CANADIAN ETF Watch

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the Importance of Indexes

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On behalf of **CIFP** and **CETFA**, we are delighted to present the second issue of ***ETF Watch.*** This digital magazine is published quarterly in partnership by the **Canadian Institute of Financial Planning (CIFP)** and the **Canadian ETF Association (CETFA)**. **CIFP** and **CETFA** are thrilled through this initiative to provide advisors with a valuable source of educational information on ETFs and the industry in general. Research that **CETFA** recently completed through **CREDO Consulting** continues to show that there is mis-information out there on the value of ETFs and the mechanics of the industry. This information is vital to assist you in making decisions on the best investments for your clients.

We are looking forward to providing you with relevant ETF educational information in future editions of ***ETF Watch***. Please feel free to contact us with any suggested topics as we welcome your ideas.

Sincerely,

Keith Costello
Global CEO,
Radius Financial Education
www.radiusfinancialeducation.com

Pat Dunwoody
Executive Director,
Canadian ETF Association (CEFTA)
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About *Canadian ETF Watch*

Through a dedicated website and quarterly issues, ***Canadian ETF Watch*** will speak to financial advisors, investors, managers and service providers to provide them with the latest information on ETFs in Canada. Canadian-based ETF markets continue to grow, which presents numerous marketing and promotional opportunities. Fund companies benefit from being featured in Canadian ETF Watch as their company name and solutions are distributed to our audience who are dedicated & targeted to ETFs.

CANADIAN ETF Watch
CanadianETFWatch.com

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The Importance of Indexes

In Canada, indexes are rapidly growing in importance and scope along with the rise of passive investing.

Paul Bowes
Head of Canada, FTSE Russell

In fact, according to PWL Capital Inc.'s "The Passive vs. Active Fund Monitor," Canada's passive funds attracted new capital at nearly the same rate as active funds between 2007 and 2017, with $70 billion and $75 billion in growth, respectively. And, since 2007, Canadian passive funds have nearly doubled their market share from 5.2% to 11.2%.

These trends are reinforced in my discussions with our Canadian clients. Institutional investors in Canada who have long understood the value of indexes as benchmarks recognize the growing role indexes play in portfolios as a complement to active strategies. And retail investors in Canada certainly view indexes as important. According to our friends at the Canadian ETF Association (CETFA), Canadian-listed ETFs finished 2019 at an all-time high of $204.8 billion—keep in mind, that number had reached $100 billion just three years ago back in May 2016.

Indexes are of course important to the markets, but I believe a better word for indexes is "useful." There are many ways that market indexes can play a useful and practical role in your financial planning practice.

FTSE Russell

An acceleration in innovation

Market indexes are not new to Canada. In fact, the FTSE Canada Universe Bond Index was first introduced nearly 40 years ago. And the very first exchange-traded, index-linked product in the world was launched in 1990 when the Toronto 35 Index Participation Units were listed on the Toronto Stock Exchange.

Canada has been a pioneer and an innovator in the index space, but until recently Canada market indexes have mainly been perceived as "plain vanilla" from an investment portfolio standpoint, having been used to benchmark and invest in major equity asset classes and fixed income sectors through retail investment products such as mutual funds and ETFs.

This situation has changed dramatically in the last decade or so as a wave of innovation has produced a more sophisticated set of index-based approaches to allow the end investor to measure a broader and more specific array of market exposures. These include thematic indexes that track ESG-friendly sustainable investments, as well as indexes that allow investors to efficiently mine various market factors, and indexes that offer alternative weighting schemes. These expanded approaches mean that you, as a financial planner, have so many more tools at your disposal for index-based market exposures.

What's next…

Index innovation continues to impress me, and as we look around the next corner we'll see new developments. The fixed income market is one area where new index approaches can help investors navigate historically low global interest rates and other fixed income challenges. Indexes may also play an increasing role in the digital asset space, for measuring multi-asset approaches across equity and fixed income, for use in sustainable investment strategies and, potentially, to measure alternative assets such as commodities and private equity.

Market indexes are important, but, even more important, they are useful. For financial planners, indexes can play a foundational role in portfolio measurement and asset allocation. And, with the innovation and constant evolution in market indexes, your use of these tools can grow as your practice grows. Gaining a better understanding of market indexes and the utility they can bring to your practice can help differentiate you with your clients.

Paul Bowes, Head of Canada, FTSE Russell
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Index-Based Investments as a Foundation for Asset Allocation

Index-based investment strategies have grown in scale and scope in recent years, increasing the level of choice for Canadian financial advisors.

Edgar Guerra
Director ETP Strategy & Business Development, FTSE Russell

And index-based investment products bring a number of strengths to the asset allocation process:

- **Efficiency.** Indexes are a very straightforward way to gain broad exposure to an asset class, investment style or company characteristic. Indexes use consistent, rules-based methodologies replicate the performance of whatever market they are tracking and regularly recalibrate and rebalance to ensure they are adhering to their methodology.

- **Predictability.** Because indexes are designed to follow a predetermined set of rules, they are quite predictable. Unlike an active manager, indexes are not able to stray from the rules they have laid out in their methodology. When viewing asset allocation as a “team” where all the players have a certain role to serve, players with predictable performance carry a premium.

- **Modularity.** Index-based investments with distinct strategies and efficient ways of gaining market exposure can be easily implemented within the context of an asset allocation portfolio. For example, if your target exposure calls for 40% Canadian equities and 60% international equities, you can fill your two buckets with distinct yet complementary index-based investments providing broad exposure to these asset classes, then easily readjusting periodically based on market performance.

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- **Liquidity.** Index-based investments can also lower your implementation and liquidity risk. Indexes provide access to liquidity across asset classes, making it easier to build exposure for your asset allocation scheme versus buying securities directly.

And while index-based investment strategies do offer many benefits, not all indexes adhere to the same set of standards. As a financial advisor, you should understand the differences among indexes and know what to look for when evaluating potential approaches. Some things to watch out for:

- **Comprehensiveness.** The index must deliver an accurate and comprehensive representation of its intended market segment. This is particularly important for Advisors as they use ETFs to gain access to a market or market segment. Omitting eligible securities from an index can lead to unintended consequences such as errors in the asset allocation structure of the total portfolio.

- **Transparency.** A transparent and objective approach to index constituent selection provides a more accurate, unbiased representation of the market it is designed to measure/represent rather than a subjective, committee-based method. You should make sure that the indexes underlying your investments have publicly available rules which allow investors to understand and potentially anticipate why and when changes are made to the index. Index providers should also to have a formal governance system in place so that the indexes are proactively evaluated to ensure they reflect and adapt to the evolving market.

- **Investability.** Advisors should also make sure that underlying indexes of ETFs in their portfolio limit their holdings to those readily available to the investor. If shares not available to public investors are included in the underlying index, replicating the exposure can be difficult, causing tracking error. Additionally, the demand for shares from investment funds replicating the index could cause unnatural stock price spikes. Index weights should be calculated using float-adjusted market cap, meaning the index should only account for the shares that are freely available for purchase by the average investor, rather than those held by employees or other investors that are restricted from selling their shares.

- **Cost Efficiency.** Advisors, similar to other investors, are very sensitive to transaction costs. For this reason, they also evaluate rebalance methodologies of the underlying indexes tracked by their ETFs. When indexes rebalance constituents and weights in order to keep them representative of their respective index strategy, passively managed investments incur in transaction costs. Advisors typically evaluate index methodologies to ensure that the index adequately represents and aligns to the market, while keeping turnover costs manageable.

In my role with global index provider FTSE Russell I have the pleasure of working with several major ETF providers in Canada, and they all stress the importance of education on index benefits to financial advisors. According to Scott Johnston, CFA and Head of Portfolio Review for the Americas at Vanguard Investments Canada, "We're seeing financial advisors in Canada using index-based investment products such as ETFs more and more as key building blocks in their clients' portfolios. Selecting low-cost ETFs built on high quality indices allows advisors to spend more time on what matters most for good investment outcomes, including asset allocation and rebalancing."

Indexes can be powerful tools for asset allocation, in many ways due to their simplicity and the straightforward nature of their design. Canadian financial advisors, however, should not confuse simplicity with consistency and it is necessary to perform proper due diligence to ensure the indexes you utilize perform as expected. This means evaluating the indexes underlying your asset allocation process just as you would any other investment to ensure they are designed to meet the needs of your clients.

Edgar Guerra, Director ETP Strategy & Business Development, FTSE Russell ***EGuerra@ftserussell.com***

Why ETFs? Why now?

When the first exchange-traded fund (ETF) launched on the Toronto Stock Exchange in 1990, investors had no way of predicting the explosive growth that led to the nearly 8,000 ETFs now available in markets around the world.

Pat Dunwoody
Executive Director, Canadian ETF Association (CETFA)

It was the 30th anniversary of that launch when the Covid-19 crisis struck in March, and while Canadian mutual funds fell into net redemptions, ETFs generated $4.1 billion in net creations.

Despite slowing inflows in April as the pandemic reality set in, Canadian-listed ETF assets saw significantly less outflows than mutual funds and even topped the $200 billion milestone that was initially achieved in November 2019.

It's clear that ETF growth has been significant, consistent and robust, so let's dig a little deeper into why. What is it about ETFs that appeals to retail and institutional investors alike?

Following are four of the unique, yet simple, features that draw investors to ETFs. (It's no coincidence that these features also happen to be key drivers of the category's resilience during difficult market environments like the recent COVID-related volatility.)

Portfolio Building | Diversification

An ETF is a basket of investments, whether stocks, bonds, commodities or currencies, that investors can purchase in shares. The basket structure creates natural diversification by spreading the investment across multiple assets within the basket. Because many ETFs track specific indexes, investors can further diversify by incorporating different ETFs based on different indexes to meet the needs of their portfolio. ETFs are an excellent tool for advisors building goals-based strategies for clients because it's easy to diversify in the manner appropriate for each investor's unique needs – asset type, geography, sector, market cap, cost and more.

cetfa
Canadian ETF Association

Performance Value | Cost

Because of the way ETFs are structured and managed, they are typically lower cost as compared to their "basket of investment" cousins, mutual funds. The majority of assets held in ETFs currently on the market passively track an index. This differs from mutual funds that are actively managed by portfolio managers who buy and sell securities in an attempt to beat a predetermined benchmark, rather than track it. While active strategies can play an important role in portfolio building (and many actively managed ETFs have hit the market in recent years), the cost savings offered by passive indexing in combination with the low cost all ETF administration is appealing to investors and can also lead to outperformance because fees can quickly eat into returns.

Precision | Transparency

ETFs trade on an exchange, which means the current price is available in real-time throughout the day. In addition, many ETFs publish holdings daily instead of the monthly or quarterly reporting schedule that most mutual funds follow. This added knowledge can help advisors ensure that the ETF is maintaining the objectives set out in the prospectus and therefore assess at any time if the ETF continues to meet their portfolio needs.

Ease | Liquidity

ETFs are available to buy and sell throughout the trading day. This means investors have the ability to initiate ETF transactions quickly and easily at the current market price. There is typically a trading commission involved, but ETFs provide straightforward access to a wide range of securities because there is no minimum investment and no additional paperwork when an investor chooses to buy or sell.

Continue Growth on the Horizon

In 2018 and 2019, ETFs outsold mutual funds in Canada and in Q1, 2020, Canadian-listed ETFs saw a remarkable $17.1 billion in net creations. While the current pandemic has caused considerable volatility in markets, it has been the same for ETFs as for any other products. "When the market goes down, so do ETFs, there isn't any amplification," says Pat Dunwoody, executive director of the Canadian ETF Association (CETFA). The continued growth of ETFs in retail investor portfolios is showing no signs of slowing.

ETFs have empowered investors and advisers to be able to make asset allocation decisions swiftly and efficiently; to trade in and out of markets when they want, depending on their views. Initially, ETF investments were largely made by institutions; today, ETFs are the investment vehicle of choice for retail investors as well.

Deborah Fuhr, Managing Partner and Founder of ETFGI, an independent global ETF research provider, agrees. "ETFs are uniquely the only democratic investment product being used by institutional investors, financial advisors and retail investors," she wrote in a recent commentary. "Many investors view ETFs as a tool or a solution to assist them in managing their investment management and asset allocation work. New ETFs are being developed to address investor needs for exposure to ESG, thematic, disruptive trends and fixed income."[1]

ETFs can add considerable value to investor portfolios and can help advisors build personalized, goals-based strategies to meet individual client needs effectively and efficiently.

Pat Dunwoody, Executive Director, Canadian ETF Association (CETFA) ***patdunwoody@cetfa.ca***

[1] Quote source: ***www.cetfa.ca/files/1588073925_ETFGI%20News%20Release%20-%2020th%20anniversary%20Europe.pdf***

Why ETFs?
Why now?

Why All Investors Should be Using Fixed Income ETFs

It is often said that exchange-traded funds (ETFs) have "democratized investing."

Alfred Lee
Director, BMO ETFs
Portfolio Manager &
Investment Strategist,
BMO

While that saying has become somewhat of a cliché, that statement couldn't be more valid for fixed income ETFs, as fixed income ETFs address many of the short-comings of the underlying bond market. The market structure of fixed income, especially when compared to that of equities, is significantly more archaic as it can suffer from a number of shortcomings, particularly during stressed markets. These include: lack of transparency and price discovery, cost inefficiency, accessibility and illiquidity. Below we highlight each of these issues and how fixed income ETFs can be used to effectively address many of these shortcomings.

1) Transparency

From a transparency standpoint, equities have a lot more visibility as they trade on a stock exchange, a centralized location where various types of investors buy and sell securities. A centralized exchange, allows for much greater visibility as it allows investors to know where buyers are willing to bid and sellers are willing to offer stock. Furthermore, additional statistics such as high, lows of the day and volume allow investors to have additional insight on a particular security. This visibility is why equity exchanges are often referred to as "lit venues."

In contrast fixed income securities trade over-the-counter (OTC), or on a decentralized market, where a buyers and sellers deal directly with one another or through a broker/dealer, rather than meeting on an exchange. Due to the "upstairs market" nature of bond transactions, significantly less information is made public. While in the U.S., broker-dealers who are Financial Industry Regulatory Authority (FINRA) members are obligated to report corporate bond transactions to the Trade Reporting and Compliance Engine (TRACE), the bond market as a whole lacks the same degree of information visibility of the equity market. In comparison, the Canadian bond market is even more opaque as even clearing data may lack sufficient detail.

In terms of transparency, fixed income ETFs address these specific issues by essentially taking an OTC market and placing it on a lit venue. As bond ETFs are essentially a basket of fixed income securities that are listed on a stock exchange, they are regulated by the rules and regulatory requirements of an exchange. This includes having a live bid-offer spread, historical high and lows, volume and additional information that allows end investors to have more transparency. Moreover, through a bond ETF, investors can also see the depth of liquidity in the order book for that specific ETF through a "level-two" stock quote. This allows investors not only to know where the current bid-offer is, but also how many shares are available on-screen at each price point. While this doesn't provide the entire picture of liquidity, as market makers can provide additional size on the bid or offer, it shows the minimum amount of liquidity available and is a significant value-add to traditional bond investors.

2) Price Discovery

At times and particularly when the underlying bond market is stressed, ETFs have demonstrated an ability to provide price discovery to investors. The crisis of March 2020 was no exception when the underlying fixed income market seized up and essentially went "no-bid." During this time, all market participants essentially became sellers of bonds simultaneously, which prevented dealers from absorbing any additional inventory. With no buyers or providers of liquidity to offset the selling pressure, investors could no longer sell any additional bonds. Bond ETFs, however, continued to trade. This was due to holders of ETFs being able to sell ETF units, albeit at a discount to net asset value (NAV).

It should be noted that while NAV is an efficient measure of the value of a fund's assets in normalized periods, it does present some shortcomings during times of stress. Bond fund NAVs, which are calculated using dealer quotes, are often inflated during major market sell-offs as dealers are reluctant to mark down their inventory. Furthermore, if a bond hasn't traded in days, the likelihood is that a dealer quote being submitted is likely stale. This is precisely why bond ETF prices often trade at a discount heading into a significant bond market sell-off and a premium coming out, as their ability to provide price discovery are more reflective of current market conditions. By definition, if a market goes "no-bid", that means prices in which assets are being offered is not where buyers and sellers are willing to transact. During these times an ETF can trade at a discount, as the ETF uses its own demand and supply to find a price where buyers are willing to step in. By doing so, fixed income ETFs provide a better price discovery mechanism than the underlying bond market, as it is able to establish a true clearing price for bonds.

Another important note, is that while fixed income ETFs don't allow for unlimited liquidity during a crisis, they do provide additional liquidity to the underlying bond market. If liquidity in the underlying market cannot be accessed, the market maker of an ETF can absorb additional selling pressure to underlying market. Therefore, an investor of an ETF can take advantage of the balance sheet of the individual bond dealing desks, but when these desks cannot take on anymore risk, the ETF market makers also can absorb additional ETF selling pressure before being forced to tap the underlying bond market for liquidity.

Order Book Visibility for Fixed Income

Continued on the next page

3) Cost Efficiency

For direct bond transactions, bid-offer spreads can vary, particularly depending on what type of investor you are. Investors such as pensions and asset managers can transact in more sizable quantities at tight bid-offer spreads through an institutional trading desk. Retail investors, however, are subject to much wider spreads and trade via their retail desk.

When a bond ETF is launched, its bid-offer spread on an exchange is based on an institutional bid-offer spread given that is the cost in which the manager of the ETF or market maker can source the bonds. Over time, however, as an ETF matures and its trading activity on the secondary market increases, its bid-offer spread will become even tighter than what's available to institutions. This is the case due to the trading of ETF units on the secondary market. For example, for larger more mature ETFs, the likelihood is that you are buying the ETF from an ETF seller and vice versa. This is achieved as the increased trading of ETF units, allows market makers to buy and sell units, without having to access the underlying market. This is particularly true for ETFs that have two-way flow of both buying and selling activity and market makers compete with one another through tighter bid-offer spreads to capture more volume. This is beneficial as tighter bid-offer spreads mean lower costs of implementation for investors.

4) Accessibility

While bonds are commonly held in the portfolio of many types of investors, accessing certain parts of the bond market may be challenging even for even some of the most sophisticated investors. An asset allocator or a pension fund looking to gain exposure to U.S. high-yield bonds may not have the necessary accounts, internal infrastructure or expertise to do so. An ETF allows investors to take on the beta-exposure of any asset class that is available through the growing ETF universe. While ETFs have expanded the investable universe for all-types of investors, it has also allowed retail investors to play on a level playing field. This is the reason why ETFs have been called "access products."

5) Liquidity and Scalability

The majority of companies only have one-listed common equity, whereas it can have many more issued bonds. Consequently, the bond market is not only much larger in terms of market capitalization, but also in terms of numbers of securities available. Liquidity for bonds tends to be lower partly because the greater number of bonds, prevents investors from having a standardized security for buyers and sellers to transact. This becomes problematic for some investors such as family offices, which follow a common model for its clientele, but are subject to whatever bonds are available when capital is received. A bond ETF, provides investors with a standardized product for all buyers and sellers to focus on. Furthermore, it allows investors to allocate all capital to a specific ETF and scale up their operations, rather than being subject to whatever bonds are available from a dealer at particular times. This allows firms to increase operational efficiency as client reporting becomes standardized across accounts and inventory of a particular bond exposure is always available.

Summary

While fixed income ETFs are often compared to traditional bond funds both in the institutional and retail space, ETF applications should be viewed more broadly. In reality, fixed income ETFs should be viewed as a capital markets vehicle that could be used by various institutional and retail investors to both compliment and replace funds and individual bonds. In recent years, it has been encouraging that fixed income ETFs are gaining traction. We've had an increasing number of conversations with a growing number of types of investors who in the past have been reluctant to utilize fixed income ETF as part of their portfolio construction process. With the ETF industry as a whole ramping up their efforts in education, we believe fixed income usage will continue to trend higher in the coming decade.

Alfred Lee, Director, BMO ETFs Portfolio Manager & Investment Strategist, BMO ***Alfred.lee@bmo.com***

		Underlying		ETF	
		Spread / Mid (bps)	Bid/Ask Spread ($)	Spread / Mid (bps)	Bid/Ask Spread ($)
Aggregate Bonds					
BMO Aggregate Bond Index ETF	ZAG	0.367%	0.41	0.12%	0.02
Federal Bonds					
BMO Short Federal Bond Index ETF	ZFS	0.07%	0.07	0.07%	0.01
BMO Mid Federal Bond Index ETF	ZFM	0.09%	0.10	0.06%	0.01
BMO Long Federal Bond Index ETF	ZFL	0.11%	0.15	0.10%	0.02
Provincial Bonds					
BMO Short Provincial Bond Index ETF	ZPS	0.06%	0.07	0.06%	0.01
BMO Mid Provincial Bond Index ETF	ZMP	0.10%	0.11	0.09%	0.02
BMO Long Provincial Bond Index ETF	ZPL	0.22%	0.28	0.17%	0.03
Corporate Bonds					
BMO Short Corporate Bond Index ETF	ZCS	0.24%	0.24	0.21%	0.03
BMO Mid Corporate Bond Index ETF	ZCM	0.55%	0.59	0.30%	0.05
BMO Long Corporate Bond Index ETF	ZLC	0.71%	0.85	0.21%	0.04

Source: BMO Global Asset Management, FTSE/TMX, Bloomberg

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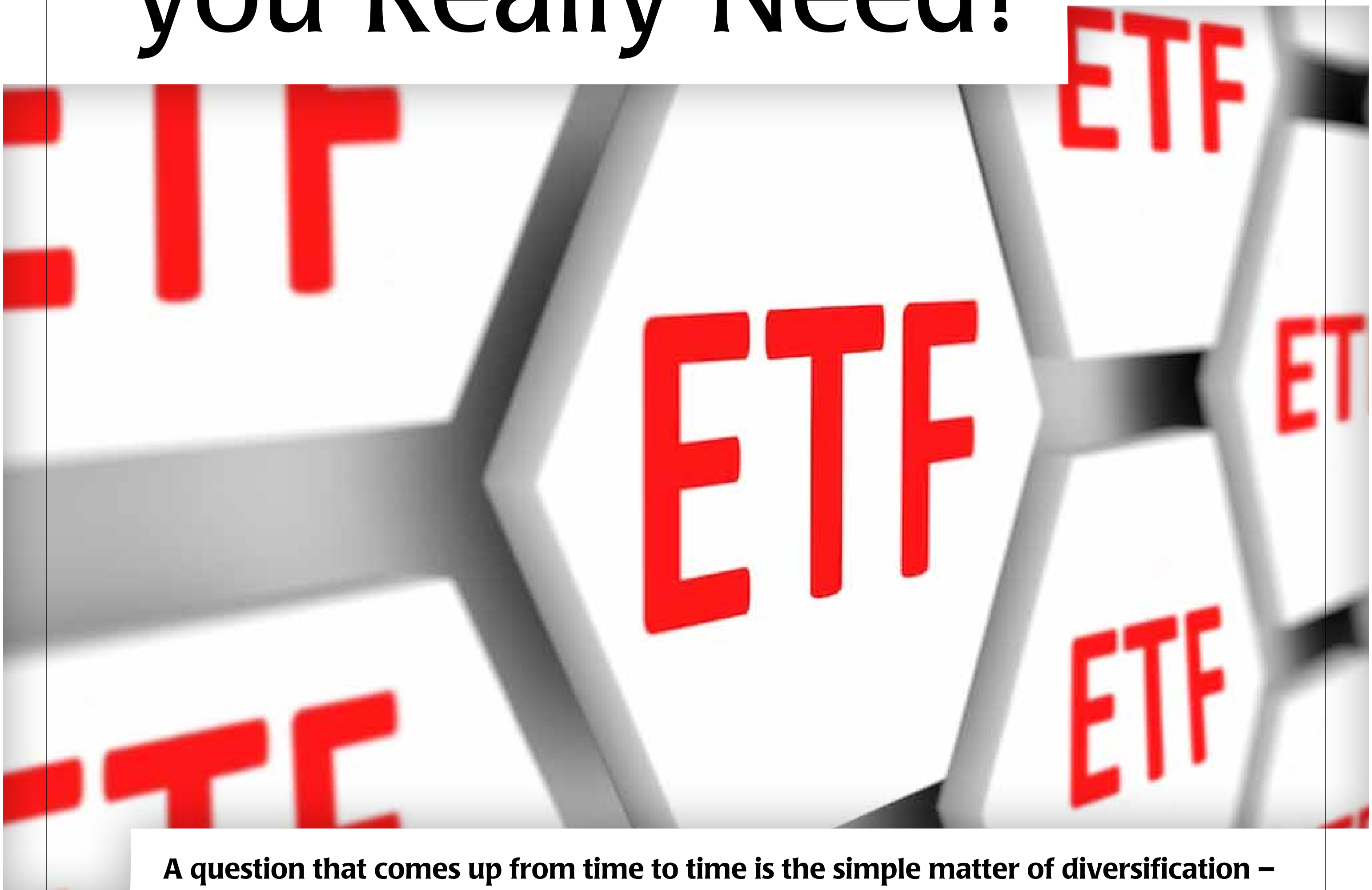
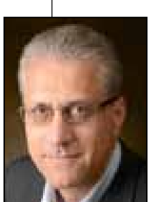
How Many ETFs do you Really Need?



A question that comes up from time to time is the simple matter of diversification – how to achieve it and how to manage it.



John J. De Goey
Portfolio Manager, Wellington-Altus Private Wealth Inc.

One simple test for this concern revolves around the number of ETFs required to build a properly structured and diversified portfolio. As with so many things in life, reasonable people might differ.

The consensus that most accept is that portfolio size is a key determinant and that the exact number of products also depends on a few other things – including client sophistication, the frequency of deposits, and whether the account is registered or not. Generally speaking, smaller accounts can justify having fewer holdings – if only to reduce the number of transaction charges (typically modest, but not nothing) involved in trading. Even if trading costs are set at a modest $15 / trade, that cost can add up if you're trying to maintain a balance on a TFSA with (say) $30,000 invested and $3,000 added semi-annually. Let's begin with some basic parameters and then flesh it out from there:

Account Size	Approximate Number of Products
< $100,000	1 to 4
$100,000 to $500,000	4 to 8
>$500,000	6 to 12

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To begin, we need to come to terms with the other primary driver in this decision: how active you intend to be in monitoring your portfolio. The more involved you intend to be, the more granularity you can justify. Most people with small accounts want simplicity, ease of use and minimal commissions. For them, there are several providers (Blackrock, BMO and Vanguard are the leaders in Canada) that offer single-ticket solutions where one can purchase an ETF that offers instant diversification. If you want simplicity and ease of use, these products are tough to beat. You'll simply need to be sure you're buying an offering that matches your risk profile. Small investors who want to be a little more involved might want to have separate products for Canadian equity, International / Global equity and income.

Once we get into low six-digit territory, we often see people who become more interested in details. That's only natural, since they now have more skin in the game. For most people with over $100,000 to invest, there's a desire for expressing more discreet preferences. The usual suspects listed above are present, but there might be a desire to subdivide foreign stocks into U.S., developed non-North America and possibly Emerging Markets. Similarly, there might be a desire to further carve the income portion into domestic and foreign, government and corporate, investment grade and speculative and possibly even currency hedged and unhedged. The amount of fine tuning is up to the investor. How committed will you be to monitoring and re-balancing? Doing this needn't take much time, but it does require regular monitoring – even if no changes are usually made.

It is only once accounts get over a half million dollars that people should give serious consideration to expressing themselves fully in their investment decisions. Building on the holdings mentioned in the $100,000 to $500,000 section, this is the point where most people can finally justify being at least somewhat funky.

There could be room for two or three positions (no more than 10% for any one and likely no more than 20% in total) for more esoteric pursuits. These include any number of potential alternative strategies, sector products and specialty products. Examples might include long/ short offerings, covered call products, thematic plays (e.g. health care) and micro-level calls (e.g. shorting cannabis). The thing about many specialty products is that, by themselves, they are often risky. Investors should be prepared to lose substantial portions of their allocations to these 'cherry on the sundae' expressions of preferences, hunches, flyers and macro-level trends that may or may not come to fruition.

As a rule, investors might want to be closer to the low number when at the low end of the account size range and only creep toward the higher number of products when they get to the high end of the range. For instance, having 8 products in a portfolio with $110,000 is likely overkill. It would almost certainly be better to simply aim for 4 and then, as the account grows, to judiciously add new products and themes along with that growth slowly over time.

Whether you build the portfolios yourself or work with an advisor, it is important that there's a resistance to the temptation to over-think and micro-manage things. Just because there are myriad options doesn't mean you need to try all of them. Have a strategic asset allocation. Monitor and maintain it. Manage turnover and taxes purposefully. Be reasonable in your expectations.

Portfolio construction is fairly easy to understand, but requires focus and discipline on an ongoing basis. Build a portfolio that suits your disposition and preferences and then stick to it.

John J. De Goey, Portfolio Manager, Wellington-Altus Private Wealth Inc. ***john.degoey@wprivate.ca***

What is the 'Spread' on an ETF?

As investors increase their awareness and use of Exchange Traded Funds (ETFs) in their investment accounts, there are a few elements to consider that will ultimately improve the experience and resulting outcome.

Erik Sloane
Chief Revenue Officer, NEO Exchange

Afterall, ETFs can be created and used to meet a range of needs beyond the most prevalent understanding: that buying an ETF enables exposure, via a single purchase, to multiple underlying securities without having to buy each individual stock.

In fact, ETFs are also being used to diversify by sector, country, management type (active vs. passive), and asset class (equities vs. fixed income). They can be a one-ticket-solution for buying a managed basket of all of the above, if desired, or they can be used to purchase securities in a market that may otherwise be challenging to reach for individual investors directly - like futures, commodities, or other unique mandates. This is just the tip of the iceberg as asset managers continue to explore how they tackle investment management challenges leveraging the ETF vehicle.

As a result, no two ETFs are the same and it is important to do your homework to ensure a clear understanding of the costs – both those clearly disclosed in a prospectus and those inherent in the way ETFs are bought and sold – before proceeding.

First and foremost, ETFs are exchange listed. This means that they exhibit similar trading characteristics and provide data points we typically see when investing in publicly traded companies – information like:

- Bid / bid size
- Offer / offer size
- Volume traded
- AUM (in place of Market Cap)
- Daily / yearly statistics like open / high / low / close

When comparing two ETFs, just like when research analysts compare two public companies, a deeper look into the fundamentals and investment strategy, among other details, creates a second set of data points for consideration. Ultimately, these details are critical to better understand the investor experience when buying and eventually selling an ETF unit – the actual security an investor is purchasing as a proxy for the basket of underlying securities, not the underlying security itself.

Evaluating Top of Book: The best bid & offer for a new buyer

Let's assume you've confirmed your investment thesis, evaluated performance benchmarks and criteria, and are now set on buying one particular ETF for your portfolio. In that review, you would have seen some information which may further inform the size of the spread you can expect to see when looking at the top of book bid / ask. Information like fees, investment strategy, liquidity of underlying holdings, asset class, geography, risk, among others, are factored into the spread that shows up in the form of a quote from a market maker on an exchange (either NEO or the TSX in Canada) for you to see and trade with.

Understanding the spread – calculated simply by taking the best offer and subtracting the best bid – is the first way an investor assesses an ETF to purchase units. A smaller spread, where there's reasonable size (in Canada, that's a standardized metric shared on all "ETF Fact Sheets", for reference), is better but it's important to understand what you're getting in order to ensure you're comfortable with the risk and exposure you may receive (e.g. index based vs. actively managed, highly liquid underlying securities vs. less liquid with perhaps a great risk / reward payoff, etc.).

When buying an ETF, your first interaction before placing an order is to understand the best offer price available in the market. This price will set your entry point into the ETF's investment mandate.

You also interact with the spread should you choose to sell the ETF you currently own - this time, however, on the bid-side. This, alongside management fees, any trading commissions due, and factoring in any distributions, would all accrue into the total cost of owning an ETF and should contribute to the evaluation of which ETF to select.

Lastly, there are a few basic elements to check on before hitting "buy" on an ETF:

- Is your data real-time or delayed? Always ensure you use limit prices and, ideally, a real-time source for indicative quotes so you don't trade at a price you're uncomfortable with
  - Advisors: you already have real-time data for all securities listed on the two Canadian exchanges that list ETFs: NEO & TSX, not consolidated
  - Investors: you likely only have either NEO or TSX data in real-time; it is not consolidated

- Do you need to trade this ETF urgently (e.g. in the opening auction, or at any prevailing market price via a market order)? If not, consider waiting until the Exchanges are open after 9:30AM and underlying securities have had a chance to open, as these market conditions will also be reflected in the spreads at the start and end of day

- Do you need to trade in size, larger than the prevailing quote? Chances are, there's substantial liquidity already available on-screen via one of Canada's twelve market places that you may simply not be seeing – if you're unsure, you can always call your firm's trading desk or the ETF manager directly to verify your ability to trade
  - For the active trading community, it may be worthwhile to source

Many other details factor into the spread presented in your financial tools. Ask questions, do your research, and be sure to understand the differences between products before purchasing.

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Understanding Exchange Traded Fund Taxation

The Income Tax Act defines many types of investment entities or structures for tax purposes including mutual fund trusts (MFTs), mutual fund corporations (MFCs) and segregated funds. A noticeable omission however is an exchange traded fund (ETF). This does not mean that an ETF is a tax-free entity.

Curtis Davis
Tax, Retirement & Estate Planning Consultant, Manulife Investment Management

In fact, the term ETF describes an investment with specific features and its use is more commercial or colloquial in nature. So how does ETF taxation work? It depends on how the fund is structured for tax purposes. Is it set up as a MFT or MFC? Most ETFs in Canada are MFTs and Manulife's ETF lineup is no exception. As such, the taxation of ETFs closely mirrors that of traditional MFTs. Going forward, this article focuses on ETFs setup as MFTs and held in non-registered accounts.

ETF Income and Distributions

Like a MFT, income generated on the underlying assets of an ETF retains its character when distributed to unitholders and is taxed accordingly. In other words, interest and foreign income is fully taxable income, Canadian dividends are grossed up and receive their corresponding dividend tax credits and half of realized capital gains are taxable. Should the ETF sustain capital losses at the fund level, these losses are used to offset realized capital gains at the fund level or are carried forward by the fund if the losses exceed realized gains in the year. Non-capital losses realized by the ETF can be used to offset any type of income at the fund level with any excess being carried forward. Finally, any foreign taxes paid by the fund can be flowed out to and used by investors as credits to reduce Canadian income tax owing on that same foreign income.

Manulife Investment Management

ETF Tax Efficiency

An ETF offers potential tax efficiency over a traditional MFT in one or both of the following ways:

Less Portfolio Turnover – Investment mandates for ETFs tend to be more passive than MFTs. While this includes traditional passive strategies like indexing, it can also include active investment strategies such as factor-based investing. With less trading activity at the fund level, there may be fewer realized capital gains to distribute to unitholders of ETFs when compared to active MFTs.

Investor Redemptions – All investor redemptions for MFTs are transacted directly with the fund itself. To provide the redeeming unitholder with cash, a MFT may have to sell underlying assets and realize capital gains. If these capital gains are not completely offset by the capital gains refund mechanism, the excess will generally be distributed to remaining unitholders. Generally, ETF investors sell their units over the stock exchange and realize any gain or loss without triggering transactions at the fund level. Therefore, the taxable distributions received by one investor are generally not impacted by the transactions undertaken by other investors in the same ETF[1].

Cash vs. Reinvested distributions[2]

Income earned by the underlying investments (i.e. interest, foreign income, Canadian dividends, etc.) in an ETF are distributed as cash to investors. Since cash distributions flow out to the investor, they do not impact the investor's adjusted cost base (ACB). On the other hand, capital gains realized at the fund level are immediately and automatically reinvested back into the ETF, increasing the investor's ACB.

Such reinvested distributions purchase new units of the ETF and these units are immediately consolidated with the investor's other units so that the number of units held by the investor and the net asset value (NAV) per unit is the same as before the capital gains distribution. To illustrate these mechanical differences, refer to the chart on the right.

As you can see from the chart, with either method the investor's FMV and ACB is $1,100. The difference lies in how the ETF and MFT got there. After the capital gains distribution, the NAV of the ETF is reduced to $10 and the $100 capital gains distribution is used to buy 10 more units like with the MFT. However, the number of ETF units outstanding is immediately consolidated so that the number of units held by the investor and the NAV per unit is the same as before the capital gains distribution (i.e. back to 100 units outstanding with a NAV = $11/unit). That is why ETF capital gains distributions are sometimes called "phantom distributions"– it appears that nothing has changed. The exception being the ACB, which has increased.

The MFT also issues new units with the reinvested distribution which increases the number of units held by the investor proportionally to the ratio of the distribution to the current unit price (1/10 in the example above). However, with the MFT there is no consolidation of units so the investor ends up with more units at a lower NAV.

Finally, return of capital distributions (ROC), if any, reduce an investor's ACB in both MFTs and ETFs. With either investment, if the ACB is reduced to zero, ROC distributions are treated as capital gains for tax purposes.

Selling units and an investor's ACB

When an investor sells units in either a MFT or an ETF, the ACB is needed to determine the capital gain or loss on the sale. The items that impact an investor's ACB in a MFT and ETF are:

Purchases and redemptions – Purchases increase the ACB and redemptions reduce the ACB. An investor's ACB is based on the average cost of units held.

Reinvested distributions – Increase the ACB to avoid double taxation of the reinvested income upon sale.

Distributions of return of capital (ROC) – Reduce the ACB. If the ACB is reduced to zero, future ROC distributions are taxable as capital gains.

While the factors impacting an investor's ACB are the same for MFTs and ETFs, a disposition of each holding is executed differently. When an investor disposes of units from a MFT, the units are redeemed by the fund in exchange for cash to the investor. When an investor disposes of ETF units, they are generally sold on the exchange like an individual stock. The tax result for the investor is the same, a capital gain or loss that is calculated by comparing the proceeds of disposition (net of redemption costs) with the ACB.

Description	Exchange Traded Fund	Mutual Fund Trust
Purchase 100 units @ $10/unit	ACB = $1,000 (100 units x $10)	ACB = $1,000 (100 units x $10)
Current NAV = $11	FMV = $1,100 (100 units x $11)	FMV = $1,100 (100 units x $11)
$1/unit capital gain distribution = $100 capital gain distribution automatically reinvested	No change to NAV and number of units. NAV= $11/unit Units owned = 100	NAV decreases by distribution and buy more units NAV = $10/unit ($11 - $1) Buy 10 more units with distribution ($100/$10 unit). Units owned = 110
Taxable amount	$100 capital gain distribution	$100 capital gain distribution
FMV after reinvested distribution	$1,100 (100 units x $11/unit)	$1,100 (110 units x $10/unit)
ACB after reinvested distribution	$1,100 (100 units x $11/unit)	$1,100 (110 units x $10/unit)

Continued on the next page

Continued from : Understanding Exchange Traded Fund Taxation page 25

Summary

While ETFs may look and feel different than a MFT, from a tax perspective they are the same, albeit with differences in operational mechanics that can provide the potential for lower taxable distributions than traditional MFTs. This is good news for investors that are new to ETFs. They will likely have a trading experience like stocks with tax reporting like MFTs. This familiarity should bring them peace of mind and comfort with adding ETFs to their own portfolios while offering the potential for greater tax efficiency.

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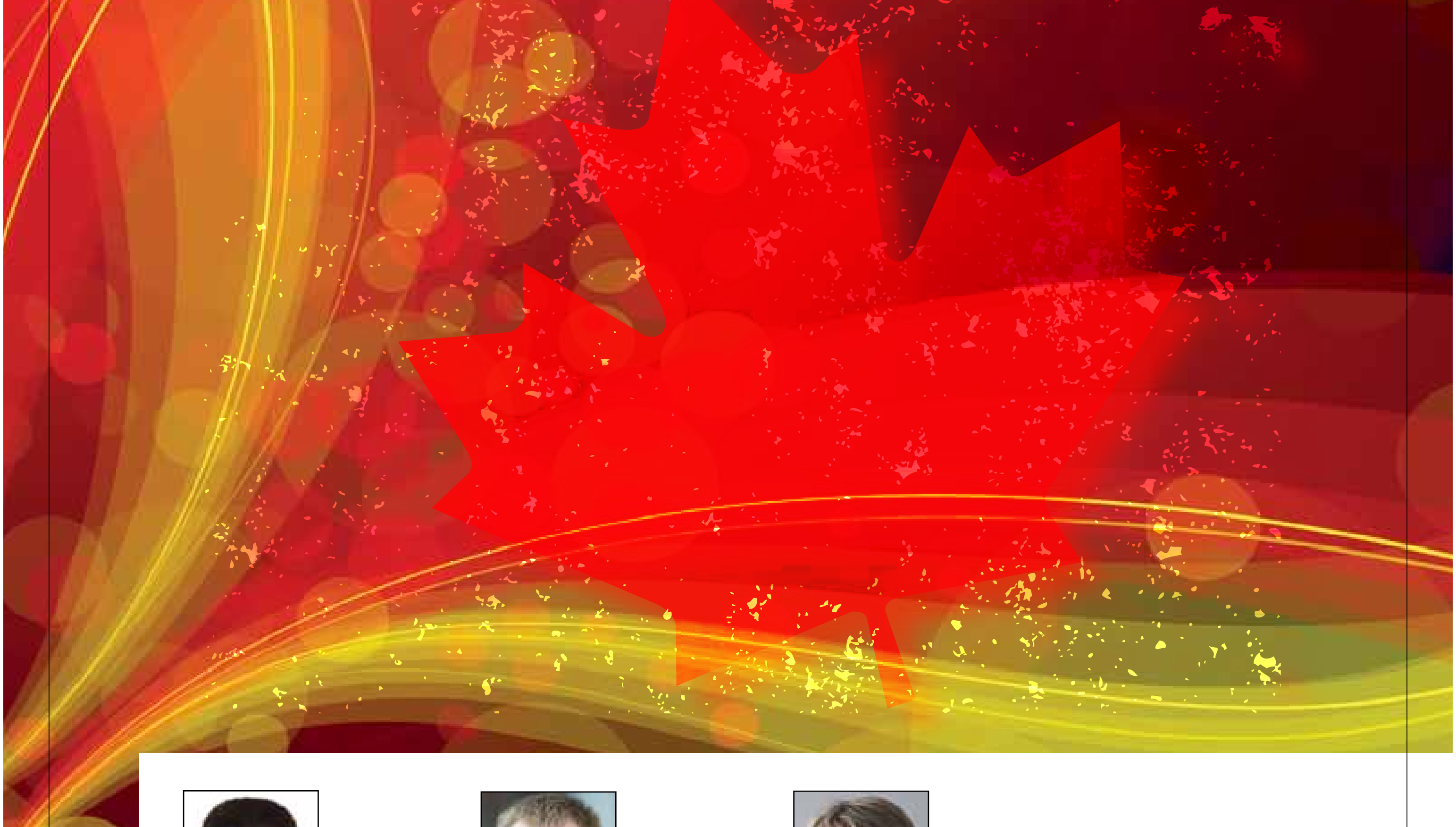
[1] This also applies in instances where transactions are conducted by investors (usually the designated broker) directly with the ETF. While such transactions may trigger capital gains at the fund level, these gains can be allocated to the redeemer, subject to certain restrictions. Because of this allocation, the taxable distributions of other unitholders are generally not impacted.

[2] The commentary regarding distributions relates to Manulife ETFs. One must confirm with other ETF providers how they administer distributions.

ETF Creation and Redemptions

A Peek Behind the Scenes of the Canadian ETF Market



Alex Perel
Head of ETF Services in Global Banking and Markets, Scotiabank

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Director of ETF Capital Markets in Global Asset Management, Scotiabank

Pat Dunwoody
Executive Director, Canadian ETF Association (CETFA)

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Canadian ETF Association

Two of Scotiabank's ETF professionals – Alex Perel, Head of ETF Services in Global Banking and Markets, and Alan Green, Director of ETF Capital Markets in Global Asset Management, along with Pat Dunwoody, Executive Director of the Canadian ETF Association – provide a deep dive on how ETFs actually work, the ins and outs of market making and how investors should consider using ETFs in their portfolios during these unprecedented times.

PD What is your role, and how are you involved with the ETF ecosystem?

AP I am Head of ETF Services at Scotiabank Global Banking and Markets. My role is to oversee ETF market making activities and everything that goes with it. We help investors access the ETF market by providing them with liquidity and advice. We provide quotes on Canadian exchanges and also directly to clients in large blocks. As a result we need to be active in the underlying markets, including equity, fixed income and foreign exchange. Our clients range from investment advisors within our channel to the largest institutional investors in the country.

AG I am Director of ETF Capital Markets at Scotia Global Asset Management. In this role I oversee the ETF creation and redemption process from an ETF issuer stand point. I also help our clients through the ETF trading process especially on larger block transactions. I am also invlovled in developing and execution of Scotia Global Asset Management's ETF strategy.

PD At a high level, what's the difference between an ETF and a mutual fund?

AP From an investor's perspective, there are similarities but also key differences. The common element is that each provides the investor with a share in a portfolio of investments, such as stocks, bonds or commodities. Both mutual funds and ETFs are really just a way of packaging up a portfolio for an investor to buy a slice of.

The key difference between a mutual fund and ETF comes when it's time to buy and sell units. With mutual funds, investors deal directly with the mutual fund company. When the investor buys units of the mutual fund, the mutual fund company has to invest the cash directly, which often happens later than the investor's decision. This has some behind-the-scenes impacts that usually result in all investors sharing in the costs of money going into and out of mutual funds.

AG With ETFs, the investor can buy and sell units in the open market in a similar way to trading stocks. A purchase by an investor could be from another ETF holder or could also be from an ETF market maker such as Scotia, who is there to enable investment in to the ETF. This allows the ETF to offer investors intraday liquidity. In addition, behind the scenes the ETF structure also shelters existing investors from paying extra costs when investors come in and out. ETFs are highly efficient in this regard.

AP It's important to understand that the ETF market does not operate in isolation. When market making firms like Scotia are establishing market prices, it is on the basis of what the underlying ETF portfolio holds and what those investments are worth at any time. This valuation process relies heavily on technology. The result is that the ETF market reflects the value of the underlying assets.

PD Sometimes we hear about ETF creations and redemptions. What is that, exactly?

AP Just as individuals can purchase mutual fund units from the fund company, ETF market makers are able to obtain new units issued by the ETF company. This means that the ETF market maker is always in a position of being able to sell ETF shares to investors. It also works in reverse, where ETF market makers are able to buy back shares from investors and redeem them to the ETF company.

The creation or redemption process is the mechanism by which this process happens. There are two key differences between ETF creation or redemption and the equivalent in mutual funds. The first is that this ability is only open to authorised dealers to allow ETF market making to occur. The second is that dealers often pay for their new ETF units by delivering the underlying basket of investments to the fund rather than cash. This leads to a range of efficiencies both for the ETF holders and for the ETF market itself.

AG It's also important to remember that while the ETF creation process sounds complex, it's entirely transparent to the end investor. It's part of the plumbing that the ETF market relies on.

PD How often does the creation and redemption process happen?

AP Creations and redemptions are a daily part of life for ETF market makers. We constantly assess our inventory levels and create or redeem units as needed. The amount of creation that actually happens is closely linked to the total amount of client investment activity into a particular ETF. If investors look to buy a certain product, there will generally be creations occurring, as we will be selling out of our inventory and will need to replenish. And the same works in reverse.

AG It's important to remember that this isn't something that is visible to the end investors. This is mechanics behind the scenes.

PD How would an investor know if their trade triggered a creation or redemption? Does it matter?

AP The short answer is that in most cases the investor won't know and it does not matter. The key thing for most investors is purchasing their investment at a fair price. In truth, on the trading desk we often won't know specifically which investor triggered a creation. We will simply know that we need to replenish inventory.

Continued on the next page

PD How have ETFs performed in the recent market volatility? Has the creation and redemption process operated as usual?

AP I would say things have held up remarkably well. There have been a few exceptions, but overall the ETF market performed better than in previous volatile market events. While March 2020 was certainly the most challenging trading environment of my career, including during the 2008 Great Financial Crisis, the structural changes that have happened in the last few years have helped the ETF ecosystem be more robust.

The stress on the markets came not from the mechanics of ETFs, but from the practical difficulties of managing risk in this environment. The technology of ETF market making desks was certainly strained, and when you layer on top of that the tremendous volatility in the market, big price movements can happen.

These aren't issues that are unique to ETFs by any means. The same stresses that were visible in the ETF market also occurred under the hood of mutual funds. The difference is that investors have more transparency into intraday price movements with ETFs than they do with mutual funds.

AG The majority of ETFs in Canada including our own suite continued to operate as normal from the perspective of creations and redemptions. There were high trading volumes across the ETF suite in recent weeks which is typically observed during peroids of market volatility. Investors were making real time decisions as the markets moved. The ETF structure which offers intra day trading ability is a great tool for these times.

PD Investors may have seen some commentary on fixed income ETFs in recent weeks, what happened and what are your thoughts on the subject?

AP The fixed income market was probably the most strained part of the capital markets ecosystem during the downturn. While eyes are often focused on the S&P 500, in reality more trading activity occurs in the bond market than in equities. The reason is that the bond market is closely linked to things like commercial loans, credit facilities and money market funds.

In early March, the fixed income market seized up. Simply put, the wave of selling to raise cash dramatically outstripped the capacity of that market in such a short amount of time.

A lack of bond liquidity impacts ETFs because fixed income ETFs do not operate in a vacuum. When the underlying bond market is challenged bond ETFs are still trading. The ETF market making desks were trying to manage their risk when the ability to sell bonds was severely impaired. The result was apparent dislocations to bond ETFs Net Asset Value (NAV), which are calculated based on pricing indexes. Those indexes had valuations which, in my opinion, were not keeping up with the market.

There has been a lot of market discussion about perceived discounts to NAVs in fixed income ETFs. My view is that in general bond ETF pricing during the period reflected the risks involved in selling bonds in a stressed fixed income market. I would also say that, in most cases, bond ETF investors who didn't trade over the period were sheltered from the fixed income market stress because well-designed ETFs protected existing investors from dilution.

PD Without giving any investment recommendations, do you have any closing thoughts on how investors should be using and trading ETFs in their portfolios in these volatile times?

AP In general, the ETF structure is an efficient vehicle for providing market exposure. I tend to lean towards a top-down approach to portfolio construction, meaning I choose asset allocation and sector allocation before looking to specific products.

Within each category, there will be products that offer low-cost access and others that offer differentiated features such as active management. Its good practise for investors to ensure they understand the features of the ETF before investing.

When it comes to trading, I think the main thing to consider is whether the underlying assets can be reasonably priced and valued at the time of your order. For example, trading a US stock ETF is usually fine during North American trading hours, but much harder on the 4th of July when the US market is closed.

AG I would encourage investors to seek counsel within their brokerage firm or ETF issuer. Most firms have specialist in-house resources that can assist with answering client questions. That is certainly a service we offer to the clients of Global Capital Markets and Global Asset Management at Scotiabank.

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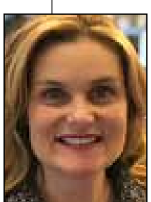
ESG – Understanding the Term



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Introduction

The global market for Environmental, Social and Governance (ESG) ETFs has grown more than eleven-fold since January 2016, reaching US$68bn across 293 funds globally in February 2020.[1] The popularity of passive investing coincides with rising demand from investors seeking to invest in companies with sustainable business strategies. We believe that investor demand, growing market awareness, and new guidelines for sustainable financial products will continue to drive growth, supported by a view that ESG factors are financially material and can, alongside traditional financial analysis, be good indicators of corporate performance.

What is Sustainable Investing and ESG?

Sustainable investing is an investment philosophy that incorporates ESG factors alongside financial considerations in the investment decision-making process. Sustainable investment products have grown significantly over the past decade, with investment opportunities spanning equity, fixed income, private equity, and the passive investment space. Between 2016 and 2018, dedicated sustainable investment products grew by 34% to reach US$31tn in global AUM.[2]

There are many different investor approaches to ESG and we highlight four of the most common sustainable investing strategies below.

- Exclusionary screening represents one of the earliest approaches to ESG and is also known as responsible or ethical investing. Investors use an exclusionary approach to avoid certain companies or sectors that conflict with the investor's values or are associated with increased ESG risk. The practice began in the 1960s as some investors began to exclude stocks or industries from their portfolios based on business activities, such as tobacco production or involvement with certain political regimes.[3]

- ESG integration refers to the practice of systematically incorporating ESG factors alongside traditional financial analysis and is grounded in the belief that sustainability metrics can provide valuable insight into corporate performance. ESG integration is growing at a faster rate than exclusionary screening, and in asset-weighted terms, is now the most popular sustainable investing approach in the United States, Canada, Australia, and New Zealand.[4,5]

- Thematic investing involves investment in broad sustainability-related themes, such as renewable energy, water and waste management, or gender diversity. Approaches to thematic investing are varied and can involve funds or single stocks, multiple or single themes, and active or passive strategies.

- Impact investing refers to targeted investments that are aimed at achieving a positive social or environmental impact while generating a financial return. Frameworks such as the UN Sustainable Development Goals (SDGs) can provide investors with a way to monitor the positive social or environmental impacts of their investments.[6]

Why Do Investors Care About ESG?

One claim that has been advanced against sustainable investing centers on the idea that an ESG-driven strategy comes at the expense of returns. However, evidence to the contrary is rapidly stacking up. BlackRock posits that strong performance on key ESG factors is a proxy for operational excellence, and studies by MSCI have found that stronger ESG performers are associated with higher profitability, lower exposure to tail risk, and lower cost of capital.[7&8] At the same time, other studies have shown that weaker ESG performers have a higher cost of capital, higher volatility due to controversies and ESG-related incidents such as environmental spills, corporate fraud, and other governance irregularities.[9]

ESG as an investment strategy largely rose to prominence during the most recent bull market, raising questions of how this investment approach would perform during an economic slowdown. Early indications suggest that ESG is outperforming during the COVID-19 crisis. Recent research from RBC Capital Markets found that on a sector neutral basis, S&P 500 companies with better overall ESG risk profiles outperformed those with worse ESG risk profiles during the recent stock market drawdown. At the sector level, companies with better ESG risk profiles outperformed those with worse ESG risk profiles within most sectors. The analysis also found that generally, names with better overall ESG risk profiles tend to have higher multiples, higher ROEs, and slightly higher growth rates than names with worse overall ESG risk profiles.

Mainstream investors are increasingly using ESG factors as an alternative dataset to provide insight into material non-financial risks that may not otherwise be captured in traditional financial analysis. The Sustainability Accounting Standards Board (SASB), an independent non-profit organization with a mission to help companies disclose material sustainability information to investors, has developed industry-specific sustainability accounting standards on topics that are likely to affect a company's financial value.[10] Ultimately, incorporating ESG factors into the investment decision-making process allows investors to be better prepared to evaluate and manage a wider scope of longer-term risks and opportunities.

How Do ESG Factors and Passive Investing Intersect?

In Canada, the market for ESG ETFs has grown rapidly as the rise of passive investing corresponded with the launch of robo-advisors. Inflows into Canadian-listed ESG ETFs have been strong in recent years, with more than $450 million in the past two years.[11] The majority of ETF launches in Canada this year have been focused on sustainability, and as of late May 2020, the total AUM within Canadian-listed ESG ETFs approximated US$1bn.[12,13]

Sustainable indices are distinguished from traditional market indices due to the inclusion of environmental, social, and/or governance criteria in the security selection process. Integrating ESG criteria can be done in a variety of ways, including through exclusionary screening or by tilting exposure to over-weight strong ESG performers and under-weight weaker ESG performers. Sustainable indices can be used to create financial products focused on sustainable investment, to perform research and identify sustainable companies, and to benchmark performance for sustainable investment portfolios.

As investors have looked to rebalance their portfolios following the COVID-19 downturn, indications show that they are increasingly preferring sustainable funds over more traditional ones. Recent research from BlackRock demonstrates that in the first quarter of 2020, global sustainable open-ended funds, which include both mutual funds and ETFs, brought in US$40.5bn in new assets, a 41% year-over-year increase.[14]

Closing Thoughts

We believe that investor demand, growing corporate awareness, and new guidelines will continue to drive growth in the market for sustainable financial products in the years ahead. ESG ETFs in particular have shown tremendous growth in recent years and reflect the growing recognition that ESG factors are financially material and, when incorporated alongside traditional financial analysis, can provide investors with valuable insight into corporate performance and material non-financial risks.

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2020/21 CALENDAR OF EVENTS

Brought to you by radius Financial Education

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Exchange Traded Forum (ETF Vancouver) 10th Annual

Tuesday, October 13 ~ Vancouver, British Columbia

Canada's largest and longest standing event dedicated to Exchange Traded Products. Hear from leading financial industry professionals and industry experts who will provide valuable insights into the issues and trends that matter most to Canada's financial professionals. Join us for presentations, advisor/client-focused sessions, roundtable discussions, networking events and knowledge sharing critical issues facing the financial industry.

EXCHANGE TRADED FORUM 2020

ExchangeTradedForum.com

VANCOUVER

WAIS Canada 19th Annual

Thursday, Oct. 29 & Friday, Oct. 30 ~ Niagara Falls, Ontario

WAIS Canada is in its 19th year and is Canada's largest gathering of alternative investments, investment professionals, investors, industry experts and service providers. Today's WAIS has gone much beyond its original alternative investment only focus attracting investment professionals from all facets of investments. WAIS Canada is a popular annual event that is not to be missed.

WAIS 2020 CANADA

waisc.com

Retirement Canada Dialogue 2nd Annual

Monday, December 7 ~ Toronto, Ontario

The Retirement Canada Dialogue is a full-day event packed with the latest trends and solutions for retirement planning professionals, turning a challenging retirement environment into an advantage for advisors. Networking and learning amongst peers and industry experts with comprehensive exposure to all important aspects for the practice of retirement planning.

RETIREMENT CANADA DIALOGUE 2020

RetirementInstituite.ca

TORONTO

Exchange Traded Forum (ETF Toronto) 11th Annual

Thursday, Dec. 10 & Friday, Dec. 11 ~ Toronto, Ontario

Canada's largest and longest standing event dedicated to Exchange Traded Products. Hear from leading financial industry professionals and industry experts who will provide valuable insights into the issues and trends that matter most to Canada's financial professionals. Join us for presentations, advisor/client-focused sessions, roundtable discussions, networking events and knowledge sharing critical issues facing the financial industry. This is an opportunity for IIROC based financial advisors and also Portfolio Managers to gather together in a great location to network, learn from each other, and participates in the numerous educational opportunities that fill the agenda.

EXCHANGE TRADED FORUM 2020

ExchangeTradedForum.com

TORONTO

Institutional Dialogue 11th Annual

Monday, Apr. 12 & Tuesday, Apr. 13, 2021 ~ Québec City, Québec

Institutional Dialogue is Canada's premier institutional event with an academic angle and a focus on education & open dialogue. The Dialogue is an invitation-only symposium creating a forum for open dialogue and debate issues facing Canada's foremost institutional investors. The distinguished speaking faculty assembled each year includes academics, authors, policymakers, journalists, consultants and select practitioners. A selected group of senior representatives from Canadian pensions and family offices will participate in three days of informative discussions, education and networking. This confidential closed-door event is reserved for select industry participants.

Institutional Dialogue

InstitutionalDialogue.com

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Financial Education
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ETF & Investment Forum London 2nd Annual

Spring 2021 ~ London, United Kingdom

A unique, 1-day European gathering of industry experts and financial professionals with comprehensive exposure to the latest products and trends in the fast growing ETF and Investment industry.

ETF & INVESTMENT FORUM 2021
RadiusEurope.com
LONDON

ETF & Investment Forum Frankfurt 2nd Annual

Spring 2021 ~ Frankfurt, Germany

A unique, 1-day European gathering of industry experts and financial professionals with comprehensive exposure to the latest products and trends in the fast growing ETF and Investment industry. (Präsentiert in deutscher Sprache)

ETF & INVESTMENT FORUM 2021
RadiusEurope.com
FRANKFURT

Institutional Dialogue 2nd Annual

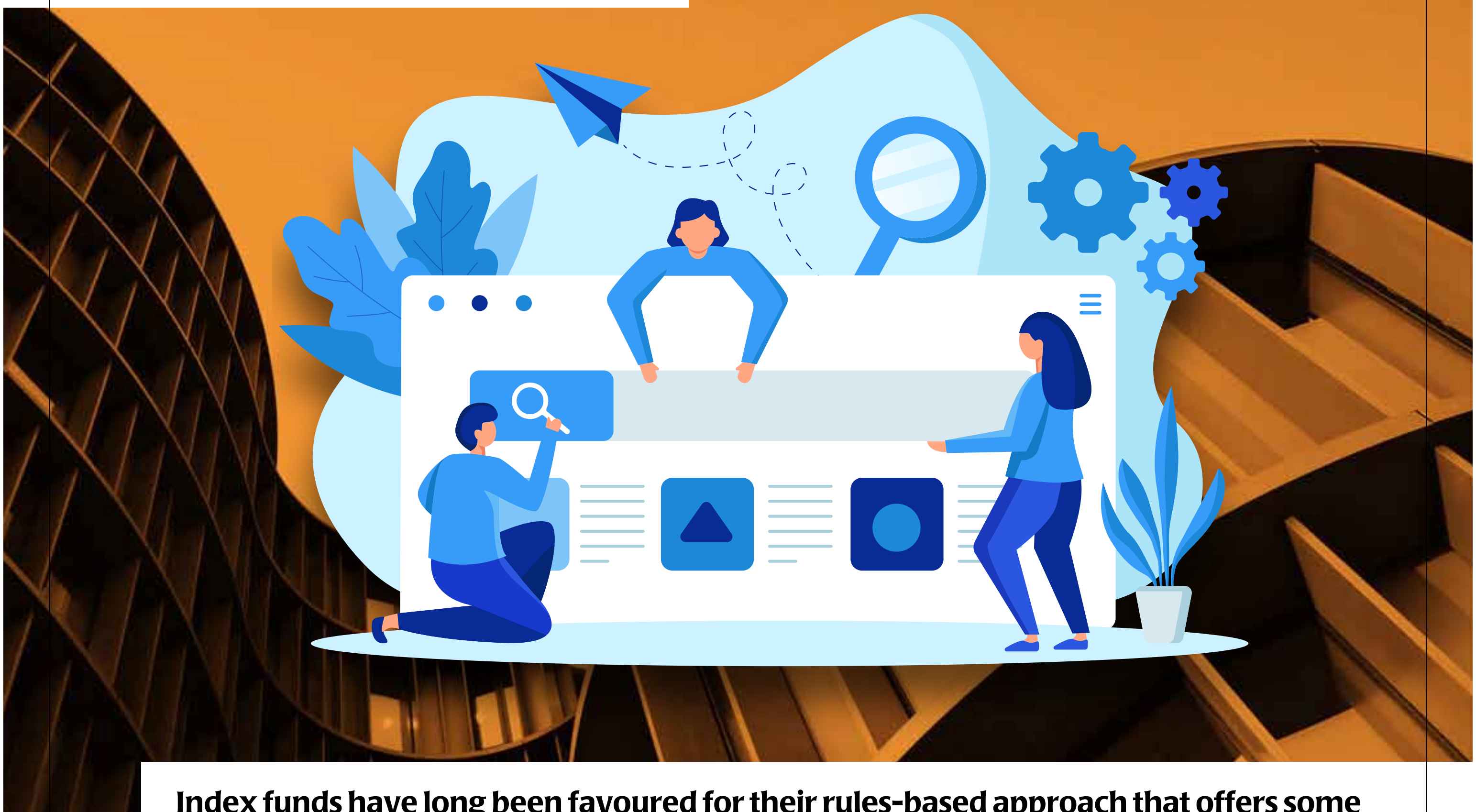
Spring 2021 ~ Edinburgh, United Kingdom

A 1 ½ day event packed with family conversations and solutions for a unique class of wealth professionals and entrepreneurs. Networking and learning among peers and industry experts with comprehensive exposure to all important aspects for family stewards.

INSTITUTIONAL DIALOGUE
RadiusEurope.com

Radius Europe Financial Education (Radius Europe) has been producing high level conferences within the financial services sector for over 18 years. As a leading producer of conferences within the financial sector, Radius Europe events focus on education and networking through an exchange of independent ideas and information, allowing our delegates to be leaders in their chosen fields. Our top-down approach to the agenda enables us to deliver relevant, thought-provoking, cutting edge, and sometimes controversial insight in a stimulating manner. We understand the importance of learning from the best. Each conference offers a well balanced speaker composition consisting of insight from authors, educators, economists, regulatory bodies and industry leaders from around the globe.

Due Diligence in Indexing



Index funds have long been favoured for their rules-based approach that offers some level of predictability. They are an investment route for those not looking to time markets or to seek active management expertise to outperform certain markets.

Prerna Chandak
Vice President, ETF Product & Strategy, Mackenzie Investments

MACKENZIE
Investments

They come with some level of certainty on movement of exposures over time through set rebalancing methodologies and are typically associated with low management fees.

But in times of significant volatility as we have seen recently, when ETFs become reliant price discovery vehicles, index investing too can require some level of active decision-making within the index ETF and the index it tracks. Some examples of this active decision-making can be seen in postponement of rebalancing schedules (this affected many equities and fixed income indices); proposed changes to index methodologies to better address liquidity and offer flexibility to those tracking that index (this affected many oil futures and fixed income indices); and ETF providers sampling securities within an ETF to better manage for short-term liquidity needs. Much of this type of active decision-making is already contemplated in ETF prospectuses and in index methodologies.

This begs a broader question on how different index ETFs within a category are constructed and what they may or may not be permitted to do. With close to 800 ETFs listed in Canada and over 2,000 listed in the US, how do you select which index ETF to use? Will all index ETFs within an asset category always act and perform the same way? Inception date, assets under management, management fees and ETF provider familiarity are all common criteria used by investors to choose index ETFs, but even index ETFs can vary from one to another.

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Advisors and investors should consider a due diligence framework for selecting index ETFs, which include four key components – assessing index exposure, product structure, total cost of ownership and the ETF provider.

Index Exposure

The first component is centered on exposure at the index level. There are some key methodology differences that can exist between one index and another. Does the ETF represent the exposure being sought? This should be a seemingly simple question to answer but not every index is built the same. Weighting methodology, free-float calculation, timing of foreign exchange (FX) rates, tax schedule used, rebalancing frequency and schedule vary by index provider and can result in meaningful differences in performance outcomes.

Historically, indexes were built for active managers to benchmark performance against –not for index funds to track. Many fixed income indexes have constituents that have minimal liquidity. ETF providers tracking these indexes are often unable to fully replicate the index, and in managing for a balance of tracking error versus trading costs, they may sample or optimize. In this method, an ETF provider holds a representative sample of securities that reflects the characteristics of the index. Although this method is a common occurrence in some types of ETFs in Canada, it is important to note that there is a certain level of active management involved in sampling an index. A portfolio manager must decide daily which securities to include or exclude from the ETF as cash flows in or out of the ETF and also at the time of rebalancing. However, more recently, some index providers have built investable indices that are more efficient to track by index ETFs.

Another factor that impacts relative performance of an index ETF compared to the index it tracks is withholding tax that is deducted at source from dividends or interest income paid to shareholders not resident in the same country as the remitting company. Withholding tax may be reclaimed in part or in full if a double-taxation treaty exists. Most index providers calculate indexes using two tax schedules, “net-of-tax” (previously known as “lux tax”) and “US RIC” – neither of which reflect a Canadian tax schedule, which impacts Canadian-listed ETFs tracking the index. A small number of index providers, such as Solactive, customize indexes to account for Canadian withholding tax rates.

Product Structure

The second component of the framework is product structure. Advisors and investors should consider implications of an ETF’s structure and country of listing.

An ETF can provide exposure by using derivatives, wrapping other ETFs, or directly investing in securities. Each of these methods can result in varying impacts on the performance of an ETF relative to its associated index. The structure also impacts how an ETF trades as well as how a portfolio manager oversees the ETF on an ongoing basis.

Canadian investors have looked to US-listed ETFs, which come with low expense ratios and high levels of secondary market liquidity. However, there are meaningful tax and currency considerations for many types of investors. When purchasing US-listed ETFs, consider withholding tax implications on distributions made by the US ETF to the Canadian taxpayer as well as at the underlying level within the US-listed ETF. Another important consideration is FX impact and hedged offerings. Investors purchasing US-listed ETFs do not have an option to purchase CAD-hedged equivalents. Buying an ETF on a Canadian exchange often provides investors and asset managers access to CAD-hedged ETFs as needed.

Total Cost of Ownership

The third component of the due diligence framework is total cost of ownership. It’s not enough to compare management fees or management expense ratio (MER) alone. ETF investors need to consider total cost of ownership, which includes costs associated with trading an ETF and those which are embedded in net asset value (NAV) and ETF performance. Costs that arise from trading an ETF include spread, commissions and any premiums/discounts. Costs that are embedded in NAV and ETF performance include MER, taxes and total expense ratio (TER).

ETF investors should also consider tracking error, the standard deviation of the difference between the returns of the portfolio and the returns of the index. There are various factors that contribute to an index ETF achieving minimal tracking error, including controlling trading expenses, cashflow management, rebalancing frequency or timing, optimization techniques, index construction, and hedging costs, if applicable.

ETF Provider

The last component of the due diligence framework is focused on getting to know the ETF provider. Understanding the ETF exposure itself is important but having some sense of how the ETF provider will manage the ETF through challenging times, provide investment insights and product support is another. Consider the ETF provider’s experience and commitment to the ETF industry, how well they understand Canadian investors’ needs and how strong their relationships are in supporting advisors, institutions and working with market makers.

Index ETFs vary in how they are managed and at the index level, which can impact performance outcomes in challenging markets. The decision on which ETF to buy cannot be based exclusively on size, history or volume. Ultimately, it is the responsibility of advisors and investors to conduct due diligence on ETFs being considered. This four-component framework of considering exposure, product structure, total cost and fund provider can help advisors and investors in the due diligence process. Much of the necessary information is available in ETF prospectuses and index methodology documents that are publicly available, however, reach out to ETF providers to help guide you to the right information.

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Inflection Point: U.S. Marijuana Stocks Rally

Mark Noble, Executive Vice-President, ETF Strategy, Horizons ETFs

The United States marijuana sector, which is comprised primarily of multi-state-operators (MSOs) — vertically integrated companies that cultivate marijuana and own dispensaries and retail distribution in various U.S. states – has rallied over the last month.

Despite not being federally legal, the U.S. marijuana market is projected to be the largest in the world by 2024, according to Arcview Research and BDS Analytics.

According to Arcview Research and BDS Analytics, the U.S. Cannabis market closed in on nearly US$12.2 billion in sales in 2019, roughly ten times the sales generated within Canada. Key state recreational markets that have recently come online, such as Illinois and Michigan, will add about US$700 million in annual revenue this year, according to Arcview Research and BDS Analytics. Those states join other major state markets such as California, Colorado, Nevada and Washington State as key hubs for recreational sales.

The largest publicly traded MSOs are all seeing revenue growth rates rise by double-digits per quarter, according to Arcview Research and BDS Analytics. The growth is exponential, but on a relative valuation basis, these stocks continue to trade at a discount relative to many licensed producers ("LPs"), Canadian corporations or corporations in countries with federal legal status to produce marijuana. This is simply because the legal status of their businesses remain challenged by federal prohibition, and accessing largescale equity financing through both debt and equity is challenging in this environment. In some cases, these constraints are limiting the expansion potential of these companies, resulting in stagnancy.

The COVID-19 crisis, however, has possibly highlighted that the U.S. marijuana industry doesn't need federal legalization to thrive, and indeed, many of the key stocks held in HMUS have demonstrated exponential revenue growth, which seems to be attracting investors.

In states that don't rely on tourism sales for marijuana —Nevada (Las Vegas) and Colorado are tourist destinations, and this is a widely studied metric for data providers of marijuana sales — sales have continued to grow during the COVID-19 restrictions. However, calling marijuana business "recession-proof" would be premature. The ability of the sector to grow sales during an environment where most retail is constrained has surprised many.

During April, U.S. MSOs experienced significant rallies in their valuations, with many of the larger MSOs such as Curaleaf, Cresco, Harvest Health and Trulieve generating double-digit returns. If you look at the revenue from a company like Massachusetts-based Curaleaf, for example – which recorded one year sales of US$221 million as at March 2019, nearly triple the US$77.1 million that it brought in the year before, for the same period– those types of revenue numbers exceed those recorded by many of the larger Canadian LPs. For comparison, Ontario-based Canopy Growth's annual revenue was C$226 million. Curaleaf has about a US$3.2 billion market cap vs. US Canopy's $5 billion market cap as at May 13, 2020, according to Bloomberg.

Ticker	Name	Weight in HMUS	1Month (%)	3Month (%)	6Month (%)	YTD (%)	1Year (%)	3Year (%)	5Year (%)	Since Common Inception* (%)
HMUS CN Equity	Horizons US Marijuana Index ETF	–	24.24	3.82	-16.01	-17.99	-55.06	--	--	-58.50
CURA CN Equity	Curaleaf Holdings Inc.	11.66	23.11	14.47%	1.88	-0.37	-26.91	185.83	--	-35.69
GTII CN Equity	Green Thumb Industries Inc.	12.21	40.66	48.21	12.64	10.09	-13.99	-5.27	8.87	-25.82
CL CN Equity	Cresco Labs Inc.	11.09	22.30	9.68	-7.86	-23.85	-54.82	--	--	-54.26
TRUL CN Equity	Trulieve Cannabis Corp.	10.68	21.59	36.73	3.35	14.54	17.21	--	--	-5.33
HARV CN Equity	Harvest Health & Recre-	9.12	3.16	-34.88	-46.30	-52.77	-78.44	--	--	-80.08

Source: Bloomberg as at May 31, 2020.

*Since HMUS Inception: April 17, 2019

The indicated rates of return are the historical annual compounded total returns including changes in per unit/share value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any securityholder that would have reduced returns. The rates of return shown in the table are not intended to reflect future values returns are not guaranteed, their values change frequently and past performance may not be repeated.

Can the Momentum Continue?

If you compare the revenue generation of the MSOs to Canadian LPs, there does seem to be a disconnect. The Canadian LPs have global footprints, but their primary source of revenue comes from the Canadian market. Building up retail distribution in Canada has been a challenge, as the largest provincial market in the country, Ontario, was slow to roll out independent retailers, such as stores not owned by producers. This has created both supply and demand challenges, but most importantly, it simply has not allowed the Canadian LPs to penetrate the Canadian retail market to the extent that many would have forecast at the dawn of legalization in October of 2018.

What the Canadian LPs do have, though, are listings on major stock exchanges such at the Toronto Stock Exchange, the New York Stock Exchange and the NASDAQ. This means that, by default, they become more widely accessible to investors in North America, particularly through online brokerages. The U.S. MSOs, while based in the U.S., have primary listings on Canadian exchanges such as the Canadian Stock Exchange and the Aequitas Neo, which are more difficult for American investors to access, although some U.S. investors trade these stocks on the over-the- counter (“OTC”) market.

This recent rally may predominantly be the result of Canadian retail investors and OTC investors deploying new capital into the U.S. sector of the global cannabis market. There may also be opportunity in the sector if you consider the potential these stocks might have if they can get a wider investor audience over the next 12 to 18 months.

In the meantime, HMUS is the only ETF focused on exposure to this sector that can provide diversified exposure across all of these names. Similar to the broader story, there will be winners and losers in the U.S. sector, but as the sector grows in aggregate, HMUS could potentially gain meaningful growth from that development.