



ETF Liquidity

June 2020



Agenda

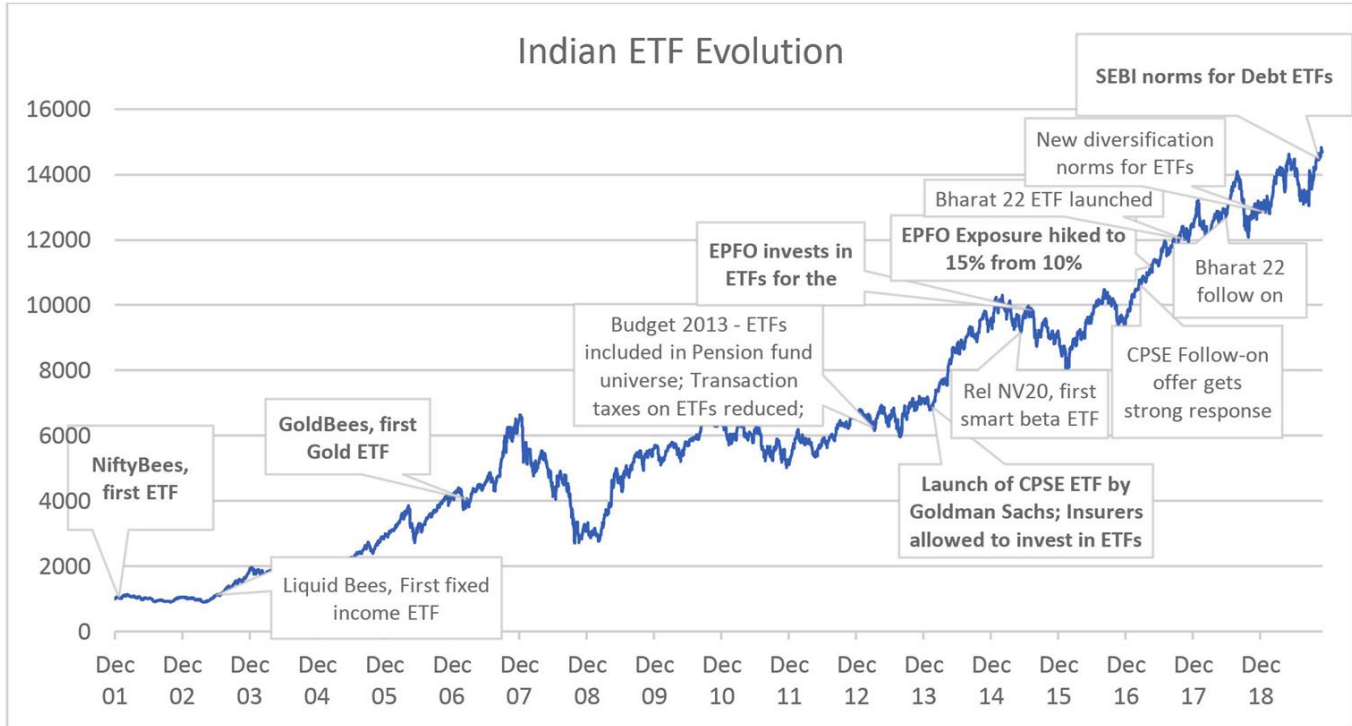
Liquidity

- Is there a liquidity issue in Indian ETFs?
- What are the causes and can we do about it?
- Does it matter for retail investors?

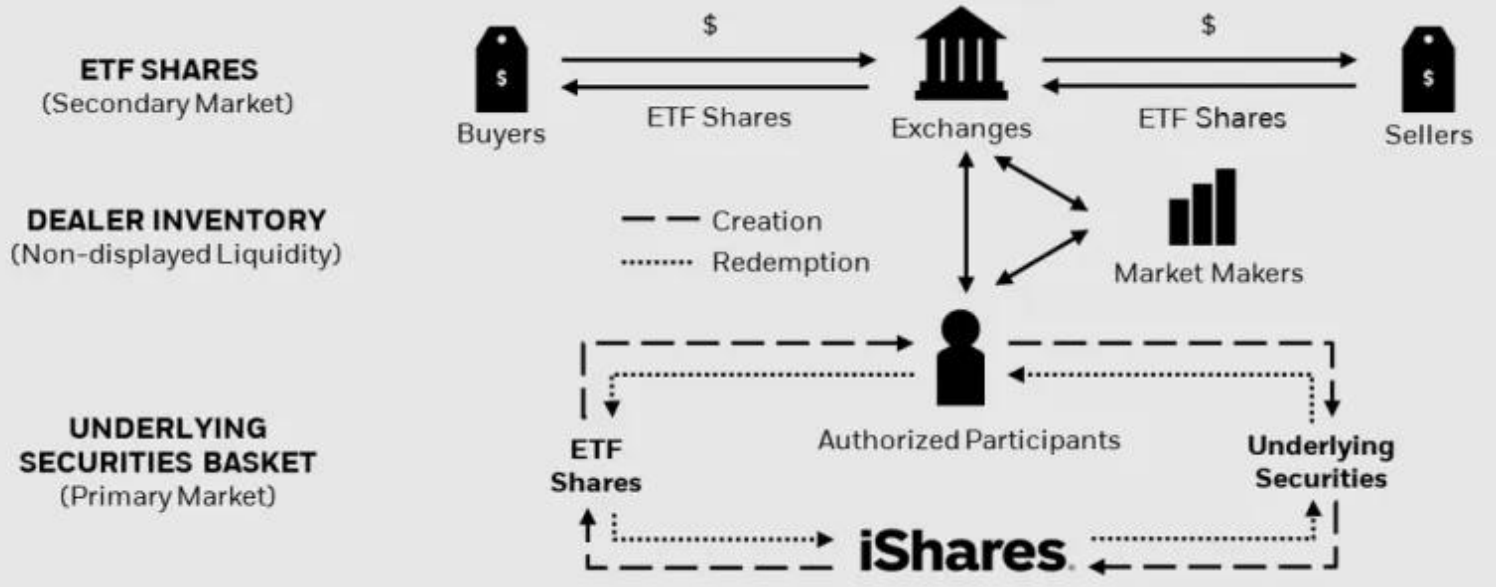
Building portfolios with ETFs

- Are enough ETFs available to build portfolios?
- How can new technology/services help?

ETF evolution in India



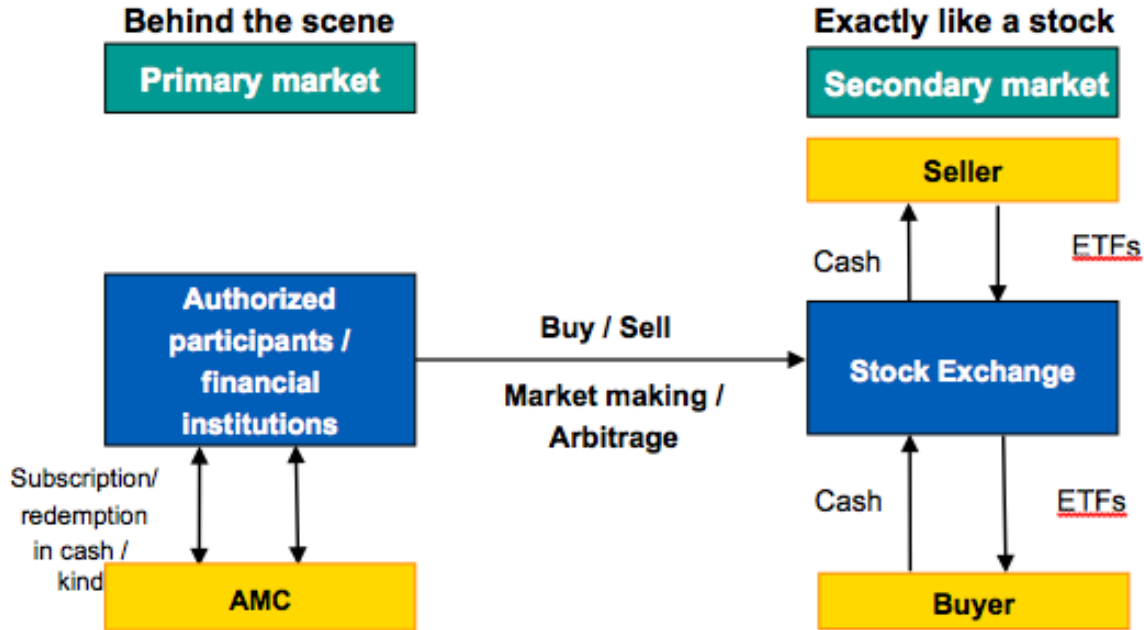
ETF basics - global



Source: BlackRock

<https://blogs.cfainstitute.org/investor/2020/03/30/dispelling-the-misperceptions-three-ways-etfs-benefit-financial-markets/>

ETF basics - India



ETF basics - India

Live quotes on NSE

Quote As on Nov 13, 2019 10:54:46 IST

NIPPON INDIA ETF NIFTY BEES
 Series: EQ | Symbol: NIFTYBEES | ISIN: INF732E01011 | Status: Listed | Market Tracker

1,261.00	Pr. Close	Open	High	Low	Close*
▼ -3.91 -0.31%	1,264.91	1,270.00	1,270.00	1,260.31	-

Trade Snapshot	Company Information	Peer Comparison	Historical Data
VWAP: 1,262.53 Face Value: 10.00 Traded Volume (shares): 6,466 Traded Value (lacs): 81.54 Free Float Market Cap(Crs): - 52 week high: 1,288.58 (07-NOV-19) 52 week low: 1,047.00 (03-OCT-18)	Print Order Book Intra-day Chart Stock V's Index Chart Quarterly Charts	Buy Qty. Buy Price Sell Price Sell Qty. 1 1,260.90 1,261.00 36 1 1,260.30 1,261.44 51 20 1,260.10 1,261.55 430 12 1,260.05 1,261.76 18 15 1,260.02 1,262.20 200 2,07,273 Total Quantity 1,43,466	

Real-time NAV on AMC site

Scheme Name	Current NAV	Previous NAV	% Change
Nippon India ETF Hang Seng BeES	3039.4585	3119.4919	-2.57 %
Nippon India ETF Infra BeES	336.0556	335.8223	0.07 %
Nippon India ETF Junior BeES	296.1261	295.0109	0.38 %
Nippon India ETF PSU Bank BeES	268.6825	270.8713	-0.81 %
Nippon India ETF Shariah BeES	256.7522	255.5970	0.45 %
Nippon India ETF Gold BeES	3361.6773	3340.3291	0.64 %
Nippon India ETF Bank BeES	3159.8070	3176.2420	-0.52 %
Nippon India ETF Nifty BeES	1262.8233	1262.2064	0.05 %

What is the liquidity problem?

What are we calling lack of liquidity?

- Low average daily turnover volumes for ETFs?
 - High bid-ask spreads?
 - High impact costs?
 - High tracking error?
-

ETF liquidity - TE/impact?

Nifty 50 ETFs

Scheme Name	AUM (Rs. Crs)	Inception Date	Expenses		Absolute Returns (%)		CAGR (%)		Annualised Tracking Error (%)		Daily Average Volume (Rs Lakhs)		Impact Cost
			Last Update	%	3 Months	6 Months	1 Year	3 Years	1 Year	3 Years	1 Year	3 Years	
SBI ETF Nifty 50	61852	22-Jul-15	04-May-20	0.07	-17.54	-16.93	-15.13	3.19	0.19%	0.11%	387.40	164.57	0.13
UTI Nifty ETF	15044	01-Sep-15	04-May-20	0.06	-17.55	-16.94	-15.13	3.20	0.19%	0.11%	71.80	33.71	0.61
Nippon India ETF Nifty BeES	3214	28-Dec-01	04-May-20	0.05	-17.49	-16.88	-15.06	3.22	0.18%	0.11%	1422.16	810.08	0.05
ICICI Prudential Nifty ETF	1793	20-Mar-13	04-May-20	0.05	-17.49	-16.86	-15.05	3.16	0.33%	0.20%	353.27	182.34	0.16
Kotak Nifty ETF	1002	02-Feb-10	04-May-20	0.14	-17.54	-16.97	-15.21	3.09	0.19%	0.11%	205.55	134.95	0.21
LIC MF ETF - Nifty 50	452	20-Nov-15	04-May-20	0.10	-17.46	-16.83	-14.99	3.18	0.31%	0.19%	0.72	0.42	2.51
HDFC NIFTY 50 ETF	394	09-Dec-15	04-May-20	0.05	-17.53	-16.93	-15.14	3.17	0.19%	0.12%	22.18	10.79	0.50
Aditya Birla Sun Life Nifty ETF	166	21-Jul-11	04-May-20	0.05	-17.50	-16.88	-15.06	3.06	0.28%	0.31%	0.85	0.58	1.40
Mirae Asset Nifty 50 ETF	149	19-Nov-18	04-May-20	0.07	-17.69	-17.05	-15.13	NA	0.30%	NA	21.51	NA	0.23
Tata Nifty Exchange Traded Fund	125	03-Jan-19	04-May-20	0.07	-17.46	-16.83	-14.91	NA	0.25%	NA	9.38	NA	1.36
Motilal Oswal M50 ETF	25	28-Jul-10	04-May-20	0.05	-17.67	-17.06	-15.32	2.58	0.31%	0.21%	5.67	3.97	0.73
Indiabulls Nifty50 ETF	11	30-Apr-19	04-May-20	0.12	-16.90	-16.33	-14.50	NA	0.41%	NA	1.25	NA	5.39
Quantum Nifty ETF - Growth	6	10-Jul-08	04-May-20	0.09	-17.58	-16.99	-15.24	0.54	0.20%	4.17%	1.19	1.05	0.69
Axis Nifty ETF	6	03-Jul-17	04-May-20	0.15	-17.51	-16.89	-15.08	NA	0.26%	NA	2.02	NA	1.28
Invesco India Nifty ETF	2	13-Jun-11	04-May-20	0.10	-17.52	-16.92	-15.10	3.14	0.20%	0.13%	0.19	0.35	3.25
Edelweiss ETF - Nifty 50	2	08-May-15	04-May-20	0.07	-17.51	-16.90	-14.99	3.35	0.21%	0.17%	0.82	1.08	4.49
IDFC Nifty ETF	1	07-Oct-16	04-May-20	0.06	-17.05	-16.47	-14.70	3.27	0.62%	0.38%	0.25	1.56	5.42
	84242												
Benchmark Index													
Nifty 50 TRI					-17.31	-16.70	-14.88	3.33					

ETF liquidity - TE/impact?

Nifty Next 50 ETFs

Scheme Name	AUM (Rs. Crs)	Inception Date	Expenses		Absolute Returns (%)		CAGR (%)		Annualised Tracking Error (%)		Daily Average Volume (Rs Lakhs)		Impact Cost
			Last Update	%	3 Months	6 Months	1 Year	3 Years	1 Year	3 Years	1 Year	3 Years	
Nippon India ETF Junior BeES	1089	21-Feb-03	04-May-20	0.15	-14.44	-15.56	-12.17	-2.01	0.15%	0.24%	280.77	152.30	0.15
SBI ETF Nifty Next 50	438	20-Mar-15	04-May-20	0.15	-14.50	-15.66	-12.26	-2.03	0.04%	0.11%	59.47	23.07	0.35
UTI Nifty Next 50 ETF	322	04-Aug-17	04-May-20	0.15	-14.46	-15.57	-11.98	NA	0.05%	NA	3.80	NA	1.88
Aditya Birla Sun Life Nifty Next 50 ETF	60	17-Dec-18	04-May-20	0.05	-14.58	-15.83	-12.24	NA	0.84%	NA	3.86	NA	2.17
Mirae Asset Nifty Next 50 ETF	31	24-Jan-20	04-May-20	0.14	-14.58	NA	NA	NA	NA	NA	NA	NA	0.31
ICICI Prudential Nifty Next 50 ETF	29	23-Aug-18	04-May-20	0.15	-14.79	-15.99	-12.67	NA	0.40%	NA	44.01	NA	0.85
	1969												
Benchmark Index													
Nifty Next 50 TRI					-14.47	-15.59	-12.15	-1.74					

ETF liquidity - causes?

Market structure

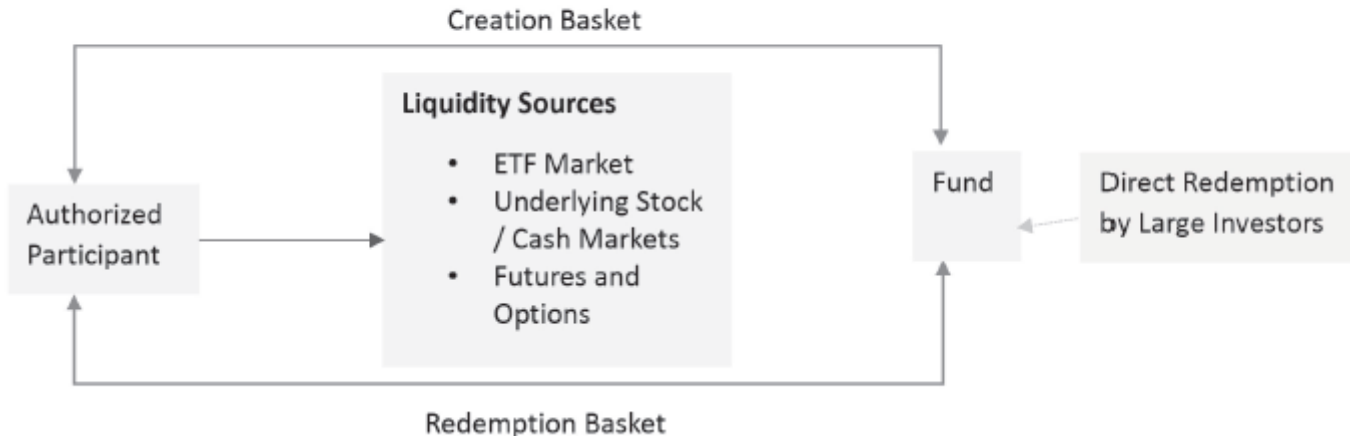
- Average daily trading volumes of ETFs vs stocks
- Role of Authorised Participants (AP) and Market Makers (MM)
- Trading & settlement?
- Securities lending & borrowing
- Futures & options

Market practice

- Product design issues
 - Disclosure of iNAV and eNAV
 - ?
-

Causes - direct redemption?

Chart 2d.1: How Indian ETFs work – Primary Transactions



Causes - market making?

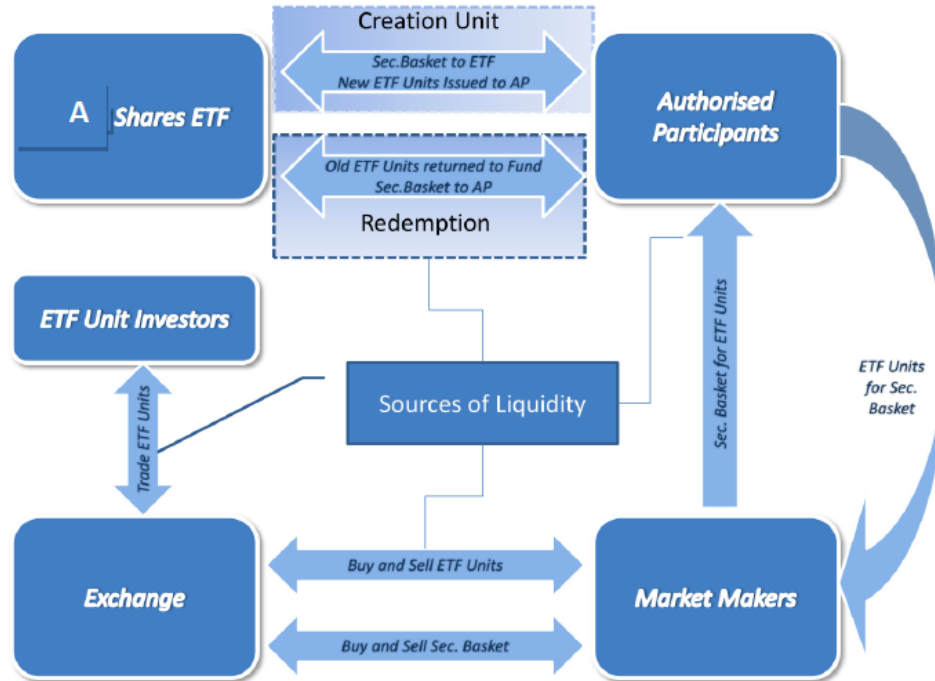
In any case, there aren't many APs / market makers to support an ETF. A typical US ETF has over 34 Authorized participants, with 5 active APs at any time. Even small ETFs (<\$27M) have 2 active APs (Antoniewicz & Heinrichs, 2015). Although large Indian ETFs may have about 5 APs, few are active at any time and reasonably large limit-orders may take hours to clear absent a vibrant secondary market.

Given thin volumes, the market making costs are (unsurprisingly) high. Whenever market makers receive any substantial trade from investors it is typically one sized and they don't have offsetting orders. Hence, they have to go to the ETF manager for liquidity in lot increments. The major costs that the market maker experiences in this regard are:

- Cost of hedging: Market maker provides ETF units on Day T+0 whereas the units from the fund house are received on day T+1 in case of a buy trade.
- Cost of funds: The market maker has to provide funds to the fund house for unit creation on T+0 while the funds from the investor are received only on T+2
- Cost of carry: Any fractional units of lots that are not accepted by the investor has to be carried by the market maker because the liquidity in secondary market is so low.

We interviewed 2 out of the 3 largest market makers in the Indian markets and they mentioned that anecdotally the charges for these come to about 10 bps for each leg of transaction over and above normal transaction charges.

Causes - basket creation process?



Source: Anubhav Srivastava's ETF liquidity and index funds

Causes - diversification?

While SEBI does not have an equivalent automatic listing process for ETFs, it came out with its portfolio diversification norms for Equity ETFs in January 2019 and Debt ETFs in November 2019, described below:

1. Equity ETF: Minimum 10 stocks; Max Single stock exposure capped at 25% weight; Weight of top 3 stocks capped at 65%.
2. Debt ETF: Minimum 8 issues; Single exposure issuer capped at 15%; Only investment grade.

In theory, defining such outer boundary for portfolio construction by regulations helps spur product innovation. However, in practice, the resultant portfolios that adhere to these norms could still be very concentrated. For example, CPSE ETFs comprise of 10 stocks dominated by energy and materials sectors, with the top 4 stocks accounting for nearly 80% of portfolio weight. The allocation to CPSE ETF by Employee Provident Fund Organization (EPFO), which has otherwise been conservative with its equity allocation, is perceived as problematic.

ETF liquidity - recommendations

Market structure

- Liquidity enhancement schemes
- Role of Authorised Participants (AP) and Market Makers (MM)
- Securities lending and borrowing
- Futures & options
- Stamp duty on ETFs

Market practice

- Phase out direct redemptions?
 - ?
-

Building portfolios

Variety of ETFs

- Fixed income ETFs may aid price discovery
- What's missing?

New technology & services

- Technology such as smallcase, WealthDesk?
 - Model portfolio services
 - Investor education (do ETFs pay 2bps charge? if so, are passive investors paying for 'education' of active investors?)
-

Building portfolios

www.themoneyhans.com

<https://youtube.com/themoneyhans>

**WHAT ARE
EXCHANGE
TRADED FUNDS?**



Discovery
Understand
Pick
Invest



Invest
Lumpsum
SIP
Rebalance
Grow
Withdraw



Control
Real Time Tracking
Instant Funds
Exit Anytime

<https://aver.wealthdesk.in/>

Conclusion - have we resolved...

Liquidity

- Is there a liquidity issue in Indian ETFs?
- What causes it and can we do about it?
- Does it matter for retail investors?

Building portfolios with ETFs

- There are now educational, model portfolio and execution services available for investors