“I thought I wanted an ETF”

Exchange-traded funds (ETFs) are catching the attention of more and more investors. You’ve heard the story before, and no doubt some assertions seem compelling. Before you get on board with ETFs, explore the facts.

Price

ASSERTION ETFs cost less in terms of the management expense ratio.

FACT The reported cost of ETFs does not include transaction fees or the cost of advice.

Performance

ASSERTION ETFs outperform the average mutual fund.

FACT Short-time periods do not reflect the actual experience of long-term investors, where mutual funds have outperformed the index.

Transparency

ASSERTION ETFs are more transparent because they disclose their holdings daily.

FACT Transparency is not simply about portfolio holdings. Comprehensive transparency involves full, regulated disclosure including apples-to-apples price comparison.

Tax efficiency

ASSERTION ETFs are tax efficient.

FACT Over the past 10 years, the largest Canadian ETF has distributed more income in a less tax-efficient form to investors compared to the average of the 10 largest Canadian equity mutual funds.

Diversification

ASSERTION ETFs generally mirror an index, which is composed of all the major stocks and/or sectors, thus offering instant diversification.

FACT Diversification requires balance and allocation. Owning an ETF could leave you significantly overweight in a specific stock or sector and increase your risk profile.

Price

ETFs assert that they cost less because of lower management expense ratios (MERs). But MERs don't represent the full cost of ETFs. The hidden cost of an ETF is in the transaction fees and the cost of advice whereas mutual funds can be obtained without transaction fees and include the cost of advice.

Transaction fees: Each time you buy or sell an ETF, you must pay a trading commission[1].

Here's a hypothetical example of the true cost of an ETF: A client wants to buy a bundled ETF whose MER is 0.70%. He contributes $1,500 every month to his RRSP and each trade costs him $24 in commissions, or 1.60%. The total cost for one year is 2.30%.

MER	Bundled product	0.70%
Transaction cost	$24 per trade / $1,500 per month	1.60%
Total		2.30%

The example uses $24 as the cost per trade but this will vary, depending on:

i) the discount brokerage firm used

ii) the investor's account size

iii) the frequency of purchases and sales.

Though the transaction fees vary, they do exist and should be factored into the total cost of owning ETFs, especially once investors need to diversify, rebalance and make regular investments.

Cost of advice: In actively managed mutual funds, the MER is a bundled fee that includes the transaction fees, professional management and the cost of advice.

If an investor seeks the help of an advisor, the advisor's fee-for-service charge should be factored into the total cost of owning the ETF. Based on a number of possible cost structures, these additional costs would range from 0.67% to 1.0%, which should be deducted from the posted rate of return of the ETF.

[1] Trading commissions can vary based on account size and company. See *http://www.ndir.com/SI/brokers/discount.shtml* for a sample summary of discount brokers and their related fees.

Performance

ETFs assert that it's difficult for the average mutual fund to outperform the index. Therefore, it's better to consider a passive strategy.

However, an active strategy gives you the opportunity to outperform – and many successful portfolio managers do – whereas a passive strategy guarantees you will never do as well as the index (due to MERs and transaction costs).

When assessing data that shows ETFs outperforming actively managed mutual funds, here are two things to remember:

1. Most ETF returns are posted without including transaction fees and the cost of advice.
2. The pro-ETF argument has focused on the Canadian market over the past five years, when energy and material stocks dominated the large-cap equity index.

   a. Over the last five years, ETFs have not outperformed mutual funds in the Canadian small-/mid-cap, Canadian small-cap, US equity, US small-cap, or international arena.

Would you invest like this?

Over the past several years, the energy and materials sectors have dominated the Canadian stock market, offering impressive returns. This means managers who used a diversified approach and held foreign content would have underperformed the index. Though energy and materials have outperformed, and were a boon for the Canadian index, most investors would agree that over the long run, it is better to be well diversified.

	Rank of ETF amongst funds in category		
Category	1 year	3 year	5 year
Canadian large-cap ETF	71/165	5/148	8/134
Canadian composite ETF	88/165	37/148	18/134
Canadian small-/mid-cap ETF	139/165	129/148	111/134
Canadian small-cap ETF	49/71		
US equity ETF	95/105	53/94	44/85
US small-cap ETF	19/22		
International ETF	51/85	53/71	45/63

Source: GlobeFund.com. Ranking based on funds with >$25 million in assets. Does not include transaction-related charges. Data to July 31, 2009. Canadian small-cap ETF and US small-cap ETF were introduced in May 2007.

b. Over the last 10 years, 8 of the 10 largest global equity mutual funds have outperformed the index. What's significant is that, of the approximately 1,000 global equity funds available, about 33% of investor assets are concentrated in those 10 largest funds.

8 of 10 largest global equity mutual funds have outperformed the index

Fund	Assets $Millions	10-year Annualized Return %	10-year Outperformance vs. Index
MSCI World ($ Cdn)	–	-2.80%	–
Mackenzie Cundill Value 'C'	$4,715	5.10%	7.90%
Trimark Select Growth	$2,244	-0.30%	2.50%
MD Growth	$2,136	-1.40%	1.40%
Templeton Growth Fund Ltd.	$2,074	-1.50%	1.30%
Mackenzie Ivy Foreign Equity	$1,877	1.70%	4.50%
AGF Global Value	$1,374	-2.30%	0.50%
Trimark Fund-SC	$1,226	1.40%	4.20%
8th Largest Fund (competitor)	$682	-3.80%	-1.00%
Dynamic Global Value	$646	1.50%	4.30%
10th Largest Fund (competitor)	$639	-3.10%	-0.30%

Source: Globe HySales. Data to July 31, 2009.

Not every active manager will beat the index. But experienced managers who use sound strategies have proven they can produce very favourable results for long-term investors.

Why ETF investors lag ETF returns

The returns posted by ETFs are usually not the same as those achieved by ETF investors. Besides transaction fees, there's a bigger reason why investors lag ETF returns: trading. Particularly in volatile categories and markets, investors typically buy and sell at the wrong times (buy high, sell low).

In an analysis by John Bogle, founder of the Vanguard Group, he found that of the 79 ETFs he examined, 68 had investor returns that were short of the returns earned by the funds themselves. And the average lag was -4.5%.

While investor returns typically trail fund returns by some margin, Bogle was surprised at the degree to which investor returns suffered in ETFs. The study also confirmed that investors trading in and out of Vanguard ETFs did worse, on average, than investors in Vanguard mutual funds.

Source: Indexuniverse.com, "Bogle: Investors Are Getting Killed in ETFs", June 17, 2009

Transparency

ETFs disclose their holdings on a daily basis to emphasize their claims of transparency.

However, true transparency is not simply about portfolio disclosure. It involves comprehensive and regulated disclosure, including apples-to-apples price comparison.

As we noted in the sections on Price and Performance, most ETF returns are posted without including transaction fees and the cost of advice whereas most mutual fund returns include them. When ETFs show returns without taking these into consideration, it does not allow investors to fairly compare the price and performance of mutual funds versus ETFs.

More investors own mutual funds than any other type of investment*, and as such, the Canadian mutual fund industry is heavily monitored and regulated.

*Source: Statistics Canada, *Survey of Financial Security*, 2005

There are more demanding regulatory requirements governing mutual funds compared to ETFs, including what information must be provided to investors.

What's in your fund?

Mutual fund companies disclose their top 25 holdings at least on a quarterly basis, and their complete list of holdings on a semi-annual basis in their financial statements. ETFs, on the other hand, disclose on a daily basis. While it is helpful to know a fund's portfolio holdings, that knowledge alone cannot help investors determine the prospects for the fund.

Tax efficiency

Tax efficiency is about paying less tax.

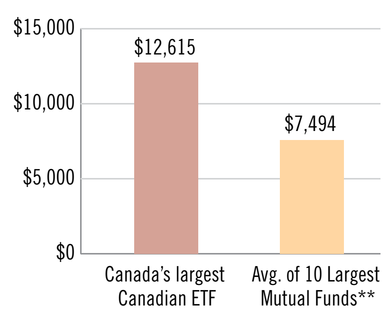
ETFs claim to generate minimal capital gains because they generally have lower turnover of the portfolio securities. In addition, they do not typically have to sell securities to meet investor redemptions.

However, any change to an index – mergers, acquisitions, de-listings, new listings, etc., – requires the ETF to buy and sell shares to match, spinning out taxable distributions to investors as a consequence.

In fact, over the last 10 years, Canada's largest Canadian ETF has paid out nearly double of the cumulative distributions compared to the average of the 10 largest Canadian equity mutual funds.

More importantly, mutual funds offer products that allow for tax efficiency such as capital class structure and efficient yield products that pay returns of capital, which ETFs do not have.

Cumulative Distribution on $10,000 investment Sept. 1999 (incep. of ETF) to June 2009



**Source: Globe HySales. Mutual fund distribution is the average distribution of the 10 largest Canadian Equity mutual funds from the Canadian Equity, Canadian Dividend & Income, and Canadian Focused Equity categories as of June 30, 2009.

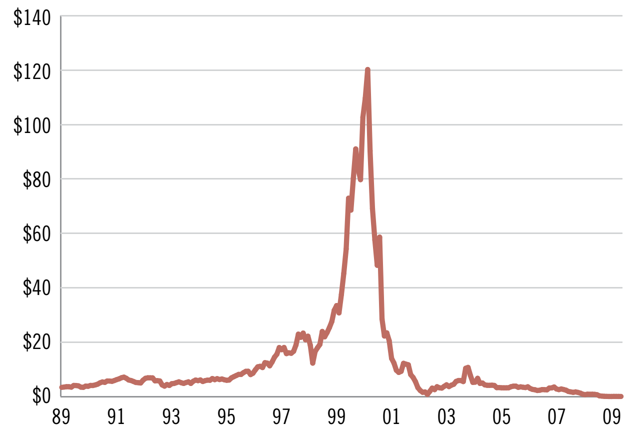
Diversification

Diversification means buying a wide variety of securities to reduce the risk from any one investment. Broad-market ETFs hold all the major stocks and sectors while sector-specific ETFs, such as Gold ETFs, may contain only a few stocks.

Certain ETFs may own a lot of securities but still not be well diversified. That's because in a market index, some stocks or sectors might come to dominate. For instance, Nortel Networks, at its peak, represented more than 45% of the S&P/TSX 60 Index, hardly providing diversification for ETF investors. And when Nortel fell, it took the index with it.

Good diversification is about balance and allocation, and the mark of good diversification is lower risk, as measured by the standard deviation. Good active managers can hold as few as 30 stocks and be better diversified than a composite index.

Nortel Networks: Share price from Dec. 1989 to June 2009



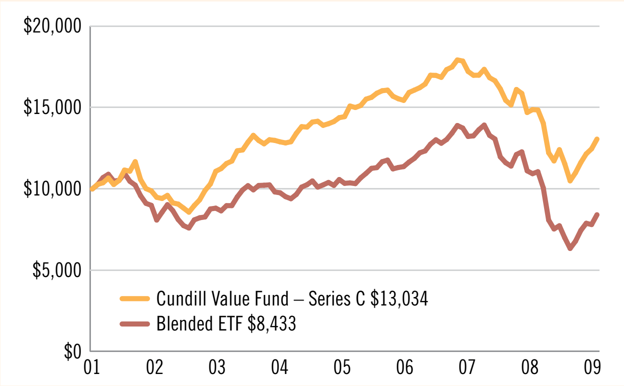
CONCLUSION

Here are five things you should keep in mind.

1. ETFs costs do not include transaction fees or the cost of advice.
2. The best you can do with an ETF is less than the index. Not all managers outperform but many good managers do.
3. Transparency involves full, regulated and ongoing disclosure, not just daily disclosure of portfolio holdings.
4. Mutual funds are able to produce extremely efficient tax characteristics and offer innovative products that can defer or reduce taxes – products which are not available from ETFs.
5. Good diversification is about having the right balance and allocation, not simply a basket of securities.

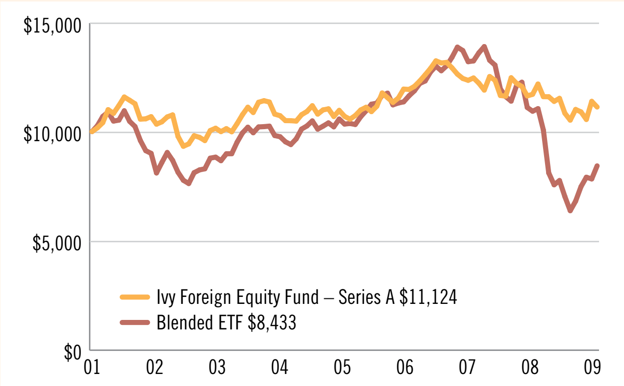
Here are three examples of Mackenzie's widely held funds that have outperformed with lower volatility and more tax efficiency.

Cundill Value Fund vs. Blended ETF (50% International / 50% US Equity)



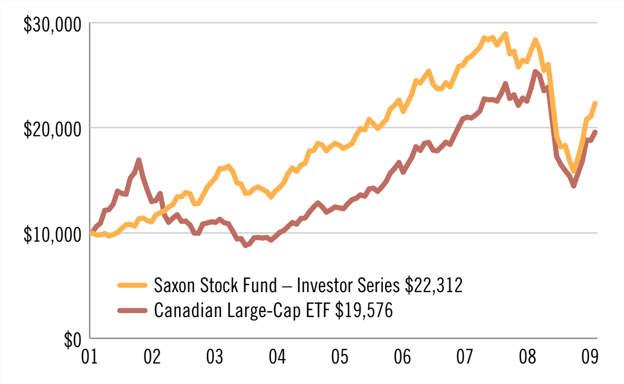
Sept 30, 2001 (incep. of ETF) to July 31, 2009	Cundill Value Fund – C	Blend ETF (50% International Equity / 50% US Equity)
Annualized Return	+3.4%	-2.2%
Standard Deviation	12.6	15.9
Cumulative Distribution on $10,000 invested	$2,837	$2,687

Ivy Foreign Equity Fund vs. Blended ETF (50% International / 50% US Equity)



Sept 30, 2001 (incep. of ETF) to July 31, 2009	Ivy Foreign Equity Fund – A	Blend ETF (50% International Equity / 50% US Equity)
Annualized Return	+1.4%	-2.2%
Standard Deviation	10.5	15.9
Cumulative Distribution on $10,000 invested	$0	$2,687

Saxon Stock Fund vs. Canadian Large-Cap ETF



May 30, 2001 (incep. of ETF) to July 31, 2009	Saxon Stock Fund	Cdn Large-Cap Equity ETF
Annualized Return	+8.5%	+7.1%
Standard Deviation	14.0	17.1
Cumulative Distribution on $10,000 invested	$2,323	$4,468

Performance Disclaimer

As of July 31, 2009	1 year	3 year	5 year	10 year	Since inception
Mackenzie Cundill Value Fund – C	-12.1	-5.4	0.1	5.1	7.8 (Oct. 98)
Mackenzie Ivy Foreign Equity Fund – A	-5.0	-2.4	0.6	1.7	6.9 (Oct. 92)
Mackenzie Saxon Stock Fund – Investor Series	-12.3	-2.0	4.0	8.4	8.0 (Dec. 85)

Choose Wisely.

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