Institutional Uses of SPDR® ETFs

Exchange Traded Funds (ETFs) have come a long way since State Street Global Advisors launched the industry's first ETF in 1993 as a cash equitisation vehicle for institutional investors. Twenty-three years later, institutions remain some of the largest investors in ETFs, with usage continuing to expand across a wider range of investors and investment strategies. Today, global ETF assets exceed US$2.9 trillion across several thousand ETFs and all manner of asset classes.[1] Here we look at how the use of ETFs by institutional investors has evolved beyond cash equitisation strategies.

Institutional ETF Applications

For institutional investors, ETFs are no longer simply a way to gain efficient exposure to a particular asset class for cash equitisation purposes. Uses have evolved to include applications such as liquidity management, asset class exposure and portfolio completion.

Liquidity Management

Many institutions revisited their processes for managing liquidity after the market turmoil of 2008. One approach has been to build 'liquidity buffers' into the management of their portfolios. In this case, a percentage of each asset class is allocated to a liquid and easily tradable ETF (or ETFs) that tracks the relevant asset class benchmark, removing the need to make regular applications or redemptions to the various active or passive fund managers used by the investor. The ETF is then used as a liquidity source to address ongoing cash flow requirements and allows for efficient rebalancing trades as well.

Asset Class Exposure

There are several thousand ETFs available today spanning the vast majority of investable asset classes that make up the global capital markets opportunity set. The range of ETFs available has opened up some asset classes that were previously uninvestable for all but the most sophisticated institutional investors. Examples of asset classes that were once difficult for many investors to access include commodities and emerging markets bonds. Today, investors can simply buy an ETF providing exposure to the asset class in a transparent and easy to use way.

Common Institutional ETF Uses

Application	Objectives	ETF Solution
Tactical Adjustments	Over or underweight certain market segments based on short term outlook.	ETFs represent virtually every asset class and offer efficient vehicles for implementing a tactical idea.
Manager Transitions	Maintain market exposure while searching for a new manager.	Invest the proceeds of manager liquidation in an ETF which tracks the appropriate benchmark until a new manager has been selected.
Cash Equitisation	Remain fully invested while maintaining liquidity.	ETFs are an attractive alternative solution to futures due to their transparency, lack of documentation and roll slippage.
Rebalancing	Increase the speed and efficiency of rebalancing across the asset allocation.	ETFs can make rebalancing more efficient due to their intraday liquidity than moving assets from illiquid managers.
Asset Class Exposure	Establish exposure to a difficult-to-reach market segment.	There are a variety of ETFs which provide exposure to difficult-to-reach asset classes.
Liquidity Management	Increase liquidity in overall asset allocation without changing allocation.	Use ETFs for a given percentage of each asset class to provide a liquidity buffer across the asset allocation.
Portfolio Completion	Fill any asset allocation holes without engaging a new investment manager.	Use an ETF to gain exposure to an asset class that is underrepresented in the asset allocation.
Fixed Income Duration and Credit Adjustments	Tweak duration and credit exposure to meet specified targets.	Fixed income ETFs provide an efficient means to adjust duration and credit exposure.
Small Institutional Plans	Implement desired asset allocation regardless of plan size.	Implement an asset allocation efficiently using ETFs. Advantages include no minimum fees and simplified rebalancing.

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Portfolio Completion

ETFs can also be used to fill portfolio gaps. One example of this is emerging markets. Investors who are invested in a broad-based emerging market index have become increasingly large cap focused over the past several years. For example, due to its index construction methodology, the MSCI Emerging Markets Index is comprised mostly of large to mid-cap companies and not small caps. Institutional investors can use the SPDR S&P Emerging Markets ETF to diversify their emerging markets capitalisation by increasing exposure to emerging markets. These companies can potentially improve sector diversification by increasing exposure to sectors that are tied more to local economies — such as consumer discretionary, information technology, and industrials — and found less in large multinational corporations.

As the ETF market continues to grow and liquidity in these vehicles continues to increase, institutions will find even more precise ETF solutions to satisfy their ongoing challenges.

Conclusion

Institutional investors are finding ETFs to be a valuable tool for a variety of portfolio management tasks such as liquidity management, asset class exposure and portfolio completion. As the ETF market continues to grow, institutions will have even more precise, liquid tools at their disposal. Fully understanding product structure, trading dynamics and competitive differences will allow institutions to fully harness the potential value that ETFs provide.

[1] Morningstar, SSGA, as of 31 December 2015.

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