Adding ETFs to Your Investment Portfolio

Exchange-traded funds (ETFs) are one of the financial products that have gained popularity in recent years. ETFs are essentially collective investment schemes that are listed and traded on a stock exchange. In Malaysia, the first ETF introduced was the ABF Malaysia Bond Index Fund which was launched in 2005[1].

ETFs are increasingly becoming better-known among investors as a viable investment instrument. ETFs offer many advantages such as transparency, broad exposure to the market, liquidity and flexibility, diversification, as well as lower investment costs. For example, with a single purchase of an ETF, an investor can benefit from broad market exposure. The purchase of FBM KLCI etf gives the investor the broad market exposure of the top 30 Malaysian stocks.

For those who are new to ETFs, here are some frequently asked questions to help you get started.

How do I start investing in ETFs?
Learn more about ETFs before you invest. Familiarize yourself with the benefits, limitations and risks to ensure that you do not have any misconceptions of the funds. Information on the funds can be easily found in the ETFs' websites and prospectuses.

You should also know your investment purpose before you invest. By knowing your investment objective (be it for a broader market exposure or a specific asset class), you can then decide which ETF investment strategy is the best fit for your portfolio.

How do I decide which ETF to invest in?
Find out what are available in the market. Then research your chosen ETF and its holdings before you invest (just as you would scrutinize any stock before you invest). With the transparency that ETF offers, you can access real-time information (e.g. ETF prices, fund information and index information) that are readily available in the ETF websites.

What about the costs?
Generally, ETFs are more cost-effective investment instruments compared to other equity instruments. Nevertheless, you must find out on all the related costs such as the fees, charges and expenses before you purchase an ETF.

How do I purchase an ETF?
To buy and sell an ETF, you must first set up the necessary accounts.

(i) Trade through a remisier— just like buying and selling of stocks, you may buy and sell by engaging a remisier from a broking firm. You need to open two accounts: (1) a trading account and (2) a Central Depository System (CDS) account. Both accounts can be opened at any stockbroking firm. To trade you are required to maintain a CDS account with Bursa Malaysia Depository Sdn Bhd (BMD) via your remisier. All transactions (buy and sell) will be registered into your CDS account.

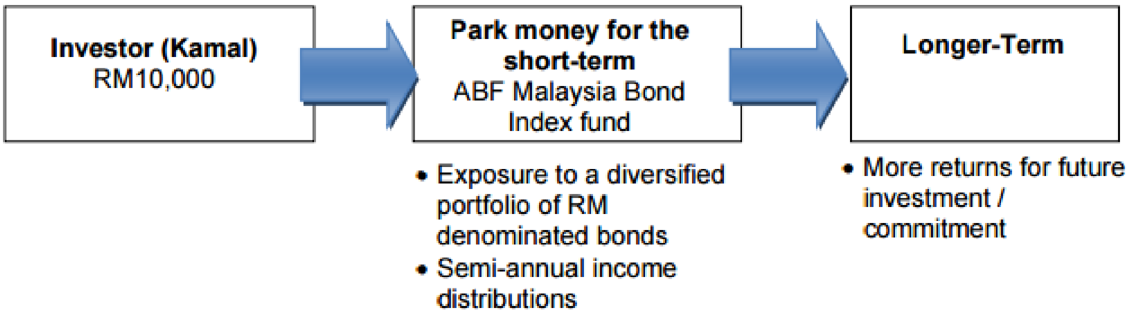
(ii) Trade online—alternatively, you may also trade online through online brokers. In Malaysia, most major banks offer e-broking services. To trade online, you must have an e-broking account plus a CDS account.

How can I use ETFs as a tool for wealth management?
You may use ETFs as a tool for wealth management by employing different investing strategies. Once you are clear on your investment purpose, choose an investment strategy—be it a cash management strategy or a core holding strategy.

How do I use ETFs as a cash management tool?
ETFs can be used as a cash management tool whereby idle cash can be invested in ETF on the short term while the longer term investment decision is to be made. You can take advantage of ETF liquidity by buying an ETF using the idle cash and sell it when you need the cash later.

For example: Kamal has RM10,000 cash. Due to the worsening economic outlook and the current low interest rate, Kamal does not want his money sitting in a low yielding fixed deposit. He wants to trade for capital gains in the short term while taking the time to analyse the market to decide on longer term investments. With the dropping interest rate, he sees the potential in Bond. Thus, he decides to first invest in the ABF Malaysia Bond Index Fund. He makes that decision after weighing the opportunity in gaining a diversified exposure to a basket of Ringgit denominated bonds that are relatively low risk as well as the possible market risk.

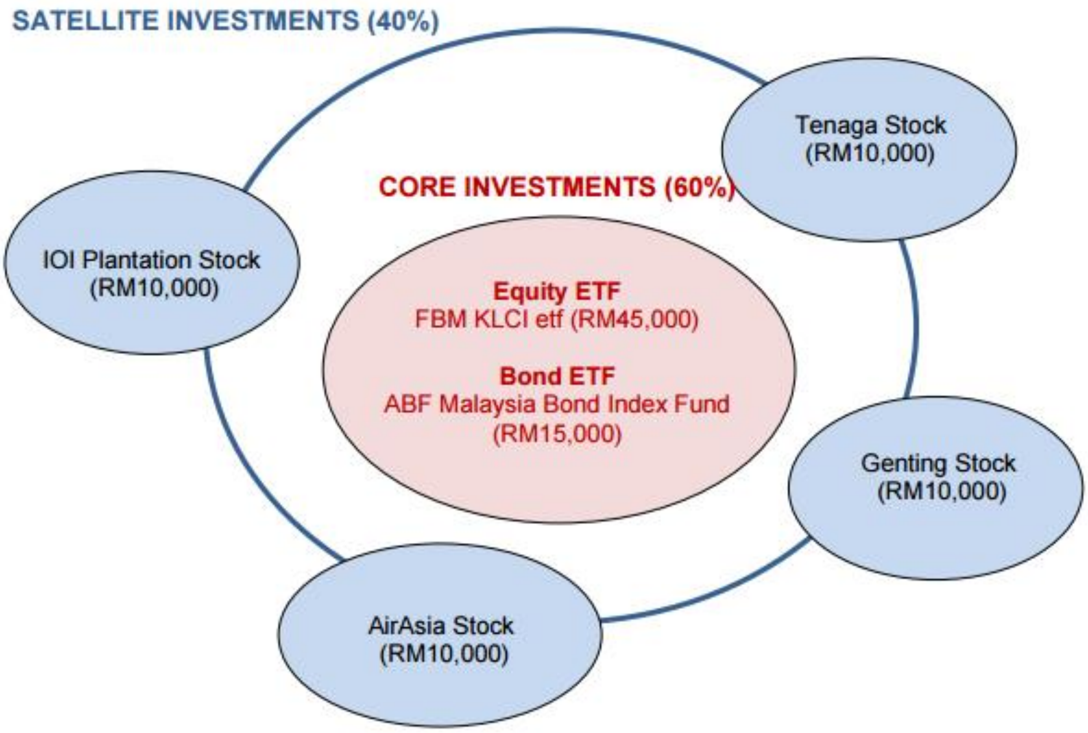
By buying into this Fund, Kamal will also be able to enjoy the semi-annual income distributions. When he is certain that the time is right, he will sell his Bond ETF and invest in other investments. The diagram below illustrates Kamal's cash management in the short-term in ensuring that his money works in the market.



How can I use ETFs as core investments?
ETFs can be used as the core investment in your portfolio. You can leverage on the broad diversification and lower costs of ETFs through the core holdings, and then add the satellite investments through the purchase of other stocks.

For example: John has RM100,000 and wants to build an investment portfolio. Using the core-satellite strategy, he intends to allocate 60% of the money into core investments and the balance 40% into satellite investments of other stocks. With an aggressive investment personality, out of the RM60,000, John plans to invest RM45,000 into FBM KLCI etf to gain a broad market exposure of Malaysian equities, and RM15,000 in the ABF Malaysia Bond Index Fund to gain exposure to a portfolio of government bonds. For his satellite investments, he plans to diversify with a few other equity stocks.

The diagram below depicts John's core-satellite investment portfolio.



For John, the use of ETFs as the core holdings is a practical approach as it offers instant diversification, lower expense ratios, and reduces his overall portfolio risk. Moreover, holding two different asset classes of ETFs also give him the flexibility to easily rebalance his portfolio to a new asset mix at different market time.

Conclusion

ETFs can open a whole new range of investing opportunities for investors. Including ETFs in your portfolio is not only easy to establish but also less costly compared to building a portfolio from multiple stocks or unit trust purchases. Before you invest, make sure you fully understand the features of the ETFs. Apply the tips that we have shared with you in this article. From there, pick the investment strategy that best fit you in building your investment portfolio.

Source :

[1]Bursa Malaysia (http://www.bursamalaysia.com/market/securities/equities/products/exchange-traded-funds-etfs) as at 29 April 2016.

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You should be aware that investments in exchange-traded funds carry risks. An outline of some of the risks is contained in the Prospectus dated 13 July 2009, Supplementary Prospectus dated 1 December 2014, Second Supplementary Prospectus dated 1 April 2015 and Third Supplementary Prospectus dated 10 September 2015 for ABF Malaysia Bond Index Fund (Prospectuses), and also in the Prospectus dated 7 June 2009, Supplementary Prospectus dated 6 July 2009, Second Supplementary Prospectus dated 1 December 2014, Third Supplementary Prospectus dated 1 April 2015, and Fourth Supplementary Prospectus dated 10 September 2015 for FTSE Bursa Malaysia KLCI etf (Prospectuses). Refer to the Prospectus(es) for detailed information of the specific risks for the fund. 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 and charges involved before investing.

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