Vanguard Australian Property Securities Index ETF

Vanguard Investments combines tradition and technique to give investors a cheaper and smarter way to access the listed property sector, writes MICHELLE BALTAZAR.

It's hard to imagine it now but the Vanguard Group, one of the best-known global brands in funds management, used to be a nobody.

Back in the mid-70s, the idea that retail investors are better off buying an index fund because three in four actively-managed funds fail to beat the market was investment heresy.

Vanguard's founder Jack Bogle set up shop anyway and defied Wall Street even more by launching a 'no-load' mutual fund, meaning anyone who buys his products didn't have to pay sales commissions normally paid to managed funds.

Time proved Bogle's theory and business model right. Since 1976, his one-man crusade jump-started the global adoption of indexed strategies. Today, Vanguard is one of the world's largest investment houses with more than $1.6 trillion in assets.

Some of Bogle's early critics have become his biggest supporters.

Sticking to tradition

In 2001, Vanguard shook Wall Street once again by branching into a new breed of investment products called exchange traded funds (ETFs).

An ETF allows investors to buy a basket of stocks just like in an index fund except an ETF can be bought and sold on the stock exchange.

Because it can be traded just like shares, an ETF combines Vanguard's low fees and 'diversified portfolio strategy' (the basic DNA of an index fund) with the transparency and liquidity of a listed security.

The product worked: Vanguard ETFs have drawn more than US$100 billion to date and global ETF assets have grown at an annual compound rate of more than 56 per cent to hit more than $1.2 trillion this year.

In Australia, Rainmaker research predicts Australian-listed ETFs would grow at 50 per cent annually and surpass the $20 billion mark in five years – accounting for 1.5 per cent of the share market.

It is against this backdrop that last month Vanguard introduced their fourth exchange traded fund called the Vanguard Australian Property Securities Index ETF (ASX code: VAP), an ETF that invests in a basket of Australian real estate investment trusts (A-REITs) and is benchmarked against the S&P/ASX 300 A-REIT Index.

VAP's investment objective is to match the return of its benchmark (before fund fees and expenses) while charging a low annual management fee of 0.34 per cent. There is no minimum investment and a financial adviser or broker can buy or sell them directly through the Australian Securities Exchange (ASX).

Focus on cost

Robyn Laidlaw, the group's ETF product manager in Australia, said that financial advisers have always been cost-conscious but the global financial crisis (GFC) and impending industry regulation have made them more so.

"What Vanguard says to investors and advisers is that all costs matter when you are investing," said Laidlaw, adding that any incremental reduction in costs adds up to "banked savings" over time.

The cost issue is also important for those looking to transition to a fee-for-service model, she said.

"ETFs suit fee-for-service advisers because they can look to provide their clients value as an investment adviser through a focus on asset allocation and portfolio construction."

ETFs and index funds also cut cost through better tax management.

"Index funds provide the potential for tax efficiency because they tend to have a buy-and-hold strategy and limited turnover in the funds themselves, therefore, they become more tax effective," said Laidlaw.

Some financial advisers have adopted a core-satellite approach to investing, meaning the 'core' of their clients' portfolios are in low-cost, passive strategies while the remaining 'satellite' portion are in actively managed funds, LICs and directly held shares (see Figure 1).

Laidlaw said that with ETFs forming the portfolio core, advisers have more room to invest at a satellite level.

Listed property in recovery

Technically speaking, VAP is not a new product because the underlying fund, the Vanguard Australian Property Securities Index fund, has been running since 1998 and manages $2.3 billion in assets.

"That's an important distinction. We have launched ETFs as a class of existing index funds rather than being a standalone fund," explained Laidlaw.

But the timing of VAP's launch couldn't be better, despite Laidlaw stressing that Vanguard products are long-term investments.

"The nature of Vanguard products is that we're offering enduring products out to the market rather than offering a product for a particular point in time," she said, adding that the group has its own diversified portfolios and use Australian listed property within those portfolios as part of their asset allocation.

But Mark Wist, senior asset consultant at property researcher Atchison Consulting, said that the A-REIT sector is becoming healthier.

"The advantage is that investors today would be coming in at a discount to the asset and in what is widely regarded to be at, or near, the bottom of the market," he said.

ROBYN LAIDLAW

The sector is slowly rebuilding itself. Merrill Lynch analyst John Richmond wrote a report in June last year about the almost $15 billion of new equity capital that went into the sector to restore ailing balance sheets.

Most of it went to the eight 'majors' including Westfield Group, Stockland and GPT, all of which are among the top 10 ETF holdings in VAP.

"Long term, the sector's prospects are sound because in place today are very freshly learned lessons from a very difficult time – reinforced by some investors wary of what can happen when the sector is left to grow using whatever means it can," said Wist.

Ultimately, Laidlaw said the product wasn't launched in time for the sector's predicted recovery. Rather, the VAP is one of the building blocks that Vanguard has developed for today's modern portfolios.

But while many advisers are familiar with ETFs, they don't fully know how to use them. To this end, Vanguard has started running national roadshows that demonstrate the use of ETFs in portfolio construction using real-life case studies.

Local researchers have started rating ETFs.

"I think that's another natural evolution and development of ETFs in Australia. As advisers start to use ETFs more and more, they would look to a third party to have done a level of research on the product and to provide an overview of information that will help them assess the suitability of the product for their clients' portfolios," said Laidlaw. ●

Figure 1. Core satellite approach

Source: Vanguard

Figure 2. Top 10 ETF holdings*

Holdings*	Percentage
1. Westfield	39.6
2. Stockland	14.0
3. GPT	7.6
4. Mirvac	6.6
5. Goodman	6.0
6. CFS	5.9
7. Dexus Property Group	5.8
8. Commonwealth Property Office	2.8
9. ING Office Fund	2.5
10. ING Industrial Fund	1.7

* The underlying fund is the Vanguard® Australian Property Securities Index Fund. Data refers to this underlying fund as at 31 August 2010.

Source: Vanguard