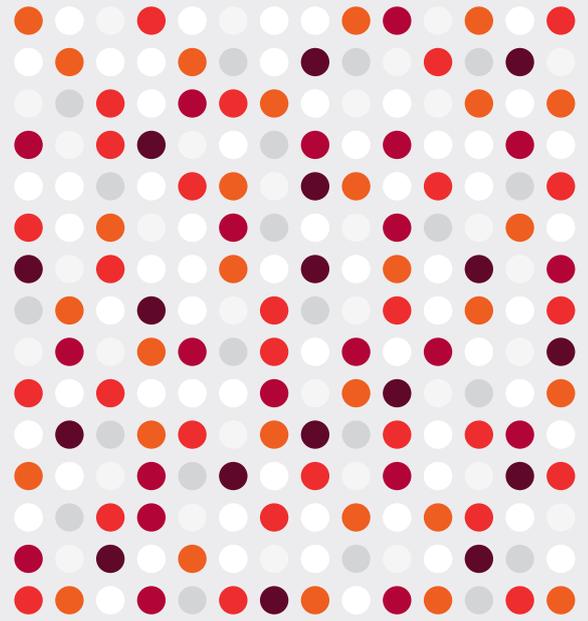


Vanguard ETF quarterly report

September quarter 2019

In this edition:

- Australian ETF market has its biggest year on record, attracting \$8.97 billion in new cash flows, with one quarter to go.
- ETF Industry AUM has grown \$15.5 billion YTD to hit \$56 billion
- Vanguard has attracted \$3.3 billion YTD, 37% of total inflows.



Quarterly economic and market review

'Uncertainty is the only certainty' was a true statement for many market watchers this quarter.

Ongoing recession risks; Britain's unclear path towards Brexit and ongoing US-China trade tensions – these are just a few of the economic questions investors grappled with this quarter. In a broad sense, the third quarter was a continuation of the uncertainty, a defining feature of the year so far.

The lack of clear answers on broad-picture questions (Brexit, US-China trade talks, etc) drove investors to seek relative 'safe haven' investments like fixed income, or bonds, over the quarter. Domestically, bond markets have returned close to double-digits so far in calendar 2019 and equities have performed strongly too, returning around 20 per cent in the year-to-date. The rise is partly due to investors reassessing their view of long-run interest rates in the world's major economies.

Central banks took more decisive action on interest rates this quarter, with the RBA making its third cut to the cash rate in five months. More broadly, downward revision to long-run policy rates was a feature of central bank behaviour in the world's major economies this quarter.

Vanguard's global economic outlook is for a more challenging and volatile environment ahead.

Locally, while the RBA's three rate cuts over the past five months should help to insulate Australia from a recession in the near-term, we are predicting a "muddle through" scenario for the domestic economy for the remainder of the year and further out in 2020.

Globally, we see a number of what we term "black swan" events on the horizon. These represent key global risks to watch, the most prominent of which are the trade and technology disputes between the US and China.

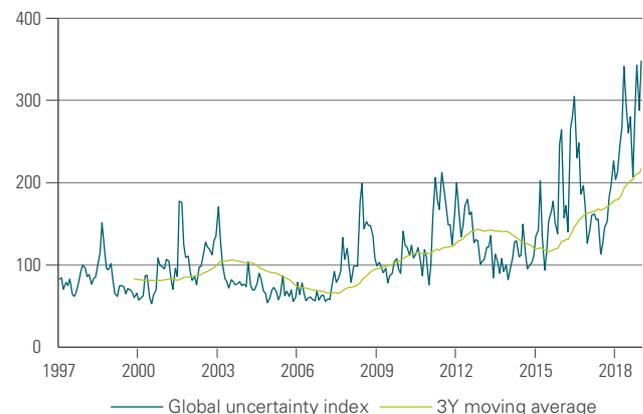
When it comes to trade talks we see little chance of a resolution between the world's superpowers. Our prediction is for a more protracted negotiation than conventional wisdom currently suggests.

In short, uncertainty is something investors should get used to in the near-term.

The chart below tells a story of just how "uncertain" markets have become when it comes to economic policy.

From this measure (**Figure 1**) we know we are indeed living through historically "uncertain" times – with this measure of "uncertainty" tracking at its highest since the last peak in 2012.

Figure 1. Economic uncertainty on the rise



Notes: The World Uncertainty Index is computed by counting the frequency of "uncertainty" (and its variants) in quarterly Economist Intelligence Unit country reports for 143 countries from 1996 onward, adjusting for scale. A higher number means higher uncertainty and vice versa. Sources: Vanguard chart, based on data from policyuncertainty.com.

Managing uncertainty poses some challenges. But a look at the performance of equities and bonds in 2019 demonstrates the power of applying investment discipline to deal with unpredictable events.

Investors who chose to stay the course this year and remain invested in bond and equity markets in the year-to-date, experienced a 20 per cent uplift in local equities and close-to-double digit returns for bonds. A sound result in a low-return environment.

The message is clear: do away with trying to predict how uncertain events may or may not unfold in favour of holding diversified assets while resisting the temptation to time the market.

Australian ETF update

The Australian ETF market had its best quarter on record attracting \$4.3 billion in the third quarter of 2019. The strong flows for the quarter pushed the full year cash flows to just under \$9 billion, already making it the best year on record (surpassing the \$8.1 billion received in 2017), with a quarter to go. Cash flows have been very evenly split across asset classes throughout 2019, with fixed income (29%), global equities (25%) and Australian equities (22%) all receiving significant inflows.



ETF new cash flows
Q3 2019

During the third quarter investors favoured domestic products, Australian equity ETFs attracted 24 per cent of total flows, while Australian fixed income attracted 21 per cent, this was ahead of global equities which received 19 per cent of total flows.

Investor caution remains a feature of markets at the moment, together the more defensive asset classes accounted for 46 per cent of total flows into ETFs this quarter (Australian and global fixed interest 27%, Cash 11%, Property 4% and Infrastructure 4%).

The Australian ETF market has already grown by \$15.5 billion (38%) this year, from \$40.4 billion at 31 December 2018 to currently \$55.9 billion. Market returns have boosted the AUM growth above the \$9 billion of cash flows.

Vanguard continues to receive the largest share of cash flows across the industry, with 37 per cent of total ETF cash flows going to Vanguard's ETFs. Vanguard enjoyed its best quarter on record with \$1.5 billion of new cash flows, with Vanguard ETF assets under management now \$17.5 billion, a growth of 45 per cent.

Industry cash flow by asset class

Asset class	Quarter	
	(\$m)	%
Australian Equity	1,030	23.9%
Global Equity	810	18.8%
Infrastructure	154	3.6%
Australian Fixed Income	916	21.3%
Global Fixed Income	245	5.7%
Cash	459	10.7%
Australian Property	165	3.8%
Global Property	32	0.8%
Commodity	368	8.6%
Currency	-24	-0.5%
Mixed	4,340	

Source: ASX Monthly Report and Vanguard.

Industry cash flow by asset class

Issuer	Cash flow \$m	Cash flow %	AUM \$m
AMP/BetaShares	-1.7	0.0	77.6
Beta Shares	2,107.6	23.5	8,067.7
ETFS	351.6	3.9	1,699.5
Fidante	79.0	0.9	83.8
Fidelity	20.4	0.2	32.3
InvestSMART	14.4	0.2	55.5
iShares	1,341.9	15.0	13,858.1
K2	-10.8	-0.1	21.8
Legg Mason/BetaShares	102.5	1.1	178.9
Magellan	352.4	3.9	2,101.3
Montgomery	4.5	0.1	97.9
Perennial	1.9	0.0	10.6
Pinnacle	10.5	0.1	24.2
Antipodes	2.8	0.0	24.4
Russell	97.4	1.1	827.8
Schroders	-4.3	0.0	53.7
State Street	183.0	2.0	6,523.8
Switzer	17.5	0.2	161.2
The Perth Mint	69.2	0.8	275.3
Platinum	49.9	0.6	503.8
UBS	-10.6	-0.1	289.8
VanEck	872.1	9.7	3,425.9
Vanguard	3,322.9	37.0	17,517.6
Total	8,974	100	55,912.5

Source: ASX Monthly Report and Vanguard.

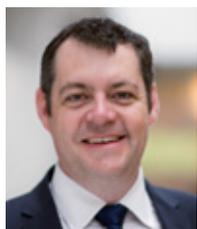
Vanguard product summary

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	\$86.08	0.10%	2.53	12.44	11.72	322.7	4,276.6
Property	VAP	\$91.09	0.23%	1.08	18.27	9.47	129.7	1,542.2
High Yield	VHY	\$62.62	0.25%	1.00	11.84	9.70	86.6	1,327.0
Large Companies	VLC	\$70.09	0.20%	1.70	15.04	11.49	2.8	96.5
Small Companies	VSO	\$59.99	0.30%	3.40	6.62	9.77	17.4	276.7
International Equity ETFs								
Developed Markets	VGS	\$78.31	0.18%	4.66	9.28	15.10	157.9	1,898.5
Developed (AUD hedged)	VGAD	\$69.88	0.21%	1.37	2.12	11.30	47.3	676.5
All world Ex US	VEU	\$73.92	0.09%	2.49	6.19	10.89	40.3	1,509.1
Total US Market	VTS	\$223.41	0.03%	5.19	10.40	17.67	25.8	1,727.0
Developed Europe	VEQ	\$57.03	0.35%	2.06	5.21	10.46	4.6	244.8
Asia ex Japan	VAE	\$65.45	0.40%	-0.74	3.13	10.03	0.8	167.7
Emerging Markets	VGE	\$67.75	0.48%	-0.54	7.51	8.67	10.3	326.4
Global Infrastructure	VBLD	\$61.09	0.47%	7.06	n/a	n/a	31.3	50.1
International Small Companies	VISM	\$52.86	0.32%	3.11	n/a	n/a	12.2	22.8
ESG	VESG	\$54.13	0.18%	5.17	10.11	n/a	7.0	38.2
Minimum Volatility - Active	VMIN	\$58.50	0.28%	3.74	9.72	n/a	1.8	12.6
Global Value - Active	VVLU	\$52.42	0.28%	2.21	-3.47	n/a	3.5	19.5
Multi Factor - Active	VGMF	\$51.86	0.33%	3.34	n/a	n/a	1.6	16.2
Fixed Income ETFs								
Australian Composite	VAF	\$52.87	0.20%	1.92	10.94	4.42	212.0	1,248.0
Australian Government	VGB	\$54.04	0.20%	2.07	11.87	4.45	81.8	384.1
Australian Corporate	VACF	\$53.75	0.26%	1.71	8.79	4.82	68.9	334.6
International Treasury (AUD hedged)	VIF	\$51.25	0.20%	2.65	10.25	3.41	53.4	382.7
International Credit (AUD hedged)	VCF	\$50.61	0.30%	2.29	10.08	4.04	25.5	153.6
Global Aggregate (AUD hedged)	VBND	\$53.76	0.20%	2.42	10.10	n/a	43.0	118.6
ESG	VEFI	\$54.13	0.26%	2.40	9.74	n/a	4.3	8.7
Diversified ETFs								
Conservative	VDCO	\$55.30	0.27%	2.26	9.07	n/a	24.3	80.0
Balanced	VDBA	\$56.29	0.27%	2.57	9.52	n/a	39.6	178.1
Growth	VDGR	\$55.96	0.27%	2.69	9.12	n/a	36.9	174.3
High Growth	VDHG	\$56.18	0.27%	2.78	8.67	n/a	47.6	226.9
TOTAL							\$1,541	\$17,518

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.

Ten things we know after ten years of ETFs in Australia



Evan Reedman

Head of Product
and Marketing,
Vanguard Australia

This year marks ten years since the first Vanguard ETF was launched in the Australian market.

Since then, the humble ETF has been on a remarkable trajectory – both within Vanguard Australia (Vanguard) but also financial markets more broadly.

Over ten years we've seen the appetite for ETFs grow significantly amongst advisers and individual investors to

a market currently worth over \$53 billion. From what was a standing start in Australia a decade ago, ETFs have moved from the margins right to the fore of portfolio construction.

With one trade an investor can put to work the same sophisticated tools of asset allocation and portfolio construction used by the world's largest financial institutions. This has surely been one of the game-changing aspects of the story of ETFs so far.

Vanguard is proud to be a part of the growth of the ETF market in Australia. At this milestone anniversary we're taking a quick glance in the rear view mirror and reflecting briefly on ten things we've learned along the way:

1. **ETFs are traded in Australia with a fluency and frequency hard to imagine when they were first launched in 2001.**

With ETFs now established as a mainstream investing tool, it's easy to forget that message wasn't as widely understood and appreciated as it is now. Ten years ago there were just 25 ETF products available in a market worth around \$2.5 billion. Flash forward ten years and today investors have the choice of around 200 different ETF products and transact an average of \$168 million every day. To put this in perspective, Vanguard's total cash flows into ETFs in the year-to-date for 2019 is equal to the entire market size when Vanguard started this ETF journey in Australia ten years ago¹.

2. **Costs matter**

As Jack Bogle said in his founding vision for Vanguard Inc.: costs matter. Investors increasingly recognise they are more likely to reach their investment goals when costs are minimised. ETFs are generally a low-cost investment. They typically cost less than traditional managed funds and substantially less than if you were investing in the same exposure of individually purchased shares. Vanguard's commitment to using its economies of scale to lower the cost of investing ensures more of what you earn as an investor stays in your pocket.

3. **When it comes to ETFs, you don't necessarily get more if you pay more.**

We know that expense ratios are a key consideration when choosing the right ETF product. This is not surprising given the powerful role costs play in investment success. Vanguard research bears out just how valuable 'low-cost' options can be to investors over time. By investing in Vanguard Australia's range of low-cost ETFs with their asset weighted average MER of 0.17% per annum, investors have saved approximately \$90 million in fees over the past decade than if they invested in ETFs at the current industry asset weighted MER of 0.40% per annum (excluding Vanguard) over that same ten-year investment horizon. The comparison draws on all Vanguard's 29 Australian-domiciled and cross-listed ETFs². In short, the rise of Vanguard's low-cost ETFs has allowed investors to save on investing expenses and ultimately keep more of their investment returns over time.

4. **The greatest ETF portfolio in the world is ineffective without an investment plan and long-term discipline.**

The best investment portfolio is one that your clients can actually live with. This means staying the course long enough to see your investment choices count meaningfully towards your investment goals. As advisers, this means helping clients to not only identify their desired investment outcomes but ensuring they keep sight of those amidst the inevitable highs and lows along the way. ETFs have become a staple tool for individuals wanting to build portfolios targeted at specific outcomes. Vanguard Research³ shows sticking to those objectives—or "staying the course"—over the long-term gives investors the best chance of investment success.

5. **The value of advice is changing**

The past decade has seen a noticeable shift in the perceived value of investment advice. This has seen advisers move away from traditional investment propositions focused on chasing outperformance by picking winners and timing the market to one built around the solid foundations of asset allocation, portfolio construction and the attainment of long-term investment objectives. ETFs are increasingly seen as an easy, convenient way to implement this trend for investors.

6. **Australia's ETF market growth has been unique.**

ETF usage has grown all over the world but has evolved differently in Australia compared to the US with retail investors and advisers, rather than institutional investors, driving much of the growth. Here in 2019, the Australian market for ETFs is around \$53 billion across around 200 products listed on the ASX. The pool of individual investors

1 ASX Monthly Update, August 2009, Listed Managed Investments Monthly Update & Vanguard Australia ETF Market Wrap, Week ending 9 August, 2019

2 Vanguard Research, ETF Cost Analysis using Morningstar & ASX July 2019

3 Vanguard Research, 'The case for low-cost, index-fund investing,' April 2019 p. 10

in Australia using the low-cost benefits of ETFs is twenty times what it was ten years ago.

7. Some of the most widely-held ETFs in the industry are from Vanguard

Today Vanguard is the largest ETF provider in the Australian market. It's humbling to think that around 37 cents of every dollar invested in ETFs in Australia is invested in a Vanguard ETF⁴. Recently our Vanguard Australian Shares Index ETF (VAS) became the largest ETF in Australia with just over \$4 billion in assets under management. We take the responsibility of managing those assets seriously knowing how important they are to every individual investors' life goals.

8. ETFs have not only been a growth story in numbers but in preferences too.

In 2019, we're seeing investors take up more fixed income options and also favour broad-based diversified products rather than single country or sector-specific exposures. Over the decade Vanguard's product line up has evolved in response to client needs. We've added new and diverse ETF strategies to our range of low-cost ETFs at the rate of at least one every year since we launched our first ETF in the local market back in 2009.

9. The ETF story is still being written.

Globally, ETF products are forecast to reach a total market capitalisation of US\$25 trillion by 2027⁵. There is a whole new generation of investors who appreciate the flexibility and choice ETFs offer. Research shows both new and existing investors are keen to meet their future investment needs with ETF products and millennials will increasingly be part of this 'next wave' of investors.

10. Vanguard Australia's ETFs are only 10 years old but already a game-changer.

Thanks to ETFs, many more individual investors have access to low-cost portfolio strategies that have transformed their investment choices. Thanks to ETFs, investors have the opportunity to keep a greater share of their investment returns than if ETFs weren't available. ETFs have given investors one-trade access to the same portfolio construction tools used by the world's largest financial institutions. These are some of the game-changing opportunities Vanguard's range of low-cost ETFs have provided in the first ten years of their life. We are proud to be a part of the growth of the ETF market in Australia and are looking forward to what we can achieve for our investors and their investing goals in the next ten years.

4 ETF Competitor Product Report, July 2019

5 Vanguard – The 101 Guide to ETFs, p. 3

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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