Insights
Asset Allocation

January 2024

European ETF Industry Evolution: $2Tn is Still in Sight as ETF Usage Democratises

SPDR ETF Strategy & Research Team

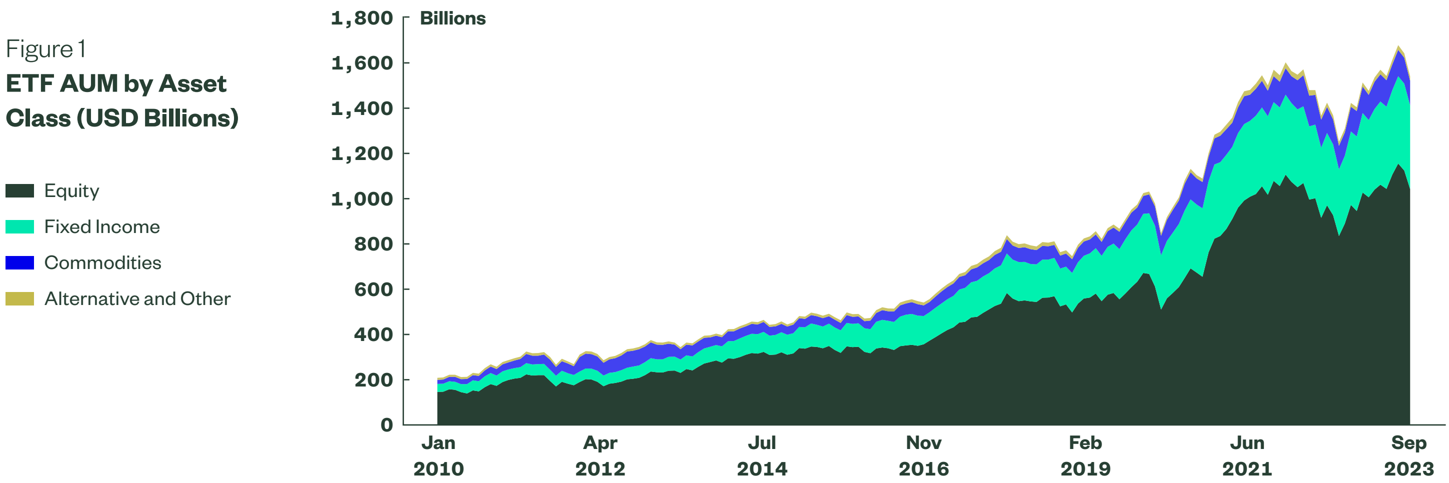
ETFs have seen strong growth and in Europe, total assets now exceed $1.5 trillion. In this paper we look at the trends across asset classes from the past 10 years and what the industry could see going forward.

Introduction

ETFs have been available in Europe since 2000, however it is only since the Global Financial Crisis that ETFs have really seen a boom in their asset growth. Over this period, ETFs in Europe have seen a Compounded Annual Growth Rate (CAGR) of more than 16%, starting 2010 with just $228 billion of assets, and entering the new decade with just over $1 trillion in total assets.

By the end of 2022, ETFs have swelled to even loftier heights, buoyed by massive inflows that year and surging markets following the dip triggered by the coronavirus pandemic crisis. European ETF assets achieved a level of just over $1.5Tn, adding half a trillion in the previous year alone. In July 2023, Europe-domiciled ETFs achieved an all-time high level of assets under management, that is over $1.65Tn.

Figure 1
ETF AUM by Asset Class (USD Billions)



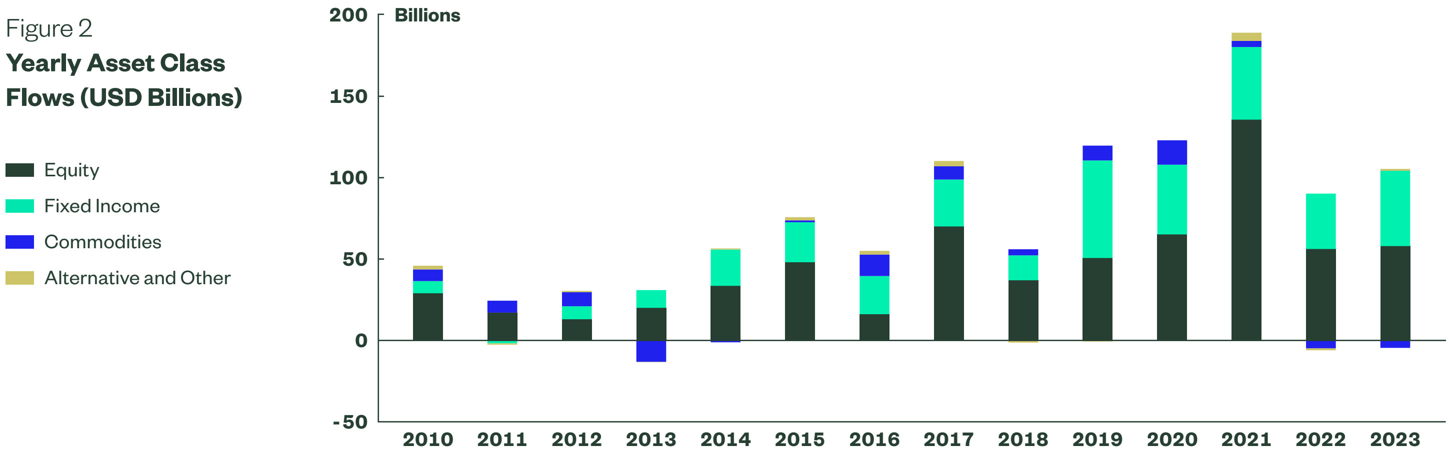
Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

So what have been the main products driving this phenomenal growth in the industry? For most of the decade, Equity products (to begin with the broad market beta products, but to a greater extent more recently Smart Beta and Sector products) have been the main driver of flows. However, for the last few years Fixed Income has started to accelerate its asset gathering, with 2019 seeing $60bn of new assets being added to these products, more than double the previous record year set in 2017. From the beginning of the 2019 until end of September 2023, the average yearly share in asset flows equalled 38.70% for Fixed Income and 58.41% for Equities.

2021 has seen a return to Equity products driving flows, as investors seek to capture the extraordinary economic growth spurred on by economic re-openings. Although Equity has outpaced other asset classes for flows in the majority of years, it is worth noting that the volatility in flows that Equity sees intra-year is far higher, with very sudden shifts in flows month by month, whereas Fixed Income flows especially tend to be a lot more steady. This state of affairs however ceased in the following years, when the volatility calmed.

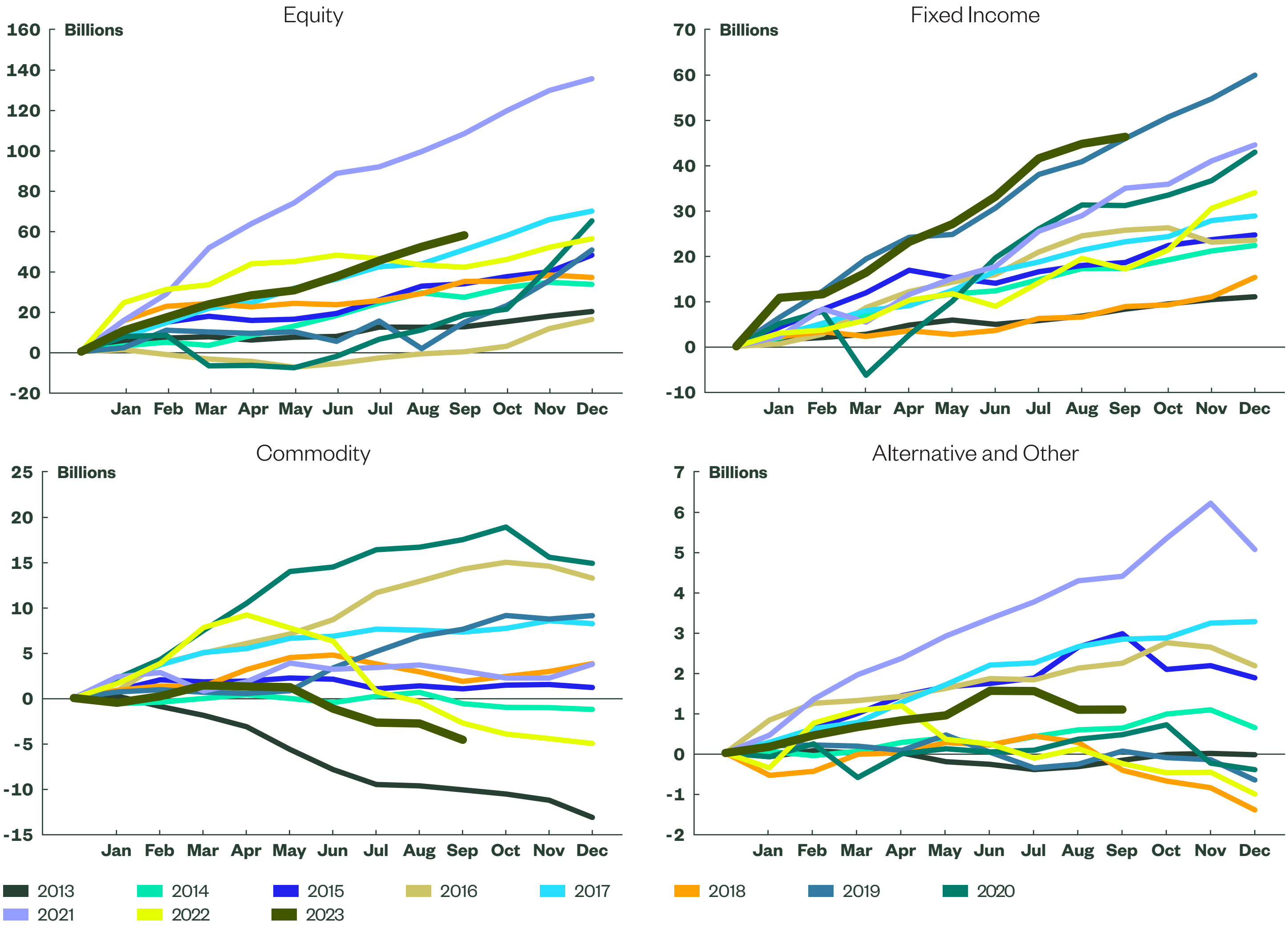
2021 has also been a record year for Alternative and Other exposure flows, largely driven by the launches of cryptocurrency ETFs in Europe which have gathered significant assets. Although these flows are still dwarfed by other asset classes.

Figure 2
Yearly Asset Class Flows (USD Billions)



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Figure 3
Annual Cumulative Asset Class Flows (USD Billions)



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Equity

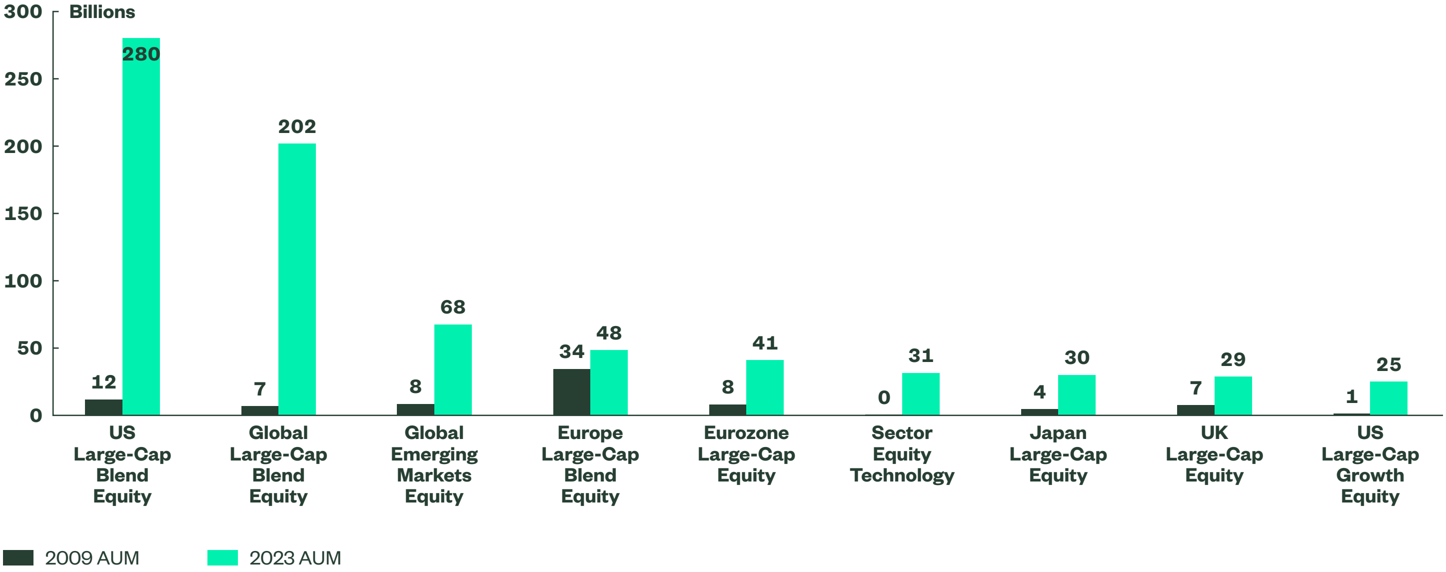
Equity is largely dominated by US Large Cap products, with many of the largest ETFs in Europe being benchmarked to the S&P 500 index. As well as attracting consistent and sizable inflows, these ETFs have also been helped by a roaring bull market, that has helped drive the AUM of these products up organically.

It is interesting to note that this was not always the case. In 2010 Europe and Eurozone focussed Equity products held a much greater proportion of total assets, and were by far the most popular exposure. Even Europe single country products, such as UK, Germany and Swiss Equity, held relatively large proportions of assets compared to the rest of the market.

Although these products still account for a large portion of total AUM, they have seen their market share eroded by growth in more diversified exposures, such as globally focussed products, as well as Emerging Markets and Japanese Equities.

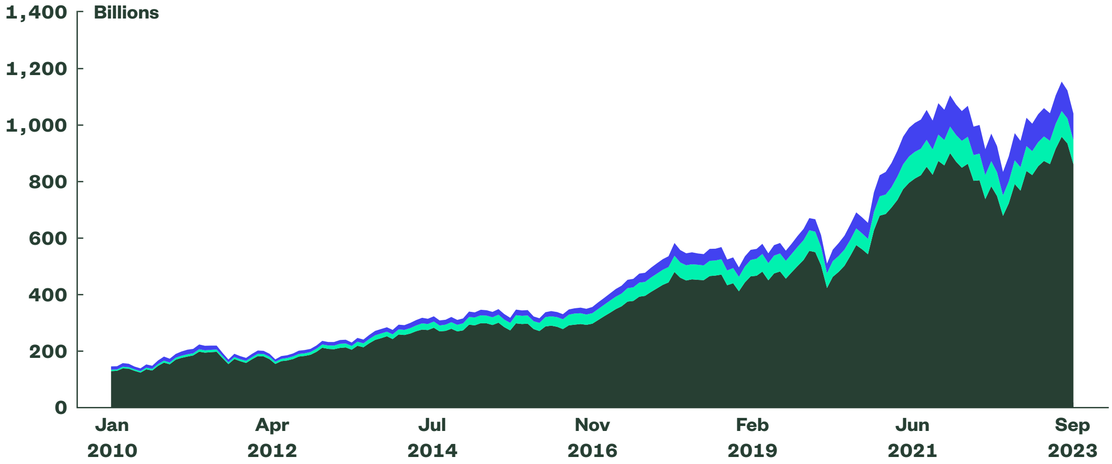
The other two areas that have seen significant expansion of assets in more recent years are Smart Beta and Sector ETFs, as investors have begun to use ETFs as a way to implement investment strategies and gain exposure to individual industries or factor portfolios through an ETF wrapper. Technology focussed ETFs in particular have become a very popular ETF for investors to use, partly helped by surging market capitalizations of the underlying companies within this sector.

Figure 4
10 Largest Categories in Equity by AUM



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Figure 5
Equity AUM Evolution by Category



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Fixed Income

Fixed Income started the decade in a fairly similar position to Equity, with Euro exposures being by far the most popular exposure to begin with, both in the Government and Corporate space. However, as time has gone on, Euro exposures have kept their dominant position, albeit in a much more diversified way, with no single exposure taking a particularly dominant position.

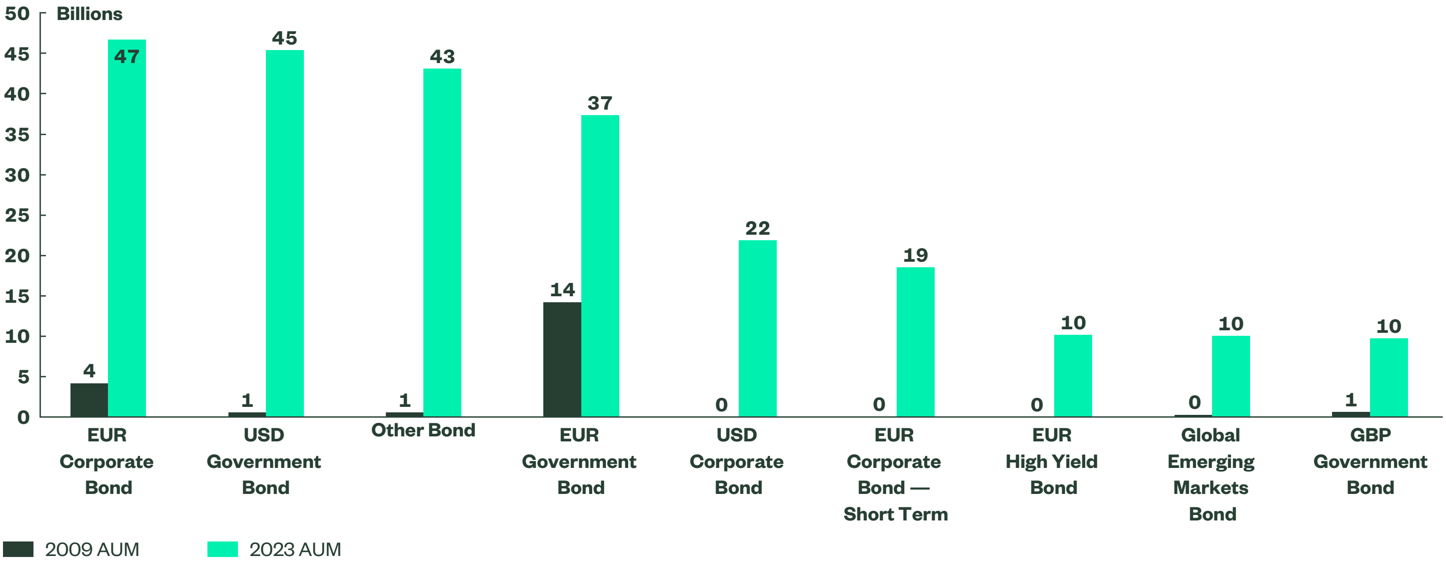
Unlike Equity, a lot of exposures that are now most popular were not being used by ETF investors 10 years ago. The biggest beneficiaries of this effect have been USD denominated exposures, as well as Emerging Market Debt Local Currency, which has grown to over $14Bn in assets from nothing 10 years ago, as well as another $16Bn just in China Local Currency Debt.

Another great beneficiary of the expansion in Fixed Income ETF coverage is High Yield exposures, both in Euro and USD space. These were also unaccounted for in ETFs at the start of the period, but have swelled to a combined $22bn, as investors look to take advantage of the added liquidity that ETFs can offer when accessing this notoriously difficult to access asset class.

One other product segment that has seen significant growth is targeted maturity products, which Fixed Income investors can use to easily adjust the duration of their portfolios. This is demonstrated by the adoption and expansion of the Short Duration products below, which have seen particular popularity more recently as investors look to shield their portfolios from bouts of volatility.

Figure 6

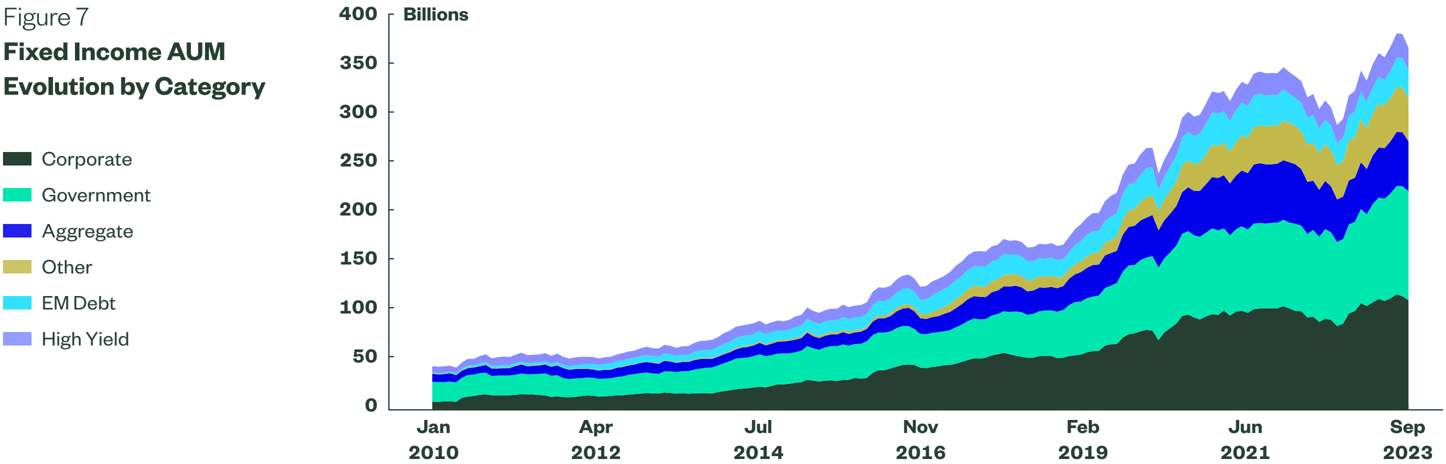
10 Largest Categories in Fixed Income by AUM



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Figure 7

Fixed Income AUM Evolution by Category



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

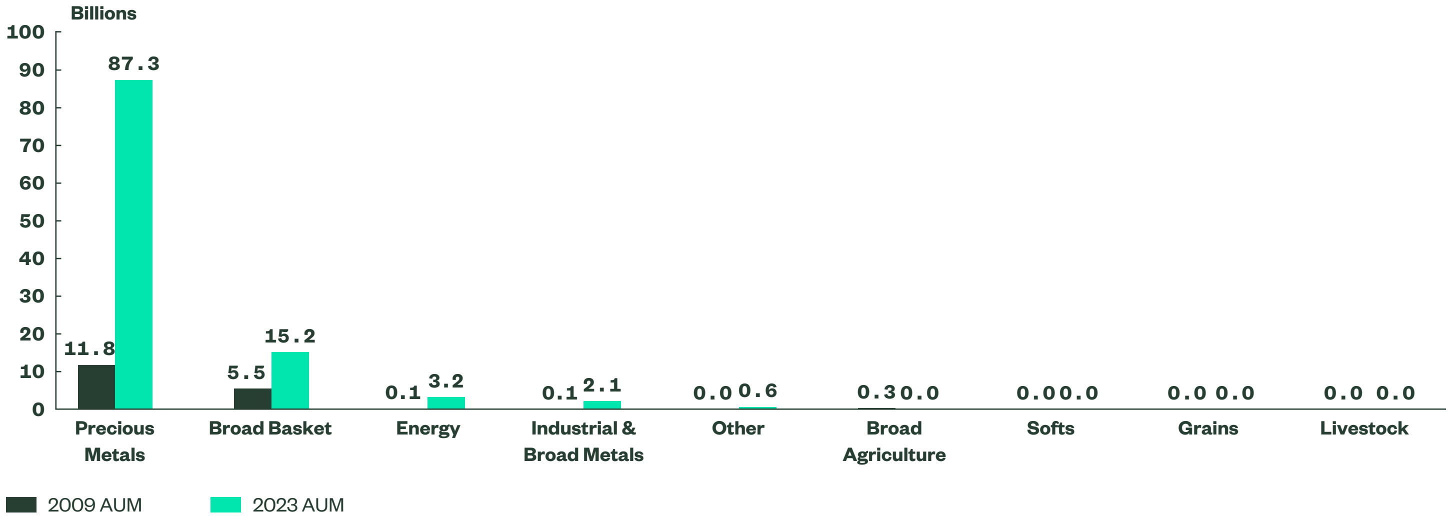
Commodities

Commodity ETFs 10 years ago were dwarfed by other asset classes, as investors mostly used ETFs for their Equity and Fixed Income asset allocations. However, more recently, investors have begun to use Commodity ETFs as a way of gaining exposure to this asset class.

This is particularly the case for Precious Metals, which have ballooned to over $136Bn of assets, at its peak in March 2022. Gold ETFs have been big contributors to this (over $110Bn of assets in beforementioned month), as investors have sought exposure to the yellow metal as the price has surged, especially following the coronavirus crisis and the subsequent global drop in bond yields.

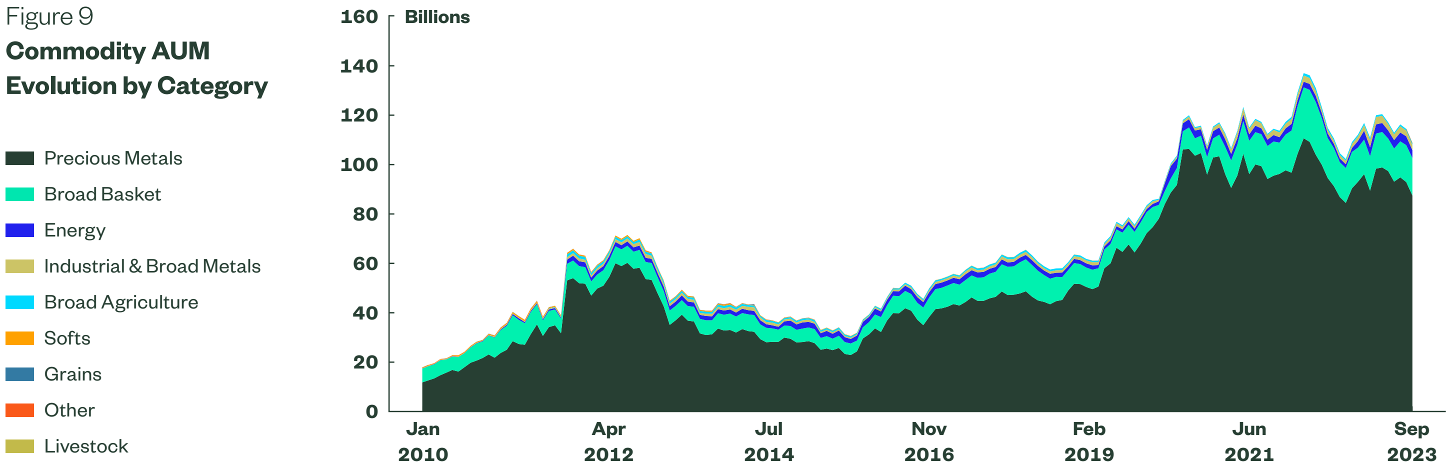
Energy has also seen significant expansion in assets, mainly from investors using oil ETFs as a way to make bets on oil prices.

Figure 8
Commodity AUM by Category



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Figure 9
Commodity AUM Evolution by Category



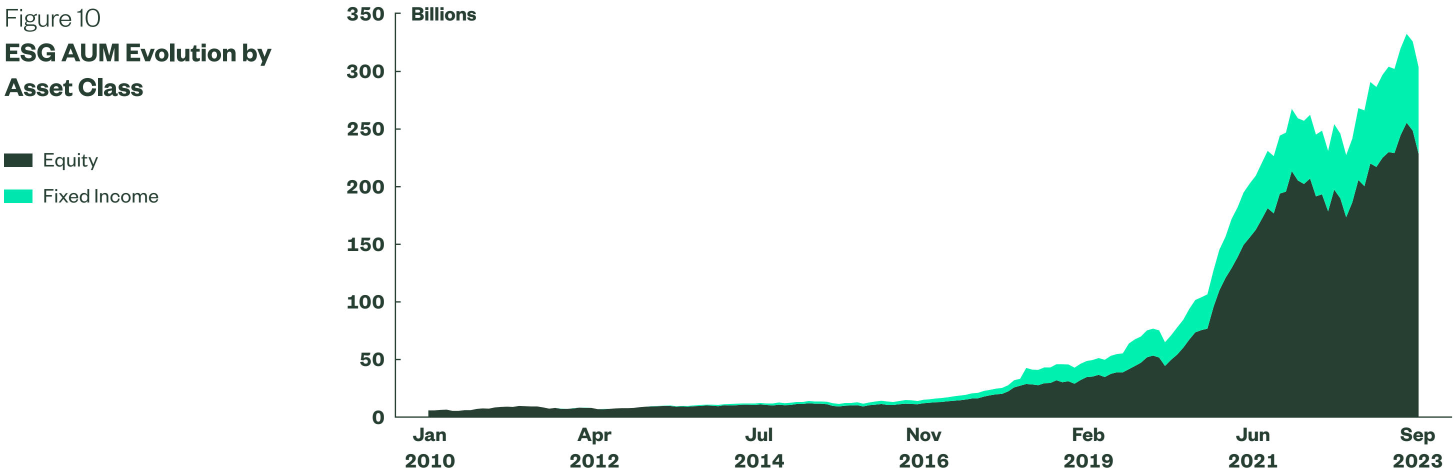
Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

ESG ETFs

ESG ETFs were not initially popular with investors, with the AUM in these instruments remaining below $15Bn until the middle of 2017. After this, the popularity of these products exploded, and particularly in the last three years the growth in assets has been outstanding, with the total skyrocketing past $331Bn in July 2023.

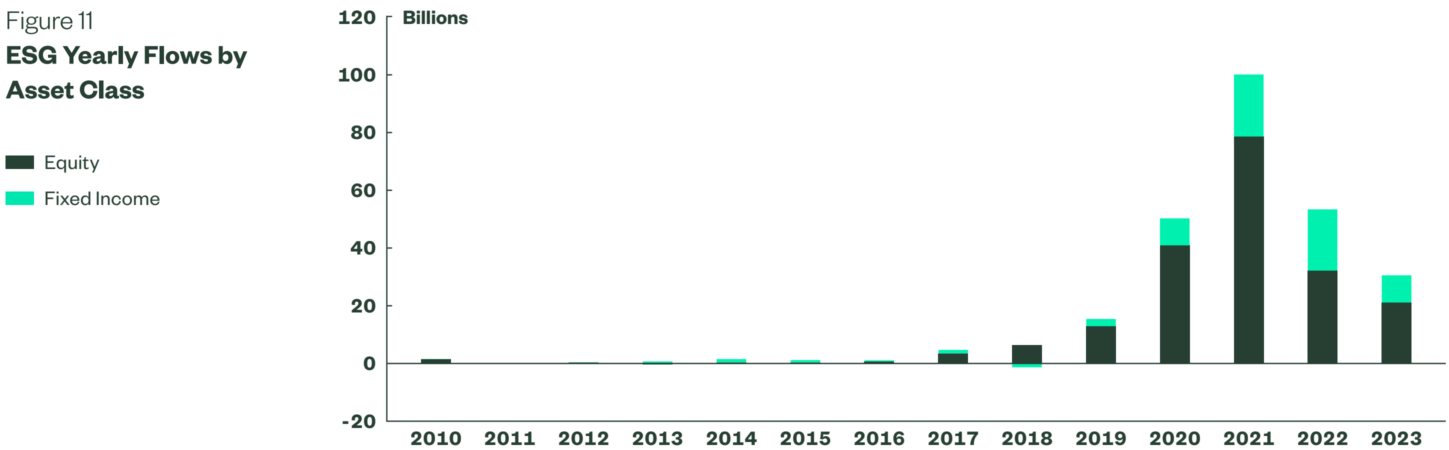
Initially, Equity made up almost the entirety of the ESG ETF AUM, however in the last couple of years Fixed Income has begun to grow in popularity as well within the ETF space, and assets in these products now stand at almost $75Bn, however Equity inflows have still far outpaced Fixed Income so far this year, with just $9Bn flowing into Fixed Income ESG ETFs compared to $21Bn flowing into Equity in September 2023.

Figure 10
ESG AUM Evolution by Asset Class



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

Figure 11
ESG Yearly Flows by Asset Class



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

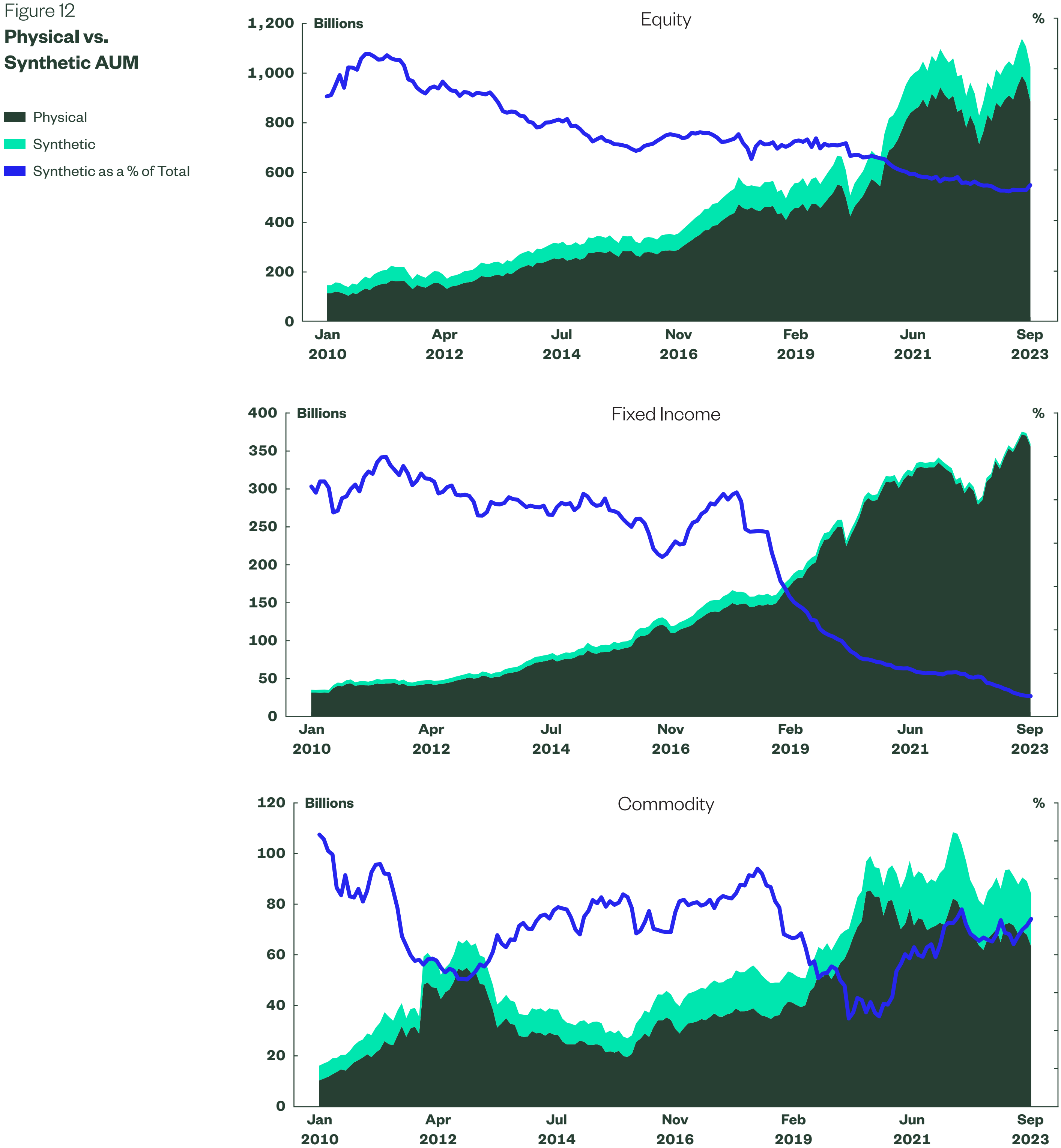
Physical vs. Synthetic ETFs

In Europe, investors can choose whether they want to invest in physically-backed ETFs (which hold the underlying securities and either directly replicate the index or replicate it through a process of optimization or sampling), or synthetic ETFs (which replicate the index through use of a Total Return Swap or other Derivatives).

Across asset classes, Physical is very clearly the preferred option for investors, and has been taking more of the share as time goes on, particularly in Fixed Income where synthetic ETFs now account for just 0.95% of the total market, with the share declining significantly over the last 5 years.

Commodity has also seen a fall in the proportion of synthetic assets, largely driven by the swell of inflows into Precious Metals ETFs in the last 5 years, where investors clearly favour physically-backed products over synthetic, although we did see synthetic begin to take back some of this share in the last year when Gold ETFs started to record outflows in the more risk on environment.

Figure 12
Physical vs. Synthetic AUM



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions.

What Could the Future Hold for the European ETF Industry?

The growth in Assets held by European ETFs has been widely reported, as has the potential for continued room to grow going forward, as new industry players enter the European ETF market regularly, hoping to capitalize on this growth. But what can we expect from the European ETF market in the future? Figure 13 shows projected future AUM levels under 3 different scenarios.

The first projection assumes the industry continues to grow at the same Compounded Annual Growth Rate that it has for the last 5 years (13.48%). Under this assumption, we can see that by 2028 ETFs in Europe could well surpass the $2.8Trillion mark.

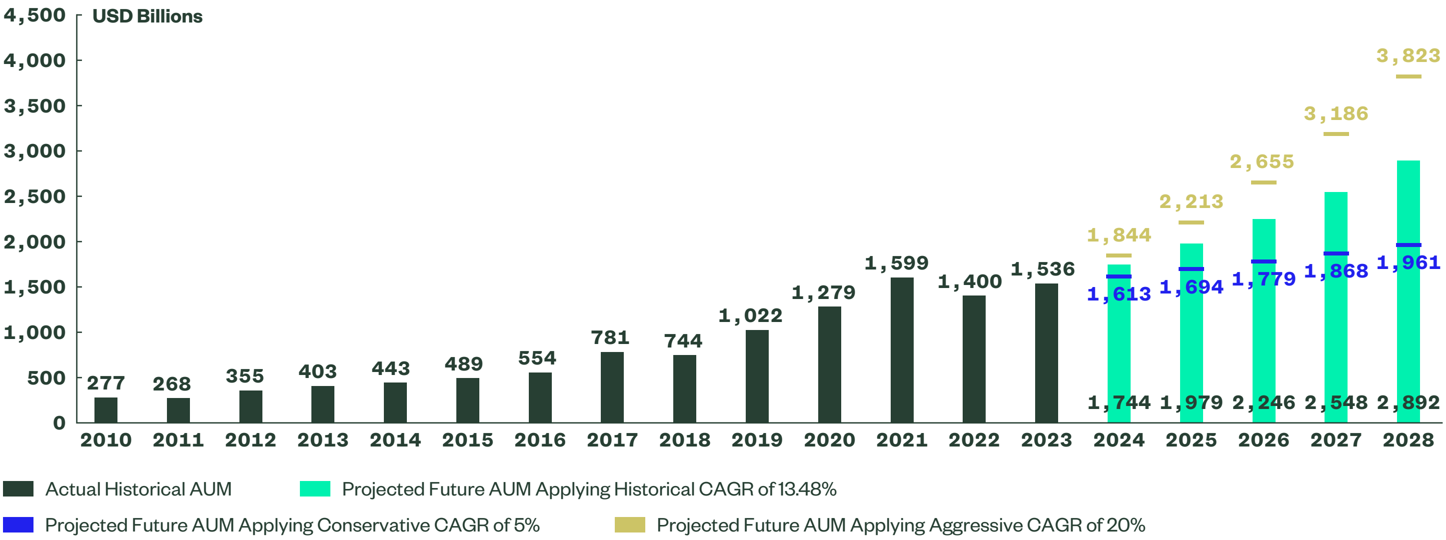
We have also taken two other projections, a more conservative assumption that growth will slow (due to a slowdown in adoption as the industry begins to mature) to just a 10% Annual Growth Rate, or a more aggressive annual growth rate (as investors get more comfortable with the vehicle and therefore plough money in at an exponential rate, as we have seen in the past years) of 20%.

Under the more cautious expected growth rate, the industry would still be predicted to reach $1.9 Trillion by 2028, while under the more aggressive scenario, assets could swell to almost $3.9 Trillion.

While some may question whether the European ETF industry could really more than double by 2028, it is worth noting that the US went through a similar rate of growth after breaking through $1.5Trillion in assets in July 2013. Within 4 years, the industry had managed to surpass the $3Trillion mark. European ETFs are in a similar position now that US ETFs were then, they still make up a much smaller proportion of the overall fund universe, and European investors are still in the midst of an adoption of passive instruments, which lends itself to continued growth in the European ETF space.

Figure 13

Annual European ETF AUM and Projected Future AUM



Source: Morningstar Direct, as of 30 September 2023. All figures expressed in USD billions. The above estimates are based on certain assumptions and analysis. There is no guarantee that the estimates will be achieved.

The SPDR ETF Strategy & Research EMEA team thanks Adrian Zachariasz (Cracow University of Economics) for his major contribution to this piece.

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