Canadian ETF Association

Myth: ETFs can "Become" the Market

As exchange-traded funds (ETFs) grow in popularity, an important part of our mission at the Canadian ETF Association (CETFA) is to help advisors make sense of the ever-changing ETF marketplace.

As part of the growth of ETF-invested assets, some broader-market ETFs inevitably grew more quickly than others. As some of the more popular funds are now extremely large, some market watchers have expressed concern that these ETFs have begun to affect market movements – in effect, the ETFs are "becoming the market." This is a misconception that has developed over time and it is important to discuss and debunk myths like this, so advisors can make informed investment decisions for their clients.

The ETF marketplace

At the end of January 2020, Canadian-listed ETF assets hit a record high of $211.1billion, up 28% from January 2019. There are now 766 ETFs listed on Canadian stock exchanges, 87 more than the previous year. The growth trajectory is real. There are new providers, new funds and new investors jumping into ETF markets.

There is certainly increased diversity in the ETF market as well, as new providers enter the space with an assortment of new strategies. But, as with any investment vehicle, there are a handful of ETFs that are the most popular, attracting more investor assets than others. For example, the top 25 ETFs (by AUM) hold 40% of the total Canadian-listed ETF assets. Of the top 20, eight are in the Canadian equity category and hold 14.7% of the total assets. What does this mean for individual stock pricing in the broader market – if anything?

Efficient markets, efficient pricing

When some common ETFs grew beyond their peers, there was speculation among some industry participants that it could lead to inefficiency in market pricing. Could ETFs cause a stock's price to be dictated by indexing, rather than by company fundamentals? The short answer: no. Despite some concentration in popular ETFs, the growing ETF market is increasingly diverse and there is no evidence that a stock's price is not unduly influenced by its inclusion in an ETF.

ETFs still only represent 12% of the total assets held in investment funds in Canada, still small relative to the total securities traded. In order to exert real pressure on securities pricing, ETF assets would have to represent the vast majority of the market. Despite rapid growth, the sheer diversity of available investments in today's markets suggests that this simply is not a realistic scenario.

The ETFs available in Canada and around the world have individual mandates, offer exposure to various segments of the market and include different underlying securities. Globally, there are thousands of ETFs with many incorporating different indexing and investment strategies.

As more ETFs launch in the Canadian market, strategic-beta and active mandates are currently at the forefront. According to CETFA's Q1, 2019 Commentary, "Strategic-beta ETFs accounted for 23 of the 49 ETF launches [in Q1], while an additional 18 ETFs employing actively-managed strategies came to market, leaving just eight launches attributed to pure passive ETFs." This trend toward alternatively weighted indexing and actively managed ETFs highlights the evolving nature of the ETF industry and provides another clear counterpoint to the notion that ETFs could "become the market".