

Thesis

Product Update

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ETFs - what's the fuss all about?

Exchange Traded Funds (ETFs) are not new. Barclays Global Investors debuted its iShares (now part of BlackRock) line in 2000 and since then the market place has exploded with new entrants. So why has the debate emerged now over the supposed dangers of ETFs?

ETFs allow investors to gain exposure to a specific index or basket of securities without having to pay the costs of active management. This effectively means the product passively tracks the performance of the underlying basket at a lower cost than a tracker fund, albeit at the expense of no possible outperformance. ETFs are structured as qualifying open ended funds (unit trusts). This limits the maximum holding size of any one asset within the fund (10%) and thus limits the funds ability to focus on one individual asset class. This has led to the creation of another form of ETF - the Exchange Traded Note (ETN).

ETNs allow investment directly in one or a small group of underlying assets, for instance Gold or a small group of commodities. As a result ETNs enable investors to benefit from directional movements in commodities, which until the advent of these instruments was the preserve of futures traders or banks with large vaults.

There are, however, risks associated with investing in ETFs and ETNs.

One increasingly divisive issue surrounding ETFs is their construction. Various methods can be employed ranging from the basic 'physical' ETF that invests funds directly into the underlying securities, to the 'synthetic', which can enter into various swap arrangements with the aim of replicating the

underlying return without actually owning the securities. As explained opposite, this does not guarantee the return.

Given the liquidity and fact that ETFs have no set trading hours, they have also become a popular hedging instrument. This can become a problem though, as prices are not set at NAV (as with other open ended investments) but are arrived at through supply and demand. Thus if a large holder became an aggressive seller, the price could fluctuate greatly from its NAV, and potentially to an investor's detriment.

Our view

ETFs and ETNs have an important role to play in any portfolio. They can be used to gain exposure to hard to reach asset classes such as the Thesis exposure to Gold, or can be used in conjunction with Asset Allocation models to produce low cost portfolios that are in-line with the house view.

As with any investment there are risks but when used correctly ETFs should be assets rather than liabilities.

Optima Fund Factsheets

Details of the performance and other information of the entire range of Optima Funds can be found on our website.

Factsheets are available to download for each of the following funds:

Optima Growth Fund
 Optima Cash Fund
 Optima Bond Fund
 Optima Balanced Fund
 Optima Multi Asset Strategy Fund
 Optima Income Fund

What are the risks?

- **Counterparty risk** - ETFs are provided/run by third parties (banks) which often invest and guarantee the assets purchased -as such the risk the counterparty fails (Lehman Brothers) is an important consideration
- **Physical vs Synthetic** - Physically invested ETFs are straightforward, however Synthetic ETFs may be a web of many different investments based on correlation measures, and thus may not always behave as expected
- **Leverage** - Many providers offer leveraged ETFs to increase potential gains and offer out-performance. This can however lead to a very quick loss instead
- **Currency** - If a fund's investments are denominated in a different currency than the underlying base currency this can also increase volatility.

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