

Best ETF provider

Source

> When Source launched in April last year, few would have predicted its success. So far, it has raised more than US\$7 billion in assets, a 117% increase in the year to date, becoming the fifth-largest equity exchange-traded fund (ETF) provider in Europe and firmly establishing itself as an innovator in the European market.

This success is attributed, in part, to the liquidity of Source ETFs. "We have raised the largest amount of assets in a very short time, particularly in the second quarter of 2010 when we were the fastest-growing ETF issuer by assets," says Michael John Lytle, managing director at Source in London.

"We have the most actively traded products in Europe, and that is because we have so many different counterparties trading our products," says Lytle.

Source has always practised create-to-lead and is the first European ETF provider to do so on a large scale. This means investors – especially institutions – can short ETFs without affecting the assets under management (AUM) of the fund, and it introduces more liquidity into the market. Source set this up with all of its partners, and Morgan Stanley has proceeded to set up create-to-lead for other providers.

Another of the firm's contributions to the wider market has been the options on Source ETFs, created by European derivatives exchange Eurex. There have been other, unsuccessful, attempts to create ETF options in Europe but the liquidity of Source's ETFs has made them a success.

The options were launched in June 2010, at which point the market for ETF options stood at €7 million. With the addition of options on Source's ETFs, the market grew to over €400 million in August this year, and more than 80% of those volumes are linked to Source ETFs.

"If we can get options on ETFs working then we can get an even more liquid market," says Lytle.

At a product level, Source has focused on innovation and providing exposure to new asset classes, which has won them plaudits from market participants. "Source are doing really well at the moment. They are being innovative and have listened to clients' concerns," says one London-based employee at an investment management company. He says Source has a better fee structure than some other providers and adds that he likes the way they collateralise products using G7 bonds and cash.

Since volatility as an asset class gained in popularity, Source issued an ETF on volatility. Even in the US market, where ETFs are a much bigger business than in Europe, volatility is usually accessed through exchange-traded notes. The S&P 500 Vix Futures Source ETF was listed on the



Michael John Lytle



London Stock Exchange (LSE) in June and had more than \$48 million in AUM at the beginning of October.

Emerging markets have been a huge story in the investment world since the financial crisis. In May, Source launched its MSCI Emerging Markets ETF. This is not a new product for the market, but it has been the fastest-growing ETF in Europe this year, according to Deutsche Bank research on exchange-traded products. In the few months since its launch, the ETF has attracted \$1.5 billion in AUM.

Continuing the emerging markets theme, Source launched an ETF tracking the Russian RDX index, which overcame the problems of investing into the Russian market.

Lytle explains: "In Russia they have a tendency to declare dividends but not necessarily pay the same amount. A company will say 'we will pay a 50 rouble dividend and we will pay it six months from now', whereas in Europe you declare and pay in three days. And when it comes to paying it, they may only pay 25 roubles.

"The problem for a bank building an ETF on that is that they guarantee investors will get 50 roubles. The bank knows that the Russian company probably won't pay that, so they haircut what they guarantee. That is inefficient, so we created a new index where, instead of realising dividends when they are declared, we realise them when they are paid."

The ETF on the RDX index was launched in January and has AUM of \$260 million.

Another development last year was the Stoxx 600 Optimised Supersector Indexes, which are based on the Stoxx 600 Sector Indexes but remove smaller, illiquid companies. This move was a building block for Source's success, says Lytle.

One London-based derivatives analyst for an investment management company recognises the firm's achievement. "Source's ETFs are based on optimised indexes which exclude hard-to-borrow names, and as they are designed to comply with the Ucits III diversification rules... The optimisation provides fund managers with a tool that allows them to trade exposure to sectors cost effectively. The reduced exposure to the largest companies allows fund managers to trade exposure to sectors without worrying too much about exposure to individual companies."

"Our success in the trading space distinguishes us from everyone else," says Lytle. "We are the only ETF issuer that has products that trade in the way that the US market trades. Europe is a buy-and-hold market. Our sector products have massive turnover and represent over 80% of ETF sector trading in Europe. They also outstrip futures trading." ●