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PERSPECTIVE

ARCA™ FINANCIAL GROUP

PEOPLE WHO CARE,
PLANS THAT PERFORM

The ABCs of **ETFs**

Exploring the evolving world of exchange-traded funds.

Many investors are looking for diversified exposure to global markets. One solution is an actively managed mutual fund, in which a portfolio manager analyzes and selects individual securities (tradable financial assets like stocks or bonds) within a specific area of the market. Another option is a passively managed exchange-traded fund (ETF) that tracks an index representing a specific area of the market.

Recently, innovative solutions have emerged that combine some of the benefits, and help avoid some of the disadvantages, of each of these approaches. They're ETFs that incorporate elements of active management, and they have the potential to deliver market-beating growth within a lower-cost ETF structure.

What is an ETF?

First, let's take a step back and look at how a traditional, passively managed ETF works. ETFs were originally created to track indexes, which are statistical measures of change within the markets. So, for example, an ETF may hold a basket of securities that matches – and is regularly rebalanced to keep matching – the securities in the S&P/TSX Composite Index. These ETFs offer exposure to a well-defined market – in this case, Canadian equities. Their aim is not to outperform, but to deliver the same performance as the index, minus fees. Passively managed ETFs have low operational costs and don't require a lot of daily involvement by portfolio managers, so the fees charged are usually low.

A passively managed ETF may hold stocks, bonds, commodities, currencies, options or a blend of assets, depending on which index it is tracking. It's easy to buy and sell, since it trades on an exchange just like a stock. It's priced throughout the trading day, rather than only at the end of the trading day like a mutual fund. It can operate tax-efficiently because it's mirroring an index, and indexes don't change their composition very frequently. That means low turnover in the ETF, and fewer realized capital gains. It's also very transparent, with portfolio holdings available daily; in contrast, mutual funds may report their holdings monthly or quarterly.

It is important to reiterate, however, that a passively managed ETF doesn't attempt to beat market returns; its goal is simply to replicate them (minus a fee). In addition, indexes can get skewed towards companies trading at high (sometimes inflated) prices, and a passive approach can't correct for this.

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Adding a dash (or more) of active management

Newer ETFs aim to outperform market returns and/or reduce risk, focusing on one of two strategies to achieve this:

- **Strategic beta ETFs** apply a set of rules, or factors, that may favour a specific type of security – for example, value, growth or low-volatility stocks; as a result, the weightings of securities in a strategic beta ETF portfolio may be quite different from the index
- **Actively managed ETFs** have a portfolio management team that selects individual securities, just like an actively managed mutual fund, but are structured as ETFs to take advantage of ETF features such as tax-efficiency and pricing throughout the trading day

Both of these ETF types give investors access to active portfolio management insights. It's worth keeping in mind that strategic beta ETFs – even those that use complex, multifactor approaches – often have lower management fees than actively managed ETFs. That's because they're more rules-based, with fewer day-to-day decisions being made by a portfolio management team.

Who can benefit from ETFs?

Because the universe of ETFs is so wide, with passively managed, strategic beta and actively managed options available, they can play many different roles in an investment portfolio. A broad-based ETF is designed to give an investor exposure to an entire market, and like a broad-based mutual fund, may form the foundation of a portfolio. More specialized ETFs, like more specialized mutual funds, can serve to add targeted exposure to specific areas of the market.

Similarly, passively managed and more actively managed ETFs can help investors achieve different goals. Passive ETFs provide exposure to market returns, while strategic beta and active ETFs may seek to deliver market-beating performance and can help achieve goals such as reducing risk in a portfolio.

In general, ETFs of all types appeal to investors who are seeking:

- Diversification
- Lower fees
- Tax-efficiency
- Transparency

Keep in mind that the advantage of lower fees is amplified over time, so investors with a longer time horizon are in the best position to benefit from it.

Speak to your advisor about whether ETFs are a good fit for your financial goals. If they are, discuss the various choices to determine the type (or mix of types) of ETF that are most appropriate for you.

Commissions, management fees and expenses all may be associated with exchange-traded funds (ETFs). Investment objectives, risks, fees, expenses and other important information are contained in the prospectus, please read it before investing. ETFs are not guaranteed, their values change frequently and past performance may not be repeated.

ARCA FAMILY ANNOUNCEMENTS

We are so happy to announce that Klarisa McDonald and Dan Wilson had a bouncy baby boy on July 15th. Welcome to the Arca family Leo!

We are also welcoming 2 new staff members to the Arca family. Madelyn Lunz has joined Arca as our receptionist while Klarisa is on maternity leave and Cindy Paray has joined the Vollmer team as an associate on the investment team. We know you will give them both a warm welcome.

If you would like to receive the newsletter by email rather than paper, please let us know by emailing **inquiries@arcafinancial.com** and stating 'newsletter by email' in the subject line. We can all do our part for the environment.

Insurance – *now with a healthy, fresh twist*

Today's solutions are evolving to keep pace with Canadian's lifestyles

For a long time, insurance has been regarded as simply part of a smart financial plan. Traditional products provide protection "just in case" – often purchased and then forgotten about – and certainly not what anyone would call fun or engaging. That's starting to change.

Innovative companies have designed new solutions to keep pace with a broader trend of encouraging healthy living, offering rewards and savings to help motivate people to achieve their health goals. By connecting insurance to day-to-day lifestyle decisions, these creative programs can make necessary protection feel much more relevant, tangible and even fun and engaging.

Encouraging healthy choices

More than two in three Canadians say they are making conscious efforts to achieve better health, according to a recent survey.[1] And those efforts extend beyond the usual habits of eating well and exercising regularly. Reflecting a more holistic attitude, 50 per cent are working on improving their work-life balance, and 70 per cent make it a priority to get enough sleep.

What's the biggest reason Canadians are adopting a healthier lifestyle? The largest number of the survey's respondents (68 per cent) say it's the prospect of preventing health issues in the future.

That's a goal many insurance providers share. It makes sense for them to encourage behaviours that prevent illness, and that's driving the move towards more health-conscious insurance solutions. How does that benefit you? Whether you're already engaged in a fitness program or just starting out, incentives that encourage good habits can help you stick to your plan – with long-term benefits for your health.

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Making budgets go further

Younger Canadians, especially, often wonder if there's room in their budget for insurance. They may have many financial priorities – from paying down student debt, to buying homes, to saving for longer-term goals such as retirement. It can be hard to fit in healthy investments such as a gym membership or fitness tracker – let alone an insurance policy.

But if the purchase of an insurance policy includes discounts on a gym membership and fitness tracker, it can be easier to make the cost fit in a tight budget. And if that insurance policy also provides an opportunity to get recognized for tracked daily activities – from exercising to booking a dental appointment – it can be seamlessly integrated into overall efforts to achieve a healthy lifestyle.

Advancements in health and activity tracking technology has enabled financial service providers to integrate wellness and behavior change with their products. Today they're available with even the simplest term life insurance products offering straightforward protection for as little as 10 years. The result is extra value packaged into what are already very cost-effective policies.

Track and go

Insurance programs that reward healthy living often begin with a lifestyle assessment. The next steps are to set goals, track activities using an activity tracker or smart phone, and earn points that may add up to savings on insurance and rewards from retailers.

For those sitting on the fence, wondering about whether they can afford the protection they need, the concept of leveraging good-health habits to earn premium reductions and store discounts can be just the right push.

Speak to your advisor about integrating your financial and health goals – and taking more control over what you spend on insurance to protect your loved ones.

Wearable technology can boost activity levels

It seems like a good idea: use an activity tracker and get moving. But do these devices motivate people to exercise more? A recent review[2] of the available research suggests that they do. The report states, "consumer wearable devices have been shown to increase physical activity and help users lose weight" – but acknowledges more studies are needed.

Wearable devices such as Apple Watch, Garmin Vivo and Fitbit can track steps, distance travelled and calories burned. Some have the ability to monitor users' heart rates, sleep patterns and active minutes throughout the day, provide reminders when it's time to get moving, and let users know how close they are to their goals. Many devices also have a built in GPS so that users can trace their walking or running route. With that extra gentle nudge in the right direction, you may find yourself doing more that you expected to improve your health.

[1] www.nielsen.com/ca/en/insights/news/2017/healthy-habits-make-healthy-canadians.html
[2] www.ncbi.nlm.nih.gov/pmc/articles/PMC5395205/

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