Vanguard ETF quarterly report

December quarter 2019

In this edition:

- Australian ETF market AUM surpassed $61b.
- Record industry cash flows in 2019 of $13.7b compared to $6.4b in 2018 and $8.0b in 2017.
- Vanguard attracted $5.1b in cash flow, with total AUM growing to $19.5b, making 2019 Vanguard's strongest year on record.

Economic and market year in review

Anyone following the financial media in late 2018 could have been tempted to steer clear of risky assets, only to watch painfully from afar the stellar performances on financial markets recorded throughout 2019.

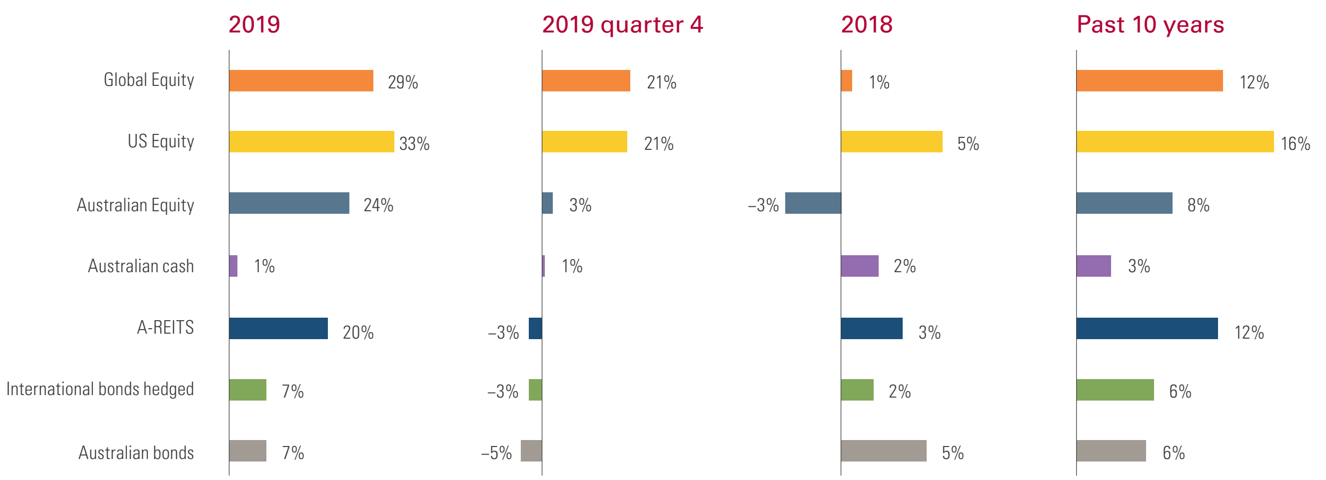
The last quarter of 2019 was no exception to this global market rally, with markets continuing to soar on the back of some stabilisation in the global manufacturing data and more positive news around Brexit talks and US-China trade negotiations.

While a rally did not materialise locally as gains were capped by profit-taking at year-end, full-year returns in equity markets above 20 per cent still stand in stark contrast to prior years, where global annualised returns have averaged around 10 per cent since the Global Financial Crisis (Figure 1).

Central bank accommodation on interest rates had no small role in orchestrating such a strong rally last year, with more than half of global central banks easing monetary policy in 2019. The Reserve Bank of Australia was no exception to this and cut rates by a further 0.25 per cent to 0.75 per cent in October.

The easing of monetary policy benefited fixed income securities, though gains were pared back somewhat towards the end of 2019 as expectations for further easing waned amidst the modestly improving economic landscape.

Figure 1. Global investment performance



Notes: All returns are annualised. Global equity represented by MSCI AC World in AUD, US equity represented by S&P 500 in AUD, Australian equity represented by S&P/ASX 300 Index, Australian property represented by the S&P/ASX 300 A-REIT Index, Australian bonds by the Bloomberg AusBond composite 0+ Yr Index, International bonds by Bloomberg Barclays Global Aggregate Index Hedged in AUD, and Australian cash by the Bloomberg AusBond Bank Bill Index. Data is through December 2019.
Source: Factset and Thomson Reuters Datastream.

With markets on average stronger last year than in 2018, some have seen this as an opportunity to pile more money into risky assets, without being aware that they may be making the same mistake as they did in late 2018 – this time in the opposite direction.

The bullish reflation theme many are banking on for 2020 may prove to be deceptive. There is a risk that financial markets are getting ahead of themselves and are pricing in too much optimism for what remains largely uncertain outcomes.

Australian ETF Update

Cash Flow

The Australian ETF market had its best quarter on record in Q4 2019 attracting $4.8b. The strong flows followed $4.3b in Q3 and pushed the total ETF cash flow in 2019 to a record $13.8b, surpassing the previous record of $8.1 billion received in 2017. In Q4 investors favoured international equities (31.1 per cent) over Australian equities (25.6 per cent), which was a consistent theme over the 12 months.

$13.8B

Total ETF cash flows for 2019

The asset class that attracted the most investor cash flow in 2019 was global equities (27.1 per cent), followed by Australian equities (23 per cent), Australian fixed income (21.1 per cent) and global fixed income (7 per cent). Vanguard continued to attract the most cash flow across the industry, with 37 per cent of total cash flow going into Vanguard ETFs.

AUM

Australia's ETF market AUM grew to $61.5b as at 31 December 2019. Inflows of $5.1b saw Vanguard's ETF AUM grow to $19.5b from $12.1b as at 31 December 2018. In 2019 the Vanguard Australian Shares ETF (VAS) became the largest ETF in the market, attracting more cash flow than any product listed on the Australian Securities Exchange (ASX) with $939m, and finished the year with a total of $4.6b in AUM.

Performance

All 29 Vanguard ETFs finished with positive returns in 2019. The average one-year total return of Vanguard's ETFs was 19.1 per cent. US and global equities were the best performing ETFs over the 12 months, with the Vanguard Total US Stock Market ETF (VTS) up 31.04 per cent, followed closely by the Vanguard Ethically Conscious International Shares Index ETF (VESG, 29.4 per cent), which outperformed the Vanguard MSCI International Shares (VGS, 28.4 per cent). The best-performing fixed income ETF in 2019 was the Vanguard International Credit Securities Index ETF (AUD hedged) (VCF, 9.95 per cent), compared with the Vanguard Global Aggregate Bond Index ETF (AUD hedged) (VBND, 7.63 per cent) and the Australian Government Bond ETF (VGB, 7.61 per cent).

Industry cash flow by asset class

	Quarter	
Asset class	($m)	%
Australian Equity	1,233	25.6
Global Equity	1,500	31.1
Infrastructure	163	3.4
Australian Fixed Income	807	16.7
Global Fixed Income	501	10.4
Cash	45	0.9
Australian Property	239	5.0
Global Property	22	0.5
Commodity	172	3.6
Currency	–21	–0.4
Mixed	165	3.4
Total	**4,827**	**100%**

Source: ASX Monthly Report and Vanguard.

Industry cash flow by issuer

Issuer	Cash flow $m	Cash flow %	AUM $m
AMP/BetaShares	0.6	0.0	80.9
Beta Shares	2,877.5	20.8	8,924.4
ETFS	609.4	4.4	1,950.7
Fidante	134.4	1.0	139.0
Fidelity	47.4	0.3	62.6
InvestSMART	9.6	0.1	50.5
iShares	2,574.9	18.7	15,488.2
K2	–14.0	–0.1	15.9
Legg Mason/BetaShares	138.5	1.0	219.7
Magellan	551.4	4.0	2,373.1
Montgomery	0.4	0.0	97.7
Morningstar	11.6	0.1	11.8
Perennial	3.4	0.0	10.8
Pinnacle	11.7	0.1	26.3
Antipodes	4.1	0.0	26.8
Russell	119.2	0.9	826.2
Schroders	–5.1	0.0	52.9
State Street	101.6	0.7	6,394.1
Switzer	38.4	0.3	183.6
The Perth Mint	92.6	0.7	292.1
Platinum	53.3	0.4	536.0
UBS	0.9	0.0	301.8
VanEck	1,331.3	9.6	3,969.2
Vanguard	5,108.2	37.0	19,473.6
Total	**13,802**	**100%**	**61,507.9**

Source: ASX Monthly Report and Vanguard.

Vanguard product summary

Asset Class	ASX Ticker	Last Price #	MER (%)	Quarter Return (%)	1 Year Return (%)	3 Year Return (% p.a.)	Quarterly Cash Flow ($m)	FUM ($m)
Australian Equity ETFs								
Broad Market	VAS	85.45	0.10	0.69	23.62	10.21	363.1	4,606.9
Property	VAP	89.65	0.23	–0.81	19.30	9.46	189.0	1,703.5
High Yield	VHY	60.43	0.25	–1.29	20.53	7.00	102.9	1,382.9
Large Companies	VLC	68.61	0.20	–0.12	22.08	9.07	9.8	104.2
Small Companies	VSO	60.06	0.30	–0.04	21.67	9.90	91.1	368.3
International Equity ETFs								
Developed Markets	VGS	81.51	0.18	4.27	28.14	13.87	16.8	2,212.4
Developed (AUD hedged)	VGAD	75.20	0.21	7.50	27.03	12.11	4.9	773.5
All world Ex US	VEU	76.67	0.09	4.45	21.81	11.10	22.8	1,634.3
Total US Market	VTS	233.82	0.03	4.59	31.00	15.70	233.9	1,874.3
Developed Europe	VEQ	60.24	0.35	5.31	24.03	10.81	44.7	263.5
Asia ex Japan	VAE	69.66	0.40	6.90	17.20	12.55	66.1	195.6
Emerging Markets	VGE	71.60	0.48	7.01	19.85	10.85	68.8	368.2
Global Infrastructure	VBLD	60.27	0.47	–0.95	25.54	—	5.8	81.1
International Small Companies	VISM	55.75	0.32	5.40	26.32	—	31.5	29.9
ESG	VESG	56.75	0.18	4.90	29.17	—	31.0	71.2
Minimum Volatility – Active	VMIN	60.55	0.28	3.59	22.67	—	3.6	16.7
Global Value – Active	VVLU	51.65	0.28	5.84	20.43	—	2.3	21.5
Multi Factor – Active	VGMF	54.33	0.33	3.73	—	—	0.3	17.1
Fixed Income ETFs								
Australian Composite	VAF	51.83	0.20	–1.37	7.07	4.96	117.8	1,339.1
Australian Government	VGB	52.76	0.20	–1.65	7.40	5.06	48.0	422.4
Australian Corporate	VACF	53.18	0.26	–0.47	6.75	5.17	58.4	389.3
International Treasury (AUD hedged)	VIF	50.40	0.20	–1.59	6.09	3.71	61.7	437.9
International Credit (AUD hedged)	VCF	50.48	0.30	0.00	9.62	4.79	15.9	169.2
Global Aggregate (AUD hedged)	VBND	53.09	0.20	–0.87	7.42	—	28.7	145.8
ESG	VEFI	53.50	0.26	–0.94	6.86	—	6.7	15.3
Diversified ETFs								
Conservative	VDCO	55.56	0.27	0.51	11.98	—	21.1	101.4
Balanced	VDBA	56.73	0.27	1.30	16.08	—	46.8	226.4
Growth	VDGR	56.93	0.27	2.21	19.75	—	37.6	215.2
High Growth	VDHG	57.48	0.27	3.13	23.51	—	54.4	286.8
TOTAL							1,785	19,474

Returns assume that an investor purchased shares at Net Asset Value and does not reflect transaction costs imposed on the creation and redemption of ETF units, the brokerage or the bid ask spread that investors pay to buy and sell ETF securities on the Australian Securities Exchange. Total returns are after management costs.
Source: Vanguard and Bloomberg.

The economic and investment outlook

The global growth outlook remains subdued for much of this year and, although we see US growth decelerating below trend to around 1 per cent, our expectation is that the world's largest economy will avoid a technical recession (two quarters of negative growth). Meanwhile, we expect growth in China to drop below its 6 per cent target rate to 5.8 per cent and, in the euro area, growth will likely stay weak at around 1 per cent.

For Australia, we expect a below-trend growth rate of 2.1 per cent, with the domestic economy being cushioned to some degree by recent monetary and fiscal policy actions. The pain of trade wars and other global uncertainty has been to some degree, alleviated by monetary and fiscal policy actions. However, it is becoming increasingly clear in Australia that there are diminishing returns to further rate cuts and the overriding priority to achieve a budget surplus will likely limit the role fiscal policy plays at boosting activity in 2020. Doubts of a long-lasting trade ceasefire between the US and China, continued geopolitical uncertainty and deteriorating industrial growth have resulted in a slowdown in growth in the world's two largest economies.

Inflation in Australia, alongside the euro area and Japan, is expected to undershoot the Reserve Bank's targets. In the absence of a strong solution to boost inflation and stimulate wage growth, we see a possibility for the deployment of "QE-lite" (the injection of cash into capital markets) by the RBA or unconventional monetary policy of some form, once the cash rate hits 0.5 per cent or even lower at 0.25 per cent.

Investment markets: Subdued returns here to stay

Investors should be mindful that as global growth slows there will be periodic bouts of volatility in the financial markets, given heightened policy uncertainties, late-cycle risks and stretched valuations. Our near-term outlook for global equity markets remains guarded, and the chance of a large drawdown for equities and other high-beta assets remains elevated and significantly higher than it would be in a normal market environment. High-quality fixed income assets, whose expected returns are positive only in nominal terms, remain a key diversifier in a portfolio.

Returns over the next decade are anticipated to be modest at best. The fixed income return outlook has fallen further because of declining policy rates, lower yields across maturities, and compressed corporate spreads. The outlook for equities has improved slightly from our forecast last year, thanks to mildly more favourable valuations, as earnings growth has outpaced market price returns since early 2018.

Annualised returns for Australian fixed income are likely to be between 0.5 per cent - 1.5 per cent over the next decade, compared with a forecast of 2 per cent - 4 per cent last year. The outlook for global ex-Australia fixed income returns is slightly higher in the range of 1.0 per cent - 2.0 per cent, annualised. For the Australian equity market, the annualised return over the next 10 years is in the 4.0 per cent - 6.0 per cent range, while returns in global ex-Australian equity markets are likely to be about 4.5 per cent - 6.5 per cent for Australian investors, because of slightly more reasonable valuations elsewhere.

Over the medium term, we expect that central banks will eventually resume the normalisation of monetary policy, thereby lifting risk-free rates from the depressed levels seen today. So, broadly speaking, given our outlook for lower global economic growth and subdued inflation expectations, risk-free rates and asset returns are likely to remain lower for longer compared with historical levels.

For more information

Personal investors can transact in Vanguard ETFs through their financial adviser or stockbroker.
Our telephone service is available from 8am to 5pm, Monday-Friday AEST.

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