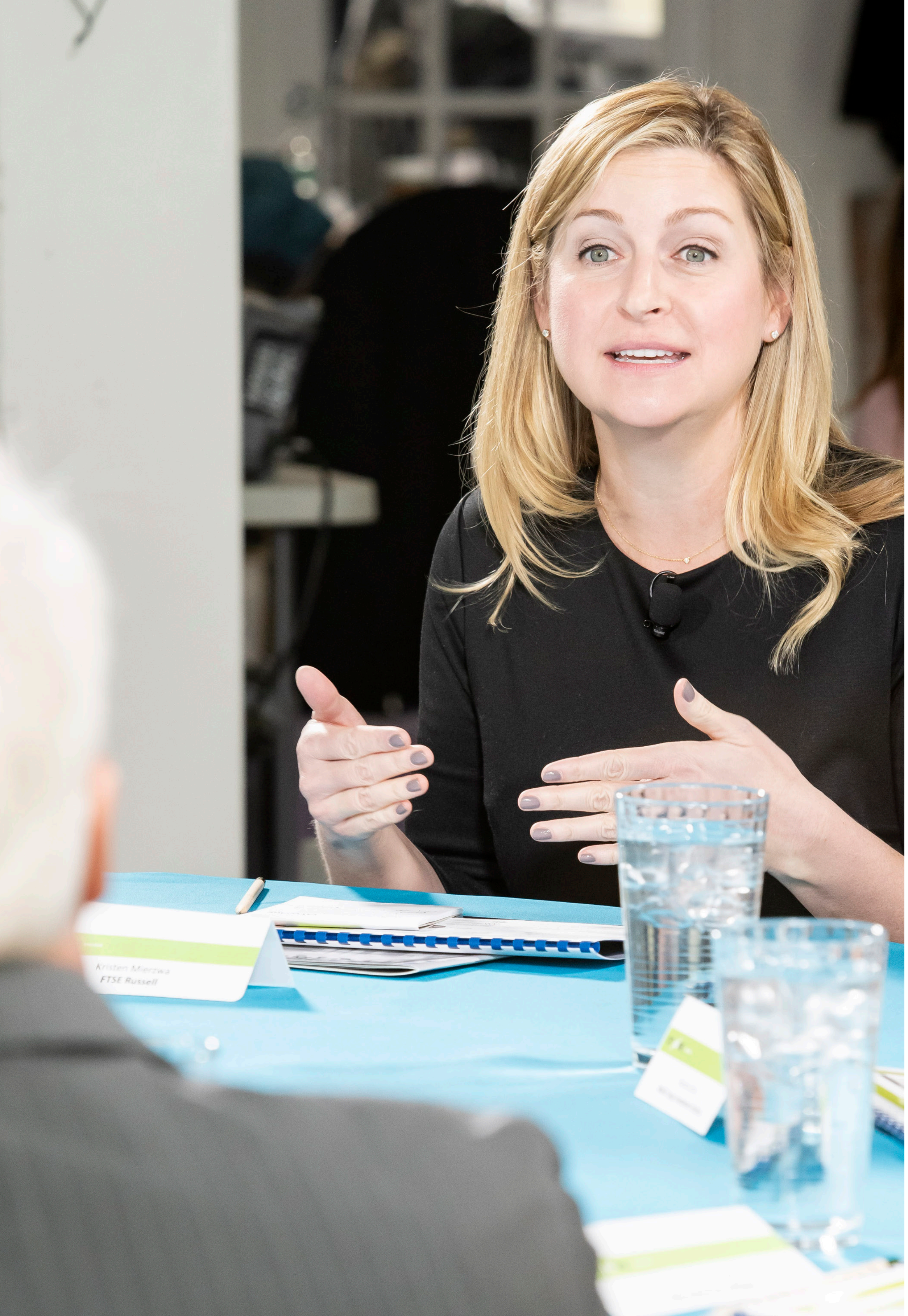
2008 – First active ETF
The first active ETF, the Bear Stearns Current Yield fund, was approved by the Securities and Exchange Commission in 2008. Active ETFs give fund managers the opportunity to adjust the portfolio as needed without being subject to the rules of an index. However, these funds remain a small portion of the US ETF market.

2010 – ETFs reach $1 trillion in assets
In the aftermath of the financial crisis, investors turned to ETFs as a more transparent and cheaper way to access the market. More than 1,000 ETFs populated the US market in 2010, hitting the $1 trillion mark.

2018 – Growth of ESG ETFs
Funds giant BlackRock has estimated that assets in ETFs incorporating ESG factors are set to grow from $25 billion to more than $400 billion over the next decade. However, most of the assets that use an ESG approach remain concentrated in the hands of active investors. There are still concerns that ETFs too often fail to capture the companies with the best ESG credentials accurately.

2018 – First 'free' ETF fund
In 2018, Fidelity Investments claimed to have launched the first free ETF following a long-standing fee war among passive providers. Early in 2019, lending startup Social Finance announced the launch of two no-fee ETFs, pushing fund giants such as Vanguard to follow suit by cutting their already low fees on a number of funds. This may be the beginning of a new era for ETFs...

Sources: Morningstar, BlackRock, Vanguard, ETFGI.com, ETF.com and etfdb.com.



GEARING UP FOR ETF INNOVATION

In April 2018, Rob Arnott, the man commonly credited with creating the notion of smart beta, told CNBC that the term no longer has any meaning.

'It has been stretched to encompass just about everything formulaic, with the result that a lot of dumb ideas are being called smart beta,' he said. 'It now spans just about everything, so the term effectively means nothing.'

And while smart beta might be developing a new identity, other areas of index investing are still cementing their role in an increasingly overcrowded market. Fixed income, for example, is often named as a particularly underresearched area in index investing, lagging behind equities.

Equally, the industry is divided on whether the emerging ESG phenomenon will take off in index investing.

At the recent FTSE Russell roundtable in New York, index investing experts were invited to answer these questions and more, while considering how providers can help investors to navigate the latest market changes.

THE SMART BETA CONUNDRUM

Smart beta funds have recently experienced a boom in flows. However, smart beta remains a misunderstood term within the industry and leaves many wondering whether the strategy can really bear fruit.

Evan Ratnow, director and third-party fixed income strategy head at Citi Private Bank, argued that one of the limitations for smart beta lies in its definition, which can be confusing, especially for the end client.

'Smart beta is anything that is not traditional cap-weighted beta. So you can change your weighting any which way and it becomes smart beta, which gets a little confusing. I don't know whether it's smarter necessarily or just a different way of doing it.'

As the industry evolves, many think the term smart beta will simply be replaced by 'factor investing,' which advisors might find easier to explain to clients when it comes to building a portfolio.

'Advisors would rather have multi-factor products available where at least there's some professional organization behind deciding what weight is being given to factors such as minimum volatility or quality,' said Ed McRedmond, founder and managing principal of etfEd Advisory.

Meanwhile, the panelists argued that a lack of understanding of the structure of an index could lead to a misallocation to sectors when it comes to smart beta strategies.

Rolf Agather, managing director for North American research at FTSE Russell, said that providers can help investors to manage their index exposures and reduce the tracking error of an ETF without denting its performance.

'We're probably not as explicit about it as we could be that when we're making a change, it's to improve either the exposure – the representation we're trying to accomplish – or the investability of a particular index. It's not because we're trying to fix a performance problem that we've observed,' Agather said.

Overall, the rise in smart beta-like indices and more esoteric products could serve as a way to measure a fund manager's ability in the future, experts said.

Tom Psarofagis, an ETF analyst at Bloomberg Intelligence, said: 'It's really going to screen out the managers that were maybe just jumping outside the benchmark and that's how they were beating it, not actually adding any value. We'll see more of these products come out.'

BONDS LAG BEHIND

They might have performed better than their active counterparts in the big market selloff last year, but fixed income ETFs still find it hard to compete against core bond funds.

In fact, fixed income ETFs still make up a small fraction of the entire passive funds universe, despite their rise in popularity.

'Until passive can consistently demonstrate competitive peer group returns, I think you'll have a hard time getting traction in passive vehicles,' Ratnow said.

However, he argued that fixed income ETFs might get more traction if they cover more niche areas of investments such as floating rate notes, which can be used as a tactical allocation.

Innovation in indices is also going to be beneficial for bond ETFs in the long term and will raise the bar for active funds, which will have to do more than just add duration or high yield to beat the benchmark.

But from the perspective of index providers, the challenge for fixed income ETFs remains related to their very nature, which is markedly different to their equity counterparts, as seen in aspects such as carry.

Agather said there is still a lot to learn about the asset class, including how index methodologies would work in practice for bonds as opposed to equity ETFs.

'There's a lot that we have to do in the fixed income space, but it is different and we recognize this. We're keen to make sure we don't just assume that what we did in equity will work the same in fixed income.'

DEMYSTIFYING ESG

There are still uncertainties on what ESG investing really means among active managers, and the story is no different for index investing. The panelists at the roundtable agreed that while ESG is very popular, it is still in its infancy.

For example, they said that data is one of the main issues when it comes to ESG. Despite some improvements in data collection and the increasing use of artificial intelligence to gather better quality information on companies, there is still a lack of transparency in the process.

Kristen Mierzwa, managing director of ETP strategy and business development at FTSE Russell, said that providers can help fill the gaps in the data companies report, especially smaller companies.

'We're not there yet with data transparency, so it's hard to build an index with ESG screens. It's really, really tough, but we're getting there.'

Because of the lack of a set framework in ESG investing, index providers could also dig more into the themes and qualities of each of its pillars – environmental, social and governance – to create better products, FTSE Russell suggested.

Performance is yet another issue when it comes to ESG. For example, many investors believe that adopting ESG strategies always comes at a cost. Mierzwa said that one way to overcome this myth is to have clearer conversations with clients and explain in detail why a certain ESG exposure might affect performance.

However, Ratnow argued that an ETF might not be the best way to invest with an ESG approach. 'For investors trying to avoid a specific company, a non-commingled vehicle is a solution. To do so with a commingled fund would be a lot harder than working with a separate account manager and saying, "Don't buy companies A, B and C."

'You can really easily meet the goals, but with a commingled fund, you're always going to be held up against the benchmark. If you underperform it, your clients are not going to be happy, most likely.'

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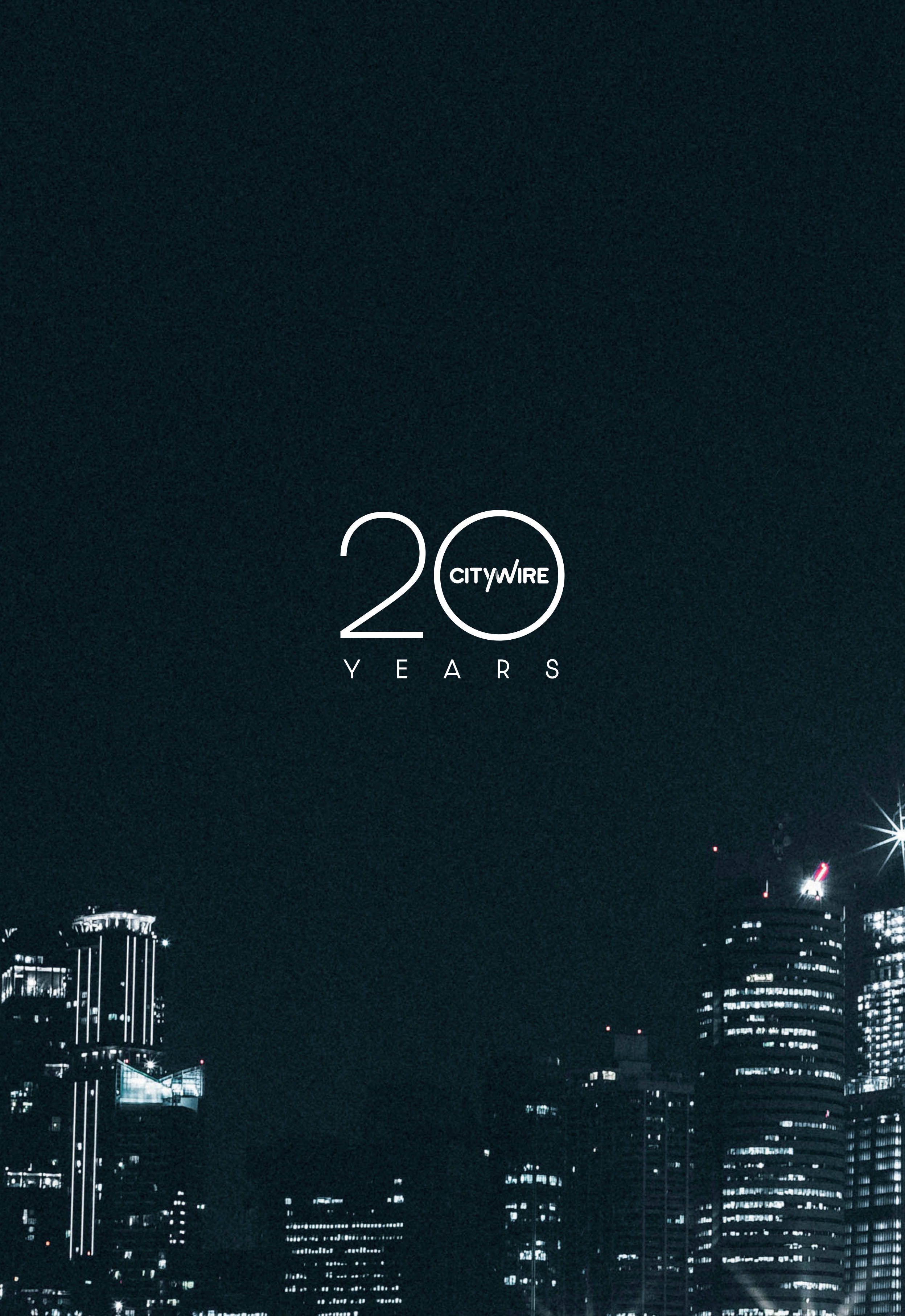
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