7IM ETF Blog: 10 years in the life of ETFs: from pre-teen to 2017

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**Peter Sleep, Senior Investment Manager, Seven Investment Management (7IM) takes a look at key developments over the decade that he's spent with 7IM. He reviews falling fees, the arrival of new players, through to some potential challengers for the future.**

I arrived at 7IM just over 10 years ago, right on the cusp of the Global Financial Crisis. I want to assure 7IM's clients that I had very little to do with the run on Northern Rock, the fall of Lehman Brothers and that I was not nationalised by Gordon Brown. I have however, been able to observe the growth of the UK's Exchange Traded Funds (ETF) market, so I thought I would pick out seven trends I have seen over the last decade.

ETFs were not unheard of back then, although they are much higher profile now. There were about 250 ETFs listed on the London Stock Exchange (LSE) in 2007 versus 1,400 today, so the market was beyond its infancy and had perhaps graduated to pre-teen. Trading on the LSE was very thin though, with only £12bn traded on exchange in 2007, versus £224bn in 2016 – nearly a 20 fold increase (Source: LSE).

Here's seven key trends as I see them:

1. **Fall in fees**

   As far as investors are concerned, I think the most important trend has been the fall in fees, particularly for ETFs tracking the major equity indexes. The ETF issuers denied the allegation of a price war, but I am not sure that anyone believed them and we all benefitted. Capitalism is a great thing and it guaranteed enough competition that the major FTSE 100, S&P 500 and Euro Stoxx ETFs' fees have fallen from around 0.4% to around 0.07%.

2. **Arrival of Vanguard**

   Competition leads nicely on to new entrants. Perhaps the most important of which has been the arrival of Vanguard into the European ETF market. I am happy to pick out Vanguard as the most important new entrant as they are the most visible ETF issuer willing to compete on price.

3. **Easy come, easy go?**

   There have been some notable exits of issuers and ETFs: let's call it creative destruction. Credit Suisse and SPA are no longer issuing ETFs, and Fresco re-discovered their brand identity when they changed their name to UBS ETF. Perhaps the other great disappearing act was the disappearance of ETF broker, Knight Trading. They blew themselves up when someone switched on some untested software that ran live for 45 minutes causing a loss of US $440m. Knight was rescued and returned as KCG for a period, before KCG agreed to be taken over earlier this year by Virtu Financial.

4. **Boring and dramatic?**

   Most boring, but perhaps the most dramatic was the very brief Financial Stability Board's report on ETFs in 2011. The effect of this report was to kill the rapid growth in synthetic ETFs stone dead and put the term 'counterparty risk' into every investors' lexicon.

5. **Growth in choice and diversity**

ETFs have become much more diverse over the last 10 years, particularly in fixed income. Areas like high yield, emerging market debt and convertible bonds, which I had assumed were small niches for specialist investors, have now become mainstream. We have always had diversity in equity ETFs, but the Horizon Marijuana Life Sciences ETF still surprised many old hands.

6. **Smart beta**

Another key theme has been the rise of the machine: smart beta ETFs, and we haven't shied away from this space, either. Everyone hates the term smart beta, usually because, they say, it implies that market cap investing is dumb. Those who read the study by Andrew Clare and his colleagues at Cass Business School will realise that, well, market cap investing really can be pretty dumb. They randomly selected 10 million monkey portfolios and only 3 monkeys failed to beat the market cap portfolio. In reality, life is rarely that simple – there's some extraordinary fund managers out there. But smart beta is a space that should not be underestimated or ignored.

7. **Robo investing**

We all love to hate them, but the final trend in the ETF sector, which seems destined to gather pace is robo investing. They may be soaking up huge amounts of venture capital cash at the moment, but surely it is a matter of time before at least of few of them gains sufficient critical mass to mount a serious challenge to the old school investment houses.

Over 10 years, the ETF sector has gone from pre-teen to a fully-fledged adult, even dabbling with drugs, via the Horizon Marijuana Lifesciences ETF, along the way. I can't begin to imagine where it will go from here, but if the last 10 years are anything to go by, it should be an interesting ride.

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