8 ETF Themes to Buy Now?

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Overview

Global equities markets started to stumble in January, and then fell flat on their face in February as Russia invaded Ukraine and caused uncertainty and alarm around the world. Investors who were already on edge thanks to the risks of inflation and the end of the recent stock market resurgence have now gone decidedly into "risk off" mode. As of this writing, about 70% of the largest U.S. stocks that make up the S&P 500 index are in the red year to date, and some big names like Meta Platforms Inc. (ticker: FB) and Netflix Inc. (NFLX) have lost more than 30% since Jan. 1 alone.

ASX-listed global equities ETFs / ETMFs have not performed well since the beginning of the year, and indeed the active ETF global equities vehicles have been slammed the most. So where are investors to turn in an environment like this? This article lists eight ETF-based themes that investors, subject to their world view, may wish to consider from a tactical asset allocation perspective.

It has been the proliferation and diversification of ETF / ETMF vehicles over the last few years in the Australian market that now enables investors to execute more detailed and precise tactical asset allocation decisions.

Gold

ASX: GDX VanEck Vectors Gold Miners ETF; **ASX: MNRS** BetaShares Global Gold Miners ETF - Currency Hedged; **ASX: GOLD** ETFS Physical Gold; **ASX: PMGOLD** Perth Mint Gold; **ASX: QAU** BetaShares Gold Bullion ETF (Currency Hedged)

Appeal: Inflation hedge, safe-haven 'risk off' asset.

Investors can either play a direct gold exposure or a leveraged gold exposure through the two gold mining stocks ETFs, GDX and MNRS.

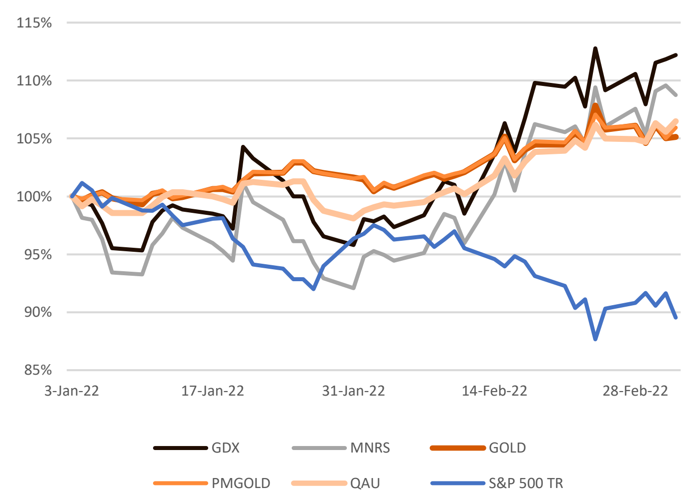
As Russel Chesler from Van Eck recently noted, "gold mining stocks, along with the gold price, have been rising recently as inflation and political instability weigh investors' considerations. NYSE Arca Gold Miners Index is up over 8% so far this year and it could continue to rise as Ukraine tensions simmer, inflation persists and mining companies continue to report strong results."

Additionally, we are now of course in a rising inflation / interest rate environment, which is likely to prove favourable to the sector.

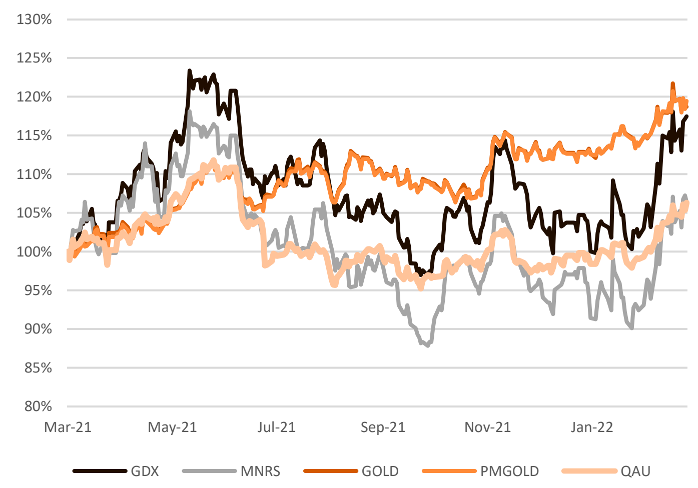
Listed gold mining companies provide leveraged exposure to the gold price, with that leverage coming through a combination of operational and financial (debt) leverage. Gold equities typically outperform gold bullion when the price rises, and underperform if the gold price falls. And we understand that the gold mining companies sector is currently trading below historical valuation averages.

GOLD and PMGOLD are unhedged, and have performed identically, whereas QAU is AUD hedged, with the performance differential with the two ETFs above wholly / largely due to this difference.

Gold vs S&P 500 TR - YTD Performance



Gold vs S&P 500 TR - Last 12-month Performance



Agricultural Commodities

ASX: FOOD BetaShares Global Agriculture Companies ETF

Appeal: Price inflation and expectations of future inflation (higher prices) based on consumer led demand, supply-chain disruptions and under-supply, combining for the potential of an asymmetric return profile where prices could spike off a low base in recent years (due to underperformance with respect to hard commodities). Ukraine – Russia – 30% of global wheat supply now off the market. Wheat traded in Chicago, the international benchmark, has jumped more than 50% since Russia invaded Ukraine.

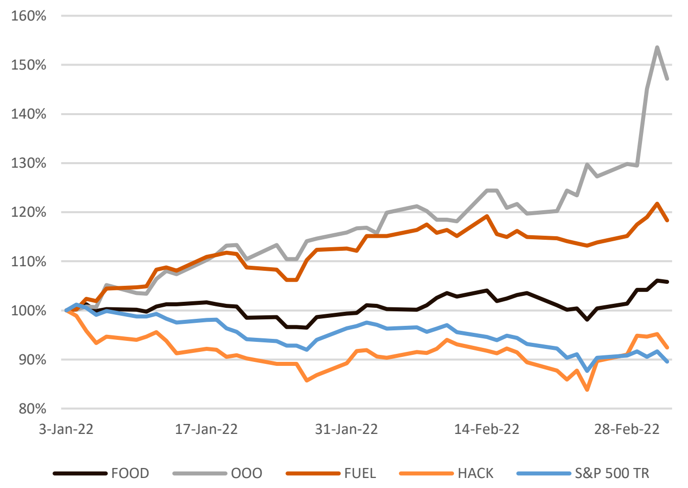
Softs commodities are generally "grown" commodities such as coffee, sugar, corn, wheat, soybeans, fruit (and juices) and livestock.

A pure play soft (agricultural) commodities ETF is a distinct gap in the Australian ETF industry, i.e., there isn't one. It is an asset class that Australian investors are not overly familiar with and even in the unlisted managed fund and institutional space there are very few dedicated soft commodities products and fund managers with expertise in the asset class. While soft commodities are a subset of the commodity asset class, it is less traded due to supply-chain nuances that provide significant insider knowledge, where industry insiders have more edge in trading and investing. This relationship holds true, until times of stronger inflationary pressure, i.e. times like now.

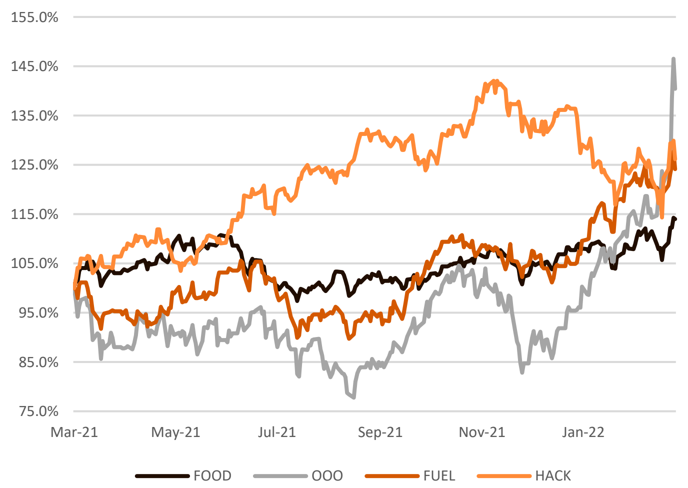
All that said, FOOD provides exposure to the agricultural commodities sector, albeit somewhat indirectly. Key portfolio exposures are detailed in the chart below. The ETF has been designed as more a long-term play on rising population and, hence, food sector related demand growth. But food inflation pressures are certainly being felt right now in countries such as the U.S. (the key geographic exposure for FOOD).

For those investors with access to the U.S. market, the VanEck Vectors Agribusiness ETF (NYSX: MOO) could serve as an attractive alternative option.

FOOD / Oil / HACK - YTD Perfromance



FOOD / Oil / HACK - Last 12-month Perfromance



Oil

ASX: OOO BetaShares Crude Oil Index ETF-Currency Hedged (Synthetic); **ASX: FUEL** BetaShares Global Energy Companies ETF - Currency Hedged

Appeal: Lowest commercial oil inventories in developed economies since January 2015, as global oil demand continues to grow, and supply remains constrained. A "geopolitical risk premium" while the Ukrainian conflict persists. In January 2022, Goldman Sachs raised its Brent oil price forecasts from $81 to $96 for 2022 and from $85 to $105 for 2023.

Commodity prices, more generally, increased at close to the fastest pace for over half a century last week. Sanctions on Russian financial institutions have led many traders to shy away from doing business with the country, even for energy. While there may be an exemption from the trade restrictions for oil and gas, insurers and dealers have decided that the risks, reputational or otherwise, of continuing to do business with the country are not worth the benefits. Oil prices rose to close to US$120 a barrel late last wek, the highest level since 2012.

Russia is the world's third biggest oil producer behind the US and Saudi Arabia and it typically exports about 5m barrels b/d of crude oil and around 2.7m b/d of products such as diesel. Its sends 2.5m to 2.6m b/d of crude oil to Europe either via pipelines or tankers, and sells 2m b/d of oil products in Europe, US and Canada.

As alluded to above, demand for Russian oil has collapsed since the assault on Ukraine began as refineries, banks and shipowners shun the country's vast commodities market. While energy markets have largely been spared from sanctions deployed by the US, EU and UK on Russia's financial sector, typical buyers are effectively self-sanctioning to reduce either legal or reputational risk (or not incur spiking freight rates and war insurance premiums), setting off a race to secure alternative supplies in an already tight market.

Cybersecurity

ASX: HACK BetaShares Global Cybersecurity ETF

Appeal: Institutions / corporates on high alert for cybersecurity risks. An estimated $1.75 trillion in global cumulative cyber spending expected between 2021 and 2025, according to Cybersecurity Ventures.

Cybersecurity is always a real and present risk but at times at takes an event to remind (potential) customers of this risk and to spur action (demand for the sector).

While the Cybersecurity sector has not performed much better than the broader market since Jan. 1, thanks in part to the fact that many investors have been selling off tech stocks lately, there was a decided bounce in cybersecurity stocks after the Russian invasion of Ukraine. That's in part because both nations have long been known as hubs for hackers (and the "hacktivist" group Anonymous declared its own cyberwar on Russian President Vladimir Putin and has proceeded with interfering with Russian websites).

This kind of environment has put all institutions on high alert for cybersecurity risks, making HACK potentially worth a look.

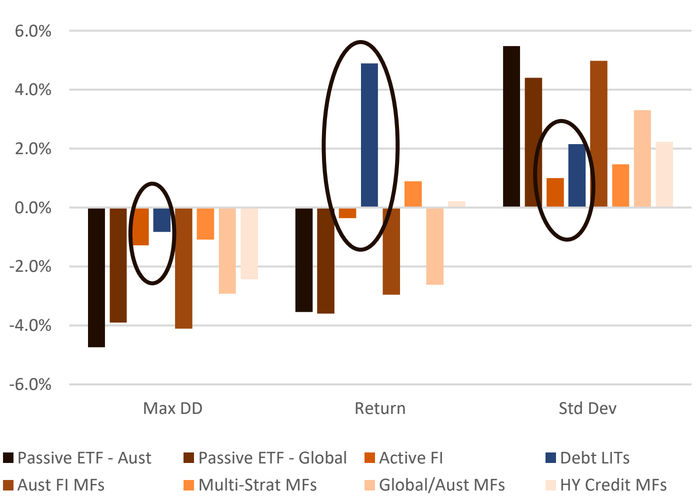
Rising Interest Rates – Fixed Interest Exposure

ASX: XARO ActiveX Ardea Real Outcome Bond Fund (Managed Fund); **ASX: FLOT** VanEck Vectors Australian Floating Rate ETF; **Chi-X: XKAP** ActiveX Kapstream Absolute Return Income Fund; **Chi-X: ECOR** eInvest Core Income Fund; **Chi-X: EMAX** eInvest Income Maximiser Fund; **Chi-X: PAYS** Schroder Absolute Return Income fund; and, **ASX: HBRD** BetaShares Active Australian Hybrids Fund.

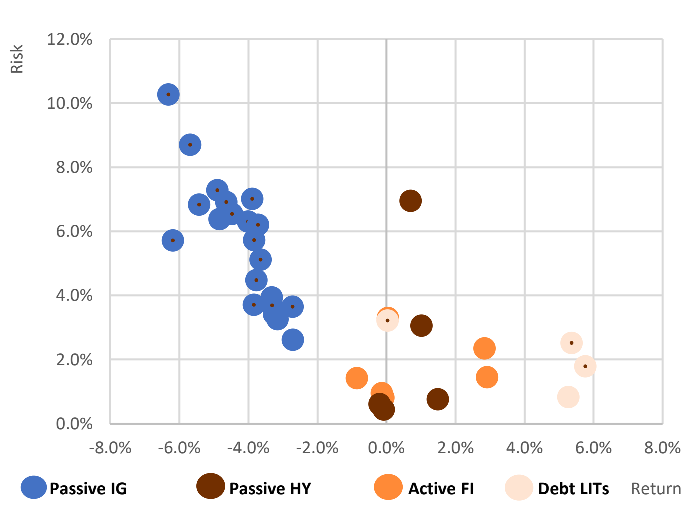
Appeal: True through cycle active fixed income strategies that have multiple strategic levers to pull in an Australian fixed income ETF environment dominated by passive long duration Investment Grade strategies. FLOT provides exposure to floating rate notes (bank loans).

We have recently covered this topic at some length in an article entitled the Dominance of Active Fixed Interest Managers. Within this report were several charts, reproduced below, that sums up performance differentials over the last 12-month period.

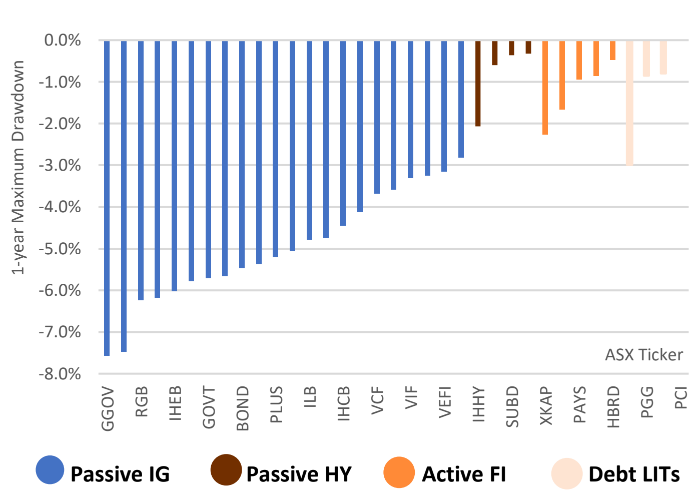
1-year Riak - Return by Fixed Income Sector / Vehicle Type



1-year Riak - Return by Listed Fixed Income Vehicle Type



1-year Maximum Drawdown by Listed Fixed Income Vehicle Type



The Bear Market View (or Hedge)

ASX: BBUS BetaShares US Equities Strong Bear Currency Hedged (Hedge Fund); **ASX: SNAS** ETFS Ultra Short Nasdaq 100 Hedge Fund

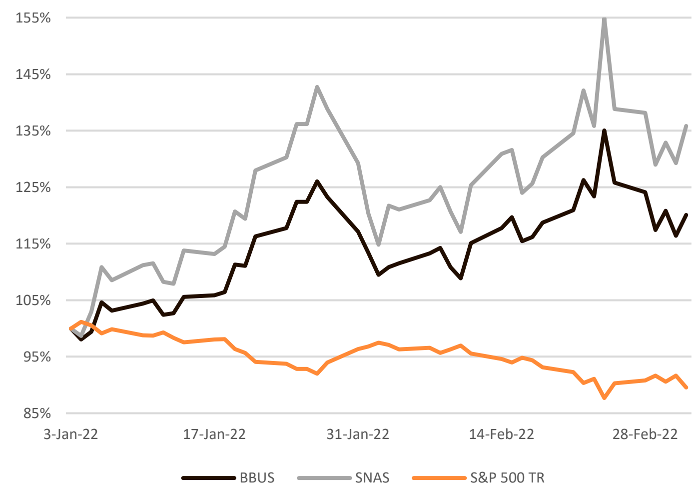
Appeal: Outright (leveraged) short U.S. market exposure or to hedge a pre-existing long exposure

Both BBUS and SNAS generate magnified returns that are negatively correlated to their respective underlying indices by maintaining a short exposure to the index between -200% to -275% on a daily basis with that short exposure reset at -235% at the close of market each day. The underlying index for BBUS is the S&P 500 Total Return Index while for SNAS it is the Nasdaq-100 Index.

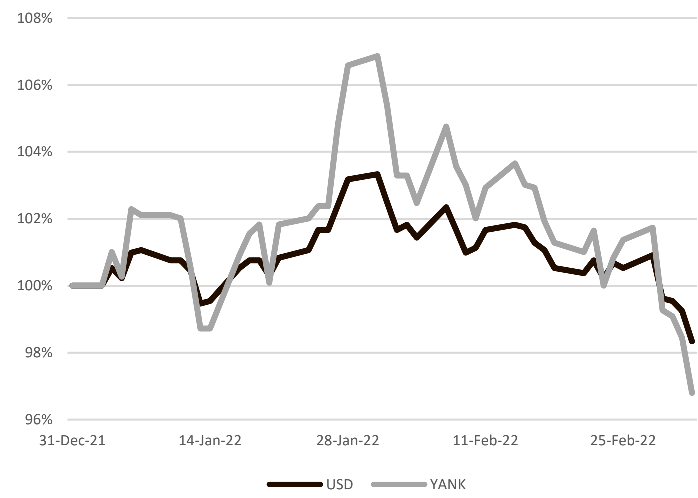
A 1% fall in the underlying index on a given day can generally be expected to deliver a 2.0% to 2.75% increase in the value of the ETF (and vice versa). Sounds simple, right? Well, leveraged ETFs, whether bull or bear leveraged ETFs, are never that simple. Due to daily leverage rebalancing it is highly unlikely that a return will be simply the result of the leverage multiple. And volatile and range bound markets are the worst environment for a detachment in what some investors may imply as the expected performance path.

There is the issue of compounding too. Leveraged ETF performance relative to delivering, or getting close to delivering on the leverage multiple is subject to the performance path of the underlying index. Such ETFs are suitable to experienced investors only and additionally certainly not long-term holdings, as markets can quickly change. They are best suited as a short-term directional 'bet' or for short term portfolio hedging purposes.

The Big Short - YTD Performance



USD/AUD ETFs - YTD Perfromance



The Big Short - Last 12-month Performance

USD View (or Currency Hedge

ASX: USD BetaShares U.S Dollar ETF; **ASX: YANK** BetaShares Strong US Dollar Fund (Hedge Fund)

Appeal: Outright view on the USD/AUD in a currency pair positively correlated to a 'risk off' environment. Could also serve to 'unwind' any hedged portfolio holdings. Potentially a portfolio diversifier, as currencies historically have shown low correlation to shares and most other major asset classes.

ASX USD is a 1 to 1 USD/AUD exposure whereas ASX: YANK is a leveraged USD/AUD exposure. Specifically, in USD If the U.S. dollar goes up 10% against the A$ USD is designed to go up 10% too, before fees and expenses. Conversely, USD will go down if the U.S. dollar falls.

In YANK, it ETF generally expects to generate a positive return of between 2% and 2.75% for a 1% rise in the value of the USD/AUD on a given day (and vice versa).

Volatility Dampening

ASX: WVOL iShares Edge MSCI World Minimum Volatility ETF; **ASX: WRLD** BetaShares Managed Risk Global Share Fund (Managed Fund).

Appeal: Two ETF based on very different means in which to achieve the same outcome: limited drawdowns and downside volatility.

WVOL invests in a subset of the MSCI World Minimum Volatility Net TR Index (AUD) which captures large- and mid-cap representation across 23 developed market countries. The subset (i.e. the WVOL portfolio) is based on a minimum volatility strategy that estimates the risk profile and expected volatility of each constituent and the correlation between all constituents in the Index and selects stock with the lowest absolute volatility of returns.

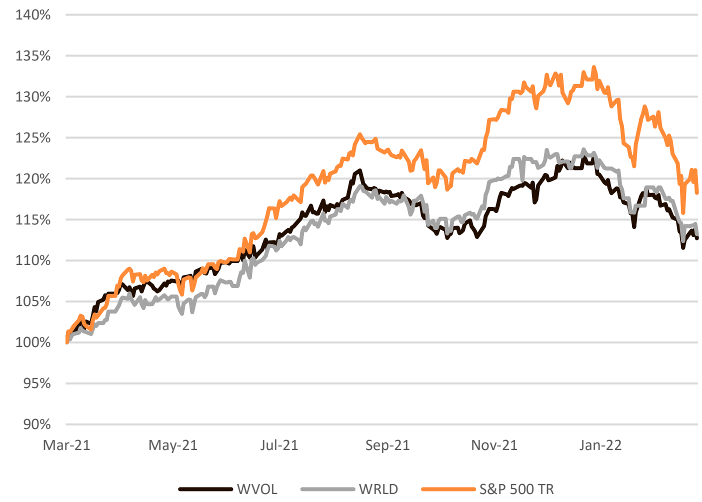
Performance to date has certainly shown WVOL to be true to the lower volatility and drawdown aspects, with comparatively very volatility, a limited maximum drawdown (14%) and only capturing half the negative performance of the peer group average.

WRLD provides exposure to global equities by holding U.S. listed ETFs with a dynamic volatility targeting (the target is a volatility of 12% p.a.) risk overlay strategy. The risk overall is run by the US based Milliman Pty Ltd, and represents the company's 'bread and butter' and they have developed both a strong expertise, systems, and reputation in doing so over the years. In essence, the risk overlay dynamically shifts capital to and from the growth asset (the global equities ETFs) in and out of a cash bucket. The latter serves to reduce net exposure and generate positive returns when the index declines.

The degree of futures contracts sold, and therefore net exposure, is a function of forecast market volatility. For example, is forecast volatility is 24% p.a. the overlay will sell enough contracts to reduce the net position to 50%, thereby achieving the target volatility of 12% p.a. Conversely, if forecast volatility is 8% p.a., the strategy will be levered up 50% to achieve the target volatility of 12% p.a.

We note WRLD recorded a comparatively low maximum drawdown of 10% vs 20% for the underlying ETFs. We also note low down market capture but even lower up market capture. This is broadly what we would expect - capped upside but materially higher capital preservation and downside risk measures.

WVOL / WRLD vs S&P 500 TR - Last 12-month Performance



About Risk Return Metrics

Risk Return Metrics Pty Ltd (ABN 98 642 969 819) was established by the company's principal Rodney Lay in June 2020 with the express intention to provide institutional grade absolute and relative performance analysis and ratings for retail and wholesale investors, IFAs and investment managers. The primary focus is on the managed investment sectors, both LICs/LITs and Active and Passive ETFs listed on the Australian market. A secondary focus is on the provision of select quantitative based profiles on select Australian domiciled unlisted managed funds. In total, RRM is expected to provide monthly updates on approximately 550 Australian domiciled investment strategies across the full asset class spectrum.

The investment product reports produced by RRM contain a number of differentiating factors to which have and are currently available in the Australian market, with the most notable being 1) HTML-based sub-reports for each strategy and 2) the emphasis on peer group benchmarking for comparative analysis as opposed to the industry standard of utilising industry benchmarks.

The former function enables the provision of detailed metrics regarding returns, risk/capital preservation, performance path, and efficiency, but does so by way of the sub-report feature without comprising the conciseness and readability of the primary report. Less is More, and More is More. The latter is viewed as a superior comparative basis in terms of facilitating investor choice regarding competing investment strategies in a particular (sub-)asset class.

Rodney Lay has 25 years' experience in investment analysis, first starting as an equities analyst at BZW / ABN Amro. Subsequently, he specialised in structured products in the lead up to the GFC and then moved to a dedicated focus on listed and unlisted managed investments. Rodney has had a long involvement in the listed space of the market, both LICs/LITs and ETFs.

Asset class experience is broad, including equities (long-only, long/short, market neutral, enhanced income), global listed infrastructure and property, alternative strategies (hedge funds, global macro, quantitative strategies), retirement solution products, private assets, and public and private debt. Public and private debt strategies have been a particular focus over the last three years, reflecting growing retail and wholesale client demand.

Rodney has a strong understanding of the nuances of different investment structures, including LICs/LITs, Active ETFs, SMAs/ IMAs and the recently launched dual listed/unlisted structure. Rodney has undertaken investment analysis on behalf of some of the most recognised global and domestic fund managers in both the listed and unlisted investment strategy sectors.

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