Education
**Fixed Income**

**February 2020**

# A Framework for Selecting Fixed Income ETFs

The growth of ETFs has made the task of navigating the investment landscape more challenging. This practical framework can help investors select the fixed income ETFs that best meet their needs, whether they're seeking risk, yield or diversification.

**1. Evaluate Your Investment Objectives**
Does the ETF you're considering align with your investment objectives?

| Questions to ask | Why is this important? |
|---|---|
| What is your risk tolerance? | Understanding your risk tolerance for your fixed income investment is the most important element of investing. Are you investing strategically over the long term or tactically? Is your style dynamic or buy and hold? The ETF should be as precise a match for your investment objectives as possible. |
| What is your investment horizon? | The transparency, tradeability and cost-efficiency* of ETFs may help strategic investors with a 5- or 10-year horizon who are cost and tracking conscious, as well as tactical investors with a 3-month horizon looking for easy and liquid access. |
| Is your portfolio diversified? | Diversification across factors such as region, country, asset class and currency can help lower idiosyncratic risk and overall portfolio volatility. |

**2. Evaluate the Index**
Does the index align with your portfolio?

| Questions to ask | Why is this important? |
|---|---|
| How does the ETF replicate the underlying index? Physically, optimisation/sample-based or synthetically? | The method may have implications for the ETF's tracking error, cost and risk. The method of choice for most fixed income ETFs is an optimisation/sample-based approach to create a representative or optimised portfolio of securities that closely matches the characteristics of the underlying index. |
| How long has the index existed? | Even as new indices are constructed, the index family's (e.g. Barclays, FTSE) tenure in the marketplace can indicate a measure of stability. |
| What is the index weighting methodology (e.g. market-capitalisation)? | Disparate index weighting methodologies can lead to differences in performance and risk/return characteristics among seemingly similar indices. |
| Does the index report holdings on a daily basis? | Transparent holdings data is key for understanding the benefits and risks in the underlying bonds. This data should be easily available on the index provider's website. |
| How often is the index rebalanced? | Traditionally, fixed income indices rebalance monthly on the last business day of the month. It allows for concentrated trading at month end and includes new issues. |
| Do the index's holdings overlap significantly with existing strategies in your portfolio? | Significant portfolio overlap can leave your portfolio over-exposed to various regions, issuers or durations. An index approach may ensure there is little or no overlap due to its transparent nature. Active management exposures in your portfolio may leave you over-exposed to specific risk factors. |
| What are the index risks? | The main sources of risk associated with fixed income indices are: currency risk, interest rate risk, credit risk and liquidity risk. |

* Frequent trading of ETFs could significantly increase commissions and other costs such that they may offset any savings from low fees or costs.

### 3. Examine the ETF Issuer

Does the firm have a solid reputation in the ETF marketplace and the appropriate resources and skills in fixed income investing?

| Questions to ask | Why is this important? |
|---|---|
| How experienced is the ETF issuer in developing and managing fixed income ETFs? | Large, well-established firms with a long ETF history may have an advantage in this evolving marketplace. |
| What are the issuer's total assets under management (AUM) in fixed income and total ETF AUM? | Total assets indicate stability, while high ETF assets further illustrate a commitment to the ETF marketplace. |
| How broad is the issuer's fixed income range? | A broad range should contain exposure to all the maturities and regions that you need in order to effectively manage the yield curve, credit, and sector allocations. |
| Does the issuer enjoy good relationships with index providers? | A trusted partnership between the index provider and the ETF issuer helps ensure the sustainability of products in the long run, and the ability to meet client needs for product support and new offerings. |
| Does the issuer provide valuable trading support? | In today's dynamic ETF marketplace, expert trading support can positively impact your bottom line. |
| Does the issuer have a strong local and global presence? | Local investment teams and operations allows for specialism in each credit market, for example. |
| How does the fund provider communicate with investors? | With more potential for risk in fixed income portfolios in the current environment, transparent investor communication is essential for investors to manage their portfolio allocations effectively. For example, SPDR provides easy access for professional investors to speak directly to our Capital Markets Group, strategists and client services. |

### 4. Consider the Total Cost

Does the ETF minimise expenses?

| Questions to ask | Why is this important? |
|---|---|
| What is the fund's total expense ratio? | An ETF's total cost of ownership often compares favourably to a mutual fund's expense ratio. The total cost of gaining exposure includes factors such as the swing factor, the average daily trading volume, the ETF spread and broker fees. |
| Does the investment process take into account the impact of rebalancing costs on the performance of the ETF? | The frequency of rebalancing can impact costs. |
| What is the average bid-ask spread? | A narrow bid-ask spread versus the underlying basket of securities' bid-ask spread could indicate an opportunity to gain exposure at a lower cost. |
| What is the tracking error of the fund? | Returns can deviate somewhat from the index, but profound differences may be a red flag for poor management or excessive trading costs. |

### 5. Gauge Liquidity

Can you trade when you want to?

| Questions to ask | Why is this important? |
|---|---|
| What is the best route to trade a fixed income ETF? | The trading route you take impacts your bottom line. A supportive ETF issuer will be able to help each professional investor assess the best route for their particular investment requirements. At SPDR, our Capital Markets Group can help — please see contact details on the next page. |
| How does the ETF maintain liquidity? | Due to their unique creation/redemption process whereby Authorised Participants (APs) create and provide liquidity when it is needed, ETFs have potential liquidity that may not be evident from assessing trading volume. |
| Has liquidity been impacted due to market volatility? | Due to their unique in-kind creation/redemption process, an ETF's liquidity actually reflects the liquidity of the underlying securities. Therefore, if the ETF holds thinly traded securities, APs may find it more difficult to source liquidity during times of market stress. Additionally, traded volume is not the only indicator of liquidity, and it is always advisable to contact the Capital Markets Group during these times. |
| Does trading activity cause dramatic price swings? | Large spreads between the bid and ask price often indicate an illiquid ETF, so you will want to study the spreads and market movements over time. |

## SPDR Fixed Income ETFs

The SPDR range of ETFs covers broad and targeted exposures across sovereign debt, investment grade and high yield corporate bonds, as well as emerging market debt.

SPDR is constantly innovating in the fixed income domain. We launched the first emerging market debt local currency ETF in May 2011, and launched the first global convertible bond ETF in October 2014.

All SPDR ETFs are physically replicated and benefit from State Street Global Advisors' deep experience in fixed income beta management. Globally, we manage $417 billion* in indexed fixed income assets.

**Visit ssga.com to learn about the range of fixed income ETFs registered in your domicile.**

* As of 31 December 2019.

## For Sales and Trading Support

The SPDR ETF Capital Markets Group (CMG) supports an open architecture liquidity platform, engaging with various market participants including Authorised Participants, market making firms and exchanges in order to ensure liquidity and competitive pricing for SPDR ETFs. The group also works directly with both institutional and intermediary clients to provide guidance on best practices for ETF trading and execution.

For more information and for help navigating the nuances of ETF trading, please contact:

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ETFs trade like stocks, are subject to investment risk and will fluctuate in market value. The investment return and principal value of an investment will fluctuate in value, so that when shares are sold or redeemed, they may be worth more or less than when they were purchased. Although shares may be bought or sold on an exchange through any brokerage account, shares are not individually redeemable from the fund. Investors may acquire shares and tender them for redemption through the fund in large aggregations known as "creation units." Please see the fund's prospectus for more details.

Diversification does not ensure a profit or guarantee against loss.

Bonds generally present less short-term risk and volatility than stocks, but contain interest rate risk (as interest rates raise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

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