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# ETF perspectives: Investors turn to ETFs to position in choppy markets

Read Vanguard's analysis of the latest ETF market trends and what they mean for investor portfolios.


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## Key takeaways

**Market overview:**

European ETFs saw further strong flows in Q1 2025 as investors braced for policy uncertainty, rotating out of US equities into global, developed-market and European equity ETF exposures, while focusing on ultra-short-maturity bond ETFs.

**Equity spotlight:**

Although the growth outlook for Europe could hinge on tariff developments, in Q1 investor appetite for Europe exposures rose sharply, with German equity ETFs seeing the highest inflows in years.

**Fixed income spotlight:**

Bond markets reflected the broadly risk-off tone in Q1 and the announced tariffs have led to heightened market volatility. In this environment, we believe investors should focus on global diversification to minimise country-specific risk.

**Capital markets spotlight:**

When analysing ETFs, investors should ensure they understand how the various cost components—such as spreads, premium/discount volatility and market impact—affect overall costs.

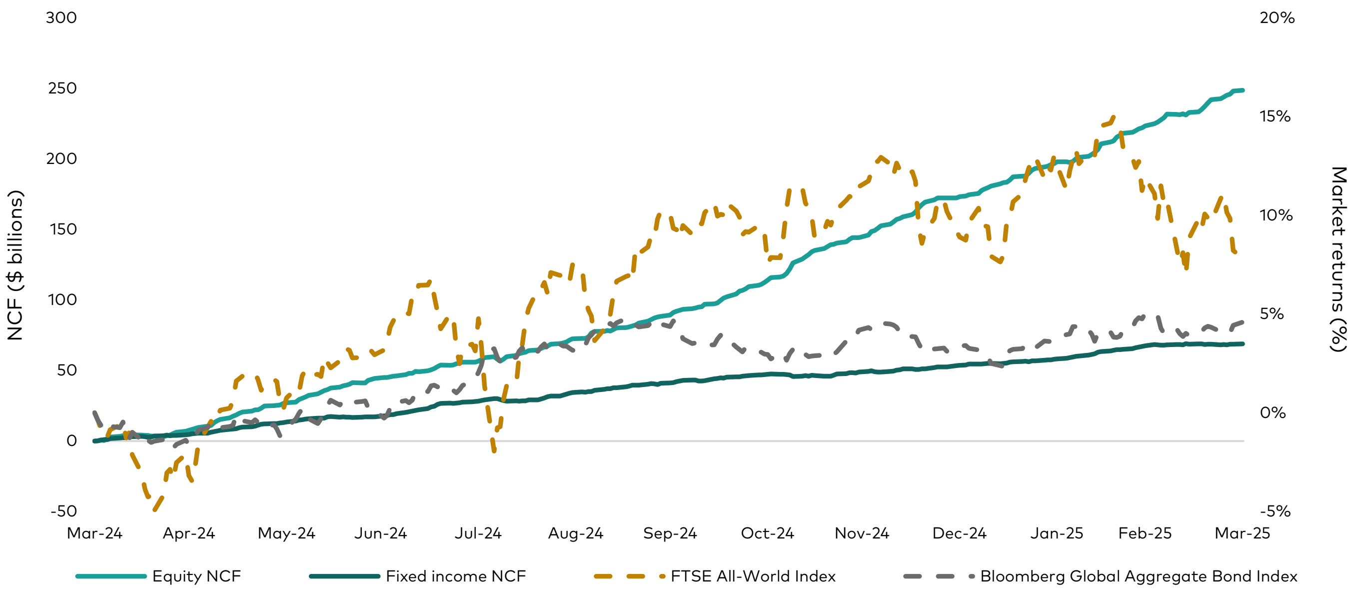
## ETF industry: Q1 at a glance

Following record-breaking inflows in 2024, European-domiciled ETFs saw another strong quarter of net inflows to start 2025. In Europe, ETFs captured net inflows of $91.8 billion in Q1 2025, just below the $94.6 total in Q4 2024[1]. Equity ETFs continued to see the majority of the inflows, contributing $75.4 billion—or 82%—of total Q1 flows. Core developed-market, global and European equity ETFs all saw net inflows throughout the quarter.

Among fixed income ETFs, investors allocated heavily into ultra-short-maturity exposures, taking advantage of attractive yields. The ultra-short ETF category saw $8.0 billion of net inflows in Q1, more than half of the total bond ETF flows of $15.1 billion.

These flow patterns emerged against a backdrop of considerable policy uncertainty (and tariff developments have since riled markets to start Q2). Investor appetite for US equity ETFs began to wane as the quarter wore on, with net outflows in February and March, while global and European equity ETFs saw relatively stronger net inflows. As investors braced for the possibility of ongoing market volatility, commodity ETFs gathered $875 million in Q1, with gold ETFs driving much of these flows.

ETF industry net cash flow (NCF) vs. market returns by asset class




**Past performance is not a reliable indicator of future results. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.**

Notes: Data from 1 April 2024 to 31 March 2025. Performance calculated in USD with gross income reinvested.

Source: ETFBook, Bloomberg and Vanguard.

[1] Source: ETFbook, as of 31 March 2025.

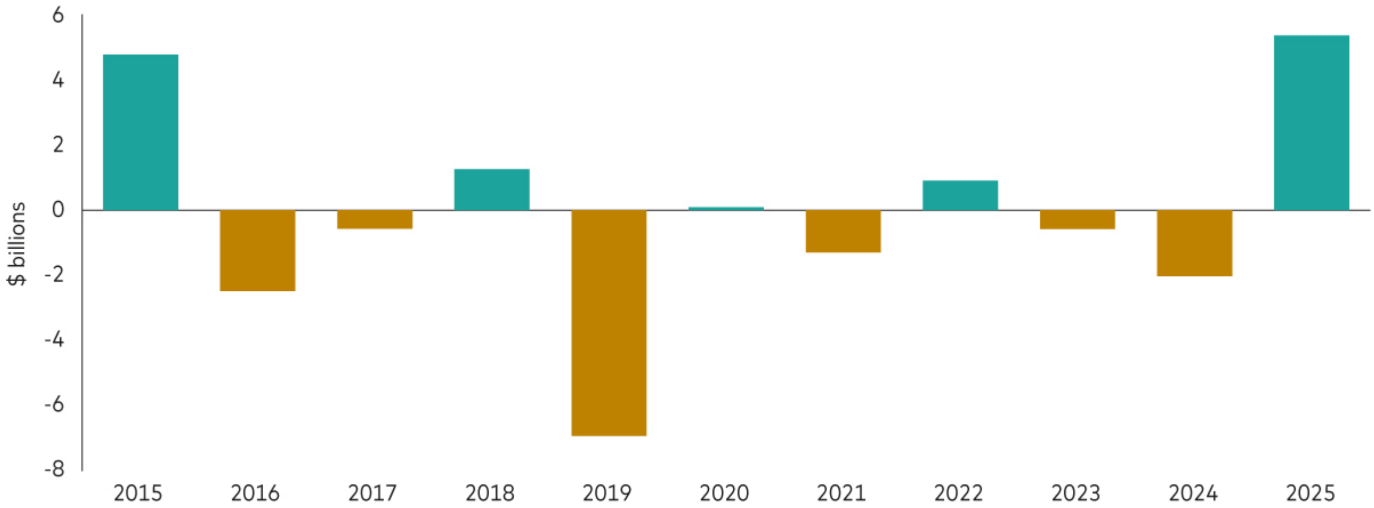
## Equity spotlight

### Europe makes a comeback – can it continue?

After underperforming US equities for much of the past decade, European equities outperformed in Q1, as the FTSE Developed Europe Index rose by 10.5% versus the S&P 500 Index's -4.3% return[2]. The dynamics underlying the European comeback stem in part from Germany's fiscal plans announced in March, while valuations also helped make the region relatively attractive.

From a flows perspective, euro area equity ETFs saw three straight months of net inflows to start the year. By contrast, US equity ETFs saw net outflows in February and March, breaking a string of monthly net inflows dating back more than a year. Looking beneath the surface of this rotation, German equity ETFs have seen particularly strong net inflows in 2025, following net outflows during each of the past two years.

Germany equity ETF flows during the past 10 years




**Past performance is not a reliable indicator of future results.**

Source: ETFbook, as of 31 March 2025.

Germany's plans to expand its fiscal spending looked like a game-changer for Europe when announced, and German equities rallied sharply on the news, rising 11.45% in Q1[3]. If implemented, the fiscal plan would unlock billions of euros in spending that could help kickstart Germany's economy, which has contracted for more than two years. The German manufacturing sector, in particular, stands to benefit.

However, it can take years for fiscal policy to feed through economies. In addition, how Germany's fiscal boost may play out against the complicated backdrop of tariffs remains to be seen. Our revised growth forecasts suggest that higher tariffs, if implemented as planned, will weigh on growth. In the event of continued higher tariffs after the 90-day pause, the impact on broader euro area growth could be enough to counteract gains from Germany's announced fiscal programme, higher defence spending and a potential ceasefire in Ukraine. Given these variables, the longer-term investment case for both Germany and Europe will likely continue to evolve.

[2] Source: FactSet, net total returns in USD terms, for the period 1 January 2025 to 31 March 2025.
[3] Source: Bloomberg, reference index is the FTSE Germany Index, returns are net total returns with dividends reinvested in US dollar terms.

## Fixed income spotlight

### Uncertain outlook underscores case for going global

Fixed income markets saw diverging performance across developed-market government bonds in Q1 2025, as US and UK bonds outperformed European fixed income markets. In the US, concerns around potential tariffs and the impact on economic growth meant that markets traded on a risk-off tone. Meanwhile, the announcement of significant defence and infrastructure spending in Europe overall led to yield curve steepening.

The tariffs announced by the US on 2 April ushered in heightened market volatility, including for fixed income markets. Immediately after the announcements, both two- and 10-year US Treasury yields fell, as markets moved to price in a negative growth shock and more than 100 basis points of US Federal Reserve cuts in 2025.

The bond market continued to see significant volatility in April as markets have tried to price in what tariffs could mean for monetary policy. US Treasury and UK government bond curves steepened, as investors favoured short-duration fixed income in place of long-end exposures. The picture is different in Europe, where German bund yields fell across the curve. One key takeaway from the recent volatility is that US policies are likely to have varying impacts depending on the country in question.

Against this backdrop, the need for global diversification in investor portfolios is clear. While a core fixed income holding such as global aggregate bonds can be useful in this context, investors who are concerned about the outlook for global growth, and therefore corporate spreads, could consider a global government bond ETF exposure, which can serve as a defensive, high-quality core holding that offers global diversification benefits.

In environments where different countries could see idiosyncratic impacts from trade tariffs, global diversification helps to reduce event risk. While fixed income helps to diversify portfolios (given its low correlation to equities), going global allows European investors to diversify further away from the equity portion of their portfolios. For example, euro-denominated government bonds have a correlation of 0.16 to both US and global equities[4]. But with global government bonds, the correlation to US and global equities approaches zero (0.02)[5].

Correlation is an important factor to consider as we start to weigh the potential effects of trade policy on economic growth and therefore the eventual impact on different asset classes. If we do see a growth slowdown taking a toll on already-overvalued equity markets, fixed income investors may want to consider how to maximise the diversification in their portfolios.

[4] Reference indices are the Bloomberg EUR Government Float Adjusted Total Return Index Hedged EUR, S&P 500 Index and MSCI World Index. In the context of equity and bond markets, a lower correlation means that the movements of the two asset classes are less closely related to each other. Source: Vanguard using Bloomberg data, as at 31 March 2025.

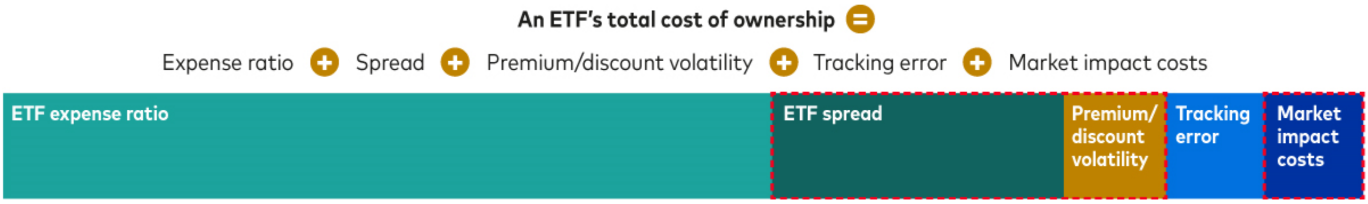
[5] Reference indices are the Bloomberg Global Treasuries Developed Countries Float-Adjusted Index Hedged EUR, S&P 500 Index and MSCI World Index.

## Capital markets spotlight

### Breaking down the total cost of ownership

In any market environment, cost should be a key consideration for ETF investors. However, understanding the overall cost of investing in an ETF may not be as straightforward as it first appears.

There are five key components of an ETF's total cost of ownership (TCO). Looking beyond expense ratios and tracking error, investors should ensure they also understand the importance of ETF spreads, premium/discount volatility and market impact.




Source: Vanguard, using data from Bloomberg to provide a hypothetical illustration.

### ETF spreads

The spread is the round-trip cost of buying and selling an ETF. This reflects the difference between the bid and offer price[6]. The narrower the difference between the bid and offer, the lower the round-trip trading cost.

An ETF's spread is directly influenced by the ETF's traded volume and volatility as well as the liquidity of the underlying securities of the ETF.

### Premium/discount volatility

If the market price of an ETF is above its net asset value (NAV)[7], then it's considered to be trading at a premium. Conversely, if the market price of an ETF is below its NAV, it's trading at a discount. Ideally, an investor wants to avoid purchasing ETF shares trading at a premium or selling at a discount, as doing so can erode total returns.

As ETFs are priced continuously, pinpointing an optimal premium or discount can be challenging. Instead, investors should assess the volatility of the premium/discount figure, which provides more insight than the daily average. Comparing this volatility between ETFs with similar underlying exposures can help investors understand market dynamics for a given fund or category.

### Market impact

When assessing an ETF's liquidity, investors should consider the resources available to minimise the potential market impact of a trade[8]. An ETF issuer's capital markets team can help investors understand and manage the potential impact, guiding them to a strategy that balances trade timing and urgency with available liquidity.

ETFs have multiple layers of liquidity[9] – accessing them can reduce market impact. It's important to appreciate that an ETF's average daily volume (ADV)[10] reflects only historic secondary market liquidity, not underlying liquidity.

When the trading volume of an ETF exceeds its ADV, market makers, collaborating with Vanguard as authorised participants (APs)[11], purchase ETF shares via the primary market in exchange for benchmark-eligible securities. This method efficiently enables further ETF liquidity, effectively making the ETF interchangeable with the underlying holdings.

[6] The bid is the price at which an investor can sell ETF shares and the offer is the price at which an investor can purchase ETF shares.

[7] Net asset value is the total value of the fund's assets minus its liabilities, divided by the number of outstanding shares.

[8] In the context of ETF trading, "market impact" refers to the effect that a trade has on the price of an ETF. When a large trade is executed, it can move the price of the ETF, either up or down, depending on the direction and size of the trade.

[9] An ETF having multiple layers of liquidity means that there are various mechanisms and participants that contribute to the ETF's overall liquidity. This multi-layered liquidity can help ensure that the ETF trades efficiently and that investors can buy or sell shares without significant price impact.

[10] Average daily volume refers to the average number of shares or units of an ETF that are traded over a given period. ADV is a useful metric for investors and traders because it provides insight into the liquidity and trading activity of an ETF.

[11] APs are large financial institutions that have special agreements with ETF issuers to create and redeem ETF shares. APs play a crucial role in maintaining the liquidity and price stability of ETFs.

## Important risk information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Performance figures shown may be calculated in a currency that differs from the currency of the share class that you are invested in. As a result, returns may decrease or increase due to currency fluctuations.

Investments in smaller companies may be more volatile than investments in well-established blue chip companies.

ETF shares can be bought or sold only through a broker. Investing in ETFs entails stockbroker commission and a bid- offer spread which should be considered fully before investing.

Funds investing in fixed interest securities carry the risk of default on repayment and erosion of the capital value of your investment and the level of income may fluctuate. Movements in interest rates are likely to affect the capital value of fixed interest securities. Corporate bonds may provide higher yields but as such may carry greater credit risk increasing the risk of default on repayment and erosion of the capital value of your investment. The level of income may fluctuate and movements in interest rates are likely to affect the capital value of bonds.

The Funds may use derivatives in order to reduce risk or cost and/or generate extra income or growth. The use of derivatives could increase or reduce exposure to underlying assets and result in greater fluctuations of the Fund's net asset value. A derivative is a financial contract whose value is based on the value of a financial asset (such as a share, bond, or currency) or a market index.

Some funds invest in securities which are denominated in different currencies. Movements in currency exchange rates can affect the return of investments.

For further information on risks please see the "Risk Factors" section of the prospectus on our website.

## Important information

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