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ETF OR UCITS: THE MODERN INVESTMENT MATCH-UP

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The world of asset management is undergoing a rapid transformation, driven by technological innovation and new investor needs. Exchange-traded funds (ETFs) are an example of how the investment industry is adapting, as asset managers and investors allocate increasing amounts of capital to these vehicles.

In recent years, investment in ETFs has soared, with 2024 marking a record year for ETF market inflows of €247 billion, surpassing the previous record of €159 billion in 2021.

The question now is whether ETFs will replace traditional investment funds or whether the tokenisation of funds will divert investment into a new range of funds.

A STRONGER REGULATORY FRAMEWORK

ETFs are now highly regulated, particularly in Europe under the UCITS Directive, which imposes strict rules on transparency, diversification, and investor protection. In the United States, the largest market globally for ETFs, the SEC supervises these products. This robust regulation has enabled ETFs to win the confidence of both retail and institutional investors.

According to Carne's latest report, Keeping Track, a very significant number (over 80%) of institutional managers recognise that investors are moving ETFs from a short-term asset allocation strategy to a core portfolio holding.

Today, almost 90% of equity and bond fund managers already offer ETFs and say they are essential to the future of their business.

ACTIVE ETFS LEAD THE CHARGE

For a long time, the prevailing idea was that ETFs were simply exchange-listed index funds that replicated the performance of a benchmark index. This notion is now being challenged by the advent of active ETFs.

Unlike passive ETFs, active ETFs offer portfolio managers the flexibility to make discretionary decisions about what to buy, sell or hold, with a target to outperform a benchmark index or achieve a specific investment objective. This allows them to efficiently broaden their investing options.

TRANSPARENCY, LIQUIDITY AND PROFITABILITY

The growing popularity of ETFs is the result of three key elements. Firstly, transparency, as ETFs must publish a list of their underlying assets daily, giving investors a clear and complete picture of their investments. Secondly, liquidity, as ETFs can be traded continuously, allowing investors to react quickly to market changes. Finally, profitability, as these instruments generally have lower fees than traditional actively managed funds.

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Another important factor is that ETFs allow leverage to be used, further refining the investment strategy.

Janus Henderson, one of the world's leading traditional fund managers, joined London-based Tabula, an ETF specialist, creating Janus Henderson Tabula. Other leaders such as Aberdeen, J.P. Morgan Asset Management, BNP Paribas Asset Management, Robeco and State Street regularly launch active ETFs.

ETFS OR TOKENISED FUNDS, WHICH WILL WIN OUT?

Although they share the common objective of making investment more accessible, transparent and efficient, ETFs and tokenised funds are based on very different rationales.

Tokenisation, which involves representing a share in an investment fund in the form of a digital token on a blockchain, enables transactions to be managed automatically, traceably and potentially instantaneously, representing a viable alternative to ETFs.

Several other pioneering initiatives show that tokenisation is on the rise. Franklin Templeton, one of the world's largest asset managers, launched the first US-registered money market fund in 2023 whose units are registered on the Stellar blockchain, providing greater visibility and faster transactions.

Similarly, Forge, Société Générale's blockchain subsidiary, has issued several tokenised bonds and fund shares, notably on Ethereum and Tezos. It is also exploring interoperability with traditional banking systems.

In the near future, it is likely that these two models will not conflict but complement each other, giving rise to tokenised ETFs, creating a new generation of hybrid products at the crossroads of traditional finance and blockchain.

COEXISTENCE RATHER THAN REPLACEMENT

ETFs have democratised access to the stock market for millions of investors. The tokenisation of funds aims to go even further, by completely rethinking the structure of financial products.

Traditional funds offer tailor-made solutions that can be adapted to complex needs such as pension funds or institutional mandates. What's more, most banking networks still sell traditional funds.

It remains unlikely that ETFs, and their tokenised version, completely replace traditional investment funds. However, they will co-exist with traditional UCITS funds, offering investors a range of choices tailored to their individual objectives, risk tolerance, and investment strategies.

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