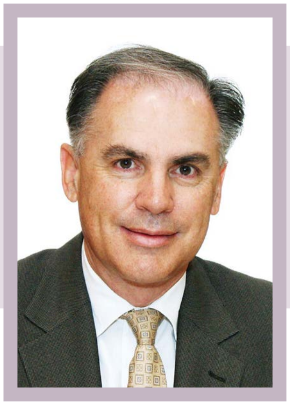
CANADIAN

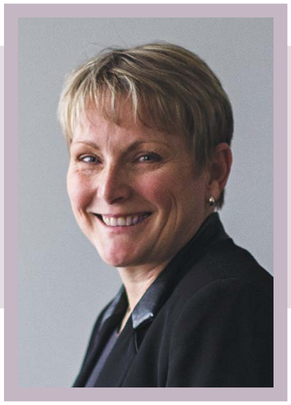
ETF Watch

WINTER 2024

CanadianETFWatch.com

How to Stand Out in a Sea of Financial Advisors





As the crisp air of winter blankets our beautiful country, we are thrilled to present the Winter 2024 edition of *Canadian ETF Watch*. This edition heralds the onset of a year that we confidently believe will be monumental for the financial services and ETF industries. The anticipation of 2024 brings with it a sense of optimism and potential, particularly for investors and advisors in the dynamic world of exchange traded funds.

This year's outlook, bolstered by Investor Economics (IE) projections, suggests a robust continuation of growth in the ETF sector. With an estimated compound annual growth rate (CAGR) of 6.2% for the period 2023 – 2032, and reflecting on a decade of 20% annual growth, the optimism is well-founded. This sustained expansion is underpinned by evolving investor preferences towards fee-sensitive solutions and the rising prevalence of fee-based accounts, both of which pivot towards ETFs.

The Canadian ETF Association (CETFA) is actively preparing to support this growth trajectory and their commitment is to ensure that you, the reader, is equipped with the essential information and tools to construct optimal portfolios for your clients.

In this, the Winter 2024 edition of *Canadian ETF Watch*, we delve into a series of insightful articles:

- Francis D'Antrade of CETFA discusses "How to Stand out in a sea of financial advisors," offering strategies for differentiation in the competitive advisory landscape.
- "Dividend ETFs – Looking Beyond Yield" from Manulife provides an in-depth analysis of dividend ETFs and what they offer beyond mere yield.
- Mark Webster, Director, Institutional & Advisory ETF Distribution, BMO ETFs, explores "Should Investment Counsellors Broaden Portfolio Construction Using Diversified Strategies?" offering fresh perspectives on portfolio diversification.
- "Get your portfolio ready for 2024 using ETFs" from CI Global Asset Management guides on preparing your investments for the upcoming year.
- Pat Dunwoody of the Canadian ETF Association examines "The Solid Foundation of Canadian HISA ETFs: Navigating the New Regulatory Era," shedding light on the evolving regulatory landscape.
- "Investing Beyond Our Borders – Adding international Equities to Portfolios," by Bobby Eng of Franklin Templeton Investments, delves into the advantages of incorporating international equities.
- Trevor Cummings, Vice President of ETF Distribution of TD Asset Management, presents "Playing the field – Key Consideration Behind Choosing the Right ETF Provider," an essential read for selecting the most suitable ETF provider.

As we navigate through the pages of the Winter 2024 edition of Canadian ETF Watch, we extend our deepest gratitude to you, our loyal readers. It is our hope that the knowledge and strategies presented here will empower you to make informed investment decisions and successfully steer through the evolving financial services landscape.

Wishing you a productive and insightful winter season!

Sincerely,

Keith Costello
Global CEO,
Canadian Institute of Financial Planning
www.CIFP.ca

Pat Dunwoody
Executive Director,
Canadian ETF Association (CEFTA)
www.CETFA.ca

About *Canadian ETF Watch*

Through a dedicated website and quarterly issues, ***Canadian ETF Watch*** will speak to financial advisors, investors, managers and service providers to provide them with the latest information on ETFs in Canada. Canadian-based ETF markets continue to grow, which presents numerous marketing and promotional opportunities. Fund companies benefit from being featured in Canadian ETF Watch as their company name and solutions are distributed to our audience who are dedicated & targeted to ETFs.

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Canadian ETF Watch is published quarterly by
Radius Financial Education & **Canadian ETF Association (CETFA).**
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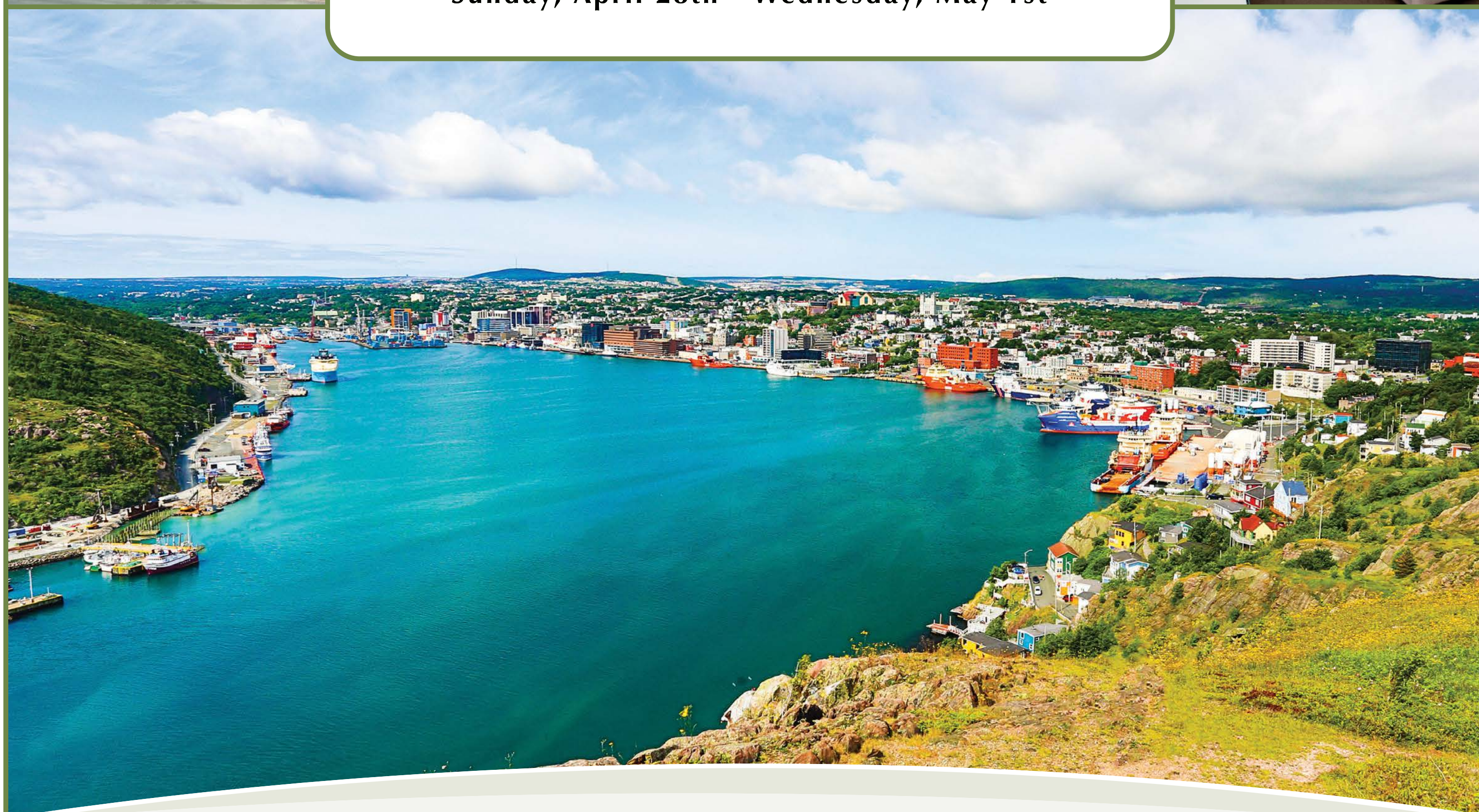

How to Stand Out in a Sea of Financial Advisors

The life of an advisor can be challenging. You're bombarded by information daily, and it's easy to get stuck in a routine. When one day is like the next, it may be difficult to realize that the industry is changing rapidly.

Francis D'Antrade

Clients are more discerning, regulators are more exacting, and they're both demanding more value from advisors. Over the past few years, it has become clear that the very nature of advice is changing, and those who don't take steps to set themselves apart from the herd will be left behind.

cetfa
Canadian ETF Association

Need proof? In May, consumer intelligence firm JD Power released a survey that should be viewed as a wake-up call for the industry. Their research indicated that approximately 40% of clients don't feel that their advisor understands their financial goals or needs, and they don't think the recommendations they make are in their best interests. In July, E&Y released a survey that indicated a shift in client preferences driven by economic uncertainty and an inclination to explore different products and providers. As a result, their research indicated that 45% of Canadians were looking to add or move wealth management providers. Advisors who have built a brand that effectively projects their value will win in an environment where plummeting client satisfaction puts money in motion.

I'm often asked, "Do I really need to brand myself as an advisor?" The short answer is you are already branding yourself through your words and actions, so you might as well be intentional about it. Many advisors do not recognize that in a discontinuous world with greater economic and geopolitical uncertainty, your brand cannot be focused on your product, investment process or commitment to service. If you've allowed your brand to be driven by exogenous events over which you have no control, like the capital markets, then your brand has likely been bruised over the last couple of years.

So, where to begin? If you think branding is the same as marketing, then you're likely not doing a very good job of either. The difference between branding and marketing is that branding is a long-term creative process designed to develop a lasting impression in the minds of consumers that is distinct in the marketplace. For successful financial advisors, it is often intensely personal, and it is distinguished by an identifiable logo, tagline or design aesthetic, vocabulary, tone, color scheme or font. The combination of these elements forms your brand personality or identity. It is the shorthand of who you are.

Marketing is a broader concept and encompasses your PR, advertising, social media, and events to promote yourself, your products, or your services. Branding and marketing are related, but a good brand builds trust and loyalty over time so that your clients perceive no other viable alternative.

Whenever I meet advisors for the first time, I invariably ask them what they stand for so that I can get a good sense of who they are. Most times, I get a blank stare. So, I asked them to provide me with a basic positioning 101 statement:

I am X, For X, Because X.

I'm always astonished by how few advisors can articulate what they stand for. Their response is usually about products or platitudes that anybody can say. Our industry typically attracts very intelligent people who quite often don't possess an ounce of imagination, and they don't realize that people buy on emotion, so they aim for the head rather than the heart.

Your brand must be authentic and deeply personal because it is based on your passions. It is a mnemonic for all the perceptions in the minds of your clients and prospects. Most importantly, your brand is your promise; it is what people can expect from every single time you interact. The most successful advisors I have encountered don't compete on their products or services. Their brands are distinct because they reflect their values and the value they provide to their clients and have become one of their most valuable assets.

The way I like to help advisors find the feeling is to share my 3 branding commandments:

1. Don't tell people what you are - you are one of many. Tell them what you do; they might find that interesting.

2. Don't tell people what your product or service is - they don't care. Tell them what it does; they might have a use for that.

3. Don't explain it to them - they won't get it. Show them.

The successful advisors I've met have their positioning in a holster, ready to go at a moment's notice. They have a deep understanding of the emotional needs that they satisfy in their clients. They recognize that clients don't care about their business; they care about their problems, so they are good at directing the conversation toward their client's problems. Only by understanding your client's passions, priorities and problems can you find the feeling.

Even when you do understand your client's values and passions, you may not be communicating your values effectively. I've met too many clients who do not appreciate the value their advisor provides. If your brand is the perceptions of you that exist in the minds of your clients, then you will need to focus more on how they perceive your value. A good place to begin is to simply ask your clients what they value in the relationship. What made them do business with you in the first place, and what keeps them doing business with you now? What is the one simple thing they feel sets you apart from all the other advisors? Ask them how they describe you to others. Their answers will tell you if your brand is not just memorable but tellable.

The sad truth for any advisor is that managing personal finances is like going to the dentist for most people. You must recognize that they don't really care about you, your products, or your commitment to service, so you must give them a reason to care. If you take the time to curate a brand that is distinct, relevant, and resonant in the marketplace, you won't be ignored. In an increasingly commoditized and homogenized industry with cookie-cutter advice, products, and solutions, it's more important than ever to stand out in a sea of advisors.

Dividend ETFs: Looking Beyond Yield

Geoffrey Kelley, CFA
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Head of Systematic Equity Research, Multi-Asset Solutions Team Manulife Investment Management

Manulife

Investors often seek out dividend ETFs based on their yield, searching for a steady income stream at an above-market rate.

However, we believe that investors can potentially benefit from dividend strategies that look beyond the yield of individual holdings, that instead target yield at the overall fund level while also seeking to generate total return and mitigate risks.

Dividend exchange-traded funds (ETFs) are a popular category with investors, particularly during difficult markets like the one experienced in 2022 and 2023. Companies that can pay dividends throughout the market cycle tend to be of higher quality, offering investors a degree of stability that helps explain their draw during times of volatility.

Most dividend ETFs, including some of the largest in the category, are passive, meaning they rely on a rules-based index methodology for portfolio construction. Although the exact methodology can differ between indexes, passive ETFs generally select the highest-yielding securities within the investment universe for inclusion within the portfolio. In our view, looking beyond the yield generated by each individual name and taking a more diversified active approach to selecting a portfolio of dividend-paying stocks can offer some advantages over these passively managed, single-factor ETFs.

Why do dividends matter?

Dividend stocks provide two separate sources of return: income from dividend payments as well as any price appreciation. Although investors usually think of fluctuations in a security's price when they consider the potential return of an investment, dividends can be a significant driver of total return. Looking at the U.S. market from 1927 through 2022, dividends account for approximately 38% of total return.

Dividends are an important component of total return

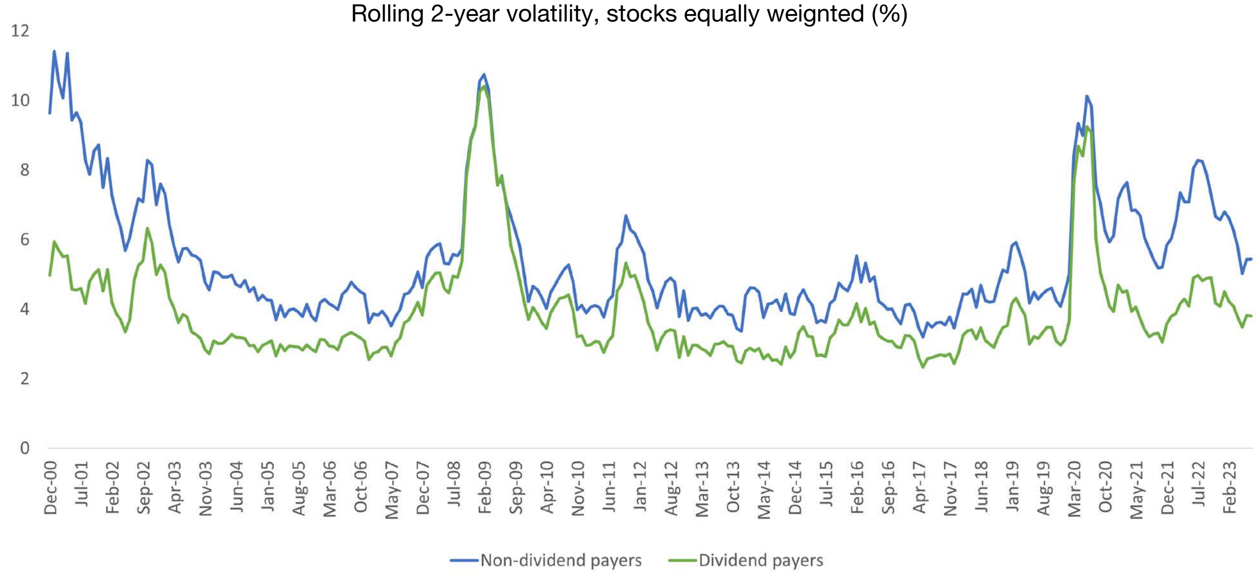
Source of U.S. market return by decade

Source: Ken French data 12/31/22. Past performance does not guarantee future results.

Dividend yields have come down over time but undeniably remain an important component of total return while also providing a level of stability for investors. Depending on the phase of the market cycle, price return can fluctuate from positive to negative year to year; in contrast, dividends are always a positive source of return. This helps to explain why dividend-paying names tend to experience less volatility on average compared with stocks that don't pay a dividend.

Dividend-paying stocks tend to be less volatile

Rolling 2-year volatility, stocks equally weignted (%)



Source: FactSet, S&P Global, Manulife Investment Management, as of 7/31/23. Past performance does not guarantee future results.

Although dividend payments provide a signal of quality to investors, price return remains the primary driver of total return and should be taken into consideration when selecting investments to construct a dividend portfolio. In other words, dividend stocks should be selected not just based on their individual dividend yield levels, but with the potential for capital appreciation in mind while also looking to mitigate relevant potential risks.

To do this, we find it beneficial to also consider factors such as valuation, momentum, and quality. By considering such metrics in tandem with dividend yield and dividend growth, we believe the process will generate a portfolio that not only offers a sustainable stream of income but also has the potential for price appreciation. This process, along with a focus on mitigating outsize risks, can potentially help provide an even greater level of stability and growth for investors' portfolios through a market cycle.

What can a high dividend yield tell us?

While dividend strategies often target a yield that's above that of the market, a high dividend yield can also serve as a signal of underlying risk. This becomes clear when we consider how a company's dividend yield is calculated.

Dividend yield is typically calculated in one of two ways: backward looking or forward looking. The backward looking, or trailing, method takes the most recent dividends per share payments in the trailing 12-month window of time and adds them together to find an annual dividend per share. Alternately, the forward-looking, or indicated, methodology takes the most recent single dividend per share payment and multiplies it by the number of dividend payments in a typical year to derive an expected annual dividend per share number.

In both cases, the results are divided by the current share price to arrive at either a trailing or indicated dividend yield. While paying out higher dividends per share can drive up a dividend yield, so can a falling stock price.

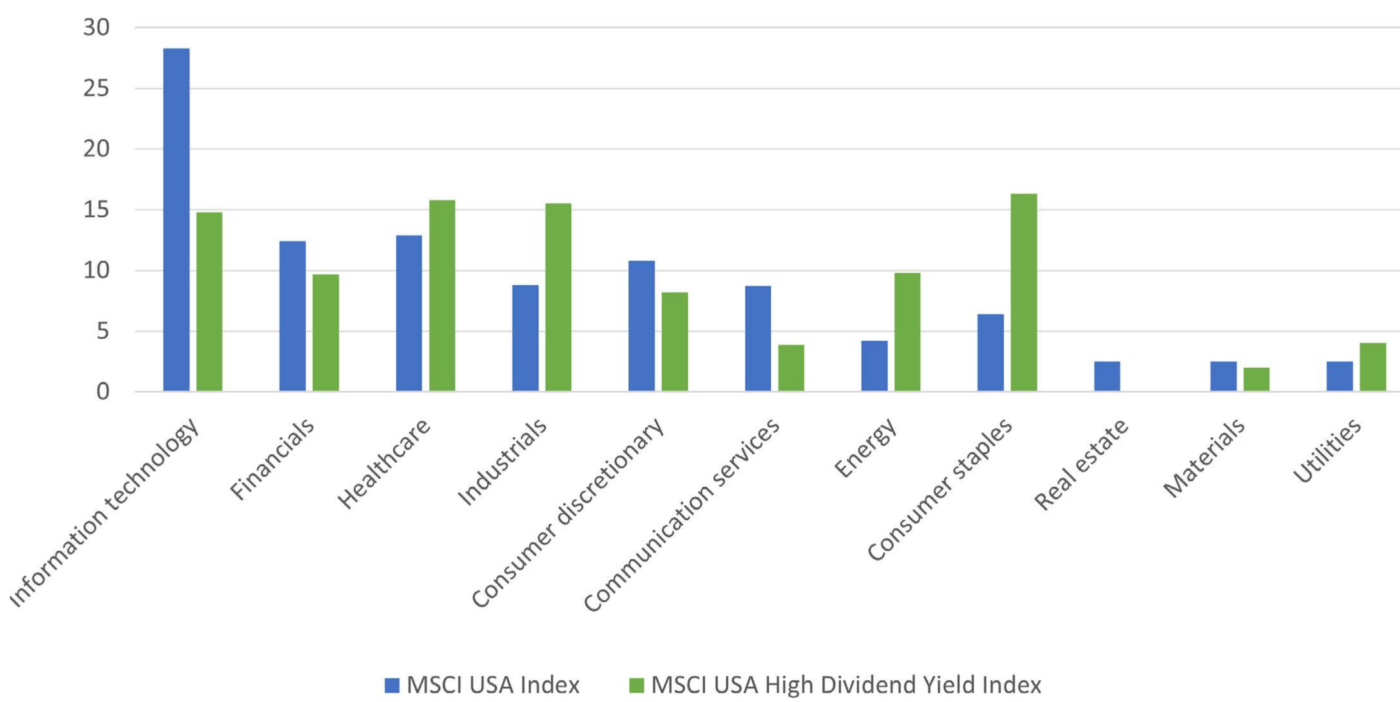
Looking beyond yield can help to avoid a dividend value trap, a situation where a stock has an elevated dividend yield due to a declining stock price. Metrics such as profitability and momentum can help a strategy identify and avoid these value traps.

Payout ratio is another measure that can provide useful information on the sustainability of a company's dividend. This ratio is calculated by looking at dividends per share divided by earnings per share. A high payout ratio can indicate that a company isn't reinvesting enough of their earnings into their operations and might have to cut dividends in the future. Although we believe that this data point can provide important insight during the investment selection process, it must be considered in context with other measures of a company's quality or profitability.

Sector concentration can be a risk

A common issue for many rules-based ETFs that track a subset of the market, including dividend ETFs, is that sector allocations might vary widely from those of the broad market. Many dividend indexes tend to favor sectors such as consumer staples and energy and may underrepresent sectors such as information technology.

Sector allocations (%) for dividend-focused indexes can vary from the broad market



Source: Manulife Investment Management, MSCI, as of 7/31/23. It is not possible to invest directly in an index.

This sector concentration can sometimes work in the fund's favor, like when many dividend ETFs performed well in 2022 due to their outsize allocation toward energy stocks; however, this can be a risk if that area of the market lags, becoming a drag on the portfolio's overall return.

Although some areas of the market such as information technology generally have lower dividend yields, companies within these sectors often have higher growth rates and, in turn, a higher potential for capital appreciation. By being mindful of sector concentrations and open to potentially including lower-yielding securities within a portfolio, an investment process can maintain a focus on total return while still reaching a fund-level yield target.

Targeting yield at the portfolio level

High dividend ETFs available in the marketplace traditionally achieve their dividend yield objective by investing exclusively in stocks with the highest dividends. As we've explained, such an approach can result in concentration in certain sectors or other unintended bets. We believe that by looking at dividend yield on the portfolio level and considering factors such as valuation, momentum, and quality, investors can benefit from companies that have stronger fundamentals and more sustainable dividends. In our view, this broader perspective can be a smarter approach to building a dividend ETF portfolio, resulting in a fund that can potentially deliver better outcomes for income-sensitive investors across the market cycle.

2024 CALENDAR OF EVENTS

Brought to you by radius Financial Education

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Exchange Traded Forum (Toronto) 14th Annual

May 27th ~ Toronto, ON @ The Delta Hotel Toronto

Canada's largest and longest standing event dedicated to Exchange Traded Products. Hear from leading financial industry professionals and industry experts who will provide valuable insights into the issues and trends that matter most to Canada's financial professionals. Join us for presentations, advisor/client-focused sessions, roundtable discussions, networking events and knowledge sharing critical issues facing the financial industry. This is an opportunity for IIROC based financial advisors and also Portfolio Managers to gather together in a great location to network, learn from each other, and participates in the numerous educational opportunities that fill the agenda.

EXCHANGE TRADED FORUM 2024

ExchangeTradedForum.com

TORONTO

Exchange Traded Forum (Vancouver) 13th Annual

June 14th ~ Vancouver, BC @ Sheraton Wall Centre

Canada's largest and longest standing event dedicated to Exchange Traded Products. Hear from leading financial industry professionals and industry experts who will provide valuable insights into the issues and trends that matter most to Canada's financial professionals. Join us for presentations, advisor/client-focused sessions, roundtable discussions, networking events and knowledge sharing critical issues facing the financial industry.

EXCHANGE TRADED FORUM 2024

ExchangeTradedForum.com

VANCOUVER

Retirement and Investment Conference 6th Annual

September 2024 ~ Toronto, ON

The Retirement Canada Dialogue is a full-day event packed with the latest trends and solutions for retirement planning professionals, turning a challenging retirement environment into an advantage for advisors. Networking and learning amongst peers and industry experts with comprehensive exposure to all important aspects for the practice of retirement planning.

RETIREMENT AND INVESTMENT CONFERENCE 2024

RetirementInstituite.ca

WAIS Canada 23rd Annual

October 2024 ~ Toronto, ON

WAIS Canada is in its 21st year and is Canada's largest gathering of alternative investments, investment professionals, investors, industry experts and service providers. Today's WAIS has gone much beyond its original alternative investment only focus attracting investment professionals from all facets of investments. WAIS Canada is a popular annual event that is not to be missed.

WAIS 2024 CANADA

waisc.com

ESG Conference (Toronto) 2nd Annual

Spring 2025 ~ Toronto, ON

The Canadian ESG Conference Toronto 2022 provides attendees with the opportunity for quality networking with a highly defined audience of credentialed advisors, investment professionals, sustainability professionals and corporate responsibility, green economy practitioners and sponsors within the financial services industry.

ESG CONFERENCE 2025

canadianesgconference.com

TORONTO

Interested in sponsoring or attending an event: info@radiusfinancialeducation.com or call us at T: 416.306.0151

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Financial Education

radiuseurope.com

ETF & Investment Forum London 2nd Annual

Autumn 2024 ~ London, United Kingdom

A unique, 1-day European gathering of industry experts and financial professionals with comprehensive exposure to the latest products and trends in the fast growing ETF and Investment industry.

ETF & INVESTMENT FORUM 2024

RadiusEurope.com

LONDON

ETF & Investment Forum Frankfurt 2nd Annual

Autumn 2024 ~ Frankfurt, Germany

A unique, 1-day European gathering of industry experts and financial professionals with comprehensive exposure to the latest products and trends in the fast growing ETF and Investment industry. (Präsentiert in deutscher Sprache)

ETF & INVESTMENT FORUM 2024

RadiusEurope.com

FRANKFURT

Institutional Dialogue 2nd Annual

Autumn 2024 ~ Edinburgh, United Kingdom

A 1 ½ day event packed with family conversations and solutions for a unique class of wealth professionals and entrepreneurs. Networking and learning among peers and industry experts with comprehensive exposure to all important aspects for family stewards.

INSTITUTIONAL DIALOGUE

RadiusEurope.com

Radius Europe Financial Education (Radius Europe) has been producing high level conferences within the financial services sector for over 20 years. As a leading producer of conferences within the financial sector, Radius Europe events focus on education and networking through an exchange of independent ideas and information, allowing our delegates to be leaders in their chosen fields. Our top-down approach to the agenda enables us to deliver relevant, thought-provoking, cutting edge, and sometimes controversial insight in a stimulating manner. We understand the importance of learning from the best. Each conference offers a well balanced speaker composition consisting of insight from authors, educators, economists, regulatory bodies and industry leaders from around the globe.

Should Investment Counsellors Broaden Portfolio Construction Using Diversified Strategies?

Multi-Family Offices and Investment Counsellors concentrate on their core competencies to construct portfolios for high-net-worth investors, but there are some areas where they may wish to consider outsourcing expertise.

Mark Webster,
Director, Institutional & Advisory ETF Distribution, BMO ETFs

Discretionary portfolio managers buy public equities or bonds, usually with a North American focus or overweight. They might buy an ETF to broaden international exposure or to accentuate a sector. In some instances, they may also invest in third-party managed private equity or private credit funds to diversify further.

BMO Global Asset Management

Another tool that could be considered is the structured note, a hybrid instrument with both equity and bond-like characteristics. Currently, all the major Canadian Banks issue notes, providing enormous depth and breadth for boutique firms to access.

What is a structured Note?

A structured note is a debt security issued by a financial institution and is typically linked to a reference portfolio of equity securities. Notes typically pay a contingent monthly coupon based on the performance of the underlying portfolio, as well as providing some contingent capital protection. They can be a portfolio diversification tool whose hybrid nature provides monthly payouts based on the performance of equities, while providing some downside risk mitigation like a bond.

One of the most common note structures in Canada is the autocallable note, a yield enhancement strategy providing the potential for above market coupons and contingent downside protection.

What do autocallable notes work?

Autocallables offer several benefits:

- Medium-term (typically), with a feature that allows the issuer to call the note
- Contingent coupon payments
- Contingent principal protection

The call feature gives the issuer the right to redeem the note at a pre-determined observation date if the underlying reference asset's level meets or exceeds the autocall level. The notes typically have a coupon that is paid if, on a pre-determined coupon observation date, the underlying reference asset's level meets or exceeds the coupon threshold. Lastly, autocallable notes offer contingent principal protection. If the note is not called prior to maturity, the invested principal is protected if the underlying reference asset's level is at or above the protection level at maturity.

While these are effective tools for Family Offices and Investment Counsellors, they can be a challenge to manage across a broad clientele. Challenges include:

- Note terms may change from one issue to the next;
- Notes require extensive due diligence and monitoring, given the contingency of coupons and capital preservation;
- Note reference portfolios may be concentrated in one sector or industry, limiting diversification;
- For proper diversification, it would be necessary to hold a number of notes which could lead to "line-item fatigue."

The BMO Strategic Equity Yield Fund

Recognizing the appeal structured notes have to all investors, BMO Global Asset Management has launched the BMO Strategic Equity Yield Fund, which replicates the exposure of a broad basket of notes — in an NI81-102 compliant fund wrapper — to simplify the access to these unique portfolio management tools.

Bridging the risk and return profiles of traditional asset classes like fixed income and equities, the Strategic Equity Yield Fund provides an appealing yield boost above what is available in core bond holdings. Another appealing feature is the contingent downside protection, which can buffer returns in a declining market.

Using a diversified approach across sectors and geographies, BMO's experienced team has created a single exposure, which would otherwise require countless hours of due diligence and administration for investment counsel. The result is a cost-effective and scalable investment solution that carries a low-to-medium risk rating, ensuring broad application across a large client swathe.

To get the most out of these two types of strategies, it may be best to think about the expected tax treatment of each solution:

- The Strategic Equity Yield Fund's return should principally be taxed as income, so may be more suitable for a registered account or as a bond substitute in a taxable account.
- The return of covered call funds should principally be taxed as capital gains, so may be more suitable for a taxable account.

Both of these strategies provide Investment Counsellors and Multi-Family Offices with more tools to diversify investor assets. Their ease of use provides expertise and scalability to complement core capabilities within boutique firms, helping to build more robust portfolios for changeable markets.

Get Your Portfolio Ready for 2024 Using ETFs

2023 Recap

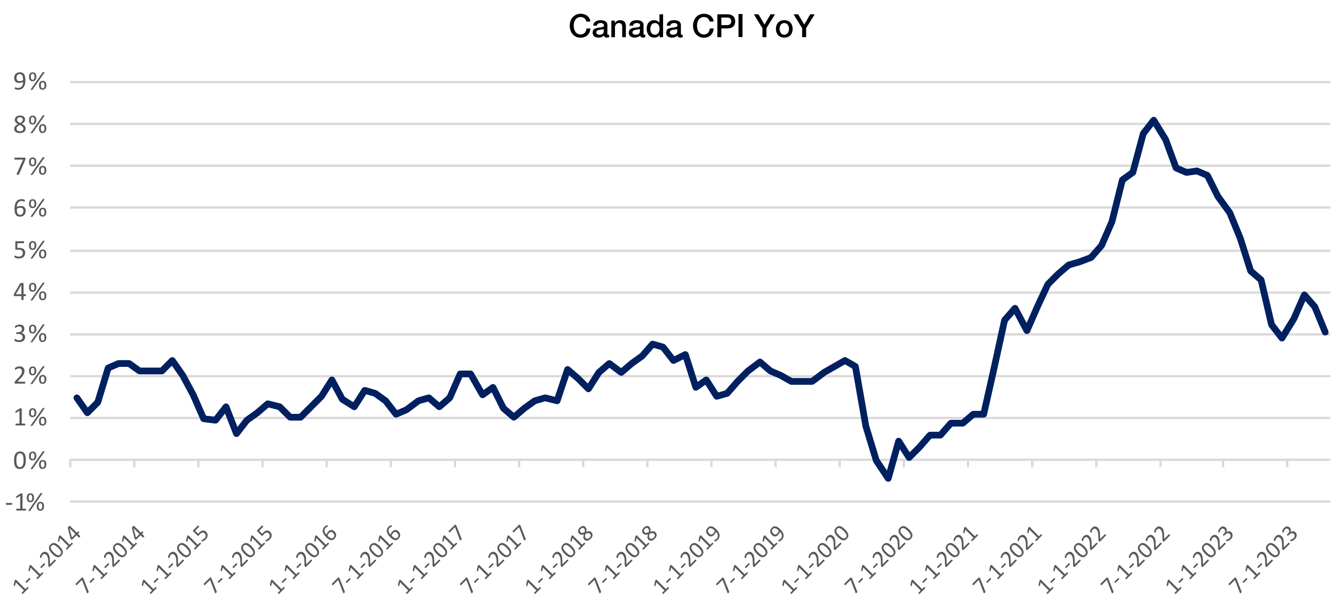
Following a tougher 2022, equity and fixed income both returned positively in 2023. Technology companies (the "magnificent seven" in particular), that are now a big part of our lives, contributed significantly to equity market returns.

CI Global Asset Management Multi Asset & ETF Strategy Teams

Central banks, such as the Federal Reserve, the Bank of Canada and the European Central Bank, have raised interest rates to fight inflation. As a result, fixed income markets were very volatile and spent most of the year in negative territory. Geopolitical tensions remain intense with ongoing war in Russia and Ukraine as well as conflict in the Middle East.

CI GLOBAL ASSET MANAGEMENT

In Canada, we have seen a slowdown in our economy and a substantial decrease in property sales. The Consumer Price Index rose (CPI) 3.1% on a year-over-year basis in October. While it is still above the 2% central bank target, it is substantially lower compared to a reading of 8.1% at the peak in June 2022 and 3.8% in September (chart below). In the U.S., inflation is also cooling but the economy and job markets remain very strong. Canadians in general are more sensitive to high interest rates as we, on average, carry more debt and our mortgages are shorter term, hence resetting to higher rates sooner.



Source: MacroBond

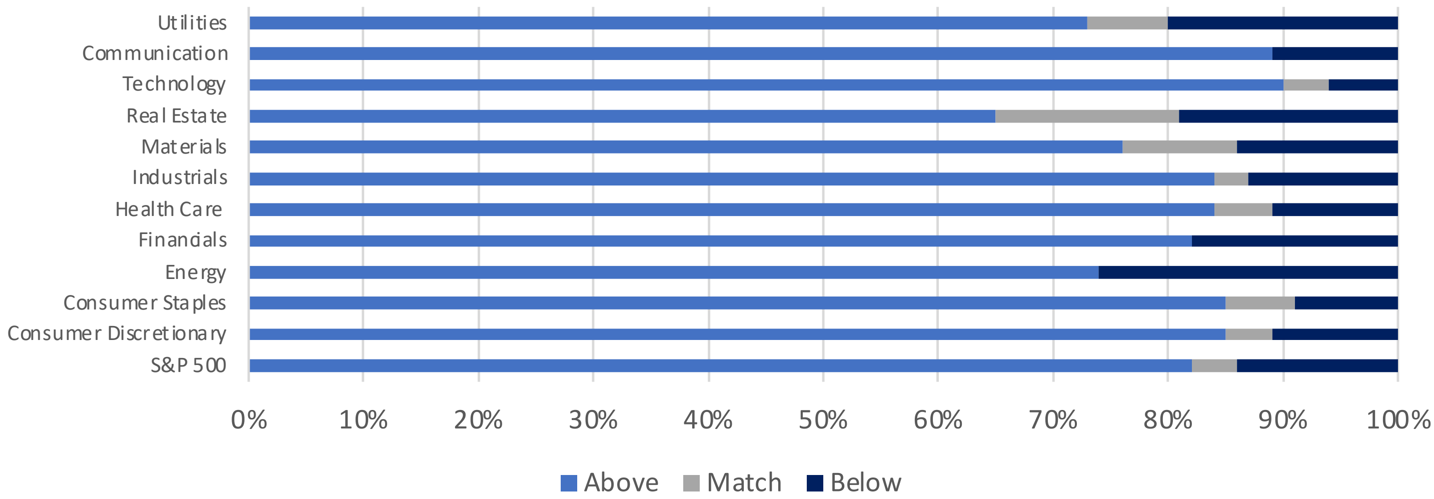
What to Expect in 2024

As you would expect, not all events start in January and end in December. Some of the trends that will likely play out in 2024 are already taking shape as we head into the last quarter of 2023. It is widely expected that the rate hike cycle is now completed in most countries, including Canada and the U.S. Since investors and central bankers anticipate neutral rates to be 2-3%, current rates are extremely restrictive and are probably meant only for the short term. While economic data are objective, reflecting economic activities, central bankers' comments are subjective. We expect investors to pay less attention to what central banks say in 2024 and more to the economy itself as it is consensus that rates have peaked.

As noted, the Canadian economy is already in a slowdown, causing prices to fall. It is likely to get worse in the coming months if rates remain at current levels. Households that carry a mortgage, effectively the majority of the population, are refinancing at much higher interest rates, thus significantly increasing their payments. This puts pressure on Canadians to spend less on everything else. That being said, we anticipate the Bank of Canada to cut rates in 2024 to avoid a severe economic downturn. This could come as soon as the first quarter and the rate cuts could total as much as 150 basis points in 2024. The yield curve appears to be capturing the cuts already.

Things are better in the U.S. as homeowners enjoy low rates locked in for longer terms as their mortgages are typically held over a 30-year term. This means higher rates have had minimal impact on those who bought houses. Inflation is cooling, driven by lower import prices (partly due to a strong USD) and, of course, easing of supply constraints experienced during COVID. The U.S. economy is also resilient for other reasons. It dominates in technology development, especially in smart phones, internet search engines, software and artificial intelligence. Companies like Apple have actually been benefiting from higher rates as they earn higher interest. The last round of corporate earnings confirmed that the U.S. is not near a recession, with 82% of companies' earnings coming in above expectations (chart below). Americans can probably afford to keep interest rates higher for longer.

Q3 Earnings Results



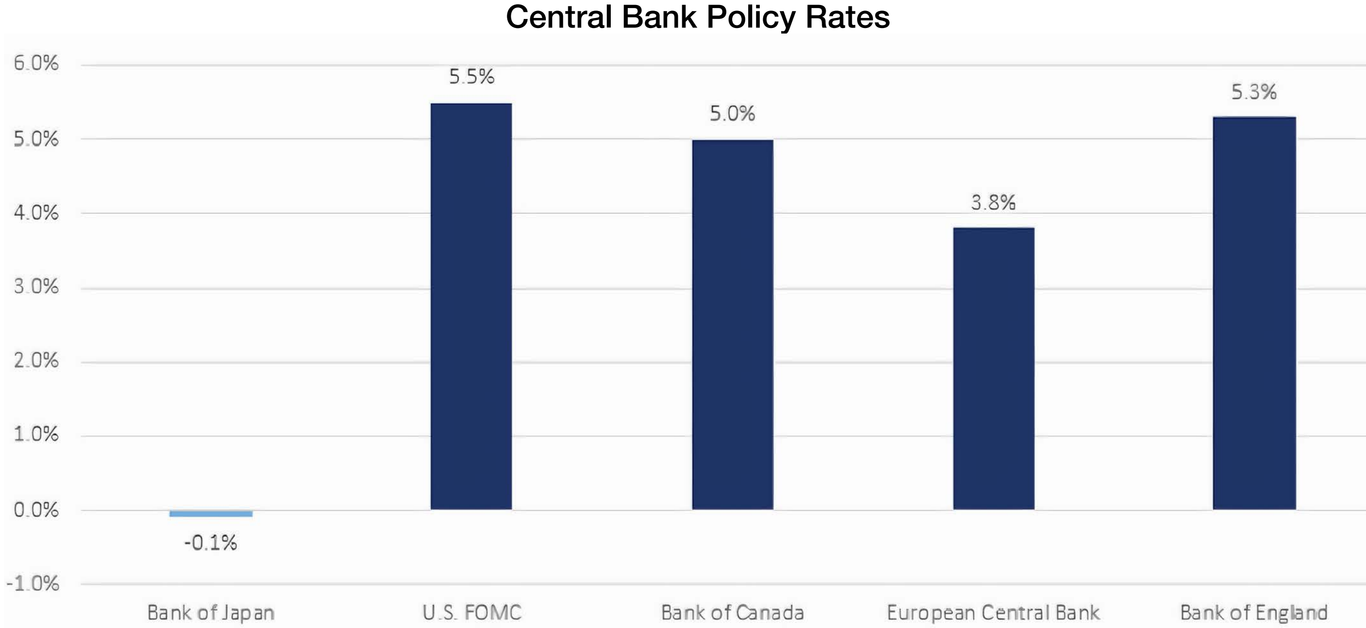
Source: LSEG I/B/E/S

We remain constructive in the technology sector as earnings are stable and new technology such as generative AI and high-speed computing are driving growth independent of the economy. Since the U.S. dominates in the tech space, we anticipate the U.S. economy to remain resilient despite high rates. The first rate cut in the U.S. may be closer to the end of the second quarter, rather than the beginning as we would expect for Canada. As a result, we prefer to have more U.S. dollar exposure and U.S. bonds rather than Canadian dollar and Canadian bonds.

Overall, the bond markets should generate a return very close to the yield, which is 4%. Those who look for more because of falling rates will likely be disappointed as the rally already began in November of this year as expectations were reset. Equity will do fine, assuming interest rates fall and global economies slow moderately but not meaningfully.

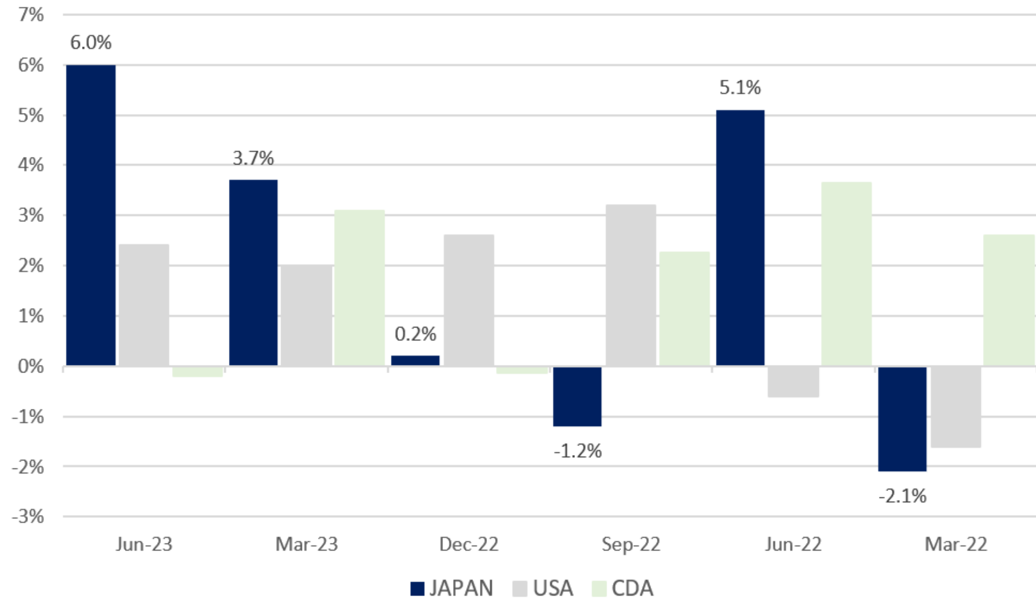
Japan is a bright spot, with low interest rates and solid growth. The yen has been penalized as the Bank of Japan was not following its peers in hiking rates, since they haven't had the same inflationary experience as other developed economies and as a result, they have been able to keep rates relatively low and more accommodative. These lower interest rates create a more conducive economic backdrop relative to other regions. As the rate hiking cycle ends, we expect the yen to strengthen versus both the Canadian dollar and the U.S. dollar. Based on these macroeconomic factors, Japan should continue to do well in 2024.

Central Bank Policy Rates



Source: Bloomberg, as of August 29, 2023

Quarterly GDP (Annualized)



Source: Bloomberg Finance L.P. as of August 28, 2023

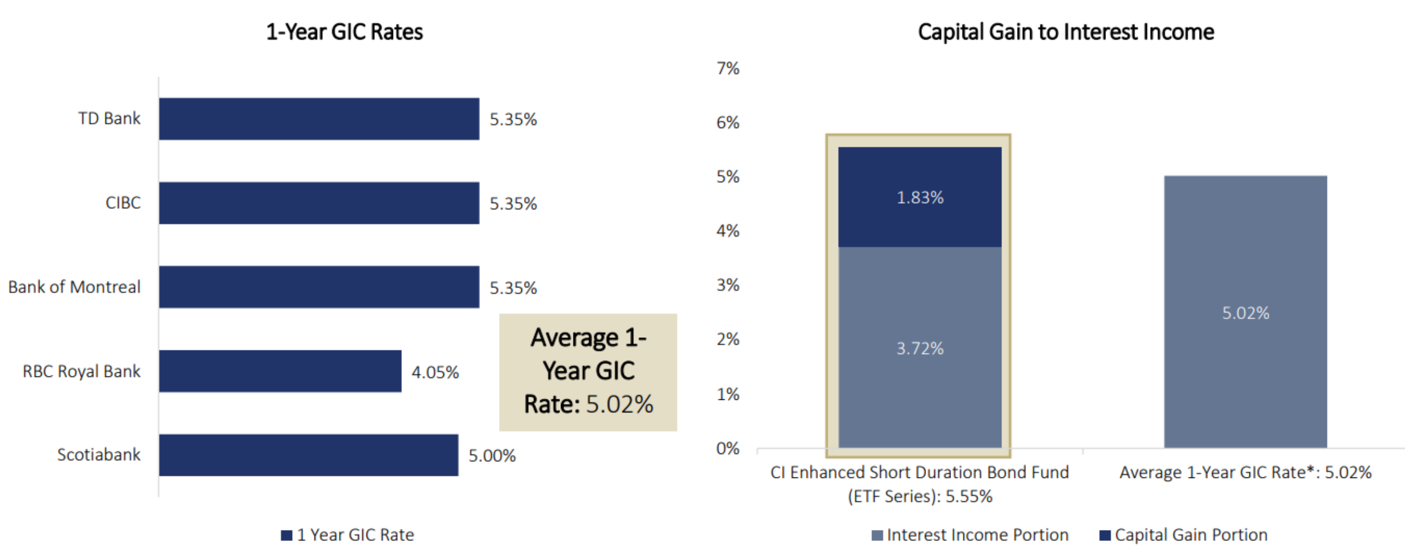
Elsewhere, we expect problems in the real estate sector in China to persist and weigh on the economy. It will take years to unwind the overbuild situations in property and manufacturing. In the meantime, it is deflationary for those that buy products from China. China could surprise on the upside if stimulating efforts are effective and investors return to China after being concerned for both economic and political reasons. Speaking of politics, there is also a U.S. election in November of 2024. However, it is probably too early to call who will be the next U.S. President and what implications that will have.

2024 Trade Ideas using CI's ETF Solutions

Short Duration Corporate Fixed Income

The low-risk trade for 2024 is likely to be short duration corporate bonds. From a term perspective, they earn a premium over long-dated bonds as the yield curve is inverted. They also earn additional credit premium, and we expect risk to be minimal in the near term. The CI Enhanced Short Duration Bond Fund (FSB/FSB.U) offers an attractive opportunity for investors seeking conservative alternatives to GICs and HISA's for cash allocation. With a nearly decade-long track record, the actively managed strategy has proven to deliver strong risk-adjusted returns, low volatility, tax efficiency, and attractive yields.

GIC After-Tax Return Comparison



*FSB YTM 5.55% as of Oct 31, 2023

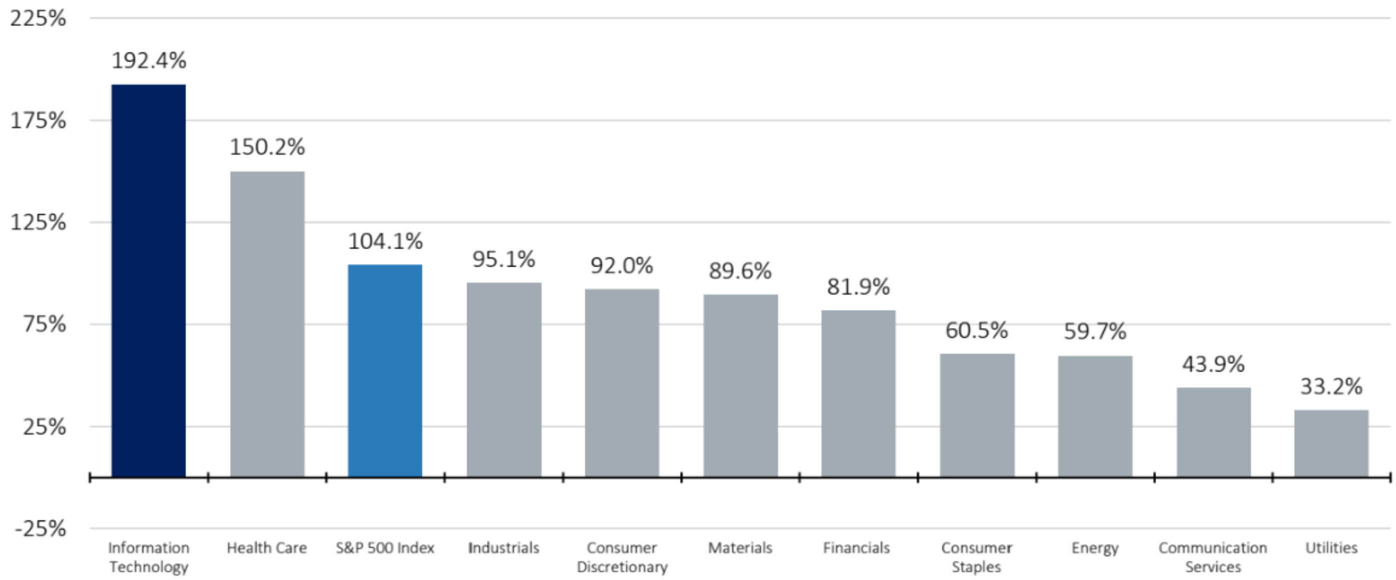
Source: CI Global Asset Management and RateHub as of October 31, 2023

Active Innovative Technology

In addition to the positive outlook for the Technology sector, the next best thing is generative AI through semi-conductors, data centers and software. We are at the beginning of a revolutionary trend, and those sectors will see a steep increase in demand and very high profit margins for a while. The last time we had a mega-trend like this was the internet and smart phones over 20 years ago and the personal computer 50 years ago. It is important we capture this trend and not ignore it. However, it will have its fair share of volatility.

Based on the view that technology and equities will do well and that the markets will be divergent, rewarding stock picking since there will be winners and losers as a result of revolutionary changes, the [CI Global Alpha Innovation ETF (CINV/CINV.U)] offers access to companies active in artificial Intelligence, digital transformation, the cloud, cryptocurrencies and blockchain, giving investors a chance to embrace the technology that will help drive global economies.

Cumulative Change in Earnings Per Share Over The Last 10 Years



Source: Bloomberg Finance L.P. as of September 30, 2023

Japanese Equities

Besides the positive tailwinds for the Japanese equity market that we noted in our market outlook above, the current interest rate differential between the Japanese Yen and the Canadian Dollar presents an opportunity to benefit from currency carry. Due to the very low interest rate in Japan relative to our rates in Canada, investors in Canada are essentially being paid to hedge their currency exposure to the Yen. The CI WisdomTree Japan Equity Index ETF (JAPN/JAPN.B) provides access to Japanese dividend-paying companies that derive less than 80% of their revenue from sources in Japan, resulting in a focus on export-oriented companies and a greater tie to the global economy, not just a bet on Japan itself. It also focuses on fundamentals and weights by dividends in order to magnify the impact dividends have on performance. The fund rebalances on an annual basis to manage valuation risk and enhance income and performance potential.

The resulting portfolio consistently outperforms the Japanese equity market and has strong fundamentals compared to other broad-based indexes when looking at Dividend Yield and various valuation metrics.

	Dividend Yield	Price/ Earnings	Price/Cash Flow	Price/Book
S&P 500	1.66%	22.64	15.71	4.00
Nikkei 225	2.32%	19.89	13.47	1.82
JAPN ETF	**3.45%**	**12.48**	**8.06**	**1.14**

Source: Bloomberg as of December 27, 2023

	YTD	1YR	3YR	5YR	SI*
JAPN ETF	**41.32%**	**36.55%**	**22.65%**	**13.26%**	**11.67%**
Nikkei 225	16.77%	15.33%	-0.38%	5.21%	4.55%

Source: Morningstar Direct as of November 30, 2023. Returns in CAD. *Inception date: 2018-08-01

Canadian ETF Association

CETFA's mandate is to support the growth, sustainability and integrity of Canada's ETF industry.

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cetfa.ca

The Solid Foundation of Canadian HISA ETFs:

Navigating the New Regulatory Era

High-Interest Savings Account (HISA) ETFs have been gaining traction in the Canadian financial landscape, marrying the traditional features of a savings account with the flexibility and accessibility of an exchange-traded fund.

Pat Dunwoody,
Executive Director,
Canadian ETF Association (CEFTA)

cetfa
Canadian ETF Association

However, [recent regulatory developments by the Office of the Superintendent of Financial Institutions (OSFI)] suggest changes for these investment vehicles.

To reinforce the stability and resilience of Canada's financial system, OSFI has upheld its core liquidity adequacy principles. This decision affects the liquidity treatment of wholesale funding sources that have retail-like characteristics, such as HISA ETFs.

In short, deposit-taking institutions counterparties to said funding will now be required to hold sufficient high-quality liquid assets, like short-term government bonds, in order to collateralize all HISA ETF balances withdrawable within 30 days.

According to industry professionals, this regulation, which needs to be implemented by January 31, 2024, may lead to a drop in yields offered by HISA ETFs as they adjust to the new requirements.

It's important to remember that regulatory change is part of the natural evolution of any innovative financial product. Regulations often follow innovations, providing necessary checks and balances, particularly in new and developing areas of the financial market.

They serve as an opportunity to refine what works and address potential vulnerabilities, ultimately contributing to the long-term viability and credibility of the financial products.

Despite these changes, the core benefits of HISA ETFs remain intact. These funds continue to offer a unique blend of benefits, including the liquidity and convenience of an ETF structure combined with the stability and interest-earning potential of a high-interest savings account.

For advisors and investors alike, HISA ETFs remain an attractive option, especially for those seeking a blend of safety, liquidity, and competitive returns in their investment portfolios.

Understanding the Basics of HISA ETFs

Unlike traditional ETFs that typically hold stocks, bonds, or commodities, HISA ETFs primarily invest in high-yield interest-bearing cash accounts held with large Canadian banks.

This unique structure allows them to offer competitive interest rates while providing the liquidity and ease of trading associated with ETFs.

One of the key mechanics of HISA ETFs is their net asset value (NAV), which is generally set at $50. This price steadily accrues interest over time, reflecting the growing value of the underlying cash accounts.

Then, at regular intervals (usually monthly), the accrued interest is distributed to investors, and the NAV resets back to $50. This cycle provides a clear and predictable pattern of growth and payout for investors, while almost eliminating volatility.

The interest rates on HISA ETFs are particularly noteworthy, especially in the current financial climate. As one of the few products that benefit from rising interest rates, similar to floating-rate bonds, HISA ETFs' yields move in lockstep with the Bank of Canada's policy rate.

Presently, most HISA ETFs offer gross annualized yields of over 5%. This makes them an attractive option for investors looking for higher returns on cash holdings, coupled with the flexibility to enter and exit positions easily, thanks to the low spread typical of the ETF creation/redemption process.

HISA ETFs Versus Other Cash Equivalents

HISA ETFs offer a modern alternative for cash management, presenting tangible benefits over traditional options like money market mutual funds and Guaranteed Investment Certificates (GICs).

Compared to money market funds, HISA ETFs stand out for their greater flexibility. The ETF structure allows for intraday trading, enabling investors to buy and sell throughout the trading day, unlike money market funds where transactions are typically executed only at the end of the day. This feature provides investors the ability to respond quickly to market changes or immediate liquidity needs.

Additionally, HISA ETFs generally have lower expense ratios than money market funds, making them a more cost-effective choice. In terms of risk, while money market funds are considered low-risk investments, they do carry a degree of credit risk as they may include assets like promissory notes and commercial paper. HISA ETFs, on the other hand, primarily invest in institutional high-yield interest-bearing cash accounts with large banks, offering a safer risk profile.

When it comes to GICs, they currently offer competitive rates, with some institutions allowing investors to lock in a risk-free rate of as high as 5.65% for a year. The main advantage of GICs lies in the certainty of the rate, which remains fixed for the term of the GIC, and they are CDIC insured.

However, GICs also have a downside – liquidity. If an investor needs to access funds quickly, selling a GIC can be challenging and may result in penalties. HISA ETFs, conversely, provide the benefit of easy liquidity. They can be quickly bought and sold in any brokerage account, offering investors flexibility and access to their funds without the risk of incurring penalties.

Using HISA ETFs in an Investment Portfolio

The extended period of low interest rates over the past decade led many investors and advisors to overlook cash as a traditional asset class, often favoring stocks and bonds.

In pursuit of higher yields, there was a tendency to take on greater credit and duration risk in fixed income investments. However, this strategy proved challenging in 2022 and 2023, as rising interest rates resulted in significant drawdowns in Canadian aggregate bond indices.

The silver lining in this scenario is the resurgence of cash as a viable component of a well-rounded investment portfolio, especially with the policy interest rate now at 5%.

Cash has re-emerged as an attractive option, particularly for investors in the withdrawal phase of their investment journey. It serves as a buffer against the volatility observed in equity and fixed income allocations, providing stability and safety.

HISA ETFs are ideally suited to this renewed focus on cash. They offer a seamless way for investors to rebalance their portfolios, thanks to their high liquidity.

Investors can easily buy and sell HISA ETFs, making them a flexible tool for adjusting asset allocations in response to market conditions.

Additionally, HISA ETFs provide monthly income – a feature particularly beneficial for those who rely on their investments for regular cash flow.

Perhaps most importantly, HISA ETFs exhibit virtually no volatility, a key consideration for investors seeking stability in uncertain financial climates.

In a time where the diversification potential of bonds is coming into question, an alternative to the traditional "60/40" portfolio consisting of perhaps, 60% equities, 30% fixed income, and 10% in cash equivalents like a HISA ETF could be a viable, accessible, and low-cost alternative.

Harnessing the Power of HISA ETFs: A Closing Perspective

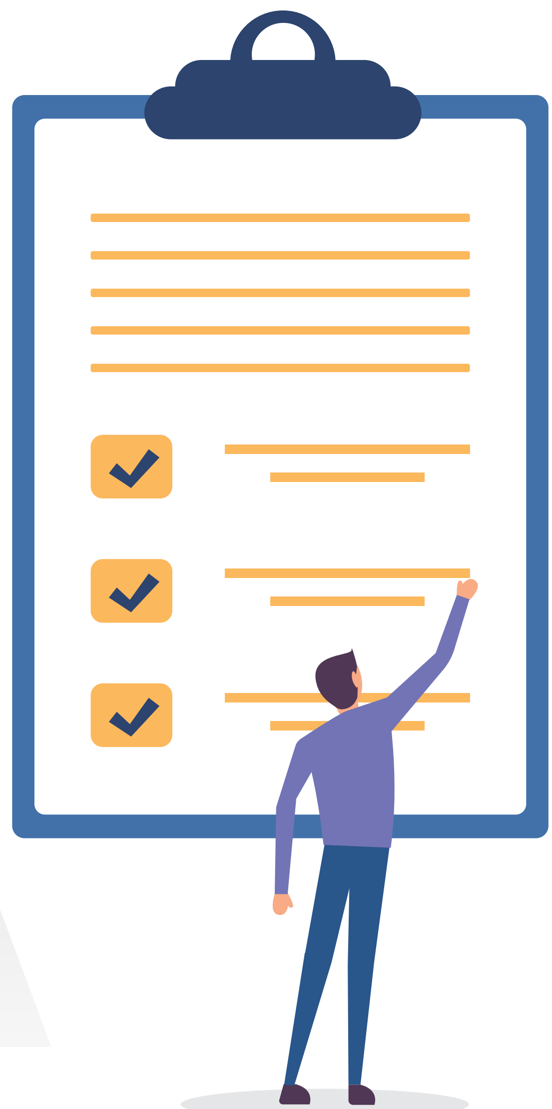
HISA ETFs stand out as a robust financial tool, offering stability and a range of benefits in today's dynamic market. They have reinvigorated the role of cash in investment portfolios, especially in an era marked by fluctuating interest rates and market uncertainties.

The key strengths of HISA ETFs – including their ability to provide liquidity, regular income, and minimal volatility – make them an attractive option for investors seeking a balanced approach to their financial planning.

Moreover, the evolving landscape of HISA ETFs in Canada, shaped by recent regulatory changes and market conditions, underscores the importance of ongoing education and research.

The ETF industry, particularly the HISA ETF vertical, is highly competitive and continuously evolving. Therefore, shopping around and comparing different HISA ETF products is essential to find the ones that best suit your specific needs.

For investors and advisors considering HISA ETFs, it's therefore crucial to stay informed about the latest developments in this niche. Navigating the segment of the domestic ETF market requires a keen understanding of the various products available and how they align with your investment goals.



HISA

Investing Beyond Our Borders – Adding International Equities to Portfolios

Canadian investors love Canada! As a result, portfolios tend to reflect a substantial home country bias. And, as with all biases, it comes at a cost.

Bobby Eng, CIMA®
Senior Vice President
Head of Platform
and Institutional ETF
Distribution
Franklin Templeton
Canada

Investors often hear about the benefits of diversification, yet they undercut those benefits by staying close to home and heavily overweighting their portfolios to Canadian companies. Canadian equities are highly concentrated within 3 sectors – Financials, Energy and Industrials – while only representing a sliver of the larger global market.[1]

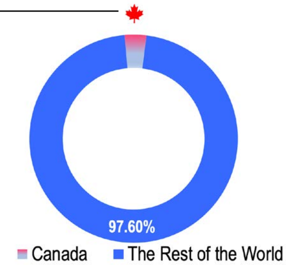
Big Country. Little Market.

Canada represents just

3.40%[1]

of global equities

The average Canadian invests **over half of their assets at home**



In the U.S. the equities sandbox is certainly larger, but recent history has shown that American stocks aren't producing the kind of diversified growth that is typically attributed to a healthy market. The magnificent 7 phenomenon demonstrates exactly how solitary gains have been, with 7 mega-cap tech companies accounting for over 70% of returns in 2023. That's a narrow band of stocks, with high concentration risk at premium valuations.

As they plan for the year ahead, we feel prudent investors should look to expand their geographic footprint by adding international exposure for a more complete portfolio. Developed and emerging market equities are a great way to improve diversification while adding upside potential. And it just so happens that international markets are currently more attractively priced than their North American counterparts, offering valuations at generational lows.

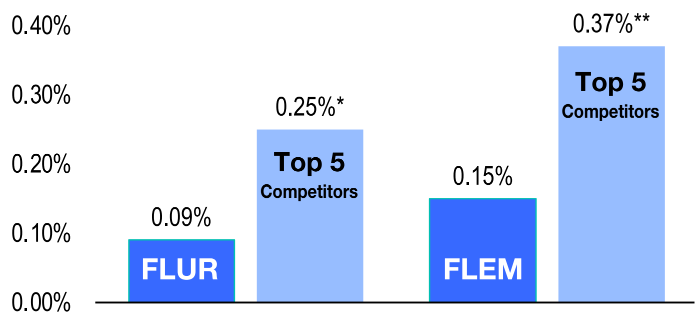
Representing over 20 countries including Japan, U.K., and France, the international developed market space features a diverse array of currencies and is home to some of the best managed companies in the world. The MSCI World Index – representing large and mid-cap companies across 23 developed markets – has a market capitalization of $57.7 trillion, while Canada's market capitalization represents only 3.14%.[1] This highlights the scale of diversity that can be accessed through developed markets.

In emerging markets, there are even more reasons for optimism as the space is buzzing with growth potential. Comprised of over 20 countries, the region boasts economic stalwarts like China and India, while also hosting prominent global 'up and comers', including Brazil and Taiwan. With valuations at historic lows, the space offers some of the most compelling growth prospects available anywhere in the world, and it's gaining momentum on the global stage.

Though emerging markets have underperformed developed markets since 2010, changing dynamics are setting the stage for a period of improved performance, as was the case during 'the lost decade' between 2000 and 2010, when emerging markets outperformed by a wide margin. Backed by favourable macroeconomic health and demographic tailwinds, the region is primed for rapid economic growth. It's also increasingly recognized as a leader in innovation, ingenuity, and wealth creation. With several key emerging market countries expected to be among the primary beneficiaries of today's secular growth trends, you can expect them to play a central role in defining the future of the global economy.

The Franklin International Index ETF (FLUR) and the Franklin Emerging Markets Index ETF (FLEM) are low cost, diversified ways to get foundational exposure to international equities markets. As part of the 'core and explore' portfolio construction strategy, both FLUR and FLEM can provide diversified 'core' exposure across international markets, while reserving the 'explore' flexibility to maneuver across other regions and investment vehicles. Importantly, both FLUR and FLEM are the lowest priced ETFs in their categories, offering Canadians the most affordable way to capture international exposure.[2]

Get international exposure for the lowest fees in Canada



*Average Management Fee and MER of Top 5 Competitors by AUM in "International Equity" Morningstar Category in Canada. As of December 31, 2023

**Average Management Fee and MER of Top 5 Competitors by AUM in "Emerging Markets Equity" Morningstar Category in Canada. As of December 31, 2023

While Canada has compelling and familiar investment opportunities, it's important for investors to be cognizant of home country bias and not limit their diversification benefits and upside potential. Adding international can also reduce volatility and while adding a world of opportunities to your portfolio. So go ahead and love Canada, but don't be afraid to embrace the rest of the world too!

1. Source: MSCI (September 2023). "A Complete Geographic Breakdown of the MSCI ACWI IMI"
2. Source: Morningstar Research Inc. as of December 31, 2023

IMPORTANT LEGAL INFORMATION

Bobby Eng's comments, opinions and analyses are for informational purposes only and should not be considered individual investment advice or recommendations to invest in any security or to adopt any investment strategy. Because market and economic conditions are subject to rapid change, comments, opinions, and analyses are rendered as of the date of the posting and may change without notice. The material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, investment, or strategy.

Commissions, management fees and expenses may all be associated with investments in ETFs. Investors should carefully consider an ETF's investment objectives and strategies, risks, fees and expenses before investing. The prospectus and ETF facts contain this and other information. Please read the prospectus and ETF facts carefully before investing. ETFs trade like stocks, fluctuate in market value and may trade at prices above or below the ETF's net asset value. Brokerage commissions and ETF expenses will reduce returns. Performance of an ETF may vary significantly from the performance of an index, as a result of transaction costs, expenses and other factors. The indicated rates of return are the historical annual compounded total returns including changes in share or unit value and reinvestment of all dividends or distributions and do not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. ETFs are not guaranteed, their values change frequently, and past performance may not be repeated.

All investments involve risks, including the possible loss of principal. Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions.

Lifting the Veil on 2024

Vanguard's economic and market outlook

Higher interest rates are here to stay. Even after policy rates recede from their cyclical peaks, in the decade ahead rates will settle at a higher level than we've grown accustomed to since the 2008 global financial crisis (GFC).

Joe Davis
Global Chief Economist & Head of Investment Strategy Group

This development ushers in a return to sound money, and the implications for the global economy and financial markets will be profound. Borrowing and savings behavior will reset, capital will be allocated more judiciously, and asset class return expectations will be recalibrated. Vanguard believes that a higher interest rate environment will serve investors well in achieving their long-term financial goals, but the transition may be bumpy.

Vanguard®

Monetary policy will bare its teeth in 2024

The global economy has proven more resilient than we expected in 2023. This is partly because monetary policy has not been as restrictive as initially thought. Fundamental changes to the global economy have pushed up the neutral rate of interest – the rate at which policy is neither expansionary nor contractionary. Various other factors have blunted the normal channels of monetary policy transmission, including the U.S. fiscal impulse from debt-financed pandemic support and industrial policies, improved household and corporate balance sheets, and tight labor markets that have resulted in real wage growth. In the U.S., our analysis suggests that these offsets almost entirely counteracted the impact of higher policy interest rates. Outside the U.S., this dynamic is less pronounced. Europe's predominantly bank-based economy is already flirting with recession, and China's rebound from the end of Covid-19-related shutdowns has been weaker than expected.

The U.S. exceptionalism is set to fade in 2024. We expect monetary policy to become increasingly restrictive as inflation falls and offsetting forces wane. The economy will experience a mild downturn as a result. This is necessary to finish the job of returning inflation to target. However, there are risks to this view. A "soft landing," in which inflation returns to target without recession, remains possible, as does a recession that is further delayed. In Europe, we expect anemic growth as restrictive monetary and fiscal policy lingers, while in China, we expect additional policy stimulus to sustain economic recovery amid increasing external and structural headwinds.

Zero rates are yesterday's news

Barring an immediate 1990s-style productivity boom, a recession is likely a necessary condition to bring down the rate of inflation, through weakening demand for labor and slower wage growth. As central banks feel more confident in inflation's path toward targets, we expect they will start to cut policy rates in the second half of 2024.

That said, we expect policy rates to settle at a higher level compared with after the GFC and during the COVID-19 pandemic. Vanguard research has found that the equilibrium level of the real interest rate, also known as r-star, or r*, has increased, driven primarily by demographics, long-term productivity growth, and higher structural fiscal deficits. This higher interest rate environment will last not months, but years. It is a structural shift that will endure beyond the next business cycle and, in our view, is the single most important financial development since the GFC.

A return to sound money

For households and businesses, higher interest rates will limit borrowing, increase the cost of capital, and encourage saving. For governments, higher rates will force a reassessment of fiscal outlooks sooner rather than later. The vicious circle of rising deficits and higher interest rates will accelerate concerns about fiscal sustainability. Vanguard's research suggests the window for governments to act on this is closing fast – it is an issue that must be tackled by this generation, not the next.

For well-diversified investors, the permanence of higher real interest rates is a welcome development. It provides a solid foundation for long-term risk-adjusted returns. However, as the transition to higher rates is not yet complete, near-term financial market volatility is likely to remain elevated.

Bonds are back!

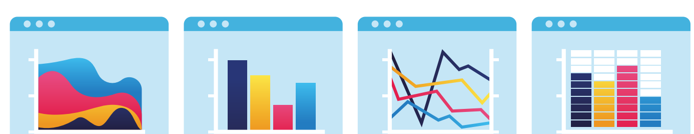
Global bond markets have repriced significantly over the last two years because of the transition to the new era of higher rates. In our view, bond valuations are now close to fair, with higher long-term rates more aligned with secularly higher neutral rates. Meanwhile, term premia have increased as well, driven by elevated inflation and fiscal and monetary outlook uncertainty.

Despite the potential for near-term volatility, we believe this rise in interest rates is the single best economic and financial development in 20 years for long-term investors. Our bond return expectations have increased substantially. We now expect Canadian bonds to return a nominal annualized 4.3%-5.3% over the next decade, compared with the 1.4%-2.4% annualized returns we expected before the rate-hiking cycle began. Similarly, for global ex-Canada bonds, we expect annualized returns of 4.0%-5.0% over the next decade, compared with a forecast of 1.1%-2.1% when policy rates were low or, in some cases, negative.

If reinvested, the income component of bond returns at this level of rates will eventually more than offset the capital losses experienced over the last two years. By the end of the decade, bond portfolio values are expected to be higher than if rates had not increased in the first place.

Similarly, the case for the 60/40 portfolio is stronger than in recent memory. Long-term investors in balanced portfolios have seen a dramatic rise in the probability of achieving a 10-year annualized return of at least 7%, from an 7% likelihood in 2021 to 32% today.

Moving up the risk spectrum, credit valuations appear fair in the investment-grade space but relatively rich in high-yield. What's more, the growing likelihood of recession and declining profit margins skew the risks toward wider spreads.



Higher rates leave equities overvalued

A higher-rate environment depresses asset price valuations across global markets while squeezing profit margins as corporations find it more expensive to issue and refinance debt.

Valuations are most stretched in the U.S. As a result, we have downgraded our U.S. equity return expectations to an annualized 3.6%-5.6% over the next 10 years from 3.8%-5.85% heading into 2023. Within the U.S. market, value stocks are more attractive than they have been since late 2021, and small-capitalization stocks also appear attractive for the long term.

U.S. equities have continued to outperform their international peers. The key drivers of this performance gap over the last two years have been valuation expansion and U.S. dollar strength beyond our fair-value estimates, both of which are likely to reverse. Indeed, our Vanguard Capital Markets Model® (VCMM) projections suggest an increasing likelihood of greater opportunities outside the U.S. from a U.S. dollar investor's perspective. We project 10-year annualized returns of 6.3%-8.3% for non-U.S. developed markets , 5.3%-7.3% for Canadian equities and 5.9%-7.9% for emerging markets.

The global equity risk premium that emerges from current stock and bond market valuations is the lowest since the 1999-2009 "lost decade." The spread between global equity and global bond returns is expected to be 0 to 2 percentage points annualized over the next 10 years. In contrast to the last decade, we expect return outcomes for diversified investors to be more balanced. For those with an appropriate risk tolerance, a more defensive risk posture may be appropriate given higher expected fixed income returns and an equity market that is yet to fully reflect the implications of the return to sound money.

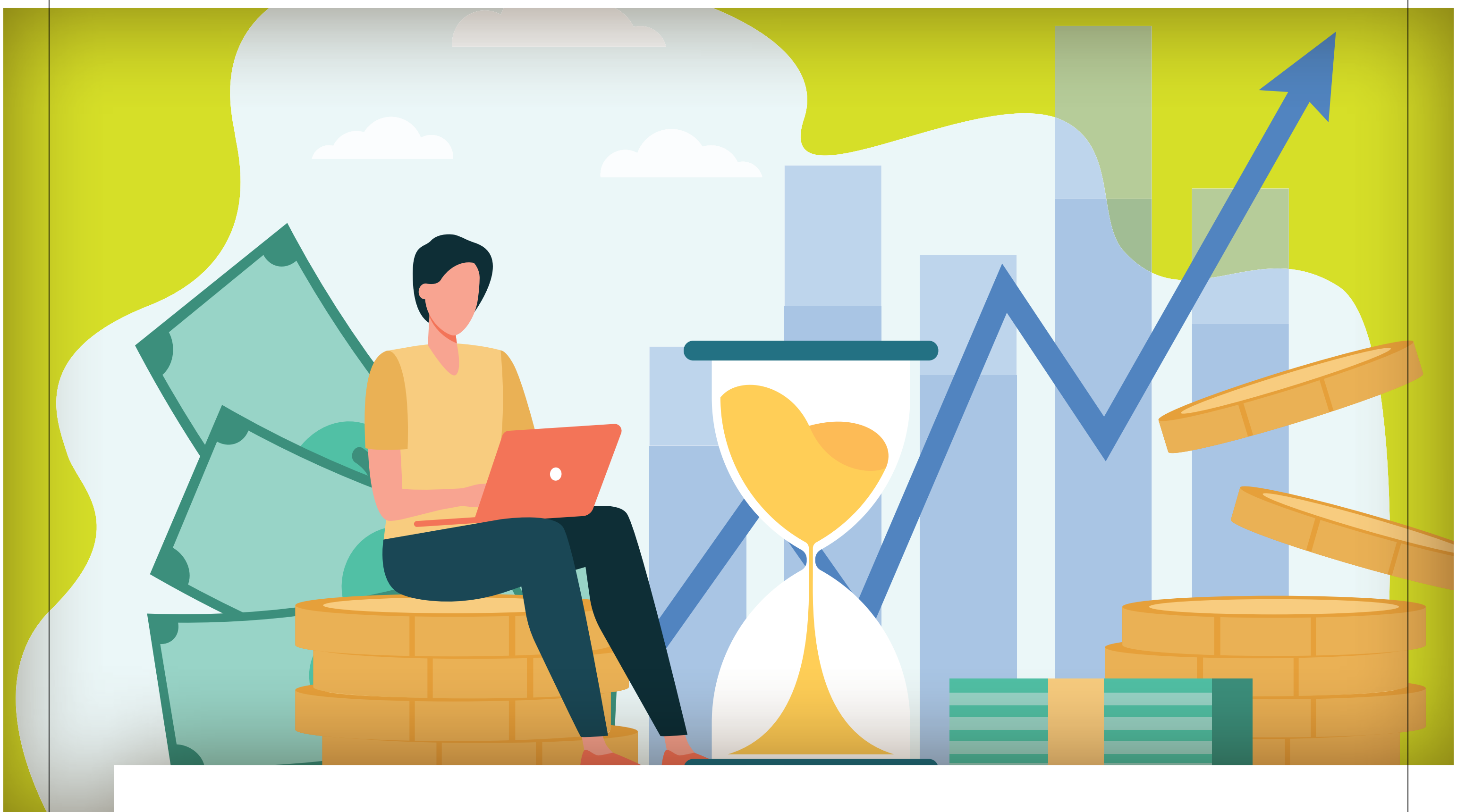
IMPORTANT: The projections and other information generated by the VCMM regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from VCMM are derived from 10,000 simulations for each modeled asset class. Simulations as of September 30, 2023. Results from the model may vary with each use and over time. For more information, please see the Notes section.

Joseph H. Davis, PhD, is a Vanguard principal, global chief economist, and global head of The Vanguard Group, Inc.'s Investment Strategy Group, whose research and client-facing team develops asset allocation strategies and conducts research on the capital markets, the global economy, portfolio construction and related investment topics. As Vanguard's global chief economist, Mr. Davis is also a key member of the senior portfolio management team for Vanguard Fixed Income Group. The Vanguard Global Economics Team contributed to this report. The detailed Vanguard Economic Outlook for 2024 can be viewed on the Vanguard website in mid-December.

Disclaimer

Extending Duration

(and Hedging Against a Market Downswing) with Aggregate Bonds



Laura Tase,
Director,
Institutional & Advisory
BMO ETFs

Bonds: A Comeback Story

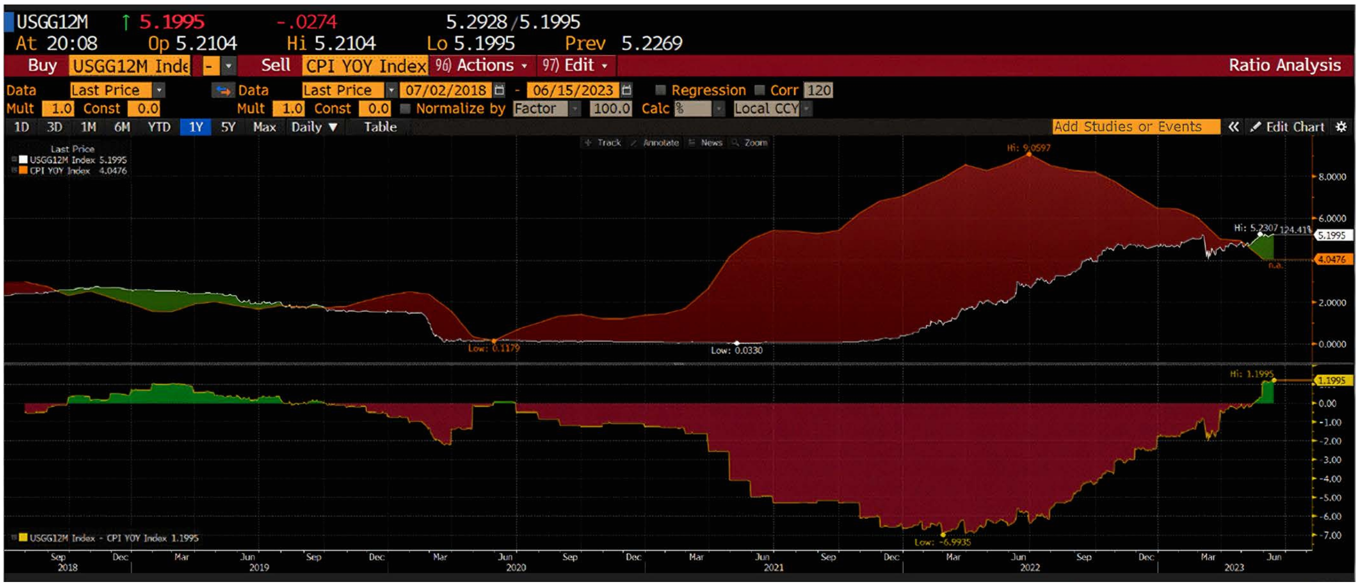
Needless to say, it's been an interesting couple of years for bonds. Since yields bottomed out in the early days of the pandemic, they've rebounded significantly—though given market volatility and uncertainty around monetary policy, it hasn't been in a straight line.

Driven by higher interest rates than we've seen in decades, short-term bonds now offer very attractive yields, with both the U.S. 2-Year Treasury Note and the Canada 2-Year Bond topping 4.5%. But it's the long end of the curve that offers another benefit: diversification.

BMO Global Asset Management

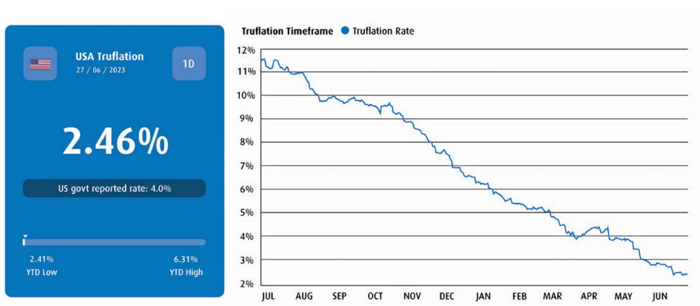
Inflation and Fixed Income Markets

A close examination of the macroeconomic picture reveals an environment that is favourable for bonds. As the Consumer Price Index (CPI) has started to trend in the right direction, rate hikes by both the U.S. Federal Reserve (Fed) and Bank of Canada (BoC) have slowed, with the Fed following through in June on what some analysts have dubbed a "hawkish pause" — keeping interest rates unchanged while maintaining a relatively hawkish tone in its commentary. The chart below shows that real interest rates, as calculated by subtracting year-over-year CPI from the U.S. 1-Year Treasury yield, are finally positive for the first time since 2019. This is a significant sign that inflation is on the mend, and is a positive bellwether for fixed income markets.



Source: Bloomberg (Real rate measured by difference between 12M U.S. Treasury and U.S. CPI, Y/Y) as of June 15, 2023.(Real rate measured by difference between 12M U.S. Treasury and U.S. CPI, Y/Y) as of June 15, 2023.)

Additionally, real-time inflation, which is calculated daily by the firm Truflation based on millions of data points, also appears to be slowing, as shown in the graph below.



Source: Truflation as of June 27, 2023.)

Rising prices in goods have largely abated and supply chains are normalizing. Inflation in services has been more resilient but also shows signs of easing. This provides additional justification for the Fed's pause.

Hedging Against an Equities Sell-Off With Aggregate Bonds

So, with the inflation picture improving, where are the risks for investors? If inflation continues to move in the right direction, this may allow the economy to avoid the 'hard landing' that markets had feared. Although inflation and the cost of money have risen, the labour market has remained resilient, helping to delay the onset of a potential recession. This is, generally speaking, good news. However, further rate hikes have the potential to expose systemic risks, which could prompt an equity market sell-off.

One strategy to sidestep such a scenario is to extend duration in your client's bond holdings. This can help provide protection and act as a hedge against a stock market downturn. For clients not comfortable allocating a portion of their portfolio to long bonds, an aggregate exposure can be an attractive alternative.

Full Full exposure to the yield curve can often help manage unexpected volatility. Our expectation is that markets will remain volatile for the foreseeable future, and that recovery won't be a straight line. Having exposure to the full bond market can be helpful in constructing client portfolios that can withstand such periods of uncertainty.

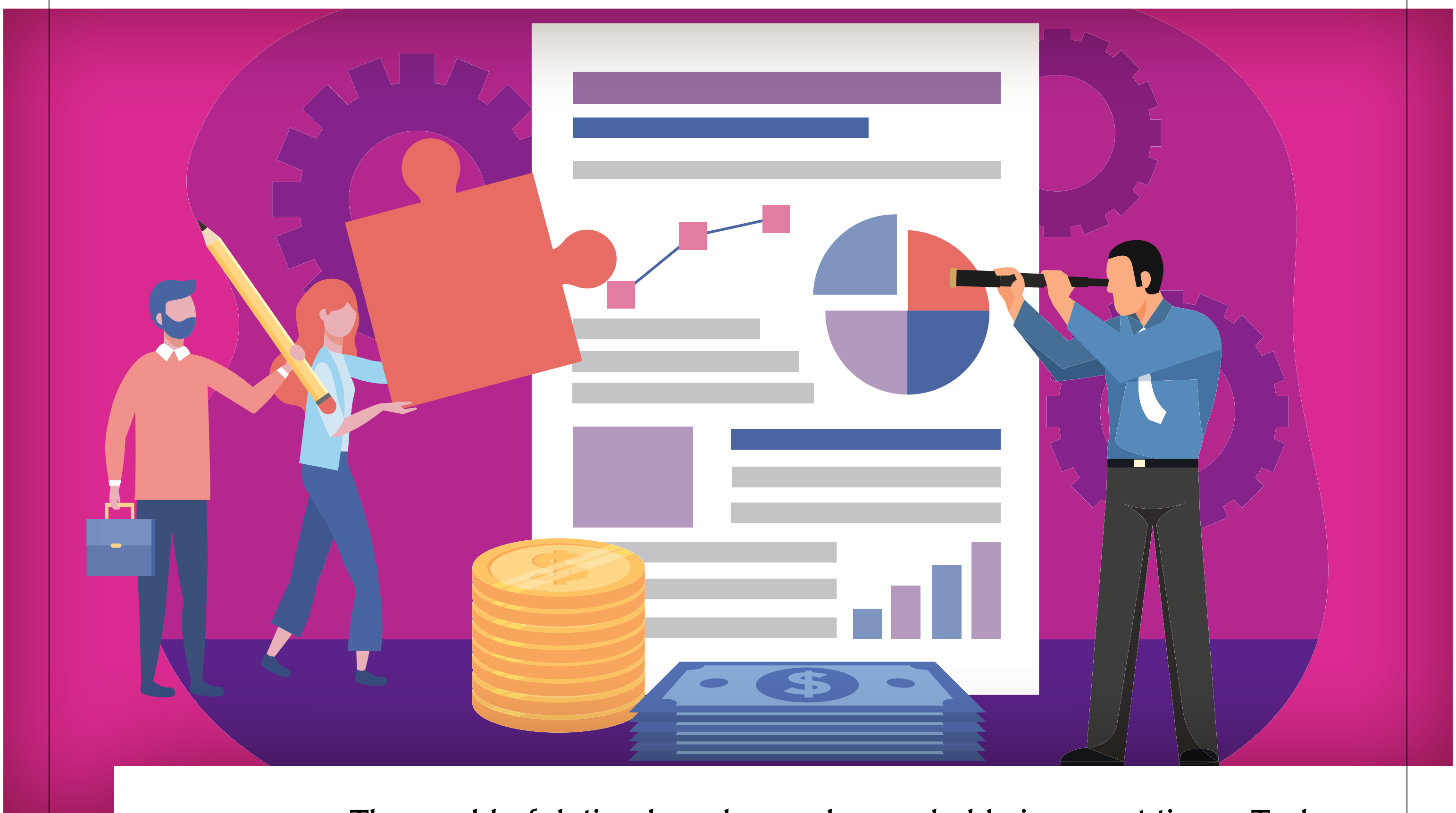
Low-cost core beta solutions like the ZAG and ZUAG offer the flexibility to be more precise and tactical around the periphery of a client's portfolio. If a portfolio has a set allocation to fees, minimizing the cost of its core frees up funds to consider a wider range of satellite solutions. Both ZAG and ZUAG provide high-quality fixed income exposures that enable investors to take advantage of credit spreads without being forced to go extremely overweight bonds in case of a market sell-off — and at an attractive MER of only nine basis points

The Advantages of ETFs

There are several advantages to using bond ETFs for the fixed income allocation of your client portfolios compared to individual bond trading. They include cost effectiveness, greater liquidity, better tactical flexibility, and the ability to precisely target duration and exposure to meet your client's investment objectives. ETFs also feature tighter spreads relative to individual bonds purchased through a retail advisory desk. As the largest bond ETF provider in Canada,4 BMO GAM offers asset managers the benefits of institutional pricing.

Playing the Field

Key Consideration Behind Choosing the Right ETF Provider



The world of dating has changed remarkably in recent times. Today, more people meet online rather than through "traditional" means like meeting at the office, gym bar or through friends and family than ever before. Technology and innovation have allowed for an absolute proliferation in dating apps and the dating game has changed.

Trevor Cummings
Vice President, ETF Distribution, Central Canada, TD Asset Management Inc.

Similarly in the investment product industry, while exchange-traded funds (ETFs) have been around for over three decades, it's only recently that their popularity has exploded. Over the last ten years, the ETF industry in Canada has grown at a compound annual growth rate of 16.7%[1] . As we close out 2023, the ETF industry now has over 40 different providers and well over 1,300 different ETFs available to investors.

We have already seen many investment professionals incorporate a variety of ETFs into models and accounts, to varying degrees. Nowadays professionals not only need to know how to invest in ETFs, but also who they should work with. Against this backdrop, we will discuss a few considerations to help you decide which ETF providers to work with.

TD Asset Management

What is the ETF provider's size?

Barriers to entry in the ETF space are very low— almost anyone can gather investment capital and 'throw some spaghetti at the wall' to see what sticks. At the same time, barriers to success are also very high, given the additional costs and lower management fees, higher break-evens, and only those ETFs that can grow quickly will be successful and have staying power.

Providers that have large ETFs (AUMs of $100M or more) will have longevity and the ones that cannot grow assets fast enough might be at risk of running out of funding and winding down. An ETF should have at least $20 million in net assets otherwise it could be subject to lower liquidity levels and wider trading spreads. ETF providers with billion-dollar ETFs will be even better positioned.

What is the ETF provider's pedigree?

What value do they bring to the industry? Do they have a legacy or expertise in passive, quantitative, or active investing? Once you know what you are looking for, it becomes easier to find. For instance, several ETF providers in Canada have long histories and expertise providing passive style investment products or have provided services to institutional clients for decades. Others have expertise in providing active management to the industry through other vehicles like mutual funds, or separately managed accounts. Rarely do you have firms that have experience in both institutional money management and retail wealth management.

Having a successful lineup of ETFs requires multidisciplinary expertise and significant resources, both in terms of capital and personnel. Take a look at the management team, their background, tenure and experience. A competent provider should have a diverse management team preferably with decades of experience navigating multiple market cycles in both good and bad times. Without these qualities, ETFs may fail to perform and gather assets and thus experience poor liquidity, and ultimately end up closing often to the detriment of investors. In some cases, investors could walk away with less that the net asset value of the fund.

How are their fees?

One of the unfortunate realities over the past several years in the ETF industry is one of fee creep. Often times ETFs are being launched at higher and higher management fees, as some providers 'test the waters' to see what prices the market will bear. This is not a universal trend of course, but what we are starting to see is that, in some cases, ETFs are launching at fees higher than comparable F-Series mutual funds. For passive investing, consider seeking out the lowest fees you can find, but for non-passive investments, make sure that the fees are reasonable, delivering value for money when one is seeking out active or quantitative solutions.

Fees can affect your returns considerably over the long term. An examination done by the Securities and Exchange Commission found that over a 20-year period, a 1.00% annual fee can reduce portfolio value by $30,000 compared to a portfolio with a 0.25% annual fee based on a $100,000 initial investment[2] .

How is the transparency?

One of the hallmarks of ETF investing has been transparency. When purchasing an index-tracking ETF, you can see the exact weights and breakdown of sectors and geographies updated daily. This is a marked departure from traditional mutual funds where transparency typically consists of top-ten holdings only.

What's interesting about the ETF space is that on the quantitative and fundamental active side, some ETF providers are still fully transparent. While there is little consistency here, it's important to note that some providers are non-transparent in their active solution set. If you and your clients prefer full transparency, note that not all ETF providers offer this. What is the best way to determine this? Ask. Transparency will allow you to build a properly diversified portfolio limiting the concentration risk in any one security or sector.

How is the service?

Last but certainly not least, ETF service has to be one of the largest determinants of which ETF companies to work with. As you consider which two or three you want to work with, give some thought to the specific team you'll be working with – are they responsive, do they have subject matter experts and access to data and analysis? Can they provide you with a quick turnaround and data you require to make informed decisions? Can they provide advice and feedback on more than just ETFs, such as mutual funds and Separately Managed Accounts (SMAs)?

Since ETFs typically have low fees, ETF providers sometimes run very lean, with many of them relying on their U.S. parent companies for trading, portfolio management, analytics, and data. This can also mean that coverage could be spread thin, which risks poor responsiveness or inquiries falling through the cracks. Other companies maintain services domestically, which translates to easy access of information and timeliness. Working with an ETF provider that has additional lines of businesses such as mutual funds can mean that the business development team is fully staffed and can be hyper-responsive to your needs.

About TD ETFs

It's not just about the proliferation of choice—nowadays investment professionals need a roadmap to be able to incorporate ETFs successfully in modern practices. As one of the largest institutional asset managers in Canada, TD Asset Management Inc. (TDAM) has been offering index investments to pension plans, endowments, and foundations for decades—but we've also been offering index investments to Canadians since before ETFs were invented, since 1985 in fact.

With a legacy of experience in passive investing, we also offer ETFs that are sector focused, quantitative active solutions from one of the largest quantitative teams in Canada, and fundamental active solutions from our award-winning portfolio managers. As one of the fastest growing providers over the past four years, we have grown our ETF assets from $1B in 2020 to $12B in 2023, thanks to the support of investment professionals such as yourselves.

Come put us to the test and decide for yourself if there is an opportunity for us to work together. To view our entire line-up, visit us at td.com/etfs and download our TD ETF Product Guide.

[1] ETFGI. (2023, October 12). ETFGI reports the ETFs industry in Canada gathered US$1.38 billion in net inflows in September.   [2] SEC. (NA). How Fees and Expenses Affect Your Investment Portfolio.

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Navigating the Future:
Timeliness, Technology, and Turning to T+1 in Canada's ETF Market

Ronald C. Landry
Head of Product and Canadian ETF Services, CIBC Mellon

In the dynamic landscape of Canada's ETF market, 2024 is set to usher in a wave of transformations and amid these changes the spotlight is on T+1.

As a pivotal factor impacting Canada's ETF market, this article will delve into the projections for the upcoming year, including the anticipated shifts, innovations, and challenges that T+1 holds.

The shift to T+1 by May 2024, though a local regulation, will significantly affect global ETFs. Essentially, it introduces the potential for settlement mismatches due to timing differences between ETF shares and the associated basket trades linked to creation/redemption orders, as well as primary/secondary market settlement mismatches.

Addressing these timing challenges will necessitate adjustments to workflows and systems supporting creations and redemptions, alongside the introduction of cash collateral. Ultimately, the variations in settlement timing between Canada, the U.S. and other markets may lead to increased failed trades and wider trading spreads in the secondary market.

By way of background, the transition to T+2 in 2017 did not have a big impact in forcing firms to eliminate manual interventions. In transitioning from T+3 to T+2, firms still had a day to work with to ensure that trades settled on time. For this reason, settlement culture did not substantially change and some firms postponed the need to upgrade processes that should be automated. In transitioning to T+1, firms will need to change their operational practices and upgrade their technology. Offices at many buy-side firms have traditionally closed at 5 p.m. ET, while settlement issues often tend to arise after hours. If investment companies maintain these same working hours in a T+1 environment, their operations teams may not identify potential settlement breaks until the following morning, leaving only 6-8 hours to deal with any settlement issues in a T+1 environment, automation will play a prominent part in ensuring that the transition to T+1 is successful.

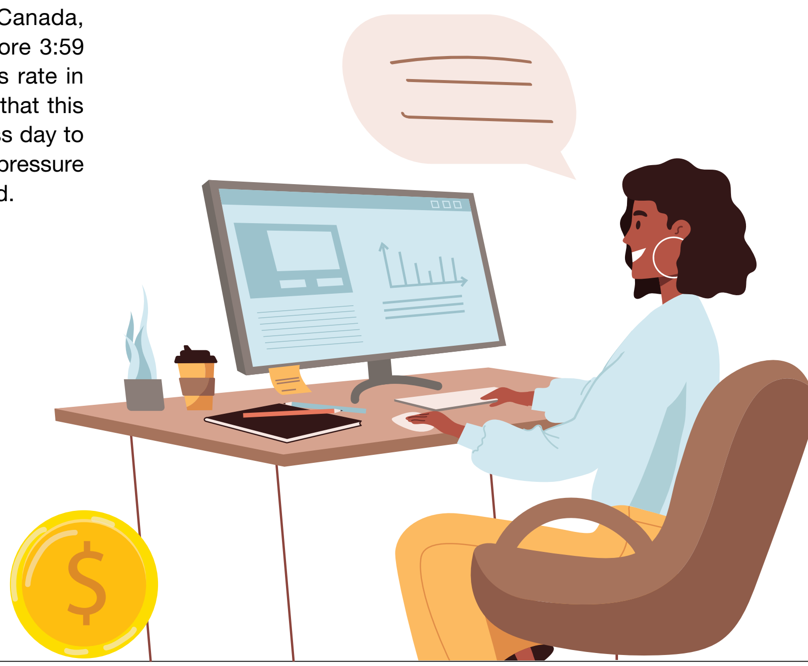
In response, we are encouraging clients to report their trades earlier and more often. In the T+1 settlement environment in Canada, counterparties are required to be matched by 3:59 a.m. ET on T+1. To meet this, we are requiring clients to have trades in by 3 a.m. on T+1

Given T+1's direct effect on the securities lending industry, it will likely be at the forefront of many standardization initiatives. The impact of T+1 on ETF trading includes a shorter time frame for completing the settlement process compared to longer settlement periods. As technology solutions improve, moving settlement gradually closer to real-time and enabling more real-time information and analytics, this will further reduce settlement risk and enhance market efficiency. With ETF trading, settlement is typically in-kind against a basket of securities, so from a lending perspective, investors will typically need to maintain a buffer. The presence of a buffer helps ensure that the ETF issuer can meet the redemption requests even if there are difficulties in sourcing the underlying securities. Firms will increasingly start to set natural buffers in place to manage their settlement risk as they move to T+1.

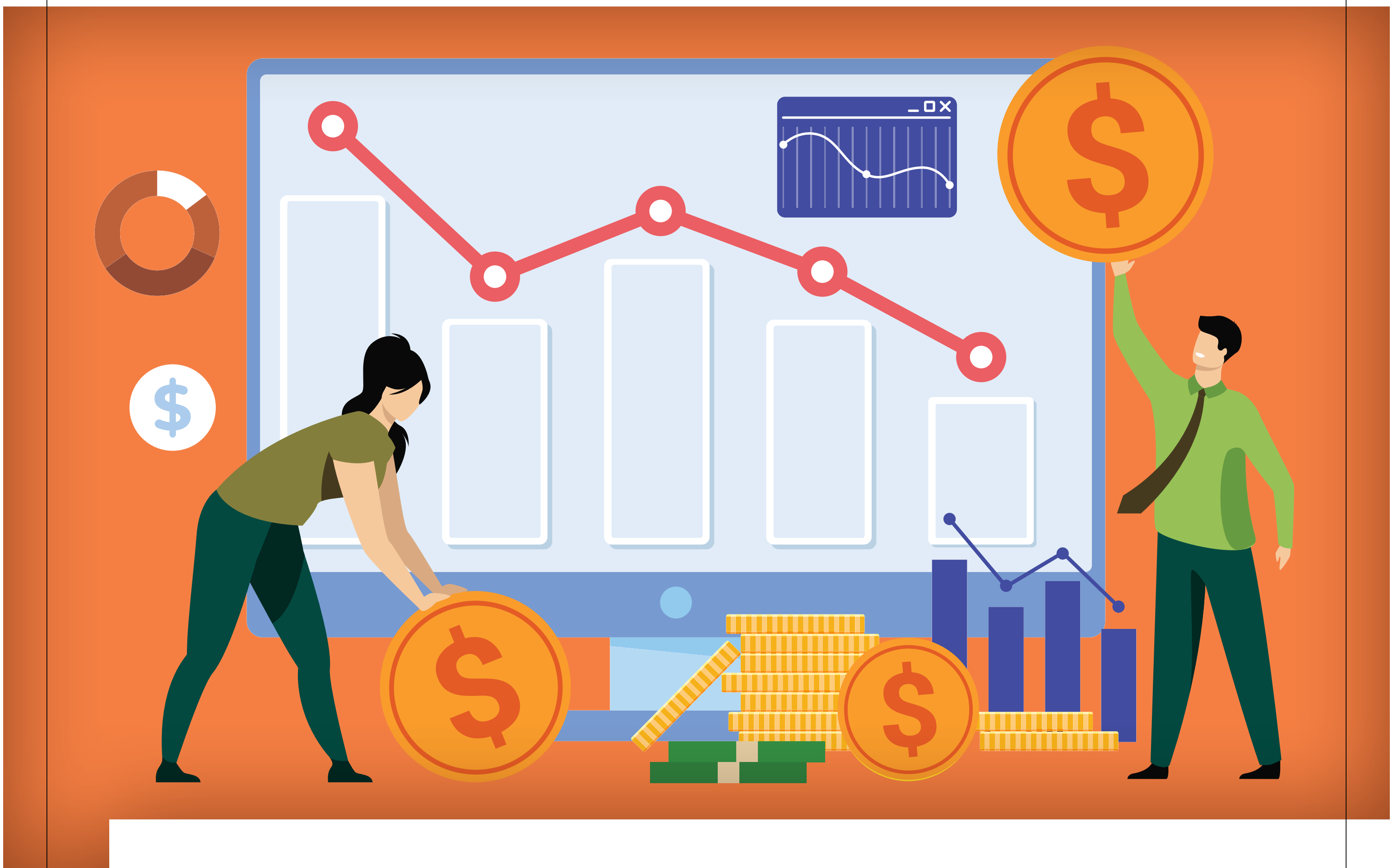
Proposed changes to National Instrument 24-101 in Canada, counterparties will be required to match transactions before 3:59 am ET on T+1. We are currently at a 78 per cent success rate in matching transactions by midnight on T. One outcome is that this puts considerable pressure on the latter half of the business day to get things done. When it gets past 2 p.m. ET, that is when pressure really builds on the CSD to get those settlements processed.

The Canadian Capital Markets Association (CCMA) T+1 taskforce has been working with industry stakeholders to solve for a lot of these challenges. In moving from T+2 to T+1, settlement practices for investment funds (mutual funds and ETFs) governed under the National Instrument 81-102, the securities regulation for investment funds in Canada. The legislation with NI81-102 related to subscription/creation and redemptions will not be changing, enabling ETFs to remain at T+2 for primary market settlement if their underlying assets do not settle predominantly on T+1. This will have an impact on Authorized Participants (APs) that have sold ETF shares to investors in the secondary market, for example, and do not have the inventory on hand to deliver to the issuer in the primary market to create additional shares. To address this situation, the CCMA Task Force has begun conversations with the Canadian Securities Administrators (CSA) to introduce exemptive relief under NI 81-102 or provide guidance, to enable collateral to be used to facilitate settlement in the primary market, without causing disruption to secondary market settlement. Without some sort of change, APs may be forced to carry excess inventory, thereby increasing the associated cost of settlement, and potentially impacting bid-ask spreads. Alternatively, they may be forced to rely on cash-only fund creation and redemptions, which will again impact overall costs for trading ETFs. More broadly, the Task Force is also examining potential to introduce central settlement for ETFs, like that offered in the U.S. by the DTCC-owned National Securities Clearing Corporation. Here in Canada that will be many years out from now, but these are all steps we are taking to prevent any downstream impact of moving to T+1 in the secondary market. I do not believe any AP firm or issuer would want the implications of remaining with T+2 settlement in the primary market to impact trading with ETF investors in the secondary market.

The focus on T+1 proves to be more than a mere point in time—it represents the ongoing evolution and adaptability within the financial sector. As ETF managers prepare for the move to T+1, planning their current workflows and timings around order settlement and portfolio trading will be key to adapting to the shortened settlement cycle. With innovation, regulatory changes, and market dynamics at play, the year ahead promises both challenges and opportunities. In embracing these shifts, stakeholders can position themselves to thrive in a landscape where adaptability and foresight remain paramount.



Falling Rates Good News for Bond ETFs



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Since their arrival over two decades ago, bond ETFs have become a popular way for individual investors to gain exposure to the fixed-income market.

Before that, investors could buy individual bond issues; however, this was not always feasible because of the high minimum investments, low liquidity, and lack of diversification.

Fixed-income mutual funds were another option that alleviated some of these issues, but at that time, these were primarily active funds that came with sales charges as well as management expense ratios (MERs) in the 1% to 2% range. Fixed-income ETFs solved these problems by packaging bonds into low-MER funds that could be bought and sold just like stocks.

As rates increased dramatically over the past two years, fixed-income products performed very poorly. This is because bond prices move inversely with the direction of interest rates. For fixed-income products, the most common metric used to measure sensitivity to changes in rates is called “duration.”

There are a few different ways to interpret duration, but the important thing to know is that the higher the duration, the more the price of a bond will fluctuate with changes in rates. In general, long-term bonds have a higher duration than short-term bonds. So, in a rising rate environment, long-term bond funds are expected to underperform short-term bond funds. As the accompanying table shows, this is exactly what has happened to Canadian bond funds across the duration spectrum.

CIFSC Category	Duration (years)	Average 2022 Calendar Return	Average 2-Year Compound Return (as of Nov. 30)
Canadian Short Term Fixed Income	< 3.5	-3.75%	-0.16%
Canadian Fixed Income	> 3.5 and < 9	-9.64%	-4.23%
Canadian Long Term Fixed Income	> 9	-16.62%	-9.58%

Over the past few months, inflation has cooled, and signs have emerged that the economy is slowing down. Many investors and market participants believe that interest rates have peaked. In fact, yields at the long end of the curve have already come down off their highs and many expect that the Bank of Canada will begin cutting the overnight rate as early as March 2024. Declining rates would be welcome news for fixed-income investors after the losses they have endured. Depending on an investor’s risk tolerance, here are three ETFs that stand to benefit from such a scenario.

iShares Core Canadian Short Term Corporate Bond Index (TSX: XSH) debuted in 2011 and is in the Canadian Short Term Fixed Income category. XSH seeks to replicate the performance of the FTSE Canada Universe + Maple Short Term Corporate Bond Index, which consists of investment-grade corporate bonds with maturities of between 1 and 5 years. It includes bonds issued by Canadian issuers as well as Maple Bonds, which are bonds issued in the Canadian market by foreign issuers. The duration is 2.6 years, and the trailing 12-month (TTM) yield is 3.2%. After losing 4.5% in 2022, XSH finished 2023 up 6.6%, gaining over 4% in the final two months of the year. The fund has an MER of 0.1% and is rated Low-risk.

BMO Aggregate Bond Index ETF (TSX: ZAG) is in the Canadian Fixed Income fund category, and was launched in 2010. It is designed to replicate the performance of the FTSE Canada Universe Bond Index. The index is a broad measure of the Canadian investment grade fixed-income market consisting of federal, provincial, and corporate bonds. The duration is just over 7 years, and the TTM yield is 3.5%. ZAG lost 11.8% in 2022 and was on track for another poor performance in 2023, down 1.1% through Oct 31. But a strong November and December propelled this fund to a gain of 6.7% for the year. The fund is rated Low-risk and has an MER of just 0.09%.

Vanguard Canadian Long-Term Bond Index ETF (TSX: VLB) debuted in 2017 and is in the Canadian Long Term Fixed Income category. This ETF seeks to track the Bloomberg Barclays Global Aggregate Canadian 10+ Year Float Adjusted Bond Index, a market-capitalization-weighted index of investment-grade government and corporate fixed-income securities issued in Canada with maturities of at least 10 years. The duration of VLB is close to 15 years, and it has yielded 3.7% on a TTM basis. 2022 was particularly painful for this fund, which fell 21.8%. It looked like more losses were in store for 2023 until it shot up 15% in the final two months, finishing the year with a gain of 9.2%. VLB has an MER of 0.17% and a risk rating of Low to Medium.

Brian Bridger, CFA, FRM, is Senior Vice President, Analytics and Data, at Fundata Canada Inc. and is a member of the Canadian Investment Funds Standards Committee (CIFSC).

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