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## **Is it time for exchange-traded products?**

Investors looking to active and quasi-active products

The remarkable upward trajectory of exchange-traded products continues unabated. Credit Suisse recently reported that inflows for U.S. exchange-traded products (ETPs) set a new record in 2012, topping \$191 billion with assets reaching an astounding \$1.36 trillion. The global ETP market is now estimated at \$1.9 trillion.

Equity inflows represented \$121 billion of that total, of which \$70 billion was invested specifically into U.S. equity ETPs, while U.S. equity mutual funds witnessed further outflows. Last year investors took \$150 billion out of U.S. equity mutual funds, which is more than double the inflow into U.S. equity ETPs.

These statistics are noteworthy because they point to a trend in portfolio management. Although a portion of the U.S. equity mutual fund outflows can be attributed to asset relocation into bond mutual funds, it is reasonable to surmise that much of the balance may be due to investors switching from mutual funds to exchange-traded products.

Investors are not only favoring these products but many are also looking to active and quasi-active ETPs. According to Credit Suisse, \$30 billion of the inflows in 2012 can be attributed to those strategies. Active and quasi-active ETPs have portfolio managers who make decisions on the underlying portfolio allocation and, although they have a benchmark index, they do not follow a passive investment strategy. Instead, the

managers use strategies to select or weight constituents.

Other investors access the ETP market by opting to have discretionary managed portfolios comprised of various individual ETPs with professionals making relatively passive investments more tactical through active management. There are typically two ways of doing this.

The first is to opt for a Separately Managed Account (SMA) focused on ETPs. These are professionally managed investment portfolios where investors have direct ownership of the individual ETPs and have institutional-caliber managers handling all the investing and ongoing rebalancing. They are designed for investors who want greater control in setting the strategy for managing their wealth, but lack the time to make the day-to-day decisions.

Another route is to purchase an ETP wrap. The key difference between it and the SMA is that investors do not own the underlying investments directly. ETP wraps are similar to mutual fund wraps, except that the underlying investments are generally much more cost effective. They are often referred to as a “one-stop” solution because the investor can gain exposure to a number of exchange-traded products through a single purchase.

## Is it time for exchange-traded products?

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For example, the PowerShares Tactical Bond ETF (TSX: PTB) provides investors with diversified exposure to fixed income securities. The ETF holdings consist of the PowerShares 1-5 Year Laddered Investment Grade Corporate Bond Index ETF (TSX: PSB), PowerShares Ultra DLUX Long Term Government Bond Index ETF (TSX: PGL), PowerShares Fundamental High Yield Corporate Bond Index ETF (TSX: PFH), and the PowerShares Emerging Markets Sovereign Debt Portfolio (NYSE: PCY). The result is a wrap ETF providing access to over 350 aggregate underlying holdings.

There is a wide variety of ETPs on the market and, as with all investment decisions, any acquisition has to fit an investor's personal criteria such as timeline, investment goals, and risk tolerance. Investors must first take care to understand the different products if they are to choose asset allocation models well suited to their individual needs.

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