Futures-based ETF

山證國際
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Asset Management | Mutual Fund | Overseas Investment

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Content

What is Futures-based ETFs

- Utilizes exchange-traded futures contracts to track the movement of an underlying index.

- To use futures contracts instead of physical assets to create ETFs initially started for commodities ETFs where holding physical assets would be difficult or unpractical for various reasons.

- By using futures, managers are able to create new products and exposures that were not possible under conventional schemes.

- Moreover, by using futures contracts, one can create a single product with multiple exposures. For example, with futures contracts, a single product can be exposed to an equity index and foreign currency simultaneously.

- All futures contracts traded on the Futures Exchange are registered, cleared and guaranteed by the Exchange or the Clearing House.

- There is no stamp duty on futures trading in most markets including Hong Kong which can make futures-based ETF relatively cost efficient.

Futures

- Futures contract is a contract between two parties where both parties agree to buy and sell a particular asset of specific quantity and at a predetermined price, at a specified date in future.
- The payment and delivery of the asset is made on the future date termed as delivery date. The buyer in the futures contract is known as to hold a long position or simply long. The seller in the futures contracts is said to be having short position or simply short.
- The underlying asset in a futures contract could be commodities, stocks, currencies, interest rates and bond. The futures contract is held at a recognized stock exchange. The exchange acts as mediator and facilitator between the parties. In the beginning both the parties are required by the exchange to put beforehand a nominal account as part of contract known as the margin.

Roll-over

- Rollover is a client who has an open position in a futures contract approaching its last trading day closes that position and opens the same position in a futures contract with a later expiry date.
- Rolling process can be illustrated as follows.
- As the Futures Contracts included in the Index come to expiration, they are replaced by contracts that have a later expiration. For example, a contract purchased and held in January may specify an February expiration. As time passes, the contract expiring in February is replaced by a contract for delivery in March. This is accomplished by selling the February contract and purchasing the March contract.
- The rolling keeps an investor fully invested. The roll return will be positive when the futures curve is downward sloping ("backwardation") or negative when the futures curve is upward sloping ("contango")

Advantages of Futures-based ETFs

- Futures-based ETFs build a portfolio of futures, forwards, and swap contracts on the underlying commodities.

- Free of the costs of holding and storing the underlying commodity.

- Roll strategy would closely tracks the current, or spot, price for the commodity.

- No rollover transaction cost is involved.