SystematicEdge
Systematic Multi-Asset Strategies
Investment Series

Thought Piece
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Demystifying Futures: 3 reasons Futures are an efficient way to gain market exposure

Futures and Exchange-Traded Funds (ETFs) are two popular instruments to get exposure to equity indices. In this paper, we look at the key differences and explain why Futures are a better choice for professional investors.

Income Maximization

Futures are more capital efficient than ETFs as they only require a cash investment of 5-10% of the dollar equity exposure. ETFs require 100% of the cash to be invested, freezing unnecessarily 90% of the investor cash. When buying Futures, the extra cash can be invested in money markets or short-term bonds, thus providing additional income. Futures also generate extra income from asset repo rates, which can be as high as 1% annualized.

By simply investing the cash in money markets and short-term bonds, a USD investor buying an Equity Futures contract can improve its overall performance by 1.0% per annum at current rates.

Cost Minimization

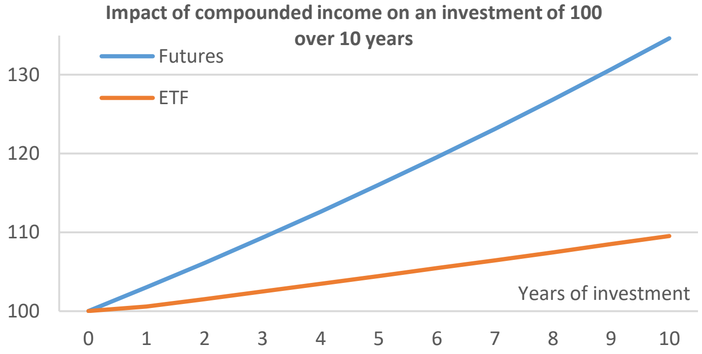
Futures are more cost-effective than ETFs as they don’t have management fees, are more tax-efficient (no withholding tax on dividends), and trade at much tighter bid-offer spreads.

Non-U.S. investors buying S&P 500 Index ETFs are exposed to a withholding tax on dividends of typically 30% at the stock level and/or ETF level. By contrast, investors buying S&P 500 Index Futures receive the index price performance and 100% of expected dividend returns.

Liquidity

Most Index Futures are very liquid, usually much more liquid than their ETF counterparts.

According to CME Group, the average daily dollar volume of the E-mini S&P 500 Futures contract alone is 2.56 times as large as that of all ETFs around the world combined (source: www.cmegroup.com).



Futures’ extra income and reduced cost translate into significant compounded returns over time:

Income comparison net of cost per instrument

	S&P 500 Income		
Period	**Futures**	**ETF**	**Difference**
1 year	3.0%	0.6%	+2.5%
5 years	16.0%	4.4%	+11.6%
10 years	34.6%	9.5%	+25.1%

While ETFs are a natural choice for retail investors (given their smaller investment size) or exotic indices for which Futures contracts don’t exist, **Index Futures** are the instrument of choice for professional investors as they are more liquid and less costly than equivalent ETFs while generating additional income. *SystematicEdge’s SEP (Systematic Equity Portfolio) and SMP (Systematic Multi-asset Portfolio) are two examples of investment solutions using Index Futures to gain efficient equity market exposure.*

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