**Volatility is stressful but not novel: ETFs can help you navigate it better**

In today’s investing scenario, the volatility sweeping global equity markets makes it impossible to accurately forecast what will happen next in a prolonged period shaped by financial uncertainty.

For advisors and investors, this summer will be “bumpy” and not nearly as fun (or as predictable) as the roller coaster at your favourite theme park. Autumn may not bring much-desired relief even if central banks prudently intervene to smooth out the ride.

Volatility has always been part of investing and managing it an inescapable reality for financial advisors. But not even during the Great Financial Crisis and the economic weakness that followed has there been such a potent mix of worry drivers.

In this column, the Canadian ETF Association (CETFA) will discuss volatility from an ETF viewpoint. We believe ETFs can contribute effectively to your clients’ portfolios in a jarring investing climate. So we’ve gleaned keen insights from several member companies to help you understand why and to manage your client relationships through the hurdles you could encounter.

**ETFs offer distinct advantages for tackling tougher markets**

Deep anxiety about the future direction of the economy, persistent supply chain issues, severe stock market drops, higher interest rates to combat historic inflation levels and disrupted growth prospects for certain sectors (e.g., technology and retail) are weighing on investor returns and emotions. Lingering uncertainty from a still-present global pandemic, the geopolitical, financial and commodity price fallout of Russia’s invasion of Ukraine, and mounting pressure to decarbonize economies continue to influence decision-making and undermine confidence. Nobody knows what’s around the next corner.

ETFs are not fully insulated from these challenges or the related shifts in capital flows and erratically changing valuations. But they can present client- and advisor-friendly solutions. And, depending on a client’s needs, goals and time horizon, there could be an upside: the stock market is “on sale.” With other investors, the silver lining of accepting a capital loss on their investment may come from gifting it to a cherished cause for the tax credit.

While ETFs and other market-based investments, such as mutual funds and individual equities inevitably respond to market change, their differences are striking. ETFs provide the risk-mitigating diversification that individual stocks and bonds cannot and (typically) at a lower cost and with greater tax efficiency than mutual funds. ETF fund managers (including active managers) don’t need to sell significant holdings to satisfy rising redemption orders as mutual fund managers may be forced to do, triggering capital gains. ETFs may therefore be better accepted than mutual funds by increasingly fee-sensitive and value-conscious investors for whom client-focused reforms (CFR) have made investing costs more transparent. (Detailed client dialogues about products and associated risks obligated by CFR may also alleviate hindsight regrets about product selection.)

**Understanding today’s realities benefits from an on-the-ground perspective**

To get their in-the-field understanding of volatility management, CETFA interviewed senior executives at several member firms: EMERGE Canada CEO & Founder Lisa Langley, AGF Investments LLC Chief Investment Officer Bill DeRoche, and CI Global Asset Management SVP, Head of Distribution Eastern & Western Canada Randall Alberts. We asked them why advisors should consider ETFs, about the volatility-suitable products their firms offer, how they support advisors and what they anticipate going forward. Here’s what they told us.

“We’re in an unprecedented, never-experienced-before economic cycle driven by the pandemic followed by a stimulative axe from government to revive the economy,” Lisa said. “Now there are supply chain issues, other hiccups and a war in Europe that has accentuated fuel costs. So there’s a trifecta of conditions causing volatility. We’ve never been here before.”

Bill also underscored the extraordinary circumstances: “We’re in a different regime now. Previously, there was an expansionary period, but from the first week of November 2021, inflation has been the primary concern for most central banks; it’s the first experience with inflation for most investors. For many people, this is a new conversation.”

Observed Randall: “It’s important to remember that bear markets are relatively short compared to bull markets.” The S&P 500 500 fell 2% or more for 41 trading days in 2008; however, the economic expansion between 2008 and 2020 lasted for 133 weeks and the S&P 500 grew by 528.9%. “Never before did we have such low interest rates for so long, or the pandemic, or the digital information processing that has potentially heightened the impact of volatility.”

**ETF’s innate strengths mean they can perform well in all market conditions**

Despite these complexities, it was clear from our discussions that our contacts retain strong convictions about the future promise of ETFs for meeting investor needs.

Five to 10 years ago, the ETFs available to Canadian investors were rather “vanilla,” but now they’re much more sophisticated, said Bill. “It’s important to educate clients that ETFs respond to different environments, that they’re so differentiated they can support many investment strategies and can perform well in all conditions. Investors can get the ‘flavour’ they need for their specific portfolios.”

ETFs allow for easy access, better diversification, liquidity and transparency into the underlying holdings, said Randall. “These attributes let investors better position their portfolios according to their risk tolerance and time horizon. Intraday pricing means ETFs have much more liquidity and can respond more rapidly to changing situations. These are advantages in volatile times.”

Commented Lisa. “If you’re truly an investor, you’re investing over different time periods. Volatility lends itself well to dollar cost averaging with ETFs and to choosing a strategic mix of ETFs that suit different time horizons.” You can buy certain ETFs at historic lows with the potential for future long-term growth: “Dollar cost averaging is being used to gain units at a lower price.”

A number of CETFA members have ETFs designed to manage risk and you can find them with our ETF Screener at cetfa.ca, so beyond any product indirectly referenced by strategy below, be aware that there are other ETFs which merit closer examination. All the same, we did ask what these three firms offered that could be unique solutions for risk-averse clients.

CI GAM is Canada’s largest provider of liquid ALT ETFs to deliver diversification and downside protection and minimize drawdown, said Randall. CI also has smart beta ETFs that use a quantitative factor approach for a better outcome in volatile situations and covered call ETFs to enhance yield and protection. For those seeking a more “traditional” ETF, CI offers a couple of divided-focused funds that, he says, can cushion the impact of volatility.

Bill noted that all equity-based ETFs have market exposure but correlations can differ, allowing portfolio volatility to be mitigated. To reduce the impact of drawdowns and deliver the potential for positive returns regardless of how markets behave, AGF offers an ETF that uses hedging to lower portfolio volatility. Another fund is a systematic, factor-driven ETF that invests in global infrastructure to generate potentially higher yields with less volatility.

Lisa did not point to any specific ETF on the EMERGE ARK product shelf but emphasized that, “investing in disruptive technology can be very beneficial because we’re expecting slower growth as world economies try to manage the current situation.” She added that, “there is a greater sense of urgency to solve major problems and companies that do so grow far above the average. Innovation is a great hedge against inflation for investors who invest for the long term.”

We’re confident that other CETFA members provide advisors with educational content about ETFs and volatility but explored what the three organizations can offer you.

EMERGE Canada has held webinars shared via YouTube, published sponsored articles in the business press and sends a regular email update. AGF is “on the road constantly” and has active conversations with clients; it also makes content available through its website, extranet, email and social media feeds. CI GAM supports advisors via its CI GAM Advisor ETF Desk and the CI Advisor Consulting channels. It encourages clients to stick to their plans and reinforces the value of saying invested to benefit from a full market cycle.

**Advisors can put volatility to work for their clients**

What, we wondered, did our contacts foresee about a change in current patterns and what other considerations should advisors heed as they guide clients through the turbulence?

Bill stated that, “we’re in a high inflation environment; it is pernicious and we have to deal with that. But the good news is that the Fed will fight it…I don’t see a recession anytime soon.” For now, advisors can address the drawdown risk through the right ETFs but should cautiously avoid promissory ETNs (exchange-traded notes) because some closed very quickly as a result of volatility.

“Volatility is not a bad thing and it’s here to stay,” said Lisa. “It always goes back to why investors are investing, what their objectives are and to taking advantage of volatility. They’re trying to cool down the economy, and I believe a soft landing is possible. It’s just going to take awhile to get back to where we were.”

Uncertainty is the single biggest driver of volatility, declared Randall. No one knows how long this will last, but the circumstances create an opportunity for FAs to differentiate themselves, so: “Lean in and be present and accept the stresses of challenging times. Go back to your shelf and look at the EFTs that may be best suited to difficult markets.”

The sector often reminds investors that there are no crystal balls to foretell the future. And from the current vantage point, it’s much too murky to identify a quick and easy path to stability.

Nonetheless, CETFA embraces the upbeat, opportunity-oriented outlook expressed by these experts, and I know that other member firms whose voices are not heard here hold similar views. Because what we can say is that ETFs have proven their resilience during many past upheavals. That is why we’re confident they’ll emerge healthy and strong when this one ends.

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