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All systems go

What does the path to $5 trillion look like for bond ETFs?

Twenty years ago, computerised stock trading was reshaping the unseen market plumbing that connects buyers with sellers. Pit-style trading floors were going digital, and global stock exchanges were becoming electronic. These advances were delivering greater convenience and efficiency to the world of investing.

For fixed income, the creation of the first bond ETFs by iShares in the summer of 2002 revolutionised this market generally perceived as cumbersome and opaque[1]. Over 20 years, bond ETFs have become fundamental to fixed income investing and removed many barriers to market participants.

In fact, bond ETFs connected the fragmented fixed income markets with transparent and liquid on-exchange trading, creating an entirely new class of building blocks for assembling fixed income portfolios. For the first time, all investors could buy a portfolio of bonds, with the click of a button, for a known bid-ask spread and relatively low fee.

It was a point of no return. A movement that started with four iShares bond ETFs has now grown to USD 1.7 trillion in assets under management (AUM) and more than 1,400 products around the world[2] . Global investor assets in bond ETFs have grown by 23% annually—double the growth of open-end bond mutual funds and triple the growth of the global market for bonds itself.[3]

Bond ETFs simplified how investors all over the globe access fixed income markets. Twenty years ago, it would have been difficult if not impossible to even imagine instantaneously buying or selling thousands of bonds in a single trade at a transparent price—exactly what bond ETFs have empowered investors to do. Bond ETFs have brought transparency, access, liquidity, and efficiency to millions of fixed income investors.

Today, millions of individuals and financial advisers use ETFs for convenient, low-cost exposure to thousands of global bonds, while large discretionary wealth managers, asset managers, and asset owners use a broad array of bond ETFs to make specialised calibrations to their multibillion- dollar portfolios. The convenience of bond ETFs makes them prime candidates for use in strategies that seek to take investment losses to offset taxable gains.

Furthermore, the adoption of bond ETFs has been accelerated by the dynamics of the pandemic, which exposed longstanding inefficiencies in fixed income markets. Bond ETF growth persists even in the face of mounting inflation and rising rates as investors around the world look for better ways to access fixed income returns.

For these reasons we are upgrading our projections for global bond ETF AUM, forecasting that the size of the industry will nearly triple and reach USD 5 trillion (or 5% of the total bond market) by the end of 2030.

We believe that tripling global AUM is achievable this decade, and the acceleration in bond ETF adoption will be fuelled by four powerful trends that broaden and deepen their usage:

1 - Building blocks in evolved 60/40 portfolios: More investors are blending bond ETFs with active strategies that seek to meet investment objectives and avoid unwanted risks.

2 - Catalysts for modernising bond markets: Bond ETFs are reshaping fixed income market structure by helping to drive electronification, algorithmic bond pricing, and portfolio-oriented trading.

3 - Increasingly precise sources of potential returns: New bond ETFs are providing more precise fixed income exposures that allow investors to build increasingly customisable portfolios, hedge risks, and capture opportunities.

4 - Tools for seeking active returns: Institutional investors including active asset managers are turning to bond ETFs for transparency, access, liquidity, and portfolio efficiency.

The future looks bright for the growth of bond ETFs because they help all types of investors take on the thorniest problems in fixed income. In fact, we think that the current challenges associated with high inflation and rising interest rates will attract more first-time ETF investors and prompt existing investors to find new ways to use these versatile investment tools.

To learn more about BlackRock's index solutions for UK pension schemes, please contact Justin Wheeler, Head of UK Asset Owners at BlackRock – Justin.Wheeler@blackrock.com and visit our website at www.blackrock.com/uk/professionals/solutions/index-investing

In association with BlackRock.

[1] iShares launched the first bond ETFs in the U.S. in July 2002.
[2] BlackRock, Bloomberg, Morningstar (as of March 31, 2022).
[3] Simfund for U.S. MFs (as of December, 2021), Broadridge for non-US MFs (as of November, 2021), BlackRock GBI iShares for global ETFs (as of December, 2021), Bank of International Settlements and Securities Industry and Financial Markets Association for global bond market (as of July, 2021). Bond ETF average annualised growth rate of 23.4% compares with open-end mutual fund growth rate of 9.5% in the five years ended December 31, 2021. Per BIS and SIFMA, the value of the outstanding global bond market grew 7.3% annually in the five years ended December 31, 2020, the most recent data available.