How to trade exchange traded products: A practical guide for investors

By Matthew Felsman 11 October 2016

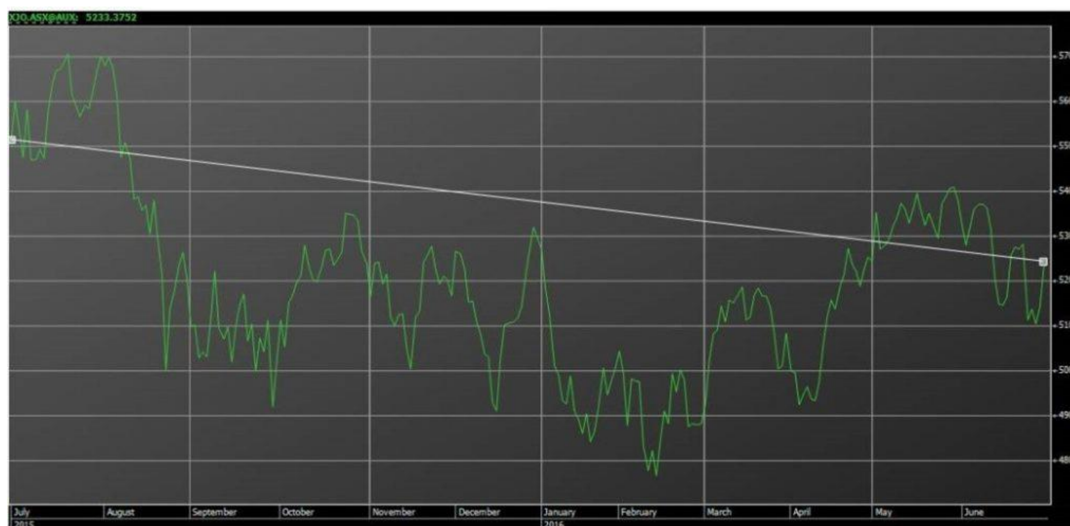
Editor's note: One of the most common requests we get from investors is for content that provides practical examples of how to use our funds in their portfolios. In this guest contribution, Matthew Felsman, Private Wealth Adviser at APP Securities, discusses some ways that he has seen clients using exchange traded products first-hand.

Over the last 15 years Australia's exchange traded market has grown to over $24 billion with 184 products now available on the Australian Securities Exchange. As one of the fastest growing investment products in recent years, a lot of content has been written on the benefits of using these products, as well as the risks associated. There is, however, less written for investors in terms of practical ways they can potentially profit from investing and trading these products. In this short note, I set out some ways that ordinary investors might look to generate profits using exchange traded products.

Tactical index investing

Locally, for the 2016 financial year the S&P/ASX 200 index fell -4.1%. Even if you include dividends the total return of the index was an insignificant +0.6%, and that's before any fees or expenses However, even though the overall outcome for the year was flat, as an index the S&P/ASX 200 experienced significant moves from its August 2015 highs and February 2016 lows, declining and rising more than 15% in either direction over this period. Index tracking ETFs allow investors to trade the entire market as though it were one single stock. In this respect, they provide an opportunity for tactical investors to take a view on the direction of shorter-term market movements through the trading of a single security. For example, if the S&P/ASX 200 is experiencing a steep rise in price through a particular period, investors can try to take advantage of this rise by purchasing an ETF that mirrors the index.

CHART #1: The S&P/ASX 200 over the 2016 financial year, finishing flat with many trading opportunities in between



Source: Bloomberg

Shorting

Short Funds are designed to go up when a particular index declines (and vice versa), providing investors the opportunity to profit from falling markets (of course, this will also mean that if markets rise, investors may face declines in their investment value). Conveniently, these types of Funds provide all the benefits of short selling, but don't require that you make a direct short sale. This means sophisticated processes like borrowing stock and setting up margin accounts are not required, and certain fees, costs and hassles are avoided. In addition Short Funds can allow you to hedge exposure to downside risk in your portfolio. This can be a great way to potentially generate returns in volatile markets. In my practice, we have had some great success trading the BetaShares Australian Equities Strong Bear Hedge Fund (ASX: BBOZ) – a 1% fall in the Australian share market on a given day can be expected to deliver a 2.0% to 2.75% increase in the value of the Fund (before fees and expenses), and vice versa. For those looking for an exposure that is not magnified we've also used ASX: BEAR, which can be expected to deliver a 0.9% to 1.1% increase in the value of the Fund (before fees and expenses) and vice versa for a 1% fall in the Australian share market.

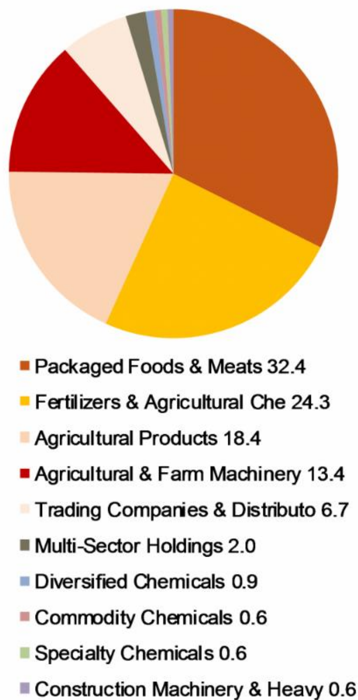
CHART #2: The S&P/ASX 200 (green) over the BetaShares Bear Hedge Fund (ASX: BEAR) (white), moving higher when the market falls, and declining when markets rise

Source: Bloomberg. The Bear and Strong Bear Funds' strategies of seeking returns that are negatively correlated to market returns are the opposite of most managed funds. Also, gearing is used in BBOZ which magnifies gains and losses and may not be a suitable strategy for all investors. Investors in geared strategies should be willing to accept higher levels of investment volatility and potentially large moves (both up and down) in the value of their investment. Geared investments involve significantly higher risk than non-geared investments. Investors should seek professional financial advice before investing, and monitor their investment actively. An investment in any of the Bear Hedge Funds should only be considered as a component of an investor's overall portfolio. The Bear and Strong Bear Funds are actively managed and do not track a published benchmark.

Direct investments into a specific investment thematic

Exchange traded funds allow an investor to easily obtain exposure to a specific investment theme without having to take a view on a specific individual stock. And the exposures available are not just restricted to Australian equities; exchange traded funds offer exposure to currencies, commodities and specific global market sectors as a whole that allow you to take an investment view without much fuss. For example, lately Central Banks have dominated news headlines which may provide opportunities within specific currencies like the US Dollar or the British Pound; OPEC meetings have fuelled oil market movements which may provide opportunities in Oil exposures (whether the direct commodity or energy companies) while investment industry trends have buoyed particular sectors of the market. All of the above can be traded using ETFs.

Chart #3: An example of the industry allocation of the Global Agriculture Companies ETF (ASX: FOOD), providing investment exposure across a global sector



*As at 30 September 2016

I hope these examples have given you a sense of some of many trading opportunities available using exchange traded products. Please don't hesitate to get in touch if you'd like to find out more!

Happy trading!

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