CANADIAN
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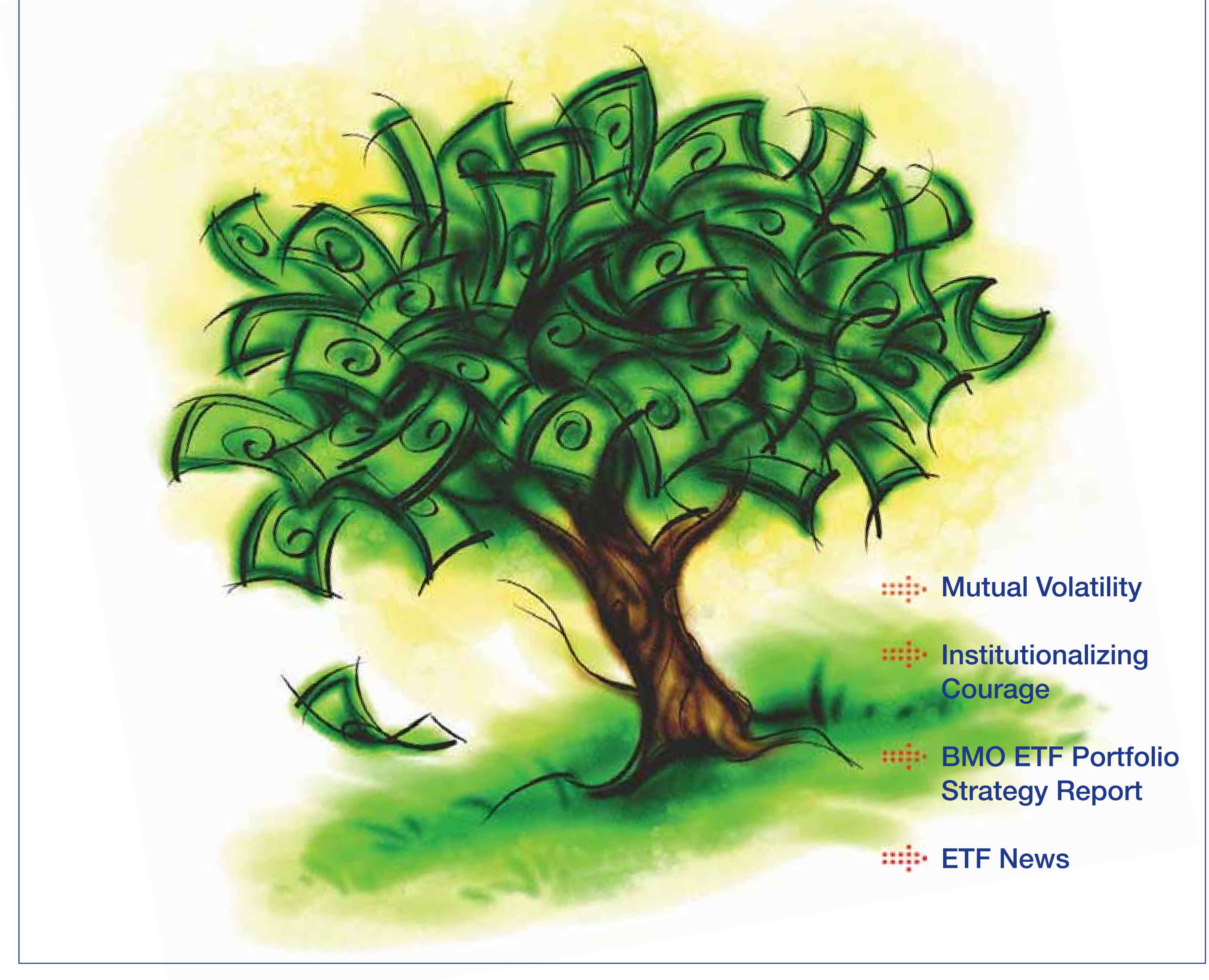
Low Volatility:
Everything You Wanted in an Investment… and Less



IndexUniverse.com just released its Q2 ETF Fund Flows data

Highlights from IndexUniverse Q2 ETF Fund Flows data include:

- Investors poured $76.44 billion into ETFs in the 2012 first half, as total U.S.-listed ETF assets, including market movements, rose 11 percent to $1.179 trillion.
- In the second quarter, they plowed $20.41 billion into exchange-traded funds, with assets rising in the quarter by more than 9 percent to that $1.179 trillion level.
- In June, investors added $13.11 billion into ETFs, and total assets – including market movements – rose 3.7 percent to that same $1.179 trillion figure.
- Bond funds loomed largely in both the first half – particularly in the second quarter, when investors added more than $18 billion to U.S. and international bond funds alike. Bond-fund inflows totaled more than $35 billion in the whole first half.
- The single most popular fund in the second quarter was the iShares iBoxx $ Investment Grade Corporate Bond Fund (NYSEArca: LQD). It pulled in $2.56 billion in the quarter.
- The least-popular fund in the quarter was the PowerShares QQQ Trust (NasdaqGM: QQQ), which bled a bit more than $2 billion in assets.
- Still, as an asset class equities ETFs still had net inflows of more than $7 billion in the second quarter and more than $36 billion in the entire first half.
- The most popular fund in the first half was the Vanguard MSCI Emerging Markets ETF (NYSEArca: VWO), which pulled in almost $7.5 billion in the first six months of 2012.
- VWO's place at the top of the first-half inflows list was a perfect representation of Vanguard Group's ongoing success at attracting assets with its low-cost, pure-beta approach to money management.
- Valley Forge, Pa.-based Vanguard, the No. 3 U.S. ETF firm by assets, hauled in more than $29 billion in the first half of 2012.
- That was a fair amount more than the $10.33 billion the No. 2 ETF firm, State Street Global Advisors, pulled in, and also topped the $16.22 billion that the world's biggest ETF firm – BlackRock's iShares unit – pulled in during the first half of the year.

You can read the full article at **www.indexuniverse.com/hot-topics/12450-q2-etf-flows-bonds-and-vanguard-rising.html**

Wishing all of you and your families a safe and happy summer.

Sincerely,

Judy Street, Vice President
Radius Financial Education

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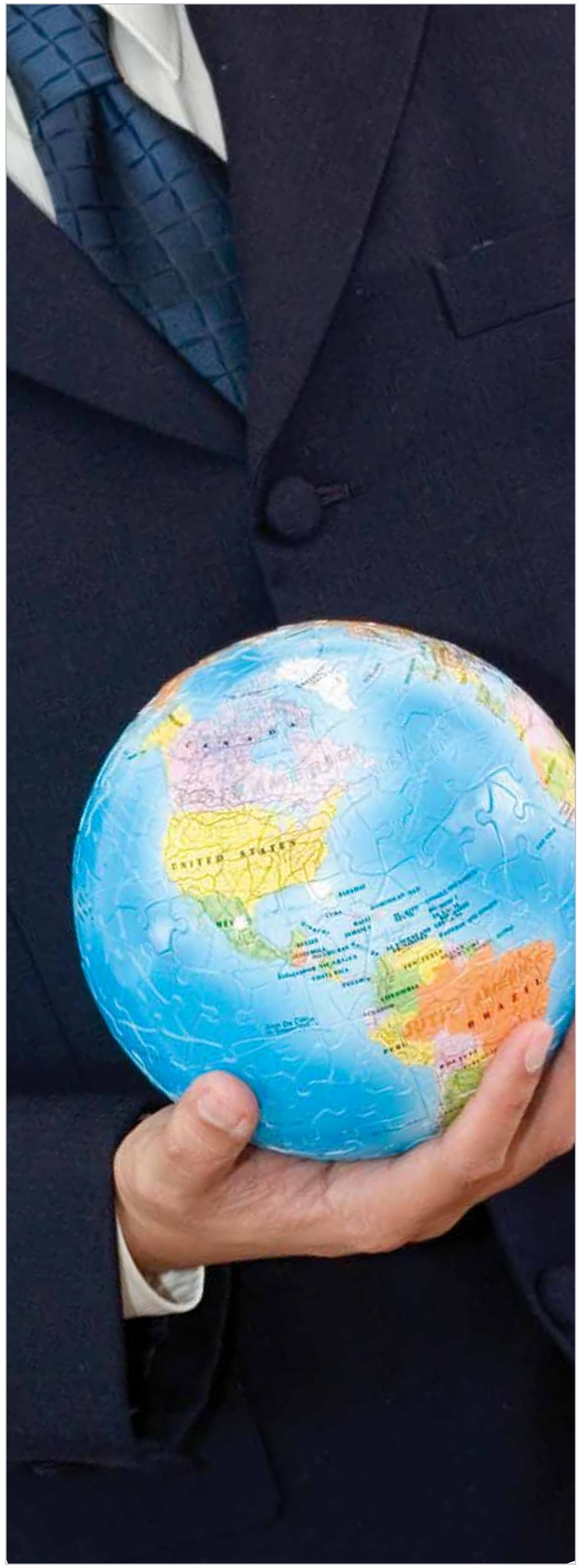

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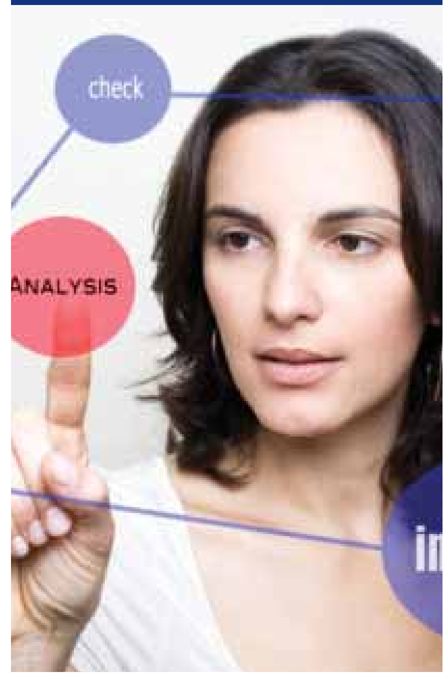


Types of ETFs

*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

Low Volatility: Everything You Wanted in an Investment... and Less

The Low-Volatility Anomaly

Michael Cooke
Head of Distribution
PowerShares
Canada

The concept of low-volatility investing is not new to investors, but it has taken on more relevance in the last five years as institutional and retail investors have become more averse to market volatility and more focused on risk avoidance.

Intuition would tell us that low-volatility (low-risk) investing would lead to lower returns. Reconstructed performance data (see tables on opposite page) from low-volatility indexing has generated about 25%–35% less volatility (as measured by standard deviation) over the long term versus capitalization-weighted indices such as the S&P/TSX Composite Index or the S&P 500 Index.

But, there is more value to low-volatility investment than its reduced risk. This investment approach has historically resulted in higher relative performance compared to cap-weighted indices over the long term. A low-volatility portfolio of equities may offer a better way for long-term investors to own equities – even if they aren't looking for lower risk exposure.

Better returns with less risk defies the logic of investment theories such as the Capital Asset Pricing Model (CAPM), which tells us that the expected return of a security or portfolio equals the risk-free rate plus a risk premium. In other words, in an efficient market, proportionately higher risk should be rewarded with proportionately higher returns. According to the CAPM, the market portfolio (cap-weighted) is expected to provide the highest level of return for its level of risk, while the low-risk, low-volatility portfolio is expected to provide commensurately lower returns.

Time and again, empirical analysis has suggested that the market portfolio is not efficient. Historically, the cap-weighted portfolio has not priced risk appropriately and fails to deliver enough additional return to compensate an investor for the additional risk taken compared with the risk-return of the low-volatility portfolio. In academic circles this has been called the low-risk or low-volatility anomaly, whereby higher risk does not always translate into higher returns.

With this in mind, equity investors may wish to consider low volatility as a long-term investment - not just a "trade" during risk-off periods in equity markets.

Annualized returns as at June 30, 2012

Index	Index creation date	1-yr	3-yr	5-yr	10-yr
S&P/TSX 60 Index	August 1999	-10.57%	4.54%	-1.01	7.65%
S&P/TSX Composite Index	1977	-10.25%	6.69%	-0.74%	7.56%
S&P/TSX Composite Low Volatility Index	April 10, 2012	9.18%	19.03	3.14%	9.37%
S&P 500 Low Volatility Index	April 20, 2011	14.26%	18.64%	5.11%	7.75%
S&P 500 Index	1957	5.45%	16.40%	0.22%	5.33%

*Index data shown before these creation dates have been reconstructed and are calculated on a basis consistent with their current basis of calculation. The reconstructed performance is hypothetical and for illustrative purposes only. You cannot invest directly in an index. Index performance does not reflect fees and expenses that would be applicable to a fund. The hypothetical performance data for the Indices should not be taken as indicating that if the Indices had, in fact, existed during the shown time periods before their creation that these Indices would have achieved the hypothetical results shown as actual results might have differed.

	Annualized Return[1]	Standard Deviation[1]
S&P/TSX 60 Index	6.00%	16.1%
S&P/TSX Composite Index	6.23%	15.75%
S&P/TSX Composite Low Volatility Index	10.92%	10.00%

[1]Source: StyleADVISOR, for the period August 31, 1999 to June 30, 2012, in CAD*

	Annualized Return[1]	Standard Deviation[1]
S&P 500 Index	9.14%	15.02%
S&P 500 Low Volatility Index	10.61%	11.26%

[1]Source: StyleADVISOR, for the period December 31, 1990 to June 30, 2012, in USD*

Can the low-volatility anomaly persist into the future?

Can the low-volatility anomaly continue to reward investors with better returns for less risk? The answer lies in an analysis of what has created the anomaly in the first place. Behavioral biases have historically led to investor demand for higher-volatility stocks that is not warranted by fundamental valuations. Such behavior is based on the inability of many investors' to evaluate small differences in probabilities – especially when large outcomes are possible – creating an apparent preference for riskier assets, which become "overbought," consequently leading to their underperformance.

Another key contributor to the low-volatility anomaly is the "limits to arbitrage." In these situations, institutional investors may be constrained or reluctant to deviate from index benchmarks, which may limit the opportunity to arbitrage between overpriced stocks and undervalued stocks. A common mandate for many money managers is to maximize the information ratio relative to a specific benchmark: in other words, maximize the active return while minimizing tracking error versus the benchmark.

Having a benchmark makes institutional investors less likely to exploit the low-volatility anomaly. Given the choice between investing in two stocks (both with the same expected alpha but one having a beta of 0.75 and the other having a beta of 1.25), the manager may invest in the higher-beta stock, which is expected to generate higher total returns with the same tracking error versus the benchmark, thus maximizing the information ratio. Both stocks involve the same amount of active risk (they deviate equally from a beta of 1.0), but the higher-beta stock offers the benefit of being levered to the positive returns of the market, offering higher expected active returns. With so many money managers acting under this mandate, high-beta stocks end up being overbought, leading to future underperformance, while low-beta stocks can end up being oversold, leading to future outperformance.

In summary, the combination of irrational investor demand for high volatility and investment managers with fixed benchmarks flattens and even inverts the relationship between risk and return.

Ideas into action

How can investors take advantage of the low-volatility anomaly when building their own portfolios? PowerShares Canada offers two TSX-listed solutions that provide low-cost, liquid exposure to low-volatility portfolios. The funds, which use a volatility-weighting scheme and rebalance on a quarterly basis, ensure that stocks exhibiting increasing volatility over the course of the year will have their weights ratcheted down or be replaced completely.

PowerShares S&P/TSX Composite Low Volatility Index ETF (TLV):
- **Management fee:** 30 bps
- Consists of the 50 stocks from the S&P/TSX Composite Index with the lowest realized volatility over the past 252 trading days as of the most recent quarterly rebalancing
- **Dividend yield:** 4.19%†

PowerShares S&P 500 Low Volatility (CAD Hedged) Index ETF (ULV):
- Management fee: 35 bps
- Consists of the 100 stocks from the S&P 500 Index with the lowest realized volatility over the past 252 trading days as of the most recent quarterly rebalancing
- Dividend yield: 3.24%†

Benefits:
1. **Portfolio diversification:** Exposure to a broad basket of Canadian or U.S. equities instead of stock picking low-volatility securities
2. **Low ownership cost:** Due to their efficient structure, TLV and ULV feature very attractive management fees (30 and 35 bps, respectively)
3. **Transparency:** TLV and ULV report their holdings on a daily basis, allowing investors to see the stocks that underpin the ETF
4. **Flexibility:** TLV and ULV offer investment flexibility, giving investors the freedom to buy and sell shares throughout the trading day on the TSX.
5. **Income:** Both funds offer dividend yields that can provide additional dividend income.

Michael Cooke,
Head of Distribution, PowerShares Canada
michael.cooke@invesco.com

[1] Quoted dividend yield are for the applicable index as at June 30, 2012, and should not be construed as an amount an investor would receive from the ETF and is subject to change.

Commissions, management fees and expenses may all be associated with investments in exchange-traded funds. Exchange-traded funds are not guaranteed, their values change frequently and past performance may not be repeated. Please read the prospectus before investing. Copies are available from Invesco at www.powershares.ca. Not all PowerShares ETFs are based on intelligent indices.

There are risks involved with investing in ETFs, including the risk of error in replicating the underlying Index holdings. Please read the prospectus for a complete description of risks relevant to the ETF. Ordinary brokerage commissions apply to purchases and sales of ETF units.

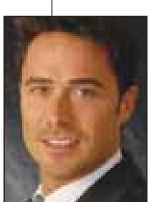
Each PowerShares ETF seeks to replicate, before fees and expenses, the performance of the applicable Index and is not actively managed. This means that the Sub-advisor will not attempt to take defensive positions in declining markets but rather continue to hold each of the securities in the Index regardless of whether the financial condition of one or more issuers of securities if the Index deteriorates.

This piece was produced by PowerShares Canada, a registered business name of Invesco Canada Ltd.

Mutual Volatility

"Restricting or eliminating the [ETF] business will not solve the sovereign debt crisis in Europe, will not balance the US budget, will not restore bank balance sheets, will not add jobs, and will not repay consumer debt and get them spending again. There are very large, very real uncertainties that are driving global financial market volatility."

Eric Noll's testimony before the Securities Subcommittee Of the Senate Banking Committee



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

In the froth of all financial innovations, fact becomes blurred with fiction. The evolving ETF story has been no different. Recently, however, the froth has lathered itself into a crescendo of misinformation. Indeed, the last year reads like a thriller novel – an imprisoned rogue ETF trader from a Swiss bank, a US congressional hearing and, even globe-trotting stock picker Mark Mobius has taken a swipe at ETFs[1].

Most of the mud-slinging focuses on ETFs' ostensible link with "unprecedented" market volatility. While these claims have enriched the ETF narrative, critics are confusing causality with correlation. Fortunately, these imagined aspects are wearing down, leaving exposed the bare facts.

The real culprit of increased volatility? By far, it is driven by human responses to global macro instabilities, not the emergence of ETFs or any other investment vehicle… "mutual" funds included.

HAHN INVESTMENT STEWARDS

Consider the following counterpoints:

Volatility spikes are nothing new

Like maple syrup for Canadians, "animal spirits" – that colorful name Keynes gave to human overconfidence – are a staple of financial markets. In periods of prosperity, this naive optimism naturally leads to higher complacency and a broad underestimation of risk. However, these are the timeless and essential ingredients for surges in volatility, as instabilities "unexpectedly" surface (when, in fact, they have likely been building for some time).

Looking at the chart, the misuse of the term "unprecedented volatility" since 2008 is apparent. We have been here before. In fact, the peak in market volatility dates back to "Black Monday's" crash of 1987 – prior to ETFs' foray into financial markets. Several macroeconomic events since then have triggered episodes of similar magnitude. Extending this chart further back would also reveal comparable volatility spikes and regime changes.

ETF data is non-correlated with volatility

The growth in ETF assets shows no correlation to broader market volatility. Looking at the period 2000 – 2005 is illustrative. The chart shows total ETF assets under management rising from USD 74.3 billion at year-end 2000 to more than USD 400 billion by the end of 2005. At that same time, volatility was moving in the opposite direction – trending lower. Since then, total ETF assets steadily marched higher to USD 1.45 trillion, yet volatility has been... well, volatile – again showing no correlation.

What's more, in today's globalized financial markets, volatility measures – whether taken in the US, Japan or Europe – are all highly correlated. Yet, the ETF spaces have developed very differently in these regions and account for very different ratios of domestic market capitalization.

Periods of increased volatility correspond with regime changes

In financial markets, a law of excess applies. Prices – and emotions – tend to run to extremes. Capital becomes braver in bull markets and more timid in bear markets. And, like the present, volatility becomes more pronounced as uncertainties remain stubbornly high. In fact, this has been the case since the turn of this century.

Not surprisingly, this corresponds with the onset of the current secular bear period. Since 2000, intraday price volatility of 4% or more occurred at 6 times the average frequency during the 1960 – 2000 period[2]. Expect this trend to continue as we enter the third period – the most emotionally charged – of the current secular bear. Importantly, these are trends clearly unrelated to ETF development.

Volatility soars on government wings

It is no secret that government activism has surged since the onset of the global financial crisis. But, less known, is that deficit-driven economies will experience more frequent bursts and lapses in growth, speeding up the cyclical rhythms compared to "normal" cycles. Why? Because private sector driven expansions typically produce organic, sustainable, and long-lasting recoveries. Government-fueled expansions do not.

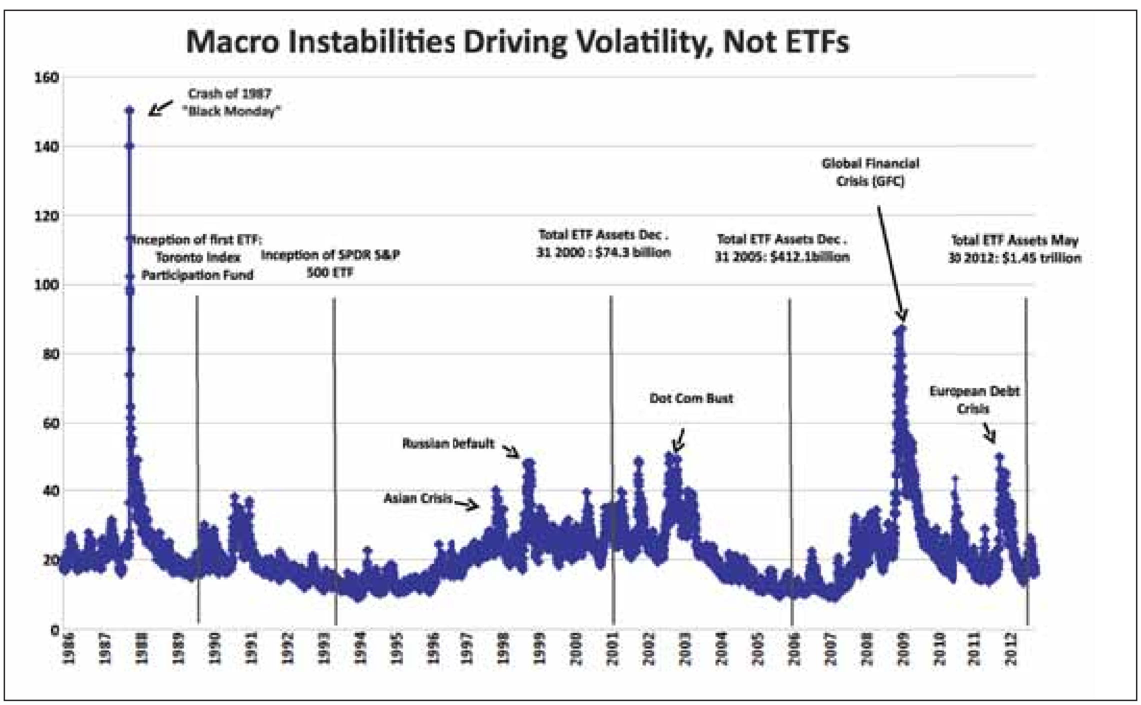
The above observation is closely correlated with trends in volatility. Currently, world economies have trouble returning to "normal" growth, despite enormous monetary and fiscal stimulus. 2010, 2011 and 2012 witnessed a similar pattern. The year begins with hopeful expectations (driven largely by renewed stimulus initiatives) and, by mid-year as growth fades, pessimistic outlooks and attendant volatility resume. This merely reflects the tug-of-war between economic realities and increasingly frantic policy responses. Expect these episodic surges in volatility to continue.

What to make of the above? In short, "macro" continues to matter. During periods of heightened volatility like today, security prices are largely driven by big picture factors. That leads to shared fundamentals and higher correlations among individual securities – a key reason for the booming popularity in ETFs. In this environment, the static 60/40 portfolio construct is increasingly dissonant with economic and financial realities. A better approach dynamically allocates by risk factors, instead of rigidly clinging to traditional asset class definitions.

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

Endnotes:

1. http://business.financialpost.com/2011/10/25/brace-for-volatility-and-beware-etfs/
2. Data from the New York Times.



Source: CBOE, ICI, Blackrock

Institutionalizing Courage

Understanding the true nature of wealth, income, and spending.

Robert D. Arnott
Chairman & Founder

Imagine a boss who is generally supportive of your efforts, but has some odd tendencies around rewarding initiative. Let's call him Mr. Market.[1] Every time you go in for your annual review, Mr. Market gives you a raise which is usually 1% or 2% above inflation, and asks, "Whaddya think?" If you're "passive" and take whatever Mr. Market offers, you wind up with a steady but modest increase in your income, year after year, assuming the company is still doing well.

Mr. Market, however, does not view all projects equally. If you offer to take over some project that he hates, he boosts your raise by an average of 3–6%. With a little initiative, you can triple the average real raise – over and above inflation – that everyone else is getting.

Unfortunately, Mr. Market is also bipolar, with wide mood swings. If you're willing to take on a project that he really hates, he may give you a 15% raise, just to get it off his desk. On the other hand, if you're taking a project that he doesn't much mind doing, he may actually take away some of the normal raise. Because you run this risk every time you propose to take on a new project, it takes a modicum of courage to make these offers to the boss.

With a boss like Mr. Market, what is the right strategy for success? The answer is obvious: You need the courage to stick with the profitable strategy through the good times and the tough times. We'll come back to Mr. Market shortly. First, we need to understand the true nature of wealth, income, and spending.

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Sustainable Spending as a Strategy

Although people tend to measure wealth in terms of the dollar value of a portfolio, we believe it is better to measure wealth in terms of the real spending that the portfolio can sustain over the entire life of the obligations served by the portfolio. In 2004, we coined the expression "sustainable spending," to gauge this true value of a portfolio.[2] Jim Garland used the term "portfolio fecundity," to describe much the same concept.[3]

Consider a simple thought experiment. It's a bull market. Prices double on everything we own, while the dividend yield drops in half. Are we better off? The long-term spending that the portfolio can sustain hasn't changed a bit. In 1997, Peter Bernstein and I[4] pointed out that bull markets are actually very bad news for those who are net savers, building a portfolio to fund future needs, because it costs more to buy the same real income stream (a very crude measure of sustainable real spending[5]) after the bull market than before. We're better off only if we're spending from the portfolio immediately, not saving more for the future!

Many people felt jubilation at the peak of the tech bubble, because they felt so wealthy. And they were – as long as they were inclined to liquidate their holdings and spend before the market lost its euphoria. If they were still investing (e.g., for some future retirement), those new purchases bought precious little yield! Reciprocally, people felt panic and dismay at the 2009 trough of the financial crisis, because they felt as if their assets had been wiped out. And they were – if they intended to liquidate and spend their assets immediately. But, for the buy-and-hold investor, their real income was higher than at the 2007 peak!

None of this is unfamiliar to the serious student of capital markets. So, what lessons can the thoughtful observer learn from "sustainable spending"? In the following discussion, we find bear market drawdowns have little impact on sustainable spending. Indeed, these sell-offs provide opportunities to increase our sustainable spending through disciplined rebalancing between asset classes or within asset classes, especially volatile ones like equities.

This requires courage: "no guts, no glory."[6]

What is Wealth?

Ben Graham liked to distinguish between a temporary loss of value and a permanent loss of capital. The former is a rebalancing opportunity; the latter is a disaster. In a highly diversified portfolio where all the idiosyncratic risk has been diversified away, the latter is extremely rare. At some time during the 20th century, the stock markets of Argentina, Russia, Germany, Japan, China, and Egypt each went essentially to zero. Suffice it to say those investors had much bigger things to worry about than their stocks! Temporary losses of value are frequent; at times they can become so frightening that they become permanent – for those that sell.

Through the lens of sustainable spending, these losses are far less severe. Table 1 illustrates the 10 bear markets larger than 30%, in real total return, in the past century. These aren't as rare as most people think! The average loss is a horrific 46% real return loss (including dividends, but before taxes). Our nest egg is chopped in half, usually in less than two years. That's awful… for anyone who wants to spend all of their money at the trough.

For those focused on the spending power of the portfolio, most of these monster bear markets were surprisingly boring. The peak to trough decline in real dividend distributions was a scant 3% drop, on average. Even in the Great Depression, real dividend distributions fell by "only" 25%. Of course, the drop was worse in simple nominal terms, because we had deflation. A 25% cut in real spending power on our portfolio, while very unpleasant, was small relative to the 80% real loss of portfolio value… and it was temporary. This 25% drop in our real spending power was the single worst outlier in a century.

On average, real sustainable spending sagged slightly during these 10 worst bear markets, then recovered massively, on average by 35%, off of their lows just five years after the market trough. In almost every case, our real distributions also achieved new highs, relative to our pre-crisis spending, besting the dividends of the previous market peak by an average of 29%! Keep in mind that this is the increase in real dividends, not just nominal payouts.

Table 1. Total Returns vs. Sustainable Spending in U.S. Bear Markets Over 30%, 1912–2011
S&P 500 from 1926; Shiller data before 1926

		Total Drawdown In:		Five Years Later Dividend Growth	
Peak	**Trough**	**Real Total Return**	**Real Dividends**	**From Trough**	**From Previous High**
Nov '15	Nov '17	-40.9%	1.6%	-3.1%	-1.5%
Aug '29	Jun '32	-79.3%	-24.7%	73.4%	38.2%
Feb '37	Mar '38	-50.0%	-14.0%	11.6%	-4.1%
Sep '39	Apr '42	-40.1%	1.8%	16.2%	18.3%
May '46	Feb '48	-35.7%	7.5%	99.5%	114.5%
Nov '68	Jun '70	-35.5%	-7.4%	8.4%	0.3%
Dec '72	Sep '74	-51.9%	-3.9%	42.9%	37.3%
Aug '87	Nov '87	-30.2%	-6.6%	40.2%	30.9%
Aug '00	Sep '02	-47.2%	-7.1%	66.2%	54.5%
Oct '07	Feb '09*	-51.8%	4.0%	-4.1%	-0.2%
Average	**20.7 Mo**	**-46.3%**	**-2.7%**	**35.1%**	**28.8%**

*Subsequent five years is truncated to March 2012. Source: Research Affiliates based on data from Ibbotson and Shiller.

Continued on page 12

For those focused on the level of real spending, rather than the level of prices, the worst market downturns in U.S. history were mostly brief bouts of minor disappointment.

The results in the recent Global Financial Crisis bear a special mention. While U.S. stocks tumbled by 51%, the real dividends distributed by the S&P 500 Index grew by 4%. To be sure, the real dividends have given up that 4% gain in the subsequent three years. But, from the perspective of spending power, these past 4½ years have been utterly boring and benign!

For the buy-and-hold investor, bear markets aren't nearly as bad as they seem. Massive market corrections disproportionately impact market prices versus spending power. But our proposed shift in our focus – drawing attention away from the value of our portfolio toward the spending power it can sustain – requires real courage: courage to ignore headlines, our brokerage statements, and our natural human instincts to sell.

Return on Courage

Now suppose we have the nerve, not only to focus on our real sustainable spending, but also to seek to increase our real sustainable spending in market downturns! If we rebalance into higher yielding assets after they've cratered, presumably funded from assets that have performed much better, we can systematically ratchet our sustainable spending ever higher. This ground is amply explored in asset allocation literature. Indeed, the essence of Tactical Asset Allocation (TAA) is an effort to rebalance into investments when they become most uncomfortable, *and are therefore priced with a superior risk premium, to reward those who are courageous enough to invest at such times.*

Even a mechanistic rebalancing policy would have compelled a trade from stocks into bonds at the peak in 2000. The trend-chasers who bought stocks at the peak, let alone buyers of high-flying growth or tech stocks, may not live long enough to be wealthier than their contrarian friends who bought ordinary Treasury bonds at that same time. They funded the success of TAA managers and strategies.

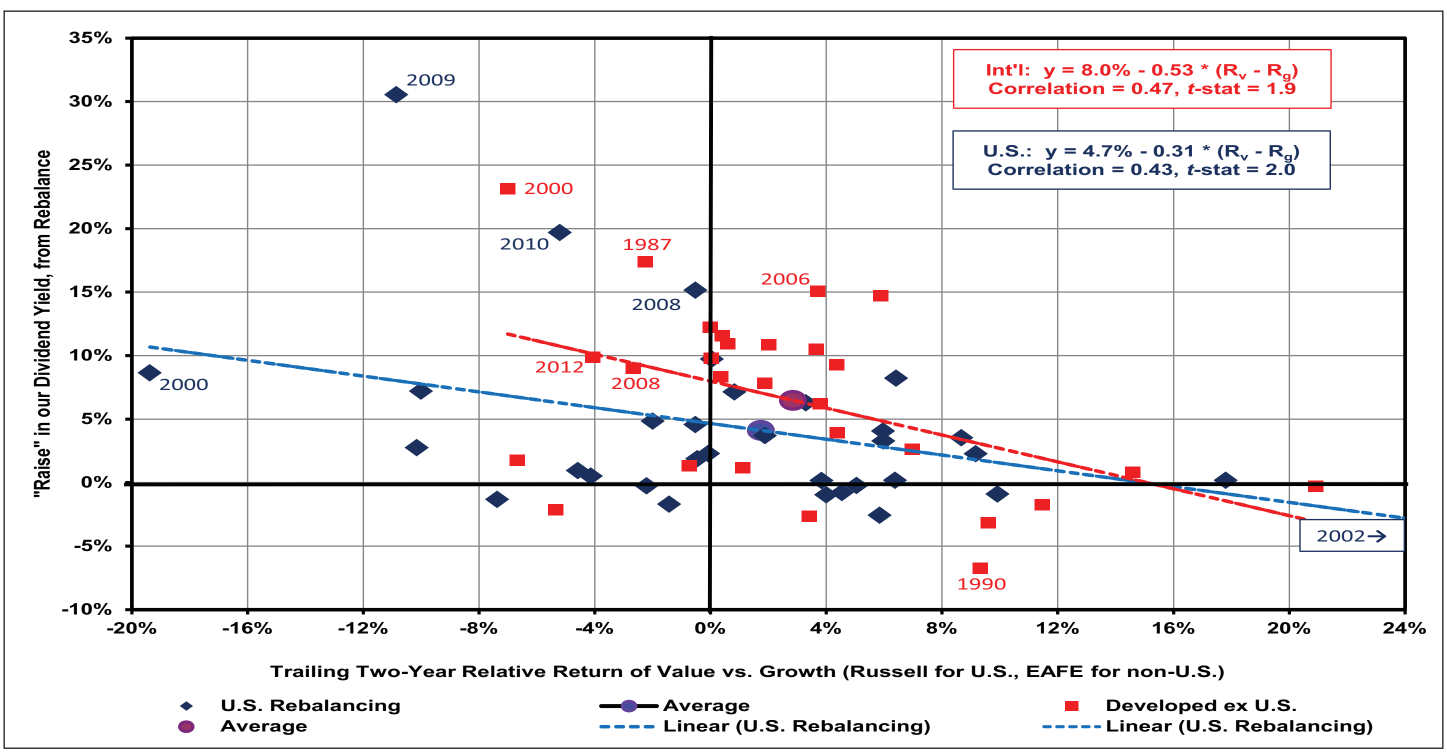
Conversely, in 2009, a disciplined rebalancing strategy compelled us to buy "Anything but Treasuries." Treasuries had dipped to the lowest yields seen in three generations. At the same time, almost anything else offered generous *future* spending, with many markets priced at near-record yields. Still, this was a very frightening trade.

Sustainable spending also has merit within an asset class. Consider equities; we'll use our Fundamental Index® approach for illustrative purposes.[7] The basic Research Affiliates Fundamental Index (RAFI®) strategy annually rebalances each stock back to its fundamental business scale. While the RAFI strategy uses multiple measures of a company's economic footprint, let's simplify by considering dividends alone. If a stock soars relative to the rest of the market, and its yield tumbles, what will a Fundamental Index strategy do? This stock will typically be trimmed, with the proceeds rebalanced into another stock *with a higher yield*. In so doing, the rebalancing in RAFI strategies raises our dividend yield. With each rebalance, we're taking on Mr. Market's most hated "projects," the feared and loathed deep value stocks.

What if value has performed poorly? Then, value stocks will likely have become cheaper, while growth stocks will have become more richly priced. In this case, a RAFI strategy will likely rebalance out of growth and into value, *more aggressively than normal*. The rebalancing *increases our dividend yield*, as well as our sustainable spending! Will a RAFI strategy ever trade out of value and into growth? Yes, but rarely. This occurs when value has outpaced growth by a wide margin.

The pattern of rebalancing is confirmed in Figure 1 for U.S. and Developed non-U.S. stocks. Each dot represents a single year's rebalance. The FTSE-RAFI® US 1000 Index rebalance at the top of the tech bubble (the left-most blue dot, labeled "2000") illustrates a big rebalance in which the portfolio yield rose from 2.34% to 2.53%, for an 8% jump in the portfolio income. The size of the rebalance was triggered by a 24-month period in which Russell Value lagged Russell Growth by a staggering 19% per year. Mr. Market just gave us an 8% raise, in real income, for allowing him to trim his most feared deep value names, even as we gave him more of his favorite high-fliers.

Figure 1. Annual Yield "Raise" in a Fundamental Index Rebalance vs. Preceding Two-Year Value Relative Performance Using Russell Value-Growth for the U.S. Market and EAFE Value-Growth for the Developed ex-U.S. Market



Note: U.S. data from 4/1/1979-3/31/2012; International data from 4/1/1983-3/31/2012.
Source: Research Affiliates based on data from eVestment Alliance, Factset, Bloomberg, and Ibbotson.

Table 2. Attribution, Sources of Return, 1962–2011, 1,000 Largest U.S. Stocks Selected and Weighted Annually by Market Cap and RAFI Weight

	Total Return	Return from Rising Valuations	Average Dividend Yield	Growth in Dividends	Growth Before Rebalance	Growth From Rebalance
Market, Cap Weight	9.8%	0.8%	3.2%	5.6%	6.7%	-1.0%
Fundamental Weight	11.6%	0.8%	3.8%	6.6%	4.8%	1.7%

Source: See Endnote 10.

Mr. Market was even more generous with the FTSE RAFI Developed ex US Index rebalance in that same year (the top red dot, labeled "2000"). In this case, EAFE Value had underperformed EAFE Growth by 7% per year in the prior 24 months. Because value had become so cheap – was so loathed by Mr. Market – our Fundamental Index portfolio moved from a dividend yield of 2.5% to 3.1%. In this case, Mr. Market gave us a 24% raise in real income.

Of course, 2000 was an exceptional year, the peak of the largest market bubble in history.[8] In more normal times, this type of rebalancing provides about a 4% extra raise – beyond what Mr. Market offered to his "passive" employees – in the United States and about a 6.5% extra raise in the Developed ex U.S. markets. Our willingness to take Mr. Market's most loathed holdings leads to a boost in our income about three-fourths of the time: 24 out of 33 years in the United States and 22 out of 28 years in the international markets. These "raises" are over and above whatever increase Mr. Market is offering as a "company-wide" average.

Mr. Market has another peculiarity that bears mentioning. The worse value has performed – and the worse we've performed as a consequence of our previous willingness to embrace value – the bigger the raise that Mr. Market will give us for taking a still larger slice of his most loathed holdings. Obviously, it requires tremendous courage to rebalance into the same deep value names that just hurt us. But Mr. Market is a thoughtful boss: If we took on a project that he hated, and we got burned last year by doing so, he wants to make it up to us with an even larger raise to ease our pain… *as long as we're willing to do it again!* We can see this in the larger "raise" in our dividend yield around inflection points, which includes 2000, 2008, and 2009, as well as 2012 for our non-U.S. holdings.

In the case of developed equities outside the United States, the recent crises deliver far more yield – if we're willing to rebalance into the recently savaged deep value stocks in Europe and the emerging markets. Uncomfortable? You bet. Assured of success? Of course not. But, we did get a 10% "raise" in the March 2012 rebalance, from a 3.8% yield to a 4.2% yield, as recompense for stepping "once more into the breach."[9] A 4.2% yield is a very nice start toward a goal of earning solid real returns.

A skeptic might suggest that we shouldn't get to keep the extra yield, if the market is properly discounting future dividend cuts among the recent price laggards. History suggests otherwise. Table 2 compares the total return for a U.S. capitalizationweighted large company portfolio and a RAFI portfolio from 1964–2009 (we revert back to a U.S. series to give us the longest track record).[10] As the data show, the RAFI methodology earned an average dividend yield of 3.83% since 1964, nearly 70 basis points per annum better than cap weighting. And, there's a bonus – the Fundamental Index approach gives us an annualized dividend growth rate of 6.6% per annum, a full percentage point per annum above the cap-weighted market.

How can we be garnering faster dividend growth, especially in light of our tendency to shun the most beloved growth stocks? Again, it's our rebalancing, as we can see when we segregate the growth in our existing holdings' dividends from the "raise" we derive from rebalancing. The value tilt of the Fundamental Index approach garners 1.9% slower growth in buy-and-hold dividends, before the rebalance, relative to the more growth-oriented holdings of a cap-weighted portfolio. This then offsets the yield difference. But the annual rebalance ratchets that yield up by 1.7% on average, while cap weight *drops its losers and chases its winners*, costing it 1% per year on its own rebalance. We garner an average "raise" of 2.7%, with each rebalance, as recompense for tolerating discomfort, instead of chasing the latest high-fliers; for international stocks we garner *twice as much of a "raise" as this… more than 6% each year*. Add it up and we get near 2% more return than cap weight per year (for nearly a half-century!), and considerably more outside the United States. All for taking on Mr. Market's most hated "projects" year after year.

Conclusion

Rebalancing into the most feared and loathed stocks, and out of the most beloved high-fliers, requires courage – even if we get a "raise" almost every time we do it! Andrew Ang of Columbia labels this "countercyclical investing." He calls on long-term investors to institutionalize this kind of contrarian behavior.[11] If we have the courage to do this, even though it creates discomfort and goes against human nature, it far better aligns our investments with the long-term obligations that they are intended to serve.

Over the long term, we get better total returns by investing for a steady increase in sustainable spending, while letting others invest for comfort. Fortunately, Mr. Market is a kindly boss, rewarding us handsomely for our courage in taking on his most hated holdings. The willingness to apply courage, in a disciplined and contrarian fashion, leads to better long-term results.

Institutionalizing a focus on sustainable spending, as a basis for gauging our investments over time, can help give us the courage to stay the course in adversity and even to take on more discomfort when it is most profitable – and most frightening – to do so.

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Disclaimer: This article originally appeared in Fundamentals, a Research Affiliates newsletter.

Endnotes
1. Ben Graham was perhaps the first to personalize the market, by calling it "Mr. Market."
2. See Arnott, Robert D., 2004, "Sustainable Spending in a Lower-Return World," Financial Analysts Journal, vol. 60, no. 5 (September/October):6–9.
3. See Garland, James P., 2004, "The Fecundity of Endowments and Long-Duration Trusts," Economics and Portfolio Strategy, September 15.
4. See Arnott, Robert D., and Peter L. Bernstein, 1997, "Bull Market? Bear Market? Should You Really Care?" Journal of Portfolio Management,vol. 24, no. 1 (Fall):26–29.
5. I prefer to use the cost of an inflation-indexed annuity to define sustainable spending. Dividends are a perfectly good proxy because dividends generally rise with inflation, plus delivering Mr. Market's average 1–2% real raise.
6. The phrase "No Guts, No Glory" was popularized by Captain Frederick "Boots" Blesse, an ace jet pilot from the Korean War. Upon returning home, Blesse used his experience to publish a manual on fighter tactics, "No Guts, No Glory," which was used in training by the United States and other air forces. In the preface, Blesse stated that "… the goal which we seek, or should be seeking, in the training of any pilot, is to produce a pilot who is aggressive and well-trained."
7. The same logic applies to any method that doesn't invest proportionately to share price, as cap weighting does.
8. With apologies to the EMH academics who still think that Pets.com was fairly priced in early 2000!
9. Shakespeare, Henry V, during the famous battle at Harfleur.
10. This table is drawn from Robert D. Arnott and Denis Chaves, "Rebalancing and the Value Effect," forthcoming in the Journal of Portfolio Management, Summer 2012.
11. See Ang, Andrew, and Knut N. Kjaer, 2011, "Investing for the Long Run," November 11. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1958258.

BMO ETF Portfolio Strategy Report

The Addiction to Intervention

Alfred Lee
Vice President & Investment Strategist, BMO Asset Management

- **Seemingly set to auto-pilot** , following the "Sell in May and Go Away" market folklore, equity market volatility saw a substantial increase over the last two months. After seeing a massive compression in both the *CBOE/S&P Implied Volatility Index (VIX)*[1] and the *S&P/TSX 60 VIX Index (VIXC)*[2] over the first quarter, implied volatility levels are back on the rise, with each index gaining as much as 55.5% and 49.0% respectively since the end of April. Over the last ten years, implied volatility has shown a tendency to exhibit a large degree of seasonality.

- **However, we would never make investment decisions based on seasonality alone.** The major source of market uncertainty continues to be real macro-economic risk factors, most notably out of the Eurozone. Risk indicators, such as credit default swaps (CDS)[3] on the sovereign debt of Spain and Italy in particular, are back on the rise, suggesting a greater concern over insolvency in these countries.

- **Recent data has also shown that the effects of the ECB's Long-term Refinancing Operation (LTRO)[4] have been exaggerated by the market.** While the program was successful in preventing a liquidity crisis in late 2011, corporate and personal lending are both down significantly, as a lack of business confidence has provided very little incentive to demand loans in the Eurozone.

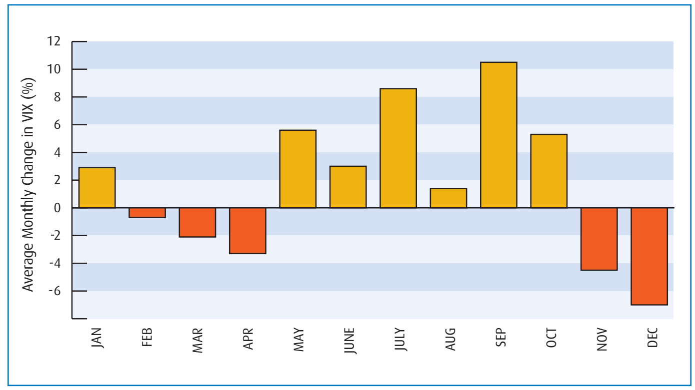
BMO Financial Group
Exchange Traded Funds

- **A coalition in Greece has finally been formed.** Pro-bailout party New Democracy will join forces with Pasok and Democratic Left and together they will hold 179 of the 300 seats of member parliament. Their focus will now shift to renegotiating austerity terms, which creditors are looking increasingly willing to do.

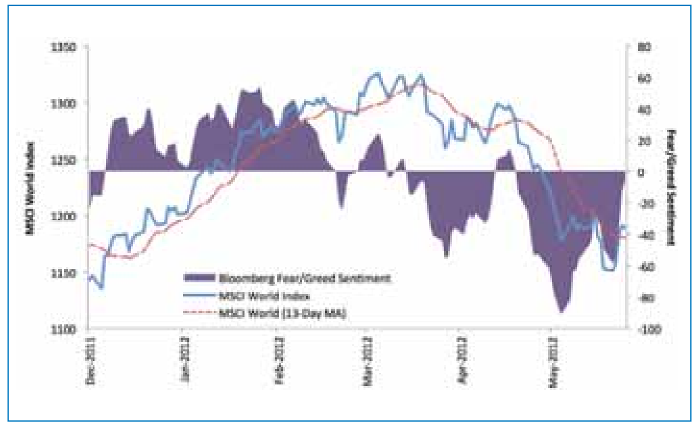
- **A number of Purchasing Managers' Indices (PMI)**[5] for individual European countries and the Eurozone as a whole remain below 50, signifying economic contraction. The recently released Euro Area Composite PMI came in at 46.0 and has been on a five month downward trend. China's HSBC Manufacturing PMI was last reported at 50.4, taking a very sharp fall between April and May. Closer to home, things look more promising with the U.S.'s ISM Manufacturing PMI at 53.5 and steadily trending upwards since last July.

- **Equity market valuations have become increasingly attractive** as a result of the global macroeconomic and geo-political landscape. Currently the *S&P/TSX Composite Index (S&P/TSX)* has a price-to-earnings (P/E) ratio of 13.2x, while the *Dow Jones Industrial Average* is even lower at 12.7x. These numbers are well below their 15 year average of 20.2x and 17.8x respectively. As we have stated throughout the year, this is not a fundamentally based market, but the negative sentiment has made for a good opportunity to pick-up high quality, long-term core positions inexpensively.

VIX Seasonality in Last Decade



Global Equity Sentiment Has Been Bearish



Source: BMO Asset Management Inc., Chicago Board Options Exchange (CBOE), Bloomberg

Things to Keep an Eye on...

Though the ride has been a turbulent one, equities and commodities have seen an enormous rally since the market bottomed "post-Lehman." Since March 9, 2009, the *MSCI World Index* is up 92.5% on a total return basis, whereas the *S&P/GSCI Commodity Index* is up 64.9%. A closer look shows that risk-assets have been largely propped up by central bank stimulus and monetary policy. Here we show two inter-market ratios (commodities vs. U.S. treasuries and Canadian equities vs. Canadian bonds) and one intra-market ratio (U.S. large-cap cyclical stocks vs. U.S. large-cap defensive stocks). Clearly, risk assets have not yet shown an ability to stand on their own two feet.

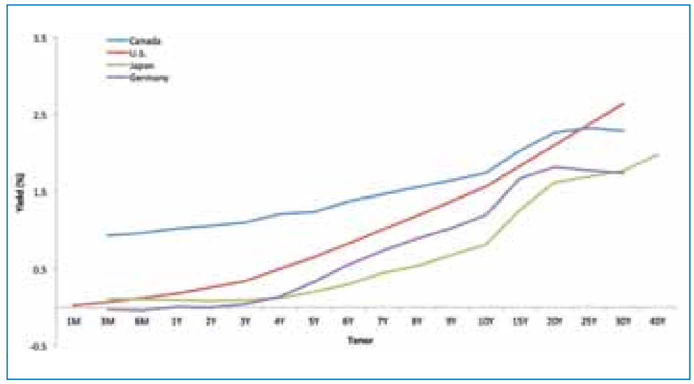
Source: BMO Asset Management Inc., Bloomberg

Recommendation: For lack of a better term, the "Risk-on, Risk-Off" behaviour of the market will likely continue, especially with central banks standing ready to inject additional stimulus into the system should markets experience considerable set-backs. As a result, the market has become far more dynamic, with frequent bouts of volatility and more changes in investor sentiment. This supports our view that investors should be tactical in their allocation amongst asset classes in this environment.

Continued on page 16

Over the last year much has been mentioned about the flattening U.S. yield curve looking eerily similar to that of Japan's. A closer look at a number of other sovereign yield curves, such as Germany's and Canada's have also shown a convergence between its shorter- and longer-dated yields. Over the last-year, the spread between 30-year and 3-month yields have fallen 31 bps and 103 bps in Germany and Canada, respectively.

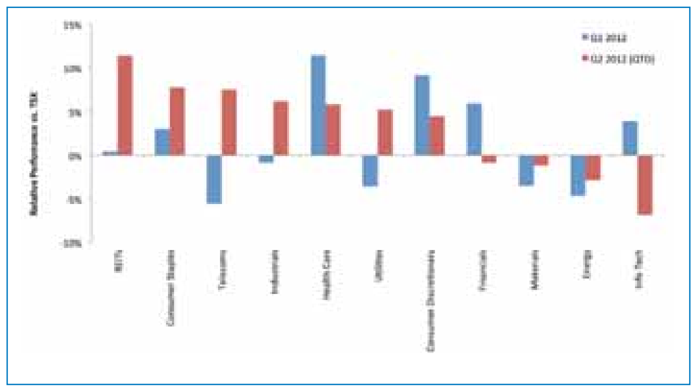
Recommendation: Although we are tactically overweight mid-term bonds, this does not suggest we are looking to completely avoid longduration bonds. In 2011, long-term Canadian federal bonds returned 19.8% and the yield curve continues to flatten with the 30-year yield down 9.3% year-to-date. However, a rally of the equity markets could place upward pressure on 30-year yields, leaving longer dated bonds vulnerable. We recommend using a broad bond ETF as a core holding and supplementing that position with more tactically positioned mid-term federal and corporate bonds.



Source: BMO Asset Management Inc., Bloomberg

Canadian equities were quick out of the gates this year, with the S&P/TSX gaining 6.1% in the first two months alone. Since March 1, however, the "broad-based" Canadian equity index declined 8.9%, as slower growth expectations out of Europe and China have become a drag on the economically sensitive, commodity related sectors. The high concentration of material and energy related stocks in the S&P/TSX have overshadowed the strong performance of other S&P/ TSX sectors over the quarter, causing many investors to miss out on returns.

Recommendation: The high exposure to resources in the S&P/ TSX has served investors well over the last decade during the commodity super-cycle. Given the lack of clarity in the Eurozone and increasing signs of economic contraction in China, commodity related stocks could potentially face increased volatility. Recently the *Canadian VIX (VIXC)* rose above its more commonly quoted U.S. counterpart, the VIX. We are therefore, utilizing the ***BMO Low Volatility Canadian Equity ETF (ZLB)*** as a way to reduce volatility while staying invested in Canadian equities and also obtaining exposure to less economically sensitive areas.


Source: BMO Asset Management Inc., Bloomberg (Based off of S&P/TSX GICS Sectors)

Though the ride has been a turbulent one, equities and commodities have seen an enormous rally since the market bottomed "post-Lehman."

Footnotes

[1] CBOE/S&P 500 Implied Volatility Index (VIX): shows the market's expectation of 30-day volatility, annualized. It is constructed using the implied volatilities of a wide range of S&P 500 index constituent options. This volatility is meant to be forward looking and is calculated from both calls and puts. The VIX is a widely used measure of market risk and is often referred to as the "investor fear gauge".

[2] S&P/TSX 60 VIX Index (VIXC): the Canadian equity market equivalent of the VIX to show the market's expectation of 30-day volatility, annualized. This index is used as a gauge for investor sentiment on Canadian large-cap stocks.

[3] Credit Default Swaps (CDS): A swap agreement where the seller of the CDS will compensate the buyer in the event of a loan default or other credit event. The buyer of a credit default swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the debt security. In doing so, the risk of default is transferred from the holder of the fixed income security to the seller of the swap. As such, a rising CDS price indicates an increasing probability of a default on a fixed income issue, while a declining price indicates a lower probability.

[4] Long-Term Refinancing Operations (LTRO): a major financing method used by the European Central Bank to provide liquidity to its member banks. Although the operation has been in existence for well over a decade, its rules were recently revised to make it considerably easier for banks to obtain funding. First, through LTRO banks can now post collateral to borrow funds for three years rather than several months. Second, the eligible collateral to obtain funding has been relaxed significantly.

[5] Purchasing Managers' Index (PMI) is an economic indicator on the financial activity reflecting purchasing managers' acquisition of goods and services. Data is for the PMI are compiled by monthly surveys polling businesses that represent the make up of the respective sector. The surveys cover private sector companies, but not the public sector. A number above 50 indicates economic expansion, whereas a number below 50 suggests economic contraction.

Changes to the Portfolio Strategy

Asset Allocation

• We are establishing our strategy with a slight overweight in risk assets. Although the macro-economic backdrop remains bleak, fundamentals are rarely attractive without potential risks. To mitigate risk in the overall strategy, we are decreasing beta in our equity exposure, to off-set our higher weight in corporate bonds. Additionally, we are utilizing U.S. high yield bonds and emerging market debt as a less volatile substitute to U.S. corporate and emerging market exposure.

Fixed Income

• Our fixed income strategy is to implement a core-satellite approach. The ***BMO Aggregate Bond Index ETF (ZAG)*** will provide us with broad-based exposure to Canadian bonds, while we use more sector specific bond ETFs to fine tune our fixed income exposure. Although long-duration bonds offer higher potential returns, they do come with more volatility and interest rate sensitivity. As we see a low probability of the Bank of Canada (BoC) hiking interest rates this year, we recommend mid-term federal and corporate bonds in the Canadian fixed income space. Thus we are utilizing the ***BMO Mid-Federal Bond Index ETF (ZFM)*** and the ***BMO Mid-Corporate Bond Index ETF (ZCM)*** to gain exposure to these areas.

Equities

• For core Canadian equity exposure we are utilizing the ***BMO Low Volatility Canadian Equity ETF (ZLB)*** and ***BMO Canadian Dividend ETF (ZDV)*** to gain exposure to lower beta and dividend paying equities, respectively. According to our *Global Index Trend- Spotter* Model, low beta and dividends are two factors that have been effective in the last two quarters. Given the heightened volatility over the last two months and less upward pressure on interest rates, we believe these two factors will continue to fare well in the third quarter.

• Over the last 18 months we have favoured U.S. equities, which has been a call that has paid off. Despite a number of unnerving data points recently, we continue to recommend a significant allocation to U.S. stocks, particularly in the multinational space. As implied volatility levels have risen, we recommend using the BMO Covered Call *Dow Jones Industrial Average Hedged to CAD ETF (ZWA)* as a way to enhance yield and reduce volatility while maintaining exposure to U.S. blue-chip companies.

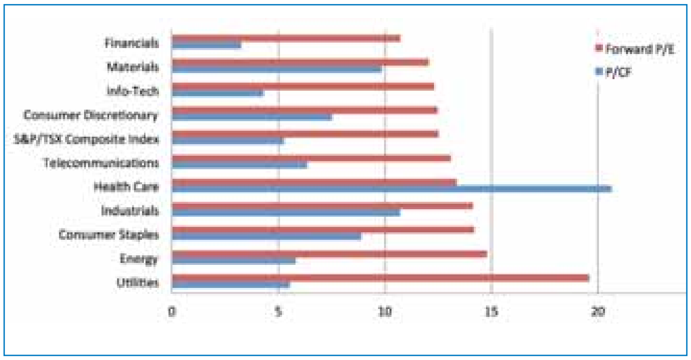
• One concern we have for multinationals is a higher U.S. dollar. Thus, we are also tactically positioning some of our U.S. equity exposure in the ***BMO U.S. Equity Index ETF (ZUE)*** in order to get exposure to some mid-cap U.S. companies. These more locally based companies should benefit from a higher U.S. dollar more so than multinationals. Additionally, we have established a small position in the ***BMO Nasdaq-100 Hedged to CAD Index ETF (ZQQ)*** to gain exposure to U.S. technology and consumer discretionary companies, based on their sensitivity to U.S. consumer confidence which has been on the rise.

• Other notable positions include Canadian banks and large-cap energy companies. We believe the recent sell-off has led to attractive valuations in those areas. Though macro-related issues could lead those sectors to become increasingly more inexpensive, we believe positions in these high quality areas can be established as long-term positions on the low. The ***BMO Covered Call Banks ETF (ZWB)*** allows us to get exposure to the big-six Canadian banks, while enhancing yield and lowering volatility, and the ***BMO Equal Weight Oil and Gas Index ETF (ZEO)*** provides exposure to larger cap energy related names.

• Additionally, we continue to believe the current low interest rate and sufficiently strong business environment in Canada will be favourable for real estate investment trusts (REITs). We are therefore establishing a tactical position in the ***BMO Equal Weight REITs Index ETF (ZRE)*** to attain exposure to Canadian REITs.

Alternatives

• Central banks look increasingly willing to take a dovish stance in monetary policy and provide further stimulus if needed. The Euro/USD cross continues to break-down technically and there are talks that the central banks of emerging markets are now selling their Euro reserves. Increased macro-economic uncertainty and continued currency wars will also be a positive for gold. Momentum indicators also show gold bullion recently turning up consistent with the trend that gold tends to strengthen in the mid-summer. We are utilizing our ***BMO Precious Metals Commodity Index ETF (ZCP)*** to gain exposure to gold and silver prices.



Source: BMO Global Asset Management, Bloomberg

Continued on page 18

Continued from : BMO ETF Portfolio Strategy Report page 17

Stats and Portfolio Holdings

Investment Objective and Strategy

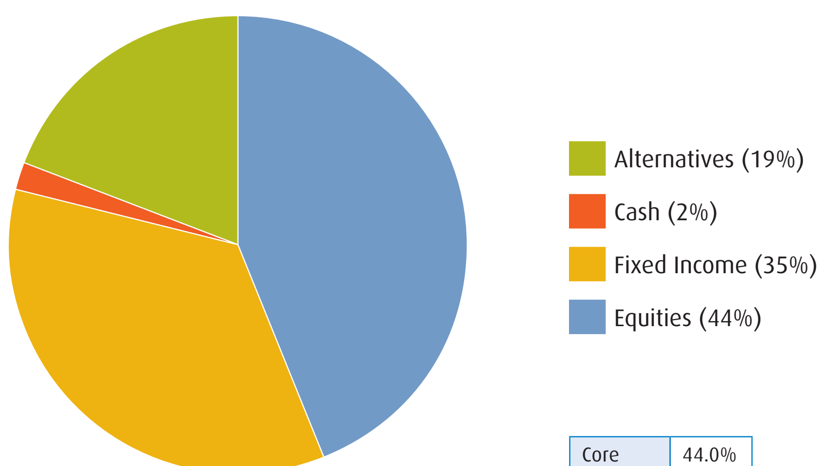
The strategy involves tactically allocating to multiple asset-classes and geographical areas to achieve long-term capital appreciation and total return by investing primarily in exchange-traded funds (ETFs).

Ticker	ETF Name		Position	Price	MER	Weight (%):	90-Day Vol	Volatility Contribution	Yield (%)*	Yield/ Vol
	Fixed Income									
ZAG	BMO AGGREGATE BOND INDEX ETF	Debt	Core	$15.98	0.28%	23.0%	4.1	10.2%	3.3%	0.806
ZFS	BMO SHORT FEDERAL BOND INDEX ETF	Debt	Tactical	$15.03	0.20%	3.5%	2.4	0.9%	2.4%	1.017
ZCM	BMO MID CORPORATE BOND INDEX ETF	Debt	Tactical	$15.92	0.30%	8.5%	4.8	4.4%	4.5%	0.946
	Total Fixed Income					35.0%		15.4%		
	Equities									
ZLB	BMO LOW VOLATILITY CANADIAN ETF	Equity	Core	$15.83	0.35%	9.0%	8.9	8.6%	2.5%	0.284
ZDV	BMO CANADIAN DIVIDEND ETF	Equity	Core	$14.94	0.35%	8.0%	10.7	9.3%	4.4%	0.411
ZWA	BMO COVERED CALL DOW JONES INDUSTRIAL AVERAGE ETF	Equity	Tactical	$15.86	0.65%	9.0%	12.1	11.7%	6.4%	0.531
ZUE	BMO US EQUITY HEDGED TO CAD INDEX ETF	Equity	Core	$20.24	0.22%	4.0%	13.8	5.9%	1.9%	0.138
ZQQ	BMO NASDAQ 100 EQUITY HEDGED TO C$ INDEX ETF	Equity	Tactical	$19.52	0.35%	3.0%	17.2	5.5%	0.6%	0.034
ZWB	BMO COVERED CALL CANADIAN BANKS ETF	Equity	Tactical	$13.48	0.65%	4.0%	11.8	5.1%	7.8%	0.664
ZRE	BMO EQUAL WEIGHT REITS INDEX ETF	Equity	Tactical	$19.72	0.55%	4.0%	9.6	4.1%	5.1%	0.525
ZEO	BMO S&P/TSX EQUAL WEIGHT OIL & GAS INDEX ETF	Equity	Tactical	$12.37	0.55%	3.0%	21.7	7.0%	3.3%	0.152
	Total Equity					44.0%		57.3%		
	Alternatives									
ZHY	BMO HIGH YIELD US CORP BOND HEDGED TO C$ INDEX ETF	Debt	Tactical	$15.37	0.55%	7.5%	7.7	6.2%	7.5%	0.971
ZEF	BMO EMERGING MARKETS BOND HEDGED TO C$ INDEX ETF	Debt	Tactical	$16.63	0.50%	5.5%	7.6	4.5%	5.1%	0.660
ZCP	BMO PRECIOUS METALS COMMODITIES INDEX ETF	Commodity	Tactical	$16.57	0.65%	6.0%	24.2	15.6%	0.0%	0.000
	Total Alternatives					19.0%		26.4%		
	Total Cash**					2.0%	3.9	0.9%	1.30%	
	Portfolio				0.41%	100.0%	9.3	100.00%	4.0%	0.427

*Note: Bond yields are based off of yield to maturity.

**Cash is based off of 3-month Canadian Dealer Offered Rate (CDOR)

Ticker	Top Holdings	Weight
ZAG	BMO AGGREGATE BOND INDEX ETF	23.0%
ZLB	BMO LOW VOLATILITY CANADIAN ETF	9.0%
ZWA	BMO COVERED CALL DOW JONES INDUSTRIAL AVERAGE ETF	9.0%
ZCM	BMO MID CORPORATE BOND INDEX ETF	8.5%
ZDV	BMO CANADIAN DIVIDEND ETF	8.0%
ZHY	BMO HIGH YIELD US CORP BOND HEDGED TO C$ INDEX ETF	7.5%
ZCP	BMO PRECIOUS METALS COMMODITIES INDEX ETF	6.0%
ZEF	BMO EMERGING MARKETS BOND HEDGED TO C$ INDEX ETF	5.5%
ZUE	BMO US EQUITY HEDGED TO CAD INDEX ETF	4.0%
ZWB	BMO COVERED CALL CANADIAN BANKS ETF	4.0%
ZRE	BMO EQUAL WEIGHT REITS INDEX ETF	4.0%
ZFS	BMO SHORT FEDERAL BOND INDEX ETF	3.5%
ZQQ	BMO NASDAQ 100 EQUITY HEDGED TO C$ INDEX ETF	3.0%
ZEO	BMO S&P/TSX EQUAL WEIGHT OIL & GAS INDEX ETF	3.0%
	Cash	2.0%



Core	44.0%
Tactical	54.0%

The Good, the Bad, and the Ugly

	Global-Macro/Political	Fundamental	Technical
Good	• New coalition being formed in Greece will provide some short-term relief. The country's focus will shift towards renegotiating austerity terms with its creditors. • China's year-over-year inflation has come down to 3.0%, suggesting they have inflation under control and providing room for further easing. *The Shanghai Composite Index* has reacted accordingly, up 4.5% year to date. • Central banks look increasingly ready to intervene with quantitative easing or further unconventional measures, which can provide a lift to the markets.	• Equity market valuations in most major markets remain very attractive, with Hong Kong and Singapore equities being the best bargains. Overall, however, the Dow, which is also inexpensive, may offer better upside. • Earnings continue to come in better than expected particularly in the U.S. with 59.9% of companies reporting a positive earnings surprise last quarter. • Cash reserves of U.S. corporations remain exceptionally strong. This can be a positive for both U.S. high yield debt and U.S. equities. • Canadian banks are trading at an average P/E ratio of 10.6x, a steep discount to their 14.1x 15-year average.	• Shorter-term momentum indicators such as Relative Strength Index (RSI) and Moving Average Convergence Divergence (MACD) suggest a possible relief rally in some risk assets. • The S&P/TSX has also recently tested its 50-day MA, with its stochastic-oscillator trending higher. • Two-year U.S. Treasury yields are also gaining positive momentum, suggesting a possible short-term risk-on rally. • Low beta continues to be a market factor that continues to build positive momentum.
Bad	• On the other hand, the need for further central bank intervention indicates the lack of a real economic recovery. • Money velocity remains stubbornly low which limits the effectiveness of monetary policy. • There are concerns that the so-called U.S. "fiscal cliff" is already delaying companies from hiring and spending. • New French President Francois Hollande may have different policy views than German Chancellor Angela Merkel, which could lead to further political divide in the Eurozone and hurdles in establishing policy measures.	• We expect the long-term average of equity market valuations to be much lower this decade than the previous as we continue to be in a macro- and policy-driven market. • There remains an excess supply of oil in the U.S. According to statistics from the U.S. Department of Energy (DOE), days of supply currently sits at 25 days, close to its 20-year high of 26.6 days. Though a negative for energy investors, this is a benefit for the general economy.	• Implied volatility measures including the VIX, VIXC and V2X indices have declined over the last week and half. However, their rapid rate of increase since mid-March shows an increase in market nervousness. • The term structure for VIX futures has steepened in certain areas, which also indicates investor unease. • Equity market breadth remains weak, only 42% of the TSX stocks are above their 200-day MA. • Volume remains very low, showing a lack of conviction behind upside market moves.
Ugly	• Lending rates for troubled Eurozone nations continue to rise. The yield for Spanish 10-year government bonds is now north of 7%, a Euro-era high. • CDSs for Portugal, Ireland, Italy and Spain also remain elevated, as default risk for those countries remains high. • Sovereign yield curves of key developed markets continue to flatten, suggesting a prolonged period of sluggish economic growth.	• Global small caps continue to trade at a heavy premium to the large caps. The current P/E ratio of the *MSCI ACWI Small Cap Index* sits at a 53.6% premium to the *MSCI ACWI Large Cap Index*. Fund flows have moved accordingly, with fund flows out of small caps and into large caps.	• The *NYSE Margin Debt Index* remains very close to its 12-month moving average. An unforeseen macro-event, can lead to massive margin covering and thus a deleveraging event. • The *CBOE Implied Correlation Index* has slightly eased since the Greek elections, now at 70.2. However, intra-market correlation remains elevated and closely tied to equity market volatility. This indicates limited diversification of an all equity portfolio.

Conclusion: News of the New Democracy party leading a coalition in Greece likely shifts the country's focus to renegotiating its austerity terms. Although Greece's creditors look willing, the situation is far from over. On a global basis, there is still chance for disappointment if further central bank intervention does not occur or falls short of current investor expectations. Some shorter term indicators look slightly more positive, with some emerging markets starting to ease monetary policy again. Attractive valuations should also bring bargain hunters back into the market. However, volume levels remain low, showing a lack of investor conviction. Over the secular period, the macro-economic story continues to dominate and the outlook lacks clarity. We continue to believe we are in a multi-period holding pattern, which leads us to conclude that investors should dedicate a significant portion of their portfolio to tactical positions.

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

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New ETF Listings YTD

December 8, 2011	iShares DEX Floating Rate Note Index Fund To Trade On Toronto Stock Exchange
December 2, 2011	Vanguard Canadian Short-Term Bond Index ETF To Trade on Toronto Stock Exchange
December 2, 2011	Vanguard MSCI Emerging Markets Index ETF To Trade on Toronto Stock Exchange
December 2, 2011	Vanguard Canadian Aggregate Bond Index ETF To Trade on Toronto Stock Exchange
December 2, 2011	Vanguard MSCI U.S. Broad Market Index ETF (CAD-hedged) To Trade on Toronto Stock Exchange
January 23, 2012	PowerShares S&P 500 Low Volatility (CAD Hedged) Index ETF To Trade On Toronto Stock Exchange
January 24, 2012	PowerShares FTSE RAFI US Fundamental (CAD Hedged) Index ETF To Trade On Toronto Stock Exchange
January 24, 2012	PowerShares FTSE RAFI Canadian Fundamental Index ETF To Trade On Toronto Stock Exchange
February 2, 2012	XTF Morningstar Canada Dividend Target 30 Index ETF To Trade On Toronto Stock Exchange
February 2, 2012	XTF Morningstar US Dividend Target 50 Index ETF To Trade On Toronto Stock Exchange
February 2, 2012	XTF Morningstar National Bank Quebec Index ETF To Trade On Toronto Stock Exchange
February 9, 2012	Claymore Managed Futures ETF To Trade On Toronto Stock Exchange
February 13, 2012	Horizons U.S. Floating Rate Bond ETF To Trade On Toronto Stock Exchange
February 13, 2012	Horizons High Yield Bond ETF To Trade On Toronto Stock Exchange
February 13, 2012	XTF Morningstar Canada Value Index ETF To Trade On Toronto Stock Exchange
February 13, 2012	XTF Morningstar Canada Momentum Index ETF To Trade On Toronto Stock Exchange
February 28, 2012	Horizons Silver Yield ETF To Trade On Toronto Stock Exchange
February 28, 2012	Horizons Natural Gas Yield ETF To Trade On Toronto Stock Exchange
February 28, 2012	Horizons Crude Oil Yield ETF To Trade On Toronto Stock Exchange
March 30, 2012	Horizons Auspice Managed Futures Index ETF To Trade On Toronto Stock Exchange
April 2, 2012	Horizons BetaPro S&P 500 VIX Short-Term Futures™ Inverse ETF To Trade On Toronto Stock Exchange
April 11, 2012	iPath Pure Beta Crude Oil CAD Hedged ETN To Trade On Toronto Stock Exchange
April 11, 2012	iPath S&P 500 Dynamic VIX CAD Hedged ETN To Trade On Toronto Stock Exchange
April 11, 2012	iPath S&P 500 VIX Short-Term Futures CAD Hedged ETN To Trade On Toronto Stock Exchange
April 12, 2012	PowerShares Senior Loan (CAD Hedged) Index ETF To Trade On Toronto Stock Exchange
April 20, 2012	Powershares S&P/TSX Composite Low Volatility Index ETF To Trade On Toronto Stock Exchange
April 20, 2012	Powershares S&P/TSX Composite High Beta Index ETF To Trade On Toronto Stock Exchange
April 20, 2012	Powershares S&P 500 High Beta (CAD Hedged) Index ETF To Trade On Toronto Stock Exchange
April 25, 2012	Horizons Morningstar Hedge Fund Index ETF To Trade On Toronto Stock Exchange
May 28, 2012	Horizons Universa Canadian Black Swan to Trade On Toronto Stock Exchange
May 28, 2012	Horizons Universa US Black Swan to Trade On Toronto Stock Exchange
July 6, 2012	First Asset DEX Canada Bond Barbell Index ETF To Trade On Toronto Stock Exchange
July 6, 2012	First Asset DEX Government Bond Barbell Index ETF To Trade On Toronto Stock Exchange
July 6, 2012	First Asset DEX Corporate Bond Barbell Index ETF To Trade On Toronto Stock Exchange

ETFs In Canada

1990
World's first ETF, TIP 35, launches

September 1999
iShares launches in Canada with XIU

October 2000
State Street Global Advisors launches ETF (closes November 2002)

January 2001
TD launches ETFs (closes March 2006)

March 2006
Claymore launches ETFs

January 2007
Horizons launches BetaPro Funds

June 2009
BMO launches ETFs

May 2011
Canadian ETF Association launched

May 2011
Invesco Trimark launches mutual-fund wrapping ETFs

May 2011
XTF launches ETFs

September 2011
RBC launches ETFs

November 2011
Vanguard enters Canada

March 2012
BlackRock acquires Claymore

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Exchange Traded Products ETPs

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ETP Style
- Broad-based
- Narrow-based
- Equal-weight
- Balanced
- Buy Write
- Preferred Share
- Dividend Income
- Small-cap
- Large-cap
- Growth
- Value
- Spreads
- Volatility
- Managed Futures

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

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

Fixed Income
- Corporate Bonds
- Convertible Bonds
- Government Bonds
- Long-term
- Short-term
- Money Market
- Laddered
- High Yield
- Target Maturity
- Floating Rate Bonds

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

Derivatives
- Options
- Leveraged
- Swaps

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

International
- Global Funds
- Japan
- Latin America
- United States
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- EAFE (Europe, Australia, Asia and the Far East)

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2012 Events

World Alternative Investment Summit Canada ~ Niagara Falls

Tuesday, September 18 to Thursday, September 20
Fallsview Casino Resort

WAISC is Canada's largest annual gathering of **alternative** and **exempt market investment** professionals and service providers. Featuring panel discussions with top-level international speakers, fund managers and leading service providers, WAISC brings together over 400 delegates to explore every side of **alternative** investments.

WAISC2012
11th World Alternative Investment Summit Canada
waisc.com

Exchange Traded Forum ~ Montreal

Thursday, October 4
Hotel Omni Mont-Royal

ETPs, ETFs, ETNs, Indexing
In its second year in Montreal, the **Exchange Traded Forum** conference will address the latest trends and developments in this rapidly changing and growing sector. The **Exchange Traded Forum** is the largest ETF event in Canada.

EXCHANGE TRADED FORUM 2012
exchangetradedforum.com

Retirement Coaching Conference (RCC) ~ Toronto

Monday, October 22
Le Méridien King Edward

2011 marked the year that the first Baby Boomers turned 65 and every single day more than 10,000 boomers will retire. This demographic will redefine retirement and clients will need "coaching" in many crucial decisions. This is a huge opportunity for the advisor who gets it right. RCC will focus on all aspects of "retirement planning", enabling a successful experience for clients.

RCC
Retirement Coaching Conference
FOR INVESTMENT ADVISORS

2013 CALENDAR OF EVENTS

2013 Events

Niagara Institutional Dialogue Interim Meeting

Coming in 2013

We've had an overwhelming request from our **NID** members to host another iterim meeting. Stay tuned for our second annual gathering, coming in 2013.

Niagara Institutional Dialogue
An Exchange of New Ideas Knowledge Practices For Institutional Investors

institutionaldialogue.com

Exchange Traded Forum ~ Toronto

We will be hosting our 4th Annual Exchange Traded Forum in 2013. Please stay tuned for details.

EXCHANGE TRADED FORUM 2013

exchangetradedforum.com

World Alternative Investment Summit Canada ~ Calgary

We will be hosting our 2nd Annual World Alternative Investment Summit Canada ~ Calgary, in 2013. Please stay tuned for details.

WAISCWEST 2013
World Alternative Investment Summit Canada

waisc.com

Niagara Institutional Dialogue

Monday, June 10 to Wednesday, June 12
Niagara-on-the-Lake ~ Queen's Landing

Niagara Institutional Dialogue is an exchange of ideas, knowledge and practices for Canadian Institutional Investors. A selected group of senior representatives from Canadian pensions and family offices, will participate in three days of informative discussions, education and networking. This confidential closed-door event is reserved for select industry participants.

Niagara Institutional Dialogue
An Exchange of New Ideas Knowledge Practices For Institutional Investors

institutionaldialogue.com

Exchange Traded Forum ~ Western Canada

We will be hosting our 3rd Annual Exchange Traded Forum in Western Canada in 2013. Please stay tuned for details.

EXCHANGE TRADED FORUM 2013

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WAISC 2012

11th Annual World Alternative Investment Summit Canada

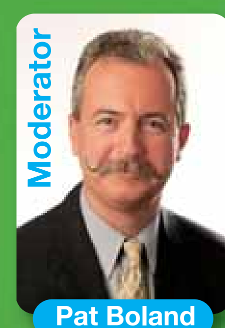
Tuesday, September 18th to Thursday, September 20th

Fallsview Casino Resort ~ Niagara Falls

Now in its 11th year, the **World Alternative Investment Summit Canada – WAISC 2012**, scheduled for **September 18-20** in Niagara Falls, will bring together 400+ investment managers; institutional, retail and accredited investors; and various professional services firms. As the largest Canadian conference serving the alternative investment and exempt market sector, delegates will hear from renowned national and international speakers who will address key industry issues, learn about new strategies from existing fund managers and network with key decision-makers and major players.

Don't miss your chance to hear Kevin O'Leary, best recognized from the CBC TV's Dragon's Den.

Philippa Malmgren is a frequent guest on the BBC's Today Program, Newsnight and a guest presenter on CNBC's Squawk Box (UK and US).



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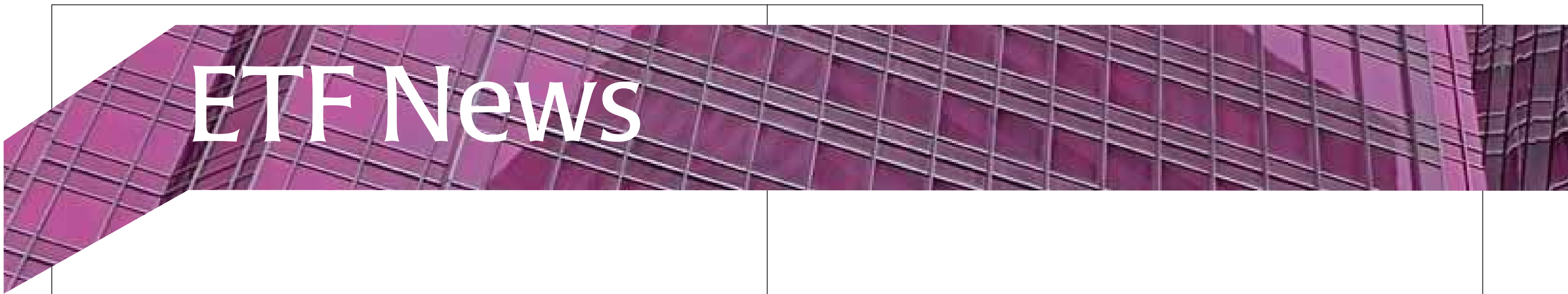

ETF News

Global X Canada Preferred ETF (CNPF) Yields 4.00% at First Year Anniversary

New York – June 25, 2012 – Global X Funds, the New York based provider of exchange traded funds, today announced the 12-month yield for the Global X Canada Preferred ETF (CNPF), following its first year anniversary.

Concurrently, Canadian banks were ranked among the world's strongest, according to a May 2012 Bloomberg News report. Canada received distinguished honors with 5 spots in the top 20 – U.S. banks did not fare so well. Even with a population 9 times larger than Canada, the U.S. held only 3 spots in the top 20. Strict regulations set by the Office of the Superintendent of Financial Institutions of Canada (OSFI) have helped Canada raise the bar beyond global banking standards by requiring more equity as a percentage of capital relative to their foreign counterparts.

Those looking for income and preferred equity holdings may want to consider the Global X Canada Preferred ETF (CNPF) to diversify their exposure. The ETF tracks the Solactive Canada Preferred Stock Index, which is designed to measure the performance of preferred stocks from Canadian issuers traded on the Toronto Stock Exchange. Currently, 75% of the index is invested in financial companies of Canada.

"CNPF provides a relatively efficient way for investors to potentially benefit from this hybrid asset class and gain access to some of the world's highest ranked banks," said Bruno del Ama, chief executive officer of Global X Funds.

The Global X Canada Preferred ETF's (CNPF) 12-month yield is 4.00%.

12-Month Yield	4.00%
30-Day SEC Yield	3.96%

(12-Month Yield as of 6/22/12, 30-Day SEC Yield as of 5/31/12)

Performance as of 3/31/12		Cumulative since Inception
NAV		-5.09%
Market Price		-6.00%
Index		0.76%
Management Fee	0.58%	
Total Expenses	0.58%	

RBC Global Asset Management Joins the Canadian ETF Association

July 14, 2012 – The Canadian ETF Association (CETFA) announces that RBC Global Asset Management(RBC GAM) has joined the association as its newest member firm.

We are very pleased to be joining CETFA and supporting their commitment to providing investor awareness and education, product definitions and standards,and regulatory advocacy in the ETF space, said Cary Blake, Vice President of RBC Global Asset Management Inc. It has become increasingly important for all ETF stakeholders to develop a unified approach in a number of key areas, and were proud to help bring the industry one step closer to this goal.˘

RBC Global Asset Management launched eight RBC TargetMaturity Corporate Bond Exchange-Traded Funds (ETFs) on September 15, 2011. The suite of RBC ETFs were developed based on advisor and investor input, offering advisors increased flexibility to tailor their bond laddering strategies for clients, serve as a source of cash to match large known future liabilities, and capture perceived opportunities at particular points on the yield curve.

The Canadian ETF Association is very proud to have RBC Global Asset Management join us as a full member, said Howard Atkinson, the current chair of the Canadian ETF Association. While RBC GAM is a relatively new entrant in the Canadian ETF space, they are the largest asset manager in Canada. Their depth of experience and expertise as it relates to investment products will be an invaluable resource for the association.

CETFA aims to be the Canadian ETF Industry's leading source for relevant ETF information and asset under management statistics. Through creating more awareness about ETFs, providing greater depth of education to investors and dealing with industry specific issues, both regulatory and structural, CETFA has taken an activist role on behalf of all ETF providers to improve industry practices and defend the positions of member firms.

ETF Executive Leaves RBC

July 24, 2012 – Cary Blake has left RBC Global Asset Management.

He joined RBC in 2010 as a vice president to head its ETF business initiative. Prior to that, he worked at BlackRock.

Blake's responsibilities included development and execution of RBC's ETF business strategy. He officially left July 19 and RBC spokesperson Leah Commisso confirmed his departure today.

Writing on his website, Yves Rebetez, managing director and editor of ETFInsight, says Blake's departure doesn't bode well. (**www.etfinsight.ca/?p=4573**)

Meanwhile, according to the Canadian ETF Association, RBC has raised about $115 million in assets under management; a small number given the scope and depth of its asset management business. Vanguard ETFs, which entered the market at similar time, has raised more than twice that. BMO ETFs raised $230 million last month alone.

Blake has been replaced by Mark Neill, president of PH&N Investment Services. "Neill leads the direct-to-client business and the third-party accounts platform, which both have investor overlap with the ETF segment. So we're confident it'll be a smooth transition," says Commisso.

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