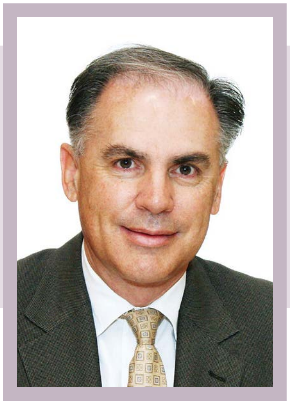
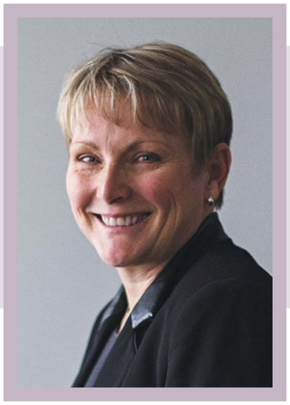
CANADIAN
ETF Watch
FALL 2023
CanadianETFWatch.com

Building a Robust Fixed Income Portfolio Using Bond ETFs





As the vibrant colours of fall begin to spread across Canada, we are delighted to introduce the Fall 2023 edition of *Canadian ETF Watch*. As always, the ever-evolving world of financial services stands at the precipice of exciting changes, ensuring many opportunities for all involved.

Regulatory initiatives set to unfold between 2024 and 2026 are undoubtedly poised to leave an indelible mark on the financial services landscape. Notably, the imminent transition to a one-day settlement cycle for ETF trades and the groundbreaking mandate for total cost reporting in investment funds promise to shape the industry in novel ways. The spirit of cooperation and industry-wide collaboration witnessed in response to these changes has been truly commendable, as it not only assures effective implementation but also resonates with our shared vision of a transparent and efficient financial world. Furthermore, the Canadian ETF Association (CETFA) remains tirelessly engaged with distributors, regulators, and other pivotal stakeholders to make the industry's continued ascent seem almost seamless.

The Canadian ETF narrative is as inspiring as ever, as the proliferation of ETF products across diverse asset classes is testimony to their enduring appeal among both advisors and investors. CETFA remains hopeful and optimistic about ETFs carving a more substantial niche in your suite of offerings for your clientele.

Now, we will steer our attention to a few of the articles awaiting you in this edition:

- Wilmot George, Vice President & Team Lead Tax, Retirement and Estate Planning from CI Investments, explains "Tax-Loss Selling" which is essential for those aiming to refine their tax strategy.
- Chris Heakes, Head of Disciplined Equity and Portfolio Manager at BMO ETFs, delves into "What is Low Volatility Investing?" and examines the fundamentals of this investment approach.
- Brian Bridger from Fundata presents the "FundGrade A+® Award ETF contenders for 2023", highlighting the top-performing contenders this year.
- "Covered Call Strategy: A Paradigm Shift in Income Generation" by Omanand Karmalkar, Portfolio Manager at BMO ETFs provides an overview of the covered call income generation method.

As we present the Fall 2023 edition of *Canadian ETF Watch*, we extend our appreciation to you, our dedicated reader. We trust that the insights found within these pages will equip you with the necessary strategies and understanding to navigate the ever-evolving financial services landscape effectively.

Here's to a productive season ahead and best wishes for the fall.

Sincerely,

Keith Costello
Global CEO,
Canadian Institute of Financial Planning
www.CIFP.ca

Pat Dunwoody
Executive Director,
Canadian ETF Association (CEFTA)
www.CETFA.ca

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.

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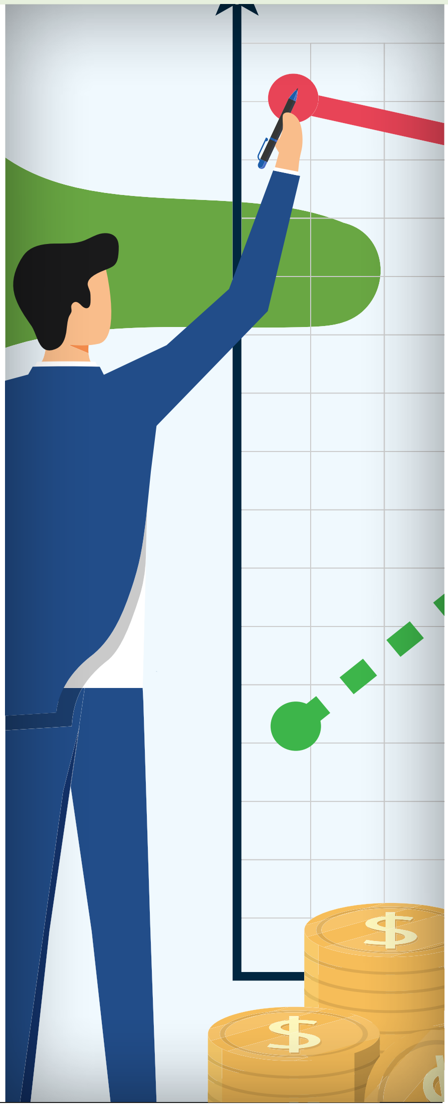

CANADIAN ETF Watch
CanadianETFWatch.com

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Radius Financial Education & **Canadian ETF Association (CETFA).**
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Building a Robust Fixed Income Portfolio Using Bond ETFs

Bond ETFs, or exchange-traded funds, offer investors a convenient way to gain exposure to a diversified portfolio of bonds without purchasing individual securities. These ETFs, which track baskets of different types of fixed income, are managed using similar mechanics:

1. **Duration**: Duration measures the sensitivity of a bond's price to changes in interest rates. A bond ETF with a longer average duration is more sensitive to interest rate changes.
2. **Yield to Maturity (YTM)**: YTM gives an idea of the total return investors can expect if they hold a bond until it matures. For a bond ETF, it is the average YTM of all the bonds in the portfolio.
3. **Credit Quality**: Bonds are rated based on the creditworthiness of the issuer. The credit quality gives an idea of the risk of default. A bond ETF with higher-rated bonds is typically less risky but may also offer lower yields.

It's important to remember that bond ETFs do not mature in the traditional sense. While holding an individual bond to maturity guarantees the return of principal (assuming no default), a bond ETF continuously reinvests in bonds, often aiming to maintain a target maturity range. As a result, bond ETF returns can vary based on both interest rate movements and the ETF's ongoing bond selections.

Another key differentiator is the payout structure. Individual bonds typically distribute interest payments semi-annually. In contrast, bond ETFs often distribute payments on a monthly basis. This difference can be advantageous for investors who prefer a more frequent income stream.

Putting the mechanics into practice

Mixing and matching bond ETFs to fine-tune the duration, YTM, and credit quality helps investors strike the balance that best aligns with their risk tolerance, financial objectives, and investment horizon.

For instance, a highly risk-averse investor with a short-term financial goal, such as accumulating funds for a down payment on a home in a year or two, might lean towards an ultra-short duration bond ETF with less sensitivity to interest rate movements.

Consider a core-satellite strategy

An effective way to diversify fixed income portfolios is the "core-satellite" approach. This strategy entails having the majority of the investment (the "core") dedicated to securing broad, stable returns, while the remainder (the "satellite") seeks higher, potentially more volatile returns to enhance overall performance.

Here are some hypothetical examples of Franklin Templeton bond ETF allocations:

1. **Conservative Investor**: 70% in Franklin Bissett Core Plus Bond Fund - ETF Series (FLCP) as the core for its balanced profile and 30% in Franklin Bissett Ultra Short Bond Fund - ETF Series (FHIS) as a satellite for liquidity and shorter-term opportunities.

2. **Income Seeker**: 50% in Franklin Bissett Corporate Bond Fund - ETF Series (FLCI) for its corporate bond yields and 50% in Franklin Brandywine Global Sustainable Income Optimiser Fund - ETF Series (FBGO) to exploit the higher YTM from global sustainable bonds.

3. **Diversified Builder**: 60% in Franklin Bissett Core Plus Bond Fund - ETF Series (FLCP) for core stability, 20% in Franklin Bissett Short Duration Bond Fund - ETF Series (FLSD) for short-term yield, and 20% in Franklin Brandywine Global Sustainable Income Optimiser Fund - ETF Series (FBGO) for global diversification and sustainable investment.

Every investor has unique financial goals, risk thresholds, and time horizons. Working with a financial advisor to evaluate objectives and comfort levels, investors can structure bond ETFs to help manage volatility and offer a steadying presence in a well managed, properly diversified portfolio.

IMPORTANT INFORMATION

Commissions, trailing commissions, management fees, brokerage fees and expenses may be associated with investments in mutual funds and ETFs. Please read the prospectus and fund fact/ETF facts document before investing. ETFs trade like stocks, fluctuate in market value and may trade at prices above or below the ETF's net asset value. Brokerage commissions and ETF expenses will reduce returns. Performance of an ETF may vary significantly from the performance of an index, as a result of transaction costs, expenses, and other factors. Indicated rates of return are historical annual compounded total returns for the period indicated, including changes in unit value and reinvestment distributions, and do not take into account any charges or income taxes payable by any security holder that would have reduced returns. Mutual funds and ETFs are not guaranteed. Their values change frequently. Past performance may not be repeated.

ETF units may be bought or sold throughout the day at their market price on the exchange on which they are listed. However, there can be no guarantee that an active trading market for ETF units will develop or be maintained, or that their listing will continue or remain unchanged. While the units of ETFs are tradable on secondary markets, they may not readily trade in all market conditions and may trade at significant discounts in periods of market stress.

Foreign Investment Risk. The value of foreign securities may be influenced by the policies of foreign governments and by political, economic, or social instability. There may be less information about foreign companies than North American firms and there may be lower standards of government supervision and regulation in foreign financial markets. The legal systems of some foreign countries may not adequately protect Unitholders' rights. Some or all of these factors could make a foreign investment more or less volatile than a North American investment. If a Franklin ETF or the underlying fund in which a Franklin ETF invests holds these securities, the Franklin ETF may have difficulty enforcing legal rights in jurisdictions outside Canada.

FundGrade A+® Award ETF Contenders for 2023

Brian Bridger,
Senior Vice President,
Analytics and Data
Fundata Canada Inc.

FUNDATA
FINANCIAL DATA THAT MATTER

Exchange-traded funds (ETFs) were originally created as passive investments. They offered investors a simple, low-cost way of index investing.

In fact, the first viable ETF was introduced in Canada in 1990, and it tracked what was then known as the TSE 35 Index. As the number of ETFs in the Canadian market expanded, so did the availability of rules-based and actively-managed ETFs, departing from a strictly index-tracking approach. Some of these funds have delivered consistently good risk-adjusted returns over the past year, and have become contenders for the 2023 Fundata FundGrade A+® Awards.

As the name implies, rules-based ETFs use prescribed rules to make investment decisions. A simple example would be an equal-weighted ETF such as **iShares Equal Weight Banc & LifeCo ETF (TSX: CEW)**, which allocates an equal percentage of the fund to the 10 largest Canadian banks and life insurance companies and is rebalanced quarterly.

On the other hand, active ETFs give portfolio managers slightly more flexibility. They still have investment objectives and strategies that they must adhere to, but the investment decisions do not necessarily follow a set of rules. Ultimately the portfolio managers are responsible for making investment decisions.

Now, two thirds of the way through 2023, let's look at a couple of rules-based and active ETFs that are vying for their first ever Fundata FundGrade A+ Award.

TD Q U.S. Small-Mid-Cap Equity ETF (TSX: TQSM) is a rules-based ETF that debuted in November 2019 and has become a top performer in the US Small/Mid Cap Equity category. The portfolio managers at TD Asset Management use a quantitative approach to security selection aimed at exploiting market inefficiencies based on pricing and valuation. The portfolio is diversified across all sectors and currently includes over 183 individual securities.

TQSM has a management expense ratio (MER) of 0.45%, which includes a management fee of 0.4%. Add to this a trading expense ratio (TER) of just 0.01%, for a total cost of just 0.46%. But despite the fund's solid performance and relatively low fund expenses, trading has historically been thin for this ETF. Based on the most recent ETF Facts, average daily volume was just 1,980 units, and the bid/ask spread was 0.29% for the 12 months ending Aug. 31, 2023. Recently, however, trading metrics have improved significantly, with an average daily volume of over 15,000 units year to date. Investors are taking notice.

In its short history, TQSM has produced superior returns with lower volatility compared with the market and its peers. Year to date the fund is up 11%, outpacing the category average of 6.7%. Over the past three years the performance has been equally impressive. While its 3-year average annual compounded return of 15% ranks fourth out of 39 funds in the category, it also boasts the lowest standard deviation over this period at 12.6%. This outstanding risk-adjusted performance is the reason why TQSM is in line for its first FundGrade A+ Award in 2023.

Dynamic Active Investment Grade Floating Rate ETF (TSX: DXV) is also looking for its first FundGrade A+ Award in 2023. Debuting in March 2018 and listed in the Canadian Short Term Fixed Income category, the fund is managed by 1832 Asset Management. It is actively managed and invests primarily in Canadian investment grade credit and uses interest rate derivatives. The fund's objective is to provide floating rate income while preserving capital and limiting interest rate risk.

DXV has a forward yield of 5.6% and a trailing 12-month yield of 6.1%. The fund is concentrated, holding only 40 securities. The duration is just 0.34 years, meaning interest rate risk is low. The MER, including a management fee of 0.3%, is 0.33%, while the trading expense ration (TER) is 0.01%. Trade data based on the most recent ETF Facts shows an average daily volume of over 35,000 units and an average bid/ask spread of 0.16%.

Over the past few years, the relative performance of DVX has improved significantly. Five years ago, it ranked 62 out of 73 funds. Three years ago, it moved up to 13 out of 80. And over the past 12 months, while many funds earned less than 1% and some actually lost money, DVX was the second best performing fund with a return of 5.8%.

True to its objective, the fund has also been able to limit volatility. Over the past three years it had a standard deviation of just 1.2%, half the category average. Suffice it to say this fund has successfully navigated the rising interest rate environment and has thrived when many passive fixed income funds have stumbled.

Winners of the FundGrade A+ Awards for 2023 will be announced in January 2024.

Brian Bridger, CFA, FRM, is Senior Vice President, Analytics and Data, at Fundata Canada Inc. and is a member of the Canadian Investment Funds Standards Committee (CIFSC).

2023/2024 CALENDAR OF EVENTS

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Retirement Canada Dialogue 5th Annual

October 2nd ~ Toronto, ON

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 2023

RetirementInstituite.ca

WAIS Canada 22nd Annual

October 3rd ~ Toronto, ON

WAIS Canada is in its 21st 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 2023 CANADA

waisc.com

Exchange Traded Forum (Vancouver) 13th Annual

May 2024 ~ Vancouver, BC

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 2024

ExchangeTradedForum.com

VANCOUVER

Exchange Traded Forum (Toronto) 14th Annual

May 2024 ~ Toronto, ON

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 2024

ExchangeTradedForum.com

TORONTO

ESG Conference (Toronto) 2nd Annual

May/June 2024 ~ Toronto, ON

The Canadian ESG Conference Toronto 2022 provides attendees with the opportunity for quality networking with a highly defined audience of credentialed advisors, investment professionals, sustainability professionals and corporate responsibility, green economy practitioners and sponsors within the financial services industry.

ESG CONFERENCE 2024

canadianesgconference.com

TORONTO

Interested in sponsoring or attending an event: info@radiusfinancialeducation.com or call us at T: 416.306.0151

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ETF & Investment Forum London 2nd Annual

Autumn 2024 ~ 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 2024
RadiusEurope.com
LONDON

ETF & Investment Forum Frankfurt 2nd Annual

Autumn 2024 ~ 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 2024
RadiusEurope.com
FRANKFURT

Institutional Dialogue 2nd Annual

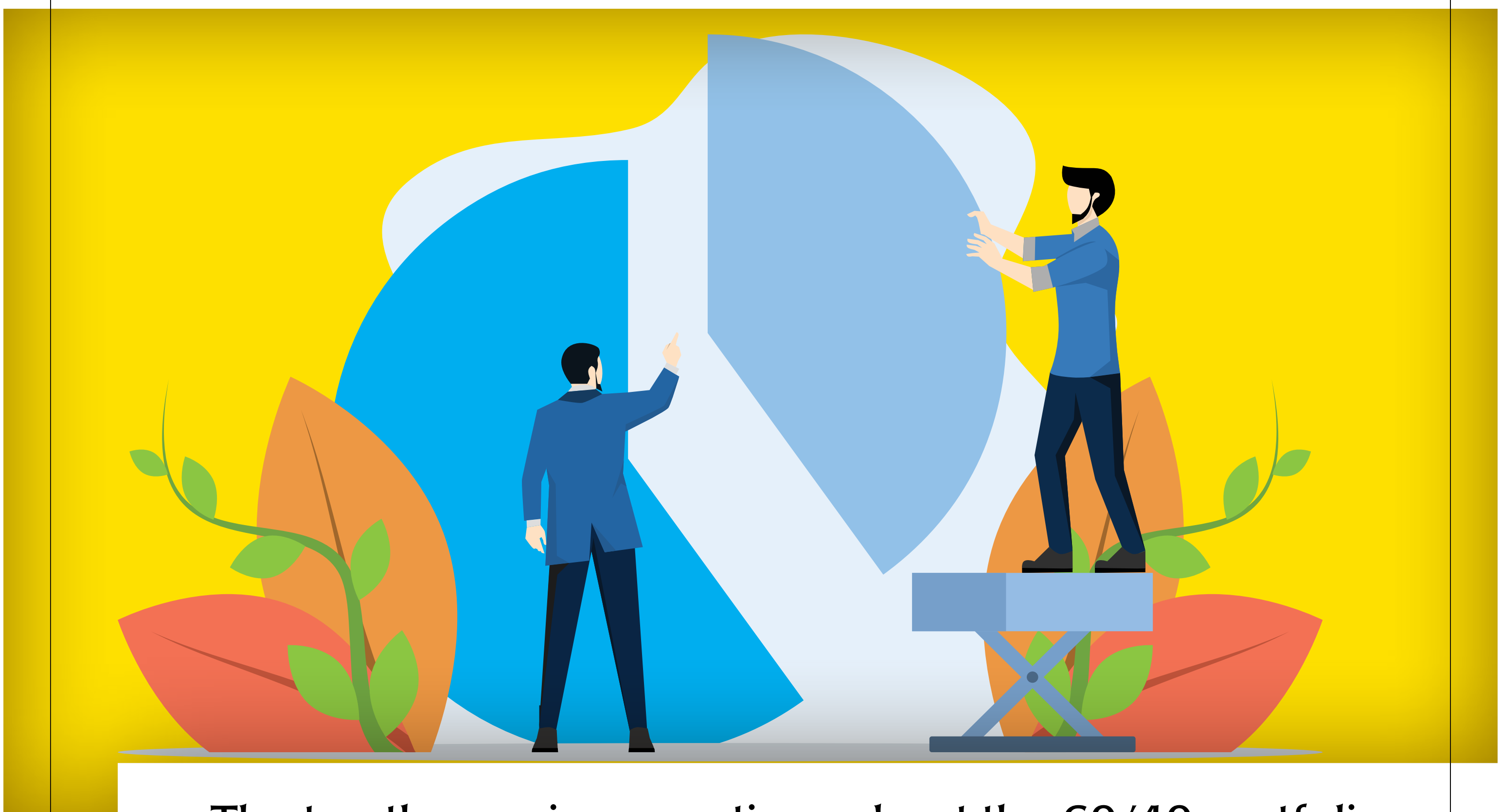
Autumn 2024 ~ Edinburgh, United Kingdom

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 20 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.

Misconceptions of 60/40



The top three misconceptions about the 60/40 portfolio.

Our article on the improved outlook for the 60/40 portfolio generated much interest from readers, but the questions our strategists fielded also made it clear that there are many misconceptions surrounding this tried-and-true investment standby. Here, we set the record straight.

"The misconceptions seem to fall into three broad themes," said Todd Schlanger, a senior investment strategist. "Two of them deal with execution, but one is fundamental—basically defining what 60/40 is."

60/40 is a proxy for the typical balanced portfolio, not one-size-fits-all.

"The 60/40 is that middle-of-the-road portfolio that reflects the typical investor's asset allocation, so it's often used as an example in industry research," Schlanger said. "It's a good proxy because many institutions have historically used this allocation to meet their objectives. Further, if you look at the most popular products for individual investors, such as target-date funds, the average asset allocation is right around 60/40. So it's a good proxy for individual investors as well.

"But that's not to say that 60/40 is any better than a 40/60 or 90/10 portfolio for investors who need a more conservative or more aggressive portfolio for their goals, time horizon, and risk tolerance. In other words, 60/40 is not the best choice for the average twenty-something with a 60- or 70-year time horizon. They would likely benefit from more equities to grow their portfolio over the long run. It's a good starting place, but an investor will need to tailor a portfolio to their needs."

There is more than one way to implement 60/40.

The strategy has evolved over time to include additional asset classes.

"The average 60/40 portfolio used to be just U.S. stocks and bonds, but non-U.S. assets have become commonplace over time as access and costs for investing in them have come down," Schlanger said.

And there's ample room for customization in such a portfolio.

"A case can be made that alternative investments—commodities, private equity, and so on—can enhance a portfolio's risk-return profile," Schlanger said. "But they are not for everyone, and you have to weigh the potential benefits against the typically higher costs, complexity, and illiquidity associated with some of those assets.

"If you invest the bulk of your retirement money in core asset classes and modestly overweight certain sectors or actively managed funds that you believe can add value over the long term, that approach is valid."

Vanguard Wellington Fund, founded in 1929, is an example of this approach, though its actual asset allocation is closer to 65/35. The fund tilts toward value stocks and corporate bonds with the goal of adding incremental alpha over time.

60/40 is not "set it and forget it."

The simplest way to implement a 60/40 portfolio is through a single fund option because you won't need to rebalance it over time—that's done by the fund's portfolio manager.

But you may have opted for multiple funds in a model portfolio. Or, even if you're in only one fund, the asset allocation may no longer be appropriate as time passes. In either case, Schlanger said, you should periodically revisit the portfolio to:

- Reassess your situation to determine whether the asset allocation is still right for you, and if it no longer is, move to a new allocation.
- When appropriate, rebalance the portfolio back to its target allocation.

On the first point, Schlanger said: "Life happens, things change. Your financial situation and goals may have evolved since you first selected that target asset allocation years or decades ago. There's nothing wrong with changing your investment strategy, as long as it's driven by careful consideration, not by market noise."

On the second point, without rebalancing, equities tend to become a larger share of the portfolio over time. Rebalancing reduces overall portfolio volatility by keeping your allocation to equities and other risky assets constant. There are multiple approaches for when to rebalance—calendar-based, threshold-based, or a combination of the two. Vanguard's research paper on this subject suggests that, for most investors, rebalancing on an annual basis is adequate.

"Whether it's 60/40 or another asset allocation, rebalancing will help make sure your portfolio is consistent with your risk tolerance," Schlanger said.

Notes:

For more information about Vanguard funds, visit vanguard.com to obtain a prospectus or, if available, a summary prospectus. Investment objectives, risks, charges, expenses, and other important information about a fund are contained in the prospectus; read and consider it carefully before investing.

All investing is subject to risk, including the possible loss of the money you invest. Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.

In a diversified portfolio, gains from some investments may help offset losses from others. However, diversification does not ensure a profit or protect against a loss.

Bond funds are subject to the risk that an issuer will fail to make payments on time, and that bond prices will decline because of rising interest rates or negative perceptions of an issuer's ability to make payments. Investments in bonds are subject to interest rate, credit, and inflation risk.

Investments in stocks or bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk.

Investments in target-date funds are subject to the risks of their underlying funds. The year in the fund name refers to the approximate year (the target date) when an investor in the fund would retire and leave the work force. The fund will gradually shift its emphasis from more aggressive investments to more conservative ones based on its target date. An investment in target date funds is not guaranteed at any time, including on or after the target date.

Publication date: July 2023

Tax-Loss Selling

Take advantage of tax loss harvesting, but be mindful of identical property and superficial loss rules

Wilmot George,
Vice President & Team Lead Tax, Retirement, and Estate Planning, CI Global Asset Management

Tax-loss selling is a popular strategy for making use of capital losses in the non-registered environment. The losses can be used to offset capital gains realized elsewhere in a portfolio and, to the extent that capital losses exceed capital gains in a year, the net capital loss can be used to offset capital gains in any of the three previous tax years or can be carried forward for use in any future year. CRA form T1A, Request for Loss Carryback, is used to carry capital losses back to a prior year.

But, there is a challenge with this strategy; realizing a capital loss can mean selling a security that plays an important role in your portfolio. ETFs can be used to maintain exposure to a particular asset class while allowing for claimable capital losses.

To implement a tax-loss selling strategy, an investor would trigger a capital loss1 by selling an individual security, mutual fund or ETF that has declined in value. If the investor wants to remain invested in the market, they would subsequently acquire a different yet similar security, mutual fund or ETF. If the investor wants to claim the capital loss, upon purchase of the new investment they should be careful not to acquire a security that is identical to the security sold, otherwise the Income Tax Act's (ITA) superficial loss rule will apply, denying the capital loss claim.

CI GLOBAL ASSET MANAGEMENT

A superficial loss is defined as "the taxpayer's loss from the disposition of a particular property where…30 days before and 30 days after the disposition, the taxpayer or a person affiliated with the taxpayer acquires a property that is identical…"2. Affiliated persons for purposes of this rule normally include the taxpayer's spouse, common-law partner, RRSP, RRIF and TFSA among other corporate, partnership and trust relationships. Where an investor sells a security or fund that has depreciated in value and acquires the same security or fund – identical property – 30 days before or 30 days after the sale, the loss would be deemed superficial and denied for tax reporting purposes. The loss would be added to the ACB of the repurchased investment, deferring use of the capital loss until the repurchased investment is sold. The purpose of the rule is to prevent investors from triggering capital losses for tax reasons without a real intention to dispose of the investment.

> Cliff purchased 3,000 shares of XYZ Emerging Markets ETF on August 10th for $30,000 ($10 per share). Thinking about capital loss planning, on October 11th, Cliff sold all shares of the fund for proceeds of $24,000 ($8 per share), resulting in a capital loss of $6,000. Wanting to participate in a potential turn in XYZ's value, three days later, on October 14th, Cliff bought back 3,000 shares of XYZ Emerging Markets ETF at $8 per share and continued to hold the shares for the remainder of the year.
>
> Because Cliff repurchased identical property within 30 days of the October 11th sale, his capital loss is deemed superficial and not claimable for the year. Instead, his $6,000 loss would be added to the ACB of the repurchased shares ($24,000 + $6,000 = $30,000), allowing for the loss to be claimed in the future when the repurchased shares are eventually sold (assuming the superficial loss rule is not triggered at that time).

What is identical property?

When it comes to the superficial loss rule, the CRA takes a "question of fact" approach when determining if two properties are identical. In other words, the CRA would review the details of the particular case and form an opinion based on the facts. With regards to the sale and purchase of mutual funds and ETFs, if the underlying investments for two funds are not identical, it is likely that the sold and purchased funds would not be considered identical properties, and thus, no superficial loss. If the underlying securities are identical, the superficial loss rule may apply.

The CRA has defined identical properties as follows: "Identical properties...are properties which are the same in all material respects, so that a prospective buyer would not have a preference for one as opposed to another.3" They went on to say the following in a technical interpretation document: "Subject to an analysis of all the relevant facts, in our view, a TSE 300 Index Fund, for example, would generally not be considered identical to a TSE 60 Index Fund. Whether any other investment instruments are identical properties is a question of fact... An investment in a TSE 300 index-based mutual fund of a financial institution would, in our view, generally be considered identical to an investment in a TSE 300 index-based mutual fund of another financial institution.4"

Understanding that the question of identical properties is a question of fact, it is often possible to trigger a capital loss while maintaining exposure to a particular sector or asset class by switching between different fund structures (e.g., traditional mutual fund to ETF or vice versa). This is, in part, because of differences in the fund structures that could cause an investor to prefer one versus the other5. The argument against a superficial loss would be even stronger where the underlying securities are not identical. Similarly, switching between different mutual funds or different ETFs with similar (but not identical) exposure would likely achieve the same result. To ensure the ability to claim a capital loss without two ETFs being considered identical property, where possible, consider ETFs that follow different benchmarks. For example, the following scenario would likely not be considered a superficial loss:

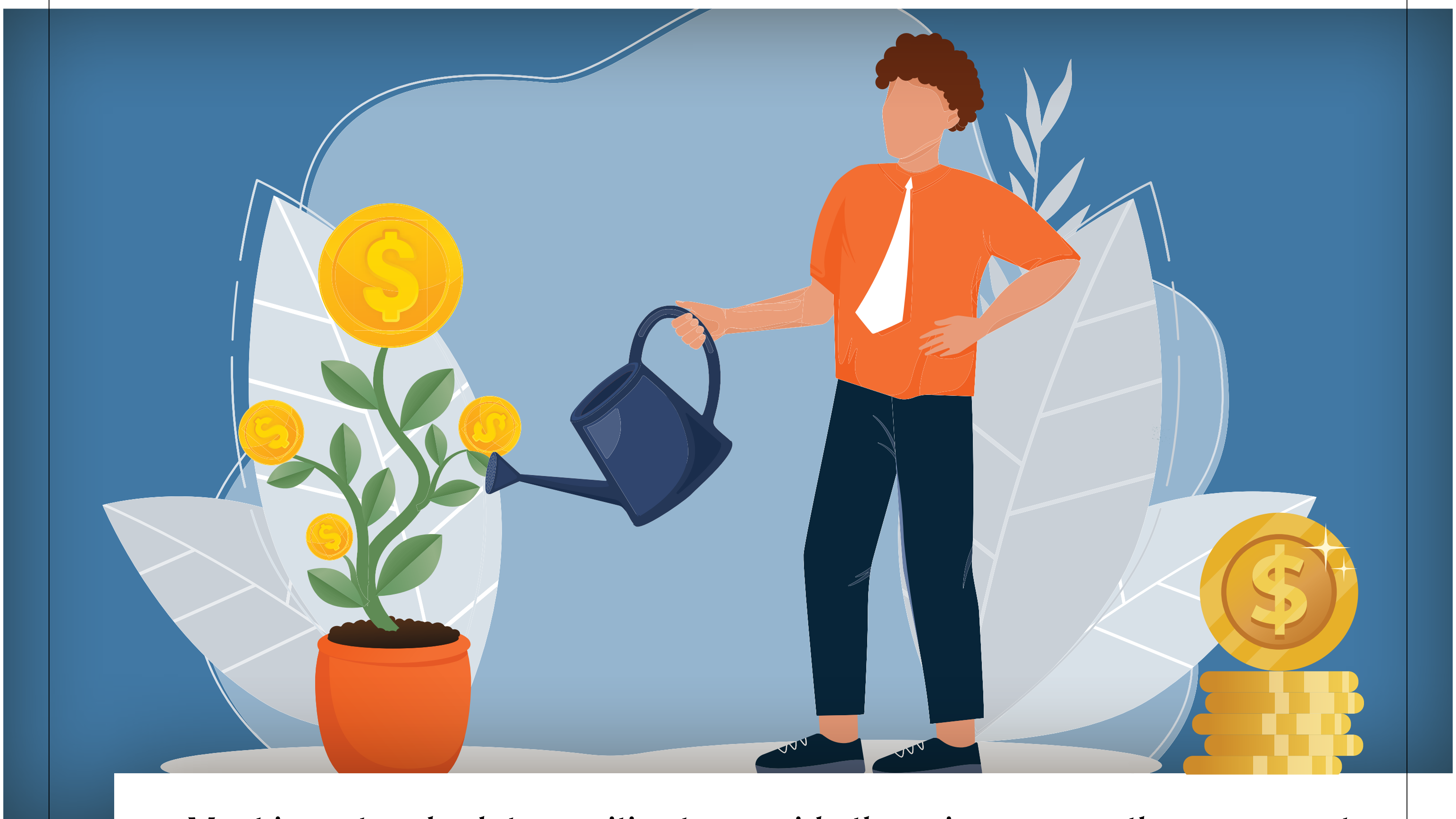
> Cliff purchased 3,000 shares of ABC Emerging Markets ETF on August 10th for $30,000 ($10 per share). Thinking about capital loss planning, on October 11th, Cliff sold all shares of the fund for proceeds of $24,000 ($8 per share), resulting in a capital loss of $6,000. Wanting to continue to participate in the emerging markets sector, three days later, on October 14th, Cliff bought 3,000 shares of XYZ Emerging Markets Plus ETF at $9 per share and continued to hold the shares for the remainder of the year.
>
> Because Cliff replaced one emerging markets ETF with another, he was able to maintain exposure to the sector. And, because the two ETFs have similar but different underlying securities and follow different benchmarks, they are not identical for purposes of the superficial loss rule.

It is also important to note that capital losses triggered by transferring securities (including ETFs) from the non-registered environment directly to an RRSP or TFSA would be denied under a separate stop loss rule6. To avoid this rule, investors can trigger the loss by switching to a different security in the non-registered environment followed by a contribution to the RRSP or TFSA. The investor should then wait 31 days from the time of the original sale before reacquiring the original security within the RRSP or TFSA. For more information on this topic, see CI GAM's Tax, Retirement and Estate Planning paper "In-kind transfers to registered plans: Dealing with superficial and denied loss rules"

1. Assumes the investment is held on capital account. If the investment is held for business purposes, business income or losses would normally result.
2. Section 54 of the federal Income Tax Act (ITA), definition "superficial loss"
3. Interpretation bulletin #IT-387R2.
4. Technical interpretation inquiry #2001-0080385.
5. If engaging this strategy, check with the product issuer to ensure that the fund structures are different and not simply different purchase options of the same structure.
6. Section 40(2)(g)(iv) of the federal ITA

For more information on the CI ETFs please visit ci.com/ETFs

What is Low Volatility Investing?



Most investors look to equities to provide the primary growth component of portfolios, and for good reason, the S&P 500 has returned an average 10.9% annualized over the past 50 years[1]. However, while the attraction of long-term growth is there, the drawback, as most investors know, is risk and volatile markets, such as the collapse of the Information Technology (IT) bubble in 2001, or the great financial crisis of 2008.

Chris Heakes, CFA, M.Fin.
Head, Disciplined Equity, Portfolio Manager, BMO ETFs

What is Low Volatility Investing?

Low Volatility investing is an approach which attempts to achieve the benefits of equity investing (upside return), while mitigating the inherent risk within equities. A soundly constructed low volatility Exchange Traded Fund (ETF) will generally achieve this by overweighting defensive stocks (using some measurement of risk – at BMO, low volatility ETFs use Beta as a measure) as well as overweighting traditionally defensive sectors such as Consumer Staples and Utilities, while underweighting more aggressive stocks and sectors, such as Energy and Materials.

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By embracing a methodology that is different from broad indexes, low volatility strategies fall into a category of ETFs we call Factor ETFs or Smart Beta ETFs (the terms are interchangeable). In this sense Low Volatility strategies seek to preserve more capital (relative to broad markets) when markets are volatile, due to the weighting to defensive stocks.

How do Low Volatility ETFs Perform?

Classic finance theory supposed a relationship between return and risk. All things being equal, an investor should get more return, for assuming more risk (and vice versa). However, the concept of the "low volatility anomaly" comes from the empirical observation that this relationship doesn't hold true in practice. Lower risk stocks generally have as good, if not better returns than higher risk stocks.

How can this be the case? Investors, or perhaps more accurately, traders, often chase higher-risk stocks, which to their detriment often don't live up to expectations. No better example is there than the recent meme-stock behaviour, where a social-media organized horde chased returns on various small cap stocks, in the often misguided "shoot for the moon". Low volatility investing is the opposite of meme-stock investing. It's about winning by not losing. Batting for singles and doubles, but not going for home runs and striking out. Keeping the ball in the fairway… and on and on. A good low volatility strategy can deliver the benefits of equity investing over the long period, while also providing better cover and portfolio protection, when the markets aren't working.

It's beyond the scope of this blog post to get into the plethora of academic research around the low volatility anomaly, but for those interested readers, an article linked on the CFA website.

What are the risks of low volatility investing?

Simply put, the different weighting methodology can both work for, and against, the investor, particularly in the short term. Higher risk stocks will enjoy their days in the sun at times, and low volatility investors may lag, in these exuberant style markets. Like other factor investing strategies (value, momentum, etc.), performance is generally best analyzed on the long-term, which is to say through business cycles. Lastly, low volatility strategies tend to be overweight more interest-rate sensitive stocks, so in periods of interest rate increases, this may pose a headwind to the overall strategy.

In the current market, where we continue to see the ever-present nature of risk – seeing the challenges of a higher-inflation rate environment, despite Tech's stunning advance in 2023 (Nasdaq up 45% YTD[1]). a portion of the portfolio also focussing on low volatility may help investors manage risk, as we continue to move through the cycle.

[1] Source: Bloomberg, as of July 31, 2023.

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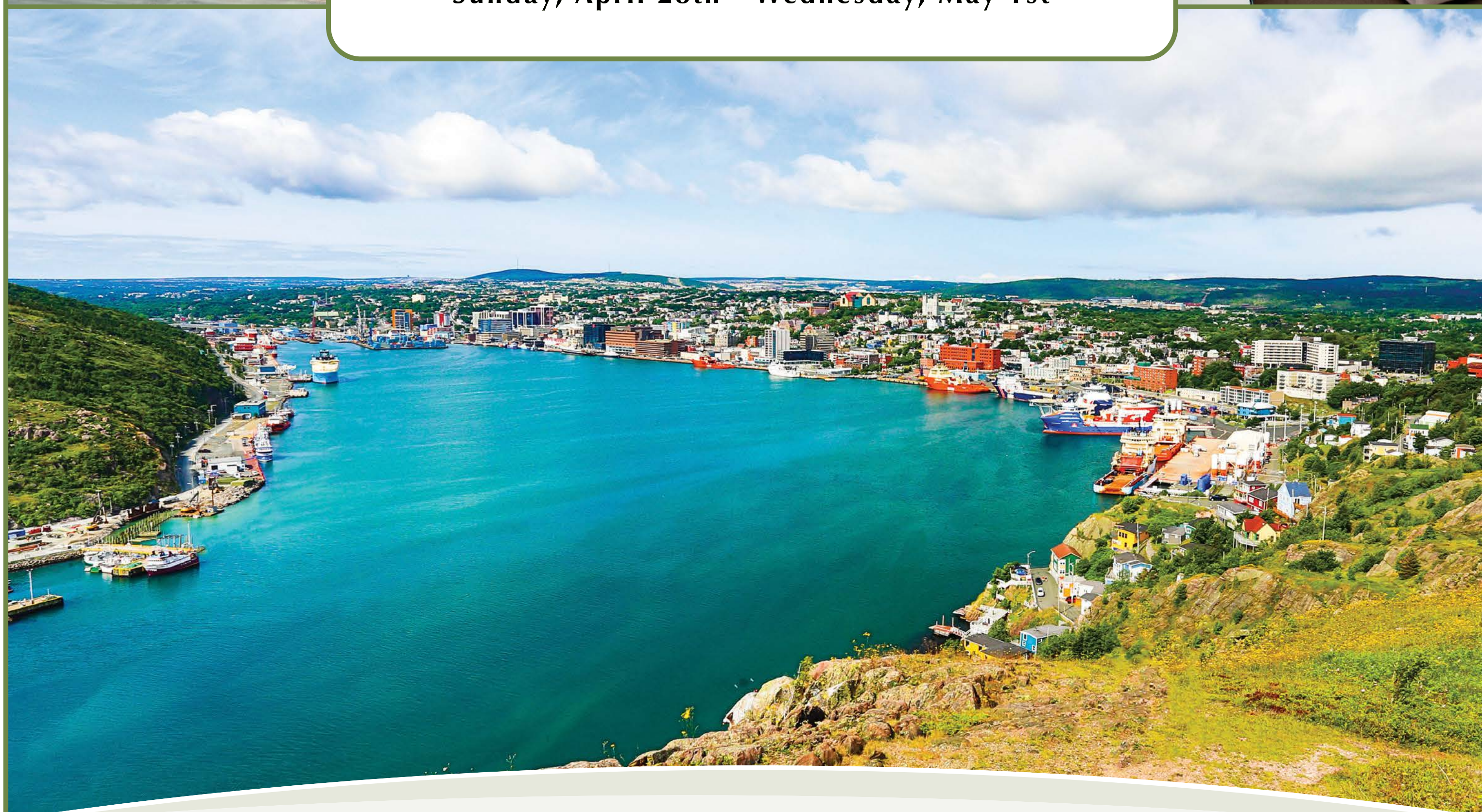

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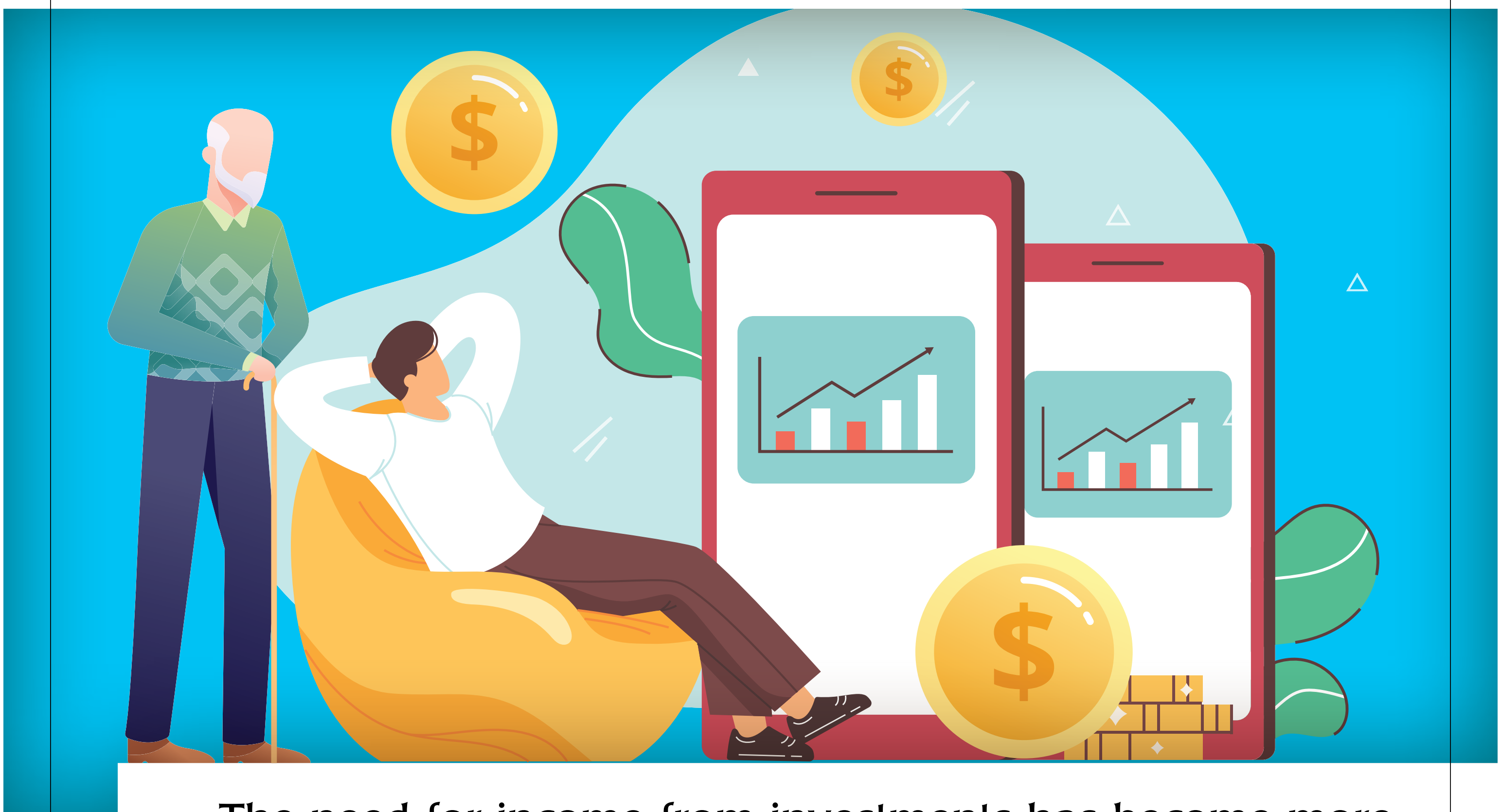
Covered Call Strategy: A Paradigm Shift in Income Generation



The need for income from investments has become more important than ever given an ageing population, higher inflation, and cost of living.

Omanand Karmalkar, CFA
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There are many ways to earn income from investments, but two distinct pathways emerge: the well-trodden path of traditional income and the emerging use of covered call strategies. Let's dive a bit deeper into the two methods.

Covered Call Strategy: A Paradigm Shift in Income Generation

The covered call strategy is an investment strategy that involves the purchase of an underlying asset, such as a stock, and the sale of a call option on that same asset. By selling the call option, the investor agrees to sell the underlying asset at the strike price of the option if the option is exercised. Essentially, they involve holding a portfolio of stocks while simultaneously selling call options on those holdings. **This approach creates a dual stream of income: dividends from the underlying stocks and premiums collected from the sale of call options**.

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- **Balancing Act: Income vs. Capital Appreciation**

  The allure of the covered call strategy lies in its potential to provide a higher yield compared to traditional income investments. Furthermore, the yield generated by writing call options is taxed more preferably under capital gains account while interest income from fixed income products (such as GICs) is taxed under income.

Traditional Income Investments: The Time-Tested Approach

- **Classic Income Investments**

  In contrast, traditional income investments have been around for a very long time and can be a reliable source of income. This category includes bonds, GICs, and dividend-paying stocks. Bonds provide regular interest payments, GICs offer fixed interest rates, and dividend stocks distribute periodic income.

- **Stability and Predictability**

  The hallmark of traditional income investments is their stability. Bond interest payments, GICs, and dividend distributions are relatively predictable. This predictability appeals to investors who prioritize a steady income stream and wish to avoid the potentially higher volatility associated with other investment options.

Comparing Covered Call Strategies and Traditional Income Investments

Yield Potential

Covered Call strategies typically offer a higher yield due to the combination of dividends and option premiums. This can be especially attractive for income-focused investors seeking higher returns. In contrast, traditional income investments tend to provide more modest but steady income streams.

Risk and Upside Potential

The risk profiles of these two approaches differ significantly. Covered Call strategies come with a form of built-in risk management due to the sale of call options, which helps mitigate losses during market downturns. However, this strategy also limits potential gains. Traditional income investments come with their own risks, such as interest rate fluctuations affecting bond prices.

Market Environment

Market conditions play a crucial role in the performance of these two options. Covered Call strategies tend to shine in stable or mildly bullish markets, where consistent option premiums can be collected. Traditional income investments, on the other hand, can offer reliable income regardless of market conditions, making them resilient during market volatility.

Income-seeking investors have a comprehensive and vast landscape of investment possibilities available to them. Both strategies offer a wide array of benefits and drawbacks and depending on the goals and preferences, one can create an income focused portfolio that can benefit from using covered call strategies, traditional income investments or both.

Unlocking Potential with HISA and T-Bill ETFs: A Shift in Canadian Investing Preferences

With the Bank of Canada interest rate at 5%, a rate not observed since 2021, Canadian investors, particularly those depending on bond allocations for stability and diversification, face formidable headwinds.

Despite these challenges, there's a noteworthy development: bank savings products like Guaranteed Investment Certificates (GICs) now offer competitive yields. However, the constraint of their lock-up period remains a limitation for many.

A solution emerges for those prioritizing liquidity, transparency, and cost-effectiveness in their brokerage accounts. New entrants, specifically ETFs invested in high-interest savings accounts (HISAs) and government Treasury bills (T-bills), present competitive options.

Furthermore, it's imperative to highlight Canada's lead in this innovation over the U.S. market. While the U.S. features T-bill ETFs and ultra-short-term bond ETFs, HISA ETFs remain a unique offering in Canada, enhancing versatility and accessibility for Canadian investors.

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Canadian ETF Association

These ETFs haven't gone unnoticed. As of August 31, 2023, numerous offerings in this space have ranked high among the top 25 ETFs by net creations that month, in addition to being among the 25 largest ETFs by assets under management (AUM) as of that month.

So, what makes these ETFs so enticing for investors and advisors alike? Let's delve deeper into their workings and the potential benefits they hold for investors.

Understanding HISA ETFs

At its core, a HISA ETF uses the familiar ETF structure, but instead of holding a diversified basket of stocks or bonds, it holds deposits in HISA accounts with established Canadian banking institutions. These accounts are the "basket" of assets for the ETF.

From a payout perspective, these ETFs are structured to provide monthly interest to investors. The typical starting price is $50 per share. As the month progresses, this value accrues interest, causing the share price to rise gradually. Upon reaching the monthly distribution date, the ETF provides a payment to its investors, after which the price resets back to its original $50.

Like all ETFs, HISA ETFs benefit from exceptional intraday liquidity. This quality is one of the hallmarks of ETFs that differentiate them from other investment vehicles. Investors can effortlessly buy and sell HISA ETFs throughout the trading day at prevailing market prices, with a typically narrow bid-ask spread. This tight spread ensures that investors do not face significant costs when entering or exiting positions.

HISA ETFs are also highly versatile in terms of currency options. Investors can find both Canadian and U.S. dollar-denominated variants. Furthermore, their yields move in lockstep prevailing interest rates: Canadian ones follow Canadian interest rates, while U.S. ones track U.S. interest rates.

However, there's a key distinction investors must understand: HISA ETFs are not like traditional GICs or HISAs offered by banks, which come with Canada Deposit Insurance Corporation (CDIC) protection. While HISA ETFs offer very low volatility, they are not entirely risk-free.

HISA ETFs present a pragmatic solution for investors seeking liquidity, stable returns, and a measure of safety for their principal. They serve multiple roles in a diversified portfolio, catering to varying financial goals and timelines.

For retirees and those nearing retirement, HISA ETFs can serve to reduce interest rate risks. They can act as a buffer, or even a replacement, for a portion of a traditional bond allocation, ensuring more stable returns during uncertain rate environments.

The recently introduced First Home Savings Account (FHSA) can benefit from HISA ETFs. For individuals saving for a down payment on a home, these ETFs offer an avenue to both preserve capital and earn interest, ensuring that when it's time to buy, they have preserved and maximized their savings.

Finally, for those with uninvested cash balances in either registered or non-registered accounts, HISA ETFs provide a means to earn monthly interest without the restrictions or lock-ups that come with GICs.

Understanding T-bill ETFs

As the Canadian financial landscape continued to evolve in 2023, new investment products emerged to meet the varied needs of investors.

A notable entrant, as of April 2023, is the T-bill ETF. This product offers an alternative to HISA ETFs, ultra-short-term bonds, and money market ETFs in the realm of cash management solutions.

T-bill ETFs hold government-issued bonds. Depending on the currency denomination of the ETF, the underlying assets are either Canadian government or U.S. government T-bills, which are bonds with a very short time until maturity (typically under a year or less).

The key selling point for these ETFs is their virtually ironclad credit quality. Given the minuscule likelihood of established governments like Canada or the U.S. defaulting on their obligations, investors are provided with a high level of security.

Other defining features of T-bill ETFs are yields that adjust with prevailing interest rates and their monthly distribution structure. It's worth noting that while the yield on T-bill ETFs tends to be lower than some other investment vehicles, this is counterbalanced by a commensurately lower credit risk.

The latest regulatory scrutiny from the Office of the Superintendent of Financial Institutions (OSFI) on liquidity treatment for HISA ETFs has prompted the industry to stay agile. With potential changes looming, fund managers have proactively explored and launched alternative products.

As a result, T-bill ETFs currently stand out as one such alternative that offers both security and yield in an environment where the regulatory stance on HISA ETFs remains under review, especially in the event that their rates are affected by possible changes.

Benefits of These ETFs

When evaluating the evolving investment landscape, the introduction and adoption of HISA ETFs and T-bill ETFs stand out as significant developments. These strategies cater to an array of investors, from retail to advisors alike, offering a suite of benefits that align with the requirements of modern portfolios.

One of the foremost advantages of these ETF strategies is the exceptional liquidity and accessibility they offer. Investors can effortlessly enter or exit positions throughout the trading day at prevailing market prices, providing flexibility that isn't always available with other investment vehicles like GICs.

In a volatile market, the relative stability of HISA ETFs and T-bill ETFs is a welcome reprieve. The foundation of these ETFs in high-interest savings accounts or government-backed bonds ensures a security level unparalleled by many other market offerings.

In the backdrop of a rising, "higher for longer" interest rate environment, the yields from HISA ETFs and T-bill ETFs can be competitive. While they may not outpace more aggressive investments, their risk-adjusted returns are compelling, especially for investors with a conservative risk appetite.

Finally, one feature that often go unnoticed is their low costs. With minimal management fees, these ETFs can be a boon for retail investors. In a world where every basis point counts, the advantage they bring can make a meaningful difference in long-term returns.

Considerations for Investors

The allure of HISA ETFs and T-bill ETFs is undeniable, given the array of benefits they offer. However, before embracing these financial instruments, investors must take stock of several nuances and caveats to watch out for.

At first glance, HISA ETFs and T-bill ETFs appear to be bastions of security in the investment landscape. Their underlying assets – deposits in high-interest savings accounts and government-backed bonds – lend a level of stability not always seen in other investment vehicles.

However, investors mustn't become complacent. It's essential to understand that these ETFs are not CDIC insured, exposing holders to a small, but still present degree of risk.

Additionally, while their performance during the March 2020 COVID crash was commendable, we have yet to witness how they'd fare under other extreme market stress events. As with any financial product, understanding one's risk appetite is paramount.

Investors must also remain vigilant to the typical challenges associated with trading ETFs. They need to be wary of potential price divergences from their net asset value (NAV), possible wide bid-ask spreads, and brokerage commissions. Each of these factors can erode returns.

Moreover, the influence interest rates on HISA ETFs and T-bill ETFs cannot be understated. Currently, with interest rates on the rise, these products are thriving. HISA ETFs have seen yields of 5% and above, while T-bill ETFs are not far behind, hovering around the 4.5% mark.

However, this favorable scenario is a double-edged sword. As interest rates rise, so do the yields of these products, but a reversal in rate trends will see yields drop in tandem.

As with any investment decision, conducting thorough research is prudent. Before choosing between a conventional bank HISA, GIC, money market mutual fund, or HISA and T-bill ETFs, investors must comprehensively assess their risk tolerance, financial objectives, and investment horizon.

They must dig deep to understand the nuances of each product, their potential returns, and associated risks. An informed decision, rooted in meticulous research, invariably stands the test of time.

Conclusion

The Canadian ETF Association (CETFA) remains steadfast in its commitment to championing investor education. As the investment landscape evolves, the importance of diversified strategies becomes even more paramount.

In this context, HISA ETFs and T-bill ETFs emerge as invaluable tools, offering a harmonious blend of liquidity, stability, and potential for competitive returns.

However, as with all investments, staying informed is essential. We urge investors to consider HISA ETFs and T-bill ETFs as integral components within their broader financial strategies, ensuring they harness their benefits while understanding their intricacies.

The future of investing is diverse and dynamic, and these instruments undeniably have a significant role to play.