CANADIAN ETF Watch

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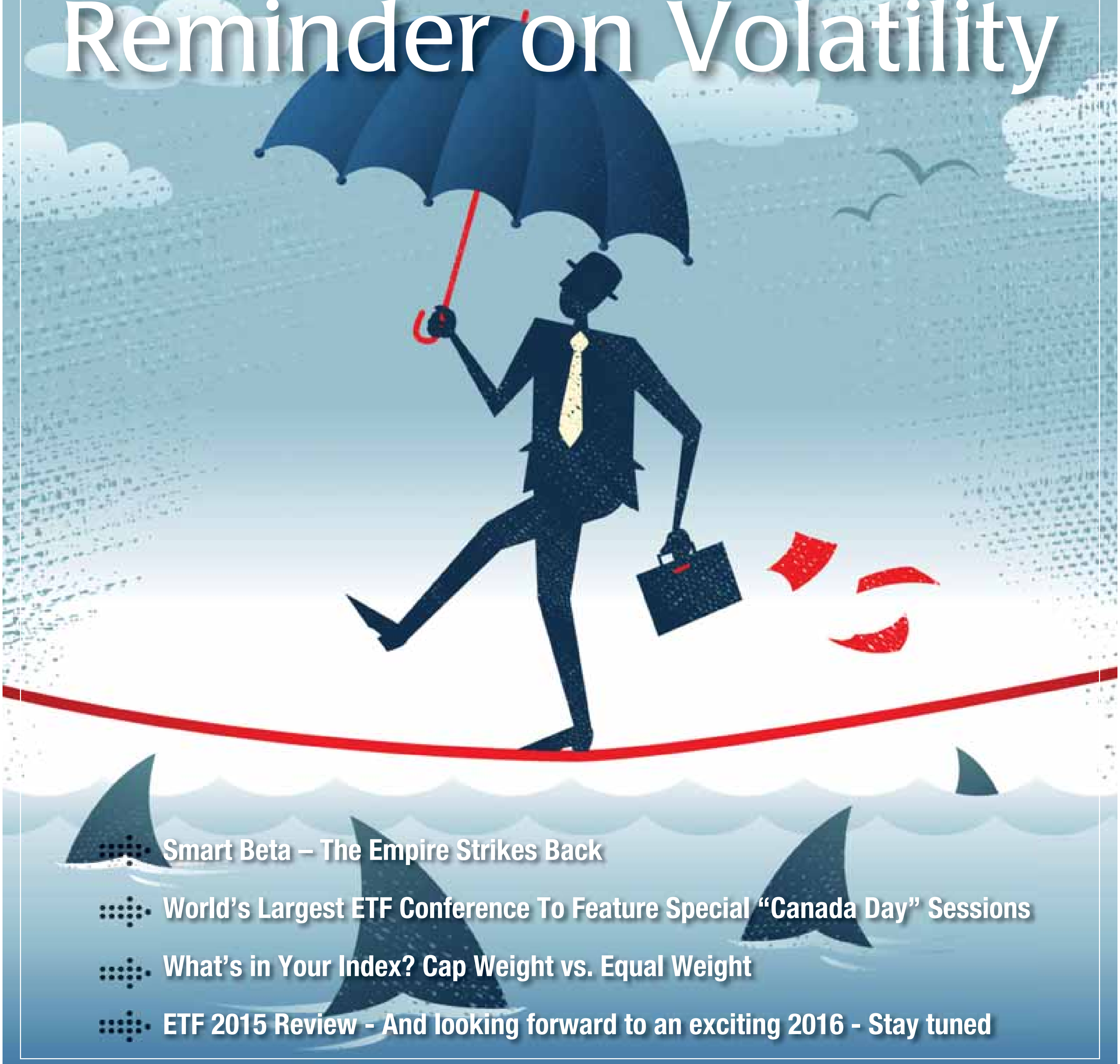
Markets Provide a Reminder on Volatility



- Smart Beta – The Empire Strikes Back
- World's Largest ETF Conference To Feature Special "Canada Day" Sessions
- What's in Your Index? Cap Weight vs. Equal Weight
- ETF 2015 Review - And looking forward to an exciting 2016 - Stay tuned

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ETFs/ETPs listed in Canada have gathered a record 10.1 billion US dollars in net new assets this year as of the end of October 2015, according to ETFGI

ETFs/ETPs listed in Canada have gathered a record US$10.1 billion in net new assets as of the end of October 2015 which is slightly ahead of the prior record set over the same period in 2012. This marks the 11th consecutive month of positive net inflows. The Canadian ETF industry had 373 ETFs/ETPs, with 522 listings, assets of US$66.5 Bn, from 12 providers on 1 exchange at the end of October 2015, according to ETFGI's Global ETF and ETP insights report for October 2015.

In the first ten months of 2015 record levels of net new assets have been gathered by ETFs/ETPs listed globally with net inflows of US$287.3 Bn marking a 22.3% increase over the prior record set at this time last year. In the United States net inflows reached US$174.8 Bn, which is 12.4% higher than the prior record set in 2013, while in Europe year to date (YTD) net inflows climbed to an all-time record of US$68.6 Bn, representing a 22.7% increase on the record set YTD through end of October 2014. In Canada, YTD net inflows are at a record US$10.1 billion which is slightly ahead of the prior record set in 2012. In Japan, YTD net inflows were up 121.9% on the record set last year, standing at US$35.0 Bn at the end of October 2015.

"Equity markets performed well globally in October: the Dow was up 9%, the S&P 500 was 8%, all 10 sectors of the S&P 500 were up for the month, developed markets gained 7%, emerging markets were up 8%. Investors put net money into riskier assets including emerging market equities in October." according to Deborah Fuhr, managing partner at ETFGI.

In October 2015, ETFs/ETPs listed in Canada saw net inflows of US$851 Mn. Equity ETFs/ETPs gathered the largest net inflows with US$594 Mn, followed by fixed income ETFs/ETPs with US$204 Mn, while commodity ETFs/ETPs experienced net outflows of US$12 Mn.

YTD through end of October 2015, ETFs/ETPs have seen net inflows of US$10.1 Bn. Equity ETFs/ETPs gathered the largest net inflows YTD with US$5.2 Bn, followed by fixed income ETFs/ETPs with US$3.4 Bn.

Source: ETFGI.com

ETFGI is an independent research and consultancy firm launched in 2012 in London offering paid for research subscription services: the ETFGI annual research service provides monthly reports on trends in the global ETF and ETP industry, access to the ETFGI database of all ETFs/ETPs listed globally with factsheets which are updated monthly, ETFGI annual review of institutions and mutual funds that use ETFs and ETPs, the Active ETF landscape report and the Smart Beta ETF Landscape report.

Deborah Fuhr is the managing partner and co-founder of ETFGI, she previously served as global head of ETF research and implementation strategy and as a managing director at BlackRock/Barclays Global Investors from 2008 – 2011. Fuhr also worked as a managing director and head of the investment strategy team at Morgan Stanley in London from 1997 – 2008, and as an associate at Greenwich Associates. **Shane Kelly** and **Matthew Murray** are co-founders and partners in ETFGI.

Sovaida Pandor, *Vice President, Business Development & Event Planning*
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CONTENTS

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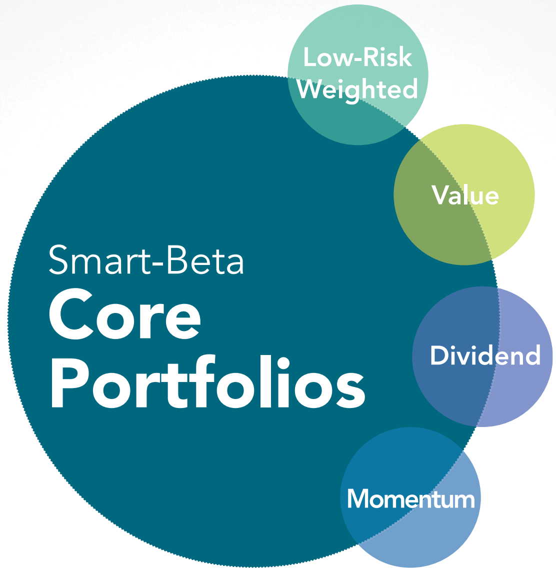

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✓ Smart Fixed-Income **✓ Smart-Beta Equity**

ETF Information		
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TSX:CES	First Asset Core U.S. Equity ETF	Hedged Units
TSX:CES.B	First Asset Core U.S. Equity ETF	Unhedged Units
TSX:CES.U	First Asset Core U.S. Equity ETF	U.S. $ Units

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1. Source: NBF - Canadian ETF Flows 2015.

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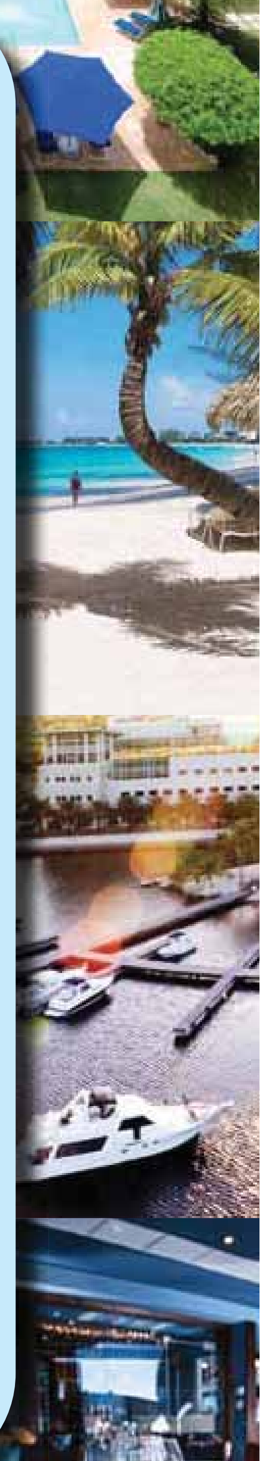

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Our sincerest congratulations to the winner of the
Fabulous Cayman Islands trip,

Robert Hesp

Hesp Wealth Advisory - BMO Nesbitt Burns

Drawn at the Exchange Traded Forum conference,
ETF Toronto North on **October 19th, 2015**.

Robert's prize includes:

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ETF 2015 Review

And looking forward to an exciting 2016. Stay tuned.

Women in ETFs (WE) Presented: The ETF Network – Delivering ETF Strategies to the Customer

Back row: Ling Zhang, Aye Soe, Linda Zhang, Deborah Fuhr
Front row: Moderator, Deborah Frame, Oricia Smith, Sharon French

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Deborah Fuhr, ETFGI

Pat Bolland, Media Consultant

Rohit Mehta, First Asset ETFs

Trevor Cummings,
RBC Global Asset Management Inc.

Mark Yamada,
PUR Investing Inc.

Warren Jestin, Scotiabank

Scott Boniferro, Invesco Canada

Rick Ferri, Portfolio Solutions

Matt Hougan, ETF.com

Dave Nadig, FactSet

Markets Provide a Reminder on Volatility

This year's market turbulence may have left your clients rattled, but it may also have provided multiple investment opportunities. Low-volatility ETFs offer investors a sense of stability, allowing them to remain invested while providing a measure of downside protection.

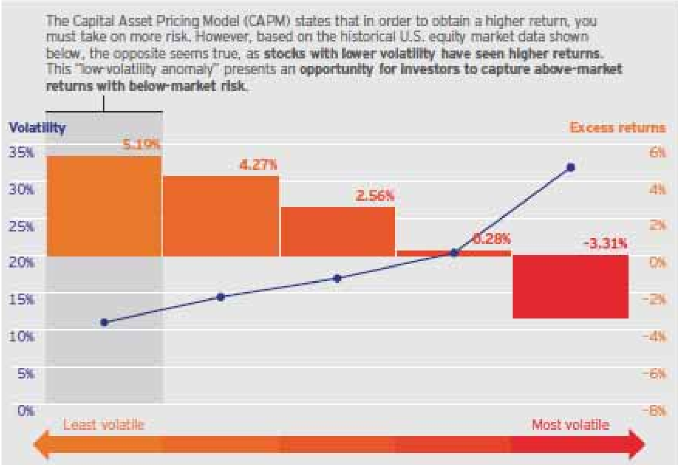
Christopher Doll
AVP,
Product Management,
PowerShares Canada

The concept of low-volatility investing is not new, but it has taken on more relevance since the market meltdown of 2008–09, as institutional and retail investors alike have become more averse to market volatility and more focused on risk avoidance.

Reconstructed performance data indicates in general low-volatility indexing has generated significantly less volatility (as measured by standard deviation) over the long term versus capitalization-weighted indices for the same market.

But there is more value to low-volatility investing than its reduced risk. This strategy has also historically resulted in higher relative performance compared with cap-weighted indices over the long term. A portfolio of low-volatility 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 established 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. According to CAPM, the cap-weighted market portfolio should provide the highest level of return for its level of risk, while the low-risk, low-volatility portfolio should provide commensurately lower returns.



Source: FactSet, as at March 31, 2015. Data is for 1,000 largest U.S. stocks by market-cap from December 1988 to March 2015. For illustrative purposes only. Equal weighted and rebalanced monthly. Volatility data is divided by quintile. Excess return refers to annualized CAPM alpha, a measure of performance relative to the market. Positive alpha is the extra return awarded to the investor for taking additional risk rather than by accepting the market return. Volatility refers to 36-month price return standard deviation.

Data is in U.S. dollars.

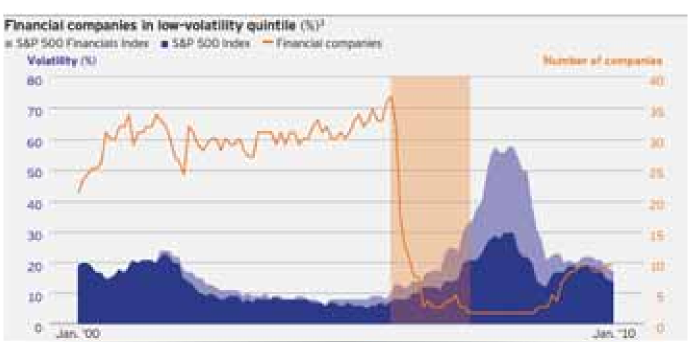
The flaw in CAPM lies in its assumption that markets are efficient processors of information.

Empirical analysis suggests that the cap-weighted portfolio is not efficient. Historically, such a portfolio has not priced risk appropriately and has failed to adequately compensate an investor for the additional risk taken compared with the risk-return profile of the low-volatility portfolio. In academic circles this has been called the "low-volatility anomaly," whereby higher risk does not always translate into higher returns.

With this in mind, equity investors may wish to consider a low-volatility strategy as a long-term investment – not just a "trade" during risk-off periods in equity markets. For example, using back-tested data from November 1990 to August 2015, the S&P 500 Low Volatility Index's underlying strategy would have outperformed the standard S&P 500 Index. Had it been in existence, the low-volatility strategy would have gained 1,169.7%, while the standard cap-weighted index gained 923.5%.

There are various strategies that seek to take advantage of the low-volatility anomaly. Some impose sector constraints, but this additional layer of screening may reduce the effects of the anomaly itself. Excluding a security on the basis of its sector – and ignoring its volatility – would be contrary to the goals of an investor seeking to participate in the low-volatility anomaly.

While some low-volatility indices have sector constraints that prohibit them from straying too far from their parent index, S&P low-volatility indices are unconstrained and dynamically rotate in and out of sectors as volatility dictates, reflecting the most current information.



Source: FactSet Research Systems Inc., as at June 30, 2011. Past Performance is not a guarantee of future results. An investor cannot invest directly in an index

This sector rotation was seen in the U.S. financial sector, which had 37 of the 100 least-volatile companies in June 2007. As volatility in financials spiked, the number of financial companies in the least volatile quintile fell to two in January 2008. Using volatility rankings to construct a low-volatility index would potentially have helped investors avoid much of the drop in the financial sector.

PowerShares Canada's suite of low-volatility ETFs are based on S&P low-volatility indices, providing low cost, unconstrained exposure to the low-volatility anomaly.

Sources: Morningstar Research Inc. and S&P Dow Jones Indices.
Time period: April 1, 2005 to August 31, 2015.
3 Missing footnote from the above chart.

PowerShares exchange-traded funds (ETFs)	Ticker	Management Fee
PowerShares S&P/TSX Composite Low Volatility Index ETF ▲	TLV	0.30%
PowerShares S&P 500 Low Volatility (CAD Hedged) Index ETF ▲	ULV	0.35%
PowerShares S&P International Developed Low Volatility Index ETF	ILV	0.40%
PowerShares S&P Emerging Markets Low Volatility Index ETF	ELV	0.44%
PowerShares Low Volatility Portfolio ETF	PLV	0.55%

▲ This strategy is also available through a PowerShares® Fund version.

Christopher Doll, AVP, Product Management,
PowerShares Canada
inquiries@invescopowershares.ca

Smart Beta – The Empire Strikes Back

As we near the release of the next blockbuster Star Wars installment, the force was simply too strong to resist borrowing the famous 1980 movie title for the purposes of this article. Rather than simply running through the benefits of smart beta ETFs – something First Asset has been doing for years – the aim of this editorial is to quite literally strike back at the skeptics and cynics of smart beta.

John Pagliacci
Product Strategist, First Asset Exchange Traded Funds

To frame things from the onset, the main critiques of smart beta (also referred to in the industry as factor beta, strategic beta, or even "marketing" beta from the most ardent of pessimists), tend to come from those that feel most threatened by the proliferation of these strategies, those that don't like change, and those that don't understand what smart beta is all about.

ETF providers focused almost entirely on cost containment are certainly the ones likely feeling the most threatened. These are firms that offer 'commoditized' ETFs – those that mirror simple, market capitalization weighted (cap weighted) indexes, like the S&P/TSX Composite Index or the S&P 500 Index. They are not trying to achieve anything other than replicating the market return as closely as possible – a laudable goal if you are looking for market returns. The key point of differentiation is cost and these firms all aspire to being the least expensive provider. In order for them to remain profitable in this context, they need tremendous scale – and with fund flows increasingly migrating to solutions that have demonstrated superior performance results, it's no wonder they're starting to sweat, and throwing anything and everything at smart beta to try to knock it off its pedestal.

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So – what are the most common salvos being fired?

1) Cheaper is Better

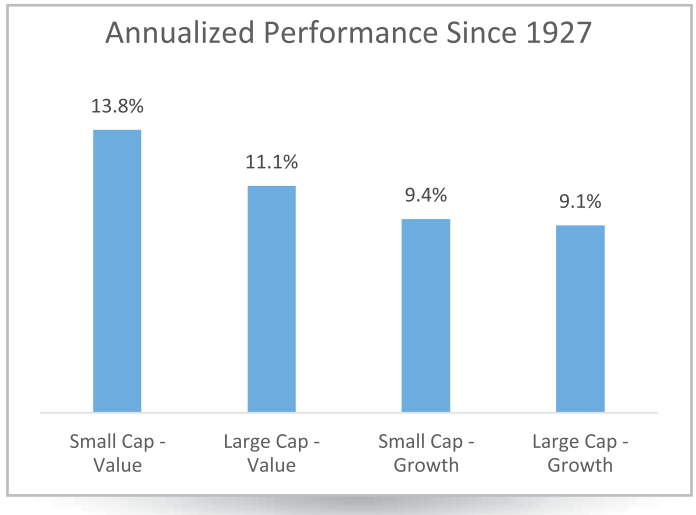
This is by far the most commonly used point to steer investors away from smart beta and into simple, market cap weighting strategies. This claim would be valid in a world where relative outperformance is not possible, but we know that's empirically not the case.

Yes – fees are typically higher than on a broad, market-cap weighted ETF, but when looked at in the context of the historical amount of alpha generated by smart beta factors, the higher fee has delivered value, both in the form of excess returns and lower risk. This truly falls into the "you get what you pay for" category. At First Asset, we believe the individual and multi-factor strategies we focus on are a smarter way to invest than broad market cap weighted index approaches. Acting as an innovator of smart beta strategies in Canada, we set out to work with leading index providers to create solutions that add value for investors and help them achieve their financial goals. By focusing on empirically proven 'return premia' in the market – using screens and filters that target very specific types of stocks – our factor solutions deliver value for the fees they charge, which is far more important than just the quantum.

2) Smart Beta is Just Clever Marketing

While certainly a clever marketing term that has obviously resonated, "smart beta" strategies – or, rather, the factors of the market they target in order to generate outperformance – have been empirically proven to add value over and above their relevant broad market benchmarks over time. Some naysayers are quick to point out that these factors do not outperform over all shorter time frames, and quite frankly, they would be right. Different factors tend to outperform the market at different times. Individual factors definitely outperform over the long term, and it is increasingly clear that combining different factors leads to consistent outperformance. The criticism that is usually levied is that "cap weighting outperformed [insert smart beta factor] last year – so clearly the paradigm is broken". This is not really much different than pointing out that the Canadian equity market outperformed the US equity market in a given year. No one would draw the conclusion that the US equity market is thus broken. In fact, the critics making this claim in support of broad market cap weighted ETFs should acknowledge that they're highlighting that a large-cap growth approach only outperformed other factors during the period in question. ETFs which adopt a broad cap-weighted methodology, like those replicating the S&P 500 Index, just award the highest weightings to the largest companies. Interestingly, and perhaps paradoxically, the two "factors" that have been empirically shown to add no value on a long-term basis are – you guessed it – large cap stocks and growth stocks. A market cap weighted approach to investing systematically tilts your portfolio to unrewarded factors.

Here's a look at four indexes that track combinations of small cap vs. large cap performance, as well as value vs. growth styles.



Source: Morningstar Direct, as of September 30, 2015. Indexes used were the Fama-French Small Value, Large Value, Small Growth and Large Growth Indexes.

As mentioned, market-cap weighted strategies tend to be built to reflect the large cap-growth style (far right of the chart), whereas smart beta strategies could really resemble any of the other style blends shown, thus capitalizing on size and value premiums. That's not to say that smart beta ETFs are all small cap funds. In fact, at least from a First Asset ETF perspective, many of them have chunkier mid-cap allocations. Nevertheless, while a 9% annualized return isn't anything to scoff at, the data certainly proves that there was more alpha generated by moving away from the inherent large-cap growth bias of market cap weighted products.

Moreover, First Asset is not proposing that investors should simply buy a single factor ETF with the expectation that it will outperform all the time. Just as you might diversify portfolios across asset classes, regions and sectors, we would recommend building a portfolio with several complementary factors, just as we do by combining Value, Momentum, Low Volatility and Dividend factor strategies in our 1-ticket core portfolio solutions – First Asset Core Canadian Equity ETF (CED) and First Asset Core US Equity ETF (CES). By taking such an approach, a portfolio becomes more insulated against single factor risk like, for example, value stocks falling out of favour, as we've seen recently.

3) Smart Beta ETFs Aren't Sufficiently Diversified

This can be interpreted a number of different ways, but most often when this point is lobbed out, it's in reference to the number of stocks held. Because market-cap weighted strategies (usually broad proxies for a given country's equity market) tend to hold more names, it could incorrectly lead investors into believing they are sufficiently diversified. As Canadians, we don't need to look any further than some of our own domestic indexes for some of the best examples of why this isn't always the case. Take the S&P/TSX Composite Index, which, as of October 31st, 2015, held 242 stocks. That's seemingly more than enough diversification – that is, until you dig into the sector and market cap allocations. Doing so would indicate a 32% position in Financials and 19% in Energy – or, more than half of the index in two sectors, one of which has been in serious decline as oil prices have fallen considerably.

Continued on page 12

Continued from : Smart Beta – The Empire Strikes Back page 11

You'd also find that 75% of the index is in large cap equities. As a result, many Canadians are overly exposed to certain areas and economic themes, and vastly under-exposed (or not exposed at all) to others. Market cap weighted approaches can result in single security concentration risks. Again, as Canadians we are well versed in this – remember Nortel, RIM, etc. A great tool that several of First Asset's smart beta ETFs use to combat this risk is to equal weight all the positions in the portfolio, and rebalance to equal weight quarterly.

A glaring example of single security overconcentration would be the S&P/TSX Capped REIT Index. While only holding 15 names, the top 2 positions account for 35% of the index. Different approaches that incorporate broader issuer diversification and concentration limits, among things, could deliver superior diversification by spreading out some individual stock risk. A perfect example exists in RIT (First Asset Canadian REIT ETF) which has delivered superior results relative to the S&P/TSX Capped REIT Index over the long term and which is better diversified with holdings in over 30 REIT and real estate investments.

Smart beta methodologies have well demonstrated track records of diversification by both controlling sector over-exposure and equal weighting to avoid single issuer concentration risk.

4) Smart Beta Only Looks Good Because the Performance is 'Back-Tested'

Critics can tend to conflate bona fide back-testing with data-mining (the search for approaches that were successful historically but have no academic merit – like investing only in companies which start with the letter S). There is nothing sinister about how the hypothetical performance of smart beta strategies are calculated or presented. At First Asset, we work with some of the most reputable index providers in the world (Morningstar, MSCI, FTSE/TMX) who have considerable resources and extremely talented financial professionals under their employ. These index providers are applying a consistent set of buy and sell rules based on certain fundamental characteristics and screens that focus on identifying stocks that exhibit specific targeted characteristics. For example, the MSCI Europe Risk Weighted Top 100 Index, which First Asset aims to replicate through the ETF ticker 'RWE', looks at the universe of European equities, selects the top 100 stocks that have exhibited the lowest historical volatility and weights them accordingly (highest weights go to stocks with the lowest volatility). To ensure consistency and reliability, the index runs this screen semi-annually and rebalances to the new proposed weightings (as does RWE). Nowhere in the hypothetical performance of this index has a human intervened to make 'beneficial' tweaks to the systematic methodology in order to improve performance. Yes – the index would have fallen significantly less than the broad MSCI Europe Index during the financial crisis, but not because it was programmed to be prescient, but rather because it was constructed to always focus on stocks that have exhibited relatively low downside potential. All indexes have a history before they become live approaches to investing in a market, including cap weighted broad market indexes. Choices are always made to include or curtail the number of stocks or the timing of additions and deletions. Otherwise, how did the S&P 500 Index end up with 500 stocks? It was a choice. Smart beta indexes makes choices as well. They are just different ones.

Conclusion

The claims that smart beta ETFs are too expensive, aren't sufficiently diversified, don't add value, and rely on 'artificially inflated' back-tests are inaccurate and unwarranted. The growing popularity of smart beta ETFs as tools to construct portfolios that exhibit better risk adjusted returns than their respective broad market peers reflects the truth.

As Yoda might say, ***"Strong is smart beta. Improve your portfolio it can."***

John Pagliacci, Product Strategist, First Asset Exchange Traded Funds ***jpagliacci@firstasset.com***

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World's Largest ETF Conference To Feature Special "Canada Day" Sessions

Inside ETFs, the world's largest exchange-traded fund conference, taking place Jan. 24-27, 2016 in Hollywood, Florida, will feature a special *"Canada Day"* for Canadian financial advisors and wealth managers.

Matt Hougan
Chief Executive Officer, ETF.com

The conference is expected to bring more than 2,000 participants from around the world to sunny Florida for four days of hard-hitting education, panel networking and keynote speeches focused on the fast-moving ETF market. New in 2016, the final day will feature session and networking events aimed specifically for Canadian advisors.

"With the massive growth in the Canadian ETF industry, we decided the time is right to expand Inside ETFs to include content specific to the Canadian advisor market," said **Matt Hougan**, chief executive officer of **ETF.com**. *"Canada Day – taking place on Wednesday, Jan. 27 – will feature a dedicated panel on the outlook for Canadian ETFs; a keynote speech by famed Canadian entrepreneur and fund giant Kevin O'Leary; and a golf networking tournament at the award-winning Diplomat Golf Course."*

All Canadian advisors who register for Canada Day will get to enjoy the entirety of the four-day conference, including ETF.com's famed ETF University (a complete introduction to ETFs, taking place on Sunday, Jan. 24), keynote speeches by luminaries like **Jeffrey Gundlach, Jeremy Siegel** and more.

ETF.com

The 2016 Inside ETFs conference is designed specifically to hit the hot-button topics that are shaping the ETF industry. Dedicated sessions throughout the conference will address:

- The massive rise in currency hedging and smart-beta ETFs… and how to evaluate the confusing wave of new products
- The entry of Wall Street giants like Goldman Sachs and John Hancock into the ETF fray… and whether advisors should buy their products
- New trading hiccups like the mini-flash crash… and how that should impact how you trade ETFs
- The aggressive push of robo advisors into the market… and how traditional advisors should respond
- The future of active ETFs and exchange-traded mutual funds

There will be significant sessions on the outlook for the market as well, including panels on emerging markets, fixed income, the U.S. economy, oil and gold. The speaking faculty includes a virtual who's-who of the ETF industry, along with leading market experts like Charles Schwab's Chief Investment Strategist **Liz Ann Sonders**, Mauldin Economics' Chairman **John Mauldin** and *"Freakonomics"* author **Stephen Dubner**. There are also numerous sessions designed to help advisors grow their businesses, including keynote speeches from legendary advisor coach **Bill Bachrach** and Betterment CEO **Jon Stein**.

"Canadian advisors have always attended Inside ETFs in large numbers, as they make extensive use of U.S.-listed ETFs," said Hougan. *"With this year's addition of Canada-specific content – and a networking golf outing after the conference – we hope to dial that up significantly."*

Space is limited for the golf outing, which is complimentary to Canadian attendees, and takes place the afternoon following the conference's conclusion on **Wednesday, Jan. 27**. Anyone interested in signing up for the conference and the Canada Day sessions can check out **www.etf.com/InsideETFs2016** for more information or to register. [Note: As a special offer for readers of Canadian ETF Watch, ETF.com is offering a $100 discount on the standard $395 registration fee for asset managers. Just enter **"CANADA100"** in the discount code category.]

Matt Hougan, Chief Executive Officer of ETF.com.

What's in Your Index? Cap Weight vs. Equal Weight

A case study: Russell 1000 Equal Health Care Index

This article examines the differences between traditional market cap weighting and equal weighting strategies in index construction and their effects on return and risk characteristics with a focus on the Russell 1000 Equal Weight Health Care Index and its market cap weight counterpart.

Index Weighting 101

In market capitalization weighting (CW), a stock's allocation is determined by its total value (number of shares outstanding x stock price) in proportion to the total value of the entire index. Alternatively, equal weight (EW) indices assign, as the name suggests, an equal proportion to all constituent holdings in the index.

The equal weight method of index and portfolio creation, despite having the simplest approach, has just recently come to fore in a meaningful, investible way. The evolution of exchange traded Funds provided the vehicle by which investors could express their strategies in a liquid, cost effective way. This innovation is viewed by many investors as a solution to many of the shortfalls of traditional cap weighted indices.

James Youn
CFA, Senior Portfolio Manager, Questrade Wealth Management

Why Equal Weight?

The EW index has the potential for higher returns by mitigating concentration risk and mega cap tilt, while instilling automated discipline and increasing diversification.

Cap weighted indices overweight exposure to mega-cap stocks. In this example, in the Russell 1000 Health Care Index, the top three stocks are pharmaceutical giants Johnson and Johnson, Pfizer, and Merck. They represented roughly 25% of the entire index (as of December 31, 2014). This overexposure to mega cap stocks skews the index and decreases diversification. In the EW index, each stock represents roughly 1% which redistributes the opportunity set.

This lack of diversification in cap weighted indices does not represent the average company in the index. For instance, the median market cap for both indices in question was USD $10.98 billion. By comparison, the average market cap for the CW index was $99.08 billion USD while the EW index was USD $28.51 billion.*

In highly technical sectors such as health care, innovation is key. Pharmaceutical giants tend to invest in growth by acquiring smaller, more innovative companies as evidenced by the flurry of consolidation in 2015. These smaller, more dynamic firms are the future leaders in the industry and have higher growth potential. Any underweighting may lead to underperformance.

Built-In Discipline:

Rebalancing instills an unbiased discipline i.e. profits are automatically taken and companies that have declined in value are bought. In other words you are adhering to the oldest mantra in investing – Buy Low, Sell High. The Russell Equal Weight Health Care Index rebalances quarterly.

The result, in this particular case, is the equal weight index outperformed. The return for the Russell 1000 Equal Weight Health Care Index for the 10 years prior to December 31, 2014, a period that included the global financial crisis, was 16.10%. This bested the CW index by 42%, with returns of 11.33%.*

Risk vs. Reward

This potential excess return does not come without its own inherent risks. First, the rebalancing means a slight tilt towards value stocks. Second, the bias to smaller cap companies is accompanied by higher volatility (as measured by standard deviation) which was 13.93% and 15.26% for the cap weight and equal weight versions respectively as of December 31, 2014. However, factoring the reward one gets for a unit of risk as measured by the Sharpe ratio, the EW index makes a compelling argument. The Sharpe ratio (the higher the better) for 2004 to 2014 was 0.96 for the equal weight index as compared to 0.78 for the cap weight.

In conclusion, the equal weight indexes can outperform their cap weight counterparts by mitigating concentration and mega-cap tilt risk while introducing disciplined rebalancing. The risk/reward characteristics of the Russell 1000 Health Care Indices suggest that one should consider expressing a bullish view with an equal weight index to maximize your potential returns. e

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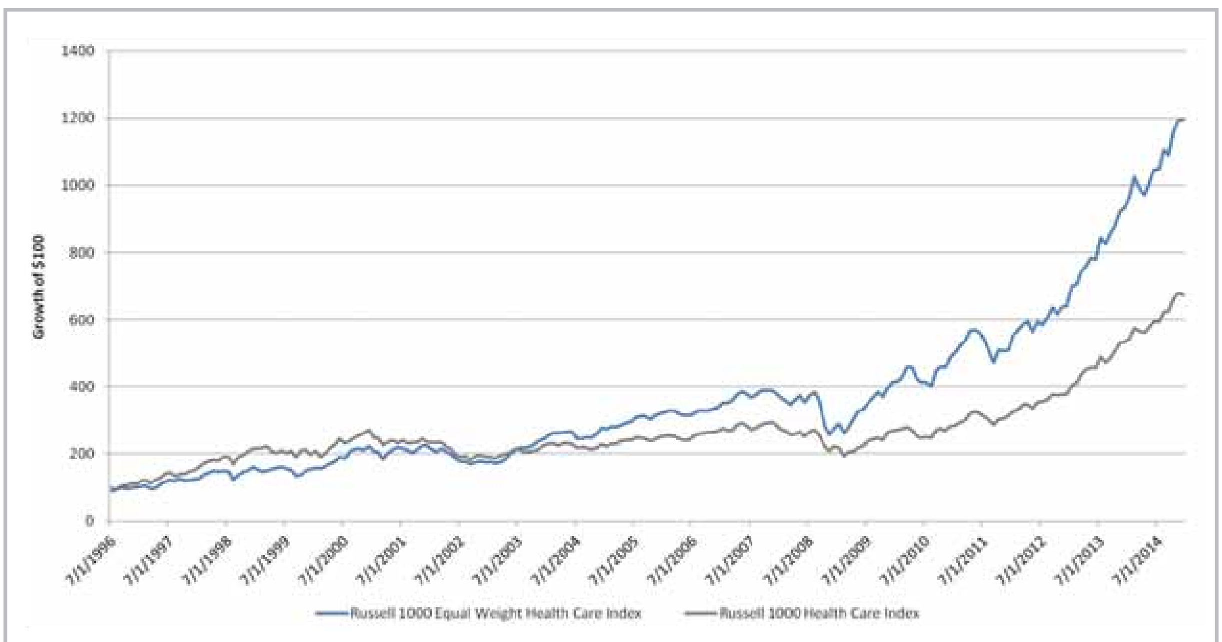

*Source: Russell Indexes Performance, December 31, 2014.

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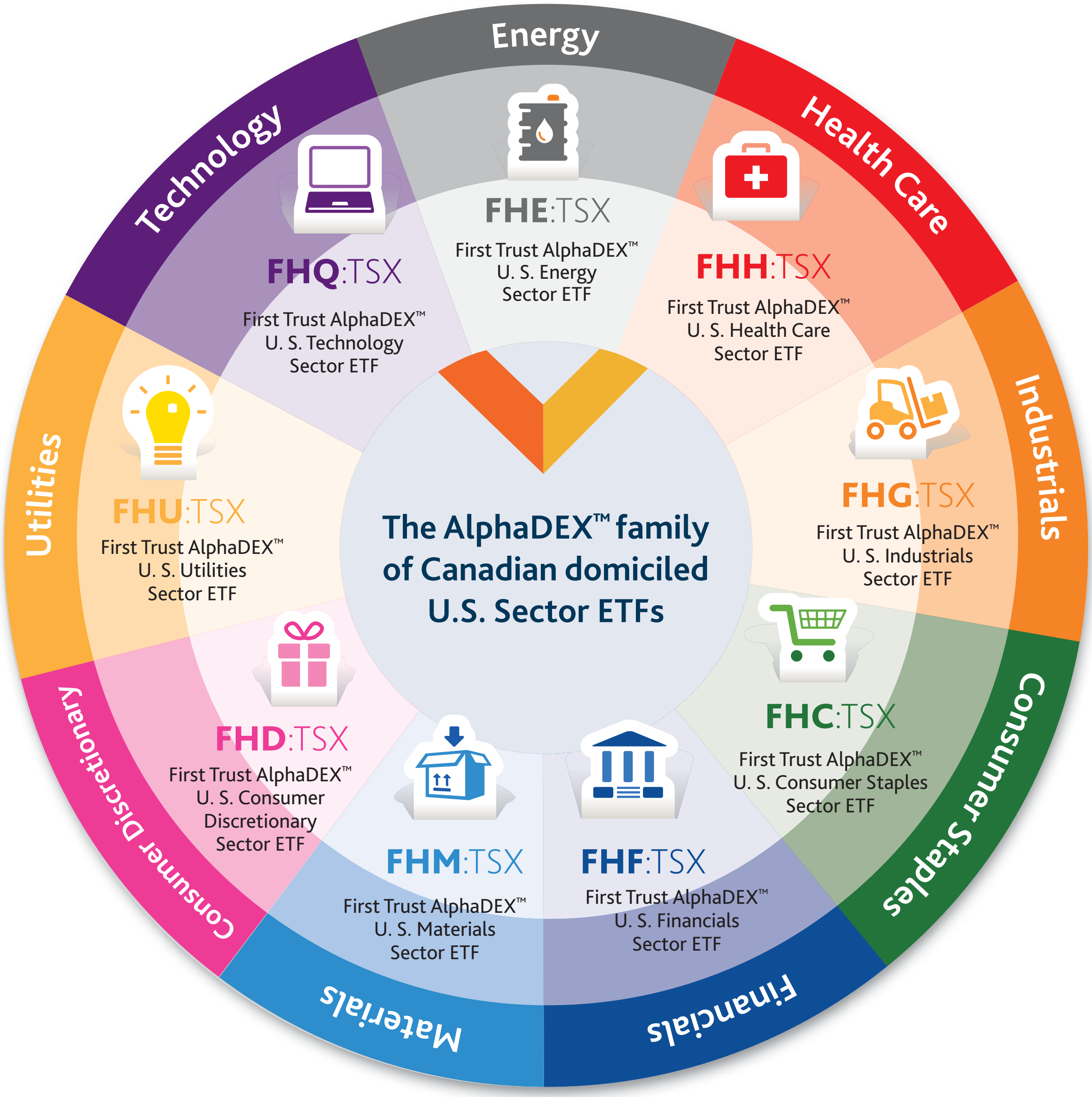

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