

Topic 1: What are international ETFs? .....	3
Exposure to international markets.....	3
Why would I want exposure to overseas markets? .....	3
Index-tracking .....	3
Buying and selling ETFs .....	4
International ETFs vs. direct investment in overseas shares.....	4
Topic 2: How international ETFs work .....	5
Chess Depository Interests (CDIs).....	5
Why do I hold a CDI, and not the international ETF itself? .....	5
Dividends and other benefits.....	6
CDIs .....	6
Different time zones .....	6
Topic 3: Growth, income and tax .....	7
Growth and income.....	7
Growth.....	7
Income.....	7
Tax .....	8
US withholding tax .....	8
Topic 4: Currency exposure and other risks .....	9
Market risk.....	9
Currency risk .....	9
Which exchange rate am I exposed to? .....	10
Why is my exposure not to the \$A/\$US rate?.....	10
How important is currency risk? .....	10
Currency risk and distributions.....	11
Topic 5: Case studies .....	12
Investment objective .....	12
Currency exposure .....	13
Case study 2 - iShares MSCI Emerging Markets .....	13
Investment objective .....	13
Currency exposure .....	14
Calculating the risk of multiple currencies .....	14
Summary.....	15

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## Topic 1: What are international ETFs?

### Exposure to international markets

Exchange traded funds (ETFs) are 'big picture' investments, giving you exposure to a broad range of assets in one trade.

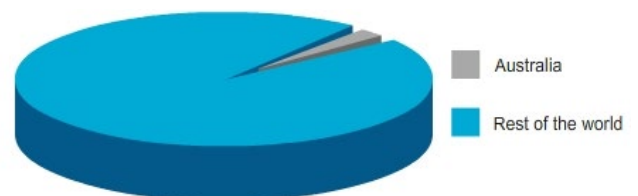
Domestic ETFs, covered in Module 4, give you exposure to the Australian sharemarket.

ETFs can also give you exposure to overseas markets.

### Why would I want exposure to overseas markets?

There are several reasons Australian investors might want overseas exposure, including:

- diversifying your exposure beyond the Australian market, which represents only 2 to 3% of world sharemarket capitalisation
- greater opportunities to invest in industries that are underrepresented in Australia, for example the technology sector, that includes companies like Microsoft, Apple and Samsung.



### Index-tracking

Like an Australian focused ETF, an international ETF tracks an index.

The index may be:

- a broad sharemarket index of a single country e.g. the S&P 500 index in the US
- a regional index of stocks that includes stocks from several markets in one region e.g. the S&P Asia 50 index
- a global index of stocks that includes stocks listed on markets around the world e.g. the S&P Global 100 index,
- a global sector index e.g. Global Healthcare, or
- an emerging market index, that includes stocks from countries such as Brazil, China, Russia and India.



## Buying and selling ETFs

You can buy and sell ASX traded international ETFs at any time during ASX trading hours, in Australian dollars.

The process is no different to buying shares or domestic ETFs. You instruct your broker to place an order, either by phone or online.

Settlement of the trade takes place three business days after the transaction.

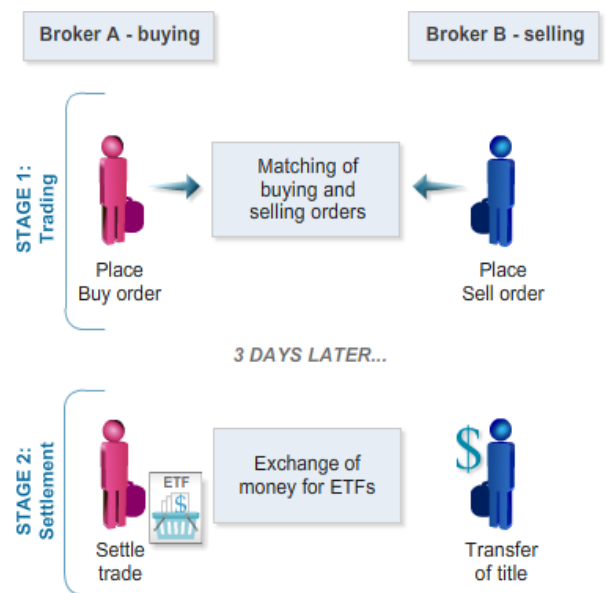
See Module 3 for important trading considerations, particularly around the ideal times for trading to capture prices that accurately reflect the net asset value (NAV).

### International ETFs vs. direct investment in overseas shares

ASX traded international ETFs are a relatively simple way to gain exposure to overseas sharemarkets.

In comparison, investing directly in overseas shares is more complicated:

- you must trade on an overseas exchange
- not all brokers offer overseas share trading services
- overseas shares must be paid for in a foreign currency
- dividends are paid in a foreign currency
- you have to pick which shares to buy.



	ASX traded international ETFs	Shares listed overseas
Buy and sell on ASX	✓	✗
Buy and sell in \$A	✓	✗
Receive dividends	✓	✓
Receive dividends in \$A	✓	✗
Trade through a stockbroker	✓	✓

## Topic 2: How international ETFs work

Most international ETFs (whether global, regional or single country) are domiciled and listed in the US, then made available for trading in Australia.

The issuers of international ETFs are large financial institutions able to take advantage of their existing infrastructure and investing arrangements to run their ETFs cost-effectively from the US.

Operating an international ETF from Australia would be significantly more expensive.

### Chess Depository Interests (CDIs)

Because most international ETFs are listed in the US, and consequently cannot be traded and settled on ASX, you do not directly hold the ETF.

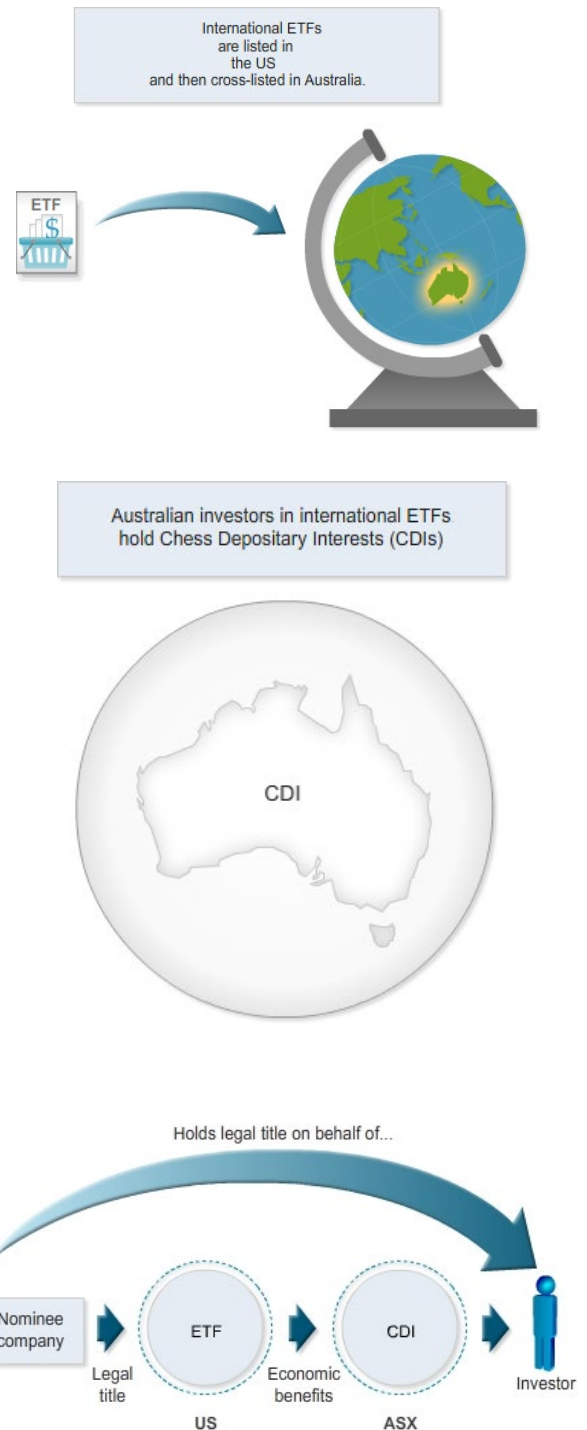
Instead you hold a CHESS Depository Interest (CDI), which is a security made available for trading on ASX that 'mirrors' the ETF listed in the US.

### Why do I hold a CDI, and not the international ETF itself?

Foreign financial products such as international ETFs cannot be directly bought and sold on ASX, as the laws governing such foreign financial products do not recognise ASX's settlement system, CHESS, to be used either to transfer legal title of such products or for electronic security holdings.

CDIs were developed as a method of transferring and holding foreign financial products in CHESS. CDIs can be transferred from seller to buyer via CHESS, so that they can be traded on ASX.

Legal title to the international ETF is held by a depository nominee - CHESS Depository Nominees Pty Ltd, a subsidiary of ASX. However, CDI holders have all the direct economic and other benefits of holding the underlying international ETFs.

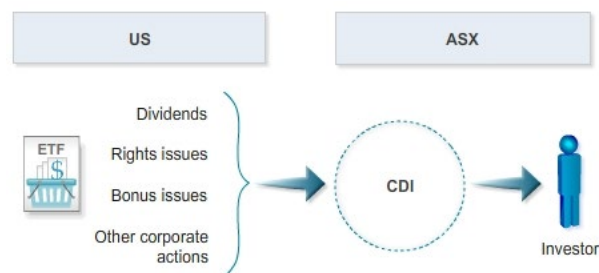


## Dividends and other benefits

A CDI gives you the same economic benefits as if you held the international ETF directly.

Dividends, bonus issues, rights issues and similar corporate actions flow through to you as if you were the ETF holder.

Only direct holders of the ETFs can vote personally at meetings of ETF holders. However, you can instruct the nominee that holds the ETFs on your behalf to cast a vote according to your wishes.



## CDIs

The CDI structure may seem complicated. Do not be put off!

You buy and sell CDIs on ASX in the same way you would trade shares or domestic ETFs, and receive a CHESS statement that shows your holding.

In practice, there is little difference from your perspective between holding a CDI and holding an international ETF directly.

For more information about CDIs, please refer to [Understanding CHESS Depository Interests](#).

## Different time zones

CDIs are traded on ASX during ASX trading hours.

When overseas markets are open for trading, the Australian market may be closed.

There may be a significant change in the price of the international ETF outside Australian trading hours. Because the Australian market is closed, you will have no opportunity to buy or sell your CDI.

Your first chance to trade will come when the Australian market re-opens - possibly at a significantly different price to the closing price the previous trading day.



## Topic 3: Growth, income and tax

### Growth and income

Returns from an ASX traded international ETF may come in two forms - growth and income.

You will enjoy capital growth if there is an increase in value.

Income comes in the form of regular distributions the fund may pay.

### Growth

Like domestic ETFs, the performance of your ASX traded international ETF depends on the performance of the index underlying the ETF.

But unlike domestic ETFs, it also depends on movements in the \$A against the currency of the index.

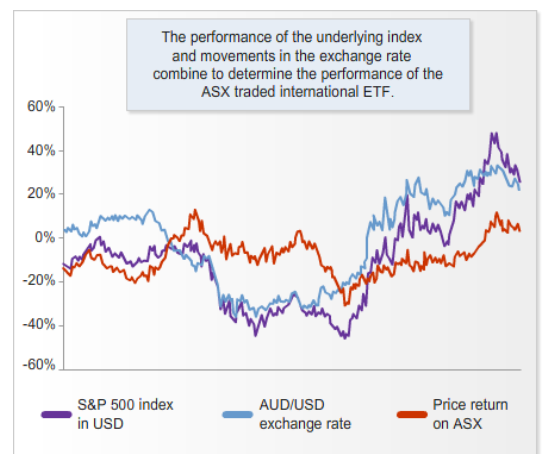
The influence of exchange rate movements will be discussed in Topic 4.

### Income

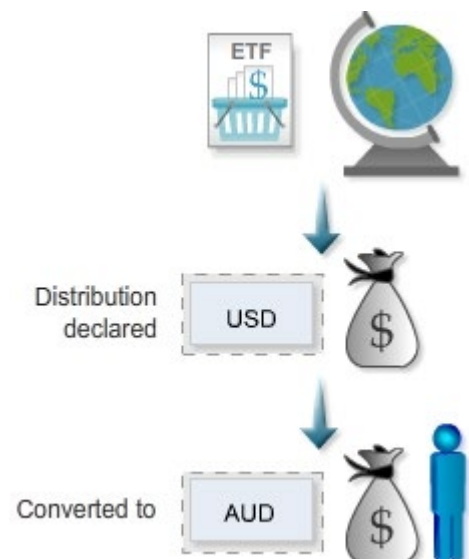
International ETFs may pay regular distributions - typically quarterly or half-yearly.

You receive your distributions in Australian dollars.

Distributions are declared and paid in US dollars by the international ETF, and then converted to Australian dollars (minus any applicable US withholding tax and application of exchange rate) before they are paid to you. Distributions are generally paid in cash into your nominated Australian bank account. There is usually no distribution reinvestment plan (DRP) available for ASX traded international ETFs.



Source: iShares

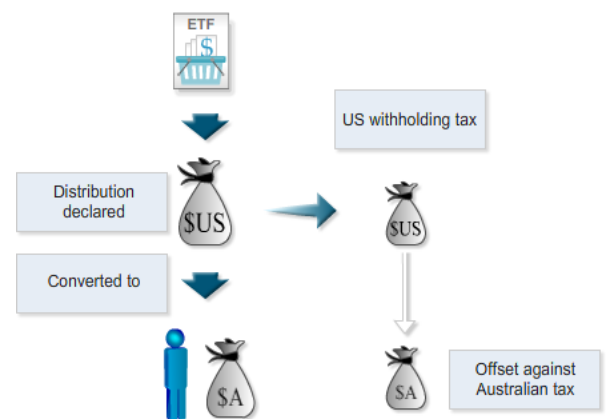


## Tax

For Australian residents, distributions are generally taxed as foreign sourced income.

US withholding tax may be deducted from your distributions. You may be able to claim an offset against the Australian tax payable on your foreign sourced income for the US withholding tax.

Your distribution statement will show the gross distribution amount and the US tax withheld in US dollars, as well as the exchange rate that was used to convert the payment into Australian dollars.



### US withholding tax

The US withholding tax rate is 30% of any distributions. Australia has a 'Double Tax Agreement' with the US, under which US withholding tax on distributions paid to Australian resident investors can be limited to 15%.

After purchasing your ETFs, the share registrar will send you a W-8BEN form. You must complete the form and return it to the registrar.

If you do not complete this form, a higher rate of withholding tax is likely to be deducted.



## Topic 4: Currency exposure and other risks

The performance of your ASX traded international ETF depends on:

- the performance of the index underlying the ETF, and
- the performance of the Australian dollar.

The two main risks you are therefore exposed to are:

- market risk, and
- currency risk.

Let's look at these two risks.

### Market risk

The portfolio underlying an ETF is diversified across many securities, protecting you against the 'specific risk' of an individual security performing poorly.

However you are still exposed to the risk of the market as a whole performing poorly.

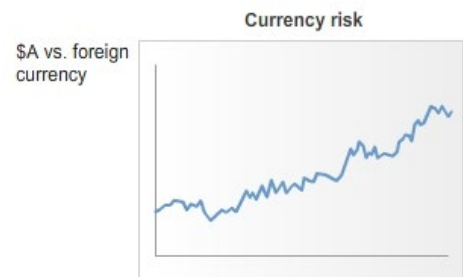
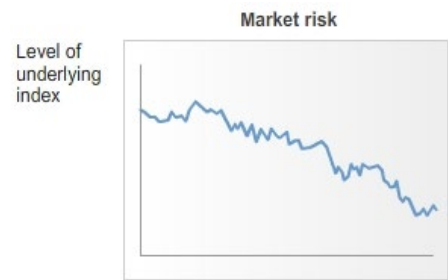
Regional and global ETFs include shares from more than one country. If you hold these types of international ETF, you may have to consider the risk of several markets.


### Currency risk

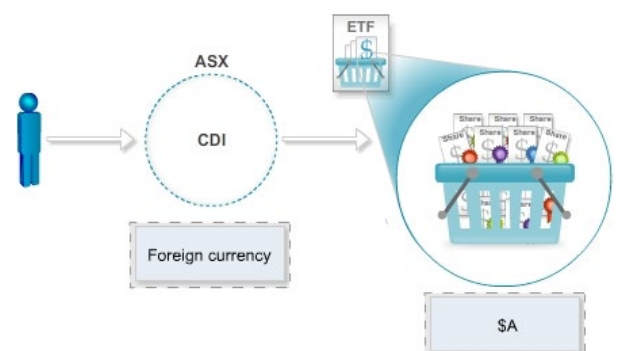
When you buy an ASX traded international ETF, you hold a security (CDI) listed in Australia and traded in Australian dollars.

However the asset you ultimately have exposure to is the portfolio of securities underlying the ETF. These securities are listed on an overseas market, or markets, and traded in the currency of the local market.

Converting the foreign currency value to an Australian dollar value introduces foreign currency risk - the risk the exchange rate will move unfavourably.



	iShares S&P Europe 350	Multiple country market risk
	iShares S&P Global 100	Multiple country market risk
	Vanguard US Total Market Shares	Single country market risk



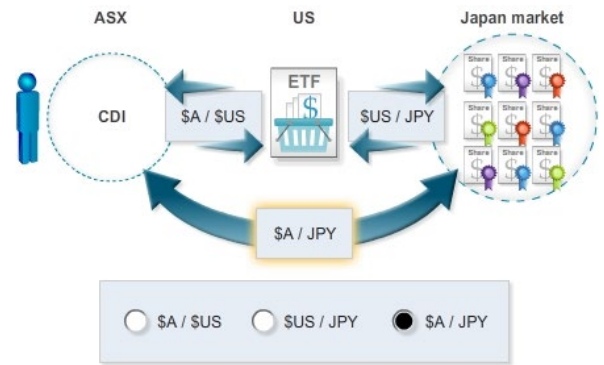
## Which exchange rate am I exposed to?

Your primary risk relates to the currency of the country where the assets underlying the ETF are listed, and how that currency moves against the Australian dollar.

### Example

The iShares MSCI Japan ETF tracks the MSCI Japan index. The shares in this index are traded in Japanese yen.

Your risk is that the \$A/JPY exchange rate moves unfavourably.



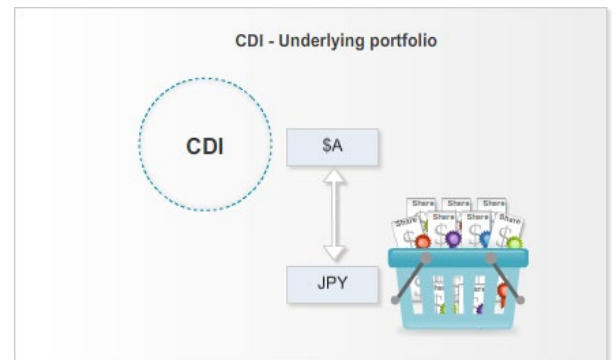
## Why is my exposure not to the \$A/\$US rate?

Even though international ETFs are listed in the US and traded in \$US, your principal risk does not relate to the \$US (unless of course you invest in an ETF that tracks a US sharemarket index).

There is a \$US exposure in converting the local currency value of the portfolio of securities underlying the ETF into the \$US value of the ETF.

There is also a \$US exposure in converting the \$US value of the ETF into the \$A value of the CDI.

The net effect is that these two \$US exposures cancel each other out - leaving you with exposure to the exchange rate of the \$A against the local currency of the securities underlying the ETF.



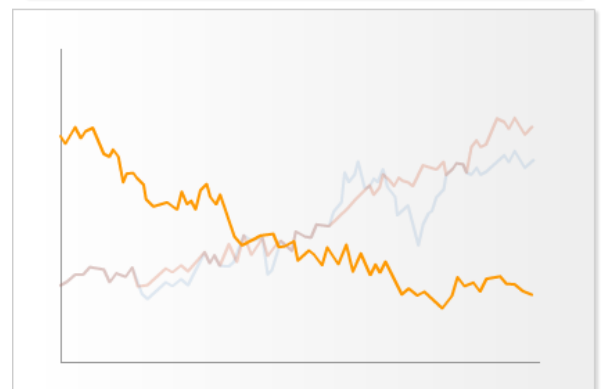
## How important is currency risk?

Currency movements can have a significant effect on your investment. They can work against you, or in your favour.

A rise in the value of the Australian dollar can lead to a fall in the value of your ASX traded international ETF, as the underlying portfolio is now worth less in Australian dollars.

A strengthening in the Australian dollar can even outweigh an increase in the value of the portfolio in local currency terms.

Even if the value of the portfolio increases in local currency terms an increase in the value of the \$A against the local currency can lead to a fall in the value of your ASX traded international ETF.



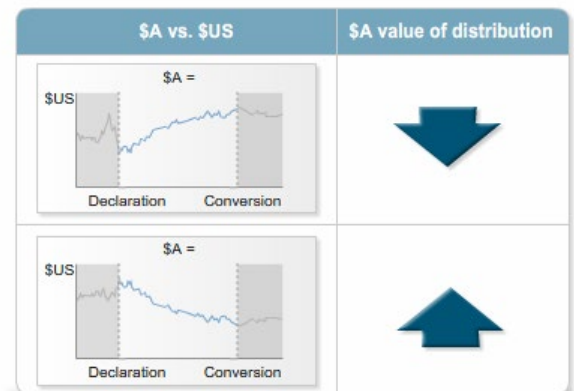
## Currency risk and distributions

There is short-term currency risk around the time distributions are paid.

This risk relates to the \$A/\$US exchange rate - for all international ETFs.

Distributions are declared and paid by the international ETF in US dollars. There may be a period of several days before they are converted into Australian dollars and subsequently paid to CDI holders.

A significant movement in the \$A/\$US exchange rate can lead to the distribution being worth significantly less (or more) in \$A terms than it was at the time the distribution was declared.



## Topic 5: Case studies

Let's take a look at a couple of international ETFs traded on ASX.

### Case study 1 - Vanguard US Total Market Shares Index ETF

The Vanguard US Total Market Shares Index ETF (VTS) seeks to track the performance of the overall US sharemarket.

The fund tracks the benchmark MSCI US Broad Market Index which represents a broadly diversified portfolio of securities traded on the New York, NASDAQ and American Stock Exchange.

The MSCI Broad Market Index provides exposure to more than 99.5% of the capitalisation of the U.S. equity market.

### Investment objective

When you buy units in the Vanguard US Total Market Shares Index ETF on ASX, you are buying CDIs. The international ETF itself is listed in the US.

The US-based fund's investment objective is to provide returns, before fees and expenses, that correspond generally to the performance of the MSCI US Broad Market Index.

The Vanguard US Total Market ETF pays distributions four times a year. Distributions are declared in US dollars, before being paid in Australian dollars into your Australian bank account.

Please refer to the Vanguard Australia web site for the current MER.

Management Expense Ratio is also called "Management Cost" in some of the issuer's documentation.



Index tracked	MSCI US Broad Market Index
MER	0.07%
Distributions: Frequency	Quarterly
Currency declared	\$US
Currency paid to Australian holders	\$A

## Currency exposure

Stocks in the MSCI US Broad Market Index are traded in \$US, consequently you have exposure to the \$A/\$US exchange rate.

Following a purchase of units in the Vanguard US Total Market ETF, a rise in the value of the \$A against the \$US will work against you, while a fall in the value of the \$A against the \$US will work in your favour.

If the \$A strengthens against the \$US, the value of your investment may fall - even if the index rises.

MSCI US Broad Market Index	\$A/\$US exchange rate	Most favourable	Least favourable
	\$US A \$1 =	<input type="radio"/>	<input type="radio"/>
	\$US A \$1 =	<input checked="" type="radio"/>	<input type="radio"/>
	\$US A \$1 =	<input type="radio"/>	<input checked="" type="radio"/>
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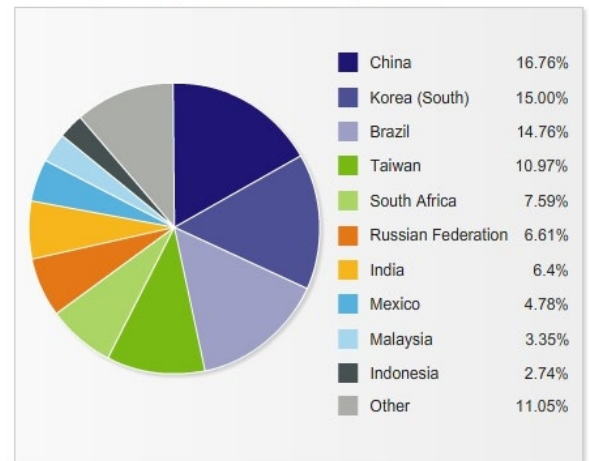
## Case study 2 - iShares MSCI Emerging Markets

The iShares MSCI Emerging Markets is issued by iShares, and managed by BlackRock Fund Advisers.

It is designed to give you diversified exposure to the sharemarkets of countries classified as 'emerging markets'.

The fund's underlying index is the MSCI Emerging Markets Index. The index is a measure of the performance of stocks in emerging markets, capturing around 85% of market capitalisation in those markets.

iShares MSCI Emerging Markets - fund country allocation



source: iShares

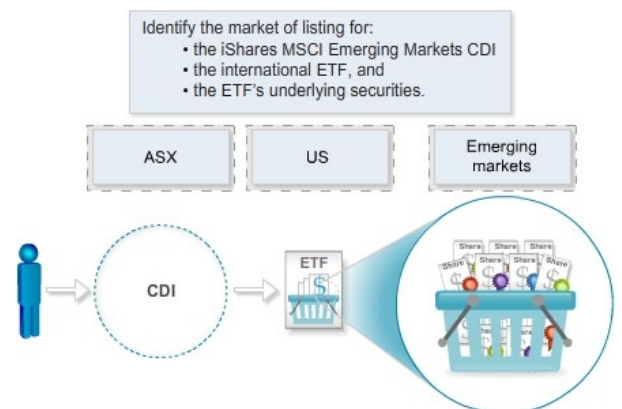
## Investment objective

When you buy shares in the iShares MSCI Emerging Markets on ASX, you are buying CDIs. The international ETF shares are listed in the US.

The US-based fund's investment objective is to provide returns, before fees and expenses, that correspond generally to the performance of the MSCI Emerging Markets Index.

The iShares MSCI Emerging Markets pays distributions twice a year. Distributions are declared in US dollars, before being paid in Australian dollars into your Australian bank account.

The Management Expense Ratio (MER) is 0.67% of net assets annually.



## Currency exposure

Stocks in the MSCI Emerging Markets Index are drawn from a range of countries. Stocks are traded in the currency of the country in which they are listed.

You have exposure to movements in the value of the \$A against each of those currencies.

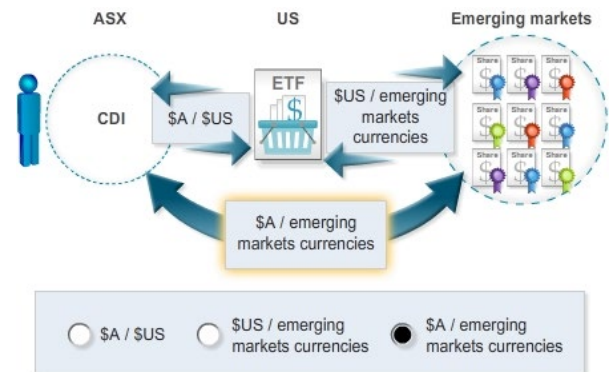
## Calculating the risk of multiple currencies

The currency exposure of a multi-market ETF is difficult to calculate with precision.

A couple of points to bear in mind are:

- Currencies do not always move in the same direction or by the same amount. The \$A may strengthen against one currency and weaken against another.
- The greater a country's representation in the index, the more significant are movements in its currency against the \$A. For example, movements in the value of the Chinese yuan or Brazilian real against the \$A may have a significant impact on the iShares MSCI Emerging Markets.

In broad terms, a strengthening of the \$A will work against you.





## Summary

- ETFs can give you exposure to international markets.
- An international ETF may track:
  - a single market index
  - a regional index
  - a global index
  - a global sector index, or
  - an emerging market index.
- You can buy and sell ASX traded international ETFs at any time during ASX trading hours, in Australian dollars.
- You invest in international ETFs by buying CHESS Depository Interests (CDIs) on ASX. A CDI gives you the same economic benefits as if you held the international ETF directly.
- Returns from an ASX traded international ETF may come in two forms - growth and income.
- Distributions are declared and paid in US dollars by the international ETF, and then converted into Australian dollars and paid into your nominated Australian bank account.
- The change in value of your ASX traded international ETF depends primarily on two factors:
  - the performance of the index underlying the ETF, and
  - movements in the \$A.
- A rise in the value of the \$A against the currency you have exposure to can lead to a fall in the value of your ASX traded international ETF.