Rob Carrick: Why Canadian investors should stop buying U.S.-listed ETFs

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PUBLISHED FEBRUARY 4, 2021

The Canadian stock market bows to none for early adoption of exchange-traded funds, but it’s only recently that our ETFs have, well, matured.

ETF precursors traded on the Toronto Stock Exchange back in the early 1990s, and the first bond ETFs appeared in Canada 20 years ago. More than 1,000 ETFs are listed on the Toronto Stock Exchange today, a mix of new products shovelled into the market to address one trend or another and tried-and-true funds with a solid track record.

There’s sufficient supply of this latter type of fund to offer a thought to Canadian ETF investors: Instead of putting money into U.S.-listed ETFs, buy domestic.

ETF industry figures show Canadian retail investors had about $47-billion invested in U.S.-listed ETFs as of Sept. 30, which compares with total Canadian ETF assets of about $260-billion. A lot of the money in U.S. ETFs reflects the market dynamics of years gone by, said Michael Cooke, head of ETFs at Mackenzie Investments.

“Ten years ago, we didn’t have nearly the same breadth of products, and we didn’t have the seasoning and maturity in Canadian-listed products and the cost-effectiveness we now enjoy,” Mr. Cooke said. “In recent years, we’ve seen the Canadian market play a lot of catch-up. It’s a more competitive market, which among other things has pressured fees lower.”

A quick fee comparison: The US$323-billion SPDR S&P 500 ETF Trust SPY-A +0.31% increase has a fee of 0.0945 per cent. You can buy TSX-listed ETFs tracking the S&P 500 with management expense ratios of 0.09 per cent.

The cost of owning SPY and its Canadian counterparts are pretty much the same, but the cost of buying is a different story. When you buy a TSX-listed ETF holding U.S. stocks, your money is converted into U.S. dollars by the ETF company. When buying a U.S.-listed ETF, your broker converts your Canadian dollars into U.S. currency. Which is the better deal?

“Definitely the Canadian-listed product,” Mr. Cooke said. “All currency conversion is done within the fund, it’s done at institutional rates and it’s very cost-effective.”

A hidden cost in ETF investing is the spread between the highest price investors are bidding to buy a stock and the lowest price sellers are asking. If you’re buying an ETF with a sizable bid-ask spread, you might end up paying more than the market price. ETFs with tight spreads help ensure you can buy and sell very close to market price.

SPY’s bid-ask spread one day this week was 2 cents; a few TSX-listed ETFs tracking the S&P 500 had spreads of 1 cent to 3 cents.

There are still situations where a U.S.-listed ETF will meet your needs best, maybe for a particular sector or geographic region not represented by a Canadian product with a track record of a few years or more. For the most part, though, a Buy Canadian approach makes sense for ETF investing.

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