

Managed Money Report

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How to use ETFs Effectively in your Portfolio

The first step to effectively utilizing ETFs in your portfolio is understanding how these products are constructed. For this issue of the Managed Money Report, we are going to take a deep dive into how Beta and Strategic Beta ETFs are built and how to properly incorporate them in your portfolio.

Benchmarks provide investors something they can measure their portfolio's performance against suggesting they are getting good value for money. However, not all benchmarks are the same and our ability to measure performance in relation to them is critical in making meaningful comparisons and, in turn, investment decisions. A tremendously effective solution to ensuring good performance relative to a benchmark is buying benchmark-linked performance through passive "Beta" ETFs. In fact, buying an ETF today is often synonymous with getting passive exposure to benchmark performance. This would not be altogether incorrect, as the vast majority of ETF assets globally are tracking passive benchmark products. That being said, ETFs are so much more than the passive market-cap weighted investment vehicles they are often perceived to be and market indices can be more "active" than you might think at first glance, but more on that later. Given the tremendous support for passive ETFs and their potential place within your portfolio, understanding how their underlying indices are created has never been more important.

Where to Buy the Index

Most Beta ETFs track broad-based and well-known indices such as the S&P 500 or the S&P/TSX composite. Beta ETFs are typically low cost and are measured on tracking error (i.e. how well the ETF mimics the performance of the index). A couple of the more important considerations for determining a quality Beta ETF is how efficient the country or market that you want exposure to is and the investability of the index. Products based on market-cap weighted indices have become the most ubiquitous ETF offering in part because of ease in recreating the benchmark. ETF manufacturers now offer these products with single digit basis point management fees and have relatively little tracking error. These products can make excellent core equity holdings for individuals in the wealth accumulation phase by providing 100% of the upside, but come at the cost of 100% of the market downside.

Over the long term this can prove to be an effective strategy, however, the efficiency of these products can be dampened significantly when applied to market indices that are more difficult to recreate in an investable product.

Index construction

Investors should be aware that not all indices can be replicated cost effectively. Take for example equal-weighted stock indices; these can provide attractive investment characteristics though when replicated by ETFs will carry higher transaction costs than their market-cap peers based on rebalancing frequencies. Thus we should expect either higher tracking error or higher management fees on products based off them. Equal-weighted indices reward all index constituents the same and this dampens performance of companies that are disproportionately successful while mitigating the single name risk associated with mega-cap companies. A prime example is the now defunct Nortel, which at its peak was a mega-cap representing almost 35% of the TSE 300 composite index. There are also indices which cannot be fully replicated in an efficient manner. Take any bond universe for example, which are simply impossible to recreate given the number of illiquid and off-the-run bonds they're comprised of. Here ETF manufacturers must apply different sampling approaches to re-create the experience of holding the underlying basket of bonds, which introduces qualitative judgement and potentially tracking error.

When to question the traditional index

Fixed income continues to be a good example of where replicating market-cap weighted indices is not necessarily an attractive trade. This is because the largest issuers of debt become the largest components of these indices and thus the largest positions in the ETFs. This means that the most indebted issuers are the ones the ETF is lending the most to, which may have worked over the past few years but doesn't seem like an attractive value proposition in a rising rate environment.

Meanwhile, skilled active credit managers overseeing funds and ETFs can provide a smoother ride for investors by being able to actively select securities they feel can outperform while not becoming forced sellers should temporary dislocations in the market trigger rules-based investment decisions found in passive ETFs. This doesn't mean it's active, passive or bust. Being able to tilt one's portfolio towards different factors over time has proven to be an excellent tool to drive risk-adjusted returns. Today there are ETFs that provide exposure to almost anything, ranging from value to growth, dividends to low volatility and even momentum. The key to employing these Smart Beta or factor-tilted ETFs is two-fold. First, not all factors will work well together or at the same time. Second, understand what you're buying and how the composition of underlying securities will change over time.

Actively Passive or Passively Active

To understand how security composition of an ETF changes over time we need to understand how these Beta and Smart Beta products are built. Are they passively constructed or actively put together? And no, it's not that same old debate again. There has been a rise in ETFs that passively follow rules-based indices that have qualitative oversight. So, while the ETF is simply recreating the exposure of the index, the firms that control the index can in fact make qualitative judgements on company inclusion. One interesting example of this is the S&P500 index, which represents the largest 500 companies in the US listed on either the NYSE or NASDAQ. Seems pretty passive right? Well, it turns out this isn't exactly the case. S&P actually has a selection committee that adds and removes names from the index when those companies are close to the size threshold rather than waiting until the criteria is fulfilled. In reality this has a marginal impact on overall performance and outcomes. However this qualitative approach is being commonly used for new niche or sector-specific ETFs where the outcome could be material, think blockchain, robotics, AI or 3D printing. These are just a handful of the new sector-specific ETFs that are passively tracking

qualitatively influenced indices. As with the equal-weighted example, this does not create an inferior product, rather it is simply important to understand what you are buying exposure to and how it's built. Often times this more involved approach also comes with a higher price tag that can at times approach what active management is charging.

So what should I pay?

Investors are becoming more informed consumers when it comes to financial products and their associated costs which is great. But is the cheapest product always the best answer? We know the compounding effect of fees over time can impact wealth accumulation and we should never pay more than what's required for the product that meets our needs. But this means we should not be afraid of products that cost more than a pure Beta index play. This would be akin to limiting our mode of transportation to walking or bike riding simply because they are the cheapest ways to get around. Of course they can potentially get you where you're going, but what are the indirect costs? Walking or riding your bike down a dark road at night is not ideal in a way that investing in inefficient markets using pure Beta ETFs isn't ideal – you have better options. Alternatively you can take a vehicle service of your choosing (Smart Beta or Active ETF) which will provide a more comfortable and likely safer journey by not having to participate in all market swings both up and down. Continuing with the same example, there are also lemons out there and we would be wise to remember that low cost doesn't always equal low quality and vice versa. Many active management teams are worth their fees, but of course there will always be managers out there charging more than what the quality of their team, investment philosophy or approach can justify.

Putting it all together

The world of passive Beta and Smart Beta ETFs have provided what feels like limitless possibilities for portfolio construction today. These are effective, cost efficient tools that are now available in every investor's toolbox. Knowing when to use them is the important question and it requires looking at a blend of market efficiency, individual needs, market expectations, timeframe and tolerance to market volatility. Given the sheer volume of new products today it's increasingly more important to have skilled asset allocators as an integrated component of your portfolio construction. Generally, Beta ETFs provide great exposure to efficient markets such as the US or Europe and can be considered core holdings over longer-term time horizons. Smart Beta products provide great exposure to market factors that can add tremendous value over time when proper asset allocation is employed. One example here could be a dividend-focused mandate that provides a steady and hopefully growing income stream. And finally it's worth paying for quality active management when the circumstances warrant this approach.

**Spencer Barnes, MSc,
Mutual Fund/ETF Specialist**

Industry Happenings

- [Highlights From Budget 2018](#) The 2018 federal budget contains several new rules that have an impact on individual investors.
- [Tighter OSFI mortgage rules sending borrowers to alternatives](#) Stricter mortgage rules imposed on the banks is sending borrowers to less regulated lenders with higher risk tolerances.
- [Fee cutting accelerates](#) Major fund companies are reducing mutual fund fees due to detailed cost disclosures and stiffer competition from ETFs.
- [Bail-in regime dampens outlook on Canadian banks](#) Despite strong asset quality, Moodys remains cautious on the Canadian banks due to potential risks related to household balance sheets and loan portfolios.
- [Scotiabank to launch ETFs business](#) Scotiabank becomes the latest of the big-five banks to enter the ETF space with plans to launch four broad-based ETFs through its 1832 Asset Management division.
- [No need to fear AI, experts say](#) Artificial intelligence has the power to complement financial advisors rather than replace them.
- [Canadians not making savings a priority](#) Data shows that Canadians have much work to do when it comes to savings, making the advice of a financial advisor all the more necessary.
- [Institutional investors warm up to responsible investing](#) Canadian institutional investors are increasingly using ESG criteria in their investment processes however there is much room for further utilization.
- [Fundata Funds to Get ESG Quality Scores](#) As ESG becomes a more popular tool leveraged in the investment process, Fundata is providing metrics for Canadian-domiciled ETFs and Mutual Funds.

New & Notable Product Launches

Mutual Funds

- [Vanguard Launches Actively Managed Low Cost Funds in Canada](#) Vanguard Investments Canada has launched four low-cost and actively managed mutual funds.
- [Mackenzie gets first to Market with a Liquid Alternative under the proposed National Instruments 81-102 structure.](#) Mackenzie will try to deliver an absolute return fund in their newly approved conventional mutual fund structure.

- [Fidelity Launches Fidelity Founders Class](#) Founders Class is a core equity strategy focused on investing primarily in founder-led companies anywhere in the world and across the market cap spectrum.

ETFs - Canada

- [Harvest Banks & Buildings Leaders Income ETF \(HCBB\)](#) Harvest launches an income oriented active ETF investing in banks, financials and REITs under PM, Paul MacDonald.
- [Evolve ETFs \(CARS, DIVS\)](#) Evolve offering access to new and innovative sectors and active portfolio managers.
- [Mackenzie Investments \(QCN, QCE, QDX, QUU, QHY, QTIP\)](#) Mackenzie launches a suite of six new ETFs while also announcing plans for 13 more.
- [Dynamic iShares Active Investment Grade Floating Rate ETF \(DXV\)](#) Dynamic and iShares launch an active short-interest rate focused product under PM, Marc-André Gaudreau.
- [Franklin Templeton \(FLGA, FLSL, FLUI\)](#) Franklin Templeton launches three actively managed fixed-income ETFs leveraging its global Fixed Income Group.
- [PowerShares 1-5 Laddered All Government Bond Index ETF \(PGB\)](#) Invesco launches a Canadian-focused laddered bond ETF designed to enhance short-term yield.

ETFs - US

- [Horizons Cadence Hedged US Dividend Yield ETF \(USDY\)](#) Horizons and Cadence launch a factor-based ETF designed to provide enhanced yield with lower volatility.
- [Franklin Templeton \(FLIN, FLRU, FLAX, FLSW\)](#) Franklin Templeton launches four new country-focused ETFs covering emerging and developed markets.
- [Fidelity Investments \(FIDI, FIVA\)](#) Fidelity launches two international products providing dividend exposure and attractively valued equities, respectively.

Raymond James MF Focus List Update

The Raymond James Mutual Funds Focus List is a compilation of what we consider best-in-class mutual funds among the competition. A fund must adhere to rigid criteria and exceed our due diligence process in order to be added to the Focus List. Please refer to the Fund Selection Process document (Appendix C) for more information on how funds are chosen for the Focus List.

Key Points

- The Focus List is currently comprised of 37 funds. We are pleased to inform you that the funds have outperformed their respective categories on average by 190 basis points since being added to the Focus List.
- Dynamic Power American Growth is the best performing fund so far this year up 33.62%. The fund has outpaced its benchmark by nearly 27% and is the best performing fund in the US equity category with the bulk of the outperformance coming from security selection, a stat we like to see from a bottom-up manager like Noah Blackstein.
- The worst performing fund is RBC Global Precious Metals (-7.38%). Precious metals have been under pressure this year with the S&P/TSX Global Gold index down -2.27%.
- The following Focus List funds are members of the Freedom Enhanced Income Portfolios: BMO Global Dividend Class, Beutel Goodman Canadian Dividend, IA Clarington Canadian Small Cap, Manulife Strategic Income and Lysander-Canso Corporate Value Bond.

Recent Changes

- The following funds have been put under review following a quantitative evaluation of long-term performance, style analysis and risk-reward characteristics.
 - Trimark US Small Companies
 - Franklin Mutual Global Discovery
 - Invesco International Growth
 - NBI Westwood Emerging Markets
- Dynamic Asian Growth fund was reinstated following a thorough review of the new management team. The fund is now overseen by the Dynamic Core Equity team led by Dana Love.

Raymond James ETF Focus List Update

The Raymond James ETF Focus List is a compilation of what we consider best-in-class ETFs among the competition. All active ETFs must adhere to rigid criteria and exceed our due diligence process in order to be added to the Focus List. Beta and Strategic Beta ETFs must be leaders in their respective market segments. Please refer to the Fund Selection Process document (Appendix C) for more information on how ETFs are chosen for the Focus List.

Key Points

- The Focus List is currently comprised of 29 ETFs.

Recent Changes

- Questrade Fixed Income Core Plus ETF was removed from the focus list in September 2017 when this product was purchased by WisdomTree and rolled into their passive offering.
- Mackenzie Core Plus Bond ETF has been added to the focus list following the purchase and consolidation of Questrade Core Plus.
- PIMCO Monthly Income ETF was added to the focus list. The ETF follows the same investment philosophy and approach as the current fund on our Mutual Fund Focus List. To note, the mutual fund offers a lower MER for tickets greater than \$100,000.

Appendix A: Raymond James Ltd. Mutual Fund Focus List

The Raymond James Ltd. Mutual Fund Focus List is a collection of best-in-class mutual funds among their respective category peers. A fund must adhere to specific criteria and undergo thorough due diligence in order to be added to the Focus List. Please refer to Appendix B for more information on how funds are selected for the Focus List.

Fixed Income

TYPE	FUND	MANAGER	STYLE/STRATEGY	FUND CODE (Front End/F Class)	RISK RATING
Canadian Fixed Income	Fidelity Canadian Bond	Catriona Martin, Sri Tella	Credit, Sector	FID233/FID633	Low
	PH&N Total Return Bond	Stephen Burke, Kristian Sawkins	Credit, Sector, Duration	RBF6340/RBF5340	Low
	TD Canadian Bond	R. Pemberton, O. Bylaard, C. Case, M. Pauls	Credit, Sector, Duration	TDB306/TDB406	Low
	Leith Wheeler Corporate Adv. Bond	Jim Gilliland, Ben Homsy, Dhruv Mallick	Credit, Sector, Duration	LWF032	Medium
Global Fixed Income	BMO Global Strategic Bond	Curtis Mewbourne (PIMCO)	Credit, Sector, Duration, Currency	GGF99736/GGF95736	Medium
	Manulife Strategic Income	Dan Janis, Tom Goggins, Kisoo Park	Credit, Sector, Duration, Currency	MMF559/MMF659	Medium
	PIMCO Monthly Income	Alfred Murata, Dan Ivascyn	Credit, Sector, Duration	PMO005/PMO205	Low
	Templeton Global Bond	Michael Hasenstab	Credit, Sector, Duration, Currency	TML704/TML257	Medium
High Yield	Lysander Corporate Value Bond	John Carswell (Canso Investment Counsel Ltd)	Credit	LYZ801A, LYZ801F	Medium
	TD High Yield Bond	Gregory Kocik, Shawna Millman	Credit	TDB822/TDB446	Medium

Balanced

TYPE	FUND	MANAGER	STYLE/STRATEGY	FUND CODE (Front End/F Class)	RISK RATING
Canadian Balanced	Dynamic Dividend Income	Oscar Belaiche, Michael McHugh	Value	DYN206/DYN254	Medium
Global Balanced	CI Signature Income & Growth	Eric Bushell	Blend, Macro	CIG6116/CIG6416	Medium
Emerging Markets Balanced	Capital Group Emerging Markets Total Opportunities	Laurentius Harrer, Luis Oliveira, Shaw Wagener	Multi-manager	CIF842/CIF822	Medium

Domestic Equity

TYPE	FUND	MANAGER	STYLE/STRATEGY	FUND CODE (Front End/F Class)	RISK RATING
Canadian Equity – Dividend	Beutel Goodman Cdn Dividend	Mark Thomson, Stephen Arpin, (Beutel, Goodman & Co.)	Value	BTG303/BTG103	Medium
	Manulife Dividend Income	Alan Wicks, Duncan Anderson, Jonathan Popper, Conrad Dabiet, Prakash Chaudhari	Value	MMF4529/MMF4629	Medium
Canadian Equity – Pure	Fidelity True North	Max Lemieux	Growth-at-a-Reasonable Price	FID225/FID625	Medium
	Sionna Canadian Equity	Kim Shannon (Sionna Investment Managers)	Relative Value	BIP181/BIP581	Medium
Canadian Equity – Focused	CI Synergy Canadian	David Picton (Picton Mahoney Asset Management)	Growth	CIG6103/CIG6403	Medium
Cdn Equity - Small and Mid Cap	IA Clarington Canadian Small Cap	Ian Cooke, Joe Jugovic (QV Investors)	Value	CCM520/CCM1450	Medium

Foreign Equity

TYPE	FUND	MANAGER	STYLE/STRATEGY	FUND CODE (Front End/F Class)	RISK RATING
US Equity - Large Cap	Epoch US Large-cap Value	David Pearl, William M. Priest, (Epoch Investment Partners)	Value	TDB826/TDB448	Medium
US Equity - All Cap	Dynamic Power American Growth	Noah Blackstein	Aggressive Growth	DYN004/DYN253	Medium
US Equity - Small and Mid-Cap	Mackenzie US Mid Cap Growth Class	Philip Taller	Growth	MFC1564/MFC1802	Medium
	Trimark US Small Companies*	Rob Mikalachki	Value	AIM5523/AIM5527	High
Global Equity	BMO Global Dividend Class	Sri Iyer, Sam Baldwin, Fiona Wilson	Dividend-Oriented	GGF87211/GGF88211	Medium
	Capital Group Global Equity	Carl M. Kawaja, Dina N. Perry, Galen Hoskin	Multi-Manager	CIF843/CIF823	Medium
	EdgePoint Global Portfolio	Tye Bousada, Geoff MacDonald	Blend	EDG100/EDG500	Medium
	Franklin Mutual Global Discovery*	Peter Langerman, Philippe Brugere-Trelat	Deep Value	TML180/TML225	Medium
	Mackenzie Ivy Foreign Equity	Paul Musson, Matt Moody	Value	MFC081/MFC077	Medium
International Equity	CI Black Creek International Equity	Bill Kanko, Richard Jenkins	Value	CIG11118/CIG11018	Medium
	Invesco International Growth*	Invesco Growth Investment Team	Growth	AIM633/AIM637	Medium
Asia	BMO Asian Growth & Income	Robert Horrocks, Kenneth Lowe, Taizo Ishida (Matthews International Capital Management)	Blend	GGF620/GGF734	Medium
	Dynamic Asia Pacific Equity	Dana Love, Benjamin Zhan	Blend	DYN079/DYN251	High
Europe	Invesco European Growth	Invesco Growth Investment Team	Growth	AIM643/AIM647	Medium
Emerging Markets	RBC Emerging Markets Equity	Phil Langham	Growth (thematic)	RBF798/RBF699	High
	NBI Westwood Emerging Markets*	Patricia Perez-Coutts, Thomas Pinto Basto	Economic Value Added	NBC469/NBC769	High

*Under review

Sector/Theme-Based

TYPE	FUND	MANAGER	STYLE/STRATEGY	FUND CODE (Front End/F Class)	RISK RATING
Precious Metals	RBC Global Precious Metals	Chris Beer, Brahm Spilfogel	Blend	RBF774/RBF614	High
Multi-Strategy	Sun Life Multi-Strategy Target Return Fund	Peter Fitzgerald, Daniel James, Ian Pizer and Brendan Walsh.	Absolute Return	SUN1110/SUN1410	High

Appendix B: ETF Focus List

The Raymond James Ltd. ETF Focus List is a collection of best in class exchange traded funds. An ETF must adhere to specific criteria and undergo thorough due diligence in order to be added to the Focus List.

Canadian Fixed Income

TYPE	ETF	INDEX/MANAGER	STRATEGY	TICKER	RISK RATING
Broad Fixed Income	BMO Aggregate Bond	FTSE TMX Canada Universe Bond Index	Beta	ZAG-T	Low
	Vanguard Canadian Short-Term Bond	Barclays Global Aggregate Canadian Gov/Credit 1–5 year Float Adjusted Bond Index	Beta	VSB-T	Low
	Mackenzie Core Plus Canadian Fixed Income	Mackenzie Investments (Steve Locke, Movin Mokbel, Felix Wong, Dan Cooper)	Active	MKB-T	Low
Corporate Bond Fixed Income	BMO Short-Term Corporate Bond	FTSE TMX Canada Short Term Corporate Bond Index	Beta	ZCS-T	Low
	BMO Mid-Term Corporate Bond	FTSE TMX Canada Mid Term Corporate Bond Index	Beta	ZCM-T	Low
	PowerShares Canada IG 1-5 Year Laddered Corporate Bond	FTSE TMX Canada Investment Grade 1-5 Year Laddered Corporate Bond Index	Beta	PSB-T	Low

Global Fixed Income

TYPE	ETF	INDEX/MANAGER	STRATEGY	TICKER		RISK RATING
				UNHEDGED	HEDGED	
US Fixed Income	Vanguard US Aggregated Bond (CAD-HEDGED)	Bloomberg Barclays U.S. Aggregate Float Adjusted Bond Index C\$ Hedged	Beta	N/A	VBU-T	Low
	PIMCO Monthly Income	Bloomberg Barclays U.S. Aggregate Index - CAD Hedged (Alfred T. Murata, Daniel J. Ivascyn)	Active	N/A	PMIF-T	Low
International Fixed Income	Vanguard Global ex-US Aggregate Bond (CAD-HEDGED)	Bloomberg Barclays Global Aggregate ex-USD Float Adjusted RIC Capped Index C\$ Hedged	Beta	N/A	VBG-T	Low
US Corporate Bond Fixed Income	BMO Short-Term US IG Corporate Bond	Barclays U.S. Investment Grade 1-5 Year Corporate Bond	Beta	N/A	ZSU-T	Low
	BMO Mid-Term US IG Corporate Bond	Barclay's U.S. Investment Grade 5-10 Year Corporate Bond Index	Beta	ZIC-T	ZMU-T	Med/Low
	First Asset Investment Grade Bond	Marret Asset Management (CI Investments)	Active	N/A	FIG-T	Low
High Yield	Horizons Active High Yield Bond	Fiera Capital	Active	N/A	HYI-T	Medium
	First Trust Senior Loans (CAD-HEDGED)	Bill Housey (First Trust)	Active	N/A	FSL-T	Medium

Domestic Equity

TYPE	ETF	INDEX/MANAGER	STRATEGY	TICKER	RISK RATING
Canadian Equity	BMO S&P/TSX Capped Composite	S&P/TSX Capped Composite Index	Beta	ZCN-T	Medium
	Vanguard FTSE Canada All Cap	FTSE Canada All Cap Index	Beta	VCN-T	Medium
	PowerShares FTSE RAFI Canadian Fundamental	FTSE RAFI Canadian Fundamental Index	Factor	PXC-T	Medium
Canadian Equity- Dividend	RBC Quant Canadian Dividend Leaders	Bill Tilford (RBC Global Asset Management)	Factor	RCD-T	Medium

Foreign Equity

TYPE	ETF	INDEX/MANAGER	STRATEGY	TICKER		RISK RATING
				UNHEDGED	HEDGED	
US Equity	Vanguard S&P 500	S&P 500	Beta	VFV-T	VSP-T	Medium
US Equity- Dividend	RBC Quant US Dividend Leaders	Bill Tilford (RBC Global Asset Management)	Factor	RUD-T	RUDH-T	Medium
US Equity- Small Cap	iShares US Small CAP (CAD-HEDGED)	Russell 2000 TR C\$ Hedged	Beta	N/A	XSU-T	Medium
	First Asset Morningstar US Value	Morningstar US Target Value Index	Factor	XXM.B-T	XXM-T	High
	First Asset Morningstar US Momentum	Morningstar US Target Momentum Index	Factor	YXM.B-T	YXM-T	Medium
Global Equity	Horizons Active Global Dividend	Sri Iyer, Fiona Wilson (Guardian Capital)	Active	HAZ-T	N/A	Medium
	iShares Core MSCI ACWI ex-Canada	MSCI ACWI ex Canada IMI Index	Beta	XAW-T	N/A	Medium
International Equity	iShares Core MSCI EAFE	MSCI EAFE IMI Index	Beta	XEI-T	XFH-T	Medium
	RBC Quant EAFE Dividend Leaders	Bill Tilford (RBC Global Asset Management)	Factor	RID-T	RIDH-T	Medium

Preferred Shares

TYPE	ETF	INDEX/MANAGER	STRATEGY	STRUCTURE	TICKER	RISK RATING
Preferred Shares	Horizons Active Preferred Shares	Fiera Capital	Active	ETF	HPR-T	Medium
	Horizons Active Floating Rate Preferred Shares	Fiera Capital	Active	ETF	HFP-T	Medium

Total Return Swap ETFs (Tax Efficient)

TYPE	ETF	INDEX/MANAGER	STRATEGY	STRUCTURE	TICKER	RISK RATING
Canadian Fixed Income	Horizons Canadian Select Universe Bond	Solactive Canadian Select Universe Bond Index (Total Return)	Beta	ETF (Swap)	HBB-T	Medium
Canadian Equity	Horizons S&P/TSX 60	S&P/TSX 60 Total Return Index	Beta	ETF (Swap)	HXT-T	Medium
US Equity	Horizons S&P 500	S&P 500 Total Return Index	Beta	ETF (Swap)	HXS-T	Medium
	Horizons S&P 500 (CAD-HEDGED)	S&P 500 Total Return Index C\$ Hedged	Beta	ETF (Swap)	HSH-T	Medium
International Equity	Horizons Euro STOXX 50	Euro STOXX 50 Total Return Index	Beta	ETF (Swap)	HXX-T	Medium

* For investors who do not need distributions (dividends/interest income) as a source of annual income, total return swap ETFs offer more tax-effective exposure to certain markets. Total return swap ETFs enter swaps with counterparties to replicate the total return performance of an index with the expectation to not pay any distributions. As a result, investors get the full pre-tax value of distributions “reinvested” into the NAV of the ETF. In non-registered accounts, price returns are treated as a capital gain/loss upon sale of unit. It is worth noting that because there are no underlying holdings other than the swap agreements, these ETFs do introduce counterparty risk.

Beta – Passive low cost solution offering index returns net of fees.

Equal Weight – Replicates an index where all securities are equally weighted

Factor – “Smart-Beta” rules based methodology to enhance or provide tilts to sectors, geographies, etc. Mid cost solution.

Active – Active manager oversight of fund decisions, typically higher cost solutions.

Important Investor Disclosures

Disclosure: Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund or ETF investments. 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 and do not take into account sales, redemptions, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. ETFs are not guaranteed, their values change frequently and past performance may not be repeated. Member – Canadian Investor Protection Fund.

Appendix C: Fund Selection Process

Mutual Funds

Core Beliefs and Philosophy

- **Objective and unbiased research** - We have the freedom to select funds from the entire universe of Canadian mutual funds without restriction or bias towards a particular fund family. In addition, we do not receive special compensation from fund companies to promote their funds. These combined factors allow us to conduct fund research in an objective and unbiased fashion.
- **Investment Horizon** - Much like the tale of the tortoise that beat the hare, we select funds that are most likely to generate strong long term results versus its peers and respective benchmark.
- **Art and Science** - Investing is both an art and a science. Likewise, our fund selection process incorporates both qualitative and quantitative elements.
- **Sustainable Competitive Advantage** - We favour funds that possess a distinct competitive advantage over other similarly managed products. We define a competitive advantage as an attribute of the fund’s investment process that cannot be easily duplicated or imitated elsewhere and, in turn, enables the fund to outperform over the long term. There are a number of ways a fund can enjoy a competitive advantage. For example, the portfolio manager may retain an informational advantage through experience or by possessing a specialized skillset. Perhaps the fund benefits from extensive research capabilities such as a large team of experienced research analysts. Being the beneficiary of a sophisticated and well-equipped trading desk is another way a fund can have an edge over the competition.

Fund Selection Process

Step 1: Quantitative Screening

The first step of the fund selection process is to identify funds that are worth further consideration. But with over 6000 offerings to choose from, distilling the unwieldy Canadian mutual fund universe can be a daunting task. This is where our quantitative screening tools come into play. In essence, they help pinpoint well managed funds.

Mutual funds that screen well are those that have outperformed with relatively low volatility. In others words, we’re looking for funds that exhibit strong risk-adjusted returns. The table below illustrates several metrics that we screen for. It is important to note that we analyze these risk-adjusted metrics on a rolling basis over multiple periods in order to mitigate end-date bias, which is an error that occurs when analyzing performance over a single time period.

Performance Risk Metrics

Alpha	Alpha is the value added by the manager as distinct from the market. We use the overall level of Alpha over time as an indicator of manager skill.
Rolling Alpha > 0	Indicates consistency of risk-adjusted outperformance over time in percentage terms. Must be well above 50%.
Up and Down Capture %	We look for funds that capture more market upside than market downside.
Omega	This is the ratio of “up” periods to “down” periods. We prefer funds with Omega at least 20% greater than the benchmark’s.
Downside Volatility	When performance is negative, how negative does it get? We prefer funds with lower downside risk.
Maximum Drawdown	The peak to trough percentage decline of a fund’s performance over a specified period of time. This metric helps determine a fund’s risk profile and the magnitude of future drawdowns.
Sharpe Ratio	This ratio measures excess return per unit of standard deviation. The greater a portfolio's Sharpe ratio, the better its risk-adjusted performance has been.
Treynor Ratio	Similar to Sharpe ratio, Treynor measures excess performance as a unit of risk. Unlike Sharpe, Treynor uses market risk (i.e. beta) instead of security risk (i.e. standard deviation) as the base unit of risk.
Information Ratio	This ratio measures a fund’s ability to generate excess returns relative to the standard deviation of its benchmark. A high ratio is achieved by producing strong returns and low volatility relative to the benchmark.

It is often the case that funds worth further consideration are those that don’t pop up on our radar through the initial screening process (e.g. limited track record). As

such, we rely on our experience and network of industry contacts to uncover these hidden gems.

Before we conduct any further analysis, we need to ensure that the fund's manufacturer or sub-advisor poses no reputation risk, is financially sound, follows strict internal risk controls, and is not embroiled in disciplinary matters with securities regulators.

Funds worth further consideration must also meet the following criteria:

- The portfolio manager or investment team has several years of lead portfolio management experience.
- Available for sale to new and existing unitholders.
- Competitively priced fees.

▪ **Step 2: Assessing Performance Drivers**

Once a fund has been identified for further consideration and meets the above eligibility criteria, we analyze the fund's performance drivers. While portfolio managers would love to have you believe that their fund's five star rating or first quartile rankings are the manifestation of their investment acumen, there are many other factors outside the control of the portfolio manager that shape a fund's track record.

Investment style is a key consideration as it strongly influences a fund's returns. Investment style is defined as the overall strategy or theory that a money manager abides by when selecting securities. The two main investment styles are value and growth, both of which rotate in and out of favour for extended periods of time, consequently obscuring the validity of a fund's track record. For example, by simply focusing on price and earnings momentum, even the most inept growth manager was able to greatly outperform the majority of value managers during the late 1990s. However, when the tech bubble imploded and growth fell off the rails, the reverse became true; a number of mediocre value funds were able to outperform growth funds by simply sticking to their investment strategy.

In order to control for style differentiation, we compare a fund's performance to a customized peer group comprised of funds with similar investment styles. This way, we ensure that we're making apples to apples comparisons when assessing fund performance.

Other factors that impact relative returns include sector and country weightings, currency exposure, and market capitalization. With respect to balanced funds, the largest determinant of a fund's success is its asset mix. In fact, academic studies have shown that approximately 90% of the variability in performance can be attributed to asset allocation. The implications of this on balanced funds are huge. That's because balanced funds abide by different asset mix policies but their returns are often compared to one another on an indiscriminate basis. As a result, a slight difference in its asset mix policy will determine whether a fund is a first quartile hero or fourth quartile laggard. As such, we don't put too much stock in relative performance metrics when assessing the performance of balanced funds.

Given that returns are heavily influenced by the aforementioned factors, we utilize holdings-based and style-based attribution techniques to determine how much value (i.e. alpha) the portfolio manager brings to the table. This also provides us with a better understanding of the strategy's risks, the consistency of management's investment approach, and whether outperformance is sustainable.

▪ **Step 3: Qualitative Assessment**

After assessing the fund's returns and performance drivers, we require the portfolio manager to complete a detailed investment strategy questionnaire. Key aspects of the questionnaire include a synopsis of the manager's investment philosophy and process, a description of the fund's risk controls, and other material facts concerning the fund. Below is a sample set of questions from the questionnaire:

- Describe how the investment team is structured in terms of research and management responsibilities?
- List all departures and additions to the investment team over the past 12 months.
- How is the portfolio manager's compensation aligned with unitholders of the fund?
- Has there been any material change to the fund's investment strategy over the past 12 months?
- What is your buy and sell discipline?
- How does the fund behave throughout a full market cycle?
- What distinguishes the fund from its closest competitor?
- What areas within the investment process require improvement?

It is mandatory that we interview the portfolio manager or investment team via conference call or face-to-face. The portfolio manager interview is an invaluable step of the fund selection process. That's because it provides us with insights that cannot be gleaned from analyzing the fund's performance or portfolio holdings.

The portfolio manager interview is structured much like a behavioural job interview, based on the belief that behavioural patterns that are identified during the meeting provide a good indication of conduct that happens behind the scenes.

In our experience, we have found that successful portfolio managers are those who are honest, passionate about investing, resolute, business-savvy, self-effacing, and competitive. They are calculated risk takers, knowing when to take chances to capture investment opportunities. They draw upon multiple educational disciplines that allow them to process information in a unique fashion. Lastly, they are independent thinkers, inclined to forge their own path rather than succumb to herd mentality.

▪ **Step 4: Investment Thesis and Portfolio Strategy**

After thoroughly analyzing all aspects of the fund, we formulate an investment thesis that answers the following question: What is the fund's sustainable competitive advantage? As discussed earlier, a competitive advantage is an attribute of the fund's investment process that cannot be easily duplicated or imitated elsewhere and, in turn, enables the fund to outperform over the long term. In order for a fund to be selected to the Focus List, we must be able to identify and clearly articulate a fund's competitive advantage.

We also consider macro-economic factors, valuations, and the relative attractiveness of an asset class when selecting funds. In addition, we consider how well a fund fits into a diversified portfolio.

▪ **Step 5: Monitoring and Ongoing Due Diligence**

All funds on the Focus List are monitored on a continuous basis. Performance is reviewed monthly. We will contact portfolio managers of funds whose returns vary dramatically from their benchmark or category average, asking the manager to explain the fund's performance variance in detail. While we would not remove a fund based on short-term underperformance, it's imperative that we understand why a fund's returns are lagging. We are equally concerned with funds that exhibit exceptionally strong performance as this may be an indication that the portfolio manager is assuming too much risk to generate excess returns.

A fund can be removed from the Focus List at any time. We would consider removing a fund for any of the following reasons:

1. If the fund experiences an adverse material change (e.g. manager departure, change in strategy, etc.).
2. If we determine that a comparable fund possesses better investment potential.
3. If our investment thesis no longer holds true (e.g. overestimate a manager's competitive advantage).

ETFs

Passive ETFs- For passive ETFs that track an index, we rely primarily on quantitative metrics that measure how well an ETF replicates its benchmark. While cost (lower is better) is a large driver and an important part of the selection process, there are a number of other metrics that we consider. Tracking Error measures how closely an ETF tracks its benchmark, e.g. a tracking error of 0% means that it perfectly tracks the index. As the number gets higher, the more the ETF differs from the index. Some ETFs may be slightly cheaper, but have issues tracking the benchmark for whatever reason and we seek to deliver returns as close to the index as possible when investing in this type of ETF. Security lending rebates are another area we look at. Security lending is fairly simple and can help generate extra returns for investors. In essence, the manufacturer holds thousands of shares of stocks which back the ETF. If there is a short-seller who wants to borrow any of those stocks, they can post collateral and pay the ETF a fee for doing so. The ETF manufacturer can then pass these fees onto the investor of the ETF to enhance the returns. However, some companies will pay all of these fees out, while some will keep a portion for the house. Repaying a larger portion of the security lending fee helps offset some of the cost. As a result, the lowest cost ETF may not always be on the Focus List if another ETF in the passive universe is delivering closer index returns for any of the reasons mentioned above.

Factor and Active ETFs- For factor and active ETFs, the exact same selection process is employed as mutual funds (outlined above).

Appendix D: Flows, Assets, and Performance

Money is flowing into....

ETF Inflows (YTD)

ETF	Estimated Net Inflows (C\$)
BMO Europe High Dividend Cov Call ETF	\$1,026,929,716
PIMCO Monthly Income Fund (Canada)	\$676,700,493
BMO S&P/TSX Capped Composite ETF	\$599,141,294

Mutual Fund Inflows (YTD)

Mutual Fund	Estimated Net Inflows (C\$)
PIMCO Monthly Income Fund (Canada)	\$2,130,263,427
Edgepoint Global Growth & Income Portfolio	\$1,630,846,487
Edgepoint Global Portfolio	\$1,102,090,672

Fund Category Inflows (YTD)

Category	Estimated Net Inflows (C\$)
Global Equity	\$5,780,061,829
Global Fixed Income	\$5,096,979,574
Global Equity Balanced	\$5,092,526,917

Largest ETFs by Assets

ETF	Total Net Assets C\$
iShares S&P/TSX 60 ETF	\$10,904,340,917
BMO S&P 500 ETF (USD)	\$4,951,465,442
iShares Core S&P 500 ETF (CAD-Hedged)	\$4,287,609,440

Money is flowing out of...

ETF Outflows (YTD)

ETF	Estimated Net Outflows (C\$)
BMO Canadian Dividend ETF	-\$371,045,367
BMO Short Corporate Bond ETF	-\$232,941,481
iShares 1-5 Year Ladder Corporate Bond ETF	-\$198,799,175

Mutual Fund Outflows (YTD)

Mutual Fund	Estimated Net Outflows (C\$)
Fidelity Monthly Income Fund	-\$1,845,730,243
Fidelity Canadian Bond Fund	-\$906,494,021
Signature High Income Fund	-\$872,370,336

Fund Category Outflows (YTD)

Category	Estimated Net Outflows (C\$)
Canadian Neutral Balanced	-\$4,917,520,289
Canadian Focused Equity	-\$2,165,428,339
Canadian Equity Balanced	-\$1,960,237,489

Largest Mutual Funds by Assets

Mutual Fund	Total Net Assets C\$
RBC Bond Fund	\$19,570,270,013
RBC Canadian Dividend Fund	\$18,564,332,357
PIMCO Monthly Income Fund (Canada)	\$14,994,828,526

Top Performers

Top Three Best Performing ETFs (YTD)

ETF	Ticker	Total Return
BetaPro S&P 500 VIX ST Futures ETF	HUV	33.3
Evolve Cyber Security ETF (Unhedged)	CYBR	21.7
iShares S&P/TSX Capped Info Tech ETF	XIT	20.4

Top Three Best Performing Mutual Funds (YTD)

Mutual Fund	Total Return
Dynamic Power American Growth	43.0
Resolute Performance	31.2
Qwest Energy Canadian Resource	29.3

Top Three Best Performing Categories (YTD)

Category	Total Return
Greater China Equity	7.1
Energy Equity	5.4
US Small/Mid Cap Equity	4.7

As of May 31, 2018
 Source: Morningstar, Raymond James Ltd.
 (Leveraged & Inverse ETFs excluded)

Bottom Performers

Bottom Three Worst Performing ETFs (YTD)

ETF	Ticker	Total Return
Purpose Enhanced Dividend ETF	PDIV	-10.7
iShares S&P/TSX Capped Utilities ETF	XUT	-8.7
First Asset US & Can Lifeco Income ETF	FLI	-7.9

Bottom Three Worst Performing Mutual Funds (YTD)

Mutual Fund	Total Return
AlphaNorth Resource	-26.1
AlphaNorth Growth	-25.8
Redwood Pension	-20.3

Bottom Three Worst Performing Categories (YTD)

Category	Total Return
Precious Metals Equity	-3.8
Emerging Markets Fixed Income	-2.7
Canadian Dividend & Income Equity	-2.0

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