The ETF INSIDER

Canadian ETF Association

Q1 2017

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QUICK CETFA STATS

8 ETF PROVIDERS

28 AFFILIATE MEMBERS

8 PORTFOLIO MANAGER MEMBERS

New Members

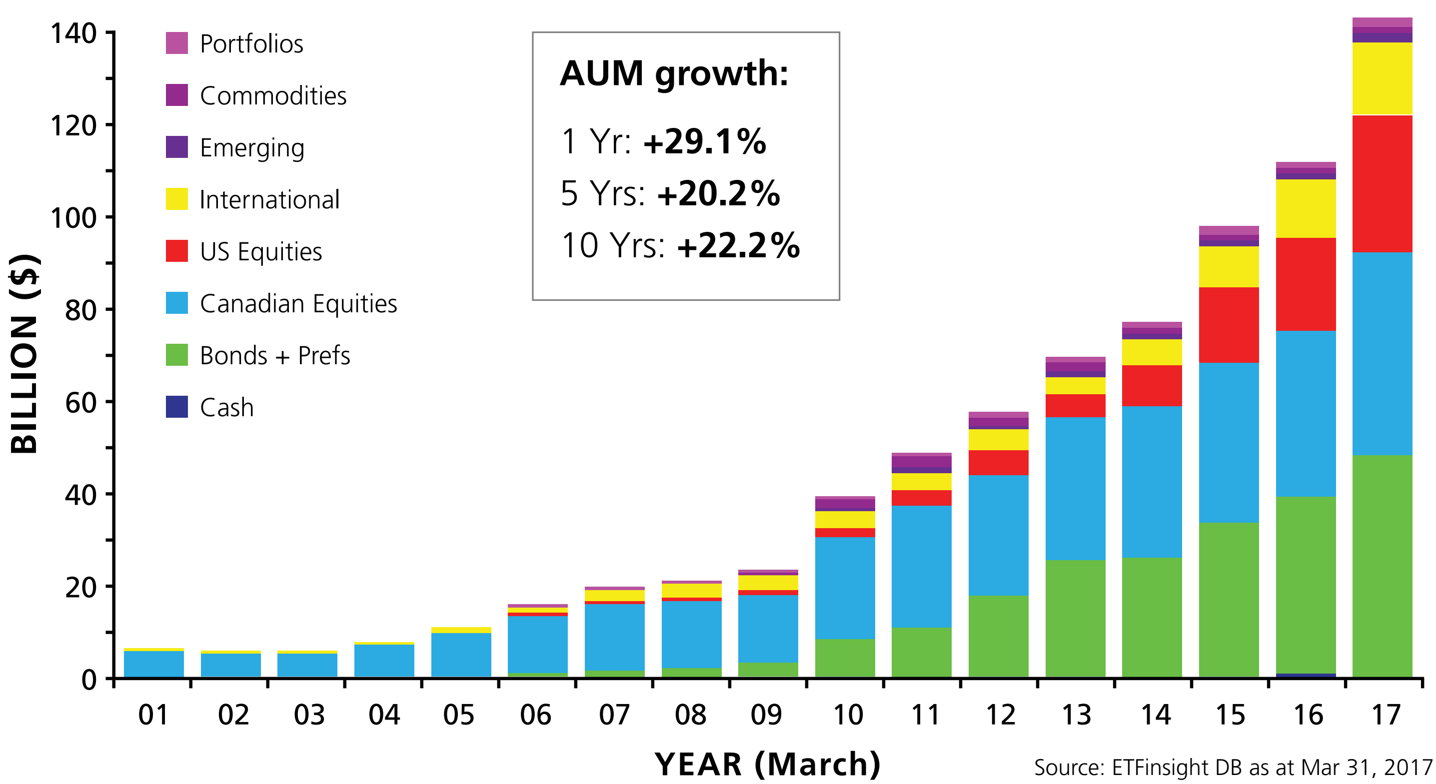
InvestorCOM - InvestorCOM (**www.investorcom.com**) is a leader in providing financial technology and outsourcing services to banks, asset managers, insurance companies and investment dealers. We have developed an innovative suite of FinTech solutions in response to increasing regulation and demand for more effective communication and disclosure from the financial services industry.

Statistics – First Quarter of 2017

The Canadian ETF Industry assets increased by an additional $2.7 Billion in the month of March, bringing the total assets to $123 Billion as at the end of the first quarter. This underpins the ongoing strong net issuances, and favorable contributions from the markets. AUM is 29.1% higher than year ago, and 2.5% higher than Feb 28, 2017. The estimated aggregate creations for the month of March is $3.75 Billion, offset by total redemptions of $1.6 Billion.

Industry Growth

Canadian ETF Asset Growth (Mar 2001 – Mar 2017)



Source: ETFinsight DB as at Mar 31, 2017

Events

Pensions & Benefits Conference – Pat Dunwoody and Cary Blake spoke on the benefits of using ETFs in the context of institutional investing.

InvestorCOM webinar of ETF Fact form – Pat Dunwoody participated in a webinar for their clients explaining the new ETF fact form and some of the data elements contained on it.

On March 8th in celebration of International Women's Day – the Canadian chapter of Women in ETFs opened both the TMX and NEO exchanges

UPCOMING EVENTS

SPIVA Presentation – Dates to be confirmed

Federation of Mutual Fund Dealers Conference – April 25th

Radius ETF Conference – May 4th – 5th

Canadian Funds Summit – May 25th – 26th

TSX-CETFA ETF Events – check the CETFA website for dates and locations

Government Relations

Meetings continue with some of the Finance Policy staff as well as MPPs.

Pat Dunwoody and Atul Tiwari met with Nicholas Daube, the Senior Policy Advisor to the Minister of Finance and Pat Dunwoody met with MPP Vic Fedeli, who is the PC Finance Critic

Waiting for trading volume – or Godot?

By: Ray Dragunas

In the Samuel Beckett play "Waiting for Godot", two characters wait for someone named Godot to arrive at a train station. Spoiler Alert: He never does. The same situation can be applied to investors who patiently wait for trading volume to increase before purchasing an Exchange Traded Fund (ETF). It seems reasonable, since volume is the traditional measuring stick of a stock's liquidity; however, daily volume of an ETF does not necessarily represent its true liquidity. In other words, you cannot view an ETF like a regular equity investment, and be able to discern how hard it is to enter or exit a trade based only on trading volume. This misunderstanding of volume and liquidity drives investors into only the largest traded ETFs, where volume begets volume, and suddenly, it seems as though only the biggest ETFs are liquid. The prevalence of this scenario is apparent in the 2015 *ETF.com and Brown Brothers Harriman US Advisor and European Investor Survey.*

Metric	Percentage of Respondents
>10,000 shares volume (assuming $50 price)	88%
Understand liquidity better	59%

Source:ETF.com Brown Brother Harriman 2015 Survey

With over 88% of investors wanting a minimum volume of 10,000 shares a day, clearly the gravitational pull of buying high volume ETFs is hard to resist; however, by strictly focusing on volume, investors may be overlooking great opportunities in the ETF space. The survey also revealed that 59% of respondents want to better understand liquidity. Clearly investors need to move beyond trading volume and look at implied liquidity.

The need to look at implied liquidity is reinforced in Eric Balchunas' book, *The Institutional ETF Toolbox: How Institutions Can Understand and Utilize the Fast-*

Growing World of ETFs. Balchunas' book illustrates that of the almost 1800 ETFs now listed in the US, 90% of ETF volume is concentrated in 134 ETFs. This leaves just 10% of volume for the remaining ETFs to fight over. This imbalance could be rectified if investors were to use implied liquidity when assessing their buys.

David J. Abner of WisdomTree does an excellent job outlining, in detail, implied liquidity in his book *The ETF Handbook – How to Value and Trade Exchange Traded Funds.* Much has been written about the ETF creation/ redemption process, Liquidity Providers etc. What follows is an oversimplification of implied liquidity.

Implied liquidity looks past the trading volume of an ETF, and into the actual trading volume of each of the securities that make up an ETF. Essentially, implied liquidity looks at how many units of an ETF you can trade without significantly impacting the price of the stocks that make up the ETF basket, and by extension the ETF itself. The more liquid the stocks in the basket, the greater the implied liquidity. For investors who are more technical, the default target of implied liquidity is that you do not trade more than 25% of the thirty day average volume of any security held in an ETF.

So how do you calculate implied liquidity? The easy answer is, you really don't need to. For those of you with the luxury of having access to a Bloomberg terminal, they have an implied liquidity field: ETFL <go>. If you don't have a Bloomberg, some ETF providers, like Wisdom Tree, list the implied liquidity of their ETFs on their websites.

What should retail investors do when they will likely not have access to a Bloomberg terminal, and where the ETF provider does not list implied liquidity of their ETFs? The easy answer is to look through an ETF's holdings. If you recognize the names of the securities as you scroll down the list, chances are there is enough liquidity in the ETF; however, if you are seeking out exposure to a microcap biotech ETF with obscure company names, be prepared to experience poor liquidity.

As of February 2017, ETF Global Intelligence reports that there are some 4,875 ETFs listed globally and $3.7 trillion under management. The onus remains with us in the ETF industry to continue to engage and educate investors. As such, I think ETF issuers should be posting implied liquidity on their websites like they do their Net Asset Value and other data. Yes, there is a cost in doing so, but it will give investors the comfort to step away from the biggest volume traded ETFs, and help them make more informed allocation decisions about a wider range of investment opportunities in the ETF space.

EDUCATION CORNER

This section will be dedicated each quarter to educational articles from our members.

The Rise of the Socially Conscious Investor & Their Influence on Companies' ESG Considerations

By Jacqueline O'Flanagan, Head of Canada & Regional Director, FTSE Russell

As FTSE Russell prepares to release its fourth annual global institutional asset owner survey this spring, which will examine the evaluation and adoption of smart beta indexes, we're noticing a new theme emerge among respondents. As smart beta interest and usage continue to grow, our 2017 survey results highlight the strong appetite for application of ESG considerations to smart beta strategies.

We're seeing an increasing number of Canadians turn to environmental, social and corporate-governance (ESG) principles as they look to invest with sustainable, ethical impacts in mind. Our findings show that among Canadian asset owners who are currently using, evaluating or planning to evaluate smart beta strategies, half of the respondents anticipate applying ESG considerations to a smart beta strategy. Our observations track with other industry reports that cite the rapid growth that Canada's broader responsible investment (RI) market is experiencing.

According to the 2016 Canadian Responsible Investment Trends Report published by the Responsible Investment Association, Canadian RI assets under management surpassed $1.5 trillion, up 49% over the previous two years.[1] This report also highlights that RI strategies represent roughly 38% of Canada's investment industry, with ESG integration leading at $1.46 trillion AUM.

Two major drivers behind this growing trend are demographic shifts and the growth of pension fund assets under RI guidelines:

- Millennials' interest in social issues and social purpose have proven to be much higher than that of older generations. The RIA released a study last year noting that millennials are 65% more likely to consider ESG factors than Baby Boomers, and they're almost twice as likely as Boomers to believe that companies with ESG practices are better long-term investments.[2]

- Looking to manage risk and fulfill their fiduciary duty, pension fund assets account for 75% of the Canadian RI industry's growth over the past two years, having grown by $374 billion over that time, according to the RIA.[3]

The world of ESG has changed dramatically in recent years, and investors' growing interest in the strategy is playing a major role in influencing a company's decision to integrate ESG considerations into their models.

Not even 15 years ago, relatively few companies disclosed information on ESG issues. The information provided tended to be of limited value to investors; data was not comparable, data was not consistently calculated, and underlying assumptions were often unclear.

Even though some asset owners and asset managers proactively accounted for ESG issues in their investment practices and processes in their engagement with companies, most paid relatively little attention to these issues. The lack of interest was reflected in companies' attitudes; in response to requests for information from investors or research organizations, they often asked why investors were asking these questions and whether investors would actually use the information in their investment decision-making.

The enthusiasm for ESG investment led to some investments being made without having access to enough information, or without having all the tools needed to fully assess these investments. While this created many valuable opportunities for 'learning by doing', it also meant that at least some of the decisions made were suboptimal, as investors did not have a complete picture of the social and environmental factors that were needed.

Better ESG disclosures and the availability of tools such as the FTSE4Good Index Series, which were designed to measure the performance of companies demonstrating good ESG practices and performance, and FTSE Russell's ESG Ratings also enable asset owners to take a much more analytical approach to assessing their fund managers. Data and portfolio analysis tools such as these enable asset owners to ask challenging questions to investment managers on exactly how ESG considerations are taken into account by their investment managers.

Now a mainstream investing strategy, the pace of change in the ESG space has proven to evolve rapidly. The increasing sophistication of the analytical tools and methodologies that are available, the better quality disclosures – in terms of accuracy, reliability, consistency and timeliness – that are provided by companies and the strengthening of investors' capacities and competencies will all facilitate this change.

However, there are challenges in this evolution: in many cases the ESG data reported by companies is still not investment grade or is not reported at all, certain risks are difficult to measure, and it is not clear how much weight investors should give to ESG issues relative to other drivers of investment performance.

Some of the challenges relate to the structure of the investment industry and the willingness of market participants to offer products that are distinctive and have high ESG convictions linked to a demonstrable investment thesis. Furthermore, asset managers do not offer the high quality ESG investment products that the end investors want. Despite these challenges, asset owners need to engage and consider ESG issues from both an investment risk and opportunity perspective. By focusing on these issues, they not only respond to the needs of stakeholders, but they can deliver investment strategies that better meet their beneficiaries' values and needs.

We think interest in ESG will remain strong as Canadians and investors worldwide continue to show an increased desire to invest in vehicles that consider the impact business practices have on society, the environment and the performance of the business itself, rather than merely focusing on the financial performance. With this prevalent focus on ESG, companies that have not adjusted their business models to align with these matters may not be viewed as an attractive investment over the long-term.

1 "2016 Canadian Responsible Investment Trends Report," *Responsible Investment Association*, February 2017 https://riacanada.ca/trendsreport/

2 "Millennials, Women, and the Future of Responsible Investing," *Responsible Investment Association*, April 2016 https://riacanada.ca/millennials-women/

3 "2016 Canadian Responsible Investment Trends Report," *Responsible Investment Association*