Inside: Trends, ideas and innovations in ETFs

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2021 Mackenzie Investments Mid-Year ETF Report

Top ETF trends for a post-pandemic world

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Investments

ETFs stay strong in the first half of the year

While it could still take months, if not longer, before life resumes to some sort of normalcy, there is at least a growing hope that vaccines will put an end to COVID-19. That is, of course, good news for Canadian investors who, for the last year, have been on heightened alert, knowing that any setback could cause their portfolios to plummet. As the world inches closer to its post-pandemic phase, investors must start thinking about some of the trends that could shape markets and their assets going forward. This is especially true for ETF holders, who should use these products to strategically take advantage of the eventual economic recovery.

So far, ETFs continue to be one of the most sought-after investment products on the market. In the first five months of 2021, $25 billion flowed into Canadian ETFs, which puts it on a path to beat 2020's record-breaking $41-billion year, according to National Bank. Once again, investors are focused on equity markets, with about 64% of inflows as of May 31 moving into Canadian, U.S. and international stock funds, says National Bank. While money poured into fixed income assets, too, it was more measured, as rising interest rates over the quarter caused bond prices to fall. Most bond-focused dollars went into short-term and aggregate fixed income ETFs.

One of the reasons why inflows have been so strong this year is because trading activity has dramatically increased, says Michael Cooke, Senior Vice President and Head of ETFs at Mackenzie Investments. According to the TMX, trading volume jumped by nearly 50% year-over-year in Q1. That's partly because people are feeling better about the future, but more do-it-yourself investors have also taken up stock trading and are using ETFs to express views on the market. More importantly, the ETF ecosystem continues to expand with more investors making larger allocations to ETFs. Also noteworthy is that ETF flow trends in the last year reflect investor demand that tends to be long term. Scotia Capital estimates the correlation between fund flows and returns on equity ETFs was just 0.08 in 2020.

ETF AUM by category in 2021

Source: National Bank (As of May 31)

	AUM ($M)	Mkt Shr (%)
Equity	$175,794	
Canada	$65,523	24%
United States	$58,563	21%
International	$51,708	19%
Fixed Income	$82,666	30%
Commodities	$2,046	1%
Multi-Asset	$12,217	4%
Inverse/Levered	$1,324	0%
Crypto-Asset	$2,892	1%
Total	$276,940	100%

Michael Cooke
Senior Vice President and Head of ETFs, Mackenzie Investments

Prerna Chandak
Vice President ETFs, Mackenzie Investments

TOP TRENDS:

Challenges and opportunities in a post-pandemic future

The world may be ready to move past COVID-19, but the pandemic has challenged markets and economies in ways that could last for a while. At the same time, innovations in the ETF space present new opportunities for investors who want to better position themselves for the future.

Protection from inflation

Investors have inflation on their minds. Since the start of the year, Canadians have gravitated toward short-term fixed income solutions to protect themselves from potential inflation and, therefore, rising bond yields. At the end of May, $458 million had flowed into short maturity ETFs, second only to the $946 million that went into broad based and mixed ETFs, according to National Bank. As the threat of inflation looms — many think the economy could overheat and that prices for goods and services could rise as cities reopen — more investors will look to ETFs for inflation protection, says Cooke. Besides shorter fixed income, there are also ETFs that invest in Treasury Inflation Protected Securities (TIPS), which can increase in value as inflation rises, or senior loan–based ETFs that protect investors from rising interest rates. ETFs with allocations to gold bullion or broad commodities can also help investors create a portfolio that seeks to provide inflation-beating returns.

The search for yield

With the Bank of Canada saying it's going to keep rates at ultra-low levels until at least 2023, investors will need to look outside of Canada for fixed income that can both reduce risk and generate yields, says Prerna Chandak, Vice President of ETFs at Mackenzie. "It's going to be harder to generate that same amount of income with the same amount of risk," she says. "When it comes to yield, the next decade is not going to look like the past decade."

Fortunately, investors can create a globally diversified fixed income portfolio with ETFs of varying yields. Owning various fixed income securities can help investors generate higher yields, but it also helps to protect them from yield-related fluctuations — if yields go up in one spot, others could stay where they are or even fall, which would help mitigate the decline in bond values.

For those who need more income specifically, there are also strategic beta ETFs that use screens to select dividend stocks based on certain criteria, while certain sector ETFs, such as real estate and infrastructure, may offer decent yields as well.

Sustainable investing

While ETFs using environmental, social and governance (ESG) insights are not new, there are more people interested in owning these kinds of funds than ever before. Between January and May, a record-breaking $3.3 billion flowed into Canadian-listed ESG-focused ETFs, up from about $1.8 billion in all of 2020, according to National Bank. Chandak expects that trend to continue well into the future, in part because the pandemic has put a spotlight on many ESG issues, including climate change, treatment of employees and disparities between the wealthy and the poor. Younger investors who are now getting into the market also care a lot about these issues. "You're seeing an increased amount of social awareness globally, and that's being driven by many movements," she says. "It's not going to stop."

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>
> Michael Cooke
> Senior Vice President and Head of ETFs

ETF STATS
(AS OF MAY 31)

$277 billion
Assets under management in Canadian-listed ETFs (National Bank)

31.2%
Year-over-year change in AUM (National Bank)

$25 billion
YTD inflows into Canadian-listed ETFs (National Bank)

917
Canadian-listed ETFs available for purchase (CETFA)

125
Increase in Canadian-listed ETFs YOY (CETFA)

40
Canadian ETF sponsors (CEFTA)

$13.8 billion
YTD flows into Canadian equity ETFs (National Bank)

$5.8 billion
YTD inflows into globally focused ETFs (National Bank)

$4.2 billion
YTD flows into Canadian fixed income ETFs (National Bank)

Focus on Canada

With 917 Canadian-listed ETFs available for purchase at the end of May, according to the Canadian ETF Association — an increase of 117 funds from the year prior — domestic investors have many more ways to build a portfolio with homegrown funds. That's important, explains Cooke, as it's easier for the average investor to buy and sell Canadian-listed ETFs, and they don't have to worry about currency fluctuations if they hold currency hedged ETFs. Some work still needs to be done by the industry to ensure the right products are available to Canadian investors, but more domestic options are coming to market every month. "If we're competitive in terms of exposures, fees and liquidity then it's often more appropriate for Canadian investors to hold Canadian-listed products," he says.

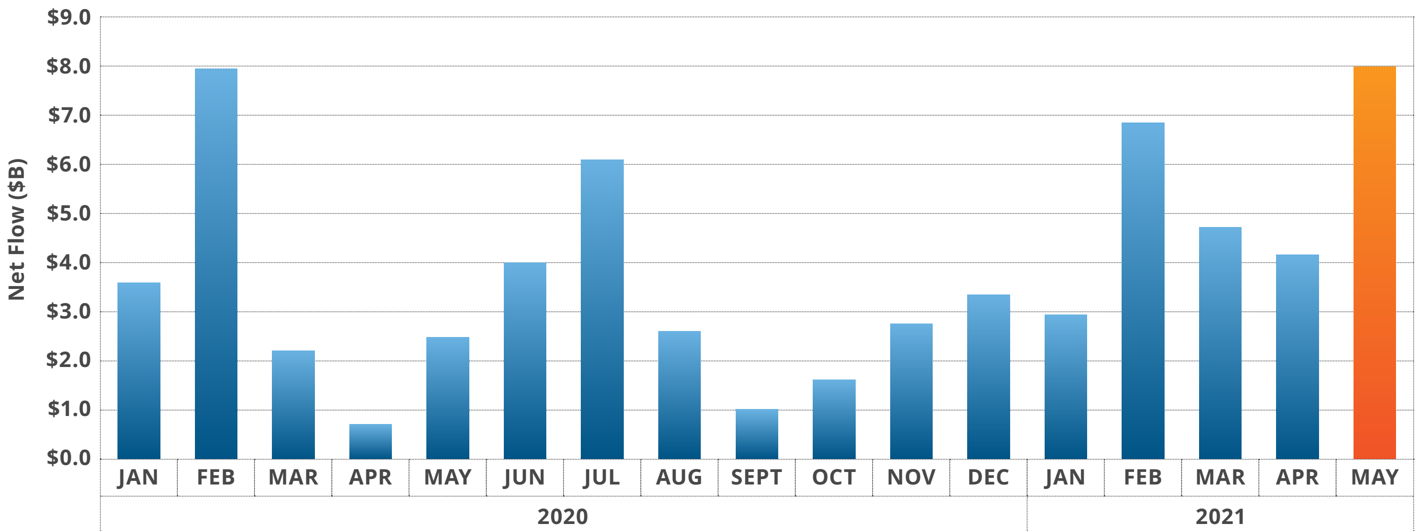
ETF innovation continues

As the world moves forward, there will be an even greater need for ETF innovation, say both Cooke and Chandak. People's financial needs — both short and long term — continue to evolve, and the ETF market must grow and expand, too. Fortunately, Canada has long been a hotbed of ETF innovation — the first equity, fixed income, currency hedged and cannabis ETFs, among others, launched here before anywhere else.

To that end, the first bitcoin ETF in the world launched in Canada this year. A second bitcoin ETF launched soon after and more home-grown cryptocurrency offerings are in the works. "Canada has emerged as a global leader in regulatory approval for cryptocurrency products like bitcoin," says Cooke. "And

Canadian ETF flows by month

Source: National Bank (as of May 31)



that's shone a brighter spotlight on Canadian ETF innovation."

Chandak agrees, adding that Canada has always had a forward-thinking ETF industry, in part because companies have taken the mindset that investors need all-encompassing investment solutions. "Since the industry has taken off here, providers have wanted to give investors a comprehensive set of solutions spanning equity, fixed income and alternative asset classes," she says, adding that Canada also has one of the largest active management ETF offerings relative to its industry's total ETF assets.

Get more tactical

More choice allows investors and advisors to be more tactical with their ETFs, explains Chandak, which is key to creating a post-pandemic portfolio. Parts of the market will look better than others going forward, while certain kinds of ETFs will be better suited to individual investors. Having the ability to easily move in and out of ETFs as the new normal takes shape is important. "We're entering the recovery phase and investors need the ability to make calls on what they think the condition of the market is today and what it might look like in the mid-term," she says. "That's going to be a continued area of focus for investors — solutions that can help them both tactically and strategically."

How investors fare for the rest of 2021 will largely depend on whether vaccines get rolled out as promised and if they are indeed effective at curbing lockdowns and reducing case counts. But no matter what, investor interest in ETFs is only going to continue. Based on the numbers so far, it looks as if this year will be another historic one for inflows, while more investors and advisors are using ETFs in the way they should be used: to create long-term portfolios tailored to one's individual financial goals. "More investors are seeing the merits of ETFs and allocating them within their portfolios accordingly," says Cooke. "That's going to continue." ■

$967 million
AUM in Canada's two bitcoin ETFs (Purpose and Evolve)

$559 billion
Global ETF net inflows, a record (ETFGI)

$9.2 trillion
Global ETF AUM (ETFGI)

24
Consecutive months of inflows into ETFs world wide (ETFGI)

17,920
ETFs and ETPs listed worldwide (ETFGI)

78
Number of exchanges with publicly traded ETFs (ETFGI)