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ETF Halftime: Bonds and Vanguard are Big Winners

Key Takeaways

- The ETF industry gathered approximately $190 billion of new money year to date as of June 17 – was on pace to have the second strongest yearly inflows, despite the emergence of an equity bear market and liquidity concerns.
- Driven by interest in corporate bonds and gold fixed income and commodity ETFs were particularly in high demand, even as they represented small slices of the ETF pie.
- The $81 billion of new money into fixed income ETFs has been directly and indirectly aided by the Federal Reserve's purchases of iShares iBoxx $ Investment Grade Corporate Bond ETF (**LQD**) and Vanguard Intermediate-Term Corporate Bond ETF (**VCIT**), which provided a confidence boost.
- Vanguard's ETF lineup pulled in $86 billion year to date, equal to the cash haul of the next six most successful asset managers, including industry leader iShares, as investors stayed relatively loyal to Vanguard's equity and fixed income suite.

Positive (+) or Negative (-) Implications
(+) iShares iBoxx $ High Yield Corporate Bond (HYG)
(+) iShares iBoxx $ Investment Grade Corporate Bond (LQD)
(+) SPDR Gold Shares (GLD)
(+) Vanguard S&P 500 Index (VOO)
(+) Vanguard Intermediate-Term Corporate Bond (VCIT)
(+) Vanguard Total Stock Market (VTI)
(-) iShares Core MSCI Emerging Markets (IEMG)
(-) iShares MSCI Emerging Markets (EEM)
(-) SPDR S&P 500 Index (SPY)
(-) Vanguard FTSE Emerging Markets (VWO)

Fundamental Context

ETFs passed the test in 2020. Year-to-date through June 17, the ETF industry gathered $187 billion of new money, according to First Bridge data – on pace to exceed the $328 billion of net inflows from 2019, despite the emergence of an equity bear market and a Covid-19-driven recession. While 2019 had the second strongest ETF inflows ever, behind only 2017's cash haul, skepticism remained prevalent that equity ETF investors would bail if the market volatility spiked while fixed income investors would face liquidity challenges from these relatively young products. The first six months of 2020 allowed ETFs to take and pass these tests.

The $74 billion equity ETFs gathered to start 2020 was strong, given the declines in most U.S. and international indexes. Rather than heading to the sidelines, many investors rebalanced into low-cost U.S. asset allocation products, such as Vanguard Total Stock Market Index (VTI 157 ****) Others favored growth-oriented funds, such as Invesco QQQ Trust (QQQ 244 *****). QQQ is highly exposed to information technology, Internet retail, and biotechnology companies positioned to benefit from the Covid-19 environment.

Meanwhile, fixed income ETF investors did not incur significant liquidity challenges when selling, and indeed many of these funds have been in high demand as a replacement for individual bonds. Fixed-income ETFs collectively gathered $81 billion of new money as of mid-June and were on pace to exceed 2019's record-setting $157 billion.

Fixed-income and commodities ETFs punching above their weight. Commodities ETFs collected $32 billion in net inflows so far this year. For the ETF category as a whole, the asset base continues to increase. After dipping below $4 trillion in overall assets at the end of the first quarterthe industry had $4.4 trillion as of mid-June – due to strong inflows and a partial recovery of the underlying securities. Relative to peers, the fixed income category captured 43% of the industry's new money in 2020, more than double its 21% overall share. In contrast, equity ETFs garnered 40% of the net inflows, almost half their 75% share of assets.

Though commodity ETFs make up just 3% of the assets, they pulled in a five-fold increase with a 17% share of net inflows thus far in 2020. As we will discuss, energy and gold ETFs were popular, though for different reasons.

Table 1: ETF categories flows in 2020

Category	YTD Net Flows ($B)	YTD Market Share	Assets ($B)*	Assets Market Share*
Bonds	81	43%	917	21%
Commodities	32	17%	121	3%
Equities	74	40%	3,284	75%
Total	187		4,378	

Source: First Bridge Data, a CFRA company. As of June 17, 2020. *Other ETFs make up the remainder of the total.

Credit sensitive fixed-income ETFs were in vogue. Demand for fixed income ETFs was aided directly and indirectly by the Federal Reserve's purchases of $5.5 billion worth of ETFs as of June 9 to support credit market liquidity. We think investor confidence toward fixed-income ETFs also improved, as the category's products traded relatively efficiently during the market volatility. iShares iBoxx $ Investment Grade Corporate Bond ETF (LQD 134 *****), iShares iBoxx $ High Yield Corporate Bond ETF (HYG 83 *****), and Vanguard Intermediate-Term Corporate Bond ETF (VCIT 95 ****) pulled in $15 billion, $9.9 billion, and $5.7 billion, respectively this year — landing on the top 10 list of asset gatherers. LQD and VCIT invest in bonds rated BBB or higher, while HYG incurs more elevated credit risk with lower-rated bonds.

Risk-off and risk-on investors embraced commodities ETFs. SPDR Gold Shares' (GLD 163 NR) $13 billion of net inflows ranked fourth overall, as investors sought exposure to the yellow metal as a hedge against economic uncertainty and fiscal deficits. Investors were rewarded as GLD significantly outperformed equity ETFs this year with double-digit returns. In contrast, demand for United States Oil Fund (USO 28 NR) was driven as investors sought to bottom fish despite falling energy demand. USO is the rare example where the $5.8 billion of net inflows in 2020 exceeds the $4.9 billion in fund assets, as the fund was down more than 70% this year.

Table 2: Top 10 Net ETF Inflows in 2020

Name	Ticker	YTD Net Flows ($B)	Assets ($B)
Vanguard S&P 500 ETF	VOO	16.2	142.7
iShares iBoxx $ Investment Grade Corporate Bond ETF	LQD	15.2	53.3
Vanguard Total Stock Market ETF	VTI	14.0	147.5
SPDR Gold Shares	GLD	13.2	63.0
Invesco QQQ Trust	QQQ	12.3	114.8
iShares iBoxx $ High Yield Corporate Bond ETF	HYG	9.9	28.6
SPDR Bloomberg Barclays 1-3 Month T-Bill ETF	BIL	7.2	16.1
Vanguard Mid-Cap ETF	VO	6.6	33.9
United States Oil Fund LP	USO	5.8	4.9
Vanguard Intermediate-Term Corporate Bond ETF	VCIT	5.7	32.4

Source: First Bridge Data, a CFRA company. As of June 17, 2020.

The largest ETF inflows and outflows came from products tracking the same index. Vanguard S&P 500 ETF (VOO) pulled in more than $16 billion in the nearly six months of the year to push its asset base above $140 billion. Some of the new money likely stemmed from outflows from SPDR S&P 500 ETF (SPY 309 ****). SPY had $21 billion of redemptions, as investors sought a cheaper alternative to SPY's 0.09% expense ratio. Yet, we think these products appeal to different investors. VOO's 0.03% expense ratio generates more interest from cost-conscious retail investors for asset allocation purposes, while the high liquidity that stems from SPY's daily volume of approximately 100 million shares appeals to institutional investors.

Table 3: Top 10 Net ETF Outflows in 2020

Name	Ticker	YTD Net Flows ($B)	Assets ($B)
SPDR S&P 500 ETF Trust	SPY	-21.1	277.2
iShares MSCI EAFE ETF	EFA	-10.1	46.1
iShares Russell 2000 ETF	IWM	-5.5	35.9
iShares Core MSCI Emerging Markets ETF	IEMG	-4.8	49.5
iShares MSCI Emerging Markets ETF	EEM	-4.6	21.9
iShares Floating Rate Bond ETF	FLOT	-3.7	5.9
iShares MSCI Japan ETF	EWJ	-3.4	9.8
Vanguard FTSE Emerging Markets ETF	VWO	-3.4	56.1
iShares Core S&P Mid-Cap ETF	IJH	-3.4	42.8
iShares U.S. Treasury Bond ETF	GOVT	-3.0	13.8

Source: First Bridge Data, a CFRA company. As of June 17, 2020.

Broadly diversified emerging markets were out of favor regardless of fees. The now $22 billion iShares MSCI Emerging Markets ETF (EEM 40 ***) has been bleeding assets in recent years, as retail and institutional investors have preferred cheaper alternatives, including the $56 billion Vanguard FTSE Emerging Markets ETF (VWO 40 ***) and $50 billion iShares Core MSCI Emerging Markets ETF (IEMG 48 ***). However, in 2020, all three of these ETFs experienced high outflows as investors limited exposure to China, Taiwan, India, and other typically high-growth, but high-risk markets. IEMG's $4.8 billion of redemptions modestly exceeded EEM's $4.6 billion, even though IEMG's 0.14% expense ratio is less than one-fourth the price of EEM. With $3.4 billion of net outflows, VWO was the only other ETF besides SPY from the top10 outflows list not managed by iShares.

iShares Russell 2000 ETF (IWM 141 *), iShares Floating Rate Bond ETF (FLOT 51 ***), and iShares MSCI Japan ETF (EWJ 56 ***) were among the others from iShares to have more than $3 billion of net outflows.

Table 4: Top 10 Inflows for Asset Managers

Name	YTD Net Flows ($B)	Assets ($B)
Vanguard	86	1,180.5
BlackRock (iShares)	34	1,649.5
State Street (SPDR)	22	711.3
ProShares	11	39.6
Direxion Shares	7.7	16.0
United States Commodity Funds	6.4	6.3
JPMorgan Chase	5.8	35.4
Schwab	4.5	157.9
First Trust	4.1	86.8
Invesco	3.5	228.8

Source: First Bridge Data, a CFRA company. As of June 17, 2020.

Vanguard has dominated in 2020. Vanguard pulled in an impressive $86 billion of net inflows thus far in 2020, equal to the cash haul of its next six more successful asset manager peers. The firm has four of the 10 most popular ETFs of the year and few blemishes, as Vanguard ETFs were used to rebalance asset allocation strategies when the markets sold off during February and March. Despite weakness from emerging markets, iShares gathered $34 billion, second most overall, aided by its diverse fixed income lineup.

Inflows to GLD and some S&P 500 based sector ETFs helped State Street Global Advisors offset the pressure from SPY's outflows this year. The asset manager had $22 billion of net inflows and matched its third place in the ETF assets leader board. However, leverage and inverse ETFs offered by ProShares and Direxion helped these much smaller firms pull in the fourth- and fifth-highest net inflows in 2020 with $11 billion and $7.7. billion, respectively, more than larger asset managers, such as Invesco and Schwab.

Conclusion

ETF inflows so far this year demonstrate the ongoing popular of ETFs as an investment instrument, as well as a broadening of interest beyond equities and into fixed income and commodity ETFs. This is a trend CFRA expects to continue.

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