MARCH 2018

CANADIAN ETF Watch

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Big Data And AI In Investment Innovation

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Conference Edition!

ETFs listed in Canada reached a new record of 122 billion US dollars

ETFs listed in Canada reached a record high of US$122 billion at the end of January 2018, shattering the previous record of US$117 billion set at the end of 2017. During January 2018 assets invested in ETFs listed in Canada increased by US$4.94 billion, representing the greatest absolute monthly increase for almost two years, according to data from ETFGI's January 2018 Canadian ETF and ETP industry insights report.

The Canadian ETF industry had 568 ETFs, assets of US$122 billion, from 27 providers listed on 2 exchanges at the end of January 2018.

Assets invested in ETFs/ETPs listed in the US increased by US$219 billion or 6.40% in January to reach a record high of US$3.64 trillion at the end of January 2018. This represents the greatest monthly growth in assets since October 2015, when assets increased by US$150 billion, according to data from ETFGI's January 2018 US ETF and ETP industry insights report.

At the end of January 2018, the US ETF/ETP industry had 2,157 ETFs/ETPs, assets of US$3.64 trillion, from 132 providers listed on 4 exchanges.

Assets invested in ETFs/ETPs listed globally grew by a record US$313 billion in January 2018 to reach a new high of US$5.15 trillion at the end of January 2018. The increase of 6.47%, from US$4.84 trillion at the end of 2017, also represents the greatest monthly growth in assets since March 2016, which saw a monthly increase of US$221 billion, according to ETFGI's January 2018 Global ETF and ETP industry insights report.

Source: ETFGI.com

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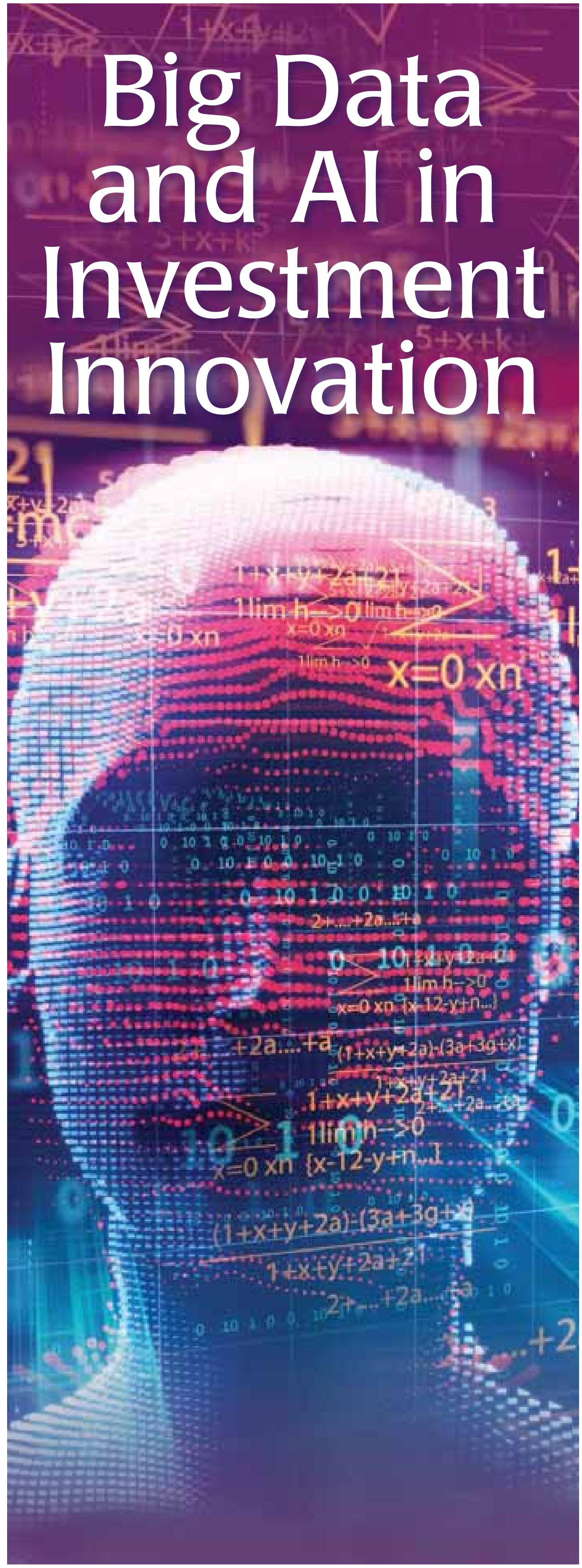

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Big Data And AI In Investment Innovation

Artificial intelligence (AI) has played a growing role in capital markets over the past fifteen years. The concept most commonly refers to the development of computer systems that are capable of undertaking decision-making tasks that normally require human intelligence.

Matteo Andreetto
CEO, STOXX Limited

However, computers are able to perform such tasks at exponentially higher speed and frequency, one that is impossible for humans. And at lower costs. Algorithmic trading, an AI application, grew six-fold from 2003 to 2012, reaching 85% of market volume.[1]

According to Deutsche Börse Group, 'big data' is currently fueling the evolution of AI-driven investment analytics.[2] The term alludes to the role that AI has played in enhancing the reach of data. This has been done through the development of tools that enable more efficient ways to mine, analyze, curate and utilize data, essentially powering the conversion of that information into better investment decisions and new investable products.

New World Technology

Big data is considered AI's life-blood and has incited a record level of interest in these technologies. Investment in AI startups has grown to nearly 2.4 billion dollars in 2015 from 282 million in 2011, according to one study.[3]

The barrage of data coming from an increasing number of sources, and ever more efficient analytical methods and architectures are showing the potential to transform the entire asset-management industry through vast competitive advantages. This disruption can already been seen in the success that interactive investment technologies such as robo-advisors have experienced. A recent PULSE ONLINE article www.stoxx.com/pulse-details?articleId=382575390) reviewed the growth of this sector.

Transforming Passive investments

Smart beta and factor investing strategies are another example of how big data is transforming the investment landscape, in this case in passive investing. Smart beta is the name given to benchmarks whose membership is constructed on criteria other than market capitalization. They rely instead on metrics such as dividend or value to construct an investment strategy. For more on these benchmarks, please visit www.stoxx.com/pulse-details?articleId=211788993.

Factor investing is a strategy where securities are chosen based on attributes associated with higher returns. While methodologies can differ, such strategies utilize an increased level of granularity when choosing securities. (www.stoxx.com/pulse-details?articleId=412840425)

Data and technology will continue to gain a bigger role in how money is managed. Just like the invention of the Internet browser transformed the retail industry, the disruptive power of new technologies cannot be overstated. The asset-management industry may be at the early stages of having a similar experience. Only this time around, with more advanced technology, higher penetration ratios and two decades of experience in how innovation can truly transform the way we live.

Digital Revolution or Disruption – Investors Hold the Key

The McKinsey Global Institute writes that 'artificial intelligence (AI) is poised to unleash the next wave of digital disruption.'1 Faster computers, increasingly sophisticated algorithms and vast amounts of available data – the fuel of AI – have opened the gates to a true AI revolution. (www.stoxx.com/pulse-details?articleId=861904696)

Many industries are already feeling its disruptive effects, from financial services to carmakers and telecommunications companies. The technology also holds great economic potential for firms that produce and adopt it, making AI an attractive theme for investors.

AI Taps into Unconventional Data Sources

Our recently launched STOXX AI Global Artificial Intelligence Index tracks companies that invest heavily in AI research and development, using AI techniques in order to identify them. Proprietary AI algorithms developed by our partner Yewno, an award-winning AI technology company, help us determine which companies hold substantial intellectual property (IP) in AI-related technologies. (www.stoxx.com/index-details?symbol=STXAAIP)

The technique's main component is called a 'knowledge graph.' On a basic level, it is a framework, which turns unstructured data into quantifiable metrics. In the case of the STOXX AI Global Artificial Intelligence Index, the knowledge graph is fed all granted patents from a number of US and international databases; it ultimately returns a list of International Patent Classification (IPC) categories that the algorithm has determined are AI-related. The output serves as a basis for calculating AI IP scores, which determine whether or not a company is included in the index.

Without AI techniques at our disposal, analyzing such a large amount of patent data would simply not be feasible. The world's patent databases include documentation on a very high number of granted patents. Humans would not be able to complete the task due to the sheer volume of information. Traditional algorithms using keyword searches would not be up to it, either, as they require keywords to be manually assigned, another impossible task given the amount of data involved.

Turning Unstructured Data into Knowledge

So how does a knowledge graph work? Essentially, it scans documents and relates them to one another, similarly to what a search engine does with individual pages. In order to do so, however, it needs to extract meaning from the text instead of simply identifying which pages are connected via hyperlinks.

To do so, the algorithm scans all patents and extracts a set of potentially associated concepts for each one. The concepts are then disambiguated, i.e. the algorithm checks whether a concept such as 'apple' refers to the fruit or the computer company. It does so from context; if a paragraph mentions the taste of an apple and then compares it to that of a pear, it is probably referring to the foodstuff whereas a mention of Apple's IPO likely refers to the company.

Connecting the dots

Crucially, the extracted concepts are not simply stored as isolated pieces of information. Instead, the scanned patents are mapped in a graph relative to each other, allowing the algorithm to discover relationships among the concepts associated with them. The knowledge graph thus creates an inferential 'semantic space' with clusters of concepts and their potential inferences – a web of knowledge.

For the STOXX AI Global Artificial Intelligence Index, the algorithm then picks concepts it has determined to be related to AI, finds all the patents that contain those concepts and selects their IPC categories. Companies which hold patents belonging to these categories are then considered for inclusion in the index.

Unleashing the Power of Big Data

Using human-like strategies but at exponentially greater scale and speed, Yewno's AI-based knowledge graph thus helps in the selection of constituents for the STOXX AI Global Artificial Intelligence Index. This makes the index a real-life example of how AI technologies can unlock the potential of big data for investing.

Matteo Andreetto, CEO, STOXX Limited
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[1] Morton Glantz and Robert Kissells, Multi-Asset Risk Modeling: Techniques for a Global Economy in an Electronic and Algorithmic Trading Era (Academic Press, 2013).
[2] Future of Fintech in Capital Markets, Deutsche Börse Group & Celent, June 20, 2016
[3] CBS Insights, June 2016.

Feeling Fickle About Domestic Options? Go Global.

Searching for high quality franchises paying above-average yields.

Ahmed Farooq
CFP, CIMA®

Vice President, ETF Business Development, Franklin Templeton Investments Canada

FRANKLIN TEMPLETON INVESTMENTS

Why Now?

Today's investors have a lot on their minds. Consider that in January of this year, after nearly a decade of accommodative monetary policy, the Bank of Canada raised interest rates for the third time since last summer. Also consider that, as part of a healthy correction, the Dow Jones index, which soared by 25 percent in 2017, lost 4.6 percent in a single day in February and triggered a global selloff. Needless to say, the benign financial environment of the last few years may be over.

In the midst of still historically low, but rising, interest rates and increasing market volatility, many investors are looking at dividend investment strategies for their performance potential and attractive yields.

But not all dividend strategies are created equal. Let's look at two dividend-oriented types of investments: high-yield and dividend-growth. A high-yield dividend company is one whose dividend yield is higher than that of its benchmark. Dividend-growers, on the other hand, are companies that have a demonstrated history of increasing their dividend payouts. Investors have appreciated both strategies, but for different reasons. While they like the income produced by high-yield focused strategies, many investors are equally interested in benefitting from the stability and quality associated with dividend growth strategies.

Traditional high-yield stocks have performed strongly in recent years; however, in the current rising rate environment, many have become overvalued and overpriced. In an ultra-low interest rate environment, many of these businesses were able to take on more debt to expand their operations and sustain their high dividend payments to investors and/or increase debt simply to finance yields. Consequently, these highly-leveraged companies may start to encounter financial challenges as the cost of borrowing increases.

In addition, after a stellar 2017, a year during which the Dow Jones closed at an all-time high more than 70 times, the index suffered its worst fall in six years, sparked by higher bond yields, higher U.S. wages and the prospect of higher interest rates. We may be seeing signs that the halcyon days of steady gains could be over.

Stocks that represent high quality franchises paying above-average sustainable yields, however, could present a compelling investment opportunity… especially in the current environment.

Why High Quality Dividends?

The upward trend in interest rates could signal an improving economy. But how are dividend-paying companies affected by rate hikes? We've already mentioned that highly leveraged companies can be sensitive to interest rate changes, as they tend to be more impacted by higher borrowing costs. Dividend-growers, on the other hand, are typically higher-quality companies with relatively strong cash flows and lower debt ratios. With less debt to service, these companies are well positioned to ride out periods of rising interest rates.

In times of market volatility, quality companies with a strong history of dividend growth can help to protect against market downturns because they are usually financially stable, well- established enterprises. These companies are also better able to offer yields on a regular basis, regardless of market moves. As a result, high quality companies can provide greater stability than those that pay high yields.

Companies paying sustainable dividend payments also tend to have strong fundamentals, such as low debt levels and a history of profitability, making them ideal long-term investments. In addition, their history of sustainable dividends indicates an ability to continue to grow and pay higher dividends in the future—a reliable way of positioning an investor's portfolio for strong returns.

Why Global?

A portfolio that holds companies from around the world offers a buffer against country or region-specific downturns. In other words, a portfolio with broad global exposure enhances diversification, which can reduce volatility – an important factor for many investors' portfolios.

Global investing also expands the types of companies a portfolio can choose from, adding broader sector and currency options, which often results in lower correlations across individual holdings.

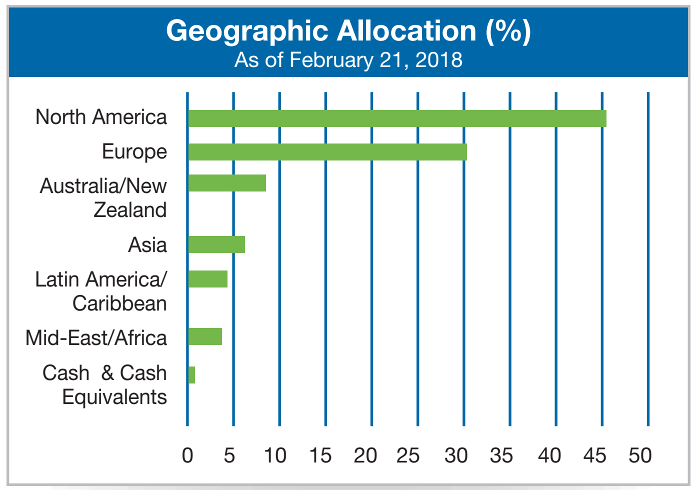
However, despite the benefits of this asset class, it has been difficult for Canadian ETF investors to access a diversified portfolio with the benefits of both high dividend yields and the characteristics of a dividend growth company, until now.

Introducing the Franklin LibertyQT Global Dividend Index ETF

Franklin LibertyQT Global Divided Index ETF (TSX Ticker: FLGD) is a Smart Beta ETF that fills an important gap in the Canadian ETF landscape. Like all of our Smart Beta offerings, it is designed to deliver better risk-adjusted investment outcomes than traditional market cap- weighted products.

With its global menu of constituents, unique investment approach and competitive management fee of 0.45%, FLGD can easily complement an investment portfolio, without detracting from returns through excessive costs.

To see how FLGD embodies a truly global perspective, take a look at the regions in which the fund invests:



Our Unique Approach

During periods of market uncertainty, there may be a "flight to quality" as many investors look to reduce risk in their portfolios.

FLGD can help investors achieve these goals by focusing on high-quality, dividend-paying companies from around the world. Let's explore some of the features of FLGD, and how it filters for quality companies to deliver reduced volatility and stable income.

FLGD offers:

- A core portfolio building block through exposure to global dividend equities (the ETF's investment universe is the MSCI ACWI Ex-REITS Index).
- A Smart Beta, low-cost solution with a management fee of 0.45%.
- A robust, two-step dividend screen that first narrows the investment universe to a shortlist of high-quality global companies paying above-average yields, and then applies a Smart Beta Quality filter to this shortlist for a final selection of approximately 100 global dividend companies.

Continued on the next page

STEP 1. General Dividend Filter

This filter screens for companies in the MSCI ACWI (ex-REITS) Index that demonstrate attractive dividend histories. During this screening process, the fund managers look for:

- Dividend Sustainability— Companies that have a five-year+ track record of consistent or rising dividends.
- Higher Dividends—Companies that have grown their dividends by at least 1.2 times the benchmark growth rate over the past five years.

STEP 2. Smart Beta/Quality Filter

This second filter focuses only on quality to further screen companies that have passed through the general dividend filter, to:

- Higher Yields – High-quality companies paying above-average yields.
- Attractive Risk/Return Characteristics – Companies that can help to reduce portfolio volatility and improve capital appreciation potential.

This second quality filter overlay further reduces the universe down to the portfolio's final 100 holdings, systematically ruling out "problematic" companies by identifying these outliers through an assessment of balance sheet and general financial statement health. As a result, FLGD is constructed to hold a healthy representation of highly reputable "global titan" companies, such as Zurich Insurance, Novartis and GlaxoSmithKline (as of February 21, 2018).

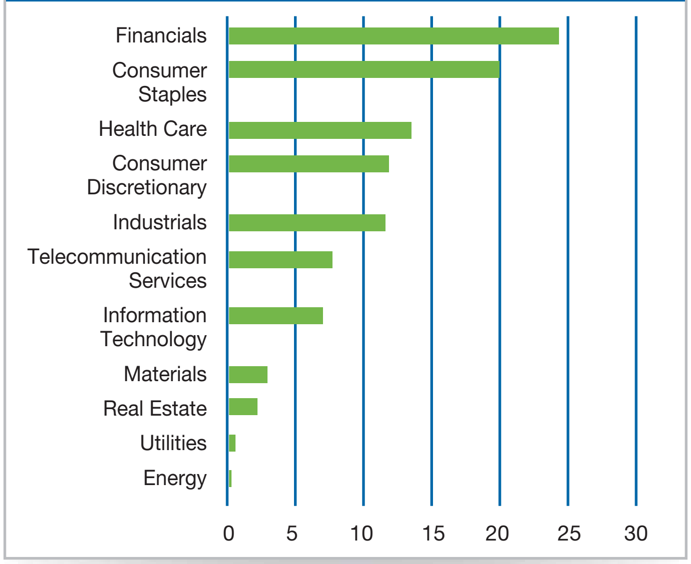
The table below compares the portfolio characteristics of the holdings in FLGD portfolio with those of the MSCI All Country World (ex-REITS) Index.

Characteristic	FLGD	MSCI ACWI (ex-REITS) Index
Return on Equity	24.66%	16.32%
Dividend Yield	~3.22%	2.18%
Price-to-Earnings (12-month trailing)	13.00	15.48
Beta	0.88	1.00

Based on the aforementioned portfolio characteristics, FLGD offers a higher return on equity, higher dividend yield, lower price-to-earnings multiple and lower beta than the index.

Below is a breakdown of FLGD holdings by sector. High-yield companies tend to be concentrated in the Utilities, Consumer Staples and Financials sectors. Dividend-growers, on the other hand, are diversified across sectors, which can help to improve portfolio stability.

Sector Allocation % (ex Cash)
As of February 21, 2018



Commitment to the ETF Market

When Franklin Templeton decided in 2016 to broaden our product platform to include ETFs, we knew that we didn't just want to jump on the "ETF bandwagon." By paying close attention to the needs of advisors and investors, we are building a suite of ETFs that provide investors with greater flexibility and choice when making investment decisions. To help make this vision a reality, we assembled a team of experienced ETF experts to help us bring high quality, differentiated and well-priced ETF products to market. We strongly believe that this specialized expertise, combined with of our 70-plus years of investment knowledge and global resources, will enable us to become an innovative leader in the ETF industry.

Is Now the Time?

For Canadians who are concerned about the effects that market volatility and rising rates could have on their investments, an ETF that focuses on the dual benefits of high yield coupled with the stability and quality of global dividend growth could be a very compelling option.

Call us at 1-800-387-0830, speak to your advisor, or visit libertyshares.ca to find out how Franklin LibertyQT Global Dividend Index ETF can meet your needs in this changing financial landscape.

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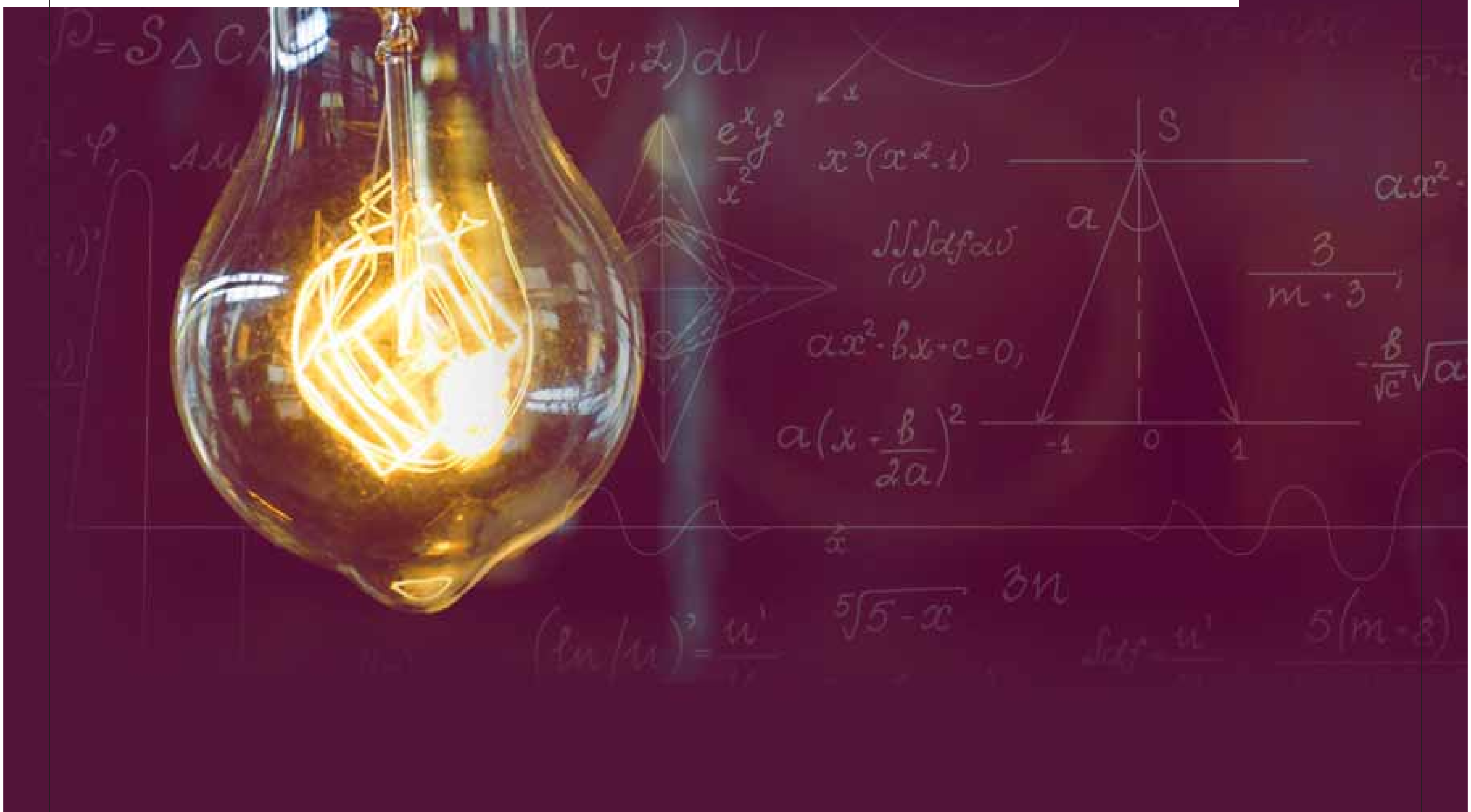
Great ETFs Start With Great Indexes



Given the integral roles played by indexes throughout the creation of an ETF, it is imperative that ETF product developers grasp how index selection can impact an investment product's ability to meet its objectives.

Tom Goodwin
Senior Research Director,
FTSE Russell

FTSE Russell

In particular, before embarking on any smart beta product development journey, providers must consider a number of core index construction tenets that will serve as a strong foundation for a smart beta index design.

Objectives

From the outset, ETF providers must have a clear vision of the objectives they are trying to meet. Product providers and index engineers can then work together to design an index that delivers the characteristics that will address the stated objectives and ensure this is maintained over time.

Representative

It is important to assess smart beta indexes from a number of angles – not just outperformance. Understanding the primary index objective and evaluating the design through this lens can help identify the design's efficacy. This approach also helps identify any unintended index exposures or outcomes that may creep into the index through the application of complex construction techniques. The introduction of constraints can be a useful safeguard against any unwanted extreme positions. In other words, a good smart beta index must be 'true to label.'

Diversification

Diversification matters. Most smart beta indexes target an index level objective of some sort: whether enhancing return, lowering volatility, or achieving targeted factor exposure(s). In trying to achieve these objectives however, smart beta indexes run the risk of becoming overly concentrated as their design might shift towards a style resembling active management relative to the market capitalization of the benchmark. Ensuring appropriate levels of diversification within an index (e.g. targeting a higher number of stocks) can mitigate potential sector, country, or stock-specific concentration risks.

Efficient

Index providers have a number of methodologies in their toolkit to build indexes designed to meet a particular objective. As part of this process, trade-offs must be made along the way; targeted factor exposure vs diversification, simplicity vs complexity etc.

In designing an index, it is important to consider the most efficient methodology that will most closely meet stated objectives, subject to real world implementation considerations. For example, in building factor indexes, constructing from the bottom up and taking factor correlations into account have been proven as more efficient ways of accessing the factor exposure (and therefore risk premia), rather than a top-down composite approach, which can dilute the intended factor exposure.

Replicable

Don't forget implementation! A popular criticism of smart beta indexes is that they are grounded in theoretical academic analysis and rely on back-tested data to simulate attractive performance outcomes.

When designing a smart beta index, practical, real-world implementation issues must be considered. It has to be "investable," meaning an investment product replicating the index can be traded in the market efficiently, and at a high capacity. Consider the size of the assets you are likely to garner, and the market capitalization breakdown of the proposed index. Can you trade the number of stocks? Is it liquid enough? Will you need to optimize further (and what impact will that have on achieving the index objective). What's the turnover and likely trading costs? Imagination and ingenuity support product innovation, but even the best ideas have to be tempered by reality.

As index solutions continue to expand and evolve, you can rely on your index provider to offer the tools you might need as you look to achieve your investment goals. Index providers should be expected to ensure that users are well informed, providing them with tools and information as they consider their opportunities across markets, asset classes, styles or strategies.

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The Case For Multifactor Investing

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Portfolio Manager, Dimensional Fund Advisors LP

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Portfolio Manager, Dimensional Fund Advisors LP

Key Takeaways

- Research has shown that there are differences in expected returns among securities.
- Dimensional Fund Advisors has identified four dimensions of expected returns in equity markets – the overall market, company size, relative price, and profitability help identify differences in expected returns across stocks.
- Incorporating the dimensions of expected returns into an investment strategy offers the potential for outperformance, but requires balancing the trade-offs among competing premiums.
- The exchange-traded fund (ETF) is a vehicle well suited to our systematic and transparent investment approach.

Executive Summary

Theoretical and empirical research in finance has led to an evolution in our understanding of how financial markets work. For instance, 45 years ago, most financial economists and some market participants thought that sensitivity to the market was the only driver of expected returns; they thought the market was the only factor needed to systematically explain differences in expected returns among securities. Today, we recognize several other factors in addition to the market itself. Economists have also done a great deal of work related to market microstructure. This academic research is highly relevant to financial market participants because it has improved our understanding of what drives expected returns.

The existence of multiple factors presents additional challenges to investors' asset allocation decisions. In the past, those decisions were relatively simple: To build their own portfolios, investors had to decide (1) how to split their money between fixed income and equities and (2) whether to invest in index funds, conventional active funds, or individual securities. Today, while investors still need to make those decisions, they can make better choices by taking into account, among other things, the additional factors that help explain returns in the equity markets and how those factors interact with each other, as well as how much emphasis they want to place on each factor. A multifactor world presents better opportunities to meet investors' needs and pursue improved outcomes, but doing so effectively requires a greater degree of expertise to evaluate and manage the trade-offs between expected returns on the one hand and risks and costs on the other.

Dimensional's Investment Philosophy

Backed by decades of theoretical and empirical research, Dimensional Fund Advisors' investment philosophy was founded on the idea that security prices contain reliable information about differences in expected returns among securities. These prices reflect the expectations of all market participants who trade voluntarily with one another at prices they see as fair given their expectations of risk and return and the information available.[1] As a result, the daily activity of market participants drives prices toward equilibrium.

Research has also shown there are differences in expected returns among securities[2]. Those differences are driven by the prices investors pay and the expected cash flows from the investment. Investors have different preferences and opportunities. They face and are willing to bear different risks. Put simply, the lower the relative price an investor pays, the higher the expected return.

Because markets are very effective at aggregating and disseminating investors' knowledge and expectations into market prices, we can use information in prices, together with fundamental data and our understanding of asset pricing theory, to systematically identify differences in expected returns among securities. At Dimensional, we refer to the systematic identification of those differences as dimensions of expected returns. We use the term dimensions instead of factors because, in our view, not all factors qualify as dimensions worth pursuing. Dimensions point to systematic differences in expected returns among securities and are the core investment insight behind relevant factors.

Dimensions of Expected Returns

We have identified four dimensions of expected returns in equity markets: the overall market, company size, relative price, and profitability. Company size and relative price are price-driven dimensions, while profitability contains information about future cash flows to investors.

The market dimension reflects the excess return over the risk-free rate that market participants demand for investing in a broadly diversified portfolio of equity securities without any style or market capitalization bias. That premium is called the equity premium. The company size dimension reflects the excess return that investors demand for investing in small-capitalization stocks relative to large-capitalization stocks. The premium associated with this dimension is the small-cap premium. The relative price dimension reflects the excess return that investors expect from investing in low relative price or value stocks (as measured, for instance, by the price-to-book ratio) relative to high relative price or growth stocks. The premium associated with this dimension is the value premium. The profitability dimension provides a way to discern the expected returns of companies with similar price-driven characteristics. If two companies trade at the same relative price, the one with higher profitability should have a higher expected return. The premium associated with this dimension is the profitability premium.

To avoid chasing data-mined results, we have high hurdles to clear before a premium can be considered a dimension. These dimensions are supported by theoretical and empirical research[3]. They are sensible, persistent over time, pervasive across markets, robust to multiple definitions, and can be captured in cost-effective ways in well-diversified portfolios. While there is no guarantee the premiums will be positive in the future, these rigorous criteria increase our confidence that these premiums are likely to continue in the future and can be pursued in a real trading environment. That is why we want to build our investment strategies around these dimensions.

The list of identified premiums is long. We have evaluated many of the premiums academics have uncovered over the years and found that most are redundant or do not meet our criteria. When we do add a new dimension, it is done with scientific rigor and involves careful analysis by Dimensional researchers and portfolio managers, as well as the financial economists with whom we maintain close ties. The investment process goes beyond identifying the drivers of expected returns. It also requires expertise in structuring and implementing cost-effective investment solutions.

Integrated Solutions

Integrated solutions that incorporate all dimensions of expected returns can potentially increase the reliability of outcomes by providing more information about securities' expected returns. However, in balancing the tradeoffs among competing premiums, diversification, and costs, successful integration requires a deep understanding of the interaction among the dimensions. Pursuing one premium without taking into account how that will impact a strategy's emphasis on the other premiums can hurt a portfolio's performance. For instance, more profitable companies tend to have higher relative prices than less profitable companies. Consequently, if we seek to capture the profitability premium without taking into account how it interacts with the value premium, it could hinder our ability to capture the value premium.

Likewise, the integration of relative price and profitability allows us to separate firms with higher profitability from firms with lower profitability within the low relative price segment of the market. This in turn allows us to overweight the securities of firms with higher profitability and exclude or underweight those with lower profitability in an effort to increase expected returns. It is difficult yet essential to properly account for the interaction among the different dimensions and the costs associated with implementing investment solutions along several dimensions.

We realize that not all securities contribute equally to the premiums. As Eugene F. Fama and Kenneth R. French (2007)[4], among others, have shown, some small or value stocks do extremely well while others have average returns.

Research has also shown that it is not possible to reliably predict which securities are going to do well on an individual basis, because in many cases news about why they will do well has not arrived yet (e.g., a new discovery or a new need by some other company), so it is not yet in the price. For that reason, the most reliable way to capture

Continued on the next page

the premiums is to have a diversified strategy that emphasizes securities with higher expected returns (lower market cap, low relative price, and high profitability stocks). Concentrated portfolios may inadvertently exclude securities that ultimately generate most of those premiums, whereas broadly diversified portfolios are more likely to include those securities and capture those expected premiums.

In addition, it is almost impossible to reliably determine when premiums maybe realized. Under these conditions, it is useful to expect the premiums to be earned every day. Thus, to increase the reliability of outcomes and the likelihood of capturing different market premiums on a daily basis, strategies should have a continual and accurate focus on the dimensions of expected returns. This need is, in fact, why we require that a premium be persistent to be considered a dimension that we use in our portfolios.

A premium that can be pursued with a large number of stocks in a relatively low turnover strategy is going to be much more attractive than a premium that is concentrated on a small set of stocks and requires significant turnover. A good portfolio design will recognize that difference and focus on premiums that can be captured with a large number of securities with relatively low turnover. Targeting these investable premiums makes implementation more efficient because it allows us to treat securities with similar characteristics as close substitutes for one another, at least over short timeframes and provided we maintain appropriate diversification. To screen out stocks that may have detrimental effects on the performance of the portfolio, good portfolio design will also recognize that noninvestable premiums must be taken into account when managing and implementing strategies.

Implementation in an ETF

The body of research is rich, but long-term results for investors depend on how effectively the insight can be implemented as strategies in competitive, real-world financial markets, either through a mutual fund, an ETF, or another investment vehicle.

Implementation through an ETF, a vehicle well suited to our systematic and transparent investment approach, begins by building a custom index that takes into account the foregoing considerations.

The application of Dimensional's investment philosophy to Manulife ETFs required careful design of the indexes tracked by the ETFs. Each ETF will track a specific index designed to target higher expected returns within a specific segment of the market in a broadly diversified way. For example, the John Hancock Dimensional Large Cap Index[5] targets the top 750 companies based on market capitalization. Within that segment, it then weights securities based on the dimensions of higher expected returns: smaller market capitalization, lower relative price, and higher profitability. Regardless of the targeted segment, the indexes are designed to consider the dimensions of expected returns when defining those segments and weighting securities within them.

Trading costs have a direct impact on investors' returns, so the indexes are constructed to allow for cost-effective trading. In the index design, we work to reduce trading costs by adding what we call "Index MemoryTM." For an index with no memory, the companies held in the index prior to rebalancing would have no bearing on the new construction of the index. In our design, the index remembers what was held previously.

To help illustrate this concept, consider a company that is currently in the index and can still be held at its current weight without meaningfully changing the overall index's characteristics. Index MemoryTM enables the index to continue to hold that company, which minimizes unnecessary turnover. Again, the idea is to target a particular segment of the market, capture dimensions of expected returns, and simultaneously be aware of costs that reduce returns.

These trade-offs, intended to minimize unnecessary turnover for the ETF portfolios, have also been incorporated into the reconstitution rules of the indexes. Reconstitution, the process by which the list of stocks and/or their weight in the indexes changes, happens twice per year. As with any decision we make regarding portfolio design and implementation, we considered multiple tradeoffs in determining how often to rebalance the indexes. Our aim for the indexes is to maintain consistent focus on the dimensions of expected returns while keeping turnover low and otherwise limiting the costs associated with pursuing the premiums associated with those dimensions. Reconstituting twice per year allows us to balance those competing objectives.

The ETFs are designed to fully replicate the indexes as efficiently as possible. In addition to trading the ETF portfolio so that it tracks the index closely, portfolio management activities include managing cash and corporate actions. Dimensional's experience with portfolio design, management, and execution provides useful knowledge applicable to both the design of the index and the ongoing management of the ETFs.

Conclusion

In liquid and competitive markets, security prices reflect the aggregate expectations of all market participants. As a result, we can use information in market prices to systematically identify differences in expected returns among securities along multiple dimensions – market, company size, relative price, and profitability – and to structure and implement investment strategies along those dimensions. The premiums associated with those dimensions are largely unpredictable over short periods, both in terms of when they will show up and which individual securities will be the drivers of those premiums. For those reasons, we believe the best way to invest is to structure broadly diversified portfolios with a consistent focus on the desired dimensions, seeking to capture the expected premiums associated with them.

This multidimensional approach increases the likelihood of capturing the premiums associated with each dimension. It requires expertise in understanding how the premiums interact and compete with each other, because stocks are often exposed to more than one premium. It also requires expertise in balancing the trade-offs among diversification, trading costs, and other market frictions.

In the end, we believe a deep commitment to theoretical and empirical research, combined with a focus on effective implementation in competitive and complex markets, can increase an investor's chance of capturing the higher expected returns supported by financial theory.

Only Manulife ETFs are sub-advised by Dimensional Canada.*

Gerard O'Reilly, Co-Chief Executive Officer and Chief Investment Officer, Dimensional Fund Advisors LP

Lukas J. Smart, CFA, Portfolio Manager, Dimensional Fund Advisors LP

Joel P. Schneider, Portfolio Manager, Dimensional Fund Advisors LP

[1]Fair is used in the sense that no market participant has an unfair advantage over others in predicting how prices will move in the future. Given their preferences and expectations, buyers think purchased securities will add to their portfolios by more than what they paid for them. Similarly, given their preferences and expectations, sellers have a different view – the money received is worth more to them than the securities sold. Buyers and sellers meet their different expectations at the traded price, which they both see as fair, and they transact voluntarily. The evolution of these views drives prices. This evolution is based on, among other things, new information.

[2]See Robert C. Merton, "An Intertemporal Capital Asset Pricing Model." Econometrica 41 (1973): 867–87; and Eugene F. Fama and Kenneth R. French, "A Five-Factor Asset Pricing Model." Journal of Financial Economics 116, no. 1 (April 2015): 1–22.

[3]For more information about the historical performance of the equity, small cap, value, and profitability premiums in the U.S. and in developed ex-U.S. markets, see http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html.

[4]See Eugene F. Fama and Kenneth R. French, "Migration," Financial Analysts Journal 63, no. 3 (2007): 48–58.

[5]The John Hancock Dimensional Large Cap Index is designed to comprise a subset of securities in the U.S. universe issued by companies whose market capitalizations are larger than that of the 750 largest U.S. company at the time of rebalancing. In selecting and weighting securities in the Indexes, the Index Provider uses a rules-based process that incorporates sources of expected returns. As currently contemplated, securities are classified according to their market capitalization, relative price, and profitability. Weights for individual securities are then determined by adjusting their natural weight within the universe of eligible names so that names with smaller market capitalizations, lower relative price and higher profitability generally receive an increased weight relative to their natural weight, and vice versa. The Index is rebalanced on a semiannual basis. Dimensional Fund Advisors LP will receive compensation from Manulife Asset Management Limited in connection with licensing rights to the indexes.

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A Basic Truth Of Investing

Fixed income is central to any portfolio, and ETFs make it much easier to get that exposure.

Mark Raes
Head of Product, ETFs and Mutual Funds, BMO Global Asset Management

"I think it's important that we give people different types of exposures so they can make meaningful investment decisions. While we offer broad exposures, what we have chosen to do with fixed income is to segment so people can pick and choose"

The democratization of investing facilitated by ETFs is perhaps the single most important development in asset management in recent years. ETFs allow investors of any means to efficiently access different exposures to build their portfolios.

Canada, the birthplace of the ETF, was slow to embrace the investment vehicle at first, but that all changed after the financial crisis. The latest data from the Canadian ETF Association puts current ETF AUM in Canada at $147 billion, thanks in part to record-breaking inflows of $26 billion in 2017. Fuelling that growth is BMO Global Asset Management, which led the industry last year in terms of net creations, adding $10.3 billion. With assets under management of $46.5 billion – a 36.6% increase in 2017 – BMO GAM is consistently gaining market share on competitors.*

BMO Global Asset Management

Mark Raes is head of product for ETFs and mutual funds at BMO GAM; for him, the spectacular growth last year came as little surprise, as it's become something of a habit for the firm since it entered the ETF space in 2009. "One of the great benefits of ETFs is that they appeal to all investors," Raes says. "More traditional investment products are targeted at a certain group of investors, but ETFs really are broad. They could be held by institutional investors, asset managers, advisors or the direct investor."

Central to BMO GAM's ETF suite is its fixed-income lineup. That sector makes up 28.5% of the Canadian ETF market,* and in a volatile rising-rate environment, it can be increasingly attractive to investors.

BMO GAM's fixed-income suite is divided into broad market or precise exposure, segmented by term or credit, along with non-traditional exposures like emerging market bonds. Investors can cover a lot of ground with the current lineup, but the firm continues to explore new options.

"I think it's important that we give people different types of exposures so they can make meaningful investment decisions," Raes says. "While we offer broad exposures, what we have chosen to do with fixed income is to segment so people can pick and choose."

It's a strategy that is proving popular with investors across Canada and helped BMO GAM pick up seven awards at the 2017 Thomson Reuters Lipper Fund Awards. Three of those came in the fixed-income category: the BMO Mid Corporate Bond Index ETF (ZCM) was named Best ETF in the Canadian Fixed Income Space (over three years), the BMO Mid-Term US IG Corporate Bond Index ETF (ZIC) was selected as Best ETF in the Global Fixed Income Space (over three years), and the BMO Long Provincial Bond Index ETF (ZPL) took home the prize for Best ETF in the Canadian Long Term Fixed Income Space (over three years).

Although accolades are nice, they can sometimes lead to complacency, but that's not likely to happen at BMO GAM. The fixedincome team launched three new funds in February: the BMO Government Bond Index ETF (ZGB), the BMO Corporate Bond Index ETF (ZCB) and the BMO Short-Term Bond Index ETF (ZSB).

For BMO GAM, Raes believes it comes down to providing the best choice for the investor. "The way our fixed-income shelf has been constructed until now is that we have broad market, then we have some precise exposures where we slice by both term and credit," he says. "So instead of just a short bond, we will have a short corporate bond or a long federal bond. Our three new ETFs will be wider exposures."

The products and the strategies involved in portfolio construction are evolving all the time, but there are some basic truths that remain constant. No matter how the equity markets are performing or what central bank policy is, fixed income will always have its place in a balanced portfolio.

"If you think of the two traditional uses for fixed income, you are talking about yield generation and then capital protection," Raes says. "Yield generation over the last couple of years has been more challenging, as we have been in an abnormal rate environment, which we are slowly coming out of. But capital protection to offset the equity market is as valid today as it always was."

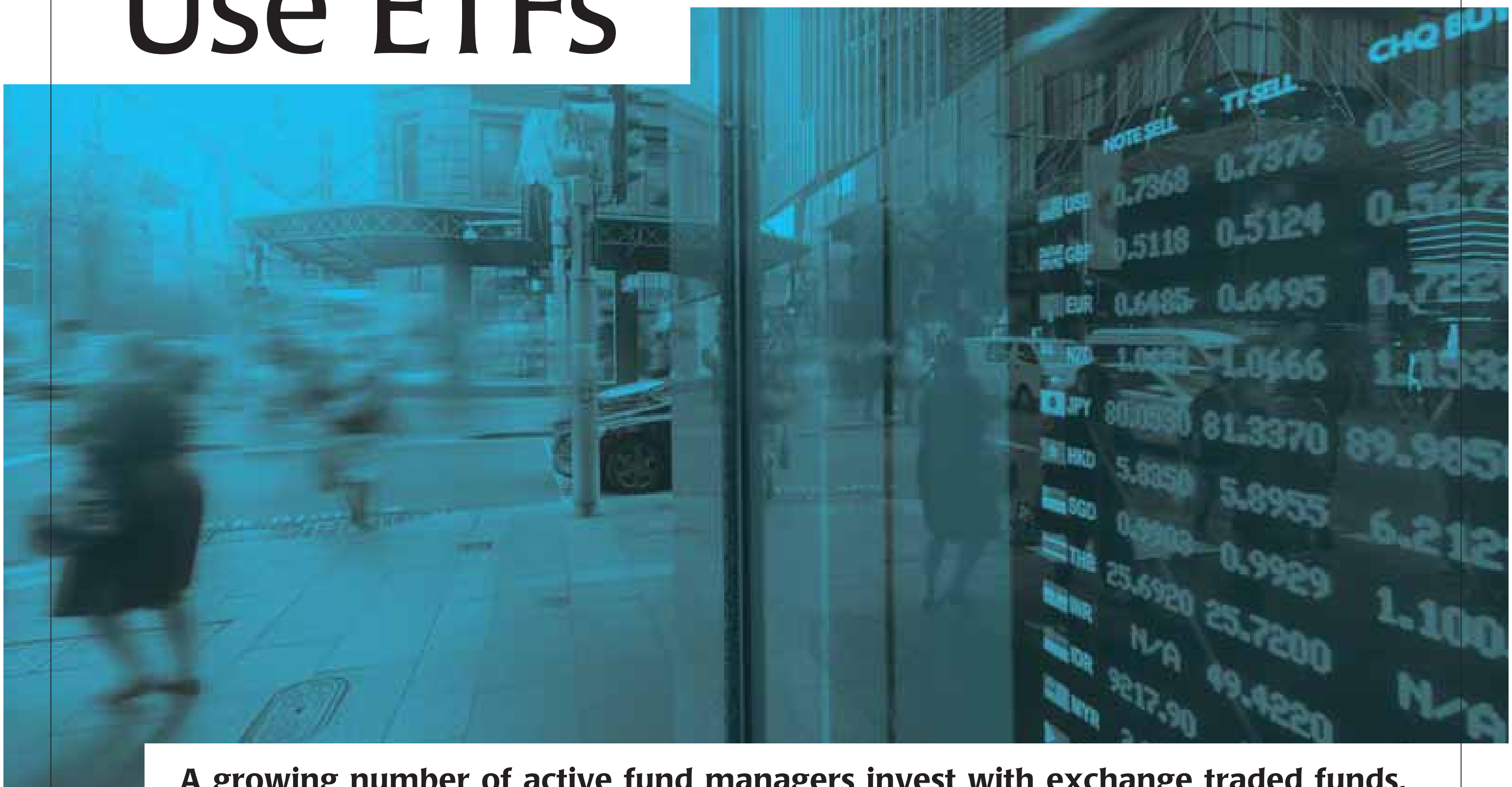
While navigating complex bond markets can be difficult, ETFs offer an easy-to-use alternative. And no matter an advisor's investment outlook, there are options out there to reflect that position.

"You might be a contrarian and believe the Bank of Canada isn't going to raise rates in 2018 and that short-term bonds (one to five years) will rebound," Raes says. "Or you might have a view that the BoC and the Fed will act aggressively, and you want to be on mid-term bonds (five to 10 years). You might have a view that the economy is going to do well and want more corporate bonds in your portfolio, or you might think we are going to have an equity correction and want a higher government bond exposure to better protect your portfolio. You might not have a view beyond that markets will be volatile, and then you want short-term bonds. ETFs give you the ability to move between these positions because they are efficient to trade and to hold because they are low-cost."

Mark Raes, Head of Product, ETFs and Mutual Funds, BMO Global Asset Management

*Source: BMO Asset Management Inc. All data as of December 31 , 2017 The Lipper Fund Awards, granted annually, are part of the Thomson Reuters Awards for Excellence awarded by Lipper, Inc. and highlight funds that have excelled in delivering consistently strong risk-adjusted performance relative to their peers. The Lipper Fund Awards are based on the Lipper Ratings for Consistent Return, which is a risk-adjusted performance measure calculated over 36, 60 and 120 month periods. The highest 20% of funds in each category are named Lipper Leaders for Consistent Return and receive a score of 5, the next 20% receive a score of 4, the middle 20% are scored 3, the next 20% are scored 2 and the lowest 20% are scored 1. The highest Lipper Leader for Consistent Return in each category wins the Lipper Fund Award. Lipper Leader ratings change monthly. For more information, see www.lipperweb.com. Although Lipper makes reasonable efforts to ensure the accuracy and reliability of the data contained herein, the accuracy is not guaranteed by Lipper. Lipper and Lipper Leader are trademarks of Lipper Limited, a Thomson Reuters Company, and have been licensed for use by the Bank of Montreal. BMO Mid Corporate Bond Index ETF (Ticker ZCM), was awarded the 2017 Lipper Fund Award in the Canadian Fixed Income ETF category for the three year period ending July 31, 2017 out of a total of 19 funds. The corresponding Lipper Leader ratings of the fund for the same period are as follows: 5 (3 years), 5 (5 years), N/A (10 years). BMO Mid-Term US IG Corporate Bond Index ETF (Ticker ZIC), was awarded the 2017 Lipper Fund Award in the Global Fixed Income ETF category for the three year period ending July 31, 2017, out of a total of 8 funds. The corresponding Lipper Leader ratings of the fund for the same period are as follows: 5 (3 years), N/A (5 years), N/A (10 years). BMO Long Provincial Bond Index ETF (Ticker ZPL), was awarded the 2017 Lipper Fund Award in the Canadia n Long Term Fixed Income ETF category for the three year period ending July 31, 2017 out of a total of 5 funds. The corresponding Lipper Leader ratings of the fund for the same period are as follows: 4 (3 years), N/A (5 years), N/A (10 years). BMO Global Asset Management is a brand name that comprises BMO Asset Management Inc., BMO Investments Inc., BMO Asset Management Corp. and BMO's specialized investment management firms. BMO ETFs are administered and managed by BMO Asset Management Inc., an investment fund manager and portfolio manager and a separate legal entity from the Bank of Montreal. Commissions, management fees and expenses all may be associated with investments in exchange traded funds. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any unitholder that would have reduced returns. Exchange traded funds are not guaranteed, their values change frequently and past performance may not be repeated. "BMO (M-bar roundel symbol)" is a registered trademark of Bank of Montreal, used under licence.

Why Active Managers Use ETFs



A growing number of active fund managers invest with exchange traded funds, not because they want to take a more passive approach, but to help them become even more responsive to opportunities and risks that arise from changing market conditions around the world.

Mark Stacey
Senior Vice President, Head of Portfolio Management & Co-Chief Investment Officer, AGFiQ

Florence Narine
Senior Vice President, Head of Product, AGF Investments Inc.

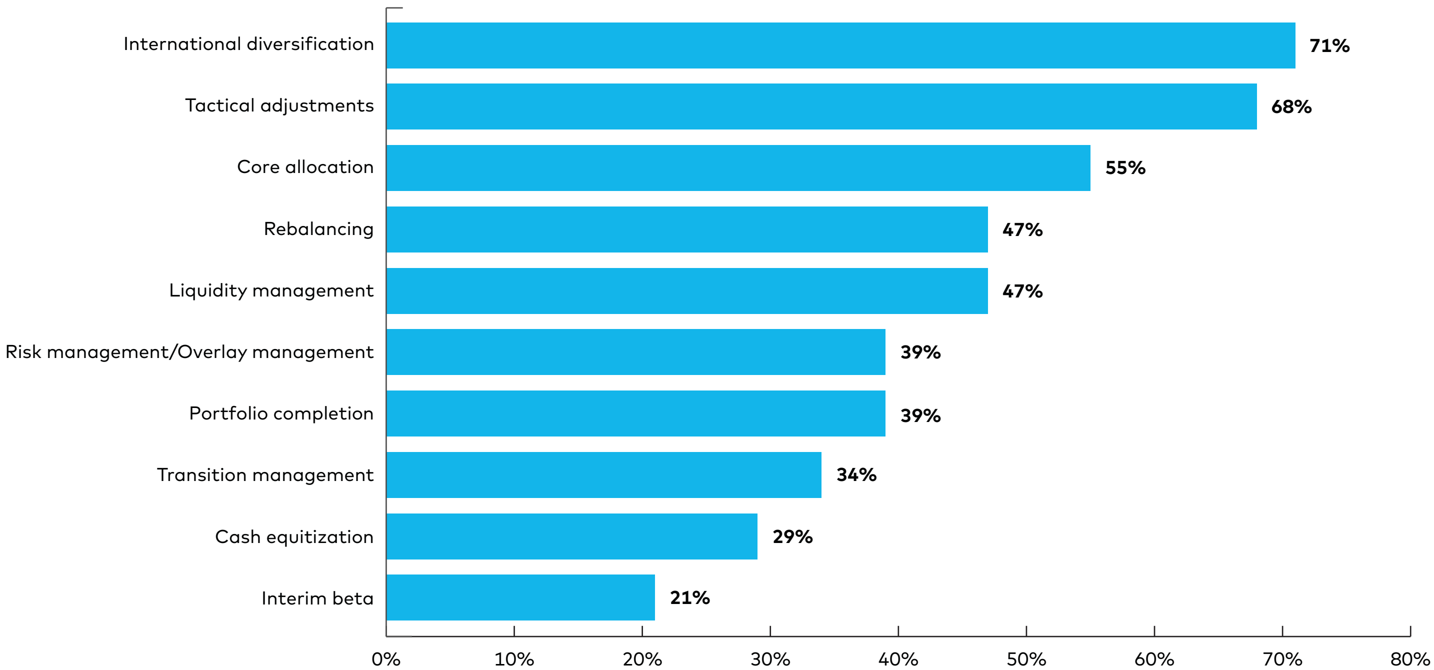
While ETFs are well known for being a low-cost, efficient way to replicate the "market" through broad-based stock indices, it's less recognized just how integral they've become – even to the most ardent stock pickers -- in the ongoing management of mutual funds, pension plans and institutional portfolios. In Canada, 82% of asset managers now use ETFs to gain some degree of exposure to equities, says a 2017 study by Greenwich & Associates. And 28% of current equity ETF investors plan to increase allocations in the next year, with 57% of them planning to boost allocations by 10% or greater.

In many of these cases, ETFs are being used to help facilitate asset allocation decisions in a more efficient manner than would be the case for individual securities. The decision to overweight or underweight an asset class, sector, geography or factor often requires swift execution to be effective in today's fast-moving market environment.

For example, when stock markets sell off aggressively, as they did in February of this year, some managers will address the market's deteriorating momentum and heightened volatility by increasing the cash position in their portfolios. These moves can sometimes be significant (i.e. zero to 50% or more of holdings). By utilizing ETFs, they can be executed for a minimal cost and require far less time and fewer trades than would have been the case if the manager needed to sell one half of an equally diversified portfolio invested in individual stocks.

AGFiQ™

ETFs used for a broad variety of applications



Note: Based on 38 responses.
Source: Greenwich Associates 2016 Canadian Exchange-Trade Funds Study

Even fund managers who primarily invest in individual stocks will hold a small percentage of ETFs in their portfolios from time to time, using them to enhance liquidity, reduce single stock risk in smaller, less liquid markets, and/or as stop gaps to fulfill short term tactical adjustments. For instance, if the outlook for a particular country or sector improves, an ETF can be purchased to add weight to that position until such time that one or more individual stocks is properly assessed and deemed a buying opportunity. This could mean holding an exchange-traded fund for a few weeks or an extended period depending on the criteria involved. On the flip side, an ETF can be used to reduce exposure if the outlook for a country or sector worsens, but the manager likes his related individual holdings and doesn't want to sell them just yet.

Beyond offering these various advantages, exchange traded funds are also gaining traction with some active managers as an alternative way to hedge equity market risk. This includes ETF options (i.e. puts and calls), but also may involve shorting a particular ETF security that is strongly correlated to a portfolio's core holdings. While the use of exchange traded funds as a hedge is still more the exception than rule, broader adoption is expected once the size and liquidity of the ETF market increases and new products that invest in truly diversifying assets and strategies are introduced.

As ETFs become more ensconced in the portfolios of active managers, it is important to recognize them as a complement to the management process rather than a replacement to it. Active decisions about where to invest and how to gain exposure to a market remain paramount and exchange traded funds are one of several tools that can be used to execute on those ideas more efficiently.

The AGFiQ Difference

AGFiQ Asset Management is the quantitative investment platform for AGF powered by an intellectually diverse, multi-disciplined team. AGFiQ designs and manages single- and multi-factor strategies to meet client objectives and also manages an array of outcome-oriented ETF Managed Portfolios as a skilled ETF Strategist.

Mark Stacey, Senior Vice President, Head of Portfolio Management & Co-Chief Investment Officer, AGFiQ; Registered Advising Representative in Canada, Highstreet Asset Management Inc., a subsidiary of AGF Investments Inc. and Florence Narine, Senior Vice President, Head of Product, AGF Investments Inc.

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AGFiQ Asset Management (AGFiQ) is a collaboration of investment professionals from Highstreet Asset Management Inc. (HSAM), a Canadian registered portfolio manager, and of FFCM, LLC (FFCM), a U.S. registered adviser. This collaboration makes up the quantitative investment team. Publication Date: March 28, 2018.

GICS Changes Upend the Sector Apple Cart. What Does it Mean for Investors?

It looks like the proverbial apple cart is going to be upended for sector investors in 2018.

Bobby Eng
Vice President, State Street Global Advisors Ltd. & Head SPDR ETF Business Development for Canada

Come September, S&P® Dow Jones® Indices and MSCI Inc. are changing the Global Industry Classification Standard (GICS®) structure and reclassifying selected companies. When these changes become effective, they will create a new landscape of growth-oriented exposures and the need for sector investors to alter their due diligence.

While there will still be 11 GICS sectors, the Telecommunication Services sector will be renamed Communication Services. Along with its new name, its profile will be expanded to include companies from Consumer Discretionary and Information Technology, which will add growth to a sector that has traditionally been seen as a value play.[1]

To explore the potential impact of these shifts on sector investing, we performed an analysis of new sectors based on the currently known list of large-cap companies expected to be impacted by the upcoming changes. To create the new sectors, we reallocated these companies to their new sectors and then weighted them by market cap. Next, we took a bottom-up approach, capturing historical information at the stock level and aggregating it at the sector level. This allowed us to avoid back testing – our analysis represents historical information repackaged under a different label.

The resulting five charts illustrate how these changes will likely impact GICS sectors and sector investing going forward.

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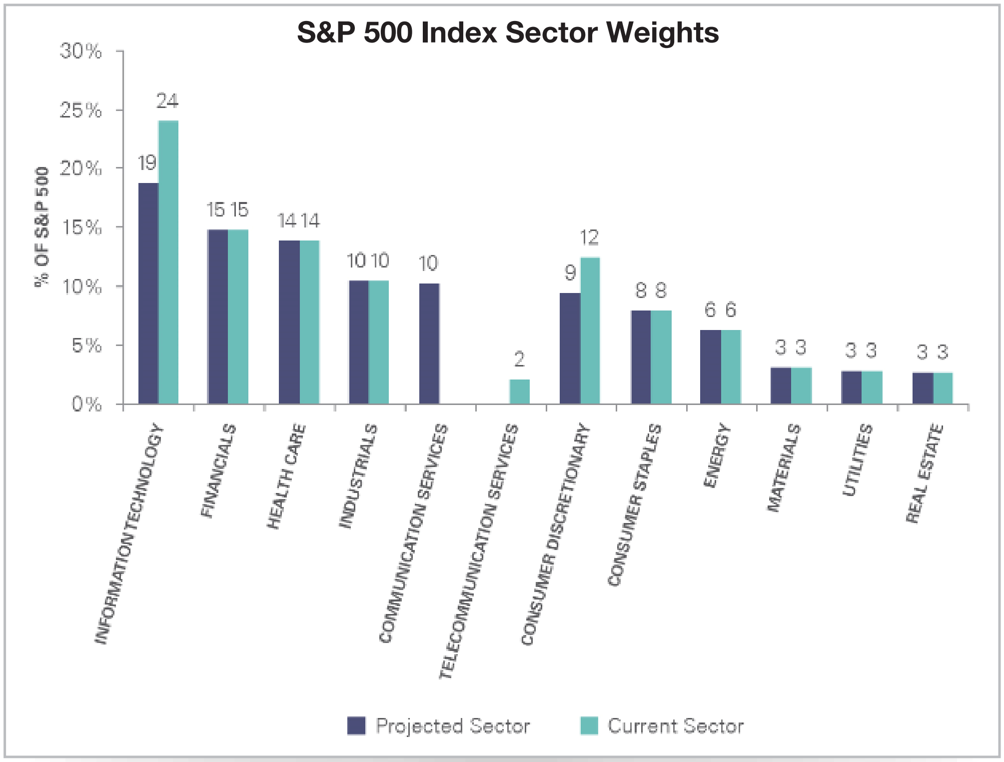


Source: FactSet, as of 1/11/2018. Characteristics are as of the date given and should not be relied upon as current thereafter.

Telecommunication Services Gets a Makeover

The new Communication Services sector will include companies that facilitate communication and offer related content and information through various types of media. This is an upgrade of the Telecommunication Services sector, allowing it to reflect modern communication activities.

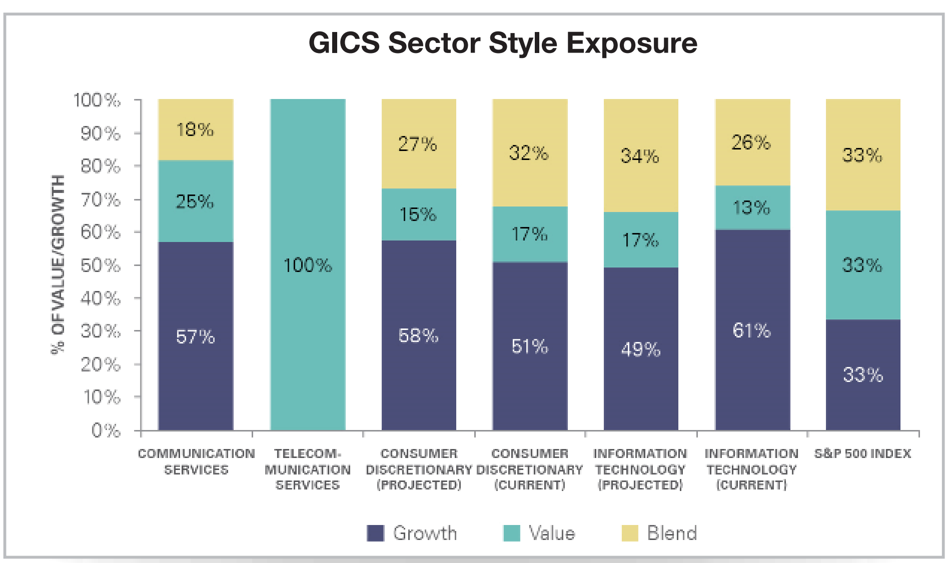
The revamped sector will include existing telecommunication companies, such as AT&T, as well as former media-related Consumer Discretionary stocks, such as Netflix, and consumer internet-oriented Information Technology stocks, like Facebook.

This means FAANG (Facebook, Apple, Amazon, Netflix and Google) will be redistributed across three sectors as opposed to two. The Communication Services sector will represent around 10% of the S&P 500® Index market cap, compared with the 2% weight of the current Telecommunication Services sector.

More Growth Options For Sector Investors

Historically, the Telecommunication Services sector was viewed under a “value” lens due to its number of bond-proxy, high dividend paying stocks. However, certain high-flying FAANG stocks will be removed from Consumer Discretionary and Information Technology to join Communication Services.

This means Communication Services may be viewed under the “growth” lens based on a style exposure analysis we conducted using Morningstar Style Box classifications. As shown below, Telecommunication Services is currently classified 100% as a value sector. When it becomes Communication Services, it will hold a majority – 57% – of growth stocks, as shown in the chart at the top of the following page.



Source: Morningstar, FactSet, as of 1/11/2018. Characteristics are as of the date given and should not be relied upon as current thereafter.

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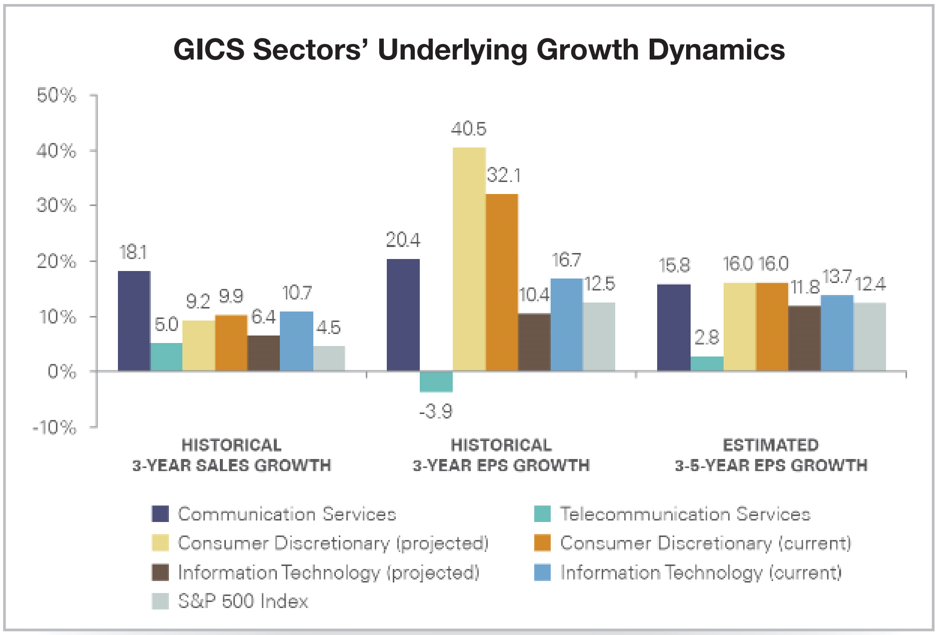

Source: FactSet, as of 1/11/2018. Characteristics are as of the date given and should not be relied upon as current thereafter. Estimated growth rates based on Consensus Analyst Estimates compiled by FactSet.

But these changes do not completely strip growth from Consumer Discretionary and Information Technology. They will have a 58% and a 49% allocation to growth stocks, respectively – figures that are higher than the broader market.

The Fundamentals of Change: Higher growth, lower leverage at attractive relative valuations

Communication Services' growth tilt is reinforced when examining the historical growth rates of its underlying companies and their consensus analyst estimates for the next three to five years.

Shown below, the new sector will result in a portfolio of stocks that have produced – and are expected to produce – a high level of earnings and sales growth. These growth rates are projected to be above that of the broader market.

The new sector will also have far less leverage, as measured by the long-term debt-to-capital (LTC) percentage. Its LTC will be 28% vs. its current rate of 62%. But the leverage profile of the other two sectors only shifts slightly, with Consumer Discretionary rising from 51.4% to 52.7% and Information Technology increasing from 30.3% to 37.4%.[2]

Growth At What Cost?

This raises the question: What is the price associated with these new growth dynamics? To answer this we chose four fundamental metrics, while also comparing the current aggregated sector level Price-to-Earnings (P/E) ratio versus the same group of stocks historical average P/E ratio over the past ten years. The latter point may provide insight into whether the new sector will be more expensive, fundamentally speaking, versus what history would indicate.

As shown below, the Communication Services sector trades at higher multiples than the old sector while the other two sectors' fundamentals remain largely the same. Compared to the 10-year average, all new versions of the sectors are trading above their historical average. However, when each sector is viewed relative to the market, a relative value opportunity exists, as each sector is trading at a lower premium to the S&P 500 than their historical average over the last 10 years.

Macro Sensitivity

Sectors are also closely aligned to specific economic variables. The table below shows the beta of the new and current sectors based on sector constituents' beta. The Communication Services sector will be more sensitive to the broad market, less negatively sensitive to the US dollar while more positively sensitive to the US 10-year Treasury yield. While the latter move is small, it illustrates that this new set of communication stocks will not be the typical bond proxies of the current telecommunication sector.

Valuation of Characteristics

	Communication Services	Telecommunication Services	Consumer Discretionary (projected)	Consumer Discretionary (current)	Information Technology (projected)	Information Technology (Current)	S&P 500 Index
Price-to-Earnings	25.8	15.5	26.1	26.7	24.7	26.0	24.4
Price-to-Cash Flow	12.0	5.3	15.5	14.0	16.2	17.7	14.4
Price-to-Book	4.1	2.6	6.1	5.2	5.6	5.6	3.3
Price-to-Sales	3.4	1.4	1.8	1.9	4.4	5.1	2.4
10-Year Average Price-to-Earnings	20.0	–	18.9	–	17.7	–	17.0
% Above/Below 10-Year Average	29%	–	38%	–	39%	–	43%
Premium/Discount to S&P 500 Based on P/E	6%	–	7%	–	1%	–	–
10-Year Average Premium/Discount to S&P 500	18%	–	11%	–	4%	–	–

Source: FactSet, as of 1/11/2018. Characteristics are as of the date given and should not be relied upon as current thereafter.

The Communication Service's shift in beta sensitivity to the US dollar is representative of its increased tech-like global footprint. The previous sector had only 2.9% of foreign sales. The new one will have 32%.[3]

Sector Due Diligence Will Need An Upgrade

These upcoming GICS changes mean sector growth opportunities will become more widespread. They also mean the Communications Services sector will be more cyclical than Telecommunication Services, which was more defensive.

Unfortunately, this sector revamp also means performing a bottom-up fundamental analysis or a top-down macro analysis will become harder. Investors can no longer simply run a screen based on historical values because the Informational Technology sector from the last ten years will look different for the next ten. Trend following rotation strategies will also have to course-correct given that the new Communication Services sector will have 13 constituents that rank in the top 50% of performers in the S&P 500 over the past year[4] – while the old Telecommunication Services sector had none.

36-Month Beta Sensitivity

	US Dollar	US 10-Year Yield	Yield Curve (US 10-Year – US 2 Year Yield)	S&P 500 Index
Communication Services	-0.23	0.04	0.02	0.90
Telecommunication Services	-0.55	-0.01	0.02	0.59
Consumer Discretionary (projected)	-0.13	0.09	0.01	1.04
Consumer Discretionary (current)	-0.18	0.11	0.04	1.08
Information Technology (projected)	-0.20	0.12	0.04	1.29
Information Technology (current)	-0.17	0.09	0.02	1.19

Source: FactSet, as of 1/11/2018. Characteristics are as of the date given and should not be relied upon as current thereafter.

Article written by:
Matthew J. Bartolini, CFA, Head of SPDR Americas Research

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[1]"S&P Dow Jones Indices and MSCI Announce Revisions to the Global Industry Classification Standard (GICS) Structure in 2018," msci.com, as of 11/15/2017
[2]FactSet, as of 1/11/2018 [3]FactSet, as of 1/1/2018 [4]FactSet, as of 1/11/2018

Definitions
Beta – Measures the volatility of a security or portfolio in relation to the market, usually as measured by the S&P 500 Index. A beta of 1 indicates the security will move with the market. A beta of 1.3 means the security is expected to be 30% more volatile than the market, while a beta of 0.8 means the security is expected to be 20% less volatile than the market.
Global Industry Classification Standard (GICS) – A financial-industry guide for classifying industries that is used by investors around the world. The GICS structure consists of 11 sectors, 24 industry groups, 68 industries and 157 sub-industries, and Standard & Poor's (S&P) has categorized all major public companies into the GICS framework. **S&P 500 Index** – The S&P 500, or the Standard & Poor's 500, is an index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices.
Sector Rotation – Sector rotation is a strategy based on moving investments across business sectors to take advantage of cyclical trends in the overall economy whereby a portfolio may overweight positions in strong sectors and underweight positions in weaker sectors.
View More Information About Our Firm: FINRA's BrokerCheck

ETF Trading Volume ≠ ETF Liquidity

It's a misconception that ETFs with a smaller market capitalization and less trading volume are illiquid and should therefore be avoided. Rather, attention should be paid to evaluating fund attributes which differentiate one ETF from another.

Karl Cheong, CFA
Head of Distribution, First Trust Portfolios Canada

In recent years, much has been made of exchangetraded funds (ETFs) and the benefits they afford investors. One of the benefits is the stock-like characteristics of ETFs, for example benefits like (intraday trading, exchange listed, various order types – to name a few). However, further examination relating to the depth of the trading market or liquidity for any particular ETF is warranted.

One of the misconceptions is that smaller ETFs with a smaller market capitalization and less trading volume are illiquid and should therefore be avoided. The "stock-like" characteristics of ETFs naturally lead to ETFs being assessed for liquidity just like you would a common stock. However, a core difference is rooted in the open-ended nature of ETFs. While stocks have a fixed number of shares requiring that there be sellers of a stock to satisfy the demand from buyers ("limited offerings") and buyers of a stock to satisfy the demands from sellers, ETF shares on the other hand can be created or redeemed in large "creation unit" aggregations to satisfy supply and demand ("continuous offerings"). As a result of this structure, there is more liquidity than can be ascertained by simply looking at the market capitalization and daily trading volume of the ETF itself.

First Trust
Portfolios Canada®

Let's take an example of a small market capitalization/ low trading volume fund and drill into the specifics.

Daily Closing Price of First Trust AlphaDEX™ U.S. Technology Sector Index ETF

Date	Last Price	Vol
9/11/2017	28.19	3,826
9/12/2017	28.39	913
9/13/2017	28.44	1,197
9/14/2017	28.42	2,798
9/15/2017	28.58	199,940
9/18/2017	29.18	41,384
9/19/2017	29.19	303,291
9/20/2017	29.06	7,801
9/21/2017	29.03	849
9/22/2017	29.15	4
9/25/2017	28.68	3,711
9/26/2017	28.77	47,506
9/27/2017	29.45	1,188
9/28/2017	29.25	24
9/29/2017	29.64	2,149

Source: Bloomberg

Trade Recap 09/19/17 of First Trust AlphaDEX™ U.S. Technology Sector Index ETF

Time	Vol.	Price
9:37:08	300	29.16
9:37:08	88	29.16
10:01:07	50	29.12
10:19:35	3,600	29.18
11:23:13	4,000	29.17
11:23:13	2,000	29.17
11:23:13	4,000	29.17
11:23:13	284,200	29.18
11:23:13	21	29.18
11:39:31	300	29.22
11:39:31	59	29.22
11:53:19	700	29.17
11:53:20	12	29.17

Source: Bloomberg

The **First Trust AlphaDEX™ U.S. Technology Sector Index ETF** (TSX:FHQ) typically trades just 5,725 shares per day on average since inception Oct. 30, 2014. The total market capitalization of the fund is $34.1 million, as of March 9, 2018. In the exhibit below you can see the historical prices and volumes of the ETF for fifteen trading days in September 2017. On 9/19/17 an investor purchased nearly 303,291 shares of the ETF. "Stock-like" analysis would suggest that this trade would significantly impact the price of the ETF as this trade would represent 53 times the volume of a typical trading day. Yet, since the security is an ETF, the more appropriate way to assess the impact of the increased trading on the liquidity of the ETF is to realize that this trade represents a small fraction of the average daily volume of the individual underlying stocks that comprise the ETF's portfolio holdings.

Despite the fact that the trading volume was extraordinary relative to historical trading levels, the price did not fluctuate accordingly. If you had been using the average daily trading volume (ADV) number to guide your trading strategy, then you might have never imagined you could trade that many shares in one day.

FHQ Trading Detail on 9/19/17 – A Closer Look

A further look at the actual trades made in FHQ during the day on 9/19/2017 allows one to draw the conclusion that volume is not driving the price of the ETF. A large block (284,200 shares) trade is executed on the heels of a number of smaller block trades with no fluctuation in the price.

Although the narrative above describes how ETF trading volume does not equal ETF liquidity, below are a few helpful points to trade ETFs:

1) Generally avoid trading on the open or close of the market. At the open, the market maker has to price the ETF relative to the prices of the underlying securities held in the ETF's portfolio which tend to be a best estimate based on the data available. Be it financial crisis, geopolitical concerns or company specific issues that are announced prior to market open, prices on the open can be volatile which impacts the ETF's pricing until the trading day gets underway and the prices of the stocks underlying the ETF are established;

2) Use limit orders – Limit orders are generally preferred over market orders, enabling investors to control the price at which ETF trades may be executed. In doing so, investors can often access much more depth than what is seen at the top of the order book, since ETF shares can be created or redeemed.

3) Stop Orders – if these are part of your strategy, then consider using stop limits as stop orders turn into market orders when triggered.

Understanding ETF Implied Liquidity

In the Bloomberg chart below, we can see that the 30-day Average Daily Volume of the ETF is only 6,300 shares as of March 9, 2018, however, the ETF's implied liquidity under the trading data section, was 36.3 million shares on March 9, 2018. The implied liquidity figure displays the number of ETF shares that could potentially be traded as implied by the trading volume of each stock in the portfolio. If you were a portfolio manager who wanted to invest $100 million in the ETF, you might be hesitant at first because the ETF usually trades only about $237,699 notional per day (6,300 shares times $37.73 per share, as of March 9, 2018). However, if you review the liquidity of the underlying holdings of the ETF, you would see that you could potentially trade more than $1.37 billion notional daily ($37.73 times 36.3 million shares) without impacting the share prices of the underlying stocks that make up the ETF portfolio.

Bloomberg Fund Summary of First Trust AlphaDEX™ U.S. Technology Sector Index ETF

Source: Bloomberg

Implied liquidity is exponentially higher than average daily volume

Why does ETF liquidity matter?

Many investors assume that ETFs tracking specific segments of the market will generally offer very similar returns. However, as the diversity of approaches followed by ETFs has increased over the past decade, so has the divergence in returns, even among funds in the same sector or asset class.

As investors begin to understand ETF liquidity, recognizing that good execution and tight spreads are made possible (even for thinly traded ETFs) by the liquidity of the funds' underlying holdings coupled with the ETF creation and redemption process, more attention can be paid to evaluating fund attributes which differentiate one ETF from another, such as index methodology and portfolio holdings. With this knowledge, investors are much better equipped to begin sorting through the evergrowing universe of ETFs on the basis of information that is relevant in order to achieve their objectives.

Karl Cheong, CFA, Head of Distribution, First Trust Portfolios Canada

WisdomTree: Canada's Benchmark For Excellence

Jeff Weniger
Asset Allocation Strategist, WisdomTree Asset Management, Inc.

Our Growth

WisdomTree Canada launched its first six TSX-listed ETFs on July 12, 2016. Back then, we closed our first month of business in Canada with C$91 million in AUM—and it paled in comparison to the US$38.1 billion we were managing south of the border at the time.[1] Since then, our Canadian asset base has grown to C$431 million across 12 ETFs—and our sights are now focused on breaking into the Canadian top 10 this year.[2]

Although we came to Canada in 2016, we are one of the original ETF players, with a list of ETFs in the U.S. that are now pushing their 12th birthdays. Our U.S. business manages US$45 billion, making us the seventh largest ETF provider there; globally, we are No. 10.[3] Even our ticker symbol (WETF) has "ETF" in it. That means we do not have any internal political conflicts between a legacy mutual fund business and our ETFs—because we have no legacy mutual funds. In fact, WisdomTree is the only publicly traded asset manager that the industry views as a large-scale ETF "pure play."

The quadrupling of assets in our TSX-listed ETFs in less than two years came despite our business having nothing in the way of Canadian fixed income or Canadian equity ETFs until June and September 2017, respectively. Our offerings are now rounded out to include those asset classes, along with dedicated Europe, U.S., non-North American international developed and emerging market equities.

WisdomTree®

The WisdomTreeLineup

Further, our ETFs wouldn't have the WisdomTree flavour if they didn't offer investors various approaches to foreign currencies. For the most part, all of our international equity ETFs come in fully hedged, unhedged and Variably Hedged™ varieties, with the last one leaving the currency decision to WisdomTree's modern alpha rules-based metrics. We thus have a suite of TSX-listed ETFs that fill entire asset allocations.

Though some investors may be new to so-called "smart beta" strategies (what we call modern alpha), WisdomTree has always been dedicated to the concept; our original foundation was based on our pioneering work in dividend-weighted ETFs, among other such innovations.

The reason we weight so many of our ETFs by dividends is because fundamental metrics offer an objective measure of a company's health, value and profitability, whereas ETFs that track indexes that weight their components by stock price alone ignore such factors. WisdomTree believes its modern alpha approach helps investors:

- Enhance returns
- Reduce risk
- Increase dividend income
- Benefit from more complete diversification

The Canadian ETF Industry

The attraction of ETFs among investors has drawn in more and more Bay Street entrants, with more than two dozen companies now providing ETFs in Canada, up from a handful just a few years ago. With all of this competition, owners of WisdomTree ETFs can rest assured that they have found a tried-and-true ETF company that has been in this business for nearly 12 years.

According to Forbes, the global ETF industry now manages US$4.6 trillion,[4] and yet in Canada, there remains $10 in mutual funds for every $1 in ETF assets.[5] There is plenty of room for our industry to continue to pick up market share.

WisdomTree has its sights set on cracking Canada's top 10 in ETF assets under management sooner rather than later. The firm that is currently ranked No. 10 had C$474 million in AUM at the end of January, while we were managing C$403 million at the time.[6] It is our goal to grab that slot on the list before WisdomTree Canada's second birthday this summer.

Make no mistake: We constantly remind our investors that we are a top 10 global ETF provider, so we want to be able to walk into meetings across Canada in 2018 and say we have achieved the same rank here that we have achieved on the planet as a whole. That will only happen if Canadians trust our brand. That means we will let our competitors launch the gimmicky and hot-money ETFs; we have a solid-gold reputation, and we wish to keep it that way.

Our Growing List For The Whole Portfolio

Now that we have introduced core fixed income ETFs, we are asking investors to consider WisdomTree for their whole portfolios.

Whether it's frustration with expensive managed mutual funds or some other issue that calls for a switch to WisdomTree, we provide mainstream allocations – Canadian equities, U.S. equities, Canadian fixed income – for the entire "pie chart."

We have two ETFs that we believe will ultimately become our flagships: CAGG, our yield-enhanced Canadian aggregate bond ETF, and DGRC, our factor-based Canadian equity ETF.

CAGG goes head to head with legacy core bond mutual funds, putting its 0.18% management fee on the table. With a yield to maturity of 3.05%, CAGG yields 44 basis points more than Canadian aggregate bonds.[7] We aspire to see this ETF become the core fixed income holding for our existing investors and for new ones, whom we welcome.

DGRC, the Canadian equity ETF, was launched in September 2017, although it is the intellectual reincarnation of ETFs that have been live in New York since 2013. DGRC is our darling, and we think it could become WisdomTree Canada's biggest product someday, maybe even in 2018, especially if its refusal to mimic Indexes like the MSCI Canada or the S&P/TSX Composite pays off.

To give an idea of how this ETF refuses to play the game of always having huge positions in financials and energy "because that is what everyone else is doing," DGRC currently has zero exposure to the Big Five banks.[8] Its composition can change in the future if those companies pass DGRC's rules-based screens, but until that happens, WisdomTree stands steadfast in its willingness to provide core Canadian equity exposure that is based on our confidence in our research process. No buckling to peer pressure. DGRC's management fee is 0.21%.

Our Philosophy

At WisdomTree, we argue that our dividend-focused Indexes are the benchmark for such concepts. Having witnessed the dot-com bubble, Lehman crisis and numerous other episodes of extreme sentiment in recent years, we adhere to a school of thought that logically says that security prices are not the best approximation of their true value.

We think that part of the reason some investors have concluded that market cap-weighted indexes are the gold standard for investment performance is their observation that so many active managers fail to beat those indexes. However, the fact that a large proportion of active managers have not beaten cap-weighted benchmarks is not a testament to how good the existing benchmarks are, but simply how bad so many active managers are.

Blindly following market capitalization-weighted indexes may have helped investors over the years because the alternative was expensive mutual funds, but these days we have players like WisdomTree to shake the proverbial tree on expenses and research. According to Cass Consulting, a research-led consultancy service provided by Cass Business School, returns of traditional market capitalization-weighted indexes lagged various fundamentally weighted indexes by as much as 2% per year from 1969 to 2011.[9] With ETFs like CAGG and DGRC coming into the fray at MERs[10] of just 0.20% and 0.21%, respectively, suddenly the reflexive grabbing of market capitalization-weighted trackers starts to make less sense than it did in mutual funds' heyday.

Continued on the next page

The New Benchmark

For core holdings – real core holdings that are based on the relative investment merit of the companies owned—WisdomTree Canada provides investors with broad exposure to all major asset classes. Owners of WisdomTree ETFs are partnering with a firm that pioneered ETFs, smart beta concepts, Variably Hedged™ currency ETFs and more.

With WisdomTree, ETF investors are choosing a firm that refuses to launch gimmicky funds based on hot-money fads. Our brand is too important to our business to tarnish it for a quick dollar.

Our ETFs are designed to complete the major sleeves of asset allocations. DGRC is for the Canadian equity allocation, and CAGG is the foundation for core Canadian fixed income.

Essentially, we think of our ETFs as the benchmark for modern alpha investing. We're challenging the big mutual funds to go head to head with our offerings on merit. Wherever our competitors do not meet investors' expectations, we are happy to ask for that business; we are grateful and humbly honoured whenever we are chosen to be a steward of precious capital.

Jeff Weniger, Asset Allocation Strategist, WisdomTree Asset Management, Inc. ***jweniger@wisdomtree.com***

[1] Source: WisdomTree; data as of 7/12/16.
[2] Sources: CETFA, WisdomTree; AUM data as of 3/26/18.
[3] Global rank includes WisdomTree's pending acquisition of ETF Securities' European ETF business.
[4] As of 10/17.
[5] Source: Mutual fund assets by the Investment Funds Institute of Canada, which reports C$1.49 trillion in mutual fund assets as of 1/31/18. The Canadian ETF Association tabulates C$150.1 billion in ETF assets for the same month.
[6] Source: CETFA January 2018 Monthly Report.
[8] Source: WisdomTree, as of 3/15/18.
[9] Andrew Clare, Steve Thomas and Nick Motson, "An Evaluation of Alternative Equity Indices Part 2: Fundamental Weighting Schemes," Cass Business School, 3/30/13.
[10] Management expense ratio (MER): As reported on the Fund's most recent management report of fund performance. MER is the total of the Fund's management fee and operating expenses, including all waivers and absorptions, and is expressed as an annualized percentage of the average daily net asset value.

Variably Hedged™ is a trademark of WisdomTree Investments, Inc., and refers to its variably currency-hedged ETFs, units thereof, Indexes, proprietary method of hedging based on technical and economic signals and/or Investment Fund services. The WisdomTree ETFs listed on the Toronto Stock Exchange are managed by WisdomTree Asset Management Canada, Inc. Commissions, management fees and expenses all may be associated with investing in WisdomTree ETFs. Please read the relevant prospectus, which is available at www.wisdomtree.com, before investing. WisdomTree ETFs are not guaranteed, their values change frequently and past performance may not be repeated. Nothing in any commentary should be considered a recommendation to buy or sell a particular security. Tax, investment and all other decisions should be made, as appropriate, only with guidance from a qualified professional.

Foreign Investors Take A Pass On Canada

New foreign direct investment continues to decline from year-ago levels. This lack of enthusiasm on the part of global investors reflects a rather lackluster domestic economic environment and is reflected in the loonie and Canadian stocks.

Kurt Reiman
Chief Investment Strategist, BlackRock Canada

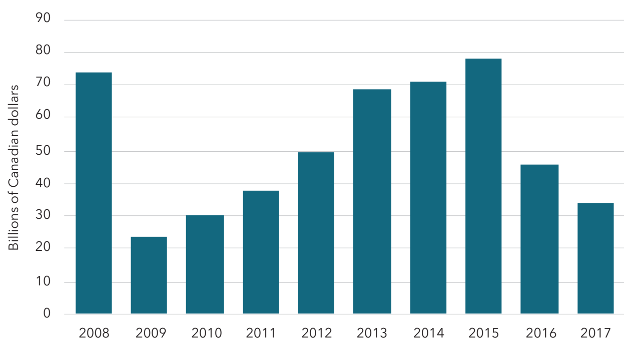
Since the start of the year, I have been hard pressed to meet anyone on my travels across Canada who is bullish about the outlook for the Canadian economy and financial markets. Global investors would appear to agree.

The US administration is pursuing a highly protectionist trade agenda, threatening to withdraw from NAFTA and imposing steep tariffs on steel and aluminum imports. Canada may have dodged this most recent bullet, but the administration has now tied a successful NAFTA negotiation to the metals tariff exemption. The Republicans passed a sweeping round of tax cuts and spending increases, boosting the competitiveness and strength of the US economy. Washington has sought to roll back burdensome regulations at a time when provincial and federal governments here are raising minimum wages and rolling out carbon emission reduction policies. Meanwhile, Canadian oil sits trapped in Alberta at a steep discount to global crude prices. And just this week in its Quarterly Review, the Bank of International Settlement is again sending an early warning signal about the potential vulnerabilities related to the sharp expansion of credit in Canada in recent years. (www.bis.org/publ/qtrpdf/r_qt1803e.htm)

BLACKROCK®

The combined effect of this uncertainty overhang – from global trade tensions to domestic debt growth to tax law changes to interprovincial disputes over east-west pipeline access – has weighed on Canadian investment activity. According to Statistics Canada, new foreign direct investment has fallen for the second year in a row, declining 27% between 2016 and 2017.

Canada less enticing to global investors

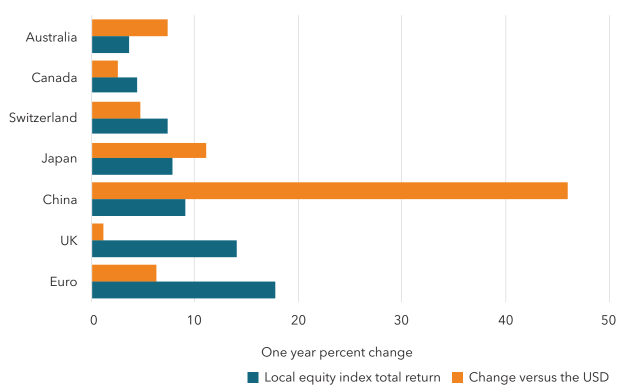


Source: BlackRock Investment Institute, with data from Bloomberg and Statistics Canada, 8 March 2018.

Reflecting the sour mood over Canadian investment opportunities, the loonie is one of the worst-performing major currencies versus the US dollar over the past year. Although the Loonie has, in fact, strengthened versus the US dollar over the past year, it has weakened versus most major global currencies (see the chart below). Whereas the Canadian dollar is up just over 3% versus the US dollar in the last 12 months, the Swiss franc, Japanese yen and Chinese yuan have appreciated in the high single digits, while the euro and British pound have strengthened in the teens. In general, we would expect the Canadian dollar to appreciate versus the US dollar amid an improving global equity market, and this time is no different. But the loonie's resilience doesn't appear to be a sign of a robust competitive landscape in Canada.

As my colleague, Richard Turnill, notes in a recent blog post, the US dollar has been steadily weakening because of an improved outlook for investment activity globally and a reduced need for precautionary savings to be tucked away in US dollar safe-haven assets. Clearly, if this is the case, Canada has not exactly been a standout beneficiary of this more constructive global investment view.

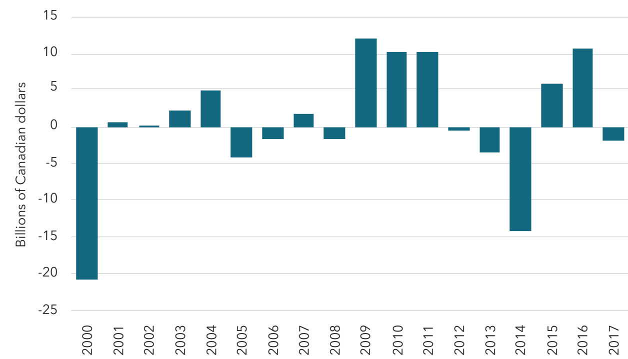
Loonie at the back of the flock



Source: BlackRock Investment Institute, with data from Bloomberg and MSCI, 8 March 2018. Notes: All stock returns are based on MSCI country/region indexes. Index performance is for illustrative purposes only. **Index performance does not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.**

A quick survey of global equity indices over the past year also supports this rather dim view of the Canadian investment opportunity set. While Canadian stocks aren't the worst performers over the past year (the Brexit-beaten UK stock market has done worse), they're pretty close to the bottom of the pack (see the chart above). Although Canadian earnings have been holding up well, the market has cheapened relative to global stocks likely on account of the uncertainty overhang. As further evidence, global investors withdrew funds from Canadian securities last year, according to Statistics Canada.

More outbound than inbound portfolio flows



Source: BlackRock Investment Institute, with data from Bloomberg and Statistics Canada, 8 March 2018.

The relative underperformance of the Canadian dollar and stocks are sending a similar message: there are better opportunities elsewhere. In our view, we prefer emerging markets, Japanese equities and US stocks given the healthier earnings prospects. That said, we would caution against taking too negative a stance on the Canadian stock market, given that there's already a lot of bad news reflected in the price. At this stage, as long as conditions don't get materially worse (a rather herculean assumption perhaps, given the trade tensions along our southern border), we think Canadian stocks could start to finally attract some investor interest.

This material is not intended to be relied upon as a forecast, research or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy. The opinions expressed are as of the date indicated and may change as subsequent conditions vary. The information and opinions contained in this post are derived from proprietary and nonproprietary sources deemed by BlackRock to be reliable, are not necessarily all-inclusive and are not guaranteed as to accuracy. As such, no warranty of accuracy or reliability is given and no responsibility arising in any other way for errors and omissions (including responsibility to any person by reason of negligence) is accepted by BlackRock, its officers, employees or agents. This post may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections and forecasts. There is no guarantee that any of these views will come to pass. Reliance upon information in this post is at the sole discretion of the reader.

Kurt Reiman, Chief Investment Strategist, BlackRock Canada

The Evolution of Vanguard Advisor's Alpha™:
From Portfolios to People

Change is coming to the financial advice industry in the form of stricter regulations, downward pressure on fees, and, last but not least, the emergence of technology.

Todd Schlanger
Senior Investment Strategist, Vanguard

Taking Vanguard Advisor's Alpha[1] to the next generation means offering a spectrum of high-touch services, from behavioural coaching to full-scale wealth management that will help you deepen the trust your clients have in you. Developing a high level of trust may likely propel your business forward by extending the life of client relationships and generating more referrals.

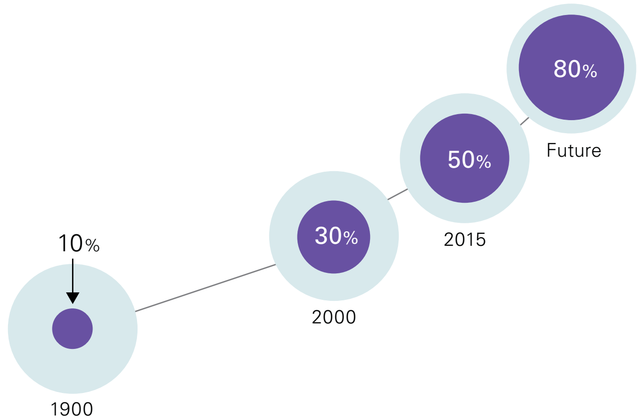
Leverage the Value of Uniquely Human Tasks

It's clearer than ever that maximising advisor's alpha in the 21st century increasingly means embracing technology. That, in turn, means understanding that advanced skills are likely to remain uniquely human, no matter what the industry.[2]

The clear historical trend has been that basic or repetitive skills are invariably outsourced to machines, resulting in the performance of more and more advanced tasks by people. This trend has undoubtedly affected the financial advice industry, with technology liberating advisors to devote more time to advanced tasks.

Vanguard®

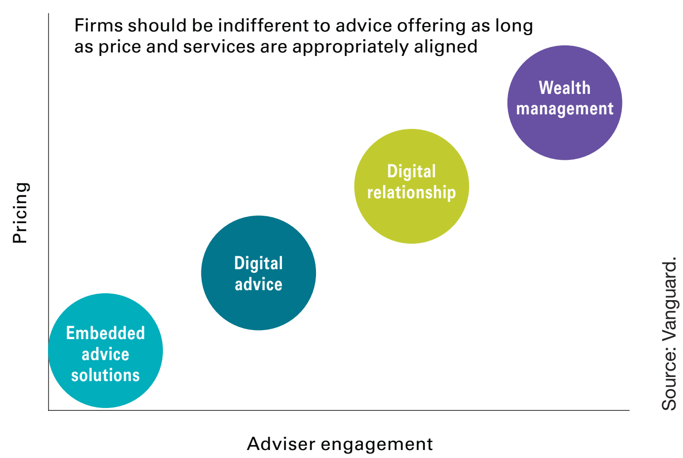
Figure 1. Advanced tasks will dominate the work of the future*



* Examples of advanced skills include maintaining relationships, training, developing teams, strategising, and solving problems.

Sources: Vanguard calculations, based on data from McKinsey & Company, US Bureau of Labour Statistics, and US Department of Labour O*Net online.

Figure 2. The efficient frontier for advice service



Find Your Efficient Frontier of Advice

In this emerging environment of sophisticated technology, fiduciary responsibility to clients, and intensifying price competition, how you spend your time is of crucial importance to the health of your business. It's vital to recognise that different clients require different types of advice and attention.

At the lower left in Figure 2 are basic services that might be recommended to a client; the next level might provide a robo-advisor service; the next and more involved offering is a full-service online experience, which might include a robo-advisor complemented by videoconferencing or other modes of electronic communication.

Finally, the most robust service is wealth management, which includes a full spectrum of relatively costly services, from a robo-advisor platform to the most detailed financial planning.

Selecting from a greater breadth of advice models, rather than less, enables an advisor to best match the preferences of the investors who are likely to become a firm's wealth management clients in the future. Doing otherwise could mean risking that by the time a client builds the wealth to become a more ideal wealth management prospect, he or she could have built a relationship with a competitor.

Take Relationship Management to the Next Level

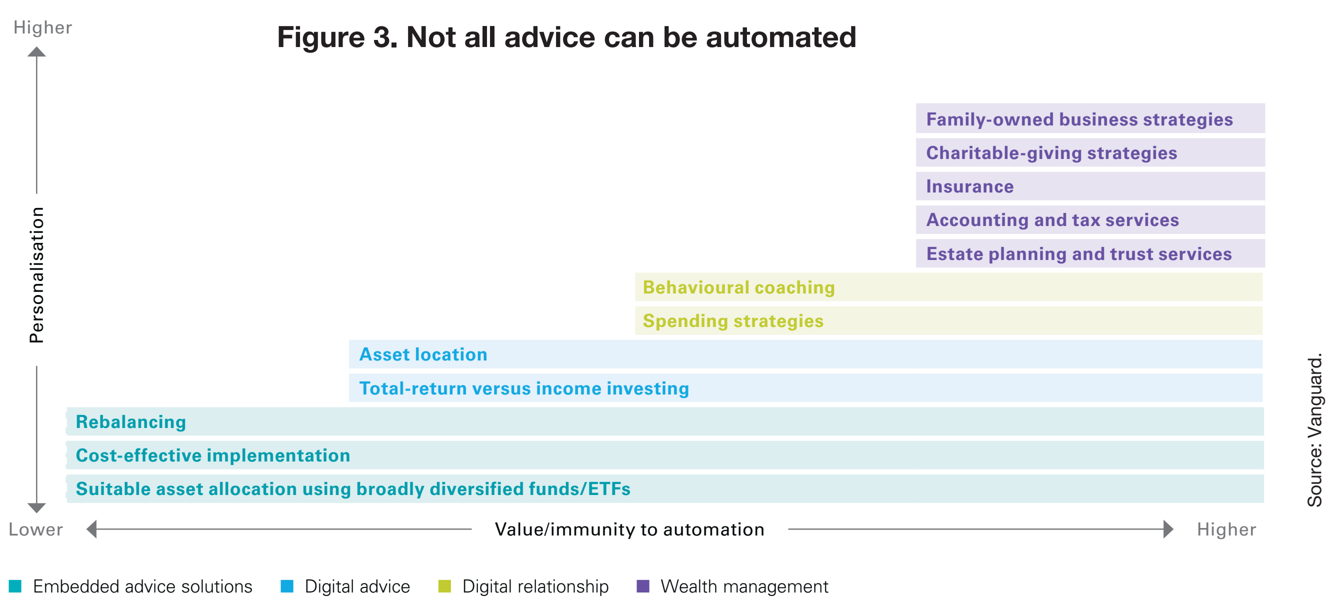
Using technology to streamline your portfolio-centric tasks will likely give you more time to provide clients with deeper, more complex, and more carefully considered advice than when more of your time was devoted to constructing asset allocation models.

The most important aspect of achieving advisor's alpha is becoming an expert at relationship management. The transition from a focus on investment management is made possible by developing deeper rapport with clients, learning as much about them and their families as possible, and building their trust.

Be a Behavioural Coach

The first step in this trust-building process is establishing and perfecting your function as a behavioural coach. Clients, particularly younger ones, need guidance on how to understand the inherent risks of investing and how to manage anxiety when markets turn volatile.

Figure 3. Not all advice can be automated



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After all, some clients have historically exhibited performance-chasing behaviour that is often injurious to returns.[3] An advisor who unfailingly reminds clients of the realities of investing is one who can thrive and build trust.

The more wealthy the client, the bigger the potential opportunity is for you to add value with financial planning that goes well beyond offering basic asset allocation advice. This includes services such as tax planning, estate planning, addressing insurance needs, charitable-giving planning, and business succession or sale planning.

Build High Trust

Advisors who embrace these challenges, that is, who seek to become relationship managers by offering everything from behavioural coaching to comprehensive financial planning, will more likely build client trust.

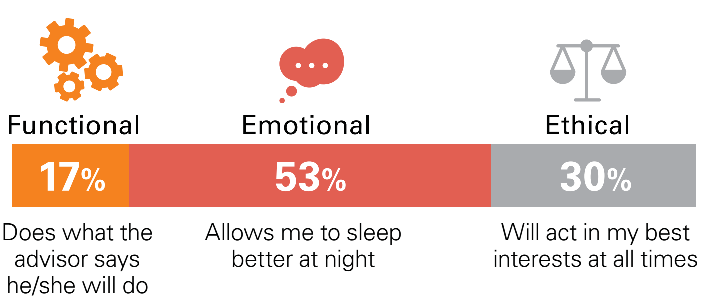
Trust is difficult to define since it has ethical and functional aspects, but data from our *Advised investor insights*™ series[4] found that 53% of respondents to a survey listed the emotional component of trust as the most important aspect of their advisory relationship. (See Figure 4.).

Certain client emotions can lead to increased levels of trust. Developing trust, in turn, may translate into obtaining referrals and developing your business in what is sure to be an increasingly competitive environment. The opposite – losing clients because of a lack of trust – is equally true, as Figure 5 shows.

Prepare to do More for Less

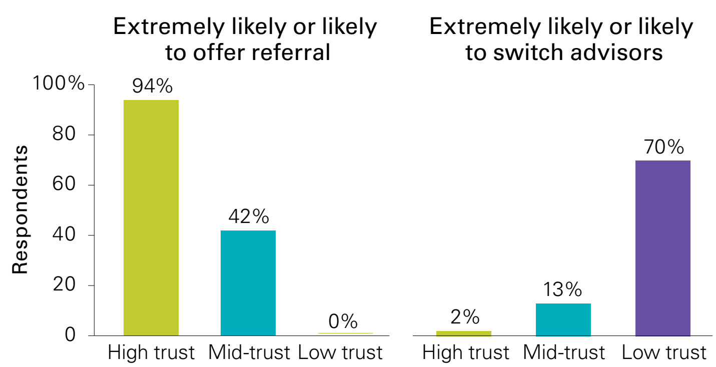
A sure sign of the changes under way in the financial advice business is that the asset allocation business that was once the bread and butter of many practices is no longer a differentiator. Investors, as consumers, expect more for less, as evidenced by the preponderance of investment flows into relatively cheap funds shows. The future is likely to be shaped by a lower-advisory-fee world.

Figure 4. The components of trust



Source: Vanguard.

Figure 5. Trust motivates referrals and drives asset retention



Sources: Vanguard and Chadwick Martin Bailey.

Develop your advisor's alpha The realities of today's financial advice landscape have put Darwinian pressure on advisors who don't adapt. But the changes, ranging from more stringent regulations to lower fees to the encroachment of technology on traditionally profitable aspects of the business, do not have to spell the end of financial advisors.

As Figure 6 illustrates, those advisors who move beyond investment management practices to become highly trusted relationship managers by offering a range of services from behavioural coaching to full-scale financial planning should thrive.

Figure 6. Vanguard Advisor's Alpha flywheel

Source: Vanguard.

Todd Schlanger, Senior Investment Strategist, Vanguard

[1] Donald G. Bennyhoff, Francis M. Kinniry, 2016. Vanguard Advisor's Alpha. Valley Forge, Pa. The Vanguard Group.
[2] Donald G. Bennyhoff, Francis M. Kinniry, and Michael A. DiJoseph, 2018. The evolution of Vanguard's Advisor's Alpha. Valley Forge, Pa. The Vanguard Group. All subsequent references in this research brief are based on this white paper.
[3] Donald G. Bennyhoff, Francis M. Kinniry, 2016. Vanguard Advisor's Alpha. Valley Forge, Pa. The Vanguard Group.
[4] Vanguard's Advised investor insights is an ongoing, proprietary research series that provides actionable insights on investor behaviour.

Smart-Beta and Factors: What You Wanted To Know But Were Afraid To Ask

"By periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals." ~ Warren Buffett, the Oracle of Omaha

Jay Aizanman
Director,
Desjardins Global Asset Management

Many people have become comfortable investing in cheap index products as part of their investment regimen. And why not? Many studies demonstrate the difficulty active managers have in beating their benchmarks which is only worsened by the fact that fees and operating costs compound the under-performance. By contrast, index investing is cheap, simple to understand given its transparency and importantly, less prone to subjective human judgement by being rules based. No wonder investors have piled into passive investment products. Given increased familiarity and acceptance, investors have begun turning towards Smart Beta and Factor indices to obtain better returns and manage risk more effectively, why is that?

Traditional Beta

Traditional indices, known as capitalisation weighted (cap-weighted) indices are derived by aggregating companies of a region or variety and giving them a weight in the index based upon their market capitalisation share of the aggregate holdings, (for stocks this is usually the number of shares outstanding multiplied by the share price).

While simple, this construction methodology has proven somewhat inefficient given the concentration accorded to larger, growth-oriented companies which then holds hostage the index performance to these companies performance. As well, fundamentally, cap-weighted index investing is counter-intuitive from an investment perspective because these funds end up owning more momentum and expensive issues, being forced to buy more of them as their prices rise, (buying high). Of course, as a corollary, the index will have the smallest position in the issue when its price troughs, (selling low).

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Smart“er” Beta – best of both worlds

What if there was a way to take advantage of some of the desired qualities of cap-weighted index investing while eliminating some of its known weaknesses? It appears that Institutional investors have already embraced this utopic notion and have expanded upon research that really became popular in the 1990’s that identified certain fundamental characteristics that have exhibited excess returns above the market. Similar to hedge fund, the catch-all term Smart Beta in now bandied as the saviour to practitioners and consumers alike.

Consensus among experts seem to fall into the camp that, apart from the market exposure to capture the long-term equity market risk premium, 6 systematic factors are worthy of investor attention. These commonly accepted factors (and brief descriptions) are:

- **Low risk:** low volatile securities outperform highly volatile securities
- **Size:** small securities outperform large securities
- **Value:** securities that are cheap to their fundamental value out-perform expensive securities
- **Momentum:** securities with strong price appreciation over the previous period tend to continue out-performing
- **Quality** (commonly defined by **Profitability** and **Investment**): enterprises with strong and growing profitability out-perform those that are weakening

Be cautious - “the rear-view mirror is always clearer than the windshield.”

Throughout the history of the capital markets there have been people convincing in their abilities to navigate the vagaries of the markets better than the next investment professional. They will even be keen to produce proof. The problem is, with abundant historical data and cheap computing power, it is easy to run tests until you get the results you are looking for. Some people call this data mining. And let’s face it, it has been proven that describing the past with tremendous accuracy may not say anything about future results.

Given the marketing prowess of the investment industry and the rush to establish a toe-hold in this burgeoning market segment, experts recommend investors trust systematic factor research that:

- Have compelling economic rationale that contributes to their longevity and ability to repeat itself into the future,
- Is based upon timeframes that extend long enough to validate the robustness of the results (i.e. beyond the last economic cycle),
- Demonstrate the ability for a purported factor to transcend various markets and geographies,
- Use of factor definitions that are simple to understand and not opaque, or proprietary,
- Had its results publicly scrutinized in order to remove any issues

Though not exhaustive, the list above allows investors to analyse the risks, verify and challenge any promotional materials issued by the provider and improve overall confidence in the results

Annual Factor Performance in USD – US Equity

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Highest	Value 36.6%	Value 21.4%	Momentum 15.1%	Low Vol 18.6%	Momentum 11.2%	Low Vol -31.9%	High Profit 38.7%	High Profit 21.9%	Low Vol 7.5%	Low Invest 17.9%	Low Invest 35.3%	Low Vol 17.8%	Momentum 2.8%	Value 17.3%	Momentum 24.7%
	Low Invest 35.7%	Low Vol 18.6%	Value 14.9%	Low Invest 17.4%	High Profit 8.9%	High Profit -36.4%	Growth 36.8%	Growth 21.3%	High Profit 1.8%	Growth 15.4%	High Profit 34.9%	High Profit 14.9%	High Profit 2.7%	Low Invest 15.9%	High Profit 24.6%
	High Profit 35.5%	Low Invest 16.9%	Low Invest 9.2%	Value 16.1%	Growth 8.2%	Low Invest -36.6%	Low Invest 31.9%	Momentum 21.1%	Market 1.5%	Market 15.2%	Momentum 34.2%	Low Invest 14.2%	Low Vol 2.2%	Market 11.2%	Growth 23.8%
Performance	Growth 34.3%	Momentum 16.7%	High Profit 9.0%	Market 15.1%	Value 6.3%	Market -37.4%	Value 29.3%	Low Invest 21.0%	Low Invest 0.7%	Value 14.4%	Value 33.5%	Value 14.1%	Growth 2.0%	Low Vol 11.1%	Market 21.1%
	Momentum 30.1%	High Profit 14.4%	Low Vol 7.3%	Momentum 14.2%	Market 4.9%	Value -37.7%	Market 25.6%	Value 19.6%	Growth 0.5%	High Profit 13.9%	Growth 33.5%	Growth 13.6%	Market 0.7%	High Profit 8.9%	Low Invest 19.0%
	Market 28.0%	Growth 11.3%	Growth 6.2%	High Profit 12.3%	Low Invest 4.3%	Growth -41.4%	Low Vol 22.6%	Low Vol 17.9%	Momentum -0.3%	Momentum 13.7%	Market 31.5%	Market 13.0%	Low Invest -1.3%	Growth 6.7%	Low Vol 18.9%
Lowest	Low Vol 25.2%	Market 10.2%	Market 4.3%	Growth 11.1%	Low Vol 0.0%	Momentum -42.8%	Momentum 22.1%	Market 14.4%	Value -2.5%	Low Vol 13.5%	Low Vol 29.0%	Momentum 11.2%	Value -4.3%	Momentum 3.7%	Value 17.1%
Delta:	11.3%	11.2%	10.7%	7.4%	11.2%	10.9%	16.6%	7.5%	10.0%	4.4%	6.3%	6.6%	7.1%	13.6%	7.6%

Delta: Difference between the highest factor and the lowest factor annual return.
Source: Market: S&P 500 Factors: Scientific Beta US Single Factor Maximum Deconcentration Indices (The Maximum Deconcentration methodology weights each security equally within the index)

Continued on the next page

Develop your core portfolio by factors diversification

We have seen it before. You implement a strategy at just the opportune time. It does well, for a while. Then it starts to not “do well”. At the 1st annual review, you declare, “it has an impeccable track record, it will recover”. The 2nd year, the same mantra “it will recover”. The 3rd year you tremble the same. The 4th year, the pressure is too much and the position is eliminated, (and it subsequently out-performs!).

Similar to the above, factor research2 has been pretty conclusive. While all systematic factor indices add value over long-periods of time, over short time periods, specific systematic factors exhibit tremendous variability, including periods of underperformance relative to the cap-weighted index.

Believe it or not, this may actually be a good thing.

The fact that some systematic factors demonstrate higher returns and higher volatility than the cap-weighted index while others have higher returns and lower volatility than the cap-weighted index, opens the door to diversification of investment portfolios by systematic factors. Investors have begun to take advantage of the fact that while some of the factors do well in a particular economic regime, or market cycle, as others do not means diversifying amongst factors can actually lead to a smoother risk-return profile than the underlying cap-weighted index.

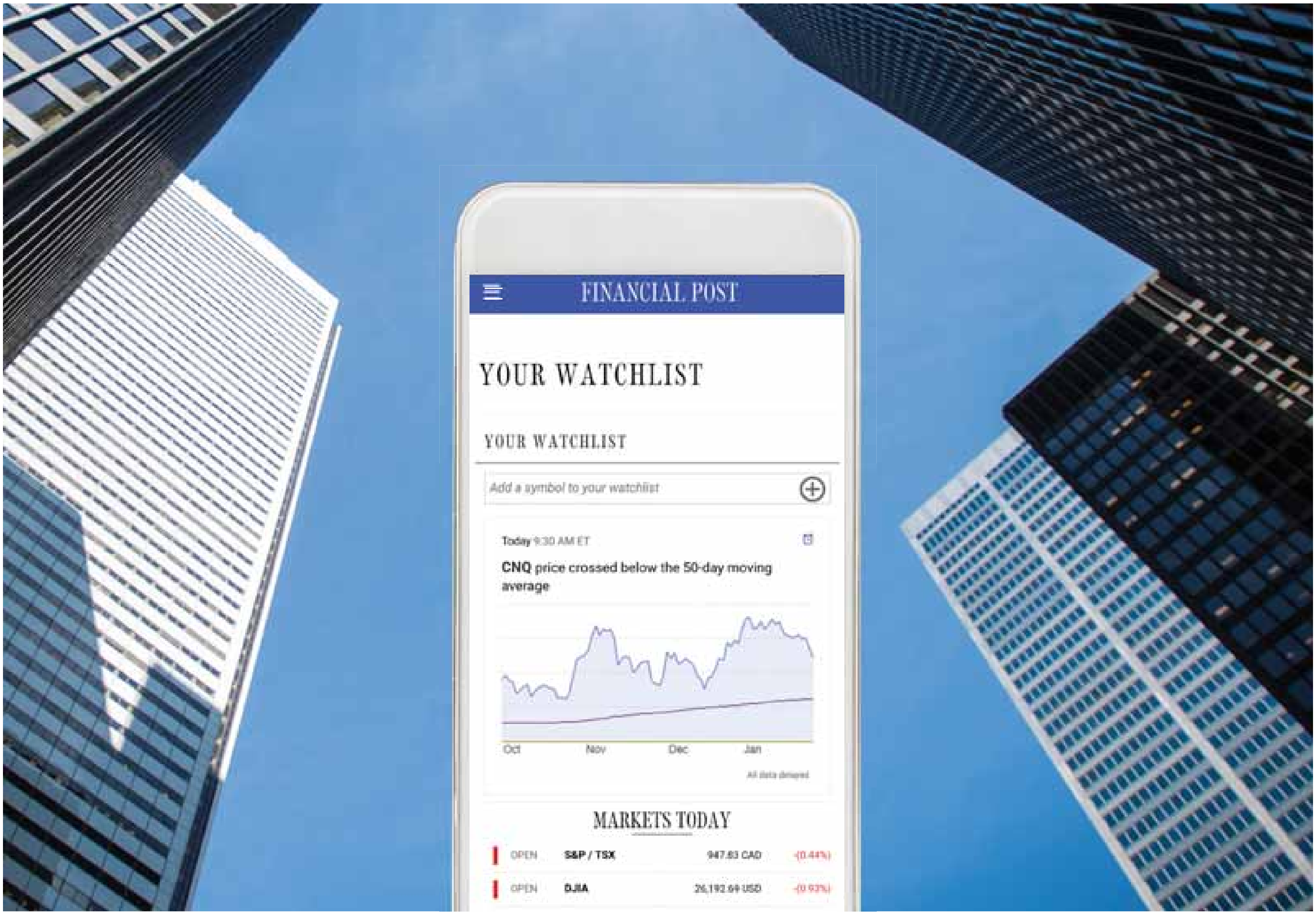
While there is much to determine in order to properly align portfolio construction to objectives and constraints, it has been demonstrated that diversifying across multiple systematic factors, benefitting from both their diversity and their long-term performance track records is a great strategy to establish a core position for your portfolio rather than focussing on one specific factor or style. Working with your local expert, one could expect from implementing a multifactor portfolio, the following benefits:

- Lower volatility portfolio with higher Sharpe Ratios (returns adjusted for risk)
- Higher information ratios (active returns adjusted for risk)
- Lower tracking errors (variability of return relative to the cap-weighted indices)
- Less dependency on a particular regime over the business cycle

Like institutional investors have been doing for over a decade, individual investors now have a way to capture the best of both worlds. Cheap, transparent and rules based investing that can be tilted, managed and constructed to produce better returns per level of risk. Looks like the Oracle of Omaha will have some more sage advice to tell his loyal followers in his next annual report!

Jay Aizanman, Director, Desjardins Global Asset Management
jay.aizanman@desjardins.com

[1] According to Morningstar, in 2017 a total $692 billion flowed into passive funds while almost $7 billion flowed out of actively managed funds in the US
[2] Source: scientificbeta.com
[3] Harvey et al, 2013 document a total of 314 of factors with positive historical risk premia showing that the discovery of the premium could be a result of data mining (i.e. strong and statistically significant factor premia may be a result of many researchers searching through the same
[4] Warren Buffett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Exchange Traded Forum (ETF) 9th Annual

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

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Exchange Traded Forum (ETF West) 8th Annual

Wednesday, June 6 ~ Vancouver

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Niagara Institutional Dialogue (NID) 9th Annual

Monday, June 11 to Wednesday, June 13 ~ Niagara-on-the-Lake

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

Niagara Institutional Dialogue

InstitutionalDialogue.com

WAIS Canada 17th Annual

Thursday, September 13 & Friday, September 14 ~ Toronto

WAIS Canada is in its 17th year and is Canada's largest gathering of **investment professionals, investors, industry experts and service providers.** Today's WAIS has gone much beyond its original alternative investment only focus attracting investment professionals from all facets of investments. WAIS Canada is a popular annual event that is not to be missed.

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Montebello Institutional Dialogue 2nd Annual

Monday, Oct. 1 to Wednesday, Oct. 3 ~ Montebello, Quebec

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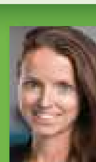
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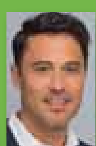
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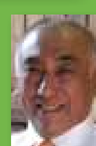
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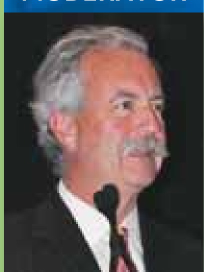
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