The active side of exchange-traded funds

Many sophisticated investors are likely familiar with the wide range of exchange-traded funds (ETFs) available in today's market. There are ETFs that give you broad market exposure by tracking well-known indices like the S&P/TSX Capped Composite Index or the FTSE TMX Canada Universe Bond Index. There are also ETFs that give you access to niche markets ranging from real estate to precious metals to global social media stocks.[1] Investors worried about market volatility may be interested in dividend-paying ETFs, which could offset some market losses with dividend payments.

With more than 500 Canadian ETFs in the marketplace and more than 4,500 available globally,[2] you can probably find an ETF that will give you exposure to almost any market you want to invest in. Despite the broad range of available ETFs, most of them are typically lower-cost products passively managed to track a market index, or some combination of indices. At least, that used to be the case.

Relatively new on the market are actively managed ETFs, in which a portfolio manager actively picks and trades stocks within the fund in order to meet a certain objective. These ETFs are managed more like an actively managed mutual fund. Their active management strategy means they tend to be a higher-cost product than the more traditional passive ETFs, but they are catching on with Canadian investors.

Actively managed ETFs and the Canadian market

According to data released by Bloomberg, Canada has the highest percentage of actively managed ETFs among G7 countries.[3] In fact, actively managed ETFs account for almost 11% of Canada's CDN $86.6 billion ETF industry,[4] and several actively managed ETFs in Canada have well over CDN $200 million of assets under management.[5]

This popularity is in stark contrast to the U.S., where actively managed ETFs make up about 1% of that country's CDN $1.2 trillion ETF industry.[6] In Britain, actively managed ETFs account for just over 2% of that country's ETF market.[7]

So, why might actively managed ETFs be gaining traction in Canada? There are two likely factors.

First, in Canada, ETFs are regulated in much the same way as mutual funds, which means they have to disclose their list of holdings quarterly. Although some Canadian ETFs may choose to disclose their holdings daily, they aren't strictly required to. In the U.S., on the other hand, ETFs must disclose their holdings daily. Because an actively managed ETF may experience multiple trades per day, this daily requirement in the U.S. could prove challenging.

The second reason has to do with costs. Although actively managed ETFs generally have higher fees than passive ETFs, in some cases, those fees can be lower than those for actively managed mutual funds with similar objectives. Canadian investors may view actively managed ETFs as a lower-cost alternative to actively managed mutual funds.

Whatever the reasons behind the current popularity of actively managed ETFs among Canadian investors, we can help you consider whether investing in this type of product might make sense for your portfolio.

Actively managed ETFs and your portfolio

Your unique investment objectives and the level of diversification that's right for you, among other factors, will drive whether or not actively managed ETFs have a place in your portfolio. However, there are a few points to keep in mind.

If you're comparing actively managed ETFs to passive ETFs, you may want to ask a key question: "Does the active strategy you're considering add enough value to cover the higher cost of the actively managed ETF?" For example, can the actively managed ETF offer you significantly lower volatility or better risk-adjusted returns? If so, is that enough to offset the higher cost? If not, you may find that passive ETFs provide you enough access to a broad range of markets and an appropriate level of diversification.

We can help you compare actively managed ETFs to mutual funds by analyzing each fund individually. Focusing on the fund's investment strategy, and what it is trying to achieve, will help determine how well the fund fits with your overall investment plan. Also, research on the investment team managing the fund, will help to determine how well their objectives align with your own.

Actively managed ETFs, passive ETFs and mutual funds all come with their own unique sets of advantages and challenges. Each of these products could have a place in your portfolio, depending on your goals, time horizon and risk tolerance.

Speak to your advisor about what types of investment products best fit your investment objectives and financial goals. Your advisor can help you decide whether actively managed ETFs make sense for you.

1 *Business News Network, ETFs aim to entice investors by going ultra-niche, http://www.bnn.ca/News/2016/4/19/ETFs-aim-to-entice-investors-by-going-ultra-niche-.aspx, April 2016*

2 *Canadian ETF Association, List of Canadian ETFs as of May 31, 2016, http://www.cetfa.ca/, May 2016; ETGFI, Global ETF and ETP growth, http://www.etfgi.com/index/home, May 2016*

3 *Globe Advisor, Canada is a pioneer in actively managed ETFs, http://www.globeadvisor.com/AdvisorContext/Articles/20151029_001/Invesco-story-activeETF.html, October 2015*

4 *Globe and Mail, Actively managed ETFs catching on quickly in Canada, http://www.theglobeandmail.com/globe-investor/advisers-view/growth-of-actively-managed-etfs-surges-in-canada/article25941079/, December 2015*

5 *Globe Advisor, Canada is a pioneer*

6 *Ibid.*

7 *Ibid.*

Handle legacies with care

When Prince died suddenly in April 2016, he left no known will. With one full sibling, five half-siblings and at least one person claiming to be his child, the estate will be difficult and costly to settle. No one truly knows who Prince would have wanted to control and benefit from his legacy. His wishes died with him. Prince's situation could have been avoided with appropriate estate planning.

Furthermore, it's important to not only ensure that your legacy plans are in order, but to also consider how you will manage a large inheritance that comes to you. After all, a recent CIBC report projected that Canadians aged 50 to 75 will inherit $750 billion in the coming decade, in the biggest transfer of wealth between generations Canada has ever seen.[1]

Consider structuring your planning around these four steps.

1. Talk to your family

Keep lines of communication open. Discuss your estate plans with your family. If you have adult children, emphasize the importance of getting their own affairs in order. Ideally, you also want to talk to your potential benefactors so you can better prepare to receive an inheritance.

Regular conversations can help prevent the misunderstandings and resentment that can be associated with inheritances. In addition, if family members inherit at the same time, you may want to recommend they speak with an advisor to help preserve their legacy.

2. Review the assets of the estate plan or the inheritance

Whether you're laying the groundwork to give or to receive, what does the inheritance include? Make a comprehensive list of all the different types of assets, such as registered and non-registered investment accounts, life insurance proceeds, trust assets, real estate and other valuables. Indicate which items should be appraised to establish their current value.

In addition, identify any assets that require tax planning. There are ways to minimize taxes, but it's important to develop an individualized plan with the help of an expert.

3. Manage your inheritance

When you receive an inheritance, you'll likely want to keep items of sentimental value. However, a collection prized by your benefactor – anything from sculptures to sports memorabilia – might be sold to someone who appreciates it more. If you are contemplating a sale, connecting with people who are knowledgeable about specialized markets can help.

When it comes to investing a legacy's financial assets, keep in mind that your current priorities and long-term goals are almost certainly different from those of your benefactor. It's essential to make thought-out decisions based on your needs today and in the future.

4. Review your estate plan

Any time your financial circumstances change significantly, it's important to update your own estate plan. After receiving a large inheritance, consider the impact on your will and the instructions for any trusts you may have set up in your will. You may want to establish a charitable legacy –perhaps in your benefactor's name. There are a number of options available with different tax benefits. We can help you decide what will work best for you and your family.

An inheritance is both a financial opportunity and a chance to honour a loved one. If you're creating a legacy, make sure your plans are well defined to help minimize the potential for disputes. If you're receiving a legacy, manage it wisely by making careful decisions about how to use it and transfer it to the next generation. Speak with us if you're creating or receiving an inheritance, and we'll work together to help you put the best possible plans in place.

1 *www.newswire.ca/news-releases/canadian-baby-boomers-stand-to-inherit-750-billion-in-the-next-10-years-cibc-581943291.html*

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