The Importance of Indexes

By Paul Bowes – Head of Canada, FTSE Russell

In Canada, indexes are rapidly growing in importance and scope along with the rise of passive investing. In fact, according to PWL Capital Inc.'s "The Passive vs. Active Fund Monitor," Canada's passive funds attracted new capital at nearly the same rate as active funds between 2007 and 2017, with $70 billion and $75 billion in growth, respectively. And, since 2007, Canadian passive funds have nearly doubled their market share from 5.2% to 11.2%.

These trends are reinforced in my discussions with our Canadian clients. Institutional investors in Canada who have long understood the value of indexes as benchmarks recognize the growing role indexes play in portfolios as a complement to active strategies. And retail investors in Canada certainly view indexes as important. According to our friends at the Canadian ETF Association (CETFA), Canadian-listed ETFs finished 2019 at an all-time high of $204.8 billion—keep in mind, that number had reached $100 billion just three years ago back in May 2016.

Indexes are of course important to the markets, but I believe a better word for indexes is "useful." There are many ways that market indexes can play a useful and practical role in your financial planning practice.

An acceleration in innovation

Market indexes are not new to Canada. In fact, the FTSE Canada Universe Bond Index was first introduced nearly 40 years ago. And the very first exchange-traded, index-linked product in the world was launched in 1990 when the Toronto 35 Index Participation Units were listed on the Toronto Stock Exchange.

Canada has been a pioneer and an innovator in the index space, but until recently Canada market indexes have mainly been perceived as "plain vanilla" from an investment portfolio standpoint, having been used to benchmark and invest in major equity asset classes and fixed income sectors through retail investment products such as mutual funds and ETFs.

This situation has changed dramatically in the last decade or so as a wave of innovation has produced a more sophisticated set of index-based approaches to allow the end investor to measure a broader and more specific array of market exposures. These include thematic indexes that track ESG-friendly sustainable investments, as well as indexes that allow investors to efficiently mine various market factors, and indexes that offer alternative weighting schemes. These expanded approaches mean that you, as a financial planner, have so many more tools at your disposal for index-based market exposures.

What's next…

Index innovation continues to impress me, and as we look around the next corner we'll see new developments. The fixed income market is one area where new index approaches can help investors navigate historically low global interest rates and other fixed income challenges. Indexes may also play an increasing role in the digital asset space, for measuring multi-asset approaches across equity and fixed income, for use in sustainable investment strategies and, potentially, to measure alternative assets such as commodities and private equity.

Market indexes are important, but, even more important, they are useful. For financial planners, indexes can play a foundational role in portfolio measurement and asset allocation. And, with the innovation and constant evolution in market indexes, your use of these tools can grow as your practice grows. Gaining a better understanding of market indexes and the utility they can bring to your practice can help differentiate you with your clients.