CANADIAN
# ETF Watch
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# A Brave New World of Opportunity

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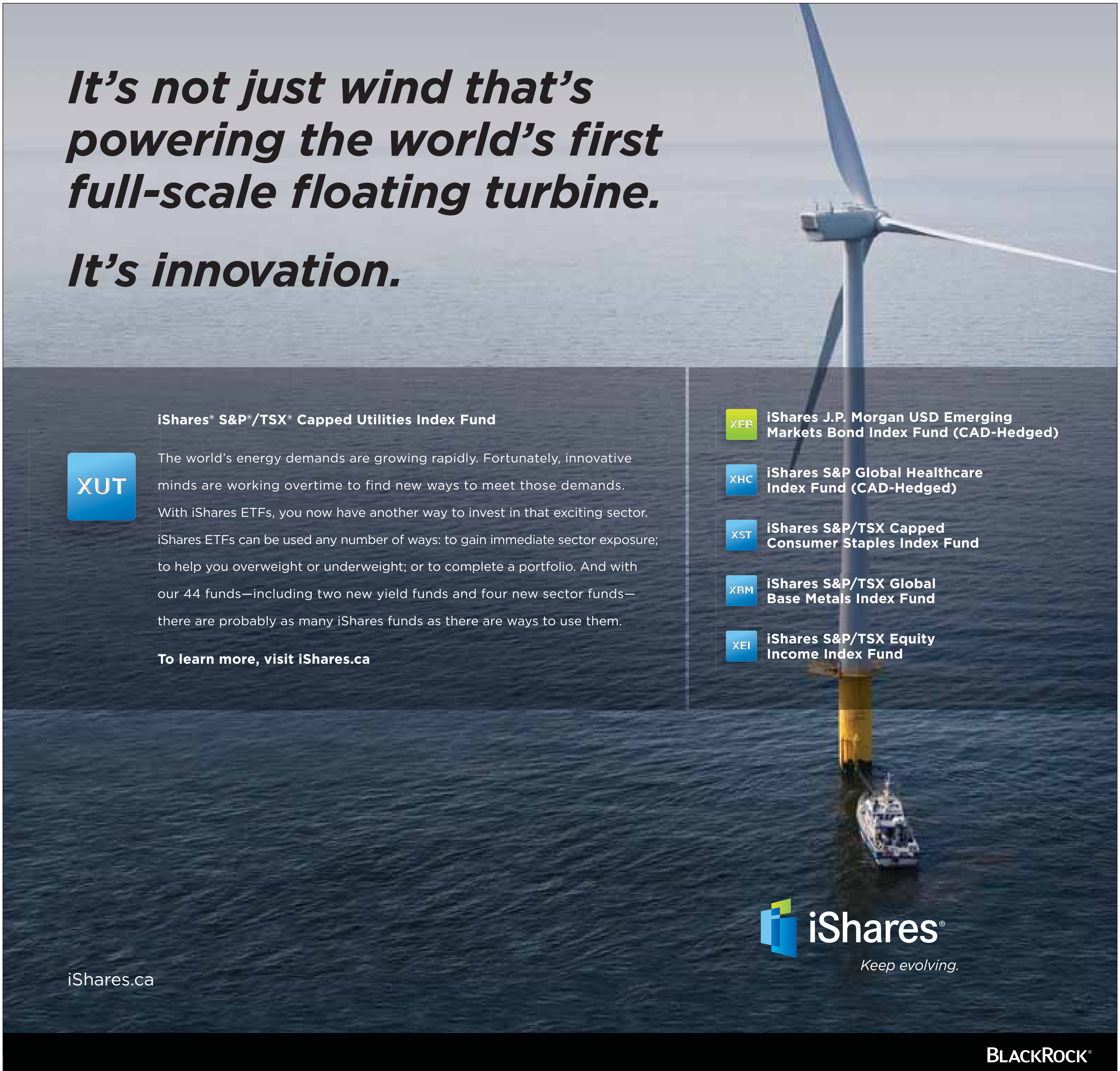
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# Radius Financial Education Introduces canadianetfwatch.com

**Radius Financial Education (RFE)** is proud to announce the launch of our **Canadian ETF Watch** website, **www.canadianetfwatch.com**, a web portal devoted to the world of Exchange Traded Funds with a focus on Canada. This website is a completely independent, Canadian resource tool that has been designed to give Investment Advisors. Investors, Service Providers and anyone interested in exchange traded funds a "one stop shop" for the most up to date information on all ETF's available in Canada. We have daily news, new issues, up to date information, interviews, education, ETF quotes provided by TSX and much more. So Please stay tuned as the website is updated daily.

In the summer of 2010, Radius Financial Education set out to create an online publication and web site that would address education, updates and timely issues in the Canadian ETF space. We are proud to say that the past several issues have accomplished this goal and will continue to do so. The authors of this and past issues have contributed important and timely articles on a range of topics including *The Fast Growing World of ETFs, Emerging Markets, Bond ETFs* and *Utilizing ETFs to Increase Portfolio Efficiency* to name a few. We encourage you to engage in discussion with our authors and other readers by commenting on the articles using the author's email address provided.

Publications like Canadian ETF Watch only materialize through the hard work of many individuals, and we had a host of people to thank for their time and generosity during the creation of both the publication and the website. Most importantly: thank you to our authors, for submitting their work in a new, untested publication. We hope our efforts and this compilation of articles makes them proud to be a part of something new and exciting.

At Radius Financial Education, our goal is to provide our visitors with informative content that is developed and written for your specific ETF needs. In addition, we will continually strive to add more information and to update you with the latest happenings and news in the ETF sector. Check out the web site and let us know what you think.

We would like to thank our readers for their continued support. We hope you enjoy **Canadian ETF Watch Volume 2, Issue 3.**

Sincerely,

**Tony Sanfelice**, President
Radius Financial Education


Your registration to ETF 2011 includes a complimentary one year subscription (via PDF) to our bi-monthly publication **Canadian ETF Watch**. If you would like to cancel your subscription at any time, please contact **info@radiusfinancialeducation.com.**

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**Editor**
Terry Krotowski

**Contributing Writers**
Paul Battaglia, Neil Bearse, David M. Blitzer, Pat Chiefalo, Robyn Graham, Betty-Anne Howard, Alfred Lee, Tyler Mordy, Jonathane Ricci, Som Seif, Mary Anne Wiley, Mark Yamada

**Research**
Terry Krotowski

**Sales Director**
Judy Street

**Art Direction**
Vic Finucci

**Online Developer**
Ferenc Schneman

**Contact Information**
**Canadian ETF Watch**
20 Toronto St., Suite 820, Toronto, Ontario M5C 2B8
tel: 416.306.0151 ext. 2225

**Editorial, Media & Advertising**
Terry Krotowski krotowski@radiusfinancialeducation.com

**Subscriptions**
subscription@canadianetfwatch.com

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# CONTENTS

# Types of ETFs

*There are a variety of **Exchange Traded Funds (ETFs)** that provide investors an opportunity to develop a diversified investment portfolio. ETF sponsors are constantly adding to the types of ETFs available, providing investors with more choice. Many ETFs track the performance of an underlying index or benchmark. The underlying index or benchmark may be broad, or sector-specific, or be linked to commodities or currencies. ETFs have evolved, however, to include those that do not passively track an underlying index or benchmark.*

ETFs can be grouped into different categories, which may include:

## Index ETFs

ETFs that use an index tracking approach generally follow a pre-selected index, called a benchmark, and the return on the ETF will closely correlate with that of the underlying index. Index ETFs follow a variety of indices, including the broad market (both Canadian and international), sectors such as infrastructure or health care, and commodities (including natural gas, oil and gold), as well as indices that offer exposure to dividends or fixed income. The weightings used in the underlying index could be based on market capitalization of the constituents or on fundamental factors such as financial criteria. Index ETFs may also follow indices that adhere to a certain investment style, such as value or growth.

## Inverse and Leveraged ETFs

Inverse ETFs are designed to seek daily investment results that correspond to the inverse daily performance of their underlying index or benchmark. To meet their investment objectives, inverse ETFs use a variety of derivatives such as futures contracts and index swaps to reproduce a daily result that is the opposite of the underlying index or benchmark; so, when the index or benchmark goes down in value on a given day, the inverse ETF will correspondingly go up in value for that given day. Conversely, when the index or benchmark goes up in value, the inverse ETF will correspondingly go down in value. Investing in these ETFs is similar to holding short positions, or using a combination of advanced investment strategies to profit from declining prices.

Leveraged ETFs are designed to seek daily investment results to provide a multiple of the daily performance return of an underlying index or benchmark (for example, 200% the return). They are not intended to provide that same multiple of the return over the mid or long term. Investors should be aware that, while leveraged ETFs typically achieve their stated objective of a multiple of the daily performance of an underlying index on a daily basis, their returns can vary considerably from that stated objective if held for a period longer than one day. Note that some leveraged ETFs are also inverse, in that they track the opposite of the return of an underlying benchmark.

To meet their investment objectives, leveraged ETFs use a variety of derivatives such as futures contracts and index swaps to provide a multiple of the market exposure of the stocks in the fund. Leveraging increases the risk of the investment in such an ETF, in that losses will be magnified by that same multiple.

Inverse and leveraged ETFs are generally intended for use in daily or short-term trading strategies, and are not intended for investors who are looking to hold positions in a security beyond the short-term. Over time, a leveraged fund can drift from its benchmark due to the effects of compounding, especially during periods of market volatility. Therefore, the return on these ETFs for periods longer than a single day will not correlate with the return of the underlying benchmark. Accordingly, significantly more risk is involved in these types of ETFs than in index ETFs.

It is important that investors clearly understand the nature and risks of any ETF prior to investing.

## Commodity ETFs

Commodity ETFs provide exposure to commodities such as energy (e.g., natural gas or oil), precious metals (e.g., gold, silver or platinum), or livestock and grains, either by (i) holding the physical commodity directly, (ii) tracking the performance of the spot market price through physical forward contracts, or (iii) investing in or tracking the performance of commodity futures contracts. ETFs that hold the physical commodity provide exposure to the spot price of the commodity without the trouble of storing the commodity. ETFs that hold futures provide exposure to futures without the trouble of rolling them over. Most commodity indices are futures price indices, reflecting a change in the price of commodity futures, not in the commodity price.

## Currency ETFs

Currency ETFs provide exposure to currencies and can also hold either the actual currency or futures contracts. Some are designed to be long or short on one currency against others; some are designed to hold a mix of long and short futures positions among several currencies.

## Actively Managed ETFs

Index ETFs are generally designed around a passive strategy and therefore typically have lower management fees. Some ETF providers offer actively managed ETFs that operate more closely to the concept of a mutual fund. These ETFs have an active manager making investment decisions, often with the objective of outperforming rather than tracking a particular benchmark index, but usually with lower management fees than a traditional mutual fund.

## Exchange Traded Notes (ETNs)

Exchange traded notes are debt obligations of the issuer and trade like ETFs. They do not guarantee any return of principal at maturity and do not pay any interest during their term. While they exhibit no tracking error in that their return at maturity is linked to the return of the underlying index (minus expenses), they do exhibit credit risk linked to the issuer. ETNs offer long and short or inverse exposure to commodities and currencies as well as leveraged exposure.

Source: tmxmoney.com

# Sector Investing in Local Markets




**ETFs now are available for many more asset types than just stocks, including commodities, real estate and bonds.**

Mary Anne Wiley
*Managing Director, Head of iShares Distribution, BlackRock Asset Management Canada Limited*

iShares®

BlackRock

***Earlier this year, we discussed how ETFs could be used to implement a global sector-based investment strategy. We touched on how important it was for investors to view developed markets along sector lines, in addition to the respective country exposure, in light of the impact globalization has had on our investing decisions. However, sector-based investing is not only relevant to capture a viewpoint on global events; it can also express an opinion on local markets. In an environment of continued economic cycles, sector-based investment strategies can offer return opportunities with less risk than investing in single stocks through tactical portfolio tilts and sector rotation.***

The earliest generation of ETFs was created to give inexpensive, liquid access to broad-based asset classes. Typically those assets were stocks and the ETFs often invested in hundreds, even thousands, of stocks. It was because of this broad diversification that investors were encouraged to use ETFs as the core vehicle in an asset allocation strategy. ETFs have evolved significantly since then.

ETFs now are available for many more asset types than just stocks, including commodities, real estate and bonds. ETFs have also expanded their geographic coverage beyond North America to include Europe and emerging markets. And most notably, within those asset class and geographic expansions, ETFs have expanded and refined to focus on specific sectors and industry slices.

## What Are Sectors?

The overall market can be organized according to the type of business a company is involved. This is a simple, yet powerful framework whereby companies are classified and grouped into sectors. The companies which make up the sector share the following characteristics:

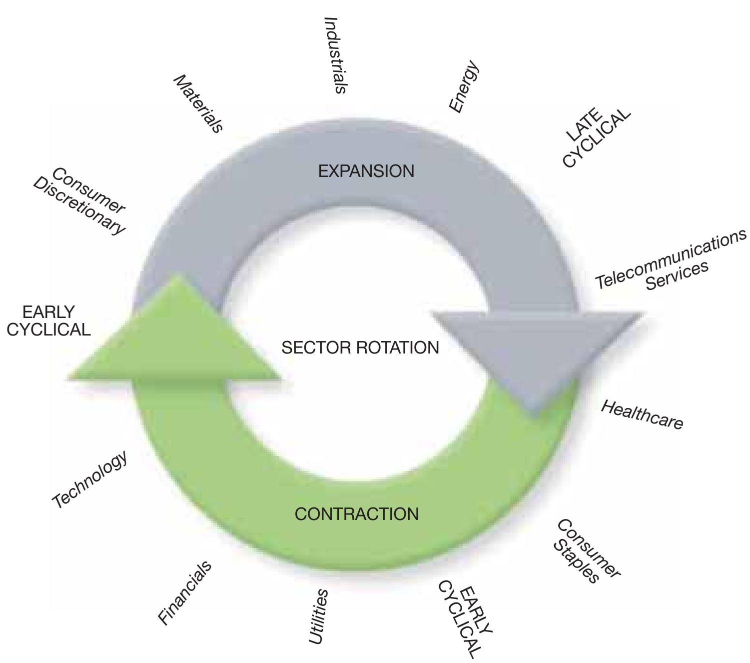
- Are involved in similar businesses, in a distinct area of an economy (product, service, function);
- Generally share similar reactions to the business cycle (expansion or contraction); and
- Generally have a similar relationship to key economic variables (inflation, interest rates, employment, etc).

The shares of companies within a given sector tend to go up and down together, in response to market and economic events. That said, even within a sector there can be significant variation in market performance. One company may be better managed than another in the same space, or have a better product, or just be favoured more by investors. However, the ability to pick which individual stock will outperform can be difficult. What can be less difficult to predict is the broader economic cycle and the typical response by the group of stocks, rather than the individual company.

### Sector Rotation Strategy: Working Within Economic Cycles

In a sector rotation strategy, an investor overweights sectors he or she believes are poised to outperform, while underweighting those he or she believes will decline, shifting these over – and underweights dynamically over time. For example, certain sectors may be better positioned than others during periods of strong economic expansion. Each phase of the economic cycle tends to be favourable and unfavourable to specific sectors relative to the overall market.

Economists have known for decades that some sectors react much better than others depending on the state of the economic cycle. As the economy moves into an early growth phase, it typically results in increased consumer confidence, the beginning of large infrastructure projects, more discretionary spending and a potential building boom. These factors are generally considered bullish signals for companies positioned to benefit from this type of economic activity, and sectors like consumer discretionary, materials and energy tend to outperform other sectors. But in a contraction, consumer confidence wanes. Within this scenario, investors may want to consider increasing their exposure to consumer staples, healthcare, and utilities given their relative stable cash flows and dividend payouts.




For illustrative purposes only

As recent history has shown, sector returns have exhibited large differences over the course of a cycle, which can vary in both the length of time and intensity of the contraction or expansion. For example, in just the last quarter, markets exhibited a clear focus on cyclical sectors, which outperformed defensive sectors, driven by signs that the continued economic recovery looks sustainable. The cyclical recovery story is easily illustrated by the S&P®/TSX® Capped Energy Index that has appreciated by 10.8 per cent in the first quarter of 2011 as investors look to improving economic conditions, as compared to the S&P/TSX Composite Index which was up 5.6 per cent over the same time period. In contrast, the S&P/TSX Capped Utilities Index, which is generally considered a defensive sector, lagged the broader market and was up just 1.2% over the first quarter.

Over a longer period of time the results can be even more obvious. You can look to the Dow Jones U.S. Index to illustrate this – during the expansionary period starting in 2002, the return differential between the best and worst performing sectors was 218 per cent (oil and gas and healthcare, respectively). While the broad historical dispersion of sector returns presents significant investment opportunities, it also highlights the risk of selecting underperforming sectors.

## Skip The Stock, Buy The Sector

Sector-based investing offer advantages over individual securities selection in two ways: diversification and market responsiveness.

Individual stocks are usually highly correlated to their respective broad sector or subsector, meaning they tend to move in the same direction as the sector or subsector. Yet investing in a single security can expose investors to uncomfortable levels of risk.

ETFs, which seek to track a benchmark index, can be used in place of individual stocks to preserve the fundamental objective behind a particular stock selection, while providing greater diversification and generally less risk than investing in a single security. For example, if we were to look inside the S&P/TSX Capped Energy Index we would find examples of companies with a wide range of performance. Over the year ending in March 2011, Encana Corporation has delivered returns of just 8.9%, compared to Suncor Energy Inc. which has returned 33.1%. However, an ETF that is modeled on this sector index is up over 25 per cent in the same period. The risk of picking a stock that lags the overall sector is a traditional concern with sector investing. The diversification provided by the ETF reduces this risk dramatically, resulting in more systematic exposure to the energy sector.

The other advantage of sector ETFs is they can allow an investor to diversify not only within his domestic market, but also to gain access to sectors beyond domestic borders. As an example, the Canadian investment scene is heavily exposed to resource-driven sectors like energy and materials. This may be advantageous in some circumstances, such as an economic recovery, but can be problematic in a contractionary cycle. In this case, a Canadian investor may have to look to internationally-exposed ETFs that track global defensive sectors, such as healthcare or consumer staples. These types of ETFs are plentiful on foreign exchanges and increasingly on Canadian exchanges as well.

The advent of the sector ETF has allowed for an easy and efficient means for retail investors to shift their investments from one sector to another, and to complete their portfolio by accessing sectors that are otherwise not available in Canada. Additionally, ETFs are often used by institutional investors and hedge funds to make long/short investments that can profit from the relative performance of two sectors (even if both are up or down). The choice and flexibility of sector ETFs can allow broad economic perspectives to be implemented in a portfolio quickly, efficiently, and in a way that balances risk and return.

*Mary Anne Wiley, Managing Director, Head of iShares Distribution, BlackRock Asset Management Canada Limited*
***maryanne.wiley@blackrock.com***

# Combining Active and Passive Investing in a Core-Satellite Strategy

**The rise in popularity of passive investments such as exchange traded funds (ETFs) and exchange traded products (ETPs) over the last decade has sparked an intense debate between the merits of active and passive investing.**


Alfred Lee
*Vice President & Investment Strategist, BMO Asset Management*


***This dispute has to an extent led to a division in the investment world with both the passive ("beta") and active ("alpha") camps developing a strong following. While we contend that there are benefits and drawbacks to both investment styles, the selection of either passive or active investments should not be one that is mutually exclusive.***

In fact, we believe a properly constructed portfolio and one that is the most optimal in efficiency should include both well selected alpha and beta investments. The combination of active and passive investments, a form of core-satellite investing, has been a strategy long utilized successfully by institutional investors. Core-satellite investing involves a portfolio core as an anchor to a strategy's strategic asset allocation while the satellite investments allow an investment strategy the potential to capture returns beyond the market and to also mitigate risk. Now with a robust selection of both alpha and beta related investments available to retail investors, they too can develop a sound portfolio using an institutional like approach. In the following chart, we quickly summarize the advantages and disadvantages of both passive and active investing. Moreover, we'll further investigate several examples in how an investor can combine active and passive investments to properly construct an efficient portfolio.

BMO Financial Group
Exchange Traded Funds

## The Advantages and Disadvantages of Active and Passive Investing

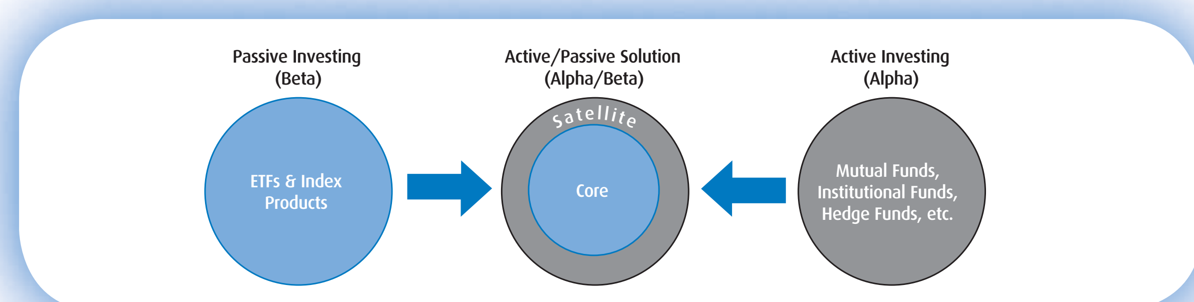
| | Passive Investing (Beta) | Active Investing (Alpha) |
|---|---|---|
| **Advantages** | • Delivers market returns less management fees<br>• Management fees tend to be lower<br>• Can more efficiently access certain markets and asset classes<br>• Rules based methodology may mitigate the emotional element of investing | • Potential to outperform the market<br>• Can provide downside protection and risk control<br>• Flexible mandates allow managers to move in and out of stocks and sectors |
| **Disadvantages** | • No potential to outperform the market<br>• May not be efficient for areas that lack liquidity and/or market breadth<br>• May introduce concentration risk of individual holdings, depending on index weighting methodology | • May underperform the market<br>• Management fees tend to be higher<br>• Even a talented manager can have extended periods of underperformance<br>• Requires the ability to select those managers who can outperform |

Source: BMO Asset Management Inc.

### Alpha/Beta Portfolio Construction

When devising a portfolio strategy, investors are exposed to two types of risk: market (or “beta”) risk through fixed income/credit and equity market investments and also active (or “alpha”) risk. Market risk is best explained as the risk of market volatility and thus is measured by standard deviation or downside deviation. Active risk, on the other hand, is the risk that a manager will perform differently from the market or its benchmark index during both market advances and declines and is best measured as tracking error In theory, well selected managers on a whole will provide better than market returns during upswings and downside protection during downswings. However, as even the most talented active managers can underperform at times, the passive portion of the portfolio would anchor a portion of the returns to the market. As a result, a properly constructed portfolio utilizing active-passive man¬dates is a way in which investors can implement risk control and potentially increase the risk-adjusted return of an overall investment strategy.

The combinations in which investors can implement an active-passive strategy are virtually limitless, with the number of investments available to investors including ETFs, mutual funds, stocks and hedge funds to name a few. In the following pages, we outline a few simple approaches in which an investor can construct a portfolio using both active and passive investments.

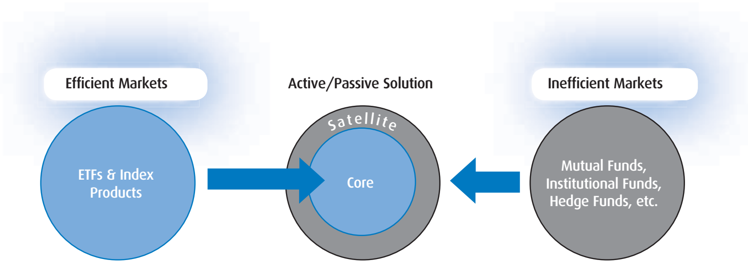



Continued on page 10

# Example 1

## Choosing Active Managers Based on Market Efficiencies

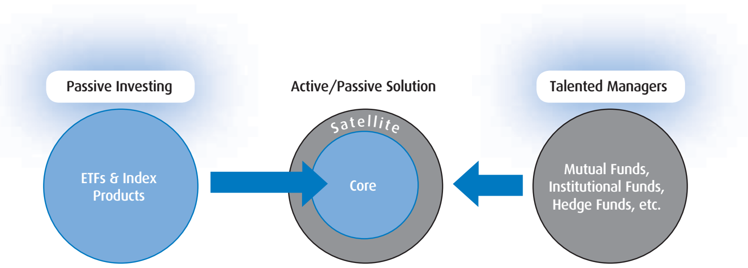
A common approach to deciding the allocation between alpha and beta investments in a portfolio is based on the efficiencies of the underlying market. Developed markets, most notably the U.S., are very efficient financial markets which make it more difficult for active managers to outperform. As such, for these areas, passive investments such as ETFs and index funds can be utilized to provide low cost beta exposure. Areas which are less efficient on the other hand, such as emerging market equities or small caps as an example, can be devoted to active management, as alpha generation in these areas can be more likely. Although technology has made information more accessible over the last decade and financial markets have become increasingly globalized, some markets still tend to be more efficient than others. As such, the active and passive management split based on the efficiency of markets is still a common approach for investors that have adopted a core-satellite approach.




# Example 2

## Choosing Active Managers Based on Talent

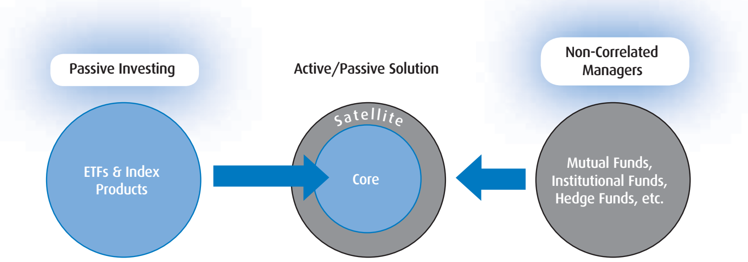
An alternative to deciding the alpha and beta allocation in a portfolio is allocating active risk to areas where an investor can source talent. For example, if an investor believes a number of Canadian equity managers who can outperform the market over the long-run are readily accessible, a greater allocation to active management can be devoted to Canadian equities. Passive management as a result, can then be left for areas in which an investor has greater difficulty in accessing talented active management.




# Example 3

## Choosing Active Managers Based on Correlation

In order for an active manager to outperform the market or to provide downside protection, the strategy utilized must differentiate itself from the market. The greater the differentiation between an active mandate and an index, the greater the potential value it can add when combined with a passive strategy. However, higher active risk also brings a greater potential for a strategy to underperform the market. Therefore managers must be carefully selected to best complement a passive strategy.




By combining non-correlated investments together, the overall investment strategy can improve its risk/ return characteristics. Theoretically, at each risk level, there is a point in which expected returns can be maximized or equivalently risk minimized for a given level of expected return. Each of these points when combined forms the efficient frontier, where a theoretically optimal portfolio exists at each risk level. Therefore, the alpha and beta allocation decision can also be based on correlation, in which non-correlated investments can be combined in an active-passive investment strategy.

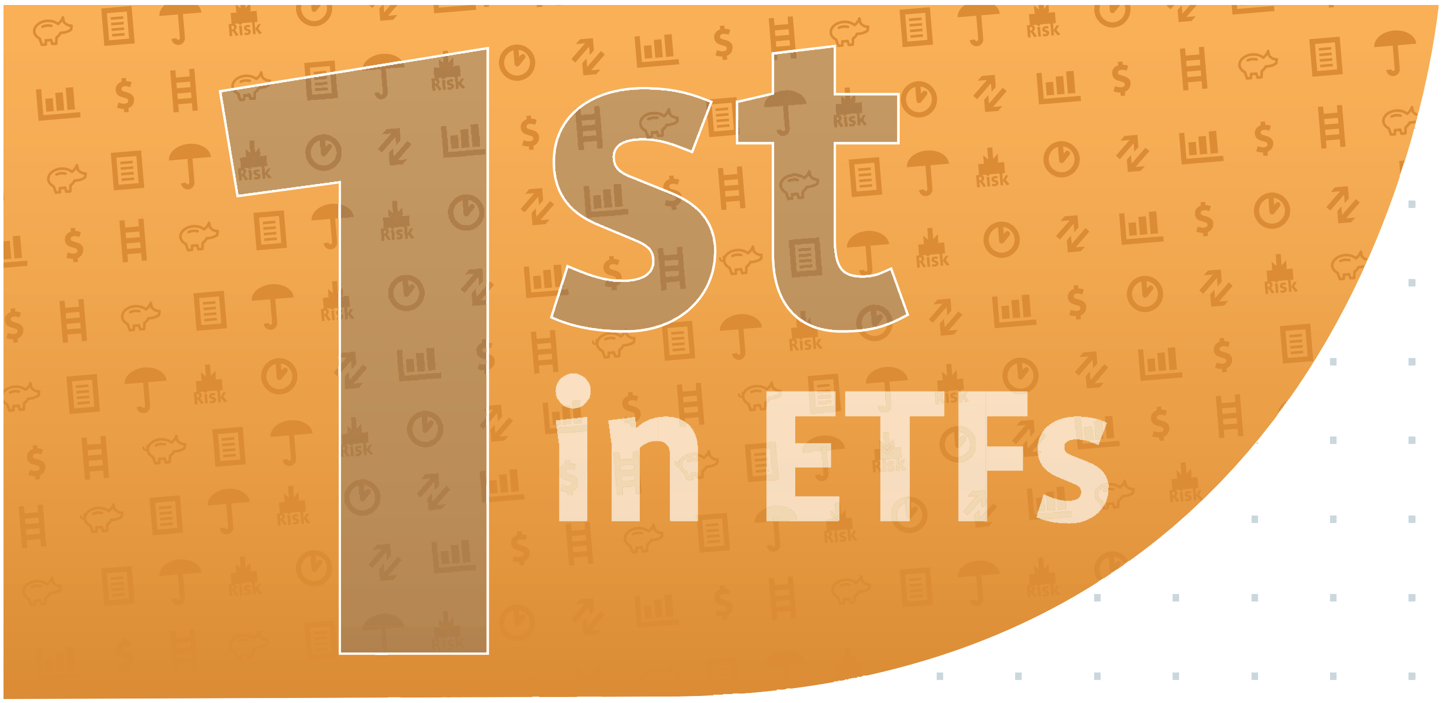
## Conclusion

We have outlined a variety of the more popular ways in which inves¬tors can effectively combine active and passive investments using a core-satellite approach. Any of the above mentioned strategies or a combination of them can be utilized to optimally construct a portfolio. Using the combination of active and passive investing in a single portfolio can help establish an understanding of risks being taken while offering prospects for outperformance accessing talented active management.

*Alfred Lee, Vice President & Investment Strategist,*
*BMO Asset Management* ***alfred.lee@bmo.com***

# TMX – an ETF leader since DAY 1

TMX | Toronto Stock Exchange




## Exchange Traded Funds ETFs | TMX

**ETF Style**
- Broad-based
- Equal-weight
- Narrow-based
- Preferred Share
- Dividend Income
- Small-cap
- Large-cap
- Growth
- Value

**Management Style**
- Passive
- Active
- Leveraged
- Inverse
- Bullish
- Bearish

**Sectors**
- Agriculture
- Base Metals and Materials
- Energy
- Financial
- Healthcare
- Infrastructure
- Information Technology
- Mining
- Real Estate
- Socially Responsible
- Utilities
- Water

**Fixed Income**
- Corporate Bonds
- Government Bonds
- Long-term
- Short-term
- Money Market

**Currencies**
- Euro
- Pound
- U.S. Dollar
- Yen

**Derivatives**
- Leveraged

**Commodities**
- Copper
- Crude Oil
- Gold
- Grains
- Natural Gas
- Oil Sands
- Silver

**International**
- Global Funds
- Latin America
- Japan
- United States
- Emerging Markets
- BRIC (Brazil, Russia, India & China)

### To find out more about TMX, 1st in ETFs, contact:

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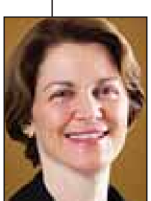
Listings
Amelia Nedovich
Head, Business Development, ETFs and Structured Products
**416-947-4499** or **amelia.nedovich@tsx.com**

Equity Trading
Olga Trofimova
Senior Account Manager
**416-947-4355** or **olga.trofimova@tsx.com**

# A Brave New World of Opportunity

**From relative obscurity only a few short years ago, the ETF has emerged as today's hot topic in the investment media.**




Robyn Graham
*Vice President, Institutional Services, Horizons HAHN Investment Stewards*

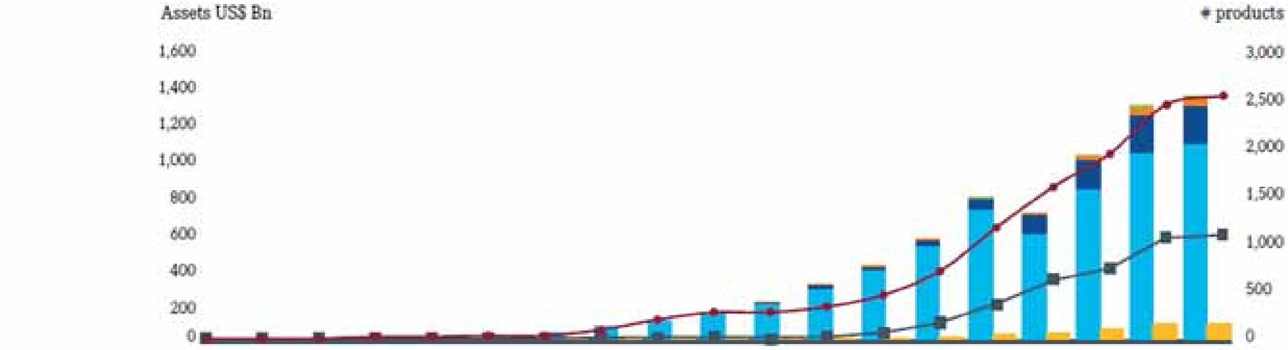

*Every week new ETFs come to market, with over 2,500 exchange traded funds available worldwide at the beginning of March 2011. There are many positives for both advisors and their clients resulting from this, but also a few things to be aware of and carefully managed.*

### A Brave New World of Opportunity

When an investment vehicle gains enormous popularity virtually overnight, there is usually good reason for it. In the case of ETFs, the obvious benefits are mostly well-known: liquidity, transparency, diversification and low cost. In the hands of a professional, however, the true efficacy of these vehicles comes to light. ETFs are the ideal building blocks for portfolio construction, providing liquid access to diversification opportunities that were either prohibitively expensive or simply not available a few short years ago.

HORIZONS
HAHN INVESTMENT STEWARDS

Figure 5: Global ETF and ETP asset growth, as at end February 2011




| Assets (US$ Bn) | 93 | 94 | 95 | 96 | 97 | 98 | 99 | 00 | 01 | 02 | 03 | 04 | 05 | 06 | 07 | 08 | 09 | 10 | Feb-11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| ETF total | 0.8 | 1.1 | 2.3 | 5.3 | 8.2 | 17.6 | 39.6 | 74.3 | 104.8 | 141.6 | 212.0 | 309.8 | 412.1 | 565.6 | 796.7 | 711.1 | 1,036.0 | 1,311.3 | 1,367.4 |
| ETF equity | 0.8 | 1.1 | 2.3 | 5.3 | 8.2 | 17.6 | 39.6 | 74.3 | 104.7 | 137.5 | 205.9 | 286.3 | 389.6 | 526.5 | 729.9 | 596.4 | 841.6 | 1,053.8 | 1,101.0 |
| ETF fixed income | – | – | – | – | – | – | – | 0.1 | 0.1 | 4.0 | 5.8 | 23.1 | 21.3 | 35.8 | 59.9 | 104.0 | 167.0 | 207.3 | 212.5 |
| ETF commodity | – | – | – | – | – | – | – | – | 0.0 | 0.1 | 0.3 | 0.5 | 1.2 | 3.4 | 6.3 | 10.0 | 25.6 | 45.7 | 48.7 |
| ETF other[1] | – | – | – | – | – | – | – | – | – | – | – | – | – | – | 0.6 | 0.6 | 1.8 | 4.5 | 5.2 |
| ETP total | – | – | – | – | – | – | 2.0 | 5.1 | 3.9 | 4.1 | 6.3 | 9.3 | 15.9 | 32.5 | 54.6 | 61.2 | 119.7 | 170.6 | 175.3 |
| **ETF/ETP total** | **0.8** | **1.1** | **2.3** | **5.3** | **8.2** | **17.6** | **41.6** | **79.4** | **108.7** | **145.7** | **218.3** | **319.1** | **428.0** | **598.1** | **851.3** | **772.3** | **1,155.8** | **1,482.0** | **1,542.7** |
| # ETFs | 3 | 3 | 4 | 21 | 21 | 31 | 33 | 92 | 202 | 280 | 282 | 336 | 461 | 713 | 1,170 | 1,595 | 1,944 | 2,460 | 2,557 |
| # ETPs | – | – | – | – | – | – | 2 | 14 | 17 | 17 | 18 | 21 | 63 | 170 | 371 | 615 | 739 | 1,065 | 1,092 |

1. ETFs classified as 'alternative', 'currency' and 'mixed'.
Source: Global ETF Research and Implementation Strategy Team, BlackRock, Bloomberg.

**Post 1999... A New World of Investing**


**$US/Cdn. vs. S&P/TSX Index -** 5 yr. Return to March 2011


Source: Globe and Mail.com

Portfolio construction was formerly a fairly straightforward exercise: a selection of wisely chosen funds or securities within a fairly simple asset mix structure usually did the job – and the bull market and falling interest rates did the rest. No more. Today's challenging investment markets are forcing investors to look much farther afield for both return opportunities, and ways to manage risk. During the Global Financial Crisis even sophisticated investors found, to their chagrin, that their portfolio simply didn't have the diversification they thought it had. "Is diversification dead?" experts wondered. On the contrary – in volatile markets, diversification is more important than ever – but we must look farther afield to find it.

Fortunately, ETFs now make it possible to scour the world for non-correlated portfolio assets, and to take advantage of them when found. Examine, for example, three asset classes which actually did well in the financial crisis: pan-Asian bonds, the US dollar and commodities. Previously, most advisors and their clients would simply not have had access to non-correlated assets of this kind. Even for institutional investors the cost, lack of liquidity and lack of transparency associated with these types of diversification opportunities were prohibitive – until ETFs changed the landscape.

The proliferation of ETFs, therefore, is a boon to investors and advisors seeking to prudently meet the risk/return objectives of their clients. Not only is the world our oyster – but we can pick which pearls we want – at reasonable cost and with an assured after-market. Today's ETFs provide exposure to an ever expanding number of asset classes, markets, and sectors available world-wide. They have made currency hedging possible for only a few basis points, and have provided liquidity where none existed before. Further, instead of expending resources on costly and time-consuming security-specific research, professionals are now able to focus their attention on the portfolio decisions that matter the most – asset allocation and risk management.

Continued on page 14

Continued from : A Brave New World of Opportunity page 13

## It's What You *Do* with it That Counts

Most are familiar with the Brinson, Singer, & Beebower study demonstrating that 91.5% of the variability in portfolio returns is attributable to the asset allocation decision. ETFs are not only ideal for easily effecting the appropriate strategic mix for a client, but are also now pushing the frontiers of portfolio management forward by facilitating active asset allocation. Active asset allocation is not speculative in nature, but rather, incorporates a macro-economic view into a client's investment policy mix, resulting in periodic asset mix shifts as risk is re-assessed. The policy mix defines tolerance bands within which a client's asset mix may be actively managed. The active range permits professionals to manage risk and return proactively – positioning for opportunity, while protecting against the loss of clients' capital during periods of market shock.

Active asset allocation as an investment strategy is not yet universally accepted. There are still those that believe a strategic asset mix, rebalanced periodically, is the right way to go. In response, consider whether you believe a fixed percentage exposure to equities was appropriate for clients at all stages of the economic cycle over the last 10 years: going into the Global Financial Crisis in 2007, for example, versus coming out of it in 2009. In hindsight, most would agree a passive asset mix strategy was neither effective nor prudent. Most wish they had the skill and the tools to manage this volatility more effectively, and take advantage of opportunity when it presented itself.

In fact, a recent study by the Research Foundation of CFA Institute concludes that the need for an active asset allocation approach is now being acknowledged by a growing number of institutions and investment professionals globally, "The events of 2007–2009 highlighted the need for a top-down approach in which macroeconomics plays a much bigger role than it has in recent times. Given the high levels of volatility in this period, which are expected to continue, asset allocation is also becoming more dynamic."

The challenge is - how do we make active asset allocation decisions successfully?

It is unlikely an individual investor has the time or expertise to employ the disciplined process necessary to effect successful tactical asset allocation decisions. Some advisors do provide this service to clients, but others, focused on building their practice and servicing clients, may choose to outsource a portion of the active asset allocation decision to professionals focused in this space. According to the same CFA Institute study, "the demand for people with multi-asset-class experience is now high," but, "It is difficult to find qualified candidates for asset allocation. There are few people with hands-on experience in more than one asset class."

In the hands of a seasoned professional, ETFs facilitate active asset allocation decisions by providing exactly the kind of asset class exposure the financial professional is seeking, and the liquidity to make tactical changes quickly and cost effectively, when appropriate.

## Staying Focused

The growth of the ETF market and the resulting media attention has significantly raised awareness of ETFs in both the investor and advisor community. This attention is mostly beneficial but also has a downside when it leads to confusion, speculative trading practices and misinformation in the market.

Today's ETFs provide exposure to a wide range of increasingly complex investment strategies, most based on an index, some not. Knowing that an ETF is simply a publicly traded basket of securities, we can see that the potential for product innovation is only limited by the creativity of the manufacturer, tempered by the desire of the investor. Unfortunately, many of these strategies have no place in the average investor's portfolio and only serve to create confusion in the marketplace. Not all products are created equal, and new offerings come to market every week. As with any security, suitability must be assessed and due diligence performed before making any recommendations.

## Putting it all Together

Initially, ETFs were primarily used by discount brokerage clients and professional investors, leaving advisors and their clients temporarily without a satisfactory way to access ETFs as a portfolio solution. This is changing. A growing number of advisors are incorporating ETFs into client portfolios in a variety of ways: for example, introducing non-correlated satellite ETFs around the core portfolio, or conversely replacing the core portfolio with a passive ETF strategy, surrounded by other actively managed investments.

For advisers wishing to outsource the portfolio management function of all or a portion of their clients' investments to specialists in the ETF or asset allocation field, referral agreements are now increasingly common at many investment dealers, while others are adding these solutions to their SMA platforms. In the mutual fund channel a number of new products now exist to bring the benefits of ETFs to a whole new audience of investors, some of which also offer active asset allocation strategies.

*Robyn Graham, Vice President, Institutional Services,*
*Horizons HAHN Investment Stewards*
***rgraham@hahninvest.com***

**i Source:** Global ETF Research and Implementation Strategy Team, ETF Landscape, Global Handbook Q1 2011, (BlackRock), Bloomberg

**ii Source:** Brinson, Singer, & Beebower, Determinants of Portfolio Performance II: an Update, (Financial Analysts Journal, May/June 1991), wwwcfapubs.org

**iii** Fabozzi, Focardi, Jonas, Investment Management after the Global Financial Crisis (Research Foundation of CFA Institute, 2010), p. 1, www.cfapubs.org

**iv Ibid**, p. 104

"...the demand for people with multi-asset-class experience is now high..."

~ CFA Institute

# The Basics of Fundamental Index® Investing


**Indexing has demonstrated its worth as a great investment idea and has provided the essential building block for developing ETFs.**

Som Seif
*President & CEO, Claymore Investments*

***However, traditional market capitalization-weighted indexes, such as the S&P/TSX 60 Index and S&P 500 Index, have one structural flaw – they link market price with the weighting of a security, therefore systematically overweight overvalued securities and underweight undervalued securities. Traditional indexing can create periods of extreme volatility and lead to a drag in performance.***

For this reason, institutional and retail investors around the world are becoming increasingly interested in alternative indexes designed to counter the flaws of market capitalization. Most notably, investors are turning to Claymore and our lineup of Fundamental Index® ETFs, a methodology designed by Research Affiliates in Newport Beach, California, to overcome the basic shortcomings of the traditional index structure. The trend towards alternative indexes is demonstrated in Canada by the increasing popularity of the Claymore Canadian Fundamental Index® ETF.

The Research Affiliates Fundamental Index® (RAFI®) methodology selects and allots index security weights based on four key financial measures of a company. These measures are indifferent to its stock price and consequently to its market cap or weighting in an index. The methodology, which is designed to work in inefficient markets, limits exposure to pricing errors and fads.

## Award Winning Methodology

The concept of fundamental-indexing was first developed in 2005 by Robert Arnott, the chairman of Research Affiliates. In the research published by Research Affiliates in 2005, Rob Arnott demonstrated that the RAFI® methodology produced a 2 per cent greater return than the S&P 500 performance from 1962-2004 with very little to no extra risk.

The RAFI® methodology determines index weights of a company based on the following four financial measures to avoid overvaluing or undervaluing stocks:

1 **Total Sales** – (five-year average total sales)

2 **Book Equity Value** – current period book equity value)

3 **Cash Flow** – (five-year average cash flow)

4 **Gross Dividends** – (five-year average of all regular and special distributions)

By using fundamental factors rather than prices to weight stocks, fundamental-indexing takes advantage of price movements and at rebalance date, reduces the index's constituents whose prices have risen relative to other constituents, and increases holdings in companies whose prices has fallen behind. When a company's stock goes up and appreciates faster than its fundamentals do, it's rebalanced downward. This is effectively a buy-low, sell-high strategy.

## A Fundamental Difference

A capitalization-weighted index, such as the S&P/TSX 60 Index, weights its components (or companies included in the index) by the total market value of their outstanding shares. The math is simple: number of shares outstanding multiplied by current market price. The impact of each component stock's price change on the index is proportional to its overall market value, not the fundamental value of the stock itself. In other words, the more a stock increases in price, the higher its weighting in the portfolio.

***"In the past five years, the RAFI® methodology has generated superior performance, even during a period of market turmoil."***

Rob Arnott
Chairman & CEO, Research Affiliates, LLC.
March 2011

On the other hand, in a Fundamental Index® portfolio, stocks are weighted by their fundamental accounting factors rather than market value – these factors include sales, book value, cash flow and dividends. Breaking the link between stock price and index weighting is critical – it eliminates the return drag built into cap-weighted indexes. This change in weighting methodology can add up substantially over time.

***The Fundamental Index® concept works globally. It's more than luck – it's the intelligence and discipline of the process.***

The Fundamental Index® methodology is based on the theory that day-to-day, markets and stock prices are not perfectly efficient (individual stocks are overvalued and undervalued from time to time), and that prices revert to their "fair value" over time. Weighting using fundamentals creates a stable anchor to trade against the market's constantly shifting expectations, fads and bubbles. In fact, this "contra rebalancing" provides a significant source of added value over time.

## The Claymore Canadian Fundamental Index ETF

Claymore ETFs is the exclusive provider of ETFs based on the FTSE RAFI® Fundamental Index Series in Canada. In March 2011, the Claymore Canadian Fundamental Index® ETF (CRQ) celebrated its 5 year anniversary with impressive results.

CRQ offers investors the highlights of a passive investment: low cost, lower turnover, and transparency. Fundamental-weighting decreases exposure to high P/E stocks during episodes of unsustainable P/E expansion, thus avoiding over-exposure to the more overvalued stocks.

Over the past five years (February 2006-March 2011), CRQ has outperformed the benchmark S&P/TSX 60 Index and the majority of mutual funds in the Canadian equity category. CRQ is the #2 ranked fund (out of 93 funds with 5 year track records) in the Canadian Equity fund category to the end of February 2011 and received a Five-Star rating from Morningstar.

| | 3 Year | 5 Year |
|---|---|---|
| Claymore Fundamental Index ETF | 7.96% | 6.69% |
| S&P/TSX 60 Index | 4.97% | 6.03% |

In addition to CRQ, Claymore offers Canadian investors four additional ETFs that utilize the RAFI methodology, including

| ETF Name | Ticker |
|---|---|
| Claymore US Fundamental Index ETF - C$ Hedged | CLU |
| Claymore US Fundamental Index ETF - Non-Hedged | CLU.C |
| Claymore International Fundamental Index ETF | CIE |
| Claymore Japan Fundamental Index ETF - C$ Hedged | CJP |

*Som Seif, President & CEO, Claymore Investments*
***sseif@claymoreinvestments.ca***

Traditional indexing can create periods of extreme volatility and lead to a drag in performance.

# Equity Hedging Strategies Using Exchange Traded Funds

**Implementing a hedge using inverse or levered inverse ETFs.**

- With the macroeconomic issues that have come to the forefront recently, we review ETF hedging tools available to investors in Canada and discuss implementation strategies. We will focus on inverse and levered inverse products.
- In Canada, investors can access a complete suite of ETF hedging tools that offer downside protection. The table at the top of the opposite page, lists some key hedging equity ETFs.
- The accessible liquidity of these ETFs goes far beyond the indicated average daily volume as the reference underlying assets are some of the most heavily traded instruments, for example, the S&P/TSX 60 stocks and the S&P 500 stocks.
- Implementing this type of hedging strategy can be quite effective, however, it does require monitoring and rebalancing to ensure proper exposure.

**Pat Chiefalo**
*Director,*
*National Bank Financial*

NATIONAL BANK
FINANCIAL MARKETS

| Table 1: Inverse Equity ETFs in Canada | | | | | |
|---|---|---|---|---|---|
| **Ticker** | **Fund Name** | **Price** | **QMV (000 $)** | **20D ADV** | **MER** |
| **HIX** | Horizons BetaPro S&P/TSX 60 Inverse ETF | $10.44 | 48 024 | 141 020 | 1.15 |
| **HIU** | Horizons BetaPro S&P 500 Inverse ETF | $8.08 | 6 868 | 25 048 | 1.15 |
| **HIF** | Horizons BetaPro S&P/TSX Capped Financials Inverse ETF | $8.23 | 4 115 | 11 288 | 1.15 |
| **HIG** | Horizons BetaPro S&P/TSX Global Gold Inverse ETF | $11.52 | 2 880 | 44 938 | 1.15 |
| **HIE** | Horizons BetaPro S&P/TSX Capped Energy Inverse ETF | $9.87 | 987 | 4 471 | 1.15 |
| **Levered Inverse Equity ETFs in Canada** | | | | | |
| **HXD** | Horizons BetaPro S&P/TSX 60 Bear Plus Fund | $8.68 | 148 949 | 2 017 771 | 1.15 |
| **HGD** | Horizons BetaPro S&P/TSX Global Gold Bear Plus ETF | $10.82 | 60 727 | 1 361 411 | 1.15 |
| **HSD** | Horizons BetaPro S&P 500 Bear Plus ETF | $10.02 | 57 164 | 456 176 | 1.15 |
| **HFD** | Horizons BetaPro S&P/TSX Capped Financials Bear Plus ETF | $7.10 | 29 607 | 150 570 | 1.15 |
| **HMD** | Horizons BetaPro S&P/TSX Global Base Metals Bear Plus ETF | $5.65 | 18 320 | 140 480 | 1.15 |
| **HED** | Horizons BetaPro S&P/TSX Capped Energy Bear Plus ETF | $3.67 | 9 689 | 248 611 | 1.15 |
| **HQD** | Horizons BetaPro NASDAQ-100 Bear Plus ETF | $7.60 | 8 778 | 121 555 | 1.15 |
| **HJD** | Horizons BetaPro MSCI Emerging Markets Bear Plus ETF | $9.06 | 3 624 | 27 411 | 1.15 |

Source: National Bank Financial

While there are a number of different underlyings and indices investors can gain inverse and even levered inverse exposure to, we highlight a few of the most popular for broad market hedges. For a complete list of ETFs, please feel free to contact our group.

**Reasons to implement a hedge using inverse or levered inverse ETFs**

**1** By going long an inverse or levered inverse ETF investors are not forced to sell underlying holdings which may trigger tax consequences, or reduce hard to acquire stock positions, and may be more operationally efficient.

**2** The costs and risk of implementing a hedging strategy may be lower using an inverse or levered inverse ETF when compared to actually shorting stocks;

**Cost**
Expect lower borrow and margin rates in certain circumstances in addition to not having any additional cash costs for borrow and dividends, which are taken into account in the ETF NAV.

**Risk**
Expect no call risk on the borrowed names and limited liability on the short position, compared to unlimited potential losses on outright shorts.

**3** By implementing the strategy with an ETF, the same advantages come along with these inverse products, including transparency of holdings, liquidity and intraday trading and pricing.

**4** ETFs may be more accessible than other more exotics products such as options, structured products or OTC swaps, and their implementation may be easier to manage, however, monitoring and rebalancing may be required.

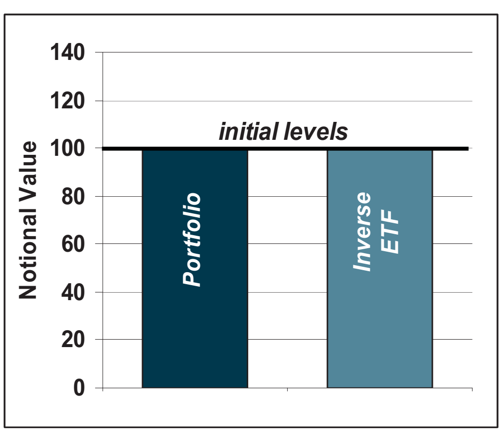
**5** Investors today also have a variety of different underlying exposures from which to choose when using an ETF, including equity indices, fixed income, commodities, currencies, etc.

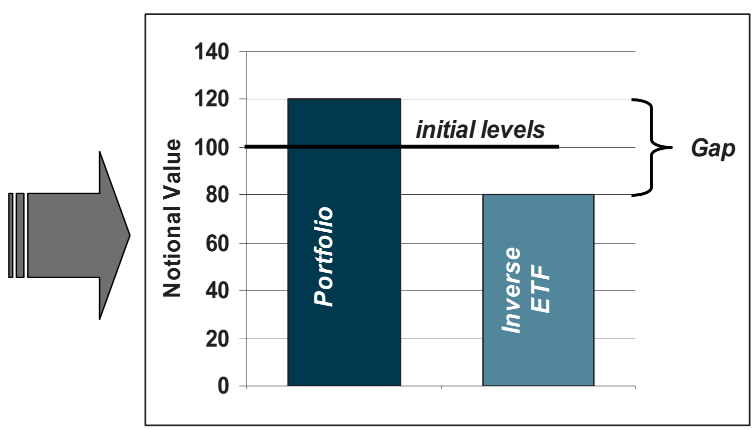
Rebalancing required when implementing a hedging strategy using inverse or levered inverse ETFs.

Inverse ETFs are designed to provide the inverse of the daily performance of an underlying index such as the S&P/TSX 60. When hedging a stock portfolio over any period longer than a day, a so-called gap might arise between the long and the short exposure, which requires management to ensure a perfect hedge:

**Net Exposure Gap =**
**Value of Stock Portfolio – Value of Inverse ETF Position**

In the example charts below, the portfolio beginning value of $100 increases to $120 over the period and the inverse ETF value of $100 decreases to $80, creating an exposure gap.

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To maintain a perfect hedge, this gap should be zero. The size of the position in a single-inverse ETF should exactly equal the offsetting notional value of the portfolio. This way, the returns from the portfolio and the inverse ETF cancel each other out.

After one day, without rebalancing, the relative size of the positions will be different from the initial ratio because of the compounding of returns, and the investor will experience an unhedged return on the net exposure. Additional daily movements in the market may cause the exposure gap to impact the effectiveness of the hedge. For this reason, investors seeking to hedge their portfolios with inverse or levered inverse ETFs should periodically rebalance their exposure.

***Step-by-step process to implement a hedging strategy using inverse or levered inverse ETFs***

**Step 1 - Choose desired exposure**

**Example:** an investor wants to completely hedge a $100 portfolio of Canadian equities. This decision determines the ratio between the inverse ETF and the original long position, which would be 1-to-1 in this case. Investors may also choose to hedge out other amounts, say 50% or 25% of their total equity exposure.

To achieve a complete hedge, 100%, the investor should buy the exact offsetting position of $100 in a single-inverse ETF. This would accomplish a net exposure of zero dollars to the underlying equity portfolio, where net exposure = long position – short position.

**Step 2 - Select hedging vehicle**

In this case, a single-inverse ETF such as HIX, the Horizons BetaPro S&P/TSX 60 Inverse ETF, may be appropriate. If the investor wishes to completely hedge the portfolio's exposure, he or she would initiate the hedge by buying an exactly offsetting notional amount of HIX. The table on the first page gives the complete list of single inverse and levered inverse equity ETFs that are available in Canada. For additional sectors or U.S. funds, please feel free to contact us.

**Step 3 - Rebalancing strategy**

It is important to anticipate the monitoring and trading that will be required to periodically bring the net exposure back in line with the target exposure, which is zero dollars in our example.

If the index rises, the inverse ETF will fall, and the investor will have to buy more shares of the inverse ETF to rebalance. Conversely, if the index falls, the inverse ETF will rise, and the investor will now be overhedged with respect to the original target exposure.

**Daily Rebalance example:** The Canadian equity portfolio goes up 5% in one day, and its corresponding inverse ETF, HIX, decreases by 5%. The loss in HIX fully offsets the gain in the portfolio, completing the hedge.

**Rebalance Trade:** In order to prepare for the next day's market movement, the investor would buy $10 of HIX so the value in the inverse ETF exactly equals the $105 in the portfolio.

**Table 2: Rebalance trade for hedging Scenario: Index rises 5%**

| Day | Canadian Portfolio | HIX ETF | Net Exposure |
|---|---|---|---|
| 0 | $100 | $100 | $0 |
| 1 | $105 | $95 | $10 |
| Rebalance Trade: Buy $10 of HIX | | | |

Source: National Bank Financial

Depending on index volatility and the pathway of returns, a daily rebalancing is usually not needed if the investor is willing to tolerate some deviation away from net exposure. There are two ways to address the rebalancing frequency:

**3a - Calendar rebalancing**

Rebalance at set time intervals that are longer than a day, such as weekly or monthly.

**Benefit**

This method lays out a defined trading frequency that is not sensitive to market volatility.

**Consideration**

In volatile market conditions, the effect of daily compounding on the inverse ETF position might cause the net exposure to deviate materially from its target.

**3b - Trigger-based rebalancing**

Rebalance when the exposure gap between the portfolio and the inverse ETF positions reaches a specific threshold percentage of the original portfolio, such as ±5%.

**Benefit**

The deviation in net exposure is not expected to drift farther from the target than the predetermined threshold.

**Consideration**

An inverse ETF based on a high-volatility index might require frequent rebalancing trades, especially if the threshold is low.

**Step 4 - Execute rebalancing trade**

The trade in the inverse ETF, HIX in our example, will equal the amount that brings the net exposure back to the target exposure.

**Current Canadian Stock Portfolio**
**– Current Inverse ETF Value**

**Rebalancing Trade $ Amount**

**Example: Weekly rebalance of inverse ETF**

Starting portfolio and inverse ETF value of $100. Compounded returns after five days equals -14.3% for portfolio and +15.7% for inverse ETF.

***To rebalance at the end of the week, the investor should sell $30.02 of the inverse ETF to bring its position down to $85.72, exactly equal to that of the index portfolio.*** In this example, the gains of $15.74 from the ETF did more than offset the loss of $14.28 to the index. This is a consequence of the particular sequence of returns, which trended downwards, and the asymmetrical effect of daily compounding. This may not always be the case.

**Table 3: Rebalance trade for hedging Example: Weekly rebalance**

| Day | Canadian Portfolio | | HIX ETF | | Net Exposure |
|---|---|---|---|---|---|
| | Position | Return | Position | Return | |
| 0 | $100 | | $100 | | $0.00 |
| 1 | $97.00 | -3% | $103.00 | 3% | -$6.00 |
| 2 | $93.12 | -4% | $107.12 | 4% | -$14.00 |
| 3 | $94.98 | 2% | $104.98 | -2% | -$10.00 |
| 4 | $90.23 | -5% | $110.23 | 5% | -$19.99 |
| 5 | $85.72 | -5% | $115.74 | 5% | -$30.02 |
| Total Return: | | -14.28% | | 15.74% | |
| Rebalance Trade: Sell $30.02 of HIX | | | | | |

Source: National Bank Financial

**Factors affecting rebalancing:**

**Fund multiple:** In the above discussion, we assumed the use of a single-inverse ETF. A double-inverse ETF can also be used for the same hedging purpose. The advantage of a levered inverse ETF is that the cash outlay to set up the initial hedge would be less; for instance, $50 of HXD, the Horizons BetaPro S&P/TSX 60 Bear Plus ETF, which provides -2x daily return, would be enough to fully hedge $100 in XIU, a single-long S&P/TSX 60 ETF. However, a levered inverse ETF would need to be rebalanced more frequently and in greater amounts. Horizons BetaPro Exchange Traded Funds offers rebalancing tools on their website and can be found at:

**www.hbpetfs.com/pub/en/resources/RebalancingTool.aspx**

**Volatility:** The higher the volatility, the more frequent the rebalancing. With trigger-based rebalancing, a highly volatile index would trigger more frequent rebalances, and in the case of calendar rebalancing, the period would have to be set to a shorter time in order to prevent the exposure gap from becoming too large.

**Percentage trigger:** All else being equal, the lower the percentage trigger threshold, the more frequent the rebalance. This could be costly, particularly for volatile indices.

**Tax and transaction costs:** the buying and selling of shares of inverse ETFs can have tax consequences, and the need to rebalance for hedging purposes should be weighed against the costs of frequent trading.

*Pat Chiefalo, Director, National Bank Financial*
***pat.chiefalo@nbfinancial.com***

In Canada, investors can access a complete suite of ETF hedging tools that offer downside protection.

# Some Basics: ETFs and Indices

**Exchange traded funds, or ETFs, continued to grow in size, number and variety as their total assets sailed past the $1 trillion mark globally in 2010.**

David M. Blitzer
*Managing Director and Chairman of the Index Committee, S&P Indicies*

*No longer little known specialty products for index investors, ETFs are now in the main stream. As more and more investors are attracted by lower fees and transparency, it becomes more important to educate investors to ask the right questions about both ETFs and the indices they track. Even with the transparency, asking questions, getting answers and understanding the investment products is crucial. In what follows, some of the key queries are discussed.*

### What is an ETF?

***Does an ETF hold stocks?***

Many do, but not all ETFs or similar products hold stocks. In some markets a distinction is made between ETFs which usually hold stock, ETNs (as in exchange traded notes) which are backed by a bank's credit and ETPs (for exchange traded products) which may hold commodity futures contracts, gold, silver or other investments. In other markets an investment called an ETF may hold a swap instead of stocks – a contract where one side promises to pay the other side an amount of money determined by the performance of a market index. So, before assuming that the ETF holds stock, it is worth asking if it does.

S&P INDICES

***If an ETF actually holds stock, does it always hold the stocks in the index in exactly the same proportions as the index?***
Not always. If the index the ETF is tracking is large – like the S&P 500® or the S&P/TSX Composite - it may not own all the stocks. The idea is that by skipping some of the smaller stocks, the savings from lower operating expenses may offset any difference in returns between the index and the ETF's less than exactly matching portfolio. This approach, called "optimizing," is most common with indices with an unusually large number of stocks or indices covering numerous markets in different countries. The idea works as long as the ETF knows which stocks it can afford to skip.

***Does size matter?***
It may. Some small ETFs, well under $100 million in assets, face higher operating expenses resulting in higher fees to investors. Liquidity in an ETF is mostly a function of the liquidity of the underlying assets, but we know that some investors look at the relatively small number of shares outstanding and the lower profile of certain ETFs and may consider them less liquid and somewhat more difficult invest in because of those measures. There is no cut-off in size to serve as a "rule of thumb" because there are too many other factors related to the kinds of stocks tracked by the index, the popularity of the index the ETF is tracking and what sectors of the market are considered "hot". This is a case where a little extra research can provide big benefits.

***Can one find more than one ETF tracking the same index?***
In a few cases, yes. For example, the S&P 500 supports three different ETFs in the U.S. market as well as others in other markets outside the U.S. The index is widely known and used and all the stocks in the S&P 500 are liquid so there is enough trading and volume to support all three ETFs as well as numerous index funds and institutional funds. But, the S&P 500 is an exception to the usual patterns. Most indices don't measure a market offering enough liquidity to support several ETFs. And where there are multiple ETFs, investors should look at them with care to determine which is the best fit for their needs.

***Could an ETF crash and fall apart?***
Nothing is guaranteed, so the answer is yes, it could happen. But look at the details for a moment. If the ETF holds the stocks specified by the index and it somehow collapses, the stock is still there so the value hasn't vanished. It is not like the situation of buying a bond where the bond issuer defaults and never pays. If the ETF holds swaps or is really an ETN backed by bank credit, then there is credit risk: the swap counter-party or the bank might not be able to meet their obligations. Further, if the stock market takes a dive, the stocks go down and so does the value of the ETF holding those stocks.

## What is an Index?

***Is the index investable?***
One might think that since the index is a list of stocks traded on the market, any ETF can really buy all those stocks with ease. Maybe not – some indices are broad benchmarks covering all the stocks in a number of markets. They may include some small, thinly traded stocks which are very difficult to buy. This is the kind of index where an ETF may optimize and skip some of the stocks. This is generally not an issue with large cap stocks in major markets, but it still pays to look under the hood.

***What's all this about weighting stocks in indices?***
Most indices are float adjusted capitalization weighted. That means that the index first excludes the portion of a stock's outstanding shares that is not traded or available in the market. A typical example is where some of the shares are owned by the government or by a shareholder, like the company founder, and will not, or cannot, be traded no matter how the price moves. Second, the weight of each stock in the index is determined by the ratio of its market capitalization compared to the market capitalization of all the stocks in the index. This weighting approach may present some benefits. Changes in stock prices can't push the weights out of sync so the ETF doesn't need to trade stocks from time to time to get the weights back in line. Further, the index will track the market because the market itself is capitalization weighted.

***What about other ways to weight stocks?***
There are an infinite variety of ideas for weighting stocks in indices – equally, by price, by other measures such as revenues, earnings, dividends, or almost anything else. When the weights are changed from market capitalization, there are two kinds of shifts to watch for. First, the size balance will change – if small stocks have their weights raised and large stocks have their weights reduced, the index will behave more like a small cap index and less like a large cap index than it would if it was cap weighted. Second, if value stocks are increased in weight while growth stocks are decreased, the index shifts towards value; and vice-versa. All this probably matters to investors. A lot of academic research over many years suggests that in the long run value stocks and small stocks out-perform growth stocks and large stocks. Note we said, "in the long run," and the long run can be very long indeed. A lot of these weighting approaches, people debate, are doing exactly this - making a cap weighted index tilt towards being a small cap value index in hopes of improving performance.

***What's equal weighting?***
The simplest one to explain – all stocks have the same weight. Many people in fact think that all indices are equally weighted. However, this is not the case. Therefore, investors should be aware that when a capitalization weighted index switches to an equal weighted index, the index will start to behave more like a small cap value index as discussed earlier.

***Are there rules about weighting stocks?***
In some markets there are regulations about how diversified an ETF portfolio must be. This avoids strange cases where one stock is 40% of the entire ETF. A typical rule found in several jurisdictions is the "5/10/40 rule" - meaning no stock can have a weight over 10% and the five largest stocks should not be more than 40% of the portfolio. In these situations, the index weighting may be capped meaning that the size of the stocks is limited by the index construction even though this departs from float adjusted market capitalization.

***Do indices ever change? Should this be a concern?***
Yes, and not really. Indices change because stocks may change (appear or disappear) or may grow or shrink. Therefore, an index needs to adjust so it can follow the segment of the market it is supposed to follow. When an index changes, an ETF tracking that index must adjust its portfolio and this means trading certain securities and thereby incurring expenses. A careful ETF investor should look at how closely the ETF tracks the index and how often the index changes. All this has an impact on the costs of running the ETF, costs that investors must cover if the ETF is to be around for the long haul.

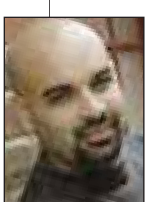
Take Away

Is this all an investor needs to know? Certainly not, it barely scratches the surface. One may never really have enough knowledge. One key is to remember that while ETFs are easier to understand than many other investments, they still must be understood for one to have any hope or opportunity of successful investing.

*David M. Blitzer, Managing Director & Chairman of the Index Committee, Standard & Poor's* ***david_blitzer@standardandpoors.com***

# A Preliminary Research Study on Take Up Rates and Class Action Settlements in Canada[1]

**The validity of settlement amounts in regards to securities related class action settlements for institutional investors.**




Jonathane Ricci
*Managing Director,*
*Canada Claims Management*



Paul Battaglia
*Managing Director,*
*Canada Claims Management*


CANADACLAIMS MANAGEMENT

***This is our preliminary research based on a larger study discussing and analyzing take up rates or claims rates and the validity of settlement amounts in regards to securities related class action settlements for institutional investors.***

It is based on the recent settlement of METZLER INVESTMENT GMBH VS. GILDAN ACTIVEWEAR.

It can be said that Gildan and their insurance provider paid far too little to settle this class action, only having to pay USD $22.5 Million in the settlement.

The worst thing in regards to the class action settlement from the defendant's point of view that could have happened here in regards to the defendants was that Gildan went into the index during the class period between August 2, 2007 and April 29, 2008.

This is normally an occasion for recognition for a corporation and its existing shareholders.

A search reveals that Gildan did not even post the news release dated October 24, 2007 on their website announcing that their stock graduated into the S&P TSX 60 and Composite as of October 31, 2007.

Gildan‟s weighting in the TSX at the time of their inclusion into the S&P/TSX 60 Index was .20%. Currently, as at the time of our research, it is .23%.

Some of the largest institutional shareholders of Gildan in Canada are Index mutual funds and Exchange Traded Funds (ETFs) and Pension Funds.

It was announced on October 24, 2007 that Gildan would be included into the S&P/TSX 60 index as of October 31, 2007. Gildan common shares reached a 2007 high of $43.99 on October 29, 2007 – up $2.70 or 6.54% since the announcement. The day prior to the announcement, it opened at $41.43 and closed at $41.29. On October 25, 2007, the common shares opened at $42.50 or up $1.21 or 2.93% and closed at $42.75 or up $1.46 or 3.54% on the day.

The average daily volume for Gildan common shares trading on the S&P/TSX for the month of October 2007 was 293,874 per day – represented $30,970,066 and $259,161,260 in market capitalization on October 25, 2007 and October 31, 2007 respectively.

In the month of November 2007, 13,657,408 common shares of Gildan traded on the S&P/TSX. The combined total for October 2007 and November 2007 equaled 26,985,971 shares. Based on the historic monthly average, only approximately 6,181,354 shares would have traded if Gildan would not have been included into the index.

Thus, it could be concluded that an extra 7,476,054 common shares of Gildan was traded on the S&P/TSX in the month of November. Based on monthly average price of $38.83, this represented $290,295,176 in market capitalization invested into Gildan common shares.

It can be estimated that an extra 13,562,985 common shares of Gildan traded in the 22 trading days in November and October 25 and October 31, 2007, resulting in approximately $569,645,370 in market capitalization.

Gildan and their insurers got off easy – a handful of claims from Index Mutual Funds or ETF Institutional Investors could have swallowed the majority of the $22.5 million.

Based on the settlement agreement, investors would be deemed to have disposed of Gildan common shares at $26.51.

Investors lost $16.74 per share based on the closing price of $43.25 on October 31, 2007. Thus, the Plaintiffs lost $100,309,277 in market value on the 5,992,191 shares traded on October 31, 2007.

Investors lost $16.24 per share based on the closing price of $42.75 on October 25, 2007. Thus, the Plaintiffs lost $11,765,003 in market value on the 724,446 shares traded on October 25, 2007.

Investors lost $12.32 per share based on the average price of $38.83 in the month of November 2007. Thus, the Plaintiffs lost $92,104,985 in market value on the 7,476,054 ADDITIONAL SHARES (13,657,408 traded in November 2007 or $168,259,266 loss in market value) traded in November, 2007.

Collectively, in these noted 24 trading days, Gildan common shares lost $280,333,546 in market value. This does not include the other trading days between August 2, 2007 to April 29, 2008.

Even weighing in the factors contributing to a valid defense on behalf of Gildan, the following questions should be asked: Who hired the consultant and/or who got lucky? Why was the above data not taken into consideration? Could either party or their Counsel been more aware of what was a stake in this particular class action case?

According to Paul Battaglia, Managing Director and Co-Founder or Canada Claims Management (CCM), based on his 23 years experience in the financial and investment industry, when it comes to investing, “the nuances will destroy you”. Did Gildan dodge a bullet without knowing it? Did institutional investors miss out on winning the lottery? This wishful non-thinking when it comes to the amounts at stake from either the institutional investors or their unit holders has to be addressed. It is in the institution investors and unit holders best interest to file a claim from class action settlements because of the fiduciary duties owed to unit holders.

If you are an institutional investor, know what is at stake. If you are an unit holder or retail investor, don’t leave money on the table yourself. Yes, you want a negotiated settlement. But if either party is well informed, use this information to make informed decisions and use it as leverage – either way. How can you make an informed decision if you do not have all the information?

Canada Claims Management ("CCM") brings a new dimension to class action litigation and settlements in Canada by doing the research to expose the nuances of each case. Based on experience, each investment – especially equities – had a nuance that would make or break the value of the investment. In the case of Gildan, it was announced on October 24th, 2007 that Gildan was to be included into the S&P TSX 60 Index as of October 31, 2007 during the stated ‘class period’.

The perfect storm for Gildan and its insurers. The perfect leverage for the plaintiffs. And based on CCM experience in communicating with Canada‟s institutional Index Investors, a wasted opportunity to reclaim money for their investors and to execute their fiduciary duty.

CCM’s propriety model for Securities related class action lawsuits has twelve points to increase the claims rates. This propriety model also applies to its Claims Administration business through National Class Actions Services. CCM’s and NCA’s twelve point propriety model can be utilized if appointed the Claims Administrator or post appointment of the Claims Administrator to increase the take-up rates of payouts to claimants. Canada Claims Management is the first of its kind in Canada, and upon belief, the first with this propriety model.

Based on Canada Claims Management experience in emailing and calling Institutional Index Investors in Gildan common shares, many institutional investors were not aware of the monetary value of filing a claim in regards to the Gildan class action settlement. In summary, the responses could be classified under five categories.

1. What to do with the Notice once it is received. In one case, Canada Claims Management was told by General Legal Counsel of one ETF firm that “compliance felt it was a corporate issue and corporate didn’t think much of it or understand the significance of the notice”.

2. Emails were ignored. Not until CCM called to follow-up, did they understand the potential. Emails went unopened for both institutional investors and brokers. Significant work is required to get in front of these portfolio managers, chief operating officers, compliance officers, and General Counsel to help them understand the significance of the money involved and their fiduciary duty. Portfolio managers deferred the issue. CCM literally had to tell them what was at stake for them to proceed with only two days before the deadline of March 10, 2011 only after CCM called to follow-up on an email sent on February 15, 2011 that was ignored.

Continued on page 26

Continued from : A Preliminary Research Study... page 25

3 A review of numerous Financial Statements did not disclose any, nor did they account for recovery of, funds from a class action settlement as an asset on their financial statements. This can only be interpreted as them not being aware that they were entitled to reclaim a significant portion from the damages of the class action settlement. Define significant? Well over $1 million dollars in the case of the Gildan class action settlement. Perhaps it is a fair assumption that any corporation would be willing to account for $1 million in assets. Especially after the turbulent and destructive markets between 2007 and 2009. This recovery would go back to the bottom line or net return of the fund(s) in question. What would an investor or unit holder say about recovering $1 million?

What demands should they have on the institutional investor to fulfill their fiduciary duty to actively recovery those funds for the investor or unit holder? Based on National Instrument 81-107 – *Independent Review Committee for Investment Funds*, applying from September 28, 2009, CCM failed to find in its preliminary research any accountability to reclaim funds from class action settlements for many mutual fund companies. Thus, based on one conversation with an Independent Review Committee, this was new to them.

4 Retail investors that Canada Claims Management contacted all said the same thing. They would pay someone to process the claim. They get the notice in the mail and have no inclination to fill it out. Some of the reasons include being 'too legal oriented', 'too convoluted' or just a 'lack of time'. One such investor who occupied a high level position at one of Canada's largest capital markets firms. Another investor, who was a prominent Doctor and business owner, stated he repeatedly ignored these notices. Both would be defined as sophisticated investors. Paul Battaglia, co-founder and Managing Director of Canada Claims Management, in his eight years as an Investment Advisor for two of the largest firms in Canada, repeatedly had clients, drop on his desk the claims forms for him to complete and file for the client. Ironically enough, as an Investment Advisor, he called his co-founding partner of Canada Claims Management, Jonathane Ricci, in 2005, to work on a securities class action claim form for one of his clients.

5 The current business model for institutional and retail investors does not work. Proof of this is in the low take-up / claim rates. To be successful, you have to be innovative to get the attention of the institutional investor to inform them what is at stake monetarily and educate them on how this fits into their fiduciary duty.

In conclusion, according to Jon Ricci, Managing Director and Co-Founder of CCM, the questions we, as professionals wanting to assist the class action process, should always ask in any class action settlement are as follows: (1) How do we get all of the money back into the hands of eligible class members; (2) What is the best Notice and Claims Method to use in doing so; and (3) How do we strengthen the lost faith in the class action claims process?

This preliminary research paper is a work in progress for Canada Claims Management, and we look forward to contributing more material, comments and thoughts to this subject.

**Jonathane Ricci** *is a Managing Director of Canada Claims Management. He attended Michigan State University College of Law from 1995-1998 and became licensed by the state bar of Michigan in 1998. From 1998-1999, he attended Georgetown University Law Centre in Washington DC and obtained an LL.M. in Taxation. He began his career at KPMG in 1999, and went on to co-found a cross border law firm in 2003, Juroviesky and Ricci LLP, where he partnered the U.S. side of the law practice for 6 years. This firm practiced heavily in the area of class actions. Jonathane's main case was as lead counsel in a cross border securities class action involving Michigan and Ontario (FMF Capital) and was an integral team member in achieving a lucrative global settlement for thousands of class members.*

*In addition to his legal experience, Jonathane began providing class action services to other lawyers and administrators in 2009. He had one chief goal - to increase take up / claims rates on class action settlements. Jonathane noticed that far too much money was being left on the table from class action settlements.*

***Paul Battaglia,*** *TEP, PFP, is a Managing Director of Canada Claims Management. Mr. Battaglia has 23 years in the investment and financial services industry. His designations include Personal Financial Planning (PFP), Society of Estate and Trust Planners (TEP), Canadian Securities Course and CPH (retired) and Insurance Licensed (retired) and a B.A. in Law from Carleton University.*

*Paul has international experience in offshore investing, banking, estate and trusts having worked and lived in Dubai, U.A.E. Paul was the Founder Chairperson of STEP Arabia.*

*Since returning to Canada from Dubai in 2003, Paul has been a successful Investment Advisor for the last seven years. During his tenure in the investment industry Paul accumulated experience in investments, personal banking, domestic and offshore estate and trust planning, financial planning and the custodian business. As an Investment Advisor, Paul advised his clients to exit the equity markets starting in the summer of 2007 protecting millions of dollars of capital for his clients.*

Based on experience, each investment – especially equities – had a nuance that would make or break the value of the investment.

# 2011 CALENDAR OF EVENTS

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# It's the End of QE As We Know It (And Hoping to Feel Fine)

*"Many governments have attempted to sustain or boost asset prices after the collapse of asset-price bubbles ... all have failed ... investors will not view asset-price increases brought about by the central bank purchases as being sustainable unless they are certain that the future cash flows generated by those assets will also increase."*

>> **Richard Koo**, Holy Grail of Macroeconomics[1]


**Tyler Mordy**
*Director of Research, Horizons HAHN Investment Stewards & Company Inc.*


When *Q Magazine* interviewed R.E.M.'s lead singer about his 1987 smash single, "It's the End of the World as We Know It (And I Feel Fine)", Michael Stipe responded by saying that "the words come from everywhere. I'm extremely aware of everything around me, whether I am in a sleeping state, awake, dream-state or just in day to day life."

Our own cerebral activity – both of the conscious and unconscious variety – has also been more active of late. Of course, our subject is a different one (and does not have a hip drummer and bass player to back our musings). Global financial markets are at a crossroads. The key question is this: with the Fed's quantitative easing program set to expire at the end of June, will there be an encore? And, given the outcome, what does it mean for investors?

**QE As We Know It.** Some scene setting is necessary to answer this question. Looking back, March 2009 marked the two-year anniversary of global stock market lows. Despite recent market wobbles, it has been an epic run. The broad-based *iShares S&P 500 ETF (NYSE:IVV)* has more than doubled in the last 100 weeks (investors would have to reach back to the 1930s to find a comparable rally). Prices of all types of risk assets – from small-cap stocks to junk bonds – have been similarly bid up. In fact, the biggest rebounds have occurred in the riskiest assets.

But, to be sure, markets have soared on government wings. During the depths of the financial crisis, Washington's liberal use of unorthodox policies were seen as necessary to resuscitate financial markets. Yet, two years and a deficit approaching 11% of GDP later, government activism still remains high.

HORIZONS
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Of course, loose monetary policies always encourage financial speculation. Easy money, like tequila, removes inhibitions. Risk-taking is promoted and penalties for imprudence are temporarily lowered (read: the "Bernanke put" is alive and well). The latest reflationary efforts have been no different, although it has taken some coaxing for some to join the party.

The Fed's second quantitative easing elixir ("QE2") seems to have done the trick. While many private investors spent most of 2009 and 2010 sitting on the sidelines (in cash or fixed income), a veritable stampede back into risk assets occurred since late 2010. US-listed equity ETFs showed net *outflows* of 26.1 and 15.0 billion for 2009 and 2010, respectively, while for the year-to-date period in 2011 alone more than 17.2 billion has flowed into the same ETF category.[3]

**The End of QE? Serial Reflationary Efforts Not Over.** Without question, monetary efforts have played a key role in the rapid re-pricing of risky assets. Since late August, when the Fed announced additional bond purchases were forthcoming, the S&P 500 has rallied more than 20%. Looking ahead, however, Fed officials have signalled an unlikely expansion in the USD 600 billion bond purchase plan. Still, the future is unclear. Even Bernanke has confessed that a self-sustaining expansion is vital before reversing stimulus measures.

For us, the curtain does not rise and fall with the start and finish of QE's first two acts. Although a brief intermission is probable, we are far from convinced that the second instalment will be the last. True, subsequent programs may not be QE as we know it *(and may involve direct purchases of assets other than bonds)*, but monetary activity should remain high. Why? A number of reasons, but consider two – slow-growth and limited policy options.

We have often pointed out the much-cited Rogoff and Reinhart studies. Their main conclusions? Post credit-crisis environments are different beasts. Historically, the aftermath of severe financial crises – such as the one we saw in 2008 – tend to share a number of characteristics. Most importantly, they are always protracted affairs involving a long, corrective period where economies become accustomed to lower aggregate demand. That is currently the case in the United States, Europe, Japan and other advanced nations. Employment, income growth and private credit-formation are all not rebounding fast enough to produce robust top-line GDP growth. That doesn't mean that intermittent growth spurts will not surface but the secular trend is for slower growth and, thus, heightened government responses. As a general rule, the gloomier the headlines, the more activist the government.

The second reason is quite straightforward and applies to the period directly ahead. As austerity gains support around the world, the US – the last holdout of pro-Keynsian policies – will need to shift gears. This is already well-advanced, with Congress under severe pressure to produce meaningful cuts to the deficit. As current stimulus packages move closer to their conclusions, fiscal policy will turn from tail to headwind. That means unconventional monetary action will be the preferred *(read: politically-accepted)* policy lever. Expect further rounds of monetary ammunition to be fired.

**Back To Low Risk Premiums.** For value-oriented and global-macro ETF analysts alike, the current environment presents a dilemma. Worldwide central banks, led by the Fed, have kept monetary spigots wide open, even as asset prices have steadily marched higher. That has been a boon for investors long all types of risk, but it also means the "margin of safety" for a number of asset types has rapidly eroded *(using value investor Benjamin Graham's nomenclature)*. That may be true, some would counter, but "fighting the Fed" has become an exercise of frustration. Better to align with the monetary hegemon and join the party. Other high-profile value investors vehemently disagree, with many returning capital to their investors (some are even packing up for good and heading to the golf course).

What remains true is that investors are rushing into risk at a time when the risk/return tradeoff has dramatically deteriorated, particularly for assets further out on the risk spectrum. This is nowhere more evident than when comparing the performance of large caps, which are typically more stable firms, versus the riskier small cap space. Measured from March 2009's low to the February 2011 high, the iShares Morningstar Large Core Index Fund *(NYSE:JKD)* returned just 95.1%, while the iShares Morningstar Small Core Index Fund *(NYSE:JKJ)* soared over 165%... a full 70 percentage points higher.

Now, to be clear, it is no surprise that lower quality companies have benefited more in the current rally. With typically riskier balance sheets, the most leveraged equities should stand the most to gain. That has certainly been reflected in the earnings of many of these corporations. What's more, there is a "base effect" at work. In general, financial market gyrations act like bouncing balls. The higher their fall, usually the loftier the bounce. During the financial crisis, junkier assets were hit the hardest. More aggressive bounce-backs ought to have been expected.

But there is a limit to all of the above. Monetary machinations cannot be expected to prop up prices forever. Fundamentals cannot be ignored indefinitely. And, consider that investor and analyst expectations are now much more optimistic than just 3 months ago. Asset prices are again pricing in bright future prospects. That means risk markets are much more vulnerable to downside disappointments, whether by economic or earnings-driven data.

If valuation levels are compared across the risk spectrum, it becomes evident that investors are no longer well-compensated in many asset types. Looking again at large versus small caps, trailing price earnings ratios stand at about 16 for the large cap core category and 28 for the riskier small cap index *(about a 150 percent higher ratio than March 2009)*. In the junk bond space, yields on junk bonds fell to a record low of 7.3%[2] *(spreads blew out to over 20 percentage points by March 2009)*. These are not values that Ben Graham opens his wallet for.

**A Prescription For Feeling Fine.** When R.E.M. played their hit single live, the audience reacted with a vibe that caught the band by surprise. They were convinced the apocalyptic lyrics would create a more subdued response, but instead the audience was energized. Similarly, some have expected that anticipation of QE2's expiry would have had more sobering effects on the market. Remarkably, however, it has not generated market instability. Rather, for the most part (recent exogenous events aside), the party in risk has continued.

For us, having long pursued both a risk-oriented and macro-driven approach, we continue to recommend staying further up in capital structures and emphasizing "high quality" ETF assets. The rally since March 2009 has first rewarded the junkiest of assets. But, as in the Scriptural prediction, we expect that the last will again be first.

In bond markets, that means overweighting investment-grade corporates and "safe" sovereigns with sound fiscal positions. In equity markets, defensive large-cap multinationals should be emphasized. They have drastically underperformed their smaller-cap counterparts and stand a better chance a preserving pricing power and growing earnings in the current environment. Higher cash levels should also be maintained, in anticipation of more favourable risk premiums ahead.

*Tyler Mordy, Director of Research, Horizons HAHN Investment Stewards & Company Inc.* **tmordy@hahninvest.com**

**Endnotes:**

1 Richard Koo, *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession*, John Wiley & Sons, Singapore, April 2008.

2 According to Bank of America Merrill Lynch index data.

3 Figures from the National Stock Exchange through to end March 2011.

# Social Media and Financial Planners


**When used effectively, social media is a valuable addition to the marketing mix of financial planners.**

**Neil Bearse**
*Manager of web-based marketing, Queen's University School of Business*

**Betty-Anne Howard**
*Certified Financial Planner, Independent Planning Group*

***Due to the wide distribution and democratic nature of these social tools, it's important for planners to understand they are already involved in the social conversations unfolding online. Word-of-mouth recommendation has existed since the dawn of language, but the social web represents an evolutionary step in communication because it empowers any individual to converse with, and also discover and learn from the experiences of others.***

Stories that were once merely told and overheard at cocktail parties by a handful of friends can now be blogged, tweeted or streamed live to the Web. As such, they have the potential to instantly reach thousands of eyeballs, while being conveniently archived for later retrieval with one click on a search engine.

Podcasting pioneer Gary Vaynerchuk describes this phenomenon as *"word of mouth on steroids."* Indeed, the basic concepts of social communication remain the same; it's just that the stakes are now higher. When confronted with this reality, it's easy to focus on the potential negatives, like worrying about criticism being broadcast for all to see. But the flip side of that coin represents an incredible opportunity for planners who already do their jobs well to get their names before the public.

Queen's SCHOOL OF BUSINESS

### Taking The Next Step... Strategically

For the financial planner who chooses to begin exploring these channels, it is important to start with realistic expectations. Avoid the assumption that since there is often no monetary cost, these channels represent free marketing, and can be used on an ad-hoc basis. What you save in money, you'll be spending in time.

An easy first step is to take some time and simply read and listen to the conversations and commentary taking place online. This allows an advisor to get accustomed to the landscape without feeling the pressure to contribute right away. By simply observing questions and comments posted on Twitter or on blogs across the web, a planner can gain great insights into questions, misconceptions and opportunities that exist within the marketplace.

Cory Papineau, a Winnipeg-based advisor has used Twitter to connect with and learn from other financial planners around the world. Through this channel, he has discovered valuable blogs and industry resources to keep him up-to-date on industry news and trends. He says he gains knowledge simply by observing what others in the industry are doing, and remarks there is a disproportionately small number of Canadian planners using social media. Still, he insists, there are "vast opportunities" for those who do it right.

After becoming accustomed to the landscape, advisors should begin engaging in communities, contributing insights, knowledge and value into the market. It is important to resist the temptation of advertising services rather than answering questions.

Let's say a single parent posts a question onto a social network about how to better save for her child's education. (This question could take the form of blog entry, a Tweet, Facebook message or message board posting). Whatever the source, the same basic strategy applies: advisors should demonstrate knowledge rather than trying to close a deal. The planner who answers the question without resorting to a sales pitch might not ring the cash register right away, but they will earn top-of-mind status as a helpful, trusted professional.

The concept of trust as currency should not be taken lightly.

As Chris Brogan and Julien Smith describe in their book Trust Agents, people are more likely to do business with a known friendly face with a proven track record, rather than engaging a stranger. By developing a solid reputation with social connections – even those who may never do business with you directly – you are creating an environment in which your services and expertise can be recommended in a peer-to-peer fashion. This further extends the value of your efforts and your potential return on investment.

Of course, it's not realistic to assume every potential client is active on social networks, posting their every financial question or concern. Similarly, no planner has the time and attention span to locate, consider and respond to every such post. So, advisors need to create inbound marketing channels for their businesses that allow for their online presences to be discovered by those who are in need of their services.

### Searching For Advice

Increasingly, people make search engines their first step in the information-gathering process. Every month, Canadians use Google or Bing to get relevant content for billions of unique search queries. The engine in turn generates a list of individual Web pages it determines are the most relevant answers to the questions being asked.

Consider for a moment the amount of knowledge surrounding financial advice, investment vehicles and useful strategies that exist only in your mind as an advisor – and then compare that to the content you provide on your web site for search engines to deliver to potential clients.

Contrast the way you converse with a potential client when he or she has contacted you via telephone with the experience provided to a potential client who is on your website. The overwhelming majority of businesses are in this exact same situation: their websites spend time describing how qualified a professional is, rather than actually distributing and demonstrating this knowledge to the visitors reading the page.

By incorporating a blog into a company website, filled with entries devoted to answering common client questions, a financial planner not only begins to leverage the inbound marketing channel, but also creates more value for visitors. This increases their propensity to inquire and engage in a business relationship.

Deborah Kearney, Executive Account Manager, Wealth with Empire Life, says financial websites must evolve from providing information about the business, and instead focusing on creating an *"interactive, user friendly site that would encourage people to come back when they need financial information".*

Ironically, for the planner who's already stretched for time, it is this conceptually arduous step of creating original content that can make entry into social media feasible in terms of time and rewarding in terms of return on investment.

### Get Blogging

Case in point: Take five minutes to write down every question a client has asked you in the last week alone. Each of these questions represents an opportunity to add an original article to your website, in the form of a blog post. There is no expectation each written article be a Pulitzer Prize winning masterpiece, every video be flawlessly edited or every audio clip sound professionally recorded. Begin by simply unlocking the knowledge from your mind and setting it free.

Chances are, if your clients are asking these questions, countless other clients and potential clients are asking the same things. By creating a page devoted to answering each question, you give the search engine a reason to serve up your content as a solution to a potential client's problem.

And, by creating a valuable and useful resource, you are increasing the potential for others to link to your Web site, increasing your traffic and leveraging the power of peer recommendation. Similarly, each piece of content you create is one more item you can share on social networks as a means of garnering trust, reputation and credibility within the community.

"...an incredible opportunity for planners who already do their jobs well to get their names before the public."

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Any addition to a routine that has proven comfortable, successful and profitable should be justified based on its merit, rather than hype. Social media is no different, and the responsible financial planner should not discard previous efforts in traditional marketing, many of which may still be lucrative and successful.

Begin your foray by allocating a few hours each week to testing out these new channels, and focus first on listening. Make use of times when business is slow to generate batches of original content and schedule these for publication over time. (This will let you function efficiently during times when the pace of business increases.) Measure the results and if they're good allocate more time to social media communication.

However you choose to use these new channels, keep their use in the proper perspective. These are not diversions or pet projects to be pursued at the expense of running your business. Instead, they represent a natural extension of what every financial planner already aims to achieve, allowing for the discovery of new opportunities to communicate ideas, knowledge and expertise. While these new channels may, at first glance, appear drastically different from what financial planners are used to, when measured against the ultimate purpose of professionals in this field, it becomes clear they simply represent another means of enabling more clients to achieve their goals, ambitions and dreams.

*Neil Bearse, Manager of Web-based marketing at Queen's University School of Business in Kingston, Ontario.*
neil@twosix2.com

*Betty-Anne Howard, CFP,*
*Independent Planning Group in Kingston, Ontario.*
bettyanne@teamipg.com

# CLAYMORE ETFs

## WE BELIEVE IN LOW-COST, TRANSPARENT, AND PASSIVE INVESTING... BUT WITH A LAYER OF INTELLIGENCE

## How We're Different:

- ### Intelligent Indices

  We believe that passive index investing does not only mean market-capitalization, and that there can be thoughtful intelligence behind how an index weighs securities.

- ### Tax-Efficient Distributions

  Several of Claymore ETFs use innovative Forward Agreements to provide investors with Return of Capital distributions.

- ### DRIP/PACC/SWP On All Claymore ETFs

  Claymore's DRIP, PACC, and SWP programs, winner of the 2010 Canadian Investment Award for Best New Initiative, allows investors to reinvest dividends, make regular contributions or income stream from their investments without having to pay additional fees.

- ### Advisor Class Offering

  Only Claymore ETFs offer the flexibility to choose between Common Class shares for fee-based clients or Advisor Class (.A) shares that pay an ongoing trailer fee for commission accounts.

# Maslow's Hammer

## An ETF Screener for Portfolio Managers.

**Mark Yamada**
*President & CEO,*
*PUR Investing Inc.*

***"Give a small boy a hammer and he will find that everything he encounters needs pounding."***
***Abraham Kaplan, 1963***

Abraham Maslow refined and popularized this idea: "if all you have is a hammer, everything looks like a nail". Such was the case when my colleagues and I began working with exchange traded funds (ETFs) in 2001. The financial services industry's most important tool, the mutual fund, shaped how every retail investment product and problem was viewed and analyzed, ETFs were no exception.

It didn't matter much back then because there were so few ETFs, 100 in the United States and just ten in Canada, so sorting them wasn't an issue. Portfolio construction was also pretty simple. We created an array of portfolios using "top down" construction. ETFs were generally groups of securities, so "bottom up" starting with stock selection, wasn't an option. We systematically developed asset mixes in a very conventional way; 80% equity, 20% bonds, 60:40, 50:50... and allowed for regional preferences like all Canadian, all U.S., all global, global no U.S. etc.. By the time we accounted for registered and taxable variations there were over 1,200 possible discreet portfolio mandates. Even by today's standards this sounds complex but if systems are built around the client, it is relatively easy to mass customize portfolios.

PUR INVESTING INC.

By 2006, when a core team of us established PŮR Investing Inc. to provide better solutions for individual investors, there were about 600 ETFs and exchange traded notes (ETNs) globally. Today there are over 3,100 exchange traded products (ETPs) encompassing ETFs and ETNs with over 225 in Canada alone.

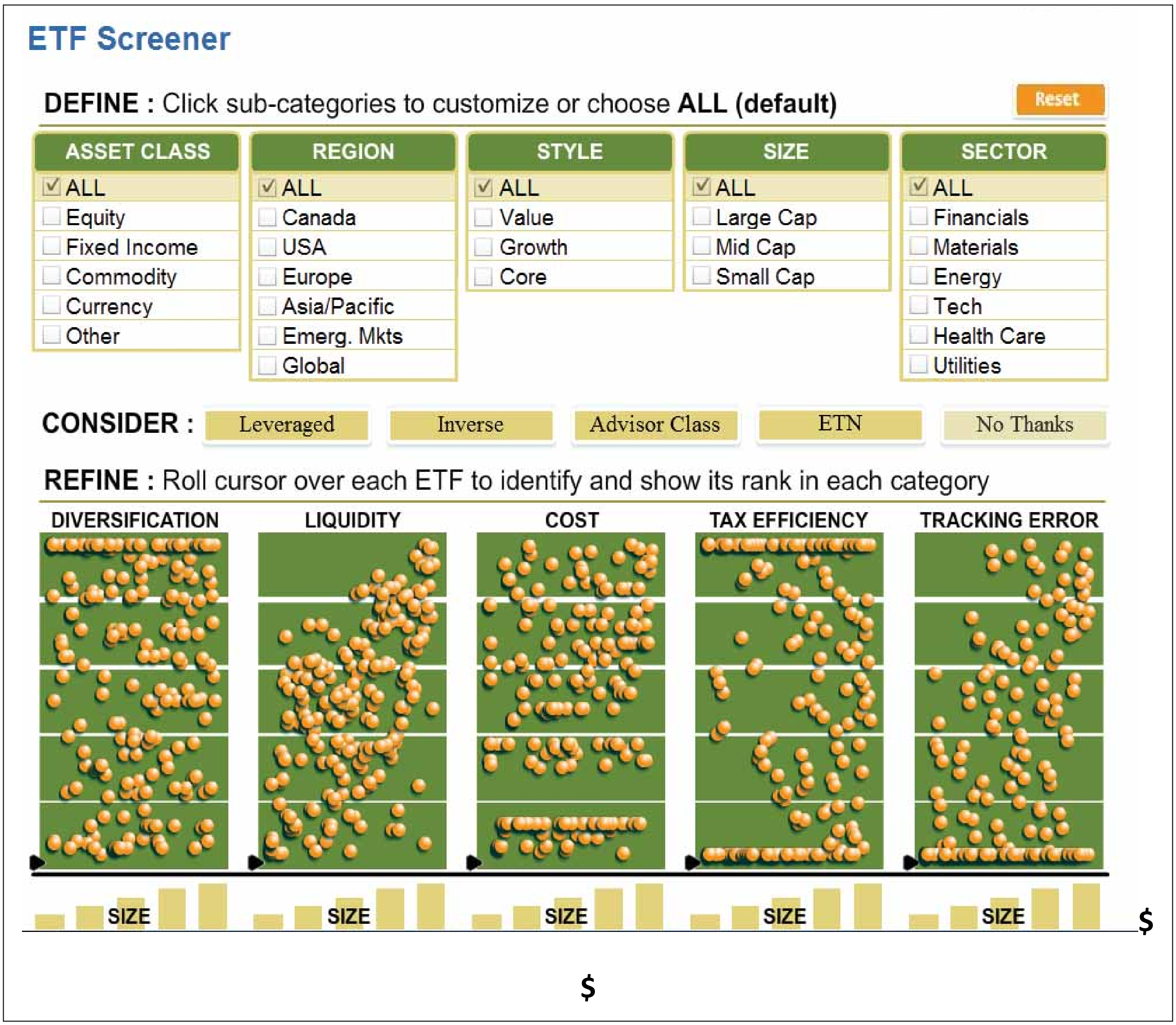
Not only did the number of products expand, but so did our understanding of unique relationships between elements of ETFs. We significantly improved portfolio construction as a result. But we needed to organize ETFs to better arrange and analyse information to use the exceptional characteristics of these efficient risk vehicles. Traditional mutual fund screeners couldn't help us, so we built our own.

### Mutual Fund Holders Can Only Guess About Risk

An industry dominated by mutual funds simply plugged ETFs into the same screeners; a good example of Maslow's Hammer! The Morningstar Style Box™, a cornerstone of mutual fund analysis, was extended to include ETFs. Style (value/growth/blend) and capitalization (small/mid/large) are interesting because they simplify screening and have broad recognition within the industry, however other measurable and arguably more valuable characteristics should be included. The transparency of ETFs makes analysis of actual holdings possible. Most mutual funds report their holdings quarterly, so positions are often three months stale before unit-holders see them. As a result, mutual fund holders can only guess about the risk to which they are exposed. Because index holdings are known, ETF diversification is known. Diversification is the primary tool for controlling risk for most institutional portfolio managers, advisors and investors, so having this information is a material boon to informed decision making.

### A Screener For Investors

Most screeners are geared to trading. We designed the version of the PŮR Screener, adopted by the TMX Money site **www.tmxmoney.com/en/sector_profiles/exchange_traded_funds/screener.html** for investors (see below). Trading-oriented tools prominently display historical performance, biggest percentage movers, highest volume etc. Investors should not care about historical performance at all. They know that past performance is no indication of future performance. Trading information is available elsewhere on the TMX Money site for those who need it.

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### DEFINE
We included Asset Class, Region, Style, Size, and Sector to help mutual fund refugees start to navigate the ETF world with familiar terms. These categories are also useful for finding specific ETFs that might provide something different for an existing portfolio or for quick sorting. Click "Equity", "Canada" to see the list focus.

### CONSIDER
You may want to deselect specialty ETFs that are Leveraged, Inverse, Advisor Class, or ETNs (with credit risk). These take specialty knowledge or have a different purpose. Click No Thanks to deselect.

### REFINE
As your selection narrows, notice that the dots start to disappear. Each dot represents an ETF's position in each of the five factors discussed below. Roll your cursor over one to see it, it's MER and how it ranks in the other areas. Click on it and get more information. We wanted to know which ETFs had the largest dollar value outstanding so we placed those towards the right side of each box. Looking for the highest ranked in each category? Click and hold the small black slider arrow (on the left side of each box). Slide up to focus your search.

### Most important considerations
We focus on five primary elements in screening ETFs, diversification, liquidity, cost, tax efficiency and tracking error. The two most important are cost and diversification. You never know where markets are going or what returns will be in the future, but you know what you will pay. In a world of uncertainty, what you know is a good place to start.

### COST
ETFs are less expensive than mutual funds. But why are some ETFs more expensive than others? Here is an example of two ETFs based on the S&P/TSX 60; iShares XIU (0.17%) and Horizon BetaPro HXT (0.07%). In this case both ETFs attempt to replicate the performance of the S&P/TSX 60 index of Canadian stocks. The difference is in the way they do it. XIUs fully replicate the index by buying the exact holdings in the exact weighting of the index. HXTs use futures to replicate the index's performance. Both have advantages and disadvantages. HXTs bear credit risk from the future's contract, (a disadvantage), but they completely avoid any income or capital gains until the swap is rolled (and even then there are mechanisms to dampen or defer the impact) and that is good from a tax standpoint. An added advantage is that HXT can deliver their strategy at a lower MER as a result. Which to choose? Institutional investors may be less comfortable assuming credit risk, don't care as much about tax efficiency (XIUs are reasonably tax efficient already) and may want the flexibility to take delivery of underlying securities as part of other strategies and will prefer the XIU. Individual investors in taxable accounts will like the tax efficiency of the HXT and the 0.07% MER is hard to resist even when there is some credit risk. We use both for client portfolios.

### DIVERSIFICATION
A well diversified ETF is one than minimizes the investor's exposure to any one holding. In the DIVERSIFICATION box on the screener, we rank all TMX-traded ETFs based on how diversified they are. This is important to Investors because some ETFs, like iShares Capped Information Technology ETF (XIT) with only five holdings are quite concentrated compared with iShares Russell 2000 (XSU) with 2,000 holdings. Caveat. This category does NOT tell you whether a particular ETF is most diversifying or whether adding it to YOUR portfolio will increase the whole portfolio's level of diversification or not. This capability is part of the portfolio construction tool available only to professionals (for now).

### LIQUIDITY
The ability to trade at a specified price is important in managing costs. Large differences between bid and asked prices impacts returns. Being able to trade large positions is important for institutional or large investors but is less important for individuals. We consider bid-asked spreads and trading volume equally in determining the LIQUIDITY of an ETF. The most liquid are at the top of the box. ETFs have a mechanism through designated brokers that makes them unique. While reported volume may be small or even non-existent, designated brokers can create or retire units to meet demand on either side of a trade. In other words ETFs are far more liquid than trading volume alone may suggest.

### TAX EFFICIENCY
Taxable investors benefit if income and capital gains distributions are kept to a minimum. Not only are tax liabilities minimized, but more money is allowed to compound for the investor. We use distributions as the guide to TAX EFFICIENCY; lower distributions are higher in the box.

### TRACKING ERROR
After working to identify an index for investment, it would be frustrating if the ETF couldn't follow it very well. We compare the value of all assets in an index to the value of the corresponding ETF. Perfect tracking would be a zero difference and would be towards the top of the box.

### List ETFs
There is an orange button at the lower right corner of the page that will allow you to list the ETFs selected. We ranked them by COST (lowest at the top) but you can rank them by any factor by clicking on the category at the top of each column.

You are ready to build a portfolio armed with ETF-specific information. We'll discuss some different approaches to portfolio construction in future articles. In the interim for more information, go to the PŮR Investing Inc. website **www.purinvesting.com.**

When looking for ETF information beware of Maslow's hammer. ETFs offer so much more than mutual funds that the tools need to reflect this new value. If mutual fund companies, banks or sales people try to pound you with their hammer, bring out your big shiny new ETF screw driver and give it to them! That would be a change!

*Mark Yamada, President & CEO, PUR Investing Inc.*
***myamada@purinvesting.com***

"If all you have is a hammer, everything looks like a nail"

~ Abraham Maslow