

ETF INVESTMENT LANDSCAPE

Q&A with Matt Camuso



Matt Camuso is Head of ETF Solutions at BNY Mellon Investment Management. He began his career in ETFs in 2012.

ETFs, or Exchange-Traded Funds, are more than 30 years old. A growing and innovative investment vehicle, ETFs are still an area that some find complex. Here, BNY Mellon Investment Management Head of ETF Solutions Matt Camuso shares his thoughts on the current ETF landscape, including recent innovations and potential headwinds.

What are some key elements that you believe are most important for new ETF investors to know?

I think it's important for new investors to really understand the mechanics behind how ETFs work. Most importantly, how they are traded and what makes them tax efficient. To do this, we often look to draw similarities rather than differences and argue that the ETF is more like a 'cousin' of the mutual fund and closed-end fund. We think an ETF brings the benefits of both of those structures into one vehicle, to create an open-ended fund that trades via an exchange. At its core, an ETF is simply just a delivery mechanism of an investment strategy, whether it be active or passive.

What do you think are the biggest misconceptions about ETFs?

That every ETF is passive. From the first ETF in 1993 through 2008, they

were all passive. So that's still in the back of many people's minds. But, that's simply not the case – there's a lot of active ETFs in today's market.

The second misconception is that an ETF itself isn't liquid. An ETF is as liquid as its underlying holdings. An ETF with 500 stocks has the liquidity of those 500 names, it's just more efficiently bundled to purchase one ticker rather than 500. The ETF is not a strategy itself, just a delivery tool.

ETFs have seen remarkable growth in recent years. What do you think is behind the shift in investor appetite?

A couple of reasons – first is the comfortability of the ETF wrapper. The industry has done a lot of work to make investors more comfortable with the mechanics of ETFs, it's a key part of our job.

Since ETFs started, they've been tested through many volatile periods,



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or different market environments and have historically proven to be efficient. The type of innovation of underlying investment strategies that have been brought into the ETF wrapper helps clients navigate different market environments. We've seen a rise in quantitative or outcome-oriented strategies that have drawdown metrics or are volatility hedged. The dynamics of the underlying investment strategies that have come out of the ETF industry have enhanced investors' tool kits, to help them build a comprehensive portfolio.

There is also an increasing number of products available, so today there's more selection for investors. Many asset management firms across the world have an ETF range. More choice brings more adoption.

How do you believe the ETF market will continue to grow?

We're only touching the surface for active ETFs so there is opportunity for not only product growth but asset growth. I think we're going to see even more product proliferation, and flows, over the next five years. Added to that is the adoption of fixed income ETFs across a varying set of clients. We're seeing a lot of institutional adoption as well and it all goes back to the innovation and operational efficiencies an ETF can bring.

What would you consider to be potential headwinds for ETFs?

Since the ETF liquidity profile is deemed by its underlying holdings,

some of my concerns are that as the industry becomes very crowded, you might have some issuers trying to put together a strategy that really doesn't fit inside the ETF model. As we consider our product development, we want to make sure the underlying components of a strategy have a very strong liquidity profile. Not every asset class belongs in an ETF. With more esoteric-type asset classes, investors will need to be vigilant about the underlying liquidity profile of the ETF.

Another challenge is truly understanding how ETFs work. I think a lot of people miss an opportunity to buy a unique strategy just because they don't understand the liquidity or how ETFs trade.

How have you seen index investing evolve?

We've seen a massive increase in product and adoption of "factor-based" index strategies, which are single or multi-factor strategies that filter by quality, value, growth or momentum. Once the strategy filters by factor, it weights the stocks by the best scoring.

I think the design of such strategies means investors get more choice in low-cost investing options with a more fundamental approach.

Can you describe some of the newer technology that's supported the ETF evolution over the last few years?

For a while there were only a couple of debt-weighted or fixed income ETFs on

the market. And everyone bought them for the right reasons, for instance, diversification, efficiency and relatively lower costs. Today, we have custom baskets, which are a newer technology enabling the efficient execution of a customized list of assets to meet an ETF issuers' criteria to satisfy the inflow or outflow. Leveraging this new technology to seamlessly exchange security lists is helping to drive the growth we're seeing, particularly in fixed income ETFs.

Do you see any challenges to launching ETFs in the future?

The biggest challenge that keeps me up at night is that there are so many issuers coming to market that it becomes tough to stand out. There can be unique strategies that are being launched that kind of get lost in the mix. And I believe that it will only become more challenging in the future.

During times of market volatility, how do you believe an investor should approach an ETF strategy?

ETFs can sound the same by title and might have roughly the same descriptor so it's crucial to know what you own. We say, 'lift up the hood' of your ETF to find out the exact exposure and really learn what it's made of. In times of market volatility, you should have an expectation of how your fund will perform. Too often investors want to just buy cheaper funds, they never take the time to see what the ETF actually owns. Then in times of volatility, when the underlying

strategy ends up being drastically different to what they expected, they're disappointed.

What are your thoughts on the age-old active vs. passive management debate?

Our big belief is moving the conversation from active versus passive to active and passive. Who's saying you can't do both within the same asset class? It really depends on the outcome an investor is looking for— are they focused on income, or downside mitigation? Whatever the outcome, look at passive and active options rather than active versus passive. It's important to consider how such strategies can really work together in a portfolio to achieve a defined outcome.

Where do you see the ETF space heading at BNY Mellon?

I think it's really a continuation of what we've already done. If you look at the tagline of our ETF platform, it's choice, quality and experience. In product development, we look to provide our investors choice when it comes to their ETF selection by looking across our underlying investment firms and finding quality solutions. I see us continuing to grow across every category in the ETF landscape, finding opportunities for innovation and adding more choices. Also looking at what I call our "embarrassment of riches" of experienced investment specialists across our affiliates and finding the best solution for that category.

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Recent market risks include pandemic risks related to COVID-19. The effects of COVID-19 have contributed to increased volatility in global markets and affected certain companies, industries and market sectors more dramatically than others.

ETFs trade like stocks, are subject to investment risk, including possible loss of principal. The risks of investing in ETFs typically reflect the risks associated with the types of instruments in which the ETF invests. Diversification cannot assure a profit or protect against loss.

ETF shares are listed on an exchange, and shares are generally purchased and sold in the secondary market at market price. At times, the market price may be at a premium or discount to the ETF's per share NAV. In addition, ETFs are subject to the risk that an active trading market for an ETF's shares may not develop or be maintained. Buying or selling ETF shares on an exchange may require the payment of brokerage commissions.

The ETF funds will issue (or redeem) fund shares to certain institutional investors known as "Authorized Participants" (typically market makers or other broker-dealers) only in large blocks of fund shares known as "Creation Units." BNY Mellon Securities Corporation ("BNYMSC"), a subsidiary of the BNY Mellon, serves as distributor of the fund. BNYMSC does not distribute fund shares in less than Creation Units, nor does it maintain a secondary market in fund shares. BNYMSC may enter into selected agreements with Authorized Participants for the sale of Creation Units of fund shares.

ETF tax efficiency can be derived from certain structural elements, including; turnover in passive strategies are typically lower than that in active; and there can be structural tax benefits from in-kind redemptions. When assets are delivered from the ETF via an in-kind transfer, no capital gains are realized. This can allow investors more control over the timing of their tax liabilities based on when they generally sell their position. Please consult your own tax advisor or financial professional for more detailed information on tax issues as they relate to your specific situation.

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