LET'S TALK ABOUT ETFs

Debunking the Myths Associated with Exchange-Traded Funds

Many potential investors are just as misinformed as they are informed about ETFs. The following helps to dispel some of the most commonly held ETF misconceptions.

1

Myth #1: Trading volume dictates an ETF's liquidity

FALSE An ETF's liquidity is not established by its trading volume but by its underlying holdings. At a minimum, an ETF or mutual fund will be as liquid as its underlying holdings.

ETFs are open-ended investment vehicles (similar to open-ended mutual funds). ETFs are able to issue new shares or withdraw existing shares in the market to meet investor supply and demand. This helps explain why metrics like AUM or trading volume are not helpful in estimating the liquidity of an ETF.

An ETF that invests in large companies will have relatively higher liquidity as these stocks trade millions of shares daily. By contrast, ETFs that invest in less liquid stocks may experience relatively lower liquidity, which may increase price swings. This would be no different within a mutual fund structure.

An advisor should evaluate an ETF's underlying holdings to determine liquidity, not its trading volume or AUM. If there is no liquidity concern with a mutual fund that invests in similar securities as an ETF, there should be no concern with regards to the liquidity of an ETF.

2

Myth #2: ETFs are more risky than mutual funds

FALSE ETFs have similar characteristics to mutual funds but trade on an exchange. There is nothing inherently different about an ETF that would expose investors to increased risk relative to a mutual fund.

The most significant influences on any ETF or mutual fund's risk profile are the risks associated with investing in the financial markets, the type of individual securities that the fund invests in and the investment style and strategy of the fund.

3

Myth #3: ETFs are not for long-term investors

FALSE Like mutual funds, ETFs are effective tools for building portfolios for investors. While ETFs may be used by active investors as trading vehicles, they can also be used effectively as buy-and-hold investments for long-term investors.

Whereas one investor may purchase a particular ETF to hedge, another may buy the same ETF for a completely different strategy, such as to grow capital. The product design and versatility of ETFs allows investors with similar or different investment objectives to own the same product and still accomplish their respective goals.

4

Myth #4: All ETFs passively track an index

FALSE While the majority of ETFs are designed to passively track an index, there is an increasingly large number of non-passive ETFs being developed that seek to outperform their respective broad market indexes.

In particular, the proliferation of ETFs in Canada has resulted in significant development of factor-based and actively managed ETFs. More than 20% of the ETFs in Canada are now actively managed[1].

For more explanation on the types of ETFs available, please refer to our primer entitled, Introduction to ETFs – Embracing a vital portfolio building block.

5

Myth #5: ETFs are so simple that you don't need professional advice to invest in them

FALSE The growth of the ETF industry has resulted in greater choices for investors. But with over 800 ETFs now available in Canada[1], it has become even more difficult to pick the right ETF.

Investors should work with an advisor to design an appropriate asset allocation strategy and then choose the individual investments that can help them meet their objectives, whether they are mutual funds or ETFs.

Speak to your financial advisor about how ETFs can add value to your portfolio and help you achieve your financial goals.

[1]Source: Bloomberg L.P., as at April 30, 2019.

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