ETF Exchange Podcast

Episode 43 Rough Transcript

Announcer: Hello and welcome to the Fidelity ETF Exchange – powered by FidelityConnects –connecting you to the world of investing and helping you stay ahead.

Today on the program, director of ETFs at Fidelity Canada, Andrei Bruno, joins us on the show.

Andre breaks down all the notable ETF industry trends of the past quarter. Flows in the Canadian ETF industry for the second quarter came in at $8.9 billion, bringing the year to date total to 19.6 billion as of the end of June. Fixed income dominated equity flows with $5.7 billion versus $1.5 billion. Some of the other notable headlines include weakening demand for U.S. equity ETFs and continued appetite for cash alternatives ETFs.

This podcast was recorded on July 18th, 2023.

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Étienne Joncas Bouchard: Hello everyone, and welcome to the Fidelity ETF Exchange. My name is Étienne Joncas Bouchard, a.k.a. EJBi. I'm your host, as always, and today we are glad to be welcoming back on a recurring guest to the show, somebody who joins me quite often for our quarterly recaps as well as. In the past we've used them for a bunch of different things. But I think, Andrei, you now take the claim, if you will, of the guest that's been on the most often. So thanks again for joining us. I'm really happy to have you again.

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Andrei Bruno: Always great to be here EJB. How you been doing?

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Étienne Joncas Bouchard: Very well. I'm finally catching up on sleep as the newborn is starting to get some Zs also. It's it's been a packed summer. We've done a lot of podcast episodes. We've done road meetings with advisors. It's been a good summer so far, and I know you've been keeping busy, but how have you been doing? Obviously we had the launch recently, which we'll get into a little bit later, but what have you been up to, buddy?

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Andrei Bruno: Yeah, so we did have we launched those four new active ETFs in May. So, you know, fund launches are always pretty hectic time. Never really a dull moment here at Fidelity, especially in the products team. We're always working on the next next best greatest things. So we always keep pretty busy. Yeah, for us, we're just kind of looking forward into, you know, the rest of the year and looking into 2020 for taking a look at product roadmap. And you know, we're always consistently working on, on new and exciting things.

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Étienne Joncas Bouchard: Awesome. Yeah, I just, I guess that to put into perspective for our audience here, for those that don't know Andre, he is our director of ETFs here at Fidelity Investments Canada. So obviously a very busy man and once again, we're very happy he's taking some time out of his schedule to to join us and chat about Q2, Canadian ETF industry trends and flows and kind of what's been going on there. But before we actually get to that, as always, just a quick recap of our last episode, which was with our colleague Rory Poole, who's actually director of Alternatives at Fidelity, to discuss kind of the landscape for alternative investments in Canada, the various types of strategies that you can employ that are that are uncorrelated or less correlated to traditional capital markets like, you know, equities, bonds and so on. So that was a really cool episode. You can catch it on any podcast app of your choice or on Fidelity dossier where all our episodes are also stored. So be sure to check that out if you're interested in alternative investing.

So let's get to it. You know, just as high level opener total flows for the quarter are around 9 billion. You know, it's 8.9 billion. Bringing the year to date total flows into the Canadian ETF industry to about 20 billion as of the end of June. Just to put that into perspective, last year, for the whole year we saw about 35 billion in net new assets under the Canadian ETF industry. So we're actually a little bit ahead of that pace so far this year with six months down and no real signs of slowing. As we started the summer, with June actually being a really strong month to cap it off, to break that down a little bit, equity flows totaled around 1.5 billion for the quarter, while fixed income flows brought in a whopping 5.7 billion. So, you know, more than 60% of the total flows for the for the quarter rising fixed income. That being said, though, you know, it's important to note about 3 billion of that was in money market or cash alternative type ETFs, which have continued to be quite popular too, to start 2023 or I guess halfway through 2023 already a bit more precisely on the equity side.

Also we saw US markets albeit have rebounded substantially from a performance standpoint and, you know, close to all time highs for certain certain indices like the Nasdaq and the S&P 500. Hence, you know, the growth segment leading, you actually saw outflows into equity, US equity ETFs for the year and that continued in the quarter at around 750 million negative for the quarter and that's about 1.5 billion negative year to date. So those are some of the big headlines that that I've you know, I wanted to mention off the bat, Andre, what are some of the notable things that caught your eye for for the quarter?

[00:05:47]

Andrei Bruno: Yeah, I'm just going to take a step back and talk about, you know, the year in general. Just for a quick second, if you don't mind me going off script here. But, you know, it was kind of an original.

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Étienne Joncas Bouchard: Script.

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Andrei Bruno: That was kind of interesting is just the amount of inflows we're seeing in the ETF space generally. You know, contrast that with mutual funds. You know, ETFs are doing tremendously well. As you mentioned, we're even ahead of last year in terms of inflows from ETF. I think it's somewhere around I think you gave the percentage there, but I think it's somewhere around 2 billion more of inflows in ETFs relative to the same time last year. So, you know, that's certainly great for the overall industry in the overall ETF space. I think that's, you know, a function of a few things. But you know, generally I think it's also a function of, you know, just just larger adoption from the investor and the advisor community with regards to the ETF vehicle. So again, great, great news for the ETF space when we talk about Q2.

We know there were a lot of the similar trends we saw in Q One, you know, fixed income dominating cash products, still bringing in a ton of flows. I think you mentioned it was about 50% of fixed income flows were in kind of cash products or money market instruments. You know, still seeing people rotate into more duration products, which is what we saw in Q1 as well. You know, to talk about credit a little bit, people are still playing in the more high, you know, higher credit rated areas. You're seeing people, you know, high yield and high yield sectors being a little bit more out of favor. Obviously, given where we are in the economic cycle, given the macroeconomic headwinds, you know, that obviously that makes a ton of sense. What's kind of interesting in Q2, though, is, you know, you mentioned kind of the breakdown between fixed income and equity. But if you take a look at June, it's a little bit more even.

I think both asset classes took took in around 2 billion each, give or take. So there seems to be a little bit more to maybe people dipping in equities a little bit more than they probably were in the first five months of the year. So so that's been interesting to see. I don't know if it'll be a one month blip or a four. You start to continue to see people add a little bit more risk and getting a little bit more more interested in equities once again. But as we mentioned, we still do have those, you know, macroeconomic headwinds that, you know, we everyone's been talking about a recession, it feels like all year.

We're not quite there yet. There's certainly, you know, some concerning parts of, you know, the economic indicators that suggest that, you know, a recession could possibly come down the pipe. I know some of our PMS are thinking maybe a Q2 of next year might be the timing for a recession. But again, no one has a crystal ball, so it'll be interesting to see. It'd be great if we could just skip the recession altogether, but we do have some signs pointing towards one.

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Étienne Joncas Bouchard: Yeah, I know those are all great points and I think the the evening out, if you will, in June between equities and fixed income, I think is just kind of a sign of investors just saying like, okay, you know, these things have run up quite a bit. But, you know, it seems like maybe earnings declines aren't as bad as what was expected. You're seeing, you know, a lot of there's more support, if you will, in earnings. So maybe the multiples that we're seeing on on a lot of the, you know, say the US market, that's 5500, which is above the historical average. Well, maybe it's not too crazy to think if earnings start to rebound next year, albeit when you look like you said at the at the economic side there are some some some warning signs.

And when you were mentioning credit, which is interesting on the fixed income side, you know, if people are buying high yield, it's usually because they also think spreads could widen and that tends to happen in the late cycle recession. So it's kind of like all these mixed signals right now. So tough environment for investors, tough environment for for advisors. Also, obviously, managing portfolios are portfolios for their clients. One thing that we saw slow down also and I actually it wasn't in my notes, if you will, that I sent you prior to to us starting this, but a category that had picked up a ton of flows last year and it's positive this year is the Multiasset category. It's it's positive this year, but it's not like as getting as much love, if you will, as last year. I would have thought this would have been a good time, you know, to to start to see flows there just because the kind of that uncertainty and the fact that bonds are somewhat attractive. So buying a strategy that's already fully diversified can make sense, right? Like kind of buying a 6040 that's already made, basically.

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Andrei Bruno: Yeah, for sure. I mean, the general industry, to your point as been kind of hasn't been getting a ton of flows. You know, us here at Fidelity, our you know, our MULTIASSET products on the ETF side have been doing tremendously well this year. So, you know, we're deviating a little bit from the industry there. So it's great from our perspective. But yeah, no, I echo your sentiment there. You'd expect to see some more folks, you know, flock into some of those products. But, you know, it could just be a reflection of the overall advisor community just being, you know, tactical, maybe not moving money around as much. You know, if you talk to some of the market makers on the street, you know, they've been talking about how, you know, ETF flows, that is trading volume has been pretty depressed this year hasn't hasn't been a lot has been of a bit of a pick up in June. But for the rest of the year, it's been kind of quiet from that perspective. So again, it could just be a reflection of investors and advisors just making tactical allocations here.

They're around the edges and not making too large a moves. And again, that that could be a reflection just around how much uncertainty is out there. Right. You mentioned kind of the divergence between, you know, fixed income markets, getting away from credit, getting into duration and treasuries. You know, some people starting to add to equity markets. So a bit of a divergence there. So I think I think, again, it's more emblematic of the overall uncertainty that people have towards kind of the economy and the market in general.

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Étienne Joncas Bouchard: I don't know that that definitely makes sense. And yeah, I know absolutely. With this podcast for, you know, I guess for for for a reason or another, we rarely actually spend time on talking about the stuff that we do here at Fidelity. You try to keep it as neutral as possible, but it's good that you bring up that, you know, we actually had a lot of success so far this year with the all in one ETFs that we have which I. These multi-asset category ETFs that really simplify things for for investors. And so that's a really good point to note, Andre. When are people going to stop buying money market?

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Andrei Bruno: That's that's a good question. You know it's as long as that front end, you know, the yield curve, as most people know, whether you're looking at Canada, US is inverted, meaning that front end interest rates are much higher than long end interest rates. So from a risk reward perspective, investors are saying, hey, I can get more on the short end with, you know, little duration risk, little credit risk depending on what products you're looking at. There's a very good value proposition there. So I think until you can get kind of back to a normal yield curve, that at very least is flat, if not back to kind of a normal sloping yield curve. I think you're going to continue to see a lot of demand for that front end, especially until both Canada, the Bank of Canada and the US Federal Reserve stop hiking rates.

So again, we had a bit of a pause with the BSE early on this year, and a lot of folks, myself included, thought, you know, this is it, we're done. Obviously, the last two meetings we've got another another couple of rate hikes from TIFF Macklem at the BSE. The Fed is poised to likely raise again sometime this year. So, you know, again, those are kind of your two things there. We need to see kind of more of a normal yield curve. Those longer run rates move higher, which might be tough because if we are going into a recession environment, you're likely not going to see long, long end rates move materially higher. And then on the other side, of course, as I mentioned, until the central banks stop hiking rates, people are just going to stay on that front end. Yeah.

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Étienne Joncas Bouchard: That's that's that's interesting. Right, Because we often talk about. You know, that yield is attractive, obviously, like if you look at whether it's, you know, or money market or Catholic high interest savings, you can get north of four and a half, 5% now, or even maybe a bit more than that with the most recent hikes that we've seen here in Canada. But at one point, it feels like maybe playing devil's advocate here is that, you know, if the yield curve does normalize, those people that have been buying duration will obviously benefit if rates start to come down. And it is also a function of expectations, because I think that's the thing that caught everyone by surprise this year, is that we were expecting at some point this year there was going to be cuts and that's kind of been pushed further back.

But you know where we are from here, you know, we're in a different place now also with, you know, 5% and potentially 5.25% next meeting, you know, overnight rate. So anyways, it's going to be interesting to see if there's a bit of a change, slowly but surely. But I definitely agree with you on the risk reward spectrum is there. And it also comes from from investors, Right. If you've had a difficult time last year with your bond mandates, just because they were more sensitive to rates, you know, it's tough to, you know, add risk, if you will, by adding duration to the side of the portfolio that's really just there as an anchor. Or are you kind of the the the lower risk end of the portfolio versus your equity component?

So I think there's I think there's a behavioral aspect to it. And correct me if I'm wrong, but I think it does play a role in not in that situation other than just looking at the yield. Right. I think it's a behavioral thing also.

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Andrei Bruno: 100% on a percent. And again, last year was obviously one of the most challenging years we've seen in fixed income. I think so I think it's been in like hundreds of years. I think it's like the worst bond market we've had going back to like the 1700s or something like that. Don't call me on that. Stop it. Someone reference that recently. But you know, again, even the year before was was a challenging year as well for fixed income. So it's kind of like two years in a row that people have gotten hit from the fixed income side.

You know, this asset class that is supposed to perform kind of that balance function, that lower volatility function, that insurance function in your portfolio. It didn't really do that for two years. So, you know, kind of near point with the psychological aspect of it. I think a lot of folks are just saying, I don't want to see that negative line item in my portfolio anymore. Let me just get something that's a little bit more guaranteed, a little bit more low risk and get by, you know, north of 5% yield with with minimal risk.

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Étienne Joncas Bouchard: No, no, Absolutely. All right, good. So I'm not I'm not not completely crazy to think that. But now it's funny just because, you know, hearing from investors, you know, in in around just my, you know, social circle, if you will, just thinking about it that way in the sense that, you know, I don't need to be taking on risk on my bonds. Why should I be doing that? But, you know, long term, we'll see what plays out. But historically, when we have had inverted curves like we do now, it has been beneficial, generally speaking, from a from an absolute returns standpoint to add duration. So anyway, it's going to be interesting to see where we go between now and the end of the year. Let's maybe, you know, kind of switch over to the equity side, which is like we said, it's kind of slowly catching up so far, I guess, in June especially. And I think it's also paired with a widening of the breadth of the market, right? Because what was doing well to start the year was just this large, you know, I guess what worked for the past decade, large mega-cap growth, you know, with few exceptions, obviously. But kind of those big heavyweights at the top of the benchmarks pulling the index up.

But now you've seen the breadth widened to, you know, if you look at the equal weighted, S&P 500, for example, is also, you know, making a significant comeback, if you will. So the other 490, call it, names are actually pulling their weight. Is that helping market? So maybe giving a bit more comfort to equity investors to say, okay, maybe this rally is more sustainable than than what we might have thought given it was just five names basically pulling up the index at first?

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Andrei Bruno: Yeah, it's interesting for sure. I wonder if it's kind of a maybe it's a bit of a valuation play, you know, selling out of some of the names that have worked already, taking some profits and getting into some names that are maybe have slightly, I would say, relatively attractive valuations. As you mentioned, valuations generally are are still kind of a little bit north of long term averages. So nothing's cheap per se. But again, you know, we're still, you know, again, last month, June, from an ETF perspective anyway, I think it was the first time that ETF equity flows were were stronger relative to underlying equity flows. But again, I don't know if this is going to be a trend changer if we're going to see, you know, equities continue, I think in Markazi made this point a couple of months ago.

I think one of our Vancouver events and just said, you know, there's four things that generally affect equity valuations, you know, liquidity, interest rates, valuations and earnings. And he said earnings are going to drive kind of returns this year. And I think that's going to be kind of the most simple. For one thing, for equity returns this year is fining those companies that are doing well. I mean, this sounds like, you know, basic stuff, but I think it's true. You know, there's going to be you know, if you do think there's a recession over the horizon, you know, those secular growers, those top, top A-class names in whatever industry or whatever sector are going to be the ones you're going to want to flock to. So, again, I think earnings are going to be important for the rest of the year and it's something to keep an eye on. I think we should we should start to get some earnings for Q2 sometime soon. No?

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Étienne Joncas Bouchard: Yeah, no, absolutely. And I think that's really because obviously, you know, my question was kind of, I guess, centered around the U.S., if you will, just because it's, you know, I guess it's always top of mind for for all investors. But, you know, in Canada is also a little bit different given the structure of our of our benchmark, if you will, which is definitely more tilted towards like financials, energy and things like that. But it was and also why you saw US markets generally speaking doing a bit better than and the K in markets it feels like which is the tech component was really strong.

But we've actually seen if you look at from a sector standpoint like ETF flows, sector ETFs in Canada, everything on the only thing that's being bought is financials, which we love our banks in Canada, right? It seems like a thing that's never going to change. It might, but it probably won't be very quick if it does. Why is there such an appetite for financials? And I don't know if there's an answer to that. Maybe it's a a tricky question, but I mean, obviously with rates being higher, you know, it seems like the argument is, you know, earnings could be pretty good for banks if they're able to stave off defaults, I guess, and and just, you know, get higher margins on their on their assets, if you will.

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Andrei Bruno: Well, generally generally, higher interest rates portends to an expansion of NIM. So net interest margins, which is a valuation metric used for banks. But I think I think you mentioned the caveat there though is, is as long as we don't get a bunch of defaults. So obviously, obviously, as we know that, you know, take a look at the structure of our mortgage market here in Canada. We've got a lot of floating rate looking at the retail residential side above 50%. I think it's about an equal split, 5050. So we're super, super sensitive. The consumer was super, super sensitive to interest rate changes. Obviously, commercial real estate's been kind of having a tough go, especially since COVID. And now, you know, a lot of firms switched to a hybrid model with work from home part time. So we've seen, you know, a little less of a demand for commercial real estate as well. So again, all those things funnel into the banks as well. Obviously, the banks have a ton of real estate exposure, whether on the commercial side or the residential side. So yeah, in one breath, higher rates typically better for net interest margins for the banks. But on the other side, it obviously is increasing the probability of defaults, which obviously factors into their allowance for bad debts account, which which obviously gets factored factored in earnings.

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Étienne Joncas Bouchard: No makes it makes a lot of sense. It's going to be it's going to be interesting to see how our big banks navigate this this environment. But anyway so it seems like investors are betting on on on us coming out of it pretty pretty well because you're seeing a lot of demand. I think it's north of $1,000,000,000 into financial sector ETFs in Canada so far year to date.

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Andrei Bruno: So can't discount their dividends as well, right?

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Étienne Joncas Bouchard: That's true. That's true. And it does it does intertwine with dividend focused or income focused equity ETFs, which historically have been very popular in Canada. Also, you know, we like our banks, we like our dividends. And, you know, some of the names that it seems like everybody holds also. But I want to move the conversation over to a few last things. I mean, we're already offshore. We're already at 21 minutes. And I know we said we try to keep it under under 30. So one of the things I wanted to obviously touch on and you kind of mentioned it, I hinted at it in our introduction, is the launch of our first active ETFs in May for Fidelity here in Canada. I think it's a really groundbreaking entry for for for us as an asset manager, but also, you know, for the marketplace where it seems maybe we're not first movers in active equity, but it seems like we're providing some pretty cool mandates out there. And I just wanted to get your $0.02 on that launch, but then also kind of the growth of the active space in general in the ETF market.

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Andrei Bruno: Yeah, for sure. So, you know, what we've noticed over the last kind of 5 to 3 years is, you know, when you can roughly break the ETF industry into kind of three broad buckets, you've got your your passive indices, which is a lot of people still think ETFs are just passive. We've obviously grown well past us. And perhaps, you know, when they when the industry first started, that was in fact the case. But nonetheless we've got our index or passive indices ETFs, we've got our smart beta factor, which is not quite passive, not quite active, sits somewhere in the middle and active. So among those three buckets, what we've noticed is that active has been growing at the fastest clip. Over the past 3 to 5 years. So, you know, obviously, we wanted to take advantage of of of the growing demand for the active space and in the ETF landscape. We also wanted to marry that as many people know, you know, fidelity. Our bread and butter has been active management, active equity management specifically.

Obviously we do fixed income really well on the active side as well. But you know, historically we've been that kind of active long only mutual fund shop. So we wanted to marry kind of our core capability and active management with the ETF vehicle and bring that to market. So I think we've done a great job at doing that. We've launched four new funds, you know, varying managers, varying styles, varying, you know, market cap sizes, you know, varying portfolio manager styles, so to speak. So, you know, we wanted to bring kind of a buffet of funds to the market, a little bit of something for everyone. And again, you know, they've been doing tremendously well, They've been attracting inflows and we're very proud of the launch.

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Étienne Joncas Bouchard: Mm hmm. That's a good point. Right? Because we the the thing you mentioned with regards to passive active, smart beta, those really are like the three buckets, like you said, in terms of management style, if you will. When I started the pack in 20, I think it's 2019 on the ETF team here at Fidelity, it was about 75% or a bit north of that. That was passive ETFs, right? So it's understandable that a lot of investors and and you know, some advisors also were thinking you know all ETFs are passive because almost every single one of them. But now it's actually, you know, it's almost close down to 65% being passive, which is still, you know, the majority. But you're slowly seeing kind of the two other segments, smart beta and active going away. And I think this next leg of growth is going to come from and you're starting to see this in the US And you've heard a lot of experts on the subject, notably people like Eric Belts units, for example.

It works with Bloomberg talking about the next wave might come from a high active share. Right So stuff that is as different from passive as possible because you've satisfied all the needs from a passive standpoint. Now investors and advisors and institutions are also are looking for things that are completely differentiated. And I think that's also what we've brought to the market here with these managers. If you look at a, you know, a mandate like our the Global Cap Opportunities Fund ETF, it's got a more than a 99% active share component given it's got, you know, benchmark of global small caps like that's something you can't replicate easily and we've got expertise there so it really interesting stuff there and it's going to be cool to see how it develops through the rest of the year and forward because who knows, You know, maybe maybe we bring more of our great managers to the market some day.

So cool development and I think it's good for for for investors also listening and because some of the managers that you're that you can get access to their on the ETF vehicle you've known them for a very long time on the fund side names like Marshmallow for example Daniel DuPont and and Hugo Lively for example, have been around for a very long time. And then obviously Connor and Chris on that on the global Smallcap mandate. So I was kind of ranting on there a little bit, but I don't know if you had any other little things to add there.

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Andrei Bruno: No, I think you make a good point. You know, the the passive spaces, I guess I'll say a little bit saturated, for lack of a better word. You know, we kind of got a lot of beta products out there, and I think there is a lot of demand on on maybe, you know, supplementing beta positions with some alpha positions and looking for, again, to get some some more access to some of that active share, some of that stack, the stock picking expertise. And that's one of the reasons why I think you are seeing more demand for for some of these active products.

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Étienne Joncas Bouchard: Oh, makes a lot of sense. Andre, last question. Kind of what we always leave these quarterly recaps off with is are there any expectations or things you're looking out for that maybe we discussed that might continue until now in the end of the year or not necessarily from a market perspective, but just from on industry trend flows or things that are coming up that would be worthwhile for audience to keep an eye on.

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Andrei Bruno: Yeah, for me, we're going to take more of a macro answer here, but I'm I'm most curious and most interested in just keeping an eye out on those those macroeconomic indicators. You know, again, one of the big uncertainties here is are we going to get a recession? If we get a recession, when is that recession coming? So those are the things I'm keeping an eye on. You know, think of your retail sales. Think of your employment, employment being a lagging indicator. So for folks, there's lagging concurrent and leading indicators in economics. So keeping an eye on all three of those, just to gain a little bit more insights of when and if we are going to get a recession. And then as I mentioned earlier, just always interested in earnings. You know, I think if that earnings few drops, I think there's going to be a little bit of a little bit of headwinds in the equity market if we see earnings. It's come in lower than expectation. So those are the two main things that I'm keeping an eye out for the rest of this year.

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Étienne Joncas Bouchard: Awesome. Perfect. Andre, thanks so much again for doing this. Thank you, everybody, for listening in. We'll catch you next time. Thank you.

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