



'Advisor-driven' ETF aims to provide operational advantages

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Financial advisors who are looking to overcome some of the operational challenges of owning the Big Six U.S. technology stocks have a new exchange-traded fund (ETF) to consider.

Evolve FANGMA Index ETF launched by Toronto-based Evolve Funds Group Inc. on May 6, is an equal-weighted collection of the six top technology securities – Alphabet Inc. , Amazon Inc. , Apple Inc. , Facebook Inc. , Netflix Inc. and Microsoft Corp. – with a management fee of 0.40 per cent.

The concept is that instead of spending around US\$7,000 to purchase one share of each of these six tech companies, the ETF offers the full suite for about \$10 per unit (at current prices). Put in context, one wouldn't be able to buy one share of each of these companies, at current prices, to put into a current tax-free savings account, which has an annual contribution limit of \$6,000. Amazon's stock alone is currently trading at around US\$3,250 a share while Google's parent, Alphabet, is trading at about US\$2,350.

"It's a question of how much exposure you want to these companies ... and whether there are some significant operational advantages to [holding] them in the form of an ETF like this versus just going into the companies outright, or through an index," says Raj Lala, Evolve's chief executive officer.

The ETF also comes in three different classes depending on the desired currency exposure; Canadian hedged, Canadian unhedged and U.S. unhedged units. Another operational advantage for advisors is they can hold these U.S. names in a Canadian investment vehicle. That eliminates the need for the different types of reporting required for holding U.S. assets over a certain value.

"This is an advisor-driven product," Mr. Lala says.

Evolve FANGMA Index ETF is one of only a few ETFs with a half-dozen holdings, including BMO Equal Weight Banks Index ETF and Hamilton Canadian Bank Mean Reversion Index ETF, both of which hold Canada's Big Six banks.

Mr. Lala says the ETF idea came to him from Eric Szöghy, an investment advisor at National Bank Financial Wealth Management in Montreal, who was looking for a simpler and less expensive way to buy the big tech firms for some of his clients.

Mr. Lala was skeptical at first, given that these six stocks represent about 20 per cent of the S&P 500 and 45 per cent of the Nasdaq and can be found in other diversified U.S. ETF



holdings. But once Mr. Szöghy pointed out the operational use cases for advisors “it resonated,” Mr. Lala says.

Mr. Szöghy says it’s challenging to get clients into these tech names at this time, given the run-up in prices, especially over the past year.

“I was trying to find a way to have an easy solution to initiate a position in these names in a prudent fashion and to build up a position in these names when opportunities present themselves,” he says.

Mr. Szöghy also likes how the equal-weighted ETF rebalances the holdings every quarter.

“These six stocks should continue to do well in the long term, but there may and probably will be short-term timing issues,” he says. “As the ETF rebalances every quarter with an equal weight of the six stocks, the ‘average cost’ concept is actually built-in, automatically trimming the stocks that have performed well in order to increase the position in the stocks that have dipped.”

It’s the first time Mr. Szöghy has pitched an ETF idea to a provider. He has initiated a position in the ETF in client accounts and says he will be proactive in adding to this position, doing so when opportunities present themselves.

He believes most investors should always have a core holding in these six stocks, noting the percentage allocated to them is much easier to dictate using a stand-alone ETF versus using the individual stocks or a broader index fund.

“It’s just like the banks in Canada: anyone who is a rational investor in Canada is going to have a position in the banks,” he says. “The important thing to keep in mind is the percentage allocated to this ETF in relation to the total portfolio; the more concentration, the more risk the portfolio takes on.”

BMO Equal Weight Banks Index ETF was launched in 2009 as a way for investors to get equal-weighted exposure to the large banks, says Mark Raes, head of product at BMO Global Asset Management.

“A lot of Canadians have individual bank positions in their portfolios, so this was a good way to diversify single-security risk,” he says.

The BMO ETF currently has about \$1.8-billion in assets under management and a management expense ratio of 0.60 per cent. It has produced a total return of more than 26 per cent year-to-date, 63 per cent over the past year, and has had an annualized return of almost 11 per cent over the past decade, according to Morningstar as of May 27.

“There’s a lot of support for the ETF,” Mr. Raes says. “It just shows that, across the investor types, people see that value regardless of that number of holdings.”



Stan Wong, a portfolio manager at ScotiaMcLeod in Toronto, says he's looking at potentially buying Evolve FANGMA Index ETF for some clients.

While there's a risk the tech sector could sell off after its recent run, Mr. Wong believes these stocks are a safer bet as mature companies with more reliable revenue and earnings.

"It's different from owning stocks like the Tesla's of the world and similar high-flying companies that are at much higher valuations, or are much longer duration type of assets, where the earnings cash flow is a little bit more down the road," he says.

Mr. Wong also likes the different currency exposure options.

"Each investor can determine what their outlook on currency is, or if they just want exposure to the stock and no currency fluctuation, they would buy the Canadian-dollar hedged version of it," he says.