

With inflation a threat, ETFs offer safer haven

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TORONTO (Dow Jones)—It might feel like it, but now is not the time to exit the markets and just hold cash, says Tyler Mordy, director of research at HAHN Investment Stewards & Co., a firm that actively manages exchange-traded funds to build global portfolios.

Though not evident currently, the government stimulus packages are “sowing the seeds of a new inflationary cycle,” Mr. Mordy predicts.

Further, there is also the opportunity risk of holding cash. Mr. Mordy argues that the values of certain assets are attractive enough for investors to slowly and steadily start to accumulate positions, otherwise they risk losing in the wake of a market and economic recovery.

That being said, how should an investor try to construct a portfolio given the particularly uncertain economic and capital-market conditions?

One solution could be to select a portfolio of equity bond mutual funds to arrive at a diversified, global portfolio.

However, Mr. Mordy argues it makes more sense to use ETFs to achieve this objective. For one, the majority of portfolio managers have historically failed to outperform their benchmarks.

For instance, only 41.9 per cent of

active Canadian equity funds outperformed the S&P/TSX Composite index in 2008, according to Standard and Poor’s Corp. The percentage figures were 21 per cent and 11.2 per cent for the three- and five-year periods, respectively, according to S&P.

Second, the proliferation of ETFs allows retail investors to gain access to a range of asset classes around the world that were otherwise inaccessible. In addition, they also allow retail investors to achieve their diversification goals at a lower cost than a mutual-fund manager could.

Faced with worsening credit conditions, Hahn Investment last year found a “safe harbor” for its clients in pan-Asian bonds through an ETF listed in Hong Kong, comprising the bonds of eight southeast Asian governments.

“While global bond managers could buy Asian bonds,” the cost of buying the ABF Pan Asia Bond Index Fund ETF to achieve this exposure is a lot less than trying to replicate the ETF’s holdings, which would require buying 320 different government bonds, Davee Gunn, president of Hahn Investment noted.

There are more than 1,500 ETFs worldwide with about \$600 billion of

assets under management. “For us as global tactical asset allocators, they are basically the perfect asset-allocation tool,” Mr. Mordy said.

There is no disputing that ETFs are an increasingly popular investment for both retail and institutional investors.

For ETFs listed in Canada, assets under management grew 11 per cent to \$19.3 billion during the fourth quarter, according to Investor Economics, a financial-services research firm. That increase is “huge” considering the Toronto Stock Exchange, for example, was down 35 per cent during the same period, said Shaw Hildebrand, an analyst at Investor Economics.

One of the criticisms of ETFs is that, as passive investments, investors in these instruments can miss opportunities created between changing fortunes of different asset classes and markets around the world.

But passive and active investing don’t need to be mutually exclusive.

Hahn Investments “is very much engaged in active strategy decisions,” moving in and out of different ETFs in response to different business cycles, “regime shifts” and market inefficiencies, Mr. Mordy said.

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