

Introduction to Exchange Traded Funds

In the current world, the financial market has become increasingly complex. Many dynamic investment instruments are created to meet the diverse needs of the investors. One of the more innovative instruments which is becoming increasingly popular is Exchange Traded Fund (ETF).

To date, there are three ETFs listed on Bursa Malaysia, namely ABF Malaysia Bond Index Fund, FBM KLCI etf (FTSE Bursa Malaysia etf which is formerly known as FBM30etf) and MyETF Dow Jones Islamic Market Malaysia Titans 25. The first two ETFs are managed by AmlInvestment Group Berhad. We spoke to Datin Maznah Mahbob, Chief Executive Officer (CEO), Funds Management Division of AmlInvestment Group Berhad who explained what are ETFs and the benefits of investing in the funds.

Question: As the pioneer fund manager who developed the first bond and the first equity exchange-traded funds in Malaysia, can you explain what actually is an ETF?

Datin Maznah: An ETF is a unit trust that is listed and traded on a stock exchange. An open-ended fund with no expiry date, it usually tracks or replicates the performance of a benchmark index. This means that ETF investors hold units of a fund that invests in a number of securities.

By investing in ETFs, investors enjoy a cheaper and easy way to gain exposure to a basket of securities represented in an index through a single transaction. The basket of securities could consist of either stocks, bonds, commodities or others.

Investors can buy or sell units of the ETFs on the stock exchange through any remisier, just like how they buy or sell stocks. They are required to have a

Central Depository System (CDS) account and a trading account – that they use for trading stocks – to trade ETFs. In Malaysia, a single trading lot for ETF consists of 100 units. This means investors can buy or sell a minimum of 100 units for each lot.

Question: How do ETFs track an index?

Datin Maznah: As ETFs are index-tracking funds, it is important to know what is an index and how do ETFs track an index. An index is a "basket" or portfolio consisting of either stocks, bonds or other securities which are grouped to reflect the movement of an entire market. The securities that form an index are called index constituents. The underlying securities of the index are chosen by the Index Provider to represent the broad market or sector. For example, Standard & Poor's is the Index Provider for the S&P 500 stock market index, which comprises 500 stocks with the largest market capitalizations in the United States.

An ETF tracks an index by holding securities in the same composition as the underlying index. The fund could also hold a sample of securities that statistically tracks the index closely. This means ETF could invest in fewer number of securities as compared to the index.

The objective of ETFs is to give returns that are very similar to the performance of the index that the funds track. The funds do not seek to outperform or underperform the index. For instance, if the index increases by 10%, the price of the ETF is likely to have an increase of 10%.

Question: Why should investors invest in ETFs?

Datin Maznah: There are four main reasons why ETFs can be a viable investment tool for investors. Firstly, it is easy for investors to buy and sell the funds. Just like trading stocks, investors could buy or sell ETFs through their

remisier during trading hours or via online trading. They could check the price of ETFs throughout trading hours and enjoy the flexibility and price transparency when they trade ETFs. In Malaysia, the prices are available real-time (live) throughout the trading day on Bursa Malaysia's MASA* feed. (*MASA refers to "Maklumat Saham", a computerised display of real-time price).

Secondly, the transaction costs of ETFs are generally lower than those of unit trusts. ETF investors do not need to pay any entry fee. They also pay lower management fees because the funds are passively-managed funds. The annual management fees for ETFs are generally below 1%. For example, the annual management fee for ABF Malaysia Bond Index Fund is 0.10% of net asset value (NAV) of the fund and FBM KLCI etf has an annual management fee of 0.50% of the NAV of the fund.

Thirdly, investors could diversify their investment because ETFs invest in a basket of securities rather than a single security. Hence, investing in ETFs allows them to have instant diversification in the index portfolio. Investors could also gain access to markets that are not easily available such as emerging markets by investing in ETFs that concentrate on emerging markets.

Last but not least, it is convenient to invest in ETFs because investors get immediate exposure to the underlying securities representing an asset class in an index by just making a single transaction. Usually, it is more expensive for them to buy a large number of individual stocks to track the index, and to spend on the trading costs for each transaction. When investors buy or sell ETFs, they incur transaction costs including brokerage fee, clearing fee and stamp duty which are applicable when trading stocks on the exchange. For instance, if investors invest in FBM KLCI etf, they are exposed to 30 largest listed companies (based on market capitalisation) in Malaysia through a single transaction.

This article was contributed by the Funds Management Division of AmlInvestment Group Berhad.

Disclaimers:

AmlInvestment Services Berhad

We recommend that you read and understand the contents of the Prospectuses for ABF Malaysia Bond Index Fund dated 13 July 2008 (expires on 12 July 2009) and the Prospectus for FBM30etf dated 7 June 2009 and its Supplementary Prospectus dated 6 July 2009 that have been registered with the Securities Commission, who takes no responsibility to the contents before investing. You may view the prospectuses from the funds' websites at www.abfmy1.com.my for ABF Malaysia Bond Index Fund and www.fbmklcietf.com.my for FBM KLCI etf or visit us at our nearest representative office for a copy of the prospectuses. Unit prices and income distribution, if any, may rise or fall. Past performance of a fund is not indicative of future performance. Please consider the fees, charges and risks involved including, but not limited to, the risk that units may be delisted from Bursa Malaysia, market risk, tracking error and the risks relating to the Benchmark Index (for ABF Malaysia Bond Index Fund) and the risk that units may be delisted from Bursa Malaysia, risks relating to the Benchmark Index, Derivatives and Zero Strike Call Options (for FBM KLCI etf). AmlInvestment Services Berhad does not guarantee any returns on the investments.

iBoxx®

iBoxx® is a registered trademark of International Index Company Limited ("IIC") and has been licensed for the use by AmlInvestment Services Berhad ("AIS") and/ or its affiliates. IIC does not approve, endorse or recommend AIS and/or its affiliates or the ABF Malaysia Bond Index Fund. This product is not sponsored, endorsed or sold by IIC and IIC makes no representation regarding the suitability of investing in the product.

FTSE

"FTSE®", "FT-SE®" and "Footsie®" are trade marks of the London Stock Exchange Plc and The Financial Times Limited and are used by FTSE International Limited ("FTSE") under licence. "BURSA MALAYSIA" is a trade mark of Bursa Malaysia Berhad ("BURSA MALAYSIA"). The FTSE Bursa Malaysia KLCI is calculated by FTSE. All intellectual property rights in the index values and constituent list vests in FTSE and BURSA MALAYSIA. Neither FTSE nor BURSA MALAYSIA sponsor, endorse or promote this product and are not in any way connected to it and do not accept any liability. AmlInvestment Services

Berhad has obtained full licence from FTSE to use such intellectual property rights in the creation of this product.