Canadian ETF Association

Canadian ETFs Ride, Lead a Powerful, Positive Global Trend

The acknowledged originator of exchange traded funds, Canada is riding a surging international wave of investor appetite for ETFs more than three decades after they debuted on the TSX.

This is the encouraging topline assessment that emerges from data collected and interpreted by ETFGI, an independent London, U.K.-based firm that reports on and analyses ETF and ETP (exchange traded product) trends.

The Canadian Exchange Traded Funds Association (CETFA) spoke with ETFGI Founder, Owner and Managing Partner Deborah Fuhr (after her overview presentation for its members in May) to probe on international ETF developments viewed through a Canadian lens. What follows are key insights Deborah shared on topical matters of interest with additional observations and data contributed by CETFA.

Proven Stability in the Midst of Pandemic Uncertainties

Regulators around the world closely monitored ETFs during the early days of COVID-19, anxious about the impact of volatility on ETFs and how that would affect capital markets. However, ETFs – in defiance of stale myths – emerged from the financial uncertainties created by the pandemic with strong performance, demonstrating their resilience and potential for growth.

The struggle for advisors to provide alpha (i.e., a measurably better return than is delivered by an index) through other investment options and the ability of ETFs to deliver liquidity and respond nimbly to redemption requests during the start of COVID-19 also reinforced confidence in ETFs.

The pandemic was therefore an important "moment" of validation but is hardly unique from the perspective of CETFA as ETFs also proved themselves in the wake of the great financial crisis of 2008-09, the dotcom bubble of early in the millennium and other economic upheavals. The durability of bond ETFs is also evident in how they performed in March 2020 when a "no-bid" bond market prevailed. Despite extraordinarily challenging market conditions, bond ETFs continued to trade (albeit with a large ETF price–NAV spread), providing investors with welcomed liquidity. While certain extreme niche ETFs are prone to illiquidity (based on the behaviour of their underlying assets), ETF liquidity in general has held up consistently well even when markets have gone haywire.

Canadian ETF Industry Supports Global Success Factors

Consistent with its invention of ETFs as a unique category of investment products, Canada continues to lead the world in developing and introducing innovative, thematic, niche offerings. These include the first cryptocurrency, cannabis and psychedelic ETFs, as well as preferred share ETFs and robo-solutions that rely on ETFs. However, the categories that dominate internationally also prevail domestically, i.e., equity-focused, fixed-income and commodity funds in that order (but due to tax considerations, from Canadian-domiciled funds).

On the world stage, the Canadian ETF industry gains from being a comparatively small but nimble community focused primarily on two main centres of expertise. The Canadian marketplace is more like Australia's than any other given the dominance of our five big banks, which influence the products that come to market and are ultimately successful; in other jurisdictions, the banks are not as involved in ETFs.

The Canadian ETF market is abetted by a sound regulatory structure, low fees and marketplace participant co-operation within a cohesive, mutually supportive industry, Deborah observed. (On the theme of fees, ETFs listed globally have an asset-weighted average expense ratio of 21 bps. The lowest-cost products track fixed income indices at 18 bps; the most expensive are leveraged ETFs at 96 bps.) By comparison, the European ETF market is highly fragmented by language and jurisdiction; in Asia, the industry is more siloed, and in the U.S., it's more intensely competitive.

Other innate factors that are global drivers of ETF purchases – simple, transparent, tax efficient, liquid, an orientation to innovate, etc. – also bode well for future Canadian ETF growth potential.

CETFA data for April 30 confirms the current healthy state of the industry: $C 289.2 billion in AUM (up 41.5% over 2020) and 893 funds (up 111 since 2020). This is consistent with the global picture.

To the end of April, ETFGI reports that there were 8,937 ETFs/ETPs worldwide, with 17,894 listings, assets of US$ 8.96 trillion, from 545 providers listed on 77 exchanges in 62 countries. April 2021 was the 23rd month of positive inflows around the world. The growth in AUM year over year was 53.25% and the 10-year compound asset growth rate (CAGR) to April 2021 was 18.4%.

Also noteworthy in the most recent ETFGI data, the worldwide AUM of ETFs/ETPs has consistently surpassed that of hedge funds since 2013. The number of hedge funds (9,137) only exceeds the number of ETFs/ETPs by 260 and is levelling off, while the number of ETFs/ETPs is poised to continue to grow. (Canadian data is unavailable but is believed consistent with worldwide trends.)

Robo-advisors are Reducing Barriers to ETF Adoption

Throughout the world, robo-advisors are helping investors better understand their finances by overcoming the “taboo” subject of money, Deborah remarked. They provide an impartial means of showing the implications of different investing scenarios and the benefits of ETF investing specifically.

Young investors – in Canada and elsewhere – who are technologically savvy have been introducing their parents to the platforms and this knowledge transfer is increasing the uptake of ETFs. The adoption process was also advanced by the pandemic, which made in-person advisor meetings impossible or unappealing. A work-from-home scenario (for many people in many countries) and the active promotion of robo-advisors and ETFs through social media channels have also stimulated interest and trial.

Europe Remains the Global ESG Investing Leader

Although the European market represents only 16% of overall ETF AUM worldwide, it is the global hotspot for ESG ETFs (environmental, social and governance), with 290 products and $US 154 billion in AUM. This product leadership has been driven by the European Union’s Sustainable Finance Taxonomy (an initiative of the UN Principles for Responsible Investment), which came into force in July 2020, and the EU’s Sustainable Finance Disclosure Regulation (SFDR), which took effect on March 10 for all EU financial market participants.

The ESG theme – like robo-advisors – resonates most among younger investors and with women more than with men, regardless of geography. The intergenerational transfer of wealth should benefit this category generally but more specifically will provide a lift for ESG ETFs with focused, thematic exposure (e.g., solar energy-focused ETFs), Deborah states. She noted that the U.K. CFA Society is now offering ESG investing certification to sustain and build momentum.

In Canada, ESG funds are still a relatively small portion of its overall ETF marketplace, but ETFGI reports that there are 58 products with $US 2.5 billion in AUM (the U.S. has 143 products and $US 93 billion in AUM). Canadian ESG ETFs offered to date have largely been exclusionary in their selection strategy, so that providers can help advisors better understand the category, differentiate it and promote it more effectively.

Canadian ETFs’ Present State and Future Potential

Asked for a summary statement that captures the current and prospective future state of the Canadian ETF marketplace, Deborah responded that from an international perspective, it is still at an early stage. But, she added – deliberately choosing a good Canadian metaphor – it has the potential to grow significantly with an upward arc resembling that of a hockey stick.

To access the analysis and information resources of ETFGI, visit etfgi.com. To learn more about the latest developments in the Canadian ETF industry, visit the CETFA ETF Information Centre.

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